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Macroeconomic and Monetary Developments Third Quarter Review 2005-06

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

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

The Real Economy

- The robust performance of the Indian economy continued during the second quarter of 2005-06. According to the Central Statistical Organisation (CSO), the economy recorded a real GDP growth 8.1 per cent in the first half of 2005-06, one percentage point higher than a year ago.
- Manufacturing activity witnessed strong performance during April-November 2005. Cumulative growth during the first eight months at 9.4 per cent was higher than a year ago (9.1 per cent). On the whole, industrial production recorded a growth of 8.3 per cent on top of 8.6 per cent in the corresponding period of the preceding year.
- Latest available information on the major indicators related to the services sector indicates continued buoyancy in 2005-06
- The normal South-West monsoon, the sustained growth of the manufacturing, the buoyancy in services and the positive business confidence and expectations have further brightened growth prospects for 2005-06.

Fiscal Situation

- The available information on finances of the Central Government for the first eight months of 2005-06 (April-November) indicates improvement in key fiscal variables due to continued buoyancy in tax collections and containment of growth in non plan expenditure.
- Gross and net market borrowings (excluding issuances under market stabilisation scheme) of the Centre (up to January 18, 2006) amounted to 82.6 per cent and 80.0 per cent of the Budget Estimates as compared with 63.7 per cent and 45.0 per cent, respectively, a year ago. The higher recourse by the Centre to market borrowings during 2005-06 so far than a year ago reflects the discontinuation of the Debt Swap Scheme (DSS), the proceeds of which were available for financing its Gross Fiscal Deficit during 2004-05.
- States have raised an amount of Rs.15,702 crore during 2005-06 so far (up to January 18, 2006), which is 65.1 per of their gross allocation for 2005-06.
- The utilisation of WMA and overdraft by the States was significantly lower than a year ago.

Monetary and Liquidity Conditions

- Monetary and liquidity conditions have generally remained comfortable during 2005-06 so far despite a sustained pick-up in credit demand from the commercial sector for support the buoyant real economic activity.

During December 2005 the banking system faced some liquidity pressures in the context of the redemption of India Millennium Deposits (IMDs). The Reserve Bank accordingly injected liquidity through repo operations and unwinding of the Market Stabilisation Scheme (MSS).

- Money supply, on a year-on-year basis, expanded by 15.9 per cent as on January 6, 2006 as compared with 13.5 per cent last year.
- Scheduled commercial banks' (SCBs') non-food credit, on a year-on-year basis, registered a growth of 32.0 per cent as on January 6, 2006 on top of a base as high as 26.6 per cent a year ago.
- Reserve money growth as on January 13, 2006 at 19.8 per cent was higher than a year ago (17.3 per cent).

Price Situation

- Headline inflation, which had edged up sharply in a number of economies during September 2005 on account of international crude oil prices reaching record highs in August 2005, eased marginally during the fourth quarter of 2005 in tandem with some moderation in crude oil prices. Although the second round effects of recent oil prices hikes have been muted so far and core inflation remains low, the prospect of a higher second round pass-through has prompted a number of central banks to tighten monetary policy during the recent months in order to contain inflation and inflationary expectations.
- In India, WPI inflation was 4.2 per cent on January 7, 2006 – after touching an intra-year low of 3.3 per cent on August 27, 2005 - as compared with 5.1 per cent at end-March 2005 (and 5.8 per cent a year ago).
- Fiscal and monetary measures undertaken since mid-2004 to reduce the impact of imported price pressures on domestic inflation and to stabilise inflationary expectations have been successful in containing inflation towards the desired trajectory during the financial year so far.

Financial Markets

- Financial markets in India have remained broadly stable during 2005-06 so far. During the quarter the redemption of India Millennium Deposits (IMDs) took place smoothly.
- Comfortable liquidity kept money market segments generally around the reverse repo rate during April-October 2005. During most part of November-December 2005, however, the call money remained above the reverse repo rate reflecting some liquidity pressures, arising partly from the IMD redemption.
- The foreign exchange market remained more or less orderly.
- Yields in the Government securities market which had hardened in April 2005 reflecting higher crude oil prices and increase in the reverse repo rate have largely remained range bound since then.
- In the credit market, deposit and lending rates edged up during the quarter ended December 2005.

The External Economy

- During April-December 2005, India's merchandise exports increased by 18.0 per cent as compared with an increase of 26.7 per cent a year ago.
- Imports of petroleum, oil and lubricants (POL) increased by 45.4 per cent during April-December 2005 due to a sharp increase in international crude oil prices. Non-oil imports during April-December 2005 registered a growth of 20.1 per cent as compared with 33.0 per cent a year ago.
- The trade deficit, based on DGCI&S data, increased by 54 per cent to US \$ 29.8 billion during April-December 2005.

- Balance of payments (BoP) developments show that the current account deficit widened further during the second quarter (July-September) of 2005-06 over its level in the first quarter, led by a higher merchandise trade deficit.
- The balance of payments position, nonetheless, remained comfortable as capital flows continued to remain strong.
- India's total external debt registered an increase of US \$ 2.2 billion (1.8 per cent) during the quarter ended September 2005 to US \$ 124.3 billion.
- India's foreign exchange reserves were US \$ 139.5 billion as on January 13, 2006, registering a decline of US \$ 2.0 billion over end-March 2005 level. The decline in reserves was mainly on account of the redemption of India Millennium Deposits (IMDs).

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