PRESS RELEASE

RESERVE BANK OF INDIA

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

www.rbi.org.in
www.rbi.org.in\hindi

Statement by Dr. Y. Venugopal Reddy, Governor, Reserve Bank of India on the First Quarter Review of Annual Monetary Policy for the Year 2005-06

The annual policy Statement for the year 2005-06, presented on April 28, 2005 had proposed quarterly reviews of monetary policy to provide the opportunity for structured communication with markets on a more frequent basis while retaining the flexibility to take specific measures as the evolving circumstances warrant. Accordingly, this First Quarter Review of the Annual Statement on Monetary Policy for the Year 2005-06 is being issued. This Review consists of two Sections: I. First Quarter Review of Macroeconomic and Monetary Developments in 2005-06; and II. Stance of Monetary Policy for the Remaining Period of 2005-06. An analytical review of macroeconomic and monetary developments for the first quarter of 2005-06 was issued, a day in advance, as a supplement to this Review providing the necessary information and analysis with the help of simple charts and tables.

I. First Quarter Review of Macroeconomic and Monetary Developments in 2005-06

Domestic Developments

2. The annual policy Statement projected real GDP growth for 2005-06 at around 7.0 per cent on the assumption of normal monsoon and that the industry and services sectors would maintain their growth momentum while absorbing the impact of oil prices. Though the onset of monsoon was delayed this year, it picked up by end-June and excess or normal rainfall was observed in 29 of the 36 meteorological subdivisions and total season rainfall was normal as on July 20, 2005.

3. The index of industrial production (IIP) increased by 9.6 per cent during April-May 2005 aided by 10.5 per cent growth in the manufacturing output. While basic goods, capital goods and consumer goods output growth remained buoyant, moderation in the growth of intermediate goods production was noticed. The production of capital goods, increasing by 18.9 per cent, recorded its highest growth in recent years.

4. The continued good performance of the Indian corporate sector, in general, and good growth in manufacturing output, in particular, has found a reflection in a positive assessment of the overall business situation and an improved level of business confidence. There has been an improvement in the outlook for major business indicators like the corporate expectations for production, order books, capacity utilisation, working capital finance requirements, exports and imports for July-September 2005.

5. During 2005-06, scheduled commercial banks' credit increased by 6.6 per cent (Rs.72,792 crore) upto July 8, 2005 as compared with 5.0 per cent (Rs.41,768 crore) in the corresponding period last year. Food credit increased by Rs.3,696 crore as against an increase of Rs.7,496 crore. Non-food credit increased by 6.5 per cent (Rs.69,096 crore) as compared with an increase of 4.3 per cent (Rs.34,272 crore). The incremental non-food credit-deposit ratio was higher at 66.8 per cent as against 54.7 per cent.

6. During 2004-05, credit to agriculture and industry increased by over 35 per cent and 17 per cent, respectively, while credit flow to non-agriculture non-industrial sectors remained buoyant at 36 per cent. For 2005-06, the disaggregated data available for the first two months show that credit to industry, housing and real estate continued to record strong growth. More recent information on industrial credit upto June 2005 indicate significant increase in credit to metals & metal products, engineering, power and roads & ports.

7. The scheduled commercial banks' investments in bonds/debentures/shares of public sector undertakings and private corporate sector, commercial paper (CP) etc., declined by 3.4 per cent (Rs.3,156 crore) up to July 8, 2005 as against a decline of 2.8 per cent (Rs.2,514 crore) in the corresponding period last year. Notwithstanding this decline, the total flow of resources from scheduled commercial banks to the commercial sector increased by 5.7 per cent (Rs.65,940 crore) as compared with the increase of

3.6 per cent (Rs.31,758 crore). The year-on-year growth in resource flow was also higher at 27.4 per cent, net of conversion, as against 20.1 per cent a year ago.

8. In the current financial year upto July 8, 2005, money supply (M_3) increased by 5.4 per cent (Rs.1,21,399 crore) as compared with 3.9 per cent (Rs. 77,514 crore) in the corresponding period of the previous year. On an annual basis, growth in M_3 at 13.9 per cent, net of conversion, was lower than the projection of 14.5 per cent for the year as given in the annual policy Statement. Aggregate deposits of scheduled commercial banks rose by 6.1 per cent (Rs.1,03,460 crore) as compared with an increase of 4.2 per cent (Rs.62,621 crore) in the corresponding period of the previous year. On an annual basis, the growth in aggregate deposits, net of conversion, was 14.9 per cent.

9. Reserve money increased by 3.7 per cent (Rs.17,932 crore) in the current financial year up to July 15, 2005 as against a decline of 1.6 per cent (Rs.7,059 crore) in the corresponding period of the previous year. Currency in circulation increased by 5.2 per cent (Rs.19,200 crore) as compared with 4.3 per cent (Rs.14,126 crore) in the corresponding period of the previous year. Bankers' deposits with RBI declined by 0.1 per cent (Rs.171 crore) as compared with a decline of 19.7 per cent (Rs.20,554 crore). As regards the sources of reserve money, net RBI credit to the Central Government increased by Rs.25,530 crore as against a decline of Rs. 33,227 crore in the corresponding period of the previous year. Adjusted for liquidity adjustment facility (LAF), net RBI credit to the Central Government showed a lower increase of Rs.13,565 crore. RBI's net foreign exchange assets (NFEA) declined by Rs.20,941 crore as against an increase of Rs.68,583 crore during the corresponding period of the previous year. NFEA adjusted for revaluation, however, increased by Rs.5,793 crore as compared with an increase of Rs.34,567 crore in the corresponding period last year. The balances under market stabilisation scheme (MSS), to sterilise the impact of forex inflows, stood at Rs.70,258 crore as on July 15, 2005. The ratio of NFEA to currency declined from 166.2 per cent in March to 152.6 per cent by July 15, 2005. The year-on-year increase in reserve money was higher at 18.1 per cent as on July 15, 2005 as compared with 14.4 per cent a year ago.

10. The annual policy Statement had placed the annual point-to-point inflation rate for 2005-06 in the range of 5.0-5.5 per cent, subject to the growing uncertainties on the oil

front both in regard to global prices and their domestic absorption. Annual inflation, as measured by variations in the wholesale price index (WPI), on a point-to-point basis, rose from 5.1 per cent at end-March to 6.0 per cent by April 23, but declined steadily thereafter to 4.1 per cent by July 9, 2005. At a disaggregated level, WPI for primary articles, 'fuel, power, light and lubricants' sub-group and manufactured products registered annual increases of 0.9 per cent, 10.5 per cent and 3.0 per cent as compared with the increases of 4.5 per cent, 10.4 per cent and 7.6 per cent, respectively, a year ago. Excluding 'fuel, power, light and lubricants' sub-group, the annual inflation was lower at 1.9 per cent as compared with 5.3 per cent a year ago.

11. In order to isolate the impact of supply shock, a contextual analysis of WPI reveals that excluding four commodities, viz., iron ore, iron & steel, mineral oils and coal mining, which have a combined weight of 12.6 per cent in WPI, the WPI inflation rate works out to 2.2 per cent as on July 9, 2005, on a point-to-point basis, as against 3.5 per cent a year ago.

12. Annual inflation, as measured by variations in the consumer price index (CPI) for industrial workers, on a point-to-point basis, was 3.7 per cent in May 2005 as against 2.8 per cent a year ago.

13. During 2005-06 so far, oil prices in the international markets continue to remain high and volatile. The average price for a basket of major international crude varieties (Brent, WTI and Dubai Fateh) at around US $ 52.1 per barrel during April-July 2005 was 12.9 per cent higher over January-March 2005 and 45.1 per cent over the corresponding period last year. With the latest hike in prices effective June 20, 2005, the average domestic price of petrol and diesel (in four metros) have increased by 6.2 per cent over the end-March 2005 level and 22.4 per cent over the level a year ago. The pass-through of crude prices continues to remain the most critical factor influencing domestic inflation.

14. The Union Budget for 2005-06 placed the net and gross market borrowings of the Central Government at Rs.1,10,291 crore and Rs.1,78,467 crore, respectively. Up to July 23, 2005, the Central Government had completed the net market borrowings of Rs.44,029 crore (39.9 per cent of the budgeted amount) and gross market borrowings of Rs.66,312 crore (37.2 per cent of the budgeted amount). The weighted average yield

on government borrowings through dated securities increased from 6.11 per cent in 2004-05 to 7.24 per cent during the current year so far. During 2005-06, the borrowings of state governments were Rs. 3,970 crore (net) and Rs.10,245 crore (gross) upto July 23, 2005.

15. In addition to normal market borrowings, the Central Government raised Rs. 6,355 crore (face value) under MSS for sterilisation purposes during 2005-06 so far (upto July 23). Overall, the net resources raised through government securities (Centre, States and MSS) amounted to Rs.54,354 crore (face value) during 2005-06 so far as compared with Rs.70,307 crore in the corresponding period of the previous year.

16. During 2005-06, scheduled commercial banks' investment in government and other approved securities declined by Rs.972 crore up to July 8, 2005 as against an increase of Rs.52,224 crore in the corresponding period of the previous year. The effective statutory liquidity ratio (SLR) investment of the banking system declined to 36.3 per cent of net demand and time liabilities (NDTL) as on July 8, 2005 from 42.3 per cent a year ago but continues to remain above the statutory minimum SLR of 25 per cent.

17. During April-May 2005, revenue deficit and fiscal deficit of the Central Government at Rs.44,154 crore and Rs.47,603 crore, respectively, accounted for 46.3 per cent and 31.5 per cent of the budget estimates for 2005-06, as compared with 57.5 per cent and 28.4 per cent in the corresponding period of the previous year.

18. The reverse repo volumes tendered under LAF declined from an average of Rs.29,809 crore in March 2005 to an average of Rs.9,363 crore in July 2005 (upto July 22). Further, there was lower absorption through MSS. Consequently, there has been gradual unwinding of liquidity by about Rs.14,000 crore during the current year upto July 22, 2005. Notwithstanding some decline in surplus liquidity during the year, the overhang of liquidity (MSS, LAF and government cash balances) continues to remain substantial at about Rs.1,00,000 crore.

19. During 2005-06 so far, financial markets have remained stable, though interest rates have displayed some upward movement. The call money rate increased from an average of 4.72 per cent in March to 5.00 per cent as on July 22, 2005. The market

repo rate increased from an average of 4.36 per cent to 4.90 per cent and the CBLO rate increased from 4.09 per cent to 4.93 per cent, over the same period.

20. The 91-day and the 364-day Treasury Bill rates increased from 5.32 per cent and 5.66 per cent at end-March to 5.49 per cent and 5.89 per cent, respectively, by July 20, 2005. The yield on 182-day Treasury Bills increased from 5.44 per cent on April 6 to 5.67 per cent by July 13, 2005. In the secondary market for government securities, the yield on securities with 1-year residual maturity increased from 5.51 per cent at end-March 2005 to 5.85 per cent by July 22, 2005 whereas the yield on government securities with residual maturities of 10-year and 20-year increased from 6.65 per cent and 6.99 per cent to 7.16 per cent and 7.70 per cent, respectively, over the same period. It may be noted that long-term yields in the government securities market had touched relatively higher levels towards the end of April and beginning of May 2005. For example, the yields of 10-year and 20-year government securities were 7.35 per cent and 7.77 per cent, respectively. Over the period end-March to July 22, 2005, with a relatively higher increase in long-term interest rates, there was a steepening of the yield curve. While the yield spread between 1-year and 10-year government securities increased from 114 basis points to 131 basis points, it increased from 148 basis points to 185 basis points between 1-year and 20-year government securities. The yield spread between AAA-rated corporate bonds of 5 years and government securities of similar maturity, however, reduced from about 76 basis points at end-March to 30 basis points by July 22, 2005. The weighted average discount rate (WADR) on commercial paper (CP) increased from 5.84 per cent at end-March to 5.93 per cent by July 15, 2005.

21. The interest rates on deposits of over 1-year offered by the public sector banks moved from a range of 4.75-7.00 per cent in March to 5.25-6.50 per cent by June 2005. The benchmark prime lending rates (BPLRs) of public sector, private and foreign banks remained unchanged in the range of 10.25-11.25 per cent, 11.00-13.50 per cent and 10.00-14.50 per cent, respectively, between March and June 2005. The representative (median) lending rates on demand and term loans (at which maximum business is contracted) of the public sector banks moved from 9.00-12.50 per cent and 8.35-12.00 per cent, respectively, in March to 8.00-12.15 per cent and 8.15-11.90 per cent by June 2005.

22. The equity market remained buoyant with the BSE sensex crossing the 7000-mark in June 2005. It rose from 4795 at end-June 2004 to 6493 at end-March 2005 and further to 7506 by July 25, 2005.

Developments in the External Sector

23. During 2004-05, the current account of the balance of payments (BoP) turned into a deficit after remaining in surplus consecutively for three years (2001-04). Notwithstanding a moderate current account deficit, there was a turnaround of US $ 17.0 billion, from a surplus of US $ 10.6 billion in 2003-04 to a deficit of US $ 6.4 billion in 2004-05, largely reflecting a deterioration both in oil balance (US $ 6.0 billion) and non-oil trade balance (US $ 7.4 billion).

24. During April-June 2005, India's exports increased by 19.5 per cent in US dollar terms as compared with 34.0 per cent in the corresponding period of the previous year. However, imports rose faster by 37.8 per cent as compared with 36.6 per cent in the corresponding period last year. Oil imports increased by 33.1 per cent and non-oil imports increased by 39.9 per cent. Consequently, the overall trade deficit widened to US $ 11.5 billion during April-June 2005 as against US $ 6.0 billion in the corresponding period of the previous year.

25. The higher trade deficit this year reflects the high oil imports bill as also the growth in non-oil imports, notably capital goods imports. Disaggregated data indicate an increase of 62.0 per cent in non-oil imports (excluding gold and silver) in April 2005 as against 8.1 per cent in April 2004. Whereas exports of ores & minerals, engineering goods, chemicals and textiles remained buoyant, there was a deceleration in exports of agriculture & allied products and leather.

26. During April-July 2005, the Indian foreign exchange market witnessed orderly conditions with the Rupee exhibiting two-way movements. Upto July 25, 2005, the Rupee appreciated by around 0.6 per cent against the US dollar, 7.9 per cent against the Euro, 8.6 per cent against the Pound Sterling and 4.8 per cent against the Japanese Yen. India's forex reserves, which were US $ 141.5 billion as at end-March 2005 declined by US $ 4.0 billion to US $ 137.5 billion on July 22, 2005.

Developments in the Global Economy

27. Global economic growth is projected by the International Monetary Fund (IMF) to slow down, *albeit* moderately, to 4.3 per cent in 2005 from 5.1 per cent in 2004. After exceeding the expectations in the first quarter of 2005, recent data suggest that global growth has slowed down in the second quarter of 2005, in part reflecting the rise in oil prices. Divergence in growth is also increasing across the regions. In the current year, the growth performance has been strong in the US, China, and most emerging markets and developing countries but the Euro zone has registered low growth.

28. During the second quarter of 2005, consumer price inflation in the US has increased, but remained stable in the Euro zone, the UK, Japan and other advanced economies. Inflation in other major emerging markets and developing countries, including Latin American countries, has also shown some decline during this quarter. Stabilisation in global prices of metals and minerals seems to have had a moderating impact on inflation. The rise in oil prices has not yet triggered generalised inflationary pressures in contrast to the experience of earlier oil shocks.

29. The global oil economy continues to be characterised by elevated prices and considerable volatility, accentuated by speculative activities. The outlook remains highly uncertain with limited scope for enhanced supplies in the near future taking account of inventories, unutilised capacities and gestation periods for new investments. The geopolitical factors seem to continue to be critical. The outlook for demand remains firm, with fast-growing China as well as India being somewhat low in energy-efficiency, and the persistence of large energy consumption in the US. While the global economy is coping with these uncertainties in a demonstrably better manner than in earlier episodes, the associated problems are getting complex for oil-exporting countries in terms of managing the surpluses and difficult for oil-importing countries like India in terms of effect on prices, output, competitiveness and indeed, disposable incomes.

30. Risks to global growth arise from the imbalances in the current account of the BoP, the fiscal imbalances, hedge fund activity, and the excessive leveraging in some

advanced economies. There is even a greater need to keep a vigil on potential bubbles in the asset markets since real estate market valuations have, in the recent past, been supported by low-interest consumer debt. The recent appreciation of the US dollar could delay the adjustment process further and has the potential for accentuating the need for sharper adjustment in future. Significantly, last week China has moved to a managed floating exchange rate regime linked to a basket of currencies, with an initial appreciation of RMB by about 2 per cent against the US dollar.

31. The paradigm shift in exchange rate policy announced by China is bound to have important consequences for the global economy. The extent of revaluation is described as a very modest one, and the policy framework explicitly provides for management of the exchange rate, but the nature, extent and intensity of management is yet to be revealed and in any case likely to evolve gradually. While the direction of change is evident, the pace, the steps and the associated administrative measures by the authorities would have to be watched to determine the impact of these changes on the global economy. Of particular significance would be the ongoing responses of the domestic financial as well as real sectors in China to the new foreign exchange policy. As per current indications, the impact on India is assessed to be marginally positive on trade account, neutral on current account, and somewhat indeterminate on capital flows but is unlikely to be negative for India, though the capital flows could be potentially volatile on the global front.

32. Of the major central banks, the US Fed has raised its policy rate by 25 basis points each on nine occasions from 1.0 per cent in June 2004 to 3.25 per cent by end-June 2005 while providing clear indications for continued rise in the policy rate. While the Bank of England has held its repo rate steady at 4.75 per cent since August 2004, in the July 2005 meeting of the Monetary Policy Committee, four out of nine members preferred a reduction in the repo rate by 25 basis points. The European Central Bank (ECB) has kept its policy rate unchanged at 2.0 per cent since June 2003.

33. The recent months have witnessed unanticipated high volatility in currency markets, a sharp drop in long-term bond yields described as a conundrum, and extraordinary buoyancy in equity markets labelled as paradox. Long-term bond yields have fallen in recent months in mature financial markets, perhaps reflecting moderate growth,

expectations of lower inflation, smaller real term premium due to moderation of the business cycle, excess of saving over intended investment, and shift in the preference of institutional investors towards fixed-income instruments. There is a view that global saving is tending to be in excess of global investment opportunities. This may be partly attributable to surpluses generated by oil exporting countries, which incidentally seem to give considerable weight to the US dollar denominated assets typical of oil economy. There are possible implications of such saving-investment imbalances for currency markets, for bond markets and equity markets with a potential for underpricing of risks. It is not impossible that, beneath the apparent stability, there are disequilibria which will get corrected sometime in future, and if the process of correction were to be abrupt, emerging economies may be particularly vulnerable. No doubt, the current macro-policy framework of most emerging economies has imparted noteworthy resilience, but heightened global uncertainties do demand close attention to elements of the recently accentuated disequilibria.

II. Stance of Monetary Policy for the Remaining Period of 2005-06

34. At the time of presentation of the annual policy Statement, the Reserve Bank faced two major challenges: one, reining in inflationary expectations in the face of several uncertainties so as to ensure stability in the financial markets and maintaining financing conditions at levels appropriate to lend support to the ongoing growth momentum; and two, liquidity management in the context of budgeted government borrowings and indications of strong credit growth. The Reserve Bank sought to moderate inflationary expectations by demonstrable commitment to price stability as reflected in the increase in policy reverse repo rate by 25 basis points to 5.0 per cent. The financial markets responded positively to this measure. With increasing absorption of capital flows by the economy and changes in the sources of liquidity, the overall MSS cap was retained at Rs.80,000 crore. The lower mobilisation through MSS coupled with the reduction in LAF volumes during 2005-06 so far reflects unwinding of liquidity, as appropriate.

35. The conduct of monetary policy during the first quarter of 2005-06 has been in accordance with the stance announced in the annual policy Statement. The macroeconomic developments and conditions in financial markets have been broadly in

line with anticipations in the annual policy Statement but, some developments need attention. First, overall industrial growth has maintained a healthy up trend, though the delayed monsoon has imparted some uncertainties to the likely level of agricultural production. The impact of the monsoon on agricultural production would depend on both inter-temporal and spatial distributions. Second, non-food credit growth has been significantly buoyant and is getting broad-based. However, the upswing continues to be driven by housing and real estate and hence a greater need to ensure credit quality. Third, despite higher credit growth, governments' borrowing programme has been conducted smoothly. While bank deposit growth is higher and non-bank financial institutions' demand for government securities remains positive, the competing demand for funds between the government and the commercial sector has been balanced. This has been facilitated by refocusing of the banks' operations in favour of the commercial sector relative to government duly supported by appropriate liquidity management by RBI. Fourth, money supply growth has been within the projected trajectory. Reserve money growth has been driven by expansion in domestic assets rather than foreign exchange assets. Fifth, the inflationary outcome turned out consistent with the anticipation at the beginning of the year and underlying inflation remains contained. However, the pass-through of oil prices is not yet complete. Sixth, financial markets remained stable though interest rates have shown some upward movement in consonance with the policy developments. Seventh, domestic financing conditions remain supportive of growth. Eight, the liquidity needs of the economy have been met by unwinding of liquidity in an orderly manner, though the overhang of liquidity continues to remain substantial. Ninth, an enlarged trade deficit, on account of high oil prices and improvement in absorptive capacity of the economy, was partly offset by the buoyancy in net invisibles, and net capital inflows have financed the current account deficit of BoP. The trends in oil economy and enhanced growth in industrial production and domestic investment activity point to the criticality of the trade deficit and the overall BoP. While it is necessary to monitor these developments carefully and respond in a measured manner, as per current assessment, the trade deficit is manageable and the current account deficit sustainable.

36. Though the outlook for global growth and inflation remains broadly unchanged since the presentation of the annual policy Statement in April 2005, the risks have

increased in recent months. The world economy has so far accommodated the large increase in international oil price without any major disruption, but strains are increasingly becoming visible which could further impair global growth and trade. The oil prices continue to remain high and volatile. While the international interest rate cycle gives a mixed signal, the policy rate of the US is on an upward trajectory which has implications for capital inflows to emerging markets. The recently announced changes in the exchange rate policy of China add to the uncertainties.

37. The domestic factors, which are admittedly more relevant for India, continue to be positive. The performance of industrial sector is strengthening and the indicators of growth in services are positive. The upturn in industrial activity is supported by pick up in investment demand as reflected in the production and import of capital goods. Credit growth continues to be strong. The business expectation surveys also point to continued optimism. While the onset of monsoon was delayed, it has progressed well subsequently, but uncertainties remain on its progress during the season and consequently its impact on agricultural output. Supply constraints could also emanate from inadequate infrastructure, especially in power and ports, to support higher levels of domestic activity and export demand. On balance, though uncertainties remain, the domestic growth impulses appear to have been reinforced in the first quarter.

38. During the current year so far, inflation has remained on the expected lines. WPI inflation, excluding energy related items, continues to remain low as also prices of manufactured products. The inflation so far has been manageable. There is no evidence yet of generalised demand pressures, though credit growth is unusually strong. However, the progress of monsoon rainfall and movements in international oil prices would be the major determinants of supply factors that may continue to dominate the price situation, though the level of food stocks and forex reserves provide necessary cushion in supply management. While some pass-through of the increase in international oil prices has taken place, its second round impact is yet not apparent. On balance, during the first quarter, the underlying inflationary pressures appear to have been contained and inflationary expectations maintained, as anticipated.

39. The financial markets have, by and large, exhibited stability. While the money market interest rates moved up in tandem with changes in policy rate, there has been a

greater convergence of rates between the collateralised and uncollateralised segments. While the yields in the government securities market have moderated from their observed peak levels in April, some upward movement is noticed and the yield curve has steepened. Though the Rupee has appreciated against major international currencies, the movement of exchange rate has been orderly. The equity market has exhibited optimism which is reflected in the magnitude of movement in stock indices.

40. Against the backdrop of developments during 2005-06 so far, the stance of monetary policy would depend on the macroeconomic developments including the global developments and the overall balance of risks. Factors such as increased global uncertainties, high and volatile international prices of oil, incomplete pass-through of oil prices domestically, upward trajectory of policy rate in the US, overhang of liquidity, high credit growth, sustained industrial growth and possible capacity pressures, enlargement of trade deficit, infrastructural constraints and delayed monsoon could prompt a change in the stance of policy. In favour of continuation of the stance, it could be argued that the oil price hike has been managed well with a combination of monetary and fiscal measures, overhang of liquidity has reduced with the increase in the absorptive capacity of the economy, excess liquidity remains sterilised, visible liquidity under LAF has reduced, money supply growth is within the projected trajectory, credit flow is getting broad-based, industrial growth has revived after a long period of sluggishness, pick up in investment demand is evident, investment climate remains favourable, corporate earnings and profits have been sustained, current level of inflation remains moderate both at the wholesale level and retail level, globally monetary policy continues to be somewhat accommodative, and global inflation during 2005 is projected to be moderate despite high oil prices. The considerations in favour of *status quo* are evenly matched by those for change in stance, but the balance of convenience at this juncture lies in continuing with *status quo* while monitoring the unfolding constellation of uncertainties, especially in the global arena.

41. In sum, the Reserve Bank's current assessment of macroeconomic outlook and the overall stance remains broadly unchanged from the annual policy Statement. It is apparent that there are several global uncertainties but there are domestic factors which indicate a confidently growing economy in a stable environment. While global factors are getting to be increasingly significant for India, the domestic factors still

dominate and the latter point to favouring stability to maintain growth momentum at this juncture while being ready to respond to evolving circumstances. Accordingly, the overall stance of monetary policy for the remaining part of the year 2005-06 will continue to be as set out in the annual policy Statement of April 2005, but the Reserve Bank would respond, promptly and effectively, to the evolving situation depending on the unfolding of the risks.

Mid-term Review

42. The Mid-term Review of the annual policy Statement will be undertaken on October 25, 2005 and will contain such other changes/measures as may be necessary.

Mumbai
July 26, 2005

G.Raghuraj
Deputy General Manager

Press Release: 2005-2006/116