Macroeconomic and Monetary Developments Third Quarter Review 2009-10

Reserve Bank of India
Mumbai

Contents

MACROECONOMIC AND MONETARY DEVELOPMENTS THIRD QUARTER REVIEW 2009-10

Overview

Global Economic Conditions

1. The global outlook improved significantly in the third quarter of 2009 with most advanced economies posting positive growth. The pace and shape of recovery, however, continue to remain uncertain. By far the biggest anxiety is about the recovery losing momentum once the props of fiscal stimulus and monetary accommodation are withdrawn. In advanced economies, there are concerns about higher unemployment levels, growing fiscal deficits and continued credit recession to productive sectors. Emerging economies, which are already on the recovery path, face various challenges from capital flows, inflationary pressures and credit revival. While the short-term debate is centered around the timing and sequencing of exit policies, several medium term issues have come to the fore. These include the growing debt burden of governments, permanent loss of output owing to capital destruction, addressing global imbalances and reforming the regulatory architectures.

2. Emerging Market Economies (EMEs) of Asia have led the global recovery, driven by domestic demand and recovering exports. As a result, the pace of growth across regions in the world has turned uneven. Despite weak global recovery from recession, commodity prices, particularly oil and metals, staged significant rebounds by the end of 2009. In 2010 commodity prices may firm up further, even though above average levels of inventories and significant spare capacity could slowdown the pace of the increase. WTO data suggest that world merchandise exports in the third quarter of 2009 increased by 10 per cent (sequential, quarter-on-quarter), though on year-on-year basis the growth continued to exhibit negative growth, at (-) 26 per cent.

3. The IMF's current (October 2009) projections for global growth suggest a recovery to 3.1 per cent in 2010, from (-) 1.1 per cent in 2009, which will be led by the emerging and developing economies that are expected to exhibit stronger recovery from 1.7 per cent in 2009 to 5.1 per cent in 2010. The recovery in the advanced economies could be from -3.4 per cent to 1.3 per cent during the corresponding period. These projections may be revised upwards, taking into account the signs of global recovery emerging since the third quarter of 2009 in the advanced economies as well as the strong growth in China in the fourth quarter. OECD outlook also suggests a similar recovery from -3.5 per cent in 2009 to 1.9 per cent in 2010 in OECD countries. What could be a concern is the expected increase in OECD unemployment rate from 8.2 per cent in 2009 to 9.0 per cent in 2010, suggesting job-less recovery, which in turn could influence the timing of exit from policy stimulus. Global financial market conditions have improved further, notwithstanding the temporary unease in *response to the Dubai World's decision on debt standstill. With improvement in appetite for risk, prices of financial assets have recovered in general, led by EME stocks. Money, bond and equity market conditions have already recovered to their respective long-run average levels.*

Indian Economy

Output

4. At 7.9 per cent, GDP growth in the second quarter of 2009-10 showed a significant recovery in relation to the 5.8 per cent growth recorded during the slowdown phase in the second half of 2008-09, but still remained lower than the average 8.8 per cent growth achieved during 2003-08. Among the major components of the GDP on the supply side, agriculture and allied activities registered a better than expected growth of 0.9 per cent, which though reflects only a part of the overall adverse impact of the deficient south-west monsoon on kharif output. According to the first advance estimates, production of kharif foodgrains and oilseeds is expected to decline by 16 per cent over the previous year.

5. Strong industrial recovery has been the key underlying strength behind the recovery of GDP in the second quarter. During April-November 2009, the Index of Industrial Production (IIP) increased by 7.6 per cent, which is higher than 4.1 per cent growth experienced during the corresponding period of the previous year. During August-November 2009, the acceleration in the IIP growth was evident in the double digit growth. However, even though twelve out of seventeen industries, accounting for about 57.2 per cent of the total weight in the IIP, contributed to the recovery, it is still driven by a few segments. The core infrastructure sector showed a higher growth at 4.8 per cent during April-December 2009, as compared with 3.2 per cent growth in the corresponding period of the previous year. The higher growth was driven mainly by cement, coal, electricity and finished steel.

6. Services activities (accounting for 64.5 per cent of the GDP) registered a growth of 9.0 per cent in the second quarter of 2009-10. The recovery was largely driven by 12.7 per cent growth in "community, social and personal services" reflecting payouts of arrears relating to the Sixth Pay Commission award. Excluding the arrears, the services sector growth would have been 7.0 per cent during the second quarter of 2009-10. Lead indicators for services activities suggest that services dependent on domestic demand exhibited robust growth during April-December 2009, whereas services dependent on external demand (which include tourist arrivals, export and import cargo, and passengers at international terminals) exhibited some improvement in recent months.

Aggregate Demand

7. Sharp deceleration in the growth of private consumption demand to 1.6 per cent in the first quarter of 2009-10, besides the subdued growth in investment demand, had emerged as the key constraint to a faster recovery in GDP growth. In the second quarter of 2009-10, however, private consumption demand registered a growth of 5.6 per cent, which is the highest in last six quarters. Investment demand, in terms of growth in gross fixed capital formation, *also exhibited a growth of 7.3 per cent, which is the highest in the last four quarters. These trends reflect the improving overall business and consumer confidence. Growth in government consumption expenditure, which had to offset the impact of deceleration in private demand on economic growth in the wake of the global recession, continues to outpace growth in private demand in the last four quarters. In the second quarter of 2009-10, government consumption expenditure increased by 27 per cent, which is partly on account of the payment of arrears relating to the Sixth Pay Commission Award.*

8. Net direct tax collections of the Central Government increased by 8.5 per cent during April-December 2009, with the increase in corporate tax collections in December 2009 exhibiting a growth of 44 per cent. Corporate performance data up to the second quarter of 2009-10 also indicate that despite the persistence of dampened (y-on-y) growth in sales, sequential quarterly growth remained positive and profitability has also improved in the two successive quarters, which partly explains both the recovery in stock prices and the collections under corporate tax. In the third quarter of 2009-10, partial data indicate significant (Y-o-Y) growth in sales.

External Economy

9. With the improvement in global macro-financial conditions, the performance of the external sector has exhibited increasing signs of turnaround. Merchandise exports registered a positive growth of 18.2 per cent in November 2009 after a phase of decline over thirteen consecutive months and the pace of decline in imports also moderated significantly to 2.6 per cent. The current account deficit in the balance of payments in the second quarter of 2009-10 remained at the same level as in the corresponding period of last year. Signs of resumption in capital inflows that were evident in the first quarter of 2009-10, improved significantly in the second quarter. Latest information on specific components of capital flows suggests that even in the third quarter of 2009-10, net inflows have sustained the revival. Due to allocation of SDRs by the IMF and purchase of gold by the Reserve Bank from the IMF, the level and composition of the country's foreign exchange reserves have changed in the recent period. It increased from US$ 252 billion at end-March 2009 to US$ 285.2 billion as on January 15, 2010. In the context of the expected surge in capital flows to EMEs, assessment and monitoring of the macroeconomic ramifications of large capital inflows would be a challenge.

Monetary Conditions

10. The overall monetary and liquidity conditions prevailing in the system continue to reflect the accommodative monetary policy stance of the Reserve Bank, which has remained geared towards meeting the goals of supporting a stronger recovery in growth while ensuring completion of the large borrowing programme of the Government without exerting pressures on the overall interest rate structure. Broad money (M_3) growth exhibited some moderation in recent months and was at 16.5 per cent as on January 15, 2010, as against the indicative money growth projection of 17.0 per cent presented in the Second Quarter Review of Monetary Policy

2009-10. On the component side of money growth, deposit growth of scheduled commercial banks at 16.8 per cent was lower than the 18.0 per cent indicative projection in the Second Quarter Review of Monetary Policy 2009-10. There was a noticeable shift in the composition of deposits - growth in time deposits decelerated, partly reflecting the decline in time deposit interest rates during the year. On the sources side of money growth, as the banking system's growth in credit to the private sector decelerated, credit to the Government remained the key driver of money growth. Since the third quarter of 2009-10, however, growth in commercial banks' credit to the Government has also moderated. Non-food credit growth, which decelerated over twelve months following the peak in October 2008, has shown a reversal in the trend since November 2009. Non-food credit growth of Scheduled Commercial Banks (SCBs) at 14.4 per cent as on January 15, 2010 remains lower than both 21.9 per cent growth seen in the corresponding period of last year and 18.0 per cent indicative growth presented in the Second Quarter Review of Monetary Policy 2009-10.

11. Availability of resources from the non-banking sources increased significantly by about Rs.50,000 crore during April-January 2009-10, primarily in the form of IPOs, private placement, net issuance of CPs by corporates, and inflows under foreign direct investment. Total flow of resources to the commercial sector from banks and non-banks taken together, however, remained lower, as incremental increase in non-food credit in absolute terms during April-January 2009-10 was lower than the increase during the corresponding period of the previous year. Pattern of capital flows, pace of the recovery in demand for credit from the private sector and the fiscal stance would influence the monetary and liquidity conditions in the near term.

Financial Markets

12. The financial markets in India remained orderly and reflected the overall expectations of stronger recovery in the economy, the impact of higher capital inflows, and the overriding influence of the accommodative monetary policy stance of the Reserve Bank. Money market rates remained well anchored within the LAF corridor, and in the CBLO market, which accounts for about 80 per cent of the volume in the money market, the rates remained below the call money rates. In the government securities market, 95.5 per cent of the net market borrowing programme of the Central Government has been completed so far. In the secondary market, the yield on government securities exhibited some hardening in the recent months, reflecting large supply of government securities and emerging inflationary pressures. In the credit market, both deposit and lending rates showed moderation, reflecting lagged transmission of the policy rate changes of the Reserve Bank. In the capital market, stock markets, though volatile, sustained the gains of previous months. Among the EMEs, India was one of the strongest performers. In the primary market, activities picked up in terms of IPOs and private placements. Net resource mobilisation by the mutual funds exhibited significant increase. With the return of capital inflows, and the resultant surplus *conditions in the forex market, the Indian rupee appreciated against major international currencies.*

Inflation Situation

13. Inflation emerged as a major concern during the third quarter, dominated by significant supply factors. While in 2008-09 the shock originated from volatile global commodity prices, in particular oil, the source of the pressure on headline inflation in 2009-10 has been concentrated in food articles, and the intensity of the shock has aggravated after the deficient south-west monsoon and its impact on kharif output. On year on year basis, WPI headline inflation in December 2009 was at 7.3 per cent, whereas WPI inflation excluding food articles was 2.1 per cent, which suggests the concentrated nature of the inflation so far. Food items (i.e. primary and manufactured) with a combined weight of 27 per cent in the WPI basket have exhibited 21.9 per cent increase in prices. In December 2009, there have been signs of emergence of generalised inflation. Weekly WPI data on primary articles indicate that primary food articles prices have increased by 16.8 per cent (y-o-y) as on January 9, 2010.

14. The acceleration in inflation is also evident from the fact that the overall WPI has increased by 8.0 per cent in December 2009 over March 2009, and different measures of CPI inflation remain inflexibly high in double digits (in the range of 13.5 per cent to 17.2 per cent in November-December 2009). The concentrated pressure on headline inflation arising from high food prices entails the risk of getting transmitted over time to other non-food items through expectations driven wage-price revisions, and thereby magnifying into a generalised inflation. While anchoring inflation expectations becomes important in such a situation, addressing supply constraints would be critical for enhancing the effectiveness of any anti-inflationary policy measures, given particularly the nature of the current sources of pressure on the headline inflation.

Growth and Inflation Outlook

15. The growth and inflation mix in India is increasingly diverging from the pattern being seen in other G-20 countries. While some countries continue to experience weak recovery with no risk of inflation, some others have witnessed strong revival in growth with modest inflation, whereas in India recovery has coincided with significant build up of inflationary pressures. In view of the dominance of food price inflation, however, balancing the policy needs of supporting durable return to the high growth path while avoiding a situation of generalised increase in inflation through monetary policy actions has emerged as a delicate challenge for the Reserve Bank.

16. The upside prospects for further acceleration in growth in the near term derive support from several factors, including signs of revival in private demand, both consumption and investment; possibility of strong industrial recovery continuing; outlook for a better Rabi crop; export growth remaining positive; favourable capital market conditions; and the general improvement in business sentiments as per the Reserve Bank's business expectations survey as well as similar surveys of other agencies.

17. The downside risks to growth in the near-term could be seen in terms of the adverse impact of the deficient monsoon on kharif crop in the GDP of next quarter, weakness in services activities that are dependent on external demand, notwithstanding the signs of improvements in recent months; and possible pressures on interest rates that may emerge from revival in demand for credit from the private sector as well as inflation expectations. Risks to global growth and higher oil prices also need to be given due consideration.

18. The outlook for inflation will be conditioned by the upside risks in terms of persistence of supply side pressures in the near term, possible return of pricing power with stronger recovery in growth, further revival in private demand with improving consumer and business confidence, possible spurt in global commodity prices in response to recovery in the EMEs and advanced economies, and the possibility of high CPI and food price inflation spilling over to cause a generalised inflation. The possible sources of comfort that could ease some of the pressures on inflation include arrival of certain new crops in the market – particularly vegetables, additional release from the high level of buffer stocks of foodgrains, and negative output-gap persisting for some more time, which would contain the demand side pressures.

19. The growth and inflation mix for India, thus, is increasingly becoming asymmetric vis-à-vis the pattern in other G-20 countries. The possibility of surges in capital inflows and the associated domestic liquidity conditions may also affect inflationary expectations, besides the impact of the rebound in international commodity prices in response to global recovery. With a stronger recovery in India, the risks of food price inflation causing generalised inflation cannot be ignored.

I. OUTPUT

The turnaround in GDP growth witnessed during the first quarter of 2009-10 was sustained during the second quarter, spurred by robust revival in industrial performance and fiscal expenditure driven services activities. The performance of the agricultural sector remained subdued due to the impact of the deficient South-West monsoon, notwithstanding the fact that a major part of the impact would be reflected in the third quarter GDP of the year. The industrial recovery, besides exhibiting acceleration in the last few months, has also become more broad based. Most of the lead indicators of services sector activities also suggest revival in growth momentum.

I.1 The Indian economy exhibited robust turnaround in economic growth in the second quarter (Q2) of 2009-10 in relation to the slowdown witnessed during the second half of 2008-09. The recovery in GDP growth that had started in the first quarter (Q1) gained momentum in Q2 of 2009-10, driven by a strong revival in industrial output and better performance of the services sector. According to the estimates of the Central Statistical Organisation (CSO), real GDP growth, which was 6.1 per cent during Q1 of 2009-10, accelerated to 7.9 per cent in Q2 of 2009-10, which was also higher than 7.7 per cent registered during the corresponding period of 2008-09. The better than expected acceleration in the second quarter placed the real GDP growth during the first half of 2009-10 at 7.0 per cent as compared with 7.8 per cent in the corresponding period of 2008-09 (Table 1.1).

I.2 The real GDP growth was driven mainly by rebound in industrial and services sector growth, after a period of noticeable fall in the wake of the global recession (Chart I.1). Agriculture sector witnessed a deceleration in growth during the second quarter of 2009-10, partly reflecting the impact of deficient South-West monsoon.

Agricultural Situation

I.3 The South-West monsoon (June-September), which significantly influences the rain dependent production of *kharif* crops, was the weakest in 2009 since 1972. The cumulative rainfall during the season turned out to be 23 per cent below normal, as against 2 per cent below normal during the corresponding period of the previous year. Drought was declared in 316 districts across 13 States, either partially or wholly. The North-East monsoon (October to December 2009) has, however, 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. Of the 36 meteorological sub-divisions, cumulative rainfall during North-East monsoon was deficient/scanty/no rain in 13 sub-divisions (30 sub-divisions during the previous year) (Chart I.2). Reservoir levels, an important indicator for making an assessment about agricultural production linked to irrigation, have improved from their lows of around 9 per cent of Full Reservoir Level (FRL) recorded in early July 2009. As on January 14, 2010, the total live water storage was 48 per cent of the FRL as against 49 per

Table 1.1: Growth Rates of Real GDP@

(Per cent)

Sector	2007-08*	2008-09#	2008-09				2009-10		April-September	
			Q1	Q2	Q3	Q4	Q1	Q2	2008-09	2009-10
1	2	3	4	5	6	7	8	9	10	11
1. Agriculture and Allied Activities	**4.9**	**1.6**	**3.0**	**2.7**	**-0.8**	**2.7**	**2.4**	**0.9**	**2.9**	**1.7**
	(17.8)	**(17.0)**								
2. Industry	**7.4**	**2.6**	**5.1**	**4.8**	**1.6**	**-0.5**	**4.2**	**9.0**	**5.0**	**6.6**
	(19.2)	**(18.5)**								
2.1 Mining and Quarrying	3.3	3.6	4.6	3.7	4.9	1.6	7.9	9.5	4.2	8.7
2.2 Manufacturing	8.2	2.4	5.5	5.1	0.9	-1.4	3.4	9.2	5.3	6.3
2.3 Electricity, Gas & Water Supply	5.3	3.4	2.7	3.8	3.5	3.6	6.2	7.4	3.3	6.8
3. Services	**10.8**	**9.4**	**10.0**	**9.8**	**9.5**	**8.4**	**7.7**	**9.0**	**9.9**	**8.3**
	(63.0)	**(64.5)**								
3.1 Trade, Hotels, Restaurants, Transport, Storage and Communication	12.4	9.0	13.0	12.1	5.9	6.3	8.1	8.5	12.5	8.3
3.2 Financing, Insurance, Real Estate and Business Services	11.7	7.8	6.9	6.4	8.3	9.5	8.1	7.7	6.6	7.9
3.3 Community, Social and Personal services	6.8	13.1	8.2	9.0	22.5	12.5	6.8	12.7	8.6	9.9
3.4 Construction	10.1	7.2	8.4	9.6	4.2	6.8	7.1	6.5	9.0	6.8
4. Real GDP at Factor Cost	**9.0**	**6.7**	**7.8**	**7.7**	**5.8**	**5.8**	**6.1**	**7.9**	**7.8**	**7.0**

Memo: (Amount in Rupees crore)

a. **Real GDP at Factor Cost (1999-2000)**	31,29,717	33,39,375
b. **GDP at current market prices**	47,23,400	53,21,753

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

Note : Figures in parentheses indicate shares in real GDP.

Source: Central Statistical Organisation.

cent during the corresponding period of the preceding year and an average of 46 per cent during the past 10 years.

I.4 The deficient South-West monsoon, along with drought conditions in several parts of the country, adversely impacted the

Chart I.1: Sectoral Contributions to Growth

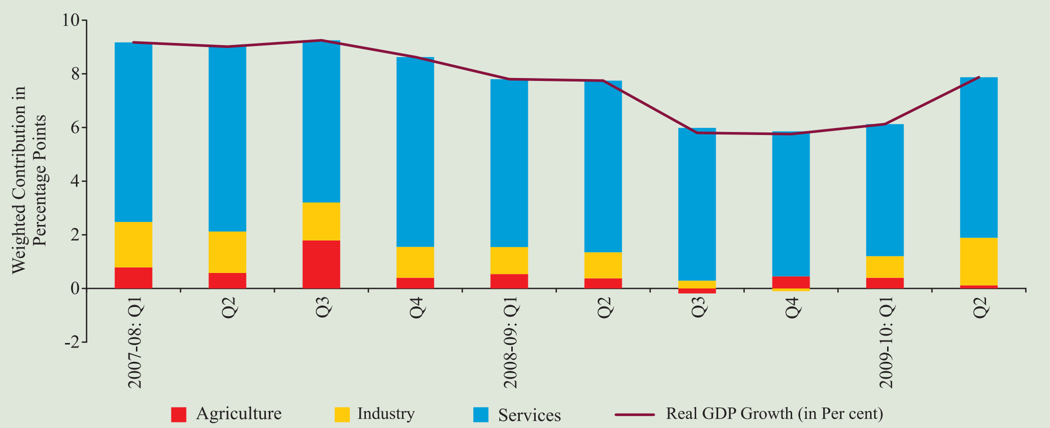
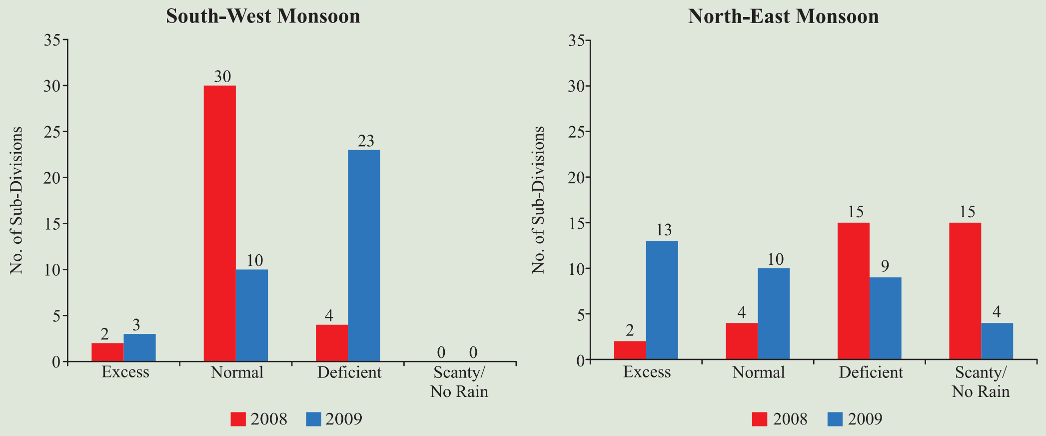


Chart I.2: Rainfall During South West and North East Monsoons



kharif sowing, which was about 5.3 per cent lower than the preceding year's sowing. Apart from shortfall in the area sown, erratic rainfall and flash floods in certain states could also have affected the *kharif* yield. The delayed withdrawal of South-West monsoon and the resultant higher moisture retention in the soil, facilitated early *rabi* sowing. Also on account of the good North-East monsoon, the area sown under *rabi* crops (up to January 15, 2010) has been close to last year's levels. Sowing has been particularly high in respect of rice, wheat and pulses (Table 1.2).

Table 1.2: Progress of Area Sown under *Rabi* Crops

(Million hectares)

Crop	Normal Area	Area Coverage (as on January 15, 2010)			Percentage Variation
		2008-09	2009-10	Variation	
1	2	3	4	5	6
Rice	4.0	1.1	1.3	0.2	14.8
Wheat	27.1	27.5	27.5	0.0	0.0
Coarse Cereals	6.3	6.6	6.3	-0.4	-5.6
of which:					
Barley	0.6	0.7	0.8	0.0	5.2
Jowar	4.8	4.9	4.5	-0.4	-8.5
Maize	0.9	1.0	1.0	0.0	1.4
Total Pulses	11.9	12.7	13.5	0.7	5.8
Total Oilseeds	9.5	9.2	8.6	-0.6	-6.8
of which:					
Rapeseed & mustard	6.5	6.6	6.4	-0.2	-3.4
Groundnut	0.9	0.6	0.6	0.0	-1.7
Sunflower	1.3	1.1	0.8	-0.3	-26.5
All Crops	**58.8**	**57.2**	**57.1**	**-0.1**	**-0.2**

Source : Ministry of Agriculture, Government of India.

I.5 Based on the record level of 233.9 million tonnes of foodgrains production achieved during 2008-09, a target of 239.1 million tonnes was set for 2009-10. According to the revised First Advance Estimates for 2009-10 released by the Ministry of Agriculture, however, total *kharif* foodgrains and oilseeds production is estimated to decline by 15.9 per cent over the previous year, reflecting the impact of deficient monsoon (Table 1.3). Crop wise, a decline is expected for all crops, except *urad*, *tur* and cotton. However, the overall *rabi* production prospects are promising this year in view of the delayed withdrawal of South-West monsoon, good progress of North-East monsoon and improved sowing, particularly for foodgrains, supported by planned Government efforts towards enhancing *rabi* production. It could be expected that *rabi* production may partially compensate for lower *kharif* production this year, as in 2008-09. The Government has also indicated that *rabi s*eason might see an additional 10 million tonnes of production comprising 8.5 million tonnes of foodgrains and 1.5 million tonnes of oilseeds. The Government's recent hike (in the month of October) in the minimum support price (MSP) for the *rabi* crops is likely to incentivise *rabi* crop production. The estimated decline in *kharif* output in 2009-10 and MSP increases in recent years have, however, contributed to firming up the pressure on food inflation. In terms of agricultural growth, the sector could also be expected to derive support from the 'allied sector' comprising horticulture, livestock and fisheries, which has been growing at above 5 per cent in recent years.

Table 1.3: Agricultural Production

(Million tonnes)

Crop	2007-08	2008-09 @	2009-10 Target	2009-10 Achievement*
1	2	3	4	5
Rice	96.7	99.2	100.5	
Kharif	82.7	84.6	86.0	71.7
Rabi	14	14.6	14.5	
Wheat	78.6	80.6	79.0	
Coarse Cereals	40.8	39.5	43.1	
Kharif	31.9	28.3	32.7	22.8
Rabi	8.9	11.1	10.5	
Pulses	14.8	14.7	16.5	
Kharif	6.4	4.8	6.5	4.4
Rabi	8.4	9.9	10.0	
Total Foodgrains	230.8	233.9	239.1	
Kharif	121	117.7	125.2	98.8
Rabi	109.8	116.2	114.0	
Total Oilseeds	29.8	28.2	31.6	
Kharif	20.7	17.9	19.4	15.2
Rabi	9	10.3	12.2	
Sugarcane	348.2	273.9	340.0	249.5
Cotton #	25.9	23.2	26.0	23.7
Jute and Mesta ##	11.2	10.4	11.2	10.2

@ : Fourth Advance Estimates for 2008-09.
* : First 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.6 The procurement of foodgrains (rice and wheat) during 2009-10 (up to January 18, 2010) was higher than that during the corresponding period of the previous year (Table 1.4). The total stock of foodgrains with the Food Corporation of India (FCI) and other Government agencies reached a peak of 54.8 million tonnes as on June 1, 2009. Since then, the stocks have declined on account of off-take exceeding the procurement. As on January 1, 2010, stocks were placed at 47.7 million tonnes, with both rice and wheat stocks significantly higher than their norms. While off-take during April-September 2009 was mainly through targeted public distribution system (TPDS) and other welfare schemes, for the period October to December 2009, the Government had allocated about 1.5

Table 1.4: Management of Food Stocks

(Million tonnes)

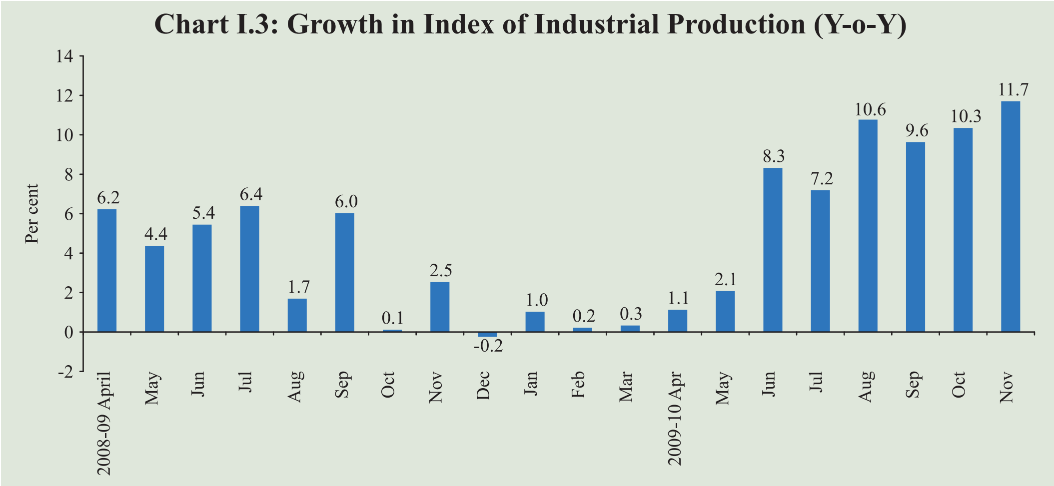
Month /Year	Opening Stock of Foodgrain			Procurement of Foodgrain			Foodgrain Off-take					Norms
	Rice	Wheat	Total	Rice	Wheat	Total	PDS	OWS	OMS - Domestic	Exports	Total	
1	2	3	4	5	6	7	8	9	10	11	12	13
2008-09	13.8	5.8	19.8	32.8	22.7	55.5	34.9	3.4	1.2	0.0	39.5	
2008-09@	13.8	5.8	19.8	21.0	22.7	43.7	19.4	1.7	0.0	0.0	21.1	
2009-10@	21.6	13.4	35.6	25.3	25.4	50.7	25.4	2.0	0.0	0.0	27.4	
2008												
April	13.8	5.8	19.8	1.1	14.2	15.3	2.7	0.0	0.0	0.0	2.8	16.2
July	11.3	24.9	36.3	0.1	0.2	0.3	3.0	0.3	0.0	0.0	3.1	26.9
October	7.9	22.0	30.0	8.1	0.0	8.1	2.8	0.1	0.0	0.0	2.8	16.2
December	15.6	19.6	35.5	4.2	0.0	4.2	3.0	0.5	0.2	0.0	3.6	
2009												
January	17.6	18.2	36.2	4.8	0.0	4.8	3.0	0.2	0.3	0.0	3.4	20.0
April	21.6	13.4	35.6	1.4	19.4	20.8	3.3	0.2	0.0	0.0	3.5	16.2
June	20.4	33.1	54.8	1.3	1.1	2.4	3.3	0.4	0.0	0.0	3.7	
July	19.6	32.9	53.2	1.4	0.4	1.8	3.8	0.1	0.0	0.0	3.9	26.9
October	15.4	28.5	44.2	8.4	0.0	8.4	3.7	0.3	0.0	0.0	3.9	16.2
November	21.6	26.9	48.8	3.6	0.0	3.6	..	..	..	..	..	
December	22.9	25.2	48.4	3.4	0.0	3.4	..	..	..	..	..	
2010												
January *	24.4	23.1	47.7	2.8	0.0	2.8	..	..	..	..	..	20.0

PDS: Public Distribution System. OWS: Other Welfare Schemes. OMS : Open Market Sales.
.. : Not Available. @ : Procurement up to January 18, off-take up to October 30. * : Procurement up to January 18.
Source : Ministry of Consumer Affairs, Food and Public Distribution, Government of India.

million tonnes of wheat and 0.5 million tonnes of rice for open market sale, keeping in view the sustained pressure on inflation in food articles. Similar quantities have also been approved for release to the open market in the January-March 2010 quarter. The Government has also recently announced additional *ad hoc* allocations of 1.1 million tonnes of rice and 2.5 million tonnes of wheat under TPDS for the period January-February 2010.

Industrial Performance

I.7 Industrial growth, which had slowed down significantly during the second half of 2008-09, exhibited strong recovery during 2009-10, especially since June 2009. The index of industrial production (IIP) posted double digit growth during August, October and November 2009, suggesting acceleration in the recovery process. During 2009-10 (April-November 2009), industrial growth was at 7.6 per cent, significantly higher than 4.1 per cent during the corresponding period of last year (Chart I.3 and Table 1.5). The recovery was led by manufacturing sector, with a relative contribution of around 86 per cent to the overall industrial growth, commensurately supported by the mining and electricity segments. Although 12 out of 17 manufacturing industries under the two-digit classification (accounting for 57.2 per cent of the weight in the IIP) contributed



to the growth in IIP, the acceleration in growth has been skewed (Table 1.6). The top five of the 17 manufacturing industries, with a combined weight of 24.1 per cent in IIP, grew by 12.7 per cent and contributed 60.3 per cent of the IIP growth during April-November 2009 (Chart I.4). This suggests that there is scope for further acceleration as the recovery becomes more broad based.

I.8 In terms of use-based classification, there was sharp acceleration in the growth of basic goods, intermediate goods and consumer durables during April-November 2009. The recovery began with a steady acceleration in growth of the intermediate goods sector during the current financial year. This was followed by the recovery in capital goods sector, to a growth of 11.4 per

Table 1.5: 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-Nov 2008-09	April-Nov 2009-10 P	April-March 2008-09	April-Nov 2008-09	April-Nov 2009-10 P
1	2	3	4	5	6	7	8
Sectoral							
Mining	10.5	2.6	3.4	8.3	6.3	5.4	7.1
Manufacturing	79.4	2.7	4.2	7.7	85.3	88.5	86.2
Electricity	10.2	2.8	2.8	6.1	8.3	5.9	6.7
Use-Based							
Basic Goods	35.6	2.6	3.6	6.1	28.4	26.5	23.8
Capital Goods	9.3	7.3	8.4	7.0	34.1	25.8	12.0
Intermediate Goods	26.5	-1.9	-0.7	11.4	-18.4	-4.8	38.5
Consumer Goods (a+b)	28.7	4.7	6.8	6.3	54.2	50.8	25.9
a) Consumer Durables	5.4	4.5	5.1	21.7	12.4	9.7	22.4
b) Consumer Non-durables	23.3	4.8	7.3	1.1	41.7	41.0	3.5
General	**100.0**	**2.7**	**4.1**	**7.6**	**100.0**	100.0	100.0

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

Table 1.6: Performance of Manufacturing Industry Groups (April-November 2009)

	Negative	Deceleration	Acceleration
	1	2	3
	1. Beverages, tobacco and related products	1. Basic Metal and Alloy Industries	1. Transport equipment and parts
	2. Food Products	2. Paper and paper products and printing, publishing and allied industries	2. Rubber, plastic, petroleum and coal products
	3. Jute and other vegetable fibre textiles (except cotton)		3. Wool, silk and man-made fibre textiles
			4. Machinery and equipment other than Transport Equipment
			5. Other manufacturing industries
			6. Textile products
			7. Chemicals and chemical products
			8. Wood and Wood Products, Furniture and fixtures
			9. Non-metallic mineral products
			10. Cotton textiles
			11. Leather and leather and fur products
			12. Metal products and parts (except machinery and equipment)
Combined Weight in IIP	**12.1**	**10.1**	**57.2**

cent during August-November 2009, from the decline in output during March-May 2009, indicating an improvement in investment sentiments. Consumer non-durables output witnessed growth since July 2009, despite being weighed down by the decline in food products, beverages and tobacco products and jute and other vegetable fibre textiles (except cotton). The overall growth in the consumer goods during April-November 2009-10 has been driven by a sharp double digit growth in the durable segment, with significant contribution coming from automobiles production.

Chart I.4: Growth Performance of the Manufacturing Sector in the IIP

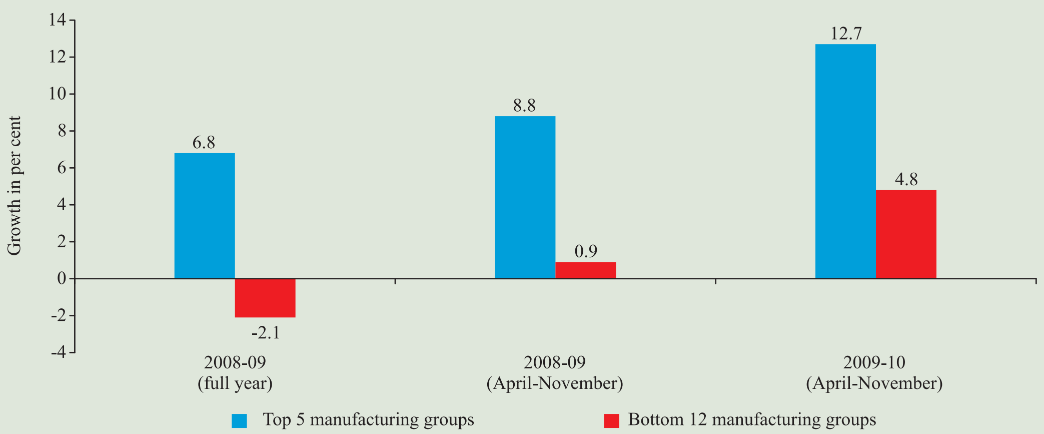
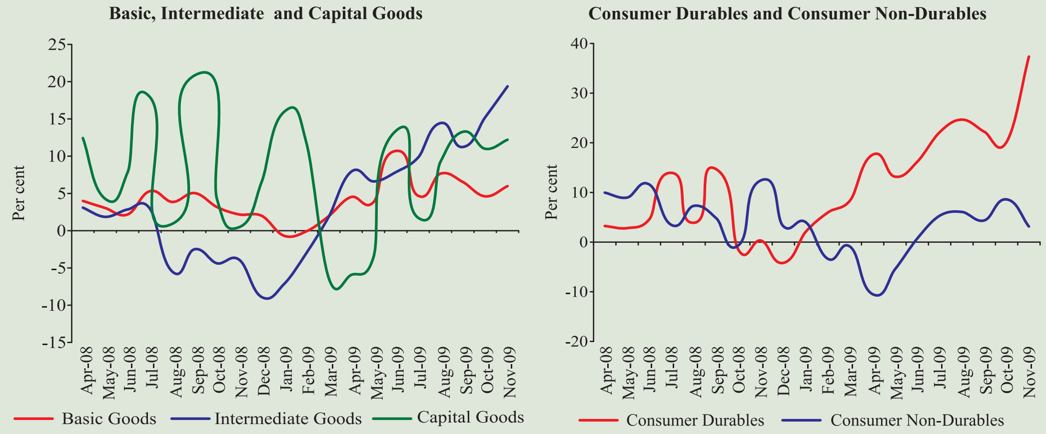


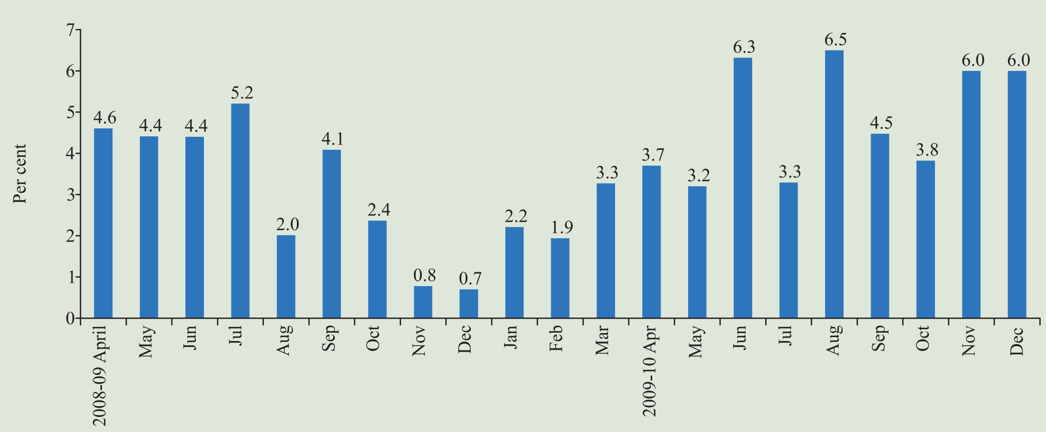
Chart I.5: Industrial Growth – Sectoral Trends

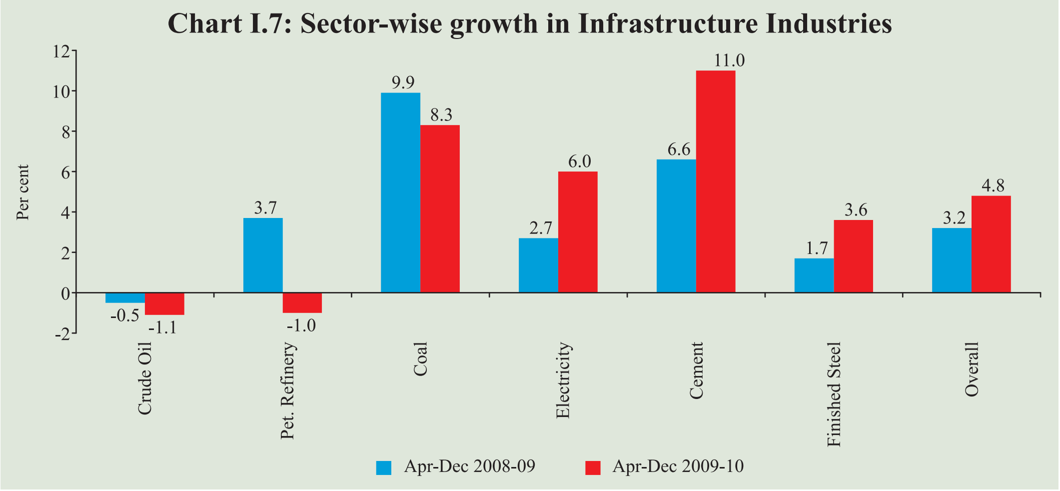


Infrastructure

I.9 The core infrastructure growth was higher at 4.8 per cent during April-December 2009 as compared with 3.2 per cent during the corresponding period of the previous year. This was led by improved growth in the output of cement, coal, electricity generation and finished steel. Finished steel production gained strength during October-December 2009, partly reflecting improved automobiles production and pick up in construction activities in recent months as well as the base effect of decline in steel production a year ago. The output of crude oil and petroleum refinery products declined during April-December 2009 over the corresponding period of the previous year. While the petroleum products segment, which witnessed some recovery since August 2009, decelerated in December 2009, the crude oil sector posted a modest recovery, reversing the declining trend in recent months (Charts I.6 and I.7).

Chart I.6: Growth in Infrastructure Industries (Y-o-Y)





Services Sector

I.10 The growth in services sector activities moderated to 8.3 per cent in the first half of 2009-10, from 9.9 per cent in the first half of 2008-09 and 8.9 per cent during the second half of 2008-09. The deceleration in the growth of 'construction' and 'trade, hotels, transports & communications' have mainly contributed to the overall moderation of the services sector growth.

I.11 Within the first half of 2009-10, the second quarter growth at 9.0 per cent shows significant acceleration over the 7.7 per cent growth in the first quarter besides showing a reversal in the trend of continuous deceleration over past few quarters. The upturn in Q2 of 2009-10 was largely contributed by 'community, personal & social services' sub-group, reflecting payouts of arrears by the Government under the Sixth Pay Commission award. Excluding the arrears, the growth in services sector would be about 7.0 per cent during the second quarter of 2009-10 (Chart I.8). The overall GDP growth of 7.9 per cent would also

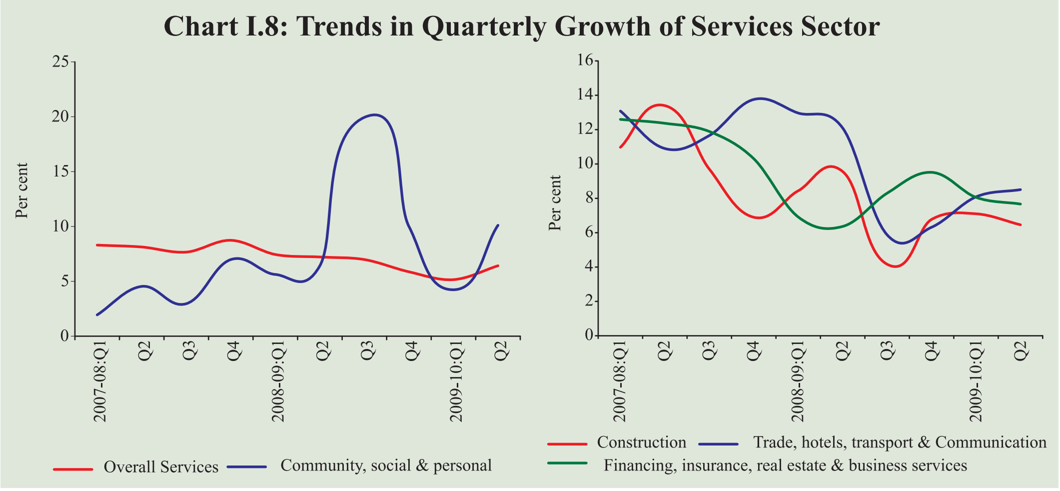


Table 1.7: Indicators of Services Sector Activity

(Per cent)

	2007-08	2008-09	April-December		2009-10		
			2008	2009	Q1	Q2	Q3
1	2	3	4	5	6	7	8
Tourist arrivals	12.2	-2.5	4.0	-3.3	-1.7	-4.0	6.5
Commercial vehicles production	4.8	-24.0	-16.0	15.1	-18.5	5.2	127.3
Railway revenue earning freight traffic	9.0	4.9	6.0	7.5	5.1	8.0	9.5
Cell phone connections*	38.3	44.8	63.5	56.5	59.4	52.4	60.1
Cargo handled at major ports*	12	2.1	5.2	3.8	2.1	3.0	11.2
Civil aviation*							
a) Export cargo handled	7.5	3.4	7.0	3.5	0.5	1.9	17.6
b) Import cargo handled	19.7	-5.7	4.2	-7.1	-12.7	-4.9	3.1
c) Passengers handled at international terminals	11.9	3.8	7.5	3.2	0.1	3.7	11.3
d) Passengers handled at domestic terminals	20.6	-12.1	-8.5	10.8	-6.5	22.2	28.7
Cement	8.1	7.2	6.6	11.0	12.1	12.6	8.5
Steel	6.2	1.6	1.7	3.6	1.7	1.7	7.8

*: Up to October 2009.

Source : Ministry of Tourism; Ministry of Commerce and Industry; Ministry of Statistics and Programme Implementation; Reserve Bank of India.

work out to be lower at 6.5 per cent, adjusted for the impact of arrears.

I.12 The lead indicators of service sector activity show that, services such as tourist arrivals, cargo handled by seaports and airports, and passengers handled by international terminals which are dependent on external demand, either registered a decline or exhibited subdued growth during 2009-10 so far, reflecting the global economic conditions. However, there has been a significant improvement in these services during the third quarter of 2009. Services dependent on domestic demand have exhibited a robust and steady growth during 2009-10, so far (Table 1.7).

I.13 In sum, the aggregate supply conditions as reflected in the GDP growth during the first two quarters of 2009-10 show acceleration in recovery, led by the industrial performance and fiscal expenditure driven services. The agricultural sector witnessed lower than expected order of deceleration in growth during the second quarter of 2009-10, as only part of the impact of the deficient South-West monsoon on *kharif* production has been captured in the Q2 GDP estimates, and the remaining part would be reflected in the GDP for Q3 of 2009-10. Favourable prospects for *rabi* output may partially offset the dampening impact of lower *kharif* output. The recovery in industrial growth has been uniform with accelerated growth seen in recent months in all the three sectors, *viz.*, mining, electricity and manufacturing. Core infrastructure sector also registered higher growth in April-December 2009 than during the corresponding period of the previous year. Major lead indicators of service sector activities indicate acceleration in the growth momentum, particularly since Q2 of 2009-10.

II. AGGREGATE DEMAND

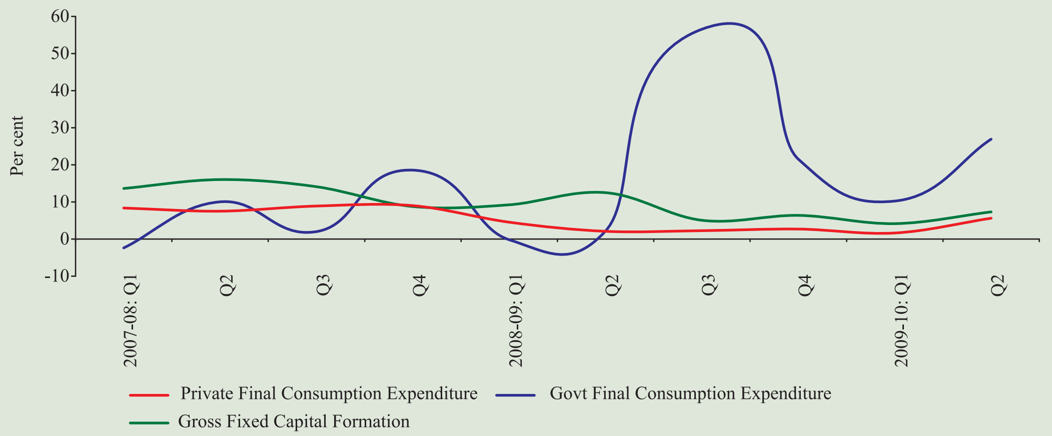
Growth in private consumption demand recovered significantly in the second quarter of 2009-10, which represents the highest growth in six quarters. Investment demand, in terms of gross fixed capital formation, also improved further. Since the onset of the global recession, growth in government expenditure has remained ahead of private demand and in the second quarter of 2009-10, there was a significant increase reflecting the payment of arrears relating to the Sixth Pay Commission award. Corporate sales growth in the second quarter of 2009-10 showed significant improvement over the preceding quarter although year-on-year growth remained flat; revival in sales growth for companies in the manufacturing sector was stronger than those in the services sector.

Domestic Demand

II.1 Deceleration in the growth of private consumption demand to 1.6 per cent in Q1 of 2009-10 and the subdued private investment demand were the key constraints to faster recovery in GDP growth from the slowdown in the second half of 2008-09. In Q2 of 2009-10, however, growth in private consumption demand revived to 5.6 per cent and investment demand, measured in terms of growth in gross fixed capital formation (GFCF), also recovered to 7.3 per cent. While the growth in private consumption demand is the highest in the last six quarters, the growth in gross fixed capital formation is the highest in last four quarters. The government final consumption expenditure (GFCE) increased by nearly 27 per cent in Q2 of 2009-10 over the corresponding period of 2008-09, mainly on account of the disbursement of arrears under the Sixth Pay Commission award (Chart II.1). Net of the arrears payments, the growth would have been lower at 11.7 per cent. Accordingly, demand side GDP would have been 5.5 per cent as against 6.7 per cent during Q2 of 2009-10.

II.2 The difference in growth rates of GDP at factor cost (supply side) and GDP at market prices (demand side) is essentially

Chart II.1:Growth Rates in Major Components of Domestic Demand



due to divergence in the growth rate of net indirect taxes (*i.e.*, indirect tax *less* subsidies). During Q2 of 2009-10, the net indirect taxes declined by 4.8 per cent as against an increase of 8.0 per cent in the corresponding period of 2008-09. As a result, GDP at market prices grew at 6.7 per cent as compared with 7.9 per cent growth in GDP at factor cost.

II.3 There has been a sharp decline in inventory levels in Q2 of 2009-10 over both the preceding quarter as well as the corresponding quarter of the previous year. This indicates that part of the growth in the near term could be driven by the need for scaling up inventories to normal levels. Data on corporate performance also point to the beginning of the turnaround in the inventory cycle (stock to sales ratio) since Q2 of 2009-10. Despite the low share of government consumption demand in aggregate demand (*i.e.*, less than 10 per cent), the fiscal response to the crisis-induced slowdown in economic activities has been manifested in the form of significant growth in government expenditure in the recent quarters (Table 2.1).

Combined Budgeted Government Finances: 2009-10

II.4 The key deficit indicators of the combined finances of the Central and State Governments are budgeted to be higher in 2009-10 than in 2008-09 (RE), reflecting the fiscal stimulus in the wake of the global financial crisis (Table 2.2). The total expenditure as per cent of GDP is budgeted

Table 2.1: Demand side of GDP (1999-2000 Prices)

(Per cent)

Item	2007-08*	2008-09#	2008-09				2009-10		April-September	
			Q1	Q2	Q3	Q4	Q1	Q2	2008-09	2009-10
1	2	3	4	5	6	7	8	9	10	11
Growth Rates										
Real GDP at market prices	9.1	6.1	8.2	7.8	4.8	4.1	6.0	6.7	8.0	6.4
Total Consumption Expenditure	8.3	5.4	3.8	2.1	9.0	6.1	2.8	8.4	3.0	5.6
(i) Private	8.5	2.9	4.5	2.1	2.3	2.7	1.6	5.6	3.3	3.6
(ii) Government	7.4	20.2	-0.2	2.2	56.6	21.5	10.2	26.9	0.9	18.1
Gross Fixed Capital Formation	12.9	8.2	9.2	12.5	5.1	6.4	4.2	7.3	10.9	5.8
Change in Stocks	51.7	2.9	6.0	5.6	1.4	-0.9	3.2	-45.4	5.8	-21.3
Exports	2.1	12.8	25.6	24.3	7.1	-0.8	-10.9	-15.0	25.1	-12.6
Less Imports	6.9	17.9	27.4	35.3	21.7	-5.7	-21.2	-29.8	31.4	-25.7
Relative shares										
Total Consumption Expenditure	66.9	66.5	67.5	63.7	69.9	64.8	65.5	64.7	65.6	65.1
(i) Private	57.2	55.5	58.0	55.5	57.4	51.4	55.6	54.9	56.7	55.2
(ii) Government	9.8	11.1	9.6	8.3	12.5	13.4	9.9	9.8	8.9	9.9
Gross Fixed Capital Formation	31.6	32.2	32.2	34.5	30.9	31.6	31.6	34.7	33.3	33.2
Change in Stocks	3.1	3	3.2	3.2	2.9	2.9	3.1	1.6	3.2	2.4
Net Exports	-4.3	-5.8	-1.3	-10.5	-8.5	-2.9	1.6	-4.2	-6.0	-1.3
Memo:										(Rupees crore)
Real GDP at market prices	34,02,716	36,09,425	8,33,631	8,49,245	9,45,121	9,81,427	8,83,492	9,06,559	16,82,876	17,90,051

*: Quick Estimates # : Revised Estimates.
Note: As only major items are included in the table, data will not add up to 100.
Source: Central Statistical Organisation.

Table 2.2: 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	-0.9	1.1	2.7	60.1
2008-09 (Provisional Accounts)	2.6	4.6	6.2	58.9 (RE)
2009-10 BE	3.0	4.8	6.8	59.7
		States		
2007-08 #	-0.6	-0.9	1.5	27.8
2008-09 # RE	0.7	-0.1	2.7	27.1
2009-10 # BE	1.4	0.6	3.4	27.5
		Combined		
2007-08	-1.3	0.2	4.2	75.1
2008-09 RE	3.5	4.4	8.9	74.7
2009-10 BE	4.5	5.5	10.2	76.6

RE: Revised Estimates. BE: Budget Estimates.

* : Includes external liabilities at historical exchange rates.

: Data pertain to 27 State Governments of which two are *Vote-on-Accounts.*

Note : 1. Negative sign indicates surplus.

2. Excludes issuances of special bonds to oil/FCI/fertiliser companies amounting to 0.8 per cent of GDP in 2007-08, 1.8 per cent of GDP in 2008-09 and 0.2 per cent of GDP in 2009-10.

to be higher than the previous year while revenue receipts are, budgeted to be lower, reflecting the economic slowdown and tax cuts to stimulate growth.

Centre's Fiscal Situation

II.5 According to the latest information available for the fiscal year 2009-10 (April-November), the revenue deficit and gross fiscal deficit (GFD) were placed significantly higher in absolute terms than in the corresponding period of the previous year, but were lower as per cent of budget estimates (Table 2.3 and Chart II.2).

II.6 On the revenue front, less than half of the budgeted amount was mobilised during the first eight months of the fiscal year 2009-10 mainly on account of a decline in indirect tax revenue. While customs duty collections were affected by the continued fall in imports as well as zero duty on certain sensitive commodities, revenue from excise duties declined mainly on account of tax cuts. The improved performance of the manufacturing sector in recent months could be expected to have a salutary impact on excise duty collections during the remaining months of the year. Despite registering a higher growth in April-November 2009 than in April-November 2008, non-tax revenue, as a per cent of budget estimates, was lower during April-November 2009 than in the corresponding period of the previous year, as the auction of the third-generation (3-G) spectrum, the proceeds of which are budgeted to yield Rs.35,000 crore, has not yet taken place. Non-debt capital receipts during April-November 2009 exceeded the budget estimates on account of higher disinvestment proceeds (Rs.4,305 crore) than was budgeted (Rs.1,120 crore).

Table 2.3: Central Government Finances during April-November 2009

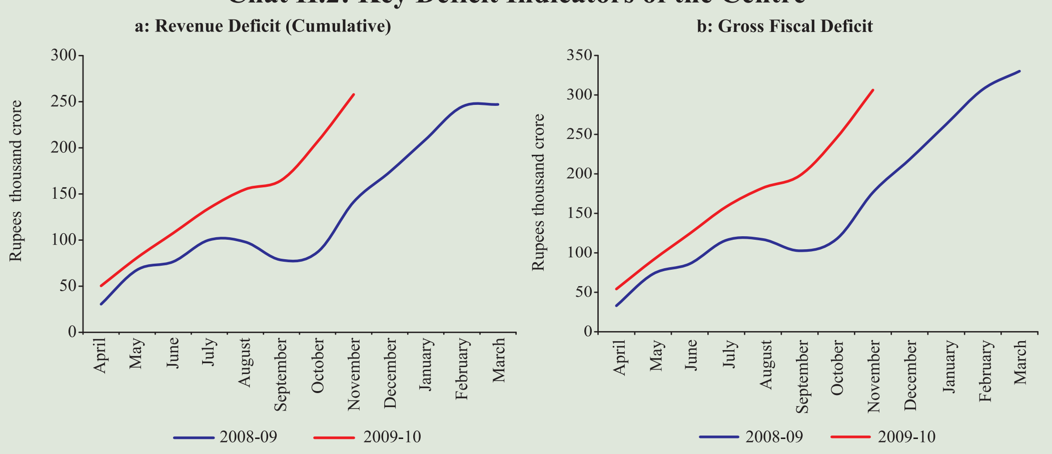
(Amount in Rupees crore)

Item	2009-10 (BE) Amount	April-November					
		Amount		Per cent to BE		Growth Rate	
		2008	2009	2008	2009	2008	2009
1	2	3	4	5	6	7	8
I. Revenue Receipts (i+ii)	6,14,497	3,14,974	3,07,125	52.2	50.0	14.7	-2.5
i) Tax Revenue	4,74,218	2,53,558	2,32,873	50.0	49.1	15.1	-8.2
ii) Non-Tax Revenue	1,40,279	61,416	74,252	64.1	52.9	13.2	20.9
2. Non-Debt Capital Receipts	5,345	2,640	8,326	18.0	155.8	-57.1@	215.4
3. Non-Plan Expenditure	6,95,689	3,57,994	4,47,995	70.5	64.4	36.0@	25.1
of which:							
i) Interest Payments	2,25,511	1,11,680	1,19,504	58.5	53.0	7.7	7.0
ii) Defence	1,41,703	52,557	78,955	49.8	55.7	30.3	50.2
iii) Major Subsidies	1,06,004	98,739	90,766	147.3	85.6	113.6	-8.1
iv) Grants to States and UTs	48,570	21,068	31,509	48.7	64.9	-6.1	49.6
4. Plan Expenditure	3,25,149	1,36,130	1,73,677	55.9	53.4	20.9	27.6
5. Revenue Expenditure	8,97,232	4,56,338	5,65,027	69.3	63.0	32.4	23.8
6. Capital Expenditure	1,23,606	37,786	56,645	40.7	45.8	21.0@	49.9
7. Total Expenditure	10,20,838	4,94,124	6,21,672	65.8	60.9	31.5@	25.8
8. Revenue Deficit	2,82,735	1,41,364	2,57,902	256.2	91.2	102.0	82.4
9. Gross Fiscal Deficit	4,00,996	1,76,510	3,06,221	132.4	76.4	85.7@	73.5
10. Gross Primary Deficit	1,75,485	64,830	1,86,717	-112.7	106.4	–	–
Memo:							
1. Gross Tax Revenue	6,41,079	3,57,441	3,29,606	52.0	51.4	17.5	-7.8
Direct Taxes	3,70,000	1,77,511	1,88,923	48.6	51.1	22.5	6.4
Indirect Taxes	2,71,079	1,79,930	1,40,683	55.8	51.9	13.0	-21.8
2. Extra-budgetary Items *	-	58,000#	10,306#	–	–	–	–

BE: Budget Estimates. UTs: Union Territories.
* : Comprises oil and fertilizer bonds. #: Up to December.
@ : Growth rate is calculated after adjusting for the transfer of Reserve Bank's stake in the SBI to the Government in 2007.
Source: Controller General of Accounts, Ministry of Finance.

II.7 On the expenditure side, despite sharp increases in defence revenue expenditure, pension and social service expenditure, total revenue expenditure decelerated during April-November 2009 as compared with the corresponding period

Chat II.2: Key Deficit Indicators of the Centre



of the previous year, mainly on account of decrease in major subsidies. While food subsidies increased by 39 per cent during April-November 2009, this was more than offset by the decline in fertiliser subsidies, in line with the fall in domestic and international prices. Capital expenditure registered a sharp increase during April-November 2009 as compared with the corresponding period of the previous year (Chart II.3). While defence capital outlay increased by 55 per cent during April-November 2009, non-defence capital outlay increased by 60 per cent, mainly on account of a steep increase in expenditure on railways.

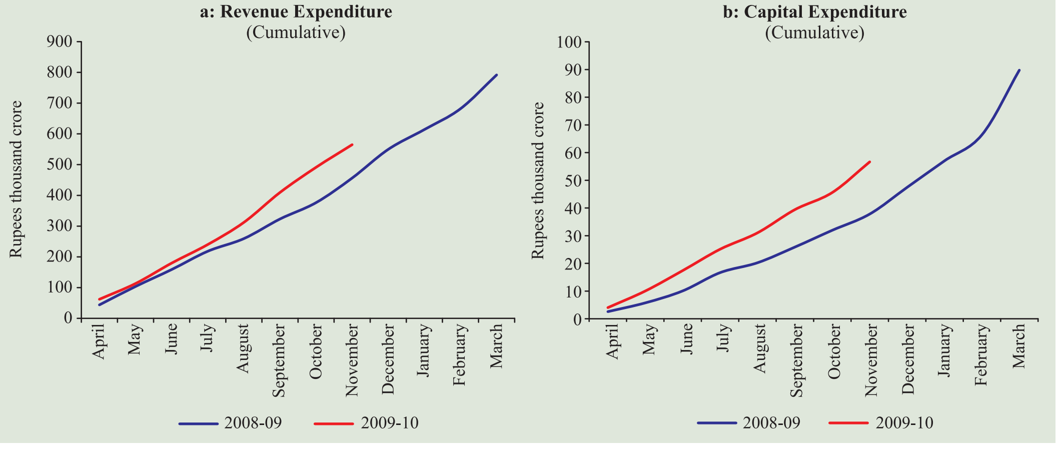
II.8 In the supplementary demand for grants in December 2009, the Central Government has taken approval for gross additional expenditure of Rs.30,943 crore, of which the net cash outgo will be Rs.25,725 crore. According to the Government, the additional expenditure is not expected to make significant variation in the total budgeted expenditure for 2009-10, as equivalent amount of savings would be realised from other grants.

II.9 According to the Ministry of Finance, net direct tax collections increased by 8.5 per cent during April-December 2009 over the corresponding period of the previous year; the increase during the month of December 2009 was substantial at 24.5 per cent, driven by a 44.0 per cent increase in corporation tax collections. Collections under personal income tax, however, declined by 0.4 per cent during April-December 2009 (-19.8 per cent in the month of December 2009), largely on account of higher tax refunds.

State Finances: 2009-10[1]

II.10 The fiscal correction and consolidation process, witnessed at the State Government level before the onset of the global financial crisis, came under pressure in the light of significant moderation in economic activity during 2008-09 which required fiscal expansion

Chart II.3:Central Government Expenditure Pattern



[1] Based on the budget documents of 27 State Governments, *of which* two are vote-on-account.

to spur economic revival. The consolidated revenue account of the State Governments was therefore, budgeted to turn into deficit of 0.6 per cent of GDP during 2009-10 after remaining in surplus during the previous three years. As a result, GFD was budgeted to be higher at 3.4 per cent of GDP during 2009-10 as compared with 2.7 per cent in 2008-09 (RE). The consolidated primary deficit was budgeted to increase to 1.4 per cent of GDP in 2009-10 from 0.7 per cent in 2008-09 (RE). During 2009-10, State Governments have been allowed to raise additional market borrowings of 0.5 per cent of gross state domestic product (GSDP) for undertaking capital expenditure. However, the increase in the consolidated revenue expenditure is budgeted to be higher than that in capital expenditure during 2009-10, both in absolute terms as well as in terms of GDP.

II.11 The deterioration in the revenue account of State Governments during 2008-09 (RE) and 2009-10 (BE) reflects the combined impact of sluggishness in own tax collections and devolution from the Centre coupled with higher expenditure commitments to implement the recommendations of the Sixth Pay Commission by majority of the State Governments. The widening of GFD would be mainly due to deterioration in the revenue account, coupled with an increase in net lending (loans extended by State Governments *minus* recoveries).

Corporate Performance

II.12 The first half of 2009-10 was a slow start for non-financial non-government companies which witnessed a fall in revenue over the previous year, primarily due to weak economic conditions and lower commodity prices. Net profit, however, increased both in the first and the second quarters of 2009-10, primarily due to a larger fall in expenditure relative to sales; significant deceleration in interest payments; lower foreign exchange related losses; and modest growth in other income (Table 2.4).

II.13 Sequentially, improved volumes lifted up the aggregated sales of companies during Q2 of 2009-10 by more than 10 per cent over Q1. Furthermore, stock-in-trade to sales ratio, which was negative in the second half of 2008-09, turned positive in Q1 and Q2 of 2009-10, reflecting adjustments in inventory levels to changes in business demand.

II.14 During Q2 of 2009-10, while the share of expenses on raw material consumption, including power and fuel, declined over the corresponding period of the previous year, it was higher than in Q1, as commodity prices started firming up. Likewise, interest payments, which had declined from the high base of the corresponding period of the previous year, rose over Q1, reflecting the increase in borrowings on account of rising economic activity as corroborated by increasing industrial production. Also, the contribution of other income in net profits for Q2 fell in comparison to the preceding quarter and corresponding quarter of the previous year, as income from non-core activities, which had increased moderately on a year-on-year (y-o-y) basis, declined over Q1, mainly on account of a fall in gains from foreign exchange transactions. As a result, the gross and net profit margins of select companies declined sequentially over the previous

Table 2.4: Corporate Sector - Financial Performance

(Y-o-Y growth rates/Ratios in per cent)

Item	2008-09	2008-09				2009-10	
		Q1	Q2	Q3	Q4	Q1	Q2
1	2	3	4	5	6	7	8
No. of companies	2,549	2,500	2,386	2,486	2,561	2,530	2,531
Sales	17.2	29.3	31.8	9.5	1.9	-0.9	0.1
Other Income	6.6	-8.4	-0.6	-4.8	39.4	50.2	6.0
Expenditure	19.5	33.5	37.5	12.6	-0.5	-4.4	-2.5
Depreciation	17.4	15.3	16.5	16.8	19.6	21.5	20.7
Gross profits	-4.2	11.9	8.7	-26.7	-8.8	5.8	10.9
Interest payments	57.3	58.1	85.3	62.9	36.5	3.7	-1.0
Profits after tax	-18.4	6.9	-2.6	-53.4	-19.9	5.5	12.0
Select Ratios							
Change in stock-in-trade to Sales	0.4	2.9	2.2	-1.7	-1.8	0.6	2.3
Gross Profits to Sales	13.3	14.5	13.5	11.0	13.7	15.7	14.9
Profits After Tax to Sales	8.1	9.7	8.6	5.3	8.1	10.2	9.4
Interest to Sales	3.1	2.4	2.9	3.8	3.2	2.8	3.1
Interest to Gross Profits	23.6	16.8	21.5	34.6	23.3	18.0	20.5
Interest Coverage (Times)	4.2	6.0	4.6	2.9	4.3	5.6	4.9

quarter, but improved substantially y-o-y. Sector-wise, the sequential pick-up in sales was more prominent for companies in the manufacturing sector *vis-à-vis* those in the services sector.

II.15 The persistence of deceleration in sales during the first half of 2009-10, despite the sequential recovery in the second quarter, pointed to weakness in aggregate demand. The turnaround in the inventory cycle since the second quarter, however, seems to support the industrial recovery. Partial data (small sample) for the third quarter of 2009-10 suggest that sales growth (y-o-y) has turned significantly positive. This lead indicator could be seen as further recovery in private demand, that could be expected to sustain the IIP recovery seen up to November 2009.

External Demand

II.16 Although both exports and imports declined in real terms during Q2 of 2009-10 over the previous quarter as well as the corresponding quarter of the previous year, there was sharper decline in imports (in real terms) than in exports. While net exports (goods and services) remained negative in the second quarters of both 2008-09 as well as 2009-10, there was an absolute increase of Rs.51,623 crore in net exports during Q2 of 2009-10 over Q2 of 2008-09. As a result, half of the growth in GDP (demand side) during Q2 of 2009-10 emanated from net exports (see Table 2.1). Information on net exports beyond the Q2 of 2009-10 could be partially obtained from the behavior of merchandise trade. Merchandise trade deficit during April-November 2009 stood at US $ 66.2 billion, which was lower by 33.9 per cent than US $ 100.2 billion in April-November 2008, due to the relatively larger decline in imports than exports during the period. A detailed discussion on the external demand conditions is set out in Chapter III.

II.17 To sum up, aggregate demand as measured by GDP at market prices indicate that there has been a revival in both private consumption demand and investment demand in Q2 of 2009-10 after the deceleration witnessed since the second half of 2008-09. Government final consumption expenditure, which had moderated in Q1 of 2009-10, increased significantly in Q2. During April-November 2009, the key deficit indicators of the Central Government, *viz*., revenue deficit and fiscal deficit, as a proportion of budget estimates, were significantly lower than the corresponding period of the previous year. Corporate sector data indicate that although, on a y-o-y basis, sales growth has broadly remained flat during Q2 of 2009-10, there has been a significant improvement over the preceding quarter. Partial information for Q3 of 2009-10 suggest stronger growth in sales and turnaround in the inventory cycle, both supporting the acceleration in IIP growth. Net exports contributed significantly to GDP growth (demand side) during Q2 of 2009-10, despite being negative in absolute terms.

III. THE EXTERNAL ECONOMY

The overall improvement in the global macroeconomic conditions have started shaping the performance of the external sector in India. While merchandise exports have witnessed a turnaround after thirteen consecutive months of decline, the pace of contraction in imports has also moderated significantly. In the balance of payments for the second quarter of 2009-10, net capital inflows and accretion to reserves have been significant. In the subsequent period, capital flows have remained buoyant and foreign exchange reserves have increased further to US $ 285.2 billion as on January 15, 2010. The expected surge in capital inflows to EMEs will have significant varied implications for macroeconomic management .

III.1 The external environment improved further with major advanced economies exhibiting stronger recovery in the third quarter of 2009, world merchandise exports showing some turnaround and capital flows to EMEs showing a sustained resumption. In India, while merchandise exports witnessed an end of thirteen consecutive months of decline, the pace of contraction in imports also eased significantly. In the balance of payments (BoP), net capital inflows and accretion to foreign exchange reserves have been buoyant. The momentum in capital inflows and the increase in reserves has continued in the third quarter. In view of allocation of SDRs by the IMF and India's purchase of gold from the IMF, the level and composition of India's foreign exchange reserves have changed in the recent period.

International Developments

III.2 The global economy is recovering, *albeit* slowly, with the G-20 countries (excluding the UK) exhibiting sequential positive growth during the third quarter of 2009. The US recorded a growth of 2.2 per cent during the third quarter of 2009 as compared with a contraction of 0.7 per cent in the second quarter of 2009. After contracting over five consecutive quarters, growth in the Euro Area returned to positive territory (0.4 per cent) during the third quarter of 2009. Asia continues to lead the global recovery. The steady upturn of the Chinese economy further strengthened with a growth of 10.7 per cent during the fourth quarter of 2009 (year-on-year) from 8.9 per cent in the third quarter. Japan also grew in the third quarter at an annualised rate of 1.3 per cent.

III.3 The unemployment rate for the OECD area was 8.8 per cent in November 2009, same as in the previous month and 2.1 percentage points higher than a year earlier. For the US, the unemployment rate for December 2009 was 10.0 per cent, same as in the previous month and 2.6 percentage points higher than a year ago.

III.4 Going forward, the global economy is projected to return to positive growth territory in 2010 after recording a decline of 1.1 per cent in 2009 (IMF World Economic Outlook, October 2009). The advanced economies are projected to post a positive growth in 2010 after being in recession during 2009. The emerging and developing economies are projected to exhibit a strong recovery from 1.7 per cent in 2009 to 5.1 per cent in 2010, with India and China leading the momentum (Table 3.1). The OECD economic outlook released on November 19, 2009 projected real GDP of the OECD area to decline by 3.5 per cent in 2009 and recover thereafter to a positive growth of 1.9 per cent in 2010.

III.5 There is return of consumer confidence and revival in industrial production in the case of advanced economies, which were adversely impacted by the crisis, even though the unemployment rates continue to be high (Chart III.1).

III.6 The sharp recovery in financial markets worldwide ahead of recovery in growth during 2009 has been accompanied by a return of private cross-border capital inflows to many countries. A combination of better growth prospects, near zero policy rates in the major centres and low long-term interest rates provide the pull and push for resurgence in capital inflows, particularly to emerging market countries and commodity exporters.

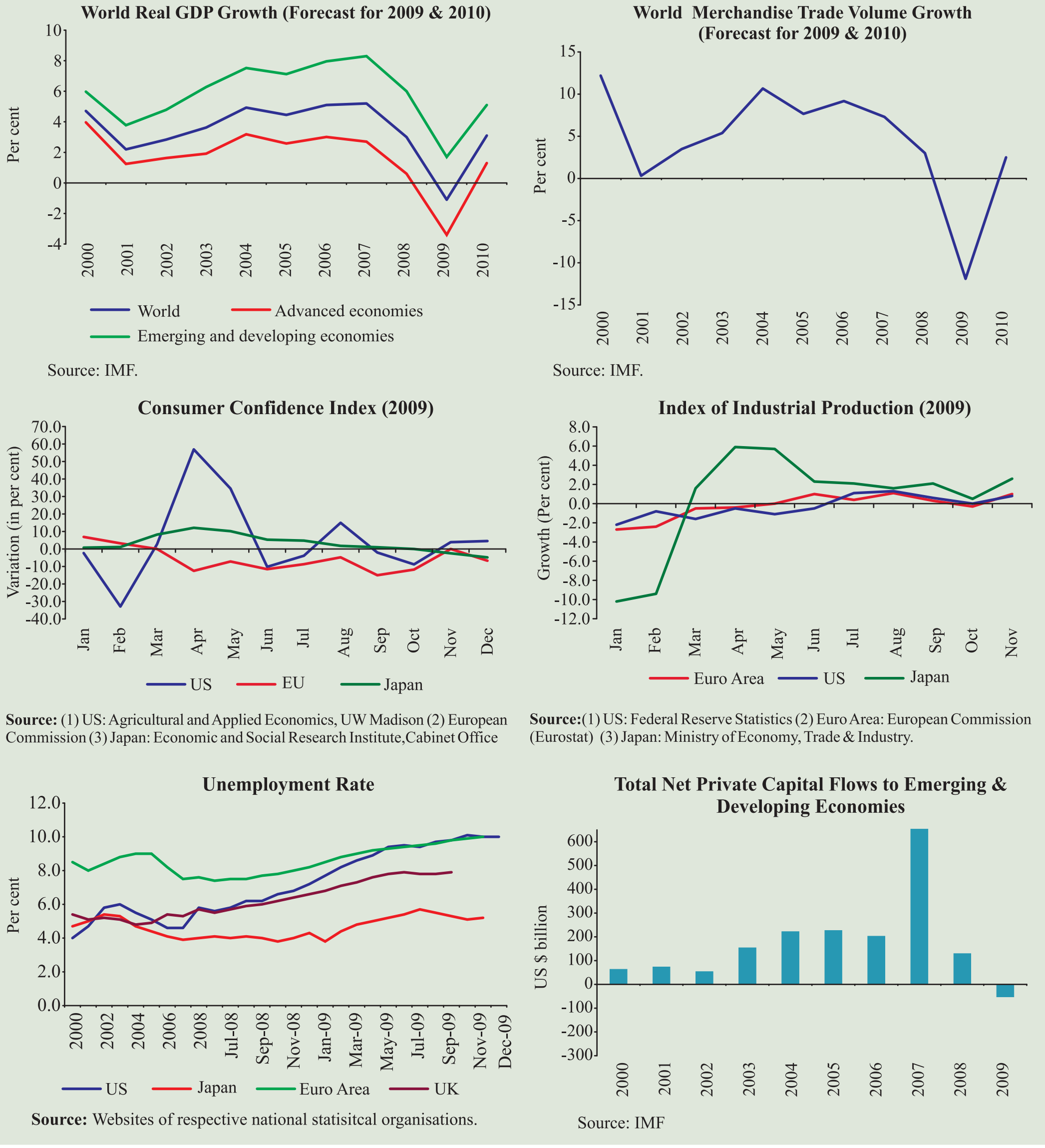
III.7 The policy responses of EMEs to the growing capital inflows include three components, *viz.*, monetary and exchange rate policy, capital account policy and

Table 3.1: Select Economic Indicators - World

Item	2007	2008	2009P	2010P
1	2	3	4	5
I. World Output (Per cent change) #	**5.2**	**3.0**	**-1.1**	**3.1**
	(3.8)	**(1.8)**	**(-2.3)**	**(2.3)**
i) Advanced Economies	2.7	0.6	-3.4	1.3
ii) Other Emerging Market and Developing Countries	8.3	6.0	1.7	5.1
of which: Developing Asia	10.6	7.6	6.2	7.3
India	**9.4**	**7.3**	**5.4**	**6.4**
II. Consumer Price Inflation (Per cent)				
i) Advanced Economies	2.2	3.4	0.1	1.1
ii) Other Emerging Market and Developing Countries	6.4	9.3	5.5	4.9
of which: Developing Asia	5.4	7.5	3.0	3.4
III. Net Capital Flows* (US$ billion)				
i) Net Private Capital Flows (a+b+c)**	696.5	129.5	-52.5	28.3
a) Net Private Direct Investment	411.2	425.0	279.0	269.5
b) Net Private Portfolio Investment	88.1	-85.4	-99.8	-110.4
c) Net Other Private Capital Flows	197.1	-210.1	-231.6	-130.8
ii) Net Official Flows	-69.5	-105.7	50.3	-14.2
IV. World Trade @				
i) Trade Volume	7.3	3.0	-11.9	2.5
ii) Export Volume	7.4	2.8	-11.4	2.6
iii) Trade Price Deflator	8.1	11.2	-12.2	5.4
V. 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

P : IMF Projections.
: Growth rates are based on exchange rates at purchasing power parities. Figures in parentheses are growth rates at market exchange rates.
* : Net capital flows to emerging market and developing countries.
** : On account of data limitations, flows listed under 'Net private capital flows' may include some official flows.
@ : Average of annual percentage change for world exports and imports of goods and services.
Source : World Economic Outlook, October 2009, International Monetary Fund.

Chart III.1: Key Global Indicators



prudential policy. First, several countries have allowed their exchange rates to appreciate, while some countries, concerned about the competitiveness of their exports, have not done so. Second, capital controls are being viewed as an additional policy instrument to deal with macroeconomic challenges associated with capital inflows. The use of prudential tools, which have been a common process, primarily aim at containing financial stability concerns. The market focus on assessment of sovereign risk has increased after the Dubai World incident.

Furthermore, the fiscal risks associated with large deficits and debt of countries will assume prominence over time.

III.8 The world merchandise exports had started declining since November 2008, with rate of decline accelerating over the successive months under the impact of the synchronised global economic slowdown. According to the International Monetary Fund's (IMF) International Financial Statistics (IFS), in September 2009, the year-on-year decline in world exports at 16.6 per cent was the lowest since January 2009, suggesting improvement in terms of decline in the pace of contraction. Cumulatively, world merchandise exports (in dollar terms) during January-September 2009, showed a decline of 27.1 per cent as against a growth of 24.2 per cent a year ago (Table 3.2). According to the WTO data, while world merchandise exports increased by 10 per cent (sequential quarter-on-quarter) in the third quarter of 2009, on year-on-year basis, the decline was 26 per cent.

Table 3.2: Growth in Exports - Global Scenario

(Per cent)

Region/Country	2007	2008	2008	2009
	January-December		January-September	
1	2	3	4	5
World	**14.1**	**15.8**	**24.2**	**-27.1**
Advanced Economies	**13.5**	**11.0**	**19.5**	**-28.1**
US	12.0	11.9	17.8	-23.0
France	12.3	10.1	19.4	-28.5
Germany	18.0	10.8	18.9	-29.5
Japan	7.8	12.3	18.6	-33.4
Emerging and Developing Economies	**15.3**	**24.6**	**33.1**	**-25.7**
Singapore	10.1	13.0	22.9	-28.5
China	25.6	17.3	22.3	-21.2
India	23.3	29.7	33.9*	-22.8*
Indonesia	14.7	24.4	27.6	-23.4
Korea	14.1	13.6	22.6	-20.9
Malaysia	9.6	19.1	23.3	-29.5
Thailand	17.1	12.9	24.7	-21.0

* January-November over corresponding period of previous year.
Source: 1. IMF (www.imfstatistics.org).
2. DGCI&S for India.

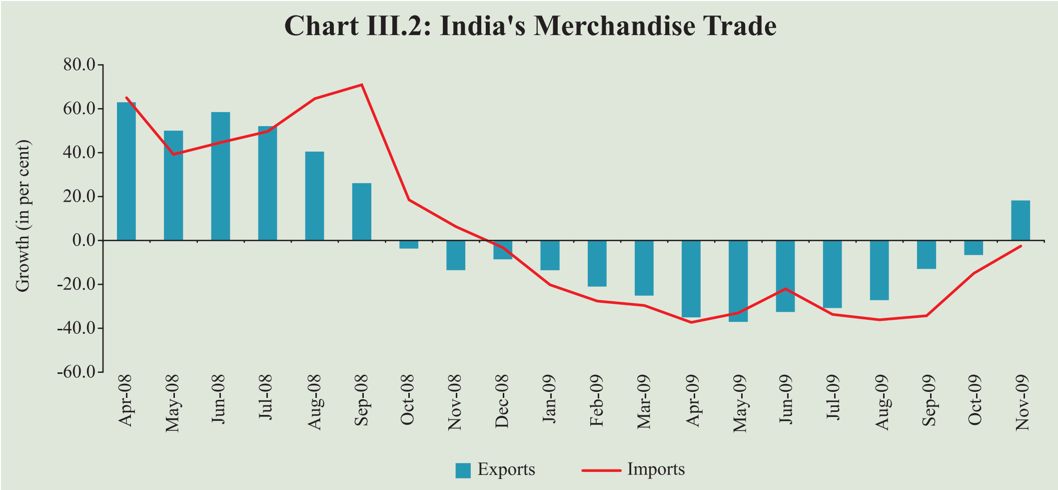
Merchandise Trade

Exports

III.9 The declining trend in India's merchandise exports, which began in October 2008, continued for thirteen consecutive months up to October 2009. The rates of decline in exports, however, showed persistent moderation starting from June 2009. During November 2009, there was reversal in the trend, with exports turning around sharply by exhibiting a growth of 18.2 per cent as compared with a decline of 13.5 per cent in November 2008 (Chart III.2). This recovery has to be seen in relation to the low base a year ago. On a cumulative basis, India's merchandise exports during April-November 2009 registered a decline of 22.4 per cent as against a growth of 32.7 per cent during the corresponding period of the previous year.

III.10 The composition of India's exports basket during 2009-10 (April-June) reveals that manufactured goods occupied the largest share at 70.9 per cent, followed by primary products (14.4 per cent) and petroleum products (12.1 per cent). Moreover, the share of manufactured goods has increased over time, along with decrease in the share of petroleum products. During April-June 2009, the exports of all major commodity groups declined (Table 3.3).

III.11 In terms of destination, developing countries and OECD countries were the major markets for India's exports with these groups accounting for 37.7 per cent and 36.9 per cent shares, respectively. Country-wise,



the UAE was the largest destination for India during April-June 2009, with a share of 14.0 per cent in India's total exports, followed by the US, China, Singapore, Hong Kong and the UK. Exports to major export destinations, such as the EU, OPEC and developing countries declined during April-June 2009 (Table 3.4).

Imports

III.12 After a spell of deceleration in growth during October-November 2008, India's imports started declining thereafter with the rate of decline accentuating over successive months. Since August 2009, however, the rate of fall in imports has

Table 3.3: Exports of Principal Commodities

Commodity/Group	US $ billion			Variation (Per cent)		
	2008-09 April-March	2008-09R April-June	2009-10P April-June	2008-09 April-March	2008-09R April-June	2009-10P April-June
1	2	3	4	5	6	7
1. Primary Products	**25.3**	**8.2**	**5.2**	**-8.0**	**72.3**	**-36.8**
of which:						
a) Agriculture and Allied Products	17.5	5.7	3.7	-4.9	95.4	-34.7
b) Ores and Minerals	7.8	2.5	1.4	-14.5	34.9	-41.5
2. Manufactured Goods	**123.1**	**36.0**	**25.6**	**19.6**	**58.8**	**-29.0**
of which:						
a) Chemicals and Related Products	22.7	6.1	4.7	7.1	33.6	-23.9
b) Engineering Goods	47.3	13.8	9.4	26.5	71.6	-31.7
c) Textiles and Textile Products	20.0	5.6	4.3	3.0	28.2	-22.5
d) Gems and Jewellery	28.0	9.1	6.1	42.1	102.4	-32.7
3. Petroleum Products	**26.8**	**9.2**	**4.4**	**-5.4**	**42.8**	**-52.4**
4. Total Exports	**185.3**	**56.4**	**36.1**	**13.7**	**57.0**	**-36.0**
Memo:						
Non-oil Exports	158.5	47.2	31.7	17.8	60.1	-32.8

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

Table 3.4: Direction of India's Exports

Group/Country	US $ billion			Variation (Per cent)		
	2008-09 April-March	2008-09R April-June	2009-10P April-June	2008-09 April-March	2008-09R April-June	2009-10P April-June
1	2	3	4	5	6	7
1. OECD Countries	**68.5**	**19.6**	**13.3**	**6.5**	**41.1**	**-32.0**
of which:						
EU	39.0	11.5	7.4	13.0	57.2	-36.1
North America	22.3	5.9	4.4	1.6	20.0	-26.6
US	21.0	5.6	4.1	1.3	19.4	-26.6
2. OPEC	**38.9**	**12.4**	**8.7**	**44.0**	**90.7**	-29.7
of which:						
UAE	24.0	8.1	5.1	53.4	112.9	-37.6
3. Developing Countries	**68.5**	**21.8**	**13.6**	**-0.9**	**53.4**	**-37.5**
of which:						
Asia	51.3	16.3	10.4	-0.4	59.2	-36.2
People's Republic of China	9.3	2.9	2.0	-14.3	49.1	-29.7
Singapore	8.2	3.5	1.9	11.4	116.8	-44.7
4. Total Exports	**185.3**	**56.4**	**36.1**	**13.7**	**57.0**	**-36.0**

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

showed considerable moderation, with the year-on-year decline in imports in November 2009 turning out to be 2.6 per cent, which is the lowest rate of decline so far. Overall, imports during April-November 2009 registered a decline of 27.4 per cent in contrast with a growth of 43.6 per cent a year ago. The decline in imports reflected the combined effects of both lower international crude oil prices and slowdown in domestic economic activity (Table 3.5 and Chart III.3).

Table 3.5: Trends in Imports (Growth)

(Per cent)

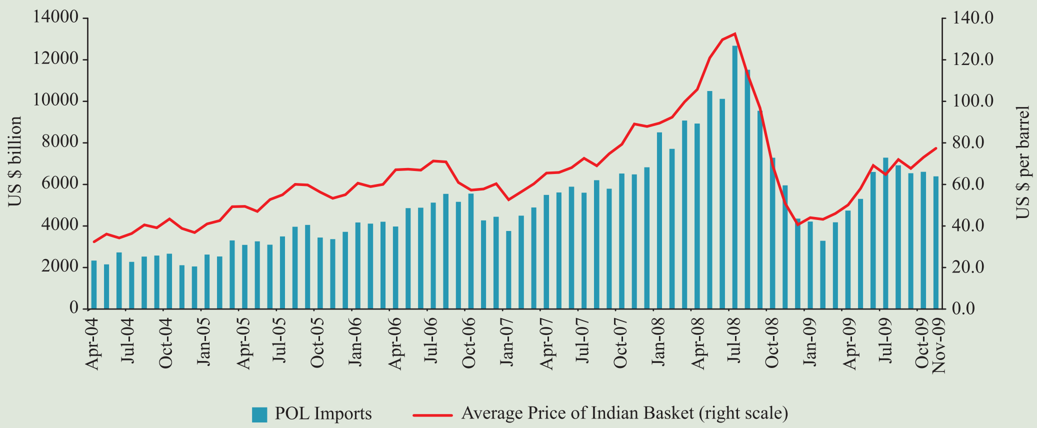
	April-November	
	2008-09R	2009-10P
POL Imports	60.8	(-) 34.5
Non-POL Imports	36.5	(-) 23.9
Total Imports	43.6	(-) 27.4

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

III.13 The commodity-wise imports during 2009-10 (April-June) indicate that POL imports showed a sharp decline. Non-POL imports during this period also witnessed a decline of 24.5 per cent, mainly due to sharp decline in imports of iron and steel, capital goods, gold and silver, pearls, precious and semi-precious stones, chemicals and coal. The imports of edible oil, however, witnessed considerable growth (Table 3.6).

III.14 Source-wise, OECD countries had the highest share in India's imports (34.1 per cent), followed by developing countries (34.0 per cent) and OPEC (28.8 per cent) during April-June 2009. The shares of developing countries and OECD countries have increased, while that of OPEC declined during the period. Country-wise, China continued to be the single largest source of imports with a share of 12.1 per

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



cent in total imports, followed by the US, the UAE, Saudi Arabia, Australia and Iran.

III.15 India's merchandise trade deficit registered an increase from 7.5 per cent of GDP in 2007-08 to 10.0 per cent in 2008-09. During April-November 2009, however, merchandise trade deficit declined over the corresponding period of the previous year, reflecting relatively larger decline in imports than exports (Table 3.7).

Table 3.6: Imports of Principal Commodities

Commodity/Group	US $ billion			Variation (Per cent)		
	2008-09 April-March	2008-09R April-June	2009-10P April-June	2008-09 April-March	2008-09R April-June	2009-10P April-June
1	2	3	4	5	6	7
Petroleum, Petroleum Products & Related Material	91.3	29.6	16.6	14.6	74.1	-43.9
Edible Oil	3.4	0.6	1.2	34.4	-10.3	99.6
Iron and Steel	9.5	2.4	1.8	8.9	5.2	-25.5
Capital Goods	71.6	19.8	15.0	2.2	60.0	-24.4
Pearls, Precious and Semi-Precious Stones	16.6	5.7	2.9	107.6	145.6	-49.2
Chemicals	12.2	3.6	3.0	23.1	50.8	-17.2
Gold and Silver	21.8	6.5	5.6	22.3	-9.1	-14.5
Total Imports	**303.7**	**88.7**	**61.2**	**20.8**	**49.0**	**-31.0**
Memo:						
Non-oil Imports	212.4	59.1	44.6	23.6	39.0	-24.5
Non-oil Imports excluding Gold and Silver	190.5	52.5	39.0	23.8	48.8	-25.7
Mainly Industrial Inputs*	169.3	48.2	34.9	20.2	45.9	-27.6

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

Table 3.7: India's Merchandise Trade

(US $ billion)

Item	2008-09R (April-March)	2008-09R April-November	2009-10P April-November
1	2	3	4
Exports	185.3	134.2	104.2
Oil	26.8	21.7	..
Non-oil	158.5	112.5	..
Imports	303.7	234.4	170.2
Oil	91.3	76.5	50.1
Non-oil	212.4	157.8	120.1
Trade Balance	-118.4	-100.2	-66.1
Non-Oil Trade Balance	-53.9	-45.3	..
Variation (per cent)			
Exports	13.7	32.7	-22.4
Oil	-5.4	25.7	..
Non-oil	17.8	34.1	..
Imports	20.8	43.6	-27.4
Oil	14.6	60.8	-34.5
Non-oil	23.6	36.5	-23.9

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

Balance of Payments (BoP)

Current Account

III.16 Notwithstanding the sequential quarterly recovery in the world output and world merchandise exports in the third quarter of 2009, the persistence of depressed global demand continued to impinge on the current account position of India. The decline in the growth of exports and imports persisted even during the second quarter of 2009-10. India's merchandise exports (on BoP basis), recorded a decline of 21.0 per cent in July-September 2009 as against a strong growth of 39.6 per cent during the corresponding period of the previous year. The contraction in imports that began in the fourth quarter of 2008-09- after a gap of almost seven years- continued through the second quarter of 2009-10. Imports (on BoP basis), registered a decline of 19.6 per cent in the second quarter of 2009-10 as compared to robust growth of 54.8 per cent in the corresponding period of the previous year. The decline in imports resulted from contraction in both oil and non-oil imports. Trade deficit, however, was lower (US$ 32.2 billion) during the second quarter of 2009-10 as compared with the corresponding quarter of the previous year (US$ 39.1 billion), reflecting larger fall in imports, especially oil imports, on account of lower oil prices. For the first half of 2009-10 (April-September) also, trade deficit remained lower (US $ 58.2 billion) as compared with the corresponding period of the preceding year (US $ 64.4 billion), mainly on account of decline in oil imports. Exports and imports during the second quarter were, however, higher than in the first quarter. As the absolute increase in imports was higher than the increase in exports, the trade deficit in the second quarter of 2009-10 was higher than that of the first quarter (Table 3.8).

Invisibles

III.17 Mirroring the adverse impact of the global financial crisis, invisibles receipts, comprising services, current transfers and income, registered a decline of 15.1 per cent in the second quarter of 2009-10 as against a growth of 33.1 per cent in the corresponding period of the previous year (Table 3.9). Major components of services exports, including software services exports, registered a decline during the quarter. Private transfer receipts, comprising mainly remittances from Indians working overseas and local withdrawals from NRI Rupee deposits,

Table 3.8: India's Balance of Payments

(US $ billion)

		2007-08 April-March	2008-09 PR April-March	2008-09 Q1 PR	2008-09 Q2 PR	2008-09 Q3 PR	2008-09 Q4 PR	2009-10 Q1 PR	2009-10 Q2 P
1		2	3	4	5	6	7	8	9
1.	Exports	166.2	189.0	57.5	53.6	39.4	38.5	38.8	42.4
2.	Imports	257.6	307.7	82.7	92.8	73.5	58.7	64.8	74.6
3.	Trade Balance (1-2)	-91.5	-118.7	-25.3	-39.1	-34.0	-20.2	-26.0	-32.2
4.	Net Invisibles	75.7	89.9	22.0	26.5	22.4	19.0	20.0	19.6
5.	Current Account Balance (3+4)	-15.7	-28.7	-3.3	-12.6	-11.7	-1.2	-6.0	-12.6
6.	Gross Capital Inflows	438.4	312.4	94.4	90.0	68.7	59.4	77.2	98.1
7.	Gross Capital Outflows	331.8	305.2	89.5	82.9	74.8	58.0	71.3	74.5
8.	Net Capital Account (6-7)	106.6	7.2	4.9	7.1	-6.1	1.4	6.0	23.6
9.	Overall Balance (5+8)#	92.2	-20.1	2.2	-4.7	-17.9	0.3	0.1	9.4
Memo:									
i.	Export growth (%)	28.9	13.7	57.0	39.6	-8.4	-20.0	-32.5	-21.0
ii.	Import growth (%)	35.1	19.4	46.8	54.8	9.2	-20.8	-21.7	-19.6
iii.	Trade balance (as a % of GDP)	-7.8	-10.3						
iv.	Invisible receipts growth (%)	30.0	9.8	31.8	33.1	5.4	-18.3	-7.5	-15.1
v.	Invisibles payments growth (%)	17.3	0.6	18.5	12.0	2.4	-20.8	-5.6	0.2
vi.	Net invisibles growth (%)	45.0	18.7	44.6	54.2	8.0	-15.8	-9.0	-26.3
vii.	CAD as a % of GDP	-1.3	-2.5						
viii.	Net capital flows as a % of GDP	9.1	0.6						
ix.	Foreign Exchange Reserves (as at end period)	309.7	252.0	312.1	286.3	256.0	252.0	265.1	281.3

Overall balance also includes errors and omissions apart from items 5 and 8.

PR: Partially Revised. P: Preliminary.

however, were sustained during the quarter. Invisibles payments, in turn, recorded a marginal increase during the quarter, mainly on account of payments under business and financial services. 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, mainly due to the decline in services exports, particularly non-software services receipts.

III.18 During the first half of 2009-10 both invisibles receipts (except private transfer receipts) and payments also registered a decline as compared with the corresponding period of the previous year. The decline in invisibles receipts was mainly attributed to the lower receipts under almost all the components of services. Invisibles payments declined, mainly due to lower payments towards travel, transportation, non-software services and private transfers. Consequently, net invisibles stood lower during the first half of 2009-10 as compared with the corresponding period of the previous year. At this level, the invisibles surplus financed about 68.0 per cent of trade deficit during April-September 2009 as against 75.4 per cent during April-September 2008. The current account deficit during the second quarter

Table 3.9: Invisibles Gross Receipts and Payments

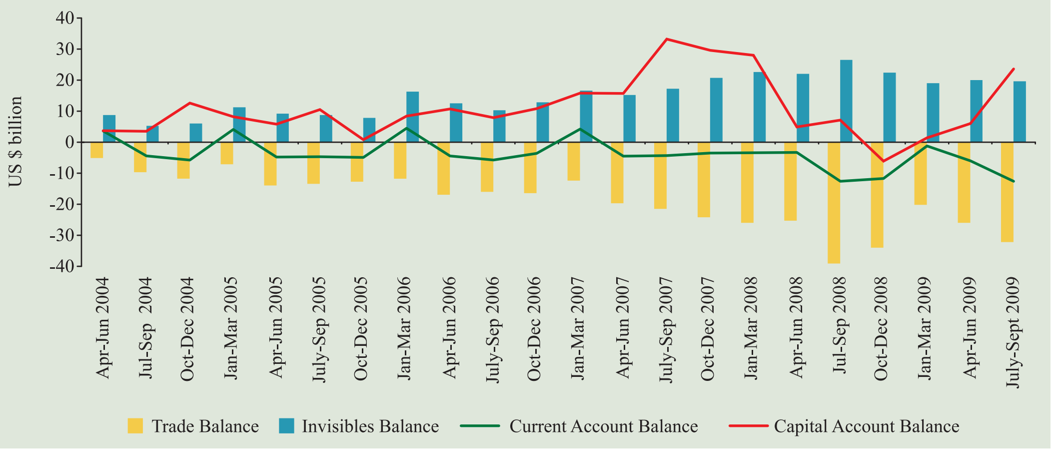
(US $ billion)

Item	Invisibles Receipts					Invisibles Payments				
	April-March	April-September		July-September		April-March	April-September		July-September	
	2008-09 PR	2008-09 PR	2009-10 P	2008-09 PR	2009-10 P	2008-09 PR	2008-09 PR	2009-10 P	2008-09 PR	2009-10 P
1	2	3	4	5	6	7	8	9	10	11
1. Travel	10.9	5.3	4.8	2.8	2.5	9.4	4.9	4.4	2.7	2.4
2. Transportation	11.3	5.7	5.1	3.0	2.6	12.8	7.1	5.0	3.8	2.2
3. Insurance	1.4	0.7	0.8	0.4	0.4	1.1	0.5	0.7	0.3	0.3
4. Govt. not included elsewhere	0.4	0.2	0.2	0.08	0.1	0.8	0.2	0.2	0.1	0.1
5. Miscellaneous	77.7	39.1	29.2	21.6	14.3	27.9	13.2	14.4	6.7	8.5
Of which: Software	46.3	24.2	21.4	12.1	10.6	2.8	1.8	0.8	0.9	0.4
Non-Software	31.4	14.9	7.8	9.5	3.7	25.1	11.4	13.6	5.8	8.1
6. Transfers	47.5	26.6	27.6	13.8	14.3	2.7	1.5	1.0	0.8	0.6
Of which: Private Transfers	46.9	26.4	27.5	13.7	14.2	2.3	1.3	0.8	0.7	0.5
7. Income	14.3	7.7	7.7	4.1	4.7	18.8	9.4	10.1	4.9	5.1
Investment Income	13.5	7.3	7.3	3.9	4.5	17.5	8.7	9.4	4.6	4.8
Compensation of Employees	0.8	0.4	0.4	0.3	0.2	1.3	0.7	0.7	0.3	0.4
Total (1 to 7)	**163.5**	**85.3**	**75.4**	**45.8**	**38.9**	**73.6**	**36.7**	**35.8**	**19.3**	**19.3**

PR: Partially Revised. P: Preliminary.

of 2009-10 remained almost at the same level (US$ 12.6 billion) as during the second quarter of 2008-09, though it represented significant increase over the level in the first quarter of 2009-10. However, despite lower trade deficit, the current account deficit increased to US $ 18.6 billion during April-September 2009 from US $ 15.8 billion in April-September 2008, mainly due to lower net invisibles surplus. During 2008-09, the current account deficit as a per cent of GDP stood higher at 2.5 per cent as compared to 1.3 per cent a year ago (Chart III.4).

Chart III.4: Current Account Balance and Capital Flows



Capital Account

III.19 The revival in capital flows witnessed during the first quarter of 2009-10 gathered momentum during the second and third quarters. Both gross capital inflows and outflows rose during the period (see Chart III. 4 and Table 3.10).

III.20 Component-wise, net inward FDI continued to remain upbeat during the second quarter of 2009-10, reflecting relatively better growth prospects of the Indian economy. Portfolio investments continued their upward trend, mainly due to the revival in FII inflows since the first quarter of 2009-10. Inflows under portfolio investment were led by large purchases of equities by FIIs in the Indian stock market and revival in net inflows under American Depository Receipts (ADRs)/ Global Depository Receipts (GDRs) due to resurgence in stock prices of Indian companies.

III.21 During the first half of 2009-10 also, net capital flows were higher, mainly driven by foreign investment inflows, particularly reflecting the turnaround in FII inflows. In banking capital, net inflows under NRI deposits remained higher. Net inward FDI into India remained buoyant during April-September 2009 as compared to the level in April-September 2008. During this period, FDI was channelled mainly into the manufacturing sector, followed by communication services and real estate sector. Inflows under net external commercial borrowings (ECBs), however, remained lower during the period. Short term trade credit recorded a net outflow

Table 3.10: Net Capital Flows

(US $ billion)

Item	2007-08 April-March	2008-09 April-March PR	2008-09 Q1 PR	2008-09 Q2 PR	2008-09 Q3 PR	2008-09 Q4 PR	2009-10 Q1 PR	2009-10 Q2 P
1	2	3	4	5	6	7	8	9
1. Foreign Direct Investment (FDI)	15.9	17.5	9.0	4.9	0.5	3.2	7.0	7.1
Inward FDI	34.7	35.0	11.9	8.8	6.3	8.0	9.7	11.3
Outward FDI	18.8	17.5	2.9	3.9	5.9	4.8	2.6	4.2
2. Portfolio Investment	27.4	-14.0	-4.2	-1.3	-5.8	-2.7	8.3	9.7
Of which:								
FIIs	20.3	-15.0	-5.2	-1.4	-5.8	-2.6	8.2	7.0
ADR/GDRs	6.6	1.2	1.0	0.1	0.00	0.02	0.04	2.7
3. External Assistance	2.1	2.6	0.4	0.5	1.0	0.8	0.08	0.5
4. External Commercial Borrowings	22.6	7.9	1.5	1.7	3.8	1.0	-0.4	1.2
5. NRI Deposits	0.2	4.3	0.8	0.3	1.0	2.2	1.8	1.0
6. Banking Capital excluding NRI Deposits	11.6	-7.5	1.9	2.0	-6.0	-5.4	-5.2	3.4
7. Short-term Trade Credits	15.9	-1.9	4.5	0.4	-4.2	-2.6	-1.5	0.8
8. Rupee Debt Service	-0.1	-0.1	-0.03	-0.03	-	-0.07	-0.02	-0.01
9. Other Capital	11.0	-1.5	-8.9	-1.4	3.7	5.1	-4.1	-0.1
Total (1 to 9)	**106.6**	**7.2**	**4.9**	**7.1**	**-6.1**	**1.4**	**6.0**	**23.6**

PR: Partially Revised. P: Preliminary.

during April-September 2009 as against a net inflow during the corresponding period of the previous year.

III.22 The latest available information on certain indicators of the capital account indicates that the revival in capital flows, which started at the beginning of 2009-10 and gathered momentum in the second quarter, have remained buoyant even in the third quarter (Table 3.11). The better than expected macroeconomic performance of India during 2009-10 and positive sentiments of global investors about India's growth prospects are the factors primarily responsible for sustained capital inflows during the year so far.

Table 3.11: Capital Flows in 2009-10 so far

(US $ billion)

Component	Period	2008-09	2009-10
1	2	3	4
FDI to India	April-Nov.	23.3	25.0
FIIs (net)	April-Jan.*	-12.1	24.7
ADRs/GDRs	April-Nov.	1.1	3.1
ECB Approvals	April-Nov.	13.0	12.3
NRI Deposits (net)	April-Dec.	2.1	3.2

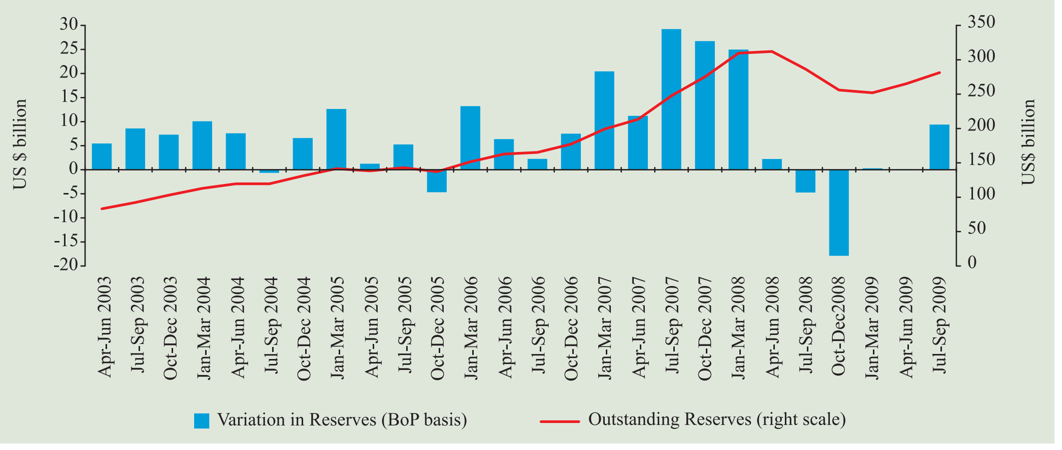
* : Up to January 15, 2010.
FDI : Foreign Direct Investment.
FIIs : Foreign Institutional Investors' Investment.
ECB : External Commercial Borrowings.
NRI : Non Resident Indians.
ADR : American Depository Receipts
GDR : Global Depository Receipts.

Foreign Exchange Reserves

III.23 On BoP basis (*i.e.*, excluding valuation effects), the foreign exchange reserves increased by US$ 9.5 billion during April-September 2009 as against a decline of US$ 2.5 billion during April-September 2008. The valuation gain, reflecting the depreciation of the US dollar against the major currencies, was US$ 19.8 billion during April-September 2009 as compared with a valuation loss of US$ 20.9 billion during April-September 2008. Accordingly, valuation gain during April-September 2009 accounted for 67.5 per cent of the total increase in foreign exchange reserves (Chart III.5).

III.24 The IMF made allocations of SDRs to India in two tranches, *viz.*, general allocation of SDR 3,082 million (equivalent to US$ 4.82 billion) on August 28, 2009

Chart III.5 : India's Foreign Exchange Reserves



and a special allocation of SDR 214.6 million (equivalent to US$ 0.34 billion) on September 9, 2009, resulting in an increase in India's foreign exchange reserves by US$ 5.16 billion during the second quarter of 2009-10 (July-September).

III.25 India's foreign exchange reserves increased by US $ 33.2 billion during 2009-10 so far (up to January 15, 2010) to US $ 285.2 billion (Table 3.12). The increase in reserves during the period reflects valuation gains and also the net surplus in the overall balance portion in the balance of payments. Furthermore, the Reserve Bank purchased 200 metric tonnes of gold from the IMF on November 3, 2009 as part of its foreign exchange reserves management operations. The foreign exchange reserves, however, remain unaffected by the gold transaction, since the gold purchase reflects only a substitution of foreign currency assets.

External Debt

III.26 India's external debt of US$ 242.8 billion as at end-September 2009 represents an increase of US$ 18.2 billion (8.1 per cent) over its end-March 2009 level, mainly on account of increase in long term debt (Table 3.13). As at end-September 2009, the long-term debt increased by 10.6 per cent

Table 3.12: 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 2005	4,500	5	135,571	1,438	141,514	–
March 2006	5,755	3	145,108	756	151,622	–
March 2007	6,784	2	191,924	469	199,179	–
March 2008	10,039	18	299,230	436	309,723	(+) 14,735
March 2009	9,577	1	241,426	981	251,985	(-) 2,042
April 2009	9,231	1	241,487	983	251,702	(-) 1,071
May 2009	9,604	1	251,456	1,245	262,306	(+) 131
June 2009	9,800	1	254,093	1,248	265,142	(+) 745
July 2009	9,671	1	260,631	1,338	271,641	(+) 800
August 2009	9,828	4,828	261,247	1,349	277,252	(+) 619
September 2009	10,316	5,224	264,373	1,365	281,278	(+) 539
October 2009	10,800	5,242	266,678	1,581	284,391	(+) 435
November 2009	18,182#	5,309	263,191	1,464	288,146	(+) 500
December 2009	18,292	5,169	258,583	1,425	283,469	-
January 2010##	18,292	5,181	260,259	1,429	285,161	-

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

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

: Includes US$ 6,699 million reflecting the purchase of 200 metric tonnes of gold from IMF on November 3, 2009.

: As on January 15, 2010. – : Not available.

Table 3.13: India's External Debt

(US $ billion)

Item	End-March 2008 PR	End-March 2009 PR	End-June 2009 PR	End-September 2009 P	Variation (September 2009 over March 2009)	
					Amount	Per cent
1	2	3	4	5	6	7
1. Multilateral	39.5	39.5	41.2	42.4	2.8	7.1
2. Bilateral	19.7	20.6	21.4	22.1	1.5	7.1
3. International Monetary Fund	1.1	1.0	1.1	6.3	5.3	519.4
4. Trade Credit (above 1 year)	10.4	14.6	14.9	15.4	0.8	5.5
5. External Commercial Borrowings	62.3	62.4	63.0	66.8	4.4	7.0
6. NRI Deposits	43.7	41.6	44.6	46.0	4.4	10.6
7. Rupee Debt	2.0	1.5	1.6	1.6	0.07	4.8
8. Long-term (1 to 7)	178.7	181.2	187.8	200.4	19.2	10.6
9. Short-term	45.7	43.4	42.0	42.4	-1.0	-2.3
Total (8+9)	**224.4**	**224.6**	**229.8**	**242.8**	**18.2**	**8.1**
Memo:					(per cent)	
Total Debt /GDP	19.0	21.5	–			
Short-term Debt/Total Debt	20.4	19.3	18.3	17.5		
Short-term Debt/Reserves	14.8	17.2	15.9	15.1		
Concessional Debt/Total Debt	19.7	18.7	18.9	18.4		
Reserves/Total Debt	138.0	112.1	115.4	115.8		
Debt Service Ratio	4.7	4.4	5.6	4.9		

P: Provisional. PR: Partially Revised.

over its end-March 2009 level, while the short-term debt registered a decline of 2.3 per cent. Of the total increase (US$ 18.2 billion) in India's external debt, the valuation effect on account of depreciation of US dollar against major international currencies accounted for US$ 8.3 billion (45.6 per cent). The increase in total external debt also reflected the impact of inclusion of cumulative SDR allocations to India by the IMF as a long-term liability in the external debt statistics.

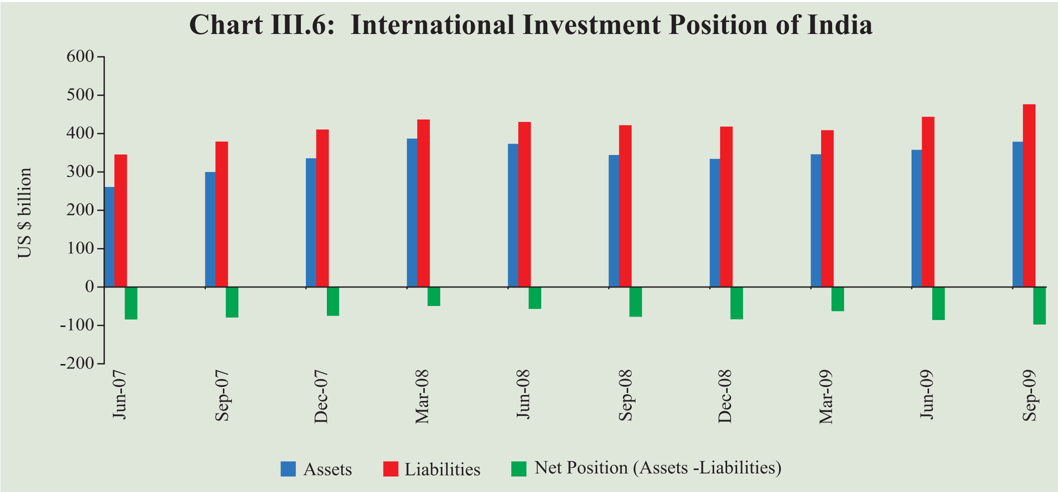
III.27 The ratio of short-term to total debt declined to 17.5 per cent at end-September 2009 from 19.3 per cent at end-March 2009. The ratio of short term debt to foreign exchange reserves moderated to 15.1 per cent as at end-September 2009 from 17.2 per cent as at end-March 2009. In terms of currency composition, US dollar denominated debt accounted for 51.4 per cent of the total external debt at end-September 2009. India's debt service ratio, *i.e.*, debt servicing as a percentage of current receipts, remained low but rose to 4.9 per cent during April-September 2009 from 3.7 per cent a year ago.

III.28 As per residual maturity of the debt stock, an indicator for assessing the potential debt service liability in the short-run, the short-term debt (below one year) as at end-September 2009 stood at US$ 93.2 billion. This includes short-term debt based on original maturity at US$ 42.4 billion and long- term external debt due for payments within one year of US$ 50.8 billion. The share of NRI deposits in the total long term debt due for repayment within one year worked out to 79.8 per cent (US$ 36.7 billion) as at end-September 2009.

International Investment Position

III.29 As at end-September 2009, India's net international liabilities were placed at US$ 97.8 billion, which was higher than US$ 86.1 billion as at end-June 2009. The international assets increased from US$ 357.6 billion at end-June 2009 to US$ 378.6 billion at end-September 2009, mainly on account of increase in reserve assets during the quarter. The increase in international liabilities from US$ 443.7 billion to US$ 476.4 billion during the same period was on account of an increase in inward direct investment, portfolio equity investment, loans to India and allocations of SDRs by the IMF to India (Chart III.6).

III.30 Thus, the balance of payments position of India remained comfortable with modest current account deficit, buoyant capital inflows and net accretion to foreign exchange reserves in the second quarter of 2009-10. During the third quarter also, the trend continued. More importantly, merchandise exports have turned around in November 2009, after thirteen consecutive months of decline and the pace of decline in imports has also significantly moderated, suggesting the impact of strong recovery in economic growth on import demand.



IV. MONETARY CONDITIONS

Reflecting the accommodative monetary policy stance of the Reserve Bank, monetary and liquidity conditions have remained supportive of growth during 2009-10. The key driver of growth in reserve money during Q3 of 2009-10 was the significant increment in net Reserve Bank credit to the Centre. Broad money growth, particularly since Q3 of 2009-10, has exhibited gradual moderation, primarily because of deceleration in growth of bank credit to both the private sector as well as the Government. There has, however, been a reversal in the decelerating trend of credit to the commercial sector since November 2009. The flow of financial resources from the non-banking sources to the commercial sector also exhibited significant increase during April-January 2009-10.

IV.1 The Reserve Bank's accommodative monetary policy stance in 2009-10 to date, has conditioned the overall monetary and liquidity trends, consistent with the need to support revival of economic growth while ensuring successful completion of the Government's borrowing programme without exerting major pressures on the overall interest rate structure in the system. Broad money growth (year-on-year) witnessed some moderation during the third quarter of 2009-10 and remained close to the Reserve Bank's projected indicative trajectory of 17.0 per cent growth for 2009-10, as set out in the Second Quarter Review of Monetary Policy for 2009-10. As on January 15, 2010 growth in broad money (y-o-y) was at 16.5 per cent as against 19.1 per cent a year ago. The moderation in M_3 growth since the third quarter has been driven by deceleration in bank credit to the commercial sector as well as to the Government on the sources side of money and by a slowdown in the growth of deposits on the components side. For the year as a whole, however, the banking system's credit to the Government has been the major driver of growth in broad money, a trend which has persisted since the third quarter of 2008-09 in response to the increase in Government's borrowing programme to finance the expansionary fiscal response to the economic slowdown.

IV.2 During the third quarter of 2009-10, the reserve money growth pattern changed, exhibiting a reversal in the decelerating trend that had set in since October 2008. On the sources side of reserve money, the increase has been driven by the significant expansion of net Reserve Bank credit to the Centre, on account of decline in reverse repo operations under the Liquidity Adjustment Facility (LAF), which was partially offset by increase in cash balances of the Government with the Reserve Bank. On the components side of reserve money, there was a significant increase in currency in circulation, consistent with the seasonal demand pattern for currency in Q3, as witnessed in previous years. During the year so far, unwinding of MSS balances has been the prime channel for expansion in net Reserve Bank credit to the Centre.

IV.3 There was a deceleration in the flow of credit to the commercial sector beginning in November 2008. With a rebound in economic growth in the second quarter of 2009-10, strong manufacturing sector growth and signs of pick-up in private consumption demand, the decelerating trend in credit growth has shown a reversal since November 2009. The flow of financial resources from non-banking sources increased significantly during April-January 2009-10, partially offsetting the impact of deceleration in credit growth, and thereby helping in financing of economic activities as well as the robust recovery in industrial production since June 2009.

Monetary Survey

IV.4 On a year-on-year (y-o-y) basis, M_3 growth was 16.5 per cent on January 15, 2010 as compared with 19.1 per cent a year ago. The growth in M_3 was primarily in line with the expansion in aggregate deposits during this period (Table 4.1 and Chart IV.1). Within aggregate deposits, time deposits registered a growth (y-o-y) of 16.0 per cent as on January 15, 2010, as compared with 23.1 per cent a year ago (Chart IV.2a). In 2009-10, there has been a gradual deceleration in the growth of time deposits, with softening of interest rates, in contrast to the shift from demand to time deposits during the second half of 2008-09. On the other hand, demand deposits expanded by 19.8 per cent (y-o-y) as on January 15, 2010, as compared with a decline of 0.8 per cent a year ago. There were net outflows from small savings schemes between December 2007 and July 2009; moderate inflows have, however, been recorded during August-November 2009 (the latest period for which the data are available) (Chart IV.2b). Growth in currency with the public at 17.3 per cent (y-o-y) as on January 15, 2010 remained almost same as a year ago.

Table 4.1: Monetary Indicators

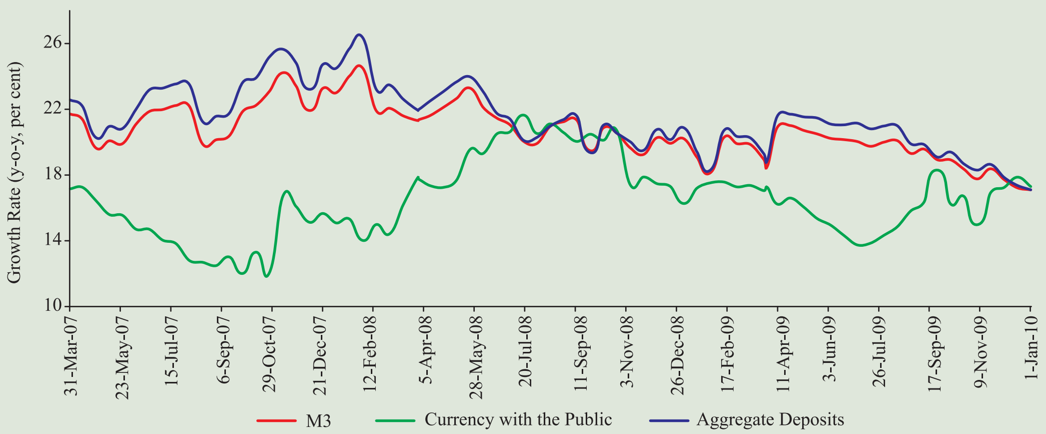
(Amount in Rupees crore)

Item	Outstanding as on January 15, 2010	Variation (year-on-year)			
		January 16, 2009		January 15, 2010	
		Absolute	Per cent	Absolute	Per cent
1	2	3	4	5	6
I. Reserve Money*	10,29,259	34,963	4.2	1,57,100	18.0
(Reserve Money Adjusted for CRR changes)			(18.0)		(17.5)
II. Narrow Money (M_1)	13,51,349	90,219	8.6	2,08,294	18.2
III. Broad Money (M_3)	52,79,684	7,25,819	19.1	7,49,504	16.5
a) Currency with the Public	7,48,417	93,642	17.2	1,10,466	17.3
b) Aggregate Deposits	45,27,403	6,31,702	19.4	6,40,409	16.5
i) Demand Deposits	5,99,068	-3,898	-0.8	99,199	19.8
ii) Time Deposits	39,28,334	6,35,600	23.1	5,41,210	16.0
VI. Major Sources of Broad Money					
a) Net Bank Credit to the Government (i+ii)	15,27,055	3,19,924	38.2	3,69,653	31.9
i) Net Reserve Bank Credit to Government	91,433	1,27,742	-	1,19,570	-
of which: to the Centre	91,400	1,27,184	-	1,19,895	-
ii) Other Banks' Credit to Government	14,35,622	1,92,182	19.3	2,50,083	21.1
b) Bank Credit to the Commercial Sector	32,51,562	4,86,966	20.5	3,88,090	13.6
c) Net Foreign Assets of the Banking Sector	13,23,797	1,20,844	10.5	55,606	4.4
d) Government Currency Liability to Public	10,731	791	8.7	890	9.0
e) Net Non-Monetary Liabilities of the Banking Sector	8,33,461	2,02,706	35.8	64,735	8.4

*: Data pertain to January 22, 2010.

Note: Data are provisional. Wherever data are not available, the data for last available month is repeated as estimates.

Chart IV.1: Money Supply



IV.5 On a financial year basis, growth in M_3 during 2009-10 (up to January 15, 2010) was 10.8 per cent as compared with 12.8 per cent during the corresponding period of the previous year (Table 4.2).

IV.6 A quarter-wise analysis of bank credit reveals that there was continuation of expansion in bank credit to the commercial sector in the third quarter of 2009-10, as against the absolute decline in the first quarter, although the absolute increment in credit was much lower than in the second quarter and in the corresponding quarter of the previous year (Chart IV.3). Banks' credit to the Government decreased in absolute terms during the third quarter due to the decline in the securities held by them under the LAF operations. The deceleration in commercial banks' credit to the Government since Q3 of 2009-10 has to be seen in the context of the high base in the second half of 2008-09 when the Government borrowing programme increased significantly to deliver the fiscal

Chart IV.2: Time Deposits and Small Savings

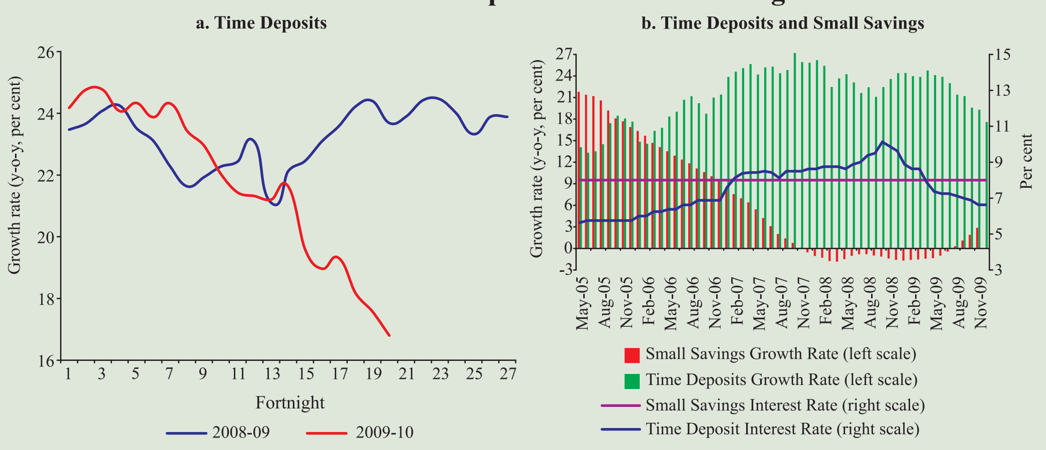


Table 4.2: Monetary Aggregates - Variations

(Rupees crore)

Item	2008-09 (up to January 16, 2009)	2009-10 (up to January 15, 2010)	2008-09				2009-10		
			Q1	Q2	Q3	Q4	Q1	Q2	Q3
1	2	3	4	5	6	7	8	9	10
M_3 (1+2+3 = 4+5+6+7-8)	5,12,297 (12.8)	5,15,664 (10.8)	89,283	1,76,379	1,60,486	3,19,989	1,70,948	1,59,421	1,14,934
Components									
1. Currency with the Public	69,541 (12.2)	82,054 (12.3)	35,772	-18,037	40,405	39,813	24,402	2,651	45,118
2. Aggregates Deposits with Banks	4,46,576 (13.0)	4,35,320 (10.6)	57,621	1,93,902	1,13,039	2,87,103	1,42,506	1,62,314	68,835
2.1. Demand Deposits with Banks	-78,503 (-13.6)	17,821 (3.1)	-79,325	52,771	-62,157	91,586	-34,146	65,695	-29,579
2.2. Time Deposits with Banks	5,25,079 (18.3)	4,17,499 (11.9)	1,36,946	1,41,131	1,75,195	1,95,517	1,76,652	96,619	98,414
3. 'Other' Deposits with RBI	-3,819 (-42.2)	-1,706 (-30.7)	-4,110	514	7,042	-6,928	4,040	-5,544	980
Sources									
4. Net Bank Credit to Government	2,57,884 (28.7)	2,49,856 (19.6)	36,124	31,654	1,29,335	1,80,568	1,19,062	70,292	18,615
4.1. RBI's Net Credit to Government	85,072	29,853	-13	51,360	30,230	93,212	-11,145	-14,953	51,428
4.1.1. RBI's Net Credit to the Centre	86,141	29,638	1,430	51,379	29,932	93,657	-11,497	-14,968	51,597
4.2. Other Banks' Credit to Government	1,72,812	2,20,003	36,137	-19,706	99,106	87,356	1,30,207	85,244	-32,813
5. Bank Credit to the Commercial Sector	2,84,482 (11.0)	2,38,225 (7.9)	30,811	1,63,138	90,616	1,49,783	-7,762	1,09,283	68,436
6. NFA of Banking Sector	-26,941	-28,387	66,858	7,271	-1,32,461	1,15,385	-37,923	47,908	-15,108
6. 1. NFA of the RBI	-10,670	-5,002	1,03,932	10,336	-1,56,330	86,048	-16,750	50,120	-15,108
7. Government's Currency Liabilities to the Public	618	677	225	206	186	213	254	302	121
8. Net Non-Monetary Liabilities of the Banking Sector	3,747	-55,293	44,735	25,890	-72,809	1,25,959	-97,318	68,363	-42,870

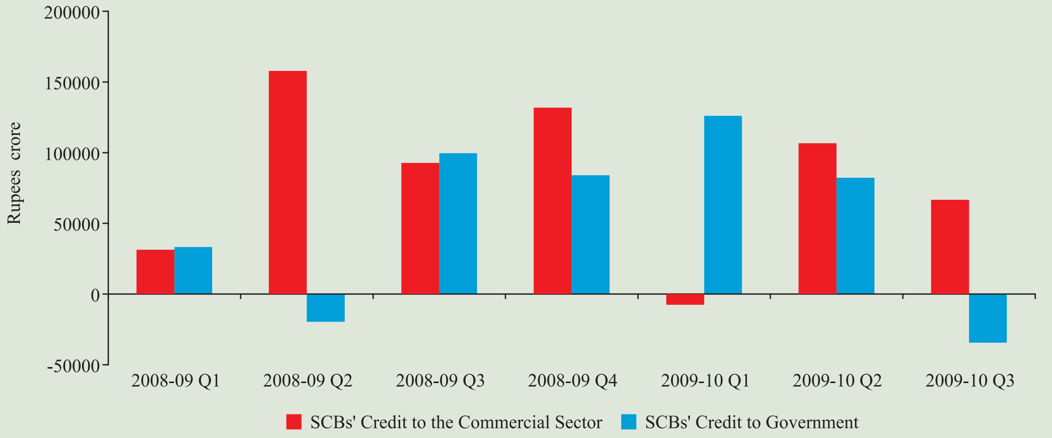
NFA: Net Foreign Assets.

Note : 1. Data are provisional. Wherever data are not available, the data for the last available month are repeated as estimates.
2. Figures in parentheses are percentage variations.

stimulus as well as completion of a greater part of the borrowing programme for 2009-10 in the first half.

IV.7 Non-food credit growth (y-o-y) of scheduled commercial banks (SCBs) decelerated over twelve months following the peak reached in October 2008, which could be partly explained by the availability of alternate non-banking sources of funding, including internal resources of corporates, besides the impact of the economic slowdown on credit from the demand side. Non-food credit growth has shown a reversal in trend since November 2009 increasing from 10.3 per cent (y-o-y) as on November 6, 2009 to 14.4 per cent as on January 15, 2010; the Reserve Bank's current indicative projection is 18.0 per cent for 2009-10. With the pick-up seen in credit growth in the last few fortnights, the persistent decline in the

Chart IV.3: Scheduled Commercial Banks' Credit (Quarterly Variation)



incremental credit-deposit ratio in 2009-10 has also reversed (Chart IV.4).

IV.8 While there has been deceleration in credit growth of the banking sector as a whole, credit flow from foreign banks registered a decline (Table 4.3). The expansion of credit from the public sector banks, which had held up till the first quarter of 2009-10, witnessed deceleration in the following two quarters.

IV.9 The high growth in deposits and weak demand for credit from the private sector led to an increase in SCBs' investment in SLR securities by 21.1 per cent (y-o-y) as on January 15, 2010 as compared with 19.5 per cent a year ago. Commercial banks' holdings of such securities as on January 15, 2010 at 29.9 per cent of their net demand and time liabilities (NDTL) were higher than 28.1 per cent at end-March 2009 and 28.8 per cent a year ago. Excess SLR investments of SCBs increased to Rs.2,26,720 crore as on January 15, 2010 from Rs. 1,69,846 crore at end-March 2009. Adjusted for LAF collateral

Chart IV.4: Scheduled Commercial Banks' Credit

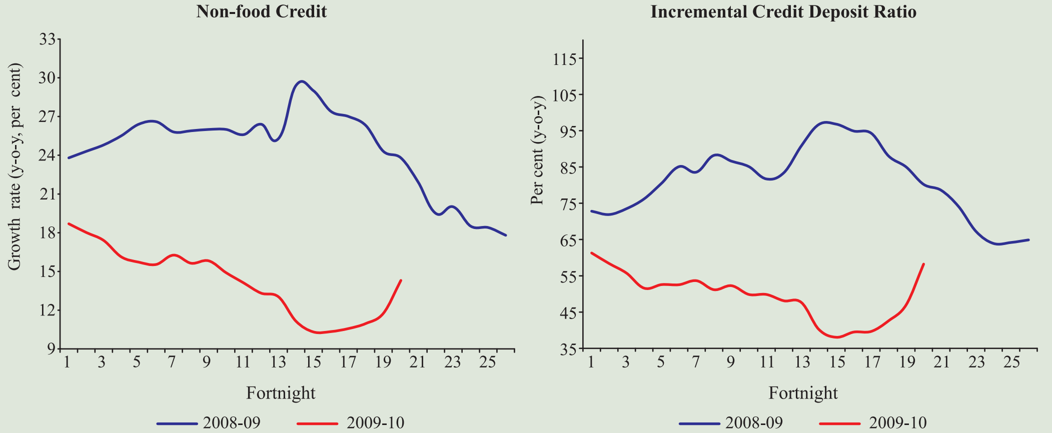


Table 4.3: Credit Flow from Scheduled Commercial Banks

(Amount in Rupees crore)

Bank Group	Outstanding as on Jan. 15, 2010	Variation (year-on-year) As on Jan. 16, 2009 Amount	Per cent	As on Jan. 15, 2010 Amount	Per cent
1	2	3	4	5	6
1. Public Sector Banks (excludes RRBs)	22,41,219	4,08,390	27.0	3,22,500	16.8
2. Foreign Banks	1,55,532	20,374	13.4	-16,720	-9.7
3. Private Banks	5,37,025	40,045	8.9	47,940	9.8
4. All Scheduled Commercial Banks*	30,08,909	4,76,514	22.0	3,66,832	13.9

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

securities on an outstanding basis, SCB's holding of SLR securities amounted to 28.2 per cent of NDTL as on January 15, 2010. Simultaneously, SCBs have reduced their overseas foreign currency borrowings (Table 4.4).

IV.10 There has been a significant turnaround in economic growth, increase in inflation and moderation in interest rates, during 2009-10. With such high variability in growth, inflation and interest rates during the year, money growth would need to be

Table 4.4.: Scheduled Commercial Bank Survey

(Amount in Rupees crore)

Item	Outstanding as on January 15, 2010	Variation (year-on-year) As on January 16, 2009 Amount	Per cent	As on January 15, 2010 Amount	Per cent
1	2	3	4	5	6
Sources of Funds					
1. Aggregate Deposits	41,75,437	6,00,101	20.2	6,08,143	17.1
2. Call/Term Funding from Financial Institutions	1,00,037	20,863	21.8	-16,395	-14.1
3. Overseas Foreign Currency Borrowings	29,006	18,166	54.0	-22,830	-44.0
4. Capital	51,610	7,334	18.5	4,637	9.9
5. Reserves	3,29,052	58,085	25.9	46,817	16.6
Uses of Funds					
1. Bank Credit	30,08,909	4,76,514	22.0	3,66,832	13.9
of which: Non-food Credit	29,66,375	4,66,002	21.9	3,73,993	14.4
2. Investments in Government and Other Approved Securities	13,80,157	1,85,779	19.5	2,40,878	21.1
a) Investments in Government Securities	13,66,055	1,88,191	20.0	2,37,566	21.1
b) Investments in Other Approved Securities	14,102	-2,412	-18.3	3,312	30.7
3. Investments in non-SLR Securities	2,58,901	29,723	15.4	35,932	16.1
4. Foreign Currency Assets	38,530	-10,390	-19.0	-5,848	-13.2
5. Balances with the RBI	2,30,565	-39,512	-15. 7	17,986	8.5

Note: Data are provisional.

Chart IV.5: Income Velocity of Money

assessed in conjunction with the recent trend of income velocity of money (Chart IV.5). With receding uncertainty, the velocity could be expected to have increased, explaining partly the modest deceleration in money supply, consistent with the overall macroeconomic developments. The key factor behind moderation in money growth, though, has been the deceleration in credit growth to the private sector.

IV.11 Disaggregated data on sectoral deployment of gross bank credit available up to November 20, 2009 show that credit flow to agriculture remained strong despite deficient monsoon-related weak economic activity, while credit to other sectors significantly decelerated. In terms of flow of incremental credit, 56.1 per cent of incremental non-food credit (y-o-y) was absorbed by industry and 23.7 per cent by the agricultural sector (as against 50.7 per cent and 9.3 per cent, respectively, in the corresponding period of the previous year). The expansion of incremental non-food credit to the industry during this period was led by infrastructure and iron and steel industries. Personal loans witnessed deceleration in flow of credit; within the category, housing loans also witnessed moderation (Table 4.5).

IV.12 Apart from banks, the commercial sector mobilised resources from a variety of other sources, such as the capital market, commercial papers (CPs), American Depository Receipts (ADRs)/Global Depository Receipts (GDRs) and foreign direct investment (FDI). During the first ten months of 2009-10, flow of resources from external sources increased as compared with the corresponding period of the previous year, mainly reflecting large FDI inflows. Resources mobilised through domestic non-bank sources also recorded an increase during this period. The increased flow from non-bank sources notwithstanding, the reduced flow of bank credit, has led to a decrease in the total flow of financial resources to the commercial sector during April 2009-January 2010, compared to a year ago (Table 4.6).

Table 4.5: Deployment of Gross Bank Credit by Major Sectors

(Amount in Rupees crore)

Sector	Outstanding as on Nov. 20, 2009	Variation (year-on-year) Nov. 21, 2008		Nov. 20, 2009	
		Absolute	Per cent	Absolute	Per cent
1	2	3	4	5	6
Non-food Gross Bank Credit (1 to 4)	**27,16,217**	**5,38,144**	**28.0**	**2,55,736**	**10.4**
1. Agriculture and Allied Activities	3,43,070	49,994	21.5	60,505	21.4
2. Industry	11,53,722	2,72,698	37.0	1,43,547	14.2
3. Personal Loans	5,67,744	65,902	13.2	3,958	0.7
Housing	2,91,760	22,713	9.1	19,820	7.3
Advances against Fixed Deposits	44,820	11,026	27.7	-6,008	-11.8
Credit Card Outstanding	22,635	6,147	25.7	-7,412	-24.7
Education	34,419	7,276	38.3	8,154	31.0
Consumer Durables	8,028	-990	-9.8	-1,069	-11.8
4. Services	6,51,681	1,49,550	32.9	47,726	7.9
Transport Operators	40,455	7,174	24.4	3,862	10.6
Professional Services	45,963	19,100	80.1	3,025	7.0
Trade	1,56,082	23,180	20.5	19,632	14.4
Real Estate Loans	88,581	25,276	49.0	11,734	15.3
Non Banking Financial Companies	1,02,750	30,147	54.0	16,735	19.5
Memo					
Priority Sector	**9,49,428**	**1,51,556**	**22.6**	**1,26,674**	**15.4**
Micro and Small Enterprises *	3,35,654	46,949	20.0	54,313	19.3
Industry	**11,53,722**	**2,72,698**	**37.0**	**1,43,547**	**14.2**
Food Processing	53,642	9,540	23.2	2,996	5.9
Textiles	1,07,948	17,556	21.2	7,430	7.4
Paper and Paper Products	17,284	3,564	29.7	1,709	11.0
Petroleum, Coal Products and Nuclear Fuels	68,021	52,233	149.2	-19,228	-22.0
Chemicals and Chemical Products	76,641	21,383	39.2	739	1.0
Rubber, Plastic and their Products	13,845	3,257	33.4	850	6.5
Iron and Steel	1,15,475	18,219	23.7	20,356	21.4
Other Metal and Metal Products	31,829	8,278	39.2	2,427	8.3
Engineering	65,472	13,091	26.5	2,963	4.7
Vehicles, Vehicle Parts and Transport Equipment	35,973	11,051	42.5	-1,079	-2.9
Gems and Jewellery	30,482	3,494	14.5	2,810	10.2
Construction	37,376	12,858	59.9	3,067	8.9
Infrastructure	3,34,293	63,178	38.6	1,07,255	47.2

*: Micro and small enterprises include services sector enterprises also.

Note: Data are provisional and relate to select banks and cover about 95 per cent of the total non-food credit extended by all SCBs. 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.

Reserve Money Survey

IV.13 During the third quarter of 2009-10, growth in reserve money showed a reversal from the decelerating trend that was in place since October 2008. Reserve money registered a growth of 18.0 per cent, y-o-y, as on January 22, 2010 as compared with a growth of 4.2 per cent a year ago. On the

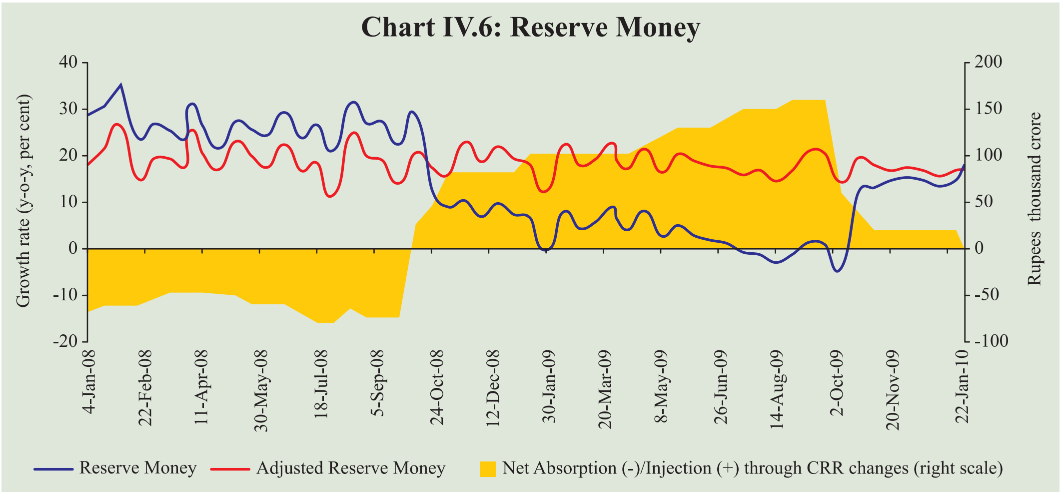
Table 4.6: Flow of Financial Resources to Commercial Sector

(Rupees crore)

Item	Full Year		April-January	
	2007-08	2008-09	2008-09	2009-10
1	2	3	4	5
A. Adjusted Non-food Bank Credit	**4,44,807**	**4,21,091**	**2,83,855**	**2,31,024**
i) Non-food Credit	4,32,846	4,11,824	2,74,867	2,37,036 $
of which: petroleum and fertiliser credit	5,057	31,632	50,436	-181 *
ii) Non-SLR Investment by SCBs	11,961	9,267	8,988	-6,012 $
B. Flow from Non-banks (B1+B2)	**5,61,511**	**5,01,014**	**3,10,888**	**3,58,392**
B1. Domestic Sources	**2,55,230**	**3,13,639**	**1,66,941**	**1,94,758**
1. Public issues by non-financial entities	51,478	14,205	13,559	19,791 ^
2. Gross private placements by non-financial entities	68,249	77,856	44,151	81,617 $$
3. Net issuance of CPs subscribed by non-banks	10,660	5,590	4,390	47,744 **
4. Net credit by housing finance companies	41,841	25,876	29,063	9,852 *
5. Total gross accommodation by 4 RBI regulated AIFIs - NABARD, NHB, SIDBI and EXIM Bank	22,267	31,423	9,839	-1,461 ^
6. Systemically important non-deposit taking NBFCs (net of bank credit)	36,460	76,828	15,661	1,889 *
7. LIC's net investment in corporate debt, infrastructure and social sector	24,275	81,861	50,278	35,326 ^
B2. Foreign Sources	**3,06,281**	**1,87,375**	**1,43,947**	**1,63,634**
1. External Commercial Borrowings/FCCBs	91,086	36,931	31,969	23,874 ^
2. ADR/GDR issues excluding banks and financial institutions	11,836	4,788	4,686	14,476 ^
3. Short-term credit from abroad	63,939	-12,972	6,799	4,447 *
4. FDI to India	1,39,420	1,58,628	1,00,493	1,20,837 *
C. Total Flow of Resources (A+B)	**10,06,318**	**9,22,105**	**5,94,743**	**5,89,416**
Memo:				
Investments in Debt (non-Gilt) Schemes of Mutual Funds	**88,457**	**-32,168**	**-28,793**	**1,50,085 ^**

$: Up to January 15, 2010. *: April-November. $$: April-September. **: Up to January 1, 2010. ^: April-December.

components side, the increment in reserve money in the third quarter of 2009-10 was mainly driven by the expansion in currency in circulation, due to the seasonal demand arising from festive season. On the sources side, even though net foreign currency assets (adjusted for valuation) decreased during Q3 of 2009-10, liquidity management operations of the Reserve Bank led to increase in the Reserve Bank's credit to the Centre. Significant decline in reverse repo balances were offset to an extent by the increase in Centre's surplus with the Reserve Bank. Adjusted for the first round effect of the changes in CRR, reserve money growth (y-o-y) as on January 22, 2010 was 17.5 per cent which is comparable to 18.0 per cent a year ago. The CRR impact (in terms of injection of liquidity during policy-driven decline in CRR and absorption during increase in CRR) explains the difference between 'reserve money' and 'adjusted reserve money'. Since the last change in CRR was effected in January 2009, the difference between the growth rates of reserve money and adjusted reserve money



has tapered after the end of the one year cycle during which the difference persisted (Chart IV.6).

IV.14 The money multiplier increased from 4.3 at end-March 2008 to 4.8 at end-March 2009, on account of the 400 basis points reduction in CRR between October 2008 and January 2009. The multiplier has remained higher in 2009-10 so far, though not in an uninterrupted fashion, reaching 5.1 at end-December 2009 (Chart IV.7).

IV.15 The financial year variations in reserve money during 2009-10 (up to January 22, 2010) show that reserve money increased by 4.2 per cent as against a decrease of 6.0 per cent in the corresponding period of the previous year (Table 4.7 and Chart IV.8).

IV.16 Movements in the Reserve Bank's net credit to the Central Government during the financial year (up to January 22, 2010) largely reflected the liquidity management

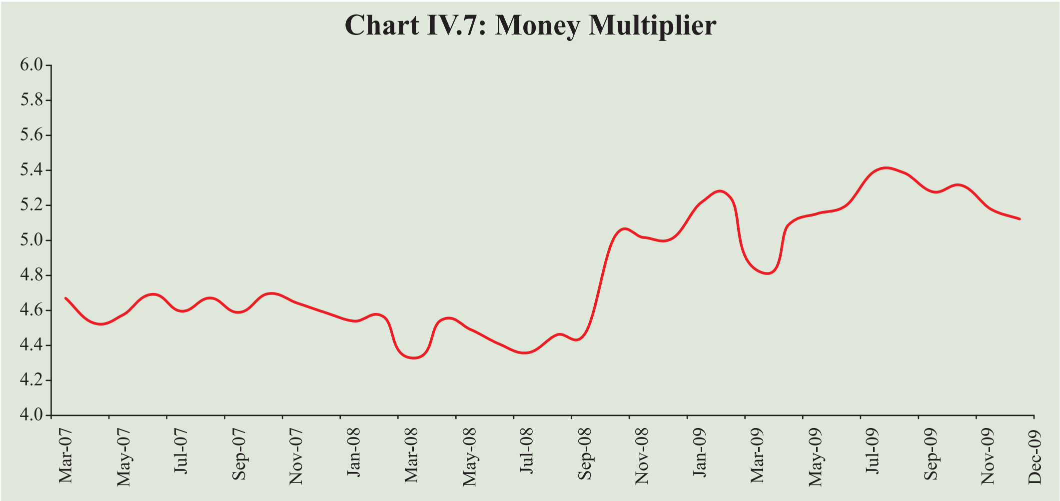


Table 4.7 : Reserve Money - Variations

(Amount in Rupees crore)

Item	2008-09 (April-March)	2008-09 (Up to Jan. 23)	2009-10 (Up to Jan. 22)	2008-09 Q1	2008-09 Q2	2008-09 Q3	2008-09 Q4	2009-10 Q1	2009-10 Q2	2009-10 Q3
1	2	3	4	5	6	7	8	9	10	11
Reserve Money	59,698	-56,144	41,258	3,416	25,218	-70,454	1,01,519	-38,932	16,217	51,691
Components (1+2+3)										
1. Currency in Circulation	1,00,352	69,286	84,242	36,859	-14,516	38,277	39,733	29,692	1,081	45,254
2. Bankers' Deposits with RBI	-37,172	-1,21,639	-41,097	-29,333	39,219	-1,15,773	68,714	-72,664	20,680	5,456
3. 'Other' Deposits with RBI	-3,482	-3,791	-1,888	-4,110	514	7,042	-6,928	4,040	-5,544	980
Sources (1+2+3+4-5)										
1. RBI's net credit to Government	1,74,789	64,020	33,555	-13	51,360	30,230	93,212	-11,145	-14,953	51,428
of which: to Centre	1,76,397	65,183	33,267	1,430	51,379	29,932	93,657	-11,497	-14,968	51,597
2. RBI's Credit to Banks and Commercial Sector	17,799	4,247	-18,650	-3,358	4,963	5,032	11,163	-9,623	-3,747	-5,926
3. Net Foreign Assets of RBI	43,986	-22,813	-2,036	1,03,932	10,336	-1,56,330	86,048	-16,750	50,120	-15,108
of which : FCA, adjusted for valuation	-1,00,308	-98,803	9,283	15,535	-31,641	-92,102	7,900	-6,245	33,441	-18,985
4. Governments' Currency Liabilities to the Public	831	618	677	225	206	186	213	254	302	121
5. Net Non-Monetary Liabilities of RBI	1,77,706	1,02,216	-27,712	97,369	41,648	-50,428	89,117	1,668	15,505	-21,176
Memo:										
Net Domestic Assets	15,712	-33,331	43,294	-1,00,516	14,882	85,876	15,471	-22,182	-33,903	66,799
LAF- Repos (+) / Reverse Repos(-)	-51,835	-97,530	-68,845	-45,350	51,480	-62,170	4,205	-132800	28,170	67,765
Net Open Market Sales # *	-94,548	-33,520	-75,477	-8,696	-10,535	-7,669	-67,649	-42,001	-31,591	-1,894
Centre's Surplus	-60,367	-76,586	51,220	-42,427	6,199	-32,830	8,691	-13,156	77,713	17,519
MSS Balances	-80,315	-58,698	-80,340	6,040	-628	-53,754	-31,973	-65,187	-4,117	0
Net Purchases(+)/Sales(-) from Authorised Dealers	-1,78,592	-1,60,127	-12,794	3,956	-52,761	-1,11,877	-17,910	-15,889	2,538	315
NFA/Reserve Money @	129.6	139.1	124.2	143.8	141.1	134.7	129.6	133.1	136.1	127.7
NFA/Currency @	185.2	183.8	164.8	213.5	220.2	183.3	185.2	175.3	181.9	169.2

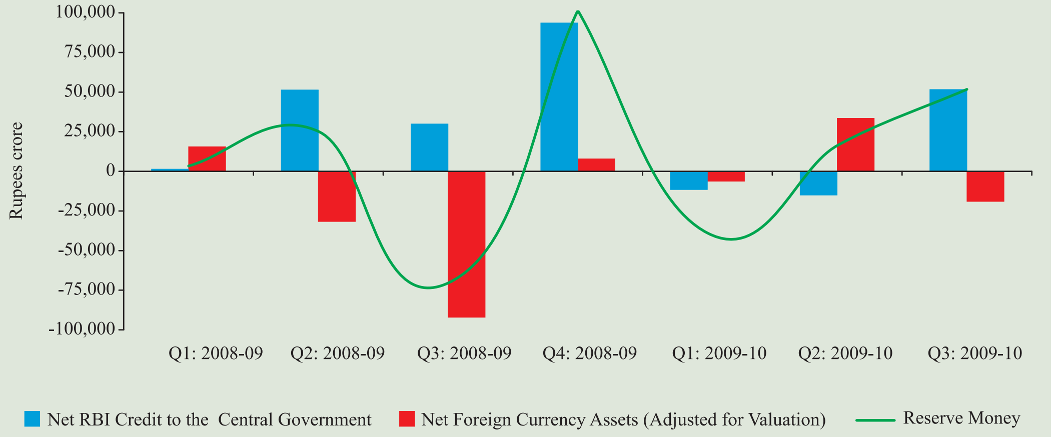
NFA: Net Foreign Assets. FCA: Foreign Currency Assets.

*: At face value. # : Excludes Treasury Bills. @ : Per cent; end of period.

Note: Data are based on March 31 for Q4 and last reporting Friday for all other quarters.

operations of the Reserve Bank and changes in Central Government deposits with the Reserve Bank. With easy liquidity conditions prevailing since mid-November 2008, the Reserve Bank has been absorbing large amount of liquidity through reverse repo under the LAF. Accordingly, Reserve Bank's holding of government securities (up to January 22, 2010) declined on account of an increase in absorption under the LAF (by Rs.68,845 crore). The Centre's surplus cash balances with the Reserve Bank also increased (by Rs.51,220 crore). On the other hand, unwinding of MSS

Chart IV.8: Important Sources of Reserve Money Variation - (Quarterly basis)



securities (by Rs.80,340 crore) led to a decline in Central Government deposits with the Reserve Bank and, therefore increased net Reserve Bank credit to the Centre. Furthermore, net open market purchases under OMO/special market operations (SMO) led to higher holding of Central Government securities/bonds (by Rs.75,477 crore) by the Reserve Bank. Reflecting the combined effect of these developments, the Reserve Bank's net credit to the Centre increased during 2009-10 (up to January 22, 2010), which is lower than the increase during the corresponding period of the previous year.

IV.17 Overall, reflecting the accommodative monetary policy stance of the Reserve Bank, monetary and liquidity conditions have remained supportive of growth. Deposit growth on the components side and higher growth in banking system credit to the Government on the sources side have been the major drivers of growth in monetary aggregates during the year. Since the third quarter of 2009-10, there has been moderation in growth of credit to both the Government and the private sector, as a result of which broad money growth exhibited some deceleration. Deposit growth has also decelerated since the third quarter of 2009-10. Going forward, higher capital inflows and the revival in demand for credit from the private sector could influence the trajectory of growth in monetary conditions.

V. FINANCIAL MARKETS

Global financial markets witnessed further improvement in Q4 of 2009, driven by traction gained from the global economic recovery, notwithstanding concerns about the shape of the global recovery, the uncertainties arising from the timing and speed of withdrawal of monetary accommodation and fiscal stimulus and large overhang of public debt in advanced economies. In the domestic markets, the overall financial market conditions in Q3 of 2009-10 were characterised by relatively low risk spreads, higher volume and a modest decline in the cost of funds. Interest rates in money markets remained low; medium to long term bond yields, however, hardened on concerns of fiscal deficit and inflationary expectations. The stock markets further consolidated the gains and the primary market witnessed considerable pick-up in mobilisation of funds. The rupee appreciated against major currencies on revival of capital inflows.

V.1 Global financial markets remained largely stable in Q4 of 2009 but for a temporary period of uncertainty associated with Dubai World incident and subsequent greater emphasis of the markets on sovereign risks. The financial markets, though have become increasingly sensitive to uncertainties arising from uneven recoveries across regions, jobless recovery and its impact on demand, the shape of the global recovery, public policy stance on financial support to entities affected by the crisis, and the consequences of eventual withdrawal of monetary accommodation (*i.e.*, low interest rates and easy liquidity) and fiscal stimulus (*i.e.*, high public expenditures and tax cuts). Furthermore, financial markets seem to be concerned about the long-term costs associated with excessively high public debt, particularly in the advanced economies, and their future sustainability. Credit default swap (CDS) spreads on corporate bonds in the US and Europe eased further. Recent developments such as the payment default by Dubai World on its debt obligations, however, suggest that there could be risk re-pricing of the bonds issued by public entities with only implicit guarantees. The liquidity in money markets remained easy with subdued spreads. Yields on government bonds also remained moderate, although witnessed some pressure due to concerns of high public debt in the advanced economies. The global stock markets continued to be conditioned by the positive economic data flowing through Q4 of 2009, with further gains seen in both the advanced and the emerging market stocks, *albeit* marked by some volatility. The uneven pace of recovery in asset prices *vis-à-vis* the real economy remains a concern for the policy makers. The US dollar, aided by low policy rates, remains weak against major international currencies.

V.2 As the Indian economy remained ahead of the advanced economies in the recovery cycle, the domestic financial markets witnessed greater stability, and risk levels generally remained low in relation to the global markets. Short-term interest rates, reflected in money market rates, remained low and stable within the LAF corridor. The liquidity conditions continued to remain easy. However, there was some decline in the surplus liquidity in the financial markets towards the end of Q3 of 2009-10 owing to advance tax outflows. The long-term government bond yields, however, rose steadily reflecting the large government borrowings. The concerns from large fiscal deficit and potential inflationary pressures were also reflected in the continuous upward shift in the yield curve in the medium to long spectrum of the maturity. The government borrowing programme was front loaded in order to provide space for private credit demand later in the year. The corporate bond yields also showed some hardening as the pace of economic activity accelerated in Q3 of 2009-10. The lending rates of banks, however, moderated, reflecting lagged transmission of policy rates. The equity prices witnessed further gains in Q3 of 2009-10, *albeit* only marginally over Q2. The primary capital market activity gained traction with substantial rise in private placement by the non-financial companies and sharp growth in funds mobilised by the mutual funds. The significant rise in the resources raised by the corporates through commercial papers indicated investment activities gaining further strength.

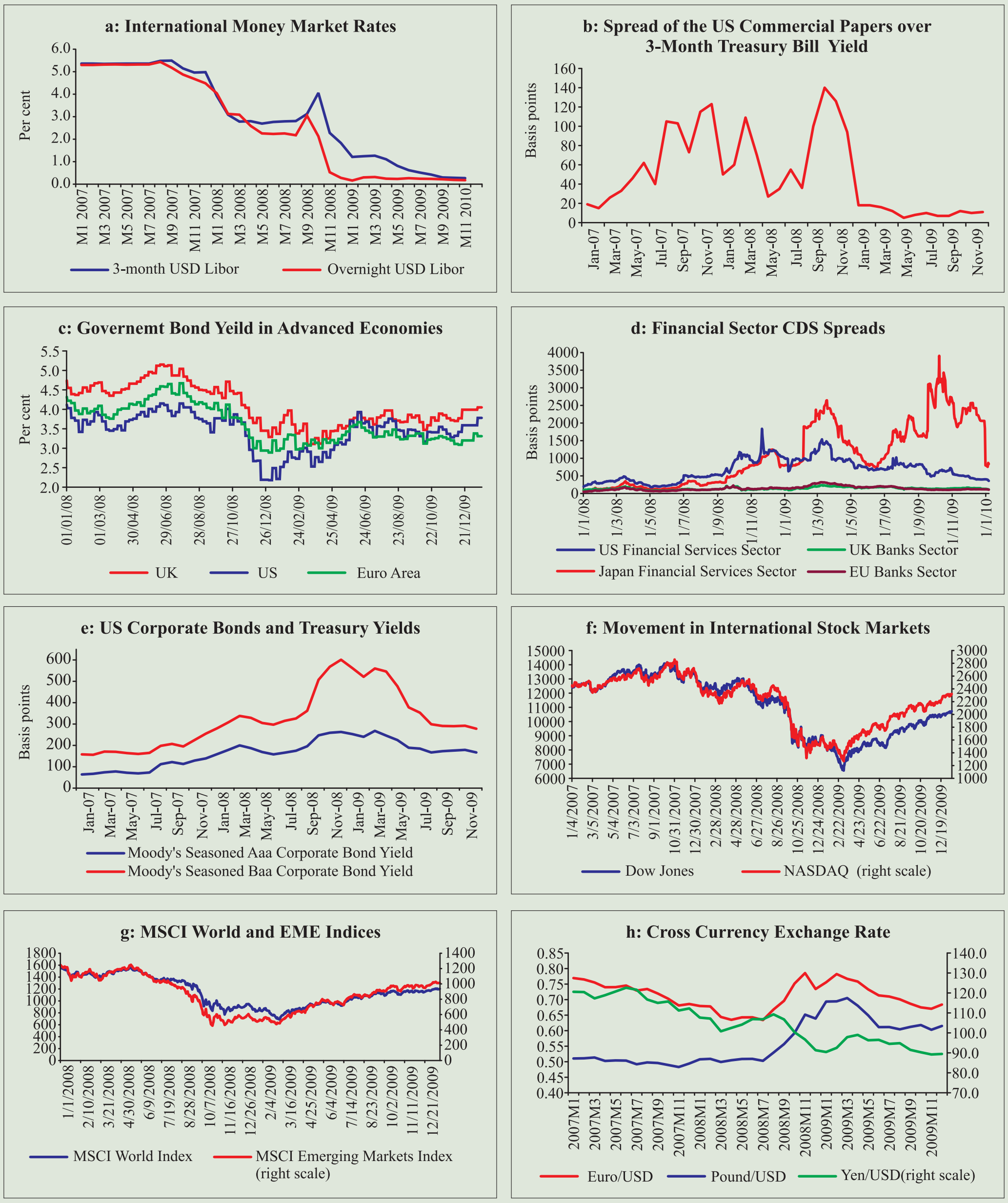
International Financial Markets

V.3 The activities in global financial markets in Q4 were significantly conditioned by the pace and shape of global economic recovery that mainly drove investor expectations. With steady flow of positive economic data indicating that the major emerging market economies (EMEs) were clearly on course to a higher growth trajectory and that the US, the EU and Japan witnessed dramatic improvement in GDP growth in 2009:Q3, investors' risk perceptions further receded. Nevertheless, markets remained apprehensive due to potential risks posed by uncertainties about the pace and shape of recovery, timing and speed of exit from fiscal-monetary stimulus and the lack of synchronisation of recovery across regions and the potential for build-up of imbalances. With the global economy on course to recovery, the focus of markets has shifted to potential inflationary pressures, particularly from commodity prices. As the actual output remains significantly below the capacity output in advanced economies, concerns about inflation remain largely contained. However, inflation is emerging a concern for many EMEs.

V.4 The continuance of easy liquidity conditions in money markets in Q4 of 2009 was evident from the significant and sustained low inter-bank rates in relation to the peak seen during the early phase of the global crisis and narrow spreads (Charts V.1a and b). With signals from the major central banks in the advanced economies that the interest rates may remain low for some time, the bond yields remained subdued (Chart V.1c). CDS on government bonds have, however, increased over time. The risk perception on financial sector and corporate bonds generally receded in Q4, reflected in lower CDS spreads for financial sector and further reduction in the corporate bond spreads (Chart V.1d and e).

V.5 The US stocks recorded gains of 7 per cent over Q3 of 2009, which were relatively moderate (Chart V.1f). Although the gains in equity prices in both the advanced economies and EMEs were relatively lower in Q4 as compared to Q3 (Chart V.1g), EMEs witnessed larger gains as compared to the advanced economies.

Chart V.1: Indicators of Global Financial Market Developments



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

The gains in EME asset prices were aided by a number of factors such as a robust economic recovery, reduced risks, low interest rates in the advanced economies and associated arbitrage in the form of carry trade from low yielding currencies to high yielding EME currencies and strong capital flows to emerging market equities in search for higher yield. The MSCI for EMEs recorded 8 per cent increase at the end of

Table 5.1: Currency and Stock Price Movement in EMEs

(Per cent)

Items	End-March 08 @	End-March 09 @	Jan 20, 2010*	Items	End-March 08 @	End-March 09 @	End-Dec. 2009*
1	2	3	4	1	5	6	7
Appreciation (+)/Depreciation (-) of the US Dollar				**Stock Price Variations**			
Chinese Yuan	-9.3	-2.6	-0.1	Indonesia (Jakarta Composite)	33.7	-41.4	76.7
Russian Ruble	-9.7	44.3	-12.9	Brazil (Bovespa)	33.1	-32.9	67.6
Turkish Lira	-5.8	27.7	-12.7	Thailand (SET Composite)	21.3	-47.2	70.2
Indian Rupee	-8.3	27.5	-10.5	India (BSE Sensex)	19.7	-37.9	79.9
Indonesian Rupiah	1.1	25.6	-20.3	South Korea (KOSPI)	17.3	-29.2	39.5
Malaysian Ringgit	-7.8	14.4	-8.5	China (Shanghai SE Composite)	9.1	-31.7	38.1
South Korea Won	5.5	38.9	-18.2	Taiwan (Taiwan Index)	8.7	-39.2	57.1
Thai Baht	-10.2	12.9	-7.4	Russia (RTS)	6.1	-66.4	109.5
Argentine Peso	2.1	17.3	2.4	Malaysia (KLSE Composite)	0.1	-30.1	45.9
Brazilian Real	-17.0	31.2	-20.8	Singapore (Straits Times)	-4.9	-43.5	70.4
Mexican Peso	-3.5	32.9	-10.6				
South African Rand	11.3	17.2	-21.8				

@: Year-on-year variation. *: Variation over end-March 2009.

Q4 over Q3. The MSCI for EMEs increased by 74 per cent between end-March and end-December 2009 with variations across EMEs (Table 5.1). The largest bout of volatility in equity prices across markets was caused by the announcement on November 25, 2009 that the Dubai World was seeking ‘standstill’ on its maturing liabilities. The risks from Dubai crisis led to jump in CDS premia across the Middle East countries.

V.6 In the foreign exchange market, the depreciating trend of the US dollar witnessed during the first half of 2009-10, generally continued during Q3 as well on the back of declining safe haven flows to the US, continuation of easy monetary policy and change in market sentiment against the dollar. However, the dollar gained some strength against major currencies, especially in December 2009, on the back of various indicators suggesting a pick-up in economic activity, followed by a spell of weakness in January 2010. Between end-March 2009 and January 20, 2010, the US dollar depreciated by 6.8 per cent against the euro, 12.2 per cent against the pound sterling and 7.7 per cent against the Japanese yen (chart V.1h). The US dollar also generally depreciated against the EME currencies (Table 5.1). The appreciating pressures on the currencies of several EMEs, led countries such as Brazil and Taiwan to resort to variants of Tobin tax to contain capital inflows.

Domestic Financial Markets

V.7 The domestic financial markets continued to witness low risks and greater volumes in various market segments (Table 5.2). During Q3 of 2009-10, the call money market rate continued to remain towards the lower bound of the LAF corridor, *albeit* with some increase in December 2009 and January 2010. Moderation in liquidity, reflected in relatively lower balances parked by the commercial banks in the reverse repo

Table 5.2: Domestic Financial Markets at a Glance

Year/ Month	Call Money		Government Securities		Foreign Exchange			Liquidity Management		Equity			
	Average Daily Turnover (Rs. crore)	Average Call Rates* (Per cent)	Average Turnover in Govt. Securities (Rs. crore)^	Average 10-Year Yield@ (Per cent)	Average Daily Inter-bank Turnover (US$ million)	Average Exchange Rate (Rs. per US$)	RBI's Net Foreign Currency Sales (-)/ Purchases (+) (US$ million)	Average MSS Out-standing# (Rs. crore)	Average Daily Reverse Repo (LAF) Out-standing (Rs. crore)	Average Daily BSE Turnover (Rs. crore)	Average Daily NSE Turnover (Rs. crore)	Average BSE Sensex**	Average S&P CNX Nifty**
1	2	3	4	5	6	7	8	9	10	11	12	13	14
2006-07	**21,725**	**7.22**	**4,863**	**7.78**	**18,717**	**45.28**	**26,824†**	**37,698**	**21,973**	**3,866**	**7,812**	**12277**	**3572**
2007-08	**21,393**	**6.07**	**8,104**	**7.91**	**34,044**	**40.24**	**78,203†**	**1,28,684**	**4,677**	**6,275**	**14,148**	**16569**	**4897**
2008-09	**22,436**	**7.06**	**10,879**	**7.54**	**34,812**	**45.92**	**-2,910†**	**1,48,889**	**2,885**	**4,498**	**11,272**	**12303**	**3713**
Apr 2008	19,516	6.11	6,657	8.10	37,580	40.02	4,325	1,70,726	26,359	5,773	13,561	16291	4902
May 2008	19,481	6.62	8,780	7.94	32,287	42.13	148	1,75,565	11,841	6,084	13,896	16946	5029
Jun 2008	21,707	7.75	6,835	8.41	38,330	42.82	-5,229	1,74,433	-8,622	5,410	12,592	14997	4464
Jul 2008	24,736	8.76	5,474	9.18	37,173	42.84	-6,320	1,72,169	-27,961	5,388	12,862	13716	4125
Aug 2008	23,408	9.10	7,498	9.06	38,388	42.94	1,210	1,71,944	-22,560	4,996	11,713	14722	4417
Sep 2008	23,379	10.52	10,418	8.38	44,700	45.56	-3,784	1,75,666	-42,591	5,147	12,489	13943	4207
Oct 2008	28,995	9.90	8,641	7.84	36,999	48.66	-18,666	1,69,123	-45,612	3,911	10,810	10550	3210
Nov 2008	21,812	7.57	11,732	7.41	31,322	49.00	-3,101	1,47,648	-8,017	3,539	9,618	9454	2835
Dec 2008	21,641	5.92	22,903	5.88	34,874	48.63	-318	1,24,848	22,294	3,851	10,141	9514	2896
Jan 2009	18,496	4.18	19,136	5.84	27,895	48.83	-29	1,13,535	45,474	3,526	9,559	9350	2854
Feb 2009	22,241	4.16	11,831	5.98	25,068	49.26	230	1,02,934	50,649	2,859	7,887	9188	2819
Mar 2009	23,818	4.17	10,644	6.58	33,126	51.23	-3,388	88,077	33,360	3,489	10,140	8966	2802
Apr 2009	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 2009	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 2009	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 2009	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 2009	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 2009	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 2009	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 2009	13,516	3.19	17,281	7.33	27,303	46.57	-36	18,773	1,01,719	5,257	16,224	16684	4954
Dec 2009	13,302	3.24	14,110	7.57	27,431	46.63	-	18,773	68,522	4,671	13,948	17090	5100

* : 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.
** : 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.
\- : Not available.
Note : In column 10, (-) indicates injection of liquidity, while (+) indicates absorption of liquidity.

facility, was essentially a result of advance tax payments and is, hence, temporary. The long-term yield, in contrast, witnessed some increase, emanating from large supply of government bonds. The gains in equity prices strengthened further in Q3 of 2009-10 over Q2, *albeit* marginally, with sporadic volatility caused by news about fundamentals and external shocks. In the foreign exchange market, transactions volume remained steady, including steady growth in currency future volumes, and the rupee appreciated in Q3 of 2009-10 as capital inflows turned robust.

Liquidity Management

V.8 Liquidity conditions remained easy during Q3 of 2009-10, even though the daily absorption under LAF declined during Q3 in comparison with that of Q2 (Table 5.3). The total MSS unwinding and auction-based open market operation (OMO) purchases during 2009-10 so far amounted to Rs.81,036 crore and Rs.57,487 crore, respectively. The decline in the average LAF absorption in Q3 of 2009-10 as compared with Q2 was mainly on account of the absence of MSS redemptions and OMO auctions. In addition, increases in cash balances of the Central Government with the Reserve Bank contributed to decline in daily absorption under LAF. The absorption through the reverse repo window declined significantly during the second half of December 2009, mainly on account of advance tax outflows. The liquidity conditions have eased in January 2010 so far on account of decline in cash balances of the Central Government and redemptions under MSS.

V.9 The key drivers of liquidity in Q3 of 2009-10 were uptick in seasonal currency demand and build up of Centre's surplus balances (Table 5.4). Keeping in view the persistence of comfortable liquidity conditions, the Reserve Bank, in its Second Quarter Review of Monetary

Table 5.3: Liquidity Position

(Rupees crore)

Outstanding as on Last Friday	LAF	MSS	Centre's Surplus @	Total (2 to 4)	Outstanding as on Last Friday	LAF	MSS	Centre's Surplus @	Total (6 to 8)
1	2	3	4	5	1	6	7	8	9
2008					**2009**				
January	985	1,66,739	70,657	2,38,381	January	54,605	1,08,764	-9,166	1,54,203
February	8,085	1,75,089	68,538	2,51,712	February	59,820	1,01,991	-9,603	1,52,208
March *	-50,350	1,68,392	76,586	1,94,628	March*	1,485	88,077	16,219	1,05,781
April	32,765	1,72,444	36,549	2,41,758	April	1,08,430	70,216	-40,412	1,38,234
May	-9,600	1,75,362	17,102	1,82,864	May	1,10,685	39,890	-6,114	1,44,461
June	-32,090	1,74,433	36,513	1,78,856	June	1,31,505	22,890	12,837	1,67,232
July	-43,260	1,71,327	15,043	1,43,110	July	1,39,690	21,063	26,440	1,87,193
August	-7,600	1,73,658	17,393	1,83,451	August	1,53,795	18,773	45,127	2,17,695
September	-56,480	1,73,804	40,358	1,57,682	September	1,06,115	18,773	80,775	2,05,663
October	-73,590	1,65,187	14,383	1,05,980	October	84,450	18,773	69,391	1,72,614
November	-9,880	1,32,531	7,981	1,30,632	November	94,070	18,773	58,460	1,71,303
December	14,630	1,20,050	3,804	1,38,484	December	19,785	18,773	1,03,438	1,41,996
					2010				
					January (15)	80,780	7,737	60,121	1,48,638

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

* : Data pertain to March 31.

Note : 1. Negative sign under LAF 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 under centre's surplus indicates WMA/OD.

Table 5.4: Reserve Bank's Liquidity Management Operations

(Rupees crore)

Item	2008-09				2008-09	2009-10		
	Q1	Q2	Q3	Q4	Apr-Mar	Q1	Q2	Q3
1	2	3	4	5	6	7	8	9
A. Drivers of Liquidity (1+2+3+4)	**6,061**	**-18,851**	**-1,01,278**	**-53,641**	**-1,67,709**	**-44,600**	**-46,367**	**-89,870**
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
2. Currency with the Public	-30,063	12,360	-40,070	-40,147	-97,921	-18,180	-8,874	-43,256
3. a. Surplus Cash balances of the Centre with RBI	40,073	-3,845	36,554	-12,415	60,367	3,382	-67,938	-22,663
b. WMA and OD	0	0	0	0	0	0	0	0
4. Others (residual)	4,606	12,884	14,406	16,541	48,437	-13,928	29,921	-24,346
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**	**1,12,734**
5. Liquidity impact of LAF Repos	-18,260	24,390	-71,110	13,145	-51,835	-1,30,020	25,390	86,330
6. Liquidity impact of OMO* (net)	14,642	11,949	10,681	67,208	1,04,480	43,159	32,869	3,540
7. Liquidity impact of MSS	-6,041	628	53,754	31,973	80,314	65,187	4,117	0
8. First round liquidity impact due to CRR change	-28,000	-29,750	1,40,000	20,000	1,02,250	0	0	0
C. Bank Reserves # (A+B)	**-31,598**	**-11,634**	**32,047**	**78,685**	**67,500**	**-66,274**	**18,009**	**22,865**

(+): Indicates injection of liquidity into the banking system.
(-) : Indicates 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.

Policy 2009-10, restored the SLR for SCBs to 25 per cent with effect from the fortnight beginning November 7, 2009. Keeping the utilisation of the various facilities in view and taking into account the liquidity conditions in the market, the special term repo facility and the forex swap facility for banks were discontinued with immediate effect; there are no outstanding balances under these facilities since August 17, 2009 and November 16, 2009, respectively.

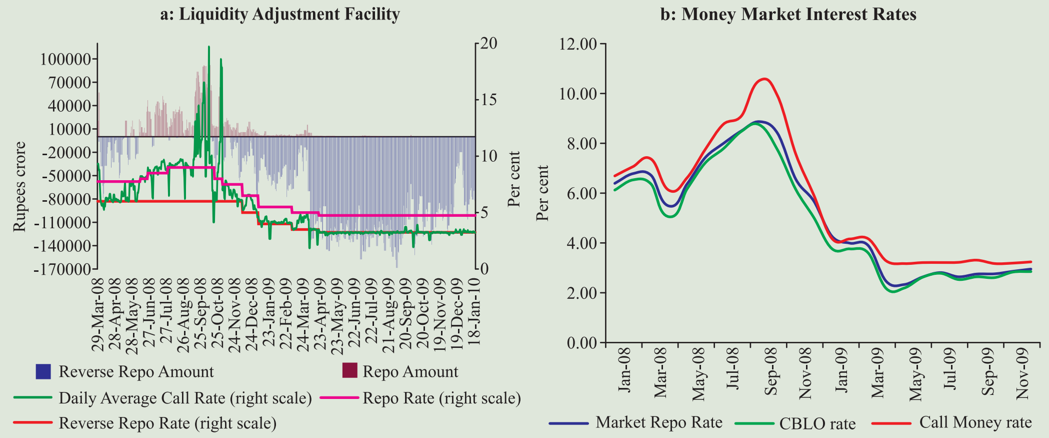
V.10 For managing the government market borrowings in a non-disruptive manner, the Reserve Bank had expressed its intention to purchase government securities amounting to Rs.80,000 crore under the OMO programme for the first half of 2009-10, of which Rs. 57,487 crore were purchased till September 2009. For the second half of 2009-10, the Reserve Bank decided to conduct OMOs as and when considered necessary.

Money Market

V.11 The money market continued to remain orderly during Q3 of 2009-10. Reflecting the surplus liquidity conditions, the call rate hovered around the lower bound of the informal LAF corridor during Q3 of 2009-10 (Chart V.2a). Interest rates in the collateralised segments of the money market- the market repo (outside the LAF) and the collateralised borrowing and lending obligation (CBLO) – moved in tandem with the call rate during Q3 of 2009-10 but remained below it (Chart V.2b).

V.12 Transaction volumes in the CBLO and market repo segments continued to

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



remain high during Q3 of 2009-10 reflecting the easy liquidity and active market conditions (Table 5.5). Banks as a group continue to be the major borrowers in the

Table 5.5: 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* (per cent)	Term Money	Outstanding	WADR (Per cent)	Outstanding	WADR (Per cent)
1	2	3	4	5	6	7	8	9	10	11
Apr-08	9,758	14,966	38,828	63,552	5.31	374	37,584	8.85	1,50,865	8.49
May-08	9,740	14,729	36,326	60,795	6.29	420	42,032	9.02	1,56,780	8.95
Jun-08	10,854	11,262	35,774	57,890	7.35	253	46,847	10.03	1,63,143	9.16
Jul-08	12,368	8,591	23,669	44,628	8.09	226	51,569	10.95	1,64,892	10.23
Aug-08	11,704	10,454	22,110	44,268	8.65	501	55,036	11.48	1,71,966	10.98
Sep-08	11,690	10,654	20,547	42,891	9.26	335	52,038	12.28	1,75,522	11.56
Oct-08	14,497	9,591	16,818	40,906	8.66	345	48,442	14.17	1,58,562	10.00
Nov-08	10,906	15,191	24,379	50,476	6.58	319	44,487	12.42	1,51,493	10.36
Dec-08	10,820	16,943	32,261	60,024	5.37	415	40,391	10.70	1,51,214	8.85
Jan-09	9,248	18,053	31,794	59,095	3.99	454	51,668	9.48	1,64,979	7.33
Feb-09	11,121	19,929	38,484	69,534	3.89	669	52,560	8.93	1,75,057	6.73
Mar-09	11,909	21,593	48,319	81,821	3.76	451	44,171	9.79	1,92,867	7.53
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	–	–	2,43,584 +	4.84 +

WADR : Weighted Average Discount Rate
*: Weighted average rate of call, market repo and CBLO. +: As on December 4, 2009.

collateralised segment whereas mutual funds (MFs) remain the single largest lender of funds in that segment. In fact, more than 75 per cent of the lending in the collateralised segment was contributed by the MFs in Q3, reflecting their continued enhanced lending capacity. The collateralised market continued to remain the predominant segment of the money market, accounting for more than 80 per cent of the total volume in the money market in Q3 of 2009-10.

Certificates of Deposit

V.13 With the easing of liquidity conditions, the fortnightly average issuance of certificates of deposit (CD) has picked up in 2009-10 so far (refer Table V.5). Most of the CDs issued were of more than six month duration.

Commercial Paper

V.14 During 2009-10, the commercial paper (CP) market also picked up and the size of fortnightly issuances also increased significantly as easy liquidity conditions prevailed and corporates' demand for working capital rose (refer Table 5.5 and 5.6).

Treasury Bills

V.15 The Treasury Bills, which were issued for enhanced amounts in the fiscal year 2008-09, were partly or fully rolled over in the first three quarters of 2009-10. For the fourth quarter it has been decided to roll over the entire notified amount of maturing Treasury Bills. The primary market yields that remained low during the first half, reflecting the impact of soft policy rate and ample liquidity in the money market, however, have increased subsequently reflecting the continued large supply of government securities and market conditions (Table 5.7).

Government Securities Market

V.16 During 2009-10 (up to January 22, 2010), the Central Government completed a large part (95.5 percent) of the budgeted borrowing programme through issuance of dated securities (including amount raised through de-sequestering of MSS balances). In view of the increase in government's borrowing requirements and the expected pick-up in credit during the second half, the market borrowing

Table 5.6: Commercial Paper-Major Issuers

(Rupees crore)

Category of Issuer	End of						
	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Nov-09
1	2	3	4	5	6	7	8
Leasing and Finance	34,957	39,053	27,965	27,183	34,437	31,648	39,514
	(76.6)	(75.0)	(73.5)	(61.5)	(50.1)	(40.0)	(38.0)
Manufacturing	8,150	9,925	6,833	12,738	23,454	31,509	46,455
	(17.4)	(19.1)	(18.0)	(28.9)	(34.1)	(40.0)	(44.7)
Financial Institutions	3,740	3,060	3,257	4,250	10,830	16,071	17,946
	(8.0)	(5.9)	(8.5)	(9.6)	(15.8)	(20.0)	(17.3)
Total	**46,847**	**52,038**	**38,055**	**44,171**	**68,721**	**79,228**	**1,03,915**

Note : Figures in parentheses are percentage share in total.

Table 5.7: 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
2007-08	**2,24,500**	**7.10**	**7.40**	**7.42**	**2.84**	**2.79**	**3.21**
2008-09	**2,99,000**	**7.10**	**7.22**	**7.15**	**3.43**	**2.91**	**3.47**
Apr 2008	26,000	7.28	7.41	7.53	2.64	3.17	2.36
May 2008	17,000	7.41	7.55	7.61	2.92	2.73	3.43
Jun 2008	11,500	8.01	8.42	7.93	2.45	2.76	2.80
Jul 2008	21,000	9.07	9.33	9.39	2.84	2.72	3.52
Aug 2008	18,500	9.15	9.31	9.24	2.99	2.86	4.24
Sept 2008	25,000	8.74	8.92	8.83	3.06	3.04	3.57
Oct 2008	35,000	8.13	8.36	7.92	1.95	2.42	4.00
Nov 2008	28,000	7.30	7.13	7.23	2.40	2.97	3.51
Dec 2008	18,000	5.49	5.35	5.47	7.01	4.67	5.59
Jan 2009	37,000	4.69	4.60	4.55	2.30	3.22	3.54
Feb 2009	32,000	4.78	4.71	4.62	2.81	1.86	2.62
Mar 2009	30,000	4.77	4.86	5.25	2.60	2.67	1.44
2009-10							
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
Jul 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
Sept 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 *	25,000	3.81	4.13	4.67	1.86	3.60	4.50

* : Up to January 22, 2010.

Note: Notified amounts are inclusive of issuances under the MSS.

programme was front loaded. The cut-off yields were lower during 2009-10 (April 2009-January 22, 2010), reflecting ample market liquidity (Table 5.8). Intra-year,

Table 5.8: Issuances of Central and State Government Dated Securities

	2007-08	2008-09	2008-09*	2009-10#
1	2	3	4	5
Central Government				
Gross amount raised (Rupees crore)	1,56,000	2,73,000	1,90,000	4,03,000
Re-issuances	34	52	36	95
New issues	1	4	3	7
Bid-cover ratio (Range)	1.6-4.8	1.7-4.5	1.2-3.9	1.4-4.3
Weighted average maturity (years)	14.9	13.8	14.6	11.2
Weighted average yield (per cent)	8.12	7.69	8.03	7.23
Devolvement on Primary Dealers (Rupees crore)	957	10,773	4,764	7,220
State Governments				
Gross amount raised (Rupees crore)	67,779	1,18,138	52,843	1,08,267
Cut-off yield	7.84-8.90	5.80-9.90	5.80-9.90	7.04-8.49
Weighted average yield (per cent)	8.25	7.87	7.74	8.04

#: Up to January 22, 2010. *: Up to January 22, 2009.

there has been a steady increase in the cut-off yields, reflecting the continued large supply of government securities. After a gap of five years, the Reserve Bank issued floating rate bonds in December 2009 for a notified amount of Rs. 2,000 crore.

V.17 The sanction (gross) from the Government of India for market borrowings for twenty seven State Governments received during 2009-10 (up to January 21, 2010) was placed at Rs. 1,28,116 crore. The Annual Policy Statement for 2009-10 had projected States' net market borrowings at Rs.1,26,000 crore, subsequently raised to Rs. 1,40,000 crore. A large part of the borrowing programme has already been smoothly completed (refer Table 5.8).

V.18 The yields moved in a broad range with a hardening bias on concerns of large fiscal deficit and inflationary pressures (Chart V.3a). The benchmark 10-year yield on government securities hardened during Q3 marked by increased turnover in the government securities market due to the large supply of government bonds (Chart V.3b).

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 in Q3 of 2009-10. The risk spreads on corporate bonds, however, declined to the pre-crisis level.

Credit Market

V.20 In response to the prevailing ample market liquidity and the lower policy interest rate environment, the SCBs softened their deposit rates for various maturities by 25-275 basis points during March 2009-January 15, 2010 (Table 5.9). The impact of the lower cost of funds for banks was also transmitted to the interest rates on bank loans with benchmark prime lending rates (BPLRs) of SCBs declining by 25-100 basis points during the same period. The share of sub-BPLR lending for all SCBs (excluding export credit and small loans) increased from 66.9 per cent in March 2009 to 70.4 per cent in September 2009.

V.21 Despite the overall favourable interest rate environment, the growth in

Chat V.3: Yield and Volume in Government Securities Market

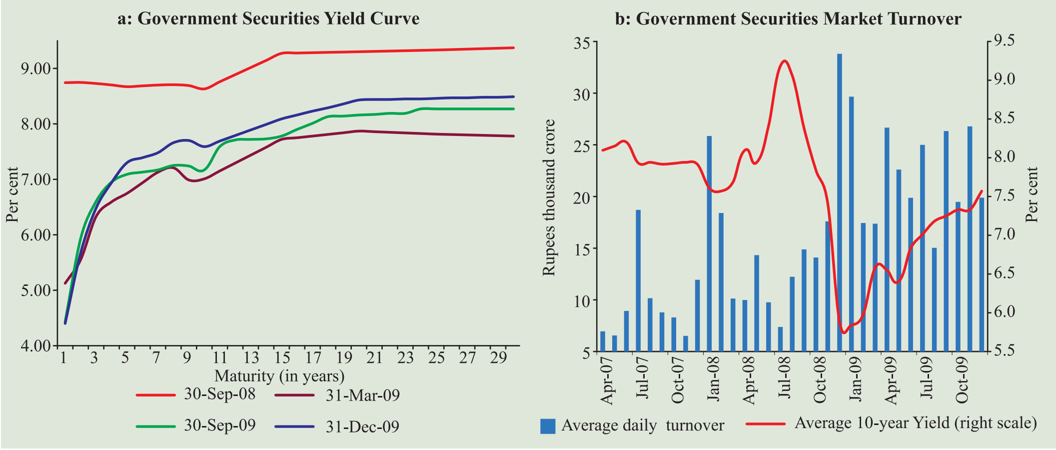


Table 5.9: Deposit and Lending Rates

(Per cent)

	March 2008	March 2009	June 2009	September 2009	December 2009	January 2010@
1	2	3	4	5	6	7
1. Domestic Deposit Rate						
Public Sector Banks						
Up to 1 year	2.75-8.50	2.75-8.25	1.00-7.00	1.00-6.75	1.00-6.25	1.00-6.25
> 1year-3 years	8.25-9.25	8.00-9.25	6.50-8.00	6.50-7.50	6.00-7.25	6.00-7.25
> 3 years	8.00-9.00	7.50-9.00	7.00-8.50	6.50-8.00	6.25-7.75	6.25-7.75
Private Sector Banks						
Up to 1 year	2.50-9.25	3.00-8.75	2.00-7.50	2.00-7.00	2.00-6.75	2.00-6.50
> 1year-3 years	7.25-9.25	7.50-10.25	6.00-8.75	5.25-8.00	5.25-7.50	5.25-7.50
> 3 years	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 year	2.25-9.25	2.50-8.50	1.80-8.00	1.25-8.00	1.25-7.00	1.25-7.00
> 1year-3 years	3.50-9.75	2.50-9.50	2.25-8.50	2.25-8.50	2.25-7.75	2.25-7.75
> 3 years	3.60-9.50	2.50-10.00	2.25-9.50	2.25-8.50	2.25-8.50	2.25-8.50
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	–	–
2. Private Sector Banks	4.00-24.00	4.75-26.00	4.10-26.00	3.00-29.50	–	–
3. Foreign Banks	5.00-28.00	5.00-25.50	2.76-25.50	3.73-21.99	–	–

* : 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.
@ : As on January 15, 2010.
– : Not Available.

banks' credit to commercial sector continued to decelerate in the first three quarters of 2009-10 due to a number of factors such as weak consumption and investment demand in the economy, substitution of funds by corporates in favour of non-banks funds and external borrowings and utilisation of internal resources of corporates. Nevertheless, there seems to be a turnaround in credit growth since November 2009.

Foreign Exchange Market

V.22 During 2009-10 so far (up to January 21, 2010), the rupee generally strengthened against the US dollar on the back of continued capital inflows, revival in growth performance of the Indian economy and general weakening of the US dollar in the international markets (Chart V.4-a).

V.23 The average 6-currency trade-based REER (base: 1993-94=100) appreciated by 9.7 per cent during April-November 2009, mainly on account of appreciation of the rupee against the US dollar and increase in inflation differential between India and its trading partners (Chart V.4-b). In terms of the broader measure, the 36-currency trade-based REER appreciated by 5.6 per cent during the period (Table 5.10). The 6-currency REER stood at 109.3 on January 21, 2010.

V.24 Reflecting the easing supply conditions in the market led by strong

Chat V.4: Nominal and Real Exchange Rates

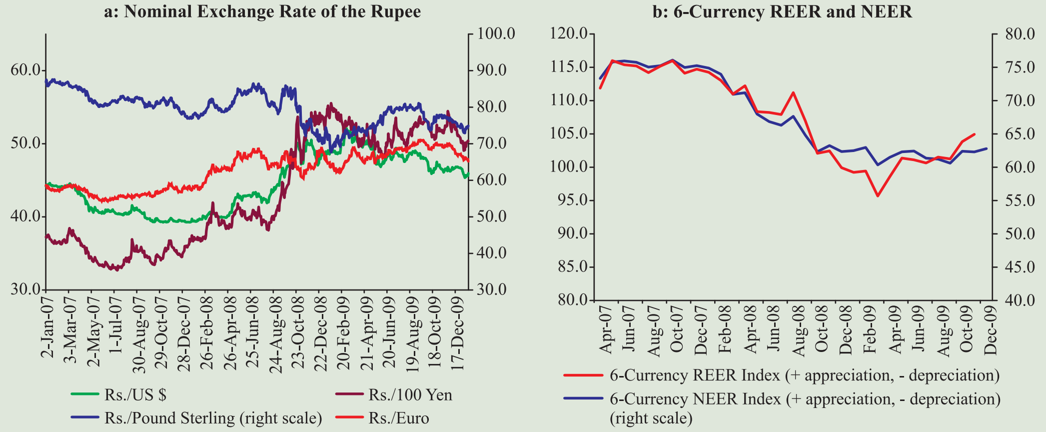


Table 5.10: Nominal and Real Effective Exchange Rate of the Indian Rupee (Trade based Weights, Base : 1993-94 = 100)				
Year/Month	6-Currency Weights		36-Currency Weights	
	NEER	REER	NEER	REER
1	2	3	4	5
2007-08	74.76	114.23	93.91	104.81
2008-09 (P)	64.87	104.47	84.67	94.32
Dec 2008(P)	62.35	99.93	82.47	90.01
Jan 2009(P)	62.49	99.23	82.27	89.80
Feb 2009(P)	62.97	99.43	83.84	90.59
Mar 2009(P)	60.35	95.68	80.75	88.05
Apr 2009(P)	61.49	98.58	83.61	87.67
May 2009(P)	62.31	101.37	84.43	89.75
June 2009(P)	62.43	101.11	84.77	90.26
July 2009(P)	61.36	100.64	83.39	89.76
Aug 2009(P)	61.22	101.52	83.08	90.27
Sept 2009(P)	60.61	101.25	82.12	90.06
Oct 2009(P)	62.40	103.84	84.29	92.00
Nov 2009(P)	62.30	104.94	84.25	92.98
Per cent Change				
	2007-08	2008-09 (P)	2008-09 (Apr-Nov)	2009-10 (Apr-Nov)
36-REER	6.4	-10.0	-9.6	5.6
36-NEER	9.3	-9.8	-7.4	4.3
6-REER	8.2	-8.5	-7.7	9.7
6-NEER	7.6	-13.2	-10.8	3.2
Rs/USD	12.5	-12.4	-18.3 *	10.8 *

NEER : Nominal Effective Exchange Rate.
REER : Real Effective Exchange Rate.
P : Provisional. *: Up to January 21.
Note: 1. Data from 2008-09 onwards are provisional.
2. Rise in indices indicates appreciation of the rupee and *vice versa*.

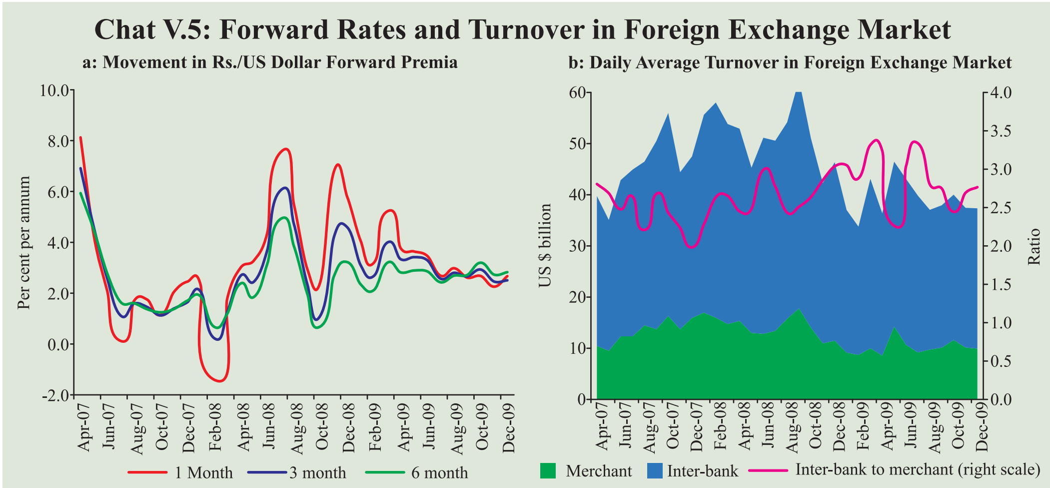
capital flows, forward premia generally exhibited declining trend during April-January 2009-10 (up to January 15) with intermittent hardening during August, October and December 2009, reflecting underlying demand conditions (Chart V.5a). Daily average forex market turnover generally registered a decline during the period June-December 2009 (Chart V.5b).

Equity Market

V.25 During the financial year so far, the Indian equity market outperformed most EMEs by registering an increase of 80 per cent and relatively lower volatility (Table 5.11).

Primary Market

V.26 The activity in the primary market segment of the domestic capital market, after remaining subdued in Q1, displayed signs of revival in Q2 and Q3 of 2009-10. Cumulatively, resources raised through public issues increased considerably during April-December 2009 (Table 5.12). Mobilisation of resources through private placement



increased by 69.0 per cent to Rs.1,67,244 crore during April-September 2009.

V.27 During April-December 2009, net resource mobilisation by mutual funds also increased substantially with liquidity conditions remaining comfortable and stock markets witnessing considerable gains (Table 5.13).

Table 5.11: Stock Market Indicators

Indicator	BSE				NSE			
	2007-08	2008-09	April-December		2007-08	2008-09	April-December	
			2008-09	2009-10			2008-09	2009-10
1	2	3	4	5	6	7	8	9
1. BSE Sensex / S&P CNX Nifty								
(i) End-period	15644	9709	9647	17465	4735	3021	2959	5201
(ii) Average	16569	12366	13388	15151	4897	3731	4021	4527
2. Coefficient of Variation	13.7	24.2	20.4	12.6	14.5	23.2	19.8	11.9
3. Price-Earning Ratio (end-period)	20.1	13.7	12.4	22.4	20.6	14.3	13.0	23.2
4. Price-Book Value Ratio (end-period)	5.2	2.7	2.6	4.2	5.1	2.5	2.4	3.7
5. Yield (per cent per annum) (end-period)	1.1	1.8	1.8	1.1	1.1	1.9	1.9	1.0
6. Listed Companies	4,887	4,929	4,921	4,955	1,381	1,432	1,428	1,453
7. Cash Segment Turnover (Rupees crore)	15,78,856	11,00,074	9,05,445	10,79,436	35,51,038	27,52,023	22,08,183	32,68,192
8. Derivative Segment Turnover (Rupees crore)	2,42,308	12,268	12,245	14	1,30,90,478	1,10,10,482	84,80,063	1,30,35,344
9. Market Capitalisation (Rupees crore) @	51,38,015	30,86,076	31,44,768	60,79,892	48,58,122	28,96,194	29,16,768	56,99,637
10. Market Capitalisation to GDP Ratio (per cent)	108.8	58.0	59.1	103.8	102.9	54.4	54.8	97.3

@: As at end-period.
Source : Bombay Stock Exchange Ltd. and National Stock Exchange Ltd.

Table 5.12: Mobilisation of Resources from the Primary Market

(Amount in Rupees crore)

Item	No. of Issues	Amount	No. of Issues	Amount
	2008-09 (April-December)		2009-10 (April-December)	
1	2	3	4	5
A. Prospectus and Rights Issues*				
1. Private Sector (a+b)	40	14,007	37	13,301
a) Financial	1	448	2	313
b) Non-financial	39	13,559	35	12,988
2. Public Sector (a+b+c)	–	–	2	6,803
a) Public Sector Undertakings	–	–	–	–
b) Government Companies	–	–	2	6,803
c) Banks/Financial Institutions	–	–	–	–
3. Total (1+2)	40	14,007	39	20,104
of which:				
(i) Equity	40	14,007	38	19,924
(ii) Debt	–	–	1	180
Memo:				
B. Euro Issues	**12**	**4,686**	**13**	**15,164**

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

Secondary Market

V.28 Market sentiments continued to remain positive during Q3 of 2009-10. After declining for a major part of December 2009, the markets moved up during the last week of December following optimism regarding growth and the Government's disinvestment plans. As at end-December 2009, the BSE Sensex and the S&P CNX Nifty both registered gains of about 2 per cent over end-September 2009 and 79.9 per cent over end-March 2009(Chart V.6a).

V.29 FIIs made net purchases in the stock markets in Q3 of 2009-10, while mutual funds were net sellers. FIIs made net purchases of US$ 19.0 billion in the Indian

Table 5.13: Resource Mobilisation by Mutual Funds

(Rupees crore)

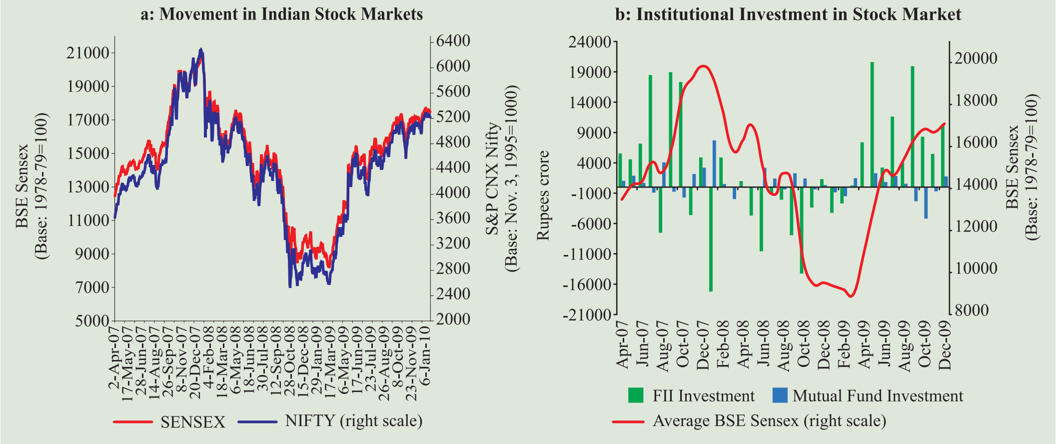
Category	April-March		April-December			
	2008-09		2008-09		2009-10	
	Net Mobilisation@	Net Assets #	Net Mobilisation@	Net Assets #	Net Mobilisation@	Net Assets #
1	2	3	4	5	6	7
Private Sector	-34,017	3,35,528	-39,942	3,30,731	1,08,170	5,24,391
Public Sector *	5,721	81,772	9,510	82,634	33,469	1,40,755
Total	**-28,296**	**4,17,300**	**-30,432**	**4,13,365**	**1,41,639**	**6,65,146**

@: Net of redemptions. #: End-period. *: Including UTI Mutual fund.

Note : Data exclude funds mobilised under Fund of Funds Schemes.

Source : Securities and Exchange Board of India.

Chat V.6: Stock Prices and Institutional Investment



equity market during April-December 2009, as against net sales of US$ 9.1 billion in the comparable period of the previous year, as per the data released by the Securities and Exchange Board of India (SEBI) (Chart V.6b). In contrast, mutual funds' net sales in stock markets during April-December 2009 amounted to Rs.4,421 crore as against net purchases of Rs.7,867 crore in the same period of previous year.

V.30 Overall, the domestic financial markets continued to remain stable and orderly in Q3 of 2009-10 with comfortable market liquidity and call rates staying close to the floor of the LAF corridor. Although the mobilisation of funds through CPs picked up significantly, the rates remained stable. The medium to long-term interest rates on government bonds, however, rose, reflecting large fiscal deficit and emerging inflationary pressures. The yield on benchmark 5-year corporate bonds also witnessed some upward movement with pick up in investment demand. The stock prices further consolidated the gains and primary market activity picked up, buoyed by private placements and mobilisation by the mutual funds. The rupee appreciated against major currencies reflecting revival of capital inflows.

VI. PRICE SITUATION

In 2009-10, particularly in recent months, sustained high inflation has been manifested in the form of rising overall WPI inflation, even though a significant number of items exhibited negative or no inflation. The inflationary momentum is clearly visible in terms of the increase in WPI by 8.0 per cent in December 2009 over March 2009 level. The consumer price inflation continues to remain high in double digits, further indicating the existence of price pressures. The risk of high food prices generating inflationary spiral through the expectations channel and thereby causing generalised inflation at some stage remains a major concern for the conduct of monetary policy.

VI.1 The year-on-year WPI inflation during 2009-10 has been significantly volatile, and in recent months inflation has firmed up, reflecting the increase in food and fuel prices as well as the impact of the waning of base effect. The WPI inflation was negative during June-August 2009, before turning positive in September and increasing sharply thereafter to 7.3 per cent by December 2009. The emerging inflationary pressures could also be seen from the increase in WPI during the current financial year over end-March 2009 by 8.0 per cent (up to December 2009) and CPI inflation remaining high in the range of 13.5-17.2 per cent in November/December 2009. Though the supply side pressures in a limited number of commodities led by food articles and the partial pass-through of increase in international oil prices have conditioned the inflation momentum so far, the risk of food inflation triggering inflationary expectations to cause generalised inflation remains a potential threat.

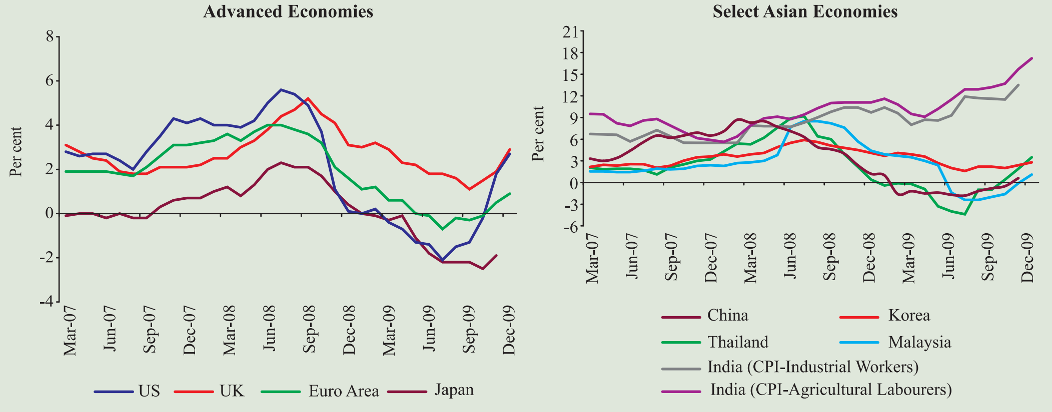
Global Inflation

VI.2 Global inflation, which had abated significantly during the first two quarters of 2009-10, continued to remain subdued during the third quarter, though inflation in most of the major economies turned positive on the back of increasing international commodity prices and stronger signs of global economic recovery. International commodity prices recorded further increases during the third quarter, continuing the firming up from the lows registered in December 2008. The uncertainty over recovery and the presence of significant unutilised capacity, however, have limited the risk of any significant rise in global inflationary pressures in the near term. The central banks, in general, have therefore continued their accommodative monetary policy stance to spur economic growth. In countries like Australia and Israel, however, the risk of potential inflationary pressures has led to the gradual retreat from the accommodative stance.

VI.3 During the first two quarters of 2009-10, headline inflation in major advanced economies remained negative on account of the significant contraction in demand. The sharp fall in global commodity prices (fuel, metals and food) during the second half of 2008-09 worked its way to the consumer prices in advanced economies, exerting further downward pressure on inflation. Since September 2009, CPI inflation in most advanced economies recorded increases, yet remained significantly moderate. Most advanced economies, except Japan, registered positive CPI inflation in December 2009 (Table 6.1). The recent increase in inflation in the advanced economies is attributable to the base effect of sharp decline in consumer prices registered a year ago and the recent increases in commodity prices. Year-on-year consumer price inflation in OECD countries, which declined to (-) 0.6 per cent in July 2009 from its peak of 4.9 per cent in July 2008, moved up to 1.3 per cent in November 2009. Amongst the major economies, headline inflation in the US and Euro Area, which had turned negative since March 2009, reversed and have become positive (Chart VI.1). UK also witnessed increase in CPI inflation to 2.9 per cent in December 2009 from 1.1 per cent in September 2009. Core inflation also started to increase in major economies. In OECD countries, excluding food and energy, consumer prices rose by 1.5 per cent in November 2009. Producer price index (PPI) inflation declined sharply, both in the advanced as well as emerging market economies (EMEs). PPI inflation in the OECD countries continued to remain negative (-1.0 per cent in November 2009).

VI.4 Concerns over a possible deflationary spiral created by the negative inflation in the US, Japan and the Euro Area during the first half of 2009 have abated with the recent increases in CPI inflation in major economies. On the other hand, inflation risks may be more in emerging economies, where output gaps are smaller and the recovery may be stronger. IMF (October 2009) projects the inflation in advanced economies to be close to zero in 2009, with modest increase to 1 per cent in the following year; inflation in emerging economies is expected to hover around 5 per cent in 2010. In the emerging economies, inflationary pressures have remained subdued during 2009-10, so far, excluding India and Russia (Table 6.1)

Chart VI.1: Consumer Price Inflation



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

VI.5 Most central banks in the advanced economies kept their policy rates unchanged at near zero levels to facilitate the recovery of their economies from recession or significant slowdown in growth. Policy rates in advanced economies, such as the US and Japan, which had reached near zero levels in 2008, were left unchanged during 2009. Policy rate cuts were effected by central banks in other advanced economies such as the U.K., Euro Area and Canada between March-May 2009, with no subsequent changes. As inflationary pressures started to emerge, the Reserve Bank of Australia has increased the policy rate by 50 basis points during 2009-10 so far on the back of signs of economic recovery and improvement in measures of confidence (Table 6.1). Bank of Israel has increased the policy rate by a total of 75 basis points since September 2009. Among the other major central banks, Peoples Bank of China raised the reserve requirement ratio by 50 basis points with effect from

Table 6.1: Global Inflation Indicators

(Per cent)

Country/ Region	Key Policy Rate	Policy Rate (As on Jan. 25, 2010)	Changes in Policy Rates (basis points)		CPI Inflation (y-o-y)	
			Sept 08 - Mar 09	Since end-Mar 09	Dec. 2008	Dec. 2009
1	2	3	4	5	6	7
Developed Economies						
Australia	Cash Rate	3.75 (Dec. 2, 2009)	(-) 400	50	5.0^	1.3^
Canada	Overnight Rate	0.25 (Apr. 21, 2009)	(-) 250	(-) 25	1.2	1.3
Euro area	Interest Rate on Main Refinancing Operations	1.00 (May 13, 2009)	(-) 275	(-) 50	1.6	0.9
Japan	Uncollateralised Overnight Call Rate	0.10 (Dec.19, 2008)	(-) 40	0	1.0*	-1.9*
UK	Official Bank Rate	0.50 (Mar. 5, 2009)	(-) 450	0	3.1	2.9
US	Federal Funds Rate	0.00 to 0.25 (Dec.16, 2008)	(-) 200	0	0.1	2.7
Developing Economies						
Brazil	Selic Rate	8.75 (Jul. 22, 2009)	(-) 250	(-) 250	5.9	4.3
India	Reverse Repo Rate	3.25 (Apr. 21, 2009)	(-) 250	(-)25	10.4*	13.5*
	Repo Rate	4.75 (Apr. 21, 2009)	(-) 400 (-400)	(-)25 (0)		
China	Benchmark 1-year Lending Rate	5.31 (Dec. 23, 2008)	(-) 216 (-300)	0 (50)	1.2	1.9
Indonesia	BI Rate	6.50 (Aug. 5, 2009)	(-) 150	(-) 125	11.1	2.7
Israel	Key Rate	1.25 (Jan. 1, 2010)	(-) 350	50	3.8	3.9
Korea	Base Rate	2.00 (Feb. 12, 2009)	(-) 325	0	4.1	2.8
Philippines	Reverse Repo Rate	4.00 (Jul. 9, 2009)	(-) 125	(-) 75	8.0	4.4
Russia	Refinancing Rate	8.75 (Dec. 28, 2009)	100	(-) 425	13.3	8.8
South Africa	Repo Rate	7.00 (Aug.14, 2009)	(-) 200	(-) 250	11.8*	5.8*
Thailand	1-day Repurchase Rate	1.25 (Apr. 8, 2009)	(-) 225	(-) 25	0.4	3.5

^ : Q3. *: November.

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) and (5) indicate the variation in the cash reserve ratio during the period.

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

January 18, 2010 while Bank of Russia reduced the policy rate by a total of 125 basis points during the third quarter of 2009-10.

Global Commodity Prices

VI.6 International commodity prices have gradually increased during 2009-10, so far, (over March 2009 levels) led by increases in crude oil and food prices (Table 6.2). On a year-on-year basis, most commodity prices, which had exhibited significant negative inflation during the first half of 2009-10, turned positive since November 2009, partly reflecting the base effect of decline in prices last year and the buildup of the commodity price pressures during the current year (Chart VI.2). Economic recovery from the recession in major advanced economies and improved growth prospects in emerging economies along with the weak supply prospects in major agricultural products have been the major drivers of the recent increases in international commodity prices.

VI.7 International crude oil prices have gradually firmed up since March 2009, in response to expected global economic recovery and successive production cuts by the Organisation of Petroleum and Exporting Countries (OPEC) to support prices. Crude oil prices increased by about 81 per cent in December 2009 (y-o-y). While crude oil prices declined marginally in September and December 2009, they have been volatile in January 2010, tracking expectations of a recovery in global oil consumption in the

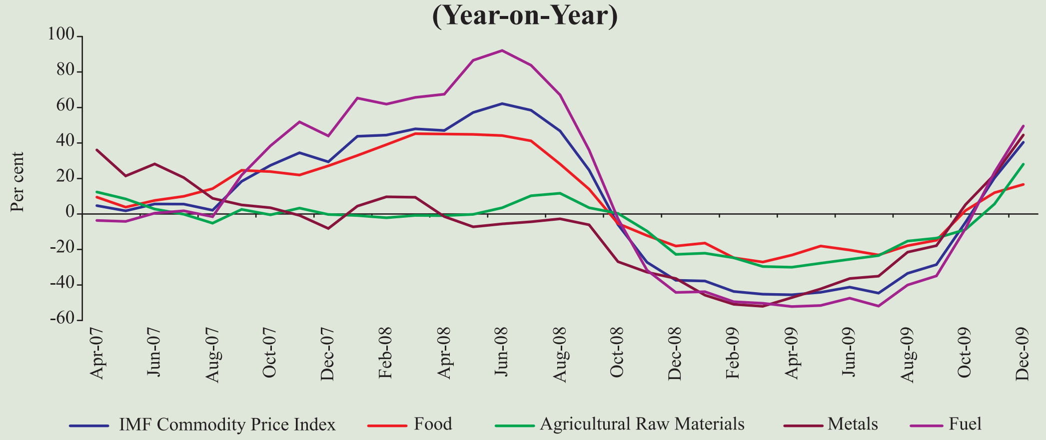
Table 6.2: International Commodity Prices

Commodity	Unit	Market Price	Index (2004=100)										Variation (Per cent)	
							2009							
		(2004)	2005	2006	2007	2008	Mar.	Jun.	Sep.	Oct.	Nov.	Dec.	Dec. 09 over Dec. 08	Dec. 09 over Mar. 09
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Energy														
Coal	$/mt	53	90	93	124	240	115	135	128	134	149	155	4.3	34.4
Crude oil (Average)	$/bbl	38	142	170	188	257	124	183	181	196	206	198	81.1	60.5
Non-Energy Commodities														
Palm oil	$/mt	471	90	101	165	201	127	154	143	144	154	168	57.3	32.3
Soybean oil	$/mt	616	88	97	143	204	118	145	137	146	151	151	26.4	28.3
Soybeans	$/mt	307	90	88	125	171	124	164	140	139	144	147	25.3	19.0
Rice	$/mt	238	120	128	137	274	247	242	218	207	228	249	11.1	0.5
Wheat	$/mt	157	97	122	163	208	147	164	122	127	134	131	-6.3	-10.7
Maize	$/mt	112	88	109	146	200	147	161	135	150	153	147	4.0	0.0
Sugar	c/kg	16	138	206	141	178	187	229	322	316	311	322	96.1	72.0
Cotton A Index	c/kg	137	89	93	102	115	83	99	103	108	115	124	38.3	48.9
Aluminium	$/mt	1716	111	150	154	150	78	92	107	109	114	127	46.3	63.2
Copper	$/mt	2866	128	235	248	243	131	175	216	219	233	244	127.3	86.2
Gold	$/toz	409	109	148	170	213	226	231	244	255	275	277	39.1	22.8
Silver	c/toz	669	110	173	200	224	196	219	246	258	267	264	71.0	34.5
Steel cold-rolled coil sheet	$/mt	607	121	114	107	159	148	115	115	115	115	115	-36.4	-22.2
Steel hot-rolled coil sheet	$/mt	503	126	119	109	176	159	119	119	119	119	119	-40.0	-25.0
Tin	c/kg	851	87	103	171	217	125	176	175	176	175	183	38.3	45.7
Zinc	c/kg	105	132	313	309	179	116	149	180	198	209	227	115.9	95.3

$: 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.

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



face of sustained economic growth in China and signs of a turnaround in other Asian countries. Despite the occasional spurts in recent months, crude oil prices have, in general, remained range bound between US$ 70 and US$ 80 per barrel. According to the US Energy Information Association (EIA), the presence of high oil inventories and expectation of increased supplies by both OPEC and non-OPEC members may prevent any sustained increase in oil prices. EIA forecasts that West Texas Intermediate (WTI) crude spot prices would average about US$ 80 and US$ 84 per barrel in 2010 and 2011, respectively. Although compliance with cuts announced by the OPEC has weakened and global oil inventories and spare production capacity remain very high by historical standards, expectations of a continued global economic turnaround have continued to buttress oil markets.

VI.8 Metal prices also have rebounded since April 2009, led by copper, lead, zinc and nickel. Improvement in global economic prospects has impacted the prices of cyclically sensitive base metals. The increases in prices were due to strong import demand and restocking in China and significant producer cuts. Supply cutbacks in response to the prolonged decline in prices have impacted the prices of certain key metals such as aluminium, tin and zinc.

VI.9 Improved supplies, particularly in foodgrains and oilseeds, and unwinding of commodity investments by financial markets participants had eased the pressure on international food prices, and the food prices declined significantly during June 2008 and February 2009. Since then, 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 has been increasing significantly since August 2009, led by all its components. In December 2009, the FAO food price index averaged 172 points, which was 24 per cent higher than the trough in February 2009. The major driver of this increase was sugar, as output in the two major sugar producing countries, *i.e.*, India and Brazil, declined.

VI.10 Agricultural raw materials exhibited greater volatility on account of changes in rubber prices, which track the price of crude oil prices. Strong demand and supply disruptions caused by unfavourable weather conditions exerted pressure on rubber price in recent months. Cotton prices also exhibited some firming up on account of strong demand from textile manufacturers in East Asia.

Inflation Conditions in India

VI.11 The Annual Policy Statement (APS) of the Reserve Bank for the year 2009-10 was announced at a time when the global demand was experiencing significant slump and global commodity prices had fallen to very low levels. Taking into account the decline of WPI inflation to below one per cent by end-March 2009 and the slowdown in economic growth, the APS had emphasised the need to support the revival of economic growth, while ensuring price stability and anchoring inflationary expectations. Accordingly, the policy rates were further reduced by 25 basis points in April 2009 as part of the monetary stimulus measures (Table 6.3).

Table 6.3: 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 14, 2007	6.00	7.75	6.25 (+0.25)	6.3	6.7
April 28, 2007	6.00	7.75	6.50 (+0.25)	6.0	6.7
August 4, 2007	6.00	7.75	7.00 (+0.50)	4.4	7.3
November 10, 2007	6.00	7.75	7.50 (+0.50)	3.2	5.5
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

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

The APS had projected WPI inflation at around 4.0 per cent by end-March 2010, keeping in view, the prevailing global trends in commodity prices and domestic demand-supply balance.

VI.12 The First Quarter Review (FQR) of Monetary Policy 2009-10 (July 2009) was announced against the backdrop of WPI inflation being negative and significant divergence between inflation based on CPIs and WPI. The FQR noted that the negative WPI inflation number in June 2009 was due to the statistical base effect and was not indicative of a contraction of demand. It also observed that the sharp decline in WPI had not brought about a commensurate decline in inflationary expectations. The FQR also stated that the immediate challenge for the Reserve Bank was to manage the balance between the short-term compulsions of providing ample liquidity and the potential build-up of inflationary pressure on the way forward. The FQR, therefore, had revised the WPI inflation projection upward to 5.0 per cent.

VI.13 The Second Quarter Review (SQR) of Monetary Policy 2009-10 (October 2009) noted that the upside risk of deficient monsoon projected in the FQR had materialised, exacerbating the price pressures in primary food items and manufactured food products. The inflationary pressures during 2009-10 were seen to be quite different from those witnessed in April-October 2008. Although both inflation episodes were driven by supply side pressures, the inflation in 2008 was triggered largely by a sharp increase in the prices of basic metals and minerals oil. In the current episode, however, price pressures are from domestic sources and concentrated in food articles and food products. The SQR had also noted, in the context of the growing divergence between CPI and WPI based inflation, the need for using all information available on price trends for the conduct of policies. Keeping in view the global trends in commodity prices and the domestic demand-supply balance, the baseline projection for WPI inflation at end-March 2010 was revised upwards to 6.5 per cent with an upside bias. Since the release of SQR, the inflationary pressures have further increased as manifested by the rise in both WPI and CPI based inflation.

Wholesale Price Inflation

VI.14 After exhibiting significant volatility in 2008-09, WPI inflation in India in 2009-10 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. As the base effect of sharp increases in prices during the first half of 2008-09 waned and price pressures from domestic supply shortages as well as international commodity prices started to emerge, WPI inflation increased significantly and reached 7.3 per cent by December 2009.

VI.15 During the current financial year so far, WPI has already increased by 8.0 per cent in December over the March 2009 level. The upward revision of prices of petrol and diesel (effective July 2, 2009), increase in prices of freely priced products under the fuel group in line with hardening of international crude oil prices, and higher prices of sugar, vegetables and drugs and medicines drive the current inflation. Prices of most non-food commodities moved in line with the international commodity prices. Domestic food prices, however, exhibited contrarian movement in relation to the international food prices, sugar being the sole exception (Table 6.4). Indian imports to address the domestic supply constraints, however, entail the risk of transferring price pressures to international markets, particularly in food items like sugar where India is among not only the major producers but also one of the largest consumers.

Table 6.4: Key Commodity Prices - Global *vis-à-vis* Domestic

(Per cent)

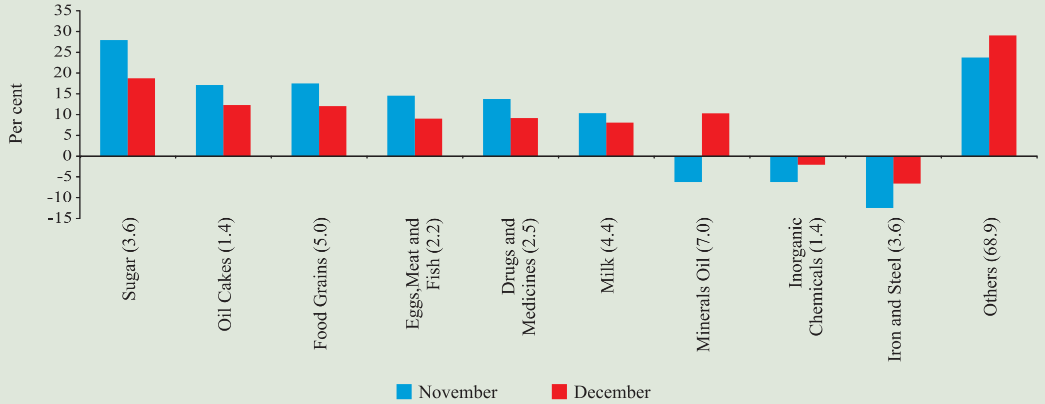
Item	Annual Inflation (y-o-y, December 2009)		Recent trends December 2009 over March 2009	
	Global	India	Global	India
1	2	3	4	5
1. Rice	11.1	12.3	0.5	7.5
2. Wheat	-6.3	12.0	-10.7	10.5
3. Raw Cotton	38.3	4.9	48.9	16.5
4. Oilseeds	25.3	6.7	19.0	8.2
5. Iron Ore	-28.2	-8.6	-28.2	-18.8
6. Coal mining	4.3	0.0	34.4	0.0
7. Minerals Oil	81.1	6.3	60.5	10.4
8. Edible Oils	57.3	-2.2	32.3	0.7
9. Oil Cakes	33.7	56.9	16.6	16.3
10. Sugar	96.1	54.0	72.0	37.5
11. Basic Metals, Alloys and Products#	44.5	-7.3	54.9	0.7
12. Iron and Steel	-27.6	-9.5	-19.7	0.8

: 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.

VI.16 The current phase of inflation in India is driven by increases in prices of a few commodities. Sugar, oil cakes, foodgrains, eggs, meat and fish and drugs and medicines, which have a combined weight of 14.8 per cent in overall WPI, explain a significant part of the inflation during the recent months. It may, however, be noted that the contribution of these key drivers has come down in December 2009 as compared with November 2009, indicating early signs of inflation getting generalised (Chart VI.3). Commodities with zero or negative inflation, however, had an aggregate weight of 50.7 per cent in the WPI.

Chart VI.3: Weighted Contribution of Commodities/Groups to Overall Inflation: November and December 2009



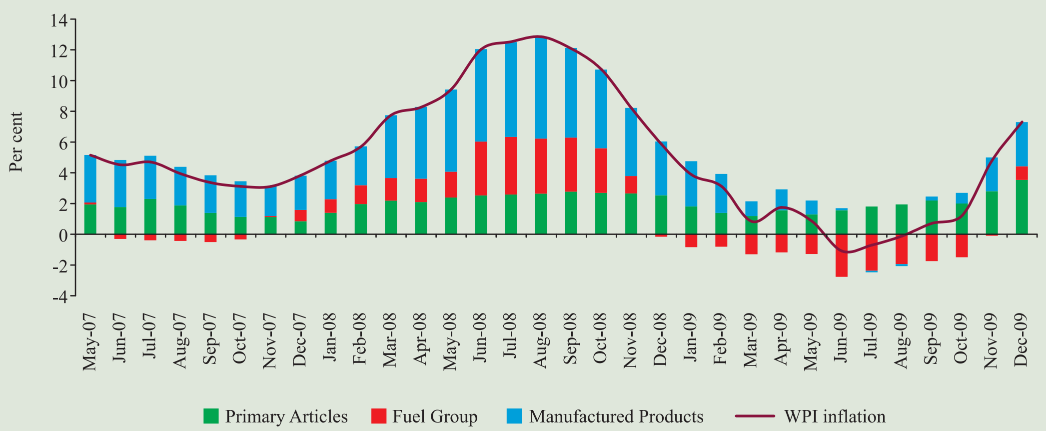
VI.17 In terms of contribution to overall inflation by the major groups, primary articles group continues to drive the overall WPI inflation, besides the manufactured food products. The contribution of non-food manufactured products group, which waned during the declining phase of inflation, has also started to increase in recent months. The contribution of the fuel group, which was significantly negative since January 2009, showed a reversal of trend in recent months and now contributes positively to overall inflation (Chart VI.4).

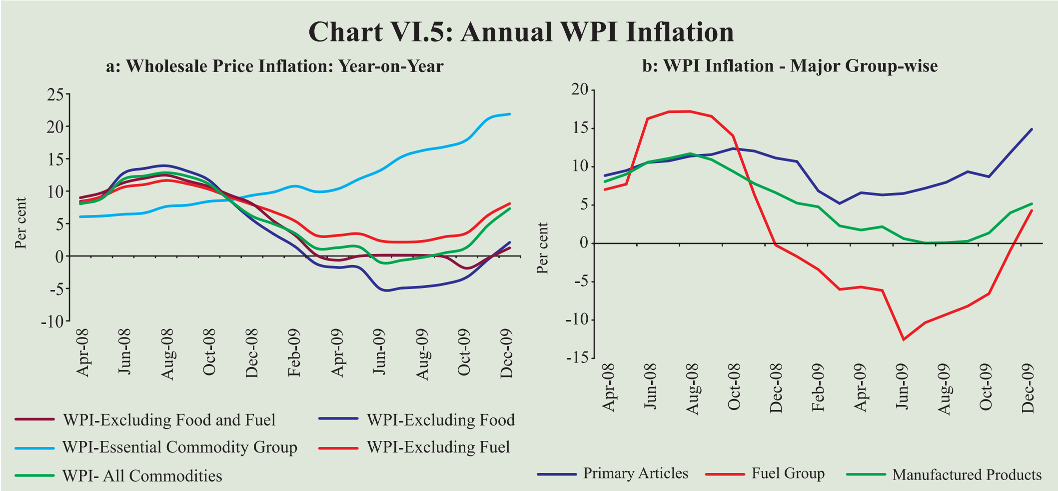
VI.18 The divergent trends in inflation across different groups and sub-groups make the assessment of overall inflationary pressures based on an overall measure of inflation difficult, and an investigation into the different components of inflation becomes necessary for understanding the underlying inflationary pressures. At a disaggregated level, the y-o-y WPI inflation excluding fuel was at 8.1 per cent in December 2009 as compared with 7.9 per cent a year ago. WPI inflation excluding food and fuel, which was negative during 2009-10 up to November 2009 turned positive in December 2009 (1.3 per cent). Prices of essential commodities group increased by 21.9 per cent, y-o-y, in December 2009, driven by food items, particularly sugar, eggs, fish, meat, milk, rice, vegetables and pulses, all of which had recorded double-digit inflation ranging from 54.0 per cent (sugar) to 13.4 per cent (milk) (Chart VI.5a).

VI.19 The weekly data release on overall WPI has been discontinued by the Ministry of Commerce and Industry from November 5, 2009 and instead, weekly price indices for primary articles and commodities in 'fuel, power, light and lubricant' group are being released. In addition, a monthly WPI for all commodities is being released from November 14, 2009.

VI.20 Amongst the major groups, primary articles inflation, y-o-y, increased by 13.9 per cent as on January 9, 2010 (5.2 per cent at end-March 2009), mainly on account of food articles, which registered high double-digit inflation. Non-food primary articles

Chart VI.4: Contribution of Major Groups to WPI Inflation





viz., raw cotton and oilseeds prices also increased on a year-on-year basis. Minerals prices, however, registered decline on a year-on-year basis (Table 6.5).

Table 6.5 Weekly Primary Articles and Fuel Group Inflation

(Per cent)

Group/Commodity	Annual (Y-o-Y) 2008-09 Jan. 10	Annual (Y-o-Y) 2009-10 Jan. 9	Financial Year (Over End-March) 2008-09 Jan. 10	Financial Year (Over End-March) 2009-10 Jan. 9
1	2	3	4	5
Primary Articles	**11.9**	**13.9**	**5.5**	**14.3**
A. Food Articles	11.6	16.8	7.1	17.0
i) Rice	14.7	12.6	11.5	9.3
ii) Wheat	5.6	14.5	4.1	14.0
iii) Pulses	12.7	47.9	5.4	42.6
iv) Vegetables	21.5	7.9	7.8	22.7
v) Fruits	19.2	3.7	9.4	7.2
vi) Milk	8.1	13.9	6.1	12.9
vii) Eggs, Fish and Meat	7.1	30.6	2.9	30.3
viii) Condiments and Spices	13.3	27.4	14.4	26.2
ix) Tea & Coffee	33.0	12.1	26.9	16.7
B. Non-food Articles	7.4	10.4	2.8	13.4
i) Raw Cotton	19.1	7.3	11.5	16.7
ii) Oilseeds	7.4	10.2	0.4	12.4
iii) Sugarcane	0.0	2.3	0.0	2.3
iv) Minerals	44.9	-5.2	-1.0	-12.4
Fuel Group	**-1.4**	**6.3**	**-3.6**	**9.2**
A. Coal Mining	0.0	0.0	-1.0	0.0
B. Minerals Oil	-3.1	9.8	-5.9	13.2
C. Electricity	1.3	2.0	0.0	4.7

VI.21 Primary articles prices have increased by 14.3 per cent (as on January 9, 2010) over the end-March 2009 level of the index. Vegetables and pulses prices have been the key drivers of the increase in primary food prices during the current financial year, so far. However, some part of the vegetable prices increase could also be attributed to the seasonal hardening of prices during the third quarter, which usually declines during the January-March quarter with the arrival of the winter crop. Pulses, another key driver of inflation, increased on account of the significant reduction in *kharif* pulses output during 2009-10 (8.3 per cent decline as per the first advance estimates for the year 2009-10). The current *rabi* sowing, however, indicates an improvement in overall pulses cropping (5.8 per cent increase as on January 15, 2010), which could help in dampening some of the price pressures by the end of the financial year.

VI.22 Among non-food articles, prices of raw cotton and oilseeds increased during the current financial year. Raw cotton and oilseeds prices mostly moved in line with the international prices, which increased by more than 25 per cent in the case of oilseeds and by about 38 per cent in the case of cotton since December 2008 when the prices hit the trough. Moreover, oilseeds output is expected to decline by 15.1 per cent for the *kharif* crop during 2009-10. Cotton output, however, is expected to increase by 2.2 per cent (First Advance Estimates).

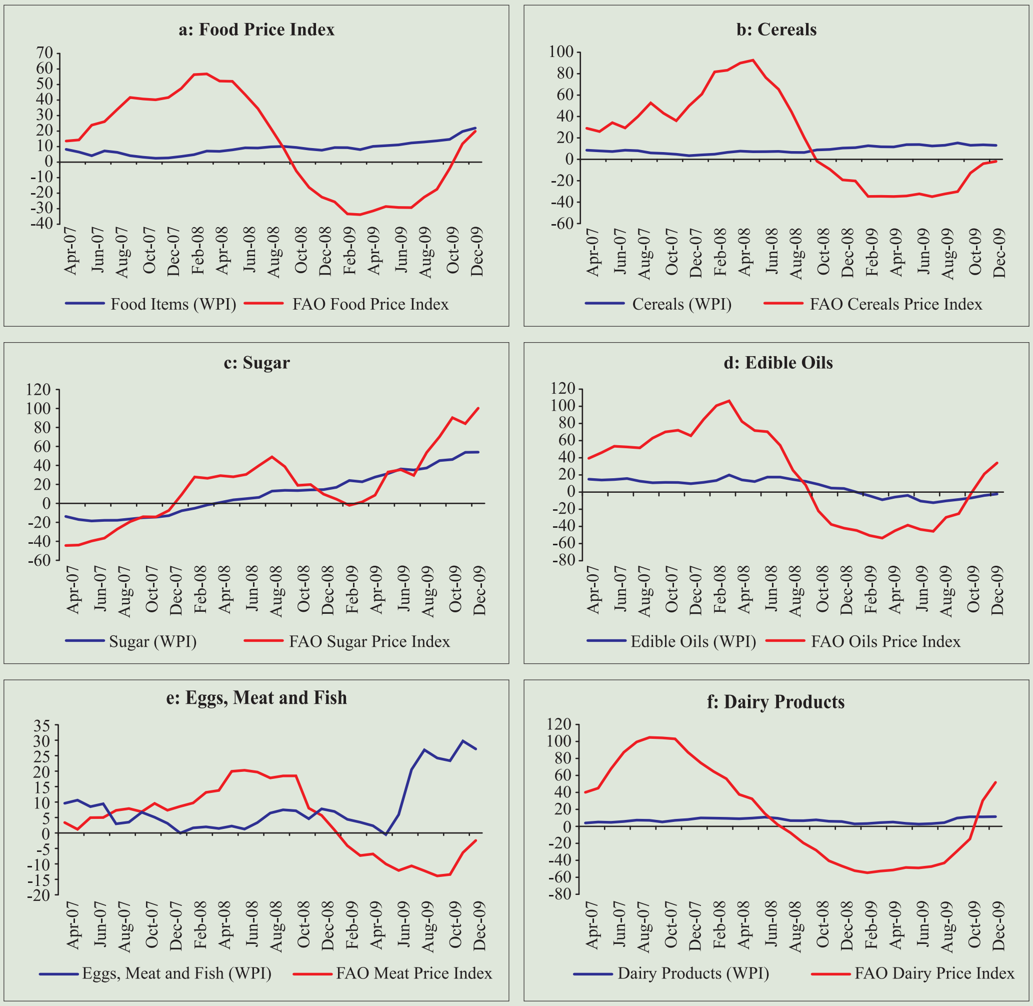
VI.23 Apart from the efforts to augment domestic supply of food, import of food has also being viewed as an option to contain high food inflation. It may, however, be noted that the recent increases in international food prices have limited the scope of import being a significant option to check price rise. All major food products registered secular increase in inflation during recent months (Chart VI.6). The volatility in international prices of essential food items, however, has been much higher than in India.

VI.24 Year-on-year, fuel group inflation, which remained significantly negative since December 2008 on account of the fall in international crude oil prices, turned positive in December 2009 reflecting the base effect of downward revision of administered prices in December 2008. With the Government announcing hikes in administered prices of petrol and diesel effective from July 2, 2009 to partially offset the under recoveries of oil companies arising from increase in international crude prices, fuel price inflation changed course. During the current financial year (up to January 9, 2010), fuel prices have increased by about 9.2 per cent. Prices of various freely priced petroleum products have increased over their levels in end-March 2009 in line with international prices. While increase in the prices of furnace oil was the highest, at 60.2 per cent, that of bitumen was the least at 15.4 per cent. Price increases in other products were 46.8 per cent for aviation turbine fuel, 27.6 per cent for light diesel oil and 52.5 per cent for naphtha.

VI.25 Manufactured products inflation, year-on-year, has also increased since August 2009 and was at 5.2 per cent in December 2009 (Table 6.6). The sub-groups under manufactured products, however, showed significant divergence. The movement in manufactured products inflation was largely driven by the manufactured food products, led by sugar. The sugarcane production during 2009-10 is expected to decline by 8.9 per cent (First Advance Estimates) on top of a decline of 21.4 per cent a year ago. On the expectations of India turning a net importer of sugar, international sugar prices also increased significantly, exerting further pressure on domestic prices. The other major contributor to manufactured food inflation was oil cakes (which moved in line with international prices) and dairy products (the prices of which were affected by reduced supplies in the wake of the recent weak monsoon and its impact on animal fodder and increase in prices of oil cakes).

VI.26 'Basic metals, alloys and products' sub-group of manufactured products registered negative inflation y-o-y, in

Chart VI.6: Trends in Food Inflation: Global *vis-a-vis* Domestic (Year-on-Year, Per cent)



Source: FAO Food Price Database and Office of Economic Adviser, Ministry of Commerce and Industry, Government of India.

December 2009, mainly on account of a decline in the prices of iron and steel. There was, however, marginal increase in the price of steel sheets within the iron and steel sub-group over end-March 2009 level. Prices of iron bar and rods have also increased since September 2009, indicating a revival in construction activity.

Consumer Price Inflation

VI.27 Inflation based on y-o-y variations in consumer price indices (CPIs) have continued to increase during 2009-10 so far, mainly due to increase in the prices of food, fuel and services (represented by the 'miscellaneous' group). The various measures of consumer price inflation

Table 6.6: Wholesale Price Inflation in India (Year-on-Year)

(Per cent)

Commodity	Weight	2008-09 (December) Inflation	C*	2008-09 (end-March) Inflation	C*	2009-10 (December) Inflation	C*	Financial Year (over end-March 09) Inflation	C*
1	2	3	4	5	6	7	8	9	10
All Commodities	**100.0**	**6.1**	**6.1**	**0.8**	**0.8**	**7.3**	**7.3**	**8.0**	**8.0**
1. Primary Articles	**22.0**	**11.1**	**2.5**	**5.2**	**1.2**	**14.9**	**3.5**	**14.5**	**3.5**
Food Articles	15.4	10.0	1.6	7.0	1.1	19.2	3.1	18.3	3.0
i. Rice	2.4	15.1	0.3	14.9	0.3	12.3	0.3	7.5	0.2
ii. Wheat	1.4	4.8	0.1	4.5	0.1	12.0	0.2	10.5	0.2
iii. Pulses	0.6	12.6	0.1	9.4	0.1	41.6	0.3	38.2	0.3
iv. Vegetables	1.5	7.6	0.1	-5.2	-0.1	39.2	0.5	54.9	0.7
v. Fruits	1.5	15.9	0.3	5.9	0.1	9.8	0.2	8.0	0.4
vi. Milk	4.4	7.4	0.3	7.0	0.3	13.4	0.6	11.6	0.5
vii. Eggs, Fish and Meat	2.2	7.8	0.2	3.2	0.1	27.2	0.7	28.8	0.7
Non-Food Articles	6.1	9.3	0.6	0.1	0.0	7.7	0.5	10.6	0.6
i. Raw Cotton	1.4	21.9	0.2	2.5	0.0	4.9	0.1	16.5	0.2
ii. Oilseeds	2.7	11.4	0.3	-1.6	0.0	6.7	0.2	8.2	0.2
iii. Sugarcane	1.3	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Minerals	0.5	41.9	0.4	7.2	0.1	-4.4	-0.1	-12.9	-0.2
2. Fuel, Power, Light and Lubricants	**14.2**	**-0.2**	**0.0**	**-6.1**	**-1.3**	**4.3**	**0.9**	**7.5**	**1.5**
i. Coal Mining	1.8	3.3	0.1	-1.0	0.0	0.0	0.0	0.0	0.0
ii Mineral Oils	7.0	-1.6	-0.2	-8.7	-1.1	6.3	0.8	10.4	1.2
iii. Electricity	5.5	1.4	0.1	-2.6	-0.2	2.0	0.1	4.7	0.3
3. Manufactured Products	**63.8**	**6.6**	**3.7**	**1.7**	**1.0**	**5.2**	**2.9**	**5.4**	**3.0**
i. Food Products	11.5	4.2	0.4	8.8	0.9	26.4	2.7	15.3	1.7
of which: Sugar	3.6	14.5	0.3	18.4	0.4	54.0	1.4	37.5	1.1
Edible Oils	2.8	4.2	0.1	-7.6	-0.2	-2.2	0.0	0.7	0.0
ii. Cotton Textiles	4.2	16.0	0.5	16.2	0.4	6.0	0.2	7.8	0.2
iii. Man Made Fibres	4.4	2.4	0.0	-1.5	0.0	-2.0	0.0	0.5	0.0
iv. Chemicals and Products	11.9	6.1	0.7	2.0	0.2	4.6	0.5	6.6	0.7
of which : Fertilisers	3.7	8.5	0.3	4.8	0.1	-3.5	-0.1	-3.5	-0.1
v. Non-Metallic Mineral Products	2.5	2.9	0.1	1.9	0.0	1.8	0.0	0.8	0.0
of which: Cement	1.7	1.3	0.0	2.2	0.0	-1.4	0.0	-2.7	0.0
vi. Basic Metals, Alloys and Metal Products	8.3	12.6	1.2	-12.2	-1.3	-7.3	-0.7	0.7	0.1
of which: Iron and Steel	3.6	15.1	0.7	-18.4	-1.0	-9.5	-0.5	0.8	0.0
vii. Machinery and Machine Tools	8.4	3.9	0.3	2.6	0.2	-0.2	0.0	0.6	0.0
of which: Electrical Machinery	5.0	2.9	0.1	1.1	0.0	-0.6	0.0	0.6	0.0
viii. Transport Equipment and Parts	4.3	3.0	0.1	3.1	0.1	0.2	0.0	0.2	0.0
Memo:									
Food Items (Composite)	**26.9**	**7.7**	**2.0**	**7.7**	**2.0**	**21.9**	**5.8**	**17.1**	**4.7**
WPI Excluding Food	**73.1**	**5.6**	**4.2**	**-1.6**	**-1.2**	**2.1**	**1.5**	**4.6**	**3.3**
WPI Excluding Fuel	**85.8**	**7.9**	**6.2**	**2.7**	**2.1**	**8.1**	**6.4**	**8.1**	**6.5**
WPI Essential Commodity Group	**17.6**	**9.4**	**1.6**	**9.0**	**1.5**	**21.9**	**3.8**	**18.2**	**3.3**

*: Contribution to inflation

remained high in the range of 13.5-17.2 per cent during November/December 2009, as compared with 10.4-11.1 per cent in November 2008 and 8.0-9.7 per cent in March 2009 (Table 6.7).

VI.28 CPI inflation has been significantly different from the WPI inflation in the recent period and despite the higher increase in WPI inflation, the divergence persists (Chart VI.7).

VI.29 Though there has been significant divergence between WPI and CPI inflation, disaggregated analysis points to similar trends in WPI inflation in essential commodities and CPI inflation. The divergence could be attributed to the

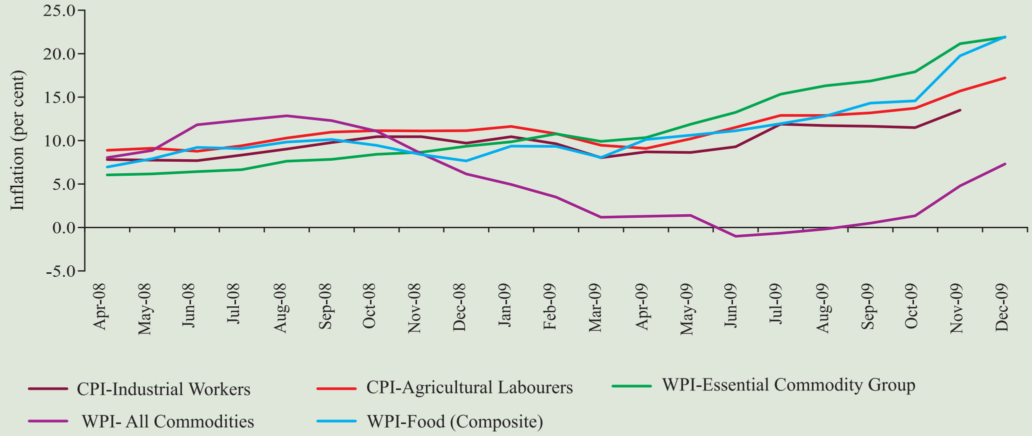
Table 6.7: Consumer Price Inflation - Major Groups

(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	Oct-09	Nov-09	Dec-09
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**	**11.5**	**13.5**	–
Food Group	46.2	12.2	9.3	10.5	13.1	13.1	10.6	12.2	13.5	13.8	17.6	–
Pan, Supari *etc.*	2.3	4.4	10.9	7.1	7.8	8.5	8.3	8.1	8.0	7.1	7.9	–
Fuel and Light	6.4	3.2	4.6	8.4	9.1	9.7	7.4	1.4	4.2	2.8	4.1	–
Housing	15.3	4.1	4.7	4.7	3.8	3.8	6.0	6.0	22.1	22.1	22.1	–
Clothing, Bedding *etc.*	6.6	3.7	2.6	2.5	2.5	4.2	5.0	4.1	4.1	4.1	4.1	–
Miscellaneous	23.3	3.3	6.3	6.2	7.6	8.3	7.4	6.6	5.7	4.2	4.2	–
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**	**12.0**	**13.9**	–
Food Group	47.1	10.9	7.8	9.6	13.2	13.4	12.2	13.6	14.4	14.0	18.1	–
Fuel and Light	5.5	6.4	4.6	5.3	6.2	7.7	5.9	1.3	4.2	2.7	4.0	–
Housing	16.4	5.6	4.0	3.8	3.5	3.5	5.8	6.0	22.0	22.0	22.0	–
Clothing, Bedding *etc.*	7.0	3.6	4.3	3.4	3.1	2.7	3.3	4.2	4.1	4.1	4.1	–
Miscellaneous	24.0	4.4	4.8	6.6	8.4	9.3	8.6	7.3	6.0	4.7	4.2	–
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**	**13.7**	**15.7**	**17.2**
Food Group	69.2	11.8	8.5	9.6	12.0	11.9	9.7	12.4	14.6	15.3	18.1	20.2
Pan, Supari *etc.*	3.8	5.7	10.4	11.2	12.8	13.7	15.3	14.2	15.5	16.1	15.3	14.6
Fuel and Light	8.4	6.9	8.0	8.9	10.2	11.3	11.5	11.0	12.0	12.3	12.9	14.3
Clothing, Bedding *etc.*	7.0	3.5	1.8	3.1	6.0	7.0	7.4	8.3	8.1	7.5	7.5	8.2
Miscellaneous	11.7	6.8	6.1	6.5	7.1	7.0	6.5	6.1	7.1	6.6	6.8	7.0
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**	**13.5**	**15.7**	**17.0**
Food Group	66.8	11.5	8.2	9.6	12.0	11.9	10.0	12.4	14.6	15.3	18.1	20.4
Pan, Supari *etc.*	3.7	5.7	10.6	10.9	12.5	13.4	15.0	14.1	15.4	15.8	15.0	14.4
Fuel and Light	7.9	6.9	8.0	8.9	10.5	11.3	11.5	11.0	12.0	12.3	12.7	14.1
Clothing, Bedding *etc.*	9.8	3.1	2.8	4.1	6.5	7.3	8.2	8.8	9.5	9.4	9.8	10.3
Miscellaneous	11.9	6.3	6.2	6.8	7.4	7.5	6.7	6.2	6.9	6.4	6.2	6.6
Memo:												
WPI Inflation		6.6	7.5	11.8	12.3	6.1	1.2	-1.0	0.5	1.5	4.8	7.3
GDP Deflator based Inflation*		5.5	4.9	8.1	10.6	8.0	7.8	0.9	0.9	–	–	–

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

Chart VI.7: CPI and WPI Inflation



higher weight of food articles in CPIs, which have displayed higher inflation in recent months.

VI.30 Overall, the WPI inflation in India has shown significant firming up in recent months, with the pressure though coming from primary articles and manufactured food products. The dominance of food prices as the key driver of inflation in recent months indicates a limited role for demand management in effectively curbing the price pressures. Consumer price inflation continues to remain firm and the divergence between CPI and WPI inflation still persists. Unlike the inflation episode of the first half of 2008, when the external supply shocks conditioned the inflation path, the current episode is characterised by dominance of domestic supply side pressures largely emanating from deficient South-West monsoon and its impact on foodgrain production. Persistence of food price inflation over a long period could erode the purchasing power of the public at large who may be compelled to devote larger share of their disposable income to food consumption. Moreover, high food inflation and elevated CPI inflation could potentially generate wage-price spiral and raise inflationary expectations.

VII. MACROECONOMIC OUTLOOK

The macroeconomic outlook of the Indian economy, as suggested by various forward looking surveys, shows a general improvement in confidence with expectations of further acceleration in activities. 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 points to upward revision to the growth outlook for 2009-10 from 6.0 per cent in the earlier survey to 6.9 per cent in the latest round. The outlook for growth and inflation is currently conditioned by the emerging upside prospects for growth and upside risks for inflation. Stronger growth outlook may increase the possibility of current high food price inflation causing generalised price pressures, first signs of which were visible in December 2009.

VII.1 Since the release of the second quarter GDP data for 2009-10, the assessment about the growth outlook has improved. Recent growth projections of different agencies suggest upward revision to India's growth outlook for 2009-10. Continuing the optimism witnessed in the last quarter's business confidence surveys, the bullish sentiments have grown stronger. The Industrial Outlook Survey of the Reserve Bank indicates further improvement in the sentiments of the manufacturing sector. The Professional Forecasters' Survey conducted in December 2009 shows overall (median) growth rate for 2009-10 at 6.9 per cent, as against 6.0 per cent reported in the previous survey.

Business Expectations Surveys

VII.2 The forward looking surveys conducted by various agencies generally convey an optimistic picture about the economy. Almost all the surveys report a strong sequential Q-o-Q as well as Y-o-Y improvements (Table 7.1).

VII.3 In continuation of the improvement witnessed during the last quarter, the Business Confidence Index (BCI) of the NCAER (National Council of Applied Economic Research) released in October 2009 showed a 21.2 per cent rise over the previous quarter. All four components of BCI recorded improvement, with 'investment climate' registering the highest improvement, followed by 'financial

Table 7.1: Business Expectations Surveys

Period/ Index	NCAER October 2009 Business Confidence Index	FICCI Q2:2009-10 Overall Business Confidence Index	Dun & Bradstreet Q1: 2010 Business Optimism Index	CII Oct- Mar 2009-10 Business Confidence Index
1	2	3	4	5
Current level of the Index	143.7	72.4	137.3	66.1
Index as per previous survey	118.6	67.2	143.2	58.7
Index level one year back	119.9	37.8	95.7	56.3
% change (Q-o-Q)	21.2	7.7	-4.1	12.6
% change (Y-o-Y)	19.8	91.5	43.4	17.4

position of the firm', 'overall economic conditions' and 'capacity utilisation'. A uniform pattern of improvement in BCI has been observed across all the major industrial sectors of the economy. The early indication from the NCAER Survey conducted during December 2009 shows continuation of improvement in BCI over October 2009.

VII.4 The Business Confidence Survey of the FICCI for the second quarter of 2009-10, which was released in December 2009, suggests that 80 per cent of the companies felt overall economic conditions to have improved 'moderately to substantially' over previous six months. Overall business confidence index rose by 7.7 per cent over the previous quarter level, as 65 per cent of the survey respondents expected sales volume to increase, 40 per cent expected investment to increase, and 16 per cent foresee the addition to the workforce in the next two quarters. Notwithstanding the overall optimism, 52 per cent and 62 per cent of the respondents reported rising prices of industrial inputs and raw materials, and weakness in market demand respectively, as the concerns that could adversely affect business performance. This was, nevertheless, an improvement over the last year, where 84 per cent of the surveyed companies had viewed market demand as a key concern. In addition, 65 per cent of the companies anticipate an improvement in their order book position in the next six months.

VII.5 The Dun and Bradstreet Business Optimism Index (BOI) for Q1 of 2010 recorded a sharp increase of 43.4 per cent on Y-o-Y basis. This increase partly reflected the low base effect, but is also indicative of improving business optimism. Even though on Q-o-Q basis the BOI for Q1 of 2010 registered a marginal decline of 4.1 per cent, this largely reflects the high degree of improvement that was seen in the previous quarter *i.e.* Q4 of 2009 (by 8.4 per cent). While the optimism parameters for 'volume of sales', 'net profits' and 'new orders' increased, the optimism parameter for 'employee levels' remained unchanged during Q1 of 2010 over the previous quarter.

VII.6 The CII Business Confidence Index (CII-BCI) for October-March 2009-10 increased by 7.4 points to 66.1, on top of a modest 2.4 point increase during the first half of 2009-10. During the period when this survey was carried out, the uncertain global economic outlook and slackening consumer demand was continuing to affect confidence levels. Subsequently however, both global economic conditions and domestic private demand have recovered, helping in return of business and consumer confidence.

VII.7 The HSBC Markit Purchasing Managers' Index (PMI) for manufacturing for December 2009 climbed to its highest level since May 2009 signaling a robust month-on-month improvement in manufacturing. With this, the PMI has remained above the no-change threshold of 50, signifying expansion, for the ninth month in a row. The stronger domestic and external demand played an important role in maintaining these gains in recent months. Notwithstanding this, the survey mentions that most manufacturers are cautious about the durability of the recovery and are, therefore, reluctant to hire new labourers. Though accelerating input price inflation is also a concern, on balance the survey predicts continuation of recovery at a robust pace. The PMI for services also registered significant expansion during November and December 2009, suggesting that services sector too is picking up steam. The survey results suggest that the growth in total activity and new business accelerated to reach fifteen months' high.

Reserve Bank's Industrial Outlook Survey

VII.8 The 48th round of Industrial Outlook Survey of the Reserve Bank conducted during October-December 2009 showed further improvement in the sentiments of the manufacturing sector, in continuation of the optimism seen during the previous quarter. The survey covered opinions on "assessment for October-December 2009" and "expectations for January–March 2010", and in line with the trend witnessed since Q2: 2009-10, both indices remained in the growth terrain (*i.e.* above 100, which is the threshold that separates contraction from expansion) (Chart VII.1). The survey respondents expect the industrial growth to gain further momentum during the last quarter of 2009-10, which has to be seen in the context of significant acceleration in IIP growth already seen during August–November, 2009.

VII.9 Better expectations about order books, capacity utilisation and production revealed by the survey are indicative of both improved demand conditions as well as perceptions of further recovery in private demand in the near term. The working capital finance requirement is expected to grow further during the last quarter of 2009-10, which suggests that demand for short term funds from the private sector may rise in the coming months. The availability of finance is expected to improve further in the last quarter of 2009-10. With stronger recovery, the pressure on profit margins is expected to be relieved in the coming months; but with the return of pricing power, inflationary pressures may increase. As a sign of gradual return of the pricing power, the selling prices are expected to increase for the second successive quarter, *albeit* at a lower rate as compared to the previous quarter. According to the survey findings, the outlook for employment is also improving and firms are expected to increase their workforce on the back of expected increase in demand (Table 7.2).

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

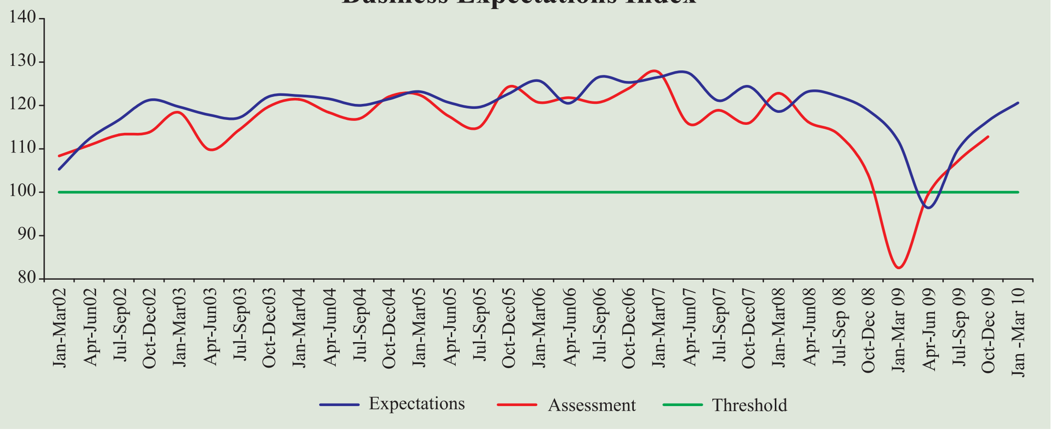


Table 7.2: Reserve Bank's Survey – Net Response on 'A Quarter Ahead' Expectations About the Industrial Performance

Parameter		Response	Oct-Dec 2008	Jan-Mar 2009	Apr-Jun 2009	Jul-Sep 2009	Oct-Dec 2009	Jan-March 2010
1		2	3	4	5	6	7	8
1	Overall business situation	Better	33.7 (44.1)	21.1 (43.9)	11.2 (47.6)	24.2 (46.7)	39.8 (45.4)	44.9 (44.2)
2	Financial situation	Better	27.7 (52.5)	16.4 (53.2)	8.4 (52.7)	20.0 (54.4)	33.5 (52.5)	39.3 (50.6)
3	Working capital finance requirement	Increase	33.8 (57.7)	32.9 (57.1)	23.2 (61.0)	26.3 (61.7)	30.4 (61.0)	32.7 (59.2)
4	Availability of Finance	Improve	23.3 (59.0)	13.7 (56.3)	9.3 (61.7)	16.6 (62.6)	26.1 (62.7)	29.2 (61.8)
5	Cost of external finance	–	–	–	–	–	–	-18.3 (68.1)
6	Production	Increase	39.8 (42.1)	26.0 (42.3)	9.9 (44.9)	22.4 (45.5)	35.0 (43.0)	40.0 (42.3)
7	Order books	Increase	35.7 (46.1)	20.6 (46.1)	6.4 (44.4)	16.8 (45.8)	32.3 (45.3)	35.8 (46.1)
8	Pending orders, if applicable	Below normal	4.6 (82.0)	11.5 (77.8)	23.2 (59.4)	19.1 (73.4)	11.0 (80.6)	5.7 (81.3)
9	Cost of raw material	Decrease	-61.1 (32.3)	-35.7 (39.7)	-16.2 (33.7)	-27.1 (55.5)	-38.4 (51.6)	-44.3 (48.5)
10	Inventory of raw material	Below average	-7.6 (77.6)	-3.3 (81.3)	1.1 (80.2)	-0.5 (82.7)	-1.2 (85.0)	-3.6 (84.7)
11	Inventory of finished Goods	Below average	-4.3 (82.6)	-4.4 (80.9)	-4.4 (78.4)	-1.8 (80.6)	-3.7 (85.3)	-1.9 (85.4)
12	Capacity utilisation (Main product)	Increase	26.4 (56.0)	12.3 (59.1)	-0.7 (55.0)	10.7 (57.5)	22.0 (56.2)	25.4 (56.9)
13	Level of capacity utilisation (Compared to the average in the preceding four quarters)	Above normal	-0.5 (78.7)	-7.4 (73.7)	-20.8 (66.4)	-12.1 (70.8)	-3.8 (76.0)	1.3 (76.1)
14	Assessment of the production capacity (With regard to expected demand in the next six months)	More than adequate	5.7 (81.7)	11.8 (81.0)	8.9 (70.7)	5.5 (76.9)	6.5 (79.7)	5.0 (81.2)
15	Employment in the company	Increase	16.6 (70.4)	7.7 (75.7)	-5.1 (74.0)	1.5 (78.6)	8.8 (77.2)	12.1 (75.6)
16	Exports, if applicable	Increase	27.3 (54.3)	16.0 (54.8)	-3.8 (57.3)	0.1 (59.0)	12.5 (58.5)	20.2 (57.8)
17	Imports, if any	Increase	21.4 (67.9)	9.1 (69.7)	-1.4 (68.8)	4.6 (70.6)	11.5 (68.9)	16.9 (70.1)
18	Selling prices are expected to	Increase	26.2 (57.6)	4.1 (61.7)	-9.1 (61.9)	0.0 (65.6)	6.0 (67.6)	9.8 (68.4)
19	Increase in selling prices, if any, is expected	At a lower rate	0.6 (54.7)	0.9 (54.0)	25.9 (53.5)	-100.0 (0.0)	19.4 (63.2)	16.8 (62.3)
20	Profit margin	Increase	-3.6 (54.7)	-12.9 (53.3)	-18.6 (50.6)	-13.4 (54.5)	-2.8 (56.8)	1.1 (58.8)

Note: 1. 'Net response' is measured as the percentage share differential between the companies reporting 'optimistic' (positive) and 'pessimistic' (negative) responses; responses indicating *status quo* (no change) are not reckoned. Higher 'net response' indicates higher level of confidence and *vice versa*.
2. Figures in parentheses are the percentages of respondents with 'no change over the preceding quarter' as responses.
3. 'Cost of external finance' is a new parameter that has been added from this survey round.

VII.10 The upturn in business expectations is broad-based across industries, with transport equipment, rubber and plastic products, electrical machinery, other machinery and apparatus, basic metals and metal products, food products and pharmaceuticals and medicines expecting overall improvement in performance. Industries like cement, paper and paper products and diversified companies, however, expect weaker performance. In the case of cement industry especially, the capacity utilisation is expected to be lower, which in turn may affect the profitability adversely. The improvement in business outlook varies by size of company, with bigger companies having better expectations as compared to the smaller companies.

Survey of Professional Forecasters[1]

VII.11 The results of the tenth round of Survey of Professional Forecasters' conducted by the Reserve Bank in December 2009 shows overall (median) growth rate for 2009-10 at 6.9 per cent, as against 6.0 per cent reported in the earlier survey (Table 7.3). The sectoral growth rate forecast for the agriculture sector was revised upwards from (-) 1.4 per cent to (-) 0.9 per cent; for industry the upward

Table 7.3: Median Forecasts of Select Macroeconomic Indicators by Professional Forecasters

	Actual 2008-09	Annual forecasts				Quarterly forecasts									
		2009-10		2010-11		2009-10				2010-11					
						Q3		Q4		Q1		Q2		Q3	
		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	6.0	6.9	7.7	7.9	5.7	6.5	6.7	7.5	7.3	7.9	7.6	7.7	-	8.2
a. Agriculture & Allied Activities	1.6	-1.4	-0.9	3.7	3.5	-3.7	-4.0	-1.0	-0.9	2.0	2.0	2.7	3.0	-	4.7
b. Industry	2.6	6.3	8.4	7.3	8.1	6.9	10.1	6.9	10.0	6.7	9.0	6.7	8.4	-	8.3
c. Services	9.4	8.1	8.7	9.1	9.0	8.4	8.8	8.6	8.9	8.9	9.3	9.1	9.1	-	9.0
2. Gross Domestic Saving (per cent of GDP at current market price)	-	33.6	35.0	36.6	36.4	-	-	-	-	-	-	-	-	-	-
3. Gross Domestic Capital Formation (per cent of GDP at current market price)	-	37.3	37.7	37.7	39.0	36.5	37.3	36.0	38.1	36.2	37.9	-	39.8	-	39.7
4. Corporate profit after tax (growth rate in percent)*	-	10.0	11.3	14.5	18.0	9.0	21.2	12.0	19.0	15.0	18.5	17.5	18.5	-	22.0
5. Inflation WPI	8.4	3.0	4.4	5.8	6.1	4.0	4.5#	6.8	8.2	7.2	7.4	6.5	6.4	-	5.5
6. Exchange Rate (US$/INR end period)	51.0	46.0	45.5	44.5	44.3	47.0	46.7 #	46.0	45.5	45.9	45.3	45.3	44.9	-	44.7
7. T-Bill 91 days Yield (per cent-end period)	7.1	4.1	4.0	4.9	5.3	-	-	-	-	-	-	-	-	-	-
8. 10-year Govt. Securities Yield (per cent-end period)	7.6	7.3	7.8	7.5	7.8	-	-	-	-	-	-	-	-	-	-
9. Export (growth rate in per cent)+	5.4	-5.0	-5.2	14.2	15.2	-	-	-	-	-	-	-	-	-	-
10. Import (growth rate in per cent)+	14.3	-15.7	-8.3	12.0	17.4	-	-	-	-	-	-	-	-	-	-
11. Trade Balance (US$ billion)	-119.4	-	-	-	-	-28.1	-31.0	-22.1	-29.7	-20.7	-28.8	-28.9	-31.9	-	-36.4

E : Earlier Projection. L : Latest Projection.
– : Not Available. # : Actuals. * : BSE listed companies. +: US$ on BoP basis.

Note : The latest round refers to tenth round for the quarter ended December 2009, while earlier round refers to ninth round for the quarter ended September 2009.

Source : Survey of Professional Forecasters, Third 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 the Reserve Bank.

revision was significant from 6.3 per cent to 8.4 per cent. For services, the forecasts suggest modest upward revision from 8.1 per cent in the earlier survey to 8.7 per cent in the current survey.

Factors Influencing the Current Growth and Inflation Outlook

VII.12 While the growth outlook has improved significantly since the release of the GDP data for the second quarter of 2009-10 and the strong industrial recovery in recent months up to November 2009, the inflationary pressures have firmed up, led by significant increase in food prices. Though the inflationary process still remains largely concentrated in food articles, there is a possibility of gradual spilling over of the pressure to other segments in the WPI basket, early signs of which were seen in December 2009. Thus, growth outlook has clear upside prospects and the inflation outlook has upside risks.

VII.13 The current optimism about the growth outlook is driven by: (a) acceleration in GDP growth to 7.9 per cent in Q2: 2009-10; (b) turnaround in exports in November 2009 after 13 consecutive months of decline; (c) strong recovery in IIP growth over successive months; (d) early indications from corporate performance suggesting significant positive growth in corporate sales in Q3 of 2009-10 after a phase of deceleration; (e) continuing trend of improved profitability of the corporate sector; (f) higher growth in core infrastructure sector over the corresponding period of the previous year; (g) revival of private final consumption demand and improvement in ‘gross fixed capital formation’ during Q2 of 2009-10; (h) optimistic business expectations reflected in RBI’s Industrial outlook survey and in similar surveys of other agencies for India; (i) revival in stock market activities, both in terms of stock prices as well as additional mobilisation of resources through IPOs and private placements; (j) revival in capital inflows; (k) signs of recovery in global growth and trade; (l) higher flow of resources from the non-banking financial sector; (m) turnaround in credit growth since November 2009; and (n) higher collection of net direct taxes, with 44 per cent increase in corporate tax collections in December 2009.

VII.14 The downside risks to the growth outlook include: (a) global recovery turning out to be not as robust as expected; (b) possibility of an oil price shock; (c) the impact of the deficient South-West monsoon on agricultural output, a large part of which is yet to be reflected in the GDP data; (d) possible pressure on interest rates with revival in demand for credit from the private sector; (e) inventory build-up reaching the cyclical peak, given the turnaround in inventory cycle since Q2 of 2009-10 as per data on corporate performance; and (f) weak performance of services dependent on external demand, notwithstanding the improvement in recent month.

VII.15 The upside risks to the already rising inflation path are: (a) supply constraints tapering off only over time in the case of food articles, given the normal crop cycles; (b) indications of rising international food prices, suggesting limited option of resorting to imports to improve the domestic supply conditions; (c) the return of pricing power with stronger recovery and scope for wage-price revisions linked to high CPI inflation; (d) rebound in private demand, with receding uncertainty and improving confidence; (e) rebound in global commodity prices, particularly oil and metals, with stronger recovery in EMEs and advanced economies; (f) asset price increases with higher capital inflows; and (g) early indications of generalised inflation, which may increase inflationary expectations. From the stand-point of monetary policy, the possibility of food price inflation spilling over to other groups in the WPI, through expectations driven price revisions to cause a generalised inflation, remains a major concern.

VII.16 Some of the factors which could help in moderating the price pressures include : (a) arrival of post-harvest crops in the last quarter of 2009-10, particularly certain vegetables; (b) additional release of rice and wheat from buffer stock and better distribution; (c) no further increase in minimum support prices; and (d) higher *rabi* production partly offsetting the impact of weak *kharif*.

VII.17 The outlook for growth has upside prospects with several supportive developments underway. The outlook for inflation is characterised by developments that have upside risks. The emerging growth and inflation mix, thus, suggests that stronger recovery could make the inflation a more generalised process. Reigning in inflation and inflationary expectations while carefully nurturing the growth impulses will be the main challenge for the conduct of monetary policy during the remaining period of the year.