RESERVE BANK OF INDIA

Macroeconomic and Monetary Developments Third Quarter Review 2008-09

Issued with the Third Quarter Review of Monetary Policy 2008-09

January 26, 2009

Macroeconomic and Monetary Developments Third Quarter Review 2008-09

Reserve Bank of India
Mumbai

Contents

	Overview	
I.	**Output**	1
	Agricultural Situation	2
	Industrial Performance	4
	Services Sector	7
II.	**Aggregate Demand**	9
	Combined Government Finances	10
	Centre's Fiscal Situation	11
	State Finances	14
	Corporate Performance	15
	External Demand	16
III.	**The External Economy**	17
	International Developments	17
	Merchandise Trade	20
	Balance of Payments	23
	Foreign Exchange Reserves	27
	External Debt	29
	International Investment Position	30
IV.	**Monetary Conditions**	32
	Monetary Survey	32
	Reserve Money Survey	41
V.	**Financial Markets**	45
	International Financial Markets	46
	Domestic Financial Markets	55
	Liquidity Conditions	56
	Money Market	61
	Foreign Exchange Market	66
	Credit Market	68
	Government Securities Market	70
	Equity Market	74
VI.	**Price Situation**	83
	Global Inflation	83
	Global Commodity Prices	89
	Inflation Conditions in India	92
VII.	**Macroeconomic Outlook**	103
	Business Expectations Surveys	103
	Survey of Professional Forecasters	106
	Balance of Risks for Growth and Inflation	107

MACROECONOMIC AND MONETARY DEVELOPMENTS THIRD QUARTER REVIEW 2008-09

Overview

The Indian economy, after exhibiting strong growth during the second quarter of 2008-09, has experienced moderation since, in the wake of the global economic slowdown. Agricultural outlook remains satisfactory with rabi sowing being higher than the previous year. Industrial growth, however, decelerated sharply during April-November 2008-09 encompassing continued slowdown in all the constituent sectors. The slowdown occurred in the use-based categories, viz., the basic, capital and intermediate goods, while the growth in consumer goods accelerated. The services sector too, which has been the prime growth engine over the years, is slowing, mainly in transport and communication, trade, hotels and restaurants sub-sectors.

Aggregate demand in the Indian economy is primarily domestically driven, though exports have been gaining progressively higher importance in recent years. The economic slowdown, during the second quarter vis-à-vis the first quarter of 2008-09, was primarily driven by a moderation of consumption growth and widening of trade deficit, offset partially by an acceleration in fixed investment demand. On the other hand, the government consumption expenditure accelerated during the same period. The progress of Central Government finances indicated a widening of both gross fiscal deficit and revenue deficit during 2008-09 (April-November) over the same period of 2007-08. The external demand conditions weakened as reflected in deterioration in net exports. The merchandise trade deficit widened during April-November 2008 on account of higher crude oil prices for most of the period coupled with loss of momentum in exports since September 2008.

The balance of payments (BoP) for the first half of 2008-09 reflected a widening of the current account deficit and moderation in capital flows. Net capital inflows reduced sharply and remained volatile during 2008-09 with foreign direct investment inflows showing an increase, while portfolio investments recording a substantial outflow. As on January 16, 2009, India's foreign exchange reserves at US $ 252.2 billion showed a decline of US $ 57.5 billion, including valuation losses, over end-March 2008 level. India's external debt indicators as well as the level of foreign exchange reserves, however, continue to be comfortable.

Monetary aggregates witnessed some moderation during the fiscal year 2008-09. Intra-year movements in reserve money largely reflected the Reserve Bank's market operations and movements in bankers' deposits with the Reserve Bank in the wake of changes in the CRR. The growth of non-food bank credit remained high, albeit, with some moderation in recent months.

Continued high growth in time deposits enabled the banking system to sustain the credit expansion while the flow of resources from the non-banking sources of funds to the commercial sector declined. The total flow of resources from banks and other sources to the commercial sector during 2008-09, so far, has been somewhat lower than the comparable period of 2007-08. In order to facilitate bank lending, several counter cyclical measures taken earlier were reviewed in view of the prevailing macroeconomic, monetary and credit conditions and measures were announced to strengthen credit delivery while maintaining credit quality.

Financial markets in India, which by and large, remained orderly from April 2008 to mid-September 2008, witnessed heightened volatility subsequently reflecting the knock-on effects of the disruptions in the international financial markets and the uncertainty that followed. Liquidity conditions tightened significantly between mid-September and October 2008, emanating from adverse international developments and some domestic factors. Consequently, the money markets in India came under some pressure, the Indian rupee generally depreciated against major currencies and the equity market continued to witness downswings in consonance with volatility in major international equity markets. This necessitated the Reserve Bank to undertake a series of measures to inject rupee and foreign exchange liquidity from mid-September 2008 onwards. Liquidity conditions turned around and became comfortable from mid-November 2008.

Headline inflation has declined in major economies since July/August 2008. In India, inflation measured as year-on-year variation in the wholesale price index (WPI), declined sharply from an intra-year peak of 12.9 per cent on August 2, 2008 to 5.6 per cent as on January 10, 2009 on account of decline in fuel, metals and select food items prices. The decline in prices of most of these commodities was in line with the decline in international commodity prices since July 2008. Some contribution to recent decline in WPI inflation has also come from the slowing domestic demand. Various measures of consumer price inflation were placed in the range of 10.4-11.1 per cent during November/December 2008 as compared with 8.5-10.3 per cent in August 2008.

On the macroeconomic front, the downside risks for economic growth emanate from the ongoing global economic slowdown, and deterioration in global financial markets along with the corresponding slowing down in domestic demand. On the other hand, some positive factors include expected increase in consumption demand mainly reflecting rise in basic exemption limits and tax slabs, Sixth Pay Commission awards, debt waiver for farmers and pre-election expenditure. While the downside risks would be extending to the future, the fall in commodity prices including oil prices and the coordinated fiscal and monetary stimulus are expected to revive the growth momentum. The easing of international oil prices and commodity prices may help in softening the inflationary pressure.

I. OUTPUT

I.1 The Indian economy registered strong growth during the second quarter of 2008-09. In the subsequent period, some moderation has since been evident in the wake of the global economic slowdown. According to the estimates released by the Central Statistical Organisation (CSO) in November 2008, real GDP growth during the second quarter of 2008-09 was lower at 7.6 per cent as compared with 9.3 per cent in the corresponding period of 2007-08 reflecting deceleration in growth of industry and services (Table 1). While the moderation in industrial growth was largely an outcome of some cyclical downturn, the services sector mainly reflected weakness in demand both at home and abroad, compounded by transmission of global factors through both the trade and financial channels. Structural drivers of the Indian growth process, however, remained strong as reflected in the acceleration in the real investment rate during the second quarter of 2008-09 supported by strong domestic saving.

Table 1: Growth Rates of Real GDP@

(Per cent)

Sector	2006-07*	2007-08#	2007-08 Q1	2007-08 Q2	2007-08 Q3	2007-08 Q4	2008-09 Q1	2008-09 Q2	2007-08 April-September	2008-09 April-September
1	2	3	4	5	6	7	8	9	10	11
1. Agriculture and Allied Activities	**3.8** **(18.5)**	**4.5** **(17.8)**	**4.4**	**4.7**	**6.0**	**2.9**	**3.0**	**2.7**	**4.5**	**2.9**
2. Industry	**10.6** **(19.5)**	**8.1** **(19.4)**	**9.6**	**8.6**	**8.6**	**5.8**	**5.2**	**4.7**	**9.1**	**5.0**
2.1 Mining and Quarrying	5.7	4.7	1.7	5.5	5.7	5.9	4.8	3.9	3.5	4.4
2.2 Manufacturing	12.0	8.8	10.9	9.2	9.6	5.8	5.6	5.0	10.1	5.3
2.3 Electricity, Gas & Water Supply	6.0	6.3	7.9	6.9	4.8	5.6	2.6	3.6	7.4	3.1
3. Services	**11.2** **(61.9)**	**10.7** **(62.9)**	**10.6**	**10.7**	**10.0**	**11.4**	**10.2**	**9.6**	**10.6**	**9.9**
3.1 Trade, Hotels, Restaurants, Transport, Storage and Communication	11.8	12.0	13.1	11.0	11.5	12.4	11.2	10.8	12.1	11.0
3.2 Financing, Insurance, Real Estate and Business Services	13.9	11.8	12.6	12.4	11.9	10.5	9.3	9.2	12.5	9.2
3.3 Community, Social and Personal services	6.9	7.3	5.2	7.7	6.2	9.5	8.4	7.6	6.5	8.0
3.4 Construction	12.0	9.8	7.7	11.8	7.1	12.6	11.4	9.7	9.7	10.5
4. Real GDP at Factor Cost	**9.6** **(100)**	**9.0** **(100)**	**9.2**	**9.3**	**8.8**	**8.8**	**7.9**	**7.6**	**9.3**	**7.8**

Memo: (Amount in Rupees crore)

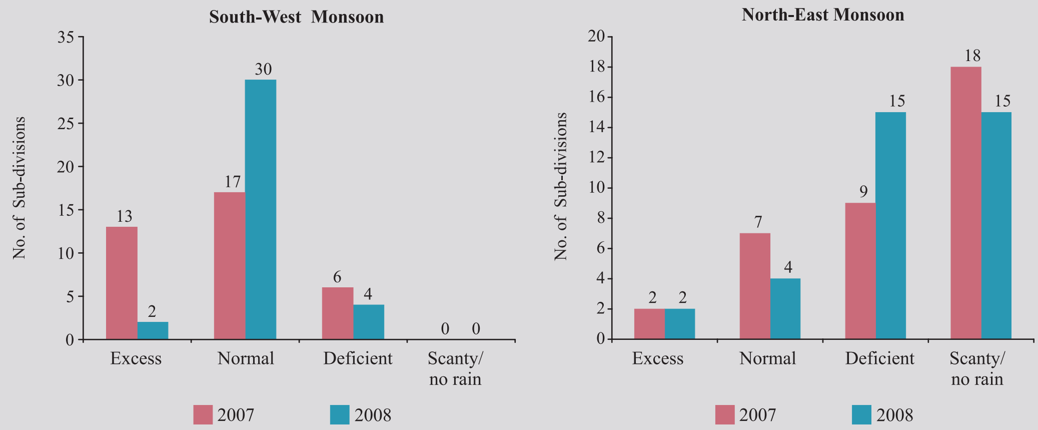
	2006-07*	2007-08#
a) **Real GDP at Factor Cost (1999-2000)**	28,64,310	31,22,862
b) **GDP at current market prices**	41,45,810	47,13,148

@ : At 1999-2000 Prices. * : Quick Estimates. # : Revised Estimates.

Note : Figures in parenthesis indicate shares in real GDP.

Source: Central Statistical Organisation.

Chart 1: Rainfall during South-West and North-East Monsoon



Source: India Metereological Department

Agricultural Situation

I.2 Cumulative rainfall during 2008 South West monsoon season (June 1 to September 30) was near normal, with rainfall over the entire country amounting to two per cent below normal as against five per cent above normal during the corresponding period of the previous year. Cumulative rainfall during the North-East monsoon season (October 1, 2008 to December 31, 2008) was, however, 31.0 per cent below normal as compared with 32.0 per cent below normal during the corresponding period of the previous year. Of the 36 meteorological sub-divisions, cumulative rainfall was deficient/scanty/ no rain in 30 sub-divisions (27 sub-divisions last year) (Chart 1). As on January 15, 2009, the total live water storage was 49.0 per cent (56.0 per cent last year) of the Full Reservoir Level (FRL).

I.3 The sowing of *kharif* crops declined marginally during 2008-09 on account of moderate shortfall in rainfall during the South-West monsoon season (Table 2). On the other hand, area sown under *rabi* crops so far (up to January 9, 2009) has been about 4.8 per cent higher than a year ago. The increase in *rabi* sowing occurred in respect of all crops.

I.4 The Ministry of Agriculture has set a target for foodgrains production for 2008-09 at 233.0 million tonnes. According to the First Advance Estimates, *kharif* foodgrains production during 2008-09 at 115.3 million tonnes is likely to be lower than that of the previous year by around 5 per cent on account of fall in the production of both pulses and the coarse cereals (Table 3). However, rice production is expected to exhibit a marginal improvement over the previous year. Among the commercial crops, the output of *kharif* oilseeds, sugarcane and cotton is expected to decline.

Table 2: Progress of Area under *Kharif* and *Rabi* Crops – 2008-09

(Million hectares)

Crop	Normal Area	Area Coverage		
		2007	2008	Variation
1	2	3	4	5
		Kharif Crops		
Rice	39.1	37.3	38.5	1.1
Coarse Cereals	22.7	21.1	20.0	-1.2
of which:				
Bajra	9.2	8.3	7.7	-0.6
Jowar	4.2	3.5	3.0	-0.5
Maize	6.4	7.4	7.1	-0.3
Total Pulses	10.9	12.3	10.4	-1.9
Total Oilseeds	15.9	17.5	18.3	0.8
of which:				
Groundnut	5.4	5.4	5.3	-0.1
Soyabean	7.3	8.7	9.6	0.9
Sugarcane	4.1	5.3	4.4	-0.9
Cotton	8.4	9.2	9.1	-0.1
All Crops	**101.9**	**103.9**	**101.5**	**-2.4**
Crop	Normal Area	Area Coverage (as on January 9, 2009		
		2008	2009	Variation
6	7	8	9	10
		Rabi Crops		
Rice	3.7	0.6	0.6	0.0
Wheat	26.5	26.6	27.0	0.1
Coarse Cereals	6.4	6.0	6.6	0.6
of which:				
Jowar	4.9	4.4	4.8	0.5
Maize	0.8	0.9	0.9	0.0
Total Pulses	11.6	12.6	13.4	0.8
Total Oilseeds	9.2	8.2	9.0	0.9
of which:				
Groundnut	0.8	0.5	0.5	0.0
Rapeseed/ Mustard	6.3	5.8	6.6	0.8
Sunflower	1.3	0.9	1.0	0.1
All Crops	**57.4**	**53.9**	**56.5**	**2.6**

Source: Ministry of Agriculture, Government of India.

Table 3: Agricultural Production

(Million tonnes)

Crop	2007-08@	2008-09@@	
		Target	Achievement
1	2	3	4
Rice	96.4	97.0	
Kharif	82.8	83.0	83.3
Rabi	13.6	14.0	
Wheat	78.4	78.5	
Coarse Cereals	40.7	42.0	
Kharif	31.7	32.6	27.4
Rabi	9.0	9.4	
Pulses	15.1	15.5	
Kharif	6.5	5.9	4.7
Rabi	8.7	9.6	
Total Foodgrains	230.7	233.0	
Kharif	121.0	121.5	115.3
Rabi	109.7	111.5	
Total Oilseeds	28.8	31.8	
Kharif	19.8	20.0	17.9
Rabi	9.0	11.8	
Sugarcane	340.7	340.0	294.7
Cotton #	26.0	26.0	23.9
Jute and Mesta ##	11.2	11.0	11.1

@ : Fourth Advance Estimates as on July 9, 2008.
@@ : First Advance Estimates for 2008-09.
\# : Million bales of 170 kgs. each.
\#\# : Million bales of 180 kgs. each.
Source : Ministry of Agriculture, Government of India.

Food Management

I.5 The procurement of foodgrains (rice and wheat) during 2008-09 (up to January 19, 2009) was higher than that in the corresponding period of the previous year largely due to more than two-fold increase in wheat procurement (Table 4). The offtake of foodgrains (rice and wheat) during 2008-09 so far (up to October 31, 2008) was marginally lower as compared to corresponding period of the previous year. Consequently, the total stocks of foodgrains with the Food Corporation of India (FCI) and other government agencies nearly doubled to about 35.3 million tonnes as on November 1, 2008. The stocks of both rice and wheat are now higher than their norms.

Table 4: Management of Food Stocks

(Million tonnes)

Month	Opening Stock of Foodgrains			Procurement of Foodgrains			Foodgrains Offtake					Closing Stock	Norms
	Rice	Wheat	Total	Rice	Wheat	Total	PDS	OWS	OMS - Domestic	Exports	Total		
1	2	3	4	5	6	7	8	9	10	11	12	13	14
2007-08	13.2	4.7	17.9	26.3	11.1	37.4	33.5	3.9	0.0	0.0	37.4	19.8	
2008-09@	13.8	5.8	19.8	25.0	22.6	47.6	19.4	1.7	0.0	0.0	21.1	..	
	(13.2)	(4.7)	(17.9)	(20.7)	(11.1)	(31.8)	(19.3)	(2.1)	(0.0)	(0.0)	(21.4)		
2007													
April	13.2	4.7	17.9	0.9	7.9	8.7	2.6	0.2	0.0	0.0	2.8	25.1	16.2
July	11.0	12.9	23.9	0.8	0.0	0.8	2.9	0.4	0.0	0.0	3.2	21.2	26.9
October	5.5	10.1	15.6	7.4	0.0	7.4	2.7	0.3	0.0	0.0	2.9	19.7	16.2
December	10.1	8.4	18.5	3.5	0.0	3.5	2.7	0.3	0.0	0.0	3.0	19.2	
2008													
January	11.5	7.7	19.2	4.5	0.0	4.5	2.9	0.3	0.0	0.0	3.2	21.4	20.0
April	13.8	5.8	19.8	1.1	12.6	13.7	2.7	0.0	0.0	0.0	2.8	30.7	16.2
July	11.3	24.9	36.3	0.1	0.2	0.3	2.8	0.3	0.0	0.0	3.1	34.3	26.9
September	8.5	23.3	31.8	1.4	0.0	1.4	2.8	0.4	0.0	0.0	3.2	30.0	
October	7.9	22.0	30.0	8.1	0.0	8.1	2.6	0.1	0.0	0.0	2.8	35.3	16.2
November	14.1	21.0	35.3	3.1	0.0	3.1	..	..	..	..	..	..	
December	..	..	..	4.2	0.0	4.2	..	..	..	..	..	..	
2009													
January*	..	..	..	3.0	0.0	3.0	..	..	..	..	..	..	20.0

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

.. : Not Available.

@ : Procurement up to January 19, 2009 and offtake up to October 31, 2008.

* : Procurement up to January 19, 2009.

Note : 1. 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.

2. Figures in parentheses indicate procurement/offtake of foodgrains during the corresponding period of 2007-08.

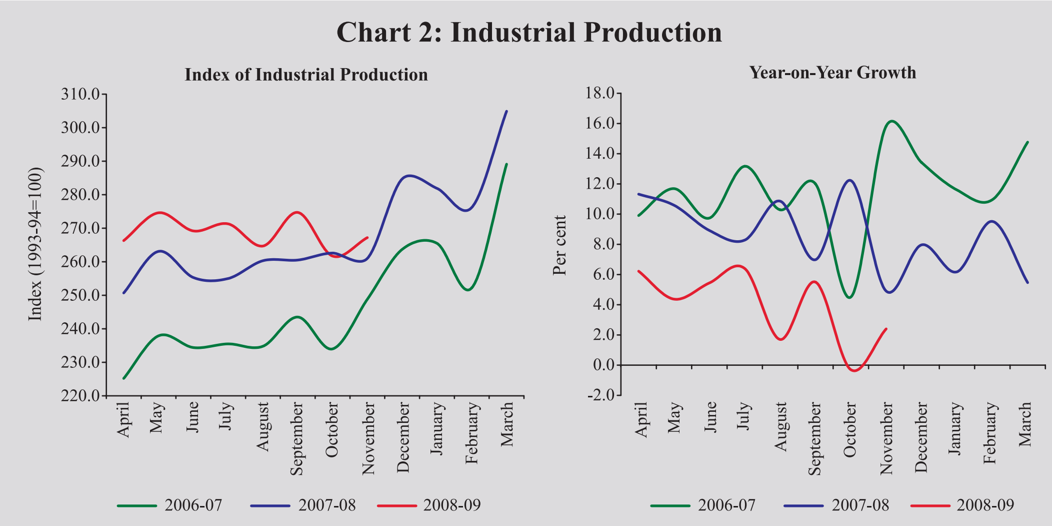
3. Total minimum stocks are to be maintained, as on April 1, July 1, October 1, and January 1, by public agencies under the 'new buffer stocking policy' with effect from March 29, 2005.

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

Industrial Performance

I.6 Industrial activity decelerated during April-November 2008-09, with the year-on-year expansion in Index of Industrial Production (IIP) being 3.9 per cent as against 9.2 per cent during the corresponding period of the previous year reflecting slowdown in all the constituent sectors (Chart 2 and Table 5). The slowdown in manufacturing sector was largely on account of food, textiles and metals. Electricity sector recorded lower growth on account of decline in power generation in nuclear and hydro-plants. The mining sector growth also decelerated.

I.7 The slowdown in the growth of manufacturing was on account of 13 industry groups (with a combined weight



of 67.5 per cent in the IIP), recording decelerated/negative growth during April-November 2008-09 (Table 6). In particular, while production declined in respect of 'food products', most of the textiles, leather and wood products, some

Table 5: Index of Industrial Production: Sectoral and Use-Based Classification of Industries

(Per cent)

Industry Group	Weight in the	Growth Rate			Weighted Contribution #		
		April-March	April-November		April-March	April-November	
		2007-08	2007-08	2008-09 P	2007-08	2007-08	2008-09 P
1	2	3	4	5	6	7	8
Sectoral							
Mining	10.5	5.1	5.1	3.4	4.2	3.8	5.6
Manufacturing	79.4	9.0	9.8	4.0	89.5	89.6	88.1
Electricity	10.2	6.3	7.0	2.9	6.3	6.6	6.2
Use-Based							
Basic Goods	35.6	7.0	8.4	3.5	24.7	27.7	27.1
Capital Goods	9.3	18.0	20.9	7.5	25.0	25.6	24.0
Intermediate Goods	26.5	8.9	9.8	0.1	27.4	28.5	0.7
Consumer Goods (a+b)	28.7	6.1	5.3	6.0	22.9	18.5	46.5
a) Consumer Durables	5.4	-1.0	-1.9	4.3	-1.0	-1.8	8.6
b) Consumer Non-durables	23.3	8.5	8.1	6.4	24.0	20.3	37.8
General	**100.0**	**8.5**	**9.2**	**3.9**	**100.0**	**100.0**	**100.0**

P : Provisional.
\# : Figures may not add up to 100 due to rounding off.
Source: Central Statistical Organisation.

Table 6: Growth of Manufacturing Groups

(Per cent)

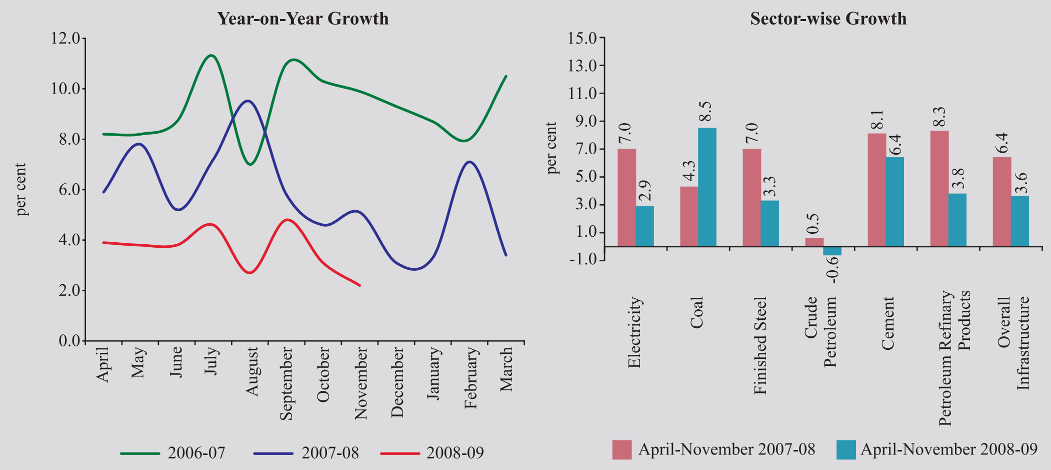
Industry Group	Weight in the IIP	Growth Rate			Weighted Contribution #		
		April-March 2007-08	April-November		April-March	April-November	
			2007-08	2008-09 P	2007-08	2007-08	2008-09 P
1	2	3	4	5	6	7	8
1. Food products	9.08	7.0	7.0	-0.4	6.3	4.5	-0.6
2. Beverages, tobacco and related products	2.38	12.0	11.4	17.9	6.8	6.1	23.3
3. Cotton textiles	5.52	4.3	5.1	-1.1	2.0	2.2	-1.1
4. Wool, silk and man-made fibre textiles	2.26	4.8	3.9	-2.8	1.5	1.2	-2.0
5. Jute and other vegetable fibre textiles (except cotton)	0.59	33.0	13.4	-3.9	0.9	0.4	-0.3
6. Textile products (including wearing apparel)	2.54	3.7	4.3	3.9	1.4	1.6	3.2
7. Wood and wood products, furniture & fixtures	2.70	40.5	72.5	-5.7	5.3	7.4	-2.2
8. Paper and paper products and printing, publishing and allied industries	2.65	2.7	1.7	4.1	0.9	0.6	3.1
9. Leather and leather & fur products	1.14	11.7	12.0	-5.7	1.1	1.0	-1.2
10. Chemicals and chemical products (except products of petroleum & coal)	14.00	10.6	9.4	3.7	22.4	19.2	18.1
11. Rubber, plastic, petroleum and coal products	5.73	8.9	10.6	1.3	6.1	6.8	2.0
12. Non-metallic mineral products	4.40	5.7	8.2	0.2	4.1	5.4	0.3
13. Basic metal and alloy industries	7.45	12.1	15.6	6.1	13.4	15.7	15.7
14. Metal products and parts (except machinery and equipment)	2.81	-5.6	-4.6	0.5	-1.5	-1.1	0.3
15. Machinery and equipment other than transport equipment	9.57	10.5	12.0	7.9	19.0	19.8	32.3
16. Transport equipment and parts	3.98	2.9	2.7	6.7	2.3	2.0	11.1
17. Other manufacturing industries	2.56	19.8	19.1	-2.1	8.0	7.2	-2.0
Manufacturing – Total	**79.36**	**8.6**	**9.8**	**4.0**	**100.0**	**100.0**	**100.0**

P: Provisional. # : Figures may not add up to 100 due to rounding off.
Source : Central Statistical Organisation.

industry groups such as textile products, chemical & chemical products, machinery & equipment and basic metal & alloy industries witnessed deceleration.

I.8 In terms of use-based classification of the IIP, basic goods, capital goods and intermediate goods sectors recorded decelerated growth during April-November 2008-09 whereas the consumer goods sector recorded marginally higher growth. The performance of the basic goods sector reflected subdued growth in electricity sector and a fall in production of phosphatic fertilisers, steel and

Chart 3: Growth in Infrastructure Industries



aluminium products, and deceleration in production of caustic soda and structurals. The capital goods sector growth moderated on account of decline in production of H.T. insulators, agricultural implements, material handling equipment, machine tools, cutting tools, control panels, electric motors, computers & peripherals, commercial vehicles, and medical & surgical instruments. Production of consumer durables accelerated, while that of non-durables decelerated. The growth in intermediate goods sector contracted mainly because of decline in production of a number of textile's items, PVC pipes & tubes, railway concrete sleepers, drums & barrels, spun pipes, yarns, hessian, sacking, particle board, corrugated boxes, filament yarn and viscose staple fibre.

Infrastructure

I.9 The core sector recorded a lower growth at 3.6 per cent during April-November 2008-09 as compared with 6.4 per cent during the corresponding period of the previous year (Chart 3). The sharp deceleration in electricity sector and decline in crude oil production impacted the performance of infrastructure. While coal production recovered, cement and steel sectors recorded decelerated growth due to capacity constraints.

Services Sector

I.10 After recording double-digit growth for fourteen consecutive quarters, the services sector growth decelerated to single digit at 9.6 per cent during the second quarter of 2008-09, thereby reducing its relative contribution to real GDP growth (Table 7). The deceleration in growth was mainly on account of lower growth recorded by 'financing, insurance, real estate and business services' and 'construction'.

Table 7: Growth in Services Sector

(Contribution to real GDP growth; percentage points)

Year/Quarter	Construction	Trade, Hotels, Transport and Communication	Financing, Insurance, Real Estate and Business Services	Community, Social and Personal Services	Total Services
1	2	3	4	5	6
2007-08	0.7	3.2	1.7	1.0	6.6
2007-08: Q1	0.6	3.4	1.8	0.7	6.5
2007-08: Q2	0.9	3.0	1.9	1.1	6.9
2007-08:Q3	0.5	3.0	1.6	0.8	5.9
2007-08:Q4	0.9	3.4	1.5	1.3	7.1
2008-09:Q1	0.8	3.0	1.4	1.1	6.4
2008-09:Q2	0.7	3.0	1.4	1.1	6.2

Source : Central Statistical Organisation.

I.11 Most of the lead indicators of services sector activity for April-October 2008-09 indicate a sharp deceleration in growth. However, revenue earning railway freight traffic witnessed acceleration during April-November 2008-09 (Table 8).

Table 8: Indicators of Services Sector Activity

(Growth rates in per cent)

Sub-sector	2007-08	April-October 2007-08	April-October 2008-09
1	2	3	4
Tourist arrivals	12.2	12.1 *	8.9 *
Commercial vehicles production	4.8	4.8 @	-8.4 @
Railway revenue earning freight traffic	9.0	11.0 @	14.3 @
New cell phone connections	38.3	46.2 @	27.7 @
Cargo handled at major ports	11.9	13.2 @	3.9 @
Civil aviation			
a) Export cargo handled	7.5	7.0	7.0
b) Import cargo handled	19.7	22.7	4.2
c) Passengers handled at international terminals	11.9	12.5	7.5
d) Passengers handled at domestic terminals	20.6	25.6	-8.5
Cement	8.1	8.1 @	6.4 @
Steel	5.1	7.0 @	3.3 @
Aggregate deposits of SCBs	22.4	14.3 @@	13.2 @@
Non-food credit of SCBs	23.0	11.6 @@	12.4 @@

* : April-September. @ : April-November. @@ : Up to January 2, 2009.

Source : Ministry of Tourism; Ministry of Commerce and Industry; Ministry of Statistics and Programme Implementation; Reserve Bank of India; and Centre for Monitoring Indian Economy.

II. AGGREGATE DEMAND

II.1 Aggregate demand in the Indian economy is primarily domestically driven, though exports have been progressively gaining higher importance in recent years. The economic slowdown during the second quarter *vis-à-vis* the first quarter of 2008-09 was primarily driven by a moderation of consumption growth and widening of trade deficit, offset partially by an acceleration in fixed investment demand. On the other hand, the government consumption expenditure accelerated during the same period. The key deficit indicators of the Central Government, *viz*., the gross fiscal deficit and revenue deficit widened during April-November 2008-09 as compared to a year ago. Merchandise trade deficit recorded a sharp increase during April-November 2008 on account of higher oil imports.

Domestic Demand

II.2 The share of total final consumption expenditure continued to decline in the second quarter of 2008-09 as compared with that of the corresponding quarter of the preceding year, mainly due to decline in private final consumption expenditure (PFCE). On the other hand, the share of real gross fixed capital formation (GFCF) increased during the second quarter of 2008-09 over the corresponding period of 2007-08 (Table 9).

II.3 The moderation of growth during the second quarter of 2008-09 *vis-à-vis*

Table 9: Disposition of GDP at Market Prices (at 1999-2000 Prices) – Shares

(Per cent of GDP at market prices)

Item	2007-08 #	2007-08				2008-09		2007-08	2008-09
		Q1	Q2	Q3	Q4	Q1	Q2	April-September	
1	2	3	4	5	6	7	8	9	10
1. Total Final Consumption Expenditure	67.8	70.1	68.2	69.0	64.6	70.1	66.7	69.1	68.4
(i) Private Final Consumption Expenditure	58.2	59.8	59.5	60.7	53.4	59.8	58.0	59.6	58.9
(ii) Government Final Consumption Expenditure	9.6	10.3	8.7	8.3	11.2	10.3	8.7	9.5	9.5
2. Gross Fixed Capital Formation	31.9	32.0	33.4	31.0	31.6	32.3	35.3	32.7	33.8
3. Change in Stocks	2.0	2.1	2.1	1.9	1.9	2.1	2.1	2.1	2.1
4. Valuables	1.3	1.2	1.3	1.4	1.1	1.3	1.4	1.3	1.3
5. Exports	20.3	23.8	16.8	19.0	21.6	26.0	17.6	20.2	21.8
6. *Less* Imports	24.4	24.9	24.8	25.4	22.8	28.4	28.3	24.8	28.4
7. Discrepancies	1.1	-4.3	3.1	3.0	1.9	-3.3	5.1	-0.5	1.0
Memo:									(Rupees crore)
Real GDP at market prices	33,98,767	7,69,870	7,88,513	8,99,098	9,41,283	8,30,681	8,48,278	15,58,383	16,78,958

: Revised Estimates.

Source: Central Statistical Organisation.

the second quarter of 2007-08 was driven by all the components of domestic demand. An analysis of the pattern of domestic demand shows that the growth in gross fixed investment was lower during the second quarter of 2008-09 than a year ago, but higher than in the first quarter of 2008-09. On the other hand, private final consumption expenditure growth during the second quarter of 2008-09 was lower than a year ago as well as that of the first quarter of 2008-09. The growth in government final consumption expenditure picked up during the second quarter of 2008-09 from that of the first quarter but was lower than that of the second quarter of 2007-08. On balance, the cumulative position during April-September 2008-09 shows that the economic slowdown was driven by both private consumption demand and gross fixed investment, while government consumption demand acted as a counter-cyclical stabiliser (Table 10).

Combined Budgeted Government Finances: 2008-09

II.4 The combined finances of the Central and State Governments for 2008-09 were budgeted to improve in line with the fiscal consolidation process. The key deficit indicators were budgeted to decline over the revised estimates for 2007-08, both in absolute terms and as percentage of GDP. Primary balance was budgeted to record a surplus in 2008-09 (BE) (Table 11). The envisaged improvement in the combined finances, in terms of budget estimates for 2008-09 is now unlikely, in view of slowing domestic economy that has necessitated fiscal stimulus, along with lower than expected revenue growth. In terms of Central

Table 10: Disposition of GDP at Market Prices (at 1999-2000 Prices) – Growth Rates

(Per cent)

Item	2007-08				2008-09		2007-08	2008-09
	Q1	Q2	Q3	Q4	Q1	Q2	April-September	
1	2	3	4	5	6	7	8	9
Total Final Consumption Expenditure	6.1	8.0	8.5	9.7	7.9	5.5	7.0	6.7
of which: Private final consumption expenditure	7.6	7.6	9.4	8.3	8.0	5.0	7.6	6.5
Government final consumption expenditure	-2.2	10.3	2.2	16.7	7.7	8.6	3.2	8.1
Gross fixed capital formation	13.3	16.7	14.3	11.2	9.0	13.8	15.0	11.4
Changes in stocks	9.1	7.4	7.7	4.0	4.3	4.3	8.2	4.3
Valuables	2.6	12.9	29.8	10.0	15.8	10.2	7.8	12.8
Exports	6.0	-2.8	15.8	10.1	18.1	13.1	2.1	16.0
Less Imports	6.0	0.4	14.2	9.6	23.4	22.6	3.1	23.0
GDP at 1999-2000 market prices	9.2	9.2	8.9	8.8	7.9	7.6	9.2	7.7

Source : Central Statistical Organisation.

Table 11: Key Fiscal Indicators

(Per cent to GDP)

Year	Primary Deficit	Revenue Deficit	Gross Fiscal Deficit	Outstanding Liabilities*
1	2	3	4	5
		Centre		
2007-08 RE	-0.6 (-0.9)	1.4 (1.2)	3.1 (2.8)	61.5
2008-09 BE	-1.1	1.0	2.5	57.7
		States		
2007-08 RE	0.1	-0.5	2.3	28.3
2008-09 BE	0.1	-0.5	2.1	27.4
		Combined		
2007-08 RE	-0.3	0.9	5.3	76.9
2008-09 BE	-0.8	0.5	4.6	73.4

RE: Revised Estimates. BE: Budget Estimates. *: Includes external liabilities at historical exchange rates.

Note : 1. Figures in parentheses relate to provisional accounts.
2. Negative sign indicates surplus.
3. Data in respect of States relate to 28 State Governments.

Government finances, it is reflected in the substantial supplementary demand for grants resorted to by the Central Government.

Centre's Fiscal Situation

II.5 According to the latest information on Central Government finances for 2008-09 (April-November), the revenue deficit was placed higher than that in April-November 2007 both in absolute terms and as per cent of budget estimates mainly on account of higher revenue expenditure (Table 12). As a result, fiscal deficit turned out to be higher than the preceding year (Chart 4).

II.6 It may be noted that in the supplementary demand for grants placed before the Parliament in October and December 2008, the Central Government has taken approval for gross expenditure of Rs.2,37,286 crore and Rs.55,605 crore, respectively, of which net cash outgo would be Rs.1,05,613 crore and Rs.42,480 crore, respectively. While expenditure is slated to increase, growth of tax revenue is likely to decelerate in the coming months of 2008-09 due to moderation in economic activity. This, in turn, will be reflected in the non-attainability of the deficit targets for 2008-09 as envisaged in the Union Budget 2008-09.

II.7 During April-November 2008, tax revenue as per cent of budget estimates was lower than a year ago on account of lower growth in income tax, corporation tax and customs duties owing to economic slowdown. Non-tax revenue, as per cent of budget estimates, was also lower than a year ago mainly on account of decline in interest receipts. Aggregate expenditure,

Table 12: Central Government Finances during April-November 2008

(Rupees crore)

Items	2008-09 (BE)	April-November (Rupees crore) 2007	April-November (Rupees crore) 2008	Per cent of BE 2007	Per cent of BE 2008
1	2	3	4	5	6
1. Revenue Receipts (i + ii)	6,02,935	2,74,633	3,14,974	56.5	52.2
i) Tax Revenue	5,07,150	2,20,372	2,53,558	54.6	50.0
ii) Non-tax Revenue	95,785	54,261	61,416	65.7	64.1
2. Non-Debt Capital Receipts	14,662	40,468 (6,159)	2,640	93.8 (195.5)	18.0
3. Non-Plan Expenditure	5,07,498	2,98,756 (2,63,225)	3,57,994	62.8 (60.5)	70.5
of which:					
i) Interest Payments	1,90,807	1,03,648	1,11,680	65.2	58.5
ii) Defence	1,05,600	40,328	52,557	42.0	49.7
iii) Subsidies	67,037	46,222	98,739	90.2	147.2
iv) Grants to States and UTs	43,294	22,428	21,068	58.4	48.7
4. Plan Expenditure	2,43,386	1,12,619	1,36,130	54.9	55.9
5. Revenue Expenditure	6,58,119	3,44,607	4,56,338	61.8	69.3
6. Capital Expenditure	92,765	64,768 (31,237)	37,786	54.5 (37.8)	40.7
7. Total Expenditure	7,50,884	4,11,375 (3,75,844)	4,94,124	60.5 (58.7)	65.8
8. Revenue Deficit	55,184	69,974	1,41,364	97.9	256.2
9. Gross Fiscal Deficit	1,33,287	96,274 (95,052)	1,76,510	63.8 (63.0)	132.4
10. Gross Primary Deficit	-57,520	-7,374 (-8,596)	64,830	–	–
Memo:					
1. Gross Tax Revenue	6,87,715	3,04,105	3,57,441	52.0	55.5
Direct Taxes	3,65,000	1,44,873	1,77,511	54.2	48.6
Indirect Taxes	3,22,715	1,59,231	1,79,930	56.7	55.8
2. Extra-budgetary Items*	–	15,147 #	58,000 #	–	–

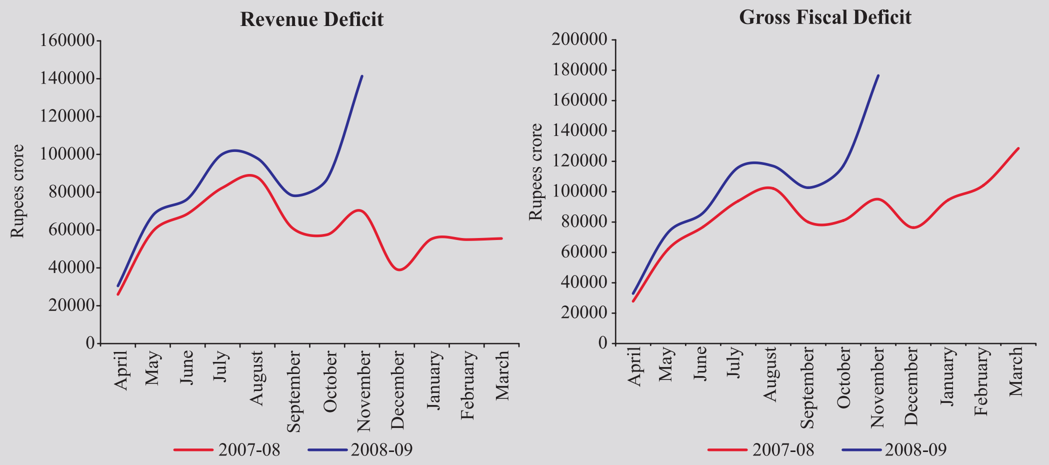
BE : Budget Estimates. UTs : Union Territories. * : Comprises oil and fertiliser bonds. # : Up to January 19.

Note : Figures in parentheses are net of transactions relating to transfer of Reserve Bank's stake in State Bank of India to the Government.

Source : Controller General of Accounts, Ministry of Finance.

as per cent of budget estimates, was higher than a year ago (adjusted for acquisition cost of Reserve Bank's stake in SBI in 2007) on account of higher revenue expenditure, particularly, subsidies, defence, other economic services, social services and plan grants to States/UTs. Capital outlay during April-November 2008-09 increased by 23.0 per cent as against a decline of 3.0 per cent during April-November, 2007 (adjusted for acquisition cost of Reserve Bank's stake in SBI in 2007). Non-plan expenditure as a per cent of budget estimates was higher

Chart 4: Key Deficit Indicators of the Centre



than a year ago. Non-debt capital receipts were lower than that of the preceding year (adjusted for profit on sale of Reserve Bank's stake in SBI) as the budgeted dilution of equities in power companies is yet to take place.

Mid-Year Review by the Government of India

II.8 The Mid-Year Review for 2008-09 by the Government of India noted that revenue deficit exceeded the target of 1.0 per cent of GDP in each of the first six months of 2008-09. The Review anticipated the expenditure to rise during the second half of the year on account of implementation of the Sixth Pay Commission recommendations, explicit food and fertiliser subsidies, farmers debt waiver and debt relief scheme and National Rural Guarantee Scheme included in the first batch of supplementary demand for grants. Actual headroom for additional committed expenditure would depend on the buoyancy of revenue. The Review hoped for some improvement in non-tax revenue on account of receipts from the telecom sector.

II.9 The Review recognised that continued momentum on fiscal consolidation is vital for the Government's capacity to use fiscal policy as an active counter-cyclic instrument for promoting stability and growth in an uncertain global context. However, it was also indicated that Government's conscious decision to increase public expenditure in order to maintain the higher trajectory of growth in the Indian Economy (Table 13) is likely to drive up the fiscal and revenue deficit for 2008-09 above the budgetary targets.

Extra-Budgetary Items

II.10 The Central Government, besides providing explicit subsidies on food, fertiliser and petroleum, has also been supporting Food Corporation of India (FCI), fertiliser companies and oil

Table 13: Major Post Budget Fiscal Stimulus Measures

October 20, 2008

- The supplementary demand for grants provided for a gross expenditure amounting to Rs.2,37,286 crore with net cash outgo of Rs.1,05,613 crore mainly to finance schemes/plans announced in the Union Budget for 2008-09 but for which no provisions were made.

December 7, 2008

- The three major *ad valorem* rates of central excise duty, *viz*., 14 per cent, 12 per cent and 8 per cent applicable to non-petroleum products were reduced by 4 percentage points each.
- For promoting exports, pre-shipment and post-shipment export credit for labour intensive exports, *i.e*., textiles (including handlooms, carpets and handicrafts), leather, gems & jewellery, marine products and SME sector is being made more attractive by providing an interest subvention of 2 per cent up to March 31, 2009 subject to minimum rate of interest of 7 per cent per annum. An additional fund of Rs.1,100 crore to ensure full refund of terminal excise duty/central sales tax (CST) was announced. Furthermore, an additional allocation of Rs.350 crore for export incentive schemes was announced.
- In order to provide a contra-cyclical stimulus *via* plan expenditure, an additional Plan expenditure of up to Rs 20,000 crore in the current fiscal year was allocated.
- In the textile sector, an additional allocation of Rs.1,400 crore will be made to clear the entire backlog of Technology Up-gradation Fund (TUF) Scheme.
- In order to support the infrastructure schemes under Public Private partnership mode, India Infrastructure Finance Company Limited (IIFCL) was authorised to raise Rs.10,000 crore through tax-free bonds by March 31, 2009.

December 19, 2008

- The second supplementary demand for grants provided for a gross expenditure amounting to Rs.55,605 crore with net cash outgo of Rs.42,480 crore.

marketing companies through issuance of special bonds. These bonds are considered to be fiscal deficit neutral since they do not involve cash flow and are, therefore, not treated as part of budgetary expenditure/receipts. However, these bonds have fiscal implications as they add to the fiscal liabilities of the Government. Furthermore, as interest payments on such bonds are treated as part of the revenue expenditure, they affect the revenue deficit and, thereby, the fiscal deficit. During 2008-09 (up to January 19, 2009), special bonds amounting to Rs.44,000 crore and Rs.14,000 crore have been issued to oil marketing companies and fertiliser companies, respectively.

State Finances

II.11 The State Governments committed to pursue fiscal correction and consolidation in their budgets for 2008-09. Notwithstanding some variations across the States, the consolidated revenue balance of 28 State Governments was budgeted to show further improvement in 2008-09, with the revenue surplus placed higher at 0.54 per cent of GDP as compared with 0.48 per cent during the previous year. GFD was budgeted lower at 2.1 per cent of GDP in 2008-09 BE as compared with 2.3 per cent in 2007-08 (RE). However, primary deficit was to be maintained at 0.1 per cent of GDP in 2008-09 (BE) as in the previous year.

Corporate Performance

II.12 Sales performance of select non-Government non-financial public limited companies in the private corporate sector during the first two quarters of 2008-09 was impressive; however, profits performance was subdued as compared with 2007-08. Higher increase in expenditure in relation to sales growth was primarily on account of rising input costs, interest expenses and large provisioning towards mark to market (MTM) losses on foreign exchange related transactions which exerted pressure on profits. Consequently, net profits decelerated during the first quarter and declined marginally during the second quarter of 2008-09 as against sizeable increases in the corresponding quarters of 2007-08 (Table 14). Reflecting increase in interest

Table 14: Corporate Sector - Financial Performance

(Per cent)

		2007-08				2008-09	
Item	2007-08	Q1	Q2	Q3	Q4	Q1	Q2
1	2	3	4	5	6	7	8
Sales	18.3	19.2	16.0	18.0	20.6	29.3	31.8
Other income	46.2	106.7	45.2	70.2	28.5	-8.4	-0.6
Expenditure	18.4	18.0	15.3	18.9	23.3	33.5	37.5
Depreciation provision	14.8	18.1	15.8	17.9	15.4	15.3	16.5
Gross profits	22.8	31.9	22.5	20.4	16.8	11.9	8.7
Interest payments	28.8	4.4	18.4	45.7	35.8	58.1	85.3
Profits after tax	26.2	33.9	22.7	29.4	14.1	6.9	-2.6
Select Ratios							
Gross Profits to Sales	16.3	16.7	16.3	16.2	15.0	14.5	13.5
Profits After Tax to Sales	11.8	11.6	11.5	12.2	10.3	9.7	8.6
Interest to Sales	2.2	2.0	2.1	2.5	2.2	2.4	2.9
Interest to Gross Profits	13.8	11.8	12.8	15.3	14.6	16.8	21.5
Interest Coverage (Times)	7.3	8.5	7.8	6.5	6.8	6.0	4.6
Memo:							(Amount in Rupees crore)
No of companies	2,359	2,342	2,228	2,329	2,357	2,500	2,386
Sales	11,41,711	2,80,814	2,97,110	3,06,238	3,50,917	3,65,303	3,93,626
Other income*	30,958	9,151	8,057	9,221	10,082	7,666	7,943
Expenditure	9,56,930	2,37,698	2,49,194	2,57,472	3,02,105	3,17,605	3,43,921
Depreciation provision	40,664	10,173	10,576	10,961	11,805	11,590	12,075
Gross profits	1,86,665	46,780	48,296	49,717	52,583	52,930	52,968
Interest Payments	25,677	5,504	6,194	7,609	7,703	8,891	11,403
Profits after tax	1,34,291	32,699	34,266	37,470	36,109	35,295	33,844

*: Other income excludes extraordinary income/expenditure if reported explicitly.

Notes : 1. Data for 2007-08 and 2008-09 are based on abridged financial results of the select non-government non-financial public limited companies.

2. Growth rates are percentage changes in the level for the period under reference over the corresponding period of the previous year for common set of companies.

3. The quarterly data may not add up to annual data due to differences in the number and composition of companies covered, in each period.

payments coupled with deceleration in gross profits, interest burden (measured as interest to gross profits) increased during the second quarter of 2008-09.

II.13 The profits of select non-financial government companies also remained subdued during the first half of 2008-09 reflecting largely the performance of oil companies. Seven listed oil companies, despite posting a revenue growth of 55.1 per cent, suffered losses during the first half of 2008-09 as against profits during the corresponding previous period. In particular, the combined losses of three major oil marketing companies arose primarily on account of increase in net under-recovery on sale of petrol, diesel, kerosene and LPG as a result of non-revision of retail selling prices in line with rising international prices. These companies were issued oil bonds by the Government to partially compensate the under-realisation. In contrast to losses reported by oil companies, the performance of 49 non-oil non-financial Government companies showed that they posted a growth in net profits of 12.8 per cent during the first half of 2008-09 over the corresponding previous period.

External Demand

II.14 External demand as reflected in net exports (of goods and services) as a percentage of GDP, deteriorated to (-) 7.9 per cent during the first half of 2008-09 as compared with (-) 4.8 per cent in the corresponding period of the previous year. Merchandise trade deficit recorded a sharp increase during April-November 2008 on account of higher oil prices coupled with loss of momentum in exports since September 2008. Export growth decelerated in September 2008 and thereafter turned negative in October-November 2008. Merchandise trade deficit during April-November 2008 widened to US $ 84.4 billion from US $ 53.2 billion a year ago. A detailed discussion on the external demand conditions is set out in Chapter III.

III. THE EXTERNAL ECONOMY

III.1 India's balance of payments position during the first half of 2008-09 (April-September) reflected a widening of trade deficit resulting in large current account deficit, and moderation in capital flows. Merchandise trade deficit recorded a sharp increase during April-November 2008 on account of higher crude oil prices for most of the period and loss of momentum in exports since September 2008. Net surplus under invisibles remained buoyant, led by increase in software exports and private transfers. Net capital inflows reduced sharply and have remained volatile during 2008-09 so far. While foreign direct investment into India increased during April-November 2008, foreign portfolio investments showed substantial outflows. As on January 16, 2009, foreign exchange reserves at US $ 252.2 billion declined by US $ 57.5 billion over the level at end-March 2008 (including changes due to valuation losses).

International Developments

III.2 Global growth prospects have deteriorated significantly, aggravated by the financial crisis and the severe strains on banking systems and credit conditions worldwide. Financial sector deleveraging has continued and the frozen credit markets have raised the spectre of a major recession in the global economy. The impact is visible not only in the financial markets but also in the real economy across the globe. Significant falls in asset prices, the end of a housing construction boom in a number of countries and fall in consumer and business sentiment are weighing on economic activity. Further deceleration in GDP growth was witnessed across both the advanced as well as the emerging market economies (EMEs) in the third quarter of 2008. While a substantial deceleration was witnessed in all major advanced economies including the US, Euro area and the UK in the third quarter as compared with the second quarter, the growth in EMEs also showed some moderation (Table 15). Uncertainty surrounding the global economic outlook remains high mainly stemming from a scenario of ongoing financial market tensions affecting the real economy more adversely than previously anticipated. Since the official recognition of recession in the US, the UK, the Euro area and Japan, the downside risks to the global economy have increased. According to the IMF, world growth is projected to slow from 5.0 per cent in 2007 to 3.7 per cent in 2008 and further to 2.2 per cent in 2009, with the downturn led by advanced economies (Table 16).

III.3 According to the IMF, the US economy is projected to contract by 0.7 per cent in 2009 (as against an increase of 1.4 per cent in 2008) as households respond to depreciating real and financial assets and tightening financial conditions. Similarly, real GDP in the Euro area is also projected to decline by 0.5 per cent in 2009 (as against an increase of 1.2 per cent in 2008) due to tightening financial conditions and falling confidence. The Japanese GDP has already shown a contraction by 0.5 per cent in the third quarter of 2008 reflecting sluggish domestic demand and slowdown in exports. Real GDP in Japan is projected to record a

Table 15: Growth Rates – Global Scenario

(Per cent)

Region/Country	2007	2008P	2009P	2008 Q1	2008 Q2	2008 Q3
1	2	3	4	5	6	7
Advanced Economies						
Euro area	2.6	1.2	-0.5	2.1	1.4	0.6
Japan	2.1	0.5	-0.2	1.4	0.7	-0.5
Korea	5.0	4.1	3.5	5.8	4.8	3.8
UK	3.0	0.8	-1.3	2.4	1.5	0.3
US	2.0	1.4	-0.7	2.5	2.1	0.7
OECD Countries	2.6	1.4	-0.4	2.6	1.9	0.8
Emerging Economies						
Argentina	8.7	6.5	3.6	8.3	7.6	6.2
Brazil	5.4	5.2	3.0	6.1	6.2	6.8
China	11.9	9.7	8.5	10.6	10.1	9.0
India	9.0	7.8	6.3	8.8	7.9	7.6
Indonesia	6.3	6.1	5.5	6.3	6.4	6.1
Malaysia	6.3	5.8	4.8	7.4	6.7	4.7
Thailand	4.8	4.7	4.5	6.0	5.3	4.0

P : IMF Projections.

Note : Data for India in column 2 pertains to fiscal year 2007-08.

Source : International Monetary Fund; The Economist; and the OECD.

decline of 0.2 per cent in 2009 as the support to growth from net exports is expected to decline further. Financial conditions continue to present significant downside risks. Significant uncertainty still remains about the extent and duration of the economic downturn in affected economies stemming from the crisis.

III.4 The growth in the EMEs, which were earlier considered to be resilient to the global financial disruptions, is also projected to slow appreciably to 5.1 per cent in 2009. Among the most affected EMEs are commodity exporters, given that commodity price projections have been marked down substantially, and countries facing external financing and liquidity constraints. The IMF projects that developing Asia will grow by 7.1 per cent in 2009 (8.3 per cent in 2008). While China's growth is projected to moderate from 9.7 per cent in 2008 to 8.5 per cent in 2009, growth for India is placed at 6.3 per cent for 2009 (7.8 per cent in 2008) by the IMF. Nevertheless, the economic outlook for the EMEs still remains relatively positive when compared to advanced economies, but uncertainties about their resilience to the global shocks have considerably increased. The impact of financial crisis is already in evidence in the currency and equity markets and the phase of capital outflows that have occurred from the EMEs. However, the macro impact on the EMEs including India has so far been contained by the strength of domestic demand.

III.5 Subsequent to the IMF's forecast released in November 2008, forecasts released by other international organisations in December 2008, reflect further economic

Table 16: Select Economic Indicators – World

Item	2006	2007	2008P	2009P
1	2	3	4	5
I. World Output (Per cent change) #	5.1	5.0	3.7	2.2
	(3.9)	(3.7)	(2.6)	(1.1)
i) Advanced Economies	3.0	2.6	1.4	-0.3
ii) Other Emerging Market and Developing Countries	7.9	8.0	6.6	5.1
of which: Developing Asia	9.8	10.0	8.3	7.1
II. Consumer Price Inflation (Per cent)				
i) Advanced Economies	2.4	2.2	3.6	1.4
ii) Other Emerging Market and Developing Countries	5.4	6.4	9.2	7.1
of which: Developing Asia	4.2	5.4	7.8	6.2
III. Net Capital Flows* (US $ billion)				
i) Net Private Capital Flows (a+b+c)**	223.0	632.8	528.6	286.6
a) Net Private Direct Investment	246.0	379.0	443.6	414.6
b Net Private Portfolio Investment	-107.3	54.5	-6.6	-89.1
c) Net Other Private Capital Flows	84.4	199.5	91.8	-38.7
ii) Net Official Flows	-158.0	-140.7	-158.6	-135.4
IV. World Trade @				
i) Volume	9.4	7.2	4.6	2.1
ii) Price Deflator	5.0	8.1	15.3	0.2
V. Current Account Balance (Per cent to GDP)				
i) US	-6.0	-5.3	-4.6	-3.3
ii) China	9.4	11.3	9.5	9.2
iii) Middle East	21.1	18.4	22.9	17.1

P : IMF Projections.
\# : Growth rates are based on exchange rates at purchasing power parities. Figures in parentheses are growth rates at market exchange rates as given in World Economic Outlook October 2008 and WEO Update of November 6, 2008.
* : Net capital flows to emerging market and developing countries.
** : On account of data limitations, flows listed under 'Net private capital flows' may include some official flows.
@ : Average of annual percentage change for world exports and imports of goods and services.
Source : World Economic Outlook (October 2008), WEO Update (November 6, 2008), International Monetary Fund.

downturn. According to World Bank projections, world real GDP (measured at market exchange rates) may slow down even deeper to 2.5 per cent in 2008 and further to 0.9 per cent in 2009. Growth prospects for both high-income and developing countries have deteriorated substantially, and the possibility of a serious global recession cannot be ruled out. The pronounced recession that began in mid-2008 in Europe, Japan, and most recently, the United States is projected to extend into 2009, resulting in a decline in GDP of high-income countries of 0.1 per cent that year. In developing countries, growth is projected to slow to 4.5 per cent in 2009, down from 7.9 and 6.3 per cent in 2007 and 2008, respectively. As per the projections of the Organization for Economic Co-operation and Development (OECD), GDP is likely to decline by 0.3 per cent in 2009 for its 30 member countries. The Asian Development Bank (ADB) projects that economic growth in developing Asia will decline to 5.8 per cent in 2009, down from 6.9 per cent in 2008 and 9.0 per cent in 2007.

III.6 According to projections updated by the IMF in November 2008, growth in world

Table 17: Growth in Exports - Global Scenario

(Per cent)

Region/Country	2007	2007	2008
		January-September	
1	2	3	4
World	**14.0**	**14.0**	**12.1**
Advanced Economies	**13.4**	**12.8**	**18.7**
Emerging and Developing Economies	**15.1**	**16.3**	**0.2**
China	25.6	27.1	22.3
France	12.3	11.0	18.9
Germany	18.4	19.4	19.8
India	21.5	21.6 *	23.7 *
Indonesia	14.7	14.0	27.1
Japan	7.8	8.1	18.9
Korea	14.1	12.7	22.7
Malaysia	9.6	7.4	19.8
Singapore	10.1	8.5	22.9
Thailand	17.0	14.6	22.7
US	12.0	11.4	17.6

* : January-November.
Source : International Financial Statistics, International Monetary Fund; DGCI&S for India.

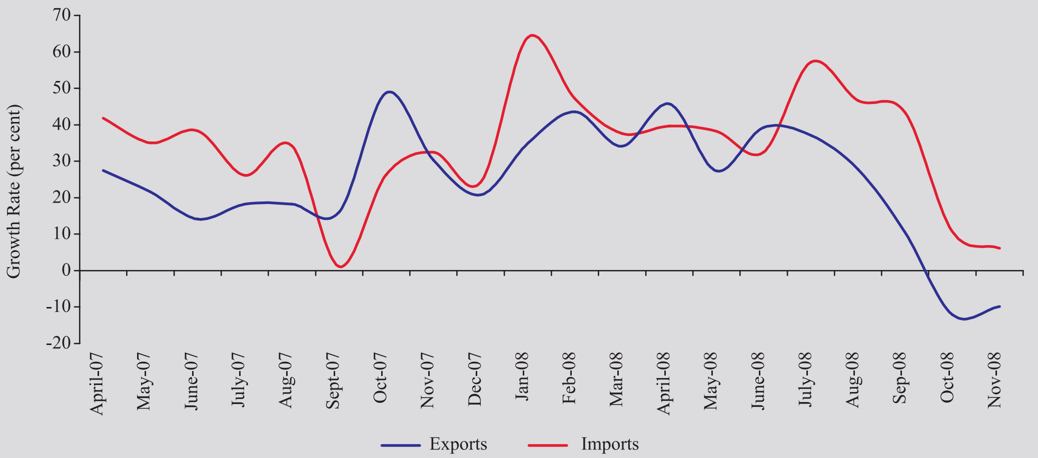
trade is expected to moderate in volume terms in 2008 and exports growth of emerging and developing economies is projected to slow.

III.7 According to the IMF's International Financial Statistics, growth in world merchandise exports during January-September 2008, in US dollar terms, decelerated to 12.1 per cent from 14.0 per cent in the previous year. While exports from the advanced economies showed higher growth, those from emerging and developing economies recorded only marginal growth (Table 17).

Merchandise Trade

III.8 India's merchandise exports, which remained resilient till August 2008 (35.3 per cent growth during April-August 2008) decelerated in September 2008 (10.4 per cent) and recorded negative growth during October and November 2008 (-12.1 per cent and -9.9 per cent, respectively), reflecting the global economic slowdown (Chart 5). According to the provisional data released by DGCI&S, India's merchandise exports during April-November 2008 increased by 18.7 per cent while imports recorded a higher growth of 32.5 per cent, largely due to the

Chart 5: India's Merchandise Trade



rise in petroleum, oil and lubricants (POL) imports. During April-November 2008, POL imports grew at an accelerated pace, reflecting the elevated international crude oil prices. Non-oil imports exhibited a deceleration in growth during April-November 2008 (Table 21).

III.9 Commodity-wise data available for the period April-September 2008 reveal that all major commodity groups except textiles and textile products, and gems and jewellery showed accelerated growth in exports. Engineering goods, agriculture & allied products and petroleum products were the main contributors of exports growth during April-September 2008, together constituting 55.9 per cent of the total exports and contributing 75.6 per cent to export growth. Primary products exports recorded an accelerated growth of 39.8 per cent, while manufactured goods exports registered a growth of 23.5 per cent during April-September 2008 (Table 18).

III.10 Destination-wise, developing countries remained the major markets for India's exports during April-September 2008. Exports to the European Union, OPEC, North America, Eastern Europe, and Asian and Latin American developing countries accelerated while those to African developing countries decelerated. The US continued to be the single largest export destination of India followed by the UAE, Singapore, China and the Netherlands (Table 19).

III.11 Commodity-wise data on imports available for April-September 2008 show that while oil imports continued to register a sharp increase, non-oil imports witnessed a moderation in growth. The rise in oil imports was primarily due to high international crude oil prices, while the volume of oil imports moderated. The moderation in the growth of non-oil imports was mainly due to decline/deceleration in the import of pearls, precious and semi-

Table 18: Exports of Principal Commodities

Commodity Group	US $ billion			Variation (per cent)		
	2007-08	2007-08R	2008-09P	2007-08	2007-08	2008-09
		April-September			April-September	
1	2	3	4	5	6	7
1. Primary Products	**27.5**	**10.3**	**14.5**	**39.8**	**21.7**	**39.8**
of which:						
a) Agriculture and Allied Products	18.4	6.9	10.0	45.1	22.7	46.5
b) Ores and Minerals	9.1	3.5	4.4	30.2	19.7	26.6
2. Manufactured Goods	**102.9**	**48.2**	**59.5**	**21.2**	**17.8**	**23.5**
of which:						
a) Chemicals and Related Products	21.2	9.5	12.1	22.2	15.4	26.4
b) Engineering Goods	37.4	17.2	24.5	26.3	22.5	43.0
c) Textiles and Textile Products	19.4	9.3	10.0	11.8	7.7	7.2
d) Gems and Jewellery	19.7	9.6	10.0	23.2	23.9	4.7
3. Petroleum Products	**28.4**	**12.7**	**18.5**	**51.8**	**27.6**	**45.6**
4. Total Exports	**162.9**	**73.3**	**94.9**	**28.9**	**19.8**	**29.5**
Memo:						
Non-oil Exports	134.5	60.6	76.4	24.9	18.3	26.2

R : Revised. P : Provisional.
Source : DGCI&S.

Table 19: Direction of India's Exports

Group/Country	US $ billion			Variation (per cent)		
	2007-08	2007-08R	2008-09P	2007-08	2007-08	2008-09
		April-September			April-September	
1	2	3	4	5	6	7
1. OECD Countries	**62.6**	**29.8**	**35.6**	**20.4**	**17.1**	**19.3**
of which:						
a) EU	32.9	15.9	20.2	27.6	26.0	27.1
b) North America	22.0	10.5	11.4	10.0	5.7	8.6
US	20.7	9.9	10.7	9.8	5.8	8.3
2. OPEC	**26.7**	**12.9**	**18.8**	**28.8**	**22.5**	**46.1**
of which:						
UAE	15.6	7.5	10.4	29.9	21.4	37.9
3. Developing Countries	**69.6**	**29.5**	**38.9**	**37.1**	**21.1**	**31.8**
of which:						
Asia	51.5	21.3	28.5	36.9	17.3	33.5
People's Republic of China	10.8	3.9	4.5	30.6	12.7	16.6
Singapore	7.4	3.1	5.2	21.4	-12.5	71.1
4. Total Exports	**162.9**	**73.3**	**94.9**	**28.9**	**19.8**	**29.5**

R : Revised. P : Provisional.
Source : DGCI&S.

precious stones, gold and silver, iron and steel and electronics goods, though chemicals and fertilisers recorded higher growth (Table 20).

III.12 Source-wise, China was the single largest source of imports accounting for 10.3 per cent of the total imports followed by Saudi Arabia, UAE, the US, Iran and Switzerland.

Table 20: Imports of Principal Commodities

Commodity Group	US $ billion			Variation (per cent)		
	2007-08	2007-08R	2008-09P	2007-08	2007-08	2008-09
		April-September			April-September	
1	2	3	4	5	6	7
Petroleum, Petroleum Products and Related Material	79.6	34.6	62.2	39.4	17.1	79.6
Edible Oil	2.6	1.4	1.4	21.4	33.3	4.0
Iron and Steel	8.7	4.5	5.0	35.3	53.9	11.1
Capital Goods	70.8	25.4	32.2	50.5	28.1	27.1
Pearls, Precious and Semi-Precious Stones	8.0	4.7	4.0	6.5	30.4	-15.2
Chemicals	9.9	4.7	7.5	26.5	21.9	57.4
Gold and Silver	17.9	11.7	11.1	22.0	73.1	-4.9
Total Imports	**251.4**	**112.1**	**162.4**	**35.4**	**28.3**	**44.9**
Memo:						
Non-oil Imports	171.8	77.4	100.2	33.6	33.9	29.4
Non-oil Imports excluding Gold and Silver	153.9	65.8	89.1	35.1	28.8	35.4
Mainly Industrial Inputs*	141.7	60.3	78.2	35.4	27.8	29.6

R : Revised. P : Provisional.
* : Non-oil imports net of gold and silver, bulk consumption goods, manufactured fertilisers and professional instruments.
Source : DGCI&S.

Table 21: India's Merchandise Trade

(US $ billion)

Item	2007-08R	2007-08R	2008-09P
		April-November	
1	2	3	4
Exports	162.9	99.8	118.4
Oil	28.4	17.2	18.5 *
Non-oil	134.5	82.5	76.4 *
Imports	251.4	153.0	202.8
Oil	79.6	47.6	73.7
Non-oil	171.8	105.4	129.1
Trade Balance	-88.5	-53.2	-84.4
Non-Oil Trade Balance	-37.3	-22.8	-23.7 *
		Variation (per cent)	
Exports	28.9	23.6	18.7
Oil	51.8	34.4	45.6 *
Non-oil	24.9	21.5	26.2 *
Imports	35.4	28.0	32.5
Oil	39.4	20.8	54.7
Non-oil	33.6	31.6	22.5

R : Revised. P : Provisional. * : April-September.
Source : DGCI&S.

III.13 Merchandise trade deficit during April-November 2008 widened to US $ 84.4 billion from US $ 53.2 billion a year ago (Table 21).

Balance of Payments

Current Account

III.14 India's current account deficit increased to US $ 22.3 billion during April-September 2008 (US $ 11.0 billion during April-September 2007) mainly due to widened trade deficit (Table 22 and Chart 6).

III.15 The widening of trade deficit during April-September 2008 could be attributed to higher import payments reflecting high international commodity prices, particularly crude oil prices (Chart 7).

Invisibles

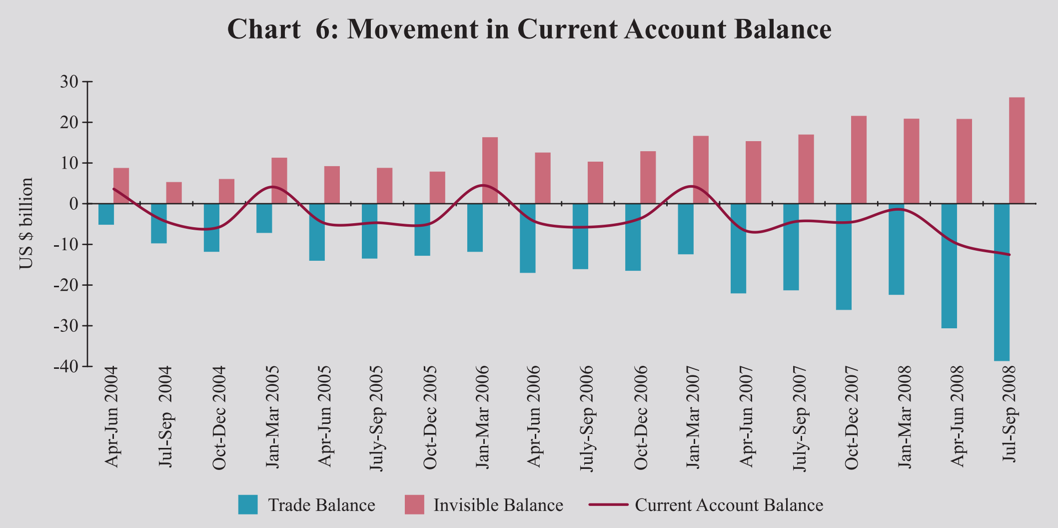
III.16 Gross invisibles receipts rose by 29.8 per cent during April-September 2008 (28.3 per cent during the corresponding period of the previous year) mainly due to increase in receipts under private transfers

Table 22: India's Balance of Payments

(US $ billion)

Item	2007-08 PR	2007-08 PR			2008-09		
	April-March	April-June	Jul-Sept.	April-Sept.	April-June PR	July-Sept. P	April-Sept. P
1	2	3	4	5	6	7	8
Export	166.2	34.4	38.3	72.6	49.1	47.7	96.7
Import	257.8	56.3	59.5	115.9	79.6	86.3	165.9
Trade Balance	-91.6	-22.0	-21.2	-43.2	-30.6	-38.6	-69.2
Net Invisibles	74.6	15.3	16.9	32.3	20.8	26.1	46.8
Current Account Balance	-17.0	-6.7	-4.3	-11.0	-9.8	-12.5	-22.3
Net Capital Account	108.0	17.8	33.2	50.9	11.8	8.2	19.9
Overall Balance*	92.2	11.2	29.2	40.4	2.2	-4.7	-2.5
Memo:							Growth Rate (Per cent)
Exports	28.9	15.8	17.0	16.5	42.8	24.6	33.2
Imports	35.2	20.9	22.2	21.5	41.3	45.0	43.2
Invisible receipts	29.7	19.8	36.8	28.3	25.1	33.9	29.8
Invisibles payments	18.7	17.3	17.0	17.1	14.0	13.9	14.0

PR : Partially Revised. P : Preliminary.
* : Overall balance includes errors and omissions.



along with the steady growth in software services exports, business services, travel and transportation. The invisible payments recorded a lower growth of 14.0 per cent during April-September 2008 (17.1 per cent during April-September 2007) mainly due to lower payments relating to a number of business and professional services. Net invisibles (invisibles receipts *minus* invisibles payments) increased by 45.3 per cent during April-September 2008 mainly led by higher growth in private transfers and software exports (Table 23). At this level, the invisibles surplus financed about 67.7 per cent of trade deficit during April-September 2008 (74.6 per cent during April-September 2007).

Capital Account

III.17 The surplus in the capital account moderated during April-September 2008

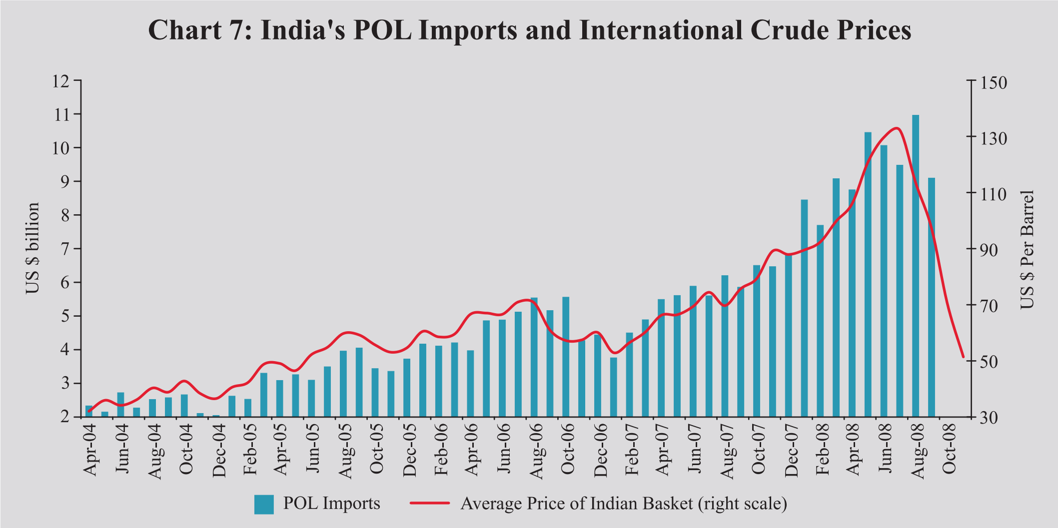


Table 23: Invisibles Account (Net)

(US $ million)

Item	2007-08 PR	2007-08 PR			2008-09		
	April-March	April-June	July-Sept.	April-Sept.	April-June PR	July-Sept. P	April-Sept. P
1	2	3	4	5	6	7	8
Services	37,565	8,974	8,998	17,972	10,175	12,701	22,876
Travel	2,095	182	201	383	340	117	457
Transportation	-1,500	-573	-468	-1,041	-798	-703	-1,501
Insurance	595	188	57	245	122	64	186
Government not included elsewhere	-46	-16	-60	-76	20	-14	6
Software	37,242	8,157	8,249	16,406	9,799	10,296	20,095
Other Services	-821	1,036	1,019	2,055	692	2,941	3,633
Transfers	41,944	8,196	9,300	17,496	11,511	14,232	25,743
Investment Income	-4,281	-1,745	-1,170	-2,915	-739	-829	-1,568
Compensation of Employees	-636	-115	-188	-303	-175	-27	-202
Total	**74,592**	**15,310**	**16,940**	**32,250**	**20,772**	**26,077**	**46,849**

PR : Partially Revised. P : Preliminary.

reflecting increased gross capital outflows following the global financial turmoil (Chart 8). The gross capital inflows were higher on account of higher FDI inflows and NRI deposits during the period.

III.18 FDI broadly comprising equity, reinvested earnings and inter-corporate loans was the major contributor to the capital inflows to India in net terms (Table 24). While the net inward FDI (net direct investment by foreign investors) remained buoyant reflecting relatively strong fundamentals of the Indian economy and continuing liberalisation measures to attract

Chart 8: Movements in Capital Inflows and Outflows

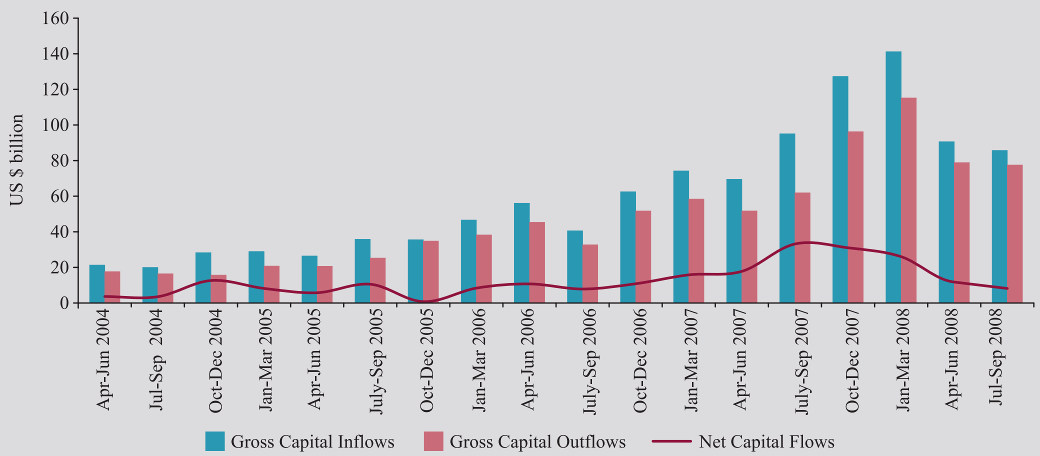


Table 24: Net Capital Flows

(US $ million)

Item	April-March		April-September	
	2006-07R	2007-08PR	2007-08PR	2008-09P
1	2	3	4	5
1. Foreign Direct Investment	7,693	15,401	4,864	14,557
2. Portfolio Investment	7,060	29,556	18,441	-5,521
of which:				
FIIs	3,225	20,328	15,508	-6,615
ADR/GDRs	3,776	8,769	2,793	1,135
3. External Assistance	1,775	2,114	709	869
4. External Commercial Borrowings	16,103	22,633	11,163	3,341
5. NRI Deposits	4,321	179	-78	1,073
6. Banking Capital excluding NRI Deposits	-2,408	11,578	5,802	3,754
7. Short-term Trade Credit	6,612	17,183	6,589	3,173
8. Rupee Debt Service	-162	-121	-45	-33
9. Other Capital	4,209	9,470	3,502	-1,275
Total (1 to 9)	**45,203**	**107,993**	**50,947**	**19,938**

R : Revised. PR : Partially Revised. P : Preliminary.

FDI, net outward FDI (net direct investment by Indian investors abroad) also remained high during April-September 2008.

III.19 Portfolio investment primarily comprising foreign institutional investors' (FIIs) investments and American Depository Receipts (ADRs)/Global Depository Receipts (GDRs) witnessed net outflows during April-September 2008 as against net inflows in the corresponding period of the previous year. Outflows under portfolio investment were led by large sales of equities by FIIs in the Indian stock market and slowdown in net inflows under ADRs/GDRs due to drying-up of liquidity in the overseas market. During the current financial year so far (up to January 9, 2009), FIIs registered a net outflow of US $ 11.9 billion (as against net inflows of US $ 26.8 billion a year ago).

III.20 Net inflows under NRI deposits, a major constituent of 'banking capital', were positive during April-September 2008. Despite higher outflows recorded during the period, there was an increase in net accretion under NRI flows at US $ 1.1 billion during April-September 2008 as against a net decline of US $ 78.0 million during April-September 2007 (Table 24). In order to facilitate inflows under NRI deposits and to revive confidence in the foreign exchange market in the aftermath of the ongoing global financial market turmoil, the Reserve Bank increased the interest rate ceiling on NRI deposits in stages to 175 basis points above LIBOR/SWAP rate in case of NRE deposits and 100 basis points above LIBOR/SWAP rate in case of FCNR(B) deposits. As a result of these policy measures, there was a turnaround in the flows since September 2008, as reflected in the increase in net inflows under the NRI deposits to US $ 1.8 billion during April-November 2008 as against a decline of US $ 0.4 billion a year ago (Table 25).

Table 25: Capital Flows to India

(US $ billion)

Component	Period	2007-08	2008-09
1	2	3	4
FDI to India	April-November	16.1	23.3
FIIs (net)	April-January #	26.8	-11.9
ADRs/GDRs	April-November	5.7	1.1
ECB Approvals*	April-November	21.5	13.8
NRI Deposits (net)	April-November	-0.4	1.8

: Up to January 9, 2009.
* : ECB approvals are on gross basis.

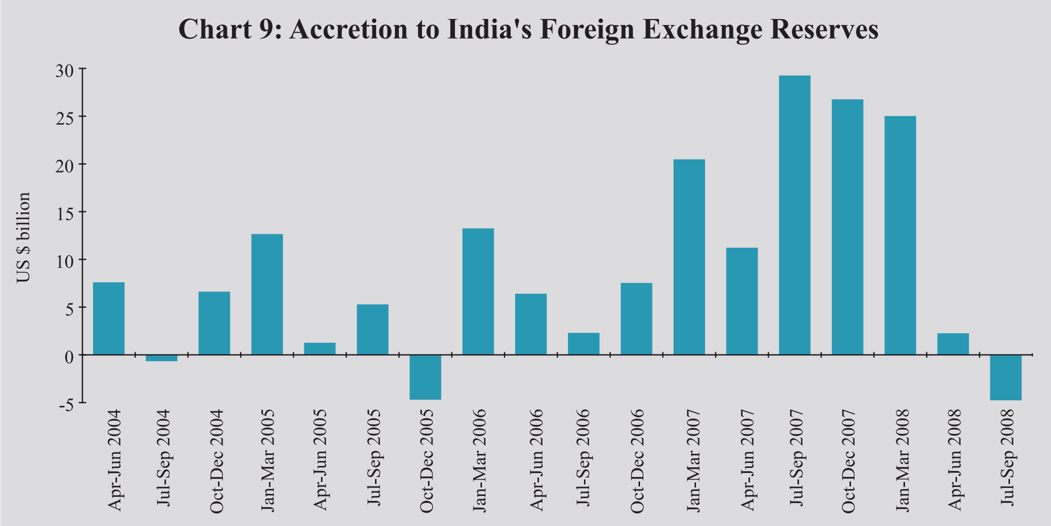
III.21 The gross disbursements under external commercial borrowings (ECBs) to India remained low during April-September 2008 reflecting tightening of overseas credit market conditions following the US sub-prime crisis. The gross ECB repayments by Indian companies increased to some extent during April-September 2008, especially in the second quarter of 2008-09. As a result, the net inflows under ECBs (including the net ECBs raised by foreigners from the Indian market) at US $ 3.3 billion during April-September 2008 was lower than the net inflows of US $ 11.2 billion during April-September 2007**.** According to the latest available information, approvals under ECBs during the current year so far (April-November) amounted to US $ 13.8 billion as compared with US $ 21.5 billion a year ago.

III.22 In order to increase capital inflows and to enable Indian companies to access overseas market for their funding needs in view of deepening of credit crunch since September 2008 in major advanced economies, the Government and the Reserve Bank modified various ECB norms in phases. The main policy measures included: (i) raising the ECB borrowing limit for infrastructure sector to US $ 500 million per financial year from the earlier limit of US $ 100 million for rupee expenditure for permissible end-uses under the approval route; (ii) the requirement of all-in-cost ceiling for ECBs over average maturity of 3-5 years and more than 5 years, which was increased to 300 basis points and 500 basis points, respectively, over 6-month LIBOR, was removed until June 30, 2009; (iii) the definition of infrastructure sector for availing ECB was expanded to include mining, exploration and refinery sectors; (iv) ECBs up to US $ 500 million per borrower per financial year were permitted for rupee expenditure and/or foreign currency expenditure for permissible end-uses under the automatic route; and (v) entities in the services sector, *viz.*, hotels, hospitals and software companies were permitted to avail ECBs up to US $ 100 million in a financial year under the approval route for the purpose of import of capital goods.

III.23 Short-term trade credit in terms of gross disbursements was higher than the repayments during the second quarter of 2008-09 reflecting rising imports. Accordingly, the buyers' credit recorded a net inflow of US $ 3.3 billion, while suppliers' credit up to 180 days recorded negligible outflow of US $ 147 million, leading to net inflows of US $ 3.2 billion during April-September 2008 (US $ 6.6 billion during April-September 2007).

Foreign Exchange Reserves

III.24 On balance, the higher current account deficit coupled with lower capital inflows led to a decline in foreign exchange reserves on BoP basis (*i.e.*, excluding



valuation) of US $ 2.5 billion during April-September 2008, as against an accretion of reserves of US $ 40.4 billion during the corresponding period of 2007-08 (Chart 9).

III.25 India's foreign exchange reserves were US $ 252.2 billion as on January 16, 2009 showing a decrease of US $ 57.5 billion over end-March 2008 (including valuation losses) (Table 26).

III.26 The overall approach to the management of India's foreign exchange reserves in recent years reflects the

Table 26: Foreign Exchange Reserves

(US $ million)

Month	Gold	SDR	Foreign Currency Assets	Reserve Position in the IMF	Total (2+3+4+5)	*Memo*: Outstanding Net Forward Sales (-) / Purchases (+) of US dollar by the Reserve Bank at the end of the month
1	2	3	4	5	6	7
March 2008	10,039	18	299,230	436	309,723	(+) 14,735
April 2008	9,427	18	304,225	485	314,155	(+) 17,095
May 2008	9,202	11	304,875	526	314,614	(+) 15,470
June 2008	9,208	11	302,340	528	312,087	(+) 13,700
July 2008	9,735	11	295,918	512	306,176	(+) 11,910
August 2008	8,692	4	286,117	496	295,309	(+) 9,925
September 2008	8,565	4	277,300	467	286,336	(+) 2,300
October 2008	8,382	9	244,045	447	252,883	(+) 90
November 2008	7,861	3	238,968	854	247,686	(-) 487
December 2008	8,485	3	246,603	877	255,968	..
January 2009*	8,485	3	242,847	843	252,178	..

* : As on January 16, 2009.

changing composition of the balance of payments and the 'liquidity risks' associated with different types of flows and other requirements. Taking these factors into account, India's foreign exchange reserves continued to be at a comfortable level and consistent with the rate of growth, the size of external sector in the economy and the size of risk-adjusted capital flow.

External Debt

III.27 India's total external debt was placed at US $ 222.6 billion at end-September 2008, recording a marginal decline of around US $ 1 billion (0.5 per cent) over end-June 2008 (Table 27). The decline in external debt stock was essentially due to reduction in long-term debt outstanding by US $ 2.7 billion during the second quarter of 2008-09. Short-term debt, however, increased mainly because of increase in short-term trade credit above 180 days of maturity, FII investments in government securities and corporate debt instruments. The Government of India and Securities Exchange Board of India (SEBI) enhanced the cumulative debt investment limit from US $ 3.0 billion to US $ 6.0 billion for FII investments in corporate debt in October 2008 and further to US $ 15 billion in January 2009. The US dollar continued to be the leading currency in which India's external debt was denominated, accounting for 56.9 per cent of total debt.

III.28 Debt sustainability indicators remained at comfortable levels at end-September 2008. The debt service ratio was placed at 4.3 per cent during the second quarter of 2008-09. The ratio of short-term

Table 27: India's External Debt

(US $ million)

Item	End-March 2007	End-March 2008	End-June 2008	End-Sept. 2008
1	2	3	4	5
1. Multilateral	35,337	39,490	39,644	38,902
2. Bilateral	16,065	19,702	18,729	18,782
3. Trade Credit (above 1 year)	7,163	10,391	11,074	12,153
4. External Commercial Borrowings	41,466	62,531	61,268	60,342
5. NRI Deposit	41,240	43,672	42,612	40,622
6. Rupee Debt	1,951	2,016	1,866	1,707
7. Long-term (1 to 6)	143,222	177,802	175,193	172,508
8. Short-term	28,130	46,999	48,619	50,104
Total (7+8)	**171,352**	**224,801**	**223,812**	**222,612**
Memo:				(Per cent)
Total debt/GDP	18.0	19.1	..	..
Short-term debt/Total debt	15.6	20.9	21.7	22.5
Short-term debt/Reserves	14.1	15.2	15.6	17.5
Concessional debt/Total debt	23.1	19.6	19.1	18.7
Reserves/Total debt	116.2	137.8	139.4	128.6
Debt Service Ratio	4.7	4.8	3.7	4.3

.. : Not available.

to total debt and short-term debt to reserves increased from that at end-June 2008. India's foreign exchange reserves exceeded the external debt by US $ 63.7 billion providing a cover of 128.6 per cent to the external debt stock at the end of September 2008.

III.29 In terms of residual maturity, as at end-March 2008, the revised short-term debt (below one year) was estimated at around US $ 85 billion, which would mature during the financial year 2008-09. This short-term debt comprises sovereign debt, commercial borrowings, NRI deposits, short-term trade credit and others maturing up to end-March 2009. It is expected that sovereign debt, NRI deposits and commercial borrowings maturing during 2008-09 would not only get rolled over, but there could also be net additional inflows. Net ECB inflows have been positive during the current year so far. Given the current trend and policy measures undertaken by the Government of India, it is expected that the ECB repayments may not pose any problem during the current year. While short-term NRI deposits by residual maturity amounted to US $ 28.8 billion at end-March 2008, bulk of these are denominated in rupees (around 64 per cent) and are expected to be rolled over by the depositors following the increase in ceiling rate of interest in these deposits. The impact of the increase in interest rates on such deposits is already visible in terms of increased inflows during April-November 2008.

III.30 Some apprehension was expressed with respect to financing of the short-term trade credit of US $ 43.2 billion during 2008-09. In this regard, it may be mentioned that in normal times, the short-term credit gets rolled over. Besides, there are net additions. According to available data for the first half of 2008-09, already US $ 21.8 billion have been disbursed. Moreover, there are reports of inflows in the pipeline on account of commitments of buyers' credit by the importers and oil companies. The issue was not about the availability of the financing but that of price at which such finances could be negotiated. In view of this, the Reserve Bank raised the all-in-cost ceiling for trade credits of maturities of 'up to one year' and 'above one year up to three years' from 75 and 125 basis points, respectively, to LIBOR *plus* 200 basis points each in October 2008. Given the trend observed in the disbursement of short-term trade credit so far and the commitments underway, it is expected that the financing of short-term trade credit may not pose much problem.

International Investment Position

III.31 India's net international liabilities declined by US $ 3.4 billion between end-March 2008 and end-June 2008, as the decline in international liabilities (US $ 7.2 billion) exceeded that in international assets (US $ 3.8 billion) (Table 28). The decline in international assets was mainly on account of decrease in external loan extended through *nostro* accounts by the banking sector. However, direct investment and reserve asset position increased between end-March 2008 and end-June 2008. On the other hand, the decline in international liabilities was mainly attributed to outflow by FIIs from portfolio equity investment during April-June 2008 and also the effect of valuation changes.

Table 28: International Investment Position of India

(US $ billion)

Item	March 2007 PR	March 2008 PR	June 2008 P
1	2	3	4
A. Assets	**246.0**	**381.4**	**377.6**
	(25.9)	**(32.4)**	**..**
1. Direct Investment	29.4	46.2	48.2
2. Portfolio Investment	0.9	0.7	0.7
2.1 Equity Securities	0.5	0.6	0.6
2.2 Debt Securities	0.4	0.1	0.1
3. Other Investment	16.5	24.8	16.6
3.1 Trade Credits	0.6	0.9	2.0
3.2 Loans	3.2	10.5	2.1
3.3 Currency and Deposits	8.5	8.2	6.4
3.4 Other Assets	4.2	5.2	6.2
4. Reserve Assets	199.2	309.7	312.1
	(20.9)	(26.3)	..
B. Liabilities	**308.0**	**434.0**	**426.8**
	(32.4)	**(36.8)**	**..**
1. Direct Investment	76.3	115.5	119.5
	(8.0)	(9.8)	..
2. Portfolio Investment	79.5	119.4	108.0
	(8.4)	(10.1)	..
2.1 Equity Securities	63.3	98.3	87.4
2.2 Debt Securities	16.2	21.2	20.5
3. Other Investment	152.3	199.0	199.2
	(16.0)	(16.9)	..
3.1 Trade Credits	27.7	45.2	47.3
3.2 Loans	80.9	106.4	106.5
3.3 Currency and Deposits	42.3	44.8	43.6
3.4 Other Liabilities	1.3	2.6	1.9
C. Net Position (A-B)	**-62.0**	**-52.5**	**-49.1**
	(-6.5)	**(-4.4)**	**..**

PR : Partially Revised. P: Provisional.

Note: Figures in parentheses are percentages to GDP.

IV. MONETARY CONDITIONS

IV.1 Monetary and liquidity aggregates that expanded at a strong pace during the first half of 2008-09 showed some moderation during the third quarter reflecting the decline in capital flows and consequent foreign exchange intervention by the Reserve Bank. Decline in net foreign exchange assets with the Reserve Bank during 2008-09 so far has also resulted in the moderation of expansion of base money. Expansion in bank credit to the commercial sector during 2008-09 so far has remained high. In response to the unfolding global financial market turmoil and its knock-on effect on the domestic financial market, and downturn in headline inflation, the Reserve Bank has taken a number of measures of monetary easing since mid-September 2008. The aim of these measures was to augment domestic and foreign exchange liquidity and to enable banks to continue to lend for productive purposes while maintaining credit quality so as to sustain the growth momentum.

Monetary Survey

IV.2 Broad money (M_3) growth, on a year-on-year (y-o-y) basis, was placed at 19.6 per cent as on January 2, 2009, which was lower than 22.6 per cent a year ago, reflecting moderation in expansion in time deposits. Expansion in the residency-based new monetary aggregate (NM_3) – which does not directly reckon non-resident foreign currency deposits such as FCNR(B) deposits – was lower at 19.4 per cent as on January 2, 2009 than 22.7 per cent a year ago. Similarly growth in liquidity aggregate, L_1, at end-December 2008 was lower at 19.0 per cent than 22.5 per cent a year ago (Table 29 and Chart 10).

IV.3 Deterioration in global financial conditions since September 2008 resulted in drying up of capital inflows. In response to the consequent pressure on the domestic money and foreign exchange markets, the Reserve Bank augmented rupee and dollar liquidity and strengthened the credit delivery mechanisms for sustaining the growth momentum. Accordingly, *inter alia*, the cash reserve ratio (CRR) has been reduced by a cumulative 4.0 percentage points to 5.0 per cent of net demand and time liabilities (NDTL) since October 11, 2008. This measure released primary liquidity into the system of the order of Rs.1,60,000 crore. The statutory liquidity ratio (SLR) was reduced by one percentage point, from 25 per cent of NDTL to 24 per cent along with relaxation in the SLR maintenance for term repo facility by 1.5 per cent of NDTL. A special refinance facility was also introduced for SCBs (excluding regional rural banks) with the limit of 1.0 per cent of each bank's NDTL as on October 24, 2008 at the LAF repo rate up to a maximum period of 90 days (with flexibility to draw and repay during this period). This facility would be available till June 30, 2009. In addition, since October 2008, the Reserve Bank has reduced the repo rate from 9.0 per cent to 5.5 per cent and the reverse repo rate from 6.0 per cent to 4.0 per cent.

Table 29: Monetary Indicators

(Amount in Rupees crore)

Item	Outstanding as on January 2, 2009	Variation (year-on-year)					
		January 4, 2008		March 31, 2008		January 2, 2009	
		Absolute	Per cent	Absolute	Per cent	Absolute	Per cent
1	2	3	4	5	6	7	8
I. Reserve Money*	8,93,565	1,96,524	30.6	2,19,427	30.9	55,361	6.6
(Adjusted Reserve Money Growth#*)			(21.6)		(25.3)		(18.0)
II. Narrow Money (M_1)	11,35,057	1,32,896	15.1	1,84,864	19.1	1,23,307	12.2
III. Broad Money (M_3)	44,91,953	6,91,768	22.6	6,90,629	20.8	7,36,777	19.6
a) Currency with the Public	6,21,997	70,242	15.1	84,571	17.5	86,809	16.2
b) Aggregate Deposits	38,64,229	6,21,944	24.0	6,04,485	21.4	6,49,152	20.2
i) Demand Deposits	5,07,333	63,072	15.4	98,721	20.8	35,682	7.6
ii) Time Deposits	33,56,896	5,58,872	25.6	5,05,765	21.5	6,13,470	22.4
of which:							
Non-Resident Foreign Currency Deposits	63,417	-8,090	-12.3	-10,525	-15.6	5,756	10.0
IV. NM_3	45,04,294	6,98,726	22.7	7,08,101	21.3	7,33,329	19.4
of which: Call Term Funding from FIs	1,05,212	8994	10.7	20,668	24.1	12,356	13.3
V. a) L_1	45,70,251	7,04,333	22.5	707403	20.6	7,29,894	19.0
of which: Postal Deposits	1,15,157	2,536	2.2	-698	-0.6	-1,744	-1.5
b) L_2	45,73,183	7,04,333	22.4	707403	20.5	7,29,894	19.0
c) L_3	45,97,830	7,04,380	22.3	708236	20.4	7,29,871	18.9
VI. Major Sources of Broad Money							
a) Net Bank Credit to the Government (i+ii)	11,38,992	52,233	6.5	72,842	8.7	2,79,785	32.6
i) Net Reserve Bank Credit to Government	-56,450	-1,49,280	–	-1,15,632	–	93,142	–
of which: to the Centre	-56,468	-1,49,358	–	-1,16,772	–	93,810	–
ii) Other Banks' Credit to Government	11,95,442	2,01,513	25.0	1,88,474	22.7	1,86,643	18.5
b) Bank Credit to the Commercial Sector	28,86,004	3,91,183	20.0	4,39,834	20.6	5,34,658	22.7
c) Net Foreign Exchange Assets of the Banking Sector	12,62,039	2,70,786	32.1	3,81,952	41.8	1,47,297	13.2
d) Government Currency Liability to Public	9,787	838	10.3	1,064	12.9	795	8.8
e) Net Non-Monetary Liabilities of the Banking Sector	8,04,870	23,273	4.2	2,05,063	36.0	2,25,758	39.0
Memo:							
Aggregate Deposits of SCBs	36,18,763	5,98,499	25.1	5,85,006	22.4	6,32,817	21.2
Non-food Credit of SCBs	26,04,379	3,79,655	22.0	4,32,846	23.0	5,01,645	23.9

*: Data pertain to January 16, 2009. # : Adjusted for changes in cash reserve ratio (CRR) of banks.

SCBs : Scheduled Commercial Banks. FIs: Financial Institutions. NBFCs: Non-Banking Financial Companies.

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).

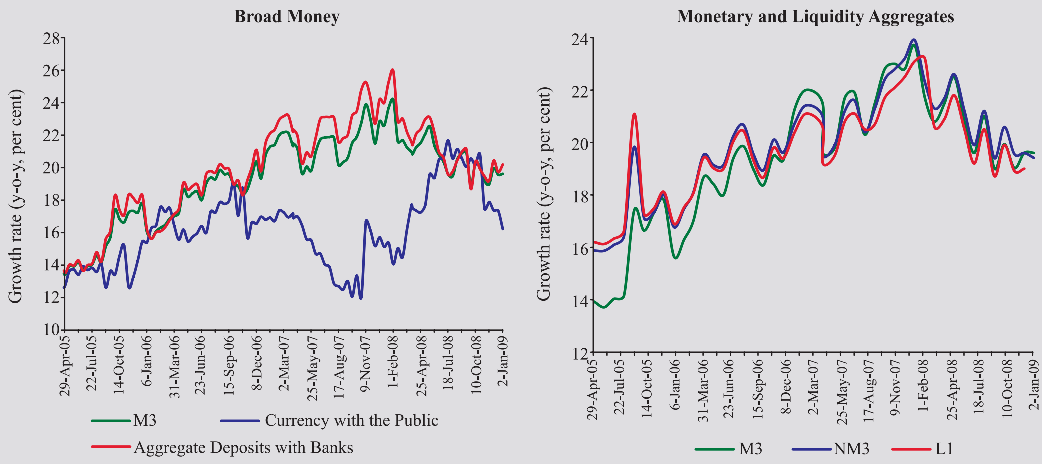
$L_1 = NM_3$ + Select deposits with the post office saving banks.

$L_2 = L_1$ +Term deposits with term lending institutions and refinancing institutions + Term borrowing by FIs + Certificates of deposit issued by FIs.

$L_3 = L_2$ + Public deposits of NBFCs.

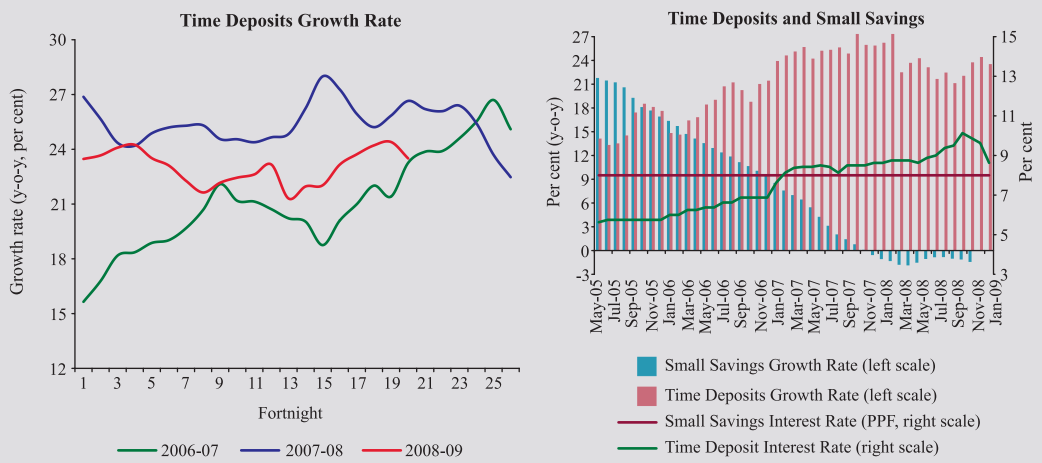
Note : 1. Data are provisional. Wherever data are not available, the data for last available month is repeated as estimates.
2. Data on postal deposits pertain to November 2008.

Chart 10: Money Supply



IV.4 The growth in broad money (M_3) mainly reflected a continued strong increase in time deposits during 2008-09 so far although with some moderations. Growth in time deposits (y-o-y) as on January 2, 2009 was 22.4 per cent as compared with 25.6 per cent a year ago. This could be attributed, *inter alia*, to higher interest rates on bank deposits relative to postal deposits and extension of tax benefits under Section 80C for bank deposits. During 2007-08, accretion to postal deposits decelerated significantly up to November 2007 and beginning December 2007, there were net outflows from small savings schemes. This trend continued up to November 2008, the latest period for which data are available (Chart 11). Currency with the

Chart 11: Time Deposits and Small Savings



public that grew by 16.2 per cent (y-o-y) as on January 2, 2009 as compared with 15.1 per cent a year ago was the other major component in the expansion of broad money.

IV.5 On a financial year basis, growth in M_3 during 2008-09 (up to January 2, 2009) was 12.1 per cent as compared with 13.2 per cent during the corresponding period of the previous year (Table 30).

Table 30: Monetary Aggregates – Variations

(Rupees crore)

Item	2007-08 (up to Jan 4)	2008-09 (up to Jan 2)	2007-08				2008-09		
			Q1	Q2	Q3	Q4	Q1	Q2	Q3
1	2	3	4	5	6	7	8	9	10
M_3 (1+2+3 = 4+5+6+7-8)	4,39,083 (13.2)	4,85,231 (12.1)	73,824	1,99,008	1,16,440	3,01,356	87,696	1,72,939	1,62,910
1. Currency with the Public	52,283 (10.8)	54,521 (9.6)	18,237	-14,856	47,723	33,466	36,300	-17,570	40,349
2. Aggregates Deposits with Banks	3,89,387 (13.8)	4,34,053 (12.7)	56,023	2,15,344	69,536	2,63,583	55,521	1,89,993	1,15,464
2.1 Demand Deposits with Banks	-4,036 (-0.8)	-67,075 (-11.7)	-44,030	58,180	-7,275	91,847	-79,771	52,275	-59,531
2.2 Time Deposits with Banks	3,93,422 (16.7)	5,01,127 (17.5)	1,00,053	1,57,164	76,811	1,71,736	1,35,292	1,37,718	1,74,994
3. 'Other' Deposits with Banks	-2,586 (-34.5)	-3,343 (-36.9)	-436	-1,479	-819	4,307	-4,125	516	7,097
4. Net Bank Credit to Government	24,973 (3.0)	2,31,915 (25.6)	28,117	15,618	-36,493	65,601	35,676	29,511	1,27,500
4.1 RBI's Net Credit to Government	-1,52,015	56,759	-22,154	-54,695	-65,787	27,004	-13	51,360	30,230
4.1.1 RBI's Net credit to the Centre	-1,52,413	58,169	-21,825	-55,588	-65,078	25,719	1,430	51,379	29,932
4.2 Other Banks' Credit to Government	1,76,987	1,75,156	50,270	70,313	29,294	38,597	35,689	-21,850	97,270
5. Bank Credit to the Commercial Sector	2,21,269 (10.4)	3,16,092 (12.3)	-30,547	1,45,442	86,877	2,38,062	36,541	1,61,505	1,00,668
6. NFEA of Banking Sector	2,01,563	-33,092	-17,945	1,18,249	94,204	1,87,444	66,858	7,271	-1,56,330
6.1 NFEA of the RBI	2,18,422	7047	-2,745	1,19,430	94,681	1,58,610	1,03,932	10,336	-1,56,330
7. Government's Currency Liabilities to the Public	732	463	166	254	312	332	125	206	132
8. Net Non-Monetary Liabilities of the Banking Sector	9,452	30,147	-94,033	80,553	28,461	1,90,082	51,503	25,554	-90,940
Memo:									
1. Non-resident Foreign Currency Deposits with SCBs	-9,800	6,482	-4,202	-1,181	-3,490	-1,653	2,048	3,898	-2,536
2. SCB' Call-term Borrowing from Financial Institutions	7,021	-1,292	-2,984	5,756	7,441	10,455	-1,116	7,015	-591
3. Overseas Borrowing by SCBs	1,940	5,801	-6,928	7,830	1,734	9,909	9,494	4,600	-5,185

SCBs: Scheduled Commercial Banks. NFEA: Net Foreign Exchange Assets.

Note : 1. Data are provisional.
2. Figures in parentheses are percentage variations.

IV.6 On the sources side, bank credit to commercial sector remained the driver of broad money (M_3) while expansion in net foreign exchange assets of the banking sector moderated to a large extent. Bank credit to the commercial sector increased by 22.7 per cent (y-o-y) as on January 2, 2009 as compared with 20.0 per cent a year ago. Non-food credit growth (y-o-y) of scheduled commercial banks (SCBs) picked up during 2008-09, on the backdrop of sizeable rise in credit to petroleum sector due to the funding requirements of oil companies and substitution of funds raised by corporates from non-banking to banking sources. It peaked during October-November 2008 but moderated somewhat thereafter. Non-food credit by SCBs expanded by 23.9 per cent, y-o-y, as on January 2, 2009, which was higher than 22.0 per cent a year ago. The higher expansion in credit relative to the expansion in deposit resulted in an increase in the incremental credit-deposit ratio (y-o-y) of SCBs to 81.4 per cent as on January 2, 2009 from 63.1 per cent a year ago (Chart 12). Net foreign exchange assets of the banking sector expanded by 13.2 per cent (y-o-y) as on January 2, 2009 much lower than 32.1 per cent a year ago.

IV.7 Credit flow from scheduled commercial banks recorded a high growth of 24.0 per cent (y-o-y) as on January 2, 2009 as compared with 21.4 per cent a year ago. The expansion in credit during 2008-09 so far was mainly on account of public sector banks, while credit growth decelerated in respect of private and foreign banks (Table 31).

IV.8 Disaggregated data on sectoral deployment of gross bank credit available up to December 19, 2008 showed that about 48.2 per cent of incremental non-food credit (y-o-y) was absorbed by industry as compared with 44.0 per cent in the corresponding period of the previous year. The expansion of incremental non-food credit to industry

Chart 12: Scheduled Commercial Banks' Credit Growth

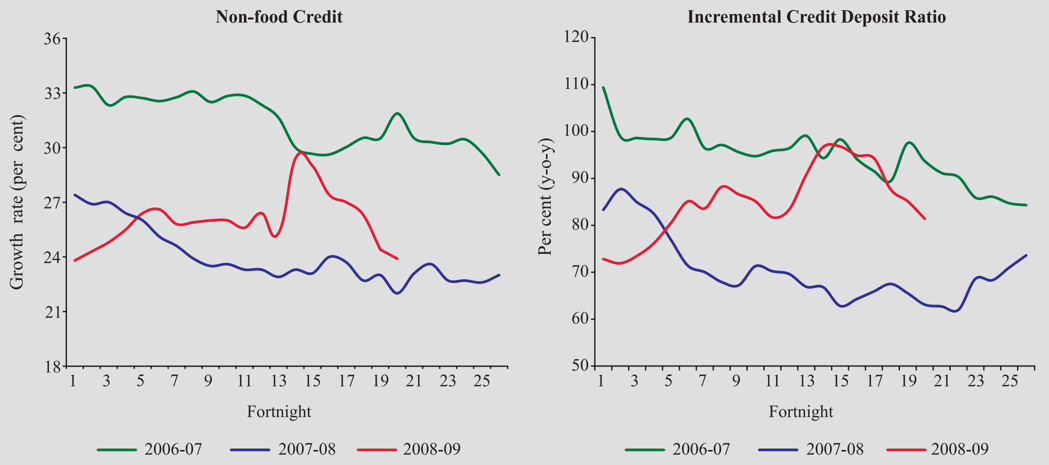


Table 31: Credit Flow from Scheduled Commercial Banks

(Amount in Rupees crore)

Item	Outstanding as on January 2, 2009	Variation (year-on-year)			
		As on Jan. 4, 2008		As on Jan. 2, 2009	
		Amount	Per cent	Amount	Per cent
1	2	3	4	5	6
1. Public Sector Banks	19,23,953	2,47,633	19.8	4,28,302	28.6
2. Foreign Banks	1,73,451	34,834	30.7	25,016	16.9
3. Private Banks	4,98,107	86,731	24.2	52,375	11.8
4. All Scheduled Commercial Banks*	26,58,997	3,77,855	21.4	5,14,980	24.0

* : Includes Regional Rural Banks.
Note: Data are provisional.

during this period was led by infrastructure, petroleum, iron & steel, chemicals & chemical products, textiles, engineering, construction and vehicles industries. The infrastructure sector alone accounted for 28.0 per cent of the incremental credit to industry as compared with 29.7 per cent in the corresponding period of the previous year. Credit to petroleum and fertiliser industries grew by 101.8 per cent (y-o-y) by December 2008 as compared with a growth of 11.8 per cent in the corresponding period of the previous year. Also, the share of incremental credit to petroleum and fertiliser industries increased to 19.9 per cent of the total incremental non-food credit in December 2008 from 3.1 per cent a year ago. The total non-food credit excluding credit to petroleum and fertiliser industries also recorded a high growth of 22.9 per cent as compared with 22.1 per cent in the previous year. The agricultural sector absorbed around 10.9 per cent of the incremental non-food bank credit expansion as compared with 10.7 per cent in the corresponding period of the previous year. Personal loans accounted for nearly 14.7 per cent of incremental non-food credit; within personal loans, the share of incremental housing loans was at 30.4 per cent. The outstanding credit under credit card receivables witnessed a sharp increase. Growth in loans to commercial real estate remained high in recent months (Table 32). In order to facilitate bank lending, several counter-cyclical measures taken earlier were reviewed in view of the prevailing macroeconomic, monetary and credit conditions, and measures were announced on November 15, 2008 to strengthen credit delivery while maintaining credit quality. Accordingly, the provisioning requirements for all types of standard assets (except in case of direct advances to agricultural and SME sector which was retained at 0.25 per cent, as hitherto) and risk weights on banks' exposures to certain sectors were revised downwards.

IV.9 Apart from banks, commercial sector mobilises resources from a variety of other sources such as issuances through capital markets, commercial paper, non-banking financial companies (NBFCs), financial institutions, external commercial

Table 32: Non-food Bank Credit - Sectoral Deployment

(Amount in Rupees crore)

Sector/Industry	Outstanding as on December 19, 19, 2008	Year-on-Year Variations			
		December 21, 2007		December 19, 2008	
		Absolute	Per cent	Absolute	Per cent
1	2	3	4	5	6
Non-food Gross Bank Credit (1 to 4)	**24,70,164**	**3,54,802**	**21.8**	**4,90,199**	**24.8**
1. Agriculture and Allied Activities	**2,89,501**	**38.139**	**19.3**	**53,612**	**22.7**
2. Industry (Small, Medium and Large)	**10,18,564**	**1,56,192**	**24.9**	**2,36,064**	**30.2**
Small Enterprises	1,46,833	35,916	35.6	10,156	7.4
3. Personal Loans	**5,68,474**	**68,079**	**15.9**	**72,245**	**14.6**
Housing	2,71,683	31,780	14.6	21,989	8.8
Advances against Fixed Deposits	50,055	4,605	12.8	9,563	23.6
Credit Cards	29,359	5,393	45.3	12,053	69.6
Education	26,760	6,123	45.7	7,233	37.0
Consumer Durables	9,122	508	5.9	50	0.6
4. Services	**5,93,625**	**92,389**	**24.8**	**1,28,278**	**27.6**
Transport Operators	38,145	6,725	29.9	8,941	30.6
Professional & Other Services	40,653	6,682	34.3	14,518	55.6
Trade	1,40,142	17,713	17.8	23,057	19.7
Real Estate Loans	76,463	13,621	35.8	24,827	48.1
Non-Banking Financial Companies	86,120	22,953	59.6	24668	40.1
Memo:					
Priority Sector	**7,64,060**	**1,10,768**	**19.6**	**87,910**	**13.0**
Industry (Small, Medium and Large)	**10,18,564**	**1,56,192**	**24.9**	**2,36,064**	**30.2**
Food Processing	52,661	10,399	30.2	7,880	17.6
Textiles	1,02,009	16,644	24.0	15,888	18.4
Paper & Paper Products	15,752	2,419	23.9	3,191	25.4
Petroleum, Coal Products & Nuclear Fuels	79,681	5,821	18.6	42,542	114.5
Chemicals and Chemical Products	74,694	7,039	13.7	16,346	28.0
Rubber, Plastic & their Products	12,767	1,508	18.8	3,241	34.0
Iron and Steel	96,832	18,723	31.8	19,179	24.7
Other Metal & Metal Products	29,070	1,826	9.3	7,507	34.8
Engineering	63,705	11,161	29.0	14,052	28.3
Vehicles, Vehicle Parts and Transport Equipments	35,794	7,622	37.6	7,897	28.3
Gems & Jewellery	28,131	3,101	14.2	3,234	13.0
Construction	34,901	6,037	37.3	12,671	57.0
Infrastructure	2,37,236	46,345	37.1	65,987	38.5

Note: 1. Data are provisional and relate to select scheduled commercial banks.
2. Data also include the figures of Bharat Overseas Bank which was merged with Indian Overseas Bank, American Express Bank with Standard Chartered Bank and State Bank of Saurashtra with State Bank of India.

borrowings, issuances of American Depository Receipts (ADRs)/ Global Depository Receipts (GDRs) and foreign direct investment. During 2008-09, so far, flow of resources from other sources to the commercial sector declined reflecting subdued conditions in the domestic capital markets and deceleration of funds flow from external sources. On the other hand, increase in bank credit during 2008-09, so far, has been significantly higher, partly reflecting increased credit demand of corporates emanating from deceleration in credit flow from other sources. Overall, total flow of resources to the commercial sector during 2008-09, so far, has been somewhat lower than that in the comparable period of 2007-08 (Table 33).

IV.10 Scheduled commercial banks' investment in SLR securities expanded by 19.2 per cent (y-o-y) on January 2, 2009 as compared with 25.8 per cent a year ago (Table 34). Commercial banks' holdings of such securities as on January 2, 2009 at 28.9 per cent of their net demand and time liabilities (NDTL) were higher than 27.8 per cent at end-March 2008 but lower than 29.3 per cent a year ago (Chart 13). Excess SLR investments of SCBs

Table 33: Flow of Resources to the Commercial Sector

(Rupees crore)

	2007-08 (Comparable period)	2008-09 (So far)
1	2	3
A. Adjusted non-food Bank Credit by Commercial Banks (1+2) @	**2,24,921**	**2,93,243**
1. Non-Food Credit	2,18,065	2,86,864
2. Non-SLR Investment by SCBs	6,856	6,379
B. Flow from Other Major Sources (B1+B2)	**2,74,563**	**1,91,470**
B1. Domestic Sources	**1,25,893**	**93,348**
1. Public issues by non-financial entities #	34,413	13,559
2. Gross private placements by non-financial entities *	32,306	39,113
3. Net Issuance of CPs subscribed to by non-banks #	31,351	20,004
4. Net Credit by housing finance companies *	8,693	16,438
5. Total gross accommodation by all-India Financial Institutions - NABARD, NHB, SIDBI & EXIM Bank *	-1,174	7,246
6. Systemically Important non-deposit taking NBFCs net of bank credit *	20,304	-3,012
B2. Foreign Sources	**1,48,670**	**98,122**
1 External Commercial Borrowings / FCCB **	63,008	27,588
2 ADR/GDR Issues (excluding by banks and financial institutions) #	24,972	4,687
3 Short-term Credit from abroad **	41,565	12,252
4 Foreign Direct Investment to India **	19,125	53,595
C. Total Credit (A+B)	**4,99,484**	**4,84,713**

@ : Up to early January. # : Up to December. * : Up to September. ** : Up to November.

Note: Data are shown for latest information available for various items during 2008-09, so far, and for the corresponding period of 2007-08.

Table 34: Scheduled Commercial Bank Survey

(Amount in Rupees crore)

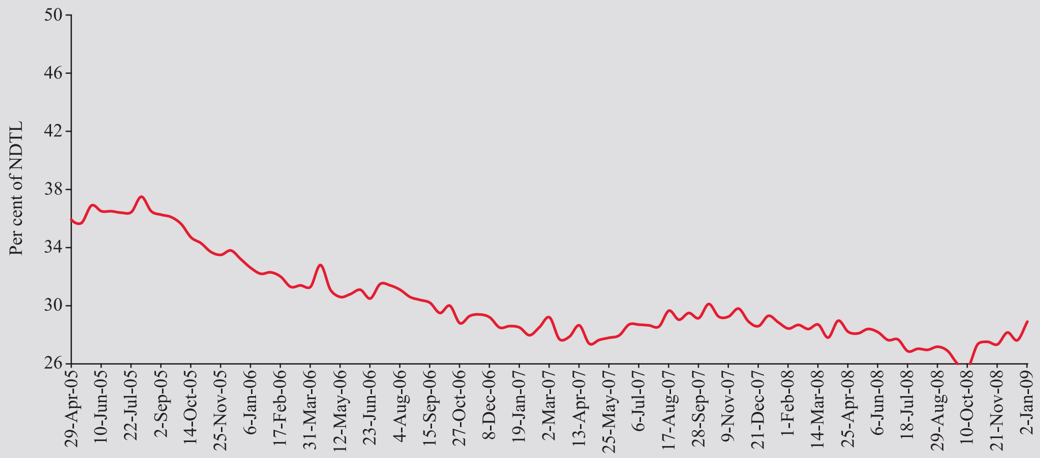
Item	Outstanding as on January 2, 2009	Variation (year-on-year)			
		As on Jan. 4, 2008		As on Jan. 2, 2009	
		Amount	Per cent	Amount	Per cent
1	2	3	4	5	6
Sources of Funds					
1. Aggregate Deposits	36,18,763	5,98,499	25.1	6,32,817	21.2
2. Call/Term Funding from Financial Institutions	1,05,212	8,994	10.7	12,356	13.3
3. Overseas Foreign Currency Borrowings	50251	8,098	31.5	16,407	48.5
4. Capital	46,303	6,513	20.1	7,324	18.8
5. Reserves	2,77,247	57,615	34.7	53,693	24.0
Uses of Funds					
1. Bank Credit	26,58,997	3,77,855	21.4	5,14,980	24.0
of which: Non-food Credit	26,04,379	3,79,655	22.0	5,01,645	23.9
2. Investments in Government and Other Approved Securities	11,48,244	1,97,511	25.8	1,85,192	19.2
a) Investments in Government Securities	11,30,517	1,99,750	26.6	1,80,713	19.0
b) Investments in Other Approved Securities*	17,726	-2,238	-14.5	4,479	33.8
3. Investments in non-SLR Securities	1,98,278	35,776	25.9	24,376	14.0
4. Foreign Currency Assets	37,280	-18,937	-36.8	4738	14.6
5. Balances with the RBI	1,97,861	99,241	76.1	-31,721	-13.8

* : Refer to investment in SLR securities as notified in the Reserve Bank notification DBOD No. Ref. BC. 61/12.02.001/2007-08 dated February 13, 2008.

Note: Data are provisional.

increased to Rs.1,95,112 crore as on January 2, 2009 from Rs. 98,033 crore at end-March 2008; excess investments in SLR securities were placed at Rs.1,41,684 crore a year ago. Adjusted for LAF collateral securities on an outstanding

Chart 13: SLR Investments by Scheduled Commercial Banks



basis, SCB's holding of SLR securities amounted to Rs.10,74,924 crore or 27.1 per cent of NDTL on January 2, 2009 implying an excess of Rs.1,21,792 crore or 3.1 per cent of NDTL over the prescribed SLR of 24 per cent of NDTL.

Reserve Money Survey

IV.11 Reserve money growth at 6.6 per cent, y-o-y, as on January 16, 2009 was lower than that of 30.6 per cent a year ago. Intra-year movements in reserve money largely reflected the Reserve Bank's market operations and movements in bankers' deposits with the Reserve Bank in the wake of changes in the CRR and large expansion in demand and time liabilities. In the wake of inflationary pressures during the first half of 2008-09, monetary policy was tightened, partly reflected in the hike of CRR by 150 basis points to 9.0 per cent during April-August 2008-09. Subsequently, intensification of global financial turmoil and its knock-on impact on the domestic financial market, and downturn in headline inflation, necessitated the Reserve Bank to ease its monetary policy since mid-September 2008. The CRR was reduced by 400 basis points to 5.0 per cent since October 11, 2008. Adjusted for the first round effect of the changes in CRR, reserve money growth (y-o-y) as on January 16, 2009 was 18.0 per cent as compared with 21.6 per cent a year ago (Chart 14).

IV.12 The changes in CRR have also affected the money multiplier, *i.e.,* the ratio between broad money and reserve money. Accordingly, the money multiplier, which had declined from 4.7 at end-March 2007 to 4.3 at end-March 2008 in the wake of CRR hikes, increased to 5.2 as on January 2, 2009, reflecting subsequent lowering of CRR (Chart 15).

IV.13 During the financial year 2008-09 (up to January 16, 2009), reserve money decreased by 3.8 per cent as against an

Chart 14: Reserve Money Growth

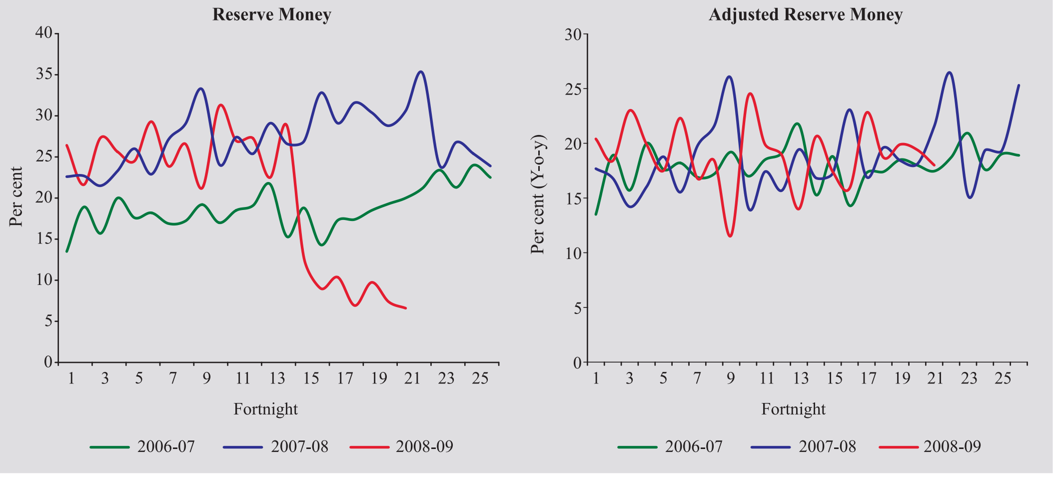
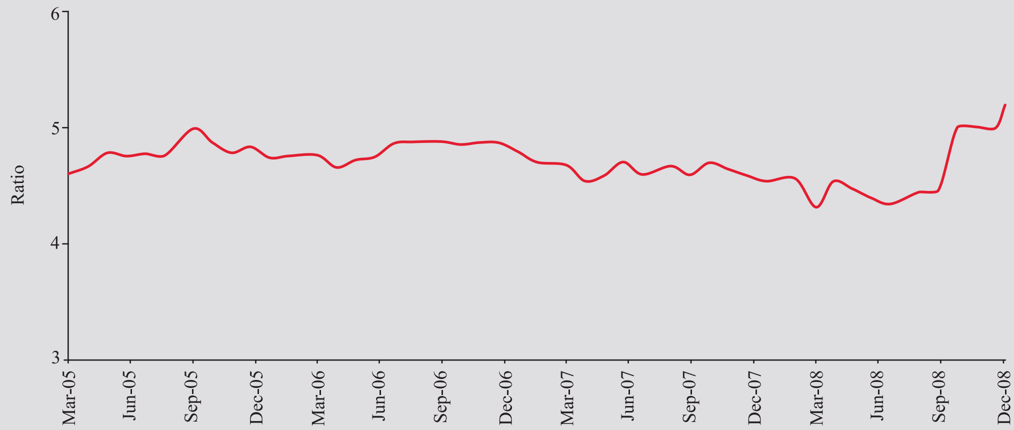


Chart 15: Money Multiplier



increase of 18.2 per cent in the corresponding period of the previous year (Table 35). On the sources side, net Reserve Bank's credit to the Centre increased by Rs. 86,141 crore as against a decrease of Rs. 1,57,815 crore during the corresponding period of the previous year. The Reserve Bank's foreign currency assets (adjusted for revaluation) declined by Rs.99,701 crore as against an increase of Rs.3,11,941 crore during the corresponding period of the previous year (Chart 16). Adjusted for the first round impact of the changes in CRR (up to January 16, 2009), reserve money expanded by 5.6 per cent as compared with 12.1 per cent during the corresponding period f the previous year.

IV.14 Movements in the Reserve Bank's net credit to the Central Government during 2008-09, so far, (up to January 16, 2009) largely reflected the liquidity management operations by the Reserve Bank and changes in Central Government deposits with the Reserve Bank. The Centre's surplus cash balances with the Reserve Bank declined (Rs.76,586 crore). Furthermore, the Centre resorted to WMA/ OD facilities (Rs.9,263 crore). The unwinding of MSS securities led to a decline in Central Government deposits (Rs.54,742 crore) with the Reserve Bank and, therefore further increased net Reserve Bank credit to Centre. Net open market purchases under OMO/special market operations (SMO) led to higher holding of Central Government securities/ bonds (Rs. 33,521 crore) by the Reserve Bank. In view of the global financial crisis and its possible impact on Indian financial market, the Reserve Bank has taken various measures to augment rupee and dollar liquidity. Consequently, liquidity condition that remained tight during the first half of 2008-09, eased from mid-November 2008 and LAF, on average, shifted to absorption mode. The Reserve Bank's holding of government securities

Table 35: Reserve Money - Variations

(Amount in Rupees crore)

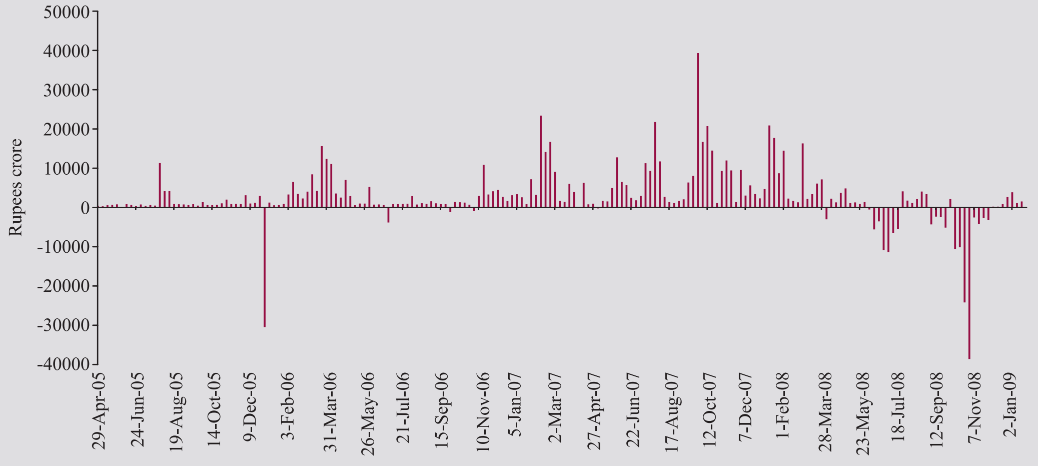
Item	2007-08 (April-March)	2007-08 (Up to Jan 18)	2008-09 (Up to Jan 16)	2007-08 Q1	2007-08 Q2	2007-08 Q3	2007-08 Q4	2008-09 Q1	2008-09 Q2	2008-09 Q3
1	2	3	4	5	6	7	8	9	10	11
Reserve Money	**2,19,427**	**1,29,213**	**-34,852**	**11,630**	**60,587**	**26,593**	**1,20,617**	**3,301**	**25,220**	**-70,453**
	(30.9)	**(18.2)**	**(-3.8)**							
Components (1+2+3)										
1. Currency in Circulation	86,702	62,190	71,952	16,866	-13,397	46,781	36,452	36,759	-14,516	38,223
	(17.2)	(12.3)	(12.2)							
2. Bankers' Deposits with RBI	1,31,152	69,760	-1,03,028	-4,800	75,464	-19,369	79,857	-29,333	39,219	-1,15,773
	(66.5)	(35.4)	(-31.4)							
3. 'Other' Deposits with the RBI	1,573	-2,736	-3,777	-436	-1,479	-819	4,307	-4,125	516	7,097
	(21.0)	(-36.5)	(-41.6)							
Sources (1+2+3+4-5)										
1. RBI's net credit to Government	-1,15,632	-1,58,302	85,072	-22,154	-54,695	-65,787	27,004	-13	51,360	30,230
of which: to Centre (i+ii+iii+iv-v)	-1,16,772	-1,57,815	86,141	-21,825	-55,588	-65,078	25,719	1,430	51,379	29,932
i. Loans and Advances	0	0	9,263	0	0	0	0	0	0	0
ii. Treasury Bills held by the RBI	0	0	0	0	0	0	0	0	0	0
iii. RBI's Holdings of Dated Securities	17,421	-52,149	-38,676	-34,284	4,019	20,874	26,812	-39,239	56,975	-44,206
iv. RBI's Holdings of Rupee Coins	121	94	-56	128	20	3	-31	-1	-26	27
v. Central Government Deposits	1,34,314	1,05,759	-1,15,611	-12,330	59,627	85,956	1,062	-40,670	5,570	-74,111
2. RBI's Credit to Banks and Commercial Sector	-2,794	-3,282	5,557	-6,450	-1,256	848	4,064	-3,358	4,963	5,032
3. NFEA of RBI	3,69,977	2,51,026	-10,670	-2,745	1,19,430	94,681	1,58,610	1,03,932	10,336	-1,56,330
	(42.7)	(29.0)	(-0.9)							
of which : FCA, adjusted for revaluation	3,70,550	3,11,941	-99,701	47,728	1,18,074	1,00,888	1,03,860	15,535	-31,641	-92,102
4. Governments' Currency Liabilities to the Public	1,064	790	463	166	254	312	332	125	206	132
5. Net Non-Monetary liabilities of RBI	33,187	-38,981	1,15,274	-42,812	3,145	3,461	69,393	97,384	41,646	-50,484
Memo:										
Net Domestic assets	-1,50,550	-1,21,813	-24,182	14,375	-58,843	-68,088	-37,994	-1,00,631	14,883	85,877
LAF- Repos (+) / Reverse Repos(-)	21,165	-41,120	-82,145	-32,182	9,067	16,300	27,980	-45,350	51,480	-62,170
Net Open Market Sales # *	-5,923	-1,793	-33,521	1,246	1,560	-3,919	-4,810	-8,696	-10,535	-7,669
Centre's Surplus	26,594	9,658	-76,586	-34,597	15,376	54,765	-8,950	-42,427	6,199	-32,830
Mobilisation under the MSS	1,05,419	98,084	-54,742	19,643	48,855	31,192	5,728	6,040	-628	-53,754
Net Purchases(+)/Sales(-) from Authorised Dealers	3,12,054	2,69,355	-1,56,460^	38,873	1,01,814	87,596	83,771	3,956	-52,760	-1,07,656^
NFEA/Reserve Money @	133.1	133.3	137.1	119.8	125.8	133.4	133.1	143.8	141.1	134.7
NFEA/Currency @	209.2	197.2	184.9	165.7	193.6	194.3	209.2	213.5	220.2	183.3

NFEA: Net Foreign Exchange Assets. FCA: Foreign Currency Assets. LAF: Liquidity Adjustment Facility.

*: At face value. # : Excludes Treasury Bills @ : Per cent; end of period ^ : up to November 28, 2008.

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, 2008 are after closure of accounts.

Chart 16: Accretion to RBI's Net Foreign Assets



(up to January 16, 2009) declined on account of an increase in absorption under LAF (Rs.82,145 crore). Reflecting these developments, the Reserve Bank's net credit to the Centre increased during 2008-09 so far (up to January 16, 2009) as against a decline during the corresponding period of the previous year.

V. FINANCIAL MARKETS

V.1 The crisis in global financial markets deepened since mid-September 2008, triggered by the collapse of Lehman Brothers followed by the failure of a number of other financial firms across countries. With the counter-party concerns mounting in the context of asset sales driven by the large-scale redemptions, there was a new wave of write-offs of Lehman related investments by the money market funds and other investors, affecting the key players in global financial system. Inter-bank markets froze on valuation concerns. In the wake of credit and money markets witnessing a squeeze and equity prices plummeting, banks and other financial institutions experienced erosion in their access to funding and capital base, owing to accumulating mark to market losses. The pressure on financial markets mounted with the credit spreads widening to record levels and equity prices crashing to historic lows leading to widespread volatility across the market spectrum. The turmoil transcended from credit and money markets to the global financial system more broadly. The contagion also spilled over to the emerging markets, which saw broad-based asset price declines amidst depressed levels of risk appetite.

V.2 In consonance with the instability of global financial system, there was a significant deterioration in the global economic outlook reflected in the downward revision of forecasts for both major and emerging market economies. While the government bond yields plummeted in the wake of recession concerns, the yield curves steepened at the short end, mirroring repeated bouts of downward adjustments in policy rates. As a result, authorities in several countries embarked upon an unprecedented wave of policy initiatives to contain systemic risk, arrest the plunge in asset prices and shore up the confidence in the international banking system.

V.3 Mounting financial sector problems forced the authorities in a large number of countries to take decisive actions in support of key financial institutions. The central banks took several initiatives to revive money markets which included, *inter alia*, substantial easing of monetary policy and provision of term funding to a wide range of institutions and against wider collateral list than in the past through introduction of new facilities. In some cases, they provided direct lending to distressed institutions and took other exceptional measures to improve funding conditions in credit markets. The central banks also adopted a co-operative approach to address the problem of foreign currency shortages faced by banks through inter-central bank swap lines. The governments in virtually all advanced economies also announced more comprehensive initiatives to stabilise banking system. While one set of measures was aimed at ensuring bank funding through explicit guarantees on retail deposits, the other set of measures sought to reduce bank leverage through government purchases of distressed assets or capital injections.

While these initiatives did help in restoring some level of stability, the financial market conditions remained far from normal during the period October-December 2008.

V.4 Financial markets in India came under pressure in mid-September 2008, mainly reflecting the knock-on effects of the disruptions in the major financial centres following the collapse of Lehman Brothers. Liquidity conditions became unduly tight as the period of quarterly tax outflows coincided with the market turmoil and necessitated forex operations by the Reserve Bank to curb excessive volatility. Mirroring the liquidity pressures in the inter-bank market, the rates in the money market rose above the upper bound of the corridor. However, except on a few days, the transactions were not impeded on account of counterparty concerns since the Indian banking system is prudently regulated, well capitalised and free from "toxic" assets. In the foreign exchange market, the Indian rupee generally depreciated against major currencies. Indian equity markets witnessed downswings quite in line with trends in major international equity markets. The series of measures swiftly initiated by the Reserve Bank helped to assuage liquidity conditions, while reassuring the market that the Indian banking system continued to be safe and sound, well capitalised and well regulated.

International Financial Markets

V.5 The developments in the financial markets since the mid-September 2008 could be seen in three phases. The first phase was marked by the takeover of two major US housing finance agencies by the US government and the Lehman bankruptcy. During the second phase, the global financial market turmoil deepened further rapidly as there was widespread crisis of confidence, leading to unprecedented global policy responses that were more broad based and increasingly fast-paced in nature. The final phase began with mid-October 2008, when price patterns started reflecting recession fears amidst markets grappling with uncertainties revolving around new policy initiatives.

Money Markets

V.6 During September 2008, the funding pressures were particularly evident in respect of cross-currency swap markets where the implied rates for US dollars spiked sharply. The benchmark US investment grade CDX credit default swap index spread jumped by 42 basis points on September 15, 2008 alone, while US high yield spreads rose by 118 basis points. During October 2008, the spread of three-month US dollar Libor over expected future short-term interest rates climbed to a record high of around 370 basis points, mirroring a combination of counter party credit risk and liquidity factors.

V.7 Moreover, US markets for other short-term bank debt remained stressed. Commercial paper markets suffered due to redemptions/ reallocations and illiquid secondary markets for these securities. Another source of funding for banks, the market for asset-backed securities became more or less defunct, in turn, affecting banks' ability to provide new lending. Added to this were widespread redemptions from 'Prime' funds, which invest in bank securities. In view of soaring demand for liquid funds in the wake of the contraction in the money market mutual fund sector, global inter-bank markets came under pressure, squeezing banks' access to short-term funding. Money markets, which were already strained, failed to recuperate, despite massive central bank liquidity injections. As a result, interbank rates spiked to historic highs. The movements in other major markets such as those for euro and sterling funds also showed similar signs, *albeit,* moderately. Credit spreads in other major markets followed suit and continued to move in tandem with the US markets.

V.8 US authorities initiated several measures during October and November 2008. For instance, announcement of temporary guarantee for money market fund investors obviated redemption pressures on money market funds with total assets gradually rising back to their levels before the Lehman breakdown, reaching US$3.6 trillion by early November. Similarly, introduction of Commercial Paper Funding Facility (CPFF), which purchased around US$270 billion helped the US money market funds through turbulence.

V.9 With the series of coordinated policy moves by the major central banks, the financial sector spreads rallied back from the peaks reached earlier during the period. Credit spreads came down with recovery in the credit markets. The signs of ease also started reflecting in other markets. After recording a peak at 364 basis points on October 10, 2008, the three-month US dollar Libor-OIS spread witnessed a steady downward trend into November 2008, with spreads reaching around 170 basis points. The euro and sterling Libor-OIS spreads came to see similar pricing movements, indicating a return of stability to the inter-bank markets. However, after an initial decline, spreads on agency debt and MBS soared beyond their peak levels reached in early September. Collateralised lending markets, especially those for repurchase agreements came to witness similar movements. The spreads in the CDS markets widened on increased demand for credit protection, while the corresponding spreads in the financial sector were tightened. While the efforts of the governments and the central banks appeared to be successful in restoring the confidence in global financial markets, the gains across most asset classes turned out to be short-lived. However, the short-term funding markets continued to recover, as the US money market fund assets started stabilising and Libor-OIS spreads began declining, *albeit,* at levels higher than those prior to the credit crisis.

V.10 By mid-October, with the reports of recession, credit markets began anchoring their expectations on ensuing global recession and the associated increase in default related losses. The contraction in bond issuance and bank lending got reflected in the lack of availability of credit for households and non-finance companies. With the release of weak macroeconomic data for the US on October 16, 2008, credit spreads started reverting back to their upward levels. Credit spreads moved to their new highs with the announcement of reallocation of funds under the Troubled Assets Relief Programme for consumer sector in mid-November. It was in late November, that credit spreads started recovering, following the announcement of a support package for Citigroup and measures aimed at supporting the markets for asset backed securities and US agency debt. However, strains persisted with the continued widening of spreads in the troubled sectors such as commercial estate.

V.11 As the outlook for economic activity weakened further and inflationary pressures dissipated, on December 10, 2008, the US Federal Reserve cut its Fed Funds rate to a target range of 0 to ¼ per cent. Similarly, Bank of England further cut its official bank rate by 100 basis points in December 2008 and again by 50 basis points to 1.5 per cent on January 8, 2009. Other central banks such as ECB including some EMEs such as China followed suit.

Short-term Interest Rates

V.12 During the third quarter of 2008-09, short-term interest rates in advanced economies witnessed an easing trend, moving broadly in tandem with cuts in the policy rates on the back of recession concerns (Table 36). In the US, short-term interest rates declined, reflecting liquidity injections and reduction in the fed funds target rate in October and December 2008.

Table 36: Short-term Interest Rates

(Per cent)

Country	March 2006	March 2007	March 2008	June 2008	September 2008	December 2008	January 2009*
1	2	3	4	5	6	7	8
Advanced Economies							
Euro area	2.80	3.91	4.72	4.96	5.07	2.97	2.65
Japan	0.04	0.57	0.75	0.75	0.75	0.62	0.62
UK	4.58	5.55	6.01	5.93	6.25	2.73	2.23
US	4.77	5.23	2.26	2.29	2.04	0.44	0.29
Emerging Market Economies							
Argentina	9.63	9.63	10.44	16.50	13.81	19.56	18.56
Brazil	16.54	12.68	11.18	12.17	13.66	13.66	13.66
China	2.40	2.86	4.50	4.48	4.31	1.86	1.48
Hong Kong	4.47	4.17	1.83	2.33	3.66	1.00	0.80
India	**6.11**	**7.98**	**7.23**	**8.73**	**8.56**	**4.71**	**4.58**
Malaysia	3.51	3.64	3.62	3.69	3.70	3.40	3.37
Philippines	7.38	5.31	6.44	6.00	4.00	5.25	5.06
Singapore	3.44	3.00	1.38	1.25	1.78	0.91	0.77
South Korea	4.26	4.94	5.32	5.36	5.78	3.98	3.16
Thailand	5.10	4.45	3.25	3.65	3.85	3.85	3.85

*: As on January 14, 2009.

Note : Data for India refer to 91-day Treasury Bills rate and for other countries 3-month money market rates.

Source : The Economist.

In the UK, short-term interest rates declined, following cuts in the policy rate thrice during October-December 2008 and again on January 8, 2009. Similar trends were witnessed in the Euro area with cuts in ECB policy rate thrice between October-December 2008. Among the EMEs, short-term interest rates generally softened in China, Hong Kong, Malaysia, Singapore and South Korea, hardened in Argentina and Philippines and remained stable in Brazil and Thailand. The central banks in the EMEs - People's Bank of China, Bank of Korea, Bank of Thailand, *etc.*, effected cuts in the policy rates during the above period.

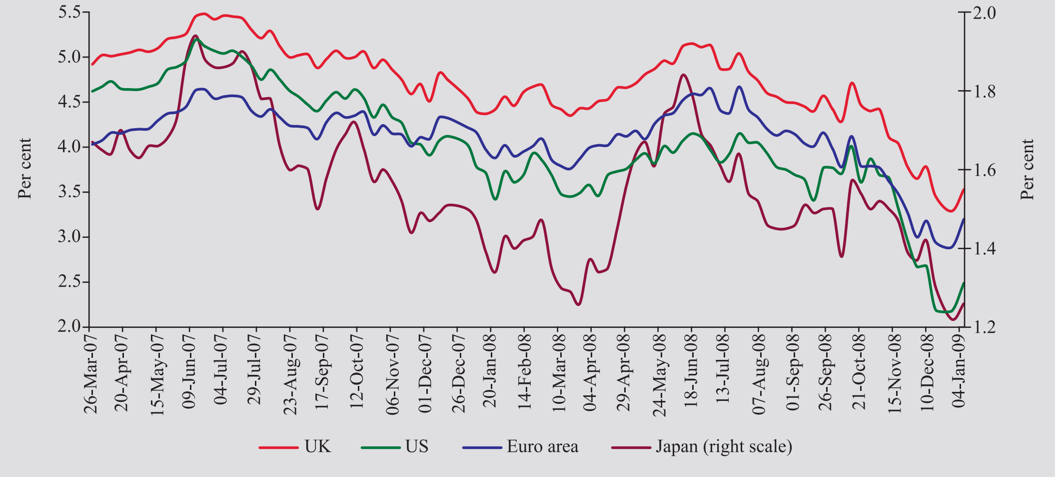
Government Bond Yields

V.13 Long-term government bond yields in major advanced economies, which had hardened during the first quarter of 2008-09 declined over the second quarter, reflecting worsening growth expectations and improved near-term inflation outlook. The decline got accentuated during the third quarter. The 10-year government bond yield in the US declined by 156 basis points between October 1, 2008 and January 14, 2009. During the same period, yields on 10-year government papers declined by 105 basis points in UK, 104 basis points in the Euro area and 23 basis points in Japan (Chart 17).

Foreign Exchange Markets

V.14 While movements in exchange rates partly reflected developments in the interest rates, a combination of three factors illustrates the perceived exchange rate movements in the recent period. *First,* a general retrenchment from risky assets as part of the ongoing deleveraging process in the financial markets, *second,* unwinding of currency carry trades with the elevated market volatilities, and *third,* repatriation of investments, particularly in the US and Japan. The accumulated gains were eroded as the low-yielding

Chart 17: 10-Year Government Bond Yields



currencies appreciated and carry trade returns turned negative.

V.15 The widening credit spreads and mounting demand for US dollar funds was reflected in the market for foreign exchange swaps, which witnessed historic high spreads for various countries including emerging market currencies *vis-à-vis* the US dollar. There were increasing pressures in obtaining US dollar funding in both uncollateralised and collateralised markets. Confronted with the foreign currency shortages, central banks responded by providing foreign currency funding to their counterparties. Alongside, major central banks came to respond with a new round of coordinated measures to address squeeze in the US dollar short-term funding. They signed enlarged currency swap facilities worth US $ 180 billion during October 2008. The use of inter-central bank swap lines, particularly those with the Federal Reserve expanded considerably in both scale and scope.

V.16 The US dollar, generally, appreciated against most of the currencies as the US investors were liquidating their positions in overseas equity and bond markets and repatriating the money back to the US. Between end-March 2008 and January 13, 2009, the US dollar appreciated against the euro and Pound sterling. However, the US dollar depreciated largely against the Japanese yen, as a result of unwinding carry trades. Amongst Asian currencies also, the US dollar appreciated against Korean won, Thai Baht, Malaysian ringgit, Indonesian rupiah and Indian rupee but depreciated against Chinese Yuan (Table 37).

Table 37: Appreciation (+) / Depreciation (-) of the US dollar *vis-à-vis* other Currencies

(Per cent)

Currency	End-March 2007 @	End-March 2008 @	January 13, 2009 *
1	2	3	4
Euro	-9.1	-15.8	19.2
Pound Sterling	-11.4	-1.5	36.3
Japanese Yen	0.2	-14.9	-10.7
Chinese Yuan	-3.4	-9.3	-2.6
Russian Rubble	-6.1	-9.7	32.9
Turkish Lira	3.2	-5.8	21.9
Indian Rupee	-2.5	-8.3	22.4
Indonesian Rupiah	0.5	1.1	21.7
Malaysian Ringgit	-6.2	-7.8	12.2
South Korean Won	-3.7	5.5	37.2
Thai Baht	-9.9	-10.2	11.1
Argentine Peso	0.7	2.1	9.0
Brazilian Peso	-6.4	-17.0	34.1
Mexican Peso	1.3	-3.5	29.2
South African Rand	17.2	11.3	24.8

@ : Year-on-year variation.
* : Variation over end-March 2008.

Equity Markets

V.17 Equity prices plummeted across the major economies, affecting broadly all the major industrial sectors, with volatility soaring across the markets. With the intensification of funding pressures in the global banking system, fall in the share prices was particularly sharp during the early October 2008. Part of the price falls was linked to the hedge funds liquidating positions to meet the increased margin calls.

V.18 The recession concerns, which surfaced in late October and November, were reflected in the equity markets with the plunge in global equity markets being the highest than any of the crisis since the 1930s. News relating to negative earnings, tightening lending standards and subdued consumer confidence came to weigh heavily on the major indices. Investment analysts came to lower their forecasts for earnings growth in 2008 and 2009 as the news about worsening macroeconomic outlook stepped in. The corporate prospects worsened with the price of dividend swaps declining sharply, particularly during October. Alongside fall in equity prices, corporate credit spreads also widened further. Falling asset prices also affected the asset portfolios of long-term investors such as pension funds and insurance companies. Notwithstanding further monetary easing by several central banks, global equity markets were down by around 40 per cent by mid-January 2009. Equity markets in most of the developed and emerging economies declined due to concerns over economic slowdown in the US, Europe and Asia and dip in the profit outlook of companies (Table 38).

Table 38: International Stock Markets

(Per cent)

Country/Index	Percentage Variation (year-on-year)		Percentage Variation
	End-March 2007	End-March 2008	January 19, 2009 over end-March 2008
1	2	3	4
Developed Markets			
US (Dow Jones)	11.2	-0.7	-32.5*
US (NASDAQ)	3.5	-5.9	-33.0*
FTSE UK 100	5.8	-9.6	-28.0
Euro area (FTSE 100)	7.5	-15.7	-35.4
Japan (Nikkei 225)	1.3	-27.6	-34.1
Hong Kong (Hang Seng)	25.3	15.4	-41.6
Emerging Markets			
Russia	34.9	6.1	-74.1
Brazil	20.7	33.1	-36.3
Colombia	-3.7	-16.0	-15.6
South Africa	34.3	11.5	-32.3
South Korea	6.8	17.3	-32.5
Hungary	1.6	-7.3	-44.6
Singapore	28.2	-4.9	-41.9
Malaysia	34.6	0.1	-28.6
Argentina	16.8	0.0	-47.3
Turkey	1.8	-10.6	-35.8
Indonesia	38.4	33.7	-44.8
India	**15.9**	**19.7**	**-40.4**
Thailand	-8.1	21.3	-46.7
China	145.2	9.1	-42.8
Memo:			
World (MSCI)	13.4	-5.1	-40.2
EMEs (MSCI)	17.9	18.9	-51.7

Source: Bloomberg.

* As on 16th Jan 2009 as the markets were closed on 19th Jan 2009.

Emerging Markets

V.19 Banks in emerging markets, which had been relatively less affected by the strains in the dollar money markets till mid-September 2008, also came to witness funding shortages. During mid-October 2008, emerging markets debt and equities came to witness significant outflows, weakening the equity markets, on the back of concerns about the availability of trade finance and falling risk appetite. Amidst the sharp depreciations in the value of EME currencies against the US dollar, spreads on sovereign and corporate bonds widened. The asset prices in these countries partly reflected the subdued global macroeconomic prospects, leading to the expectations of lower returns on EME assets. The decline in commodity prices also appeared to have put further pressure on EME commodity exporters.

V.20 Central banks in most of the emerging markets conducted outright sales of foreign reserves to cater to their domestic demand for foreign currency funding. Some central banks sought to offer foreign reserves to counterparties under repurchase agreements, while others either modified their existing forex swap facilities or set up new swap facilities. By end-November 2008, emerging credit and equity markets came to recover from late-October levels. However, the adjustments in price/earnings multiples were sharp than those in the major markets, with relative valuations broadly back in line with the historical levels.

V.21 Central banks have engaged in continuous close consultation and have cooperated in unprecedented joint actions to reduce strains in financial markets. In order to arrest the rapid erosion of market confidence, ease the funding pressures, restore liquidity in the markets and stablise the banking system, the governments and the central banks in virtually all advanced economies responded with a new array of comprehensive initiatives in quick succession during October and November 2008. These initiatives came in the following forms. *First*, monetary policy easing by both individual central banks and coordinated international response by the major central banks in the form of an unprecedented rounds of policy rate cuts. *Second*, provision of cross-border liquidity through swap arrangements by the co-ordination of major central banks. *Third*, extending the list of eligible collaterals and counterparties and auctioning of term funds through new channels. *Fourth*, explicit government guarantees on retail deposits and other bank liabilities. *Fifth*, reducing bank leverage through government purchases of distressed assets or capital injections. *Sixth*, decisive actions to combat market manipulation and stabilise financial markets, including a temporary ban on short selling of financial stocks. *Seventh*, measures aimed at facilitating lending to consumer and small business sectors. *Finally*, rescue packages for restructuring and recapitalisation - guarantees and equity injections aimed at restarting inter-bank lending and replenishing banks' capital positions. These coordinated moves by the major central banks have been critical in addressing disruptions in the global financial markets and were successful in driving modest improvement in the market sentiments and easing the acute instability across the global banking system (Table 39).

V.22 The recent episode of global financial market distress was unprecedented in terms of its magnitude and scale, which has brought several difficult issues to the fore. *First*, it has raised the issue of appropriateness of structured products and derivatives in the credit markets and their financial stability implications, thereby underscoring a need for eliminating the shortcomings.

Table 39: Recent Global Response to Finance Market Turmoil

Country	Key Measures
1	2
United States	**Monetary Policy Easing** • Federal funds rate target was reduced by 50 basis points (bps) each on October 8 and October 29, 2008 to 1.0 per cent. • It was further reduced to a target range of 0 to 0.25 per cent on December 16, 2008. **Liquidity Provision** • Term funds were auctioned through new channels (TAF, TSLF and PDSLF). • Eligible list of collaterals and counterparties (including investment banks) was expanded. • Foreign exchange swaps were established with major central banks for infusing dollar liquidity. • The duration of liquidity support and provision of cross-border liquidity through swap arrangements was extended. • Commercial Paper (CP) Funding Facility (CPFF) was created to provide liquidity backstop to CP issuers. • Temporary Liquidity Guarantee Program (TLGP) was created on October 14, 2008, to help restore market confidence. • Money Market Investor Funding Facility (MMIFF) was authorised to support a private-sector initiative designed to provide liquidity to U.S. money market investors. • Term Asset-Backed Securities Loan Facility (TALF) was created to facilitate credit flow to households and small businesses. • Three liquidity facilities: the Primary Dealer Credit Facility (PDCF), the Asset-Backed Commercial Paper Money Market Fund Liquidity Facility (AMLF), and the Term Securities Lending Facility (TSLF) were extended up to April 30, 2009. **Financial Restructuring** • Write downs were made by financial institutions approximating US$ 635 billion. • Top investment banks- Bear Stearns, Merrill Lynch and Lehman Brothers ceased to exist; Goldman Sachs and Morgan Stanley were converted into bank holding companies. • 15 banks declared bankruptcy - Washington Mutual Inc. filed for biggest ever bankruptcy after sale of assets of its banking unit to JP Morgan. • Wachovia, the 6th largest US bank was taken over by Wells Fargo & Co. • American Express Company and American Express Travel Related Services Company were allowed to convert into bank holding companies. • Bank of America Corporation was permitted to acquire Merrill Lynch & Company. **Recapitalisation of the Financial System** • Fannie Mae and Freddie Mac and AIG were taken over by the US Government. • Emergency Economic Stabilisation Act was passed on October 3, 2008. • Troubled Assets Relief Program, authorising the US Government to purchase troubled assets of US$ 700 billion was introduced. • Limit on deposit insurance was raised at banks and credit unions from US$ 100,000 to US$ 250,000 per account. • The US Treasury Department of the Treasury announced voluntary Capital Purchase Program. Under the program, the US Treasury would purchase up to US$ 250 billion of senior preferred shares on standardised terms as described in the program's term sheet. • Restructuring of Government's financial support to the American International Group (AIG) was announced. • The U.S. government entered into an agreement with Citigroup to provide a package of guarantees, liquidity access, and capital. • A program to purchase the direct obligations of housing-related government-sponsored enterprises and mortgage-backed securities (MBS) was initiated.

(Contd...)

Table 39: Recent Global Response to Finance Market Turmoil *(Concld.)*

Country	Key Measures
1	2
	Other Measures • Short selling in specific stocks in stock exchanges was temporary banned and mark-to-market rules were eased.
United Kingdom	**Monetary Policy Easing** • Official bank rate was cut thrice by 300 bps during October- December, 2008 and further by 50 bps to 1.5 per cent on January 8, 2009. • The collateral eligible for the long-term repo operations was extended on October 3, 2008. **Recapitalisation of the Financial System** • After Northern Rock, Bradford and Bingley became the second mortgage lender to get nationalised • Government rescue plan of UK£400 billion for financial institutions was introduced. • The Government invested £50 billion in the banking industry, offered guarantees over £250 billion of new bank debt and further added £100 billion to the existing Bank of England short-term loan scheme. • The Government took control of Royal Bank of Scotland (RBS) and Halifax Bank of Scotland (HBOS). **Other Measures** • Short selling in specific stocks in stock exchanges was temporary banned. • Reciprocal currency arrangements (swap lines) were established with major central banks on September 18 and 26, 2008.
Other Countries	**Monetary Policy Easing** • ECB decided to conduct a special term refinancing operation . • Central banks in the Euro area, Canada, Sweden and Switzerland reduced their policy rates by 50 bps on October 8, 2008. • ECB announced measures to further expand the list eligible for collateral, enhance the provision of liquidity through long-term refinancing and to provide US dollar liquidity through foreign exchange swaps. • ECB cut its policy rate thrice by a total of 225 bps between October-December 2008 to 2.0 per cent. • Bank of Japan reduced its policy rate by 20 bps each on October 31, 2008 and December 19, 2008 to 0.1 per cent. • Reserve Bank of Australia (RBA) relaxed the collateral norms and reduced four times its policy rate by 300 bps to 4.25 per cent during September-December 2008. • RBA announced a foreign exchange swap facility with the Federal Reserve and a domestic term deposit facility to further enhance the domestic liquidity. • Bank of Canada lowered its policy rate by a total of 200 bps since October 2008 to 1.0 per cent. • China cut its benchmark 1-year lending rate by a total of 216 basis points to 5.31 per cent and CRR by a total of 300 bps since September 2008. • The Hong Kong Monetary Authority and People's Bank of China signed a currency swap arrangement. • Bank of Korea reduced its policy rate by 275 bps since October 2008 to 2.5 per cent. • Bank of Thailand lowered its policy rate by 100 bps on December 3, 2008 and further by 75 bps to 2 per cent on January 14, 2009. **Recapitalisation of the Financial System** • Germany bailed out IKB Deutsche Industriebank AG after losses on the US sub-prime investments in June 2008. • Danish central bank rescued Roskilde Bank and Ebh bank in July and September 2008, respectively. • German Government rescued Hypo Real Estate Holding AG. • France and Belgium Governments announced measures to support Dexia SA, the world's largest lender to local governments. • Governments of Belgium, the Netherlands and Luxembourg rescued Fortis, a Belgo Dutch banking and insurance group. **Other Measures** • Short-selling in specific stocks in France, Australia, Ireland, Portugal and Korea was banned/restricted. • Irish government guaranteed deposits from the six major banks. • Germany guaranteed bank deposits of private savers. • Australia guaranteed all bank deposits for three years. • New Zealand guaranteed all deposits for two years.

Source: Websites of respective central banks.

Second, there is a need to address regulatory arbitrage, which had encouraged loose practices, hunt for quick yields and non-transparent and risky financial products among private equity funds, structured investment vehicles/ conduits and money market funds, which were highly leveraged and had nexus with the banking system. *Third*, the emerging lesson undeniably remains that regulations have to keep pace with the innovations and they need to be ahead of the curve, while ensuring concomitantly that such regulations do not throttle innovation. *Fourth*, it has also raised the issue of suitability of universal banking model that has been adopted widely in recent years. *Fifth*, the above issues also call for close coordination among various agencies in which the role of banks, regulators, supervisors and fiscal authorities with regard to financial stability needs to be relooked. *Sixth*, in the wake of unprecedented crisis in the US financial sector and consequent erosion in the confidence, it cannot be inferred that markets and competition do not work, but they do need to be managed and regulated appropriately. The right lesson to draw is that markets and institutions do succumb occasionally to excesses and regulators have to be vigilant, constantly finding the right balance between attenuating risk-taking and inhibiting growth. *Seventh*, notwithstanding the recent use of innovative and unconventional measures, a more systematic approach would be required to deal with disposition of distressed assets, the degree of protection offered to depositors, and the scale and scope of liquidity support that is offered to institutions and markets. *Finally*, the recent dip in the global macro economic outlook has further added to the unstable global financial market conditions, thus, reiterating that financial sector has no standing of its own, it derives its strength and resilience from the real economy.

V.23 As indicated in its Mid-Term Review of Monetary Policy on October 24, 2008, the Reserve Bank has been closely and consistently monitoring the liquidity and monetary situation to respond swiftly and effectively to the impact of the global developments on Indian financial markets. In response to emerging global developments, the Reserve Bank has taken a number of measures since mid-September 2008. These measures were aimed at augmenting domestic and foreign exchange liquidity and enabling banks to continue to lend for productive purposes while maintaining credit quality so as to sustain the growth momentum (Annex).

Domestic Financial Markets

V.24 The Indian financial markets came under pressure from mid-September 2008 reflecting the knock-on effects of the global crises through the monetary, financial and real channels. The contagion was initially felt in the equity market due to reversal of foreign institutional portfolio flows and the concomitant effects on the domestic foreign exchange market and liquidity conditions. The liquidity pressure faced by the mutual funds in the wake of redemption demands affected banks and other segments of the financial sector. Thus, all the segments of the financial market came under pressure which necessitated the Reserve Bank to undertake several measures to augment domestic and foreign exchange liquidity (Annex). The pressure on money markets was reflected in call rates breaching the upper bound of LAF corridor till end-October 2008. In the foreign exchange market, the Indian rupee generally depreciated against major currencies. In the credit market, lending rates of scheduled commercial banks, which witnessed a hardening trend initially, declined during December 2008. Yields softened in the government securities market during the third quarter 2008-09. Following the trends in major international equity markets, Indian equity markets saw a decline during the same period (Table 40).

Liquidity Conditions

V.25 During 2008-09 so far, liquidity management operations had to swiftly change beginning mid-September 2008 in order to address the sharp changes in the financial environment brought about by the knock-on effects of the severe disruptions in international financial

Table 40: Domestic Financial Markets at a Glance

Year/ Month	Call Money		Government Securities		Foreign Exchange				Liquidity Management		Equity			
	Average Daily Turnover (Rs. crore)	Average Call Rates* (Per cent)	Average Turnover in Govt. Securities (Rs. crore)+	Average 10-Year Yield@ (Per cent)	Average Daily Inter-bank Turnover (US $ million)	Average Exchange Rate (Rs. per US $)	RBI's net Foreign Currency Sales (-)/ Purchases (+) (US $ million)	Average 3-month Forward Premia (Per cent)	Average MSS Out-standing# (Rs. crore)	Average Daily Reverse Repo (LAF) Out-standing (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
2006-07	**21,725**	**7.22**	**4,863**	**7.78**	**18,540**	**45.28**	**26,824##**	**2.14**	**37,698**	**21,973**	**3,832**	**7,812**	**12277**	**3572**
2007-08	**21,393**	**6.07**	**8,104**	**7.91**	**33,672**	**40.24**	**78,203##**	**2.16**	**1,28,684**	**4,677**	**6,275**	**14,148**	**16569**	**4897**
Apr 2008	19,516	6.11	6,657	8.10	36,710 P	40.02	4,325	2.68	1,70,726	26,359	5,773	13,561	16291	4902
May 2008	19,481	6.62	6,780	8.04	31,868 P	42.13	148	2.45	1,75,565	11,841	6,084	13,896	16946	5029
Jun 2008	21,707	7.75	6,835	8.43	38,108 P	42.82	-5,229	3.78	1,74,433	-8,622	5,410	12,592	14997	4464
Jul 2008	24,736	8.76	5,474	9.18	37,163 P	42.84	-6,320	6.04	1,72,169	-27,961	5,388	12,862	13716	4125
Aug 2008	23,408	9.10	7,498	9.06	38,002P	42.94	1,210	4.71	1,71,944	-22,560	4,996	11,713	14722	4417
Sep 2008	23,379	10.52	10,418	8.45	44,032P	45.56	-3,784	2.35	1,75,666	-42,591	5,147	12,489	13943	4207
Oct 2008	28,995	9.9	4,321	7.85	36,662P	48.66	-18,666	1.13	1,69,123	-45,612	3,911	10,810	10550	3210
Nov 2008	21,812	7.57	5,866	7.41	30,938P	49.00	-3,101	4.20	1,47,648	-8,017	3,539	9,618	9454	2835
Dec.2008	21,641	5.92	11,451	5.88	–	48.63	–	4.59	1,24,848	22,294	3,850	10,141	9514	2896

* : Average of daily weighted call money borrowing rates.
@ : Average of daily closing rates.
** : Average of daily closing indices.
LAF : Liquidity Adjustment Facility.
MSS : Market Stabilisation Scheme.
NSE : National Stock Exchange of India Ltd.
\+ : Average of daily outright turnover in Central Government dated securities.
\# : Average of weekly outstanding MSS.
\#\# : Cumulative for the financial year.
BSE : Bombay Stock Exchange Limited.
– : Not available.
P : Provisional.

Note : In column 11, (-) indicates injection of liquidity, while (+) indicates absorption of liquidity.

markets. A holistic account of liquidity management operations is given in Box 1.

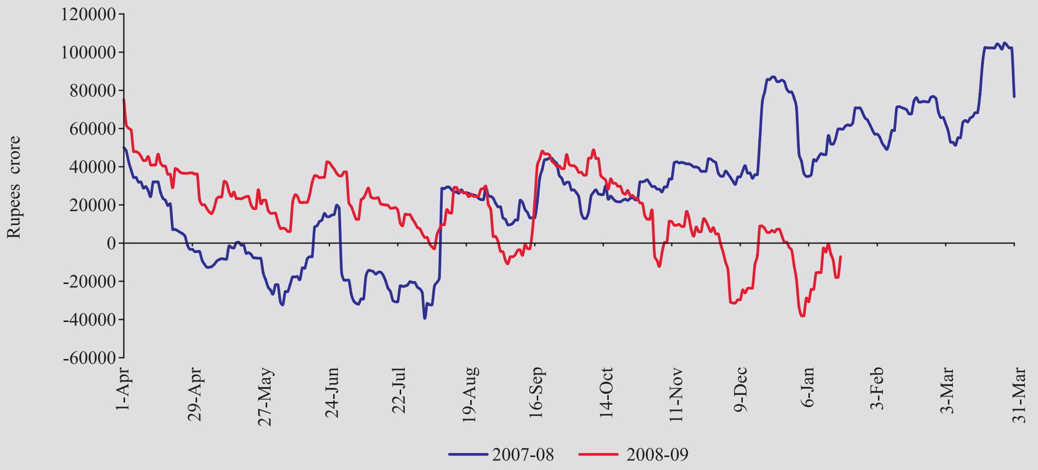
Cash Management of the Central Government

V.26 Commencing the year with a surplus cash balance of Rs.76,686 crore (end-March 2008), built primarily from surplus balances of State Governments which were invested in Treasury Bills, the Central Government used up these balances to meet its expenditure needs and resorted to WMA between August 4, 2008 and August 6, 2008. With inflow of indirect taxes and surplus transferred from the Reserve Bank, the cash balances turned into surplus between August 7, 2008 and September 1, 2008. The Central Government again resorted to WMA during September 2-14, 2008 to meet the mismatches in receipts and expenditure. Surpluses built by advance tax flows in the latter half of September 2008 were utilised to meet the increased expenditure requirement of the Central Government. During the second half of 2008-09 (up to January 19, 2009), the Central Government resorted to WMA on three occasions, *viz.,* November 4-7, 2008, December 1-16, 2008 and December 29, 2008-January 19, 2009. The daily average utilisation of WMA by the Central Government (up to January 19, 2009) was Rs.1,623 crore as compared with Rs.3,196 crore a year ago. Due to additional funding requirements, the Central Government also availed of overdraft (OD) for the first time in the current financial year, during December 5-14, 2008, January 1-11, 2009 and January 16-19, 2009. The daily average of OD was Rs.1,088 crore as compared with Rs.425 crore a year ago (Chart 18).

Box 1: Liquidity Management Operations during 2008-09

During most part of the first half of the current fiscal year 2008-09, liquidity management operations were essentially geared towards mopping up of excess domestic liquidity, mainly through CRR hikes, with a view to containing inflationary pressures largely emanating from rising crude and commodity prices. In conjunction, the foreign exchange market operations of the Reserve Bank to contain excessive volatility in the exchange rate also absorbed domestic liquidity and obviated the need for issuing dated securities under MSS. Overnight rates were maintained at the upper end of the corridor during July to mid-September 2008 and the frictional liquidity requirements of the banking system were met through LAF. Beginning mid-September 2008, domestic money and foreign exchange markets came under pressure from the indirect effects of the global financial turmoil. The Reserve Bank's operations to contain volatility in the foreign exchange market coupled with transient factors like advance tax payments exacerbated the pressure on rupee liquidity. Consequently, overnight rates moved above the upper bound of the LAF corridor. With the abatement of inflationary pressures, rupee liquidity was augmented through, *inter alia*, reduction in the CRR and a slew of special facilities as detailed in the Annex. The availment under LAF also increased substantially. These apart, MSS buyback auctions were timed to alleviate domestic liquidity pressures.

Chart 18: Cash Balances of the Central Government



Liquidity Management

V.27 During the period April to mid-September 2008, the drying up of capital inflows and the consequent turnaround in the foreign exchange operations of the Reserve Bank from net spot purchases up to May 2008 to net spot sales thereafter (barring August 2008) reduced the generation of domestic liquidity (Table 41). Consequently, the MSS auctions of dated securities were kept in abeyance since end-April 2008 (Chart 19). At the same time, however, the general decline in the cash balances of the Central Government eased systemic liquidity conditions except during advance tax collections around mid-June 2008. On the other hand, against the backdrop of inflationary pressures, CRR was increased (in April, May, July and August) cumulatively by 150 basis points to 9.0 per cent effective August 30, 2008 and the repo rate was raised cumulatively by 125 basis points (in June and July 2008) to 9.0 per cent effective July 30, 2008. Reflecting the impact of these developments, the LAF turned from absorption mode to injection mode after the first week of June 2008.

V.28 Beginning mid-September 2008, the bankruptcy/sell out/ restructuring of some of the world's largest financial institutions brought pressures on the domestic money and foreign exchange markets, in conjunction with temporary local factors such as advance tax outflows. In order to alleviate these pressures, the Reserve Bank initiated a series of measures beginning mid-September 2008 to augment rupee and dollar liquidity (Annex). The average daily net outstanding liquidity injection under LAF was Rs.42,591 crore during September 2008 as compared with Rs. 22,560 crore in the previous month. There were no fresh issuances under the MSS after September 2, 2008 and the actual balances under the MSS was Rs.1,73,804 crore as on September 26, 2008 (Table 42).

Table 41: Reserve Bank's Liquidity Management Operations

(Rupees crore)

Item	2007-08	2007-08				2008-09			
		Q1	Q2	Q3	Q4	Q1	Q2	Oct.	Nov.
1	2	3	4	5	6	7	8	9	10
A. Drivers of Liquidity (1+2+3+4+5)	**2,04,026**	**51,146**	**1,11,169**	**-1,694**	**43,405**	**28,489**	**-13,572**	**-82,724**	**-4,821**
1. RBI's net purchases from Authorised Dealers	3,12,054	39,791	1,00,896	88,545	82,822	-8,555	-40,249	-91,403	-16,253
2. Currency with the Public	-84,571	-12,946	9,565	-47,131	-34,058	-30,623	11,894	-34,422	5,103
3. Surplus cash balances of the Centre with the Reserve Bank	-26,594	49,992	-30,771	-49,820	4,005	40,073	-3,845	25,975	6,402
4. WMA and OD	0	15,159	-15,159	0	0	0	0	0	0
5. Others (residual)	3,137	-40,850	46,639	6,712	-9,364	27,595	18,629	17,126	-73
B. Management of Liquidity (6+7+8+9)	**-1,17,743**	**-53,943**	**-68,621**	**-11,189**	**16,010**	**-51,239**	**1,472**	**1,26,355**	**9,073**
6. Liquidity impact of LAF	21,165	-20,290	-2,825	27,795	16,485	-18,260	24,390	17,110	-63,710
7. Liquidity impact of OMO (Net) *	13,510	10	40	5,260	8,200	1,062	6,204	628	127
8. Liquidity impact of MSS	-1,05,418	-18,163	-50,336	-28,244	-8,675	-6,041	628	8,617	32,656
9. First round liquidity impact due to CRR change	-47,000	-15,500	-15,500	-16,000	0	-28,000	-29,750	1,00,000	40,000
C. Bank Reserves (A+B) #	**86,283**	**-2,797**	**42,548**	**-12,883**	**59,415**	**-22,750**	**-12,100**	**43,631**	**4,252**

(+) : Indicates injection of liquidity into the banking system.
(-) : Indicates absorption of liquidity from the banking system.
\# : Includes vault cash with banks and adjusted for first round liquidity impact due to CRR change.
* : Adjusted for Consolidated Sinking Funds (CSF) and Oil bonds.
Note : Data pertain to March 31 and last Friday for all other months.

V.29 In October 2008, as part of the various measures to augment rupee liquidity, the CRR was reduced by 250 basis points to 6.50 per cent effective from the fortnight beginning October 11, 2008. Deficit liquidity conditions, however,

Chart 19: Market Stabilisation Scheme

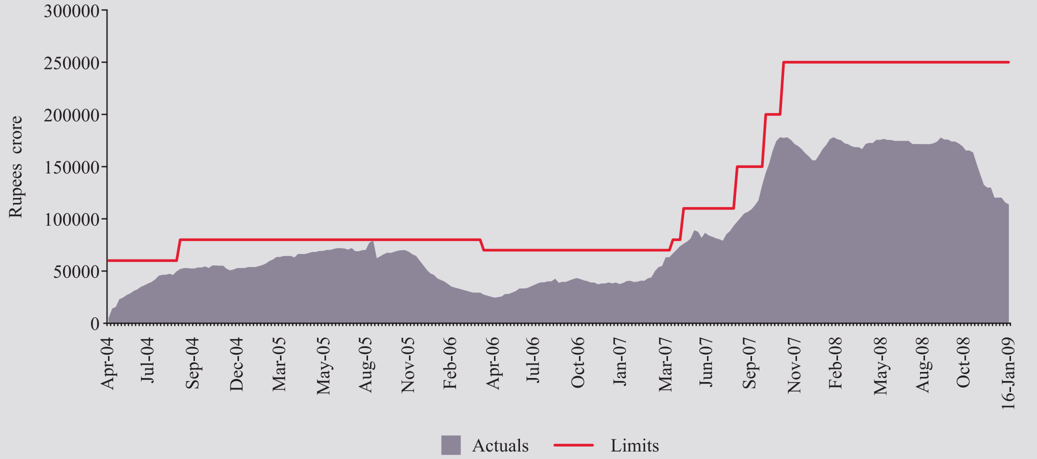


Table 42: Liquidity Management

(Rupees crore)

Outstanding as on Last Friday	LAF	MSS	Centre's Surplus with the RBI @	Total (2 to 4)	Outstanding as on Last Friday	LAF	MSS	Centre's Surplus with the RBI @	Total (2 to 4)
1	2	3	4	5	1	2	3	4	5
2007					**2008**				
January	-11,445	39,375	42,494	70,424	January	985	1,66,739	70,657	2,38,381
February	6,940	42,807	53,115	1,02,862	February	8,085	1,75,089	68,538	2,51,712
March *	-29,185	62,974	49,992	83,781	March*	-50,350	1,68,392	76,586	1,94,628
April	-9,996	75,924	-980	64,948	April	32,765	1,72,444	36,549	2,41,758
May	-4,690	87,319	-7,753	74,876	May	-9,600	1,75,362	17,102	1,82,864
June	-8,895	81,137	-15,159	57,083	June	-32,090	1,74,433	36,513	1,78,856
July	2,992	88,010	-20,199	70,803	July	-43,260	1,71,327	15,043	1,43,110
August	16,855	1,06,434	20,807	1,44,096	August	-7,600	1,73,658	17,393	1,83,451
September	-6,070	1,31,473	30,771	1,56,174	September	-56480	1,73,804	40,358	1,57,682
October	18,135	1,74,277	23,735	2,16,147	October	-73,590	1,65,187	14,383	1,05,980
November	-1,320	1,71,468	36,668	2,06,816	November	-9,880	1,32,531	7,981	1,30,632
December	-33,865	1,59,717	80,591	2,06,443	December	14,630	1,20,050	3,804	1,38,484
					2009				
					January 16	31,795	1,13,651	-9,263	1,36,183

@ : Excludes minimum cash balances with the Reserve Bank in case of surplus.

* : Data pertain to March 31.

Note : 1. Negative sign in column 2 indicates net injection of liquidity through LAF.

2. Between March 5 and August 5, 2007, daily reverse repo absorptions were restricted to a maximum of Rs.3,000 crore comprising Rs.2,000 crore in the First LAF and Rs.1,000 crore in the Second LAF. The Second LAF that was discontinued from August 6, 2007 was reintroduced from August 1, 2008 on Reporting Fridays and from September 17, 2008 on daily basis.

3. Negative sign in column 4 indicates injection of liquidity through WMA/overdraft.

persisted during October 2008 mainly due to sharp increase in bank credit and festive season currency demand.

V.30 On November 1, 2008, another set of monetary measures were announced in view of then prevailing financial conditions, which included: (i) further reduction in CRR by 100 basis points in two stages *viz*., to 6.0 per cent retrospectively with effect from October 25 and to 5.5 per cent with effect from November 8, 2008; (ii) introduction of a special refinance facility under Section 17 (3B) of the Reserve Bank of India Act to provide further comfort on liquidity and to impart flexibility in liquidity management to banks; (iii) permanent reduction of 100 basis points in SLR to 24 per cent from November 8, 2008 (as against a temporary reduction to the same extent announced on September 16, 2008); and (iv) enhancement of the relaxation in SLR maintenance in the context of the term repo facility from 0.5 per cent to 1.5 per cent of the banks' NDTL with effect from November 1, 2008. Furthermore, between April 1, 2008-December 31, 2008, the outstanding balances under MSS fell by Rs.49,201 crore to Rs.1,21,353 crore, notwithstanding fresh issuances of

Rs.43,500 crore till September 2008. This fall was on account of redemption to the tune of Rs.54,737 crore and buy-backs (during November-December 2008) of Rs.37,964 crore (Chart 20). Reflecting the impact of the various monetary measures, the average daily net outstanding liquidity injection under LAF declined significantly to Rs.8,017 crore during November 2008 from that of Rs.45,612 crore during October 2008.

V.31 Liquidity conditions continued to ease during December 2008. The LAF shifted from net injection mode to net absorption mode with effect from December 1, 2008. The average daily net outstanding liquidity absorption under LAF was Rs.22,294 crore during December 2008.

V.32 On a review of the prevailing global and domestic macroeconomic situation, the Reserve Bank reduced (a) the CRR by a further 50 basis points to 5.0 per cent effective from the fortnight beginning January 17, 2009, (b) the repo rate by a further 100 basis points to 5.5 per cent and (c) the reverse repo rate by 100 basis points to 4.0 per cent effective from January 5, 2009. The liquidity absorption under LAF on January 22, 2009 was at Rs.54,750 crore. The outstanding balances under the MSS declined further to Rs.1,10,651 crore as on January 19, 2009, mainly reflecting buy-back of Rs.6,580 crore.

Money Market

V.33 Money market remained, by and large orderly, with call rates remaining generally within the informal corridor of reverse repo and repo rates during the first quarter of 2008-09. The weighted average daily call rate was 6.83 per cent in the first quarter. As detailed in previous section, monetary policy was tightened on the back of inflationary pressues in stages till August 2008 and the call rates hovered around the upper bound of the corridor during the second quarter (upto mid-September 2008). In mid-September, the failure of Lehman Brothers and some

Chart 20: MSS Buy-back and Issuance of Central Government securities

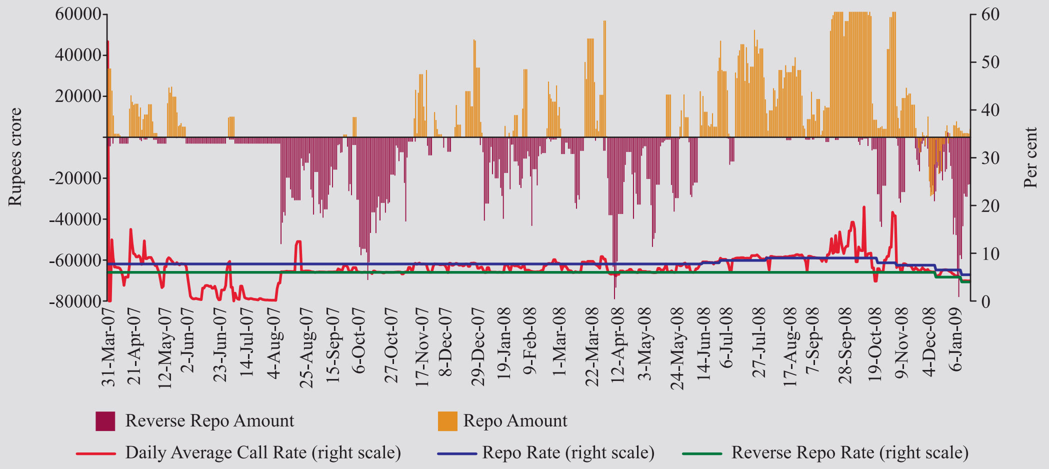
other global financial institutions led to freezing of money market activities in major financial centres. The Indian markets were also indirectly affected and the impact on money market rates was magnified as it concided with the period of advance tax outflows from the banking system. Reflecting the tight liquidity conditions, the call money rate moved above the repo rate till the end of September 2008. The weighted average daily call rate was 9.46 per cent in the second quarter.

V.34 The pressure on money markets continued to prevail in the beginning of the third quarter of 2008-09, partly on account of the foreign exchange operations of the Reserve Bank undertaken to contain excess volatility. Consequently, the call rate continued to remain above the informal corridor in the first half of October 2008. Subsequently, the call rate declined under the impact of the reduction in the cash reserve ratio (CRR) by 250 basis points to 6.50 per cent with effect from the fortnight beginning October 11, 2008. The call rate again crossed the upper bound of the LAF corridor in the last week of October 2008, partly reflecting the festive season increase in demand for currency.

V.35 During the period of market stress, *i.e.*, during mid-September to end-October 2008, out of a total of 47 days, the daily weighted average call rate and the overnight weighted average money market rate (OWAR) crossed the upper bound of the LAF corridor on 36 days and 31 days, respectively (Chart 21). During the same period the call rate averaged 10.56 per cent, while the OWAR averaged lower at 8.98 per cent.

V.36 As the demand for currency receded and as the series of measures initiated by the Reserve Bank, including the reduction in the repo rate by a cumulative 150 basis points to 7.5 per cent with effect from November 3, 2008, began to take effect, the weighted average call

Chart 21: Liquidity Adjustment Facility and the Call Rate



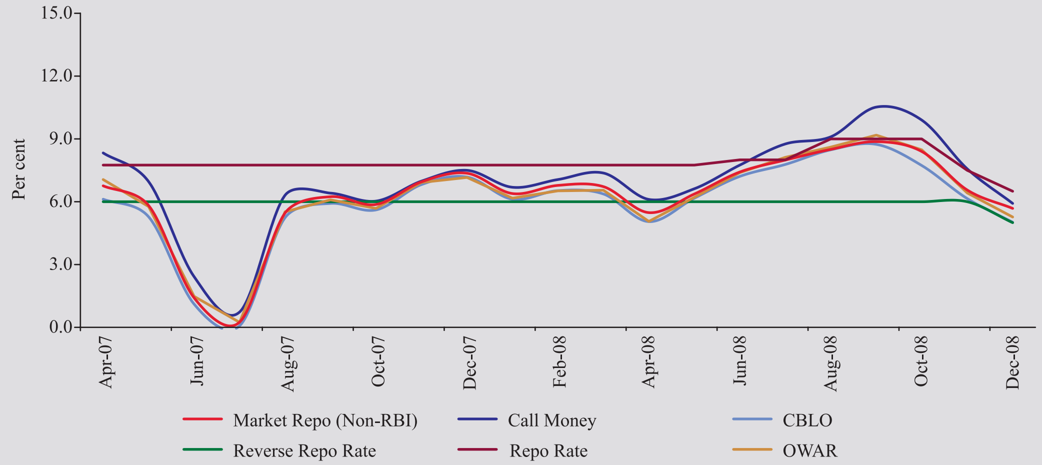
money rate declined from a high of 19.7 per cent (on October 10, 2008) and mostly remained within the LAF corridor from November 3, 2008 onwards.

V.37 Liquidity conditions continued to improve from December 2008 onwards following the reduction of 100 basis points each in repo rate and reverse repo rate to 6.5 per cent and 5.0 per cent, respectively with effect from December 8, 2008. The weighted average daily call rate declined from 9.9 per cent in October 2008 to 7.57 per cent in November 2008. The OWAR has also mostly remained well below the upper bound of the LAF corridor since November 3, 2008. The weighted average daily call rate and the OWAR in December 2008 were placed at 5.92 per cent and 5.22 per cent, respectively. The call money rate declined further with the reduction in the repo rate and reverse repo rate to 5.5 per cent and 4.0 per cent, respectively, effective from January 5, 2009. On January 22, 2009, the weighted average daily call rate and the OWAR were placed at 4.21 per cent and 4.01 per cent, respectively (Chart 22). Interest rates in the collateralised segments of the money market – the market repo (outside the LAF) and the Collateralised Borrowing and Lending Obligation (CBLO) – moved in tandem with but remained below the call rate during the third quarter of 2008-09.

V.38 Unlike in the case of some of the other countries, there were no major disruptions in the money market in India during post mid-September 2008, primarily because there was no solvency issue in respect of Indian banks and the prudent SLR prescription provided adequate leeway to the Reserve Bank for meeting their liquidity needs through LAF without diluting the collateral quality.

V.39 Special Market Operations (SMO) were conducted by the Reserve Bank from June 2008 till August 2008 to improve the access of public sector oil companies to domestic liquidity and alleviate the lumpy demand in the foreign exchange market in

Chart 22: Money Market Interest Rates



the context of the unprecedented increase in international oil prices. The SMO was an exceptional measure for minimising potential adverse consequences for financial markets in a transparent manner. In this phase, the SMOs were liquidity neutral since the settlement dates of the foreign exchange transactions and transactions in oil bonds were synchronised. SMOs were resumed but with calibrated provision of US dollars from November 24, 2008 and continued till January 2, 2009.

Certificates of Deposit

V.40 The outstanding amount of certificates of deposit (CDs) issued by scheduled commercial banks (SCBs) increased from Rs.1,47,792 crore at end-March 2008 to Rs.1,78,280 crore as on September 12, 2008. Thereafter, the outstanding amount declined to Rs.1,51,214 crore as on December 19, 2008 reflecting the pressures on domestic financial markets. The outstanding amount constituted 5.2 per cent of aggregate deposit of CD-issuing banks with a significant inter-bank variation as on December 19, 2008. During April-December 2008, the average issuance of CDs was placed at Rs.6,253 crore as compared with Rs.5,780 crore in the corresponding period of previous year and Rs.6,709 crore during 2007-08 (full year). Most of the CDs issued were of more than six months duration. The weighted average discount rate (WADR) of CDs declined from 10.0 per cent at end-March 2008 to 9.16 per cent at end-June 2008, but increased steadily to 12.57 per cent on October 10, 2008. Thereafter, the WADR declined to 8.85 per cent as on December 19, 2008 in tandem with movements in other money market rates (Table 43).

Table 43: Activity in Money Market Segments

(Rupees crore)

Year/ Month	Average Daily Volume (One Leg)					Commercial Paper		Certificates of Deposit	
	Call Money Market	Repo Market (Outside the LAF)	Collateralised Borrowing and Lending Obligation (CBLO)	Total (2+3+4)	Term Money Market	Outstanding	WADR (per cent)	Outstanding	WADR (per cent)
1	2	3	4	5	6	7	8	9	10
2006-07	**10,863**	**8,419**	**16,195**	**35,477**	**506**	**21,329 ***	**8.08**	**64,821 ***	**8.24**
2007-08	**10,697**	**13,684**	**27,813**	**52,194**	**352**	**33,813 ***	**9.20**	**1,16,904 ***	**8.94**
Apr 2008	9,758	14,966	38,828	63,552	374	37,584	8.85	1,50,865	8.49
May 2008	9,740	14,729	36,326	60,795	420	42,032	9.02	1,56,780	8.95
Jun 2008	10,854	11,262	35,774	57,890	253	46,847	10.03	1,63,143	9.16
Jul 2008	12,368	8,591	23,669	44,628	226	51,569	10.95	1,64,892	10.23
Aug 2008	11,704	10,454	22,110	44,268	501	55,036	11.48	1,71,966	10.98
Sep 2008	11,690	10,654	20,547	42,891	335	52,038-	12.28	1,75,522	11.56
Oct 2008	14,497	9,591	16,818	40,906	345	48,442	14.17	1,58,562	10.00
Nov 2008	10,906	15,191	24,379	50,476	319	44,487	12.42	1,51,493	10.36
Dec 2008	10,820	16,943	32,261	60,024	415	38,055	10.98	1,51,214	8.85

* : Average for the year.

WADR : Weighted Average Discount Rate.

Commercial Paper

V.41 The outstanding amount of commercial paper issued by corporates increased gradually from Rs.32,592 crore at end-March 2008 to Rs.55,036 crore at end-August 2008 in line with the seasonal pattern observed in case of CP issuances. The average issuance of CP during April-December 2008 was at Rs.4,643 crore as compared with Rs.4,033 crore in the corresponding period of previous year and Rs.4,153 crore during 2007-08 (full year). Leasing and Finance Companies continued to be the major issuers of CP, followed by 'manufacturing and other companies' and financial institutions (Table 44). As earlier, CP issuance was dominated by the prime-rated companies. The WADR on CP declined from 10.38 per cent on March 31, 2008 to 8.57 per cent as at mid-May 2008. Thereafter it increased steadily to 14.17 per cent as at end-October 2008 but again declined to 10.98 per cent as at end-December 2008. The most preferred tenor of CP issuance was 'more than 180 days'.

V.42 Starting from mid-September 2008, the outstanding amount of CPs declined continuously reflecting disturbances in financial markets and stood at Rs.38,055 crore as at end-December 2008. Issuing & Paying Agents (IPAs) have reported defaults in repayments of CPs issued by two realty companies in recent months. Also, the differential in the WADR of CP *vis-a-vis* CDs, has widened reflecting preference for bank CDs in the recent period.

Treasury Bills

V.43 During the third quarter of 2008-09 primary market yields on Treasury Bills (TBs) showed a declining trend on account of various measures taken by the Reserve Bank to enhance liquidity in the system and cuts in policy rates (Table 45 and Chart 23). Thus, movements in Treasury Bill yields have corresponded to monetary policy changes. The yield spread between 364-day and 91-day TB was -1 basis point in December 2008 (7 basis points in March 2008).

Table 44: Commercial Paper - Major Issuers

(Rupees crore)

Category of Issuer	End of				
	March 2007	March 2008	June 2008	September 2008	December 2008
1	2	3	4	5	6
Leasing and Finance	12,594	24,925	34,957	39,053	27,965
	(70.5)	(76.5)	(76.6)	(75.0)	(73.5)
Manufacturing	2,754	5,687	8,150	9,925	6,833
	(15.4)	(17.4)	(17.4)	(19.1)	(18.0)
Financial Institutions	2,515	1,980	3,740	3,060	3,257
	(14.1)	(6.1)	(8.0)	(5.9)	(8.5)
Total	**17,863**	**32,592**	**46,847**	**52,038**	**38,055**
	(100.0)	**(100.0)**	**(100.0)**	**(100)**	**(100)**

Note : Figures in parentheses are percentage shares in the total outstanding.

Table 45: Treasury Bills in the Primary Market

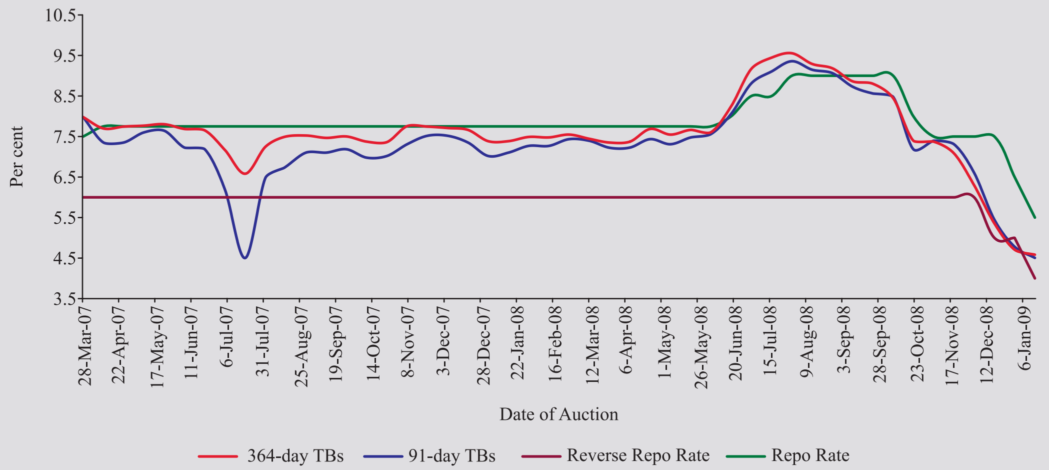
Month	Notified Amount (Rupees crore)	Average Implicit Yield at Minimum Cut-off Price (Per cent)			Average Bid-Cover Ratio		
		91-day	182-day	364-day	91-day	182-day	364-day
1	2	3	4	5	6	7	8
2006-07	**1,86,500@**	**6.64**	**6.91**	**7.01**	**1.97**	**2.00**	**2.66**
2007-08	**2,24,500@**	**7.10**	**7.40**	**7.42**	**2.84**	**2.79**	**3.21**
Apr 2008	22,000	7.28	7.41	7.53	2.63	3.17	2.36
May 2008	21,000	7.41	7.55	7.61	2.92	2.73	3.43
Jun 2008	11,500	8.01	8.42	7.93	2.45	2.76	2.80
Jul 2008	16,000	9.07	9.33	9.39	2.56	2.72	3.52
Aug 2008	23,500	9.15	9.31	9.24	2.99	2.86	4.24
Sep 2008	25,000	8.74	8.92	8.83	3.06	3.04	3.57
Oct 2008	35,000	8.13	8.36	7.92	1.95	2.42	4.00
Nov 2008	28,000	7.30	7.13	7.23	7.95	2.97	3.51
Dec 2008	16,500	5.49	5.35	5.48	5.36	4.67	5.59

@: Total for the financial year.
Note : 1. 182-day TBs were reintroduced with effect from April 2005.
2. Notified amounts are inclusive of issuances under the Market Stabilisation Scheme (MSS).

Foreign Exchange Market

V.44 The rupee moved in the range of Rs.39.89-50.53 per US dollar during the financial year 2008-09 so far (up to January 20, 2009). The rupee showed a depreciating trend during the second quarter of 2008-09, which started in the beginning of current financial year. The rupee remained around the level of Rs.43 per US dollar during third week of May 2008 to second week of August 2008, depreciated thereafter sharply mainly on the back of widening trade deficit, capital outflows and strengthening of US dollar *vis-à-vis* other major currencies. The

Chart 23: Yields on Treasury Bills



rupee/US dollar exchange rate, which was Rs. 39.99 per dollar at end-March 2008, fell to its lowest level at Rs. 50.53 per dollar as on December 02, 2008, before recovering to Rs. 49.00 per dollar as on January 20, 2009. As on January 20, 2009, the Indian rupee depreciated by 18.4 per cent over its level on March 31, 2008. Over the same period, the rupee experienced a depreciation of 1.0 per cent against the euro, 26.1 per cent against the Japanese yen and 20.5 per cent against the Chinese yuan. However, the rupee showed an appreciation of 13.9 per cent against Pound sterling (Chart 24).

V.45 After witnessing appreciation during 2007-08 on account of large capital inflows, the trade weights based nominal effective exchange rate (NEER) and real effective exchange rate (REER) of the Indian rupee depreciated during 2008-09 so far. The 36-currency trade weighted NEER and REER depreciated by 7.8 per cent and 9.4 per cent, respectively, between March 2008 and October 2008 as against an appreciation of 9.4 per cent and 5.9 per cent, respectively, during the corresponding period of the previous year, reflecting widened trade deficit and moderation in capital flows. Over the same period, the 6-currency trade weighted NEER and REER of the rupee depreciated by 11.8 per cent and 7.6 per cent, respectively, as against an appreciation of 7.4 per cent and 7.8 per cent, respectively during the corresponding period of previous year. As on January 20, 2009, the 6-currency trade weighted NEER and REER of the rupee indicated a depreciation of 10.7 per cent and 10.1 per cent, respectively, over its end-March 2008 level (Table 46).

V.46 Forward premia increased during November-December 2008 on the back of reduced interest rates in the domestic market and declined hedging requirements by the exporters as a result of rupee depreciation and decreased export and import performance. As on January 16, 2009, the one month, three month and six

Chart 24: Movement of Rupee *vis-à-vis* Major Currencies

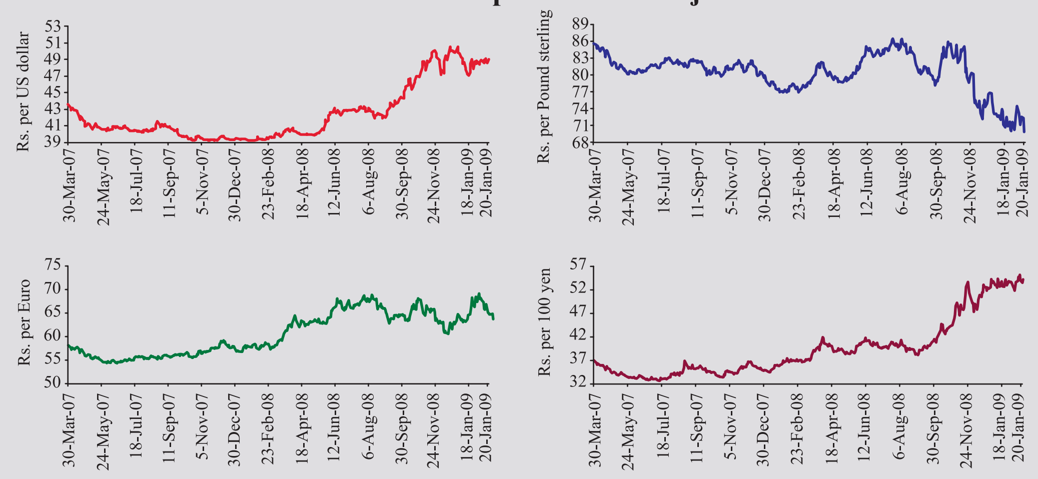


Table 46: Nominal and Real Effective Exchange Rate of the Indian Rupee (Trade-Based Weights)

Year/Month	Base : 1993-94 (April-March) = 100			
	6-Currency Weights		36-Currency Weights	
	NEER	REER	NEER	REER
1	2	3	4	5
2006-07	**69.49**	**105.57**	**85.89**	**98.48**
2007-08 (P)	**74.17**	**114.09**	**93.91**	**105.13**
Apr 2008 (P)	70.63	112.16	93.26	102.10
May 2008 (P)	67.48	108.23	89.02	97.95
Jun 2008 (P)	66.38	108.20	87.65	98.00
July 2008(P)	65.83	107.94	87.04	97.67
Aug 2008(P)	67.22	111.30	88.60	99.93
Sep. 2008(P)	64.37	106.96	85.54	96.65
Oct 2008(P)	62.08	102.40	83.02	92.73
Nov 2008(P)	63.06	102.94	–	–
Dec 2008(P)	62.12	100.10	–	–
Jan 20, 2009 (P)	62.66	99.89		

NEER : Nominal Effective Exchange Rate.
REER : Real Effective Exchange Rate.
P : Provisional. – : Not available.
Note : 1. Data from 2007-08 onwards are provisional.
2. Rise in indices indicates appreciation of the rupee and *vice versa*.

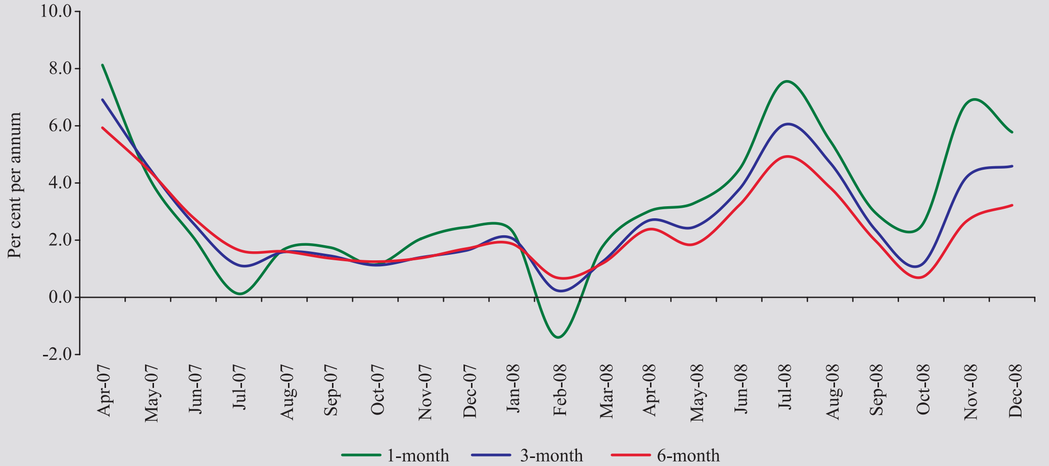
month premia were at 4.1 per cent, 3.0 per cent and 2.3 per cent, respectively (Chart 25).

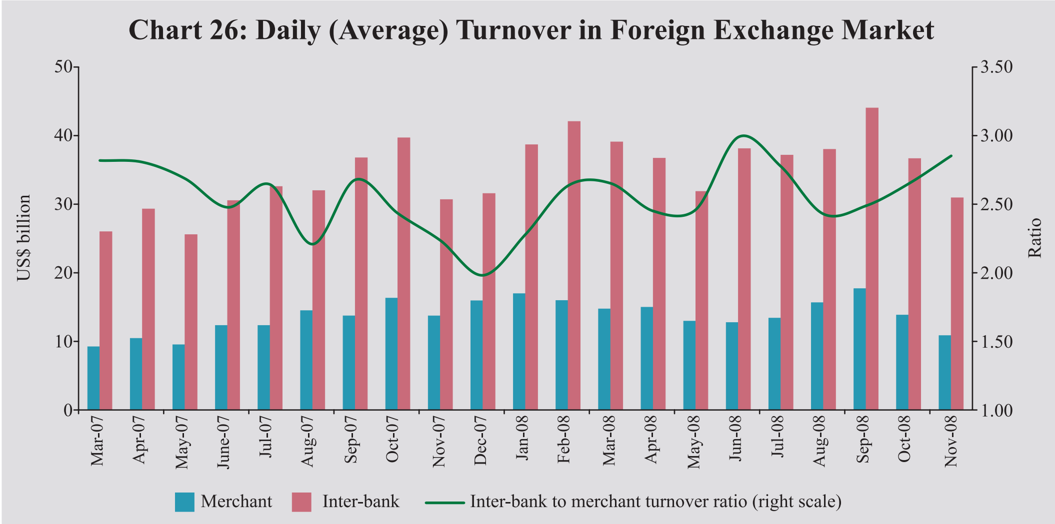
V.47 The daily average turnover in the foreign exchange market has decreased to US $ 46.1 billion during the third quarter of 2008-09 (October-November) as compared with US $ 50.2 billion during the corresponding quarter of the previous year. The daily average turnover in inter-bank and merchant segments of the foreign exchange market were US $ 33.8 billion and US $ 12.3 billion, respectively, during the third quarter of the current financial year. The ratio of inter-bank to merchant turnover remained at 2.7 during the third quarter of 2008-09 (Chart 26).

Credit Market

V.48 Benchmark prime lending rates (BPLRs) hardened during October 2008 over the levels in March 2008. In response to the Reserve Bank's measures taken since mid-September 2008, most of the PSBs have reduced their BPLRs from November 2008. Accordingly, the BPLR of PSBs decreased from the range of 13.75-14.75 per cent in September 2008

Chart 25: Movement in Rupees/US Dollar Forward Premia





to a range of 12.00-14.00 per cent in January 2009 (up to January 20, 2009). Similarly, the private sector banks also reduced their BPLR from the range of 13.75-17.75 per cent to 13.00-17.25 per cent during the same period (Table 47 and Chart 27).

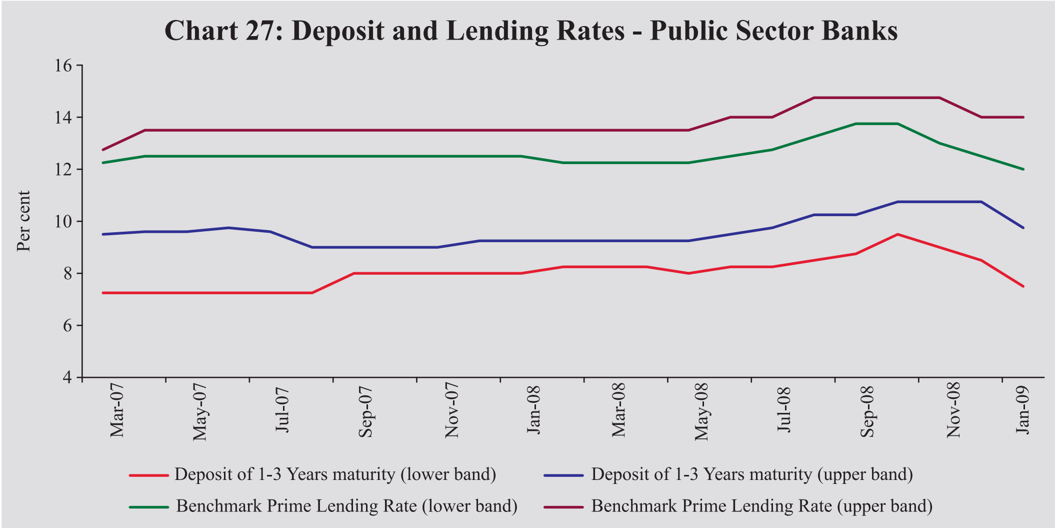
Table 47: Deposit and Lending Rates

(Per cent)

Item	March 2007	March 2008	June 2008	September 2008	December 2008	January 2009#
1	2	3	4	5	6	7
1. Domestic Deposit Rate						
Public Sector Banks						
Up to 1 year	2.75-8.75	2.75-8.50	2.75-9.00	2.75-10.25	2.75-10.25	2.75-9.75
More than 1 year and up to 3 years	7.25-9.50	8.25-9.25	8.25-9.50	8.75-10.25	8.50-10.75	7.50-9.75
More than 3 years	7.50-9.50	8.00-9.00	8.00-9.35	8.50-9.75	8.50-9.75	7.50-9.25
Private Sector Banks						
Up to 1 year	3.00-9.00	2.50-9.25	3.00-8.75	3.00-9.75	3.00-10.00	3.00-10.00
More than 1 year and up to 3 years	6.75-9.75	7.25-9.25	8.00-9.50	8.30-10.50	9.00-11.00	8.25-11.00
More than 3 years	7.75-9.60	7.25-9.75	8.00-10.00	8.25-10.25	8.50-11.00	8.25-10.25
Foreign Banks						
Up to 1 year	3.00-9.50	2.25-9.25	3.00-9.25	3.50-9.75	3.50-9.75	3.00-9.00
More than 1 year and up to 3 years	3.50-9.50	3.50-9.75	3.50-9.75	3.50-10.50	3.50-11.25	3.50-10.25
More than 3 years	4.05-9.50	3.60-9.50	3.60-9.50	3.60-11.00	3.60.11.00	3.60-10.00
2. Benchmark Prime Lending Rate						
Public Sector Banks	12.25-12.75	12.25-13.50	12.50-14.00	13.75-14.75	12.50-14.00	12.00-14.00
Private Sector Banks	12.00-16.50	13.00-16.50	13.00-17.00	13.75-17.75	13.00-17.25	13.00-17.25
Foreign Banks	10.00-15.50	10.00-15.50	10.00-15.50	10.00-16.00	10.00-17.00	10.00-17.00
3. Actual Lending Rate*						
Public Sector Banks	4.00-17.00	4.00-17.75	4.00-18.00	6.00-18.75	–	–
Private Sector Banks	3.15-25.50	4.00-24.00	4.00-25.00	5.06-23.00	–	–
Foreign Banks	5.00-26.50	5.00-28.00	5.00-25.50	5.00-25.50	–	–

: Up to January 20, 2009. – : Not available.

*: Interest rate on non-export demand and term loans above Rs.2 lakh excluding lending rates at the extreme five per cent on both sides.



Government Securities Market

Central Government Securities

V.49 Gross and net market borrowings (dated securities and 364-day Treasury Bills) of the Central Government during 2008-09 (up to January 19, 2009) amounted to Rs.2,22,154 crore and Rs.1,51,697 crore, respectively, accounting for 89.9 per cent and 89.0 per cent of the estimated market borrowings for the year (Table 48). During the corresponding period of the previous year, gross and net borrowings accounted for 91.6 per cent and 93.1 per cent, respectively, of the estimated market borrowing for the year. During the first half of the year, all the issuances of dated securities were in accordance with the issuance calendar for the first half of the year, except on two occasions. During the second half of the year, two auctions scheduled for the month of October for dated securities amounting to Rs.20,000 crore were cancelled in view of the prevailing liquidity conditions and cut in repo rate. This amount was raised in the subsequent auctions. The issuance calendar for dated securities for the second half of 2008-09 (October-March), which was released on September 26, 2008 in consultation with the Government of India to raise Rs.39,000 crore, was revised on two occasions in the light of additional expenditure requirement of the Central Government following passage of the first and second supplementary demand for grants and the concomitant need to raise additional resources. Accordingly, two indicative calendars were issued on December 5, 2008 and January 6, 2009 – the latter superseding the former – in consultation with the Government of India, for raising an additional Rs.70,000 crore over and above the budgeted amount during the period from December 1, 2008 to March 31, 2009. All auctions during 2008-09 (up to January 19, 2009) were for reissuance of existing securities, barring three new issues. There was a devolvement of Rs.4,764 crore on primary dealers (PDs) during 2008-09 (up to January 19, 2009) as compared with devolvement of Rs.957 crore during the corresponding period of the previous year.

Table 48: Central Government Dated Securities Issued during 2008-09

(Amount in Rupees crore/Maturity in years/Yield in Per cent)

	Borrowings as per Auction Calendar			Actual Borrowings			
Sr. No.	Period of auction	Amount	Residual Maturity	Date of Auction	Amount	Residual Maturity	Yield
1	2	3	4	5	6	7	8
1.	April 4 - 11, 2008	6,000	5-9 year	April 11, 2008	6,000	7.38	8.14
		4,000	20-year and above		4,000	24.37	8.67
2.	April 18 - 25, 2008	6,000	10-14 year	April 21, 2008	6,000	10.00	8.24
		4,000	20-year and above		4,000	28.13	8.77
3.	May 2-9, 2008	6,000	5-9 year	May 9, 2008	6,000	7.92	7.96
		4,000	20-year and above		4,000	24.29	8.35
4.	May 16-23, 2008	6,000	10-14 year	May 23, 2008	6,000	9.91	8.07
		4,000	20-year and above		4,000	23.72	8.52
5.	May 30-June 6, 2008	6,000	10-14 year	June 6, 2008	6,000	9.87	8.26
		4,000	20 year and above		4,000	24.22	8.72
6.	June 13-20, 2008	6,000	15-19 year security	June 20, 2008	6,000	18.64	9.25
7.	July 4-11, 2008	6,000	10-14 year	July 4, 2008	6,000	9.79	9.13
		4,000	20 year and above		4,000	23.60	10.02
8.	July 18-25, 2008	6,000	15-19 year	July 24, 2008	6,000	9.74	9.08
9.	August 1-8, 2008	6,000	10-14 year	August 8, 2008	6,000	9.70	9.14
		4,000	20 year and above		4,000	24.05	9.88
10.	August 14-22, 2008	6,000	15-19 year	August 22, 2008	6,000	18.47	9.86
11.	September 5-12, 2008	5,000	10-14 year	September 12, 2008	5,000	9.60	8.30
		3,000	20-year and above		3,000	23.95	8.70
				September 26, 2008	6,000	12.65	9.04
					4,000	23.38	9.26
12.	October 3-10, 2008	6,000	5-9 year	Auction Cancelled	–	–	–
		4,000	20-year and above	Auction Cancelled	–	–	–
13.	October 17-24, 2008	6,000	10-14 year	Auction Cancelled	–	–	–
		4,000	20-year and above	Auction Cancelled	–	–	–
14.	October 31-November 7, 2008	6,000	5-9 year	October 31 , 2008	6,000	6.00	7.56
		4,000	20-year and above		4,000	23.82	8.08
				November 7, 2008	6,000	9.45	7.73
					4,000	23.26	8.44
15.	November 14-21, 2008	6,000	5-9 year	November 14, 2008	6,000	5.96	7.38
					4,000	23.78	8.21
				November 21, 2008	6,000	5.94	7.16
					3,000	12.50	7.42
16.	December 5-12, 2008	3,000@	10-14 year	Preponed to November 21, 2008	–	–	–
		6,000*	5-9 year	December 12, 2008	6,000	4.72	6.24
		4,000*	20-year and above		4,000	25.65	6.98
17.	January 2-9, 2009*	6,000	5-9 year	January 2, 2009	6,000	8.65	5.73
		4,000	20-year and above		4,000	26.68	6.53
18.	January 5-9, 2009#	7,000	5-9 year	January 9, 2009	7,000	7.25	6.70
		4,000	15-19 year		4,000	14.24	7.35
		4,000	20-year and above		4,000	25.58	7.60
19.	January 12-16, 2009#	6,000	5-9 year and above	January 16, 2009	4,000	5.79	5.50
		4,000	20 year and above		3,000	30.00	6.83
					4,000	9.26	5.45

@ : As per indicative calendar issued on September 26, 2008. * : As per indicative calendar issued on December 5, 2008.
# : As per indicative calendar issued on January 6, 2009.

The bid-cover ratio ranged between 1.22 and 3.94. The weighted average maturity of dated securities issued during 2008-09 (up to January 19, 2009) at 14.59 years was marginally higher than 14.57 years during the corresponding period of the previous year. The weighted average yield of dated securities issued during 2008-09 (up to January 19, 2009) at 8.03 per cent was lower than 8.15 per cent during the corresponding period of last year.

V.50 The notified amounts for 91-day, 182-day and 364-day Treasury Bills were kept unchanged in the issuance calendar for 2008-09. However, the notified amounts (excluding MSS) in respect of all three Treasury Bills were raised during the course of the year to finance the temporary cash mismatch, *inter alia*, arising from the expenditure on farmers' debt waiver scheme. Thus, an additional amount of Rs.1,19,500 crore (Rs.69,000 crore, net) was raised over and above the notified amount in the calendar as on January 19, 2009.

State Government Securities

V.51 The provisional net allocation under market borrowing programme of the State Governments and the Union Territory of Puducherry for 2008-09 is placed at Rs.49,539 crore. Taking into account repayments of Rs.14,371 crore and additional allocation of Rs.13,859 crore, the gross market borrowings of the State Governments are estimated at Rs.77,770 crore. During the current year, so far (up to January 19, 2009), 22 State Governments and the Union Territory of Puducherry raised a total amount of Rs.52,843 crore through auctions (Table 49) with cut-off yields in the

Table 49: Market Borrowings of the State Governments/U.T. - 2008-09

Item	Date	Cut-off Yield (Per cent)	Tenor (Years)	Amount Raised (Rupees crore)
1	2	3	4	5
Auction				
i. First	April 4, 2008	8.50-8.60	10	2,648
ii. Second	May 27, 2008	8.39-8.68	10	3,264
iii. Third	June 27, 2008	9.38-9.59	10	2,300
iv. Fourth	July 10, 2008	9.81	10	500
v. Fifth	August 31,2008	9.86-9.90	10	2,100
vi. Sixth	August 26,2008	9.30-9.44	10	2,060
vii. Seventh	September 9, 2008	8.80	10	1,800
viii. Eighth	September 25, 2008	8.81-8.88	10	1,212
ix. Ninth	October 7,2008	8.50-8.89	10	2,012
x. Tenth	October 22, 2008	7.97-8.11	10	4,300
xi Eleventh	November 11, 2008	8.21-8.54	10	3,595
xii. Twelfth	November 20, 2008	7.77-7.86	10	4,850
xiii. Thirteenth	December 11, 2008	6.95-7.10	10	5,910
xiv. Fourteenth	December 23, 2008	6.38-6.45	10	4,795
xv. Fifteenth	January 6, 2009	5.80-6.10	10	5,702
xvi. Sixteenth	January 13, 2009	6.65-6.73	10	5,795
Grand Total				**52,843**

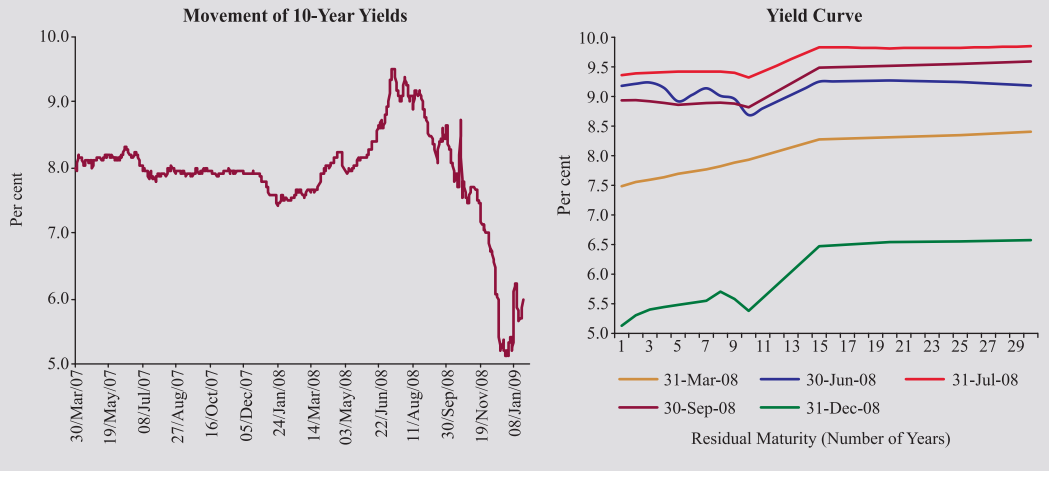
range 5.80-9.90 per cent as compared with Rs.39,671 crore by 22 State Governments (cut-off yields in the range 8.00-8.90 per cent) during the corresponding period of the previous year. The weighted average interest rate on market loans eased to 7.74 per cent during 2008-09 (up to January 19, 2009) from 8.35 per cent during the corresponding period of 2007-08. The spreads of State Government securities over the yields of Central Government securities of corresponding maturity ranged between 21 and 110 basis points as compared with 19 and 90 basis points during the corresponding period of 2007-08.

Secondary Market

V.52 Yields in the government securities market hardened at the beginning of the current financial year with the 10-year yield reaching 8.23 per cent on April 21, 2008 from 7.93 per cent on end-March 2008 in response to higher reading in domestic inflation (Chart 28). Subsequently, heightened inflationary expectations emanating from the sharp increase in global commodity prices and concomitant policy responses in the form of hike in CRR and repo rate, led to further hardening of yields. The 10-year yield consequently rose to 9.51 per cent on July 15, 2008.

V.53 Yields in the government securities market generally eased from end-July till around mid-September 2008 following the reduction in inflationary pressures tracking softening crude oil prices. The yields, however, hardened in the second fortnight of September 2008 as the liquidity conditions tightened mainly reflecting advance tax outflows in conjunction with the impact of adverse developments in international financial markets. The 10-year yield increased from 8.08 per cent to 8.63 per cent over the second half of end-September 2008. Subsequently, the yields eased substantially in tandem with the liquidity enhancing measures, including cuts in CRR, reduction in policy rates and the sharp decline in WPI. The 10-year G-sec yield stood at 5.87 per cent as at January 23, 2009.

Chart 28: Yields on Central Government Securities



V.54 During the year, the Government securities yield curve moved upwards and peaked by end-July 2008. Thereafter, the yield curve has moved downwards. The yield curve remains flat beyond 15 years. A notable feature was the inversion of the yield curve with the 10-year yield falling below that of the sub-10 year segment. This is attributable to the concentration of trading around the 10 year tenor as well as the impact of monetary policy actions at the short end. Resultantly, the spread between 1-year and 10-year yields was 25 basis points as against the spread of 35 basis points between the 1-year and 5-year yields, and 145 basis points between 1-year and 30-year yields, as at end-December 2008.

V.55 The daily turnover in the Central Government securities market averaged Rs.7,213 crore during October-December 2008, which was around 7.0 per cent lower than that in the preceding quarter (Chart 29).

V.56 The yield on 5-year AAA-rated corporate bonds, which witnessed a hardening trend during the second quarter, came to soften during the third quarter of 2008-09. The credit spread between the yields on 5-year AAA-rated bonds and 5-year government securities has narrowed on the back of easing liquidity conditions (Chart 30).

Equity Market

Primary Market

V.57 The primary market segment of the domestic capital market witnessed a weak trend during the third quarter of 2008-09 so far. Cumulatively, resources raised through public issues declined sharply to Rs.14,007 crore during April-December 2008 from Rs.49,215 crore during the corresponding period of 2007. The number of issues also declined considerably from 91 to 40 (Table 50). Out of 40 issues during April-December 2008, 20 were initial public offerings (IPOs) issued by private sector companies, constituting 14.3 per cent of total resource mobilisation. Furthermore, all the issues

Chart 29: Average DailyTurnover and Yields in Government Securities Market

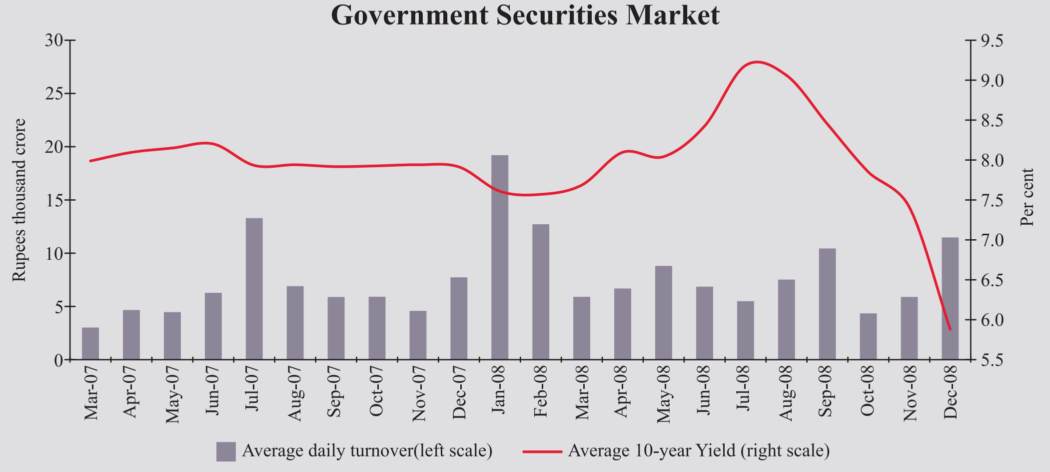
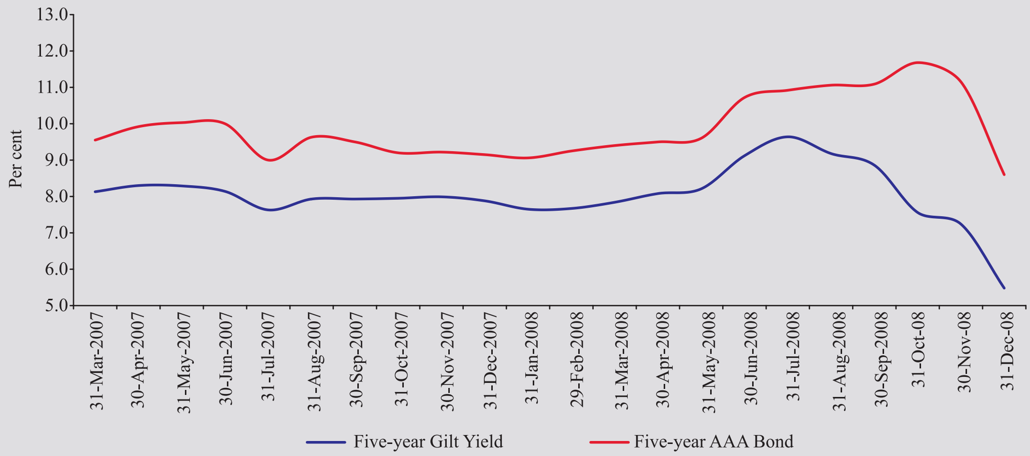


Chart 30: Credit Spreads



during April-December 2008 were equity issues by private non-financial companies except one by private-financial company. The average size of public issues declined considerably from Rs.540.8 crore during April-December 2007 to Rs.350.2 crore during April-December 2008.

V.58 Mobilisation of resources through private placement declined by 15.7 per cent to Rs. 79,594 crore during April-September 2008 (period for which latest data are available) as against an increase of 25.6 per cent during April-September 2007. Public sector entities accounted for 51.5 per cent of total mobilisation as compared with 38.5 per cent of total mobilisation during the corresponding period of last year. Resource mobilisation through financial intermediaries (both from public and private sector) registered a decline of 34.8 per cent over the corresponding period of last year, accounting for 50.9 per cent of the total mobilisation during April-September 2008. Resources raised by non-financial intermediaries also registered a decline of 21.1 per cent (49.1 per cent of total resource mobilisation) during April-September 2008 over the corresponding period of last year.

V.59 During April-December 2008, the resources raised through Euro issues – American Depository Receipts (ADRs) and Global Depository Receipts (GDRs) – by Indian corporates declined considerably by 81.2 per cent to Rs.4,686 crore as compared with the corresponding period of the previous year. All the Euro issues were GDR issues during April-December 2008.

V.60 During April-December 2008, net resource mobilisation by mutual funds indicated an outflow of Rs.30,432 crore compared to an inflow of Rs.1,23,993 crore during April-December 2007 (Table 51). Scheme-wise, during April-December 2008, while income/debt-oriented schemes witnessed a net outflow of Rs.34,601 crore, growth/equity-oriented schemes registered a net inflow of

Table 50: Mobilisation of Resources from the Primary Market

(Amount in Rupees crore)

Item	No. of Issues	Amount	No. of Issues	Amount
1	2	3	4	5
	April-December 2007		April-December 2008	
A. Prospectus and Rights Issues*				
1. Private Sector (a+b)	**88**	**45,882**	**40**	**14.007**
a) Financial	9	13,986	1	448
b) Non-financial	79	31,896	39	13,559
2. Public Sector (a+b+c)	**3**	**3,332**	**–**	**–**
a) Public Sector Undertakings	2	2,516	–	–
b) Government Companies	–	–	–	–
c) Banks/Financial Institutions	1	816	–	–
3.Total (1+2)	**91**	**49,215**	**40**	**14,007**
of which:				
(i) Equity	90	48,715	40	14,007
(ii) Debt	1	500	–	–
	April-September 2007		April-September 2008	
B. Private Placement				
1. Private Sector (a+b)	**819**	**58,089**	**476**	**38,613**
a) Financial	426	35,061	217	20,521
b) Non-financial	393	23,028	259	18,092
2. Public Sector (a+b)	**59**	**36,322**	**84**	**40,981**
a) Financial	45	27,044	42	19,960
b) Non-financial	14	9,278	42	21,021
3. Total (1+2)	**878**	**94,411**	**560**	**79,594**
of which:				
(i) Equity	–	–	–	–
(ii) Debt	**878**	94,411	**560**	**79,594**
Memo:				
C. Euro Issues (April-December)	**17**	**24,972**	**12**	**4,686**

P : Provisional. * : Excluding offers for sale. – : Nil/Negligible.

Rs.3,087 crore. The outflow may primarily be attributed to the uncertain conditions in the stock markets, redemption pressures from banks and corporates due to tight liquidity conditions since June 2008 and payment of third instalment of advance corporate tax by mid-December 2008.

Secondary Market

V.61 The domestic stock markets remained weak and volatile during the third quarter of 2008-09. The markets recorded substantial losses due to downward trend in international equity markets on reports of the US, Europe and Japan slipping into recession, decline in

Table 51: Resource Mobilisation by Mutual Funds

(Rupees crore)

Category	April-March		April-December			
	2007-08		2007-08		2008-09	
	Net Mobilisation @	Net Assets #	Net Mobilisation @	Net Assets	Net Mobilisation @	Net Assets #
1	2	3	4	5	6	7
Private Sector	1,33,304	4,15,621	1,05,868	4,47,174	-39,942	3,30,730
Public Sector *	20,497	89,531	18,125	1,02,762	9,510	82,634
Total	**1,53,801**	**5,05,152**	**1,23,993**	**5,49,936**	**-30,432**	**4,13,365**

@ : Net of redemptions. # : End-period. * : Including UTI Mutual fund.
Note : Data exclude funds mobilised under Fund of Funds Schemes.
Source : Securities and Exchange Board of India.

commodity prices, traces of slowdown in Indian economy with reports of decline in exports for October 2008, lower industrial growth for April-September 2008 and lower indirect tax collections for October 2008, deceleration in the second quarter corporate earnings, fall in the value of rupee against the US dollar and substantial net sales by FIIs in the Indian equity market. Both the BSE Sensex and the S&P CNX Nifty closed lower at 9101 and 2797 on January 20, 2009, both registering loss of 40.1 per cent over end-March 2008 (Chart 31).

V.62 According to the data released by the Securities and Exchange Board of India (SEBI), FIIs have made net sales of Rs.43,782 crore (US $ 10.9 billion) in the Indian equity market during 2008-09 so far (up to January 16, 2009) as against net purchases of Rs.64,776 crore (US $15.8 billion) during the corresponding period of the previous year (Chart 32). Mutual funds, on the other hand, have made net purchases

Chart 31: Indian Stock Markets

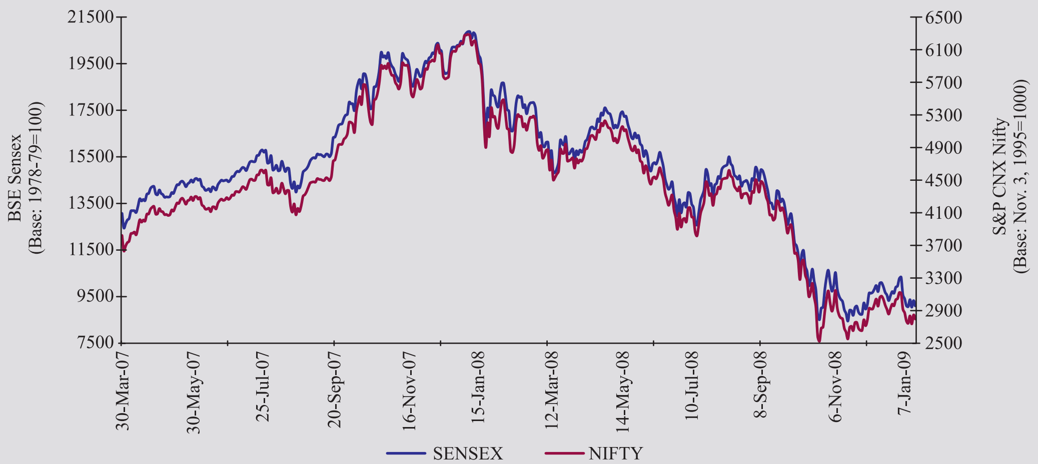
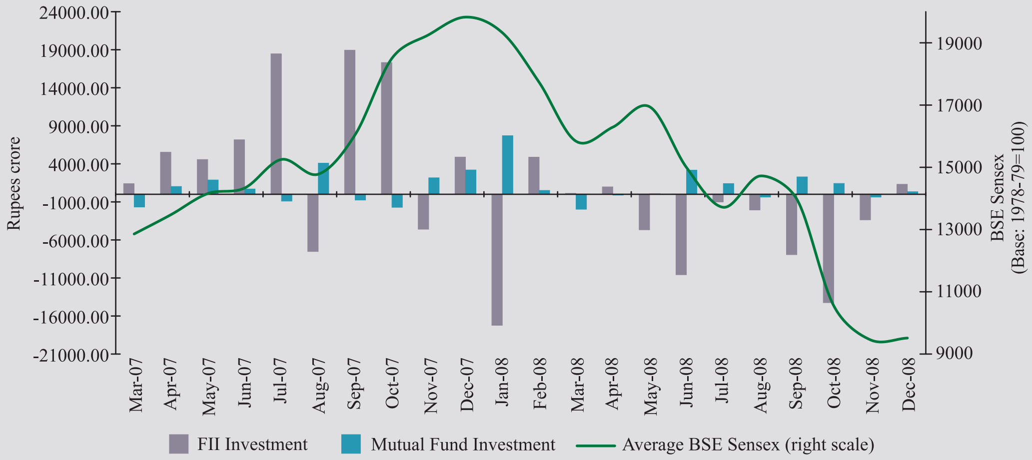


Chart 32: Institutional Investment and Stock Market



of Rs.6,043 crore during 2008-09 so far (up to January 16, 2009) as compared with net purchases of Rs.9,598 crore during the corresponding period of last year.

V.63 The sectoral indices witnessed selling pressure across the board during the current financial year so far (up to January 20, 2009). The major losers among the sectoral indices were metal, capital goods, consumer durables, auto, oil and gas, IT, banking, PSU, healthcare and FMCG (Table 52).

Table 52: BSE Sectoral Stock Indices
(Base: 1978-79=100)

Sector	Variation (per cent)		
	End-March 2007@	End-March 2008@	January 20, 2009 #
1	2	3	4
Fast Moving Consumer Goods	-21.4	31.7	-14.28
Public Sector Undertakings	-3.2	25.4	-30.75
Information Technology	21.6	-27.6	-39.51
Auto	-8.5	-7.1	-45.27
Oil and Gas	30.5	56.0	-41.46
Metal	-4.3	65.2	-65.08
Health Care	-5.4	5.4	-26.93
Bankex	24.2	18.0	37.37
Capital Goods	11.1	54.4	-53.81
Consumer Durables	11.1	8.8	-53.69
BSE 500	**9.7**	**24.3**	**-45.15**
BSE Sensex	**15.9**	**19.7**	**-41.83**

@: year-on-year variation.
: Variation over end-March 2008.
Source : Bombay Stock Exchange Limited.

V.64 In line with the downward trend in stock prices, the price-earning (P/E) ratio of the 30 scrips included in the BSE Sensex declined from 20.1 at end-March 2008 to 12.4 at end-December 2008. The market capitalisation of the BSE also declined by 38.8 per cent between end-March 2008 and end-December 2008. The turnover of BSE and NSE in the cash segment during April-December 2008 also declined by 24.4 per cent over that in the corresponding period of 2007. The turnover in the derivative segment of BSE and NSE also declined by 4.7 per cent during April-December 2008 over the corresponding period of the previous year. The volatility in the stock market measured as coefficient of variation, also increased during April-December 2008 (Table 53).

Table 53: Stock Market Indicators

Indicator		BSE				NSE		
		2007-08	April-December			2007-08	April-December	
			2007	2008			2007	2008
1	2	3	4	5	6	7	8	9
1. BSE Sensex / S&P CNX Nifty								
(i) End-period		15644	20287	9647		4735	6139	2959
(ii) Average		16569	19827	9514		4897	5964	2896
2. Coefficient of Variation		13.7	3.9	4.3		14.4	4.1	4.5
3. Price-Earning Ratio (end-period)*		20.1	27.7	12.4		20.6	27.6	12.8
4. Price-Book Value Ratio (end-period)*		5.2	6.7	2.58		5.1	6.4	2.4
5. Yield* (per cent per annum) (end-period)		1.0	0.83	1.84		1.1	0.84	1.9
6. Listed Companies		4,887	4,887	4,821		1,381	1,353	1,428
7. Cash Segment Turnover (Rupees crore)		15,78,856	11,60,249	9,05,445		35,51,038	25,70,712	22,08,183
8. Derivative Segment Turnover (Rupees crore)		2,42,308	1,78,883	12,245		1,30,90,478	99,16,166	84,80,063
9. Market Capitalisation (Rupees crore) @		51,38,015	71,69,985	31,44,768		48,58,122	65,43,272	29,16,768
10. Market Capitalisation to GDP Ratio (per cent)		109.5	152.1	59.0		103.1	138.8	55.5

* : Based on 30 scrips included in the BSE Sensex and 50 scrips included in the S&P CNX Nifty. @ : As at end-period.

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

Annex: Recent Policy Measures of the Reserve Bank

Country	Key Measures
1	2
Monetary Measures	• Cut in repo rate under the liquidity adjustment facility (LAF) by a cumulative 350 basis points from 9.0 to 5.5 per cent since mid-October 2008. • Cut in reverse repo rate by a cumulative 200 basis points from 6.0 to 4.0 per cent since December 8, 2008.
Rupee Liquidity/ Credit Delivery	• Cut in cash reserve ratio (CRR) by a cumulative 4 percentage points of net demand and time liabilities (NDTL) from 9.0 per cent of NDTL up to October 10, 2008 to 5.0 per cent by January 17, 2009. • Introduction of a special refinance facility under Section 17(3B) of the Reserve Bank of India Act, 1934 under which all SCBs (excluding RRBs) are provided refinance from the Reserve Bank equivalent up to 1.0 per cent of each bank's NDTL as on October 24, 2008 at the LAF repo rate up to a maximum period of 90 days. Banks are encouraged to use this facility for the purpose of extending finance to micro and small enterprises. This facility will continue up to June 2009. • Institution of a term repo facility for an amount of Rs.60,000 crore under the LAF to enable banks to ease liquidity stress faced by mutual funds (MFs), non-banking financial companies (NBFCs) and housing finance companies (HFCs) with associated SLR exemption of 1.5 per cent of NDTL. This facility has been extended up to June 30, 2009. • Reduction in statutory liquidity ratio (SLR) by one percentage points from 25 to 24 per cent of NDTL. • Introduction of a mechanism to buy back dated securities issued under the market stabilisation scheme (MSS) so as to provide another avenue for injecting liquidity of a more durable nature into the system. • Extension of the period of entitlement of the first slab of pre-shipment rupee export credit, currently available at a concessional interest rate ceiling of the benchmark prime lending rate (BPLR) minus 2.5 percentage points from 180 days to 270 days. • Increase in the eligible limit of the ECR facility for scheduled banks (excluding RRBs) from 15 to 50 per cent of the outstanding export credit eligible for refinance at the prevailing repo rate under the LAF. • To allocate amounts, in advance, from scheduled commercial banks for contribution to the SIDBI and the NHB to the extent of Rs.2,000 crore and Rs.1,000 crore, respectively, against banks' estimated shortfall in priority sector lending in March 2009.

(Contd...)

Annex: Recent Policy Measures of the Reserve Bank *(Contd.)*

Country	Key Measures
1	2
	• Reduction in the provisioning requirements for all types of standard assets (for residential housing loan beyond Rs.20 lakh, standard advances in the commercial real estate sector, personal loans including outstanding credit card receivables, loans and advances qualifying as capital market exposure and non-deposit taking systemically important NBFCs) to a uniform level of 0.40 per cent except in case of direct advances to agricultural and SME sector, which shall continue to attract provisioning of 0.25 per cent, as hitherto. • Downward revision of risk weights on banks' exposures to certain sectors, which had been increased counter cyclically earlier. All unrated claims on corporates and claims secured by commercial real estate shall attract a uniform risk weight of 100 per cent as against the risk weight of 150 per cent prescribed earlier. Claims on rated as well as unrated non-deposit taking systemically important non-banking financial companies (NBFC-ND-SI) shall be uniformly risk weighted at 100 per cent. As regards the claims on asset financing companies (AFCs), there is no change in the risk weights, which would continue to be governed by the credit rating of the AFCs, except the claims that attract a risk weight of 150 per cent under the new capital adequacy framework, stands reduced to a level of 100 per cent. • In order to provide liquidity support to housing, export and micro and small (MSE) sectors, the Reserve Bank provided a refinance facility of Rs.4,000 crore to National Housing Bank (NHB), Rs. 5,000 crore to the EXIM Bank and Rs. 7,000 core to the Small Industries Development Bank of India (SIDBI) upto March 2010.
Forex Liquidity/ ECB Norms	• RBI to continue selling foreign exchange (US dollars) through agent banks to augment supply in the domestic foreign exchange market or intervene directly to meet any demand-supply gaps. • RBI to institute special market operations to meet the foreign exchange requirements of public sector oil marketing companies against oil bonds. • Enhancing the all-in-cost ceiling for trade credit less than 3 years to 6 months LIBOR plus 200 basis points. • Temporarily permitting systemically Important Non-Deposit taking NBFCs and housing finance companies to raise short-term foreign currency borrowings under the approval route, subject to their complying with the prudential requirements of capital adequacy and exposure norms.

(Contd...)

Annex: Recent Policy Measures of the Reserve Bank *(Concld.)*

Country	Key Measures
1	2
	• Increase in interest rate ceiling on FCNR (B) deposits by a 175 basis points, *i.e.*, to Libor/Swap rates plus 100 basis points and on NR(E)RA deposits by a 175 basis points, *i.e.*, to Libor/Swap rates plus 175 basis points for US dollar of corresponding maturities. • Proposal from Indian companies to prematurely buy back their FCCBs to be considered under approval or automatic route, depending on the extent of discount of the FCCBs and souce of funds, subject to compliance with certain stipulated conditions. Under the approval route, the buy back should be financed by the company's internal accruals and the buy back under automatic route should be financed by the company's foreign currency resources held in India or abroad and/or out of fresh external commercial borrowing (ECB) raised in conformity with the current norms for ECBs. • ECBs up to US $ 500 million per borrower per financial year were permitted for rupee expenditure and/or foreign currency expenditure for permissible end-uses under the automatic route. The requirement of minimum average maturity period of 7 years for ECB of more than US $ 100 million for Rupee capital expenditure by the borrowers in infrastructure sector has been deispensed with. • The requirement of all-in-cost ceiling for ECBs over average maturity of 3-5 years and more than 5 years, which was increased to 300 basis points and 500 basis points, respectively, over 6-month LIBOR, was removed untill June 30, 2009. • The definition of Infrastructure sector for availing ECB was expanded to include mining, exploration and refinery sectors. • ECBs up to US $ 500 million per borrower per financial year were permitted for rupee expenditure and/or foreign currency expenditure for permissible end-uses under the automatic route. • Entities in the services sector, *viz*., hotels, hospitals and software companies were permitted to avail ECBs up to US $ 100 million in a financial year under the automatic route for foreign currency and/or Rupee capital expenditure for permissible end-use. (The proceeds of the ECBs should not be used for acquisition of land). • NBFCs exclusively involved in financing of the infrastructure sector were permitted to avail of ECBs under the approval route from multilateral/regional financial institutions and Government owned development financial institutions for onlending to the borrowers in the infrastructure sector, subject to complying with certain conditions.

VI. PRICE SITUATION

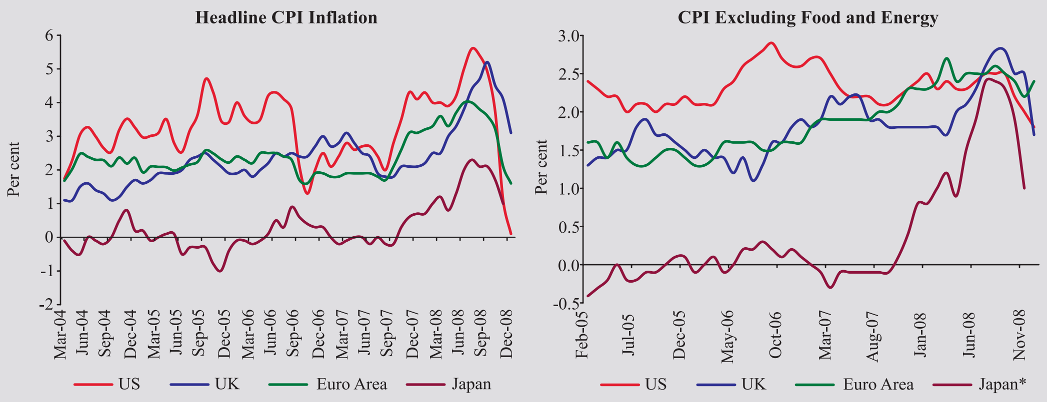
VI.1 Headline inflation moderated in major economies since July/August 2008 on account of the marked decline in international energy and commodity prices as well as slowdown in aggregate demand emerging from the persistence of financial market turmoil following the US sub-prime crisis. The accommodative monetary policy pursued by most central banks since September 2008 aimed at mitigating the adverse implications of the recent financial market crisis on economic growth and employment. Amongst developed countries, central banks in the US, the UK, Euro area, Canada and Australia further reduced their policy rates during the third quarter of 2008-09. Most central banks in emerging market economies, which were continuing with pre-emptive monetary tightening to contain inflation and inflationary expectations till the second quarter of 2008-09, reversed their policy stance and reduced their policy rates as the spillover of the US sub-prime crisis led to increasing downward risks to economic growth.

VI.2 In India, inflation measured as year-on-year variation in the wholesale price index (WPI), declined sharply from an intra-year peak of 12.9 per cent on August 2, 2008 to 5.6 per cent as on January 10, 2009 led by the reductions in the prices of administered prices of petroleum products as well as decline in the prices of freely priced petroleum products, oilseeds/edible oils/oil cakes, raw cotton, cotton textiles and iron & steel. The decline in prices of most of these commodities was in line with the decline in international commodity prices since July 2008. Various measures of consumer price inflation were still seen to be at elevated levels in the range of 10.4-11.1 per cent during November/December 2008 as compared with 7.3-8.8 per cent in June 2008 and 5.1-6.2 per cent in November 2007.

Global Inflation

VI.3 Headline inflation in major advanced economies, which firmed up till the second quarter of 2008-09 on account of higher energy and food prices, eased subsequently. Inflation in OECD countries declined to 2.3 per cent in November 2008 from the peak of 4.9 per cent in July 2008. The recent decline in inflation in OECD countries was led by a decline in inflation of energy and food articles. Amongst major economies, headline inflation in the US declined to 0.1 per cent in December 2008 from 5.6 per cent in July 2008. In the UK, inflation declined to 3.1 per cent in December 2008 from 5.2 per cent in September 2008 while in the Euro area inflation came down to 1.6 per cent in December 2008 from 4.0 per cent in July 2008 (Chart 33). Core inflation also moderated in major economies. In OECD countries, CPI, excluding food and energy, came down to 2.2 per cent in November 2008 from 2.4 per cent in September 2008. Producer price index (PPI) inflation also moderated in both advanced and emerging market economies (EMEs). PPI inflation in the OECD countries declined to 2.8 per cent in November 2008 from 9.9 per cent in July 2008.

Chart 33: Consumer Price Inflation



* : Data for Japan exclude fresh food only.
Source: International Financial Statistics and official websites of respective countries.

VI.4 In the US, headline inflation firmed up till July 2008 driven by higher food, energy and transportation prices. However, inflation declined subsequently on account of decline in energy and transportation index. According to the latest assessment of the US Federal Open Market Committee (FOMC) on December 16, 2008, inflationary pressures in the US economy have diminished appreciably and are expected to moderate further in coming quarters. However, the outlook for economic activity has weakened further with deteriorating labour market conditions, and decline in consumer spending, business investment, and industrial production. Financial markets remained quite strained and credit conditions were tight. Against this backdrop, the FOMC reduced the policy rate by 50 basis points each on October 8 and October 29, 2008 to 1.0 per cent. Furthermore, as the weak economic conditions warranted for exceptionally low levels of the federal funds rate (US policy rate) for some time, the FOMC reduced the policy rate to a target range of 0-0.25 per cent on December 16, 2008.

VI.5 In the UK, CPI inflation increased sharply up to September 2008, mainly reflecting upward contributions from prices of housing and household services, clothing and transport costs. Subsequently, CPI inflation declined on account of reduction in transport costs and downward pressure from housing and household services. According to the latest assessment of the Monetary Policy Committee (MPC), inflation is expected to fall further, reflecting waning contributions from retail energy and food prices and the direct impact of the temporary reduction in value added tax. The Committee's projection for inflation showed a substantial risk of undershooting the 2 per cent CPI inflation target in the medium term at the existing bank rate while the outlook on economic activity remained weak. Accordingly, after keeping the policy rate unchanged since April 2008, the Bank of England cut the policy rate by a total of 350 basis points to 1.5 per cent since October 2008 (Table 54).

Table 54: Global Inflation Indicators

(Per cent)

Country/ Region	Key Policy Rate	Policy Rate (As on January 22, 2009)	Changes in Policy Rates (basis points)		CPI Inflation (y-o-y)		PPI Inflation (y-o-y)		Real GDP Growth (y-o-y)	
			2007-08 (Apr-Mar)	Since end-March 2008	Dec. 2007	Dec. 2008	Nov. 2007	Nov. 2008	2007 (Q3)	2008 (Q3)
1	2	3	4	5	6	7	8	9	10	11
Developed Economies										
Australia	Cash Rate	4.25 (Dec. 2, 2008)	100	(-) 300	1.9^	5.0^	2.4^	5.6^	4.5	1.9
Canada	Overnight Rate	1.00 (Jan.20, 2009)	(-)75	(-) 250	2.5*	2.0*	-0.6	5.9	3.1	0.5
Euro area	Interest Rate on Main Refinancing Operations	2.00 (Jan. 15, 2009)	25	(-) 200	3.1	1.6	4.3	3.3	2.6	0.6
Japan	Uncollateralised Overnight Call Rate	0.10 (Dec.19, 2008)	0	(-) 40	0.6*	1.0*	2.6	1.1	1.9	-0.5
UK	Official Bank Rate	1.50 (Jan 8, 2009)	0	(-) 375	2.1	3.1	5.0	4.7	3.3	0.3
US	Federal Funds Rate	0.00 to 0.25 (Dec.16, 2008)	(-)300	(-) 200	4.1	0.1	6.3	-0.9	2.8	0.7
Developing Economies										
Brazil	Selic Rate	12.75 (Jan. 21, 2009)	(-)150	150	4.5	5.9	9.4	9.8	5.6	6.8
India	Reverse Repo Rate	4.00 (Jan 2, 2009)	0	(-) 200	5.5*	10.4*	3.6	5.9	9.3	7.6
	Repo Rate	5.50 (Jan 2, 2009)	0 (150)	-225 (-250)						
China	Benchmark 1-year Lending Rate	5.31 (Dec 23, 2008)	108 (550)	(-) 216 (-300)	6.9*	2.4*	4.6	2.0	11.5	9.0
Indonesia	BI Rate	8.75 (Jan 7, 2009)	(-)100	75	4.9	11.1	20.6	20.3	6.5	6.1
Israel	Key Rate	1.75 (Dec. 29, 2008)	(-)25	(-) 200	3.4	3.8	9.8	0.6	4.9	5.1
Korea	Base Rate**	2.50 (Jan 9, 2009)	50	(-) 250	3.6	4.1	3.6	5.6	5.1	3.8
Philippines	Reverse Repo Rate	5.50 (Dec.18 2008) +	(-)250	50	3.9	8.0	11.8#	5.5#	7.1	4.6
Russia	Refinancing Rate	13.00 (Dec.1, 2008)	(-)25	275	11.9	13.3	15.2#	17.5#	7.6	6.2
South Africa	Repo Rate	11.50 (Dec.12, 2008)	200	50	8.4*	11.8*	9.0	12.6	5.1	2.9
Thailand	1-day Repurchase Rate	2.00 (Jan 14, 2009)	(-)125	(-)125	3.2	0.4	8.7	-1.7	4.8	4.0

^ : Q3. *: November. # : October.

+ : The tiering system on placement with the BSP was removed and interest rates were adjusted to 6.0 per cent for the reverse repo rate and 8.0 per cent for the repo rate effective July 13, 2007.

** : Since March 2008, the policy rate has been changed from overnight call rate to "the Bank of Korea Rate or (Base Rate)" and fixed at the same level as the current call rate target of 5.0 per cent on March 7, 2008.

Note : 1. For India, data on inflation pertain to CPI for Industrial Workers. Data on GDP growth for 2007 pertain to fiscal year 2007-08.

2. Figures in parentheses in column (3) indicate the dates when the policy rates were last revised.

3. Figures in parentheses in columns (5) and (6) indicate the variation in the cash reserve ratios during the period.

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

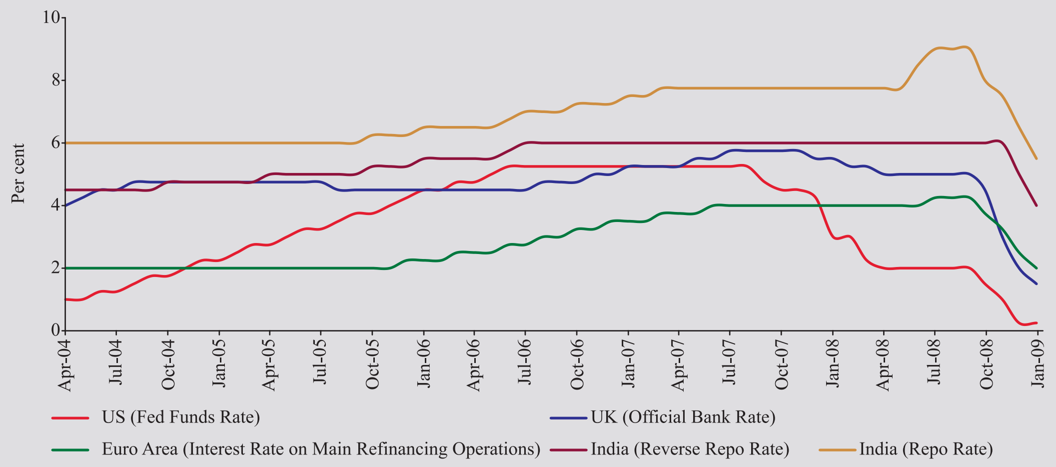
VI.6 In the Euro area, inflation based on Harmonised Index of Consumer Prices (HICP) declined significantly since July 2008 due to sharp fall in global commodity prices and major slowdown in economic activity. According to the Governing Council of the ECB, inflation is expected to be in line with price stability over the policy-relevant horizon. The Council also assessed that both global demand and Euro area demand are likely to be dampened for a protracted period of time due to the effects of intensification of financial turmoil. Accordingly, the ECB reduced the policy rate thrice by a total of 225 basis points between October and December 2008 to 2.0 per cent. It had earlier raised policy rate by 25 basis points effective July 9, 2008 (Chart 34).

VI.7 Bank of Japan (BoJ) expected the CPI inflation in Japan to moderate further reflecting the declines in prices of petroleum products and stabilisation in the prices of food. However, economic conditions have been deteriorating and are likely to increase in severity for the immediate future as domestic demand had become weaker against the background of the declining corporate profits and the worsening employment and income situation in the household sector. Accordingly, BoJ reduced its policy rate by 20 basis points each on October 31, 2008 and December 19, 2008 to 0.1 per cent.

VI.8 Amongst the central banks in other major advanced economies, the policy rates were reduced in the third quarter of 2008-09 by the Reserve Bank of Australia by a total of 300 basis points to 4.25 per cent (lowest since December 2001) since September 2008, Bank of Canada by a total of 200 basis points since October 2008 to 1.00 per cent, Sveriges Riksbank (Sweden) by 275 basis points to 2.0 per cent and Swiss National Bank by 250 basis points to 0.0 to 1.0 per cent since October 2008.

VI.9 Inflation firmed up in most emerging market economies (EMEs) during the first half of 2008-09 on the back of strong growth and ample liquidity as well as upward

Chart 34: Central Bank Policy Rates

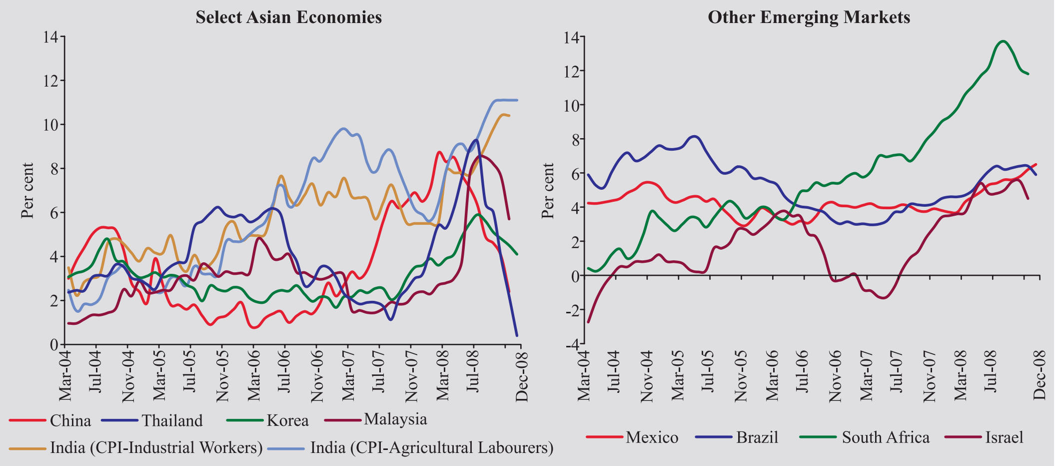


pressures from increasing international commodity prices. Subsequently, inflation in EMEs started easing on account of decline in international commodity prices and general slowdown in economic activity emerging from the spillover of the global financial crisis. The monetary policy responses of most central banks in EMEs during the first half of 2008-09 were oriented towards containing inflation and inflationary expectations using pre-emptive tightening of the monetary policy. As the inflationary pressures subsided and adverse impact of the global financial crisis led to a slowdown in economic activity in most developing economies, the focus of monetary policy shifted towards easing monetary conditions to support the recovery of economic activity.

VI.10 Among the major emerging economies, consumer price inflation in China eased to 2.4 per cent in November 2008 from 8.3 per cent in March 2008 (Chart 35). Accordingly, the Peoples Bank of China (PBC) reduced the benchmark 1-year lending rate by a total of 216 basis points to 5.31 per cent and cash reserve ratio (CRR) by a total of 300 basis points (400 basis points for small and medium-sized depositary financial institutions) since September 2008 to facilitate continued stable and fast development of the national economy. The PBC had earlier increased the benchmark 1-year lending rate by a total of 189 basis points beginning April 2006 to 7.47 per cent on December 21, 2007 and the CRR by a total of 1000 basis points to 17.5 per cent between July 2006 and June 2008.

VI.11 In Korea, consumer price inflation declined to 4.1 per cent in December 2008 from 5.9 per cent in July 2008. As the consumer price inflation has been decelerating steadily and domestic economy was slackening at a rapid pace, the Monetary Policy Committee of the Bank of Korea reduced the policy rate by a total of 275 basis points since October 2008 to 2.5 per cent. In Thailand, as the risks to inflation declined while the economic activity has slowed down notably, the Bank

Chart 35: Consumer Price Inflation – Emerging Market Economies



of Thailand reduced the policy rate by 100 basis points on December 3, 2008 and further by 75 basis points on January 14, 2009 to 2.0 per cent to help the economic recovery as the economy faced numerous negative risks, both on domestic and external fronts. In Indonesia, as domestic inflationary pressures have eased steadily in recent months, Bank Indonesia reduced its policy rate by 25 basis points on December 4, 2008 and further by 50 basis points to 8.75 per cent on January 7, 2009 to promote economic growth while continuing to safeguard medium term inflation and financial sector stability.

VI.12 An assessment of key macroeconomic indicators in select EMEs shows that consumer price inflation was in the range of 0.4-13.3 per cent in December 2008. Real policy rates ranged between (-)3.9 and 7.9 per cent in December 2008 (Table 55). Current account in major EMEs, except India and South Africa, was in

Table 55: Key Macroeconomic Indicators: Emerging Markets

(Per cent)

Country	Consumer Price Inflation		Current Account Balance (per cent to GDP)		Real Effective Exchange Rate (REER)		Central Govt. Fiscal Balance (per cent of GDP)		Real Policy Rate		Real GDP Growth	
	Dec. 2007	Dec. 2008	2006	2007	Dec. 2007	Dec. 2008	2007	2008	Dec. 2007	Dec. 2008	2007	2008P
1	2	3	4	5	6	7	8	9	10	11	12	13
Brazil	4.5	5.9	1.3	0.1	15.8	-18.4	-2.3	-1.5	6.8	7.9	5.4	5.2
China	6.9*	2.4*	9.4	11.3	4.9	12.7	1.0	0.8	0.6	2.9	11.9	9.7
India	**5.5***	**10.4***	**-1.1**	**-1.5**	**7.5**	**-12.6**	**-2.8^**	**-2.5 @**	**2.3**	**-3.9**	**9.0**	**7.8**
	(3.8)	**(5.9)**	**(-6.8)**	**(-7.8)**			**(61.5)**	**(57.7)**	**(4.0)**	**(0.6)**		
Indonesia	4.9	11.1	3.0	2.5	-6.3	-8.3	-1.6	-1.1	3.1	-1.9	6.3	6.1
Israel	3.4	3.8	5.9	3.2	1.2	10.7	-0.8	-1.9	0.6	-1.3	5.4	4.3
Korea	3.6	4.1	0.6	0.6	-5.8	-30.6	-1.5	-1.1	1.4	-1.1	5.0	4.1
Philippines	3.9	8.0	4.5	4.4	14.9	-7.6	-0.2	-1.0	1.4	-2.5	7.2	4.4
Russia	11.9	13.3	9.5	5.9	7.1	3.8	6.2	6.1	-1.9	-0.3	8.1	6.8
South Africa	8.4*	11.8*	-6.5	-7.3	2.0	-19.3	0.9	0.8	2.6	-0.3	5.1	3.8
Thailand	3.2	0.4	1.1	6.4	1.0	-5.0	-1.7	-1.8	-0.5	3.4	4.8	4.7

^ : Provisional Accounts. * : November. P : Projected. @ : Budget estimates.

Note:
1. For India, data pertain to fiscal years 2007-08 and 2008-09.
2. Consumer price inflation data are on a year-on-year basis. Data for India are for CPI-Industrial Workers.
3. Real policy rate is the policy rate less year-on-year consumer price inflation. For India, repo rate is used.
4. Figures in parentheses in columns (2) and (3) refer to wholesale price inflation.
5. Figures in parentheses in columns (4) and (5) refer to trade balance/GDP ratio.
6. Data on fiscal balance for Israel pertain to general government balance.
7. Figures in parentheses in columns (8) and (9) refer to central government debt/GDP ratio.
8. Figures in parentheses in columns (10) and (11) for India are based on wholesale price inflation.
9. Data on REER refer to year-on-year variation in broad indices (CPI-based) compiled by the Bank for International Settlements. A positive figure indicates appreciation while a negative figure indicates depreciation. For India, data are based on movements in 6-currency indices.

Source: International Monetary Fund; Asian Development Bank; Bank for International Settlements; World Bank, The Economist and official websites of respective central banks.

surplus during 2006-07. The real effective exchange rate (REER) for the select EMEs, barring the currencies in China, Israel and Russia underwent real depreciation, on a year-on-year basis, in December 2008. Although the Central Government's fiscal deficit as per cent of GDP in India declined during 2007-08, it remained higher than that in most EMEs.

Global Commodity Prices

VI.13 After remaining at elevated levels for an extended period, global commodity prices declined sharply since the second quarter of 2008-09 led by decline in the prices of crude oil, metals and food (Table 56 and Chart 36).

VI.14 International crude oil prices, represented by the West Texas Intermediate (WTI), which had risen sharply up to early July 2008 reflecting tight supply-demand balance, geo-political tensions, weakening of the US dollar against major currencies and increased interest from investors and financial market participants, eased subsequently (Table 57). The WTI crude oil prices have eased from its historical

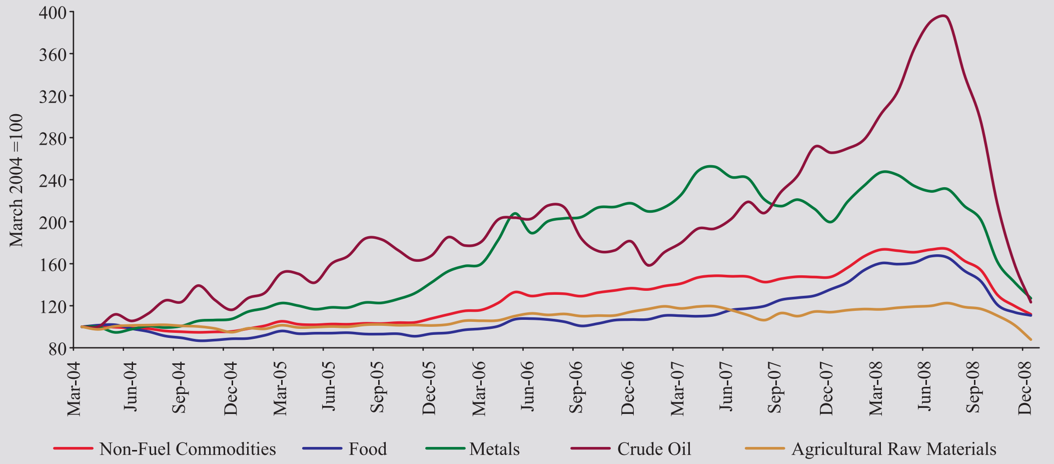
Table 56: International Commodity Prices

Commodity	Unit	2004 Market Price	Index (2004=100)							Variation (Per cent)	
			2005	2006	2007	2008				Dec. 08/	Dec. 08/
						Mar.	Jun.	Sep.	Dec.	Mar. 08	Dec. 07
1	2	3	4	5	6	7	8	9	10	11	12
Energy											
Coal	$/mt	53.0	90	93	124	223	302	283	149	-33.5	-13.6
Crude oil (Average)	$/bbl	37.7	142	170	188	270	349	264	110	-59.4	-53.8
Non-Energy Commodities											
Palm oil	$/mt	471.3	90	101	165	265	257	164	107	-59.7	-47.1
Soybean oil	$/mt	616.0	88	97	143	240	250	199	120	-50.0	-36.6
Soybeans	$/mt	306.5	90	88	125	188	203	166	117	-37.4	-30.1
Rice	$/mt	237.7	120	128	137	250	318	288	224	-10.6	47.3
Wheat	$/mt	156.9	97	122	163	280	222	188	140	-49.9	-40.3
Maize	$/mt	111.8	88	109	146	210	257	209	142	-32.5	-12.2
Sugar	c/kg	15.8	138	206	141	184	169	189	164	-11.0	10.1
Cotton A Index	c/kg	136.6	89	93	102	129	124	119	90	-30.8	-20.2
Aluminium	$/mt	1716.0	111	150	154	175	172	147	87	-50.4	-37.4
Copper	$/mt	2866.0	128	235	248	294	288	244	107	-63.6	-53.4
Gold	$/toz	409.2	109	148	170	237	217	203	199	-15.7	1.6
Silver	c/toz	669.0	110	173	200	287	255	182	154	-46.3	-27.9
Steel cold-rolled coilsheet	$/mt	607.1	121	114	107	132	181	181	181	37.5	69.2
Steel hot-rolled coilsheet	$/mt	502.5	126	119	109	149	199	199	199	33.3	81.8
Tin	c/kg	851.3	87	103	171	233	261	216	132	-43.2	-30.9
Zinc	c/kg	104.8	132	313	309	240	181	166	105	-56.2	-53.2

$: US dollar. c: US cent. bbl: barrel. mt: metric tonne. kg: Kilogram. toz: troy oz.

Source: Based on World Bank's actual commodity price data. The year 2004 has been taken as the base to better exhibit price trends over the relevant period.

Chart 36: International Commodity Prices



high of US $ 145.3 a barrel level on July 3, 2008 to US $ 42.3 a barrel as on January 22, 2009 reflecting falling demand in the Organisation for Economic Co-operation and Development (OECD) countries as well as some developing countries, notably in Asia, following the economic slowdown.

VI.15 The slower consumption growth in advanced economies in the wake of significant slowdown in these economies is expected to keep oil prices low. In view of the relatively tight demand supply-balance, the long term outlook for oil, however, remains highly uncertain (Table 58). According to the US Energy Information

Table 57: International Crude Oil Prices

(US dollars per barrel)

Year/Month	Dubai Crude	UK Brent	US WTI	Average Crude Price	Indian Basket Price
1	2	3	4	5	6
2004-05	36.4	42.2	45.0	41.3	38.9
2005-06	53.4	58.0	59.9	57.1	55.4
2006-07	60.9	64.4	64.7	63.3	62.4
2007-08	77.3	82.4	82.3	80.7	79.2
March 2008	96.8	103.3	105.5	101.8	99.4
June 2008	127.6	133.1	133.9	131.5	129.8
July 2008	131.2	133.9	133.4	132.8	132.3
August 2008	113.2	113.9	116.6	114.6	113.5
September 2008	96.0	99.1	103.9	99.7	97.1
October 2008	68.6	72.8	76.6	72.7	70.2
November 2008	51.4	53.2	57.3	54.0	52.1
December 2008	41.0	41.6	41.4	41.3	41.2

Source : International Monetary Fund and the World Bank.

Table 58: World Supply-Demand Balance of Oil

(Million barrels per day)

Item	2007	2008	2009 (P)	2009 (P)			
				Q1	Q2	Q3	Q4
1	2	3	4	5	6	7	8
Demand							
1. OECD	49.1	47.7	46.4	47.2	45.2	45.8	47.5
2. Non-OECD	36.8	38.2	38.7	38.2	38.6	38.8	39.2
of which: China	7.6	8.0	8.3	8.0	8.3	8.3	8.5
3. Total (1+2)	85.9	85.9	85.1	85.4	83.8	84.6	86.7
Supply							
4. OPEC	34.4	35.8	35.0	34.1	34.3	35.6	36.1
5. Non-OPEC	50.0	49.7	49.9	49.5	50.1	49.9	50.0
6. Total (4+5)	84.4	85.5	84.9	83.6	84.4	85.5	86.1
Stock Changes	-1.5	-0.4	-0.2	-1.8	0.6	0.9	0.6

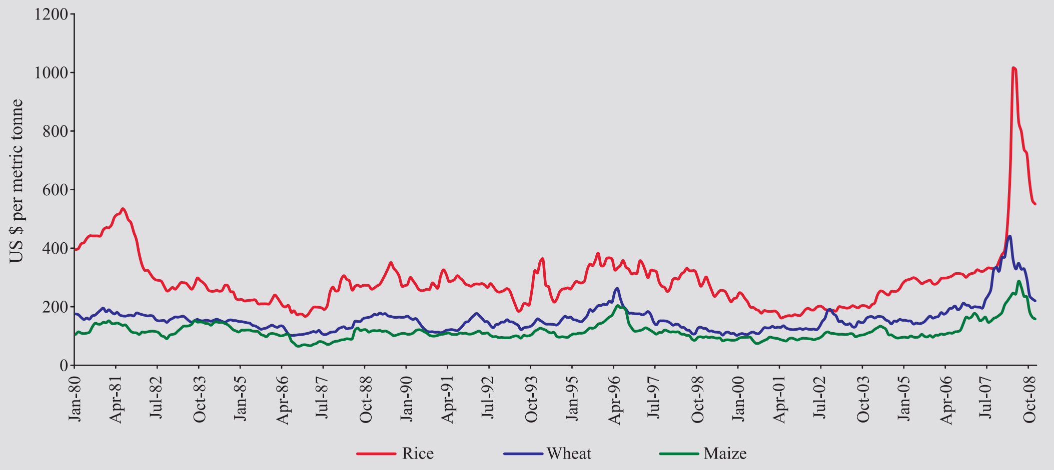
P: Projections.
Source: US Energy Information Administration, January 2009.

Administration (EIA), the global economic downturn pointed to declining oil consumption in 2009, while additional production capacity from both OPEC and non-OPEC nations is expected to boost surplus production capacity, reducing the likelihood of a renewed strong upward pressure on prices. Assuming no major crude oil supply disruptions, average WTI prices are expected to be US$ 43.3 per barrel in 2009 which is 57 per cent lower than the average price for the year 2008 (US$ 99.6 per barrel). The depth and duration of the global economic downturn, the pace and timing of the recovery, and actual OPEC production are expected to be the crucial factors driving world oil prices.

VI.16 Metal prices eased further during the third quarter of 2008-09, reflecting weak construction demand in OECD countries and some improvement in supply, especially in China. Between March and December 2008, the IMF metals price index (which includes copper, aluminum, iron ore, tin, nickel, zinc, lead, and uranium price indices) declined by 48 per cent. International steel prices (represented by World Bank steel products index) declined by about 17 per cent during August-December 2008. After increasing by about 66 per cent in January 2008, international iron ore prices remained flat thereafter up to December 2008.

VI.17 Food prices, which had increased sharply up to the first quarter of 2008-09 reflecting higher demand and low stocks, eased significantly since the second quarter of the year on the back of improved supply prospects, particularly for oilseeds and grains in major producing countries. The World Bank's food price index declined by about 38 per cent during July-December 2008, led by edible oils, rice, maize and wheat (Chart 37). Notwithstanding the recent easing,

Chart 37: Prices of Rice, Wheat and Maize



however, on a year-on-year basis, international prices of rice were 47 per cent higher in December 2008. Notwithstanding the recent decline in food prices since June 2008, the IMF food price index in December 2008 was still above the level which was last seen in 1981. According to the US Department of Agriculture, global wheat and rice production are projected to increase by about 12 per cent and 2 per cent, respectively, during 2008-09 to 683 million metric tonnes and 439 million metric tonnes. Similarly, global supplies of oilseeds and vegetables oils are also expected to increase by about 3 per cent and 4 per cent, respectively, during 2008-09.

VI.18 International sugar prices, which had declined somewhat during the first quarter of 2008-09, have increased thereafter by about 21 per cent during June-August 2008, declined again by 20 per cent during September-December 2008. Global cotton prices, which had declined during the first quarter of 2008-09, increased subsequently before declining since September 2008. Accordingly, cotton prices represented by the 'Cotton A Index' were lower by about 20 per cent, year-on-year, in December 2008. According to the International Cotton Advisory Committee (ICAC), world cotton production and consumption were expected to decline by 8 per cent and 7 per cent respectively in 2008-09 and the shortage is expected to be met by a fall in world cotton stocks. Accordingly, ICAC expects prices to go down by about 7 per cent in 2008-09.

Inflation Conditions in India

VI.19 The Annual Policy Statement for 2008-09 (April 2008) of the Reserve Bank reaffirmed its resolve to bring down inflation to around 5.5 per cent in 2008-09 with a preference for bringing it as close to 5.0 per cent as soon as possible, recognising the evolving complexities in globally transmitted inflation. As the potential inflationary pressures from international food and energy prices had amplified, the policy focused on conditioning perceptions for inflation in the range of 4.0-4.5 per cent so that an inflation rate of around 3.0 per cent became a medium-term objective consistent with India's broader integration into the global economy and with the goal of maintaining self-accelerating growth over the medium-term.

VI.20 With the inflation rate, based on wholesale price index hardening, following on adjustment of overall aggregate demand on an economy-wide basis was warranted to ensure that generalised instability did not develop and erode the hard-earned gains in terms of both outcomes of and positive sentiments on India's growth momentum. The priority for monetary policy was identified to be eschewing any further intensification of inflationary pressures and to firmly anchor inflation expectations. Accordingly, the Reserve Bank increased the cash reserve ratio (CRR) by a total of 100 basis points between May and July 2008 to 8.75 per cent. Furthermore, the repo rate under the Liquidity Adjustment Facility (LAF) was increased by a total of 75 basis points to 8.50 per cent in June 2008. The First Quarter Review of the Annual Statement on Monetary Policy for 2008-09 expected that inflation would moderate from then prevailing high levels in the months to come. In view of the prevailing macroeconomic, liquidity and overall monetary conditions, the First Quarter Review announced an increase in the fixed repo rate under the LAF by 50 basis points from 8.5 per cent to 9.0 per cent with effect from July 30, 2008 and an increase in the CRR by 25 basis points to 9.0 per cent with effect from August 30, 2008 (Table 59). These measures were aimed at bringing down inflation from the then prevailing level to a level close to 7.0 per cent by end March 2009.

VI.21 As the WPI inflation started ebbing since August 2008, mainly on account of decline in prices of freely priced petroleum products, edible oils and textiles, the Mid-Term Review of Annual Policy for the Year 2008-09 observed that in the absence of further shocks, generalised inflation cannot be sustained, especially with money supply contained at the average rate of 2003-08, a period when inflation was low and stable. Also just as the elevation of international commodity prices were not fully passed on to domestic prices, the effect of softening international commodity prices on inflation in India could be similarly muted. The challenge for the setting of monetary policy was identified to be balancing the costs of lowering inflation in terms of output volatility, particularly in the context of the moderation in industrial and service sector activity, against the risk of the then prevailing levels of inflation persisting and getting embedded in inflation expectations. While there were considerable uncertainties associated with this judgment, the review highlighted the importance of remaining focused on bringing inflation down to levels that are compatible with a high but stable momentum of growth in the economy and financial stability.

VI.22 The extraordinary global developments triggered by the bankruptcy/ sellout/ restructuring of some of the world's largest financial institutions since

Table 59: Movement in Key Policy Rates in India

(Per cent)

Effective since	Reverse Repo Rate	Repo Rate	Cash Reserve Ratio	WPI Inflation
1	2	3	4	5
June 9, 2006	5.75 (+0.25)	6.75 (+0.25)	5.00	4.9
July 25, 2006	6.00 (+0.25)	7.00 (+0.25)	5.00	4.7
October 31, 2006	6.00	7.25 (+0.25)	5.00	5.4
December 23, 2006	6.00	7.25	5.25 (+0.25)	5.8
January 6, 2007	6.00	7.25	5.50 (+0.25)	6.4
January 31, 2007	6.00	7.50 (+0.25)	5.50	6.7
February 17, 2007	6.00	7.50	5.75 (+0.25)	6.0
March 3, 2007	6.00	7.50	6.00 (+0.25)	6.5
March 31, 2007	6.00	7.75 (+0.25)	6.00	5.9
April 14, 2007	6.00	7.75	6.25 (+0.25)	6.3
April 28, 2007	6.00	7.75	6.50 (+0.25)	6.0
August 4, 2007	6.00	7.75	7.00 (+0.50)	4.4
November 10, 2007	6.00	7.75	7.50 (+0.50)	3.2
April 26, 2008	6.00	7.75	7.75 (+0.25)	8.3
May 10,2008	6.00	7.75	8.00 (+0.25)	8.6
May 24,2008	6.00	7.75	8.25 (+0.25)	8.9
June 12, 2008	6.00	8.00 (+0.25)	8.25	11.7
June 25, 2008	6.00	8.50 (+0.50)	8.25	11.9
July 5, 2008	6.00	8.50	8.50 (+0.25)	12.2
July 19, 2008	6.00	8.50	8.75 (+0.25)	12.5
July 30, 2008	6.00	9.00 (+0.50)	8.75	12.5
August 30, 2008	6.00	9.00	9.00 (+0.25)	12.4
October 11, 2008	6.00	9.00	6.50 (-2.50)	11.3
October 20, 2008	6.00	8.00 (-1.00)	6.50	10.8
October 25, 2008	6.00	8.00	6.00 (-0.50)	10.7
November 3, 2008	6.00	7.50 (-0.50)	6.00	8.7
November 8, 2008	6.00	7.50	5.50 (-0.50)	8.7
December 8, 2008	5.00 (-1.00)	6.50 (-1.00)	5.50	6.8
January 5, 2009	4.00 (-1.00)	5.50 (-1.00)	5.50	5.2
January 17, 2009	4.00	5.50	5.00 (-0.50)	–

Note: 1. With effect from October 29, 2004, the nomenclature of repo and reverse repo was changed in keeping with international usage. Now, reverse repo indicates absorption of liquidity and repo signifies injection of liquidity. Prior to October 29, 2004, repo indicated absorption of liquidity, while reverse repo meant injection of liquidity.

2. Figures in parentheses indicate change in policy rates.

September 2008 resulted in a sharp deterioration in the global financial environment and recession in major advanced economies. India's growth trajectory has also been impacted both by the financial crisis and the follow-on global economic downturn. Reflecting these developments, the Reserve Bank adjusted its policy stance from demand management to arresting the moderation in growth. Accordingly, since mid-September 2008, the Reserve Bank has reduced the repo rate under the LAF from 9.0 per cent to 5.5 per cent, the reverse repo rate under the LAF from 6.0 per cent to 4.0 per cent and the CRR from 9.0 per cent to 5.0 per cent. The aim of these measures was to augment domestic liquidity and to ensure that credit continues to flow to productive sectors of the economy.

Wholesale Price Inflation

VI.23 In India, inflation based on the wholesale price index (WPI) increased to an intra-year peak of 12.9 per cent on August 2, 2008 from 7.7 per cent at end-March 2008. This mainly reflected the impact of some pass-through of international crude oil prices to domestic prices as well as elevated levels of prices of iron and steel, basic heavy inorganic chemicals, machinery and machine tools, oilseeds/oil cakes, raw cotton and textiles on account of strong demand as well as international commodity price pressures. Subsequently, inflation declined sharply to 5.6 per cent as on January 10, 2009. The decline in WPI index by 4.7 per cent over the same period was driven by the decline in prices of minerals oil, iron and steel, oilseeds, edible oils, oil cakes and raw cotton (Table 60).

Table 60: Key Commodity Prices – Global *vis-à-vis* Domestic (year-on-year)

Per cent

Item	Annual Inflation			Recent trends		
	Global	India		Global	India	
	Dec. 2008 over Dec. 2007	Inflation*	Weighted contribution	Dec. 2008 over July 2008	Jan. 10, 2009 over Aug. 2, 2008	Weighted contribution
1	2	3	4	5	6	7
1. Rice	47.3	12.8	5.0	-27.4	8.3	3.6
2. Wheat	-40.3	5.8	1.5	-32.9	1.9	0.6
3. Milk	..	7.1	5.5	..	2.9	2.5
4. Raw Cotton	-20.2	19.1	3.9	-28.2	-10.4	-3.0
5. Oilseeds	-30.1	7.2	3.6	-43.2	-6.4	-3.9
6. Iron Ore	66.0	40.1	5.7	0.0	-9.1	-2.1
7. Coal mining	-13.6	1.0	0.4	-56.3	0.0	0.0
8. Minerals Oil	-53.8	-3.1	-7.0	-68.9	-20.9	-63.2
9. Edible Oils	-(37-47)	-0.2	-0.1	-(55- 51)	-8.6	-4.1
10. Oil Cakes	-19.0	0.2	0.1	-32.1	-18.8	-8.4
11. Basic Heavy Inorganic Chemicals	..	-8.1	-2.0	..	-18.6	-5.7
12. Basic Metals, Alloys and Products	-36.4#	11.5	19.6	-45.0#	-7.8	-17.1
- Iron and Steel	54.6	14.1	11.8	-15.1	-11.9	-13.8

*: Based on WPI as on January 10, 2009.

#: Represented by IMF metals price index, which covers copper, aluminium, iron ore, tin, nickel, zinc, lead and uranium.

Note: Global price increases are based on the World Bank and IMF primary commodity prices data.

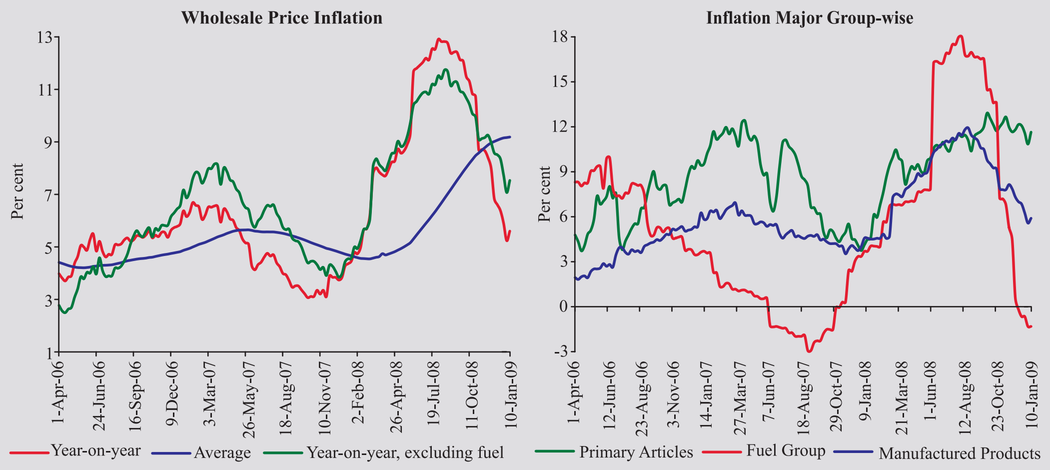
Chart 38: Annualised month over month (M-o-M) seasonally adjusted inflation: WPI-All Commodities

VI.24 Inflation momentum, as indicated by the movement of the annualised month-over-month (M-o-M) seasonally adjusted WPI inflation, has shown considerable volatility during 2007-08 as also 2008-09 so far. While annualised M-o-M seasonally adjusted inflation reached a peak in March 2008, it entered negative territory since September 2008 (Chart 38).

VI.25 The y-o-y inflation, excluding fuel, was at 7.5 per cent as on January 10, 2009 as compared with 4.5 per cent a year ago. The annual average WPI inflation rate (average of 52 weeks) increased to 9.2 per cent as on January 10, 2009 from 5.8 per cent at end-June 2008 and 4.7 per cent at end-March 2008 (4.7 per cent a year ago) (Chart 39).

VI.26 Amongst major groups, primary articles inflation, y-o-y, increased to 11.6 per cent on January 10, 2009 from 4.5 per cent a year ago and (it was 9.7 per cent at

Chart 39: Annual WPI Inflation



end-March 2008). This mainly reflected increase in the prices of food articles, especially of wheat, fruits, milk, and eggs, fish and meat as well as non-food articles such as oilseeds and raw cotton. The higher annual inflation in prices of oilseeds could be attributed to higher demand as well as elevated global prices. Notwithstanding higher domestic production during 2007-08, raw cotton prices have increased by 11.5 per cent over end-March 2008 reflecting estimated lower domestic production under the current *kharif* crop (down by 7.4 per cent as per the First Advance Estimates for 2008-09) as well as higher exports on the back of firm international prices. Minerals prices increased sharply as iron ore prices increased by 40.1 per cent, y-o-y, as compared with 6.2 per cent a year ago.

VI.27 Fuel group inflation, increased to an intra-year peak of 18.0 per cent on August 2, 2008 from 6.8 per cent at end-March 2008 mainly due to increase in the prices of minerals oils reflecting the effect of the hikes in the prices of petrol (Rs.5 per litre), diesel (Rs.3 per litre) and LPG (Rs.50 per cylinder) on June 4, 2008 as well as increase in the prices of freely priced petroleum products.

VI.28 In response to easing in international crude oil prices, domestic prices of freely priced petroleum products declined by about 65 per cent in case of naphtha (beginning the first week of August 2008), about 61 per cent in case of aviation turbine fuel (beginning the first week of September 2008), about 58 per cent in case of furnace oil (beginning mid-August 2008), about 30 per cent in the case of bitumen (beginning mid-November 2008) and about 3 per cent in the case of lubricants (beginning first week of December 2008). An analysis of price variation from February 2007 (when the fuel price was cut) reveals that international crude (Indian Basket) prices have come down to US $ 41.2 a barrel in December 2008 from US $ 56.6 a barrel in February 2007 after increasing up to US $ 132.2 in July 2008. Against this backdrop, the Government cut the price of petrol by Rs. 5 per litre and diesel by Rs. 2 per litre effective December 6, 2008. Consequently, the fuel group inflation turned negative (-1.3 per cent) as on January 10, 2009.

VI.29 Manufactured products inflation, year-on-year, also moderated to 5.9 per cent on January 10, 2009 as compared with the peak of 11.9 per cent in mid-August 2008 but remained higher than 4.6 per cent a year ago (Table 61). The year-on-year increase in manufactured products prices was mainly driven by sugar, edible oils/oil cakes, textiles, chemicals, iron and steel and machinery and machine tools.

VI.30 Oilseeds and edible oils/oil cakes prices declined recently reflecting the effect of fiscal measures as well as easing international prices on the back of projected increase in global production (Chart 40). However, according to the First Advance Estimates for 2008-09, domestic *kharif* oilseeds crop is expected to be down by 9.6 per cent. Moreover, the Government has imposed 20 per cent customs duty on import of crude soybean

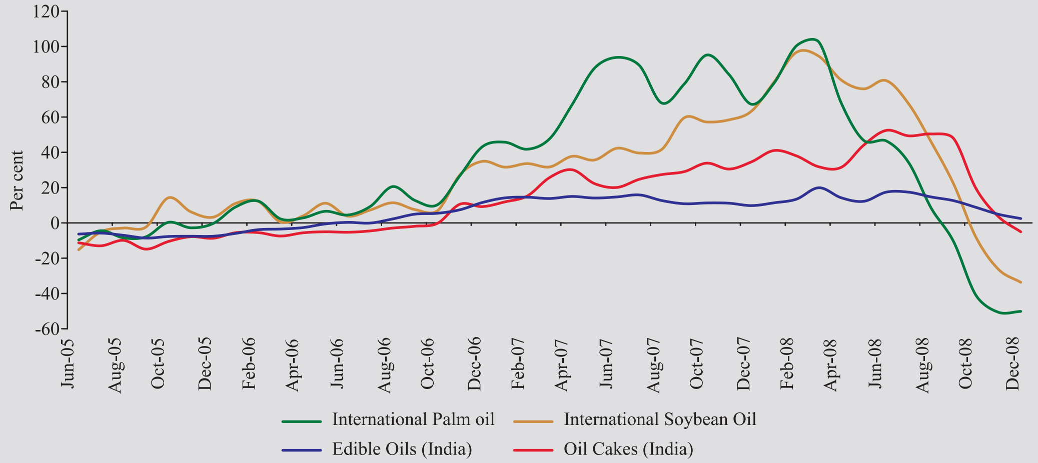
Table 61: Wholesale Price Inflation in India (year-on-year)

(Per cent)

Commodity	Weight	2007-08 (March 29)		2007-08 (January 12)		2008-09 P (January 10)	
		Inflation	WC	Inflation	WC	Inflation	WC
1	2	3	4	5	6	7	8
All Commodities	**100.0**	**7.7**	**100.0**	**4.4**	**100.0**	**5.6**	**100.0**
1. Primary Articles	**22.0**	**9.7**	**28.2**	**4.5**	**23.2**	**11.6**	**46.9**
Food Articles	15.4	6.5	13.2	2.0	7.1	11.6	32.2
i. Rice	2.4	9.1	2.5	7.6	3.7	12.8	5.0
ii. Wheat	1.4	5.1	1.0	-1.7	-0.6	5.8	1.5
iii. Pulses	0.6	-1.9	-0.2	-10.9	-1.9	13.4	1.5
iv. Vegetables	1.5	14.2	2.3	0.9	0.3	27.9	6.1
v. Fruits	1.5	4.1	1.0	-8.6	-3.8	19.5	5.9
vi. Milk	4.4	8.7	4.7	9.5	9.0	7.1	5.5
vii. Eggs, Fish and Meat	2.2	2.4	0.8	-0.5	-0.3	7.5	3.2
Non-Food Articles	6.1	11.4	8.8	11.8	15.5	7.1	7.8
i. Raw Cotton	1.4	14.0	2.0	24.4	5.3	19.1	3.9
ii. Oilseeds	2.7	20.3	6.7	17.6	10.0	7.2	3.6
iii. Sugarcane	1.3	-0.4	-0.1	-0.4	-0.1	0.0	0.0
Minerals	0.5	49.9	6.2	3.3	0.7	41.0	7.0
2. Fuel, Power, Light and Lubricants	**14.2**	**6.8**	**18.9**	**3.7**	**18.6**	**-1.3**	**-5.1**
i. Minerals Oil	7.0	9.3	15.1	5.4	15.8	-3.1	-7.0
ii. Electricity	5.5	1.5	1.4	-0.7	-1.1	1.3	1.6
iii. Coal Mining	1.8	9.8	2.5	8.8	3.9	1.0	0.4
3. Manufactured Products	**63.8**	**7.3**	**52.8**	**4.6**	**58.1**	**5.9**	**58.5**
i. Food Products	11.5	9.4	12.4	6.3	14.7	4.5	8.3
of which: Sugar	3.6	1.1	0.4	-7.8	-4.8	13.5	5.7
Edible Oils	2.8	20.0	5.5	11.1	5.5	-0.2	-0.1
ii. Cotton Textiles	4.2	-6.8	-2.8	-6.4	-4.7	16.0	8.3
iii. Man -made Fibres	4.4	2.8	0.7	1.4	0.6	1.1	0.4
iv. Chemicals and Products	11.9	6.0	8.7	7.4	18.9	2.9	5.9
of which : Fertilisers	3.7	5.1	2.0	1.9	1.3	8.1	4.4
v. Basic Metals, Alloys and Metal Products	8.3	20.3	25.2	2.9	6.3	11.5	19.6
of which: Iron and Steel	3.6	34.2	20.1	7.6	7.9	14.1	11.8
vi. Non-Metallic Mineral Products	2.5	6.4	2.0	9.4	5.0	1.9	0.8
of which:Cement	1.7	5.1	1.1	11.6	4.4	0.0	0.0
vii. Machinery and Machine Tools	8.4	3.5	2.9	5.2	7.6	5.1	5.8
of which: Electrical Machinery	5.0	4.8	2.0	8.0	5.9	5.2	3.1
viii. Transport Equipment and Parts	4.3	3.9	1.7	4.9	3.8	3.4	2.0
Memo:							
Food Items (Composite)	**26.9**	**7.7**	**25.6**	**3.6**	**21.8**	**8.8**	**40.5**
WPI Excluding Food	**73.1**	**7.8**	**74.4**	**4.6**	**78.2**	**4.5**	**59.5**
WPI Excluding Fuel	**85.8**	**8.0**	**81.1**	**4.5**	**81.4**	**7.5**	**105.1**

WC: Weighted Contribution. P: Provisional.

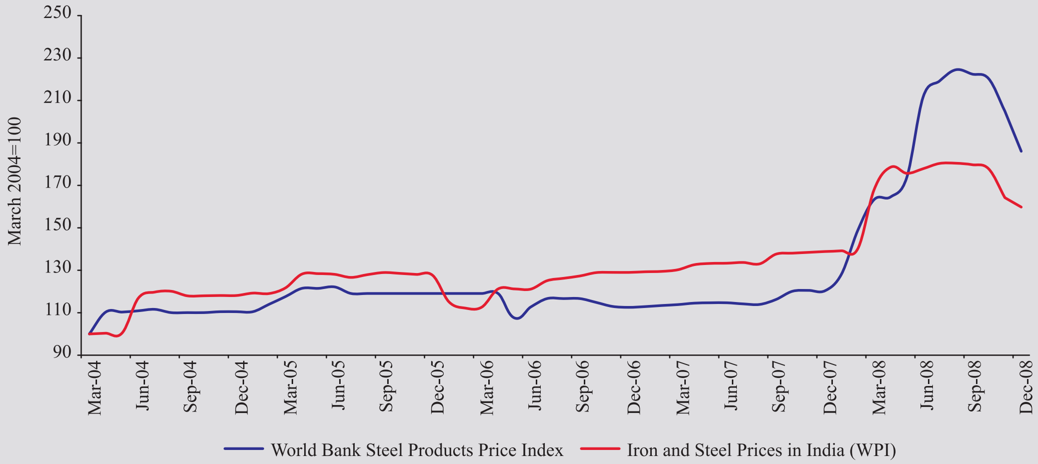
Chart 40: Edible Oils Inflation



oil to safeguard the interest of domestic producers on November 18, 2008. Reflecting hardening of raw cotton prices, cotton textile prices in India also increased by 16.9 per cent over end-March 2008 as on January 10, 2009.

VI.31 Domestic metal prices have gone up by 11.5 per cent, y-o-y, on January 10, 2009 (reflecting 14.1 per cent increase in iron and steel prices and 4.3 per cent decline in non-ferrous metals prices). Recently, iron and steel prices have shown a decline since end-August 2008 by 12.1 per cent (Chart 41). This decline in domestic iron and steel prices could be attributed to declining global prices, expected deceleration in demand, both domestic and external, as well as various

Chart 41: Iron and Steel Prices



fiscal measures in the form of reductions in customs duties and imposition of export duties on various steel items announced by the Government of India since April 2008.

VI.32 Overall, 'manufactured products' group was the major driver of y-o-y WPI inflation as on January 10, 2009 with weighted contribution of 58.5 per cent (58.1 per cent a year ago), followed by 'primary articles' group at 46.9 per cent (23.2 per cent) while the contribution of the 'fuel, power, light and lubricants' group was negative 5.1 per cent as against a positive contribution of 18.6 per cent a year ago. The recent declining phase of WPI inflation is marked by a sharp decline in contribution of fuel group to overall WPI inflation while that of primary articles increased substantially (Chart 42).

Consumer Price Inflation

VI.33 Inflation, based on y-o-y variation in consumer price indices (CPIs), increased further during November 2008 mainly due to increase in the prices of food, fuel and services (represented by the 'miscellaneous' group). Various measures of consumer price inflation were placed in the range of 10.4-11.1 per cent during November/December 2008 as compared with 7.3-8.8 per cent in June 2008 and 5.1-6.2 per cent in November 2007 (Table 62). The higher order increase in consumer price inflation as compared to WPI inflation in recent months could be attributed to higher weight of food articles in CPIs and higher prices of food articles.

Asset Prices

VI.34 Domestic equity prices witnessed further corrections during the third quarter of 2008-09 in line with trends in major international financial markets, which fell due to the persistence of financial market turmoil following the US sub-prime crisis, and concerns about

Chart 42: Major Groups' Weighted Contribution to WPI Inflation (year-on-year)

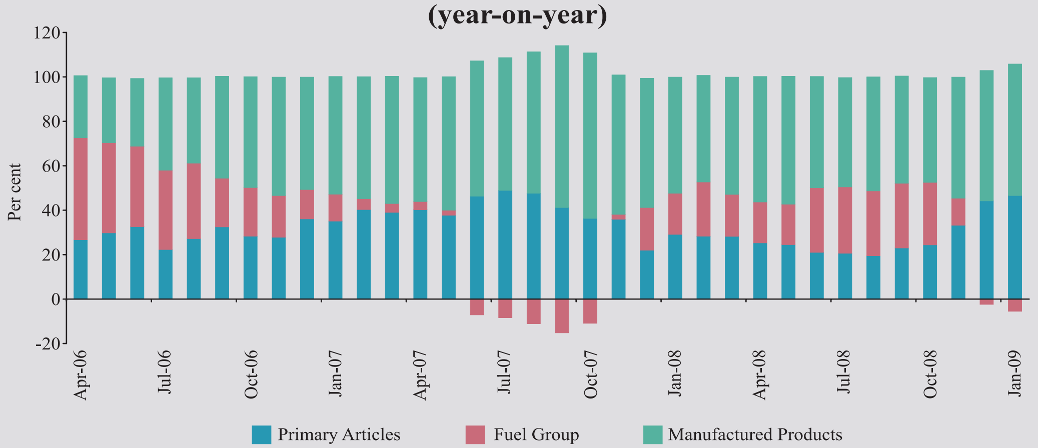


Table 62: Consumer Price Inflation - Major Groups

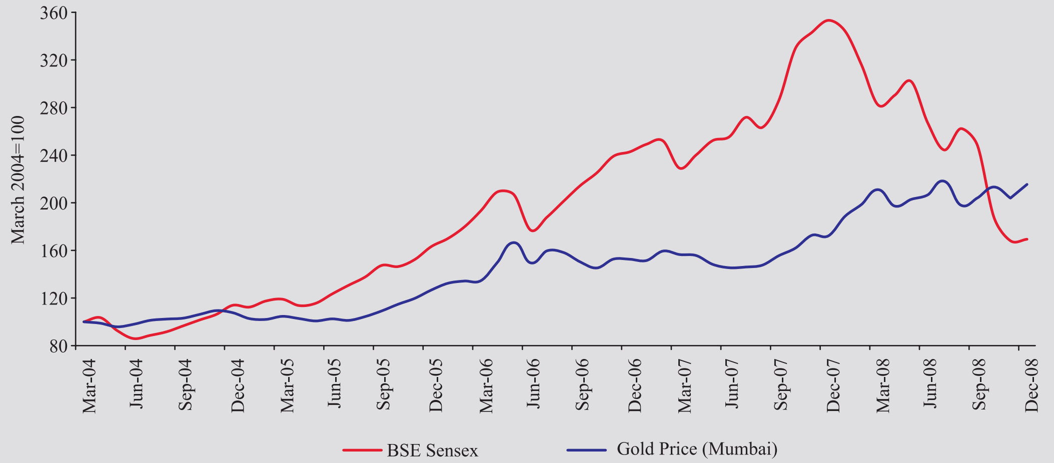
(Year-on-year variation in per cent)

CPI Measure	Weight	Mar-06	Mar-07	Jun-07	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08	Oct-08	Nov-08	Dec-08
1	2	3	4	5	6	7	8	9	10	11	12	13
CPI-IW (Base: 2001=100)#												
General	**100.0**	**4.9**	**6.7**	**5.7**	**6.4**	**5.5**	**7.9**	**7.7**	**9.8**	**10.4**	**10.4**	–
Food Group	46.2	4.9	12.2	8.1	8.7	6.2	9.3	10.5	13.1	14.4	–	–
Pan, Supari *etc*.	2.3	3.1	4.4	9.6	10.3	10.3	10.9	7.1	7.8	9.4	–	–
Fuel and Light	6.4	-2.9	3.2	1.6	2.3	2.3	4.6	8.4	9.1	9.8	–	–
Housing	15.3	6.6	4.1	4.1	4.0	4.0	4.7	4.7	3.8	3.8	–	–
Clothing, Bedding *etc*.	6.6	3.0	3.7	4.4	5.3	3.5	2.6	2.5	2.5	3.4	–	–
Miscellaneous	23.3	4.6	3.3	4.0	4.0	4.7	6.3	6.2	7.6	8.3	–	–
CPI-UNME (Base: 1984-85=100)												
General	**100.0**	**5.0**	**7.6**	**6.1**	**5.7**	**5.1**	**6.0**	**7.3**	**9.5**	**10.4**	**10.8**	–
Food Group	47.1	5.3	10.9	7.7	7.7	6.2	7.8	9.6	13.2	15.2	15.7	–
Fuel and Light	5.5	1.9	6.4	7.2	7.0	5.4	4.6	5.3	6.2	6.8	6.7	–
Housing	16.4	5.5	5.6	5.6	4.9	4.7	4.0	3.8	3.5	3.5	3.5	–
Clothing, Bedding *etc*.	7.0	2.9	3.6	4.3	4.0	4.1	4.3	3.4	3.1	2.7	3.1	–
Miscellaneous	24.0	5.1	4.4	3.7	3.2	3.8	4.8	6.6	8.4	9.4	10.1	–
CPI-AL (Base: 1986-87=100)												
General	**100.0**	**5.3**	**9.5**	**7.8**	**7.9**	**5.9**	**7.9**	**8.8**	**11.0**	**11.1**	**11.1**	**11.1**
Food Group	69.2	5.5	11.8	8.8	8.8	6.2	8.5	9.6	12.0	12.1	12.1	11.9
Pan, Supari *etc*.	3.8	6.6	5.7	9.1	11.1	11.3	10.4	11.2	12.8	13.1	14.1	13.7
Fuel and Light	8.4	4.3	6.9	7.4	7.2	6.3	8.0	8.9	10.2	10.9	11.1	11.3
Clothing, Bedding *etc*.	7.0	2.2	3.5	2.7	1.9	1.3	1.8	3.1	6.0	6.8	7.0	7.0
Miscellaneous	11.7	5.5	6.8	6.7	5.5	5.2	6.1	6.5	7.1	7.1	7.3	7.0
CPI-RL (Base: 1986-87=100)												
General	**100.0**	**5.3**	**9.2**	**7.5**	**7.6**	**5.6**	**7.6**	**8.7**	**11.0**	**11.1**	**11.1**	**11.1**
Food Group	66.8	5.8	11.5	8.5	8.8	6.2	8.2	9.6	12.0	12.4	12.4	11.9
Pan, Supari *etc*.	3.7	6.3	5.7	9.3	11.6	11.5	10.6	10.9	12.5	13.0	13.8	13.4
Fuel and Light	7.9	4.0	6.9	7.4	7.2	6.3	8.0	8.9	10.5	10.7	11.1	11.3
Clothing, Bedding *etc*.	9.8	2.7	3.1	2.6	2.1	2.6	2.8	4.1	6.5	6.8	7.0	7.3
Miscellaneous	11.9	5.2	6.3	6.2	5.3	5.0	6.2	6.8	7.4	7.4	7.6	7.5
Memo:												
WPI Inflation (End of period)		4.1	5.9	4.4	3.4	3.8	7.7	12.0	12.1	10.7	8.0	5.9
GDP Deflator based Inflation*		4.9	5.5	5.4	3.9	2.7	4.2	7.2	10.3	–	–	–

#: Data prior to January 2006 are based on the old series (Base: 1982=100).
*: Data for March pertain to full year.
IW : Industrial Workers. UNME : Urban Non-Manual Employees.
AL : Agricultural Labourers. RL : Rural Labourers.

slowdown in the domestic economy (see Chapter V). Domestic gold prices, which had eased somewhat during the second quarter of 2008-09 mirroring movements in international prices, hardened subsequently to around Rs.12,897 per 10 grams in December 2008 in line with movements in international prices. International prices increased by over 7 per cent to around US $ 817 per ounce during November-December 2008 (Chart 43).

Chart 43: Asset Price Movements



VII. MACROECONOMIC OUTLOOK

VII.1 The various business expectations surveys released recently reflect less than optimistic sentiments prevailing in the economy. The results of professional forecasters' survey conducted by the Reserve Bank in December 2008 also suggested further moderation in economic activity for 2008-09. The downside risks for economic growth include factors like global economic slowdown and deterioration in global financial markets as also some slowdown in domestic demand, while the positive factors are expected increase in consumption demand in medium term. The upward pressure on primary articles' inflation, and aggressive monetary easing domestically and internationally constitute upside risks to inflationary expectations. On the positive side, significant easing of international oil prices and softening of international food prices may help in softening the inflationary pressure. On balance, however, the inflation outlook is tilted downwards at the current juncture.

Business Expectations Surveys

VII.2 According to the quarterly business expectations survey of the National Council of Applied Economic Research (NCAER) conducted in October 2008, the overall business confidence index (BCI) for the next six months continued to decline (Table 63). The sustained decline was attributed by the survey to tightening liquidity conditions, high inflation and political uncertainties revolving around the Indo-US nuclear deal. The survey, however, noted that while some issues were resolved, the global economic climate worsened. A component-wise analysis shows that all the four components of BCI, *viz*., overall economic conditions, investment climate, financial position of firms and capacity utilisation declined over the previous round. The fall in business confidence was noticeable particularly in capital goods and services sectors followed by consumer durable and non-durable sectors, while intermediate goods sector registered no change in confidence levels. All five constituting sectors of BCI, *viz*., consumer goods (durables and non-durables), capital goods and services, barring intermediates, declined over the previous period. In contrast, the Political Confidence Index surged by 24.9 per cent in October 2008 over July 2008 reflecting regaining of faith by firms in political management of economic policies.

VII.3 According to the quarterly business expectations survey of Confederation of Indian Industry (CII),

Table 63: Business Expectations Surveys

Organisation	Business Expectations		Growth over a year ago (per cent)	Growth over previous round (per cent)
	Period	Index		
1	2	3	4	5
NCAER	November 2008- April 2009	Business Confidence Index	-17.8	-4.7
CII	October 2008-March 2009	Business Confidence Index	-15.1	-7.7
Dun & Bradstreet	October-December 2008	Business Optimism Index	-28.0	1.8
RBI	January-March 2009	Business Expectation Index	-5.6	-5.9

the business confidence index (CII-BCI) for October-March 2009 has also declined both as compared with the previous six months as well as with the corresponding period in the year earlier (Table 63). The decline reflected uncertainties on global economic outlook and concerns about high cost of funds.

VII.4 The composite business optimism index for October-December 2008 compiled by Dun and Bradstreet (D&B) increased moderately as compared with the previous quarter but declined sharply as compared with the previous year and it was the largest magnitude of year-on-year fall ever witnessed in the index. All the six optimism indices - volumes of sales, net profits, selling prices, new orders, inventory levels and employee levels have fallen significantly as compared to the corresponding period last year. Optimism was particularly low among respondents in the services sector.

VII.5 According to the Reserve Bank's Industrial Outlook Survey of manufacturing companies in the private sector, the business expectations indices based on assessment for October-December 2008 and on expectations for January-March 2009 declined by 2.6 per cent and 5.9 per cent, respectively, over the corresponding previous quarters. Similar trend was observed in these indices when compared over the corresponding quarters of the previous year (Chart 44).

VII.6 During the period October 2008-March 2009, optimism on major business sentiment indicators such as overall business situation, overall financial situation, production, order books, capacity utilisation, employment of the company, exports, imports and profit margin significantly declined compared to a year ago. Raw material cost seems to have eased up to a certain extent during October-December 2008 and significantly higher net proportion of respondents view that there would be a 'decline' in selling prices from the respective levels in the previous quarter (Table 64).

Chart 44: Reserve Bank's Industrial Outlook Survey -Business Expectations Index

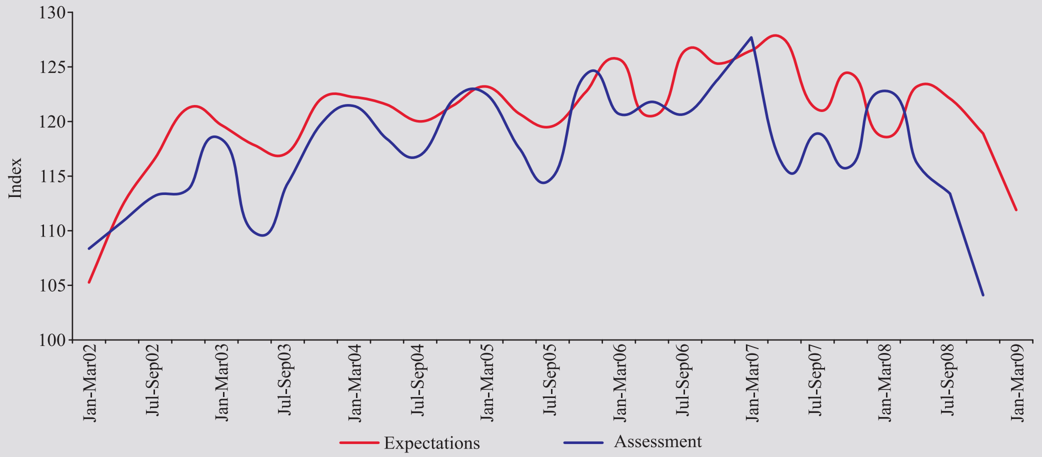


Table 64: Reserve Bank's Survey – Net Response on 'A Quarter Ahead' Expectations About the Industrial Performance

Parameter	Response	Oct-Dec 2007	Jan-Mar 2008	Apr-Jun 2008	Jul-Sep 2008	Oct-Dec 2008	Jan-Mar 2009
1	2	3	4	5	6	7	8
1. Overall business situation	Better	50.2 (42.1)	47.7 (42.9)	46.0 (42.7)	41.8 (42.6)	33.7 (44.1)	21.1 (43.9)
2. Financial situation	Better	40.1 (51.3)	40.3 (50.3)	36.6 (51.6)	32.7 (53.0)	27.7 (52.5)	16.4 (53.2)
3. Working capital finance requirement	Increase	32.2 (62.6)	34.7 (60.3)	36.6 (56.5)	33.6 (57.3)	33.8 (57.7)	32.9 (57.1)
4. Availability of finance	Improve	33.8 (58.8)	31.1 (59.5)	32.3 (58.3)	30.2 (57.9)	23.3 (59.0)	13.7 (56.3)
5. Production	Increase	49.0 (40.9)	43.9 (42.3)	45.2 (41.0)	43.5 (36.6)	39.8 (42.1)	26.0 (42.3)
6. Order books	Increase	44.1 (46.0)	37.1 (48.6)	41.5 (44.3)	38.5 (43.5)	35.7 (46.1)	20.6 (46.1)
7. Pending orders, if applicable	Below normal	-3.5 (82.4)	0.4 (80.2)	-4.3 (81.3)	2.2 (80.9)	4.6 (82.0)	11.5 (77.8)
8. Cost of raw material	Decrease	-42.4 (51.0)	-44.1 (49.2)	-48.2 (46.0)	-54.7 (39.1)	-61.1 (32.3)	-35.7 (39.7)
9. Inventory of raw material	Below average	-6.3 (85.0)	-7.3 (84.8)	-7.0 (83.2)	-3.8 (81.8)	-7.6 (77.6)	-3.3 (81.3)
10. Inventory of finished goods	Below average	-3.5 (86.4)	-4.5 (86.1)	-5.8 (84.5)	-1.5 (84.5)	-4.3 (82.6)	-4.4 (80.9)
11. Capacity utilisation (Main product)	Increase	28.4 (61.5)	24.2 (62.3)	25.6 (59.9)	22.2 (58.8)	26.4 (56.0)	12.3 (59.1)
12. Level of capacity utilisation (Compared to the average in the preceding four quarters)	Above normal	10.7 (77.2)	6.4 (78.3)	9.4 (77.0)	3.6 (74.9)	-0.5 (78.7)	-7.4 (73.7)
13. Assessment of the production capacity (With regard to expected demand in the next six months)	More than adequate	4.2 (83.0)	4.7 (83.8)	8.0 (81.2)	4.6 (81.3)	5.7 (81.7)	11.8 (81.0)
14. Employment in the company	Increase	16.7 (74.1)	14.6 (75.6)	20.8 (68.2)	15.8 (71.5)	16.6 (70.4)	7.7 (75.7)
15. Exports, if applicable	Increase	31.4 (55.9)	24.3 (58.3)	27.7 (53.3)	27.7 (54.9)	27.3 (54.3)	16.0 (54.8)
16. Imports, if any	Increase	20.8 (68.6)	20.1 (70.5)	25.3 (65.6)	21.3 (66.5)	21.4 (67.9)	9.1 (69.7)
17. Selling prices are expected to	Increase	13.0 (68.5)	14.9 (67.1)	19.1 (66.0)	21.0 (61.5)	26.2 (57.6)	4.1 (61.7)
18. If increase expected in selling prices	Increase at lower rate	3.7 (58.9)	13.3 (66.7)	9.0 (64.0)	3.0 (61.3)	0.6 (54.7)	0.9 (54.0)
19. Profit margin	Increase	9.6 (59.6)	5.4 (60.0)	7.2 (61.0)	3.8 (59.8)	-3.6 (54.7)	-12.9 (53.3)

Note: 1. 'Net response' is measured as the percentage share differential between the companies reporting 'optimistic' (positive) and 'pessimistic' (negative) responses; responses indicating *status quo* (no change) are not reckoned. Higher 'net response' indicates higher level of confidence and *vice versa*.

2. Figures in parentheses are the percentages of respondents with 'no change over the preceding quarter' as responses.

VII.7 The ABN-AMRO Purchasing Managers' Index[1] (PMI) for December 2008 touched a record low of 44.4. The PMI survey signalled further declines in both pre- and post-production stocks, with the respective rates of contraction accelerating to the fastest in the survey history. This mainly reflected the deteriorating outlook for the manufacturing sector. The New Orders Index, which is also a leading indicator of economic activity for the next month, has declined sharply in December 2008 to 41.4, signalling the possibility of weakening of activity in the manufacturing sector.

Survey of Professional Forecasters[2]

VII.8 The results of professional forecasters' survey conducted by the Reserve Bank in December 2008 suggested further moderation in economic activity for 2008-09 on the whole (Table 65). Between

Table 65: Median Forecasts of Select Macroeconomic Indicators by Professional Forecasters 2008-09

	Actual 2007-08	2008-09						2009-10			
		Annual		Q3		Q4		Q1		Q2	
		E	L	E	L	E	L	E	L	E	L
1	2	3	4	5	6	7	8	9	10	11	12
1. Real GDP growth rate at factor cost (in per cent)	9.0	7.7	6.8	7.6	6.1	7.6	6.2	7.5	6.1	7.8	6.3
a. Agriculture & Allied Activities	4.5	3.0	3.0	2.5	2.5	3.0	3.5	3.0	3.0	3.0	3.0
b. Industry	8.1	7.0	4.9	6.9	4.0	7.5	4.0	7.3	4.0	7.0	4.5
c. Services	10.7	9.5	9.0	9.5	8.5	9.3	8.0	9.4	7.6	9.5	8.1
2. Gross Domestic Saving (per cent of GDP at current market price)	34.8*	34.8	33.0	–	–	–	–	–	–	–	–
3. Gross Domestic Capital Formation (per cent of GDP at current market price)	35.9*	36.3	34.9	36.2	33.0	36.0	33.0	36.0	34.0	35.8	34.3
4. Corporate profit after tax (growth rate in per cent)	26.2	18.0	15.0	17.5	6.5	17.8	11.0	18.0	10.0	19.0	12.5
5. T-Bill 91 days Yield (per cent-end period)	7.1	8.4	5.9	–	–	–	–	–	–	–	–
6. 10-year Govt. Securities Yield (per cent-end period)	7.9	8.5	7.0	–	–	–	–	–	–	–	–
7 Exports (growth rate in per cent)	23.7	20.0	12.0	–	–	–	–	–	–	–	–
8 Imports (Growth rate in per cent)	29.9	27.2	17.7	–	–	–	–	–	–	–	–
9 Trade Balance (US $ billion)	–	–	–	-31.0	-27.0	-29.0	-24.4	-32.0	-33.3	-30.4	-35.5

E : Earlier Projection. L : Latest Projection. – : Not Available. * : Pertains to 2006-07.

Note : The latest round refers to sixth round for the quarter ended December 2008, while earlier round refers to fifth round for the quarter ended September 2008.

Source : Survey of Professional Forecasters, Third Quarter 2008-09.

[1] The PMI is a composite indicator designed to provide an overall view of activity in the manufacturing sector. A PMI of 50.0 indicates no change while values above or below this level indicate an expansion or a contraction of the manufacturing activity.

[2] Introduced by the Reserve Bank from the quarter ended September 2007. The forecasts made in the section are that of professional forecasters and not that of the Reserve Bank.

the fifth round of survey conducted in September 2008 and sixth round survey in December 2008, median forecast of real GDP growth for 2008-09 was placed at 6.8 per cent, lower than the 7.7 per cent forecast earlier. The sectoral growth rate forecast for the agriculture sector was kept unchanged. However, the sectoral growth rate forecast for industry was revised downwards from 7.0 per cent to 4.9 per cent and for services sector, from 9.5 per cent to 9.0 per cent. The annual growth rate in imports was revised downwards to 17.7 per cent from 27.2 per cent.

VII.9 Forecasts by select agencies for real GDP growth in 2008-09 are set out in Table 66.

Balance of Risks for Growth and Inflation

VII.10 Several significant global and domestic developments recently have rendered the outlook uncertain and have increased the downside risks associated with real GDP growth. The global economic outlook has deteriorated sharply since September 2008 with several countries, notably the US, the UK, the Euro area and Japan experiencing recession. Furthermore, at present, the indications are that the global downturn may be deeper and more protracted than expected earlier. Consequently, the adverse implications through trade and financial channels for emerging economies, including India, have

Table 66: Projections of Real GDP for India by Various Agencies – 2008-09

(Per cent)

Agency	Latest Projection				Month of Projection	Earlier Projection	
	Overall Growth	Agriculture	Industry	Services		Overall Growth (Per cent)	Month
1	2	3	4	5	6	7	8
ADB	**7.0**	–	–	–	Dec-08	7.4	Sep-08
ASSOCHAM	**7.6**	4.0	7.2	9.0	Nov-08	7.6	Jul-08
Confederation of Indian Industries (CII)	**Above 8**	–	–	–	Sep-08	8.0-8.5	Mar-08
CRISIL	**6.5-7.0**	2.5	5.5-6.0	8.5-9.0	Dec-08	7.8	Sep-08
Economic Advisory Council to PM	**7.1**	3.0	5.1	9.3	Jan-09	7.7	Jul- 08
Merrill Lynch	**7.2**	3.0	4.6	9.1	Dec-08	7.5	Oct-08
Citigroup	**7.2**	2.0	6.1	9.4	Oct-08	7.5	Aug-08
CMIE	**7.4**	3.2	5.5	9.5	Jan-09	7.5	Dec-08
NCAER	**7.6**	2.3	8.2	9.8	Oct-08	7.8	Jul-08
UNCTAD	**7.6**	–	–	–	Sep-08		
IMF (Calendar year)	**7.8**	–	–	–	Nov-08	7.9	Oct-08
Ministry of Finance, Government of India	**7.0**				Dec-08		
World Bank	**6.3**	–	–	–	Dec-08	7.0	Jun-08
Range	**6.3-8.0**	**2.0-4.0**	**4.6-8.2**	**8.5-9.8**		**7.0-8.5**	

amplified. If the recession is deeper and the recovery is long drawn as is the current expectation, emerging economies have also to contend with second round effects in the form of potential terms of trade losses, erosion of export competitiveness and restricted external financing.

VII.11 The outlook for India going forward is mixed. There is evidence of a slowing down of economic activity. Real GDP growth has moderated in the first half of 2008-09. Industrial activity, particularly in the manufacturing and infrastructure sectors, is decelerating. In the coming months, the services sector too, which has been the prime growth engine for the last five years, is slowing, mainly in the construction, transport and communication, trade, hotels and restaurants subsectors. For the first time in seven years, exports have declined in absolute terms in October and November 2008. Higher input costs and dampened demand have dented corporate margins while the uncertainty surrounding the crisis has affected business confidence. The major inputs of the construction sector, *viz.*, cement and steel continued to record deceleration in growth during April-October 2008. Various leading indicators of services have also witnessed deceleration in growth during 2008-09. The OECD's latest Composite Index of Leading Indicators (CILI) for India fell by 1.2 point in November 2008 and was 7.6 point lower than a year ago. The OECD suggested a strong slowdown in the industrial sector in India. Furthermore, its analysis exhibited strong slowdown in the industrial sector for Euro area, the US and China during the recent period. It may also be recognised that unlike in the advanced countries where the contagion spread from the financial to the real sector, in India the slowdown in the real sector is affecting the financial sector, which in turn, has a second-order impact on the real sector.

VII.12 On the other hand, some positive factors include an expected increase in consumption demand mainly reflecting rise in basic exemption limits and tax slabs, Sixth Pay Commission awards, debt waiver for farmers and pre-election expenditure. The consumption expenditure is also expected to improve in the medium-run due to changing pattern of demographic profile in India. Furthermore, India's export destinations have diversified in recent years. Other countries such as China, Hong Kong, Singapore, UAE, Germany and other Asian countries have emerged as important destinations for India's exports.

VII.13 Overall, the balance of risks on growth outlook is tilted towards downside. While downside risks would be extending to the future, the fall in commodity including oil prices and the coordinated fiscal and monetary stimulus are expected to revive the growth momentum.

VII.14 WPI inflation has fallen sharply from an intra-year peak of 12.9 per cent on August 2, 2008 to 5.6 per cent by January 10, 2009 and the decline has been sustained since August 2008, pointing out to a faster than expected reduction in inflation. Clearly, falling international commodity prices especially those of crude oil, steel and selected food items have been the key drivers behind the decline in inflation rate, although, some contribution has also come from the slowing domestic demand. The reduction in administered prices of petrol and diesel announced in the first week of December 2008 further eased inflationary pressures.

VII.15 Going forward, the outlook on international commodity prices indicate further downward pressure to domestic prices. Crude oil prices are expected to be at lower levels in the year 2009 as compared to 2008 on account of weaker demand across the OECD as well as increasing likelihood of a prolonged global economic downturn. Improved global production prospects of key agricultural items such as cereals and oilseeds are expected to keep food prices lower in 2009. Metal prices are expected to decline reflecting lower manufacturing demand in the OECD countries and some improvement in supply in China. International steel prices, which have remained at elevated levels up to August 2008, have eased since then as the slowdown in demand set in following recession in major advanced economies.

VII.16 On the domestic front, the shortfall in output in major agricultural commodities (food, oilseeds, sugar and cotton) as per the first advance estimates of *kharif* production for the year 2008-09 is likely to pose upside risks to the prices of these commodities. However, easing international prices along with improved *rabi* sowing could eventually balance these risks. Among the manufacturing products, prices are expected to moderate for metals in line with international prices. In addition, the pass-through of recent reduction in CENVAT by 4 per cent by the Government of India as part of the fiscal stimulus package would lead to a general reduction in price levels. The moderation in aggregate demand on account of the expected slowdown in economic growth is further expected to diminish the upside risks to inflation in coming months. Overall, the outlook on inflation has shifted to the downside and keeping in view the supply management measures taken by the Government of India and the lagged response to the monetary policy measures taken by the Reserve Bank, the inflation by end-March 2009 is expected to be significantly lower than that projected.

VII.17 Double-digit consumer price inflation during September-December 2008 reflected firm trend in food articles inflation and the higher weight of food articles in measures of consumer price inflation.