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April 28, 2008

Macroeconomic and Monetary Developments in 2007-08

The Reserve Bank of India today released the document “Macroeconomic and Monetary Developments in 2007-08” to serve as a backdrop to the Annual Policy Statement for 2008-09 being announced on April 29, 2008.

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

The Real Economy

- The Indian economy continued to expand at a robust pace during 2007-08 for the fifth consecutive year. According to the advance estimates released by Central Statistical Organisation (CSO), the real GDP growth rate was placed at 8.7 per cent in 2007-08 as compared with 9.6 per cent in 2006-07, reflecting moderation in growth in all the three sectors, viz., agriculture and allied activities, industry and services. Notwithstanding the moderation, the growth performance was in tune with the high average real GDP growth of 8.7 per cent per annum during the five-year period, 2003-04 to 2007-08.
- According to the Third Advance Estimates for 2007-08, the total foodgrains production is slated to reach an all-time high at 227.3 million tonnes, recording an increase of 4.6 per cent over the previous year (217.3 million tonnes). The production during 2007-08 would exceed the target set earlier (221.5 million tonnes) by 5.8 million tonnes.
- During 2007-08 (April-February) the index of industrial production (IIP) rose by 8.7 per cent as compared with an increase of 11.2 per cent during 2006-07 (April-February). The manufacturing sector recorded a growth of 9.1 per cent during 2007-08 (April-February) as compared with 12.2 per cent during April-February 2006-07.
- During 2007-08(April-February), growth of the infrastructure sector was placed at 5.6 per cent as compared with 8.7 per cent during the corresponding period of the previous year, reflecting deceleration in all the sectors, except coal.
- The services sector maintained its double-digit growth at 10.6 per cent during 2007-08 despite some moderation in pace. It continued to be the major contributor to GDP growth. Leading indicators of service sector activity for April-February 2007-08 suggest that the growth rates in tourist arrivals, 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 over the previous year.
- Gross Domestic Saving (GDS), as percentage of GDP at current market prices, was placed at 34.8 per cent in 2006-07 as compared with 34.3 per cent in 2005-06, reflecting improved saving performance by the private corporate and public sectors. On the other hand, the household saving rate declined marginally in 2006-07 from the previous year on account of decline in the financial saving rate. The sales and net profits of Reserve Bank’s sample non-government non-financial companies moderated during 2007-08 (up to December 2007) relative to the previous year. However, gross profits to sales ratio improved marginally over the same period.

Fiscal Situation

- The process of fiscal correction and consolidation under the Fiscal Responsibility and Budget Management (FRBM) Act continued for the Central Government during 2007-08; the revised estimates (RE) for the year placed the revenue deficit and gross fiscal deficit at 1.4 per cent and 3.1 per cent of GDP, respectively, which were lower than the budget estimates, both in absolute terms and relative to GDP. The reduction in GFD and revenue deficit by 0.4 per cent and 0.5 per cent of GDP, respectively, during 2007-08 (RE) over 2006-07 met the stipulated minimum threshold levels of 0.3 per cent and 0.5 per cent of GDP for GFD and revenue deficit, respectively, under the FRBM Rules, 2004. Gross primary surplus of the Centre was placed higher at 0.6 per cent of GDP during 2007-08 (RE) than 0.2 per cent in the budget estimates for the same year.
- According to the Reserve Bank records, gross and net market borrowings (including 364-day Treasury Bills) during 2007-08 amounted to Rs.1,88,205 crore and Rs.1,09,504 crore, respectively, accounting for 99.7 per cent and 99.9 per cent of the estimated borrowings for the year. The weighted average maturity of dated securities issued during 2007-08 at 14.90 years was higher than that of 14.72 years during the previous year. The weighted average yield of dated securities issued during 2007-08 was 8.12 per cent as compared with 7.89 per cent during 2006-07.
- The State Governments budgeted a revenue surplus of 0.3 per cent of GDP in 2007-08 as against revenue deficit (RD) of 0.1 per cent in 2006-07 (RE). The gross fiscal deficit (GFD) was budgeted at 2.3 per cent of GDP in 2007-08, lower by 0.4 percentage points over the previous year.
- During 2007-08, the States (including the Union Territory of Puducherry) raised market loans amounting to Rs. 67,779 crore (84.1 per cent of gross allocation) through auctions, as compared with Rs.20,825 crore (78.3 per cent of gross allocation) during the previous year. The cut-off yield was placed at 7.84-8.90 per cent. The weighted average yield on market loans firmed up to 8.25 per cent during 2007-08 from 8.10 per cent in the previous year.
- The average daily utilisation of WMA and overdraft by the States during 2007-08 was Rs. 648 crore, as against Rs.248 crore during 2006-07. The cash surplus position of the States, as reflected in their investments in Treasury Bills (14-day and auction Treasury Bills), remained sizeable. The average investment by the States in Treasury Bills during 2007-08 amounted to Rs.73,680 crore as against Rs.63,718 crore during the previous year.
- The Union Budget for 2008-09 proposed to continue the fiscal consolidation process, with the key deficit indicators, viz., revenue deficit and GFD, budgeted to be lower by 0.4-0.6 percentage points and primary surplus higher by 0.5 percentage points of GDP in 2008-09 than in the previous year. While the FRBM targets relating to GFD are set to be achieved in accordance with the mandate, the Budget proposed to reschedule the stipulated target of zero revenue deficit by 2008-09 under FRBM Rules, 2004, primarily on account of a shift in plan priorities in favour of revenue expenditure-intensive programmes and schemes.

Monetary and Liquidity Conditions

- Broad money growth (M3), on a year-on-year (y-o-y) basis, was at 20.7 per cent (Rs. 6,86,096 crore) as at end-March 2008 as compared with 21.5 per cent (Rs. 5,86,548 crore) a year ago.
- Aggregate deposits of banks, y-o-y, increased by 21.2 per cent (Rs.5,99,687 crore) as at end-March 2008 as compared with 22.3 per cent (Rs. 5,16,134 crore) a year ago.

- Growth in bank credit moderated during 2007-08 after the strong pace in the preceding three years. Non-food credit by scheduled commercial banks (SCBs) expanded by 22.3 per cent (Rs.4,19,425 crore), y-o-y, as on March 28, 2008 as compared with 28.5 per cent (Rs.4,18,282 crore) a year ago.
- Reserve money growth was higher at 30.9 per cent, y-o-y, as on March 31, 2008 than 23.7 per cent a year ago, reflecting the year-end liquidity requirements of the banks. Adjusted for the first round impact of the hike in the cash reserve ratio, reserve money growth was 25.3 per cent as compared with 18.9 per cent a year ago.
- Liquidity conditions during 2007-08 continued to be influenced by variation in cash balances of the Governments and capital flows. The Reserve Bank continued with the policy of active management of liquidity through appropriate use of the cash reserve ratio (CRR) and open market operations (OMO), including issuances of securities under the market stabilisation scheme (MSS) and operations under the liquidity adjustment facility (LAF).

Price Situation

- Headline inflation firmed up in major economies, mostly during the second half 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 responses during the year, however, were mixed in view of heightened concerns about the implications of credit crunch arising out of the US sub-prime crisis on financial stability and economic growth in the latter part of the year.
- Global commodity prices firmed up during 2007-08 led by sharp increases in food and crude oil prices. Metal prices, which had witnessed some moderation during June-December 2007, rose again during January-March 2008. Agricultural raw materials prices, however, remained largely range bound during 2007-08. International crude oil prices, represented by the West Texas Intermediate (WTI) rose to a historical peak of US \$ 119.2 a barrel level on April 22, 2008. Food prices firmed up especially during the second half of 2007-08, led by wheat, rice, 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.
- In India, headline inflation based on the wholesale price index (WPI) softened from 6.4 per cent at the beginning of the fiscal year to a low of 3.1 per cent on October 13, 2007 before increasing again to 7.4 per cent by March 29, 2008, mainly reflecting hardening of prices of primary articles, fuel group and some manufactured products items.
- Primary articles inflation, y-o-y, eased from 12.2 per cent at the beginning of April 2007 to an intra-year low of 3.7 per cent by end-December 2007 but increased to 8.9 per cent on March 29, 2008 mainly led by fruits and vegetables, oilseeds, raw cotton and iron ore. Fuel group inflation, after remaining negative during June-November 2007, turned positive from mid-November 2007 to reach 6.7 per cent on March 29, 2008 reflecting increases in the prices of some petroleum products such as naphtha, furnace oil, aviation turbine fuel (ATF) and bitumen as well the upward revision in the domestic prices of petrol and diesel in February 2008. Manufactured products inflation, y-o-y, eased from 6.4 per cent at the beginning of the year to 3.5 per cent by November 24, 2007 but increased to 7.1 per cent by March 29, 2008, mainly reflecting the continued rise in the prices of edible oils/oil cakes, basic heavy inorganic chemicals, and basic metals and alloys.

- Inflation based on year-on-year variation in consumer price indices (CPIs) eased up to January 2008, mainly reflecting the deceleration in food price inflation. Subsequently, there has been some increase in CPI inflation measures mainly due to food and fuel prices. Various measures of consumer price inflation were placed in the range of 5.5-7.9 per cent during February/March 2008 as compared with 6.7-9.5 per cent in March 2007.
- As per the latest available information on WPI, headline inflation eased marginally to 7.3 per cent during the week ended April 12, 2008 from 7.4 per cent at end-March 2008.

Financial Markets

- Global financial markets remained volatile during 2007-08 as the crises about the US sub-prime mortgage market and other credit markets exposures deepened and spilled over to markets for other assets.
- The Indian financial markets remained largely orderly during 2007-08, barring the equity market which witnessed bouts of volatility, especially beginning the second week of January 2008 in tandem with trends in major international equity markets. Over the year, however, the equity market registered gains.
- Brief spells of volatility were observed in the money market on account of changes in capital flows and cash balances of the Central Government with the Reserve Bank.
- After the withdrawal of the ceiling of Rs. 3,000 crore on reverse repo acceptances under the LAF on August 6, 2007, interest rates in the overnight money markets moved in the reverse repo and repo corridor and remained within the corridor during the remaining part of the year. Interest rates in the collateralised segment of the overnight money market remained below the call rate during the year.
- In the foreign exchange market, the Indian rupee generally exhibited two-way movements against major currencies.
- The 10-year yield in the Government securities market softened during the most part of the year.

The External Economy

- India's balance of payments position remained comfortable during 2007-08 (April-December). The merchandise trade deficit, on balance of payments basis, widened to US \$ 66.5 billion in April-December 2007 from US \$ 50.3 billion in April-December 2006. Net surplus under invisibles (services, transfers and income taken together) was higher at US \$ 50.5 billion in April-December 2007 as compared with US \$ 36.3 billion in April-December 2006.
- Despite sharp rise in merchandise trade deficit, the net invisible surplus, mainly emanating from the rise in remittances from the overseas Indians and software services exports, contained the current account deficit at US \$ 16.0 billion during April-December 2007 (US \$ 14.0 billion in April-December 2006). The current account deficit was more than financed by capital flows which remained large during 2007-08.
- Net inflows by foreign institutional investors (FIIs) aggregated US \$ 20.3 billion during 2007-08 (US \$ 3.2 billion during 2006-07). Inflows under foreign direct investment (FDI) were US \$ 25.5 billion during 2007-08 (April-February) as compared to US \$ 19.6 billion during 2006-07 (April-February). During 2007-08 (April-December), inflows (net) under external commercial borrowings (ECBs) amounted to US \$ 16.3 billion (US \$ 9.8 billion during April-December 2006). Non-Resident Indian deposits registered a net inflow of US \$ 106 million during 2007-08 (April-February) as compared with net inflows of US \$ 3.9 billion during the corresponding period of the previous year.

- According to the data released by the Directorate General of Commercial Intelligence and Statistics (DGCI&S), during 2007-08 (April-February), merchandise exports recorded a growth of 22.8 per cent as compared with 23.2 per cent growth posted during 2006-07 (April-February). Growth in imports at 30.1 per cent was higher than 25.2 per cent recorded a year ago. Non-oil imports recorded a substantial increase of 31.8 per cent (22.6 per cent a year ago), while oil imports showed a deceleration in growth (26.4 per cent as against 31.2 per cent in April-February 2007). Merchandise trade deficit during April-February 2008 widened to US \$ 72.5 billion from US \$ 49.4 billion, a year ago.
- Foreign exchange reserves increased by US \$ 110.5 billion during 2007-08 to US \$ 309.7 billion as on March 31, 2008. As on April 18, 2008, India's foreign exchange reserves were US \$ 313.5 billion.

Alpana Killawala
Chief General Manager

Press Release : 2007-2008/1391