

**RESERVE BANK OF INDIA**www.rbi.org.inwww.rbi.org.in/hindi[e-mail: helpprdr@rbi.org.in](mailto:helpprdr@rbi.org.in)

PRESS RELATIONS DIVISION, Central Office, Post Box 406, Mumbai 400001
Phone: 2266 0502 Fax: 2266 0358, 2270 3279

April 27, 2005

MACROECONOMIC AND MONETARY DEVELOPMENTS IN 2004-05

In the past, the “Macroeconomic and Monetary Developments” was issued simultaneous to the release of the Annual Policy Statement, as a separate accompanying document. However, this document is being issued this year a day ahead of the Annual Policy Statement being released tomorrow, since it could serve as a backdrop to the context and rationale of the monetary policy formulation.

The highlights of macroeconomic and monetary developments in 2004-05 are:

I. Growth Saving and Investment

- With real GDP growth at 6.9 per cent in 2004-05, India’s macroeconomic performance turned out to be stronger than anticipated.
- Despite unfavourable monsoons, real GDP originating in agricultural and allied activities rose by 1.1 per cent with foodgrains production at over 210 million tonnes.
- Industrial recovery firmed up and broadened, driven mainly by manufacturing and buoyant exports.
- The services sector remained the main engine of growth.
- The rate of gross domestic saving is estimated at 28.1 per cent of GDP in 2003-04 and the rate of gross domestic capital formation at 26.3 per cent.

II. Fiscal Situation

- The introduction of the Fiscal Responsibility and Budget Management (FRBM) Rules 2004 marked a new beginning in the fiscal consolidation process.
- While the required reduction in the revenue deficit and the fiscal deficit of the Centre in the FRBM Rules was achieved, the budgeted targets for 2004-05 were missed.
- Gross tax revenue was 3.7 per cent lower than the budget estimates mainly on account of lower corporation tax collections and union excise duties; aggregate expenditure net of debt swap transactions was lower than the budgeted level by one per cent.
- Major deficit indicators for States are budgeted to decline in 2004-05 with an ongoing endeavour of the State Governments to carry forward fiscal reforms.
- The Union Budget, 2005-06 has set a 'pause' in the path set by the FRBM due to implementation of the Twelfth Finance Commission’s (TWFC) recommendations and the need to compensate the States for any revenue loss due to implementation of VAT.
- Centre’s fiscal deficit is budgeted to decline to 4.3 per cent from 4.5 per cent in the preceding year during 2005-06 while net market borrowings are

budgeted to be higher at Rs.1,03,791 crore as against Rs.45,943 crore in the revised estimates for 2004-05.

III. Monetary and Liquidity Conditions

- Monetary conditions continued to be driven by large capital inflows in 2004-05 as in the previous year.
- Money supply (M3) at 12.8 per cent remained well within the trajectory of 14.0 per cent projected by the Annual Policy Statement for 2004-05.
- The growth in banks deposits was a shade lower than projected due to substitution in favour of postal deposits.
- Foreign currency assets of the Reserve Bank increased by Rs. 1,15,044 crore in 2004-05 on top of an accretion of Rs. 1,41,428 crore in 2003-04.
- A sharp rise in non-food credit set in from July 2004.
- With the overhang of liquidity in the beginning of the year, combined with large capital inflows, the Reserve Bank had to continually absorb liquidity during the year barring some episodic pressures.
- Sterilisation operations were conducted through institution of a new mechanism called Market Stabilisation Scheme (MSS).

IV. Price Situation

- Inflation conditions firmed up worldwide in 2004.
- Central banks began signaling a reversal of their accommodative monetary policy stance to stabilise inflation expectations.
- Commodity prices, especially crude oil, metals and coal, picked up as global demand outpaced supply alongside strengthening economic activity.
- Supply side pressures dominated the domestic inflation scenario.
- Headline inflation, measured by year-on-year changes in the wholesale price index (WPI) moved in two distinct phases during 2004-05
 - April-August 2004 marked by hardening of domestic prices of coal, petroleum products and metals due to imported inflation and unfavourable South-West monsoon;
 - September 2004 – March 2005 when inflationary pressures began to recede reflecting the waning of the impact of monsoon, fiscal measures to cushion the pass-through of international prices and monetary policy measures to drain excess liquidity and rein in inflation expectations.

V. Financial Markets

- Domestic financial markets remained broadly stable during 2004-05.
 - Money market segments exhibited easy liquidity conditions barring episodic pressures.
 - The foreign exchange market remained generally orderly with moderate upward pressure on the exchange rate.
 - Yields in the government securities market firmed up due to resurgence of inflationary pressures and the hardening of international interest rates.
 - Stock market reflected the growing confidence in the strong fundamentals of the Indian economy with investor optimism straining against intermittent corrections.
 - The BSE Sensex outperformed many major international stock market indices.

- Investor interest in the public issues segment strengthened during 2004-05, encouraged by the upbeat sentiment in the secondary market.

VI. The External Economy

- India's merchandise exports grew by 27.1 per cent during the first eleven months of 2004-05 – much higher than the target of 16 per cent set for 2004-05 by the Government of India.
- India's imports grew strongly by 36.4 per cent (April-February); surge in oil imports by 44.6 per cent and non-oil imports by 33.3 per cent took the trade deficit to an all time high.
- Invisible receipts increased by 37.5 per cent during April-December 2004 year on year, led by software, remittances and earnings from tourism.
- Invisible payments recorded a sharp rise of 62.3 per cent in April-December 2004 on account of travel, transportation, insurance and business services.
- The current account balance swung from a continuous run of surpluses between 2001-02 and 2003-04 into a modest deficit during 2004-05.
- Net capital inflows at US\$20.7 billion during April-December 2004 were higher by 25 per cent as compared with US\$ 16.6 billion recorded in the corresponding period of the previous year.
- India's foreign exchange reserves rose by US \$ 28.6 billion to US \$141.5 billion as on March 31, 2005, the fifth largest in the world.

Alpana Killawala
Chief General Manager

Press Release: 2004-2005/1119