Macroeconomic and Monetary Developments Second Quarter Review 2009-10

Reserve Bank of India
Mumbai

Contents

MACROECONOMIC AND MONETARY DEVELOPMENTS SECOND QUARTER REVIEW 2009-10

Overview

Global Economic Conditions

1. The global economy is showing tentative signs of recovery signalling, albeit hesitantly, the winding down of the global recession. For several advanced economies the pace of contraction in output has declined in the second quarter of 2009. The emerging outlook for recovery is still dependent on sustained policy stimulus that has spurred aggregate demand while also reducing overall uncertainty. The recovery is widely perceived to remain slow and gradual, with receding but significant downside risks.

2. The downside risks could arise from premature withdrawal of policy stimulus, the possibility of some permanent loss in output in the advanced economies owing to the crisis, need for improving domestic savings in several advanced economies to make growth less dependent on global imbalances, unfinished financial and corporate restructuring that would involve further deleveraging and tight credit market conditions, current level of high excess capacity, large and rising unemployment and the associated pressures on both aggregate demand and protectionism, anaemic private consumption and investment demand, and the costs of sustained large fiscal stimulus.

3. These possibilities point to the risks of a job-less recovery, and a W-shaped double-dip recession where another mild phase of recession may intervene before a durable recovery. The timing of the exit from the policy stimulus will, thus, be critical to the recovery path of the global economy; both premature exit as well as delayed exit would have concomitant costs. In September 2009 the G-20 highlighted the importance of continuing the stimulus till the recovery is secured, consistent though with the other important objectives of price stability and fiscal sustainability.

4. After a series of successive and frequent downward revisions to the growth outlook of the world economy for 2009 from (+) 3.9 per cent in July 2008 to (-) 1.4 per cent in July 2009, the IMF, for the first time, revised the projected growth outlook upwards in October 2009, recognising the emerging signs of recovery. The latest forecast is for a contraction in the world output by (-) 1.1 per cent. The recovery is expected to be led by emerging market economies (EMEs), particularly from Asia. According to the WTO, world merchandise exports increased by about 8.0 per cent in the second quarter of 2009 over the preceding quarter, even though year-on-year growth continued to decline by 33.0 per cent. The outlook of the Institute of International Finance (IIF) for October 2009 suggests that net private capital flows to the EMEs which had *recovered in the second quarter of 2009 gained pace in the third quarter; 30 EMEs are projected to receive US$ 349 billion in 2009, which will still be only about one fourth of the peak level of net flows received in 2007.*

Outlook - Indian Economy

Output

5. In India, economic growth in the first quarter of 2009-10 at 6.1 per cent represents a mild recovery over the 5.8 per cent growth recorded during the preceding two quarters in the second half of 2008-09. In comparison to the high average growth of 8.8 per cent recorded during the five-year period 2003-08, however, the first quarter growth in 2009-10 still points to persistence of the slowdown. Information available on various lead indicators of economic activity in the second quarter of 2009-10 suggests that because of the deficient monsoon, kharif output may be adversely affected. The industrial sector has started exhibiting recovery, with 10.4 per cent growth in August 2009 and 5.8 per cent growth during April-August 2009, as against 1.7 per cent and 4.8 per cent during the corresponding periods of the previous year, respectively. Growth in core infrastructure witnessed notable acceleration in August 2009, and the growth over April-August 2009 was higher at 4.8 per cent as against 3.3 per cent during the corresponding period of the previous year. Lead indicators for services suggest pick up in activities relating to construction and telecommunications, even though external demand dependent services, such as tourism and cargo handled at ports, continue to be depressed.

Aggregate Demand

6. The deceleration in aggregate demand that was witnessed in the second half of 2008-09 continued during 2009-10. Growth in private consumption demand fell to as low as 1.6 per cent in the first quarter of 2009-10. Investment demand also decelerated further, and the high growth in government consumption demand that was witnessed in the last two quarters of 2008-09 also moderated. Corporate performance data indicate that growth in sales, which had decelerated significantly in the second half of 2008-09, exhibited negative growth in the first quarter of 2009-10, notwithstanding improvement in profitability. The deficient monsoon and the associated drought like conditions in several parts of the country, and the more recent floods could also dampen rural demand. Given the predominant role of domestic demand in conditioning the growth outlook in India, weak private consumption and investment demand, thus, continue to be a key drag on faster recovery.

External Economy

7. Weak external demand conditions persisted, as reflected in the sustained decline in India's exports. In the first quarter of 2009-10, exports continued to decline while imports increased, primarily reflecting higher oil prices, resulting in a higher trade deficit in the balance of *payments in relation to the preceding quarter. The surplus in net invisibles, led by buoyant remittance inflows, contributed to finance close to 78 per cent of the trade deficit. The current account, thus, remained in deficit of about US$ 5.8 billion. Reflecting India's resilience to the crisis in 2008-09 and the growth prospects of the economy, capital flows, which had turned negative in the last two quarters of 2008-09, reversed in the first quarter to ensure financing of the current account deficit without any depletion of foreign exchange reserves. The rebound in capital inflows has persisted through the second quarter of 2009-10. Including valuation gains on foreign exchange reserves and the SDRs allocated by the IMF to India, India's foreign exchange reserves increased by USD 32.8 billion during 2009-10 (up to October 16, 2009) to a level of USD 284.8 billion.*

Monetary Conditions

8. The accommodative monetary policy stance adopted by the Reserve Bank in response to the global financial crisis, particularly post-September 2008, continued in 2009-10. The aim of this policy stance was to maintain ample rupee liquidity, comfortable dollar liquidity and ensure flow of credit to productive areas of the economy. Reflecting the accommodative policy stance, the liquidity conditions remained in surplus on a sustained basis, which was absorbed by the Reserve Bank through reverse repo operations under the LAF. Growth in broad money (M3) also remained high at 18.9 per cent (as on October 09, 2009), supported by high growth in deposits (by 19.4 per cent). On the sources side, monetary expansion was driven by the large borrowing programme of the Government, while bank credit to the commercial sector continued to decelerate (with a growth of 10.7 per cent).

Financial Markets

9. The financial markets in India which functioned normally even at the height of the crisis, posted further decline in risk spreads and higher volume of activities. The overnight call rate hovered around the floor of the LAF corridor reflecting the abundant liquidity in the system. In the collateralised segments, namely market repo and collateralised borrowing and lending obligation (CBLO), the interest rates remained below the inter-bank call rates while there was increase in activities. Volumes in the CP and CD markets also increased.

10. In the government securities market, 80.4 per cent of the net borrowing requirement has been completed so far; weak demand for credit in the private sector and comfortable liquidity conditions helped in containing the pressures on yield. Corporate bond yields hardened somewhat but the risk spread fell to the pre-Lehman levels.

11. In the credit market, the gradual moderation in lending and deposit rates continued through the second quarter of 2009-10, demonstrating the transmission of lower policy rates, though with lags.

Despite some reduction in interest rates, the flow of credit to the private sector remained sluggish due to subdued overall private consumption and investment demand. Credit card and consumer durables related credit exhibited negative growth, corroborating the impact of significant deceleration in private consumption demand. The flow of resources from the non-banking sources, however, increased marginally in the first half of 2009-10.

12. In the foreign exchange market, the rupee appreciated by about 10.0 per cent against the US dollar over the end-March level. The equity market sustained the recovery seen since April 2009, and outperformed most of the EMEs in terms of the extent of recovery in stock prices. The primary market activities also picked up significantly, with higher funds mobilised through public issues and private placements, large oversubscription of certain new issues indicating the return of risk appetite in the market, and manifold increase in mobilisation of resources by mutual funds.

Inflation Situation

13. The sharp decline in headline WPI inflation from the peak level of 12.9 per cent in August 2008 yielded space for adoption of growth-supportive accommodative monetary policy to mitigate the impact of the crisis. After remaining negative for 13 consecutive weeks, WPI inflation turned modestly positive in September 2009. Despite the low headline (year on year) WPI inflation at 1.2 per cent (as on October 10, 2009), inflationary pressures have started to emerge, with WPI showing 5.9 per cent increase over March 2009 level and CPI inflation remaining stubbornly elevated at double digit levels. The changing inflation environment, however, is being driven by strong escalation in the prices of food articles, which have increased by 14.4 per cent (year-on-year) so far. Excluding food items, the WPI inflation remains depressed at (-) 3.4 per cent. This suggests both short supply as well as inefficient distribution channels. From the stand point of monetary policy, anchoring inflation expectations in the face of sustained high inflation in essential commodities will be a key challenge.

Growth and Inflation Outlook

14. The growth and inflation mix could change over time, creating conflicting demands on the stance of monetary policy. While premature reversal of the monetary policy stance entails the risk of stifling recovery, persistence of accommodative stance could adversely impact inflation expectations.

15. The current growth outlook for 2009-10 has both upside prospects as well as down side risks. Upside prospects to growth include the impact of the growth-supportive policy stimulus, recovery in industrial production and core infrastructure sector, significant upturn in overall business confidence as per different surveys, strong recovery in the *stock market with higher mobilisation of resources, return of capital inflows and the improving outlook for the global economy which could boost the sluggish consumer and investor confidence. The downside risks include the unexpectedly large deceleration in private consumption demand and some decline in corporate sales in the first quarter of 2009-10, impact of the deficient monsoon and recent flood in certain parts of the country on agricultural output and rural demand, sustained deceleration in credit growth and decline in exports. The Reserve Bank's professional forecasters survey points to downward revision to the growth outlook from 6.5 per cent to 6.0 per cent in 2009-10, reflecting the drought situation in the agriculture sector.*

16. The inflation outlook is currently driven by the emerging signs of inflationary pressures, even though certain developments could neutralise these pressures. These include sluggish aggregate demand and negative output-gap, stabilisation of oil prices in last few months – notwithstanding the recent increase in October 2009, adequate buffer stocks of foodgrains and the prospects of a better rabi crop that could partly offset the adverse impact of deficient kharif, selective import of certain commodities and the normal trend reversal seen in prices of food articles over different crop seasons. On the other hand, the visible inflationary pressures may also persist and escalate further on account of the fading away of the base effect, cost push pressures through wage-price revisions in the face of elevated CPI inflation, challenges in improving the supply situation in the short-run of essential commodities, gradual pressure on global commodity prices along with global recovery, and rising inflation expectations on account of elevated CPI inflation.

17. Financial conditions have improved significantly in India, ahead of a stronger recovery in growth. This is evident from the return of capital flows, significant recovery in the stock markets, and better transmission from low policy rates to declining lending rates. There also need be no concerns about private credit getting crowded out since over 80.4 per cent of the government borrowing programme has been completed so far as there is adequate liquidity in the system. The deceleration in private consumption and investment demand needs to be reversed from the low levels seen in the first quarter of 2009-10 for ensuring a sustainable recovery. Lead information in terms of growth in non-oil imports and demand for credit in the second quarter of 2009-10, however, does not point to any major recovery in demand from the private sector. The overall economic outlook is, therefore, a mixture of upside prospects of recovery and downside risks. Managing this trade-off between supporting growth and reining in inflation expectations poses a complex policy challenge.

I. OUTPUT

India's GDP growth during the first quarter of 2009-10 at 6.1 per cent represents a modest recovery from the 5.8 per cent growth registered during the preceding two quarters, though still lower than 7.8 per cent growth that was achieved in the first quarter of 2008-09 and the 8.8 per cent average growth experienced during 2003-08. The sequential recovery over the previous quarter was driven by notable turnaround in industrial output. During April to August 2009-10, both industry and core infrastructure sectors have shown accelerated growth and few lead indicators of services sector activities also suggest some pick up in growth momentum. The deficient monsoon coupled with recent floods in some States and their expected adverse impact on the kharif agricultural production, however, entail downside risk for the overall growth prospects.

I.1 After a phase of distinct deceleration in growth during the second half of 2008-09, the Indian economy exhibited signs of recovery with higher growth in GDP during the first quarter of 2009-10 and acceleration in the pace of recovery in industrial output and core infrastructure activities. According to the estimates released by the Central Statistical Organisation (CSO) in August 2009, real GDP growth during the first quarter of 2009-10 was placed at 6.1 per cent, which is higher than 5.8 per cent recorded during the preceding two quarters of 2008-09. The growth during the first quarter of 2009-10 was supported by rebound in industrial activity, particularly the turnaround in manufacturing sector (from the negative growth in the previous quarter) and relative resilience of growth in services, notwithstanding the recent deceleration. The real GDP growth during the first quarter of 2009-10, however, was lower than 7.8 per cent recorded in the first quarter of 2008-09, which reflects the persistence of the impact of the synchronised global recession, notwithstanding the emerging signs of recovery. (Table 1.1).

Agricultural Situation

I.2 Deficient monsoon has emerged as the key factor in dampening the pace of recovery in India's growth in the near-term. The South-West Monsoon had arrived in Kerala on May 23, 2009, *i.e.*, one week ahead of the normal schedule. The progress of monsoon, however, got delayed significantly and with every delay, the rainfall deficiency and the prospects of drought like conditions also increased. The cumulative rainfall during the season (up to September 30, 2009) over the entire country has been 23 per cent below normal as against 1 per cent below normal during the corresponding period of the previous year. The shortfall in rainfall as per the foodgrains production weighted index of the Reserve Bank has been higher (27 per cent below normal) as compared to the corresponding period of the previous year (4 per cent above normal). The deficiency

Table 1.1: Growth Rates of Real GDP@

(Per cent)

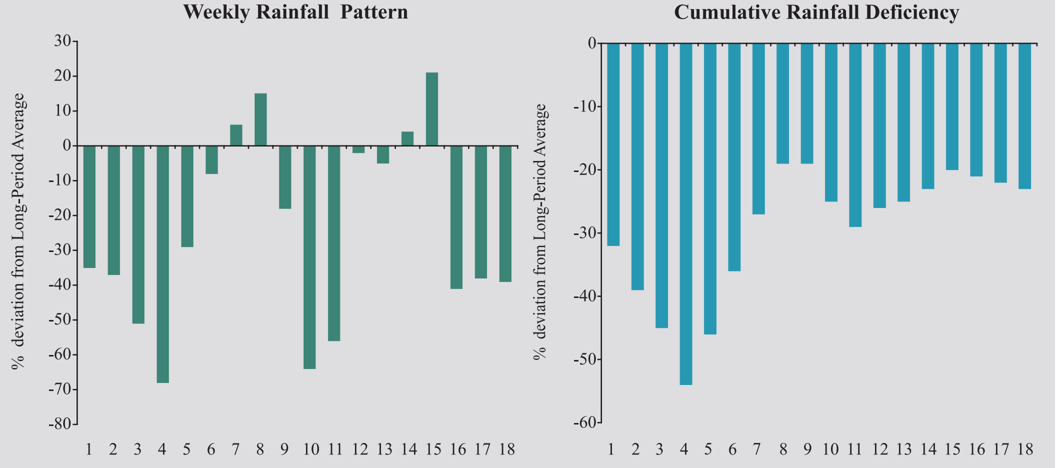
Sector	2007-08*	2008-09#	2008-09 Q1	2008-09 Q2	2008-09 Q3	2008-09 Q4	2009-10 Q1
1	2	3	4	5	6	7	8
1. Agriculture and Allied Activities	**4.9**	**1.6**	**3.0**	**2.7**	**-0.8**	**2.7**	**2.4**
	(17.8)	**(17.0)**					
2. Industry	**7.4**	**2.6**	**5.1**	**4.8**	**1.6**	**-0.5**	**4.2**
	(19.2)	**(18.5)**					
2.1 Mining and Quarrying	3.3	3.6	4.6	3.7	4.9	1.6	7.9
2.2 Manufacturing	8.2	2.4	5.5	5.1	0.9	-1.4	3.4
2.3 Electricity, Gas and Water Supply	5.3	3.4	2.7	3.8	3.5	3.6	6.2
3. Services	**10.8**	**9.4**	**10.0**	**9.8**	**9.5**	**8.4**	**7.7**
	(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
3.2 Financing, Insurance, Real Estate and Business Services	11.7	7.8	6.9	6.4	8.3	9.5	8.1
3.3 Community, Social and Personal Services	6.8	13.1	8.2	9.0	22.5	12.5	6.8
3.4 Construction	10.1	7.2	8.4	9.6	4.2	6.8	7.1
Real GDP at Factor Cost	**9.0**	**6.7**	**7.8**	**7.7**	**5.8**	**5.8**	**6.1**
	(100)	**(100)**					
Memo:							(Amount in Rupees crore)
Real GDP at Factor Cost (1999-2000)	31,29,717	33,39,375					
GDP at current market prices	47,23,400	53,21,753					

@: At 1999-2000 Prices *: Quick Estimates. #: Revised Estimates.
Note : Figures in parenthesis indicate shares in real GDP.
Source : Central Statistical Organisation.

in rainfall during the South-West monsoon season has exceeded the revised forecast of the India Meteorological Department (IMD) issued in August, according to which rainfall during the season (June to September, 2009) was likely to be below normal at 93 per cent of the Long Period Average (with a model error of ± 4.0 per cent). The temporal distribution of the rainfall activity shows that the initial concerns about shortfall in June rainfall receded somewhat in July, which helped to improve the sowing position. The rainfall turned deficient again during the first half of August 2009, before picking up subsequently since the middle of the month (Chart I.1).

I.3 The spatial distribution of rainfall reveals that of the 36 meteorological sub-divisions, cumulative rainfall has been excess/normal in 13 sub-divisions (32 sub-divisions last year) (Chart I.2). The pick up in rainfall activity since mid-August 2009 has resulted in substantial improvement in the country's water reservoir level, though it continues to remain below last year's level. As on October 22, 2009, the total live water storage in the 81 major reservoirs of the country was 64.0 per cent of the Full

Chart I.1: South-West Monsoon: 2009 (June 1 to September 30)

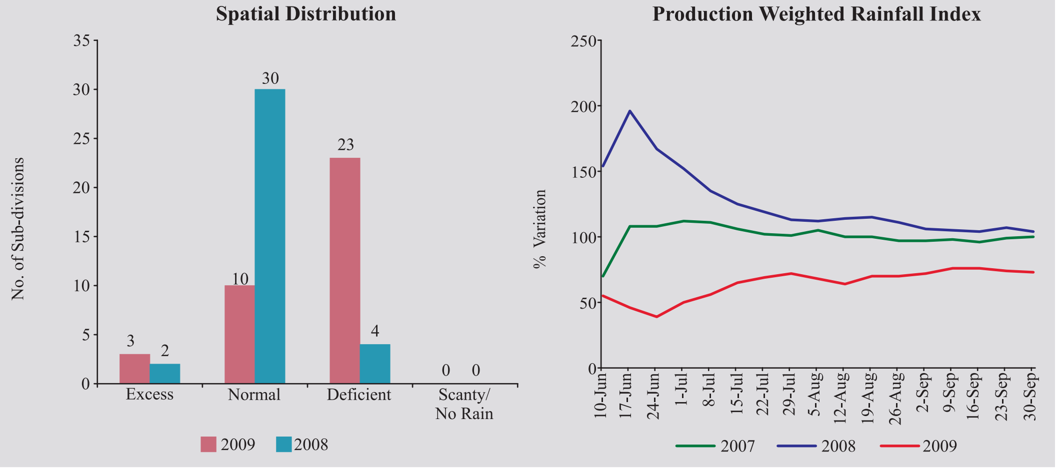


Reservoir Level (FRL) (72.0 per cent during the corresponding period last year).

I.4 As on September 30, 2009, around 300 districts have been declared drought hit, partially or wholly, in 12 States. During the season, flood incidents were also reported in some States, *viz.*, Karnataka, Assam, Meghalaya, Arunachal Pradesh, West Bengal, Orissa, Bihar, Jharkhand, Uttar Pradesh, Uttarakhand, Haryana, Punjab, Himachal Pradesh, Gujarat, Maharashtra, Madhya Pradesh, Kerala and Andhra Pradesh.

I.5 The deficient South-West monsoon has impacted the *kharif* sowing, which is about 5.4 per cent below that of the last year. Latest sowing position indicates that sowing of all crops during the current *kharif* season

Chart I.2: South-West Monsoon: 2009 (June 1 to September 30)



as on October 16, 2009 was 92 per cent of the normal level (Table 1.2). Sowing of most pulses and cotton are higher than last year levels, while the sowing of coarse cereals and jute remained the same as last year, though paddy sowing has been substantially affected (16 per cent below last year's level). Other crops whose sowing has been affected somewhat include oilseeds and sugarcane. Considering that *Kharif* paddy is an important crop accounting for about 86 per cent of total rice production and 36 per cent of total foodgrains production in India, the shortfall in its sowing could be expected to depress the overall foodgrains production during 2009-10.

I.6 The impact of the overall deficiency in rainfall during South-West monsoon season has to be assessed in the context of the pick up in monsoon in the later part of August and in September that could help standing crops in improving their yield. Besides, rainfall has been more deficient in the irrigated belt of the country like Punjab and Haryana where availability of irrigation, particularly in the snow fed Northern river basin could offset some of the potential loss in output. Shortfall in rice sowing during this *kharif* is being partly compensated in some parts of the country by sowing of short duration Boro rice (post *kharif*) and shortfall in groundnut sowing is being partly offset by sowing of Toria that could be sown even in the late *kharif* season. Moreover, delayed withdrawal of South-West monsoon augurs well for *rabi* crops, particularly winter wheat and oilseeds on account of high moisture retention in the soil. In addition, Indian

Table 1.2: Progress of Area Sown under *Kharif* Crops: 2009-10

(Million hectares)

Crop	Normal Area	Area Coverage (as on October 16, 2009)			
		2008	2009	Absolute variation	Percentage change
1	2	3	4	5	6
Rice	39.2	38.8	32.7	-6.1	-15.7
Coarse Cereals	23.0	20.6	20.7	0.1	0.3
of which:					
Bajra	9.7	8.5	8.5	0.0	0.2
Jowar	3.9	2.9	3.1	0.2	6.6
Maize	6.8	7.1	7.1	0.1	0.9
Total Pulses	11.2	9.6	10.1	0.5	5.6
Total Oilseeds	16.9	18.4	17.5	-1.0	-5.2
of which:					
Groundnut	5.4	5.3	4.4	0.9	-16.6
Soyabean	7.8	9.6	9.6	0.0	-0.2
Sugarcane	4.4	4.4	4.3	-0.1	-2.9
Cotton	8.7	8.5	9.6	1.1	13.4
Jute	0.8	0.7	0.7	0.0	-2.0
All Crops	**104.2**	**101.1**	**95.7**	**-5.4**	**-5.4**

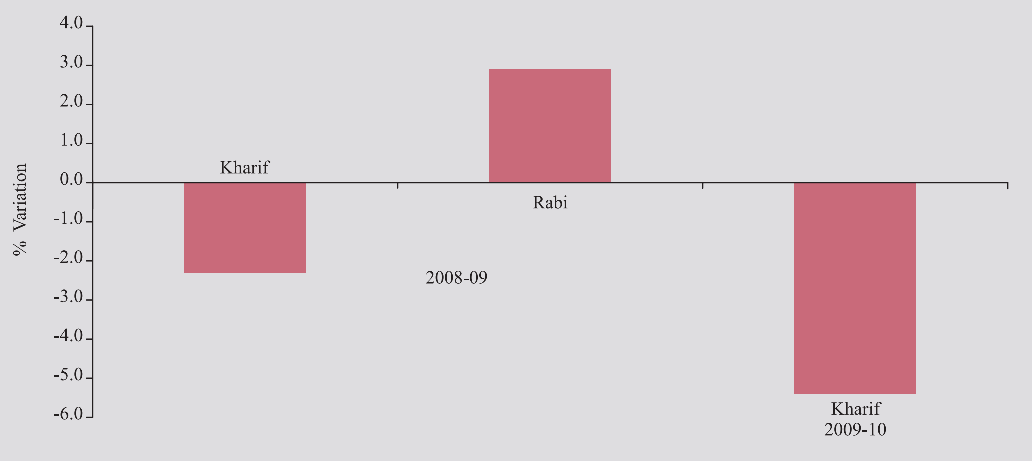
Source : Ministry of Agriculture, Government of India.

agriculture is substantially diversified now. *Kharif* 'cereals, pulses and oilseeds' contribute only around 20 per cent to total agricultural output. *Rabi* contributes another 20 per cent to the overall agricultural GDP. The balance 60 per cent comes from allied sector comprising of horticulture, livestock and fisheries, which has been growing at above 5 per cent during last few years.

I.7 Moreover, in recent years, the share of *rabi* output in total foodgrains production has been increasing and during 2008-09, the *rabi* accounted for almost half of the overall foodgrains production. During 2008-09, despite shortfall in *kharif* sowing (-2.3 per cent), the foodgrains production touched an all-time peak, mainly because of higher *rabi* sowing (2.9 per cent), which compensated for the loss in *kharif* output (Chart I.3). In view of the drought like situation prevailing in some of the States, the Government of India has initiated several timely measures to overcome the shortfall in *kharif* production, which include provision of incentives for supplemental irrigation facilities *via* the diesel subsidy in States having more than 50 per cent deficiency in rainfall; planned efforts to increase *rabi* production through ensuring availability of seeds, fertilisers and other inputs to farmers and issuing several policies/ advisories with regard to water conservation techniques and providing flexibility to States in the use of funds under various central schemes. In view of the above, there is a possibility of *rabi* production compensating somewhat for the loss in *kharif* output as in the previous year, provided that North-East monsoon and climatic conditions remain favourable during the *rabi* season of 2009-10.

I.8 According to IMD, during the Post Monsoon Season (October-December) cumulative rainfall for the period October 1 to 21, 2009 was 12 per cent above normal as compared with 40 per cent below normal during the corresponding period of the

Chart I.3: Comparative Sowing Position



previous year. The spatial distribution of rainfall reveals that of the 36 meteorological sub-divisions, cumulative rainfall was excess/normal in 26 sub-divisions (5 sub-divisions last year).

I.9 According to the Fourth Advance Estimates, the total foodgrains production during 2008-09 reached to a record level of 233.9 million tonnes, about 3 million tonnes higher than the previous year (Table 1.3). The increase in foodgrains production could be mainly attributed to increase in the output of rice and wheat.

Table 1.3: Agricultural Production

(Million tonnes)

Crop	2007-08	2008-09@
1	2	3
Rice	96.7	99.2
Kharif	82.7	84.6
Rabi	14.0	14.6
Wheat	78.6	80.6
Coarse Cereals	40.8	39.5
Kharif	31.9	28.3
Rabi	8.9	11.1
Pulses	14.8	14.7
Kharif	6.4	4.8
Rabi	8.4	9.9
Total Foodgrains	**230.8**	**233.9**
Kharif	121.0	117.7
Rabi	109.8	116.2
Total Oilseeds	29.8	28.2
Kharif	20.7	17.9
Rabi	9.0	10.3
Sugarcane	348.2	271.3
Cotton #	25.9	23.2
Jute and Mesta ##	11.2	10.4

@ : Fourth Advance Estimates.
# : Million bales of 170 kgs. each.
: Million bales of 180 kgs. each.
Source : Ministry of Agriculture, Government of India.

Food Management

I.10 The procurement of rice and wheat during 2009-10 (up to October 20, 2009) was higher than that in the corresponding period of the previous year (Table 1.4). As a result, 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 being higher than the procurement and were at 44.3 million tonnes as on October 1, 2009. The stocks of both rice and wheat are, however, much higher than their norms.

Industrial Performance

I.11 During the current financial year, industrial production has exhibited recovery from the loss of growth momentum witnessed during the second half of 2008-09. After a short phase of deceleration, the industrial growth turned negative in December 2008 and thereafter turned positive, but remained depressed till the end of 2008-09. Since April 2009, the recovery has been more visible and industrial output clocked double digit growth in August 2009, which is the highest recorded since November 2007. The growth in industrial production at 5.8 per cent during the current financial year 2009-10 (April-August) exceeded the growth recorded during the corresponding period of previous year (4.8 per cent) on account of higher growth in June-August 2009 (Chart I.4 and Table 1.5). The recovery in industrial growth has been broad based with acceleration in growth of all the three

Table 1.4: Management of Food Stocks

(Million tonnes)

Month	Opening Stock of Foodgrains			Procurement of Foodgrains			Foodgrains Off-take					Closing Stock	Norms
	Rice	Wheat	Total	Rice	Wheat	Total	PDS	OWS	OMS-Domestic	Exports	Total		
1	2	3	4	5	6	7	8	9	10	11	12	13	14
2008-09	13.8	5.8	19.8	32.8	22.7	55.5	34.9	3.4	1.2	0.0	39.5	35.6	
2009-10@	21.6	13.4	35.6	11.1	25.4	36.5	14.3	0.9	0.0	0.0	15.2	N.A.	
	(13.8)	(5.8)	(19.8)	(11.3)	(22.7)	(33.9)	(11.2)	(0.9)	(0.0)	(0.0)	(12.1)	N.A.	
2008													
January	11.5	7.7	19.2	4.5	0.0	4.5	2.9	0.3	0.0	0.0	3.2	21.4	20.0
April	13.8	5.8	19.8	1.1	14.2	15.3	2.7	0.0	0.0	0.0	2.8	30.7	16.2
2009													
January	17.6	18.2	36.2	4.8	0.0	4.8	3.0	0.2	0.3	0.0	3.4	37.4	20.0
February	20.2	16.8	37.4	3.7	0.0	3.7	3.0	0.3	0.2	0.0	3.6	37.1	
March	21.3	15.3	37.1	2.3	0.0	2.3	2.9	0.4	0.0	0.0	3.9	35.6	
April	21.6	13.4	35.6	1.4	19.4	20.8	3.3	0.2	0.0	0.0	3.5	51.8	16.2
May	21.4	29.8	51.8	1.9	4.4	6.4	3.6	0.2	0.0	0.0	3.9	54.8	
June	20.4	33.1	54.8	1.3	1.1	2.4	3.3	0.4	0.0	0.0	3.7	53.2	
July	19.6	32.9	53.2	1.4	0.4	1.8	N.A.	N.A.	N.A.	N.A.	N.A.	51.0	26.9
August	18.8	31.6	51.0	0.8	0.0	0.8	N.A.	N.A.	N.A.	N.A.	N.A.	47.8	
September	17.2	30.1	47.8	0.4	0.1	0.5	N.A.	N.A.	N.A.	N.A.	N.A.	44.3	
October*	15.4	28.5	44.3	4.0	0.0	4.0	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	16.2

PDS: Public Distribution System. OWS: Other Welfare Schemes. OMS : Open Market Sales. N.A.: Not Available.
@ : Procurement up to October 20, Off-take up to July 31. * : Procurement up to October 20.

Note : 1. Closing stock figures may differ from those arrived at by adding the opening stocks and procurement and deducting off-take, as stocks include coarse grains also.

2. Figures in parenthesis indicate procurement/offtake of foodgrains during corresponding period of 2008-09.

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

sectors, *viz.*, mining, electricity and manufacturing. The acceleration in the manufacturing sector in April-August 2009 was on account of increase in the production of 'rubber, plastic, petroleum products', 'textile products', 'wool, silk and man-made

Chart I.4: Growth in Index of Industrial Production (Y-o-Y)

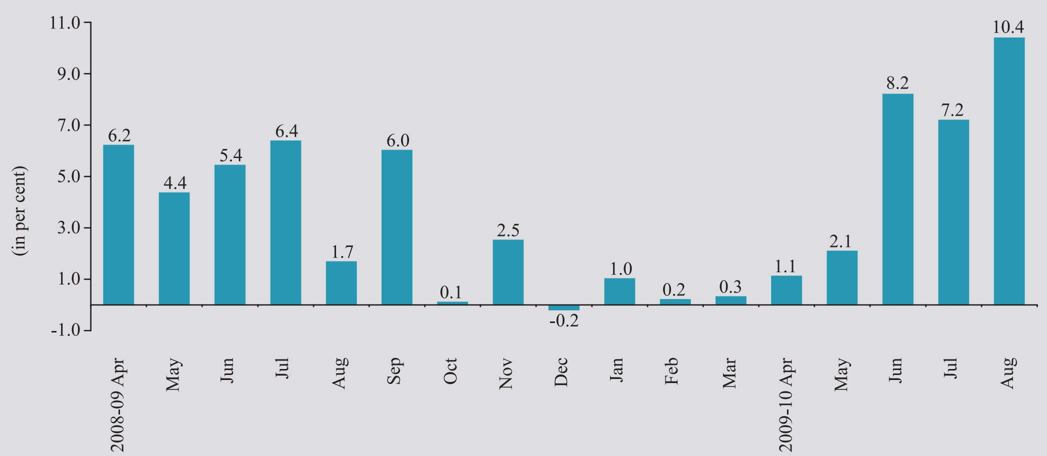


Table 1.5: Index of Industrial Production: Sectoral and Use-Based Classification of Industries

(Per cent)

Industry Group	Weight in the IIP	Growth Rate			Weighted Contribution #		
		April-March	April-August		April-March	April-August	
		2008-09	2008-09	2009-10 P	2008-09	2008-09	2009-10 P
1	2	3	4	5	6	7	8
Sectoral							
Mining	10.5	2.6	3.5	8.4	6.3	4.8	9.3
Manufacturing	79.4	2.7	5.1	5.5	85.3	91.1	81.2
Electricity	10.2	2.8	2.3	6.6	8.3	4.0	9.5
Use-Based							
Basic Goods	35.6	2.6	3.7	6.7	28.4	23.0	34.5
Capital Goods	9.3	7.3	8.3	3.2	34.1	20.6	6.8
Intermediate Goods	26.5	-1.9	1.0	9.2	-18.4	5.5	41.5
Consumer Goods (a+b)	28.7	4.7	7.6	3.1	54.2	49.2	17.4
a) Consumer Durables	5.4	4.5	5.7	18.1	12.4	8.9	23.8
b) Consumer Non-durables	23.3	4.8	8.3	-1.5	41.7	40.3	-6.4
General	**100.0**	**2.7**	**4.8**	**5.8**	**100.0**	**100.0**	**100.0**

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

fibre textiles', 'wood and wood products', 'machinery and equipment other than transport equipment', 'non-metallic mineral products', 'basic metal and alloy industries', 'leather and leather fur products' and 'other manufacturing industries' (Table 1.6).

Table 1.6: Performance of Manufacturing Industry Groups (April-August 2009-10)

	Negative	Deceleration	Acceleration
1	2	3	4
1.	Food Products	Transport equipment and parts	Wood and wood products; furnitures and fixtures
2.	Jute and other vegetable fibre textiles (except cotton)	Chemicals and chemical products	Non-metallic mineral products
3.	Metal products and parts	Paper and paper products	Textile products
4.	Beverages, tobacco and related products	Cotton textiles	Rubber, plastic, petroleum and coal products
5.			Other manufacturing industries
6.			Wool, silk and man-made fibre textiles;
7.			Basic metal and alloy industries
8			Machinery and equipment
9.			Leather and fur products
Combined Weight in the IIP	**14.9**	**23.5**	**41.0**

I.12 In terms of use-based classification, while there was noticeable acceleration in basic and intermediate goods segments, the performance of capital and consumer goods still remained sluggish during April-August 2009-10 over the corresponding period of last year. The continuous rise in intermediate goods production indicates pick up in upstream industries and strength in inventory investments. The growth in the capital goods sector, which recovered with robust growth in June 2009 from negative territory during March-May 2009, fell sharply in July 2009, before recouping subsequently with buoyant growth in August 2009. Despite robust growth in the durables goods segment, the growth in the consumer goods remained weak during April-August 2009-10, reflecting mainly the contraction in non-durables output. Non-durables segment has, however, displayed recovery with positive growth in June-August 2009.

I.13 Out of 17 two-digit manufacturing industry groups, eight industry groups accounting for 38.4 per cent weight in the IIP recorded decelerated/negative growth during April-August 2009-10 (Table 1.7).

I.14 The basic goods sector has manifested steady acceleration during April-August 2009-10, mainly on account of improved performance in electricity, non-metallic mineral products like cement and basic metals. After decline in growth for seven consecutive months (August 2008 to February 2009), intermediate goods sector has recovered strongly since March 2009 and showed a double digit growth in August 2009. Demand seems to have picked up in 2009-10 for intermediate products such as 'wool, silk and man-made fibre textiles', 'wood and wood products', 'non metallic mineral products', 'metal products and parts except machinery equipment' and 'machinery and equipment other than transport equipment. On the contrary, the sharp deceleration in the growth witnessed in the capital goods sector in April-August 2009 as compared to the same period last year has been on account of lower growth in production of 'machinery and equipment other than transport equipment' and 'transport equipment and parts'. The trend in production of capital goods has been volatile, reflecting some uncertainty in investment outlook and the competition from imports.

I.15 The positive growth in consumer non-durables during July and August 2009 was on account of 'cotton textiles', 'wool and man-made fibre textiles', 'paper and paper products', 'leather and fur products', 'rubber, plastic, petroleum and coal products' and 'machinery and equipment other than transport equipment'. The trends in consumer durables show steady rise in production since January 2009 driven by the production of giant tubes, tractor tyres, window type air conditioners, refrigerators, washing/laundry machines, electric fans, telephone instruments, TV receivers, passenger cars, motor cycles, *etc*.

Infrastructure

I.16 During the current financial year 2009-10 (April-August), the core

Table 1.7: Growth of Manufacturing Industry Groups

(Per cent)

Industry Group	Weight in the IIP	Growth Rate			Weighted Contribution #		
		April-March 2008-09	April-August 2008-09	April-August 2009-10 P	April-March 2008-09	April-August 2008-09	April-August 2009-10 P
1	2	3	4	5	6	7	8
1. Food products	9.08	-9.7	-2.5	-12.6	-28.1	-3.1	-13.7
2. Beverages, tobacco and related products	2.38	16.2	22.2	-3.3	30.7	22.7	-3.6
3. Cotton textiles	5.52	-1.9	1.2	0.7	-2.8	1.0	0.5
4. Wool, silk and man-made fibre textiles	2.26	0.0	-1.2	11.9	0.0	-0.7	5.8
5. Jute and other vegetable fibre textiles (except cotton)	0.59	-10.1	-6.5	-16.4	-1.1	-0.4	-0.9
6. Textile products (including wearing apparel)	2.54	5.7	4.7	9.5	6.9	3.1	5.9
7. Wood and wood products, furniture and fixtures	2.70	-9.6	-6.7	11.8	-5.3	-2.1	3.0
8. Paper and paper products and printing, publishing and allied Industries	2.65	1.9	3.1	2.7	2.0	1.9	1.5
9. Leather and leather and fur products	1.14	-6.9	0.8	1.3	-2.1	0.1	0.2
10. Chemicals and chemical products (except products of petroleum and coal)	14.00	4.1	8.1	5.0	29.0	31.8	18.9
11. Rubber, plastic, petroleum and coal products	5.73	-1.5	-4.2	13.2	-3.5	-5.3	14.1
12. Non-metallic mineral products	4.40	1.2	0.7	7.6	2.7	0.9	8.5
13. Basic metal and alloy industries	7.45	4.0	6.6	7.1	14.8	13.2	13.3
14. Metal products and parts (except machinery and equipment)	2.81	-4.0	-0.8	-0.2	-3.1	-0.3	-0.1
15. Machinery and equipment other than transport equipment	9.57	8.8	8.3	9.5	53.2	26.1	28.7
16. Transport equipment and parts	3.98	2.5	11.2	9.1	6.1	14.1	11.3
17. Other manufacturing industries	2.56	0.4	-4.0	10.8	0.6	-2.9	6.6
Manufacturing – Total	79.36	2.7	5.1	5.5	100.0	100.0	100.0

P: Provisional. # : Figures may not add up to 100 due to rounding off.

Source: Central Statistical Organisation.

infrastructure sector recorded higher growth at 4.8 per cent compared to 3.3 per cent during the corresponding period of the previous year led by acceleration in coal, cement, and electricity (Chart I.5). The production of crude oil and petroleum refinary products, however, recorded a decline. The production of finished steel witnessed decelerated growth during the period (Chart I.6).

Services Sector

I.17 The services sector recorded a lower growth of 7.7 per cent during the first quarter of 2009-10 compared with the double digit growth of 10.0 per cent during the corresponding period of last year. The growth in sub-sectors such as ‘trade, hotels, transport and communication’ and ‘construction’, exceeded the growth in the preceding two quarters but remained lower

Chart I.5: Growth in Infrastructure Industries (Y-o-Y)

than the first quarter of 2008-09. However, 'financing, insurance, real estate and business services' recorded acceleration in growth compared to the first quarter of 2008-09, reflecting the improved conditions in the financial markets (see Table 1.1).

I.18 The slowdown in the services sector is reflected in its contribution to real GDP growth, which receded to 4.9 per cent in the first quarter of 2009-10 from 6.3 per cent during the corresponding period of the previous year (Table 1.8).

I.19 The lead indicators of services sector activity for 2009-10, so far, suggest decline in growth in respect of foreign tourist arrivals and production of commercial vehicles, while most of the other lead indicators pertaining to transport

Chart I.6: Sector-wise Growth in Infrastructure Industries

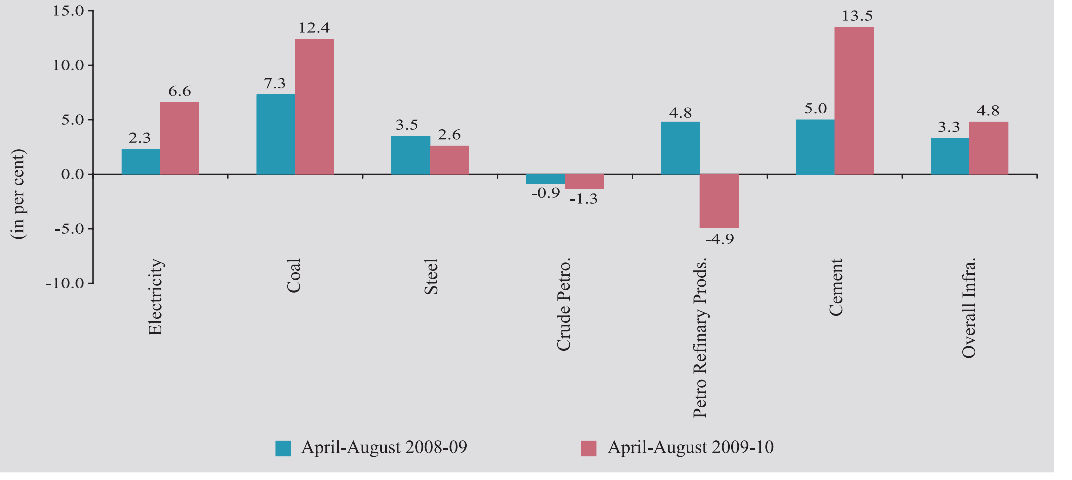


Table 1.8: Contribution of Services to Real GDP Growth

(Per cent)

Year/Quarter		Construction	Trade, Hotels, Transport and Communication	Financing, Insurance, Real Estate and Business Services	Community, Social and Personal Services	Total Services
1		2	3	4	5	6
2005-06		1.1	3.0	1.5	1.0	6.7
2006-07		0.8	3.5	1.9	0.8	6.9
2007-08		0.7	3.4	1.7	0.9	6.7
2008-09	RE	0.5	2.5	1.1	1.7	5.9
2008-09	: Q1	0.6	3.5	1.0	1.0	6.3
	: Q2	0.7	3.4	1.0	1.3	6.4
	: Q3	0.3	1.6	1.2	2.7	5.7
	: Q4	0.5	1.8	1.3	1.7	5.4
2009-10	: Q1	0.5	2.3	1.2	0.9	4.9

RE : Revised Estimates.
Source: Central Statistical Organisation.

services also display a subdued outlook. The production of cement has, however, shown a turnaround along with some buoyancy in steel output, indicating growing momentum in construction activities. There is also pick up in the growth in respect of passengers handled at domestic terminals (Table 1.9). Telecommunication services remain

Table 1.9: Indicators of Services Sector Activity

(Growth in per cent)

			April-September	
	2007-08	2008-09	2008-09	2009-10
1	2	3	4	5
Tourist arrivals	12.2	-2.5	8.9	-2.8
Commercial vehicles production#	4.8	-24.0	4.4	-7.4
Railway revenue earning freight traffic	9.0	4.9	18.9	7.5
Cell phone connections^	38.3	44.8	24.9	62.3
Cargo handled at major ports^	12.0	2.1	8.4	1.8
Civil aviation				
Export cargo handled^	7.5	3.4	7.7	1.5
Import cargo handled^	19.7	-5.7	6.2	-9.3
Passengers handled at international terminals^	11.9	3.8	7.8	1.8
Passengers handled at domestic terminals^	20.6	-12.1	-5.1	2.4
Cement ##	7.8	7.5	5.0	13.5
Steel ##	6.8	0.6	3.5	2.6

\# : Leading Indicator for Transportation.
^ : Data for 2009-10 pertains to April-August.
\## : Leading Indicator for construction and data for 2009-10 pertains to April-August.
Source: Ministry of Tourism; Ministry of Commerce and Industry; Ministry of Statistics and Programme Implementation; Reserve Bank of India; and Centre for Monitoring Indian Economy.

buoyant on considerable growth in the cell phone connections.

I.20 In sum, the aggregate supply conditions as reflected in the growth of GDP indicate that although there is a recovery from the slowdown of the second half of 2008-09, the pace of revival remains subdued. The deficient and uneven precipitation during the South-West monsoon season coupled with recent floods in some States have considerably increased the downside risks for the *kharif* production during 2009-10. Nonetheless, given the recent past experience and the proactive measures already initiated by the Government, the *rabi* production may partly reverse the shortfall in *kharif* production, if climatic and North-East monsoon conditions remain favourable during the *rabi* season. During the current financial year 2009-10 (April-August), the industrial production has staged a recovery (5.8 per cent) from the loss of growth momentum that it witnessed during the second half of 2008-09. Similarly, the core infrastructure sector during 2009-10 (April-August) has also displayed higher growth (4.8 per cent) over the comparable period last year, underpinned by considerable acceleration in coal, cement, and electricity. Some of the lead indicators for the services sector also show signs of momentum in growth.

II. AGGREGATE DEMAND

Aggregate demand, which had moderated considerably in 2008-09, remained sluggish during the first quarter of 2009-10. Private consumption and investment demand continued to decelerate during the first quarter of 2009-10, with the former registering the lowest quarterly growth in recent years. Government consumption expenditure growth, which had risen sharply in the third and fourth quarters of 2008-09, moderated during the first quarter of 2009-10, but continued to remain in double-digits. During April-August, 2009 the key deficit indicators of the Central Government, viz., revenue deficit and fiscal deficit, were significantly higher than during the corresponding period of the previous year, reflecting the combined impact of slowdown induced decline in revenue receipts and increase in public expenditure consistent with expansionary fiscal stance. Corporate sector data indicate modest decline in sales growth during the first quarter of 2009-10, although profit margins improved.

II.1 The contagion from the global crisis operating through the confidence channel has dampened the private consumption and investment demand and the impact persisted even in the first quarter of 2009-10, when the growth in private consumption demand fell to one of the lowest levels. While the real GDP growth measured from the demand side was higher during the first quarter of 2009-10, at 6.0 per cent, than the preceding two quarters, the improvement largely resulted from a sharper contraction in imports than in exports, which led to a reversal in the share of net exports in GDP from negative to positive. The domestic component of demand continued to remain weak during the first quarter of 2009-10. Private consumption demand decelerated sharply to 1.6 per cent, which is the lowest growth in recent years. This deceleration is significant in the context of the high share of private consumption demand in the aggregate demand (*i.e.*, 55.6 per cent during the first quarter of 2009-10). The growth in investment demand, as could be inferred from the behavior of gross fixed capital formation, was less than half of that registered in the corresponding period of the preceding year. Growth in government consumption expenditure continued to remain in double digits, but was substantially lower than the high growth that was witnessed in the third and fourth quarters of 2008-09. In view of its lower share in aggregate demand, government final consumption expenditure could not fully compensate for the adverse impact of private consumption and investment demand on the overall consumption expenditure. Key deficit indicators of the Central Government, *viz.*, the revenue deficit and the gross fiscal deficit during April-August 2009 were lower, as proportions to budget estimates, than in the corresponding period of the previous year. Corporate performance remained subdued, and the impact of moderation in demand was visible in the decline in sales growth in the first quarter of 2009-10. Gross profits, however, increased after two consecutive quarters of decline, mainly due to lower input and operating costs and higher non-core income. Net exports turned positive despite the continued decline in exports, mainly on account of the sharper contraction in imports[1].

Domestic Demand

II.2 Domestic demand in the form of private consumption expenditure and investment, which had moderated in 2008-09, continued to decelerate in the first quarter of 2009-10, reflecting weak domestic demand as a constraint to faster recovery. According to the data released by the Central Statistical Organisation (CSO) for the first quarter of 2009-10, private final consumption expenditure (PFCE) and gross fixed capital formation (GFCF) witnessed sharp deceleration in growth as compared with the corresponding period in 2008-09 (Table 2.1 and Chart II.1). The deficient monsoon could have further weakened

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

(Per cent)

Item	2007-08*	2008-09#	2008-09				2009-10
			Q1	Q2	Q3	Q4	Q1
1	2	3	4	5	6	7	8
Growth Rates							
Real GDP at market prices	9.1	6.1	8.2	7.8	4.8	4.1	6.0
Total Consumption Expenditure	8.3	5.4	3.8	2.1	9.0	6.1	2.8
(i) Private	8.5	2.9	4.5	2.1	2.3	2.7	1.6
(ii) Government	7.4	20.2	-0.2	2.2	56.6	21.5	10.2
Gross Fixed Capital Formation	12.9	8.2	9.2	12.5	5.1	6.4	4.2
Change in Stocks	51.7	2.9	6.0	5.6	1.4	-0.9	3.2
Exports	2.1	12.8	25.6	24.3	7.1	-0.8	-10.9
Less Imports	6.9	17.9	27.4	35.3	21.7	-5.7	-21.2
Relative shares							
Total Consumption Expenditure	66.9	66.5	67.5	63.7	69.9	64.8	65.5
(i) Private	57.2	55.5	58.0	55.5	57.4	51.4	55.6
(ii) Government	9.8	11.1	9.6	8.3	12.5	13.4	9.9
Gross Fixed Capital Formation	31.6	32.2	32.2	34.5	30.9	31.6	31.6
Change in Stocks	3.1	3	3.2	3.2	2.9	2.9	3.1
Net Exports	-4.3	-5.8	-1.3	-10.5	-8.5	-2.9	1.6
Memo:							(Rupees crore)
Real GDP at market prices	34,02,716	36,09,425	8,33,631	8,49,247	9,45,121	9,81,427	8,83,489

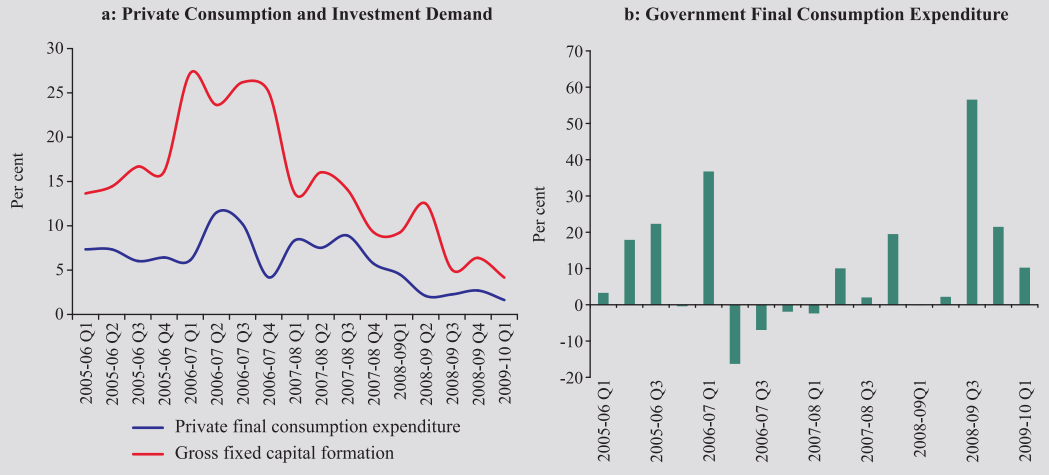
* : Quick Estimates # : Revised Estimates.

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

Source : Central Statistical Organisation.

[1] Net exports data reported in the GDP for the first quarter of 2009-10 (at constant prices) differ from net exports in the balance of payments (BoP) data for the first quarter because of : (a) release of BoP data after the GDP data and hence use of estimates of services in the GDP data and (b) use of deflators for arriving at net exports at constant prices, as at current prices the differences are primarily because of (a).

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



private consumption demand since the first quarter of 2009-10, through the adverse effect on rural demand. The decline in credit card and consumer durables related credit also point to persistence of weak consumption demand.

II.3 Growth in government final consumption expenditure which had increased considerably in response to policy driven fiscal stimulus aimed at cushioning the impact of contraction in other sectors in 2008-09, registered a double digit growth in the first quarter of 2009-10, which though represents a deceleration over the previous two quarters.

II.4 In terms of share, the private final consumption expenditure decreased to 55.6 per cent from 58.0 per cent during the corresponding period of 2008-09 (Table 2.1).

Combined Budgeted Finances: 2009-10

II.5 An overview of the combined finances of the Central and State Governments budgeted for 2009-10 indicates that the key deficit indicators as per cent of GDP would remain at the elevated levels as in 2008-09 (Table 2.2). This increase in the combined deficits reflects the continuation of expansionary fiscal stance adopted by both the Central and State Governments to contain economic slowdown. Though the growth in total expenditure would moderate somewhat from the previous year, the non-developmental component is budgeted to increase substantially. The total expenditure as a per cent of GDP is thus slated to increase further. Growth in tax collections, on the other hand, would decelerate further on account of indirect tax cuts and the continued moderation in economic growth. As a result, the combined revenue receipts as a per cent of GDP is budgeted to decline in 2009-10 over 2008-09, even though the non-tax receipts as a percentage of GDP would increase to 4.2 per cent from 3.8 per cent.

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 RE	2.5 (2.6)	4.4 (4.6)	6.0 (6.2)	58.9
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. Figures in parentheses relate to provisional accounts.
3. Excludes issuances of special bonds to oil/FCI/fertiliser companies amounting to 0.8 per cent in 2007-08, 1.8 per cent of GDP in 2008-09 and 0.2 per cent in 2009-10.

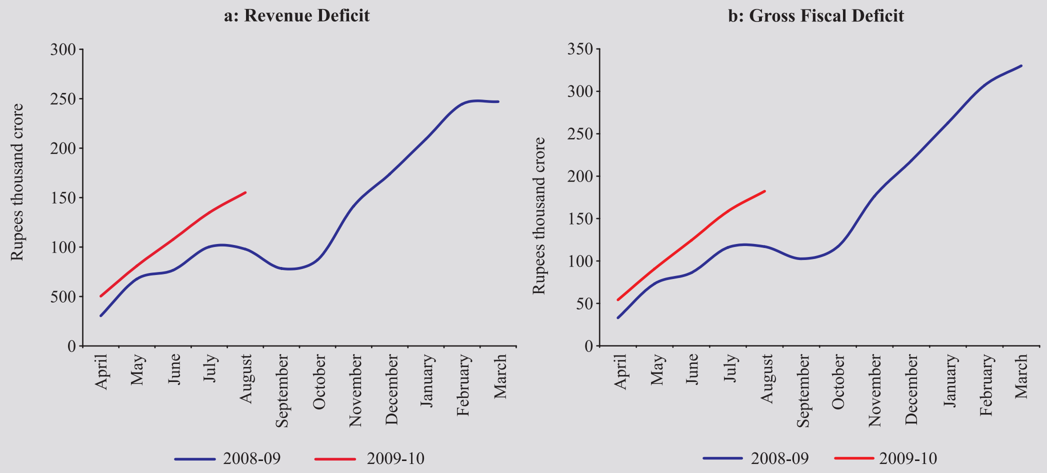
Consequently, the combined revenue deficit and fiscal deficit as percent of GDP in 2009-10 would increase by 1.1 and 1.3 percentage points to 5.5 per cent and 10.2 per cent, respectively.

Central Government Finances

II.6 Available information on Central Government finances for the first five months of 2009-10 (April-August) from the Controller General of Accounts indicates that both revenue deficit and gross fiscal deficit (GFD) were substantially higher, in absolute terms, than the corresponding period of previous year, but were lower as proportions of budget estimates (Chart II.2a and b and Table 2.3).

II.7 The pattern of Central Government finances during April-August 2009 showed that net tax revenue as a proportion of budget estimates was lower than in April-August 2008, due to a sharp decline in gross tax revenue in each of the five months, as against an increase in the corresponding period of the previous year. Reflecting the impact of economic slowdown, collections under direct taxes such as corporation tax and income tax decelerated to single digit growth in April-August 2009 as compared with significantly high growth registered during April-August 2008. While revenue from customs declined over the same period due to the sharp fall in imports, revenue from excise duties declined due to tax cuts and fall in domestic sales. Non-tax revenue

Chat II.2: Key Deficit Indicators of the Centre



registered a growth of nearly 40 per cent over the corresponding period of the previous year, with the transfer of surplus from the Reserve Bank accounting for about 50 per cent of the total non-tax revenue.

Despite the substantial increase in the growth of non-tax revenue, revenue receipts recorded a decline in April-August 2009 over the corresponding period of the preceding year.

Table 2.3: Central Government Finances during April-August 2009

Item	April-August (Rupees crore)		Percentages to Budget Estimates for		Growth Rate (Per cent)	
	2008	2009	2008-09	2009-10	2008-09	2009-10
1	2	3	4	5	6	7
1. Revenue Receipts	1,61,511	1,57,198	26.8	25.6	24.5	-2.7
i) Tax Revenue (Net)	1,25,436	1,06,837	24.7	22.5	26.2	-14.8
ii) Non-Tax Revenue	36,075	50,361	37.7	35.9	18.6	39.6
2. Non-Debt Capital Receipts	1,203	3,835	8.2	71.7	-69.5	–
3. Non-Plan Expenditure	1,92,962	2,45,275	38.0	35.3	18.0 *	27.1
of which :						
(i) Interest Payments	65,841	72,133	34.5	32.0	4.4	9.6
(ii) Defence	24,811	41,129	23.5	29.0	6.1	65.8
(iii) Major Subsidies	51,780	54,193	77.2	51.1	72.4	4.7
4. Plan Expenditure	86,642	98,048	35.6	30.2	19.8	13.2
5. Total Expenditure	2,79,604	3,43,323	37.2	33.6	18.6 *	22.8
6. Revenue Expenditure	2,59,390	3,12,283	39.4	34.8	19.2	20.4
7. Capital Expenditure	20,214	31,040	21.8	25.1	10.8 *	53.6
8. Revenue Deficit	97,879	1,55,085	177.4	54.9	11.4	58.4
9. Fiscal Deficit	1,16,890	1,82,290	87.7	45.5	14.5	56.0
10. Gross Primary Deficit	51,049	1,10,157	-88.8	62.8	30.6	–

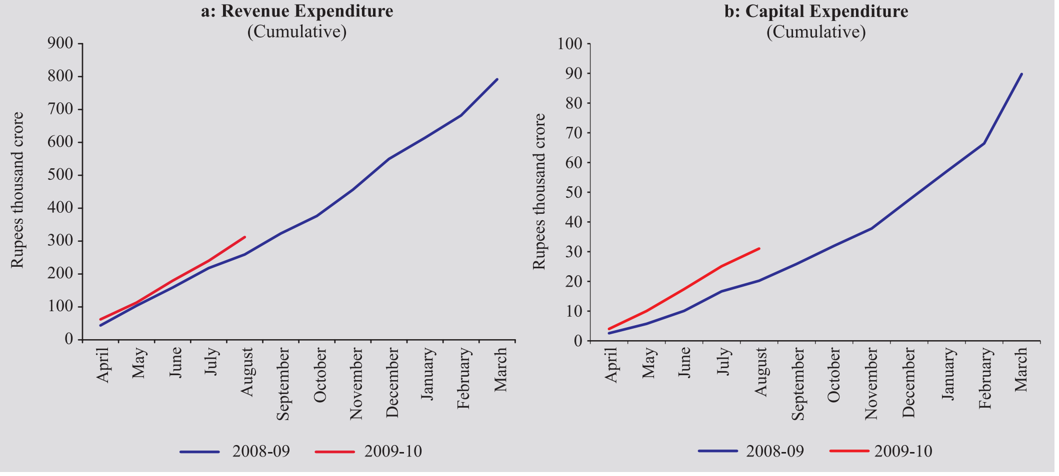
* : Growth rate is worked out after netting out acquisition cost of Reserve Bank's Stake in SBI in June 2007.
Source: Controller General of Accounts, Ministry of Finance, Government of India.

II.8 Revenue expenditure increased at a higher rate during April-August 2009 than during April-August 2008, mainly on account of higher expenditure on interest payments, food subsidies, defence revenue expenditure and pensions (Chart II.3a). While higher interest payments were mainly due to the large borrowing undertaken in 2008-09, increased salary payout under the Sixth Pay Commission Award raised the expenditure under defence and pensions. Total revenue expenditure as a proportion of budget estimates was, however, lower than the corresponding period of the previous year. Thus, revenue deficit during the first five months of 2009-10 was substantially lower at 54.9 per cent of budget estimates as compared with 177.4 per cent during the corresponding period of the previous year.

II.9 During April-August 2009, capital expenditure registered a high double-digit growth (Chart II.3b). While defence capital expenditure registered nearly a three-fold increase, non-defence capital outlay was high in railways. Aggregate expenditure during April-August 2009 accelerated over April-August 2008 but accounted for a lower share of budget estimates. GFD during the same period was 45.5 per cent of the budget estimates as compared with 87.7 per cent during April-August 2008. The Centre recorded a large gross primary deficit of 62.8 per cent of budget estimates during the first five months of 2009-10.

II.10 According to the latest available data, direct tax collections during the current financial year (up to end-September 2009) registered a growth of 3.7 per cent over the same period of last fiscal year. While corporate tax collections grew by 5.6 per cent, collections under personal income tax (including security transaction tax) increased by 0.38 per cent. Advance tax collections were reported to have been higher during the second quarter of 2009-10 than the preceding quarter of the year.

Chart II.3: Central Government Expenditure Patterns



State Finances: 2009-10[2]

II.11 The fiscal correction and consolidation witnessed till 2007-08 reversed somewhat during 2008-09 on account of the economic slowdown. The consolidated revenue account of the State Governments is budgeted to turn into deficit of 0.6 per cent of GDP during 2009-10, after being in surplus in the previous three years, due to the sluggishness in own tax collections and devolution from the Centre along with higher expenditure commitment to implement recommendations of the Sixth Pay Commission by many of the State Governments. As a result, GFD is budgeted to be higher at 3.4 per cent of GDP as compared with 2.7 per cent in 2008-09 (RE). The consolidated primary deficit is budgeted to increase to 1.4 per cent of GDP in 2009-10 from 0.7 per cent in 2008-09 (RE) (Table 2.2).

II.12 Keeping in view the need for spurring aggregate demand in the economy, the Central Government allowed the States to raise additional market borrowings of 0.5 per cent of Gross State Domestic Product (GSDP), thus increasing the limit of GFD to 4.0 per cent of GSDP during 2009-10 (3.5 per cent of GSDP during 2008-09). However, the aggregate expenditure of States at consolidated level is budgeted to rise by 12.2 per cent in 2009-10 (BE) as compared with 26.0 per cent during 2008-09 (RE).

Corporate Performance

II.13 An analysis of the performance of select non-financial non-government companies showed that the sales growth, that had been substantial in the first and second quarters of 2008-09, witnessed sharp deceleration post-September 2008 on account of falling demand and confidence. Sluggishness in demand and lower commodity prices affected sales growth, which turned negative in the first quarter of 2009-10 (Table 2.4). Despite a fall in revenues, corporates on an aggregate were able to improve their performance largely on account of higher profit margins, which, in turn, were driven primarily by lower input costs, significant deceleration in interest payments, lower foreign exchange related losses and high growth in non-core other income. Improved margins in the first quarter of 2009-10 also reflected the corporate sector's cost reduction initiatives in response to the slowdown in economic conditions that helped in controlling operating expenses. The subdued sales and improved profit performance in first quarter was also partly on account of base effects, as private corporate sector had posted around 7 per cent profit growth during the corresponding period last year, on the back of 29.3 per cent growth in sales.

II.14 In terms of sectoral breakdown, the slowdown in sales and profits performance for companies in manufacturing sector was more evident *vis-à-vis* those in information technology and other services sectors. The aggregate sales of manufacturing companies that had decelerated sharply in third quarter of 2008-09 in relation to increases in sales in first two quarters,

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

Table 2.4: Corporate Sector - Financial Performance

(Growth Rate/Ratios in per cent)

Item	2007-08	2008-09	2008-09				2009-10
			Q1	Q2	Q3	Q4	Q1
1	2	3	4	5	6	7	8
Sales	18.6	17.2	29.3	31.8	9.5	1.9	-0.9
Other Income*	62.2	6.6	-8.4	-0.6	-4.8	39.4	50.2
Expenditure	19.4	19.5	33.5	37.5	12.6	-0.5	-4.4
Depreciation provision	15.7	17.4	15.3	16.5	16.8	19.6	21.5
Gross profits	24.9	-4.2	11.9	8.7	-26.7	-8.8	5.8
Interest payments	29.4	57.3	58.1	85.3	62.9	36.5	3.7
Profits after tax	26.0	-18.4	6.9	-2.6	-53.4	-19.9	5.5
Select Ratios							
Change in Stock-in-trade to Sales	1.9	0.4	2.9	2.2	-1.7	-1.8	0.6
Gross Profits to Sales	14.9	13.3	14.5	13.5	11.0	13.7	15.7
Profits After Tax to Sales	9.8	8.1	9.7	8.6	5.3	8.1	10.2
Interest to Sales	2.5	3.1	2.4	2.9	3.8	3.2	2.8
Interest to Gross Profits	16.8	23.6	16.8	21.5	34.6	23.3	18.0
Interest coverage (Times)	5.8	4.2	6.0	4.6	2.9	4.3	5.6

* : Excludes extraordinary income/expenditure if reported explicitly.

Notes: 1. Data for 2007-08 is based on audited financial accounts; data for 2008-09 and 2009-10 are based on abridged financial results of the select non-government non-financial public limited companies.

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

witnessed a modest fall in the first quarter of 2009-10, reflecting sluggishness in product prices and subdued demand growth. The net profit margin, measured as net income to sales ratio, which was the lowest for manufacturing sector and had declined to less than 5.0 per cent in the third quarter of 2008-09, recovered to 9.2 per cent in the first quarter of 2009-10, as operating conditions improved and interest outflow decelerated considerably. In comparison, companies in services sector more or less maintained profit margins despite the sales deceleration in the first quarter of 2009-10.

II.15 Select non-financial listed government (oil and non-oil) companies recorded 20.1 per cent rise in net profits despite 24.3 per cent decline in sales in the first quarter of 2009-10. The overall performance was driven by the performance of oil companies, for which the net profit margin improved considerably due to fall in interest payments, raw material and staff costs, on the one hand and sizeable rise in other income, on the other. The operating margin for non-oil government companies, however, declined as expenditure outpaced sales.

External Demand

II.16 External demand continued to remain adverse on account of the global recession and decline in world trade volume, notwithstanding the recent signs of recovery. In the first quarter of 2009-10, India's imports of goods and services contracted faster than exports, and as a result net exports, which had negative contribution to GDP in the previous quarters, turned positive (Table 2.1). Information on net exports beyond the first quarter of 2009-10 could be partially inferred from the behavior of merchandise trade. Merchandise trade deficit during April-August 2009 stood at US $ 38.2 billion, which was lower by 37.1 per cent than US $ 60.7 billion in April-August 2008, due to relatively larger year-on-year decline in imports than exports during the period. A detailed discussion on the external demand conditions is set out in Chapter III.

II.17 On balance, aggregate demand continues to remain weak, notwithstanding the role of policy stimulus in providing support to private demand. Growth in private consumption demand decelerated so sharply during the first quarter of 2009-10 that it could be reasonable to expect considerable revival from that level in subsequent quarters. Consumption could also be expected to improve in the current fiscal year on account of continuation of the expansionary fiscal policy, particularly higher expenditure under the National Rural Employment Guarantee Scheme (NREGS) and disbursement of remaining arrears of Sixth Pay Commission award which could stimulate private consumption. The drought could adversely affect agricultural income and hence rural spending but higher minimum support price announced by the Government in August 2009 could help in moderating any deceleration in rural demand. Investment demand could pick up in the near term with a lag, in line with the improved domestic business sentiments, favourable domestic capital market conditions, signs of revival in global capital markets and reduced risk premia.

III. THE EXTERNAL ECONOMY

The adverse impact of the global crisis operating through the trade channel continued to depress India's trade transactions in 2009-10. In the first five months of 2009-10, merchandise exports and imports declined by 31.0 per cent and 33.4 per cent (year-on-year), respectively. In India's balance of payments for the first quarter of 2009-10, while exports declined, imports increased over the preceding quarter, reflecting the increase in oil prices. As a result, the balance of payments witnessed a higher trade deficit over the preceding quarter. Surplus in net invisibles, led by buoyant remittances, financed about 78 per cent of the trade deficit. The current account, as a result, remained in deficit of US$ 5.8 billion. Return of capital inflows after the phase of net outflows experienced during the last two quarters of 2008-09, however, ensured the financing of the deficit without any loss of reserves. Including valuation gains and the SDRs allocated to India by the IMF, India's foreign exchange reserves increased by US$ 32.8 billion during 2009-10 to US$ 284.8 billion as on October 16, 2009.

III.1 The external economic environment improved in the recent months with emerging signs of recovery from the global recession, though recession like conditions still persist and the outlook for the global economy points to a slow paced recovery. The balance of payments transactions of the countries, which were severely disrupted by the crisis induced shocks to every important channel of globalisation, are yet to recover to normal levels. India's balance of payments had exhibited resilience to the channels of contagion, which is evident from a current account deficit of 2.6 per cent of GDP and a reserve loss (net of valuation) of US$ 20.1 billion during 2008-09. In 2009-10, while the year-on-year decline in exports and imports continued, remittance related inflows remained buoyant and return of capital inflows has also reversed the pattern that was experienced in the capital account during the last two quarters of 2008-09.

International Developments

III.2 The global economy exhibited early signs of end of the recession with several advanced economies recording modest positive growth in the second quarter of 2008-09, while the pace of contraction in output declining significantly in others. The pace of global recovery, however, continues to be uncertain, given the fact that the recovery is still gaining support from the unprecedented stimulus measures amidst persisting stress in the financial systems of advanced economies. After successive rounds of downward revisions to the 2009 growth outlook from 3.9 per cent in July 2008 to -1.4 per cent in July 2009, the IMF for the first time, revised the growth outlook upwards to -1.1 per cent in October 2009. China and India are expected to lead the global recovery.

III.3 Following a contraction in the last quarter of 2008 and the first quarter of 2009, global growth turned positive in the second quarter of 2009 bolstered by the strong performance of the Asian economies and stabilisation in other regions. Different economies are at differing points of the cycle. Although advanced economies continue to be in recession with a growth forecast of -3.4 per cent, the emerging and developing economies are forecast to grow by 1.7 per cent during 2009 (Table 3.1). Emerging Asia is leading the global rebound, with significant acceleration in growth in the second quarter in China, Hong Kong, Singapore and South Korea. In China, GDP growth is estimated to have further accelerated to 8.9 per cent in the third quarter, supported by the substantial fiscal stimulus and rapid increase in bank lending. GDP growth in other Asian emerging-market economies has also strongly recovered, partly in response to policy stimulus.

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 (3.8)**	**3.0 (1.8)**	**-1.1 (-2.3)**	**3.1 (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.

III.4 Going forward, the global economy is expected to make a modest recovery in 2010. In October 2009, the IMF revised its growth forecast for world output for 2010 upwards to 3.1 per cent from 2.9 per cent forecast in July 2009. The recovery is, however, expected to be slow and there are concerns about the prospect of long-term damage to the potential growth path of the world economy.

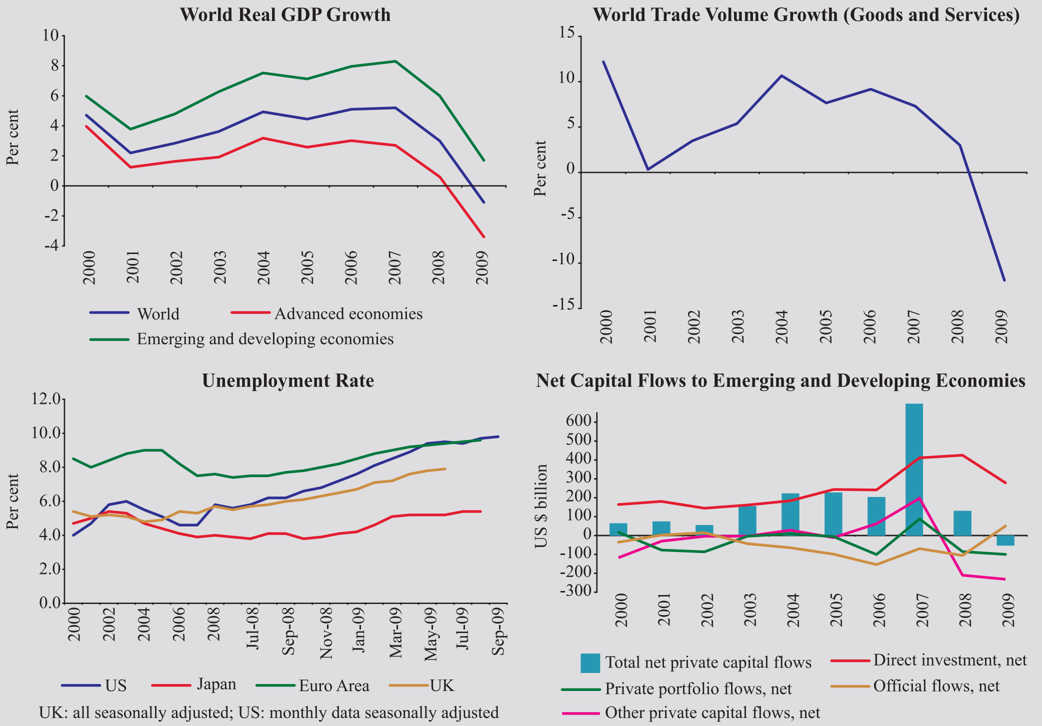
III.5 Although global economic prospects continue to be uncertain, the risks to global activity are overall viewed to be broadly balanced. On the positive side, inventories appear to be leaner, world trade seems to be stabilising and capital flows are returning to the emerging world. There are, however, many challenges on the road to a sustained global recovery. An important concern is rising unemployment and associated sluggish consumer spending.

III.6 A critical and complex issue that will have a bearing on the global recovery relates to appropriate timing and pace of exit from the current unprecedented levels of expansionary macroeconomic policies. While early reversal of easy monetary policy may thwart the incipient recovery, delaying the exit can potentially fuel inflation and inflationary expectations. That, in turn, would push up interest rates, which would militate against sustained growth. Different timings of the exit from accommodative monetary policy in different countries would result in interest rate differentials, with the resultant effects on capital flows and exchange rates, which may have to be managed prudently in emerging markets to contain the adverse implications for growth and inflation.

III.7 The OECD Economic Outlook (September 2009) points to a recovery earlier than what was envisaged a few months ago. There has been a marked improvement in the overall financial conditions, though bank lending continues to decline and concerns about the health of the banking system remain. The inventory adjustment underway appears to have progressed and augurs well for the growth in the near-term. Similarly, decline in global trade appears to have reached a trough, with exports in the second quarter showing positive growth over the first quarter of 2009. The pace of the recovery, however, is likely to remain modest for some time to come as ample spare capacity, low levels of profitability, high and rising unemployment, anaemic growth in labour income and ongoing housing market corrections will dampen any upturn in private demand.

III.8 The global financial crisis had affected the world economy through various channels. In addition to the growth slowdown and trade contraction worldwide, which was a common shock for all the countries, the advanced economies were affected by rising unemployment, which lowered the demand, while the emerging market economies (EMEs) experienced significant reversal in capital flows that affected their markets and the growth outlook. Unemployment rates in advanced economies continue to be high, even though EMEs have started to experience return of capital flows (Chart III.1).

Chart III.1: Key Global Indicators



III.9 World merchandise exports started declining from November 2008 as a result of depressed world economic activity under the impact of global economic crisis. The decline in world exports accelerated over successive months during 2009. Subsequently, however, world exports came to show an improvement in June 2009, with the year-on-year decline being the smallest (26.9 per cent) in 2009 so far. According to the IMF's International Financial Statistics, world merchandise exports (in dollar terms) showed a sharp decline of 29.5 per cent during January-June 2009, as against a growth of 25.9 per cent a year ago (Table 3.2). During the same period, exports of advanced economies witnessed an even sharper negative growth of 31.1

Table 3.2: Growth in Exports - Global Scenario

(Per cent)

Region/Country	2007	2008	2008	2009
	January-December		January-June	
1	2	3	4	5
World	**14.1**	**16.2**	**25.9**	**-29.5**
Advanced Economies	**13.5**	**11.0**	**21.6**	**-31.1**
US	12.0	11.9	18.0	-23.8
France	12.8	10.0	22.5	-32.0
Germany	18.0	10.6	23.6	-33.4
Japan	7.8	12.3	23.2	-37.9
Emerging and Developing Economies	**15.1**	**25.6**	**34.1**	**-27.6**
Singapore	10.1	13.0	23.8	-31.7
China	25.6	17.3	21.8	-21.7
India	23.3	20.0	39.8 *	-25.6 *
Indonesia	14.7	24.4	27.8	-28.3
Korea	14.1	13.6	20.4	-22.7
Malaysia	9.6	19.1	24.2	-31.2
Thailand	17.0	12.9	25.0	-23.4

*: Pertains to January-August over the corresponding period of previous year.

Source: 1. IMF (www.imfstatistics.org)
2. DGCI&S for India.

per cent in contrast with a growth of 21.6 per cent a year back. According to the WTO, world merchandise exports increased by about 8 per cent in the second quarter of 2009 over the preceding quarter, though year-on-year growth continued to decline by 33.0 per cent.

Merchandise Trade

Exports

III.10 In India, the decline in exports, which began in October 2008 as an impact of the global economic crisis through the trade channel, continued in 2009-10. The rate of decline in exports peaked in April 2009, before moderating somewhat during the subsequent months (Chart III.2). Overall, India's merchandise exports during the first five months of 2009-10 (April-August 2009) posted a decline of 31.0 per cent, as against a high growth of 52.3 per cent during the same period last year.

III.11 The composition of India's export basket during 2008-09 suggests that the manufactured goods account for the largest share in total exports at 67.2 per cent, followed by petroleum and primary products. During 2008-09, the exports of major commodity groups slowed down, that of gems and jewellery exhibited substantial acceleration, while engineering goods displayed a marginal improvement in growth (Table 3.3).

III.12 Destination-wise, developing and OECD countries were the major markets for India's exports during 2008-09 with each group accounting for over 37.0 per cent of share in total exports followed by the OPEC (21.2 per cent). Country-wise, the UAE became the single largest export destination for India in 2008-09, replacing thereby the US, which had remained India's largest export market for a number of years. Overall, the direction of India's exports during 2008-09 indicated that the exports

Chart III.2: India's Merchandise Trade

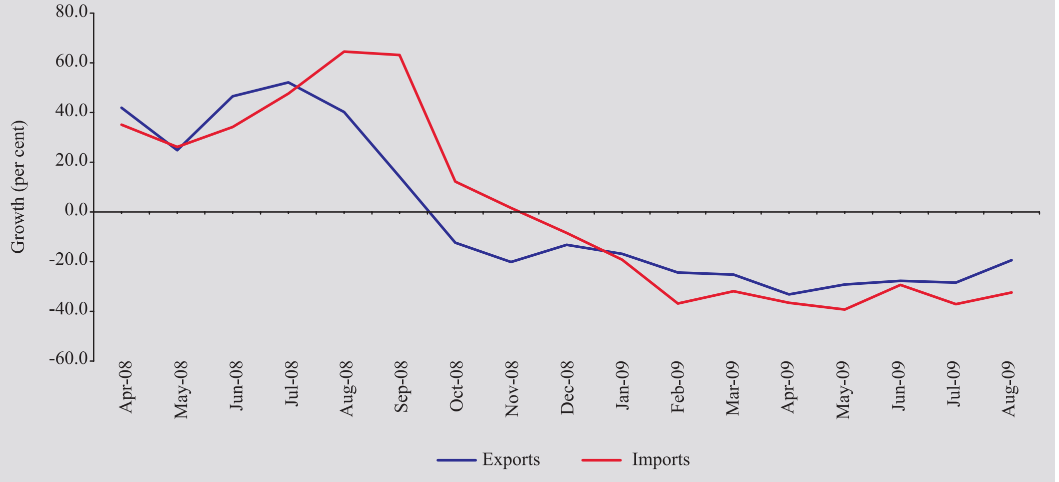


Table 3.3: Exports of Principal Commodities

Commodity/Group	US $ billion			Variation (Per cent)	
	2006-07	2007-08R	2008-09P	2007-08	2008-09
	April-March			April-March	
1	2	3	4	5	6
1. Primary Products	**19.7**	**27.6**	**25.3**	**40.0**	**-8.1**
of which:					
a) Agriculture and Allied Products	12.7	18.4	17.5	45.3	-4.9
b) Ores and Minerals	7.0	9.1	7.8	30.2	-14.5
2. Manufactured Goods	**84.9**	**103.0**	**122.8**	**21.3**	**19.3**
of which:					
a) Chemicals and Related Products	17.3	21.2	22.6	22.3	6.8
b) Engineering Goods	29.6	37.4	47.3	26.4	26.5
c) Textiles and Textile Products	17.4	19.4	20.0	11.8	3.0
d) Gems and Jewellery	16.0	19.7	27.7	23.2	40.8
3. Petroleum Products	**18.6**	**28.4**	**26.8**	**52.2**	**-5.4**
4. Total Exports	**126.4**	**162.9**	**182.6**	**28.9**	**12.1**
Memo:					
Non-oil Exports	107.8	134.5	155.8	24.8	15.8

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

to Asian developing countries declined; exports growth to EU and North America decelerated, while exports to OPEC showed accelerated growth (Table 3.4).

Table 3.4: Direction of India's Exports

Group/Country	US $ billion			Variation (Per cent)	
	2006-07	2007-08R	2008-09P	2007-08	2008-09
	April-March			April-March	
1	2	3	4	5	6
1. OECD Countries	**53.1**	**64.3**	**68.3**	**21.1**	**6.2**
of which:					
a) EU	26.8	34.5	39.0	28.7	12.9
b) North America	20.0	22.0	22.2	10.0	0.9
US	18.9	20.7	20.8	9.8	0.5
2. OPEC	**21.0**	**27.0**	**38.8**	**28.8**	**43.8**
of which:					
UAE	12.0	15.6	23.9	29.9	53.1
3. Developing Countries	**50.4**	**69.2**	**68.6**	**37.2**	**-0.8**
of which:					
Asia	37.6	51.5	51.4	36.9	-0.2
People’s Republic of China	8.3	10.8	9.3	30.6	-14.3
Singapore	6.1	7.4	8.2	21.4	11.4
4. Total Exports	**126.4**	**162.9**	**182.6**	**28.9**	**12.1**

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

Imports

III.13 The phase of deceleration in imports, which prevailed during October-November 2008, turned negative thereafter with the rate of fall in imports progressively increasing and reaching a peak in May 2009 (39.2 per cent). Although the rate of fall in imports moderated considerably during June 2009, it again accelerated in July 2009. The decline in imports, however, during August 2009 was lower than that in July 2009. During April-August 2009, imports registered a decline of 33.4 per cent in contrast with a growth of 52.1 per cent a year ago and the decline was seen in both POL and non-POL imports. The decline in imports witnessed in the last nine consecutive months was mainly an outcome of lower international crude oil prices and slowdown in domestic economic activity, apart from the high base effect.

III.14 Commodity-wise imports indicated that growth of POL imports showed a deceleration (14.6 per cent) during 2008-09 from the level a year ago (39.9 per cent), mainly due to sharp reduction in international crude oil prices since August 2008, as also due to slowdown in the growth of volume of POL imports (Chart III.3). Growth in non-POL imports also witnessed moderation (16.5 per cent) from the previous year's level (33.4 per cent), with deceleration mainly emanating from the imports of capital goods, gold and silver, and iron and steel. Imports of pearls, precious and semi-precious stones, however, grew considerably during the year (Table 3.5).

III.15 Source-wise, developing countries occupied the highest share in India's imports (32.9 per cent), followed by OPEC and OECD countries during 2008-09. This was in contrast with 2007-08 when OECD countries had the highest share in India's imports. Country-wise, China continued to be the single largest source of imports followed by the UAE, Saudi Arabia, the US, Iran and Germany.

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

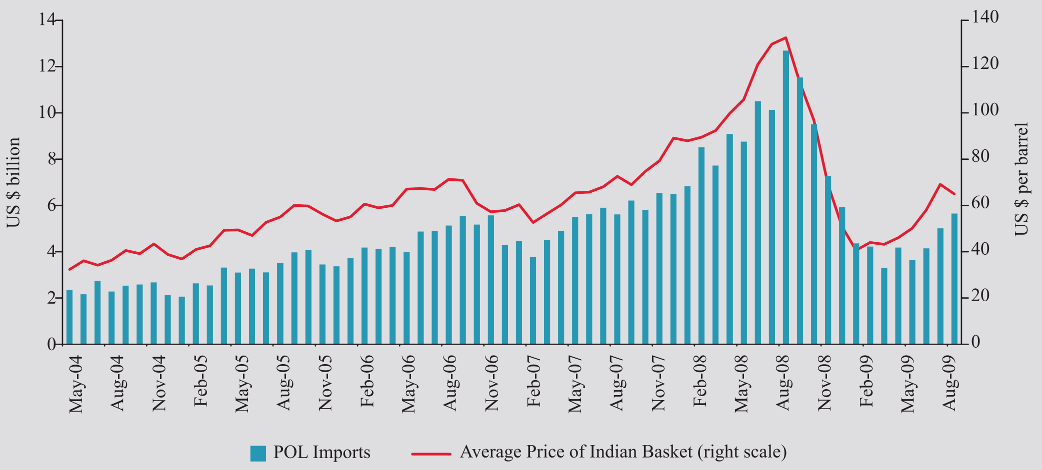


Table 3.5: Imports of Principal Commodities

Commodity/Group	US $ billion			Variation (Per cent)	
	2006-07	2007-08R	2008-09P	2007-08	2008-09
	April-March			April-March	
1	2	3	4	5	6
Petroleum, Petroleum Products and Related Material	56.9	79.6	91.3	39.9	14.6
Edible Oil	2.1	2.6	3.4	21.4	34.4
Iron and Steel	6.4	8.7	9.4	35.2	7.8
Capital Goods	47.1	70.1	70.5	49.0	0.6
Pearls, Precious and Semi-Precious Stones	7.5	8.0	14.4	6.5	81.1
Chemicals	7.8	9.9	12.2	26.4	22.8
Gold and Silver	14.6	17.9	18.7	22.0	4.6
Total Imports	**185.7**	**251.4**	**291.5**	**35.4**	**15.9**
Memo:					
Non-oil Imports	128.8	171.8	200.2	33.4	16.5
Non-oil Imports excluding Gold and Silver	114.1	153.9	181.5	34.9	17.9
Mainly Industrial Inputs*	104.8	140.9	160.3	34.4	13.8

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

III.16 India's merchandise trade deficit witnessed an increase from 7.5 per cent of GDP in 2007-08 to 9.4 per cent in 2008-09. During April-August 2009, merchandise trade deficit declined over the corresponding period of previous year, reflecting relatively larger decline in imports than exports (Table 3.6).

Table 3.6: India's Merchandise Trade

(US $ billion)

Item	2008-09R	2008-09R	2009-10P
		April-August	
1	2	3	4
Exports	182.6	93.0	64.1
Oil	26.8	16.0	..
Non-oil	155.8	77.0	..
Imports	291.5	153.7	102.3
Oil	91.3	53.7	28.3
Non-oil	200.2	99.9	74.0
Trade Balance	-108.8	-60.7	-38.2
Non-Oil Trade Balance	-44.4	-23.0	..
			Variation (per cent)
Exports	12.1	52.3	-31.0
Oil	-5.4	50.8	..
Non-oil	15.8	52.6	..
Imports	15.9	52.1	-33.4
Oil	14.6	86.6	-47.4
Non-oil	16.5	38.4	-25.9

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

Balance of Payments (BoP)

Current Account

III.17 The combined impact of synchronised global economic recession and deceleration in world trade witnessed since the second half of 2008-09 continued to affect the transactions in India's current account during the first quarter of 2009-10. The decline in exports observed since October 2008 persisted during the first quarter of 2009-10. On a BoP basis, India's merchandise exports recorded a decline of 21.0 per cent during April-June 2009 as against a high growth of 43.0 per cent during April-June 2008. Similarly, the trend of negative import growth that surfaced during the fourth quarter of 2008-09 after a gap of almost seven years, continued in the first quarter of 2009-10. Imports declined by 19.6 per cent during the first quarter of 2009-10 as against a positive growth of 42.9 per cent during the corresponding period a year ago – mainly due to lower oil import bill. However, as compared to the last quarter of 2008-09, exports during the first quarter of 2009-10 declined, while imports recorded an increase reflecting the increase in oil prices. As a result, there was a higher trade deficit (US$ 26.0 billion) during the first quarter of 2009-10 over the preceding quarter, although it was lower than the deficit observed during the first quarter of 2008-09 (Table 3.7).

Invisibles

III.18 Manifesting the impact of continuing global recession, the gross invisibles receipts registered a marginal decline, while invisibles payments recorded a positive growth during the first quarter of 2009-10 (Table 3.8). The decline in invisibles receipts during the quarter was on account of a decline in almost all the

Table 3.7: India's Balance of Payments

(US $ billion)

Item	April-March		2008-09				2009-10
	2007-08 PR	2008-09 P	Apr-Jun PR	Jul-Sep PR	Oct-Dec PR	Jan-Mar P	Apr-Jun P
1	2	3	4	5	6	7	8
1. Exports	166.2	175.2	49.1	49.0	37.3	39.8	38.8
2. Imports	257.8	294.6	80.5	87.7	72.0	54.4	64.8
3. Trade Balance (1-2)	-91.6	-119.4	-31.4	-38.7	-34.7	-14.6	-26.0
4. Net Invisibles	74.6	89.6	22.4	26.2	21.7	19.3	20.2
5. Current Account Balance (3+4)	-17.0	-29.8	-9.0	-12.5	-13.0	4.7	-5.8
6. Gross Capital Inflows	433.0	302.5	90.9	85.0	69.5	57.1	78.5
7. Gross Capital Outflows	325.0	293.3	79.7	77.5	73.7	62.4	71.8
8. Net Capital Account (6-7)	108.0	9.1	11.1	7.6	-4.3	-5.3	6.7
9. Overall Balance (5+8)#	92.2	-20.1	2.2	-4.7	-17.9	0.3	0.1
Memo:							
i. Export growth (%)	28.9	5.4	43.0	28.0	-9.1	-24.2	-21.0
ii. Import growth (%)	35.2	14.3	42.9	47.3	7.3	-27.3	-19.6
iii. Trade balance (as a % of GDP)	-7.8	-10.3					
iv. Invisible receipts growth (%)	29.7	9.4	30.3	34.3	1.8	-16.6	-0.7
v. Invisibles payments growth (%)	18.7	-1.4	13.5	14.4	3.1	-24.7	11.9
vi. CAD as a % of GDP	1.5	2.6					
vii. Foreign Exchange Reserves (as at end of the period)	309.7	252.0	312.1	286.3	256.0	252.0	265.1

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

Table 3.8: Invisibles Gross Receipts and Payments

(US $ billion)

Item	Invisibles Receipts			Invisibles Payments		
	April-March	April-June		April-March	April-June	
	2008-09(P)	2008-09(PR)	2009-10 (P)	2008-09(P)	2008-09(PR)	2009-10(P)
1	2	3	4	5	6	7
1. Travel	10.9	2.5	2.3	9.4	2.2	2.0
2. Transportation	11.1	2.6	2.5	12.8	3.3	2.8
3. Insurance	1.4	0.4	0.4	1.1	0.2	0.3
4. Govt. not included elsewhere	0.4	0.1	0.1	0.8	0.1	0.1
5. Miscellaneous	77.5	17.5	17.1	27.3	5.6	8.2
Of which:						
Software	47.0	12.2	10.8	2.8	0.9	0.4
Non-Software	30.5	5.3	6.4	24.5	4.8	7.8
6. Transfers	47.0	12.3	13.3	2.7	0.7	0.5
Of which						
Private Transfers	46.4	12.2	13.3	2.3	0.5	0.4
7. Income	14.3	3.6	3.0	18.8	4.4	4.7
Investment Income	13.5	3.4	2.7	17.5	4.1	4.4
Compensation of Employees	0.8	0.2	0.2	1.3	0.3	0.3
Total (1 to 7)	**162.6**	**38.9**	**38.7**	**73.0**	**16.5**	**18.5**

P : Preliminary. PR : Partially Revised.

categories of services except insurance and financial services, and a sharp decline in investment income receipts (20.3 per cent) mainly due to lower interest rates prevailing in other countries. Although exports of software services registered a decline during the first quarter, they are projected (by NASSCOM) to grow by 4 to 7 per cent during the financial year 2009-10. Private transfer receipts, comprising mainly remittances from Indians working overseas and local withdrawals from NRI Rupee deposits increased during the first quarter of 2009-10. A positive growth observed in invisibles payments during the quarter was mainly due to a higher growth in payments under non-software services such as business and financial services and the income account. Investment income payments increased marginally owing to increased reinvested earnings of FDI companies in India.

III.19 Although, net invisibles (invisibles receipts *minus* invisibles payments) were marginally lower during the first quarter of 2009-10 than that in the corresponding period of the previous year, the invisibles surplus financed about 77.7 per cent of the trade deficit during the first quarter of 2009-10 (71.3 per cent during the first quarter of 2008-09). Despite net invisibles surplus, the large trade deficit mainly on account of decline in exports and increase in imports over the preceding quarter led to a current account deficit of US$ 5.8 billion during the first quarter of 2009-10 as against US$ 9.0 billion during the first quarter of 2008-09. During 2008-09, current account deficit as a per cent of GDP stood at 2.6 per cent, higher than 1.5 per cent a year ago (Chart III.4).

Capital Account

III.20 During the first quarter of 2009-10, capital account witnessed a revival after undergoing a sustained pressure since the third quarter of 2008-09, on the back of massive deleveraging in the advanced financial markets. With the revival in capital inflows to India, particularly foreign investments, the capital account showed a turnaround from a negative balance in the last two quarters of 2008-09 to a positive balance of US$ 6.7 billion during the first quarter of 2009-10 (Table 3.9).

III.21 Component-wise, net inward FDI into India remained buoyant during April-June of 2009-10, reflecting relatively better investment climate in India and the continuing liberalisation measures to attract FDI. During the first quarter of 2009-10, manufacturing sector continued to attract most part of FDI (19.2 per cent), followed by real estate activities (15.6 per cent) and financial services (15.4 per cent).

III.22 Portfolio investment, primarily comprising foreign institutional investors' (FIIs) investments and American Depository Receipts (ADRs)/Global Depository Receipts (GDRs) witnessed a sharp turnaround from net outflows in the fourth quarter of 2008-09 to net inflows during the first quarter of 2009-10. During 2009-10, the sharp increase in FII inflows could be attributed mainly to the recovery in domestic stock markets following the international trends and comparatively better growth prospects in India. Net inflows under ADRs/GDRs were significantly lower during the first quarter of 2009-10 as compared to the coresponding quarter of the previous year, reflecting continued

Chart III.4: Current Account Balance and Capital Flows

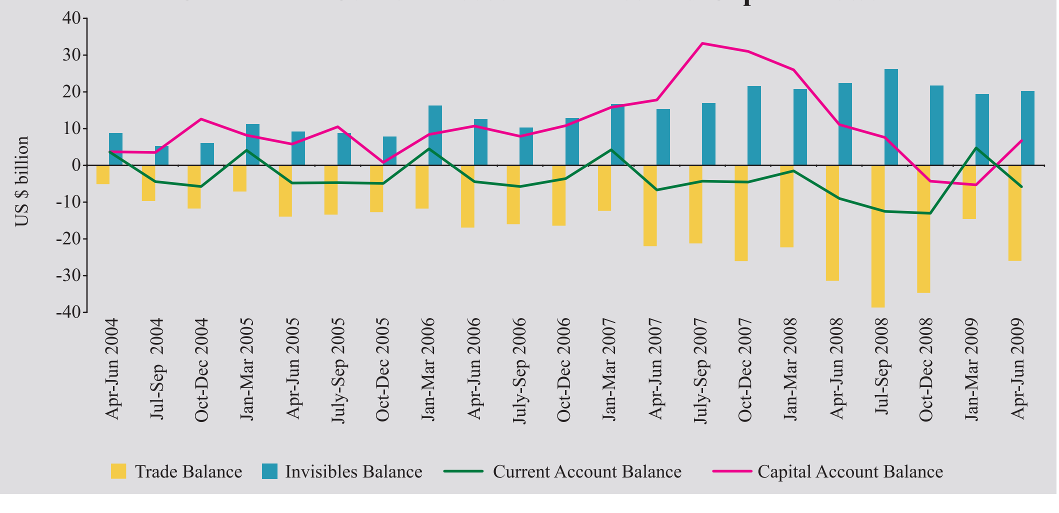


Table 3.9: Net Capital Flows

(US $ billion)

Item	2008-09 April-March P	2008-09 Apr-Jun PR	Jul-Sep PR	Oct-Dec PR	Jan-Mar P	2009-10 Apr-Jun P
1	2	3	4	5	6	7
1. Foreign Direct Investment (FDI)	17.5	9.0	4.9	0.4	3.2	6.8
Inward FDI	35.0	11.9	8.8	6.3	8.0	9.5
Outward FDI	17.5	2.9	3.9	5.9	4.8	2.6
2. Portfolio Investment	-14.0	-4.2	-1.3	-5.8	-2.7	8.3
Of which:						
FIIs	-15.0	-5.2	-1.4	-5.8	-2.6	8.2
ADR/GDRs	1.2	1.0	0.1	0.0	0.02	0.04
3. External Assistance	2.6	0.4	0.5	1.0	0.8	0.08
4. External Commercial Borrowings	8.2	1.5	1.7	3.9	1.1	-0.4
5. NRI Deposits	4.3	0.8	0.3	1.0	2.2	1.8
6. Banking Capital excluding NRI Deposits	-7.7	1.9	1.9	-6.0	-5.4	-5.2
7. Short-term Trade Credit	-5.8	2.4	1.3	-4.0	-5.5	-3.1
8. Rupee Debt Service	-0.1	-0.03	-	-	-0.07	-0.02
9. Other Capital	4.1	-0.5	-1.6	5.2	1.1	-1.6
Total (1 to 9)	**9.1**	**11.1**	**7.6**	**-4.3**	**-5.3**	**6.7**

P: Preliminary. PR: Partially Revised.

tightness in liquidity in the overseas markets. The net ECBs recorded an outflow during the first quarter of 2009-10 as against net inflows during the first quarter of 2008-09. Banking capital mainly consists of foreign assets and liabilities of commercial banks. NRI deposits constitute major part of the foreign liabilities. Net Banking capital, including NRI deposits also were negative during the first quarter of 2009-10 as against a positive net inflow witnessed during the first quarter of 2008-09.

III.23 During April-June 2009, the disbursement under short-term trade credit continued to remain steady on the back of various policy measures undertaken such as hike in the all-in-cost ceilings for trade credit of various maturities that was necessary in the context of hardening of cost of funds in the international markets. The repayments were, however, somewhat higher than the comparable period of the previous year. It is expected that the current trend in disbursement of short-term trade credit will continue.

III.24 The latest available information on certain indicators of the capital account indicates a revival in capital flows to India (Table 3.10). This could be attributed to relatively better macroeconomic performance of India during 2008-09 and positive sentiments of global investors about the growth potential of EMEs, including India.

Table 3.10: Capital Flows in 2009-10 so far

(US $ billion)

Component	Period	2008-09	2009-10
1	2	3	4
FDI to India	April-August	16.5	16.2
FIIs (net)	April-October *	-9.5	18.4
ADRs/GDRs	April-September	1.1	2.6
ECB Approvals	April-September	10.2	7.1
NRI Deposits (net)	April-September	1.1	2.7

* : Up to October 16, 2009.
FDI : Foreign Direct Investment.
FII : Foreign Institutional Investors' Investment.
ECB : External Commercial Borrowings.
NRI : Non Resident Indians.
ADR : American Depository Receipts
GDR : Global Depository Receipts.

Foreign Exchange Reserves

III.25 The foreign exchange reserves on BoP basis (*i.e.*, excluding valuation) increased by US$ 0.1 billion during the first quarter of 2009-10 as compared with an increase of US$ 2.2 billion during the corresponding quarter of 2008-09. Taking into account the valuation gain due to depreciation of the US dollar against the major currencies, the foreign exchange reserves increased by US$ 13.2 billion during April-June 2009 as compared with an increase of US$ 2.4 billion during April-June 2008 (Chart III.5).

III.26 As on October 16, 2009, India's foreign exchange reserves stood at US$ 284.8 billion, which is higher by US$ 32.8 billion over end-March 2009 level (US$ 252.0 billion). The increase in foreign exchange reserves during this period also includes the SDRs allocation made by the IMF in two consecutive tranches on August 28, 2009 and September 9, 2009, respectively (Table 3.11).

External Debt

III.27 India's external debt was placed at US$ 227.7 billion at the end of June 2009 as compared to US$ 224.0 billion as at the end of March 2009. The increase in the external debt by 1.7 per cent during this

Chart III.5: India's Foreign Exchange Reserves

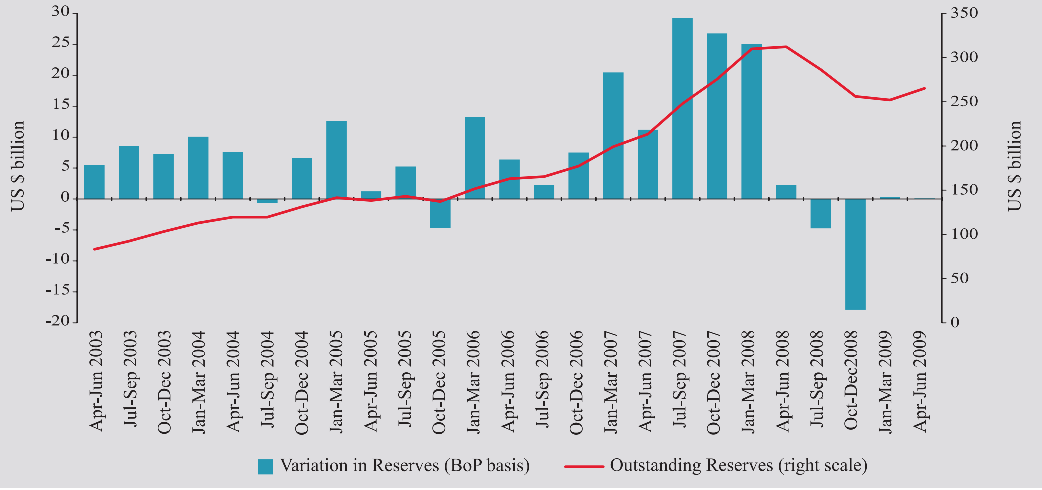


Table 3.11: India's Foreign Exchange Reserves

(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	–
October 2009#	10,316	5,250	267,898	1,372	284,836	–

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

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

: As on October 16, 2009. – : Not available.

period was mainly due to the increase in long term external debt, particularly Non-Resident Indian (NRI) deposits (Table 3.12). Short-term debt, however, declined by US$ 3.0 billion during the same period mainly on account of decline in short-term trade credit (up to 6 months). Accordingly, the ratio of short-term to total debt declined to 17.8 per cent from 19.5 per cent during the same period. The ratio of external debt to GDP increased to 21.4 per cent as at end-March 2009 from 18.9 per cent as at end-March 2008. The debt service ratio declined steadily during the last three years and stood at 4.6 per cent as at end-March 2009. The debt service ratio for April-June 2009 worked out to 5.5 per cent.

III.28 Based on the measure of residual maturity of the outstanding debt - an indicator for assessing the debt service liability in the short-run - the revised short-term debt (below one year) as at end-March 2009 was estimated at around US$ 87.5 billion, which would become due for repayment during 2009-10. This includes short-term debt based on original maturity at US$ 43.6 billion and long term external debt due for payments within one year of US$ 43.9 billion. Out of these US$ 43.9

Table 3.12: India's External Debt

(US $ billion)

Item	End-March 2008	End-March 2009 PR	End-June 2009 P	Variation (June 2009 over March 2009)	
				Amount	Per cent
1	2	3	4	5	6
1. Multilateral	39.5	39.5	41.2	1.7	4.3
2. Bilateral	19.7	20.6	21.4	0.8	3.9
3. International Monetary Fund	0	0	0	0.0	0
4. Trade Credit (above 1 year)	10.4	14.6	15.1	0.4	2.9
5. External Commercial Borrowings	62.3	62.5	63.2	0.6	1.0
6. NRI Deposit	43.7	41.6	44.6	3.0	7.3
7. Rupee Debt	2.0	1.5	1.6	0.1	5.2
8. Long-term (1 to 7)	177.6	180.4	187.1	6.7	3.7
9. Short-term	45.7	43.6	40.6	-3.0	-6.8
Total (8+9)	**223.3**	**224.0**	**227.7**	**3.7**	**1.7**
Memo:					(Per cent)
Total Debt /GDP	18.9	21.4	–		
Short-term Debt/Total Debt	20.5	19.5	17.8		
Short-term Debt/Reserves	14.8	17.3	15.3		
Concessional Debt/Total Debt	19.8	18.7	19.0		
Reserves/Total Debt	138.7	112.5	116.5		
Debt Service Ratio	4.8	4.6	5.5		

P: Provisional. PR: Partially Revised.

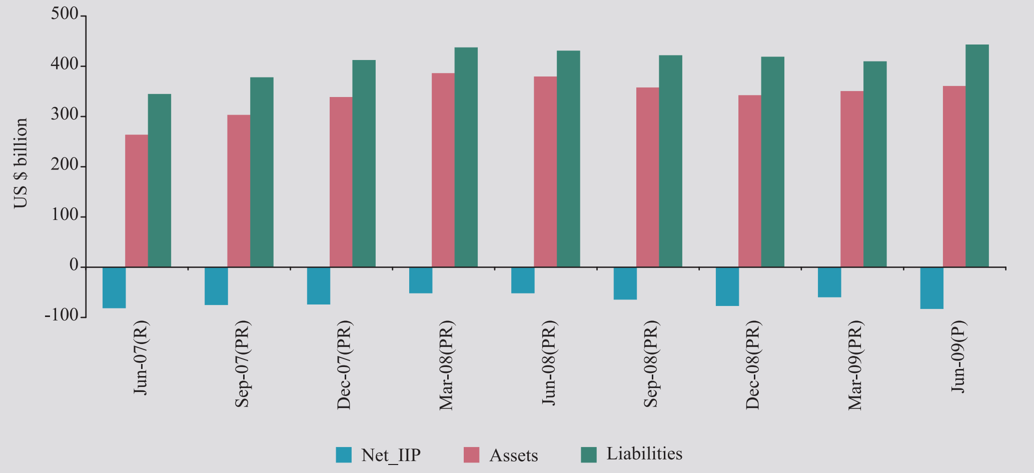
billion, the NRI deposits constitute US$ 32.1 billion. The bulk of NRI deposits (around 70 per cent) are in rupee-terms and there have been net accretions of around US$ 2.7 billion during 2009-10 so far (up to September 30, 2009).

International Investment Position

III.29 India's net international liabilities were placed at US$ 82.5 billion as at end-June 2009 as compared to US$ 59.4 billion as at end-March 2009. The international assets increased from US$ 350.0 billion at end-March 2009 to US$ 360.2 billion at end-June 2009 mainly on account of increase in reserve assets during the quarter. The increase in international liabilities from US$ 409.4 billion to US$ 442.7 billion during the same period was on account of an increase in inward direct investment and portfolio equity investment in India (Chart III.6).

III.30 During the first quarter of 2009-10 (April-June), exports declined and imports increased over the preceding quarter, while private transfer receipts remained buoyant. Notwithstanding net invisibles surplus, higher trade deficit on account of decline in exports and increase in imports resulted in a current account deficit during the first quarter of 2009-10. Nevertheless, the renewed confidence of international investors in India has led to the revival in

Chart III.6: International Investment Position of India (at the end of quarter)



capital inflows, turning the capital account from a deficit in the last two quarters of 2008-09 into a surplus in the first quarter of 2009-10. Accordingly, there was a marginal increase in foreign exchange reserves on BoP basis (*i.e.*, excluding valuation). Including valuation effects, reserves showed a larger increase during the first quarter of 2009-10 and reserve accretion continued in the second quarter of 2009-10. Thus, the balance of payments developments indicate that concerns relating to the external sector have receded with the revival in capital flows and modest level of current account deficit. The Indian rupee has exhibited some appreciation in the recent period while the country's reserve levels have increased.

IV. MONETARY CONDITIONS

The accommodative monetary policy stance of the Reserve Bank has continued during 2009-10 so far to support the emerging recovery. While broad money growth witnessed some moderation in recent period, availability of surplus liquidity in the system was evident in the large daily absorption through reverse repo by the Reserve Bank. With the persistence of deceleration in bank credit to the commercial sector, high deposit growth and the Reserve Bank's liquidity augmenting measures created space for market absorption of the large government borrowing programme. Flow of resources from non-bank sources to the commercial sector during 2009-10 so far has been marginally higher than the corresponding period of the previous year.

IV.1 Monetary and liquidity conditions during 2009-10 so far have been conditioned by the continuation of accommodative monetary policy stance of the Reserve Bank to support a faster economic recovery. Broad money growth (year-on-year) witnessed some moderation during the second quarter of 2009-10 but still remained above the Reserve Bank's projected trajectory of 18.0 per cent for 2009-10. On the sources side of monetary expansion, banking system's credit to the Government continued to be the major driver as bank credit to the commercial sector continued to exhibit deceleration. On the component side of monetary expansion, the key driver was the high growth in aggregate deposits. The movements in reserve money reflected the changes in net Reserve Bank credit to the Centre and net foreign assets with the Reserve Bank. Expansion of net Reserve Bank credit to the Centre through purchases under open market operations and unwinding of MSS was moderated significantly due to large daily absorption of liquidity through reverse repo window under LAF. Net foreign assets (net of valuations) with the Reserve Bank recorded an increase in the second quarter of 2009-10, after witnessing decline in the previous quarter.

IV.2 The thrust of the various policy initiatives taken by the Reserve Bank since mid-September 2008 has been on providing ample rupee for the smooth functioning of the financial market, ensuring comfortable dollar liquidity and maintaining a market environment conducive for the continued flow of credit to productive sectors to revive the economic growth in the midst of severe global recession. The important measures which reflect the accommodative monetary policy stance include reduction of the repo and reverse repo rates, reduction of the CRR and the SLR, and institution of several sector-specific liquidity facilities. Since October 11, 2008, the Reserve Bank reduced CRR by a cumulative 400 basis points to 5.0 per cent of net demand and time liabilities (NDTL), repo rate by 425 basis points to 4.75 per cent and the reverse repo rate by 275 basis points to 3.25 per cent. The nature of injection of liquidity through unwinding of MSS and reduction of CRR ensured the attainment of the Reserve Bank's objective of maintaining ample liquidity in the system without expanding the balance sheet of the Reserve Bank or compromising on the quality of the assets in the balance sheet.

Monetary Survey

IV.3 On a year-on-year (y-o-y) basis, M_3 growth was 18.9 per cent as on October 9, 2009 as compared with 20.9 per cent a year ago. The growth in M_3 mainly reflected the sustained expansion in aggregate deposits during this period. Within aggregate deposits, time deposits registered a growth (y-o-y) of 20.9 per cent as on October 9, 2009 as compared with 21.6 per cent a year ago (Table 4.1 and Chart IV.1). Banks mobilised large time deposits during the third quarter of 2008-09, as investors reallocated their portfolios in favour of bank deposits with the intensification of financial crisis and increase in risk perception in the face of snowballing uncertainty. This period also witnessed a shift from demand deposits to time deposits. Demand deposits that posted a sharp decline in the last two quarters of 2008-09 and registered a growth of only 0.5 per cent at end-March 2009 witnessed a turnaround. Demand deposits expanded by 10.3 per cent (y-o-y) as on October 9, 2009 as compared with

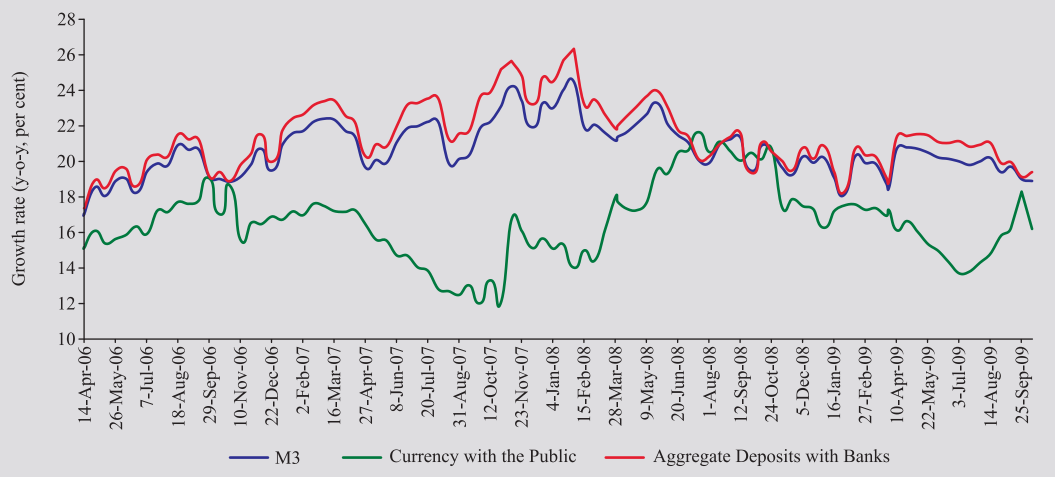
Table 4.1: Monetary Indicators

(Amount in Rupees crore)

Item	Outstanding as on October 9, 2009	Variation (year-on-year)			
		October 10, 2008		October 9, 2009	
		Absolute	Per cent	Absolute	Per cent
1	2	3	4	5	6
I. Reserve Money*	10,10,786	1,35,117	17.6	1,09,589	12.2
(Reserve Money Adjusted for CRR changes)			(22.8)		(19.5)
II. Narrow Money (M_1)	12,96,628	1,81,395	18.8	1,52,610	13.3
III. Broad Money (M_3)	51,46,157	7,47,558	20.9	8,17,802	18.9
a) Currency with the Public	7,01,417	1,01,095	20.1	97,846	16.2
b) Aggregate Deposits	44,40,318	6,46,568	21.0	7,20,413	19.4
i) Demand Deposits	5,90,788	80,405	17.7	55,221	10.3
ii) Time Deposits	38,49,530	5,66,162	21.6	6,65,192	20.9
VI. Major Sources of Broad Money					
a) Net Bank Credit to the Government (i+ii)	14,35,356	1,42,385	16.8	4,44,655	44.9
i) Net Reserve Bank Credit to Government	5,365	1,05,435	–	36,641	–
of which: to the Centre	5,407	1,05,182	–	37,037	–
ii) Other Banks' Credit to Government	14,29,991	36,950	3.8	4,08,014	39.9
b) Bank Credit to the Commercial Sector	31,35,885	6,08,888	27.4	3,04,381	10.7
c) Net Foreign Assets of the Banking Sector	13,33,575	3,11,273	30.0	-16,445	-1.2
d) Government Currency Liability to Public	10,504	975	11.2	849	8.8
e) Net Non-Monetary Liabilities of the Banking Sector	7,69,163	3,15,963	58.8	-84,362	-9.9

*: Data pertain to October 16, 2009.
Note: Data are provisional.

Chart IV.1: Money Supply



17.7 per cent a year ago. The net outflows from small savings schemes that started in December 2007 continued up to July 2009 (the latest period for which the data are available) (Chart IV.2). Growth in currency with the public moderated to 16.2 per cent (y-o-y) as on October 9, 2009 as compared with 20.1 per cent a year ago, mainly reflecting the impact of moderation in economic activity on currency demand.

IV.4 On a financial year basis, growth in M_3 during 2009-10 (up to October 9, 2009) was 8.0 per cent as compared with 7.7 per cent during the corresponding period of the previous year (Table 4.2).

IV.5 A quarter-wise analysis of growth in bank credit shows that expansion in bank credit recovered in the second quarter of 2009-10 from an absolute decline posted

Chart IV.2: Time Deposits and Small Savings

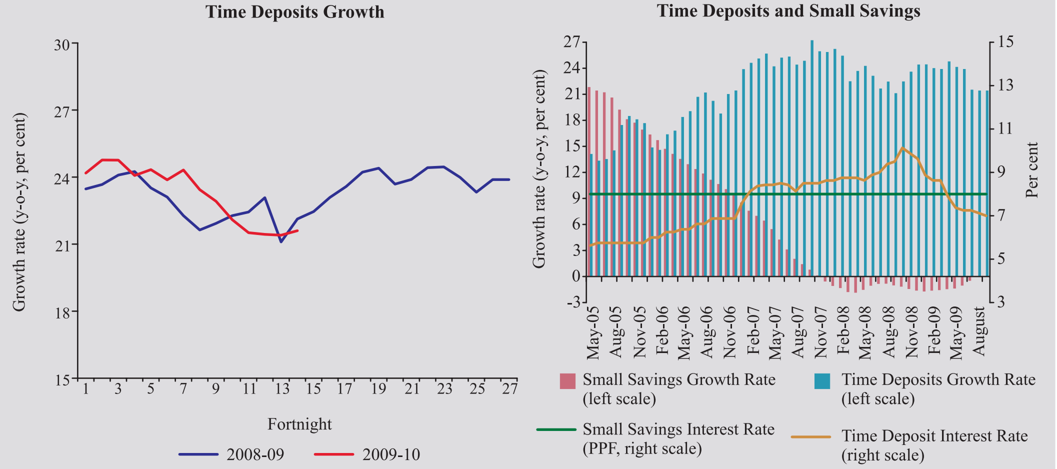


Table 4.2: Monetary Aggregates - Variations

(Rupees crore)

Item	2008-09 (up to October 10, 2008)	2009-10 (up to October 9, 2009)	2008-09				2009-10	
			Q1	Q2	Q3	Q4	Q1	Q2
1	2	3	4	5	6	7	8	9
M_3 (1+2+3 = 4+5+6+7-8)	3,10,472 (7.7)	3,82,138 (8.0)	89,283	1,76,379	1,60,487	3,19,987	1,70,385	1,61,408
Components								
1. Currency with the Public	35,161 (6.2)	35,053 (5.3)	35,772	-18,037	40,405	39,813	24,400	2,682
2. Aggregates Deposits with Banks	2,79,487 (8.1)	3,48,235 (8.5)	57,621	1,93,902	1,13,039	2,87,103	1,41,942	1,64,282
2.1 Demand Deposits with Banks	-42,805 (-7.4)	9,540 (1.6)	-79,325	52,771	-62,157	91,586	-34,409	62,870
2.2 Time Deposits with Banks	3,22,292 (11.3)	3,38,695 (9.6)	1,36,946	1,41,131	1,75,195	1,95,517	1,76,350	1,01,412
3. 'Other' Deposits with Banks	-4,175 (-46.1)	-1,150 (-20.6)	-4,110	514	7,044	-6,930	4,044	-5,555
Sources								
4. Net Bank Credit to Government	91,183 (10.1)	1,58,157 (12.4)	36,124	31,654	1,29,335	1,80,568	1,19,062	63,346
4.1 RBI's Net Credit to Government	81,933	-56,214	-13	51,360	30,230	93,212	-11,145	-14,953
4.1.1 RBI's Net credit to the Centre	83,006	-56,355	1,430	51,379	29,932	93,657	-11,497	-14,968
4.2 Other Banks' Credit to Government	9,250	2,14,372	36,137	-19,706	99,106	87,356	1,30,207	78,299
5. Bank Credit to the Commercial Sector	2,52,515 (9.8)	1,22,548 (4.1)	30,811	1,63,138	90,616	1,49,783	-7,737	1,15,625
6. NFA of Banking Sector	54,889	-18,609	66,858	7,271	-1,32,461	1,15,385	-37,923	50,120
6.1 NFA of the RBI	95,028	2,564	1,03,932	10,336	-1,56,330	86,048	-16,750	50,120
7. Government's Currency Liabilities to the Public	431	450	225	206	186	213	254	196
8. Net Non-Monetary liabilities of the Banking Sector	88,546	-1,19,591	44,735	25,890	-72,811	1,25,961	-96,730	67,879

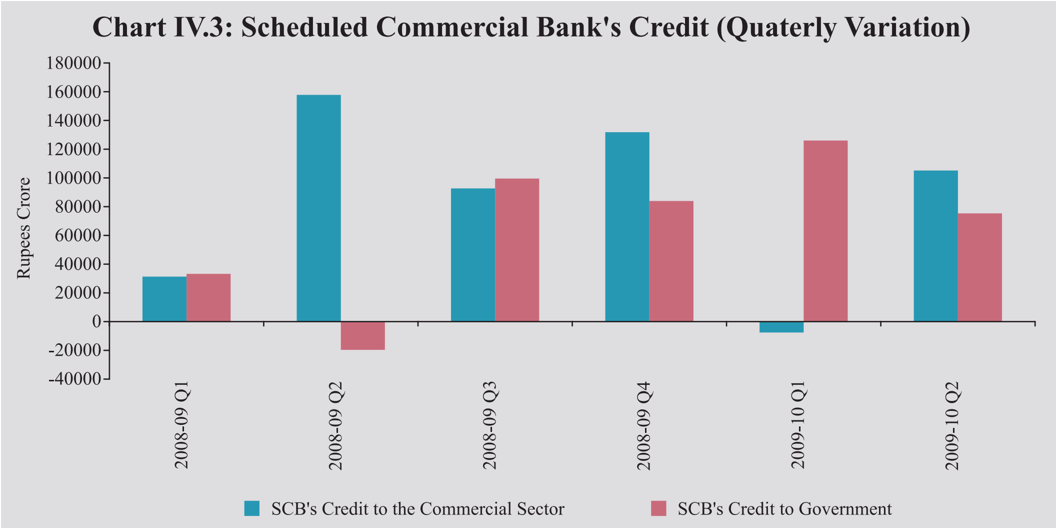
NFA: Net Foreign Assets.

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

in the first quarter, although the expansion of credit remained much lower than the corresponding quarter of the previous year (Chart IV.3).

IV.6 Much of the financial year expansion in broad money (M_3) during 2009-10 (up to October 9, 2009) resulted from the increase in commercial banks' credit to the Government. On the other hand, net Reserve Bank credit to the Centre during 2009-10 (up to October 9, 2009) decreased, reflecting large absorption under the LAF, despite the sizeable decline in outstanding balances under MSS with the Reserve Bank and increase in purchases under OMOs.

IV.7 Non-food credit growth (y-o-y) of scheduled commercial banks (SCBs)



that reached its peak in October 2008, witnessed sustained deceleration thereafter, reflecting moderation in economic activity. Non-food credit by SCBs expanded by 11.2 per cent, y-o-y, as on October 9, 2009, lower than 29.4 per cent a year ago and the Reserve Bank's indicative projected trajectory of 20.0 per cent as set out in the First Quarter Review for 2009-10. The lower expansion in credit relative to the significant expansion in deposits during 2009-10 has resulted in a decline in the incremental credit-deposit ratio (Chart IV.4).

IV.8 Though the moderation in credit growth was witnessed across the banking sector, credit growth decelerated sharply for private banks while foreign banks registered a decline (Table 4.3). The

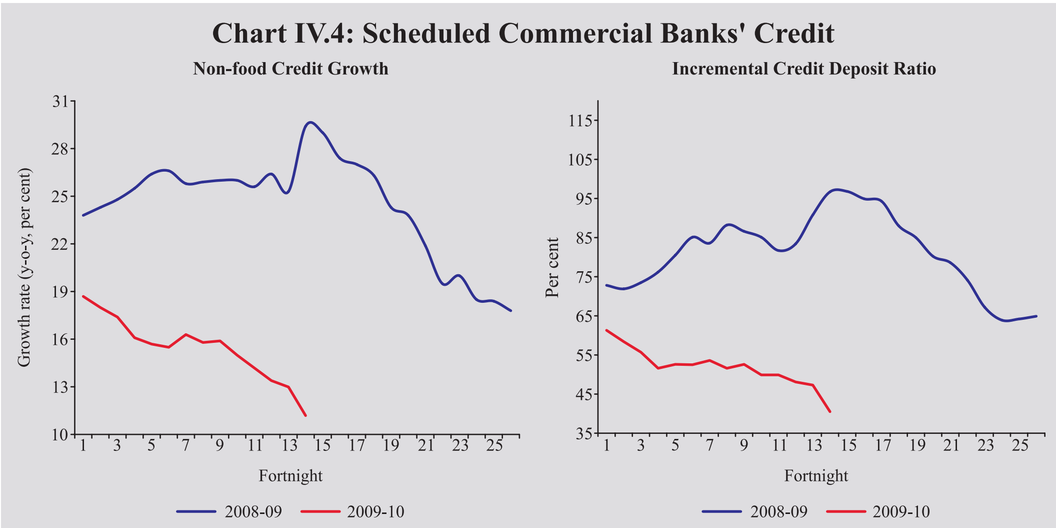


Table 4.3: Credit Flow from Scheduled Commercial Banks

(Amount in Rupees crore)

Item	Outstanding as on Oct. 9, 2009	Variation (year-on-year)			
		As on Oct. 10, 2008		As on Oct. 9, 2009	
		Amount	Per cent	Amount	Per cent
1	2	3	4	5	6
1. Public Sector Banks	21,44,697	4,58,297	32.7	2,84,513	15.3
2. Foreign Banks	1,57,601	46,421	32.9	-29,771	-15.9
3. Private Banks	5,15,474	82,704	19.7	12,402	2.5
4. All Scheduled Commercial Banks*	28,90,316	5,94,220	29.5	2,80,627	10.8

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

expansion of credit from the public sector banks has also moderated to some extent.

IV.9 Scheduled commercial banks' investment in SLR securities expanded by 40.9 per cent (y-o-y) as on October 9, 2009, as compared with 3.2 per cent a year ago, driven by the higher market borrowing by the Government (Table 4.4). This was facilitated by low credit growth and ample

Table 4.4: Scheduled Commercial Bank Survey

(Amount in Rupees crore)

Item	Outstanding as on October 09, 2009	Variation (year-on-year)			
		As on October 10, 2008		As on October 09, 2009	
		Amount	Per cent	Amount	Per cent
1	2	3	4	5	6
Sources of Funds					
1. Aggregate Deposits	41,61,354	6,14,272	21.5	6,92,986	20.0
2. Call/Term Funding from Financial Institutions	98,432	29,097	33.3	-18,058	-15.5
3. Overseas Foreign Currency Borrowings	27,702	31,244	100.6	-34,586	-55.5
4. Capital	58,940	8,948	24.5	13,433	29.5
5. Reserves	3,24,335	60023	27.2	43,706	15.6
Uses of Funds					
1. Bank Credit	28,90,316	5,94,220	29.5	2,80,627	10.8
of which: Non-food Credit	28,47,595	5,82,344	29.4	2,86,801	11.2
2. Investments in Government and Other Approved Securities	13,77,910	30,131	3.2	4,00,027	40.9
a) Investments in Government Securities	13,62,250	31,501	3.4	3,96,844	41.1
b) Investments in Other Approved Securities	15,661	-1,370	-9.9	3,183	25.5
3. Investments in non-SLR Securities	2,82,655	-32,157	-17.6	1,31,868	87.5
4. Foreign Currency Assets	42,662	-6,406	-21.9	19,776	86.4
5. Balances with the RBI	1,88,727	99,638	45.6	-1,29,595	-40.7

Note: Data are provisional.

liquidity in the system. Commercial banks' holdings of such securities as on October 9, 2009 at 30.4 per cent of their net demand and time liabilities (NDTL) were higher than 28.1 per cent at end-March 2009 and 25.7 per cent a year ago. Excess SLR investments of SCBs increased to Rs.2,91,279 crore as on October 9, 2009 from Rs.1,69,846 crore at end-March 2009 and Rs.26,933 crore a year ago. SCB's also increased their investment in non-SLR securities substantially. Simultaneously, SCBs reduced their overseas foreign currency borrowings and increased their holding of foreign currency assets.

IV.10 Growth and inflation conditions changed significantly during the course of 2008-09. In 2009-10 so far, while growth impulses remained subdued, the divergence between WPI and CPI inflation reached a high level. Given such high variability in growth and inflation, money growth may have to be seen in relation to the recent trend in income velocity of money (Chart IV.5).

IV.11 Disaggregated data on sectoral deployment of gross bank credit available up to August 28, 2009 show that 53.8 per cent of incremental non-food credit (y-o-y) was absorbed by industry as compared with 47.5 per cent in the corresponding period of the previous year. The agricultural sector absorbed 21.8 per cent of the incremental non-food bank credit as compared with 8.5 per cent in the corresponding period of the previous year. Personal loans that accounted for 4.1 per cent of the incremental non-food credit witnessed moderation; within personal loans, housing loans decelerated to a large extent. Growth in loans to commercial real estate, however, remained high. Credit card and consumer durables segments exhibited negative growth in credit, which corroborates the sharp decline in private consumption demand as per GDP data for the first quarter of 2009-10. Growth in incremental credit for services activities also exhibited significant deceleration (Table 4.5).

Chart IV.5: Income velocity of Money

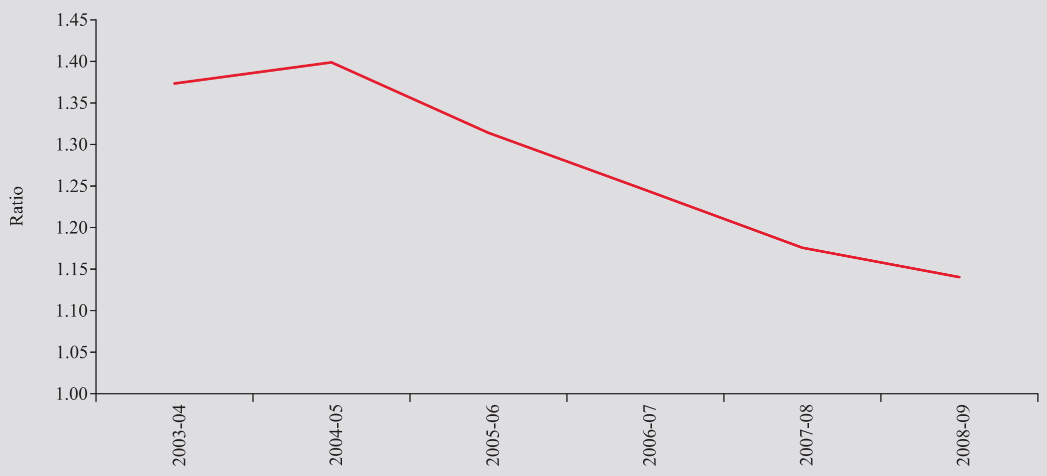


Table 4.5: Deployment of Gross Bank Credit by Major Sectors

(Amount in Rs. crore)

Sector	Outstanding as on August 28, 2009	Year-on-Year Variations			
		August 29, 2008		August 28, 2009	
		Absolute	Per cent	Absolute	Per cent
1	2	3	4	5	6
Non-Food Gross Bank Credit (1 to 4)	**26,23,551**	**4,84,805**	**26.5**	**3,08,718**	**13.3**
1. Agriculture & Allied Activities	3,29,847	41,185	18.6	67,228	25.6
2. Industry	10,96,764	2,30,229	32.9	1,66,121	17.9
3. Personal Loans	5,64,689	69,763	14.5	12,594	2.3
Housing	2,84,721	29,872	12.4	14,668	5.4
Advances against Fixed Deposits	44,760	2,919	7.0	290	0.7
Credit Card Outstanding	24,889	7,173	32.8	-4,167	-14.3
Education	32,017	6,576	38.2	8,217	34.5
Consumer Durables	7,832	-304	-3.1	-1,571	-16.7
4. Services	6,32,251	1,43,628	33.7	62,775	11.0
Transport Operators	39,250	7,485	26.3	3,264	9.1
Professional Services	46,383	15,114	64.6	7,889	20.5
Trade	1,47,354	22,686	21.3	17,951	13.9
Real Estate Loans	96,701	20,580	43.1	28,353	41.5
Non-Banking Financial Companies	1,01,281	26,443	51.8	23,837	30.8
Memo					
Priority Sector	**9,27,322**	**1,46,145**	**22.7**	**1,37,965**	**17.5**
Micro and Small Enterprises*	2,77,728	38,013	21.1	59,764	27.4
Industry	**10,96,764**	**2,30,229**	**32.9**	**1,66,121**	**17.9**
Food Processing	53,137	11,757	30.4	2,743	5.4
Textiles	1,06,033	17,402	21.9	9,036	9.3
Paper & Paper Products	15,795	3,037	26.6	1,342	9.3
Petroleum, Coal Products and Nuclear Fuels	60,273	29,713	90.7	-2,183	-3.5
Chemicals and Chemical Products	73,303	16,172	30.2	3,546	5.1
Rubber, Plastic & their Products	13,496	2,415	24.9	1,372	11.3
Iron and Steel.	1,08,758	21,177	31.6	20,490	23.2
Other Metal and Metal Products	31,271	5,403	25.7	4,844	18.3
Engineering	61,766	9,941	21.3	5,224	9.2
Vehicles, Vehicle Parts and Transport Equipments	35,850	7,244	27.9	2,657	8.0
Gems & Jewellery	29,141	3,693	15.7	1,890	6.9
Construction	37,421	10,020	47.6	6,354	20.5
Infrastructure	3,03,013	55,533	36.1	93,647	44.7

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

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

IV.12 Apart from banks, the commercial sector mobilised resources from a variety of other sources such as capital markets, issuance of commercial papers (CPs), non-banking financial companies (NBFCs), financial institutions, external commercial borrowings (ECBs), American Depository Receipts (ADRs)/Global Depository

Receipts (GDRs) and foreign direct investment. During the first half of 2009-10, flow of resources from external sources was lower as compared with the corresponding period of the previous year, although they were significantly higher as compared to the second half of 2008-09. On the other hand, resources mobilised through domestic non-bank sources recorded an increase during this period with significant increase in issuance of CPs and private placements. Thus, total flow of resources from non-bank sources has recorded an increase during 2009-10 so far as compared with the corresponding period of the previous year (Table 4.6). The total flow of financial resources to the commercial sector, however, remained lower, reflecting moderation in expansion in bank credit to the commercial sector.

Table 4.6: Flow of Financial Resources to Commercial Sector

(Rupees crore)

Item	Full Year		April-September*	
	2007-08	2008-09	2008-09	2009-10
1	2	3	4	5
A. Adjusted non-food Bank Credit (NFC)	**4,44,807**	**4,21,091**	**2,40,092**	**1,07,861 ****
i) Non-Food Credit	4,32,846	4,11,824	2,43,280	1,18,257
of which petroleum and fertilizer credit	5,057	31,632	22,391	-9,179 ^
ii) Non-SLR Investment by SCBs	11,961	9,267	-3,188	-10,395
B. Flow from Non-banks (B1+B2)	**5,64,558**	**4,68,567**	**2,28,119**	**2,30,130**
B1. Domestic Sources	**2,55,230**	**2,98,351**	**1,22,518**	**1,40,213**
1. Public issues by non-financial entities	51,478	14,205	11,913	13,617
2. Gross private placements by non-financial entities	68,249.	77,856	17,847	34,790 #
3. Net issuance of CPs subscribed by non-banks	10,660	5,590	22,187	51,012
4. Net Credit by housing finance companies	41,841	26,634	14,893	8,124
5. Total gross accommodation by 4 RBI regulated AIFIs - NABARD, NHB, SIDBI & EXIM Bank	22,267	31,423	7,248	-3,347
6. Systemically important non-deposit taking NBFCs net of bank credit	36,460	76,828	37,744	17,990 ^
7. LIC's gross investment in Corporate Debt, Infrastructure and Social Sector	24,275	65,815	10,686	18,027 ^
B2. Foreign Sources	**3,09,328**	**1,70,216**	**1,05,601**	**89,917**
1. External Commercial Borrowings / FCCB	91,180	38,009	10,906	6,486
2. ADR/GDR Issues excluding banks and financial institutions	11,836	4,788	4,652	12,645
3. Short-term Credit from abroad	68,878	-31,160	21,009	-8,133 ^
4. Foreign Direct Investment to India	1,37,434	1,58,579	69,034	78,919 ^
C. Total Flow of Resources (A+B)	**10,09,365**	**8,89,658**	**4,68,211**	**3,37,991**
Memo Item:				
Mutual Funds Investments in Debt (non-Gilt) Instruments	**88,457**	**-32,168**	**19,896**	**1,01,956**

**: up to October 9, 2009. ^: Data pertain to April-August.
*: Comparable period for respective items. #: Data pertain to April-June.

Reserve Money Survey

IV.13 Growth in reserve money that remained low/negative during the 2009-10 up to the second week of October 2009 registered a growth of 12.2 per cent, y-o-y, as on October 16, 2009 as compared with a growth of 17.6 per cent a year ago. The significant acceleration in growth in reserve money in the week ended October 16, 2009 reflects the reduction in CRR by 250 basis points by the Reserve Bank effective from the fortnight beginning October 11, 2008 and consequent decline in bankers' deposits with the Reserve Bank. The reserve money growth as on October 16, 2009, therefore, is over a lower base that resulted from the reduction in CRR a year ago. Reserve Bank has reduced CRR by 400 basis points since October 2008 to augment domestic liquidity in view of the intensification of global financial crisis and its related impact on domestic markets. The movement in reserve money in the second quarter of 2009-10 was mainly driven by liquidity management operations of the Reserve Bank and variation in bankers' deposits with the Reserve Bank. The growth in reserve money has to be seen along with policy driven changes to the CRR, since the combined impact gets reflected in the growth of broad money. A reduction in CRR may lead to a corresponding fall in reserve money in the first round; the higher money multiplier resulting from lower CRR, however, will lead to higher growth in broad money, though with a lag. When the variation in reserve money reflects the result of a policy driven change in CRR, for the purpose of analytical comparison reserve money adjusted for CRR changes becomes more relevant. Adjusted for the first round effect of the changes in CRR, reserve money growth (y-o-y) as on October 16, 2009 was 19.5 per cent as compared with 22.8 per cent a year ago. The CRR impact explains the difference between 'reserve money' and 'adjusted reserve money' (Chart IV.6).

Chart IV.6: Reserve Money Variation (year-on-year)

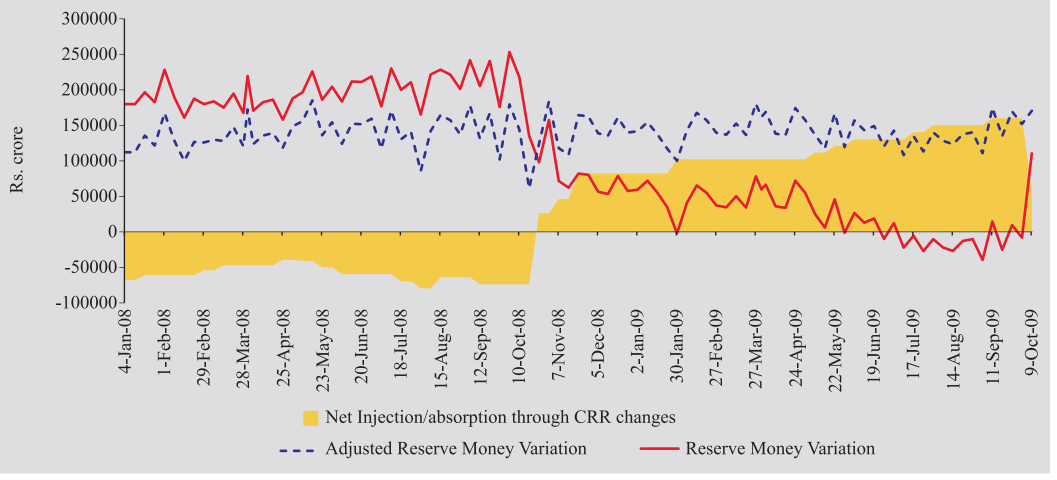
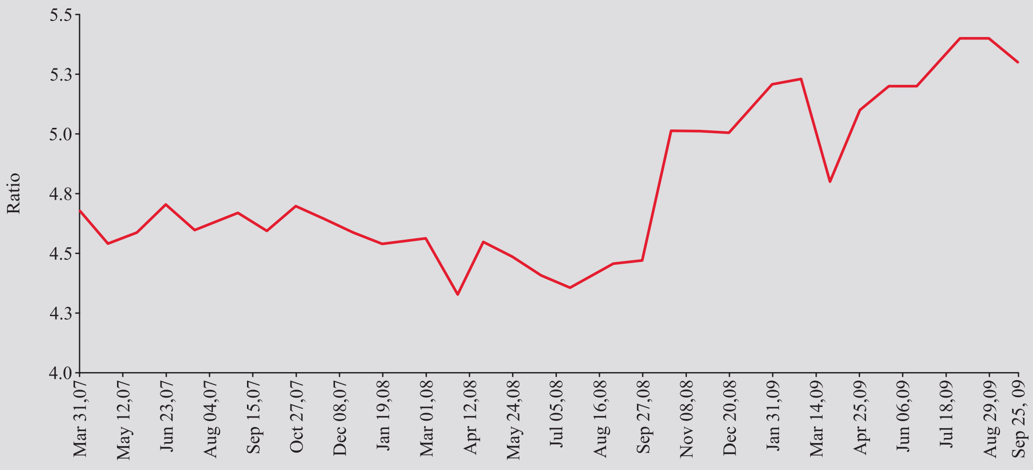


Chart IV.7: Money Multiplier



IV.14 The money multiplier, which had declined from 4.7 at end-March 2007 to 4.3 at end-March 2008 in the wake of CRR hikes, increased to 4.8 as on March 31, 2009 and 5.4 by end-July 2009, reflecting subsequent lowering of CRR by 400 basis points. The money multiplier at end-September 2009 was 5.3 (Chart IV.7).

IV.15 Reserve money during the financial year 2009-10 (up to October 16, 2009) recorded a growth of 2.3 per cent as against a decline of 2.9 per cent in the corresponding period of the previous year (Table 4.7). On the sources side, both net Reserve Bank credit to the Centre and net foreign assets (adjusted for valuation) increased. Net Reserve Bank's credit to the Centre increased by Rs. 24,123 crore (up to October 16, 2009) as compared with an increase of Rs.15,534 crore during the corresponding period of the previous year. The Reserve Bank's foreign currency assets (adjusted for valuation) increased by Rs.31,150 crore as against a decrease of Rs.34,556 crore during the corresponding period of the previous year (Chart IV.8). Adjusted for the first round impact of the changes in CRR (up to October 16, 2009), reserve money expanded by 2.2 per cent as compared with an increase of 1.8 per cent during the corresponding period of the previous year.

IV.16 Movements in the Reserve Bank's net credit to the Central Government during 2009-10 (up to October 16, 2009) largely reflected the liquidity management operations of the Reserve Bank and changes in Central Government deposits with the Reserve Bank. Liquidity condition eased from mid-November 2008, in response to the liquidity augmenting measures of the Reserve Bank and on an average, Reserve Bank started absorbing large amount of liquidity through reverse repo under the LAF. Accordingly, Reserve Bank's holding of government securities (up to October 16, 2009) declined on account of an increase in absorption

Table 4.7: Reserve Money - Variations

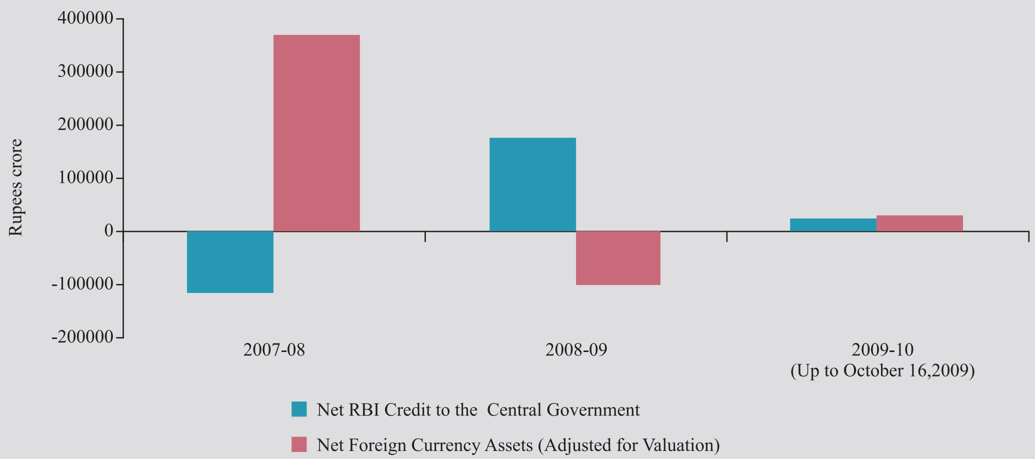
(Amount in Rupees crore)

Item	2008-09 (April-March)	2008-09 (Up to Oct.17)	2009-10 (Up to Oct.16)	2008-09 Q1	2008-09 Q2	2008-09 Q3	2008-09 Q4	2009-10 Q1	2009-10 Q2
1	2	3	4	5	6	7	8	9	10
Reserve Money	59,698	-27,105 (-2.9)	22,786 (2.3)	3,416	25,218	-70,453	1,01,517	-38,929	16,100
(Adjusted Reserve Money)		*(1.8)*	*(2.2)*						
Components (1+2+3)									
1. Currency in Circulation	1,00,352	43,226 (7.3)	53,369 (7.7)	36,859	-14,516	38,277	39,733	29,692	976
2. Bankers' Deposits with RBI	-37,172	-66,793 (-20.3)	-30,973 (-10.6)	-29,333	39,219	-1,15,773	68,714	-72,664	20,680
3. 'Other' Deposits with the RBI	-3,482	-3,538 (-39.1)	390 (7.0)	-4,110	514	7,044	-6,930	4,044	-5,555
Sources (1+2+3+4-5)									
1. RBI's net credit to Government	1,74,789	15,196	23,153	-13	51,360	30,230	93,212	-11,145	-14,953
of which: to Centre (i+ii+iii+iv-v)	1,76,397	15,534	24,123	1,430	51,379	29,932	93,657	-11,497	-14,968
2. RBI's Credit to Banks and Commercial Sector	17,799	5,886	-17,520	-3,358	4,963	5,032	11,163	-9,623	-3,747
3. Net Foreign Assets of RBI	43,986	93,402 (7.6)	10,144 (0.8)	1,03,932	10,336	-1,56,330	86,048	-16,750	50,120
of which : FCA, adjusted for valuation	-1,00,308	-34,556	31,150	15,535	-31,641	-92,102	7,900	-6,245	33,441
4. Governments' Currency Liabilities to the Public	831	431	450	225	206	186	213	254	196
5. Net Non-Monetary liabilities of RBI	1,77,706	1,42,021	-6,558	97,369	41,648	-50,430	89,119	1,664	15,516
Memo:									
Net Domestic assets	15,712	-1,20,507	12,641	-1,00,516	14,882	85,877	15,469	-22,178	-34,020
LAF- Repos (+) / Reverse Repos(-)	-51,835	-41,710	-74,775	-45,350	51,480	-62,170	4,205	-1,32,800	28,170
Net Open Market Sales # *	-94,548	-19,227	-74,068	-8,696	-10,535	-7,669	-67,649	-42,001	-31,591
Centre's Surplus	-60,367	-43,130	45,124	-42,427	6,199	-32,830	8,691	-13,156	77,713
Mobilisation under the MSS	-80,315	1,103	-69,304	6,040	-628	-53,754	-31,973	-65,187	-4,117
Net Purchases(+)/Sales(-) from Authorised Dealers	-1,78,592	-73,331	-14,385 ^	3,956	-52,761	-1,11,877	-17,910	-15,889	1,504 ^
NFA/Reserve Money @	129.6	147.5	127.6	143.8	141.1	134.7	129.6	133.1	136.1
NFA/Currency @	185.2	209.7	173.3	213.5	220.2	183.3	185.2	175.3	182.0

NFA: Net Foreign Assets. FCA: Foreign Currency Assets. LAF: Liquidity Adjustment Facility.
* : At face value. # : Excludes Treasury Bills. @ : Per cent; end of period. ^ : up to August 28, 2009.
Note: 1. Data are based on March 31 for Q4 and last reporting Friday for all other quarters.
2. Figures in parentheses are percentage variations during the fiscal year.

under the LAF (Rs.74,775 crore). The Centre's surplus cash balances with the Reserve Bank also increased (Rs.45,124 crore). On the other hand, unwinding of MSS securities (Rs.69,304 crore) led to a decline in Central Government deposits

Chart IV.8: Important Sources of Reserve Money Variation



with the Reserve Bank. Furthermore, net open market purchases under OMO/ special market operations (SMO) led to higher holding of Central Government securities/bonds (Rs.74,068 crore) by the Reserve Bank. Reflecting combined effect of these developments, the Reserve Bank's net credit to the Centre increased during 2009-10 (up to October 16, 2009).

IV.17 To sum up, the growth-supportive accommodative monetary policy stance was evident from sustained high growth in broad money notwithstanding the recent moderation, and also the daily absorption of excess liquidity in excess of Rs.1,00,000 crore on average throughout the second quarter of 2009-10. High growth in deposits on the component side and high growth in investment of the banking system in government securities in the wake of large market borrowing programme of the Government on the sources side have been the major drivers of growth in monetary aggregates. Moderation in non-food credit growth continued. Momentum in capital inflows and revival in demand for credit from the private sector could, however, alter the monetary conditions over time.

V. FINANCIAL MARKETS

The global financial markets witnessed further easing of pressures on the back of receding uncertainties and risk, and a strong rebound in activity in various market segments in Q3 of 2009, albeit, with persistence of weakness in credit and mortgage markets. The equity markets in both advanced economies and EMEs recovered a large part of losses incurred in the aftermath of the global crisis; bond markets turned to normalcy with pick up in global issuances; sovereign and corporate - financial and non-financial - credit spreads declined further. The domestic financial markets continued to function normally and also witnessed further moderation in risk premia in Q2 of 2009-10, besides significant improvement in market activity. While the money markets continued to reflect the impact of ample liquidity and lower policy rates, the long term government bond yields reflected concerns about government borrowing programme. The rupee witnessed appreciating trend against the US dollar, reflecting in part the impact of revival in capital inflows and the general weakness of the US dollar against major currencies. While the secondary equity market continued to outperform most other EMEs, the primary market witnessed strong resumption of activity in terms of primary issuances, private placements and mobilisation of resources by the mutual funds.

V.1 The global financial markets further extended the steady improvement in Q3 of 2009 that had started in Q2, with significant reduction in liquidity and credit risk across asset classes, though some segments in the credit and mortgage markets still remain weak. Alongside easing of stress in the global market conditions, the domestic financial markets also witnessed further decline of risk premia and significant recovery in asset prices – extending the pattern that had started in Q1 of 2009-10. A combination of factors such as improving market perception about the growth outlook, ample liquidity in the system and continuance of low policy rates facilitated overall easing of the market conditions. Notwithstanding the gradual moderation in lending rates, indicating improved transmission of monetary policy with a lag, there was further moderation in credit growth. The equity markets, apart from recovery in prices, also exhibited substantial improvement in activity in the primary market with higher momentum in IPOs, private placements and mobilisation of resources by the mutual funds.

International Financial Markets

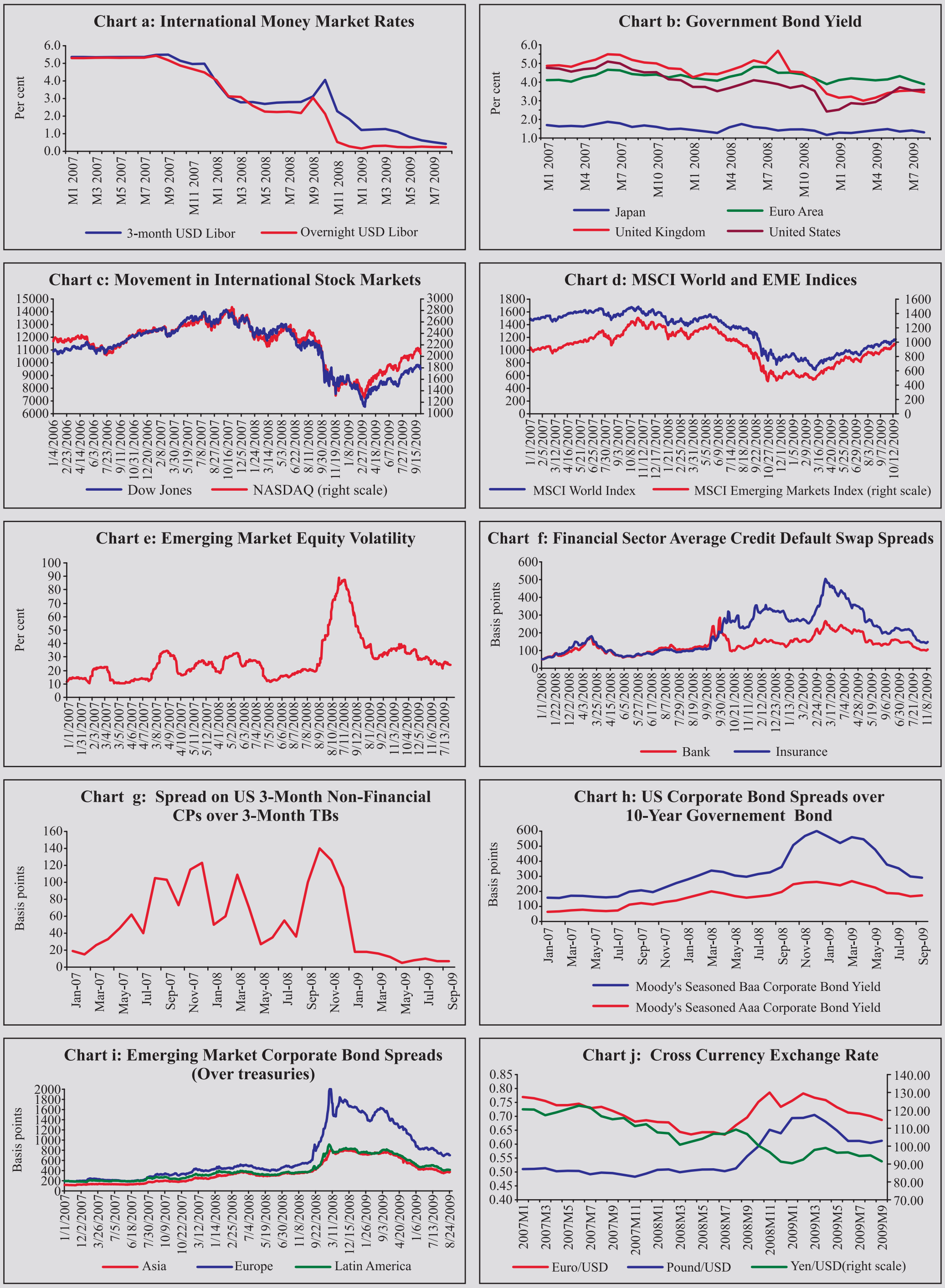
V.2 The global financial markets had witnessed signs of stabilisation in Q2 of 2009, with strong rebound in activity in some of the market segments on the back of incipient signs of slowdown in the pace of deterioration of economic conditions in the advanced economies, better than expected corporate performance and confidence building measures taken by the governments and central banks. The financial markets showed further improvement in Q3 of 2009 with increasing risk tolerance and receding risk premia on various asset classes. According to the BIS Quarterly Review (September 2009), while in interbank money markets key spreads narrowed to levels not seen since the beginning of 2008, improvements were also evident in credit markets, although important segments continued to rely on central bank support.

V.3 The easing of pressures in money markets in Q3 of 2009 was evident from the significant and sustained moderation in inter-bank rates from the peak seen during the early phase of the global crisis (Chart V.1a). The bonds market also mirrored the receding liquidity premia and return of risk appetite. However, government bond yields witnessed some intermittent volatility due to factors such as fluctuating perceptions about the future path of global recovery and the expected reversal in the stance of monetary policies. The long-term government bond yields, which rose in the first two quarters of 2009 on concerns of rising fiscal deficits, did witness signs of stabilisation in Q3 of 2009 upon changing outlook regarding macroeconomic conditions and fiscal and monetary policies (Chart V.1b). Furthermore, the steepening of yield curve witnessed in the first two quarters was not so evident during Q3 of 2009. However, the long-term bond yield in the US continued to reflect the consequences of large government debt and borrowing programme.

V.4 The equity markets in developed as well as EMEs have witnessed perceptible recovery and reduced volatility since March 2009, with intermittent corrections in response to specific adverse news/ perceptions (Chart V.1c, d and e). In Q3 of 2009, the pace of recovery of global equity prices accelerated further and displayed a more firm pattern. Both Dow Jones and NASDAQ equity indices recorded around 16 per cent rise during Q3 of 2009 over the preceding quarter. Thus, the markets have been able to recoup a part of the household wealth lost in the aftermath of the financial crisis. Although equity markets rallied on better than expected economic data and corporate earnings results for Q2 of 2009 with financial sector showing significant improvement, and upward shift in the earnings expectations, there were episodes of intermittent volatility caused by investors' reaction to any negative news relating to the pace of economic recovery. Furthermore, concerns on the quality and sustainability of the financial sector profitability continue to worry the markets, as evident from the still relatively higher credit default swap spreads for the banks and the insurance sector (Chart V.1f).

V.5 Both sovereign and corporate (financial and non-financial) credit spreads narrowed further, indicating significant drop in risk and liquidity premiums (Chart V.1g, h and i). The improvement in credit market conditions was also evident in the high level of global corporate bond issuances, although there was at the same time deleveraging by the banks. Furthermore, in the US, while there were signs of recovery in the

Chart V.1: Indicators of Global Financial Market Developments



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

commercial paper (CP) market, asset backed securities (ABS) and commercial mortgage backed securities (CMBS) markets continued to mirror weak sentiments. Lower risk spread and improved market liquidity helped in lifting the pace of domestic as well as international bond issuances by the corporates.

V.6 EME equity markets reflected investors' increasing risk tolerance which continued to support asset prices (Chart V.1d). The resumption of capital flows to EMEs and return of investors' risk appetite, bolstered by the strong recovery and rebound in domestic consumption demand in Asia, incipient recovery in commodity exporting countries in Latin America and the Middle East, led to further acceleration in growth of equity prices in Q3 of 2009. The Morgan Stanley Capital International (MSCI) index increased by 17.4 per cent during the Q3 of 2009, although the pace of increase in equity prices differed across EMEs depending on the domestic factors (Table 5.1). Between mid-September 2009 and end-March 2009, MSCI increased by 56.9 per cent.

V.7 In the foreign exchange market, the US dollar which depreciated in the first quarter of 2009-10, continued to depreciate during the second quarter on the back of declining flows to the US, continuation of easy monetary policy in the US and change in market sentiment against the dollar (Chart V.1j). Between end-March 2009 and October 20, 2009, the US dollar depreciated by 11.1 per cent against the euro, 12.6 per cent against the pound sterling and 7.8 per cent against the Japanese yen. The EME currencies witnessed appreciating trend in Q3 of 2009, reflecting in part their relative attractiveness to foreign investors for higher yields. Coming to Asian

Table 5.1: Currency and Stock Price Movement in EMEs

(Per cent)

Items	End-March 08 @	End-March 09 @	October 20, 2009*	Items	End-March 08 @	End-March 09 @	October 12, 2009*
1	2	3	4	1	5	6	7
Appreciation (+)/Depreciation (-) of the US Dollar				**Stock Price Variations**			
Japanese Yen	-14.9	-2.0	-7.8	Indonesia (Jakarta Composite)	33.7	71.3	67.2
Chinese Yuan	-9.3	-2.6	-0.1	Brazil (Bovespa)**	33.1	56.6	47.5
Russian Ruble	-9.7	44.3	-13.9	Thailand (SET Composite)	21.3	74.2	67.2
Turkish Lira	-5.8	27.7	-13.3	India (BSE Sensex)	19.7	75.4	71.9
Indian Rupee	-8.3	27.5	-9.6	South Korea (KOSPI)	17.3	35.9	40.2
Indonesian Rupiah	1.1	25.6	-19.1	China (Shanghai SE Composite)	9.1	22.0	19.6
Malaysian Ringgit	-7.8	14.4	-7.9	Taiwan (Taiwan Index)	8.7	45.9	41.0
South Korea Won	5.5	38.9	-14.6	Russia (RTS)	6.1	107.1	77.7
Thai Baht	-10.2	12.9	-5.8	Malaysia (KLSE Composite)	0.1	41.9	39.5
Argentina	2.1	17.3	2.9	Singapore (Straits Times)	-4.9	57.7	56.6
Brazilian Real	-17.0	31.2	-23.4				
Mexican Peso	-3.5	32.9	-8.6				

@ : Year-on-year variation. * : Variation over end-March 2009. ** : Data as on October 09, 2009.
Source: Bloomberg and the IFS, IMF.

currencies, the US dollar depreciated against Indian rupee, Indonesian rupiah, Malaysian ringgit, South Korean won and Thai Baht. Among other emerging market currencies, the US dollar registered significant depreciation against South African Rand, Brazilian real, Mexican peso, Turkish lira and Russian ruble. However, it appreciated against the Argentine peso during the period (Table 5.1).

Domestic Financial Markets

V.8 All through the crisis, financial markets in India continued to function normally. However, financial market conditions tightened in sympathy with the international markets and this was reflected in the large credit spreads and higher liquidity premia. However, the financial markets recovered from this sooner than their counterparts elsewhere, with some indications of risk perception and volumes returning to the pre-Lehman levels. The domestic markets recorded further improvement in Q2 of 2009-10, with external financial environment turning more favourable. The call rate in the money market remained within the informal LAF corridor, while volumes increased, indicating declining risk and liquidity premia. In the foreign exchange market, the Indian rupee generally appreciated against major currencies as the appetite for EME assets rose and capital flows gained further momentum. In the credit market, the lending rates of scheduled commercial banks (SCBs) further softened, although concerns remained regarding the pace of pick up in bank credit. The activity in the government securities market further picked up in Q2 of 2009-10 as 69.3 per cent of the Government's gross market borrowing programme was completed by the end of September. Ample liquidity conditions ensured by the Reserve Bank and high growth in bank deposits in the face of subdued growth in credit to private sector continued to contain pressure on bond yields. Indian equity markets outperformed most of the EMEs.

Liquidity conditions

V.9 The Reserve Bank carried forward its stance of maintaining ample liquidity in the system in Q2 of 2009-10, which was reflected in the average reverse repo balances on daily basis with the Reserve Bank increasing to about Rs.1,26,811 crore in Q2 from Rs.1,16,993 crore in Q1 of 2009-10 (Table 5.2). As against a steep decline in cash balances of the Central Government with the Reserve Bank in Q1 of 2009-10, there was a large build up of cash balances in Q2, mainly reflecting market borrowings of the Central Government and surplus transfer by the Reserve Bank (Chart V.2). The Reserve Bank, as against its intention to purchase government securities amounting to Rs.80,000 crore under the Open Market Operation (OMO) programme for the first half of 2009-10, purchased securities through the auction route amounting to Rs.57,487 crore up to end-September 2009.

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**	**18,540**	**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	**22436**	**7.06**	**10,879**	**7.54**	**34,712**	**45.92**	**-2,910^**	**1,48,889**	**2,885**	**4,498**	**11,272**	**12303**	**3713**
2008													
Apr	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	19,481	6.62	8,780	8.04	32,287	42.13	148	1,75,565	11,841	6,084	13,896	16946	5029
Jun	21,707	7.75	6,835	8.43	38,330	42.82	-5,229	1,74,433	-8,622	5,410	12,592	14997	4464
Jul	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	23,408	9.1	7,498	9.06	38,388	42.94	1,210	1,71,944	-22,560	4,996	11,713	14722	4417
Sep	23,379	10.52	10,418	8.45	44,700	45.56	-3,784	1,75,666	-42,591	5,147	12,489	13943	4207
Oct	28,995	9.9	8,641	7.85	36,999	48.66	-18,666	1,69,123	-45,612	3,911	10,810	10550	3210
Nov	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	21,641	5.92	22,903	5.88	34,874	48.63	-318	1,24,848	22,294	3,851	10,141	9514	2896
2009													
Jan	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	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	23,818	4.17	10,644	6.59	33,126	51.23	-3,388	88,077	33,360	3,489	10,140	8966	2802
Apr	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	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	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	14,394	3.21	17,739	7.01	30,396	48.48	-55	22,159	1,30,891	6,043	18,528	14635	4343
Aug	15,137	3.22	9,699	7.18	27,284	48.34	181	19,804	1,28,275	5,825	17,379	15415	4571
Sep	16,118	3.31	16,988	7.26	27,574	48.41	–	18,773	1,21,548	6,211	18,253	16338	4859

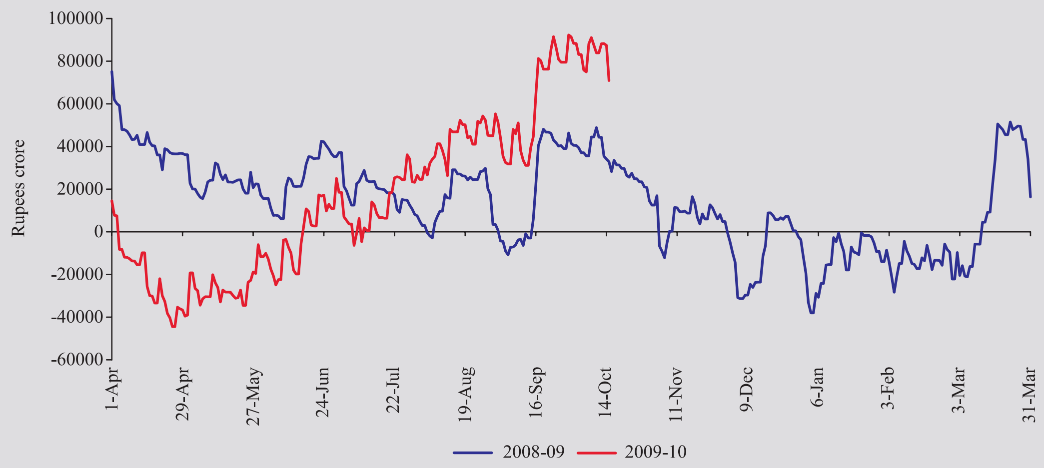
* : Average of daily weighted call money borrowing rates.
\+ : Average of daily outright turnover in Central Government dated securities.
@ : Average of daily closing rates.
\# : Average of weekly outstanding MSS.
** : Average of daily closing indices.
^ : Cumulative for the financial year.
LAF : Liquidity 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.

Cash Management of the Government

V.10 During Q1 of 2009-10, the Central Government took recourse to ways and means advances (WMA) and overdrafts (OD) on several occasions (Table 5.3). The cash balances turned positive on June 16, 2009 on account of the quarterly advance tax inflows and remained so almost throughout Q2 of 2009-10. The surplus cash balance increased from Rs.18,527 crore as at end-June 2009 to Rs.91,410 crore as at end-September 2009,buoyed by the improvement in tax revenue (direct as well

Chart V.2: Cash Balances of the Central Government



as indirect) collections, increase in surplus transfer from the Reserve Bank and increased quantum of market borrowings. The surplus cash balance moderated to Rs.69,554 crore as on October 20, 2009.

Liquidity Management

V.11 Liquidity conditions eased further during Q2 of 2009-10 with the average daily absorption under the LAF remaining high. The daily absorption under LAF which had peaked on September 4, 2009, however, moderated somewhat during the second-half of September 2009, reflecting significant outflows on account of advance tax payments (Table 5.4). The easing of liquidity conditions in the banking system in Q2, despite an increase in the cash balances of the Central Government, mainly reflected MSS unwinding (Rs.4,500 crore) and OMO auction-based purchases (Rs.29,298 crore). During 2009-10 (up to September 2009), MSS unwinding at Rs.70,000 crore (de-sequestering of Rs.28,000crore) was used as a key instrument of liquidity management (Chart V.3).

Table 5.3: Cash Management of the Central Government

			Up to end-September	
	2007-08	2008-09	2008-09	2009-10
1	2	3	4	5
Number of Days				
WMA @	91	109	16	76
OD	37	65	–	44
Cash Deficit	91	109	16	76
Average Utilisation (Rupees crore)				
WMA	3,605	2,077	371	6,194
OD	645	1,823	–	2,309

@ : Includes days of OD.

V.12 The significantly reduced rupee liquidity needs of the banking system were also evident from the fact that the special term repo facility has not been availed continuously since August 17, 2009. In view of the ample liquidity conditions, the term repo auctions which were being

Table 5.4: Liquidity Position

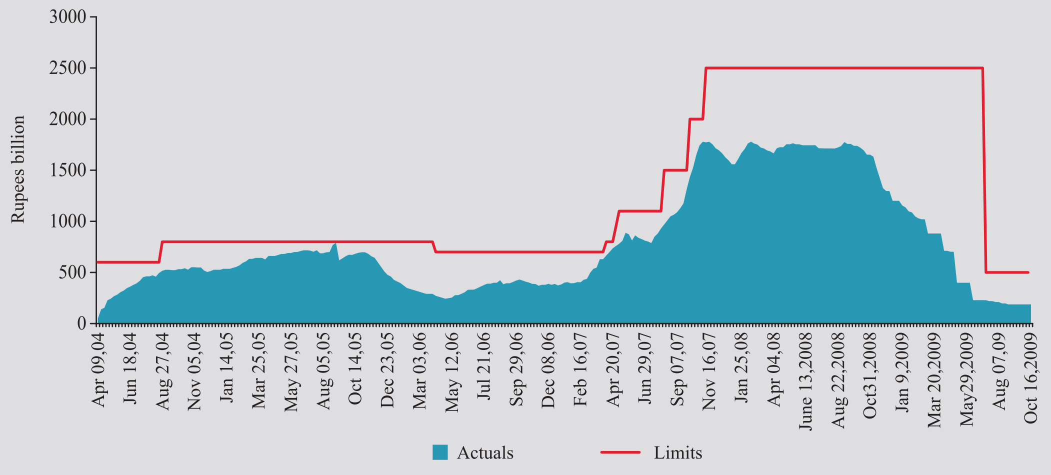
(Rupees crore)

Outstanding as on Last Friday	LAF	MSS	Centre's Surplus with the RBI @	Total (2 to 4)	Outstanding as on Last Friday	LAF	MSS	Centre's Surplus with the RBI @	Total (2 to 4)
1	2	3	4	5	1	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 16	76,260	18,773	61,343	1,56,376
November	-9,880	1,32,531	7,981	1,30,632					
December	14,630	1,20,050	3,804	1,38,484					

@ : Excludes minimum cash balances with the Reserve Bank in case of surplus.
* : Data pertain to March 31.
Note : 1. Negative sign in column 2 indicates injection of liquidity through LAF.
2. The Second LAF, conducted on a daily basis from September 17, 2008 to May 5, 2009 is being conducted only on reporting Fridays from May 8, 2009.
3. Negative sign in column 4 indicates injection of liquidity through WMA/OD.

conducted on a daily basis since October 14, 2008 are now being conducted on a weekly basis since April 27, 2009. Furthermore, the outstanding under the

Chart V.3: Market Stabilisation Scheme



forex swap facility, which was instituted to provide forex liquidity to Indian banks having foreign branches or subsidiaries, also declined to Rs.240 crore at end-September 2009 from Rs.595 crore as at end-June 2009. The tenure of the term repo and the forex swap facilities, which have been extended from time to time, is up to end-March 2010. The surplus cash balances of the centre emerged as the key drivers of liquidity conditions in Q2 of 2009-10 (Table 5.5).

Money Market

V.13 The money market continued to remain orderly during Q2 of 2009-10. Reflecting the surplus liquidity conditions, the call rate hovered around the lower bound of the informal LAF corridor during the Q2 of 2009-10 (Chart V.4). The call rate averaged 3.25 per cent in Q2, which was marginally higher than 3.22 per cent in Q1.

V.14 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 Q2 but remained below the call rate (Chart V.5). The weighted average interest rate in the collateralised segment of the money market marginally increased to 2.7 per cent during Q2 of 2009-10 from 2.4 per cent during Q1. Transaction volumes in CBLO and market repo segments continued to remain high during Q2 of

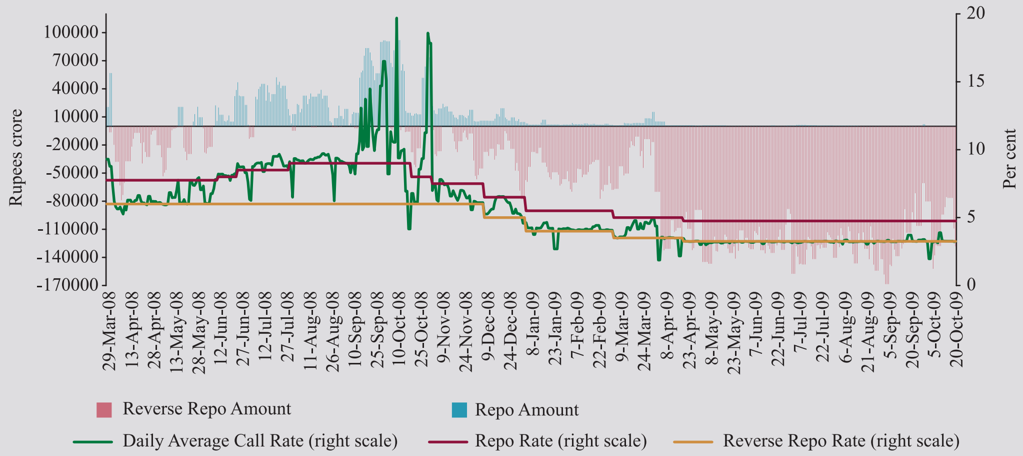
Table 5.5: Reserve Bank's Liquidity Management Operations

(Rupees crore)

Item	2008-09 Apr-Mar	2008-09				2009-10		
		Q1	Q2	Q3	Q4	Q1	July	Aug
1	2	3	4	5	6	7	8	9
A. Drivers of Liquidity (1+2+3+4)	**-1,67,708**	**6,061**	**-18,851**	**-1,01,278**	**-53,640**	**-44,599**	**1,237**	**-57**
1. RBI's net Purchase from Authorised Dealers	-1,78,592	-8,555	-40,249	-1,12,168	-17,620	-15,874	1,665	-176
2. Currency with the Public	-97,921	-30,063	12,360	-40,070	-40,147	-18,178	8,219	-3,197
3. a. Surplus Cash balances of the Centre with the Reserve Bank	60,367	40,073	-3,845	36,554	-12,415	3,382	-13,603	-18,686
3. b. WMA and OD	0	0	0	0	0	0	0	0
4. Others (residual)	48,438	4,606	12,884	14,406	16,542	-13,929	4,956	22,003
B. Management of Liquidity (5+6+7+8)	**2,35,209**	**-37,659**	**7,217**	**1,33,325**	**1,32,326**	**-21,674**	**-317**	**492**
5. Liquidity impact of LAF Repos	-51,835	-18,260	24,390	-71,110	13,145	-1,30,020	-8,185	-14,105
6. Liquidity impact of OMO (net) *	104,480	14,642	11,949	10,681	67,208	43,159	6,040	12,307
7. Liquidity impact of MSS	80,314	-6,041	628	53,754	31,973	65,187	1,827	2,290
8. First round liquidity impact due to CRR change	1,02,250	-28,000	-29,750	1,40,000	20,000	–	–	–
C. Bank Reserves # (A+B)	**67,501**	**-31,598**	**-11,634**	**32,047**	**78,686**	**-66,273**	**920**	**435**

(+) : 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.

Chart V.4: Liquidity Adjustment Facility



2009-10 reflecting the easy liquidity and active market conditions (Table 5.6). Banks as a group are the major borrowers in the collateralised segment whereas mutual funds (MFs) continue to 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 Q2, reflecting their continued enhanced lending capacity. The collateralised market remained the predominant segment of the money market, accounting for more than 80 per cent of the total volume in the money market in Q2.

V.15 There has been some circularity in the movement of funds between MFs and

Chart V.5: Money Market Interest Rates

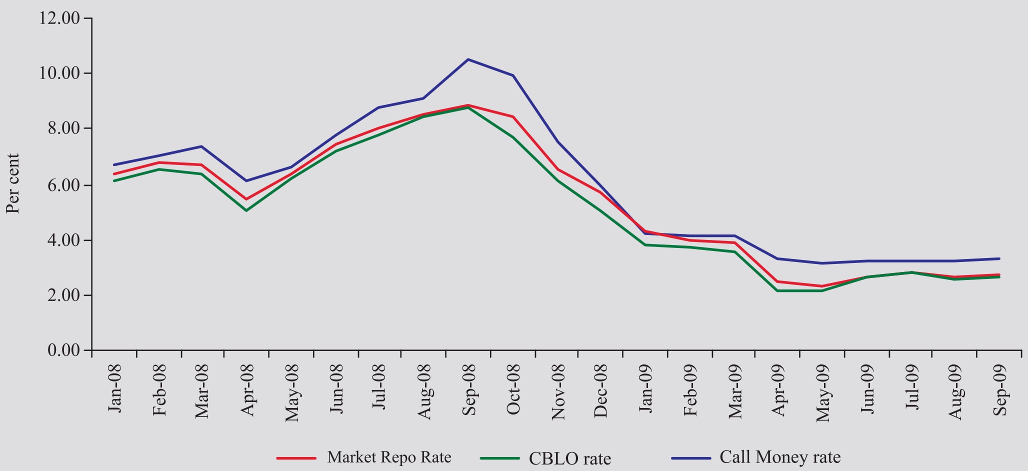


Table 5.6: Activity in Money Market Segments

(Rupees crore)

Year/Month	Average Daily Volume (One Leg)						Commercial Paper		Certificates of Deposit	
	Call	Market Repo	CBLO	Total (2+3+4)	Money Market Rate* (per cent)	Term Money Market	Outstanding	WADR (Per cent)	Outstanding	WADR (Per cent)
1	2	3	4	5	6	7	8	9	10	11
2008-09										
April	9,758	14,966	38,828	63,552	5.31	374	37,584	8.85	1,50,865	8.49
May	9,740	14,729	36,326	60,795	6.29	420	42,032	9.02	1,56,780	8.95
June	10,854	11,262	35,774	57,890	7.35	253	46,847	10.03	1,63,143	9.16
July	12,368	8,591	23,669	44,628	8.09	226	51,569	10.95	1,64,892	10.23
August	11,704	10,454	22,110	44,268	8.65	501	55,036	11.48	1,71,966	10.98
September	11,690	10,654	20,547	42,891	9.26	335	52,038	12.28	1,75,522	11.56
October	14,497	9,591	16,818	40,906	8.66	345	48,442	14.17	1,58,562	10.00
November	10,906	15,191	24,379	50,476	6.58	319	44,487	12.42	1,51,493	10.36
December	10,820	16,943	32,261	60,024	5.37	415	40,391	10.70	1,51,214	8.85
January	9,248	18,053	31,794	59,095	3.99	454	51,668	9.48	1,64,979	7.33
February	11,121	19,929	38,484	69,534	3.89	669	52,560	8.93	1,75,057	6.73
March	11,909	21,593	48,319	81,821	3.76	451	44,171	9.79	1,92,867	7.53
2009-10										
April	10,910	20,545	43,958	75,413	2.41	332	52,881	6.29	2,10,954	6.48
May	9,518	22,449	48,505	80,472	2.34	338	60,740	5.75	2,18,437	6.20
June	8,960	21,694	53,553	84,207	2.69	335	68,721	5.00	2,21,491	4.90
July	7,197	20,254	46,501	73,952	2.83	389	79,582	4.71	2,40,395	4.96
August	7,569	23,305	57,099	87,973	2.62	461	83,026	5.05	2,32,522	4.91
September	8,059	27,978	62,388	98,425	2.73	381	88,161 +	4.96 +	–	–

* : Weighted average rate of call, market repo and CBLO. + : As on September 15, 2009.
WADR: Weighted average discount rate.

banks. Banks invest a part of their resources in MFs. The MFs also lend funds to banks through CBLO and market repo. For instance, in Q2 of 2009-10, almost over 50 per cent of the banks' investment in MFs was in turn lent to banks by the MFs in the collateralised segments (Table 5.7).

Table 5.7: Movement of Funds between Banks and Mutual Funds

(Rupees crore)

Reporting Friday	MF Lending		Banks' Outstanding Investment in MFs	MFs lending in the collateralised segment as % of Banks' Investment in MFs	
	CBLO	Market repo		CBLO	Market Repo
1	2	3	4	5	6
03-Jul-09	28,320	28,846	89,472	32	32
17-Jul-09	34,851	33,984	1,29,998	27	26
31-Jul-09	42,485	26,724	1,39,619	30	19
14-Aug-09	55,540	43,203	1,56,910	35	28
28-Aug-09	58,725	33,596	1,51,136	39	22
11-Sep-09	59,899	46,754	1,56,573	38	30
25-Sep-09	29,504	29,328	66,687	44	44

Certificates of Deposit

V.16 With the easing of liquidity conditions, the fortnightly average issuance of certificates of deposit (CD) has picked up in 2009-10 so far. Most of the CD issued were of more than six months duration. The average interest rate on CD, on the back of abundant liquidity, declined between end-March 2009 and mid-June 2009 but has increased somewhat thereafter (Table 5.6).

Commercial Paper

V.17 During 2009-10, the commercial paper (CP) market also picked up with the easing of liquidity conditions and the size of fortnightly issuance has increased significantly. Leasing and finance companies continued to be the major issuers of CPs (45 per cent), followed by 'manufacturing and other companies' (41 per cent) and financial institutions (14 per cent) as at end-August 2009. The share of 'manufacturing and other companies' and 'financial institutions' in the total outstanding CPs has increased in the recent period (Table 5.8).

V.18 The significant easing of risk in the commercial paper market was evident in the secular decline in spread of CPs over 91-day treasury bills from a peak of 604 basis points in October 2008 to 161 basis points in September 2009 (Chart V.6). During 2009-10 so far, the most preferred tenor for issuance of CPs has been 60-180 days, as compared with more than 180 days in the previous year.

Treasury Bills

V.19 The gross amount mobilised through treasury bills remained substantially higher at Rs.2,23,210 crore during 2009-10 (up to October 23, 2009) as compared to the same period last year, reflecting in part the higher liquidity requirements of the Government. On July 16, 2009, it was decided to roll over the maturing amount of Treasury Bills till

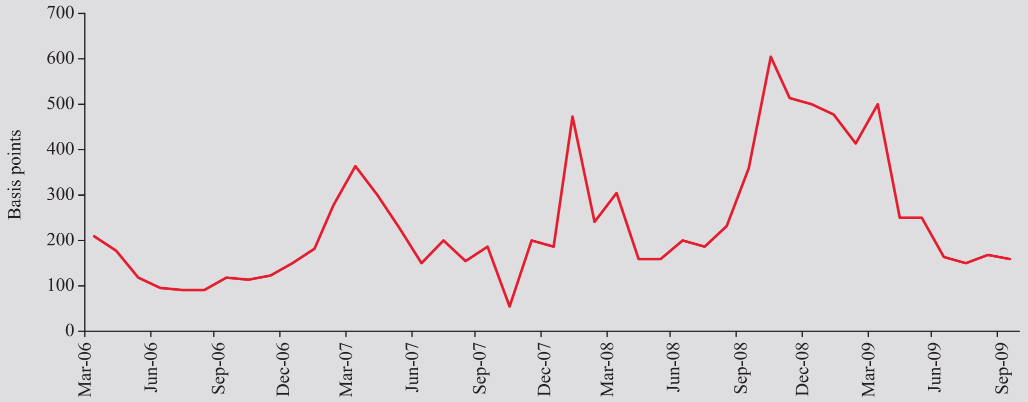
Table 5.8: Commercial Paper-Major Issuers

(Rupees crore)

Category of Issuer	End of					
	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Aug-09
1	2	3	4	5	6	7
Leasing and Finance	34,957 (74.6)	39,123 (75.0)	27,965 (73.5)	27,183 (61.5)	34,437 (50.1)	36,926 (44.5)
Manufacturing	8,150 (17.4)	9925 (19.10)	6,833 (18.0)	12,738 (28.9)	23,454 (34.1)	33,985 (40.9)
Financial Institutions	3,740 (8.0)	3,060 (5.9)	3,257 (8.5)	4,250 (9.6)	10,830 (15.8)	12,115 (14.6)
Total	**46,847**	**52,108**	**38,055**	**44,171**	**68,721**	**83,026**

Note: Figures in brackets are percentage share in total.

Chart V.6: Spread of CPs over 91-Day TBs



September 30, 2009. The implicit yield on 182-day and 364-day Treasury Bills increased somewhat in recent months (Table 5.9).

Table 5.9: 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	22,000	7.28	7.41	7.53	1.70	1.36	2.36
May 2008	21,000	7.41	7.55	7.61	2.65	2.78	3.05
Jun 2008	11,500	8.01	8.42	7.93	2.00	2.76	2.80
Jul 2008	16,000	9.07	9.33	9.39	2.35	2.72	2.70
Aug 2008	23,500	9.15	9.31	9.24	2.99	2.86	4.35
Sept 2008	25,000	8.69	8.92	8.83	3.06	3.04	3.57
Oct 2008	35,000	8.13	8.36	7.92	1.95	2.42	4.00
Nov 2008	28,000	7.30	7.13	7.23	7.95	2.97	4.33
Dec 2008	16,500	5.69	5.35	5.07	5.36	4.67	5.14
Jan 2009	38,500	4.69	4.60	4.64	4.56	3.22	4.80
Feb 2009	32,000	4.78	4.71	4.62	2.81	1.86	2.62
March 2009	30,000	4.77	4.86	5.25	2.10	2.67	1.44
2009-10							
April 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
June 2009	22,500	3.35	3.56	3.99	3.37	5.65	2.86
July 2009	40,000	3.23	3.45	3.77	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

@: Total for the financial year.

Note: 1. 182-day Treasury Bills were reintroduced with effect from April 2005.
2. Notified amounts are inclusive of issuances under the MSS.

Government Securities Market

Central Government Securities

V.20 The Central Government completed a large part (74.0 percent) of the budgeted gross market borrowing programme (including amounts raised through de-sequestering of MSS balances) during 2009-10 (up to October 23, 2009). Ample liquidity in the system facilitated borrowings, although there was some impact on interest rates arising from financing of higher fiscal deficit (Table 5.10).

State Government Securities

V.21 The Annual Policy Statement for 2009-10 had projected States' net market borrowings at Rs.1,26,000 crore, which was subsequently raised to Rs.1,40,000 crore. Up to October 22, 2009, 21 states mobilised Rs.72,216 crore (net Rs.58,683 crore) as compared with Rs.17,896 crore (net Rs.4,438 crore) raised by 12 states during the corresponding period of the previous year. Despite higher borrowings, the interest rate on the State Government securities moderated reflecting the market liquidity, although there has been some pressure on interest rates in recent months (Table 5.10).

Secondary Market

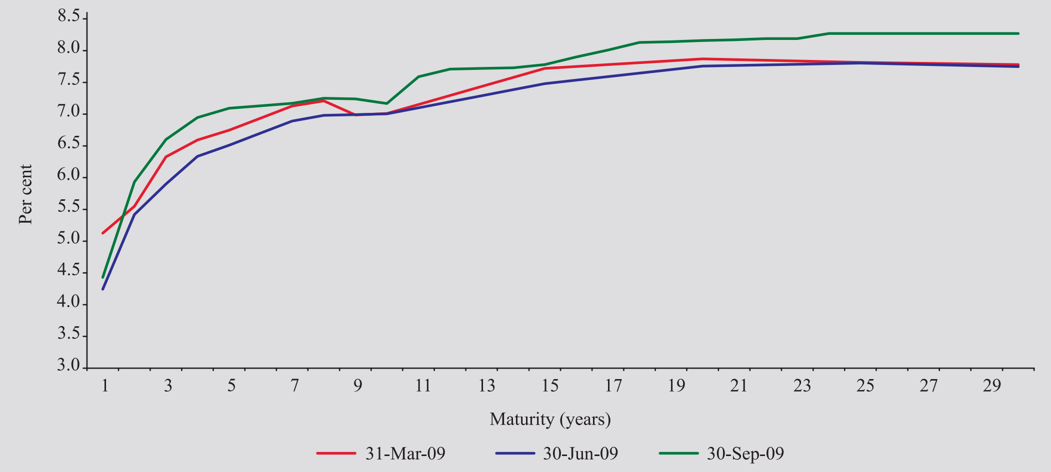
V.22 The gradual increase in yield across the maturity spectrum was evident during Q2 of 2009-10. Between end-June 2009 and end-September 2009, the yield on 1-30 year maturity increased between 16-70 basis points. The yield curve continued to reveal moderation in rates towards the short end on account of prevalence of abundant liquidity in the financial system. However, the medium to long-term yields hardened on concerns of large fiscal deficit (Chart V.7). The turnover in government securities market

Table 5.10: 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	1,06,000	3,23,000
Re-issuances	34	52	20	64
New issues	1	4	1	5
Bid-cover ratio (Range)	1.6-4.8	1.7-4.5	1.4-3.5	1.4-3.6
Weighted average maturity (years)	14.9	13.8	15.5	10.9
Weighted average yield (per cent)	8.12	7.69	8.81	7.08
Devolvement on PDs (Rupees crore)	957	10,773	2,420	6050
State Governments				
Gross amount raised (Rupees crore)	67,779	1,18,138	15,884	63,212
Cut-off yield	7.84-8.90	5.80-9.90	8.39-9.90	7.04-8.37
Weighted average yield (per cent)	8.25	7.87	9.05	7.90

: Up to September 30.

Chart V.7: Government Securities Yield Curve



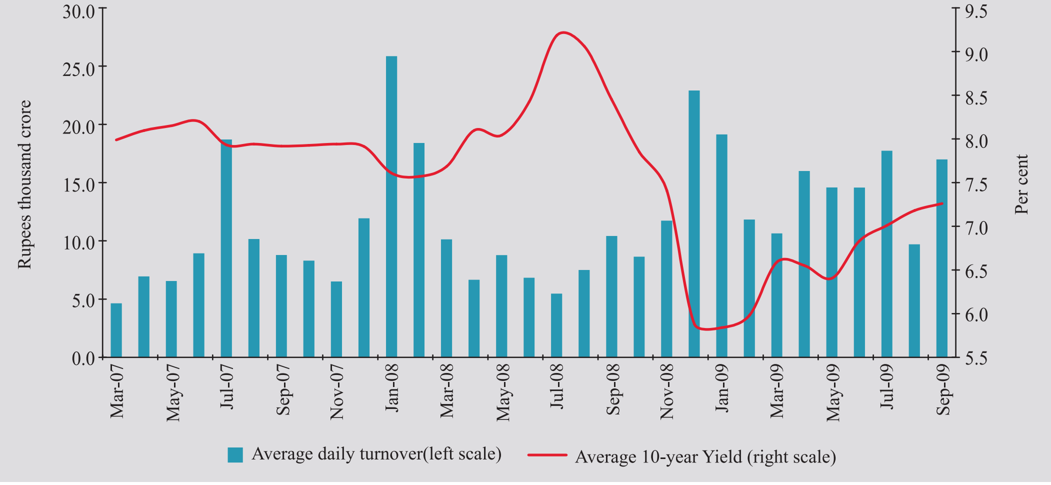
started showing signs of pick up in the current fiscal year so far (Chart V.8).

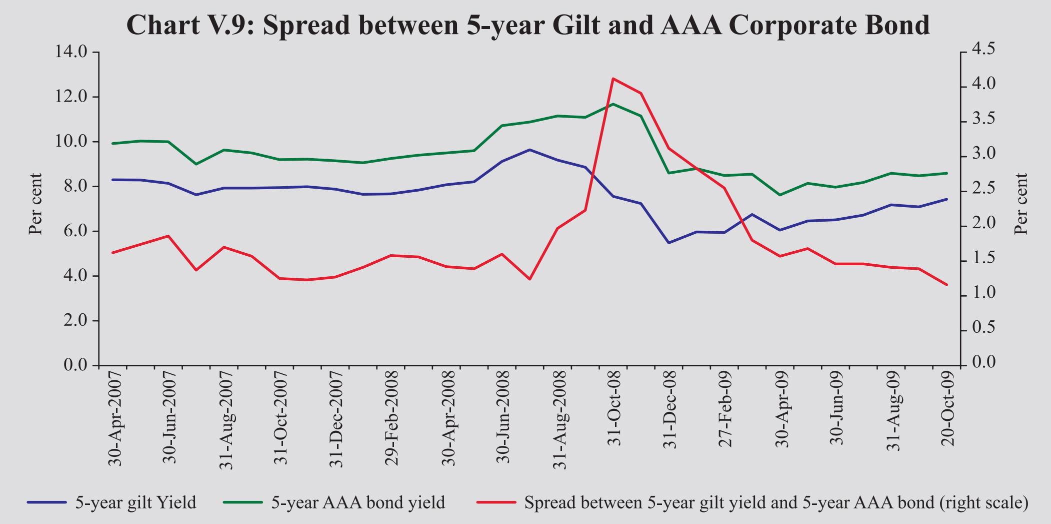
V.23 The yield on 5-year AAA-rated corporate bonds started hardening in Q2 of 2009-10, in tandem with increase in government bond yields. The risk spread on corporate bonds, however, continued to narrow to broadly return to the pre-Lehman level (Chart V.9).

Credit Market

V.24 In response to the prevailing ample market liquidity and the lower policy interest rate environment, the SCBs continued to soften their deposit rates for various maturities by 25-225 basis points during Q2 2009-10 (Table 5.11). The impact of the lower cost of funds for banks was also transmitted to the interest

Chart V.8: Government Securities Market turnover





rates on bank loans with benchmark prime lending rates (BPLRs) of SCBs declining by 25-100 basis points during the same period.

Table 5.11: Deposit and Lending Rates

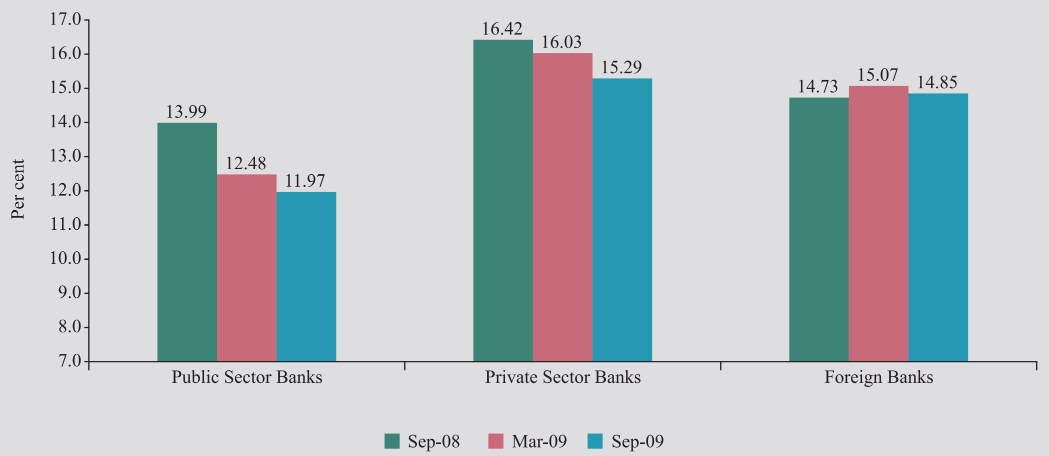
(Per cent)

	March 2007	March 2008	March 2009	June 2009	October 2009#
1	2	3	4	5	6
1) Domestic Deposit Rate					
Public Sector Banks					
Up to 1 year	2.75-8.75	2.75-8.50	2.75-8.25	1.00-7.00	1.00-6.75
> 1year-3 years	7.25-9.50	8.25-9.25	8.00-9.25	6.50-8.00	6.25-7.50
> 3 years	7.50-9.50	8.00-9.00	7.50-9.00	7.00-8.50	6.50-8.00
Private Sector Banks					
Up to 1 year	3.00-9.00	2.50-9.25	3.00-8.75	2.00-7.50	2.00-7.00
> 1year-3 years	6.75-9.75	7.25-9.25	7.50-10.25	6.00-8.75	5.25-8.00
> 3 years	7.75-9.60	7.25-9.75	7.50-9.75	6.00-9.00	5.75-8.25
Foreign Banks					
Up to 1 year	3.00-9.50	2.25-9.25	2.50-8.50	1.80-8.00	1.25-8.00
> 1year-3 years	3.50-9.50	3.50-9.75	2.50-9.50	2.25-8.50	2.25-8.50
> 3 years	4.05-9.50	3.60-9.50	2.50-10.00	2.25-9.50	2.25-8.50
2) BPLR					
1. Public Sector Banks	12.25-12.75	12.25-13.50	11.50-14.00	11.00-13.50	11.00-13.50
2. Private Sector Banks	12.00-16.50	13.00-16.50	12.75-16.75	12.50-16.75	12.50-16.75
3. Foreign Banks	10.00-15.50	10.00-15.50	10.00-17.00	10.50-16.00	10.50-16.00
3) Actual Lending Rate*					
1. Public Sector Banks	4.00-17.00	4.00-17.75	3.50-18.00	3.50-17.50	–
2. Private Sector Banks	3.15-25.50	4.00-24.00	4.75-26.00	4.10-26.00	–
3. Foreign Banks	5.00-26.50	5.00-28.00	5.00-25.50	2.76-25.50	–

* : 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 October 15, 2009. –: Not available.

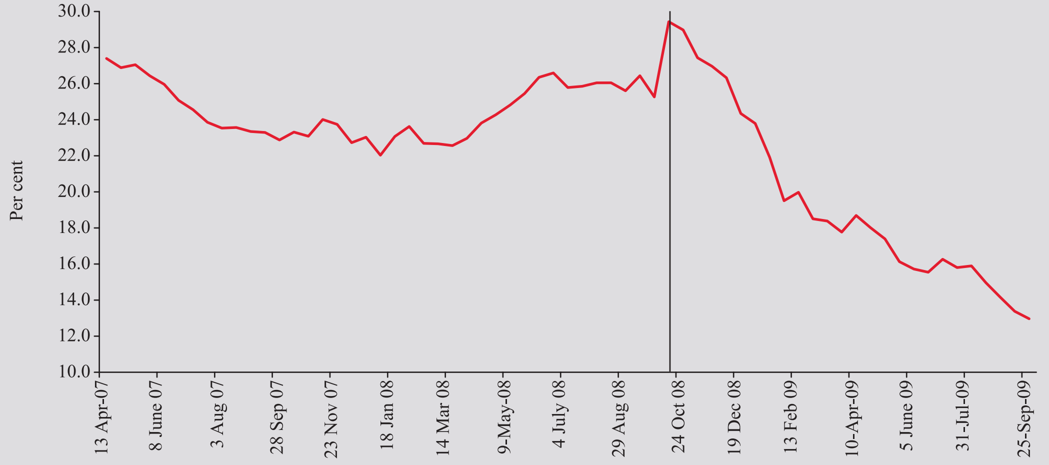
Chart V.10: Weighted Average BPLRs of Commercial Banks



V.25 The weighted average BPLRs of public sector and private sector banks exhibited a secular decline after September 2008 (Chart V.10). The share of sub-BPLR lending for all SCBs (excluding export credit and small loans) declined from 75.8 per cent in March 2008 to 66.9 per cent in March 2009. On the whole, gradual moderation in lending and deposit rates continued, contributing thereby to an improvement in the monetary policy transmission.

V.26 Despite lower interest rates on lending, the growth of non-food bank credit continued to decelerate in Q2 of 2009-10 (Chart V.11). This should be interpreted though along with the increase in resources mobilised from the non-banking sources, particularly in the form of issuance of CPs

Chart V.11: Non-Food Bank Credit Growth (Year-on-Year)



and private placements in equity market. Nevertheless, credit cards and consumer durables related credit have exhibited negative growth so far suggesting persistent slowdown in consumption demand.

Foreign Exchange Market

V.27 After exhibiting appreciating trend in Q1 of 2009-10, the rupee exhibited greater two-way movements during Q2 on the back of return of capital inflows. The resilience shown by the Indian economy in the face of global economic crisis and continued weakness of the US dollar in the international markets also contributed to the strength of the rupee (Chart V.12). The rupee has strengthened against the US dollar during October 2009 so far on the back of sustained dollar inflows and continued weakness of the US dollar against the euro. As on October 22, 2009, the rupee appreciated by 9.2 per cent against the US dollar and 1.7 per cent against the Japanese yen over end-March 2009 level. The rupee, however, depreciated by 5.9 per cent against the pound sterling and 3.4 per cent against the euro.

V.28 The average 6-currency trade-based REER (base: 1993-94=100) appreciated by 5.2 per cent between March and August 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.12 and Table 5.12). The 6-currency REER stood at 104.2 on October 21, 2009. In relation to the base year, over a long-term, the REER exhibits relative stability.

V.29 Reflecting the easing supply conditions in the foreign exchange market led by capital inflows, the forward premia generally exhibited declining trend during April-July 2009. However, the forward premia have exhibited both hardening as well as softening trend since August 2009, reflecting underlying demand and supply conditions (Chart V.13). The daily average

Chart V.12: Nominal and Real Exchange Rates

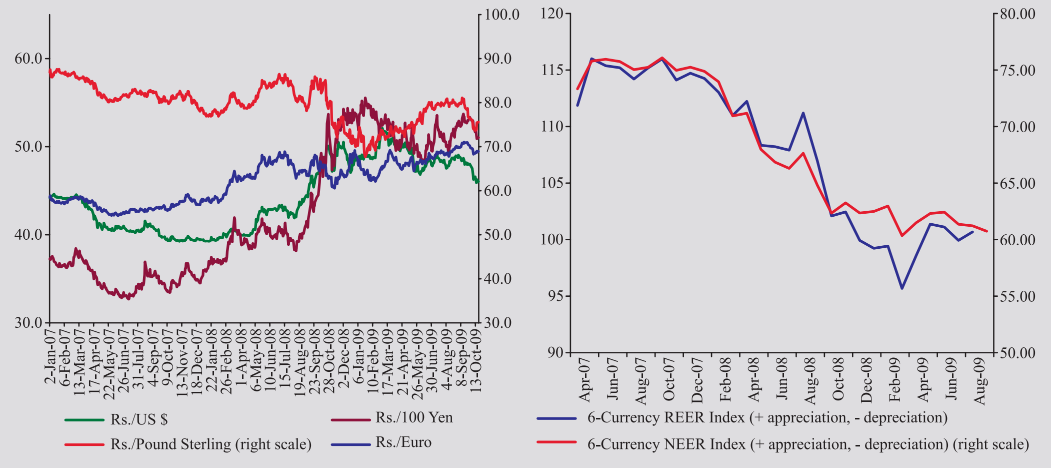


Table 5.12: Nominal and Real Effective Exchange Rate of the Indian Rupee (Trade Based Weights, Base : 1993-94 (April-March) = 100)

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	86.15	94.62
Sep. 2008(P)	64.81	106.96	85.42	95.96
Oct 2008(P)	62.34	102.09	83.23	92.31
Nov 2008(P)	63.25	102.45	84.69	92.59
Dec 2008(P)	62.35	99.93	83.91	90.48
Jan 2009(P)	62.49	99.23	83.62	90.02
Feb 2009(P)	62.97	99.43	85.20	91.02
Mar, 2009(P)	60.35	95.68	82.13	88.51
Apr 2009(P)	61.49	98.58	82.67	89.72
May 2009(P)	62.31	101.37	83.41	91.76
June 2009(P)	62.43	101.11	83.71	92.19
July 2009(P)	61.36	99.93	82.33	91.54
Aug 2009(P)	61.22	100.68	82.02	91.58
Per cent Change				
	2007-08	2008-09 (P)	2008-09 (Apr-Aug)	2009-10 (Apr-Aug)
36-REER	6.4	-9.7	-2.2	3.5
36-NEER	9.3	-8.3	-1.6	-0.1
6-REER	8.2	-8.5	0.2	5.2
6-NEER	7.6	-13.2	-4.7	1.4
Rs/USD	12.5	-12.4	-14.8 *	6.0 *

NEER : Nominal Effective Exchange Rate.
REER : Real Effective Exchange Rate.
P : Provisional. - : Not available. * : Up to end-September
Note: 1. Data from 2008-09 onwards are provisional.
2. Rise in indices indicates appreciation of the rupee and *vice versa*.

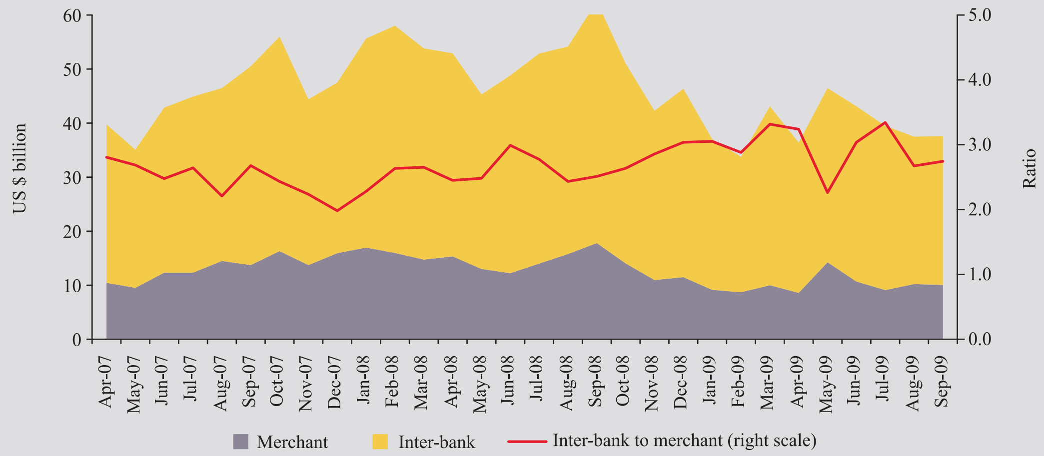
turnover in the foreign exchange market, which showed some signs of improvement in May 2009, registered decline during the period June-September 2009. The ratio of inter-bank to merchant turnover increased to 2.9 during April-September 2009 from 2.6 a year ago (Chart V.14).

Equity Market

V.30 During 2009-10 so far, the Indian capital market outperformed most EMEs, recovering a large part of the household wealth that was eroded by the contagion from global financial crisis. The secondary markets continued to register considerable gains on the back of credible indications of pickup in the domestic industrial activity and emerging signs of recovery in the world economy. The primary market, which had remained subdued up to May 2009 also resumed activity. Indeed, a few IPOs were oversubscribed by more than 20 times. Resource mobilisation by mutual funds also

Chart V.13: Movement in Rs./US Dollar Forward Premia

Chart V.14: Daily Average Turnover in Foreign Exchange Market



increased substantially. The volatility in the stock market during April-September 2009 was higher compared with the same period of last year (Table 5.13) arising from intermittent uncertainty regarding global economy and the changing perception about the real impact of domestic monsoon situation. The turnover in cash segment and

Table 5.13: Stock Market Indicators

Indicator	BSE				NSE			
	2007-08	2008-09	April-September		2007-08	2008-09	April-September	
			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	12860	17127	4735	3021	3921	5084
(ii) Average	16569	12366	15059	14298	4897	3731	4511	4284
2. Coefficient of Variation	13.7	24.2	8.7	12.5	14.5	23.2	8.3	11.6
3. Price-Earning Ratio (end-period)*	20.1	13.7	16.2	22.2	20.6	14.3	16.9	22.9
4. Price-Book Value Ratio (end-period)*	5.2	2.7	3.4	4.1	5.1	2.5	3.3	3.8
5. Yield* (per cent per annum) (end-period)	1.1	1.8	1.4	1.1	1.1	1.9	1.5	1.0
6. Listed Companies	4,867	4,929	4,926	4,946	1,381	1,432	1,424	1,435
7. Cash Segment Turnover (Rupees crore)	15,78,856	11,00,074	6,82,658	7,62,205	35,51,038	27,52,023	16,05,906	22,87,846
8. Derivative Segment Turnover (Rupees crore)	2,42,308	12,268	11,983	1,007	1,30,90,478	1,10,10,482	59,63,895	83,38,128
9. Market Capitalisation (Rupees crore) @	51,38,015	30,86,076	41,65,388	57,08,338	48,58,122	28,96,194	39,00,185	53,53,880
10. Market Capitalisation to GDP Ratio (per cent)	108.8	58.0	78.3	107.3	102.9	54.4	73.3	100.6

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

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

market capitalisation increased during April-September 2009 compared with April-September 2008. The turnover in the derivative segment at the NSE was also higher during the period.

Primary Market

V.31 The activity in the primary market segment of the domestic capital market has displayed signs of revival since June 2009. Cumulatively, resources raised through public issues increased considerably during April-September 2009 (Table 5.14). The resources raised through Euro issues by the Indian corporates also increased markedly.

V.32 Mobilisation of resources through private placement increased by 28.7 per cent during April-June 2009 (the latest data available) as against decline of 15.7 per cent during April-June 2008. Resource mobilisation through financial intermediaries (both public and private sector) registered a decline of 19.1 per cent, while the non-financial intermediaries registered an increase of 94.6 per cent during the same period.

V.33 During April-September 2009, net resource mobilisation by mutual funds increased sharply with liquidity conditions remaining comfortable and the stock markets witnessing considerable gains (Table 5.15). Scheme-wise, during April-September 2009, income/debt oriented schemes witnessed a net inflow of Rs.1,07,012 crore, while growth/equity oriented schemes registered a net inflow Rs.5,721 crore.

Table 5.14: Mobilisation of Resources from the Primary Market

(Amount in Rupees crore)

Item	No. of Issues	Amount	No. of Issues	Amount
	2008-09 (April-September)		2009-10 (April-September)	
1	2	3	4	5
A. Prospectus and Rights Issues*				
1. Private Sector (a+b)	32	12,361	25	6,814
a) Financial	1	448	–	–
b) Non-financial	31	11,913	25	6,814
2. Public Sector (a+b+c)	–	–	2	6,803
a) Public Sector Undertakings	–	–	1	4,026
b) Government Companies	–	–	1	2,777
c) Banks/Financial Institutions	–	–	-	–
3. Total (1+2)	**32**	**12,361**	**27**	**13,617**
of which:				
(i) Equity	32	12,361	26	13,437
(ii) Debt	–	–	1	180
Memo:				
B. Euro Issues	**10**	**4,652**	**8**	**12,645**

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

Table 5.15: Resource Mobilisation by Mutual Funds

(Rupees crore)

Category	April-March 2008-09 Net Mobilisation@	April-March 2008-09 Net Assets #	April-September 2008-09 Net Mobilisation@	April-September 2008-09 Net Assets #	April-September 2009-10 Net Mobilisation@	April-September 2009-10 Net Assets #
1	2	3	4	5	6	7
Private Sector	-34,017	3,35,527	-2,667	3,95,074	83,864	4,95,709
Public Sector *	5,721	81,772	5,141	88,205	28,563	1,32,290
Total	-28,296	4,17,300	2,473	4,83,278	1,12,427	6,27,999

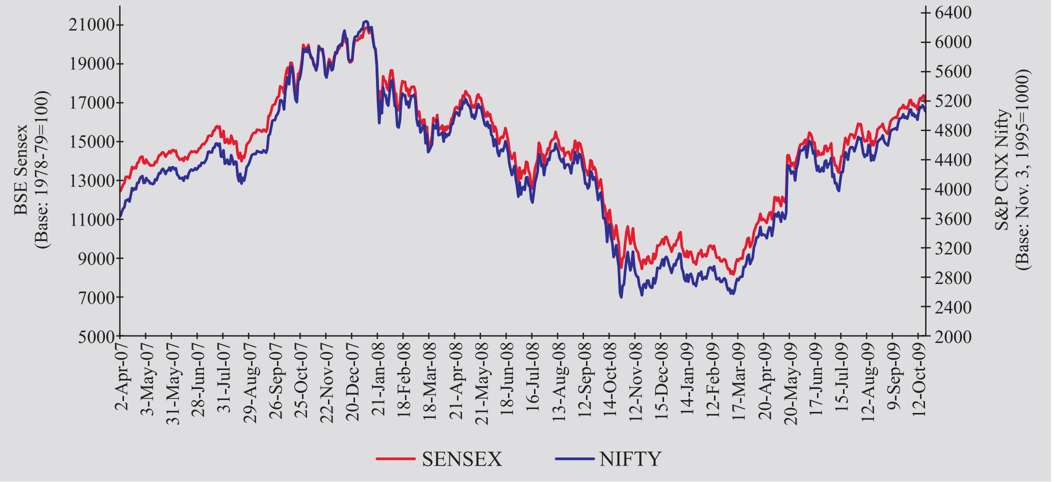
@ : Net of redemptions. # : End-period. * : Including UTI Mutual fund.
Note : Data exclude funds mobilised under Fund of Funds Schemes.
Source : Securities and Exchange Board of India.

Secondary Market

V.34 The market sentiments continued to remain positive during Q2 of 2009-10. After remaining subdued at the beginning of July 2009, the markets moved up subsequently following the firm trend in the international equity markets, better than expected earnings result by some Indian corporates and banks, besides the Reserve Bank allowing FIIs and NRIs to invest in Indian Depository Receipts. The Indian stock markets again witnessed some correction beginning in the second week of August 2009 with negative feedback from the US unemployment and retail data, concerns over expected tightening of bank lending in China, deficient monsoon and sustained decline in India's exports. The markets, thereafter, recovered on better than expected economic data from the US and the Euro area, robust IIP growth in India for June 2009 and higher GDP growth for Q1 of 2009-10. The positive sentiments continued through September 2009 mainly on account of strong global cues such as G-20 leaders pledging to maintain stimulus measures, Federal Reserve's survey reporting economic activity stabilising or improving in most regions of US in July-August 2009, strong growth in Chinese industrial production, the Bank of Japan upgrading its economic outlook as well as positive domestic developments such as higher advance tax paid by major Indian banks and corporates indicating robust quarterly earnings. The Sensex crossed 17000 mark by the end-September 2009 with strong support from FII inflows and positive global data. As at end-September 2009, the BSE Sensex and the S&P CNX Nifty both registered gains of about 18 per cent over end-June 2009 (Chart V.15).

V.35 FIIs and mutual funds made net purchases in the stock markets in Q2 of 2009-10. According to the data released by the Securities and Exchange Board of India (SEBI), FIIs made net purchases of US$ 7.4 billion in the Indian equity market

Chart V.15: Movement in Indian Stock Markets



during Q2 of 2009-10 as against net sales of US $2.4 billion in the comparable period of the previous year (Chart V.16). Mutual funds purchases in stock markets, however, decreased during Q2 of 2009-10 compared with the comparable period of previous year.

V.36 The sectoral indices witnessed buying pressure across the board during the current financial (up to end-September 2009) with rising investor interest. This resulted in significant gains in prices in sectors such as realty, metal, banking, auto, consumer durable, capital goods and information technology sector stocks (Table 5.16).

V.37 During Q3 of 2009, international financial markets exhibited higher

Chart V.16: Institutional Investment in Stock Market

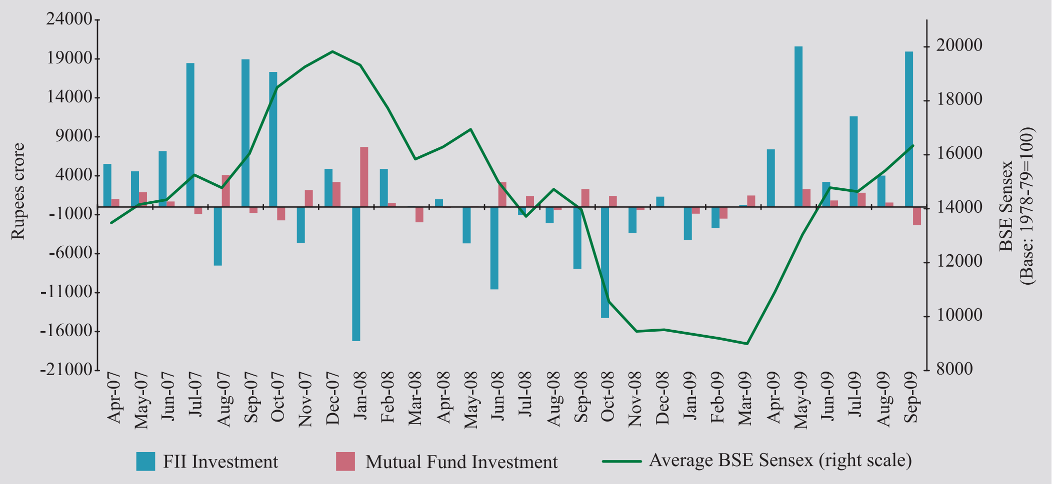


Table 5.16: BSE Sectoral Stock Indices

(Base: 1978-79=100)

Sector	Variation (per cent)		
	End-March 2008@	End-March 2009@	End-September 2009#
1	2	3	4
Fast Moving Consumer Goods	31.7	-11.1	26.5
Public Sector Undertakings	25.4	-29.6	70.3
Information Technology	-27.6	-35.6	100.0
Auto	-7.1	-32.3	116.4
Oil and Gas	56.0	-29.6	48.5
Metal	65.2	-58.7	144.6
Health Care	5.4	-26.5	55.6
Bankex	18.0	-41.8	119.5
Realty	33.8	-79.3	188.9
Capital Goods	54.4	-53.8	112.8
Consumer Durables	8.8	-58.1	115.8
BSE 500	**24.3**	**-42.8**	**86.0**
BSE Sensex	**19.7**	**-37.9**	**76.4**

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

Source: Bombay Stock Exchange Limited.

confidence, improved risk appetite, narrowing of spreads and reduced volatility. In the interbank money market, key spreads narrowed to further low levels due to receding risks and continuation of easing policy stance by the major central banks; improvements were also evident in credit markets although still marked by weaknesses in some segments of the mortgage market. Despite deleveraging by the international financial institutions, the pace of corporate bond issuances picked up, indicating momentum in the underlying investment and real activity. The risk spread on EME bonds significantly receded, indicating rise in risk appetite towards EME assets and improvement in their access to international capital. The equity markets of both advanced economies and EMEs staged further recovery in Q3 of 2009.

V.38 The domestic financial markets witnessed further reduction in risk and liquidity premia in various segments besides a pickup in transaction volumes during Q2 of 2009-10. The prevalence of easy liquidity conditions in money market was evident in the large absorption through the reverse repo operation. This ample liquidity condition facilitated low interest rates in money market with call rates hovering within the LAF corridor. Transaction volumes in CBLO and market repo segments continued to remain high during Q2 of 2009-10, reflecting easy liquidity conditions. The CP issuances also increased significantly. The longer-term yield, however, witnessed some increase, both for the government and corporate bonds, reflecting the concerns regarding government borrowing programme, incipient inflationary pressures and possible increase in demand for credit with expected recovery in the real activity. Although the growth of bank credit to private sector continued to be moderate, improved transmission of policy rates to lending rates was discernible. The equity markets made substantial recovery on the strength of improved domestic fundamentals, on clearer signs of recovery in the global economy and resumption of capital flows. In the primary market there was improvement in resource mobilisation by corporates in Q2 of 2009-10. The net resources mobilised by mutual funds recorded substantial increase, with liquidity conditions remaining comfortable. The equity prices witnessed considerable gains in sectors such as realty, metal, banking, auto, consumer durables, capital goods and information technology. Overall, the domestic financial markets remained stable and supportive of recovery in growth.

VI. PRICE SITUATION

The decline in WPI inflation from a peak of 12.9 per cent in August 2008 coincided with the moderation in economic growth, thereby creating space for the adoption of an accommodative growth supportive monetary policy stance, which has continued in 2009-10 so far. The emerging inflationary pressures are clearly visible in terms of the increase in WPI by 5.9 per cent over its end-March level as well as high and rigid CPI inflation. The changing inflation environment is being driven by high order of price increases in essential commodities, particularly in items of mass consumption like vegetables, pulses and sugar. The dominance of the food price inflation is evident from the fact that inflation in WPI (y-o-y) excluding the food category remains significantly lower at (-)3.4 per cent, as against the headline inflation of 1.2 per cent as on October 10, 2009. Given the nature of the sources of emerging inflation, sustained policy emphasis on improving both supply conditions and supply chain for distribution would be necessary.

VI.1 The significant moderation in global inflation that had started with the onset of the global crisis in 2008-09, continued in 2009-10, with several advanced countries experiencing negative inflation due to sharp fall in commodity prices in the second half of 2008-09 and the sustained recession in aggregate demand. Prices of food, fuel and metal prices had bottomed in December 2008 and have been firming up moderately since then. Sluggish global demand and presence of unutilised capacity have, however, contained the risk of inflation, thereby allowing the central banks around the world to sustain the accommodative monetary policy stance to spur economic growth.

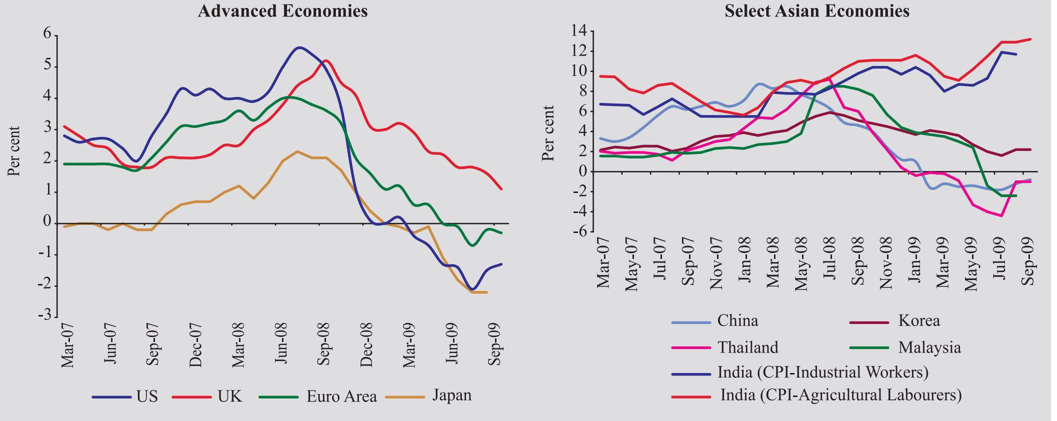
VI.2 In India, inflation as measured by year-on-year variations in the wholesale price index (WPI), which had tracked the global inflation in 2008-09, declined sharply from 12.9 per cent in August 2008 to 0.8 per cent by end-March 2009. The gradual moderation, thereafter, yielded negative inflation for 13 consecutive weeks beginning in June 2009, before WPI inflation turned positive again since early September 2009. The emerging inflationary pressure is evident from the increase in WPI inflation during the current financial year over end-March 2009 by 5.9 per cent (up to October 10, 2009) and high CPI inflation in the range of 11.7-13.2 per cent in August/ September 2009. Given the weak demand as well as slowdown in economic activities, it is the supply constraints in a limited number of commodities, led by food, which have been driving the current inflation pressures.

Global Inflation

VI.3 After registering high levels of inflation during the first half of 2008-09, headline inflation in major advanced economies steeply declined subsequently and turned negative in 2009. Year-on-year consumer price inflation in OECD countries, which had consistently been declining up to July 2009 from its peak of 4.9 per cent in July 2008, moved up marginally in August 2009, but continued to remain negative at (-) 0.3 per cent. The recent decline in inflation in OECD countries was led by a sharp decline in CPI for energy. Amongst the major economies, headline inflation in the US, Japan and Euro Area has turned negative while in the UK, inflation has been steadily declining (Chart VI.1). Core inflation also moderated in major economies. In OECD countries, inflation, excluding food and energy, decelerated to 1.5 per cent in August 2009 from 2.4 per cent in September 2008. Producer Price Index (PPI) inflation declined sharply both in advanced as well as emerging market economies (EMEs). PPI inflation in the euro-area, which firmed up to 9.9 per cent in July 2008, declined steadily during 2009; the maximum decline of 8.4 per cent was registered in July 2009. The rate of decline was lower at (-) 7.5 per cent in August 2009, with the index of euro-area manufacturing posting the highest month-on-month increase in the past 14 months.

VI.4 Even though the headline inflation in most of the advanced countries have declined significantly since mid-2008, the earlier 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 moderated to some extent, due to signs of policy induced recovery in terms of a rebound in manufacturing and a turn in the inventory cycle. Major factors that contributed to the disinflation process include the steep decline in oil prices from the record level in July 2008, large downward corrections in food and metals prices, lower transportation costs and the existence of significant industrial slackness due to sub-optimal capacity utilisation. According to the IMF (October 2009), global inflation is expected to remain subdued and vulnerable to mild deflation. With inflationary expectations remaining generally well-anchored, risks for sustained

Chart VI.1: Consumer Price Inflation



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

deflation are, however, perceived to be small. On the other hand, inflation risk may be more in emerging economies where output gaps are smaller and recovery may be stronger. IMF 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 2009-10. China, a few ASEAN economies and most emerging European economies are likely to experience inflation of less than 5 per cent.

VI.5 Mitigating the adverse impact of the financial crisis continued to be the focus of monetary policy actions of most central banks. Policy rates in advanced economies such as 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. Reserve Bank of Australia had reduced its policy rate by 25 basis points on April 8, 2009 but reversed it in October 7, 2009 on signs of economic recovery and improvement in measures of confidence (Table 6.1). Bank of Israel had also reduced its policy rate by 25 basis points effective from April 2009 but raised it back by 25 basis points effective from September 2009.

VI.6 In the emerging economies, inflation eased significantly since July 2008, in line with decreases in international commodity prices and general slowdown in economic activity brought about by the global financial crisis. Among the major emerging economies, consumer price inflation in China and Thailand turned negative in early 2009, while it turned negative in Malaysia in June 2009; other major economies also witnessed significant easing in price pressures. Most central banks in emerging economies (except China) reduced their policy rates in 2009 in an effort to arrest the moderation in growth and to counter the spillover effects of the global financial crisis. The central banks of Russia, Thailand, Indonesia and Philippines continued to reduce their policy rates during the July-September quarter of 2009.

Global Commodity Prices

VI.7 International commodity prices, after sharply declining during the period July to December 2008, witnessed increases in 2009 up to September 2009 on account of crude oil and metal prices. Prices of foodgrains, such as rice, wheat and maize, however, declined both on a year-on-year basis as well as over end-March 2009 (Table 6.2). Most commodity prices, however, remained substantially below the very high levels recorded during the first half of 2008, which contributed to the negative year-on-year changes (Chart VI.2). Expectations of global economic recovery and weak supply prospects in major agricultural products, such as sugar and tea have been the major drivers of the recent increases in international commodity prices.

VI.8 After exhibiting the highest intra-year volatility in 2008-09, international crude oil prices have gradually firmed up since March 2009, in response to expected global economic recovery and successive production cuts by Oil Producing and Exporting Countries (OPEC) to support

Table 6.1: Global Inflation Indicators

(Per cent)

Country/ Region	Key Policy Rate	Policy Rate (As on October 22, 2009)		Changes in Policy Rates (basis points)		CPI Inflation (y-o-y)	
				Sept 08 - Mar 09	Since end-Mar 09	Sep. 2008	Sep. 2009
1	2	3		4	5	6	7
Developed economies							
Australia	Cash Rate	3.25	(Oct.7, 2009)	(-) 400	0	4.5^	1.5^
Canada	Overnight Rate	0.25	(Apr.21,2009)	(-) 250	(-) 25	3.4	-0.9
Euro area	Interest Rate on Main Refinancing Operations	1.00	(May 13,2009)	(-) 275	(-) 50	3.6	-0.3
Japan	Uncollateralised Overnight Call Rate	0.10	(Dec.19,2008)	(-) 40	0	2.1*	-2.2*
UK	Official Bank Rate	0.50	(Mar. 5,2009)	(-) 450	0	5.2	1.1
US	Federal Funds Rate	0.00 to 0.25	(Dec.16,2008)	(-) 200	0	4.9	-1.3
Developing economies							
Brazil	Selic Rate	8.75	(July 22, 2009)	(-) 250	(-) 250	6.3	4.3
India	Reverse Repo Rate	3.25	(Apr. 21, 2009)	(-) 250	(-) 25	9.0*	11.7*
	Repo Rate	4.75	(Apr. 21, 2009)	(-) 400	(-) 25		
				(-400)	0		
China	Benchmark 1-year Lending Rate	5.31	(Dec 23, 2008)	(-) 216	0	4.6	-0.8
				(-300)	0		
Indonesia	BI Rate	6.50	(Aug. 5, 2009)	(-) 150	(-) 125	12.2	2.8
Israel	Key Rate	0.75	(Sep. 1, 2009)	(-) 350	0	5.5	2.8
Korea	Base Rate**	2.00	(Feb. 12, 2009)	(-) 325	0	5.1	2.2
Philippines	Reverse Repo Rate+	4.00	(Jul. 9, 2009)	(-) 125	(-) 75	11.9	0.7
Russia	Refinancing Rate	10.00	(Sep 30, 2009)	200	(-) 300	15.1	10.7
South Africa	Repo Rate	7.00	(Aug.14, 2009)	(-) 250	(-) 250	13.7*	6.4*
Thailand	1-day Repurchase Rate	1.25	(Apr. 8, 2009)	(-) 225	(-) 25	6.0	-1.0

^ : Q2. *: August.

Note : 1. The central banks of Australia and Israel had reduced their policy rates by 25 basis points, effective from April 2009 but increased them again by 25 basis points, effective from October 2009 and September 2009, respectively.
2. For India, data on inflation pertain to CPI for Industrial Workers.
3. Figures in parentheses in column (3) indicate the dates when the policy rates were last revised.
4. Figures in parentheses in column (4) indicate the variation in the cash reserve ratio during the period.

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

prices. Crude oil prices breached the US $70 per barrel level in June 2009 and again in August 2009. While crude oil prices marginally declined in September 2009, they started firming up in October 2009 and crossed US $ 80 per barrel on October 21, 2009 due to the weakness of the US dollar and expectations of a recovery in global oil consumption in the face of sustained economic growth in China and signs of a turnaround in other Asian countries. According to the US Energy Information Association, the presence of high oil inventories and expectation of

Table 6.2: International Commodity Prices

Commodity	Unit	Market Price (2004)	Index (2004=100) 2006	2007	2008	2009 Mar	Apr	May	Jun	Jul	Aug	Sep	Variation (Per cent) Sep-09 over Sep-08	Sep-09 over Mar 09
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Energy														
Coal	$/mt	53	93	124	240	115	120	122	135	139	137	128	-54.9	10.9
Crude oil (Average)	$/bbl	38	170	188	257	124	133	154	183	171	190	181	-31.4	46.5
Non-Energy Commodities														
Palm oil	$/mt	471	101	165	201	127	149	170	154	136	153	143	-12.6	12.7
Soybean oil	$/mt	616	97	143	204	118	130	145	145	136	144	137	-31.0	16.4
Soybeans	$/mt	307	88	125	171	124	135	152	164	151	154	140	-15.5	13.5
Rice	$/mt	238	128	137	274	247	231	224	242	241	221	218	-24.1	-11.8
Wheat	$/mt	157	122	163	208	147	149	167	164	143	134	121	-35.6	-17.6
Maize	$/mt	112	109	146	200	147	151	161	161	136	136	135	-35.7	-8.6
Sugar	c/kg	16	206	141	178	187	190	224	229	257	313	322	70.4	72.1
Cotton A Index	c/kg	137	93	102	115	83	92	100	99	105	104	103	-13.0	24.4
Aluminium	$/mt	1716	150	154	150	78	83	85	92	97	113	107	-27.4	37.3
Copper	$/mt	2866	235	248	243	131	154	159	175	182	215	216	-11.4	65.2
Gold	$/toz	409	148	170	213	226	218	227	231	228	232	244	20.1	7.9
Silver	c/toz	669	173	200	224	196	187	211	219	200	216	246	35.2	25.7
Steel cold-rolled coil sheet	$/mt	607	114	107	159	148	115	115	115	115	115	115	-36.4	-22.2
Steel hot-rolled coil sheet	$/mt	503	119	109	176	159	119	119	119	119	119	119	-40.0	-25.0
Tin	c/kg	851	103	171	217	125	138	162	176	165	175	175	-19.1	39.3
Zinc	c/kg	105	313	309	179	116	132	142	149	151	174	180	8.6	54.8

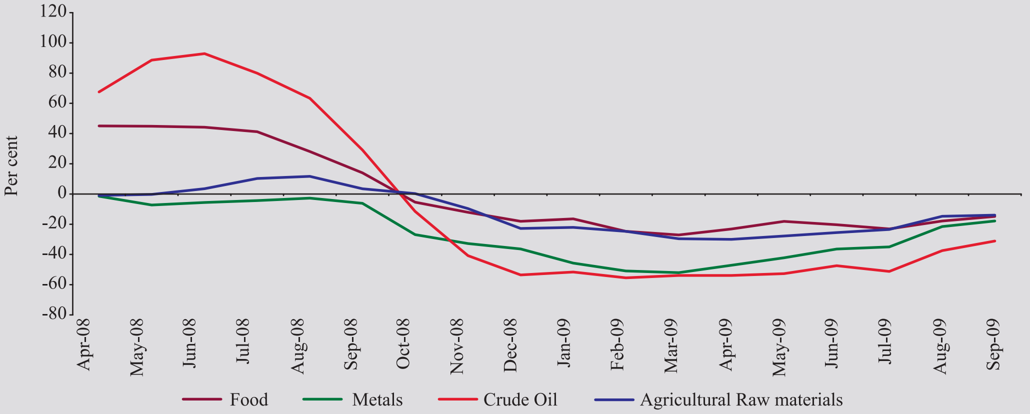
$: US dollar. c: US cent. bbl: Barrel mt: metric tonne kg:Kilogram toz: troy oz.

Note: The year 2004 has been taken as the base to exhibit price trends over the relevant period.

Source: World Bank.

increased supplies by both OPEC and non-OPEC members during the second half of 2009 may prevent any sustained increase in oil prices.

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



Source: IMF Primary Commodity data, October 2009

VI.9 Metal prices, which had witnessed a declining trend since the second quarter of 2008 due to recessionary conditions prevailing in major economies, registered the sharpest decline in March 2009; prices have rebounded since April 2009, led by copper, lead and nickel. Improvement in global economic prospects has impacted the prices of cyclically sensitive base metals. Supply cutbacks in response to the prolonged decline in prices have impacted on the prices of certain key metals such as aluminium, tin and zinc. Increased demand from China to build up inventories and support domestic industrial revival has lent impetus to the rebound in metal prices.

VI.10 Improved supplies, particularly in foodgrains and oilseeds, and unwinding of commodity investments by financial markets participants had eased the pressure on international food prices, which had peaked in 2008. There is, however, wide divergence in prices across various commodities due to commodity-specific factors such as weather conditions and acreage. International sugar prices, which had remained high in 2008, increased further in 2009. Price pressures mainly emanate from reduced global output, with India, the second major producer of sugar, turning a net importer in 2009-10, following a sharp decline in its sugar output in 2008-09. Sugar output in India is expected to decline further during 2009-10 due to drought in some of the major sugarcane growing States and unseasonal rains in others, which are likely to affect sugarcane output and sugar recovery rate from sugarcane, respectively. Wet weather conditions in Brazil, the largest producer of sugar, has also hampered harvest, thereby further reducing global supplies.

VI.11 Agricultural raw materials exhibited greater volatility on account of changes in rubber prices, which track the crude oil prices. Strong demand and supply disruptions caused by unfavourable weather conditions exerted pressure on rubber price in recent months. Global cotton prices, which had slumped to a four-year low in March 2009 due to weak demand, firmed up in the subsequent months, particularly in October 2009, on expectations of a supply-demand mismatch due to a possible rebound in consumption from textile manufacturers and a shortfall in production. The International Cotton Advisory Committee (ICAC) expects the world cotton production to fall by 1 per cent in 2009-10 over the previous year.

Inflation Conditions in India

VI.12 The sharp decline in WPI inflation from the peak of 12.9 per cent in August 2008 had created adequate space for the Reserve Bank to adopt and sustain an accommodative monetary policy stance since mid-September 2008 so as to remove uncertainty about the availability of liquidity in the system and to contain the moderation in growth.

VI.13 The Annual Policy Statement (APS) of the Reserve Bank for the year 2009-10, formulated against the backdrop of the slump in global demand and the resultant abatement of global commodity prices and the collapse of WPI inflation to near zero level in March 2009, continued to emphasise on 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 as part of the monetary stimulus measures (Table 6.3). The APS projected WPI inflation at around 4.0 per cent by end-March 2010, keeping in view the global trends in commodity prices and domestic demand-supply balance.

VI.14 The First Quarter Review of Monetary Policy 2009-10 (FQR) (July 2009) noted that the negative WPI inflation in June 2009 was due to the 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, therefore, revised the WPI inflation projection upward to 5.0 per cent.

VI.15 The WPI inflation, which had turned negative by the first week of June 2009, remained so for 13 consecutive weeks before

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.

moving up to above zero in September 2009. Unlike the volatile pattern in WPI inflation, CPI inflation continues to remain high in the range of 11.7 per cent to 13.2 per cent during August/September 2009. The divergence between the WPI and CPI inflation was highlighted both in the APS and the FQR. The FQR 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 inflationary pressures have increased since the presentation of FQR, as evident from the recent trends in WPI, CPIs and inflation expectations.

Wholesale Price Inflation

VI.16 WPI inflation in India declined steadily since August 2008 and reached near zero levels by end-March 2009, driven by the reduction in the administered prices of petroleum products and electricity as well as decline in prices of freely priced minerals oil items, iron and steel, oilseeds, edible oils, oil cakes and raw cotton. Significant part of the decline in WPI inflation during this period was also on account of the base effect.

VI.17 Year-on-year WPI inflation declined further during 2009-10 and turned negative on June 6, 2009. WPI inflation turned positive on September 5, 2009 and has remained marginally above zero since then (1.2 per cent as on October 10, 2009), with the petering out of the strong base effect of the significant increase in administered prices of petroleum products in June 2008. Freely priced products such as iron and steel, non-ferrous metals, chemicals and edible oils also recorded year-on-year declines during this period.

VI.18 During the current financial year so far, WPI has already increased by 5.9 per cent in October 10, 2009 over the end-March-2009 level. The recent increase in the WPI was largely on account of 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. Most non-food commodity prices moved in line with the international commodity prices (Table 6.4).

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

(Per cent)

Item	Annual Inflation (y-o-y, Sep. 2009*)		Recent trends Sep. 2009 over end-Mar. 2009	
	Global	India	Global	India*
1	2	3	4	5
1. Rice	-24.1	17.2	-11.8	2.9
2. Wheat	-35.6	4.2	-17.6	3.0
3. Milk	–	8.7	–	5.8
4. Raw Cotton	-13.0	-13.3	24.4	5.2
5. Oilseeds	-15.5	2.0	13.5	6.5
6. Iron Ore	-28.2	-5.8	-28.2	-18.8
7. Coal mining	-54.9	-1.0	10.9	0.0
8. Minerals Oil	-31.4	-13.2	46.5	10.6
9. Edible Oils	-21.8	-7.2	14.5	-1.9
10. Oil Cakes	4.4	0.0	23.5	0.0
11. Sugar	70.4	42.7	72.1	28.0
11. Basic Heavy Inorganic Chemicals	–	-26.8	–	-4.2
12. Basic Metals, Alloys and Products#	-17.8	-12.7	39.7	1.7
13. Iron and Steel	-37.8	-17.2	-17.5	3.4

* : Based on WPI as on September 26, 2009.
\# : Represented by IMF metals price index, which covers copper, aluminium, iron ore, tin, nickel, zinc, lead and uranium.
Note: Global price increases are based on the World Bank and IMF primary commodity prices data.

VI.19 In terms of contribution to overall inflation by the major groups, the contribution of the fuel group declined sharply and is negative at present (Chart VI.3). The contribution of manufactured products group which had turned negative, coincidental to the negative phase of WPI inflation during June-August 2009, moved up subsequently and is marginally above zero. The contribution of primary article group continues to remain positive and strong.

VI.20 At a disaggregated level, the y-o-y WPI inflation excluding fuel was lower at 3.5 per cent as on October 10, 2009 as compared with 10.4 per cent a year ago. This was on account of the substantially high WPI fuel group inflation during the period June-October 2008. WPI inflation excluding food and fuel was, however, negative at (-) 1.9 per cent as on October 10, 2009. The annual average WPI inflation rate (average of 52 weeks) also declined to 2.5 per cent as on October 10, 2009 from 8.3 per cent at end-March 2009. Essential commodities group increased by 17.8 per cent, y-o-y, as on October 10, 2009, driven mainly by prices of sugar (45.1 per cent), pulses (22.8 per cent) and vegetables (19.6 per cent) (Chart VI.4a).

VI.21 Amongst the major groups, primary articles inflation, y-o-y, was higher at 8.6 per cent as on October 10, 2009 from 5.2 per cent at end-March 2009, mainly on account of food articles which registered double-digit inflation (Table 6.5 and Chart VI.4b). The sharp upward revision in the minimum support prices (MSP) for most of the agricultural crops during the 2008-09 crop season partly accounts for the increase in the prices of foodgrain prices, particularly for rice and pulses (Chart VI.5). Rice price increase, y-o-y, has been in double digits since mid-October 2008, despite a record harvest and increase in public stocks. Supply constraints and increases in MSP affected the prices of pulses. Tea prices which had increased sharply in 2008-09, moderated

Chart VI.3: Contribution of Major Groups to WPI Inflation

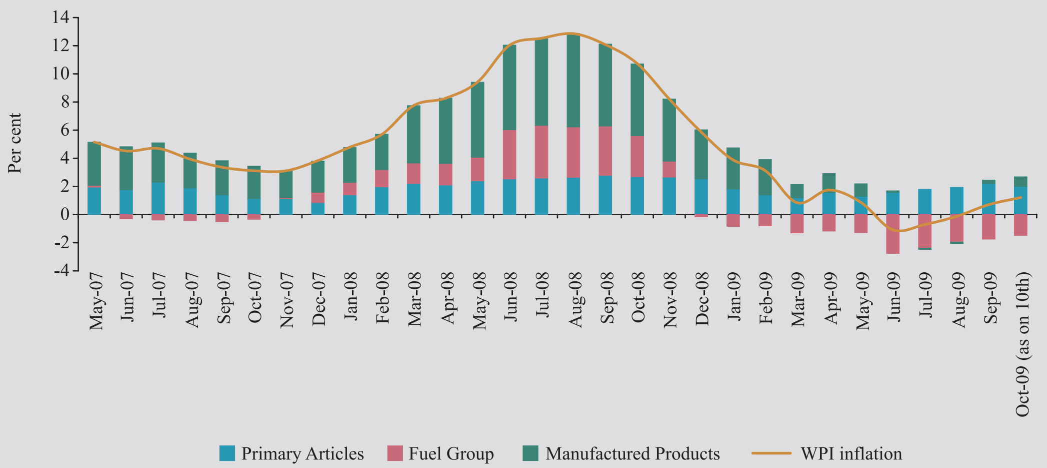
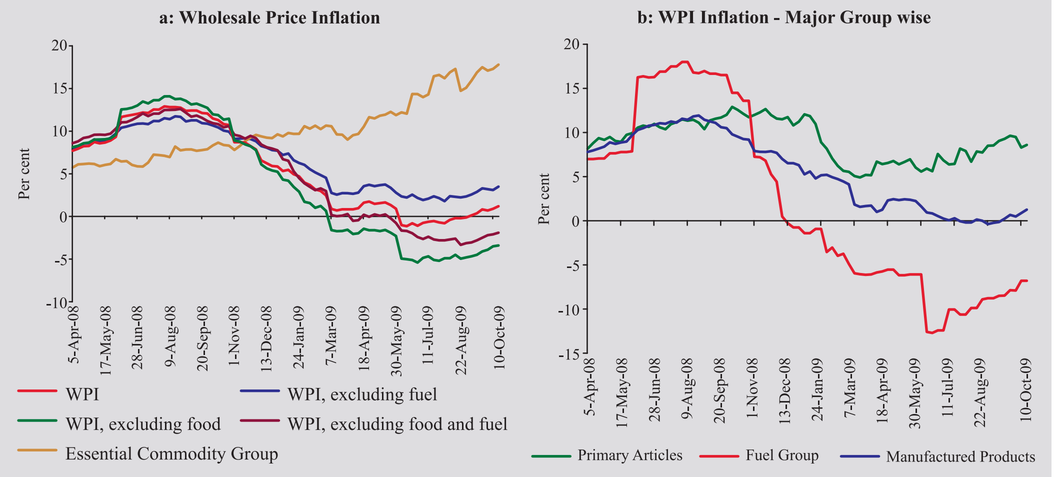


Chart VI.4: Annual WPI Inflation



to some extent in April 2009, only to rise steeply again since May 2009, with global tea production forecast to decline. Estimated production of tea up to August 2009 by the Tea Board of India showed a decline over the previous year. Price increases, though, have significantly decelerated since June 2009, largely on account of the base effect.

VI.22 Among the non-food articles, y-o-y inflation in raw cotton declined steadily since end-May 2009 although there has been some moderation in the decline in recent weeks. With the acreage under cotton increasing in the current financial year so far, cotton output is estimated to be higher than the previous year. Oilseed prices which had declined since June 2009, marginally increased since September 2009 with output likely to fall due to delayed and deficient monsoon.

VI.23 Year-on-year fuel group inflation, which turned negative in December 2008 in line with the international crude oil prices, continued to decline during the current financial year, dragging down the overall WPI inflation. Despite the increase in international crude prices to around US$ 70 per barrel by end-June 2009 and the corresponding increase in freely priced products, the disinflation in the fuel group moved to double digit level in June 2009, weighed by the base effect of upward revision of administered prices in June 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 disinflation moderated.

VI.24 Manufactured products inflation, year-on-year, has also decelerated since March 2009, reflecting the base effect, and turned negative in July 2009. It, however, reversed on September 12, 2009 and remained marginally positive since then. The movement in manufactured products inflation was largely driven by the year-on-year decline in

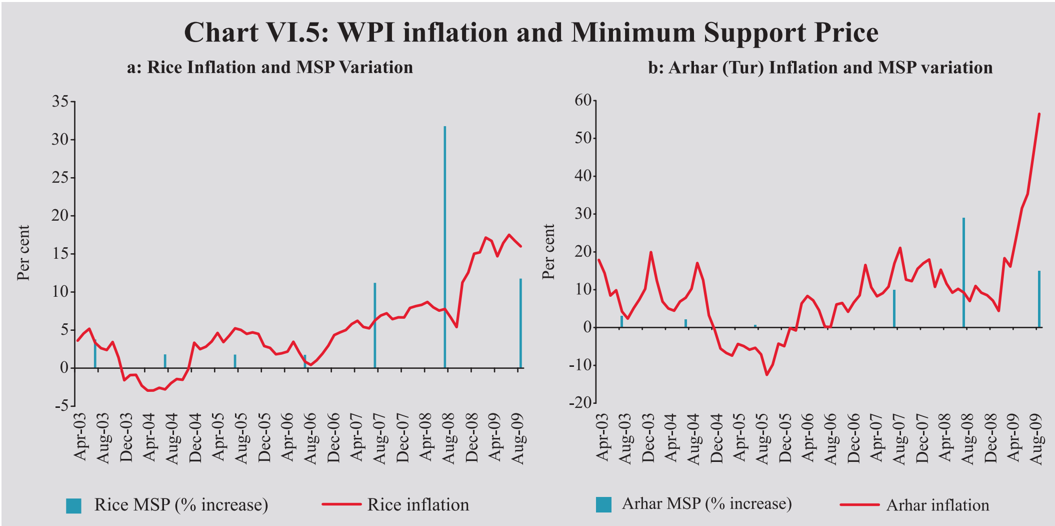
Table 6.5: Wholesale Price Inflation in India (year-on-year)

(Per cent)

Commodity		2008-09 (October 11)		2008-09 (Mar 28)		2009-10 (October 10) P		Financial Year (over end-March 09) P	
	Weight	Inflation	C	Inflation	C	Inflation	C	Inflation	C
1	2	3	4	5	6	7	8	9	10
All Commodities	**100.0**	**11.3**	**11.3**	**0.8**	**0.8**	**1.2**	**1.2**	**5.9**	**5.9**
1. Primary Articles	**22.0**	**12.6**	**2.9**	**5.2**	**1.2**	**8.6**	**2.0**	**9.8**	**2.4**
Food Articles	15.4	10.2	1.6	7.0	1.1	13.3	2.1	14.1	2.3
i. Rice	2.4	12.4	0.3	14.9	0.3	12.7	0.3	5.9	0.1
ii. Wheat	1.4	5.0	0.1	4.5	0.1	6.7	0.1	3.5	0.1
iii. Pulses	0.6	8.6	0.1	9.4	0.1	22.8	0.2	19.2	0.1
iv. Vegetables	1.5	11.1	0.2	-5.2	-0.1	19.6	0.3	59.3	0.7
v. Fruits	1.5	16.2	0.3	5.9	0.1	3.2	0.1	5.2	0.1
vi. Milk	4.4	7.9	0.3	7.0	0.3	10.0	0.4	7.0	0.3
vii. Eggs, Fish and Meat	2.2	7.6	0.2	3.2	0.1	24.1	0.6	25.3	0.6
Non-Food Articles	6.1	14.1	0.8	0.1	0.0	-1.2	-0.1	3.6	0.2
i. Raw Cotton	1.4	32.5	0.4	2.5	0.0	-11.2	-0.1	3.2	0.0
ii. Oilseeds	2.7	15.2	0.4	-1.6	0.0	0.8	0.0	3.4	0.1
iii. Sugarcane	1.3	-0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Minerals	0.5	43.6	0.4	7.2	0.1	-3.8	0.0	-13.1	-0.2
2. Fuel, Power, Light and Lubricants	**14.2**	**14.5**	**3.1**	**-6.1**	**-1.3**	**-6.8**	**-1.5**	**7.6**	**1.5**
i. Coal Mining	1.8	9.8	0.2	-1.0	0.0	-1.0	0.0	0.0	0.0
ii Mineral Oils	7.0	22.4	2.8	-8.7	-1.1	-11.6	-1.6	10.5	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**	**9.5**	**5.3**	**1.7**	**1.0**	**1.3**	**0.7**	**3.7**	**2.1**
i. Food Products	11.5	8.8	0.9	8.8	0.9	16.1	1.6	8.0	0.9
of which: Sugar	3.6	13.9	0.3	18.4	0.4	45.1	1.1	31.0	0.9
Edible Oils	2.8	8.9	0.2	-7.6	-0.2	-7.2	-0.2	-3.9	-0.1
ii. Cotton Textiles	4.2	6.3	0.2	16.2	0.4	6.5	0.2	3.3	0.1
iii. Man Made Fibres	4.4	3.5	0.1	-1.5	0.0	-4.7	-0.1	0.8	0.0
iv. Chemicals and Products	11.9	9.7	1.1	2.0	0.2	2.1	0.2	6.6	0.7
of which : Fertilisers	3.7	9.1	0.3	4.8	0.1	-2.9	-0.1	-2.4	-0.1
v. Non-Metallic Mineral Products	2.5	3.6	0.1	1.9	0.0	3.0	0.1	2.7	0.1
of which: Cement	1.7	2.3	0.0	2.2	0.0	0.3	0.0	-0.1	0.0
vi. Basic Metals, Alloys and Metal Products	8.3	19.7	1.9	-12.2	-1.3	-13.2	-1.4	0.4	0.0
of which: Iron and Steel	3.6	28.4	1.3	-18.4	-1.0	-18.4	-1.0	1.0	0.0
vii. Machinery and Machine Tools	8.4	5.3	0.3	2.6	0.2	-1.5	-0.1	0.9	0.1
of which: Electrical Machinery	5.0	5.2	0.2	1.1	0.0	-2.8	-0.1	1.0	0.0
viii. Transport Equipment and Parts	4.3	7.0	0.2	3.1	0.1	-0.8	0.0	0.5	0.0
Memo:									
Food Items (Composite)	**26.9**	**9.6**	**2.5**	**7.7**	**2.0**	**14.4**	**3.7**	**11.6**	**3.2**
WPI Excluding Food	**73.1**	**11.9**	**8.8**	**-1.6**	**-1.2**	**-3.4**	**-2.5**	**3.8**	**2.7**
WPI Excluding Fuel	**85.8**	**10.4**	**8.2**	**2.7**	**2.1**	**3.5**	**2.7**	**5.5**	**4.4**
WPI Essential Commodity Group	**17.6**	**8.7**	**1.5**	**9.0**	**1.4**	**17.8**	**2.9**	**13.8**	**2.5**

C : Contribution to inflation. P : Provisional.

Note: As per the press realease by the Ministry of Commerce and Industry dated October 19, 2009, the current series of WPI (base 1993-94) would be released on a monthly basis instead of the present practice of weekly releases. However, a weekly price index for primary articles and commodities in 'fuel, power, light and lubricant' group would be compiled to facilitate weekly monitoring of sensitive commodities.



prices of iron and steel, edible oils, fertilisers, man-made fibre and machinery and machine tools. Manufactured food articles inflation was mainly driven by sugar prices, which rose sharply due to falling stocks and weak and sporadic monsoon. The other major contributor to manufactured food inflation was 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.

VI.25 'Basic metals, alloys and products' sub-group of manufactured products registered negative inflation y-o-y, as on October 10, 2009, mainly on account of a decline in the prices of iron and steel which could be attributed to decline in global prices and sluggish domestic and external demand.

VI.26 Primary articles prices have increased by 9.8 per cent over the end-March 2009 level of the index. Vegetable prices recorded an increase of around 59.3 per cent over end-March 2009. This was mainly on account of a steep increase of over 100 per cent in the price of potatoes, the second highest weighted commodity amongst the vegetables, due to a decline in output in the current season following a slump in potato prices during the previous year. Pulses prices moved into double digit during the second quarter of 2009-10. Although increase in rice prices over end-March 2009 were moderate, at less than 3 per cent up to October 3, 2009, prospects of a decline in output during 2009-10 due to the shortfall in acreage under paddy as well as the damage caused by floods in rice growing States has led to the firming up of prices to around 6 per cent as on October 10, 2009.

VI.27 During the current financial year (up to October 10, 2009), prices of various freely priced petroleum products 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 55.7 per cent, that of bitumen was the least at 5.4 per cent. Price increases in other products were 39.9 per cent for avian turbine fuel, 30.1 per cent for light diesel oil, 28.1 per cent for naphtha and 6.5 per cent for high speed diesel.

VI.28 Manufactured product inflation for the financial year (up to October 10, 2009) was driven by the increase in manufactured food products and drugs and medicines. A sharp increase in the volume of edible oil imports in the face of low international prices exerted downward pressure on edible oils which declined over the end-March level. With the revival in automobile sales and the unwinding of stocks, both in the domestic and international markets, major steel companies have raised their prices of flat steel during the current financial year. This has resulted in a marginal increase in the price of steel sheets within the iron and steel sub-group over end-March 2009 level.

VI.29 Overall, the year-on-year deceleration in WPI inflation has been on account of the sharp decline in fuel group. While prices of primary articles continue to remain high, manufactured products posted modest price increases.

Consumer Price Inflation

VI.30 Inflation based on y-o-y variation in consumer price indices (CPIs) has increased since June 2008, mainly due to increase in the prices of food, fuel and services (represented by the 'miscellaneous' group). The various measures of consumer price inflation remained high in the range of 11.7-13.2 per cent during August/ September 2009 as compared with 8.5-12.4 per cent in August/September 2008 and 8.0-9.7 per cent in March 2009 (Table 6.6).

VI.31 CPI inflation has been significantly different from the WPI inflation in the recent period and the divergence has also been increasing (Chart VI.6).

VI.32 The greater divergence between WPI and CPI inflation could be attributed to the higher weight in CPIs of food articles, which have displayed higher inflation in recent months. When there is an upward pressure on food prices, CPI (IW) food inflation in general appears to increase at a faster rate and remain at the elevated level for a longer period than the WPI inflation. There has, however, been a dip in CPI food inflation in August 2009, bringing it closer to WPI food inflation (Chart VI.7). The higher order of inflation in the same commodities at the retail level (as captured in CPI) could be on account of intermediation costs, higher transportation and labour costs between wholesale and retail markets, as well as better pricing power in the retail market in relation to wholesale markets. Thus, the divergence between WPI and CPI inflation is not only because of differences in weights and coverage, but also because of the actual price differences for similar commodities at the wholesale and retail levels.

VI.33 Among the non-common groups in the WPI and CPI, the miscellaneous group under CPIs (with weights ranging from 11.9 per cent to 24 per cent) which includes services, also exhibited significant price pressures. Similarly, metals group (weight

Table 6.6: Consumer Price Inflation - Major Groups

(Year-on-year variation in per cent)

CPI Measure	Weight	Mar-07	Mar-08	Jul-08	Aug-08	Sep-08	Mar-09	Apr-09	May-09	Jun-09	Jul-09	Aug-09	Sep-09
1	2	3	4	5	6	7	8	9	10	11	10	11	12
CPI-IW (Base: 2001=100)													
General	**100**	**6.7**	**7.9**	**8.3**	**9.0**	**9.8**	**8**	**8.7**	**8.6**	**9.3**	**11.9**	**11.7**	**–**
Food Group	46.2	12.2	9.3	10.3	11.7	13.1	10.6	10.4	11.7	12.2	14.7	13.7	–
Pan, Supari *etc*.	2.3	4.4	10.9	6.3	6.3	7.8	8.3	6.7	7.5	8.1	8.9	9.6	–
Fuel and Light	6.4	3.2	4.6	9.2	9.9	9.1	7.4	6.6	5.9	1.4	2.1	2.8	–
Housing	15.3	4.1	4.7	3.8	3.8	3.8	6	6	6	6	22.1	22.1	–
Clothing, Bedding *etc*.	6.6	3.7	2.6	2.5	3.4	2.5	5	4.2	4.1	4.1	5.0	4.1	–
Miscellaneous	23.3	3.3	6.3	7.8	7.7	7.6	7.4	7.4	7.4	6.6	5.8	6.4	–
CPI-UNME (Base: 1984-85=100)													
General	**100**	**7.6**	**6**	**7.4**	**8.5**	**9.5**	**9.3**	**8.8**	**9.7**	**9.6**	**13.0**	**12.9**	**–**
Food Group	47.1	10.9	7.8	10.0	11.5	13.2	12.2	11.1	12.9	13.6	15.3	15.0	–
Fuel and Light	5.5	6.4	4.6	6.2	6.5	6.2	5.9	6.7	5.8	1.3	2.1	2.7	–
Housing	16.4	5.6	4	3.7	3.5	3.5	5.8	6	6	6.0	22.0	22.0	–
Clothing, Bedding *etc*.	7	3.6	4.3	3.2	3.8	3.1	3.3	4.2	4.2	4.2	5.0	4.1	–
Miscellaneous	24	4.4	4.8	7.3	7.7	8.4	8.6	7.6	8.1	7.3	7.0	6.8	–
CPI-AL (Base: 1986-87=100)													
General	100	9.5	7.9	9.4	10.3	11.0	9.5	9.1	10.2	11.5	12.9	12.9	13.2
Food Group	69.2	11.8	8.5	10.7	11.3	12.0	9.7	9.1	11.2	12.4	14	14.1	14.6
Pan, Supari *etc*.	3.8	5.7	10.4	10.8	11.8	12.8	15.3	14.5	14.4	14.2	15.6	16.5	15.5
Fuel and Light	8.4	6.9	8	9.3	9.5	10.2	11.5	10.9	10.6	11.0	12.0	11.6	12.0
Clothing, Bedding *etc*.	7	3.5	1.8	3.6	5.0	6.0	7.4	7.9	7.6	8.3	8.8	8.5	8.1
Miscellaneous	11.7	6.8	6.1	7.0	6.9	7.1	6.5	6.2	6.6	6.1	6.5	7.2	7.1
CPI-RL (Base: 1986-87=100)													
General	100	9.2	7.6	9.4	10.3	11.0	9.7	9.1	10.2	11.3	12.7	12.7	13.0
Food Group	66.8	11.5	8.2	10.5	11.6	12.0	10	9.1	11.2	12.4	14.2	14.1	14.6
Pan, Supari *etc*.	3.7	5.7	10.6	10.5	11.5	12.5	15	14	14.1	14.1	15.3	16.2	15.4
Fuel and Light	7.9	6.9	8	9.3	9.8	10.5	11.5	10.9	10.6	11.0	11.8	11.4	12.0
Clothing, Bedding *etc*.	9.8	3.1	2.8	4.3	5.6	6.5	8.2	8.4	8.3	8.8	9.7	9.1	9.5
Miscellaneous	11.9	6.3	6.2	7.0	7.2	7.4	6.7	6.2	6.4	6.2	6.1	7.0	6.9
Memo:													
WPI Inflation (End of period)		5.9	7.7	12.5	12.4	12.1	0.8	1.7	0.1	-1.1	-0.7	-0.1	0.7
GDP Deflator based Inflation*		5.5	4.9	–	–	10.6	7.0	–	–	0.9	–	–	–

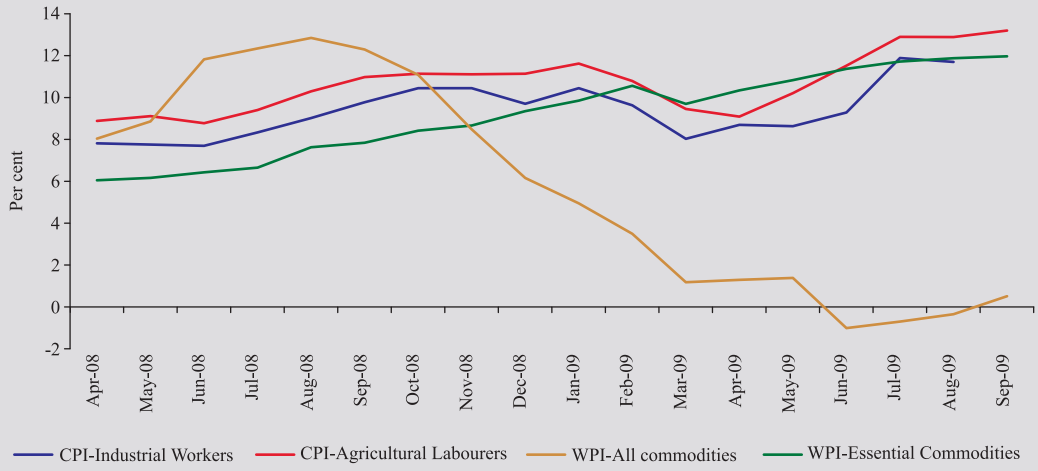
*: Data for March pertain to full year.

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

of 8.3 per cent), which is only represented in the WPI, has exhibited significant negative inflation, contributing to the widening of the overall difference between inflations as per the CPIs and WPI. There also exists a lag in the movement of CPI inflation in relation to the WPI inflation.

VI.34 Within the food category of the CPI (IW), inflation has been the highest in the

Chart VI.6: Movements in CPI and WPI inflation

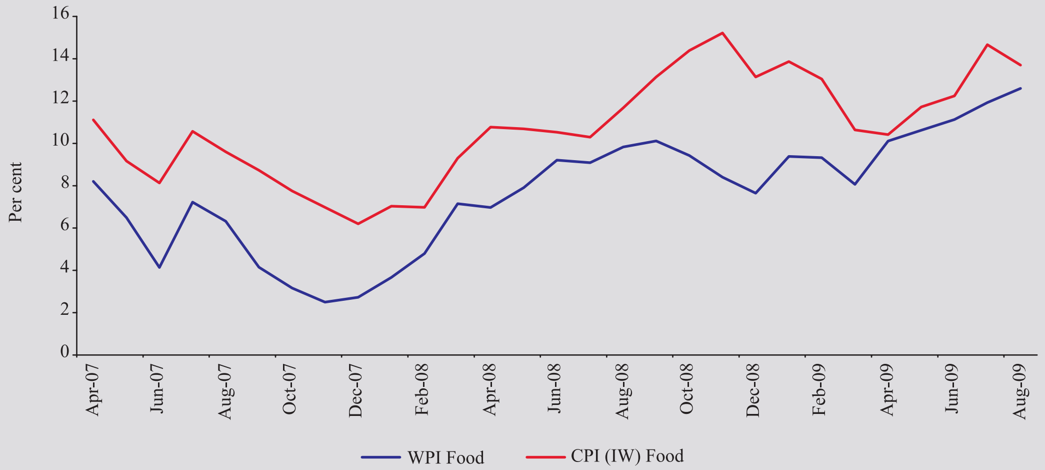


pulses sub-group amongst the staples and in the vegetables sub-group amongst the perishables, since April 2009 and May 2009, respectively (Charts VI.8a and b).

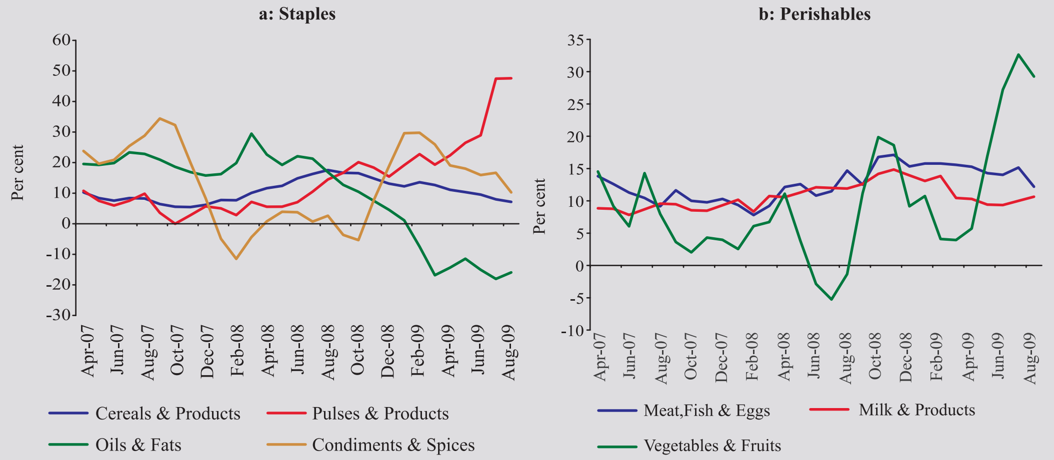
VI.35 CPI-IW for housing, which is not represented in the CPI-AL and CPI-RL showed a sharp rise of 22.1 per cent in July 2009 on account of revision of imputed rent for rent-free accommodation, reflecting the impact of the Sixth Pay Commission award on CPI inflation. It may be mentioned that housing index in the CPI is compiled once in every six months, *viz.*, January and July. The index would, therefore, remain at the elevated level in the months to come.

VI.36 Overall, the emerging price pressures are already visible, even though year-on-year WPI inflation remains low. With the base effect of sharp fuel price

Chart VI.7: Food inflation - WPI and CPI (IW)



Chat VI.8: CPI(IW) inflation in Food Articles



increases a year ago petering out, year-on-year WPI inflation has emerged out from the negative zone after 13 weeks. Within the WPI, the essential commodities group, particularly food articles contributed the most to the increase in inflation. Reflecting inflation momentum, WPI has been rising since end-March 2009, spurred both by domestic supply constraints in certain commodities and increases in international commodity prices. Consumer price inflation continues to remain firm and the divergence between CPI and WPI inflation has widened further during the first half of 2009-10. High CPI inflation is a major risk to inclusive growth, since it could potentially lead to erosion in real income of the segments of population for which the CPI indices are prepared. Persistent high CPI inflation could also lead to wage/cost push inflation because of the pressures for price/wage revisions and revisions to minimum support prices, which are linked to CPI indices. More importantly, it could further inflate the inflationary expectations.

Given the supply side sources of emerging inflationary pressures, the policy focus needs to be directed at improving both the supply conditions and the supply chain for more efficient distribution. Measures are already afoot to manage the supply side pressure on inflation. These include the proposed release of 30 lakh tonnes of wheat during October 2009-March 2010 under the open market sale scheme; removal of restrictions such as stock holding limits on wheat in order to facilitate purchase by private traders during the harvesting season; restrictions on large consumers of sugar to conserve stock; increased release in sugar quota ahead of the festival season; removal of import duty on rice, wheat and raw sugar; and permission for duty free import of white/refined sugar up to 10 lakh tonnes by Central/State Government agencies and private traders in addition to designated agencies. Sustained high CPI and essential commodities inflation could pose a challenge to the Reserve Bank's objective of firmly anchoring inflation expectations.

VII. MACROECONOMIC OUTLOOK

Surveys conducted by the Reserve Bank as well as other agencies to collect lead information on the expectations about the overall business outlook point to significant turnaround and rising optimism, which is also corroborated by the recovery in the industrial production up to August 2009. The expected decline in agricultural output under the influence of the deficient monsoon, however, has impacted the overall growth outlook, which is evident from the findings of the Reserve Bank's survey of professional forecasters suggesting a downward revision to the growth outlook for 2009-10 from 6.5 per cent to 6.0 per cent. The inflation outlook, notwithstanding the low year-on-year WPI inflation so far, is conditioned by the pressures of emerging high inflation in essential commodities as well as elevated and expanding consumer price inflation.

VII.1 The projections of various domestic and international agencies as well as the different forward looking surveys point to an improvement in India's growth outlook. However, the impact of the deficient monsoon on agricultural output and rural demand could inhibit a faster recovery. Business confidence surveys in general exhibit significant optimism, a marked turnaround from the bearish sentiments of the previous quarters. The industrial outlook survey of the Reserve Bank indicates the return of the economy to an expansion path. The professional forecasters' survey conducted by the Reserve Bank in September 2009, however, suggests a downward revision to the growth outlook, reflecting the expected negative impact of the deficient monsoon on agricultural output.

Business Expectations Surveys

VII.2 Surveys conducted by different agencies to collect lead information on the forward looking assessment of the companies about the prospects of the economy show a general pattern of optimism, with the relevant business confidence indices exhibiting significant increases over the levels in the preceding quarter (Table 7.1)

Table 7.1: Business Expectations Surveys

Period Index	NCAER Q3: 2009 Business Confidence Index	FICCI Q1:2009-10 Overall Business Confidence Index	Dun& Bradstreet Q3: 2009 Business Optimism Index
1	2	3	4
Current level of the Index	118.6	67.2	132.1
Index as per previous survey	81.6	64.1	93.8
Index Levels on Year back	125.4	52.5	136.5
% change (Q-on-Q) sequential	45.4	4.8	40.8
% change (Y-on-Y)	-5.7	28.0	-3.2

VII.3 The Business Confidence Index (BCI) of the NCAER (National Council of Applied Economic Research) that was released in July 2009 showed a 45 percent increase over the level in the previous quarter, which represents a reversal of the declining trend that was noticed in the previous five quarters. The survey exhibited improvement in all four components of BCI, *i.e.* "investment climate", "overall economic conditions", "financial position of firms" and "capacity utilisation". The improvement was also broad based across all five sectors, *i.e.* consumer durables, consumer non-durables, capital goods, intermediates and services. The October 2009 NCAER-Mastercard Worldwide Index of Business Confidence shows further improvement in the BCI by 21 per cent, over and above the 45 per cent increase in July over April 2009. The findings of the survey suggest business sentiments returning closer to the pre-crisis levels.

VII.4 The Business Confidence Survey of the FICCI for Q1:2009-10 that was released in September 2009 suggests that 70 per cent of the companies felt the overall economic conditions to be "moderately to substantially better" compared to previous six months. The overall business confidence index rose by 4.8 per cent over the previous quarter level, as 50 per cent of the survey respondents expected sales volume to increase, 30 per cent expected investment to increase, and 22 per cent viewed that they would add to the workforce in the next two quarters. While 80 per cent of the respondents recognised the beneficial effects of the fiscal stimulus on economic activity, rising cost of raw materials and manpower, delayed monsoon and high interest rates were expressed as areas of concern.

VII.5 The Dun and Bradstreet Business Optimism Index for Q3:2009 which was conducted in June 2009 rose sharply by 40.8 per cent over the lowest level of the index in the previous quarter. Five of the six optimism indices, namely volume of sales, net profits, new orders, selling prices, and employee levels recorded improvement over the previous quarter. Inventory levels, however, declined by 2 percentage points.

VII.6 The HSBC Markit Purchasing Managers' Index (PMI) – which is an indicative measure of the health of the manufacturing sector – moved up in September 2009 after the decline in August 2009, but remained above the threshold (of 50) for the sixth month in a row suggesting expansion in activities. The turnaround into the expansion phase since April 2009 is largely driven by home market. PMI for the services remained in the expansion zone (*i.e.*, above 50), though with some moderation in September 2009. The composite PMI in September 2009 was almost unchanged in the expansion zone, as improvement in manufacturing was offset by moderation in services.

Reserve Bank's Industrial Outlook Survey

VII.7 The 47th round of Industrial Outlook Survey of the Reserve Bank conducted in July-August 2009 showed further improvement in the sentiments of the manufacturing sector after the turnaround that was seen in the survey findings of the previous quarter. The survey covered opinions on "assessment for July-September 2009" and "expectations for October-December 2009", and both indices remained in the growth terrain (*i.e.* above 100, which is the threshold that separates contraction from expansion) for the last two quarters of 2009. This suggests that as per expectations of the survey respondents, the industrial recovery already seen up to August 2009 in terms of trends in IIP growth could gain further momentum during 2009-10 (Chart VII.1). The indices for assessment (July-September) and expectations (October-December) reached 107.2 and 116.4, respectively.

VII.8 The survey findings also indicate improving demand conditions, as reflected in better expectations about order books, capacity utilisation and production. The working capital finance requirement is expected to grow in the October-December quarter of 2009, which suggests that demand for credit from the private sector may exhibit a turnaround from the persistent deceleration experienced so far. The overall survey response indicates that availability of finance has further improved and eased, which corroborates the impact of the accommodative monetary policy stance in improving the availability of finance in general. The survey findings also point to continuation of pressures on profit margins, though of a much lower magnitude in relation to what was experienced in past few quarters. The input prices are expected to firm up for the second successive quarter; with improving demand condition, however, gradual return of pricing power could also give rise to higher selling prices. 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

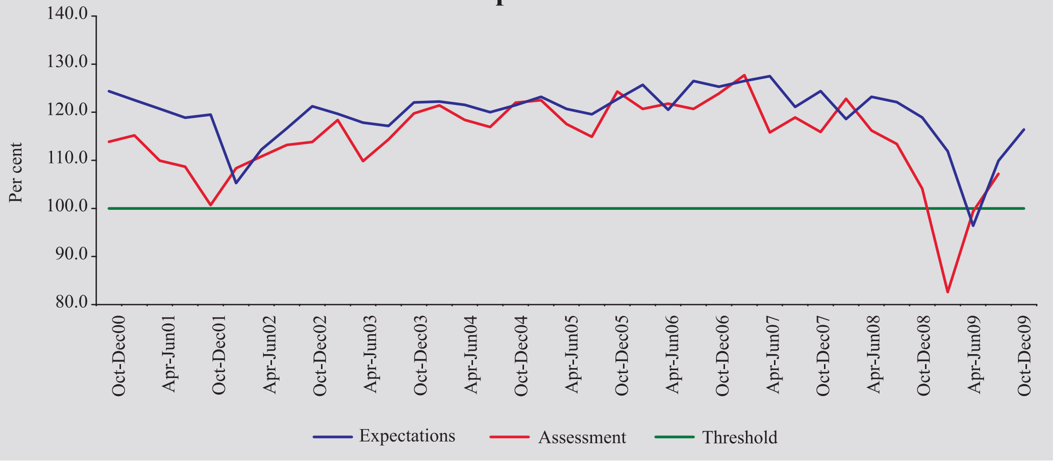


Table 7.2: Reserve Bank's Survey – Net Response on 'A Quarter Ahead' Expectations About the Industrial Performance

	Parameter	Response	Jul-Sep 2008	Oct-Dec 2008	Jan-Mar 2009	Apr-Jun 2009	Jul-Sep 2009	Oct-Dec 2009
1		2	4	5	6	7	8	9
1	Overall business situation	Better	41.8 (42.6)	33.7 (44.1)	21.1 (43.9)	11.2 (47.6)	24.2 (46.7)	39.8 (45.4)
2	Financial situation	Better	32.7 (53.0)	27.7 (52.5)	16.4 (53.2)	8.4 (52.7)	20.0 (54.4)	33.5 (52.5)
3	Working capital finance requirement	Increase	33.6 (57.3)	33.8 (57.7)	32.9 (57.1)	23.2 (61.0)	26.3 (61.7)	30.4 (61.0)
4	Availability of finance	Improve	30.2 (57.9)	23.3 (59.0)	13.7 (56.3)	9.3 (61.7)	16.6 (62.6)	26.1 (62.7)
5	Production	Increase	43.5 (36.6)	39.8 (42.1)	26.0 (42.3)	9.9 (44.9)	22.4 (45.5)	35.0 (43.0)
6	Order books	Increase	38.5 (43.5)	35.7 (46.1)	20.6 (46.1)	6.4 (44.4)	16.8 (45.8)	32.3 (45.3)
7	Pending orders, if applicable	Below normal	2.2 (80.9)	4.6 (82.0)	11.5 (77.8)	23.2 (59.4)	19.1 (73.4)	11.0 (80.6)
8	Cost of raw material	Decrease	-54.7 (39.1)	-61.1 (32.3)	-35.7 (39.7)	-16.2 (33.7)	-27.1 (55.5)	-38.4 (51.6)
	Inventory of raw material	Below average	-3.8 (81.8)	-7.6 (77.6)	-3.3 (81.3)	1.1 (80.2)	-0.5 (82.7)	-1.2 (85.0)
9	Inventory of finished goods	Below average	-1.5 (84.5)	-4.3 (82.6)	-4.4 (80.9)	-4.4 (78.4)	-1.8 (80.6)	-3.7 (85.3)
10	Capacity utilisation (Main product)	Increase	22.2 (58.8)	26.4 (56.0)	12.3 (59.1)	-0.7 (55.0)	10.7 (57.5)	22.0 (56.2)
11	Level of capacity utilisation (Compared to the average in the preceding four quarters)	Above normal	3.6 (74.9)	-0.5 (78.7)	-7.4 (73.7)	-20.8 (66.4)	-12.1 (70.8)	-3.8 (76.0)
12	Assessment of the production capacity (With regard to expected demand in the next six months)	More than adequate	4.6 (81.3)	5.7 (81.7)	11.8 (81.0)	8.9 (70.7)	5.5 (76.9)	6.5 (79.7)
13	Employment in the company	Increase	15.8 (71.5)	16.6 (70.4)	7.7 (75.7)	-5.1 (74.0)	1.5 (78.6)	8.8 (77.2)
14	Exports, if applicable	Increase	27.7 (54.9)	27.3 (54.3)	16.0 (54.8)	-3.8 (57.3)	0.1 (59.0)	12.5 (58.5)
15	Imports, if any	Increase	21.3 (66.5)	21.4 (67.9)	9.1 (69.7)	-1.4 (68.8)	4.6 (70.6)	11.5 (68.9)
16	Selling prices are expected to	Increase	21.0 (61.5)	26.2 (57.6)	4.1 (61.7)	-9.1 (61.9)	0.0 (65.6)	6.0 (67.6)
17	If increase expected in selling prices	Increase at lower rate	3.0 (61.3)	0.6 (54.7)	0.9 (54.0)	25.9 (53.5)	-100.0 (0.0)	19.4 (63.2)
18	Profit margin	Increase	3.8 (59.8)	-3.6 (54.7)	-12.9 (53.3)	-18.6 (50.6)	-13.4 (54.5)	-2.8 (56.8)

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.

VII.9 The significant upturn in business expectations could be seen as broad based across industry groups, though industries such as transportation, food products, pharmaceuticals and fertilisers look more optimistic than the others. The input price inflation is also felt across the board, but it is higher for paper, rubber, textiles and food industries. All industries, excluding textiles, are expected to increase their employment levels. The improvement is also seen across all size groups, but the bigger companies with annual production of Rs. 1,000 crore or more look most optimistic.

Survey of Professional Forecasters[1]

VII.10 The general prevailing perception about the impact of the delayed monsoon gets reflected in the assessment of the growth outlook of the professional forecasters. The results of the ninth round of survey of professional forecasters'

Table 7.3: Median Forecasts of Select Macroeconomic Indicators by Professional Forecasters 2009-10

	Actual 2008-09	Annual forecasts				Quarterly forecasts									
		2009-10		2010-11		2009-10						2010-11			
						Q2		Q3		Q4		Q1		Q2	
		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	6.5	6.0	7.5	7.7	6.2	6.2	6.9	5.7	7.1	6.7	7.5	7.3	–	7.6
a. Agriculture & Allied Activities	1.6	2.5	-1.4	3.0	3.7	2.4	-1.0	3.5	-3.7	3.0	-1.0	3.0	2.0	–	2.7
b. Industry	2.6	4.8	6.3	7.4	7.3	3.5	6.6	5.9	6.9	7.2	6.9	7.0	6.7	–	6.7
c. Services	9.4	8.3	8.1	9.0	9.1	8.0	7.8	8.5	8.4	8.5	8.6	8.8	8.9	–	9.1
2. Gross Domestic Saving (per cent of GDP at current market price)	–	35.0	33.6	36.0	36.6	–	–	–	–	–	–	–	–	–	–
3. Gross Domestic Capital Formation (per cent of GDP at current market price)	–	36.6	37.3	37.9	37.7	36.4	34.8	38.0	36.5	37.0	36.0	36.2	36.2	–	–
4. Corporate profit after tax (growth rate in per cent)*	–	7.5	10.0	15.0	14.5	3.0	4.5	8.0	9.0	9.0	12.0	15.0	15.0	–	17.5
5. Inflation WPI	8.4	1.6	3.0	5.5	5.8	-1.4	-0.24#	2.5	4.0	5.4	6.8	5.9	7.2	–	6.5
6. Exchange Rate (US$/INR end period)	51.0	46.5	46.0	44.5	44.5	47.5	48#	47.0	47.0	46.0	46.0	45.4	45.9	–	45.3
7. T-Bill 91 days Yield (per cent-end period)	7.1	4.6	4.1	5.0	4.9	–	–	–	–	–	–	–	–	–	–
8. 10-year Govt. Securities Yield (per cent-end period)	7.6	7.0	7.3	7.0	7.5	–	–	–	–	–	–	–	–	–	–
9. Export (growth rate in per cent)!	5.4	-0.5	-5.0	12.0	14.2	–	–	–	–	–	–	–	–	–	–
10. Import (growth rate in per cent)!	14.3	-3.5	-15.7	14.0	12.0	–	–	–	–	–	–	–	–	–	–
11. Trade Balance (US $ billion)	-119.4	–	–	–	–	-25.8	-23.5	-31.0	-28.1	-19.9	-22.1	-29.3	-20.7	–	-28.9

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

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

Source : Survey of Professional Forecasters, Second 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.

conducted by the Reserve Bank in September 2009 shows overall (median) growth rate for 2009-10 at 6.0 per cent, as against 6.5 per cent reported in the earlier survey (Table 7.3). The sectoral growth rate forecast for the agriculture sector was revised downwards from 2.5 per cent to (-) 1.4 per cent, whereas for industry the assessment was revised upwards from 4.8 per cent to 6.3 per cent. For services, the forecasts suggest modest downward revision from 8.3 per cent in the earlier survey to 8.1 per cent in the current survey.

VII.11 The outlook for India's growth in 2009-10 as projected by different organisations since June 2009 has been either revised upwards or maintained unchanged (Table 7.4). The Asian Development Bank (ADB) revised the growth outlook for India upwards in September 2009 from 5 per cent to 6 per cent, highlighting the role of both emerging signs of recovery in business confidence and continuation of fiscal stimulus. NCAER outlook released in July 2009 also showed a higher projected growth figure of 7.2 per cent for 2009-10, notwithstanding the significant downward revision in growth outlook for the agriculture sector to 1 per cent from the previous projection of 2.5 per cent. The IMF had already scaled up the projected growth for India in its July 2009 outlook from 4.5 per cent to 5.4 per cent. The October 2009 outlook of the IMF retains the projected growth at the same level for 2009, while highlighting the role of policy stimulus in boosting domestic demand and relatively lower dependence of India on exports in relation to other Asian countries. The Economic Advisory Council to the Prime Minister projected recently the Indian economy to grow by 6.5 per cent in 2009-10, with an assessment suggesting growth unlikely to be lower than 6.25 per cent but with the possibility of reaching 6.75 per cent.

Table 7.4: Projections of Real GDP for India by Various Agencies – 2009-10

(Per cent)

Agency	Latest Projection				Month of Projection	Earlier Projection	
	Overall Growth	Agriculture	Industry	Services		Overall Growth (Per cent)	Month
1	2	3	4	5	6	7	8
Economic Advisory Council to PM	6.5	-2.0	8.2	8.2	Oct-09	7.0-7.5	Jan-09
IMF (Calendar year)	5.4	–	–	–	Oct-09	5.4	July-09
ICRIER*	5.8 -6.1				Oct-09	6.0	June-09
ADB	6.0	–	–	–	Sep-09	5.0	Mar-09
NCAER	7.2	1.0	6.7	9.4	July-09	6.5-6.9	April-09
OECD	5.9	–	–	–	June-09	4.3	Mar-09
World Bank	5.1	–	–	–	June-09	4.0	Mar-09
Range	**5.1-7.2**					**4.0-7.5**	

* ICRIER Macro Team.

Factors Influencing the Current Growth and Inflation Outlook

VII.12 Emerging upside prospects as well as possible downside risks condition the current assessment of India's growth outlook for 2009-10. Factors that support the prospects of a faster and sustained recovery in growth include: (a) the impact of the policy stimulus, (b) visible signs of industrial recovery, as evidenced by 5.8 per cent growth in IIP during April-August 2009, with double digit growth recorded in August, (c) stronger performance of the core infrastructure sector, showing higher growth of 4.8 per cent in April-August 2009 as against 3.3 per cent in the corresponding period of the previous year, besides the significant acceleration in growth in August 2009 at 7.1 per cent, (d) improvement in lead indicators of services in July-September 2009, such as railways freight, cement production/delivery, sales of steel and automobiles including commercial vehicles, (e) significant upturn in the business confidence as per different business expectations surveys, including the Reserve Bank's Industrial Outlook Survey, (f) revival in capital flows in the first half of 2009-10, after two consecutive quarters of net outflows in the second half of 2008-09, (g) significant recovery in the stock market (over end March 2009 level), and higher resource mobilisation through public issues and private placements in the first five months of 2009-10 over the corresponding period of last year, and (h) the improving overall global economic and financial conditions.

VII.13 A number of strong downside risks weigh down the growth prospects: (a) the deceleration in growth of private consumption and investment demand, (b) deficient monsoon and drought like conditions in several parts of the country and the flood in a few states affecting both *kharif* production as well as rural demand, (c) decline in sales of corporates in the first quarter of 2009-10, (d) persistence of deceleration in non-food credit growth, with growth in credit card and consumer durables related credit turning negative, suggesting possible continuation of the deceleration in private consumption demand even in the second quarter of 2009-10, (e) persistence of decline in exports for the 12th consecutive month, (f) external demand dependent services activities remaining sluggish, such as tourism and cargo handled at ports, and (g) negative growth in non-oil imports and weak growth in capital goods production (notwithstanding the pick up in August 2009) corroborating the sluggish demand conditions.

VII.14 The combination of weak recovery and elevated CPI inflation has already magnified the complexity of policy challenges, notwithstanding the subdued nature of headline WPI inflation so far. Among the alternative plausible sources of inflation that could determine the near-term inflation outlook, factors which support possible firming up of headline inflation clearly overshadow the factors which may help in containing the inflationary pressures. The sources of comfort for the inflation outlook could be: (a) persistence of negative output-gap and weak aggregate demand, (b) stabilisation of international oil prices over the last few months, notwithstanding the recent increase in October 2009 so far, (c) modest recent deceleration in broad money growth, despite the accommodative monetary policy stance of the Reserve Bank, (d) no further increase in minimum support prices for agricultural commodities, since that could worsen the inflation with much greater certainty than helping in generating positive supply response, (e) effective use of the high stock of foodgrains with special focus on improved distribution to contain the high food prices, (f) better harvest during *rabi* season that could help in bringing down the prices of certain commodities which have led the spiral in inflation in essential commodities so far, and (g) selective import of certain commodities where the current price differentials with international markets could still be significant.

VII.15 Factors that could firm up inflationary pressures further in the near-term, particularly in terms of headline WPI inflation include: (a) fading base effect of the last year, which in itself alone will manifest in the form of positive WPI inflation in the second half of 2009-10, (b) the rigidity of the CPI inflation at the double digit level for last few months, (c) strong upward momentum already seen in WPI inflation as the index has risen by 5.9 per cent over its end-March 2009 level, even though the year-on-year inflation continues to be low at 1.2 per cent, (d) high inflation in food and essential commodities, which requires augmentation of supply, but could be difficult to ensure over the short-run, and limited import options for specific commodities, (e) persistent high CPI inflation, which could lead to wage/ cost push inflation, as wages and prices would come under increasing pressure of revision with gradual return of pricing power and wage bargaining, (f) the risk of further increase in minimum support prices under the cost-plus pricing approach, (g) possible firming up of international commodity prices with economic recovery and sudden spurt in demand from EMEs, and more importantly (h) given the dominance of supply side factors in the emerging inflationary pressures, the policy challenges in anchoring inflation expectations. The overall economic outlook, thus, is conditioned by both upside prospects of recovery with downside risks and emerging inflationary pressures.