PRESS RELEASE

RESERVE BANK OF INDIA

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Macroeconomic and Monetary Developments in 2005-06

The Reserve Bank of India today released the document "Macroeconomic and Monetary Developments in 2005-06" to serve as a backdrop to the Annual Policy Statement for the year 2006-07.

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

The Real Economy

- The Indian economy exhibited strong performance during 2005-06, led by sustained growth in the industry and the services sectors. According to the advance estimates of the Central Statistical Organisation (CSO), the real GDP growth accelerated from 7.5 per cent in 2004-05 to 8.1 per cent in 2005-06.
- Industrial production registered strong growth during April-February 2005-06 on the back of broad-based manufacturing activity. The manufacturing sector recorded growth of 9.0 per cent in 2005-06 (April-February) on top of 8.9 per cent growth a year ago. On the whole, industrial production recorded growth of 8.0 per cent as compared with 8.2 per cent in the corresponding period of the preceding year.
- Growth in the services sector accelerated to 9.9 per cent during April-December 2005 from 9.7 per cent during April-December 2004, benefiting from robust growth in the major sub-sectors *viz*., 'trade, hotels, transport and communication', 'financing, insurance, real estate and business services' and 'construction'.
- The buoyancy in manufacturing and services sector activities and the positive business confidence and expectations suggest that the recent growth momentum in the Indian economy is likely to be maintained in 2006-07, as has also been projected by different agencies.

Fiscal Situation

- The revised estimates for 2005-06 placed the key deficit indicators of the Central Government lower than the budgeted levels. This was enabled mainly by compression undertaken in non-Plan expenditures in respect of interest payments, subsidies, grants to the States and defence expenditure.
- As per Reserve Bank records, during 2005-06, gross and net market borrowings (excluding issuances under the Market Stabilisation Scheme) of the Centre amounted to 97.3 per cent and 94.3 per cent of the budget estimates as compared with 70.6 per cent and 51.0 per cent, respectively, a year ago.
- During 2005-06, the States raised Rs.21,729 crore, *i.e.*, 84 per cent of their gross allocation.
- The weekly average utilisation of WMA and overdraft by the States during 2005-06 was significantly lower than that during the previous year.

- The Union Budget 2006-07 committed to resume the path of fiscal consolidation under the FRBM so as to eliminate the revenue deficit by 2008-09. The key deficit indicators, *viz.*, gross fiscal deficit, revenue deficit and primary deficit, as per cent of GDP, are budgeted to be lower in 2006-07 than the previous year's level.

Monetary and Liquidity Conditions

- Monetary and liquidity conditions remained largely comfortable during 2005-06 although there was some tightness in liquidity conditions during the last four months of 2005-06 reflecting partly the impact of the redemption of India Millennium Deposits (IMDs). The Reserve Bank injected liquidity through unwinding of the Market Stabilisation Scheme (MSS) and repo operations under the liquidity adjustment facility (LAF) along with some private placement of the Central Government securities. As a result, the banking system was able to meet the sustained pick-up in credit demand from the commercial sector.
- In the face of the rising demand for commercial credit, banks restricted their incremental investments in Government paper. Strong growth in deposits as well as access to non-deposit sources also enabled the banking system to meet the enhanced demand for commercial credit. Scheduled commercial banks' non-food credit, on a year-on-year basis, registered a growth of 30.8 per cent as on March 31, 2006 on top of 28.8 per cent a year ago.
- Money supply (M3) expanded by 16.2 per cent on a year-on-year basis as on March 31, 2006 as compared with 13.9 per cent a year ago. On a fiscal year basis, M3 expanded by 20.4 per cent during 2005-06 as compared with 12.1 per cent a year ago. In this context, it may be noted that data on fiscal year variation for 2005-06 are not comparable with those of the previous years as the data for 2005-06 include 27 fortnights while usually the data for a year include 26 fortnights. Moreover, the last reporting Friday of 2005-06 coincided with March 31, the closing day for banks' accounts, thereby giving rise to the phenomenon of year-end bulge in aggregate deposits and credit.
- Reserve money expanded by 16.9 per cent on a year-on-year basis as on April 7, 2006 as compared with 15.1 per cent a year ago.

Price Situation

- Headline inflation firmed up in a number of economies during 2005-06 on account of international crude oil prices reaching a record high and remaining at elevated levels. Accordingly, many central banks tightened monetary policy during 2005-06 in order to contain inflation and inflationary expectations, especially in view of the fact that a significant part of the increase in international crude oil prices is increasingly viewed as somewhat permanent.
- In India, headline inflation and inflation expectations remained well-contained during 2005-06, despite continued dominance of supply-side factors. Fiscal and monetary measures undertaken since mid-2004 to reduce the impact of imported price pressures on domestic inflation and to stabilise inflationary expectations were successful in containing inflation towards the desired trajectory during 2005-06.
- In India, year-on-year wholesale price inflation was 3.5 per cent on April 1, 2006 as compared with 5.7 per cent a year ago.

Financial Markets

- Indian financial markets remained orderly during 2005-06 even as interest rates edged up across the spectrum.

- Money market conditions, which remained comfortable up to October 2005, turned somewhat tight thereafter. Call money rates generally remained within the repo-reverse repo rate corridor except the last quarter of 2005-06. Rates in the collateralised segments of the money market – the market repo (outside the LAF) and the Collateralised Borrowing and Lending Obligation (CBLO) segments – however remained within the corridor. The collateralised segments account for a growing and predominant share (about 70 percent) of the total money market turnover. The call rates have eased to below 6.0 per cent during April 2006 so far, reflecting improvement in liquidity conditions.
- The foreign exchange market remained more or less orderly, exhibiting two-way movements.
- Yields in the Government securities market hardened during 2005-06, with the increase at the longer end less than at the short-end.
- In the credit market, deposit and lending rates edged up during the year as credit demand accelerated further.

The External Economy

- During 2005-06, India's exports continued to maintain the momentum of high growth for the fourth year in succession, registering strong growth of 24.7 per cent on top of 26.4 per cent growth a year ago
- Imports of petroleum, oil and lubricants (POL) increased by 46.8 per cent during 2005-06, reflecting the impact of sharp increase in international crude oil prices. Non-oil imports posted a growth of 25.6 per cent during 2005-06 as compared with 33.3 per cent a year ago.
- The trade deficit, based on DGCI&S data, increased by 52.7 per cent over the previous year to US $ 39.6 billion during 2005-06.
- Balance of payments (BoP) data available for April-December 2005 show that the current account deficit widened in line with the growth in investment demand in the economy. The balance of payments position, nonetheless, remained comfortable during 2005-06 as capital flows continued to remain large.
- India's total external debt declined by US $ 4.0 billion (3.3 per cent) during April-December 2005 to US $ 119.2 billion at end-December 2005, primarily reflecting the redemption of the India Millennium Deposits (IMDs).
- India's foreign exchange reserves were US $ 154.2 billion as on April 7, 2006; at this level, they were US $ 12.8 billion higher over a year ago level, despite an outgo of US $ 7.1 billion on account of redemption of IMDs in December 2005.

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