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Macroeconomic and Monetary Developments Mid-Term Review 2005-06

The Reserve Bank of India today released the document “Macroeconomic and Monetary Developments: Mid-Term Review 2005-06” to serve as a backdrop to the Mid-Term Review of the Annual Policy Statement.

The highlights of macroeconomic and monetary developments during 2005-06 so far are:

I. The Real Economy

- The Indian economy recorded an impressive performance during the first quarter of 2005-06. According to the Central Statistical Organisation (CSO), real GDP growth in the first quarter (April-June) of 2005-06 accelerated to 8.1 per cent from 7.6 per cent in the corresponding period of the preceding year.
- The cumulative rainfall during the South-West monsoon (June 1 to September 30, 2005) was one per cent below normal as compared with 13 cent below normal a year ago.
- Industrial activity gathered further strength during the first five months of 2005-06, although there was some loss of momentum during July-August 2005. During April-August 2005 industrial production accelerated to 8.8 per cent led by the manufacturing sector.
- Lead information on the major indicators of services sector indicates continued buoyancy in the second quarter of 2005-06
- The revival of the South-West monsoon, the acceleration of the industry, buoyancy in services and positive business confidence and expectations have improved growth prospects for 2005-06.

II. Fiscal Situation

- Available information for the first five months of 2005-06 (April-August) indicates improvement in Central Government finances, benefiting from higher tax collections and expenditure management through control over non plan expenditure.
- Gross and net market borrowings raised by the Centre during 2005-06 so far have amounted to 60.1 per cent and 50.0 per cent, respectively, of the budget estimates.
- States have raised an amount of Rs.14,265 crore during 2005-06 so far, which is 63.6 per of their gross allocation for 2005-06.
- The weekly average utilisation of WMA and overdraft by the States was significantly lower than a year ago.

III. Monetary and Liquidity Conditions

- Monetary conditions have remained comfortable during 2005-06 so far despite a sustained pick-up in credit demand from the commercial sector. Banks were able to finance the higher demand for commercial credit by curtailing their incremental investments in Government securities.

- Up to September 30, 2005 money supply expanded by 16.6 per cent as compared with the indicative trajectory (14.5 per cent growth) set in the Annual Policy Statement.
- Scheduled commercial banks' non-food credit, on a year-on-year basis, registered a growth of 31.5 per cent as on September 30, 2005 on top of 24.9 per cent a year ago.
- Reserve money growth as on October 14, 2005 at 17.9 per cent was almost the same as that a year ago (18.0 per cent).

IV. Price Situation

- Inflation pressures firmed up in a number of economies during first half of 2005-06, reflecting the impact of further increases in international crude oil prices which reached a new high of US \$ 70.8 per barrel on August 30, 2005. The issue of changes in inflation expectations has been revived globally in the recent weeks.
- In India, year-on-year inflation fell to 3.0 per cent on August 27, 2005 from 5.1 per cent at end March 2005. It has since increased to 4.6 per cent as on October 8, 2005.
- Fiscal and monetary measures undertaken since mid-2004 to reduce the impact of imported price pressures on domestic inflation and to stabilise inflationary expectations, coupled with base effects and the revival of monsoon, enabled the moderation in headline inflation from its high of 8.7 per cent last year.
- However, when a significant part of what may be considered as permanent component of oil price increase is yet to be passed on, there is a need to consider two factors: First, the advisability of treating the oil price increase as a shock rather than a permanent shift in relative prices may need to be questioned; and, second, the inevitability of second order effects on inflation needs to be taken on board.

V. Financial Markets

- Comfortable liquidity conditions have kept interest rates in different money market segments generally around the reverse repo rate during the year so far.
- The foreign exchange market remained more or less orderly. Forward premia continued to decline in tandem with the narrowing interest differential following hikes in the US interest rates.
- Yields in the Government securities market since May 2005 have largely been range-bound with intra-year movements influenced by domestic liquidity conditions.
- In the credit market, key interest rates edged up as commercial credit offtake continued to remain strong and broad-based.

VI. The External Economy

- During April-September 2005, merchandise export growth at 20.5 per cent was higher than the annual target of 16 per cent set for the fiscal year by the Government of India
- Imports maintained the tempo of high growth, driven by both oil and non-oil imports, in an environment of buoyant economy. The rise in petroleum, oil and lubricants (POL) imports (42.9 per cent) in April-September 2005 was due to a sharp increase in international crude oil prices. Non-oil imports maintained high growth (28.8 per cent) in tune with the acceleration in industrial activity.
- Trade deficit, based on DGCI&S data, increased by 71 per cent to US \$ 20.3 billion during April-September 2005
- Balance of payments (BoP) developments during the first quarter of 2005-06 point to a sharp turnaround in the current account balance, due to a widening of the merchandise trade deficit.

- Nonetheless, with capital flows remaining strong - led by foreign investment flows, direct as well as portfolio - and in excess of the current account deficit, the balance of payments position remained comfortable and the overall balance recorded a modest surplus.
- External debt recorded a modest decline during the quarter ended June 2005.
- Foreign exchange reserves have increased by US \$ 1.9 billion in the current fiscal year so far to US \$ 143.4 billion as on October 14, 2005.

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