

## *Flow of Funds Accounts of the Indian Economy: 2010-11 and 2011-12\**

*The sectoral and overall saving-investment gaps and the concomitant flow of funds across sectors were influenced by the short-lived pick-up in economic activity in 2009-10 and 2010-11 and the subsequent exchange market volatility and growth slowdown during 2011-12. The increase in aggregate financial claims during 2010-11 was on account of the private corporate business and banking sectors while the reduction in aggregate financial claims in 2011-12 was reflected in the private corporate business and the rest of the world sectors. The financial surplus of the household sector (as a ratio to net national income) declined for the second consecutive year during 2011-12. Loans and advances were the most preferred instruments for financial transactions across sectors, followed by currency and deposits. The finance ratio, the financial inter-relations ratio and the new issues ratio generally moved in tandem with the growth of the real economy.*

### **I. Introduction**

This article analyses the Flow of Funds accounts for the two fiscal years, 2010-11 and 2011-12, along with revised/updated data for 2009-10<sup>1</sup>.

\* Prepared in the National Accounts Analysis Division of the Department of Economic and Policy Research, Reserve Bank of India, Mumbai. The previous article on Flow of Funds accounts which covered the fiscal years 2008-09 and 2009-10 was published in the December 2012 issue of the RBI Bulletin.

<sup>1</sup> The Flow of Funds (FOF) accounts show the transactions in financial instruments between the major sectors of the economy on a 'from-whom-to-whom basis'. In the extant system of compilation of the FOF accounts, the Indian economy is divided into six major sectors – Banking, Other Financial Institutions (OFI), Private Corporate Business (PCB), Government, Rest of the World (ROW) and Households. It is evident that in contrast to the classification adopted by the Central Statistics Office in the compilation of data on savings and investment as part of the National Accounts, banking and other financial institutions are shown as separate sectors (irrespective of their ownership) in the FOF accounts. Furthermore, the financial transactions in respect of the ROW sector in the FOF accounts are reported from the standpoint of that sector (and not of the 'domestic' economy). The transactions between sectors are classified under nine major categories of financial instruments viz., currency and deposits, investments, loans and advances, small savings, life funds, provident funds, trade debts, foreign claims not elsewhere classified (NEC) and other claims NEC.

Over this period, the Indian economy staged a strong yet brief recovery from the downturn witnessed in 2008-09 following the global financial crisis. The revival of growth during 2009-10 and 2010-11 was largely due to coordinated and accommodative fiscal and monetary policy actions. On the other hand, the relapse of economic activity during 2011-12 reflected a host of factors such as deterioration in the domestic investment climate, structural weaknesses in the fiscal accounts, persistently high inflation as well as continued uncertainty and slump in the global macroeconomic environment as the European sovereign debt crisis remained intractable. These developments also impeded a sustained rebound in the domestic equity market that was briefly evident around mid-2010-11. Moreover, while the mutual funds sector recorded net outflow of resources during 2010-11 and 2011-12, the premium income of the life insurance industry decelerated in 2010-11 and, in fact, declined during 2011-12.

Monetary policy was progressively tightened during 2010-11 and the first half of 2011-12 in response to inflationary pressures, but further changes were subsequently put on hold as growth concerns mounted even as inflation softened. Deceleration in exports, spill-over from the fiscal accounts and rising international prices of oil and gold, led to a widening of the current account deficit (CAD) during 2011-12. Exchange markets turned volatile during the second half of 2011-12 on account of global uncertainty, slackening of capital inflows and rising CAD, which prompted foreign currency sales by the Reserve Bank. This accentuated banking system liquidity conditions in the domestic market, constrained, as it were, by build-up of government cash balances, strong growth in currency holdings by households as well as lower growth in bank deposits than that in bank credit to the commercial sector. The Reserve Bank responded with open market operations and a Cash Reserve Ratio (CRR) cut to alleviate liquidity conditions. All these developments were reflected in the changing pattern of flow of funds across the different sectors of the economy.

The article is organised as follows. Section II provides an overview of the sectoral (resource) gaps between saving and physical (or real) investment<sup>2</sup>. Section III analyses the trends in the net financial claims issued by the different sectors to finance their resource gaps. Instrument-wise financial flows are discussed in Section IV while select indicators of financial development are covered in Section V. A summary of the findings of the article is set out in Section VI. Detailed Statements relating to FOF have been released separately on the RBI website ([www.rbi.org.in](http://www.rbi.org.in)). The data on instrument-wise FOF accounts for each of the sectors are presented in Statements 1 to 6. The annual inter-sectoral flows are summarised in Statement 7. Instrument-wise financial flows are summarised for each year separately in Statement 8.

## II. Evolution of Sectoral Saving-Investment Gaps

During 2010-11, while the overall resource gap (*i.e.*, the CAD), as a ratio to GDP, remained unchanged *vis-a-vis* the previous year, sectoral resource gaps showed contrasting changes (Table 1). The resource gap of the private corporate sector increased in 2010-11 largely led by the resurgence of private investment activity. On the other hand, the resource gap of the public sector was substantially brought down by the one-off improvement in public sector saving mainly on account of substantial revenues generated from 3G/Broadband Wireless Access (BWA) spectrum auctions. At the same time, the financial surplus of the household sector declined mainly because saving under life funds came off the peak attained in the previous year. Taking into account the increase in

**Table 1: Net Saving and Net Investment of Different Sectors  
(As percentage of NNP at current market prices)**

	2003-04 to 2007-08 (Average)	2008-09	2009-10	2010-11	2011-12
<b>1. Private Corporate Sector</b>					
(i) Net Savings	4.4	3.8	4.7	4.3	3.6
(ii) Net Investment	10.3	7.6	8.5	9.8	7.0
<b>(iii) Resource Gap (i-ii)</b>	<b>-5.9</b>	<b>-3.9</b>	<b>-3.8</b>	<b>-5.4</b>	<b>-3.4</b>
<b>2. Public Sector</b>					
(i) Net Savings	-0.3	-1.9	-2.8	-0.1	-1.3
(ii) Net Investment	5.1	6.6	6.2	5.7	5.3
<b>(iii) Resource Gap (i-ii)</b>	<b>-5.5</b>	<b>-8.5</b>	<b>-9.0</b>	<b>-5.8</b>	<b>-6.6</b>
<b>3. Household Sector</b>					
(i) Net Savings	22.0	20.1	21.6	20.0	18.8
(ii) Net Investment	9.6	10.0	9.6	9.6	10.8
<b>(iii) Surplus (i-ii)</b>	<b>12.4</b>	<b>10.1</b>	<b>12.0</b>	<b>10.4</b>	<b>8.0</b>
<b>4. Total</b>					
(i) Net Savings	<b>26.1</b>	<b>22.0</b>	<b>23.5</b>	<b>24.2</b>	<b>21.0</b>
(ii) Net Investment	<b>25.0</b>	<b>24.2</b>	<b>24.3</b>	<b>25.1</b>	<b>23.0</b>
<b>(iii) Resource Gap (i-ii)</b>	<b>1.1</b>	<b>-2.2</b>	<b>-0.8</b>	<b>-0.9</b>	<b>-1.9</b>
5. Valuables	1.2	1.3	1.8	2.1	2.7
6. Errors and Omissions	0.3	-1.2	0.2	-0.1	-0.4
<b>7. Adjusted Resource Gap [4(iii)-5-6]</b>	<b>-0.4</b>	<b>-2.3</b>	<b>-2.8</b>	<b>-2.8</b>	<b>-4.2</b>

**Note:** (i) Saving and Investment are shown on net basis *i.e.* adjusting for consumption of fixed capital (CFC). In respect of the household sector, this means CFC is excluded from their gross investment in physical assets. The financial saving of the household sector are always reported after netting out financial liabilities from their gross investment in financial assets.

(ii) The resource gaps may be adjusted for capital transfers (generally unrequited and non-recurrent transfers which are designed to finance the gross capital formation of the recipient and made out of the wealth or saving of the donor) though these have been usually small.

**Source:** Central Statistics Office.

<sup>2</sup> While every sector undertakes borrowing and lending/financial investment simultaneously, a sector with a resource deficit, *in the aggregate*, borrows financial resources from other sectors. In contrast, a sector with a resource surplus, *in the aggregate*, provides financial resources to other sectors.

valuables and 'errors and omissions', the overall resource gap remained the same as that in the previous year but much higher than that during the high growth phase (2003-04 to 2007-08).

In 2011-12, as investment by the private corporate sector dried up, the resource gap of that sector declined, even as private sector profitability (and hence saving) came under pressure. In contrast, the resource gap of the public sector widened in the absence of sustained fiscal correction, even as the public sector investment rate declined. Household financial surplus declined further, impacted by slackening economic activity and persistently high inflation on the one hand, and the

increase in physical investment, on the other. Additionally, investment in valuables, largely gold, increased further during the year. On the whole, therefore, the CAD increased sharply during 2011-12.

### III. Sectoral Trends in Flow of Funds<sup>3</sup>

In tandem with the revival of the growth process, aggregate funds raised by all the sectors (*i.e.*, their total financial claims) as a ratio to Net National Income (NNI), picked up during 2009-10 and increased further to 67 per cent during 2010-11, as compared with the average of about 60 per cent during the five-year period 2003-04 to 2007-08 (Table 2). With growth slowing down in

**Table 2: Financial Claims by Sectors**

(₹ Billion)

Sectors	2003-04 to 2007-08 (Average)\$	2008-09	2009-10	2010-11	2011-12
<b>1. Domestic non-financial sector (1.1+1.2+1.3)</b>	<b>17,589</b>	<b>13,522</b>	<b>18,440</b>	<b>24,488</b>	<b>25,720</b>
1.1 Private Corporate Business	(50.0)	(54.1)	(54.0)	(56.6)	(56.8)
1.2. Government	4,646	4,996	8640	14,368	13,700
Central Government	(20.4)	(20.0)	(25.3)	(33.2)	(30.2)
State Government	3,320	6,889	7763	7,340	9,201
1.3. Households	(19.9)	(27.6)	(22.7)	(17.0)	(20.3)
Central Government	2,600	3,241	3980	4,192	5,511
State Government	(14.5)	(13.0)	(11.7)	(9.7)	(12.2)
Households	411	1,344	1,708	1,755	1,820
Banking	(1.8)	(5.4)	(5.0)	(4.1)	(4.0)
Other Financial Institutions	1,690	1,636	2,037	2,780	2,819
Households	(9.2)	(6.5)	(6.0)	(6.4)	(6.2)
<b>2. Domestic Financial Institutions (2.1 + 2.2)</b>	<b>7,715</b>	<b>11,184</b>	<b>13,743</b>	<b>16,645</b>	<b>19,408</b>
2.1. Banking	(40.3)	(44.8)	(40.3)	(38.5)	(42.8)
2.2. Other Financial Institutions	5,311	8,550	7,426	11,794	14,556
Banking	(28.3)	(34.2)	(21.8)	(27.3)	(32.1)
Other Financial Institutions	2,404	2,635	6,318	4,851	4,852
Banking	(12.1)	(10.5)	(18.5)	(11.2)	(10.7)
<b>3. Rest of the World</b>	<b>1,944</b>	<b>272</b>	<b>1,945</b>	<b>2,141</b>	<b>169</b>
Rest of the World	(10.1)	(1.1)	(5.7)	(4.9)	(0.4)
<b>4. All Non-Financial Institutions (1+3)</b>	<b>11,599</b>	<b>13,794</b>	<b>20,385</b>	<b>26,629</b>	<b>25,889</b>
All Non-Financial Institutions	(59.7)	(55.2)	(59.7)	(61.5)	(57.2)
<b>5. Total Claims Issued (1+2+3)</b>	<b>19,314</b>	<b>24,978</b>	<b>34,128</b>	<b>43,274</b>	<b>45,296</b>
Total Claims Issued	(100.0)	(100.0)	(100.0)	(100.0)	(100.0)
<b>Percent to NNP</b>	<b>59.5</b>	<b>53.1</b>	<b>63.1</b>	<b>67.0</b>	<b>61.2</b>

\$ : The absolute numbers are averages of flows in current prices from 2003-04 to 2007-08.

Note: Figures in brackets are percentages to total claims issued.

<sup>3</sup> Following periodic improvements in the compilation of Flow of Funds data, largely following from the recommendations of the High Level Committee on Estimation of Saving and investment (Chairman: Dr. C. Rangarajan), 2009, such data may not be strictly comparable across the years. The consolidated data for the insurance sector for the FOF accounts has been sourced from the Insurance Regulatory and Development Authority (IRDA) from 2008-09 onwards. In the current FOF accounts for the Indian economy, the coverage of Housing Finance Companies (HFCs) and Mutual Funds has improved significantly. The coverage of HFCs is now universal due to the consolidated data provided by the National Housing Bank. In the case of Mutual Funds, the Securities and Exchange Board of India (SEBI) provided assistance in collecting the data from 33 mutual funds. In the case of the OFI sector, the consolidated data obtained from the Department of Non-Banking Supervision (DNBS), RBI has been used for the first time, instead of the earlier practice of estimating from the survey results of 'Financial and Investment Companies'. In the Co-operative sector, consolidated balance sheet data of State Co-operative Banks and District Central Co-operative Banks were obtained from the Rural Planning and Credit Department (RPCD), RBI.

2011-12, aggregate funds raised by all the sectors, as a ratio to NNI, declined to around 61 per cent.

The increase in total claims issued (as per cent of NNI) during 2010-11 was primarily on account of the private corporate business (PCB) and the banking sectors, even as claims issued by other financial institutions (OFI) and the government sector lost pace. On the other hand, the reduction in total claims issued (as per cent of NNI) in 2011-12 was mainly on account of the PCB and rest of the world (ROW) sectors which offset the increase in the claims issued by the financial sector (banking and OFI) and the central government during the year.

On the whole, the composition of total claims issued shows that the domestic non-financial sector continues to predominate, followed by the domestic financial sector. Within the domestic non-financial sector, claims issued by the PCB sector have almost invariably been higher than those issued by the government or household sectors. On the other hand,

within the domestic financial sector, claims issued by the banking sector have exceeded those of the OFI sector. The share of claims issued by the ROW sector in total claims issued by all the sectors has, in general, remained relatively small over the years and declined further in 2011-12. Against this backdrop, the sector-wise changes in the flow of funds are discussed next.

### Private Corporate Business Sector

As indicated earlier, the total financial claims issued by the PCB sector increased in 2010-11 but declined in 2011-12 (Table 3). Financial uses of funds by this sector also increased substantially in 2010-11 and moved up further during 2011-12 which largely mirrored the movement in the loans and advances of the private non-financial companies. Reflecting these trends, the net borrowing requirement (or the financial deficit) of the PCB sector increased during 2010-11 but declined during 2011-12.

**Table 3: Financing of the Private Corporate Business Sector**

(₹ Billion)

Item	2003-04 to 2007-08 (Average) \$	2008-09	2009-10	2010-11	2011-12
1. Financial Sources	4,646	4,996	8,640	14,368	13,700
2. Financial Uses	2,890	2,123	3,702	7,042	7,701
<b>3. Financial Deficit (1-2)</b>	<b>1,756</b>	<b>2,874</b>	<b>4,938</b>	<b>7,326</b>	<b>5,999</b>
	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
<b>4. Deficit Financed by Net Issues from the following Sectors</b>					
(i) Banking	945 (12.1)	690 (24.0)	985 (19.9)	1,393 (19.0)	1,445 (24.1)
(ii) Other Financial Institutions	133 (97.3)	392 (13.6)	1,247 (25.3)	1,732 (23.6)	1,813 (30.2)
(iii) Government	-202 (-16.7)	-317 (-11.0)	-281 (-5.7)	-519 (-7.1)	-268 (-4.5)
(iv) Rest of the World	946 (39.5)	527 (18.3)	2,869 (58.1)	3,023 (41.3)	2,614 (43.6)
(v) Households	88 (6.8)	70 (2.4)	240 (4.9)	205 (2.8)	223 (3.7)
(vi) Others	-167 (-38.5)	1,512 (52.6)	-122 (-2.5)	1,493 (20.4)	172 (2.9)

\$ : The absolute numbers are averages of flows in current prices from 2003-04 to 2007-08.

Note: Figures in brackets are percentages to total financial deficit.

The pattern of financing the resource gap of the PCB sector showed an increase in the share of the banking sector during 2011-12. Borrowings from the OFI sector also picked up in 2010-11 and remained strong in 2011-12. Financing by the ROW sector was mainly in the form of investments (FDI and portfolio) as well as external commercial borrowings; portfolio inflows, however, slackened in 2011-12, largely induced by changing perceptions about India's growth prospects. Net financing by the government sector was negative in 2010-11 and 2011-12. On the whole, the resource gap of the PCB sector was predominantly financed by the ROW sector in the recent period, followed by the OFI and banking sectors.

### Government Sector

Total financial claims of the government sector declined in 2010-11 but then increased in 2011-12, largely in line with the movement in the net borrowing requirements (*i.e.*, the fiscal deficit) of the central and state governments (Table 4). The banking and the OFI

sectors continued to be the major providers of funds to the government sector as a whole during 2010-11 and 2011-12. The share of the banking sector in financing the resource gap of the government increased in 2010-11 mainly on account of loans to Non-Departmental Commercial Undertakings (NDCUs). The share of the banking sector remained high in 2011-12, largely reflecting preference for risk-free investment avenues in an environment weighed down by global uncertainty and slackening private investment even as the funding requirement of the central government increased during the year. The share of OFI, however, declined in 2010-11 and 2011-12. Households' investment in small savings also declined in 2011-12.

### Rest of the World Sector

Net financial claims (increase in liabilities minus decrease in liabilities) issued by the ROW sector increased consecutively in 2009-10 and 2010-11, reflecting an improvement in foreign investment by the PCB sector and the Reserve Bank's purchases of foreign currency as part of exchange rate management

**Table 4: Financing of the Government Sector**

(₹ Billion)

Item	2003-04 to 2007-08 (Average) \$	2008-09	2009-10	2010-11	2011-12
1. Financial Sources	3,320	6,889	7,763	7,340	9,201
2. Financial Uses	351	492	995	3,193	3,735
<b>3. Financial Deficit (1-2)</b>	<b>2,969</b>	<b>6,397</b>	<b>6,768</b>	<b>4,147</b>	<b>5,466</b>
	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
<b>4. Deficit Financed by Net Issues from the following Sectors</b>					
(i) Banking	3,89 (15.7)	4014 (62.7)	3,649 (53.9)	2,978 (71.8)	3,947 (72.2)
(ii) Other Financial Institutions	997 (31.2)	2,797 (43.7)	2,452 (36.2)	1,152 (27.8)	1,466 (26.8)
(iii) Government	-4 (-0.2)	-2 (0.0)	-1 (0.0)	-1 (0.0)	-3 (-0.1)
(iv) Rest of the World	164 (5.6)	-143 (-2.2)	207 (3.1)	-129 (-3.1)	85 (1.6)
(v) Households	918 (34.5)	-54 (-0.8)	984 (14.5)	893 (21.5)	191 (3.5)
(vi) Others	505 (13.0)	-215 (-3.4)	-523 (-7.7)	-747 (-18.0)	-220 (-4.0)

\$ : The absolute numbers are averages of flows in current prices from 2003-04 to 2007-08.

Notes: Figures in brackets are percentages to total financial deficit.

operations (Table 2). In 2011-12, net financial claims issued by the ROW sector, however, declined sharply largely reflecting the sale of foreign currency by the Reserve Bank in the face of slackening capital inflows.

Movements in net financial assets of the ROW sector (*i.e.*, increase in assets minus decrease in assets) largely reflected the increase in net foreign currency borrowings by the PCB sector and net foreign investment in India (essentially in the PCB sector) during 2010-11. On the other hand, during 2011-12, while non-resident rupee deposits of commercial banks responded positively to the increase in the offered interest rates, net foreign (portfolio) investment in India and foreign currency loans (net) availed by the PCB sector declined as domestic activity weakened and global uncertainty accentuated.

### Household sector

Financial sources (or borrowings) of the household sector – predominantly mobilised from commercial banks – have, over the years, remained much smaller than their financial investment. Consequently, the

household sector has always been a surplus sector (net lender) in the Indian economy (Table 5). The financial surplus, in absolute terms, of the household sector recovered substantially in 2009-10 and 2010-11, but declined in 2011-12, largely in line with the growth-inflation dynamics. Furthermore, in the face of high inflation, relatively low real returns on financial instruments and heightened uncertainty in financial markets, households have increasingly invested in valuables (mainly, gold) in recent years, which has further impaired their saving in financial assets.

In 2010-11, the increase in financial resources provided by the household sector to the banking sector reflected the pick-up in the growth rates of (i) currency (cash holdings) as economic activity revived and inflation surged, as well as (ii) term deposits, on account of higher interest rates. On the other hand, household investment in the OFI sector declined in 2010-11 on account of deceleration in saving under life funds and disinvestment of mutual fund units, even as private provident and pension funds showed some improvement.

**Table 5: Household Sector Financial Surplus**

(₹ Billion)

Item	2003-04 to 2007-08 (Average) \$	2008-09	2009-10	2010-11	2011-12
1. Financial Sources	1,690	1,636	2,037	2,780	2,819
2. Financial Uses	5,682	7,233	9,750	10,799	9,629
<b>3. Financial Surplus (2-1)</b>	<b>3,993</b>	<b>5,597</b>	<b>7,713</b>	<b>8,019</b>	<b>6,810</b>
	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
<b>4. Surplus made available to the following Sectors</b>					
(i) Banking	1,514 (36.4)	3,546 (63.4)	3,027 (39.2)	4,153 (51.8)	3,637 (53.4)
(ii) Other Financial Institutions	1,464 (35.0)	2,012 (35.9)	3,296 (42.7)	2,697 (33.6)	2,608 (38.3)
(iii) Private Corporate Business	88 (2.2)	70 (1.3)	240 (3.1)	205 (2.6)	223 (3.3)
(iv) Government	924 (26.3)	-31 (-0.6)	1150 (14.9)	963 (12.0)	343 (5.0)

\$ : The absolute numbers are averages of flows in current prices from 2003-04 to 2007-08.

**Note:** Figures in brackets are percentages to total financial surplus.

As growth slackened and inflation remained high during 2011-12, currency and term deposits lost momentum. At the same time, however, household borrowings from commercial banks remained more or less steady during the year. This showed up in an absolute decline in household net financial resources provided to the banking sector. Furthermore, apart from further disinvestment of their mutual fund units (under the OFI sector), households redeemed their investment in small savings (under the government sector) during 2011-12.

### Banking Sector

Financial claims issued by the banking sector increased substantially in 2010-11 and 2011-12 mainly on account of strong growth in currency (issued by the Reserve Bank) as well as commercial bank deposits held by households. Furthermore, 'other liabilities' of the Reserve Bank increased during 2010-11 and more significantly in 2011-12, reflecting accretion to the currency and gold revaluation account (CGRA) following the depreciation of the Indian rupee against the US dollar.

The build up on the financial asset side ('financial uses') of the banking sector during 2010-11 and 2011-12 essentially reflected (i) increase in the Rupee value of foreign currency assets held by the Reserve Bank; (ii) primary liquidity injection by the Reserve Bank through the liquidity adjustment facility (LAF) and open market operations (OMO), which implied higher growth in the Reserve Bank credit to the government sector; (iii) increase in credit extended by commercial banks to the PCB sector and government commercial undertakings; and (iv) strong growth in commercial bank investment in government dated securities in 2011-12.

A circular flow of funds between banks and mutual funds has been prevalent via the substantial investment of banks in the liquid/short-term debt schemes of mutual funds and the provision of funds by mutual funds to banks through the collateralised borrowing and lending obligation (CBLO) and market repo routes as well as via investment in certificates of deposits

(CDs). Recognising the potential systemic risk of such a circular flow of funds in times of stress/liquidity crunch, a prudential cap on the banks investment in the liquid/short term debt schemes of mutual funds was put in place in July 2011. Subsequently, the volume of such circular flows of funds generally moderated. In fact, the incremental amount of CDs issued by scheduled commercial banks declined from ₹1,482 billion in 2009-10 to ₹837 billion in 2010-11 and turned negative (₹52 billion) in 2011-12.

### Other Financial Institutions (OFI) Sector

Total financial claims issued by the OFI sector declined in 2010-11 mainly on account of redemption of mutual fund units by households, moderation under life funds subscribed by households and reduction in deposits of financial corporations with the banking sector, partially offset by an increase in borrowings by financial corporations from commercial banks (Table 2). In 2011-12, total financial claims issued by the OFI sector remained largely unchanged despite an increase in issuance of bonds and debentures; this was largely because borrowings from various sectors declined and life funds continued to moderate.

Total financial assets of the OFI sector also moved in tandem with their total financial liabilities. In 2010-11, loans and advances provided by financial corporations to commercial and cooperative banks as well as state governments declined while those provided to the PCB sector increased substantially. Investment by the OFI sector in commercial banks and in bonds issued by government commercial undertakings also declined during the year. Financial assets of the OFI sector recovered in 2011-12, led by strong growth in loans and advances provided to the PCB sector and in deposits of commercial banks, even as investment in the PCB sector and commercial banks declined.

### III. Instrument-wise Financial Flows

Trends in the use of different financial instruments show that loans and advances account for the predominant share of total claims issued (Table 6). In fact, during 2011-12, the share of loans and advances

**Table 6: Financial Flows by type of Instruments**

(₹ Billion)

Instruments	2003-04 to 2007-08 (Average)\$	2008-09	2009-10	2010-11	2011-12
1. Currency and Deposits	4,759 (25.0)	7,222 (28.9)	8,143 (23.9)	11,001 (25.6)	11,205 (24.7)
2. Investments	6,216 (31.2)	5,194 (20.8)	11,167 (32.7)	8,920 (20.7)	11,604 (25.6)
(a) Central and State Governments' Securities	1,785 (10.5)	3,616 (14.5)	4,427 (13.0)	4,052 (9.4)	6,942 (15.3)
(b) Other Securities	4,432 (20.7)	1,578 (6.3)	6,740 (19.7)	5,042 (11.7)	4,662 (10.3)
<i>of which</i> : (i) All Mutual Funds	301 (0.7)	-704 (-2.8)	318 (0.9)	-174 (-0.4)	-49 (-0.1)
3. Loans and Advances	5,053 (25.4)	6,052 (24.2)	8,942 (26.2)	13,587 (31.4)	12,709 (28.1)
4. Small Savings	441 (3.6)	-144 (-0.6)	395 (1.2)	361 (0.8)	-218 (-0.5)
5. Life Fund	964 (5.1)	1,713 (6.9)	3,842 (11.3)	2,226 (5.1)	1241 (2.7)
6. Provident Fund	617 (3.7)	713 (2.9)	1,289 (3.8)	1,375 (3.2)	1,366 (3.0)
7. Trade Debt	164 (0.9)	280 (1.1)	-18 (-0.1)	361 (0.8)	404 (0.9)
8. Foreign claims not elsewhere classified	-154 (-0.7)	224 (0.9)	632 (1.9)	567 (1.3)	301 (0.7)
9. Other claims not elsewhere classified	1253 (5.9)	3,724 (14.9)	-265 (-0.8)	4,702 (10.9)	6,684 (14.8)
<b>10. Total Claims Issued</b>	<b>19,314</b> <b>(100.0)</b>	<b>24,978</b> <b>(100.0)</b>	<b>34,128</b> <b>(100.0)</b>	<b>43,274</b> <b>(100.0)</b>	<b>45,296</b> <b>(100.0)</b>

\$ : The absolute numbers are averages of flows in current prices from 2003-04 to 2007-08.

**Note:** Figures in brackets are percentages to total claims issued.

in total claims was higher than the average during 2003-04 to 2007-08. Currency and deposits are the next most preferred financial instruments. Sharp and contrasting year-to-year changes are generally evident in the shares of investments in government and non-government securities (with the exception of 2010-11, when the shares of both these instruments declined). Corroborating the general trend, the share of government securities increased and that of other securities declined during 2011-12, reflecting increasing preference for risk-free investment avenues in an largely uncertain macro-financial environment, apart from a substantial increase in the government's funding requirements. A disconcerting development is the steady reduction in

the shares of instruments of household financial saving *i.e.*, small savings, life funds and provident and pension funds.

#### IV. Select Indicators of Financial Development

The trends in the various financial development ratios derived from the FOF data *viz.*, the finance ratio, the financial inter-relations ratio, the new issue ratio and intermediation ratio are set out in Table 7 and Chart 1.<sup>4</sup>

It is evident that the finance ratio, financial inter-relations ratio and the new issues ratio have moved in tandem with the growth of the real economy. During 2011-13 the finance ratio and the financial inter-

<sup>4</sup> The finance ratio, the ratio of total financial claims to national income, is an indicator of the rate of financial development in relation to economic growth. The financial inter-relations ratio, the ratio between total issues to net domestic capital formation, reflects the relation between financial development and growth of physical investment. The new issue ratio, the ratio of primary issues to net domestic capital formation is indicative of the extent of dependence of the non-financial sector on its own funds in financing the capital formation. A decline in the ratio suggests increase in the role of financial intermediation in capital formation. The intermediation ratio is the ratio between the financial claims issued by the financial institutions and the financial claims issued by nonfinancial units. An increase in the ratio is reflective of higher degree of intermediation provided by financial institutions.



**Table 7: Select Indicators of Financial Development**

(₹ Billion)

	2003-04 to 2007-08 (Average)\$	2008-09	2009-10	2010-11	2011-12
1. Secondary Issues#	7,715	11,184	13,743	16,645	19,408
2. Primary Issues##	11,599	13,794	20,385	26,629	25,889
2.1 Domestic Sectors	9,656	13,522	18,440	24,488	25,720
2.2 Rest of the World	1,944	272	1,945	2,141	169
3. Total Issues (1+2)	19,314	24,978	34,128	43,274	45,296
4. Net Domestic Capital Formation@	9,358	13,662	17,033	21,088	22,647
5. National Income**	30,891	47,054	54,111	64,224	73,999
<b>6. Finance Ratio (Ratio of 3 to 5)</b>	<b>0.60</b>	<b>0.53</b>	<b>0.63</b>	<b>0.67</b>	<b>0.61</b>
<b>7. Financial Inter-relations Ratio (Ratio of 3 to 4)</b>	<b>2.01</b>	<b>1.83</b>	<b>2.00</b>	<b>2.05</b>	<b>2.00</b>
<b>8. New Issue Ratio (Ratio of 2 to 4)</b>	<b>1.21</b>	<b>1.01</b>	<b>1.20</b>	<b>1.25</b>	<b>1.14</b>
<b>9. Intermediation Ratio (Ratio of 1 to 2)</b>	<b>0.68</b>	<b>0.81</b>	<b>0.67</b>	<b>0.63</b>	<b>0.75</b>
10. Growth in real GDP at factor cost	8.7	6.7	8.4	9.3	6.2

\$ : The absolute numbers are averages of flows in current prices from 2003-04 to 2007-08.

# : Refers to issues by financial intermediaries (*i.e.*, Banks and Other Financial Institutions).

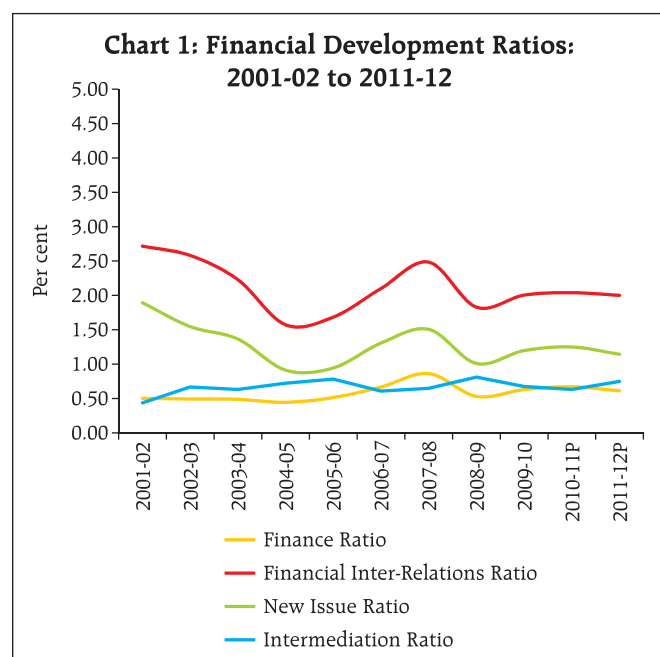
## : Refers to issues by all sectors other than financial intermediaries.

@ : At Current Prices.

\*\* : Net National Product at Factor Cost at Current Prices.

**Note:** Item No. 4 and 5 are sourced from National Accounts Statistics, CSO.

relations ratio were at their respective averages during 2003-04 to 2007-08. On the other hand, the intermediation ratio has fluctuated over the years and in the recent period, increased sharply in 2008-09 and 2011-12 when real activity slackened but claims issued by the financial sector had increased substantially.



## V. Summing Up

- The Indian economy rebounded quite strongly in 2009-10 and 2010-11 but lost momentum in 2011-12 on account of domestic and external factors. These factors impacted the sectoral and overall saving-investment gaps and the concomitant flow of funds across sectors.
- The overall resource gap (or the CAD), as ratio to GDP, remained steady during 2010-11 but then increased in 2011-12. Underlying this was the widening of the resource gap of the public sector (after a one-off improvement in 2010-11) and the dwindling of the financial surplus of the household sector for the second consecutive year, even as the resource gap of the private corporate sector contracted after a temporary expansion in 2010-11.
- In line with the trends in economic activity, total financial claims issued by all the sectors, as ratio to net national income, increased in 2010-11 but declined in the following year, even as it was placed somewhat above the average during 2003-04 to 2007-08.

- The increase in aggregate financial claims during 2010-11 was on account of the PCB and banking sectors while the reduction in aggregate financial claims in 2011-12 was reflected in the PCB and the ROW sectors.
- The composition of aggregate financial claims indicates that over the years, the banking sector has generally predominated, followed by the PCB sector, government sector, OFI sector, household sector and then the ROW sector. During 2011-12, the claims issued (as a ratio to net national income) by the PCB, banking and the government sectors were higher than their respective averages during 2003-04 to 2007-08, while those issued by the ROW, household and the OFI sectors were lower.
- The resource gap of the PCB sector has been predominantly financed by the ROW sector (largely through FDI and portfolio inflows and external commercial borrowings), followed by the OFI and banking sectors.
- The banking and the OFI sectors continue to be the major providers of funds to the government sector in the recent period.
- The financial surplus of the household sector has been largely channelised towards the banking sector, followed by the OFI sector (which includes insurance, mutual funds and provident funds). Household financing of the government sector has depleted over the years, largely reflecting the deflection from small savings.
- Claims issued by the banking sector increased during 2010-11 mainly on account of strong growth in currency and bank deposits.
- Claims issued by the OFI sector dipped during 2010-11 mainly on account of redemption of mutual fund units, moderation under life funds and reduction in deposits of financial corporations with the banking sector. Total financial claims issued by this sector remained largely unchanged in 2011-12 despite an increase in issuances of bonds and debentures.
- In recent years, the OFI sector has generally accounted for less than 10 per cent of the total sources or uses of funds of the banking sector whereas the banking sector has accounted for around 20 per cent of the total sources and uses of funds of the OFI sector.
- Loans and advances have been the most preferred instruments for financial transactions across sectors, followed by currency and deposits. The share of government securities in total claims issued has generally increased reflecting preference for risk-free investment avenues apart from a substantial increase in the government's funding requirements. On the other hand, the shares of instruments of household financial saving *i.e.*, small savings, life funds and provident and pension funds, have declined steadily.
- The finance ratio, the financial inter-relations ratio and the new issues ratio have generally moved in tandem with the growth of the real economy. On the other hand, the intermediation ratio has fluctuated over the years but increased during 2011-12 (and in 2008-09) even as the growth rate slackened, reflecting higher degree of financial intermediation.