

**RESERVE BANK OF INDIA**

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### **Macroeconomic and Monetary Developments: First Quarter 2007-08**

The Reserve Bank of India released today the document "Macroeconomic and Monetary Developments: First Quarter Review 2007-08" to serve as a backdrop to the First Quarter Review of the Annual Statement on Monetary Policy for 2007-08.

The highlights of macroeconomic and monetary developments during 2007-08 so far are:

#### **The Real Economy**

- The cumulative rainfall recorded during the 2007 monsoon (up to July 25) was 4 per cent above normal as compared with 14 per cent below normal a year ago. As on July 20, 2007, sowing was undertaken in almost 54 per cent of normal area under *kharif* crops. Total area sown was 1.7 per cent higher than that in the corresponding period of 2006.
- Industrial production remained robust during April-May 2007, recording a year-on-year expansion of 11.7 per cent. The manufacturing sector remained the key driver of industrial activity with growth of 12.7 per cent.
- The infrastructure sector recorded a higher growth of 8.1 per cent during April-May 2007 as compared with 7.2 per cent than a year ago mainly on account of improvement in electricity and petroleum refinery products.
- Growth rates in tourist arrivals, revenue earning freight traffic of the railways, new cell phone connections, export cargo handled by civil aviation, passengers handled by civil aviation, cement and steel moderated. On the other hand, cargo handled at major ports accelerated *vis-à-vis* the previous year.

#### **Fiscal Situation**

- Available information on Central Government finances for April-May 2007 indicates that all the key deficit indicators were lower than a year ago in absolute terms. As percentage of budget estimates, gross fiscal deficit was also lower than in April-May 2006. The improvement in Central Government finances during April-May 2007 was brought about by higher tax revenues, higher non-debt capital receipts and lower plan expenditure.
- Gross and net market borrowings (including dated securities and 364-day Treasury Bills) of the Centre during 2007-08 (up to July 26, 2007) amounted to Rs.85,628 crore and Rs.46,047 crore, respectively, accounting for 45.3 per cent and 42.0 per cent, respectively, of the estimated borrowings for the year. During the corresponding period of the previous year, the gross and net borrowings accounted for 39.5 per cent and 31.3 per cent, respectively, of the actual borrowings for 2006-07.
- During 2007-08 (up to July 26, 2007), the Centre took recourse to WMA for 72 days as compared with 33 days during the same period in 2006-07.
- During 2007-08 (up to July 26, 2007), fourteen States have raised market borrowings amounting to Rs. 8,542 crore (25.6 per cent of gross allocation for the year).
- The average utilisation of WMA and overdraft by the States was Rs.694 crore during 2007-08 (up to July 20, 2007) as compared with Rs. 258 crore in the corresponding period of the previous year. The average investments by the States in Treasury Bills during April-June 2007 amounted to Rs.68,800 crore as against Rs. 52,876 crore during the corresponding period of the previous year.

### **Monetary and Liquidity Conditions**

- Growth in broad money (M<sub>3</sub>), year-on-year (y-o-y), was 21.6 per cent (Rs. 6,09,610 crore) on July 6, 2007 as compared with 19.0 per cent (Rs. 4,51,636 crore) a year ago.
- Aggregate deposits of banks, y-o-y, increased by 22.8 per cent (Rs. 5,42,766 crore) on July 6, 2007 as compared with 19.6 per cent (Rs. 3,90,409 crore) a year ago.
- Growth in bank credit moderated after the strong pace in the preceding three years. Non-food credit by scheduled commercial banks (SCBs) moderated to 24.4 per cent (Rs.3,67,258 crore), y-o-y, as on July 6, 2007 from 32.8 per cent (Rs. 3,70,899 crore) a year ago.
- Reserve money expanded by 29.1 per cent (21.7 per cent adjusted for the first round impact of the increase in the cash reserve ratio), y-o-y, as on July 20, 2007 as compared with 17.2 per cent a year ago.
- Liquidity conditions continued to be influenced by movements in capital flows and cash balances of the Governments. The Reserve Bank modulated market liquidity with the help of issuances of securities under the Market Stabilisation Scheme (MSS), operations under Liquidity Adjustment Facility (LAF) and increase in the cash reserve ratio (CRR).

### **Price Situation**

- Both headline and core inflation in major economies have remained firm during 2007-08 so far, reflecting the combined impact of high commodity prices and strong demand conditions. Several central banks further tightened monetary policy during March-June 2007.
- Global commodity prices firmed up further in the first quarter of 2007-08 led by crude oil, metals and edible oils. WTI crude oil prices increased to US \$ 76 a barrel on July 19, 2007 from around US \$ 60 a barrel in March 2007. The overall food price index compiled by the IMF increased by 10 per cent in June 2007 (y-o-y) on top of an increase of 12 per cent a year ago. Reflecting the sustained rise in food prices, the IMF's food price index in June 2007 reached its highest level since 1981.
- In India, inflation based on the wholesale price index (WPI) initially rose to above 6.0 per cent in early April 2007 but eased to 4.4 per cent by July 14, 2007. Manufactured products inflation was 4.6 per cent on July 14, 2007 as compared with 3.9 per cent a year ago.
- Consumer price inflation also eased somewhat to 6.1-7.5 per cent by June 2007 from 7.6-9.2 per cent in March 2007, though it continued to remain high, mainly reflecting the impact of higher food prices.
- Pre-emptive monetary measures since mid-2004 accompanied by fiscal and supply-side measures helped in containing inflation.

### **Financial Markets**

- Indian financial markets remained generally orderly for the most part of the first quarter of 2007-08. Capital flows and swings in cash balances of the Governments were the main drivers of liquidity conditions in the financial markets, imparting volatility to overnight interest rates.
- The call money rate softened during April-June 2007 and remained below the reverse repo rate on many occasions on the back of easier liquidity conditions. Interest rates in the collateralised segment of the overnight money market also softened and remained below the call rate during the quarter.
- In the foreign exchange market, the Indian rupee appreciated *vis-a-vis* all major currencies (US dollar, Euro, Pound sterling and Japanese yen) during the first quarter.
- Yields in the Government securities market, which hardened up to mid-June 2007 eased thereafter.
- Banks' deposit and lending rates rose further during the first quarter; however, there was some softening in deposit rates in July 2007.

## **The External Economy**

- The merchandise trade deficit, on a balance of payments basis, rose from US \$ 51.8 billion (6.4 per cent of GDP) in 2005-06 to US \$ 64.9 billion (7.1 per cent of GDP) in 2006-07. Net invisibles increased from 5.3 per cent of GDP during 2005-06 to 6.0 per cent of GDP during 2006-07 and continued to finance a large part of the merchandise trade deficit. The current account deficit, as a proportion to GDP, in 2006-07 was, thus, contained at the previous year's level of 1.1 per cent. Net of remittances, the current account deficit was 4.0 per cent of GDP in 2006-07 (4.1 per cent in 2005-06 and 3.3 per cent in 2004-05).
- Net capital inflows were substantially higher than those in 2005-06 reflecting large flows under foreign direct investment (FDI) and external commercial borrowings. With capital flows (net) (US\$ 46.2 billion) remaining well above the current account deficit (US\$ 9.6 billion), the overall balance of payments recorded a surplus of US\$ 36.6 billion during 2006-07, which was higher than US\$ 15.1 billion recorded during 2005-06.
- During 2007-08 so far, merchandise exports and imports exhibited acceleration in growth.
- Capital flows have remained buoyant led by FII inflows. During 2007-08 (up to July 13, 2007), FIIs registered net inflows of US \$ 8.4 billion as compared with outflows of US \$ 2.0 billion in the corresponding period of 2006-07. FDI inflows were US \$ 1.6 billion during April 2007 (US \$ 0.7 billion a year ago). Non-resident deposits registered net outflows amounting to US \$ 274 million during April 2007 as against net inflows of US \$ 253 million during April 2006.
- India's foreign exchange reserves were US \$ 222.0 billion as on July 20, 2007, an increase of US \$ 22.9 billion over end-March 2007 level.
- A comparison of major reserve holding countries over the period 2000-2006 shows that current account surpluses accounted for 179 per cent and 138 per cent of accretion to reserves in Japan and Russia, respectively, and 56 per cent each in case of China and Korea. In contrast, in India, over the same period, accretion to foreign exchange reserves was almost entirely due to capital inflows. Total reserves increased by US \$ 143.8 billion during 2000-2006; net capital inflows increased by US \$ 143.9 billion over the same period.

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