II RECENT ECONOMIC DEVELOPMENTS

2.1 The Indian economy continued to exhibit robust macroeconomic performance during 2006-07. Industrial production maintained its momentum with growth accelerating to double digit during 2006-07, propelled by strong growth in manufacturing. A significant feature of the industrial sector performance has been the continued high growth rate of the capital goods sector. The performance of the private corporate sector has improved, after a brief moderation during the second half of 2005-06, underpinned by buoyant domestic and export demand. Investment climate continues to be encouraging. The growth in the services sector accelerated during the first three quarters of 2006-07 mainly led by the sub-sectors 'trade, hotel, transport and communication' and 'financing, insurance, real estate and business services'. The onset of the South-West Monsoon 2006 was delayed by over a week. Although the overall performance of the Monsoon was close to normal, the temporal and spatial distribution was uneven. However, on the whole, the Indian Economy is expected to grow at a robust pace.

2.2 Headline inflation remained at an elevated level from November 2006, driven mainly by primary food articles and manufactured products. Consumer price inflation remained above WPI inflation throughout the year, mainly reflecting the impact of higher food prices. The Mid-term Review of the Annual Policy Statement of the Reserve Bank in October 2006 observed that the combination of high growth and consumer inflation coupled with escalating asset prices and tightening infrastructural bottlenecks underscored the need to reckon with dangers of overheating and implications for the timing and direction of monetary policy setting. It, however, also emphasised that it was important to recognise that the apprehension of overheating could at best be transitional in nature as there was evidence of substantial investment taking place, accompanied by overall productivity increases which should augment potential output. The Reserve Bank continued to emphasise the criticality of monitoring all available indicators that point to excess aggregate demand.

2.3 During 2006-07, the Reserve Bank managed liquidity with a judicious mix of the available tools, *viz.,* liquidity adjustment facility (LAF) and issuance of securities under the market stabilisation scheme (MSS). In order to ensure an effective liquidity management, the Reserve Bank in March 2007 modified and put in place an augmented programme of issuance under the MSS with a mix of treasury bills and dated securities in a more flexible manner. Accordingly, the daily reverse repo absorption was limited to a maximum of Rs.3,000 crore. In view of underlying inflationary pressures, the Reserve Bank has resorted to a series of pre-emptive monetary policy measures, *viz.,* increase in the Cash Reserve Ratio (CRR) by 150 basis points and the repo/reverse repo rate by 125/50 basis points in phases since June 2006. These measures combined with supply side fiscal measures and moderation in fuel prices helped in keeping inflationary expectations well-anchored. The approach to liquidity management, however, continued to ensure that appropriate liquidity is maintained in the system to meet all the legitimate requirements of credit for the productive purposes, consistent with the objective of price and financial stability, as emphasised by the Third Quarter Review in January 2007.

2.4 Financial markets remained orderly, barring brief spells in November and mid-December 2006 and in mid-March 2007, when call money rates moved up to high levels due to liquidity frictions. The equity market also encountered brief spells of volatility during May-June 2006 and February/March 2007. Barring these episodes, financial markets were stable.

2.5 Financial institutions, especially scheduled commercial banks, witnessed improved business and financial performance during 2005-06, underpinned by robust macroeconomic fundamentals. Public finances of both the Centre and the States as per revised estimates showed improvement on the back of buoyancy in both tax and non-tax revenue, which more than offset the higher expenditure.

2.6 The external sector continues to reflect dynamism with strong growth in merchandise exports of goods and services. The balance of payments position has remained comfortable, despite high and volatile international crude oil prices during the most part of the year. Large capital flows continued much in excess of the current account deficit, resulting in substantial net accretion to foreign exchange reserves.

2.7 Against the above backdrop, this chapter presents a detailed account of macroeconomic developments during 2005-06 and 2006-07 (up to the

Table 2.1: Real Gross Domestic Product
(At 1999-2000 Prices)

(Per cent)

Sector	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06 (QE)	2006-07 (AE)
1	2	3	4	5	6	7	8
				Growth Rate			
1. Agriculture and Allied Activities	**-0.2**	**6.3**	**-7.2**	**10.0**	**0.0**	**6.0**	**2.7**
a) Agriculture	-0.6	6.5	-8.1	10.9	-0.2	6.3	..
2. Industry	**6.4**	**2.4**	**6.8**	**6.0**	**8.4**	**8.0**	**10.2**
a) Manufacturing	7.7	2.5	6.8	6.6	8.7	9.1	11.3
b) Mining and Quarrying	2.4	1.8	8.8	3.1	7.5	3.6	4.5
c) Electricity, Gas and Water supply	2.1	1.7	4.7	4.8	7.5	5.3	7.7
3. Services	**5.7**	**6.8**	**7.4**	**8.9**	**10.0**	**10.3**	**11.0**
a) Trade, Hotels and Restaurants	5.2	9.6	6.9	10.3	8.4	8.2	13.0 $
b) Transport, Storage and Communication	11.2	8.2	13.6	15.1	15.2	13.9	
c) Financing, Insurance, Real Estate and Business Services	4.1	7.3	8.0	5.6	8.7	10.9	11.1
d) Community, Social and Personal Services	4.8	4.1	3.9	5.4	7.9	7.7	7.8
e) Construction	6.2	4.0	7.9	12.0	14.1	14.2	9.4
4. Gross Domestic Product at Factor Cost	**4.4**	**5.8**	**3.8**	**8.5**	**7.5**	**9.0**	**9.2**
				Sectoral Composition			
1. Agriculture and Allied Activities	23.9	24.0	21.5	21.7	20.2	19.7	18.5
2. Industry	20.0	19.3	19.9	19.5	19.6	19.4	19.6
3. Services	56.1	56.7	58.7	58.8	60.2	60.9	61.9
4. Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Memo:							
Real GDP at Factor Cost at 1999-2000 Prices (Rupees crore)	18,64,773	19,72,912	20,47,733	22,22,591	23,89,660	26,04,532	28,44,022

.. : Not available. QE: Quick Estimates. AE: Advance Estimates.
$: Includes 'trade, hotels and restaurants' and 'transport, storage and communication'.
Source: Central Statistical Organisation.

period for which latest data are available). Latest macroeconomic developments for 2007-08, wherever available, are also covered. While section I presents developments in the real sector, section II presents a detailed account of Central and State Government finances. Section III dwells on monetary and credit developments along with the inflation trends. Section IV outlines developments in the financial markets. Business operations of financial institutions are covered in Section V. Section VI sets out external sector developments. Overall assessment is presented in Section VII.

I. REAL SECTOR

National Income

2.8 The Indian economy exhibited robust growth performance during 2005-06 with real GDP growth accelerating to 9.0 per cent from 7.5 per cent in 2004-05. The improved performance during 2005-06 was underpinned by a turnaround in the growth of agriculture and allied activities and sustained growth of the services. The industrial sector maintained high growth, *albeit* somewhat lower than in 2004-05 (Table 2.1 and Chart II.1). Growth in agriculture and

Chart II.1: Annual Growth Rate of GDP at Factor Cost (At 1999-2000 Prices)

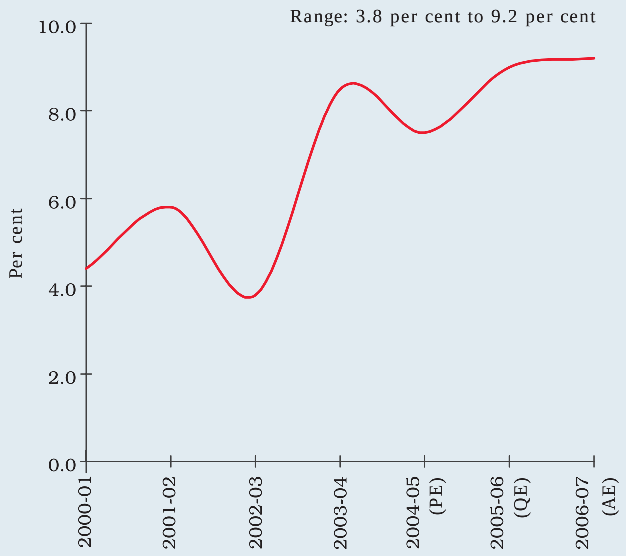


Table 2.2: Quarterly Growth Rates of Gross Domestic Product
(At 1999-2000 prices)

(Per cent)

Sector	2001-02 to 2006-07 (Average)	2005-06*	2006-07#	2005-06				2006-07			April-December	
				Q1	Q2	Q3	Q4	Q1	Q2	Q3	2005-06	2006-07
1	2	3	4	5	6	7	8	9	10	11	12	13
1. Agriculture and Allied Activities	**3.0** **(20.9)**	**6.0** **(19.7)**	**2.7** **(18.5)**	**4.0**	**4.0**	**8.7**	**5.5**	**3.4**	**1.7**	**1.5**	**6.0**	**2.2**
1.1 Agriculture	..	6.3	..									
2. Industry	**7.0** **(19.5)**	**8.0** **(19.4)**	**10.2** **(19.6)**	**9.8**	**6.6**	**7.2**	**7.9**	**9.7**	**10.5**	**10.0**	**7.8**	**10.1**
2.1 Mining and Quarrying	4.9	3.6	4.5	6.0	0.1	2.7	3.0	3.4	3.1	5.7	3.0	4.1
2.2 Manufacturing	7.5	9.1	11.3	10.7	8.1	8.2	8.9	11.3	11.9	10.7	9.0	11.3
2.3 Electricity, Gas and Water Supply	5.3	5.3	7.7	7.4	2.6	5.0	6.1	5.4	7.7	9.3	5.0	7.5
3. Services	**9.1** **(59.5)**	**10.3** **(60.9)**	**11.0** **(61.9)**	**9.5**	**9.5**	**10.3**	**11.0**	**10.4**	**10.7**	**11.1**	**9.8**	**10.8**
3.1 Trade, Hotels, Transport & Communication	10.8	10.4	13.0	10.2	9.5	10.0	12.9	13.1	13.8	13.0	9.9	13.3
3.2 Financing, Insurance, Real Estate and Business Services	8.6	10.9	11.1	8.9	10.6	9.8	10.5	9.0	9.5	11.6	9.8	10.1
3.3 Community, Social and Personal Services	6.2	7.7	7.8	7.5	7.9	8.3	7.6	7.4	6.9	7.5	7.9	7.2
3.4 Construction	10.3	14.2	9.4	12.7	11.3	16.6	12.0	9.5	9.8	9.9	13.6	9.7
4. Real GDP at Factor Cost	**7.3** **(100.0)**	**9.0** **(100.0)**	**9.2** **(100.0)**	**8.4**	**8.0**	**9.3**	**9.3**	**8.9**	**9.2**	**8.6**	**8.6**	**8.9**

* : Quick Estimates. # : Advanced Estimates. .. : Not Available.
Note : Figures in parentheses denote share in real GDP.
Source : Central Statistical Organisation.

allied activities was enabled by both foodgrains and non-foodgrains production and improvement in respect of horticulture, livestock, fisheries and plantation crops. Real GDP growth originating from the industrial sector was driven mainly by strong manufacturing activity. Sustained expansion in domestic as well as exports demand, increased capacity utilisation, augmentation of capacities and positive business and consumer confidence underpinned the growth of the manufacturing sector. Continuing the double digit growth of the previous year, real GDP originating in the services sector recorded a growth of 10.3 per cent during 2005-06. The services sector remained the key driver of growth during 2005-06, contributing three-fifth to the overall real GDP. The robust performance of the services sector was led mainly by the sub-sectors 'trade, hotels, transport and communication' and 'financing, insurance, real estate and business services'.

2.9 The Advance Estimates by the Central Statistical Organisation (CSO) have placed the GDP growth for 2006-07 at 9.2 per cent, which points to continuing buoyancy in domestic economic activity. Real GDP growth for the first three quarters of 2006-07 (April-December) was placed higher at 8.9 per cent as against 8.6 per cent in the corresponding period a year ago (Table 2.2). Overall industrial production increased sharply by 10.1 per cent in the three quarters of 2006-07 (April-December) from 7.8 per cent in the corresponding period of 2005-06. The services sector growth is estimated to be higher at 10.8 per cent in the first three quarters (April-December) of 2006-07 as against 9.8 per cent during the same period in 2005-06.

2.10 Various national and international organisations have placed the real GDP growth rate for 2007-08 in the range of 7.9-8.5 per cent (Table 2.3). At this rate, India would continue to be one of the fastest growing

Table 2.3: Growth in Real Gross Domestic Product, 2007-08 – Forecasts for India

(Per cent)

Institution	Latest	Month of Projection
1	2	3
Asian Development Bank	8.0	(March 2007)
Centre for Monitoring Indian Economy	8.5	(May 2007)
Confederation of Indian Industry	8.5	(April 2007)
Credit Rating Information Services of India Limited	7.9-8.4	(March 2007)
National Council of Applied Economic Research	8.3	(April 2007)
International Monetary Fund	8.4	(April 2007)
Reserve Bank of India	**Around 8.5**	**(April 2007)**
Memo:		
Range	7.9-8.5	

Table 2.4: Output Growth: Cross-Country Comparison

(Per cent)

Country	Average 1999-2008	1999	2000	2001	2002	2003	2004	2005	2006	2007P	2008P
1	2	3	4	5	6	7	8	9	10	11	12
World	**4.4**	**3.7**	**4.8**	**2.5**	**3.1**	**4.0**	**5.3**	**4.9**	**5.4**	**4.9**	**4.9**
Advanced Economies	**2.6**	**3.5**	**4.0**	**1.2**	**1.6**	**1.9**	**3.3**	**2.5**	**3.1**	**2.5**	**2.7**
Other Emerging Markets and Developing Countries	**6.4**	**4.1**	**6.0**	**4.3**	**5.0**	**6.7**	**7.7**	**7.5**	**7.9**	**7.5**	**7.1**
Argentina	2.9	-3.4	-0.8	-4.4	-10.9	8.8	9.0	9.2	8.5	7.5	5.5
Bangladesh	5.9	5.4	5.6	4.8	4.8	5.8	6.1	6.3	6.7	6.6	6.5
Brazil	3.1	0.3	4.3	1.3	2.7	1.1	5.7	2.9	3.7	4.4	4.2
Chile	4.0	-0.4	4.5	3.5	2.2	4.0	6.0	5.7	4.0	5.2	5.1
China	9.4	7.6	8.4	8.3	9.1	10.0	10.1	10.4	10.7	10.0	9.5
India	**7.0**	**6.7**	**5.3**	**4.1**	**4.3**	**7.3**	**7.8**	**9.2**	**9.2**	**8.4**	**7.8**
Indonesia	4.8	0.8	5.4	3.6	4.5	4.8	5.0	5.7	5.5	6.0	6.3
Malaysia	5.5	6.1	8.9	0.3	4.4	5.5	7.2	5.2	5.9	5.5	5.8
Mexico	3.1	3.8	6.6	–	0.8	1.4	4.2	2.8	4.8	3.4	3.5
Pakistan	5.3	3.7	4.3	2.0	3.2	4.9	7.4	8.0	6.2	6.5	6.5
Philippines	4.9	3.4	6.0	1.8	4.4	4.9	6.2	5.0	5.4	5.8	5.8
Sri Lanka	5.2	4.3	6.0	-1.5	4.0	6.0	5.4	6.0	7.5	7.0	7.0
Thailand	4.9	4.4	4.8	2.2	5.3	7.1	6.3	4.5	5.0	4.5	4.8

P : IMF Projections.
Source: World Economic Outlook, April 2007.

economies among the emerging market economies in the world (Table 2.4).

Saving and Investment

2.11 The rate of gross domestic saving (GDS), as a proportion to GDP at current market prices, which has been continuously increasing since 2000-01, was placed at 32.4 per cent in 2005-06 (Table 2.5 and Chart II.2).The rate of GDS at 32.4 per cent was the highest ever achieved since 1950-51. The household sector continued to be the major contributor to GDS with its saving rate placed at 22.3 per cent in 2005-06 as compared with 21.6 per cent in 2004-05. Savings

Table 2.5: Gross Domestic Saving and Investment

(Per cent of GDP at current market prices)

Sector	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05P	2005-06 QE
1	2	3	4	5	6	7	8
1. Gross Domestic Saving (GDS) (1.1+1.2+1.3)	**24.8**	**23.4**	**23.5**	**26.4**	**29.7**	**31.1**	**32.4**
1.1 Household Saving	21.1	21.0	21.8	22.7	23.8	21.6	22.3
a) Financial assets	10.6	10.2	10.8	10.3	11.3	10.2	11.7
b) Physical assets	10.5	10.8	10.9	12.4	12.4	11.4	10.7
1.2 Private corporate sector	4.5	4.3	3.7	4.2	4.7	7.1	8.1
1.3 Public sector	-0.8	-1.9	-2.0	-0.6	1.2	2.4	2.0
2. Gross Domestic Capital Formation (GDCF)#	**25.9**	**24.0**	**22.9**	**25.2**	**28.0**	**31.5**	**33.8**
3. Saving-Investment Balance (1-2)	**-1.1**	**-0.6**	**0.6**	**1.2**	**1.7**	**-0.4**	**-1.3**
4. Gross Capital Formation (4.1+4.2+4.3+4.4)	**26.1**	**24.1**	**23.8**	**25.0**	**26.6**	**29.7**	**32.2**
4.1 Household sector	10.5	10.8	10.9	12.4	12.4	11.4	10.7
4.2 Private corporate sector	7.4	5.7	5.4	5.9	6.9	9.9	12.9
4.3 Public sector	7.4	6.9	6.9	6.1	6.3	7.1	7.4
4.4 Valuables@	0.8	0.7	0.6	0.6	0.9	1.3	1.2

P : Provisional. QE : Quick Estimates.
\# : Adjusted for errors and omission.
@ : Valuables covers the expenditure made on acquisition of valuables included in the Gross Capital Formation.
Note : Figures may not add up to the totals due to rounding off.
Source : Central Statistical Organisation.

Chart II.2: Saving by Institutional Sources (At 1999-2000 Prices)

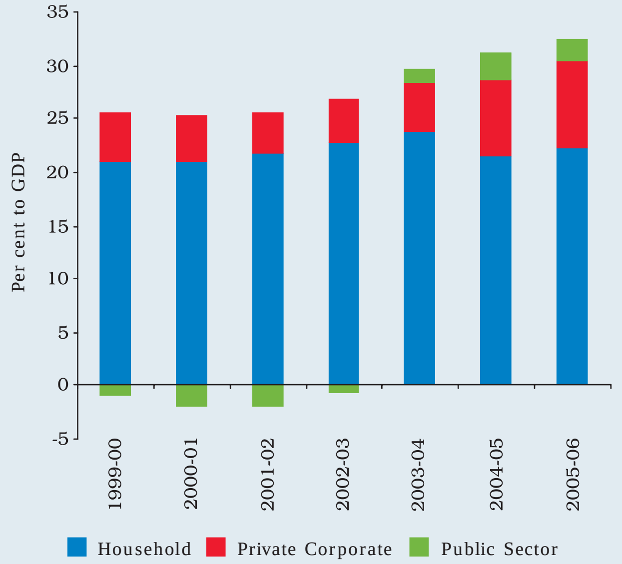
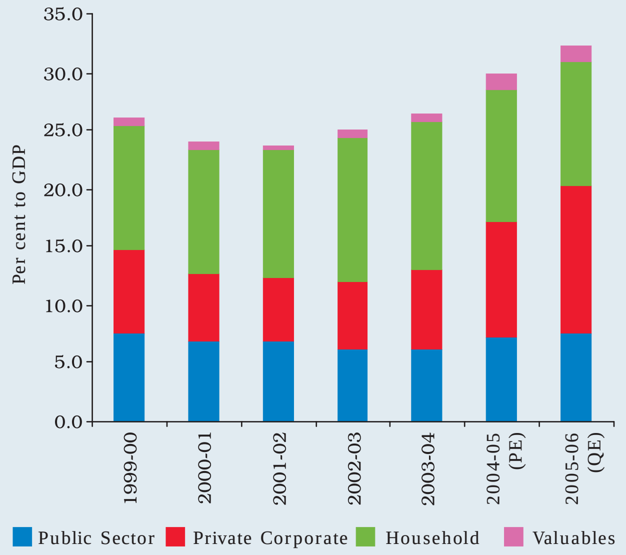


Chart II.3: Gross Capital Formation by Institutional Sources (At 1999-2000 Prices)



by households in the form of physical assets during 2000-01 to 2004-05 exceeded those in financial assets. This trend, however, was reversed in 2005-06. Private corporate saving, which has been increasing steadily since 2001-02, grew by 8.1 per cent in 2005-06, reflecting a significant growth in profit. The public sector, which started posting positive saving rate beginning 2003-04, recorded a saving rate of 2.0 per cent in 2005-06, on account of continuing fiscal improvement.

2.12 The rate of gross domestic capital formation (GDCF), as a proportion to GDP at current market prices, increased sharply to 33.8 per cent in 2005-06 from 31.5 per cent in 2004-05 due to improvement in public investment as well as private corporate investment. The higher increase in the investment rate than the saving rate is reflected in a deficit of 1.3 per cent in the overall saving-investment balance in 2005-06 as compared with a deficit of 0.4 per cent in 2004-05 (Table 2.6 and Chart II.3).

Agriculture

2.13 After witnessing a marked recovery during 2005-06, agricultural growth is expected to remain subdued during 2006-07, mainly on account of expected lower growth in foodgrains production. According to the Third Advance Estimates, the total foodgrains production during 2006-07 has been estimated at 211.8 million tonnes, indicating an increase of 1.5 per cent over the previous year (5.2 per cent).

Table 2.6: Saving-Investment Balance
(At 1999-2000 prices)

(Per cent of GDP at current market prices)

Item	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05P	2005-06 QE
1	2	3	4	5	6	7	8
Saving-Investment Balance (GDS-GDCF)	-1.1	-0.6	0.6	1.2	1.6	-0.4	-1.3
Private Sector*	7.7	8.8	9.2	8.6	9.2	7.4	6.9
Public Sector*	-8.2	-8.8	-8.9	-6.6	-5.2	-4.7	-5.4
Current Account Balance	-1.0	-0.6	0.7	1.2	2.3	-0.8	-1.3
Memo:							
Valuables@	0.8	0.7	0.6	0.6	0.9	1.3	1.2

P : Provisional. QE : Quick Estimates. GDS : Gross Domestic Saving. GDCF : Gross Domestic Capital Formation.
* : Private and Public Investments refer to gross capital formation (GCF), unadjusted for errors and omissions.
@ : Valuables covers the expenditure made on acquisition of valuables included in the GCF.
Note: Derived from CSO and Reserve Bank of India data. Components may not add up to totals due to errors and omissions.

South-West Monsoon 2006

2.14 The vagaries of the South-West monsoon with regard to the time of onset as also its temporal and spatial distribution have a profound impact on the performance of the agriculture sector. As two-thirds of the cultivated area is still unirrigated, agronomic potential is largely determined by the progress and performance of the South-West monsoon. According to the long range forecast of India Meteorological Department (IMD) issued on June 30, 2006, the South-West monsoon rainfall for the country as a whole was expected to be around 92 per cent of the Long Period Average (LPA) with a model error of +/- 4 per cent. However, the actual rainfall during the South-West monsoon was 99 per cent of the normal, resulting in replenishment of the moisture content of the soil as well as that of the reservoirs.

2.15 Although overall performance of the South-West monsoon 2006 turned out to be of the same order as that of the previous year, its spatial distribution was more uneven compared to the previous year. Of the 36 meteorological sub-divisions, cumulative rainfall was excess/normal in 26 sub-divisions (32 sub-divisions during last year) and deficient/scanty/no rain in 10 sub-divisions (4 sub-divisions during last year) (Table 2.7). During the season, rainfall was also not well distributed over time. Large rainfall deficiency was observed from the second to the fourth week of June and July, last week of August and during the middle of September 2006. The excess rainfall during the first three weeks of August, especially over Central India, was responsible for the revival of the rainfall scenario in the country.

Table 2.7: Cumulative Rainfall

Category	Number of Sub-Divisions					
	South-West Monsoon			North-East Monsoon		
	2004	2005	2006	2004	2005	2006
	(Jun. 1 to Sep. 30)			(Oct. 1 to Dec. 31)		
1	2	3	4	5	6	7
Excess	0	9	6	8	11	3
Normal	23	23	20	10	6	6
Deficient	13	4	10	17	5	14
Scanty/No Rain	0	0	0	1	14	13

Source : India Meteorological Department.

2.16 The rainfall over the country as a whole was below normal in June (13 per cent below LPA) and near normal in July (2 per cent below LPA) and September (1 per cent below LPA). However, the monsoon was active in August with excess rainfall (5 per cent above LPA). Thus, the South-West monsoon rainfall witnessed deficiency only during the month of June and remained close to normal in the subsequent months. Among the four homogenous regions, the South-West monsoon rainfall was deficient in North-East India, North-West India and Southern Peninsula, which recorded rainfall of 83 per cent, 94 per cent and 95 per cent of LPA, respectively. The near normal performance of the South-West monsoon rainfall over the country was contributed mainly by the excess rainfall over Central India (116 per cent of LPA). At the sub-division level, five sub-divisions (Andaman and Nicobar Islands, Arunachal Pradesh, Assam and Meghalaya, Western Uttar Pradesh and Haryana) experienced moderate drought[1] conditions at the end of the season. Of the 533 meteorological districts, 130 districts (25 per cent) experienced moderate drought, while 30 districts (6 per cent) experienced severe drought conditions at the end of the season.

Reservoir Status

2.17 The Central Water Commission monitors the total live water storage in 76 major reservoirs accounting for around 63 per cent of the total reservoir capacity of the country. At the end of the South-West monsoon season (as on September 28, 2006), the reservoir position with total live water storage at 91 per cent of the Full Reservoir Level (FRL) was higher than the previous year's position (81 per cent) and the last ten year's average (71 per cent). The comfortable reservoir position is likely to augur well for the *rabi* crop production as well as hydroelectricity generation during 2006-07. As on April 12, 2007, the total live water storage was 35 per cent (32 per cent as on March 29, 2006) of the FRL. In view of the near normal performance of the South-West monsoon and improvement in the water storage levels, the Ministry of Agriculture set the target for the total foodgrains production during 2006-07 at 220 million tonnes, higher than the target of 215 million tonnes during the previous year (Table 2.8).

1 According to IMD, the departure of aridity index from the normal value is expressed in percentage and accordingly drought is categorised as severe (more than 50 per cent), moderate (26-50 per cent) and mild (up to 25 per cent).

Table 2.8: Crop-wise Targets/Achievements

(Million tonnes)

Crops	2004-05		2005-06		2006-07	
	T	A	T	A	T	AE
1	2	3	4	5	6	7
Rice	93.5	83.1	87.8	91.8	92.8	91.1
Wheat	79.5	68.6	75.5	69.4	75.5	73.7
Coarse cereals	36.8	33.5	36.5	34.1	36.5	32.9
Pulses	15.3	13.1	15.2	13.4	15.2	14.1
Total Foodgrains	**225.1**	**198.4**	**215.0**	**208.6**	**220.0**	**211.8**
Oilseeds	26.2	24.4	26.6	28.0	29.4	23.3
Sugarcane	270.0	237.1	237.5	281.2	270.0	322.9
Cotton*	15.0	16.4	16.5	18.5	18.5	21.0
Jute & Mesta**	11.8	10.3	11.3	10.8	11.3	11.3

T : Target. A : Achievement.
AE : Third Advance Estimates as on April 4, 2007.
* : In million bales of 170 kilograms each.
** : In million bales of 180 kilograms each.
Source : Ministry of Agriculture, Government of India.

North-East Monsoon 2006

2.18 Cumulative rainfall recorded during the North-East monsoon (October 1, 2006 to December 31, 2006) was 21 per cent below normal as compared with 10 per cent above normal during the corresponding period of the previous year. Of the 36 meteorological sub-divisions, cumulative rainfall was excess/normal in 9 sub-divisions (17 sub-divisions during last year) and deficient/scanty/no rainfall in 27 sub-divisions (19 sub-divisions during last year) (Table 2.7).

Kharif 2006

2.19 Against the backdrop of a normal monsoon, production of foodgrains during *kharif* 2005 (109.9 million tonnes) registered a growth of 6.3 per cent over that in the previous year. According to the Third Advance Estimates, the *kharif* foodgrains production during 2006-07 has been estimated at 108.4 million tonnes, a decline of 1.4 per cent over the previous year (Table 2.9). Among *kharif* foodgrains, while the production of coarse cereals (6.5 per cent) and pulses (0.8 per cent) witnessed a decline, that of rice (0.3 per cent) registered a marginal improvement over the previous year. After witnessing a sharp recovery during 2005-06, production of *kharif* oilseeds is expected to witness a sharp decline during 2006-07. However, with the continued growth momentum since 2003-04, sugarcane and cotton are expected to scale new peaks during 2006-07.

Rabi 2006-07

2.20 Total foodgrains production during *rabi* 2005-06 increased by 3.7 million tonnes to 98.7 million tonnes (Table 2.9). Consequently, the overall foodgrains production for 2005-06 at 208.6 million tonnes registered a growth of 5.2 per cent over the previous year. Favourable soil moisture conditions along with remunerative open market and support prices led to improved sowing position during *rabi* 2006-07. Area sown under *rabi* crops so far (up to April 27, 2007) has been about 2.2 per cent higher than that a year ago. Barring oilseeds and rice, all major crop groups have witnessed improvement in

Table 2.9: Season-wise Agricultural Production

(Million tonnes)

Crop	*Kharif*			*Rabi*		
	2004-05 A	2005-06 A	2006-07 AE	2004-05 A	2005-06 A	2006-07 AE
1	2	3	4	5	6	7
Rice	72.2	78.3	78.5	10.9	13.5	12.5
Wheat	..	..	..	68.6	69.4	73.7
Coarse Cereals	26.4	26.7	25.0	7.1	7.3	7.9
Pulses	4.7	4.9	4.8	8.4	8.5	9.3
Total Foodgrains	**103.3**	**109.9**	**108.4**	**95.1**	**98.7**	**103.4**
Oilseeds	14.1	16.8	13.9	10.2	11.2	9.4
Sugarcane	237.1	281.2	322.9	..	..	..
Cotton*	16.4	18.5	21.0	..	..	..
Jute & Mesta**	10.3	10.8	11.3	..	..	..

A : Achievement. AE : Third Advance Estimates (2006-07) as on April 4, 2007.
.. : Not Available. * : In million bales of 170 kilograms each. ** : In million bales of 180 kilograms each.
Source: Ministry of Agriculture, Government of India.

the area sown. According to the Ministry of Agriculture, Government of India, the less coverage under oilseeds was mainly due to diversion of area from rapeseed and mustard to bengal gram in Madhya Pradesh and to wheat in Haryana, Rajasthan and Uttar Pradesh.

2.21 Timely sowing of the *rabi* crops along with improvement in area sown have brightened the prospects of *rabi* crops during 2006-07. Accordingly, the Third Advance Estimates have placed the *rabi* foodgrains production at 103.4 million tonnes, an increase of 4.8 per cent over the previous year. Total production of wheat is expected at 73.7 million tonnes, an increase of 6.3 per cent over the previous year.

Procurement, Offtake and Stocks of Foodgrains

2.22 The procurement of foodgrains (rice and wheat) during 2006-07 at 35.9 million tonnes was lower by 13.2 per cent over the corresponding period of the preceding year (Table 2.10). This was mainly on account of a significantly lower procurement of wheat at 9.2 million tonnes during 2006-07 as against

Table 2.10: Management of Foodstocks

(Million Tonnes)

Year/ Month	Opening Stock of Foodgrains	Foodgrains Procurement	Foodgrains offtake				Closing Stock	Buffer Stock Norms $
			PDS	OWS	OMS - Domestic	Exports		
1	2	3	4	5	6	7	8	9
2005								
April	18.0	14.2	2.4	1.0	0.0	0.0	28.5	16.2
May	28.5	3.0	2.5	0.8	0.0	0.0	27.9	
June	27.9	0.9	2.5	1.7	0.0	0.0	25.1	
July	25.1	0.8	2.8	0.8	0.1	0.0	21.4	26.9
August	21.4	0.4	2.6	0.8	0.1	0.0	18.4	
September	18.4	0.4	2.7	0.7	0.1	0.0	15.5	
October	15.5	7.5	2.7	0.5	0.0	0.0	19.8	16.2
November	19.8	2.7	2.3	0.5	0.1	0.0	19.0	
December	19.0	2.9	2.7	0.7	0.2	0.0	19.3	
2006								
January	19.3	4.0	2.7	0.8	0.1	0.0	19.5	20.0
February	19.5	2.9	2.7	0.6	0.3	0.0	18.3	
March	18.3	1.9	2.5	0.9	0.2	0.0	16.6	
April	16.6	10.3	2.5	0.3	0.0	0.0	22.8	16.2
May	22.8	2.2	2.9	0.4	0.0	0.0	22.3	
June	22.3	1.5	2.6	0.6	0.0	0.0	20.5	
July	20.5	0.8	2.7	0.4	0.0	0.0	17.1	26.9
August	17.1	0.5	2.7	0.4	0.0	0.0	15.5	
September	15.5	0.2	2.6	0.5	0.0	0.0	12.6	
October	12.6	8.0	2.5	0.3	0.0	0.0	18.6	16.2
November	18.6	2.0	2.5	0.4	0.0	0.0	17.8	
December	17.8	2.6	2.6	0.3	0.0	0.0	17.5	
2007								
January	17.5	4.3	2.7	0.4	0.0	0.0	18.1	20.0
February	18.1	2.4	2.7	0.5	0.0	0.0	19.1	
March	19.1	1.2	..	..	..	..	..	
April	..	8.7	..	..	..	..	..	16.2
May*	..	1.4	..	..	..	..	..	
Memo :								
2005-06 @	18.0	41.4	28.6	8.9	0.9	0.0	18.3	
2006-07 @	16.6	35.9	28.9	4.6	0.0	0.0	19.1	
2007-08 *	..	10.1	..	..	..	..	..	

PDS : Public Distribution System. OWS : Other Welfare Schemes. OMS : Open Market Sales.

$: Minimum Buffer Stock norms to be maintained, as on 1st April, 1st July, 1st October and 1st January, revised under New Buffer Stocking Policy with effect from March 29, 2005.

* : Procurement up to May 8, 2007.

@ : Offtake up to end-February and closing stock as on March 1.

.. : Not Available.

Note : Closing Stock figures may differ from those arrived at by adding the opening stocks and procurement and deducting, offtake as stocks include coarse grains also.

Source : Ministry of Consumer Affairs, Food and Public Distribution, Government of India.

14.8 million tonnes during the corresponding period of the previous year. Similarly, the offtake of rice and wheat during 2006-07 (April 1 to February 28, 2007) was lower by 12.7 per cent over the comparable period of the previous year. The decline in offtake was mainly due to a sharp fall in the offtake under Other Welfare Schemes (OWS). Furthermore, the offtake of wheat under the Targeted Public Distribution System (TPDS) also declined by 14.5 per cent. Total stocks of foodgrains with Food Corporation of India and other Government agencies at 19.1 million tonnes as on March 1, 2007 were 4.3 per cent higher as compared with 18.3 million tonnes in the corresponding period of last year. During 2007-08 so far (up to May 8, 2007), total procurement of wheat and rice at 10.1 million tonnes was 7.5 per cent lower than 11.0 million tonnes procured during the corresponding period of the previous financial year.

Recent Policy Initiatives

2.23 With a view to achieving the target of around 4.0 per cent agricultural growth as envisaged in the Approach Paper to the Eleventh Plan, a number of new initiatives were undertaken by the Government during last year for redressing the problems afflicting the agriculture sector. These, *inter alia*, were (i) creation of a National Rain-fed Area Authority in November 2006 to support upgradation and management of dry-land and rain-fed agriculture; (ii) formulation of a model law on agricultural marketing in consultation with the State Governments/ UTs to bring about marketing reforms; (iii) package for revival of Short-term Rural Co-operative Credit Structure in January 2006; (iv) interest subvention to enable lending for crop loans up to a principal amount of Rs.3 lakh at 7.0 per cent rate of interest beginning *Kharif* 2006-07; (v) special relief package for farmers in 31 high incidence districts of farmers' suicides in Andhra Pradesh, Maharashtra, Karnataka and Kerala; and (vi) launch of National Agricultural Innovation Project in July 2006 aimed at enhancing livelihood security by involving farmer groups, *Panchayati Raj* institutions and the private sector.

2.24 To promote more broad-based and inclusive growth, the Union Budget, 2007-08 has placed the acceleration of agricultural growth at the top of the Government's agenda. The Budget has fixed a farm credit target of Rs.2,25,000 crore for the ensuing financial year with an objective of bringing 5 million new farmers into the fold of the banking system. In order to augment resources to refinance rural credit co-operatives, NABARD has been permitted to issue rural bonds of Rs.5,000 crore and RRBs have been asked to undertake a significant branch expansion programme. Further, the Budget has proposed to extend the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act to loans advanced by RRBs; permit RRBs to accept NRE/FCNR deposits; and recapitalise, in a phased programme, the RRBs which have a negative net worth. A Fund with NABARD for meeting the cost of developmental and promotional interventions and a Technology Fund to meet the costs of technology adoption has been proposed in the Budget for promoting financial inclusion.

2.25 The National Commission on Farmers had drawn attention to the knowledge deficit, which constrains agricultural productivity. Farming practices in large parts of the country are sub-optimal. The Union Budget, 2007-08 has highlighted the need for establishing a good extension system to make full use of the existing technology in the agriculture sector. The Budget has also proposed to (i) expand the Integrated Oilseeds, Oil palm, Pulses and Maize Development Programme; (ii) enhance outlay under Accelerated Irrigation Benefit Programme (AIBP); and (iii) restore water bodies and groundwater recharge for improving the productivity of crops.

Industry

2.26 The industrial sector expanded at a robust pace for the fifth year in succession during 2006-07. The upswing in the industrial sector was driven mainly by manufacturing activity, which contributes more than 90 per cent to the industrial growth. During 2006-07, the IIP registered an accelerated double digit growth of 11.3 per cent – the highest since 1995-96 (13.1 per cent) (Table 2.11). Strong consumption demand, expansion in investment and capacity additions were the main factors that contributed to the accelerated growth. The growth was well-diversified across all the sectors. A significant pick-up in the intermediate goods sector in recent months underlines the new acquired dynamism and competitiveness of the Indian industry. The continued buoyant performance of the basic and the capital goods sectors provides a basis for sustained high industrial growth.

2.27 During 2006-07, the manufacturing sector recorded a growth of 12.3 per cent, which has been the highest since 1995-96, when it recorded a growth of 14.1 per cent. The mining sector recorded a higher growth of 5.1 per cent, benefiting from higher production of crude oil. Higher output of crude oil

Table 2.11: Monthly Growth of IIP

(Per cent)

Month/Weight	General (100.00)		Electricity (10.17)		Mining & Quarrying (10.47)		Manufacturing (79.36)	
	2005-06	2006-07	2005-06	2006-07	2005-06	2006-07	2005-06	2006-07
1	2	3	4	5	6	7	8	9
April	8.1	9.9	3.1	5.9	2.8	3.4	9.2	11.0
May	10.8	11.7	10.5	5.0	5.2	2.9	11.3	13.3
June	12.2	9.7	9.6	4.9	4.8	4.7	13.2	10.7
July	4.7	13.2	-0.9	8.9	-1.9	5.1	6.0	14.3
August	7.6	10.3	7.9	4.1	-2.5	-1.7	8.5	11.9
September	7.2	12.0	-0.8	11.3	-1.9	4.3	8.9	12.7
October	9.8	4.5	7.7	9.7	-0.1	5.9	10.9	3.8
November	6.0	15.8	3.4	8.7	-2.1	8.8	7.0	17.2
December	5.7	13.4	3.4	9.1	-0.1	6.1	6.4	14.5
January	8.5	11.4	6.4	8.3	2.0	7.2	9.4	12.1
February	8.8	10.8	9.1	3.3	3.8	7.1	9.2	11.9
March	8.9	12.9	3.4	7.9	2.0	6.2	10.1	14.1
April-March	**8.2**	**11.3**	**5.2**	**7.2**	**1.0**	**5.1**	**9.1**	**12.3**

Source: Central Statistical Organisation.

reflected the recovery from the setback to production, following the outbreak of fire at Mumbai High in July 2005. The electricity sector recorded a higher growth of 7.2 per cent during the period, reflecting mainly the higher plant load factor (PLF) in thermal power plants and double-digit growth in hydro-power generation.

2.28 A notable feature of industrial growth in recent years has been the continued buoyancy of the manufacturing sector. During 2006-07, 16 manufacturing industry groups (in terms of 2-digit level classification) recorded a positive growth (Table 2.12). Significantly, two industries constituting around 24 per cent weight in IIP, *viz.,* machinery and

Table 2.12: Growth of Manufacturing Industries (2-digit level Classification) (April-March 2006-07)

Above 15 per cent	10-15 per cent	0-10 per cent	Negative
1	2	3	4
1. Wood and wood products, furniture and fixtures (29.1)	1. Transport equipment and parts (14.9)	1. Chemicals and chemical products except products of petroleum and coal (9.2)	1. Jute and other vegetable fibre textiles (-17.2)
2. Basic metal and alloy (22.8)	2. Cotton textiles (14.8)	2. Paper and paper products (8.3)	
	3. Machinery and equipment other than transport equipment (14.0)	3. Wool, silk and man-made fibre textiles (8.2)	
	4. Non-metallic mineral products (12.8)	4. Food products (8.2)	
	5. Rubber, plastic, petroleum and coal products (12.7)	5. Other manufacturing industries (6.5)	
	6. Metal products and parts (11.4)	6. Leather and leather & fur products (0.3)	
	7. Beverages, tobacco and related products (11.3)		
	8. Textiles products (including apparels) (11.2)		

Note : Figures in parentheses are growth rates.
Source : Central Statistical Organisation.

Table 2.13: Sectoral Contribution to IIP Growth (April-March)

(Per cent)

Industry Group	Weight in IIP	Growth			Relative Contribution		
		2004-05	2005-06	2006-07 P	2004-05	2005-06	2006-07 P
1	2	3	4	5	6	7	8
Basic Goods	**35.57**	5.5	6.7	10.2	20.9	25.4	27.5
Capital Goods	**9.26**	13.9	15.8	17.7	16.4	20.0	17.4
Intermediate Goods	**26.51**	6.1	2.5	11.7	20.3	8.4	26.7
Consumer Goods (a+b)	**28.66**	11.7	12.0	10.0	42.6	46.3	28.7
a) Consumer Durables	**5.36**	14.3	15.3	9.0	12.9	14.9	6.7
b) Consumer Non-durables	**23.3**	10.8	11.0	10.3	29.6	31.4	22.0
IIP	**100.0**	**8.4**	**8.2**	**11.3**	**100.0**	**100.0**	**100.0**

P : Provisional.
Source : Central Statistical Organisation.

equipments, and chemicals and chemical products contributed 32.9 per cent to the manufacturing sector growth during 2006-07. 'Metal products and parts', 'wood and wood products', 'leather and leather and fur products', 'paper and paper products' and 'wool, silk and man-made fibre textiles' made a turnaround, while 'jute and other vegetable fibre textiles' recorded negative growth during the year.

2.29 The performance of industry in terms of use-based classification was equally impressive during 2006-07. The basic goods sector recorded a growth of 10.2 per cent – the highest growth since 1995-96 (Table 2.13). The accelerated growth of cement, high speed diesel and various other iron and steel products such as carbon steel, bars and rods, pipes and tubes, structurals, *etc*., contributed to higher growth of the basic goods sector. Growth of the intermediate goods sector at 11.7 per cent has also been the highest since 1995-96 (19.3 per cent). The growth was driven largely by the higher growth of some yarns, polyester fibre, viscose staple fibre, PVC pipes and tubes and glazed tiles/ceramic tiles. The capital goods sector also recorded a high growth of 17.7 per cent during 2006-07 as compared with 15.8 per cent during 2005-06 and was sustained by complete tractors, boilers, diesel engines, textile machinery, material handling equipment, protection system/switch board, and process-control instruments. The consumer goods sector recorded a moderately lower growth of 10.0 per cent during 2006-07 as compared with 12.0 per cent during the corresponding period of the previous year. This was on account of the decelerated growth of both consumer durables and non-durables mainly due to negative performance of some of the food products and edible oils and some drugs.

Infrastructure

2.30 During 2006-07, the overall growth of core infrastructure industries at 8.6 per cent (as compared with 6.2 per cent during 2005-06) was the highest since 1999-00 (Table 2.14). The higher growth was

Table 2.14: Growth Rate of Infrastructure Industries

(Per cent)

Sector	Weight in IIP	2002-03	2003-04	2004-05	2005-06	2006-07 (P)
1	2	3	4	5	7	8
1. Electricity	10.17	3.2	5.1	5.2	5.2	7.2
2. Coal	3.22	4.5	5.1	6.2	6.6	5.9
3. Finished Steel	5.13	7.3	9.8	8.4	11.2	10.9
4. Cement	1.99	8.8	6.1	6.6	12.4	9.1
5. Crude Petroleum	4.17	3.4	0.7	1.8	-5.3	5.6
6. Petroleum Refinery Products	2.00	4.9	8.2	4.3	2.4	12.6
Composite Index	**26.68**	**5.0**	**6.1**	**5.8**	**6.2**	**8.6**

Source: Office of the Economic Adviser, Ministry of Commerce and Industry, Government of India.

mainly a reflection of strong growth of electricity and petroleum refinery products and turnaround in the growth of crude petroleum during the period. Amongst the core sector groups, petroleum refinery products recorded the highest growth of 12.6 per cent during the period.

2.31 Despite strong domestic demand, a high base contributed to a double-digit but moderate growth in steel output. Rising domestic and external demand continued to underpin the growth of the cement sector, notwithstanding some moderation on account of the base effect. Negative growth in coal production in September resulted in a lower growth in the coal sector during the year. Crude petroleum recorded a turnaround due to restoration of production of crude oil in ONGC plant at Mumbai High and rise in crude oil production in private and joint-venture companies. Higher capacity utilisation in various refineries across the country and higher exports of petroleum refinery products enabled the petroleum refinery products sector to register an impressive growth.

Services Sector

2.32 India's growth over the past few years has been driven primarily by the services sector. The services sector continued to grow at a robust pace of 10.3 per cent during 2005-06 on top of 10.0 per cent growth in 2004-05. The services sector maintained the growth momentum and recorded an impressive double-digit growth (10.7) during April-December 2006, despite a higher base (9.8 per cent during the same period in 2005). The acceleration in the growth was led by 'trade, hotels, transport and communication', which recorded the highest growth of 13.3 per cent among the sub-sectors during the period (Table 2.15).

2.33 Enhanced synergy with the industrial sector as well as the robust economic condition have spurred the strong growth of trade, transportation, communication, construction and financial services. The trade sector recorded a double-digit growth as both exports and imports grew at a strong pace. Rapid growth in domestic and international tourism, both business and leisure, aided the growth of the hotel industry. Burgeoning revenue earning freight traffic of railways and robust growth of aviation sector propped up the transport sector. Strong growth in the cellular subscriber base and steady growth in broadband connections underpinned the strong growth in the communication sector. The 'financing, insurance, real estate and business services' sub-sector benefited from the healthy growth in bank deposits and non-food credit, surge in insurance business of both public and private insurance companies, and increased business process outsourcing-information technology enabled services exports. 'Community, social and personal services' sub-sector recorded a higher growth due to increase in both plan and non-plan expenditure.

Information Technology Enabled Services and Business Process Outsourcing

2.34 The export-oriented information technology (IT) and business process outsourcing (BPO) sectors continued to perform well due to growing international demand for skilled, low-cost English-speaking Indian workers. The Information Technology Enabled Services (ITES) and BPO segments have contributed significantly in sustaining the growth of the services sector. According to the National Association of Software and Services Companies (NASSCOM), ITES-BPO revenue increased significantly in 2005-06 to US$ 29.6 billion on account of a rapid growth in

Table 2.15: Quarterly Growth Performance of Sub-Sectors of Services
(Base: 1999-2000)

(Per cent)

Sub-sector	2004-05				2005-06				2006-07		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
1	2	3	4	5	6	7	8	9	10	11	12
Construction	12.4	8.5	14.5	13.5	12.7	11.3	16.6	12.0	9.5	9.8	9.8
Trade, hotels, transport & communication	11.7	12.2	10.2	11.0	10.2	9.5	10.0	12.9	13.1	13.8	13.0
Financing, insurance, real estate & business services	9.7	8.4	10.6	10.7	8.9	10.6	9.8	10.5	9.0	9.5	11.6
Community, social & personal services	11.2	5.1	8.9	12.7	7.5	7.9	8.3	7.6	7.4	6.9	7.5
Services	**11.2**	**9.1**	**10.4**	**11.6**	**9.5**	**9.5**	**10.3**	**11.0**	**10.4**	**10.7**	**11.1**
GDP at factor cost	**8.1**	**6.9**	**5.5**	**8.6**	**8.4**	**8.0**	**9.3**	**9.3**	**8.9**	**9.2**	**8.6**

Source: Central Statistical Organisation.

demand from overseas and domestic consumers. The exports of Indian IT-ITES industry increased by 33 per cent, generating revenues of US$ 23.6 billion in 2005-06 as compared with US$ 17.7 billion in 2004-05. Factors such as evolution of global delivery model and unbundling of large IT outsourcing deals with large companies based in India contributed to the buoyant export performance. India's strength in the IT enabled and BPO segments has increased in recent years through large client wins, cross-border mergers and acquisitions, and movement of the industry towards a stable pricing model.

Industrial Outlook

2.35 The Industrial sector, which performed consistently well in recent years remained buoyant during 2006-07, underpinned by strong consumption demand, expansion in investment and capacity additions. The performance of the mining sector improved in 2006-07. It is expected to put up a modest growth as the recent de-blocking of coal reserves for captive consumption by steel and power companies would push up the coal production activity in the country. The power sector continues to suffer from gas supply shortages, which has forced gas-based plants to operate at lower capacity. Growth of the manufacturing sector is well-diversified. Considering the buoyant industrial climate in the country, growth in the manufacturing sector is expected to be sustained at a double-digit level.

II. FISCAL SITUATION

Central Government Finances

2.36 The Union Budget, 2007-08 was presented against the backdrop of strong macroeconomic fundamentals, *albeit* with some concerns on the inflation front. The Budget commits to further strengthen the fiscal correction as stipulated in the Fiscal Responsibility and Budget Management (FRBM) Rules, 2004 with the proposed reductions in the revenue deficit and fiscal deficit, while at the same time allocating higher funds for social sector expenditure.

2.37 The major thrust of the Budget, 2007-08 was on attaining faster and more inclusive growth. In order to achieve the objective of inclusive growth, bulk of the budgetary resources have been allocated to eight flagship programmes of the Government covering the areas of education, health and rural employment. In order to sustain the growth momentum, the budget has proposed policies aimed at tapping extra budgetary resources and leveraging them for investment, especially the infrastructure.

2.38 The budget seeks to continue the impressive performance on the tax front through a strategy of moderate and stable tax rates and administering the tax laws in a tax payer-friendly manner. In the case of direct taxes the strategy is to (a) minimise the distortions within the tax structure by rationalising the tax structure and expanding the tax base and maintaining moderate tax rates; and (b) improve the efficiency and effectiveness of the tax administration so as to enhance voluntary compliance through a higher deterrence level. The strategy of indirect taxes is to bring down the customs tariff to the comparable levels of East Asian countries, widen the tax base and converge the excise duty to the CENVAT rate. In the case of service tax, the strategy is to expand the tax base, while at the same time provide exemption to small service providers. In the case of indirect taxes, tax policy was aimed at containing the inflationary pressures in the economy and taking steps for introducing the fully integrated goods and services tax by April 1, 2010.

Revised Estimates 2006-07 [2]

2.39 The revised estimates for 2006-07 showed improvement in all the key deficit indicators, *viz.,* revenue deficit (RD), gross fiscal deficit (GFD) and primary deficit (PD) relative to GDP over their budgeted levels. Reduction in deficit indicators was mainly on account of improved revenue receipts, both tax and non-tax, which more than offset the higher expenditure. Aggregate expenditure was higher than the budget estimates on account of revenue expenditure, particularly on interest payments, fertilizer and interest subsidies, and non-plan non-defence capital outlay. Plan expenditure was in line with the budget estimates.

2.40 The revenue deficit in the revised estimates constituted 2.0 per cent of the GDP in 2006-07 as against the budgeted level of 2.1 per cent. The decline in revenue deficit was on account of a marked improvement in revenue receipts by Rs.19,866 crore (4.9 per cent) which offset the increase in revenue expenditure. Notwithstanding the fall in revenue deficit, the GFD was higher by Rs.3,642 crore (2.4

[2] All comparisons of 2006-07 in this Section are with budget estimates, unless stated otherwise.

Table 2.16: Key Deficit Indicators of the Central Government

(Amount in Rupees crore)

Item	2005-06 (Accounts)	2006-07 (BE)	2006-07 (RE)	2007-08 (BE)	Variation (Per cent)	
					col.4 over 3	col. 5 over 4
1	2	3	4	5	6	7
Gross Fiscal Deficit	1,46,435 (4.1)	1,48,686 (3.8)	1,52,328 (3.7)	1,50,948 (3.3)	2.4	-0.9
Revenue Deficit	92,299 (2.6)	84,727 (2.1)	83,436 (2.0)	71,478 (1.5)	-1.5	-14.3
Gross Primary Deficit	13,805 (0.4)	8,863 (0.2)	6,136 (0.1)	-8,047 (-0.2)	-30.8	-231.1

BE : Budget Estimates. RE : Revised Estimates.
Note: Figures in parentheses are percentages to GDP.

per cent) than the budgeted level on account of a fall in non-debt capital receipts as well as higher non-plan non-defence capital outlay. In relation to GDP, however, it was lower at 3.7 per cent than the budget estimates of 3.8 per cent. Primary deficit at 0.1 per cent of GDP was lower by 30.8 per cent in the revised estimates for 2006-07 than the budget estimates (Table 2.16).

2.41 Revenue receipts in the revised estimates for 2006-07 increased by 4.9 per cent over the budgeted level. The gross tax revenue in the revised estimates for 2006-07 was higher by Rs.25,695 crore than the budget estimates. Collections under all the taxes are set to be higher than the budgeted level. Among the recently introduced taxes, fringe benefit tax is estimated to yield Rs.5,500 crore, Securities Transactions Tax (STT) Rs.3,750 crore and banking cash transaction tax Rs.550 crore in 2006-07. The net tax revenue [gross tax revenue less States share in Central taxes and amount transferred to National Calamity Contingency Fund (NCCF)] increased by 5.7 per cent and constituted 8.4 per cent of the GDP (Table 2.17).

2.42 Under non-debt capital receipts, recoveries of loans and advances declined by 31.9 per cent over the budget estimates (Table 2.17). Recoveries of loans to the State Governments are estimated to decline by Rs.4,102 crore in the revised estimates for 2006-07 due to the impact of the debt waiver under the Twelfth Finance Commission (TFC) award. Recoveries from Public Sector Enterprises, statutory bodies, *etc.*, are, however, estimated to increase by Rs.1,596 crore.

2.43 Revenue expenditure in the revised estimates for 2006-07 was higher by 3.8 per cent than the budget estimates, while capital expenditure declined by 1.2 per cent over the budget estimates (Table 2.18). Revenue expenditure was higher on account of interest payments, fertiliser and interest subsidies, grants to the States and pensions. In the capital expenditure, non-defence capital outlay and loans and advances were higher than the budget estimates.

Budget Estimates 2007-08[3]

2.44 After achieving the targets in the preceding year, the Union Budget for 2007-08 proposes to further strengthen the fiscal correction as stipulated in FRBM Rules, 2004. Accordingly, key deficit indicators, *viz*., revenue deficit (RD), gross fiscal deficit (GFD) and primary deficit (PD), as per cent of GDP, are budgeted lower at 1.5 per cent, 3.3 per cent and -0.2 per cent in 2007-08 than 2.0 per cent, 3.7 per cent and 0.1 per cent, respectively, in the preceding year (Table 2.16). The Union Budget, 2007-08 proposes to acquire the Reserve Bank's equity holding in State Bank of India, for which it provided a sum of Rs.40,000 crore. This transaction, however, being shown as a non-debt capital receipt matched by capital expenditure, would not have an impact on the deficit indicators.

2.45 The revenue receipts in 2007-08 are budgeted to increase by 14.9 per cent on top of a high growth of 21.8 per cent recorded in 2006-07, primarily reflecting a growth of 17.2 per cent in gross tax collections as compared with an increase of 27.8 per cent in 2006-07. Among the direct taxes, corporation

3 All comparisons of 2007-08 in this Section are with revised estimates for 2006-07, unless stated otherwise.

Table 2.17: Receipts of the Centre

(Amount in Rupees crore)

Item	2005-06 (Accounts)	2006-07 (BE)	2006-07 (RE)	2007-08 (BE)	Variation (per cent) Col.4 over 3	Col.5 over 4
1	2	3	4	5	6	7
Total Receipts (1+2)	**5,06,123** (14.2)	**5,63,991** (14.3)	**5,81,637** (14.2)	**6,40,521 *** (13.8)	**3.1**	**10.1**
1. Revenue Receipts	3,47,462 (9.7)	4,03,465 (10.2)	4,23,331 (10.3)	4,86,422 (10.5)	4.9	14.9
i) Tax Revenue (Net)	2,70,264 (7.6)	3,27,205 (8.3)	3,45,971 (8.4)	4,03,872 (8.7)	5.7	16.7
ii) Non-Tax Revenue	77,198 (2.2)	76,260 (1.9)	77,360 (1.9)	82,550 (1.8)	1.4	6.7
2. Capital Receipts	1,58,661 (4.4)	1,60,526 (4.1)	1,58,306 (3.9)	1,54,099 * (3.3)	-1.4	-2.7
of which:						
Market Borrowings	1,06,241 (3.0)	1,13,778 (2.9)	1,10,500 (2.7)	1,10,827 (2.4)	-2.9	0.3
Recoveries of Loans	10,645 (0.3)	8,000 (0.2)	5,450 (0.1)	1,500 (0.0)	-31.9	-72.5
Disinvestment of Equity of Public Sector Undertakings	1,581 (0.0)	3,840 (0.1)	528 (0.0)	1,651 * (0.0)	-86.3	212.7
Memo Items:						
Gross Tax Revenue	**3,66,152** (10.3)	**4,42,153** (11.2)	**4,67,848** (11.4)	**5,48,122** (11.8)	**5.8**	**17.2**
of which:						
i) Corporation Tax	1,01,277 (2.8)	1,33,010 (3.4)	1,46,497 (3.6)	1,68,401 (3.6)	10.1	15.0
ii) Taxes on Income other than Corporation Tax #	60,749 (1.7)	73,409 (1.9)	78,210 (1.9)	93,629 (2.0)	6.5	19.7
iii) Customs Duty	65,067 (1.8)	77,066 (1.9)	81,800 (2.0)	98,770 (2.1)	6.1	20.7
iv) Union Excise Duty	1,11,226 (3.1)	1,19,000 (3.0)	1,17,266 (2.9)	1,30,220 (2.8)	-1.5	11.0
v) Service Tax	23,055 (0.6)	34,500 (0.9)	38,169 (0.9)	50,200 (1.1)	10.6	31.5
vi) Securities Transaction Tax	2,559 (0.1)	3,500 (0.1)	3,750 (0.1)	4,500 (0.1)	7.1	20.0
vii) Banking Cash Transaction Tax	321 (0.0)	500 (0.0)	550 (0.0)	645 (0.0)	10.0	17.3
viii) Taxes of UTs (Net of Assignments to Local Bodies)	1,125 (0.0)	903 (0.0)	1,341 (0.0)	1,442 (0.0)	48.5	7.5
ix) Other Taxes	773 (0.0)	265 (0.0)	265 (0.0)	315 (0.0)	0.0	18.9

BE : Budget Estimates. RE : Revised Estimates.
* : Adjusted for an amount of Rs.40,000 crore on account of transactions relating to transfer of Reserve Bank's stake in SBI to the Government.
# : Includes Fringe Benefit Tax.
Note: Figures in parentheses are percentages to GDP.

tax collections are expected to increase by 15.0 per cent in 2007-08 as compared with an increase of 44.6 per cent in 2006-07. Revenue from the personal income tax is estimated to grow by 19.4 per cent as compared with an increase of 29.9 per cent in 2006-07. In the case of indirect taxes, the collections under customs duty are budgeted to increase by 20.7 per cent as compared with 25.7 per cent, a year ago. Excise duty collections are, however, budgeted to show a higher growth of 11.0 per cent from 5.4 per cent. Non-tax revenues (NTR) are budgeted to increase to Rs.82,550 crore in 2007-08 from

Table 2.18: Expenditure Pattern of the Centre

(Amount in Rupees crore)

Item	2005-06 (Accounts)	2006-07 (BE)	2006-07 (RE)	2007-08 (BE)	Variation (per cent)	
					Col.4 over 3	Col.5 over 4
1	2	3	4	5	6	7
Aggregate Expenditure (1+2)	**5,06,123** (14.2)	**5,63,991** (14.3)	**5,81,637** (14.2)	**6,40,521 *** (13.8)	**3.1**	**10.1**
1. Revenue Expenditure	**4,39,761** (12.3)	**4,88,192** (12.4)	**5,06,767** (12.4)	**5,57,900** (12.0)	**3.8**	**10.1**
Interest Payments	1,32,630 (3.7)	1,39,823 (3.5)	1,46,192 (3.6)	1,58,995 (3.4)	4.6	8.8
Subsidies	47,520 (1.3)	46,213 (1.2)	53,463 (1.3)	54,330 (1.2)	15.7	1.6
Grants to States	30,475 (0.9)	35,361 (0.9)	36,152 (0.9)	38,403 (0.8)	2.2	6.2
Defence Revenue	48,211 (1.4)	51,542 (1.3)	51,542 (1.3)	54,078 (1.2)	0.0	4.9
2. Capital Expenditure	**66,362** (1.9)	**75,799** (1.9)	**74,870** (1.8)	**82,621 *** (1.8)	**-1.2**	**10.4**
Loans and Advances	11,337 (0.3)	8,861 (0.2)	9,706 (0.2)	7,498 (0.2)	9.5	-22.7
Defence Capital	32,338 (0.9)	37,458 (0.9)	34,458 (0.8)	41,922 (0.9)	-8.0	21.7
Non-defence Capital Outlay	22,687 (0.6)	29,480 (0.7)	30,706 (0.7)	33,201 * (0.7)	4.2	8.1

BE : Budget Estimates. RE : Revised Estimates.

* : Adjusted for an amount of Rs.40,000 crore on account of transactions relating to transfer of Reserve Bank's stake in SBI to the Government.

Note : Figures in parentheses are percentages to GDP.

Rs.77,360 crore in 2006-07, reflecting higher revenues from dividends and profits (Table 2.17). Interest receipts, on the other hand, declined primarily on account of Centre's disengagement from lending to the States, except for loans under externally aided projects in pursuance of the recommendation of Twelfth Finance Commission (TFC). The other factors behind lower interest receipts include reduced lending rate on loans to the States, operation of incentive linked debt restructuring of the States that enact fiscal responsibility legislation, the debt swap scheme which operated from 2002-03 to 2004-05 that allowed the States to pre-pay high cost debt and prepayments of loans by Central Public Sector Undertakings(CPSUs).

2.46 A salient feature of the fiscal consolidation process in recent years has been the Government's continued effort to control revenue expenditure. The revenue expenditure in 2007-08 is budgeted to show a growth of 10.1 per cent, lower than 15.2 per cent in 2006-07. Total subsidies are budgeted to increase by 1.6 per cent as against an increase of 12.5 per cent in 2006-07. Adjusting for Rs.40,000 crore proposed to be incurred on account of transactions relating to the transfer of Reserve Bank's stake in State Bank of India to the Government, the capital expenditure is budgeted to increase by 10.4 per cent in 2007-08 as against an increase of 12.8 per cent in 2006-07. Adjusted for transactions for purchasing the stake in the State Bank of India, the capital outlay is budgeted to increase by Rs.9,959 crore (15.3 per cent) as against an increase of Rs.10,139 crore (18.4 per cent) in 2006-07. The defence capital outlay is estimated to increase by Rs.7,464 crore and the non-defence capital outlay by Rs.2,495 crore (Table 2.18).

2.47 The net market borrowings (excluding enabling allocations budgeted under MSS) would finance 73.4 per cent of the GFD in 2007-08 as compared with 72.5 per cent in the previous year. The budget estimates did not make any provision for drawdown of cash balances. Securities against small savings, which financed only 2.0 per cent of the GFD in 2006-07, are expected to finance 7.0 per cent in 2007-08 (Table 2.19). This increase reflects the reinvestment of redemptions proceeds as well as investment from small savings collections following the decision to reduce the minimum obligation of the States to borrow from NSSF to 80 per cent of net collections. External assistance is budgeted to finance

Table 2.19: Financing Pattern of Gross Fiscal Deficit

(Amount in Rupees crore)

Item	2006-07(RE)	2007-08 (BE)
1	2	3
Gross Fiscal Deficit	1,52,328	1,50,948
Financed by :		
Market Borrowings	1,10,500 (72.5)	1,10,827 (73.4)
NSSF investments in Securities against Small Savings	3,010 (2.0)	10,510 (7.0)
External Assistance	7,892 (5.2)	9,111 (6.0)
State Provident Fund	5,000 (3.3)	5,000 (3.3)
NSSF	-3,128 (-2.1)	17,850 (11.8)
Reserve Funds	4,265 (2.8)	738 (0.5)
Deposit and Advances	11,647 (7.6)	-2,411 (-1.6)
Postal Insurance and Life Annuity Funds	1,237 (0.8)	1,261 (0.8)
Draw down of Cash Balances	10,926 (7.2)	0 (0.0)
Others #	979 (0.6)	-1,938 (-1.3)

RE : Revised Estimates. BE : Budget Estimates.

: Includes savings (taxable) bonds 2003 and Deposits Scheme for Retiring Employees.

Note : Figures in parentheses are percentages to GFD.

6.0 per cent of GFD compared with 5.2 per cent in the previous year.

State Finances

2.48 The State Governments continued to pursue fiscal correction and consolidation programmes during 2006-07. As per the latest information available, Fiscal Responsibility Legislations (FRLs) have been enacted by 25 State Governments. By April 5, 2007 all States, barring Uttar Pradesh, implemented Value Added Tax (VAT) in *lieu* of sales tax.

2.49 The State Governments in their budgets for 2006-07 proposed various policy initiatives to carry forward the process of fiscal correction and consolidation. The States have emphasised fiscal empowerment through broadening and rationalisation of the tax system. Simultaneously, they have laid stress on improvement in tax administration, streamlining and strengthening of the existing tax and non-tax collections, plugging of revenue leakages and loopholes and effective expenditure management.

Budget Estimates – 2006-07[4]

2.50 The consolidated position indicates that the State Governments have budgeted to achieve near revenue balance during 2006-07, notwithstanding some variation across the States. The budgeted reduction in revenue deficit will facilitate a decline of 0.5 percentage point in the GFD-GDP ratio from 3.2 per cent in 2005-06 (RE) to 2.7 per cent in 2006-07 (BE). Primary deficit is also budgeted to decline sharply to 0.2 per cent of GDP in 2006-07 from 0.7 per cent in the previous year (Table 2.20). The improvement in the fiscal position of the States during 2006-07 was facilitated by the larger grants

Table 2.20: Major Deficit Indicators of the State Governments

(Amount in Rupees crore)

Item	1990-95 (Avg.)	1995-00 (Avg.)	2000-04 (Avg.)	2004-05	2005-06 (BE)	2005-06 (RE)	2006-07 (BE)	Percentage variations		
								Col.7/5	Col.7/6	Col.8/7
1	2	3	4	5	6	7	8	9	10	11
Gross Fiscal Deficit	(2.8)	(3.4)	(4.3)	1,09,257 (3.5)	1,10,050 (3.1)	1,13,888 (3.2)	1,09,610 (2.7)	4.2	3.0	-3.8
Revenue Deficit	(0.7)	(1.6)	(2.4)	36,423 (1.2)	24,913 (0.7)	17,178 (0.5)	4,511 (0.1)	-52.8	-31.0	-73.7
Primary Deficit	(1.1)	(1.4)	(1.5)	21,268 (0.7)	17,252 (0.5)	24,894 (0.7)	10,185 (0.2)	17.0	44.3	-59.1

BE : Budget Estimates. RE : Revised Estimates. Avg. : Average.

Note : 1. Figures in parentheses are percentages to GDP.
2. GDP from 1990-91 to 1998-99 are on old base (1993-94) and from 1999-2000 onwards on new base (1999-2000).
3. Data on GDP for 2006-07 are based on CSO's Advanced Estimates while for 2005-06 are based on Quick Estimates.

Source : 1. Data on fiscal variables have been compiled from budget documents of State Governments.
2. Data for GDP have been obtained from the website of Central Statistical Organisation (CSO).

[4] The analysis of State Finances for 2006-07 (Budget Estimates) is based on the budgets of 29 State Governments (including NCT Delhi).

Table 2.21: Aggregate Receipts of the State Governments

(Amount in Rupees crore)

Item	1990-95 (Avg.)	1995-00 (Avg.)	2000-04 (Avg.)	2004-05	2005-06 (BE)	2005-06 (RE)	2006-07 (BE)	Percentage variations		
								col.7/5	col.7/6	col.8/7
1	2	3	4	5	6	7	8	9	10	11
Aggregate Receipts (1+2)				**5,76,762**	**5,80,092**	**6,13,379**	**6,72,116**	**6.3**	**5.7**	**9.6**
	(16.1)	**(15.1)**	**(17.4)**	**(18.4)**	**(16.3)**	**(17.2)**	**(16.4)**			
1. Total revenue receipts (a+b)				3,72,075	4,30,679	4,54,243	5,20,148	22.1	5.5	14.5
	(12.1)	(10.9)	(11.3)	(11.9)	(12.1)	(12.7)	(12.7)			
(a) States own Revenue				2,36,668	2,61,796	2,71,518	3,10,540	14.7	3.7	14.4
	(7.3)	(6.9)	(7.1)	(7.6)	(7.3)	(7.6)	(7.6)			
States own tax				1,89,133	2,15,246	2,24,817	2,57,203	18.9	4.4	14.4
	(5.4)	(5.3)	(5.7)	(6.0)	(6.0)	(6.3)	(6.3)			
States own non tax				47,535	46,550	46,702	53,337	-1.8	0.3	14.2
	(1.8)	(1.6)	(1.4)	(1.5)	(1.3)	(1.3)	(1.3)			
(b) Central Transfers				1,35,406	1,68,883	1,82,725	2,09,608	34.9	8.2	14.7
	(4.9)	(4.0)	(4.2)	(4.3)	(4.7)	(5.1)	(5.1)			
Shareable taxes				78,550	90,002	92,723	1,09,419	18.0	3.0	18.0
	(2.6)	(2.4)	(2.4)	(2.5)	(2.5)	(2.6)	(2.7)			
Central Grants				56,857	78,882	90,002	1,00,188	58.3	14.1	11.3
	(2.3)	(1.6)	(1.9)	(1.8)	(2.2)	(2.5)	(2.4)			
2. Capital Receipts (a+b)				2,04,687	1,49,413	1,59,136	1,51,969	-22.3	6.5	-4.5
	(4.0)	(4.2)	(6.0)	(6.5)	(4.2)	(4.5)	(3.7)			
(a) Loans from Centre @				26,157	31,216	10,911	13,525	-58.3	-65.0	24.0
	(1.2)	(1.0)	(1.0)	(0.8)	(0.9)	(0.3)	(0.3)			
(b) Others Capital Receipts				1,78,529	1,18,197	1,48,224	1,38,443	-17.0	25.4	-6.6
	(2.9)	(3.2)	(5.0)	(5.7)	(3.3)	(4.2)	(3.4)			

BE : Budget Estimates. RE : Revised Estimates. Avg. : Average.

@ : With the change in the system of accounting with effect from 1999-2000, States' share in small savings which was included earlier under loans from Centre is included under internal debt and shown as special securities issued to National Small Saving Fund (NSSF) of the Central Government. The data for the years prior to 1999-2000 as reported in this Table, however, exclude loans against small savings, for the purpose of comparability.

Note :
1. Figures in parentheses are percentages to GDP.
2. GDP from 1990-91 to 1998-99 are on old base (1993-94) while the same is on new base (1999-2000) from 1999-2000 onwards.
3. Data on GDP for 2006-07 are based on CSO's Advanced Estimates while for 2005-06 are based on Quick Estimates.
4. Capital receipts include public accounts on a net basis.
5. Figures for 2005-06 (BE) and 2006-07 (BE) for revenue receipts are adjusted for Rs.742 crore and Rs.273 crore respectively towards
Additional Resource Mobilisation measures proposed by the States.

Source :
1. Data on fiscal variables have been compiled from budget documents of State Governments.
2. Data for GDP have been obtained from the website of Central Statistical Organisation (CSO).

and increase in shareable Central taxes, as recommended by the TFC. The sharp correction in revenue deficit during 2006-07 would emanate mainly from higher transfers from the Centre, especially the shareable Central taxes[5] (Table 2.21). Correction in revenue deficit during 2006-07 will also be facilitated by a deceleration in revenue expenditure, partly on account of deceleration in expenditure on administrative services and pensions. Capital outlay is budgeted to decelerate during 2006-07, though, as a ratio to GDP, it would be maintained at 2.4 per cent. Developmental expenditure will decelerate

[5] The Union Budget 2007-08 indicates an increase in transfers from the Central Government to the State Governments by Rs.10,391 crore (0.3 per cent of GDP) in 2006-07 (RE) over 2006-07(BE).

Table 2.22: Expenditure Pattern of the State Governments

(Amount in Rupees crore)

Item	1990-95 (Avg.)	1995-00 (Avg.)	2000-04 (Avg.)	2004-05	2005-06 BE	2005-06 RE	2006-07 BE	Percentage variations Col.7/5	Col.7/6	Col.8/7
1	2	3	4	5	6	7	8	9	10	11
Aggregate Expenditure				**5,66,303**	**5,78,891**	**6,07,753**	**6,68,129**	**7.3**	**5.0**	**9.9**
(1+2 =3+4+5)	**(16.0)**	**(15.2)**	**(17.3)**	**(18.1)**	**(16.2)**	**(17.0)**	**(16.3)**			
1. Revenue Expenditure				4,08,497	4,55,593	4,71,421	5,24,658	15.4	3.5	11.3
of which:	(12.8)	(12.6)	(13.7)	(13.1)	(12.8)	(13.2)	(12.8)			
Interest payments				87,989	93,298	88,994	99,425	1.1	-4.6	11.7
	(1.7)	(2.0)	(2.8)	(2.8)	(2.6)	(2.5)	(2.4)			
2. Capital Expenditure				1,57,805	1,23,299	1,36,332	1,43,471	-13.6	10.6	5.2
of which:	(3.2)	(2.7)	(3.6)	(5.0)	(3.5)	(3.8)	(3.5)			
Capital outlay				61,559	77,048	85,350	96,506	38.6	10.8	13.1
	(1.6)	(1.4)	(1.6)	(2.0)	(2.2)	(2.4)	(2.4)			
3. Developmental Expenditure				2,93,538	3,26,482	3,62,300	3,92,926	23.4	11.0	8.5
	(10.8)	(9.6)	(9.7)	(9.4)	(9.2)	(10.2)	(9.6)			
4. Non-Developmental Expenditure				1,88,298	2,11,447	2,03,189	2,30,225	7.9	-3.9	13.3
	(4.3)	(4.9)	(6.0)	(6.0)	(5.9)	(5.7)	(5.6)			
5. Others*				84,467	40,962	42,265	44,978	-50.0	3.2	6.4
	(0.9)	(0.8)	(1.6)	(2.7)	(1.1)	(1.2)	(1.1)			

BE : Budget Estimates. RE : Revised Estimates. Avg : Average.

* : Comprises Compensation and Assignments to local bodies, Grants-in-Aid and Contributions, Reserve with Finance Department, Discharge of Internal Debt, Repayment of loans to the Centre till 2002-03. Since 2003-04, it also includes Inter-State Settlement, Contingency Fund, Small Savings, Provident Fund, *etc.*, Reserve Funds, Deposit & Advances, Suspense & Miscellaneous, Appropriation to Contingency Fund and Remittances.

Note : 1. Figures in parentheses are percentages to GDP.

2. GDP from 1990-91 to 1998-99 are on old base (1993-94) while the same is on new base (1999-2000) from 1999-2000 onwards.
3. Data on GDP for 2006-07 are based on CSO's Advanced Estimates while for 2005-06 are based on Quick Estimates.
4. Capital expenditure excludes public accounts.

Source : 1. Data on fiscal variables have been compiled from budget documents of State Governments.

2. Data for GDP have been obtained from the website of Central Statistical Organisation (CSO).

during 2006-07 as against a sharp increase in the previous year (Table 2.22).

2.51 Decomposition of GFD indicates that fiscal deficit during 2006-07 was mainly on account of capital outlay as RD declined sharply. Small savings (NSSF) remained the major source of financing of the GFD, followed by market borrowings (Table 2.23).

2.52 The net allocation of market borrowings for all States during 2006-07 amounted to Rs.17,242 crore. The gross allocation of market borrowing was Rs.26,597 crore, including the additional allocation of Rs.2,803 crore. During 2006-07, total market borrowing raised by all States was Rs.20,825 crore. All the State Governments resorted to the auction route for raising the market loans during 2006-07 (Table 2.24).

2.53 The weighted average interest rate of market loans of State Governments during 2006-07 was at 8.10 per cent as compared with 7.63 per cent during the previous year (Chart II.4).

2.54 The weekly average utilisation of ways and means advances (WMA) and overdrafts (OD) by the State Governments during 2006-07 was at Rs.234 crore as compared with the average utilisation of Rs.482 crore during the previous year, reflecting the comfortable liquidity position of the States. During 2006-07, only eight States resorted to normal WMA and two States resorted to OD (Chart II.5).

Table 2.23: Decomposition and Financing Pattern of Gross Fiscal Deficit of the States

(per cent)

Item	1990-95 (Avg.)	1995-00 (Avg.)	2000-04 (Avg.)	2004-05	2005-06 BE	2005-06 RE	2006-07 BE
1	2	3	4	5	6	7	8
Decomposition (1 to 4)	**100**	**100**	**100**	**100**	**100**	**100**	**100**
1. Revenue Deficit	24.7	44.8	56.3	33.3	22.5	15.1	4.1
2. Capital Outlay	55.3	43.3	36.7	56.3	69.7	74.9	88.0
3. Net Lending	20.0	12.2	7.0	10.3	7.8	10.0	8.8
4. Disinvestments	..	-0.2	..	..	..	..	-0.9
Financing (1 to 11)	**100**	**100**	**100**	**100**	**100**	**100**	**100**
1. Market Borrowings	16.0	16.1	24.6	31.6	16.2	16.4	20.8
2. Loans from Centre	49.0	40.6	7.8	-10.8	15.7	1.9	4.4
3. Loans against Securities Issued to NSSF	–	28.9 *	35.4	62.2	50.0	65.4	53.1
4. Loans from LIC, NABARD, NCDC, SBI and Other Banks	1.8	2.8	4.9	– **	7.7	4.9	6.9
5. State Provident Fund	14.3	13.4	8.3	7.2	7.2	7.9	8.0
6. Reserve Funds	6.8	5.5	4.5	6.5	3.8	2.9	4.0
7. Deposits & Advances	9.8	9.8	3.4	7.4	-2.5	-0.6	-1.1
8. Suspense & Miscellaneous	4.3	2.7	-0.4	-2.4	-1.4	3.3	3.3
9. Remittances	-1.4	-3.6	0.6	1.1	1.5	0.8	1.8
10. Overall Surplus (+)/Deficit (-)	4.4	-2.6	1.1	9.6	0.4	4.9	3.6
11. Others	-5.0	9.5	9.8	-12.4 $	1.2	-7.9	-4.7

BE : Budget Estimates. RE : Revised Estimates. Avg. : Average. .. : Nil. – : Not Applicable.

* : Pertains to 1999-2000 as it was introduced from that year only. The sum of items will not be equal to 100 for 1995-2000 (Avg.).

** : Tamil Nadu has taken into their budget the bonds issued by Tamil Nadu Industrial Development Corporation (TIDCO) and Power Bonds of Tamil Nadu State Electricity Board showing negative figures for Loans from NCDC and Loans from Other Institutions. The consolidated picture has, therefore, undergone a change.

$: On account of Land Compensation and other Bonds (Rs.1,962 crore) issued by Government of Tamil Nadu during 2004-05.

Note : 1. Due to the change in the accounting procedure from 1999-2000, Loans from the Centre excludes States' share in small savings collections which is shown under Securities issued to the NSSF under Internal Debt. Accordingly, repayments of small saving collections included under repayments of Loans to Centre is now shown under discharge of Internal Debt to have consistent accounting for receipts and expenditure.

2. Figures for 2004-05 (Accounts) in respect of Jammu & Kashmir and Jharkhand relate to Revised Estimates.
3. Financing Items are on a net basis.
4. 'Others' is a residual and includes, *inter alia*, Contingency Funds, Appropriation to Contingency Funds, Miscellaneous Capital Receipts, Inter-State Settlement, Land Compensation and Other Bonds and Loans from Financial Institutions other than mentioned in the Table.

Source : Budget Documents of State Governments.

2.55 The weekly average investment by the States in the 14-day Intermediate Treasury Bills during 2006-07 amounted to Rs.43,075 crore as compared with the weekly average investment of Rs.35,278 crore during the corresponding period of the previous year (Chart II.6). The surge in surplus cash balances may pose challenges to cash and financial management by the State Governments.

Outlook

2.56 With a view to improving transparency and efficiency in transactions of the Governments, many States have proposed to complete computerisation of their treasuries and also to introduce e-transfer for the transactions. For improving accountability of budget proposals, some States have proposed to introduce 'Outcome Budgets'. Furthermore, many State Governments have proposed to introduce 'Gender Budgeting'. Some States have proposed comprehensive restructuring of State public sector undertakings, including closure of chronically loss-making units for reducing budgetary support for them. Some States have announced introduction of new pension scheme based on defined contribution to arrest their rising pension obligations. Some States have also proposed curtailment of non-developmental expenditure by doing away with vacated posts, adoption of austerity measures and reduction of non-plan expenditure.

Table 2.24: Market Borrowings of the State Governments – 2006-07

(Amount in Rupees crore)

Items		Date	Cut-off Rate (%)	Tenor (years)	Amount Raised
1		2	3	4	5
(A) Tap Issues		–	–	–	–
(B) Auctions					
i.	First	April 27, 2006	7.65	10	300
ii.	Second	May 11, 2006	7.87	10	400
iii.	Second	May 11, 2006	7.89	10	500
iv.	Second	May 11, 2006	7.91	10	500
v.	Second	May 11, 2006	7.93	10	1,307
vi.	Second	May 11, 2006	7.95	10	881
vii.	Second	May 11, 2006	7.96	10	130
viii.	Second	May 11, 2006	7.98	10	57
ix.	Second	May 11, 2006	8.00	10	1,646
x.	Second	May 11, 2006	8.04	10	150
xi.	Second	May 11, 2006	8.05	10	15
xii.	Third	July 13, 2006	8.62	10	225
xiii.	Third	July 13, 2006	8.65	10	933
xiv.	Third	July 13, 2006	8.66	10	300
xv.	Fourth	August 25, 2006	8.11	10	1,050
xvi.	Fifth	October 17, 2006	7.99	10	153
xvii.	Fifth	October 17, 2006	8.04	10	48
xviii.	Sixth	November 16, 2006	7.74	10	2,184
xix.	Sixth	November 16, 2006	7.80	10	91
xx.	Sixth	November 16, 2006	7.82	10	156
xxi.	Seventh	December 14, 2006	7.81	10	340
xxii.	Seventh	December 14, 2006	7.89	10	166
xxiii.	Seventh	December 14, 2006	7.93	10	809
xxiv.	Seventh	December 14, 2006	7.94	10	455
xxv.	Seventh	December 14, 2006	7.99	10	193
xxvi.	Eighth	January 18, 2007	7.96	10	500
xxvii.	Eighth	January 18, 2007	7.99	10	715
xxviii.	Ninth	February 2, 2007	7.95	10	200
xxix.	Tenth	February 22, 2007	8.10	10	47
xxx.	Tenth	February 22, 2007	8.17	10	375
xxxi.	Tenth	February 22, 2007	8.19	10	800
xxxii.	Tenth	February 22, 2007	8.20	10	563
xxxiii.	Tenth	February 22, 2007	8.45	10	1,615
xxxiv.	Eleventh	March 13, 2007	8.38	10	212
xxxv.	Eleventh	March 13, 2007	8.45	10	250
xxxvi.	Eleventh	March 13, 2007	8.40	10	470
xxxvii.	Eleventh	March 13, 2007	8.39	10	67
xxxviii.	Eleventh	March 13, 2007	8.39	10	70
xxxix.	Eleventh	March 13, 2007	8.39	10	90
xxxx.	Eleventh	March 13, 2007	8.32	10	300
xxxxi.	Eleventh	March 13, 2007	8.25	10	200
xxxxii.	Eleventh	March 13, 2007	8.32	10	414
xxxxiii.	Eleventh	March 13, 2007	8.38	10	211
xxxxiv.	Twelfth	March 23, 2007	8.35	10	738
Total - B (i to xxxxiv)					**20,825**
Grand Total (A+B)					**20,825**

2.57 Notwithstanding the progress in fiscal consolidation since 2004-05, structural rigidities persist as manifested in sluggish non-tax revenue, downwardly rigid non-development expenditure and low allocation in respect of social sectors such as health and education. The State Governments have a major responsibility with regard to provision of social and economic services such as education and health and economic infrastructure such as roads, waterworks and power. In order to make the process of fiscal consolidation durable and sustainable, adequate investment in economic infrastructure and spending on social services would be essential. Against this backdrop, a desirable path to fiscal correction lies through fiscal empowerment, *i.e.*, by expanding the scope and size of revenue flows into budget, rather than fiscal enfeeblement. Augmenting

Chart II.4: Weighted Average Interest Rate on State Governments' Market Borrowing

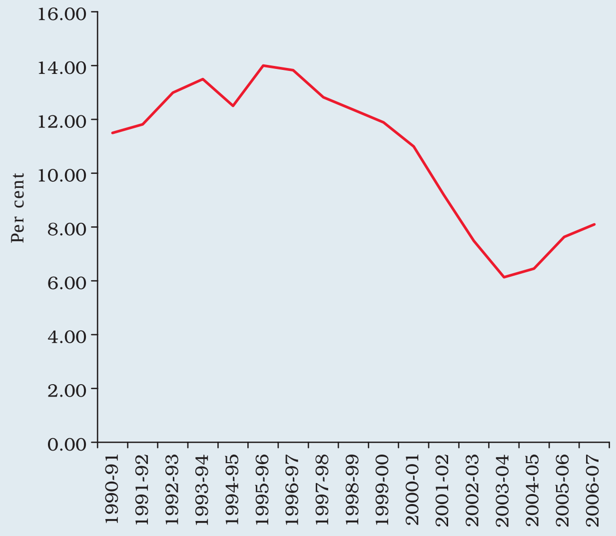


Chart II.5: Utilisation of WMA and Overdraft by States (Weekly Average)

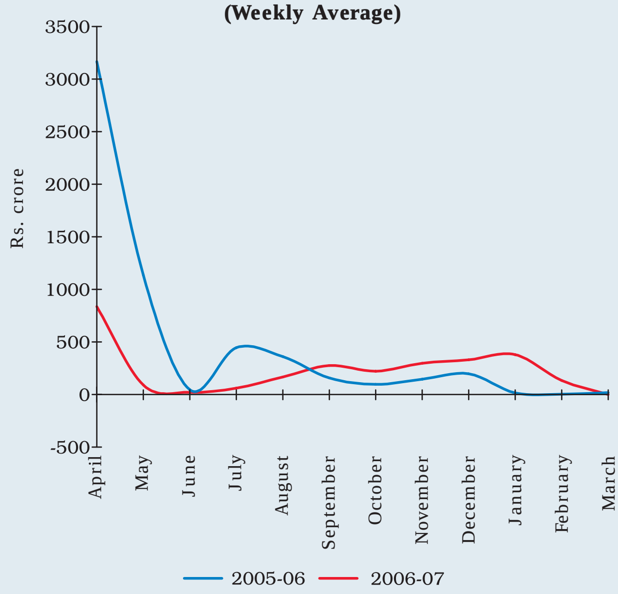
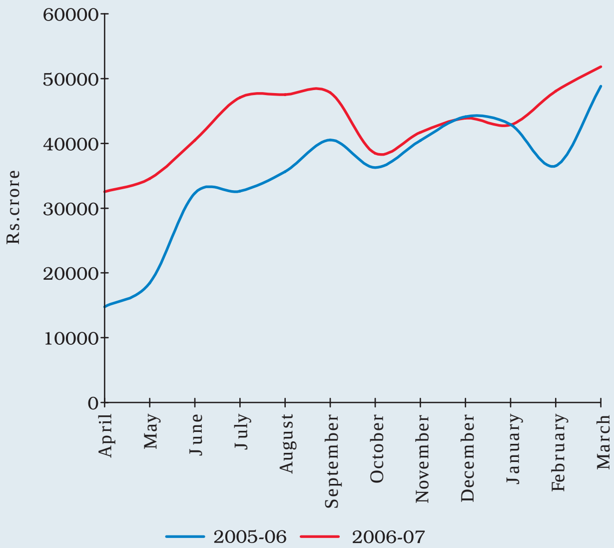


Chart II.6: Investment in 14-day Intermediate Treasury Bills by the State Governments (Weekly Average)



resource mobilisation from non-tax revenue through appropriate user charges and restructuring of State public sector undertakings continue to be of critical importance.

Public Debt

2.58 The combined outstanding liabilities of the Central and State Governments, as a proportion to GDP, is budgeted to decline to 75.7 per cent by end-March 2007 from 78.5 per cent as at end-March 2006. The fiscal consolidation process underway at the Centre and States as well as the strong macroeconomic performance have led to the budgeted decline in combined Government liabilities (Table 2.25).

III. MONETARY AND CREDIT SITUATION

Monetary Conditions

2.59 This section makes an assessment of the conduct of monetary policy during 2006-07 and outlines the developments relating to the monetary and credit situation, followed by a discussion on liquidity management operations of the Reserve Bank. In line with the Annual Policy Statement of the Reserve Bank announced in April 2006, the First Quarter Review (July 2006), the Mid-term Review (October 2006) and the Third Quarter Review (January 2007) of the Annual Policy Statement indicated that it would continue to ensure that appropriate liquidity is maintained in the system so that all legitimate requirements of credit are met, particularly for productive purposes, consistent with the objective of price and financial stability. Towards this end, it was indicated that it would continue with its policy of active demand management of liquidity through open market operations (OMOs), including MSS, LAF and CRR, and use all the policy instruments at its disposal flexibly, as and when the situation warrants.

2.60 The Mid-term Review of Annual Policy Statement for 2006-07 (October 31, 2006) of the Reserve Bank noted that barring the emergence of any adverse and unexpected developments in various sectors of the economy and keeping in view the assessment of the economy including the outlook for inflation, the overall stance of monetary policy would be to ensure a monetary and interest rate environment that supports export and investment demand in the economy so as to enable continuation of the growth momentum while reinforcing price stability with a view

Table 2.25: Combined Liabilities and Debt-GDP Ratio

Year (end -March)	Outstanding Liabilities (Rupees crore)			Debt-GDP Ratio (per cent)		
	Centre	States	Combined	Centre	States	Combined
1	2	3	4	5	6	7
1990-91	3,14,558	1,28,155	3,68,824	55.3	22.5	64.9
1995-96	6,06,232	2,50,889	7,28,208	51.0	21.1	61.3
2002-03	15,59,201	7,98,921	19,83,298	63.4	32.5	80.7
2003-04	17,36,678	9,23,500	22,52,074	62.8	33.4	81.4
2004-05	19,94,422	10,42,305	25,75,146	63.8	33.3	82.4
2005-06 RE	21,95,387	11,52,652	28,01,050	61.5	32.3	78.5
2006-07 BE	24,73,562	12,58,672	31,04,262	60.3	30.7	75.7

RE: Revised Estimates. BE: Budget Estimates.

Note : Ratios to GDP for the years 2002-03 onwards are based on the new series of National Accounts Statistics with the base year 1999-2000. The debt-GDP ratio for 2006-07 BE is based on CSO's Advance Estimates of GDP.

Source : Budget documents of the Central Government; and State Finances - A Study of Budgets of 2006-07, Reserve Bank of India, December 2006.

to anchor inflation expectations with an emphasis to maintain macroeconomic and, in particular, financial stability by promptly considering all possible measures as appropriate to the evolving global and domestic circumstances.

2.61 The Third Quarter Review of the Annual Statement on Monetary Policy for the year 2006-07 also emphasised that the outlook for inflation assumes criticality in terms of policy monitoring and action and accordingly management of liquidity would receive priority in policy hierarchy over the remaining part of the year. Furthermore, a judicious balancing of weights has been assigned to monetary policy objectives to accord priority to stability in order to support growth on a sustainable basis and to demonstrate that inflation beyond the tolerance threshold of the Reserve Bank is unacceptable and that the resolve to ensure price stability is always backed by timely and appropriate policy responses.

2.62 In the Third Quarter Review of Annual Statement on Monetary Policy for the Year 2006-07 in January 2007, the Reserve Bank indicated that barring the emergence of any adverse and unexpected developments in various sectors of the economy and keeping in view the then assessment of the economy including the outlook for inflation, the overall stance of monetary policy in the period ahead would be:

- To reinforce the emphasis on price stability and well-anchored inflation expectations, while ensuring a monetary and interest rate environment that supports export and investment demand in the economy so as to enable continuation of the growth momentum.
- To re-emphasise credit quality and orderly conditions in financial markets for securing macroeconomic and, in particular, financial stability while simultaneously pursuing greater credit penetration and financial inclusion.
- To respond swiftly with all possible measures as appropriate to the evolving global and domestic situation impinging on inflation expectations and the growth momentum.

2.63 In recognition of the cumulative and lagged effects of monetary policy, the Reserve Bank began a gradual withdrawal of accommodation in mid-2004 in spite of inflation being within tolerance limits at that time. Since September 2004, repo/reverse repo rates have been increased by 175/150 basis points and the CRR by 200 basis points. General provisioning requirements for standard advances and risk weights have also been raised in the case of banks' exposures to specific sectors. The stance of monetary policy has progressively shifted from an equal emphasis on price stability along with growth to one of reinforcing price stability with immediate monetary measures and to take recourse to all possible measures promptly in response to the evolving circumstances.

2.64 In pursuance of the stance of monetary policy, liquidity management was modified on March 2, 2007 to put in place an augmented programme of issuance under the MSS with a mix of Treasury Bills and dated securities in a more flexible manner. In view of the enhanced MSS programme and the need to conduct LAF as a facility for equilibrating very short-term mismatches, daily reverse repo absorptions were limited to a maximum of Rs.3,000 crore, effective March 5, 2007. In the light of the prevailing macroeconomic, monetary and anticipated liquidity conditions, and with a view to containing inflation expectations, the Reserve Bank increased the fixed repo rate under LAF by 25 basis points from March 30, 2007 and the CRR by 50 basis points in two stages from April 14, 2007 and April 28, 2007. Globally, the process of withdrawal of accommodation in monetary policy is being vigorously pursued. Since mid-February, 2007 among the leading central banks, the European Central Bank and the Bank of Japan have raised the key policy rates by 25 basis points each, while the People's Bank of China has raised the one year benchmark lending rate by 45 basis points (27 basis points in March 2007 and 18 basis points in May 2007) and the reserve requirements by 150 basis points (including the hike of 50 basis points to be effective from June 5, 2007). There has been no change in the policy rates of the US Federal Reserve, the Bank of England, the Bank of Canada, and the Reserve Bank of Australia, all of which had undertaken prior policy action.

Reserve Money Survey

2.65 Growth in reserve money at 23.7 per cent, year-on-year (y-o-y), as on March 31, 2007 was higher than that of 17.2 per cent a year ago. Adjusted for the impact of the hike in the CRR, reserve money expansion was 18.9 per cent as on March 31, 2007. Expansion in reserve money was mainly led by foreign currency assets of the Reserve Bank which increased (net of revaluation) by Rs.1,64,601 crore during 2006-07 as compared with an increase of Rs.68,834 crore in the previous year. On the other hand, the Reserve Bank's net credit to the Centre declined by Rs.1,042 crore during 2006-07 as against an increase of Rs.28,417 crore during the previous year (Table 2.26).

Table 2.26: Reserve Money

(Amount in Rupees crore)

Item	Outstanding as on March 31, 2007	Variation during					
		2005-06	2006-07	2006-07			
				Q1	Q2	Q3	Q4
1	2	3	4	5	6	7	8
Reserve Money	7,08,950	83,922 (17.2)	1,35,892 (23.7)	13,470	18,666	14,210	89,546
Components (1+2+3)							
1. Currency in Circulation	5,04,167	62,015 (16.8)	73,491 (17.1)	22,283	-2,011	26,871	26,348
2. Bankers' Deposits with RBI	1,97,295	21,515 (18.9)	61,784 (45.6)	-7,204	20,224	-12,165	60,929
3. 'Other' Deposits with the RBI	7,487	393 (6.1)	617 (9.0)	-1,610	453	-495	2,269
Sources (1+2+3+4-5)							
1. RBI's net credit to Government	4,362	26,111	-3,775	53	2,826	-12,754	6,100
of which: to Centre (i+ii+iii+iv-v)	4,118	28,417	-1,042	3,071	2,584	-12,568	5,871
i. Loans and Advances	0	0	0	0	0	0	0
ii. Treasury Bills held by the RBI	0	0	0	0	0	0	0
iii. RBI's Holdings of Dated Securities	97,172	13,869	26,763	-27,610	24,944	22,733	6,696
iv. RBI's Holdings of Rupee coins	12	7	-143	9	-107	97	-142
v. Central Government Deposits	93,066	-14,541	27,662	-30,672	22,253	35,398	683
2. RBI's credit to banks and commercial sector	9,173	535	1,990	-3,135	3,107	2,065	-47
3. NFEA of RBI	8,66,153	60,193 (9.8)	1,93,170 (28.7)	71,845	11,392	27,250	82,682
of which: FCA, adjusted for revaluation	–	68,834	1,64,601	28,107	10,948	31,634	93,913
4. Government's Currency Liabilities to the Public	8,229	1,306	-525	-920	155	166	75
5. Net Non-Monetary liabilities of RBI	1,78,967	4,222	54,968	54,373	-1,186	2,517	-736
Memo:							
Net Domestic Assets	-1,57,203	23,729	-57,277	-58,376	7,274	-13,040	6,864
Reserve Bank's Primary Subscription to Dated Securities	0	10,000	0	0	0	0	0
LAF, Repos (+)/Reverse Repos (-)	29,185	12,080	36,435	-23,060	28,395	22,195	8,905
Net Open Market Sales # *	–	3,913	5,125	1,536	1,176	389	2,024
Mobilisation under MSS *	62,974	-35,149	33912	4,062	8,940	-3,315	24,225
Net Purchases(+)/Sales(-) from Authorised Dealers	–	32,884	1,18,994	21,545	0	19,776	77,673
NFEA/Reserve Money £	122.2	117.4	122.2	127.0	125.0	126.5	122.2
NFEA/Currency £	171.8	156.3	171.8	164.4	167.7	164.0	171.8

NFEA : Net Foreign Exchange Assets. FCA : Foreign Currency Assets. LAF : Liquidity Adjustment Facility.
* : At face value. # : Excludes Treasury Bills. £ : Per cent, end of period.
Note : 1. Data are based on March 31 for Q4 and last reporting Friday for all other quarters.
2. Figures in parentheses are percentage variations during the fiscal year.
3. Government balances as on March 31, 2007 are before closure of accounts.

The decline in net RBI credit to the Centre during 2006-07 could be attributed to higher deposits of the Centre, which, in turn, reflected fresh issuance of securities under the MSS. Bankers' deposits with the Reserve Bank expanded partly on account of the hike in the CRR.

2.66 The year-on-year (y-o-y) reserve money expansion was 23.6 per cent (16.3 per cent adjusted for increase in the CRR) as on May 18, 2007 as compared with 17.1 per cent a year ago. The Reserve Bank's foreign currency assets (adjusted for revaluation), on a y-o-y basis, increased by Rs.1,55,105 crore as on May 18, 2007 as compared with an increase of Rs. 90,841 crore a year ago. The Reserve Bank's net credit to the Centre increased by Rs. 4,414 crore as compared with an increase of Rs. 8,458 crore a year ago.

Table 2.27: Monetary Indicators

(Amount in Rupees crore)

Item	Outstanding as on March 31, 2007	Variation			
		2005-06		2006-07	
		Amount	Per cent	Amount	Per cent
1	2	3	4	5	6
I. Reserve Money	7,08,950	83,922	17.2	1,35,892	23.7
II. Narrow Money (M_1)	9,59,875	1,43,825	21.1	1,33,497	16.2
III. Broad Money (M_3)	32,96,919	3,96,881	17.0	5,67,372	20.8
a) Currency with the Public	4,84,171	58,248	16.4	71,052	17.2
b) Aggregate Deposits	28,05,261	3,38,081	17.1	4,95,704	21.5
i) Demand Deposits	4,68,216	85,025	26.5	61,829	15.2
ii) Time Deposits	23,37,045	2,53,056	15.3	4,33,875	22.8
of which: Non-Resident Foreign Currency Deposits	66,242	-16,876	-22.2	6,967	11.8
IV. NM_3	33,06,958	4,21,126	18.1	5,59,370	20.4
of which: Call Term Funding from Financial Institutions	86,151	11,224	15.6	3,007	3.6
V. a) L_1	34,21,762	4,36,397	18.1	5,70,256	20.0
of which: Postal Deposits	1,14,804	15,271	17.2	10,886	10.5
b) L_2	34,24,694	4,37,206	18.1	5,70,256	20.0
c) L_3	34,50,758	4,41,207	18.1	5,72,479	19.9
VI. Major Sources of Broad Money					
a) Net Bank Credit to the Government (i+ii)	8,32,867	17,888	2.4	66,272	8.6
i) Net Reserve Bank Credit to Government	4,362	35,799		-3,775	
ii) Other Banks' Credit to Government	8,28,505	-17,910	-2.3	70,046	9.2
b) Bank Credit to Commercial Sector	21,23,290	3,61,746	27.2	4,30,287	25.4
c) Net Foreign Exchange Assets of Banking Sector	9,30,319	78,291	12.1	2,04,125	28.1
Memo: SCBs Aggregate Deposits	25,94,259	3,23,913	18.1	4,85,210	23.0
SCBs Non-food Credit	18,76,672	3,54,193	31.8	4,10,285	28.0

SCBs : Scheduled Commercial Banks.

NM_3 is the residency-based broad money aggregate and L_1, L_2 and L_3 are liquidity aggregates compiled on the recommendations of the Working Group on Money Supply (Chairman: Dr. Y.V. Reddy, 1998). Liquidity aggregates are defined as follows:

L_1 = NM_3 + Select deposits with the post office saving banks. L_2 = L_1 +Term deposits with term lending institutions and refinancing institutions (FIs) + Term borrowing by FIs + Certificates of deposits issued by FIs. L_3 = L_2 + Public deposits of non-banking financial companies.

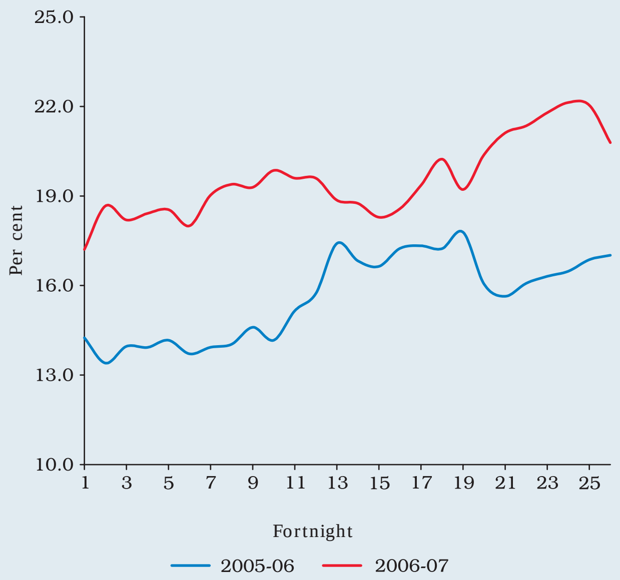
Note : 1. Data are provisional.
2. Data reflect redemption of India Millennium Deposits (IMDs) on December 29, 2005.
3. Government balances as on March 31, 2007 are before closure of accounts.
4. Variation during 2006-07 is worked out from March 31, 2006, whereas variation during 2005-06 is worked out from April 1, 2005.
5. Postal deposits data pertain to February 2007.

Monetary Survey

2.67 Broad money (M_3) growth was 20.8 per cent, y-o-y, as on March 31, 2007 as compared with 17.0 per cent in the previous year (Table 2.27 and Chart II.7). Growth in M_3, thus, remained above the projection of 15.0 per cent as set out in the Annual Policy Statement in April 2006.

2.68 Aggregate deposits of banks accelerated on the back of higher time deposits. Demand deposits recorded a growth of 15.2 per cent (y-o-y) as on March 31, 2007 on top of the growth of 26.5 per cent a year ago. Time deposits increased by 22.8 per cent as compared with 15.3 per cent a year ago, benefiting, *inter alia*, from higher interest rates and tax benefits for deposits of 5 year and above maturity. Concomitantly, growth in postal deposits decelerated to 10.5 per cent, year-on-year, as at end-February 2007 from 17.2 per cent a year ago.

Chart II.7: Broad Money Growth (y-o-y)



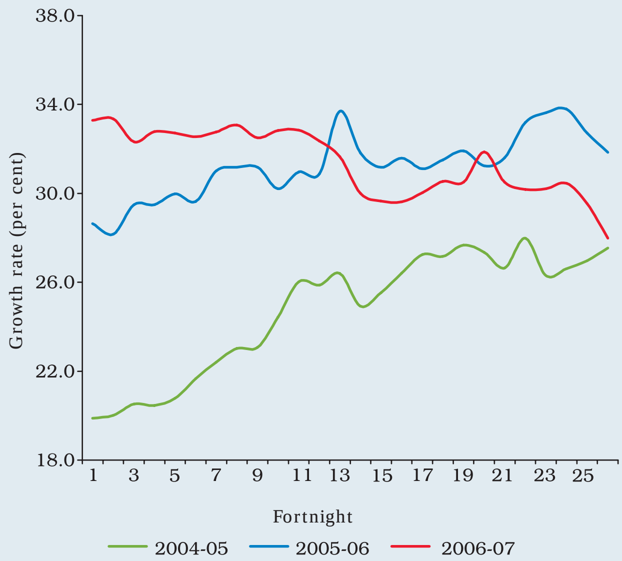
2.69 Growth in broad money (M_3) was 20.2 per cent (y-o-y) as on May 11, 2007 as compared with 18.2 per cent a year ago. Of the major components, growth in aggregate deposits accelerated to 21.1 per cent from 18.6 per cent a year ago.

Bank Credit

2.70 Demand for bank credit continued to remain strong in 2006-07, *albeit* with some moderation. As on March 30, 2007, non-food credit extended by scheduled commercial banks grew by 28.0 per cent (y-o-y) on top of the growth of 31.8 per cent as on March 31, 2006. During 2006-07 banks' investments in government securities increased by 10.0 per cent (Table 2.28 and Chart II.8). Growth in banks' SLR investments was, however, lower than that of their net demand and time liabilities. As a result, commercial banks' holdings of government securities declined to 28.0 per cent of their net demand and time liabilities (NDTL) at end-March 2007 from 31.3 per cent at end-March 2006.

2.71 Provisional information on sectoral deployment of bank credit indicates that growth in credit was largely broad-based. The y-o-y growth in credit to industry and agriculture was 28.8 per cent and 30.4 per cent, respectively, at end-January 2007.

Chart II.8: Non-food Credit



The increase in industrial credit in consonance with the buoyancy in industrial activity was mainly on account of infrastructure (power, roads, ports, telecommunication, *etc.*), metals, textiles, petroleum, chemicals, food processing and engineering. Credit to the housing sector and commercial real estate continued to remain strong (Table 2.29).

Table 2.28: Scheduled Commercial Banks Survey

(Amount in Rupees crore)

Item	Outstanding as on March 30, 2007	Variation (year-on-year)			
		As on March 31, 2006		As on March 30, 2007	
		Absolute	Per cent	Absolute	Per cent
1	2	3	4	5	6
Sources of Funds					
1. Aggregate Deposits	25,94,259	3,23,913	18.1	4,85,210	23.0
2. Call/Term Funding from Financial Institutions	86,151	11,224	15.6	3,007	3.6
3. Overseas Foreign Currency Borrowings	32,377	1,295	4.5	2,543	8.5
4. Capital	33,868	5,705	21.2	1,254	3.8
5. Reserves	1,66,290	34,616	31.3	21,177	14.6
Uses of Funds					
1. Bank Credit	19,23,192	3,54,868	30.8	4,16,115	27.6
of which: Non-food Credit	18,76,672	3,54,193	31.8	4,10,285	28.0
2. Investments in Government Papers	7,71,060	-19,514	-2.7	70,318	10.0
3. Investments in Other Approved Securities	21,100	-3,295	-16.5	4,388	26.3
4. Investments in Non-SLR Securities	1,43,750	-11,838	-8.0	8,410	6.2
5. Foreign Currency Assets	39,287	14,059	47.8	-4,207	-9.7
6. Balances with the RBI	1,80,222	34,077	36.6	53,161	41.8

Note : Data are provisional.

Table 2.29: Deployment of Non-food Bank Credit

(Amount in Rupees crore)

Sector/Industry	Outstanding as on January 19, 2007	Year-on-Year Variations			
		2005-06 *		2006-07**	
		Absolute	Per cent	Absolute	Per cent
1	2	3	4	5	6
Non-food Gross Bank Credit (1 to 4)	**16,47,521**	**2,56,580**	**25.7**	**3,84,187**	**30.4**
1. Agriculture and Allied Activities	**2,01,927**	**28,089**	**22.4**	**47,044**	**30.4**
2. Industry (Small, Medium and Large)	**6,34,804**	**66,480**	**15.6**	**1,41,774**	**28.8**
Small Scale Industries	1,03,089	7,453	10.0	20,179	24.3
3. Personal Loans	**4,34,860**	**68,386**	**27.9**	**1,03,587**	**31.3**
Housing	2,21,072	37,431	29.1	46,501	26.6
Advances against Fixed Deposits	35,627	2,378	8.0	3,517	11.0
Credit Cards	12,307	3,072	53.3	3,749	43.8
Education	13,910	3884	75.9	4,742	51.7
Consumer Durables	8,731	-220	-2.4	1,690	24.0
4. Other Services	**3,75,930**	**12,049**	**39.4**	**91,782**	**32.3**
Transport Operators	23,179	1,990	20.7	10,045	76.5
Professional & Others	19,377	1,513	11.4	5,252	37.2
Trade	99,460	13,975	24.1	24,135	32.0
Real Estate Loans	40,790	11,225	84.4	17,899	78.2
Non-Banking Financial Companies	41,093	6,023	26.8	10,653	35.0
Memo:					
Priority Sector	**5,75,282**	**78,172**	**20.5**	**1,11,551**	**24.1**
Industry (Small, Medium and Large)	**6,34,804**	**66,480**	**15.6**	**1,41,774**	**28.8**
Food Processing	35,619	3,878	15.9	7,675	27.5
Textiles	71,274	8,989	20.4	17,849	33.4
Paper & Paper Products	10,416	1,650	24.0	1,882	22.1
Petroleum, Coal Products & Nuclear Fuels	33,991	2,203	14.1	15,399	82.8
Chemical and Chemical Products	51,073	5,265	13.3	6,880	15.6
Rubber, Plastic & their Products	8,318	2,403	65.5	2,141	34.7
Iron and Steel	59,356	7,841	21.8	15,096	34.1
Other Metal & Metal Products	20,261	2,046	17.6	6,460	46.8
Engineering	39,741	2,913	9.9	7,212	22.2
Vehicles, Vehicle Parts and Transport Equipments	19,311	4,964	41.8	2,483	14.8
Gems & Jewellery	22,249	4,276	29.9	3,053	15.9
Construction	17,131	3,696	45.5	5,550	47.9
Infrastructure	1,28,405	22,717	28.8	27,162	26.8

* : January 20, 2006 over January 28, 2005.
** : January 19, 2007 over January 20, 2006.

Note : 1. Data are provisional and relate to select scheduled commercial banks.
2. Owing to change in classification of sectors/industries and coverage of banks, data for 2006 are not comparable with earlier data.

2.72 In addition to bank credit, the corporate sector continued to rely on non-bank sources of funds for their financing requirements during 2006-07. Mobilisation of resources through equity issuances abroad (ADRs/GDRs) during 2006-07 more than doubled from the level a year ago. Recourse to debt flows in the form of external commercial borrowings (ECBs) during April-December 2006 was also higher than that a year ago. Internal sources of funds continued to provide a strong support to the corporate sector during April-December 2006 (Table 2.30).

2.73 Scheduled commercial banks' non-food credit registered a growth of 27.2 per cent (y-o-y) as on May 11, 2007 on top of 32.3 per cent a year ago, while their investments in Government securities expanded by 9.5 per cent (2.0 per cent a year ago).

Table 2.30: Select Sources of Funds to Industry

(Rupees crore)

Item	2005-06	2006-07
1	2	3
A. Bank Credit to Industry #	1,27,192 (66,244) *	74,981 *
B. Flow from Non-banks to Corporates		
1. Capital Issues (i+ii)	13,781	29,180
i) Non-Government Public Ltd. Companies (a+b)	13,408	29,180
a) Bonds/Debentures	245	585
b) Shares	13,163	28,595
ii) PSUs and Government Companies	373	0
2. ADR/GDR Issues	7,263	16,184
3. External Commercial Borrowings (ECBs)	45,078 (27,228) *	48,328 *
4. Issue of CPs	-1,517	4,970
C. Depreciation Provision +	28,883 (22,044) *	24,557 *
D. Profit after Tax +	67,506 (52,891) *	75,460 *

: Data pertain to select scheduled commercial banks. Figures for 2005-06 are not comparable with those of 2006-07 due to increase in number of banks selected in the sample.

+ : Data are based on audited/ unaudited abridged results of select sample of non-financial non-Government companies.

* : Data pertain to April-December.

Note : 1. Data are provisional.

2. Data on capital issues pertain to gross issuances excluding issues by banks and financial institutions. Figures are not adjusted for banks' investments in capital issues, which are not expected to be significant.

3. Data on ADR/GDR issues exclude issuances by banks and financial institutions.

4. Data on external commercial borrowings include short-term credit. Data for 2005-06 are exclusive of the IMD redemption.

Price Situation

2.74 Headline inflation in major advanced economies broadly mirrored movements in international crude oil prices during 2006-07. Headline inflation, which remained firm up to August 2006 in line with the hardening of international crude oil prices, eased during September-October 2006 on account of base effects and the sharp decline in international crude oil prices (Table 2.31 and Chart II.9). However, it rose again during December 2006 - March 2007. Core inflation continues to remain firm in major economies. CPI inflation (excluding food and energy) was 2.5 per cent in the US in March 2007 (2.1 per cent a year ago) and 2.1 per cent in the OECD countries in March 2007 (1.6 per cent a year ago).

Table 2.31: Annual Consumer Price Inflation

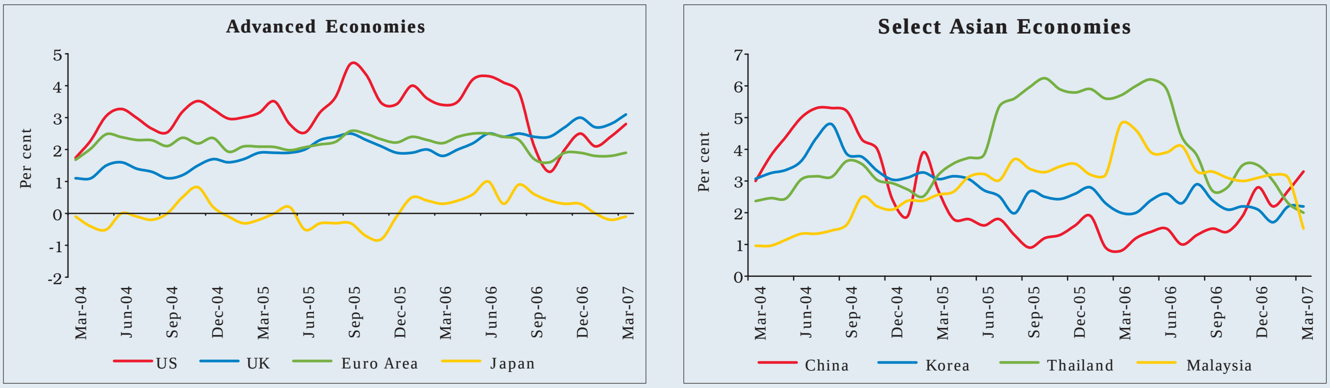
(Per cent)

Country/Area	2001	2002	2003	2004	2005	2006	2007 P
1	2	3	4	5	6	7	8
Advanced Economies	**2.1**	**1.5**	**1.8**	**2.0**	**2.3**	**2.3**	**1.8**
US	2.8	1.6	2.3	2.7	3.4	3.2	1.9
Japan	-0.8	-0.9	-0.2	–	-0.6	0.2	0.3
Euro Area	2.4	2.3	2.1	2.1	2.2	2.2	2.0
Other Emerging Market and Developing Countries	**6.7**	**5.8**	**5.8**	**5.6**	**5.4**	**5.3**	**5.4**
Developing Asia	2.7	2.0	2.5	4.1	3.6	4.0	3.9
China	0.7	-0.8	1.2	3.9	1.8	1.5	2.2
India	**3.8**	**4.3**	**3.8**	**3.8**	**4.2**	**6.1**	**6.2**

P: IMF Projections.

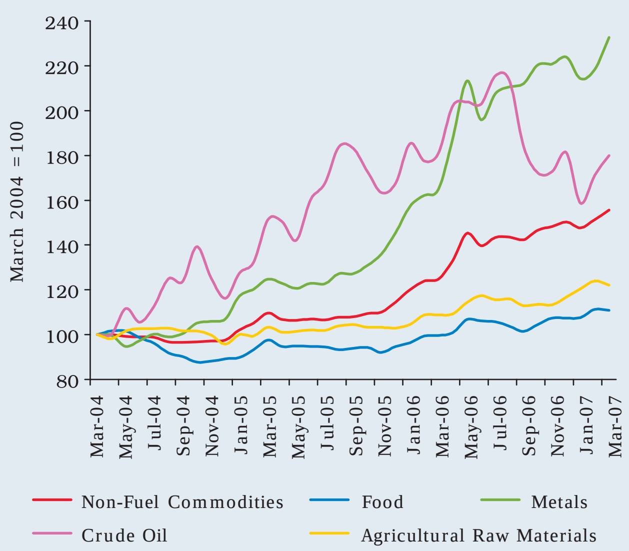
Source: World Economic Outlook, April 2007, IMF.

Chart II.9: Consumer Price Inflation



2.75 Reflecting strong demand, non-oil international commodity prices remained at elevated levels. Metals prices firmed up further during 2006-07, largely reflecting robust demand and supply constraints amidst speculative interest (Chart II.10). Amongst food items, prices of wheat edged higher by 14 per cent in March 2007 (y-o-y), largely reflecting shortfall in global production and steady increase in utilisation. Prices of edible oils also increased; in March 2007 (y-o-y), palm oil increased by 41.4 per cent and soyabean oil by 33.2 per cent. On the other hand, crude oil prices eased from the historical peak of US $ 78.4 a barrel on July 14, 2006 to around US $ 51 a barrel in January 2007 on the back of slowdown in global demand, build up of US inventories, and mild winter in the US. Crude oil prices, however, rose again from the last week of January 2007 to about US $ 67 a barrel in late March 2007. Sugar prices have eased in recent months, reflecting improved production prospects.

Chart II.10: International Commodity Prices



Source: International Monetary Fund.

2.76 A number of central banks tightened monetary policies during 2006-07 and 2007-08 (April-May) in order to contain inflation expectations. In the euro area, notwithstanding some easing in inflation, risks to the price outlook are seen on the upside due to the possibility of further oil price rises, additional increases in administered prices and indirect taxes and stronger than currently expected wage developments. The European Central Bank (ECB), therefore, raised the key policy rate by 25 basis points each in June, August, October and December 2006, and March 2007 – a total increase of 175 basis points since December 2005 – to keep medium to long-term inflation expectations in the euro area anchored to levels consistent with price stability. In the UK, in view of strong economic activity, limited spare capacity, rapid growth of broad money and credit, rise in asset prices and expectations about inflation remaining above the target in the near term, the Bank of England raised its policy rate by 25 basis points each in August and November 2006, and January and May 2007 to 5.50 per cent (Table 2.32). The Reserve Bank of Australia raised its policy rate by 25 basis points in November 2006 to 6.25 per cent – a total increase of 75 basis points since May 2006 – in response to strong economic activity and underlying inflation pressures. After maintaining zero interest rates for an extended period, the Bank of Japan (BoJ) increased the uncollateralised overnight call rate (adopted as the operating target of monetary policy since March 2006) by 25 basis points each in July 2006 and February 2007 to 0.50 per cent. On the other hand, the US Fed, after having raised its target federal funds rate by 25 basis points each on 17 successive occasions between June 2004 and June 2006, has

Table 2.32: Global Inflation Indicators

(Per cent)

Country/Region	Key Policy Rate	Policy Rates (As on May 19, 2007)	Changes in Policy Rates (basis points)		CPI Inflation (y-o-y)		Growth (y-o-y)	
			Since end-March 2005	Since end-March 2006	2006 (Mar.)	2007 (Mar.)	2005 (Q4)	2006 (Q4)
1	2	3	4	5	6	7	8	9
Developed Economies								
Australia	Cash Rate	6.25 (Nov. 8, 2006)	75	75	3.0	2.4	2.7	2.8
Canada	Overnight Rate	4.25 (May 24, 2006)	175	50	2.2	2.3	2.9	2.3
Euro area	Interest Rate on Main Refinancing Operations	3.75 (Mar. 8, 2007)	175	125	2.2	1.9	1.7	3.3
Japan	Uncollateralised Overnight Call Rate	0.50 (Feb. 21, 2007)	**	50	-0.2	-0.1	4.0	2.3
UK	Official Bank Rate	5.50 (May. 10, 2007)	75	100	1.8	3.1	1.8	3.0
US	Federal Funds Rate	5.25 (June 29, 2006)	250	50	3.4	2.8	3.2	3.1
Developing Economies								
Brazil	Selic Rate	12.50 (Apr. 18, 2007)	(-)675	(-)400	5.3	3.0	1.4	3.8
India	Reverse Repo Rate	6.00 (July 25, 2006)	125	50	4.9	6.7	9.3	8.6
	Repo Rate	7.75 (Mar. 30, 2007)	175	125				
China	Benchmark 1-year Lending Rate	6.57 (May 19, 2007)	99	99	0.8	3.3	9.9	10.7
Indonesia	BI Rate	8.75 (May 8, 2007)	25@	(-)400	15.8	6.5	4.9	6.1
Israel	Key Rate	3.75 (Apr. 22, 2007)	25	(-)100	3.6	-0.9	4.8	3.7
Korea	Overnight Call Rate	4.50 (Aug. 10, 2006)	125	50	2.0	2.2	5.3	4.0
Philippines	Reverse Repo Rate	7.50 (Oct. 20, 2005)	75	0	7.6	2.2	6.1	6.5
South Africa	Repo Rate	9.00 (Dec. 8, 2006)	150	200	3.4	6.1	4.5	6.1
Thailand	14-day Repurchase Rate	5.00 (June 7, 2006)	275	50	5.7	2.0	4.7	4.2
	1-day Repurchase Rate	4.00 (Apr. 11, 2007)	—	(-)94 ^				

** : The Bank of Japan decided on March 9, 2006 to change the operating target of money market operations from the outstanding balance of current accounts at the Bank to the uncollateralised overnight call rate.

@ : Change since July 2005 when Bank Indonesia adopted BI rate as the reference rate with the formal adoption of inflation targeting.

^ : Change over January 16, 2007. Effective January 17, 2007, the 1-day repurchase rate replaced the 14-day repurchase rate as the policy rate.

Note : 1. For India, data on inflation pertain to CPI for Industrial Workers.
2. Figures in parentheses in column (3) give the date when the policy rates were last revised.

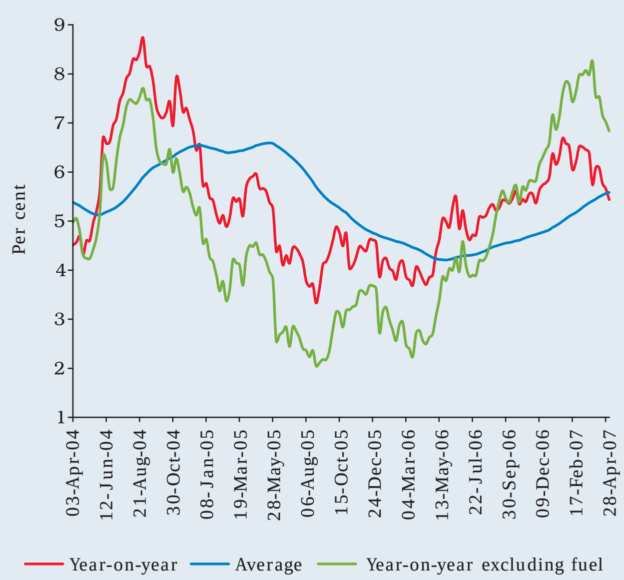
Source : International Monetary Fund, websites of respective central banks and the Economist.

paused since then as economic growth has moderated from its quite strong pace, partly reflecting a cooling of the housing market. The US Fed has indicated that future policy adjustments will depend on the evolution of the outlook for both inflation and economic growth, as implied by incoming information.

2.77 In emerging Asia, inflation remains relatively modest in a number of economies, reflecting both pre-emptive monetary tightening as well as appreciation of the exchange rates. However, there is an emerging concern regarding excess liquidity arising particularly from large external capital flows. Consumer price inflation in China increased to 3.3 per cent in March 2007 from 0.8 per cent a year ago. In view of stronger growth in money supply and credit, the People's Bank of China has increased the benchmark 1-year lending rate by 27 basis points each in April 2006, August 2006, March 2007 and by 18 basis points in May 2007 accompanied by a series of administrative curbs on new project approvals. It has also raised the cash reserve ratio by 400 basis points since July 2006 in eight steps to 11.50 per cent (including the hike of 50 basis points to be effective from June 5, 2007). Amongst other emerging Asian economies, Korea has kept its rates unchanged since August 2006. On the other hand, in Thailand and Indonesia, the policy rates have been cut by 94 basis points (since January 2007) and 400 basis points (since May 2006), respectively, to support growth.

2.78 In India, headline inflation, measured by y-o-y changes in the wholesale price index (WPI), was at 5.7 per cent during the week ended March 31, 2007 as compared with 4.0 per cent a year ago. The average WPI inflation rate (average of the 52 weeks) was 5.4 per cent in 2006-07 as compared with 4.4 per cent a year ago (Chart II.11). Inflation movements in 2006-07 were driven by primary food articles and manufactured products prices, reflecting the impact of both supply-side and demand-side pressures.

Chart II.11: Wholesale Price Inflation



2.79 Prices of primary articles led by wheat, pulses, milk, oilseeds and raw cotton exerted upward pressures on headline inflation during 2006-07 (Table 2.33). Wheat prices rose by 7.6 per cent, year-on-year, on the back of low domestic stocks and high international prices. Prices of pulses increased by 12.0 per cent from last year's level, reflecting stagnant domestic production. Milk prices increased by 8.4 per cent. Prices of oilseeds increased by 30.6 per cent in contrast to a decline of 9.2 per cent a year ago in tandem with international trends. Overall, prices of primary articles increased by 10.7 per cent on a y-o-y basis as on March 31, 2007 (4.8 per cent a year ago).

2.80 Fuel group inflation eased to 1.0 per cent, y-o-y, as on March 31, 2007 from 8.3 per cent a year ago. Fuel group inflation initially rose to a peak of 9.9 per cent, y-o-y, on June 17, 2006 under the impact of the rise in domestic petrol and diesel prices on June 6, 2006. Subsequently, the fuel group's inflation moderated due to the base effect and the decline in domestic prices of petrol and diesel in November 2006 and February 2007. It may be noted that the pass-through of higher international oil prices has been restricted to petrol and diesel. Domestic prices of liquefied petroleum gas (LPG) and kerosene have remained unchanged since November 2004 and April 2002, respectively, on grounds of societal concerns.

2.81 Manufactured products inflation increased to 5.8 per cent, y-o-y, as on March 31, 2007 from 1.9 per cent a year ago, led by edible oils/oil cakes, cement, metals and electrical machinery. Metal prices have generally moved in line with international trends. 'Basic metals, alloys and products' group inflation was 11.0 per cent, y-o-y, as on March 31 2007 as against a decline of 0.6 per cent a year ago. Domestic prices of cement increased by 11.6 per cent, y-o-y, over and above the increase of 14.9 per cent a year ago, partly reflecting strong domestic demand. Electrical machinery prices rose by 12.8 per cent as compared with 4.1 per cent a year ago. While grain mill product prices increased by 21.4 per cent in tandem with domestic wheat prices, domestic sugar prices have eased in recent months in line with global trends. Edible oil prices increased by 14.7 per cent as against a decline of 3.3 per cent a year ago.

2.82 Apart from monetary measures by the Reserve Bank to contain inflationary expectations, the Government also undertook a number of fiscal and supply side measures during the year to contain the price rise in primary commodities as well as some manufactured items.

Table 2.33: Wholesale Price Inflation in India (year-on-year)

(Per cent)

Commodity		April 1, 2006		March 31, 2007 P	
	Weight	Inflation	WC	Inflation	WC
1	2	3	4	5	6
All Commodities	**100.0**	**4.0**	**100.0**	**5.7**	**100.0**
1. Primary Articles	**22.0**	**4.8**	**25.8**	**10.7**	**40.4**
Food Articles	15.4	5.9	22.5	8.3	22.3
i. Rice	2.4	2.1	1.1	5.7	2.1
ii. Wheat	1.4	12.7	4.3	7.6	1.9
iii. Pulses	0.6	33.3	4.5	12.0	1.4
iv. Vegetables	1.5	7.6	2.4	1.4	0.3
v. Fruits	1.5	-3.9	-1.9	5.5	1.7
vi. Milk	4.4	1.9	2.0	8.4	6.0
vii. Eggs, Meat and Fish	2.2	13.2	7.3	11.1	4.6
Non-Food Articles	6.1	-2.4	-3.5	16.6	15.5
i. Raw Cotton	1.4	-1.7	-0.4	21.4	3.6
ii. Oilseeds	2.7	-9.2	-5.5	30.6	11.0
iii. Sugarcane	1.3	0.7	0.3	1.1	0.3
Minerals	0.5	43.6	6.9	17.0	2.6
2. Fuel, Power, Light and Lubricants	**14.2**	**8.3**	**45.5**	**1.0**	**4.1**
i. Mineral Oils	7.0	12.0	37.2	0.5	1.2
ii. Electricity	5.5	4.5	8.3	2.3	2.9
iii. Coal Mining	1.8	0.0	0.0	0.0	0.0
3. Manufactured Products	**63.8**	**1.9**	**27.7**	**5.8**	**55.9**
i. Food Products	11.5	1.0	2.6	6.4	11.3
of which: Sugar	3.6	6.2	4.7	-12.7	-6.9
Edible Oils	2.8	-3.3	-1.8	14.7	5.1
ii. Cotton Textiles	4.2	2.3	2.1	-1.0	-0.6
iii. Man Made Fibres	4.4	-3.9	-2.1	3.7	1.3
iv. Chemicals and Chemical Products	11.9	3.3	9.7	2.9	5.8
of which: Fertilisers	3.7	0.2	0.1	1.8	1.0
v. Basic Metals, Alloys and Metal Products	8.3	-0.6	-1.5	11.0	17.6
of which: Iron and Steel	3.6	-4.2	-5.1	7.5	5.8
vi. Non-Metallic Mineral Products	2.5	9.6	5.4	9.0	3.7
of which: Cement	1.7	14.9	5.6	11.6	3.3
vii. Machinery and Machine Tools	8.4	3.2	5.2	8.0	8.8
of which: Electrical Machinery	5.0	4.1	3.1	12.8	6.9
viii. Transport Equipment and Parts	4.3	0.9	0.8	2.1	1.2
Memo:					
Food Items (Composite)	**26.9**	**3.9**	**25.1**	**7.5**	**33.6**
WPI Excluding Food	**73.1**	**4.0**	**74.9**	**5.1**	**66.4**
WPI Excluding Fuel	**85.8**	**2.8**	**54.5**	**7.1**	**95.9**

P : Provisional. WC : Weighted Contribution.

2.83 Headline WPI inflation was 5.4 per cent, y-o-y, as on May 5, 2007 as compared with 5.7 per cent at end-March 2007 and 4.4 per cent a year ago. Primary articles and manufactured group inflation hardened to 11.1 per cent (5.1 per cent a year ago) and 5.1 per cent (2.3 per cent), respectively, while fuel group inflation softened to 0.7 per cent (9.0 per cent). The average WPI inflation rate increased to 5.6 per cent as on May 5, 2007 from 4.2 per cent a year ago.

Table 2.34: Consumer Price Inflation (CPI) in India (year-on-year)

(Per cent)

Inflation Measure	Mar. 2003	Mar. 2004	Mar. 2005	Mar. 2006	Jun. 2006	Sep. 2006	Dec.2006	Mar. 2007
1	2	3	4	5	6	7	8	9
CPI-IW	4.1	3.5	4.2	4.9	7.7	6.8	6.9	6.7
CPI-UNME	3.8	3.4	4.0	5.0	6.5	6.6	6.9	7.6
CPI-AL	4.9	2.5	2.4	5.3	7.2	7.3	8.9	9.5
CPI-RL	4.8	2.5	2.4	5.3	7.2	7.0	8.3	9.2
Memo:								
WPI Inflation	6.5	4.6	5.1	4.1	4.8	5.4	5.9	5.7

IW : Industrial Workers. UNME : Urban Non-Manual Employees. AL : Agricultural Labourers. RL : Rural Labourers.

2.84 Consumer price inflation also edged higher and remained higher than the WPI inflation during 2006-07. This could be attributed to the higher order of increase in food prices as well as the higher weight of food items in the CPI (Table 2.34).

2.85 To sum up, demand for bank credit remained buoyant during 2006-07. This could be accommodated by the acceleration in bank deposits. Concomitantly, growth in money supply also remained higher than a year ago; it exceeded the indicative projections set out in the Annual Policy Statement. Inflation firmed up during 2006-07 driven by primary food articles and manufactured product prices, reflecting the inter-play between supply and demand pressures. The domestic oil price pass-through remains incomplete in respect of LPG and kerosene oil. Reflecting the sharp rise in primary food prices, various measures of consumer price inflation remained above the WPI inflation during 2006-07.

IV. FINANCIAL MARKETS

2.86 Financial markets in India remained orderly during 2006-07, barring some episodes of volatility. Short-term money rates remained generally within the reverse repo rate and repo rate corridor till mid-December 2006. However, beginning the second fortnight of December 2006, call rates shot up occasionally as a result of swings in liquidity conditions arising from large changes in government cash balances and volatile forex flows, as also shortage of collateral faced by some participants, at a time when monetary policy was in tightening mode. In the foreign exchange market, the Indian rupee had recorded both way movements *vis-à-vis* the US dollar during the financial year along with marked appreciation against the US dollar since March 2007. Yields in the government securities market hardened during 2006-07. The equity market remained orderly during the financial year, barring periods of volatility during May-June 2006 and February-March 2007. This section takes a review and assessment of various segments of the financial market during the fiscal year 2006-07 and 2007-08 (wherever data are available).

Money Market

Call Money Market

2.87 Money market conditions remained largely comfortable during 2006-07, barring a few spells of volatility. Call money rates, which had edged up during the second half of 2005-06, eased during April-May 2006 and remained close to the reverse repo rate [the lower band of the liquidity adjustment facility (LAF) corridor], reflecting easing of liquidity conditions. With the increase in the fixed reverse repo/repo rate by 25 basis points effective June 9, 2006, call rates also edged up by a similar magnitude. In July 2006, call rates again edged up with the increase in fixed reverse repo/repo rate by 25 basis points (effective July 25, 2006). Liquidity conditions became relatively tight in September 2006 when the average call money rate increased to 6.33 per cent, *inter alia,* on account of liquidity pressures emanating from advance tax outflows and festival season currency demand amidst high credit demand. In October 2006, the average monthly call money rate increased further to 6.75 per cent. With the increase in fixed repo rate by 25 basis points to 7.25 per cent (the reverse repo rate was left unchanged) effective October 31, 2006, call rates edged up somewhat, averaging 6.90 per cent during the first three weeks of November 2006. However, as a result of decline in call rates towards the end of November, monthly average call rates declined to 6.69 per cent. From the second week of December, call rates started firming up reaching a high of 16.9 per cent on December 29, 2006 and averaged 8.63 per cent during

Table 2.35: Domestic Financial Markets – Select Indicators

Year/ Month	Call Money		Govt. Securities		Foreign Exchange				Liquidity Management		Equity			
	Average Daily Turn-over (Rs crore)	Average Call Rates* (Per cent)	Average 10-year Yield @ (Per cent)	Average Daily Turn-over in Govt. Securities (Rs. crore)+	Average Daily Inter-bank Turnover (US $ million)	Average Ex-change Rate (Rs. per US $)	RBI's net Foreign Currency Sales (-) / Purchases (+) (US $ million	Average Forward Premia 3 month (Per cent)	Average MSS Outstan-ding # (Rs. crore)	Average Daily Reverse Repo (LAF) Outsta-nding (Rs. crore)	Average Daily BSE Turnover (Rs. crore)	Average Daily NSE Turnover (Rs. crore)	Average BSE Sensex**	Average S&P CNX Nifty**
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
2005-06														
April	17,213	4.77	7.02	3,001	9,880	43.74	–	1.96	65,638	30,675	1,890	4,136	6,379	1,987
May	15,269	4.99	7.11	3,805	10,083	43.49	–	1.57	68,539	22,754	1,971	3,946	6,483	2,002
June	20,134	5.10	6.88	6,807	10,871	43.58	-104	1.40	70,651	13,916	2,543	4,843	6,926	2,134
July	20,046	5.02	7.13	3,698	11,003	43.54	2,473	1.56	70,758	10,754	3,095	6,150	7,337	2,237
August	16,158	5.02	7.04	4,239	11,749	43.62	1,552	0.69	71,346	34,832	3,451	6,624	7,726	2,358
September	16,292	5.05	7.04	5,207	11,040	43.92	–	0.62	67,617	30,815	3,871	6,923	8,272	2,512
October	17,164	5.12	7.14	2,815	13,087	44.82	–	0.69	68,602	18,608	2,955	6,040	8,220	2,487
November	22,620	5.79	7.10	3,314	11,228	45.73	–	0.67	67,041	3,268	2,635	5,480	8,552	2,575
December	21,149	6.00	7.13	2,948	13,808	45.64	-6,541	1.51	52,040	1,452	3,516	6,814	9,162	2,773
January	17,911	6.83	7.15	3,094	16,713	44.40	–	2.60	40,219	-15,386	3,966	7,472	9,540	2,893
February	13,497	6.95	7.32	2,584	15,798	44.33	2,614	2.85	33,405	-13,532	3,688	7,125	10,090	3,019
March	18,290	6.58	7.40	2,203	17,600	44.48	8,149	3.11	29,652	-6,319	5,398	9,518	10,857	3,236
2006-07														
April	16,909	5.62	7.45	3,685	17,712	44.95	4,305	1.31	25,709	46,088	4,860	9,854	11,742	3,494
May	18,074	5.54	7.58	3,550	18,420	45.41	504	0.87	26,457	59,505	4,355	9,155	11,599	3,437
June	17,425	5.73	7.86	2,258	15,310	46.06	–	0.73	31,845	48,610	3,261	6,828	9,935	2,915
July	18,254	5.86	8.26	2,243	14,325	46.46	–	0.83	36,936	48,027	2,605	5,652	10,557	3,092
August	21,294	6.06	8.09	5,786	15,934	46.54	–	1.22	40,305	36,326	2,869	5,945	11,305	3,306
September	23,665	6.33	7.76	8,306	18,107	46.12	–	1.31	40,018	25,862	3,411	6,873	12,036	3,492
October	26,429	6.75	7.65	4,313	16,924	45.47	–	1.67	41,537	12,983	3,481	6,919	12,637	3,649
November	25,649	6.69	7.52	10,654	20,475	44.85	3,198	2.07	38,099	9,937	4,629	8,630	13,416	3,869
December	24,168	8.63	7.55	5,362	19,932	44.64	1,818	3.20	38,148	-1,713	4,276	8,505	13,647	3,918
January	22,360	8.18	7.71	4,822	21,065 P	44.33	2,830	4.22	39,553	-10,738	4,380	8,757	13,984	4,037
February	23,254	7.16	7.90	4,386	20,050 P	44.16	11,862	3.71	40,827	648	4,680	9,483	14,143	4,079
March	23,217	14.07	8.00	2,991	24,231 P	44.03	–	4.51	52,944	-11,858	3,716	7,998	12,850	3,731

* : Average of daily weighted call money borrowing rates. @ : Average daily closing rates. + : Outright turnover in Central Government dated securities.
# : Average of weekly outstanding MSS. ** : Average daily closing indices. – : Nil. P : Provisional.

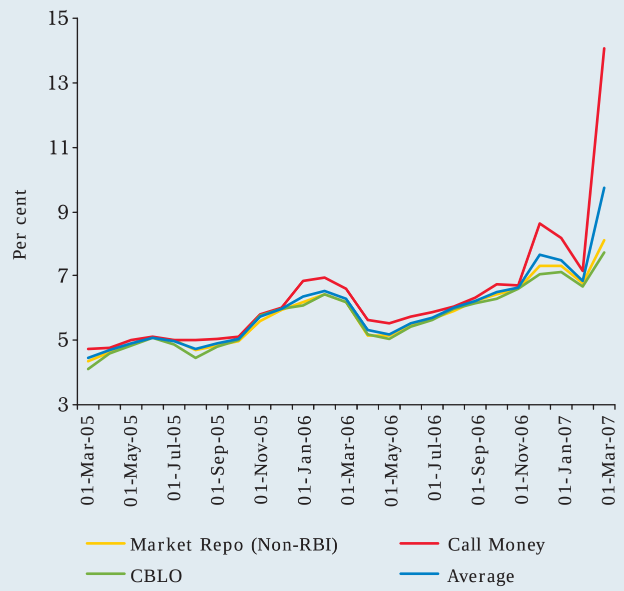
the month. Hardening of call rates was due to tightening of liquidity in the system as a result of CRR hike and advance tax outflow (Table 2.35). However, call rates eased in January 2007 and averaged 8.18 per cent. In February 2007, the call rate further declined to around 6.5 per cent by the end of the second week. Following the announcement of a further CRR hike on February 13, 2007, it again firmed up to around 8.0 per cent by mid-February before dropping to 6.0 per cent by end of the month. Call rates averaged 7.16 per cent during February 2007.

2.88 Call money rates went below the lower bound of the repo-reverse repo corridor during the first week and the average rate was at 5.62 per cent till the mid-March. The overnight call rate hovered above the upper bound of the corridor during March 17-31, 2007 and ruled above 20 per cent on the following five days. The call rate crossed 50 per cent on March 21 and March 30, 2007. The average call rate for the month was 14.07 per cent. Call money rates eased and on a daily weighted average basis ranged between 3.27-12.83 per cent in the first half of April 2007 as a result of improvement in the liquidity condition following a sharp decline in government cash balances. With the first stage of CRR hike announced as part of the monetary measures on March 30, 2007 becoming effective from April 14, 2007 and government raising resources as part of its market borrowing programme, the call rate hardened in the second half of April ranging between 7.36-15.01 per cent and averaging 9.76 per cent. The average call rate for April 2007 was 8.33 per cent. During May 2007 (up to May 19, 2007), the daily weighted average call money rates ranged between 2.80-9.08 per cent and averaged 7.24 per cent, *i.e.*, below the LAF repo rate. Increased volatility in money markets in the recent period was, in part, caused by asymmetric distribution of funds and eligible collateral amongst banks. This was reinforced by asset liability mismatches in some banks who had insufficient provisions at the short-end of maturity bucket at a time when they were also short of collateral. This limited their ability to borrow in the collateralised market or obtain liquidity through the Reserve Bank's LAF window, forcing them to scout for funds on adverse terms in the uncollateralised market. On its part, the Reserve Bank has been accepting all demands for liquidity made at its LAF window. Thus, the liquidity pressures emanating from advance tax flows during the second half of March 2007, accentuated in April/May and resulted in larger spikes in call rates.

Collateralised Markets

2.89 After the abolition of non-bank participants (other than PDs) from uncollaterised money market since August 2005, the collateralised segment has emerged as the predominant segment of the money market. Interest rates in the collateralised segments of the money market – the market repo (outside the LAF) and the Collateralised Borrowing and Lending Obligation (CBLO) segments – eased in the first two months of 2006-07 as compared with the last quarter of 2005-06. However, the rates in the collateralised money market have increased gradually from June 2006, following the fixed reverse repo rate hikes and subsequent tightening of liquidity condition in September 2006. The market repo and CBLO rates, which declined to 5.15 per cent and 5.18 per cent, respectively, during April 2006, increased gradually to 7.33 per cent and 7.05 per cent, respectively, in December 2006. The market repo and CBLO segment rates declined to 6.76 per cent and 6.67 per cent, respectively, during February 2007 before climbing up to 8.13 per cent and 7.73 per cent, respectively, in March 2007 in line with the call money market. On a weighted average basis, the CBLO rate and market repo rate averaged 6.70 per cent in February 2007 and 7.86 per cent in March 2007. Interest rates in these segments, however, remained below the call rate during 2006-07 (Chart II.12). Interest rates in the CBLO and the market repo segments had remained within repo-reverse repo corridor till mid-December 2006. In tandem with tightness in money markets, interest rates in these segments also edged up and hovered around the repo rate beginning the second half of December 2006, but remained below the call rate. In the subsequent spells of liquidity tightening as well, the rates in collateralised segments have, by and large, remained anchored around the repo rate, except towards end of March, when the rates exceeded LAF repo rates significantly, but remained well below the call rates.

Chart II.12: Movement in Key Market Rates



2.90 During 2006-07, the CBLO and market repo rates averaged 6.24 per cent and 6.34 per cent, respectively, as compared with 7.22 per cent in the call money market. The CBLO and market repo rates remained well within the corridor, averaging 6.12 and 6.76 per cent, respectively, in April 2007. The CBLO and market repo rates declined below the reverse repo rate in the first half of May 2007, and then hovered around the repo rate in the third week. During April and May 2007 (up to May 19, 2007), rates in these collateralised segments of the money market more or less stayed inside or around the LAF repo rate.

2.91 The collateralised market is now the predominant segment of the money market, with a share of around 70 per cent in total volume during 2006-07. Mutual funds and financial institutions are the major lenders in the CBLO market, while nationalised banks are the major borrowers. In the market repo segment, mutual funds are the major providers of funds, while foreign banks, private sector banks and primary dealers are the major borrowers.

2.92 A screen-based negotiated quote-driven system for all dealings in the call/notice and term money market (NDS-CALL), as announced in the Annual Policy Statement for the year 2005-06, was launched on September 18, 2006. NDS-CALL has been developed by the Clearing Corporation of India Limited (CCIL) on behalf of the Reserve Bank and is expected to bring about increased transparency and better price discovery. Though dealing on this platform is optional, 84 banks (including 16 co-operative banks) and 7 primary dealers have taken membership of NDS-CALL so far.

Liquidity Situation

2.93 Liquidity conditions remained generally comfortable during 2006-07, despite sustained growth of bank credit. Liquidity eased during April-June 2006, following reduction in the Centre's surplus balances with the Reserve Bank and the impact of the Reserve Bank's foreign exchange market operations. The Reserve Bank absorbed liquidity through operations under the LAF and resumed auctions of Treasury Bills under the MSS in May 2006. Under the LAF, on an average, the Reserve Bank absorbed liquidity through reverse repos to the extent of Rs.51,490 crore during April-June 2006 as against a net injection of liquidity through repos to the extent of Rs.11,686 crore during the previous quarter (January-March 2006). The average net absorption through reverse repo declined from around Rs.48,000 crore in July 2006 to Rs.12,983 crore in October 2006. In November, the average net absorption through reverse repo was at Rs.9,937 crore. However, December 2006 and January 2007 witnessed net injection of liquidity averaging Rs.1,713 crore and Rs.10,738 crore, respectively, mainly due to pressure emanating from advanced tax outflows and CRR hike in the midst of high credit growth and rise in inflation. Liquidity was absorbed through the MSS, following the reintroduction of issuances under the MSS effective May 3, 2006. An incremental amount of Rs.33,912 crore was absorbed under the MSS in the last financial year. The LAF returned to absorption mode in the second week of February 2007 and keeping in view the liquidity conditions and the paramount need to contain inflation expectations, the Reserve Bank announced another hike in the CRR on February 13, 2007.

2.94 In February 2007, the average daily absorption through reverse repo was at Rs.648 crore. On a review of the liquidity conditions, the Reserve Bank introduced a modified arrangement in liquidity management on March 2, 2007, wherein the LAF as a facility for equilibrating very short-term mismatches was emphasised, and it was decided that the liquidity absorption would be modulated through the daily reverse repo auctions. Accordingly, beginning March 5, 2007, daily reverse repo absorption was limited to a maximum of Rs.3,000 crore each day (allocations would be proportionate on a pro-rata basis) comprising Rs.2,000 crore in the First LAF and Rs.1,000 crore in the Second LAF. Between March 5 and 15, 2007, liquidity was in surplus mode and daily absorption was close to the upper bound of Rs.3,000 crore. From March 16, 2007, however, liquidity in the system reverted to a deficit mode largely on account of quarterly direct tax payment schedules. Daily net injection of liquidity averaged Rs.31,124 crore during the second half of March and Rs.11,858 crore for the entire month of March.

2.95 In April 2007, the implementation of CRR hike in two phases impounded liquidity from the system, forcing the LAF window to go to the injection mode. The average daily net injection of liquidity through the LAF operation was Rs.8,937 crore. During the month, absorption took place for only 7 days, *i.e.,* between April 9-15, 2007. In May 2007 (up to May 19, 2007), the Reserve Bank injected liquidity through LAF, except for the period between May 7-13, 2007.

2.96 The major issues relating to liquidity management in recent years include large and unpredictable nature of capital flows, which increased liquidity exogenously, putting upward pressure on money supply, prices and exchange rates. This necessitated appropriate sterilisation measures. Government cash balances with the Reserve Bank often display large periodic variation mainly due to lumpy character of direct tax inflows on account of quarterly payment schedule, the impact of which has become more pronounced in recent quarters due to buoyancy in tax revenue. The volatile Government cash balances also cause unanticipated expansion or contraction of the monetary base, and consequently, making money supply management even more challenging. Over the years, the LAF has emerged as the principal operating instrument for both liquidity management and monetary policy. The MSS, on the other hand, has functioned as an additional instrument to deal with the enduring capital inflows without affecting the short-term liquidity management role of the LAF. In addition, modified arrangements for the LAF and the MSS put in place in March 2007, are expected to facilitate the maintenance of appropriate liquidity in the system and to respond more swiftly to the evolving liquidity situation in line with the objectives and stance of monetary policy.

Certificates of Deposit

2.97 The demand for certificates of deposit (CDs) issued by the scheduled commercial banks (SCBs) remained strong during the fiscal year 2006-07. In view of the sustained credit demand, the SCBs resorted to deposit mobilisation through CDs. The amount of outstanding CDs increased from Rs.43,568 crore at end-March 2006 (4.8 per cent of aggregate deposits of issuing banks) to Rs.93,272 crore (4.83 per cent of aggregate deposits of issuing banks with significant intra-group variation) by March 30, 2007. The overall weighted average discount rate (WADR) for CDs, which had risen to 8.62 per cent by end-March 2006, declined to 7.03 per cent by end-April 2006. The interest rate on CDs firmed up again beginning July with the WADR rising to 10.75 per cent by March 30, 2007. As on April 13, 2007, the WADR of CDs stood at 10.15 per cent. Some of the private sector and foreign banks are also taking increased recourse to the CD route to meet the resource gap. Institutional investors such as mutual funds are investing in these certificates to deploy short-term resources.

Commercial Paper

2.98 The total outstanding amount of commercial paper (CP) issued increased considerably from Rs.12,718 crore as on March 31, 2006 to Rs.17,688 crore as on March 31, 2007. The WADR, which had risen to 8.59 per cent at end-March 2006, softened by mid-May 2006. CP rates have been firming up somewhat since mid-August in tandem with the increase in money market rates. Corporates have been offering typically a yield in the range of 10.25 to 12.50 per cent for a CP with a maturity period of more than 3 months in consonance with other money market segments. Leasing and finance companies remained the predominant issuers of CP. The share of issuances by financial institutions recorded an increase during 2006-07 (Table 2.36). As on April 15, 2007, the WADR of CP stood at 10.5 per cent.

Table 2.36: Commercial Paper – Major Issuers

(Amount in Rs. crore)

Category of Issuer	End of		
	March-05	March-06	March-07
1	2	3	4
Leasing and Finance	8,479 (59.6)	9,400 (73.9)	12,419 (70.2)
Manufacturing	2,881 (20.2)	1,982 (15.6)	2,754 (15.6)
Financial Institutions	2,875 (20.2)	1,336 (10.5)	2,515 (14.2)
Total	14,235 (100)	12,718 (100)	17,688 (100)

Note: Figures in parentheses are percentage share to the total.

Government Securities Market

Central Government Cash Management

2.99 With a view to achieving a smooth transition to the new regime as envisaged in the Fiscal Responsibility and Budget Management (FRBM) Act, 2003, the WMA arrangements for 2006-07 were revised in consultation with the Government of India. As per the revised arrangement, the WMA limits were fixed on a quarterly basis instead of the existing half-yearly basis. Accordingly, the WMA limits for 2006-07 were placed at Rs.20,000 crore and Rs.10,000 crore for the first and second quarters, respectively, and Rs.6,000 crore each for the third and fourth quarters of the year. The Reserve Bank would retain the flexibility to revise the limits in consultation with the Government taking into consideration the transitional issues and prevailing circumstances. Furthermore, the interest rates on WMA and overdraft have been linked to the repo rate, following its emergence as the short-term reference rate. Accordingly, the interest rate on WMA is at the repo rate, while on overdraft it is at the repo rate plus two percentage points. Reflecting the improvement in its cash position, the Central Government did not resort to overdrafts during 2006-07, but availed of WMA on five occasions (39 days in all).

Market Borrowings of the Central Government – 2006-07

2.100 Under the FRBM Act, 2003, the Reserve Bank has been prohibited from subscribing to the primary issues of Central Government securities from the financial year beginning April 1, 2006. In order to ensure a smooth transition to the new system, the Reserve Bank has taken a number of measures to make the market deeper, broader and more liquid, while improving the trading/settlement and institutional infrastructure.

2.101 Market borrowings (including dated securities and 364-day TBs) of the Central Government for 2006-07 were budgeted at Rs.1,81,875 crore (net Rs.1,13,778 crore) which were Rs.21,857 crore higher than the actual amount raised in 2005-06. On March 24, 2006, the issuance calendar for dated securities for the first half of 2006-07 was fixed at Rs.89,000 crore (Rs.81,000 crore raised during the corresponding period of previous year) in consultation with the Central Government. The actual amount raised during the first half of the year was Rs.89,000 crore, which was as per the issuance calendar. The calendar for issuance of Government of India dated securities for the second half of the fiscal was issued on September 25, 2006. The total amount to be raised was fixed at Rs.63,000 crore, of which an amount of Rs.57,000 crore was raised.

Dated Securities

2.102 During 2006-07, gross market borrowings by way of dated securities by the Central Government amounted to Rs.1,46,000 crore as compared with Rs.1,31,000 crore during the previous year. Gross market borrowings through dated securities during 2006-07 accounted for 94 per cent of the budget estimates, same as that of the previous year. Three new securities, *viz*., (i) a 10-year security (7.59 % GS 2016 issued for the first time in April 2006); (ii) a 15-year security (7.94 % GS 2021 issued in May 2006); and (iii) a 30-year security (8.33% GS 2036 issued in June 2006) were issued to provide benchmark in the respective segments of the secondary market. During June 2006, Rs.4,000 crore was raised outside the issuance calendar to absorb excess liquidity in the system. The additional issue was offset by reduction in the auction amount in the subsequent auctions held in July 2006. The scheduled auction in the 10-14 year segment (Rs.5,000 crore) was cancelled in the auction held on January 12, 2007, after a review of the Government's borrowing requirements. Of the 33 securities issued during 2006-07, 30 securities were re-issues. The total devolvement on PDs during the financial year was at Rs.5,604 crore.

2.103 The weighted average yield of dated securities issued during 2006-07 was higher at 7.89 per cent as compared with 7.34 per cent during 2005-06. The weighted average maturity of dated securities issued during the year worked out to 14.72 years as compared with 16.90 years during the previous year.

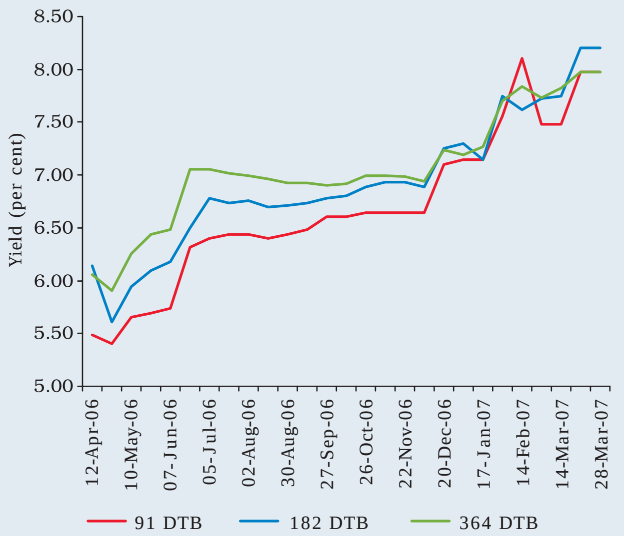
Treasury Bills

2.104 As per the annual issuance calendar that was issued on March 24, 2006, the notified amounts of 91-day, 182-day and 364-day Treasury Bills under the normal market borrowing programme were kept unchanged at Rs.500 crore (weekly auction), Rs.500 crore (fortnightly auction) and Rs.1,000 crore (fortnightly auction), respectively. During April-June 2006, the primary market yields of 91-day, 182-day and 364-day Treasury Bills firmed up due to a variety of factors such as expectations of rise in inflation, larger issuances under the MSS and the unexpected hike in repo and reverse repo rates on June 8, 2006. From July to December 2006, the yields generally remained flat amidst ample liquidity in the system. However, after the announcement of a hike in CRR on December 8, 2006, the yields for 91-day, 182-day and 364-day Treasury Bills increased significantly by 45 basis points, 36 basis points and 30 basis points, respectively over the previous auctions. Yields moved further upwards following another hike in the CRR in February 2007 and tight liquidity conditions in the wake of advance tax outflows in mid-March 2007. The closing primary market yields for March 2007 in respect of 91-day, 182-day and 364-day Treasury Bills were placed at 7.98 per cent, 8.20 per cent and 7.98 per cent, respectively, exhibiting increases of 1.87 per cent, 1.59 per cent and 1.56 per cent, respectively, over the yields in the first auctions of 2006-07 (Chart II.13).

2.105 The secondary market yields of Treasury Bills during April and May 2007 remained range bound. The primary market yields during May 2007 in respect of 91-day Treasury Bills (on May 23, 2007), 182-day Treasury Bills (on May 16, 2007) and 364-day Treasury Bills (on May 23, 2007) were placed at 7.64 per cent, 7.75 per cent and 7.80 per cent, respectively.

2.106 The liquidity position of the States remained comfortable during 2006-07. Eight States availed of WMA and two States resorted to overdraft. The weekly average utilisation of WMA and overdraft by the States at Rs.234 crore in 2006-07 was lower than that of Rs.482 crore in 2005-06. Concomitantly, the weekly average investment by the States in 14-day Intermediate Treasury Bills during 2006-07 at Rs.43,075 crore was considerably higher than that of Rs.35,278 crore in the previous year.

Chart II.13: Movement of Primary Yields of Treasury Bills 2006-07 (April-March)



Market Borrowings of the State Governments

2.107 Following the recommendation of the Twelfth Finance Commission, Central loans for State Plans were eliminated from 2005-06 and the States were expected to access the market directly for meeting their resource requirements. At the same time, overall borrowings requirements of the States, as a ratio to GDP, moderated in recent years consequent to fiscal consolidation initiatives and enhanced Central transfers. These apart, continuous accretions to NSSF, *albeit* at a decelerated pace, led to a sharp build up of cash balances at the State level, thereby facilitating lower net (and gross) open market borrowings by the States during 2006-07 *vis-à-vis* the previous year.

2.108 The net allocation (provisional) under the market borrowing programme for the State Governments for 2006-07 was placed at Rs.17,242 crore. Taking into account additional allocations amounting to Rs.2,803 crore and repayments of Rs.6,551 crore during the year, the gross allocation amounted to Rs.26,597 crore as compared with the actual gross borrowings of Rs.21,729 crore in the previous year. The gross borrowings of the State Governments during the year amounted to Rs.20,825 crore (raised exclusively through auction route) as compared with Rs.21,729 crore (Rs.8,723 crore through auction route and Rs.11,186 crore through tap issuance) in the previous year. In the auctions of State Government market loans during the year, the spreads of the cut-off yields generally remained lower than 50 basis points.

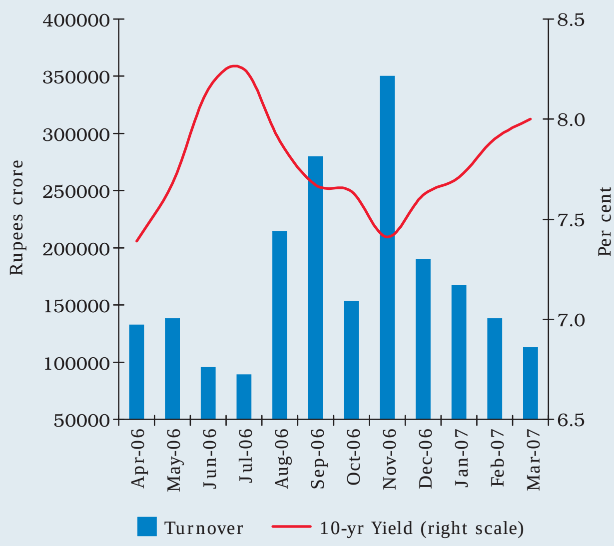
2.109 During 2006-07, the weighted average yield of the securities issued by the State Governments was at 8.10 per cent as compared with 7.63 per cent during the previous year. The cut-off yield ranged between 7.65 and 8.66 per cent during the same period. All the issues during the fiscal were of 10-year maturity. Six States did not enter the market during the year.

2.110 On a review of the State-wise limits of Normal WMA, it was decided to keep these limits unchanged for 2007-08. Accordingly, the aggregate Normal WMA limit was retained at Rs.9,875 crore for 2007-08.

Secondary Market Transactions in Government Securities

2.111 The volume of secondary market transactions increased marginally to Rs.2,64,868 crore (21 per cent of which were outright and the remaining on account of repos) in March 2007 from Rs.2,40,478 crore (19.1 per cent of which were outright and the rest on account of repos) in March 2006. An inverse relationship was evident between the volume of outright transactions and 10-year month-end yield. Turnover in government securities was lowest in July 2006 when the yield was at the peak (Chart II.14). Turnover during March 2007 (calculated as twice the outright transactions and four times the repos) was higher at Rs.9,46,608 crore as against Rs.8,70,109 crore during March 2006. Five most traded securities in NDS accounted for around 57 per cent of total transactions during March 2007, reflecting skewed distribution of liquidity across securities.

Chart II.14: Government Securities Turnover and Yield Curve



Yield Movement and Yield Curve

2.112 The market borrowing programme of the Central Government during 2006-07 was higher than that in the previous year. Furthermore, oil price induced inflationary pressures and upturn in the international interest rate cycle resulted in hardening of yields *vis-a-vis* the previous year.

2.113 The secondary market yields during 2006-07 remained higher than those in the previous year. From a level of 7.52 per cent at end-March 2006, secondary market yields exhibited a sharp rise and moved upwards thereafter up to mid-July 2006, reflecting a variety of factors such as expectations of monetary policy tightening following the US and other economies, high and volatile crude oil prices, apprehension over domestic fuel price hike, devolvement at auction held on July 11, 2006 on the primary dealers and hike in the reverse repo and repo rates by 25 basis points effective June 9, 2006. The 10-year yield peaked at 8.40 per cent on July 11, 2006. Yields eased thereafter on account of rally in US Treasuries following the pause in the US Federal Funds rate hikes and decline in global crude oil prices since August 2006. The announcement of issuance calendar for the second half of the fiscal, which was as per the market expectation, also helped the yields to ease further. Yields started increasing from the first week of December 2006 reflecting, *inter alia*, CRR hikes (in December 2006 February and March 2007) in the context of inflationary pressures, promulgation of SLR Ordinance and tightening of liquidity conditions following advance tax outflows in December 2006 and March 2007. The yields finally closed at 7.97 per cent at end-March 2007.

2.114 The announcement of CRR hike on March 30, 2007 pushed up the yields to 8.19 per cent by April 3, 2007. Volatility was witnessed in yields during April and May 2007 due to changes in the liquidity conditions. As on May 24, 2007 the yield was at 8.19 per cent.

2.115 The Reserve Bank's exit from the primary auctions of central government securities and the cessation of Central loans for State Plans necessitating mobilisation of resources by the States from the market warranted not only improved liquidity but also newer instruments for managing market risks for a smooth transition to the new environment. Against this backdrop, the steps taken by the Reserve Bank towards deepening and widening of the government securities market through measures such as emphasis on passive consolidation, phased introduction of short-selling and 'When Issued' market in government securities and allowing diversification of activities by the existing participants are expected to enhance liquidity and facilitate efficient price discovery for the smooth conduct of debt management operations. As a result of various market development measures, the combined market borrowing programme for 2006-07, though larger than that in 2005-06, was completed smoothly.

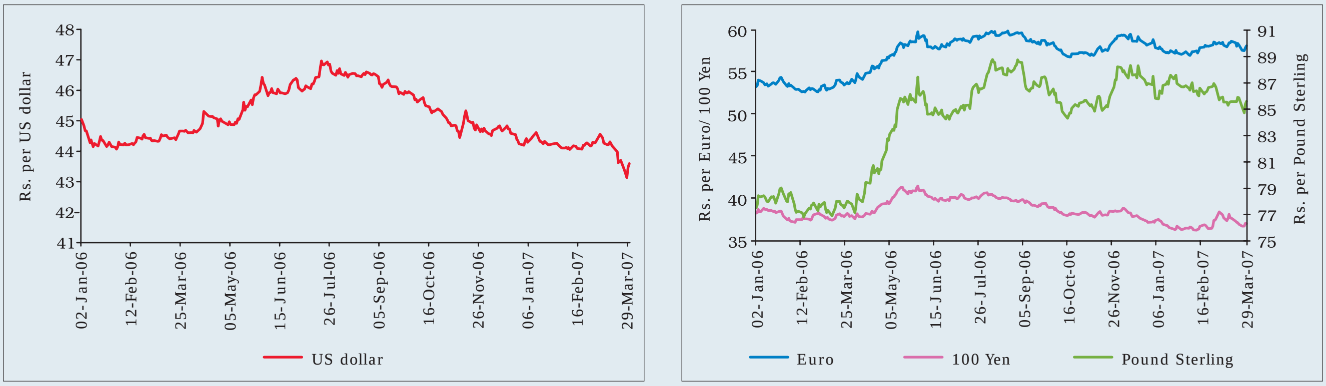
Foreign Exchange Market

2.116 The foreign exchange market, in general, exhibited orderly conditions with the Indian rupee moving two-way *vis-à-vis* the US dollar during 2005-06, despite pressures from the hike in oil prices and IMD redemptions. During 2006-07, the rupee moved in a range of Rs.43.14 – 46.97 per US dollar in response to switches in capital flows, movement of oil prices and liquidity conditions in the market. During May-July 2006, the rupee came under pressure due to heavy sales by foreign institutional investors (FIIs) in the equity market coupled with interest rate tightening by the major central banks. The continuous hike in oil prices as a result of geo-political risks in the Middle East region also put downward pressure on the rupee. The rupee started recovering from the last week of July 2006 due to easing of oil prices. The rupee continued to gain strength against the US dollar till mid-November 2006 and reached the level of Rs.44.45 per US dollar on November 10, 2006 tracking the movement of yen/dollar rate, moderating oil prices, FII inflows and buoyant corporate performance. However, heavy dollar demand by corporates and banks during the second week of November led to a sharp depreciation of rupee *vis-à-vis* the US dollar. The rupee quickly began to appreciate from November 16, 2006 due to heavy capital inflows and tight liquidity conditions in the market. The rupee stood at Rs.43.60 per US dollar on March 30, 2007, at which level it appreciated by 2.3 per cent over its level on March 31, 2006. During the same period, the rupee experienced a depreciation of 9.1 per cent against the Pound sterling, 6.8 per cent against the Euro and an appreciation of 2.7 per cent against the Japanese yen.

2.117 During 2007-08 so far (up to May 22, 2007), the rupee appreciated mainly due to strong capital inflows. The rupee at the level of Rs.40.64 per US dollar as on May 22, 2007 experienced an appreciation of 7.3 per cent over its level at end-March 2007. Over the same period, the rupee appreciated by 6.2 per cent, 6.8 per cent and 10.6 per cent against the euro, pound sterling and Japanese yen, respectively (Chart II.15).

2.118 The forward rate remained in premium throughout the year 2006-07. The forward premia declined in tandem with narrowing of interest rate differentials, following monetary tightening in the US during April-May 2006. However, it started increasing from the second week of June 2006 on account of rise in interest rate differentials due to increase in domestic interest rates. Tight liquidity conditions also resulted in increase in forward premia. The average 3-month premia rose from 0.73 per cent in June 2006 to 4.51 per cent in March 2007 (Chart II.16) and further to 6.91 per cent in April 2007.

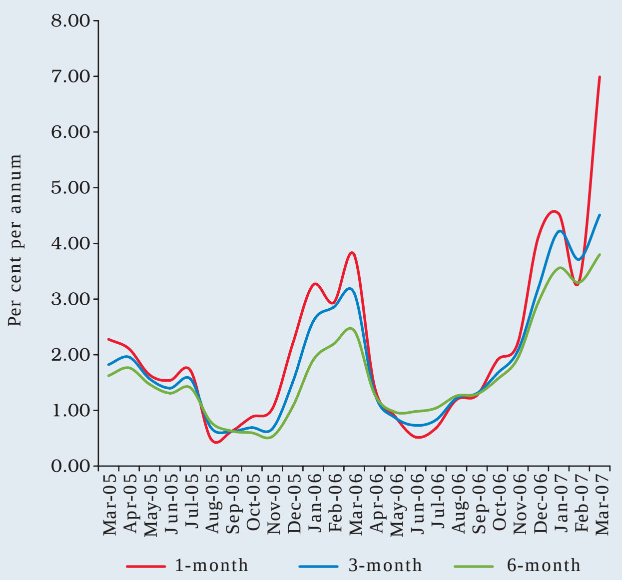
Chart II.15: Rupee *vis-à-vis* Major Currencies



Capital Market

2.119 Resources mobilised through public issues, private placements and Euro issues were higher during 2006-07 than those in the last year. Continuing the upward trend of 2005-06, the stock markets in India firmed up further during 2006-07 with the benchmark BSE Sensex closing at an all-time high of 14652.09 on February 8, 2007. However, share prices witnessed a correction thereafter on account of sell-off in global equity markets following reports of crisis in the US sub-prime mortgage lending industry coupled with an unexpected drop in US February retail sales, the rise in international crude oil prices, net sales by FIIs in March 2007 in the Indian equity market and decline in other international equity markets.

Chart II.16: Movement in Forward Premia



Primary Market

2.120 During 2006-07, the primary market witnessed buoyant conditions. Resource mobilisation through public issues was higher at Rs.32,382 crore (through 119 issues) during 2006-07 as compared with Rs.26,940 crore (through 138 issues) during the previous year (Table 2.37). All the public issues, except one, were by private sector companies. Further, out of 119 public issues, 116 were in the form of equity and three in debt.

2.121 Resource mobilisation through the private placement aggregated Rs.1,03,169 crore during April-December 2006, which was 50.8 per cent higher than that in the corresponding period of 2005. The public sector entities accounted for 42.0 per cent of total resource mobilisation through private placement during April-December 2006 as compared with 56.9 per cent in the corresponding period of 2005 (Table 2.37). Resources mobilised by financial intermediaries (both public and private sector) increased by 63.3 per cent to Rs.71,621 crore during April-December 2006 from Rs.43,868 crore in the corresponding period of the last year.

2.122 Resource mobilisation through Euro issues by way of American Depository Receipts (ADRs) and Global Depository Receipts (GDRs) increased by 49.8 per cent during 2006-07. There were 40 Euro issues during 2006-07 amounting to Rs.17,005 crore as compared with 48 issues aggregating Rs.11,352 crore during 2005-06 (Table 2.37).

2.123 Resource mobilisation by mutual funds (net of redemption) increased sharply by 78.1 per cent during 2006-07 to Rs.93,985 crore. UTI Mutual Fund witnessed higher net inflows of Rs.7,326 crore during 2006-07 than Rs.3,424 crore during the previous year. Public sector mutual funds and private sector mutual

Table 2.37: Mobilisation of Resources through the Primary Market*

(Amount in Rupees crore)

Item	2004-05		2005-06		2006-07#	
	No. of Issues	Amount	No. of Issues	Amount	No. of Issues	Amount
1	2	3	4	5	6	7
A. Public Issues @ (Prospectus and Rights)	**59**	**21,892**	**138**	**26,940**	**119**	**32,382**
I. Public Sector	5	8,410	7	5,786	1	782
II. Private Sector	54	13,482	131	21,154	118	31,600
B. Private Placement	**910**	**83,405**	**1,112**	**96,369**	**1,195**	**1,03,169**
I. Public Sector	193	47,611	168	55,164	84	43,373
II. Private Sector	717	35,794	944	41,205	1,111	59,796
C. Euro Issues@@	**12**	**2,730**	**48**	**11,352**	**40**	**17,005**

* : Including both debt and equity. # : For 'Private Placement', data pertain to April-December.
@ : Excluding offer for sale. @@ : Excluding FCCBs
Note : Estimates are based on information gathered from arrangers, FIs and SEBI.

funds recorded net inflows of Rs.7,621 crore and Rs.79,038 crore, respectively, during 2006-07, which were significantly higher than those in the previous year (Table 2.38). Scheme-wise, 5.3 per cent of the net mobilisation of funds was under liquid/money market oriented schemes during 2006-07 (as compared with 8.0 per cent during the previous year) and 63.9 per cent under debt oriented schemes (26.5 per cent during the previous year). Funds mobilised under equity-linked savings schemes, on the other hand, accounted for 4.7 per cent of net mobilisation of funds as compared with 6.8 per cent during the previous year. During 2006-07, there was a net outflow of 1.0 per cent under Gilt oriented schemes as compared with net outflow of 3.0 per cent during the previous year.

Secondary Market

2.124 The stock markets remained firm till May 10, 2006, when both the BSE Sensex and S&P CNX Nifty closed at all-time high levels of 12612.38 and 3754.25, respectively, mainly on account of net FII investments on the back of strong macroeconomic fundamentals, robust corporate earnings, firm trend in international equity markets and rise in metal prices. However, the markets witnessed a sharp correction beginning May 11, 2006 mainly due to net heavy sales by FIIs caused by a fear of rise in global interest rates, sharp fall in base metal prices at London Metal Exchange, rise in global crude oil prices and fear of higher domestic inflation. The BSE Sensex slipped to 8929.44 by June 14, 2006, recording a decline of 20.8 per cent over end-March 2006. Stock markets, however, recovered thereafter on fresh buying by FIIs and mutual funds, robust Q2 and Q3 corporate results of major companies, upward trend in the international equity markets, appreciation of rupee against US dollar, near normal monsoon, decline in global crude oil prices, US Federal Reserve's decision to keep interest rates unchanged, rise in metal prices on London Metal Exchange and other sector and stock specific news. The BSE Sensex reached new all-time high on February 8, 2007 to close at 14652.09. However, between February 9, 2007 and end-March 2007, the key indices witnessed a downward trend on concerns over rising domestic inflation, nervousness across international equity markets, reports of crisis in US sub-prime mortgage lending segment, rise in international crude oil prices and net sales by FIIs in the Indian equity market. The BSE Sensex closed at 13072.10 on March 30, 2007, registering an increase of 1792 points or 15.9 per cent over end-March 2006. During the year 2006-07 on an average basis, it increased by 48.3 per cent over the previous year.

Table 2.38: Net Resource Mobilisation by Mutual Funds

(Rupees crore)

Category	2004-05	2005-06	2006-07
1	2	3	4
I. UTI Mutual Fund	-2,722	3,424	7,326
II. Private Sector	7,599	42,977	79,038
III. Public Sector	-2,677	6,379	7,621
Total (I+II+III)	**2,200**	**52,780**	**93,985**

Source : Securities and Exchange Board of India.

The BSE 500 and BSE Mid-cap during 2006-07 increased by 9.7 per cent and 0.66 per cent, respectively, while the BSE Small-cap declined by 1.9 per cent.

2.125 During 2007-08 so far (up to May 21, 2007), the domestic stock markets remained firm with intermittent corrections. Both the BSE Sensex and S&P CNX Nifty closed higher at 14418.60 and 4260.90 on May 21, 2007, registering gains of 10.3 per cent and 11.5 per cent, respectively, over their level at end-March 2007. Robust Q4 corporate results, strong macroeconomic fundamentals, decline in domestic annual inflation rate, upward trend in major international equity markets, net purchases by FIIs and mutual funds in the Indian equity market, rise in metal prices on London Metal Exchange and reports of a normal South-West monsoon forecast by the India Meteorological Department (IMD) aided the market sentiment.

2.126 The market capitalisation of the BSE surged to 86.5 per cent of GDP at end-March 2007 from 84.7 per cent of GDP at end-March 2006. The total turnover of BSE and NSE during April-March 2006-07 at Rs.28,99,916 crore recorded an increase of 21.6 per cent over the corresponding period of last year. The price-earning ratio (P/E) of the BSE Sensex at 20.33 at end-March 2007 was lower than 20.92 at end-March 2006 (Table 2.39). The P/E ratio was 21.04 as on May 23, 2007. Volatility declined during 2006-07.

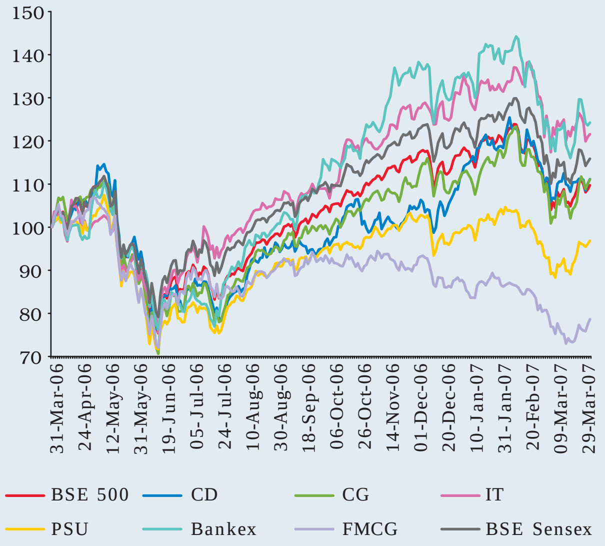
2.127 An analysis of sectoral trends during 2006-07 suggests that buying interest was witnessed in oil and

Table 2.39: Trends in Stock Markets

Item	BSE		NSE	
	April-March			
	2005-06	2006-07	2005-06	2006-07
1	2	3	4	5
1. Average BSE Sensex/ S&P CNX Nifty	8280	12277	2513	3572
2. Volatility (Coefficient of Variation)	16.72	11.09	15.60	10.36
3. Turnover (Rs. crore)	8,16,074	9,56,185	15,69,556	19,44,645
4. Market Capitalisation (end-period) (Rs.crore)	30,22,191	35,45,041	28,13,201	33,67,350
(Per cent of GDP)	84.7	86.5	78.9	82.1
5. P/E ratio (end-period)	20.92	20.33	20.26	18.40

Source: The Bombay Stock Exchange Limited (BSE) and The National Stock Exchange of India Limited (NSE).

Chart II.17: Trends in Sectoral Stock Indices
(Normalised to March 31, 2006=100)



gas, IT, banking, capital goods and consumer durables, while FMCG, healthcare, auto, metal and PSU sector underperformed (Chart II.17). The oil and gas stocks gained primarily on account of rise in global crude oil prices. IT stocks capitalised on the rising demand for IT and IT enabled services abroad coupled with robust corporate performance of IT companies. Rising demand for credit to meet increasing capacity additions, undertaking of infrastructure projects and high growth in personal loans are mainly responsible for boosting banking sector scrips. Capital goods stocks have risen due to pick up in investment activity and strong industrial and infrastructure performance, reflecting the overall growth in the economy. On the other hand, auto stocks lost on account of rise in steel prices and interest rates, while FMCG stocks suffered due to lack of demand on account of rise in prices of consumer goods.

2.128 According to the SEBI data, investments by FIIs in Indian equities during 2006-07 at Rs.25,236 crore were lower than those in 2005-06. However, net investments in debt were at Rs.5,605 crore as against net outflows in the previous year. Investments by mutual funds in equities were lower at Rs.9,024 crore during 2006-07 than those in the corresponding period of the previous year. However, investments by mutual funds in debt were substantially higher at Rs.52,546 crore in 2006-07 than those in 2005-06 (Table 2.40). Net investments by FIIs and mutual funds during 2007-08 (up to May 22, 2007) aggregated Rs.8,785 crore and Rs.2,704 crore, respectively.

Table 2.40: Institutional Investments in the Stock Market

(Rupees crore)

Year	FIIs		Mutual Funds	
	Equity	Debt	Equity	Debt
1	2	3	4	5
2001-02	8,067	685	-3,796	10,959
2002-03	2,528	60	-2,067	12,604
2003-04	39,959	5,805	1,308	22,701
2004-05	44,123	1,759	448	16,987
2005-06	48,542	-7,065	14,302	36,801
2006-07	25,236	5,605	9,024	52,546

Source: Securities and Exchange Board of India.

2.129 The total turnover in the derivatives segment on NSE during 2006-07 remained significantly higher than the turnover in the cash segment (Table 2.41).

Table 2.41: Turnover in Derivatives Market *vis-à-vis* Cash Market in NSE

(Rupees crore)

Year	Derivatives	Cash
1	2	3
2001-02	1,01,926	5,13,167
2002-03	4,39,862	6,17,989
2003-04	21,30,610	10,99,535
2004-05	25,46,982	11,40,071
2005-06	48,24,174	15,69,556
2006-07	73,56,242	19,45,285

Source: The National Stock Exchange of India Ltd (NSE).

V. BANKS AND FINANCIAL INSTITUTIONS

2.130 Robust macroeconomic performance continued to underpin the business operations and financial performance of all types of financial institutions. The total assets of Scheduled Commercial Banks (SCBs) expanded by 18.4 per cent during 2005-06. The ratio of assets of SCBs to GDP at factor cost at current prices increased to 86.9 per cent at end-March 2006 from 82.8 per cent at end-March 2005, suggesting a faster growth of the banking system in relation to the real economy. In the backdrop of robust growth performance in industrial and services sectors during 2005-06, bank credit witnessed a strong expansion for the second year in succession.

2.131 Loans and advances of SCBs registered robust growth of 31.8 per cent during 2005-06 on top of the high growth of 33.2 per cent in 2004-05. The credit growth was broad-based even as credit expansion was more pronounced in respect of the retail sector, particularly housing and loans to commercial real estate. Credit to the priority sector increased by 33.7 per cent in 2005-06 as against 40.3 per cent in the previous year. The agriculture and housing sectors were the major beneficiaries, which together accounted for more than two-third of incremental priority sector lending in 2005-06. Credit to the small scale industries also accelerated. Owing to large credit offtake, the incremental C-D ratio remained generally above 100 per cent during the year. The growth in deposits (17.8 per cent during 2005-06), though higher than the previous year (16.6 per cent), was insufficient to meet the high credit demand forcing the banks to liquidate their holdings of Government securities.

2.132 Net profits of SCBs, as a group, increased by 17.5 per cent as against the decline of 5.9 per cent in the previous year mainly due to a turnaround in non-interest income (Table 2.42). However, net profit as a percentage of total assets was roughly the same as that in the previous year. Gross NPAs at 3.3 per cent and net NPAs at 1.2 per cent at end-March 2006 were significantly lower than those of 5.2 per cent and 2.0 per cent, respectively, at end-March 2005. Banks' capital to risk-weighted assets ratio remained more or less at the previous year's level (12.3 per cent at end-March 2006 as against 12.8 per cent at end-March 2005), despite sharp increase in risk-weighted assets, increase in risk weights on lending to certain sectors and application of capital charge for market risk.

2.133 Operations of urban co-operative banks (UCBs) witnessed moderate growth during 2005-06 facilitated mainly by deposits growth. While loans and advances and investments witnessed a moderate growth, non-SLR investments grew significantly. A sharp growth was also noticed in short-term deployment of funds. The financial performance of scheduled UCBs improved significantly. Asset quality of UCBs improved markedly, both in absolute terms and relative to the loan portfolio (Table 2.43).

2.134 Till the early 1990s, FIs were funded through concessional resources by way of Government guaranteed bonds and advances from Long-Term Operations (LTO) Fund of the Reserve Bank. Currently, FIs can raise their total resources, short-term as well as long-term, such that the total outstanding of such funds at any point of time does not exceed 10 times of their Net Owned Fund (NOF) as per their latest audited balance sheet. Within this overall ceiling, an "umbrella limit" has been fixed for

Table 2.42: Important Parameters of Select Bank Groups

(Per cent)

Bank Group	1996-97	2002-03	2003-04	2004-05	2005-06
1	2	3	4	5	6
Operating Expenses/Total Assets					
Scheduled Commercial Banks	2.9	2.2	2.2	2.1	2.1
Public Sector Banks	2.9	2.3	2.2	2.1	2.1
Old Private Sector Banks	2.5	2.1	2.0	2.0	2.1
New Private Sector Banks	1.9	2.0	2.0	2.1	2.0
Foreign Banks	3.0	2.8	2.8	2.9	2.8
Spread/Total Assets					
Scheduled Commercial Banks	3.2	2.8	2.9	2.8	2.8
Public Sector Banks	3.2	2.9	3.0	2.9	2.9
Old Private Sector Banks	2.9	2.5	2.6	2.7	2.7
New Private Sector Banks	2.9	1.7	2.0	2.2	2.1
Foreign Banks	4.1	3.4	3.6	3.3	3.5
Net Profit/Total Assets					
Scheduled Commercial Banks	0.7	1.0	1.1	0.9	0.9
Public Sector Banks	0.6	1.0	1.1	0.9	0.8
Old Private Sector Banks	0.9	1.2	1.2	0.3	0.6
New Private Sector Banks	1.7	0.9	0.8	1.1	1.0
Foreign Banks	1.2	1.6	1.7	1.3	1.5
Gross NPAs to Gross Advances					
Scheduled Commercial Banks	15.7	8.8	7.2	5.2	3.3
Public Sector Banks	17.8	9.4	7.8	5.5	3.7
Old Private Sector Banks	10.7	8.9	7.6	6.0	4.3
New Private Sector Banks	2.6	7.6	5.0	3.6	1.7
Foreign Banks	4.3	5.3	4.6	2.8	1.9
Net NPAs to Net Advances					
Scheduled Commercial Banks	8.1	4.4	2.9	2.0	1.2
Public Sector Banks	9.2	4.5	3.0	2.1	1.3
Old Private Sector Banks	6.6	5.5	3.8	2.7	1.6
New Private Sector Banks	2.0	4.6	2.4	1.9	0.8
Foreign Banks	1.9	1.8	1.5	0.8	0.8
CRAR					
Scheduled Commercial Banks	10.4	12.7	12.9	12.8	12.3
Public Sector Banks	10.0	12.6	13.2	12.9	12.2
Old Private Sector Banks	11.7	12.8	13.7	12.5	11.7
New Private Sector Banks	15.3	11.3	10.2	12.1	12.6
Foreign Banks	..	15.2	15.0	14.0	13.0

.. : Not Available.

eight institutions, *viz*., IFCI, EXIM bank, SIDBI, IIBI, TFCI, NABARD, and NHB. In terms of the umbrella limit, each of these FIs can raise resources through term money, CP, CDs, inter-corporate deposits (ICDs) and term deposits, equivalent to 100 per cent of its NOF as per its latest audited balance sheet.

2.135 The aggregate umbrella limits of these select FIs for raising resources increased from Rs.16,657 crore as on March 31, 2006 to Rs.19,001 crore as on March 30, 2007. The aggregate outstanding resources raised by these FIs under the umbrella limit increased from Rs.1,204 crore (7.2 per cent of aggregate limit) as on March 31, 2006 to Rs.3,293 crore (17.33 per cent of aggregate limit) as on March 30, 2007. Based on outstanding position as on March 30, 2007, FIs raised bulk of resources through commercial paper (Rs.2,540 crore), followed by certificate of deposits (Rs.664 crore) and term deposits (Rs.90 crore). FIs, active in mobilising resources through these instruments during 2006-07 have been EXIM Bank, NHB and SIDBI. None of the FIs mobilised resources through term money or inter-corporate deposit during the period.

Table 2.43: Urban Co-operative Banks – Select Financial Indicators

Indicator	2004-05	2005-06
1	2	3
Growth in Major Aggregates (Per cent)		
Deposits	-4.7	6.9
Credit	-1.6	5.2
Financial Indicators@ *(as percentage of total assets)*		
Operating Profits	0.8	1.1
Net Profits	0.2	0.5
Spread	1.8	1.9
Gross Non-Performing Assets *(as percentage of advances)*	**23.4**	**19.7**

@ : Relates to Scheduled Urban Co-operative Banks.

2.136 Financial performance of all-India financial institutions (AIFIs) improved significantly during 2005-06 (Table 2.44). Financial assistance sanctioned and disbursed by FIs, including AIFIs, specialised financial institutions and investment institutions, increased by 38.9 per cent and 33.9 per cent, respectively, during 2005-06 as compared with a sharp decline of 45.1 per cent and 37.0 per cent, respectively, during the previous year. Almost all categories of financial institutions witnessed a high growth during 2005-06 as against the varied performance witnessed during 2004-05.

2.137 Capital adequacy ratio of FIs, barring the two loss-making institutions, continued to be significantly higher than the prescribed norms. However, CRAR of IIBI and IFCI eroded further during the year on account of continued financial losses. The higher lending rates accompanied with reduced costs resulted in higher spread for FIs as the net interest income as percentage of total assets increased to 1.8 per cent in 2005-06 from 1.6 per cent in 2004-05. Non-interest income of FIs also registered a significant increase during the year.

Table 2.44: Financial Institutions – Select Performance Indicators

Indicator	2004-05	2005-06
1	2	3
Balance Sheet Indicators *(as percentage total assets)*		
Operating Profits	1.2	1.4
Net Profits	0.8	1.0
Spread	1.6	1.8
Resource flows *(Rupees crore)*		
Sanctions	9,091	11,942
Disbursements	6,279	9,237

Note : 1. Data on balance sheet indicators relate to IFCI, IIBI, TFCI, NABARD, NHB, SIDBI and EXIM Bank.
2. Data on resource flows pertain to IFCI, SIDBI and IIBI.

Table 2.45: Consolidated Balance Sheets of NBFCs

(Amount in Rupees crore)

Item	As at end-March		
	2004	2005	2006
1	2	3	4
Liabilities			
1. Paid up capital	2,327	2,206	1,949
	(7.1)	(6.1)	(5.5)
2. Reserves and Surplus	4,414	4,544	4,838
	(13.5)	(12.6)	(13.6)
3. Public Deposits	4,317	3,926	2,667
	(13.2)	(10.9)	(7.5)
4. Borrowings	20,852	23,044	23,641
	(63.7)	(64.0)	(66.5)
5. Other Liabilities	844	2,283	2,466
	(2.6)	(6.3)	(6.9)
Total Liabilities/Assets	**32,754**	**36,003**	**35,561**
Assets			
1. Investments			
i) SLR Investments	1,707	2,237	1,314
	(5.2)	(6.2)	(3.7)
ii) Non-SLR Investments	2,110	1,720	2,275
	(6.4)	(4.8)	(6.4)
2. Loans and Advances	12,363	12,749	9,199
	(37.7)	(35.4)	(25.9)
3. Hire Purchase Assets	11,649	14,400	19,893
	(35.6)	(40.0)	(55.9)
4. Equipment Leasing Assets	3,036	2,025	1,620
	(9.3)	(5.6)	(4.6)
5. Bill business	436	471	45
	(1.3)	(1.3)	(0.1)
6. Other Assets	1,453	2,401	1,215
	(4.4)	(6.7)	(3.4)

Note : 1. Number of reporting NBFCs declined to 466 in 2006 from 703 in 2005.
2. Figures in parentheses are percentages to total liabilities/ assets.

2.138 Total assets/liabilities of NBFCs (excluding RNBCs), which had increased by 9.9 per cent during 2004-05, declined by 1.2 per cent during 2005-06 (Table 2.45). Borrowings, which represent a major source of funds for NBFCs, increased at a lower rate of 2.6 per cent during 2005-06 as compared with a growth of 10.5 per cent in the previous year. While owned funds (capital and reserves) registered a marginal increase, public deposits declined by 32.1

per cent during 2005-06. On the asset side, loans and advances and hire purchase assets together accounted for more than three-fourth of total assets. While loans and advances declined by 27.8 per cent, hire purchase assets increased by 38.1 per cent during 2005-06. Among NBFC groups, while assets/ liabilities of hire purchase finance companies increased, those of equipment leasing companies, investment and loan companies declined during the year ended March 2006. This broadly reflected the impact of resources raised through deposits and borrowings. Hire purchase finance companies were the largest NBFC group at end-March 2006, followed distantly by equipment leasing companies, investment companies and loan companies.

2.139 Assets of three RNBCs increased by 14.9 per cent during the year ended March 2006. Their assets in the form of fixed deposits with banks and unencumbered approved securities increased sharply, while those in bonds/debentures and other investments increased marginally (Table 2.46). Net owned funds of RNBCs increased by 11.1 per cent during 2005-06.

Table 2.46: Profile of Residuary Non-Banking Companies (RNBCs)

(Rupees crore)

Item	As at end-March		
	2004	2005	2006
1	2	3	4
I. Assets (i to v)	**20,362**	**19,057**	**21,891**
(i) Unencumbered approved securities	5,824	2,037	2,346
(ii) Fixed deposits with banks	2,033	4,859	6,070
(iii) Bonds or debentures or commercial papers*	6,048	9,225	9,577
(iv) Other investments	2,059	1,639	1,658
(v) Other assets	4,398	1,297	2,240
II. Net Owned Funds	**1,002**	**1,065**	**1,183**
III. Total Income (i+ii)	**2,055**	**1,532**	**1,620**
(i) Fund Income	2,055	1,530	1,616
(ii) Fee Income	–	2	3
IV. Total Expenses (i+ii+iii)	**1,813**	**1,396**	**1,439**
(i) Financial Cost	1,368	1,176	1,165
(ii) Operating Cost	129	146	159
(iii) Other cost	316	74	115
V. Provision for Taxation	**32**	**48**	**22**
VI. Operating Profit (PBT)	**242**	**136**	**180**
VII. Net profit (PAT)	**210**	**88**	**158**

* : Of Government companies/public sector banks/public financial institutions/corporations.
– : Nil/Negligible.
Note : 1. PBT – Profit before tax.
2. PAT – Profit after tax.

2.140 Sustained efforts by the Government, the Reserve Bank and by banks themselves have resulted in a competitive, healthy and resilient financial system. The asset quality and soundness parameters of the Indian banking sector, on the whole, are now comparable with global levels. This has been achieved in the backdrop of gradual alignment of prudential norms with best international standards and in an environment of growing competitive pressures.

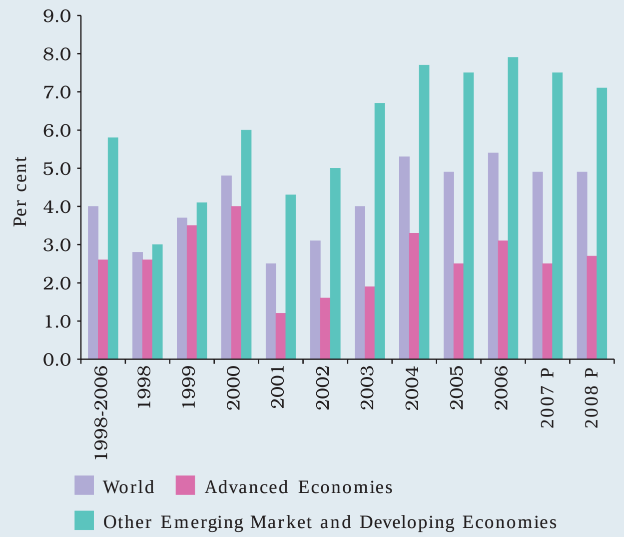
VI. EXTERNAL SECTOR

Global Economic Outlook

2.141 The global economy continued to expand at a robust pace in 2006. As against the growth rate of 4.9 per cent in 2005, the IMF has placed the growth of global economy at 5.4 per cent for 2006 and projected it to moderate to 4.9 per cent during 2007 (Chart II.18). Despite a moderate slowdown in the third quarter, all the major advanced economies including the US, Japan and OECD countries showed a higher growth in the fourth quarter of 2006 before dipping in the first quarter of 2007.

2.142 In the US, real GDP growth (year-on-year basis) in the fourth quarter of 2006 increased to 3.1 per cent from 3.0 per cent in the third quarter (Table 2.47). The acceleration in real GDP growth in the fourth quarter primarily reflected a downturn in imports and acceleration in exports and also

Chart II.18: World Output Growth



P : Projections.

Table 2.47: Country-wise Growth Rates (Year-on-Year basis)

(Per cent)

Country/Region	2005	2006-Q1	2006-Q2	2006-Q3	2006-Q4	2006	2007-Q1	2007 P
1	2	3	4	5	6	7	8	9
Advanced Economies								
Euro area	1.4	2.2	2.8	2.8	3.3	2.7	3.1	2.3
Japan	1.9	3.0	2.1	1.4	2.2	2.2	2.0	2.3
Korea	4.2	6.3	5.1	4.8	4.0	5.0	4.0	4.4
OECD	2.5	3.3	3.3	2.9	3.3	3.0	..	2.5
UK	1.9	2.4	2.8	2.9	3.0	2.7	2.8	2.9
US	3.2	3.7	3.5	3.0	3.1	3.3	2.1	2.2
Emerging Economies								
Argentina	9.2	8.6	7.9	8.7	8.6	8.5	..	7.5
Brazil	2.9	3.4	1.2	3.2	3.8	3.7	..	4.4
China	10.4	10.3	10.9	10.7	10.7	10.7	11.1	10.0
India	**9.2**	**9.3**	**8.9**	**9.2**	**8.6**	**9.2**	**..**	**8.4**
Indonesia	5.7	5.0	5.0	5.9	6.1	5.5	..	6.0
Malaysia	5.2	5.3	6.2	5.8	5.7	5.9	..	5.5
Thailand	4.5	6.1	5.0	4.7	4.2	5.0	..	4.5

P : IMF Projection. .. Not available.
Source : IMF, The Economist, OECD and ECB Bulletin, May 2007.

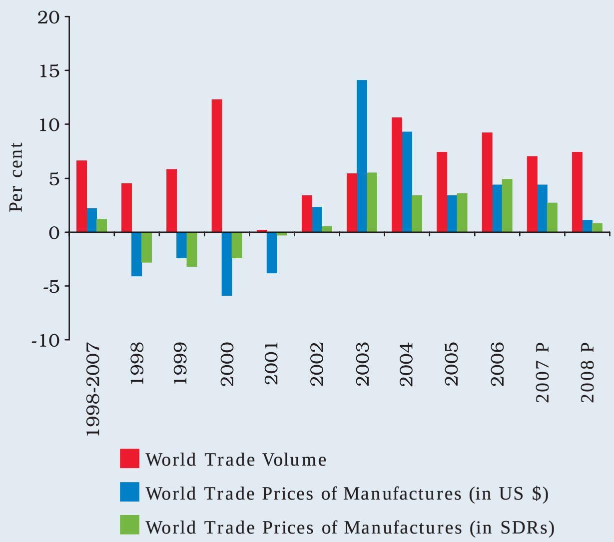
acceleration in private consumption expenditure for non-durable goods. For the year 2006, as a whole, real GDP growth in the US was marginally higher than in 2005. The Japanese economy continued to recover in 2006, driven by strong exports and steady domestic demand. In China, GDP growth continued to remain robust as both domestic and external demand expanded strongly. The rate of increase in fixed asset investment remained high, although it slowed somewhat on account of tightening measures introduced in the mid-2006.

2.143 Growth prospects of global economy remain subject to certain downside risks. However, the risks to growth outlook are less threatening than were expected earlier. Although, overall risk perceptions about satisfactory global growth are modest, certain uncertainties and concerns are still raised in terms of revival of inflation pressures as output gaps continue to narrow, oil price rise, risk of sharper slowdown in US economy in case the housing sector continues to deteriorate, financial market volatility and possible disorderly adjustment of global imbalances.

2.144 According to the IMF, the world trade volume increased by 9.2 per cent in 2006 (7.4 per cent in 2005) but its growth is projected to decelerate to 7.0 per cent in 2007. Growth in world trade prices of manufactures accelerated from 3.4 per cent in 2005 to 4.4 per cent in 2006 (Chart II.19). According to the IMF, the private net capital flows to emerging and developing countries recorded a marginal fall from US$ 257.2 billion in 2005 to US$ 255.8 billion in 2006; capital flows are projected to fall further to US$ 252.7 billion in 2007 mainly on account of projected decline in private portfolio flows.

2.145 International financial markets experienced a pullback in prices after a brief period of turbulence in May-June 2006. There has been a significant recovery of prices across a wide spectrum of assets since end-June. Equity markets have rallied with prices in major

Chart II.19: Growth in World Trade Volume and Prices



P : Projections.

advanced and emerging economies exceeding the cyclical highs reached in May 2006. In most of the emerging economies, financial markets remained firm towards the end of 2006. Despite a bout of financial volatility in February-March 2007 and rising concerns about the US sub-prime mortgage market, equity markets remain close to all-time highs. Furthermore, real long term bond yields have remained below long-term trends, and risks spreads have narrowed in most markets.

2.146 During 2006, the average petroleum spot prices rose by 20.5 per cent. After reaching a record high of US$ 78.4 a barrel in July 2006, the average petroleum spot price fell sharply to around US$ 58–US$ 61 a barrel during October-December 2006 which largely reflected some easing of tensions in the Middle East, improved supply-demand balance in oil markets, and favorable weather conditions in the second half of 2006. In early 2007, oil prices witnessed a further brief dip, falling to just over US$50 a barrel, before rebounding in late March 2007 to almost US$65 a barrel. Oil prices recovered with a strengthening of demand due to colder weather, further OPEC production cuts, and declining inventories in key OECD economies. Renewed geopolitical tensions in the Middle East also pushed prices up at end-March. The International Energy Agency in its Report released on May 11, 2007, has placed the global oil demand at 85.7 million barrel per day (mb/d) for 2007, up from 84.2 mb/d in 2006.

India's Merchandise Trade

2.147 India's merchandise trade – both exports and imports – maintained its high growth momentum during 2005-06. According to DGCI&S, exports registered a growth of 23 per cent in 2005-06 compared with 31 per cent in the preceding year. The growth in exports was attributable mainly to the favourable global demand conditions, increasing competitiveness of India's manufactured products, firming up of commodity prices and supportive domestic policy measures. In 2005, India was one of the fastest growing exporting countries in the world (Table 2.48). Merchandise imports also registered a growth of 29 per cent in 2005-06 on top of 43 per cent a year ago due to sharp increase in oil imports in the wake of rise in international crude oil prices. With the imports far outstripping exports, the trade deficit widened to US $ 40.3 billion in 2005-06 from US $ 28.0 billion a year ago.

2.148 Export growth during 2005-06 was broad-based across major product groups. Primary product exports recorded a growth of 21 per cent during 2005-06. Manufactured exports maintained the growth momentum. Export of textiles and textile products posted an accelerated growth in a quota free environment. Technology intensive items such as transport equipments and machinery and instruments also posted a strong growth. During 2005-06, petroleum products exports rose sharply by 65 per cent and emerged as one of the major export items.

Table 2.48: Global Merchandise Export Growth

(Per cent)

Country/Region	January-December	
	2005	2006
1	2	3
World	13.9	15.6
Industrial Countries	8.5	12.6
United States	10.8	14.5
Japan	5.2	9.2
Germany	7.3	15.1
Developing Countries	21.9	19.6
China	28.4	27.2
India	29.6	21.5
Korea	12.0	14.4
Indonesia	18.2	16.5
Malayasia	12.0	14.0
Singapore	15.6	18.4
Thailand	14.5	18.7

Sources: 1. International Financial Statistics, IMF.
2. DGCI&S for India.

2.149 On the imports front, oil imports surged by 47 per cent during 2005-06 (April-March) mainly due to increase in international crude oil prices. The average crude oil price (Indian basket) at US $ 55.3 per barrel was higher by 42.2 per cent during 2005-06 compared with a year ago. In volume terms, the POL imports registered a lower growth of 4.2 per cent compared with 5.5 per cent a year ago.

2.150 Non-oil imports decelerated during 2005-06 (April-March) mainly due to deceleration in the import of gold and silver and pearl, precious and semi-precious stones. Imports of 'mainly' industrial inputs (non-oil imports net of gold and silver, bulk consumption goods, manufactured fertilisers and professional imports), however, posted a strong growth of 34.7 per cent on top of 41.4 per cent a year ago. The growth of capital goods imports (mainly comprising metals, machine tools, machinery and electronic goods) at 49.9 per cent during 2005-06 (37.5 per cent a year ago) reflected the continued investment demand in an environment of buoyant industrial activity and capacity building in India's manufacturing.

Table 2.49: India's Foreign Trade

(US $ million)

Item	April-March			
	2003-04	2004-05	2005-06	2006-07
1	2	3	4	5
Exports	**63,843 (21.1)**	**83,536 (30.8)**	**103,101 (23.4)**	**124,598 (20.9)**
Oil	3,568 (38.5)	6989 (95.9)	11526 (64.9)	..
Non-Oil	60,274 (20.2)	76,547 (27.0)	91,575 (19.6)	..
Imports	**78,149 (27.3)**	**111,517 (42.7)**	**143,430 (28.6)**	**181,343 (26.4)**
Oil	20,569 (16.6)	29,844 (45.1)	43,963 (47.3)	57,308 (30.4)
Non-Oil	57,580 (31.5)	81,673 (41.8)	99,466 (21.8)	124,035 (24.7)
Trade Balance	**-14,307**	**-27,981**	**-40,329**	**-56,745**
Oil	-17,001	-22,855	-32,437	..
Non-Oil	2,694	-5,127	-7,892	..

.. : Not available.
Note : Figures in parentheses are year-on-year growth rates.
Source: DGCI&S.

2.151 Destination-wise, the US continued to be the principal export destination, accounting for 16.8 per cent of India's total exports in 2005-06 (April-March), followed by UAE (8.3 per cent), China (6.6 per cent), Singapore (5.3 per cent) and UK (4.9 per cent).

2.152 During 2006-07, merchandise exports registered a growth of 20.9 per cent (Table 2.49). Imports posted a growth of 26.4 per cent, with non-oil imports contributing 64.9 per cent of increase in imports. After registering a slowdown at the beginning of the fiscal year, non-oil imports picked up from September 2006. Oil imports, on the other hand, moderated due to softening of oil prices.

2.153 Trade deficit during 2006-07 widened to US $ 56.7 billion from US $ 40.3 billion a year ago. The non-oil trade deficit increased by 52.6 per cent to US $ 14.2 billion during April-January 2006-07, while the deficit on the oil account widened by 23.2 per cent to US $ 32.3 billion during the same period.

2.154 Commodity-wise data for 2006-07 (April-January) displayed marked dissimilarities in export performance (Table 2.50). While engineering goods and petroleum product posted a high growth, export growth of other major items like primary products, chemicals and related products, textiles and gems and jewellery moderated. Exports of petroleum products posted a growth of 62.2 per cent in US dollar terms, accounting for 30.2 per cent of the increase in total exports. Exports of agriculture and allied products moderated during April-January 2006-07, even as exports of tea, tobacco, spices and sugar and molasses posted a high growth. The growth of manufactured product exports decelerated to 16.1 per cent during the same period from 22.9 per cent a year ago. Among the major items in the manufactured goods category, exports of engineering goods (such as machinery and instruments, manufactures of metals, iron and steel and electronics) registered a strong growth, while those of gems and jewellery, chemicals, leather, textiles and handicrafts declined or decelerated.

Table 2.50: India's Principal Exports

Item	April-March (US $ million)		April-March Growth rate (Per cent)		April-January (US $ million)		April-January Growth rate (Per cent)	
	2004-05	2005-06	2004-05	2005-06	2005-06	2006-07	2005-06	2006-07
1	2	3	4	5	6	7	8	9
Primary Products	13553	16377	36.9	20.8	12761	14959	29.4	17.2
Agricultural & Allied Products	8475	10213	12.5	20.5	8026	9598	22.3	19.6
Ores & Minerals	5079	6164	114.4	21.4	4735	5361	43.3	13.2
Manufactured Goods	60731	72230	25.2	18.9	58041	67372	22.9	16.1
Leather & Manufactures	2422	2691	12.0	11.1	2203	2401	12.1	9.0
Chemicals & Related Products	12444	14757	31.7	18.6	11726	13427	20.4	14.5
Engineering Goods	17348	21463	39.8	23.7	17175	23468	30.5	36.6
Textiles and Textile Products	13555	16350	6.0	20.6	13145	13965	23.0	6.2
Gems & Jewellery	13762	15529	30.2	12.8	12593	12850	17.5	2.0
Handicrafts	377	458	-24.5	21.3	385	306	22.3	-20.7
Carpets	636	848	8.7	33.2	694	742	34.9	6.8
Petroleum Products	6989	11526	95.9	64.9	9452	15331	66.8	62.2
Total Exports	**83536**	**103101**	**30.8**	**23.4**	**82396**	**101846**	**27.7**	**23.6**

Source: DGCI&S.

Table 2.51: Major Destinations of India's Exports

Country	April-March (US $ million)		April-March Growth rate (Per cent)		April-January (US $ million)		April-January Growth rate (Per cent)	
	2004-05	2005-06	2004-05	2005-06	2005-06	2006-07	2005-06	2006-07
1	2	3	4	5	6	7	8	9
U S A	13766	17353	19.8	26.1	14108	15486	27.2	9.8
U A E	7348	8592	43.4	16.9	6847	9873	20.5	44.2
U K	3681	5059	21.8	37.4	4164	4547	46.7	9.2
Hong Kong	3692	4471	13.2	21.1	3584	3676	25.9	2.6
Germany	2826	3586	11.1	26.9	2842	3164	30.4	11.3
China	5616	6759	90.0	20.4	5177	6438	45.6	24.3
Japan	2128	2481	24.5	16.6	1999	2266	24.9	13.3
Belgium	2510	2871	39.0	14.4	2294	2803	17.9	22.2
Singapore	4001	5425	88.3	35.6	4382	4766	45.7	8.8
Italy	2286	2519	32.2	10.2	1967	2910	12.7	48.0
Bangladesh	1631	1664	-6.3	2.0	1354	1310	6.5	-3.2
Sri Lanka	1413	2025	7.1	43.3	1648	1712	48.1	3.9
France	1681	2080	31.2	23.7	1665	1707	25.5	2.5

Source: DGCI&S.

2.155 During 2006-07 (April-January), exports to UAE posted a growth of 44.2 per cent, thereby raising its share in total exports to 9.7 per cent. India's exports to the US, China, Singapore and the EU decelerated, while those to Eastern Europe and Africa, showed a robust growth (Table 2.51).

2.156 During 2006-07 (April-January), imports of mainly exports related items, particularly, pearls, precious and semi-precious stones declined, while those of gold and silver, capital goods and POL maintained the growth momentum. Imports of capital goods posted a growth of 32.4 per cent during April-January 2006, reflecting the continued strong domestic industrial demand (Table 2.52).

Balance of Payments

Current Account

2.157 The sustained rise in invisibles surplus during the period April-December 2006 continued to moderate the impact of growing merchandise trade deficit (Table 2.53 and Chart II.20). Invisible receipts rose by 29.9 per cent during April-December 2006 mainly due to a significant steady growth in software

Table 2.52: India's Principal Imports

Commodity	April-March (US $ million)		April-March Growth rate (Per cent)		April-January (US $ million)		April-January Growth rate (Per cent)	
	2004-05	2005-06	2004-05	2005-06	2005-06	2006-07	2005-06	2006-07
1	2	3	4	5	6	7	8	9
Petroleum, Petroleum Products & Related Material	29844	43963	45.1	47.3	35647	47609	48.3	33.6
Edible Oil	2465	2024	-3.0	-17.9	1627	1798	18.5	10.5
Non-Ferrous Metals	1310	1844	38.1	40.8	1519	2142	43.2	41.0
Metalliferrous Ores & Metal Scrap	2468	3882	90.5	57.3	3126	6815	61.7	118.0
Iron & Steel	2670	4572	77.3	71.3	3844	5046	88.6	31.3
Capital Goods	25135	37666	37.5	49.9	25900	34299	39.9	32.4
Pearls, Precious & Semi-Precious Stones	9423	9134	32.2	-3.1	8028	5966	10.9	-25.7
Textile Yarn, Fabric, *etc.*	1571	2051	24.9	30.5	1748	1815	37.7	3.8
Chemicals, Organic & Inorganic	5700	6984	41.4	22.5	5783	6444	30.0	11.4
Gold & Silver	11150	11318	62.6	1.5	9189	12344	2.9	34.3
Total Imports	**111517**	**143430**	**42.7**	**33.8**	**117872**	**148291**	**35.1**	**25.8**

Source: DGCI&S.

Table 2.53: India's Current Account

(US $ million)

Item					April-December	
	2002-03	2003-04	2004-05	2005-06 PR	2005 PR	2006 P
1	2	3	4	5	6	7
I. Merchandise Balance	-10,690	-13,718	-33,702	-51,841	-40,089	-52,302
II. Invisibles Balance (a+b+c)	17,035	27,801	31,232	42,655	28,147	40,481
a) Services	3,643	10,144	15,426	23,881	16,416	25,064
i) Travel	-29	1,435	1,417	1,389	788	981
ii) Transportation	-736	879	144	-1,550	-1087	-450
iii) Insurance	19	56	148	22	100	365
iv) G.N.I.E.	65	28	-10	-197	-107	-97
v) Miscellaneous	4,324	7,746	13,727	24,217	16,722	24,265
of which:						
Software Services	8,863	12,324	16,900	22,262	15,597	20,143
b) Transfers	16,838	22,162	20,785	24,284	16,937	18,943
i) Official	451	554	260	182	63	115
ii) Private	16,387	21,608	20,525	24,102	16,874	18,828
c) Income	-3,446	-4,505	-4,979	-5,510	-5,206	-3,526
i) Investment Income	-3,544	-3,757	-4,095	-4,921	-4,741	-3,100
ii) Compensation of Employees	98	-748	-884	-589	-465	-426
Total Current Account	**6,345**	**14,083**	**-2,470**	**-9,186**	**-11,942**	**-11,821**

G.N.I.E : Government not included elsewhere. P : Provisional. PR : Partially Revised.

exports, other professional and business services, travel and transportation, besides remittances from overseas Indians. Net surplus under software services during April-December 2006 (US $ 20.1 billion) increased by 29.1 per cent over that during April-December 2005. Business services during April-December 2006 at US $ 4.0 billion (US $ 1.5 billion in the corresponding period of the previous year) were mainly driven by trade related services, business and management consultancy services, architectural, engineering and other technical services, and services relating to maintenance of offices. These reflect the underlying momentum in trade of professional and technology related services. Private transfers (net), comprising primarily remittances from Indians working overseas, were higher at US $ 18.8 billion in April-December 2006 as compared with US $ 16.9 billion in April-December 2005. Investment income balance continued to record a deficit as payments associated with servicing of India's external liabilities were in excess of earnings on India's external assets.

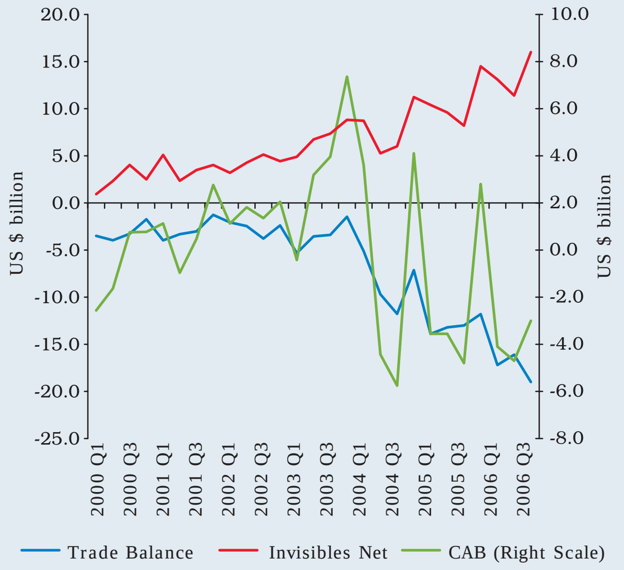
Chart II.20: Movement of Invisibles Surplus

2.158 On balance, the net surplus under invisibles (services, transfers and income taken together) increased from US $ 28.1 billion during April-December 2005 to US $ 40.5 billion during April-December 2006 (Chart II.21). Due to a higher net invisibles surplus, current account deficit at US $ 11.8 billion remained broadly the same as in the corresponding period of the previous year (US $ 11.9 billion).

Capital Account

2.159 Capital inflows to India have remained large during 2006-07 (April-December). The capital inflows under FDI, external commercial borrowings, NRI

Chart II.21: Current Account Balance



deposits and portfolio investment remained steady resulting in higher net capital inflows (US $ 27.3 billion) as compared with the previous year (Table 2.54).

2.160 Foreign investment inflows continued to be robust in 2006-07 (April-February). FDI inflows into India (including equity capital of unincorporated entities, reinvested earnings and inter-corporate debt transactions between the related entities) at US $ 17.1 billion during April-February were little less than three times of those during the corresponding period of the previous year (Table 2.55). The pick-up in FDI inflows reflects growing investor interest in the Indian economy on the back of strong fundamentals as well as the impact of policy initiatives aimed at rationalising and liberalising the FDI policy and simplifying the procedures. During 2006, FDI up to 100 per cent through Reserve Bank's automatic route was permitted for a large number of new sectors, *viz.,* greenfield airport projects, laying of Natural Gas/ LNG pipelines, cash and carry wholesale trading, export trading and manufacture of industrial explosives and hazardous chemicals. FDI caps under the automatic route were enhanced to 100 per cent for coal and lignite mining for captive consumption and setting up infrastructure relating to marketing in petroleum and natural gas sector. The Government has decided to allow FDI up to 51 per cent, with prior approval, in retail trade of 'single brand' products and enhance the ceiling on FDI in the up-linking of TV channels, subject to certain conditions. FDI was channelled mainly into manufacturing, banking, financial, computer and business services and

Table 2.54: Capital Flows (Net)

(US $ billion)

Item	April-March		April-December	
	2004-05	2005-06 PR	2005 PR	2006 P
1	2	3	4	5
Foreign Direct Investment	3.7	4.7	3.3	5.8
Portfolio Investment	9.3	12.5	8.2	5.2
External Assistance	1.9	1.7	1.1	0.9
External Commercial Borrowings	5.2	2.7	-1.2	9.1
NRI Deposits	-1.0	2.8	1.1	3.2
Other Banking Capital	4.9	-1.4	0.7	-2.1
Short Term Credits	3.8	1.7	1.7	1.3
Other Capital	0.2	-1.3	-1.5	3.9
Total	**28.0**	**23.4**	**13.4**	**27.3**

P : Provisional. PR : Partially Revised.

Table 2.55: Foreign Investment Flows by Category

(US $ million)

Item	2004-05	2005-06 P	April - February 2005-06	April - February 2006-07P
1	2	3	4	5
A. Direct Investment (I+II+III)	**6051**	**7722**	**5948**	**17142**
1. Equity (a+b+c+d+e)	3778	5820	4510	15343
a. Government (SIA/FIPB)	1062	1126	1030	2096
b. RBI	1258	2233	1559	6737
c. NRI	–	–	–	–
d. Acquisition of Shares*	930	2181	1711	6149
e. Equity capital of Unincorporated bodies #	528	280	210	361
II. Re-invested earnings $	1904	1676	1257	1730
III. Other Capital $$	369	226	181	69
B. Portfolio Investment (a+b+c)	**9315**	**12492**	**11527**	**9409**
a. GDRs/ADRs ##	613	2552	2270	3751
b. FIIs**	8686	9926	9243	5658
c. Offshore Funds and Others	16	14	14	–
C. Total (A+B)	**15366**	**20214**	**17475**	**26551**

P : Provisional.

* : Relates to acquisition of shares of Indian Companies by non-residents under Section 6 of the FEMA, 1999. Data on such acquisitions have been included as part of FDI since January 1996.

\# : Figures for equity capital of unincorporated bodies for 2005-06 and 2006-07 are estimates.

$: Data for 2005-06 and 2006-07 are estimated as average of previous two years.

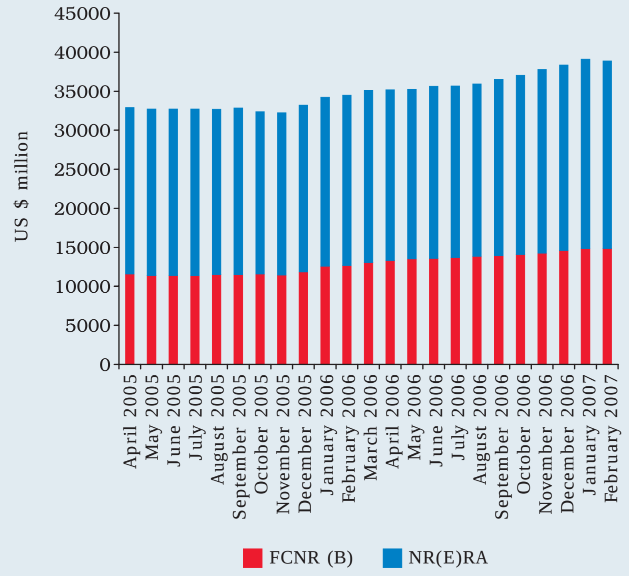
$$: Data pertain to inter-company debt transaction of FDI entities.

\## : Represents the amount raised by Indian Corporates through Global Depository Receipts (GDRs) and American Depository Receipts (ADRs).

** : Represents inflow of funds (net) by Foreign Institutional Investors (FIIs).

Chart II.22: Net Inflows/Outflows by Foreign Institutional Investors

Chart II.23: NRI Deposits – Outstanding



construction. Mauritius, the US and United Kingdom remain the dominant sources of FDI into India.

2.161 Net inflows by foreign institutional investors (FIIs) turned negative during May-July 2006 against the backdrop of weakness in domestic equity markets in consonance with the trends in international markets. Between August 2006 and November 2006, however, FIIs made large purchases in the Indian stock markets (Chart II.22). During December 2006, FIIs flows again turned negative in the backdrop of volatility in Asian equity markets subsequent to the tightening of capital controls by Thailand. After witnessing inflows between mid-January 2007 and third week of February 2007, FII flows turned negative in the last week of February 2007 due to sharp fall in Asian equity markets on account of concerns of a slowdown in the US economy.

2.162 Net cumulative FII inflows during 2006-07 amounted to US $ 3.2 billion (US $ 9.9 billion during previous year). Number of FIIs registered with the SEBI increased to 996 at end-March 2007 (882 at end-March 2006). Resources mobilised through issuance of ADRs/GDRs abroad during April-February 2006-07 remained higher than their levels during corresponding period of the previous year (Table 2.55).

2.163 Inflows under NRI deposits during April-February 2006-07 amounted to US $ 3.5 billion as compared with US $ 2.0 billion during the corresponding period of previous year, partly reflecting the impact of higher interest rates (Table 2.56 and Chart II.23). The ceiling interest rate on NRE deposits was raised by 25 basis points each in November 2005 and April 2006 to LIBOR/SWAP rates of US dollar plus 100 basis points. The ceiling interest rate on FCNR(B) deposits was also raised by 25 basis points to "LIBOR/SWAP rates for the respective currency/ maturity" in March 2006 from "LIBOR/SWAP rates minus 25 basis points". Subsequently, in the Third Quarter Review of Annual Policy for 2006-07 announced on January 31, 2007, the interest rate ceilings on NR(E)RA & FCNR(B) deposits were reduced by 50 basis points and 25 basis points, respectively.

2.164 FDI by Indian corporates abroad has assumed increasing significance in recent years. Indian investments overseas, investments in joint ventures (JV) and wholly owned subsidiaries (WOS) abroad have emerged as important avenues for promoting global business by Indian entrepreneurs, besides a source of increased exports of plants and machinery and goods from India. Joint ventures are perceived

Table 2.56: Inflows under NRI Deposit Schemes

(US $ in Millions)

Scheme	April -March		April-February	
	2004-05	2005-06	2005-06	2006-07P
1	2	3	4	5
FCNR (B)	492	1,612	1,219	1,804
NR (E) RA	84	1,177	807	1,744
Total	**576**	**2,789**	**2,026**	**3,548**

P: Provisional.

as a medium of economic cooperation between India and other countries. Further, transfer of technology and skill, sharing of results of R&D, access to wider global markets, promotion of brand image, generation of employment and utilisation of raw materials available in India and in the host country are the significant benefits of such overseas investments. Overseas investments by Indian companies, initiated with the acquisition of foreign companies in the IT and related services sector, have now spread to other areas, particularly pharmaceuticals and petroleum. India's direct investment abroad continued to show momentum in April-December 2006 as Indian companies continued their overseas acquisitions. Reflecting this, overseas investment undertaken by the Indian companies rose to US $ 8.7 billion in April-December 2006 from US $ 1.9 billion in the corresponding period of last year.

Foreign Exchange Reserves

2.165 India's foreign exchange reserves comprising foreign currency assets, gold, Special Drawing Rights (SDRs) and Reserve Tranche Position (RTP) in the Fund reached US $ 199.18 billion as on March 30, 2007 (Chart II.24). During the first three quarters of 2006-07, net capital inflows more than financed the current account deficit. Overall, the foreign exchange reserves in 2006-07 increased by US $ 47.6 billion as compared with an increase of US $ 10.1 billion in 2005-06. India's foreign exchange reserves increased further to US $ 204.0 billion as on May 18, 2007.

Chart II.24: Accretion to Foreign Exchange Reserves

Table 2.57: Components of External Debt

Item	At the end-of March 06	At the end-of December 06	Variation over the period (US $ million)	Variation over the period (Per cent)
	(Amount in US $ million)			
1	2	3	4	5
1. Multilateral	32,559 (25.8)	34,569 (24.2)	2,010	6.2
2. Bilateral	15,727 (12.4)	15,770 (11.1)	43	0.3
3. IMF	0	0	0	0.0
4. Trade Credit				
a. Above 1 year	5,398 (4.3)	5,957 (4.2)	559	10.4
b. Up to 1 year*	8,696 (6.9)	10,015 (7.0)	1,319	15.2
5. Commercial Borrowings	26,869 (21.2)	35,980 (25.2)	9,111	33.9
6. NRI Deposits (long- term)	35,134 (27.8)	38,382 (26.9)	3,248	9.2
7. Rupee Debt	2,031 (1.6)	1,983 (1.4)	-48	-2.3
8. Total Debt	**1,26,414 (100.0)**	**1,42,656 (100.0)**	**16,242**	**12.8**
Memo Items:				
A. Long-Term Debt	1,17,718 (93.1)	1,32,641 (93.0)	14,923	12.7
B. Short-Term Debt	8,696 (6.9)	10,015 (7.0)	1,319	15.2

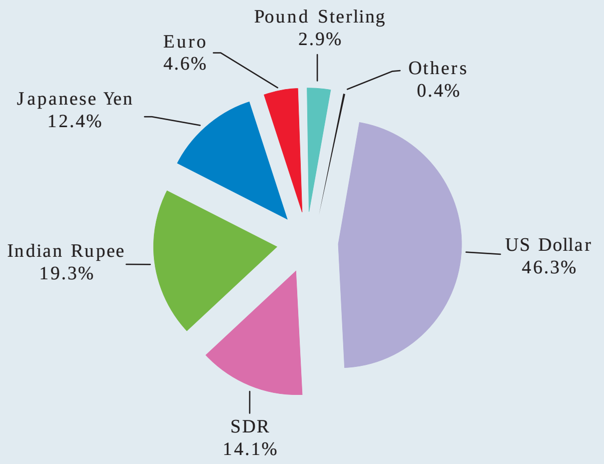
* : Supplier's credits of up to 180 days are not included.
Note : Figures in parenthesis indicate percentage share in the total debt.
Source : Reserve Bank of India and Ministry of Finance, GoI.

India's External Debt

2.166 India's total external debt at US $ 142.7 billion at the end of December 2006 recorded an increase of US $ 16.2 billion over the end-March 2006 level (Table 2.57). The rise in external debt outstanding at end-December 2006 was essentially brought about by a rise in external commercial borrowings, NRI deposits and short-term credit. Higher commercial borrowings and short-term credits could be attributed to increased investment and import demand, while the rise in NRI deposits was on account of upward revision in interest rates on these deposits. The US dollar continued to dominate the currency composition of India's external debt at end-December 2006 (Chart II.25).

2.167 External debt sustainability indicators have exhibited continued improvement. The proportion of short-term debt in total debt and the ratio of short-term debt to foreign exchange reserves remained almost unchanged between end-March 2006 and end-December 2006. The share of concessional debt in total external debt declined to 28.3 per cent at end-

Chart II.25: Currency Composition of External Debt – End-December 2006



December 2006 from 31.2 per cent at end-March 2006, reflecting a gradual surge in non-concessional private debt in India's external debt stock. India's foreign exchange reserves exceeded the external debt by US $ 34.6 billion providing a cover of 124.3 per cent to the external debt stock at end-December 2006 (Table 2.58).

Table 2.58: Debt Indicators

(in per cent)

Indicators	End-March 06	End-December 06
1	2	3
Short-term/Total debt	6.9	7.0
Short-term debt/Reserves	5.7	5.7
Concessional debt/Total debt	31.2	28.3
Reserves/Total debt	120.0	124.3

Source: Reserve Bank of India and Ministry of Finance, GoI.

VII. OVERALL ASSESSMENT

2.168 Developments during 2006-07 indicate that the Indian economy has been able to maintain the strong momentum witnessed in the recent past. Domestic and external developments, on the whole, remained conducive to growth. Notwithstanding uneven spatial distribution and initial deficiency, the overall performance of the South-West monsoon 2006 turned out to be close to normal. Oil prices, which eased significantly between August 2006 and January 2007, have firmed up again in recent months. The industrial sector remained buoyant with industrial production growth rate accelerating to double digit. The manufacturing sector growth, which touched a ten-year high, continued to be the key driver of industrial activity. The strength of the industrial sector has been underpinned by strong domestic and export demand and comfortable financing conditions as was evident from the high credit growth and large resources raised by the corporates from the domestic and international capital markets. High growth in capital goods sector and large import of capital goods point to the strengthening of investment demand. Business confidence surveys conducted by the Reserve Bank and other agencies suggest an optimistic outlook in terms of overall economic conditions and investment climate. The services sector continued to be the main engine of the overall growth process. The lead indicators suggest continued robust prospects for growth in services. GDP growth for 2006-07, which was projected by the Reserve Bank in the range of 7.5-8.0 per cent in the Annual Policy Statement in April 2006, was placed at around 8.5 to 9.0 per cent in the Third Quarter Review in January 2007. The Advance Estimates by the CSO place the growth at 9.2 per cent for 2006-07. The Reserve Bank in its Annual Policy Statement for 2007-08 has placed the real GDP growth for 2007-08 at around 8.5 per cent.

2.169 All the key deficit indicators, *viz.,* gross fiscal deficit, revenue deficit and primary deficit, as ratios to GDP, in the revised estimates of the Central Government for 2006-07 were placed lower than the budgeted targets. This was mainly on account of buoyant revenue receipts, both tax and non-tax, which more than offset the increased expenditures emerging particularly in respect of non-Plan components. The budget estimates for 2007-08 project a further reduction in all the key deficit indicators based on continued improvement in tax revenues and containment of subsidies. The capital outlays, on the other hand, are budgeted to increase in 2007-08 as against a decline recorded in 2006-07. The Union Budget 2007-08 proposes to continue with the strategy of sound tax system, with moderate rates, broad tax base with fewer exemptions, and containment of non-developmental expenditure, while providing for adequate investment in social and physical infrastructure.

2.170 Inflation movements in 2006-07 were driven largely by primary food articles prices and some manufactured items. The impact of mineral oils, which was the major driver of inflation over the past two years, petered out by early September 2006 on account of easing of oil prices and the base effect. The pass-through of higher international oil prices has been restricted to petrol and diesel. The CPI inflation has remained higher than WPI inflation mainly due to increase in food prices as well as the higher weight of food items in the CPI. Consistent with the objective of price stability, the Reserve Bank continued with its policy of active demand management of liquidity through judicious and flexible mix of instruments (OMOs, MSS and CRR) to anchor the inflationary expectations. Accordingly, it raised the repo rate by 50 basis points and the cash reserve ratio by 150 basis points in phases with effect from the fortnight beginning December 23, 2006. In the Annual Policy Statement for 2007-08, the Reserve Bank indicated that its policy endeavour would be to contain inflation close to 5.0 per cent in 2007-08.

2.171 Financial market conditions remained orderly during 2006-07, barring a few episodes of volatility. Short term money market rates remained generally within the corridor of reverse repo and repo rate till mid-December 2006. However, call rates shot up occasionally thereafter due to swings in liquidity conditions arising from large changes in government cash balances and volatile forex flows, as also shortage of collaterals faced by some participants, at a time when monetary policy was in tightening mode. Similarly, yields in the government securities market also hardened. The equity market turned volatile during May-June 2006 due to selling pressure by FIIs in the wake of hardening of interest rates in international markets, concerns over rising domestic inflation and the nervousness across international equity markets. However, stock markets have remained generally stable thereafter, barring some occasions in February-March 2007 when equity markets turned volatile in line with international markets.

2.172 Operations of banks and other financial institutions continued to expand during 2005-06. This was accompanied by improvement in asset quality. Gross and net NPAs are now below 3 per cent and 2 per cent, respectively.

2.173 India's balance of payments position remained comfortable. The sustained rise in invisibles surplus during April-December 2006 helped in financing the growing merchandise trade deficit. Travel earnings, business and professional services, software services and remittances, invisible receipts in particular, rose sharply. India continued to attract large capital inflows, both portfolio and FDI. FIIs made large net investments, *albeit* somewhat lower than last year. Gross FDI inflows into India during 2006-07 (April-February) were little less than three times those in the previous year. The pick-up in FDI inflows reflects growing investor interest in the Indian economy on the back of strong fundamentals as well as the impact of policy initiatives aimed at rationalising and liberalising the FDI policy and simplifying the procedures.

2.174 India's comfortable BOP position was also reflected in the foreign exchange reserves, which in the financial year 2006-07 increased by US $ 47.6 billion. The external debt sustainability indicators have improved further.

2.175 The global economy continued to expand at a robust pace in 2006, notwithstanding some moderation in the growth momentum in recent quarters. Growth prospects of the global economy, however, remain subject to certain downside risks. In addition to the uncertainties regarding the adjustment in the persisting global imbalances, other major risks include the underlying inflationary pressures on account of limited spare capacity, emerging wage pressures, notably in the US and possibility of rise in crude oil prices, weakness in the US housing market and concerns relating to overcomplacency of the financial markets about global risks.

2.176 Against this backdrop, barring the emergence of any adverse and unexpected developments in various sectors of the economy and keeping in view the current assessment of the economy, including the outlook for inflation, the Annual Policy Statement for 2007-08 observed that the step-up in the overall growth momentum in the economy during 2006-07 occurred in an environment of increasing strength and dynamism, backed by rising business and consumer confidence and increasing international interest. The growth momentum was driven by an increase in the investment rate, improvement in capital use in both the manufacturing and the services sectors and stronger linkages with the global economy. While structural changes are taking place in the economy, the upsurge of demand pressures may contain a cyclical component in the presence of upside pressures on aggregate demand, support from encouraging global GDP growth, steady increase in prices of manufactures, resurgence of pricing power among corporates, indications of wage pressures in some sectors, strained capacity utilisation and elevated asset prices. The optimism generated by robust macroeconomic performance needs to be assessed against the evolving configuration of risks in terms of substantial deceleration of agriculture, presence of supply constraints in agriculture and physical infrastructure gaps, the firming up of inflation due to supply constrains, emerging strains on capacity and elevated asset prices. The sustained momentum of growth in the industrial and service sectors is somewhat clouded by supply pressures from deceleration in agriculture and large gaps in the physical infrastructure. There are indications that the pace of growth will continue to be supported by steady increases in the rate of gross domestic saving and some improvement in the efficiency of capital use while recognising that international trade cannot, by its nature, fully mitigate all supply side issues among all sectors. The initial effects of the expansion in demand would be reflected in inflationary pressures and risks to macroeconomic and financial stability which have been in evidence in the form of sustained demand for capital goods and consumer durables, high rates of money and credit, indications of wage pressures in some sectors, rising input costs and the emergence of pricing power of the corporate sector. The overarching policy challenge is to manage the transition to a higher growth path while containing inflationary pressures.

2.177 The stance of monetary policy in 2007-08 would be conditioned by the patterns in which the global and, more particularly, the domestic environment unfold. The likely evolution of macroeconomic and financial conditions indicate an environment supportive of sustaining the current growth momentum in India. It is important to reiterate that monetary policy, while contributing to growth, has to ensure and maintain price and financial stability. The policy preference for the period ahead is strongly in favour of reinforcing the emphasis on price stability and anchoring inflation expectations. Accordingly, the overall stance of monetary policy will continue to be: (i) to reinforce the emphasis on price stability and well-anchored inflation expectations while ensuring a monetary and interest rate environment that supports export and investment demand in the economy so as to enable continuation of the growth momentum; (ii) to re-emphasise credit quality and orderly conditions in financial markets for securing macroeconomic and, in particular, financial stability while simultaneously pursuing greater credit penetration and financial inclusion; (iii) to respond swiftly with all possible measures as appropriate to the evolving global and domestic situation impinging on inflation expectations and the growth momentum.