प्रेस प्रकाशनी PRESS RELEASE

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

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

November 1, 2010

Macroeconomic and Monetary Developments in the Second Quarter of 2010-11

The Reserve Bank of India today released its Macroeconomic and Monetary Developments: Second Quarter Review 2010-11 document.The document serves as a background to the Second Quarter Review of Monetary Policy 2010-11 to be announced on November 02, 2010.

Overall Assessment

- The uncertain global outlook, and the dominance of supply rigidities in certain sectors that impart rigidity to the inflation path, pose greater challenge for monetary policy in its objective of anchoring inflationary expectations without hurting growth.

Highlights

Global Economic Conditions

- The momentum of global recovery, which exceeded expectations in the first half of 2010, has slowed down in the last few months. According to IMF projections, the temporary slowdown in the pace of global growth in the second half of 2010 could extend up to the first half of 2011.
- In advanced economies, the weakening of recovery has raised concerns about both unemployment and deflation. With capacity for fiscal stimulus already stretched and given the concerns about sovereign debt, further quantitative easing seems the preferred option to address the weakness in growth.
- The persisting output gap could tempt advanced economies to resort to protectionist measures along with preference for undervalued exchange rates, and that could pose downside risks to global recovery.
- EMEs, which had led the global recovery, continue to exhibit strong growth momentum. Notwithstanding some likely moderation in the momentum in the second half of the year, the growth imbalance relative to advanced economies is expected to persist.

Indian Economy

Output

- The sharp and broad-based recovery of the Indian economy, which started in the second half of 2009-10 continued through Q1 of 2010-11, leading to further consolidation of growth around the trend.
- A normal monsoon, following a severely deficient monsoon last year, is expected to lift the agriculture sector growth to above the trend rate of growth in 2010-11.

- Industrial production showed robust growth though with wide volatility around the trend. The core infrastructure sector continues to lag behind the pace of growth in industrial production.
- Lead indicators of services activities suggest continuation of the momentum.
- The current data on indicators of economic performance remain consistent with the 8.5 per cent growth projected in the July 2010 Monetary Policy Statement.

Aggregate Demand

- Given the weakening external demand conditions and the need for fiscal consolidation, sustained growth will hinge increasingly on private consumption and investment demand.
- Trends in production of capital goods, capital expenditure plans of corporates, non-oil imports and growth in credit as well as financing from non-banking sources during 2010-11 so far suggest strong conditions for investment activities.
- Private consumption expenditure data for the first quarter of 2010-11 and the trends in corporate sales as well as production of consumer durables point to a pick up.
- Both the revenue deficit and fiscal deficit, as percentage of GDP, have been lower this year so far relative to the corresponding period of last year. There has, however, been higher growth in both revenue and capital expenditure this year. These provide demand support to the growth process.
- Contribution of net exports to growth on the expenditure side of GDP was negative in the first quarter of 2010-11. The trend is expected to continue during the rest of the year.

External Sector

- The current account deficit in balance of payments widened in the first quarter of 2010-11 due to higher trade deficit and moderation in the surplus in the invisibles account.
- Capital inflows, led by FII flows in recent months, have met the financing needs of the current account deficit.
- The current account deficit, as percentage of GDP, could be expected to be higher in 2010-11 than 2.9 per cent recorded in 2009-10.
- While the deficit may be fully financed by capital inflows, the potential volatility in such flows poses some risk.
- The Indian rupee has appreciated on the basis of 6-currency real effective exchange rate (REER) during the year so far, over and above the significant appreciation last year. The 36 currency REER remained largely stable.
- The higher inflation differential between India and major trading partners is a source of pressure on the competitiveness of Indian exports. Containing inflation, thus, is important even for improving the external balance position.
- The foreign exchange reserves stood at US$ 295.4 billion as on October 22, 2010.

Monetary and Liquidity Conditions

- Liquidity conditions became tight in the month of May 2010 consequent to the transfer of liquidity from the markets to the Government in the wake of the

3G/BWA auctions. Since then, liquidity conditions have generally remained in deficit mode, consistence with the monetary policy stance of the Reserve Bank.

- To ease excessive frictional liquidity pressure around the end of October 2010, the Reserve Bank provided temporary liquidity comfort to the market.
- Policy interest rates have been raised five times since the beginning of March 2010, raising the repo rate by 125 basis points and the reverse repo rate by 175 basis points.
- This asymmetric tightening narrowed the policy corridor from 150 basis points to 100 basis points. With repo replacing reverse repo as the operative rate in the LAF, the effective policy interest rate has increased by 275 basis points since March 2010.
- Broad money (M_3) continues to exhibit subdued growth largely due to the deceleration in the growth of long-term deposits.
- With non-food credit growth converging to the 20 per cent growth trajectory indicated in the First Quarter Review of Monetary Policy, banks have scaled up their deposit mobilisation efforts as evident from the higher deposit rates being offered since July 2010.

Financial Markets

- In the global financial markets, concerns about sovereign defaults eased, but they were replaced by concerns about risks stemming from the slowdown in global recovery.
- The multi-speed recovery around the world and the consequent differential exit from the accommodative monetary stance have strengthened both the push and pull content underlying the significant pick up in private capital flows to EMEs.
- In the Indian financial markets, the impact of this trend has been visible in the appreciation of the exchange rate of the rupee against the US dollar and the bullish spikes in equity prices. Housing prices in major cities generally increased.
- The transmission of higher policy interest rates and deficit liquidity conditions strengthened across different segments of the financial markets.

Inflation

- The headline inflation has started to soften after staying in double digit for five months up to July 2010.
- Inflation in non-food manufactured products, though remains above its medium-term trend, has shown some moderation.
- But food inflation remains disconcertingly high despite a normal monsoon. This can be attributed partly to a change in the consumption pattern in favour of protein-rich items, such as, egg, milk, fish and meat where price increases have been high.
- Despite moderation in recent months, elevated inflation remains a challenge for monetary policy.

Alpana Killawala
Chief General Manager

Press Release : 2010-2011/606