

# भारतीय रिज़र्व बैंक RESERVE BANK OF INDIA

वेबसाइट : www.rbi.org.in/hindi Website : www.rbi.org.in इ-मेल email: helpdoc@rbi.org.in

संचार विभाग, केंद्रीय कार्यालय, एस.बी.एस.मार्ग, मुंबई 400001

**DEPARTMENT OF COMMUNICATION**, Central Office, S.B.S. Marg, Mumbai 400001 फोन/Phone: 91 22 2266 0502 फैक्स/Fax: 91 22 2270 3279

July 26, 2010

# Macroeconomic and Monetary Developments in the First Quarter of 2010-11

The Reserve Bank of India today released the document <u>Macroeconomic and Monetary Developments: First Quarter Review 2010-11</u>, which serves as a background to the First Quarter Review of Monetary Policy 2010-11 to be announced on July 27, 2010.

#### **Overall Assessment**

- The normalisation of monetary policy of the Reserve Bank in 2010-11 so far has been conditioned by the changing growth-inflation dynamics characterised by robust acceleration in growth and increasing generalisation of inflation.
- With concerns about the recovery receding, increasing risks of generalised inflation indicate that monetary policy has to continue the calibrated normalisation process.

## **Highlights**

## **Global Economic Conditions**

- Global output increased by over 5 per cent in Q1 of 2010 but the global economy has hit a soft patch thereafter due to concerns stemming from the sovereign debt situation in the euro area.
- Emerging Market Economies (EMEs) are expected to continue the process of normalisation of monetary policy in view of their stronger recovery, emerging inflationary pressures, and risks of asset price build-up. Advanced economies, on the other hand, may further delay monetary exit, due to the emergence of new risks to recovery, as also their well anchored inflation expectations.
- Global demand may weaken in the second half of 2010 if the pace of global recovery slows down due to possible escalation of the euro area fiscal stress and adoption of fiscal austerity measures by the advanced economies.

# **Indian Economy**

#### **Output**

Going by the progress of the monsoon so far, agricultural output is expected
to be better than last year. Industrial production continues to exhibit double
digit growth in the current year; notwithstanding some moderation in May
2010, the downside risks to growth are low. Lead indicators for services
activities suggest continuation of the growth momentum.

- Thus, GDP growth in 2010-11 can be expected to be higher than the 8.0 per cent projected in the April 2010 Monetary Policy Statement.
- The Professional Forecasters' Survey conducted by the Reserve Bank in June 2010 places overall (median) GDP growth rate for 2010-11 at 8.4 per cent, higher than 8.2 per cent reported in the previous round of the survey.

# **Aggregate Demand**

- Private investment demand recovered sharply in the last quarter of 2009-10.
   Production trends in capital goods point to continuation of the strong investment activities in the near-term.
- Disaggregated information such as production of consumer durables and nondurables, auto sales and non-oil imports suggest stronger recovery in private consumption demand going forward.
- Pick-up in demand for credit from the private sector, rapid growth in corporate sales, and information on order books available from forward looking surveys indicate strengthening of domestic demand.
- Growth in government consumption demand is likely to moderate, reflecting the fiscal consolidation programmed in the Budget.
- Overall, private consumption and investment demand will be the two major drivers of growth during 2010-11.

## **Fiscal Conditions**

- The fiscal consolidation plans programmed in the Union Budget for 2010-11 will benefit from the larger than expected mobilisation from 3G/ Broadband Wireless Access (BWA) spectrum auctions, which together represent 1 per cent point of GDP.
- The partial deregulation/upward revision to the prices of petroleum products in June 2010 will contain pressure on the fiscal situation from under-recoveries of the public sector oil companies.
- While the price adjustment in the petroleum sector may add to headline inflation in the near-term, the improved fiscal situation would be congenial to both inflation and growth in the medium run.

# **External Economy**

- With recovery in growth of exports and the return of capital flows, external sector conditions improved during the course of 2009-10.
- The current account deficit, however, widened to 2.9 per cent of GDP in 2009-10, from 2.4 per cent in 2008-09, which contributed to the recovery through higher absorption of foreign capital.
- In 2010-11 so far, import growth has exceeded export growth, reflecting stronger growth performance of India relative to the global economy; capital inflows have also moderated, led by the decline in portfolio flows.

# **Monetary and Liquidity Conditions**

- The surplus liquidity conditions that prevailed all through 2009-10 started moderating in early 2010-11 in response to the calibrated normalisation of monetary policy by the Reserve Bank.
- In June 2010, however, there was severe tightness in liquidity conditions resulting from a sudden and sharp increase in the government cash balances stemming from significantly higher mobilisation under 3G/BWA spectrum auctions.
- While mitigating the liquidity pressure, the Reserve Bank persevered with calibrated monetary tightening keeping in view the higher level of inflation.
- Reflecting increased demand for credit associated with recovery in growth, non-food credit growth to the private sector remained buoyant.

#### **Financial Markets**

- In the first quarter of 2010-11, the volatility in global markets emanating from concerns about fiscal sustainability in the euro area, spilled over to the Indian markets, particularly the equity market.
- Reflecting the tight liquidity conditions in June 2010, interest rates at the short end of the term structure edged up, while medium to long-term yields moderated, in view of the improved fiscal position after 3G/BWA auction revenues.
- The banking sector switched over to a new "base rate" system of lending effective July 1, 2010, which is expected to enhance transparency in loan pricing, promote competition in the credit market and also improve the transmission of monetary policy. The base rates set by major public sector banks were in the narrow range of 7.25-8.0 per cent.

#### **Inflation Situation**

Press Release: 2010-2011/132

- Headline WPI inflation has been in double digits since February 2010 and has also become increasingly generalised in every successive month.
- Non-food manufacturing inflation accelerated from near zero in November 2009 to 7.3 per cent in June 2010, reflecting the impact of rising input costs, recovering private demand and associated return of pricing power.
- Since November 2009, 42 per cent of the overall increase in WPI has resulted from revisions in administered prices and lagged reporting of past increases in prices.
- Given the risks to inclusive growth from high inflation, the monetary unwinding that started in October 2009 should continue till inflation expectations are firmly anchored and inflation is brought down.

**Alpana Killawala** Chief General Manager