PRESS RELEASE

RESERVE BANK OF INDIA
www.rbi.org.in
www.rbi.org.in\hindi
e-mail: helpprd@rbi.org.in

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

January 29, 2007

Macroeconomic and Monetary Developments: Third Quarter Review 2006-07

The Reserve Bank of India today released the document "Macroeconomic and Monetary Developments: Third Quarter Review 2006-07" to serve as a backdrop to the Third Quarter Review of the Annual Statement on Monetary Policy for 2006-07 being announced on January 31, 2007.

The highlights of macroeconomic and monetary developments during 2006-07 so far are:

The Real Economy

- The robust performance of the Indian economy continued during the second quarter (July–September) of 2006-07. According to the Central Statistical Organisation (CSO), real gross domestic product (GDP) growth accelerated to 9.2 per cent in the second quarter from 8.9 per cent in the preceding quarter and 8.4 per cent a year ago led by manufacturing and services. With both the first and second quarters of 2006-07 recording higher growth over the corresponding quarters of 2005-06, real GDP growth accelerated to 9.1 per cent in the first half of 2006-07 from 8.5 per cent a year ago.
- Growth in agriculture and allied activities decelerated to 2.6 per cent during April-September 2006 from 3.7 per cent a year ago.
- Industrial production continued its growth momentum during 2006-07, with growth accelerating to 10.6 per cent during April-November 2006 from 8.3 per cent a year ago. The manufacturing sector with double digit growth (11.5 per cent) continued to be the key driver of industrial activity, contributing almost 91.2 per cent of the growth in industry.
- Growth in infrastructure industries improved to 7.8 per cent during April-November 2006 from 5.2 per cent during the same period of 2005 on account of better performance of electricity, crude petroleum and petroleum refinery products.
- During the first half of 2006-07, growth in the services sector accelerated to 10.6 per cent from 10.2 per cent during the first half of 2005-06.
- The industry and the services sectors have remained strong during 2006-07 so far. Business confidence surveys also suggest that economic activity is likely to remain buoyant in the near term. The ongoing momentum in economic growth is, thus, likely to remain robust in the rest of 2006-07.
- Profits after tax of select non-Government non-financial companies increased by 49.4 per cent during the quarter ended September 2006 as compared with 34.7 per cent in the preceding quarter. Ratio of profits after tax to sales of select non-Government non-financial companies improved to 11.0 per cent during the quarter ended September 2006 from 10.6 per cent in the preceding quarter and 8.5 per cent a year ago.

Fiscal Situation

- Central Government finances for the first eight months (April-November) of the fiscal year 2006-07 show that the fiscal deficit, as per cent of the full year budget estimate (BE), was placed lower than that in the corresponding period of the previous year. Revenue deficit, as per cent of BE, however, continued to be higher than in the previous year on account of increase in non-Plan expenditure which offset buoyant tax revenues. Contraction in non-defence capital outlay and loans and advances, however, moderated the impact on fiscal deficit.
- Gross and net market borrowings (including dated securities and 364-day Treasury Bills) raised by the Centre during 2006-07 up to January 22, 2007 amounted to 83.1 per cent and 80.4 per cent of the budget estimates as compared with 84.9 per cent and 82.7 per cent, respectively, a year ago.
- During 2006-07 so far (up to January 22, 2007), the States have raised market loans amounting to Rs.14,204 crore (or 54.9 per cent of gross allocation) exclusively through auctions.
- The weekly average utilisation of WMA and overdraft by the States at Rs.256 crore during April-December 2006 was lower than that of Rs.639 crore in the corresponding period of 2005. The cash surplus position of the State Governments has improved further during 2006-07 so far. This was reflected in an increase in their investments in 14-day Treasury Bills to Rs.41,567 crore (weekly average) during April-December 2006 from Rs.32,789 crore in the corresponding period of the previous year. The surplus cash balances of State Governments are automatically invested in 14-day Treasury Bills.

Monetary and Liquidity Conditions

- Bank credit continued to grow at a strong pace during 2006-07. Non-food credit of scheduled commercial banks (SCBs) grew by 31.2 per cent (Rs. 4,07,735 crore), year-on-year (y-o-y), as on January 5, 2007, as compared with a similar 31.2 per cent (Rs. 3,11,013 crore) a year ago.
- Sustained growth of bank credit could be accommodated by acceleration in deposit growth of SCBs of Rs. 4,38,037 crore (22.5 per cent) (y-o-y) as on January 5, 2007 from Rs. 2,85,182 crore (17.2 per cent) as on January 6, 2006.
- Concomitantly, broad money growth has remained above the indicative trajectory. Broad money growth was Rs. 5,17,318 crore (20.4 per cent) (y-o-y) as on January 5, 2007 as compared with 3,50,747 crore (16.0 per cent) a year ago.
- Banks' SLR investments, as a proportion of their net demand and time liabilities, declined further from their end-March 2006 levels.
- The Reserve Bank continued to modulate market liquidity with the help of LAF repo and reverse repos and issuance of securities under the Market Stabilisation Scheme (MSS). Furthermore, the Reserve Bank raised the cash reserve ratio by 50 basis points in two phases with effect from the fortnight beginning December 23, 2006. Liquidity management emerged to be more complex during the past year, with greater variation in market liquidity, largely reflecting variations in cash balances of the Governments and capital flows.
- Reserve money growth was Rs.1,06,846 crore (20.0 per cent) (y-o-y) as on January 19, 2007 as compared with Rs.69,213 crore (14.9 per cent) a year ago.

Price Situation

- Headline inflation in major advanced economies eased during September-October 2006 on the back of base effects as well as the sharp decline in international crude oil prices, but again rose during November-December 2006; core inflation remains firm. Many central banks such as the European Central

Bank (ECB), the Bank of England, the Reserve Bank of Australia, and the South African Reserve Bank continued with pre-emptive monetary tightening to abate the second round effects.

- In India, inflation movements in 2006-07 have been driven by primary food articles and manufactured products prices. Headline inflation, based on movement in the wholesale price index (WPI), increased to 6.0 per cent as on January 13, 2007 from 4.1 per cent at end-March 2006 and 4.2 per cent a year ago. The y-o-y inflation, excluding the fuel group, at 6.6 per cent was above the headline inflation rate of 6.0 per cent as on January 13, 2007.
- Consumer price inflation has remained higher than the WPI inflation since November 2005, reflecting the higher order of increase in food prices as well as the higher weight of food items in the CPI. Consumer price inflation for industrial workers was placed at 6.3 per cent in November 2006 while that for urban non-manual employees, agricultural labourers and rural labourers was placed at 6.9 per cent, 8.9 per cent and 8.3 per cent, respectively, in December 2006.

Financial Markets

- Short-term money rates remained generally within the reverse repo rate and repo rate corridor till mid-December 2006. However, since the last fortnight of December 2006, call rates moved up sharply.
- In the foreign exchange market, the Indian rupee appreciated *vis-à-vis* the US dollar during the third quarter of 2006-07 (October-December 2006).
- Yields on the longer maturity bonds in the Government securities market softened between during October-November 2006 but increased in December 2006 and January 2007.
- Banks' deposit and lending rates edged up further during the third quarter (October-December 2006) in the wake of strong credit demand.

The External Economy

- India’s external sector has continued to register robust performance during 2006-07 so far.
- Merchandise exports have exhibited strong growth, notwithstanding some deceleration (22.0 per cent during April-December 2006 as compared with 29.9 per cent a year ago). Non-oil imports recorded a deceleration mainly on account of decline in imports of gold and silver, and pearls, precious and semi-precious stones; imports of capital goods, however, remained buoyant. Growth in oil imports remained high on the back of higher volumes.
- Sustained growth in exports of services and remittances continued to provide buoyancy to the surplus in the invisibles account, which enabled financing a large part of the deficit on the merchandise trade account.
- The current account deficit widened from US $ 7.2 billion during April-September 2005 to US $ 11.7 billion during April-September 2006.
- The higher current account deficit was easily financed by continuing large capital flows. Capital flows increased from US $ 13.7 billion during April-September 2005 to US $ 20.3 billion during April-September 2006, driven by FDI flows which nearly doubled to US $ 8.6 billion in April-November 2006 from a year ago.
- Foreign exchange reserves have increased by US $ 26.5 billion during 2006-07 so far to US $ 178.1 billion as on January 19, 2007.

Alpana Killawala
Chief General Manager

Press Release : 2006-2007/1023