RESERVE BANK OF INDIA

Macroeconomic and Monetary Developments in 2009-10

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Reserve Bank of India
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Contents

MACROECONOMIC AND MONETARY DEVELOPMENTS IN 2009-10

Overview

Global Economic Conditions

1. Recovery in the global economy picked up momentum in the fourth quarter of 2009. The speed of recovery, however, remains significantly divergent. The projections for global output for 2010 generally point to consolidating recovery, led by the Emerging Market Economies (EMEs). The WTO projects world trade to stage a strong recovery in 2010. The risks to the overall global macroeconomic environment have, however, increased because of large public debt in advanced economies, on the back of concerns relating to reduction in potential output, high unemployment rates, impaired financial systems and premature exit from the policy stimulus. Closer home, the improvement in global macroeconomic conditions is reflected in the turnaround in India's exports and the return of capital flows. With stronger recovery in EMEs driven largely by domestic demand, improving exports and return of capital flows, EMEs face the risks of inflation and asset price build up.

Output

2. Concerns about domestic output growth are now subdued as the recovery is getting more broad-based. This is the result of a rebound in industrial output, better prospects for the Rabi crop and continuing resilience of the services sector. Survey data suggest increasing levels of capacity utilisation in recent months. Subject to normal monsoons, output growth during 2010-11 is expected to gain further momentum.

Aggregate Demand

3. Final consumption expenditure remained subdued during 2009-10, as growth in both private final consumption expenditure and government final consumption expenditure decelerated. Investment demand, particularly gross fixed capital formation, however, showed a gradual recovery during the year. While the momentum in investment demand is expected to continue, pick-up in private consumption demand could drive the recovery in growth. The fiscal exit, as planned in the Union Budget for 2010-11, would contribute to improving the overall medium-term growth outlook, even as going forward, greater emphasis on quality of fiscal adjustment would be necessary.

External Sector Developments

4. India's external sector position improved alongside the recovery in the global economy. After declining for 12 consecutive months, exports recovered in October 2009. Similarly, imports recovered in November 2009 following a phase of decline. Despite a lower trade deficit, the current account deficit widened during April–December 2009, as compared with *the corresponding period of the previous year. This is attributable to a fall in invisibles, particularly on account of business services. During 2009-10, foreign exchange reserves increased by US$ 27.1 billion, comprising mainly of increase in gold holdings (US$ 8.4 billion), SDRs (US$ 5.0 billion) and foreign currency assets (US$ 13.3 billion). The bulk of the increase in foreign currency assets was on account of valuation. Net capital inflows can be expected to increase further during the current year, reflecting the prospects of higher growth and larger interest rate differentials between India and the advanced economies. Like other EMEs, however, higher capital inflows could influence asset prices, domestic liquidity conditions and the exchange rate. This will have implications for monetary management.*

Monetary and Credit Conditions

5. Reflecting the stronger recovery in economic activities, growth in broad money (M_3) and flow of credit to the private sector exceeded the Reserve Bank's indicative projections for 2009-10. While the increase in CRR effected by the Reserve Bank in its Third Quarter Policy Review of January 2010 led to some moderation in excess liquidity, overall liquidity conditions remain comfortable as reflected in the daily reverse repo operations. The banking system's credit to the Government was the prime driver of monetary expansion during the year. The flow of resources to commercial sector distinctly improved from both bank as well as non-bank sources. Going forward, the demand for money may increase with acceleration in recovery and the elevated level of inflation.

Global Financial Markets

6. Global financial markets exhibited significant stabilisation during 2009, despite the drag from the global financial crisis. However, volatility increased in the beginning of 2010 due to concerns about unsustainable fiscal positions, as reflected in sovereign risks. Episodes such as the Dubai World debt standstill and the sovereign debt problems in Greece and East European countries pose a major risk to the stability of financial markets going forward.

Domestic Financial Markets

7. With market activity returning to the pre-global crisis level, volatility in the domestic financial markets was much lower during 2009-10 than in the year before, when the crisis erupted. Despite considerable stability and the commencement of exit, markets faced concerns emerging from large government borrowings and the increase in inflation. This affected yields in the government bond market. The transmission of lower policy rates to the credit markets improved, albeit, slowly. Asset prices increased at a relatively faster pace in the recent months. With the revival of capital inflows, nominal exchange rate appreciated. Given higher domestic inflation, the appreciation in real terms was even higher.

Inflation Situation

8. Headline WPI inflation firmed up significantly during the fourth quarter of 2009-10. The initial inflationary pressure was predominantly conditioned by rising food and fuel prices, reflecting the impact *of a deficient monsoon on agricultural output and the increase in international crude prices. In the second half of the year, with persistent supply side pressures, inflation became increasingly generalised. This is evident from the acceleration of inflation in non-food manufactured products from -0.4 per cent in November 2009 to 4.7 per cent in March 2010. Inflation, as measured by consumer price indices (CPIs) also remained high, though there was some moderation in February 2010. These inflationary conditions, coupled with the stronger momentum seen in the pace of economic recovery, created the compelling ground for altering the Reserve Bank's balance of policy focus to anchoring inflation expectations.*

Growth Outlook

9. Output growth in 2010-11 is expected to be higher than in 2009-10, assuming a normal monsoon. Support for sustained momentum in growth can be expected from all three major components, viz., agriculture, industry and services. Nevertheless, apart from monsoon-related uncertainty, other downside risks to growth need to be recognised. First, private consumption demand needs to improve significantly to support the growth momentum. Second, global recovery, despite gaining strength, is expected to remain fragile, which has implications for exports. Third, the exit from fiscal stimulus and the growth-supportive monetary policy, unless calibrated carefully, could impact the growth process. Finally, the domestic saving rate has exhibited some decline, led by significant decline in public sector savings. This has adverse implications for the potential growth of the economy.

Inflation Outlook

10. Inflation can be expected to moderate over the next few months, from the peak levels seen in recent months. There are, however, upside risks to inflation. First, international commodity prices, particularly oil, have started to increase again. In several commodities, the import option for India to contain domestic inflation is limited, because of higher international prices. Second, the revival in private consumption demand and the bridging of the output gap will add to inflationary pressures. Finally, it is important to guard against the risk of hardening of inflation expectations conditioned by near double digit headline WPI inflation.

Overall Assessment

11. With the improving growth outlook, monetary and fiscal exit measures have started. While recovery in private demand needs to be stronger to reinforce the growth momentum, the already elevated headline inflation suggests that the weight of policy balance may have to shift to containing inflation, since high inflation itself will dampen recovery in growth. In the emerging macroeconomic scenario, monetary policy management in 2010-11 will be dominated by the challenge of moderating inflation and anchoring inflation expectations, while remaining supportive of growth impulses.

I. OUTPUT

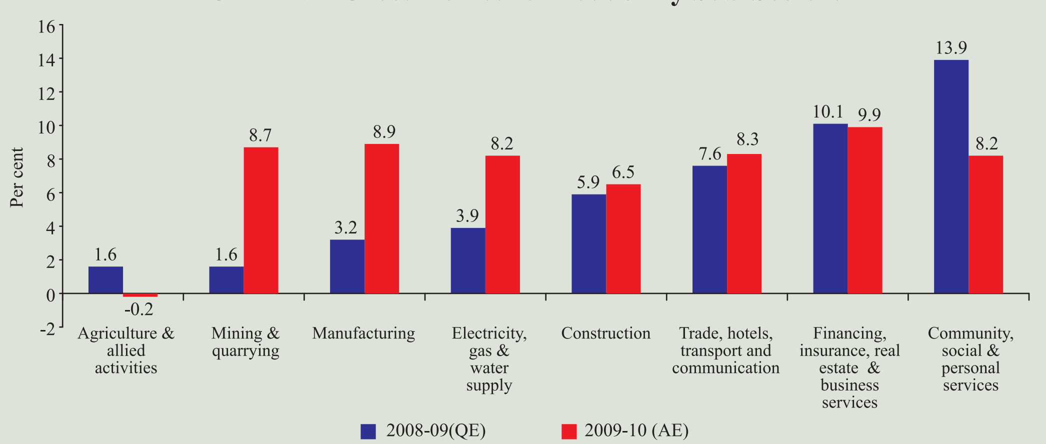
The Indian economy exhibited clear momentum in recovery, and despite the impact of a deficient monsoon on agricultural production, GDP growth for 2009-10 has been estimated at 7.2 per cent, up from 6.7 per cent recorded in 2008-09. The recovery also has been broad based, excluding "agriculture" and "community, social and personal services". The Index of Industrial Production (IIP) has shown double digit growth in recent months. Lead indicators for services activities point to overall improvement since the third quarter of 2009-10. Survey data suggest pick up in capacity utilisation levels in recent quarters, which however, remain below their previous peaks.

I.1 After experiencing a distinct moderation in growth to 6.7 per cent in 2008-09, the Indian economy recovered in 2009-10 with a growth of 7.2 per cent (as per Central Statistical Organisation (CSO) advance estimates). Five of the eight sectors/subsectors of the economy recorded higher growth rates in 2009-10 (Chart I.1).

I.2 The CSO recently revised the base year of national accounts statistics from 1999-2000 to 2004-05. Apart from revising the deflator, the new series (base : 2004-05) incorporates the available results of various surveys and studies undertaken by the CSO in collaboration with other Government agencies. The coverage of the new series has been expanded in terms of new activities, besides incorporating a number of procedural changes in estimation. There are no major changes in the overall annual growth rates between the old and new series, with the exception of 2007-08. At the sectoral level, however, there are changes in the growth rates and shares in GDP.

I.3 The overall agricultural growth during 2009-10 was earlier expected to decline significantly as in the previous drought years. However, supported by good *rabi* prospects and a strong 'allied sector', decline in agricultural and allied activities GDP for the year is now expected

Chart I.1: Gross Domestic Product By Sub-Sectors



to be much smaller at (-) 0.2 per cent as per the CSO's advance estimates.

I.4 Quarterly growth trends during 2009-10 indicate moderation in Q3 after the strong recovery seen in Q2 (Table I.1 and Chart I.2). This moderation in growth resulted primarily from two factors: first, the adverse impact of deficient monsoon on agricultural output getting largely reflected in Q3 data. Second, the impact of high base in Q3 of 2008-09, when 'community, social and personal services' had exhibited higher growth reflecting disbursement of Sixth Pay Commission arrears. If the impact of these two factors is netted out, Q3 growth maintains the momentum seen in earlier quarters. The acceleration in industrial growth has been particularly strong since December 2009.

Agricultural Situation

I.5 The deficient South-West monsoon during 2009, with a short fall of 23 per cent in precipitation, resulted in drought in several states. The North-East monsoon performance during 2009 has been satisfactory, with the cumulative rainfall being 8 per cent above normal as compared to 31 per cent below normal during the corresponding period of the previous year. The delayed withdrawal of the South West monsoon, above normal

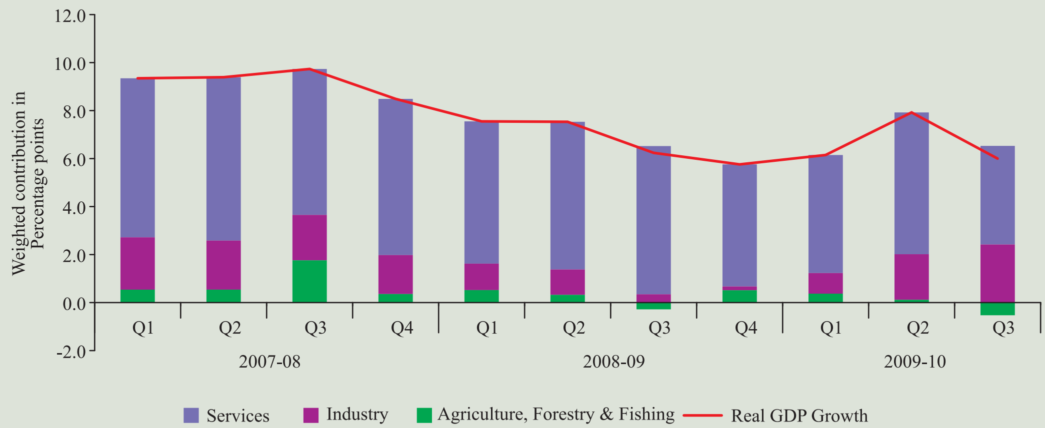
Table I.1: Growth Rates of Real GDP@

(Per cent)

Sector	2008-09*	2009-10#	2008-09			2009-10		
			Q1	Q2	Q3	Q1	Q2	Q3
1	2	3	4	5	6	7	8	9
1. Agriculture and Allied Activities	**1.6 (15.7)**	**-0.2 (14.6)**	**3.2**	**2.4**	**-1.4**	**2.4**	**0.9**	**-2.8**
2. Industry	**3.1 (20.0)**	**8.8 (20.3)**	**5.2**	**4.9**	**1.7**	**4.2**	**9.1**	**12.8**
2.1 Mining and Quarrying	1.6	8.7	2.6	1.6	2.8	7.9	9.5	9.6
2.2 Manufacturing	3.2	8.9	5.9	5.5	1.3	3.4	9.2	14.3
2.3 Electricity, Gas & Water Supply	3.9	8.2	3.3	4.3	4.0	6.2	7.4	4.9
3. Services	**9.3 (64.4)**	**8.5 (65.1)**	**9.4**	**9.4**	**10.3**	**7.7**	**8.9**	**6.6**
3.1 Trade, Hotels, Restaurants, Transport, Storage and Communication	7.6	8.3	10.8	10.0	4.4	8.1	8.5	10.0
3.2 Financing, Insurance, Real Estate and Business Services	10.1	9.9	9.1	8.5	10.2	8.1	7.7	7.8
3.3 Community, Social and Personal services	13.9	8.2	8.7	10.4	28.7	6.8	12.7	-2.2
3.4 Construction	5.9	6.5	7.1	8.0	3.0	7.1	6.5	8.7
4. Real GDP at Factor Cost	**6.7 (100)**	**7.2 (100)**	**7.6**	**7.5**	**6.2**	**6.1**	**7.9**	**6.0**
Memo:								(Amount in Rupees crore)
a. Real GDP at Factor Cost (Base: 2004-05)	41,54,973	44,53,064						
b. GDP at current market prices	55,74,449	61,64,178						

@ : At 2004-05 Prices. * : Quick Estimates. # : Advance Estimates.
Note: Figures in paranthesis indicate shares in real GDP.
Source: Central Statistical Organisation.

Chart I.2: Sectoral Contributions to Growth



North East monsoon and focused Government efforts towards improving *rabi* production are likely to have a positive effect on *rabi* output, thereby partially offsetting the losses in *kharif* output.

I.6 Encouraged by the record foodgrains production of 234.5 million tonnes during 2008-09, the Ministry of Agriculture had set a higher target of foodgrains production in 2009-10 (Table I.2). As per the Second Advance Estimates for 2009-10, total foodgrains production is estimated to decline by 7.5 per cent over the previous year. While *kharif* foodgrains and oilseeds production is expected to decline by 14.6 per cent, *rabi* production is expected to exhibit a marginal increase of 0.7 per cent. Crop-wise, a decline is expected for all crops except *tur*, gram, rapeseed and mustard, soyabean, cotton and jute.

Table I.2: Agricultural Production

(Million tonnes)

Crop	2007-08	2008-09	2009-10	
			Target	Achieve-ment@
1	2	3	4	5
Rice	96.7	99.2	100.5	87.6
Kharif	82.7	84.9	86.0	72.9
Rabi	14.0	14.3	14.5	14.7
Wheat	78.6	80.7	79.0	80.3
Coarse Cereals	40.8	40.0	43.1	34.3
Kharif	31.9	28.5	32.7	22.8
Rabi	8.9	11.5	10.5	11.5
Pulses	14.8	14.6	16.5	14.7
Kharif	6.4	4.7	6.5	4.2
Rabi	8.4	9.9	10.0	10.5
Total Foodgrains	**230.8**	**234.5**	**239.1**	**216.9**
Kharif	121.0	118.1	125.2	99.9
Rabi	109.8	116.3	114.0	117.0
Total Oilseeds	29.8	27.7	31.6	26.3
Kharif	20.7	17.8	19.4	16.2
Rabi	9.0	9.9	12.2	10.1
Sugarcane	348.2	285.0	340.0	251.3
Cotton #	25.9	22.3	26.0	22.3
Jute and Mesta ##	11.2	10.4	11.2	10.4

@ : Second advance estimate for 2009-10.
\# : Million bales of 170 kgs. each.
\## : Million bales of 180 kgs. each.
Source : Ministry of Agriculture, Government of India.

Food Management

I.7 Notwithstanding the decline in production, procurement of foodgrains (rice and wheat) during 2009-10 (up to March 15, 2010) was higher than in the previous year (Table I.3). The total stock of

Table I.3: Management of Food Stocks

(Million tonnes)

Month /Year	Opening Stock of Foodgrain			Procurement of Foodgrain			Foodgrain Off-take					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
2008-09	13.8	5.8	19.8	32.8	22.7	55.5	34.9	3.4	1.2	0.0	39.5	
2008-09@	13.8	5.8	19.8	31.2	22.7	53.9	23.0	2.0	0.1	0.0	25.1	
2009-10@	21.6	13.4	35.6	31.3	25.4	56.7	28.8	2.5	0.2	0.0	31.4	
Memo												
January 2010	24.4	23.1	47.7	4.4	0.0	4.4	–	–	–	–	–	20.0
February 2010	25.7	20.6	46.5	3.3	0.0	3.3	–	–	–	–	–	
March 2010	27.0	18.4	45.8	1.1	0.0	1.1	–	–	–	–	–	
April 2010*	–	–	–	0.4	4.4	4.8	–	–	–	–	–	16.2

PDS: Public Distribution System. OWS: Other Welfare Schemes. OMS : Open Market Sales.
– : Not Available. @ : Procurement up to March 15, off-take upto November 30. * : Procurement up to April 12.
Note : Closing stock figures may differ from those arrived at by adding the opening stocks and procurement and deducting off-take, as stocks include coarse grains also.
Source: Ministry of Consumer Affairs, Food and Public Distribution, Government of India.

foodgrains declined from the peak of 54.8 million tonnes as on June 1, 2009 to 45.8 million tonnes as on March 1, 2010 due to higher off-take. Even after the decline, both rice and wheat stocks have remained substantially higher than their respective buffer norms.

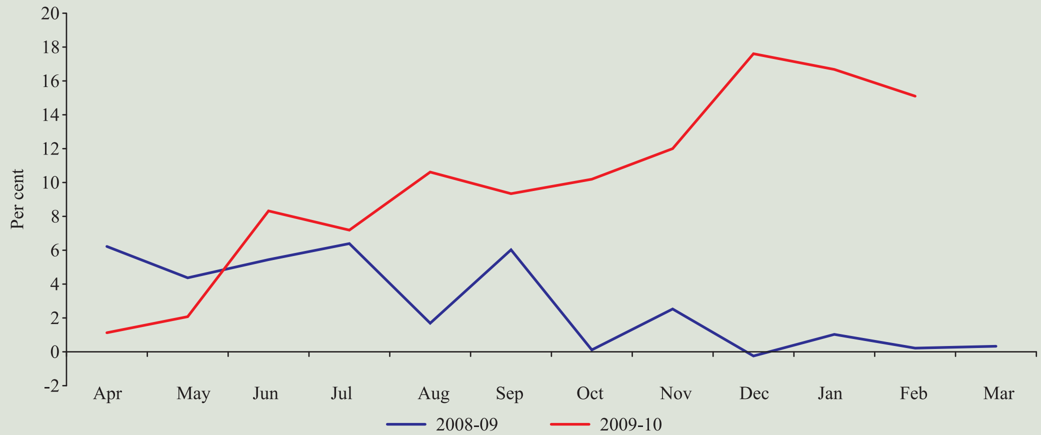
I.8 While off-take during the first half of 2009-10 was mainly through the targeted public distribution system (TPDS) and other welfare schemes, in the second half of the year, the Government allocated 3 million tonnes of wheat and 1 million tonne of rice for open market sale with a view to containing rising prices of food articles. Additional *ad hoc* allocations of 1.1 million tonnes of rice and 2.5 million tonnes of wheat were made under TPDS for the period January-February 2010 to augment supply of these items.

Industrial Performance

I.9 Industrial output, which was affected by the cyclical slowdown and international commodity price shocks in 2007-08 and the global recession in 2008-09, recovered substantially in 2009-10. The Index of Industrial Production (IIP) registered double digit growth during October 2009-February 2010 (Chart I.3 and Table I.4a). The industrial growth was driven by the manufacturing sector, with a weighted contribution of 88.8 per cent, higher than its weight of 79.4 per cent in the IIP.

I.10 Thirteen out of seventeen industries in the IIP, accounting for 59.9 per cent of the weight, recorded higher growth than in the previous year. The top five manufacturing industries with a combined weight of 36.1 per cent in the IIP contributed about 80.7 per cent of the growth during April-February 2009-10, as compared with 122.2 per cent contribution in the corresponding period in 2008-09 and 34 per cent in 2007-08. This suggests that though the recovery has become more broad-based as compared to the last year,

Chart I.3: Growth in Index of Industrial Production (y-o-y)



there is scope for further improvement (Chart I.4b).

I.11 The use-based classification of industries shows that capital goods since September 2009 and intermediate goods since August 2009 have registered double-digit growth, which will support the growth momentum in several downstream industries. Durables production, which had remained on the double-digit growth trajectory since the beginning of 2009-10, accelerated further between November 2009 and February 2010. The growth in basic goods remained relatively moderate during 2009-10, with intermittent spikes. Industry segments like 'transport equipment and parts', 'machinery and equipment other than transport equipment' and 'metal products and parts, except machinery and equipment' recorded growth

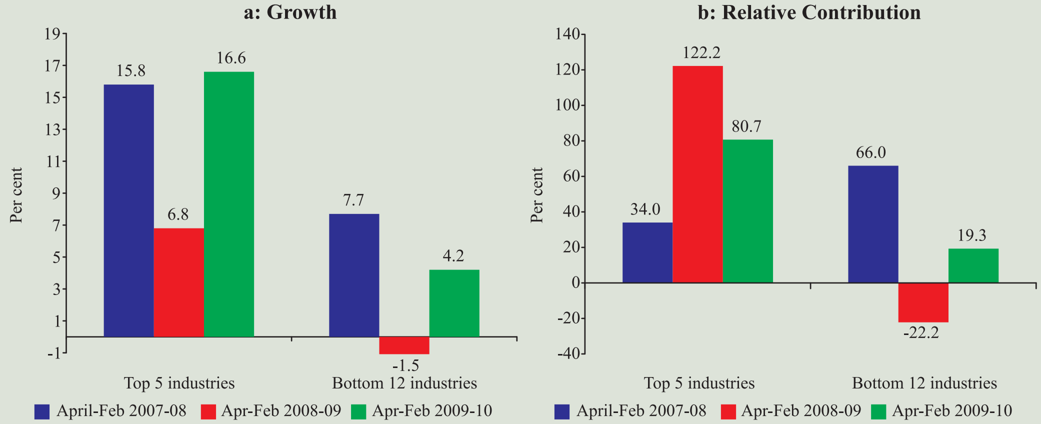
Table I.4: Index of Industrial Production: Sectoral and Use-Based Classification of Industries

(Per cent)

Industry Group	Weight in the IIP	Growth Rate			Weighted Contribution #		
		April-March 2008-09	April-Feb		April-March 2008-09	April-Feb	
			2008-09	2009-10 P		2008-09	2009-10 P
1	2	3	4	5	6	7	8
Sectoral							
Mining	10.5	2.6	2.6	9.7	6.3	5.9	6.4
Manufacturing	79.4	2.7	3.1	10.5	85.3	87.2	88.8
Electricity	10.2	2.8	2.4	5.8	8.3	6.7	4.8
Use-Based							
Basic Goods	35.6	2.6	2.7	6.7	28.4	26.7	19.8
Capital Goods	9.3	7.3	9.2	18.2	34.1	38.2	23.8
Intermediate Goods	26.5	-1.9	-2.3	13.7	-18.4	-20.2	34.0
Consumer Goods (a+b)	28.7	4.7	5.1	7.1	54.2	53.4	22.5
a) Consumer Durables	5.4	4.5	4.1	25.5	12.4	10.4	19.4
b) Consumer Non-durables	23.3	4.8	5.4	1.3	41.7	43.0	3.1
General	**100.0**	**2.7**	**3.0**	**10.1**	**100.0**	**100.0**	**100.0**

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

Chart I.4: Growth Concentration in the Manufacturing Sector



rates in the range of 36-59 per cent during December 2009-February 2010. The surge in growth of 'transport, equipment and parts' during the last few months is also corroborated by the robust performance seen in automobiles production. Overall automobiles production grew by almost 24 per cent during April-February 2009-10 and the share of exports in total production was about 13 per cent[1]. The consumer non-durables segment, remained subdued, notwithstanding some improvement in February 2010. The relative weakness in this segment could be attributed to output contraction in food products, beverages and tobacco products and jute and other vegetable fibre textiles (except cotton). Given its substantial weight in the overall consumer goods output, the weak performance of the consumer non-durable segment has dampened recovery in this sub-sector.

I.12 During the period April-January 2009-10, capacity utilisation in infrastructure sector showed a mixed trend, with finished steel and fertilizer sectors recording higher utilisation as compared with the corresponding period last year, while cement and refinery production of petroleum products witnessed lesser utlisation for the same period (Table I.5).

I.13 The Order Book, Inventory and Capacity Utilisation Survey of the Reserve Bank indicates that even though capacity utilisation has been witnessing an improvement since Q2 of 2009-10 it

Table I.5: Capacity Utilisation in Infrastructure Sector

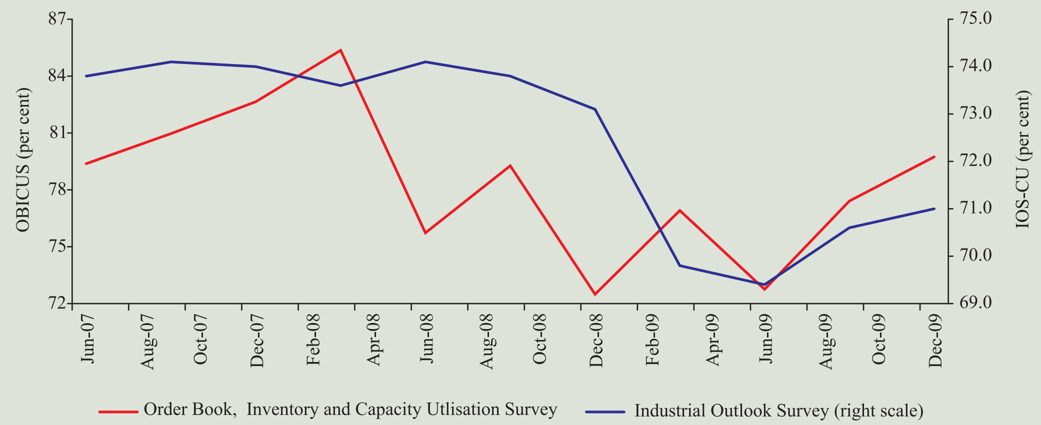
(Per cent)

Sector	2008-09 (April-January)	2009-10 (April-January)
1	2	3
Finished Steel (SAIL+VSP+ Tata Steel)	86.3	89.8
Cement	85.0	83.0
Fertilizer	84.8	95.6
Petroleum-Refinery Production	107.3	106.7

Source: Capsule Report on Infrastructure Sector Performance (April 2009-Janaury 2010), Ministry of Statistics and Programme Implementation, GoI.

[1] Source: Society for Indian Automobile Manufacturers (SIAM).

Chart I.5: Capacity Utilisation



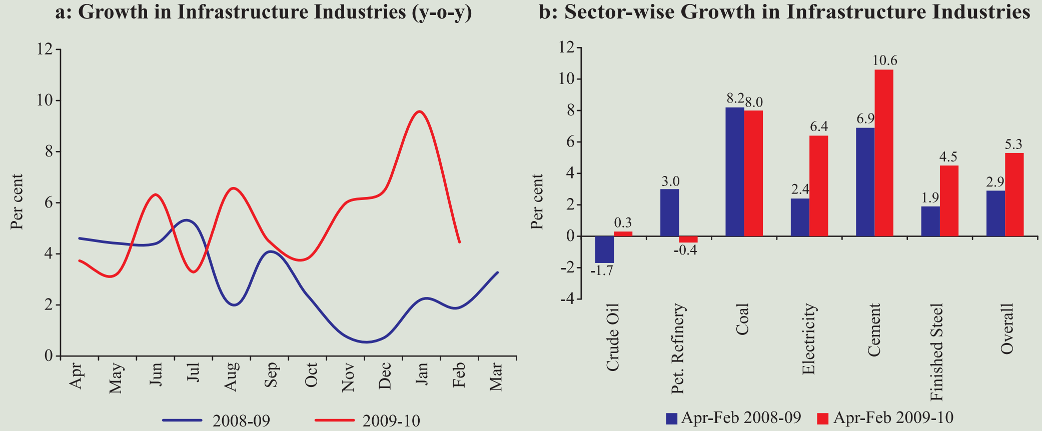
remains below the peak observed during the pre-global crisis period. Similar pattern is also observed from the Industrial Outlook Survey of the Reserve Bank (Chart I.5).

Infrastructure

I.14 The performance of core infrastructure after improving significantly during November 2009 to January 2010, decelerated in February 2010 (Charts I.6a). The slowdown in the growth of core infrastructure during February 2010 (4.5 per cent as compared to 9.4 per cent in January 2010) is led by cement and steel, which may be attributed partly to adjustment in inventories. The accelerated growth in power was led by the robust manufacturing sector performance, while the growth in the output of cement and steel until February 2010 has been on account of improved construction activity. The output of crude and petroleum products remained generally subdued during the year so far (Chart I.6b). The petroleum products picked up somewhat

Chart I.6: Growth in Infrastructure Industries

a: Growth in Infrastructure Industries (y-o-y) **b: Sector-wise Growth in Infrastructure Industries**



since August 2009, while crude oil production has recovered since December 2009. Natural gas production, which is not represented in the core infrastructure index, increased sharply during 2009-10 on account of commencement of production from the D6 block in Krishna-Godavari (KG) basin and Rajasthan fields (Cairn). Natural gas production grew by about 40 per cent in April-January 2009-10 with high growth recorded particularly during the last few months (an average of 61 per cent during November 2009- January 2010).

Services Sector

I.15 The growth of services sector, after exhibiting significant recovery in the second quarter, decelerated to 6.6 per cent in Q3 of 2009-10 (Chart I.7). The decline in the growth of 'community, social & personal services' depressed the pace of growth during Q3 of 2009-10. Growth in the output of the sub-groups *viz.*, 'construction' and 'trade, hotel, transports & communication', however, accelerated.

I.16 The lead indicators for services sector activity suggest an overall improvement, particularly since Q3 in relation to the performance in the first half of 2009-10. The services dependent on external demand such as tourist arrivals, cargo handled by seaports and airports, and passengers handled by international terminals recovered significantly during Q3 of 2009-10, reflecting the improving external environment. Services driven by domestic demand also displayed robust performance in Q3 of 2009-10, particularly those having strong linkages with the manufacturing sector. Commercial vehicle production, a lead indicator for transport services, grew significantly during Q3 of 2009-10 (Table I.6).

I.17 To sum up, GDP growth in 2009-10 has been higher than in the previous year, despite the adverse impact of the deficient South West monsoon on agricultural output. Going forward, the short-term favourable impact of certain fiscal stimulus measures on growth will be absent, which has to be compensated

Chart I.7: Trends in Quarterly Growth of Services Sector

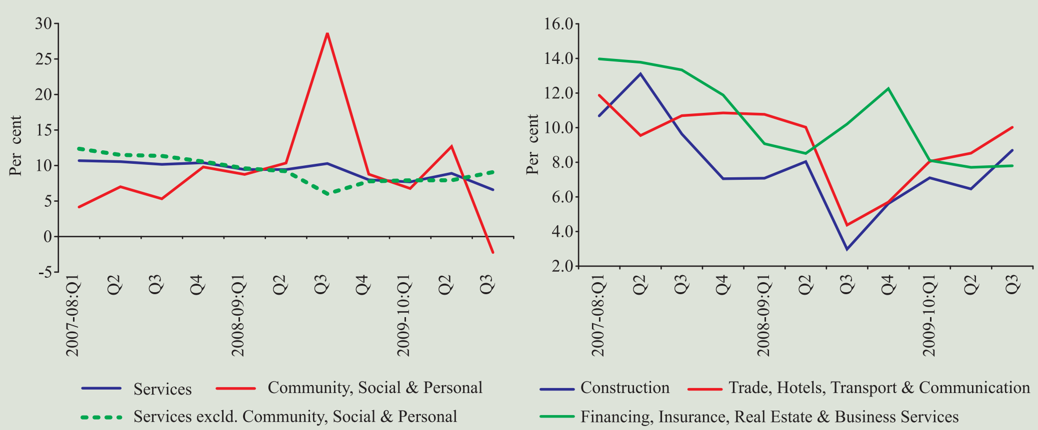


Table I.6: Indicators of Services Sector Activity

(Growth in Per cent)

			2009-10				April-February	
	2007-08	2008-09	Q1	Q2	Q3	Q4	2008-09	2009-10
1	2	3	4	5	6	7	8	9
Tourist arrivals *	12.2	-3.3	-1.7	-4.0	6.5	13.2	-3.3	3.5
Commercial vehicles production	4.8	-24.0	-18.5	5.2	127.3	152.6	-23.4	58.9
Cement ##	8.1	7.2	12.1	12.6	8.5	9.7	6.9	10.6
Steel ##	6.2	1.6	1.7	1.7	7.8	8.6	1.9	4.5
Railway revenue earning freight traffic	9.0	4.9	5.1	8.0	10.4	3.4	5.0	8.8
Cell phone connections#	38.3	44.8	59.4	52.4	69.1	29.2	73.7	51.4
Cargo handled at major ports#	12.0	2.1	2.1	3.0	10.7	13.2	3.0	6.0
Civil aviation								
Export cargo handled#	7.5	3.4	0.5	1.9	21.0	17.4	5.0	8.2
Import cargo handled#	19.7	-5.7	-12.7	-4.9	18.9	49.7	-3.5	2.8
Passengers handled at international terminals#	11.9	3.8	0.1	3.7	7.6	9.8	5.3	4.5
Passengers handled at domestic terminals#	20.6	-12.1	-6.5	22.2	30.7	20.6	-12.0	14.3

* : Data pertain to full years.
\# : Data up to January 2010.
\## : Leading Indicator for construction and up to February.
Source: Ministry of Tourism; Ministry of Commerce and Industry; Ministry of Statistics and Programme Implementation and Reserve Bank of India.

by durable growth in private demand to sustain recovery. Industrial growth has already shown sustained acceleration, and better prospects for *rabi* crops would also add momentum to the overall recovery. The lead indicators of services activities point to firmer recovery in this sector.

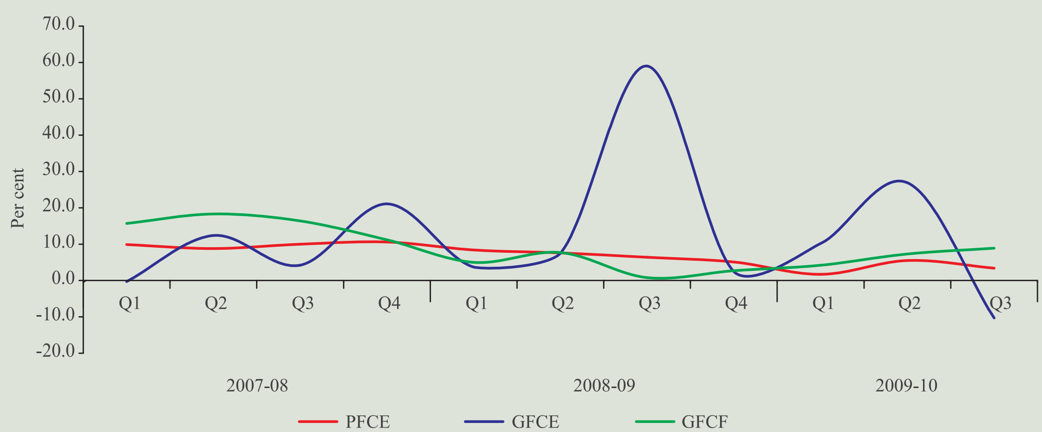
II. AGGREGATE DEMAND

Growth in private consumption demand was subdued in 2009-10, while growth in Government consumption expenditure decelerated. As a result, consumption demand, accounting for about 70 per cent of aggregate demand, is estimated to have grown at 4.8 per cent in 2009-10. Investment demand, in terms of growth in gross fixed capital formation, sustained the recovery seen over last few quarters, though remained below the growth rates seen during the pre-global crisis period. Corporate sales growth witnessed major rebound in the third quarter of 2009-10. The fiscal exit, as planned in the Union Budget for 2010-11, would contribute to improving the overall medium-term growth outlook, even though greater emphasis on quality of fiscal adjustment would be necessary. Stronger pick-up in private consumption and investment demand could be expected to drive and sustain the recovery in growth.

II.1 During the recovery phase, trends in private consumption and investment demand become critical, not only for providing information on the strength of the recovery but also for conditioning the timing and the pace of policy exit. Growth in private consumption demand moderated in 2009-10, while growth in Government consumption expenditure decelerated significantly (Chart II.1). Investment demand, in terms of growth in gross fixed capital formation, sustained the gradual recovery seen over the preceding four quarters. In comparison with the significant acceleration in the growth of capital formation during 2003-08, however, the recovery still looks subdued. Net exports during 2009-10 contributed positively to the demand side GDP, unlike in the preceding year (Chart II.2).

II.2 Data on corporate performance points to a moderation in the inventory stock to sales ratio, even though that is largely on account of the strong rebound in sales growth

Chart II.I: Growth Rates of Major Components of Domestic Demand

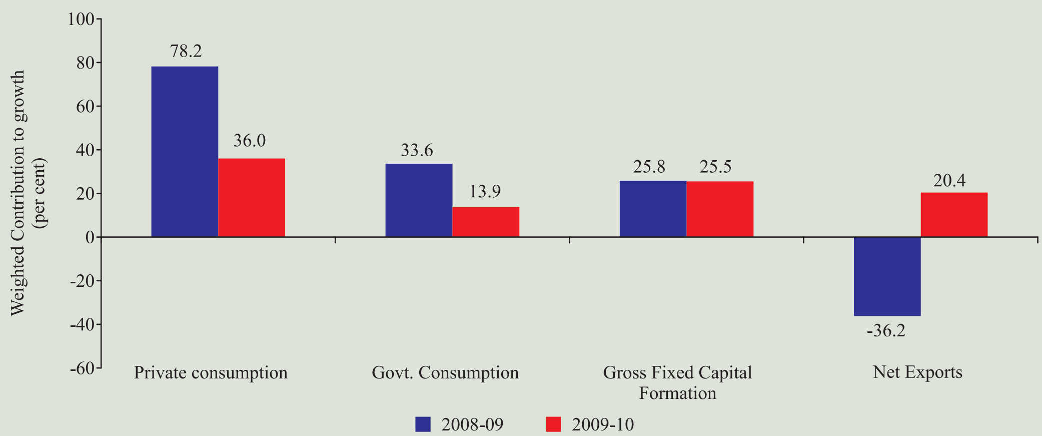


in the third quarter of 2009-10, after a phase of significant deceleration over the preceding four quarters. Strong recovery in the growth of consumer durables as per the index of industrial production (IIP) in recent months, along with the pick up in corporate sales suggests stronger revival in consumption demand in relation to the subdued growth seen in the demand side GDP data. In this context, one has to recognise the excessive weight of demand emanating from agricultural growth in the overall demand side GDP data and the associated need for referring to other relevant indicators of consumption demand for drawing policy relevant inferences. In view of the significant deceleration in the Government expenditure planned in the Union Budget for 2010-11, further pick-up in private demand will be important to sustain the recovery seen so far.

Domestic Demand

II.3 As per the new national accounts statistics series (base: 2004-05), the growth rates of GDP at factor cost for 2008-09 and 2009-10 have been higher than the growth rates of GDP at market prices reflecting the impact of fiscal stimulus measures on declines in net indirect taxes (*i.e.*, indirect tax revenues net of subsidies). Private and Government consumption expenditures have been estimated to grow at a lower rate in 2009-10 over the previous year (Table II.1). Decline in agricultural production affected private consumption demand during 2009-10, which is also reflected in the weakness in production of consumer non-durable goods in the recent period. The overall share of consumption expenditure in GDP at market prices (2004-05 prices) declined from 70.9 per cent in 2008-09 to 69.6 per cent in 2009-10. More importantly, the contribution of consumption expenditure (both private and Government) to overall GDP growth has been estimated to come down significantly from 111.8 per cent in 2008-09 to around 50 per cent in 2009-10, with declines estimated in both private and government consumption demand (Chart II.2). The contribution of gross fixed capital formation remains almost unchanged. The remaining part of the contribution to overall growth has been estimated to result from a

Chart II.2: Contribution to GDP Growth from Demand Side



sharp revival in the pattern of net exports (of goods and services). In absolute terms, while imports would exceed exports, the deceleration in the import growth in 2009-10 has been sharper than the deceleration in export growth. As a result, the share of net exports has been estimated to reverse from (-)36.2 per cent in 2008-09 to 20.7 per cent in 2009-10.

II.4 Compared to annual estimates, quarterly data show a stronger moderation in private final consumption expenditure (PFCE) growth in Q3 of 2009-10 over both the preceding quarter and the corresponding quarter of the previous year. This could be attributed to the adverse impact of a decline in agricultural output on both rural income and food prices, and hence on consumption demand. Government final consumption expenditure (GFCE) registered a sharp decline in Q3 of 2009-10 over the comparable quarter of the previous year due to the base effect of fiscal stimulus measures delivered then. Investment demand, however, picked up further during the quarter, alongside the industrial recovery; gross fixed capital formation rose by 8.9 per cent as compared to 0.8 per cent in the corresponding quarter of 2008-09.

Demand Management through Fiscal Policy

Central Government Finances: 2009-10 and 2010-11

II.5 During 2009-10, even though the expansionary fiscal stance continued in terms of further increase in the key deficit indicators

Table II.1: Demand Side of GDP (at 2004-05 prices)

(Per cent)

Item	2008-09*	2009-10#	2008-09				2009-10			April-December	
			Q1	Q2	Q3	Q4	Q1	Q2	Q3	2008-09	2009-10
1	2	3	4	5	6	7	8	9	10	11	12
Growth Rates											
Real GDP at market prices	5.1	6.8	7.0	6.9	3.1	4.0	6.1	6.8	5.9	5.5	6.3
Total Final Consumption Expenditure	8.3	4.8	7.7	7.6	13.2	4.6	2.9	8.4	0.9	9.7	3.9
(i) Private Final Consumption Expenditure	6.8	4.1	8.4	7.6	6.4	5.1	1.7	5.5	3.4	7.4	3.5
(ii) Government Final Consumption Expenditure	16.7	8.2	3.7	7.5	59.0	2.5	10.2	26.9	-10.3	23.5	5.8
Gross Fixed Capital Formation	4.0	5.2	5.0	7.7	0.8	2.7	4.2	7.3	8.9	4.4	6.9
Change in Stocks	-61.2	4.7	-60.2	-60.3	-61.9	-62.2	3.2	-45.4	-41.4	-60.8	-28.0
Net Exports	40.2	-22.4	31.2	101.0	77.7	-29.4	26.7	10.0	-25.1	71.3	1.2
Relative Shares											
Total final consumption expenditure	70.9	69.6	71.9	69.4	75.1	67.4	69.8	70.4	71.6	72.2	70.6
(i) Private	59.5	58.0	61.4	60.1	61.5	55.3	58.9	59.4	60.0	61.0	59.5
(ii) Government	11.5	11.6	10.5	9.2	13.7	12.1	10.9	11.0	11.6	11.2	11.2
Gross Fixed Capital Formation	32.9	32.5	32.7	34.9	31.7	32.6	32.1	35.1	32.6	33.1	33.2
Change in Stocks	1.3	1.3	1.4	1.4	1.3	1.3	1.4	0.7	0.7	1.4	0.9
Net Exports	-6.1	-4.5	-5.2	-8.8	-7.3	-3.5	-6.3	-9.0	-5.1	-7.1	-6.8
Memo :											
Real GDP at market prices (Rs. crore)	4465360	4767142	1042528	1057115	1159298	1206421	1105641	1129182	1228201	3258941	3463024

* : Quick Estimates. # : Advance Estimates.

Note : As only major items are included in the table, data will not add up to 100.

Source : CSO.

of the Central Government, growth in total expenditure decelerated substantially, led by significant curtailment in the growth of revenue expenditure (Table II.2). A key reason for the enlargement in all the deficit indicators during 2009-10 (RE), despite the moderation in the growth of expenditure was the much lower growth in tax receipts resulting from the cuts in indirect tax rates as well as the revenue impact of slowdown in the economy. Lower indirect taxes, by lowering the prices of manufactured products, however, would have helped in boosting demand indirectly.

II.6 The budgeted plans for 2010-11, recognising the significance of fiscal discipline for medium-term growth and inflation outlook, and also taking into account the clearer signs of recovery in GDP growth, point to the beginning of exit of fiscal stimulus measures in a calibrated manner. This is reflected in envisaged reduction in the size of all the key deficit indicators (Table II.2). The total expenditure is slated to increase at a substantially lower rate than in the previous two years. Growth in capital expenditure, which was raised significantly in 2009-10 has further been revised upwards in 2010-11. This could be expected to aid medium-term growth prospects, despite overall moderation in the growth of Government expenditure.

II.7 On the revenue front also, the Budget for 2010-11 has announced partial rollback of the central excise duties on non-petroleum products and basic duties on petroleum products. The expected increase in prices of manufactured goods following this rollback in indirect taxes may entail some dampening effects on private sector aggregate demand. Along with the impact of decelerated Government expenditure, the support from fiscal policy related measures to aggregate demand, thus, could be much less than in the preceding two years. It needs to be recognised that large fiscal stimulus was a response to an exceptional circumstance, *i.e.*, the risk of contagion from the global crisis weakening domestic growth. But by nature, these measures had to be temporary and rolled back over time to ensure sound fiscal position as a means to sustainable high growth in the medium-term.

II.8 Moreover, the Budget announced certain direct tax measures, such as increase in income tax slabs, which would increase

Table II.2: Central Government Finances

Item	Growth rate (per cent)			Per cent to GDP		
	2008-09	2009-10 (RE)	2010-11 (BE)	2008-09	2009-10 (RE)	2010-11 (BE)
1	2	3	4	5	6	7
1. Total Expenditure	30.5	15.6	8.5	15.9	16.6	16.0
2. Revenue Expenditure	33.5	14.2	5.8	14.2	14.7	13.8
3. Capital Expenditure	9.0	27.8	30.2	1.6	1.9	2.2
4. Non-Plan Expenditure	29.0	16.0	4.1	10.9	11.5	10.6
5. Plan Expenditure	34.2	14.5	18.4	4.9	5.1	5.4
6. Revenue Receipts	-0.3	6.9	18.2	9.7	9.4	9.8
i) Tax Revenue (net)	0.9	4.9	14.8	8.0	7.5	7.7
ii) Non Tax Revenue	-5.3	15.7	32.0	1.7	1.8	2.1

RE : Revised Estimate. BE : Budget Estimate.

the private disposable income by about 0.4 per cent of GDP. This will have some positive impact on aggregate demand. The concessional customs duty, exemption of excise duty and service tax announced in the Budget on a number of items such as select agricultural goods and related sectors, environment friendly products, monorail projects for urban transport, domestic manufacture of mobile phones and medical equipments will also have some positive impact on the private sector aggregate demand, while providing incentive to expand output of these goods.

State Finances

II.9 The State Governments also recognised the need for enhanced public expenditure in view of the economic slowdown in the second half of 2008-09 (Chart II.3). The increase in revenue receipts by 9.1 per cent in 2009-10 (BE) was lower than the 18.3 per cent rise recorded in 2008-09 (RE). The economic slowdown also affected the statutory transfer of tax revenues from the Centre to the States.

II.10 With a view to encouraging the State Governments to undertake additional capital investments and boost domestic aggregate demand, they were allowed to raise additional market borrowings to the extent of 0.5 per cent of the GSDP in 2008-09 and further 0.5 per cent in 2009-10. However, budget estimates for 2009-10 for capital expenditure do not seem to reflect these developments; capital expenditure as a ratio to GDP is budgeted to decline from 3.8 per cent in 2008-09 (RE) to 3.5 per cent in 2009-10 (BE). An additional factor that influenced State finances during 2009-10 but with positive implications for aggregate demand, is the implementation of the Sixth Central Pay Commission/State Pay Commissions recommendations.

Combined Fiscal Position

II.11 The fiscal stance during 2009-10 continued to be expansionary in order to boost aggregate demand and thereby contain the pace of economic slowdown. As a result, the combined fiscal deficit of the Central and State Governments during

Chart II.3: Development and Non-Development Expenditure

DE: Development Expenditure
SSE: Social Sector Expenditure
NDE: Non-Development Expenditure
GDP: Gross Domestic Product

Table II.3: 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 (Actual)	-0.9	1.1	2.5	57.3
2008-09 (Actual)	2.6	4.5	6.0	56.7
2009-10 RE	3.2	5.3	6.7	57.0
2010-11 BE	1.9	4.0	5.5	56.9
		States		
2007-08 (Actual)	-0.5	-0.9	1.5	26.8
2008-09 RE	0.7	-0.2	2.6	26.2
2009-10 BE	1.3	0.5	3.2	26.5
		Combined		
2007-08 (Actual)	-1.1	0.2	4.1	72.0
2008-09 RE	3.4	4.1	8.5	71.6
2009-10 BE	4.3	5.1	9.7	73.2

RE : Revised Estimate. BE : Budget Estimate.

2009-10 (BE) increased further to 9.7 per cent from 8.5 per cent in 2008-09 (RE) (Table II.3). Higher deficits, though, were not reflected in stronger expansion in public expenditure, since revenue receipts exhibited significant deceleration (Table II.4). Unlike in 2008-09 (RE) when substantial emphasis was placed on boosting government consumption expenditure directly, during 2009-10 (BE), the total expenditure of the combined government decelerated sharply, particularly due to containment of revenue expenditure. Thus, the direct contribution of Government expenditure to the growth in aggregate demand weakened in relation to the previous year.

Corporate Performance

II.12 The moderation in private demand during the phase of economic slowdown was evident from the corporate sales data as well. In the third quarter of 2009-10, however, year-on-year sales growth of select non-financial non-government listed companies was the highest in last five quarters. Seasonally adjusted sequential sales growth over the previous quarter also showed improvement. The rebound in sales growth points to improving private demand.

Table II.4: Combined Finances

Item	Growth rate (per cent)			Per cent to GDP		
	2007-08	2008-09 (RE)	2009-10 (BE)	2007-08	2008-09 (RE)	2009-10 (BE)
1	2	3	4	5	6	7
1. Total Expenditure	18.7	27.4	12.9	26.6	30.1	30.7
2. Revenue Expenditure	14.9	31.9	13.3	21.7	25.3	26.0
3. Capital Expenditure	38.5	8.0	10.4	4.9	4.7	4.7
4. Non-Developmental Expenditure	16.2	11.3	20.9	11.9	11.8	12.9
5. Development Expenditure	20.8	40.9	7.6	14.4	17.9	17.5
6. Revenue Receipts	21.1	11.3	8.8	21.5	21.2	20.9
i) Tax Revenue (net)	21.2	10.5	5.8	17.7	17.4	16.7
ii) Non Tax Revenue	20.5	15.2	22.1	3.7	3.8	4.2

RE : Revised Estimate. BE : Budget Estimate.

Reflecting the lower interest rate regime, interest expenses declined significantly in the third quarter of 2009-10, which also contributed to the improvement in profit after taxes. Gross and net profits rose by 60 per cent and 99.3 per cent, respectively, in Q3 of 2009-10, which was particularly aided by the low base effect of the same quarter of the previous year when profits had registered significant negative growth (Table II.5). Profit figures were further influenced by the last year's cost reduction initiatives by the Government. While year-on-year growth in net profits was impacted by low base effect, sequentially net profits rose moderately in Q3 over the previous quarter.

II.13 Reflecting the strong rebound in sales, the change in stocks to sales ratio declined in Q3 of 2009-10 (Chart II.4). The trend depicts the inventory cycle in relation to sales, and hence, a downward movement in the cycle may as much reflect an increase in sales as decrease in inventory stocks.

External Demand

II.14 Net exports (of goods and services) contributed positively (20.4 per cent) to GDP growth in 2009-10, as against a negative contribution of around 36.2 per cent in 2008-09 (Chart II.2). This revival in the pattern in the first three quarters of 2009-10 was on account of sharper contraction in imports than in exports, even though in absolute terms, imports continued to exceed exports, thereby yielding negative net exports. Export growth continued to be negative in Q3 of 2009-10, but the rate of contraction had declined over the preceding quarters, indicating signs of recovery in external

Table II.5: Performance of Non-Government Non-Financial Listed Companies

(Growth rate/ratios in per cent)

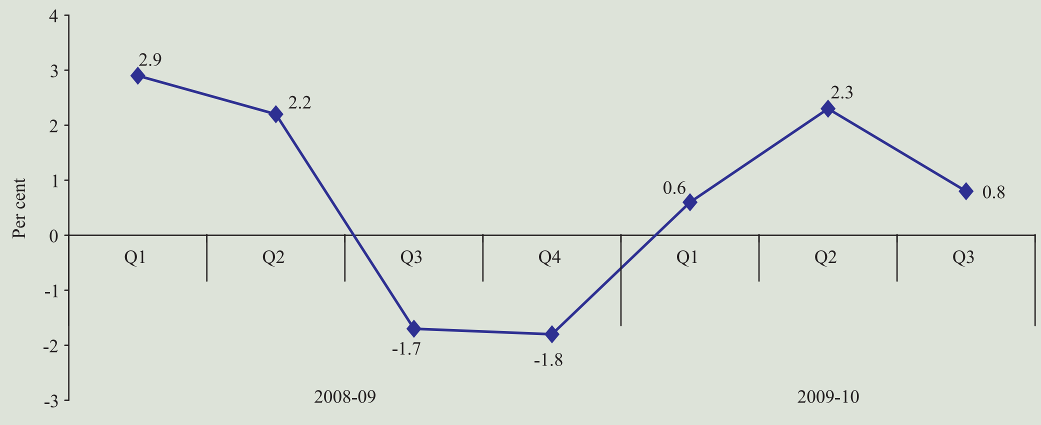
Item	2008-09	2008-09				2009-10		
		Q1	Q2	Q3	Q4	Q1	Q2	Q3
1	2	3	4	5	6	7	8	9
Sales	17.2	29.3	31.8	9.5	1.9	-0.9	0.1	22.5
Other Income*	6.6	-8.4	-0.6	-4.8	39.4	50.2	6.0	7.4
Expenditure	19.5	33.5	37.5	12.6	-0.5	-4.4	-2.5	20.6
Depreciation Provision	17.4	15.3	16.5	16.8	19.6	21.5	20.7	21.6
Gross Profits	-4.2	11.9	8.7	-26.7	-8.8	5.8	10.9	60.0
Interest Payments	57.3	58.1	85.3	62.9	36.5	3.7	-1.0	-12.3
Profits After Tax	-18.4	6.9	-2.6	-53.4	-19.9	5.5	12.0	99.3
Select Ratios								
Change in Stocks to Sales #	0.4	2.9	2.2	-1.7	-1.8	0.6	2.3	0.8
Gross Profit to Sales	13.3	14.5	13.5	11.0	13.7	15.7	14.9	14.3
Profit After Tax to Sales	8.1	9.7	8.6	5.3	8.1	10.2	9.4	8.8
Interest to Sales	3.1	2.4	2.9	3.8	3.2	2.8	3.1	2.7
Interest to Gross Profit	23.6	16.8	21.5	34.6	23.3	18.0	20.5	19.1
Interest Coverage (Times)	4.2	6.0	4.6	2.9	4.3	5.6	4.9	5.2

: For companies reporting this item explicitly.

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

Note : Though the number and composition of companies covered in each period are different, growth rates are percentage changes in the level for the period under reference over the corresponding period of the previous year for the common set of companies.

Chart II.4: Change in Stock in Trade to Sales



demand. Import growth continued to shrink at a higher rate than export growth, but the rate of decline, like in the case of exports, moderated in Q3 of 2009-10. The positive contribution of net exports could, however, reverse in the coming year as imports are likely to grow at a faster pace than exports given the prospects of Indian recovery remaining ahead of the global economy. Merchandise trade deficit during April-February (2009-10) stood at US$ 95.7 billion, which was lower by 16.6 per cent than US$ 114.7 billion in April-February 2008-09, due to relatively sharper deceleration in imports than exports during the period. The merchandise trade data also corroborate the reversal in contribution of net exports to growth in demand. A detailed discussion on the external demand conditions is set out in Chapter III.

II.15 An overall assessment of trends in aggregate demand and its different components, thus, suggests that while the support of expansionary Government expenditure to economic recovery has started to moderate significantly, private consumption demand needs to exhibit stronger momentum in growth. Investment demand has picked up and could be expected to gain further acceleration. Major rebound in corporate sales growth and robust growth in consumer durables production in the recent period point to recovery in private demand. The Union Budget for 2010-11 indicates that the direct and indirect impact of fiscal policy measures in supporting aggregate demand in 2010-11 would be much less than in the preceding two years. The fiscal exit as planned in the Union Budget for 2010-11, however, would contribute to improving the medium-term growth outlook, and the significantly stronger growth programmed for capital expenditure would also stimulate growth. Alongside calibrated exit from the expansionary fiscal and accomodative monetary policy stances, stronger pick up in private consumption and investment demand would be necessary to sustain the growth momentum.

III. THE EXTERNAL ECONOMY

India's external sector witnessed further improvement with the recovery seen in the global economy as reflected in the turnaround in exports, buoyancy in capital inflows and further accretion to the country's foreign exchange reserves. Exports recovered from 12 months of consecutive decline and posted an average growth of 20.5 per cent during November 2009-February 2010. Imports also turned around and exhibited an average growth of about 43.0 per cent during December 2009-February 2010, mirroring the impact of strong recovery in growth. India's balance of payments position during April-December 2009 remained comfortable with a modest increase in current account deficit, despite a lower trade deficit, on account of decline in invisibles surplus. There has been a turnaround in capital inflows, mainly led by portfolio inflows, reflecting the buoyant growth prospects of the Indian economy. India's foreign exchange reserves during 2009-10 increased by US$ 27.1 billion to reach US$ 279.1 billion as at end-March 2010. As on April 9, 2010, foreign exchange reserves stood at US$ 280.0 billion.

III.1 Reflecting the improving global conditions, India's merchandise exports have recovered since October 2009, after a phase of twelve consecutive months of decline. Imports have also shown a strong turnaround since December 2009, driven by the stronger recovery in growth. The balance of payments (BoP) position during April-December 2009 remained comfortable.

International Developments

III.2 The international economic situation improved further with most economies exhibiting acceleration in recovery during the fourth quarter of 2009 on the back of revival in world trade and industrial production. Since the decline in industrial production and exports had been sharper than in output during the global recession, recovery in industrial production and exports has also been stronger than in output. Global recovery, however, now seems to be multi-paced, led by the EMEs and self-sustaining recovery is yet to take hold.

III.3 Signs of recovery were particularly firm in the fourth quarter data of various economies (Chart III.1 a and b). Asia continues to spearhead the global recovery. Going forward, both advanced and emerging market economies are expected to exhibit stronger recovery in 2010, though the speed would remain divergent across the countries (Table III.1). Stronger economic frameworks and rapid policy responses have helped many emerging economies to mitigate the impact of the unprecedented external shocks.

III.4 After a period of decline in world trade over four consecutive quarters, growth in world trade has turned around (Chart III.1 c). According to the latest monthly data from the IMF (International Financial Statistics), world exports showed a positive growth of 19.1 per cent in January 2010. This was in line with the rise in world commodity prices. As per the WTO data, the world merchandise exports increased by 10.3 per cent (sequential quarter-on-quarter) in the fourth quarter of 2009, though on a year-on-year basis, the increase was lower at 3.9 per cent.

Table III.1: Select Economic Indicators - World

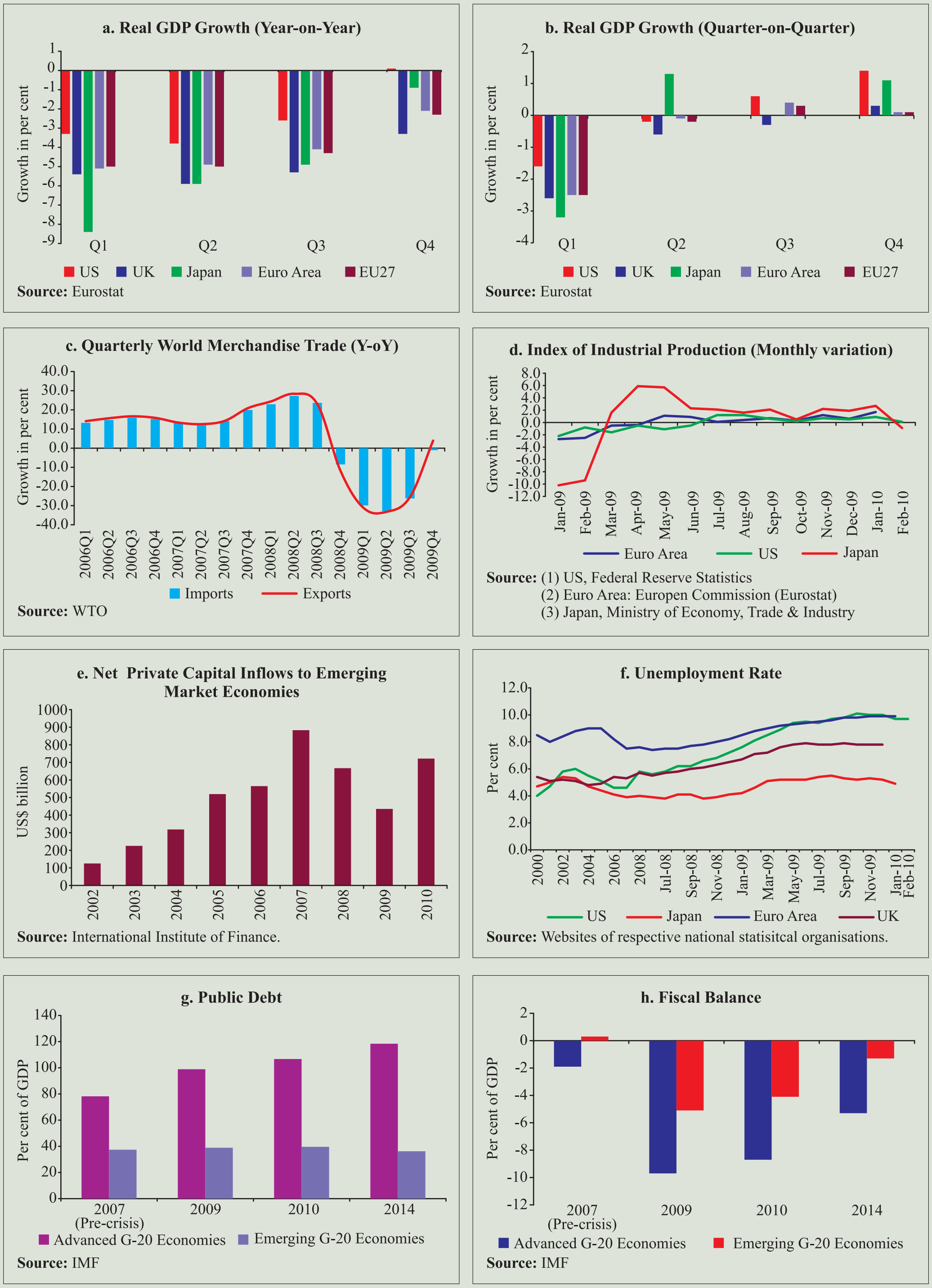
Item			2007	2008	2009	2010P
1			2	3	4	5
I.	**World Output (Per cent change) #**		**5.2** **(3.8)**	**3.0** **(1.8)**	**-0.8** **(-2.1)**	**3.9** **(3.0)**
	i)	Advanced Economies	2.7	0.5	-3.2	2.1
	ii)	Other Emerging Market and Developing Countries	8.3	6.1	2.1	6.0
		of which: Developing Asia	10.6	7.9	6.5	8.4
		India	9.4	7.3	5.6	7.7
II.	**Consumer Price Inflation (Per cent)**					
	i)	Advanced Economies	2.2	3.4	0.1	1.3
	ii)	Other Emerging Market and Developing Countries	6.4	9.2	5.2	6.2
		of which: Developing Asia	5.4	7.5	3.0	3.4
III.	**World Trade @**					
	i)	Trade Volume	7.3	2.8	-12.3	5.8
	ii)	Export Volume	7.4	2.8	-11.4	2.6
	iii)	Trade Price Deflator	8.1	11.2	-12.2	5.4
IV.	**Current Account Balance (Per cent to GDP)**					
	i)	US	-5.2	-4.9	-2.6	-2.2
	ii)	China	11.0	9.8	7.8	8.6
	iii)	India	-1.0	-2.2	-2.2	-2.5
	iv)	Middle East	18.1	18.3	2.6	7.9
V.	**Net Capital Inflows## (US$ billion)**					
	i)	Private Capital Inflows	887.8	667.1	435.2	721.6*
	ii)	Official Capital Inflows	38.7	57.2	68.0	55.8*

P : IMF Projections.
\# : Growth rates are based on exchange rates at purchasing power parities. Figures in parentheses are growth rates at market exchange rates.
@ : Average of annual percentage change for world exports and imports of goods and services.
\## : The source for data on net capital inflows to emerging market economies is International Institute of Finance (IIF).
* : IIF Projections.
Source : World Economic Outlook (WEO), October 2009 and WEO Update January 2010, International Monetary Fund.

III.5 The recovery in advanced economies was also evident in the growth of industrial production (month over month) (Chart III.1 d). With stronger recovery in EMEs and given the easy global liquidity conditions, capital inflows to EMEs have been projected to revive in 2010, though may remain much below the high level reached in the pre-global crisis period (Chart III.1 e). The persisting high unemployment has brought to the fore the risk of jobless recovery, which would influence country strategies on exit (Chart III.1 f). Post-stimulus high levels of public debt in advanced economies and the challenges of recovering to pre-crisis levels would remain a permanent concern for the global economy in the post-crisis period (Chart III.1 g and h).

III.6 On the way forward, there are significant risks to the global growth outlook. On the downside, a key risk emanates from differential growth and inflation conditions across countries leading to asymmetry in the timing of exit from crisis-time supportive policies, which may negatively impact global growth pattern and its rebalancing, besides influencing exchange rate and asset prices

Chart III.1: Key Global Indicators



in EMEs through shifts in the pattern of capital flows. The impaired financial systems/housing markets and rising unemployment in key advanced economies may hold back the recovery in household spending. Another key risk to global growth at the current juncture seems to be rising sovereign risk, presently confined to parts of Europe but likely to extend over time to other advanced economies. The other risk is the threat of rising inflation if large fiscal deficits are monetized. The still-low levels of capacity utilisation and well-anchored inflation expectations are expected to contain inflationary pressures. Growing concerns about worsening budgetary positions and fiscal sustainability could ruffle financial markets and stifle the recovery by raising the cost of borrowing for households and companies.

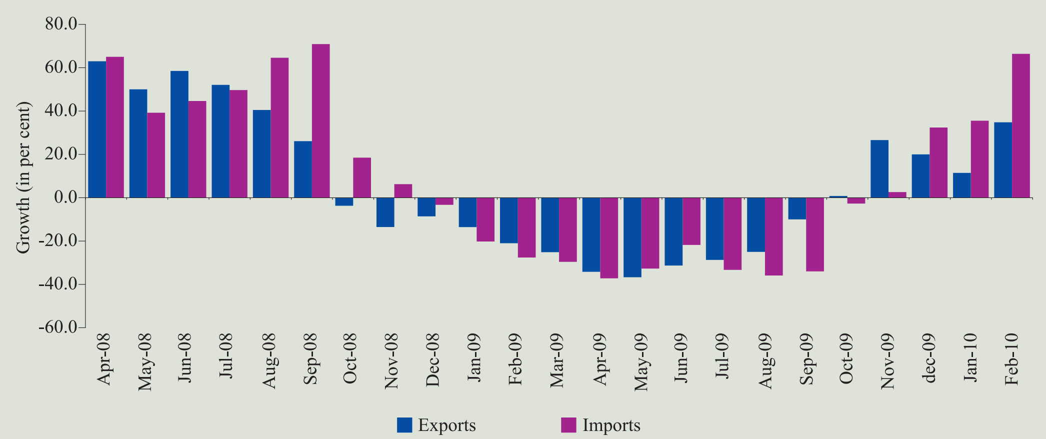
III.7 The impact of the recovery in the global economy on India's external sector was visible in the turnaround in exports and continuation of capital inflows. Despite concerns about protectionism as a response to the global crisis, the recovery in world trade projected for 2010 would improve the export prospects for India. Easy global liquidity conditions and higher growth prospects of India could add momentum to the revival in capital flows seen so far. The de-coupling of recovery across countries and the increasing divergence of inflationary conditions were also reflected in India. This suggests that while global developments continue to impact India, there is greater evidence of asymmetry, both in terms of the pace of recovery and the headline inflation.

Merchandise Trade

Exports

III.8 Trade channel of the contagion from the global crisis had affected India's export performance, which declined over twelve consecutive months. Since October 2009, export growth has turned around (Chart III.2). Export growth averaged at 20.5 per cent during November 2009 to February 2010. The increase in exports has coincided with the uptrend in world commodity prices as well as the recovery in the global economy. Cumulatively,

Chart III.2: India's Merchandise Trade



exports during 2009-10 (April-February) registered a decline of 11.4 per cent as against a growth of 18.2 per cent a year ago.

III.9 Commodity-wise exports data for the period 2009-10 (April-September) revealed that manufactured goods continued to maintain their largest share (69.4 per cent), followed by petroleum and primary products. Moreover, during the period, the share of manufactured goods increased along with decline in the shares of petroleum and primary products. During April-September 2009, the exports of all major commodity groups declined (Table III.2).

III.10 Destination-wise, developing countries and OECD countries were the major markets for India's exports, accounting for 37.9 per cent and 36.6 per cent shares, respectively. Another major destination was OPEC with 23.3 per cent share. Country-wise, the UAE (with a share of 14.1 per cent) was the largest destination for India's total exports followed by the US, China, Singapore, Hong Kong and the UK. Exports to all major export destinations declined during the period.

Imports

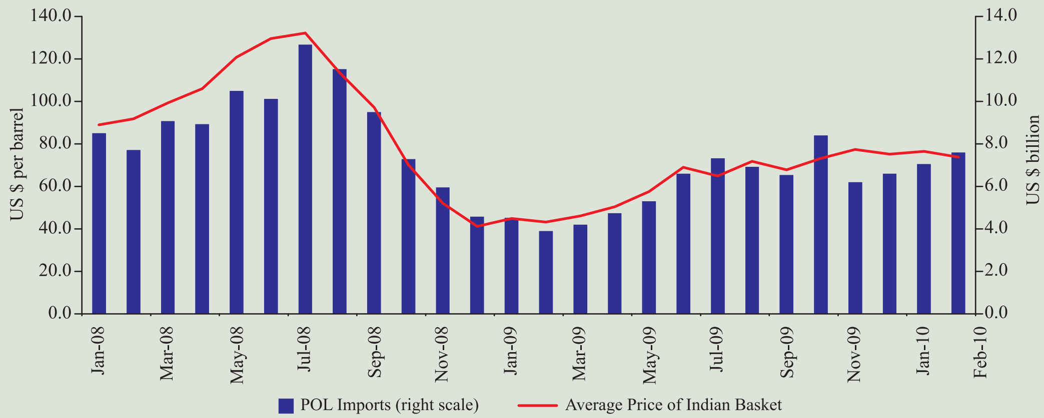
III.11 India's imports, after declining since December 2008 for eleven months, exhibited reversal in trend in November 2009 with an increase of 2.6 per cent. The uptrend in imports continued through February 2010. Between December 2009 and February 2010, import growth averaged at 43.0 per cent. Cumulatively, during 2009-10 (April-February), imports recorded a decline of 13.5 per cent in contrast with a growth of 25.9 per cent a year ago, which resulted from lower international crude oil prices during the period and slowdown in domestic economic activity. Reflecting the increase in oil prices and the higher volume of oil imports on account of the economic

Table III.2: Exports of Principal Commodities

Commodity/Group	US$ billion			Variation (Per cent)		
	2008-09 April-March	2008-09R April-September	2009-10P April-September	2008-09 April-March	2008-09R April-September	2009-10P April-September
1	2	3	4	5	6	7
1. Primary Products	**25.3**	**14.8**	**10.5**	**-8.0**	**43.0**	**-29.3**
of which:						
a) Agriculture and Allied Products	17.5	10.3	7.2	-4.9	50.8	-30.6
b) Ores and Minerals	7.8	4.5	3.3	-14.5	27.6	-26.5
2. Manufactured Goods	**123.1**	**70.6**	**54.3**	**19.6**	**46.4**	**-23.0**
of which:						
a) Chemicals and Related Products	22.7	12.6	10.2	7.1	31.5	-19.0
b) Engineering Goods	47.3	27.1	18.6	26.5	58.1	-31.3
c) Textiles and Textile Products	20.0	10.6	9.3	3.0	13.6	-11.6
d) Gems and Jewellery	28.0	17.4	13.7	42.1	81.3	-20.9
3. Petroleum Products	**26.8**	**18.7**	**10.7**	**-5.4**	**47.4**	**-43.0**
4. Total Exports	**185.3**	**108.9**	**78.3**	**13.7**	**48.1**	**-28.1**
Memo:						
Non-oil Exports	158.5	90.2	67.6	17.8	48.2	-25.0

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

Chart III.3: India's POL Imports and International Crude Oil Prices



recovery, oil imports have increased during the recent period (Chart III.3).

III.12 The commodity-wise imports during April-September 2009 indicated slowdown in non-POL imports, which was mainly due to sharp decline in imports of capital goods, gold and silver, pearls, precious and semi-precious stones, chemicals, iron and steel. Imports of edible oil and pulses, however, witnessed considerable growth, reflecting domestic supply constraints and higher prices (Table III.3).

Table III.3: Imports of Principal Commodities

Commodity/Group	US$ billion			Variation (Per cent)		
	2008-09	2008-09R	2009-10P	2008-09	2008-09R	2009-10P
	April-March	April-September		April-March	April-September	
1	2	3	4	5	6	7
Petroleum, Petroleum Products & Related Material	91.3	63.3	37.4	14.6	83.0	-40.8
Edible Oil	3.4	1.5	2.4	34.4	4.7	67.4
Iron and Steel	9.5	5.1	3.9	8.9	14.5	-24.3
Capital Goods	71.6	39.0	29.2	2.2	53.7	-25.0
Pearls, Precious and Semi-Precious Stones	16.6	10.5	5.5	107.6	122.2	-47.7
Chemicals	12.2	7.6	5.6	23.1	61.4	-26.3
Gold and Silver	21.8	15.4	11.6	22.3	32.3	-24.6
Total Imports	**303.7**	**185.0**	**124.6**	**20.8**	**55.1**	**-32.6**
Memo:						
Non-oil Imports	212.4	121.7	87.2	23.6	43.8	-28.4
Non-oil Imports excluding Gold and Silver	190.5	106.3	75.5	23.8	45.6	-28.9
Mainly Industrial Inputs*	169.3	94.9	67.3	20.2	40.4	-29.1

R: Revised. P: Provisional.

*: Non-oil imports net of gold and silver, bulk consumption goods, manufactured fertilisers and professional instruments.

Source : DGCI&S.

Table III.4: India's Merchandise Trade

(US$ billion)

Item	April-March		April-February			
	2008-09R		2008-09 R		2009-10 P	
	Absolute	Growth (%)	Absolute	Growth (%)	Absolute	Growth (%)
1	2	3	4	5	6	7
Exports	185.3	13.7	172.4	18.2	152.7	-11.4
Oil	26.8	-5.4	25.4	4.4	..	..
Non-oil	158.5	17.8	147.0	20.9	..	..
Imports	303.7	20.8	287.1	25.9	248.4	-13.5
Oil	91.3	14.6	89.5	26.6	73.2	-18.2
Non-oil	212.4	23.6	197.6	25.6	175.2	-11.4
Trade Balance	**-118.4**	**33.7**	**-114.7**	**39.6**	**-95.7**	**-16.6**
Non-Oil Trade Balance	**-53.9**	**44.8**	**-50.6**	**41.4**	**..**	**..**

R: Revised. P: Provisional. .. Not Available.
Source: DGCI&S.

III.13 Source-wise, during April-September 2009, developing countries had the highest share in India's imports (33.6 per cent), followed by OECD (32.7 per cent) and OPEC (30.7 per cent). Country-wise, China continued to be the single largest source of imports with a share of 12.0 per cent in India's total imports, followed by the US, the UAE, Saudi Arabia, Australia and Iran.

III.14 Merchandise trade deficit during 2009-10 (April-February) stood at US$ 95.7 billion, which was lower by 16.6 per cent than the level during 2008-09 (April-February), reflecting relatively larger decline in imports than exports (Table III.4).

Balance of Payments (BoP)

Current Account

III.15 The impact of global economic recovery was visible in different accounts of India's balance of payments. The current account position during the third quarter of 2009-10 witnessed a turnaround in both exports and imports. India's merchandise exports (on BoP basis) registered a robust growth in the third quarter of 2009-10 as compared with decline in the corresponding period of 2008-09. Imports (on BoP basis) increased moderately during the quarter as compared with a higher growth in the corresponding quarter of the previous year. Trade deficit was lower during the third quarter of 2009-10 as compared with the preceding quarter and the corresponding quarter a year ago. During April-December 2009 also, trade deficit remained lower (US $ 89.5 billion) as compared with the corresponding period of the preceding year (US$ 98.4 billion) led by decline in both oil and non-oil imports (Table III.5).

Invisibles

III.16 The robust growth observed in invisibles receipts and payments in the past few years was reversed during 2009-10, reflecting the lagged impact of the recession in advanced economies. The decline was seen in both factor and non-factor components. Although software exports witnessed a turnaround, the decline in non-software exports mirroring the impact of

Table III.5: India's Balance of Payments

(US $ billion)

	2008-09PR	2008-09			2009-10			2008-09	2009-10
	April-March	Apr-Jun PR	Jul-Sep PR	Oct-Dec PR	Apr-Jun PR	Jul-Sep PR	Oct-Dec P	Apr-Dec PR	Apr-Dec P
1	2	3	4	5	6	7	8	9	10
1. Exports	189.0	57.5	53.6	39.4	37.9	41.9	44.6	150.5	124.5
2. Imports	307.7	82.7	92.8	73.5	64.8	73.8	75.4	249.0	214.0
3. Trade Balance (1-2)	-118.7	-25.3	-39.1	-34.0	-26.9	-31.9	-30.7	-98.4	-89.5
4. Net Invisibles	89.9	22.0	26.5	22.4	20.5	20.0	18.7	70.9	59.2
5. Current Account Balance (3+4)	-28.7	-3.3	-12.6	-11.7	-6.4	-11.9	-12.0	-27.5	-30.3
6. Gross Capital Inflows	312.4	94.4	90.0	68.7	77.9	97.7	81.5	253.1	257.1
7. Gross Capital Outflows	305.2	89.5	82.9	74.8	72.0	75.1	66.8	247.2	213.9
8. Net Capital Account (6-7)	7.2	4.9	7.1	-6.1	5.9	22.6	14.7	5.8	43.2
9. Overall Balance (5+8)#	-20.1	2.2	-4.7	-17.9	0.1	9.4	1.8	-20.4	11.3
Memo:									
i. Export growth (%)	13.7	57.0	39.6	-8.4	-34.0	-21.8	13.2	27.5	-17.3
ii. Import growth (%)	19.4	46.8	54.8	9.2	-21.7	-20.4	2.6	35.6	-14.0
iii. Trade balance (as a % of GDP)	-9.8								
iii. Invisibles receipts growth (%)	9.8	31.8	33.1	5.4	-6.3	-13.0	-3.1	22.2	-7.7
iv. Invisibles payments growth (%)	0.6	18.5	12.0	2.4	-5.8	3.3	12.9	10.4	3.7
vi. CAD as a % of GDP	2.4								
vii. Foreign Exchange Reserves (as at end of Period)	252.0	312.1	286.3	256.0	265.1	281.3	283.5	256.0	283.5

Overall balance also includes errors and omissions apart from items 5 and 8.
PR: Partially Revised. P: Preliminary.

global economic slowdown resulted in a decline in the overall services exports during the quarter. The decline in investment income receipts during the quarter was mainly on account of continued lower interest rates in advanced economies. Private transfer receipts, however, remained strong during the quarter. Invisibles payments registered a higher growth during the quarter as compared with the corresponding period of 2008-09. Overall, the net invisibles (*i.e.*, invisibles receipts *minus* invisibles payments) were lower during the quarter as compared with the corresponding period of the previous year (Table III.6).

III.17 During April-December 2009, invisibles receipts (except private transfer receipts) registered a decline, while invisibles payments witnessed a marginal increase over the corresponding period of the previous year. Net services exports of India declined by 36.9 per cent during April-December 2009 as against an increase of 30.9 per cent during the corresponding period of last year, mainly due to significant decline in services receipts coupled with increase in services payments. While the decline in services receipts was due to decline in almost all the components of services, the increase in services payments was mainly driven by business and financial services. Consequently, net invisibles stood lower during April-December 2009 as compared with the corresponding period of the previous year. At this level, the invisibles surplus financed 66.1 per cent of trade deficit during April-December 2009 as against 72.1

Table III.6: Invisibles Gross Receipts and Payments

(US$ billion)

Item	Invisibles Receipts		Invisibles Payments	
	April-December			
	2008-09 PR	2009-10 P	2008-09 PR	2009-10 P
1	2	3	4	5
1. Travel	8.2	7.9	6.8	6.6
2. Transportation	8.4	8.0	10.3	8.4
3. Insurance	1.1	1.2	0.8	1.0
4. Govt. not included elsewhere	0.3	0.3	0.4	0.4
5. Miscellaneous	60.0	47.7	20.6	24.2
Of which:				
Software	35.5	34.9	2.4	1.2
Non-Software	24.5	12.8	18.2	23.1
6. Transfers	37.6	41.2	2.3	1.7
Of which				
Private Transfers	37.1	40.8	2.0	1.3
7. Income	10.9	10.3	14.2	15.3
Investment Income	10.3	9.6	13.2	14.1
Compensation of Employees	0.6	0.7	1.0	1.2
Total (1 to 7)	**126.4**	**116.7**	**55.5**	**57.5**

P: Preliminary. PR: Partially Revised.

per cent during April-December 2008. Despite lower trade deficit, the fall in invisibles surplus led to marginally higher current account deficit during the third quarter of 2009-10 (Chart III.4). The current account deficit during April-December 2009 stood at US$ 30.3 billion, higher than US$ 27.5 billion during April-December 2008. During 2008-09, current account deficit as a per cent of GDP stood higher at 2.4 per cent as compared to 1.3 per cent a year ago.

Capital Account

III.18 Capital flows continued to remain buoyant during the third quarter of 2009-10, mainly led by large inflows under foreign direct investments, portfolio investments and short-term trade credits (Chart III.4 and Table III.7).

III.19 The latest available information on certain indicators of the capital account indicates that the revival in capital inflows, which started at the beginning of 2009-10 and gathered momentum in the second and third quarters, has remained buoyant even in the last quarter (Table III.8). Stronger recovery in 2009-10 ahead of the global

Chart III.4: Current Account and Capital Flows

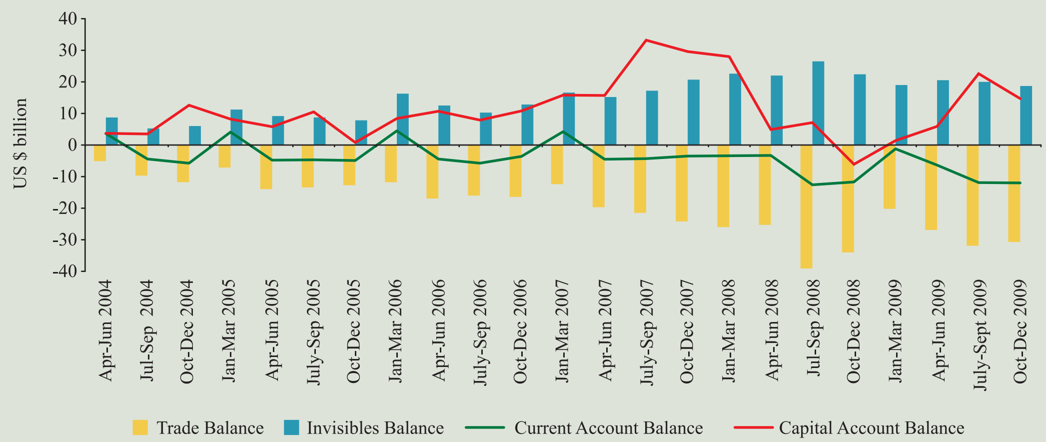


Table III.7: Net Capital Flows

(US$ billion)

Item	2007-08 April-March R	2008-09 April-March PR	2008-09 Apr-Jun PR	Jul-Sep PR	Oct-Dec PR	2009-10 Apr-Jun PR	Jul-Sep PR	Oct-Dec P	2008-09 Apr-Dec PR	2009-10 Apr-Dec P
1	2	3	4	5	6	7	8	9	10	11
1. Foreign Direct Investment (FDI)	15.9	17.5	9.0	4.9	0.5	6.1	6.5	3.9	14.3	16.5
Inward	34.7	35.0	11.9	8.8	6.3	8.7	10.7	7.1	27.0	26.6
Outward	18.8	17.5	2.9	3.9	5.9	2.6	4.2	3.2	12.7	10.0
2. Portfolio Investment	27.4	-14.0	-4.2	-1.3	-5.8	8.3	9.7	5.7	-11.3	23.6
Of which:										
FIIs	20.3	-15.0	-5.2	-1.4	-5.8	8.2	7.0	5.3	-12.4	20.5
ADR/GDRs	6.6	1.2	1.0	0.1	–	0.04	2.7	0.4	1.1	3.2
3. External Assistance	2.1	2.6	0.4	0.5	1.0	0.1	0.5	0.6	1.9	1.2
4. External Commercial Borrowings	22.6	7.9	1.5	1.7	3.8	-0.5	1.2	1.5	6.9	2.3
5. NRI Deposits	0.2	4.3	0.8	0.3	1.0	1.8	1.0	0.6	2.1	3.5
6. Banking Capital excluding NRI Deposits	11.6	-7.5	1.9	2.0	-6.0	-5.2	3.4	1.3	-2.1	-0.5
7. Short-term Trade Credits	15.9	-1.9	4.5	0.4	-4.2	-1.5	0.8	3.3	0.7	2.7
8. Rupee Debt Service	-0.1	-0.1	-0.03	–	–	-0.02	–	–	-0.03	-0.02
9. Other Capital	11.0	-1.5	-8.9	-1.4	3.7	-3.2	-0.6	-2.2	-6.6	-6.1
Total (1 to 9)	**106.6**	**7.2**	**4.9**	**7.1**	**-6.1**	**5.9**	**22.6**	**14.7**	**5.8**	**43.2**

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

economy coupled with positive sentiments of global investors about India's growth prospects are the factors that underlie the momentum of sustained capital inflows during the year.

Table III.8: Capital Flows in 2009-10, so far

(US$ billion)

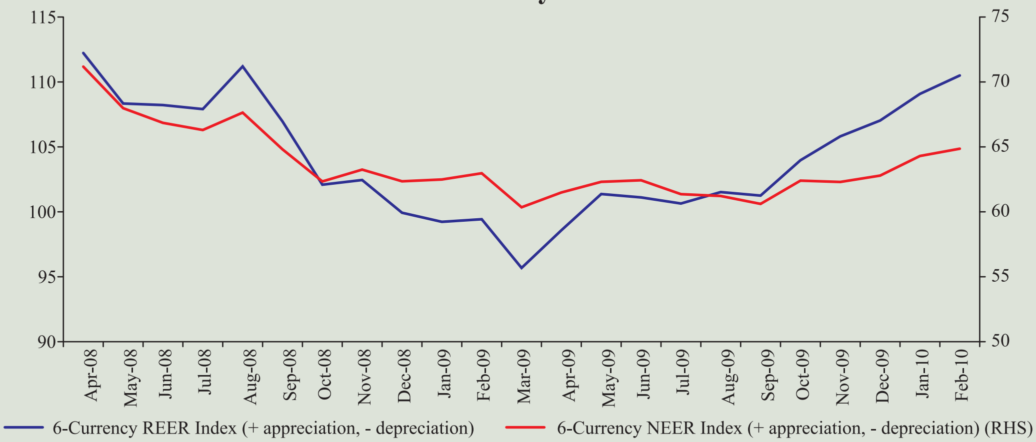
Component	Period	2008-09	2009-10
1	2	3	4
FDI to India	April-Feb.	31.3	33.1
FIIs (net)	April-Mar.	-15.0	29.0
ADRs/GDRs	April-Mar.	1.2	3.3
ECB Approvals	April-Mar.	17.2	21.7
NRI Deposits (net)	April-Feb.	2.9	3.0

FDI : Foreign Direct Investment.
FII : Foreign Institutional Investors.
ECB : External Commercial Borrowings.
NRI : Non Resident Indians.
ADR : American Depository Receipts.
GDR : Global Depository Receipts.

III.20 Going forward, capital inflows to India during 2010-11 are expected to be stronger driven by both push and pull factors. While the push factors for surge in capital inflows include excess global liquidity accompanied by low interest rates leading to search for higher yield, the pull factors include the buoyant growth prospects, favourable interest rate differential and relaxation of ECB norms for 3G spectrum. Higher expected capital inflows, however, may exert pressures on asset prices and exchange rate.

III.21 The appreciation of the rupee against the US dollar and increase in inflation differentials between India and its trading partners during the year led to appreciation of the real exchange rate (Chart III.5 and Table III.9).

Chart III.5: 6-Currency REER and NEER



Foreign Exchange Reserves

III.22 On balance of payments basis (*i.e.*, excluding valuation effects), the foreign exchange reserves increased by US$ 11.3 billion during April-December 2009 as against a decline of US$ 20.4 billion during April-December 2008. The valuation gain, reflecting the depreciation of the US dollar against the major international currencies, accounted for US$ 20.2 billion during April-December 2009 as compared with a valuation loss of US$ 33.4 billion during April-December 2008. Accordingly, valuation gain during April-December 2009 accounts for 64.1 per cent of the total gross increase in foreign exchange reserves.

Table III.9: Nominal and Real Effective Exchange Rate of the Indian Rupee (Trade-based Weights, Base : 1993-94)

(Per cent appreciation + /depreciation -)

	2007-08	2008-09 (P)	2008-09 (Apr-Feb)	2009-10 (Apr-Feb)
1	2	3	4	5
36-currency REER	6.4	-10.0	-11.1	9.8
36-currency NEER	9.3	-9.9	-6.9	7.5
6-currency REER	8.2	-8.5	-10.4	15.5
6-currency NEER	7.6	-13.2	-11.2	7.5
Rs/USD	12.5	-12.4	-21.5*	12.9*

NEER : Nominal Effective Exchange Rate.
REER : Real Effective Exchange Rate. P: Provisional.
*: Up to end-March.

Note: 1. Data from 2008-09 onwards are provisional.
2. Rise in indices indicates appreciation of the rupee and *vice versa*.

III.23 During 2009-10, India's foreign exchange reserves increased by US$ 27.1 billion to reach US$ 279.1 billion as at end-March 2010 (Table III.10 and Chart III.6). Foreign currency assets (FCAs) increased by US$ 13.3 billion during the year. Furthermore, the Reserve Bank purchased 200 metric tonnes of gold from the IMF on November 3, 2009 as part of the Reserve Bank's foreign exchange reserve management operations. The foreign exchange reserves, however, remained unaffected by this transaction as it merely reflected substitution of foreign currency assets by gold. The IMF made additional allocations of SDRs to India in two tranches, *viz.*, general allocation of SDR 3,082 million (equivalent to US$ 4.82

Table III.10: Foreign Exchange Reserves

(US $ million)

End of 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 2000	2,974	4	35,058	658	38,694	(-) 675
March 2009	9,577	1	241,426	981	251,985	(-) 2,042
June 2009	9,800	1	254,093	1,248	265,142	(+) 745
September 2009	10,316	5,224	264,373	1,365	281,278	(+) 539
December 2009	18,292	5,169	258,583	1,426	283,470	(+) 525
January 2010	18,056	5124	256362	1,413	280,955	(+) 525
February 2010	17,920	5053	253991	1,393	278,357	(+) 525
March 2010	17,986	5,006	254,685	1,380	279,057	–
April 2010 ##	17,986	5,000	255,663	1,379	280,028	–

* : Excludes US$ 250 million invested in foreign currency denominated bonds issued by IIFC(UK) since March 20, 2009.

@ : Include SDRs 3,082.5 million allocated under general allocation and SDRs 214.6 million allocated under special allocation by the IMF on August 28, 2009 and September 9, 2009, respectively.

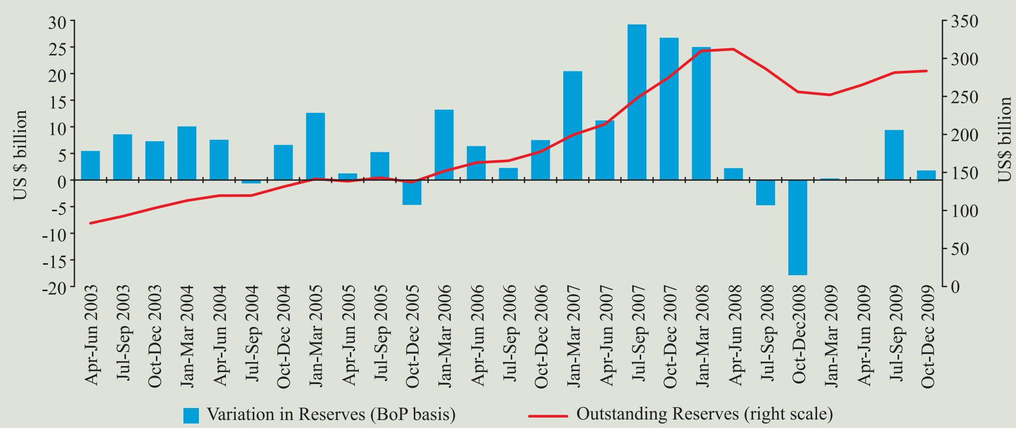
: As on April 9, 2010. – : Not available.

billion) on August 28, 2009 and a special allocation of SDR 214.6 million (equivalent to US$ 0.34 billion) on September 9, 2009. Foreign exchange reserves stood at US$ 280.0 billion as on April 9, 2010.

External Debt

III.24 India's external debt stock at US$ 251.4 billion at end-December 2009 recorded an increase of US$ 26.8 billion over its level at end-March 2009, mainly

Chart III.6: India's Foreign Exchange Reserves



on account of increase in long-term debt (Table III.11). Both long-term and short-term debt increased at end-December 2009 from their levels at end-March 2009. Of the total increase in India's external debt at end-December 2009, the valuation effect on account of depreciation of US dollar against major international currencies accounted for 36.9 per cent.

III.25 The ratio of short-term to total debt declined at end-December 2009 from its level at end-March 2009. Similarly, the ratio of short-term debt to foreign exchange reserves moderated during the period. In terms of currency composition, the US dollar denominated debt accounted for the major portion of total external debt at end-December 2009.

International Investment Position

III.26 India's net international liabilities were placed at US$ 117.1 billion at end-December 2009 as compared with US$ 96.0 billion at end-September 2009. The international assets increased from US$ 378.9 billion at end-September 2009 to US$ 385.9 billion at end-December 2009, mainly on account of increase in direct investment abroad, reserve assets, and other investment during the quarter. The increase in international liabilities from US$ 474.8 billion to US$ 503.0 billion during the same period was on account of an increase in inward direct investment and portfolio equity investment (Chart III.7).

III.27 India's external sector, thus, improved alongside the recovery in global economy and further stabilisation in

Table III.11: India's External Debt

(US $ billion)

Item	End-March 2008	End-March 2009	End-September 2009	End-December 2009	Variation (Dec 2009 over March 2009)	
					Amount	Per cent
1	2	3	4	5	6	7
1. Multilateral	39.5	39.5	42.4	42.7	3.2	8.1
2. Bilateral	19.7	20.6	22.1	22.3	1.7	8.4
3. International Monetary Fund*	1.1	1.0	6.3	6.2	5.2	512.7
4. Trade Credit (above 1 year)	10.3	14.5	15.4	15.7	1.2	8.2
5. External Commercial Borrowings	62.3	62.4	66.6	70.0	7.5	12.1
6. NRI Deposit	43.7	41.6	46.0	47.5	5.9	14.3
7. Rupee Debt	2.0	1.5	1.6	1.6	0.1	7.9
8. Long-term (1 to 7)	178.7	181.2	200.3	206.2	25.0	13.8
9. Short-term	45.7	43.4	42.4	45.2	1.9	4.3
Total (8+9)	**224.4**	**224.6**	**242.7**	**251.4**	**26.8**	**11.9**
Memo:						(Per cent)
Total Debt /GDP	19.0	21.5	–			
Short-term Debt/Total Debt	20.4	19.3	17.5	18.0		
Short-term Debt/Reserves	14.8	17.2	15.1	15.7		
Concessional Debt/Total Debt	19.7	18.7	18.4	17.7		
Reserves/Total Debt	138.0	112.1	115.9	112.8		
Debt Service Ratio	4.7	4.4	4.9	5.1		

* : Includes SDR allocations by the IMF on August 28, 2009 and September 9, 2009.

Chart III.7: International Investment Position of India

global financial conditions. This was reflected in the turnaround in exports and continued buoyancy in capital inflows. Despite higher net capital inflows during 2009-10, reflecting improved absorptive capacity of the economy, capital inflows mostly financed the higher current account deficit. Reflecting easy global liquidity conditions and both interest rate and growth differentials in favour of India, capital inflows are expected to be strong, which may put pressure on asset prices and exchange rate. Global commodity price trends, particularly possible firming up of oil prices could exert pressures on the balance of payments through higher imports. For dealing with the external shocks transmitting through various accounts of the balance of payments, it is important to have adequate foreign exchange reserves.

IV. MONETARY CONDITIONS

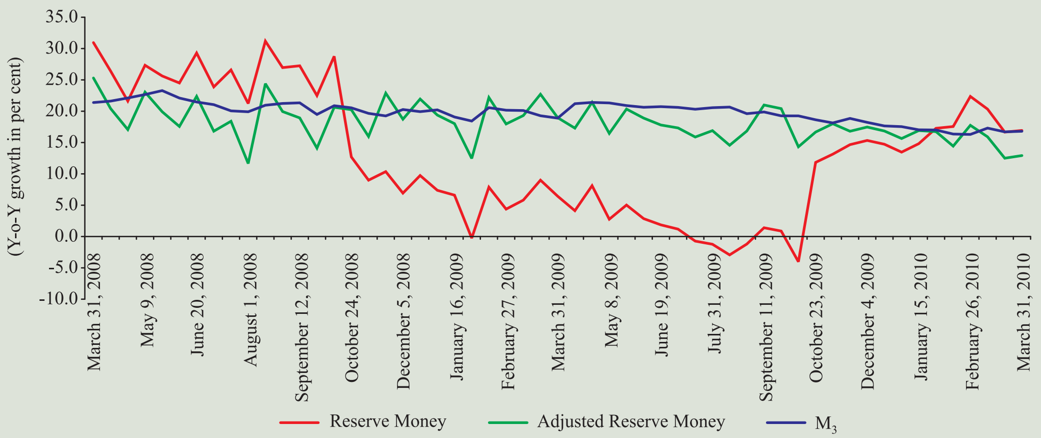
During the first half of 2009-10, growth in both broad money (M3) and non-food credit decelerated. This reversed course during the second half reflecting the pull of economic recovery. While non-food credit, which had been decelerating since October 2008 reached its inflexion point in November 2009, money growth turned around in March 2010. By the end of the financial year, growth in both M_3 and non-food credit exceeded the Reserve Bank's indicative projections of growth of 16.5 per cent and 16.0 per cent, respectively. During the year, there was a slowdown in the pace of deposit mobilisation by the banking system, mainly due to the gradual decline in interest rates on time deposits in lagged response to the lower policy rates. With the increasing demand for credit from the banking system, deposit mobilisation has begun to gain strength, and deposit rates have also moved up in the recent period. Even after the absorption of Rs.36,000 crore through the 75 basis points hike in CRR effected in February 2010, liquidity conditions have remained comfortable, as evident from the reverse repo operations under the LAF in the recent weeks.

IV.1 During the crisis, maintenance of ample liquidity and lower policy rates were used by the Reserve Bank as the key channels to stimulate private demand and thereby contain the pace of slowdown in economic activity. The interest rate transmission through lower lending rates started becoming visible with a lag. When the private demand for credit remained depressed and decelerated till the middle of Q3 of 2009-10, the flow of resources from the non-banking sources to the commercial sector increased. The recent upturn in monetary and credit aggregates provides additional evidence that the recovery is taking hold.

IV.2 In 2009-10, growth in reserve money decelerated up to October and thereafter gradually rose back to the growth rate prevailing in September 2008, *i.e.*, before the onset of the global financial crisis. In contrast, reserve money adjusted for the first round impact of CRR change, exhibited less volatility and followed a mildly decelerating trend for the year.

IV.3 Growth in broad money (M_3) showed deceleration throughout the year, with a moderate turnaround seen in March 2010 (Chart IV.1 and Table IV.1). This was on account of deceleration in aggregate deposits on the components side of M_3. On the sources side of M_3, the deceleration was driven by the relatively weak demand for credit from the commercial sector during the first half of 2009-10, combined with moderation in banking system's credit to the Government during the second half of 2009-10. After a phase of deceleration, there has been a revival in the flow of bank credit since November 2009, as a result of which the Reserve Bank's indicative target of 16.0 per cent credit growth for the year was exceeded by mid-March 2010. The improved flow of credit from the banking sector in conjunction with higher availability of resources from the non-banking sources (both domestic as well as foreign) led to a significant increase in total flow of financial resources to the commercial sector, thereby financing the

Chart IV.1: Monetary Aggregates



activities underpinning the economic recovery that is underway.

Reserve Money

IV.4 In 2008-09, the deceleration in the growth rate of reserve money was primarily on account of decline in bankers' deposits with the Reserve Bank on the components side of reserve money (due to a net reduction in CRR by 250 basis points during the year) and decline in foreign currency assets (on account of capital outflows) on the sources

Table IV.1: Monetary Indicators

(Amount in Rupees crore)

Item	Outstanding as on March 31, 2010	Variation (y-o-y)			
		2008-09		2009-10	
		Absolute	Per cent	Absolute	Per cent
1	2	3	4	5	6
I. Reserve Money	11,55,281	59,698	6.4	1,67,281	16.9
(Reserve Money adjusted for CRR changes)			(19.0)		(12.9)
II. Broad Money (M_3)	55,79,567	7,59,186	18.9	8,02,498	16.8
III. Components of M_3 (a + b + c)					
a) Currency with the Public	7,68,048	97,866	17.2	1,01,722	15.3
b) Aggregate Deposits (i+ii)	48,07,734	6,64,802	19.3	7,02,514	17.1
i) Demand Deposits	7,14,157	3,143	0.5	1,32,643	22.8
ii) Time Deposits	40,93,577	6,61,660	23.1	5,69,872	16.2
c) Other Deposits with RBI	3,785	-3,482	-38.5	-1,788	-32.1
IV. Sources of M_3 (a + b + c + d - e)					
a) Net Bank Credit to the Government (i+ii)	16,68,258	3,78,207	42.0	3,90,534	30.6
i) Net Reserve Bank Credit to the Government	2,20,218	1,74,789	–	1,58,638	–
of which: to the Centre	2,19,836	1,76,397	–	1,58,074	–
ii) Other Banks' Credit to the Government	14,48,041	2,03,418	20.1	2,31,897	19.1
b) Bank Credit to the Commercial Sector	34,83,253	4,41,526	17.1	4,62,737	15.3
c) Net Foreign Exchange Assets of the Banking Sector	12,75,039	57,053	4.4	-77,145	-5.7
d) Government's Currency Liabilities to the Public	10,919	831	9.0	865	8.6
e) Net Non-Monetary Liabilities of the Banking Sector	8,57,902	1,18,430	15.5	-25,508	-2.9

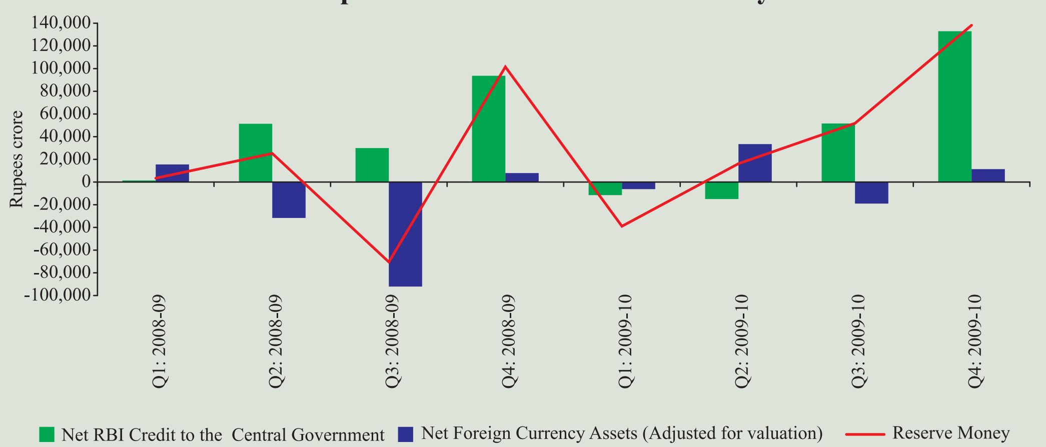
Note: Data are provisional.

side of reserve money. During 2009-10, the deceleration continued up to October. This was mainly due to decline in bankers' deposits (since growth in banks' aggregate deposits decelerated even as the CRR stayed unchanged at 5.0 per cent) on the components side of reserve money and decline in Reserve Bank's credit to the Centre, reflecting increased reverse repo operations[1] and increase in Centre's surplus on the sources side of reserve money. As the outstanding reverse repo balances and open market operations declined October 2009 onwards, net Reserve Bank credit to the Centre became the important driver of acceleration in reserve money growth.

IV.5 For the entire financial year 2009-10, the decline in MSS balances by Rs.85,340 crore (through unwinding and de-sequestering of balances to the Government) was the largest source of increase in reserve money, accounting for more than 50 per cent of the Rs.1,67,281 crore increase in reserve money. The other major source was open market purchases. LAF operations and Centre's surplus with the Reserve Bank played a significant role in quarter to quarter movements in net Reserve Bank credit to the Centre and hence in reserve money.

IV.6 The foreign currency assets of the Reserve Bank (adjusted for valuation) were the dominant source of variations in reserve money in the past five years. During 2009-10, net accretion to foreign currency assets was the highest during the second quarter (Chart IV.2). In the last two quarters of 2009-10, however, the expansion in reserve money was not affected much by the moderate contraction and the subsequent expansion in foreign currency assets of the Reserve Bank. The significant movement in the net non-monetary liabilities of the Reserve Bank was mainly on account of the

Chart IV.2: Important Sources of Reserve Money Variation



[1] The increased recourse to reverse repo offset to a large extent the increase in Reserve Bank credit to the Central Government stemming from unwinding of MSS balances and open market purchases during the first half of the year.

movement in the valuation of foreign exchange assets of the Reserve Bank.

IV.7 During the fourth quarter of 2009-10, reserve money growth on the components side was led by the increase in bankers' deposits with the Reserve Bank. This was on account of the increase in CRR by 75 basis points in February 2010. Currency in circulation also increased in line with the increased economic activity in the country (Table IV.2). On the sources side, net Reserve Bank credit to the Centre accounted for nearly the entire increase in reserve money (Chart IV.2). The increase in net Reserve Bank credit to the Centre was mainly due to the reduction in the Government's cash surplus with the Reserve Bank. The other factor contributing to increase in net Reserve Bank credit to the Centre was decline in outstanding reverse repo balances[2], which reflected the impact of the absorption of part of the

Table IV.2: Reserve Money - Variations

Item	2008-09				2009-10			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
1	2	3	4	5	6	7	8	9
Reserve Money	3,416	25,218	-70,454	1,01,519	-38,932	16,219	51,786	1,38,208
Components (1+2+3)								
1. Currency in Circulation	36,859	-14,516	38,277	39,733	29,692	1,081	45,351	31,921
2. Bankers' Deposits with RBI	-29,333	39,219	-1,15,773	68,714	-72,664	20,680	5,456	1,07,552
3. 'Other' Deposits with the RBI	-4,110	514	7,042	-6,928	4,040	-5,542	980	-1,266
Sources (4+5+6+7-8)								
4. RBI's Net Credit to Government	-13	51,360	30,230	93,212	-11,145	-14,953	51,428	1,33,308
of which: to Centre	1,430	51,379	29,932	93,657	-11,497	-14,968	51,597	1,32,943
5. RBI's Credit to Banks and Commercial Sector	-3,358	4,963	5,032	11,163	-9,623	-3,747	-5,926	-2,384
6. Net Foreign Assets of RBI	1,03,932	10,336	-1,56,330	86,048	-16,750	50,120	-15,108	-66,428
of which: Foreign Currency Assets, adjusted for valuation	15,535	-31,641	-92,102	7,900	-6,245	33,441	-18,985	11,390
7. Governments' Currency Liabilities to the Public	225	206	186	213	254	302	218	91
8. Net Non-Monetary Liabilities of RBI	97,369	41,648	-50,428	89,117	1,668	15,503	-21,175	-73,621
Memo:								
LAF - Repo (+) / Reverse Repo (-)	-45,350	51,480	-62,170	4,205	-1,32,800	28,170	67,765	37,360
Net Open Market Sales *	-8,696	-10,535	-7,669	-67,649	-42,001	-31,591	-1,894	17
Centre's Surplus	-42,427	6,199	-32,830	8,691	-13,156	77,713	17,519	-80,112
MSS Balances	6,040	-628	-53,754	-31,973	-65,187	-4,117	0	-16,036

*: Excludes Treasury Bills.

Note: 1. The sum of the memo items will not add up to the net Reserve Bank credit to the Centre as LAF and OMO transactions are at face value and also due to margin adjustment for LAF operations.
2. Data are based on March 31 for Q4 and last reporting Friday for all other quarters.
3. Data are provisional.

[2] The Reserve Bank's credit to the Centre is affected by LAF operations, OMO, MSS balances and Government's cash surplus with the Reserve Bank. Increase in repo/OMO purchases and decline in reverse repo/MSS balances/Government's surplus balances with Reserve Bank lead to increase in net Reserve Bank credit to the Centre, and *vice versa*.

excess liquidity in the system by the hike in the CRR as well as some tightening of the overall liquidity conditions resulting from the advance tax payments during the first fortnight of March 2010. There was also a reduction in MSS balances with the Reserve Bank due to unwinding (Rs.11,036 crore in the first week of January 2010) and de-sequestering (Rs.5,000 crore on March 11, 2010).

IV.8 Since bankers' deposits with the Reserve Bank, a key determinant of reserve money on the components side, change in response to variations in CRR effected by the Reserve Bank as part of its monetary policy actions, it is often useful to analyse the behaviour of reserve money adjusted for the policy induced part of the change in base money. Adjusting the reserve money series for injection/absorption through CRR changes gives the adjusted reserve money series. The reserve money growth for the last few fortnights of 2009-10 exceeds the adjusted reserve money growth, reflecting the impact of the hike in CRR in February 2010 that led to absorption of about Rs.36,000 crore of surplus liquidity from the system (Chart IV.3).

Money Supply

IV.9 Broad money growth followed the growth pattern of its largest component – aggregate deposits. Since there was gradual deceleration in aggregate deposits, led primarily by time deposits, money growth decelerated during the year (Table IV.3). Due to the softening of interest rates, there was deceleration in the growth of time deposits through the year, with an erratic pattern in the closing fortnights of 2009-10 (Chart IV.4 a). Since April 2009, returns on small savings have remained higher than that of time deposits, leading to rising inflows since August 2009, after a period of 20 consecutive months of outflows. As the interest differentials over time deposits became more attractive, the rate of accretion into the small savings schemes increased in each successive month up to February 2010, *i.e.*, the latest period for which data are available (Chart IV.4 b).

Chart IV.3: Reserve Money and Adjusted Reserve Money

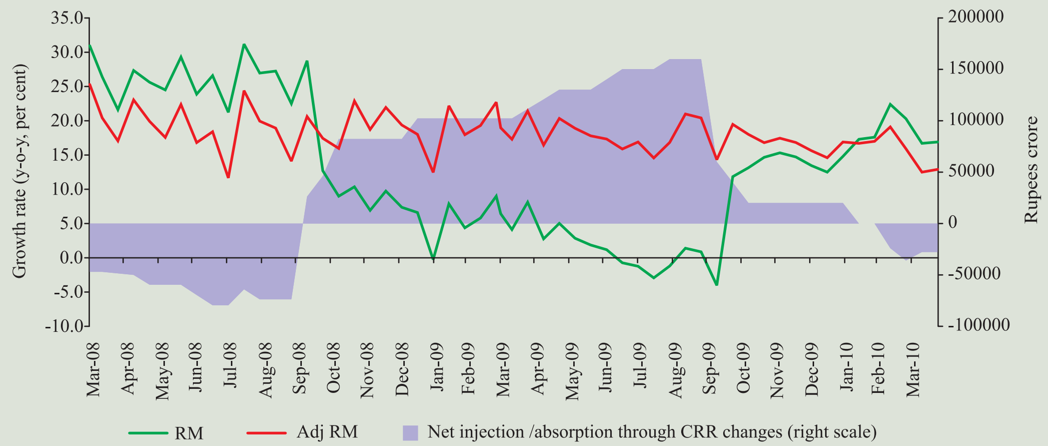


Table IV.3: Monetary Aggregates - Variations

Item	2008-09				2009-10			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
1	2	3	4	5	6	7	8	9
M_3 (1+2+3 = 4+5+6+7-8)	89,283	1,76,379	1,60,486	3,33,039	1,81,527	1,49,994	1,19,907	3,51,070
Components								
1. Currency with the Public	35,772	-18,037	40,405	39,726	24,086	2,910	44,994	29,782
2. Aggregate Deposits with Banks	57,621	1,93,902	1,13,039	3,00,241	1,53,401	1,52,626	73,933	3,22,554
2.1 Demand Deposits with Banks	-79,325	52,771	-62,157	91,854	-33,738	65,288	-27,888	1,28,980
2.2 Time Deposits with Banks	1,36,946	1,41,131	1,75,195	2,08,389	1,87,139	87,339	1,01,821	1,93,573
3. 'Other' Deposits with RBI	-4,110	514	7,042	-6,928	4,040	-5,542	980	-1,266
Sources								
4. Net Bank Credit to Government	36,124	31,654	1,29,335	1,81,093	1,20,425	71,011	33,105	1,65,994
4.1 RBI's Net Credit to Government	-13	51,360	30,230	93,212	-11,145	-14,953	51,428	1,33,308
4.2 Other Banks' Credit to Government	36,137	-19,706	99,106	87,881	1,31,570	85,963	-18,323	32,686
5. Bank Credit to the Commercial Sector	30,811	1,63,138	90,616	1,56,962	-12,855	1,13,963	60,825	3,00,804
6. NFA of Banking Sector	66,858	7,271	-1,32,461	1,15,385	-37,923	47,908	-20,701	-66,428
7. Government's Currency Liabilities to the Public	225	206	186	213	254	302	218	91
8 Net Non-Monetary Liabilities of the Banking Sector	44,735	25,890	-72,809	1,20,614	-1,11,627	83,188	-46,460	49,390

Note: Data are provisional.

IV.10 On the sources side, the main driver of M_3 has been the banking system's credit to the Government, while credit to the commercial sector also showed revival in the last quarter of 2009-10. A quarter-wise analysis reveals that incremental credit extended by scheduled commercial banks (SCBs) in absolute terms in the fourth quarter of 2009-10 was the highest in last two years (Chart IV.5). After showing an

Chart IV.4: Time Deposits and Small Savings

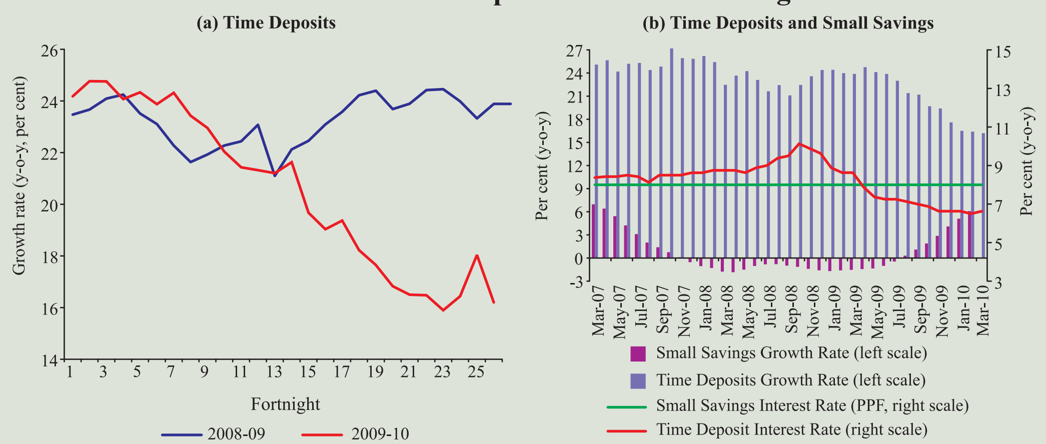
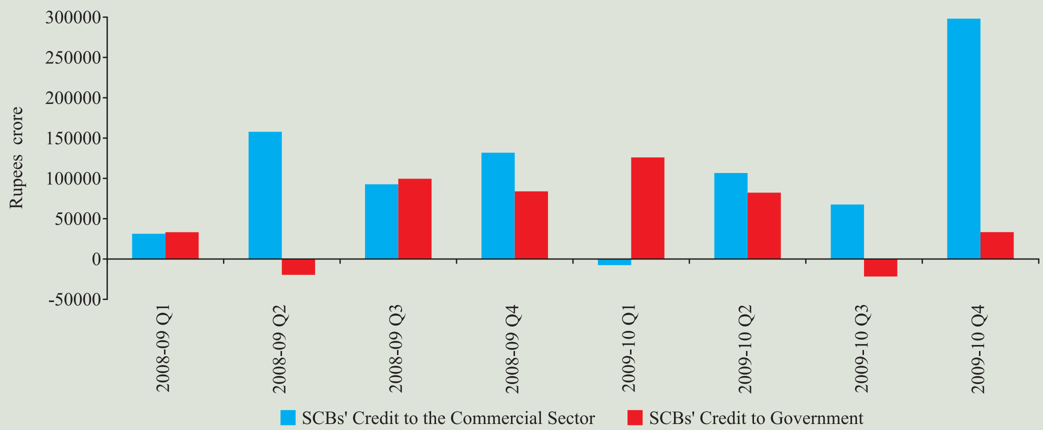


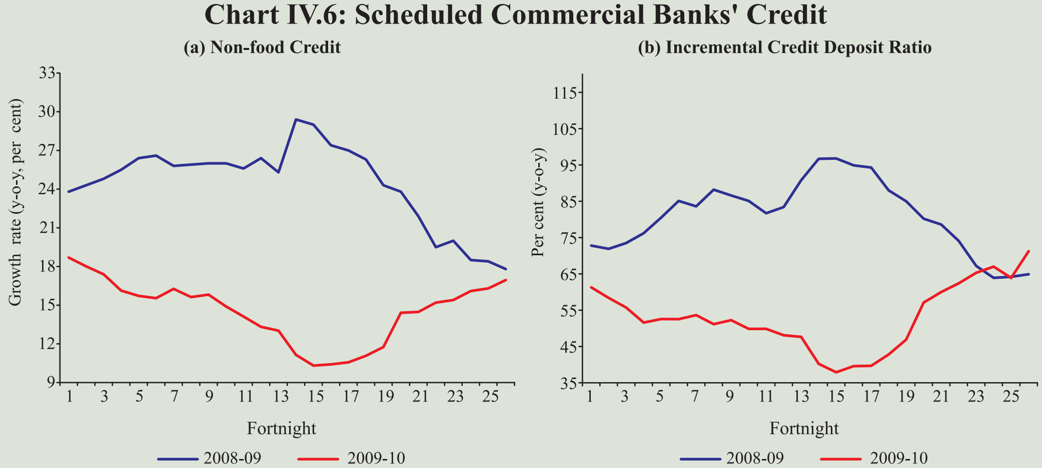
Chart IV.5: Scheduled Commercial Bank's Credit (Quaterly Variation)



absolute decline in the third quarter of 2009-10, SCBs' credit to the Government increased during the fourth quarter, when the Government's borrowing programme was completed.

IV.11 Reflecting the revival in flow of credit from the SCBs, the non-food credit growth was 16.9 per cent by end-March 2010 as against the Reserve Bank's indicative trajectory of growth of 16 per cent (Chart IV.6 a). In the year up to October 2009, deceleration in non-food credit had continued and reached the low of 10.3 per cent. As the economic recovery is increasingly becoming more broad-based, with industrial output exhibiting particularly strong acceleration in recent months, there is a significant revival in credit demand since end-November 2009 and the incremental credit deposit ratio has also risen steadily in the second half of 2009-10 (Chart IV.6 b).

Chart IV.6: Scheduled Commercial Banks' Credit



IV.12 Due to the revival in credit demand for the banking system as a whole, the credit extended by private banks at end-March 2010 showed some improvement over last year. The loan portfolio of foreign banks, however, contracted (Table IV.4).

IV.13 Reflecting the revival in credit demand from the private sector, SCBs' investment in SLR securities increased at a lower rate of 18.5 per cent (y-o-y) as on March 26, 2010 as compared with 20.0 per cent a year ago. Commercial banks' holdings of such securities at 28.8 per cent of their net demand and time liabilities (NDTL) were only marginally higher than 28.1 per cent at end-March 2009. Adjusted for LAF collateral securities on an outstanding basis, SCBs' holding of SLR securities amounted to 28.4 per cent of NDTL as on March 26, 2010. SCBs reduced their overseas foreign currency borrowings as well as their holding of foreign currency assets during the year (Table IV.5).

IV.14 Disaggregated data on sectoral deployment of gross bank credit show improvement in credit growth (y-o-y) to all major sectors such as agriculture, industry, services and personal loans from November 2009 onwards. Industry absorbed 52.6 per cent of incremental non-food credit (y-o-y) in February 2010 as compared with 55.8 per cent in the corresponding month of the previous year. This expansion was led by infrastructure and basic metals and metal products. The share of incremental non-food credit to services sector was 22.6 per cent in February 2010. Within services sector, credit growth (y-o-y) for transport operators, computer software, tourism, hotels and restaurants and trade accelerated in February 2010. Also, the share of incremental non-food credit to micro and small enterprises (industry as well as services) increased to 16.4 per cent in February 2010 as compared with 12.4 per cent in February 2009. Credit to real estate decelerated sharply mainly on account of the definitional change to the concept of "lending to real estate sector" effected in September 2009. The agricultural sector absorbed 18.3 per cent of the incremental non-food bank credit in February 2010 (12.7 per cent last year). Share of personal loans in incremental non-food credit increased markedly to 6.5 per

Table IV.4: Credit Flow from Scheduled Commercial Banks

(Amount in Rupees crore)

Item	Outstanding as on Mar. 26, 2010	Variation (Y-on-Y)			
		As on Mar. 27, 2009		As on Mar. 26, 2010	
		Amount	Per cent	Amount	Per cent
1	2	3	4	5	6
1. Public Sector Banks	24,12,508	3,48,562	20.9	3,93,797	19.5
2. Foreign Banks	1,66,839	6,467	4.0	-2,496	-1.5
3. Private Banks	5,84,703	52,013	11.0	61,211	11.7
4. All Scheduled Commercial Banks*	32,40,399	4,13,636	17.5	4,64,849	16.7

*: including Regional Rural Banks.

Note: Data are provisional.

Table IV.5.: Scheduled Commercial Banks - Sources and Uses of Funds

(Amount in Rupees crore)

Item	Outstanding as on March 26, 2010	Variation (year-on-year)			
		As on March 27, 2009		As on March 26, 2010	
		Amount	Per cent	Amount	Per cent
1	2	3	4	5	6
Sources of Funds					
1. Aggregate Deposits	44,21,639	6,26,838	20.0	6,54,798	17.4
2. Call/Term Funding from Financial Institutions	1,04,501	7,432	7.0	-9,435	-8.3
3. Overseas Foreign Currency Borrowings	35,217	-3,047	-6.9	-6,187	-14.9
4. Capital	59,486	3,601	8.2	12,115	25.6
5. Reserves	3,26,870	56,221	24.6	41,797	14.7
Uses of Funds					
1. Bank Credit	32,40,399	4,13,636	17.5	4,64,849	16.7
of which: Non-food Credit	31,91,909	4,11,824	17.8	4,62,571	16.9
2. Investments in Government and Other Approved Securities	13,82,684	1,94,695	20.0	2,16,273	18.5
a) Investments in Government Securities	13,75,704	1,97,124	20.6	2,19,918	19.0
b) Investments in Other Approved Securities	6,980	-2,429	-18.6	-3,645	-34.3
3. Investments in non-SLR Securities	2,34,114	36,907	21.6	26,597	12.8
4. Foreign Currency Assets	43,788	24,123	77.3	-11,524	-20.8
5. Balances with the RBI	2,81,390	-18,927	-7.4	43,195	18.1

Note: Data are provisional.

cent by February 2010, from (-) 0.2 per cent in October 2009. Within personal loans, while education loan and housing loan continued to grow over 30 per cent and 8 per cent, respectively, the contraction in credit to some sub-sectors such as consumer durables and advances against shares, bonds, *etc.*, moderated (Table IV.6).

IV.15 In 2009-10, part of the impact of the deceleration in credit to the private sector was offset by higher availability of resources from non-banking sources, particularly in the first three quarters. While non-banking domestic sources such as issuance of commercial papers (CPs), private placements and initial public offerings (IPOs) have shown significant increase; financing from foreign sources in the form of FDI and issuance of American Depository Receipts (ADRs)/Global Depository Receipts (GDRs) also improved (Table IV.7).

IV.16 The emerging trends in monetary and credit aggregates in recent months, thus, corroborate the momentum seen in real activities. While elevated headline inflation and the recovery in growth could increase the demand for money, policy driven increase in CRR could contribute to containing the growth in broad money. Given the size of the Government's borrowing programme for 2010-11, if the

Table IV.6: Deployment of Gross Bank Credit by Major Sectors

(Amount in Rupees crore)

Sector	Outstanding as on February 26, 2010	Variation (year-on-year)			
		February 27, 2009		February 26, 2010	
		Absolute	Per cent	Absolute	Per cent
1	2	3	4	5	6
Non-Food Gross Bank Credit (1 to 4)	**28,89,737**	**4,09,191**	**19.6**	**3,97,052**	**15.9**
1. Agriculture and Allied Activities	**3,70,407**	**52,126**	**21.2**	**72,654**	**24.4**
2. Industry	**12,48,507**	**2,28,286**	**28.1**	**2,08,686**	**20.1**
3. Personal Loans	**5,81,357**	**34,218**	**6.6**	**25,965**	**4.7**
Housing	2,97,203	16,431	6.4	22,880	8.3
Advances against Fixed Deposits	46,529	2,927	6.8	750	1.6
Credit Card Outstanding	20,737	2,122	7.9	-8,189	-28.3
Education	36,522	7,033	33.8	8,690	31.2
Consumer Durables	8,102	-2,399	-22.6	-109	-1.3
4. Services	**6,89,466**	**94,561**	**18.7**	**89,747**	**15.0**
Transport Operators	46,165	5,616	17.0	7,527	19.5
Professional Services	12,599	1,686	22.4	3,399	36.9
Trade	1,65,046	17,379	14.4	26,859	19.4
Real Estate Loans	91,607	33,617	58.8	842	0.9
Non-Banking Financial Companies	1,13,834	24,469	37.0	23,313	25.8
Memo:					
Priority Sector	**10,32,454**	**1,34,477**	**18.9**	**1,87,879**	**22.2**
Small Enterprises	3,60,859	50,932	20.8	65,033	22.0
Industry	**12,48,507**	**2,28,286**	**28.1**	**2,08,686**	**20.1**
Food Processing	60,489	6,622	14.0	6,634	12.3
Textiles	1,16,926	11,555	12.5	13,194	12.7
Paper and Paper Products	18,626	3,295	25.0	2,135	12.9
Petroleum, Coal Products and Nuclear Fuels	65,626	31,739	77.4	-7,136	-9.8
Chemicals and Chemical Products	79,543	13,391	22.4	6,274	8.6
Rubber, Plastic and their Products	14,977	2,814	26.9	1,708	12.9
Iron and Steel	1,24,367	25,774	34.5	23,984	23.9
Other Metals and Metal Products	34,238	6,129	25.6	4,127	13.7
Engineering	71,637	14,614	28.0	4,769	7.1
Vehicles, Vehicle Parts and Transport Equipments	37,724	7,018	24.6	2,219	6.2
Gems and Jewellery	30,135	2,618	10.6	2,893	10.6
Construction	41,294	14,637	62.1	3,087	8.1
Infrastructure	3,65,617	65,711	34.4	1,08,757	42.3

Note: Data are provisional and relate to select banks. Data also include the effects of mergers of Bharat Overseas Bank with Indian Overseas Bank, American Express Bank with Standard Chartered Bank and State Bank of Saurashtra with State Bank of India.

Table IV.7: Flow of Financial Resources to the Commercial Sector

(Rupees crore)

Item	April-March 2008-09	April-March 2009-10
1	2	3
A. Adjusted Non-food Bank Credit	**4,21,091**	**4,73,819**
i) Non-food Credit	4,11,824	4,62,571
ii) Non-SLR Investment by SCBs	9,267	11,248
B. Flow from Non-banks (B1+B2)	**4,12,864**	**4,96,937**
B1. Domestic Sources	**2,28,491**	**2,93,142**
1. Public issues by non-financial entities	13,583	27,165 #
2. Gross private placements by non-financial entities	66,980	1,10,404 ^
3. Net issuance of CPs subscribed by non-banks	10,718	41,667 $
4. Net credit from housing finance companies	17,627	16,051 #
5. Total gross accommodation by the four RBI regulated all India financial institutions - NABARD, NHB, SIDBI and EXIM bank	16,502	13,260 #
6. Systemically important non-deposit taking NBFCs (net of bank credit)	28,858	37,962 #
7. LIC's gross investment in corporate debt, infrastructure and social sector	74,223	46,633 #
B2. Foreign Sources	**1,84,373**	**2,03,795**
1. External commercial borrowings/foreign currency convertible bonds	35,277	12,699 #
2. ADR/GDR issues excluding banks and financial institutions	4,686	14,669 #
3. Short-term credit from abroad	-927	15,921 ##
4. FDI in India	1,45,337	1,60,506 ##
C. Total Flow of Resources (A+B)	**8,33,955**	**9,70,756**
Memo Item:		
Net resource mobilisation by mutual funds through debt (non-Gilt) schemes	30,214	2,61,065 #

$: Up to March 15. # : April-February. ## : April-January. ^ : April-December.

recovery in demand for credit from the private sector firms up further and capital flows also increase, then monetary expansion could be driven by all three main factors on the sources side, *i.e.*, banking system's credit to the Government, credit to the commercial sector and increase in net foreign assets.

V. FINANCIAL MARKETS

The global financial markets witnessed further stabilisation with firmer indications about the strength of the recovery but with concerns about fiscal conditions as reflected in sovereign risks. Domestic financial markets remained stable. While the persistent surplus liquidity conditions kept the money market interest rates low, the medium to long-term yield on government bonds increased, reflecting the concerns relating to the size of the borrowing programme and inflationary conditions as well expectations about the monetary exit. The credit market conditions improved with a turnaround in the demand for credit from the corporate sector as well as better transmission of policy rates to the deposit and lending rates, though with lags. Asset prices, in terms of stock prices as well as residential housing prices, exhibited significant rise. The upward pressure on the exchange rate continued, reflecting the revival in capital inflows.

V.1 Uncertainties about the path of future global recovery and risks arising from large sovereign debt continue to threaten the return to stability in the international financial markets. These developments in the global financial markets transmitted to the domestic financial markets by way of sporadic volatility in stock prices and the exchange rate. The domestic financial markets faced concerns emerging from the large fiscal deficit, despite the beginning of exit, and the inflationary expectations stemming from high headline inflation, which affected the government bond market. The transmission of lower policy rates to the credit markets improved through lower lending rates, though with lags. The flow of credit to support the recovery in growth improved in recent months, while availability of resources from non-banking sources also increased. Asset prices increased at a relatively faster pace in the recent period. With the turnaround in capital inflows, the exchange rate appreciated.

International Financial Markets

V.2 The global financial markets during 2009 exhibited significant stabilisation, despite the drag from the global financial crisis. Although financial markets were marked by intermittent volatility, mainly arising from the uncertainty regarding the shape of the global recovery, the risks in the global financial markets declined for most part of 2009, as stronger signs of global recovery became visible. The sovereign risk concerns, however, dominated the financial markets. Two major events *i.e.*, the Dubai World debt standstill and the sovereign debt problem of the East European countries, mainly Greece, posed another bout of risk to the financial system towards the end of 2009 and beginning of 2010, which led to greater volatility in the international markets.

V.3 In the aftermath of the global financial crisis, the high debt levels in the advanced economies – an outcome of bailouts and unprecedented fiscal stimulus – have created adverse market expectations about sustainability of such debt levels and exerted pressures on the government bond yield (Chart V.1a). With signals from the major central banks in the advanced economies that interest rates may remain low for some time, the bond yields have somewhat moderated towards the end of the year. The government bond yields in EMEs witnessed broadly a moderating trend, excluding India (Chart V.1b). Recent events, *i.e.*, Greece's sharp revisions of budget deficit from 3.7 per cent to 12.7 of GDP in 2009 and the Dubai World default, have renewed risk aversion in the sovereign bond markets (Chart V.1c and d). Besides Greece, the other Euro area countries such as Italy, Portugal, Ireland and Spain also seem to be under stress due to high public debt. While Ireland is already on fiscal adjustment, the contingent liabilities from the banking sector still loom large.

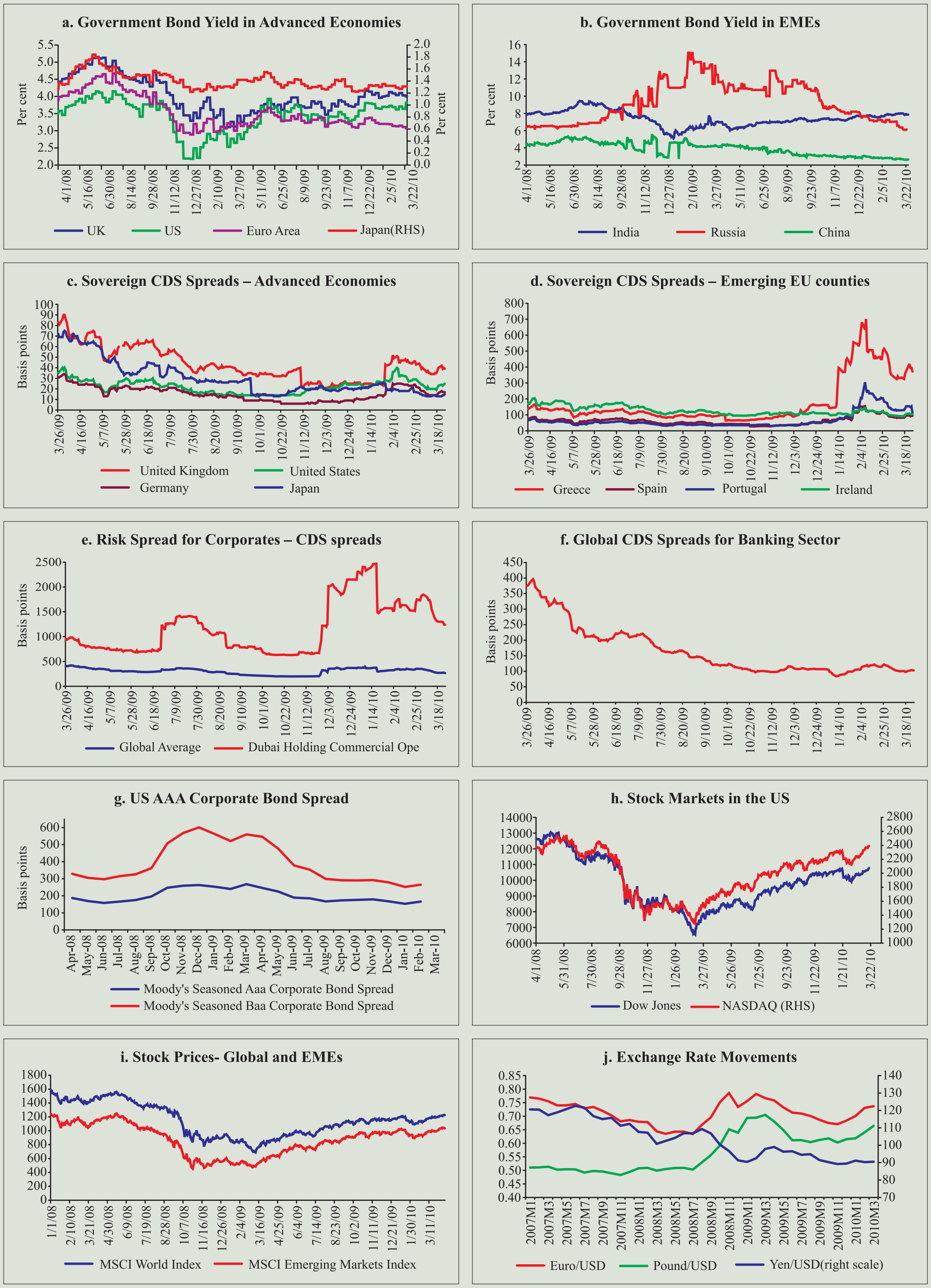
V.4 The US AAA-rated corporate bond spreads declined by about 100 basis points between January 2009 and March 2010 (Chart VI.1g). In the aftermath of the Dubai World debt default, however, the credit risk repricing for corporates was evident from the increase in global credit default swap (CDS) spreads for the corporate sector (Chart V.1e). In fact, activity in the CDS market in advanced economies increased significantly as investors reassessed their exposure to sovereign risks. The CDS spreads for the banking sector, which had shown sequential drop in 2009 due to improved bottom lines of the banks, witnessed pressure in Q1:2010 as the market concerns of sustainability of sovereign debt in many advanced countries and EMEs impacted on the risk perception towards the banking sector as they accumulated a large portfolio of government bonds in their balance sheet (Chart V.1f).

V.5 A significant reduction in investor risk appetite to both the advanced economies and the EMEs was reflected in large gains in equity prices in 2009, which have been sustained in 2010 so far. The US stocks recorded gains of about 42 to 56 percent between March 2009 and March 2010 (Chart V.1h). Although the gains in equity prices in both the advanced economies and EMEs were marginal in Q1: 2010 over Q4:2009, overall the advanced economies' stock prices gained by 52 per cent between March 2009 and March 2010, while the EMEs recorded even higher gains of 78 per cent, reflecting the uneven pace of global recovery (Chart V.1i).

V.6 The gains in EME asset prices were aided by a number of factors such as robust economic recovery, reduced risks, low interest rates in the advanced economies and capital inflows in search for higher yield. The rising short-term capital flows to EMEs raised concerns about their adverse impact on the exchange rate and liquidity management, prompting some countries to impose variants of Tobin tax. Brazil imposed a 2 per cent tax on foreign capital (invested in domestic equity and bond markets) in October 2009 and a further 1.5 per cent tax on certain trades involving American Depository Receipts (ADRs). Taiwan also prevented flow of foreign funds into time deposits from mid-November 2009.

V.7 In the foreign exchange market, the depreciating trend of the US dollar was reversed during Q1 of 2010 (V.1j). The US dollar generally appreciated against major currencies like the euro and pound sterling during the quarter, buoyed by positive economic data from the US. However, despite the strength exhibited by the US dollar against major currencies during Q4 of 2009, it depreciated against the major

Chart V.1: Indicators of Global Financial Market Developments



Source: The IMF, the Federal Reserve of St. Louis, the Bloomberg and the Datastream.

currencies as also against the currencies of EMEs during the year as a whole (see Table V.1).

V.8 The stronger signs of global recovery taking hold led to reduction in risks in the international markets, which also favourably impacted the domestic equity markets during the major part of 2009. Reduction in risk perception towards EMEs along with continuance of low policy rates in the advanced economies for the extended periods, led to revival in capital flows to India, which in turn contributed to significant gains by the equity markets and at the same time put appreciation pressures on the exchange rate. Nevertheless, since the last quarter of 2009, the global shocks from Dubai World standstill on debt payments and sovereign debt concerns spreading from Greece to other East European countries, have impacted the domestic markets in terms of higher volatility in stock prices and to some extent the exchange rate. Overall, the impact of such global shocks remained contained and transient; the various segments of the domestic market functioned in an orderly manner, with increasing volumes in activities.

Domestic Financial Markets

V.9 The domestic financial markets during 2009-10 were characterised by certain major trends, such as prevalence of comfortable liquidity conditions in money markets despite large government borrowing programme, MSS unwinding in alignment with the borrowing programme to contain pressure on yield, call rate remaining low and around the lower bound of the liquidity adjustment facility (LAF) corridor, rising pressure on medium to long-term government bond yield, appreciation of the rupee amid a two-way movement, and substantial gain in asset prices, in terms of both stock and housing prices (Table V.2).

Table V.1: Currency and Stock Price Movement in EMEs

(Per cent)

Items	End-March 08 @	End-March 09 @	End-March 2010@	Items	End-March 08 @	End-March 09 @	End-March 2010@
1	2	3	4	1	5	6	7
Appreciation (+)/Depreciation (-) of the US Dollar				**Stock Price Variations**			
Japanese Yen	-14.9	-2.0	-4.9	Indonesia (Jakarta Composite)	33.7	-41.4	93.7
Chinese Yuan	-9.3	-2.6	-0.1	Brazil (Bovespa)	33.1	-32.9	71.9
Russian Ruble	-9.7	44.3	-13.0	Thailand (SET Composite)	21.3	-47.2	82.6
Turkish Lira	-5.8	27.7	-9.1	India (BSE Sensex)	19.7	-37.9	80.5
Indian Rupee	-8.3	27.5	-11.4	South Korea (KOSPI)	17.3	-29.2	40.3
Indonesian Rupiah	1.1	25.6	-21.3	China	9.1	-31.7	31.0
Malaysian Ringgit	-7.8	14.4	-10.3	Taiwan (Taiwan Index)	8.7	-39.2	52.0
South Korea Won	5.5	38.9	-17.9	Russia (RTS)	6.1	-66.4	128.0
Thai Baht	-10.2	12.9	-8.9	Malaysia (KLSE Composite)	0.1	-30.1	51.3
Argentine Peso	2.1	17.3	4.4	Singapore (Straits Times)	-4.9	-43.5	69.9
Brazilian Real	-17.0	31.2	-19.8				
Mexican Peso	-3.5	32.9	-11.4				

@: Year-on-year variation.
Source: Bloomberg, IFS, IMF.

Table V.2: Domestic Financial Markets at a Glance

Year/Month	Call Money		Govt. Securities Market		Foreign Exchange Market			Liquidity Management		Stock Markets			
	Daily Turnover (Rs. crore)	Call Rates* (Per cent)	Daily Turnover^ (Rs. Crore)	10-Year Yield@ (Per cent)	Daily Inter-bank Turnover (US$ mn)	Exchange rate@ (Rs./ US$)	RBI's net FC purchase (+)/ sale (-)	MSS Out-standing# (Rs. crore)	Daily LAF Reverse Repo (Rs. crore)	Daily BSE Turnover (Rs. crore)	Daily NSE Turnover (Rs. crore)	BSE Sensex**	CNX Nifty**
1	2	3	4	5	6	7	8	9	10	11	12	13	14
2008-09	**22,436**	**7.06**	**10,879**	**7.54**	**34,712**	**45.92**	**-34,922†**	**1,48,889**	**2,885**	**6,275**	**11,325**	**16569**	**4897**
2009-10	**15,924**	**3.24**	**13,936**	**7.23**	**29,447**	**44.95**	**-2,635†**	**23,914**	**1,00,015**	**5,651**	**16,959**	**15585**	**4658**
Apr-09	21,820	3.28	15,997	6.55	27,796	50.06	-2,487	75,146	1,01,561	5,232	15,688	10911	3360
May-09	19,037	3.17	14,585	6.41	32,227	48.53	-1,437	45,955	1,25,728	6,427	19,128	13046	3958
Jun-09	17,921	3.21	14,575	6.83	32,431	47.77	1,044	27,140	1,23,400	7,236	21,928	14782	4436
Jul-09	14,394	3.21	17,739	7.01	30,638	48.48	-55	22,159	1,30,891	6,043	18,528	14635	4343
Aug-09	15,137	3.22	9,699	7.18	27,306	48.34	181	19,804	1,28,275	5,825	17,379	15415	4571
Sep-09	16,118	3.31	16,988	7.25	27,824	48.44	80	18,773	1,21,083	6,211	18,253	16338	4859
Oct-09	15,776	3.17	12,567	7.33	28,402	46.72	75	18,773	1,01,675	5,700	18,148	16826	4994
Nov-09	13,516	3.19	17,281	7.33	27,599	46.57	-36	18,773	1,01,719	5,257	16,224	16684	4954
Dec-09	13,302	3.24	14,110	7.57	27,431	46.63	..	18,773	68,522	4,671	13,948	17090	5100
Jan-10	12,822	3.23	12,614	7.62	32,819	45.97	..	9,944	81,027	6,162	17,813	17260	5156
Feb-10	13,618	3.17	12,535	7.79	33,745	46.33	..	7,737	78,661	4,125	12,257	16184	4840
Mar-10	17,624	3.51	8,544	7.94		45.50		3,987	37,640	4,751	13,631	17303	5178

* : Average of daily weighted call money borrowing rates.
^ : Average of daily outright turnover in Central Government dated securities.
@ : Average of daily closing rates.
\# : Average of weekly outstanding MSS.
.. : Nil.
** : Average of daily closing indices.
† : Cumulative for the financial year.
LAF : Liquidity Adjustment Facility.
MSS : Market Stabilisation Scheme.
BSE : Bombay Stock Exchange Limited.
NSE : National Stock Exchange of India Limited.
FC : Foreign Currency.
Note : In column 10, (-) indicates injection of liquidity, while (+) indicates absorption of liquidity.

Liquidity Conditions

V.10 The intra-year dynamics of liquidity conditions reflected the calibrated policy response to the evolving macroeconomic and financial market environment, interspersed with the impact of quarterly advance tax outflows. The surplus liquidity in the domestic markets, partly induced by unwinding of the MSS balances, prevailed during almost the entire financial year 2009-10. The key drivers of liquidity during the first half of 2009-10 were open market operations (OMO) to manage the Government borrowing programme coupled with MSS unwinding. The total liquidity released during 2009-10 through the unwinding of MSS and auction-based OMO purchases amounted to Rs.1,42,827 crore. The surplus liquidity, however, declined somewhat in the second half of 2009-10 on account of relatively lower MSS redemptions, absence of OMO auctions, apart from the CRR hike in February 2010, which absorbed primary liquidity of around Rs.36,000 crore from the system. The surplus liquidity declined further on account of quarterly advance tax outflows from the banking system that more than offset the impact of de-sequestering of Rs.5,000 crore of MSS balances on March 11, 2010 (Table V.3). Thus, the overall surplus liquidity in the system declined during the last quarter of 2009-10.

V.11 Overall, changes in the centre's balances were the key drivers of autonomous liquidity in 2009-10 along with

Table V.3: Liquidity Position

(Rupees crore)

Outstanding as on Last Friday	LAF	MSS	Centre's Surplus @	Total (2 to 4)
1	2	3	4	5
2009				
March*	1,485	88,077	16,219	1,05,781
April	1,08,430	70,216	-40,412	1,38,234
May	1,10,685	39,890	-6,114	1,44,461
June	1,31,505	22,890	12,837	1,67,232
July	1,39,690	21,063	26,440	1,87,193
August	1,53,795	18,773	45,127	2,17,695
September	1,06,115	18,773	80,775	2,05,663
October	84,450	18,773	69,391	1,72,614
November	94,070	18,773	58,460	1,71,303
December	19,785	18,773	1,03,438	1,41,996
2010				
January	88,290	7,737	54,111	1,50,138
February	47,430	7,737	33,834	89,001
March*	990	2,737	18,182	21,909
April (9)	1,15,295	2,737	-10,789	1,07,243

@ : 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 injection of liquidity through LAF.

2. The Second LAF, conducted on a daily basis from September 17, 2008 to May 5, 2009 is being conducted only on reporting Fridays from May 8, 2009.

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

the uptick in currency demand in the latter half of the year (Table V.4).

Money Market

V.12 The call rate continued to hover around the lower bound of the informal LAF corridor during the financial year 2009-10 as surplus liquidity persisted throughout the year (Chart V.2a). Interest rates in the collateralised segments generally moved in tandem with but remained below the call rate (Chart V.2b).

V.13 Transaction volumes in the collateralised borrowing and lending obligation (CBLO) and market repo segments continued to remain high during 2009-10 reflecting surplus liquidity and active market conditions throughout the year (Table V.5). Banks as a group continue to be the major borrowers in the collateralised segment whereas mutual funds (MFs) remain the single largest lender of funds in that segment. In fact, over 75 per cent of the lending in the collateralised

Table V.4: Reserve Bank's Liquidity Management Operations

(Rupees crore)

Item		2008-09					2009-10			
		Q1	Q2	Q3	Q4	Apr-Mar	Q1	Q2	Q3	Q4
1	2	3	4	5	6	7	8	9	10	11
A.	**Drivers of Liquidity (1+2+3+4)**	**6,061**	**-18,851**	**-1,01,278**	**-53,641**	**-1,67,709**	**-44,284**	**-44,626**	**-66,784**	**54,801**
1.	RBI's net Purchase from Authorised Dealers	-8,555	-40,249	-1,12,168	-17,620	-1,78,592	-15,874	2,523	436	395
2.	Currency with the Public	-30,063	12,360	-40,070	-40,147	-97,921	-17,863	-9,132	-43,223	-31,553
3.	a. Centre's surplus balances with RBI	40,073	-3,845	36,554	-12,415	60,367	3,382	-67,938	-22,663	85,257
	b. WMA and OD	0	0	0	0	0	0	0	0	0
4.	Others (residual)	4,606	12,884	14,406	16,541	48,437	-13,929	29,921	-1,334	702
B.	**Management of Liquidity (5+6+7+8)**	**-37,659**	**7,217**	**1,33,325**	**1,32,326**	**2,35,209**	**-21,674**	**62,376**	**89,870**	**1,618**
5.	Liquidity impact of LAF Repos	-18,260	24,390	-71,110	13,145	-51,835	-1,30,020	25,390	86,330	18,795
6.	Liquidity impact of OMO* (net)	14,642	11,949	10,681	67,208	1,04,480	43,159	32,869	3,540	2,787
7.	Liquidity impact of MSS	-6,041	628	53,754	31,973	80,314	65,187	4,117	0	16,036
8.	First round impact of CRR change	-28,000	-29,750	1,40,000	20,000	1,02,250	0	0	0	-36,000
C.	**Bank Reserves # (A+B)**	**-31,598**	**-11,634**	**32,047**	**78,685**	**67,500**	**-65,958**	**17,750**	**23,086**	**56,418**

(+) : Injection of liquidity into the banking system. (-): Absorption of liquidity from the banking system.

* : Includes oil bonds but excludes purchases of government securities on behalf of State Governments.

\# : Includes vault cash with banks and adjusted for first round liquidity impact due to CRR change.

Note: Data pertain to March 31 and last Friday for all other months.

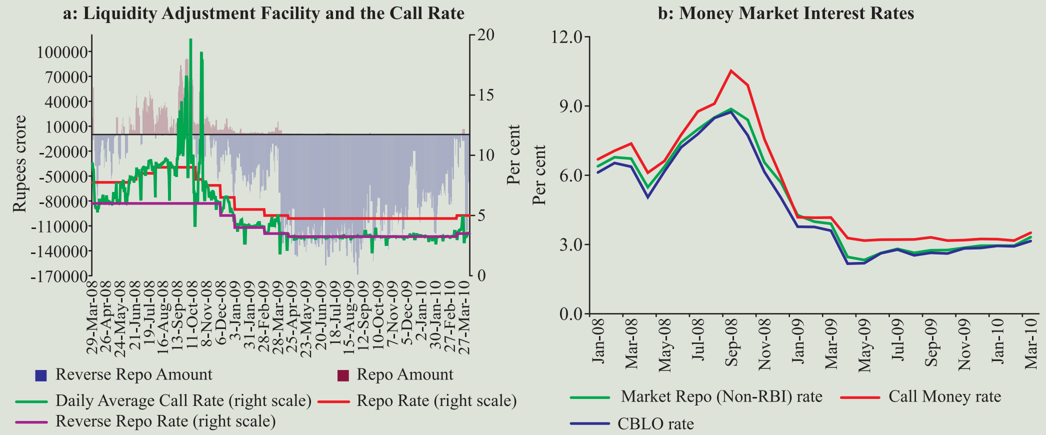


Chart V.2: Liquidity Conditions and Money Market Interest Rates

segment is contributed by MFs, reflecting their high lending capacity. The collateralised segment continued to be the predominant segment of the money market, and its share in the total volume reached around 90 per cent during the year 2009-10.

V.14 During the year 2009-10, as observed in the Reporting Fridays' statements, aggregate lending by MFs to banks (through CBLO, market repo and certificates of deposit) has generally exceeded banks' aggregate investment in MFs. In general, banks have invested around Rs.1,00,000 crore in the liquid schemes of the MFs, while the MFs have lent around Rs.2,75,000 crore to banks through market repo, CBLO and certificates

Table V.5: Activity in Money Market Segments

(Rupees crore)

Year/Month	Average Daily Volume (One Leg)						Commercial Paper		Certificates of Deposit	
	Call	Market Repo	CBLO	Total (2 to 4)	Money Market Rate (%)*	Term Money	Outstanding	WADR (%)	Outstanding	WADR (%)
1	2	3	4	5	6	7	8	9	10	11
Apr-09	10,910	20,545	43,958	75,413	2.41	332	52,881	6.29	2,10,954	6.48
May-09	9,518	22,449	48,505	80,472	2.34	338	60,740	5.75	2,18,437	6.20
Jun-09	8,960	21,694	53,553	84,207	2.69	335	68,721	5.00	2,21,491	4.90
Jul-09	7,197	20,254	46,501	73,952	2.83	389	79,582	4.71	2,40,395	4.96
Aug-09	7,569	23,305	57,099	87,973	2.62	461	83,026	5.05	2,32,522	4.91
Sep-09	8,059	27,978	62,388	98,425	2.73	381	79,228	5.04	2,16,691	5.30
Oct-09	7,888	23,444	58,313	89,645	2.70	225	98,835	5.06	2,27,227	4.70
Nov-09	6,758	22,529	54,875	84,162	2.87	191	1,03,915	5.17	2,45,101	4.86
Dec-09	6,651	20,500	55,338	82,489	2.91	289	90,305	5.40	2,48,440	4.92
Jan-10	6,411	14,565	50,571	71,547	2.97	404	91,564	4.80	2,82,284	5.65
Feb-10	6,809	19,821	63,645	90,275	2.95	151	97,000	4.99	3,09,390	6.15
Mar-10	8,812	19,150	60,006	87,968	3.22	393	91,025 ^	6.41 ^	3,39,279 #	6.21 #

* : Weighted average rate of call, market repo and CBLO. # : As on March 12, 2010. ^ : As on March 15, 2010.
CBLO: Collateralised Borrowing and Lending Obligation WADR: Weighted Average Discount Rate.

of deposit (CD); most of the increase in MFs investment in banks during 2009-10 has been in CD.

V.15 With persisting surplus liquidity conditions, the issuances of CD also remained substantially higher during 2009-10 than that in the previous year. The liquidity in the market ensured interest rates on CD to remain stable with some uptick in the last quarter. The commercial paper (CP) market also picked up as corporates increasingly took recourse to CPs as a means to financing their working capital requirements that led to a significant increase in the share of 'manufacturing companies' in the outstanding amount of CPs (Table V.6). Despite the sizeable increase in the issuances of CPs, the comfortable liquidity in the system led to a decline of about 340 basis points in the interest rates between March 2009 and mid-March 2010.

V.16 The Government mobilised large amount through issuances or rollover of treasury bills (TBs) in 2009-10. The yield on TBs that remained soft during the first half, reflecting the impact of low policy rate and ample liquidity, however, increased subsequently on account of expectations of policy rate hike and rise in inflationary pressures (Table V.7).

Government Securities Market

V.17 In view of the increase in government's borrowing requirements and the expected pick-up in credit during the second half, the market borrowing programme for 2009-10 was front loaded (Table V.8). In contrast to the low interest rates that prevailed in money markets, the yield on government bonds hardened after Q1 of 2009-10 reflecting the concerns of stimulus led large fiscal deficit and the rising inflationary expectations (Chart V.3a). The Market Stabilisation Scheme (MSS) buyback auctions and open market purchases were synchronised with the Government's normal market borrowings coupled with the de-sequestering of MSS balances. By appropriately releasing liquidity to the financial system, the Reserve Bank ensured a relatively smooth conduct of the Government's market borrowing programme in 2009-10. The

Table V.6: Major Issuers of Commercial Paper

(Rupees crore)

Category of Issuer	End of the period							
	Jun 08	Sep 08	Dec 08	Mar 09	Jun 09	Sep 09	Dec 09	Mar 15, 2010
1	2	3	4	5	6	7	8	9
Leasing and Finance	34,957 (76.6)	39,053 (75.0)	27,965 (73.5)	27,183 (61.5)	34,437 (50.1)	31,648 (40.0)	36,027 (39.9)	41,821 (45.9)
Manufacturing	8,150 (17.4)	9,925 (19.1)	6,833 (18.0)	12,738 (28.9)	23,454 (34.1)	31,509 (40.0)	42,443 (47.0)	33,154 (36.4)
Financial Institutions	3,740 (8.0)	3,060 (5.9)	3,257 (8.5)	4,250 (9.6)	10,830 (15.8)	16,071 (20.0)	11,835 (13.1)	16,050 (17.7)
Total	46,847	52,038	38,055	44,171	68,721	79,228	90,305	91,025

Note: Figures in brackets are percentage share in total.

Table V.7: Treasury Bills in the Primary Market

Year/ 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
2008-09	**2,99,000**	**7.10**	**7.22**	**7.15**	**3.43**	**2.91**	**3.47**
2009-10	**3,80,000**	**3.57**	**4.00**	**4.37**	**3.08**	**3.35**	**3.67**
Apr 2009	39,000	3.81	4.11	4.07	3.22	2.79	5.07
May 2009	29,000	3.26	3.54	3.58	3.18	2.25	3.14
Jun 2009	22,500	3.35	3.56	3.99	3.37	5.65	2.86
July 2009	40,000	3.23	3.45	3.76	3.92	2.86	3.90
Aug 2009	28,000	3.35	3.84	4.25	3.04	2.18	3.76
Sep 2009	32,000	3.35	3.94	4.47	3.67	4.17	4.05
Oct 2009	36,000	3.23	4.01	4.57	3.15	3.88	2.86
Nov 2009	30,000	3.28	3.78	4.49	3.50	3.59	3.36
Dec 2009	26,500	3.57	4.08	4.63	3.12	2.99	4.10
Jan 2010	33,000	3.86	4.13	4.67	1.97	3.60	4.61
Feb 2010	31,000	4.11	4.52	4.95	2.10	2.51	2.49
Mar 2010	33,000	4.35	4.67	5.13	2.48	3.51	3.48

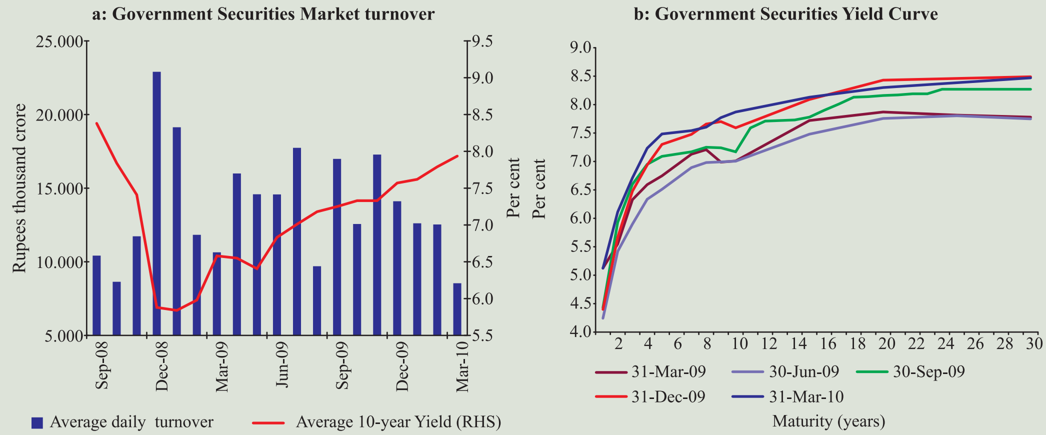
borrowing programme for State governments was also completed smoothly; however, the pressure on interest rates persisted (Table V.8). The Government will complete a major part (about 63 per cent) of the gross market borrowing programme for 2010-11 in the first half of the year to ensure that there is no crowding out in the latter half of the year when the private credit demand is normally strong. Given the prevailing comfortable liquidity conditions, the frontloading of borrowings would ensure that the pressure on interest rates could be managed.

V.18 Notwithstanding easy liquidity conditions in the money market during 2009-10, the yield curve generally continued to shift upwards indicating market concerns of fiscal deficit and rising inflationary pressures (Chart V.3b). While the medium to long-term bond yields, in general, moved up during the year,

Table V.8: Issuances of Central and State Government Dated Securities

	2007-08	2008-09	2009-10
1	2	3	4
Central Government			
Gross amount raised (Rupees crore)	1,56,000	2,61,000	4,18,000
Devolvement on Primary Dealers (Rupees crore)	957	10,773	7,219
Bid-cover ratio (Range)	1.6-4.8	1.2-4.5	1.4-4.3
Weighted average maturity (years)	14.9	13.80	11.2
Weighted average yield (per cent)	8.12	7.69	7.23
State Governments			
Gross amount raised (Rupees crore)	67,779	1,18,138	1,31,122
Cut-off yield	7.84-8.90	5.80-9.90	7.04-8.58
Weighted average yield (per cent)	8.25	7.87	8.11

Chart V.3: Turnover and Yield in Government Securities Market

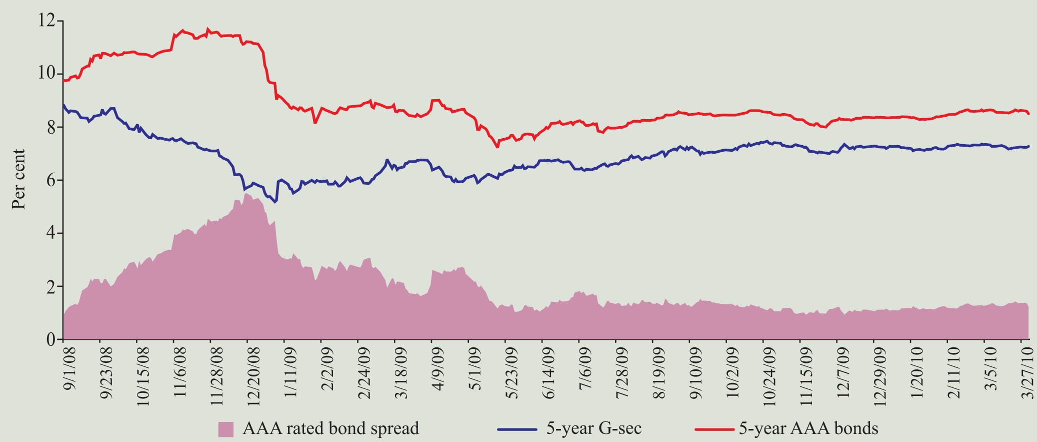


reflecting inflation and fiscal deficit concerns, the short-term yield softened till Q3 of 2009-10, reflecting the surplus liquidity conditions, followed by a hardening trend in Q4 as the surplus liquidity reduced and there was a general shift in the interest rate environment. During the Q4 of 2009-10, the government securities market continued to trade with a hardening bias tracking the impact of the increase in CRR on liquidity conditions and the rising WPI inflation.

Credit Market

V.19 In tandem with the increase in the government bond yields, yield on 5-year AAA-rated corporate bonds, that had started hardening in Q2, continued the trend (Chart V.4). Nevertheless, the spreads on corporate bonds over the government bond yield declined to the pre-global crisis level, indicating that the pressure on corporate borrowings has moderated, which has significance during the recovery phase.

Chart V.4: Spread on Corporate Bonds



V.20 The monetary transmission, which was a concern when the policy rates were reduced by the Reserve Bank, has improved, although with some lags. In response to the ample market liquidity and the lower policy interest rate environment, the banks softened their deposit rates for various maturities between March and December 2009 (Table V.9). The deposit rates, however, moved up in February-March 2010 by 25-50 basis points, reflecting not only the competition for attracting deposits with the pickup in demand for credit but also a change in the interest rate environment resulting from higher policy rates and hardening yield on Government bonds. The transmission of lower cost of funds for banks was visible on the interest rates for private credit as the benchmark prime lending rates (BPLRs) declined. The sub-BPLR lending of banks (excluding export credit and small loans) decreased to 65.8 per cent in December 2009 from 66.9 per cent in March 2009. The introduction of the base rate is likely to impart greater transparency to fixation of lending rates by banks and may also improve the assessment of the monetary policy transmission.

V.21 The monetary policy transmission is reasonably efficient to the money and bond markets, though, slower to the credit market because of existing structural rigidities (Chart V.5a). The transmission of lower policy rates to lending rates in India looks comparable with trends in other EMEs (Chart V.5b). It is possible

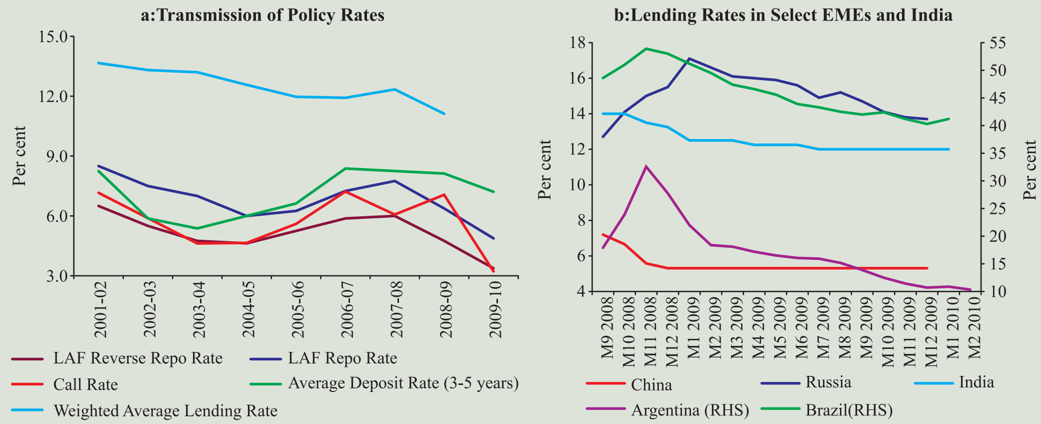
Table V.9: Deposit and Lending Rates of Scheduled Commercial Banks

(Per cent)

	Mar-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10
1	2	3	4	5	6	7
1. Domestic Deposit Rate						
Public Sector Banks						
Up to 1 yr.	2.75-8.50	2.75-8.25	1.00-7.00	1.00-6.75	1.00-6.25	1.00-6.50
1 yr. to 3 yr.	8.25-9.25	8.00-9.25	6.50-8.00	6.50-7.50	6.00-7.25	6.00-7.25
above 3 yr.	8.00-9.00	7.50-9.00	7.00-8.50	6.50-8.00	6.25-7.75	6.50-7.75
Private sector banks						
Up to 1 yr.	2.50-9.25	3.00-8.75	2.00-7.50	2.00-7.00	2.00-6.75	2.00-6.50
1 yr. to 3 yr.	7.25-9.25	7.50-10.25	6.00-8.75	5.25-8.00	5.25-7.50	5.25-7.75
above 3 yr.	7.25-9.75	7.50-9.75	6.00-9.00	5.75-8.25	5.75-8.00	5.75-8.00
Foreign banks						
Up to 1 yr.	2.25-9.25	2.50-8.50	1.80-8.00	1.25-8.00	1.25-7.00	1.25-7.00
1 yr. to 3 yr.	3.50-9.75	2.50-9.50	2.25-8.50	2.25-8.50	2.25-7.75	2.25-8.00
above 3 yr.	3.60-9.50	2.50-10.00	2.25-9.50	2.25-8.50	2.25-8.50	2.25-8.75
2. BPLR						
1. Public Sector Banks	12.25-13.50	11.50-14.00	11.00-13.50	11.00-13.50	11.00-13.50	11.00-13.50
2. Private Sector Banks	13.00-16.50	12.75-16.75	12.50-16.75	12.50-16.75	12.50-16.75	12.50-16.75
3. Foreign Banks	10.00-15.50	10.00-17.00	10.50-16.00	10.50-16.00	10.50-16.00	10.50-16.00
3. Actual Lending Rate@						
1. Public Sector Banks	4.00-17.75	3.50-18.00	3.50-17.50	4.25-18.00	3.25-18.00	
2. Private Sector Banks	4.00-24.00	4.75-26.00	4.10-26.00	3.00-29.50	3.50-25.84	
3. Foreign Banks	5.00-28.00	5.00-25.50	2.76-25.50	3.73-21.99	3.50-22.00	

Note: @ 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

Chart V.5: Transmission of Policy Rates to Credit Market



Source: Reserve Bank of India

Source: International Monetary Fund

that the transmission to credit market may exhibit an asymmetric response in terms of speed when the interest rate cycle turns around.

Foreign Exchange Market

V.22 The Indian rupee generally exhibited strengthening trend against the US dollar on the back of capital inflows and positive growth outlook, although marked by intermittent depreciation pressures (Chart V.6).

V.23 Reflecting the easing supply conditions in the market led by capital inflows, forward premia generally exhibited declining trend during 2009-10, with sporadic hardening on account of underlying demand conditions (Chart V.7).

V.24 A relatively subdued trade growth seems to have kept the activity in the merchant segment of the foreign exchange market at a relatively lower level, although it is slowly getting back to the pre-global crisis level. The ratio of inter-bank to

Chart V.6: Nominal Exchange Rates

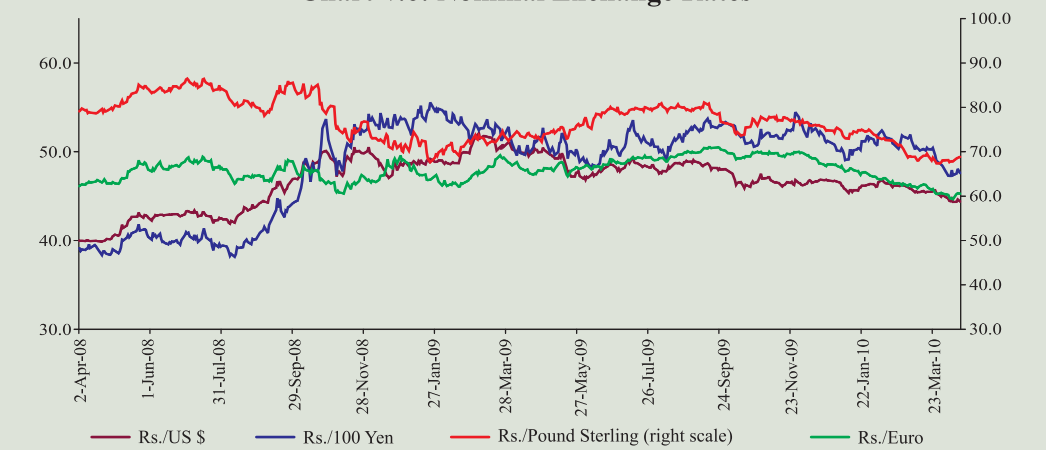
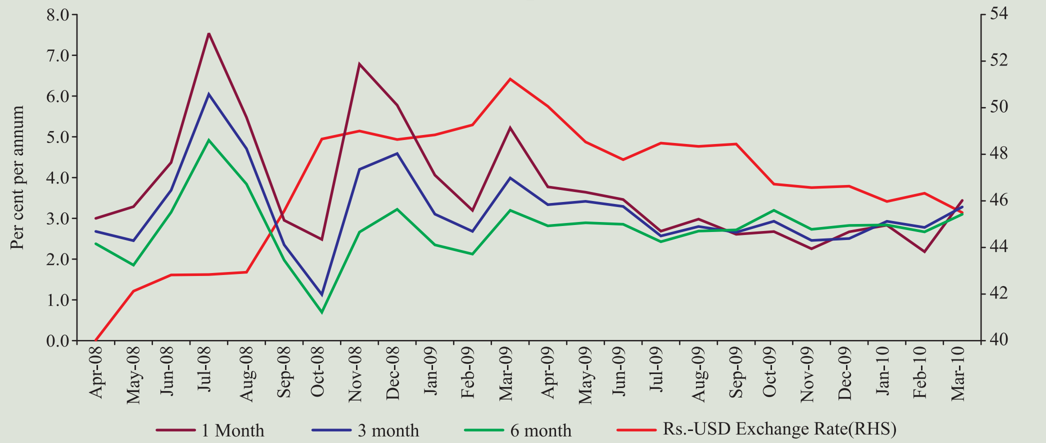


Chart V.7: Movement in Rupee-Dollar Forward Premia



merchant turnover, thus, increased marginally (Chart V.8a). The currency futures have also grown significantly in volume as the contracts are cash settled and unlike their OTC variants, do not require proof of an underlying that needs hedging (Chart V.8b).

Equity and Housing Markets

V.25 In the aftermath of the global financial crisis, the movements in asset prices and their implications for the financial stability and monetary policy have been explicitly recognised. During 2009-10, there was sharp growth in key asset prices in India; particularly the domestic equity market registered a phenomenal increase of 81 per cent in prices, outperforming many EMEs (Table V.10).

V.26 The slack in the growth of bank credit to the industry in 2009-10 was offset to a large extent by higher mobilisation of resources through IPOs, private placements and mobilisation by mutual funds. The

Chart V.8: Turnover in Foreign Exchange Market

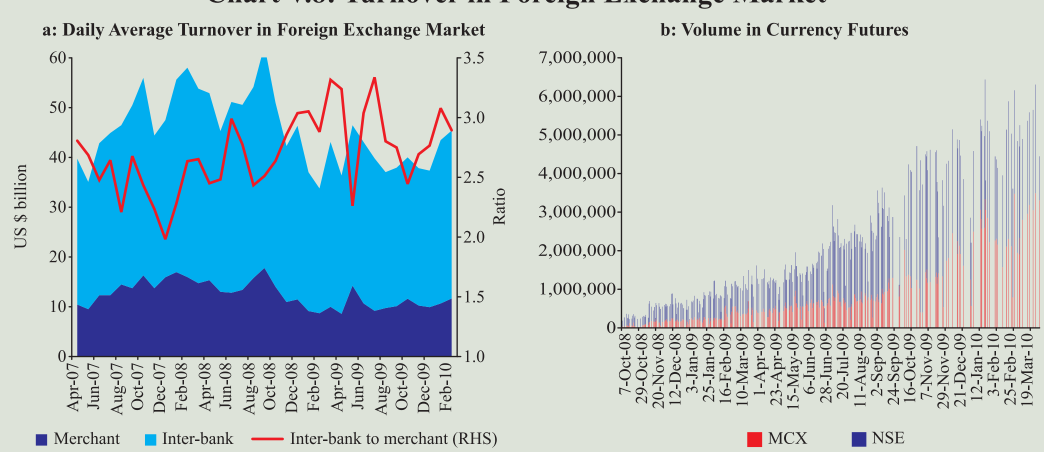


Table V.10: Key Stock Market Indicators

Indicator	BSE			NSE		
	2007-08	2008-09	2009-10	2007-08	2008-09	2009-10
1	2	3	4	5	6	7
1. BSE Sensex/S&PCNX Nifty						
(i) End-period	15644	9709	17528	4735	3021	5249
(ii) Average	16569	12366	15585	4897	3731	4658
2. Coefficient of Variation	13.7	24.2	11.8	14.5	23.2	11.33
3. Price-Earning Ratio (end-period)*	20.1	13.7	21.3	20.6	14.3	22.3
4. Market Capitalisation (Rupees thousand crore) @	5,138	3,086	6,164	4,858	2,896	6,009
5. Market Capitalisation to GDP Ratio (per cent)	113.1	59.0	106.5	107.0	55.4	103.8

*: 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).

activity in the primary segment of the domestic capital market displayed signs of revival in Q2 and Q3 of 2009-10. The resources raised through public issues increased considerably during 2009-10 (Table V.11). Mobilisation of resources through private placement (Rs.2,44,107 crore) also increased by 61.0 per cent during April-December 2009. The resource mobilisation by mutual funds increased substantially with liquidity conditions remaining comfortable, deposit interest rates moderating and stock markets witnessing considerable gains.

V.27 Stock prices displayed a continuous upward momentum throughout the year, except for some occasional corrections during the last two quarters caused by Dubai World default and the Greek sovereign debt concerns. Following the optimism on account of measures announced in the Union Budget 2010-11 such as the roadmap for fiscal consolidation and PSU divestment, stock prices recorded further gains. As at end-March 2010, the Sensex and the Nifty both registered gains of 81 per cent and 74 per cent, respectively, over end-March 2009 (Chart V.9a). The gains in stock prices were associated with substantial increase in the activity in the

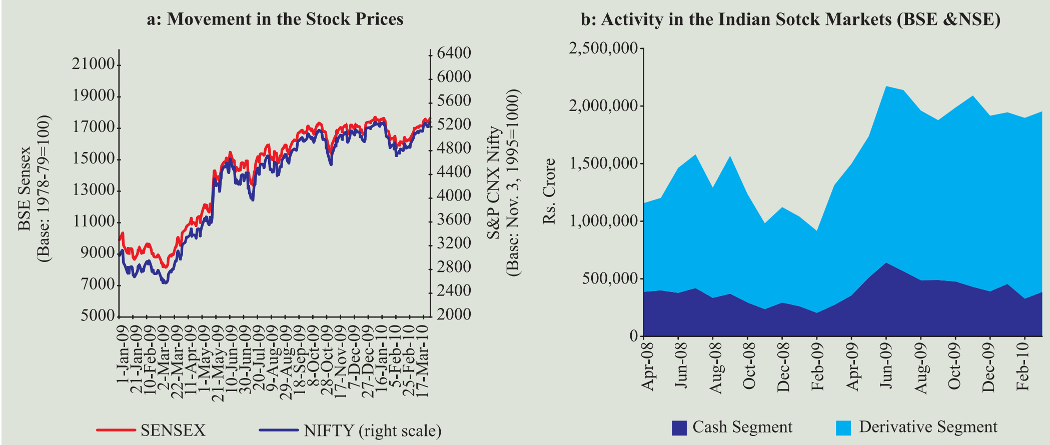
Table V.11: Resource Mobilisation from Capital Market

(Rupees crore)

Category	2008-09 (Apr-Mar)	2009-10 (Apr-Mar) P
1	2	3
A. Prospectus and Rights Issues*	14,671	32,607
1. Private Sector (a+b)	14,671	25,479
a) Financial	466	326
b) Non-financial	14,205	25,153
2. Public Sector	–	7,128
a) Financial	–	325
b) Non-financial	–	6,803
B. Euro Issues	4,788	15,967
C. Mutual Fund Mobilisation (net)@	-28,296	83,080
1. Private Sector	-34,017	54,928
2. Public Sector #	5,721	28,152

P: Provisional. *: Excluding offer for sale.
@: Net of redemptions. #: Including UTI Mutual fund.
Note: Data exclude funds mobilised under Fund of Funds Schemes.
Source: Mutual Fund data are sourced from Securities and Exchange Board of India.

Chart V.9: Movement in Sotck Prices and Turnover



derivative segment surpassing the pre-global crisis level (Chart V.9b). The gains in stock prices were also led by the FII investments, while at the same time mutual funds turned net sellers. FIIs made net purchases of US$ 23.7 billion in the Indian equity market during 2009-10 (net sales of US$ 10.4 billion in 2008-09), while the mutual funds' net sales during 2009-10 amounted to Rs.10,512 crore (net purchases of Rs.6,985 crore in of 2008-09) (Chart V.10).

V.28 Another important segment of asset prices is the residential housing segment that has important implications for the behaviour of general prices and overall macroeconomic and financial stability. There has been a general upward pressure on housing prices in the recent period, which broadly co-terminates with the rise in stock prices, thus, indicating generalised asset price pressures (Chart V.11a and b).

V.29 The domestic financial markets during 2009-10, thus, exhibited reduced

Chart V.10: FII and Mutual Fund Investment in the Stock Market

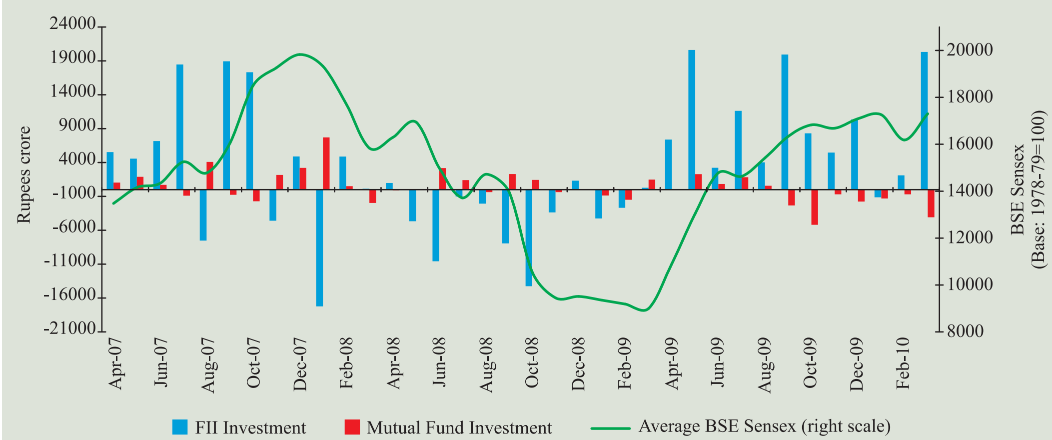
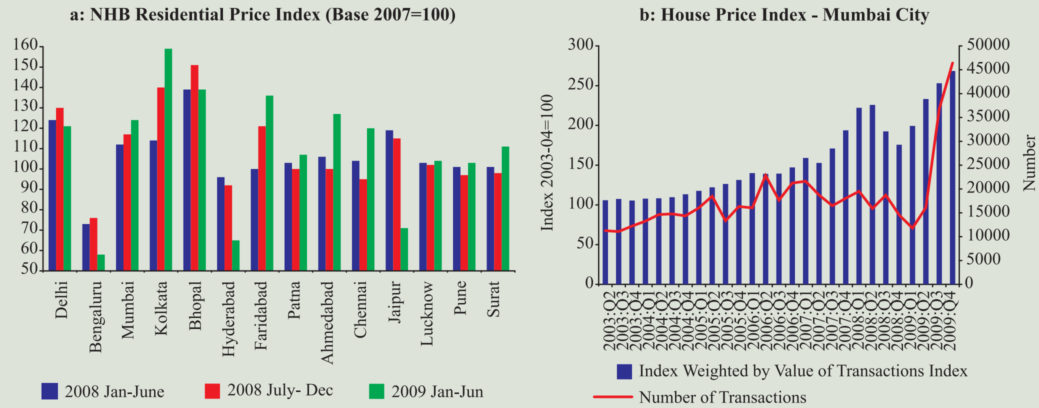


Chart V.11: Movement in Residential Housing Prices



Source: National Housing Bank.

Source: Reserve Bank of India.

volatility with market activity returning to the pre-global crisis level. The evolution of interest rates in money and government bonds markets was different. While money market interest rates remained low, reflecting surplus liquidity conditions, there was persistent pressure on medium to long term bond yields. Nevertheless, stronger potential pressure on interest rate on account of the large size of the government borrowing programme was managed by the Reserve Bank through an array of liquidity management tools such as MSS unwinding, OMO purchases and shortening the maturity structure of new issues. Going forward, with the revival of credit demand from the private sector to normal levels, the borrowing programme for 2010-11, despite planned frontloading, could exert some crowding out pressures. A stronger recovery in India and the favourable interest rate differentials in the face of easy global liquidity conditions could lead to higher capital inflows, which may influence both exchange rate and asset prices. The strong rebound in asset prices needs to be monitored closely, given their implications for financial and macroeconomic stability.

VI. PRICE SITUATION

The Wholesale Price Index (WPI) inflation, after remaining significantly subdued during the first half of the year, increased at a faster pace in the second half and reached 9.9 per cent by February 2010, and remained almost unchanged at the same high level in March 2010. The Wholesale Price Index, though, exhibited secular increases throughout the year, indicating sustained momentum in inflation. Decline in agricultural production caused by deficient South-West monsoon as well as increases in international price of crude oil largely conditioned the inflation path. Indications of generalisation of inflation became increasingly evident starting from November 2009. Inflation in non-food manufactured products increased from (-)0.4 per cent in November 2009 to 4.7 per cent in March 2010. Alongside increasing generalisation of the inflation process, demand side pressures from certain quarters also became visible. Consumer price inflation moderated in February 2010 although it still remains high in double digits. With recovery in growth gaining momentum, the Reserve Banks' policy emphasis has shifted to anchoring inflation expectations.

VI.1 Inflationary conditions in India during 2009-10 were marked by two distinct phases. During the first half of 2009-10, the year-on-year WPI inflation remained significantly low (negative during June-August 2009) on account of the high base of sharp increases in prices recorded a year ago. This period, however, was characterised by a significant build-up of inflationary momentum, largely on account of the partial pass-through of increases in international prices. During the second half of the year, increasing food prices, on account of unfavourable agricultural supply conditions caused by the deficient South-West monsoon coupled with the waning of base effect led to sharp increase in inflation and the headline WPI inflation reached 9.9 per cent (y-o-y) in February 2010. Increase in international oil prices, and the resultant upward revision in POL prices also contributed to the inflation process during the course of the year. The recent increases in manufactured non-food products inflation signal how an inflation process triggered by supply side pressures could get generalised over time. The primary factor behind the rising headline inflation, *i.e.*, food price inflation, however, has started to moderate since December 2009, largely reflecting seasonal pattern, though it still remains elevated. Moreover, inflation as per Consumer Price Indices (CPIs), which have a higher relative weight for food articles, though declined marginally in February 2010, still remain high.

Global Inflation

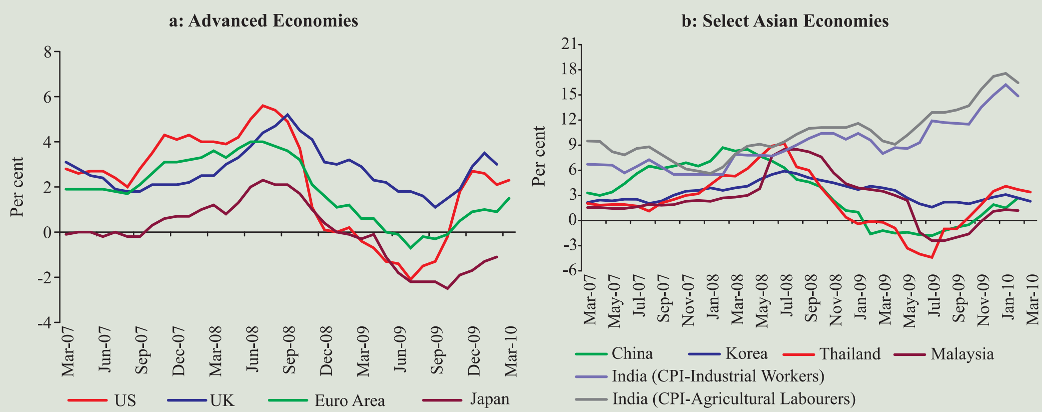
VI.2 Most advanced economies witnessed very low or negative headline inflation during the first half of 2009-10. This was mainly on account of the contraction in demand associated with the recession as well the impact of sharp decline in international commodity prices. The emerging economies also experienced significant decline in inflation, mostly due to decline in commodity prices and lower demand pressures on account of moderation in growth. During the second half of 2009-10, inflation in major economies increased from sub zero/low levels, mainly reflecting the waning impact of the base (commodity prices had declined sharply during the second half of 2008-09 leading to decline in prices then in most countries). Some part of the recent increase in inflation across the globe could also be attributed to the rebound in commodity prices ahead of global recovery as well as gradual pick-up in demand as the economies work their way out of recession.

VI.3 Except Japan, most economies registered positive, though subdued CPI inflation by November 2009 (Chart VI.1). Year-on-year consumer price inflation in OECD countries, which was negative during the period June-September 2009, increased to 1.9 per cent in February 2010. Core inflation (excluding food and energy) in OECD countries, after declining since September 2008, has remained stable at around 1.5 per cent since June 2009, indicating the limited pressure on inflation from the demand side.

VI.4 During the first half of 2009-10, there were concerns over a possible deflationary spiral created by the negative inflation in the US, Japan and the Euro area. Those concerns abated with the recent increases in CPI inflation of major economies and stabilising core inflation. In the advanced economies, headline inflation is expected to pick up from 0.1 per cent in 2009 to 1.3 per cent in 2010, as rebound in energy prices could more than offset slowing labour costs. In emerging and developing economies, inflation is expected to increase from 5.2 per cent in 2009 to 6.2 per cent in 2010, as some of these economies may face growing upward pressures from limited economic slack and domestic liquidity effects of increased capital flows. In the emerging economies, inflationary pressures have remained subdued during 2009-10, *albeit*, with some firming up during the last quarter, except in India and Russia (Table VI.1).

VI.5 Monetary policy stance of most central banks in the advanced economies during 2009-10 was conditioned by concerns

Chart VI.1: Consumer Price Inflation



Source: International Financial Statistics and official websites of respective countries.

Table VI.1: Global Inflation Indicators

(Per cent)

Country/ Region	Key Policy Rate	Policy Rate (As on Apr. 16, 2010)	Changes in Policy Rates (basis points)			CPI Inflation (y-o-y)	
			Sept 08 - Mar 09	Apr 09 - Aug 09	Sep 09 - Apr 10	Mar. 2009	Mar. 2010
1	2	3	4	5	6	7	8
Developed Economies							
Australia	Cash Rate	4.25 (Apr.7, 2010)	(-) 400	(-)25	125	3.7^	2.1^
Canada	Overnight Rate	0.25 (Apr.21,2009)	(-) 250	(-) 25	0	1.4*	1.6*
Euro area	Interest Rate on Main Refinancing Operations	1.00 (May 13,2009)	(-) 275	(-) 50	0	0.6	1.4
Japan	Uncollateralised Overnight Call Rate	0.10 (Dec.19,2008)	(-) 40	0	0	-0.1*	-1.1*
UK	Official Bank Rate	0.50 (Mar. 5,2009)	(-) 450	0	0	3.2*	3.0*
US	Federal Funds Rate	0.00 to 0.25 (Dec.16,2008)	(-) 200	0	0	-0.4	2.3
Developing Economies							
Brazil	Selic Rate	8.75 (July 22, 2009)	(-) 250	(-) 250	0	5.6	5.2
India	Reverse Repo Rate	3.50 (Mar.19, 2010)	(-) 250	(-)25	25	9.6*	14.9*
	Repo Rate	5.00 (Mar 19, 2010)	(-) 400	(-) 25	25		
			(-400)		(75)		
China	Benchmark 1-year Lending Rate	5.31 (Dec 23, 2008)	(-) 216	0	0	-1.2	2.4
			(-300)	0	(100)		
Indonesia	BI Rate	6.50 (Aug. 5, 2009)	(-) 150	(-) 125	0	7.9	3.4
Israel	Key Rate	1.50 (Apr. 1, 2010)	(-) 350	(-)25	100	3.3*	3.6*
Korea	Base Rate	2.00 (Feb. 12, 2009)	(-) 325	0	0	3.9	2.3
Philippines	Reverse Repo Rate	4.00 (Jul. 9, 2009)	(-) 125	(-)75	0	6.4	4.4
Russia	Refinancing Rate	8.25 (Mar 29, 2010)	100	(-)225	(-)250	14.0	6.4
South Africa	Repo Rate	6.50 (Mar. 26, 2010)	(-) 200	(-)250	(-) 50	8.6*	5.7*
Thailand	1-day Repurchase Rate	1.25 (Apr. 8, 2009)	(-) 225	(-) 25	0	-0.2	3.4

^ : Q4. *: February.

Note : 1. For India, data on inflation pertain to CPI for Industrial Workers.
2. Figures in parentheses in column (3) indicate the dates when the policy rates were last revised.
3. Figures in parentheses in column (4) indicate the variation in the cash reserve ratio during the period.

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

over the recession and the subsequent fragile recovery, and policy rates accordingly were left unchanged at near zero levels. During the second half of the year inflationary pressures started to emerge in some economies, particularly those that witnessed faster than expected recovery and gradual closing of the output gap, which led to exit from easy monetary policy. The Reserve Bank of Australia and Bank of Israel have increased their policy rates by 125 and 100 basis points, respectively, since September 2009 on the back of signs of economic recovery and improvement in indicators of confidence (Table VI.1). Peoples Bank of China also raised the reserve requirement ratio by 50 basis points each in January and February 2010.

Global Commodity Prices

VI.6 International commodity prices, which declined sharply during June-December 2008, gradually firmed up in 2009-10. Commodity price rebound ahead

Table VI.2: International Commodity Prices

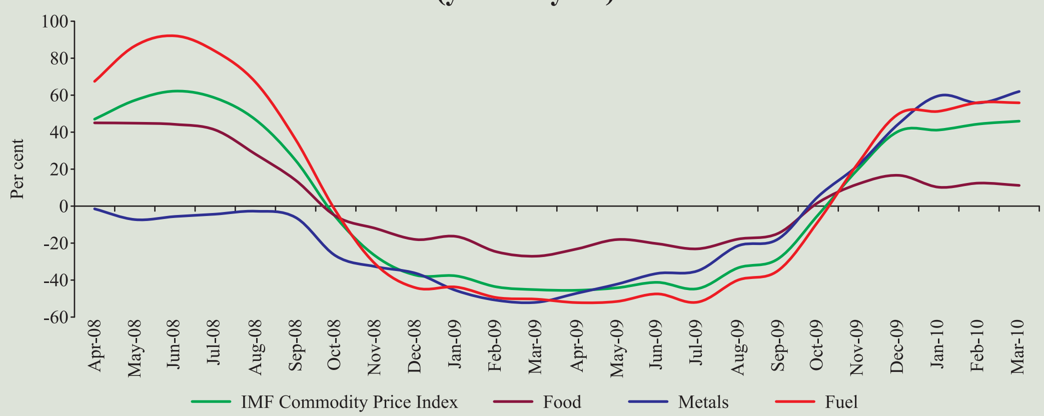
Commodity	Unit	Market Price	Index (2004=100)											Variation (Per cent)	
		(2004)	2005	2006	2007	2008	2009-10							Mar.09 over Jun.08	Mar.10 over Mar.09
							Mar.	Jun.	Sep.	Dec.	Jan.	Feb.	Mar.		
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
Energy															
Coal	$/mt	53	90	93	124	240	115	135	128	157	183	178	178	-61.8	54.7
Crude oil	$/bbl	38	142	170	188	257	124	183	181	198	204	198	210	-64.5	70.0
Non-Energy Commodities															
Palm oil	$/mt	471	90	101	165	201	127	154	143	168	168	169	177	-50.7	39.1
Soybean oil	$/mt	616	88	97	143	204	118	145	137	152	150	148	149	-52.7	25.9
Soybeans	$/mt	307	90	88	125	171	124	164	140	147	142	132	133	-39.1	7.7
Rice	$/mt	238	120	128	137	274	247	242	218	249	239	225	212	-22.3	-14.2
Wheat	$/mt	157	97	122	163	208	147	164	122	131	128	124	122	-33.7	-17.3
Maize	$/mt	112	88	109	146	200	147	161	135	147	150	145	142	-42.7	-3.4
Sugar	c/kg	16	138	206	141	178	187	229	322	322	369	354	264	10.5	41.4
Cotton A Index	c/kg	137	89	93	102	115	83	99	103	123	125	129	138	-33.2	66.5
Aluminium	$/mt	1716	111	150	154	150	78	92	107	127	130	119	129	-54.8	65.1
Copper	$/mt	2866	128	235	248	243	131	175	216	244	258	239	260	-54.6	99.0
Gold	$/toz	409	109	148	170	213	226	231	244	277	273	268	272	3.9	20.4
Silver	c/toz	669	110	173	200	224	196	219	246	264	265	237	256	-23.0	30.8
Steel cold-rolled coil sheet	$/mt	607	121	114	107	159	148	115	115	115	115	115	128	-18.2	-13.9
Steel hot-rolled coil sheet	$/mt	503	126	119	109	176	159	119	119	119	119	119	134	-20.0	-15.6
Tin	c/kg	851	87	103	171	217	125	176	175	183	208	192	206	-52.0	64.4
Zinc	c/kg	105	132	313	309	179	116	149	180	227	232	206	217	-35.8	87.0

$: 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 exhibit price trends over the relevant period.

of global recovery has been driven by the expectations of recovery in growth and resultant tighter demand conditions in relation to supply (Table VI.2, Chart VI.2).

Chart VI.2: Increase in International Commodity Prices (year-on-year)



VI.7 Crude oil prices increased by about 70 per cent (year-on-year) in March 2010. According to the International Energy Agency (IEA) estimates, stronger global economic growth during 2010 may increase oil consumption by 1.7 million barrels per day. While this could suggest possible firming of crude oil prices, availability of ample surplus capacity may dampen any significant pressure on oil prices.

VI.8 The increase in metal prices was led by the improvement in global economic prospects as well as supply cutbacks in response to the prolonged decline in price. International food prices have been increasing gradually (except in July 2009). The FAO Food Price Index, a measure of the monthly change in international prices of a food basket composed of cereals, oilseeds, dairy, meat and sugar increased significantly up to January 2010. The major driver of this increase was sugar, the production of which was affected in the two major sugar producers, *i.e.*, India and Brazil. The FAO Food Price Index, however, declined by 6.8 per cent during January-March 2010 as sugar and cereals price indices declined by 29 per cent and 7 per cent, respectively.

VI.9 The impact of increases in international commodity prices on domestic prices to an extent was modulated by the movements in exchange rate. As the exchange rate appreciated during the course of the year, the exchange rate pass-through effects helped in moderating the impact of higher international commodity prices on domestic inflation.

Inflation Conditions in India

VI.10 The global trends in commodity prices and domestic demand-supply balance pointed towards less pressure on prices during 2009-10 at the time of the Annual Policy Statement (APS) of the Reserve Bank for the year 2009-10 (April 2009) and accordingly the APS projected WPI inflation at around 4.0 per cent by end-March 2010. The APS reduced the policy rates further by 25 basis points to support the revival of economic growth as economic growth had declined well below its potential level on account of the impact of the crisis along with significant moderation in price pressures (Table VI.3).

VI.11 The First Quarter Review (FQR) of Monetary Policy 2009-10 (July 2009) had highlighted that despite headline inflation turning negative, commensurate decline in inflationary expectations had not materialised. As the uncertain monsoon outlook increased the inflation risks, the FQR revised the end-March 2010 WPI inflation projection upward to 5.0 per cent. The Second Quarter Review (SQR) of Monetary Policy 2009-10 (October 2009) noted that the upside risk from deficient monsoon rainfall materialised and the baseline projection for WPI inflation at end-March 2010, therefore, was revised upwards to 6.5 per cent with an upside bias. The SQR noted that indications of consolidating recovery warranted a shift in policy stance from 'managing the crisis' to 'managing the recovery'. The SQR also indicated the Reserve Bank's commitment to a calibrated 'exit' from the expansionary monetary policy stance without hampering recovery process while anchoring inflation expectations and announced closure of some special liquidity support measures that had largely remained unutilised and restored the statutory liquidity ratio (SLR) of scheduled commercial banks to its pre-crisis level (25 per cent). It signalled the first phase of exit.

Table VI.3: Movements in Key Policy Rates in India

(Per cent)

Effective since	Reverse Repo Rate	Repo Rate	Cash Reserve Ratio	WPI Inflation	CPI (IW) Inflation
1	2	3	4	5	6
April 26, 2008	6.00	7.75	7.75 (+0.25)	8.3	7.8
May 10,2008	6.00	7.75	8.00 (+0.25)	8.6	7.8
May 24,2008	6.00	7.75	8.25 (+0.25)	8.9	7.8
June 12, 2008	6.00	8.00 (+0.25)	8.25	11.7	7.7
June 25, 2008	6.00	8.50 (+0.50)	8.25	11.9	7.7
July 5, 2008	6.00	8.50	8.50 (+0.25)	12.2	8.3
July 19, 2008	6.00	8.50	8.75 (+0.25)	12.5	8.3
July 30, 2008	6.00	9.00 (+0.50)	8.75	12.5	8.3
August 30, 2008	6.00	9.00	9.00 (+0.25)	12.4	9.0
October 11, 2008	6.00	9.00	6.50 (–2.50)	11.3	10.4
October 20, 2008	6.00	8.00 (–1.00)	6.50	10.8	10.4
October 25, 2008	6.00	8.00	6.00 (–0.50)	10.7	10.4
November 3, 2008	6.00	7.50 (–0.50)	6.00	8.7	10.4
November 8, 2008	6.00	7.50	5.50 (–0.50)	8.7	10.4
December 8, 2008	5.00 (-1.00)	6.50 (–1.00)	5.50	6.6	9.7
January 5, 2009	4.00 (-1.00)	5.50 (–1.00)	5.50	5.3	10.4
January 17, 2009	4.00	5.50	5.00 (–0.50)	4.9	10.4
March 4, 2009	3.50(-0.50)	5.00(-0.50)	5.00	0.9	8.0
April 21, 2009	3.25 (-0.25)	4.75(-0.25)	5.00	1.6	8.7
February 13, 2010	3.25	4.75	5.50(+0.50)	9.9	14.9
February 27, 2010	3.25	4.75	5.75(+0.25)	9.9	14.9
March 19, 2010	3.50(+0.25)	5.00(+0.25)	5.75	9.9	–

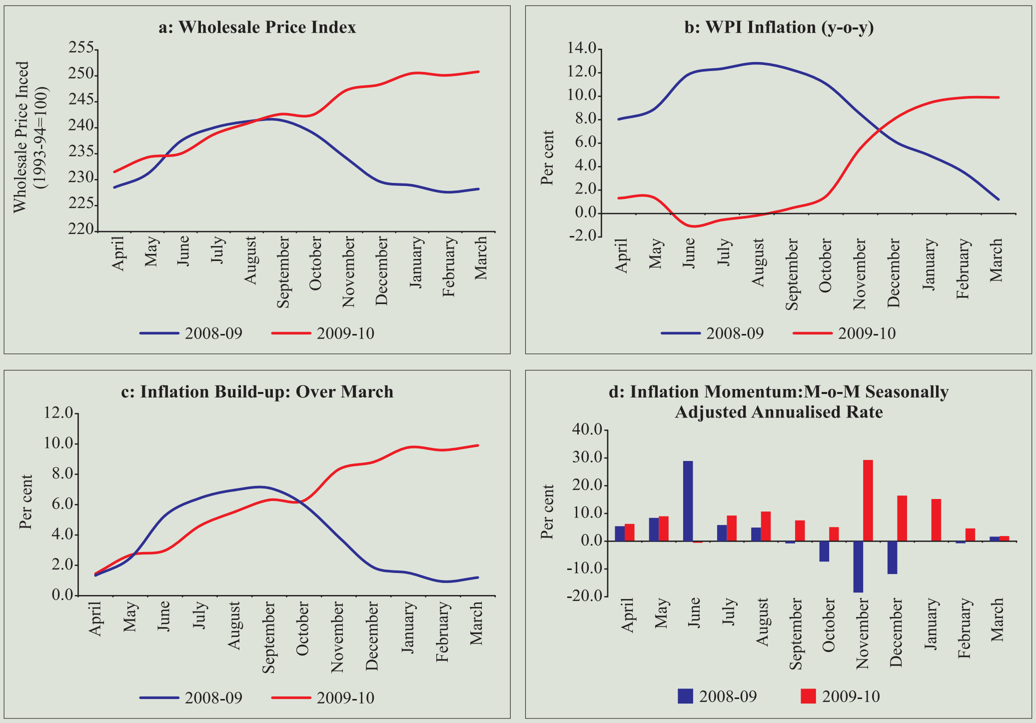
Note: 1. Reverse repo indicates absorption of liquidity and repo signifies injection of liquidity.
2. Figures in parentheses indicate change in policy rates.

VI.12 The Third Quarter Review (TQR) of Monetary Policy 2009-10 (January 2010) raised the baseline projection for WPI inflation for March 2010 to 8.5 per cent on account of further strengthening of supply side pressures and emerging risks of such pressures spilling over on to a wider inflationary process. As part of the calibrated exit strategy, the CRR of scheduled banks was increased by 75 basis points from 5.0 per cent to 5.75 per cent of NDTL in two stages. Further, as WPI inflation increased and reached 9.9 per cent (y-o-y) in February 2010 amidst signs of generalisation of inflation, the Reserve Bank raised the repo and reverse repo rates under the LAF by 25 basis points each on March 19, 2010, balancing the needs of supporting recovery while anchoring inflation expectations.

Wholesale Price Inflation

VI.13 During the first half of 2009-10, the year-on-year WPI inflation remained moderate during April-May 2009 and subsequently turned negative during June-August 2009 on account of the strong base effect of the significant increase in administered prices of petroleum products in June 2008 (Chart VI.3a and b). The base effect of sharp increases in prices during the first half of 2008-09 waned during the second half as WPI had declined during the period September 2008-February 2009 (Chart VI.3a). The secular build up in price

Chart VI.3: Trends in Wholesale Price Inflation

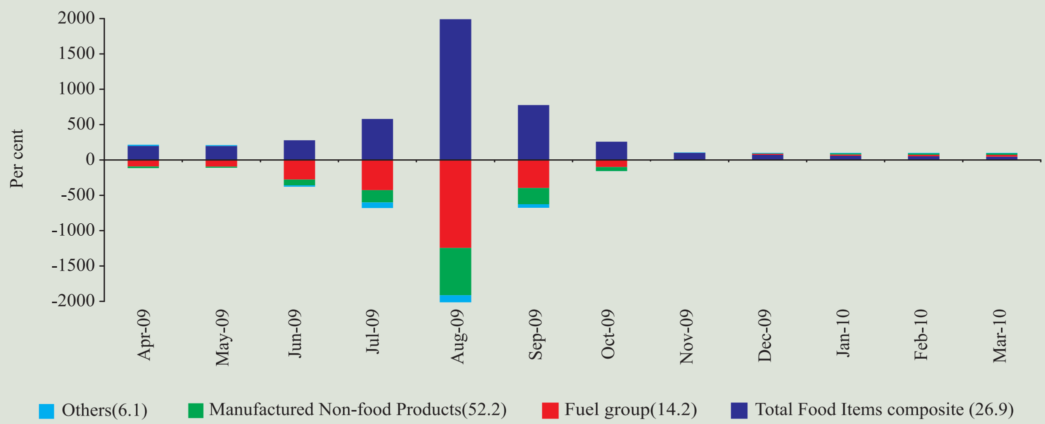


pressures, however, was visible throughout the year and WPI inflation increased significantly to 9.9 per cent by March 2010. The financial year build up of inflation exhibited secular uptrend during the year which was corroborated by the positive inflation momentum during all the months of 2009-10 (except June 2009) (Chart VI.3c and d).

VI.14 Though the WPI inflation remained moderate/negative during the first half of 2009-10, contrasting trends among the major sub-groups were visible during that period in terms of weighted contribution to the headline inflation. Since the rate of inflation in each month was different, the weighted contribution based analysis needs to be seen from the standpoint of making an assessment about the extent of variability resulting from different components of the WPI. Food inflation was significantly high during this period, which meant that food group (both primary food articles and manufactured food products) had a disproportionately larger contribution to inflation. On the other hand, fuel group exhibited large negative inflation, which pulled down the overall inflation low during the first half of the year (Chart VI.4 and Chart VI.5). In the second half of the year, inflation contribution came from all the major groups as positive contribution was visible from all the categories, indicating generalisation of inflation.

VI.15 In terms of contribution to overall inflation by the major groups, the contribution of the fuel group, which was significantly negative since January 2009,

Chart VI.4: Weighted Contribution of Major Groups to WPI Inflation (per cent)



showed a reversal of trend in recent months (Chart VI.5). The contribution of non-food manufactured products group, which declined during the receding phase of inflation and turned negative during April-November 2009, has also started to increase in recent months. Food articles and products, as a group continue to drive the overall WPI inflation, though its contribution has declined since December 2009.

VI.16 The supply constraints on account of the shortfall in agricultural production and increasing international crude prices were the major drivers of inflation in India uptill November 2009. The emergence of inflationary pressures, thus, was led by increases in prices of a few commodities and inflation remained concentrated in a few commodities. Since then, the inflation has become increasingly generalised as more number of commodities have started to exhibit significant pick-up in inflation. This is manifested in the declining share of top ten contributors to inflation since November 2009. The cumulative weight

Chart VI.5: Contribution to Overall Inflation - Major groups

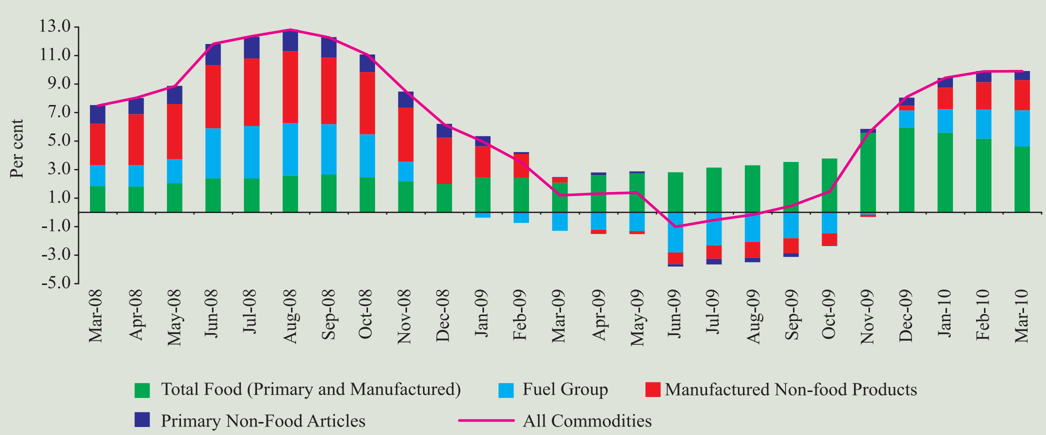
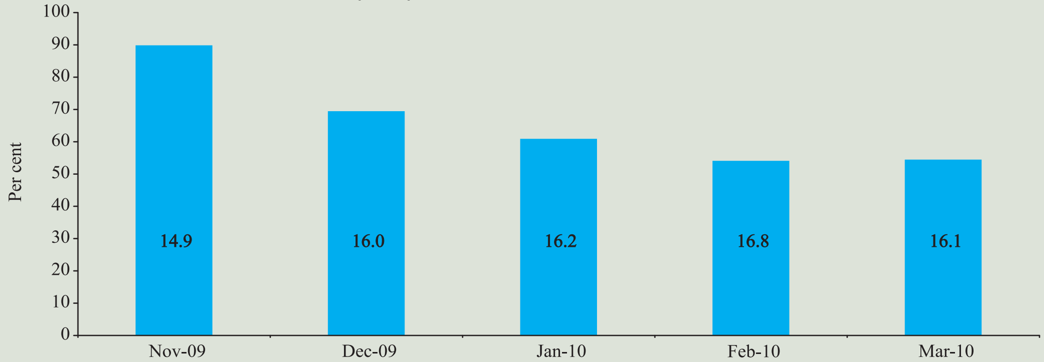


Chart VI.6: Weighted Contribution of Top Ten Commodities to WPI Inflation (y-o-y) since November 2009



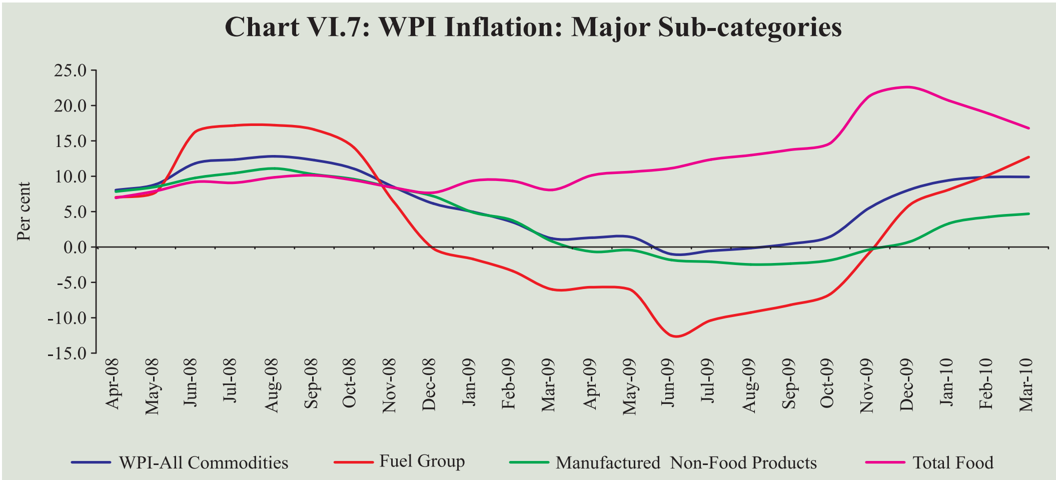
Figures inside the bar indicate the cumulative weight of top 10 commodities in WPI.

of the top ten contributors to inflation have also increased indicating that commodities with relatively higher weights have emerged as the drivers of inflation (Chart VI.6).

VI.17 When the inflation process tends to get generalised, the transmission from segmented pressures in certain items to the general inflation takes place with a lag, and during this period, containing inflation expectations becomes critical to enhance the effectiveness of monetary policy actions to reign in inflationary pressures. It can be expected that price pressure originating from inflation in fuel group may entail much greater risk to generalisation of inflation with more immediate impact as fuel enter as an intermediate input in most manufacturing products. Pressure from food price shocks on generalised inflation, on the other hand, may be gradual. This, to an extent, has been corroborated by the movements in manufactured non-food products inflation, which moved up significantly in recent months alongside increase in fuel inflation, while food inflation moderated in recent months (Chart VI.7).

VI.18 The y-o-y WPI inflation excluding food and fuel consistently remained below the headline inflation during 2009-10. The trend of non-food non-fuel inflation, however, was mostly in sync with the headline inflation. Inflation in essential commodities group increased sharply during 2009-10, largely driven by food items' price increases. Essential commodity inflation shows signs of moderation since January 2010 in line with the moderation in food prices (Chart VI.8a).

VI.19 The increases in prices of food articles and food products have contributed 47 per cent of the build-up in WPI inflation during 2009-10. The upward revision of prices of petrol and diesel (effective July 2, 2009) and increase in prices of freely priced products under the fuel group in line with hardening of international crude oil prices further contributed to the increase in inflation during the year. Increases in administered prices of coal, reversal of excise and customs duty on petrol and diesel also partly contributed to the increase in inflation. Thus, the WPI inflation was



above the Reserve Bank's projection of 8.5 per cent by March 2010.

VI.20 Amongst the major groups, primary articles inflation, y-o-y, remained in single digit up to October 2009 and increased significantly thereafter, mainly on account of food prices, which registered high double-digit increase (Chart VI.8b). Some softening of inflation in primary articles is visible in recent months reflecting the seasonal moderation in prices of food articles and the impact of arrival of fresh crops in the market.

VI.21 Year-on-year fuel group inflation, remained significantly negative during December 2008-November 2009 on account of the lower international crude oil prices compared to the very high levels in 2008. Fuel inflation turned positive in December 2009 reflecting the base effect of downward revision of administered prices in December 2008. The hikes in administered prices of petrol and diesel effective from July 2, 2009 and the reversal of customs and excise duty concessions given on petroleum products in the Union

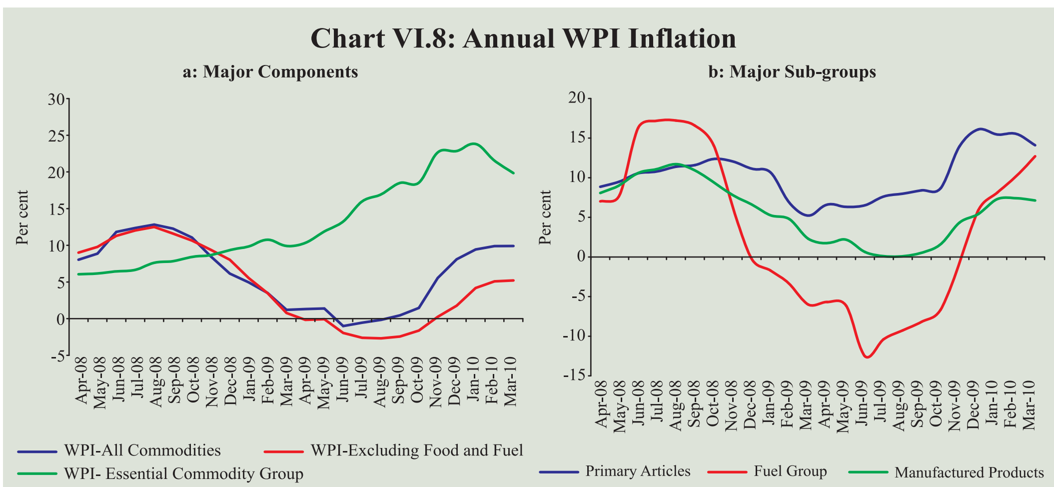
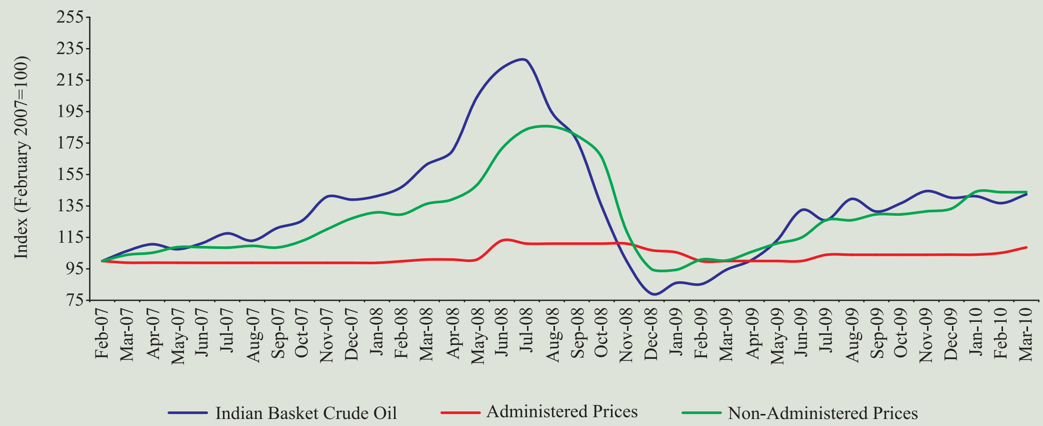


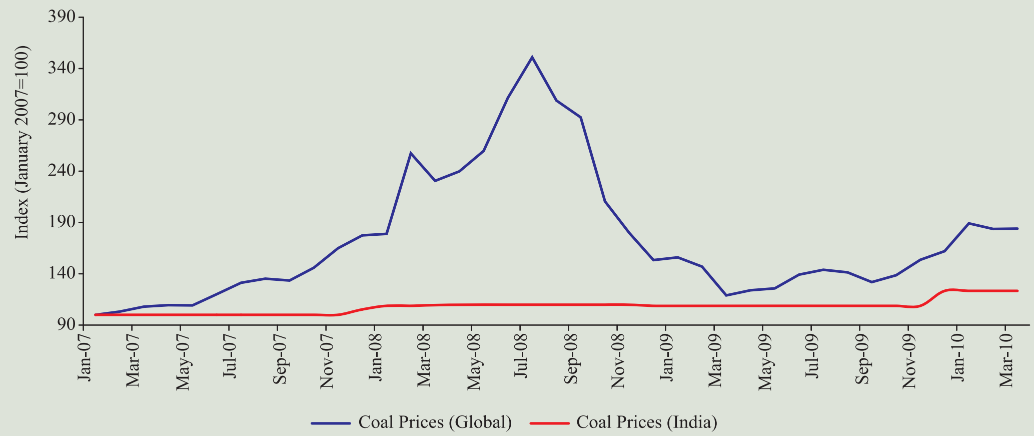
Chart VI.9: Fuel Price Pass-through



Budget for 2010-11, as part of the fiscal exit, led to increases in administered prices of petroleum products. Freely priced products under the minerals oil group followed the trends in international crude prices and gradually increased during the year (Chart VI.9). It is also to be noted that international oil prices remaining at current levels would imply a significant gap in the administered prices of petroleum products in relation to the price of Indian basket crude oil (converted to rupees at respective monthly average exchange rates), which would significantly increase the under-recoveries of oil marketing companies.

VI.22 Among the other major items in fuel group, coal prices were raised in January 2010 as global prices increased substantially (Chart VI.10). Increase in domestic coal prices, however, remain significantly lower than international prices. Electricity prices inflation remained moderate during the year. Recent increases in oil and coal prices may, over time, spillover to electricity prices.

Chart VI.10: Coal Prices: Global *vis-à-vis* Domestic



VI.23 Manufactured products inflation, y-o-y, declined during the first half of 2009-10 mainly reflecting the significant negative inflation in metals. Manufactured products inflation, however, increased from 0.1 per cent in August 2009 to 7.1 per cent in March 2010 mainly driven by the manufactured food products, led by sugar (Table VI.4). The non-food manufacturing inflation, which was

Table VI.4: Wholesale Price Inflation in India (Year-on-Year)

(Per cent)

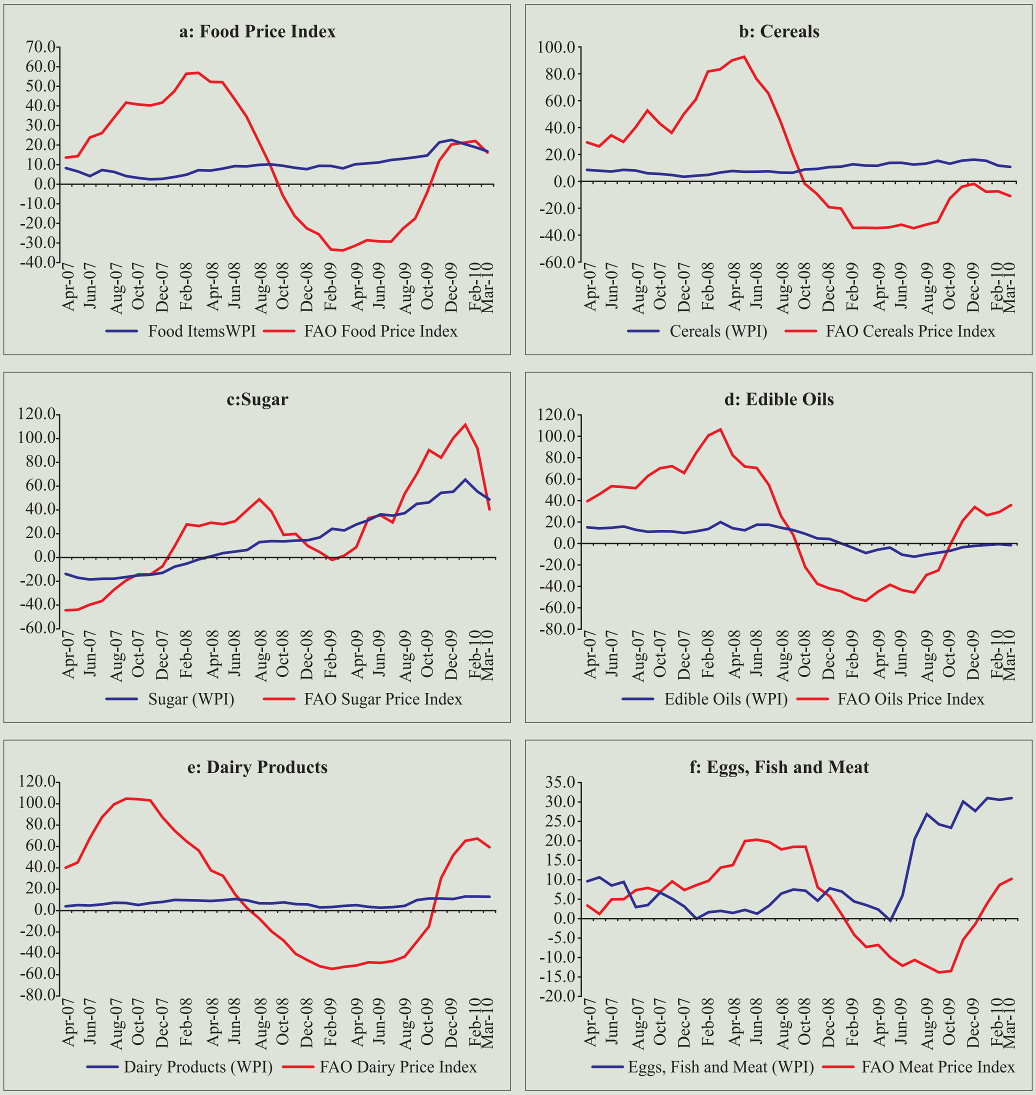
Commodity		2008-09 (March)		2009-10 (March)	
	Weight	Inflation	C*	Inflation	C*
1	2	3	4	5	6
All Commodities	**100.0**	**1.2**	**1.2**	**9.9**	**9.9**
1. Primary Articles	**22.0**	**5.2**	**1.2**	**14.1**	**3.4**
Food Articles	15.4	7.5	1.2	16.7	2.7
i. Rice	2.4	16.7	0.4	8.0	0.2
ii. Wheat	1.4	4.6	0.1	14.4	0.2
iii. Pulses	0.6	10.8	0.1	31.4	0.2
iv. Vegetables	1.5	-5.3	-0.1	1.6	0.0
v. Fruits	1.5	7.5	0.1	12.0	0.2
vi. Milk	4.4	7.4	0.3	17.6	0.8
vii. Eggs, Fish and Meat	2.2	3.5	0.1	31.0	0.7
Non-Food Articles	6.1	-0.9	-0.1	12.8	0.8
i. Raw Cotton	1.4	1.9	0.0	17.5	0.2
ii. Oilseeds	2.7	-3.1	-0.1	9.8	0.3
iii. Sugarcane	1.3	0.0	0.0	2.3	0.0
Minerals	0.5	7.2	0.1	-9.6	-0.1
2. Fuel, Power, Light and Lubricants	**14.2**	**-6.0**	**-1.3**	**12.7**	**2.5**
i. Coal Mining	1.8	-0.7	0.0	13.5	0.3
ii Minerals Oil	7.0	-8.6	-1.1	17.0	2.0
iii. Electricity	5.5	-2.6	-0.2	4.7	0.3
3. Manufactured Products	**63.7**	**2.3**	**1.3**	**7.1**	**4.0**
i. Food Products	11.5	8.9	0.9	17.0	1.9
of which: Sugar	3.6	22.7	0.5	48.8	1.4
Edible Oils	2.8	-8.9	-0.2	-1.6	0.0
ii. Cotton Textiles	4.2	13.4	0.4	13.9	0.4
iii. Man Made Fibres	4.4	-1.3	0.0	2.2	0.0
iv. Chemicals and Products	11.9	2.2	0.2	8.1	0.9
of which : Fertilisers	3.7	5.4	0.2	-4.4	-0.1
v. Non-Metallic Mineral Products	2.5	2.2	0.1	0.5	0.0
of which: Cement	1.7	2.0	0.0	-3.2	-0.1
vi. Basic Metals, Alloys and Metal Products	8.3	-9.4	-1.0	1.1	0.1
of which: Iron and Steel	3.6	-14.6	-0.8	1.9	0.1
vii. Machinery and Machine Tools	8.4	2.6	0.2	3.2	0.2
of which: Electrical Machinery	5.0	1.1	0.0	2.9	0.1
viii. Transport Equipment and Parts	4.3	2.8	0.1	0.5	0.0
Memo:					
Food Items (Composite)	**26.9**	**8.1**	**2.1**	**16.8**	**4.6**
Manufactured Non-food Products	**52.2**	**0.8**	**0.4**	**4.7**	**2.1**
WPI Excluding Food	**73.1**	**-1.2**	**-0.9**	**7.3**	**5.3**
WPI Excluding Fuel	**85.8**	**3.2**	**2.5**	**9.2**	**7.4**
Essential Commodities	**17.6**	**9.9**	**1.6**	**19.8**	**3.6**

*: Contribution to inflation

negative up to November 2009, has changed course since then and increased significantly to 4.7 per cent in March 2010.

VI.24 Though the current inflation in food articles in India is quite significant, it needs to be noted that the international food prices have been much volatile in the recent past as compared to the domestic prices. Imports as an option to check price rise in India may not be fully effective as global inflation in food has already caught up with the high levels in India (Chart VI.11, Table VI.5).

Chart VI.11: Trends in Food Inflation: Global *vis-à-vis* Domestic (year-on-year, per cent)



Source: FAO Food Price Database and Office of Economic Adviser Ministry of Commerce and Industry

Table VI.5: Key Commodity Prices - Global *vis-à-vis* Domestic

(Per cent)

Item	Annual Inflation (y-o-y, March 2010)	
	Global	India
1	2	3
1. Rice	-14.2	8.0
2. Wheat	-17.3	14.4
3. Raw Cotton	66.5	17.5
4. Oilseeds	7.7	9.8
5. Iron Ore	-28.2	-15.5
6. Coal mining	54.7	13.5
7. Minerals Oil	70.0	17.0
8. Edible Oils	39.1	-1.6
9. Oil Cakes	-4.4	7.0
10. Sugar	41.4	48.8
11. Non-ferrous metals *	62.0	3.3
12. Iron and Steel	-13.8	1.9

: Global oilseeds and edible oils prices are represented by soybeans and palm oil, respectively.

* : 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 and WPI for India.

Consumer Price Inflation

VI.25 The divergence between WPI and CPI inflation increased during the first half of 2009-10 as WPI inflation declined and became negative while CPI inflation continued to increase. During the second half of the year, even though both CPI (up to January 2010) and WPI inflation increased, the increase in WPI inflation was much faster than CPI inflation. This led to some narrowing down of the gap between and WPI and CPI inflation in recent months (Table VI.6 and Chart VI.12).

VI.26 Overall, while the inflation process continues to be dominated by supply factors, there is increasing evidence of generalisation as well as pick-up in demand in certain areas, which could be expected to continue with added momentum, going forward. Strong revival in import growth, major turnaround in corporate sales, gradual increase in capacity utilisation and recent trends in demand for credit from the private sector point to the emerging demand side risks to inflation. Though food prices have started to show seasonal moderation, the level still remains high. Fuel group inflation has accelerated significantly, reflecting higher prices of freely priced fuel products, upward

Chart VI.12: CPI and WPI Inflation

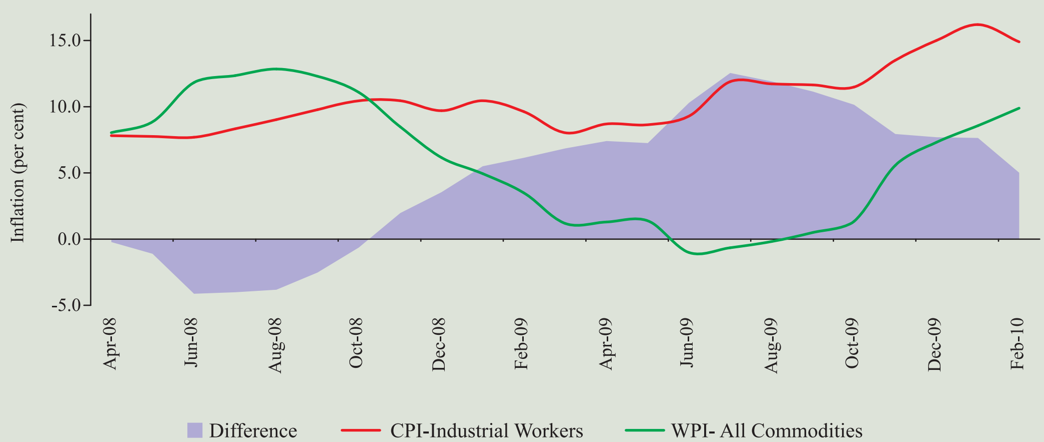


Table VI.6: Consumer Price Inflation - Major Groups

(Year-on-year variation in per cent)

CPI Measure	Weight	Mar-07	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Jan-10	Feb-10
1	2	3	4	5	6	7	8	9	10	11	12	13
CPI-IW (Base: 2001=100)												
General	**100.0**	**6.7**	**7.9**	**7.7**	**9.8**	**9.7**	**8.0**	**9.3**	**11.6**	**15.0**	**16.2**	**14.9**
Food Group	46.2	12.2	9.3	10.5	13.1	13.1	10.6	12.2	13.5	21.3	19.2	17.3
Pan, Supari *etc.*	2.3	4.4	10.9	7.1	7.8	8.5	8.3	8.1	8.0	8.6	8.5	9.2
Fuel and Light	6.4	3.2	4.6	8.4	9.1	9.7	7.4	1.4	4.2	3.4	3.4	3.4
Housing	15.3	4.1	4.7	4.7	3.8	3.8	6.0	6.0	22.1	22.1	33.1	33.1
Clothing, Bedding *etc.*	6.6	3.7	2.6	2.5	2.5	4.2	5.0	4.1	4.1	4.1	4.9	4.8
Miscellaneous	23.3	3.3	6.3	6.2	7.6	8.3	7.4	6.6	5.7	4.2	4.1	4.8
CPI-UNME (Base: 1984-85=100)												
General	**100.0**	**7.6**	**6.0**	**7.3**	**9.5**	**9.8**	**9.3**	**9.6**	**12.4**	**15.5**	**16.9**	–
Food Group	47.1	10.9	7.8	9.6	13.2	13.4	12.2	13.6	14.4	21.4	20.3	–
Fuel and Light	5.5	6.4	4.6	5.3	6.2	7.7	5.9	1.3	4.2	3.5	3.5	–
Housing	16.4	5.6	4.0	3.8	3.5	3.5	5.8	6.0	22.0	22.0	33.2	–
Clothing, Bedding *etc.*	7.0	3.6	4.3	3.4	3.1	2.7	3.3	4.2	4.1	4.1	4.7	–
Miscellaneous	24.0	4.4	4.8	6.6	8.4	9.3	8.6	7.3	6.0	4.6	4.4	–
CPI-AL (Base: 1986-87=100)												
General	**100.0**	**9.5**	**7.9**	**8.8**	**11.0**	**11.1**	**9.5**	**11.5**	**13.2**	**17.2**	**17.6**	**16.5**
Food Group	69.2	11.8	8.5	9.6	12.0	11.9	9.7	12.4	14.6	20.2	20.6	19.0
Pan, Supari *etc.*	3.8	5.7	10.4	11.2	12.8	13.7	15.3	14.2	15.5	14.6	14.2	14.6
Fuel and Light	8.4	6.9	8.0	8.9	10.2	11.3	11.5	11.0	12.0	14.3	15.1	15.1
Clothing, Bedding *etc.*	7.0	3.5	1.8	3.1	6.0	7.0	7.4	8.3	8.1	8.2	8.4	8.9
Miscellaneous	11.7	6.8	6.1	6.5	7.1	7.0	6.5	6.1	7.1	7.0	7.2	7.4
CPI-RL (Base: 1986-87=100)												
General	**100.0**	**9.2**	**7.6**	**8.7**	**11.0**	**11.1**	**9.7**	**11.3**	**13.0**	**17.0**	**17.4**	**16.5**
Food Group	66.8	11.5	8.2	9.6	12.0	11.9	10.0	12.4	14.6	20.4	20.8	19.3
Pan, Supari *etc.*	3.7	5.7	10.6	10.9	12.5	13.4	15.0	14.1	15.4	14.4	13.9	14.8
Fuel and Light	7.9	6.9	8.0	8.9	10.5	11.3	11.5	11.0	12.0	14.1	15.1	15.1
Clothing, Bedding *etc.*	9.8	3.1	2.8	4.1	6.5	7.3	8.2	8.8	9.5	10.3	10.0	10.1
Miscellaneous	11.9	6.3	6.2	6.8	7.4	7.5	6.7	6.2	6.9	6.6	6.8	7.0
Memo:												
WPI Inflation		6.6	7.5	11.8	12.3	6.1	1.2	-1.0	0.5	8.1	9.4	9.9
GDP Deflator based Inflation*		5.5	4.9	8.8	11.6	8.7	7.9	0.9	0.8	5.6	–	–

*: Data for March pertain to full year.
IW : Industrial Workers. UNME : Urban Non-Manual Employees. AL : Agricultural Labourers. RL : Rural Labourers.

revision in coal prices, and reversal in excise and customs duties that led to corresponding increases in POL product prices, besides the impact of low base. Pressure on the inflation process to get generalised has, therefore, been persistent. Non-food manufacturing products inflation rose from (-)0.4 in November 2009 to 4.7 per cent in March 2010 suggesting more generalisation of the inflation process. Given inflation persistence, high generalised inflation, if not contained, could aggravate inflation expectations and impede the ongoing recovery.

VII. MACROECONOMIC OUTLOOK

Various forward looking surveys in the recent period generally point to an improvement in business sentiments, besides the prospects of further acceleration in economic activities in the forthcoming quarters. The Industrial Outlook Survey conducted by the Reserve Bank shows improvement in the sentiments in the manufacturing sector, in continuation of the trend seen in the previous survey. The professional forecasters' survey of the Reserve Bank suggests an overall (median) GDP growth of 8.2 per cent for 2010-11. Stronger growth impulses now coexist with significant acceleration in headline inflation in recent months. While the recovery in growth is expected to further firm up in 2010-11 over the preceding year, headline inflation could be expected to moderate over the next few months.

VII.1 After witnessing a slowdown during 2008-09, the economy has recovered in 2009-10, which is expected to firm up further and take hold in 2010-11. Continuing the optimism witnessed in the previous business confidence surveys, the bullish sentiments have grown stronger. The industrial outlook survey of the Reserve Bank indicates improved assessment of the January-March 2010 quarter. The professional forecasters' survey conducted in March 2010 shows overall (median) growth rate for 2010-11 at 8.2 per cent, driven mainly by increased private consumption expenditure growth and relatively increased industrial activity in the first half and pick-up in services in the second half.

Business Expectation Surveys

VII.2 The forward looking surveys conducted by various agencies generally convey an optimistic picture about the economy. While almost all the surveys report strong Y-o-Y improvements, the picture about sequential Q-o-Q growth is somewhat mixed (Table VII.1)

VII.3 Business Confidence Index (BCI) of the National Council of Applied Economic Research (NCAER) increased to 156.8 in April 2010, registering a gain of 2.0 per cent over its January 2010 level (Table VII.1). This is the fourth successive quarter in which the BCI has registered an increase. Among the four components, 'investment climate' and 'capacity

Table VII.1: Business Expectations Surveys

Period/Index	NCAER Apr. 2010 Business Confidence Index	FICCI Q3:2009-10 Overall Business Confidence Index	Dun & Bradstreet Q2: 2010 Business Optimism Index	CII Oct. 2009- Mar. 2010 Business Confidence Index
1	2	3	4	5
Current level of the Index	156.8	70.0	142.8	66.1
Index as per previous survey	153.8	72.4	137.3	58.7
Index levels one year back	81.6	44.0	93.8	56.3
% change (Q-o-Q)	2.0	-3.3	4.0	12.6
% change (Y-o-Y)	92.2	59.1	52.2	17.4

utilisation' were weaker as compared to the earlier quarter, but expectations about improvement in 'overall business conditions' and 'financial position of firms' in the next six months rose substantially, thus driving the increase in the BCI.

VII.4 The Business Confidence Survey of the FICCI for Q3:2009-10, which was released in February 2010, suggests that 83 per cent of the companies felt the overall current economic conditions to be "moderately to substantially better". Going ahead, around 77 per cent of the companies feel that the economic conditions would improve further in the coming six months. The overall business confidence index contracted by 3.3 per cent over the previous quarter on account of anxiety over withdrawal of stimulus measures. The outlook for jobs, according to the survey, has somewhat improved, with 30 per cent firms stating that they would add to their employee strength in the coming six months.

VII.5 The Dun and Bradstreet Business Optimism Index (BOI) for Q2:2010 increased by 4.0 per cent to 142.8 over Q1:2010 on account of improvement in overall business sentiment. However, some cautiousness on account of high inflation and expected hardening of interest rates is visible from relatively lower optimism with regard to volume of sales, new orders, net profits and employee levels during Q2:2010 as compared to Q1:2010. On a Y-o-Y basis, the BOI for the Q2:2010 recorded a sharp increase of 52.2 per cent, corroborating the fact that the economy is firmly on a revival path. Improving domestic demand, surge in domestic stock markets, increase in advance tax collections, increased capital inflows and stabilising export demand seem to have supported the optimism in the business sentiments.

VII.6 The CII Business Confidence Index for October 2009-March 2010 increased by 7.4 points to 66.1 on top of the 2.4 point increase during the first half of 2009-10. Nevertheless, according to the survey, uncertain global economic outlook and slackening consumer demand continue to affect confidence levels.

VII.7 The seasonally adjusted HSBC Markit Purchasing Managers' Index (PMI) (manufacturing) which had recorded a twenty month high in February 2010 witnessed a marginal fall in March 2010 largely reflecting weaker expansion of both output and new orders. Notwithstanding this fall, the index which reached a level of 57.8 in March 2010, has remained in the above neutral territory (above 50 mark) in each of the past twelve months. It is noteworthy that the strong rise in domestic new orders had been driving the index in recent months. The survey also revealed a sharp rise in input prices, which in turn may be reflected in higher output prices, thus building up supply side pressures on inflation.

VII.8 The HSBC Markit Services PMI complemented the trend in manufacturing PMI. The Services PMI declined to 58.1 in March 2010 from the seventeen month peak of 60.9 witnessed in February 2010. In the case of services as well, both input prices and prices charged in the services sector registered some increase.

Reserve Bank's Industrial Outlook Survey

VII.9 The 49th round of Industrial Outlook Survey of the Reserve Bank conducted during January-March 2010 showed improvement in assessment for the same quarter (Table VII.2). The expectations for the quarter April-June 2010, however, exhibited marginal moderation as compared to January-March 2010 quarter, partly reflecting seasonality. The index, though, remained significantly higher as compared to the corresponding quarter last year. It is noteworthy that in line with the trend witnessed since Q2: 2009-10, both indices (*i.e.* assessment about the current quarter and expectations about the next quarter) remained in the growth terrain (*i.e.*, above 100, which is the threshold that separates contraction from expansion) (Chart VII.1).

Table VII.2: Reserve Bank's Survey – Net Response on Expectations and Assessment About the Industrial Performance

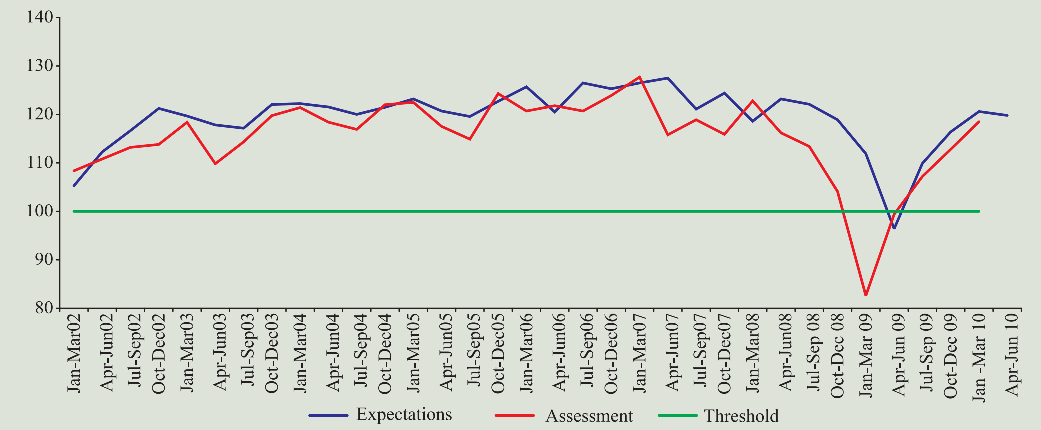
Parameter	Optimistic Response	Apr-Jun 2009		Jul-Sep 2009		Oct-Dec 2009		Jan-Mar 2010		Apr-Jun 2010
		E	A	E	A	E	A	E	A	E
1	2	3	4	5	6	7	8	9	10	11
1. Overall business situation	Better	11.2	9.3	24.2	26.3	39.8	36.0	44.9	43.1	41.2
2. Overall financial situation	Better	8.4	7.0	20.0	21.8	33.5	29.5	39.3	35.8	36.3
3. Working capital finance requirement	Increase	23.2	24.6	26.3	23.8	30.4	28.8	32.7	30.5	27.7
4. Availability of finance	Improve	9.3	11.2	16.6	19.2	26.1	23.0	29.2	25.7	26.8
5. Cost of external finance	Decrease						-14.7	-18.3	-15.9	-20.6
6. Production	Increase	9.9	6.9	22.4	22.6	35.0	28.9	40.0	36.5	35.9
7. Order books	Increase	6.4	-0.9	16.8	20.5	32.3	25.9	35.8	31.9	33.4
8. Pending orders, if applicable	Below normal	23.2	24.6	19.1	17.4	11.0	11.6	5.7	8.8	6.4
9. Cost of raw material	Decrease	-16.2	-26.3	-27.1	-41.7	-38.4	-47.1	-44.3	-60.2	-48.6
10. Inventory of raw material	Below average	1.1	-2.4	-0.5	-2.1	-1.2	-4.2	-3.6	-5.8	-2.6
11. Inventory of finished goods	Below average	-4.4	-4.2	-1.8	-4.3	-3.7	-4.3	-1.9	-4.3	-2.6
12. Capacity utilisation (Main product)	Increase	-0.7	-3.7	10.7	10.1	22.0	16.5	25.4	21.7	19.7
13. Level of capacity utilisation (Compared to the average in the preceding four quarters)	Above normal	-20.8	-19.2	-12.1	-11.2	-3.8	-3.9	1.3	3.0	1.6
14. Assessment of the production capacity (With regard to expected demand in the next six months)	More than adequate	8.9	4.6	5.5	5.8	6.5	5.3	5.0	6.4	7.1
15. Employment in the company	Increase	-5.1	-3.3	1.5	4.1	8.8	10.3	12.1	13.7	13.6
16. Exports, if applicable	Increase	-3.8	-13.5	0.1	-2.9	12.5	9.2	20.2	12.7	18.5
17. Imports, if any	Increase	-1.4	-1.3	4.6	7.8	11.5	13.0	16.9	17.1	17.1
18. Selling prices are expected to	Increase	-9.1	-7.4	0.0	0.2	6.0	2.6	9.8	12.4	13.3
19. Increase in selling prices, if any, is expected	At a lower rate	25.9	11.0	-100.0	23.2	19.4	19.3	16.8	21.6	19.7
20. Profit margin	Increase	-18.6	-25.1	-13.4	-15.1	-2.8	-9.9	1.1	-2.9	3.2

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. E: Expectations and A: Assessment.

3. 'Cost of external finance' is a newly added question from the 48th survey round (October-December 2009).

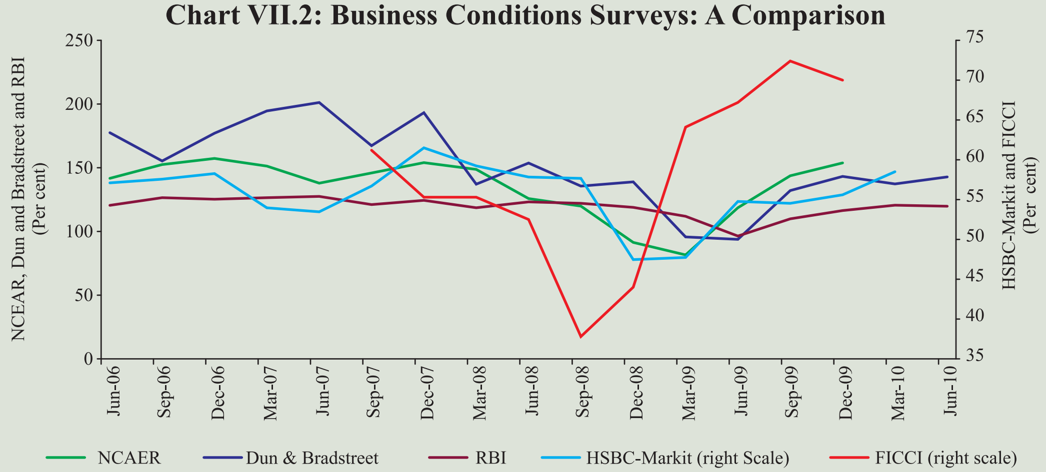
Chart VII.1: Reserve Bank's Industrial Outlook Survey: Business Expectations Index



VII.10 The survey reveals that for the assessment quarter, an optimistic view was expressed about the demand conditions. For the forthcoming quarter, however, deterioration in production capacity and capacity utilisation are anticipated by the respondents, reflecting an expected slowdown in demand. The respondents also expect the financial conditions to be adversely affected in the next quarter as reflected in an expected decline in working capital finance requirement and availability of finance. Notwithstanding this, the respondents expect their profit margins to increase as compared to the present quarter. Furthermore, as a sign of gradual return of the pricing power, the selling prices are expected to increase at a higher rate as compared to the previous quarter.

VII.11 The findings of various surveys on business conditions largely reflect similar pattern (Chart VII.2).

Chart VII.2: Business Conditions Surveys: A Comparison



Survey of Professional Forecasters[1]

VII.12 The results of the eleventh round of 'Survey of Professional Forecasters' conducted by the Reserve Bank in March 2010 places overall (median) growth rate for 2010-11 at 8.2 per cent, driven mainly by increased private consumption expenditure growth, stronger industrial activity in first half and further pick-up in services in the second half (Table VII.3). The sectoral growth rate forecast for 2010-11 suggests upward revision for agriculture and industry. The forecast for the agriculture sector growth was revised upwards to 4.0 per cent from 3.5 per cent. The forecast for industry was also revised upwards to 9.0 per cent from 8.1 per cent. For services, however, the forecasts remained constant at 9.0 per cent. The overall (median) growth rate for 2009-10 was revised upward to 7.2 per cent, as against 6.9 per cent reported in the earlier survey.

Table VII.3: Median Forecasts of Select Macroeconomic Indicators by Professional Forecasters : 2009-10 and 2010-11

	Actual 2008-09	Annual Forecasts				Quarterly Forecasts									
						2009-10		2010-11							
		2009-10		2010-11		Q4		Q1		Q2		Q3		Q4	
		E	L	E	L	E	L	E	L	E	L	E	L	E	L
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
1. Real GDP growth rate at factor cost (in per cent)	6.7	6.9	7.2	7.9	8.2	7.5	8.4	7.9	8.1	7.7	8.3	8.2	8.4	–	8.5
a. Agriculture & Allied Activities	1.6	-0.9	-0.5	3.5	4.0	-0.9	-1.0	2.0	2.9	3.0	3.8	4.7	5.7	–	4.3
b. Industry	3.1	8.4	8.9	8.1	9.0	10.0	11.8	9.0	10.6	8.4	9.3	8.3	9.0	–	8.5
c. Services	9.3	8.7	8.4	9.0	9.0	8.9	9.2	9.3	8.9	9.1	8.8	9.0	9.7	–	9.9
2. Gross Domestic Saving (per cent of GDP at current market price)	32.5	35.0	34.0	36.4	35.3	–	–	–	–	–	–	–	–	–	–
3. Gross Domestic Capital Formation (per cent of GDP at current market price)	34.9	37.7	36.0	39.0	38.0	38.1	36.0	37.9	37.0	39.8	38.0	39.7	38.7	–	38.8
4. Corporate Profit after Tax (growth rate in per cent)*	–	11.3	17.8	18.0	20.0	19.0	12.5	18.5	18.5	18.5	18.8	22.0	18.4	–	26.1
5. Inflation WPI	8.4	4.4	3.7	6.1	7.0	8.2	9.6	7.4	9.5	6.4	8.0	5.5	6.7	–	5.7
6. Exchange Rate (INR/US$ end period)	51.0	45.5	45.5	44.3	44.0	45.5	45.1	45.3	45.0	44.9	44.8	44.7	44.6	–	44.1
7. T-Bill 91 days Yield (per cent-end period)	5.0	4.0	4.5	5.3	5.3	–	–	–	–	–	–	–	–	–	–
8. 10-year Govt. Securities Yield (per cent-end period)	7.0	7.8	8.0	7.8	8.0	–	–	–	–	–	–	–	–	–	–
9. Export (growth rate in per cent)@	13.7	-5.2	-9.1	15.2	15.0	–	–	–	–	–	–	–	–	–	–
10. Import (growth rate in per cent)@	19.4	-8.3	-9.0	17.4	18.0	–	–	–	–	–	–	–	–	–	–
11. Trade Balance (US $ billion)	-118.7	–	–	–	–	-29.7	-29.7	-28.8	-32.7	-31.9	-34.6	-36.4	-35.5	–	-32.1

E : Earlier Projection. L : Latest Projection.
– : Not Available. * : BSE listed companies. @ : US $ on BoP Basis.

Note: The latest round refers to eleventh round for the quarter ended March 2010, while earlier round refers to tenth round for the quarter ended December 2009.

Source : Survey of Professional Forecasters, Fourth Quarter 2009-10.

[1] Introduced by the Reserve Bank from the quarter ended September 2007. The forecasts reflect the views of professional forecasters and not of the Reserve Bank.

Growth Projections of Different Agencies

VII.13 The CSO advance estimates for GDP growth for 2009-10 at 7.2 per cent suggest that the economy has outperformed the earlier projections of most of the agencies, leading to subsequent upward revisions (Table VII.4). Various agency estimates suggest that this uptrend in growth rate is expected to continue in the next financial year as well.

Factors Influencing the Current Growth and Inflation Outlook

VII.14 The economic recovery in 2009-10 so far has been driven by a turnaround in the industrial output and continuing resilience of the services sector. At this juncture, the strong outlook for growth points to significant improvement in the overall macroeconomic conditions while the substantial firming up of headline inflation in recent months has emerged as a key concern.

VII.15 The growth outlook for the Indian economy in the near term remains positive on account of the following factors: (a) expectations of satisfactory *rabi* output, which may offset, partially, the decline in *kharif* output; (b) expectations that the industrial sector would remain buoyant; (c) increase in corporate sales and profitability; (d) pick-up in order books and capacity utilisation as per different survey results; (e) turnaround in exports with improving global conditions; (f) pick-up in lead services indicators for transportation, telecommunication and construction, and (g) revival in credit demand from the private sector.

VII.16 Notwithstanding the overwhelming positive sentiments about stronger growth in the near term, certain downside risks remain: (a) the revival in growth of agriculture during 2010-11 hinges on the assumption of normal monsoon, which entails the usual uncertainties; (b) while investment demand is showing signs of picking up, it is still much below the rate of growth in the pre-global crisis period; (c) the private consumption demand, which accounts for about 60 per cent of aggregate demand, needs to gain significant momentum; (d) decline in saving rate last

Table VII.4: Projections of Real GDP Growth for India by Various Agencies

(Per cent)

Agency	Real GDP Growth for 2010-11	Latest Projections for 2009-10		Earlier Projections for 2009-10	
		Real GDP Growth	Month	Real GDP Growth	Month
1	2	3	4	5	6
Economic Advisory Council to PM	8.2	7.2	Feb-10	6.5	Oct-09
Ministry of Finance	8.5 (+/-0.25)	7.2	Feb-10	Above 7.0	Dec-09
IMF	8.0	6.7	Feb-10	5.3	Jan-09
ADB	8.2	7.2	Apr-10	7.0	Dec-09
NCAER	–	7.0	Jan-10	6.9	Oct-09
OECD	7.3	6.1	Nov-09	5.9	Jun-09

year, led by sharp decline in public sector savings; (e) global economic recovery, though clearly visible, is still weak and thus has implications for sustaining the growth in Indian exports; and (f) the rising inflation, which may push costs through demand for higher wages and increase in input costs.

VII.17 The headline inflation, which remained at 9.9 per cent in February-March 2010, has emerged as a major policy concern. In the recent weeks, while food inflation is showing signs of slowdown, inflation in fuel and manufactured products is causing more generalised inflationary pressures. Going forward, following factors may exert further upward pressures on inflation: (a) on the supply side, international commodity prices, especially of crude oil and industrial inputs have been rising in the recent months, thus limiting the option of imports that could contain inflation in India; (b) return of pricing power of the corporates with stronger revival in demand; (c) on demand side, revival in private consumption demand coupled with revival in growth of credit and money supply, and (d) the gradual exit of the fiscal stimulus measures which has and would entail roll back of excise and customs duty reliefs as well as measures to align domestic prices with international oil prices.

VII.18 While the near-term factors corroborate the acceleration in inflation seen so far, certain factors could help in dampening the inflationary pressures, which include: (a) satisfactory *rabi* production and arrival of new crops in the market that could improve the supply conditions; (b) a normal monsoon that may translate into improvement in agricultural production, and (c) the impact of monetary policy actions already initiated by the Reserve Bank to anchor inflationary expectations.

VII.19 The conflicting pulls of supporting the recovery and anchoring inflationary expectations continue to pose a challenge for the conduct of monetary policy. While recovery in private demand needs to be stronger to make the growth process self-sustaining, recent strong pick-up in headline inflation has emerged as a key policy concern, since high inflation itself may hamper the recovery in growth. The near-term outlook suggests that economic growth in 2010-11 will be higher than in 2009-10. Inflation, in turn, could be expected to moderate in next few months, from the peak levels seen in recent months, reflecting easing of supply pressures and the impact of necessary policy actions. In sum, there is an overall improvement in business sentiments and economic activity, but concerns relating to elevated levels of inflation remain in the near term. It is likely that the growth impulses could further strengthen during 2010-11, and therefore, anchoring inflationary expectations without hurting the growth process continue to be the focus of monetary policy.