



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

RESERVE BANK OF INDIA

www.rbi.org.in
www.rbi.org.in/hindi
e-mail: helpprd@rbi.org.in

January 28, 2008

Macroeconomic and Monetary Developments: Third Quarter Review 2007-08

The Reserve Bank of India today released the document "Macroeconomic and Monetary Developments: Third Quarter Review 2007-08" to serve as a backdrop to the Third-Quarter Review of the Annual Policy Statement for 2007-08 being announced on January 29, 2008.

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

The Real Economy

- The Indian economy continued to exhibit robust growth during the second quarter (July-September) of 2007-08, *albeit* with some moderation. **According to the Central Statistical Organisation (CSO), real GDP growth was 8.9 per cent during the second quarter of 2007-08 as compared with 10.2 per cent during the same period in 2006-07.** While 'agriculture and allied activities' recorded higher growth during the first half of 2007-08 over the corresponding period of the previous year, the growth of industrial and services sectors was somewhat lower than that during the first half of the previous year.
- The cumulative rainfall during the South-West monsoon season 2007 (June 1 to September 30) was 5 per cent above normal as compared with one per cent below normal during the corresponding period of the previous year. Cumulative rainfall during the North-East monsoon (October 1, 2007 to December 31, 2007) was 32 per cent below normal as compared with 21 per cent below normal during the corresponding period of the previous year. The reported sown area of *kharif* crops (up to October 26, 2007) increased by 2.7 per cent, while that of *rabi* crops (up to January 18, 2008) was about 3.7 per cent lower than a year ago.
- During April-November 2007, the index of industrial production (IIP) rose by 9.2 per cent as compared with the increase of 10.9 per cent recorded during the corresponding period of the previous year. **The manufacturing sector registered a growth of 9.8 per cent during April-November 2007 as compared with 11.8 per cent during April-November 2006.**
- During April-November 2007, the infrastructure sector recorded a growth of 6.0 per cent as compared with 8.9 per cent a year ago, with all the sectors exhibiting growth rates lower than a year ago.
- The services sector continued to record double-digit growth (10.5 per cent) in April-September 2007. Leading indicators of service sector activity for April-October 2007 show that growth rates in revenue earning freight traffic of the railways, commercial vehicles production, new cell phone connections, passengers handled by civil aviation at domestic terminals, cement and steel moderated *albeit* over a high base.

Fiscal Situation

- According to the latest information on Central Government finances for 2007-08 (April-November), key deficit indicators, *viz.*, revenue deficit and GFD, were placed lower than those in the corresponding period of the previous year, both in absolute terms and as per cent of the budget estimates. Apart from the lower revenue deficit, contraction in defence capital outlay also moderated the fiscal deficit. There was a primary surplus of Rs. 7,374 crore during April-November 2007 as compared with a budgeted surplus of Rs. 8,047 crore.
- Gross and net market borrowings (including 364-day Treasury Bills) of the Central Government during 2007-08 (up to January 25, 2008) were Rs.1,73,429 crore and Rs.1,03,092 crore, respectively, accounting for 91.8 per cent and 94.1 per cent of the estimated borrowings for the year.

- During 2007-08 (up to January 25, 2008), the States raised market loans amounting to Rs.47,449 crore through auctions, as compared with Rs. 14,204 crore during the corresponding period of the previous year.

Price Situation

- Headline inflation firmed up in major economies during the third quarter of 2007-08, reflecting the combined impact of higher food and fuel prices as well as strong demand conditions, especially in emerging markets. The monetary policy response during the quarter, however, was mixed in view of heightened concerns about the implications of credit crunch arising out of the US sub-prime crisis on financial stability.
- Global commodity prices firmed up during the third quarter of 2007-08 led by food and crude oil prices, although there was some moderation in prices of metals. International crude oil prices, represented by the West Texas Intermediate (WTI), touched a historical peak of US \$ 99.6 a barrel level on January 2, 2008. Although the prices eased somewhat subsequently, they continued to remain at an elevated level (US \$ 89.9 a barrel on January 23, 2008). International food prices firmed up further during the third quarter of 2007-08 led by wheat and oilseeds/edible oils, reflecting surging demand (both consumption demand and demand for non-food uses such as bio-fuels production) and low stocks of major crops, partly on account of weather related disturbances.
- In India, headline inflation, based on movement in the wholesale price index (WPI) was 3.8 per cent on January 12, 2008 (3.4 per cent at end-September 2007) as compared with 5.9 per cent at end-March 2007 (and 6.2 per cent a year ago). The easing in inflation from a year ago was mainly led by primary food articles and some manufactured products items.
- Primary articles' inflation, y-o-y, eased to 3.9 per cent on January 12, 2008 from 6.2 per cent at end-September 2007 and 9.5 per cent a year ago; it was 10.7 per cent at end-March 2007. The deceleration was mainly due to easing of food articles' inflation. Manufactured products inflation, y-o-y, eased to 3.9 per cent on January 12, 2008 from 4.5 per cent at end-September 2007 and 6.1 per cent at end-March 2007; it was 5.8 per cent a year ago. The deceleration in manufactured products inflation, y-o-y, was mainly due to decline in the prices of non-ferrous metals, textiles and sugar. Fuel group inflation, which was negative during June-November 2007, turned positive from the beginning of December 2007 (3.7 per cent on January 12, 2008) partly reflecting the base effects of fuel (petrol and diesel) price cuts last year and increase in the prices of some petroleum products such as naphtha, furnace oil and aviation turbine fuel.
- Inflation based on year-on-year variation in consumer price indices (CPIs) also eased during November/December 2007 (from a year ago) but continued to remain above the WPI inflation, mainly reflecting the impact of food prices and their higher weights in the CPI *vis-à-vis* WPI. CPI inflation measures were placed in the range of 5.1-5.9 per cent during November/December 2007 as compared with 5.7-7.9 per cent in September 2007 (and 6.7-9.5 per cent in March 2007).

Monetary and Liquidity Conditions

- Growth in broad money (M3), year-on-year (y-o-y), was 22.4 per cent (Rs. 6,86,925 crore) on January 4, 2008 as compared with 20.8 per cent (Rs. 5,26,566 crore) a year ago.
- Aggregate deposits of banks, y-o-y, increased by 23.8 per cent (Rs.6,17,035 crore) on January 4, 2008 as compared with 21.5 per cent (Rs. 4,59,021 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 22.2 per cent (Rs.3,82,155 crore), y-o-y, as on January 4, 2008 from 31.9 per cent (Rs.4,16,418 crore) a year ago.
- Reserve money expanded by 30.6 per cent, y-o-y, as on January 18, 2008 as compared with 20.0 per cent a year ago. Adjusted for the first round impact of the hike in the cash reserve ratio, reserve money growth was 21.5 per cent as compared with 17.5 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 continued with the policy of active management of liquidity through increase in the cash reserve ratio (CRR), issuances of securities under the market stabilisation scheme (MSS) and operations under liquidity adjustment facility (LAF).

Financial Markets

- During the third quarter of 2007-08, international financial markets remained volatile as uncertainties about the US sub-prime mortgage market and other credit markets exposures persisted.
- Indian financial markets remained generally orderly for the most part of the third quarter of 2007-08 except for some volatility in the equity market. Swings in cash balances of the Government and capital flows were the main drivers of liquidity conditions in the financial markets.
- Interest rates in the overnight money markets mostly remained within the informal corridor set by reverse repo and repo rates during the third quarter of 2007-08. Interest rates in the collateralised segment of the overnight money market hardened but remained below the call rate during the quarter.
- In the foreign exchange market, the Indian rupee generally appreciated during the quarter *vis-a-vis* all major currencies (US dollar, Euro, Pound sterling and Japanese yen).
- Yields in the Government securities market remained range-bound, partly reflecting global trends in yields. Yields softened beginning in the first week of January 2008. The 10-year yield moved in a range of 7.42-8.32 per cent during 2007-08 (up to January 23, 2008).

The External Economy

- India's balance of payments position continued to remain comfortable during the first half of 2007-08 (April-September). The merchandise trade deficit, on balance of payments basis, widened to US\$ 42.4 billion in April-September 2007 from US\$ 33.8 billion in April-September 2006. Net surplus under invisibles (services, transfers and income taken together) was higher at US \$ 31.7 billion in April-September 2007 (US \$ 23.4 billion in April-September 2006). The net invisible surplus offset a large part of the trade deficit (74.7 per cent during April-September 2007 as compared with 69.4 per cent during April-September 2006).
- Despite large merchandise trade deficit, higher net invisible surplus, mainly emanating from private transfers, contained the current account deficit at US \$ 10.7 billion in the first half of 2007-08 (US \$10.3 billion in April-September 2006). The current account deficit was financed by capital flows which have remained large during 2007-08 so far.
- During 2007-08 (up to January 11, 2008), net inflows by FIIs amounted to US \$26.8 billion (US \$ 2.5 billion in the corresponding period of 2006-07). Inflows under foreign direct investment (FDI) were US \$ 13.8 billion during April-November 2007 as against US \$ 10.1 billion during the corresponding period of the previous year. During the current financial year 2007-08 (April-September), inflows (net) under external commercial borrowings (ECBs) amounted to US \$ 10.6 billion (US \$ 5.7 billion during April-September 2006). The ECB approvals (including under the automatic route) amounted to US \$ 23.3 billion during April-December 2007 as compared with US \$ 15.3 billion during April-December 2006. Non-resident Indians' deposits registered net outflows of US \$ 433 million during April-September 2007 as against net inflows of US \$ 3.0 billion during April-September 2006.
- According to the data released by the Directorate General of Commercial Intelligence and Statistics (DGCI&S), during 2007-08 so far (April-November), merchandise exports posted a growth rate of around 22 per cent moderating from the growth rate of 26.2 per cent during April-November 2006, while growth in imports at 26.9 per cent was marginally lower than that of 27.4 per cent in April-November 2006. Non-oil imports recorded a substantial increase, while oil imports showed a sharp deceleration in growth. Overall, the merchandise trade deficit widened to US \$ 52.8 billion in April-November 2007 from US \$ 38.5 billion in April-November 2006.
- India's foreign exchange reserves were US \$ 284.9 billion as on January 18, 2008, showing an increase of US \$ 85.7 billion over end-March 2007.

Alpana Killawala
Chief General Manager