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RESERVE BANK OF INDIA

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Macroeconomic and Monetary Developments
Mid-Term Review 2008-09

The Reserve Bank today released the document “Macroeconomic and Monetary Developments Mid-Term Review 2008-09” to serve as a backdrop to the Mid-Term Review of Annual Policy Statement for 2008-09 being announced on October 24, 2008.

The highlights of macroeconomic and monetary developments during 2008-09 so far are:

The Real Economy

- According to the first quarter estimates of 2008-09 released by the Central Statistical Organisation (CSO) in August 2008, the real GDP growth was placed at 7.9 per cent during the first quarter of 2008-09 as compared with 9.2 per cent during the corresponding quarter of 2007-08. The deceleration in growth was spread across all the three sectors, *viz*., agriculture and allied activities, industry and services.
- The cumulative rainfall during the South-West monsoon season 2008 (June-September) was near normal, with rainfall over the entire country being two per cent below normal as against five per cent above normal during the corresponding period of the previous year. According to the First Advance Estimates, the *kharif* foodgrains production during 2008-09 was placed at 115.3 million tonnes as compared with that of 121.0 million tonnes during 2007-08 (Fourth Advance Estimates).
- The index of industrial production during April-August 2008-09 recorded year-on-year expansion of 4.9 per cent as compared with 10.0 per cent during April-August 2007-08. The manufacturing sector recorded growth of 5.2 per cent during April-August 2008-09 (10.6 per cent during April-August 2007-08) and the electricity sector recorded growth of 2.3 per cent (8.3 per cent during April-August 2007-08).
- The infrastructure sector recorded growth of 3.4 per cent during April-August 2008-09 (7.1 per cent during April-August 2007-08), reflecting deceleration in all the sectors except coal.
- Available information on the leading indicators of services sector activity during 2008-09 so far suggest healthy growth in respect of some indicators such as railway revenue earning freight traffic, commercial vehicle production, telephone connections and export cargo handled by civil aviation as compared with the corresponding period of 2007-08. On the other hand, growth decelerated in respect of cargo handled at major ports and other indicators of civil aviation excluding export cargo. Some deceleration was also observed in tourist arrivals and production of cement and steel.

Fiscal Situation

- Available information on Central Government finances for 2008-09 (April-August) indicates that gross fiscal deficit and revenue deficit were placed higher than a year ago. Revenue deficit was 177.4 per cent of budget estimates for 2008-09 as compared with 74.9 per cent (122.9 per cent, net of transfer of profit on sale of the Reserve Bank’s stake in SBI to the Central Government) a year ago. GFD during the same period was 87.7 per cent of the budget estimates as compared with 68.5 per cent in April-August 2007. Tax revenue rose by 26.2 per cent over that during April-August 2007. Aggregate expenditure (adjusted for acquisition cost of Reserve Bank’s stake in SBI) increased mainly on account of sharp increase in revenue expenditure, particularly food and fertiliser subsidies, pension and rural development.
- Gross and net market borrowings (dated securities and 364-day Treasury Bills) during 2008-09 (up to October 22, 2008) amounted to Rs.1,27,872 crore and Rs.64,808 crore, respectively, accounting for 72.8 per cent and 65.5 per cent of the estimated market borrowings for the year. During the corresponding period of the previous year, gross and net borrowings accounted for 66.5 per cent and 68.1 per cent, respectively, of the estimated market borrowings for the year.

- During 2008-09 (up to October 18, 2008), the Central Government took recourse to ways and means advances (WMA) for 16 days as compared with 91 days during the corresponding period of 2007-08. As on October 18, 2008, the Central Government maintained a surplus cash balance of Rs.31,349 crore with the Reserve Bank.
- During 2008-09 (up to October 22, 2008), 11 State Governments and the Union Territory of Puducherry raised a total amount of Rs.22,196 crore (35.4 per cent of gross allocation) through auctions with cut-off yields in the range 7.97-9.90 per cent as compared with Rs.20,362 crore by 19 State Governments (cut-off yields in the range 8.00-8.90 per cent) during the corresponding period of the previous year.
- The average daily utilisation of WMA and overdraft by the States during April-September 2008 was Rs.243 crore as compared with Rs.986 crore during the corresponding period of 2007-08.
- The average daily investments by the States in Treasury Bills (14-day Intermediate Treasury Bills and Auction Treasury Bills) during April-September 2008 amounted to Rs.82,382 crore as compared with Rs.72,805 crore during the corresponding period of 2007-08.

Monetary and Liquidity Conditions

- Growth in broad money (M_3), year-on-year (y-o-y), moderated to 20.3 per cent (Rs. 7,29,338 crore) on October 10, 2008 as compared with 21.9 per cent (Rs. 6,43,963 crore) a year ago.
- Aggregate deposits of banks, y-o-y, increased by 20.4 per cent (Rs.6,28,140 crore) on October 10, 2008 as compared with 23.5 per cent (Rs. 5,85,253 crore) a year ago.
- Growth in bank credit continued to expand at a strong pace. Non-food credit by scheduled commercial banks (SCBs) increased by 29.3 per cent (Rs.5,80,060 crore), y-o-y, as on October 10, 2008 as compared with 23.3 per cent (Rs.3,74,054 crore) a year ago. The higher credit growth relative to the deposit growth resulted in an increase in the incremental credit deposit ratio (y-o-y) of SCBs to 96.2 per cent as on October 10, 2008 from 66.8 per cent a year ago. During the financial year 2008-09 (up to October 10, 2008), non-food credit expanded by 10.4 per cent (Rs. 2,40,995 crore) as compared with 5.0 per cent (Rs. 93,781 crore) during the corresponding period of the previous year.
- Disaggregated sectoral data available up to August 29, 2008 showed that about 45 per cent (Rs. 2,18,246 crore) of incremental non-food credit (y-o-y) was absorbed by industry as compared with 40 per cent (Rs. 1,43,614 crore) in the corresponding period of the previous year. The agricultural sector absorbed around 8 per cent (Rs. 40,913 crore) of the incremental non-food bank credit expansion as compared with 13 per cent (Rs. 44,360 crore) in the corresponding period of the previous year. Personal loans accounted for nearly 17 per cent (Rs. 81,729 crore) of incremental non-food credit; within personal loans, the share of incremental housing loans was at 40 per cent (Rs. 32,792 crore).
- Reserve money growth at 17.6 per cent, y-o-y, as on October 17, 2008 was lower than that of 24.4 per cent a year ago.
- The Reserve Bank continued with its policy of active management of liquidity during the current financial year through appropriate use of the CRR, and OMO, including MSS and LAF, and other policy instruments at its disposal flexibly. Developments on both international and domestic fronts, particularly from mid-September 2008, have impacted domestic liquidity conditions. Nonetheless, liquidity modulation through a flexible use of a combination of instruments has, to a significant extent, cushioned the impact of international financial turbulences on domestic financial market by absorbing excessive market pressure and ensuring orderly conditions.

Price Situation

- Headline inflation has remained firm in major economies during 2008-09 so far. However, there are signs of moderation in inflationary pressures reflecting marked decline in prices of food, fuel and other commodities, as well as augmentation of downward risks to growth from the intensification of global financial market crisis.
- The monetary policy responses of different countries, which were initially somewhat independent in view of inflation concerns, became more coordinated in terms of simultaneous easing of monetary conditions during the period July-October 2008 in view of the increasing downside risks to growth and the consequent diminishing upside risks to price stability.

- Global commodity prices have eased somewhat during the second quarter of 2008-09 led by a decline in the prices of crude oil, metals and food. After touching a historical high of US $ 145.3 a barrel level on July 3, 2008, international crude oil prices, represented by the West Texas Intermediate (WTI), have eased reflecting decline in demand in OECD countries and improved near-term supply prospects in non-OPEC countries. WTI crude oil price was at around US $ 66 a barrel on October 22, 2008. Metal prices eased further during the second quarter of 2008-09, reflecting weak construction demand in OECD countries and some improvement in supply, especially in China. Food prices, which had increased sharply up to the first quarter of 2008-09, reflecting higher demand and low stocks, eased somewhat during the second quarter of the year on the back of improved supply prospects, particularly for oilseeds and grains in major producing countries.
- Mirroring global trends, inflation in India increased during 2008-09 so far, *albeit* with some recent easing. Inflation, measured as year-on-year (y-o-y) variation in the wholesale price index (WPI), increased to 11.1 per cent on October 11, 2008 from 3.1 per cent a year ago and 7.7 per cent at end-March 2008, reflecting the impact of some pass-through of international crude oil prices to domestic prices as well as elevated levels of prices of iron and steel, basic heavy inorganic chemicals, machinery and machinery tools, oilseeds, sugar, raw cotton and textiles on account of strong demand as well as international commodity price pressures. However, there has been some moderation in the prices of freely priced petroleum products and edible oils/oil cakes over end-June 2008.
- Primary articles inflation, y-o-y, increased to 11.5 per cent on October 11, 2008 from 4.6 per cent a year ago and 11.0 per cent at end-June 2008 (9.7 per cent at end-March 2008) mainly reflecting the increase in the prices of food articles, especially of wheat, rice, fruits and vegetables, milk, and eggs, fish and meat as well as non-food articles such as oilseeds and raw cotton.
- Fuel group inflation increased to 14.5 per cent on October 11, 2008 from a decline of 1.5 per cent a year ago and an increase of 6.8 per cent at end-March 2008 (it was 16.3 per cent at end-June 2008) mainly due to increase in the prices of minerals oil by 14.1 per cent over end-March 2008. However, in response to easing in international crude oil prices from the peak of early-July 2008, domestic prices of freely priced minerals oil items such as naphtha, furnace oil and aviation turbine fuel have declined in the range of 12-22 per cent beginning August 2008.
- Manufactured products inflation, year-on-year, was 9.5 per cent as on October 11, 2008 as compared with 4.3 per cent a year ago and 10.9 per cent at end-June 2008 (it was 7.3 per cent at end-March 2008). The year-on-year increase in manufactured products prices was driven mainly by sugar, edible oils/oil cakes, textiles, chemicals, iron and steel, and machinery and machine tools. Prices of edible oils and grain mill products, however, eased somewhat over end-March 2008.
- Consumer price inflation increased further during August/September 2008 mainly due to increase in the prices of food, fuel and services (represented by the ‘miscellaneous’ group).
- Consumer price inflation for industrial workers increased to 9.0 per cent in August 2008 from 7.7 per cent in June 2008 and 7.3 per cent a year ago.
- Consumer price inflation for urban non-manual employees firmed up to 8.5 per cent in August 2008 from 7.3 per cent in June 2008 and 6.4 per cent a year ago.
- Consumer price inflation for agricultural labourers increased to 11.0 per cent in September 2008 from 8.8 per cent in June 2008 and 7.9 per cent a year ago.
- Consumer price inflation for rural labourers was 11.0 per cent in September 2008 as compared with 8.7 per cent in June 2008 and 7.6 per cent a year ago.

Financial Markets

- Global financial market conditions deteriorated substantially during July-October 2008. Bankruptcy/sell-out/restructuring became more widespread emanating from mortgage lending institutions to systemically important financial institutions and further to commercial banks. The failure of banks and financial institutions also broadened geographically from the US to many European countries. As a result, funding pressures in the inter-bank money market persisted, equity markets weakened further and counterpart credit risk increased. Central banks continued to take action independently and also in a coordinated manner to enhance the effectiveness of their liquidity facilities.
- Emerging market economies (EMEs), which had been relatively resilient in the initial phase of the financial turbulence, witnessed a changed environment in recent months, reflecting tightened liquidity conditions and rising risk.

- Financial markets in India, which remained largely orderly from April 2008 to mid-September 2008, witnessed heightened volatility between mid-September and mid-October 2008.
- Interest rates in the money market moved in accordance with evolving liquidity conditions. The daily average call rate, which had remained mostly within the informal corridor set by the reverse repo and repo rates of liquidity adjustment facility (LAF) during the first quarter of 2008-09, hovered generally close to the repo rate during the second quarter, but witnessed some spikes in late September due to tightened market liquidity. Interest rates in the collateralised segments of the money market moved in tandem with the call rate and continued to remain below the call rate during the second quarter.
- In the foreign exchange market, the Indian rupee generally depreciated against major currencies.
- In the credit market, lending rates of scheduled commercial banks increased.
- Yields in the government securities market generally softened during the second quarter 2008-09.
- Indian equity markets declined in tandem with trends in major international equity markets as well as edging up of domestic inflation.
- The Reserve Bank took necessary actions to inject liquidity and reassured the market that the Indian banking system remained sound, well capitalised and well regulated.

The External Economy

- India's balance of payments position during the first quarter of 2008-09 (April-June) reflected a widening of the current account deficit and moderation in capital flows. The merchandise trade deficit, on balance of payments basis, increased from US $ 20.7 billion in April-June 2007 to US $ 31.6 billion in April-June 2008. Net surplus under invisibles remained buoyant, led by increase in software exports and private transfers and financed 66.0 per cent of the merchandise trade deficit during April-June 2008.
- The large increase in merchandise trade deficit during April-June 2008 led to a significant increase in the current account deficit over its level during April-June 2007. The current account deficit was financed by capital flows which have, however, remained volatile during 2008-09 so far.
- Net capital flows during 2008-09 so far have been lower than those in the corresponding period of 2007-08, mainly on account of outflows by foreign institutional investors (US $ 7.3 billion) during 2008-09 (up to October 10, 2008) in contrast to net FII inflows (US $ 18.9 billion) during the corresponding period of 2007-08. On the other hand, net FDI flows into India were higher at US $ 16.7 billion during April-August 2008 as compared with US $ 8.5 billion during April-August 2007. NRI deposits recorded a net inflow (US $ 273 million) during April-August 2008 as against a net outflow (US $ 168) during April-August 2007.
- According to the data released by the Directorate General of Commercial Intelligence and Statistics (DGCI&S), during 2008-09 (April-August), merchandise exports recorded a growth of 35.3 per cent, which was higher than that of 19.3 per cent during April-August 2007. Imports during April-August 2008 grew by 38.0 per cent, as compared with the growth of 34.2 per cent recorded a year ago. Petroleum, oil and lubricants (POL) imports grew significantly by 60.0 per cent during April-August 2008 as against 17.9 per cent during April-August 2007, largely due to the escalation in international crude oil prices. Non-oil imports showed a moderation in growth to 28.3 per cent from 42.7 per cent a year ago. Merchandise trade deficit during April-August 2008 increased to US $ 49.3 billion from US $ 34.6 billion during April-August 2007.
- India's foreign exchange reserves at US $ 273.9 billion as on October 17, 2008 were lower by US $ 35.8 billion over end-March 2008.

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