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July 25, 2005

Macroeconomic and Monetary Developments First Quarter Review 2005-06

The Annual Policy Statement for the year 2005-06 had indicated that there will be a First Quarter Review and a Third Quarter Review of Part I of the Statement in addition to the Mid-term Review. Accordingly, the document "Macroeconomic and Monetary Developments: First Quarter Review 2005-06" is being issued today to serve as a backdrop to the First Quarter Review of the Annual Policy Statement.

The highlights of macroeconomic and monetary developments in the first quarter or Q₁ (April-June), 2005-06 are:

I. The Real Economy

- The cumulative rainfall recorded during June 1 to July 13, 2005 was one per cent above normal as against 10 cent below normal a year ago.
- Industrial production was buoyant and broad-based in April-May, 2005 with growth accelerating in the manufacturing sector.
- Lead indicators point to robust services sector performance in Q1, 2005-06.
- The generally positive developments in agriculture, industry and services coupled with upbeat business confidence have imparted optimism regarding growth prospects for 2005-06.

II. Fiscal Situation

- In April-May, 2005-06 the Centre's revenue deficit and the primary deficit were placed lower than their levels a year ago as proportion to budget estimates.
- During the first quarter of 2005-06 (April-June), gross and net market borrowings raised by the Centre amounted to 29.7 per cent and 30.9 per cent of the budget estimates.
- States raised an amount of Rs.10,245 crore (Rs.7,554 crore through tap sale and Rs.2,691 crore through auctions).
- The weekly average utilisation of WMA and overdraft by the States was significantly lower than a year ago.

III. Monetary and Liquidity Conditions

- Up to July 8, 2005 money supply expansion at 13.9 per cent remained well within the indicative trajectory (14.5 per cent growth) set in the Annual Policy Statement.
- Reserve money increased by 18.1 per cent up to July 15, 2005 as banks unwound LAF positions and withdrew liquidity to finance the higher demand for credit.

IV. Price Situation

- Inflation remained firm worldwide in Q₁ of 2005-06, driven up by high and volatile international crude oil prices.
- Producer prices continue to lead consumer prices in most economies, reflective of the supply-side character of inflation.
- International oil prices reached new highs, crossing US \$ 62 per barrel on July 7, 2005.
- In India, supply-side pressures on inflation conditions in April 2005 eased in May and June pulled down by the base effect of higher prices last year as well as various monetary and fiscal measures to stabilise inflation expectations.
- Despite increases in electricity and petrol and diesel prices during June 2005, year-on-year wholesale price inflation edged down to 4.1 per cent as on July 9, 2005, from 5.1 per cent at end-March 2005.

V. Financial Markets

- Comfortable liquidity kept money market segments tethered to the reverse repo rate during the greater part of the quarter.
- The foreign exchange market remained orderly and forward premia declined sharply in tandem with the movement of the rupee in the spot segment.
- Yields in the Government securities market eased after April, 2005 with ebbing of inflationary pressures.
- In the credit market, key interest rates edged up as commercial credit offtake was strong and broad-based.
- The equity market staged a strong rally which pushed the BSE Sensex to new highs beyond the 7300 level in July 2005.

VI. The External Economy

- In 2004-05, India's balance of payments recorded a modest current account deficit after a gap of three years. Buoyant merchandise exports and invisible earnings were outstripped by a massive expansion of imports, powered by soaring international crude prices as well as strong domestic demand.
- Merchandise export growth at 19.5 per cent remained robust during April-June 2005.
- Non-oil imports recorded a sharp increase of 40.2 per cent indicative of rising investment demand in the economy.
- High and volatile international crude oil prices have translated into a large expansion in the POL import bill.
- The trade deficit almost doubled from US \$ 6.0 billion during April-June 2004 to US \$ 11.5 billion during April-June 2005.
- Foreign direct investment (FDI) flows picked up alongside various types of debt flows, while institutional portfolio flows significantly moderated in April-May 2005 as in other emerging markets.
- India's foreign exchange reserves at US \$ 137.6 billion on July 15, 2005 were sufficient to finance 14 months of imports.

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