Report of the Central Board of Directors on the working of the Reserve Bank of India for the year ended June 30, 2006 submitted to the Central Government in terms of Section 53(2) of the Reserve Bank of India Act, 1934

RESERVE BANK OF INDIA ANNUAL REPORT 2005-06

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DEPUTY GOVERNORS
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K.J. Udeshi (up to October 12, 2005)
V. Leeladhar
Shyamala Gopinath
Usha Thorat (from November 10, 2005)

DIRECTORS NOMINATED UNDER SECTION 8 (1) (b) OF THE RBI ACT, 1934
Y.H. Malegam

Up to June 27, 2006
Mihir Rakshit
K. Madhava Rao

From June 27, 2006
Suresh D. Tendulkar
U.R. Rao
Lakshmi Chand

DIRECTORS NOMINATED UNDER SECTION 8 (1) (c) OF THE RBI ACT, 1934
D. S. Brar
H. P. Ranina
Ashok S. Ganguly

Up to June 27, 2006
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Amrita Patel
K. P. Singh
V. S. Vyas
N. R. Narayana Murthy
Suresh Krishna

From June 27, 2006
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Kumar Mangalam Birla
Shashi Rekha Rajagopalan
Suresh Kumar Neotia
A. Vaidyanathan
Man Mohan Sharma
D. Jayavarthanavelu

DIRECTOR NOMINATED UNDER SECTION 8 (1) (d) OF THE RBI ACT, 1934
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K. Venkatesan
Dattaraj V. Salgaocar
Jayanti Lal Bavjibhai Patel
Mahendra Singh Sodha

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Suresh D. Tendulkar (from June 27, 2006)
A. K. Saikia
Sovan Kanungo

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Ram Nath
Pritam Singh

SOUTHERN AREA
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Lakshmi Chand (from June 27, 2006)
C. P. Nair
S. Ramachander
M. Govinda Rao
Devaki Jain

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(As on June 30, 2006)

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	V.K. Sharma
	C. Krishnan
	Anand Sinha
	V.S. Das
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Department of Banking Operations and Development	P. Saran, Chief General Manager-in-Charge
Department of Banking Supervision	G. Gopalakrishna, Chief General Manager-in-Charge
Department of Currency Management	U.S. Paliwal, Chief General Manager
Department of Economic Analysis and Policy	R. Kannan, Principal Adviser *
Department of Expenditure and Budgetary Control	Ramesh Chander, Chief General Manager-in-Charge
Department of External Investments and Operations	H. Bhattacharya, Chief General Manager-in-Charge
Department of Government and Bank Accounts	Prabal Sen, Chief General Manager-in-Charge
Department of Information Technology	G. Padmanabhan, Chief General Manager-in-Charge
Department of Non-Banking Supervision	P. Krishnamurthy, Chief General Manager-in-Charge
Department of Payment and Settlement Systems	A.P. Hota, Chief General Manager
Department of Statistical Analysis and Computer Services	K.S.R. Rao, Principal Adviser
Financial Markets Department	Chandan Sinha, Chief General Manager
Foreign Exchange Department	M. Sebastian, Chief General Manager
Human Resources Development Department	Sandip Ghose, Chief General Manager-in-Charge
Inspection Department	Karuna Sagar, Chief General Manager
Internal Debt Management Department	G. Mahalingam, Chief General Manager
Legal Department	S.C. Gupta, Legal Adviser-in-Charge
Monetary Policy Department	M.D. Patra, Adviser-in-Charge
Premises Department	Deepak Singhal, Chief General Manager
Rural Planning and Credit Department	C.S. Murthy, Chief General Manager-in-Charge
Secretary's Department	Smt. Grace Koshie, Chief General Manager & Secretary
Urban Banks Department	N.S. Vishwanathan, Chief General Manager-in-Charge
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College of Agricultural Banking, Pune	H.R. Khan
Reserve Bank Staff College, Chennai	S. Karuppasamy
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Kolkata	B. Mahapatra
Mumbai	A.N Rao
New Delhi	Smt. Deepa Srivastava
BRANCHES	**REGIONAL DIRECTORS**
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Bangalore	Smt. D. Muthukrishnan
Bhopal	K.V.Rajan
Bhubaneswar	G. Jaganmohan Rao
Chandigarh	D.P.S. Rathore
Guwahati	Amerandra Sahoo
Hyderabad	R. Gandhi
Jaipur	B.P. Vijayendra
Jammu	O.P. Aggarwal
Kanpur	J.B. Bhoria
Nagpur	S. Ramaswamy
Patna	S. Ganesh
Thiruvananthapuram	N. Krishna Mohan
	GENERAL MANAGERS (O-in-C)
Kochi	P. Aravindakshan
Panaji	Smt. Doris D'souza
Lucknow	A. R. Khan
Dehradun	Manoj Sharma

* : Officiating.

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THE ANNUAL REPORT ON THE WORKING OF THE RESERVE BANK OF INDIA

*For the Year July 1, 2005 to June 30, 2006**

PART ONE : THE ECONOMY : REVIEW AND PROSPECTS

I ECONOMIC REVIEW

I. MACROECONOMIC POLICY ENVIRONMENT

I.1.1 The global economy recorded strong growth of 4.8 per cent in 2005 on top of a three-decade high growth of 5.3 per cent in 2004, thus remaining well above its long-run average, and exhibited considerable resilience despite the record high international crude oil prices. Economic activity during 2005 continued to be supported by benign financial market conditions and still accommodative macroeconomic policies, notwithstanding continuing tightening of monetary policies in a number of economies. The above average performance of the global economy was mainly driven by strong activity in the US and the emerging market economies led by China and India. Reflecting the impact of record high oil prices, headline inflation firmed up around the world. Although inflation expectations have been contained till recently, there are signs of some firming up of inflationary expectations globally. The possibility of higher second order effects of oil prices, therefore, continues to be a cause of policy concern internationally. Looking ahead, the global economy is expected to grow in 2006 and 2007 at broadly at the same pace as in 2005. However, firming up of inflationary expectations, high and volatile crude oil prices, the probability of disorderly and rapid adjustment of large and growing current account imbalances, and the recent volatility and re-pricing of risks in international financial markets are key downside risks to global growth prospects.

I.1.2 In the backdrop of these global developments, the Indian economy built upon its recent phase of high growth in 2005-06 led by strong performance of the industry and services sectors. Growth in real GDP accelerated from 7.5 per cent in 2004-05 to 8.4 per cent in 2005-06. The Indian economy has, thus, recorded an average growth of over eight per cent for the last three years. A noteworthy feature of this outcome is that it has been achieved in an environment of macroeconomic and financial stability. Despite continued pressure from international crude oil prices, headline inflation was lower than projected and inflation expectations remained well-contained though underlying pressures remained. Strong macroeconomic performance during 2005-06 was underpinned by robust export growth for the fourth successive year, sustained non-oil import demand, continued fiscal consolidation, high domestic savings, buoyant investment activity, acceleration in credit growth and some expansion in current account deficit. Timely and calibrated macroeconomic policy measures during the year ensured that growth momentum was maintained during 2005-06 while ensuring macroeconomic and financial stability.

I.1.3 In order to maintain and further improve upon the current growth momentum, various macroeconomic policy measures have been initiated, as discussed below, encompassing the real, fiscal, external, monetary and financial sectors.

REAL SECTOR POLICIES

I.1.4 A number of measures were taken during 2005-06 to improve the productivity and competitiveness of the economy for ensuring and maintaining the high growth momentum. Simultaneously, the objective of increasing gainful employment for vast sections of population in the rural areas was pursued through the passage of National Rural Employment Guarantee Act.

Agriculture and Allied Activities

I.1.5 In order to strengthen the agricultural sector, the Union Budget 2006-07 identified assured

* While the Reserve Bank of India's accounting year is July-June, data on a number of variables are available on a financial year basis, *i.e.*, April-March, and hence, the data are analysed on the basis of the financial year. Where available, the data have been updated beyond March 2006. For the purpose of analysis and for providing proper perspective on policies, reference to past years as also prospective periods, wherever necessary, has been made in this Report.

irrigation, access to credit, diversification and creation of markets for agricultural products as thrust areas for growth. The Union Budget also provided for an enhanced outlay of Rs.7,121 crore in 2006-07 (Rs.4,500 crore in the previous year) to give a boost to irrigation. The programme for repair, renovation and restoration of water bodies is being implemented through pilot projects in 23 districts in 13 States. The design of the programme has been finalised in consultation with the States. Restoration of water bodies is expected to give an element of stability to agricultural production and thereby give a boost to yields.

I.1.6 In order to set up terminal markets in different parts of the country by employing the public-private Partnership (PPP) model, an amount of Rs.150 crore has been earmarked under the National Horticulture Mission. During 2005-06, a scheme for Marketing Research and Information Network, AGMARKNET, was implemented to provide electronic connectivity to important wholesale markets in the country for collection and dissemination of price and market related information. These markets are reporting daily prices in respect of more than 300 commodities. More than 1,000 markets from all over the country have been linked to a central portal and the number is expected to increase to 2,700 by end-March 2007.

I.1.7 The Union Budget 2006-07 provided relief to the farmers who had availed crop loans from scheduled commercial banks, regional rural banks (RRBs) and primary agricultural co-operative societies (PACS) for *Kharif* and *Rabi* 2005-06. Accordingly, an amount equal to two percentage points of the borrower's interest liability on the principal amount, up to Rs.1,00,000, was required to be credited to their bank accounts before March 31, 2006. For this, the Budget provided a sum of Rs.1,700 crore. Furthermore, to provide farmers loans at a reasonable rate, the Government has decided to ensure that the farmer receives short-term credit at 7 per cent on loans up to Rs.3 lakh on the principal amount with effect from *Kharif* 2006-07. The Budget has proposed to provide budgetary subventions for this purpose.

I.1.8 The findings of the National Sample Survey Organisation (NSSO) 59th Round (2003) reveal that only 27 per cent of the total number of cultivator households received credit from formal sources while 22 per cent received credit from informal sources. The remaining households, mainly small and marginal farmers, have virtually no access to credit. The Government has, therefore, appointed a Committee on Financial Inclusion to identify the reasons for exclusion of vulnerable groups and suggest a strategy to extend financial services to such vulnerable groups.

I.1.9 The Reserve Bank in its Annual Policy Statement for 2006-07 announced a set of measures to further improve the flow of credit to agriculture. These, *inter alia*, include: setting up of a Working Group to suggest measures for assisting distressed farmers, including provision of financial counselling services; introduction of a specific credit guarantee scheme under the DICGC Act for distressed farmers; constitution of a Technical Group to review the efficacy of the existing legislative framework governing money lending and its enforcement machinery in different States and make recommendations to the State Governments for improving the legal and enforcement framework in the interest of rural households; and, advising the State Level Bankers Committee convenors in all States/UTs to identify at least one district in their area for achieving 100 per cent financial inclusion by providing a 'no-frills' account and a general purpose credit card (GCC).

I.1.10 *Bharat Nirman* programme covering six components of infrastructure development - accelerated irrigation benefit programme, accelerated rural water supply project, construction of rural roads, rural houses, providing rural electrification and telephone connectivity in the villages - was launched during 2005-06. The Union Budget for 2006-07 has proposed to enhance the allocation to Rs.18,696 crore from Rs.12,160 crore provided in the preceding year.

I.1.11 In order to meet the rising requirements for creation of rural infrastructure, the Union Budget for 2006-07 proposed to increase the corpus of Rural Infrastructure Development Fund (RIDF) XII to Rs.10,000 crore. It also proposed to allow specified projects under the PPP model to access RIDF funds. As rural roads component of *Bharat Nirman* requires large funds, it has been decided to open a separate window under RIDF XII for rural roads with a corpus of Rs.4,000 crore during 2006-07.

I.1.12 In order to provide further fillip to micro finance programme, the Union Budget 2006-07 announced various measures. These include: introduction of a Bill to provide a formal statutory framework for the promotion, development and regulation of the micro finance sector; advising the banking sector to credit-link another 3,85,000 self-help groups (SHGs) in 2006-07 over and above 2 million SHGs credit-linked as at end-March 2006; and advising NABARD to open a separate line of credit for financing farm production and investment activities through SHGs.

I.1.13 The National Rural Employment Guarantee (NREG) Act was notified in September 2005 and the Scheme - subsuming the earlier programmes of *Sampoorna Grameen Rozgar Yojana* (SGRY) and National Food for Work Programme (NFFWP) - was launched in February 2006, in 200 districts. All the districts would be covered under the Scheme within five years. The Act envisages that every State Government would make a scheme for providing not less than 100 days of guaranteed employment in a year to every household in rural areas whose adult members volunteer to do unskilled manual work. The Union Budget for 2006-07 has announced a total allocation of Rs.14,300 crore for rural employment during 2006-07. Of this, Rs.11,300 crore would be under the NREG Act and Rs.3,000 crore would be under the SGRY.

I.1.14 With a view to giving a fillip to the food processing industry, the Union Budget 2006-07 announced fiscal incentives, *viz.*, reduction of duty on packaging machines from 15 per cent to 5 per cent; complete exemption from excise duty on condensed milk, ice cream, preparations of meat, fish and poultry, pasta and yeast; and reduction of excise duty on ready-to-eat packaged foods and instant food mixes from 16 per cent to 8 per cent. These measures are expected to give a boost to the agriculture sector.

Manufacturing and Infrastructure

I.1.15 The high growth rate of the Indian economy witnessed in the past three years has been driven, *inter alia*, by strong manufacturing activity. In order to sustain higher manufacturing growth, a number of steps have been taken.

I.1.16 A High Level Committee on Manufacturing was constituted in April 2006 with the Prime Minister as the Chairman. The Committee would initiate steps to make India a manufacturing hub in industries having potential for global competitiveness such as textiles, automobiles, leather, food processing, steel, metals, chemicals and petroleum products. It would also address macroeconomic issues impinging on growth and competitiveness of the manufacturing sector in India, and create a policy framework for necessary reforms covering all the aspects of manufacturing competitiveness to achieve the objective of 12 per cent growth in manufacturing sector.

I.1.17 The Government approved the constitution of National Investment Fund (NIF) in 2005. Under the arrangements, the proceeds from disinvestment of central public sector enterprises are to be channelised into NIF, which is to be maintained outside the Consolidated Fund of India. NIF is to be professionally managed to provide sustainable returns to the Government, without depleting the corpus. Public sector mutual funds are to be entrusted with the management of the corpus of NIF. The income from NIF is to be used for financing specific schemes for investment in social sector projects and for capital investment in selected profitable and revivable central public sector enterprises that yield adequate returns.

I.1.18 In compliance with the Electricity Act 2003, the Government of India notified the Tariff Policy in January 2006 with the objectives of (i) ensuring availability of electricity to consumers at reasonable and competitive rates; (ii) ensuring financial viability of the sector and attract investments; and (iii) promoting transparency, consistency and predictability in regulatory approaches across jurisdictions and minimise perceptions of regulatory risks.

I.1.19 In order to make the Indian steel industry globally competitive, the National Steel Policy was approved in November 2005. The Policy envisages that India should have a modern and efficient steel industry of world standards, catering to diversified steel demand. This will require indigenous production of over 100 million tonnes per annum by 2019-20 from the level of 38 million tonnes per annum in 2004-05.

I.1.20 The Scheme for Integrated Textile Parks (SITP) was launched in October 2005 with the intention of creating 25 textile parks. About 7 parks have been sanctioned and 10 parks have been identified for development.

I.1.21 In order to promote infrastructure development, a Special Purpose Vehicle (SPV), *viz.*, India Infrastructure Finance Company Limited (IIFCL), was incorporated in January 2006, with a paid up capital of Rs.10 crore and an authorised capital of Rs.1,000 crore, to meet the long term financing requirements of potential investors. In addition, in order to leverage public funds through public-private partnership (PPP), a scheme for viability gap funding was also approved. The viability gap funding will normally be in the form of a capital grant at the stage of project construction, not exceeding 20 per cent of the total project cost. In order to be eligible for funding under this viability gap support scheme, the PPP must be implemented by an entity with at least 51 per cent private equity.

I.1.22 All States have signed memoranda of understanding to implement the Rajiv Gandhi *Grameen Vidyutikaran Yojana*. Under this scheme, 10,000 villages were to be electrified during 2005-06 and 40,000 more villages are to be electrified in 2006-07. The key to the success of this programme is the engagement of franchisees and proper commercial and contractual arrangements for distribution, billing and collection.

I.1.23 The investment limit in plant and machinery has been increased to Rs. five crore from Rs. one crore in respect of 61 items in the drugs and pharmaceutical sector reserved for exclusive manufacturing by the Small Scale Industries (SSIs) sector. Continuing the policy of gradual dereservation of items reserved for exclusive manufacturing by the SSI sector, the Ministry of Small Scale Industries dereserved another 108 items in March 2005. Consequent upon the announcement made in the Union Budget 2006-07, further 180 items were dereserved in May 2006. This has reduced the number of items reserved for exclusive manufacturing by the SSI sector to 326.

I.1.24 On a review of the foreign direct investment (FDI) policy in February 2006, the Government of India decided to allow FDI up to 100 per cent under the automatic route for distillation and brewing of potable alcohol; manufacture of industrial explosives; manufacture of hazardous chemicals; setting up of greenfield airport projects; laying of natural gas/LNG pipelines, market study and formulation and investment financing in the petroleum and natural gas sector; and cash and carry wholesale trading and export trading. Furthermore, the FDI caps were raised to 100 per cent under the automatic route for coal and lignite mining for captive consumption. The Government also allowed FDI up to 100 per cent under the automatic route in power trading, subject to compliance with regulations under the Electricity Act, 2003.

I.1.25 In the Union Budget 2006-07, the customs duty structure was reduced/rationalised for many industrial commodities. The duty on naptha for plastics has been reduced to nil. The duty on ores and concentrates, 10 anti-AIDS and 14 anti-cancer drugs was reduced to 2 per cent. The duty on mineral products, cyclic and acyclic hydrocarbons and their derivatives, major bulk plastics like PVC, LDPE and PP, certain life saving drugs, kits and equipment, and packaging machines was reduced to 5 per cent. The duty on alloy steel, non-ferrous metals, catalysts and refractories was reduced to 7.5 per cent. Duty on basic inorganic chemicals, all man-made fibres and yarns, and raw materials such as DMT, PTA and MEG was reduced to 10 per cent. Similarly, the excise duty on all man-made fibre yarn, filament yarn, aerated drinks, small cars and footwear was reduced.

FISCAL POLICY

I.1.26 Fiscal policy continued to pursue the objectives of economic growth, stability and equity in 2005-06 while staying on the course of fiscal consolidation. In the wake of higher fiscal devolution to the States as recommended by the Twelfth Finance Commission (TFC), the Central Government indicated a 'pause' in its fiscal correction in terms of targets prescribed under the Fiscal Responsibility and Budget Management (FRBM) Rules, 2004. The provisional accounts indicate that the Centre could contain revenue deficit (as per cent to GDP) at its budgeted level while gross fiscal deficit and primary deficit (as per cent to GDP) turned out to be below the budget estimates. With the purpose of enhancing the efficiency in the delivery mechanism and to stress on "outcomes" rather than "outlays", an Outcome Budget providing monitorable performance indicators for the Plan programmes was brought out for the first time by the Government in August 2005. The Government stressed upon the need to avoid ostentatious expenditure. In case of non-tax revenues, the need for timely collection of various user charges was also emphasised.

I.1.27 The tax reforms in 2005-06 were mainly centred on improving the tax to GDP ratio, expanding the tax base, increasing tax compliance and making tax administration more efficient. There was a major overhaul of direct tax rates with the exemption limit for income tax rates raised to Rs. one lakh, reduction in the effective income tax rates through scaling up of tax brackets and the removal of sectoral caps in tax savings to allow for a consolidated limit of Rs. one lakh. The corporation tax rate was reduced to 30 per cent from 35 per cent. With the aim of bringing the perquisites (excluding transport and canteen services) that are enjoyed collectively by employees (which cannot be collected individually under the tax net), a Fringe Benefit Tax (FBT) was introduced with a rate of 30 per cent on an appropriately defined base. In order to check tax evasion, tax on cash withdrawal (on a single day) of Rs.25,000 and above in case of individuals and Rs.one lakh and above for corporates from accounts other than savings accounts was introduced. In the case of indirect taxes, the peak customs rate on non-agricultural imports was reduced to 15 per cent from 20 per cent with a few exceptions. With the aim of increasing the Central Value Added Tax (CENVAT) coverage, three more items were brought under the CENVAT excise duty rate of 16 per cent. In the case of service tax, the existing tax rate of 10 per cent was retained while the base was expanded by bringing nine additional items under the tax net.

Union Budget, 2006-07

I.1.28 The Union Budget 2006-07 proposed to resume the process of fiscal correction in 2006-07 as stipulated in FRBM Rules, 2004. The Budget sought to increase spending on social sectors (specifically rural employment, education and health) and in improving the infrastructure in rural and urban areas with the aim of making economic growth more inclusive, while lowering non-Plan expenditures. On the basis of the measures aimed at widening of tax base and improvements in the efficiency of tax administration, the gross tax/ GDP ratio is budgeted to reach a peak of 11.2 per cent in 2006-07.

I.1.29 The Union Budget 2006-07 kept the rates of income and corporation taxes unchanged and no new taxes were introduced. The tax base was, however, widened by removing some exemptions. In a bid to narrow the differential of the minimum alternate tax (MAT) with corporation tax rate, the MAT rate was increased from 7.5 per cent of book profit to 10 per cent. The rate of securities transaction tax (STT) was raised by 25 per cent across the board on account of the increase in implicit capital gains in securities transactions. The FBT was rationalised by exempting expenditures on free sample of medicines and medical equipment for doctors, expenses on brand ambassador and celebrity endorsement, free or subsidised transport and allowances for the employees to their place of work and back, and employer contributions up to Rs. one lakh per annum per employee to an approved superannuation fund. Furthermore, valuation of benefits with respect to ‘tour and travel’ and ‘hospitality, hotel boarding and lodging’ provided by airline and shipping industry was reduced from 20 per cent to 5 per cent for application of the FBT. The ‘one-by-six’ scheme, which had mandated the filing of income tax returns if the person falls under any one of the expenditure/asset criteria even if his/ her total income was below the threshold limit, has been abolished from April 2006. Expressing concerns over build up of tax and non-tax arrears, the Union Budget 2006-07 introduced statements on tax revenue raised but not realised and arrears on non-tax revenues. In order to provide information on revenue forgone on account of various tax exemptions, the Budget also provided statements on tax expenditures under various taxes.

I.1.30 In line with the objective of bringing customs duty to the level of East Asian countries, the peak rate on non-agricultural products was reduced from 15 per cent to 12.5 per cent. In order to make the input tariff rates lower than output tariff rates, customs duties on capital goods and raw materials were reduced to ensure that inputs are available at competitive rates to domestic manufacturers. In pursuance of the Government’s objective of converging the excise duty rates to the CENVAT rate of 16 per cent, the rate on aerated drinks and small car was reduced from 24 per cent to 16 per cent. An excise duty of 12 per cent on computers was reintroduced to enable domestic manufacturers to take CENVAT credit as well as to face competition from imports.

I.1.31 In recent years, the Government has taken a number of measures to widen the service tax net to include greater number of services in line with the rising share of services in GDP. With a view to carrying forward this process, the service tax rate was increased from 10 per cent to 12 per cent, thereby moving further towards the CENVAT rate. The base of service tax was also widened by including 15 new services under the tax net including certain financial services (Box I.1). Furthermore, the Union Budget underlined the need to move towards a national level Goods and Services Tax (GST) and set April 1, 2010 as the date for introducing GST.

I.1.32 The expenditure policy, in the backdrop of the efforts underway at fiscal consolidation, is to curtail non-development expenditure while providing adequate funds for social and infrastructural sectors. The Union Budget 2006-07 sought to increase expenditure on social sectors, primarily on rural health care and education by means of the *National Rural Health Mission*, *Sarva Shiksha Abhiyan* and *Mid-day Meal Scheme*. The *National Rural Health Mission* seeks to address the gaps in providing effective health care in rural areas with special focus on 18 States. The programme is a shift away from vertical health and family welfare programmes to a new architecture of all inclusive health development which merges societies under different programmes and pools resources at the district level. The *Sarva Shiksha Abhiyan* aims to provide universal elementary education and bridge all social, gender and regional gaps with the active participation of the community in the management of schools. The *Mid-day Meal Scheme* compliments these efforts by helping to increase school attendance and improve the children’s nutritional status through micro nutrient supplementation. In order to augment the infrastructure, additional funds for *Bharat Nirman* for

Box I.1

Taxation of Financial Services

Financial institutions provide a host of services such as asset management, investment advice and insurance products in addition to discharging their primary function of intermediating between depositors and lenders. Some of these services may be bundled with the intermediation services, while others may be rendered for explicit fees. Differing views exist as to whether these financial services should be taxed. Taxation of financial services under a consumption tax is opposed on the ground that financial services by themselves are not an object of final utility to consumers but merely a form of intermediate transaction. A contrary view, however, is that the issue is not whether financial services appear in the utility function of the consumer, but on how they enter into the pattern of observable net trades. In such a context, as a matter of principle, financial services charged through a fixed fee should be taxed while the implicitly priced financial services charged through a spread should not be taxed. In practice, implicit fee based financial services are difficult to observe and apportion for the purpose of taxation.

Cross-country experience shows that countries which have a value added tax (VAT) system for taxation on consumption of goods and services, in general, exempt financial services from taxation due to the lack of an explicit measure of consideration. Most countries in the European Union (EU) exempt core financial services that relate to lending, bank accounts, insurance and dealings in money, share and bonds from taxation, but tax explicit fee-based secondary services such as financial advisory services and safe deposit lockers. South Africa imposes taxes on almost all explicit fee-based financial services, including non-life insurance, although exported services are zero rated. In Singapore, all core financial services supplied domestically are exempted from service tax but all agency services are taxable. Financial institutions can claim input tax credit for exempted services which are used as business inputs so as to reduce the cascading effect. Australia follows the EU approach but provides input tax relief with a view to limit vertical integration of services. Argentina imposes VAT on gross interest on loans in order to curtail inflation by restricting consumer demand. Israel taxes the full value of financial services on the basis of addition method and does not allow for input tax credit.

In India, while service tax was introduced in 1994-95, financial services were brought within the ambit of service tax in July 2001, with the inclusion of banking and other financial services. Progressively, the service tax net has been widened to include the insurance sector, corporate bodies and other concerns providing services similar to financial intermediaries, and brokers, including sub-brokers dealing in stocks and foreign exchange. Transactions which are subject to service tax include, *inter alia*, lending, operation of bank accounts, issue of negotiable instruments, provision of bank guarantee, overdraft facility and safe deposit lockers/vaults. Interest amount is, however, excluded from the purview of service tax. The Union Budget 2006-07 imposed service tax on financial services like ATM operations, share transfer agents and bankers to an issue among others and widened the coverage of certain existing financial services. At present, services are not under the VAT system in India. However, with the operationalisation of the integrated VAT based goods and services tax, the issues emerging from international experience on VAT-based financial services taxation would become relevant.

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infrastructure development in rural areas and *Jawaharlal Nehru National Urban Renewal Mission* for urban areas have been allocated. The *Bharat Nirman* programme seeks to impart a sense of urgency to the goals set for building rural infrastructure by making it time bound, transparent and accountable. The *Jawaharlal Nehru National Urban Renewal Mission* envisages providing focussed attention on integrated development of infrastructural services in 63 selected cities so as to secure effective linkages between asset creation and asset management to ensure adequate investment of funds, to scale up delivery of civic amenities and to encourage planned development of cities.

I.1.33 The Government reiterated its commitment to target subsidies effectively at the poor and the truly needy and sought to evolve a consensus on the issue. In a bid to delegate greater authority to administrative ministries in managing their financial affairs, a revised and updated “General Financial Rules” has been implemented. To avoid rush of expenditure and promote a sound cash management system, a quarterly exchequer control based expenditure management system which releases funds in a time-sliced manner is being implemented in respect of 14 demands from grants. The Ministry of Finance presented its Outcome Budget for 2006-07 in March 2006. This sets out the outlays, quantifiable outputs, projected outcome, time line and the risk factors associated with the Plan schemes and select non-Plan schemes under the four departments in the Ministry. The other Ministries/Departments would individually present their own Outcome Budgets for 2006-07.

State Governments

I.1.34 The State Governments continued to pursue fiscal correction and consolidation programme during 2005-06. Fiscal responsibility legislations (FRLs) have been enacted by 22 State Governments (as of end-March 2006). By April 1, 2006 all States barring two (Tamil Nadu and Uttar Pradesh) implemented value added tax (VAT) in lieu of sales tax. The year 2005-06 happened to be the first year of the award period of the TFC. The improvement in fiscal position of the States was facilitated by the larger grants and shareable Central taxes, as recommended by the TFC. The State Governments also initiated measures to restructure their finances in terms of the path prescribed by the TFC.

I.1.35 The State Governments in their budgets for 2006-07 have proposed various policy initiatives to carry forward the process of fiscal correction and consolidation. The States have emphasised fiscal empowerment through broadening and rationalising tax system. Simultaneously, they have laid stress on improvement in tax administration, streamlining and strengthening existing tax and non-tax collections and plugging of revenues leakages and loopholes. One State has proposed to constitute a Task Force in this regard. With a view to improving transparency and efficiency in transactions of the Governments, many States have proposed to complete computerisation of their treasuries and also to introduce e-transfer for their transactions. With a view to improving accountability of budget proposals, some States have proposed to introduce ‘Outcome Budget’, on the lines of the one initiated by the Central Government. Furthermore, several State Governments have proposed to introduce ‘Gender Budgeting’. Some States have proposed comprehensive restructuring of their public sector undertakings including closure of chronically loss making units for reducing budgetary support for them. A number of States announced introduction of new pension schemes based on defined contribution to restrict their rising pension obligations. Some States proposed curtailment of unwarranted expenditure by doing away with vacated posts, adoption of austerity measures and reduction of non-plan expenditure. Many States have proposed to improve spending on education and health under the social sector while also implementing the centrally sponsored schemes such as rural employment guarantee, urban renewal mission and roads. On the whole, the State Governments in their budgets for 2006-07 have stressed the need for revenue optimisation, improved tax administration and effective expenditure management.

EXTERNAL SECTOR POLICIES

I.1.36 In April 2006, the Government of India announced the Annual Supplement 2006 to the Foreign Trade Policy (2004-09). The Annual Supplement, 2006 envisaged the twin objectives of putting country’s exports on a trajectory of quantum growth by doubling the share of India in global merchandise trade within the next five years and creating employment opportunities, especially in the rural and semi-urban areas. Towards these objectives, the Annual Supplement introduced two incentive schemes, Focus Product Scheme (FPS) and Focus Market Scheme (FMS). While the FMS emphasises on promotion of exports to markets where India’s share is low, the FPS stresses on promoting products having high employment potential.

I.1.37 In order to promote exports of rural and agro products and to bring the benefits of foreign trade to rural areas, the *Vishesh Krishi Upaj Yojana,* renamed as *Vishesh Krishi Upaj aur Gram Udyog Yojana*, has been expanded to include village industries-based products. The products under this Scheme are entitled for duty free credit scrip equivalent to 5 per cent of free on board (fob) value of exports. Furthermore, in the sphere of services, the ‘Served from India Scheme’, which was introduced to encourage exports of services, was extended to allow transfer of both scrip and the imported input to the Group Service Company, whereas earlier only transfer of imported material was allowed. The Annual Supplement has also introduced various measures to promote India as a hub of auto components, gems and jewellery and to tap the business opportunity in supplies of stores (food, beverages and other supplies) and refuelling of long distance flights.

I.1.38 In order to instil confidence in investors and signal the Government’s commitment to a stable Special Economic Zone (SEZ) policy regime, a comprehensive Special Economic Zones Act, 2005,

Box I.2

Special Economic Zones Act, 2005

The SEZ Act 2005 provides several incentives to reduce transaction costs and improve the competitiveness of exports. The simplification of procedures and tax breaks as envisaged by the Act are expected to attract investments of about Rs.1,00,000 crore and help create 500,000 jobs. For streamlining regulations pertaining to the SEZs, the new guidelines have brought into effect a uniform set of regulations for setting up units with single window clearance with matters relating to State as well as Central governments. Developers are allowed to set up sector specific and multi-product SEZs. The Act provides for a minimum area requirement of 1000 hectares for multi-product and 100 hectares for service sector SEZs. Exemptions to the area requirement are allowed to support sectors where India has a comparative advantage, such as gems and jewellery, information technology and bio-technology. For these sectors, the minimum area requirement is stipulated at 10 hectares. The Act provides for: (i) simplification of procedures for development, operation, and maintenance of SEZs and for setting up and conducting business in SEZs; (ii) single window clearance for setting up a unit in SEZs; (iii) simplified compliance procedures and documentation with an emphasis on self certification; (iv) dispensing the requirement for bank guarantees to reduce transaction costs; and (v) allowing contract manufacturing for foreign principals and option to obtain sub-contracting permission at the initial approval stage.

The SEZ Act 2005 also incorporates fiscal incentives for exporters in order to provide stability of policy regime to SEZ units. The Act, *inter alia*, provides for: (i) full income tax exemption to SEZ units for the first five consecutive years, and 50 per cent exemption for further five years; and, (ii) exemption of SEZ units and developers from payment of customs duty on all imported inputs and excise duty on products sourced from domestic market.

The SEZs are envisaged to act as catalysts for growth. The simplification of the procedures for development, operation and maintenance of the SEZs and the fiscal incentives are expected to spur investment and promote industrial activity. At the same time, there are concerns that the SEZs could aggravate the uneven pattern of development by pulling out resources from less developed areas. Revenue implications of taxation benefits would also need to be factored. The revenue loss for the Government in providing incentives may be justified only if the SEZ units ensure forward and backward linkages with the domestic economy.

has been enacted. The SEZ Act 2005, which came into force on February 10, 2006, is expected to facilitate large flow of foreign and domestic investment to the SEZs, and contribute to improvements in infrastructure and productive capacity, generation of additional economic activity and creation of employment opportunities (Box I.2).

Foreign Exchange Transactions[1]

I.1.39 Various policy initiatives were taken to further liberalise cross-border capital flows in the area of foreign investment and external commercial borrowings (ECBs). With a view to promoting Indian investment abroad and to enable Indian companies to reap benefits of globalisation, the limit of investment overseas under the automatic route was raised from 100 per cent of net worth of the investing Indian entity to 200 per cent of its net worth.

I.1.40 Foreign direct investment (FDI) in petroleum sector, air transport services (domestic airlines) sector, print media sector, construction development sector was further liberalised. Persons/entities eligible under the FDI route were permitted to invest in the equity capital of Asset Reconstruction Companies (ARCs) registered with the Reserve Bank of India. Foreign Institutional Investors (FIIs) were permitted to invest up to 49 per cent in security receipts issued by ARCs under the Government approval route. The ECB policy was further liberalised, *inter alia*, to permit Authorised Dealer banks to allow prepayment of ECBs up to US $ 200 million against the existing limit of US $ 100 million. Non-banking financial companies (NBFCs) satisfying certain criteria were allowed to raise ECBs under approval route. Domestic rupee denominated structured obligations credit enhanced by international banks/international financial institutions/joint venture partners, which earlier required approval of Government of India, would be considered by the Reserve Bank under the approval route.

I.1.41 In regard to current account transactions, procedures were further simplified in order to improve customer services. In view of the increased concerns

[1] A detailed discussion of foreign exchange management is presented in Chapter IV (“Development and Regulation of Financial Markets”) of the Report.

regarding money laundering activities and to prevent Authorised Money Changers (AMCs) from being misused for such activities, the Reserve Bank has brought out detailed Anti-Money Laundering (AML) guidelines to enable AMCs to put in place the policy framework and systems for prevention of money laundering while undertaking money exchange transactions.

MONETARY POLICY FRAMEWORK[1]

I.1.42 The Annual Policy Statement for 2005-06 (April 2005) indicated that the stance of monetary policy during 2005-06 would depend on several factors, including macroeconomic prospects, global developments and the balance of risks. The Statement stressed that the system has to recognise interest rate cycles and strengthen risk management processes to cope with eventualities so that financial stability could be maintained and interest rate movements could be transited in a non-disruptive manner. In this regard, as the Statement added, it would be instructive to observe global trends as the Indian economy is progressively getting linked to the world economy. It was also noted that while there is an overhang of domestic liquidity, partly mirroring abundant global liquidity, the trends in global interest rates, inflation expectations and investment demand would also have some relevance in the evolution of the domestic interest rates. Against this backdrop, barring the emergence of any adverse and unexpected developments in various sectors of the economy and keeping in view the inflationary situation, the overall stance of monetary policy for the year 2005-06 was stated as follows:

- Provision of appropriate liquidity to meet credit growth and support investment and export demand in the economy while placing equal emphasis on price stability.
- Consistent with the above, to pursue an interest rate environment that is conducive to macroeconomic and price stability, and maintaining the momentum of growth.
- To consider measures in a calibrated manner in response to evolving circumstances with a view to stabilising inflationary expectations.

The Reserve Bank increased the reverse repo rate under the liquidity adjustment facility (LAF) by 25 basis points to 5.00 per cent effective April 29, 2005 to moderate inflationary expectations.

I.1.43 In its First Quarter Review of Annual Statement on Monetary Policy for 2005-06 (July 2005), the Reserve Bank indicated that while global factors were getting to be increasingly significant for India, domestic factors still dominate and the latter pointed to favouring stability to maintain growth momentum. Accordingly, while continuing with the overall stance of monetary policy for the remaining part of the year 2005-06 as set out in the Annual Policy Statement of April 2005, the Reserve Bank indicated that it would respond, promptly and effectively, to the evolving situation depending on the unfolding of the risks.

I.1.44 In its Mid-term Review of Annual Policy Statement (October 2005), while noting that, on balance, macroeconomic and financial conditions have evolved as anticipated, the Reserve Bank pointed to the emergence of several factors posing risks to the outlook on growth and inflation. While reaffirming the stance of monetary policy set out in the Annual Policy Statement, the priorities assigned to policy objectives were rebalanced in the context of the assessment of the economy and, particularly, the outlook on inflation. The fixed reverse repo rate under the LAF was increased by 25 basis points to 5.25 per cent while retaining the spread between reverse repo and repo rates at 100 basis points.

I.1.45 In its Third Quarter Review of Annual Statement on Monetary Policy for 2005-06 (January 2006), the Reserve Bank observed that macroeconomic and financial developments remain in support of the monetary policy stance. In view of the remaining pass-through of international crude oil prices in to domestic prices of LPG and kerosene, the monetary policy stance was articulated in favour of a greater emphasis on price stability through measured but timely and even pre-emptive policy action to anchor inflation expectations. Accordingly, the reverse repo rate and the repo rate under the LAF were increased by 25 basis points each.

I.1.46 The Annual Policy Statement for 2006-07 (April 2006) emphasised that the stance of monetary policy for 2006-07 would depend on macroeconomic developments including the global scenario. The Statement added that the balance of risks was tilted towards the global factors. The adverse consequences of further escalation of international crude oil prices and/or of disruptive unwinding of

[1] A detailed discussion of monetary management is presented in Chapter III ("Monetary and Credit Policy Operations") of the Report.

global imbalances are likely to be pervasive across economies, including India. Moreover, in a situation of generalised tightening of monetary policy, India can not afford to stay out of step. The Statement added that it was necessary, therefore, to keep in view the dominance of domestic factors as in the past but to assign more weight to global factors than before while formulating the policy stance. The overall stance of monetary policy was stated as: to ensure a monetary and interest rate environment that enables continuation of the growth momentum consistent with price stability while being in readiness to act in a timely and prompt manner on any signs of evolving circumstances impinging on inflation expectations; focus on credit quality and financial market conditions to support export and investment demand in the economy for maintaining macroeconomic, in particular, financial stability; and respond swiftly to evolving global developments. On a review of macroeconomic developments and overall monetary conditions, the Reserve Bank increased the reverse repo rate and the repo rate by 25 basis points each to 5.75 per cent and 6.75 per cent, respectively, effective June 9, 2006.

I.1.47 In its First Quarter Review of the Annual Statement on Monetary Policy (July 2006), the Reserve Bank noted that demand pressures, especially continuing high credit growth, could exert upward pressure on prices when associated with supply shocks such as from oil. The global outlook for growth is positive but downside risks in regard to inflation and re-pricing of risks in financial markets need to be recognised. These pressures have the potential for impacting stability and inflation expectations. Accordingly, the Reserve Bank increased the reverse repo rate and the repo rate by 25 basis points each to 6.00 per cent and 7.00 per cent, respectively, effective July 25, 2006.

Credit Delivery System

I.1.48 The Reserve Bank continued with its efforts to improve flow of credit to different sectors of the economy particularly to the agriculture and small scale industries sector at reasonable rates without procedural impediments. The policies relating to rural credit are being redesigned to bring about maximum financial inclusion of the poorer sections of the society.

FINANCIAL SECTOR POLICIES[1]

I.1.49 The Reserve Bank took various supervisory and regulatory measures during 2005-06 to further strengthen the financial sector covering the scheduled commercial banks, urban cooperative banks and NBFCs. The measures aimed at strengthening the financial sector with a view to ensuring financial stability included aspects relating to corporate governance practices, risk management and pricing techniques and counter-cyclical prudential norms. In the context of the rapid expansion of bank credit, banks were urged to undertake a comprehensive assessment of segment-wise credit with special reference to those sectors in which credit has been expanding rapidly. The prudential measures were tightened to ensure safety of the health of the financial sector. In order to augment the capital of the banks in view of the enlarged capital requirement under new capital adequacy framework of Basel II, the Reserve Bank permitted banks to raise capital through new instruments. Simultaneously, the focus was on financial inclusion to reorient financial intermediation to cover the widest sections of society.

I.1.50 In order to facilitate a macro level assessment of large non-deposit taking NBFCs at more frequent intervals, the periodicity of the returns was changed from quarterly to monthly. The reporting format has been amended to incorporate additional information relating to capital market exposure. In the case of urban cooperative banks (UCBs), memoranda of understanding (MoU) were signed between the Reserve Bank and five State Governments, *viz*., Andhra Pradesh, Gujarat, Karnataka, Madhya Pradesh and Uttaranchal to sort out issues relating to regulation and supervision.

Polices for Financial Markets

I.1.51 The Reserve Bank continued to take measures to increase depth and liquidity in the money, Government securities and foreign exchange markets during the year in order to improve the price discovery mechanism. These efforts were intensified during the year in view of the FRBM provision which prohibits the Reserve Bank from participating in the primary market for Central Government securities with effect from April 2006 onwards. The implementation of

[1] A detailed discussion of financial market and financial sector policies is presented in Chapter IV ("Development and Regulation of Financial Markets") and Chapter V ("Financial Regulation and Supervision").

FRBM Act necessitated a review of the Reserve Bank's market operations, including introduction of new instruments and refining existing instruments in the context of the evolving scenario. Within the Reserve Bank, a clearer assignment of functional responsibilities has been sought to improve operational effectiveness by minimising overlaps and conflict of interest. A Financial Markets Department (FMD) was set up in July 2005 with a view to strengthening monetary, debt and reserve management functions by moving towards functional separation in these objectives within the Reserve Bank. By January 2006 the Reserve Bank operations in financial markets were fully integrated with FMD conducting all domestic market operations in money, Government securities and foreign exchange markets. A high level Committee on Fuller Capital Account Convertibility (Chairman: Shri S.S. Tarapore) was constituted to set a road-map for fuller convertibility on the capital account. The Committee submitted its Report to the Reserve Bank on July 31, 2006. The Reserve Bank will place the Report in public domain in due course.

I.1.52 During 2005-06, policy initiatives in the capital market were directed towards further broadening and deepening of the capital market. In order to make Indian primary market more efficient and transparent, Securities and Exchange Board of India (SEBI) amended the SEBI (Disclosure and Investor Protection) {DIP} Guidelines, 2000 with reference to rationalisation of disclosure requirements for listed companies, disclosure of issue price, further issue of shares and lock-in provisions. SEBI also decided to fix five per cent specific allocation for mutual funds within the Qualified Institutional Buyer (QIB) category in book built issues and extended the existing provisions of the proportionate allotment as applicable for retail individual investors and non-institutional investors to the QIB category. SEBI prescribed a margin of 10 per cent for QIBs for applying in book built issues. In order to provide an additional route for raising funds in the domestic market, SEBI permitted listed companies to raise funds in the form of 'Qualified Institutional Placement' (QIP). The aggregate funds that can be raised through QIP route in a financial year should not exceed five times the net worth of the issuer at the end of previous financial year and there should be a gap of at least six months between each placement. The minimum number of allottees for each placement can not be less than two in case of issue size of up to Rs.250 crore and not less than five in case of issue size of more than Rs.250 crore. SEBI amended the SEBI (DIP) Guidelines to permit unlisted companies to opt for grading of IPO from credit rating agencies and to ensure disclosure of all grades obtained by it, including unaccepted grades. Furthermore, to enable foreign companies to raise capital from India and to give an opportunity to the domestic investors to invest in the equity of reputed foreign firms, SEBI introduced guidelines for issue of India Depository Receipts (IDRs). IDR is an instrument in the form of a depository receipt against the underlying equity of the issuing company (a foreign company, in this case). QIBs can make investments in IDRs. However, NRIs/FIIs can not purchase IDRs and automatic fungibility of IDRs is not permitted.

I.1.53 In order to ensure availability of floating stock on a continuous basis and to bring about greater transparency in respect of disclosure of shareholding pattern of companies, SEBI amended the Clause 40A and 35 of equity listing agreement and decided that all listed companies are required to ensure a minimum level of public share holding at 25 per cent of the total number of issued shares. In order to facilitate execution of large trades, SEBI changed the definition of block deals on the stock exchanges, while permitting the stock exchanges to provide a separate trading window. A trade with a minimum quantity of 5,00,000 shares or minimum value of Rs.5 crore executed through a single transaction on this window will constitute a "block deal" as distinguished from "bulk deal" defined earlier.

I.1.54 SEBI permitted the mutual funds to participate in the derivatives market at par with FIIs in respect of position limits in index futures, index options, stock options and stock futures contracts. SEBI amended the SEBI (Mutual Funds) Regulations, 1996 to introduce gold exchange traded funds, thereby permitting mutual funds to invest in gold and gold related instruments.

I.1.55 The Union Budget 2006-07 laid strong emphasis on strengthening the Indian capital market. With a view to developing the debt market, FII investment limit in the Government securities was increased from US $ 1.75 billion to US $ 2 billion. FII investment limit in corporate debt was also increased from US $ 0.5 billion to US $1.5 billion. Ceiling on aggregate investment by mutual funds in overseas instruments was raised from US $ 1 billion to US $ 2 billion and the requirement of 10 per cent reciprocal share holding was removed.

Legal Framework

I.1.56 Institutional and policy measures to improve the legal system continued during the year. The Credit Information Companies (Regulation) Bill, 2005 has been enacted as the Credit Information Companies (Regulation) Act, 2005 (Act No. 30 of 2005) and would come into force with effect from the date as may be notified by the Government in this behalf. The Act regulates credit information companies to facilitate efficient distribution of credit. A Working Group was constituted to provide draft of the Rules and Regulations for the purpose of implementation of the provisions of the Act, which is in progress. After the Act comes into force, it would be permissible for credit information companies to collect credit information from banks/FIs and to disseminate same in accordance with the Act.

I.1.57 In order to provide the Reserve Bank greater flexibility in the conduct of monetary policy, the Reserve Bank of India Act, 1934 has been amended by the Reserve Bank of India (Amendment) Act, 2006. The Amendment Act includes provisions for (i) empowering the Reserve Bank to deal in derivatives, to lend or borrow securities and to undertake repo or reverse repo operation; (ii) defining the expressions 'derivative', 'repo' and 'reverse repo'; (iii) removing ambiguity regarding the legal validity of derivatives; (iv) removing the floor and ceiling of cash reserve ratio (CRR) for scheduled banks so as to provide flexibility to the Reserve Bank to specify CRR; and (v) empowering the Reserve Bank to lay down policy relating to interest rates or interest rate products and issue directions to any agency dealing in securities, money market instruments, derivatives, *etc.*, and to inspect such agencies.

I.1.58 The Banking Regulation (Amendment) Bill, 2005, introduced in the *Lok Sabha* on May 13, 2005, seeks to amend some of the provisions of the Banking Regulation Act, 1949 with a view to strengthening the regulatory powers of the Reserve Bank. The Bill includes provisions for (i) removing the restriction on voting rights and introducing the requirement of prior approval of the Reserve Bank for acquisition of shares or voting rights above the specified limit (empowering the Reserve Bank to satisfy itself that the applicant is a 'fit and proper person' to acquire shares or voting rights and to impose such further conditions that the Reserve Bank may deem fit to impose); (ii) removing the lower limit (floor) of statutory liquidity ratio (SLR) and empowering the Reserve Bank to specify the SLR subject to a maximum of forty per cent of the total demand and time liabilities; (iii) amending the definition of approved securities in Section 5(a) of the Act to empower the Reserve Bank to specify from time to time any security, in addition to securities issued by the Central or State Government, as 'approved securities'; (iv) amendment of Section 12 of the Act to enable banking companies to issue preference shares subject to regulatory guidelines framed by the Reserve Bank; (v) empowering the Reserve Bank to direct a banking company to disclose in its financial statement or furnish to the Reserve Bank separately such statements and information relating to the business of any associate enterprise as the Reserve Bank considers necessary and also to cause an inspection to be made of any associate enterprise; (vi) empowering the Reserve Bank to supersede the board of directors of a banking company and appoint an administrator; (vii) amendment of Section 56 of the Act to remove the provision facilitating primary credit societies to carry on the business of banking without obtaining a licence from the Reserve Bank; and, (viii) empowering the Reserve Bank to order special audit of a cooperative bank in public interest or in the interest of the cooperative bank or its depositors.

I.1.59 The Banking Companies (Acquisition and Transfer of Undertakings) and Financial Institutions Laws (Amendment) Bill, 2005 mainly seeks to amend the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 and the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980. The Bill, *inter alia*, contains provisions to: (a) elect one to three shareholder directors to the board of the nationalised banks on the basis of issued capital of the bank instead of one to six directors under the existing provisions; (b) omit the provisions relating to mandatory nomination of directors by the Reserve Bank and financial institutions on the board of nationalised banks; (c) confer power upon the Reserve Bank to appoint one or more additional directors; (d) empower the shareholders of nationalised banks to discuss, adopt and approve the Directors' report, the profit and loss accounts and balance sheet of the bank at the annual general meeting; (e) enable the banks to transfer the unclaimed dividends for more than seven years to Investor Education and Protection Fund established under section 205 C of the Companies Act, 1956; and (f) empower the Central Government to supersede, on the recommendation of the Reserve Bank, the board of directors of any nationalised bank. Subsequently, the Reserve Bank had suggested the following modifications to the Amendment Bill: (a) enabling nationalised banks to issue preference shares in accordance with guidelines framed by the Reserve Bank and to raise capital by preferential allotment or private placement or public issue with the approval of the Reserve Bank and Central Government; (b) restricting the voting rights of preference shareholders to resolutions directly affecting their rights and up to a maximum of one per cent of the total voting rights of all the shareholders holding preference share capital only; (c) providing that the elected directors should be persons of 'fit and proper' status; and, (d) supersession of board by Central Government on the recommendation of the Reserve Bank and appointment of Administrator and a Committee to assist the Administrator. These suggestions of the Reserve Bank are under consideration of the Central Government.

I.1.60 The Securities Contracts (Regulation) Amendment Bill, 2005 seeks to amend the Securities Contract (Regulation) Act, 1956 so as to provide a legal framework for trading in securitised debt including mortgage backed debt. The Bill proposes, *inter alia*, (a) to include securitisation certificate or instrument under the definition of 'securities' and to insert for the said purpose a new sub-clause (ie) in clause (h) of Section 2 of the SCR Act, 1956; and (b) to provide for obtaining approval from the SEBI for issue of securitisation certificate or instrument and procedure thereof and insert for the purpose a new Section 17 A in the SCR Act, 1956.

I.1.61 The Government Securities Bill, 2004 has been passed by *Lok Sabha* on August 7, 2006, and by *Rajya Sabha* on August 14, 2006. The Bill proposes to consolidate and amend the law relating to issue and management of Government securities by the Reserve Bank. The Bill provides for (i) empowering the Reserve Bank to prescribe the form for transferring Government securities; (ii) holding of Government promissory notes by Trusts; (iii) simple procedure for recognising title to Government securities up to Rs. one lakh with enabling power to the Central Government to enhance the said limit up to Rs. one crore; (iv) micro films, facsimile copies of documents, magnetic tapes and computer printouts to be admissible as evidence; and (v) suspension of the holders of subsidiary general ledger account from trading with the facility of that account in the event of misuse. Other salient features of the Bill include enabling creation of pledge, hypothecation or lien in respect of Government securities; and, empowering the Reserve Bank to call for information, cause inspection and issue directions as well as make regulations with the previous approval of the Central Government for carrying out the purposes of the Bill.

I.1.62 The Central Government has introduced the State Bank of India (Subsidiary Banks Laws) Amendment Bill, 2006 in the *Lok Sabha* to amend the laws governing subsidiary banks to enhance the capital of the subsidiary banks, to enable them to raise resources from the market and to provide flexibility in the management of these banks.

I.1.63 The Payments and Settlements Bill, 2006 has been introduced in the *Lok Sabha* on July 25, 2006. The Bill seeks to designate the Reserve Bank as the authority to regulate Payment and Settlement Systems. The Bill contains provisions for (i) compulsory requirement of an authorisation by the Reserve Bank to operate payment systems; (ii) empowering the Reserve Bank to regulate and supervise the payment systems by determining standards, and calling for information, returns, documents, *etc*.; (iii) empowering the Reserve Bank to audit and inspect by entering the premises where payment systems are being operated; (iv) empowering the Reserve Bank to issue directions; and, (v) providing for settlement and netting to be final and irrevocable at the determination of the amount of money, securities or foreign exchange payable by participants.

II. THE REAL ECONOMY

I.2.1 The Indian economy continued to record strong growth during the fiscal year 2005-06, backed by sustained manufacturing activity and impressive performance of the services sector with reasonable support from the recovery in agricultural activity. According to the revised estimates released by the Central Statistical Organisation (CSO) in May 2006, real gross domestic product (GDP) increased by 8.4 per cent during 2005-06 on top of growth of 7.5 per cent in 2004-05 (Table 1.1 and Appendix Table 4). Thus, real GDP growth has averaged at above 8 per cent in the past three years, reviving interest in the country's potential output growth (Box I.3). It may be mentioned that the CSO, on January 31, 2006, changed the base year of National Accounts Statistics from 1993-94 to 1999-2000. This is the fifth time that the CSO has changed the base year to factor in the structural changes taking place in the economy in order to reflect a more realistic picture of the economy. Apart from changing the base year, improvements were also made in terms of coverage following the recommendations of the United Nations System of National Accounts, 1993 (UNSNA, 1993).

AGGREGATE SUPPLY

Agriculture

I.2.2 Real GDP growth originating from agriculture and allied activities registered a growth of 3.9 per cent during 2005-06, recovering from a low of 0.7 per cent in 2004-05 (Table 1.1 and Appendix Table 4). The improvement in agricultural sector was enabled by both foodgrains and non-foodgrains production. Furthermore, improvement in respect of horticulture, livestock, fisheries and plantation crops has imparted some resilience to the real GDP growth originating from agricultural and allied activities. Backed by a normal monsoon and post-monsoon rains, agricultural production, as measured by the Index of Agricultural Production, is estimated to have staged a recovery of 7.9 per cent during 2005-06 in contrast to a decline of 2.7 per cent during the preceding year.

I.2.3 During the year 2005, although the onset of South-West monsoon was delayed by a week, it covered the entire country almost two weeks ahead of its normal schedule. The cumulative area-weighted rainfall during the 2005 South-West monsoon (June 1 to September 30) turned out to be 99 per cent of the Long Period Average (LPA), closer to the prediction of a near normal monsoon (98 per cent) by the India Meteorological Department (IMD). The performance of South-West monsoon in 2005 was better compared to the previous year when the country had recorded 13 per cent below normal rainfall. Although the progress of the monsoon was not well-distributed in time with deficiency during the first three weeks of June, whole of August and the first week of September, it was offset by a perceptible improvement in the last week of June, most of July and in the second and third weeks of September 2005. The cumulative rainfall was evenly distributed with 32 out of 36 meteorological sub-divisions recording excess/normal rainfall and only 4 receiving deficient/scanty rainfall (Chart I.1). Only one sub-division, *viz*., Jharkhand recorded moderate drought conditions. Among the four homogeneous regions, Central India, North-West India and South Peninsula received 110 per cent, 90 per cent and 112 per cent of normal rainfall, respectively; the rainfall was deficient by 20 per cent over North-East India. Out of the 525 meteorological districts, only 17 districts

Table 1.1: Growth Rates of Real GDP (at 1999-2000 prices)

(per cent)

Sector	2000-01 to 2002-03 (Average)	2003-04@	2004-05 *	2005-06 #	2005-06 Q1	Q2	Q3	Q4
1	2	3	4	5	6	7	8	9
1. Agriculture and Allied Activities	**-0.2**	**10.0**	**0.7**	**3.9**	**3.4**	**4.0**	**2.9**	**5.5**
	(23.5)	**(22.2)**	**(20.8)**	**(19.9)**				
1.1 Agriculture	-0.5	10.7	0.7	n.a.				
2. Industry	**5.2**	**6.6**	**7.4**	**7.6**	**9.5**	**6.3**	**7.0**	**7.9**
	(19.7)	**(19.5)**	**(19.5)**	**(19.3)**				
2.1 Mining and Quarrying	4.4	5.3	5.8	0.9	3.1	-2.6	0.0	3.0
2.2 Manufacturing	5.7	7.1	8.1	9.0	10.7	8.1	8.3	8.9
2.3 Electricity, Gas and Water Supply	2.8	4.8	4.3	5.3	7.4	2.6	5.0	6.1
3. Services	**6.6**	**8.5**	**10.2**	**10.3**	**10.1**	**10.3**	**9.7**	**11.0**
	(56.8)	**(58.3)**	**(59.7)**	**(60.7)**				
3.1 Trade, Hotels, Transport, Storage and Communication	8.5	12.0	10.6	11.5	11.7	11.0	10.2	12.9
3.2 Financing, Insurance, Real Estate and Business Services	6.5	4.5	9.2	9.7	8.8	10.5	8.9	10.5
3.3 Community, Social and Personal Services	4.1	5.4	9.2	7.8	7.3	8.0	8.4	7.6
3.4 Construction	5.9	10.9	12.5	12.1	12.4	12.3	11.5	12.0
4. Real GDP at Factor Cost	**4.6**	**8.5**	**7.5**	**8.4**	**8.5**	**8.4**	**7.5**	**9.3**

@ : Provisional Estimates. * : Quick Estimates. # : Revised Estimates. n.a. : Not Available.

Note : 1. Figures in parentheses denote percentage shares in real GDP.
2. Q1: First Quarter (April-June); Q2: Second Quarter (July-September); Q3: Third Quarter (October-December); and Q4: Fourth Quarter (January-March).

Source : Central Statistical Organisation.

Box I.3
Potential Output

Achievement of growth of above eight per cent per annum during the past three years (*i.e.*, 2003-04 to 2005-06) has raised optimism about future growth prospects of the economy. In the context of this acceleration in real GDP growth, an issue of debate is: whether the current acceleration in real GDP growth reflects a cyclical upturn after the slowdown of the late 1990s or is it a manifestation of an increase in the potential growth rate? For instance, according to Acharya (2006), an average real GDP growth of eight per cent for the next five years may not be sustainable in view of infirmities of economic policies emanating from infrastructure constraints, rising real interest rates, underutilisation of manpower resources due to labour laws, deceleration in agricultural growth, and inadequate policy response to rising oil prices; on the basis of this assessment, he suggests an average growth of 6.5 per cent is more likely for 2006-2011. Against this backdrop, estimates of India's potential output growth assume importance.

Potential output is an estimate of the level of real GDP attainable when the economy is making full use of its resources. It is, however, not a technical ceiling on output. Rather, it is a measure of maximum sustainable output, consistent with a low and stable rate of inflation. If actual output rises above its potential level, then constraints on capacity begin to bind and inflationary pressures can start building; on the other hand, if output falls below potential, then resources may be lying idle.

While conceptually it is easy to define potential output, its measurement raises a number of issues. The methods available for estimating potential output can be grouped into two approaches: the "production function" approach and the "statistical" approach. The first approach relates output to the level of technology and factor inputs, usually labour and capital. Potential output would be the output if both labour and capital are fully utilised in an efficient manner. The approach requires the need to measure quantity and, especially quality, of inputs since the physical quantity of inputs does not fully capture the dynamics of output. Reliable data on the inputs – labour and capital – are not relatively easily available, especially for emerging economies. The approach also requires assumption about the mathematical form of the production function. For simplicity, typically, constant returns to scale production function (Cobb-Douglas specification) is assumed, but this specification need not be appropriate. Thus, the practical implementation of the production function approach involves a number of complex issues. In view of these problems, statistical approaches have become quite popular. A widely used approach in this context is the 'Hodrick-Prescott' filter which decomposes the actual real GDP into two components – a trend and a cyclical component – and potential output is proxied by the trend component. While being simple, this approach also has a number of drawbacks such as sensitivity to the sample period and the choice of the smoothing parameter. As this approach essentially smoothens the actual output series, it may not be able to capture any incipient trends in the growth process. Estimates of potential output are, thus, subject to a considerable degree of uncertainty and researchers, therefore, use a variety of techniques to estimate potential output.

As regards India, existing studies place estimates of potential output growth in a wide range of 6-9 per cent, reflecting differing time periods of study and different approaches. Donde and Saggar (1999) estimated the potential output growth to be 6.3 per cent using univariate approach. Dhal (1999) using dynamic input-output framework placed the potential growth at 6.5 per cent while a potential growth rate of 8-10 per cent was estimated based on the production function approach. Rodrik and Subramanian (2004) used growth accounting framework and placed India's potential output growth over the next two decades at close to seven per cent, with more upside potential.

The domestic savings rate has improved from 23.6 per cent in 2001-02 to 29.1 per cent in 2004-05. Concomitantly, with modest recourse to foreign savings, the domestic investment rate has increased from 23.0 per cent to 30.1 per cent over the same period. The improvement in domestic savings and investment rates in recent years augurs well for future growth prospects. Three issues, namely, the physical infrastructure, fiscal deficit, and agriculture are critical for maintaining the momentum of growth with stability (Reddy, 2006). In this context, as the draft approach document to the 11th Plan observes, the baseline growth rate, *i.e.*, the growth likely to be achieved without significant new policy initiatives, is around seven per cent per annum. With additional policy initiatives, as the draft approach document adds, it is possible to increase the average growth rate to somewhere between eight and nine per cent per annum.

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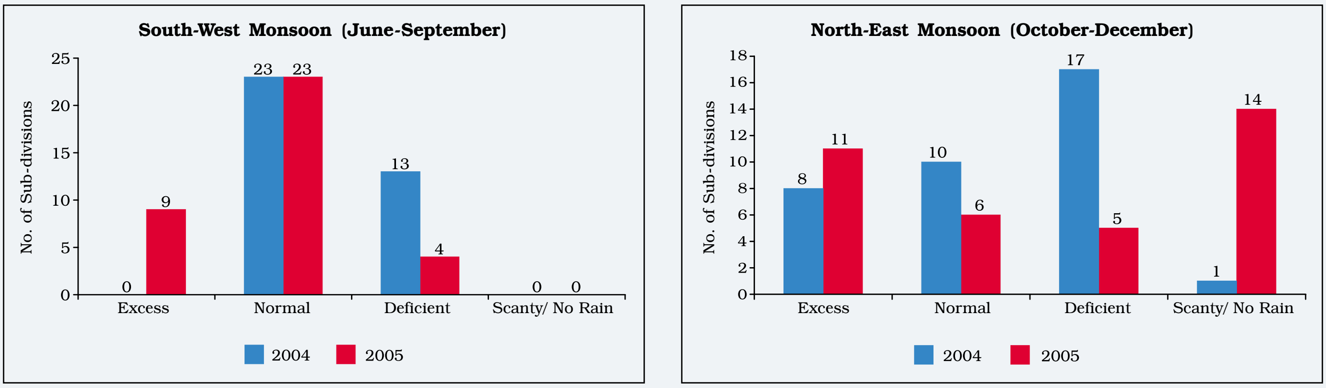
Chart I.1: Monsoon Conditions



(3 per cent) experienced severe drought conditions at the end of the season. Out of the 168 meteorological districts, which faced drought conditions in 2004, as many as 113 districts received normal/excess rainfall in the 2005 monsoon season, while drought continued in 55 districts.

I.2.4 Following a near normal South-West monsoon during 2005, the overall performance of North-East monsoon also turned out to be better. The cumulative area weighted rainfall during the 2005 North-East monsoon season (October 1 to December 31) was 10 per cent above normal as against 11 per cent below normal during the previous year. However, the spatial distribution was uneven with 17 out of 36 meteorological sub-divisions receiving excess/normal rainfall and 19 sub-divisions receiving deficient/ scanty/no rain.

I.2.5 Reflecting the increased area coverage as well as better monsoon conditions, the total foodgrains production during 2005-06 is estimated at 208.3 million tonnes, almost five per cent higher than the previous year's level. The improvement was on account of both *kharif* and *rabi* foodgrains production. Crop-wise, the higher production was mainly on account of rice. Among the cash crops, the production of sugarcane showed a smart recovery (17.4 per cent) along with oilseeds. Production of cotton continued to record strong growth. (Table 1.2 and Appendix Table 6).

I.2.6 The production of cereals in the country has witnessed a stagnation since late 1990s. Rice production has generally fluctuated in the range of 83-90 million tonnes during the last decade. Wheat production witnessed a rising trend during the early 1990s and touched a peak (76 million tonnes) in 1999-2000, but since then it has moved around 70 million tonnes. The production of pulses has also been range-bound (around 11-14 million tonnes). Stagnancy in yields, limited varietal improvements, low resilience to moisture stress and pest infestation amidst decline in agricultural investment have held down cereal production despite consecutive good monsoons (Box I.4).

Table 1.2: Agricultural Production

	Crop	2002-03	2003-04	2004-05	2005-06#
1		2	3	4	5
1	**Growth Rate (Per cent) $**				
	All Crops	**-13.2**	**16.1**	**-2.7**	**7.9**
	a. Foodgrains	-14.9	16.4	-7.2	4.4
	b. Non-foodgrains	-11.1	15.6	2.6	11.8
2	**Production (Million Tonnes)**				
	a. Foodgrains	**174.8**	**213.2**	**198.4**	**208.3**
	i. Rice	71.8	88.5	83.1	91.0
	ii. Wheat	65.8	72.2	68.6	69.5
	iii. Coarse Cereals	26.1	37.6	33.5	34.7
	iv. Pulses	11.1	14.9	13.1	13.1
	b. Non-foodgrains				
	i. Oilseeds++	14.8	25.2	24.4	27.7
	ii. Sugarcane	287.4	233.9	237.1	278.4
	iii. Cotton@	8.6	13.7	16.4	19.6
	iv. Jute and Mesta+	11.3	11.2	10.3	10.7
	v. Tea*	838.5	878.1	982.9	928.0
	vi. Coffee*	275.3	270.5	n.a.	n.a.

\# : Production based on Fourth Advance Estimates.
$: Growth rates are based on Index of Agricultural Production with base triennium ending 1993-94=100.
\+ : Million bales of 180 kg. each
++ : For nine oilseeds out of eleven in all.
@ : Million bales of 170 kg. each.
* : Million kilograms; data for tea are on calendar year basis.
n.a. : Not Available.
Source : Ministry of Agriculture, Government of India.

Box I.4
Investment Trend in Agriculture

The Tenth Five Year Plan targeted real GDP growth in agricultural sector at four per cent per annum so as to reverse the deceleration in agricultural growth. The actual growth during the first four years of the Plan, however, averaged only two per cent per annum, reflecting, *inter alia*, decline in investment and the concomitant widening gaps in rural infrastructure. Investment in agriculture has declined from 2.2 per cent of GDP in 1999-00 to 1.7 per cent in 2004-05. Expenditure on various subsidies, namely, food, fertilisers, power and irrigation, is widely believed to have crowded out the resources for public investment in agriculture-related infrastructure. Inordinate delays in completing the projects on hand, relatively lower allocation for irrigation, and poor rural infrastructure and research, have held down agricultural investment in the economy. However, there is an indication of a reversal of the declining trend in public sector investment in agriculture in recent years. Private investment in agriculture, on the other hand, has continued to decline (Table).

Step-up in investment in agriculture is critical for higher as well as stable growth of the sector. As a response to inadequate private investment for agriculture, the Government, *inter alia*, established the Rural Infrastructure Development Fund (RIDF). Banks that fail to meet the required target of lending to priority sector/agriculture finance the Fund. With a view to addressing various issues and to suggest a road-map for banks to increase investment in agriculture, the Reserve Bank constituted an Expert Group on Investment Credit to Agriculture in 2005 (Chairman: Shri Y.S.P. Thorat). The Group's major recommendations included: i) State Governments to make legal provision/computerisation of land records, provide legal support for recovery, and introduce reforms in agricultural marketing; ii) improve credit absorption capacity by strengthening infrastructure and extension network and developing marketing links; iii) NABARD to design appropriate products for financing rural infrastructure; iv) banks to make efforts to reach the 'unreached' areas, and integrate short-term with term credit; and v) promote supplementary credit delivery channels, outsource monitoring services and provide loan support for diversified agriculture. The Government also launched an ambitious programme of doubling of credit flow to agriculture during the period 2004-05 to 2006-07. The improved availability of credit for agriculture and liberalised trade for agricultural products should enhance private investment in agriculture.

The Union Budget 2005-06 also stepped up public investment significantly for rural infrastructure development. The Union Budget 2006-07 identified assured irrigation, access to credit, diversification and creation of market for agricultural products as thrust areas and several initiatives were announced. Furthermore, following measures have been taken for agriculture development through enhanced capital formation such as: i) preparation of a road-map for agriculture diversification with a focus on horticulture, floriculture, animal husbandry and fisheries; ii) strengthening of agriculture marketing infrastructure; iii) national scheme for the repair, renovation and restoration of water bodies; iv) focus on micro irrigation, micro-insurance and rural credit; and v) setting up a national fund for strategic agriculture research. The recent improvement in State finances also augurs well for enhanced public investment in agriculture. While the increase in investment is important to improve production, the efficiency in the use of investment is also critical. The composition of investments and the quality of facilities created by them and the efficacy with which they are managed will also have an impact on agricultural production and incomes. Thus, apart from irrigation, investments in areas such as watershed development, rural road connectivity and rural electrification need to be stepped up. In this context, there is a need to revisit the issue of power subsidies to agriculture, since they are believed to be leading to overdrawal of ground water and lowering of water table in many areas.

Table: Gross Capital Formation in Agriculture

Year	Investment in Agriculture (Rupees crore)			Share in Agricultural Gross Investment (per cent)		Investment in Agriculture (per cent of GDP at constant prices)
	Total	Public	Private	Public	Private	
1	2	3	4	5	6	7
Old Series (at 1993-94 prices)						
1990-91	14,836	4,395	10,441	29.6	70.4	1.9
1995-96	15,690	4,849	10,841	30.9	69.1	1.6
1996-97	16,176	4,668	11,508	28.9	71.1	1.5
1997-98	15,942	3,979	11,963	25.0	75.0	1.4
1998-99	14,895	3,870	11,025	26.0	74.0	1.3
1999-00	17,304	4,221	13,083	24.4	75.6	1.4
New series (at 1999-00 prices)						
1999-00	43,473	7,754	35,719	17.8	82.2	2.2
2000-01	38,176	7,018	31,158	18.4	81.6	1.9
2001-02	46,744	8,529	38,215	18.2	81.8	2.2
2002-03	45,867	7,849	38,018	17.1	82.9	2.1
2003-04	47,833	12,809	35,024	26.8	73.2	2.0
2004-05 *	43,123	12,591	30,532	29.2	70.8	1.7

* : Quick Estimates
Source : Central Statistical Organisation.

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Allied Activities

I.2.7 India is endowed with diverse agro-ecological features that enable it to grow a variety of horticultural crops, rear different species of livestock and harvest wide range of fish species from various sources. From just about 10 per cent of the gross cropped area, the Indian horticulture sector contributed about 28 per cent to agricultural GDP during 2004-05. India was the second largest producer of fruits and vegetables in the world, with an estimated production of around 58 million tonnes and 99 million tonnes, respectively, during 2005-06. The share of fruits and vegetables output in GDP originating from agriculture and allied activities has increased sharply from 17.8 per cent during 1993-94 to 26.0 per cent during 2003-04.

I.2.8 Livestock sector plays an important role in value addition, providing employment and augmenting incomes, besides enhancing nutritional security of the people. With a production of 91 million tonnes during 2004-05, India was the world's largest producer of milk. During 2003-04, the output of milk was almost 22 per cent of GDP originating from agricultural and allied activities, exceeding that of output of paddy and wheat (15.4 per cent and 9.5 per cent, respectively). The share of livestock sector output in GDP originating from agriculture and allied activities increased from 30.9 per cent during 1993-94 to 32.4 per cent during 2003-04.

Food Management

I.2.9 The total stock of foodgrains with the Food Corporation of India (FCI) and the State agencies was 22.3 million tonnes as on June 1, 2006 (Table 1.3 and Appendix Table 7). The stocks were higher than the buffer stock norms (16.2 million tonnes as on April 1, 2006). The procurement of foodgrains (rice and wheat) at 15.0 million tonnes was lower by 21 per cent during 2006-07 (up to August 1, 2006). This was on account of procurement of wheat falling from 14.8 million tonnes to 9.2 million tonnes. During 2006-07, total off-take of rice and wheat (up to May 31, 2006) at 5.8 million tonnes was lower by 14.6 per cent than that a year ago (6.8 million tonnes).

Table 1.3: Management of Food Stocks

(Million tonnes)

	Opening Stock of Foodgrains			Procurement of Foodgrains			Foodgrains off-take				Closing Stock	Norms
	Rice	Wheat	Total	Rice	Wheat	Total	PDS	OWS	OMS - Domestic	Exports		
1	2	3	4	5	6	7	8	9	10	11	12	13
2005												
January	12.8	8.9	21.7	3.3	0.0	3.3	2.7	0.8	0.0	0.0	21.6	16.8
February	14.2	7.3	21.6	2.2	0.0	2.3	2.7	0.9	0.0	0.0	20.0	
March	13.7	5.8	20.0	1.7	0.0	1.7	2.7	1.7	0.0	0.0	18.0	
April	13.3	4.1	18.0	1.4	12.8	14.2	2.4	1.0	0.0	0.0	28.5	16.2
May	13.0	15.1	28.5	1.0	1.9	3.0	2.5	0.8	0.0	0.0	27.9	
June	11.6	15.7	27.9	0.8	0.1	0.9	2.5	1.7	0.0	0.0	25.1	
July	10.1	14.5	25.1	0.8	0.0	0.8	2.8	0.8	0.1	0.0	21.4	26.9
August	8.0	13.0	21.4	0.4	0.0	0.4	2.6	0.8	0.1	0.0	18.4	
September	6.4	11.6	18.4	0.4	0.0	0.4	2.7	0.7	0.1	0.0	15.5	
October	4.8	10.3	15.5	7.6	0.0	7.6	2.7	0.5	0.0	0.0	19.8	16.2
November	10.3	9.1	19.8	2.7	0.0	2.7	2.3	0.5	0.1	0.0	19.0	
December	11.1	7.6	19.0	3.4	0.0	3.4	2.7	0.7	0.2	0.0	19.3	
2006												
January	12.6	6.2	19.3	3.8	0.0	3.8	2.7	0.8	0.1	0.0	19.5	20.0
February	14.0	4.9	19.5	2.5	0.0	2.5	2.7	0.6	0.3	0.0	18.3	
March	14.1	3.5	18.3	1.9	0.0	1.9	2.6	0.9	0.2	0.0	16.6	
April	13.7	2.0	16.6	1.7	8.7	10.3	2.5	0.3	0.0	0.0	22.8	16.2
May	12.8	9.0	22.8	1.6	0.6	2.2	2.5	0.4	0.0	0.0	22.3	
June	12.0	9.3	22.3	1.5	0.0	1.5	n.a.	n.a.	n.a.	n.a.	n.a.	
July	n.a.	n.a.	n.a.	0.9	0.0	0.9	n.a.	n.a.	n.a.	n.a.	n.a.	26.9

PDS : Public Distribution System. OWS: Other Welfare Schemes. OMS: Open Market Sales. n.a. : Not Available.

Note : Closing stock figures may differ from those arrived at by adding the opening stocks and procurement and deducting offtake, as stocks include coarse grains.

Source : Ministry of Consumer Affairs, Food and Public Distribution, Government of India.

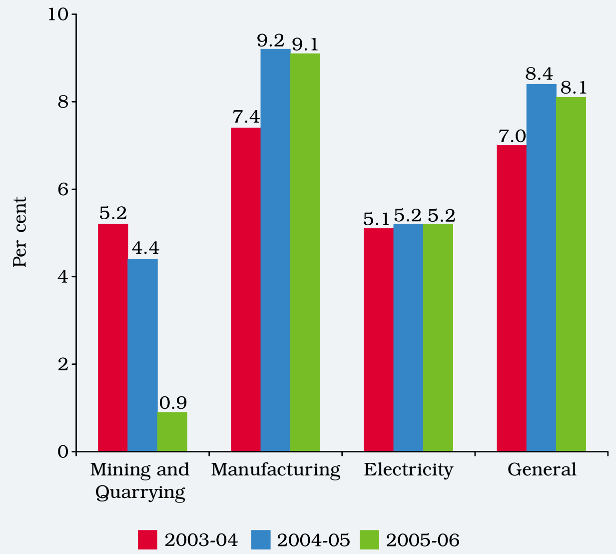
Industrial Performance

I.2.10 According to the CSO's advance estimates, real GDP growth originating from the industrial sector increased from 7.4 per cent in 2004-05 to 7.6 per cent in 2005-06, driven by strong manufacturing activity (see Table 1.1 and Appendix Table 4). Sustained expansion in domestic as well as export demand, increased capacity utilisation, augmentation of capacities and positive business and consumer confidence underpinned the strength of the manufacturing sector.

I.2.11 Industrial production, based on the movements in the index of industrial production (IIP), recorded a strong growth of 8.1 per cent during 2005-06 – *albeit* marginally lower than that of 8.4 per cent during 2004-05 – led by sustained manufacturing activity (Chart I.2 and Appendix Table 8). The marginal deceleration was largely the reflection of a sharp slowdown in the mining sector, which recorded negative growth between July and December 2005 on account of decline in crude oil production due to break-out of fire at Mumbai High oil field in July 2005. The electricity sector continued to record subdued growth reflecting, *inter alia*, inadequate availability of coal in the Eastern region and insufficient supply of gas. The pick-up in manufacturing sector, which began in April 2002, sustained its momentum during 2005-06. Manufacturing activity was broad-based, supported by both investment and consumption demand.

I.2.12 At the two-digit manufacturing classification level, 13 out of 17 industry groups logged positive growth during the year. Industry-wise, manufacturing growth was led mainly by basic chemicals and chemical products, basic metal and alloy industries, machinery and transport equipment industries. Certain discernible changes can be observed in the sources of growth of the manufacturing sector during

Chart I.2: Sectoral Growth of Index of Industrial Production



2005-06 *vis-à-vis* the previous year. In 2004-05, nearly 60 per cent of the manufacturing sector growth was contributed by 'chemicals and chemical products' and 'machinery and equipments'. In 2005-06, the contribution of both these groups went down, while the contribution of 'basic metal and alloy' and 'transport equipments' increased (Appendix Tables 9 and 10). Turnaround in the growth of 'food products' was facilitated by high growth of sugar, tea, chocolate and sugar confectionery. Growth in respect of 'metal products and parts' and 'leather and leather products', however, turned negative while 'wood and wood products' witnessed negative growth for the second successive year.

I.2.13 In terms of use-based classification, acceleration in growth was observed in respect of all sectors except intermediate goods sector (Table 1.4).

Table 1.4: Index of Industrial Production (IIP) – Use-based Classification

(Per cent)

Sector	Weight	Growth Rate		Contribution to IIP Growth	
		2004-05	2005-06	2004-05	2005-06
1	2	3	4	5	6
Overall IIP	**100.0**	**8.4**	**8.1**	**100.0**	**100.0**
Basic Goods	35.6	5.5	6.6	20.9	25.3
Capital Goods	9.3	13.9	15.7	16.5	20.1
Intermediate Goods	26.5	6.1	2.4	20.3	8.0
Consumer Goods	28.7	11.7	12.0	42.6	46.8
Consumer Durables	5.4	14.4	15.2	12.9	14.9
Consumer Non-durables	23.3	10.8	11.0	29.8	31.9

Source: Based on data from Central Statistical Organisation.

Capital goods sector logged double-digit growth even as there was a sharp rise in imports, reflecting high investment demand on account of fresh investments in various sectors such as power equipment, metals, oil and gas, and petrochemicals. Higher spending on infrastructure also boosted domestic capital goods production. As a result, the capital goods sector recorded a growth of 15.7 per cent during 2005-06 – the highest rate of growth since 1993-94 (Appendix Table 11). Impressive performance of both the durable and non-durable segments aided the strong growth of consumer goods sector. Durable goods demand benefited from growing income levels, easier availability of credit and improved accessibility, particularly in rural areas. Growth in consumer non-durables was largely driven by items such as sugar, cigarettes, chocolate, sugar confectionary, sulpha drugs, sunflower oil and rectified sprit. Growth of the basic goods sector was facilitated by expansion in production of cement, salt, hard coke, carbon steel, structurals, ferro silicon, copper metal, and aluminium extrusion. The weak performance of the intermediate goods sector during 2005-06 could be attributed to a variety of factors such as subdued performance of the petroleum refinery products, increase in imports of goods such as yarn and polyester fibre, and continued negative growth of wood and wood products industries.

I.2.14 The current industrial upturn entered its fourth year of expansion during 2005-06. Based on the IIP, growth in industrial production reached a peak of 12.2 per cent in June 2005 – the highest growth after May 1996 – and the phase of expansion continued despite some signs of slowdown in the second and third quarters of 2005-06. The recent uptrend in the industrial production has been one of the longest in the past decade (Box I.5).

Capacity Utilisation

I.2.15 Reflecting the sustained growth in industrial activity, the overall capacity utilisation of the industrial sector is estimated to have increased from 82.2 per cent during 2004-05 to 82.7 per cent during 2005-06. Capacity utilisation is estimated to be above 90 per cent in the case of industries like cotton textiles, wool, silk and man-made fibres, and textile products. Capacity utilisation recorded an improvement, even as capacity additions took place across various industries during the year (Table 1.5).

Infrastructure Industries

I.2.16 The infrastructure sector recorded a subdued performance for the second successive year. Growth in infrastructure industries, which have a weight of 26.7 per cent in the IIP, decelerated from 5.8 per cent during 2004-05 to 5.3 per cent during 2005-06 (Appendix Table 12 and Chart I.3). The deceleration was mainly on account of decline, as noted earlier, in production of crude petroleum largely due to lower production in ONGC oil fields due to break-out of fire in Mumbai-High on July 27, 2005. Among various infrastructure industries, only cement exhibited robust growth (12.3 per cent in 2005-06 as compared with 6.6 per cent in 2004-05), reflecting increased demand from the housing and infrastructure sectors. Substantial increase in exports (48 per cent during 2005-06) also provided a boost to domestic production of cement.

I.2.17 As regards coal, its production was affected severely in the first half of 2005-06 owing to disruption in mining activities in various coal fields caused by heavy downpour in some regions during the monsoon. However, mining activities improved in the second half of the fiscal which facilitated a recovery in coal production. The finished steel sector witnessed some deceleration during the year, which could be partly attributed to higher imports and slowdown in exports. Growth in the production of petroleum refinery products recorded a slowdown due to unscheduled shutdown of certain refineries and some moderation in off-take of petroleum products. The subdued growth in electricity sector, as noted earlier, could be attributed to inadequate availability of coal and gas. Reflecting these trends, production of many infrastructure industries fell short of their targets for 2005-06 (Table 1.6). The fertiliser sector also remained below target due to lacklustre performance both by public and private sector plants on the back of shortage of raw materials and natural gas in a few plants and equipment problems. Natural gas production, however, exceeded the target, even as electricity generation was held down by inadequate supply of gas.

Performance of Central Sector Projects

I.2.18 The number of delayed Central sector projects increased during the year. The delays, largely on account of projects in railways and surface transport sectors, are mainly attributable to factors such as fund constraints, land problems, environmental clearance, and lack of supporting

Box I.5
Growth Cycles in Industrial Production

Macroeconomic variables tend to exhibit cyclical behaviour, displaying phases of expansion and contraction. An analysis of the cyclical fluctuations provides useful information in predicting the sustenance/subsidence of expansion or contraction. For India, several studies such as Chitre (1982), Dua and Banerji (1999), Mall (1999) and Gangopadhyay and Wadhwa (1997) have established synchronous movements in respect of a large number of key economic processes. Mohanty *et al.* (2000) using the composite leading indicator approach found that there have been 13 growth cycles in the Indian economy with varying durations between 1970-71 and 2001-02. According to Nilsson and Brunet (2006), industrial production in India registered seven growth cycles measured from trough to trough over the period 1978-2004 and the average duration of the cycle was 38 months – with the expansion and contraction phases lasting for 20 months and 18 months, respectively.

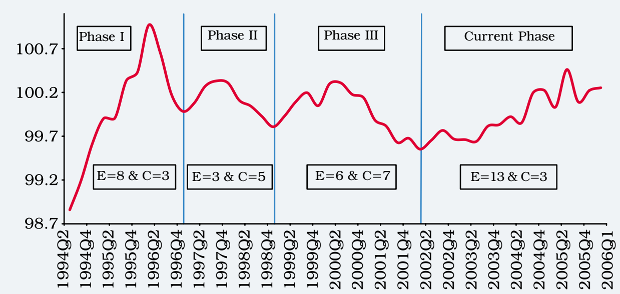
Empirical analysis based on the cyclicity[1] of the IIP growth behaviour since 1994 reveals that the industrial sector in India has seen several upswings and downswings. These can broadly be divided in to four phases (Chart).

Phase I marked eight quarters of expansion (1994Q2 to 1996Q1) which was supported by all round growth of the industrial sector. The cyclical downturn of the industrial sector in 1996Q2 was led by the slowdown in mining and electricity sectors on account of poor performance of crude oil and negative growth in hydro-electricity generation. Recovery in industrial growth in the second phase was supported by improved performance of all the three sub-groups, *viz.*, manufacturing, mining and electricity sectors. However, this recovery phase lasted only for a short while. The industrial sector once again entered recession in 1998 which can be attributed to poor performances by mining and manufacturing sectors in an environment of slowdown in global demand following the Asian crisis.

In the third phase starting from the first quarter of 1999, the industrial sector witnessed some turnaround. Various supportive policies of the Government such as rationalisation of excise duties on intermediate goods and customs duty on imported raw materials, reduction in interest rates and extension of infrastructure status to telecommunications, oil exploration and industrial parks, fiscal incentives, such as tax holidays and concessional duties as well as cut in corporate tax rates across-the-board helped in rejuvenating industrial growth. Subsequently, marked slowdown in manufacturing sector as well as electricity and mining sectors led to the downswing of the industrial sector during 2001-02.

The current phase of industrial resurgence, which started in 2002Q2, was buoyed by sharp rise in the production of capital goods, non-oil imports, higher level of manufacturing exports enabled by global recovery, and higher domestic demand for consumer durables in an environment of softer interest rate regime. Industrial recovery also benefited from growing efficiency and competitiveness of domestic production, emanating from various policy reforms and restructuring of the country's industrial sector since the early 1990s. The current cyclical upturn remains one of the longest in the last decade as it has continued for four years. The IIP growth reached a peak in 2005Q2. Although some signs of slowdown were visible in the third and fourth quarters of 2005, industrial activity recovered in 2006Q1. While contraction in industrial activity during 2005Q3 and 2005Q4 seemed to suggest that industrial growth might lose some of its momentum in the ensuing quarters, the phenomenal growth of capital goods sectors coupled with its imports and increased capacity additions across the industry suggest a buoyant investment climate.

Chart: Growth Cycles in Industrial Production in India



E: Expansion and C: Contraction (In Quarters)

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[1] For obtaining the cyclical components, the IIP series is first adjusted for seasonality using the census X-11 method and the deseasonalised series is then detrended using the Hodrick-Prescott (HP) filter.

Table 1.5: Capacity Utilisation

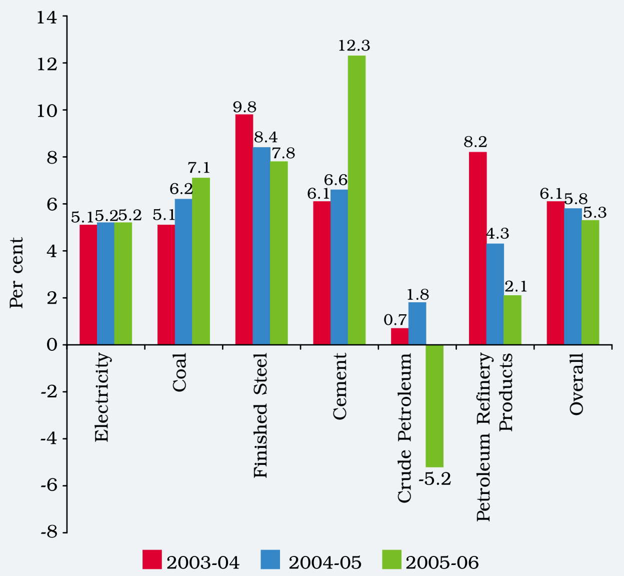
(Per cent)

Industry	Weight	Growth Rate		Capacity Utilisation	
		2004-05	2005-06	2004-05	2005-06
1	2	3	4	5	6
Food products	90.83	-0.9	2.1	66.2	66.0
Beverages, tobacco and products	23.82	10.8	15.9	77.0	84.9
Cotton textiles	55.18	7.4	8.5	91.4	97.4
Wool, silk and man-made fibre textiles	22.58	3.6	0.0	89.2	90.8
Jute and other vegetable fibre textiles	5.90	3.7	0.5	83.6	83.5
Textile products	25.37	19.2	16.3	81.5	92.7
Wood and wood products, furniture	27.01	-9.1	-6.8	81.6	81.0
Paper and products and printing	26.52	9.7	-1.0	82.5	88.7
Leather and leather and fur products	11.39	6.9	-5.6	84.5	79.9
Chemicals and chemical products	140.02	14.3	8.2	81.6	80.5
Rubber, plastic, petroleum and coal	57.28	2.4	4.3	86.5	86.1
Non-metallic mineral products	43.97	1.5	10.6	86.8	83.8
Basic metal and alloy industries	74.53	5.5	15.7	86.3	83.8
Metal products and parts	28.10	5.7	-1.1	71.1	68.8
Machinery and equipment	95.65	19.5	11.8	74.9	75.1
Transport equipment and parts	39.84	3.9	12.7	78.2	82.3
Other manufacturing industries	25.59	17.3	25.0	79.8	71.9
Manufacturing Industry	**793.58**	**9.2**	**9.1**	**80.4**	**80.8**
Mining and Quarrying	**104.73**	**4.4**	**0.9**	**86.1**	**85.9**
Electricity	**101.69**	**5.2**	**5.2**	**92.5**	**94.0**
All Industries	**1000**	**8.4**	**8.1**	**82.2**	**82.7**

Note : 1. Data are provisional.
2. Capacity utilisation has been calculated from the production data for 299 industries supplied by the Ministry of Statistics and Programme Implementation.
3. Capacity utilisation has been estimated using the peak-output approach.

Source : Based on data from Ministry of Statistics and Programme Implementation, Government of India.

Chart I.3: Sector-wise Infrastructure Industries Growth



infrastructure facilities. Although the number of delayed projects has increased, there has been a marked improvement in controlling the cost overrun in respect of ongoing projects. This is reflected in a significant decline in the cost overrun of delayed projects in terms of their original cost: the ratio has declined to 35.6 per cent at end-March 2006 from around 92 per cent in 2001 (Table 1.7). The decline in cost overrun during the recent years is attributable, *inter alia*, to increase in number of projects in surface transport sector with lower cost overrun, decline in anticipated cost over the originally envisaged cost in respect of coal and telecommunication sectors, improved implementation efficiency and, low and stable inflation.

Mergers and Acquisitions

I.2.19 During 2005-06, the process of mergers and acquisitions (M&A) activities gathered further momentum, reflecting efforts at consolidation to face

Table 1.6: Targets and Achievements of Infrastructure Industries

Sector	Unit	2004-05			2005-06		
		Target	Achievement	Gap (%)	Target	Achievement	Gap (%)
1	2	3	4	5	6	7	8
Power	Billion Units	586	587	0.3	620	616	-0.7
Coal	Million Tonnes	365	377	3.3	400	402	0.4
Finished Steel	Million Tonnes	44.1	40.7	-7.6	50.3	44.8	-11.0
Railways	Million Tonnes	600	602	0.3	668	667	-0.1
Shipping (Major Ports)	Million Tonnes	362	384	6.1	425	423	-0.4
Fertilisers	Million Tonnes	16.3	15.3	-6.0	16.2	15.5	-4.4
Cement	Million Tonnes	133	132	-1.1	142	148	4.1
Crude Petroleum	Million Tonnes	33	34	2.5	34	32	-6.6
Petroleum Refinery Products	Million Tonnes	122	127	4.2	129	130	0.8
Natural Gas Production	Million Cubic Meters	30,927	31,774	2.7	30,986	32,205	3.9

Source : Ministry of Statistics and Programme Implementation, Government of India.

enhanced competition. The value involved in acquisition deals increased by over 70 per cent during the year (Table 1.8). Significant activities were also observed in the overseas acquisitions of foreign companies by the Indian corporates. During 2005-06, maximum mergers were witnessed in the financial services, chemical industry, textiles, food and beverages, machinery and trading activities. As regards acquisitions, maximum activity was observed in respect of electronics, financial services, information technology, machinery and textiles. Financial services sector witnessed increased M&A activities in tune with the consolidation in the sector as well as the potential for high growth and steady revenue streams. The M&A activities in the Information Technology Enabled Services (ITES) sector were driven by the greater level of competition and need for economies of scale in order to compete with global IT majors as also by the influx of multinational IT companies for expanding their global reach. In the chemicals sector, drugs and pharmaceuticals segment recorded the highest M&A activities due to the tremendous export potential of the industry, potential for clinical R&D, lower cost production facilities as well as the vastness of the market. M&A activities are expected to remain strong in the coming years as the Indian corporate sector is likely to intensify efforts towards consolidation to reap efficiency gains and scale economies. Financial services, IT, pharmaceutical and manufacturing sectors such as auto components are amongst the sectors likely to see continued high levels of M&A activities in view of growing international interest in India as an outsourcing base.

Investment Climate

I.2.20 The investment intentions registered in Industrial Entrepreneurs Memoranda, after having increased substantially during 2004-05, recorded

Table 1.7: Performance of Central Sector Projects

	March			
	2001	2004	2005	2006
1	2	3	4	5
1. Number of Projects (a to d)	**187**	**286**	**327**	**396**
(a) Ahead	5	28	16	6
(b) On Schedule	58	73	65	113
(c) Delayed	65	112	125	149
(d) Without Date of Commissioning	59	73	121	128
2. Cost Overrun of Total Projects (Rupees crore)	40,303	40,411	39,585	47,337
3. Cost Overrun of Total Projects (% of original cost)	36.4	21.8	19.2	18.2
4. Cost Overrun of Delayed Projects (Rupees crore)	23,374	26,689	25,388	29,655
5. Cost Overrun of Delayed Projects (% of original cost)	91.6	51.8	45.2	35.6

Source : Ministry of Statistics and Programme Implementation, Government of India.

Table 1.8: Mergers and Acquisitions Announced

(Amount in Rupees crore)

Period	Acquisitions				Mergers	
	2004-05		2005-06		2004-05	2005-06
	Number	Amount	Number	Amount	Number	
1	2	3	4	5	6	7
Q1	184	10,980	212	17,014	39	72
Q2	177	5,809	190	26,465	53	102
Q3	231	17,619	201	32,994	79	107
Q4	205	25,874	264	23,804	101	89
Total	**797**	**60,282**	**867**	**1,00,277**	**272**	**370**

Note : Deals include preferential allotments, buy-back of shares and disinvestment proposals, amongst others.
Source : Centre for Monitoring Indian Economy.

further growth during 2005-06, indicative of the buoyancy in investment climate (Table 1.9). Industries such as metallurgical industries, chemicals, fuels, textiles, mechanical industries, electrical equipments and telecommunications which performed well during the year attracted more investment.

Small Scale Industries

I.2.21 Small scale industries (SSI) continued to record steady progress during 2005-06 (Table 1.10). The sector plays a vital role in the growth of the country as it contributes almost 40 per cent of the gross industrial value added in the Indian economy. Almost 44 per cent of the total manufactured exports of the country are directly accounted for by the SSI sector.

Table 1.9: Industrial Investment Proposals

Year	IEMs		LOI/DILs	
	No. of Proposals	Proposed Investment (Rupees crore)	No. of Proposals	Proposed Investment (Rupees crore)
1	2	3	4	5
2001-02	3,094	71,017	102	1,361
2002-03	3,178	80,824	60	332
2003-04	4,130	1,54,954	145	3,454
2004-05	5,548	2,89,782	101	4,309
2005-06	6,341	3,82,743	135	3,638
Cumulative*	**64,207**	**18,77,257**	**4,154**	**1,19,083**

* : August 1991 to March 2006.
IEM : Industrial Entrepreneurs Memoranda.
LOI : Letters of Intent.
DILs: Direct Industrial Licences, which are being issued since November 2003.
Source : Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Government of India.

I.2.22 Industrial production has continued with its momentum during 2006-07 so far registering growth of 10.1 per cent during April-June 2006 (10.4 per cent in April-June 2005). The manufacturing sector with 11.2 per cent growth (the same as a year ago) continued to be the key driver of industrial activity, contributing almost 92.7 per cent of the growth in industry. Electricity and mining sectors continued to record subdued growth. In terms of the use-based classification, capital goods growth remained buoyant (22.9 per cent as compared with 13.8 per cent a year ago), reflecting the strength of investment activity. The production of basic goods rose by 8.8 per cent (7.8 per cent) and that of intermediate goods rose by 9.1 per cent (3.6 per cent). On the other hand, there was deceleration in the growth of consumer goods to 8.2 per cent (18.4 per cent), partly reflecting base effect. Growth in the six infrastructure industries decelerated to 6.3 per cent in April-June 2006 from 7.5 per cent in April-June 2005 on account of slowdown in all industries except petroleum refinery products and coal.

Services Sector

I.2.23 The services sector recorded growth of 10.3 per cent during 2005-06, maintaining the double digit growth recorded in the previous year – and, notably higher than the average growth of 8.6 per cent during the last five years (Table 1.1 and Appendix Table 4). The sector, thus, remained the key driver of growth during 2005-06, contributing almost three-fourths to the overall real GDP growth. The robust performance of the services sector during 2005-06 was led mainly by 'trade, hotels, transport and communication', which contributed almost one-half of the sector's growth (Table 1.11). 'Trade, hotels, transport and communication services' continued to grow at double-digit rates for the third successive year. Activity in the

Table 1.10: Performance of Small Scale Industries

Item	2001-02	2002-03	2003-04	2004-05	2005-06
1	2	3	4	5	6
Number of Units (Million)	10.5	11.0	11.4	11.9	12.3
Employment (Million)	24.9	26.0	27.1	28.3	29.5
Investment (Rupees crore)	1,54,349	1,62,317	1,70,219	1,78,699	1,88113
Value of Output (Rupees crore)	2,82,270	3,11,993	3,57,733	4,18,263	4,71,244 *
Exports (Rupees crore)	71,244	86,013	97,644	n.a.	n.a.

* : Based on April-September 2005 production estimates.
n.a. : Not Available.
Source : Ministry of Small Scale Industries, Government of India.

hotel industry improved significantly, aided by rise in domestic and international tourism, both business as well as leisure. The transport sector recorded a healthy growth during 2005-06 reflecting growth in the revenue earning freight traffic by the railways (10.7 per cent), cargo handled at major ports (10.3 per cent), cargo handled by civil aviation (10.6 per cent) and passengers handled at five major airports (21.6 per cent). Growth in the number of new cell phone connections (89.4 per cent) during 2005-06 also strengthened the services sector. Growth in 'financing, insurance, real estate and business services' benefited from sustained growth in bank credit and deposits, progressive expansion of insurance activity and continued buoyancy in exports of software and other business services. The construction sector exhibited double-digit growth for the third consecutive year, reflecting the focus on infrastructure development and supported by housing activity. Capacity addition across various industries also strengthened the demand for construction services. 'Community, social and personal services', however, recorded deceleration during 2005-06, reflecting the process of fiscal consolidation and increased efficiency in expenditure management.

I.2.24 Reflecting the sustained growth, the share of the services sector (including construction) in the overall GDP of the economy has increased from 46 per cent in 1990-91 to over 60 per cent during 2005-06. The rising share of the services sector in the GDP corresponds to general pattern of growth observed in developed and in some of the emerging market economies (Chart I.4). Although the share of services activity in overall activity has increased in India in line with the international experience, the Indian experience is somewhat atypical, since the share of manufacturing in GDP has remained broadly unchanged. For example, in China, the decline in the share of agriculture from 27 per cent in 1990 to 15 per cent in 2004 was completely cornered by rise in the share of mining, manufacturing and utilities sector from 37 per cent to 46 per cent; the share of the services sector remained stagnant at 37 per cent during the period. Similarly, in the case of Malaysia, decline in agriculture's share from 15 per cent to 10

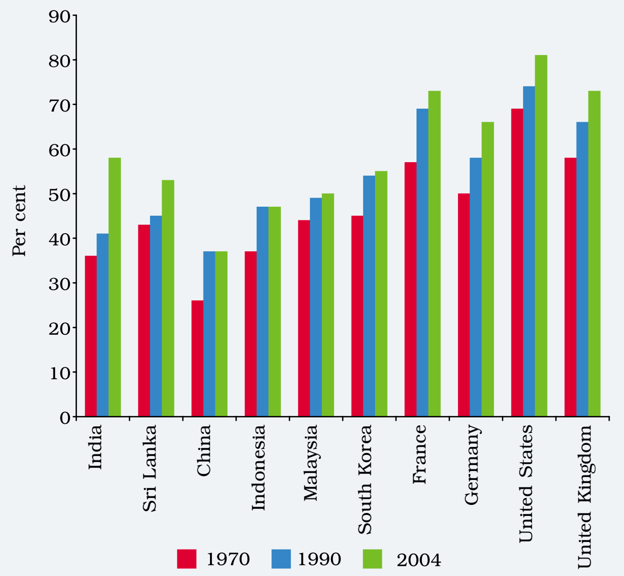
Table 1.11: Performance of the Services Sector

(Per cent)

Sub-sector	Growth Rate						Relative Contribution	
	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2004-05	2005-06
1	2	3	4	5	6	7	8	9
Trade, Hotels, Transport and Communication	7.1	9.2	9.1	12.0	10.6	11.5	44.4	47.8
Financing, Insurance, Real Estate and Business Services	4.1	7.3	8.0	4.5	9.2	9.7	20.5	21.1
Community, Social and Personal Services	4.7	3.9	3.8	5.4	9.2	7.8	22.0	18.3
Construction	6.1	4.0	7.7	10.9	12.5	12.1	13.2	12.8
Services Sector	**5.7**	**6.8**	**7.3**	**8.5**	**10.2**	**10.3**	**100.0**	**100.0**
Memo:								
Shares of Services in GDP	55.8	56.3	58.3	58.3	59.7	60.7		

Source : Central Statistical Organisation.

Chart I.4: Trends in Service Sector's Share in GDP



per cent over the period 1990 to 2004 was absorbed by rise in manufacturing sector's share from 24 per cent to 31 per cent. This is in line with the general pattern of development wherein transformation from agriculture to modern economy is intercepted first by rise of industrial sector and subsequently dominance of services sector prevails with economic maturity. On the other hand, in India, the entire decline in the share of agricultural sector from 41 per cent in 1970-71 to 20 per cent in 2005-06 has been more than absorbed by the services sector, as its share rose from 36 per cent to 61 per cent. Manufacturing sector's share has recorded only a modest rise from around 13 per cent in 1970 to 15 per cent in 2005-06. India has, however, a unique opportunity to be a major global player in both knowledge-based services as well as knowledge-based manufacturing. With a massive human resource base, a large proportion of young people and a strong foundation in technical education, India is well positioned to capitalise on the worldwide potential in the knowledge economy and the services sector is expected to continue to remain the driver of economic growth in India (Box I.6).

I.2.25 The Indian software services sector, including ITES and BPO segments, continued to record strong growth during 2005-06. According to the National Association of Software and Services Companies (NASSCOM), the revenues of the Indian IT sector (including software services, IT-enabled services and hardware) exceeded US $ 36 billion during 2005-06, almost 4.8 per cent of India's GDP (Table 1.12). These revenues were mainly on account of exports of software and services which grew by 33 per cent to reach US $ 23.6 billion during the year. The revenues of the Indian IT sector are largely on account of export revenues; domestic market now accounts for 20 per cent of the total revenues of the Indian industry from software and ITES-BPO services. The total global software and IT services market is estimated to be about $ 1.2 trillion. As India's share is about two per cent, it suggests a strong growth potential. As a result of sustained high growth in software exports as well as other services, India's share in world export of services has trebled from 0.6 per cent in 1995 to 1.8 per cent in 2004.

AGGREGATE DEMAND

I.2.26 Information on the constituents of aggregate demand, available upto 2004-05, indicates that growth remained domestic demand driven, led by consumption as well as investment. Real gross domestic capital formation continued to remain buoyant, recording an increase of over 15 per cent for the third consecutive year. Both private and public investment recorded an acceleration during the year and this was manifested in the rapid rate of growth of credit, improvement in production and import of capital goods, increase in number and value of primary issues and the stock price rally in secondary markets. Consumption expenditure continued to dominate the demand side of national income, although growth rate of total final consumption expenditure recorded some deceleration on account of slowdown in private final consumption expenditure in consonance with some deceleration in real GDP growth during 2004-05 (Table 1.13).

Saving and Capital Formation

I.2.27 The domestic savings rate increased further during 2004-05, driven mainly by improvement in public saving. Gross domestic saving (GDS), as per cent of GDP at current market prices, increased from 28.9 per cent in 2003-04 to 29.1 per cent in 2004-05. Public sector saving – which had witnessed a turnaround in 2003-04 – improved from 1.0 per cent of GDP in 2003-04 to 2.2 per cent in 2004-05, due to lower dis-saving by public authorities as well as increase in savings of non-departmental enterprises. While dis-saving by Government administration declined from 3.7 per cent of GDP in 2003-04 to 2.7 per cent in 2004-05, saving by non-departmental enterprises increased from 4.2 per cent to 4.4 per cent over the same period. The private corporate savings rate improved for the third consecutive year

Box I.6
Services Sector Growth

The conventional wisdom about the stages of development process suggests that an economy evolves from being agriculture-dominated to industry-dominated, and then to services-dominated. History suggests that the dominance of services sector is unlikely to be sustained without strong growth of industry and agriculture (Acharya, 2002).

The Indian growth experience, however, appears to negate the stylised Rostowian stages of growth hypothesis, since transition in India has been marked by the rapid movement from agriculture-dominated growth to services-dominated growth bypassing the stage of industry-dominated growth. In this context, it may be noted that the process of economic growth leads to the creation of new services (*e.g.*, software development), which provide inputs to other sectors. The high-income elasticity of services indicates that as real per capita income rises, the quantity demanded rises more than the quantity of commodities. Trade liberalisation and reforms also have had a positive impact on growth of services. In particular, revolution in information and communication technology (ICT) sectors has imparted tradability to services, which were hitherto considered untradable.

The synergy between services and industry is found to be significant for India[1]. Services can be classified as producer, consumer and Government services[2]. While the producer and consumer services have recorded higher growth rates and shares in the post-reform period, the share of Government services witnessed a decline mainly due to curtailment of revenue expenditure (Table).

The increasing share of producer services reflects the growing complementarity between services and manufacturing (Banga and Goldar, 2004; Hansda, 2001). Concomitantly, there also exists a positive relationship between use of services input and industrial productivity in the manufacturing sector (Banga and Goldar, 2004). In this context, as the cross-country experience suggests, investments in the ICT sectors contribute to productivity gains across other sectors of the economy such as manufacturing. Productivity gains in manufacturing, of course, also reflected benefits of increased competition following the reforms in the 1990s which, *inter alia*, led to declines in import tariffs and domestic barriers to entry.

Table: Growth of Gross Value Added in Services Sector

(Per cent)

Services	1981-82 to 1990-91	1992-93 to 2004-05	2001-02	2002-03	2003-04	2004-05
1	2	3	4	5	6	7
Producer Services	7.7 (67.5)	8.4 (70.0)	8.5 (68.7)	8.9 (69.6)	9.3 (70.4)	9.9 (70.4)
Consumer Services	6.2 (18.1)	8.6 (17.6)	5.5 (18.8)	5.7 (18.6)	6.2 (18.2)	10.7 (18.4)
Government Services	6.5 (14.4)	5.9 (12.4)	2.4 (12.5)	1.1 (11.8)	4.6 (11.4)	8.2 (11.2)

Note : Figures in brackets are shares of sub-sectors in gross value added of services excluding construction.
Source : Central Statistical Organisation.

In brief, evidence suggests that the services activity could be leading to higher growth in manufacturing sector by providing sustained demand for manufactured goods as well as by raising the productivity. Further research is, however, required to have a clearer understanding of the sources and significance of the role of service sectors in propelling India's recent growth and the marked differences in this respect from other countries. In this context, it also needs to be noted that the nature of services sector activity is evolving quite rapidly with the emergence of new services as well as innovations in the delivery of these services. Accordingly, issues of appropriate measurement of services activity in national accounts along with their productivity assume importance.

Services-led growth should, however, not assume a lopsided nature. Policies to accelerate the current pace of growth in manufacturing activity and raise agricultural growth would need to be pursued for a further step-up in the economy's overall growth rate. An economy of India's size and scope cannot ignore the manufacturing sector. A substantial manufacturing base is essential to absorb the workforce moving out of agriculture. Finally, the advanced skill-intensive part of the Indian economy may be bidding up scarce skills in such a way as to slow the growth of labour intensive manufacturing. Greater attention may need to be paid to improve the quality of education so as to enhance the supply of skilled labour.

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[1] LSERVICE = 2.02 + 0.68*LINDUSTRY + 0.67*LSEREXP - 0.97*LPD
[5.04] [7.69] [-2.81]
where LSERVICE = Log of Service Sector Output, LINDUSTRY= Log of Industrial Output, LSEREXP = Log of Service Exports, LPD = Log of Prices of Service. Figures in parentheses are t-statistics.

[2] Trade, transport and communication, financing, insurance, real estate and business services can be categorised as producer services with hotels and restaurants and other services as consumer services. Government services comprise public administration and defence services.

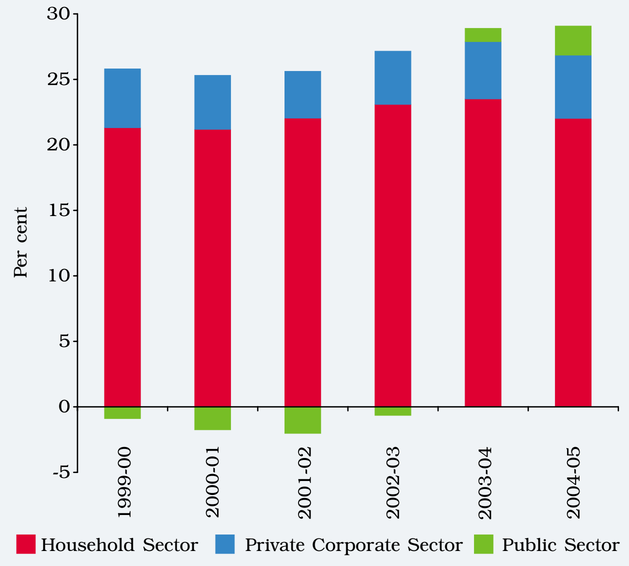
Table 1.12: Performance of Indian IT Sector

Year	Annual Revenue (US $ billion)	Per cent of GDP
1	2	3
1997-98	4.8	1.2
1998-99	6.0	1.5
1999-00	8.2	1.9
2000-01	12.1	2.7
2001-02	13.4	2.9
2002-03	16.1	3.2
2003-04	21.6	3.5
2004-05	28.4	4.1
2005-06	36.3	4.8

Note : IT includes hardware, software and related business service industry.

Source : NASSCOM.

Chart I.5: Sector-wise Saving Rates



(Appendix Table 13 and Chart I.5). From a low of 3.6 per cent in 2001-02, it increased to 4.8 per cent of GDP in 2004-05, reflecting higher retained earnings (Box I.7).

I.2.28 Savings of the household sector, on the other hand, recorded some decline although the sector continued to be the major contributor to total savings, with its share remaining at more than three-fourths in 2004-05 (Box I.8).

I.2.29 While the domestic savings rate improved by 0.2 percentage points of GDP during 2004-05, domestic investment registered a much higher increase of 2.9 percentage points of GDP, reflecting an increased recourse to foreign savings. There was a turnaround in foreign savings – net capital inflows amounted to 1.0 per cent of GDP during 2004-05 as against an outflow of 1.6 per cent of GDP during 2003-04. As a result, domestic investment rate crossed 30 per cent of GDP in 2004-05. In the 1999-2000 series, a new item, 'valuables', which covers expenditures made on acquisition of precious metals and stones as a store of value has been included in the gross capital formation, in line with the recommendations of UNSNA, 1993. A pick up in 'valuables' also helped in acceleration in the investment rate during 2004-05 (Table 1.14).

I.2.30 Preliminary estimates based on the latest available information place financial saving (net) of the household sector in 2005-06 at 11.5 per cent of GDP at current market prices as compared with

Table 1.13: Growth in Select Sources of Real Effective Demand #

(Per cent)

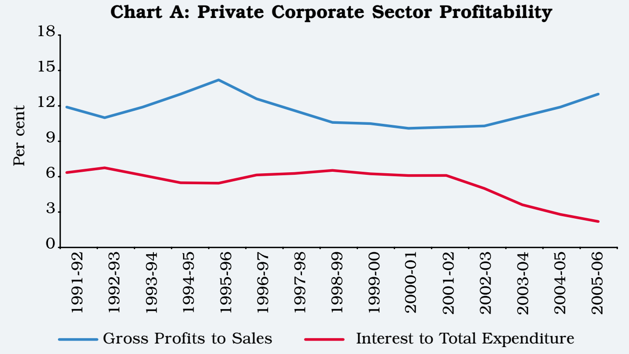
Item	2000-01	2001-02	2002-03	2003-04@	2004-05*
1	2	3	4	5	6
1. Total Final Consumption Expenditure	1.9	5.2	1.2	7.0	6.7
of which:					
Private Final Consumption	2.3	5.9	1.6	7.9	6.3
Government Final Consumption	0.3	1.7	-0.6	2.4	9.2
2. Total Investment +	-4.5	-1.9	16.5	15.8	15.7
Private Investment ++	-4.6	3.8	16.9	10.3	10.4
Public Investment ++	-4.0	3.2	-6.0	11.8	16.7
Valuables $	-8.1	-5.4	-4.1	66.0	54.4
3. Total Fixed Investment	0.0	5.0	9.9	11.3	9.5
of which:					
Private Fixed	-0.6	5.5	13.0	10.5	9.8
Public Fixed	1.3	3.9	2.2	13.7	8.6

\# : Based on select disposition of real GDP at market prices.
@ : Provisional estimates. * : Quick estimates. + : Adjusted for errors and omissions. ++ : Unadjusted for errors and omissions.
$: 'Valuables' covers the expenditures made on acquisition of valuables, excluding works of art and antiques.
Source : Central Statistical Organisation.

Box I.7
Corporate Performance in Recent Years

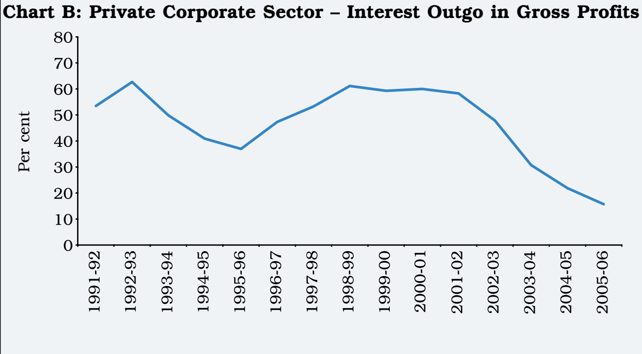
The Indian private corporate sector has witnessed a significant improvement in the financial performance during the period 2003-04 to 2005-06 in terms of key parameters. Growth in gross profits from 2001-02 to 2005-06 outpaced sales growth indicating improvement in profit margin of corporates[1] (Chart A). High level of corporate profitability resulted from two major factors – higher economic activity and declining debt servicing. Lower dependence on borrowed funds also helped in curtailing the interest outgo. The stability of sales growth *vis-à-vis* gross profit growth is also notable, indicating the ability of corporates to cut costs including the debt servicing costs and thereby enhance profit per unit of sales. Furthermore, a steep decline in inventory to sales ratio is observed, which suggests improved efficiency in inventory management thereby reducing working capital requirements.

Chart A: Private Corporate Sector Profitability



The share of interest outgo in gross profits, which averaged over 50 per cent during the 1990s has seen a steady decline since 2002-03 and was 15.7 per cent in 2005-06 (Chart B). Consequently, the share of pre-tax profits in sales steadily increased from below 7 per cent in 1990s to 11.0 per cent in 2005-06.

Chart B: Private Corporate Sector – Interest Outgo in Gross Profits



The decline in interest rates and high profitability in the recent years has led to significant changes in the pattern of funding of the corporate sector. Internal sources are now a major source of funds, thereby reducing the dependence on borrowed funds. Concomitantly, the debt-equity ratio of corporates, which averaged about 69 per cent during 1998-2002, has declined sharply to around 53 per cent in 2004-05 (Chart C). At the same time, the share of bank borrowings in total borrowings shows an increasing trend, suggesting that corporates have undertaken a major debt restructuring exercise, including retiring high cost debt contracted earlier (Chart D).

Chart C: Private Corporate Sector – Financing Pattern

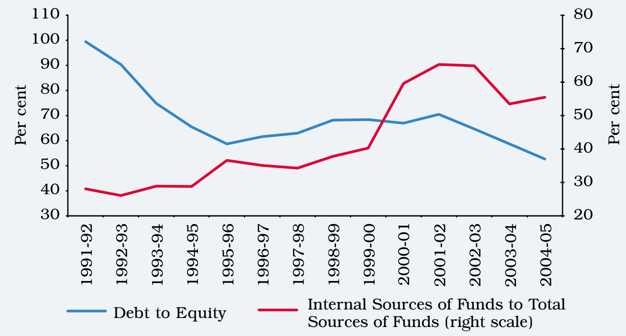
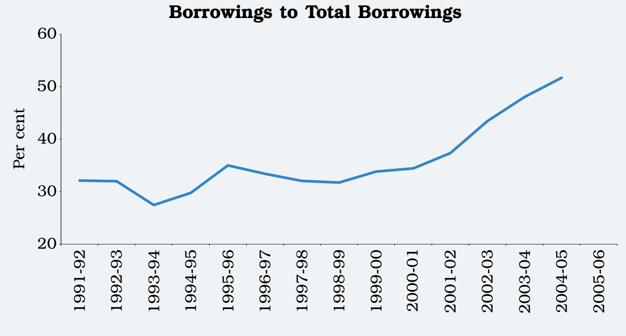


Chart D: Private Corporate Sector – Bank Borrowings to Total Borrowings

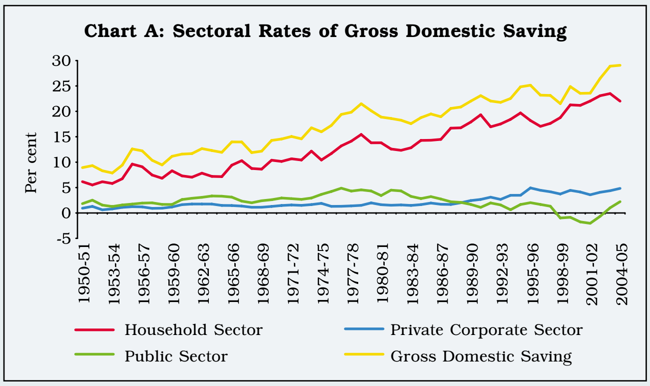


In brief, the strong economic activity as well as a reduction in debt servicing costs in the past few years enabled the corporates to register strong profitability and strengthen their balance sheets. Strong corporate balance sheets are expected to have a positive effect on private investment in the economy. At the same time, they will provide the Indian corporate sector greater flexibility in the years ahead to face enhanced competition as well as increase their capacity to acquire companies, both at home and abroad.

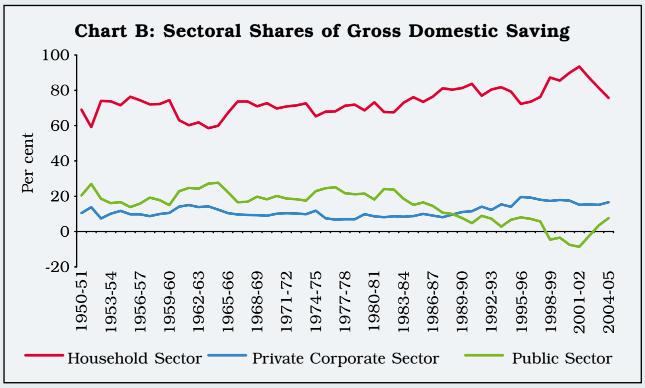
[1] The analysis in this Box is based on RBI studies on company finances using audited annual accounts of selected non-Government non-financial public limited companies.

Box I.8
Evolution of Savings in India

India is one of the high saving economies of the world. The rate of gross domestic savings (GDS) (*i.e.*, GDS as a percentage of GDP at current market prices) has recorded a steady increase since the 1950s. The savings rate has increased from an average of around 10 per cent in the 1950s to over 23 per cent in the 1990s. It crossed 25 per cent in the mid-1990s and reached its highest level of 29.1 per cent in 2004-05 (Chart A).



A large part of the overall improvement in domestic savings has emanated from higher household savings. The rate of household saving – comprising financial and physical savings – increased from around 7 per cent in the 1950s to over 18 per cent in the 1990s. In 2004-05, it stood at 22.0 per cent. Since the 1950s, the household sector has remained the predominant source of the GDS, and it contributed around 76 per cent of total domestic savings in 2004-05 (Chart B). Over time, although both financial and physical savings have recorded an increase, the composition of household savings has seen a shift in favour of financial savings reflecting the spread of banking and financial services across the country. The share of household savings in physical assets – comprising investment in 'construction', 'machinery and equipments' and 'change in stocks'– in the total household saving declined from more than 70 per cent in the 1950s to around 53 per cent in 2004-05. Concomitantly, the share of household financial savings – comprising currency, 'net deposits', 'shares and debentures', 'net claims on government', 'life insurance funds' and 'provident and pension funds' – in the total household savings increased from around 25 per cent in the 1950s to around 47 per cent in 2004-05. The rate of financial saving increased from less than 2 per cent in the 1950s to 10.3 per cent in 2004-05.



Since 2000-01, the household sector has shown some preference for saving in the form of physical assets, which could be attributed partly to the soft interest rate regime in recent years as well as investments in housing. Within financial assets, preference has shifted from savings in the form of shares and debentures and deposits to claims on government and contractual savings. Contractual savings – comprising saving in life insurance funds and provident and pension funds – amounted to 3.8 per cent of GDP during 2000-01 to 2004-05. Demographic variables like life expectancy, literacy rate and dependency ratios have emerged as key determinants of savings in addition to traditional variables like real interest rate, growth, per capita income, spread of banking facility and rate of inflation.

The rate of savings of the private corporate sector increased from around one per cent in 1950s to 1.8 per cent in 1980s and 3.7 per cent in 1990s. By 2004-05, it improved to 4.8 per cent.

The rate of savings of the public sector has witnessed mixed trends. It recorded an increasing trend till the 1970s, but started declining thereafter and turned negative between 1998-99 and 2002-03 owing to sharp deterioration in the savings of the Government administration. From 2003-04 onwards, public savings have turned positive again, mainly reflecting fiscal consolidation. In 2004-05, public savings rate was 2.2 per cent, still less than a half of the peak of almost five per cent touched in 1976-77. Nonetheless, the turnaround of 4.2 percentage points of GDP in public sector savings – from a negative 2.0 per cent of GDP in 2001-02 to a positive 2.2 per cent of GDP in 2004-05 – has been a key factor that has boosted domestic savings from 23.6 per cent to 29.1 per cent over the same period. In particular, the dissaving by Government administration has more than halved from 6.0 per cent of GDP in 2001-02 to 2.7 per cent in 2004-05. This augurs well for the Indian economy as it aims for a higher growth path.

References

1. Athukorala, Prema-Chandra and Kunal Sen (2002), Saving, Investment and Growth in India, Oxford University Press, New Delhi.
2. Reserve Bank of India (2003), Report on Currency and Finance 2001-02.

Table 1.14: Gross Capital Formation

(Per cent of GDP at current market prices)

Item	1999-2000	2000-01	2001-02	2002-03	2003-04@	2004-05*
1	2	3	4	5	6	7
1. Household Sector	10.7	11.0	11.2	12.7	12.0	11.7
2. Public Sector	7.5	6.9	6.9	6.2	6.5	7.2
3. Private Corporate Sector	7.2	5.7	5.6	5.8	6.8	8.2
4. Valuables+	0.8	0.7	0.6	0.6	0.9	1.3
5. Gross Domestic Capital Formation (GDCF) #	26.0	24.2	23.0	25.3	27.2	30.1

@ : Provisional. * : Quick Estimates. + : 'Valuables' covers the expenditures made on acquisition of valuables, excluding works of art and antiques.
# : As GDCF is adjusted for errors and omissions, the sector-wise capital formation figures do not add up to the GDCF.
Source : Central Statistical Organisation.

the revised estimates of 10.1 per cent in 2004-05 (Table 1.15 and Appendix Table 14). Savings in the form of 'currency', 'deposits' and 'investment in shares and debentures', as per cent to GDP, increased in 2005-06. While the rate of 'contractual savings' was the same as in the previous year, that of 'claims on Government' (particularly small savings) decreased. Financial liabilities of the household sector registered a sharp increase due to higher loans and advances principally driven by personal loans to finance consumer durables and increased demand for housing loans. However, it needs to be noted that the fiscal year variations for banking and monetary data for 2005-06 had an additional fortnight (see para I.3.6). For comparability purposes, if the data on currency, bank deposits and credit are adjusted for the additional fortnight, financial savings (net) of the household sector for the year 2005-06 would be placed at 10.7 per cent of GDP at current market prices.

Table 1.15: Household Saving in Financial Assets

(Amount in Rupees crore)

Item	2003-04 P	2004-05 P	2005-06 #
1	2	3	4
A. Financial Assets (Gross)	**3,80,090**	**4,35,706**	**5,88,656**
	(13.8)	**(14.0)**	**(16.7)**
1. Currency	42,675	36,977	51,954
	(1.5)	(1.2)	(1.5)
	[11.2]	[8.5]	[8.8]
2. Deposits@	1,45,657	1,61,416	2,78,985
	(5.3)	(5.2)	(7.9)
	[38.3]	[37.0]	[47.4]
3. Claims on Government	87,372	1,06,420	86,755
	(3.2)	(3.4)	(2.5)
	[23.0]	[24.4]	[14.7]
4. Investment in Shares and Debentures +	492	4,967	29,008
	(0.0)	(0.2)	(0.8)
	[0.1]	[1.1]	[4.9]
5. Contractual Saving**	1,03,895	1,25,926	1,41,954
	(3.8)	(4.0)	(4.0)
	[27.3]	[28.9]	[24.1]
B. Financial Liabilities	**70,732**	**1,21,187**	**1,82,539**
	(2.6)	**(3.9)**	**(5.2)**
C. Saving in Financial Assets (Net) (A-B)	**3,09,358**	**3,14,519**	**4,06,117**
	(11.2)	**(10.1)**	**(11.5)**

P : Provisional. # : Preliminary Estimates.
@ : Comprise bank deposits, non-bank deposits and trade debt (net).
+ : Including units of Unit Trust of India and other mutual funds.
** : Comprise life insurance, provident and pension funds.
Note: 1. Components may not add up to the total due to rounding off.
2. Figures in ( ) indicate per cent of GDP at current market prices and [ ] indicate per cent of financial assets (gross).

I.2.31 To sum up, the Indian economy exhibited strong growth for the third successive year. Real GDP growth has averaged above eight per cent for the past three years. Agriculture sector recorded an improvement, partly reflecting the base effect. A noteworthy feature of 2005-06 was the sustained buoyancy in manufacturing activity, led by both investment and consumption demand. The infrastructure sector, however, continued to record subdued growth. Services activity continued with its double-digit growth, remaining the driver of economic activity. Another positive development was the step-up in investment rate in consonance with an increase in the savings rate, mainly led by higher public sector savings.

III. MONEY, CREDIT AND PRICES

I.3.1 Demand for bank credit remained strong for the second successive year in line with buoyant economic activity. In view of strong credit demand, banks reduced their investments in Government paper. Higher mobilisation of funds through both deposit and non-deposit sources also helped banks to support the enhanced demand for commercial credit. Due to some tightness in the liquidity position during December 2005-March 2006, partly due to the redemption of the India Millennium Deposits (IMDs), the Reserve Bank injected liquidity in the system through Liquidity Adjustment Facility (LAF) operations, unwinding of the balances under the Market Stabilisation Scheme (MSS) and some private placement of Central Government securities.

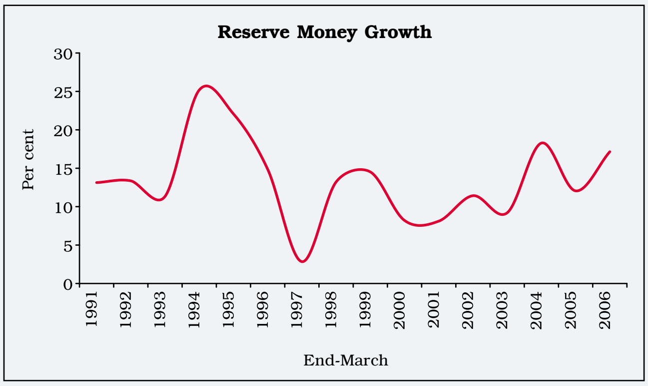
Reflecting the liquidity injection operations, reserve money recorded a higher rate of expansion during 2005-06. Broad money (M_3) growth also recorded acceleration in consonance with higher credit growth and acceleration in overall economic activity. Inflation was contained within the desired trajectory, despite continued pressures from record high international crude oil prices. Pre-emptive monetary policy measures helped to keep inflation expectations low and stable during the year. Less than complete pass-through of higher oil prices, productivity gains and increased competition also enabled to keep inflationary pressures under control.

RESERVE MONEY

I.3.2 Reserve money expanded by 17.2 per cent during 2005-06 as compared with 12.1 per cent during 2004-05. The higher order of reserve money growth reflected the Reserve Bank's liquidity injection operations through LAF repos, unwinding of balances under the MSS and some private placement in an environment of strong credit demand and some tightness emanating from the IMD redemption on December 29, 2005. As a result, the Reserve Bank's net domestic assets (NDA) expanded by Rs.23,737 crore during 2005-06 in contrast to a sizable contraction (Rs.75,754 crore) during the previous year. Foreign currency assets (FCA) (adjusted for revaluation) of the Reserve Bank increased by a lower order (Rs.68,834 crore) during 2005-06 as compared with Rs.1,15,044 crore in 2004-05, partly due to the impact of IMD redemption. Thus, unlike the previous few years, when reserve money growth was driven largely by sizable accretions to foreign exchange reserves, the higher order of reserve money growth during 2005-06 could be attributed largely to a turnaround in net domestic assets. Nonetheless, as at end-March 2006, the Reserve Bank's net foreign exchange assets (NFEA) continued to dominate its asset portfolio (Chart I.6).

I.3.3 Intra-year movements in reserve money reflected the Reserve Bank's liquidity management operations and accretions to foreign exchange reserves. Most of the increase in reserve money took place in the second half of the year, especially the last quarter, mirroring injection of liquidity by the Reserve Bank. Currency in circulation followed the usual seasonal pattern, contracting during the second quarter while expanding in the other quarters. The expansion of reserve money in the first quarter of 2005-06 was primarily due to an increase in net Reserve Bank credit to the Government on account of reversal of reverse repos and reduction in the Centre's surplus investment with the Reserve Bank, partly offset by absorption through the MSS. During the second quarter, the Reserve Bank's foreign currency assets witnessed large increase. Concomitantly, this led to an increase in absorption of liquidity through LAF reverse repos and hence, net Reserve Bank credit to the Centre declined during the quarter. The dynamics of reserve money during the third quarter were driven by net injection of liquidity – initially through reversal of reverse repos and subsequently through repos under the LAF operations as well as through unwinding of the balances under MSS. During the fourth quarter, liquidity conditions were relatively tighter following the IMD redemption and build-up of large Government surplus amidst continued high credit demand. Consequently, the Reserve Bank injected liquidity through LAF repo operations, continued unwinding of MSS, some private placement and purchases of foreign exchange (Table 1.16).

Chart I.6: Reserve Money



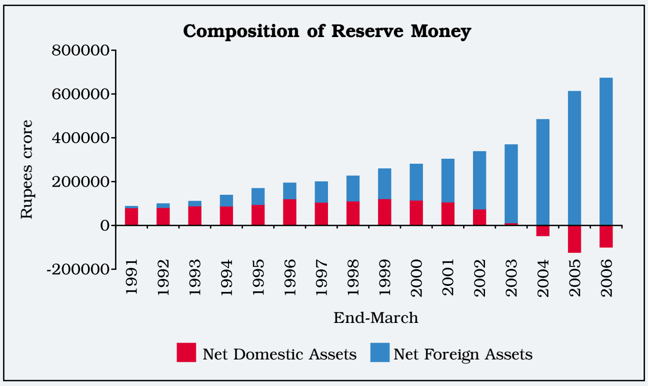


Table 1.16: Variation in Major Components and Sources of Reserve Money

(Rupees crore)

Item	2004-05	2005-06	2004-05				2005-06			
			Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
1	2	3	4	5	6	7	8	9	10	11
Reserve Money	**52,623 (12.1)**	**83,930 (17.2)**	**-6,812**	**-6,285**	**31,546**	**34,174**	**7,177**	**1,062**	**25,440**	**50,251**
Components										
1. Currency in Circulation	41,633	62,015	14,317	-4,166	16,467	15,015	19,877	-9,479	29,154	22,462
2. Bankers' Deposits with RBI	9,631	21,515	-19,665	-2,874	14,769	17,401	-10680	9,780	-2,967	25,382
3. 'Other' Deposits with the RBI	1,359	401	-1,463	755	310	1,757	-2,021	761	-747	2,408
Sources										
1. RBI's net Credit to Government	-62,882	26,111	-34,143	-6,179	184	-22,744	9,275	-25,251	19,879	22,208
of which: to Central Government	-60,177	28,417	-30,029	-4,499	203	-25,852	14,600	-25,251	19,812	19,256
2. RBI's credit to banks and commercial sector	-833	535	-2,985	-740	3,726	-835	1,155	-1,869	101	1,148
3. NFEA of RBI	1,28,377	60,193	57,525	-5,260	31,462	44,651	-14,595	24,823	23,741	26,224
4. Government's Currency Liabilities to the Public	152	1,306	37	9	89	17	384	910	-100	112
5. Net Non-Monetary Liabilities of RBI	12,191	4,215	27,245	-5,885	3,916	-13,085	-10,957	-2,450	18,180	-559
Memo:										
1. Net Domestic Assets	-75,754	23,737	-64,336	-1,025	84	-10,477	21,771	-23,761	1,700	24,027
2. FCA, adjusted for revaluation	1,15,044	68,834	33,160	-3,413	29,858	55,440	5,034	23,665	11,998	28,137
3. NFEA/Reserve Money (per cent) (end-period)	125.3	117.4	126.1	126.7	124.9	125.3	120.5	125.3	123.7	117.4
4. NFEA/Currency (per cent) (end-period)	166.2	156.3	158.8	159.2	160.7	166.2	154.0	164.4	158.4	156.3

NFEA : Net Foreign Exchange Assets. FCA: Foreign Currency Assets.

Note : 1. Data are based on March 31 for Q4 and last reporting Friday for all other quarters.
2. Figures in parentheses are growth rates over the previous year.

I.3.4 The Reserve Bank's net credit to the Centre increased by Rs.28,417 crore during 2005-06 in contrast to a decline of Rs.60,177 crore during 2004-05 (Table 1.17). The increase during the year was mainly on account of the liquidity management operations, rather than passive financing of the Centre's fiscal gap. First, unwinding of the balances under the MSS following the suspension of the issuances under the Scheme from mid-November 2005 led to a decline of Rs.14,541 crore in the Centre's deposits with the Reserve Bank during 2005-06 in contrast to an increase of Rs.72,558 crore on account of large issuances under MSS during 2004-05. Second, the balances under the LAF reverse repos declined by Rs.12,080 crore during 2005-06. Finally, the private placement of Rs.10,000 crore in March 2006 with the Reserve Bank resulted in an increase in the Reserve Bank's holding of dated securities.

Developments during 2006-07

I.3.5 The year-on-year (y-o-y) reserve money expansion was 17.5 per cent as on August 11, 2006, higher than that of 15.3 per cent recorded a year ago. The Reserve Bank's foreign currency assets (adjusted for revaluation), on a y-o-y basis, increased by Rs.75,825 crore as on August 11, 2006 as compared with Rs.1,12,281 crore a year ago. The Reserve Bank's net credit to the Centre increased, y-o-y, by Rs.26,629 crore as against a decline of Rs.43,430 crore in the preceding year.

MONETARY SURVEY

I.3.6 Broad money (M_3) registered a growth of 17.0 per cent during 2005-06 – higher than that of 12.1 per cent during the previous year and above the growth rate of 14.5 per cent projected in the Annual Policy Statement in April 2005 (Chart I.7). In this context, it

Table 1.17: Net Reserve Bank Credit to the Centre – Variations

(Rupees crore)

Item	2004-05	2005-06	2004-05				2005-06			
			Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
1	2	3	4	5	6	7	8	9	10	11
Net Reserve Bank Credit to the Centre (1+2+3+4-5)	**-60,177**	**28,417**	**-30,029**	**-4,499**	**203**	**-25,852**	**14,600**	**-25,251**	**19,812**	**19,256**
1. Loans and Advances	0	0	3,222	-3,222	0	0	0	0	0	0
2. Treasury Bills held by the Reserve Bank	0	0	0	0	0	0	0	0	0	0
3. Reserve Bank's holdings of Dated Securities	12,323	13,869	-2,900	22,176	14,095	-21,048	8,221	-17,243	19,378	3,513
4. Reserve Bank's holdings of Rupee Coins	57	7	175	-10	-94	-14	-40	-33	157	-77
5. Central Government Deposits	72,558	-14,541	30,525	23,443	13,799	4,791	-6,419	7,974	-277	-15,820
Memo *										
6. Market Borrowings of Dated Securities by the Centre #	80,350	1,31,000	28,000	26,000	14,000	12,350	42,000	39,000	24,000	26,000
7. Reserve Bank's Primary Subscription to Dated Securities	1,197	10,000	0	847	0	350	0	0	0	10,000
8. Repos (+) / Reverse Repos (-) (LAF), net position	15,315	12,080	-26,720	34,205	27,600	-19,770	9,660	-14,835	18,635	-1,380
9. Net Open Market Operations {Purchase (+)/ Sales (-)} @	-2,899	-3,913	-429	-427	-871	-1,171	-1,543	-941	-261	-1,168
10. Injection (+)/ Absorption (-) through MSS	-64,211	35,149	-37,812	-14,444	-353	-11,602	-7,470	4,353	19,713	18,552
11. Primary Operations $	-6,625	-33,328	37,353	-30,484	-36,984	23,490	18,205	-24,689	-38,715	11,871

* : At face value. # : Excluding Treasury Bills. $: Adjusted for MSS and Centre's surplus investment.

@ : Excluding Treasury Bills but including Consolidated Sinking Funds (CSF) and other investments.

Note : 1. Quarterly variations are based on March 31 for Q4 and last reporting Fridays for other quarters.

2. In case of rows 8 to 11, (+) sign indicates injection of liquidity to the banking system while (-) sign indicates absorption of liquidity.

Chart I.7: Broad Money Growth

*: Variation over April 1, 2005.

may be noted that data on fiscal year variations in monetary and banking indicators for 2005-06 have been worked out with respect to April 1, 2005 as the base date. Conventionally, the Reserve Bank publishes data on monetary and banking aggregates on a fortnightly basis on alternate Fridays. Variations in monetary and banking aggregates for a particular financial year are worked out in relation to the last reporting Friday of the previous financial year. Thus, variations for banking data during 2005-06 would have been conventionally calculated from March 18, 2005, which was the last reporting Friday of the previous financial year. This would have resulted in the incorporation of data for an additional fortnight in the variations in monetary and banking aggregates for 2005-06 in relation to the same for 2004-05. For meaningful comparison of variations in monetary and banking variables in 2005-06 with those of other years on a financial year basis, April 1, 2005 has been taken as the base date for 2005-06. The expansion of residency-based new monetary aggregate NM_3, at 18.1 per cent during 2005-06, was higher than that in M_3, reflecting the impact of IMD redemption. Based on the recommendations of the Working Group on Money Supply (Chairman: Dr.Y.V. Reddy, 1998), NM_3 is compiled on a residency basis and, therefore, banks' non-resident foreign currency deposits such as FCNR(B) and IMDs are not directly reckoned. Banks' non-resident foreign currency deposits declined by Rs.16,876 crore during 2005-06 as against an increase of Rs.802 crore during 2004-05. The decline during 2005-06 was entirely due to the IMD redemption (US $ 7.1 billion or Rs.31,959 crore) in December 2005. The redemption of the IMDs, therefore, did not have any direct impact on NM_3, and growth in NM_3 was accordingly higher than that in M_3. Liquidity aggregates (L_1, L_2, L_3) also registered a stronger growth during 2005-06 compared with the previous year, mirroring the movements in NM_3. Apart from monetary liabilities of the banking sector, liquidity aggregates include select liabilities of non-bank institutions such as postal department, financial institutions and NBFCs (Table 1.18).

Table 1.18: Monetary Indicators

(Amount in Rupees crore)

	Outstanding as on March 31, 2006	Variation			
		2004-05		2005-06	
		Amount	Per cent	Amount	Per cent
1	2	3	4	5	6
I. Reserve Money	5,73,066	52,623	12.1	83,930 *	17.2 *
II. Broad Money (M_3)	27,29,535	2,45,773 (2,42,260)	12.3 (12.1)	3,96,868	17.0
a) Currency with the Public	4,13,143	40,892	13.0	58,272	16.4
b) Aggregate Deposits	23,09,514	2,03,522 (2,00,009)	12.1 (11.9)	3,38,037	17.1
i) Demand Deposits	4,05,224	26,528	10.3	83,861	26.1
ii) Time Deposits	19,04,290	1,76,994 (1,73,481)	12.4 (12.2)	2,54,176	15.4
of which: Non-Resident Foreign Currency Deposits	59,275	802	1.1	-16,876	-22.2
III. NM_3	27,47,575	2,82,988 (2,44,300)	14.4 (12.5)	4,21,114	18.1
of which: Call/Term Funding from Financial Institutions	83,144	44,853 (9,678)	181.8 (39.2)	11,224	15.6
IV. a) L_1	28,51,364	3,00,247	14.8	5,19,543	22.3
of which: Postal Deposits	1,03,789	17,259	24.2	15,142	17.1
b) L_2	28,54,296	2,96,125	14.5	5,20,352	22.3
of which: FI Deposits	2.932	-4,122	-66.0	809	38.1
c) L_3	28,75,990	2,96,244	14.4	5,22,206	22.2
of which: NBFC Deposits	21,694	118	0.6	1,854	9.3
V. Major Sources of Broad Money					
a) Net Bank Credit to the Government	7,69,093	13,863 (1,670)	1.9 (0.2)	20,386	2.7
b) Bank Credit to Commercial Sector	16,90,961	2,64,098 (2,31,216)	26.0 (22.8)	3,59,703	27.0
c) Net Foreign Exchange Assets of Banking Sector	7,26,194	1,22,669	23.3	78,291	12.1
Memo :					
Scheduled Commercial Banks' Aggregate Deposits	21,09,049	1,95,782 (1,92,269)	13.0 (12.8)	3,23,913	18.1
Scheduled Commercial Banks' Non-food Credit	14,66,386	2,54,484 (2,21,602)	31.6 (27.5)	3,54,193	31.8

FIs : Financial Institutions. NBFCs : Non-Banking Financial Companies. * : Variation over March 31, 2005.

NM_3 is the residency-based broad money aggregate and L_1, L_2 and L_3 are liquidity aggregates compiled on the recommendations of the Working Group on Money Supply (Chairman: Dr. Y.V. Reddy, 1998). Liquidity aggregates are defined as follows:

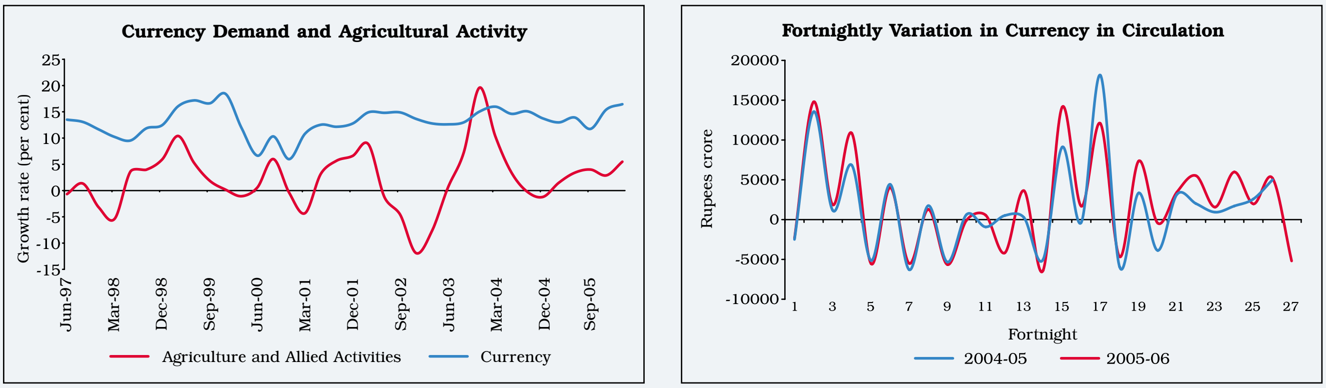
L_1 = NM_3 + Select deposits with the post office saving banks.

L_2 = L_1 +Term deposits with term lending institutions and refinancing institutions (FIs) + Term borrowing by FIs + Certificates of deposits issued by FIs.

L_3 = L_2 + Public deposits of non-banking financial companies.

Note : 1. Data are provisional.
2. Figures in parentheses are adjusted for the effect of conversion of a non-banking entity into a banking entity on October 11, 2004.
3. Data on variation for 2005-06 are variations between April 1, 2005 and March 31, 2006 unless otherwise stated.

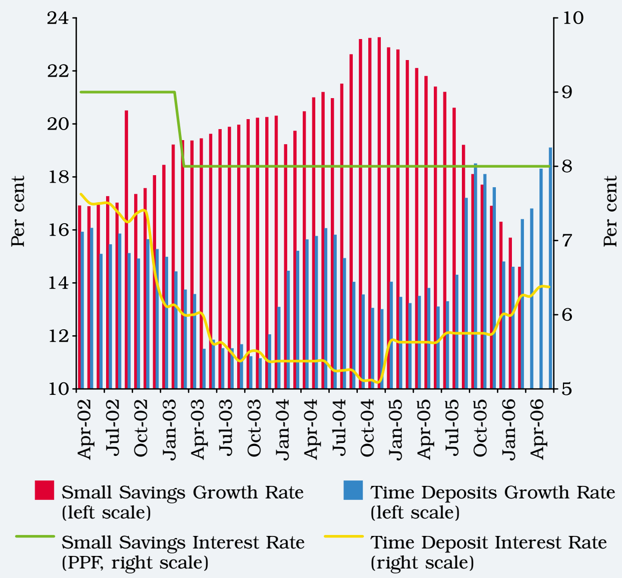
Chart I.8: Currency with the Public



I.3.7 Demand for currency accelerated during 2005-06 to 16.4 per cent from 13.0 per cent during the previous year, in consonance with higher economic activity, particularly recovery in agricultural activity. Currency demand broadly exhibited the usual intra-year seasonal pattern, increasing during festival seasons and initial part of the month (Chart I.8).

I.3.8 Both demand and time deposits registered higher growth during 2005-06. Acceleration in demand deposit growth could be attributed to a variety of factors such as sharp rise in non-food credit, higher resource mobilisation through the primary capital market, and large mobilisation by domestic mutual funds, with funds getting temporarily parked in demand deposits pending utilisation. Growth in time deposits picked up from the second quarter of 2005-06, benefiting from the rise in deposit rates over the course of the year as well as the base effects. The blip in the growth rate of time deposits in the month of January 2006 reflected the bullet repayment of the maturity proceeds of the IMDs. Concomitantly, growth in postal small savings moderated to 14.6 per cent as at end-March 2006 from its recent peak of 23.3 per cent in December 2004 (Chart I.9). The increase in time deposits during 2005-06 was mainly on account of short-term wholesale deposits of up to one year maturity. Banks' deposit mobilisation efforts during the year thus seem to have turned in favour of non-core bulk deposits of corporates instead of core retail deposits, with a potential for adverse consequences for balance sheet management and profitability.

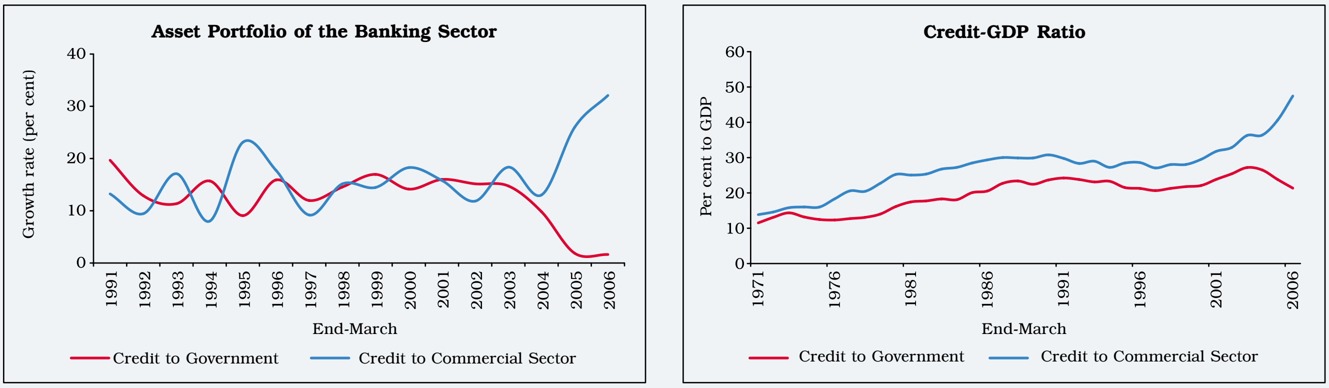
Chart I.9: Time Deposits and Small Savings



Sources of Money

I.3.9 Sustained acceleration in demand for bank credit from the commercial sector on top of a high base was witnessed during 2005-06. Growth in bank credit to the commercial sector accelerated from 22.8 per cent during 2004-05 to 27.0 per cent during 2005-06. Scheduled commercial banks' (SCBs') non-food credit increased by 31.8 per cent in 2005-06, after having recorded an increase of 27.5 per cent in 2004-05. Food-credit increased by Rs.675 crore during 2005-06. Although, as noted above, deposit growth picked up during the year, credit growth still outpaced deposit growth during 2005-06. As a result, incremental credit deposit ratio of SCBs remained mostly above 100 per cent during 2005-06. With credit growth outpacing nominal GDP growth by a large margin for the second successive year, credit-GDP ratio continued with its upward trend (Chart I.10). Credit-GDP ratio has increased from 30 per cent as at end-March 2000 to 41 per cent at end-March 2005 and further to 48 per cent at end-March 2006. While

Chart I.10: Bank Credit to Commercial Sector



availability of bank credit is critical to support investment and growth, evidence suggests that sharp growth in credit can be a cause of policy concern (see Box III.1). Cross-country analysis indicates that credit-GDP ratio in India is lower than major advanced economies as well as most East Asian economies. On the other hand, the ratio in India is higher than that of some EMEs such as Indonesia, Brazil, Mexico, Philippines, Russia and Sri Lanka. Since 2000, the increase in credit-GDP ratio in India has been, however, higher than many East Asian economies (Table 1.19).

I.3.10 In view of the credit demand remaining high, banks liquidated part of their excess holdings of Government securities. The gilt portfolio of commercial banks declined by Rs.19,514 crore during 2005-06 in contrast to an increase of Rs.52,031 crore (net of conversion effect) during the previous year. Accordingly, commercial banks' holding of Government and other approved securities declined to around 31 per cent of their net demand and time liabilities (NDTL) as on March 31, 2006 from around 38 per cent a year ago, *albeit* still higher than

Table 1.19: Credit to Private Sector

(Per cent to GDP)

Country	1980	1990	1995	2000	2001	2002	2003	2004
1	2	3	4	5	6	7	8	9
Brazil	42	39	37	36	35	36	35	35
Chile	47	47	54	63	63	65	62	63
China	53	88	85	112	111	119	127	120
Hong Kong, China	..	164	153	156	155	151	152	150
India	25	30	29	32	33	37	37	41
Indonesia	9	47	54	20	18	19	21	24
Korea	51	63	61	91	95	101	103	98
Malaysia	49	69	124	140	149	146	141	130
Mexico	19	17	29	18	16	19	17	17
Philippines	42	22	45	44	40	37	36	35
Russian Federation	..	..	9	13	16	18	21	25
Singapore	81	97	106	111	130	114	115	107
Sri Lanka	17	20	31	29	28	29	30	32
Thailand	41	83	140	108	97	103	103	97
United Kingdom	28	116	115	133	138	142	148	156
United States	112	144	173	231	225	212	236	249
Region								
East Asia and Pacific	41	74	86	99	99	104	110	105
Europe and Central Asia	..	..	17	22	22	22	24	27
Latin America and Caribbean Islands	33	29	31	28	26	27	25	26
Middle East and North Africa	32	35	31	39	41	41	40	40
World	77	108	118	134	134	130	136	138

.. : Not available.

Source : World Development Indicators Database, World Bank; and Reserve Bank of India.

Table 1.20: Scheduled Commercial Banks' Non-SLR Investments

(Rupees crore)

Instrument	Outstanding as at end-March		
	2004	2005	2006
1	2	3	4
1. Commercial Paper	3,770	3,891	4,821
2. Units of UTI and other Mutual Funds	11,808	12,623	10,345
3. Shares issued by	9,696	13,427	15,044
3.1 Public Sector Undertakings	1,272	1,613	2,274
3.2 Private Corporate Sector	7,395	10,288	10,501
3.3 Public Financial Institutions	1,029	1,525	2,270
4. Bonds/debentures issued by	1,12,371	1,13,695	1,03,170
4.1 Public Sector Undertakings	48,646	45,937	32,345
4.2 Private Corporate Sector	27,903	31,934	29,523
4.3 Public Financial Institutions	30,704	29,190	26,402
4.4 Others	5,118	6,633	14,899
Total (1+2+3+4)	1,37,644	1,43,636	1,33,380
Memo :			
Bank Credit	8,40,785	11,00,428	15,07,077

Note : Excluding Regional Rural Banks.

Table 1.21: Scheduled Commercial Banks Survey

(Amount in Rupees crore)

Item	Variation			
	2004-05		2005-06*	
	Amount	Per cent	Amount	Per cent
1	2	3	4	5
Sources of Funds				
I. Aggregate Deposits	1,92,269	12.8	3,23,913	18.1
II. Call/Term Funding from Financial Institutions	9,678	39.2	11,224	15.6
III. Overseas Foreign Currency Borrowings	8,529	49.8	1,295	4.5
IV. Capital and Reserves	29,135	27.9	40,320	29.3
Uses of Funds				
I. Bank Credit	2,26,761	27.0	3,54,868	30.8
II. Investments in Government Securities	52,031	7.9	-19,514	-2.7
III. Investments in Other Approved Securities	-2,658	-11.6	-3,295	-16.5
IV. Foreign Currency Assets	-8,295	-24.1	14,059	47.8
V. Balances with Reserve Bank	19,108	27.7	34,077	36.6

* : Variation over April 1, 2005.

Note : 1. Data are provisional.

2. Variations of select aggregates are adjusted for the effect of conversion of a non-banking entity into a banking entity on October 11, 2004.

the statutory requirement of 25 per cent. On the other hand, the Reserve Bank's net credit to the Government, as noted earlier, increased during 2005-06 reflecting the liquidity injection operations. As a result, the overall net bank credit to Government (*i.e.*, including the Reserve Bank and commercial and co-operative banks) increased by Rs.20,386 crore during 2005-06 as compared with Rs.1,670 crore in 2004-05.

I.3.11 In addition to liquidating a part of their gilt portfolio, banks also reduced their non-SLR investments (especially, investments in the bonds/ debentures issued by various corporate entities) by Rs.10,256 crore during 2005-06 (Table 1.20). Non-food credit extended by scheduled commercial banks, including their non-SLR investments, increased by 27.3 per cent during 2005-06 as compared with 24.1 per cent, net of conversion, during 2004-05.

I.3.12 Apart from higher deposit mobilisation and liquidating their gilt as well as non-SLR investments, banks were able to finance higher demand for bank credit by raising funds from the primary market and internal accruals. Continued recourse to call/term funding as well as issuances of subordinate Tier II bonds also provided funds to banks to finance higher credit demand (Table 1.21).

I.3.13 On a quarterly basis, operations of scheduled commercial banks display certain important features. As the reporting Fridays for end-September and end-March during 2005-06 fell on September 30, 2005 and March 31, 2006 (coinciding with half yearly and yearly closing, respectively), the second and the fourth quarter data show sharp increases *vis-à-vis* the other quarters as well as the corresponding quarters of the previous year (Table 1.22).

I.3.14 Sectoral deployment of credit indicates that demand for retail credit is emerging as a major component of bank credit. During 2005-06, almost 27 per cent of the incremental bank credit was absorbed by the retail sector (mainly on account of loans for housing). Industry accounted for another 30 per cent of the incremental credit while agricultural sector absorbed 12 per cent of the incremental credit (Chart I.11).

Table 1.22: Operations of Scheduled Commercial Banks

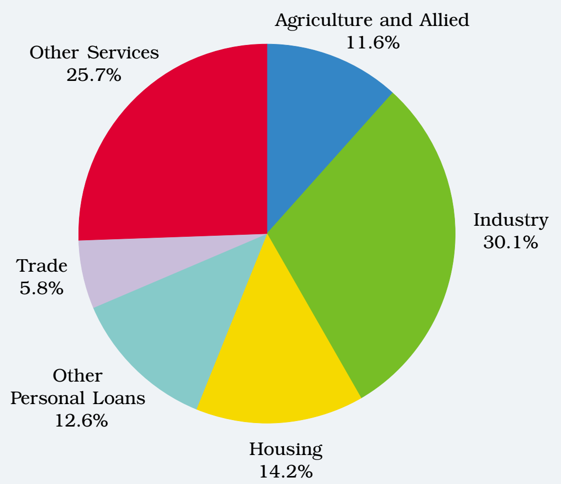
(Rupees crore)

	Outstanding as on March 31, 2006	Variation 2004-05 Q1	Q2	Q3	Q4	Variation 2005-06 Q1*	Q2	Q3	Q4
1	2	3	4	5	6	7	8	9	10
Components									
1. Aggregate Deposits of Residents (a+b)	20,49,773	57,050	21,232	38,447	78,251	7,145	1,29,596	13,065	1,90,983
a) Demand Deposits	3,64,640	-12,155	2,277	15,280	17,604	-22,249	41,167	-3,430	63,135
b) Time Deposits of Residents	16,85,133	69,206	18,955	23,167 (19,654)	60,647	29,394	88,430	16,495	1,27,848
2. Call/Term Funding from Financial Institutions	83,144	5,409	530	35,464 (289)	3,451	-1,002	7,359	1,836	3,031
Sources									
1. Credit to the Government	7,00,742	40,056	-9,546	-5,918 (-18,111)	39,632	-1,457	18,324	-25,068	-11,314
2. Credit to the Commercial Sector (a to d)	16,63,499	32,884	40,538	1,08,835 (75,953)	79,929	12,862	1,04,416	53,032	1,72,011
a. Bank Credit	15,07,077	38,085	41,605	1,07,402	72,551	8,994	1,15,035	62,858	1,67,981
Food Credit	40,691	7,100	-4,872	5,590	-2,659	4,788	-5,255	1,464	-322
Non-food Credit	14,66,386	30,985	46,477	1,01,812	75,210	4,206	1,20,290	61,394	1,68,303
b. Net Credit to Primary Dealers	4,369	-678	977	-923	125	7,130	-2,759	1,128	-2,913
c. Investments in Other Approved Securities	16,712	-184	-561	-1,232	-680	-532	-10	-736	-2,017
d. Other Investments (in non-SLR Securities)	1,35,340	-4,339	-1,482	3,587	7,933	-2,730	-7,851	-10,218	8,961
3. Net Foreign Currency Assets of Commercial Banks (a-b-c)	-45,616	-6,706	904	-3,172	-8,652	-2,057	-4,850	9,935	26,612
a. Foreign Currency Assets	43,494	-2,741	56	2,441	-8,051	-2,179	-1044	11,169	6,114
b. Non-resident Foreign Currency Repatriable Fixed Deposits	59,275	953	-189	-654	692	804	187	1,856	-19,723
c. Overseas Foreign Currency Borrowings	29,834	3,012	-658	6,267	-90	-925	3,618	-622	-775
4. Net Bank Reserves	1,38,619	10,392	-3,644	14,151	-1,267	3,060	9,679	-2,886	25,729
5. Capital Account	1,77,727	14,884	1,393	9,435	3,423	20,359	2,530	9,342	8,090

* : Variation over April 1, 2005.

Note : 1. Data relate to last reporting Friday of each quarter.
2. Figures in parentheses are adjusted for the effect of conversion of a non-banking entity into a banking entity on October 11, 2004.

Chart I.11: Incremental Bank Credit during 2005-06



I.3.15 Growth in credit to industry was mainly accounted for by infrastructure (transport, power, roads, port, telecommunication, *etc.*), construction, textiles, iron and steel, chemicals, petroleum, vehicles, gems and jewellery, engineering and food-processing industries (Table 1.23 and Appendix Table I.22). Infrastructure sector alone absorbed around one-fourth of incremental credit to the industry, while textiles and iron and steel together bagged another one-fourth of the incremental credit. Credit to agriculture sector also accelerated reflecting the various initiatives to increase the flow of credit to the sector. Housing sector continued to be a key driver of bank credit – recording a growth of 44.8 per cent during 2005-06 and absorbing around 14 per cent of the incremental bank credit (Box I.9). Rising disposable incomes, low interest rates and tax incentives have sustained demand for housing in the recent years. Credit to commercial real estate continued to grow at a fast pace.

Table 1.23: Sectoral Deployment of Non-food Gross Bank Credit

(Amount in Rupees crore)

Sector/Industry	Outstanding as on March 31, 2006	Variation 2004-05 (March 18, 2005 over March 19, 2004)		Variation 2005-06 (March 31, 2006 over March 18, 2005)	
		Absolute	Per cent	Absolute	Per cent
1	2	3	4	5	6
Non-food Gross Bank Credit (1 to 6)	**14,05,146**	**1,88,069**	**25.8**	**4,05,358**	**40.5**
1. Agriculture and Allied Activities	**1,72,292**	**31,774**	**35.1**	**47,042**	**37.6**
2. Industry (Small, Medium and Large)	**5,49,057**	**62,014**	**19.8**	**1,22,165**	**28.6**
Small Scale Industries	90,239	8,051	12.2	15,651	21.0
3. Services	**48,137**	n.a.	n.a.	**17,553**	**57.4**
Transport Operators	16,101	n.a.	n.a.	6,502	67.7
Professional & Others	16,070	n.a.	n.a.	2,809	21.2
4. Personal Loans	**3,53,777**	n.a.	n.a.	**1,08,697**	**44.4**
Consumer Durable	8,783	108	1.3	-300	-3.3
Housing	1,86,429	n.a. (23,192)	n.a. (44.6)	57,701	44.8
Advances against Fixed Deposits	34,897	3,259	12.4	5,047	16.9
Advances to Individuals against share, bonds, *etc.*	5089	366	18.1	972	23.6
Credit Cards Outstanding	9,177	n.a.	n.a.	3,417	59.3
Education	10,057	n.a.	n.a.	4,938	96.5
5. Trade	**81,402**	**31,262**	**125.7**	**23,454**	**40.5**
6. Others	**2,00,481**	n.a.	n.a.	**86,447**	**75.8**
Real Estate Loans	26,682	7,622	136.7	13,380	100.6
Non-Banking Financial Companies	30,942	2,501	14.9	8,458	37.6
Memo :					
Priority Sector	**5,09,910**	**1,06,235**	**40.3**	**1,28,434**	**33.7**
Industry (Small, Medium and Large)	**5,49,057**	**62,014**	**19.8**	**1,22,165**	**28.6**
Food Processing	30,843	1,109	5.4	6,410	26.2
Textiles	57,716	4,648	13.6	13,739	31.2
Petroleum, Coal Products & Nuclear Fuels	24,103	1,426	10.6	8,534	54.8
Chemical and Chemical Products	48,935	1,661	5.4	9,443	23.9
Iron and Steel	50,358	3,120	11.9	14,384	40.0
Other Metal and Metal Products	14,436	1,938	23.7	2,800	24.1
All Engineering	34,666	273	1.0	5,270	17.9
Vehicles, Vehicle Parts and Transport Equipments	18,667	2,990	54.7	6,805	57.4
Gems and Jewellery	19,866	3,013	32.8	5,560	38.9
Construction	13,867	1,708	28.6	5,745	70.7
Infrastructure	1,08,787	21,829	42.5	29,778	37.7

n.a. : Not Available.

Note : 1. Data are provisional and relate to select scheduled commercial banks which account for over 90 per cent of bank credit of all scheduled commercial banks.

2. Owing to change in classification of sectors/industries and coverage of banks, data for 2005-06 are not comparable with earlier data. Figures in parentheses for 2004-05 pertain only to housing loans of above Rs.15 lakh. Data on housing loans for 2005-06, on the other hand, are also inclusive of loans less than 15 lakhs.

I.3.16 In addition to increased recourse to bank credit, the corporate sector also resorted to other sources of funding – both domestic and foreign – to meet their financing needs. Amongst domestic sources, buoyant domestic capital markets provided corporates an opportunity to raise funds through primary capital market issuances. Funds raised through issuances of commercial paper, however, turned negative in view of some tightness in domestic markets. Amongst foreign sources, funds mobilised through ADR/GDR issues more than doubled. Funds raised through external commercial borrowings also

Box I.9
Drivers of Credit Growth

Sustained demand for bank credit has characterised the Indian banking system in the past four years in consonance with the upturn in economic activity. Non-food credit extended by scheduled commercial banks (SCBs) recorded an average annual growth of 26.1 per cent between 2002-03 and 2005-06, notably higher than that of 14.5 per cent recorded during the preceding four-year period (1998-99 to 2001-02) as well as the long-run average of 17.8 per cent (1970-2006). The recent acceleration in credit growth could be partly attributed to the step-up in real GDP growth from 5.7 per cent between 1998-99 and 2001-02 to 7.1 per cent between 2002-03 and 2005-06. Empirical evidence indicates that credit demand is strongly influenced by economic activity. For the period since mid-1970s, income elasticity of (real) credit demand is estimated to be 1.6[1]. In recent years, growth in credit demand has outpaced the growth that would have emanated from the historical relationship between credit and economic activity. Decline in interest rates in the recent years could have also boosted demand for credit. The stagnation in credit flow observed during the late 1990s, in retrospect, was partly caused by reduction in demand on account of increase in real interest rates, turn down in the business cycle, and the significant business restructuring that occurred during that period (Mohan, 2006).

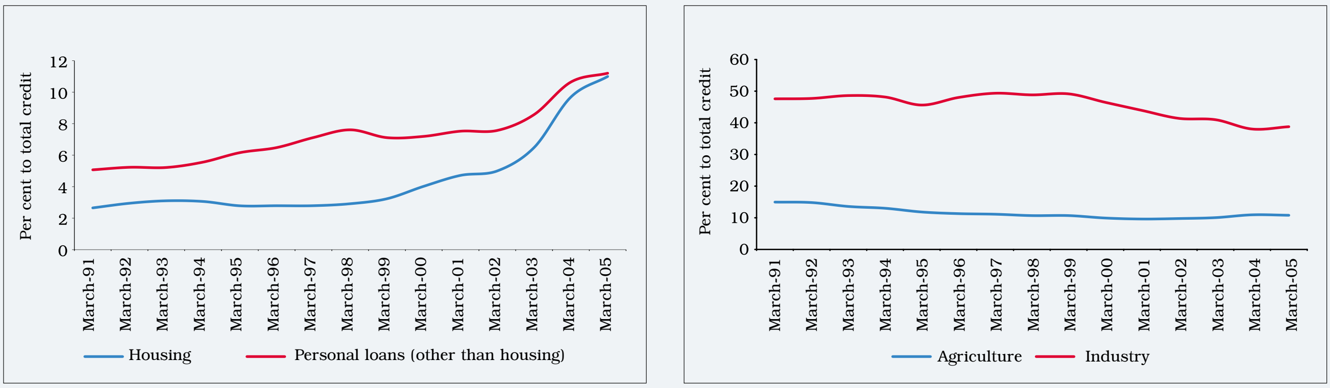
The sharp expansion in credit in recent years also reflects, in part, policy initiatives to improve flow of credit to sectors like agriculture. Thus, growth of credit to agriculture accelerated from 10.7 per cent during 1990s to 24.9 per cent between 2002-03 and 2004-05[2]. Similarly, demand for credit by industry has shown a recovery in the current cyclical upturn. Growth of credit to the industrial sector accelerated from 15.6 per cent during 1990s to 18.5 per cent between 2002-03 and 2004-05. Increasingly, retail credit led by demand for housing loans has emerged as a driver of growth in bank credit. Credit to housing sector recorded an increase of 57.3 per cent during 2002-05, well-above the growth recorded in the overall non-food credit over the same period. As a result, the share of housing credit in overall credit extended by SCBs has increased from 2.4 per cent at end-March 1990 to 11.0 per cent at end-March 2005. Retail credit growth has also emanated from increased use of credit cards, loans for consumer durables and demand for education loans (Chart). The share of non-housing retail credit has increased from four per cent at end-March 1990 to around 11 per cent at end-March 2005. Thus, the share of total retail credit in bank credit has increased from 6.4 per cent to over 22 per cent in the past 15 years. The share of agriculture in total credit, which had declined from 15.9 per cent at end-March 1990 to 9.6 per cent at end-March 2001 has since recovered to 10.8 per cent by end-March 2005. The share of industry in total credit has continued to decline, falling to 38.8 per cent by March 2005 from its recent peak of 49.1 per cent in March 1999.

Demand for bank credit is expected to remain buoyant. With their investments in SLR securities fast approaching the statutory requirement, banks will need to intensify efforts to mobilise higher deposits through stable sources in order to be able to finance higher credit requirements. At the same time, in the light of high credit growth, a need is recognised to ensure that asset quality is maintained.

Reference

Mohan, Rakesh (2006), “Financial Sector Reforms and Monetary Policy: The Indian Experience”, Reserve Bank of India Bulletin, July.

Chart : Bank Credit by SCBs – Sectoral Shares



[1] Using annual data from 1975-76 to 2004-05, the estimated long-run relationship in an autoregressive distributed lag (ARDL) model of order (1,0,0) is as follows: LRNFC = -12.6 + 1.65 LGDPR – 0.12 AVGRATE,

(10.6) (16.9) (2.3)

where, LRNFC, LGDPR and AVGRATE denote (log of) real non-food credit, (log of) real GDP and weighted average lending rate of scheduled commercial banks, respectively. Figures in parentheses are t-statistics.

[2] Data on sectoral deployment of credit in this Box are based on Basic Statistical Returns of Scheduled Commercial Banks in India.

Table 1.24: Key Sources of Funds to Corporates

(Rupees crore)

Item	Variation during	
	2004-05	2005-06
1	2	3
A. Bank Credit to Industry #	62,014	1,22,165
B. Flow from Non-banks to Corporates		
1. Capital Issues (i+ii)	10,456	13,781
i) Non-Government Public Ltd. Companies (a+b)	7,772	13,408
a) Bonds/Debentures	0	245
b) Shares	7,772	13,163
ii) PSUs and Government Companies	2,684	373
2. ADR/GDR Issues	2,960	7,262
3. External Commercial Borrowings (ECBs)	39,517	40,496
4. Issue of CPs	4,734	-1,517
C. Depreciation Provision +	22,697	28,883
D. Profit after Tax +	39,599	67,506

: Data pertain to select banks which account for over 90 per cent of bank credit of all scheduled commercial banks.

+ : Data are based on audited/unaudited abridged results of select non-financial non-Government companies.

Note : 1. Data are provisional.
2. Data on capital issues pertain to gross issuances excluding issues by banks and financial institutions. Figures are not adjusted for banks' investments in capital issues, which are not expected to be significant.
3. Data on ADR/GDR issues exclude issuances by banks and financial institutions.
4. Data on external commercial borrowings include short-term credit. Data for 2005-06 are exclusive of the IMD redemption.

remained steady, reflecting investment demand in the economy even as interest rates in international financial markets edged up over the course of the year. Internal accruals in view of robust profitability continued to remain an important source of funds to corporates (Table 1.24).

Developments during 2006-07

I.3.17 On a y-o-y basis, growth in broad money (M_3) accelerated to 19.1 per cent on August 4, 2006 from 14.4 per cent a year earlier reflecting the impact of sustained credit demand. Scheduled commercial banks' non-food credit registered a growth of 32.2 per cent as on August 4, 2006 on top of 31.2 per cent a year back while growth in aggregate deposits accelerated to 20.9 per cent from 15.8 per cent a year ago.

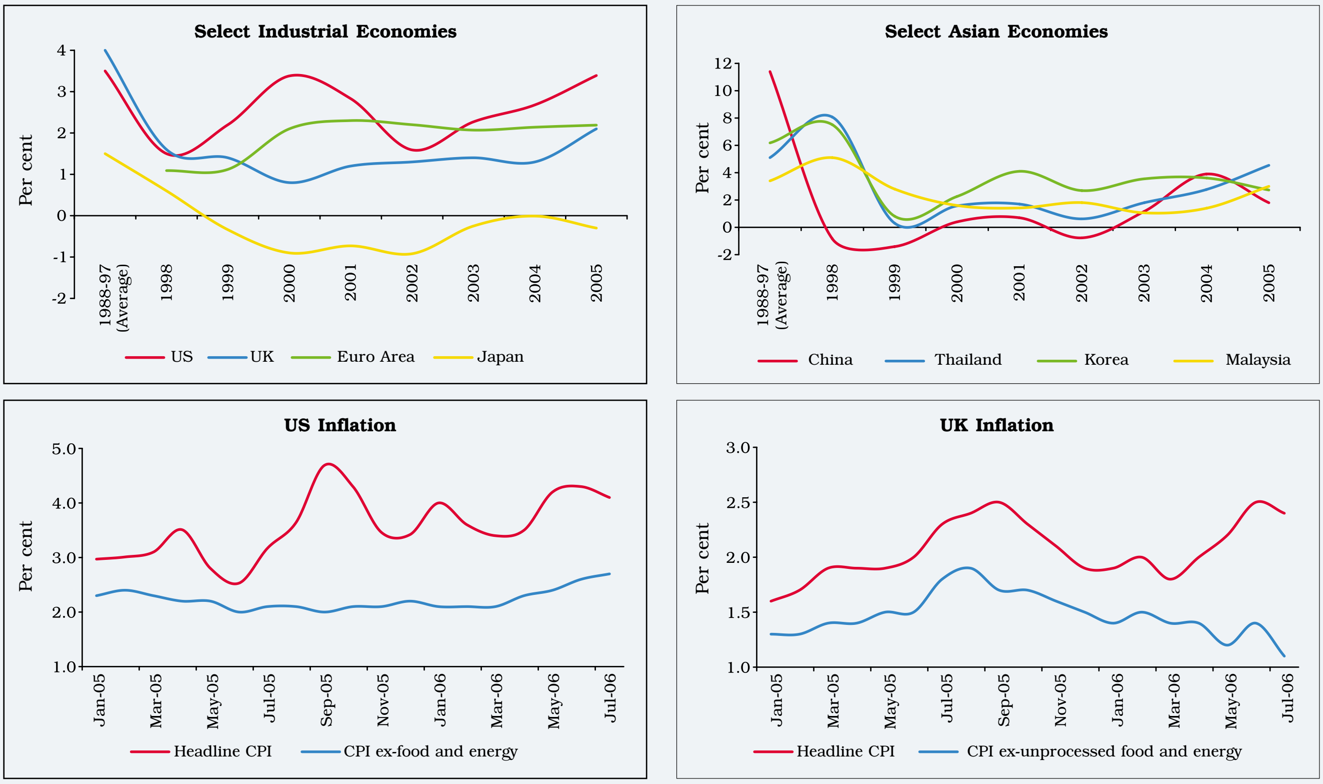
PRICE SITUATION

I.3.18 Headline inflation firmed up in 2005-06 in a number of economies led by record high international crude oil and elevated metals prices. Compared to earlier oil shocks, however, inflation pressures remained modest reflecting a variety of factors such as stable inflationary expectations, fall in intensity of oil usage, and, in case of many emerging market economies, less-than-complete pass-through of oil prices. Lower trade barriers, increased deregulation, innovation and competition all over the world arising out of the force of globalisation have also contained inflation. With the rapid expansion in tradables, domestic economies are, therefore, increasingly exposed to the rigours of international competition and comparative advantage, reducing unwarranted price mark-ups. Productivity growth in a number of sectors, partly due to IT investments combined with restructuring, has also enabled absorption of higher costs. Inflationary expectations remained largely anchored in view of continuous pre-emptive monetary tightening. In India, headline inflation during 2005-06 turned out to be within the indicative trajectory, despite continued dominance of supply-side factors. This could be attributed largely to inflation expectations, which remained stable in view of timely fiscal and monetary measures. Increased competition, strong corporate balance sheets and productivity gains in several sectors of the economy also restrained the second-order effects of higher oil prices. Incomplete pass-through of international crude oil prices also helped to contain headline inflation during 2005-06.

Global Inflation Environment

I.3.19 Global headline inflation firmed up during the second half of 2005 in response to pressures from international crude oil prices reaching record highs (Chart I.12 and Table 1.25). According to the International Monetary Fund's *World Economic Outlook*, April 2006, consumer price inflation in advanced economies increased from 2.0 per cent in 2004 to 2.3 per cent in 2005. In many Asian emerging markets also, inflation firmed up as these economies passed on higher international crude oil prices to domestic prices of petroleum products in a phased manner (Box I.10). However, for the group 'other emerging market and developing countries' as a whole, inflation fell from 5.7 per cent in 2004 to 5.4 per cent in 2005, partly reflecting incomplete pass-through of higher international oil prices to domestic prices. Core inflation and inflation expectations after remaining relatively stable during 2005 have shown signs of increase in recent months.

Chart I.12: Consumer Price Inflation



Source : World Economic Outlook, April 2006, IMF; US Bureau of Labour Statistics; and National Statistics, UK.

I.3.20 Many central banks tightened monetary policy during 2005 and 2006 in order to contain inflation and inflationary expectations, especially in view of continued strong output growth and the fact that a significant part of the increase in international crude oil prices is increasingly viewed by policy authorities as somewhat permanent. In the US, with rising resource utilisation and elevated prices of energy and other commodities viewed as having the potential to add to inflationary pressures, the US Federal Reserve raised its target Federal Funds rate to 5.25 per cent – an increase of 425 basis points between June 2004 and June 2006 (25 basis points hike at each of its 17 meetings till June 2006) (Table 1.26). In its latest

Table 1.25: Retail Petroleum Products Prices – Select Countries

(Per cent increase between March 2004 and June 2006)

Sr. No.	Country	Petrol: Including Tax	Petrol: Excluding Tax	Petrol: Share of Taxes in Total Price (June 2006)	Diesel: Including Tax	Diesel: Excluding Tax	Diesel: Share of Taxes in Total Price (June 2006)
1	2	3	4	5	6	7	8
1.	France	30.1	87.8	62.1	38.2	90.7	45.3
2.	Germany	26.5	79.0	63.0	32.8	81.0	48.8
3.	Italy	28.2	66.5	58.9	40.3	80.9	41.4
4.	Spain	34.9	73.8	50.6	44.7	84.4	35.1
5.	UK	28.3	88.1	64.3	28.7	85.3	56.7
6.	Japan	23.5	56.2	44.3	26.7	47.1	33.2
7.	Canada	66.9	92.9	30.3	71.4	90.6	23.9
8.	USA	66.7	85.6	13.8	78.1	107.7	15.9

Source : International Energy Agency.

Box I.10
Oil Price Pass-through: A Cross-country Analysis

International crude oil prices have more than doubled in the past two years. In view of the fact that a large component of this increase is viewed as permanent, keeping domestic prices unchanged not only leads to inefficiency in the use of petroleum products but also poses increasing risks to the health of public finances and overall macroeconomic stability. In most industrial economies, end-user prices, which are market-determined, have increased in consonance with higher crude oil costs. Developing countries, where fuel prices are typically administered, have also been passing on the impact to domestic petroleum products prices, although the pass-through remains incomplete.

The increase in end-user prices of petroleum products varies across countries depending upon the share of taxes in retail prices as well as the extent of pass-through. Amongst the sample countries, retail prices of petrol (including tax) have increased ranging from 24 per cent (Japan) to 67 per cent (USA and Canada) between March 2004 and June 2006 (see Table 1.25). As regards diesel, the increase in prices (including tax) ranged between 27 per cent (Japan) and 78 per cent (USA). In comparison, India's domestic retail prices of petrol and diesel increased by about 40 per cent and 50 per cent, respectively, over the same period. Amongst Asian economies, in Thailand, petrol and diesel prices have been increased by about 75 per cent and 88 per cent, respectively, between March 2004 and June 2006. In Indonesia, which used to cover only crude costs, petrol prices have been increased by almost 150 per cent since February 2005. Similarly, in Malaysia, petrol prices were raised by 19 per cent in February 2006.

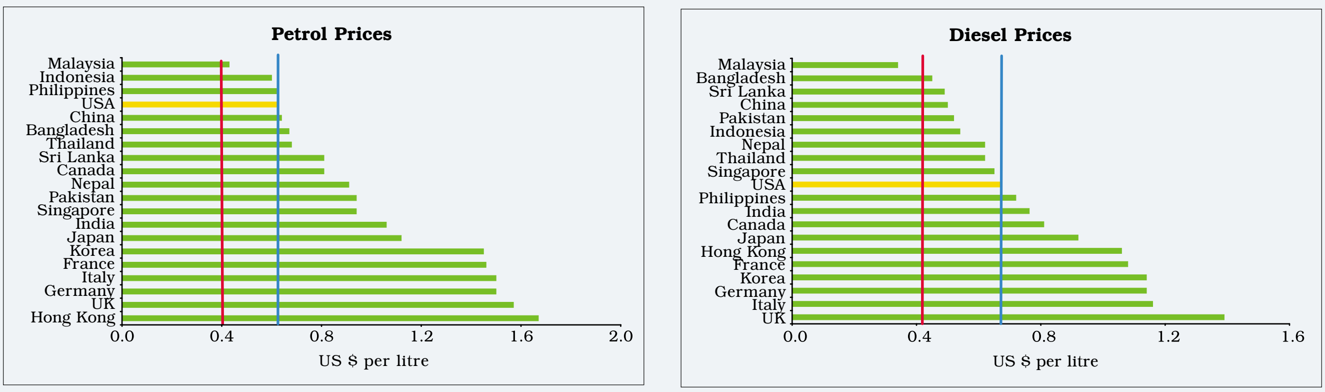
However, cross-country analysis of end-user prices does not present a proper picture of the pass-through in view of the wedge created by the tax component. The tax component varies across countries and is as high as 40-60 per cent of retail prices of petrol and diesel in European countries such as the UK, France, Italy and Germany. On the other hand, taxes at 14-16 per cent are fairly low for the US. In India, the tax component is estimated to be around 55 per cent of the retail price of petrol and 34 per cent in the case of diesel. Analysis of the pass-through by excluding the tax component shows that petrol prices (excluding taxes) have increased in a range of 56-93 per cent while diesel prices (excluding taxes) have recorded an increase in the range of 47-108 per cent. For countries with high tax components such as the European countries, the price increase (excluding tax component) is much higher than that obtained from variation in end-user prices (inclusive of taxes); on the other hand, for countries with low tax component such as the US, the increase in prices (excluding the tax component) is much closer to prices inclusive of the tax component. Illustratively, for the UK, petrol prices (excluding tax) have increased by about 88 per cent between March 2004 and June 2006 in contrast to an increase of about 28 per cent (including tax component). On the other hand, in the USA, the increase in petrol prices (excluding tax) at 86 per cent was much more comparable to that of 67 per cent in prices inclusive of the tax component over the same period.

Since the tax component is fairly small in the US, the retail US prices - determined in a competitive market with an efficient refining industry - can be considered as an approximate benchmark for the full pass-through retail price particularly for countries with low tax components (ADB, 2006). In a number of developing countries, retail prices, especially diesel, remain below this benchmark suggesting that domestic prices need to increase further in those economies (Chart).

References

1. Asian Development Bank (2006), Asian Development Outlook 2006.
2. International Monetary Fund (2006), World Economic Outlook, April.
3. Reserve Bank of India (2006), 'Oil Price Hike: The Implications for SAARC Countries', May.

Chart : International Oil Prices



Note : 1. Data for China, Hong Kong, Korea, Thailand, Malaysia, Indonesia, Philippines, Bangladesh, Pakistan and Sri Lanka pertain to February 2006 as per the Asian Development Outlook 2006, ADB and data for other countries are for March 2006 from IEA.

2. Blue line indicates the retail petroleum product prices in the US market, while red line indicates the price of crude oil.

meeting held on August 8, 2006, the US Federal Reserve kept the Fed Funds target rate unchanged at 5.25 per cent. With inflation remaining above the target, the European Central Bank (ECB) - after maintaining rates at historically low levels for two and a half years – has raised the key policy rate by 100 basis points since December 2005 to keep inflation expectations anchored to levels consistent with price stability. In the UK, the Bank of England raised its policy rate by 25 basis points on August 3, 2006 after having kept it unchanged for almost a year. In Japan, year-on-year consumer price inflation has turned positive since January 2006 and unit labour costs have picked up suggesting easing of underlying deflationary pressures. The Bank of Japan (BoJ), therefore, decided in March 2006 to end the quantitative easing policy by changing the operating target of money market operations from the outstanding balance of current accounts at the Bank to the uncollateralised overnight call rate. In July 2006, the BoJ decided to raise the uncollateralised overnight call rate by 25 basis points on expectations that the economy would expand for a sustained period and CPI inflation would follow a positive trend. The Reserve Bank of Australia also raised its policy rate by 25 basis points each in May and August 2006 to 6.0 per cent in response to strong economic activity and underlying inflationary pressures.

I.3.21 Many central banks in emerging Asia also tightened their monetary policies during 2005 and 2006 in view of inflationary pressures. The Bank Indonesia raised policy rates by 425 basis points between July-December 2005; the policy rate has been cut by 100 basis points since May 2006. The Bank of Thailand has raised rates by 275 basis points since June 2005 while the Bank of Philippines has raised rates by 75 basis points since March 2005. In Korea, inflationary pressures seen from strong economic recovery and high oil prices have prompted the Bank of Korea to raise the policy rate by 125 basis points since the tightening began in October 2005. On the other hand, despite strong growth, consumer price inflation in China fell to 1.8 per cent in 2005 from 3.9 per cent a year ago, mainly due to incomplete pass-through of higher oil prices, lower food prices and downward pressures on prices in some sectors

Table 1.26: Global Inflation Indicators

(Per cent)

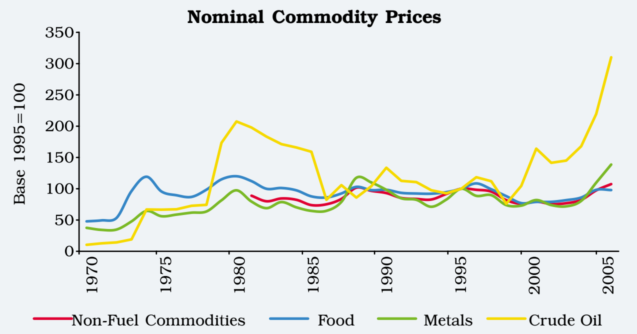
Country/ Region	Key Policy Rate	Policy Rates (August 17, 2006)	Changes in Policy Rates (basis points)		Inflation (y-o-y)		Growth (y-o-y)	
			Since end-March 2005	Since end-March 2006	2004	2005	2004	2005
1	2	3	4	5	6	7	8	9
Developed Economies								
Australia	Cash Rate	6.00	50	50	2.3	2.7	3.6	2.5
Canada	Overnight Rate	4.25	175	50	1.8	2.2	2.9	2.9
Euro area	Interest Rate on Main Refinancing Operations	3.00	100	50	2.1	2.2	2.1	1.3
Japan	Uncollateralised Overnight Call Rate**	0.25	25	25	0.0	-0.3	2.3	2.7
UK	Official Bank Rate	4.75	0	25	1.3	2.1	3.1	1.8
US	Federal Funds Rate	5.25	250	50	2.7	3.4	4.2	3.5
Developing Economies								
Brazil	Selic Rate	14.75	(-) 450	(-) 175	6.6	6.9	4.9	2.3
India	Reverse Repo Rate	6.00	125	50	3.8	4.2	7.5	8.4*
Indonesia	BI Rate	11.75	325^	(-)100	6.1	10.5	5.1	5.6
Israel	Key Rate	5.50	200	75	-0.4	1.3	4.4	5.2
Korea	Overnight Call Rate	4.50	125	50	3.6	2.7	4.6	4.0
Philippines	Reverse Repo Rate	7.50	75	0	6.0	7.6	6.0	5.1
South Africa	Repo Rate	8.00	50	100	1.4	3.4	4.5	4.9
Thailand	14-day Repo Rate	5.00	275	50	2.8	4.5	6.2	4.4

* : Financial year basis. **^ :** Change since July 2005.

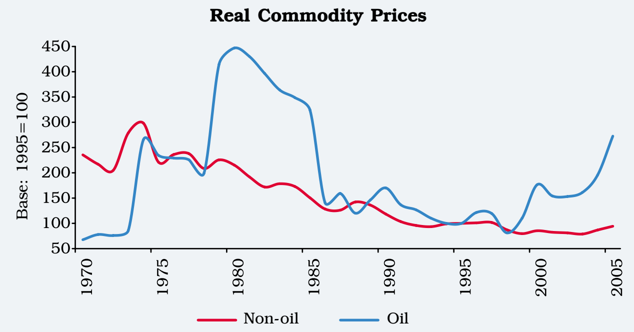
** : The Bank of Japan decided on March 9, 2006 to change the operating target of money market operations from the outstanding balance of current accounts at the Bank to the uncollateralised overnight call rate.

Source : World Economic Outlook, April 2006, IMF and websites of respective central banks.

Chart I.13: International Commodity Prices



Source: IFS CD-ROM, June 2006.



Source: World Economic Outlook, IMF, April 2006.

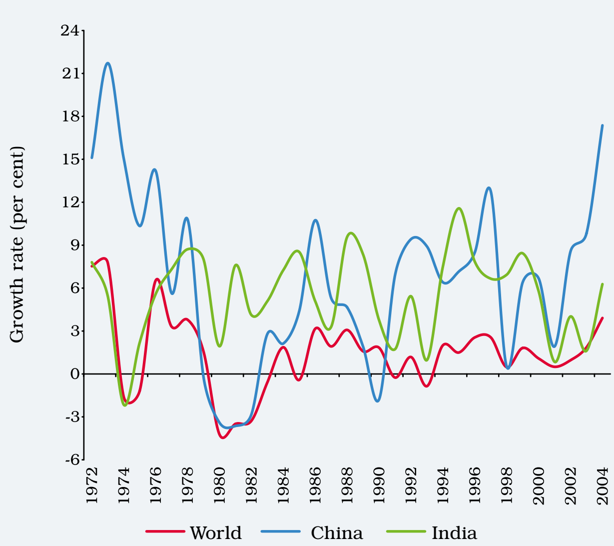
reflecting excess capacity. In view of stronger growth in money supply and credit, however, the People's Bank of China increased the benchmark 1-year lending rate by 27 basis points to 5.85 per cent effective April 28, 2006 and raised the cash reserve ratio by 50 basis points each effective July 5, 2006 and August 15, 2006. Amongst other emerging economies, South Africa raised the policy rates by 50 basis points each in June and August 2006 to 8.0 per cent. Turkey also raised the policy rate by 425 basis points during June - July 2006. On the other hand in view of weak economic activity, Brazil has reduced policy rates on nine occasions since September 2005 to 14.75 per cent on July 19, 2006.

Global Commodity Prices

I.3.22 International commodity prices rose further during 2005-06, led by crude oil and metals prices, reflecting robust economic activity and supply constraints. Crude oil prices, which witnessed a record high during 2005-06, continue to touch newer peaks reflecting tight supply conditions and geo-political factors (Charts I.13 and I.14). Non-fuel commodity prices also increased led by metals reflecting strong demand, higher energy prices, lags in supply and interest by investors in commodity markets. In real terms, while oil prices have risen sharply, they remain still lower than the peak of 1980; non-oil commodity prices in real terms, notwithstanding the recent increases, have been on a downward trajectory since mid-1970s.

I.3.23 International crude oil prices which rose to record highs during 2005-06 firmed up further during the first four months of 2006-07. Although growth in global demand for oil decelerated during 2005, oil prices have firmed up reflecting limited spare capacity. Notwithstanding periodic increases in supply by the Organisation of the Petroleum Exporting Countries (OPEC), tight supply conditions were further exacerbated by hurricane-related supply disruptions in the US and concerns over stability of supplies from the Middle East due to geo-political uncertainties. Speculative purchases by hedge funds further added to nervousness in the world oil market, imparting a great deal of volatility to oil prices. Reflecting these factors, international crude oil prices have reached successive record highs - the US West Texas Intermediate (WTI) crude prices rose to US $ 70.8 a barrel on August 30, 2005 in the immediate aftermath of Hurricane Katrina. Prices in the subsequent months moderated to below US $ 60 a barrel during November-December 2005 reflecting supply augmenting efforts by the International Energy Agency (IEA) and the OPEC amidst signs of slowing global oil demand growth

Chart I.14: Oil Consumption



Source: BP Statistical Review of World Energy.

and a relatively warmer weather in the US. But, prices again edged up to US $ 67-68 a barrel in January 2006 on disruption of Russian natural gas deliveries to Ukraine threatening supplies to Western Europe, unrest in Nigeria and tensions over Iran's nuclear programme. Average international crude oil prices increased by 38.3 per cent from US $ 41.3 a barrel in 2004-05 to US $ 57.1 a barrel in 2005-06 (Table 1.27). Renewed concerns over Iran's nuclear programme, unrest in Nigeria and heightened geo-political uncertainties in the Middle East have led to further increases since March 2006, with prices reaching a new record high of US $ 78.4 a barrel on July 14, 2006.

I.3.24 Non-fuel commodity prices were led by higher metals and sugar prices. Metal prices firmed up sharply during 2005, and gathered pace during the first quarter of 2006 with prices reaching record highs/ multi-year highs on the back of robust construction and manufacturing demand from China and the US on the one hand and supply constraints on the other hand. The rally in metal prices was led by copper, zinc, iron ore and aluminium whose prices increased by 37 per cent, 45 per cent, 52 per cent and 14 per cent, respectively, during 2005-06 reflecting declining inventories to historical lows as well as a series of supply disturbances, including the labour strikes in the US and Chile in the copper industry. As a result, the IMF's metals price index rose by 29 per cent in 2005-06. However, following the release of higher than anticipated US inflation data for April 2006, global metals prices witnessed correction during May-June 2006 on fears that further monetary tightening by the US might slow down demand for metals. International steel prices stabilised in the second half of 2005 on the back of supply management efforts by major steel producers in the face of strong increase in Chinese production, higher inventories in the US and sluggish demand in Japan. Prices have, however, again edged higher in recent months.

Table 1.27: International Crude Oil Prices

(US dollars per barrel)

Year/ Month	Dubai Crude	UK Brent	US WTI	Average Crude Price	Indian Basket Price
1	2	3	4	5	6
2001-02	21.8	23.2	24.1	23.0	22.4
2002-03	25.9	27.6	29.2	27.6	26.6
2003-04	26.9	29.0	31.4	29.1	27.8
2004-05	36.4	42.2	45.0	41.3	38.9
2005-06	53.4	58.0	59.9	57.1	55.4
March 2004	30.5	33.8	36.7	33.7	31.9
March 2005	45.6	53.1	54.2	50.9	48.8
March 2006	57.7	62.3	62.9	60.9	59.6
April 2006	64.1	70.4	69.4	68.0	66.8
May 2006	64.9	70.2	70.9	68.7	67.2
June 2006	65.1	68.9	70.9	68.3	66.7
July 2006	69.1	73.9	74.4	72.5	71.1

Source : International Monetary Fund and the World Bank.

I.3.25 After remaining broadly stable during April-June 2005, sugar prices firmed up sharply from September 2005 reflecting declining global inventories and higher global sugar consumption, especially from the developing countries of the Far East and Latin America. Global sugar prices during April-June 2006 were almost double of their levels a year ago.

I.3.26 Prices of agricultural commodities exhibited mixed trends during 2005-06. Wheat prices firmed up from the second half of 2005 due to lower production. Rice prices eased in the second half of 2005 on the back of record output, but again hardened in the first half of 2006 reflecting higher demand from many countries in Asia and a tightening of export availabilities in major exporting countries. Prices of oilseeds eased during the second half of 2005-06 with the waning of weather concerns and record carryover stocks at the close of the marketing season (October-September). On the other hand, prices of edible oils and fats which eased during the second half of 2005, have strengthened in recent months due to strong consumption demand from China and India and demand for non-food uses such as biodiesel from the EU and the US. Global cotton prices increased between October 2005 and March 2006 on the back of strong demand, especially from China and estimated lower global production during 2005-06 season.

I.3.27 International gold prices increased sharply during 2005 as investors switched to gold, partly on concerns over higher US inflation and expected depreciation of the US dollar. According to the estimates of the World Gold Council (WGC), global demand for gold rose by 7 per cent to 3574 tonnes in 2005. Global supply of gold rose by 15 per cent to 3859 tonnes in 2005 partly reflecting higher official sector sales – net central bank selling reached a record level of 663 tonnes. In India, overall demand in 2005 was estimated to have increased by 17 per cent to 724 tonnes. India's share was, thus, more than a fifth of total global demand in 2005. Available information indicates that only a small proportion (less than 10 per cent) of the gold imported into India is used for jewellery exports.

INFLATION CONDITIONS IN INDIA

Wholesale Price Inflation

I.3.28 Headline inflation, measured by year-on-year (y-o-y) changes in the wholesale price index (WPI), fell to 4.1 per cent by end-March 2006 from 5.1 per cent a year ago (Table 1.28). Pre-emptive monetary actions by the Reserve Bank in the form of hike in policy reverse repo rates of 25 basis points each in October 2004, April 2005, October 2005 and January 2006 and 50 basis points hike in cash reserve ratio in September-October 2004 helped stabilise inflation expectations in the face of spurt in international oil prices and rising domestic demand. The average WPI inflation rate eased to 4.4 per cent during 2005-06 from 6.4 per cent a year ago (Appendix Tables 25 and 26).

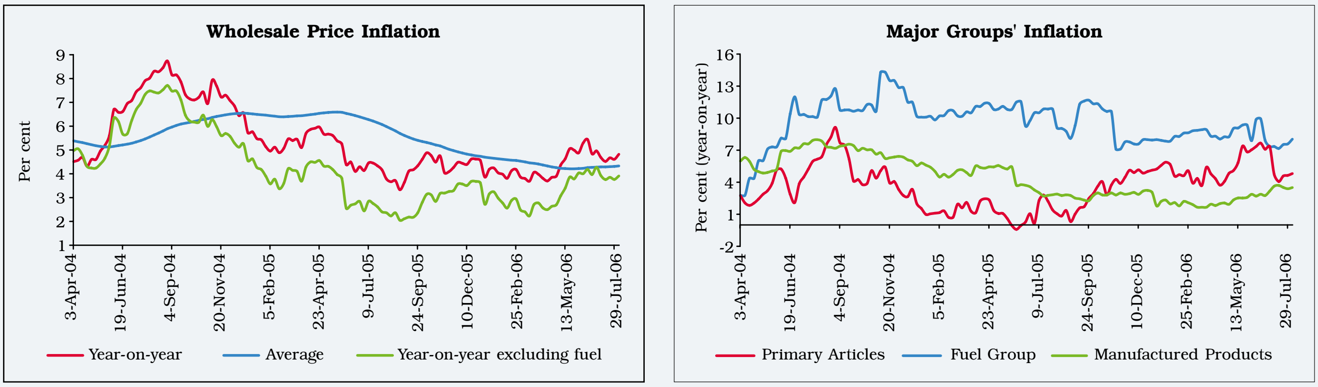
Table 1.28: Annual WPI Inflation by Component

(Base: 1993-94=100)

(Per cent)

Major Group / Item	Weight	Inflation Rate (year-on-year) 2004-05	Inflation Rate (year-on-year) 2005-06	Weighted Contribution to Inflation 2004-05	Weighted Contribution to Inflation 2005-06
1	2	3	4	5	6
All Commodities	**100.0**	**5.1**	**4.1**	**100.0**	**100.0**
1. Primary Articles	**22.0**	**1.3**	**5.4**	**5.5**	**28.3**
Food Articles	15.4	3.0	6.6	8.9	24.2
i. Rice	2.4	2.9	2.7	1.3	1.4
ii. Wheat	1.4	-1.1	12.9	-0.3	4.3
iii. Pulses	0.6	-2.6	33.2	-0.3	4.4
iv. Vegetables	1.5	11.9	8.1	2.3	2.1
v. Fruits	1.5	11.5	-1.0	4.1	-0.5
vi. Milk	4.4	-1.7	1.9	-1.5	1.9
vii. Eggs, Fish and Meat	2.2	7.3	14.3	3.1	7.9
Non-Food Articles	6.1	-6.9	-1.9	-8.8	-2.7
i. Raw Cotton	1.4	-23.8	-1.4	-6.5	-0.4
ii. Oil Seeds	2.7	-6.5	-7.8	-3.4	-4.5
iii. Sugarcane	1.3	-0.7	0.7	-0.2	0.3
Minerals	0.5	68.0	43.6	5.3	6.8
i. Iron Ore	0.2	119.1	60.0	5.2	6.9
2. Fuel, Power, Light and Lubricants	**14.2**	**10.5**	**8.9**	**42.7**	**47.9**
i. Mineral Oils	7.0	16.0	13.2	34.9	39.8
ii. Electricity	5.5	0.8	4.5	1.2	8.2
iii. Coal Mining	1.8	17.1	0.0	6.4	0.0
3. Manufactured Products	**63.8**	**4.6**	**1.7**	**52.0**	**23.2**
i. Food Products	11.5	0.4	0.9	0.9	2.2
of which: Sugar	3.6	19.7	6.6	10.3	4.9
ii. Cotton Textiles	4.2	-12.7	1.1	-10.4	1.0
iii. Man Made Fibre	4.4	0.6	-4.6	0.3	-2.5
iv. Chemicals and Chemical Products	11.9	3.9	3.6	9.1	10.2
of which : Fertilisers	3.7	3.3	0.3	2.2	0.2
v. Basic Metals, Alloys and Metal Products	8.3	17.1	-2.9	28.4	-6.7
of which: Iron and Steel	3.6	21.3	-7.5	17.0	-8.7
vi. Non-Metallic Mineral Products	2.5	11.4	8.6	4.7	4.7
of which: Cement	1.7	10.2	13.0	2.9	4.8
vii. Machinery and Machine Tools	8.4	7.1	3.9	8.6	6.1
viii. Transport Equipment and Parts	4.3	6.2	1.2	4.3	1.1
Food Items (Composite)	**26.9**	**1.9**	**4.2**	**9.8**	**26.5**
WPI Excluding Food	**73.1**	**6.3**	**4.0**	**90.2**	**73.5**
WPI Excluding Fuel	**85.8**	**3.7**	**2.7**	**57.3**	**52.1**
Memo:					
GDP Deflator (as per the Base: 1999-2000=100)		4.0	4.1		
Average WPI Inflation		6.4	4.4		
Average CPI Inflation:					
Industrial Workers		3.8	4.4		
Urban Non-Manual Employees		3.6	4.7		
Agricultural Labourers		2.6	3.9		
Rural Labourers		2.6	3.9		

Chart I.15: WPI Inflation

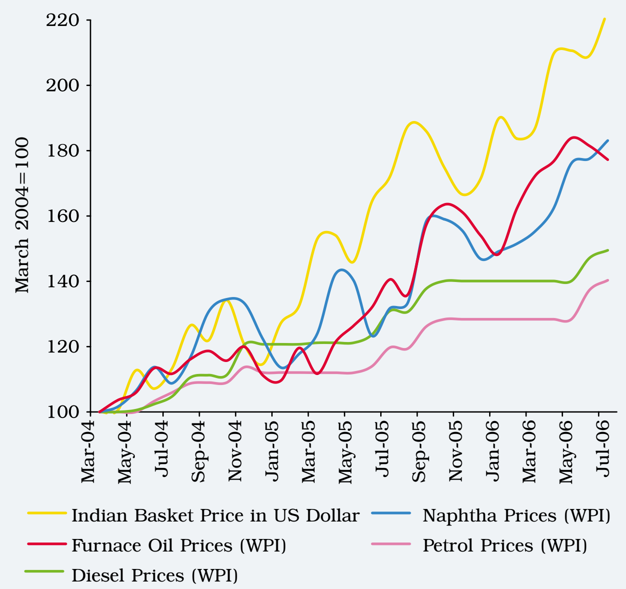


I.3.29 Inflation initially increased during 2005-06 to an intra-year high of 6.0 per cent on April 23, 2005 reflecting increase in prices of fruits and vegetables, iron and steel and select petroleum products such as furnace oil and naphtha. Subsequently, with the base effect coming into play and the revival of the monsoon, inflation began to ease reaching an intra-year low of 3.3 per cent on August 27, 2005. Inflation again edged up during the third quarter of 2005-06 – but remained below 5.0 per cent - under the impact of the hike in petrol and diesel prices in early September 2005 as also elevated vegetables prices. Headline inflation remained low during January-March 2006 on account of the seasonal easing of vegetables prices as well as reduction in domestic iron and steel prices, which offset upward pressures from non-ferrous metals and electricity prices. Consequently, inflation moderated to 4.1 per cent by end-March 2006.

I.3.30 Fuel prices dominated the inflation outcome during 2005-06. Mineral oils inflation alone contributed about 40 per cent to the headline inflation. Accordingly, the y-o-y WPI inflation excluding the fuel group at 2.7 per cent remained well below the headline rate (Chart I.15).

I.3.31 Although fuel prices were the key driver of domestic inflation during 2005-06, domestic petroleum products prices still lag the increase in international crude oil prices (Chart I.16). The pass-through of higher international oil prices has been restricted mainly to petrol and diesel (hike of 7-8 per cent each in June and September 2005, and 6-9 per cent in June 2006). Domestic prices of liquefied petroleum gas (LPG) have remained unchanged since November 2004 while kerosene prices have been unchanged since April 2002. In view of international oil prices remaining high and volatile, the outlook on inflation as well as the choice of the appropriate manner of dealing with the pass-through of oil prices remains clouded (Box I.11).

Chart I.16: Oil Prices in India



I.3.32 Apart from petroleum product prices, prices of primary food articles posed some upward pressures on inflation during 2005-06. Wheat prices firmed up during the second half of 2005-06 on reports of fall in stocks. Vegetables prices remained high for most part of the third quarter of 2005-06 due to damage to the standing crops from excessive rains/floods in various parts of the country. Prices of pulses, and eggs, fish and meat also edged higher during 2005-06. Raw cotton prices after remaining flat during the first half of the year increased marginally during November-December 2005 reflecting international trends. Oilseeds prices, which had hardened somewhat during the first half of 2005-06, reflecting last year's shortfall in domestic *kharif* production and worries

Box I.11

Report of the Committee on Pricing and Taxation of Petroleum Products

In India, the pass-through of international crude oil prices to domestic prices has been partial as well as incomplete (restricted only to petrol and diesel), reflecting burden sharing between the Government and oil companies on the one hand and the consumers on the other hand. LPG and kerosene prices have been unchanged, but this has adverse implications for the oil marketing companies as well as the efficiency of resource use. The issues related to fuel subsidy were comprehensively addressed by the Committee on Pricing and Taxation of Petroleum Products (February 2006) (Chairman: Dr. C. Rangarajan). As international crude oil prices are unlikely to soften in the near to medium term, the Committee stressed on immediate adjustment of prices and subsidies with regard to petroleum products prices in India to promote efficiency in their use. Accordingly, the Committee recommended the following:

i) Trade parity principle should be followed for pricing petrol and diesel. Initially, the trade parity price could be a weighted average of the import parity and export parity prices in the ratio of 80:20;

ii) The Government should keep an arms length from the actual price setting by the oil marketing companies (OMCs) subject to the indicative ceiling;

iii) OMCs should disseminate the details of the pricing model adopted by them for promoting transparency;

iv) Termination of the principle of freight equalisation;

v) Customs duty on crude oil to be retained at 5 per cent, whereas that on petrol and diesel should be reduced from 10 per cent to 7.5 per cent.

vi) Excise duties should be restructured to protect the consumers from excessive volatility in prices by shifting to a system of pure specific excise duty (Rs.14.75 per litre for petrol and Rs.5 per litre for diesel) from the current position of a mix of *ad valorem* and specific excise duty (8 per cent + Rs.13 per litre for petrol and 8 per cent + Rs.3.25 per litre for diesel). The rate of specific duty may be reviewed every year as a part of the budgetary process.

vii) The Committee noted that if its recommendations were fully accepted, the domestic prices needed to increase by Rs.1.21/litre for petrol and Rs.1.96/litre for diesel;

viii) Subsidy for kerosene to be restricted to below poverty line (BPL) families;

ix) As regards LPG, given the large subsidy of Rs.171 per cylinder, domestic prices needed to be increased by Rs.75 per cylinder immediately followed by gradual increase of retail prices to eliminate subsidy over time;

x) Cost of subsidy should be met through current provisioning without any recourse to oil bonds since it only postpones the resolution of the problem. The Committee estimated that gross annual subsidy burden on account of LPG and kerosene is Rs.26,604 crore (0.8 per cent of GDP). The Committee noted that if its recommendations of restricting subsidising kerosene only to BPL families and one time increase of Rs.75 per cylinder for LPG were accepted, then the subsidy burden would be Rs.15,875 crore (0.5 per cent of GDP). The Committee further recommended that the upstream subsidies being paid by Oil and Natural Gas Corporation (ONGC)/Oil India Limited (OIL) to OMCs be stopped and the cess being paid by ONGC/OIL be increased accordingly to increase transparency and fiscal integrity. Fiscal integrity demands that all the support required to be borne by ONGC/OIL should come as a cess, be accounted for in the consolidated fund and then allocated for funding the subsidy. The total subsidy amount (Rs.15,875 crore) be shown explicitly in the budget as such.

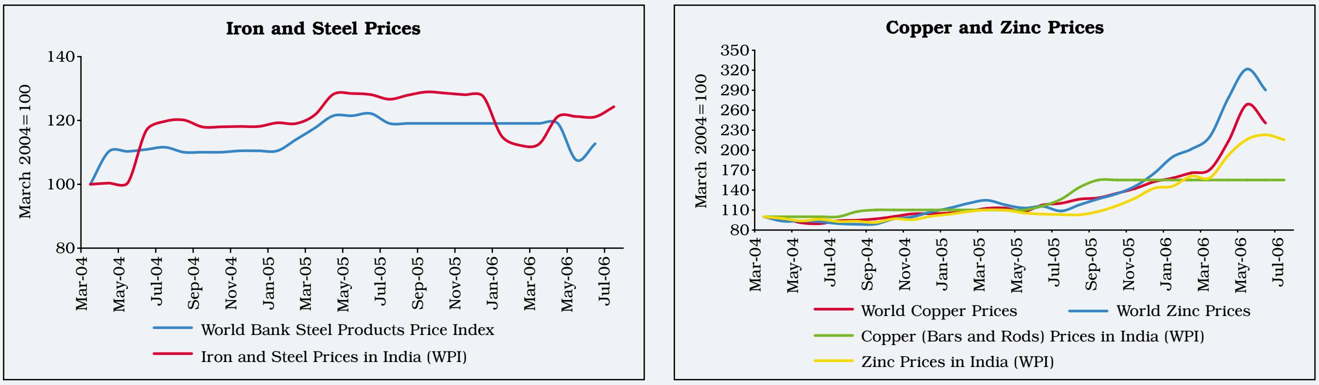
It needs to be noted that international crude oil prices which were around US $ 60 a barrel at the time of the Committee's recommendations are moving around US $ 75 a barrel. In this context, as the Reserve Bank's Annual Policy Statement for 2006-07 observed, the Indian economy needs to prepare for higher orders of pass-through into consumer prices, in respect of the overhang as well as the possibility of additional increases in crude prices in the future. While the recommendations of the Rangarajan Committee are being debated, it is increasingly becoming clear that there has to be a fuller pass-through of increases in international crude prices. In the event, inflation could turn out to be higher in 2006-07 than the current benign levels. Regardless of the manner in which the future scenario for crude oil prices unfolds, there is a need for continuous and close monitoring and appropriate policy responses to contain its inflationary impact.

Reference

Government of India (2006), Report of the Committee on Pricing and Taxation of Petroleum Products (Chairman: Dr. C. Rangarajan), February.

about a poor ensuing crop due to the unsatisfactory progress of the South-West monsoon, moderated from November 2005 on account of improved crop prospects. Overall, primary articles' contribution to headline inflation increased to 28.3 per cent during 2005-06 (5.5 per cent a year ago).

Chart I.17: Metals Prices



I.3.33 Manufactured products inflation, on the other hand, remained modest. It eased to 1.7 per cent (y-o-y) at end-March 2006 from 4.6 per cent a year ago, reflecting stable inflation expectations, productivity gains as well as increased competition. Strong corporate profitability also provided firms the flexibility to absorb higher input prices into their profit margins. Commodity-wise, upward pressures from sugar and other food products, cement and non-ferrous metals were offset by easing of manmade fibres, edible oils, oil cakes and, in particular, iron and steel prices. Domestic sugar prices have remained firm in line with international trends, notwithstanding higher sugarcane output in the country. Non-ferrous metal prices rose sharply - prices of copper and zinc increased, y-o-y, by about 41 per cent and 50 per cent, respectively, during 2005-06 in line with international trends (Chart I.17). In contrast, iron and steel prices witnessed a large turnaround during 2005-06 – a decline of 7.5 per cent, y-o-y, as at end-March 2006 as against a sharp increase of 21.3 per cent a year ago – and this contributed to a moderation in headline inflation. However, since end-March 2006, domestic iron and steel prices have again increased by 10.7 per cent (up to August 5, 2006) in tandem with international price movements.

I.3.34 To summarise, despite dominance of supply-side pressures emanating from oil prices, headline inflation for 2005-06 turned out to be lower than anticipated. Pre-emptive monetary policy actions in the form of reverse repo rate hikes have helped in anchoring inflation expectations. The incomplete pass-through of international oil prices to domestic prices amidst the burden sharing strategy by oil companies as well as through customs/excise duty reductions also mitigated the immediate cost push impact of international crude oil prices. Furthermore, competitive pressures, improved corporate profitability and productivity gains in several sectors helped abate the second order effects of higher oil prices and contained manufactured products inflation.

Consumer Price Inflation

I.3.35 Consumer price inflation edged up during 2005-06 largely reflecting higher food and fuel prices (Table 1.29). While all measures of consumer price inflation recorded an increase, the CPI for Agricultural Labourers and Rural Labourers recorded relatively higher order of increases in 2005-06 as these indices have higher weights on food products. Food prices remained firm for greater part of the year initially on concerns about unsatisfactory progress of the South-West monsoon and subsequently due to damages to some crops on account of excessive rainfall and floods in parts of the country. Prices of services such as medical care, and transport and communication recorded higher increase during 2005-06. On the other hand, increase in the housing index - which includes rent paid for rented, self-owned and rent free houses - in the CPI-IW basket decelerated to 6.6 per cent (y-o-y) in March 2006 from 20.4 per cent in March 2005.

Table 1.29: Consumer Price Inflation (CPI) in India
(year-on-year)

(Per cent)

Inflation Measure	March 2003	March 2004	March 2005	March 2006	June 2006	July 2006
1	2	3	4	5	6	7
CPI-IW	4.1	3.5	4.2	4.9	7.7	-
CPI- UNME	3.8	3.4	4.0	5.0	6.5	-
CPI-AL	4.9	2.5	2.4	5.3	7.2	6.3
CPI-RL	4.8	2.5	2.4	5.3	7.2	5.9
Memo:						
WPI Inflation	6.5	4.6	5.1	4.1	4.8	4.6

IW : Industrial Workers UNME : Urban Non-Manual Employees
AL : Agricultural Labourers RL : Rural Labourers

Chart I.18: CPI and WPI Inflation

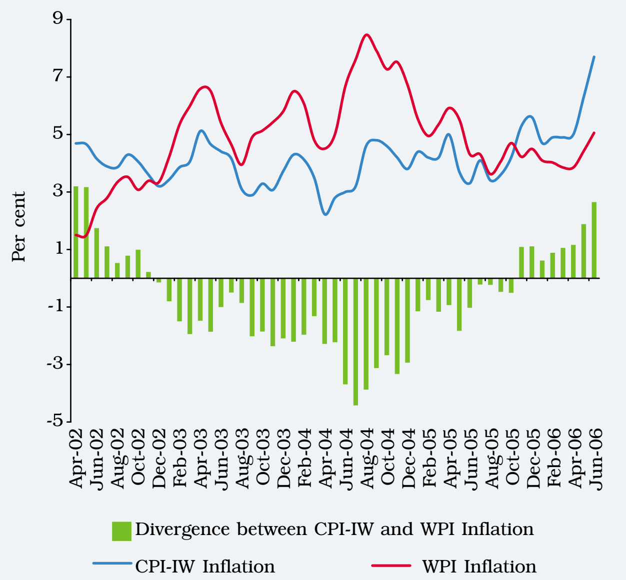
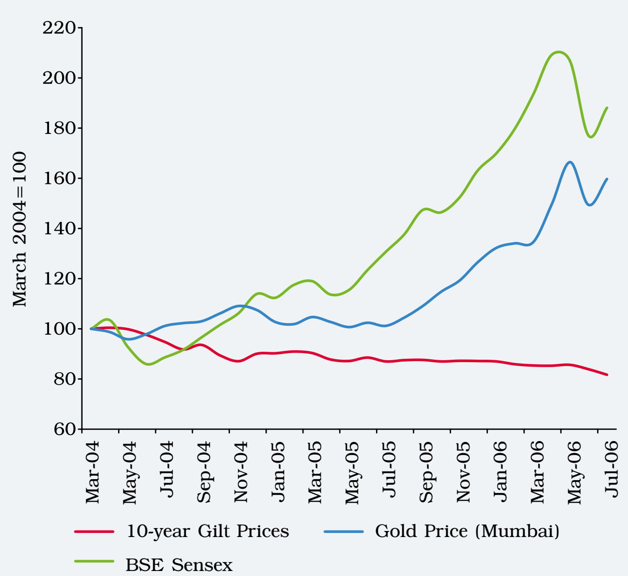


Chart I.19: Asset Price Movements



I.3.36 WPI inflation exceeded CPI inflation during the first half of 2005-06 reflecting higher fuel and metals prices which have higher weights in the WPI *vis-à-vis* CPI. In contrast, CPI inflation exceeded WPI inflation in the second half of the year reflecting higher food prices, which have a higher weight in the CPI *vis-à-vis* WPI (Chart I.18 and Appendix Table 27).

Asset Prices and Inflation

I.3.37 While prices of goods and services remained relatively moderate, asset prices in India, as in other parts of the world, recorded sharp increase in 2005-06. Buoyancy in domestic equity markets continued on the back of strong support by FIIs as well as domestic mutual funds reflecting better prospects for economic activity and strong corporate performance (Chart I.19). Domestic gold prices firmed up in line with international trends. International gold prices, as noted earlier, have risen sharply since mid-2005 as investors preferred gold in an environment of higher inflation. During May-June 2006, domestic equity and gold prices witnessed some corrections in line with global trends. Gilt yields edged higher during 2005-06 and prices fell during the year, with intra-year movements influenced by trends in domestic inflation and liquidity conditions. Gilt yields edged up further during the first four months of 2006-07.

Developments during 2006-07

I.3.38 Headline WPI inflation eased initially during 2006-07 to 3.7 per cent as on April 15, 2006 from 4.1 per cent at end-March 2006, reflecting partly the base effect of higher prices last year. Inflation rate edged up in May-June 2006 to reach 5.4 per cent on June 17, 2006 reflecting higher prices of petrol and diesel, milk, vegetables and metals. Subsequently, inflation moderated to 4.8 per cent as on August 5, 2006 on account of decline in the prices of fruits, vegetables and milk and base effects. The average WPI inflation rate eased to 4.3 per cent as on August 5, 2006 from 6.0 per cent a year ago. Consumer price inflation edged higher during the first quarter of 2006-07 reflecting higher food prices – CPI for Industrial Workers rose from 4.9 per cent in March 2006 to 7.7 per cent in June 2006. Consumer price inflation for agricultural and rural labourers also rose during the quarter ended June 2006 but eased in July 2006.

I.3.39 In view of sustained rise in international crude oil prices, domestic petrol and diesel prices were raised by about Rs.4 (around nine per cent) and Rs.2 (around six per cent), respectively, effective June 6, 2006. LPG and kerosene prices were, however, left unchanged. The Government also announced the following measures: i) reduction in customs duty on petrol and diesel to 7.5 per cent from 10.0 per cent, ii) movement to trade parity pricing mechanism for petrol and diesel from the existing system of import parity pricing, and iii) issuance of oil bonds worth Rs.28,000 crore (over and above Rs.11,500 crore issued during 2005-06) to oil marketing companies to compensate for their under-recoveries in domestic operations.

I.3.40 In brief, monetary and liquidity conditions remained more or less comfortable during 2005-06 amidst a sharp and sustained pick-up in demand for bank credit. With credit growth outpacing deposit growth during 2005-06, banks scaled down their investments in Government securities as well as non-SLR securities. The Reserve Bank's liquidity injection operations also helped to finance enhanced demand for commercial credit. Reserve money growth during 2005-06 was higher than 2004-05 reflecting the Reserve Bank's injection of primary liquidity. Broad money growth was also higher than the previous year.

I.3.41 Despite continued pressures from record high international crude oil prices, inflation was contained during 2005-06. This could be attributed to pre-emptive monetary policy measures by the Reserve Bank which helped stabilise inflationary expectations. Fiscal measures such as rationalisation of the duty structure in regard to crude oil and petroleum products, productivity gains, increased competition and incomplete pass-through also helped to contain inflation. Although headline inflation was low, it needs to be noted that underlying inflationary pressures continue, especially in view of the incomplete pass-through of higher international crude oil prices. During 2006-07 so far, while headline inflation has remained contained within the indicative trajectory, upward pressures are seen from higher primary food articles prices as well as continued high and volatile international crude oil prices. Accordingly, in order to stabilise inflation expectations as also taking into account the global interest rate cycle, the Reserve Bank has increased the LAF reverse repo rate by 50 basis points during 2006-07 so far - 25 basis points each effective June 9, 2006 and July 25, 2006. In order to improve domestic supplies so as to stabilise inflation expectations, the Government also took fiscal measures such as exempting imports of pulses and sugar from customs duty, reduction in customs duty on imports of wheat and palm oils, and restriction on exports of pulses.

I.3.42 Cross-country analysis shows that while inflation in India is higher than developed economies, it is comparable to most of the emerging economies. In major advanced economies, for instance, consumer price inflation in March 2006 (year-on-year) was in the range of 2-3 per cent as compared with 4.9 per cent for India. In emerging economies, consumer price inflation displays a greater variability : 0.8 per cent in China, 2.0 per cent in Korea, 3.4 per cent in South Africa, 3.4 per cent in Mexico, 3.6 per cent in Israel, 4.7 per cent in Malaysia, 5.4 per cent in Brazil, 5.7 per cent in Thailand, 7.6 per cent in Philippines, 11.1 per cent in Argentina and 15.8 per cent in Indonesia.

IV. GOVERNMENT FINANCES

I.4.1 The combined finances of the Central and State Governments showed improvement in 2005-06 in the revenue account. The revenue deficit (RD) was placed lower than the preceding year, led by a significant increase in tax revenues (Table 1.30). The 'pause' in fiscal consolidation by the Central Government due to implementation of the Twelfth Finance Commission (TFC) recommendations was offset by faster progress in fiscal consolidation of the State Governments.

Table 1.30: Indicators of Fiscal Policy: Combined Finances

(Per cent of GDP)

Item	1990-91	1995-96	2004-05	2005-06 RE
1	2	3	4	5
Gross Fiscal Deficit (GFD)	9.4	6.5	7.5	7.5
Revenue Deficit	4.2	3.2	3.7	3.1
Primary Deficit	5.0	1.6	1.4	1.6
Revenue Receipts	18.6	18.3	19.7	20.8
Tax Revenue	15.4	14.7	15.8	16.8
Direct Taxes	2.5	3.5	5.0	5.7
Indirect Taxes	12.9	11.2	10.8	11.1
Non-tax Revenue	3.2	3.6	3.9	4.0
Total Expenditure*	28.7	25.4	27.9	28.6
Developmental Expenditure	17.1	13.9	14.3	15.5
Non-developmental Expenditure*	11.6	11.5	13.6	12.8
Interest Payments	4.4	5.0	6.2	5.8
Debt@	64.9	61.3	82.5	79.5
				Per cent
Capital Outlay/ Total Expenditure	13.1	10.8	13.0	14.1
Interest Payments/ Revenue Receipts	23.6	27.2	31.2	28.1
Revenue Deficit/ Gross Fiscal Deficit	44.6	48.8	48.9	41.5

RE : Revised Estimates. * : Net of repayments.

@ : Includes 'reserve funds', 'deposits and advances' and 'contingency fund'.

Note : 1. All indicators are based on combined data of the Centre and States with inter-Governmental transactions netted out.

2. Data in respect of the State Governments are provisional for the years 2004-05 and 2005-06 and relate to budgets of 29 State Governments (including National Capital Territory of Delhi), of which four are *Vote-on-Accounts*.

Table 1.31: Major Fiscal Indicators of the Centre

(Rupees crore)

	Item	2005-06 (BE)	2005-06 (RE)	2006-07 (BE)	Variation (3 over 2)		Variation (4 over 3)	
					Amount	Per cent	Amount	Per cent
1		2	3	4	5	6	7	8
1.	Revenue Receipts	3,51,200	3,48,474	4,03,465	-2,726	-0.8	54,991	15.8
2.	Disinvestment	0	2,356	3,840	2,356	-	1,484	63.0
3.	Revenue Expenditure	4,46,512	4,40,295	4,88,192	-6,217	-1.4	47,897	10.9
4.	Capital Outlay	62,180	56,993	66,938	-5,187	-8.3	9,945	17.4
	of which: Defence	34,375	33,075	37,458	-1,300	-3.8	4,383	13.3
5.	Net Lending @	-6,348	-283	861	6,065	-95.5	1,144	-404.2
6.	**Revenue Deficit (3-1)**	**95,312 (2.7)**	**91,821 (2.6)**	**84,727 (2.1)**	**-3,491**	**-3.7**	**-7,094**	**-7.7**
7.	**Gross Fiscal Deficit (4+5+6-2)**	**1,51,144 (4.3)**	**1,46,175 (4.1)**	**1,48,686 (3.8)**	**-4,969**	**-3.3**	**2,511**	**1.7**
8.	Interest Payments	1,33,945	1,30,032	1,39,823	-3,913	-2.9	9,791	**7.5**
9.	**Primary Deficit (7-8)**	**17,199 (0.5)**	**16,143 (0.5)**	**8,863 (0.2)**	**-1,056**	**-6.1**	**-7,280**	**-45.1**

RE : Revised Estimates. BE : Budget Estimates.

@ : Net lending was negative in 2005-06 (BE) and 2005-06 (RE) on account of decrease in loans to States/UTs following the recommendations of Twelfth Finance Commission.

Note : Figures in parentheses are percentages to GDP.

Central Government Finances – 2005-06

Revised Estimates

I.4.2 The revised estimates (RE) of the Central Government finances for 2005-06 indicate an improvement *vis-à-vis* the budget estimates (BE). The key deficit indicators, *viz*., revenue deficit, gross fiscal deficit (GFD) and primary deficit were placed lower than the budgeted levels (Table 1.31). The progress in fiscal consolidation in terms of the reduction in deficit indicators needs to be seen in the light of the 'pause' taken by the Government in its Union Budget for 2005-06. It may be recalled that 'pause' was taken from effecting the minimum annual deficit reductions prescribed under the Fiscal Responsibility and Budget Management (FRBM) Rules, 2004 on account of increased commitments in devolution of taxes and grants to States in pursuance of the recommendations of the TFC.

I.4.3 The improvement in revenue account *vis-à-vis* the budget estimates was mainly due to curtailment of non-plan revenue expenditure in respect of interest payments, subsidies and grants to States. There was, however, a shortfall in revenue receipts on account of non-tax revenue due to lower interest receipts, reflecting the impact of rescheduling of loans of the Centre to the States under the TFC's award. Tax revenues, on the other hand, turned out to be marginally higher than the budget estimates, with the improved collections under customs duties and service tax benefiting from strong import growth and upbeat activity in the services sector. The new taxes introduced in the last two budgets also boosted the overall tax revenue. Corporation tax, personal income tax and excise duties in the revised estimates were, however, lower than the budgeted levels. The gross fiscal deficit was also placed lower in the revised estimates than the budgeted level. This reduction was contributed by improved performance in the revenue account, the availability of disinvestment proceeds and lower capital outlay. The curtailment of capital outlay by Rs.5,187 crore was mainly in respect of non-defence expenditure. Loans and advances, however, exceeded the budget estimates by Rs.5,765 crore on account of post-budget provision for pass-through of loan component of Externally Aided Projects under State and Union Territory Plans.

I.4.4 Reflecting the reduction in the fiscal deficit, net market borrowings were lower by 2.6 per cent than budgeted. Market borrowings (dated securities and 364-day Treasury Bills) financed 69.2 per cent of GFD as compared with 68.7 per cent in the BE. While draw down of cash balances financed 10.3 per cent of GFD as compared with 2.1 per cent in the BE, financing from external assistance in the RE was lower at 5.1 per cent of GFD than the budgeted level of 6.4 per cent.

Table 1.32: Key Deficit Indicators of the Centre for 2005-06: Provisional Accounts

(Rupees crore)

Indicator	Budget Estimates	Revised Estimates	Provisional Accounts	Variation (per cent)	
				Col. 4 over Col.3	Col.4 over Col.2
1	2	3	4	5	6
Revenue Deficit	95,312 (2.7)	91,821 (2.6)	94,644 (2.7)	3.1	-0.7
Gross Fiscal Deficit	1,51,144 (4.3)	1,46,175 (4.1)	1,46,348 (4.1)	0.1	-3.2
Primary Deficit	17,199 (0.5)	16,143 (0.5)	14,591 (0.4)	-9.6	-15.2

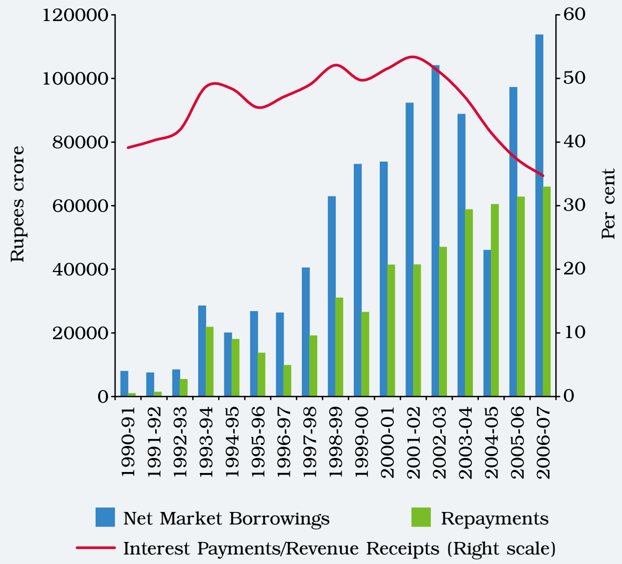
Note: Figures in parentheses are percentages to GDP.

I.4.5 The provisional accounts for 2005-06 released by the Controller General of Accounts revealed that the Central Government finances during 2005-06 were generally in line with the revised estimates. The revenue deficit widened marginally to 2.7 per cent of the GDP in the provisional accounts for 2005-06 from the revised estimate of 2.6 per cent on account of lower tax revenues. The fiscal deficit was broadly in line with the revised estimates (Table 1.32). Net market borrowings in the provisional accounts, at Rs.1,06,242 crore, financed 72.6 per cent of GFD as compared with 69.2 per cent in the revised estimates[1].

Debt Position of the Central Government

I.4.6 The fiscal consolidation process enabled a decline in the outstanding domestic liabilities of the Central Government to 60.2 per cent of GDP at end-March 2006 from 61.9 per cent at the end of the preceding fiscal year (Appendix Table 34). Internal debt, as per cent of GDP, declined to 38.4 per cent at end-March 2006 from 40.9 per cent at end-March 2005. The reduction in internal debt was facilitated by unwinding of balances under the Market Stabilisation Scheme during the year. Of the total outstanding debt of the Central Government, internal debt accounted for 61.8 per cent while small savings and provident funds constituted 22.1 per cent at end-March 2006. The total debt of the Centre is, however, still high by global standards.

Chart I.20: Debt Service of the Central Government



I.4.7 The ratio of interest payments to revenue receipts continued its downward trajectory, falling from 53.4 per cent in 2001-02 to 37.3 per cent in 2005-06 (Chart I.20). This reflected the twin impact of a moderate growth in interest payments (21.0 per cent between 2001-02 and 2005-06) and an impressive growth in revenue receipts (73.1 per cent over the same period). The average interest rate on outstanding market loans declined by 111 basis points during 2005-06 to 8.76 per cent, although weighted average yield on incremental Government market borrowings firmed up during 2005-06. On account of the States Debt Swap Scheme, the average interest cost of borrowing from National Small Savings Fund (NSSF) has also shown a marked decline in the last three years. On the other hand, the average interest rate on State Provident Funds continued to increase in 2005-06 (Table 1.33).

State Government Finances - 2005-06[2]

I.4.8 Consolidated fiscal position of State Governments for 2005-06 indicates that the States are pursuing fiscal correction and consolidation. The year 2005-06 was the first year of the award period of the TFC. The revised estimates for 2005-06 indicate a decline in the revenue deficit-GDP ratio to 0.5 per cent from 0.7 per cent in the budget estimates. The

[1] As per Reserve Bank records, net and gross market borrowings in 2005-06 were Rs.98,237 crore and Rs.1,60,018 crore, respectively.

[2] The analysis of State Finances and combined finances for 2005-06 (Revised Estimates) is based on the budgets of 29 State Governments (including National Capital Territory (NCT) of Delhi), of which 4 are *Vote-on-Accounts*. All data are provisional.

Table 1.33: Average Interest Rate on Outstanding Domestic Liabilities of the Centre

(Per cent)

Year	Market Loans	Small Savings/ NSSF	State Provident Funds	Special Deposits
1	2	3	4	5
1990-91 to 1994-95	10.86	10.85	11.63	11.53
1995-96 to 1999-2000	12.39	11.62	11.62	10.93
2000-01	12.99	11.60	10.54	9.87
2001-02	12.83	11.61	9.09	10.50
2002-03	12.11	11.56	8.53	8.82
2003-04	11.11	10.88	7.39	7.94
2004-05	9.87	9.37	7.99	7.65
2005-06 (RE)	8.76	8.91	8.15	7.49

RE: Revised Estimates.

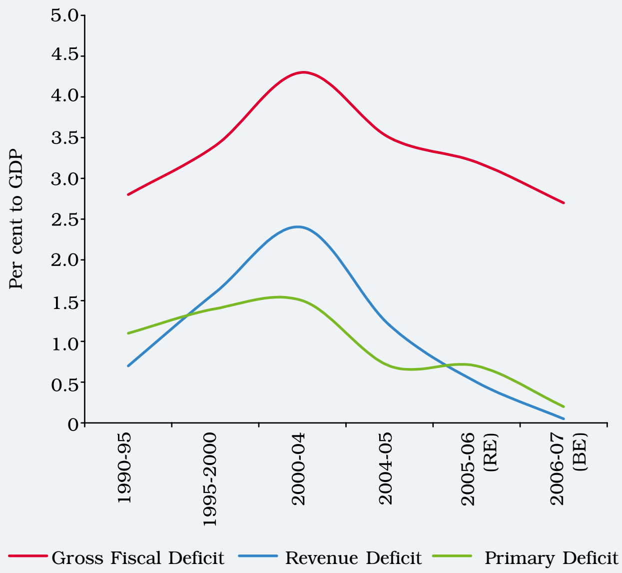
Note: 1. Market loans represent dated securities.

2. Small savings represent small saving deposits, certificates and public provident fund. Since 1999-2000, interest on small savings represents interest on Central Government Special Securities issued to the National Small Savings Fund (NSSF).
3. The Government notified the freezing of the corpus of the Special Deposit Scheme as on June 30, 2003.
4. The interest rate for each component is computed by dividing the interest payments in a year by the outstanding liabilities at the end of the preceding year.

reduction in revenue deficit was possible due to higher revenue receipts (5.6 per cent above budgeted level) offsetting the slippage in revenue expenditure (3.6 per cent). The higher revenue receipts in 2005-06 (RE) compared to the budgeted level were due to an increase in grants from the Centre (14.8 per cent) and increase in States' own tax receipts (4.4 per cent). There was, however, slippage with regard to GFD from its budgeted level on account of enhanced capital outlay (11.2 per cent) mainly in respect of irrigation, energy and transport sectors. Capital outlay, as a ratio to GDP, rose to 2.4 per cent from the budgeted level of 2.2 per cent. All the major deficit indicators, as per cent of GDP, were placed much lower in the revised estimates of 2005-06 than their average levels during the period 2000-04 as well as the second half of 1990s (Box I.12 and Chart I.21).

I.4.9 As regards financing of GFD, flows from the NSSF continued to retain their dominant position, accounting for about 65 per cent of GFD in 2005-06 (RE) followed by market borrowings (15.7 per cent) and State Provident Funds (7.9 per cent). The decline in the share of market borrowings during 2005-06 reflected completion of debt swap scheme (DSS) in 2004-05. The reduction in the share of loans from the Centre could be attributed to discontinuance of loans from the Centre following the recommendations of the TFC.

Chart I.21: Major Deficit Indicators of State Governments



COMBINED BUDGETARY POSITION OF THE CENTRE AND THE STATES – 2005-06

I.4.10 An overview of the combined finances of the Centre and States during 2005-06 reveals improvement in all the key deficit indicators *vis-à-vis* the budget estimates. Buoyant tax collections, both direct and indirect, and significantly higher non-tax receipts enabled a lower revenue deficit than was budgeted (Table 1.34). Aggregate expenditure was higher than budgeted due to an increase in development expenditure. This was largely on account of higher expenditure on relief for natural calamities, transport and communications and energy. Expenditure on medical and health services in terms of GDP improved over the budgeted levels.

Combined Debt

I.4.11 The combined outstanding liabilities, as a proportion to GDP, declined by 3.0 percentage points during 2005-06 to 79.5 per cent, reflecting the improvement in the fiscal position as well as the buoyant economic growth (Table 1.35).

Contingent Liabilities/Guarantees of the Government

I.4.12 The combined outstanding guarantees given by the Central and State Governments continued to decline during the year ended March 2005 on account of a sharp decline in the guarantees given by State Governments. The Central Government guarantees, however, increased during 2004-05 mainly on account of guarantees given in favour of Food Corporation of

Box I.12
Evolution of State Finances in India

In recent years, State finances have witnessed a significant improvement after recording progressive deterioration during the second half of the 1990s. Factors like growing revenue expenditure (particularly wages, salaries and pensions), losses of the State public sector enterprises (particularly power utilities), declining Central transfers (as per cent to GDP) and inadequate user charges contributed in large measure to the fiscal deterioration. One major reason for the sharp deterioration in the finances of the State Governments in the late 1990s was the implementation of the Fifth Pay Commission award. The slower growth in revenues in relation to expenditure and ambitious plan outlays of the States compounded the problem. With the widening gaps in the revenue account, States resorted to higher borrowings resulting in rising debt servicing costs. The States also became increasingly dependent on 'Small Savings' loans (securities issued to NSSF). The deterioration in fiscal imbalances during the late 1990s had an adverse impact on the quality of expenditure of the State Governments (Table).

The fiscal deterioration and the erosion in the quality of expenditure led to growing recognition of an urgent need to improve State finances. Based on recommendations of the Eleventh Finance Commission, the Union Government created a Fiscal Reform Facility (2000-01 to 2004-05) to provide incentives to the States to undertake Medium Term Fiscal Reforms (MTFR). The Union Government also introduced a debt swap scheme (2002-03 to 2004-05) to swap high cost debt of the State Governments with low cost debt. The State Governments also adopted specific expenditure and revenue reform measures along with undertaking institutional measures such as setting up of consolidated sinking funds and guarantee redemption funds. These steps are being backed by putting an institutional mechanism for rule-based fiscal policy through the enactment of fiscal responsibility legislations for durable fiscal adjustment plans. Efforts are underway by States to control the rising pension liabilities. The Twelfth Finance Commission (TFC) has also prescribed a path of financial restructuring for the State Governments (see Box I.14).

Table: Major Indicators of State Finances

(Per cent of GDP)

Sr. No.	Indicator	1990-91 to 1994-95	1995-96 to 1997-98	1998-99 to 2003-04	2004-05 to 2006-07
	1	2	3	4	5
1.	Gross Fiscal Deficit (GFD)	2.8	2.8	4.3	3.1
2.	Revenue Deficit (RD)	0.7	1.0	2.5	0.6
3.	Capital Outlay (CO)	1.6	1.4	1.5	2.3
4.	Revenue Receipts	12.1	11.3	11.0	12.6
5.	Own Tax Revenue	5.4	5.3	5.5	6.3
6.	Own Non-Tax Revenue	1.8	1.8	1.4	1.4
7.	Current Transfers	4.9	4.2	4.0	4.9
8.	Shareable Taxes	2.6	2.6	2.3	2.6
9.	Grants	2.3	1.7	1.7	2.3
10.	Revenue Expenditure	12.8	12.3	13.5	13.1
11.	Development Expenditure	10.8	9.6	9.7	9.8
12.	Non Development Expenditure	4.3	4.6	5.8	5.9
13.	Debt	22.2	21.4	29.1	32.7
	Memo				(Per cent)
1.	Interest Payments/Revenue Receipts	14.4	16.8	23.2	20.9
2.	RD/GFD	24.7	35.4	57.1	16.7
3.	CO/GFD	55.3	52.5	34.3	73.7

The reform measures appear to be having a favourable impact on the fiscal situation. As a ratio to GDP, revenue receipts have increased and revenue expenditure has declined in the recent years. Revenue receipts showed acceleration due to increase in own tax revenue, and shareable Central taxes and grants, despite the secular decline in States' own non-tax revenue. Reduction in revenue deficit/GDP ratio has also enabled an improvement in the quality of expenditure. Capital outlay-GDP ratio has seen a notable increase. While the decline in the developmental expenditure has been contained in recent years, the rise in non-developmental expenditure continues. Factors like inappropriate user charges and large accumulation of debt continue to affect State finances. Appropriate user charges along with improvement in the provision of public services will help in further consolidation of State finances. This will, in turn, allow States to provide higher outlays for infrastructure spending and thus contribute to the economy's growth prospects.

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Table 1.34: Indicators of Combined Finances of the Centre and States

(Amount in Rupees crore)

Item	1990-91	1995-96	2000-01	2004-05	2005-06 BE	2005-06 RE	Variation (RE over BE) Amount	Per cent
1	2	3	4	5	6	7	8	9
Gross Fiscal Deficit [II - IA - IB(a)]	53,580	77,671	1,99,852	2,34,719	2,70,901	2,63,195	-7,706	-2.8
	(9.4)	(6.5)	(9.5)	(7.5)	(7.8)	(7.5)		
Revenue Deficit [II1 - IA]	23,871	37,932	1,38,803	1,14,761	1,20,082	1,09,105	-10,977	-9.1
	(4.2)	(3.2)	(6.6)	(3.7)	(3.4)	(3.1)		
Primary Deficit	28,585	18,598	75,035	42,407	61,807	57,233	-4,574	-7.4
	(5.0)	(1.6)	(3.6)	(1.4)	(1.8)	(1.6)		
I. Total Receipts (A+B)	1,51,593	2,96,628	5,94,804	8,78,536	9,78,565	9,94,959	16,394	1.7
A. Revenue Receipts (1+2)	1,05,757	2,17,526	3,78,817	6,15,643	7,01,296	7,32,848	31,552	4.5
1. Tax Receipts (a+b)	87,564	1,74,851	3,05,374	4,92,481	5,78,711	5,91,641	12,930	2.2
a) Direct Taxes	14,267	41,603	80,215	1,56,804	1,98,593	1,99,984	1,390	0.7
b) Indirect Taxes	73,297	1,33,248	2,25,159	3,35,677	3,80,118	3,91,657	11,539	3.0
2. Non-Tax Receipts	18,193	42,675	73,443	1,23,162	1,22,584	1,41,207	18,622	15.2
B. Capital Receipts (a+b)	45,836	79,102	2,15,987	2,62,893	2,77,270	2,62,111	-15,158	-5.5
a) Non Debt Capital Receipts	3,531	6,968	12,591	19,393	7,639	13,621	5,982	78.3
b) Debt Capital Receipts	42,305	72,134	2,03,396	2,43,500	2,69,631	2,48,490	-21,141	-7.8
II. Aggregate Expenditure (1+2+3=4+5)	1,62,868	3,02,166	5,91,258	8,69,755	9,79,836	10,09,665	29,829	3.0
1. Revenue Expenditure	1,29,628	2,55,457	5,17,618	7,30,404	8,21,377	8,41,953	20,576	2.5
2. Capital Outlay	21,353	32,594	55,875	1,13,304	1,38,944	1,42,324	3,380	2.4
3. Loans and Advances	11,887	14,115	17,766	26,048	19,514	25,387	5,873	30.1
4. Development Expenditure	97,149	1,65,361	3,08,546	4,45,352	5,06,551	5,46,795	40,244	7.9
5. Non- Development Expenditure @	65,719	1,36,805	2,82,712	4,24,403	4,73,285	4,62,870	-10,415	-2.2

RE : Revised Estimates. BE: Budget Estimates.
@ : Excludes repayments.
Note : 1. Inter-Governmental transactions have been netted out.
2. Figures in parentheses are percentages to GDP.

India for procurement operations to ensure food security (Table 1.36). The net accretion to guarantee stock of the Central Government during 2004-05 was 0.57 per cent of GDP as against 0.50 per cent stipulated under FRBM Rules, 2004.

Table 1.35: Combined Liabilities of the Centre and States

(Rupees crore)

end-March	Outstanding Liabilities Centre	States	Combined	Debt-GDP Ratio (per cent) Centre	States	Combined
1	2	3	4	5	6	7
1990-91	3,14,558	1,28,155	3,68,824	55.3	22.5	64.9
1995-96	6,06,232	2,50,889	7,28,208	51.0	21.1	61.3
2000-01	11,68,541	6,02,073	14,92,032	55.4	28.6	70.8
2001-02	13,66,408	7,00,524	17,42,810	59.9	30.7	76.4
2002-03	15,59,201	7,98,921	19,83,298	63.6	32.6	81.0
2003-04	17,36,678	9,24,422	22,52,996	62.9	33.5	81.6
2004-05	19,94,422	10,43,809	25,76,650	63.9	33.4	82.5
2005-06 RE	21,95,387	11,57,476	28,05,874	62.2	32.8	79.5
2006-07 BE	24,73,562	12,61,461	31,07,051	62.6	31.9	78.6

RE: Revised Estimates. BE : Budget Estimates.
Note : 1. Under 'combined liabilities', inter-Governmental transactions are netted out.
2. Data include 'reserve funds', 'deposits and advances' and 'contingency fund'.

Table 1.36: Outstanding Government Guarantees

(Amount in Rupees crore)

end-March	Centre Amount	Per cent of GDP	States Amount	Per cent of GDP	Total Amount	Per cent of GDP
1	2	3	4	5	6	7
1993	58,088	7.8	42,515	5.7	1,00,603	13.4
1994	62,834	7.3	48,865	5.7	1,11,700	13.0
1995	62,468	6.2	48,479	4.8	1,10,947	11.0
1996	65,573	5.5	52,631	4.4	1,18,204	9.9
1997	69,748	5.1	63,409	4.6	1,33,157	9.7
1998	73,877	4.9	73,751	4.8	1,47,628	9.7
1999	74,606	4.3	97,454	5.6	1,72,060	9.9
2000	83,954	4.3	1,32,029	6.7	2,15,983	11.0
2001	86,862	4.1	1,68,719	8.0	2,55,581	12.1
2002	95,859	4.2	1,65,386	7.2	2,61,245	11.5
2003	90,617	3.7	1,84,294	7.5	2,74,911	11.2
2004	87,780	3.2	2,17,091 (P)	7.8	3,04,871	11.0
2005	1,07,957	3.5	2,00,602 (P)	6.4	3,08,559	9.9

P: Provisional.
Note : Ratios to GDP may not add up to the total due to rounding off.
Source : 1. Data on Centre's guarantees are from budget documents of the Central Government.
2. Data on States' guarantees are based on the information received from State Governments and pertain to 17 major States.

FISCAL OUTLOOK FOR 2006-07

Central Government

I.4.13 The Union Budget 2006-07 committed to take forward the fiscal correction process as prescribed under the FRBM Rules, 2004 in a conducive macroeconomic environment (Box I.13). Accordingly, the GFD is budgeted to decline by 0.3 percentage point of GDP to 3.8 per cent of GDP during 2006-07 while the revenue deficit is budgeted to decline by 0.5 percentage point to 2.1 per cent of GDP (see Table 1.31 and Appendix Table 28). The budgeted reductions in revenue and fiscal deficits match the minimum threshold reductions stipulated in the FRBM Rules, 2004. The primary deficit is also budgeted to decline to 0.2 per cent of GDP from 0.5 per cent in 2005-06. The reduction in the deficit indicators is expected to be primarily on the basis of improved revenue performance and reprioritisation of expenditure.

Box I.13

Recent Fiscal Consolidation: Role of Macroeconomic Performance

Fiscal policy plays a key role in determining an economy's growth path. Macroeconomic performance also has an impact on a country's fiscal position. For instance, high growth contributes to fiscal consolidation through improved tax collections and lower requirement for undertaking social sector expenditures such as unemployment benefits and social security. Similarly, reduction in fiscal deficit, particularly when the public debt is high and unsustainable, can accelerate economic growth through lower interest rates and increase in investment. Fiscal tightening achieved primarily through reductions in non-productive expenditure is found to have a more favourable impact on growth than that achieved through cutbacks in public investment or increases in taxes. Furthermore, fiscal consolidation that persists over time has the greatest positive effect on growth.

The impact of macroeconomic performance on fiscal operations is usually assessed through measurement of cyclical components of relevant budgetary variables. The functioning of automatic stabilisers is, however, weakened in the case of developing countries where expenditures such as unemployment benefits, which are responsive to business cycles, are less important while structural components of expenditure dominate. However, it needs to be stressed that while the effects of macroeconomic variables on the behaviour of public finances probably may prevail in the short run, the impact of autonomous fiscal policies on macroeconomic performance certainly becomes the more important linkage in the longer run.

Empirical evidence on the inverse relationship between the macroeconomic performance and cyclical fiscal position is, however, mixed. For instance, fiscal deficit in the EU countries did not fall during favourable cyclical periods as the effects of automatic stabilisers were offset by the countries' discretionary fiscal policies (European Commission, 2001). Analysing the experience of industrial countries (European countries and the US), McDermott and Wescott (1996) concluded that real economic growth did not seem to significantly affect the chances of successful action towards fiscal consolidation. The authors found that while favourable economic environment helps fiscal consolidation, the outcome is not guaranteed.

The Indian experience during the recent years shows that economic growth, through buoyant revenues, appears to have contributed to the fiscal consolidation process. For instance, during 1994-95 to 1996-97 (which experienced an average growth rate of 7.5 per cent) and the recent phase 2003-04 to 2005-06 (which experienced an average growth rate of 8.1 per cent), average annual reduction in GFD-GDP ratio of the Centre was 0.7 percentage point and 0.6 percentage point, respectively. On the other hand, during the period 1997-98 to 2002-03, which witnessed a modest growth of 5.2 per cent, the GFD-GDP ratio, on an average, increased by 0.2 percentage point annually. Since the late 1990s, the fiscal consolidation process has been primarily led by revenue augmentation which implies greater role to be played by economic growth in containment of fiscal gaps. The correlation between change in GFD-GDP ratio and real GDP growth for the period 1999-2000 to 2005-06 at (-)0.42 was substantially stronger than that of (-)0.02 for the period 1971-72 to 1989-90. The experience of the recent years suggests that prudent fiscal policy and high economic growth comprise a virtuous circle.

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Table 1.37: Decomposition of the GFD of the Centre

(Per cent)

Year	Revenue Deficit	Capital Outlay	Net Lending	Other Non-debt Receipts @
1	2	3	4	5
1990-91	41.6	27.2	31.2	0
1995-96	49.4	23.4	29.6	-2.3
2000-01	71.7	20.8	9.2	-1.8
2001-02	71.1	18.8	12.7	-2.6
2002-03	74.4	20.1	7.7*	-2.2
2003-04	79.7	27.8	6.3*	-13.8
2004-05	62.6	41.3	-0.4*	-3.5
2005-06(RE)	62.8	39.0	-0.2	-1.6
2006-07(BE)	57.0	45.0	0.6	-2.6

@ : Include disinvestment proceeds and value of bonus shares.
* : Adjusted for debt swap transactions.

I.4.14 During 2006-07, the GFD is budgeted to be lower than the gross budgetary support for the Plan. Thus, as was the case in 2004-05 (after a gap of 20 years), the financing for the Plan will not be entirely from borrowed resources. Another salient feature of the Central Government finances is the continuous decline in the revenue deficit to gross fiscal deficit ratio. This has enabled freeing of resources for undertaking capital outlays while maintaining the momentum of fiscal correction (Table 1.37).

Pattern of Receipts

I.4.15 Growth in revenue receipts in 2006-07 is budgeted to accelerate to 15.8 per cent, primarily due to higher tax collections. As a result, gross tax to GDP ratio, which has consistently increased in recent years, is budgeted to improve further to 11.2 per cent in 2006-07 (Table 1.38).

I.4.16 Among the direct taxes, corporation tax is budgeted to show a substantial growth on the back of expectations of strong economic activity as well as measures to neutralise the erosion of tax base. Personal income tax collections, on the other hand, are budgeted to decelerate in 2006-07. Under indirect taxes, the growth in collections under customs duty is budgeted to accelerate, notwithstanding the further reduction in tariffs. Service tax collections are budgeted to increase substantially, reflecting the continued policy to enhance service tax rates towards CENVAT rate level as well as the further widening of the service tax base. The growth rate in excise duty collections would, however, show a deceleration in 2006-07 (Table 1.39 and Appendix Table 30). The

Table 1.38: Gross Tax Revenues of the Centre

(Per cent to GDP)

Year	Direct Tax	Indirect Tax	Total
1	2	3	4
1990-91	1.9	8.2	10.1
1991-92	2.3	8.0	10.3
1992-93	2.4	7.5	10.0
1993-94	2.4	6.5	8.8
1994-95	2.7	6.5	9.1
1995-96	2.8	6.5	9.4
1996-97	2.8	6.6	9.4
1997-98	3.2	6.0	9.1
1998-99	2.7	5.6	8.3
1999-2000	3.0	5.8	8.8
2000-01	3.2	5.7	8.9
2001-02	3.0	5.2	8.2
2002-03	3.4	5.4	8.8
2003-04	3.8	5.4	9.2
2004-05	4.3	5.5	9.8
2005-06 (RE)	4.8	5.7	10.5
2006-07 (BE)	5.3	5.9	11.2

RE : Revised Estimates. BE : Budget Estimates.

Securities Transaction Tax and the Banking Cash Transactions Tax are budgeted to show substantial growth.

I.4.17 Non tax revenue in 2006-07 is budgeted to show a marginal increase of 2.6 per cent as higher receipts from dividends and profits are expected to offset lower interest receipts. Interest receipts are expected to maintain the declining trend on account of reduction in lending rates to State Governments and debt swap scheme which enabled them to prepay their high cost debt to the Centre.

Pattern of Expenditure

I.4.18 Aggregate expenditure, as per cent of GDP, is budgeted to decline marginally in 2006-07 on account of containment in non-Plan expenditure on subsidies and interest payments (Table 1.40 and Appendix Table 29). The share of interest payments, defence expenditure and subsidies in non-Plan revenue expenditure would decrease marginally from 69.2 per cent in 2005-06 (RE) to 69.0 per cent in 2006-07 (BE). Lower expenditure on subsidies is mainly on account of decline in interest subsidies and containment of fertilisers subsidies. The share of the Plan component in total revenue expenditure, on the other hand, would improve from 25.9 per cent in 2005-06 (RE) to 29.4 per cent in 2006-07 (BE) primarily on account of higher allocation to the Central Plan.

Table 1.39: Revenue Position of the Centre

(Rupees crore)

Item	2004-05 (Actuals)	2005-06 (RE)	2006-07 (BE)	Variation			
				2005-06		2006-07	
				Amount	Per cent	Amount	Per cent
1	2	3	4	5	6	7	8
Total Receipts (1+2)@	**4,73,137 (15.2)**	**4,93,668 (14.0)**	**5,63,991 (14.3)**	**20,531**	**4.3**	**70,323**	**14.2**
1. Revenue Receipts	3,06,013 (9.8)	3,48,474 (9.9)	4,03,465 (10.2)	42,461	13.9	54,991	15.8
Tax Revenue (Net)	2,24,798 (7.2)	2,74,139 (7.8)	3,27,205 (8.3)	49,341	21.9	53,066	19.4
Non-Tax Revenue	81,215 (2.6)	74,335 (2.1)	76,260 (1.9)	-6,880	-8.5	1,925	2.6
2. Capital Receipts	1,67,124* (5.4)	1,45,194 (4.1)	1,60,526 (4.1)	-21,930	-13.1	15,332	10.6
Non-Debt Capital Receipts	33,792* (1.1)	14,056 (0.4)	11,840 (0.3)	-19,736	-58.4	-2,216	-15.8
Debt Capital Receipts@	1,34,907 (4.3)	1,31,138 (3.7)	1,48,686 (3.8)	-3,769	-2.8	17,548	13.4
Memo:							
Gross Tax Revenue	**3,04,958 (9.8)**	**3,70,141 (10.5)**	**4,42,153 (11.2)**	**65,183**	**21.4**	**72,012**	**19.5**
Corporation Tax	82,680 (2.6)	1,03,573 (2.9)	1,33,010 (3.4)	20,893	25.3	29,437	28.4
Income Tax	49,259 (1.6)	63,500 (1.8)	73,409 (1.9)	14,241	28.9	9,909	15.6
Customs Duty	57,611 (1.8)	64,215 (1.8)	77,066 (1.9)	6,604	11.5	12,851	20.0
Union Excise Duty	99,125 (3.2)	1,12,000 (3.2)	1,19,000 (3.0)	12,875	13.0	7,000	6.3
Service Tax	14,200 (0.5)	23,000 (0.7)	34,500 (0.9)	8,800	62.0	11,500	50.0
Securities Transaction Tax	590	2,389	3,500	1,799	304.9	1,111	46.5
Banking Cash Transaction Tax	-	350	500	-	-	150	42.9

BE : Budget Estimates. RE: Revised Estimates.

@ : Excludes changes in cash balances.

* : Net of Rs.32,675 crore received under Debt Swap Scheme utilised for repayments to National Small Savings Fund (NSSF).

Note : Figures in parentheses are percentages to GDP.

I.4.19 Capital expenditure would remain unchanged at 1.9 per cent of GDP in 2006-07. Within capital expenditure, share of capital outlay is budgeted to increase from 83.3 per cent in 2005-06 to 88.3 per cent, mainly on account of higher non-defence outlay. While defence capital outlay would increase from 48.3 per cent of total capital expenditure to 49.4 per cent, non-defence capital outlay would improve from 35.0 per cent to 38.9 per cent.

I.4.20 The Budget continued with its thrust on education and health, with their shares in total expenditure budgeted to improve by 0.7 percentage point and 0.3 percentage point, respectively, in 2006-07 (Table 1.41). The Budget sought to improve

Table 1.40: Expenditure Pattern of the Centre

(Rupees crore)

Item	2004-05 (Actuals)	2005-06 (RE)	2006-07 (BE)	Variation 2005-06 Amount	Variation 2005-06 Per cent	Variation 2006-07 Amount	Variation 2006-07 Per cent
1	2	3	4	5	6	7	8
Total Expenditure	4,65,007 * (14.9)	5,08,705 (14.4)	5,63,991 (14.3)	43,698	9.4	55,286	10.9
1. Non-Plan Expenditure	3,32,731 * (10.7)	3,64,914 (10.3)	3,91,263 (9.9)	32,183	9.7	26,349	7.2
i) Interest Payments	1,26,934 (4.1)	1,30,032 (3.7)	1,39,823 (3.5)	3,098	2.4	9,791	7.5
ii) Defence	75,856 (2.4)	81,700 (2.3)	89,000 (2.3)	5,844	7.7	7,300	8.9
iii) Subsidies	43,653 (1.4)	46,874 (1.3)	46,213 (1.2)	3,221	7.4	-661	-1.4
iv) Grants to States	14,784 (0.5)	30,390 (0.9)	35,361 (0.9)	15,606	105.6	4,971	16.4
v) Other non-Plan Expenditure	71,504 * (3.3)	75,918 (2.2)	80,866 (2.0)	4,414	6.2	4,948	6.5
2. Plan Expenditure	1,32,276 (4.2)	1,43,791 (4.1)	1,72,728 (4.4)	11,515	8.7	28,937	20.1
i) Budgetary Support to Central Plan	80,120 (2.6)	1,07,253 (3.0)	1,31,285 (3.3)	27,133	33.9	24,032	22.4
ii) Central Assistance for State and UT Plans	52,156 (1.7)	36,538 (1.0)	41,444 (1.0)	-15,618	-29.9	4,906	13.4
Memo:							
Grants	55,321	73,927	86,273	18,606	33.6	12,346	16.7
Loans	37,910	11,417	8,861	-26,494	-69.9	-2,555	-22.4

BE : Budget Estimates. RE: Revised Estimates. * : Net of repayments to the NSSF.
Note : Figures in parentheses are percentages to GDP.

Table 1.41: Expenditure on Select Development Heads of the Centre

(Rupees crore)

Item	2005-06 (RE)	2006-07 (BE)
1	2	3
Agriculture	36,641 (7.2)	39,843 (7.1)
Education	15,792 (3.1)	21,670 (3.8)
Health	8,373 (1.6)	10,579 (1.9)
Rural Development	14,108 (2.8)	15,508 (2.7)
Irrigation	392 (0.1)	446 (0.1)
Total Expenditure	**5,08,705**	**5,63,991**

RE : Revised Estimates. BE : Budget Estimates.
Note : Figures in parentheses are percentages to total expenditure.

the health services by placing more emphasis on health care infrastructure and family welfare in rural areas.

Financing of Gross Fiscal Deficit

I.4.21 Net market borrowings (excluding allocations budgeted under the MSS) will continue to be the largest source of financing the GFD in 2006-07. The budget estimates have not made any provision for draw down of cash balances as compared with 10.3 per cent of GFD in the preceding year (Table 1.42 and Appendix Table 31).

Central Government Finances: April-June 2006

I.4.22 Revenue receipts of the Union Government, as a proportion to the budget estimates (BE), improved from 10.8 per cent in April-June 2005 to

Table 1.42: Financing Pattern of Gross Fiscal Deficit of the Centre

(Amount in Rupees crore)

Item	2005-06 (RE)	2006-07 (BE)
1	2	3
Gross Fiscal Deficit	1,46,175	1,48,686
Financed by		
Market Borrowings	1,01,082	1,13,778
	(69.2)	(76.5)
Securities against Small Savings	1,350	3,010
	(0.9)	(2.0)
External Assistance	7,515	8,324
	(5.1)	(5.6)
State Provident Funds	5,500	6,000
	(3.8)	(4.0)
NSSF	-7,332	648
	-(5.0)	(0.4)
Reserve Funds	3,526	1,725
	(2.4)	(1.2)
Deposit and Advances	4,654	11,013
	(3.2)	(7.4)
Postal Insurance and Life Annuity Funds	1,215	1,265
	(0.8)	(0.9)
Draw Down of Cash Balances	15,037	0
	(10.3)	(0.0)
Others #	13,627	2,923
	(9.3)	(2.0)

: Include savings (taxable) bonds 2003 and Deposits Scheme for Retiring Employees.

Note : Figures in parentheses are percentages to GFD.

13.0 per cent in April-June 2006 reflecting both higher tax and non-tax revenues. Total expenditure at 23.3 per cent of the BE was also higher than 18.2 per cent of the BE in April-June 2005. There was a substantial increase in Plan expenditure under economic and social services. There was also a sharp rise in non-Plan revenue expenditure under grants to States, food and fertiliser subsidies, and interest payments. Accordingly, as a proportion to the BE, the gross fiscal deficit and revenue deficit increased to 52.3 per cent and 83.4 per cent, respectively, during April-June 2006 from 36.1 per cent and 49.6 per cent in the corresponding period of 2005.

State Budgets 2006-07[1]

I.4.23 State budgets for 2006-07 have committed to carry forward the process of fiscal correction and consolidation. Notwithstanding the variation across the States, the consolidated position indicates that the State Governments have budgeted to achieve near revenue balance during 2006-07. The budgeted reduction in RD will facilitate a decline of 0.5 percentage point in GFD-GDP ratio during the year. Primary deficit is also budgeted to decline sharply to 0.2 per cent of GDP (Table 1.43 and Appendix Table 32). It may be mentioned that the TFC had indicated a restructuring path for the State Governments so as to achieve revenue balance by 2008-09 (Box I.14).

I.4.24 The sharp correction in revenue deficit during 2006-07 is proposed to be brought mainly by higher transfers from the Centre, especially the shareable Central taxes (Table 1.44).

Table 1.43: Major Deficit Indicators of State Governments

(Rupees crore)

Item	1990-95 (Average)	1995-00 (Average)	2000-04 (Average)	2004-05	2005-06 BE	2005-06 RE	2006-07 BE	Percentage variations Col.7/5	Col.7/6	Col.8/7
1	2	3	4	5	6	7	8	9	10	11
Gross Fiscal Deficit				109,256	110,070	113,978	105,895	4.3	3.6	-7.1
	(2.8)	(3.4)	(4.3)	(3.5)	(3.1)	(3.2)	(2.7)			
Revenue Deficit				36,423	24,770	17,284	1,786	-52.5	-30.2	-89.7
	(0.7)	(1.6)	(2.4)	(1.2)	(0.7)	(0.5)	(0.05)			
Primary Deficit				21,267	16,772	24,984	6,449	17.5	49.0	-74.2
	(1.1)	(1.4)	(1.5)	(0.7)	(0.5)	(0.7)	(0.2)			

BE : Budget Estimates. RE : Revised Estimates.

Note : Figures in parentheses are percentages to GDP.

[1] The analysis of State Finances and combined finances for 2006-07 (Budget Estimates) is based on the budgets of 29 State Governments (including NCT Delhi), of which 4 are *Vote-on-Accounts*. All data are provisional.

Box I.14

Twelfth Finance Commission (TFC) and State Finances

The Report of the TFC, which covers the period from 2005-06 to 2009-10, is expected to have far reaching implications on State finances in the medium term. A unique feature of the TFC, unlike the earlier Finance Commissions, has been its emphasis on outlining a time bound restructuring path and setting fiscal targets for the States. Besides, the TFC has recommended incentive-linked debt relief scheme, contingent upon the enactment of fiscal responsibility legislations prescribing specific annual fiscal targets.

The revised estimates of 2005-06, the first year of the TFC award period, indicate the favourable impact of recommendations of the TFC on State finances (Table). Notably, the major deficit indicators, *i.e.*, revenue deficit and gross fiscal deficit witnessed substantial improvement in 2005-06 and are budgeted to attain the TFC's targets in 2006-07. However, the consolidated position masks variations across the States in respect of these indicators.

The recommendations like enhanced devolution and transfer to the States (through shareable taxes and grants) have enabled the States to progress towards the restructuring targets set by the TFC. Moreover, the debt relief scheme of the TFC has paved way for decline in debt levels as well as interest payments. The achievement of revenue balance (even surplus) would enable the States to deploy larger resources under capital outlay as well as reduce the reliance on debt. It is noteworthy that following recommendations of the TFC, the State Governments have been expediting enactment of fiscal responsibility legislations, and setting of sinking funds and guarantee redemption funds. The benefits to the States from the award of the TFC are likely to accrue till the year 2009-10. The States would have the challenge of sustaining the fiscal prudence that they achieve under an incentivised target oriented framework without compressing their development spending, particularly in respect of the social sectors.

Table: Restructuring Plan of TFC: State Finances

(Per cent of GDP)

Sr. No.	Item	2004-05	2005-06 (RE)	2006-07 (BE)	TFC target for 2009-10	Average Annual Adjustment based on 2005-06 (RE)
1	2	3	4	5	6	7
1.	Revenue Deficit	1.2	0.5	0.05	0.0 *	-0.17
2.	Fiscal Deficit	3.5	3.2	2.7	3.0	-0.05
3.	Primary Deficit	0.7	0.7	0.2	1.0	-
4.	States' Own Tax Revenues	6.1	6.4	6.4	6.8	0.10
5.	Own Non-Tax Revenue	1.5	1.3	1.3	1.4	0.03
6.	Revenue Receipts	11.9	12.9	13.0	13.2	0.07
7.	Interest Payments	2.8	2.5	2.5	2.0	-0.13
8.	Revenue Expenditure	13.1	13.3	13.0	13.2	-0.03
9.	Capital Expenditure (Capital Outlay)	2.0	2.4	2.4	3.1	0.18
10.	Total Expenditure	18.3	17.3	16.7	16.3	-0.25
11.	Interest Payments/Revenue Receipts	23.6	19.6	19.4	15.0	-1.15
12.	Debt (end-year Adjusted Liabilities)	33.4	32.8	31.9	30.8	-0.50

* : The target for achieving revenue deficit of zero is 2008-09.

Note : The Table is based on the Budget Documents of 29 States (of which four are *Vote-on-Accounts*).

Source : Report of the Twelfth Finance Commission and Budget Documents of State Governments.

I.4.25 Correction in revenue deficit during 2006-07 will also be facilitated by deceleration in revenue expenditure, partly on account of deceleration in expenditure on administrative services and pensions (Table 1.45). Capital outlay is budgeted to decelerate during 2006-07 though, as a ratio to GDP, it would be maintained at 2.4 per cent. Power is one of the sectors under which expenditure is expected to decline in 2006-07. Developmental expenditure will decelerate during 2006-07 after recording a sharp increase in the previous year.

I.4.26 Decomposition of GFD indicates that fiscal deficit during 2006-07 would be mainly on account of capital outlay reflecting the sharp decline in revenue deficit. Small savings (NSSF) remain the major source of financing the GFD followed by market borrowings (Table 1.46 and Appendix Table 36).

I.4.27 As regards resource transfer from the Centre to States, a perusal of Union Budget 2006-07 in conjunction with State Budgets reveals that, first, States have over-estimated grants from the Centre while shareable Central taxes have been under-estimated during 2006-07. Second, as regards the financing of GFD, the flows from NSSF have been under-estimated in State Budgets for 2006-07 compared to those announced in Union Budget 2006-07. Finally, there are some differences with regard to loans from the Centre. Taking into account the data on current devolution and transfers from the Centre as indicated in the Union Budget 2006-07, the States' revenue deficit and gross

Table 1.44: Aggregate Receipts of State Governments

(Amount in Rupees crore)

Item	1990-95 (Average)	1995-00 (Average)	2000-04 (Average)	2004-05	2005-06 BE	2005-06 RE	2006-07 BE	Percentage variations Col.7/5	Percentage variations Col.7/6	Percentage variations Col.8/7
1	2	3	4	5	6	7	8	9	10	11
Aggregate Receipts (1+2)				15,50,787	11,55,807	14,99,747	13,99,224	-3.3	29.8	-6.7
				(49.7)	(33.2)	(42.5)	(35.4)			
	(16.1)	(15.2)	(17.4)	*18.6*	*16.6*	*17.4*	*16.8*			
1. Total Revenue Receipts (a+b)				3,72,075	4,30,270	4,54,152	5,13,166	22.1	5.6	13.0
	(12.1)	(10.9)	(11.4)	(11.9)	(12.4)	(12.9)	(13.0)			
(a) States Own Revenue				2,36,667	2,61,795	2,71,356	3,05,275	14.7	3.7	12.5
	(7.3)	(6.9)	(7.1)	(7.6)	(7.5)	(7.7)	(7.7)			
States Own Tax				1,89,132	2,15,243	2,24,780	2,52,573	18.8	4.4	12.4
	(5.4)	(5.3)	(5.7)	(6.1)	(6.2)	(6.4)	(6.4)			
States Own Non Tax				47,535	46,552	46,576	52,702	-2.0	0.1	13.2
	(1.8)	(1.6)	(1.4)	(1.5)	(1.3)	(1.3)	(1.3)			
(b) Central Transfers				1,35,408	1,68,475	1,82,796	2,07,891	35.0	8.5	13.7
	(4.9)	(4.0)	(4.2)	(4.3)	(4.8)	(5.2)	(5.3)			
Shareable Taxes				78,551	90,003	92,722	108,325	18.0	3.0	16.8
	(2.6)	(2.4)	(2.4)	(2.5)	(2.6)	(2.6)	(2.7)			
Central Grants				56,857	78,472	90,074	99,566	58.4	14.8	10.5
	(2.3)	(1.6)	(1.9)	(1.8)	(2.3)	(2.6)	(2.5)			
2. Capital Receipts (a+b)				1,178,712	7,25,537	10,45,595	8,86,058	-11.3	44.1	-15.3
				(37.8)	(20.8)	(29.6)	(22.4)			
	(4.0)	(4.2)	(6.0)	*6.7*	*4.3*	*4.6*	*3.8*			
(a) Loans from Centre@				26,991	31,216	11,561	13,855	-57.2	-63.0	19.8
	(1.2)	(1.0)	(1.0)	(0.9)	(0.9)	(0.3)	(0.4)			
(b) Others Capital Receipts				11,51,721	6,94,321	10,34,034	8,72,203	-10.2	48.9	-15.7
				(36.9)	(19.9)	(29.3)	(22.1)			
	(2.8)	(3.2)	(5.0)	*5.8*	*3.4*	*4.3*	*3.4*			

BE: Budget Estimates. RE: Revised Estimates.

@ : With the change in the system of accounting with effect from 1999-2000, States' share in small savings which was earlier included under loans from Centre is included under internal debt and shown as special securities issued to National Small Saving Fund (NSSF) of the Central Government. The data for the years prior to 1999-2000 as reported in this Table exclude loans against small savings, for the purpose of comparability.

Notes : 1. Figures in parentheses are percentages to GDP.

2. Since 2003-04, data on capital receipts are on a gross basis and therefore, not comparable with that of earlier years. Figures in *italics* are percentages to GDP and are on a net basis (for items of public account) and given for comparison with earlier years.

fiscal deficit will be somewhat higher than that emanating from their Budget documents. States, however, are not likely to have much difficulty in financing their budget deficits primarily due to higher accrual from NSSF. The dependence on market borrowings and loans from other sources by States is likely to be subdued during 2006-07.

Combined Budgets for 2006-07

I.4.28 With the Central Government resuming fiscal consolidation as stipulated under the FRBM Rules and the State Governments increasingly adopting fiscal responsibility legislations, all the key deficit indicators are budgeted to decline during 2006-07, both in absolute terms as well as in terms of GDP (Table 1.47).

I.4.29 Revenue receipts are budgeted to increase mainly on account of increase in tax revenue (Table 1.48 and Appendix Table 33). The combined tax-GDP ratio is budgeted to improve from 16.8 per cent in 2005-06 to 17.4 per cent in 2006-07. On the expenditure side, the share of development expenditure in total expenditure is, however, budgeted to decline from 54.2 per cent in 2005-06 to 53.6 per cent during 2006-07.

I.4.30 Market borrowings are budgeted to finance a higher proportion of the combined gross fiscal deficit during 2006-07 than in the preceding year. The contribution of small savings to GFD financing is budgeted to decline marginally during 2006-07 (Table 1.49 and Appendix Table 36).

Social Sector Expenditure

I.4.31 The combined social sector expenditure, as a proportion of GDP, is budgeted to decline marginally during 2006-07. However, expenditure on education - which is a major component of social sector expenditure, with a share of almost 44 per cent - is

Table 1.45: Expenditure Pattern of State Governments

(Amount in Rupees crore)

Item	1990-95 (Average)	1995-00 (Average)	2000-04 (Average)	2004-05	2005-06 BE	2005-06 RE	2006-07 BE	Percentage variations Col.7/5	Col.7/6	Col.8/7
1	2	3	4	5	6	7	8	9	10	11
Aggregate Expenditure				15,50,136	11,53,938	14,99,416	13,95,333	-3.3	29.9	-6.9
1+2 =3+4+5				(49.7)	(33.1)	(42.5)	(35.3)			
	(16.0)	(15.3)	(17.4)	*18.3*	*16.6*	*17.3*	*16.7*			
1. Revenue Expenditure				4,08,497	4,55,040	4,71,437	5,14,952	15.4	3.6	9.2
of which	(12.8)	(12.6)	(13.8)	(13.1)	(13.1)	(13.3)	(13.0)			
Interest Payments				87,989	93,298	88,994	99,446	1.1	-4.6	11.7
	(1.7)	(2.0)	(2.8)	(2.8)	(2.7)	(2.5)	(2.5)			
2. Capital Expenditure				11,41,639	6,98,898	10,27,979	8,80,381	-10.0	47.1	-14.4
of which				(36.6)	(20.1)	(29.1)	(22.3)			
	(3.2)	(2.7)	(3.6)	*5.2*	*3.5*	*3.9*	*3.7*			
Capital Outlay				61,559	76,764	85,331	95,192	38.6	11.2	11.6
	(1.6)	(1.4)	(1.6)	(2.0)	(2.2)	(2.4)	(2.4)			
3. Dev. Expenditure				2,93,537	3,25,848	3,62,273	3,84,040	23.4	11.2	6.0
	(10.8)	(9.6)	(9.7)	(9.4)	(9.4)	(10.3)	(9.7)			
4. Non-Dev. Expenditure				1,88,299	2,11,192	2,03,212	2,28,036	7.9	-3.8	12.2
	(4.3)	(4.9)	(6.0)	(6.0)	(6.1)	(5.8)	(5.8)			
5. Others*				10,68,300	6,16,898	9,33,931	7,83,257	-12.6	51.4	-16.1
				(34.2)	(17.7)	(26.4)	(19.8)			
	(0.9)	(0.8)	(1.7)	*2.9*	*1.2*	*1.3*	*1.2*			

RE: Revised Estimates. BE: Budget Estimates.

* : Comprises Compensation and Assignments to local bodies, Grants-in-Aid and Contributions, Reserve with Finance Department, Discharge of Internal Debt, Repayment of Loans to the Centre till 2002-03. Since 2003-04, it also includes Inter-State Settlement, Contingency Fund, Small Savings, Provident Fund, Reserve Funds, Deposit & Advances, Suspense & Miscellaneous, Appropriation to Contingency Fund and Remittances.

Note : 1. Figures in parentheses are percentages to GDP.

2. Capital expenditure starting with 2003-04 includes corresponding heads of public account, which were hitherto included on a net basis under capital receipts. The figures, therefore, are not comparable with that of earlier years. Figures in *italics* are percentages to GDP with expenditure heads of public account being excluded from capital expenditure and are given for comparison with earlier years.

budgeted to increase by 0.5 percentage point of GDP, with both the Central and State Governments allocating significantly higher outlays in the revenue account (Table 1.50).

Table 1.46: Decomposition and Financing Pattern of Gross Fiscal Deficit of States

(Per cent)

	1990-95 (Average)	1995-00 (Average)	2000-04 (Average)	2004-05	2005-06 BE	2005-06 RE	2006-07 BE
1	2	3	4	5	6	7	8
Decomposition (1 to 4)	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
1. Revenue Deficit	24.7	44.7	56.3	33.3	22.5	15.2	1.7
2. Capital Outlay	55.3	43.2	36.7	56.3	69.7	74.8	89.9
3. Net Lending	20.0	12.1	7.0	10.4	7.8	10.0	9.4
4. Disinvestments	..	..	..	..	..	..	-1.0
Financing (1 to 11)	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
1. Market Borrowings	16.0	16.1	24.6	30.1	16.3	15.7	21.0
2. Loans from Centre	49.0	40.6	7.9	-15.1	15.8	2.3	4.8
3. Loans against Securities Issued to NSSF	-	28.9 *	35.4	66.5	50.3	65.0	53.5
4. Loans from LIC, NABARD, NCDC, SBI and Other Banks	1.8	2.8	5.0	0.1	7.7	4.8	6.7
5. State Provident Fund	14.3	13.4	8.3	7.4	7.7	7.9	7.8
6. Reserve Funds	6.8	5.5	4.5	6.5	3.8	2.9	4.1
7. Deposits & Advances	9.8	9.8	3.4	7.4	-2.5	-0.5	-0.7
8. Suspense & Miscellaneous	4.3	2.7	-0.8	-9.7	-1.3	-0.8	1.7
9. Remittances	-1.4	-3.6	0.6	1.1	1.5	0.8	1.9
10. Overall Surplus (+)/Deficit (-)	4.4	-2.6	0.7	0.6	1.7	0.3	3.7
11. Others	-5.0	9.5	10.4	5.2	-0.9	1.5	-4.5

BE : Budget Estimates. RE : Revised Estimates. .. : Nil. - : Not applicable.

* : Pertains to 1999-2000 as it was introduced from that year only. The sum of items for 1995-2000 (average) will not thus be equal to 100.

Notes : 1. Overall surplus/deficit would be matched by increase/decrease in cash balance since 2003-04. This is due to Cash Balance Investment Account now included under 'Suspense and Miscellaneous' while WMA/OD from RBI is included under 'Internal Debt'.

2. 'Others' (item no.11) includes miscellaneous capital receipts, Contingency Fund, Inter-State Settlement, *etc.*

Table 1.47: Measures of Deficit of the Central and State Governments

Year	Amount (Rupees crore)			Per cent to GDP		
	Gross Fiscal Deficit	Revenue Deficit	Primary Deficit	Gross Fiscal Deficit	Revenue Deficit	Primary Deficit
1	2	3	4	5	6	7
1990-91	53,580	23,871	28,585	9.4	4.2	5.0
1995-96	77,671	37,932	18,598	6.5	3.2	1.6
2000-01	1,99,852	1,38,803	75,035	9.5	6.6	3.6
2001-02	2,26,425	1,59,350	84,039	9.9	7.0	3.7
2002-03	2,34,987	1,62,990	75,927	9.6	6.7	3.1
2003-04	2,34,502	1,59,406	56,701	8.5	5.8	2.1
2004-05	2,34,719	1,14,761	42,407	7.5	3.7	1.4
2005-06 RE	2,63,195	1,09,105	57,233	7.5	3.1	1.6
2006-07 BE	2,57,088	86,512	30,488	6.5	2.2	0.8

BE : Budget Estimates. RE : Revised Estimates.

I.4.32 To conclude, the combined finances are budgeted to show improvement during 2006-07 with the fiscal consolidation process at both the Centre and the States gathering momentum. The fiscal consolidation strategy is based on revenue augmentation through buoyant tax collections in an environment of strong economic activity and a reasonably stable tax structure. On the expenditure front, the emphasis is on reprioritising expenditures towards development expenditure, especially education and containing non-development expenditures. Notwithstanding the fiscal consolidation in recent years, the combined fiscal deficit continues to be high by global standards. The persistence of large deficits over the past decades has resulted in high levels of public debt, currently around 80 per cent of GDP. Furthermore, revenue deficits continue to remain high. Determined measures for fiscal consolidation would be necessary to achieve the declared FRBM targets so that the current growth momentum of the Indian economy can be maintained.

Table 1.48: Combined Receipts and Disbursements of the Centre and States

(Amount in Rupees crore)

Item	2005-06 (RE)	2006-07 (BE)	Variation	
			Amount	Per cent
1	2	3	4	5
Total Receipts (A+B)	9,94,959	11,07,432	1,12,473	11.3
A. Revenue Receipts (1+2)	7,32,848	8,35,469	1,02,621	14.0
1 Tax Receipts (a+b)	5,91,641	6,88,103	96,462	16.3
a) Direct Taxes	1,99,984	2,40,728	40,744	20.4
b) Indirect Taxes	3,91,657	4,47,375	55,718	14.2
2 Non Tax Receipts	1,41,207	1,47,365	6,158	4.4
B. Capital Receipts	2,62,111	2,71,963	9,852	3.8
Total Disbursements (A+B)	10,09,665	11,03,534	93,869	9.3
A. Development Expenditure	5,46,795	5,91,683	44,888	8.2
B. Non-Development Expenditure@	4,62,869	5,11,852	48,983	10.6

RE: Revised Estimates. BE: Budget Estimates.
@: Exclude repayments.
Note : Figures in parentheses are percentages to GDP.

Table 1.49: Financing of Gross Fiscal Deficit of the Centre and States

(Rupees crore)

Year	Market Borrowings	State Provident Funds	Small Savings	External Borrow-ings	Others	Gross Fiscal Deficit
1	2	3	4	5	6	7
2004-05	83,849 (35.7)	13,344 (5.7)	87,690 (37.4)	14,753 (6.3)	35,083 (14.9)	2,34,719 (100.0)
2005-06 BE	1,19,899 (44.3)	12,925 (4.8)	90,000 (33.2)	9,656 (3.6)	38,421 (14.2)	2,70,901 (100.0)
2005-06 RE	1,18,993 (45.2)	13,733 (5.2)	89,800 (34.1)	7,515 (2.9)	33,153 (12.6)	2,63,195 (100.0)
2006-07 BE	1,36,013 (52.9)	14,190 (5.5)	86,500 (33.6)	8,324 (3.2)	12,061 (4.7)	2,57,088 (100.0)

BE: Budget Estimates. RE: Revised Estimates.
Note : Figures in parentheses are percentages to GFD.

Table 1.50: Combined Expenditure of the Centre and States on Social Sector

(Amount in Rupees crore)

Item	2004-05	2005-06 (BE)	2005-06 (RE)	2006-07 (BE)
1	2	3	4	5
Expenditure on Social Sector *	2,30,956	2,66,630	2,86,259	3,09,444
of which: Social Services	1,77,013	2,05,351	2,22,172	2,42,722
of which:				
i) Education	85,792	99,238	1,03,194	1,35,416
ii) Medical & Public Health	25,764	32,538	33,874	3,9251
Per cent to GDP				
Expenditure on Social Sector	7.4	7.7	8.1	7.8
of which: Social Services	5.7	5.9	6.3	6.1
of which:				
i) Education	2.7	2.9	2.9	3.4
ii) Medical & Public Health	0.8	0.9	1.0	1.0
Per cent to Total Expenditure				
Expenditure on Social Sector	26.6	27.2	28.4	28.0
of which: Social Services	20.4	21.0	22.0	22.0
of which:				
i) Education	9.9	10.1	10.2	12.3
ii) Medical & Public Health	3.0	3.3	3.4	3.6

* : Expenditure on social sector includes expenditure on social services, rural development and food subsidies.

V. FINANCIAL MARKETS

I.5.1 Global financial markets remained generally benign during 2005-06 notwithstanding a sharp rise in international crude oil prices and growing global financial imbalances. Although short-term interest rates moved up in a number of economies, financing conditions were favourable as real long term rates remained at very low levels and equity prices recorded large gains. Financing conditions in emerging market economies (EMEs) also benefited from record low spreads, reflecting shortage of foreign currency denominated bonds on account of improvements in the fiscal position of many EMEs as well as buybacks of outstanding bonds. Global financial markets, however, exhibited large volatility during May-June 2006 on concerns over rising inflation and expectations that central banks might tighten monetary policy further. Risk spreads widened as investors re-priced risk. Foreign investors pulled out from EMEs, even as fundamentals remained largely strong.

I.5.2 Indian financial markets remained on the whole orderly during 2005-06 even as interest rates edged up across the spectrum in the second half of the financial year. Liquidity conditions were generally comfortable except for some tightness in the fourth quarter due to the redemption of the India Millennium Deposits (IMDs) amidst sustained credit growth and build-up of cash balances by the Government of India. Call money rates remained generally close to the reverse repo rate for most part of the first half of 2005-06, while remaining close to/exceeding the repo rate in the fourth quarter. Interest rates in the collateralised segment of the money market – which now dominates the turnover in the money market – also edged up, but remained below the repo rate during the fourth quarter. The foreign exchange market remained by and large orderly, exhibiting two-way movements. Yields in the Government securities market hardened during 2005-06 and the yield curve flattened. In the credit market, deposit and lending rates edged up during the year as credit demand accelerated further. Capital markets remained buoyant during 2005-06. The stock indices reached record highs, driven by increased interest by domestic as well as foreign investors on the back of strong macroeconomic fundamentals. Buoyancy in secondary markets enabled a substantial increase in resources raised by the Indian corporates through domestic as well as euro issues (Table 1.51).

Table 1.51: Domestic Financial Markets at a Glance

Month	Call Money		Govt. Securities		Foreign Exchange				Liquidity Management		Equity			
	Average Daily Turnover (Rupees crore)	Average Call Rates* (Per cent)	Average Turnover in Govt. Securities (Rupees crore)+	Average 10-year Yield@ (Per cent)	Average Daily Inter-bank Turnover (US $ million)	Average Exchange Rate (Rs. per US $)	RBI's Net Foreign Currency Sales(-)/ Purchases(+) (US $ million)	Average Forward Premia 3-month (Per cent)	Average MSS Outstanding (Rupees crore) #	Average Daily LAF Outstanding (Rupees crore)	Average Daily BSE Turnover (Rupees crore)	Average Daily NSE Turnover (Rupees crore)	Average BSE Sensex**	Average S & P CNX Nifty**
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
2004-05 ^	**14,170**	**4.65**	**4,826**	**6.22**	**8,892**	**44.93**	**20,847 £**	**1.66**	**46,445**	**35,592**	**2,050**	**4,506**	**5741**	**1805**
2005-06 ^	**17,979**	**5.60**	**3,643**	**7.12**	**12,738**	**44.27**	**8,143 £**	**1.60**	**58,792**	**10,986**	**3,251**	**6,253**	**8280**	**2513**
April	17,213	4.77	3,001	7.02	9,880	43.74	0	1.96	65,638	30,675	1,890	4,136	6379	1987
May	15,269	4.99	3,805	7.11	10,083	43.49	0	1.57	68,539	22,754	1,971	3,946	6483	2002
June	20,134	5.10	6,807	6.88	10,871	43.58	-104	1.40	70,651	13,916	2,543	4,843	6926	2134
July	20,046	5.02	3,698	7.13	11,003	43.54	2,473	1.56	70,758	10,754	3,095	6,150	7337	2237
August	16,158	5.02	4,239	7.04	11,749	43.62	1,552	0.69	71,346	34,832	3,452	6,624	7726	2358
September	16,292	5.05	5,207	7.04	10,040	43.92	0	0.62	67,617	30,815	3,871	6,923	8272	2512
October	17,164	5.12	2,815	7.14	13,087	44.82	0	0.69	68,602	18,608	2,955	6,040	8220	2487
November	22,620	5.79	3,314	7.10	11,228	45.73	0	0.67	67,041	3,268	2,635	5,480	8552	2575
December	21,149	6.00	2,948	7.13	13,808	45.64	-6,541	1.51	52,040	1,452	3,516	6,814	9162	2773
January	17,911	6.83	3,094	7.15	16,713	44.40	0	2.60	40,219	-15,386	3,966	7,472	9540	2893
February	13,497	6.93	2,584	7.32	15,798	44.33	2,614	2.85	33,405	-13,532	3,688	7,125	10090	3019
March	18,290	6.58	2,203	7.40	17,600	44.48	8,149	3.11	29,652	-6,319	5,398	9,518	10857	3236
2006-07														
April	16,909	5.62	3,685	7.45	17,574 P	44.95	4,305	1.31	25,709	46,088	4,860	9,854	11742	3494
May	18,074	5.54	3,550	7.58	17,908 P	45.41	504	0.87	26,457	59,505	4,355	9,155	11599	3437
June	17,425	5.73	2,258	7.89	14,512 P	46.06	0	0.73	31,845	48,611	3,131	6,567	9935	2915
July	18,254	5.86	2,243	8.29	14,047 P	46.46	n.a.	0.83	36,936	48,188	2,605	5,652	10557	3092

* : Average of daily weighted call money borrowing rates. + : Average of daily outright turnover in Central Government dated securities.
@ : Average of daily closing rates. ** : Average of daily closing indices. # : Average of weekly outstanding MSS. n.a. : Not Available.
^ : Data are monthly averages. P : Provisional. £ : Cumulative for the financial year. LAF : Liquidity Adjustment Facility.
MSS : Market Stabilisation Scheme. BSE : The Stock Exchange, Mumbai. NSE : National Stock Exchange of India Ltd .
Note : In column 11, (-) indicates injection of liquidity while (+) indicates absorption of liquidity.

INTERNATIONAL FINANCIAL MARKETS

I.5.3 Short-term rates increased in a number of economies during 2005-06 in consonance with continuous monetary tightening as central banks raised their policy rates to ward off inflationary pressures stemming from higher international crude oil prices in an environment of strong domestic demand (Table 1.52). Short-term rates have increased further in a number of economies during 2006-07 so far. In some economies such as Brazil, short-term rates eased in response to weakening of economic activity.

I.5.4 Long-term Government bond yields in major economies remained largely range-bound during 2005-06. This reflected a variety of factors such as: increased demand for fixed income products from pension funds and insurance companies in response to regulatory changes; excess of global savings over global investment; and reduction in inflation risk premium. Intra-year movements in yields were influenced by inflation developments and expectations about the future course of monetary policy. Thus, 10-year Treasury yields in the US declined initially to a 14-month low of 3.8 per cent in early-June 2005 on expectations that monetary authorities could slow down policy tightening due to fragility in the economic recovery. Yields, however, firmed up during July 2005 on expectations that revaluation of the Chinese currency could lead to a reduction in demand for bonds of advanced economies. With the Chinese authorities continuing to manage the renminbi tightly, the yields reversed the increasing trend. Yields, however, again increased in the third quarter of 2005-06 as sharp rise in headline inflation increased expectations regarding future policy rates. In the second half of December 2005, 10-year yields eased again and by the close of December 2005 the yield curve in the US became inverted (Chart I.22). Yields again increased from the second week of January 2006 reaching 4.86 per cent on March 31, 2006 – the highest since June 2004 – on the back of strong data and expectations that the US Fed may push the Federal Funds rate target higher than anticipated. Yields increased further during the first quarter of 2006-07 reflecting concerns over growing inflationary pressures. Long-term yields in Japan increased during 2005-06 reflecting improved economic prospects as also the decision of the Bank of Japan (March 2006) to switch back its operating target to the

Table 1.52: Short-term Interest Rates

(Per cent)

Region/Country	At end of March 2005	At end of March 2006	At end of July 2006
1	2	3	4
Advanced Economies			
Euro Area	2.15	2.80	3.14
Japan	0.02	0.04	0.34
Sweden	1.97	1.99	2.25
UK	4.95	4.58	4.70
US	2.90	4.77	5.45
Emerging Market Economies			
Argentina	4.56	9.63	10.13
Brazil	19.25	16.54	14.66
China	2.25	2.40	2.73
Hong Kong	2.79	4.47	4.39
India	**5.37**	**6.11**	**6.44**
Malaysia	2.82	3.51	3.93
Philippines	7.25	7.38	7.56
Singapore	2.06	3.44	3.56
South Korea	3.54	4.26	4.63
Thailand	2.64	5.10	5.40

Note : Data for India refer to 91-day Treasury Bills rate and for other countries 3-month money market rates.

Source : The Economist.

Chart I.22: Long-term Yields – Advanced Economies

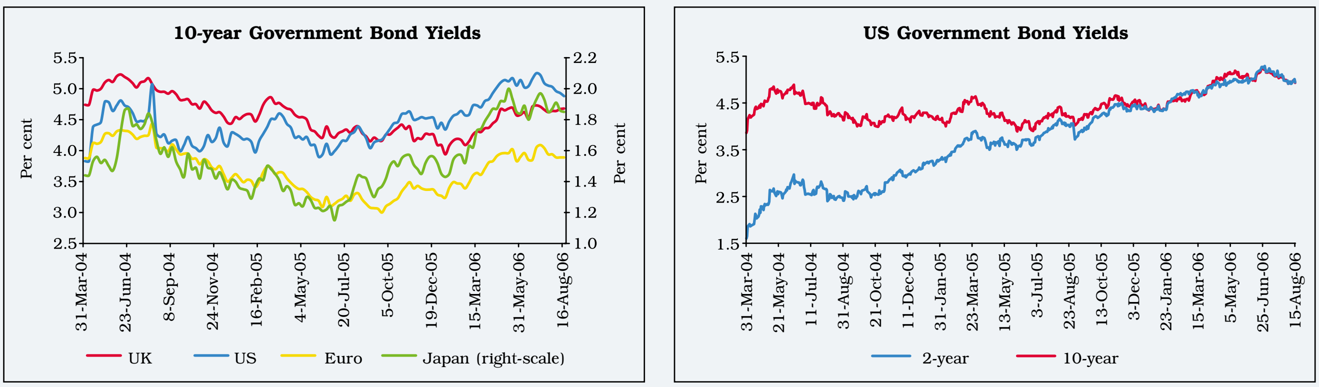


Table 1.53: Equity Markets in 2005-06

Country (Index)	Percentage variation*	P/E Ratio 31-Mar-2005	P/E Ratio 31-Mar-2006	Volatility**
1	2	3	4	5
Emerging Markets				
Russia (RTS)	114.5	15.8	22.5	26.8
India (BSE Sensex)	**73.7**	**15.6**	**20.9**	**16.7**
Brazil (Bovespa)	42.6	10.5	12.0	15.7
South Korea (KOSPI)	40.8	13.9	10.9	13.3
Indonesia (Jakarta Composite)	22.5	11.8	14.1	6.9
Singapore (Straits Times)	18.3	14.2	15.3	4.6
Taiwan	10.1	11.1	13.8	4.4
Thailand (Bangkok SET)	7.6	9.6	7.4	4.3
Malaysia (KLSE Composite)	6.3	13.8	13.0	2.2
Developed Markets				
US (DJIA)	5.8	19.1	18.6	2.7
US (Nasdaq)	17.0	-	-	5.1
UK (FTSE 100)	21.9	14.5	15.1	6.0
Japan (Nikkei 225)	46.2	27.7	36.0	14.7
Hong Kong (Hang Seng)	16.9	14.4	12.7	4.7
Memo:				
MSCI Emerging Markets	45.9	-	-	12.8
MSCI Asia	20.1	-	-	6.6

* : Variation between end-March 2005 and end-March 2006.
** : Measured as coefficient of variation.
Source : Moneyline Telerate, The Stock Exchange, Mumbai (BSE) and Financial Times, London.

uncollateralised overnight call rate. In the UK, the yields eased marginally during 2005-06 in tandem with short-term rates.

I.5.5 Equity markets in many economies exhibited buoyancy during 2005-06 (Table 1.53). Many EMEs in particular, recorded sharp gains reflecting improvements in their fundamentals as well as higher risk appetite in an environment of very low long-term real interest rates. This pushed up valuations sharply and in some cases to new highs. Equity markets in the US under-performed as equities struggled to cope with the impact of higher US interest rates and increasing activity by US investors in overseas markets. Equity markets, however, registered sharp losses in a number of economies during the quarter ended June 2006 following the turmoil in global financial markets on higher than anticipated US inflation and the concomitant increase in risk aversion.

I.5.6 In the foreign exchange market, the US dollar appreciated during 2005-06. Growing interest rate and growth differential in favour of the US contributed to the US dollar's appreciation, offsetting concerns over its growing macroeconomic imbalances. A year-long tax break designed to encourage US multinationals to repatriate cash held overseas during 2005 also boosted the US dollar (Chart I.23). The US dollar has, however, depreciated during 2006-07 so far over concerns of growing macroeconomic imbalances.

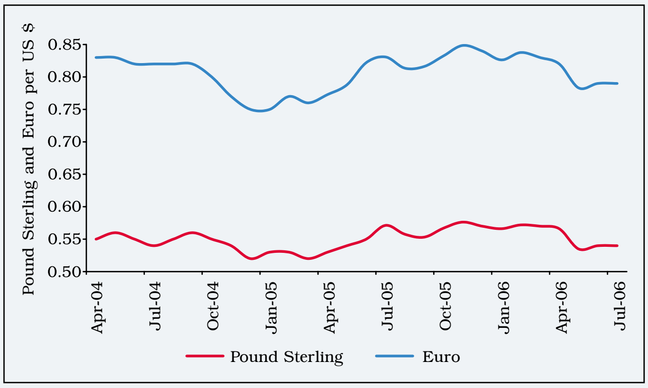
DOMESTIC FINANCIAL MARKETS

Money Market

Call/Notice Money Market

I.5.7 Money market conditions remained largely comfortable during 2005-06, except during the period mid-December 2005 to end-February 2006. During the first half of 2005-06, call money rates were closer to the reverse repo rate, the lower band of the LAF corridor, reflecting comfortable liquidity conditions. With the increase in the fixed reverse repo rate by 25 basis points on April 29, 2005, call rates also edged up by a similar magnitude. Towards the end of June 2005, call rates rose above the reverse repo rate under liquidity pressures on account of advance tax payments and scheduled Treasury Bills auctions. Call rates, however, edged lower towards the reverse repo rate by mid-July 2005 as liquidity conditions improved due to cancellation of some scheduled

Chart I.23: Exchange Rate of Major Currencies per US dollar

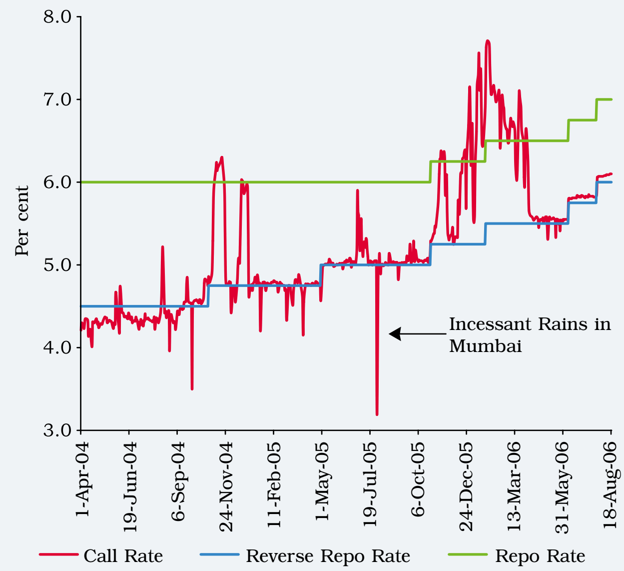


Treasury Bills auctions, return of advance tax payments to the banking system and foreign currency purchases from the authorised dealers during July-August 2005. Call rates remained broadly stable between August 2005 and October 2005 except for transitory mild pressure during the second half of September 2005 reflecting advance tax outflows and scheduled auctions (Chart I.24). During November 2005, the call money rate remained generally above the reverse repo rate and also exceeded the repo rate on a few occasions reflecting liquidity pressures emanating from sustained credit demand, festival demand for currency and scheduled auctions. The Reserve Bank, therefore, injected liquidity into the system through LAF repos on seven occasions during the month (Appendix Table 37). The notified amount of Treasury Bills auctions under the MSS was also cancelled. To fine tune the management of liquidity and in response to suggestions from the market participants, the Reserve Bank introduced a Second Liquidity Adjustment Facility (SLAF), with effect from November 28, 2005.

I.5.8 Beginning with the second half of December 2005, call money rates again edged up and generally remained above the repo rate reflecting liquidity pressures emanating from the IMD redemptions amidst sustained large credit offtake and quarter-end advance tax payments. The Reserve Bank accordingly injected liquidity through LAF operations, unwinding of MSS and purchases of foreign currency. The call rates eased during the second half of March 2006, reflecting improvement in liquidity conditions.

I.5.9 The interest rates in the collateralised segments of the money market also edged higher during the fourth quarter. However, in contrast to call money market, the rates in the collateralised segment

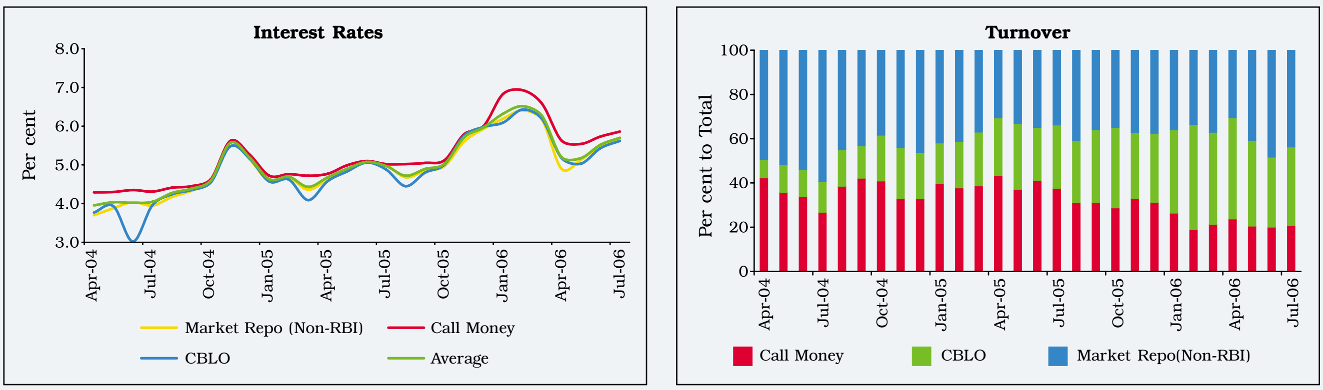
Chart I.24: Call Rate and the Reverse Repo Rate



– the market repo (outside the LAF) and the Collateralised Borrowing and Lending Obligation (CBLO) segments – remained below the repo rate. For instance, the rates in the CBLO segment averaged 6.3 per cent during January-February 2006, lower than that of 6.9 per cent in the call money market for the same period. The collateralised market has now emerged as the predominant segment in the money market, with a share of nearly 80 per cent of the total turnover (Chart I.25). The higher call money rates during the last quarter of 2005-06 thus reflected not only liquidity pressures but also the shortage of the eligible collateral with the borrowing banks.

I.5.10 A noteworthy development during the year, as mentioned above, was the substantial migration of money market activity from the uncollateralised call money segment to the collateralised market repo and

Chart I.25: Money Markets – Interest Rates and Turnover



CBLO (Table 1.54). This migration of activity has been largely the result of the considered policy of phasing out non-bank participants from the call money market, the process for which was completed in August 2005. Volumes in the market repo (outside the LAF) increased from Rs.3,043 crore in April 2005 to Rs.7,991 crore in March 2006 whereas in the CBLO markets, the volumes increased from Rs.5,185 crore to Rs.17,887 crore. Thus, the share of the uncollateralised call market in the total overnight market transactions declined from 51.0 per cent in April 2005 to 26.1 per cent in March 2006. The CBLO market emerged as the preferred overnight segment in 2005-06. By March 2006, 152 members with 79 active members have been admitted in the CBLO segment of the Clearing Corporation of India Limited (CCIL). Initially, only one insurance company and a few cooperative banks had been supplying funds in this segment. However, now mutual funds have emerged as the largest suppliers of funds. For the borrowing banks, CBLO is attractive since it offers anonymity and provides funds at lower costs. The composition of borrowers is undergoing change with corporates becoming significant borrowers.

I.5.11 During 2006-07 so far, call rates have remained close to the reverse repo rate. Reflecting comfortable liquidity conditions, average call rates eased to 6.10 per cent as on August 18, 2006, 54 basis points lower than that at end-March 2006.

Certificates of Deposit

I.5.12 There was a sharp increase in issuances of certificates of deposit (CDs) during 2005-06 – the amount of CDs outstanding increased from Rs.12,078 crore at end-March 2005 to Rs.43,568 crore by end-March 2006 (Chart I.26 and Appendix Table 38). As on July 7, 2006, the outstanding amount of CDs increased further to Rs.57,256 crore. The large recourse to CDs could be attributed to banks' demand for funds in the wake of acceleration in demand for bank credit. Outstanding CDs constituted 4.8 per cent of aggregate deposits of issuing banks at end-March 2006, marginally higher than that of 4.1 per cent a

Table 1.54: Activity in Money Market Segments

(Rupees crore)

Month	Average Daily Turnover #				Commercial Paper		Certificates of Deposit Outstanding
	Call Money Market	Market Repo (Outside the LAF)	Collateralised Borrowing and Lending Obligation (CBLO)	Term Money Market	Outstanding	Amount Issued	
1	2	3	4	5	6	7	8
2004-05 ^	**14,170**	**17,135**	**6,697**	**526**	**11,723**	**1,090**	**6,052**
2005-06 ^	**17,979**	**21,183**	**20,039**	**833**	**17,285**	**3,140**	**27,298**
April	17,213	12,174	10,370	661	15,598	3,549	16,602
May	15,269	13,688	12,233	545	17,182	3,824	17,689
June	20,134	17,163	11,792	534	17,797	2,925	19,270
July	20,046	18,103	15,292	717	18,607	3,360	20,768
August	16,158	21,325	14,544	754	19,508	4,110	23,568
September	16,292	18,872	17,143	1,116	19,725	2,519	27,641
October	17,164	20,980	21,763	734	18,726	2,892	29,193
November	22,620	25,660	20,496	917	18,013	2,483	27,457
December	21,149	25,574	21,265	775	17,234	4,104	32,806
January	17,911	24,596	25,634	1,089	16,431	1,937	34,521
February	13,497	24,096	34,162	813	15,876	3,160	34,487
March	18,290	31,964	35,775	1,338	12,718	2,813	43,568
2006-07							
April	16,909	21,914	32,657	894	16,550	6,065	44,059
May	18,074	36,107	34,293	945	17,067	4,701	50,228
June	17,425	42,250	27,617	1,256	19,550	4,981	56,390
July	18,254	38,684	31,340	864	20,602	5,812	57,256*

: Turnover is twice the single leg volumes in case of call money and CBLO to capture borrowing and lending both, and four times in case of market repo (outside LAF) to capture the borrowing and lending in the two legs for a repo.
^ : Data are monthly averages. * : As on July 7, 2006.

Chart I.26: Certificates of Deposit

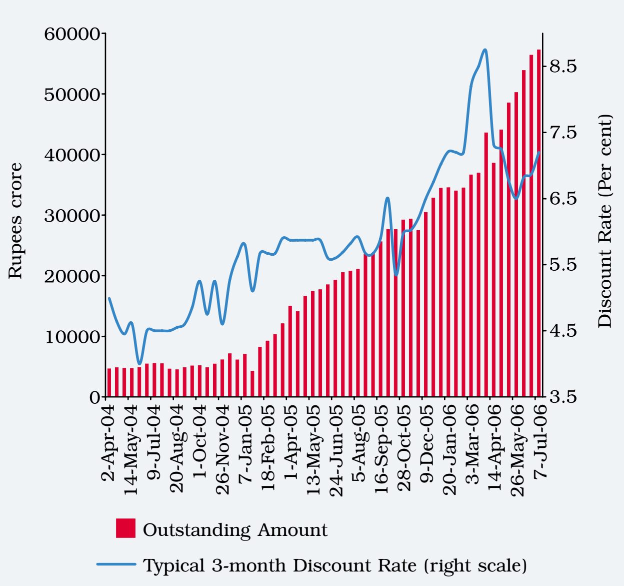
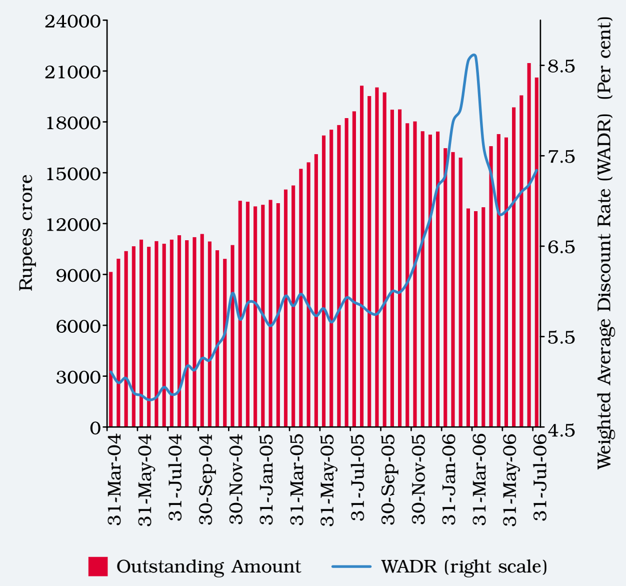


Chart I.27: Commercial Paper



year ago. Private sector banks were the major issuers of CDs. Reflecting the competitive pressures on banks to offer competing returns to attract wholesale corporate and mutual fund surpluses in an environment of tight liquidity, the issuance costs recorded a sharp rise during 2005-06. The typical discount rate for 3-month maturity on CDs increased from 5.87 per cent in March 2005 to 8.72 per cent in March 2006. The discount rate has since eased to 7.20 per cent as on July 7, 2006.

Commercial Paper

I.5.13 Issuances of commercial paper (CP), which had exhibited sustained increase till mid-September 2005, witnessed a slowdown during the second half of 2005-06. Outstanding CPs after increasing from Rs.14,235 crore at end-March 2005 to Rs.20,019 crore by mid-September 2005 declined to Rs.12,718 crore by end-March 2006 (Chart I.27 and Appendix Table 39). The weighted average discount rate (WADR) on CPs increased from 5.84 per cent on March 31, 2005 to 8.59 per cent on March 31, 2006. Following the easing of liquidity conditions, issuances under CPs have increased during 2006-07 so far and the outstanding amount of CPs was Rs.20,602 crore as on July 31, 2006; concomitantly, the WADR eased to 7.34 per cent.

I.5.14 Leasing and finance companies remained the pre-dominant issuers of CPs, partly reflecting the policy of phasing out the access of these companies to public deposits (Table 1.55). Issuances by manufacturing companies, on the other hand, recorded a decline. This could be attributed to a variety of factors such as enhanced efficiency in their operations and larger internal accruals. Sub-PLR lending has also enabled some of the corporates to raise funds at comparable rates from banks without incurring additional cost towards stamp duty, demat costs and fees for Issuing and Paying Agents (IPAs) associated with the launching of CP. Currently, a corporate having minimum credit rating of P2 of CRISIL or its equivalent can raise resources through CP. However, the CP issuance is dominated by the prime rated companies. The most preferred maturity of CP had been periods ranging from '61 to 90 days' and '181 days and above'.

Table 1.55: Commercial Paper – Major Issuers

(Rupees crore)

Category of Issuer	End of			
	March 2004	March 2005	March 2006	July 2006
1	2	3	4	5
Leasing and Finance	4,423 (48.4)	8,479 (59.6)	9,400 (73.9)	13,624 (66.1)
Manufacturing	2,039 (22.4)	2,881 (20.2)	1,982 (15.6)	3,993 (19.4)
Financial Institutions	2,670 (29.2)	2,875 (20.2)	1,336 (10.5)	2,985 (14.5)
Total	**9,131 (100.0)**	**14,235 (100.0)**	**12,718 (100.0)**	**20,602 (100.0)**

Note : Figures in parentheses are percentage share to the total.

Chart I.28: Movement of Rupee *vis-à-vis* Major Currencies

Forward Rate Agreements (FRAs)/Interest Rates Swaps (IRS)

I.5.15 The outstanding notional principal amount in FRAs/IRS market rose from Rs.13,58,487 crore in April 2005 to Rs.21,94,637 crore in March 2006. Select foreign banks, private sector banks and Primary Dealers (PDs) are the major participants in this market. The interest rate derivatives market in India has remained an Over-the-Counter (OTC) market and the exchange traded products introduced in 2003 have not picked up.

FOREIGN EXCHANGE MARKET

I.5.16 In the foreign exchange market, the Indian rupee exhibited two-way movement *vis-à-vis* the US dollar during 2005-06, moving in a range of Rs.43.30–46.33 per US dollar (Chart I.28).

I.5.17 The rupee, which was largely range bound during the first quarter of 2005-06, witnessed some appreciation following the revaluation of the Chinese renminbi on July 21, 2005. The rupee reached Rs.43.56 per US dollar on August 18, 2005. The Reserve Bank made net market purchases of US $ 4.0 billion during July-August 2005 (Table 1.56 and Chart I.29). The rupee, however, came under pressure from end-August 2005 under the impact of oil prices, sharp increase in the current account deficit and strong US dollar. The exchange rate moved to Rs.46.33 per US dollar on December 8, 2005. With the revival of FII inflows and weakening of the US dollar in the international markets, the rupee strengthened sharply beginning with the second half of December 2005 notwithstanding the IMD redemptions. Sales of US $ 6.5 billion during December 2005 on account of redemption of IMDs were recouped by purchases of US $ 10.8 billion during February-March, 2006. The exchange rate was Rs.44.61 per US dollar as on March 31, 2006. At this level, the Indian rupee depreciated by 1.9 per cent over its level on March 31, 2005. On an annual average basis, the rupee, however, appreciated by 1.5 per cent against the US dollar. Based on daily data, the standard deviation of rupee-dollar exchange rate decreased from 1.03 during 2004-05 to 0.79 during 2005-06. Reflecting cross-currency movements, the rupee appreciated by 4.4 per cent against the Euro, 5.5 per cent against the Pound sterling and 7.3 per cent against the Japanese yen

Table 1.56: Purchases and Sales of US Dollars by the Reserve Bank

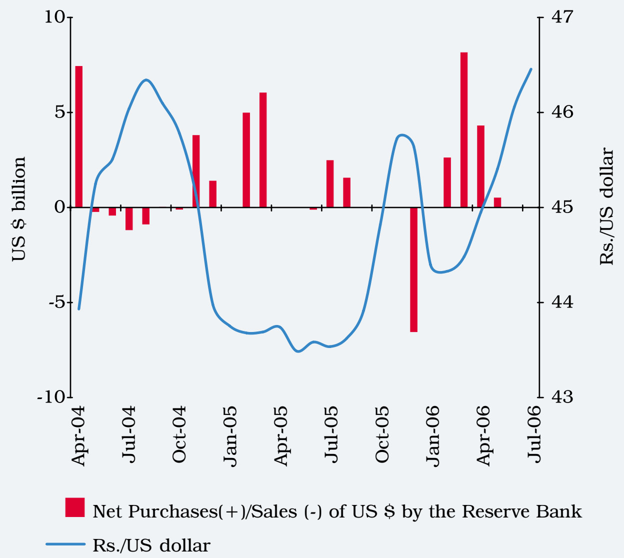
(US $ million)

Month	Purchases(+)	Sales (-)	Net (+/-)	Cumulative (during the financial year)	Outstanding Net Forward Sales (-) / Purchases (+) (end of month)
1	2	3	4	5	6
2004-05	**31,398**	**10,551**	**(+) 20,847**	**(+) 20,847**	**781**
2005-06	**15,239**	**7,096**	**(+) 8,143**	**(+) 8,143**	**0**
April	0	0	0	0	0
May	0	0	0	0	0
June	0	104	(-) 104	(-) 104	0
July	2,473	0	(+) 2,473	(+) 2,369	0
August	2,003	451	(+)1,552	(+) 3,921	0
September	0	0	0	(+) 3,921	0
October	0	0	0	(+) 3,921	0
November	0	0	0	(+) 3,921	0
December	0	6,541	(-) 6,541	(-) 2,620	0
January	0	0	0	(-) 2,620	0
February	2,614		(+) 2,614	(-) 6	0
March	8,149	0	(+) 8,149	(+) 8,143	0
2006-07					
April	4,305	0	(+) 4,305	(+) 4,305	0
May	504	0	(+) 504	(+) 4,809	0
June	0	0	0	(+) 4,809	0

(+) : Implies purchases including purchase leg under swaps and outright forwards.
(-) : Implies sales including sale leg under swaps and outright forwards.
Note : This Table is based on value dates and data are inclusive of transactions under India Millennium Deposits.

between end-March 2005 and end-March 2006. On an annual average basis, the rupee appreciated by 5.0 percent each against the Pound sterling and the euro and by 6.8 per cent against the Japanese yen.

Chart I.29: Foreign Exchange Market Intervention and Exchange Rate



I.5.18 During 2006-07 so far, the rupee has depreciated *vis-à-vis* the US dollar from Rs.44.61 per US dollar at end-March 2006 to Rs.46.48 per US dollar as on August 18, 2006 partly reflecting FII outflows, higher oil prices and further monetary tightening in the US.

I.5.19 In order to take into account the changing composition of India's trade, revised Nominal Effective Exchange Rate (NEER) and Real Effective Exchange Rate (REER) indices have been constructed with 1993-94 as the base year (Box I.15). The revised 36-currency NEER appreciated by 2.9 per cent during 2005-06, while the REER appreciated by 2.4 per cent (Appendix Table 40).

I.5.20 Forward premia declined during the first half of 2005-06 in tandem with the narrowing of interest rate differential following the higher pace of monetary tightening in the US. The premia, however, edged higher from December 2005 reflecting the rise in domestic money market rates (Chart I.30). Forward premia again declined during the first quarter of 2006-07 in tandem with the narrowing of interest rate differential following easing of domestic money market interest rates coupled with further monetary tightening in the US.

Box I.15
Revision of Nominal and Real Effective Exchange Rate Indices

The Reserve Bank has been constructing 5-country and 36-country indices of Nominal Effective Exchange Rate (NEER) and Real Effective Exchange Rate (REER) as part of its communication policy and for use as indicators of external competitiveness. Conceptually, the NEER is the weighted average of bilateral nominal exchange rates of the home currency in terms of foreign currencies. The REER, on the other hand, is the weighted average of nominal exchange rates adjusted for relative price differential between the domestic and foreign countries, drawing upon the purchasing power parity (PPP) hypothesis.

The significant shift in India's trade relations across countries/regions, mainly towards developing and emerging economies, during the last decade necessitated a change in the currency basket and the weights assigned to India's trading partners included in the existing indices. The revision was also undertaken in order to replace the existing national currencies of the euro zone by the common currency Euro for the members. In view of these developments the Reserve Bank, in December 2005, revised its 5-country and 36-country indices with new 6-currency and 36-currency indices of NEER and REER.

The new 6-currency indices include the US, euro zone, UK, Japan, China and Hong Kong. Two currencies in the old 5-country series, *viz*., French franc and Deutsche mark have been replaced by Euro in the new indices. The inclusion of China and Hong Kong reflects increasing trade with these economies. The six countries/regions, represented by the six currencies, together accounted for around 40 per cent of India's total foreign trade in 2004-05 as compared with coverage of around 22 per cent in the case of the earlier 5-country index.

The coverage has also changed for the 36-currency REER/NEER indices. The old indices comprised 36 countries including five members of the euro area[1]. Countries in the new series have been chosen based on (i) the share in India's exports and trade, (ii) regional representation and (iii) the availability of data on exchange rate and prices on a monthly basis. The new countries included in the revised series are Hong Kong, Denmark, Iran, Kuwait, Qatar, Russia, South Africa, Sweden and United Arab Emirates[2]. With the inclusion of the euro zone, the new 36-currency indices include all the 12 countries that have Euro as common currency. The revised 36 countries/regions, represented by the 36 currencies, together accounted for, on an average, 76 per cent and 85 per cent of India's total foreign trade and exports, respectively, during 2002-03 to 2004-05 as compared with around 61 per cent and 66 per cent, respectively, in case of the earlier indices. The new 6-currency and 36-currency indices use a 3-year moving average trade weights in order to suitably reflect the dynamically changing pattern of India's foreign trade with its major trading partners in contrast to the fixed weights used hitherto.

In line with the earlier practice, the revised indices (both 6-currency and 36-currency) use the wholesale price index (WPI) as a proxy for Indian prices and the consumer price index (CPI) as a proxy for foreign partner countries. While the 6-currency index updates the WPI data every week, it is updated monthly for the 36-currency index. For a few countries where CPI data are not readily available on a monthly basis, suitable proxies have been used.

The new 6-currency indices have been calculated for two base years: 1993-94 as a fixed base and 2003-04 as a moving base, which would change every year as at present. The choice of 1993-94 as the base year is attributable to generally stable macroeconomic conditions and satisfactory external sector performance during that year, following significant changes in the macroeconomic environment due to structural reforms introduced in the wake of balance of payments crisis in 1990-91. India had moved to a market determined exchange rate regime in April 1993.

Reference

"Revision of Nominal Effective Exchange Rate (NEER) and Real Effective Exchange Rate (REER) Indices", Reserve Bank of India Bulletin, December 2005.

I.5.21 The turnover in the inter-bank as well as merchant segments of the foreign exchange market increased sharply during 2005-06, reflecting strong growth in underlying transactions relating to current as well as capital account of balance of payments. While inter-bank turnover increased from US $ 237 billion during March 2005 to US $ 405 billion in March 2006, the merchant turnover increased from US $ 89 billion to US $ 141 billion (Chart I.31 and Appendix Table 41). The ratio of inter-bank to merchant turnover ranged between 2.3-3.1 during 2005-06.

1 These were Belgium, France, Germany, Italy and Netherlands.

2 The 36 currencies included in the revised REER series are those of Argentina, Australia, Bangladesh, Brazil, Canada, China, Denmark, Egypt, Euro, Hong Kong, Indonesia, Iran, Israel, Japan, Kenya, Korea, Kuwait, Malaysia, Myanmar, Mexico, Nigeria, Pakistan, Philippines, Qatar, Russia, Saudi Arabia, Singapore, South Africa, Sri Lanka, Sweden, Switzerland, Thailand, Turkey, UAE, UK and USA.

Chart I.30: Movement in Forward Premia

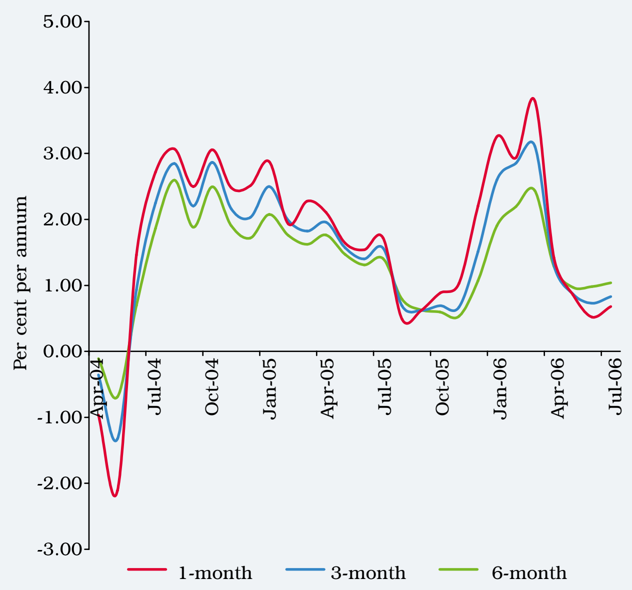
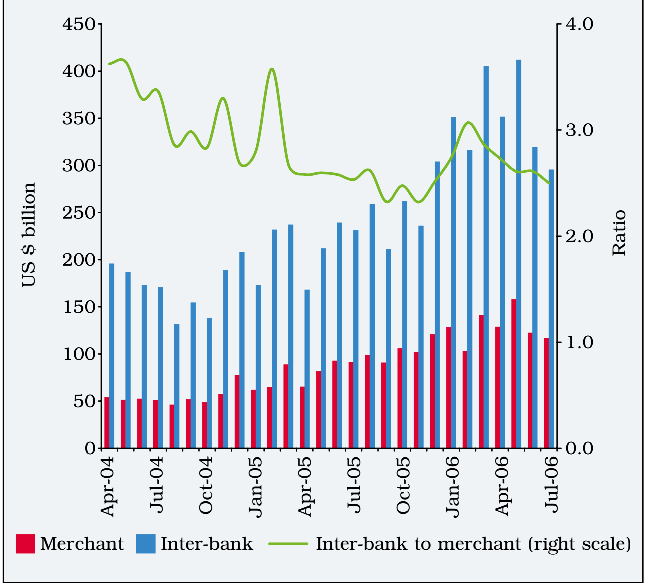


Chart I.31: Turnover in Foreign Exchange Market

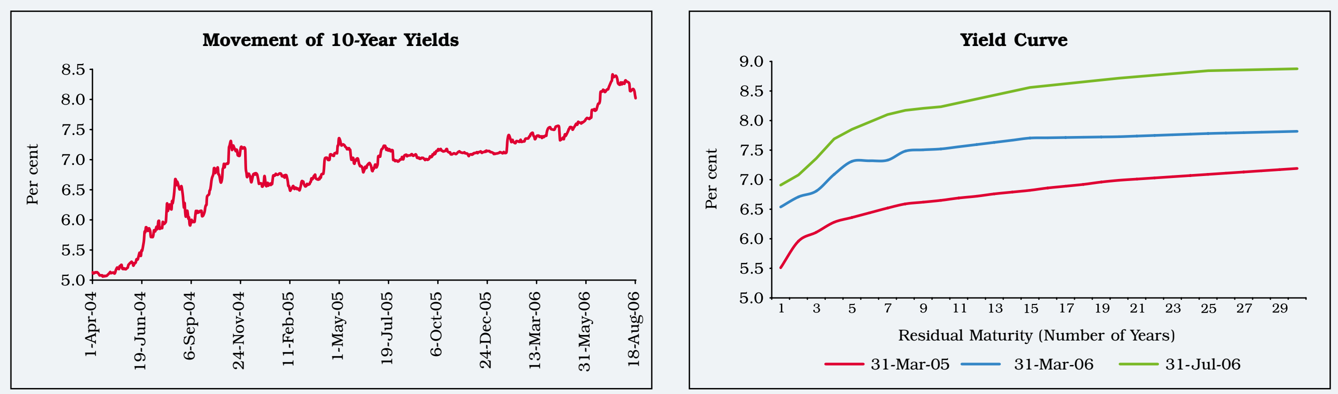


GOVERNMENT SECURITIES MARKET

I.5.22 Yields in the Government securities market hardened during 2005-06. The increase in yields for longer-term maturities was, however, less than for shorter-term maturities, reflecting relatively stable inflation expectations. Intra-year movements in yields were influenced by domestic liquidity conditions, inflationary expectations, volatility in crude oil prices and movements in the US yields. On April 30, 2005 the yields on 10-year paper firmed up sharply by 70 basis points to 7.35 per cent over end-March 2005 on fears of higher inflation in the backdrop of rising global crude oil prices and announcement of hike in the reverse repo rate by 25 basis points in the Annual Policy Statement on April 28, 2005. The yields, however, eased during May and June 2005 to reach 6.89 per cent on June 30, 2005 amidst comfortable liquidity position, benign inflation and fall in the US treasury yields. The markets rallied briefly in July 2005 and yields softened as the reverse repo rate was left unchanged in the First Quarter Review of the Annual Statement on Monetary Policy on July 26, 2005. Yields remained broadly stable between August and December 2005 (Chart I.32).

I.5.23 Yields, however, edged up in the last week of January 2006 following the increase of 25 basis points in both the reverse repo and the repo rates in the Third Quarter Review of the Annual Statement on Monetary Policy on January 24, 2006. The 10-year yield reached 7.41 per cent on January 27, 2006 before declining somewhat to 7.28 per cent on January 31, 2006. For most part of February-March 2006, yields were range-bound. However, in end-March, rise in US yields led to a rise in the yields in

Chart I.32: Yields on Central Government Securities



the Indian market with the 10-year yield reaching 7.52 per cent on March 31, 2006. The spread between 1-year and 10-year yields narrowed to 98 basis points at end-March 2006 (from 114 basis points at end-March 2005), mirroring liquidity tightness in money markets. The spread between 10-year and 30-year yields narrowed to 30 basis points (from 54 basis points at end-March 2005), reflecting increased appetite for long-term securities from non-bank participants such as insurance companies and pension funds (Table 1.57).

I.5.24 Yields increased further during April-July 2006 reflecting further monetary policy tightening in the US and in other economies, high and volatile crude oil prices, hike in domestic policy rates, expected issuances of oil bonds and higher Government expenditure in the first quarter of 2006-07. Yield on 10-year paper increased from 7.52 per cent at end-March 2006 to 8.02 per cent as on August 18, 2006.

I.5.25 The yields on 5-year AAA-rated corporate bonds increased during 2005-06 in tandem with higher yields in Government securities. The yield spread over 5-year Government securities – after remaining broadly stable at 30 basis points during April-October 2005 – increased to 91 basis points at end-March 2006 from 67 basis points at end-March 2005 (Chart I.33).

Table 1.57: Yield Spread

(Basis points)

Month-end	10 Year-reverse repo rate	10 Year-1 Year	20 Year-10 Year	30 Year-10 Year
1	2	3	4	5
2004-05 *	**164**	**101**	**55**	**77**
2005-06 *	**196**	**106**	**36**	**45**
April	231	141	46	60
May	197	120	42	75
June	189	111	26	56
July	201	120	48	45
August	209	129	42	44
September	211	124	35	38
October	185	121	40	42
November	183	111	37	48
December	186	91	37	34
January	178	51	30	35
February	186	53	25	30
March	202	98	21	30
2006-07				
April	190	118	40	56
May	218	120	36	52
June	237	113	38	41
July	223	133	48	64

* : Data are monthly averages.

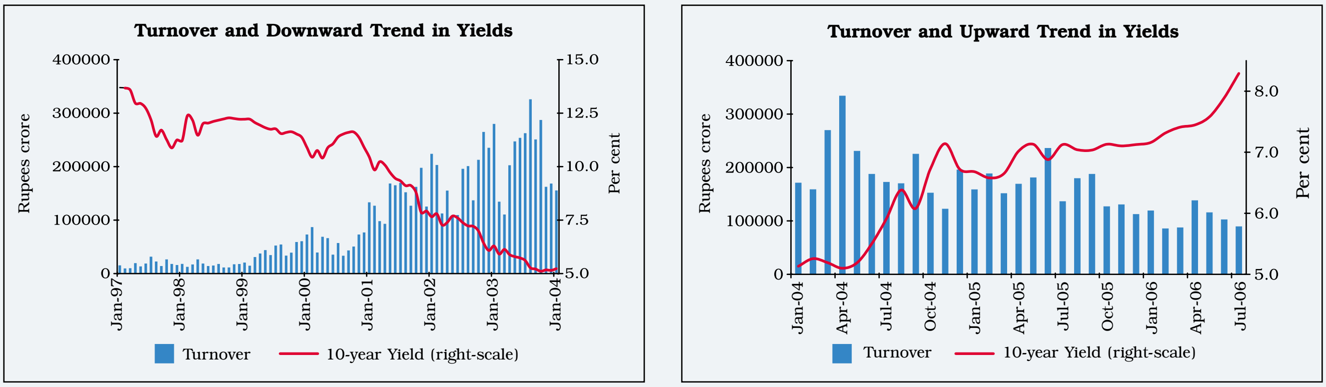
Chart I.33: Yield Spreads

I.5.26 The turnover in Government securities declined during 2005-06 as banks preferred to hold securities, rather than trade, in an environment of hardening of yields. Average daily turnover fell from Rs.4,826 crore during 2004-05 to Rs.3,643 crore during 2005-06. The ratio of turnover to outstanding stock of Government securities also fell from 2.0 to 1.5. In the absence of instruments that allow players to take a view on the interest rates, it is observed that the markets are active and liquid when the rates are falling but turn lacklustre and illiquid when the rates rise (Chart I.34 and Appendix Table 42). A number of measures have been taken to enable participants to manage their interest rate risk more efficiently and also to impart liquidity to the markets, even in a rising interest rate scenario (see Chapter IV).

CREDIT MARKET

I.5.27 As discussed earlier in this Chapter, demand for bank credit accelerated during 2005-06. In order to meet the higher credit demand, banks, *inter alia*, intensified efforts to mobilise deposits. This was reflected in upward movement in deposits as well as lending rates. During the second half of 2005-06, banks increased their deposit rates by about 25-150 basis points across various maturities (Table 1.58). As regards lending rates, many banks revised upwards their sub-Benchmark Prime Lending Rates (BPLRs), while keeping their BPLRs unchanged. Some private sector banks increased their BPLRs as well. The band of BPLRs for private sector banks and foreign banks remained wider than that of public

Chart I.34: Government Securities Market – Turnover and Yields



sector banks, although for a majority of banks, the BPLRs lie in a relatively narrow range. For instance, in regard to private sector banks, more than half of banks (16 out of 29 for which comparative data are available) had BPLRs in a range of 11-12 per cent at end-March 2006, while five banks had BPLRs in a range of 10-11 per cent. As regards foreign banks, nine of them had BPLRs in a range of 12-13 per cent, while five each had BPLRs in a range of 10-11 per cent and 11-12 per cent. Deposit as well as lending rates of banks increased further during the first quarter of 2006-07. Deposit rates increased by about 25-100 basis points across various maturities between March 2006 and June 2006. On the lending side, banks revised upwards their BPLRs by 25-50 basis points.

EQUITY AND DEBT MARKETS

I.5.28 The capital market exhibited buoyancy during 2005-06. Resources raised by the Indian corporates through public offerings, private placements and euro

Table 1.58: Movements in Deposit and Lending Rates

(Per cent)

Interest Rate	March 2005	June 2005	September 2005	December 2005	March 2006	June 2006
1	2	3	4	5	6	7
1. Domestic Deposit Rate						
Public Sector Banks						
Up to 1 year	2.75-6.00	2.75-6.00	2.00-6.00	2.00-6.00	2.25-6.50	2.75-6.50
More than 1 year and up to 3 years	4.75-6.50	5.25-6.25	5.25-6.25	5.25-6.25	5.75-6.75	5.75-7.00
More than 3 years	5.25-7.00	5.50-6.50	5.50-6.00	5.50-6.50	6.00-7.25	6.00-7.25
Private Sector Banks						
Up to 1 year	3.00-6.25	3.00-6.25	3.00-6.25	3.00-6.25	3.50-7.25	3.50-6.75
More than 1 year and up to 3 years	5.25-7.25	5.00-7.00	5.00-7.00	5.00-7.00	5.50-7.75	6.50-7.75
More than 3 years	5.75-7.00	5.50-7.25	5.75-7.25	5.75-7.25	6.00-7.75	6.50-8.25
Foreign Banks						
Up to 1 year	3.00-6.25	3.00-5.50	3.00-5.75	3.00-5.75	3.00-6.15	3.25-6.50
More than 1 year and up to 3 years	3.50-6.50	3.50-6.50	3.50-6.50	3.50-6.50	4.00-6.50	5.00-6.50
More than 3 years	3.50-7.00	4.00-7.00	4.00-7.00	4.00-7.00	5.50-6.50	5.50-6.75
2. Benchmark Prime Lending Rate						
Public Sector Banks	10.25-11.25	10.25-11.25	10.25-11.25	10.25-11.25	10.25-11.25	10.75-11.50
Private Sector Banks	11.00-13.50	11.00-13.50	11.00-13.50	11.00-13.50	11.00-14.00	11.00-14.50
Foreign Banks	10.00-14.50	10.00-14.50	10.00-14.50	10.00-14.50	10.00-14.50	10.00-14.50
3. Actual Lending Rate*						
Public Sector Banks	2.75-16.00	3.35-16.50	4.00-16.50	4.00-16.50	4.00-16.50	4.00-16.50 P
Private Sector Banks	3.15-22.00	3.15-24.94	3.15-20.22	3.15-20.50	3.15-20.50	3.15-26.00 P
Foreign Banks	3.55-23.50	4.00-25.00	2.86-25.00	2.86-24.00	4.75-26.00	4.75-25.00 P

* : Interest rate on non-export demand and term loans above Rs.2 lakh excluding lending rates at the extreme five per cent on both sides.
P : Provisional.

issues increased significantly. Resource mobilisation by mutual funds through various schemes also increased sharply. The secondary market registered sharp gains during 2005-06 and continued to surge during early part of 2006-07 with the benchmark indices recording all time high levels. Large investments by foreign institutional investors (FIIs) and domestic mutual funds on the back of robust macroeconomic fundamentals, congenial investment climate and strong corporate profitability buoyed the stock markets.

Primary Market

I.5.29 Resource mobilisation from the primary market through public issues (excluding offers for sale) increased by 23.1 per cent to Rs.26,940 crore during 2005-06 (Table 1.59 and Chart I.35). The increase in

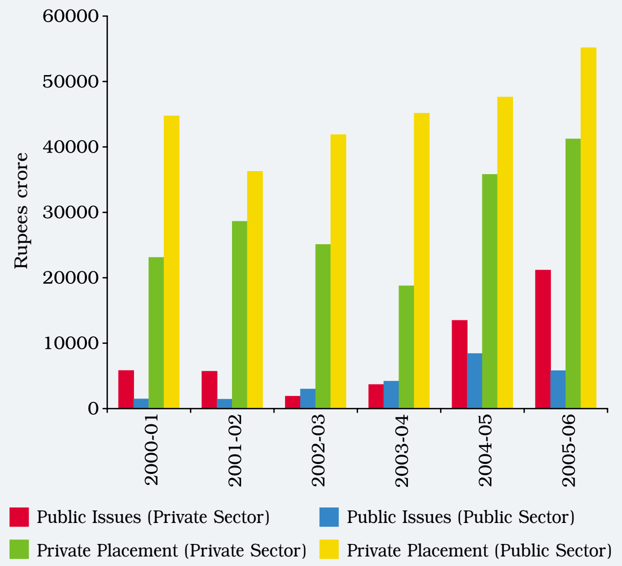
Table 1.59: Mobilisation of Resources from the Primary Market*

(Amount in Rupees crore)

Item	2004-05 No. of Issues	2004-05 Amount	2005-06P No. of Issues	2005-06P Amount
1	2	3	4	5
A. Prospectus and Rights Issues**				
1. Private Sector (a+b)	**54**	**13,482**	**131**	**21,154**
		(266.9)		**(56.9)**
a) Financial	12	5,710	11	7,746
b) Non-financial	42	7,772	120	13,408
2. Public Sector (a+b+c)	**5**	**8,410**	**7**	**5,786**
		(101.4)		**(-31.2)**
a) Public Sector Undertakings	-	-	-	-
b) Government Companies	1	2,684	1	373
c) Banks/Financial Institutions	4	5,726	6	5,413
3. Total (1+2)	**59**	**21,892**	**138**	**26,940**
		(178.8)		**(23.1)**
Of which:				
(i) Equity	54	18,024	136	26,695
(ii) Debt	5	3,868	2	245
B. Private Placement				
1. Private Sector	**717**	**35,794**	**944**	**41,205**
		(92.1)		**(15.1)**
a) Financial	255	20,974	374	26,553
b) Non-financial	462	14,820	570	14,652
2. Public Sector	**193**	**47,611**	**168**	**55,164**
		(5.2)		**(15.9)**
a) Financial	124	25,531	138	39,395
b) Non-financial	69	22,080	30	15,769
3. Total (1+2)	**910**	**83,405**	**1,112**	**96,368**
		(30.5)		**(15.5)**
Memo:				
Euro Issues	**15**	**3,353**	**49**	**11, 358**
		(8.2)		**(238.7)**

* : Including both debt and equity. P : Provisional.
** : Excluding offers for sale. - : Nil/Negligible.
Note : Figures in parentheses represent percentage variations over the previous year.

Chart I.35: Resource Mobilisation in the Primary Market

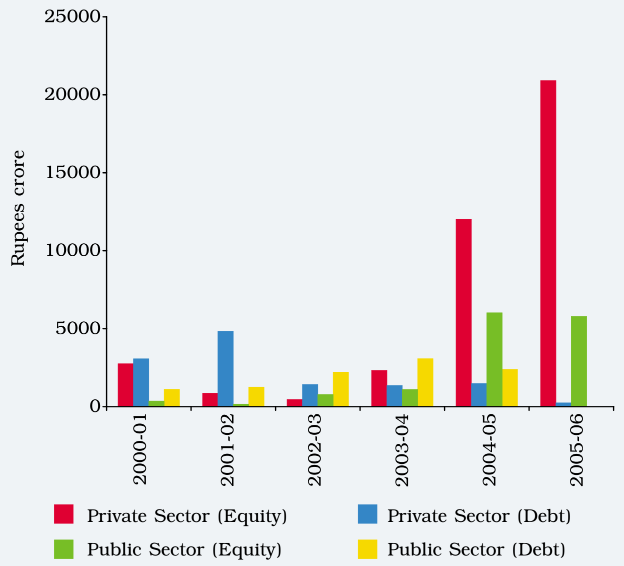


resource mobilisation during 2005-06 was entirely on account of private sector companies as resources raised by public sector companies were lower than a year ago. Private sector companies continued to dominate the public issues market, mobilising 78.5 per cent of the total resource mobilisation during 2005-06 as compared with 61.6 per cent during 2004-05 (Appendix Table 43). Banks were the major issuers during the year in view of their requirements for capital adequacy purposes. Banks and financial institutions in both public and private sectors mobilised 48.8 per cent of resources by public issues in 2005-06. Six public sector banks raised equity worth Rs.5,413 crore through public issues, accounting for about 20.1 per cent of the resources raised during 2005-06. Almost one-half (46.7 per cent) of the amounts raised during the year were through the initial public offerings (IPOs). Equity issues constituted 99.1 per cent of the total resource mobilisation through public issues during 2005-06 as compared with 82.3 per cent during the previous year (Chart I.36).

I.5.30 During 2006-07 (April-June), resource mobilisation through public issues (excluding offers for sale) amounted to Rs.10,642 crore through 25 issues as compared with Rs.3,894 crore through 25 issues during the corresponding period of 2005-06.

I.5.31 The Indian corporate sector also continued to rely heavily on domestic private placement market. Mobilisation of resources through private placements increased by 15.5 per cent during 2005-06 as compared with an increase of 30.5 per cent during 2004-05 (Table 1.59). The increase during the year

Chart I.36: Public Issues – Instrument-wise



was led by issuances by the public sector entities (both financial and non-financial) who mobilised bulk of the resources (57.2 per cent). The resource mobilisation by financial intermediaries (both public and private sectors) increased by 41.8 per cent to Rs.65,948 crore, accounting for 68.5 per cent of the total resource mobilisation. Amongst the financial intermediaries, banks (both public and private sectors) mobilised Rs.30,151 crore through private placements, which was 98.1 per cent higher than that in the previous year.

I.5.32 Buoyant stock markets also provided an opportunity to corporates to raise funds from international capital markets for their investment requirements. Resources raised by Indian corporates from international capital markets during 2005-06 increased substantially by 238.7 per cent to Rs.11,358 crore (see Table 1.59). Out of these, Rs.9,779 crore were mobilised in the form of Global Depository Receipts (GDRs), followed by American Depository Receipts (ADRs) (Rs.1,573 crore) and Foreign Currency Convertible Bonds (FCCBs) (Rs.6 crore). Most of the euro issues were made by private non-financial companies. During 2006-07(April-June), resources raised through euro issues by Indian corporates at Rs.5,786 crore were substantially higher than those of Rs.1,834 crore during the corresponding period of 2005-06.

Mutual Funds

I.5.33 Net resources mobilised by mutual funds increased sharply during 2005-06 led by higher inflows under equity oriented schemes reflecting investor interest due to attractive returns in a buoyant secondary market. Net assets of mutual funds also increased considerably by 55.0 per cent during 2005-06 as compared with 7.2 per cent during 2004-05 on account of increase in the market value of their equity portfolio (Tables 1.60 and 1.61). Net assets of mutual funds, thus, increased from 4.8 per cent of GDP at end-March 2005 to 6.6 per cent of GDP at end-March 2006. During April-June 2006, net resources mobilised by mutual funds increased further by 264.7 per cent to Rs.52,053 crore. Net mobilisation during the first quarter of 2006-07 was almost at the same level as during the full year 2005-06.

Table 1.60: Resource Mobilisation by Mutual Funds

(Rupees crore)

Mutual Funds	2004-05		2005-06	
	Net Mobilisation	Net Assets*	Net Mobilisation	Net Assets*
1	2	3	4	5
Private Sector	7,600	1,17,487	42,977	1,81,515
Public Sector	-2,677	11,374	6,379	20,829
UTI	-2,722	20,740	3,424	29,519
Total	**2,201**	**1,49,601**	**52,780**	**2,31,862**

* : As at end-March.
Note : Data exclude funds mobilised under Fund of Funds schemes.
Source: Securities and Exchange Board of India (SEBI).

All India Financial Institutions

I.5.34 Currently, a Financial Institution (FI) can raise resources, short term as well as long term, such that the total outstanding at any time does not exceed 10 times of its Net Owned Funds (NOF). Within this overall ceiling, eight institutions, *viz.*, IFCI, EXIM Bank, SIDBI, IIBI, TFCI, NABARD, IDFC and NHB have been given umbrella limits to raise resources equivalent to 100 per cent of their NOF through such instruments as term money, term deposit, inter-corporate deposits (ICDs), CDs and CP. The aggregate umbrella limit for raising resources by these FIs increased from Rs.16,160 crore as on April 1, 2005 to Rs.17,046 crore as on March 31, 2006 and further to Rs.18,041 crore as on May 26, 2006. The outstanding amount of resources raised by the financial institutions by way of these instruments declined from Rs.2,862 crore (17.7 per cent of limits) as on April 1, 2005 to Rs.1,449 crore (8.5 per cent of limits) as on March 31, 2006. CP was the most preferred instrument throughout the year. Only five institutions, *viz.*, NABARD, EXIM Bank, NHB, IDFC and SIDBI were active in mobilising resources through these instruments during 2005-06.

Table 1.61: Funds Mobilised by Mutual Funds – Type of Schemes

(Amount in Rupees crore)

Scheme	2004-05			2005-06		
	No. of Schemes	Net Mobilisation	Net Assets*	No. of Schemes	Net Mobilisation	Net Assets*
1	2	3	4	5	6	7
A. Income/Debt Oriented Schemes	**227**	**-5,244**	**1,06,250**	**325**	**16,622**	**1,24,913**
(i) Liquid/ Money Market	39	10,348	54,068	45	4,205	61,500
(ii) Gilt	30	-1,345	4,576	29	-1,560	3,135
(iii) Debt (other than assured return)	158	-14,247	47,605	251	13,977	60,278
B. Growth/Equity Oriented Schemes	**188**	**7,100**	**38,484**	**231**	**35,231**	**99,456**
(i) Equity Linked Savings Scheme	37	-194	1,727	37	3,592	6,589
(ii) Others	151	7,294	36,757	194	31,639	92,867
C. Balanced Schemes	**35**	**345**	**4,867**	**36**	**927**	**7,493**
D. Fund of Funds Scheme	**12**	**59**	**980**	**13**	**-241**	**1,012**
TOTAL	**462**	**2,260**	**1,50,581**	**605**	**52,539**	**2,32,874**

* : As at end-March.

Source: Securities and Exchange Board of India.

I.5.35 Total resources mobilised by the All-India Financial Institutions (AIFIs), excluding erstwhile IDBI, in the form of bonds and debentures rose by 19.0 per cent to Rs.17,828 crore during 2005-06 (Table 1.62). Some FIs such as IFCI Ltd. and IIBI Ltd. continued to be barred from mobilising fresh resources on account of their poor financial performance. Financial assistance sanctioned and disbursed by AIFIs increased by 77.4 per cent and 56.3 per cent, respectively, during 2005-06 (Appendix Table 44).

Secondary Market

I.5.36 The stock markets witnessed bullish conditions during 2005-06 with the benchmark indices touching all time high levels. The BSE Sensex rose by 73.7 per cent between end-March 2005 and end-March 2006, while the S&P CNX Nifty increased by 67.1 per cent (Chart I.37 and Appendix Table 45).

I.5.37 The stock market gains were driven mainly by continued investments by both FIIs and domestic

Table 1.62: Resources Raised by way of Bonds/Debentures by Select All-India FIs

(Amount in Rupees crore)

Institution	Resources Raised		Outstanding Borrowings		Weighted Average Cost of Funds (Per cent)		Weighted Average Maturity (years)	
	2004-05	2005-06	March 2005	March 2006	2004-05	2005-06	2004-05	2005-06
1	2	3	4	5	6	7	8	9
IIBI	..	..	1,855	1,425	..	..	..	..
IFCI	..	..	11,628	10,805	..	..	..	..
TFCI	..	..	339	277	..	..	..	..
Exim Bank	955	2,860	9,384	6,949	6.9	7.0	5.1	4.7
IDFC	1,153	1,532	3,183	4,212	6.8	7.0	5.9	7.3
SIDBI	1,607	2,610	6,239	8,025	6.3	4.5	7.0	7.0
NABARD	8,843	8,195	17,204	20,817	6.6	5.8	2.1	2.0
NHB	2,419	2,631	11,215	13,693	6.5	5.9	2.8	2.2
Total	**14,977**	**17,828**	**61,047**	**66,203**				

.. : Not applicable.

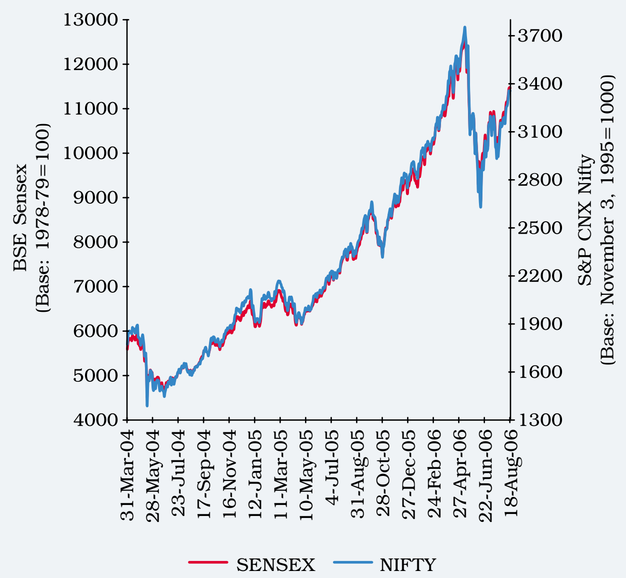
Note : 1. Data relate to rupee resources only.

2. Data on resources raised include: long-term resources mobilised through bonds/debentures; short-term resources mobilised through commercial papers, certificates of deposit, ICDs, term deposits and term money.

3. Data are provisional.

Source : Respective Financial Institutions (FIs).

Chart I.37: Indian Stock Markets



institutional investors on the back of strong macroeconomic fundamentals, sound business outlook and robust corporate earnings. Profits after tax of select non-financial non-Government companies recorded a growth of more than 40 per cent for 11 successive quarters from October-December 2002 to April-June 2005. Subsequently, growth in profits decelerated, but still remains high given the strong base of the previous quarters (Table 1.63).

I.5.38 FIIs continued to make large investments in stock markets for the third successive year. Equity investments by FIIs in domestic markets have averaged Rs.44,294 crore (US$ 9.8 billion) per annum between 2003-04 and 2005-06. Investments by domestic mutual funds surged from Rs.448 crore in 2004-05 to Rs.14,302 crore in 2005-06. Consequently, equity investments by mutual funds which were only one per cent of investments by FIIs during 2004-05 increased sharply during 2005-06 and were about 30 per cent of investment by FIIs (Table 1.64). Positive measures announced in the Union Budget, 2006-07 such as raising FII investment limit in Government securities and corporate debt, treating open-ended equity-oriented schemes and close-ended equity-oriented schemes on par for dividend distribution tax,

Table 1.63 Corporate Financial Performance

(Growth rates in per cent)

Item	2003-04	2004-05	2005-06	2004-05				2005-06			
				Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
1	2	3	4	5	6	7	8	9	10	11	12
Sales	16.0	24.1	16.9	24.8	23.7	24.1	21.0	18.5	16.4	13.2	19.5
Expenditure	13.2	21.9	16.4	23.4	22.4	24.3	19.8	18.0	16.3	12.7	18.9
Gross Profit	25.0	32.5	20.3	36.0	35.8	30.5	35.3	32.0	19.1	21.2	16.6
Interest	-11.9	-5.8	1.9	-3.2	2.1	-13.0	-5.4	-13.5	-8.0	4.6	3.8
Profit After Tax	59.8	51.2	24.2	51.2	45.3	45.5	51.4	54.2	27.5	27.0	15.1
Select Ratios (Per cent)											
Gross Profit to Sales	11.1	11.9	13.0	12.8	13.4	12.3	13.2	13.1	13.0	12.8	12.7
Profit After Tax to Sales	5.9	7.2	8.7	7.7	8.5	8.1	9.4	8.6	8.5	8.6	8.7
Interest Coverage Ratio (number)	3.3	4.6	6.4	4.8	5.7	6.1	7.5	6.0	6.2	6.2	7.3
Interest to Sales	3.4	2.6	2.0	2.7	2.3	2.0	1.8	2.2	2.1	2.1	1.7
Interest to Gross Profits	30.7	21.8	15.7	20.9	17.5	16.4	13.4	16.6	16.2	16.2	13.7
Memo :											(Amount in Rupees crore)
No. of Companies	2,214	2,214	2,210	1,255	1,353	1,464	1,301	2,355	2,361	2,366	2,415
Sales	4,42,743	5,49,449	7,74,578	1,35,156	1,53,040	1,62,193	1,79,632	1,94,608	2,12,693	2,19,098	2,49,971
Expenditure	4,22,110	5,14,574	6,66,690	1,15,656	1,31,227	1,40,574	1,56,647	1,66,972	1,83,717	1,88,934	2,18,511
Depreciation Provision	20,406	22,697	28,883	5,504	5,836	5,731	6,106	7,137	7,617	7,748	8,340
Gross Profit	49,278	65,301	1,00,666	17,234	20,448	20,017	23,736	25,577	27,620	28,135	31,652
Interest	15,143	14,268	15,789	3,597	3,584	3,273	3,177	4,241	4,467	4,555	4,348
Profit After Tax	26,182	39,599	67,506	10,396	13,004	13,196	16,798	16,726	18,169	18,790	21,634

Note : 1. Growth rates are percentage change in the level for the period under reference over the corresponding period of the previous year.
2. Data are based on the audited/unaudited abridged results of the non-financial non-Government companies except column (2) and column (3) which are based on audited balance sheets for 2003-04 and 2004-05, respectively.

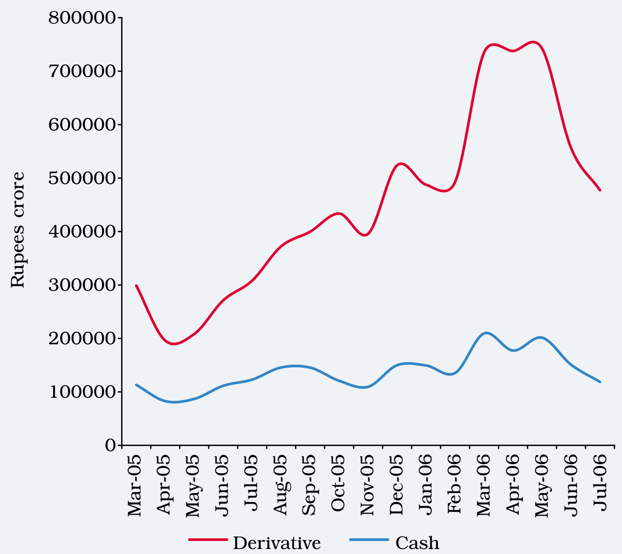
Table 1.64: Trends in Institutional Investments

(Rupees crore)

Year	FIIs		Mutual Funds	
	Net Investment in Equity	Net Investment in Debt	Net Investment in Equity	Net Investment in Debt
1	2	3	4	5
2001-02	8,067	685	-3,796	10,959
2002-03	2,528	60	-2,067	12,604
2003-04	39,959	5,805	1,308	22,701
2004-05	44,123	1,759	448	16,987
2005-06	48,801	-7,334	14,302	36,801

Source: Securities and Exchange Board of India.

Chart I.38: Turnover in Cash and Derivative Segment - NSE



rationalisation of excise duties and relaxation in fringe benefit tax (FBT) also helped to boost the market sentiment.

I.5.39 Reflecting strong gains in stock prices, the price-earning (P/E) ratios increased during the year; for instance, the P/E ratio for the 30 scrips included in the BSE Sensex increased from 15.6 at end-March 2005 to 20.9 at end-March 2006 (Table 1.65 and Appendix Table 46). The market capitalisation of the BSE increased by 77.9 per cent during 2005-06, reflecting increase in stock prices as well as listing of new securities. Market capitalisation of the BSE jumped from 54.4 per cent of GDP at end-March 2005 to 85.5 per cent at end-March 2006. Although volatility in the stock market increased, domestic stock markets functioned smoothly without causing any disruption in the financial markets. The total turnover in cash segment increased sharply during 2005-06. The average daily turnover of BSE and NSE increased by 44.9 per cent to Rs.9,504 crore during 2005-06. The increase in turnover in equity derivatives segment was stronger than that of the cash segment (Chart I.38 and Appendix Table 47). Trading in stock futures accounted for a significant portion of turnover in equity derivatives.

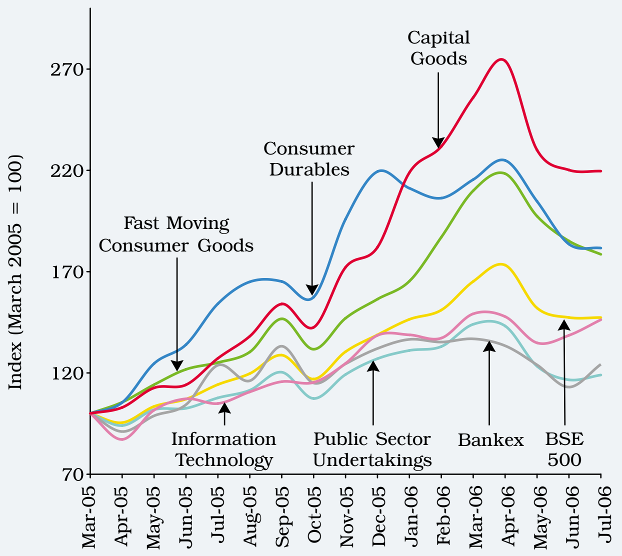
I.5.40 The spurt in stock prices during 2005-06 was broad based, encompassing all indices (BSE 500, BSE Mid-cap, BSE Small-cap and BSE Sensex) and across all sectors (metal, auto, banks, capital goods, consumer durables, IT, oil and gas). The broad-based BSE 500 index increased by 65.2 per cent on a point-to-point basis during 2005-06 as

Table 1.65: Indian Equity Markets – Key Indicators

Indicator	BSE		NSE	
	2004-05	2005-06	2004-05	2005-06
1	2	3	4	5
1. BSE Sensex/S&P CNX Nifty				
(i) Average	5741	8280	1805	2513
(ii) End of the year	6493	11280	2036	3403
2. Coefficient of Variation (per cent)	11.16	16.72	11.28	15.60
3. Price–Earning Ratio (end-period) @	15.61	20.92	14.60	20.26
4. Price-Book Value Ratio@	3.70	5.10	3.82	5.15
5. Yield @ (per cent per annum)	1.70	1.20	1.97	1.33
6. Listed Companies	4,731	4,781	970	1,069
7. Cash Segment Turnover (Rupees crore)	5,18,715	8,16,074	11,40,071	15,69,556
8. Market Capitalisation (Rupees crore) #	16,98,428	30,22,191	15,85,585	28,13,201

@ : Based on 30 scrips included in the BSE Sensex and 50 scrips included in the S&P CNX Nifty. # : As at end-March.
Source: The Stock Exchange, Mumbai and the National Stock Exchange of India Limited.

Chart I.39: Trends in BSE Sectoral Stock Indices



compared with an increase of 73.7 per cent in the BSE Sensex (Chart I.39).

I.5.41 The capital goods stocks rose due to pick-up in investment activity, strong industrial performance and Government's emphasis on infrastructural developments. The consumer durables and fast moving consumer goods (FMCG) stocks were buoyant due to good financial results of some of the companies. FMCG stocks also gained from abolition of excise duty on branded foods and reduction in excise duty from 16 per cent to eight per cent on select fast food items in the Union Budget, 2006-07. Banking sector scrips registered gains due to sustained pick up in non-food credit of the banks, and permission to banks to raise capital through a variety of new instruments.

I.5.42 After recording sharp gains during 2005-06, stock markets witnessed correction during May-June 2006. Stock markets began 2006-07 on a buoyant note, continuing to record new highs on back of sustained investments by FIIs and domestic mutual funds. Both the BSE Sensex and S&P CNX Nifty closed at all time high levels of 12612 and 3754, respectively, on May 10, 2006, registering an increase of 11.8 per cent and 10.3 per cent, respectively, over their end-March levels. In the second half of May 2006, the stock markets declined substantially, following sharp correction in international commodity prices on concerns that US monetary policy tightening may be more than expected. Weakness in international stock markets, sales by FIIs, lower than expected results of some major corporates, triggering of margin calls and fears of higher tax on investors led to further weakness in domestic stock markets. The BSE Sensex fell to 8929 on June 14, 2006. Stock markets, however, recovered some of the losses thereafter, reflecting fresh buying by FIIs, onset of the monsoon, robust corporate earnings and recovery in major international stock markets. The BSE Sensex closed at 11466 as on August 18, 2006, 1.6 per cent higher than that its end-March 2006 level.

Developments in Wholesale Debt Market Segment of NSE

I.5.43 In the Wholesale Debt Market (WDM) segment of the NSE, 3,174 securities were available for trading as on March 31, 2006 as compared with 3,097 securities as on March 31, 2005. Total market capitalisation of the securities available for trading on the WDM segment increased from Rs.14,61,374 crore at March-2005 to Rs.15,67,574 crore at end-March 2006. The turnover in WDM, however, declined by 46.4 per cent to Rs.4,75,523 crore in 2005-06.

I.5.44 To conclude, domestic financial markets largely remained orderly during 2005-06 even as interest rates edged up in various market segments during the year. There was a substantial migration of money market activity from uncollateralised segment to the collateralised segment. The foreign exchange market remained by and large orderly. Yields in Government securities market edged up. Capital markets remained buoyant and the stock indices reached record highs during 2005-06 reflecting increased interest by domestic as well as foreign investors on the back of growth prospects.

VI. EXTERNAL SECTOR

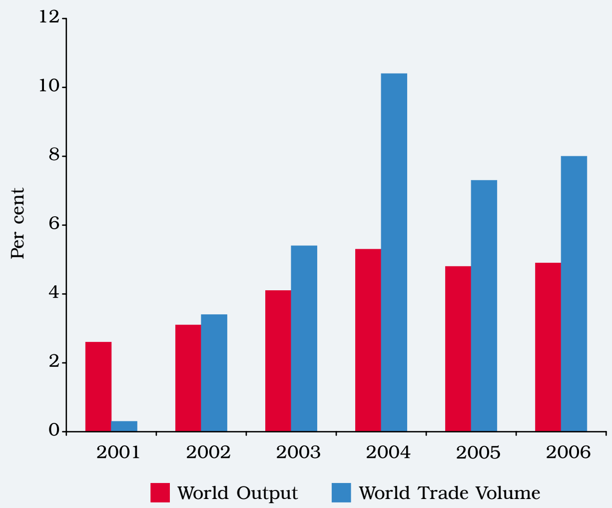
I.6.1 India's balance of payments position remained comfortable during 2005-06, notwithstanding pressures posed by record high oil prices. Balance of payments developments during 2005-06 showed a number of positive features. First, merchandise exports remained robust for the fourth year in succession, reflecting increasing competitiveness of technology intensive domestic manufacturing. Second, non-oil import demand recorded strong growth led by imports of capital goods, on account of large investment activity in the economy. Imports of gold and silver, on the other hand, were almost unchanged from the previous year. Third, invisible earnings from services and transfers continued to grow at a stable pace and thereby financed a large part of the trade deficit. Fourth, the current account deficit widened during 2005-06. As a proportion to GDP, the current account deficit, however, remained modest. Fifth, sustained appetite for domestic financial assets was maintained in view of growth prospects of the Indian economy. This led to capital inflows remaining well in excess of the current account deficit. Sixth, the redemption of India Millennium Deposits (IMDs) amounting to US $ 7.1 billion was completed smoothly. Seventh, notwithstanding the large outgo on IMD redemption and higher current account deficit, the overall balance of payments recorded a substantial surplus, leading to a further increase in foreign exchange reserves. Finally, external debt (as a proportion to GDP) continued to decline. Annual current receipts and the stock of foreign exchange reserves exceed the country's stock of external debt.

INTERNATIONAL DEVELOPMENTS

I.6.2 Global output growth remained robust at 4.8 per cent in 2005, *albeit* it decelerated from the three-decade high of 5.3 per cent during 2004 (Appendix Table 48). Thus, global economic activity exhibited considerable strength despite continued headwinds from record high international crude oil prices. Notwithstanding continuous pre-emptive monetary tightening by major central banks, macroeconomic policies were still largely accommodative. Financial market conditions were largely benign with real long-term rates remaining at low levels which supported the growth process. In advanced economies, growth decelerated from 3.3 per cent in 2004 to 2.7 per cent in 2005, reflecting some slowdown in the US and the euro area partly offset by the Japanese expansion. Growth in emerging market and developing economies remained strong at 7.2 per cent in 2005 on top of 7.6 per cent in 2004, led by China (9.9 per cent), India (8.4 per cent) and Russia (6.4 per cent). Volume of world trade in goods and services witnessed a growth of 7.3 per cent during 2005 as compared with 10.4 per cent in 2004 (Chart I.40). Developing countries maintained higher export growth during 2005 at 11.5 per cent than that of industrial countries (5.3 per cent).

I.6.3 Private capital flows to emerging market and developing countries strengthened further during 2005, reflecting enhanced growth prospects in these economies. Foreign direct investment flows continued to be the major driver of private capital flows, contributing more than four-fifths to total flows. Net portfolio investments, which had increased sharply during 2004, were sustained at elevated levels during 2005 (Table 1.66). Asia continued to be a major recipient of private foreign capital, led by China. Capital flows to Western Hemisphere, particularly, Mexico and Brazil were boosted by increased cross-border merger and acquisition activity in the banking and manufacturing sectors.

Chart I.40: Growth in World Output and Trade



Note : Data for 2006 are projections.
Source : World Economic Outlook, IMF, April 2006.

I.6.4 Global GDP is projected by the IMF to grow by 4.9 per cent in 2006 (Appendix Table 48). Continued headwinds from high oil prices are expected to be offset by a gradual pick-up in investment, as increasing capacity constraints are expected to encourage corporates to reduce their net savings. Growth forecasts for the emerging market and developing countries remain robust, led by India and China. World trade in volume terms is projected to grow by 8.0 per cent during 2006, slightly higher than a year ago.

Table 1.66: Net Capital Flows to Emerging Market and Developing Economies

(US $ billion)

Item	2003	2004	2005	2006P	2007P
1	2	3	4	5	6
Private Capital Flows	**160.4**	**230.6**	**254.0**	**178.8**	**153.8**
Direct Investment	157.5	184.3	212.3	220.6	217.5
Portfolio Investment	-3.7	34.5	38.5	-4.7	-3.2
Others	6.6	11.8	3.2	-37.1	-60.5
Official Capital Flows	**-61.5**	**-81.5**	**-138.6**	**-161.3**	**-163.6**

P : IMF Projections.
Source : World Economic Outlook, IMF, April 2006.

I.6.5 Global growth prospects, however, are subject to a number of downside risks. First, a major risk arises from the huge and growing financial imbalances between the US and the rest of the world (Box I.16). The huge current account deficit of the US is currently being financed by other advanced countries, oil exporting countries of the Middle East and middle income countries of South East Asia. The possibility of an abrupt and disorderly adjustment of the imbalances poses significant risks to the world economy in the form of disorderly exchange rate adjustments and large increase in interest rates. Second, high and volatile oil prices continue to pose a threat to global economy. Rising oil prices by increasing the current account surplus of the major oil exporting countries are also exacerbating global

Box I.16
Global Macroeconomic Imbalances

The current global macroeconomic imbalance is reflected in large mismatches in the current account positions in some countries (large and growing deficit in the US and surpluses in oil exporting countries and some Asian countries such as China) and its mirror image in the form of mismatches in domestic savings and investment. The massive absorption of global capital by the US is of questionable sustainability and, if sustainable, of dubious desirability (Summers, 2006). The possibility of an abrupt and disorderly adjustment of the imbalances poses significant risks to the world economy. An unwinding of global imbalances, if it is not to be recessionary for the global economy, requires compensatory actions in other parts of the world.

Against this backdrop, as the Communiqué issued by the International Monetary and Financial Committee (IMFC) released on April 22, 2006 observed, adequate and timely policy action for orderly medium-term resolution of global imbalances is a shared responsibility, and will bring greater benefit to members and the international community than actions taken individually by countries. Key elements of the strategy towards orderly resolution of the global imbalances suggested in the Communiqué are:

- Raising national saving in the United States — with measures to reduce the budget deficit and spur private saving;
- Implementing structural reforms to sustain growth potential and boost domestic demand in the euro area and other countries;
- Further structural reforms, including fiscal consolidation, in Japan;
- Allowing greater exchange rate flexibility in a number of countries in emerging Asia; and
- Promoting efficient absorption of higher oil revenues in oil-exporting countries with strong macroeconomic policies.

In view of the complex nature of global imbalances, various possibilities may be explored to minimise the risks of disorderly adjustments. Looking at the national balance sheets would be useful to acquire a sense about the potential for adjustment, and they will give a sense of the possible impact of relative price changes on the value of assets and liabilities (Reddy, 2006). The possibility of bringing about global rebalancing through exchange rate adjustment by itself may not be very encouraging. Although exchange rate would have an important role to play in global rebalancing, its relationship with other components of the whole package like saving-investment, fiscal deficit, structural reforms and domestic output as well as employment is important.

As regards India, its policies have not only served the economy well but have also contributed to global stability. Between 2001-02 and 2003-04, India registered modest current account surpluses, but this was more of a reflection of phase of business cycle, and with the turnaround in the business cycle, India has registered a current account deficit in the last two years. Second, in contrast to most of the Asian EMEs and Japan, capital flows, as opposed to current account surpluses, played an increasingly important role in the accumulation of reserves in India. Third, India's policy of market determined exchange rate with no predetermined target along with market interventions essentially to manage volatility has served the country well. Finally, the main driver of growth in India has been domestic demand, facilitated by improvement in the rate of aggregate domestic saving.

As regards the likely impact of disorderly adjustment of the global imbalances on India, it may be noted that India does not depend on the international capital market for financing the fiscal deficit and consequently, to some extent, adverse consequences of the global developments would be muted. However, there could be a spill over effect of global developments on domestic interest rates and thus on the fisc too. Similarly, any abrupt adjustment in global imbalances may affect corporates, banks and households in India, though the impact may be less than in some other emerging economies. In other words, while India by itself hardly contributes to the current global financial imbalances, any large and rapid adjustments in major currencies and related interest rates or current accounts of trading partners could indirectly, but significantly, impact the Indian economy (Reddy, 2006).

Reference

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2. Summers, Lawrence (2006), "Reflections on Global Account Imbalances and Emerging Markets Reserve Accumulation", Reserve Bank of India Bulletin, April.

current account imbalances. Third, the recent volatility and re-pricing of risk in the international financial markets also pose downside risks. Finally, while both the probability and potential risk from the avian flu pandemic are impossible to assess with any certainty, a worse case scenario could have extremely high human and economic costs, particularly for developing countries.

BALANCE OF PAYMENTS

I.6.6 India's balance of payments remained comfortable during 2005-06 despite record high oil prices and the redemption of the India Millennium Deposits (IMDs). Although export growth remained robust for the fourth successive year and invisible earnings were buoyant, the current account deficit widened during 2005-06 reflecting the cumulative impact of high level of international crude oil prices and growth in imports emanating from strong industrial activity (Table 1.67 and Appendix Table 49). Structural shifts in the services exports since the mid-1990s have provided much needed resilience to India's invisibles. During 2005-06, besides software, there was a surge in exports of a number of professional and business services. India continued to remain the leading remittance receiving country in the world with relative stability in such inflows. Capital flows continued to remain large, led by foreign investment flows reflecting increased appetite for domestic financial assets. The surge in imports was also manifested in recourse to debt flows – trade credit and external commercial borrowings. Consequently, the balance of payments position remained comfortable with foreign exchange reserves increasing by US $ 10.1 billion during 2005-06, despite an outgo of US $ 7.1 billion during December 2005 from the reserves on account of the redemption of IMDs.

Table 1.67: Balance of Payments – Key Indicators

(US $ million)

Item/Indicator	1990-91	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06 P
1	2	3	4	5	6	7	8
i) Trade Balance	-9,438	-12,460	-11,574	-10,690	-13,718	-36,629	-51,554
ii) Invisibles, net	-242	9,794	14,974	17,035	27,801	31,229	40,942
iii) Current Account Balance	-9,680	-2,666	3,400	6,345	14,083	-5,400	-10,612
iv) Capital Account	7,056	8,840	8,551	10,840	16,736	31,027	24,693
v) Overall Balance #	-2,492	5,868	11,757	16,985	31,421	26,159	15,052
vi) Foreign Exchange Reserves* [Increase(-), Decrease (+)]	1,278	-5,842	-11,757	-16,985	-31,421	-26,159	-15,052
Indicators (in per cent)							
1. Trade							
i) Exports/GDP	5.8	9.9	9.4	10.6	11.0	11.8	13.1
ii) Imports/GDP	8.8	12.6	11.8	12.7	13.3	17.1	19.6
iii) Export Volume Growth	11.0	23.9	3.9	21.7	6.0	13.2	n.a.
2. Invisibles							
i) Invisibles Receipts/GDP	2.4	7.0	7.7	8.3	8.9	10.3	11.5
ii) Invisibles Payments/GDP	2.4	4.9	4.5	4.9	4.3	5.8	6.4
iii) Invisibles (net)/GDP	-0.1	2.1	3.1	3.4	4.6	4.5	5.1
3. Current Account							
i) Current Receipts@/GDP	8.0	16.8	16.9	18.8	19.8	22.0	24.5
ii) Current Receipts Growth@	6.6	14.8	4.5	17.6	25.2	28.6	27.5
iii) Current Receipts@/Current Payments	71.5	96.4	103.8	106.6	112.8	96.2	94.5
iv) Current Account Balance/GDP	-3.1	-0.6	0.7	1.3	2.3	-0.8	-1.3
4. Capital Account							
i) Foreign Investment/GDP	0.0	1.5	1.7	1.2	2.6	2.1	2.5
ii) Foreign Investment/Exports	0.6	14.9	18.2	11.2	23.7	17.6	19.3
5. Others							
i) Debt - GDP Ratio	28.7	22.4	21.1	20.4	17.8	17.3	15.8
ii) Debt - Service Ratio	35.3	16.6	13.4	16.4	16.3	6.1	10.2
iii) Liability - Service Ratio	35.6	18.4	14.9	16.1	19.1	7.1	11.5
iv) Import Cover of Reserves (in months)	2.5	8.8	11.7	14.2	16.9	14.3	11.6

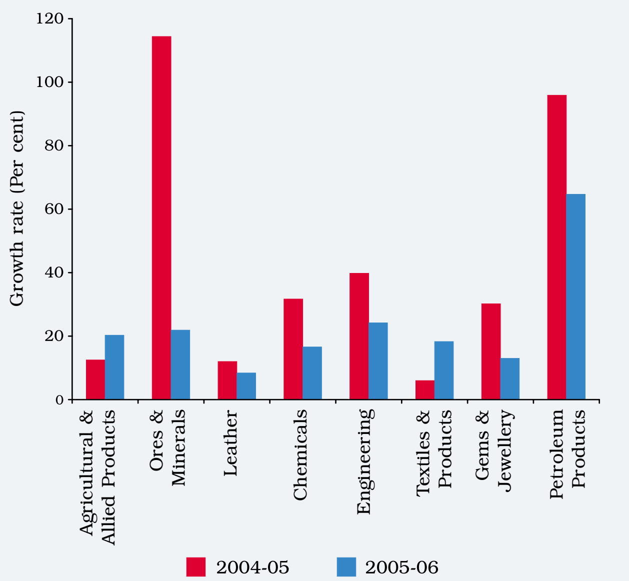
P : Preliminary. # : Includes errors and omissions.
* : Excluding valuation changes. @ : Excluding official transfers. n.a. : Not Available.

Merchandise Trade

I.6.7 India's merchandise trade maintained the momentum of strong growth in the environment of buoyant global economy and supportive domestic policy measures. India's merchandise exports sustained the high growth trajectory for the fourth year in succession, averaging 24 per cent per annum, reflecting increasing competitiveness of the technology intensive domestic manufacturing. Despite some moderation in growth in global trade in 2005, India was one of the fastest growing exporters among emerging economies in the world. As a result, India's share in world exports increased to 0.86 per cent in 2005. According to the World Trade Organisation (WTO), India became the 29th largest exporter in 2005 from being the 30th largest in 2004. India's merchandise imports also remained buoyant in 2005 reflecting strong growth in domestic industrial activity – India emerged as the 17th largest importer in the world in 2005 (24th in 2004).

I.6.8 India's merchandise exports increased by 23.0 per cent during 2005-06 on top of 30.8 per cent during 2004-05. As a result, exports crossed US $ 100 billion during 2005-06, surpassing the annual target of US $ 92 billion set by Government of India for 2005-06 (Appendix Table 50). Export growth was broad-based (Chart I.41). Exports of primary products benefited, *inter alia*, from the strengthening of commodity prices. Agricultural and allied commodities exports witnessed a sharp acceleration, driven by coffee, rice, cotton, oil meal and spices. Ores and minerals, especially iron ore, continued to post high

Chart I.41: Exports of Major Commodities



export growth, although there was some deceleration partly due to strong domestic demand for metals.

I.6.9 Exports of manufactured products during 2005-06 were led by technology intensive engineering goods, chemicals, textiles, and gems and jewellery. In the recent years, the commodity composition of manufactured exports has witnessed a notable shift with engineering goods emerging as the key driver of growth (Box I.17). In 2005-06, engineering goods (comprising goods such as machinery and instruments, transport equipments, manufactures of metals, iron and steel, and electronic goods) remained the mainstay, accounting for the highest share of 21.0 per cent in the total exports, followed by textiles (15.6 per cent), gems and jewellery (15.1 per cent) and chemicals (14.1 per cent). Engineering goods exports registered growth of 24.2 per cent during 2005-06, fuelled by strong demand from major markets such as the US, euro area, Eastern Europe, East Asia and Latin America. Within chemicals, basic chemicals, drugs and pharmaceuticals, rubber, glass and paints registered higher growth than a year ago. Growth in India's exports of textiles and textile products accelerated from 6.0 per cent in 2004-05 to 18.3 per cent in 2005-06 benefiting from access to the markets of erstwhile quota countries. Exports to erstwhile quota countries (the US, EU and Canada) increased sharply by 31.6 per cent. Exports to non-quota countries, on the other hand, were almost unchanged during 2005-06 (in fact, a marginal decline of 0.1 per cent). The EU and the US remained the major export markets, together accounting for 62 per cent of India's total textile exports in 2005-06. Within textile and textile products, exports of manmade fabrics, yarn and made-ups declined by 2.2 per cent mainly due to the sharp decline in exports to non-quota countries. Readymade garments, the major component of India's textiles exports, benefited from strong demand in the major markets such as the US and Europe. According to the US Department of Commerce, Office of Textiles and Apparel, India's textiles and apparel exports to the US increased by 27.1 per cent during 2005 (13.1 per cent during 2004) and India was one of the fastest growing exporters to the US. During 2005-06, petroleum exports continued to record strong growth, reflecting higher international prices of petroleum products. Petroleum exports have now emerged as a major export item of India, accounting for 11.2 per cent of total exports, as compared with 8.4 per cent in 2004-05. Growth in gems and jewellery exports, however, moderated which could be attributed, *inter alia,* to sharp increase in prices of gold and cut and polished diamonds (Appendix Table 51).

Box I.17
India's Exports of Engineering Goods

India's exports of engineering goods have shown a phenomenal growth in recent years. In an environment of increasing openness of the economy and supportive policy framework since the early 1990s, exports of engineering goods have increased from US $ 1.2 billion in 1987-88 to US $ 21.5 billion in 2005-06. In the recent three years (2003-04 to 2005-06), exports of engineering goods recorded an annual average growth of 33.8 per cent. As a result, their share in India's total exports has increased sharply and they now contribute more than one-fifth of India's total exports. Since 2004-05, engineering goods have emerged as the largest item of manufacturing exports, surpassing the exports of textiles and gems and jewellery. According to the Engineering Export Promotion Council (EEPC), almost 40 per cent of engineering goods exports are contributed by small and medium enterprises.

The destination of India's engineering goods exports has undergone substantial diversification in recent years. During the 1980s, the major destinations of India's engineering goods exports were Asia and Africa. Since the 1990s, the trend has changed with the share of the US, Europe and Australia increasing substantially. During 2005-06, the US was the major export destination accounting for 15.5 per cent of total engineering products exports.

Within engineering goods, automotive products segment has turned out to be the major driver. Since the mid-1990s, India's automotive industry has witnessed rapid transformation from a low volume and fragmented sector into a highly competitive sector characterised by world-class technology, large and assured volumes and strict delivery schedules in response to the demand from global vehicle manufacturers. Several Indian companies have entered into technological collaborations and equity partnerships with world leaders in automotive components. India's competitive advantages in this sector are low labour costs and availability of skilled workforce. Furthermore, India's automotive components industry is highly diversified with a capacity to produce as many as 150 different products. Despite the increasing share of engineering products exports in India's total trade, India's share in world engineering goods exports remains negligible. Moreover, India's exports consist mainly of low value and some amount of medium value products.

References

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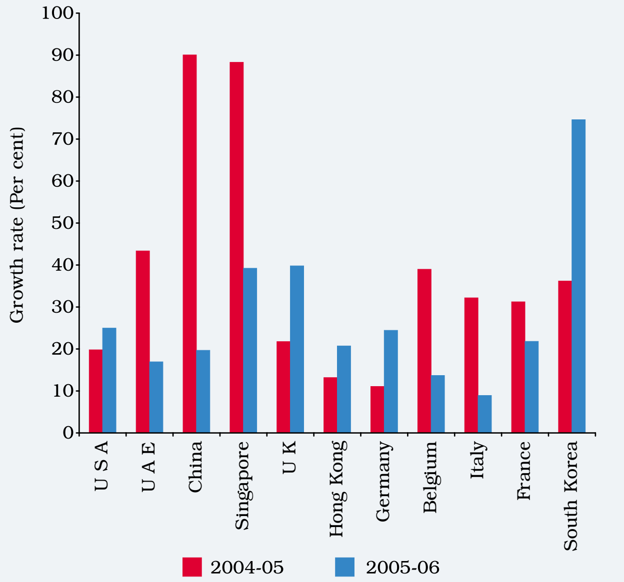
3. Illiyan, A. (2006), "Progress and Prospects of Indian Engineering Goods Exports (1956-2005)", Foreign Trade Review, Vol. XL, No.4, January-March.

I.6.10 Destination-wise, the US continued to be the major trade partner of India accounting for 16.7 per cent of India's total exports, followed by the UAE (8.4 per cent), China (6.5 per cent), Singapore (5.4 per cent), UK (5.0 per cent), Hong Kong (4.3 per cent) and Germany (3.4 per cent). Region-wise, Latin America was the fastest growing market for India's exports during 2005-06 followed by Africa, Europe, East Asia and South Asia. A key feature of India's exports in the recent years is the emergence of Asian countries as an important destination in an environment of growing role of south-south trade in world trade (Chart I.42, Box I.18).

I.6.11 Imports maintained high growth at 27.7 per cent during 2005-06 (42.7 per cent growth a year ago), reflecting higher oil prices as well as strong overall domestic demand. Oil imports at US $ 44.0 billion increased by 47.3 per cent during 2005-06. This was mainly on account of elevated international oil prices as in volume terms, the growth of oil imports decelerated from 5.5 per cent during 2004-05 to 4.2 per cent in 2005-06. India's oil import bill has increased from 2.9 per cent of GDP in 2001-02 to 5.5 per cent of GDP in 2005-06, mirroring the surge in international crude oil prices.

Chart 1.42: Export Destinations



Box I.18
India's Merchandise Trade with Asia

World trade has witnessed many noteworthy changes over the past 25 years with trade between developing economies growing twice as fast as world trade. Intra-regional trade accounted for 43 per cent of developing countries' exports in 2004 as compared with only 26 per cent in 1980. The surge in developing economies trade, led by East Asia, China and India, has occurred due to the significant improvement in market access resulting from outward-oriented development strategies, trade and economic reforms, regional trade agreements and above all, faster output growth in developing Asian countries. The fragmentation of vertically integrated supply chains based on locational advantages has played a major role in promoting intra-regional trade in the Asian region.

India's merchandise trade has moved increasingly towards developing countries, especially with other Asian countries in tune with the shifts in destination of world trade. Developing economies account for a major share of India's total trade: 56.7 per cent of India's total exports and 52.9 per cent of India's total non-oil imports in 2005-06 (Table). In particular, the Asian economies are emerging as major trading partners of India. India's trade has grown faster with these countries than its overall trade growth. Emerging Asian economies accounted for 22.6 per cent of India's total exports in 2005-06 (15.6 per cent in 2000-01) and 29.0 per cent of total non-oil imports (22.1 per cent in 2000-01). In 2005-06, China emerged as the third major export destination for India and it has now become the largest source of imports for India. Exports to China surged by 19.7 per cent in 2005-06, while imports from China increased by 51.3 per cent reflecting growing trade relations between the two countries.

Table: India's Trade with Asia in 2005-06

(US $ million)

Region/Group	Exports	Non-oil Imports	Share in total exports (Per cent)	Share in non-oil imports (Per cent)
Developing Countries	58,265	52,039	56.7	52.9
Asia	44,812	40,755	43.6	41.4
Emerging Asia	23,258	28,577	22.6	29.0
China	6,721	10,740	6.5	10.9
SAARC	5,359	1,339	5.2	1.4
ASEAN	10,513	10,611	10.2	10.8
Gulf Cooperation Council	11,753	7,728	11.4	7.8

Source : DGCI&S.

Commodity-wise, engineering goods (including metals, metal products, transport equipment, and iron and steel), gems and jewellery, petroleum products, chemicals and iron ores are India's major exports to Asia. The major items of India's imports from Asia are electronic goods, pearls, precious and semi-precious stones, chemicals, gold and silver, vegetable oils and non-electrical machinery.

India's increasing trade with developing countries is attributable to trade liberalisation, reduction in tariffs, reduction of non-tariff barriers, various trade policy measures and regional cooperation efforts. Emerging Asia has the advantage of geographical proximity and a large market of 45 per cent of the world population and 11 per cent of world GDP.

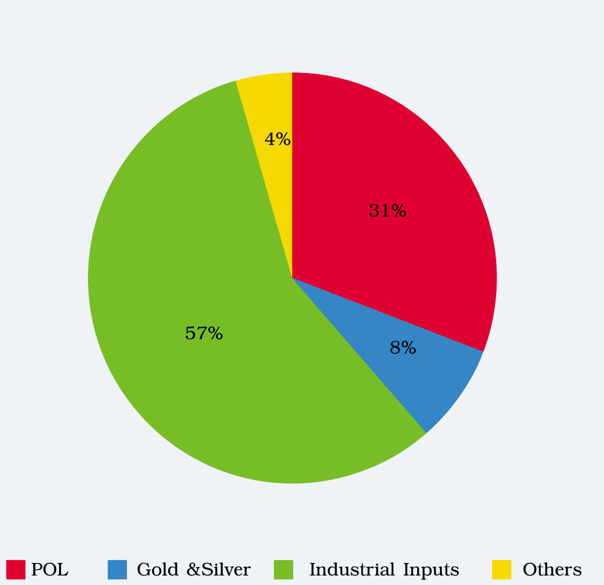
In recognition of the growing importance of Asian countries in India's foreign trade, the series of nominal and real effective exchange rate indices released by the Reserve Bank have been revised to include Chinese renminbi and Hong Kong dollar in the weighting scheme. Japan being already included, the representation of Asian economies has increased to three out of the total of six countries (Reddy, 2006).

References

1. Reddy, Y.V. (2006), "India in Emerging Asia", Reserve Bank of India Bulletin, June.
2. UNCTAD (2005), Handbook of Statistics.
3. _____ (2005), Trade and Development Report.

I.6.12 Non-oil non-gold imports maintained the momentum of growth, increasing by 23.7 per cent during 2005-06 as compared with 39.0 per cent a year ago. Imports of industrial inputs (non-oil imports net of gold and silver, bulk consumption goods, manufactured fertilisers and professional instruments) recorded strong growth of 24.7 per cent (41.4 per cent increase a year ago). Imports of capital goods were the mainstay, accounting for 39.1 per cent of the imports of industrial inputs. Imports of capital goods increased by 26.0 per cent during 2005-06 (37.5 per cent a year ago) in consonance with acceleration in domestic production of capital goods, reflecting large investment demand and continued expansion in capacity. Growth in imports of gold and silver, however, decelerated to 0.4 per cent in 2005-06 from 62.6 per cent a year ago, which could be attributed to the surge in gold prices (Appendix Table 52 and Chart I.43). Among bulk commodities, imports of manufactured fertilisers, metalliferrous ores and scraps, non-ferrous metals, and iron and steel rose steeply while imports of bulk consumption goods such as edible oils witnessed a decline during 2005-06.

Chart I.43: Composition of India's Imports: 2005-06



I.6.13 Country-wise, China was the major source of imports with a share of 10.9 per cent in India's total non-oil imports, followed by the US (7.9 per cent), Switzerland (6.6 per cent), Australia (4.9 per cent), Belgium (4.8 per cent) and UAE (4.4 per cent). Region-wise, developing economies were the major source, accounting for 52.9 per cent of India's total non-oil imports.

I.6.14 Led by the expansion of oil imports (which increased by US $ 14.1 billion) and non-oil imports (an increase of US $ 16.8 billion), trade deficit, on DGCI&S basis, expanded by 41.8 per cent to US $ 39.7 billion during 2005-06 (Appendix Table 50). Non-oil trade deficit, however, recorded a relatively modest increase from US $ 5.1 billion during 2004-05 to US $ 7.2 billion during 2005-06.

I.6.15 During 2006-07 (April-July), growth in merchandise exports decelerated to 20.8 per cent (in US dollar terms) from 34.6 per cent a year ago. Oil imports during April-July 2006 increased by 43.2 per cent on top of 36.5 per cent growth a year ago, reflecting further hardening of international crude oil prices. Non-oil imports during April-July 2006 grew by 9.9 per cent, a sharp deceleration from growth of 52.0 per cent a year ago. Commodity-wise data available for April-May 2006 indicate that this deceleration could be partly attributed to imports of gold and silver which declined by 33.7 per cent as against an increase of 55.6 per cent during April-May 2005. Imports of capital goods continued to record strong growth (37.2 per cent during April-May 2006, *albeit* lower than that of 55.9 per cent during April-May 2005). The trade deficit increased to US $ 16.7 billion during April-July 2006 from US $ 14.4 billion during the corresponding period of 2005.

Invisibles

I.6.16 The sustained rise in invisibles surplus during 2005-06 – net balance under services, transfers and income – continued to moderate the impact of growing merchandise trade deficit. Net surplus under invisibles expanded from US $ 31.2 billion during 2004-05 to US $ 40.9 billion during 2005-06 (Appendix Table 53). As in recent years, growth in invisible receipts during 2005-06 was led mainly by significant expansion in software exports, other professional and business services and remittances from overseas Indians. This has led to a rise in the share of invisibles in the current receipts from 29 per cent in 1990-91 to 47 per cent in 2005-06 (Chart I.44). Reflecting the sustained growth since the early 1990s, gross invisible receipts have expanded sharply from 2.4 per cent of GDP in 1990-91 to 11.5 per cent in 2005-06. Gross invisible payments have expanded at a relatively modest pace over the same period from 2.4 per cent of GDP to 6.4 per cent. Consequently, the net surplus under invisibles – which recorded a modest deficit of 0.1 per cent in 1990-91 – has turned out to be quite substantial in recent years to reach 5.1 per cent of GDP in 2005-06.

Chart I.44: India's Invisible Receipts

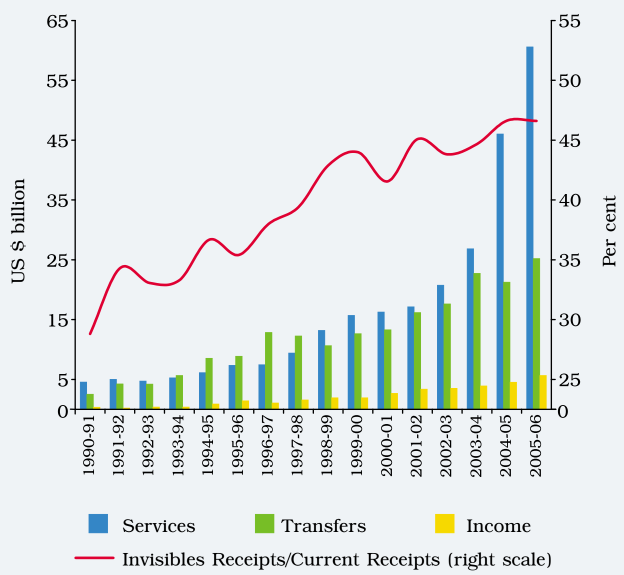


Table 1.68: Structure of India's Services Exports

Year	Amount (US $ million)	Share in Total Services Exports (Per cent)					
		Travel	Transportation	Insurance	G.N.I.E.	Software	Miscellaneous*
1	2	3	4	5	6	7	8
1970-71	292	16.8	49.7	5.5	13.7	–	14.4
1980-81	2,804	43.5	16.3	2.3	4.0	–	33.9
1990-91	4,551	32.0	21.6	2.4	0.3	–	43.6
2000-01	16,268	21.5	12.6	1.7	4.0	39.0	21.3
2003-04	26,868	18.7	11.9	1.6	0.9	47.6	19.2
2004-05	46,031	14.1	10.4	2.0	0.7	37.4	35.4
2005-06	60,610	12.9	10.4	1.7	0.5	38.9	35.6

* : Excluding software services.
G.N.I.E. : Government not included elsewhere.

Services

I.6.17 Services exports during 2005-06 continued to be led by rapid growth in software services exports, other business and professional services (Table 1.68). Within the services exports, rising prominence of business services reflects high skill intensity of the Indian work force. There has also been a strong revival in international tourist interest in India since 2003-04.

I.6.18 Reflecting these positive developments and continued buoyancy of India's services exports, the share of India's services exports in world exports has recorded a significant increase from 0.6 per cent in 1995 to 1.8 per cent in 2004. India was the 18th largest service exporter in the world in 2004 (Table 1.69). The gains recorded by the exports of services have far exceeded those recorded by exports of goods (Chart I.45).

Table 1.69: Exports of Services, 2004

Country	Exports (US $ billion)	Share in World Exports (%)
1	2	3
USA	340	15.2
UK	181	8.1
Germany	142	6.3
France	110	4.9
Japan	98	4.4
Spain	85	3.8
Italy	84	3.7
Netherlands	73	3.3
China	62	2.8
Hong Kong	54	2.4
Belgium	52	2.3
Ireland	52	2.3
Austria	49	2.2
Canada	48	2.1
Switzerland	43	1.9
Korea	41	1.9
Singapore	41	1.8
India	**40**	**1.8**
Sweden	39	1.7

Source : Balance of Payments Statistics Yearbook 2005, IMF and Reserve Bank of India.

I.6.19 Tourism earnings continued with their buoyancy witnessed since 2003-04, reflecting both business and leisure travel (Table 1.70). Foreign tourist arrivals in India followed the usual seasonal pattern, peaking in October-December with the tourist season extending up to March. Concomitantly, travel payments also increased from US $ 5.5 billion in 2004-05 to US $ 6.4 billion in 2005-06, reflecting rising business and leisure travel in consonance with (i) growing merchandise and services trade and (ii) growing disposable incomes of residents in an environment of liberalised payments regime.

Chart I.45: India's Exports of Goods and Services

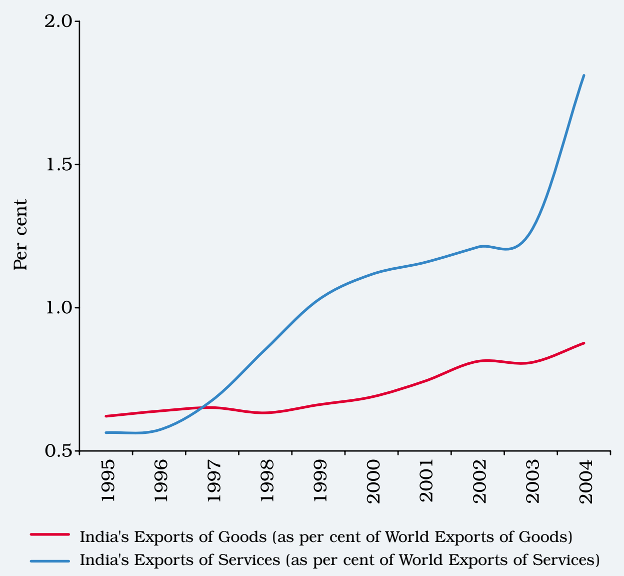


Table 1.70: Foreign Tourist Arrivals in India and Outbound Tourist Traffic

Year	Arrivals (millions)	Growth Rate (%)	Departure (millions)	Growth Rate (%)
1	2	3	4	5
1992	1.9	11.3	2.2	15.8
2000	2.7	6.9	4.4	7.3
2001	2.5	-7.4	4.6	4.5
2002	2.4	-4.0	4.9	6.5
2003	2.7	12.5	5.4	10.2
2004	3.5	29.6	6.2	14.8
2005	3.9	11.4	7.2	16.1

Source : Ministry of Tourism and Culture, Government of India.

I.6.20 Impressive growth in receipts from business services continued during 2005-06, indicating India's rising comparative advantage in commercial services. Earnings from exports of software and IT-enabled services remained the key driver of services earnings during 2005-06, recording a growth of 33 per cent (Table 1.71). Globally, India ranks second to Ireland in exports of computer and information services (Table 1.72). Notwithstanding increasing competitive pressures, India remains an attractive source because of its low cost of operations, high quality of products and services and availability of skilled manpower. Favourable time zone difference also helps organisations run round the clock internal operations and render better customer service. In order to withstand growing global competition, the Indian IT companies have started moving up the value chain by exploring untapped potential in IT consulting and system integration, hardware support and installation and processing services. Security concerns have also been duly recognised to maintain customer confidence. Sharp acceleration in non-software services exports continued during the year, emanating from dynamism in export of services such as communications, construction, and management services. Business services payments also expanded reflecting the ongoing technological transformation of the economy and modernisation of Indian industry with the focus on foreign technological collaborations.

Table 1.71: Services and Software Exports of India

(US $ million)

Year	IT Services	ITES-BPO	Total Software
1	2	3	4 (2+3)
1995-96	754	-	754
2000-01	5,287	930	6,217
2004-05	13,100	4,600	17,700
2005-06	17,300	6,300	23,600

ITES : IT Enabled Services.
BPO : Business Process Outsourcing.
Source : NASSCOM.

Table 1.72: Computer and Information Services Exports, 2004

(US $ billion)

Rank	Country	Amount
1	2	3
1	Ireland	18.6
2	**India**	**17.7**
3	U.K.	10.6
4	Germany	7.9
5	U.S.A.	6.6
6	Israel	4.3
7	Netherlands	3.6
8	Spain	2.9
9	Canada	2.8
10	Belgium	2.4

Source : Balance of Payments Statistics Year Book 2005, IMF and Reserve Bank of India.

Private Transfers

I.6.21 Workers' remittances remained buoyant during 2005-06 benefiting from robust global output growth and constant improvement in remittance infrastructure domestically (Box I.19). Strong growth in oil exporting countries on the back of the surge in international crude oil prices also provided support to private remittances. India continues to be the highest remittance receiving country in the world (Table 1.73).

Investment Income

I.6.22 Investment income receipts continued to rise during 2005-06, reflecting mainly the income earned on deployment of foreign exchange reserves. Higher investment income receipts also reflect the impact of rising Indian overseas investment as also the expansion of commercial activities by the Indian companies. Investment income payments expanded, primarily on account of debt servicing costs as well as reinvested earnings of FDI enterprises. As income payments remained in excess of receipts, investment income recorded a deficit of US $ 5 billion during 2005-06.

Box I.19
Inward Remittances

Remittance inflows have become an important source of financing of current account deficit not only in India but in several countries. Inward remittances to developing countries have surged from US $ 58 billion in 1995 to US $ 160 billion in 2004 (World Bank, 2005). Remittances have emerged as the second important source of funds to developing countries after foreign direct investment. Remittances are equivalent to about 6.7 percent of developing countries' imports and 7.5 percent of their domestic investment, indicating the significance of these inflows for the host economies, especially smaller economies. Remittances were even larger than total capital inflows in many developing countries in 2004 and exceeded merchandise exports in a number of countries. In part, the surge in officially recorded remittances to developing countries in recent years reflects better data collection owing to greater awareness of the development potential of remittances as well as concerns about money laundering. In a number of countries, Government policies to improve banking access and the technology of money transfers have also helped increase the flow of remittances and promote their transfer through formal channels. Workers remittances are found to be counter-cyclical and as such they have provided some element of stability to the recipient countries.

Remittance Inflows to India

The surge in workers' remittances to India, responding to the oil boom in the Middle East during the 1970s and 1980s, and the information technology revolution in the 1990s, has put India as the highest remittance receiving country in the world. Remittances include repatriation of funds for family maintenance and local withdrawals from the non-resident Indian (NRI) deposits.

Inward remittances from Indians working abroad have surged from US $ 2.1 billion in 1990-91 to reach US $ 24.6 billion in 2005-06, thereby proving to be a source of stable support to India's balance of payments (Table).

Table: Private Transfers to India

Year	Total Remittances (US $ billion)	Share in Current Receipts (Per cent)	Total Remittances (Per cent of GDP)
1990-91	2.1	8.0	0.7
1995-96	8.5	17.1	2.4
1999-00	12.3	18.1	2.7
2000-01	13.1	16.8	2.8
2001-02	15.8	19.4	3.3
2002-03	17.2	18.0	3.4
2003-04	22.2	18.5	3.7
2004-05	20.7	13.4	3.0
2005-06	24.6	12.5	3.1

Inward remittances have offset India's merchandise trade deficit to a large extent, thus keeping current account deficits modest through the 1990s.

The sustained expansion in remittances since the 1990s has been underpinned by structural reforms, including market-based exchange rate, current account convertibility as well as a shift in the labour outflow pattern from semi-skilled to increasingly high-skilled categories. Policy initiatives to facilitate remittance flows through speedier and cost effective money transfer arrangements like banking channels, money transfer agencies and post offices have also contributed to stability in remittances. While banking channels account for bulk of the inward remittances to India, Money Transfer Service Scheme (MTSS) and Rupee Drawing Arrangements (RDA) are also assuming significance. These schemes provide benefits of easier and speedier operations and play an important role in expanding the outreach of remittance services to remote locations in the country.

Reference

World Bank (2005), *Global Economic Prospects 2006*.

Table 1.73: Workers' Remittances

(US $ million)

Country	1996	2003	2004
1	2	3	4
Brazil	1,866	2,018	2,459
China	1,672	3,343	4,627
Colombia	..	3,060	3,170
Egypt	3,107	2,961	3,341
India	**8,453**	**21,885**	**19,612**
Mexico	4,224	13,396	16,613
Morocco	2,165	3,614	4,221
Pakistan	..	3,963	3,943
Portugal	3,575	2,752	3,032
Spain	2,749	4,718	5,189

Source : Balance of Payments Statistics Yearbook, 2005, IMF and Reserve Bank of India.

Current Account

I.6.23 Merchandise trade deficit, on balance of payments basis, increased from US $ 36.6 billion during 2004-05 to US $ 51.6 billion during 2005-06, led by higher imports. Net invisibles surplus also expanded during the year, financing a substantial part – about 79 per cent – of trade deficit during 2005-06. With the expansion in merchandise trade deficit, however, in excess of the expansion in the invisibles surplus, the deficit on the current account increased from US $ 5.4 billion during 2004-05 to US $ 10.6 billion during 2005-06. As a proportion to GDP, the current account deficit increased from 0.8 per cent during 2004-05 to 1.3 per cent in 2005-06. Thus, unlike many other emerging markets, which continue

Table 1.74: Current Account Balances in Select Countries

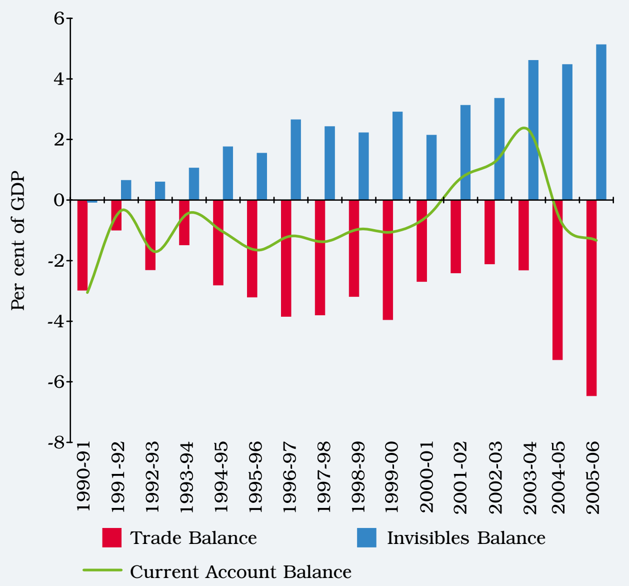
(Per cent to GDP)

Country	1996	2000	2003	2004	2005
1	2	3	4	5	6
Argentina	-2.5	-3.2	6.3	2.2	1.8
Brazil	-3.0	-4.0	0.8	1.9	1.8
China	0.9	1.7	2.8	3.6	7.1
Germany	-0.6	-1.7	1.9	3.7	4.1
India@	**-1.2**	**-0.6**	**2.3**	**-0.8**	**-1.3**
Indonesia	-3.2	4.8	3.4	1.2	1.1
Japan	1.4	2.6	3.2	3.8	3.6
Korea	-4.1	2.4	2.0	4.1	2.1
Malaysia	-4.4	9.4	12.7	12.6	15.6
Mexico	-0.8	-3.2	-1.3	-1.1	-0.7
Philippines	-4.6	8.2	1.8	2.7	3.0
Thailand	-7.9	7.6	5.6	4.2	-2.3
US	-1.5	-4.2	-4.7	-5.7	-6.4

@ : Data pertain to fiscal year.
Note : (-) indicates deficit.
Source : World Economic Outlook, IMF, April 2006.

to record surpluses, India's current account balance shows a deficit (Table 1.74 and Chart I.46). Current account developments during 2005-06 point towards growing openness and integration of the Indian economy with the global economy. The ratio of current receipts to GDP increased from 22.0 per cent in 2004-05 to 24.5 per cent in 2005-06. Similarly, trade openness – the ratio of merchandise exports and imports to GDP – has increased from 28.9 per cent during 2004-05 to 32.7 per cent during 2005-06.

Chart I.46: India's Current Account



Capital Account

I.6.24 During 2005-06, capital flows remained buoyant, mainly led by foreign investment flows reflecting, to a large extent, growing interest in the economy's growth prospects (Appendix Table 54).

Foreign Investment

I.6.25 Both direct and portfolio foreign investment flows increased during 2005-06 (Table 1.75 and Box I.20). Foreign direct investment (FDI) flows into India were 37 per cent higher during 2005-06 on the back of positive investment climate, improved growth prospects and initiatives aimed at rationalising and liberalising the FDI policy and simplifying the procedures.

I.6.26 Country-wise, Mauritius and the US remained the major FDI investors in India (Table 1.76). FDI flows from the UK and Singapore increased sharply during 2005-06. Sector-wise, FDI flows continued to be

Table 1.75: Foreign Investment Flows to India

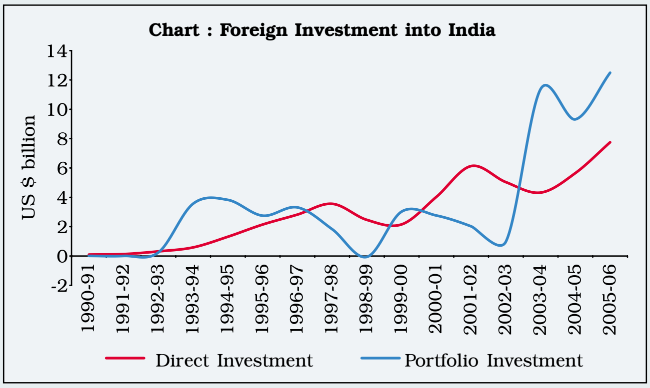
(US $ million)

Item	2003-04	2004-05	2005-06 P
1	2	3	4
A. Direct Investment (I+II+III)	**4,322**	**5,652**	**7,751**
I. Equity (a+b+c+d+e)	**2,229**	**3,777**	**5,820**
a) Government (SIA/FIPB)	928	1,062	1,126
b) RBI	534	1,258	2,233
c) NRI	-	-	-
d) Acquisition of shares*	735	930	2,181
e) Equity capital of unincorporated bodies	32	527	280
II. Re-invested Earnings	**1,460**	**1,508**	**1,676**
III. Other Capital #	**633**	**367**	**255**
B. Portfolio Investment (a+b+c)	**11,377**	**9,315**	**12,492**
a) GDRs/ADRs	459	613	2,552
b) FIIs @	10,918	8,686	9,926
c) Off-shore funds and others	-	16	14
C. Total (A+B)	**15,699**	**14,967**	**20,243**

P : Provisional
- : Nil/Negligible.
* : Relates to acquisition of shares of Indian companies by non-residents under section 6 of the FEMA, 1999.
# : Data pertain to inter-company debt transactions of FDI entities.
@: Data represent net inflow of funds by FIIs.
Note : 1. Data on reinvested earnings for 2004-05 and 2005-06 are estimates.
2. Data on foreign investment presented in this table represent inflows into the country and may not tally with the data presented in other tables. They may also differ from data relating to net investment in stock exchanges by FIIs.

Box I.20
Foreign Investment Flows to India

Foreign investment flows in to India, comprising foreign direct investment (FDI) and foreign portfolio investment (FPI), have risen sharply during the 1990s reflecting the policies to attract non-debt creating flows. Foreign investment flows have increased from negligible levels during 1980s to reach US $ 20 billion by 2005-06 (Chart). Cumulative foreign investment flows have amounted to US $ 106 billion since 1990-91 and almost evenly balanced between direct investment flows (US $ 49 billion) and portfolio flows (US $ 57 billion). Since 1993-94, FDI flows have exceeded portfolio flows in five years while portfolio flows have exceeded FDI flows in the remaining eight years. As a proportion to FDI flows to emerging market and developing countries, FDI flows to India have shown a consistent rise from 1.6 per cent in 1998 to 3.7 per cent in 2005. The share of net FPI flows to India as a proportion to total flows to emerging market and developing countries is higher and remained in the range of 12-15 per cent during 2004 and 2005.



The sharp rise in portfolio investment into India since 2003-04 reflects both global and domestic factors. Search for yield in view of very low real long-term rates in advanced economies have been an important factor driving portfolio flows to emerging market economies as a group and India has also attracted such flows. Domestic factors such as strong macroeconomic fundamentals, resilient financial sector, deep and liquid capital market, improved financial performance of the corporate sector and attractive valuations also attracted large portfolio flows between 2003-04 and 2005-06.

Recognising the macro economic implications of volatility associated with capital flows, India has adopted a policy of managing the capital account with a preference for non-debt flows (Mohan, 2005). Consistent with the principle of hierarchy of capital flows, India has been making efforts towards encouraging more inflows through FDI and enhancing the quality of portfolio flows by strict adherence to 'Know Your Investor' principle (Reddy, 2005). The Government has also taken steps to enhance the FDI sectoral caps in infrastructure in recent years (*e.g.* telecom, civil aviation). FDI up to 100 per cent through the Reserve Bank's automatic route was permitted for a number of new sectors in 2005-06 such as greenfield airport projects, laying of pipelines, export trading. FDI caps under the automatic route were enhanced to 100 per cent for coal and lignite mining for captive consumption and setting up infrastructure relating to marketing in petroleum and natural gas sector. All these measures have been contributing towards increasing direct investment. With the FDI inflows to developing world still in a stage of recovery to the pre-East Asian crisis level, India's FDI growth of above 30 per cent during past two years is encouraging. Although the FDI inflows into India are small as compared to other emerging markets, their size is growing on the back of growing interest by many of the world's leading multinationals. India has improved its rank from fifteenth (in 2002) to become the second most likely FDI destination after China in 2005 (AT Kearney).

In the context of encouraging FII flows, sufficient attention needs to be given to address the macroeconomic implications of volatility of capital flows. There is a need to examine the likely implications of excessive inflows and outflows on macroeconomic management. Furthermore, in order to maintain the financial integrity of the Indian markets, there is a need to take suitable measures to address the growing international concerns regarding origin and source of investment funds flowing into the country. Such measures would enhance the confidence of the foreign investors and regulators alike in the Indian financial system, given the fact that adherence to best practices and standards are important determinants for assessment of the quality of regulation.

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Table 1.76: Foreign Direct Investment to India: Country-wise and Industry-wise*

(US $ million)

Source/Industry	2003-04	2004-05	2005-06 P
1	2	3	4
Total FDI Flows	**1,462**	**2,320**	**3,358**
Country-wise Inflows			
Mauritius	381	820	1,363
USA	297	469	346
UK	157	84	261
Germany	69	143	45
Netherlands	197	196	50
Japan	67	122	86
France	34	44	12
Singapore	15	64	166
Switzerland	5	64	68
South Korea	22	14	61
Others	218	300	901
Industry-wise Inflows			
Fisheries	2	10	28
Mining	18	11	6
Manufacturing	426	924	1,257
Food and Dairy Products	64	183	148
Electricity	90	14	83
Construction	172	209	191
Trade, Hotels & Restaurants	67	22	95
Transport	20	70	66
Financing, Insurance, Real Estate & Business Services	206	363	452
Computer Services	166	372	770
Educational Services	0	2	4
Research & Scientific Services	1	5	5
Health & Medical Services	15	25	61
Other Services	2	10	49
Others	213	100	143

* : Data in this Table exclude FDI inflows under the NRI direct investment route through the Reserve Bank and inflows due to acquisition of shares under section 6 of FEMA, 1999.
P : Provisional.

attracted by the increasing competitiveness of select manufacturing industries and services, particularly business and computer services. At the global level, services have been the key attraction for foreign direct investors, a structural shift indicative of offshoring. In India, the services sector attracted the largest FDI flows – US $ 1.8 billion in 2005-06 (US $ 1.1 billion in 2004-05). FDI flows into the manufacturing sector also increased substantially during 2005-06.

I.6.27 India has steadily improved its rank of both Inward and Outward FDI Performance Index (World Investment Report, 2005) indicating improved investment climate and better growth prospects (Chart I.47).

I.6.28 Portfolio equity flows increased further during 2005-06, led mainly by higher inflows from foreign institutional investors (FIIs). Net inflows by FIIs in the Indian stock markets increased by 14 per cent to US $ 9.9 billion, driven by strong corporate profitability and better growth prospects (see Table 1.75). The number of FIIs registered with the SEBI increased from 685 at end-March 2005 to 882 by end-March 2006. Capital inflows through the issuances of American depository receipts (ADRs)/global depository receipts (GDRs) were also substantially higher as booming stock markets offered corporates the opportunity to issue equities abroad. India remained one of the largest recipients of portfolio inflows during 2005 (Table 1.77 and Chart I.48).

I.6.29 An expert group under the Chairmanship of the Chief Economic Adviser, Ministry of Finance was constituted by the Government of India to examine the issues regarding FII flows and provide an action plan for time-bound implementation. The Group came out with its recommendations in November 2005. The Reserve Bank expressed its dissent on certain issues which were also made part of the Report.

Chart I.47: FDI Flows to India

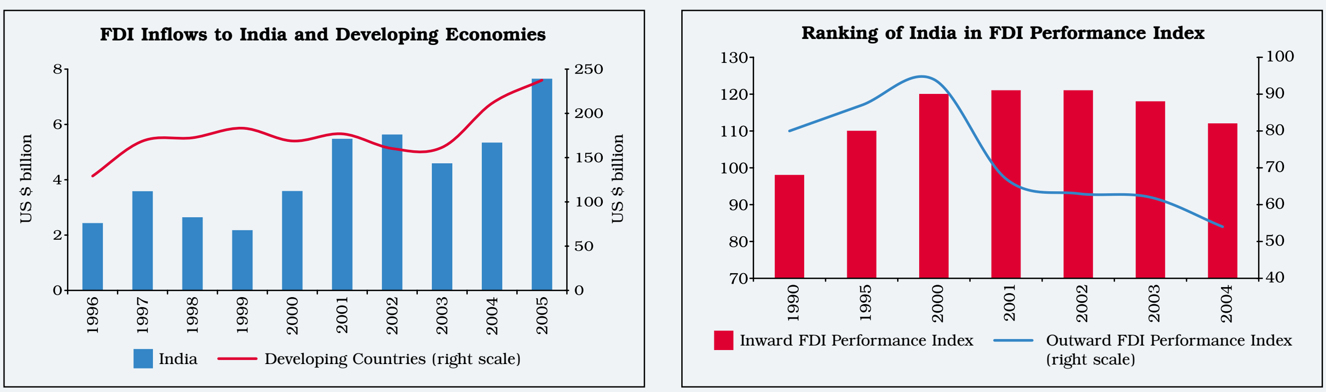


Table 1.77: Foreign Portfolio Investment Flows

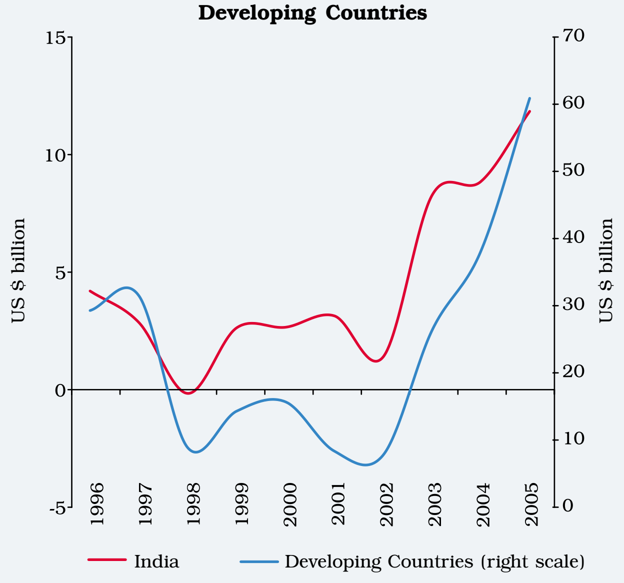
(US $ billion)

Country	2003	2004	2005
1	2	3	4
Brazil	5.1	-4.0	6.7
Chile	2.1	1.1	1.6
Hong Kong	1.4	3.9	9.1
India	8.2	8.8	11.9
Philippines	0.2	0.3	n.a.
Russia	-2.3	4.4	-0.9
South Korea	22.7	19.0	8.4 *
Thailand	0.9	0.9	6.9

n.a. : Not Available. * : Up to September.
Note : Data include both debt and equity investments.
Source : International Financial Statistics, IMF.

First, the Group had recommended that investments by FIIs may be considered over and above the sectoral caps prescribed for FDI. According to the Reserve Bank, the Group's recommendation could lead to a situation where total foreign investments would exceed the sectoral cap and, therefore, the Government should retain the option of keeping separate FII limits without allowing any interchange. Second, the Group was of the view that the existing arrangement for participatory notes (PNs) may continue. According to the Reserve Bank, PNs should not be permitted to be issued since the nature of the beneficial ownership or the identity of the investor will not be known. If PNs are allowed to be issued by the FIIs, it would bypass the processes

Chart I.48: Portfolio Equity Flows to India and Developing Countries



to ensure compliance with 'Know Your Investor' as, in case of PNs, the ultimate beneficiary of the funds is not known. Both conceptually and in practice, restrictions on suspicious flows enhance the reputation of markets and lead to healthy flows. Third, regulatory developments with regard to hedge funds in the US and elsewhere, including Europe, may be closely watched to formulate policy on the basis of experiences of these countries. In case there are any funds which are believed to be hedge funds and are registered with SEBI, such cases would need to be looked at closely. Fourth, in regard to cases where sub-accounts are not eligible to register as FIIs, the Reserve Bank noted that it may not be advisable to permit registration under the sub-account category. Finally, regarding the recommendations to ease the quantitative restrictions on FII investments in debt instruments and allow investment based on a cap on the annual flows instead of a ceiling on aggregate portfolio flows, the Reserve Bank indicated that it may not be feasible to allow FIIs unhindered access to the domestic debt markets as long as there is a wedge between the Indian inflation and debt yield with the rest of the world. Accordingly, the ceiling should be on the total stock of FII investment in debt and not on an incremental basis.

India's Direct Investment Abroad

I.6.30 Following the phased liberalisation in the regime for Indian investments overseas, investments in joint ventures (JV) and wholly owned subsidiaries (WOS) abroad have emerged as important avenues for promoting global business by Indian entrepreneurs. They are also a source of increased exports of plants and machinery and goods from India. Joint ventures have also been perceived as a medium of economic cooperation between India and other countries. Transfer of technology and skill, sharing of results of R&D, access to wider global markets, promotion of brand image, generation of employment and utilisation of raw materials available in India and in the host country are other significant benefits arising out of such overseas investments. Overseas investments which started off initially with the acquisition of foreign companies in the IT and related services sector have now spread to other areas, particularly pharmaceuticals and petroleum (Table 1.78). Overseas investment is being funded through a variety of sources such as drawal of foreign exchange in India, capitalisation of exports, balances held in EEFC accounts and swap of shares. A part of overseas investment is also financed through funds raised abroad such as external commercial borrowings,

Table 1.78: India's Direct Investment Abroad

(US $ million)

Industry	2000-01	2003-04	2004-05	2005-06
1	2	3	4	5
Manufacturing	169	893	1,068	1,538
Financial Services	6	1	7	156
Non-Financial Services	470	456	283	531
Trading	52	113	181	215
Others	12	31	108	239
Total	**709**	**1,494**	**1,647**	**2,679**

Note : Data are provisional.

foreign currency convertible bonds and ADRs/GDRs. Overseas investment also takes place through leveraged buyout by way of setting up of special purpose vehicles (SPVs) abroad. These SPVs typically raise funds from international markets to finance the buyout and such transactions are not captured in the overseas investment statistics.

Debt Flows

I.6.31 Reflecting the increased domestic investment activity, demand for external commercial borrowings (ECBs), including foreign currency convertible bonds (FCCBs), remained high during 2005-06. Corporates resorted to ECBs mainly for import of capital goods, project financing, capital investment, modernisation of plants and expansion of activity. Gross disbursements under ECBs increased from US $ 8.5 billion during 2004-05 to US $ 13.5 billion during 2005-06. Net disbursements under ECBs were lower during 2005-06 essentially on account of the one-off effect of principal repayment of IMDs (US $ 5.5 billion). Recourse to short-term trade credits also increased during the year, reflecting rising import financing requirements.

I.6.32 NRI deposits recorded larger inflows during 2005-06. This could be partly attributed to relaxation of ceiling on interest rates on NRE deposits from "US dollar LIBOR/swap rates of corresponding maturity *plus* 50 basis points" in November 2004 to "LIBOR/swap rates of US dollar *plus* 75 basis points" on November 17, 2005 (Table 1.79). Inflows under NRI deposits also appear to have benefited from the IMD redemptions.

External Assistance

I.6.33 India received external assistance (net) of US $ 1.5 billion during 2005-06 as compared with US $ 2.0 billion a year ago. India continued to extend

Table 1.79: Balances under NRI Deposit Schemes

(US $ million)

Scheme	Outstanding (end-March)		Net Inflows@ (April-March)	
	2005	2006	2004-05	2005-06
1	2	3	4	5
1. FCNR(B)	11,452	13,064	492	1,612
2. NR(E)RA	21,291	22,070	84	1,177
Total	**32,743**	**35,134**	**576**	**2,789**

@ : All figures are inclusive of accrued interest and valuation changes arising on account of fluctuation in non-dollar currencies against the US dollar.

Note : Net inflows in respect of NR(E)RA deposits in columns 4 and 5 may not match with the differences between the outstanding stocks on account of exchange rate fluctuations during the year.

assistance to other countries, mainly in the form of grants and loans. External assistance provided in the form of grants and loans by India to other countries rose to US $ 489 million in 2005-06 from US $ 247 million in 2000-01 (Table 1.80). India provides aid mainly in the form of technical cooperation and training, with the grants component dominating external aid with a share of 79 per cent. The major beneficiaries of the assistance during 2005-06 were Bhutan, Nepal, Bangladesh and the African countries.

I.6.34 During 2006-07 so far, capital flows, except FII flows, have remained large. FDI inflows increased from US $ 922 million during April-May 2005 to US $ 1,199 million during April-May 2006 while amounts raised under ADRs/GDRs increased from US $ 360 million to US $ 1,007 million. NRI deposits recorded net inflows of US $ 816 million during April-May 2006 as against net outflows of US $ 118 million over the same period of 2005. In contrast, FII flows recorded net outflows of US $ 1,787 million during April-June 2006 as against net inflows of US $ 544 million a year ago.

EXTERNAL DEBT

I.6.35 India's total external debt increased by about US $ 2 billion during 2005-06 and was placed at US $ 125.2 billion at end-March 2006. The increase in the external debt during 2005-06 was mainly on account of a rise in NRI deposits and trade credit (up to 1 year maturity) [Table 1.81 and Appendix Table 56]. The rise in NRI deposits, as noted earlier, could be attributed partly to the upward revision in interest rates on NRE term deposits, while higher short-term trade credit reflected rising import financing requirements. The decline in the stock of external

Table 1.80: India's Grants and Loans to Foreign Governments

(US $ million)

Item	2000-01			2005-06		
	Grant	Loan	Total	Grant	Loan	Total
1	2	3	4	5	6	7
A. Plan (External Affairs)	**76**	**44**	**120**	**100**	**63**	**163**
B. Non-Plan (i+ii+iii)	**88**	**38**	**127**	**287**	**39**	**326**
i. External Affairs	81	16	97	261	0	261
Bangladesh	2	16	18	12	0	12
Bhutan	44	0	44	93	0	93
Nepal	14	0	14	15	0	15
Africa	1	0	1	14	0	14
Myanmar	4	0	4	5	0	5
Sri Lanka	2	0	2	6	0	6
Other Developing Countries	14	0	14	117	0	117
ii. Finance	7	22	29	25	39	65
Contribution to U.N.D.P.	5	0	5	5	0	5
Mauritius	0	2	2	0	7	7
Myanmar	0	4	4	0	6	6
Sri Lanka	0	3	3	0	16	16
Surinam	0	0	0	0	2	2
Other Countries	2	13	15	5	0	5
Development Assistance	0	0	0	16	0	16
iii. Shipping	1	0	1	0	0	0
Bangladesh	1	0	1	0	0	0
C. Grand Total (A+B)	**165**	**82**	**247**	**387**	**102**	**489**

Source : Union Budgets, Government of India.

commercial borrowings was mainly due to the one-off effect of the repayment of IMDs. The valuation effect, on account of appreciation of the US dollar against other major international currencies, had a moderating impact on the stock of external debt. The US dollar continues to dominate the currency composition of external debt.

I.6.36 Indicators of sustainability suggest continued improvement in India's external debt position. The ratio of external debt to GDP has recorded a steady decline to 15.8 per cent at end-March 2006 from 30.8 per cent at end-March 1995 (Table 1.82). Amongst the top 15 debtor countries, India had the lowest debt-GDP ratio, next only to China. India's foreign exchange reserves continued to exceed the external debt stock. Current receipts also exceed the external debt stock. This reflects the sustained robust growth in exports of goods, services and remittances. The ratio of the short-term debt to total external debt, notwithstanding some increase during the year, remains modest. The increase in debt service ratio during 2005-06 was on account of redemption of the IMDs during the year.

Table 1.81: India's External Debt

(US $ million)

Item	End-March 2005	End-March 2006	Variation during 2005-06	
			Amount	Per cent
1	2	3	4	5
1. Multilateral	31,702	32,558	856	2.7
2. Bilateral	16,930	15,784	-1,146	-6.8
3. Trade Credit	4,980	5,326	346	6.9
4. External Commercial Borrowings	27,024	25,560	-1,464	-5.4
5. NRI Deposit	32,743	35,134	2,391	7.3
6. Rupee Debt	2,301	2,031	-270	-11.7
7. Long-term (1 to 6)	1,15,680	1,16,393	713	0.6
8. Short-term	7,524	8,788	1,264	16.8
Total	**1,23,204**	**1,25,181**	**1,977**	**1.6**

Table 1.82: External Debt Service Payments

(US $ million)

Item	2004-05	2005-06
1	2	3
1. External Assistance@	2,468	2,690
2. External Commercial Borrowings*	5,101	15,217
3. IMF	0	0
4. NRI Deposits (Interest Payments)	1,353	1,497
5. Rupee Debt Service	417	572
6. Total Debt Servicing	9,339	19,976
7. Total Current Receipts **	1,53,381	1,95,594
8. External Debt to GDP Ratio	17.3	15.8
9. Short Term Debt to Total Debt Ratio (%)	6.1	7.0
10. Short Term Debt to Foreign Exchange Reserves Ratio (%)	5.3	5.8
11. Foreign Exchange Reserves to External Debt Ratio (%)	114.9	121.1
12. Debt Service Ratio (6/7) (%)	6.1	10.2
13. Interest Payments to Current Receipts Ratio (%)	9.7	3.1
14. Debt to Current Receipts Ratio (%)	80.3	64.0
15. Liability Service Ratio (%)	7.1	11.5

@ : Inclusive of non-Government loans.
* : Inclusive of interest components of trade credits.
** : Excluding official transfers.

Note : 1. Debt Service payments in this table follow accrual method of accounting consistent with balance of payments compilation and may, therefore, vary from those recorded on cash basis.
2. Liability service ratio represents debt service payments and remittances of profits and dividends taken together as a ratio of total current receipts.

Table 1.83: Foreign Exchange Reserves

(US $ million)

As at end of March	Gold	SDRs	Foreign Currency Assets	Reserve Position in the IMF	Total (2+3+4+5)	Use of IMF Credit
1	2	3	4	5	6	7
1993	3,380	18	6,434	296	10,128	4,799
1994	4,078	108	15,068	299	19,553	5,040
1995	4,370	7	20,809	331	25,517	4,300
1996	4,561	82	17,044	310	21,997	2,374
1997	4,054	2	22,367	291	26,714	1,313
1998	3,391	1	25,975	283	29,650	664
1999	2,960	8	29,522	663	33,153	287
2000	2,974	4	35,058	658	38,694	26
2001	2,725	2	39,554	616	42,897	0
2002	3,047	10	51,049	610	54,716	0
2003	3,534	4	71,890	672	76,100	0
2004	4,198	2	1,07,448	1,311	1,12,959	0
2005	4,500	5	1,35,571	1,438	1,41,514	0
2006	5,755	3	1,45,108	756	1,51,622	0

FOREIGN EXCHANGE RESERVES

I.6.37 With capital flows remaining in excess of the current account deficit, the balance of payments continued to record an overall surplus during 2005-06. As a result, India's foreign exchange reserves – comprising foreign currency assets, gold, SDRs and the reserve tranche position with the IMF – increased by US $ 10.1 billion during 2005-06 to reach US $ 151.6 billion at end-March 2006 (Table 1.83 and Appendix Table 57). The increase in the value of gold holdings mirrored the increase in global prices of gold. India which had turned a creditor to the IMF under the Financial Transactions Plan (FTP) in 2003 provided SDR 34 million during 2005-06 to countries like Turkey and Uruguay. The total quantum of India's contribution under FTP has been SDR 493 million as at end-March 2006. At end-March 2006, India held the fifth largest stock of international reserve assets among EMEs. India's foreign exchange reserves were US $ 165.4 billion as on August 18, 2006, an increase of US $ 13.7 billion over end-March 2006.

I.6.38 In terms of various adequacy indicators, India's reserves remain comfortable. As noted above, reserves exceed external debt stock while short-term debt/reserves ratio remains modest. As regards trade-related indicators, reserves are well-above the conventional criterion although the import cover came down from 14 months at end-March 2005 to about 12 months at the end of March 2006.

I.6.39 The overall approach to the management of India's foreign exchange reserves takes into account the changing composition of the balance of payments and endeavours to reflect the 'liquidity risks' associated with different types of flows and other requirements. The objectives of reserve management in India are preservation of the long-term value of the reserves in terms of purchasing power and the need to minimise risk and volatility in returns. Foreign assets are held in major convertible currencies. Investments comprise deposits with other central banks, the Bank for International Settlements (BIS), top-rated foreign commercial banks, securities representing debt of sovereigns and supranational institutions with residual maturity not exceeding 10 years and any other instruments or institutions as approved by the Central Board of the Reserve Bank. Accordingly, the foreign currency assets are invested in multi-currency and multi-market portfolios (Table 1.84).

INTERNATIONAL INVESTMENT POSITION

I.6.40 India's net international investment position, *i.e.,* the stock of external assets net of the stock of external liabilities, has witnessed continuous

Table 1.84: Deployment Pattern of Foreign Currency Assets

(US $ million)

Item	March 31, 2005	March 31, 2006
1	2	3
Foreign Currency Assets	**1,35,571**	**1,45,108**
(a) Securities	36,819	35,172
(b) Deposits with other central banks and BIS	65,127	65,399
(c) Deposits with foreign commercial banks	33,625	44,537

improvement in the recent years. Latest available data on international investment position, which pertain to end-March 2005, show that India's external assets continued to be dominated by reserve assets. As regards external liabilities, the share of non-debt liabilities such as direct and portfolio investment in total liabilities has increased. Net external liabilities declined by US $ 6 billion during 2004-05 to US $ 41 billion at end-March 2005 as the increase in reserve assets exceeded the expansion in international liabilities. Reflecting these trends, the ratio of net external liabilities to GDP ratio has almost halved since end-March 2003 to 6.3 per cent at end-March 2005 (Table 1.85).

I.6.41 International liabilities of the Indian banking sector rose by 17.9 per cent during the year ended March 2006. The international assets increased by 16.4 per cent during the same period (Table 1.86). The international liabilities of banks continued to be almost double their international assets. Country-wise, the US accounted for nearly one fourth of total international liabilities and assets of Indian banks. While the assets denominated in foreign currency formed 95.5 per cent of total international assets, the proportion of foreign currency denominated liabilities in total international liabilities was lower at 50.4 per cent at end-March 2006.

Table 1.85: International Investment Position of India

(US $ billion)

Item	End-March		
	2003 PR	2004 PR	2005P
1	2	3	4
A. Assets	**95.6**	**137.1**	**169.3**
1. Direct Investment	5.8	7.1	9.6
2. Portfolio Investment	0.8	0.8	0.8
2.1 Equity Securities	0.4	0.4	0.4
2.2 Debt Securities	0.4	0.4	0.4
3. Other Investment	12.9	16.3	17.4
3.1 Trade Credits	1.1	1.9	3.9
3.2 Loans	1.4	1.7	1.8
3.3 Currency and Deposits	7.5	9.6	8.3
3.4 Other Assets	2.9	3.1	3.3
4. Reserve Assets	76.1	113.0	141.5
B. Liabilities	**156.0**	**184.1**	**210.1**
1. Direct Investment	31.2	39.1	44.5
2. Portfolio Investment	32.4	43.7	55.5
2.1 Equity Securities	20.1	34.0	42.8
2.2 Debt Securities	12.3	9.8	12.7
3. Other Investment	92.4	101.3	110.2
3.1 Trade Credits	4.8	6.3	9.6
3.2 Loans	61.1	61.9	65.9
3.3 Currency and Deposits	25.6	32.2	33.5
3.4 Other Liabilities	0.9	0.9	1.2
C. Net Position (A-B)	**-60.4**	**-47.0**	**-40.9**
D. Net Foreign Liabilities to GDP (%)	**12.7**	**8.1**	**6.3**
Memo:			
Debt Liabilities/Total Liabilities	67.1	60.3	58.5
Non-debt Liabilities/Total Liabilities	32.9	39.7	41.5

PR: Partially revised. P: Provisional.

Table 1.86: International Liabilities and Assets of Banks in India

(US $ million)

Category/Item	Amount outstanding at end of		
	March 2004	March 2005	March 2006 P
1	2	3	4
Total International Liabilities	**50,871**	**58,292**	**68,723**
of which:			
FCNR(B) Deposits	10,460	11,612	13,025
NRE Rupee Deposits	17,501	19,616	22,483
Foreign Currency Borrowings	7,743	10,410	14,283
Bonds (including IMDs)	6,389	6,681	988
NR(NR) Rupee Deposits	1,690	188	0
ADRs and GDRs	1,474	2,265	3,325
EEFC Accounts	1,045	1,296	1,348
Total International Assets	**26,680**	**30,458**	**35,459**
of which:			
Foreign Currency Loans to Residents	10,159	13,280	14,173
Outstanding Export Bills	4,750	5,983	7,073
NOSTRO Balances	9,053	8,155	9,978

P : Provisional
IMDs : India Millennium Deposits.
ADRs : American Depository Receipts
GDRs : Global Depository Receipts.
EEFC : Exchange Earners' Foreign Currency.
Note : All figures are inclusive of accrued interest.

I.6.42 To sum up, export earnings from goods and services as well as remittances remained robust during 2005-06. The current account deficit, however, widened mirroring the sharp expansion in imports in consonance with higher oil prices and the pick-up in investment activity in the economy. Despite some expansion of the current account deficit as well as large outgo on account of the redemption of the IMDs, India's balance of payments remained comfortable during 2005-06 as normal capital flows continued to remain large and were more than sufficient to finance the current account deficit. India's foreign exchange reserves increased by US $ 10.1 billion during 2005-06.

II ASSESSMENT AND PROSPECTS

ASSESSMENT OF 2005-06

II.1 The Indian economy recorded strong growth for the third successive year during 2005-06 in an environment of macroeconomic and financial stability, notwithstanding sustained pressures from record high international crude oil prices. Real GDP growth accelerated from 7.5 per cent during 2004-05 to 8.4 per cent during 2005-06 on the back of buoyant manufacturing and services activity supported by a recovery in the agricultural sector. Real GDP growth has, thus, averaged over eight per cent during the last three years and over seven per cent in the first four years (2002-03 to 2005-06) of the Tenth Five Year Plan.

II.2 Growth in real GDP originating from the agricultural sector recovered to 3.9 per cent in 2005-06 from 0.7 per cent in 2004-05 led by improvement in the production of foodgrains as well as non-foodgrains. Growth in the production of foodgrains was almost entirely on account of recovery in the production of rice to 91.0 million tonnes (mt) in 2005-06 from 83.1 mt in 2004-05; the growth in 2005-06 partly reflected the base effect as rice output had dipped in 2004-05 from 88.5 mt in 2003-04. As regards other major foodgrains, wheat output in 2005-06 (69.5 mt) was only marginally higher than that in 2004-05 (68.6 mt) but lower than that two years earlier (72.2 mt in 2003-04). Similarly, the production of coarse cereals in 2005-06, although higher than the preceding year, was lower than it was two years earlier. The production of pulses at 13.1 mt in 2005-06 was unchanged from a year earlier, but lower than that in 2003-04. Overall, the total production of foodgrains at 208.3 mt in 2005-06, *albeit* higher than that in 2004-05 (198.4 mt), was lower than that in 2003-04 (213.2 mt).

II.3 A noteworthy aspect of economic activity during 2005-06 was the continued recovery of manufacturing activity, led by both investment and consumption demand. The industrial recovery that set in during 2002-03 has been sustained on the back of expansion in domestic as well as export demand, increased capacity utilisation, augmentation of capacities and positive business and consumer confidence. An impressive feature during 2005-06 was the double-digit expansion in both capital and consumer goods. The basic goods sector also picked-up, benefiting from strong growth in cement, basic metal and alloy industries. Growth in the intermediate goods sector, however, decelerated, which could be attributed to a variety of factors such as competition from the unorganised sector and larger imports of goods such as yarn. Deceleration in production of petroleum products also contributed to deceleration in intermediate goods production. The infrastructure sector continued to record subdued performance. Growth in the generation of electricity remained sluggish during 2005-06, possibly hampered by inadequate availability of gas and coal. It may be noted with some concern that average growth in electricity generation during 2004-05 and 2005-06 at 5.1 per cent has been significantly lower than that of manufacturing growth of 9.1 per cent over the same period.

II.4 The services sector maintained double-digit growth for the second successive year, and remained the key driver of growth during 2005-06 by contributing almost three-fourths to the overall real GDP growth. The buoyant growth in the services sector during 2005-06 was largely supported by the strong performance of trade, hotels, transport and communication sub-sector. The construction sector witnessed double digit growth for the third successive year benefiting from the focus on infrastructure and supported by housing activity. The high-growth components of the services sector such as information technology (IT), and business process outsourcing (BPO) provided a stable anchor to the economy in face of risks emanating from high oil prices. A favourable market is emerging for services products from India as evident by the trebling of India's share in world export of services from 0.6 per cent in 1995 to 1.8 per cent in 2004.

II.5 The strengthening of economic activity in the recent years has been supported by a consistent increase in the gross domestic investment rate from 23.0 per cent of GDP in 2001-02 to 30.1 per cent in 2004-05. The gross domestic saving rate has improved from 23.6 per cent to 29.1 per cent over the same period, led by a turnaround of 4.2 per cent of GDP in public savings – from a dissaving of 2.0 per cent of GDP in 2001-02 to positive savings of 2.2 per cent of GDP in 2004-05 – mainly reflecting the fiscal consolidation process.

II.6 Non-food credit extended by scheduled commercial banks increased by 31.8 per cent during 2005-06 on top of growth of 27.5 per cent a year ago. Almost 30 per cent of incremental non-food credit during 2005-06 went to the industrial sector, while over 14 per cent of incremental non-food credit was on account of housing loans and another 12 per cent of incremental non-food credit was absorbed by the agricultural sector and allied activities. In order to fund high credit demand, banks, apart from mobilising higher deposits, restricted their incremental investments in Government securities taking advantage of their excess SLR holdings. Internal reserves as well as recourse to raising of capital through equity issuances also enabled banks to fund credit demand. Notwithstanding the large order of increase in bank credit, monetary and liquidity conditions remained largely comfortable during 2005-06 reflecting proactive liquidity management operations by the Reserve Bank under the liquidity adjustment facility, flexible management of issuances under the market stabilisation scheme, and some private placement of Government securities.

II.7 Reflecting the large order of growth in bank credit, broad money (M_3) growth (17.0 per cent) during 2005-06 was higher than in the previous year (12.1 per cent) as well as the expansion of 14.5 per cent projected in April 2005 in the Annual Policy Statement for 2005-06. Growth in residency-based monetary aggregate (NM_3) at 18.1 per cent was even higher than that in M_3. It may be noted that residency-based monetary aggregate (NM_3) does not directly reckon non-resident foreign currency deposits such as India Millennium Deposits (IMDs). The redemption of IMDs depressed the growth rate of M_3, but did not have any direct impact on NM_3. Accordingly, NM_3 growth turned out to be higher than M_3. The above trend growth in monetary aggregates was indicative of strong aggregate demand conditions during the year. Reflecting the liquidity injection operations by the Reserve Bank during the year, growth in reserve money accelerated from 12.1 per cent in 2004-05 to 17.2 per cent in 2005-06.

II.8 Inflation was contained to 4.1 per cent by end-March 2006 within the indicative trajectory of 5.0-5.5 per cent during 2005-06. The actual inflation was considerably lower than the indicative trajectory and this could be mainly attributed to the deferred pass-through of even the cognisable permanent component of international crude oil prices. Notwithstanding the incomplete pass-through, mineral oil prices dominated the inflation outcome, contributing almost 40 per cent to the headline inflation. Prices of primary articles also posed upward pressures, led by higher prices of wheat, pulses and 'eggs, fish and meat'. On the whole, primary food articles contributed almost 24 per cent to headline inflation. In order to stabilise inflationary expectations, the Reserve Bank raised the reverse repo rate by 75 basis points during 2005-06 – 25 basis points each in April 2005, October 2005 and January 2006. These pre-emptive monetary policy measures by the Reserve Bank coupled with productivity gains and increased competition helped to contain inflationary expectations. However, underlying inflationary pressures continue to remain in view of the incomplete pass-through of permanent component of higher international crude oil prices to domestic prices.

II.9 The Centre's provisional accounts for 2005-06 indicate that revenue deficit and gross fiscal deficit, as per cent to GDP, at 2.7 per cent and 4.1 per cent, respectively, were higher by 0.2 percentage point and 0.1 percentage point than their levels in 2004-05. The 'pause' taken from attaining the minimum stipulated reductions under the Fiscal Responsibility and Budget Management (FRBM) Rules in 2005-06 has resulted in a departure from the FRBM path. Adherence to the FRBM path would have required revenue and fiscal deficits at 2.0 per cent and 3.7 per cent of GDP, respectively, in 2005-06. During 2005-06, the Centre continued with its efforts to rationalise the direct tax structure. A downward adjustment of tax slabs and lowering of rates were complemented by appropriate base enhancing measures which included introduction of new taxes, reduction of depreciation rates and removal of certain tax concessions. Indirect tax reforms focused on moving towards ASEAN levels for customs tariff and CENVAT rate for excise duties. Gross tax/GDP ratio continued its rising trend, crossing 10 per cent. Expenditure management laid emphasis on reducing non-plan expenditure and providing adequately for meeting pressing social and infrastructural needs of a growing economy. Capital outlay, however, continued to be low, at around 1.5 per cent of GDP.

II.10 The consolidated fiscal position of the State Governments during 2005-06 (revised estimates) reflected commitment by most State Governments to carry forward the process of fiscal correction and consolidation. The buoyancy in States' own tax revenue based on tax rationalisation and improved administration, higher transfer and devolution of resources from the Centre and deceleration in revenue expenditure facilitated the correction of the revenue deficit and consequently the gross fiscal deficit. The proportion of revenue deficit to gross fiscal deficit declined sharply in 2005-06 and this allowed an increase in the proportion of capital outlay, indicating improvement in the quality of expenditure of the State Governments. Furthermore, the States maintained large cash surplus position during 2005-06 following a surge in accruals from the National Small Savings Fund (NSSF). During 2005-06, the slippage in fiscal consolidation at the Centre was made good by the States, resulting in a reduction in the combined revenue deficit by 0.6 percentage point of GDP over its level in 2004-05 while the combined fiscal deficit remained unchanged at 7.5 per cent.

II.11 The balance of payments position remained comfortable during 2005-06 despite pressures imposed by higher international crude oil prices and outgo on account of redemption of IMDs. Merchandise export growth remained robust for the fourth successive year, reflecting growing competitiveness of the Indian industry. The expansion in merchandise exports (in US dollar terms) during the last four years (2002-03 to 2005-06) at a rate of 24 per cent, on average, has been an important source of growth in domestic manufacturing activity and in sustaining higher overall growth. Manufactured products such as engineering goods, chemicals, gems and jewellery and petroleum products were the major drivers of export growth during 2005-06. A redeeming feature during 2005-06 was the resurgence in exports of textiles and agricultural products. Non-oil import demand growth remained buoyant in consonance with higher investment activity. Oil imports increased sharply by 47 per cent during 2005-06 to US $ 44 billion. This increase was mainly on account of record high international crude oil prices as, in volume terms, the increase was only 4.2 per cent during the year. Reflecting the sustained hardening of international crude oil prices in the past few years, oil imports have increased from 2.8 per cent of GDP in 1999-2000 to 5.5 per cent of GDP in 2005-06. Net oil imports – oil imports net of oil exports – have increased from 2.8 per cent of GDP to 4.1 per cent of GDP over the same period. The merchandise trade deficit, on balance of payments basis, widened to 6.5 per cent of GDP in 2005-06, the highest level recorded in the last three decades, surpassing the peak of the second oil price shock. The current account deficit, nonetheless, remained modest during 2005-06 (1.3 per cent of GDP) as the surplus under invisibles continued to remain buoyant, benefiting from the sustained growth in exports of services such as software and other business services, and remittances. Growth in gross invisible receipts has outpaced growth in merchandise exports since the early 1990s. As a result, gross invisible receipts are now nearing the levels of merchandise exports – for instance, during 2005-06, invisible receipts were nearly 87 per cent of merchandise exports as compared with only 40 per cent in 1990-91. Concomitantly, the current receipts-GDP ratio has trebled from 8.0 per cent in early 1990s to 24.5 per cent in 2005-06.

II.12 Capital flows remained significant during 2005-06, exceeding the current account deficit. Foreign investment flows, both direct and portfolio, increased reflecting mainly the foreign appetite for domestic financial assets on the back of strong fundamentals and robust corporate performance. Debt flows also remained large primarily on account of growing investment demand in the economy. The gross disbursements under external commercial borrowings issues showed expansion of 57 per cent. Growing investment interest by Indian companies in the overseas markets continued during 2005-06, as these entities took advantage of the congenial policy regime. Thus, despite some expansion of the current account deficit as well as large outgo (US $ 7.1 billion) on account of the redemption of the IMDs, India's balance of payments recorded a surplus and the foreign exchange reserves increased by US $ 10.1 billion during the year. External debt, as a proportion of GDP, continued its declining trajectory.

II.13 Domestic financial markets remained largely orderly during 2005-06 even as interest rates edged up in various market segments during the year. Some tightness was observed in liquidity conditions between December 2005 and March 2006 and the Reserve Bank undertook appropriate liquidity management operations. There was a substantial migration of money market activity from the uncollateralised segment to the collateralised segment in response to policy measures. In the foreign exchange market, the rupee exhibited two-way movements. Yields in the Government securities market edged up reflecting higher domestic policy rates, higher crude oil prices, strong credit demand and global monetary tightening. Domestic stock indices reached record highs during 2005-06 reflecting increased interest by domestic as well as foreign investors on the back of strengthening growth prospects.

II.14 The Reserve Bank continued with its initiatives to strengthen the financial sector with a view to maintaining financial stability. In order to maintain asset quality, prudential measures were tightened by raising risk weights for specific sectors such as real estate where credit expansion was observed to be extremely high. In addition, the provisioning requirement for standard assets was increased. In November 2005, the provisioning requirement on standard assets, with the exception of direct advances to agricultural and small and medium enterprises (SME) sectors, was raised from 0.25 per cent to 0.40 per cent of the funded outstanding on global loan portfolio basis. Following the announcement in the Annual Policy Statement for 2006-07 (April 2006), the provisioning requirement on standard advances in specific sectors, *i.e.*, personal loans, loans and advances qualifying as capital market exposures, residential housing loans beyond Rs.20 lakh and commercial real estate loans was raised from 0.40 per cent to 1.0 per cent. Guidelines were issued to permit banks to raise capital through new instruments to provide them greater flexibility to meet the enlarged capital requirements under Basel II. Concomitantly, the Reserve Bank laid increasing emphasis on financial inclusion and improvement in customer services. Initiatives to strengthen other segments of the banking system included focus on amalgamations in the case of regional rural banks to improve the efficiency of their operations and signing of memoranda of understanding with a few State Governments in the case of urban cooperative banks to overcome, to an extent, the problem of dual control. The Government of India, after consultations with State Governments, has accepted the package for revival of short-term cooperative credit structure.

II.15 In its endeavour to provide a safe, secure, efficient and integrated payment and settlement system, the Reserve Bank continued to strengthen the institutional framework for payment and settlement systems during 2005-06. Key initiatives during the year included the laying down of a road map for the medium-term through the release of the Payment and Settlement Systems Vision Document (2005-08) and focus on promoting electronic funds transfer. Concomitantly, the Reserve Bank published the 'Financial Sector Technology Vision Document' in July 2005 for facilitating smooth and orderly change in the technological upgradation of the financial sector.

OUTLOOK FOR 2006-07

II.16 Developments during 2006-07 so far suggest that the growth momentum of recent years is likely to continue during the year. High growth in the last three years has been led by strong performance of the services activity and manufacturing sector with some support from agricultural activity. This suggests that the growth momentum mainly reflected structural factors, although supported by cyclical and seasonal components. Early trends from the industrial production, services sector indicators, trends in *kharif* sowing, business confidence surveys, corporate performance, external trade, monetary and credit indicators and financial market conditions support an overall optimistic near-term outlook.

II.17 The India Meteorological Department (IMD) in its forecast on June 30, 2006 indicated that the rainfall during the South-West monsoon season (June-September) 2006 for the country as a whole is likely to be 92 per cent of the Long Period Average (LPA) with a model error of +/- 4 per cent. The cumulative rainfall during the South-West monsoon season 2006 so far (June 1 to August 16, 2006) has been two per cent below normal; the shortfall was the same as during the comparable period of 2005. Of the 36 meteorological sub-divisions, cumulative rainfall was deficient/scanty/no rain in 14 sub-divisions. On the positive side, the total live water storage in the 76 major reservoirs as on August 4, 2006 was 56 per cent of the Full Reservoir Level, higher than that of 52 per cent a year ago. *Kharif* sowing picked up in July 2006 and as of July 31, 2006, around 67 per cent of normal area had been sown. The area sown under *kharif* crops up to July 31, 2006 was 2.4 per cent higher than a year ago. The total stock of foodgrains with the Food Corporation of India (FCI) and the State Government agencies at 22.3 million tonnes as on June 1, 2006 was almost 20 per cent lower than a year ago, but higher than the buffer stock norms (16.2 million tonnes).

II.18 Industrial production continued with its momentum during April-June 2006 (growth of 10.1 per cent as compared with 10.4 per cent in the corresponding period of 2005) led by the double-digit growth in manufacturing activity. The upturn in the industrial sector appears to be entering its fifth year of expansion in 2006-07. The manufacturing sector recorded growth of 11.2 per cent during April-June 2006, the same rate as a year ago. Electricity and mining sectors, however, continued to exhibit subdued growth. In terms of use-based classification, capital goods production recorded high growth, even on a high base, reflective of strong investment activity in the economy. Basic goods production also recorded an improvement. The intermediate goods sector, after recording subdued growth during most of 2005-06, witnessed improvement. Consumer goods continued to record high growth, *albeit* with some deceleration. The six infrastructure industries recorded growth of 6.3 per cent during April-June 2006 as compared with 7.5 per cent in the corresponding period of 2005.

II.19 Lead indicators of services sector activity suggest continued growth momentum during 2006-07 so far. Revenue generating traffic of railways, tourist arrivals, cargo and passenger handled by civil aviation, export earnings from software and other IT-enabled services, telecommunications and bank deposits and credit have recorded strong growth in 2006-07 so far. In the road sector, completion of about 92 per cent of the Golden Quadrilateral (5,846 km) by December 2005 would provide the necessary impetus to basic infrastructure development, particularly to the transportation sector. The targeted completion of North-South and East-West corridors (7,300 km) by December 2008 would lead to further improvement in the extent and quality of connectivity in the country and thereby contribute to overall productivity growth. India's competitiveness in IT and BPO segments has been aided by substantial investment in telecommunications infrastructure. The synergy between the manufacturing and the services sector creates strong multiplier effects on the growth of the services sub-sectors like traditional trading, banking, transport and *vice versa*. The services sector is, therefore, expected to continue to lead the economy, drawing from its linkage with the well performing industrial sector and expanding international trade.

II.20 Assuming trend growth in agriculture under normal monsoon conditions and barring domestic or external shocks, the Reserve Bank in its Annual Policy Statement for 2006-07 (April 2006) placed real GDP growth, for policy purposes, in the range of 7.5-8.0 per cent during 2006-07. The Reserve Bank reaffirmed its forecast for GDP growth in July 2006 in its First Quarter Review of the Annual Statement on Monetary Policy. Growth prospects are, however, subject to a number of downside risks. The risks emanating from the global economy are: potential escalation and volatility in international crude oil prices, a disorderly unwinding of the macroeconomic imbalances of the major economies, firming up of overall inflationary pressures and expectations, and a hardening of international interest rates along with the withdrawal of monetary accommodation. In the wake of rising inflationary pressures, central banks continue to tighten monetary policies. For instance, during the first fortnight of August 2006, monetary policy was tightened in Australia, euro area, United Kingdom, South Korea and South Africa. The US Federal Open Market Committee left its Federal Funds target rate unchanged in its latest meeting held on August 8, 2006, after having raised it by 425 basis points – 25 basis points hike each on 17 successive occasions – between June 2004 and June 2006. Furthermore, the recent re-pricing of risks in global financial markets needs to be recognised. The risk factors from domestic conditions relate to the progress of the monsoon, infrastructural bottlenecks, emerging apprehensions regarding the fiscal outlook and possible hardening of inflation expectations.

II.21 Bank deposits as well as credit have recorded strong growth during the fiscal year 2006-07 so far. Bank deposits and bank credit to the commercial sector have increased by Rs.1,11,750 crore (4.8 per cent) and Rs.61,343 crore (3.6 per cent), respectively, during the fiscal year 2006-07 so far (between March 31, 2006 and August 4, 2006) as compared with Rs.55,873 crore (2.8 per cent) and Rs.43,307 crore (3.3 per cent), respectively, during the corresponding period of 2005-06 (between April 1, 2005 and August 5, 2005). Acceleration in deposit growth could be attributed to higher interest rates on time deposits as well as base effects. Demand for bank credit continued to remain high in consonance with strong economic activity. Scheduled commercial banks' non-food credit, on a year-on-year basis, exhibited growth of 32.2 per cent as on August 4, 2006 on top of a high base of 31.2 per cent a year ago. Provisional information on sectoral deployment of bank credit indicates that retail lending rose by 47 per cent at end-June 2006, year-on-year, with growth in housing loans being 54 per cent. Loans to commercial real estate rose by 102 per cent. The year-on-year growth in credit to industry and agriculture was 27 per cent and 37 per cent, respectively, at end-June 2006.

II.22 Concomitantly, growth in broad money (M_3), y-o-y, accelerated to 19.1 per cent as on August 4, 2006 from 14.4 per cent a year ago. The sustained high growth in money supply and credit indicates that aggregate demand conditions continue to remain strong. Reflecting higher order of expansion in deposits, banks' incremental investments in Government securities have turned positive in the fiscal 2006-07 so far; banks had liquidated a part of their gilt investments in the second half of the preceding fiscal year to fund demand for credit from the commercial sector. Commercial banks' holding of Government securities has declined from 37.5 per cent of their net demand and time liabilities (NDTL) as on August 5, 2005 to around 31 per cent as on August 4, 2006, but still remain above the statutory minimum of 25 per cent. Despite sustained growth of bank credit, monetary and liquidity conditions have remained comfortable during 2006-07 so far.

II.23 During 2006-07 so far, headline inflation has continued to be driven by supply shocks as pressures from higher primary articles prices augmented sustained pressures from record high international crude oil prices. Pressures from primary articles prices emanated from higher prices of wheat, pulses and milk. Primary articles inflation, year-on-year, rose to a high of 7.7 per cent as on June 17, 2006 under the impact of the seasonal spike in prices of vegetables; it eased to 4.8 per cent as on August 5, 2006, partly on account of base effects. As regards fuel prices, while domestic prices of petrol and diesel have been increased in phases, the pass-through of higher international crude oil prices to domestic prices remains incomplete. Furthermore, LPG and kerosene prices have remained unchanged since November 2004 and April 2002, respectively. Notwithstanding the incomplete pass-through, mineral oil prices contributed 38 per cent to headline inflation as on August 5, 2006. Manufactured products inflation has remained modest, attributable to a variety of factors such as open trade, higher competition, productivity gains and stable inflation expectations. Headline inflation measured in terms of variation in wholesale prices was 4.8 per cent as on August 5, 2006 as compared with 3.8 per cent a year ago. Measures of consumer price inflation – which have a greater weight on prices of food articles – remain higher than that of wholesale price inflation with implications for inflation perceptions and expectations. During June 2006, various measures of CPI inflation, year-on-year, rose to above seven per cent; however, there was some easing during July 2006.

II.24 In the context of inflation, it may be noted that, globally, consumer price inflation is the preferred indicator of central banks for assessing inflationary conditions. On the other hand, in India, wholesale price inflation has emerged as the key measure of assessing inflationary pressures, partly due to its availability on a higher frequency (weekly basis) and partly due to the absence of a comprehensive measure of consumer price inflation in the country. At present, there are four measures of consumer price inflation in India; these measures, compiled on the basis of occupational classification and residence, cater to the specific needs of the user groups. The multiple consumer price indices, in view of differences in weighting diagrams of the commodity baskets, can lead to divergences in inflation numbers, especially in the short-run, and this constrains the assessment of inflationary pressures in the economy. At the same time, the limitations of the wholesale price index are well-recognised; in particular, its coverage is restricted to prices of goods while the growing services sector is excluded. In recognition of these limitations, the Reserve Bank attempts to extract information available from all the price indices; moreover, other indicators such as output, monetary and credit aggregates, rates of return in different financial market segments, fiscal position, merchandise trade, capital flows and exchange rates are also analysed for drawing policy perspectives.

II.25 In view of the developments in the real economy, and also taking in to account monetary and global factors having a bearing on domestic prices, the Reserve Bank in its Annual Policy Statement for 2006-07 (April 2006) indicated that containing inflationary expectations would continue to pose a challenge to monetary management. Barring the emergence of any adverse and unexpected developments in various sectors of the economy and keeping in view the prevailing assessment of the economy including the outlook for inflation, the Annual Policy Statement indicated that the overall stance of monetary policy will be to ensure a monetary and interest rate environment that enables continuation of the growth momentum consistent with price stability while being in readiness to act in a timely and prompt manner on any signs of evolving circumstances impinging on inflation expectations; to focus on credit quality and financial market conditions to support export and investment demand in the economy for maintaining macroeconomic, in particular, financial stability; and, to respond swiftly to evolving global developments.

II.26 There was widespread and simultaneous monetary policy tightening in several countries in early June 2006, against the backdrop of marked and heightened volatility in the international financial markets. Though not entirely unanticipated, the virtual global coverage, nature and timing of these developments posed a serious threat to the domestic economy which, thus far, had been spared of turbulence in the debt and foreign exchange markets. These developments, viewed in the light of the prevailing monetary and credit environment underscored compulsions of swift action, as indicated in the Annual Policy Statement. Accordingly, on June 8, 2006, the LAF reverse repo and repo rates were increased by 25 basis points each to 5.75 per cent and 6.75 per cent, respectively.

II.27 As noted earlier, prices of food articles such as wheat, pulses and sugar posed upward pressures on domestic inflation during the first quarter of 2006-07. In order to improve domestic supplies of these commodities so as to stabilise inflation expectations, the Government also took fiscal measures such as exempting imports of pulses and sugar from customs duty, reduction in customs duty on wheat and palm oils and restriction on exports of pulses.

II.28 In its First Quarter Review of the Annual Statement on Monetary Policy (July 2006), the Reserve Bank observed that containing inflation in the range of 5.0 - 5.5 per cent warrants appropriate priority in policy responses. Accordingly, the Reserve Bank raised the reverse repo rate and the repo rate by 25 basis points each to 6.00 per cent and 7.00 per cent, respectively, on July 25, 2006 while continuing to keep Bank Rate and cash reserve ratio unchanged. In the context of sustained high growth in bank credit, the Reserve Bank again laid stress on the need to ensure asset quality in order to maintain financial stability.

II.29 The revenue and fiscal deficits in 2006-07 of the Central Government are budgeted to be reduced by the minimum annual thresholds as stipulated under the FRBM Rules. The progress in Central Government finances during 2006-07 so far (April-June 2006) indicates that the key deficit indicators departed from the past trend, both in terms of proportion to budget estimates as well as growth rates. Revenue deficit during April-June 2006 registered growth of 49.4 per cent (as against growth of only 2.0 per cent a year ago), and constituted 83.4 per cent of the budget estimates for 2006-07. The fiscal deficit increased by 42.6 per cent during the first three months of the current fiscal year as compared with a growth of 30.8 per cent a year ago. The Government has, however, reiterated that the deficit targets set under the FRBM would be met with an evening out of revenues and expenditures over the course of the year. The widening of deficits was essentially on account of increase in revenue expenditure which more than offset the buoyant tax collections under corporation tax, income tax and customs duties and the significant increase in non-tax revenue. Substantial increases in plan revenue expenditure, interest payments, food and fertiliser subsidies and grants to States contributed to the sharp increase in expenditure.

II.30 Gross market borrowings of the Centre (net of market stabilisation scheme) during 2006-07 are placed at Rs.1,81,875 crore, Rs.21,857 crore higher than in the previous year. During 2006-07 so far (up to August 21, 2006), 51.6 per cent of the gross market borrowings budgeted for the year have been completed as compared with 46.4 per cent during the corresponding period of the preceding year. The weighted average yield on fresh borrowings has increased to 7.92 per cent during 2006-07 so far (up to August 21, 2006) from 7.27 per cent in the corresponding period of 2005-06; the weighted average maturity decreased to 12.73 years from 14.04 years over the same period. In this context, it may be noted that the Reserve Bank has stopped participating in the primary issues of the Central Government securities effective April 1, 2006 following the implementation of the provisions of the FRBM Act prohibiting the Reserve Bank's participation in the primary market.

II.31 Continuing the fiscal correction and consolidation process, the State Governments have budgeted to further reduce revenue and fiscal deficits in 2006-07. The revenue deficit, relative to GDP, is estimated to reach near zero level in 2006-07, brought out by higher growth in revenue receipts compared to that in revenue expenditure. The States have committed to continue their tax simplification measures while restricting current expenditures. In the backdrop of States having achieved budgetary targets on deficit indicators in 2005-06, the final targets of the Twelfth Finance Commission (TFC) on these deficit indicators are likely to be achieved ahead of the recommended schedule. The incentives provided by the recommendations of the TFC, particularly those relating to debt relief, have enabled the State Governments to restructure their finances, primarily through the revenue account. The process of fiscal correction adopted by the States is, however, not without some concerns. Development expenditure, as ratio to GDP, is budgeted to decline by 0.6 percentage point to 9.7 per cent in 2006-07 while non-development expenditure is estimated to be stagnant at 5.8 per cent.

II.32 The higher accrual of NSSF funds than budgeted has enabled the State Governments to maintain a high level of cash surplus on a continuous basis during 2006-07 so far. In such a scenario, the States would have less pressure for resorting to market borrowings and loans from other financial institutions during 2006-07. The cash surplus would also provide the State Governments the flexibility to raise the level of development expenditure.

II.33 Indian financial markets have remained largely orderly during 2006-07 so far though some pressures have been observed in the Government securities market. Call money rates have eased by 54 basis points in the current fiscal year so far from 6.64 per cent as at end-March 2006 to 6.10 per cent as on August 18, 2006, reflecting the easing of liquidity conditions. Call money rates remained generally close to the reverse repo rate. Yields on 10-year Government securities, on the other hand, have increased by 50 basis points so far (from 7.52 per cent as at end-March 2006 to 8.02 per cent as on August 18, 2006) reflecting a variety of factors such as unsettled inflation expectations in the wake of soaring international crude oil prices feeding into interest rate uncertainty; sustained credit growth and competing demand for funds between public and private sectors; some spill over from global markets; and apprehensions of additional pressures on market resources from perceptions of possible higher borrowings by the Centre in the second half of the year coupled with announcement of issuances of bonds to oil companies. In the foreign exchange market, some indications of pressure from mid-May 2006 due to the sharp decline in stock indices and currencies worldwide were observed. Market sentiment corrected by June 2006 and orderly conditions have prevailed since then. The Indian rupee has depreciated by 4.0 per cent *vis-à-vis* the US dollar in 2006-07 so far (from Rs.44.61 per US dollar at end-March 2006 to Rs.46.48 per US dollar as on August 18, 2006). In the credit market, deposit and lending rates have edged up as credit demand remained strong. Banks increased their deposit rates by about 25-100 basis points across various maturities between March 2006 and June 2006. Many banks increased their benchmark prime lending rates by 25-50 basis points over the same period. The stock markets witnessed correction during May-June 2006 in line with the trends in major international markets. The markets recovered some of the losses thereafter and the BSE Sensex, as on August 18, 2006, was 1.6 per cent higher over its March 31, 2006 level.

II.34 Global economic growth has remained strong in 2006 so far, exhibiting continued resilience to high oil prices. In the US, after transient impact of hurricanes on economic activity, growth bounced back in early 2006. There are, however, incipient signs of deceleration in spending in the US attributable to higher interest rates, gasoline prices and a cooling housing market. Global growth has become more broad-based with continuing recoveries in Japan and in the euro area. Emerging economies led by China and India continue to record high growth. The near-term outlook for the world economy remains benign, in view of still accommodative macroeconomic policies in many countries, favourable financing conditions, healthy corporate profits, and strong consumer confidence. The IMF projects the world economy to grow by 4.9 per cent in 2006, marginally higher than that of 4.8 per cent in 2005; growth is projected to moderate to 4.7 per cent in 2007. However, it is widely recognised that several features of the current global upswing are causes for concern: large fiscal deficits, low household savings and low investment in some large economies; unprecedented and growing current account imbalances; narrowing or closing in of output gaps in many economies; record highs in oil prices accompanied by uncertainties about their future evolution; and the outlook for inflation firming up. The recent volatility in international financial markets poses additional downside risks to global growth prospects.

II.35 India's merchandise exports continued to post strong growth during April-July 2006 *albeit* with some deceleration (20.8 per cent as compared with 34.6 per cent a year ago). Non-oil imports recorded a much lower growth of 9.9 per cent (52.0 per cent a year ago). Commodity-wise data available for April-May 2006 indicate that imports of gold and silver declined by 33.7 per cent as against an increase of 55.6 per cent during April-May 2005. Imports of capital goods continued to record strong growth (37.2 per cent during April-May 2006, *albeit* lower than that of 55.9 per cent during April-May 2005). Oil imports posted acceleration in growth during April-July 2006 (43.2 per cent on top of 36.5 per cent a year ago) on the back of further hardening of international crude oil prices. The trade deficit widened from US $ 14.4 billion during April-July 2005 to US $ 16.7 billion during April-July 2006. The buoyancy witnessed in the capital inflows to India during the year 2005-06 appears to have continued in the current year as well. Inflows under FDI, NRI deposits and issuances under ADRs/GDRs during April-May 2006 were higher than that in the corresponding period of 2005. On the other hand, foreign institutional investors (FIIs) recorded net outflows during April-June 2006 (US $ 1.8 billion) as against net inflows of US $ 0.5 billion during the corresponding period of 2005. India's foreign exchange reserves have increased by US $ 13.7 billion in the current fiscal year so far to US $ 165.4 billion as on August 18, 2006. On the whole, despite the growing oil import bill, the anticipated current account deficit in 2006-07 is manageable, as in the past, due to the continuing underlying strength of merchandise exports, invisibles and capital flows. The balance of payments is, therefore, expected to remain comfortable during 2006-07. Assessed in terms of a medium-term perspective taking into account the possible levels of the current account deficits, the composition of capital flows, the level of international confidence in the ability of the country's payment position and pace and quality of growth, the current level of reserves continues to be comfortable. In this context, it is relevant to note that two major international rating agencies have upgraded India's foreign currency rating to investment grade. The continuous strength of the external sector and, in particular, the recent fiscal consolidation efforts are among the important factors that have led to upgrading of external ratings in the recent past.

II.36 Since May 2006, global financial markets have been characterised by significant re-pricing of risks on concerns over higher inflation in the US and the possibility of larger than anticipated monetary tightening. As a result of the increased risk aversion, the prices of highly rated government bonds rose, while those of riskier assets fell. The mid-May correction was felt acutely by emerging market economies – especially in equity markets – including India. Currencies of some emerging market economies depreciated significantly against the US dollar. It is clear that fundamentals could not have changed in such a dramatic fashion in a short time and, hence, it is reasonable to suggest that those economies that had gained most from lower pricing of risks in recent years felt the impact of reversal in direction since mid-May the most. The overall macroeconomic and geopolitical global environment is admittedly indicative of marked downside risks.

II.37 To sum up, for the Indian economy, the evolving economic and business environment exhibits a number of encouraging signs that suggest reinforcement of the robust economic growth exhibited in recent years. First, increase in the gross domestic saving rate to levels around 30 per cent, coupled with sustained absorption of external savings of 2 to 3 per cent of GDP, would provide the potential for attainment of an accelerated growth trajectory. Second, productivity growth in both the real and financial sectors bodes well for consistent economic growth with price stability. Third, there is evidence of improvement in business confidence corroborated by some signs of enhanced levels of foreign direct investment, both inward and outward. The robust performance of Indian merchandise exports in recent years also testifies to the attainment of higher competitiveness of Indian manufacturing, which itself promotes business confidence. The containment of inflation, and particularly inflation expectations, has boosted growth prospects in an environment of stability and confidence. Timely and even pre-emptive monetary measures reinforcing the policy stance paid dividends in terms of low and stable inflation which, in turn, provided conducive conditions for the undisrupted expansion of economic activity while maintaining macroeconomic and financial stability. The successes gained in external sector management in the context of the large trade deficit have also demonstrated the resilience of the Indian economy. In addition to persevering with monetary policy aimed at containing inflation expectations and preserving macroeconomic stability, in particular, financial stability, the maintenance of the current growth momentum will depend, *inter alia*, on policy improvements in agriculture, improved quantity and quality of physical infrastructure and progress in fiscal consolidation.

REAL SECTOR

Agriculture

II.38 For the Indian economy to maintain its growth momentum on a sustained basis, the agriculture sector would have to play a more important role than it has in recent years. Real GDP growth in the agricultural sector in recent years has been low and volatile. For instance, the actual growth in the agricultural sector during the first four years of the Tenth Five Year Plan has averaged only two per cent per annum as against four per cent envisaged in the Plan period (2002-07). While the share of agriculture in the overall GDP has declined from around 35 per cent in 1980-81 to around 20 per cent at present, the fall in the proportion of population dependent on the sector has been small. Thus, a majority of the workforce is still dependent on agriculture while the GDP growth due to agriculture is marginally above the rate of growth of the population, in contrast to strong growth in the non-agriculture sector. While the scope for better terms in the global trading environment is still elusive, India has a large enough domestic market to facilitate a more rapid growth in agriculture. Legislative, institutional and attitudinal changes to supplement enhanced public and private investment may be needed. The Reserve Bank, for its part, is intensifying its efforts in revitalising the rural cooperative credit system, strengthening regional rural banks, providing incentives to commercial banks for investments in rural economy and ensuring an adequate and timely delivery of credit at an appropriate price. The Reserve Bank is also mounting a study of legislation and implementation of non-institutional money lending.

II.39 The slow growth in agriculture in recent years is characterised by the stagnation in domestic production in the case of commodities like wheat, sugar and pulses. Illustratively, the production of wheat after touching a peak of 76 million tonnes (mt) in 1999-2000 has since then been range-bound at around 70 mt. Similarly, the production of pulses has not been able to exceed the peak of 14.9 mt reached in 1998-99. The production of pulses at 13.1 mt in 2005-06 was even lower than the level achieved more than 15 years back (14.3 mt in 1990-91). As a result, the share of pulses in total foodgrains output has declined consistently from 8.1 per cent in 1990-91 to 6.3 per cent in 2005-06. At constant (1999-2000) prices, investment in agriculture has been stagnant in recent years: Rs.43,123 crore in 2004-05 as compared with Rs.43,473 crore in 1999-2000. As a result, the ratio of investment to GDP fell from 2.2 per cent in 1999-2000 to 1.7 per cent in 2004-05. The decline is mainly on account of private investment which has fallen from Rs.35,719 crore to Rs.30,532 crore over the same period. On the other hand, public sector investment in agriculture has shown signs of revival, increasing from Rs.7,018 crore in 2000-01 to Rs.12,591 crore in 2004-05. Revival of rural cooperative credit institutions through legal and institutional reforms will help in improving the flow of credit to the agricultural sector and this could, in turn, encourage investment in the sector. While increase in investment is essential for improving the prospects of the agricultural sector, the composition of investments, the quality of facilities created and the efficacy with which these facilities are used are also important.

II.40 Reflecting the decline in overall investment in the agricultural sector, infrastructure bottlenecks, particularly in regard to irrigation facilities, continue to impede speedy adoption of improved technology. Indian agriculture continues to be heavily dependent on the vagaries of the monsoon. In the case of principal crops, the coverage of irrigated area is only about 40 per cent. Furthermore, water use efficiency in Indian agriculture is one of the lowest in the world. Apart from increasing outlays on irrigation, efficient use of water resources is also important. In this context, appropriate pricing of power can be helpful in avoiding the excessive use of ground water.

II.41 Promotion of micro-irrigation technology comprising drip and sprinkler irrigation on a large scale also deserves priority attention. About 1.2 million hectares have been covered under micro-irrigation so far, and the plan is to increase the coverage to 3 million hectares by the end of the Tenth Plan and to 14 million hectares by the end of the Eleventh Plan. In order to improve the pace of implementation of Accelerated Irrigation Benefit Programme (AIBP), the Union Budget for 2006-07 increased the outlay in irrigation from Rs.4,500 crore to Rs.7,121 crore. Restoration of water bodies is a cost effective way of enhancing irrigation capacities and can be expected to give an element of stability to agricultural production and yields. Improvement in State finances witnessed in the past couple of years, if sustained, could provide the States greater flexibility to increase outlays on irrigation and other infrastructural facilities. This would also help in reducing the dependence of agriculture on monsoon and provide stability to agricultural production.

II.42 Given the several risks that farmers face such as future price and monsoon conditions, there is a need to put in place proper risk mitigation policies. Even in regard to price risk, although the minimum support price mechanism in respect of rice, wheat and, to a limited extent, cotton has served the country well, its effectiveness could be an issue. Accordingly, a comprehensive public policy on risk management in agriculture could act as an ingredient for more efficient commercialised agriculture and also provide relief to distressed farmers.

II.43 Rural infrastructure, which includes agriculture research and extension, transport, electricity, storage structures, not only enhances the productivity of physical resources, but also helps in supply chain management and value addition in agriculture. In this context, the focus on rural infrastructure development under *Bharat Nirman* – covering irrigation, rural water supply, construction of rural roads, rural houses, rural electrification and telephone connectivity in the villages – would help in improving infrastructure facilities in rural areas and provide productivity gains. Improvements in rural infrastructure will also facilitate food processing and other agro-based industries. The Union Budget 2006-07 has identified access to credit, diversification and creation of market for agricultural products as thrust areas and several initiatives have been taken. These measures are expected to provide boost to the agriculture sector.

II.44 The Green Revolution has been the cornerstone of India's agricultural development, transforming the country from one of food deficiency to self-sufficiency. The time is now ripe for a second Green Revolution with an emphasis on diversifying agricultural sector further in order to capture new market opportunities. Globalisation, rising income, and urbanisation call for increasing diversification and value addition in Indian agriculture. The shifts in consumption pattern warrant a shift of land and other resources to crops with higher potential for value addition. India has tremendous export potential in the areas of dairying, sericulture, floriculture, horticulture and the like. A National Horticulture Mission has been launched as a Central Sector Scheme to promote holistic growth of the horticulture sector through area based regionally differentiated strategies.

II.45 Going forward, agricultural growth would largely accrue from improvements in productivity of diversified farming systems with regional specialisation and sustainable management of natural resources, especially land and water. Effective linkages of production systems with marketing, agro-processing and other value added activities would play an increasingly important role in diversification of agriculture. Improvements in marketing infrastructure would help in agricultural production by enhancing market efficiency, promoting exports and encouraging processing industry. Amendment of State Agricultural Produce Marketing Committee (APMC) Acts in line with the Model Act (2003) is expected to provide the necessary marketing infrastructure in place. The model legislation, *inter alia*, provides for direct sale, promotion of public-private partnership in the management and development of agricultural markets, promotion of contract farming, pledge financing, trading, export, and introduction of a negotiable warehousing receipt system in respect of agricultural commodities.

II.46 More focus needs to be placed on agricultural research in the coming years as the success so far has been restricted to select crops. A growing disparity between the actual and the potential yields points to a crucial gap between research and extension. There is, thus, a need to evolve and put in place appropriate agricultural technologies and agro-management practices to respond to food and nutritional security, poverty alleviation, diversifying market demands, export opportunities, and environmental concerns. The public extension system needs to become more demand driven, with stronger synergies between public and private extension efforts.

II.47 The promotion of efficient use of resources and technology, private sector participation through contract farming and leasing arrangements, involving new location specific and improved varieties of farm crops, livestock species will help to improve the competitiveness of Indian agriculture. Apart from agronomic measures for raising productivity, interventions are required for educating farmers to enable them to upgrade their skills to improve the quality of products so that they conform to the strictest sanitary standards in the context of WTO.

II.48 In this context, the suspension of the Doha Round of multilateral trade negotiations over the issue of huge subsidies being paid by developed countries to their farmers is a matter of concern. Subsidised exports by developed countries not only pose a threat to food and livelihood security in developing countries, but also expose farmers of developing countries like India to unfair trade competition in their exports. These developments are of particular concern to India in view of the continued dependence of a majority of population on agriculture and a large number of rural poor.

II.49 The Government has introduced the National Rural Employment Guarantee Act in 2005. The basic objective of the Act is to enhance livelihood security in rural areas by providing at least 100 days of guaranteed wage employment in a financial year to every household whose adult members volunteer to do unskilled manual work. This work guarantee can serve other objectives: generating productive assets, protecting the environment, empowering rural women, reducing rural-urban migration and fostering social equity, among others. This is also expected to help in addressing the problems of rural unemployment and poverty as well as provide an impetus to demand in the economy.

Industry

II.50 The rebound in the industrial sector in conjunction with the services sector has powered India's GDP growth since 2003-04 and has led to build up of optimism of targeting still higher growth for the economy. The resilience shown by the industrial sector against the hardening of global oil prices is reflective of inherent strengths and capabilities that the industrial sector has built up over the years since the initiation of economic reforms in the country. Strong corporate profitability and balance sheets in the past three years have also provided the corporate sector necessary resilience to absorb various shocks. A distinctive feature of India's industrial sector is the growing competitiveness especially in respect of automobiles and pharmaceuticals, evidenced from their export performance. This has strengthened the manufacturing performance further, which holds potential for India to become more of a manufacturing base for global production in certain sectors. The recent performance of the capital goods sector and the business investment surveys suggest a further scope for capacity additions in the Indian industries. At the same time, corporates are likely to face challenges from factors such as infrastructural bottlenecks, rising input costs from higher oil and other commodity prices, and the possibility of emerging shortages of domestic skilled labour. Furthermore, the manufacturing sector, especially the small and medium enterprises (SMEs), will have to gear up to meet challenges that may emanate from imports from China; it may be recalled that China has already emerged as the largest source of India's non-oil imports. The domestic manufacturing sector will have, thus, to continuously improve its productivity and competitiveness in order to effectively face the likely challenges.

II.51 Improvements in infrastructure facilities will be critical to sustain and accelerate the current industrial growth. It is noteworthy that, in the recent years, improvements have taken place in infrastructure facilities in areas such as telecommunications, roads and, to some extent, ports and railways. These developments are having a positive impact on the productivity and competitiveness of Indian economy. At the same time, infrastructural constraints in most critical areas such as power supply and urban infrastructure continue to impinge on the competitiveness of manufacturing activity. Apart from higher levels of investment, issues of governance and management including policies relating to appropriate pricing and user charges would need to be addressed to achieve satisfactory results.

II.52 Electricity and mining sectors have continued to record subdued growth, remaining a cause of concern and this could hinder the sustainability of manufacturing activity. Electricity generation continues to be hampered by policy shortcomings, continued excessive transmission and distribution losses, and collection of dues along with emerging difficulties in the availability of coal and gas. Furthermore, apart from unreliable supply of power, the tariffs facing the domestic manufacturing sector are higher *vis-à-vis* other countries such as China with implications for domestic competitiveness. The higher tariffs for the manufacturing sector in India reflect cross-subsidisation of tariffs on the one hand and the recourse to captive generation on the other hand.

II.53 India remains dependent upon coal for its energy requirements. The share of coal in total commercial energy consumption in the country is 55 per cent while that of oil is one-third. Supply of coal, however, continues to lag the demand and this, in turn, is having an adverse impact on the power situation in the country. Illustratively, as against the requirement of 338 million tonnes of coal during 2005-06, domestic availability was only 317 million tonnes. Non-availability of the desired level of coal is estimated to have resulted in generation loss of 1512 million units during 2004-05.

II.54 Similarly, demand for natural gas is outstripping supply in India, resulting in a huge loss of power generation. For instance, the country's requirement of gas during 2004-05 at 90 per cent plant load factor (PLF) was 49.7 million cubic metres per day (mcmd). As against this, only 30.7 mcmd (*i.e.*, 62 per cent of the demand) was supplied. The shortage in the gas availability is estimated to have resulted in a generation loss of almost 35 billion units per annum, on average, during 2000-05. Inadequate power generation capacity, lack of optimum utilisation of the existing generation capacity, insufficient inter-regional transmission links, inadequate and ageing sub-transmission and distribution network, slow pace of rural electrification and inefficient use of electricity by the end use consumer have exacerbated the absolute shortages.

II.55 Given the rising international crude oil prices and stagnant domestic crude oil production, an integrated approach to efficient use of energy – both oil and non-oil energy resources – assumes importance. The intensity of oil and overall energy use per unit of GDP in India remains higher than in developed as well as many developing economies. Against this backdrop, measures such as better house keeping in industrial units, better maintenance and upkeep of transport vehicles and improved traffic management would help in energy security. It also becomes necessary to increase the domestic availability of coal and gas through measures such as private participation in non-captive mining through legislative amendments; revival of loss making companies and restructuring of the coal sector; permitting freer trade of coal; and, intensification of exploration and upgradation of coal reserves. Alternative avenues of energy such as coal bed methane, hydel and wind energy sources, ethanol and bio-diesel would also need to be explored. Finally, in view of the large increase in international crude oil prices, a higher degree of pass-through to domestic prices will encourage incentives to economise on the use of oil and thereby moderate the adverse consequences of high oil prices on the real economy.

II.56 Provision of urban infrastructure facilities also needs greater attention. Globally, cities have consistently provided the environment for institutional and technological innovation, and acted as engines of economic growth. Substantial improvement in the quality of urban infrastructure, governance and management is essential to maintain and accelerate the momentum of economic growth and productivity enhancement. The recently launched "National Urban Renewal Mission" with its focus on improving infrastructural facilities in urban areas is a welcome development.

II.57 After carving out its niche in the services sector, India has also the potential of emerging as a favoured manufacturing destination of the world especially in respect of certain manufacturing activities enjoined by entrepreneurial dynamism and cost competitiveness that the country enjoys. Indian manufacturing industries have certain inherent strengths such as relatively inexpensive, adequate and highly skilled labour force, large manufacturing base, vast domestic market and growing external market as well as proximity to some of the fast growing EMEs in the Asian region, which augur well for maintaining high growth in the manufacturing sector in the medium term. The process of dereservation of items reserved for exclusive production by SSIs could be expedited, especially since imports of such reserved items are in any case freely permitted. This would help the sector to reap the economies of scale and add to the manufacturing sector's competitiveness. A substantial manufacturing base is essential to absorb the workforce and ensure sustainable growth of the economy. An economy of India's size and scope cannot ignore the manufacturing sector. A modern manufacturing sector is essential for the development of scientific and technological base, growth of knowledge economy and national security.

II.58 For this potential of manufacturing to be achieved, productivity of Indian labour needs to be improved further. Apart from improvements in physical and social infrastructure, this would, *inter alia*, require imparting requisite skills to the labour through setting up of high quality industrial training institutes (ITIs). Furthermore, the Indian industry needs to step up research and development expenditure to improve its competitiveness in the global economy to move up the value chain and to strengthen its position in skill intensive industries.

Services

II.59 The services sector in the country has benefited from the availability of vast skilled labour and is expected to continue to lead the economy, drawing from its linkage with the well performing industrial sector and expanding international trade. The synergetic relationship between manufacturing and services needs to be sustained and accelerated further. Gains in the services sector activities such as telecommunications and software have not only provided a boost to the value added in the services sector but are also providing cost-efficiency gains and productivity benefits to manufacturing. The spread and the thrust of information and communication technology (ICT) have provided unprecedented scope for productivity gains the world over in a very short span of time. The ICT can have a positive impact on growth through a surge in ICT investment, strong productivity effects from the ICT-producing industries and a more productive use of the ICT in the rest of the economy. The ICT equipments enable new organisational models and other innovations in the production process as well as the production of new goods and services. Thus, even if the ICT investment goods are standard products, they enable firms to innovate and accumulate firm-specific capital with positive spillovers on production. For reaping full benefits of the ICT, complementary investments in human and knowledge capital as well as in organisational innovations become necessary. In this context, it is necessary for the Indian services sector to continuously scan the global markets, identify the evolving preferences of the international clients, diversify the range of services offered and achieve greater efficiency to face the emerging global competition.

II.60 Unlike other countries at this stage of development, India appears to have skipped directly to specialisation in skill intensive industries (within manufacturing) or to services where they appear to have a comparative advantage (at least *vis-à-vis* other poor countries). This advanced skill-intensive part of the Indian economy may be bidding up scarce skills. A renewed emphasis on quality higher education commensurate with the requirements of knowledge intensive industries is needed for the current growth momentum to be maintained and built upon.

II.61 In the coming years, India is expected to benefit further from the demographic dividend emanating from a higher proportion of younger population. For this demographic dividend to be reaped fully, improvements in education, skills, health and governance would be needed so that the Indian labour force is globally competitive. In particular, the provision of educational facilities requires greater attention than before to take advantage of the evolving demographics. There is need to improve the availability of educational facilities at all levels – primary, secondary and tertiary – to equip the labour with the necessary skills to maintain current competitive advantage. With the quality of manufactured goods improving all the time, the demand for high skilled labour is expected to accelerate. Furthermore, the growing knowledge-intensive services activities will require human resources equipped with appropriate skills. Hence, enhancement of skills of human resources at all levels, especially at higher levels of education, requires greater priority. In particular, demand for tertiary education is expected to increase significantly in the coming years. A renewed focus on developing high quality institutions of learning at all levels will be essential for India to benefit from its demographic advantage. Finally, it may be noted that growth of population is not evenly spread through out the country. There is, therefore, a greater need to improve employment skills rapidly in regions with higher population growth and higher unemployment.

FISCAL POLICY

II.62 While the front-loaded revenue augmenting fiscal policy for 2004-05 led to a reduction in revenue and fiscal deficits by more than twice the stipulated minimum thresholds under the FRBM Rules, the 'pause' in the FRBM path in 2005-06 has resulted in a slowdown in the progress towards fiscal consolidation. Both revenue deficit and gross fiscal deficit, relative to GDP, slipped in 2005-06 over their levels in 2004-05. With the resumption of progress in approaching FRBM targets in 2006-07, reductions in key deficits have been budgeted to fulfil only the minimum annual stipulations. Consequently, larger deficit reductions in 2007-08 and 2008-09 will be required to meet the FRBM targets. Given that revenue expenditure has remained broadly stable in the last decade and a half, and non-tax receipts continue to be sluggish, the scope for deepening fiscal empowerment lies in improving tax revenue. This would require concerted efforts in substantially improving the tax/GDP ratio through further widening of the tax base and severe curtailment in tax exemptions. In this regard, the Government has identified several exemptions, both in direct as well as indirect taxes, and the continuance of these exemptions is proposed to be reviewed after receiving public feedback and examining the rationale thereof. Broadly, such exemptions are end-use based or have outlived their utility or need certification or give rise to disputes. Removal/ reductions of tax exemptions would not only lead to higher tax/GDP ratio but would also enhance economic growth since tax exemptions and deductions distort allocative efficiency, undermine horizontal and vertical equity, increase compliance costs and impose administrative burdens. The Government's strategy of augmenting tax collection through, *inter alia*, liquidation of tax arrears and improvement in tax administration needs to be continued with greater vigour in the wake of expected sluggishness in non-debt receipts. In addition, the tax regime could be revisited in a comprehensive fashion to minimise transaction costs and remove regressive elements, thus contributing to both growth and fairness in public policy.

II.63 On the expenditure front, with the scope for increasing outlays being constrained by compulsions to meet FRBM targets, reprioritisation needs to be continued so as to ensure adequate investment in the social sector. The shift in emphasis from outlays to outcomes of plan expenditure since 2005-06 with the objective of improving the efficiency of the delivery mechanism needs to be extended to non-plan expenditure as well. A beginning has been made in this regard with the Outcome Budget of Ministry of Finance for 2006-07 also covering select non-plan schemes apart from plan expenditure. The Government has proposed a thorough review of Plan schemes ahead of the Eleventh Plan so as to merge similar schemes, review schemes of sub-critical size and redesign schemes to improve asset creation role of plan expenditure. These measures along with containment and proper targeting of subsidies would enable effective expenditure management.

II.64 The persistence of large fiscal deficits in the past has resulted in accumulation of outstanding debt which is substantially high by international standards. The interest burden of the Government, therefore, continues to be high constraining the Government's ability to increase social sector and other productive outlays. Budgetary implications of issuance of oil bonds, outlays on the National Rural Employment Guarantee scheme and revenue implications of special economic zones also need to be factored.

II.65 Adhering to the FRBM targets in respect of fiscal deficit and revenue deficit is, therefore, critical for macroeconomic, financial, external sector and budgetary sustainability. Furthermore, as use of borrowed resources for meeting the current expenditure requirements has resulted in widening of asset-liability mismatches over the years, it is essential to eliminate revenue deficit and generate sufficient revenue surplus which may be utilised for asset creation without creating liabilities. Any slippage in achieving the FRBM targets could erode the gains achieved in the initial year of the FRBM. It could also generate a chain effect at the State levels to relax targets set out in their fiscal responsibility legislations. Any deviation from the FRBM targets will have both national and international repercussions in terms of credibility.

II.66 As regards State finances, notwithstanding the progress in fiscal consolidation since 2004-05, structural rigidities persist as manifested in sluggish non-tax revenue, downwardly rigid non-development expenditure and low allocation in respect of social sectors such as health and education. The State Governments have a major responsibility in regard to provision of social and economic services such as education and health and economic infrastructure such as roads, waterworks and power. In order to make the process of fiscal consolidation durable and sustainable, adequate investment in economic infrastructure and spending on social services would be essential. Accordingly, the States would be required to incur higher outlays on the provision of these services. Against this backdrop, a desirable path to fiscal correction lies through fiscal empowerment, *i.e.*, by expanding the scope and size of revenue flows into budget, rather than fiscal enfeeblement. Augmenting resource mobilisation from non-tax revenue through appropriate user charges and restructuring of State public sector undertakings continues to be of critical importance. Higher user charges will, however, not be feasible unless there is a greater efficiency in the delivery of the services provided by the States. Therefore, improving delivery of public services should be a priority for the State Governments. The issues of power subsidies also need to be addressed.

II.67 Finally, while the fiscal responsibility legislations address the need to constrain deficits of the Central and State Governments, there are no such rules for containing the deficits of the public sector undertakings. As borrowing needs of different segments of the public sector increase and the need to monitor the market behaviour and responses increases, it would be desirable to assess the overall public sector borrowing requirements.

EXTERNAL SECTOR

II.68 Merchandise export growth of 24 per cent per annum, on average, in the past four years points to the growing competitiveness of the Indian manufacturing. In the current fiscal year, export growth has remained strong so far, *albeit* with some deceleration. India's export base (*i.e.*, the commodity and country composition) is far more diversified now than it used to be in the early 1990s. Improvements in infrastructure assume critical importance for maintaining and improving our competitiveness as also encouraging investment in export production and sustaining the pace of export growth in the longer term.

II.69 As the Asian region has developed, intra-Asian trade has gathered momentum leading to even higher economic integration within the region. In the recent years, the Asian economies have, therefore, emerged as major trading partners of India. Emerging Asian economies accounted for a significant share of 22.6 per cent in India's total exports in 2005-06 (15.6 per cent in 2000-01) and 29.0 per cent of India's total non-oil imports (22.1 per cent in 2000-01). China has emerged as the third major export destination for India after the US and the UAE; it has now become the largest source of non-oil imports for India, surpassing the US. India is also at various stages of negotiation for entering into various regional economic cooperation, free/preferential trade agreements and bilateral investment treaties with its Asian neighbours.

II.70 The engagement of Indian firms with the world has acquired new dimensions. Apart from its leading edge in the software services, India has also the potential for becoming a centre for manufacturing in certain sectors. The Indian information technology industry is becoming increasingly global through cross-border acquisitions, on-shore contract wins and organic growth in other low-cost locations. This has been complemented by global majors continuing to significantly improve their off-shore delivery capabilities in India. Indian firms are also acquiring manufacturing firms abroad to leverage comparative advantage of foreign locations, using synergies between the parent company and the company under acquisition and having production facilities near the major markets also. The acquisitions are also driven by the need to have a marketing and distribution base as well as the need to acquire appropriate technologies. The attainment of domain knowledge through such activities, along with best practice business knowledge, and economies of scale in marketing may enhance the productivity growth of Indian business. Reportedly, there is an increasing emphasis on service approach to manufacturing with adaptation of techniques such as lean production to keep quality high and boost efficiency. These tendencies are perhaps reflective of a penchant for innovation among growing entrepreneurial class in India, imbued with professionalism and seeking to be globally competitive.

II.71 The buoyancy observed in service exports in the recent years is likely to strengthen as exports of business and professional services gather further growth momentum. The remittances from overseas Indian workers are also likely to remain an important and stable source of financial inflows with a continuous transition to higher skill categories of the Indian migrant workers. For the full potential of earnings from exports of services to be realised, issues relating to skill enhancement and quality of education assume greater importance. Demand for education, especially higher education, is expected to grow immensely in the coming years in view of the demand emanating from knowledge intensive nature of the services sector as well as demands from the manufacturing sector. In view of reports of growing shortages of skilled human power, policies that hinder setting up of high quality educational institutions need to be ironed out. Public-private partnership in the field of education holds great promise for equipping the country with institutes of excellence.

II.72 The overall approach to the management of India's foreign exchange reserves takes into account the changing composition of the balance of payments and endeavours to reflect the 'liquidity risks' associated with different types of flows and other requirements. India's foreign exchange reserves are comfortable in terms of various reserve adequacy indicators. The increase in the reserves in recent years has been mainly on account of higher capital flows rather than a surplus on the current account. The exchange rate policy in recent years has been guided by the broad principles of careful monitoring and management of exchange rates with flexibility, without a fixed target or a pre-announced target or a band, coupled with the ability to intervene if and when necessary. These policies have served the country well so far.

II.73 Persistent rise in international crude oil prices to record highs has led to hardening of consumer price inflation in a number of economies. Core inflation and inflation expectations have also indicated signs of edging higher in recent months. Higher oil prices coupled with ongoing monetary tightening globally are expected to lead to slowdown in aggregate demand and output.

II.74 Apart from higher oil prices, global economic prospects continue to be marked by the risk of a disorderly adjustment to the rising level of global imbalances and their changing distribution across nation states and country groups. International financial markets have witnessed large volatility since May 2006 after having remained benign during 2005 and early part of 2006. Risk premia on a wide variety of risky assets – equities, corporate bonds, emerging markets debt, housing and real estate property assets and government bonds – had declined during 2005, reflecting investors' appetite for risk despite the major macroeconomic risks. However, beginning mid-May 2006, concerns over higher US inflation and possibility of larger than anticipated monetary tightening seemed to have unnerved global financial markets. As a result, investors pulled out of risky assets, especially from those of emerging market economies. Stock markets in many emerging economies recorded large losses while exchange rates came under pressure. The flight to safety led to easing of the yields on gilts in the US and other major economies. Financial markets are currently re-pricing risks in an environment of uncertainty and, in particular, in emerging market economies. There is uncertainty as to whether the process of re-pricing of risks, in general, is complete; and whether corrections are incomplete in the economies which benefited from lower-priced risks in the past. These developments pose downside risks to the growth prospects of the Indian economy.

FINANCIAL SECTOR

II.75 The various reform measures in the financial sector since the early 1990s have had a positive impact on the overall efficiency, productivity and stability of the banking system in India. The measures have also enabled accelerated economic growth in an environment of macroeconomic stability. The financial system is now robust and resilient, contributing to public confidence and overall stability.

II.76 Consistent with the policy approach of conforming the financial sector in India to the best international standards with emphasis on gradual harmonisation with the international best practices, all commercial banks in India are required to start implementing Basel II with effect from March 31, 2007. Banks in India will initially adopt the Standardised Approach for credit risk and the Basic Indicator Approach for operational risk. After adequate skills are developed, both by the banks and also by the supervisors, some of the banks may be allowed to migrate to the Internal Rating Based (IRB) Approach. On current indications, implementation of Basel II will require more capital for banks in India due to the fact that operational risk is not captured under Basel I, and the capital charge for market risk was not prescribed until recently. The cushion available in the system, which at present has a Capital to Risk Assets Ratio (CRAR) of over 12 per cent, provides for some comfort but the banks are exploring various avenues for meeting the capital requirements under Basel II. In addition to the issue of a Guidance Note on Operational Risk Management and the issue of draft guidelines on implementation of the New Capital Adequacy Framework, the Reserve Bank has, for its part, issued policy guidelines enabling issuance of innovative perpetual debt instruments and debt capital instruments by banks so as to enhance their capital raising options. It has also been decided that banks may augment, their capital funds through issuance of perpetual non-cumulative preference shares and redeemable cumulative preference shares; guidelines in these cases will be issued separately in due course.

II.77 Taking into account the size, the complexity of operations, the relevance to the financial sector, the need to ensure greater financial inclusion and the need for having an efficient delivery mechanism, the capital adequacy norms applicable to the various entities in the financial sector have been maintained at varying levels of stringency. In the post-March 2007 scenario, thus, Basel II, Basel I and non-Basel entities will be operating simultaneously in the Indian banking system. The three-track approach would not only ensure greater outreach of banking business, but also, in the present scenario of high growth, enable the banks to usefully lend to the disadvantageous sections and successfully pierce the informal credit segment. The three-track approach to Basel II implementation can, in principle, give rise to scope for regulatory arbitrage within the banking system. This would, however, not be of much concern in the Indian context on account of the relatively insignificant size of the non Basel II entities and their relevance from the systemic perspective.

II.78 With gross domestic savings rate of nearly 30 per cent of GDP and the economy recording a growth rate of about 8 per cent annually, a continued increase in household financial savings can be expected. On the production side, there are vast demands for financing the infrastructure investment, the growing services sector, SMEs and rural enterprises. The emphasis on financial inclusion will also lead to enhanced need for financial intermediation. The banking system has to respond adequately to these new challenges, opportunities and risks. Innovative channels for credit delivery for serving these new rural credit needs, encompassing full supply chain financing, covering storage, warehousing, processing, and transportation from farm to market will have to be found.

II.79 While continuing with its efforts to strengthen the domestic financial sector, the Reserve Bank has been laying an increasing stress on financial inclusion with particular attention to issues relating to farmers. A beginning has already been made to ensure greater outreach of banking facilities in rural areas through appointment of reputed non-governmental organisations (NGOs)/post offices *etc*. as banking facilitators and banking correspondents. The Reserve Bank will pursue with its efforts to ensure greater outreach of banking facilities in rural areas and to ensure availability of bank finance at reasonable rates with focus on measures to assist distressed farmers, including provision of financial counselling services and introduction of a specific Credit Guarantee Scheme.

II.80 The Reserve Bank is also laying greater stress on customer services to improve basic banking services provided to the common persons. A Banking Ombudsman facility has been established covering all States and Union Territories for redressal of grievances against deficient banking services. The recently constituted Banking Codes and Standards Board of India is an important step in this regard which is expected to ensure that the banks formulate and adhere to their own comprehensive code of conduct for fair treatment of customers. To provide a framework for a minimum standard of banking services, which individual customers can legitimately expect, a “Code of Bank’s Commitment to Customers” has been released. A similar code for lending to SMEs, such as on the lines of the Business Banking Code in the UK, would be useful to nurture the SME sector given their importance in the Indian economy.

MONETARY POLICY

II.81 In the light of high credit growth, the need to ensure asset quality assumes importance. The Reserve Bank has accordingly drawn attention of the banking sector to maintain asset quality. Although the increase in bank credit has been quite broad-based, expansion in bank credit to some sensitive sectors such as commercial real estate was quite large. Appropriate measures such as higher risk weights in case of sectors that have witnessed very high growth and increased provisioning requirements have been put in place in order to ensure financial stability. Furthermore, banks have been advised to put in place stricter credit appraisals on a sectoral basis, monitor loan-to-value ratios and generally ensure the health of credit portfolios on an enduring basis.

II.82 Concomitantly, in view of the observed increased dependence of banks on short-term non-core bulk deposits raised from corporates, banks were advised to focus on mobilisation of retail deposits which have durability. Bulk deposits raised at relatively higher rates can not sustain a higher credit demand on an enduring basis and have a potential for adverse consequences for balance sheet management and profitability. Banks were advised to review their policies and make sustained efforts towards mobilising stable retail deposits by providing wider access to better quality of banking services. This would sustain prudent business expansion without facing undue asset-liability mismatches.

II.83 Consistent with the multiple indicator approach adopted by the Reserve Bank, monetary policy in India has emphasised the need to be watchful about indications of rising aggregate demand embedded in consumer and business confidence, asset prices, corporate performance, the sizeable growth of reserve money and money supply, the rising trade and current account deficits and, in particular, the quality of credit growth. In retrospect, this risk sensitive approach has served the country well in containing aggregate demand pressures and second round effects to an extent. It has also ensured that constant vigil is maintained on threats to financial stability through a period when inflation was on the upturn and asset prices, especially in housing and real estate, are emerging as a challenge to monetary authorities worldwide. Significantly, it has also reinforced the growth momentum in the economy. It is noteworthy that the cyclical expansion in bank credit has extended without encountering any destabilising volatility but this situation warrants enhanced vigilance. In this context, despite sustained pressures from record high international crude oil prices as well as pressures from prices of primary food articles, inflation has been contained while keeping inflation expectations low and stable. This has been facilitated by timely and appropriate monetary policy measures. In this context, it is also important to recognise the importance of inflation perceptions. If the prices of commodities, which are purchased frequently, rise, the perception of inflation would be different from say, a rise in the price of television set. While recognising the overlap, the distinction between inflationary expectations and inflation perceptions in the context of inflation policy is worth bearing in mind. Inflation perceptions tend to harden if prices of frequently purchased goods increase.

II.84 In the context of the recent firming up of headline inflation across the globe, primarily on account of higher oil and other commodity prices, issues of proper measurement of inflation and inflationary pressures have attracted renewed debate. In particular, the debate involves the relevance of core inflation as a guide for the conduct of monetary policy *vis-à-vis* the use of headline inflation. Use of core measures is debatable in the current context of record high crude oil prices. A core measure is useful if a shock is temporary. In the current scenario, a large part of increase in the oil price is widely believed to have a large permanent component. Therefore, the use of core inflation excluding oil prices could be somewhat misleading. Furthermore, the current high oil prices reflect in large part the increase in global demand for oil from countries such as China. At the same time, these emerging economies have added to global supply of manufactures and this has kept prices of tradables low. Thus, exclusion of high oil prices while including the benefits from low prices of tradables – both of which are a result of the phenomenon of increased globalisation – is conceptually debatable. In India, core inflation is not considered relevant for several reasons, especially because the two major sources of supply shock, food and fuel, account for a large share of the index. Moreover, pass through of higher oil prices has been halting and not full and the headline inflation in a way understates the problem. Thus, the Reserve Bank in its recent monetary policy communications has emphasised the fact that there is clear evidence of a permanent component in the oil price increase, and hence the headline inflation may be understated till that component is fully passed through. While the permanent component is judgmental, broad magnitudes could be perceived and articulated. Such an explanatory approach to headline and underlying inflation pressure in monetary policy has added credibility to the policy and influenced and guided the inflation expectations in India.

II.85 In this context, distinction between monitoring and influencing inflation expectations on the one hand and giving forward indication on the other has attracted growing interest in recent months. There are dangers of a central bank trying to give forward guidance in a highly uncertain world. The Reserve Bank of India provides detailed information and shares relevant analysis fully to influence expectations while being hesitant to give firm inferences from analysis or forward guidance. Guidance on future course becomes far more difficult when the policy rates of monetary authorities get closer to what appears to be the relevant range of neutral interest rates. This is because the trade offs get more acute, judgmental and contextual relative to a state when interest rates are clearly farther from the range of possible neutral rates and the direction of movement is fairly obvious to all. The challenge of communication gets more daunting, if simultaneously, the inflation expectations are also under stress.

II.86 To conclude, the Indian economy is exhibiting strong fundamentals and displaying considerable resilience. At the same time, there are continuing signs of demand pressures, especially high credit growth, that could exert upward pressure on prices when associated with supply shocks such as from oil. These pressures have the potential for impacting stability and inflation expectations. Against this background, judgments are necessary on a continuing basis as to the relative weights to be accorded to growth and price stability, recognising lags in monetary policy. While domestic developments continue to dominate the economy, global factors tend to gain more attention now than before. The global outlook for growth is positive but downside risks in regard to inflation and re-pricing of risks in financial markets need to be recognised. Hence, it is necessary to strike a balance between reinforcing the resilience of the Indian economy against global risks and giving a boost to growth prospects over the medium-term, taking advantage of global expansion.

PART TWO : THE WORKING AND OPERATIONS OF THE RESERVE BANK OF INDIA

III MONETARY AND CREDIT POLICY OPERATIONS

III.1 The key issues that had to be addressed by monetary management during 2005-06 were the risks arising from rising domestic demand, high and volatile international crude oil prices and upturn in the global interest rate cycle. Monetary management also faced some challenges in maintaining stable liquidity conditions, which particularly arose in the last quarter of 2005-06, partly due to transient factors such as the redemption of India Millennium Deposits (IMDs) and partly cyclical factors associated with the upturn in credit demand. Nonetheless, calibrated and pre-emptive monetary measures during the year helped to keep inflation and inflationary expectations well-contained while supporting investment demand in the economy. The Reserve Bank continued with its policy of active demand management of liquidity through the flexible use of policy instruments at its disposal designed to ensure stability in financial markets. With inflation contained and inflationary expectations seen to be consistent with the policy stance, real growth picked up in an environment of price and financial stability, raising expectations of a structural shift in the medium-term growth path of the economy. Monetary policy was particularly effective in ensuring that the cost-push impulses from oil prices did not feed through into aggregate demand conditions. Monetary management during 2005-06 was, thus, conducted broadly in conformity with the stance of the policy set out in the policy statements during the year.

III.2 During 2005-06, the Reserve Bank initiated the system of reviewing the Annual Policy Statement on a quarterly basis as against the prevailing system of a half-yearly review. With a view to further strengthening the consultative process in monetary policy formulation, the Reserve Bank, in July 2005, set up a Technical Advisory Committee on Monetary Policy (TACMP) with external experts in the areas of monetary economics, central banking, financial markets and public finance. The Committee meets at least once in a quarter and reviews macroeconomic and monetary developments, and advises the Reserve Bank on the stance of monetary policy. The Committee has met five times since its inception and has contributed to enriching the inputs and processes of policy setting.

III.3 This Chapter presents monetary and credit policy operations of the Reserve Bank during 2005-06. Various monetary measures by the Reserve Bank along with liquidity management operations are covered in this Chapter. Policy initiatives to improve the credit delivery mechanism are also included in this Chapter.

MONETARY POLICY OPERATIONS

III.4 The Annual Policy Statement for 2005-06 (April 2005) indicated that the stance of monetary policy would depend on several factors, including macroeconomic prospects, global developments and the balance of risks. Assuming a normal monsoon, and with expectations that industry and services sectors would maintain their growth momentum while absorbing the impact of oil prices, real GDP growth during 2005-06 was placed around 7.0 per cent for the purpose of monetary policy formulation. The inflation rate in 2005-06, on a point-to-point basis, was projected in a range of 5.0-5.5 per cent subject to the growing uncertainties on the oil front both in regard to global prices and their domestic absorption. The Statement stressed that the system has to recognise interest rate cycles and strengthen risk management processes to cope with eventualities so that financial stability could be maintained and interest rate movements could be transited in a non-disruptive manner. The Statement also stressed that it would be instructive to observe global trends as the Indian economy is progressively getting linked to the world economy. It was noted that while there was an overhang of domestic liquidity, partly mirroring abundant global liquidity, the trends in global interest rates, inflationary expectations and investment demand would also have some relevance in the evolution of the domestic interest rates. It would, therefore, be desirable to contain inflationary pressures to stabilise domestic financing conditions both for the Governments and the private sector. Against this backdrop, barring the emergence of any adverse and unexpected developments in various sectors of the economy and keeping in view the inflationary situation, the overall stance of monetary policy for the year 2005-06 was stated as follows:

- Provision of appropriate liquidity to meet credit growth and support investment and export demand in the economy while placing equal emphasis on price stability.
- Consistent with the above, to pursue an interest rate environment that is conducive to macroeconomic and price stability, and maintaining the momentum of growth.
- To consider measures in a calibrated manner in response to evolving circumstances with a view to stabilising inflationary expectations.

III.5 At the time of presentation of the Annual Policy Statement, the Reserve Bank faced two major challenges: (i) reining in inflationary expectations in the face of several uncertainties so as to ensure stability in the financial markets and maintaining financing conditions at levels appropriate to lend support to the ongoing growth momentum; and (ii) liquidity management in the context of budgeted Government borrowings and indications of strong credit growth. The Reserve Bank, therefore, sought to moderate inflationary expectations by demonstrable commitment to price stability by increasing the LAF reverse repo rate by 25 basis points to 5.0 per cent while retaining the repo rate at 6.0 per cent, thereby narrowing the LAF rate corridor from 125 basis points to 100 basis points with effect from April 29, 2005.

III.6 In its First Quarter Review of the Annual Statement on Monetary Policy (July 2005), the Reserve Bank indicated that while the outlook for global growth and inflation was broadly unchanged from the presentation in the Annual Policy Statement in April 2005, the risks had increased since then. On balance, the Review noted that, during the first quarter, the underlying inflationary pressures appeared to have been contained and inflationary expectations maintained, as anticipated. While global factors were getting to be increasingly significant for India, the domestic factors were still the dominant factors and the latter pointed to favouring stability to maintain growth momentum. Accordingly, the Reserve Bank indicated that the overall stance of monetary policy for the remaining part of 2005-06 would continue to be as set out in the Annual Policy Statement of April 2005, but it would respond, promptly and effectively, to the evolving situation depending on the unfolding of the risks.

III.7 While leaving the repo rate and the reverse repo rate unchanged during the July 2005 Review, the Reserve Bank, however, enhanced risk weights on exposures to certain sectors around the same time in view of rapid credit growth to these sectors. Accordingly, the Reserve Bank raised risk weights on exposures of banks to commercial real estate as well as for credit risk on capital market exposures from 100 per cent to 125 per cent in July 2005 (Box III.1).

III.8 In its Mid-term Review of the Annual Policy Statement (October 2005), while noting that, on balance, macroeconomic and financial conditions have evolved as anticipated, the Reserve Bank pointed to the emergence of several factors posing risks to the outlook on growth and inflation. These included: need to ensure credit quality in light of the high expansion of non-food credit; continued infrastructure bottlenecks; substantial increase in asset prices, especially housing prices; high and volatile global crude oil prices, with an overwhelming part of the increase being increasingly regarded as permanent; emergence of increased current account deficits even if manageable; and upturn in the international interest rates cycle. Taking into account real sector developments of the first half, the Review revised upwards real GDP growth projections for 2005-06 to a range of 7.0-7.5 per cent from around 7.0 per cent as projected earlier. As regards outlook for inflation, taking into account oil prices having reached record highs, the Review noted that it may be difficult to contain the inflation in the range of 5.0-5.5 per cent projected earlier without an appropriate policy response. The Review reiterated that it is necessary, both for policy makers and market participants, to recognise interest rate cycles and strengthen risk management processes to cope with eventualities so that financial stability could be maintained and interest rate movements could be transited in a non-disruptive manner.

III.9 Against the backdrop of these developments, the Mid-term Review reaffirmed the stance of monetary policy set out in the Annual Policy Statement while rebalancing the priorities assigned to policy objectives in the context of the assessment of the economy and, particularly, the outlook on inflation. In response to the risks that had emerged, greater emphasis was placed on price stability. The fixed reverse repo rate under the LAF was increased by 25 basis points to 5.25 per cent to stabilise

Box III.1

Bank Credit and Financial Stability

Bank credit plays a critical role in economic growth, particularly in case of bank-based financial systems like India. At the same time, sustained episodes of high credit growth have often been found to be followed by banking and financial crisis. Credit booms, especially in the current environment of relatively less regulated global order, therefore, need careful watch by policy authorities. With many central banks moving away from quantitative targets to use of interest rates as the key instrument of monetary policy, neglect of credit and monetary aggregates can be risky. Periods of credit boom are often associated with easing of lending standards, which sow possible seeds of future financial instability. It is widely believed that the Asian financial crisis of the late 1990s was, *inter alia*, caused by the existence of an inefficient banking system that failed to perform the role of effective financial intermediation, as money and credit expanded without adequate risk management. Credit in many pre-crisis Asian economies was directed to speculative and ultimately unprofitable investments, such as real estate ventures or loss-making projects.

Empirical evidence suggests that credit booms – defined as a situation where credit/GDP ratio is four percentage points above its trend – turn out to be the best predictor of future financial imbalances and dominate other possible predictors such as money, asset prices and output gaps. Over a 3-5 year horizon, credit booms predict 80 per cent of banking crises, much higher than the predictive power of 47 per cent in case of asset price misalignments. Asset price misalignments taken in conjunction with sharp movements in credit aggregates turn out to be the best predictors of future instability.

With more and more EMEs progressively moving away from micromanagement of credit towards permitting interest rates a greater role in credit allocation, the potential threat of speculative movement of bank credit is stronger than ever before unless an efficient prudential and regulatory framework is put in place for the banking and financial system. Thus, it is necessary on the part of central banks today to pay particular attention to developments and movements in the credit market. Financial instability that might result from credit booms can, in fact, threaten the objective of price stability. Therefore, adequate stress by central banks on the quantum and quality of credit would be helpful in maintaining monetary and financial stability. Accordingly, the use of monetary and credit data can be a basis for resisting financial excesses.

In this context, following the multiple indicator approach adopted by the Reserve Bank, monetary policy in India has consistently emphasised the need to be watchful about indications of rising aggregate demand embedded in consumer and business confidence, asset prices, corporate performance, the sizeable growth of reserve money and money supply, the rising trade and current account deficits and, in particular, the quality of credit growth. This risk sensitive approach has served the Reserve Bank well in reining in aggregate demand pressures and second round effects of oil price increases to an extent while ensuring that constant vigil is maintained on threats to financial stability.

Since growth in credit during the recent period was relatively higher in a few sectors such as retail credit and real estate, monetary policy faced a dilemma in terms of instruments. An increase in policy rate across the board could adversely affect even the productive sectors of the economy such as industry and agriculture. While policy rates have indeed been raised, they have been mainly aimed at reining in inflation expectations in view of continuing pressures from high and volatile crude oil prices. Therefore, while ensuring that credit demand for the productive sectors of the economy is met, the Reserve Bank has resorted to prudential measures in order to engineer a ‘calibrated’ deceleration in the overall growth of credit to the commercial sector. Accordingly, the Reserve Bank raised risk weights on loans to these sectors during July 2005 and April 2006. It also more than doubled provisioning requirements on standard loans for the specific sectors from 0.4 per cent to 1.0 per cent in April 2006. Thus, the basic objective has been to ensure that the growth process is facilitated while ensuring price and financial stability in the economy.

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inflationary expectations while retaining the spread between reverse repo and repo rates at 100 basis points. The overall stance of monetary policy for the remaining part of the year was stated as:

- Consistent with emphasis on price stability, provision of appropriate liquidity to meet genuine credit needs and support export and investment demand in the economy.

- Ensuring an interest rate environment that is conducive to macroeconomic and price stability, and maintaining the growth momentum.
- To consider measures in a calibrated and prompt manner, in response to evolving circumstances with a view to stabilising inflationary expectations.

III.10 In its Third Quarter Review of the Annual Statement on Monetary Policy (January 2006), the Reserve Bank observed that macroeconomic and financial developments were in support of the monetary policy stance. Real GDP growth in 2005-06, for the purpose of monetary management, was further revised upwards in the range of 7.5-8.0 per cent based on the assessment of a pick up in agricultural output and in the momentum in industrial and services sectors. Inflation was placed in the range of 5.0-5.5 per cent as projected earlier. While recognising that the current configuration of macroeconomic and financial factors favoured growth with stability in India, the need to extend these gains by continuing the greater emphasis on price stability was stressed. The risks to inflation from both domestic and global developments were perceived to remain high, persisting well into 2006-07, in view of the remaining pass-through of international crude prices into domestic prices. Emphasising the need to shore up the gains of recent high growth, the monetary policy stance was articulated in favour of a greater emphasis on price stability through measured but timely and even pre-emptive policy action to anchor inflation expectations. Accordingly, the fixed reverse repo rate and the repo rate under the LAF were increased by 25 basis points each to 5.50 per cent and 6.50 per cent, respectively. The overall stance of monetary policy was stated as:

- To maintain the emphasis on price stability with a view to anchoring inflationary expectations.
- To continue to support export and investment demand in the economy for maintaining the growth momentum by ensuring a conducive interest rate environment for macroeconomic, price and financial stability.
- To provide appropriate liquidity to meet genuine credit needs of the economy with due emphasis on quality.
- To consider responses as appropriate to evolving circumstances.

III.11 The fixed reverse repo rate, the price at which the Reserve Bank absorbs liquidity under the LAF was, thus, increased by 75 basis points during 2005-06 – 25 basis points each on three occasions (April 2005, July 2005 and January 2006) – to 5.50 per cent by end-March 2006 (Table 3.1). The repo rate, the price at which the Reserve Bank injects

Table 3.1: Movement in Key Policy Rates

(Per cent)

Effective since	Reverse Repo Rate	Repo Rate	Effective since	Bank Rate	Effective since	Cash Reserve Ratio (CRR)
1	2	3	4	5	6	7
March 5, 2002	6.00	8.50	February 17, 2001	7.50	December 29, 2001	5.50
March 28, 2002	6.00	8.00	March 2, 2001	7.00	June 1, 2002	5.00
June 27, 2002	5.75	8.00	October 23, 2001	6.50	November 16, 2002	4.75
October 30, 2002	5.50	8.00	October 30, 2002	6.25	June 14, 2003	4.50
November 12, 2002	5.50	7.50	April 30, 2003	6.00	September 18, 2004	4.75
March 3, 2003	5.00	7.50			October 2, 2004	5.00
March 7, 2003	5.00	7.10				
March 19, 2003	5.00	7.00				
August 25, 2003	4.50	7.00				
March 31, 2004	4.50	6.00				
October 27, 2004	4.75	6.00				
April 29, 2005	5.00	6.00				
October 26, 2005	5.25	6.25				
January 24, 2006	5.50	6.50				
June 9, 2006	5.75	6.75				
July 25, 2006	6.00	7.00				

Note : With effect from October 29, 2004, nomenclature of repo and reverse repo has been interchanged as per international usage. Prior to that date, repo indicated absorption of liquidity while reverse repo meant injection of liquidity. The nomenclature in this Report is based on the new use of terms even for the period prior to October 29, 2004.

liquidity under the LAF, was hiked twice – 25 basis points each during October 2005 and January 2006 – to 6.5 per cent by end-March 2006. The spread between the repo rate and the reverse repo rate has, thus, been progressively reduced to 100 basis points by end-April 2005 from 200 basis points at end-March 2003.

Bank Rate

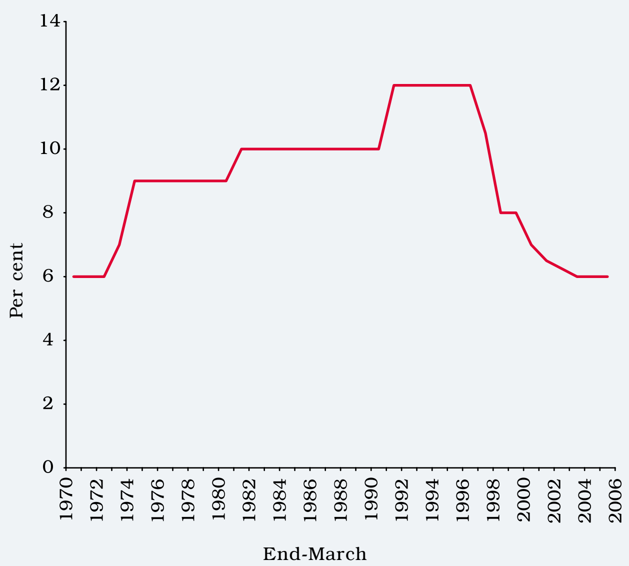
III.12 The Bank Rate signals the medium-term stance of monetary policy. Keeping in view the assessment of the economy including the outlook for inflation, the Bank Rate was retained at the existing level of 6.0 per cent, unchanged since April 2003 (Chart III.1).

Cash Reserve Ratio

III.13 The cash reserve ratio (CRR), which was increased by 50 basis points during September-October 2004, was left unchanged at 5.0 per cent of the net demand and time liabilities (NDTL) during 2005-06. All scheduled commercial banks (excluding RRBs) complied with CRR requirements during 2005-06. In line with the stipulation, banks generally maintained minimum daily level of 70 per cent of fortnightly CRR requirement on all the days.

III.14 Consequent upon amendment to sub-Section 42(1) of the Reserve Bank of India Act, 1934 in June 2006, the Reserve Bank, having regard to the needs of securing the monetary stability in the country, can prescribe CRR for scheduled banks without any floor

Chart III.1: Bank Rate



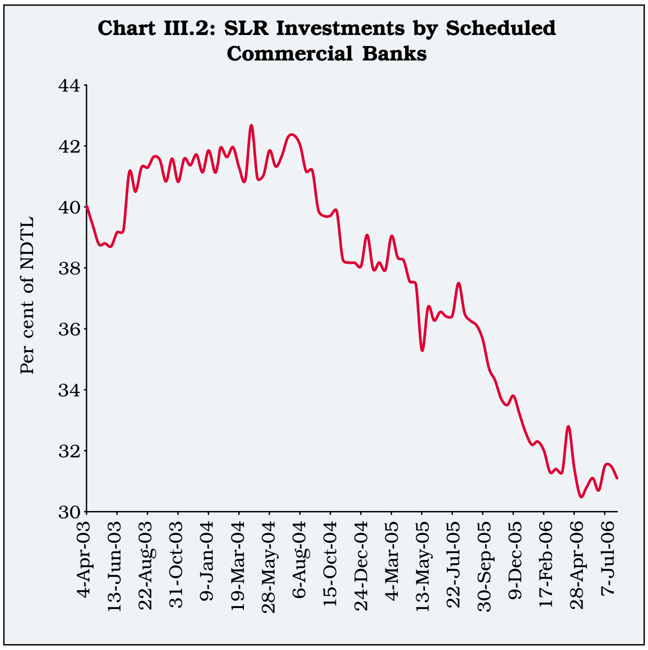
rate or ceiling rate. Before the enactment of this amendment, in terms of Section 42(1) of the Act, the Reserve Bank could prescribe CRR for scheduled banks between 3 per cent and 20 per cent of their NDTL. The amendments will provide the Reserve Bank with greater flexibility in the conduct of monetary policy. In the light of the enactment of the Reserve Bank of India (Amendment) Bill, 2006 the Reserve Bank has decided to continue with the *status quo* on the existing provisions of CRR maintenance, including the CRR rate and extant exemptions. Accordingly, scheduled banks shall continue to maintain CRR of 5.0 per cent of their NDTL.

III.15 The Reserve Bank, prior to the amendment of the Act, had been paying interest on scheduled banks' CRR balances above the statutory minimum of 3.0 per cent and up to the prescribed level of 5.0 per cent – known as eligible cash balances – at an interest rate determined by the Reserve Bank, which has been set at 3.5 per cent with effect from September 18, 2004. No interest was payable on any amount upto the statutory minimum CRR balances of 3.0 per cent or any amount actually maintained in excess of the balance required to be maintained. Consequent upon the amendment of sub-Section 42 (1A) of the Act, the statutory minimum CRR of 3.0 per cent no longer exists. Furthermore, with the removal of the sub-Section 42 (1B) of the Act, the Reserve Bank can not pay interest on any portion of CRR balances of banks. Accordingly, no interest is payable on CRR balances with effect from the fortnight beginning June 24, 2006.

III.16 The CRR for non-scheduled banks and non-scheduled cooperative banks continues to be governed by the provisions of Section 18 and Section 56, respectively, of the Banking Regulation Act, 1949 which remain unchanged. Accordingly, non-scheduled banks, including non-scheduled cooperative banks, shall continue to maintain CRR equivalent to 3.0 per cent of their NDTL as on the last Friday of the second preceding fortnight.

Statutory Liquidity Ratio

III.17 Statutory liquidity ratio (SLR) for scheduled commercial banks, at present, is at the statutory minimum of 25 per cent of their NDTL. Any further reduction in SLR would require amendment to the Banking Regulation Act. The legislative process of amendment of the Act in this regard has been initiated in order to provide greater flexibility to the Reserve Bank to specify SLR without any floor subject to the ceiling of 40 per cent. As discussed in Chapter I,



reflecting strong demand for credit from the commercial sector, banks liquidated their holdings of Government securities during 2005-06. As a result, scheduled commercial banks' holding of SLR securities fell from around 38 per cent of NDTL at end-March 2005 to 31.3 per cent at end-March 2006, but still above the statutory requirements (Chart III.2). The excess holdings of SLR securities at end-March 2006 at about Rs.1,45,297 crore exceeded the budgeted combined net market borrowings programme of the Central and State Governments for 2006-07.

Liquidity Management

III.18 Monetary management faced some challenges in maintaining stable liquidity conditions particularly in the last quarter of 2005-06. The recourse of market participants to primary liquidity support from the Reserve Bank during the last quarter of 2005-06 suggested an overlap between frictional and structural liquidity. First, some market participants had not prepared for the liquidity implications of the movements in the interest rate cycle as also the one-off impact of IMDs redemption and, as a consequence, found themselves facing a shortage of liquidity as well as securities eligible for accessing the Reserve Bank's liquidity facilities or even the collateralised money markets. Second, the banking system as a whole was significantly overdrawn in order to sustain the credit disbursements and the persistent mismatches between the sources and uses of funds forced them to seek recourse to borrowing and rolling over on an overnight basis, thereby putting pressure on interest rates and liquidity conditions.

III.19 Against this backdrop, the Reserve Bank continued to manage liquidity using a combination of instruments consisting of repo and reverse repo operations under the LAF, open market operations (OMOs), operations under the MSS and interest rate signals through the reverse repo/repo rates (Box III.2 and Table 3.2).

Course of Liquidity Management

III.20 The market operations of the Reserve Bank responded to the change in liquidity conditions during 2005-06. The year 2005-06 was characterised by strong and sustained credit demand, a relatively lower order of accretion of the foreign exchange reserves to the Reserve Bank and redemption of IMDs along with a build-up of the Centre's surplus with the Reserve Bank in the second half of the year. Against this backdrop, the Reserve Bank's liquidity management operations led to injection of liquidity through LAF operations and unwinding of the balances under the MSS in contrast to liquidity absorption through issuances under the MSS during the preceding year. Liquidity management operations during 2005-06 could be analysed in terms of five phases (Table 3.3). In the first phase, between end-March 2005 and up to July 22, 2005, absorption through continued issuances under the MSS was accompanied by reduction in absorption through reverse repos under LAF. In the face of widening of the trade deficit, outflows by the FIIs during April-May 2005 and strong currency demand, banks unwound their investments in Government securities in order to finance the buoyant credit demand. Reduction in the Centre's surplus with the Reserve Bank also kept liquidity conditions comfortable. Liquidity in the system increased during the second phase (July 23 - August 12, 2005), mainly due to the spurt in foreign exchange inflows (following the revaluation of the Chinese currency) and a further reduction in the Centre's surplus investment balances with the Reserve Bank. Excess liquidity in the system was absorbed by the Reserve Bank through LAF reverse repos which rose from Rs.10,485 crore as on July 22 to a peak of Rs.50,610 crore as on August 3, 2005.

III.21 During the third phase (August 13 – October 28, 2005), the Reserve Bank's purchase of foreign exchange assets moderated while Government's cash balances with the Reserve Bank started to build up. In view of the resultant tightness in liquidity, there was

Box III.2
Liquidity Management by the Reserve Bank

Following the initiation of reforms in India in the early 1990s, the monetary policy framework also witnessed a significant transformation. While the conduct of monetary policy continues to be guided by the twin objectives of maintaining price stability and to provide appropriate liquidity to meet genuine credit needs of the economy, maintenance of financial stability has also emerged as a key consideration in the conduct of monetary policy. Concomitantly, with the growing market-orientation of the economy, there has been a shift from direct instruments of monetary management to an increasing reliance on indirect instruments. In the context of this shift towards indirect instruments and in line with international trends, the Reserve Bank has put in place a liquidity management framework. Liquidity management is carried out through open market operations (OMO) in the form of outright purchases/sales of Government securities and reverse repo/repo operations, supplemented by the Market Stabilisation Scheme (MSS).

The Liquidity Adjustment Facility (LAF), introduced in June 2000, enables the Reserve Bank to manage day-to-day liquidity or short-term mismatches under varied financial market conditions in order to ensure stable conditions in the overnight money market. The LAF operates through reverse repo and repo auctions, thereby setting a corridor for the short-term interest rate consistent with the policy objectives. The introduction of LAF had several advantages. First, it helped the transition from direct instruments of monetary control to indirect instruments. Second, it enabled the Reserve Bank to modulate the supply of funds on a daily basis to meet day-to-day liquidity mismatches. Third, it enabled the Reserve Bank to affect demand for funds through policy rate changes. Finally, it helped stabilise short-term money market rates.

Open market operations (OMOs) through outright sale and purchase of securities are also an important array of tools of the Reserve Bank's monetary management. Apart from being directed at influencing enduring liquidity, OMOs can also be undertaken as 'switch' operations through purchase of gilts of a particular maturity against the sale of another to provide liquidity. In view of the large stock of Government securities in its portfolio, the OMOs were used effectively by the Reserve Bank from the second half of the 1990s to 2003-04 to manage the impact of capital flows. However, in the context of sustained large capital flows, large-scale OMOs led to a decline in the Reserve Bank's holdings of Government securities. The finite stock of Government securities held by the Reserve Bank as well as the legal restrictions on the Reserve Bank on issuing its own paper were seen as placing constraints on future sterilisation operations. Accordingly, an innovative scheme in the form of MSS was introduced in April 2004 wherein Government of India dated securities/Treasury Bills are being issued to absorb enduring surplus liquidity. These dated securities/ Treasury Bills are the same as those issued for normal market borrowings and this avoids segmentation of the market. With the introduction of MSS, the pressure of sterilisation on LAF has declined considerably and the LAF operations have been able to fine-tune liquidity on a day-to-day basis more effectively. The MSS has provided the flexibility to the Reserve Bank to not only absorb liquidity but also to inject liquidity in case of need.

The efficacy of various liquidity management tools was reflected clearly in the Reserve Bank's market operations during 2005-06. Liquidity surpluses declined during October-November 2005 due to sustained demand for bank credit and currency demand during the festival season. Ahead of the redemption of the IMDs in December 2005, the Reserve Bank, making a forward looking assessment, began to unwind sterilised liquidity in a calibrated manner from September 2005. As part of this unwinding, fresh issuances under the MSS were suspended between November 2005 and April 2006. Redemptions of securities/ Treasury Bills issued earlier along with active management of liquidity through repo/reverse repo operations under LAF during January-March 2006 provided liquidity to the market. Some private placement during March 2006 and purchases of foreign exchange from the market also injected liquidity. The various tools of liquidity management, thus, provided the flexibility to Reserve Bank to maintain liquidity conditions and conduct monetary policy in accordance with the stated objectives.

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decline in bids received under LAF reverse repos. On the whole, liquidity conditions were broadly stable and comfortable with call money rates generally staying within the reverse repo and the repo rate corridor. Till the third phase, the Reserve Bank injected liquidity through LAF repos only on four occasions; on a net basis, the Reserve Bank absorbed liquidity even on those four days.

Table 3.2: Liquidity Management

(Rupees crore)

Outstanding as on last Friday of	LAF	MSS	Centre's Surplus with the RBI @	Total (2 to 4)
1	2	3	4	5
2005				
January	14,760	54,499	17,274	86,533
February	26,575	60,835	15,357	1,02,767
March*	19,330	64,211	26,102	1,09,643
April	27,650	67,087	6,449	1,01,186
May	33,120	69,016	7,974	1,10,110
June	9,670	71,681	21,745	1,03,096
July	18,895	68,765	16,093	1,03,753
August	25,435	76,936	23,562	1,25,933
September	24,505	67,328	34,073	1,25,906
October	20,840	69,752	21,498	1,12,090
November	3,685	64,332	33,302	1,01,319
December	-27,755	46,112	45,855	64,212
2006				
January	-20,555	37,280	39,080	55,805
February	-12,715	31,958	37,013	56,256
March	7,250	29,062	48,828	85,140
April	47,805	24,276	5,611	77,692
May	57,245	27,817	0	85,062
June	42,565	33,295	8,621	84,481
July	44,155	38,995	8,770	91,920

@ : Excludes minimum cash balances with the Reserve Bank.

* : Data pertain to March 31, 2005.

Note: Negative sign in column 2 indicates injection of liquidity through LAF repo.

III.22 In the fourth phase (October 29 – December 30, 2005), some tightness in the liquidity position started emanating from a host of factors such as festival season currency demand, scheduled auctions, advance tax outflows and redemption of IMDs amidst continuing strong demand for commercial credit. To ensure smooth redemption of IMDs, the Reserve Bank sold foreign exchange of US $ 7.1 billion out of its foreign exchange reserves to the State Bank of India during December 27-29, 2005 against equivalent rupees (Rs.31,959 crore). In response to the emergence of tight liquidity conditions, balances under LAF transited from absorption to injection mode, characterised by a swing of Rs.48,595 crore. The Reserve Bank provided liquidity on a net basis to the market through repo operations during November 10-18, 2005 (daily average net injection of Rs.1,565 crore). Furthermore, in view of the tightness in liquidity conditions, auctions of Treasury Bills (TBs) under the MSS were discontinued effective November 16, 2005. This also led to a substantial injection of liquidity (Rs.23,640 crore) during this phase from the redemption of maturing issuances under MSS.

III.23 In the fifth phase (end-December 2005 to end-March 2006), liquidity conditions generally remained tight following the IMDs redemption and a further build-up of Centre's cash balances amidst sustained growth in demand for bank credit. On a review of the prevalent macroeconomic, monetary and liquidity

Table 3.3: Reserve Bank's Liquidity Management Operations: 2005-06

(Rupees crore)

Item	April 1 - July 22, 2005	July 23 - August 12, 2005	August 13 - October 28, 2005	October 29 - December 30, 2005	December 31, 2005 March 31, 2006	2005-06
1	2	3	4	5	6	7
A. Drivers of Liquidity (1 to 4)	**-6,587**	**27,406**	**-14,621**	**-60,555**	**22,638**	**-31,719**
1. RBI's Foreign Currency Assets (adjusted for revaluation)	6,412	19,348	5,193	- 21,696	59,577	68,834
2. Currency with the Public	-15,125	-1,914	-7,434	-12,734	-20,073	-57,280
3. Surplus Cash Balances of the Centre with the Reserve Bank	6,053	5,972	-7,421	-24,357	-2,973	-22,726
4. Others (residual)	-3,927	4,000	-4,959	-1,768	- 13,893	-20,547
B. Management of Liquidity (5 to 8)	**1,329**	**-24,567**	**16,187**	**72,235**	**-7,215**	**57,969**
5. Liquidity impact of LAF Repos	8,845	-26,565	16,210	48,595	-35,005	12,080
6. Liquidity impact of OMO* (net)	0	0	0	0	10,740	10,740
7. Liquidity impact of MSS	-7,516	1,998	-23	23,640	17,050	35,149
8. First round liquidity impact due to CRR change	0	0	0	0	0	0
C. Bank Reserves # (A+B)	**-5,258**	**2,839**	**1,566**	**11,680**	**15,423**	**26,250**

+ : Indicates injection of liquidity into the banking system.

– : Indicates absorption of liquidity from the banking system.

: Includes vault cash with banks and adjusted for first round liquidity impact due to CRR change.

* : Adjusted for Consolidated Sinking Funds (CSF) and including private placement.

Table 3.4: Primary Liquidity Flows and Open Market Operations

(Rupees crore)

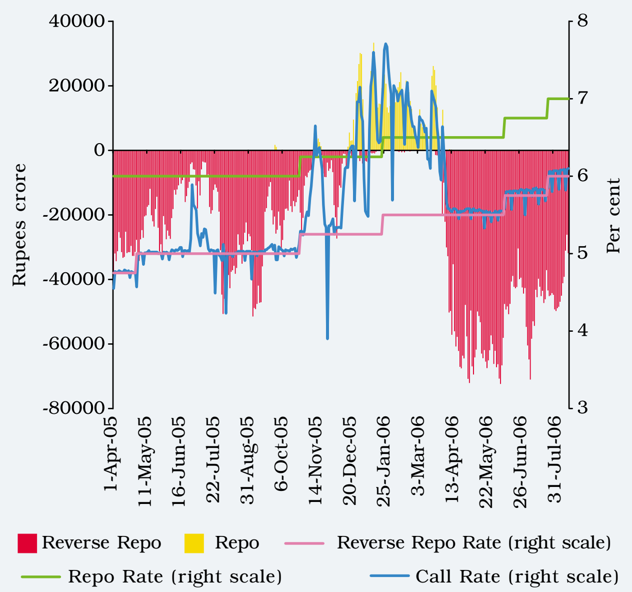
Month	RBI's Net Foreign Currency Assets #			Net Repos under the LAF			RBI's Initial Subscription			Net Open Market Operations			Market Stabilisation Scheme		
	2004-05	2005-06	2006-07	2004-05	2005-06	2006-07	2004-05	2005-06	2006-07	2004-05	2005-06	2006-07	2004-05	2005-06	2006-07
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
April	32,608	1,432	20,832	-38,430	-8,320	-40,555	0	0	0	-253	-263	-112	-22,851	-2,876	4,786
May	202	1,970	4,781	230	-5,470	-9,440	0	0	0	-116	-325	-1,303	-7,850	-1,929	-3,541
June	350	1,632	2,494	11,480	23,450	26,935	0	0	0	-60	-954	-121	-7,111	-2,665	-5,307
July	946	1,378	2,556	3,290	-815	-15,760	0	0	0	-218	-526	-967	-8,394	-47	-4,603
August	-5,360	20,069		24,350	-15,450		217	0		-78	-66		-3,235	1,765	
September	1,001	2,218		6,565	1,430		630	0		-131	-348		-2,815	2,635	
October	1,635	2,254		19,705	3,665		0	0		-189	-124		-2,831	-2,424	
November	15,039	2,811		1,630	17,155		0	0		-342	-79		3,215	5,420	
December	13,184	6,933		6,265	-2,185		0	0		-339	-59		-737	16,717	
January	1,537	-29,512		-15,795	19,640		0	0		-703	-660		-945	7,911	
February	14,392	12,292		-10,610	-4,850		0	0		-37	-401		-5,800	6,772	
March	39,510	45,357		6,635	-16,170		350	10,000		-431	-107		-4,857	3,869	
Total	**1,15,044**	**68,835**	**30,663**	**15,315**	**12,080**	**-38,820**	**1,197**	**10,000**	**0**	**-2,897**	**-3,912**	**-2,503**	**-64,211**	**35,148**	**-8,665**

: Adjusted for revaluation. + : Indicates injection of liquidity into the banking system. - : Indicates absorption of liquidity from the banking system.

Note : Data are based on March 31 for March and last reporting Friday for all other months.

conditions, including the redemptions of IMDs, the Reserve Bank decided on December 30, 2005 to suspend the issue of Treasury Bills and dated securities under the MSS. Consequently, Rs.17,050 crore was further injected between end-December 2005 and end-March 2006 through unwinding of balances held under the MSS. The Reserve Bank also injected liquidity through repo operations (on a net basis) averaging Rs.15,386 crore during January 2006, Rs.13,532 crore during February 2006 and Rs.6,319 crore during March 2006 (Chart III.3). Although call money rates edged above the repo rate during January-February 2006, the rates in the collateralised segment of the money market – market repos and Collateralised Borrowing and Lending Obligations (CBLO), which account for nearly 80 per cent of the market turnover – remained below the repo rate (see Chapter I).

Chart III.3: Liquidity Adjustment Facility and Call Rate



III.24 During March 2006, the private placement of dated Government securities (Rs.10,000 crore) with the Reserve Bank and the Reserve Bank's forex operations led to some easing of liquidity conditions (Table 3.4). As a result, repo volumes under LAF declined in the first half of March 2006 and there was absorption of liquidity on a few occasions. Call money rates also started easing. In the third week of March 2006, some tightness in market liquidity was again observed due to advance tax outflows and build-up of Centre's surplus with the Reserve Bank. Liquidity conditions, however, improved during the last week of March 2006 and the LAF window witnessed net absorption of liquidity of Rs.7,250 crore as at end-March 2006. Call rates edged below the repo rate.

III.25 During 2006-07 (up to August 18, 2006), liquidity conditions have remained comfortable. This can largely be attributed to a reduction in the Centre's surplus with the Reserve Bank as well as purchases of foreign exchange by the Reserve Bank. Concomitantly, the liquidity absorbed through LAF reverse repos has increased from Rs.7,250 crore at end-March 2006 to Rs.29,990 crore as on August 18, 2006. On a review of liquidity conditions, issuances under the MSS were reintroduced effective May 3, 2006.

Call rate eased to 6.10 per cent as on August 18, 2006 from 6.64 per cent at end-March 2006, notwithstanding the two hikes of 25 basis points each in the policy rates by the Reserve Bank.

Liquidity Adjustment Facility

III.26 The LAF remained the Reserve Bank's primary instrument for managing day-to-day liquidity and transmitting interest rate signals to the market. During 2005-06, the Reserve Bank injected liquidity through repo operations on 76 days while it absorbed liquidity through reverse repo operations on as many as 244 days (Table 3.5).

III.27 In order to fine-tune the management of liquidity and in response to suggestions from the market participants, the Reserve Bank also introduced a Second Liquidity Adjustment Facility (SLAF) with effect from November 28, 2005 (Chart III.4). While operations under the second LAF were relatively lower with respect to the first LAF during the phase of liquidity injection between November 2005 and March 2006, there has been a substantial recourse to second LAF from April 2006 onwards. The daily

Chart III.4: Repo (+)/ Reverse Repo (-) under LAF

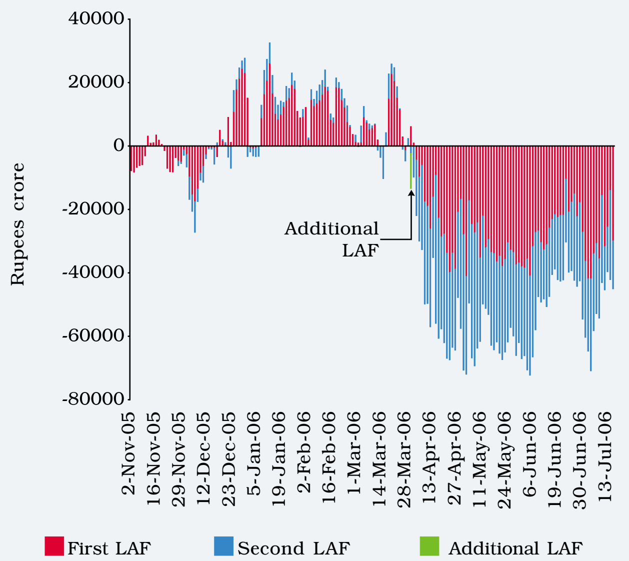


Table 3.5: Reverse Repo/Repo Bids under LAF

Year/ Month	Reverse Repo				Repo			
	No. of days bids were received	No. of days all bids were rejected	No. of days of full acceptance of bids	No. of days of partial acceptance of bids	No. of days bids were received	No. of days all bids were rejected	No. of days of full acceptance of bids	No. of days of partial acceptance of bids
1	2	3	4	5	6	7	8	9
2004-05	**242**	**0**	**242**	**0**	**23**	**0**	**23**	**0**
2005-06	**244**	**0**	**244**	**0**	**78**	**0**	**76**	**0**
April	18	0	18	0	0	0	0	0
May	21	0	21	0	0	0	0	0
June	22	0	22	0	2	0	2	0
July	18	0	18	0	0	0	0	0
August	22	0	22	0	0	0	0	0
September	21	0	21	0	2	0	2	0
October	20	0	20	0	0	0	0	0
November	20	0	20	0	7	0	7	0
December	22	0	22	0	11	0	11	0
January	20	0	20	0	18	0	17@	0
February	19	0	19	0	19	0	19	0
March	21	0	21	0	19	0	18@	0
2006-07								
April	17	0	17	0	3	0	2@	0
May	22	0	22	0	0	0	0	0
June	22	0	22	0	0	0	0	0
July	21	0	21	0	0	0	0	0

@ : Number of days of full acceptance of bids is less than number of days bids were received on account of non-acceptance of one bid each on technical grounds on January 24, 2006, March 23, 2006 and April 4, 2006.

Note : 1. With effect from October 29, 2004, nomenclature of repo and reverse repo has been interchanged as per international usage. Prior to that date, repo indicated absorption of liquidity while reverse repo meant injection of liquidity. The nomenclature in this Report is based on the new use of terms even for the period prior to October 29, 2004.

2. With effect from November 2005, data include operations under second LAF (SLAF).

Table 3.6: Reserve Bank's Holdings of Central Government Dated Securities

(Rupees crore)

Year	Devolvement on Reserve Bank	Private Placement taken by Reserve Bank	OMO Purchases by Reserve Bank	Conversion of Special Securities into Dated Securities	Total Addition to Stock of Reserve Bank's Investments (2+3+4+5)	Open Market Sales by Reserve Bank	Net Addition to Stock (6-7)	Outstanding Holding by Reserve Bank (end period)*	Memo: Net Repo (+)/Reverse Repos (-) Out-standing #
1	2	3	4	5	6	7	8	9	10
1996-97	3,698	–	623	–	4,321	11,206	-6,885	6,666	-2,300
1997-98	7,028	6,000	467	20,000	33,495	8,081	25,414	31,977	-4,202
1998-99	8,205	30,000	–	–	38,205	26,348	11,857	42,212	-400
1999-00	–	27,000	1,244	–	28,244	36,614	-8,370	35,190	–
2000-01	13,151	18,000	4,471	–	35,622	23,795	11,827	41,732	-1,355
2001-02	679	28,213	5,084	–	33,976	35,419	-1,443	40,927	-4,355
2002-03	5,175	31,000	–	40,000	76,175	53,780	22,395	55,438	-2,415
2003-04	–	21,500	–	61,818	83,318	41,849	41,469	77,397	-34,645
2004-05	847	350	–	–	1,197	2,899	-1,702	80,770	-19,330
2005-06	–	10,000	740	–	10,740	4,653	6,087	83,205	-7,250

* : Inclusive of securities sold under the LAF. # : Data pertain to end-March

average absorption under the second LAF during April-July 2006 was nearly the same as that in the first LAF. At the request of the market participants, the Reserve Bank conducted an additional LAF on March 31, 2006 between 9.00 p.m. to 9.30 p.m. to facilitate funds management by banks on account of the year-end closing on March 31, 2006 falling on a reporting Friday.

Open Market Operations

III.28 In view of the finite stock of Government securities with the Reserve Bank, the use of open market operations (OMOs) as an instrument of liquidity management has been limited since 2004-05. However, in view of the recent developments, including the FRBM provisions which prohibit the Reserve Bank from participating in the primary market for Central Government securities, OMOs are set to increase in importance as an operating instrument. The activation of OMOs will further enable the LAF to be even more focused on the role for which it has been designed. In view of these developments, the increase in the Reserve Bank's holdings of dated securities during 2005-06 will provide greater flexibility to the Reserve Bank in conducting OMOs (Table 3.6).

Interest Rate Policy

III.29 Progressive deregulation of interest rates in those segments that have remained regulated for reasons relevant at different times has been engaging the attention of Reserve Bank and wide consultations have been held with various stakeholders. In this context, the Reserve Bank requested the Indian Banks' Association (IBA) to undertake a comprehensive review of the interest rate on savings bank deposits and lending rates on small loans up to Rs.2 lakh.

III.30 The interest rate on savings bank deposits is regulated by the Reserve Bank and is currently prescribed at 3.5 per cent per annum. Based on a review of current monetary and interest rate conditions, including a careful consideration of the suggestions received from the IBA, the Annual Policy Statement for 2006-07 maintained the *status quo* while recognising that the deregulation of this interest rate would be essential for product innovation and price discovery in the long run.

Interest Rates on Non-Resident Deposits

III.31 The ceilings on interest rates on non-resident deposits are linked to the LIBOR/swap rates and are reviewed from time to time depending on monetary and macroeconomic developments. On a review, the ceiling interest rate on foreign currency non-resident (banks) [FCNR(B)] deposits was raised by 25 basis points from "LIBOR/swap rates for the respective currency/maturities minus 25 basis points" to "LIBOR/swap rates for the respective currency/maturities" with effect from close of business in India on March 28, 2006. The ceiling interest rate on non-resident (external) rupee deposits for one to three year maturity was increased by 50 basis points in two stages – from "50 basis points above LIBOR/swap rates for US dollar of corresponding maturity" to "75 basis points above LIBOR/swap rates" effective close of business in India on November 17, 2005 and further to "100 basis points above LIBOR/swap rates" effective close of business in India on April 18, 2006.

Rupee Export Credit Rate

III.32 The validity of the reduction in the interest rate ceiling to 250 basis points below benchmark prime lending rate (BPLR) on pre-shipment rupee export credit up to 180 days and post-shipment rupee export credit up to 90 days announced on September 24, 2001 has been extended up to October 31, 2006.

Foreign Currency Export Credit Rate

III.33 On the basis of the recommendations of the Working Group to Review Export Credit, the Annual Policy Statement for 2006-07 increased the ceiling interest rate on export credit in foreign currency by 25 basis points to LIBOR *plus* 100 basis points with effect from April 18, 2006.

MONETARY POLICY STANCE FOR 2006-07

III.34 Under the assumption of a normal monsoon, positive industrial outlook and sustained momentum in services sector growth, the Annual Policy Statement for 2006-07 (April 2006), for policy purposes, placed real GDP growth in the range of 7.5-8.0 per cent during 2006-07 barring domestic or external shocks. Taking into account the real, monetary and global factors having a bearing on domestic prices, the statement noted that containing inflationary expectations would continue to pose a challenge to monetary management. The policy endeavour would be to contain the year-on-year inflation rate for 2006-07 in the range of 5.0-5.5 per cent. For the purpose of monetary policy formulation, the expansion in M_3 was projected at around 15.0 per cent for 2006-07. While this indicative projection is consistent with the projected GDP growth and inflation, the Statement pointed to overhang of above-trend growth in money supply in the preceding year. In normal circumstances, the policy preference would be for maintaining a lower order of money supply growth in 2006-07. The growth in aggregate deposits was projected at around Rs.3,30,000 crore in 2006-07. Non-food bank credit including investments in bonds/debentures/shares of public sector undertakings and private corporate sector and commercial paper (CP) was expected to increase by around 20 per cent, implying a calibrated deceleration from a growth of above 30 per cent ruling at end-March 2006.

III.35 Against the backdrop of developments during 2005-06, the stance of monetary policy during 2006-07, as the Annual Policy Statement for 2006-07 noted, would depend on macroeconomic developments including the global scenario. Domestic macroeconomic and financial conditions support prospects of sustained growth momentum with stability in India. It is important to recognise, however, that there are risks to both growth and stability from domestic as well as global factors and, the balance of risks is currently tilted towards the global factors. The adverse consequences of further escalation of international crude prices and/or of disruptive unwinding of global imbalances are likely to be pervasive across economies, including India. Moreover, in a situation of generalised tightening of monetary policy, India cannot afford to stay out of step. Barring the emergence of any adverse and unexpected developments in various sectors of the economy and keeping in view the prevailing assessment of the economy including the outlook for inflation, the Annual Policy Statement for 2006-07 indicated that the overall stance of monetary policy would be:

- To ensure a monetary and interest rate environment that enables continuation of the growth momentum consistent with price stability while being in readiness to act in a timely and prompt manner on any signs of evolving circumstances impinging on inflation expectations.
- To focus on credit quality and financial market conditions to support export and investment demand in the economy for maintaining macroeconomic, in particular, financial stability.
- To respond swiftly to evolving global developments.

III.36 While leaving the repo rate and the reverse repo rate unchanged, the Reserve Bank took certain prudential measures in April 2006 (see Box III.1). In the context of continued strong credit growth and in order to maintain asset quality, the Reserve Bank raised risk weight on exposures to commercial real estate and banks' total exposure to venture capital funds further to 150 per cent. The general provisioning requirement on standard advances in specific sectors, *i.e.*, personal loans, loans and advances qualifying as capital market exposures, residential housing loans beyond Rs.20 lakh and commercial real estate loans was also raised from the existing level of 0.40 per cent to 1.0 per cent.

III.37 On review of macroeconomic and overall monetary conditions, the Reserve Bank increased the reverse repo rate and the repo rate by 25 basis points each to 5.75 per cent and 6.75 per cent, respectively, with effect from June 9, 2006.

Quarterly Review of Monetary Policy

III.38 In its First Quarter Review of Annual Statement on Monetary Policy in July 2006, the Reserve Bank observed that the domestic economy is exhibiting strong fundamentals and displaying considerable resilience. At the same time, the Review pointed out that disturbing signs of demand pressures, especially continuing high credit growth, could exert upward pressure on prices when associated with supply shocks such as from oil. These pressures have the potential for impacting stability and inflationary expectations. Although domestic developments continue to dominate the Indian economy, global factors tend to gain more attention now than before. The global outlook for growth is positive but downside risks in regard to inflation and re-pricing of risks in financial markets need to be recognised. Both domestic and global factors are delicately balanced in terms of growth *vis-à-vis* price stability with a tilt towards the possibility of identified downside risks materialising in the near-term being more likely than before. While reaffirming its forecast for GDP growth of 7.5-8.0 per cent as set out in the April 2006 Statement, the Reserve Bank observed that containing the year-on-year inflation rate for 2006-07 in the range of 5.0-5.5 per cent warrants appropriate priority in policy responses. On balance, the Reserve Bank indicated that a modest pre-emptive action in monetary policy was appropriate. Accordingly, the Reserve Bank increased the reverse repo rate and the repo rate further by 25 basis points each to 6.00 per cent and 7.00 per cent, respectively, with effect from July 25, 2006.

III.39 Barring the emergence of any adverse and unexpected developments in various sectors of the economy and keeping in view the current assessment of the economy including the outlook for inflation, the Reserve Bank indicated that the overall stance of monetary policy in the period ahead will be:

- To ensure a monetary and interest rate environment that enables continuation of the growth momentum while emphasising price stability with a view to anchoring inflation expectations.
- To reinforce the focus on credit quality and financial market conditions to support export and investment demand in the economy for maintaining macroeconomic and, in particular, financial stability.
- To consider measures as appropriate to the evolving global and domestic circumstances impinging on inflation expectations and the growth momentum.

III.40 The Mid-term Review and the Third Quarter Review of the Annual Policy Statement will be undertaken on October 31, 2006 and January 30, 2007, respectively.

CREDIT DELIVERY

III.41 It has been the endeavour of the Reserve Bank to improve credit delivery mechanisms for small borrowers, particularly the agriculture and Small Scale Industries (SSI) sector by creating a conducive environment for banks to provide adequate and timely finance at reasonable rates without procedural hassles.

Priority Sector Lending

III.42 In order to improve the credit delivery to priority sector, the Reserve Bank took various measures during 2005-06. These included:

- For stepping up credit to small and medium enterprises (SMEs), banks to treat units with investment in plant and machinery in excess of SSI limit and up to Rs.10 crore as Medium Enterprises (ME). However, only SSI financing to be included in priority sector.
- Banks to fix self-targets for financing to SME sector to achieve higher disbursement over the immediately preceding year and initiate steps to rationalise the cost of loans to SME sector by adopting a transparent rating system with cost of credit being linked to the credit rating of enterprise.
- Banks to consider the Credit Appraisal and Rating Tool (CART) as well as Risk Assessment Model (RAM) and the comprehensive rating model for risk assessment of proposals for SMEs developed by SIDBI as appropriate and reduce their transaction costs.
- Banks to make concerted efforts to provide credit cover on an average to at least 5 new small/medium enterprises per year at each of their semi-urban/urban branches.

- In respect of loans to SME sector, boards of banks to formulate more comprehensive and liberal policies, based on the guidelines issued on lending to SSI sector.
- Banks to adopt cluster based approach as a thrust area and increasingly adopt the same for SME financing.
- Public sector banks to implement a one-time settlement scheme for recovery of NPAs below Rs.10 crore for SME accounts.
- Banks to ensure specialised SME branches in identified clusters/centres with preponderance of MEs to enable the SME entrepreneurs to have easy access to bank credit. The existing specialised SSI branches to be redesignated as SME branches.
- In order to offer small borrowers an opportunity to settle their NPA accounts with banks and to become eligible for fresh finance, banks to provide a simplified mechanism for one-time settlement of loans where the principal amount is equal to or less than Rs.25,000 and which have become doubtful and loss assets as on September 30, 2005. In case of loans granted under Government sponsored schemes, banks to frame separate guidelines following a state-specific approach to be evolved by the State Level Bankers' Committee (SLBC).
- Banks to introduce a General Credit Card (GCC) scheme for issuing GCC to their constituents in rural and semi-urban areas, based on the assessment of income and cash flow of the household, without any insistence on security and the purpose or end-use of the credit. Banks to utilise the services of local post offices, schools, primary health centres, local government functionaries, farmers' associations/ clubs, well-established community-based agencies and civil society organisations for sourcing of borrowers for issuing GCC. Fifty per cent of credit outstanding under GCC to be classified as indirect finance to agriculture.
- Loans to power distribution corporations/ companies emerging out of bifurcation/ restructuring of State Electricity Boards (SEBs) for reimbursing the expenditure already incurred by them for providing low tension connection from step-down point to individual farmers for energising their wells to be classified as indirect finance to agriculture.
- Fresh investments made on or after July 1, 2005 in venture capital not eligible for classification under priority sector lending. The investments already made up to June 30, 2005 not eligible for classification under priority sector lending with effect from April 1, 2006.

III.43 Public sector banks, private sector banks and foreign banks, as groups, achieved the overall target for priority sector lending as on the last reporting Friday of March 2006 (Table 3.7). However, two public sector banks and 11 private sector banks could not achieve the overall priority sector lending target of 40 per cent.

III.44 An internal Working Group was set up by the Reserve Bank to examine the need for continuance of priority sector lending prescriptions, review the existing policy on priority sector lending including the segments constituting the priority sector, targets and sub-targets and to recommend changes, if any, required in this regard. The draft Technical Paper submitted by the Group was placed in the public domain for inviting views/comments from the public. Based on the feedback received, modifications would again be placed in public domain for views.

Credit to Agricultural Sector

III.45 The Reserve Bank had advised public sector banks in 1994-95 to prepare Special Agricultural

Table 3.7: Priority Sector Advances

(Amount in Rupees crore)

As on Last Reporting Friday	Public Sector Banks	Private Sector Banks	Foreign Banks
1	2	3	4
March-2000	1,27,478 (40.3)	18,368 (38.0)	9,934 (35.2)
March-2001	1,49,116 (43.7)	21,567 (36.7)	11,572 (33.5)
March-2002	1,71,484 (43.5)	24,184 (38.4)	9,936 (34.6)
March-2003	1,99,786 (41.2)	36,648 (44.1)	14,555 (33.1)
March-2004	2,44,456 (43.6)	48,920 (47.3)	17,960 (34.1)
March-2005	3,07,046 (42.8)	69,886 (43.6)	23,843 (35.3)
March-2006*	4,10,379 (40.3)	1,06,566 (42.8)	30,449 (34.6)

* Data are provisional.

Notes: 1. Figures in parentheses are percentages to net bank credit in the respective groups.

2. The target for aggregate advances to the priority sector is 40 per cent of net bank credit for domestic banks and 32 per cent of net bank credit for foreign banks.

Credit Plans (SACPs) on an annual basis. During the fiscal year 2005-06, the disbursements to agriculture under this Plan, at Rs.94,278 crore, exceeded the target of Rs.85,024 crore (Table 3.8). The SACP mechanism has been made applicable to private sector banks from the year 2005-06. Disbursements to agriculture by private sector banks were Rs.30,386 crore (provisional) as against the target of Rs.24,222 crore for the year.

III.46 With a view to doubling credit flow to agriculture within a period of three years and to provide some debt relief to farmers within the limits of financial prudence, the Union Finance Minister had announced several measures on June 18, 2004. While the Reserve Bank and the IBA issued necessary operational guidelines to commercial banks, NABARD issued similar guidelines to regional rural banks (RRBs), state cooperative banks (StCBs) and district central cooperative banks (DCCBs). As against a target of Rs.1,05,000 crore to agriculture sector for the year 2004-05, banks (including cooperative banks and RRBs) disbursed Rs.1,15,243 crore, a growth of 32 per cent over the actual disbursement of Rs.86,981 crore during 2003-04. For the year 2005-06, banks were advised to increase the flow of credit to agriculture to Rs.1,42,000 crore. As against this target, the disbursement by all banks during the year 2005-06 was Rs.1,57,480 crore, a growth of 37 per cent over the disbursement during the previous year.

III.47 The Union Finance Minister, in his budget speech for the year 2006-07, asked the banks to increase the level of agricultural credit to Rs.1,75,000 crore during the year 2006-07 and also add another five million farmers to their portfolio. In view of tenant farmers not being adequately served, banks have been asked to open a separate window for Self-Help Groups (SHGs) or joint liability groups of tenant farmers and ensure that a certain proportion of the total credit is extended to them.

Table 3.8: Disbursements by Public Sector Banks under Special Agricultural Credit Plans

(Amount in Rupees crore)

Year	Target	Disburse-ments	Achieve-ment of Target (Per cent)	Annual Growth in Disburse-ments (Per cent)
1	2	3	4	5
2000-01	25,893	24,654	95.2	12.5
2001-02	30,883	29,332	95.0	19.0
2002-03	36,838	33,921	92.1	15.6
2003-04	42,576	42,211	99.1	24.4
2004-05	55,616	65,218	117.3	54.5
2005-06	85,024	94,278	110.9	44.6

Table 3.9: Outstanding Agricultural Advances

(Amount in Rupees crore)

As at end-March	Public Sector Banks		Private Sector Banks	
	Amount Outstanding	% of Net Bank Credit	Amount Outstanding	% of Net Bank Credit
1	2	3	4	5
2000	45,296	14.3	4,023	8.3
2001	53,571	15.7	5,634	9.6
2002	58,142	14.8	6,581	8.5
2003	70,501	14.5	9,924	10.9
2004	84,435	15.1	14,730	14.2
2005	1,09,917	15.3	21,636	12.3
2006*	1,54,900	15.2	36,185	13.5

* : Data are provisional.

Note: For the domestic banks, the target for advances to agriculture is 18 per cent of net bank credit.

III.48 Outstanding agricultural advances of public as well as private sector banks increased by 40.9 per cent and 67.2 per cent, respectively, during 2005-06. While the share of agricultural advances in bank credit for public sector banks decreased marginally during the year, that of private sector banks increased (Table 3.9).

III.49 The recovery of direct agricultural advances of public sector banks continued to show improvement during the year ended June 2005 (Table 3.10).

Guidelines for Relief to Farmers

III.50 The Union Budget 2006-07 envisaged grant of interest relief of two percentage points in the interest rate on the principal amount up to Rs. one lakh on crop loans availed by the farmers for *Kharif* and *Rabi* 2005-06. The amount of the relief was

Table 3.10: Public Sector Banks – Recovery of Direct Agricultural Advances

(Rupees crore)

Year ended June	Demand	Recovery	Overdues	Recovery to Demand (per cent)
1	2	3	4	5
2001	22,429	15,540	6,889	69.3
2002	24,561	17,758	6,803	72.3
2003	28,940	21,011	7,930	72.6
2004	33,544	25,002	8,542	74.5
2005	35,192	29,612	5,580	84.1

required to be credited to the borrower's account before March 31, 2006. Commercial banks were advised that all crop loans for *Kharif* and *Rabi* disbursed to farmers during the financial year 2005-06 would be eligible for the interest relief. In cases, where each crop loan exceeds Rs. one lakh, the interest relief would be applicable on the principal amount up to Rs. one lakh only. Banks were also advised that interest relief may be calculated at two percentage points on the amount of the crop loan disbursed from the date of disbursement/drawal up to the date of payment or up to the date beyond which the outstanding loan becomes overdue *(i.e.*, March 31, 2006 for *Kharif* and June 30, 2006 for *Rabi*, respectively), whichever was earlier.

III.51 Furthermore, to provide farmers loans at a reasonable rate, the Government has decided to ensure that the farmers receive short-term credit at 7 per cent on loans up to Rs.3,00,000 on the principal amount with effect from *Kharif* 2006-07. The public sector banks and regional rural banks have been advised that Government will provide interest rate subvention of 2 per cent per annum to them in respect of short-term production credit up to Rs.3,00,000 provided to farmers. This amount of subvention will be calculated on the amount of crop loan disbursed from the date of disbursement/drawal up to the date of payment or up to the date beyond which the outstanding loan becomes overdue *i.e.* March 31, 2007 for *Kharif* and June 30, 2007 for *Rabi*, respectively, whichever is earlier.

III.52 Following the announcement in the Annual Policy Statement for 2006-07, a Working Group has been constituted under the chairmanship of Prof. S.S. Johl to suggest measures for assisting distressed farmers, including provision of financial counselling services and introduction of a specific Credit Guarantee Scheme under the DICGC Act for such farmers. The Group is expected to submit its report by September 30, 2006.

Micro Finance

III.53 Among the different models for purvey of micro finance, the Self Help Group (SHG)-bank linkage programme has emerged as the major micro finance programme in the country, which is being implemented by commercial banks, RRBs and cooperative banks. During the year 2005-06, 6.2 lakh new SHGs were provided with bank loans amounting to Rs.2330 crore and 3.45 lakh existing SHGs were extended further financial assistance. The total bank loan disbursed during the year 2005-06 amounted to Rs.4499 crore. As at March 31, 2006, the cumulative number of SHGs linked to banks stood at 2.2 million with total bank credit to these SHGs at Rs.11,398 crore. The Union Budget for the year 2006-07 envisages the banking industry to credit link another 3,85,000 SHGs in the year 2006-07.

III.54 In the context of the recent developments in the micro finance sector in certain districts of the country, the Reserve Bank, responding to requests from the various stakeholders, provided a forum to promote better understanding of the issues involved and enhance transparency in the operations of the MFIs. All Regional Directors of the Reserve Bank were advised that whenever issues relating to the sector are brought to their notice, they may offer to constitute a coordination forum comprising representatives of SLBC convenor bank, NABARD, SIDBI, State Government officials and representatives of MFIs (including NBFCs) and NGOs/SHGs to facilitate discussion and enable resolution of issues affecting the operations of the micro finance sector.

III.55 In order to examine the issues relating to (i) allowing banks to adopt agency model by using infrastructure of civil society organisations, (ii) appointment of 'banking correspondents' to function as intermediaries between the lending banks and the beneficiaries and (iii) identification of steps to promote MFIs, an in-house Group was set up in the Reserve Bank under the Chairmanship of Shri H. R. Khan, Principal, College of Agricultural Banking, Pune. Based on the recommendations of the Group and with the objective of ensuring greater financial inclusion and increasing the outreach of the banking sector, banks have been permitted to use the services of specified intermediaries as also post offices as business facilitator and correspondents.

Technical Group for Review of Legislation on Money Lending

III.56 The All-India Debt and Investment Survey (NSS 59th Round) has revealed that the share of money lenders in total dues of rural households has increased from 17.5 per cent in 1991 to 29.6 per cent in 2002. Considering that high indebtedness to money lenders can be an important reason for distress of farmers, a Technical Group (Chairman: Shri S.C. Gupta) has been set up to review the efficacy of the existing legislative framework governing money lending and its enforcement machinery in different States and to make recommendations to the State Governments for improving the legal and enforcement framework in the interest of rural households. The

Committee is expected to submit its report by September 30, 2006.

Relief Measures for Natural Calamities

III.57 Standing guidelines have been issued by Reserve Bank to banks in August 1984 and June 1998 to be followed by them for providing relief in areas affected by natural calamities. These guidelines, *inter alia*, permit banks to convert/ reschedule loans for periods ranging from 3 to 9 years depending upon the successive crop failure/ intensity of damage to crops, grant fresh crop loans to affected farmers, convert principal as well as interest due on the existing loans, relax the security and margin norms, and provide consumption loans to the affected persons.

III.58 Consequent upon the loss of life and property caused by the *Tsunami* in the states of Andhra Pradesh, Tamil Nadu and Kerala, and the Union Territories (UTs) of Pondicherry, and Andaman and Nicobar Islands, the convenor banks of the State Level Bankers' Committees (SLBCs) in these states/UTs were advised to take measures to provide appropriate relief to the affected people in terms of the standing guidelines. A Task Force (Chairman: Shri V. Leeladhar) was formed on December 27, 2004 to monitor the progress of relief and rehabilitation measures through banks and to constantly review the situation. An Empowered Task Force to accelerate the resolution of relief measures to the *Tsunami* affected borrowers, adopting a bank specific approach, in the Union Territory of Andaman and Nicobar Islands was constituted in February 2006 under the chairmanship of the Regional Director, Reserve Bank of India, Kolkata. Taking note of the revival package announced by the Government of India for small traders and businessmen in Andaman and Nicobar Islands, the Task Force made the following additional recommendations:

- Given the fact that the extent of damage and destruction of life and property in the Southern Group of Islands comprising Little Andaman (in Andaman district) and entire Nicobar district was much more severe, compared to the damage in the Northern Group of Islands (caused more due to earthquake), there should be separate relief packages for the two groups of islands. Therefore, the Task Force recommended that there should be complete waiver of all loans irrespective of outstanding amounts in the Southern Group of Islands.
- Housing loans, in the personal segment, not covered by insurance claim payment may be considered for relief, as applicable to respective outstanding amounts envisaged in the revival package of the Government of India.
- Borrowers with outstanding loans above Rs.5 lakh in the Northern Group of Islands, except those under personal segment and covered by financial securities, should be given interest remission on the balance outstanding as on December 26, 2004 for one year up to December 31, 2005, subject to minimum benefit of Rs.1.80 lakh. Housing loans may also be included to the extent they were not covered by insurance claim payments.
- The entire additional burden arising out of implementation of the above recommendations may be considered by the banks/ other financial institutions at their option.

III.59 The convenor bank of the Union Territory Level Bankers' Committee (UTLBC) for the Union Territory of Andaman and Nicobar Islands has been advised that the recommendations of the Task Force may be brought to the notice of the banks in these areas for early implementation. Progress made in this regard may be invariably monitored in the UTLBC meetings.

III.60 There have been a spate of natural calamities during 2005-06 *viz*., floods in Maharashtra (July 2005), earthquake in Jammu & Kashmir (October 2005) and unprecedented rainfall in Tamil Nadu (November/ December 2005) claiming many lives and destroying wealth. In all the cases, the Reserve Bank advised the convenor bank of the SLBCs to assess the situation and take immediate measures to provide appropriate relief to the affected people in terms of standing guidelines on relief measures by banks in areas affected by natural calamities. The measures included rescheduling/ restructuring of existing loans; treatment of such loans as current dues; non-compounding of interest; financial assistance to artisans, self-employed, traders, tiny and small scale industrial units affected by the unprecedented calamity; increasing the limit of consumption loans; and financial assistance for the purpose of repairs/ reconstruction of dwelling units, *etc*.

Guidelines for Relief Measures by Banks to Poultry Industry

III.61 There have been instances of outbreak of Avian Influenza (commonly known as Bird Flu) in some areas of the country. Keeping in view the loss of income that had occurred due to culling of birds as well as steep fall in the demand for poultry products and their prices, banks were advised, *inter alia*, to consider (i) converting principal and interest due on working capital loans as also instalments and interest on term loans which have fallen due for payment on/after the onset of bird flu (February 1, 2006) and remaining unpaid into term loans and recovering such loans in instalments over a period up to three years with an initial moratorium of up to one year; (ii) rescheduling remaining portion of term loan with a moratorium period up to one year depending upon the cash flow generating capacity of the unit; and (iii) treating the rescheduled/converted loans as current dues. Banks were also advised that the borrower will be eligible for fresh need based finance and the relief measures may be extended to all accounts of poultry industry, which were classified as standard accounts as on March 31, 2006.

Kisan Credit Cards

III.62 The *Kisan* Credit Card (KCC) scheme was introduced in the year 1998-99 to enable the farmers to purchase agricultural inputs and draw cash for their production needs. During 2005-06, public sector banks issued 4.2 million KCCs. Since inception of the scheme, public sector banks have issued 21.8 million KCCs.

III.63 In order to safeguard the interest of the KCC holders by providing personal accident insurance coverage on an ongoing basis at competitive rates/ terms, banks have been given the discretion to approach either any general insurance company which is a member of GIPSA (General Insurer's [Public sector] Association of India) or any private sector general insurance company, to take advantage of the competitive offers. However, the banks have been advised that they may, while negotiating with the insurers, keep in mind the guiding principles of Personal Accident Insurance Scheme (PAIS), especially the aspects such as premium sharing formula and coverage. This "add on" benefit is expected to bring in an increasing number of farmers under the KCC fold, thereby leading to complete coverage.

Advisory Committee on Flow of Credit to Agriculture and Related Activities from the Banking System

III.64 The Advisory Committee on Flow of Credit to Agriculture and Related Activities from the Banking System (Chairman: Prof. V.S. Vyas), set up by the Reserve Bank, examined the problems relating to agricultural credit and made recommendations to address the issues. Out of 99 recommendations of the Committee, 32 recommendations were accepted and implemented by the Reserve Bank. The recommendation relating to an alternative to the present system of declaration of *Annewari* for providing relief measures by banks through rescheduling of loans in the case of natural calamities has been accepted and advised to banks for implementation. Accordingly, the District Collector, on occurrence of the natural calamity such as drought and flood may ask the Lead Bank Officer to convene a meeting of the District Consultative Committee (DCC), and submit a report to the DCC on the extent of crop loss in the area affected by the natural calamity. If the DCC is satisfied that there has been extensive crop loss on account of the natural calamity, the relief including conversion/restructuring facilities of agricultural loans as per the standing guidelines may be extended to the farmers affected by the natural calamity, without declaring *Annewari.* In respect of another 32 recommendations, either no action is necessary at this stage or action has already been initiated by NABARD.

Rural Infrastructure Development Fund (RIDF)

III.65 Domestic scheduled commercial banks, both in the public and private sector, having shortfall in lending to priority sector and/or agricultural lending target are required to deposit the shortfall in Rural Infrastructure Development Fund (RIDF) established with the NABARD at specified interest rates. The Fund has completed its eleventh year of operation. Out of the total corpus of RIDF (RIDF I to RIDF XI) of Rs.50,000 crore, cumulative sanctions and disbursements under various tranches of RIDF (RIDF I to XI) were Rs.51,283 crore and Rs.31,337 crore, respectively, as on March 31, 2006. In terms of the announcement made by the Union Finance Minister in his budget speech for the year 2006-07, RIDF XII has been set up with NABARD with a corpus of Rs.10,000 crore during the year 2006-07. Furthermore, a separate window will be opened under RIDF XII for financing of rural roads under *Bharat Nirman* with a corpus of Rs.4,000 crore during 2006-07. Specified projects under the Public Private Partnership (PPP) model will also be allowed to access RIDF funds.

Credit to Women

III.66 Public sector banks were advised to lend at least five per cent of their net bank credit to women. The credit extended to women by all public sector banks stood at 5.37 per cent of their overall net bank credit as at the end of March 2006. Twenty two public sector banks have achieved the above target as on March 31, 2006. Ten public sector banks have opened 17 specialised women branches.

Credit to Small Scale Industries

III.67 The total credit provided by public sector banks to Small Scale Industries (SSI) at end-March 2006 was Rs.82,492 crore, forming 8.1 per cent of their total bank credit and 20.1 per cent of their total priority sector advances. Of these, advances to cottage industries, artisans and tiny industries amounted to Rs.33,314 crore, constituting 40.4 per cent of the advances to the SSI sector. Credit extended by scheduled commercial banks to 1,38,039 sick SSI units stood at Rs.5,380 crore as at end-March 2005. Of these, 3922 units were found to be viable, with their outstanding bank credit at Rs.435 crore (8.1 per cent). Banks placed 2080 units involving outstanding credit of Rs.260 crore (4.8 per cent) under nursing programmes. Public sector banks were advised to operationalise at least one specialised SSI branch in every district and centre having cluster of SSI units. At end-March 2006, 629 specialised SSI bank branches had been operationalised by the banks.

III.68 With effect from October 26, 2004, the composite loan limits for SSI entrepreneurs have been raised from Rs.50 lakh to Rs.1 crore and investment by banks in securitised assets representing direct lending to the SSI sector is treated as their direct lending to SSI sector under priority sector. With effect from January 12, 2005, SSI investment limit in plant and machinery in respect of sports goods has been enhanced from Rs.1 crore to Rs.5 crore.

III.69 The tenure and interest rate on deposits placed by foreign banks with SIDBI on account of their shortfall towards priority sector lending have been revised. With effect from 2005-06, the amount of shortfall in priority sector obligation is being placed with SIDBI by foreign banks for a tenor of three years (as against the tenor of one year earlier) at a graded interest rate structure linked to the Bank Rate (Table 3.11).

III.70 As announced by the Reserve Bank in the Annual Policy Statement for 2005-06, a scheme for Small Enterprises Financial Centres (SEFCs) has been worked out and circulated to all scheduled commercial banks for implementation. Under the scheme, banks are encouraged to establish mechanisms for better coordination between their branches and of SIDBI, which are located in the clusters identified by the Ministry of SSI, Government of India for co-financing of SME sector (including tiny and services sector) on mutually agreeable operational modalities to be worked out by SIDBI and the strategic partner banks. 388 SSI clusters have been identified by United Nations Industrial Development Organisation (UNIDO) spread over 21 states in the country.

Debt Restructuring Mechanism for Small and Medium Enterprises

III.71 As part of the announcement made by the Union Finance Minister for improving flow of credit to small and medium enterprises (SMEs), a debt restructuring mechanism for units in SME sector was formulated for implementation by all scheduled commercial banks. Accordingly, detailed guidelines were issued to all scheduled commercial banks to ensure restructuring of debt of all eligible small and medium enterprises at terms which are, at least, as favourable as the Corporate Debt Restructuring mechanism in the banking sector. Banks may decide on the acceptable viability benchmark, consistent with the unit becoming viable in 7 years and the

Table 3.11: Interest Rate Structure for Foreign Banks' Deposits with SIDBI

Shortfall in Target*	Rate of interest on the entire deposit to be placed with SIDBI (Per cent per annum)
1	2
Less than 2 percentage points	Bank Rate (6 per cent at present)
2 and above, but less than 5 percentage points	Bank Rate minus 1 percentage point
5 and above, but less than 9 percentage points	Bank Rate minus 2 percentage points
9 percentage points and above	Bank rate minus 3 percentage points

* : Shortfall in overall target (32 per cent of net bank credit) or aggregate shortfall in sub targets SSI (10 per cent) and export credit (12 per cent), whichever is higher.

repayment period for restructured debt not exceeding 10 years. Banks are required to work out the restructuring package and implement the same within a maximum period of 60 days from date of receipt of requests.

Government Sponsored Schemes

III.72 Under the *Swarna Jayanti Gram Swarozgar Yojana* (SGSY), during 2005-06 (up to end-December 2005), a total number of 7,55,969 *Swarozgaris* received bank credit amounting to Rs.644 crore (and Government subsidy amounting to Rs.238 crore). Of the *Swarozgaris* assisted, 2,88,131 (38.1 per cent) were Scheduled Castes and Scheduled Tribes (SCs/STs), 4,72,972 (62.6 per cent) were women and 12,687 (1.7 per cent) were physically handicapped. Under the *Swarna Jayanti Shahari Rozgar Yojana* (SJSRY), disbursements amounting to Rs.93 crore were made in 30,420 cases (out of 77,408 applications received) during 2005-06 (up to December 2005). Of the above, Rs.23.7 crore was disbursed to 7,113 SCs/STs, Rs.21.7 crore to 6,785 women and Rs.1.7 crore to 442 disabled persons. Under the Scheme for Liberation and Rehabilitation of Scavengers (SLRS), out of the total 10,363 applications received, Rs.15.5 crore was sanctioned and Rs.10.9 crore was disbursed to 5,437 beneficiaries. Of the above, Rs.9.8 crore was disbursed to 4,702 SCs/STs and Rs.0.4 crore was disbursed to 517 OBCs during 2005-06 (up to December 2005). During the period, Rs.2.1 crore was disbursed to 1,148 women.

III.73 Assistance under the Prime Minister's *Rozgar Yojana* (PMRY) as at end-March 2006 amounted to Rs.761 crore for 1,31,290 beneficiaries. In the State of Himachal Pradesh, the condition that banks having less than 5 branches shall not be allocated targets under PMRY has been relaxed with effect from August 2005.

Differential Rate of Interest (DRI) Scheme

III.74 The outstanding advances of public sector banks under the DRI scheme as on the last reporting Friday of March 2006 amounted to Rs.490 crore under 3.89 lakh borrowal accounts, forming 0.07 per cent of the total advances outstanding as at the end of the previous year, as against the target of 1.0 per cent.

General Line of Credit (GLC) to NABARD

III.75 The Reserve Bank has been providing two General Lines of Credit (GLC) to NABARD under Section 17(4E) of the Reserve Bank of India Act 1934 to enable the latter to meet the short-term requirements of SCBs, state cooperative banks and RRBs. For the year 2005-06 (July-June), a GLC of Rs.3,000 crore was sanctioned at an interest rate of 6 per cent per annum for providing refinance to state cooperative banks and RRBs for seasonal agricultural operations. NABARD has been permitted to operate the GLC limit sanctioned for 2005-06 up to December 31, 2006. As the limit would not be available after this date, NABARD has been advised to start accessing the markets on a regular basis for sufficient amounts so that the time frame indicated for withdrawal of GLC is adhered to.

Package of Assistance for Sugar Industry

III.76 The Union Finance Minister in the Budget speech for the year 2005-06 had, on the basis of Tuteja Committee Report, announced that NABARD, in consultation with the State Governments, the Reserve Bank, banks and financial institutions will work out a scheme for providing a financial package for sugar industry. Accordingly, a Committee was set up in NABARD to work out a scheme/package of assistance for the sugar industry. The Committee had submitted its report to the Government on July 23, 2005. Under the package approved by the Government, cooperative sugar mills in the country which have term loans outstanding as on March 31, 2005, and which are commercially viable and have adequate operational surplus to repay the said term loans will be classified into two categories 'A' and 'B'. Category A will comprise the mills which can repay the term loan within a period of 5 years including a moratorium of two years for payment of interest and principal. Category B will comprise the mills which can repay the term loan within a period of 15 years including a moratorium of two years for payment of interest and principal. Accordingly, the term loans will be restructured/ rescheduled to enable repayment within five years (for Category A) or within 15 years (for Category B). The rate of interest on the restructured loans will be reduced to 10 per cent per annum with effect from April 1, 2005, irrespective of the original contractual rate. The Government of India will provide interest subvention on the restructured loan. The amount of interest subvention is estimated at Rs.525 crore.

Committee on Procedures and Performance Audit on Public Services (CPPAPS) – Study/Satisfaction Survey

III.77 The Committee on Procedures and Performance Audit on Public Services (CPPAPS)

(Chairman: S.S. Tarapore), in its Special Report No.8, had set out its comments/recommendations on the Reserve Bank report on the study of services to depositors and small borrowers in rural and semi-urban areas. In paragraphs 3.1 and 3.2 of the Report, it was observed that the kind of survey undertaken by the Reserve Bank should have twin objectives, *viz*. regional comparison of services and inter-bank comparison of services rendered by various banks on all-India basis. The Committee had suggested that the Reserve Bank may consider conducting a study over an appropriately enlarged size of sample to accomplish the objectives. The Committee had further recommended that the Reserve Bank should commission a full-fledged study over a larger sample on the basis of a revised questionnaire and the results should be analyzed to throw up regional and inter-bank comparison of services rendered by bank branches in rural and semi-urban centres. Accordingly, the National Council of Applied Economic Research (NCAER) has been requested to undertake a detailed study on services offered by commercial banks in the rural and semi urban areas of the country.

Expert Committee on Credit Deposit Ratio

III.78 The Government of India had appointed a Group of Experts (Chairman: Shri Y.S.P. Thorat) to go into the nature and magnitude of the problem of low credit deposit (CD) ratio across States/regions and to suggest steps to overcome the problem. The Expert Group examined the problems and causes of low CD ratio and submitted its report to the Government of India. The recommendations of the Group have since been examined and accepted by the Government of India with certain modifications. Accordingly, all scheduled commercial banks were advised in November 2005 that the CD ratio of banks should be monitored at different levels on the basis of the specified parameters (Table 3.12). On the basis of the recommendations, the banks have also been advised to set up Special Sub-Committees (SSCs) of the District Level Consultative Committee (DLCC) in districts having CD ratio of less than 40 per cent in order to monitor the CD ratio and to draw up Monitorable Action Plans to increase the CD ratio. 181 districts have been identified by the Reserve Bank as having CD ratio of less than 40 per cent as on March 31, 2006. So far, SSCs have been formed in 152 districts and steps have been initiated to constitute similar committees in the remaining 29 districts.

Table 3.12: Specification Parameters for Monitoring Credit-Deposit Ratio of Banks

Institution / Level	Indicator
1	2
Individual Banks at Head Office	Cu + RIDF
State Level (SLBC)	Cu + RIDF
District Level	Cs

Note : Cu= Credit as per place of utilisation.
Cs = Credit as per place of sanction.
RIDF = Total resource support provided to States under RIDF.

IV DEVELOPMENT AND REGULATION OF FINANCIAL MARKETS

IV.1 During 2005-06, a number of steps were taken to strengthen the institutional framework for financial markets in terms of instruments and processes so as to improve price discovery. Simultaneously, the orderly functioning and soundness of financial market segments has been pursued through regulatory initiatives. The policy initiatives during 2005-06 were particularly guided by provisions of the Fiscal Responsibility and Budget Management (FRBM) Act, 2003. The FRBM Act, *inter alia*, prohibits the Reserve Bank from participating in the primary market for Central Government securities with effect from April 2006. This development has completed the transition to a fully market based issuance of Government securities, a process that was initiated in the early 1990s with the introduction of auctions. The implementation of the FRBM Act also necessitated a review of the Reserve Bank's market operations. A Financial Markets Department (FMD) was set up in July 2005 to fully integrate market operations and improve efficiency in the Reserve Bank's operations in the money, Government securities and foreign exchange markets. An Informal Group to examine financial market operations by the Reserve Bank was also constituted to evaluate current practices in regard to market operations and refinements in the operating procedure in accordance with evolving circumstances.

IV.2 Against this backdrop, this Chapter presents the regulatory and developmental aspects of the Reserve Bank's oversight of the money, Government securities and foreign exchange markets in 2005-06. The review focuses on the various policy initiatives to widen and deepen the markets so as to improve the day-to-day functioning of market segments.

MONEY MARKET

IV.3 The money market provides a focal point for the central bank's operations in influencing liquidity and transmitting the monetary policy impulses. The broad policy objectives that are being pursued for the development of money market include ensuring stability in short-term interest rates, minimising default risk and achieving a balanced development of various segments of the money market. Following recommendations of the Technical Group on Money Market (May 2005), the focus and policy thrust of the Reserve Bank in the money market has been towards encouraging the growth of collateralised segment, developing the rupee yield curve, ensuring transparency and better price discovery, providing avenues for better risk management and strengthening monetary operations.

Call/Notice Money Market

IV.4 In pursuance of the recommendations of the Committee on Banking Sector Reforms (Chairman: Shri M. Narasimham) (1998), the process of transforming the call/notice money market into a pure inter-bank market was completed in August 2005. This has been supported by the development of a repo market outside the Reserve Bank in which non-bank participants are allowed to trade their surplus/deficit liquidity. Prudential limits have been placed on borrowings and lendings of banks and Primary Dealers (PDs) in the call/notice money market.

IV.5 Following the announcement in the Annual Policy Statement for 2005-06, a screen-based negotiated quote-driven system for dealings in call/ notice and term money market (NDS-CALL) has been developed by the Clearing Corporation of India Ltd. (CCIL). The introduction of NDS-CALL will make the deals transparent, enable better price discovery and improve the market microstructure. The system would be launched shortly with participation by market constituents on a voluntary basis.

IV.6 A noteworthy and desirable development during 2005-06 was the substantial migration of money market activity from the uncollateralised call money segment to the collateralised markets (see Chapter I). This shift has largely resulted from measures relating to limiting the call market transactions to banks and primary dealers (Box IV.1). In order to enable market participants to assess the liquidity conditions in an efficient and transparent manner, information on transactions in the collateralised segment of the money market is also being provided on the Reserve Bank's website since April 24, 2006.

Commercial Paper

IV.7 Information on commercial paper (CP) issuance as reported by the issuing and paying agents (IPA) on the negotiated dealing system (NDS) platform

Box IV.1

Money Markets: Changing Dynamics

Till mid-1980s, the Indian money market was constrained by a paucity of instruments and it was regulated heavily with regard to participants and interest rates. Pursuant to the recommendations of the Committee to Review the Working of the Monetary System (Chairman: Prof. Sukhamoy Chakravarty) (1985) and the Working Group on the Money Market (Chairman: Shri N. Vaghul) (1987), a number of measures were taken by the Reserve Bank to widen and deepen the money market through institution building and instrument development. The Discount and Finance House of India Ltd. (DFHI) set up jointly by the Reserve Bank, public sector banks and financial institutions commenced operations in April 1988 to deal in short-term money market instruments with the primary objective of improving liquidity. The introduction of new instruments, broadening of participants' base and strengthening of institutional infrastructure have been pursued during the 1990s based on the framework provided by the Vaghul Committee and the Narasimham Committee II.

Since 2000-01, a number of structural and instrument-specific measures taken by the Reserve Bank have contributed to the growth and sophistication of Indian money market. These include the introduction of Liquidity Adjustment Facility (LAF) effective June 5, 2000. Introduction of Collateralised Borrowing and Lending Obligation (CBLO) through the Clearing Corporation of India Limited (CCIL) from January 20, 2003 and expansion of repo market outside the LAF have also provided an avenue for bank and non-bank participants to trade funds after the conversion of call/money market into a pure inter-bank market. In order to broaden the market, non-scheduled urban cooperative banks and listed companies with gilt accounts with scheduled commercial banks have also been allowed to participate in the repo market outside the Reserve Bank. The minimum maturity period of CDs has been reduced to seven days effective April 29, 2005. The technological infrastructure, particularly with the introduction of Negotiated Dealing System (NDS), Real-Time Gross Settlement (RTGS) system and Centralised Funds Management System (CFMS) has brought about immense benefits to the money market. The functioning of the CCIL as central counterparty guaranteeing settlement for a substantial portion of trade in money, foreign exchange and Government securities market has also helped lowering risks and expanding volumes in money market.

The migration of money market activity from the uncollateralised call money segment to the collateralised segments – market repo and CBLO – has been driven by standardisation of accounting practices, broad- basing of eligibility criteria in the collateralised markets, the gradual phasing out of non-banks from the call money market, exemption of CBLO from CRR requirements and anonymity provided by the order matching systems. Availability of alternate avenues for mobilising short term funds like the market repo and CBLO has also led to market rates aligning to the informal interest rate corridor of repo and reverse repo rate under the LAF.

In recent years, mutual funds and insurance companies have emerged as the main supplier of funds in the repo and the CBLO markets. On the borrowing side, banks and PDs continue to be the major players, while corporates are emerging as significant borrowers in the CBLO segment. PDs are increasing their recourse to collateralised markets to meet their overnight borrowing needs.

In brief, various policy initiatives by the Reserve Bank have facilitated development of a wider range of instruments such as CBLO, market repo, interest rate swaps, CDs and CPs. This approach has avoided market segmentation while meeting demand for various products. These developments in money markets have enabled better liquidity management by the Reserve Bank.

References

1. Mohan, Rakesh (2006), "Coping with Liquidity Management in India: A Practitioner's View", Reserve Bank of India Bulletin, April.

2. Reserve Bank of India (2005), Technical Group on Money Market, May.

has been made available on the Reserve Bank's website with effect from July 2005 to enhance transparency and facilitate wider dissemination.

Certificates of Deposit

IV.8 The minimum maturity period of certificates of deposit (CDs) was reduced from 15 days to 7 days with effect from April 29, 2005 to align it with the minimum maturity of CPs and fixed deposits with banks.

GOVERNMENT SECURITIES MARKET

IV.9 In light of the FRBM Act under which the Reserve Bank can no longer participate in primary issues of Central Government securities from April 1, 2006, a number of initiatives were taken during 2005-06 to deepen and widen the Government securities market. Various initiatives during the year included permitting intra-day short sale; introduction of 'When Issued' markets; proposals for active consolidation of Government securities; greater responsibilities for PDs to support primary issuances, such as, 100 per cent underwriting commitments for PDs; allowing PDs to diversify and expand their business; and the operationalisation of NDS-Order Matching (NDS-OM) system.

Technical Advisory Committee

IV.10 During 2005-06, two meetings of the Technical Advisory Committee (TAC) on Money, Foreign Exchange and Government Securities Market were held. In the meeting held on April 12, 2005, the draft Report of the Technical Group on Central Government Securities Market was deliberated upon. In the meeting held on September 23, 2005, issues relating to discontinuation of trading in Government securities on Saturday, draft Report of the Sub-Group on Floating Rate Bonds, and permitted structure of PD business to include banks were discussed.

Operationalisation of NDS-Order Matching System

IV.11 As part of its long term objective of developing the Government securities market, the Reserve Bank had introduced the Negotiated Dealing System (NDS) in February 2002 with the broad objectives of (i) ushering in an automated electronic reporting and settlement process, (ii) facilitating electronic auctions and (iii) providing a platform for trading in Government securities on a negotiated basis as well as through a quote driven mechanism. NDS has helped in achieving paperless and straight-through settlement of secondary market transactions and has brought about significant improvements in transactional efficiency and transparency. However, the trading facilities on the NDS (both negotiated and quote driven) were hardly used, largely because they were less user-friendly. In order to provide NDS members with a more advanced and more efficient trading platform, and as recommended by the Working Group on Screen Based Trading in Government Securities (Chairman: Dr. R. H. Patil), the NDS-OM trading module was introduced effective August 1, 2005 (Box IV.2).

Standardisation of Settlement Cycle to T+1

IV.12 The settlement cycle for secondary market Government securities transactions has been standardised to T+1 cycle effective May 11, 2005 to provide the participants with more processing time and therefore, to enable better management of both funds as well as risk.

Box IV.2

NDS-Order Matching Trade Module (NDS-OM)

As part of its continuous endeavour to improve the facilities for trading and settlement in the Government securities market, the Reserve Bank operationalised an electronic order matching trade module for Government securities on its Negotiated Dealing System (RBI-NDS-GILTS-Order Matching Segment, NDS-OM in short) on August 1, 2005. The system is purely order-driven with all orders being matched based on strict price/time priority and the executed trades flowing straight to Clearing Corporation of India Ltd. (CCIL) in a ready-for-settlement stage. The NDS-OM system is an anonymous order matching system wherein identity of parties is not revealed. CCIL is the central counterparty to each trade done on the system. The NDS-OM system has been made available as an additional facility to the participants and the participants continue to have the option of using the current reporting and trading platform of the NDS. The settlement of both types of transactions are, however, integrated.

In the first phase of operationalisation of NDS-OM, only the Reserve Bank regulated entities, *i.e.,* banks, PDs and FIs were permitted to access the system. Subsequently, insurance companies were allowed access by permitting them (those which did not have a current account with the Reserve Bank) to open a special current account with the Reserve Bank. As announced in the Union Budget 2006-07, the access to NDS-OM has further been extended to all qualified mutual funds, provident funds and pension funds. While bigger participants in these categories can have a direct access to NDS-OM system by obtaining the direct membership to the same, smaller players will be allowed to access the system through their principal member (CSGL route). In the subsequent phases, the access to NDS-OM system would be extended to other participants as well. The increased participant base should improve liquidity thus providing better price discovery.

The NDS-OM system has been well received by the market participants. This system accounted for about 50 to 60 per cent of the total traded volume in Government securities.

Reference

Mohan, Rakesh (2006), “Recent Trends in the Indian Debt Market and Current Initiatives”, Reserve Bank of India Bulletin, April.

Extension of Ready Forward Contracts

IV.13 In order to further widen the repo market in Government securities, the participant base has been enlarged by including listed companies and non-scheduled urban cooperative banks effective May 11, 2005.

Sale of Auctioned Stock

IV.14 With a view to deepening the Government securities market and to enable the successful bidders to mitigate the price risk, the sale of Government securities allotted to successful bidders in primary issues on the day of allotment was permitted, with and between Constituents Subsidiary General Ledger (CSGL) account holders under Delivery *versus* Payment (D*v*P) III, effective May 11, 2005. Hitherto, the sale contract in respect of securities allotted to successful bidders in primary issues on the day of allotment could be entered into only between entities having SGL account and settled under the Reserve Bank's D*v*P system.

Primary Dealers

IV.15 The Reserve Bank's non-participation in primary auctions except under exceptional circumstances, effective April 2006, as required in the FRBM Act, has necessitated institutional changes to ensure that debt management objectives are met and the Government is able to borrow under all market conditions without exacerbating market volatility. The Reserve Bank's role in the primary market hitherto needed to be replaced by a more active and dynamic participation by PDs. Accordingly, the following measures have been undertaken:

- The permitted structure of PD business has been expanded to include banks, which fulfil certain minimum eligibility criteria. The guidelines for banks undertaking PD business were issued in February 2006, taking into account the views/ suggestions from banks and PDs (Box IV.3).
- For better risk management through generation of alternative streams of income, PDs have been permitted to diversify their activities in addition

Box IV.3

Guidelines for Banks' Undertaking PD Business

The permitted structure of Primary Dealership business has been expanded to include banks, subject to certain minimum eligibility criteria. Banks which do not, at present, have a partly or wholly owned subsidiary will be eligible to apply for PD licence if they fulfil the following criteria:

a) Minimum net owned funds (NOF) of Rs.1,000 crore;
b) Minimum CRAR of nine per cent; and
c) Net NPAs of less than three per cent and a profit making record for the last three years.

Indian banks which are undertaking PD business through a partly or wholly owned subsidiary will also be allowed to undertake PD business departmentally by merging/taking over PD business from their partly/wholly owned subsidiary subject to fulfilling the criteria at (a) to (c) above. Similarly, foreign banks operating in India will be permitted to undertake PD business departmentally by merging the PD business being undertaken by group companies subject to fulfilment of criteria at (a) to (c) above.

The Reserve Bank will grant authorisation to the eligible entities to undertake PD business for a period of one year (July-June) and thereafter, the Reserve Bank will review the authorisation on a yearly basis based on the performance criteria, such as underwriting in auctions of primary issuance of Government dated securities and Treasury Bills or fulfilment of bidding commitment and success ratio in the primary market and achieving the turnover ratio in the secondary market.

The Bank-PDs will be subject to underwriting and all other obligations as applicable to stand alone PDs and as may be prescribed from time to time. Furthermore, the banks will have to maintain separate books of accounts for transactions relating to PD business (distinct from the normal banking business) with necessary audit trails. It should be ensured that, at any point of time, there is a minimum balance of Rs.100 crore of Government securities earmarked for PD business.

The Bank-PDs will be subject to the following prudential norms:

- No separate capital adequacy is prescribed for PD business, and the capital adequacy requirement for a bank will also apply to its PD business.
- The Government dated securities and Treasury Bills under PD business will count for Statutory Liquidity Ratio.
- The investment valuation guidelines as applicable to banks in regard to "Held for Trading" portfolio will also apply to the portfolio of Government dated securities and Treasury Bills earmarked for PD business.
- Bank-PDs will not have separate access to call money market and Liquidity Adjustment Facility (LAF).
- The Reserve Bank's instructions to PDs would apply to Bank-PDs, to the extent applicable.

to their core business of Government securities, subject to limits. The guidelines covering regulatory and prudential norms were issued on July 4, 2006.

- Since the extant system of annual bidding commitments did not guarantee that the notified amount will be sold in each auction, a revised scheme for underwriting commitment and liquidity support to PDs has been introduced with effect from April 1, 2006. Under the scheme, PDs are required to meet an underwriting commitment, replacing the earlier requirement of bidding commitment and voluntary underwriting. The underwriting commitment is divided into two parts – minimum underwriting commitment (MUC) and additional competitive underwriting (ACU). The MUC of each PD is computed to ensure that at least 50 per cent of each issue is covered by the aggregate of all MUCs. The remaining portion of the notified amount is open to competitive underwriting under ACU.
- Liquidity support would be extended to stand alone PDs only. Of the total liquidity support, half would be divided equally among all the stand alone PDs and the remaining half would be extended on the basis of their performance in the primary auctions and turnover in the secondary market.

Short Sale in Government Securities

IV.16 In the absence of instruments that allow players to take a view on interest rates, it is observed that the markets are active and liquid when the rates fall but turn lacklustre and illiquid when the rates rise. Low volumes render markets shallow and prone to price manipulations. To enable participants to manage their interest rate risk more efficiently and to impart liquidity to the markets, even in a rising interest rate scenario, the Internal Technical Group on Central Government Securities Market recommended permitting short sales in Government securities in a calibrated manner. This would enable market participants to express their views on interest rate expectations and enable them to better manage their interest rate risk. Accordingly, on February 28, 2006, banks and PDs were allowed to undertake outright sale of Central Government dated securities that they do not own, subject to the same being covered by outright purchase from the secondary market within the same trading day. The intra-day short selling was permitted subject to certain stipulations in terms of stock-wise limits and overall risk limits. The subsequent phases of short sale are proposed to be implemented after assessing the feedback and experience with intra-day short selling.

Active Consolidation of Central Government Securities

IV.17 The Internal Technical Group on Central Government Securities Market had recommended active consolidation of securities in order to impart liquidity to the Government securities market, which would involve, in one form or another, buying back illiquid, small-sized securities and reissuing larger sized liquid securities in their place. Various alternatives of active consolidation have been worked out and the consolidation process would be taken up once the methodology is finalised.

Introduction of 'When Issued' Markets

IV.18 As part of restructuring the debt issuance framework in light of the FRBM Act and following the recommendations of the Internal Technical Group on Central Government Securities Market, 'When Issued' (WI) transactions have commenced in Central Government securities with effect from August 1, 2006. 'When Issued', a short form of 'when, as and if issued', indicates a conditional transaction in a security authorised for issuance but not as yet actually issued. All 'WI' transactions are on an 'if' basis, to be settled if and when the actual security is issued. 'WI' transactions have been permitted to be undertaken on NDS-OM platform after the necessary upgradation was done on NDS-OM. 'When Issued' market facilitates the distribution process for Government securities by stretching the actual distribution period for each issue and allowing the market more time to absorb large issues without disruption. Furthermore, it also enables price discovery process by reducing uncertainties surrounding auctions. As 'WI' transactions required specific exemption under Securities Contract Regulation Act (SCRA), 1956, the relevant Reserve Bank notification under SCRA has been amended.

FOREIGN EXCHANGE MARKET

IV.19 During 2005-06, the Reserve Bank took a number of steps to create a more conducive environment for external transactions while according high priority to customer service. The measures taken on the capital account front are part of gradual and sequenced approach to liberalisation of capital account and for the current account transactions, the objectives were aimed towards the removal of restrictions and simplification of procedures.

The procedure for compounding of contraventions was put in place with a view to reducing the transaction costs and providing comfort to the citizens and corporates. Anti-Money Laundering (AML) guidelines have been put in place for prevention of money laundering.

IV.20 Services are one of the fastest growing sectors in the Indian economy and contribute substantially to output, employment and exports. The Foreign Exchange Management Act (FEMA) regulations are, however, generally oriented to trade in both goods and services. The unique features of the services sector may need to be specifically and clearly addressed. It is, therefore, proposed to constitute an Advisory Group to review all foreign exchange regulations relating to services and make appropriate suggestions for further clarification or simplification and prepare a compendium of all foreign exchange regulations that apply to the services sector.

IV.21 For further deepening the foreign exchange market, the closing time for inter-bank foreign exchange market in India was extended by one hour up to 5.00 p.m. effective May 16, 2005.

Facilities for Resident Individuals

IV.22 With the progressive liberalisation in foreign exchange related transactions, a large segment of the population can undertake a variety of current account transactions without approaching the Reserve Bank. More entities are being allowed to handle non-trade current account transactions in order to enable individuals to have easy access to foreign exchange as well as to enhance competition among the service providers. In continuation of this process, select full fledged money changers (FFMCs), urban cooperative banks (UCBs) and regional rural banks (RRBs) were permitted to release/remit foreign exchange for a range of current account transactions such as private visits, business travel, fee for participation in global conferences/training/international events, film shooting, medical treatment, emigration and emigration consultancy fees.

IV.23 Prior permission from the Reserve Bank is not required by authorised dealers (ADs) for issue of Store Value Cards/Charge Cards/Smart Cards to residents travelling on private/business visit abroad for making payments to merchant establishment overseas and also for drawing cash from ATM terminals. However, the use of such cards is limited to permissible current account transactions and is subject to the limits prescribed under the current account transactions rules, as amended from time to time.

Facilities for Corporates

IV.24 It has been decided that establishment of Liaison Offices in India by foreign insurance companies may be allowed by Insurance Regulatory and Development Authority (IRDA).

IV.25 ADs have been allowed to open foreign currency accounts for the project offices established under the general/specific approval of the Reserve Bank as well as to permit intermittent remittances by project offices, without approval of the Reserve Bank, subject to certain conditions. Inter-project transfer of funds shall, however, require prior approval of the concerned regional office of the Reserve Bank. In case of disputes between the project office and the project sanctioning authority or other Government/ non-Government agencies, the balance held in such account shall be converted into Indian Rupees and credited to a special account and shall be dealt with as per the settlement of the dispute.

Facilities for Exporters and Importers

IV.26 With a view to further liberalise the facilities available to exporters/importers and simplify the procedures, following measures were undertaken during the year:

- ADs were permitted to grant extension of time for realisation of export proceeds up to US $ 1 million beyond the prescribed period of six months.
- The process to open Standby Letters of Credit for import of gold on loan basis was simplified and the period for fixing the price and repayment of gold loan was rationalised in consultation with the Central Government.
- ADs were allowed to permit airline companies to remit security deposits with lessor for payment of lease rentals of an aircraft/aircraft engine/ helicopter on operating lease subject to certain specific conditions.
- As per the existing guidelines, it was obligatory on the part of the ADs to follow up with the importers for submission of evidence of import where the value of foreign exchange remitted for import proceeds exceeded US $ 1,00,000. It was clarified that ADs need not follow up submission of evidence of import involving amount of US $ 1,00,000 or less provided they are satisfied about the genuineness of the transaction and the *bona fides* of the remitter.
- Residents in India were allowed to enter into contracts in commodity exchanges or markets

outside India to hedge the price risk on import/ export of a commodity, subject to certain conditions and reporting requirements. Powers were delegated to select commercial banks satisfying minimum prescribed norms to grant general permission to companies listed on a recognised stock exchange to hedge the price risk in respect of any commodity except gold, silver, petroleum and petroleum products in the international commodity exchanges/markets. The company is required to submit a board resolution indicating that it understands the risks involved in such transactions, the nature of hedge transactions that it would undertake in the ensuing year and that it would undertake hedge transaction only where it is exposed to price risk. However, the ADs may refuse to undertake any hedge transaction in case of doubt about the *bona fides* of the transaction or if the corporate is not exposed to price risk.

- Powers were granted to AD banks to grant GR approval in cases where goods are being exported for re-import after repairs / maintenance / testing / calibration, *etc.,* subject to the condition that the exporter shall produce the relative Bill of Entry within one month of re-import of the item exported from India. If goods being exported for testing are destroyed during testing, AD banks may, in lieu of Bill of Entry for import, obtain a certificate issued by the testing agency that the goods were destroyed during testing.

Overseas Investment

IV.27 To enable Indian companies to reap benefits of globalisation, and to promote Indian investment abroad, the limit of overseas investment in any *bona fide* business activity, under the automatic route, has been raised from 100 per cent of net worth of the Indian entity to 200 per cent of its net worth, as on date of its last audited balance sheet. In addition to the existing facility of making investments in Indian Rupees, investments in Bhutan can now be made in any freely convertible foreign currency. However, all dues receivable on such investments including winding up and sale proceeds should be repatriated to India in freely convertible currencies only.

IV.28 The scope of guarantees under the automatic route for overseas investment has been enlarged and Indian entities are now allowed to offer other forms of guarantee – corporate or personal/primary or collateral/ guarantee by the promoter company/guarantee by group company, sister concern or associate company in India – subject to certain conditions.

IV.29 In order to enable companies to have operational flexibility, the automatic route of disinvestment has been further liberalised by allowing following categories of companies to divest, without prior approval of the Reserve Bank, subject to reporting requirement: (i) cases where Joint Ventures (JV)/ Wholly Owned Subsidiaries (WOS) are listed in the overseas stock exchanges, (ii) cases where the Indian promoter company is listed on a stock exchange in India and has a net worth of not less than Rs.100 crore, and (iii) cases where the Indian promoter is an unlisted company and the investment in overseas venture does not exceed US $ 10 million.

IV.30 With a view to enabling recognised star exporters with a proven track record and consistently high export performance to reap the benefits of globalisation and liberalisation, proprietary/ unregistered partnership firms, satisfying certain eligibility criteria, have been allowed to set up a JV/WOS outside India with prior approval of the Reserve Bank.

IV.31 AD banks have been permitted to allow remittance for expenses of branch offices opened abroad up to 10 per cent for initial and up to five percent for recurring expenses of the average annual sales/income or turnover during last two accounting years subject to the existing terms and conditions.

IV.32 AD banks have been allowed remittances for acquiring shares under Employees Stock Option Plan (ESOP) schemes, irrespective of the method of the operationalisation of the scheme, subject to certain specific conditions.

Foreign Investment in India

IV.33 Foreign direct investment (FDI) limit in the petroleum sector and air transport services (domestic airlines), under the automatic route, has been further liberalised. FDI up to 100 per cent has been permitted under the automatic route in petroleum product marketing, oil exploration in both small - and medium - sized fields and petroleum product pipelines. In air transport services (domestic airlines) sector, FDI up to 100 per cent has been permitted under the automatic route by Non-Resident Indians (NRIs) and up to 49 per cent by others. No direct or indirect equity participation by foreign airlines is allowed. FDI up to 100 per cent has been permitted in townships, housing, built-up infrastructure and construction development projects under the automatic route, subject to certain guidelines.

IV.34 FDI and portfolio investment are now permitted in an Indian company publishing newspapers and periodicals dealing with news and current affairs within a composite ceiling of 26 per cent of the paid-up capital of the company, subject to the guidelines issued by the Ministry of Information and Broadcasting. As such, foreign institutional investors (FIIs), NRIs and foreign venture capital investors are now allowed to purchase shares of an Indian company engaged in print media sector.

IV.35 Persons/entities eligible under the FDI route other than FIIs have been permitted to invest in the equity capital of asset reconstruction companies (ARCs) registered with the Reserve Bank. FIIs registered with the Securities and Exchange Board of India (SEBI) are allowed to invest in security receipts (SRs) issued by ARCs registered with the Reserve Bank up to 49 per cent of each tranche of scheme of SRs subject to the condition that investment of a single FII in each tranche of scheme of SRs should not exceed 10 per cent of the issue.

External Commercial Borrowings (ECB)

IV.36 Relaxations in regard to access to ECBs were allowed in certain cases as follows:

- NGOs engaged in micro finance activities were permitted to raise ECBs up to US $ 5 million during a financial year for permitted end-use, under the automatic route. NGOs having satisfactory borrowing relationship of at least three years with a scheduled commercial bank authorised to deal in foreign exchange and 'fit and proper' status of the board/management committee, would be eligible to avail ECBs, subject to certain conditions.
- Non-banking financial companies (NBFCs) were allowed to raise ECBs with a minimum average maturity of five years from certain category of lenders under the approval route, to finance import of infrastructure equipment for leasing to infrastructure projects.
- Housing finance companies satisfying certain criteria were allowed to raise Foreign Currency Convertible Bonds with prior approval of the Reserve Bank.
- In order to facilitate capacity expansion and technological upgradation in the Indian textile industry after the phasing out of Multi-Fibre Agreement (MFA), banks were allowed to issue guarantees / standby letters of credit / letters of undertaking / letters of comfort in respect of ECBs by textile companies for modernisation or expansion of their textile units.
- AD banks were permitted to allow prepayment of ECBs up to US $ 200 million against the existing limit of US $ 100 million.
- Special Purpose Vehicles (SPVs) or any other entity notified by the Reserve Bank set up exclusively to finance infrastructure companies/ projects will also be treated as financial institutions and ECBs by such entities will be considered under the approval route on a case by case basis.
- Multi-State cooperative societies engaged in manufacturing activities were allowed to raise ECBs under the approval route subject to the other parameters of the ECB guidelines.

Facilities for Non-resident Indians and Persons of Indian Origin

IV.37 NRIs/PIOs are permitted to remit an amount not exceeding US $ 1 million, per calendar year, out of balances held in Non-Resident Ordinary (NRO) account/sale proceeds of assets/ assets in India acquired by them by way of inheritance/legacy, on production of certain documents. The facility available under inheritance/legacy has been extended to an arrangement under a "settlement" whereby the property is passed on to the legatees during the lifetime of the owner/parent who normally retains a life interest in the property since "settlement" is also a mode of inheritance from the parent, the only difference being that the property under the "settlement" passes to the beneficiary on the death of the owner/parent without any legal procedures/hassles. This helps in avoiding delay and inconvenience in applying for probate. Accordingly, banks authorised to deal in foreign exchange were allowed remittance facility to a NRI/PIO under a deed of settlement made either by his parents or close relatives (as defined in Section 6 of the Companies Act, 1956). The remittance facility would be available only on demise of the settler.

Anti-Money Laundering (AML) Guidelines for Authorised Money Changers (AMCs)

IV.38 In view of the increased concerns regarding money laundering activities and to prevent AMCs from being misused for such activities, the Reserve Bank has brought out detailed Anti-Money Laundering (AML) guidelines to enable AMCs to put in place the policy framework and systems for prevention of money laundering while undertaking money exchange transactions. All AMCs will formulate suitable policies and procedures for the AML measures which include (i) "Know your Customer" norms, (ii) recognition, handling and disclosure of suspicious transactions, (iii) appointment of Money Laundering Reporting Officer (MLRO), (iv) staff training, (v) maintenance of records, and (vi) audit of transactions in accordance with the guidelines issued. The AML policy framework and measures were to be formulated and put in place before March 31, 2006 with the approval of the board of directors of the AMC. The AML guidelines were further amended in view of the difficulties expressed by AMCs in implementing some of the guidelines. According to the amended instructions: (i) for purchase of foreign exchange less than US $ 200 or its equivalent, photocopies of the identification document need not be kept on record; however, full details of the identification document should be maintained; (ii) for encashment of foreign exchange between US $ 200 and US $ 2,000 or its equivalent, the photocopies of the identification document should be maintained for one year and completion of statutory audit; (iii) for encashment in excess of US $ 2,000 or its equivalent, the photocopies of the identification document should be maintained for a minimum period of five years; and (iv) requests for payment in cash by foreign visitors / NRIs may be acceded to the extent of US $ 2,000 or its equivalent.

Committee on Fuller Capital Account Convertibility

IV.39 India's cautious approach towards opening of the capital account and viewing capital account liberalisation as a process contingent upon certain preconditions has stood India in good stead. Given the changes that have taken place over the last two decades, a need was felt to revisit the subject and come out with a road-map towards fuller capital account convertibility based on current realities. In consultation with the Government of India, the Reserve Bank, therefore, in March 2006, appointed a Committee on Fuller Capital Account Convertibility under Chairmanship of Shri S.S Tarapore. The terms and conditions the Committee were:

- To review the experience of various measures of capital account liberalisation in India,
- To examine implications of fuller capital account convertibility on monetary and exchange rate management, financial markets and financial system,
- To study the implications of dollarisation in India of domestic assets and liabilities and internationalisation of the Indian rupee,
- To provide a comprehensive medium-term operational framework, with sequencing and timing, for fuller capital account convertibility taking into account the above implications and progress in revenue and fiscal deficits of both Centre and States,
- To survey regulatory framework in countries which have advanced towards fuller capital account convertibility,
- To suggest appropriate policy measures and prudential safeguards to ensure monetary and financial stability, and
- To make such other recommendations as the Committee may deem relevant to the subject.

The Committee submitted its Report on July 31, 2006. The Reserve Bank will place the Report in the public domain in due course.

Outlook

IV.40 The Reserve Bank will continue with its efforts to deepen and widen the various segments of the financial markets in order to enable efficient price discovery in interest rate and exchange rate markets. In regard to foreign exchange market, the calibrated liberalisation of capital account transactions will be continued. Given the fact that the Reserve Bank is not participating in primary issuance of Central Government securities with effect from April 1, 2006 and States will have to be more market dependent, this situation calls for a paradigm shift in the Government securities market. The Reserve Bank will, therefore, continue to take initiatives to widen and deepen the market so as to ensure that the borrowing programme of the Government is successfully carried out and the cost of borrowing is also kept at a reasonable level.

V FINANCIAL REGULATION AND SUPERVISION

V.1 The Reserve Bank undertook various measures during 2005-06 to strengthen the financial sector with a view to maintaining financial stability. Various policy initiatives during 2005-06 were guided by the need to prepare the commercial banks for implementation of Basel II. In view of the enlarged capital requirements under Basel II, banks were permitted to raise capital through new instruments. In order to provide a benchmark for banks to establish a scientific operational risk management framework, a guidance note was issued to banks. In the context of sharp growth in bank credit to a few sectors, prudential measures were tightened for the specific sectors to safeguard the health of the banking system. Concomitantly, the Reserve Bank laid an increasing emphasis on financial inclusion to provide the financial services to vast segments of the population. Apart from scheduled commercial banks, which are the dominant players in the financial sector, initiatives to strengthen other segments of the banking system were intensified. In the case of regional rural banks, the focus was on amalgamations for improving the efficiency of their operations. In regard to urban cooperatives banks, memoranda of understanding have been signed between the Reserve Bank and a few State Governments to overcome, to an extent, the problem of dual control. In the case of non-banking financial companies, the reporting system for large non-deposit taking companies was strengthened to facilitate macro-level assessment.

V.2 These regulatory and supervisory policy initiatives of the Reserve Bank during the year 2005-06 are presented in this Chapter. It reviews the policy measures to strengthen the financial sector in the light of the implementation of Basel II from March 2007. Efforts for greater financial inclusion and steps to improve customer service measures by the Reserve Bank are also covered in this Chapter. Finally, this Chapter provides an assessment of the banking sector in terms of macro-prudential indicators.

REGULATORY FRAMEWORK FOR THE INDIAN FINANCIAL SYSTEM

V.3 The Reserve Bank continued to exercise its supervisory role over the financial system encompassing commercial and urban cooperative banks (UCBs), financial institutions, non-banking financial companies (NBFCs) and primary dealers (PDs) through the Board for Financial Supervision (BFS). As on March 31, 2006, there were 89 scheduled commercial banks [excluding regional rural banks (RRBs)], 133 RRBs, 1,864 UCBs, 8 development finance institutions (DFIs), 13,049 NBFCs (of which 434 NBFCs are permitted to accept/ hold public deposits) and 17 PDs. The BFS, constituted as a Committee of the Central Board of the Reserve Bank since November 1994, is headed by the Governor with a Deputy Governor as Vice Chairperson and other Deputy Governors and four Directors of the Central Board as members. The BFS provides direction on a continuing basis on regulatory polices and supervisory practices. In respect of State and district central co-operative banks, and regional rural banks, while the Reserve Bank is the regulator, the supervision is vested with the National Bank for Agriculture and Rural Development (NABARD). Insurance companies and mutual funds are regulated by the Insurance Regulatory and Development Authority (IRDA) and the Securities and Exchange Board of India (SEBI), respectively. A coordinated approach to supervision is ensured through a High-Level Coordination Committee on Financial Markets with the Governor of the Reserve Bank, as Chairman, and the chiefs of SEBI, IRDA and Pension Fund Regulatory and Development Authority (PFRDA), and the Secretary, Economic Affairs, Ministry of Finance, Government of India as the members.

V.4 During the year (July 2005 - June 2006), the BFS held 13 meetings and examined 57 inspection reports. The findings of on-site inspection of the Clearing Corporation of India Ltd. and the follow up actions taken were also reviewed by the BFS. Besides delineating the course of action to be pursued in respect of institution-specific supervisory concerns, the Board provided guidance on several regulatory and supervisory policy decisions.

V.5 As a result of the continued oversight by the BFS, there has been considerable overall improvement in the banking system particularly in housekeeping, internal controls and quality of assets in banks. During 2005-06, the Board focused its attention on a number of issues. First, the Board stressed the importance of good corporate governance in financial institutions. It was decided that banks that have governance concerns because of dominant ownership or other reasons should be kept under close monitoring. The Board, therefore, emphasised the desirability of diversified ownership in banks, 'fit and proper' status of important shareholders, directors, CEO and the need for a minimum capital/net worth criteria. In case of public sector banks, the Government of India was requested to set up a new 'Board' on the lines of Public Sector Enterprises Board, for recommending to the Government the appointment of CMDs and EDs and directors. It was also suggested to the Government to extend the 'fit and proper status' guidelines prescribed for private sector banks to the public sector banks, with a view to attaining higher standards of 'corporate governance'.

V.6 Second, the Board's concern for continuity of a healthy and vibrant financial sector and a robust regulatory and supervisory regime translated into issue of several important guidelines during the year. Guidelines on credit cards were issued in November 2005 covering issues such as unsolicited cards and disclosure of various charges including interest charged on an annualised basis. Guidelines were also issued laying down the process for mergers, determination of swap ratios and disclosures. Furthermore, guidelines for purchase/sale of non-performing financial assets by banks, including valuation and pricing aspects and prudential norms were finalised. Draft guidelines on outsourcing of services by banks were placed on the Reserve Banks website inviting feedback/suggestions for issue of final instructions.

V.7 Finally, since the financial sector in India has become increasingly complex due to the proliferation of financial groups, the Reserve Bank in consultation with SEBI and IRDA has identified certain groups as financial conglomerates and also put in place an oversight framework for their monitoring. The financial conglomerate monitoring system envisages submission and analysis of quarterly returns on intra-group transactions and exposures, exposures to various segments of financial markets and information on cross-share holding/commonality of back office arrangements by the conglomerates to their principal regulators. The oversight framework was further strengthened with the launch of half-yearly discussion meetings in 2005-06 with the conglomerates attended by all the regulators.

REGULATORY AND SUPERVISORY INITIATIVES

Commercial Banks

V.8 As at end-March 2006, there were 89 scheduled commercial banks (excluding RRBs) comprising 28 public sector banks, 28 private banks, 29 foreign banks and four local area banks.

Strengthening Prudential Norms

V.9 The Committee on Banking Sector Reforms (Chairman: Shri M. Narasimham) had recommended that, as a prudential measure, a general provision of one per cent of standard assets would be appropriate and this should be implemented in a phased manner. To maintain asset quality in the light of high credit growth during 2005-06, provisioning requirements were tightened in two stages. In November 2005, the provisioning requirement on standard assets, with the exception of direct advances to agricultural and small and medium enterprise (SME) sectors, was raised from 0.25 per cent to 0.40 per cent of the funded outstanding on global loan portfolio basis. In May 2006, the provisioning requirement on standard advances in specific sectors, *i.e.*, personal loans, loans and advances qualifying as capital market exposures, residential housing loans beyond Rs.20 lakh and commercial real estate loans was raised from 0.40 per cent to 1.0 per cent. As hitherto, these provisions would be eligible for inclusion in Tier II capital for capital adequacy purposes up to the permitted extent.

V.10 In order to provide banks additional options for raising capital funds for smooth transition to Basel II, banks were allowed to augment their capital funds by issue of additional instruments (Box V.1).

V.11 Risk weights were tightened during the year for some sensitive sectors. In view of the sharp growth in bank credit to commercial real estate, the risk weight on banks' exposure to the commercial real estate was increased from 100 per cent to 125 per cent in July 2005 and further to 150 per cent in April 2006. Furthermore, banks have been advised that while appraising loan proposals involving real estate, they should ensure that the borrowers have obtained prior permission from government/local governments/ other statutory authorities for the project, wherever required. In order that the loan approval process is not hampered on account of this, while the proposals could be sanctioned in the normal course, the disbursements should be made only after the borrower has obtained the requisite clearances from the government authorities (Box V.2).

Box V.1
Enhancement of Capital Raising Options for Capital Adequacy Purposes

With the transition to the new capital adequacy framework (Basel II) scheduled for March 2007, banks would need to further shore up their capital funds to meet the requirements under the revised framework. Under Basel II, the capital requirements are not only more sensitive to the level of credit risk but also apply to operational risks. Thus, banks would need to raise additional capital on account of market risk, Basel II requirements, and to support the expansion of their balance sheets.

While equity is the purest form of capital, the Basel prescriptions recognise other instruments as eligible for inclusion as capital for capital adequacy purposes. The instruments that are generally recognised as capital have various features of equity built into them which take them closer to equity in substance and give the regulator the comfort that these will be available to absorb losses, when required. At the same time, the features of debt present in these instruments - like maturity, call option and coupon - help the issuer to raise capital funds through these instruments at a cost lower than that of equity. The advantages with these instruments are that these are non-dilutive and cost effective.

Taking into account these considerations, the Reserve Bank, in January 2006, allowed Indian banks to augment their capital funds by issue of the following additional instruments: (a) innovative perpetual debt instruments (IPDI) eligible for inclusion as Tier I capital; (b) debt capital instruments eligible for inclusion as Upper Tier II capital; (c) perpetual non-cumulative preference shares eligible for inclusion as Tier I capital subject to laws in force from time to time; and (d) redeemable cumulative preference shares eligible for inclusion as Tier II capital subject to laws in force from time to time.

The basic features/minimum regulatory requirements in respect of IPDI for inclusion as Tier I and debt capital instruments eligible for inclusion as Tier II capital are as under :

Feature	Innovative Perpetual Debt Instruments	Debt Capital Instruments
Limits	Shall not exceed 15 per cent of total Tier I capital	Shall not exceed 100 per cent of Tier I capital along with other components of Tier II capital.
Maturity	Perpetual	Minimum 15 years
Put option	Not available	
Call option	Available after ten years with the approval of the Reserve Bank.	
Step up option	Available only once during the life of the instrument, in conjunction with the call option, after lapse of ten years from the date of issue. The step-up shall not be more than 100 basis points.	
Loss absorption	Interest due will not be payable and will be non-cumulative if CRAR is/will be less than minimum prescribed.	Interest due and principal on redemption will be deferred, but would be cumulative for interest, if CRAR is/ will be less than the minimum prescribed.
	Banks may be allowed to pay with the prior approval of the Reserve Bank when the payment of interest will result in net loss/ increase net loss provided CRAR remains above the regulatory norm.	
Seniority of claim	Superior to the claims of investors in equity shares; and Subordinate to the claims of all other creditors.	Superior to the claims of investors in equity shares and in instruments eligible for inclusion in Tier I capital; and Subordinate to the claims of all other creditors
Discount for the purpose of capital adequacy	Not subjected to progressive discount.	Progressive discount at 20 per cent per year in the last five years before maturity.
FII/NRI Investment	Investment in these instruments by FIIs and NRIs shall be within an overall limit of 49% and 24% of the issue, respectively, subject to the investment by each FII not exceeding 10 % of the issue and investment by each NRI not exceeding 5% of the issue. Investment by FIIs shall be outside the limit for investment in corporate debt instruments *i.e.*, US $ 1.5 billion	Investment by FIIs in Upper Tier II Instruments raised in Indian Rupees shall be outside the limit for investment in corporate debt instruments i.e, US $ 1.5 billion. However, investment by FIIs in these instruments will be subject to a separate ceiling of US $ 500 million. NRIs shall be eligible to invest in these instruments as per existing policy.
Issue of these instruments in foreign currency.	Not more than 49% of the eligible amount can be issued in foreign currency.	The total amount of Upper Tier II Instruments issued in foreign currency shall not exceed 25% of the unimpaired Tier I capital. This limit will be distinct from other limits in foreign currency borrowings by authorised dealers.
CRR/SLR requirements	Will not attract CRR/SLR requirements.	Will attract CRR/SLR requirements.

Foreign banks in India are allowed to raise Head Office borrowings in foreign currency for inclusion in Tier I capital and in upper Tier II capital subject to the same terms and conditions as above. Detailed guidelines regarding perpetual non-cumulative preference shares eligible for inclusion as Tier I capital and redeemable cumulative preference shares eligible for inclusion as Tier II capital will be issued separately as appropriate in due course.

Box V.2

Banks' Exposure to Real Estate Sector - Risk Management and Checks

Given the volatile nature of real estate prices, central banks across the world treat exposures to real estate as a sensitive sector. The concern stems from the adverse consequences on banks' balance sheets in the event of a meltdown in the prices of such assets. Large flow of bank funds to the real estate sector runs the risk of fuelling prices further.

Banks/financial institutions, therefore, need to develop proper risk management systems, as part of their overall strategy, before undertaking any exposure to this sector. It is advisable that banks have a Board mandated policy in respect of their real estate exposures. The policy may include, among other things, permissible exposure limits, collaterals to be considered, margins to be kept, sanctioning authority/level and sector to be financed. The actual limits/margins may vary from bank to bank depending upon the individual bank's portfolio size, risk appetite and risk containing abilities. While a bank may specify an overall internal limit for this sector as a whole, it should also specify sub-limits for each individual sub-sectors of the real estate sector. The risk management system should specifically address the price risk involved in this sector. For ensuring these, banks need to develop effective Management Information System (MIS) to have accurate and timely data on their actual exposure and also a proper monitoring mechanism to ensure that the policy stipulations are being followed by field level functionaries and that their actual exposures, overall as well as segment-wise, are within the stipulated limits.

As part of its regulatory responsibilities, the Reserve Bank has been collecting and analysing data on the banks' exposures to this sector under its off-site monitoring mechanism. In view of the sharp increase in growth of such advances in recent period, banks have been advised to have a proper risk management system in place to contain the risks involved. Banks have also been advised to put in place a system for ensuring proper checking and documentation of related papers before sanctioning/ disbursing of such loans. Owing to the perceived risks involved in this sector, 'risk weights' for real estate advances have been increased.

V.12 With effect from July 26, 2005, the risk weight for credit risk on certain capital market exposures was increased from 100 percent to 125 percent. Capital market exposures subject to higher risk weights included: (i) direct investment by a bank in equity shares, convertible bonds and debentures and units of equity oriented mutual funds; (ii) advances against shares to individuals for investment in equity shares [including Initial Public Offerings (IPOs)/ Employee Stock Option Plans (ESOPs)], bonds and debentures and units of equity oriented mutual funds; and (iii) secured and unsecured advances to stock brokers and guarantees issued on behalf of stock brokers and market makers.

V.13 Venture capital funds (VCFs) play an important role in encouraging entrepreneurship. While significance of venture capital activities and need for banks' involvement in financing venture capital funds is well recognised, there is also a need to address the relatively higher risks inherent in such exposures. In the absence of adequate public disclosures with regard to performance/asset quality of VCFs, prudence demands treatment of exposures to VCFs as 'high risk'. Accordingly, in May 2006, it was decided that a bank's total exposure to venture capital funds will form a part of its capital market exposure and banks are, therefore, required to assign a higher risk weight of 150 per cent to these exposures.

V.14 The Basel Committee on Banking Supervision (BCBS) had issued the 'Amendment to the Capital Accord to Incorporate Market Risks' containing comprehensive guidelines to provide explicit capital charge for market risks in 1998. Pending adoption and prescription of these guidelines for banks in India, the Reserve Bank had as an initial step advised banks to: i) assign an additional risk weight of 2.5 per cent on the entire investment portfolio; ii) assign a risk weight of 100 per cent on the open position limits on foreign exchange and gold; and iii) build up Investment Fluctuation Reserve (IFR) up to a minimum of five per cent of the investments held in Held for Trading (HFT) and Available for Sale (AFS) categories in the investment portfolio. With a view to ensuring smooth transition to Basel II norms, banks were advised in 2004 to maintain capital charge for market risk in a phased manner over a two year period: i) in respect of securities included in the HFT category, open gold position limit, open foreign exchange position limit, trading positions in derivatives and derivatives entered into for hedging trading book exposures by March 31, 2005, and ii) in respect of securities included in the AFS category by March 31, 2006. Banks were advised in October 2005 that they may treat the entire balance held in IFR as Tier I capital, provided they have maintained capital of at least 9 per cent of the risk weighted assets for both credit risk and capital charge for market risk as prescribed above. For this purpose, banks may have to transfer the balance in the IFR 'below the line' in the Profit and Loss Appropriation Account to Statutory Reserve, General Reserve or balance of Profit & Loss Account. In the event that the provisions created on account of depreciation in the AFS or HFT categories are found to be in excess of the required amount in any year, the excess should be credited to the Profit and Loss account and an equivalent amount (net of taxes, if any and net of transfer to statutory reserves as applicable to such excess provision) should be appropriated to an Investment Reserve Account in Schedule 2 – "Reserves & Surplus" under the head "Revenue and other Reserves" and would be eligible for inclusion under Tier II within the overall ceiling of 1.25 per cent of total risk weighted assets prescribed for General Provisions/ Loss Reserves.

V.15 In partial modification of the guidelines dated March 15, 2005 on compliance with Accounting Standard (AS) 11 (dealing with the effects of changes in foreign exchange rates), the threshold limits relating to recording the foreign currency transactions at the date of the transaction were revised and banks were advised that:

(i) the weekly average closing rate of the preceding week would not be considered for approximating the actual rate at the date of the transaction if the difference between (a) the weekly average closing rate of the preceding week and (b) the exchange rate prevailing at the date of the transaction is more than three and a half percent of (b);

(ii) in respect of non-integral foreign operations, the quarterly average closing rate would not be considered for approximating the actual rate at the date of the transaction, if the difference between (a) the quarterly average closing rate and (b) the exchange rate prevailing at the date of the transaction is more than seven percent of (b).

Banks were, however, encouraged to equip themselves to record the foreign currency transactions of Indian branches as well as integral foreign operations and translate the income as well as expense items of non-integral foreign operations at the exchange rate prevailing on the date of the transaction.

V.16 The market for securitisation of standard assets has grown significantly in recent years. In order to ensure orderly development of the market, the Reserve Bank had issued draft guidelines on securitisation of standard assets in April 2005. Based on the feedback, the draft guidelines were suitably modified and the final guidelines on securitisation of standard assets as applicable to banks, financial institutions and non-banking financial companies were issued. The final guidelines applicable from February 1, 2006 include, *inter alia*, the criteria for 'true sale', the criteria that should be met by the SPV to enable the originator to avail off-balance sheet treatment for the assets securitised, policies on provision of credit enhancement/liquidity/underwriting facilities and services, prudential norms for investment in securities issued by SPV, and accounting treatment of the securitisation transactions and disclosures. As regards criteria for true sale, the guidelines, *inter alia*, indicate that (i) the sale should result in immediate legal separation of the originator from the assets that are sold to the new owner *viz.*, the SPV; the assets should stand completely isolated from the originator after its transfer to the SPV, *i.e.*, put beyond the originator's as well as their creditors' reach, even in the event of bankruptcy of the originator; (ii) the originator should effectively transfer all risks/rewards and rights/obligations pertaining to the asset and shall not hold any beneficial interest in the asset after its sale to the SPV and the SPV shall have no recourse to the originator for any expenses or losses except those specifically permitted under these guidelines; and (iii) the securities issued by the SPV shall not have any put options. The securities may have a call option to address the pre-payment risk on the underlying assets.

V.17 Globally, banks are increasingly relying on outsourcing as a means of reducing costs as well as accessing external expertise. At the same time, outsourcing is associated with certain risks, *viz.*, strategic risk, reputation risk, compliance risk, operational risk, exit strategy risk, counterparty risk, country risk, contractual risk, access risk concentration and systemic risk. The failure to manage these risks could lead to financial losses/reputational risk for the bank and systemic risks within the banking system. It is, therefore, imperative for the banks outsourcing their activities to ensure effective management of these risks. In view of this, the Reserve Bank in December 2005 released draft guidelines for outsourcing of financial services by banks.

V.18 In terms of the Rules notified by the Government under the Prevention of Money Laundering Act (PMLA) 2002, a Financial Intelligence Unit-India (FIU-IND) has been set up to collect, compile, collate and analyse the cash and suspicious transactions reported by banks and financial institutions. The Reserve Bank has advised banks that Cash Transaction Report (CTR) for each month should be submitted to FIU-IND by 15th of the succeeding month, and the Suspicious Transaction Report (STR) should be furnished within 7 days of arriving at a conclusion that any transaction, whether cash or non-cash, is of suspicious nature. Cash transactions of Rs.10 lakh and above or a series of integrally connected transactions aggregate of which, in a month, exceed Rs.10 lakh are to be reported in CTR. Individual cash transactions below Rs.50,000 have been excluded from the purview of reporting to FIU-IND. Banks have been advised to report all other cash transactions where forged or counterfeit bank notes have been used and any forgery of a valuable security has taken place.

Resolution of Non-Performing Loans

V.19 In order to increase the options available to banks for resolving their non-performing assets (NPAs) and to develop a healthy secondary market for NPAs, where securitisation companies and reconstruction companies are not involved, the guidelines on sale/purchase of NPAs were formulated and forwarded to banks / FIs / NBFCs in July 2005. Banks were advised to place the guidelines before their boards and take appropriate steps for their implementation.

V.20 Under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002, commercial banks have issued 1,33,665 notices by end-March 2006 involving an outstanding amount of Rs.41,053 crore. Of this, banks have recovered an amount of Rs.7,296 crore in respect of 72,178 cases. Furthermore, an amount of Rs.4,410 crore has been received through 35,090 compromise proposals. The Act provides, *inter alia*, for enforcement of security interest for realisation of dues without intervention of courts or tribunals.

V.21 The Recovery of Debts due to Banks and Financial Institutions Act, 1993 provides for the establishment of tribunals for expeditious adjudication and recovery of debts due to banks and financial institutions. The amendments made in 2000 and 2003 to the above Act and the Rules framed thereunder have strengthened the functioning of Debts Recovery Tribunals (DRTs). Out of 71,399 cases involving Rs.1,11,293 crore filed with DRTs by the banks, 36,803 cases involving Rs.42,792 crore have been adjudicated by end-March 2006. The amount recovered so far through the adjudicated cases is Rs.14,992 crore.

V.22 The Reserve Bank has issued guidelines to commercial banks and financial institutions to enable them to make increasing use of the forum of *Lok Adalats*. By end-March 2006, commercial banks have filed 8,16,068 cases with *Lok Adalats* involving an amount of Rs.4,263 crore. The number of cases decided was 3,07,189 involving an amount of Rs.1,574 crore. The recoveries effected in 2,40,819 cases stood at Rs.649 crore.

V.23 A Special Group was constituted in September 2004 with Smt. Shyamala Gopinath, Deputy Governor, Reserve Bank to undertake a review of the Corporate Debt Restructuring System. The Special Group suggested certain changes/improvements in the existing scheme for enhancing its scope and making it more efficient. Based on the recommendations made by the Special Group and feedback on the revised draft guidelines, final guidelines on Corporate Debt Restructuring mechanism were furnished to all commercial banks/FIs (excluding RRBs) in November 2005. Key features of the revised guidelines are: (i) extension of the scheme to entities with outstanding exposure of Rs.10 crore or more; (ii) requirement of support of 60 per cent of creditors by number in addition to the support of 75 per cent of creditors by value to make the decision making more equitable; (iii) linking the restoration of asset classification prevailing on the date of reference to the CDR Cell to implementation of the CDR package within four months from the date of approval of the package; (iv) restricting the regulatory concession in asset classification and provisioning to the first restructuring where the package also has to meet norms relating to turnaround period and minimum sacrifice and funds infusion by promoters; and (v) pro-rata sharing of additional finance requirement by both term lenders and working capital lenders.

V.24 In order to improve flow of credit to SMEs, detailed guidelines were issued to banks to ensure restructuring of debt of all eligible SMEs at terms, which are, at least, as favourable as the existing corporate debt restructuring mechanism. The guidelines include: (i) definition of SMEs; (ii) eligibility criteria; (iii) viability criteria; (iv) prudential norms for restructured accounts; (v) additional finance; (vii) upgradation of restructured accounts; (viii) asset classification status; and (ix) repeated restructuring.

V.25 The guidelines relating to one-time settlement scheme for recovery of NPAs below Rs.10 crore for SME accounts issued to public sector banks were extended to FIs in November 2005.

Financial Inclusion

V.26 In view of the extant banking practices that tend to exclude, rather than attract, vast sections of population, the Reserve Bank urged banks to review their existing banking practices to align them with the objective of financial inclusion. With a view to achieving the objective of greater financial inclusion, all banks were advised in November 2005 to make available a basic banking 'no-frills' account either with 'nil' or very low minimum balances as well as charges that would make such accounts accessible to vast sections of population (Box V.3).

V.27 With the objective of ensuring greater financial inclusion and increasing the outreach of the banking sector, banks have been allowed to use the services of Non-Governmental Organisations (NGOs)/Self Help Groups (SHGs), Micro Finance Institutions (MFIs) and other civil society organisations as intermediaries in providing financial and banking services through the use of business facilitator and correspondent models. Since engagement of intermediaries as business facilitators/correspondents involves significant reputational, legal and operational risks, banks were advised to give due consideration to such risks. Banks were also advised to constitute

Box V.3

Financial Inclusion

Over the last decade, there has been expansion, competition and diversification of ownership of banks leading to both enhanced efficiency and systemic resilience. However, there are legitimate concerns in regard to the banking practices that tend to exclude rather than attract vast sections of population, in particular, pensioners, self-employed and those employed in unorganised sector. While commercial considerations are no doubt important, the banks have been bestowed with several privileges, especially of mobilising public deposits on a highly leveraged basis and consequently they should be obliged to provide banking services to all segments of the population on equitable basis. Regulation and supervision by the Reserve Bank enables banks to access funds from a wider investor base while access to the payment and settlement systems provides efficient payments and funds transfer services. All these services, which are in the nature of public good, involve significant costs and are made available only to banks to ensure availability of banking and payment services to the entire population without discrimination. It is, therefore, inappropriate to ignore the mandate relating to depositors' interests. The socio-economic profile for a typical depositor who seeks safe avenues for his savings deserves special attention relative to other stakeholders in the banks.

The Reserve Bank in its Annual Policy Statement for 2005-06, therefore, emphasised that banks should empower the depositors by providing wider access and better quality of banking services. Furthermore, banks were advised in August 2005 to ensure that customers belonging to poor sections of the society are not kept away from banking system, on account of difficulties in meeting the KYC requirements for opening bank account. The KYC procedure for opening accounts was simplified further for persons who intend to keep balances not exceeding Rs.50,000/- in all their accounts taken together and the total credit in all the accounts taken together is not expected to exceed Rs.1,00,000/- in a year. The customer is allowed to exceed the threshold limit only after the full compliance with the KYC norms.

The Reserve Bank reiterated the concerns of financial inclusion in its Mid-term Review of Annual Policy Statement for 2005-06. All banks were advised in November 2005 to make available a basic banking 'no-frills' account either with 'nil' or very low minimum balances as well as charges that would make such accounts accessible to vast sections of population. The nature and number of transactions in such accounts could be restricted, but made known to the customer in advance in a transparent manner. All banks were also advised to give wide publicity to the facility of such a 'no-frills' account including on their web sites indicating the facilities and charges in a transparent manner.

Furthermore, banks were advised in December 2005 to make available all printed material used by retail customers such as account opening forms, pay-in-slips and passbooks in trilingual form, *i.e.*, English, Hindi and the concerned regional language. Banks were also advised to provide a simplified general credit card (GCC) facility without insistence on collateral or purpose, with a revolving credit limit up to Rs.25,000 based on cash flow of the household to enable hassle-free access to credit to rural households. Fifty per cent of credit outstanding under GCC could be included by banks under indirect finance to agriculture. A simplified mechanism for one-time settlement (OTS) of loans with principal amount up to Rs.25,000 which have become doubtful and loss assets as on September 30, 2005 was suggested for adoption. In case of loans granted under Government-sponsored schemes, banks were advised to frame separate guidelines following a State-specific approach to be evolved by the State Level Bankers' Committee (SLBC). Banks have been specifically advised that borrowers with loans settled under the OTS scheme will be eligible to re-access the formal financial system for fresh credit. Banks were advised to give effect to these measures at all branches for achieving greater financial inclusion.

grievance redressal machinery within the bank for redressing complaints about services rendered by business facilitators and correspondents. Since the objective is to extend savings and loan facilities to the underprivileged and unbanked population, banks were advised to adopt a flexible approach within the parameters of guidelines issued on Know Your Customer (KYC) from time to time. Special initiatives have been taken to improve the provision of financial services in the North-Eastern region (Box V.4)

Towards More Deregulation

V.28 Comprehensive changes were effected in the branch authorisation policy in September 2005 in order to rationalise the policy for opening of new branches in India while giving reasonable freedom to banks. The revised framework takes into account the following elements before granting approval to opening of new branches by banks: (a) the nature and scope of banking facilities provided by banks to common persons, particularly in under-banked areas, actual credit flow to the priority sector, pricing of products and overall efforts for promoting financial inclusion, including introduction of appropriate new products and the enhanced use of technology for delivery of banking services; (b) policy on minimum balance requirements and whether depositors have access to minimum banking or "no frills" banking services and commitment to the basic banking activity *viz.,* acceptance of deposits and provision of credit and quality of customer service; (c) need to induce enhanced competition in the banking sector at various locations; and (d) regulatory comfort encompassing compliance with the spirit and underlying principles of the regulation, quality of corporate governance, risk management systems and internal control mechanisms. As regards the procedural aspects, the existing system of granting authorisations for opening individual branches from time to time has been replaced by a system of giving aggregated approvals, on an annual basis, through a consultative and interactive process. The authorisations given on an annual basis would be valid for one year from the date of communication. Reasonable flexibility and freedom have been provided to banks in matters relating to shifting, conversion of branches and upgradation of extension counters.

Box V.4

Committee on Financial Sector Plan for North-Eastern Region

A Committee (Chairperson: Smt. Usha Thorat, Deputy Governor) with members from banks, State Governments from the North-Eastern States and academics was constituted in January 2006 by the Reserve Bank in order to improve provision of financial services in the North-Eastern Region (NER) and also to prepare an appropriate state-specific monitorable action plan for the region. The Committee has since submitted its report. Some of the major recommendations made by the Committee are as follows:

- In order to achieve greater financial inclusion, banks in the NER should draw up plans for each branch to provide "no frills" account to at least 50 households per month in the next 4 years. Massive awareness campaign and sensitisation of the staff and clientele along with adequate groundwork in the region has been suggested for this purpose.
- Keeping in view the local conditions, extensive recourse to bank/SHG linkage programme and business correspondent/business facilitator model was recommended. Given the improving mobile connectivity in the region, IT based solutions including smart cards based and mobile payments for carrying out banking transactions from non-branch locations may be used for increasing outreach.
- Recognising that community ownership and non-transferable rights on land lead to problems in offering land as collateral, simplified alternatives like land possession certificate/certificate from the group/local tribal bodies/farmers clubs/VDBs regarding the borrowers' right to cultivate land have been suggested.
- In the area of human resources, the existing *ad hoc* incentive package may be replaced with a fresh package comprising two components. While one component would cover usual facilities including suitable cash allowance along with prescription of minimum effective tenure, the other component would involve performance based cash incentive based on parameters suggested by the Committee.
- Revamping of RRBs and cooperative banks, including strengthening of staff and market recruitment of CEOs for RRBs.
- Measures for improving currency management and payments/settlement system in the region.
- Implementation of location specific activity-wise action plans for stepping up flow of credit to agriculture, allied activities and SME sector. Setting up of a dedicated SME Debt Fund by SIDBI to provide co-finance up to 25 per cent of project cost to first time entrepreneurs. An increase in the insurance cover under Credit Guarantee Fund Trust for Small Industries (CGTSI) scheme for the NER has also been recommended.

V.29 The branch authorisation policy for Indian banks shall also be applicable to foreign banks subject to certain criteria: (i) foreign banks are required to bring an assigned capital of US $ 25 million up front at the time of opening the first branch in India; (ii) existing foreign banks having only one branch would have to comply with the above requirement before their request for opening of second branch is considered; and (iii) foreign banks will be required to submit their branch expansion plan on an annual basis. In addition to the parameters laid down for Indian banks, the following parameters would also be considered for foreign banks :

- Foreign bank's and its group's track record of compliance and functioning in the global markets would be considered. Reports from home country supervisors will be sought, wherever necessary.
- Weightage would be given to even distribution of home countries of foreign banks having presence in India.
- The treatment extended to Indian banks in the home country of the applicant foreign bank would be considered.
- Due consideration would be given to the bilateral and diplomatic relations between India and the home country.

The branch expansion of foreign banks would be considered keeping in view India's commitments at the World Trade Organisation (WTO). ATMs will not be included in the number of branches for such computation.

Opening Up of Financial Sector

V.30 Indian banks continued to expand their presence overseas during 2005-06. There were 18 Indian banks with overseas operations by end-July 2006, with a network of 168 offices (110 branches, 34 representative offices, 6 joint ventures and 18 subsidiaries) in 47 countries. During the year 2005-06 (July-June), State Bank of India (SBI) opened a branch in Kandy (Sri Lanka), Gulshan (Bangladesh), three branches in UK (Manchester, Leicester and Birmingham) and upgraded its representative office in Shanghai into a branch. SBI also opened a representative office in Istanbul (Turkey). ICICI Bank Ltd. opened branches in Hong Kong and Colombo (Sri Lanka) and representative offices in Johannesburg (South Africa) and Dhaka (Bangladesh). Bank of Baroda opened a branch in Leicester (UK). UTI Bank Ltd. opened a merchant banking unit with ACU capabilities in Singapore. Representative offices were opened by Canara Bank in Shanghai (China), by UCO Bank in Kuala Lumpur (Malaysia), by Andhra Bank in Dubai (UAE), by Bank of India in Beijing (China) and by Indian Overseas Bank in Gaungzou (China) and in Kuala Lumpur (Malaysia).

V.31 SBI has acquired an equity stake of 51 per cent with management control in Indian Ocean International Bank Ltd. (IOIB), a Mauritian Bank. SBI has also taken Reserve Bank's approval for acquiring additional 25 per cent shareholding in IOIB.

V.32 During the calendar year 2005, permission was granted to eight foreign banks to open 13 branches, one more than the existing World Trade Organisation (WTO) commitment of 12 branches in a year. During the calendar year 2006 so far (up to July), four foreign banks have been given permission to open 13 branches. Approval was also given for opening of representative office to one foreign bank during the calendar year 2005. Seven more foreign banks have been given approval to open representative offices during 2006 so far (up to July 2006). At present, 31 representative offices of foreign banks are operating in India. During 2005-06, Commonwealth Bank of Australia from Australia, BPU Banca (Banche Popolari Unite Scrl) and Monte Dei Pasche Di Siena (both from Italy), and Zurcher Kontanal Bank (from Switzerland) opened their representative offices in Mumbai. Vneshtorg Bank and Promswyaz Bank from Russia, and Banca Popalaredi Vicenza from Italy opened their representative offices in New Delhi. During the year, Baden Wurttembergische Bank A G closed its office at Mumbai following its merger with Landes bank Baden-Wruttemberg which already has a representative office in Mumbai. Wachovia Bank NA acquired the correspondent business of the Union Bank of California and accordingly Union Bank of California closed its representative offices at Chennai, Delhi and Mumbai in February-April 2006. Mizuho Corporate Bank Ltd. upgraded its representative office at New Delhi to a branch with effect from May 1, 2006.

V.33 Consequent upon ING Bank NV's acquiring strategic stake of 43.99 per cent in Vysya Bank, ING Bank closed its banking business in India. Consequent upon the global merger of "The Bank of Tokyo-Mitsubishi Ltd." with "UFJ Bank Ltd." effective from January 1, 2006, UFJ Bank Ltd. was excluded from the second schedule of the Reserve Bank of India Act, 1934 and the surviving unit's name was changed to "The Bank of Tokyo-Mitsubishi UFJ Ltd.". Likewise, the Chohung Bank name was changed under Section

42(6) (C) of the RBI Act to "Shinhan Bank" with effect from July 25, 2006 due to global merger of 'Chohung Bank' with Shinhan Bank. At present, 29 foreign banks with 255 branches are operating in India.

Offshore Banking Units

V.34 By end-July 2006, six banks *viz.*, State Bank of India, Bank of Baroda, Union Bank of India, Punjab National Bank, Canara Bank and ICICI Bank Ltd. had opened seven offshore banking units in Special Economic Zones at Kochi, Mumbai and Noida.

Amalgamation of Bank of Punjab Ltd with Centurion Bank Ltd.

V.35 Centurion Bank Ltd. and Bank of Punjab Ltd. made an application to the Reserve Bank for approval of merger of Bank of Punjab Ltd with Centurion Bank Ltd. After examining the applications of both banks in terms of the extant guidelines, the Reserve Bank sanctioned the scheme of amalgamation vide order dated September 24, 2005. The amalgamation became effective from October 1, 2005 and the Centurion Bank Ltd. subsequently altered its name to Centurion Bank of Punjab Ltd. with effect from October 17, 2005.

Amalgamation of the Ganesh Bank of Kurundwad Ltd with the Federal Bank Ltd.

V.36 Based on the recommendations of the Reserve Bank, the Government of India placed Ganesh Bank of Kurundwad Ltd. under moratorium from the close of business on January 7, 2006 and up to and inclusive of April 6, 2006. The Reserve Bank received a proposal from Federal Bank Ltd. for taking over the Ganesh Bank of Kurundwad Ltd. On January 9, 2006 a draft Scheme of Amalgamation of Ganesh Bank of Kurundwad Ltd. with Federal Bank Ltd. was issued. The Government of India sanctioned the said scheme on January 24, 2006 and the Scheme of Amalgamation came into force with effect from January 25, 2006.

V.37 The matter was challenged by Ganesh Bank of Kurundwad Ltd. in the Bombay High Court. The High Court dismissed the petition on April 5, 2006, and four weeks time was given to prefer an appeal before the Supreme Court of India. As the moratorium was coming to an end on April 6, 2006, the Government of India, on application made by the Reserve Bank, extended the order of moratorium for further three months up to July 6, 2006. The Ganesh Bank of Kurundwad Ltd. filed a Special Leave Petition before the Supreme Court on April 21, 2006. The matter was finally heard by the Supreme Court on June 6, 2006 and the Court has reserved its judgement.

V.38 The order of moratorium extended by the Government of India on April 5, 2006 expired on July 6, 2006. As the Banking Regulation Act, 1949 does not provide for placing a bank under moratorium for more than six months, the Reserve Bank issued certain directions to the bank under Section 35A of the Banking Regulation Act, 1949 on July 6, 2006. Furthermore, on an application made by the Reserve Bank, the Government of India issued a fresh order of moratorium on July 6, 2006 for the period from the close of business on July 7, 2006 up to and inclusive of October 6, 2006. The bank has been advised that during the period of the moratorium, it should not make any payment to any depositors or discharge any liabilities or obligation to any other creditors except to the extent and in the manner prescribed in the order of moratorium.

Supervisory Initiatives

V.39 The growing number of high-profile operational loss events worldwide has led banks and supervisors to increasingly view operational risk management as an integral part of the risk management activity. Management of specific operational risks is not a new practice; it has always been important for banks to try to prevent fraud, maintain the integrity of internal controls, and reduce errors in transaction processing. However, what is relatively new is the view of operational risk management as a comprehensive practice comparable to the management of credit and market risk. Management of operational risk embodies the identification, assessment, measurement, monitoring and control or mitigation of risk. In view of this recognition, the New Capital Adequacy Framework requires banks to hold capital towards operational risk (Box V.5).

V.40 Draft guidelines for implementation of the new capital adequacy framework were formulated and placed on the Reserve Bank's website on February 15, 2005 for wider dissemination and comments (Box V.6).

V.41 It is imperative for banks to prepare for business disruptions and system failures and ensure continuity of operations. The unprecedented floods in recent times in a few cities and the resultant reports of electronic delivery channels of some of the banks

Box V.5

Guidance Note on Management of Operational Risk

The New Capital Adequacy Framework, *inter alia,* requires banks to hold capital explicitly towards operational risk. In view of this, a guidance note was prepared by the Reserve Bank and issued to banks in October 2005. The guidance note is an outline of a set of sound principles for effective management and supervision of operational risk by banks.

Clear strategies and oversight by the board of directors and senior management, strong operational risk management culture, effective internal control and reporting, and contingency planning are crucial elements for effective operational risk management. Initiatives required to be taken by banks in this regard include: (i) the recognition that board of directors is primarily responsible for ensuring effective management of the operational risk in banks. The board of directors has the ultimate responsibility for ensuring that the senior management establishes and maintains an adequate and effective system of internal controls; (ii) operational risk management should be identified and introduced as an independent risk management function across the entire bank/banking group; (iii) senior management should have clear responsibilities for implementing operational risk management as approved by the board of directors; (iv) the board of directors and senior management are responsible for creating an awareness of operational risks and demonstrate to all the levels of personnel the importance of operational risk within the bank; (v) the direction for effective operational risk management should be embedded in the policies and procedures that clearly describe the key elements for identifying, assessing, monitoring and controlling/mitigating operational risk; and (vi) the internal audit function assists the senior management and the board by independently reviewing application and effectiveness of operational risk management procedures and practices approved by the board/senior management.

The new capital adequacy framework has put forward various options for calculating operational risk capital charge in a 'continuum' of increasing sophistication and risk sensitivity and increasing complexity. Banks in India are required to adopt Basic Indicator Approach for computing capital requirements for operational risk when they adopt Basel II in March 2007. They are required to benchmark their operational risk management systems with the guidance provided and aim to move towards more sophisticated approaches. In this regard, the guidance note should be used to put in place an effective operational risk management system which should be constantly upgraded. The design and architecture for management of operational risk is to be oriented towards banks own requirements dictated by the size and complexity of business, risk perception, market perception and the expected level of capital. The exact approach would, therefore, differ from bank to bank. Hence the systems, procedures and tools given in the guidance note are indicative.

being affected has further reinforced the need for robust business continuity planning (BCP) in banks. In recognition of such eventualities, detailed guidelines were issued by the Reserve Bank in April 2005 requiring commercial banks to put in place business continuity measures within a fixed time frame (Box V.7).

V.42 Banks and financial institutions are increasingly making use of sophisticated financial models in order to aid them in quantifying, aggregating and managing risks across geographical and product lines. Given this extensive use of models, their validation assumes importance because the errors in the modelling exercise can lead to poor management decisions and result in actual losses or foregone income from opportunity costs. The supervisory validation of models forms an important signpost in the road-map for Basel II implementation (Box V.8)

Box V.6

Draft Guidelines on Basel II Implementation

Banks in India would be adopting the 'Standardised Approach' for credit risk and 'Basic Indicator Approach' for operational risk under Basel II from March 31, 2007. Under the Standardised Approach, banks are required to compute capital requirements for credit risk exposures on the basis of ratings assigned to these exposures by external credit assessment institutions (ECAI). Final guidelines on implementation of the new capital adequacy framework would be issued after taking into account the recommendations of the in-house Group on accreditation of external credit assessment institutions whose ratings may be relied upon by banks for computing their capital requirements.

In terms of the new capital adequacy framework, the national supervisors are required to identify the rating agencies which meet the minimum requirements laid down therein. They are also responsible for assigning the assessments of the eligible rating agencies to the risk weights available under the Standardised Approach. Accordingly, the Reserve Bank has constituted an internal Working Group to identify the eligible rating agencies and recommend an appropriate risk weight mapping.

Box V.7
Business Continuity Planning in Commercial Banks

The extensive leverage of technology for various internal processes, for developing sophisticated financial products and for providing multifarious electronic touch-points for customers transactions has brought to the fore the banks' critical dependence on information technology (IT). This growing dependence on IT tips the risk-scale from "high frequency-low impact" observed in manual processes to one of "low frequency-high impact" in the technology-dependent milieu. It is, therefore, imperative for banks to prepare for business disruptions and system failures and ensure continuity of operations. In view of these developments, detailed guidelines were issued by the Reserve Bank in April 2005 requiring commercial banks to put in place business continuity measures within a fixed time-frame. The guidelines encompassed both technological as well as non-technology related components required for a comprehensive Business Continuity Planning (BCP) process.

Banks are required to submit BCP document, approved by the Board, to the Reserve Bank for perusal. Furthermore, banks are required to file an annual report indicating the critical systems, their recovery time objectives (RTO) and the strategy to achieve the RTO. Banks also need to submit a quarterly report indicating major failures of critical systems, customer segments/services impacted by the failures and steps taken to avoid such failures. In order to further buttress the importance of BCP, one-to-one meetings were held by the Reserve Bank with thirty-five banks having high coverage of business under core banking system. Several action points and suggestions emanated from the meetings such as framing of a comprehensive BCP, ensuring robustness of disaster recovery processes for critical systems and electronic delivery channels, avoiding single-point-of-failure scenarios, considering wide area disasters and periodic training, testing, updation and audit of BCP/DR plans. Specific concerns are being followed up with banks wherever necessary.

V.43 With the increase in the complexities of banking business and consequent exposure of their balance sheets to the various risks, particularly market risks, it has become imperative for banks to

Box V.8
Model Risk

The process of model validation should fundamentally assess the predictive ability of a bank's risk estimates. The model errors may arise from factors such as wrong assumptions or data, misspecification, incorrect implementation and misapplication of model. The existence of potential errors in modelling is called model risk which is essentially an operational risk.

The guiding principle of model validation is that the benefits for risk management need to be balanced with the costs of validation. Validation involves a series of processes designed to ensure that the model accurately captures the relationships in the underlying markets. It is primarily used to identify problems in model design and to ensure that the model functions at an appropriate level of confidence. It also entails establishing model boundaries, including sensitivity of the outputs to changes on modelling assumptions, the circumstances in which it can be useful and those in which it may be inappropriate.

As per Basel prescriptions, banks using internal models must have an independent control unit that is responsible for initial and on-going validation of internal models. The banks should have a regular cycle of model validation. The main features of sound validation policy are:

- Input and output should always be scrutinised and tested.
- Decision makers are kept adequately informed about the underlying assumptions of the model and its potential limitations.
- Responsibilities need to be defined, such as for initial approval of model, approval of assumptions, verification of data flaws, and installation of new releases and tracking of identified bugs.
- Documentation process should be undertaken listing all models used by the bank, procedures for their use, descriptions of their components, personnel responsible for running the models and contingency plan for model and data loss.
- Frequency of changes needs to be limited. Access to all models and key support programmes should be restricted and there should be adequate backup.
- The audit should be responsible for assessing efficacy of policy, adherence to policy and aspects of validation.
- Model validation should be independent from model construction and model validation responsibilities must be clearly defined. The responsibility is on the bank to satisfy the supervisor that a model has good predictive power and that regulatory capital requirements will not be distorted as a result of its application.

References

1. BCBS (1999), "Credit Risk Modelling: Current Practices and Applications" April.
2. ——(2005), "Studies on the Validation of Internal Rating Systems" May.
3. ——(2005), "International Convergence of Capital Measurement and Capital Standard - A Revised Framework", November.

rely on various techniques to manage these risks. While the principal technique used by most of the banks for quantification of market risk is Value at Risk (VaR), there are certain inherent weaknesses/ deficiencies of this technique. Therefore, stress testing has emerged as an important complementary technique to VaR. Stress testing not only helps in understanding the impact of extreme events on the performance of a portfolio, but it also helps in identifying key areas where the vulnerability of the portfolio is higher (Box V.9).

V.44 In order to strengthen compliance structure in banks, the Basel Committee on Banking Supervision (BCBS) released a paper 'Compliance and the Compliance Function in Banks'. The paper released in April 2005 defines compliance risk as "the risk of legal or regulatory sanctions, material financial loss, or loss to its reputation that a bank may suffer as a result of its failure to comply with laws, regulations, rules, related self-regulatory organisation standards, and codes of conduct applicable to its banking activities". Consequently, the Reserve Bank set up a Working Group consisting of a few Compliance Officers of banks in July 2005 to review the present organisational structure and compliance machinery in banks, weaknesses in the existing system, international standards and best practices and to make recommendations with a view to put in place a robust compliance system in banks. The Working Group has submitted its report and its recommendations are being acted upon.

Customer Service and Grievance Redressal System in Banks

V.45 The Reserve Bank has been periodically issuing guidelines on public grievance redressal mechanism in banks, including constitution of customer service centres, committees on customer service and method of disposal of complaints. Based on the recommendations of the Committee on Procedures and Performance Audit on Public Services (Chairman: Shri S.S.Tarapore) for bringing about improvements in the quality of services rendered by them, banks have been advised to constitute

Box V.9

Stress Testing in Risk Management

Stress testing refers to the analysis of portfolio performance and risk under conditions of extreme price/ rate movements. It is a risk management method to assess a bank's internal capital requirements and its risk profile. It, therefore, provides scope to be employed as a forward-looking assessment tool in bank risk management. It complements the traditional VaR model as it enables an informed guess of extreme events that are plausible but not necessarily quantifiable in terms of probability. The importance of stress testing also emanates from the fact that there is a need to ensure the solvency of the institution under unlikely but not impossible extreme situations.

Sensitivity analysis is the simplest form of stress testing. Stress tests based on this approach examine the impact of a pre-defined unusual shock in a specific risk factor. For instance, a currency price may be shocked, say, by plus / minus 10 per cent. The portfolio is then revalued. The change in value of the portfolio is then used to determine the worst case loss on the portfolio. This is typically done using the deltas, although full revaluation may be used.

Scenario analysis formulates an extreme, but possible state. This approach constructs a series of large/extreme price changes and the performance of the portfolio under this combination is then analysed. In effect, scenario analysis is a form of sensitivity analysis using a combination of changes in key risk factors. Unlike sensitivity analysis, the identified risk factors are assumed to change in an adverse manner simultaneously.

Stress tests must be systematically reassessed because financial markets, instruments, regulatory policies and macroeconomic and political environment are dynamic in nature. Bank managements need to play an active role in the design of stress scenarios. A proper understanding of stress scenarios and their effects is essential for assessing whether the risk to which the bank is exposed corresponds with the bank's risk appetite. In the event of an excessive risk in the stress scenarios, the bank's management shall be prepared to take appropriate measures which may include re-evaluation of limits, reduction of the bank's exposure to risky areas, change in the business strategy, and infusion of additional capital. Regular evaluation of adequacy of stress testing should be subject to internal audit and should be an integral part of a bank's risk management.

References

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3. Lièák, Marek (2006), "Stress Testing as a Risk Management Method," National Bank of Slovakia, March.

Customer Services Committee of the Board. They have been also advised to include experts as also representatives of customers as invitees in this Committee, which would formulate policies and assess compliance thereof. Furthermore, banks were advised to convert the *ad hoc* Committee of Executives on customer service headed by CMD/ED into a Standing Committee that would periodically review the policies and procedures and working of their internal grievance redressal machinery. Every bank is expected to have a nodal department and a nodal official for customer service at the Head Office and at each controlling office, whom customers with grievances could approach at the first instance, and with whom the Banking Ombudsman and the Reserve Bank could liaise.

V.46 Banks have been advised to periodically conduct comprehensive reviews of their Grievance Redressal Machinery so as to identify drawbacks, if any, in their functioning and take necessary corrective steps. They have also been advised to submit half-yearly reviews of functioning of Customer Service and Grievance Redressal Cell to their respective boards.

V.47 To enhance the accessibility and effectiveness of the redressal machinery, banks have been advised to ensure that details of the officials to be contacted for complaint redressal are kept updated and prominently displayed at the branches, together with their direct telephone/fax numbers, complete address and e-mail address. The name and address of the Banking Ombudsman should also be displayed at the branches. Banks should give wide publicity to the grievance redressal machinery in the press, besides placing such information on their websites. Banks have also been advised that a complaint form along with the name of the nodal officer for complaint redressal may be made available on their homepage to facilitate submission of complaints.

V.48 The Reserve Bank also receives complaints against banks at its offices/departments. The Government of India also forwards to the Reserve Bank complaints against banks received by it. Such complaints are handled at the regional offices of the Reserve Bank by the regulatory departments concerned, which liaise with the banks named in the complaints. At the central office of the Reserve Bank, receipts of such complaints and liaison with banks concerned were centralised at the Public Grievances and Redressal Cell in the Department of Banking Supervision till June 30, 2006. A separate complaints redressal system, with the Complaints Redressal Cell in the Department of Government and Bank Accounts as the nodal point, was also in place till then to attend to customer service and grievance redressal in respect of services rendered by the Reserve Bank. In order to bring together all activities relating to customer service in banks and the Reserve Bank in a single department, the Reserve Bank constituted on July 1, 2006 a new department called 'Customer Service Department (CSD)'. The functions of this new department include administering the Banking Ombudsman scheme, taking steps for ensuring transparency in banker-customer relationship, monitoring the working of internal grievance machinery of banks, and liaison with banks, Indian Banks' Association, Banking Codes and Standards Board of India (BCSBI), Banking Ombudsmen and various customer fora on matters relating to customer service.

V.49 Introduction of the Banking Ombudsman scheme in 1995 to provide expeditious and inexpensive forum to bank customers for resolution of their complaints relating to deficiency in banking services was an important initiative of the Reserve Bank in the area of customer service. The Scheme was revised first in 2002 and again in 2006. The present Banking Ombudsman Scheme, 2006 is applicable to all commercial banks, regional rural banks and scheduled primary cooperative banks having business in India. Banking Ombudsmen currently have their offices in 15 centres spread across the country. The Ombudsman offices are staffed and funded by the Reserve Bank (Box V.10).

V.50 Recognising an institutional gap in measuring the performance of the banks against codes and standards based on established best practices, the Reserve Bank set up the Banking Codes and Standards Board of India (BCSBI) in February 2006 (Box V.11). The BCSBI is an autonomous and independent body, adopting the stance of a self-regulatory organisation in the larger interest of improving the quality of customer services by the Indian banking system. Banks register themselves with the Board as its members and provide services as per the agreed standards and codes. The Board, in turn, monitors and assesses the compliance with codes and standards, which the banks have agreed to. The registration of banks with the BCSBI enables the Reserve Bank to derive greater supervisory comfort.

Regional Rural Banks

V.51 In view of the importance of the regional rural banks (RRBs) as purveyors of rural credit, and in order

Box V.10
Banking Ombudsman Scheme

The Banking Ombudsman scheme in operation since 1995 provides for a system of redressal of grievances against banks in an expeditious and inexpensive manner. In India, any person whose grievance against a bank is not resolved to his satisfaction by that bank within a period of one month can approach the Banking Ombudsman if his complaint pertains to any of the matters specified in the Scheme. Banking Ombudsmen have been authorised to look into complaints concerning (a) deficiency in banking service (b) sanction of loans and advances as they relate to non-observance of the Reserve Bank directives on interest rates, delay in sanction or non-observance of prescribed time schedule for disposal of loan applications or non-observance of any other directions or instructions of the Reserve Bank as may be specified for this purpose, from time to time, and (c) such other matters as may be specified by the Reserve Bank.

The Banking Ombudsman on receipt of any complaint endeavours to promote a settlement of the complaint by agreement between the complainant and the bank named in the complaint through conciliation or mediation. If a complaint is not settled by agreement within a period of one month from the date of receipt of the complaint or such further period as the Banking Ombudsman may consider necessary, he may pass an Award after affording the parties reasonable opportunity to present their case. He shall be guided by the evidence placed before him by the parties, the principles of banking law and practice, directions, instructions and guidelines issued by the Reserve Bank from time to time and such other factors, which in his opinion are necessary in the interest of justice.

The Banking Ombudsman Scheme, 1995 covered all commercial banks and scheduled primary co-operative banks. The Banking Ombudsman Scheme, 2002 which came into effect on 14th June 2002 also included RRBs within its ambit. It additionally provided for the institution of a "Review Authority" to review the Banking Ombudsman's Award, when warranted. A bank against whom an Award has been passed, may with the approval of its Chief Executive, file an application to the Deputy Governor-in-charge of Rural Planning and Credit Department , Reserve Bank to seek a review of the Award, only when the Award appears to be patently in conflict with the Reserve Bank's instructions and/or the law and practice relating to banking. The Banking Ombudsman was also authorised to function as an Arbitrator on reference to him of disputes (value of subject matter not exceeding Rs. ten lakh) either between banks and their customers or between banks.

The various reviews of the Scheme during the year 2005 indicated that though the complaints received at the Banking Ombudsman Offices have been increasing, the Scheme was not addressing some areas of the customer complaints of the customers. Furthermore, the functioning of the Scheme needed to be facilitated by streamlining the process of settlement of customer complaints. As the formulator and monitoring authority of the Scheme, the Reserve Bank needed to have more control over functioning of the Scheme. These issues have been addressed in the Banking Ombudsman Scheme, 2006 which came into effect from January 1, 2006. The following are the major changes in the revised Scheme:

(i) New grounds of complaints such as credit card issues, failure in providing the promised facilities, non-adherence to fair practices code and levying of excessive charges without prior notice have been included.

(ii) In order to facilitate complaint submission, the prescribed application format is not mandatory for filing the complaint. Complaints can be filed online as well as by sending an email.

(iii) Only serving senior officers of the Reserve Bank are appointed as Banking Ombudsmen.

(iv) The cost of running the Scheme, which was shared by all the participant banks, shall be borne by the Reserve Bank.

(v) The secretariat of the office of the Banking Ombudsman, which earlier also consisted of officers from SLBC Convenor banks, will consist of officers deputed from the Reserve Bank only.

(vi) The banks are required to appoint Nodal Officers in their Zonal Offices/Regional Offices for the Scheme.

(vii) The complainants can also appeal against the Award of Banking Ombudsman.

(viii) In order to enable the Banking Ombudsmen concentrate on the complaints, rather than on arbitration of inter-bank disputes, the arbitration option rested with the Banking Ombudsman has been removed in the Banking Ombudsman Scheme, 2006.

to strengthen them, sponsor banks were encouraged to merge, State-wise, the RRBs sponsored by them. In this context, the Government of India, after consultation with NABARD, the concerned State Governments and the concerned sponsor banks initiated the process of amalgamation of the RRBs in September 2005. As a result of these initiatives, 132 RRBs have been amalgamated till August 2, 2006 to form 41 new RRBs (sponsored by 19 banks in 15 States). This has brought down the total number of RRBs from 196 at end-March 2005 and 133 at end-March 2006 to 105 as on August 2, 2006. Some more amalgamation proposals are under consideration of the Government of India.

Box V.11

Banking Codes and Standards Board of India

The Reserve Bank has made improved customer service to the common person as one of its key objectives. To this effect, a significant recent initiative of the Reserve Bank has been the setting up of an independent body called the Banking Codes and Standards Board of India (BCSBI) as recommended by the Committee on Procedures and Performance Audit on Public Services. The Committee, set up by the Reserve Bank, had noted that there is a disenfranchisement of depositors and customers and recognised the need to bring about a fundamental change in the overall approach to customer service through a change in the mindset of the players themselves. This issue has been addressed by the banks themselves voluntarily drawing up a "Code of Bank's Commitment to Customers". The BCSBI's role is to evaluate, oversee and enforce observance of the Code by banks through the means of a 'covenant' between each member bank and the BCSBI. The BCSBI's objective is to locate and rectify systemic deficiencies by taking collaborative remedial action rather than through penal measures.

The Code is applicable only to banks dealings with customers in their capacity as individuals. The Code has been evolved through collaborative effort between the BCSBI, the Reserve Bank and the banking industry with the objective of promoting best international banking practices by setting minimum standards; increasing transparency; achieving higher operating standards; and promoting cordial banker-customer relationship which would in turn foster confidence of the individual customer in the banking system. Through the Code, the banks have committed to having in place a Tariff Schedule covering all charges and fees and free policy documents, *viz*., the Cheque Collection policy, Compensation policy and Security Repossession policy. The single most significant feature of this Code is that now the common man will have a Charter of Rights in his hand, which he can enforce against his bank.

The Reserve Bank is fully funding the financing of the BCSBI for the first five years so that it can effectively function as a truly independent and autonomous institution. The annual membership subscriptions received from banks would go towards the setting up of a corpus which would enable the Board to become self-financing as and when the Reserve Bank funding phases out.

The BCSBI's membership is voluntary and is open to scheduled commercial banks. 65 of these banks have already registered with the BCSBI indicating their willingness to become members and adopt the voluntary Code.

V.52 With a view to achieving the objective of greater financial inclusion, all RRBs were advised in December 2005 to make available a basic banking 'no-frills' account either with 'nil' or very low minimum balances as well as charges that would make such accounts accessible to vast sections of population. RRBs were also advised to explore the provision of small overdraft facility to account holders in order to encourage more and more persons in their area of operation to open zero balance accounts. The limit of such overdraft could be reviewed depending on repayment record and may not be linked to any specific activity/end use or security.

V.53 In order to reposition RRBs as an effective instrument of credit delivery, the Reserve Bank initiated measures such as enhancing their resource base, permitting them to issue credit/ debit cards and set up ATMs. They have also been allowed to open (on a case by case basis) currency chests and to handle pension and other government businesses as sub-agents of banks.

Cooperative Banks

V.54 Urban cooperative banks (UCBs) complement the efforts of the Reserve Bank towards greater financial inclusion by providing credit facilities to middle class/lower middle class population in the urban and semi-urban areas. In recent years, the Reserve Bank's policy initiatives in regard to UCBs have, therefore, focused on ensuring that they emerge as a sound and healthy network of jointly owned, democratically controlled and ethically managed banking institutions, providing need-based quality banking services, essentially to the middle and lower middle classes and marginalised sections of the society. During 2005-06, the Reserve Bank continued to undertake several initiatives to strengthen the cooperative banking sector.

V.55 As UCBs are subject to dual control by the Reserve Bank and State Governments, efforts are on to harmonise the regulation and supervision over UCBs to facilitate the development of the sector. In order to address issues/difficulties related to dual control within the existing legal framework, a working arrangement in the form of Memorandum of Understanding (MoU) has been proposed. Accordingly, the Reserve Bank has so far signed MoU with five State Governments, *viz*., Andhra Pradesh, Gujarat, Karnataka, Madhya Pradesh and Uttaranchal. Other States that have a sizeable presence of UCBs have also been approached for entering into an MoU. The MoU, *inter alia*, envisages constitution of State-level Task Forces for Urban Co-operative Banks (TAFCUBs).

These TAFCUBs would, *inter alia*, be responsible for identifying viable and non-viable UCBs in the States and suggest time-bound programme for revival of the former and non-disruptive exit route for the latter. Accordingly, the Reserve Bank constituted TAFCUBs in five States that have signed the MoUs. Based on the encouraging experience of TAFCUBs, their scope was widened to cover the scheduled UCBs registered in the States concerned. A similar forum for regulatory coordination in respect of UCBs registered under the Multi-State Cooperative Societies Act is also under consideration.

V.56 With a view to facilitating emergence of strong entities and also for providing an avenue for non-disruptive exit of unviable entities, the Reserve Bank issued guidelines on merger/amalgamation in UCB sector in February 2005. The protection of depositors' interests and financial soundness of the merged entity are the twin objectives of the guidelines. In order to smoothen the process of merger in the UCB sector, general permission was given to the acquirer UCBs to amortise the losses taken over from the acquired UCBs over a period of not more than five years, including the year of merger. The Reserve Bank has since then given 'no objection certificate' for 17 merger proposals; of these, 12 mergers have already taken effect. The remaining proposals are under various stages of consideration/operationalisation by the registrars of cooperative societies of the respective States/Union Government.

V.57 In order to revitalise and rehabilitate the scheduled UCBs with negative net worth, the Reserve Bank began a consultative process with the concerned State Governments and banks. The emphasis is on a time bound programme for restructuring of such UCBs by demarcating the contours of their rehabilitation plan and setting up monitorable milestones. During the year, 10 scheduled UCBs were placed under restructuring plan; of these, one cooperative bank *viz.*, Cooperative Bank of Ahmedabad has merged with Cosmos Cooperative Urban Bank Ltd., Pune, and the Reserve Bank is closely monitoring the progress of the other banks with a view to protecting depositors' interest and avoiding systemic problems.

V.58 Share capital and retained earnings constitute the owned funds of UCBs. Share capital can be withdrawn by members after the minimum lock-in period and can also be adjusted against their loans and advances. Therefore, the shares of UCBs do not have all the characteristics of equity. Cooperative banks are also not permitted to issue shares at a premium. In order to explore various options for raising capital, a Working Group was constituted comprising representatives of the Reserve Bank, State Governments and the UCB sector to examine the issues involved and to identify alternate instruments/ avenues for augmenting the capital funds of UCBs.

V.59 The Reserve Bank has permitted UCBs in States where MoUs have been signed and those registered under the Multi-State Cooperative Societies Act to offer mutual fund products, as agents, to their customers, subject to certain conditions. The Reserve Bank also allowed well managed UCBs - both scheduled and non-scheduled - to open select off-site/on-site ATMs, based on the recommendation of the TAFCUBs.

V.60 The Reserve Bank has undertaken various regulatory measures to strengthen the urban cooperative banking sector. In line with the international best practices, the 180 days delinquency period for reckoning an advance as non-performing was brought down to 90 days with effect from March 31, 2004. However, this norm was relaxed and deferred for UCBs with deposits of less than Rs.100 crore and having branches within a single district (including unit banks, *i.e.*, having single branch/head office) considering difficulties expressed by them in meeting the norms. These UCBs have been permitted to classify their loan accounts as NPAs based on the 180 days delinquency norm instead of the 90 days norm. The relaxation would be valid up to end-March 2007 to enable the UCBs concerned to build up adequate provisions and strengthen their procedures in order to transit to the 90 days delinquency norm within the stipulated period.

V.61 As in the case of SCBs, general provisioning requirement for 'standard advances' other than direct advances to agriculture and SME sector was increased for UCBs from 0.25 per cent to 0.40 percent. For UCBs that have branches in only one district (including unit banks) and deposits of less than Rs.100 crore, the existing requirement of provisioning of 0.25 per cent for standard assets would continue. These provisions would be eligible for inclusion in Tier II capital for capital adequacy purposes up to the permitted extent as hitherto.

V.62 The risk weight for loans extended against primary/collateral security of shares/debentures was increased to 125 per cent from the existing level of 100 per cent. The risk weight on investment in equities of all-India financial institutions (AIFIs)/units of UTI was increased to 127.5 per cent from 102.5 per cent. As in the case of SCBs, risk weight on the exposure of UCBs to commercial real estate was increased from 100 per cent to 125 per cent in July 2005 and further to 150 per cent in April 2006.

V.63 UCBs were advised in April 2001 to maintain certain percentage of their assets u/s 24 of the Banking Regulation Act, 1949 (AACS) in the form of Government and other approved securities. In view of the difficulty in making investments in Government securities, the UCBs with deposit base of less than Rs.100 crore and having branches within a single district were given partial exemption (not exceeding 15 per cent) from the prescribed SLR of 25 per cent to the extent of funds placed in interest-bearing deposits with public sector banks. Consequently, these banks can obviate market risks associated with investment in Government securities. The exemption would be applicable up to March 31, 2008.

V.64 Based on representations received, UCBs were allowed to shift their securities to HTM category once more before March 31, 2006. In cases, where the market value of the security was lower than the face value, the provision required would be the difference between book value and the face value which could be amortised during the remaining period of maturity instead of five years as advised earlier to scheduled cooperative banks. These revised valuation norms would apply only in respect of transfers to HTM category made during the current financial year.

V.65 For improving flow of credit to SMEs, certain guidelines were issued for restructuring of debt of SMEs. UCBs were advised to formulate the debt restructuring scheme with the approval of concerned State /Central Registrar of Cooperative Societies and give adequate publicity to the scheme among the customers so as to bring it to the notice of all beneficiaries.

V.66 A Task Force on Revival of Rural Cooperative Credit Institutions (Chairman: Prof.A.Vaidyanathan) was appointed by Government of India in August 2004. The Task Force submitted its final report on strengthening the rural cooperative banking system to the Government in February, 2005. The Task Force has broadly advocated four sets of remedial measures: a) special financial assistance to the tune of Rs.14,839 crore; b) institutional restructuring; c) radical changes in the legal framework to empower the Reserve Bank; and d) qualitative improvement of personnel in all tiers. The Government of India has accepted the recommendations of the Task Force in principle and has held consultative meetings with the State Governments. NABARD has begun the process of implementing the recommendations. The Government of India has decided to set up a National Implementing and Monitoring Committee to oversee implementation and monitoring of revival package for Short Term Cooperative Credit Structure. Governor, Reserve Bank has been nominated as Chairman of the Committee.

V.67 In January 2005, the same Task Force was also entrusted the task of strengthening the long-term co-operative credit structure for agriculture and rural development. The Task Force submitted a draft report to the Government of India in December 2005. The Report has been placed by NABARD and Government of India on their websites for wider dissemination and comments. The Reserve Bank's comments on the Report have been sent to the Government of India on March 1, 2006.

V.68 As on March 31, 2006, 130 out of 366 District Central Cooperative Banks (DCCBs) and six out of 31 State Cooperative Banks (StCBs) have not complied with the provisions of Section 11 (1) of the Banking Regulation Act, 1949 (AACS). The number of DCCBs not complying with the provisions of Section 22(3)(a) and Section 22(3) (b) of the Act stood at 134 and 330, respectively, as on March 31, 2006. Show cause notices were issued to eight DCCBs for rejection of licence application during 2005-06. As on March 31, 2006, two State Cooperative Banks and 12 DCCBs were placed under the Reserve Bank directions, prohibiting them from granting any loans and advances and/accepting fresh deposits and renewing the existing ones.

Financial Institutions

V.69 As in the case of SCBs, general provisioning requirement for 'standard advances' other than direct advances to agriculture and SME sector was increased for FIs from 0.25 per cent to 0.40 percent.

V.70 A minimum framework for disclosures on risk exposures in derivatives of FIs including both qualitative and quantitative aspects has been prescribed with a view to provide a clear picture of the exposure to risks in derivatives, risk management systems, objectives and policies. FIs are required to make these disclosures as a part of the 'Notes on Accounts' to the Balance Sheet with effect from March 31, 2005 (June 30, 2005 in the case of National Housing Bank)

Non-Banking Financial Companies

V.71 The Reserve Bank continued its efforts to strengthen the non-banking financial companies. The submission of quarterly return on important financial parameters of NBFCs not accepting/holding public deposits and having asset size of Rs.500 crore has been changed to monthly periodicity to facilitate a macro level assessment of large non-deposit taking companies at more frequent intervals. The asset size was also changed from Rs.500 crore and above to Rs.100 crore and above to widen the coverage. Besides, the reporting format has been amended to incorporate additional information relating to capital market exposure covering financing of IPOs, gross sales and purchases in various segments and guarantees issued on behalf of share brokers.

V.72 In order to enhance transparency in the operations and to protect the depositors interest, all deposit taking NBFCs were advised in October 2005 that they should have systems in place to ensure that the books of account of persons authorised by NBFCs (including brokers/agents so far as they relate to brokerage functions of the company) are available for audit and inspection. Residuary non-banking companies (RNBCs) had already been advised in December 2004 to put in place such system in respect of their agents/brokers.

V.73 All deposit taking NBFCs/RNBCs were advised in October 2005 that all individual cases of frauds involving Rs.1 lakh and above but less than Rs.25 lakh may be reported to the respective regional offices of the Reserve Bank's Department of Non-Banking Supervision (DNBS) in whose jurisdiction the registered office of the company is located. Individual cases of frauds involving amount of Rs.25 lakh and above are required to be reported to the Reserve Bank's Department of Banking Supervision, Fraud Monitoring Cell, Central Office, Mumbai.

V.74 NBFCs/RNBCs with public deposits/deposits of Rs.50 crore and above were advised in December 2005 that it would be desirable to stipulate rotation of partners of audit firms appointed for auditing the company after every three years so that the same partner does not conduct audit of the company continuously for more than a period of three years. However, the partner so rotated will be eligible for conducting the audit of the NBFC/RNBC after an interval of three years, if the NBFC/RNBC so decides. Companies were advised to incorporate appropriate terms in the letter of appointment of the firm of auditors and ensure its compliance.

V.75 With a view to ensuring financial inclusion of persons belonging to low income group both in urban and rural areas, KYC procedure for opening accounts by NBFCs, as in the case of SCBs, were simplified for those persons who intend to keep balances not exceeding Rs.50,000 in all their accounts taken together and the total credit in all the accounts taken together is not expected to exceed Rs.1,00,000 in a year, subject to certain conditions.

V.76 RNBCs were earlier advised that effective April 1, 2006, no discretionary investments would be permitted. On a review, the Reserve Bank decided to modify the pattern of the investments. Under the modified pattern, RNBCs have been permitted to continue (up to March 31, 2007) with the discretionary investments of not more than five per cent of the outstanding aggregate liability to depositors (ALD) as on December 31, 2005 or one time of net owned funds of the company, whichever is less. No discretionary investment is permitted on the incremental ALD (*i.e.,* incremental over end-December 2005). There will be no discretionary investment from April 1, 2007.

V.77 The Chairmen/CEOs of NBFCs were earlier advised to personally monitor the progress in regard to compliance with the policy framework on KYC and Anti-Money Laundering Standards and take appropriate steps to ensure that systems and procedures were put in place and instructions had percolated to the operational levels. They were further advised to ensure that there was a proper system of fixing accountability for serious lapses and intentional circumvention of the prescribed procedures and guidelines. NBFCs have to appoint a Principal Officer and put in place a system of internal reporting of suspicious transactions and cash transactions of Rs.10 lakh and above. In terms of the Rules framed under Prevention of Money Laundering Act 2002 (PMLA), the provisions of the Act came into effect from July 1, 2005. Section 12 of the PMLA, 2002 casts certain obligations on the NBFCs in regard to preservation and reporting of customer account information. NBFCs were advised to go through the provisions of the PMLA, 2002 and Rules notified thereunder and take all steps considered necessary to ensure compliance with the requirements of Section 12 of the Act.

MACRO-PRUDENTIAL INDICATORS REVIEW

V.78 In order to monitor the health and the stability of financial system in India, the Reserve Bank has been compiling macro-prudential indicators (MPIs) from March 2000 onwards. The MPIs comprise both aggregated micro-prudential indicators of the health of individual financial institutions and macroeconomic indicators associated with financial system soundness. India is one of the countries which volunteered to participate in the coordinated compilation exercise of the financial soundness indicators for December 2005 under the aegis of the International Monetary Fund (IMF); the requisite data was forwarded to the IMF on July 31, 2006.

Table 5.1: Select Financial Indicators

(Per cent)

Item	Year	Scheduled Commercial Banks	Scheduled Urban Cooperative Banks	Development Finance Institutions	Primary Dealers	Non-Banking Financial Companies
1	2	3	4	5	6	7
CRAR	2005	12.8	12.7	23.9	54.3	18.2
	2006	12.4	12.1	22.5	53.9	15.5
Gross NPAs to Gross Advances	2005	5.2	24.8	11.6	n.a.	5.4
	2006	3.5	18.2	8.8	n.a.	4.1
Net NPAs to Net Advances	2005	2.0	6.5	3.6	n.a.	2.3
	2006	1.3	3.0	1.3	n.a.	1.0
Return on Total Assets	2005	0.9	0.3	1.5	-1.8	1.9
	2006	0.9	0.6	1.1	5.6	n.a.
Return on Equity	2005	13.6	n.a.	6.8	-5.1	14.6
	2006	12.7	n.a.	4.7	12.5	n.a.
Cost/Income Ratio	2005	49.4	25.5	1.7	29.7	16.8
	2006	51.5	24.6	1.5	32.8	n.a.

n.a.: Not Available.

Note: 1. Data for March 2006 are provisional.
2. Data for 2006 in respect of NBFCs pertain to the period ended September 2005.
3. Data for scheduled commercial banks pertain to domestic operations only and may not tally with the balance sheet data.

V.79 An overview of MPIs for 2005-06 indicates a further improvement in asset quality of all the constituents of the financial sector (Table 5.1). Although there was some decline in the capital adequacy ratios, they remained above the minimum requirements. Return on assets of scheduled commercial banks during 2005-06 was almost the same as in the previous year while that of primary dealers (PDs) witnessed a substantial turnaround.

Capital Adequacy

V.80 At end-March 2006, scheduled commercial banks were well placed in respect of capital requirements, notwithstanding a modest decline in the aggregated capital ratios during the year (see Table 5.1). The decline in CRAR during 2005-06 could be attributed to the higher rate of increase in total risk weighted assets *vis-à-vis* the expansion in capital during the year. Higher growth in risk weighted assets, in turn, reflected (i) higher growth in the advances portfolio of banks as compared with investments in Government securities (ii) increase in risk weights for personal loans, real estate and capital market exposure and (iii) application of capital charge for market risk for investments held under the AFS category from March 2006. Although the overall CRAR declined, the core capital (*i.e.*, Tier I) ratio of the banks increased from 8.4 per cent at end-March 2005 to 9.3 per cent at end-March 2006 reflecting increased access by banks to primary capital market as also transfer of IFR from Tier II to Tier I capital. The increase in Tier I ratio would provide more headroom to banks in raising capital funds through Tier II, especially in the context of implementation of Basel II norms from March 2007. Only three scheduled commercial banks, of which one is under moratorium, could not meet the prescribed CRAR requirements at end March 2006 (Table 5.2).

Table 5.2: Scheduled Commercial Banks: Frequency Distribution of CRAR (end-March 2006)

Bank Group	Negative per cent	Between 0 and 9 per cent	Between 9 and 10 per cent	Between 10 and15 and above	15 per cent	Total
1	2	3	4	5	6	7
			Number of Banks			
Public Sector Banks	0 (0)	0 (0)	0 (2)	28 (22)	0 (4)	28 (28)
Nationalised Banks	0 (0)	0 (0)	0 (2)	20 (14)	0 (4)	20 (20)
SBI Group	0 (0)	0 (0)	0 (0)	8 (8)	0 (0)	8 (8)
Private Sector Banks	0 (1)	3 (2)	1 (4)	21 (15)	3 (7)	28 (29)
Old Private Sector Banks *	0 (1)	3 (2)	0 (2)	15 (10)	2 (5)	20 (20)
New Private Sector Banks	0 (0)	0 (0)	1 (2)	6 (5)	1 (2)	8 (9)
Foreign Banks	0 (0)	0 (0)	2 (2)	8 (9)	19 (19)	29 (30)
All Banks	**0 (1)**	**3 (2)**	**3 (8)**	**57 (46)**	**22 (30)**	**85 (87)**

* : Including one bank under order of moratorium

Note : 1. Data are provisional and unaudited.
2. Figures in parentheses are data for March 2005.

Source : Off-site supervisory returns submitted by the banks pertaining to their domestic operations only.

Table 5.3: Key Financial Indicators of Scheduled UCBs

(Rupees crore)

Indicator	End-March 2005	End-March 2006	Percentage variation
1	2	3	4
Number of Scheduled UCBs	55	55	
Paid-Up Capital	761	881	15.7
Reserve Fund and other Reserves	4,841	4,664	-3.6
Tier I Capital	816	1,216	48.9
Tier II Capital	452	592	31.0
Deposits	40,606	44,938	10.7
Investments in Government and other approved securities	15,428	16,527	7.1
Loans and Advances	24,934	27,745	11.3
Gross NPAs	6,193	5,053	-18.4
Net NPAs	1,515	806	-46.8
Net Profit *	298	509	70.7
Net Loss @	154	118	-23.2
Accumulated Loss	468	1,598	241.8

* : 45 banks in 2005; 46 banks in 2006.
@ : 7 banks in 2005; 8 banks in 2006.
Note : Data as on March 2006 are unaudited and provisional.

V.81 The CRAR of the scheduled UCBs was 12.1 per cent at end March 2006, marginally lower than 12.7 per cent at end March 2005 (Table 5.1). Both Tier I and Tier II capital increased during the year (Table 5.3).

V.82 The aggregated CRAR of FIs decreased from 23.9 per cent at end-March 2005 to 22.5 per cent at end-March 2006 (Table 5.1). Two FIs continued to have negative CRAR in view of repeated financial losses resulting into erosion in their reserves and capital (Table 5.4).

Table 5.4: CRAR and Net NPAs of Select FIs (end-March 2006)

Financial Institution	CRAR (Per cent)	Net NPAs (Rupees crore)	Net NPAs to Net Loans (Per cent)
1	2	3	4
Term-Lending Institutions (TLIs)			
IFCI	-30.4	666	9.6
EXIM Bank	18.4	105	0.6
IIBI	-46.2	387	72.0
TFCI	35.1	19	3.9
All TLIs	**-0.3**	**1,176**	**4.6**
Refinancing Institutions (RFIs)			
NABARD	34.4	0	0
NHB	22.2	0	0
SIDBI	43.2	261	2.0
All RFIs	**35.6**	**261**	**0.3**
All FIs	**22.5**	**1,437**	**1.3**

Source : Off-site returns submitted by FIs.

V.83 The aggregate capital ratio of the NBFCs fell to 15.5 per cent at end-September 2005 from 18.2 per cent at end-March 2005, but remained well above the regulatory minimum (12 per cent for equipment leasing and hire purchase finance companies and 15 per cent for other NBFCs). As at end-September 2005, 96.3 percent of reporting companies had CRAR equal to or in excess of 12 per cent (Chart V.1). The CRAR of PDs remained high at 53.9 per cent as at end-March 2006, although marginally down from 54.3 per cent at end-March 2005.

Asset Quality

V.84 Asset quality of scheduled commercial banks improved further during the year, with gross and net NPA ratios reaching historical low levels of 3.5 per cent and 1.3 per cent, respectively, at end-March 2006 (Table 5.5). Robust economic activity and better recovery climate have facilitated reduction in non-performing assets in recent years. Only five banks had net NPAs in excess of five per cent of their net advances (Table 5.6). Financial institutions, scheduled UCBs and NBFCs also recorded an improvement in their asset quality during 2005-06, with net NPA ratios reaching 1.3 per cent, 3.0 per cent and 1.0 per cent, respectively, of their net advances at end-March 2006 (see Table 5.1).

Earnings and Profitability Indicators

V.85 Total income of SCBs declined from 8.21 per cent of their assets in 2004-05 to 8.03 per cent in

Chart V.1: Frequency Distribution of CRAR of Reporting NBFCs

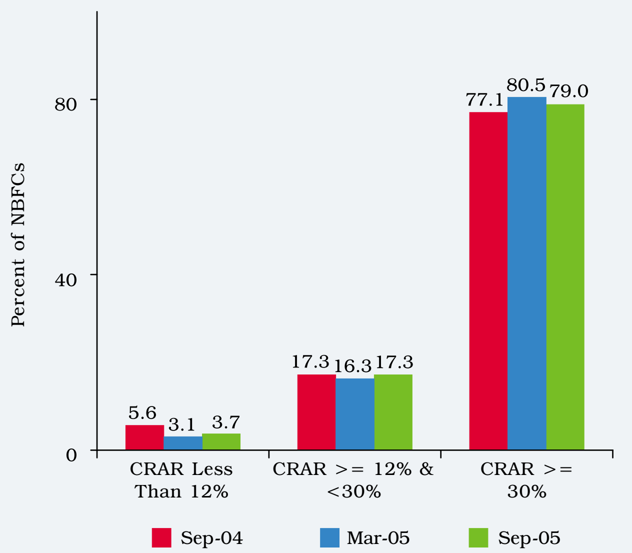


Table 5.5: Scheduled Commercial Banks – Performance Indicators

(Per cent)

Item/ Bank Group	2005-06 Q1	2005-06 Q2	2005-06 Q3	2005-06 Q4	2006-07 Q1
1	2	3	4	5	6
Operating Expenses/ Total Assets*					
Scheduled Commercial Banks	2.2	2.3	2.4	1.7	2.3
Public Sector Banks	2.1	2.3	2.4	1.7	2.2
Old Private Sector Banks	2.3	2.2	2.3	1.5	2.1
New Private Sector Banks	2.4	2.4	2.1	1.6	2.6
Foreign Banks	2.8	2.7	3.5	2.0	2.7
Net Interest Income/Total Assets*					
Scheduled Commercial Banks	3.1	2.8	3.1	2.3	3.0
Public Sector Banks	3.2	2.8	3.2	2.4	3.0
Old Private Sector Banks	3.0	2.8	3.0	2.1	3.0
New Private Sector Banks	2.3	2.5	2.3	1.6	2.6
Foreign Banks	3.8	3.7	3.6	2.8	4.2
Net Profit/Total Assets*					
Scheduled Commercial Banks	0.9	1.0	1.0	0.7	0.9
Public Sector Banks	0.8	0.9	1.0	0.6	0.7
Old Private Sector Banks	0.7	0.6	0.8	0.3	0.8
New Private Sector Banks	1.1	1.1	1.0	0.6	0.8
Foreign Banks	1.7	1.9	1.0	1.5	2.4
Gross NPAs to Gross Advances**					
Scheduled Commercial Banks	5.1	4.7	4.1	3.5	3.4
Public Sector Banks	5.5	5.2	4.5	3.9	3.8
Old Private Sector Banks	6.2	5.8	5.4	4.5	4.6
New Private Sector Banks	3.1	2.6	2.1	1.8	1.9
Foreign Banks	3.0	2.5	2.4	2.1	1.9
Net NPAs to Net Advances**					
Scheduled Commercial Banks	1.9	1.7	1.4	1.3	1.3
Public Sector Banks	2.0	1.8	1.5	1.4	1.4
Old Private Sector Banks	2.7	2.5	2.2	1.7	1.6
New Private Sector Banks	1.6	1.1	1.0	0.8	0.9
Foreign Banks	0.9	0.7	0.7	0.8	0.7
CRAR**					
Scheduled Commercial Banks	12.7	12.4	12.8	12.4	12.0
Public Sector Banks	12.8	12.6	12.7	12.2	12.0
Old Private Sector Banks	13.1	12.2	12.1	11.8	11.6
New Private Sector Banks	12.1	11.4	13.0	12.6	12.2
Foreign Banks	13.4	13.2	13.3	13.0	12.3

* : Annualised to ensure comparability between quarters.

** : Position as at the end of the quarter.

Note : Data are un-audited and provisional.

Source : Off-site supervisory returns submitted by the banks pertaining to their domestic operations

Table 5.6: Net NPAs to Net Advances of Scheduled Commercial Banks

(Frequency Distribution)

Year/Net NPAs to Net Advances Ratio	Public Sector Banks: SBI Group	Public Sector Banks: Nationalised Banks	Private Sector Banks: Old	Private Sector Banks: New	Foreign Banks
1	2	3	4	5	6
	Number of Banks				
2001-02					
Up to 2 per cent	0	0	1	1	20
Above 2 per cent and up to 5 per cent	4	4	2	3	4
Above 5 per cent and up to 10 per cent	4	12	13	5	1
Above 10 per cent	0	3	6	0	14
2002-03					
Up to 2 per cent	1	3	1	3	21
Above 2 per cent and up to 5 per cent	6	6	4	2	2
Above 5 per cent and up to 10 per cent	1	8	13	4	5
Above 10 per cent	0	2	2	1	8
2003-04					
Up to 2 per cent	6	5	2	4	19
Above 2 per cent and up to 5 per cent	2	9	9	5	4
Above 5 per cent and up to 10 per cent	0	4	7	0	3
Above 10 per cent	0	1	2	1	7
2004-05					
Up to 2 per cent	7	10	4	5	22
Above 2 per cent and up to 5 per cent	1	8	11	3	2
Above 5 per cent and up to 10 per cent	0	2	5	1	2
Above 10 per cent	0	0	0	0	4
2005-06 P					
Up to 2 per cent	7	15	11	6	26
Above 2 per cent and up to 5 per cent	1	5	7	2	0
Above 5 per cent and up to 10 per cent	0	0	2	0	0
Above 10 per cent	0	0	0	0	3

P : Data as on March 31, 2006 are unaudited and provisional.

Source : Off-site supervisory returns submitted by the banks pertaining to their domestic operations only.

2005-06, as both interest and non-interest income moderated during the year (Table 5.7). Total expenditure (as per cent to total assets), on the other hand, was unchanged from the previous year. As a result, earnings before provisions and taxes, as per cent to total assets, during 2005-06 were lower than the previous year. However, in view of lower provisions, profits after tax, as per cent to total assets, at 0.88 per cent during 2005-06 were almost the same as during 2004-05 (0.89 per cent). As many as 45 banks (out of the total of 85 banks) recorded an increase in the profits ratio during the year (Table 5.8).

V.86 The return on total assets of scheduled UCBs increased from 0.3 per cent in 2004-05 to 0.6 per cent in 2005-06. The return on assets of the PDs witnessed substantial turnaround to reach 5.6 per cent during 2005-06. The return on assets had turned negative during the year 2004-05 on account of upward

Table 5.7: Operational Results of Scheduled Commercial Banks – Key Ratios

(Per cent to total assets)

Indicator	2004-05	2005-06
1	2	3
1. Total Income	8.21	8.03
Interest Income (net of interest tax)	6.72	6.64
Non-Interest Income	1.49	1.38
2. Total Expenditure	5.98	5.98
Interest Expenses	3.83	3.82
Operating Expenses	2.15	2.16
3. Earnings Before Provisions and Taxes (EBPT)	2.22	2.05
4. Provisions and Contingencies	1.33	1.17
5. Profit after Tax	0.89	0.88

Note : Data for March 2006 are provisional and unaudited.
Source : Off-site supervisory returns submitted by the banks pertaining to their domestic operations only.

movement in the yield curve and the consequent losses suffered by the PDs on their portfolio.

Sensitivity to Market Risk

Interest Rate Risk

V.87 Given the substantial holdings of investments in Government securities, the balance sheets of commercial banks is sensitive to interest rate movements. Banks have adopted various portfolio management techniques like reduction of duration particularly in case of trading book in conjunction with reduction in the size of the trading book itself (thereby immunising themselves significantly from marked to market losses) to counter interest rate risk to the extent possible. In this context, it may be noted that in view of sustained demand for bank credit from the commercial sector, banks restricted their incremental investments in Government securities during 2005-06. As a result, the share of investments in Government securities in total assets declined during 2005-06.

Currency Risk

V.88 In the foreign exchange market, the Indian rupee exhibited two-way movement *vis-à-vis* the US dollar during 2005-06, moving in a range of Rs.43.30-46.33 per US dollar. The two way movement in exchange rates and the risks involved in unhedged foreign exchange positions need to be recognised.

Equity Risk

V.89 The Reserve Bank has put in place several regulatory requirements in place to ensure that the banks foray into the capital market is within prudential limit. The margin requirements ensure that the bank advances are well collateralised. The capital market exposure of the banking system, as per cent of gross advances, was 2.1 per cent at end-March 2006, remaining well within the regulatory limit of 5 per cent.

Liquidity

V.90 The ratio of liquid assets to total assets in respect of SCBs declined to 34.5 per cent as at

Table 5.8: Operational Results of Scheduled Commercial Banks – 2005-06
(Number of banks showing increase in ratios during the period)

Ratio to Total Assets	Public Sector Banks		Private Sector Banks		Foreign Banks	All Banks
	SBI Group	Nationalised Banks	Old Private Sector Banks	New Private Sector Banks		
1	2	3	4	5	6	7
1. Total Income	1	4	6	6	18	35
Interest Income	3	5	5	5	21	39
Non-Interest Income	3	2	12	6	16	39
2. Total Expenditure	5	7	7	6	21	46
Interest Expenses	5	7	5	6	20	43
Operating Expenses	5	7	15	5	13	45
3. Earnings before Provisions and Taxes (EBPT)	1	2	10	6	18	37
4. Provisions and Contingencies	1	4	3	6	16	30
5. Profit after Tax	2	9	14	3	17	45

Note : Data are provisional and unaudited.
Source : Off-site supervisory returns submitted by the banks pertaining to their domestic operations only.

end-March 2006 from 39.2 per cent as at end-March 2005. This decrease in ratio can be attributed primarily to sustained large demand for bank credit in an environment of acceleration in economic activity.

Outlook

V.91 The Reserve Bank would continue to undertake regulatory and supervisory initiatives to strengthen the financial sector in order to enhance efficiency of resource allocation while ensuring financial stability in the economy. These initiatives will be guided by the objective of benchmarking the financial sector in India to the best international standards, but with emphasis on gradual harmonisation with the international best practices. All commercial banks in India are required to start implementing Basel II with effect from March 31, 2007. While banks will initially adopt the Standardised Approach for credit risk and the Basic Indicator Approach for operational risk, some of them may be allowed to migrate to the Internal Rating Based (IRB) Approach after adequate skills are developed, both by the banks and the supervisors. Banks which are internationally active should look to significantly improve their risk management systems and migrate to the advanced approaches under Basel II since they will be required to compete with the international banks which are adopting the advanced approaches. This strategy would also be relevant to other banks which are looking at adoption of the advanced approaches. Finally, while pursuing with its initiatives to strengthen the financial sector, the Reserve Bank would intensify its efforts to ensure financial inclusion so that banking services are available to all segments of the population.

VI PUBLIC DEBT MANAGEMENT

VI.1 During 2005-06, the Reserve Bank, as the Government's debt manager, continued to be guided by the twin objectives of minimisation of cost over time and elongation of the maturity profile of Government securities in a scenario of an upward shifting yield curve. A number of developments had an impact on the management of the internal marketable debt as well as the liquidity position of the Central and State Governments during 2005-06. First, the sustained pick-up in non-food credit coupled with the rise in international crude oil prices and global interest rates put some upward pressure on domestic interest rates, which affected the volume of transactions and yields on Government securities. Second, reflecting the ongoing fiscal consolidation process, gross fiscal deficit (GFD) of State Governments showed further moderation during 2005-06, which helped to contain the pressure on the demand for funds. Third, following the recommendations of the Twelfth Finance Commission (TFC), Central loans for State Plan schemes were eliminated during 2005-06, exposing the States to greater market discipline. Finally, the financing pattern of the GFD of the State Governments continued to reflect the predominance and buoyancy of small savings, an 'autonomous' source of funds, which helped to reduce the need for accessing alternative market resources, *albeit* at a relatively higher cost.

VI.2 The Reserve Bank continued with its efforts towards imparting liquidity to the Government securities market by favouring reissuances of existing securities. The borrowing programme of the Central Government which was considerably larger than that in the previous year was completed successfully in 2005-06 without any devolvement on the Reserve Bank. Market borrowings by States during 2005-06 also elicited good response reflecting improved market perception of States' fiscal position. Both the Central and the State Governments recorded an improvement in their liquidity positions. The issuances of floating rate bonds were discontinued in 2005-06 due to lukewarm market response in the previous year on concerns about issues relating to their pricing and liquidity.

VI.3 The weighted average cost of market borrowings of the Centre and the States increased for the second consecutive year amidst the general hardening of interest rates across the financial markets. The weighted average maturity of the primary issuances of loans of the Centre during 2005-06 increased by nearly three years as the lukewarm response from banks was neutralised by increased participation by non-bank players, such as insurance companies and pension/provident funds, with higher appetite for longer maturity papers. Furthermore, there was a decline in the spread between primary market cut-off yields in the auctions of dated securities and the prevailing secondary market yields of securities of similar maturity reflecting efficient price discovery on account of the concerted efforts by the Reserve Bank in deepening and widening the market.

VI.4 This Chapter reviews the debt management operations of the Reserve Bank taking into account the monetary policy objectives and the prevailing macroeconomic situation. The review covers the trends in cash management by the Centre as well as the State Governments, progress of market borrowings of the Central and State Governments and maturity profile of the outstanding stock of Government securities. Initiatives taken during the year to put in place institutional arrangements to meet the debt management objectives in the context of the withdrawal of the Reserve Bank from the primary market for Central Government securities effective April 2006 and cessation of Central loans for State plans are also presented.

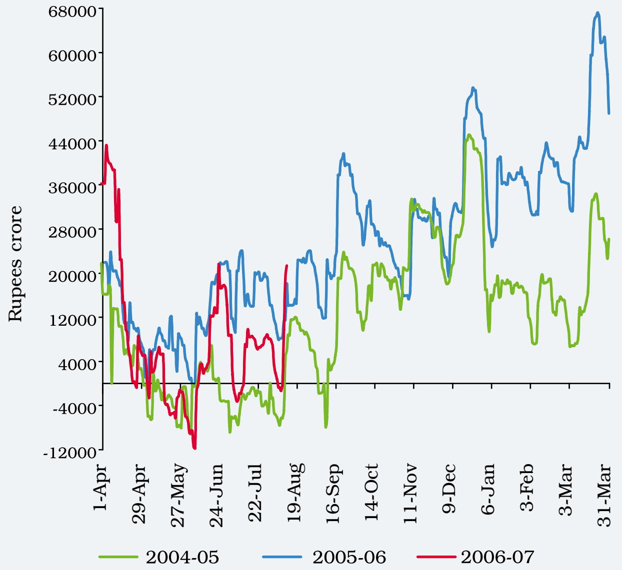
CENTRAL GOVERNMENT

Ways and Means Advances

VI.5 The limits of Ways and Means Advances (WMA) to the Central Government for the fiscal year 2005-06 were retained at Rs.10,000 crore during the first half of the year (April–September) and Rs. 6,000 crore during the second half of the year (October-March). The interest rate on WMA continued to be at the Bank Rate and that on overdraft at two percentage points above the Bank Rate. The minimum balance required to be maintained by the Government of India with the Reserve Bank was to be not less than Rs.100 crore on Fridays, on March 31 (*i.e.,* closure of Government of India's financial year) and on June 30 (*i.e.,* closure of the annual accounts of the Reserve Bank) and not less than Rs.10 crore on other days. Reflecting the improvement in its cash position, the

Central Government did not resort to overdrafts during 2005-06. Furthermore, the Centre availed WMA on two days only during the year (May 3 and June 4, 2005). In the previous year, although the Centre had not resorted to overdraft, it had availed of WMA on a number of occasions till September 9, 2004. Since then, the Central Government continuously maintained surplus cash balances in its current account with the Reserve Bank up to end-March 2006. While the build-up of the Centre's surplus during 2004-05 had mainly reflected substantial inflows on account of prepayment of high cost debt by the States under the debt swap scheme (DSS), the build-up during 2005-06 mainly reflected the investment of the State Governments in 14-day Intermediate Treasury Bills and auction Treasury Bills. With the ceiling on investment balance retained at Rs. 20,000 crore since October 2004, the Central Government's cash balances in the form of investment balance (Rs.20,000 crore) and cash balance (Rs.28,928 crore) parked as non-interest bearing deposits with the Reserve Bank amounted to Rs.48,928 crore as at end-March 2006 as compared with Rs.26,202 crore in the previous year (Chart VI.1). Large surplus cash balances can have significant impact on liquidity in the banking system necessitating active management of surplus cash balances (Box VI.1).

Chart VI.1: Cash Balances of the Central Government



Box VI.1
Management of Surplus Cash Balances: Cross Country Practices

During 2005-06, the build-up and volatility in Central Government's cash surplus with the Reserve Bank had a significant impact on liquidity conditions in India. Government's cash balances, when maintained with the central bank, do not form part of the liquidity in the banking system. Therefore, sharp increase in surplus balances in Government's account reduces liquidity in the banking system and this could drive up the short term interest rates. Arrangements which facilitate transfer of surplus funds from Government's account to deficit participants in the system could help in better management of liquidity in the system. Such arrangements not only enable the Government to earn better returns on the cash balances, but also mitigate volatility in short-term interest rates and keep overnight money market rates stable.

Arrangements aimed at achieving such transfer of liquidity vary widely across countries. For instance, in Canada, the cash balances of the Central Government are auctioned in a competitive auction twice a day to a select set of participants. The participants' auction limits (collateralised and uncollateralised) are decided on the basis of their credit rating. All Government receipts and disbursements flow through the Government's accounts at the Bank of Canada and the accounts are managed such that the balances at the central bank are essentially nominal. As a result, the Central Government invests effectively all of its cash balances in the market almost on a daily basis.

In contrast, in other G-7 countries, substantial cash balances are generally maintained with their respective central banks. Japan and Italy, for example, maintain all Government balances at their respective central banks. France and the United States maintain a significant working balance at their central banks while amounts beyond the targeted working balances are invested in the market. Germany invests cash surpluses in the market only on rare occasions.

Countries that keep balances at the central bank, of course, rely on the central bank to invest the funds. The United States allocates its balances to market participants on a *pro rata* basis at a fixed reference rate of interest (currently 25 basis points below the Fed funds rate), while France and the United Kingdom deal directly with market participants. The United States requires full collateral for its cash balances while France and the United Kingdom invest mainly through the repo market. These country practices may be useful in designing an appropriate cash management strategy for the Government of India.

References

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2. Bank of Canada (2000), "Proposed Revisions to the Rules Pertaining to Auctions of Receiver General Term Deposits", Bank of Canada Discussion Paper, July.

VI.6 With a view to achieving a smooth transition to the new regime as envisaged in the Fiscal Responsibility and Budget Management (FRBM) Act whereby the participation of the Reserve Bank in the primary issuance of Central Government securities has been prohibited with effect from April 1, 2006, and to facilitate market preparedness, the WMA arrangements for 2006-07 were revised in consultation with the Government. As per the revised arrangement, the WMA limits would be fixed on a quarterly basis instead of the existing half-yearly basis. Accordingly, the WMA limits for 2006-07 have been placed at Rs.20,000 crore and Rs.10,000 crore for the first and second quarters, respectively, and Rs.6,000 crore each for the third and fourth quarters of the year. The Reserve Bank would retain the flexibility to revise the limits in consultation with the Government of India taking into consideration the transitional issues and prevailing circumstances. Furthermore, the interest rates on WMA and overdraft have been linked to the repo rate as against the Bank Rate hitherto, following its emergence as the short-term reference rate. Accordingly, the interest rate on WMA will be at the repo rate and that on overdraft will be at repo rate plus two percentage points. During 2006-07 so far (up to August 18, 2006), the Centre did not resort to overdraft but availed of WMA on five occasions (39 days in all).

Treasury Bills

VI.7 During 2005-06, the notified amounts of regular issuances of 91-day and 364-day Treasury Bills (*i.e.* excluding that under Market Stabilisation Scheme (MSS)) were retained at Rs.500 crore and Rs.1,000 crore, respectively. The auction of 182-day Treasury Bills (TBs) was re-introduced in April 2005 with a notified amount of Rs.500 crore. All the auctions during the year were held as per schedule except for the auctions of 91-day and 182-day TBs scheduled for July 27, 2005 which were cancelled due to declaration of holidays on July 27-28, 2005 by the State Government on account of heavy rains in Mumbai.

VI.8 The notified amount of TBs issued under the MSS was, however, varied during the year keeping in view the prevailing liquidity conditions. During the period up to August 24, 2005, the notified amount for issuance under the MSS was Rs.1,500 crore in case of 91-day TBs and Rs.1,000 crore each in case of 182-day TBs and 364-day TBs. Subsequently, the notified amount in respect of 91-day TBs under MSS was increased to Rs.3,500 crore for the five auctions between August 31, 2005 and September 28, 2005. In view of liquidity conditions, the Reserve Bank rejected all the bids for the TBs auctions under the MSS scheduled on November 9, 2005 and discontinued the auctions under the MSS from November 16, 2005 onwards. On a review of the liquidity conditions, the auctions under the MSS were re-introduced effective May 3, 2006.

VI.9 All the issues of regular TBs were fully subscribed to by the market and there was no devolvement on the Reserve Bank. During 2005-06, non-competitive bids amounting to Rs.25,368 crore, Rs.2,250 crore and Rs.2,019 crore were received in the auctions of 91-day, 182-day and 364-day TBs, respectively, mainly reflecting the investment of surplus cash balances with State Governments.

VI.10 The primary market yields of TBs edged higher during 2005-06 mirroring the liquidity conditions as well as movements in the LAF (repo/reverse repo) rates (Table 6.1 and Appendix Table 58). The increase in primary market yields during the year mainly took place after mid-September 2005, reflecting liquidity tightening due to festival demand for cash, quarterly advance tax outflows, and IMD redemption on December 29, 2005 amidst strong credit demand. After recording a somewhat sharp jump during January-

Table 6.1: Profile of Treasury Bills

(At Face Value)

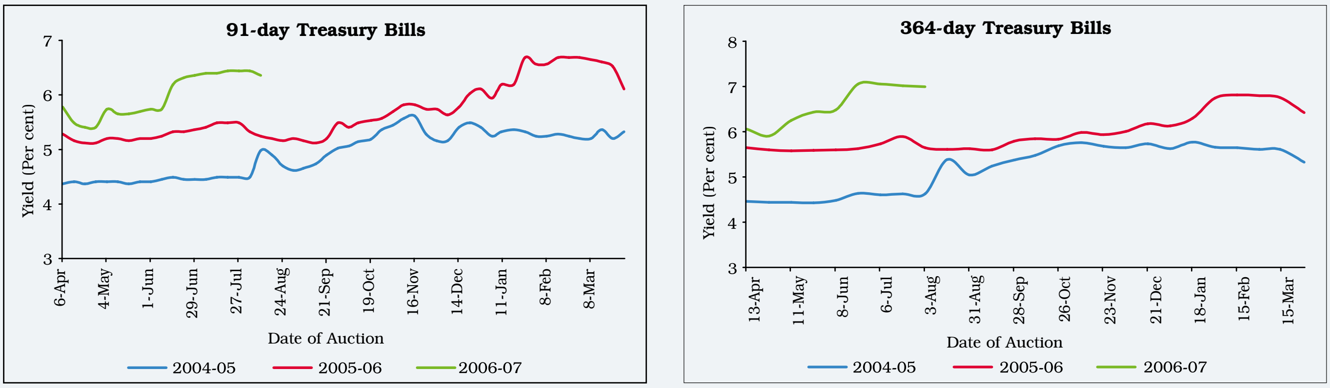
(Rupees crore)

Type of Treasury Bill	Weighted Average Cut-off Yield (Per cent)		Gross Amount		Net Amount		Outstanding Amount	
	2004-05	2005-06	2004-05	2005-06	2004-05	2005-06	End-March 2005	End-March 2006
1	2	3	4	5	6	7	8	9
91-day	4.89	5.51	1,00,592	1,03,424	20,653	-11,474	27,792	16,318
			(67,955)	(52,057)	(19,500)	(-19,500)	(19,500)	(0)
182-day*	-	5.65	-	26,828	-	9,771	-	9,771
		-	(13,078)	-	(3,000)	-	(3,000)	
364-day	5.15	5.87	47,132	45,018	20,997	-2,114	47,132	45,018
			(20,981)	(16,000)	(20,981)	(-4,981)	(20,981)	(16,000)

* : 182-day TBs were re-introduced on April 6, 2005.

Note : Figures in parentheses pertain to issuances under the MSS.

Chart VI.2: Primary Market Yields of Treasury Bills



February 2006 reflecting the continued tight liquidity conditions in the aftermath of IMD redemption, the yields eased during March 2006 with the easing of liquidity conditions (Chart VI.2). The primary market weighted average cut-off yields increased by 62-72 basis points during 2005-06.

VI.11 The yield spread between 91-day and 364-day TBs turned negative in January 2006 but remained otherwise positive and varied between 46 basis points (September 2005) and 15 basis points (February and March 2006) during 2005-06 (Table 6.2).

VI.12 On March 24, 2006, the calendar for the regular auction of TBs for the period April 1, 2006 to March 31, 2007 was announced. The notified amounts of 91-day, 182-day and 364-day TBs were kept unchanged at Rs.500 crore, Rs.500 crore and Rs.1,000 crore, respectively. As noted earlier, auctions of TBs under the MSS were resumed from May 3, 2006. The notified amount under MSS was placed at Rs. 1,500 crore in case of 91-day TBs and Rs. 1000 crore each in the case of 182-day and 364-day TBs. The yields of TBs dipped in April 2006 and increased thereafter. The yield spread between 91-day and 364-day TBs increased from 46 basis points in April 2006 to 62 basis points in July 2006.

Table 6.2: Treasury Bills - Primary Market

Month	Notified Amount (Rupees crore)	Average Implicit Yield at Minimum Cut-off Price (Per cent)			Bid-Cover Ratio*		
		91-day	182-day	364-day	91-day	182-day	364-day
1	2	3	4	5	6	7	8
2005-06							
April	19,000	5.17	5.36	5.62	4.03	4.48	2.54
May	15,000	5.19	5.35	5.58	3.30	3.37	2.29
June	18,500	5.29	5.37	5.61	1.54	2.42	1.81
July	11,500	5.46	5.67	5.81	1.21	1.79	1.68
August	21,000	5.23	5.42	5.63	3.07	2.68	2.54
September	23,000	5.24	5.37	5.70	1.52	1.45	1.61
October	15,000	5.50	5.71	5.84	1.69	1.53	3.44
November	11,000	5.76	5.85	5.96	2.12	1.92	2.30
December	5,000	5.89	6.00	6.09	3.07	2.97	2.36
January	5,000	6.25	6.22	6.21	2.86	2.83	2.72
February	5,000	6.63	6.74	6.78	3.04	2.07	2.71
March	6,500	6.51	6.66	6.66	4.17	3.43	3.36
2006-07							
April	5,000	5.52	5.87	5.98	5.57	4.96	2.03
May	18,500	5.70	6.07	6.34	1.88	1.84	1.69
June	15,000	6.15	6.64	6.77	1.63	1.35	2.11
July	15,000	6.41	6.75	7.03	1.82	1.55	3.12

* : Ratio of Competitive Bids Received to Notified Amount.
Note : 182-day TBs were re-introduced with effect from April 6, 2005.

Dated Securities

VI.13 During 2005-06, the gross market borrowings (including dated securities and 364-day TBs but excluding issuances under MSS) raised by the Central Government were significantly higher at Rs.1,60,018 crore (net Rs.98,237 crore) than the previous year, reflecting discontinuation of DSS on the one hand and requirements of financing a higher GFD on the other hand (Rs.1,46,175 crore in 2005-06 as compared with Rs.1,25,202 crore a year ago) (Table 6.3 and Appendix

Table 6.3: Gross and Net Market Borrowings of the Central Government

(Rupees crore)

Market Borrowings	2004-05 (Actual)	2005-06 (Estimates)#	2005-06 (Actual)	2006-07 (Estimates)#	2006-07 (Actual)*
1	2	3	4	5	6
Total	1,06,501 (46,050)	1,65,573 (1,03,791)	1,60,018 (98,237)	1,81,875 (1,13,778)	93,821 (52,715)
Of which:					
(i) Dated Securities	80,350 (46,034)	1,39,573 (1,03,942)	1,31,000 (95,370)	1,55,018 (1,15,939)	80,000 (50,212)
(ii) 364-day Treasury Bills	26,151 (16)	26,000 (-151)	29,018 (2,867)	26,857 (-2,161)	13,821 (2,503)

\# : Net market borrowings as per budget estimates and repayments as per RBI records.
* : Up to August 21, 2006.
Note : Figures in parentheses represent net borrowings.

Table 59). There was no devolvement on the Reserve Bank or Primary Dealers (PDs) during 2005-06 as against devolvement of Rs.847 crore on the Reserve Bank and Rs.985 crore on PDs during the previous year. During 2005-06, Rs.10,000 crore was, however, privately placed with the Reserve Bank on March 6, 2006 as against Rs.350 crore during 2004-05.

VI.14 The Reserve Bank persisted with the policy of passive consolidation and elongation of maturity profile of Government dated securities during the year. Out of 30 issues of dated securities during the year, 29 were reissues while a new security was issued to provide a benchmark for 30-year maturity. Thus, the share of reissuances in the total securities issued increased to 97.7 per cent during 2005-06 from 82.1 per cent during 2004-05. All issuances were by way of fixed rate securities during 2005-06. The issuance of Floating Rate Bonds (FRBs) was not undertaken on account of lukewarm market response during 2004-05 reflecting, *inter alia,* issues relating to liquidity and pricing (Box VI.2).

Box VI.2
Floating Rate Bonds

Floating Rate Bonds (FRBs) are medium to long term debt instruments offering variable coupons linked to some prefixed benchmark rate, which is usually some short-term rate such as yields on Treasury Bills (TBs) or money market rate. Coupons also include a fixed spread, which may, *inter alia*, reflect credit risk of issuer, liquidity risk and demand and supply of FRBs at the time of issue. The spread, which remains fixed throughout the tenure of the bonds, is decided at the time of first issuance of the bonds either through an auction or is prefixed by the issuer just before the issuance of bonds. The coupon rate of the bonds is reset at current market rate on every coupon reset date providing market risk immunising characteristic to FRBs. This makes them an attractive investment instrument to depository institutions particularly in a rising interest rate scenario. To the issuer, the bonds offer the advantage of bringing down the cost of borrowing in falling interest rate scenario but in a rising interest rate scenario the debt servicing cost may increase.

In India, the FRBs were issued by the Government of India for the first time on September 29, 1995. As the first issuance failed to generate enthusiastic response, no further issuance of FRBs was undertaken for nearly 6 years. Subsequently, on November 21, 2001, the FRBs were reintroduced with some modification in the structure on the request of market participants. Overwhelming market response showed the way for subsequent issuances and till October 9, 2004 ten issuances of FRBs were undertaken. However, the later phase witnessed gradual erosion in the market interest for FRBs, with last two FRBs devolving partially on the Reserve Bank and the PDs. Erosion in the market interest for FRBs at that time was, *inter alia*, attributed to strong credit pick-up, low secondary market liquidity in FRBs, structure related issues and consequent complex pricing methodology followed by market participants. As regards low secondary market liquidity in FRBs, it could be attributed to (i) low trading interest of market participants in the FRBs as they, by design, are a hedging instrument and offer limited scope for trading gains, (ii) no reissuance of FRBs on account of complexities associated with pricing FRBs, (iii) preference of the commercial banks to place these bonds under 'HTM' category reducing the availability of bonds for trading, and (iv) complex pricing method which deterred the market participants from undertaking outright transactions in FRBs.

The complexities in pricing of existing FRBs are associated with the method of valuation used by market participants and the benchmark for determining the semi-annual coupon payments. Theoretically, an ideal benchmark instrument should have the following characteristics: (i) the tenor of that instrument should equal the coupon payment period as well as the coupon reset period of the bonds, and (ii) the yield of the instrument should reflect the prevailing market yield. In the absence of any instrument fulfilling the above characteristics, 364-day TBs were used as a benchmark instrument at the time of re-introduction of FRBs. The use of cut-off yield of 364-day TBs as benchmark rate for resetting semi-annual coupon has contributed to the complexity in the pricing of FRBs. The issue could theoretically be addressed by making use of 182-day TBs as the benchmark instrument but these TBs have not emerged so far as a liquid instrument.

The existing valuation method used by market participants assumes FRBs as long term bonds, paying variable coupons till the date of maturity. The (dirty) price of FRBs as per this method is arrived at by discounting the sum of the expected coupon flows on the next coupon payment date and the expected price of the FRBs on the next coupon reset date by a suitable discount factor for a period covering the valuation date to the next coupon reset date. The expected price of FRBs on the next coupon payment date is recursively derived from the expected price on the maturity date. For this purpose, forward rates computed from the zero coupon rates, which are adjusted for convexity and time factors, are used to estimate the expected coupon payment rate on each coupon reset dates and also the suitable discount factor. Besides complexity, the above method also suffers from a lacuna that the price of FRBs under this method does not necessarily come back to its par value on a reset date, which undermines the interest rate risk immunisation characteristic of the bonds. The existing methodology for pricing of FRBs, therefore, needs simplification. A simpler method for pricing the FRBs such as one which uses spread based pricing, as is the case internationally, may perhaps be more appropriate.

References

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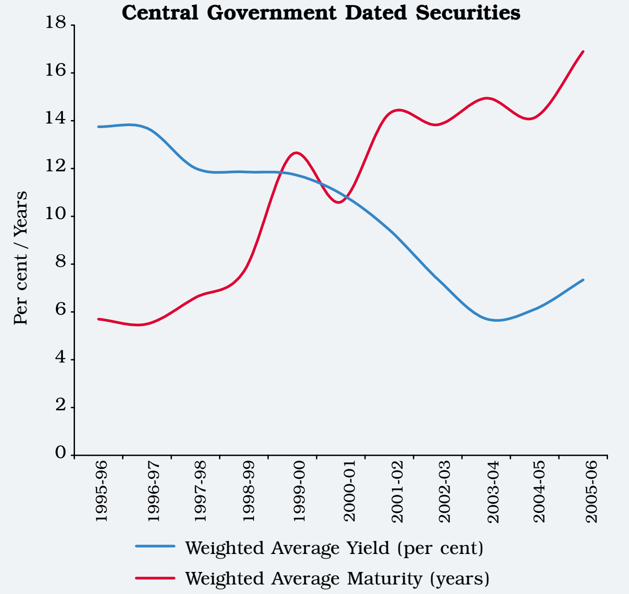
2. FIMMDA (2001), "Valuation Methodology for SLR and non-SLR Securities".

VI.15 During 2005-06, as against Rs.83,000 crore to be issued as per the issuance calendar for the first half (April 1, 2005 - September 30, 2005), only Rs.81,000 crore were raised through dated securities as the notified amount in the auction of dated security held on May 3, 2005 was reduced from Rs.4,000 crore to Rs.2,000 crore. Taking into account this reduction in the notified amount, the amount of dated securities to be issued during the second half of the year (October 2005-March 2006) as per the issuance calendar was placed at Rs.58,000 crore. Against this, the actual issuance was lower at Rs.40,000 crore. This shortfall was on account of (i) rejection of bids for an issue of Rs.6,000 crore on October 6, 2005, (ii) cancellation of auction of dated securities scheduled for October 18-25, 2005 for an amount of Rs.4,000 crore, (iii) reduction in the notified amount from Rs.6,000 crore to Rs.3,000 crore in the auction of dated security on February 7, 2006, and (iv) cancellation of the auction of dated security scheduled for February 14-22, 2006 for an amount of Rs.5,000 crore. As against this, the Government of India privately placed dated securities for an amount of Rs.10,000 crore with the Reserve Bank on March 6, 2006, which was outside the issuance calendar. As a result, the total borrowings of the Centre through dated securities amounted to Rs.50,000 crore in the second half of the fiscal year.

VI.16 The weighted average yield of the dated securities issued during 2005-06 increased further by 123 basis points to 7.34 per cent. The weighted average maturity of the dated securities issued during 2005-06 increased by 2.77 years to 16.90 years, reflecting appetite for longer maturity papers by non-bank investors such as insurance companies (Table 6.4, Appendix Table 60 and Chart VI.3). Despite an increase in the yield during the year, the weighted average coupon on the outstanding stock of Government securities declined further, *albeit* marginally, during the year.

Chart VI.3: Yield and Maturity of Central Government Dated Securities



VI.17 During 2005-06, the spread between primary cut-off yields in the auctions of dated securities and the prevailing secondary market yields of dated securities of similar maturity ranged between (-)12 to

Table 6.4: Central Government's Market Loans - A Profile*

(Yield in per cent/Maturity in years)

Year	Range of YTMs at Primary Issues			Weighted Average Yield	Range of Maturities of New Loans	Weighted Average Maturity	Weighted Average Maturity of Outstanding Stock	Weighted Average Coupon of Outstanding Stock
	Under 5 years	5-10 years	Over 10 years					
1	2	3	4	5	6	7	8	9
1997-98	10.85-12.14	11.15-13.05	-	12.01	3-10	6.60	6.50	..
1998-99	11.40-11.68	11.10-12.25	12.25-12.60	11.86	2-20	7.70	6.30	..
1999-00	-	10.73-11.99	10.77-12.45	11.77	5-19	12.60	7.10	..
2000-01	9.47-10.95	9.88-11.69	10.47-11.70	10.95	2-20	10.60	7.50	..
2001-02	-	6.98-9.81	7.18-11.00	9.44	5-25	14.30	8.20	10.84
2002-03	-	6.65-8.14	6.84-8.62	7.34	7-30	13.80	8.90	10.44
2003-04	4.69	4.62-5.73	5.18-6.35	5.71	4-30	14.94	9.80	9.30
2004-05	5.90	5.53-7.20	4.49-8.24	6.11	5-30	14.13	9.63	8.79
2005-06	-	6.70-7.06	6.91-7.79	7.34	5-30	16.90	9.92	8.75
2006-07 @	7.69-7.94	7.06-8.29	7.94-8.75	7.92	4-30	12.73	10.12	8.64

* : Excludes issuances under MSS. YTM : Yield to Maturity. .. : Not available. – : No Issues.
@ : Up to August 21, 2006.

Table 6.5: Primary Cut-off Yield and Prevailing Secondary Market Yield

(Amount in Rupees crore/Yield in per cent)

Date of Auction	Residual Maturity (Years)	Gross Amount Raised	Primary Cut-off Yield	Prevailing Secondary Market Yield	Spread (Basis points) (4) - (5)	Bid-Cover Ratio
1	2	3	4	5	6	7
April 5, 2005	6.98	5,000	6.80	6.77	3	2.16
April 5, 2005	27.39	3,000	7.79	7.69	10	2.00
April 19, 2005	11.74	5,000	7.48	7.45	3	1.94
April 19, 2005	29.31	2,000	7.94	7.93	1	2.47
May 3, 2005	5.03	6,000	6.99	6.94	5	3.59
May 3, 2005	29.27	2,000	7.98	8.02	-4	3.21
May 24, 2005	16.05	4,000	7.28	7.40	-12	2.63
June 6, 2005	15.98	4,000	7.47	7.27	20	1.88
June 6, 2005	8.86	6,000	6.91	6.86	5	1.94
June 23, 2005	10.81	5,000	6.91	6.94	-3	2.28
July 5, 2005	8.16	6,000	7.06	7.11	-5	1.90
July 5, 2005	15.90	4,000	7.57	7.46	11	2.05
July 18, 2005	15.86	5,000	7.81	7.65	16	2.59
August 11, 2005	28.99	3,000	7.44	7.48	-4	2.15
August 11, 2005	11.43	5,000	7.14	7.10	4	1.82
August 18, 2005	8.66	5,000	7.04	7.03	1	2.10
August 18, 2005	28.98	3,000	7.55	7.46	9	1.63
September 8, 2005	13.04	5,000	7.23	7.19	4	1.51
September 8, 2005	30.00	3,000	7.40	7.40	0	2.17
October 6, 2005	29.92	3,000	7.66	7.58	8	1.54
October 6, 2005 *	9.10	..	..	7.13	..	..
November 8, 2005	11.44	5,000	7.33	7.31	2	1.79
November 8, 2005	29.83	3,000	7.73	7.51	22	2.13
November 24, 2005	16.47	5,000	7.43	7.41	2	2.81
December 6, 2005	11.11	5,000	7.24	7.22	2	1.78
December 6, 2005	29.76	3,000	7.55	7.53	2	2.89
January 9, 2006	5.48	6,000	6.70	6.68	2	1.67
January 9, 2006	29.66	4,000	7.43	7.43	0	2.92
February 7, 2006	11.56	3,000	7.38	7.39	-1	2.49
February 7, 2006	29.59	3,000	7.63	7.52	11	2.50
March 6, 2006 #	29.51	10,000	7.77	7.78	-1	..

* : All the bids were rejected. # : Private placement with the Reserve Bank. .. : Not Applicable.

22 basis points. However, for a majority of issues (20 out of the 29 auctions of dated securities), the spread ranged lower between (-) 5 to 5 basis points, indicating efficient price discovery in the primary auctions (Table 6.5).

VI.18 Securities of over 10-year maturity continue to represent the largest share in the outstanding stock of securities as well as in new issuances (Table 6.6).

VI.19 The repayment schedule of outstanding market loans of the Central Government as on March 31, 2006 indicates bunching of repayments in the short to medium term period. Repayment obligations would be of the order of around Rs.60,000 crore during 2010-11 to 2013-14 and 2015-16 to 2017-18 (Table 6.7).

Table 6.6: Maturity Profile of Central Government Dated Securities

(Per cent)

Year	Issued during the Year			Outstanding Stock (End-March)		
	Under 5 Years	5-10 Years	Over 10 Years	Under 5 Years	5-10 Years	Over 10 Years
1	2	3	4	5	6	7
1997-98	18	82	0	41	41	18
1998-99	18	68	14	41	42	16
1999-00	0	35	65	37	39	24
2000-01	6	41	53	27	47	26
2001-02	2	24	74	31	36	33
2002-03	0	36	64	26	35	39
2003-04	5	18	77	24	32	44
2004-05	4	19	77	27	30	43
2005-06	0	26	74	26	31	43

Table 6.7: Repayment Schedule of Central Government Dated Securities

(As on March 31, 2006)

(Rupees crore)

Year	Amount
1	2
2006-07	44,079 *
2007-08	51,876 **
2008-09	44,028
2009-10	52,589
2010-11	62,586
2011-12	61,581
2012-13	62,074
2013-14	65,009
2014-15	53,018
2015-16	65,244
2016-17	63,130
2017-18	63,774
2018-19	42,478
2019-20	28,000
2020-21	11,000
2021-22	26,213
2022-23	41,000
2023-24	21,000
2025-26	16,688
2026-27	15,000
2027-28	15,000
2028-29	11,000
2032-33	17,000
2034-35	14,350
2035-36	29,000
Total	**9,76,717**

* : Includes repayment of Rs.5,000 crore under MSS.
** : Includes repayment of Rs.6,000 crore under MSS.

VI.20 The declining trend in the share of high cost debt continued during 2005-06. The share of the outstanding stock with a coupon of less than 8 per cent increased to 50.2 per cent from 47.6 per cent in the previous year (Table 6.8).

Table 6.8: Interest Rate Profile of the Outstanding Stock of Central Government Securities

Interest Rate (Per cent)	Outstanding Amount (Rupees crore)		Share in Total (Per cent)	
	end-March 2005	end-March 2006	end-March 2005	end-March 2006
1	2	3	4	5
4.00-4.99	42,500	19,500	4.8	2.0
5.00-5.99	96,818	83,818	10.8	8.6
6.00-6.99	1,51,772	1,62,307	17.0	16.6
7.00-7.99	1,34,540	2,24,540	15.0	23.0
8.00-8.99	37,638	60,973	4.2	6.2
9.00-9.99	56,424	59,424	6.3	6.1
10.00-10.99	83,537	93,067	9.3	9.5
11.00-11.99	1,65,646	1,59,308	18.5	16.3
12.00-12.99	94,249	94,249	10.5	9.7
13.00-14.00	32,222	19,530	3.6	2.0
Total	**8,95,348**	**9,76,717**	**100.0**	**100.0**

VI.21 As noted earlier, under the FRBM Act 2003, the Reserve Bank has been prohibited from subscribing to the primary issues of the Central Government securities from the financial year beginning April 1, 2006. In order to ensure a smooth transition to the new system, the Reserve Bank has taken a number of measures to make the market deeper, broader and more liquid while improving trading/settlement and institutional infrastructure (Box VI.3).

Oil Bonds

VI.22 With a view to compensating oil marketing companies for under-recoveries in their domestic LPG and kerosene sales under the Public Distribution System (PDS) during the financial year 2005-06, the Government of India issued six special marketable dated securities to oil marketing companies on two occasions, *viz.*, March 7, 2006 and March 23, 2006, aggregating Rs. 11,500 crore. These securities with interest rates in the range of 7.07 per cent and 7.61 per cent were issued with 3-years, 6-years and 9-years maturities without SLR status as these were not part of the approved market borrowing programme of the Government. The coupon rates on these bonds were fixed on the basis of prevailing secondary market yields with a suitable non-SLR spread of 20-25 basis points.

Recapitalisation Bonds

VI.23 The Union Budget 2006-07 announced the unwinding of entire outstanding Recapitalisation Bonds/Special Securities issued to nationalised banks, amounting to Rs. 20,809 crore, through conversion into tradable, SLR eligible, Government of India dated securities. The substitution of non-tradable securities with tradable securities having SLR status would facilitate increased access of the banking sector to additional resources for lending to productive sectors especially agriculture and SME sectors, in the light of the increasing credit needs of the economy.

Market Borrowings during 2006-07

VI.24 Market borrowings (including dated securities and 364-day TBs) of the Central Government for the year 2006-07 are budgeted at Rs.1,81,875 crore (net Rs.1,13,778 crore), Rs.21,857 crore higher than the actual amount raised in 2005-06. On March 24, 2006, the issuance calendar for dated securities for the first half of 2006-07 fixed at Rs.89,000 crore (Rs.81,000 crore raised during the corresponding period of last year) was issued in consultation with the Central Government (Table 6.9). During 2006-07 so far (up to August 21, 2006), gross market borrowings (excluding

Box VI.3

Implementation of the FRBM Act : Reserve Bank's Initiatives

As per the provisions under the Fiscal Responsibility and Budget Management (FRBM) Act 2003, the Reserve Bank's participation in the primary market for Central Government Securities stands withdrawn beginning April 1, 2006.

In order to address the issues arising from these provisions of the FRBM Act and to equip the Reserve Bank as well as the market participants appropriately, a Technical Group on Central Government Securities Market was constituted which proposed a medium-term framework for the evolution of the Central Government securities market. On the basis of the recommendations of this Group, the Reserve Bank's Annual Policy Statement of April 2005 indicated that in the post-FRBM period, the Reserve Bank would reorient Government debt management operations while simultaneously strengthening monetary operations. Accordingly, the Reserve Bank constituted a new department, named as Financial Markets Department (FMD) in July 2005, with a view to moving towards functional separation between debt management and monetary operations.

Second, it was proposed that the number of actively traded securities would be enlarged to enhance liquidity and improve pricing in the market through active consolidation in consultation with the Government while continuing the programme of reissuances. In this regard, the Annual Policy Statement of April 2006 has further proposed that identified illiquid securities will be bought from the secondary market by the Reserve Bank and once a critical amount of securities is acquired, they would be bought back by the Government to extinguish the stock. The modalities of consolidation are being worked out in consultation with the Government.

Third, the settlement system for transactions in Government securities was standardised to T+1 cycle effective May 11, 2005 to provide the participants with more processing time at their disposal and therefore, to enable better management of both funds as well as risk.

Fourth, in order to provide Negotiated Dealing System (NDS) members with a more advanced and more efficient trading platform in Government securities, the Negotiated Dealing System - Order Matching (NDS-OM) trading module was introduced effective August 1, 2005.

Fifth, intra-day short sale was permitted in Government dated securities subject to certain stipulations with effect from February 28, 2006. The subsequent phases of short sale are proposed to be implemented after assessing the feedback and experience with intra-day short selling.

Sixth, guidelines for introduction of 'When Issued' market in Central Government securities were issued on May 3, 2006. 'When Issued' is a conditional transaction in a security authorised for issuance but not as yet actually issued. 'When Issued' market facilitates stretching the actual distribution period for each issue and allows the market more time to absorb large issues without disruption and helps in price discovery by reducing uncertainties surrounding auctions. When issued trading commenced from August 1, 2006 in respect of two securities auctioned on August 8, 2006.

Seventh, guidelines on the expansion of the permitted structure of PD business to banks which fulfil certain minimum eligibility criteria were issued on February 27, 2006.

Eighth, operational guidelines permitting stand alone PDs to diversify their activities, in addition to their core business of Government securities, were issued on July 4, 2006.

Finally, a revised scheme for underwriting commitment and liquidity support to PDs has been introduced with effect from April 1, 2006 whereby PDs are required to meet an underwriting commitment, replacing the earlier requirement of bidding commitment and voluntary underwriting.

Reference

Mohan, Rakesh (2006), "Recent Trends in the Indian Debt Market and Current Initiatives", Reserve Bank of India Bulletin, April.

issuances under the MSS) raised by the Central Government through dated securities and 364-day TBs amounted to Rs.93,821 crore (net Rs.52,715 crore) as compared with Rs.67,312 crore (net Rs.44,259 crore) during the corresponding period of the previous year. All issuances were by way of fixed coupon securities. Out of the Rs.80,000 crore raised through issuances of dated securities up to August 21, 2006, Rs.5,604 crore devolved on PDs; there was no devolvement in the previous year. The weighted average yield of dated securities issued during 2006-07 (up to August 21, 2006) increased to 7.92 per cent from 7.27 per cent in the corresponding period of 2005-06. The spread between primary cut-off yields and the prevailing secondary market yields of dated securities ranged between (-) 15 to 8 basis points. For a majority of issues (13 out of 18 auctions) the spread ranged lower between (-) 1 to 4 basis points. The weighted average maturity of securities decreased to 12.73 years during 2006-07 (up to August 21, 2006) from 14.04 years in the corresponding period of 2005-06.

Table 6.9: Indicative Issuance Calendar and Actual Borrowings of the Central Government during 2006-07

(Amount in Rupees crore)

	Borrowings as per Indicative Issuance Auction Calendar			Actual Borrowings			
Sr. No.	Period of Auction	Amount	Residual Maturity (Years)	Date of Auction	Amount	Residual Maturity (Years)	Yield (Per cent)
1	2	3	4	5	6	7	8
1.	April 3-12, 2006	5,000	10 -14 year	April 10, 2006	5,000	10.00	7.59
		3,000	20 year and above	April 10, 2006	3,000	28.33	7.97
2.	April 18-25, 2006	6,000	5-9 year	April 25, 2006	6,000	6.02	7.06
		4,000	20 year and above	April 25, 2006	4,000	26.34	8.00
3.	May 2-9, 2006	6,000	10-14 year	May 4, 2006	6,000	9.94	7.55
		4,000	20 year and above	May 4, 2006	4,000	28.26	8.14
4.	May 16-24, 2006	5,000	15 -19 year	May 23, 2006	5,000	15.00	7.94
5.	June 1-8, 2006	6,000	5-9 year	June 6, 2006	6,000	5.07	7.39
		4,000	20 year and above	June 6, 2006	4,000	30.00	8.33
6.	June 15 - 24, 2006	5,000	15-19 year	June 22, 2006	5,000	8.52	7.92
				June 22, 2006 *	4,000	14.95	8.46
7.	July 3-11, 2006	6,000	10-14 year	July 11, 2006	5,000	9.75	8.29
		4,000	20 year and above	July 11, 2006	2,000	28.08	8.75
8.	July 17-25, 2006	5,000	15-19 year	July 27, 2006	4,000	3.79	7.69
9.	August 1-8, 2006	6,000	5-9 year	August 8, 2006	6,000	4.90	7.86
		3,000	20 year and above	August 8, 2006	3,000	9.68	8.20
10.	August 14-22, 2006	5,000	10-14 year	August 18, 2006	5,000	10.40	8.12
		3,000	20 year and above	August 18, 2006	3,000	29.79	8.73
11.	September 4-12, 2006	6,000	10-14 year				
		3,000	20 year and above				
	Total	**89,000**			**80,000**		

* : Not scheduled.

STATE GOVERNMENTS

Ways and Means Advances

VI.25 During 2005-06, the average utilisation of normal WMA, special WMA and overdrafts by the States remained substantially lower reflecting an improvement in their overall cash position (Table 6.10 and Chart VI.4).

VI.26 There was a reduction in the number of States that availed normal WMA during 2005-06 (12 States as compared with 21 States in 2004-05) as well as the number of days (ranging between 14-63 days, except for Kerala which had availed normal WMA for 240 days as compared with 348 days in 2004-05). Similarly, there was a reduction in the number of the State Governments availing overdraft

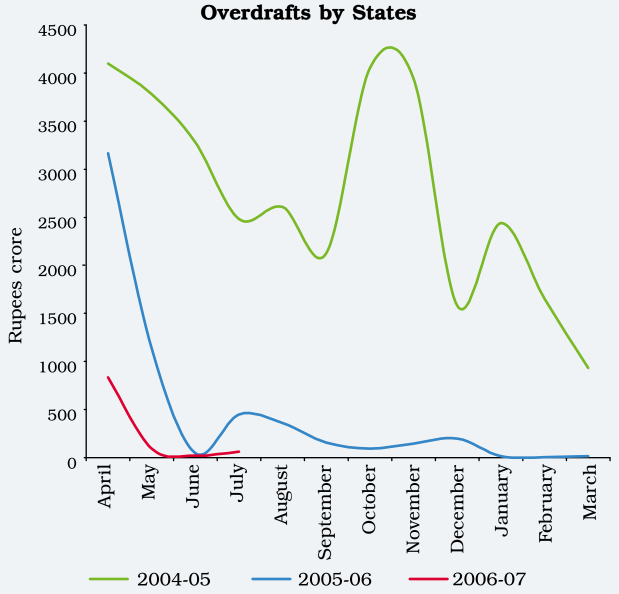
Table 6.10: WMA/Overdrafts and Investments of State Governments*

(Rupees crore)

Month	Special WMA		Normal WMA		Overdraft		Investments in 14-day Treasury Bills	
	2004-05	2005-06	2004-05	2005-06	2004-05	2005-06	2004-05	2005-06
1	2	3	4	5	6	7	8	9
April	1,118	368	1,908	1,824	1,075	974	5,585	14,764
May	1,044	221	2,177	824	560	90	5,917	18,458
June	1,049	3	1,724	43	506	0	7,959	32,318
July	863	78	1,196	292	425	76	7,693	32,633
August	890	93	1,472	254	247	14	8,348	35,611
September	856	61	1,258	97	14	0	9,887	40,530
October	951	11	2,556	85	547	0	9,606	36,252
November	933	13	2,545	132	465	0	12,011	40,429
December	601	8	827	181	152	9	14,722	44,109
January	695	3	1,530	11	216	0	12,632	42,905
February	438	1	1,110	2	107	0	15,039	36,515
March	115	1	631	16	188	0	17,337	48,811
Average	**796**	**72**	**1,578**	**313**	**375**	**97**	**10,561**	**35,278**

* : Average of Friday outstandings.

Chart VI.4: Average Utilisation of WMA and Overdrafts by States



(eight States as compared with 13 States in the previous year) (Table 6.11). Only two States resorted to overdraft on more than one occasion during the year. During 2006-07 so far (up to August 18, 2006), six States availed of WMA for a period of 2-61 days while two States resorted to overdraft for a period ranging between 3-15 days. The lower utilisation of WMA reflects persistent cash surplus with State Governments.

VI.27 The large build up of surplus cash balances by the State Governments was reflected in the spurt in their investments in 14-day Intermediate Treasury Bills. During 2005-06, the monthly investments averaged more than thrice their levels in the previous year. The outstanding investments increased from Rs.14,314 crore (by 16 States) as at end-March 2005 to Rs.38,983 crore (by 24 States) as at end-March 2006 and further to Rs. 44,370 crore (25 States as on August 18, 2006) (Chart VI.5). In view of the build-up of surplus cash balances, some States have desired to utilise their surplus to swap high cost debt with new low coupon issues or prepay their outstanding high coupon market borrowings (Box VI.4).

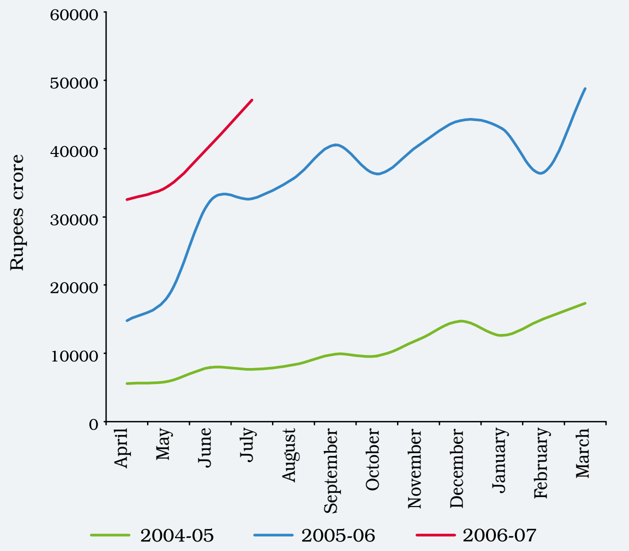
Table 6.11 State-wise Availment of WMA/Overdraft

(Rupees crore)

Sr. No.	States	WMA		Overdraft			
		2004-05	2005-06	2004-05		2005-06	
		Number of days	Number of days	Number of Occasions*	Number of days	Number of Occasions*	Number of days
1		2	3	4	5	6	7
Non-Special Category States							
1.	Andhra Pradesh	0	0	0	0	0	0
2.	Bihar	5	0	0	0	0	0
3.	Chhattisgarh	0	0	0	0	0	0
4.	Goa	212	0	3	13	0	0
5.	Gujarat	116	0	0	0	0	0
6.	Haryana	0	0	0	0	0	0
7.	Jharkhand	0	0	0	0	0	0
8.	Karnataka	7	0	0	0	0	0
9.	Kerala	348	240	19	161	11	63
10.	Madhya Pradesh	110	0	0	0	0	0
11.	Maharashtra	68	41	5	22	1	20
12.	Orissa	91	0	0	0	0	0
13.	Punjab	268	22	9	115	0	0
14.	Rajasthan	21	0	0	0	0	0
15.	Tamil Nadu	7	0	0	0	0	0
16.	Uttar Pradesh	294	34	13	98	1	11
17.	West Bengal	268	0	15	115	0	0
Special Category States							
1.	Arunachal Pradesh	35	29	3	6	0	18
2.	Assam	225	57	13	126	2	22
3.	Himachal Pradesh	159	25	4	27	0	0
4.	Manipur	149	63	2	118	1	44
5.	Meghalaya	0	15	0	0	1	1
6.	Mizoram	147	14	1	1	0	0
7.	Nagaland	103	42	3	18	1	17
8.	Tripura	31	0	0	0	0	0
9.	Uttaranchal	95	27	2	16	1	13

* : Refers to fresh occurrences of overdraft during the year.

Chart VI.5: Investments in 14-day Intermediate Treasury Bills by State Governments (Weekly Average)



VI.28 The Advisory Committee on Ways and Means Advances and Overdrafts to the State Governments (Chairman: Shri M.P. Bezbaruah) constituted by the Reserve Bank in April 2005 to review the WMA/OD Scheme in the light of the recommendations of the Twelfth Finance Commission (TFC) submitted its Report on October 29, 2005. The Report was discussed in the 17th Conference of State Finance Secretaries on January 13, 2006 and there was a general concurrence of the States on the recommendations of the Committee. Based on the recommendations of the Bezbaruah Committee, a revised WMA Scheme for State Governments was put in place for 2006-07 (Box VI.5). Accordingly, the aggregate Normal WMA limit was increased by 10.5 per cent to Rs.9,875 crore for the year 2006-07 (Table 6.12). The interest rate on WMA has been linked to the LAF repo rate as against the Bank Rate earlier.

Market Borrowings

VI.29 Following the implementation of the recommendations of the TFC, no provision was made in the Union Budget in respect of Central loans for State plans during 2005-06 and States were encouraged to access the market to raise their required resources. Gross market borrowings during 2005-06 by the State Governments were, however, lower than the previous year, mainly reflecting the impact of the DSS in 2004-05 as well as build up in their surplus cash balances (Table 6.13 and Appendix Table 61). Nine States (*viz*., Bihar, Goa, Gujarat, Karnataka, Madhya Pradesh, Orissa, Rajasthan, Tamil Nadu and West Bengal) did not raise the entire allocated amount in view of their holdings of surplus cash balances while Chhatisgarh did not participate in the market borrowing programme during the year. Excluding market borrowings raised under DSS and to pre-pay Rural Infrastructure Development Fund (RIDF) loan, the net market borrowings of States during 2005-06 were in line with that in the previous year.

Box VI.4
Surplus Cash Balances and High Coupon Debt

Auction-based buy-back and swapping of high coupon debt are two alternative ways of reducing the quantum of high coupon debt stock of State Governments. As regards debt swap, the gains to the Government on account of lower coupon on new issues is exactly offset by the premia the Government will have to pay to the high coupon bond holders and the net present value (NPV) of the cash flows under both streams will be exactly equal. As in the case of debt swap, outright prepayment also involves upfront payment of premia in the year of prepayment as long as the coupon on the stock being bought back is higher than the rate at which it is bought back. Debt prepayment enables the Government to improve its fiscal and revenue balances, the extent of which would depend on the difference between the (higher) average yield arrived at the debt buy-back auction and the (lower) rate of return on investments of surplus cash balances in Treasury Bills. Second, the reduction in the outstanding liabilities due to prepayment of debt is expected to improve the market perception of States' fiscal position with positive implications for the cost of future market borrowings. Thus, auction-based buy-back of outstanding high coupon debt could in certain situations be a superior alternative to swapping of high coupon debt with low coupon debt contracted, assuming that both are conducted on a pure voluntary basis and without any incentive.

At the same time, it needs to be recognised that surplus cash balances provide a cushion to tide over any unforeseen developments such as a deterioration in the liquidity environment. Hence, States that are considering prepayment of debt need to satisfy themselves that the surplus cash balances are of an enduring nature. Second, given that the State Government securities are rarely traded, the pricing of securities contemplated to be bought back could be an issue. Third, since the investor profile is dominated by the 'buy-and-hold' investors, the likely response from the market participants could be lukewarm. An alternative option to debt buy-back could be refraining from open market borrowings and other loans where States have an active role in mobilisation.

Box VI.5
Report of the Advisory Committee on Ways and Means Advances (WMA) to State Governments and the Revised WMA Scheme (2006-07)

The Advisory Committee on Ways and Means Advances to State Governments (Chairman: Shri M.P. Bezbaruah) observed that there was an improvement in the finances of the State Governments in recent years as evident from the reduction in alternative measures of deficit as well as improvement in liquidity management. Viewing the existing Normal WMA limits as more than adequate, the Committee observed that the recommendations of the Twelfth Finance Commission (TFC) (2005-06 to 2009-10) would have an increasingly positive impact on the finances and liquidity position of the State Governments over the medium term. In view of the shift from Central Plan loans (which are relatively 'orderly' flows to the States) to market borrowings by the State Governments, as recommended by the TFC, the year 2006-07 would be a period of transition and accordingly, State Governments require some more time to adjust to the fiscal *milieu* as envisaged by the TFC.

Based on the recommendations of the Bezbaruah Committee, a revised WMA Scheme for State Governments has been put in place by the Reserve Bank for 2006-07 with the following key features:

- The base for calculating Normal WMA limit has been changed from revenue receipts, as hitherto, to total (revenue plus capital) expenditure excluding repayments and adjusted for one-time *ad hoc* expenditures. The revenue deficit, wherever applicable, would be excluded from the base.
- The base would be obtained as the average of actual data for three years (as against the existing practice of incorporating actual data for two years and revised estimates for one year). A multiplication factor of 3.1 per cent (existing: 3.19 per cent) for the non-special category States and 4.1 per cent (existing: 3.84 per cent) for the special category States has been applied on the average of the recommended base, with the objective of maintaining equivalence with the existing limits. The computed limits for 2006-07 have been rounded off to the nearest multiple of Rs.5 crore. It has also been ensured that there is no reduction in the Normal WMA limit for any State Government from the existing (2005-06) level.
- As per the revised formula, the total Normal WMA limits for 2006-07 work out to Rs.9,875 crore, an increase of about 10.5 per cent over the limits for 2005-06.
- The Normal WMA limits would be reviewed every year and the decision to modify the limits would be taken by the Reserve Bank in the light of the emerging situation.
- The interest rate on WMA has been linked to the repo rate (as against the existing Bank Rate), since it is more reflective of short-term monetary conditions. Accordingly, the rate of interest charged on Normal WMA will be (a) repo rate for the period of 1 to 90 days and (b) one percentage point above the repo rate for the period beyond 90 days. The rate of interest applicable to Special WMA will be one percentage point below the repo rate.
- The rate of interest on overdraft will be: (a) two percentage points above the repo rate (existing: 3 percentage points above the Bank Rate) for overdraft up to 100 per cent of Normal WMA limit, and (b) five percentage points above the repo rate (existing: 6 percentage points above the Bank Rate) for overdraft exceeding 100 per cent of the Normal WMA limit.
- The net incremental (*i.e.*, new investment less redemption/liquidation) annual investment of States in Consolidated Sinking Fund (CSF)/Guarantee Redemption Fund (GRF) will be eligible for availing Special WMA, as an incentive for the States to build-up these funds. In case the CSF/GRF Scheme of the State Governments incorporate this provision, then Special WMA against the net incremental annual investment in CSF/GRF will be provided but up to a ceiling equivalent to their Normal WMA limit.
- The next review of the WMA scheme will be undertaken after the receipt of the recommendations of the Thirteenth Finance Commission.

Reference

Reserve Bank of India (2005), Report of the Advisory Committee on Ways and Means Advances to State Governments (Chairman: Shri M.P. Bezbaruah), October.

VI.30 During 2005-06, State Governments preferred to borrow through the auction route, raising as much as 48.5 per cent of their total borrowings through auctions (only 2.3 per cent in 2004-05). Twenty-four States opted for the auction route under the market borrowing programme during 2005-06 as compared with only three States in the previous year. In fact, for the first time ever, a State (Punjab) raised the entire amount through the auction mode. The increased recourse to auctions indicated improved market perception of States' fiscal situation as reflected in the lower spread of cut-off yields *vis-à-vis* tap issues (20-50 basis points in auctions as against 50 basis points in tap issues) over Central Government securities of corresponding maturity. The coupon of the tap issuance ranged between 7.53-7.77 per cent while the cut-off yield in the auction of State Government securities ranged between 7.32-7.85 per cent. The wider range of yields at auctions mainly reflected the timing of the issuances which were spread throughout the year

Table 6.12: Normal WMA Limits of States

(Rupees crore)

State	2002 (effective April 1, 2002)	2003 (effective March 3, 2003)*	2004 (effective April 1, 2004)	2005 (effective April 1, 2005)	2006 (effective April 1, 2006)#
1	2	3	4	5	6
Non-Special Category States					
Andhra Pradesh	520	620	700	770	880
Bihar	245	305	340	380	425
Chhattisgarh	100	130	155	175	190
Goa	50	50	65	65	65
Gujarat	445	485	520	575	630
Jharkhand	75	105	175	225	280
Haryana	180	205	245	280	295
Karnataka	375	460	505	570	625
Kerala	225	270	315	345	350
Madhya Pradesh	275	345	395	420	460
Maharashtra	760	905	1,000	1,050	1,160
Orissa	185	215	250	270	300
Punjab	235	240	325	360	360
Rajasthan	310	365	405	440	505
Tamil Nadu	415	570	615	670	730
Uttar Pradesh	630	755	835	920	1,020
West Bengal	360	420	480	495	545
Sub Total	**5,385**	**6,445**	**7,325**	**8010**	**8,820**
Special Category States					
Arunachal Pradesh	50	50	50	50	65
Assam	180	210	250	295	300
Himachal Pradesh	115	135	140	145	190
Manipur	50	50	50	55	60
Meghalaya	50	50	50	55	60
Mizoram	50	50	50	50	55
Nagaland	50	55	60	65	80
Tripura	55	60	70	80	100
Uttaranchal	50	65	95	130	145
Sub Total	**650**	**725**	**815**	**925**	**1,055**
Total	**6,035**	**7,170**	**8,140**	**8,935**	**9,875**

* : Advisory Committee on WMA to State Governments (Chairman: Shri C. Ramachandran), January 2003.
# : Advisory Committee on WMA to State Governments (Chairman: Shri M. P. Bezbaruah), October 2005.

(except May, July and October 2005) (Appendix Table 62). There were only three tap issuances during 2005-06 (in the months of May 2005, September 2005 and January 2006) (Table 6.14 and Appendix Table 63).

Table 6.13: Annual Market Borrowings of State Governments

(Rupees crore)

	Item	2004-05	2005-06	2006-07
1		2	3	4
1.	Net Allocation	13,969	16,112	17,077
2.	Additional Allocation	843	3,522	35
3.	Allocation to be Raised under DSS	19,766	-	-
4.	Allocation to Prepay RIDF Loan	2,393	-	-
5.	**Total Allocation (1+2+3+4)**	**36,970**	**19,634**	**17,112**
6.	Repayments	5,123	6,274	6,551 (4,926#)
7.	**Gross Allocation (5+6)**	**42,093**	**25,909**	**23,663**
8.	Amount Raised under DSS	16,943	-	-
9.	Amount Raised to Prepay RIDF Loan	1,386	-	-
10.	**Total Amount Raised (10.1 + 10.2)**	**39,101**	**21,729**	**7,343#**
	10.1 Raised through Tap	38,216	11,186	-
	10.2 Raised through Auction	885	10,544	7,343#
11.	Net Amount Raised (10 - 6)	33,978	15,455	2,417#
12.	Net Amount Raised (other than DSS) (11 – 8)	17,035	15,455	2,417#
13.	Net Amount Raised (other than DSS and RIDF) (11- 8- 9)	**15,649**	**15,455**	2,417#
14.	**Outstanding State Development Loans (end-period)**	**2,13,443**	**2,28,898**	**2,32,608**

: Up to August 21, 2006.
Source: Reserve Bank of India.

Table 6.14: Month-wise Market Borrowings of State Governments

(Amount in Rupees crore)

Month	Raised through Tap		Raised through Auction		Total Raised
	Amount	Coupon (Per cent)	Amount	Cut-off Yield (Per cent)	
1	2	3	4	5	6
2005					
April	-	-	300	7.45	300
May	7,554	7.77	-	-	7,554
June	-	-	2,391	7.35-7.39	2,391
July	-	-	-	-	-
August	-	-	250	7.32	250
September	2,931	7.53	839	7.42-7.50	3,770
October	-	-	-	-	-
November	-	-	375	7.34	375
December	-	-	361	7.33	361
2006					
January	701	7.61	482	7.32-7.33	1,183
February	-	-	3,724	7.65-7.85	3,724
March	-	-	1,821	7.69-7.79	1,821
Total	**11,186**	**7.53-7.77**	**10,544**	**7.32-7.85**	**21,729**

VI.31 The weighted average yield of State Government securities issued during 2005-06 increased to 7.63 per cent from 6.45 per cent during 2004-05 (Table 6.15). The rise in yields was in line with that of Central Government securities and reflected general upward movement in interest rates. All the securities issued during 2005-06 were of 10-year maturity while in the previous year one issue was of 9-year maturity and two issuances were of 12-year maturity.

VI.32 The share of high cost market loans of State Governments declined further during 2005-06. As at end-March 2006, the share of outstanding stock with interest rate of 10 per cent and above declined to 32 per cent from 37 per cent as at end-March 2005 and 47 per cent as at end-March 2004 (Table 6.16).

Table 6.15: Weighted Average Yield of State Government Securities

(Per cent)

Year	Range	Weighted Average
1	2	3
1997-98	12.30-13.05	12.82
1998-99	12.15-12.50	12.35
1999-00	11.00-12.25	11.89
2000-01	10.50-12.00	10.99
2001-02	7.80-10.53	9.20
2002-03	6.60-8.00	7.49
2003-04	5.78-6.40	6.13
2004-05	5.60-7.36	6.45
2005-06	7.32-7.85	7.63
2006-07*	7.65-8.66	8.06

* Up to August 21, 2006.

VI.33 With the tenor of securities issued during 2005-06 limited to 10 years, 67 per cent of the outstanding stock of State Government securities belonged to the maturity bucket of 6-10 years as at end-March 2006 as compared with 60 per cent as at end-March 2005 (Table 6.17).

VI.34 The maturity profile of market borrowings shows a hump in repayments during 2012-13 to 2015-16 due to high amount of borrowings during 2002-03 to 2004-05 under the Debt Swap Scheme (Table 6.18).

Market Borrowings of State Governments during 2006-07

VI.35 Net initial allocations and gross market borrowings (provisional) of the State Governments for 2006-07 are placed at Rs.17,077 crore and Rs.23,663 crore, respectively (see Table 6.13). During 2006-07 (up to August 21, 2006), 18 State Governments raised Rs.7,343 crore exclusively by way of auctions (as compared with Rs.7,854 crore raised through a combination of auctions and tap issuances during the corresponding period of the previous year) at cut-off

Table 6.16: Interest Rate Profile of the Outstanding Stock of State Government Securities

Sr.No.	Range of Interest Rate (Per cent)	Outstanding Amount (Rupees crore)		Percentage to Total	
		End-March 2005	End-March 2006	End-March 2005	End-March 2006
1	2	3	4	5	6
1.	5.00-5.99	33,825	33,825	15.8	14.8
2.	6.00-6.99	58,563	58,563	27.4	25.6
3.	7.00-7.99	27,872	49,601	13.1	21.7
4.	8.00-8.99	8,004	8,004	3.7	3.5
5.	9.00-9.99	5,412	5,412	2.5	2.4
6.	10.00-10.99	14,563	14,563	6.8	6.4
7.	11.00-11.99	17,062	17,062	8.0	7.5
8.	12.00-12.99	26,146	26,146	12.2	11.4
9.	13.00-13.99	15,722	15,722	7.4	6.9
10.	14.00	6,274	Nil	2.9	Nil
	Total	**2,13,443**	**2,28,898**	**100.0**	**100.0**

Table 6.17: Maturity Profile of Outstanding State Government Securities
(At end-March 2006)

Sr. No.	State	Per cent to Total Amount Outstanding 0-5 years	6-10 years	above 10 years	Total Amount Outstanding (Rupees crore)
1	2	3	4	5	6
1.	Andhra Pradesh	33.1	65.3	1.7	21,347
2.	Arunachal Pradesh	17.2	64.7	18.1	321
3.	Assam	29.9	66.0	4.1	5,847
4.	Bihar	30.4	61.4	8.2	10,909
5.	Chhattisgarh	33.5	55.1	11.4	2,657
6.	Goa	30.9	64.4	4.8	1,027
7.	Gujarat	25.0	70.1	4.8	13,003
8.	Haryana	25.3	72.0	2.7	5,142
9.	Himachal Pradesh	18.9	78.0	3.1	4,116
10.	Jammu & Kashmir	24.4	68.7	6.8	2,920
11.	Jharkhand	32.6	66.6	0.8	3,448
12.	Karnataka	29.6	68.5	1.9	11,933
13.	Kerala	29.4	66.6	4.0	11,060
14.	Madhya Pradesh	28.0	70.8	1.3	10,288
15.	Maharashtra	20.5	69.9	9.6	18,697
16.	Manipur	21.9	71.4	6.7	787
17.	Meghalaya	31.5	59.0	9.5	956
18.	Mizoram	22.4	64.3	13.3	601
19.	Nagaland	31.5	65.5	3.0	1,451
20.	Orissa	36.0	57.2	6.8	9,686
21.	Punjab	23.1	71.4	5.5	8,697
22.	Rajasthan	33.9	64.6	1.5	15,005
23.	Sikkim	40.5	46.4	13.1	420
24.	Tamil Nadu	28.1	69.0	3.0	15,002
25.	Tripura	29.0	53.3	17.7	1,144
26.	Uttar Pradesh	34.1	62.7	3.1	28,519
27.	Uttaranchal	13.1	86.9	0.0	3,920
28.	West Bengal	21.1	69.6	9.3	19,995
Total		**28.3**	**67.0**	**4.7**	**2,28,898**

yields ranging between 7.65–8.66 per cent. The weighted average yield of State Government securities issued during 2006-07 (up to August 21, 2006) was 8.06 per cent as compared with 7.66 per cent during the corresponding period of the previous year. The spreads over the corresponding yields of Central Government securities ranged between 22-47 basis points for all but two of 18 States. All the issues during the current fiscal year so far were of 10-year maturity, as in the previous year.

Table 6.18: Maturity Profile of Outstanding State Loans and Power Bonds
(At end-March 2006)

(Rupees crore)

Year	State Loans	Power Bonds	Total
1	2	3	4
2006-07	6,551	1,579	8,130
2007-08	11,555	3,159	14,714
2008-09	14,400	3,159	17,559
2009-10	16,511	3,159	19,670
2010-11	15,870	3,159	19,029
2011-12	22,032	3,159	25,191
2012-13	30,628	3,159	33,787
2013-14	32,078	3,159	35,237
2014-15	33,384	3,159	36,543
2015-16	35,191	3,159	38,350
2016-17	10,698	1,579	12,277
Total	**2,28,898**	**31,587**	**2,60,485**

Major Initiatives

VI.36 At present, Consolidated Sinking Funds (CSFs) and the Guarantee Redemption Funds (GRFs) of State Governments are invested in Government securities held in the books of the Reserve Bank. The TFC recommended that all States should set up sinking funds for amortisation of all loans (and not just market borrowings) and continue to maintain the Calamity Relief Fund (CRF) in its present form. In the context of these developments and for management of investments of State Governments, the Annual Policy Statement for 2006-07 proposed to revisit the scheme of CSF to cover the entire liabilities of State Governments. It was also proposed to prepare a scheme of CRF in consultation with the Government (Box VI.6).

VI.37 A Working Group on Liquidity of State Government Securities (Chairman: Shri V.K. Sharma) was constituted with members drawn from the Technical Advisory Committee on Money, Forex and Government Securities Markets (TAC), select State Finance Secretaries and the Reserve Bank to review the issue of low liquidity of State Government securities and suggest appropriate measures (Box VI.7). The Group submitted its Report to the Reserve Bank in September 2005. Drawing from the recommendations of the Group and with a view to widening the investor base in State Development Loans (SDLs), the Annual Policy Statement for 2006-07 proposed to extend the facility of non-competitive bidding (currently limited to Central Government dated securities) to the primary auction of SDLs and also to introduce purchase and resale of SDLs by the Reserve Bank under the overnight LAF repo operations.

Borrowing Arrangements for States

VI.38 The Reserve Bank's Annual Policy Statement for 2005-06 had drawn attention to the likely impact of the implementation of the recommendations of the TFC on the borrowing arrangements for State Governments. In the 16th Conference of State Finance Secretaries convened on April 8, 2005 to specifically discuss the recommendations of the TFC, the necessity to strengthen the joint approach among the

Box VI.6

Investment Portfolio Management of State Governments

The Reserve Bank has been managing, since the late 1990s, the investments of Consolidated Sinking Funds (CSFs) of 14 State Governments and the Guarantee Redemption Funds (GRFs) of five State Governments from its portfolio of holdings of Government securities. The investments under Calamity Relief Fund (CRF) set up by the State Governments are being managed by select public sector banks. The Twelfth Finance Commission (TFC) had recommended in favour of an expanded coverage of CSF to include amortisation of all loans (and not just open market borrowings as at present), while GRF and CRF would be continued in its present form. The expanded ambit of CSF is likely to increase States' investments in CSF and could constrain Reserve Bank's open market operations for monetary policy purposes in view of the finite stock of securities with the Reserve Bank. In this regard, the Technical Group on Borrowings by States (Chairperson: Smt. Shyamala Gopinath), in its Report submitted in December 2005, recommended that whereas the Reserve Bank should continue to manage the expanded CSF, the Reserve Bank should also acquire Central Government securities from the PDs/banks and immediately pass them on to the State Government concerned at the same price *i.e.*, without loading any charge and with proper dissemination of such transactions so as to obviate any confusion among market participants about the intent of such transactions.

In the context of these developments, the Annual Policy Statement for 2006-07 proposed to revisit the scheme of CSF to cover the entire liabilities of State Governments. Furthermore, the Advisory Committee on Ways and Means Advances to State Governments (Chairman: Shri M.P. Bezbaruah) had recommended that the net incremental (*i.e.* new investment less redemption/ liquidation) annual investment of States in CSF/GRF may be made eligible for availing Special WMA in case the CSF/ GRF schemes of the State Governments incorporate the above provision. Accepting this recommendation, the Reserve Bank circulated the revised model schemes of CSF/GRF among the States in May 2006. As regards CRF, following the recommendations of the TFC, the Government of India had circulated the details of the scheme among all the State Governments. In this context, and in consultation with the Government of India, the Reserve Bank had drafted a revised scheme as applicable to the Reserve Bank as the manager of investments in the Fund and had forwarded the same to the Government of India for concurrence. The Central Government, in turn, has forwarded the revised scheme to all the State Governments. The changes incorporated by the Reserve Bank in the CRF scheme are essentially to bring about uniformity in the modalities of investment and payment of commission, similar to the CSF and GRF schemes. States would, however, have the discretion to choose the Reserve Bank as the fund manager. The investments of the CRF would be dictated by consideration of maximisation of market-related return to the State Governments while ensuring safety and liquidity of the investments.

Centre, States and the Reserve Bank to ensure a smooth transition to the proposed arrangement was noted. Subsequently, in July 2005, the Government of India constituted a Technical Group (Chairperson: Smt. Shyamala Gopinath) comprising members from the Centre, select State Governments and the Reserve Bank to work out the modalities for a smooth transition to the proposed arrangement for States' borrowings. The Group submitted its Report to the Government of India on December 22, 2005. On the basis of the recommendations of the Group, the Annual Policy Statement for 2006-07 proposed to constitute a Standing Technical Committee (STC) under the aegis of the State Finance Secretaries Conference with representation from the Central and State Governments and the Reserve Bank to advise on the wide-ranging issues relating to the borrowing programmes of Central and State Governments through a consensual and cooperative approach.

Conference of State Finance Secretaries

VI.39 During 2005-06, the 16th and 17th conferences of State Finance Secretaries were held on April 8, 2005 and January 13, 2006, respectively. In the 16th Conference, the recommendations of the TFC and operational issues emanating therefrom were deliberated exclusively.

VI.40 In the 17th Conference, issues relating to market borrowings of State Governments, setting up of Consolidated Sinking Fund, and operational and technical issues regarding Government transactions were discussed. In the Conference, the recommendations of the Report of the Technical Group on Borrowings by State Governments, Report of the Advisory Committee on WMA to State Governments, Report of the Working Group on Liquidity of State Government Securities and Report of the Working Group on Compilation of State Government Liabilities were also discussed. While the recommendations of the WMA Committee have been implemented from the year 2006-07, the Annual Policy Statement for 2006-07 has proposed action points in respect of recommendations made by the Groups on 'Borrowings by State Governments' and 'Liquidity of State Government Securities'.

Box VI.7
Report of the Working Group on Liquidity of State Government Securities

The negligible level of secondary market liquidity in State Government securities could be attributed to certain interrelated factors such as (i) low level of outstanding stock resulting in an even lower level of floating stock, (ii) predominance of buy-and-hold investors, (iii) disconnect between the uniform coupon fixed in respect of States participating in a tap issue with their corresponding secondary market yields, and (iv) fragmentation across issuers (28 States) and securities (each State issuing up to eight new securities in a year). To address these issues, the Group explored the following options to build up volumes to ensure a critical minimum mass for secondary market liquidity: (i) increase in issue size; (ii) consolidation of securities; (iii) higher share of open market borrowings in financing of fiscal deficit; and (iv) securitisation of outstanding State Government securities. While considering these options, the Group felt that the issue size could be raised by limiting the number of issues. Second, passive consolidation of securities through reissuances of existing securities would involve bunching of repayments and reduction in the maturity profile. Third, an increase in the share of open market borrowings would depend, *inter alia*, on fiscal reform measures to boost investor confidence. Fourth, the outstanding stock of State Government securities could be consolidated through the securitisation route whereby the assets would be assigned to a special purpose vehicle (SPV) against which securities would be issued to the new investors. However, since this would result in a transfer of risk from the issuer to the SPV, the risk profile of the SPV would determine the yield/price of SPV securities.

Recommendations

(a) Role of Issuers (States)

In the Short Run

- Improve their debt repayment capability to facilitate consolidation of securities.
- Resort to the auction route for market borrowings.

In the Medium Term

- Seek credit rating to impart greater transparency and enable pooling structures to attract wider base of investors.

(b) ***Role of Primary Dealers (PDs)***

In the Short Run

- Provide two-way quotes for State Development Loans (SDLs).
- Retail SDLs to develop a wider investor base.

(c) Role of the Reserve Bank

In the Short Run

- Market borrowings with a minimum size of Rs.1,000 crore per tranche.
- Incentives such as short sale and reserved allotment at cut-off price/yield to encourage retailing and market making.
- Extension of non-competitive bidding facility in Central Government dated securities to the primary auction of SDLs to widen the investor base in SDLs.

In the Medium Term

- Use of OTC derivatives with State Government securities as the underlying and the exchanges permitting State Government bonds as eligible securities for delivery under the bond futures after wider consultation.
- Introduction of LAF repos using SDLs.
- Use of SDLs as collateral for the provision of intra-day liquidity under the RTGS.

(d) Role of Government of India

In the Short Run

- Align tax structure/incentives on small savings with SDLs for a level playing field to promote retail investment in the SDLs.

In the Medium Term

- Set up SPV to issue SPV securities backed by Central Government guarantee for consolidation of outstanding State Government securities and build up volumes.

Reference

Reserve Bank of India (2005), Report of the Working Group on Liquidity of State Government Securities (Chairman: Shri V.K. Sharma).

VI.41 In the 18th conference held on August 7, 2006, the discussions primarily focussed on issues relating to computerisation of treasuries, underwriting in respect of open market loans and management of open market borrowings of the State Governments apart from operational issues pertaining to Government transactions. Issues arising from the sizable build-up of surplus cash balances of the State Governments and the exchange rate risk arising from the back-to-back transfer of external assistance loans by the Centre to the State Governments were also discussed (Box VI.8)

Outlook

VI.42 The market borrowing programme of the Central Government during 2006-07 is budgeted to be higher than that in the previous year. Furthermore, yields have hardened domestically reflecting oil price induced inflationary pressures and upturn in the international interest rate cycle. The Reserve Bank would endeavour to conduct debt management consistent with the objectives of minimising cost and rollover risk. The Reserve Bank's exit from the primary auctions of Central Government securities and the cessation of Central loans for State Plans

Box VI. 8

Conference of State Finance Secretaries – Emerging Issues in Cash and Debt Management

The improvement in the fiscal position of the State Governments in recent years, the buoyancy in economic growth and savings, and the change in the policy environment effected by the recommendations of the Twelfth Finance Commission (TFC) have brought to the fore new challenges in cash and debt management at the State-level. The major issues that have been raised in this regard in the 18th Conference of State Finance Secretaries are briefly highlighted below.

In sharp contrast to the experience of the past, there has been a sizable build-up of surplus cash balances of the State Governments since the second half of 2004-05. The build-up of cash balances mainly reflects buoyancy of Small Savings collections, increase in Central devolution and transfers to the States as recommended by the TFC and containment of expenditures by the State Governments.

The surplus cash balances are automatically invested in 14-day Intermediate Treasury Bills and auction Treasury Bills (as non-competitive bids) earning a return that is lower than the interest cost on borrowings (mainly Small Savings and open market loans). This negative carry adversely impacts on State finances. This has prompted some of the States to consider prepayment of some of their outstanding high cost market loans (see Box VI.4).

The excess inflow of high-cost Small Savings *vis-à-vis* the borrowing requirements of the State Governments is a consequence of the extant arrangement under which the entire Small Savings collections within a State are automatically transferred to the State budgets, irrespective of the budgetary requirements. The degree of such fund flow mismatches is, however, not uniform across States. In this context, many of the States have suggested that there should be a ceiling on the share of Small Savings in financing the GFD. Others have suggested that each State should be first permitted to draw upon the national pool of Small Savings collections as per its requirements; the balance of Small Savings in the pool could then be distributed amongst the States. It may be noted in this context that the issue of Small Savings as a source of finance for the State budgets is being examined by a Committee under the chairmanship of the Hon'ble Union Finance Minister.

Some of the States have set up Consolidated Sinking Fund (CSF), Guarantee Redemption Fund (GRF) and Calamity Relief Fund (CRF). These funds can be invested in auction Treasury Bills and dated securities of the Government of India. Setting up and enhancing the corpus of these funds through the surplus cash balances could enable the States to improve the credibility of their fiscal policies as well as reduce the negative carry on their cash balances.

Other investment options – especially for reversible/temporary surpluses – could include collateralised lending by way of market repos/CBLOs.

Keeping in view the various factors that impinge upon the alternative investment options of the cash balances of the State Governments, a Working Group of select State Finance Secretaries has been recently constituted to examine the issue in its various dimensions and evolve a framework for such investments. The Group is expected to submit its Report by end-October 2006.

The 18th Conference of State Finance Secretaries also deliberated upon the future course of market borrowings. The TFC had recommended that Central loans for State Plans should be eliminated with effect from 2005-06 and the States should raise requisite resources from the market. The Annual Policy Statement issued in April 2006 had proposed to (i) encourage States to progressively increase the share of market borrowings under the auction route with a view to covering the entire borrowings through auctions as early as possible; (ii) encourage the States at their discretion and initiative to develop an advance indicative borrowing calendar; and (iii) extend the facility of non-competitive bidding – currently limited to Central Government dated securities – to the primary auction of State Government securities. Most States have favoured all the three proposals. These issues are being discussed with the States and steps are being taken to evolve a concrete action plan.

Another issue that has been engaging the attention of State Governments is the management of exchange rate risk in the context of the back-to-back transfer of external loans by the Centre, as recommended by the TFC. In this connection, it is felt that capacity building among State Government officials for managing the implications of exchange rate volatility would have to be accorded due importance. States could also consider setting up sinking funds for managing exchange rate risks which could be funded by the savings resulting from payment of lower rate of interest on external borrowings in favourable times.

necessitating States to mobilise resources from the market call not only for improved liquidity but also newer instruments for managing market risks for a smooth transition to the new environment. Against this backdrop, the steps taken by the Reserve Bank towards deepening and widening the Government securities market through measures such as emphasis on passive consolidation, introduction of intra-day short-selling and 'when issued' market in Government securities as well as allowing new participants and diversification of activities by the existing participants are expected to enhance liquidity and facilitate efficient price discovery for the smooth conduct of debt management operations. As a result of the various market development measures, the combined market borrowing programme for 2006-07, though larger than that in 2005-06, is expected to be completed successfully.

VII CURRENCY MANAGEMENT

VII.1 The Reserve Bank continued to take measures to ensure adequate availability of banknotes and coins while improving the quality of banknotes in circulation. Banknotes with new/ additional security features were introduced during the year. Mechanisation of note processing activities at currency chests and disposal of soiled banknotes remained the major thrust areas towards improving the quality of banknotes. Banks were advised to install note sorting machines at all currency chests. The trend of reverse flow of coins continued although there was some abatement towards the end of the year as demand for coins picked up in a few centres.

VII.2 This Chapter reviews the currency management operations during 2005-06 covering the currency chest network, issue of new banknotes and coin and distribution strategies. Various measures taken to ensure the quality of banknotes in circulation and the initiatives undertaken to expand the use of computerisation in currency management as part of the overall drive to upgrade customer service are also covered along with activities of the Bharatiya Reserve Bank Note Mudran Private Limited (BRBNMPL).

Currency Operations

VII.3 The core central banking function of note issue and currency management vested with the Reserve Bank in terms of Section 22 of the Reserve Bank of India Act, 1934 is performed by the Reserve Bank through its 18 Issue Offices, the sub-office of Issue Department at Lucknow, a currency chest at Kochi and a wide network of 4,408 currency chests and 4,102 small coin depots. The Reserve Bank has agency arrangements mainly with scheduled commercial banks under which the currency chest facility is granted to them. A currency chest branch is an extended arm of the Issue Department and carries out the same functions of issue of fresh banknotes/ coins, retrieval of soiled banknotes, exchange of banknotes and coins including mutilated banknotes. The total number of currency chests declined marginally during 2005-06 reflecting the implementation of the on-going policy to progressively convert and/or close currency chests held with the State Treasuries (Table 7.1). The currency operations at sub-Treasury currency chests are very nominal and they cause difficulties for accounting not only for the Reserve Bank Issue Offices but also the concerned State Governments. In view of these factors, it has been decided to progressively close the currency chests with the Treasuries and sub-Treasuries. The needs of the State Governments at these places are proposed to be met from the currency chests with the public sector banks. The State Bank of India closed or merged a few chests during the year after carrying out cost benefit analysis. It has, however, been ensured that Government business, public services and linkage schemes to the attached banks are not affected adversely by closure of these currency chests. The State Bank of India is also setting up Currency Administration Cells to streamline currency chest functioning. Subsequent to the announcement in the Mid-term Review of the Annual Policy Statement for 2005-06, it has been decided to grant in-principle approval to urban cooperative banks and regional rural banks to set up currency chests.

Table 7.1: Currency Chests

Category	Number of Currency Chests		
	June 30, 2004	June 30, 2005	June 30, 2006
1	2	3	4
Treasuries	214	149	116
State Bank of India	2,173	2,198	2,182
SBI Associate Banks	1,004	1,008	994
Nationalised Banks	943	983	1,028
Private Sector Banks	58	72	83
Co-operative Banks	1	1	1
Foreign Banks	4	4	4
Reserve Bank	20	20	20
Total	**4,417**	**4,435**	**4,428**

BANKNOTES IN CIRCULATION

VII.4 During 2005-06, banknotes in circulation registered growth of 16.8 per cent (13.0 per cent a year ago) in value terms in consonance with acceleration in economic activity. The ratio of currency with the public to broad money fell to 15.1 per cent at end-March 2006 from 15.8 per cent at end-March 2005, continuing with its declining trajectory over the past few years (Chart VII.1).

Chart VII.1: Share of Currency in Broad Money

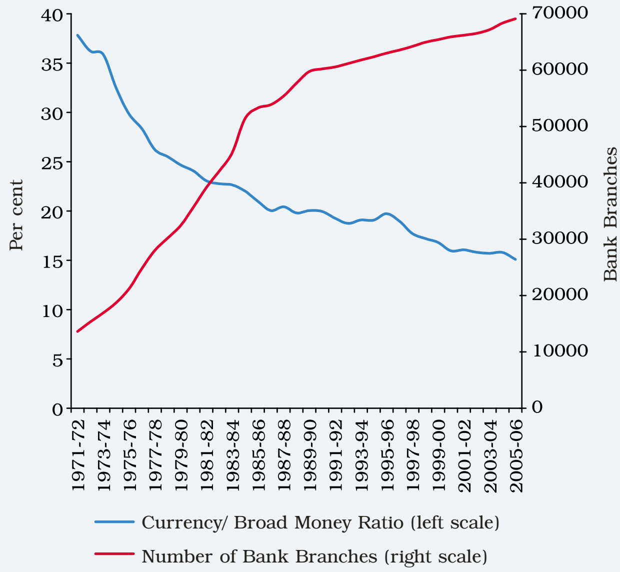


Table 7.2: Banknotes in Circulation

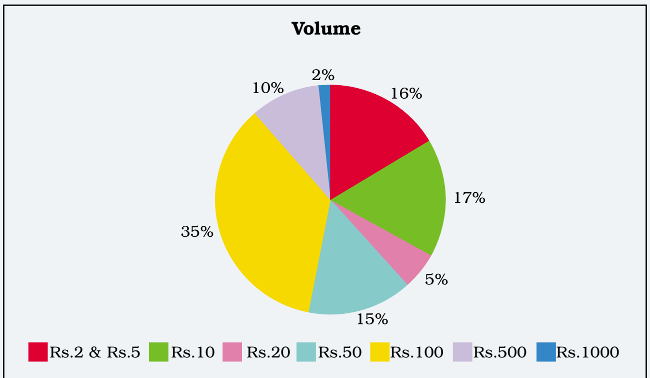
Denomination	Volume (Million pieces)			Value (Rupees crore)		
	End-March 2004	End-March 2005	End-March 2006	End-March 2004	End-March 2005	End-March 2006
1	2	3	4	5	6	7
Rs.2 & Rs.5	6,911	6,484	6,217	2,748	2,548	2,431
Rs.10	7,750	6,770	6,274	7,750	6,770	6,274
Rs.20	2,192	1,938	2,038	4,383	3,876	4,076
Rs.50	6,605	5,988	5,568	33,027	29,941	27,840
Rs.100	12,144	12,328	13,464	1,21,442	1,23,282	1,34,640
Rs.500	2,459	3,055	3,647	1,22,938	1,52,728	1,82,350
Rs.1000	275	421	643	27,473	42,082	64,300
Total	**38,336**	**36,984**	**37,851**	**3,19,761**	**3,61,227**	**4,21,911**

VII.5 The growth in volume of banknotes (2.3 per cent) continued to be substantially lower than that in the value, reflecting the ongoing compositional shift towards higher denomination banknotes, particularly Rs.1000 and Rs.500 denominations. The volume of banknotes in circulation of Rs.2, Rs.5, Rs.10 and Rs.50 denominations declined further during the year. On the other hand, the volume of banknotes in circulation of Rs.100 denomination recorded an increase of 9.2 per cent while those of Rs.500 and Rs.1000 denominations recorded sharp increases of 19.4 per cent and 52.7 per cent, respectively. In terms of volume, Rs.100 denomination notes continue to lead the circulation while in terms of value, Rs.500 denomination notes take the largest share (Table 7.2 and Chart VII.2).

VII.6 The consistent shift from lower denomination notes to higher denomination notes can be partly attributed to the growing network of Automated Teller Machines (ATMs). Banks do not find it commercially viable to stock the machines with lower denomination notes because they run out sooner and increase both the capital cost and operating costs. The Reserve Bank has accordingly been facing increasing demand of fresh notes in Rs.500 and Rs.100 denominations. In the context of the increased demand for ATM fit notes, banks have been advised to use desktop sorters to salvage good quality notes for use in their ATMs.

VII.7 The total value of coins (including small coins in circulation) increased by 2.3 per cent during 2005-06 as compared with a decline of 2.0 per cent in 2004-05. In volume terms, the increase was 1.4 per cent in 2005-06 as compared with a decline of 2.8 per cent in 2004-05 (Table 7.3 and Chart VII.3). The increase during 2005-06 could be attributed to the increase in circulation of Re.1 and Rs.2 denomination coins by 4.6 per cent and 3.6 per cent, respectively.

Chart VII.2: Banknotes in Circulation: March 2006



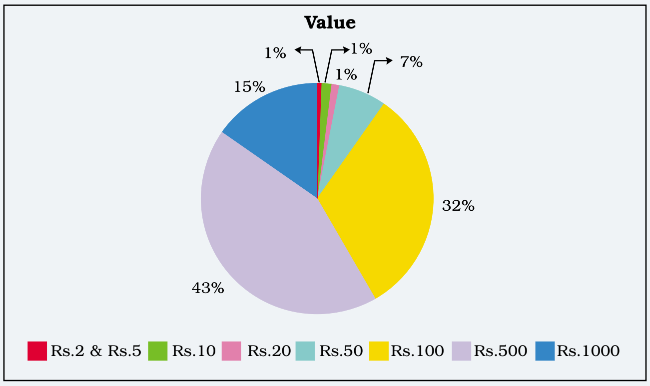


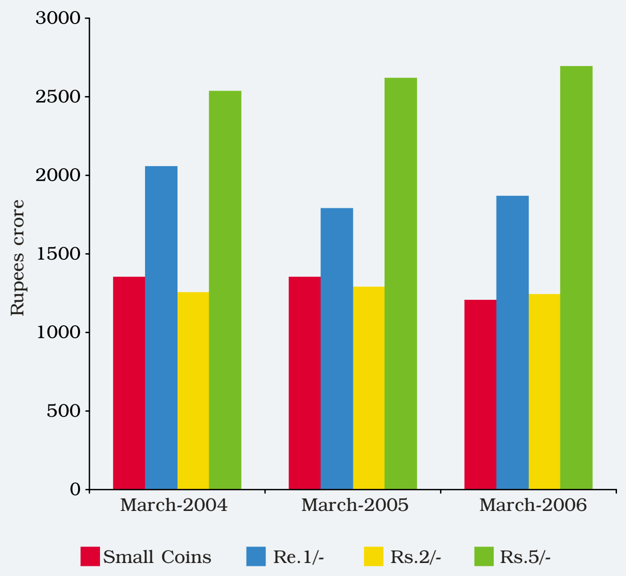
Table 7.3: Coins in Circulation

Denomination	Volume (Million pieces)			Value (Rupees crore)		
	End-March 2004	End-March 2005	End-March 2006	End-March 2004	End-March 2005	End-March 2006
1	2	3	4	5	6	7
Small Coins	54,102	54,051	54,115	1,353	1,353	1,357
Re. 1 coin	20,565	17,896	18,730	2,057	1,790	1,873
Rs. 2 coin	6,275	6,449	6,684	1,255	1,290	1,337
Rs. 5 coin	5,071	5,238	5,289	2,536	2,619	2,645
Total	**86,013**	**83,631**	**84,818**	**7,201**	**7,052**	**7,212**

Printing of Fresh Banknotes

VII.8 Total supplies by the Presses were 47 per cent of indent in terms of volume and 41 per cent of indent in terms of value (Tables 7.4 and 7.5). The shortfall in supply was due to the delay in arrival of Cylinder Mould Vat Watermarked Bank Note (CWBN) paper with revised specifications for printing of banknotes with new/additional security features and the decision to commence printing of new design banknotes only on exhausting old design paper to avoid mixing of old and new notes and to salvage maximum number of old design notes from semi-processed sheets. Although supply was less than 50 per cent of the indent, the available supplies were distributed judiciously by arranging supplies from surplus circles to needy circles, especially during festival season. Furthermore, the return of soiled notes recorded a decline from 11,285 million pieces in 2004-05 to 9,304 million pieces in 2005-06. No case of any short supply of banknotes was reported.

Chart VII.3: Coins in Circulation - Value



VII.9 As noted above, demand for banknotes during 2005-06 could be met even though supply was lower than the indent. Taking into account the experience of 2005-06 as well as improvements in inventory management practice, indent for fresh banknotes for 2006-07 (April-March) has been placed 23.3 per cent lower than that for 2005-06, although it would be substantially higher (64.2 per cent) than the actual supplies during 2005-06 (Table 7.4). The Reserve Bank has taken various steps to assess an optimal inventory of banknote requirements. In order to strengthen these efforts, an internal Working Group was constituted to look into issues relating to currency

Table 7.4: Volume of Banknotes Indented and Supplied

(Million pieces)

Denomination	2003-04			2004-05			2005-06			2006-07
	Indent	Supply	% of Supply to Indent	Indent	Supply	% of Supply to Indent	Indent	Supply	% of Supply to Indent	Indent
1	2	3	4	5	6	7	8	9	10	11
Rs.5	1,500	1,470	98	160	179	112	-	50	-	-
Rs.10	3,500	3,070	88	4,700	4,332	92	3,300	1,183	36	3,500
Rs.20	1,000	959	96	1,000	755	76	1,200	706	59	500
Rs.50	3,000	2,129	71	2,040	1,862	91	2,700	1,063	39	1,400
Rs.100	5,000	4,161	83	5,030	3,956	79	5,550	3,208	58	4,000
Rs.500	1,500	1,168	78	1,625	1,252	77	1,800	661	37	1,500
Rs.1000	300	209	70	300	257	86	450	130	29	600
Total	**15,800**	**13,166**	**83**	**14,855**	**12,593**	**85**	**15,000**	**7,001**	**47**	**11,500**

Table 7.5: Value of Banknotes Indented and Supplied

(Rupees crore)

Denomination	2003-04			2004-05			2005-06		
	Indent	Supply	% of Supply to Indent	Indent	Supply	% of Supply to Indent	Indent	Supply	% of Supply to Indent
1	2	3	4	5	6	7	8	9	10
Rs.5	750	735	98	80	90	113	-	-	-
Rs.10	3,500	3,070	88	4,700	4,332	92	3,300	1,183	36
Rs.20	2,000	1,918	96	2,000	1,510	76	2,400	1,412	59
Rs.50	15,000	10,645	71	10,200	9,310	91	13,500	5,316	39
Rs.100	50,000	41,610	83	50,300	39,560	79	55,500	32,084	58
Rs.500	75,000	58,400	78	81,250	62,600	77	90,000	33,065	37
Rs.1000	30,000	20,900	70	30,000	25,700	86	45,000	12,960	29
Total	**1,76,250**	**1,37,278**	**78**	**1,78,530**	**1,43,102**	**80**	**2,09,700**	**86,020**	**41**

management and suggest ways for further improvement and rationalisation. It has been decided to design a model for forecasting the demand for banknotes. Furthermore, with a view to streamlining the procedures relating to remittance of fresh banknotes, it has been decided to explore the possibility of rationalisation of logistics of distribution and movement of currency/treasure. The Indian Institute of Technology (IIT), Madras has been requested for developing an optimal distribution model for sending currency notes to the currency chests. As part of its efforts to reduce the expenditure for printing of banknotes, the Reserve Bank continued with its efforts to source the maximum amount of banknotes from the lowest cost producer.

VII.10 For the past three years there has been reverse flow of coins, particularly of lower denominations. The Reserve Bank has advised the banks to accept coins of all denominations and also made arrangements with the Government of India mints to accept non-current coins for melting. It has already been decided to phase out from circulation all coins of 5 paise, 10 paise and 20 paise denomination, irrespective of their metal composition, as they are no more in demand. Cupro-nickel coins of 25 paise, 50 paise and Re. 1 denomination are also being phased out. Banks have been directed to accept and remit these coins to the Government mints. The Reserve Bank has not placed any indent for coins for 2006-07 with the Government mints in view of the adequate stock position at the Reserve Bank and the reverse flow of coins (Table 7.6).

VII.11 In order to address various issues pertaining to the availability and distribution of small coins, the Reserve Bank commissioned a study 'The Need and Use Behaviour for Small Coins' by Dr. Velayudhan of Birla Institute of Technology and Science (BITS), Pilani. The findings of the study reaffirm the belief that there is no shortage of both rupee coins and small coins. However, in case of small denomination coins, especially of 25 paise, the problem is more of acceptance than that of availability. The regional offices continued to receive coins over the counters from members of the public (Table 7.7).

Table 7.6: Indent and Supply of Coins

(Million pieces)

Denomination	2003-04		2004-05		2005-06	
	Indent	Supply	Indent	Supply	Indent	Supply
1	2	3	4	5	6	7
25 paise	0	20	0	0	0	0
50 paise	0	325	0	0	0	0
Re. 1	2,000	1,463	1,250	463	0	12.7
Rs. 2	700	546	500	232	0	21.5
Rs. 5	760	474	750	201	0	7.2
Total	**3,460**	**2,828**	**2,500**	**896**	**0**	**41.4 ***

* : Includes commemorative coins.

Table 7.7: Coins Received from Public

Denomination	2003-04		2004-05		2005-06	
	Pieces (million)	Value (Rupees crore)	Pieces (million)	Value (Rupees crore)	Pieces (million)	Value (Rupees crore)
1	2	3	4	5	6	7
5 paise	0.5	0.0	0.4	0.0	0.2	0.0
10 paise	8.1	0.0	8.5	0.0	5.6	0.0
20 paise	36.5	0.0	21.3	0.0	12.5	0.0
25 paise	32.4	0.1	129.7	0.3	101.6	0.3
50 paise	49.9	0.3	131.6	0.7	117.7	0.6
Re. 1	49.4	4.9	66.7	6.7	47.8	4.8
Rs. 2	21.3	4.3	59.8	12.0	41.8	8.4
Rs. 5	15.2	7.6	25.1	12.6	19.2	9.6
Total	**213.3**	**17.2**	**443.1**	**32.3**	**346.4**	**23.7**

CLEAN NOTE POLICY

VII.12 The Reserve Bank persevered with its efforts to improve the quality of banknotes in circulation. In addition to regular supply of fresh notes, speedier disposal of soiled banknotes, mechanisation of cash processing activity, and discontinuance of the practice of stapling banknotes have contributed to improvement in quality of banknotes. Banks have also been issued directives instructing, *inter alia*, to sort banknotes into issuable and non-issuable, issue only clean notes to public and to remit the soiled notes in unstapled condition to the Reserve Bank through currency chests.

Disposal of Soiled Notes

VII.13 During 2005-06, 9,304 million pieces of banknotes (almost one-fourth of total banknotes in circulation) were processed and disposed off. Rs.100 denomination notes constituted the largest share of soiled notes (Table 7.8).

Table 7.8: Disposal of Soiled Notes

Denomination	Volume in million pieces		
	2003-04	2004-05	2005-06
1	2	3	4
Rs. 1000	13	5	5
Rs. 500	247	257	242
Rs. 100	3,954	4,324	3,250
Rs. 50	2,617	2,490	2,160
Rs. 20	306	485	532
Rs. 10	5,004	3,716	2,593
Up to Rs. 5	304	475	522
Total	**12,445**	**11,752**	**9,304**
Memo:			
Total Banknotes in Circulation	**38,336**	**36,984**	**37,851**

Mechanisation

VII.14 Mechanisation of cash processing activity and disposal of soiled banknotes has been one of the major thrust areas of the Reserve Bank in currency management. With a view to augmenting the banknote processing capacity, as also to equip all the offices with mechanised processing capabilities, six Currency Verification and Processing Systems (CVPSs) and one Shredding and Briquetting System (SBS) were installed in the new office building at Lucknow during 2005-06, in addition to the existing 48 CVPSs and 27 SBSs installed in phases, at 18 Issue Offices. During 2005-06, 5,309 million pieces of banknotes were processed on these machines.

Counterfeit Banknotes

VII.15 The number and value of counterfeit banknotes detected at the Reserve Bank offices and bank branches during the year continued the declining trend of the previous two years. There was a reduction of 31.9 per cent in the number and 27.5 per cent in the value of counterfeit banknotes detected at the Reserve Bank offices and bank branches during the year. There was an increase in the detection of the counterfeits of Rs.1000 denomination while there was a large decline in detection of counterfeits of Rs.100 denomination banknotes (Table 7.9). Data on counterfeits detected is reviewed and analysed on a continuing basis to aid in policy decisions relating to upgradation of security features and mechanisation of bank branches to facilitate detection of counterfeit banknotes by banks.

New/Additional Security Features of Banknotes

VII.16 Security features of banknotes are reviewed continuously and updated periodically with the

Table 7.9: Counterfeit Banknotes Detected

Denomination	Number of pieces			Value (Rupees)		
	2003-04	2004-05	2005-06	2003-04	2004-05	2005-06
1	2	3	4	5	6	7
Rs.10	77	79	80	770	790	800
Rs. 20	56	156	340	1,120	3,120	6,800
Rs. 50	4,701	4,737	5,991	2,35,050	2,36,850	2,99,550
Rs. 100	1,82,361	1,61,797	1,04,590	1,82,36,100	1,61,79,700	1,04,59,000
Rs. 500	17,783	14,400	12,014	88,91,500	72,00,000	60,07,000
Rs. 1000	248	759	902	2,48,000	7,59,000	9,02,000
Total	**2,05,226**	**1,81,928**	**1,23,917**	**2,76,12,540**	**2,43,79,460**	**1,76,75,150**

Note: The above data do not include the counterfeit notes seized by police and other enforcement agencies.

objective of staying ahead of the counterfeiters and to maintain the confidence of the public in the banknotes as also to take advantage of the latest innovations. In continuation of this process, the Reserve Bank introduced banknotes with the following new/additional security features in a phased manner in 2005-06: (a) demetallised, magnetic and machine readable windowed security thread with a colour shift from green to blue in Rs.100, Rs.500 and Rs.1000 denominations, (b) improved intaglio printing, (c) improved see-through feature having the denominational numeral instead of the floral design and (d) electrolyte watermark having denominational numeral alongside Mahatma Gandhi portrait in the watermark window. These enhanced features approved for banknotes of Rs.10, Rs.20, Rs.50, Rs.100, Rs.500 and Rs.1000 denominations have already been introduced. Press briefings and posters containing the pictorial details on security features of banknotes with additional/new security features for educating the public were made available to all the banks. Posters in Hindi and English have been put on the website of the Reserve Bank. Regional offices have also been advised to create public awareness at the local level through public organisations like the railways and police authorities. The publicity is being carried out continuously. All banks have been advised to set up a Forged Note Vigilance Cell at their Head Offices to closely monitor detection of counterfeit banknotes at currency chests and initiate control/measures on the dispensation of counterfeit banknotes through ATMs or over the counters. Banks have also been advised to install note sorting machines at their currency chest branches to, *inter alia*, detect counterfeit banknotes so that they are not issued through ATMs/cash counters or any other delivery channel at the bank branches.

Introduction of Star Series Banknotes

VII.17 It has been decided to introduce star series numbering system for replacement of defectively printed banknotes at the printing presses (Box VII.1).

Computerisation of Currency Management

VII.18 The Reserve Bank has taken up the task of putting in place an Integrated Computerised Currency Operations and Management System (ICCOMS) in the Issue Departments in regional offices and in the central office. The project also includes computerisation and networking of the currency chests with the Reserve Bank's offices to facilitate prompt, efficient and error-free reporting and accounting of the currency chest transactions in a secure manner (Box VII.2). It is expected that the IT initiatives taken by the banks for computerisation of branch operations coupled with the advances in the communication facilities in the country will provide the necessary environment for successful implementation of the system across all banks and all over the country.

VII.19 The progress of the system is being closely monitored. Parallel run has started in Belapur and Mumbai offices. Workshops have already been conducted for all offices to provide a first hand knowledge of the Currency Chest Reporting System (CCRS). The CCRS module is being rolled out parallel in phases in all Issue Offices and is expected to be completed in all offices by August 2006. All modules pertaining to ICCOMS are likely to be completed by September 2006. Thereafter, the MIS module for Department of Currency Management (DCM) shall be implemented. The entire project is expected to be in place and operational by December 2006.

Box VII.1

Introduction of Star Series of Banknotes

Genuine banknotes bear a distinctive serial number along with a prefix. The prefix consists of a numeral and a letter depending upon the banknote denomination. Banknotes up to Rs.20 denomination have two numerals and one alphabet as prefix while banknotes of Rs.50 and above denominations have one numeral and two alphabets as prefix. Fresh banknotes issued by the Reserve Bank, at present, are serially numbered. The notes are issued in packets containing 100 pieces. In the existing system, the banknotes/packets with defects related to printing, numbering and wrong cuts are replaced at press level with good re-numbered (same number) banknotes to maintain the sequential numbering of banknotes in a packet. This procedure involves additional time/cost and manual intervention.

Adoption of star series concept would imply that a fresh banknote packet which, at present, contains banknotes numbered from 1 to 100 may contain 100 pieces that are not serially numbered from 1 to 100. The packet would still contain 100 pieces but one or more pieces in the packet may have a different number containing the star series notes. This system would help in streamlining procedures and reducing manpower deployed in replacement activity.

Star series banknotes, to begin with, will be issued in Rs.10, Rs.20 and Rs.50 denominations and will look exactly like the existing banknotes in the Mahatma Gandhi series but will have an additional character *viz.,* * (Star) in the number panel between the prefix and the serial number. The bands of the fresh note packets containing the star series numbered note/s will clearly indicate the presence of such banknotes in the packets. The packets with star series notes will, as usual, have 100 pieces but not in serial order. The quantitative correctness of these packets can be verified with the help of note counting machines provided at the counters by banks. It may be mentioned that the serially numbered banknotes are available only in fresh banknote packets. The majority of the public/users of cash receive re-issuable banknotes which are not serially numbered. Star series banknotes will be legal tender. Adequate publicity in Hindi, English and regional languages through print/electronic media is being given to this effect.

Customer Service

VII.20 During the year, the Reserve Bank stepped up its measures towards improvement of customer services in matters relating to issue of coins, acceptance of coins from public and exchange of soiled and mutilated banknotes. The Reserve Bank reiterated its directions to all scheduled commercial banks to issue coins and, accept coins and soiled banknotes in transactions or for exchange without any restriction. Adequate availability of coins in circulation was thus ensured.

VII.21 Efforts were continued to provide timely and efficient customer service not only at the Reserve Bank offices but also at the bank branches. The Reserve Bank also revised the Citizens' Charter and placed the same on its website. The recommendations of the Committee on Procedures and Performance Audit on Public Services (CPPAPS) have been accepted for implementation. Department of Currency Management is one of the departments that have received ISO 9001: 2000 certification (Box VII.3).

The Bharatiya Reserve Bank Note Mudran Pvt. Ltd

VII.22 The Bharatiya Reserve Bank Note Mudran Private Ltd. (BRBNMPL), incorporated as a wholly owned subsidiary of the Reserve Bank, was set up in 1996 to take over the work of the new note press project. It operates the single business of printing

Box VII.2

Automation in Currency Chests

Banks have been advised to provide, in a time-bound manner, note sorting machines of appropriate capacity at currency chest branches for proper sorting of banknotes and identification of suspect banknotes. These note sorting machines will help: (i) mitigate the circulation of counterfeit banknotes through the banking channel; (ii) ensure that only non-issuable banknotes are sent to the Reserve Bank while re-issuable banknotes are sent to the public; and (iii) facilitate smooth processing of banknotes in the Reserve Bank. Out of a total of 4,428 currency chests, 4,292 currency chests are maintained by various banks and rest are with State Treasury Offices (STOs) and the Reserve Bank. Of the 4,292 currency chests maintained by the banks, 2,027 currency chests have so far been equipped with note sorting machines and orders have been placed in respect of 2,087 currency chests. The position is being monitored in the remaining 178 currency chests.

Out of the banks having less than 100 currency chests, 12 public sector banks and 17 private sector banks have mechanised their currency chests fully. The Reserve Bank is closely monitoring the progress made by various banks.

Box VII.3
ISO Certification on Currency Management and Banking Services

International Organisation for Standardisation's (ISO) certification ensures that minimum international quality standards are adhered to in the systems and procedures followed in an organisation. Quality means doing the right things, the right way, first time and every time. The Reserve Bank decided to opt for ISO certification of currency management and banking services as they are highly service oriented in nature. Furthermore, currency management is one of the most important functions of the Reserve Bank. Department of Currency Management (DCM), Department of Government and Bank Accounts (DGBA) and Issue/Banking Departments of Kolkata and Hyderabad offices were identified for the ISO Certification. Accordingly, a Core Group was set up to ensure smooth implementation of the ISO standards. Quality Manual and Procedural Manual were prepared towards implementation of ISO standards. The Quality Policy for Currency Management was formulated as follows:

"That the Bank is committed to consistently provide adequate quantity of clean banknotes and coins to the members of the public coupled with timely withdrawal of soiled and mutilated notes from the currency chests as also facilitating processes to check the circulation of counterfeit banknotes and also to continuous improvements in the currency management systems through upgradation of technology for maximisation of the satisfaction of the members of the public."

Departmental officials were given awareness and internal audit training by Consultants, M/s. Allied Boston Consultancy India Limited. Certification audit of the Departments concerned was conducted in March 2006 by Certifying Agency M/s. International Certification Services Asia (P) Limited. The Certificate stating that the audited Departments are conforming to the international quality norms was received in June 2006.

Bank Note Forms in its two Note Presses at Mysore (Karnataka) and Salboni (West Bengal). Both the Presses put together have an annual installed capacity of 9,540 million pieces of note forms in single shift depending on the mix of denominations. The total production of banknotes by the two presses at Mysore and Salboni during the year 2005-06 was 4,092 million pieces as compared with 8,625 million pieces during the year 2004-05, showing a decline of 52.6 per cent. The fall in production was due to the switchover to printing of banknotes with new/additional security features and, as noted before, the delay in arrival of CWBN paper with revised specifications. The Company has been re-certified as being fully compliant with the requirement of ISO 9001:2000 for a further period of three years.

Outlook

VII.23 The Reserve Bank will continue with its key objectives of providing adequate supply of good quality banknotes and coins in the country. The ongoing computerisation of currency chests along with enhanced mechanisation of note processing would help to improve the quality of banknotes. The Reserve Bank will pursue with its efforts to further strengthen security features in banknotes to offset challenges posed by counterfeiting. Efforts will, therefore, continue to ensure availability of coins and banknotes to the consumers in their day-to-day cash transactions, to combat the counterfeiting of banknotes, to examine various options for increasing the circulation life of banknotes of lower denominations, to ensure printing of banknotes to very strict quality rules/standards, to review the banknotes and coins handling practices including recycling of banknotes and coins, to upgrade banknote security features on a continuous basis, and to put in place an integrated computerised system for management of currency.

VII.24 Various alternatives are being explored to ensure availability of adequate quantity and quality of banknotes and coins to the public in all parts of the country while containing the cost of currency management. The measures being taken/explored in this regard are: (i) use of alternate substrates and coating for enhancing life of banknotes, especially lower denomination notes; (ii) optimising the size of inventory in note form of currency chests; and (iii) more efficient practices in movement of treasure without compromising on security aspects. The Reserve Bank is taking up the issue of indigenisation of raw materials for printing of banknotes. An initial feasibility study conducted by the BRBNMPL for indigenisation of the CWBN paper indicates that setting up of paper mill in India is technically feasible. BRBNMPL proposes to undertake a detail project report by constituting an in-house team. BRBNMPL has called for 'Expression of Interest' from interested parties for setting up a paper mill in India. In order to promote research and development on currency management, the Reserve Bank would facilitate BRBNMPL's partnership with external institutions/ experts on a continuous basis with regard to issues such as indigenisation, alternate substrates and coating.

VIII PAYMENT AND SETTLEMENT SYSTEMS AND INFORMATION TECHNOLOGY IN THE RESERVE BANK

VIII.1 Payment and settlement systems play a vital role in the efficient functioning of the financial system. The Reserve Bank, therefore, continued to strengthen the institutional framework for payment and settlement systems during 2005-06. The 'Payment and Settlement Systems Vision Document (2005-08)' was released in May 2005 laying down a road-map for the medium-term. The Reserve Bank focused on promoting electronic modes of funds transfer during the year with a view to bringing about efficiency in the retail and large value payment systems. The National Electronic Funds Transfer (NEFT) system for catering to retail payment requirements was operationalised in November 2005, a month ahead of the target. A noteworthy event in the payment and settlement systems is the growing popularity of the Real Time Gross Settlement (RTGS) system which enabled the discontinuation of the paper based inter-bank clearing during 2005-06.

VIII.2 The role played by information technology (IT) in the financial sector is considerable. The banking sector, in particular, has been an extensive user of IT for improving efficiency and customer service with the introduction of new technology oriented delivery channels. The Reserve Bank, therefore, published the 'Financial Sector Technology Vision Document' in July 2005 for facilitating smooth and orderly technological upgradation of the financial sector.

VIII.3 This Chapter profiles the initiatives taken by the Reserve Bank during 2005-06 in its endeavour to provide a safe, secure, efficient and sound payment and settlement systems. This Chapter also details the initiatives by the Reserve Bank on the use of IT within the Reserve Bank as well as in the banking sector.

Board for Regulation and Supervision of Payment and Settlement Systems

VIII.4 The Board for Regulation and Supervision of Payment and Settlement Systems (BPSS) has been constituted as a Committee of the Central Board of the Reserve Bank since March 2005. The Board lays down policies relating to the regulation and supervision of all types of payment and settlement systems, sets standards for existing and future systems, authorises the payment and settlement systems, determines criteria for membership to these systems, including continuation, termination and rejection of membership. The Department of Payment and Settlement Systems provides secretarial assistance to the BPSS. The BPSS, since its constitution on March 7, 2005, has met on five occasions till June 2006. The BPSS provided policy inputs and direction relating to:

- Vision document on payment and settlement system for the period 2005-08 which was released in May 2005.
- Draft bill relating to payment and settlement systems.
- Need for separate EFT Regulations to be framed under the Reserve Bank of India Act, 1934. The EFT Regulations drafted on approval of the BPSS and after the approval by the Central Board of the Reserve Bank were forwarded to the Government of India for approval for notification.
- Standards of operational efficiency for MICR Cheque Processing Centres.
- Best Practices in Payment Systems – a comparative study of India's position *vis-à-vis* a few developed countries.
- Conducting a comparative study of the Indian RTGS system with those of other countries to explore the feasibility of implementing the best features available in other RTGS systems in India.
- Leapfrogging from cash/paper based payment systems to electronic payment systems.
- Use of electronic modes for making payments.

VIII.5 The Reserve Bank plays a proactive role in facilitating the payment systems initiatives of banks in providing various services like internet banking, mobile banking as also other innovative services to their customers (Box VIII.1). While permitting such initiatives by banks, the Reserve Bank prescribes minimum safeguards which the banks should put in place before implementing such channels for payments.

Box VIII.1

Mobile Payments – Retail Small Value Payments

Growing usage of mobile phones has encouraged banks and non-banks to develop new payment services for their customers. Mobile payments are defined by the channel through which the payment instruction is entered into the payment system. Mobile payments cater largely to micro-payments segment and can be made through voice access, short messaging service (SMS) or wireless application protocol (WAP). WAP technology enables a mobile phone holder registered with this service to access his/her bank website for banking services. Some products use phones as an access channel to initiate and authenticate transactions from existing payment means such as bank accounts or payment cards. Another arrangement allows customers to pay using the prepaid value stored on the mobile phone or pay *ex post*, where payments for goods/ services are placed as additional items on the customer's phone bill. Authentication of payments is done by keying in a unique PIN (personal identification number).

The number of mobile phone users in India (over 100 million) exceeds the number of card holders and their network covers a very large area. Therefore, a payment mechanism using mobile phones has turned out to be a convenient mode for small value transactions. Accordingly, banks in India are tapping the potential of this mode of payment and promoting this as a delivery channel for small value retail payments. The facilities provided by banks through this mode include: enquires about bank account; alerts on debits / credit to the account above the limit set; alerts on cheque bounce; information on balance above / below limit; and reminders for payment due date for credit card.

PAYMENT SYSTEMS

VIII.6 The overall turnover in the various payment and settlement systems rose by 35 per cent during 2005-06 on top of 67 per cent during 2004-05. The turnover in respect of RTGS transactions increased sharply. In terms of value, turnover in RTGS now constitutes the largest component, followed by foreign exchange clearing and high value clearing among the Systemically Important Payment Systems (SIPS) (Table 8.1).

Table 8.1: Payment System Indicators: Annual Turnover

	Volume (000s)			Value (Rupees crore)		
	2003-04	2004-05	2005-06	2003-04	2004-05	2005-06
1	2	3	4	5	6	7
Systemically Important Payment Systems (SIPS)						
1. Inter-bank Clearing	1,142	808	-	30,46,666	9,91,436	-
2. High Value Clearing	13,172	13,077	18,748	30,23,290	46,07,208	49,75,477
3. Negotiated Dealing System	265	185	151	25,18,323	26,92,126	25,59,260
4. Forex Clearing	331	466	490	23,18,530	40,42,435	52,39,674
5. RTGS	67	460	1,767	1,965	40,66,184	1,15,40,836
Total SIPS (1 to 5)	**14,977**	**14,996**	**21,156**	**1,09,08,774**	**1,63,99,389**	**2,43,15,247**
Others						
6. MICR Clearing	6,24,360	9,41,693	10,34,539	20,35,934	90,18,073	94,82,300
7. Non-MICR Clearing	3,34,039	2,25,392	2,52,911	30,05,139	11,02,643	18,54,763
8. Electronic Clearing	31,352	57,900	83,241	29,606	77,702	1,06,599
9. Cards	1,86,558	3,61,517	10,45,319	36,176	77,266	2,36,994
Total Others (6 to 9)	**11,76,309**	**15,86,502**	**24,16,010**	**51,06,855**	**1,02,75,684**	**1,16,80,656**
Grand Total (1 to 9)	**11,91,286**	**16,01,498**	**24,37,166**	**1,60,15,629**	**2,66,75,073**	**3,59,95,903**

Note :
1. Paper-based inter-bank clearing was closed at Mumbai with effect from November 1, 2004 and subsequently at other centres in phases. By June 2005 it was discontinued at all the centres. Inter-bank transactions are now settled through RTGS system. RTGS became operational on March 26, 2004.
2. High value clearing refers to cheques of Rs.1 lakh and above.
3. Settlement of NDS and forex clearing is through Clearing Corporation of India Limited (CCIL).
4. At end-March 2006, the MICR clearing was at 53 centres. Non-MICR clearing refers to all paper based clearings at the centres where MICR cheque processing centres have not been set up.
5. Electronic clearings comprise Electronic Clearing Service (ECS), Electronic Funds Transfer (EFT), Special Electronic Funds Transfer (SEFT) and National Electronic Funds Transfer (NEFT).
6. Cards include credit and debit cards.

Table 8.2: Retail Electronic Funds Transfer Systems

Type	Volume of transactions (000s)			Value of transactions (Rupees crore)		
	2003-04	2004-05	2005-06	2003-04	2004-05	2005-06
1	2	3	4	5	6	7
ECS-Credit	22,654	40,051	44,216	10,228	20,180	32,324
ECS-Debit	7,897	15,300	35,958	2,253	2,921	12,987
EFT	801	2,549	3,067	17,125	54,601	61,288
Total	**31,352**	**57,900**	**83,241**	**29,606**	**77,702**	**1,06,599**

Retail Payment Systems

VIII.7 The turnover in retail payment systems recorded an increase of 13.7 per cent in value during 2005-06. These systems include the conventional cheque clearing system – the predominant mode for retail payments (both the MICR and Non-MICR clearings). Retail payments system also include electronic systems, *i.e.*, the Electronic Clearing Service (ECS-Debit and Credit), EFT, NEFT and card-based systems (credit, debit and ATM cards) (Tables 8.2 and 8.3). ECS was available at 44 centres as at end-June 2006. In order to facilitate electronic modes of payment, banks are providing innovative products to their customers by developing new products and integrating them with ECS/EFT/NEFT/RTGS at the back-end for settlement.

VIII.8 In view of the increased popularity of the card-based payment systems, it is imperative to ensure that such systems continue to operate in a safe and efficient manner. Accordingly, the Reserve Bank has issued detailed operational guidelines for banks issuing credit cards based on the recommendations of the Working Group on the Regulatory Mechanism for Cards. The guidelines require that the banks/NBFCs issuing credit cards should have a well documented policy and a Fair Practices Code for credit card operations. The guidelines, *inter alia*, require that terms and conditions should be mentioned clearly; the most important terms and conditions should be highlighted; and interest rates and other charges should be indicated clearly. Guidelines also lay down the code of conduct for Direct Selling Agents (DSAs)/ Direct Marketing Agents (DMAs) and provide for protection of customer rights (right to privacy, customer confidentiality, fair practices in debt collection and redressal of grievances). Adherence to Know Your Customer (KYC) norms and adequate internal control and monitoring systems are also stressed in the guidelines.

Table 8.3: Card based Payments

Type	Volume of transactions (000s)			Value of transactions (Rupees crore)		
	2003-04	2004-05	2005-06	2003-04	2004-05	2005-06
1	2	3	4	5	6	7
Credit Cards	1,00,179	1,29,472	1,32,242	17,663	25,686	34,694
Debit Cards	86,379	2,32,045	9,13,077	18,513	51,580	2,02,300

VIII.9 In order to enhance the security features in the cards, a Working Group on Security Issues in Card Transactions (Chairman: Dr.R.B. Barman) has been set up to study the (i) status of migration of current magnetic strip based credit/debit cards to chip based credit/debit cards in India; (ii) status of migrating all points of sales (POS) and ATMs to accept chip based debit/credit cards as well; and (iii) issues involved in migration to chip based debit/credit cards.

SETTLEMENT SYSTEMS

Paper Based Clearing

VIII.10 Paper-based clearing remains the most important segment of the retail payment and settlement system. New MICR cheque processing centres (CPCs) started operations at 10 centres during 2005-06, increasing the total number of centres to 53. These centres account for about 83 per cent and 85 per cent of the total cheque volumes and value, respectively. MICR CPCs will be set up at six more centres by March 2007.

VIII.11 In view of the large volumes of paper-based instruments processed by the MICR clearing system, setting up of back up centres/arrangements gains importance. The Reserve Bank operates the MICR CPCs at the four metropolitan centres; at each of these four metropolitan centres, back up centres have been set up by the State Bank of India. Banks which have set up MICR CPCs at other centres have been advised to identify nearby CPCs to operate as back up centres. Besides, the banks managing the clearing houses have been advised to use magnetic media based clearing system (MMBCS) as back up for clearing and settlement. In order to ensure smooth operations of clearing and settlement in case of any eventuality, banks managing the clearing house have also been advised to work out arrangements with the second largest bank at the respective centres which should be in a position to take over the clearing and settlement operations. The presidentship of the Clearing House has been taken over by the bank managing the CPC at all non-RBI centres facilitating better coordination between the CPC and the branch where settlement accounts are located. As a step towards standardisation, the

Reserve Bank had advised banks/Governments that all paper payment instruments should be in MICR format by March 31, 2006. The date has been extended as some Government departments are still in the process of exhausting their existing non-MICR cheque stocks and printing new MICR cheques. Furthermore, as a step towards increasing the efficiency in the paper-based clearing system at the centres where the volumes are less and where it is not viable to setup a MICR CPC, banks managing the clearing houses have been asked to implement the MMBCS system. A plan has been worked out for computerisation of clearing operations at 40 non-MICR centres with more than 25 member banks. Finally, with a view to maintaining the operational efficiency of various CPCs as also to have a formal oversight over the MICR CPCs, the Reserve Bank framed a set of standards known as “The Standards of Operational Efficiency for MICR Cheque Processing Centres” (Box VIII.2).

Box VIII.2

Minimum Standards of Operational Efficiency for MICR Cheque Processing Centres

MICR clearing is an important constituent of retail payment system and thus the efficient operation of MICR clearing is very critical to the system. The Reserve Bank has, therefore, developed “The Standards of Operational Efficiency for MICR Cheque Processing Centres” with the following objectives: (i) uninterrupted availability of clearing service; (ii) completion of clearing operations within the available time window; (iii) minimising clearing differences; (iv) risk mitigation; (v) minimum transaction costs; and (vi) fully meeting the customers’ expectations. In terms of these standards, general guidelines to be followed by MICR Cheque Processing Centres (CPCs) include:

- Each CPC should adopt the Uniform Regulations and Rules for Bankers’ Clearing House (URRBCH) as the legal/contractual basis for its functioning. Well-documented operational and procedural guidelines should also be in place and the staff members should be made familiar with the document.
- Daily clearing schedules (cheque receipt timing, processing timing, delivery timing, timing for posting the settlement of presentation clearing, time of holding the return clearing) should be adhered to as a matter of routine.
- CPCs should have working hours during the night to accommodate all the cheques received to be taken up for processing on the same day. The inward cheques for the drawee banks should be available for delivery in the early morning of the following day.
- Presentation of cheques by the member banks at the CPC should be as per requirements of the cheque processing system. Instruments should be as per MICR specifications.
- CPC should have a reliable computer system with high degree of security and contingency arrangement for timely completion of daily processing.
- Levels of access to the system, application programmes and clearing database should be strictly controlled with appropriate security set-up. The system should create necessary logs and audit trails.
- There should be a system of reporting clearing differences as well as a mechanism to resolve such differences within a fixed time-frame.
- Credit arising out of clearing settlement to member banks should not be allowed to be withdrawn/availed of before the return clearing process is completed. Accounting of presentation clearing and return clearing should be organised on the same day.
- A system of monitoring returns against presentations and returns against drawing should also be put in place. Banks showing unusually high percentage of returns may be cautioned about the likelihood of some irregular practices. In no case, fresh presentation should be permitted in return clearing.
- The recommendations of the Working Group on Monitoring of Clearing Operations should be fully complied with.
- There should be a system of ensuring timely completion of daily settlement in the event of inability on the part of a member to meet its liability by resorting to partial unwinding under Rule 11 of the URRBCH.
- Instrument-wise clearing data should be made available to the member banks electronically immediately after the settlement is over, preferably by populating the same in the CPC’s web-server. This will facilitate Straight-Through-Processing (STP) at member banks end and quicken the process of coming back for return clearing.
- The CPC should lay down a comprehensive back-up policy and procedure as well as identify storage sites to ensure business continuity and uninterrupted access to critical data.
- A self assessment on the above guidelines should be done every quarter and a report should be submitted to the Reserve Bank.
- The CPC should subject itself to periodical internal audit and inspection by the bank managing the CPC.

The Reserve Bank would conduct oversight visit to the CPC at least once a year. The Reserve Bank may also organise audit/ inspection either through its own officers or through auditing firms, if required.

National Settlement System

VIII.12 At present, there are about 1,030 clearing houses spread all over the country. The settlement of the net pay/receive obligations is done in the books of accounts of the settlement bank separately at each clearing centre. Banks participating in clearing who have net pay obligations and do not have adequate funds with the settlement bank are often required to get funds from other places by telegraphic transfer. Similarly, banks who have large surplus funds have to send out funds to places where there are shortages. This casts a liquidity burden on the banks as they do not get benefit of excess funds at one clearing centre to offset the deficit at another. Moreover, moving funds from one place to another is expensive, cumbersome and results in poor liquidity management. There was, therefore, an imperative need to settle the positions of banks in the various clearing houses centrally in the accounts maintained at Mumbai. Accordingly, a National Settlement System (NSS) is proposed to be set-up. The NSS would primarily cover 20 large commercially important centres and the Reserve Bank centres which do not fall under the category of such “Top 20” centres. The implementation of the NSS would be taken up after the full fledged RTGS-IAS is implemented.

Cheque Truncation

VIII.13 With a view to further enhancing the efficiency in the existing paper-based clearing systems, the Cheque Truncation System (CTS) project has been undertaken in the National Capital Region of Delhi on a pilot basis. The CTS would enable the realisation of cheques on the same day, thereby improving the operational efficiency of the clearing process. It would also be a more cost effective mode of settlement than manual and MICR clearing. The vendor for the project has been identified. The project is expected to go live in the second half of 2006.

National Electronic Funds Transfer System

VIII.14 The National Electronic Funds Transfer (NEFT) system which uses Structured Financial Messaging Solution (SFMS) of the Indian Financial Network (INFINET) was operationalised in November 2005, ahead of the target date of December 2005. The NEFT, a deferred net settlement funds transfer system, addresses the lacunae which are faced in the EFT and SEFT system. The use of digital signatures under NEFT provides a legal basis for EFT under the Information Technology Act, 2000. With the implementation of the NEFT, the Special EFT system in operation has been discontinued from January 2006. The existing EFT system in operation at the 15 Reserve Bank centres is also scheduled to be discontinued once NEFT system stabilises. The number of settlements of NEFT has been gradually increased from 2 settlements a day to 4 settlements (9:30 am, 10:30 am, 12 noon and 4:00 pm). This has enabled customers to get funds on a near to real time basis and mitigate risk in a deferred net settlement system.

Real Time Gross Settlement System

VIII.15 The implementation of Real Time Gross Settlement (RTGS) system has revolutionised the large value payment system in the country by facilitating faster movement of funds across accounts. With the stabilisation of the RTGS, the paper based inter-bank clearing at all the Reserve Bank managed centres was discontinued from June 2005. The RTGS facility was being provided by 96 banks as at end-June 2006, including the Reserve Bank, at over 21,916 branches in 2,793 centres in 469 districts. The value of transactions through RTGS system nearly trebled during 2005-06 (Table 8.4).

VIII.16 The Integrated Accounting System (IAS) of the Reserve Bank is being integrated with the RTGS system. The full fledged operation of the RTGS-IAS system would begin shortly. The benefits of implementation of RTGS-IAS are:

- Automated Start-of-Day funding of the RTGS Settlement Account (*i.e.*, transfer of funds on the basis of standing instruction from the current account to the settlement account);
- Automated End-of-Day flushing of the RTGS Settlement Account (*i.e.*, transfer of funds from the settlement account to the current account to make the settlement account zero);
- Message-based Own Account Transfer (OAT) between the RTGS Settlement Account and the current account in IAS or two current accounts in IAS in Deposit Accounts Department (DAD) of the Reserve Bank at Mumbai;
- Multilateral Net Settlement Batch-Settlement of the Net Clearing Batches such as MICR, EFT, ECS from NCC, Government securities, foreign exchange, CBLO and NFS-ATM from CCIL and the net clearing batches originating from BSE and NSE;
- Automated Intra-day Liquidity (IDL) facility including automated request for grant of IDL, automated reversal of outstanding IDL with

Table 8.4: Month-wise RTGS Transactions

(Value in Rupees crore)

Months	No. of Participants	Inter-bank		Customer		Total	
		Volume	Value	Volume	Value	Volume (3+5)	Value (4+6)
1	2	3	4	5	6	7	8
2004-05		**3,91,931**	**38,16,522**	**68,492**	**2,49,662**	**4,60,423**	**40,66,184**
2005-06		**10,53,940**	**89,70,624**	**7,13,058**	**25,70,212**	**17,66,998**	**1,15,40,836**
2005-06							
April	109	53,165	5,27,315	15,901	57,415	69,066	5,84,730
May	109	71,622	5,71,514	22,925	59,043	94,547	6,30,557
June	109	79,503	7,40,482	28,678	90,338	1,08,181	8,30,820
July	109	82,422	7,16,966	31,479	95,696	1,13,901	8,12,662
August	109	86,989	6,72,654	45,967	1,98,733	1,32,956	8,71,387
September	109	85,087	7,29,196	52,232	2,51,968	1,37,319	9,81,164
October	108	95,711	7,96,742	61,060	2,50,214	1,56,771	10,46,956
November	110	89,486	8,17,065	58,742	2,09,524	1,48,228	10,26,589
December	110	1,04,117	9,97,337	77,917	3,11,481	1,82,034	13,08,818
January	110	97,189	8,12,150	83,697	2,75,305	1,80,886	10,87,455
February	110	94,754	6,46,547	96,238	3,03,202	1,90,992	9,49,749
March	110	1,13,895	9,42,656	1,38,222	4,67,294	2,52,117	14,09,949
2006-07							
April	110	91,558	8,00,906	1,35,856	4,14,833	2,27,414	12,15,739
May	110	1,10,385	9,83,348	1,71,731	5,22,422	2,82,116	15,05,770
June	110	1,12,529	9,46,691	1,81,519	4,90,717	2,94,048	14,37,408
July	110	11,10,728	8,91,473	1,86,750	4,54,992	2,97,478	13,46,466

incoming credits, and intra-day addition/withdrawal of un-encumbered securities offered for IDL availment; and

- Gridlock Resolution Mechanism.

Centralised Funds Management System

VIII.17 The funds transfer facility among DADs of the Reserve Bank in four metropolitan cities, *viz.*, Mumbai, Delhi, Chennai, and Kolkata was operationalised using CFMS during the year. At present, 27 banks are making use of this facility for own account transfer of funds across these four DADs. The system was extended to other Reserve Bank centres, *viz.*, Hyderabad and Bangalore, during July 2006.

INFORMATION TECHNOLOGY IN THE RESERVE BANK

VIII.18 Information technology (IT) has brought substantial changes in the functioning of organisations the world over in the last decade. In the Reserve Bank too, the use of IT has become vital and an integral part of the day to day operations and functions. With IT becoming an important facilitator, efforts have been made to ensure the smooth implementation of IT while meeting all user requirements with relative ease.

Technology Implementation in the Reserve Bank

VIII.19 The Reserve Bank has made concerted efforts in exploiting the potential of IT based on a set of guiding principles: (i) providing for latest, state-of-the-art systems; (ii) migration towards centralisation to the maximum extent possible; (iii) conforming to the generic architecture for the Reserve Bank and ensuring standardisation of systems; and (iv) providing holistic solutions rather than attempting to provide for individual, stand alone requirements. These guidelines have been followed with due importance to safety and security. Furthermore, the implementation of systems has been pursued using a project based approach with close coordination with the business owners, and by involving external expertise, wherever required.

VIII.20 Various efforts were made in 2005-06 towards consolidation of IT within the Reserve Bank. The year saw the completion of many projects which followed the generic architecture of 'Centralised Data Processing with Decentralised Access'. One of the major activities which got a fillip during the year was the integration of related processing functions. The year witnessed commencement of parallel runs using the new IAS for the DAD at Mumbai. This system is tightly coupled with the RTGS system, thus enabling

Box VIII.3
Data Centres of the Reserve Bank

The critical processing requirements of the Reserve Bank are now being increasingly performed using IT based systems. As a result, the need for consolidation of the critical systems has gained significance. Therefore, a state-of-the-art Data Centre housing critical computer systems with adequate back up Data Centres has been envisaged as under:

- A primary data centre conforming to the Tier IV Standard of the Uptime Institute (which is recognised internationally) and having multiple active power and cooling distribution paths, fault tolerant redundant components and providing very high availability in an exclusive area;
- An on-city back up data centre to be located in the same city; and
- An off-city back up data centre located in a different city.

The Data Centre will house all the critical systems of the Reserve Bank and shall provide for centralised databases with a decentralised access facility.

Straight-Through-Processing (STP) operations between these components. The system is also being provided with interfaces to operate with the Centralised PDO system. A new Centralised PAD system is currently being tested along with the existing system, and will be made fully operational soon; and the consolidation of this with the IAS would make the systems used for operations of the Banking Department of the Reserve Bank function in an integrated way.

VIII.21 The Integrated Establishment System (IES) which was tested comprehensively at all offices has been put to parallel operations at two centres; it will be made fully operational during the second half of 2006. A new Human Resources Management System (HRMS) incorporating latest systems will be ready for implementation during the second half of 2006-07. This system will be integrated with the IES.

VIII.22 In order to bridge the gap in communication across various offices of the Reserve Bank, video conferencing facility was implemented during the year. The facility was inaugurated by the Governor by using it for his New Year Address on January 2, 2006. The system has been initially installed at 14 locations and has been well received. The system has facilitated regional media to interact with the Governor and the Deputy Governors on the day of the release of the Annual Policy Statement/reviews every quarter.

VIII.23 In the recent period, the focus has been on rationalising the existing approach of distributed processing capabilities (which necessitated the existence of multiple facilities to house such systems as also additional manpower for regular updating and maintenance at high levels) through setting up of the Reserve Bank's Data Centres (Box VIII.3).

Status of IT in the Reserve Bank

VIII.24 Reflecting the ongoing efforts to increase the use of IT as well as to improve its efficient use, the usage of IT increased significantly during 2005-06 (Table 8.5).

Table 8.5: Critical IT Implementation Factors in 2005-06

Critical Requirement Factor	Performance Yardstick	Position as at end-March 2005	Position as at end-March 2006
Standardisation	Across all departments	40% completed 40% under progress 20% being started	85 % completed 15% under progress
Integrated Application Systems	For all functional units	50% completed 38% under progress 12% being started	65% completed 35% under progress
Server Consolidation	At all locations	25% completed 50% under progress 25% being started	70% completed 30% under progress
Connectivity	Across all offices and all locations	100% completed	100% completed
Productivity Tools	For all critical mainframe applications	95% completed	100% completed
Corporate e-mail	For all users at all locations	100% demand met	100% completed
IS Security	For all information systems	75-80% completed	90+% under progress

VIII.25 The smooth functioning of the Centralised PDO (CPDO) system in the light of migration towards the usage of centralised IT systems was an important event during the year. The Reserve Bank's corporate e-mail system has been functioning smoothly but has been following the distributed architecture. The migration to a single forest to ensure efficiency has already commenced. Enhancements to the system to make it easily accessible through the internet have been provided. The secured website of the Reserve Bank which facilitates registered users, including Government departments, to obtain data/information relevant to them has been extended to cover the Central Database Management System (CDBMSi). Member banks of the clearing houses have also been allowed to download clearing data through the Reserve Bank website.

VIII.26 In order to track the movement of cases, letters and notings, within and across departments, an in-house developed Document Management and Inward-Outward System was made operational during the year. This software has been implemented by all offices/departments of the Reserve Bank and has been well received. A multi-application smart card-based access control system for the Reserve Bank staff was also introduced during the year at the Central Office.

VIII.27 In view of the growing use of technology within the Reserve Bank, necessary steps have been put in place for a Business Continuity Plan (BCP) and a disaster recovery mechanism through technological upgradation. All critical payment systems are operated using mainframe computer systems, as elsewhere in the world; the potential of such systems is indicated in Box VIII.4.

Reserve Bank and the IDRBT

VIII.28 Continuing research, development and training is critical to ensure that the implementation of IT for the financial sector is in line with the developments in the IT industry. These aspects are being addressed by the Institute for Development and Research in Banking Technology (IDRBT), an institution funded by the Reserve Bank. The Institute is a Certifying Authority under the Information Technology Act, 2000 and is engaged in pioneering research and networking service functions. During the year, IDRBT commenced operations relating to the National Financial Switch (NFS). NFS facilitates apex level connectivity among ATM networks of banks and funds settlement at a central point. The NFS enables customers of banks connected to it to withdraw cash and information from ATMs of any of those banks. The NFS has the potential to provide large scale

Box VIII.4
Mainframe Computer Systems

Mainframe computers are large computer systems used mainly by government institutions and large companies for mission critical applications. Modern mainframe computer abilities are not measured by their performance capabilities; instead, their high-quality internal engineering and proven reliability, high-quality technical support, top-notch security, and strict backward compatibility for older softwares make them a class apart from other systems. These machines can be used for non-stop processing operations for many years without interruption and even facilitate repairs to take place whilst they continue to be in operation. The robustness and dependability of these systems are amongst the main reasons for the longevity of this class of computers and use in applications where down-time would be catastrophic. Terms such as Reliability, Availability and Serviceability (RAS) have become synonymous with mainframe computer systems.

Nearly all mainframes have the ability to run (or “host”) multiple operating systems and thereby operate not as a single computer but as a number of virtual machines. In this role, a single mainframe can replace dozens or even hundreds of smaller servers, reducing management and administrative costs while providing greatly improved scalability and reliability. The reliability is improved because of the hardware redundancy noted above, and the scalability is achieved because hardware resources can be reallocated among the virtual machines as needed out of total system capacity. Mainframes can add system capacity in a non-disruptive, instant, and granular manner which is the need of most businesses of today. In contrast, most of the relatively smaller processing systems do not offer levels of security available in mainframe systems. Their total cost of ownership may be relatively lower, but their total cost per user tends to be far more than those of the mainframe systems.

Reflecting these factors, mainframe computer systems are also preferred by most of the central banks for BCP. The European Central Bank uses four such systems in tandem to take care of business continuity and disaster recovery; the Federal Reserve System has many such systems. In India too, the critical payment and settlement system processes are carried out using mainframe computer systems. These have not only stood the test of time but have also reinforced the dependability of these systems.

Box VIII.5
Pre-Implementation Audit of Critical Systems

Software development and implementation follows a structured approach in most organisations. In the Reserve Bank too, software implementation follows a well-defined method. With outsourcing emerging as the common method of procuring software, pre-implementation audit of critical systems assumes importance. This is generally done after the systems are tested internally by following a pre-determined plan relating to various situations and followed by an acceptance test. The major thrust areas of such a pre-implementation audit are : (i) gaining awareness of the scope of release management and control; (ii) planning and initiating key activities in the release and control process; (iii) learning how to integrate activities with change and configuration management; (iv) defining the release and control quality, policy and procedures; (v) defining and maintaining procedures, work instructions and guidelines for the release and control process; (vi) understanding the role of the release and control manager; (vii) learning about definitive software libraries and the definitive hardware store; (viii) learning to plan, manage and implement all releases from request to successful closure; (ix) learning to design, build and configure all releases; (x) learning to select the best release and control strategies; (xi) creating key performance indicators (KPIs) for release and control; (xii) learning how and what to audit through best practice; and (xiii) discovering service improvement plans for release and control. Such an audit provides more comfort for users of the systems.

services to meet the ‘ANY-WHERE-MONEY’ through ‘ANY-BANK-ATM’.

Networks and Network-based IT Usage

VIII.29 In order to provide for increased availability of telecommunication capabilities, the bandwidth of the inter-city telecommunication links, which are part of the INFINET, was upgraded during the year. This has resulted in the existence of 2 mbps links across all the offices of the Reserve Bank, with the major offices being upgraded to 8 mbps.

VIII.30 The INFINET continues to perform satisfactorily as a safe and secure network for transmission of financial messages for member banks, especially for processing the common inter-bank payment system applications implemented by the Reserve Bank for the use by all member banks.

Information Security Policy

VIII.31 With increased dependence on IT in the Reserve Bank, an information security policy has been put in place. This policy will form the basis for detailed procedural indicators. IS Audit of critical systems – such as the PDO-NDS and the Reserve Bank’s website – was conducted during the year. As a part of effective corporate governance, the IS audit function is performed not by the Department which implements the technological system. Thus, for IT systems implemented by Department of Information Technology (DIT) of the Reserve Bank, IS audit is undertaken by Inspection Department. Based on the findings, compliance is ensured by the DIT in conjunction with the business owner department for the respective system. Plans are on to conduct a pre-implementation IS Audit of the full scale RTGS-IAS as well (Box VIII.5).

IT for the Financial Sector

VIII.32 The Reserve Bank has been functioning as a catalyst in ensuring that latest developments in IT which are beneficial to banks are implemented by them. This process has witnessed substantial benefits. In order to provide the financial sector a roadmap, the Reserve Bank brought out the Vision Document outlining the IT plans for the financial sector for the medium term. The Vision Document elucidates Technology Vision for the financial sector and covers areas such as: IT regulation and supervision; IT and IDRBT; IT for the financial sector; and IT for Government related functions. With its Vision Statement of ‘IT for efficiency and excellence’, the objective is to ‘enable banks to leverage on IT for better customer service, improved housekeeping and overall system efficiency’. This document provided a useful backdrop for discussions held by the Reserve Bank in January 2006 with the chiefs of the Computer Planning and Policy Departments of banks.

Outlook

VIII.33 The Reserve Bank would continue to focus on oversight of the various payment and settlement systems for ensuring safety and improving efficiency. As a step in this direction, the Reserve Bank has framed minimum operational standards for MICR cheque processing centres. These centres will be assessed through quarterly returns against the standards. The Reserve Bank is in the process of bringing out the first Report on Payment Systems Oversight. The Report would help in highlighting the areas which require further improvements. The Reserve Bank would also endeavour to put in place a more formal structure for conducting oversight over existing payment systems. In order to provide a statutory basis for its oversight function over the payment and settlement systems within the country, the Reserve Bank is pursuing with the Government of India for enactment of a separate legislation *viz.*, the Payment and Settlement Systems Act. The Bill was introduced in the Parliament on July 25, 2006. The Reserve Bank has also framed the Electronic Funds Transfer Regulations which are awaiting the approval of the Government of India.

VIII.34 The Reserve Bank would continue to harness the full potential of IT to improve operational efficiency. The amalgamation of IT with business requirements would pave the way for capabilities to process increased volume of transactions and provide good and efficient management information system inputs. It would also provide for better risk management and more effective ways of monitoring performance of banks.

IX HUMAN RESOURCE DEVELOPMENT AND ORGANISATIONAL MATTERS

IX.1 During 2005-06, the Reserve Bank continued to take initiatives to manage its human resources to enhance the efficiency of its operations while nurturing the personal growth and well-being of its staff to foster a feeling of pride and belonging. Efforts to upgrade the skills of its human resources as well as of those in the financial sector remained an area of thrust. A key development in this regard was the launching of the *Centre for Advanced Financial Learning* by the Honourable Prime Minister. The other significant initiative was the setting up of the Joint India-IMF Training Programme as a cooperative effort between the International Monetary Fund (IMF) and the Reserve Bank of India. Improving the internal communications mechanism in the Reserve Bank, striving towards a better work life balance, putting in place human resource management systems and working out a substantially improved compensation package were amongst the important initiatives in the area of human resource development. Measures were initiated to ensure transparency in operations and to improve customer service. Initiatives to improve inputs for the conduct and formulation of policies were intensified during the year. The Reserve Bank continued to disseminate information to the public on its policies, their rationale as well as its assessments through speeches by top management and key publications (Annex I). A noteworthy development was the release of the third volume of the Reserve Bank's History covering the period 1967-81 by the Honourable Prime Minister.

IX.2 This Chapter describes the various initiatives taken by the Reserve Bank to manage its human capital in the year 2005-06 in an environment of ongoing rapid transformation in the financial sector. It also covers various measures taken to improve the quality of customer service. The initiatives of the Reserve Bank to communicate its policies to the public as well as the inputs to improve policy formulation are also covered in this Chapter. Finally, the Chapter presents an overview of the meetings of the Central Board and its Committees, appointment/retirement of executives and visits of important Committees and foreign dignitaries to the Reserve Bank.

HUMAN RESOURCE INITIATIVES

IX.3 The ongoing opening and liberalisation of the financial sector in India over the last decade and a half has triggered the need for developing a distinctly different set of competencies in banks and financial institutions in India. An urgent need was, therefore, felt for a policy-oriented institute that would promote the study and dissemination of knowledge on the entire range of issues relating to banking and finance and would conduct high-quality research and training for senior executives of banks and financial institutions from a broad, multi-disciplinary perspective. To meet these objectives, a major initiative by the Reserve Bank during the year 2005-06 was the setting up of the *Centre for Advanced Financial Learning*. The Centre was launched by the Honourable Prime Minister of India during the course of his visit to the Reserve Bank's central office on March 18, 2006 (Box IX.1). The broad contours of the new Centre are based on the recommendations made by a Committee of external experts set up by the Reserve Bank to review the original mandate of the *Bankers' Training College* (BTC) and reposition it in consonance with the needs of the banking and financial sector in India in the context of the changed environment.

IX.4 In order to put in place an effective interface mechanism for Heads of its regional offices as well as its central office departments, the Reserve Bank has been organising the Regional Directors' conference every year. This forum has over the years generated critical feedback for the top management both in terms of location-specific as well as general inputs for designing policy initiatives. Given the criticality of open communication and transmission and sharing of information, it was felt that the twin purposes of effective executive communication and informal meeting of minds would be better served if the Regional Directors' conference was held in a more informal setting while retaining the formal corporate structure of the deliberations. Accordingly, the Regional Directors' conference for the year 2005 was, for the first time ever, organised off-site at Madh Islands, Mumbai in December 2005. This afforded an opportunity for discussing critical organisational issues, listening to eminent speakers on major areas and issues of concern and spending quality time in an informal and close-to-nature setting. The participant response was extremely positive.

IX.5 With effect from the week commencing October 10, 2005, the offices of the Reserve Bank

Box IX.1

Centre for Advanced Financial Learning

The recent years have witnessed an increased interest in India's economic growth. In this context, human skills have a key role to play and this is very well-reflected in the noteworthy performance recorded by India's services sector. Financial services have emerged as one of the major services industry in the Indian economy. In order to reap opportunities provided by globalisation, enhancement of skills of personnel involved with the financial sector is important. It was, therefore, decided to reposition the *Bankers' Training College* (BTC) as *Centre for Advanced Financial Learning*. The Centre was launched by the Honourable Prime Minister, Dr. Manmohan Singh on March 18, 2006. On this occasion, the Honourable Prime Minister observed as follows:

> "The motive force behind India's emergence as a knowledge economy is the skill endowment and capacity of our work force. We should strive not only to maintain, but improve our comparative advantage in the services sector. Financial services have emerged as one of the major service industries in the Indian economy. At the same time, the integration of Indian financial markets into the global system and the introduction of new financial products require better risk management and financial engineering skills. It also casts new burdens on regulatory institutions. Enhancing the skills of personnel involved in the financial sector is, therefore important."

> "The Bankers' Training College is one of the frontier institutions under the RBI umbrella. In view of the rapidly changing environment, and given the growing strength of the Indian financial sector, there is a strong need for an institution that can act as a centre for policy research on areas relating to banking and finance. The BTC is well-poised to take on this new role. Therefore, the BTC will henceforth be repositioned as a policy oriented institute and I am happy to rename the BTC as Centre for Advanced Financial Learning. I am sure that in the near future, the Centre would grow into a global hub for banking and finance. I wish the Centre all the best in its challenging role."

The Centre is expected to emerge not only a centre of excellence catering to an international clientele, but also as a Centre that would drive change. It would be a part of a strategic plan which recognises that the sources of competitive advantage of nations have changed and that India can be uniquely poised to leverage her banking, technical and human resources to make a serious bid as a player in the international financial sphere as well as a global training provider in the sphere of finance. This Centre would constitute a source of intellectual power for India and would aim to put the Indian financial sector in the international resource map for policy, strategy and know-how in the field of banking and finance.

The core focus of the new Centre would be on system-analytic policy orientation and response to contemporary and emerging issues and build models and strategies for the financial sector. It would organise seminars for policy sensitisation and dissemination amongst senior executives in the Indian financial sector and act as a platform for such senior finance professionals to meet and brainstorm. The Centre will also engage in strategic partnerships with reputed organisations / academic institutions in both India and abroad that have broad-based research constituencies.

are being kept open for an extended period of 45 minutes on weekdays, *i.e.*, from Monday to Friday. On Saturdays, those departments which render critical support services to banks and Government such as Department of Payment and Settlement Systems, Public Accounts Department and Deposit Accounts Department continue to remain open, as hitherto. The other departments, however, now remain closed on Saturdays. These changes in work timings are expected to enable getting the most out of the working hours while bringing the Reserve Bank in closer alignment with other financial sector regulatory authorities in the country as well as the leading central banks across the world. Members of the staff cutting across categories welcomed this move.

IX.6 The Reserve Bank is in the process of putting in place a Human Resource Management System (HRMS) to enhance the efficacy of HR management. The proposed HRMS, in conjunction with the Integrated Establishment System (IES), would not only enable efficiencies in transactions for managing personnel in the Reserve Bank but it also aims to serve Management Information System (MIS) needs of the Reserve Bank as a tool of talent management. This would enable shifting over from mechanistic system of placements by rotation to a more scientific system of internal advertisements of vacancies by matching job profile with holder profile more effectively.

Training and Skills Enhancement

IX.7 As competencies required to perform in the changed environment and context would be vastly different, the Reserve Bank has been trying to shift the focus of its capacity building initiatives from training to learning. In view of this, the three major training colleges of the Reserve Bank, *viz.*, the

Table 9.1: Reserve Bank Training Establishments - Programmes Conducted

Colleges	2001-02 (July-June)		2002-03 (July-June)		2003-04 (July-June)		2004-05 (July-June)		2005-06 (July-June)	
	Number of Programmes	Number of Participants	Number of Programmes	Number of Participants	Number of Programmes	Number of Participants	Number of Programmes	Number of Participants	Number of Programmes	Number of Participants
1	2	3	4	5	6	7	8	9	10	11
BTC, Mumbai	115	2,532	160	3,735	171	3,204	153	3,287	85	1,908
RBSC, Chennai	125	2,795	139	3,013	144	2,874	133	2,895	127	2,633
CAB, Pune	179	3,777	173	3,461	147 *	3,138 *	146	3,364	152 #	3,812 #
ZTCs (Class III)	131	2,576	153	2,991	187	3,652	245	5,442	230	4,710
ZTCs (Class IV)	26	470	31	535	56	958	40	1,295	76	1,592

* : Includes 10 outstations programmes conducted at the initiative of regional offices involving 384 participants.
# : Includes 13 offsite programmes involving 437 participants.

Bankers' Training College (BTC), Mumbai, the *Reserve Bank Staff College* (RBSC), Chennai and the *College of Agricultural Banking* (CAB), Pune have been in process of reorienting their focus for catering to the training needs of the officers of the Reserve Bank and the banking industry. In addition to this, the four *Zonal Training Centres* (ZTCs) located in the four metros across the country continued to focus exclusively on training of Class III and IV staff of the Reserve Bank (Table 9.1).

Bankers' Training College, Mumbai

IX.8 The *Bankers' Training College* (BTC) which, as indicated above, is being repositioned as *Centre for Advanced Financial Learning*, conducted 11 new programmes/seminars/ conferences during the year (Table 9.2). The BTC conducted two collaborative programmes with the Kenya School of Monetary Studies at Nairobi in the areas of Payment and Settlement Systems and Dealership and Forex

Table 9.2: New Programmes/Seminar/Workshops Conducted by Training Colleges during 2005-06

Bankers Training College	Reserve Bank Staff College	College of Agricultural Banking
1	2	3
1. Funds and Liquidity Management in RTGS Environment	1. Unix System Administration	1. Information and Communication Technology for Rural Financial Services
2. Women Executive Empowerment	2. Health Awareness	2. Agro Processing and Agribusiness Enterprises
3. Supervision in the context of BASEL II	3. Financial Analysis	3. Cooperative Banking
4. Trends and Progress in Banking	4. Change Management	4. Microfinance and Microenterprises
5. Latest Trends in Banking Industry	5. BASEL II	5. Flow of Credit to Unorganised Sector
6. Changing Face of Cross Border Settlement	6. Anti Money Laundering	6. Security Management for Security Officers of the Bank
7. Strategic Decision Making in Integrated Treasury	7. Right to Information Act, 2005	7. Customised Programme on Agricultural Financing
8. Use of Derivatives for Risk Management	8. Risk Modelling	8. Customised Programme on Leadership Renewal
9. Policy Requirements for Credit Pricing and Rating	9. Financial Crimes	9. Programme for Provident Fund Managers
10. International Financial Standards and Codes		10. Programmes for trainees of Indian Economic Service
11. Conference of Principals of Bank's Training Colleges		11. Programmes for liquidators of Urban Cooperative Banks

Operations for 48 officers of central banking authorities of Tanzania, Zambia, Uganda, Malawi and Kenya. The College also conducted three programmes in collaboration with the Indian Institute of Bank Management (IIBM), Guwahati on Credit Management; Know Your Customer, Anti Money Laundering and Frauds; and, Investment in Government Securities and Corporate Bonds. The College provided infrastructural facilities and assistance in coordinating 19 programmes conducted by different central office departments which were attended by 503 participants. The College also conducted in-company programmes for officers of NABARD, SIDBI, Indian Economic Service probationers, Indian Statistical Service probationers, Corporation Bank, ICICI Bank, Canara Bank, Syndicate Bank, Vijaya Bank and Bank of India. The College also extended faculty support to Sir Sorabji Pochkhanawala Bankers' Training College, the Stock Exchange and Indian Overseas Bank Staff Training College. Thirteen foreign participants from Sri Lanka, Uganda, Bangladesh and Kenya attended five training programmes at the College.

Reserve Bank Staff College, Chennai

IX.9 The *Reserve Bank Staff College* (RBSC), which caters primarily to the training and development needs of officers of the Reserve Bank, continued to play a crucial role in updating the skills of officers. The interactive page of the College website has become a storehouse of information on the working of the Reserve Bank facilitating distance learning through an interactive process of questions and answers on central banking and related areas. The College also publishes a quarterly newsletter 'RBSC News and Views' for circulation amongst the participants of the various programmes at the College.

IX.10 A team of 17 international participants from eight countries who attended the training programme at the National Institute of Small Industries Extension Training (NISIET), Hyderabad paid a visit to the College to observe the academic and organisational aspects of training in the Reserve Bank. The College also extended faculty support to institutions such as the Indian Institute of Technology (IIT), Madras and National Academy of Customs, Excise and Narcotics, Chennai.

IX.11 The Reserve Bank has formalised an arrangement with Da Afghanistan Bank (DAB) (the Central Bank of Afghanistan) for extending training assistance to their staff. The proposed assistance envisages conducting in-company programmes for their staff at RBSC as well as deputation of faculty members from the College to Afghanistan for providing in-house training to DAB staff. The College has already conducted two in-company programmes on "Budgeting and Planning" and "Monetary and Financial Statistics" for the officers of the DAB which were attended by 21 and 19 participants, respectively. It also conducted an international seminar on Payment System attended by 18 participants from foreign central banks.

College of Agricultural Banking, Pune

IX.12 The *College of Agricultural Banking* (CAB) conducted collaborative programmes mainly on areas relating to rural credit with the IIBM, Guwahati, Bankers' Institute of Rural Development (BIRD), Lucknow, NABARD and the National Institute of Rural Development (NIRD), Hyderabad. It also organised a customised programme for the United Nations Development Programme (UNDP). It also conducted training and interactive sessions in areas such as non-banking financial sector, human resources management and information technology, besides its niche areas of agriculture and rural banking. Moreover, the College extended faculty support to institutions such as National Institute of Bank Management (NIBM), Pune, Vaikunth Mehta National Institute of Cooperative Management (VAMNICOM) and Bank of Maharashtra. Twenty one foreign participants attended various training programmes conducted at the College during the year. An Internal Group constituted under the Chairmanship of Shri H. R. Khan, Principal to examine the issues relating to Rural Credit and Microfinance submitted its final report in July 2005. A delegation from Bhutan comprising representatives from National Pension and Provident Fund (NPPF), Royal Monetary Authority (RMA), Bhutan Development Finance Corporation and Bank of Bhutan visited the College. A two-week training programme for the officials of RMA was organised by the College in collaboration with RBSC. The College continued to publish a quarterly magazine, 'CAB Calling', devoted to development banking with special focus on subjects of topical interests like microfinance, poverty alleviation and rural credit.

Zonal Training Centres

IX.13 *Zonal Training Centres* (ZTCs) conduct programmes on functional areas, information technology and behavioural areas for Class III and IV employees of the Reserve Bank. Apart from regular programmes at their premises, ZTCs also conducted off-site programmes on Personnel Effectiveness, Management of Office Life, Functions and Working of the Reserve Bank for Class III staff and Developmental Programme for Class IV staff. A Development Programme for Class III employees on all-India basis was organised at ZTC, New Delhi. ZTCs added out-bound segments as part of their curricula in a number of programmes to encourage team spirit and group learning. ZTCs also conducted pilot programmes for Assistant Caretakers, Class IV technical staff, electricians, plumbers and wiremen. ZTC, Belapur conducted a programme for Junior Engineers on all-India basis and three omnibus programmes for the Assistants. NABARD has also been deputing its Class III and IV employees for the investment and retirement planning programme conducted by ZTCs on a cost basis.

Deputation of Officers for Training in India and Abroad

IX.14 During 2005-06, 625 officers were deputed by the Reserve Bank to participate in training programmes, seminars and conferences organised by external management/banking institutions in India (Table 9.3). The areas of training included human resources management, risk management, security, international banking, foreign trade, labour laws and microfinance. The Reserve Bank also deputed 273 officers to attend training courses, seminars, conferences and workshops conducted by banking and financial institutions and multilateral institutions in various countries. The areas of training covered, *inter alia*, banking supervision, derivatives, risk management, financial programming and policies, central bank accounting, monetary policy and operations, finance for agriculture, rural development and macroeconomic management, human resources and reserve management.

IX.15 Four officers were selected in 2005-06 under the Golden Jubilee Scholarship Scheme for higher studies abroad. One officer is pursuing MS in Business Administration at University of Rochester, USA; one officer has joined Department of Economics, Harvard University as an Associate to pursue post-doctoral research while two officers are pursuing M.Sc (Taught) at University of Birmingham. In all, 83 officers have been selected under this scheme since its inception in 1986.

Table 9.3: Number of Officers Trained in External Training Institutions in India and Abroad

Year	Number of officers trained in India	Number of officers trained abroad
1	2	3
2001-2002	355	137
2002-2003	452	208
2003-2004	433	242
2004-2005	521	171
2005-2006	625	273

IX.16 Thirteen officers availed the benefit of different schemes for pursuing higher studies during the year. Besides, one officer completed research under the Bank for International Settlements (BIS) Visiting Fellowship Programme - 2005.

IX.17 The joint India-IMF training programme has been established at the NIBM campus in Pune. The first course on “Financial Programming and Policy” commenced on July 24, 2006. This is the seventh such facility of the IMF Institute in the world. This initiative is part of the Reserve Bank’s strategy to position India as a global training provider in the field of banking and finance and is expected to pitch India strategically on the training scene in South-East Asia and Africa.

Deputation of Class III and IV Staff to External Institutions in India

IX.18 Under the scheme for deputation of Class III and IV staff for training in external institutions in India in human resource development, 177 Class III and 17 Class IV employees were deputed to external training institutions during 2005-06. Two in-company programmes were conducted for Class III employees at V. V. Giri National Labour Institute, Noida and National Productivity Council, New Delhi, which were attended by 30 and 25 participants, respectively.

Training in Computer Technology

IX.19 During 2005-06, 48 officers were deputed by the Reserve Bank for advanced training programmes in various fields including information technology to leading training institutions such as NIBM, Pune and Institute for Development and Research in Banking Technology (IDRBT), Hyderabad.

Other Initiatives

IX.20 As part of its efforts in enabling and furthering research, the Reserve Bank made a contribution of Rs.5 crore to the Indira Gandhi Institute for Development Research (IGIDR) during 2005-06.

IX.21 To enable employees to enrich their knowledge and skill base *vis-à-vis* their job requirements and facilitate their career progression, a liberal incentive scheme that covers a larger variety of professional courses/qualifications relevant to the Reserve Bank's functions was introduced in November 2004. During the year 2005-06, 229 officers, 207 Class III employees and 29 Class IV employees availed the benefits under the incentive scheme for pursuing select categories of part time and distance education courses. The major areas of study are management, information technology, financial analysis and post-graduation in commerce and economics.

Training Attachments and Interface Sessions

IX.22 During 2005-06, nine officials from Afghanistan, Tanzania and Nigeria were provided study attachments at the Reserve Bank's central office departments. Interface sessions were held with senior officers of central office departments for the participants of Management Education Tour - Higher Defence Management Course, Secunderabad; International Programme in Banking and Finance organised by NIBM, Pune; National Defence College Team, New Delhi; Naval Higher Command Course from College of Naval Warfare; delegates from Central Bank of Nigeria; and, students from Oakland University, USA.

Summer Placement

IX.23 The Reserve Bank has in place a "Summer Placement" scheme which affords an opportunity to domestic and foreign students to expose themselves to an actual managerial environment and apply their acquired theoretical knowledge to operational issues in the central bank while working alongside experts and professionals. A total of 50 students were selected for summer placements in the Reserve Bank during the year. These summer interns were drawn from diverse disciplines such as commerce, management, science, engineering and IT. The interns were placed predominantly in the Reserve Bank's central office at Mumbai, while some were assigned to select regional offices. Furthermore, seven more students engaged in higher studies in universities abroad have also been selected this year for summer placement in the Reserve Bank.

Industrial Relations

IX.24 Industrial relations in the Reserve Bank remained, by and large, peaceful during 2005-06. Recognising the significance of designing reasonable compensation packages for appropriate harnessing of human capital, the pay and allowances of all categories of employees in the Reserve Bank were revised during the year effective November 1, 2002. These changes have reflected the Reserve Bank's keenness in being alive to the criticality of positive organisational development interventions for putting in place productivity-enhancing strategies as well as better work-life balance for its employees.

Table 9.4: Recruitment by the Reserve Bank - 2005*

Category Recruitment	Total	*of which*		Percentage	
		SC	ST	SC	ST
1	2	3	4	5	6
Class I	106	13	10	12.3	9.4
Class III	7	-	-	-	-
Class IV					
(a) Sweepers	11	3	-	27.3	-
(b) Others	23	4	3	17.4	13.0
Total	**147**	**20**	**13**	**13.6**	**8.8**

* : January-December

SC: Scheduled Castes. ST: Scheduled Tribes.

Recruitment

IX.25 During 2005 (January-December), the Reserve Bank recruited 147 employees. Of this, 33 belonged to Scheduled Castes (SCs) and Scheduled Tribes (STs) categories, constituting 22.4 per cent of total recruitment (Table 9.4).

IX.26 The total staff strength as on December 31, 2005 was 22,192 as compared with 22,727 a year ago (Chart IX.1 and Table 9.5). Of the total staff, 21.0

Chart IX.1: Total Staff Strength of the Reserve Bank

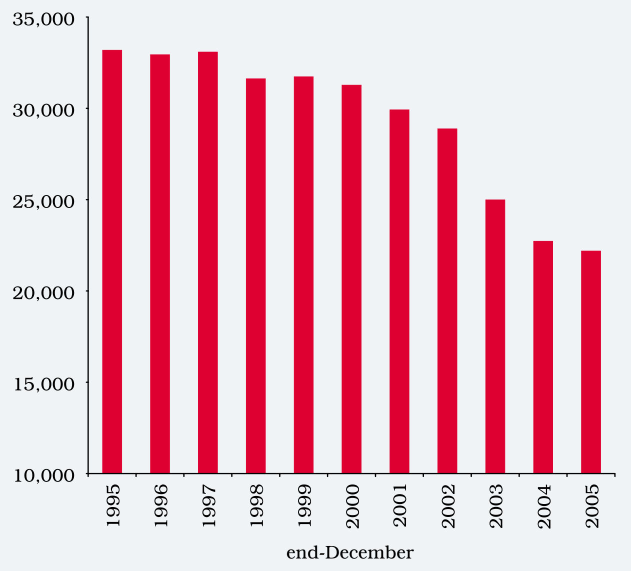


Table 9.5: Staff Strength of the Reserve Bank

Category	Category-wise strength						Percent to Total Strength	
	Total Strength		SC		ST		SC	ST
	December 31, 2004	December 31, 2005	December 31, 2004	December 31, 2005	December 31, 2004	December 31, 2005	December 31, 2005	
1	2	3	4	5	6	7	8	9
Class I	5,208	5,885	790	870	306	367	14.8	6.2
Class III	9,810	8,773	1,327	1,341	917	845	15.3	9.6
Class IV	7,709	7,534	2,502	2,459	734	731	32.6	9.7
Total	**22,727**	**22,192**	**4,619**	**4,670**	**1,957**	**1,943**	**21.0**	**8.8**

SC: Scheduled Castes. ST: Scheduled Tribes

per cent belonged to Scheduled Castes and 8.8 per cent belonged to Scheduled Tribes.

IX.27 During 2005 (January-December), the Reserve Bank's Liaison Officer for Scheduled Caste/ Scheduled Tribe employees conducted inspection of reservation rosters maintained at 13 offices, *viz*., Ahmedabad, Bangalore, Belapur, Bhopal, Bhubaneshwar, Chandigarh, Chennai, Kanpur, Kolkata, Nagpur, New Delhi, Patna and Pune (CAB). Meetings between the Management and the representatives of the All India Reserve Bank Scheduled Castes/Scheduled Tribes and the Buddhist Federation were held on four occasions during the year to discuss issues relating to the implementation of reservation policy in the Reserve Bank. In accordance with the Central Government's policy, the Reserve Bank provided reservation to Other Backward Classes (OBCs) effective September 8, 1993. The representation of OBCs (recruited after September 1993) in the Reserve Bank as on December 31, 2005 stood at 727. Of these, 179 were in Class I, 117 in Class III and 431 in Class IV. Two meetings were held with the All India Reserve Bank OBC Employees' Welfare Association to discuss issues relating to implementation of reservation policy in the Reserve Bank.

IX.28 The total strength of ex-servicemen in the Reserve Bank at end-December 2005 stood at 128 in Class I, 363 in Class III and 848 in Class IV. The total number of physically handicapped employees in Class I, Class III and Class IV cadres in the Reserve Bank stood at 92, 245 and 130, respectively, at end-December 2005.

IX.29 Of the total staff, 26.5 per cent was in Class I, 39.5 per cent in Class III and the remaining 34.0 per cent in Class IV (Table 9.6).

IX.30 Department-wise deployment of the staff strength in the Reserve Bank in both central and regional offices indicates that almost one-fourth of the total staff was involved with the work related to currency management (Table 9.7).

IX.31 Mumbai continued to have the largest number of officers and staff in the Reserve Bank - 13 per cent of total staff strength - reflecting the location of central office departments. Mumbai was followed by Kolkata and Delhi with 10 per cent and seven per cent, respectively, of the total staff strength (Table 9.8).

Table 9.6: Category-wise Actual Staff Strength
(As on December 31, 2005)

Class	Actual Strength
1	2
Class I	
1. Senior Officers in Grade F	89
2. Senior Officers in Grade E	220
3. Senior Officers in Grade D	358
4. Officers in Grade C	849
5. Officers in Grade B	1,382
6. Officers in Grade A	2,649
7. Treasurers	18
8. Deputy Treasurers	64
9. Assistant Treasurers	256
Total Strength in Class I	**5,885**
Class III	
1. Clerks Grade I	2,842
2. Clerks Grade II	4,094
3. Stenographers	253
4. Typists	558
5. Tellers	402
6. Class III (Others)	624
Total Strength in Class III	**8,773**
Class IV	
1. Peons	1,475
2. Mazdoors	1,976
3. Class IV (Others)	4, 083
Total Strength in Class IV	**7,534**
Total Strength in the Reserve Bank	**22,192**

Table 9.7: Reserve Bank's Department-wise Strength of Staff as on December 31, 2005

Sr. No.	Department/Office	Class I			Class III			Class IV			Grand Total
		C.O	R.O	Total	C.O	R.O	Total	C.O	R.O	Total	
1	2	3	4	5	6	7	8	9	10	11	12
1.	Department of Administration and Personnel Management (DAPM)	73	601	674	93	1,260	1,353	47	2,276	2,323	4,350
2.	Department of Banking Operations and Development (DBOD)	130	6	136	102	47	149	84	14	98	383
3.	Department of Banking Supervision (DBS)	115	707	822	32	271	303	18	156	174	1,299
4.	Department of Currency Management (DCM)	35	920	955	25	2,128	2,153	17	2,332	2,349	5,457
5.	Department of Economic Analysis and Policy (DEAP)	174	49	223	183	55	238	73	30	103	564
6.	Department of Expenditure and Budgetary Control (DEBC)	55	246	301	99	613	712	33	139	172	1,185
7.	Department of External Investment and Operations (DEIO)	54	-	54	31	-	31	12	-	12	97
8.	Department of Statistical Analysis and Computer Services (DESACS)	155	33	188	139	96	235	79	28	107	530
9.	Department of Government and Bank Accounts (DGBA)	51	547	598	64	1,491	1,555	21	478	499	2,652
10.	Department of Information Technology (DIT)	68	16	84	17	3	20	14	1	15	119
11.	Department of Non-Banking Supervision (DNBS)	44	227	271	10	135	145	7	74	81	497
12.	Foreign Exchange Department (FED)	60	170	230	117	499	616	50	231	281	1,127
13.	Human Resources Development Department (HRDD)	43	2	45	58	6	64	28	2	30	139
13A.	Bankers Training College, Mumbai	-	33	33	-	36	36	-	88	88	157
13B.	Reserve Bank Staff College, Chennai	-	40	40	-	24	24	-	33	33	97
13C.	Zonal Training Colleges	-	16	16	-	9	9	-	5	5	30
13D.	College of Agricultural Banking, Pune	-	39	39	-	34	34	-	77	77	150
14.	Internal Debt Management Department (IDMD)	26	-	26	13	-	13	7	-	7	46
15.	Inspection Department (ID)	49	-	49	19	-	19	10	-	10	78
16.	Legal Department (LD)	38	4	42	16	6	22	15	2	17	81
17.	Press Relations Division (PRD)	7	-	7	7	-	7	6	-	6	20
18.	Premises Department (PD)	45	198	243	42	418	460	48	697	745	1,448
19.	Rural Planning and Credit Department (RPCD)	74	210	284	40	166	206	35	81	116	606
20.	Secretary's Department	42	-	42	21	-	21	39	-	39	102
21.	Urban Banks Department (UBD)	66	330	396	30	195	225	39	66	105	726
22.	Rajbhasha Department	-	39	39	-	59	59	-	11	11	109
23.	Deposit Insurance and Credit Guarantee Corporation	35	-	35	47	4	51	24	-	24	110
24.	Reserve Bank Services Board	13	-	13	13	-	13	7	-	7	33
	Total	**1,452**	**4,433**	**5,885**	**1,218**	**7,555**	**8,773**	**713**	**6,821**	**7,534**	**22,192**

Note :
1. C.O - Central Office. R.O - Regional Office.
2. The staff in Monetary Policy Department (MPD) is not shown separately since the staff is drawn from five departments, *viz*., DEAP, DESACS, DBOD, RPCD and DAPM. The staff strength of MPD in different categories as on December 31, 2005 was 28 in Class I, 19 in Class III and 16 in Class IV.
3. The Department of Payment and Settlement Systems (DPSS) is not shown separately as their staff forms a part of staff strength of DIT.
4. The staff of Financial Markets Department (FMD) is not shown separately since the staff is drawn from six departments *viz*., DEAP, DESACS, MPD, IDMD, DEIO and DAPM. The staff strength of FMD in different categories as on December 31, 2005 was15 in Class I, 3 in Class III and 2 in Class IV.
5. The staff shown against DCM is inclusive of staff employed in Issue Department.
6. The staff shown against DGBA is inclusive of staff employed in Banking Department, Public Accounts Department and Public Debt Offices.

Table 9.8: Office-wise Strength of Staff
(As on December 31, 2005)

	Office	Class I	Class III	Class IV	Total
	1	2	3	4	5
1.	Ahmedabad	266	390	320	976
2.	Bangalore	332	415	316	1,063
3.	Belapur	78	200	243	521
4.	Bhopal	126	72	102	300
5.	Bhubaneswar	128	185	223	536
6.	Chandigarh	161	81	116	358
7.	Chennai	397	643	604	1,644
8.	Guwahati	133	299	222	654
9.	Hyderabad	233	321	334	888
10.	Jaipur	201	283	271	755
11.	Jammu	71	26	42	139
12.	Kanpur	157	485	441	1,083
13.	Kochi	19	76	50	145
14.	Kolkata	482	1021	802	2,305
15.	Lucknow	131	185	126	442
16.	Mumbai	607	1,106	1,237	2,950
17.	Nagpur	153	488	323	964
18.	New Delhi	376	743	499	1,618
19.	Panaji, Goa	05	07	02	14
20.	Patna	205	334	300	839
21.	Pune (CAB and CRDC)	47	35	84	166
22.	Thiruvananthapuram	160	207	188	555
23.	Mumbai Central Office	1,417	1,171	689	3,277
	Total	**5885**	**8,773**	**7,534**	**22,192**

CRDC: Central Records and Documentation Centre.

Organisational Climate Survey

IX.32 The Reserve Bank has, from time to time, conducted surveys to ascertain the satisfaction level of its employees with various aspects of organisational work and to ascertain the organisational climate generally. These surveys provide useful feedback to design organisational development intervention initiatives to further enhance the level of satisfaction. The latest survey suggests a significant improvement in satisfaction levels amongst staff (Box IX.2).

Promotion of Hindi

IX.33 During 2005-06, the Reserve Bank continued with its efforts to promote the use of Hindi in its working. In fulfilling the statutory requirements of Rajbhasha Policy, involving implementation of the provision of the Official Languages Act, 1963, the Official Language Rules, 1976 and the Annual Programme issued by the Government of India, Hindi training programmes and other promotional activities such as shield competitions, essay competitions and House journal competitions were conducted. Many programmes were conducted as usual at the time of Hindi fortnight observed from September 14.

Box IX.2

Organisational Climate Survey

An organisational climate survey was conducted in January 2006 amongst the staff in Class I and Class III to gauge the impact of the policy initiatives and welfare measures undertaken by the Reserve Bank since 2003, when the previous survey was conducted. Prior to that, such surveys were conducted in 1996 and 1998. The survey received a response level of approximately 44 per cent as against a response of 40 per cent to the survey conducted in 2003, 17 per cent in 1998 and 16 per cent in 1996. Results of the latest survey show a significant improvement in the satisfaction levels across all the related areas and cadres (Table). The overall satisfaction level, as measured in terms of net satisfaction factor, has improved from (-) 0.6 per cent in 1998 to 16.4 per cent in 2003 and 33.5 per cent in the current survey. In broad terms, approximately 67 per cent of the respondents were generally satisfied as against 58 per cent in the last survey.

Table: Results of Organisational Climate Survey

(Net Satisfaction Factor, Per cent)

Year	1996	1998	2003	2006	Year	1996	1998	2003	2006
1	2	3	4	5	1	2	3	4	5
Area-wise					**Cadre-wise**				
Job Satisfaction	17.54	20.95	38.02	51.28	Class III	-7.94	-5.87	7.23	23.04
Organisation Culture	11.71	14.67	7.82	27.84	Officers in Grade A	10.50	16.66	26.92	49.03
Infrastructure Support	2.61	6.70	49.30	60.73	Officers in Grade B	1.29	12.24	21.97	41.32
Training	-5.90	-0.30	18.31	32.63	Officers in Grade C	12.72	23.81	33.06	47.30
Performance Appraisal System (PAS) and Merit	-31.76	-26.13	-10.60	5.34	Officers in Grade D	18.80	31.09	41.10	59.41
					Officers in Grade E	9.09	40.52	32.41	60.82
Personnel Welfare	-19.17	-11.38	18.49	28.85	Officers in Grade F	58.84	46.61	48.82	66.45

Note: Net Satisfaction Factor represents the overall difference between those replying to the question as satisfied and dissatisfied.

IX.34 All offices and departments made efforts for use of Rajbhasha in day-to-day functioning of the Bank. The Reserve Bank properly implemented the annual programme for 2005-06 issued by the Government of India. The Reserve Bank continued to promote Hindi by bringing out its various publications bilingually *i.e.*, both in Hindi and English. The BTC continued its prestigious Hindi publication named '*Banking Chintan-Anuchintan*' which is widely welcomed in the banking sector. The College also brought out some books in Hindi which included useful articles on current topics on banking. Such books published by the College have been widely appreciated and are in great demand. Other training colleges *viz*., CAB, Pune and RBSC, Chennai also promoted the use of Hindi in their magazines. Regional offices also made attempts to publish regular magazines. During 2005-06, Chandigarh and Bangalore offices published '*Pravahini*' and '*Pradipti*', respectively. The publication 'Banking Glossary' is being revised with the cooperation of the representatives of the public sector banks to enhance its usefulness. The Reserve Bank further strengthened the use of Hindi in computerisation.

IX.35 The Committee of Parliament on Official Language visited the CAB, Pune during 2005-06 and expressed satisfaction with progress on use of Hindi in the College. The Committee also visited the Jammu office and expressed its satisfaction over the progress achieved so far in the progressive use of Hindi in that office.

Complaints Redressal Mechanism – Prevention of Sexual Harassment of Women at Work Place

IX.36 Pursuant to the guidelines laid down in the Supreme Court Judgment [Vishaka and Others. *vs.* State of Rajasthan (1997) SCC 241], a Complaints Redressal Mechanism for prevention of incidence of sexual harassment of women at workplaces was put in place in the Reserve Bank in 1998. Under the system, a Central Complaints Committee (CCC) headed by a lady officer in Grade 'F' is functional at the central office level. In order to provide an easy access to the complaints redressal mechanism for the lady staff working in offices located at various premises in Mumbai, six additional complaints committees were formed in 2005. These committees are also headed by senior woman officers. The CCC and Regional Complaints Committees (RCCs), besides having a NGO member, have more than 50 per cent women members. The CCC acts as the focal point for all the Complaints Committees constituted at 20 centres of the Reserve Bank as well as for the six newly formed committees in Mumbai. During the period from July 2005 to July 2006, three complaints of the alleged harassment were received. Of these, two complaints did not fall under the purview of the committees. Action is being taken in case of the third complaint.

Premises Department

IX.37 In order to provide better ambience at work and residential colonies, the Premises Department focused on ensuring better services and maintenance standards at the Reserve Bank's offices and residential premises, renovating the various ageing premises across the country and modernisation of the workplace by providing workstations. The focus has shifted from fresh construction or acquisition of property to concerns about idle assets and disposal of identified surplus real estate. The office building at Lucknow was completed during the year. Renovation projects taken up during the last year were duly completed and a few other buildings were taken up for renovation. The Department is also undertaking structural rehabilitation of the old buildings at a few centres to enhance the useful life of these properties. To provide modern facilities and to adapt the regional offices to a computerised environment, infrastructural facilities like backbone/structured cabling for local area networks (LANs), modern communication systems including video conferencing and modern work stations have been provided. Improvements in facilities in the residential colonies have also been taken up in a phased manner. A few Visiting Officers Flats (VOFs) are being renovated. On completion of renovation of these VOFs, benchmarking for remaining VOFs across the country will be done.

Inspection of Offices/Departments in the Reserve Bank

IX.38 In order to enhance the effectiveness of the internal inspection/audit process, Management Audit & Systems Inspection (MA&SI), Information Systems Audit, Concurrent Audit (CA) and Control Self Assessment Audit (CSAA) are undertaken at prescribed intervals. The focus of the MA&SI continues to be on three 'E's, *i.e.*, efficiency, economy and effectiveness of the system. The MA&SI evaluates and reports on the adequacy and reliability of existing systems and procedures to ensure that laws, regulations, internal policy guidelines and instructions are meticulously followed. Apart from conducting systems inspection, the inspection teams also carry out management audit under which aspects relating to organisational goals, delegation of power and customer service in the department/ office and management efficacy are looked into. During 2005-06, Systems Inspections, including Information Systems Audits of nine regional offices, twelve central office departments, two associate institutions, two training establishments and the Reserve Bank of India Services Board were completed. Technology Audit of PDO-NDS application and Technical Infrastructure Audit of Payment Systems Processing Centre (PSPC) were also completed in February 2006.

IX.39 Under the Audit Monitoring Arrangement, the Inspection Department performed various functions related to oversight, monitoring and guidance of CA and CSAA for ensuring comprehensive coverage of work areas/activities. The Inspection Department took over the task of appointment of chartered accountant firms for Concurrent Audit which was earlier done by Department of Government and Bank Accounts**.** During 2005-06, snap audits of nineteen regional offices, twenty central office departments and one training establishment were conducted. The functioning of the system of Concurrent Audit and CSAA was reviewed and measures to improve upon areas found deficient were advised to the auditee departments/offices concerned. The Department also contributed to the stabilisation/strengthening of CSAA and CA by way of extending faculty support for conducting training programmes/workshops on these audits. The compliance with the major findings of MA&SI Reports continues to be monitored by the Executive Directors' Committee under the overall supervision and guidance of the Inspection and Audit Sub-Committee (IASC) of the Central Board. During 2005-06, three meetings of the IASC and four meetings of the Executive Directors' Committee were held.

IX.40 In keeping with the recommendations of the Committee on Procedures and Performance Audit on Public Services (CPPAPS), it was decided to take up the ISO 9001-2000 certification process in phases. ISO 9001-2000 Standards are generic management standards providing an internationally accepted framework for establishing quality management systems with customer focus as the key element. These standards also provide an inbuilt mechanism for effecting continual improvements in the system. Certification under these standards demonstrates that the management systems of the organisation conform to the specified requirements and are capable of consistently achieving the stated service policy and ensuring its effective implementation. The ISO Standards have been implemented for currency management and banking functions at Kolkata and Hyderabad regional offices of the Bank as also in the central office departments concerned *viz.*, Department of Currency Management and Department of Government and Bank Accounts. Certificates for the same were received in June 2006. It has further been decided to obtain ISO 9001-2000 certification for currency management and banking functions at Bangalore, Chennai, Jaipur and New Delhi offices in the next phase.

IX.41 The Reserve Bank has also received BS7799 certification for two of its important work areas, namely, internal debt management and external investments and operations handled by Internal Debt Management Department and, Department of External Investments and Operations, respectively. Seeking BS7799 certification was a part of the Reserve Bank's continuing initiatives to adopt and adhere to international best practices and standards. BS7799 standards are internationally recognised information security management standards, which define the desired methods of controlling the confidentiality, integrity and availability of information. The certification under these standards implies establishment/existence of requisite policies for information security management, their effective implementation and suitable mechanism for improvement in the domain, in tandem with the functional information security requirements. The Reserve Bank has further decided to implement BS 7799 Standards in its Department of Banking Supervision and Department of Banking Operations and Development in the next phase. These two departments receive, analyse and store crucial information on the Indian banking sector.

Customer Service and Grievance Redressal System in Reserve Bank

IX.42 The Reserve Bank renders services to members of public, banks, Central and State Governments and financial institutions in areas covering currency management, Government receipts and payments including tax collections, public debt management, clearing and remittance of funds and foreign exchange. In order to redress complaints on deficiencies in the services rendered by the Reserve Bank, a Complaints Redressal Cell (CRC) was established in 1996 in the Department of Government and Bank Accounts to function as a nodal point at the Reserve Bank's central office level. Similar Cells were also created at the regional offices of the Reserve Bank to redress complaints at the local level. The Regional Directors, usually of the rank of Chief General Manager, are the Chief Complaints Redressal Officers at the regional offices. Similarly, the Chief General Managers-in-Charge of different central office departments are the Chief Complaints Redressal Officers at the departments concerned. Furthermore, in each regional office, a Public Grievance Redressal Officer is identified, who is usually of the rank of a Deputy General Manager. This officer directly reports to the Regional Director/Chief General Manager-in-Charge, who directly monitors timely redressal of complaints. The functioning of the complaint redressal cells are given wide publicity through advertisements in leading English, Hindi and regional languages dailies released on a half-yearly basis.

IX.43 Issues relating to customer service and redressal of complaints are discussed at the Branch Level Management Committee meetings held periodically at offices/departments. Furthermore, monthly reports on the number and nature of complaints and status of their redressal are submitted by the CRC to the top management. The status of receipt/redressal of complaints is also reviewed in the meetings of the Local Boards of the Reserve Bank.

IX.44 As part of its efforts for creating awareness and improving customer service, the Reserve Bank has brought out Citizens' Charters specifying time frame for various services provided to customers by its Banking, Issue and Foreign Exchange departments. These Citizens' Charters are displayed prominently in the Reserve Bank's premises for the benefit of customers/members of the public.

Dissemination Policy

IX.45 The Reserve Bank continued to disseminate information through press releases, publications, notifications, master circulars, speeches, frequently asked questions and advertisements. During the year ended June 30, 2006, the Reserve Bank issued 1,716 press releases, 90 master circulars and 431 notifications. It organised meetings, workshops and seminars to interact with special audiences. The helpdesks in departments and offices continued to furnish replies to the queries raised by the general public mainly through emails.

IX.46 The Reserve Bank's website (URL: http://www.rbi.org.in) is increasingly becoming a dependable resource for reference on banking and finance. During the year, 1.92 giga-bytes (GBs) of information were added to the website, taking the volume of information available on the website to 11 GBs. The website was refurbished with the intention of making it more attractive and user-friendly. The revamped website was launched in August 2005. Encouraged by the positive feedback received on the revamped English website, the Reserve Bank has now commenced a similar exercise for its Hindi website.

IX.47 For wider dissemination, the Reserve Bank, for the first time, included, through video conferencing facility, the regional press in its customary press conference held after the announcement of monetary policy. To begin with, in the press conference held in January 2006 after the Third Quarter Review of the Annual Policy Statement, three centres (Chennai, Kolkata and New Delhi) were included apart from Mumbai. Subsequently, in April 2006, while announcing the Annual Policy Statement for 2006-2007, three more centres - Ahmedabad, Bangalore and Hyderabad - were added in the video conference. Furthermore, the Reserve Bank conducted interactive seminars on monetary policy for press persons at Mumbai, Chennai, Kolkata and New Delhi immediately after the announcement of the Annual Policy in April 2006. Interactive seminars were also conducted on subjects such as securitisation of standard assets, new capital instruments for banks and analysing commercial banks' balance sheet. Such seminars, which were conducted earlier on an *ad hoc* basis, are now a part of the Reserve Bank's outreach programme. As part of its outreach programme, the Reserve Bank has also initiated the process of creating a multi-lingual website. This site will provide information of interest to bank customers in 14 languages, including Hindi and English.

IX.48 In its endeavour to take central banking to the common man, the Reserve Bank has also been facilitating visits of school/college children and other interest groups of members of the public to the Reserve Bank. The visitors are given an insight into the role and functions of the Reserve Bank through an interactive session with its officials, a tour of the Monetary Museum and a visit to the National Clearing Cell where cheques are processed. The response to this new initiative was encouraging. During the year, more than 300 visitors from eight organisations visited the Reserve Bank under this arrangement.

IX.49 As part of its campaign to create awareness on issues directly concerning the general public, the Reserve Bank released advertisements on the facilities available in deceased depositors' accounts

Box IX.3

Right to Information Act, 2005

The Right to Information Act, 2005, which has come into effect from October 12, 2005, is meant to give to the citizens of India access to information under control of public authorities to promote transparency and accountability in these organisations. The Act, under Sections 8 and 9, provides for certain categories of information to be exempt from disclosure. The Act also provides for appointment of a Chief Public Information Officer to deal with requests for information.

The Reserve Bank of India is a public authority as defined in the Right to Information Act, 2005. As such, the Reserve Bank is obliged to provide information to members of public.

Accordingly, the Reserve Bank has designated Shri V.S.Das, Executive Director, as the Chief Public Information Officer (CPIO) and Principal Chief General Manager as the Alternate CPIO in the absence of regular CPIO. Dr. Rakesh Mohan, Deputy Governor, has been designated as the Appellate Authority. In addition to the above, Central Assistant Public Information Officers (CAPIOs) have been designated to receive the applications for information or appeals under the Act at all regional offices and central office departments.

A seminar was organised in Mumbai for all the nodal officers to enlighten them on the implementation of the Right to Information Act in the Reserve Bank. The seminar covered aspects, such as the objective of the Act, steps taken by the Reserve Bank to implement the Act, set-up in the Reserve Bank to deal with requests, the need for proper preservation of records and retrieval of information, the need for improving communication protocols to ensure compliance with the provisions of the Act, procedures to be followed at regional offices and exemption of certain categories of information.

In this context, it may be noted that the Reserve Bank has an established communication policy. Under this, the Reserve Bank regularly releases information and data on Indian economy, banking and finance at regular periodicity – daily, weekly, monthly, quarterly, six monthly and annually. In addition, it also releases information, as and when required, through occasional publications, such as studies and reports.

The Reserve Bank also places in public domain its instructions relating to banking, finance, foreign exchange and other related subjects. Furthermore, the Reserve Bank also disseminates information, especially of general interest, through daily press releases. The information and data routinely released by the Reserve Bank are available on its website (www.rbi.org.in).

and on the Banking Ombudsman Scheme 2006. These advertisements were released in 74 newspapers and in 14 languages including Hindi and English. By releasing the advertisements strategically in 74 largest circulating regional language newspapers, the message was brought home to as many as 197 million readers. The advertisements were also released in 17 major English newspapers reaching a readership of 18 million.

The Right to Information Act, 2005

IX.50 The Government of India enacted the Right to Information Act, 2005 on June 15, 2005. The Act which came into effect from October 12, 2005 aims at providing right to information for citizens in order to promote transparency and accountability in the working of every public authority. The Reserve Bank, as a public authority, as defined in the Right to Information Act, 2005 is obliged to provide information to the members of public (Box IX.3). During the period up to June 30, 2006, 702 requests (88 per cent of total requests) received under the Act have been resolved. As on June 30, 2006, 74 appeal cases have been filed. Of these, 7 cases have been referred to the Central Information Commissioner (CIC) (Table 9.9).

Table 9.9: Right to Information Act – Requests Received and Resolved up to June 30, 2006

	Item	Number of Requests	
	1	2	
1.	**Requests Received**	**796**	
2.	**Total Requests Resolved**	**702**	
	of which:		
	(i) Requests met fully	415	(59)
	(ii) Requests met partly	63	(9)
	(iii) Requests declined	81	(12)
	(iv) Resolved in other manner	143	(20)
3.	**Appeal Cases**	**74**	
	of which:		
	(i) Appeals referred to Central Information Commissioner	7	

Note: Figures in parentheses are proportion to total requests resolved.

Research Activities

Department of Economic Analysis and Policy

IX.51 Department of Economic Analysis and Policy (DEAP) continued to provide analytical research on various aspects of the Indian economy in the conduct and formulation of policies by the Reserve Bank. The

Department also contributed to the Reserve Bank's efforts to disseminate information to the public about its policies and assessments through major publications. The statutory reports prepared in the Department and released during the year were the Reserve Bank's Annual Report, 2004-05, and the Report on Trend and Progress of Banking in India, 2004-05.

IX.52 The Report on Currency and Finance, 2004-05 with the theme as 'Evolution of Central Banking in India' was also released during the year. The Report which analyses and presents the Reserve Bank's evolution over the past seventy years in the backdrop of development of central banking worldwide was released by the Honourable Union Finance Minister in March 2006. The Finance Minister commended the effort and observed that the concept of central banking in India and the world is under transformation. Stating that in India the financial sector reforms were an integral part of the economic reforms since 1990s, the Finance Minister appreciated the role the Reserve Bank has played in modernising the banking infrastructure and in making it competitive to bring it in line with the global competition. The Finance Minister expressed satisfaction that the Reserve Bank has been successful in meeting its objective of ensuring price stability and financial stability in the economy while contributing to economic growth through channelising credit to productive sectors.

IX.53 In order to provide researchers with a storehouse of time series statistical information at one place, the publications 'Handbook of Statistics on Indian Economy, 2004-05' and 'Handbook of Monetary Statistics of India' were released during the year. 'State Finances: A Study of Budgets, 2004-05' was also released during the year. The document 'Macroeconomic and Monetary Developments' which was earlier released once a year along with the Governor's Annual Policy Statement was released on a quarterly basis during 2005-06 along with the Mid-term Review and the First and the Third Quarter Reviews of the Annual Policy Statement. The Department also disseminated information on key parameters of the Indian economy in the Reserve Bank's Monthly Bulletin and its Weekly Statistical Supplement. The Reserve Bank of India Occasional Papers continued to publish analytical studies in the areas concerning the Indian economy.

IX.54 The Department made presentations on macroeconomic and monetary developments before the Technical Advisory Committee on Monetary Policy at each of its quarterly meetings during the year. The Department also provided technical inputs to other departments and participated in several Inter-Departmental Groups. The Department coordinated the work relating to Article IV consultations with the staff of the IMF. The Department conducted the 9th L.K. Jha Memorial Lecture delivered by Professor Lawrence H. Summers on 'Reflections on Global Current Account Imbalances and Emerging Markets Reserve Accumulation' on March 24, 2006. In addition, a series of seminars/lectures by foreign dignitaries and experts from India were organised by the Department.

IX.55 The Development Research Group (DRG), constituted in the Reserve Bank in November 1991, continued to serve as a forum for collaborative research efforts between professional economists and officers of the Bank. The DRG has published 25 studies since its inception on a wide range of subjects relating to monetary, fiscal, banking and external areas besides real and social sector. During the year 2005-06, the DRG published a study on 'Transmission of Monetary Policy and the Bank Lending Channel: Analysis and Evidence for India'. Ongoing studies include, *inter alia*, 1) Municipal Finances in India; 2) Comparative Study of Dutch Disease Infliction in Eight Countries; 3) Role of Divisia Monetary Indices in Monetary Policy Making; and 4) Competitiveness, Efficiency and Productivity in the Indian Manufacturing Sector. Since 2001, the DRG has been entrusted with the work related to the Reserve Bank's Endowment Scheme, under which financial support is provided to various universities/institutions for the purpose of research and training in areas of interest to the Reserve Bank.

IX.56 The third volume of the History of the Reserve Bank was released during the year by the Honourable Prime Minister. The Reserve Bank completed 70 years in 2005 and the three History volumes released so far cover the first 46 years of the Reserve Bank's working - from the inception of the Reserve Bank, *i.e.*, 1935 till 1981. The first volume of the History covered the years 1935-1951, a period spanning the pre-independence and pre-planning era. The second volume covered the period 1951-67 and focused on the Reserve Bank's pioneering efforts in public policy and institutional building during the initial stages of planned economic development. Finally, the third volume covered the years 1967-81, a period marked by nationalisation of major banks and the consequent phenomenal expansion and diversification of the financial sector (Box. IX.4).

Box IX.4

History of the Reserve Bank of India

The third volume of the History of the Reserve Bank covering the period 1967-81 was released by the Honourable Prime Minister on March 18, 2006. In his remarks on the occasion the Honourable Prime Minister observed:

> "I am delighted to release the third volume of the History of Reserve Bank of India covering the period 1967-1981. Those were truly momentous years for the central bank, marked by the nationalisation of banks, a phenomenal expansion and diversification of the financial sector and battles with monetary policy during an era of high inflation."

> "Taken together, the three published volumes covering the period 1935 to 1981, span a truly historic phase in the economic evolution of India and in the maturation of our financial institutions. On this occasion, I pay tribute to the former Governors of the Reserve Bank such as C.D. Deshmukh, L.K. Jha, S. Jagannathan, I.G. Patel, R.N.Malhotra, C.Rangarajan, and Bimal Jalan who contributed to the growth and evolution of this great institution."

> "Institutional histories are important because they record the role played by institutions in shaping events of the time. But history is not a mere record of events. A useful history must also look beyond and behind the events, analyse, explain and evaluate the role played by the institutions in shaping and designing public policy of the time as well as the impact of the political and economic circumstances of the time on the institution itself. I am sure that the three volumes narrating the functioning of the Reserve Bank during the period 1935-1981 will not only have a 'historical value' but also 'contemporary relevance'."

The 'defining event' of the period 1967-1981, elaborated in the third volume, was the nationalisation of major commercial banks which, as argued in the volume, essentially reflected deep rooted economic consideration debated over a long time although the timing of the event may have been a political one. This led to a 'dramatic shift' in the orientation and operation of commercial banks. Post nationalisation there was an impressive and unparalleled spread of the banking system and significant directing of credit to the hitherto neglected sectors. The emergence of the Government as the owner of the major banks also created a new situation of 'dual control' over the banking system to which the Reserve Bank had to adjust.

The budget deficits of the Government rose sharply and fiscal policy held centre stage from the 1970s. The volume notes that there 'was abandonment of monetary policy as a tool of economic policy and corrective intervention'. While monetary policy in conjunction with other measures was actively used to control inflation when it reached alarmingly high levels, during the rest of the period it had to accommodate the fiscal policy. Thus, the Reserve Bank's monetary management became a delicate balancing act between the compulsions of fiscal policy and price stability considerations. In order to contain inflationary pressures, monetary policy used non-price instruments like raising the SLR and CRR. As the Government progressively mobilised greater resources from the banking system, problems arose regarding allocation of scarce credit, which led to rationing of credit.

The volume also vividly describes the challenges faced by the Reserve Bank to fine tune inspection procedures so that viability of the banking system was not compromised in the wake of geographical branch expansion of the banks.

The volume provides a backdrop of several successive shocks – economic, political, military, diplomatic and social – while discussing the history of the Reserve Bank during the period covered. In particular, the Reserve Bank had to face several uncertainties associated with two oil shocks, the breakdown of the Bretton Woods system of exchange rates and the Bangladesh war. Furthermore, there were frequent changes in the Finance Minister and Governor of the Reserve Bank. As a result, the policy regime had to take nuanced positions at an unsettling frequency. Crises led the policy makers to experiment with shifts in policy and priorities particularly in banking, exchange rate management and exchange controls. Operationally, the Reserve Bank had to reorient its financial and credit policies in a manner consistent with the economic and institutional aims of the Government which may not have been consistent with sound economic management. This was a period with endemic and severe foreign exchange shortages. Coping with the uncertainties of the time took a great deal of effort and sagacity and the Reserve Bank played an important role especially in the dealings with the International Monetary Fund (IMF). The third volume of history analyses the anatomy of exchange control and exchange rate management in this context.

The third volume also narrates the developments regarding the growth of organisation and office structure of the Reserve Bank over the period since 1951 as the second volume had not dwelt on this specifically.

It may be noted that the history is based on official records, published sources and discussions with persons who were closely involved with the events. The volumes are an institutional but not an official history as considerable freedom has been available to those who worked on it.

Library

IX.57 The Central Library of the Reserve Bank attached to the Department of Economic Analysis and Policy (DEAP) plays an important role in the collection, storage and dissemination of information. The Library has a comprehensive collection of books, journals, working papers, reports, CD-ROMs and other documents. The Library maintains electronic database of all these documents (OPAC – Online Public Access Catalogue), which can be accessed through intranet from the central office building and from all other offices of the Reserve Bank. Through its home page, the Library offers access to various online databases such as ECONLIT, Proquest Business Periodicals Database (covering 4,000 journals), Elsevier Science Direct online, NBER working papers and IMF working papers. Other online services provided by the Library are PROWESS, World Bank publications, Financial Times online, Economist online, CEPR Discussion papers online, JSTOR and DATASTREAM.

IX.58 The Library database has 1,04,483 records which cover books and other documents. The Library receives 344 technical journals. The Library provides Current Awareness Services for all new documents added in the Library as well as select articles from professional journals through intranet on a regular basis. The Library also provides information services and support to training colleges and libraries in other offices of the Reserve Bank.

Department of Statistical Analysis and Computer Services

IX.59 Department of Statistical Analysis and Computer Services (DESACS) conducted various surveys during 2005-06 to provide support to the Reserve Bank's conduct and formulation of policies. Given the growing importance of inflation expectations in the conduct of monetary policy, the Department introduced surveys on inflation expectations and conducted four rounds of the survey during 2005-06. A pilot survey was conducted in the month of September 2005 in four metros *viz.*, Mumbai, Delhi, Chennai and Kolkata and 1,000 households were covered. The questionnaire elicited the respondents' views on directional movement in prices on four parameters (*i.e.*, general price level, prices of food products, house rent and cost of services) for the next 3 months and for next one year. In the second round of the survey, the parameters were increased to six by including prices of non-food products and household durables. An additional question seeking quantitative measures on the expected rate of inflation for next 3 months and for next one year was also included. In the third round, the sample size was increased to 4,000 households and the survey was extended to other major cities *viz.*, Ahmedabad, Bhopal, Bangalore, Guwahati, Jaipur, Hyderabad, Lucknow and Patna. The fourth round of the survey was conducted in June 2006 with the same sample size as in the previous round.

IX.60 The Department also conducted the following surveys: quarterly industrial outlook survey of non-Government non-financial private corporate manufacturing sector; survey of small borrowal accounts (each with a credit limit of Rs.2,00,000 or less) with March 31, 2004 as the reference period; annual BSR 1 & 2 surveys on distributional aspects of deposits and gross bank credit of scheduled commercial banks (SCBs) for March 2005; annual survey on composition and ownership pattern of deposits with SCBs as on March 31, 2005; annual survey on investment portfolio of SCBs as on March 31, 2005; quarterly surveys on aggregate deposits and gross bank credit of SCBs as on last Fridays of June 2005, September 2005 and December 2005 and as on March 31, 2006; and the quinquennial survey on debits to deposit accounts for the year 2004-05. Consequent upon the Reserve Bank's decision to join the IMF's Coordinated Portfolio Investment Survey (CPIS) (2004), a survey titled 'Coordinated Portfolio Investment Survey' was conducted.

IX.61 In order to compile a Business Service Price Index (BSPI), covering major services, the Reserve Bank has taken up the work to compile a price index for banking services. A methodological paper was submitted to the Technical Advisory Committee on Statistics of Prices and Cost of Living and the Ministry of Commerce and Industry. While initially direct services will be captured in the index, the coverage of the index will be extended over time to include intermediation services.

IX.62 Inventories, order books and capacity utilisation are amongst the useful indicators of business cycle analysis and provide lead information on the likely course of output and prices for conduct of monetary policy. The Reserve Bank has taken up a project to conduct such a survey on a quarterly basis. The survey proposes to cover about 4,000 companies in the manufacturing sector.

IX.63 The Reserve Bank has since November 2004 provided web-based access to time series data on key macro economic aggregates of Indian economy to the public in user-friendly manner through dynamic web-based application, *viz.*, Database on Indian

Economy (DBIE). The Database built for the convenience of researchers, analysts and other users is accessible directly through the URL https://cdbmsi.reservebank.org.in. A Standing Advisory Group constituted under the chairmanship of Dr. R.B. Barman, Executive Director meets on quarterly intervals to review the contents and format of DBIE. The list of the data series available is being progressively enlarged on the basis of feedback received and availability of relevant data series in the data warehouse.

IX.64 In December 2005, the Reserve Bank joined the databank hosted by the Bank for International Settlements (BIS). The BIS databank is a joint effort of central banks of member countries of the BIS with the aim to provide the economists and statisticians of the central bank community with high quality, well documented and timely economic, monetary and financial statistics. The Reserve Bank's Central Database Management System (CDBMS) was identified as the single gateway for exchanging data between the BIS and the Reserve Bank's users. The exchange of data started in January 2006 and the BIS declared the Reserve Bank as a full member of the databank in February 2006 following the reporting of forty seven national data series to the BIS databank. As per the reciprocity principle, the Reserve Bank has received data series for other participants from the BIS. These series along with the relevant documentations would be made available through CDBMS platform to all CDBMS users to facilitate cross-country analysis.

IX.65 In order to streamline the receipt of data from banks, the Reserve Bank has implemented an on-line returns filing system (ORFS). The system has been conceived, designed and developed to provide an end-to-end secured channel for banks to submit various returns to the Reserve Bank. The system exploits the features of the secured web server installed at IDRBT, Hyderabad, INFINET, MQ-Series and XML. To start with, submission of data by commercial banks through Form A under Section 42(2) of the Reserve Bank of India Act has been brought under ORFS. The project is being implemented by DESACS in coordination with other departments like DIT, DBOD, DBS, FED, MPD, DPSS and RPCD.

IX.66 The Reserve Bank had implemented the BIS system of compilation of International Banking Statistics (IBS) for banks in India on quarterly basis from December 1999. The BIS revised its guidelines for compiling consolidated banking statistics (CBS) by modifying its reporting format and increasing the coverage by including financial instruments, such as derivatives and guarantees. Accordingly, the IBS reporting system in India was also revised and implemented from the reporting quarter March 2005. The Guide to the IBS for banks in India and foreign branches of Indian banks was also revised. These data have been incorporated by the BIS in their publications.

IX.67 In order to ensure improvement in quality/coverage of BSR system, IBS data, external sector returns and other returns, the Department conducted workshops/training programs for officials of participating banks at the colleges and various centres of the Reserve Bank.

CENTRAL BOARD AND ITS COMMITTEES

IX.68 Eight meetings, including one Special meeting, of the Central Board were held during the year ended June 30, 2006. Of these, five meetings were held at traditional centres, *viz.*, New Delhi, Kolkata, Chennai and Mumbai and three were held at non-traditional centres, *viz.*, Bhopal, Port Blair and Mussoorie. The Special Central Board meeting, held at Mumbai was addressed by Dr. Manmohan Singh, Honourable Prime Minister of India and was attended by Shri S.M. Krishna, Honourable Governor of Maharashtra, Shri Vilasrao Deshmukh, Honourable Chief Minister of Maharashtra and Shri P. Chidambaram, Honourable Union Finance Minister, as Guests of Honour. Former Governors, Shri M. Narasimham, Shri S.Venkitaramanan, Dr. C. Rangarajan and Dr. Bimal Jalan were the special invitees for the meeting. The discussions at the meetings of the Central Board broadly covered matters pertaining to general superintendence and direction of the Reserve Bank's affairs, in which the Directors, with their vast experience in diverse fields, actively contributed to important decisions in areas such as currency management, information technology, human resource development, banking supervision, monetary and credit policy, the Reserve Bank's accounting policy, internal debt management policy and central bank governance. The deliberations of the Board also focused on the critical assessment of the percolation of benefits of growth to the poorer sections of the society and the efficacy of the Reserve Bank's policies relating to agriculture and rural areas. The Central Board and its Committee also reviewed the functioning of Local Boards in their areas of operations. 46 weekly meetings of the Committee of the Central Board were held during the year at Mumbai. The Committee of the Central Board, as usual, attended to the current business of the Reserve Bank, including approval of the Reserve Bank's weekly accounts pertaining to the Issue and the Banking Departments.

IX.69 In its meeting held on May 5, 2005 at Srinagar, the Central Board decided to set up a Working Group on Credit for Jammu and Kashmir to identify areas where nationalised banks could help the State in advancing loans for self-employment projects, SME sector, agriculture, tourism and other important areas. As a follow-up of the discussions of Governor, Reserve Bank with the Chief Minister of Jammu and Kashmir on May 5, 2005, a Standing Forum to Review Credit and Other issues relating to Industrial Development in Jammu and Kashmir was constituted, as a sub-group of the State Level Bankers' Committee. Some of the major recommendations of the Forum are: (i) credit requirement is to be disposed off within 2 to 6 weeks and *ad hoc* requirement to be met in one week; (ii) rate of interest on SME/SSI cases may be at PLR; (iii) banks not to levy any charges on anywhere banking; (iv) Government to take necessary steps to ensure timely encashment of Government cheques at treasuries as the trade and industry is suffering on account of delayed payments; (v) banks to consider debt equity ratio of 3:1 in case of SME sector; (vi) in case of cash credits, banks to consider unencumbered machinery or any other asset as part of collateral security; (vii) the amount settled under one-time settlement scheme may be recovered in 2 to 3 years instead of one year as per the existing guidelines; (viii) banks to designate SSI branches near industrial estates with adequate lending powers; (ix) State Government may arrange to provide margin money for rehabilitation of sick units; (x) restrengthening of financial institutions like SFC and SIDCO through equity support by Government and adequate refinance by SIDBI; (xi) banks to identify good NGOs and support Panchayat Raj institutions for promotion of SHGs; (xii) State Government may waive stamp duty in respect of loans availed by SHGs from banks; (xiii) Entrepreneurship Development Institutes set up by the State Government may be assigned the short-term task of training the entrepreneurs for vocations under the Government sponsored programmes; setting up a Rural Development and Self Employment Training Institute (RUDSETI) type institute may be a long-term goal; and (xiv) frequent meetings, either bimonthly or quarterly, of NABARD, SIDBI, commercial banks, RRBs may be convened and the Reserve Bank may be the nodal agency for this. The recommendations were discussed in the SLBC meeting held on June 15, 2006 and adopted for implementation.

IX.70 In its meeting held on February 16, 2006 at Port Blair, the Central Board decided to set up an Empowered Task Force to accelerate the resolution of relief measures to the *Tsunami* affected borrowers. The Empowered Task Force has submitted its recommendations and suggested a few additional measures for the southern and northern group of islands. The issue of opening more currency chests by banks in Car Nicobar and Campbell Bay was also taken up in the aforesaid meeting (see Chapter III for details).

IX.71 Pursuant to the meeting held between Governor, Reserve Bank, Chief Minister of Uttaranchal and banks/ financial institutions at Mussoorie on May 5, 2006, a Working Group has been constituted under the chairmanship of Shri V. S. Das, Executive Director on May 22, 2006 to formulate an action plan for improvement of banking services in Uttaranchal. The Group's report is under finalisation. The Reserve Bank opened a sub-office at Dehradun on June 30, 2006. The sub-office, initially comprising two departments *viz.*, Rural Planning and Credit Department (RPCD) and Urban Banks Department (UBD), will focus on issues relating to rural credit and cooperative banks in the State.

IX.72 The Sub-Committees of the Central Board have been constituted to assist the Central Board in direction of the affairs of the Reserve Bank. One meeting of the Staff Sub-Committee, three meetings of the Inspection and Audit Sub-Committee and three meetings of the Building Sub-Committee were held during the year. The Building Sub-Committee advised the Reserve Bank on various matters including construction of staff quarters, and renovation of office and residential buildings. The Committee also reviewed the utilisation of capital budget for the year 2006-07. The Staff Sub-Committee dealt with the matters concerning manpower planning in the Reserve Bank and considered proposals for sanction of additional posts in various categories of staff in the Reserve Bank. The Inspection and Audit Sub-Committee examined the critical areas emanating from Management Audit and Systems Inspection of central office departments/regional offices of the Reserve Bank.

Reconstitution of Central Board

IX.73 The Central Board was reconstituted with effect from June 27, 2006 (Table 9.10). Shri Y.H. Malegam was re-appointed as Member of the Western Area Local Board of the Reserve Bank with effect from June 27, 2006 and was re-nominated as Director of the Central Board under Section 8(1)(b) of the Reserve Bank of India Act, 1934 with effect from the same date. Shri Suresh D.

Table 9.10: Central Board of the Reserve Bank

Directors up to June 27, 2006	Directors effective June 27, 2006
1	2
Directors nominated under Section 8 (1) (b) of the RBI Act, 1934.	
Y.H. Malegam	Y.H. Malegam
Mihir Rakshit	Suresh D. Tendulkar
K. Madhava Rao	U.R. Rao
	Lakshmi Chand
Directors nominated under Section 8 (1) (c) of the RBI Act, 1934	
Ratan N. Tata	D.S. Brar
Amrita Patel	H.P. Ranina
K. P. Singh	Ashok S. Ganguly
V. S. Vyas	Azim Premji
D. S. Brar	Kumar Mangalam Birla
H. P. Ranina	Shashi Rekha Rajagopalan
N. R. Narayana Murthy	Suresh Kumar Neotia
Suresh Krishna	A. Vaidyanathan
Ashok S. Ganguly	Man Mohan Sharma
	D. Jayavarthanavelu

Tendulkar, Dr. U.R. Rao and Shri Lakshmi Chand were appointed as Members of the Eastern, Northern and Southern Area Local Boards of the Reserve Bank, respectively, with effect from June 27, 2006 and were nominated as Directors of the Central Board under Section 8(1)(b) of the Reserve Bank of India Act from the respective Local Boards, with effect from the same date. With effect from June 27, 2006, Shri H.P. Ranina and Dr. A.S. Ganguly were re-nominated as Directors of the Central Board under Section 8(1)(c) of the Reserve Bank of India Act, 1934. Shri Azim Premji, Shri Kumar Mangalam Birla, Smt. Shashi Rekha Rajagopalan, Shri Suresh Kumar Neotia, Dr. A.Vaidyanathan, Prof. Man Mohan Sharma, and Dr. D. Jayavarthanavelu were nominated as Directors under Section 8(1)(c) of the Act with effect from June 27, 2006.

IX.74 Consequent upon reconstitution of the Central Board of the Reserve Bank with effect from June 27, 2006, the Board for Financial Supervision (BFS), the Board for Regulation and Supervision of Payment and Settlement Systems (BPSS) and the three Sub-Committees of the Central Board were also reconstituted in consultation with the Central Board at its meeting held on July 6, 2006 (Table 9.11).

Table 9.11: Committees and Sub-Committees of the Central Board

Committees /Sub-Committees	Director
1	2
1. Board for Financial Supervision (BFS)	Y.H. Malegam Shashi Rekha Rajagopalan A. Vaidyanathan Ashok S. Ganguly
2. Board for Regulation and Supervision of Payment and Settlement Systems (BPSS)	U.R. Rao H.P. Ranina
3. Inspection and Audit Sub-Committee	H.P. Ranina Man Mohan Sharma D.S. Brar D. Jayavarthanavelu
4. Staff Sub-Committee	Kumar Mangalam Birla Suresh D. Tendulkar
5. Building Sub-Committee	Lakshmi Chand Suresh Kumar Neotia

Directors/Members of the Central Board/Local Boards

IX.75 Smt K.J. Udeshi retired from the Central Board on completing her term as Deputy Governor of the Bank on October 12, 2005.

IX.76 Smt. Usha Thorat joined the Central Board after taking over as Deputy Governor with effect from November 10, 2005.

IX.77 Dr. I.G. Patel, former Governor of the Bank (December 1, 1977 to September 15, 1982) passed away on July 17, 2005.

IX.78 Dr. Bhai Mohan Singh, former Director of the Central Board (March 28, 1994 to November 27, 2000) passed away on March 27, 2006.

IX.79 Prof. V.S. Vyas, former Director of the Central Board was awarded Padma Bhushan in the field of literature and education on the Republic Day 2006.

IX.80 Shri Suresh Krishna, former Director of the Central Board was awarded Padma Shree in the field of trade and industry on the Republic Day 2006.

Appointment/Retirement of Executives

IX.81 Shri P.V. Subba Rao, Executive Director retired with effect from July 31, 2005.

IX.82 Shri C. Krishnan, Chief General Manager was appointed as Executive Director with effect from August 1, 2005.

IX.83 Shri A.V. Sardesai, Executive Director retired with effect from September 30, 2005.

IX.84 Shri Anand Sinha and Shri V.S. Das, Chief General Managers were appointed as Executive Directors with effect from November 11, 2005.

Parliamentary Committee

IX.85 The Parliamentary Standing Committee on Personnel, Public Grievances, Law and Justice headed by Shri E.M. Sudarsana Natchiappan, Member of Parliament visited Mumbai during June

25 to 27, 2006 and held discussions with Smt. Usha Thorat, Deputy Governor, Shri V.S. Das, Executive Director and other senior executives on status of public grievances redressal mechanism and policy of appointments on compassionate ground.

Foreign Dignitaries

IX.86 A number of foreign delegations visited the Reserve Bank during the year and interacted with top management (Annex III).

IX.87 SAARCFINANCE Governors' Symposium was hosted by the Reserve Bank on September 9, 2005. Governors and top executives of SAARC central banks attended the symposium chaired by Dr. Y.V. Reddy, Governor.

IX.88 Mr. Nicholas C. Garganas, Governor, Bank of Greece, who visited the Reserve Bank on November 25, 2005 delivered a talk on 'The Challenge of Monetary Policy in Single-Currency Area: The ECB Experience'. Prof Lawrence Summers, President, Harvard University, visited the Reserve Bank to deliver the 9^{th} L.K. Jha Memorial Lecture on 'Reflections on Global Current Account Imbalances and Emerging Markets Reserve Accumulation' on March 24, 2006.

X THE RESERVE BANK'S ACCOUNTS FOR 2005-06

X.1 The key financial results of the Reserve Bank's operations during the year are presented in this Chapter.

INCOME AND EXPENDITURE

X.2 The gross income, expenditure, appropriations and net disposable income of the Reserve Bank have been evolving over the last five years (Table 10.1).

converted into marketable securities. The transfer on account of interest differential is intended to compensate the Government for the difference in interest expenditure which the Government had to bear consequent on the conversion.

INCOME

X.4 The gross income of the Reserve Bank for the year 2005-06 was Rs.26,320.31 crore, which was higher by Rs.7,292.03 crore (38.3 per cent) than the previous year's total income of Rs.19,028.28 crore. There was an increase in income from foreign sources while income from domestic sources declined during the year (Table 10.2 and Chart X.1).

Table 10.1: Trends in Gross Income, Expenditure and Net Disposable Income

(Rupees crore)

Item	2001-02	2002-03	2003-04	2004-05	2005-06
1	2	3	4	5	6
Total Income (Gross)	24,690.34	23,185.64	14,323.70	19,028.28	26,320.31
Less transfer to:					
(i) Contingency Reserve	6,996.04	6,733.92	969.47	6,125.92	10,936.42
(ii) Asset Development Reserve	827.91	890.31	188.09	687.09	1,126.79
Total (i + ii)	7,823.95	7,624.23	1,157.56	6,813.01	12,063.21
Total Income (Net)	16,866.39	15,561.41	13,166.14	12,215.27	14,257.10
Total Expenditure	6,542.39	6,723.41	7,762.14	6,811.27	5,849.10
Net Disposable Income	10,324.00	8,838.00	5,404.00	5,404.00	8,408.00
Less : Transfer to Funds *	4.00	4.00	4.00	4.00	4.00
Surplus Transfer to the Government	10,320.00	8,834.00	5,400.00	5,400.00	8,404.00

* : An amount of Rupees one crore each transferred to the National Industrial Credit (Long Term Operations) Fund, National Rural Credit (Long Term Operations) Fund, National Rural Credit (Stabilisation) Fund and National Housing Credit (Long Term Operations) Fund during each of the five years.

Surplus Transferable to Government of India

X.3 The surplus transferable to the Central Government for the year 2005-06 amounted to Rs.8,404.00 crore, inclusive of Rs.2,106.00 crore towards interest differential on special securities

Table 10.2: Gross Income

(Rupees crore)

Item	2001-02	2002-03	2003-04	2004-05	2005-06
1	2	3	4	5	6
A. Foreign Sources					
Interest, Discount, Exchange	9,986.46	9,826.65	9,103.50	16,979.47	24,538.03
B. Domestic Sources					
Interest	14,492.14	13,064.77	4,872.41	1,607.34	1,207.04
Other Earnings	211.74	294.22	347.79	441.47	575.24
Total: Domestic	14,703.88	13,358.99	5,220.20	2,048.81	1,782.28
C. Total Income (Gross) (A+B)	**24,690.34**	**23,185.64**	**14,323.70**	**19,028.28**	**26,320.31**

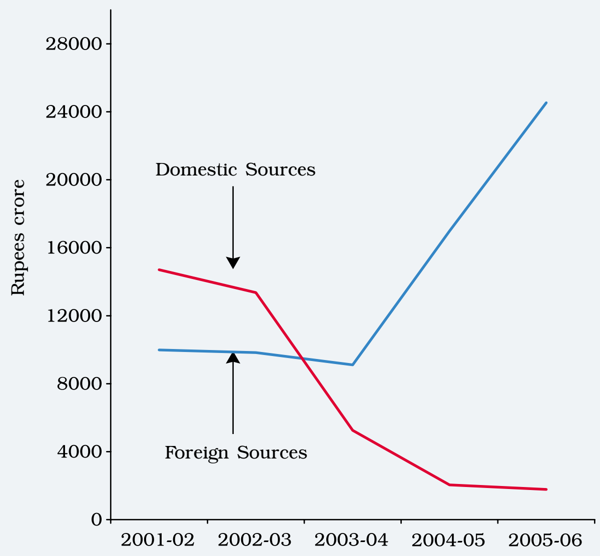
Table 10.3: Contingency and Asset Development Reserves and Surplus Transfer to the Government

(Rupees crore)

Item	2001-02	2002-03	2003-04	2004-05	2005-06
1	2	3	4	5	6
Total Income (Gross)	24,690.34	23,185.64	14,323.70	19,028.28	26,320.31
Transfer to Contingency Reserve	6,996.04	6,733.92	969.47	6,125.92	10,936.42
	(28.3)	(29.0)	(6.8)	(32.2)	(41.6)
Asset Development Reserve	827.91	890.31	188.09	687.09	1,126.79
	(3.4)	(3.8)	(1.3)	(3.6)	(4.3)
Surplus Transfer to the Government	10,320.00	8,834.00	5,400.00	5,400.00	8,404.00
	(41.8)	(38.1)	(37.7)	(28.4)	(31.9)

Note : Figures in parentheses indicate proportion to total income.

Chart X.1: Sources of Income



X.5 The share of transfer to Contingency Reserve, Asset Development Reserve and surplus transferred to Government as a percentage to total income is given in Table 10.3.

Earnings from Foreign Sources

X.6 The Reserve Bank's earnings from the deployment of foreign currency assets and gold increased by Rs.7,558.56 crore (44.5 per cent) from Rs.16,979.47 crore in 2004-05 to Rs.24,538.03 crore in 2005-06 (Table 10.4). This was mainly on account of increase in the level of foreign currency assets and hardening of global short term interest rates. Before accounting for mark-to-market depreciation on securities, the rate of earnings on foreign currency assets and gold was 4.1 per cent in 2005-06 as against 3.2 per cent in 2004-05. The rate of earnings on foreign currency assets and gold, after accounting for depreciation, increased from 3.1 per cent in 2004-05 to 3.9 per cent in 2005-06.

Table 10.4: Earnings from Foreign Sources

(Rupees crore)

Item	As on		Variation	
	June 30, 2005	June 30, 2006	Absolute	Per cent
1	2	3	4	5
Foreign Currency Assets (FCA)	5,75,863.66	7,18,701.18	1,42,837.52	24.8
Gold	19,375.10	28,478.87	9,103.77	47.0
Special Drawing Rights (SDR)	18.35	2.17	(-) 16.18	(-) 88.2
Reserve Position in the IMF **	6,791.43	3,518.31	(-) 3,273.12	(-) 48.2
Total Foreign Exchange Reserves (FER)	6,02,048.54	7,50,700.53	1,48,651.99	24.7
Average FCA	5,51,659.54	6,29,067.47	77,407.93	14.0
Earnings (Interest, Discount, Exchange gain/loss, Capital gain / loss on Securities)	17,889.74	25,569.34	7,679.60	42.9
Depreciation on Securities	(-) 910.27	(-) 1,031.31	121.04	13.3
Earnings Net of Depreciation	16,979.47	24,538.03	7,558.56	44.5
Memo :				
Unrealised Appreciation on Securities	900.14	194.83	(-) 705.31	(-) 78.4
Earnings as percentage of Average FCA	3.2	4.1		
Earnings (net of depreciation) as percentage of Average FCA	3.1	3.9		

** : Reserve position in the International Monetary Fund (IMF), which was shown as a memo item from May 23, 2003 to March 26, 2004 has been included in the reserves from the week ended April 2, 2004.

Table 10.5: Earnings from Domestic Sources

(Rupees crore)

Item	As on		Variation	
	June 30, 2005	June 30, 2006	Absolute	Per cent
1	2	3	4	5
Domestic Assets	106,952.94	90,106.99	(-) 16,845.95	(-) 15.8
Weekly Average of Domestic Assets	99,977.76	101,303.96	1,326.20	1.3
Earnings	**2,048.81**	**1,782.28**	**(-) 266.53**	**(-) 13.0**
	(8,143.92)	(7,631.93)		
of which:				
Interest	**1,607.34**	**1,207.04**	**(-) 400.30**	**(-) 24.9**
(i) Profit on Sale of Securities	4,220.52	3,776.20	(-) 444.32	(-) 10.5
(ii) Interest on Securities	(-) 3,272.08	(-) 2,834.23	437.85	13.4
(iii) Interest on Loans and Advances	367.35	219.27	(-) 148.08	(-) 40.3
(iv) Other Interest Receipts	291.55	45.80	(-) 245.75	(-) 84.3
Other Earnings	**441.47**	**575.24**	**133.77**	**30.3**
(i) Discount	0.01	-	(-) 0.01	(-) 100
(ii) Exchange	0.04	0.05	0.01	25.0
(iii) Commission	381.36	395.20	13.84	3.6
(iv) Rent Realised and Others	60.06	179.99	119.93	199.7
Memo :				
Earnings in percentage terms (on average domestic assets)	2.0	1.8		
Earnings in percentage terms (excluding profit on sale of securities)	(-) 2.2	(-) 2.0		

Note : Figures in parentheses are depreciation on securities.

Income from Domestic Sources

X.7 Domestic income decreased by Rs.266.53 crore (13 per cent) from Rs.2,048.81 crore in 2004-05 to Rs.1,782.28 crore in 2005-06. The decline in income was mainly on account of reduced profit on sale of securities (from Rs.4,220.52 crore in 2004-05 to Rs.3,776.20 crore in 2005-06) and a decline in interest income on loans due to lower recourse to WMA by Central and State Governments in the face of substantial cash balances (Table 10.5).

EXPENDITURE

X.8 Total expenditure of the Reserve Bank declined by Rs.962.17 crore (14.1 per cent) from Rs.6,811.27 crore in 2004-05 to Rs.5,849.10 crore in 2005-06 (Table 10.6 and Chart X.2).

Interest Payment

X.9 Interest payment increased by Rs.138.13 crore (10 per cent) from Rs.1,386.28 crore in 2004-05 to Rs.1,524.41 crore in 2005-06. The increase was mainly on account of higher payment of interest on cash reserve ratio (CRR) which was due to higher growth in aggregate deposits during the year. The Bank had earmarked certain Government securities from its Investment Account in order to cover the liabilities in Provident Fund, Superannuation Fund and Encashment of Ordinary Leave Fund. Consequently, interest payments on these funds during 2005-06 (Rs.449.21 crore) have been made from the interest earned on these earmarked securities and hence do not form part of interest payments.

Establishment Expenditure

X.10 Establishment expenditure declined by Rs.733.29 crore (44.4 per cent) from Rs.1,653.17 crore in 2004-05 to Rs.919.88 crore in 2005-06. The decline in establishment expenditure was due to reduction in provision towards Gratuity and Superannuation Fund from Rs.743.06 crore in 2004-05

Table 10.6: Expenditure

(Rupees crore)

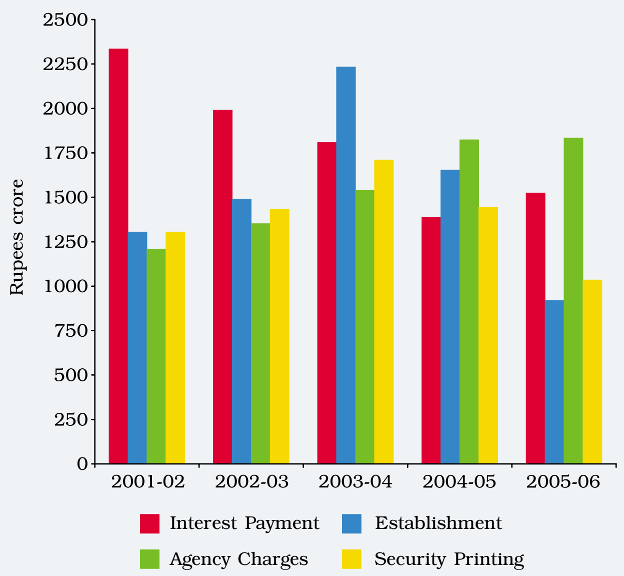
Item	2001-02	2002-03	2003-04	2004-05	2005-06
1	2	3	4	5	6
I. Interest Payment	**2,334.99**	**1,990.09**	**1,808.48**	**1,386.28**	**1,524.41**
of which: Scheduled Banks	1,838.57	1,483.02	1,323.23	1,276.83	1,523.72
II. Establishment	**1,304.36**	**1,488.86**	**2,232.99**	**1,653.17**	**919.88**
III Non-Establishment	**2,903.04**	**3,244.46**	**3,720.67**	**3,771.82**	**3,404.81**
of which: a) Agency charges	1,207.84	1,352.41	1,539.12	1,824.17	1,833.55
b) Security printing	1,304.49	1,433.09	1,709.56	1,443.57	1,034.86
Total [I+II+III]	**6,542.39**	**6,723.41**	**7,762.14**	**6,811.27**	**5,849.10**

to Rs.19.26 crore in 2005-06, which was on account of utilisation of additional provision of Rs.515 crore made in earlier year. The establishment expenditure during 2005-06 comprised of salary (45.8 per cent), allowances (23.3 per cent), funds (7.2 per cent) and miscellaneous expenditure (23.7 per cent).

Non-Establishment Expenditure

X.11 Expenditure on security printing comprising, *inter alia*, cost of printing currency notes and cheque forms decreased by Rs.408.71 crore (28.3 per cent) from Rs.1,443.57 crore in 2004-05 to Rs.1,034.86 crore in 2005-06 mainly due to lower supply of notes by 478.30 crore pieces. The expenditure incurred for security printing includes a sum of Rs.106.67 crore paid for banknotes supplied during the previous years.

Chart X.2: Major Expenditure Items



BALANCE SHEET

LIABILITIES

National Industrial Credit (Long Term Operations) Fund

X.12 There were no operations in the National Industrial Credit (Long Term Operations) Fund (established under Section 46 C of the Reserve Bank of India Act, 1934) during 2005-06 except the credit of Rs.1.00 crore to the Fund out of the Reserve Bank's income.

National Housing Credit (Long Term Operations) Fund

X.13 The National Housing Credit (Long Term Operations) Fund was established by the Reserve Bank in terms of Section 46 D(l) of the Reserve Bank of India Act, 1934 in January 1989. A token contribution of Rs.1.00 crore was made to the Fund out of the Reserve Bank's income during 2005-06.

Deposits - Banks

X.14 'Deposits - Banks' represent balances maintained by banks in current account with the Reserve Bank mainly for maintaining CRR and as working funds for clearing adjustments.

Deposits - Others

X.15 'Deposits - Others' include deposits from financial institutions, employees' provident fund deposits, surplus earmarked pending transfer to the Government and sundry deposits.

Other Liabilities

X.16 'Other Liabilities' include the internal reserves and provisions of the Reserve Bank and net credit balance in the RBI General Account. These liabilities have increased by Rs.72,017.53 crore (71.8 per cent) from Rs.1,00,356.27 crore as on June 30, 2005 to Rs.1,72,373.80 crore as on June 30, 2006 mainly on account of increase in the level of Currency and Gold Revaluation Account (CGRA).

X.17 The reserves, *viz.* Contingency Reserve, Asset Development Reserve, Currency and Gold Revaluation Account and Exchange Equalisation Account reflected in 'Other Liabilities' are in addition to the 'Reserve Fund' of Rs.6,500.00 crore held by the Reserve Bank as a distinct balance sheet head.

Currency and Gold Revaluation Account (CGRA) and Exchange Equalisation Account (EEA)

X.18 Gains/losses on valuation of foreign currency assets and gold due to movements in the exchange rates and/or prices of gold are not taken to Profit and Loss Account but instead booked under a balance sheet head named as CGRA. The balance represents accumulated net gain on valuation of foreign currency assets and gold. During 2005-06, there was an accretion of Rs.59,882.97 crore in CGRA, thus increasing its balance from Rs.26,906.21 crore as on June 30, 2005 to Rs.86,789.18 crore as on June 30, 2006. The balance in CGRA at the end of June 2006 was equivalent to 11.6 per cent of foreign currency assets and gold holdings of the Reserve Bank, as compared with 4.5 per cent at the end of June 2005. The increase was on account of increase in the level of foreign currency assets during 2005-06, hardening of international gold prices, depreciation of rupee against the US dollar and depreciation of US dollar against other currencies. The balance in EEA represents provision made for exchange losses arising out of forward commitments. The balance in the EEA as on June 30, 2006 stood at Rs.3.28 crore.

Table 10.7: Balances in Currency and Gold Revaluation Account and Exchange Equalisation Account

(Rupees crore)

As on June 30	Currency and Gold Revaluation Account	Exchange Equalisation Account
1	2	3
2002	51,010.77	51.50
2003	51,276.41	567.25
2004	62,283.04	5.65
2005	26,906.21	0.50
2006	86,789.18	3.28

The balances in CGRA and EEA are grouped under 'Other Liabilities' in the balance sheet (Table 10.7).

Contingency Reserve and Asset Development Reserve

X.19 The Reserve Bank maintains a Contingency Reserve (CR) to enable it to absorb unexpected and unforeseen contingencies. The balance in CR has increased from Rs.62,344.68 crore as on June 30, 2005 to Rs.73,281.10 crore as on June 30, 2006. A transfer of Rs.10,936.42 crore was made to CR during 2005-06 from the Reserve Bank's income. The balance in CR is sufficient to meet contingent liabilities.

X.20 In order to meet the internal capital expenditure and make investments in its subsidiaries and associate institutions, the Reserve Bank had created a separate Asset Development Reserve (ADR) in 1997-98, with the aim of reaching one per cent of the Reserve Bank's total assets within the overall indicative target of 12 per cent set for CR. In the year 2005-06, an amount of Rs.1,126.79 crore was transferred from income to ADR raising its level from Rs.6,466.03 crore as on June 30, 2005 to Rs.7,592.82 crore as on June 30, 2006. CR and ADR together constituted 10 per cent of total assets of the Bank as on June 30, 2006 (Table 10.8).

Table 10.8: Balances in Contingency Reserve and Asset Development Reserve

(Rupees crore)

As on June 30	Balance in CR	Balance in ADR	Total	Percentage to total assets
1	2	3	4	5
2002	48,434.17	4,700.54	53,134.71	11.7
2003	55,249.29	5,590.85	60,840.14	11.7
2004	56,218.76	5,778.94	61,997.70	10.2
2005	62,344.68	6,466.03	68,810.71	10.1
2006	73,281.10	7,592.82	80,873.92	10.0

ASSETS

Foreign Currency Assets

X.21 The foreign currency assets comprise foreign securities held in Issue Department, balances held abroad and investments in foreign securities held in Banking Department. Such assets rose from Rs.5,75,863.66 crore as on June 30, 2005 to

Table 10.9: Outstanding Foreign Currency and Domestic Assets

(Rupees crore)

As on June 30	Foreign Currency Assets	Domestic Assets
1	2	3
2002	2,67,333.18	1,86,226.62
2003	3,65,000.98	1,54,812.91
2004	5,24,865.01	84,872.74
2005	5,75,863.66	1,06,952.94
2006	7,18,701.18	90,106.99

Rs.7,18,701.18 crore as on June 30, 2006. The increase in the level of foreign currency assets was mainly on account of net purchases of US dollars from the market, interest and discount received and revaluation gains (Table 10.9 and Chart X.3).

Investment in Government of India Rupee Securities

X.22 Investment in Government of India Rupee Securities, which was Rs.68,476.48 crore as on June 30, 2005 declined by Rs.29,541.98 crore (43.1 per cent) to Rs.38,934.50 crore as on June 30, 2006.

Chart X.3: Trends in Foreign Currency and Domestic Assets

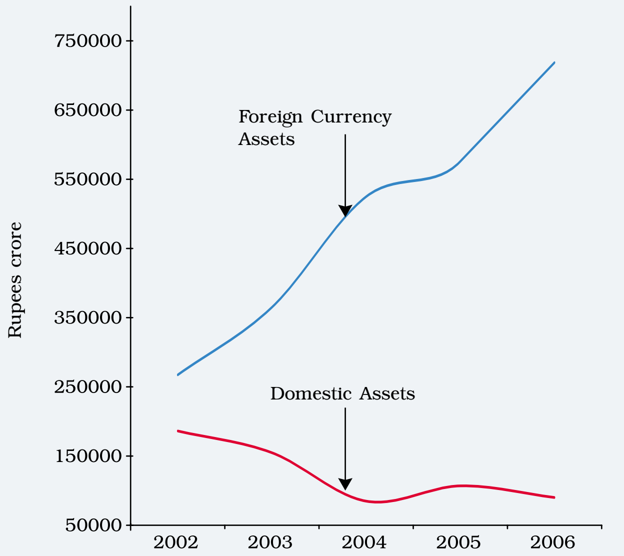


Table 10.10: Investments in Shares of Subsidiaries/Associate Institutions

(Rupees crore)

Institution	Book value of shares held as on June 30, 2005	Book value of shares held as on June 30, 2006
1	2	3
1. Deposit Insurance and Credit Guarantee Corporation	50.00	50.00
2. National Bank for Agriculture and Rural Development	1,450.00	1,450.00
3. State Bank of India	1,222.73	1,222.73
4. National Housing Bank	450.00	450.00
5. Bharatiya Reserve Bank Note Mudran (Pvt.) Ltd.	800.00	800.00
Total	**3,972.73**	**3,972.73**

Investments in Shares of Subsidiaries and Associate Institutions

X.23 There was no change in the Reserve Bank's investments in the shares of its subsidiaries and associate institutions during 2005-06 (Table 10.10).

Other Assets

X.24 'Other Assets' comprise mainly fixed assets, gold holdings in the Banking Department, amounts spent on projects pending completion and staff advances. The level of 'Other Assets' has increased by Rs.6,220.23 crore (43.2 per cent) from Rs.14,403.57 crore as on June 30, 2005 to Rs.20,623.80 crore as on June 30, 2006.

Auditors

X.25 The accounts of the Reserve Bank for the year 2005-06 were audited by M/s. Khimji Kunverji & Co., Mumbai, M/s. J.L. Sengupta & Co., Kolkata, M/s. S.N. Nanda & Co., New Delhi, M/s. Rajendra K. Goel & Co., New Delhi, M/s. Ford, Rhodes, Parks & Co., Mumbai and M/s. M.K.Dandeker & Co., Chennai appointed by the Central Government.

ANNEX IV

CHRONOLOGY OF MAJOR POLICY ANNOUNCEMENTS: APRIL 2005 – JULY 2006

Date of Announcement		POLICY ANNOUNCEMENTS
		I. MONETARY POLICY MEASURES
2005		
April	**28**	• The fixed reverse repo rate under Liquidity Adjustment Facility (LAF) of the Reserve Bank increased by 25 basis points to 5.0 per cent effective April 29, 2005. The fixed repo rate under LAF retained at 6.0 per cent.
		• With effect from the fortnight beginning June 11, 2005, non-bank participants, except primary dealers (PDs), allowed to lend, on average in a reporting fortnight, up to 10 per cent of their average daily lending in call/notice money market during 2000-01. With effect from August 6, 2005, non-bank participants, except PDs, to be completely phased out from the call/notice money market.
		• With effect from the fortnight beginning April 30, 2005, the benchmark for fixing prudential limits on exposures to call/ notice money market in the case of scheduled commercial banks (SCBs) linked to their capital funds (sum of Tier I and Tier II capital).
		• From April 30, 2005, all negotiated dealing system (NDS) members required to report their term money deals on NDS platform.
		• An electronic trading platform for conduct of market repo operations in Government securities, in addition to the existing voice based system, to be facilitated.
		• The minimum maturity period of certificates of deposit (CDs) reduced from 15 days to 7 days with immediate effect.
		• Keeping in view the importance of post-harvest operations, the limit on loans to farmers through the produce marketing scheme increased from Rs.5 lakh to Rs.10 lakh under priority sector lending.
Oct.	**25**	• The fixed reverse repo rate increased by 25 basis points to 5.25 per cent, effective October 26, 2005. Repo rate also increased by 25 basis points to 6.25 percent.
		• Indian Banks' Association (IBA) asked to review the benchmark prime lending rate (BPLR) system and issue transparent guidelines for appropriate pricing of credit.
Nov.	**17**	• The ceiling on interest rates on non-resident (external) rupee deposits for one to three years maturity raised by 25 basis points to LIBOR/SWAP rates plus 75 basis points for US dollar of corresponding maturity with immediate effect.
2006		
Jan	**24**	• The fixed reverse repo rate and the repo rate increased by 25 basis points each to 5.50 per cent and 6.50 per cent, respectively.
March	**28**	• The ceiling on interest rates on FCNR(B) deposits of all maturities raised by 25 basis points to 'not exceeding LIBOR/ SWAP rates' from '25 basis points below the LIBOR/SWAP rates'.
April	**18**	• The ceiling on interest rates on non-resident (external) rupee deposits for one to three years maturity raised by 25 basis points to LIBOR/SWAP rates plus 100 basis points for US dollar of corresponding maturity with immediate effect.
		• The ceiling interest rate on export credit in foreign currency raised by 25 basis points to LIBOR plus 100 basis points from LIBOR plus 75 basis points with immediate effect.
		• The Reserve Bank to provide information on overnight rates and volumes for collateralised borrowing and lending operations (CBLO) and market repo, in addition to call money market, on its website.
	24	• The validity of the interest rate ceiling stipulated at BPLR minus 2.5 percentage points on pre-shipment rupee export credit up to 180 days and post-shipment rupee export credit up to 90 days was extended up to October 31, 2006.
June	**8**	• The fixed reverse repo rate and the repo rate increased by 25 basis points each to 5.75 per cent and 6.75 per cent, respectively, effective June 9, 2006.
July	**25**	• The fixed reverse repo rate and the repo rate increased by 25 basis points each to 6.00 per cent and 7.00 per cent, respectively.
		II. INTERNAL DEBT MANAGEMENT POLICIES
2005		
May	**11**	• Guidelines issued on adoption of standardised settlement on T+1 basis of all outright secondary market transactions in Government securities.
		• Guidelines issued permitting sale of Government securities allotted to successful bidders in primary issues on the day of allotment, with and between Constituents' Subsidiary General Ledger (CSGL) account holders.

Date of Announcement		POLICY ANNOUNCEMENTS
2005		**II. INTERNAL DEBT MANAGEMENT POLICIES** *(Contd.)*
May	**11**	• Non-scheduled urban cooperative banks (UCBs) and listed companies, having a gilt account with a scheduled commercial bank, made eligible to participate in repo market subject to certain conditions.
July	**20**	• Guidelines on transaction in Government securities further relaxed by permitting a buyer from an allottee in primary auction to re-sell the security.
Aug.	**1**	• The NDS-OM trading module introduced to provide NDS members with a more advanced and more efficient trading platform in Government securities.
	22	• Guidelines issued dispensing with the need to obtain counterparty confirmation in respect of deals matched on NDS-OM as Clearing Corporation of India Ltd. (CCIL) is the counter party in such transactions.
2006		
Feb.	**27**	• Guidelines issued permitting banks, both Indian and foreign, which fulfil certain eligibility criteria, to undertake Primary Dealer (PD) business departmentally. Banks, which do not, at present have partly or wholly owned subsidiary made eligible to apply for PD licence subject to the fulfilment of the following criteria: i) Minimum net owned funds of Rs.1,000 crore; ii) Minimum capital to risk weighted asset ratio (CRAR) of nine per cent; and iii) Net non-performing assets (NPAs) of less than three per cent and a profit making record for the last three years. Indian banks which are currently undertaking PD business through a partly or wholly owned subsidiary allowed to undertake PD business departmentally by merging/taking over PD business from their partly/wholly owned subsidiary subject to fulfilling the above stipulated criteria on minimum net owned funds and net NPAs. Foreign banks operating in India also permitted to undertake PD business departmentally by merging the PD business being undertaken by group companies subject to fulfilment of the above stipulated criteria pertaining to minimum net owned funds and net NPAs.
	28	• Guidelines issued permitting banks and PDs to undertake intra-day short sale in Central Government dated securities subject to the same being covered by outright purchase in secondary market within the same trading day.
April	**4**	• Guidelines issued on revised scheme for underwriting commitment and liquidity support to PDs and banks undertaking PD business departmentally in the wake of coming into effect of the provisions of the Fiscal Responsibility and Budget Management (FRBM) Act, 2003. Accordingly, PDs are required to meet an underwriting commitment, replacing the earlier requirement of bidding commitment and voluntary underwriting. • Based on the recommendations of the Bezbaruah Committee, a revised ways and means advances (WMA) scheme for State Governments was announced. The aggregate Normal WMA limits were increased by 10.5 per cent to Rs.9,875 crore for 2006-07. The interest rates on WMA and overdraft were linked to the repo rate (as against the Bank rate, as hitherto).
	18	• Mutual funds (MFs), which are NDS members, permitted to access the NDS-OM module with immediate effect. Other MFs would be permitted access by opening temporary current/Subsidiary General Ledger (SGL) accounts with the Reserve Bank. • Large pension/provident funds like Central Board of Trustees (CBOT)/Seamens'/ Coal Miners' funds permitted to access the NDS-OM module by opening temporary current/SGL accounts with the Reserve Bank. The smaller funds would be allowed access through the CSGL route. • Facility of non-competitive bidding (currently limited to Central Government dated securities) proposed to be extended to the primary auction of State Development Loans (SDLs). • Purchase and resale of SDLs by the Reserve Bank proposed to be introduced under the overnight LAF repo operations.
	19	• The scheme of ways and means advances (WMA) to the Central Government was revised in consultation with the Government. As per the revised arrangement, the WMA limits would be fixed on a quarterly basis instead of the existing half-yearly basis. Accordingly, the WMA limits for 2006-07 were placed at Rs.20,000 crore and Rs.10,000 crore for the first and second quarters, respectively, and Rs.6,000 crore each for the third and fourth quarters of the year. The Reserve Bank would retain the flexibility to revise the limits in consultation with the Government of India. The interest rates on WMA and overdraft linked to the repo rate as against the Bank Rate hitherto. Accordingly, the interest rate on WMA to be at the repo rate and that on overdraft to be at repo rate plus two percentage points.

Date of Announcement		POLICY ANNOUNCEMENTS
2006		**II. INTERNAL DEBT MANAGEMENT POLICIES** *(Concld.)*
May	**3**	• Guidelines issued permitting NDS-OM members to enter into 'When Issued' transactions in Central Government securities that have been notified for issuance but not actually issued.
July	**4**	• Guidelines issued permitting stand-alone PDs to diversify their activities in addition to existing business of Government securities, subject to limits.
		III. FINANCIAL SECTOR MEASURES
2005		
April	**11**	• Detailed guidelines issued to banks for preparation of Annual Credit Plans on the basis of Potential Linked Plans (PLPs) prepared by NABARD.
		• Banks advised to pay compensation for delayed credit under electronic clearing services (ECS) / electronic funds transfer (EFT) / special electronic funds transfer (SEFT) *suo moto*.
		• Normal donations (for development of cooperative movement, charitable or any other public purpose) to be made during a year may, in aggregate, be restricted to a ceiling of 1 per cent of the published profits of the UCB for the previous year. Such normal donations, together with those that may be made to National Funds and other funds recognised / sponsored by the Central / State Government, during a year, may not exceed 2 per cent of the published profits of the bank for the previous year.
	15	• Banks advised to put in place a Business Continuity Plan including a robust information risk management system within a fixed time frame.
		• Prudential exposure limits fixed at 15 per cent and 40 per cent of the 'Capital Funds' in case of single borrower and group of borrowers, respectively, in the case of UCBs. 'Capital Funds' for the purpose of prudential exposure norm may be fixed in relation to bank's capital adequacy norms (both for Tier I and Tier II capital). The exposure shall henceforth include both credit exposure and investment exposure (Non-SLR), *viz*. Funded and non-Funded credit limits and underwriting and similar commitments.
	16	• Banks advised to take necessary action to convert the existing *ad hoc* Committees on Procedures and Performance Audit of Public Services (CPPAPS) into a Standing Committee on Customer Service.
	19	• Banks advised on the role of Customer Service Committee of the Board for monitoring the implementation of awards under the Banking Ombudsman Scheme.
	26	• A minimum framework for disclosures by financial institutions (FIs) on their risk exposures in derivatives laid out to provide a clear picture of their exposure to risks in derivatives, risk management systems, objectives and policies.
	27	• Banks permitted to shift their rural branches within the block/service area without obtaining prior approval of the Reserve Bank, subject to their complying with specified conditions.
		• Financial institutions not accepting public deposits but having asset size of Rs.500 crore and above would be subjected to limited off-site supervision by the Reserve Bank. Therefore, with effect from the period ended March 31, 2005, the existing system of off-site supervision has been replaced by a simplified information system known as the "Quarterly Return on Important Financial Parameters in respect of Select Financial Institutions".
	28	• UCBs advised to explore the option of merger/ amalgamation, wherever necessary for revitalising and rehabilitating the weak scheduled UCBs.
	30	• Banks allowed to formulate schemes for providing services at the premises of a customer within the framework of Section 23 of Banking Regulation Act, 1949 and submit to the Reserve Bank for approval.
		• Banks with capital of at least 9 per cent of the risk weighted assets for both credit risk and market risk for both Held for Trading (HFT) and Available for Sale (AFS) categories may transfer the balance in excess of 5 per cent of securities included under HFT and AFS categories in the Investment Fluctuation Reserve (IFR) to Statutory Reserve, which is eligible for inclusion in Tier I capital.
May	**4**	• General permission granted to banks to declare dividends under fulfilment of conditions such as observance of minimum CRAR and NPA ratio, subject to a ceiling of dividend payout ratio of 40 per cent.
		• UCBs to include a footnote in the quarterly statement on 'consolidated position of frauds outstanding' detailing the position of frauds outstanding in the housing loan segment effective quarter ended March 2005.
	11	• Detailed guidelines issued for merger/amalgamation of private sector banks laying down the process of merger proposal, determination of swap ratios, disclosures, the stages at which Boards will get involved in the merger process and norms of buying/selling of shares by the promoters before and during the process of merger.

Date of Announce-ment		POLICY ANNOUNCEMENTS
2005		**III. FINANCIAL SECTOR MEASURES** *(Contd.)*
May	**13**	• Vision Document on Payment and Settlement Systems 2005-08 released.
	20	• Banks advised to initiate early action with regard to scheme for "Small Enterprises Financial Centres" (SEFCs) envisaged for forming a strategic alliance between branches of banks and SIDBI located in the clusters for improving credit flow to the small scale industries (SSIs).
June	**7**	• Banks allowed to extend financial assistance to Indian companies for acquisition of equity in overseas joint ventures/ wholly owned subsidiaries or in other overseas companies, new or existing, as strategic investment in terms of a Board approved policy, duly incorporated in the loan policy of the bank.
	9	• Instructions issued to banks, in supersession of all earlier instructions, on settlement of claims in respect of deceased depositors, covering aspects relating to i) access to balance in deposit accounts, ii) premature termination of term deposit accounts, iii) treatment of flows in the name of the deceased depositor, iv) access to the safe deposit lockers/ safe custody articles, and v) time limit for settlement of claims.
		• Banks (both in private and public sector) need not obtain approval of the Reserve Bank for permitting any of their whole-time officers or employees (other than Chairmen/CEOs) to become director or a part-time employee of any other company.
	14	• Processing charges waived for all electronic products for transactions under EFT, SEFT and ECS facility involving Rs.2 crore and above with effect from June 14, 2005 up to the period ending March 31, 2006. This was in addition to the existing waiver on transactions involving up to Rs.2 crore.
	20	• Banks advised that while furnishing data/information to the Government or other investigating agencies they should satisfy themselves that the information is not of such a nature which will violate the provisions of the laws relating to secrecy in banking transactions.
	25	• Banks going for rights issues to make complete disclosure of the regulatory requirements in their offer documents.
	29	• Banks to have a Board mandated policy in respect of their real estate exposure covering exposure limits, collaterals to be considered, margins to be kept, sanctioning authority/level and sector to be financed. Banks to also report their real estate exposure under certain heads and disclose their gross exposure to real estate sector as well as the details of the break-up in their Annual Reports.
July	**1**	• Fresh investments by banks on or after July 1, 2005 in venture capital made ineligible for classification under priority sector leading. Investments in venture capital made by banks up to June 30, 2005 in venture capital made ineligible for classification under priority sector lending with effect from April 1, 2006.
	4	• UCBs having a single branch/Head Office with deposits up to Rs.100 crore and those having multiple branches within a single district with deposits up to Rs.100 crore permitted to classify NPAs based on 180 days delinquency norm till March 31, 2007 instead of the extant 90 days norm.
	5	• SCBs allowed the discretion to approach any general insurance company [which is a member of General Insurers' Public Sector Association of India] or any private sector general insurance company to provide personal accident insurance cover to Kisan Credit Card (KCC) holders at competitive rates/terms on an ongoing basis.
	6	• Lead Banks advised to ensure the presence of MPs/MLAs in District Level Review Committee Meetings as far as possible.
	13	• Banks advised to furnish information on pricing of services for products based on real time gross settlement (RTGS)/ SEFT/ EFT/ECS infrastructure.
		• Guidelines issued on sale/purchase of NPAs, including valuation and pricing aspects, and prudential and disclosure norms.
		• The norms relating to classification and valuation of investment portfolio of State cooperative banks (StCBs) and District central cooperative banks (DCCBs) modified allowing them to amortise their additional provisioning requirement, subject to specified conditions.
	20	• Prior approval of the Reserve Bank not required for offering internet banking services, subject to fulfilment of certain conditions.
	23	• The authority to grant permission to companies listed on a recognised stock exchange to hedge the price risk in respect of any commodity (except gold, silver, petroleum and petroleum products) in the international commodity exchanges/markets delegated to select commercial banks.
	26	• The risk weight for credit risk on capital market exposures and commercial real estate exposures increased from 100 per cent to 125 per cent.

Date of Announcement		POLICY ANNOUNCEMENTS
2005		**III. FINANCIAL SECTOR MEASURES** *(Contd.)*
July	**29**	• Guidelines issued for relief measures by banks in areas affected by unprecedented rains and floods in Maharashtra. Accordingly, banks were advised to consider granting consumption loans to the affected persons up to Rs.5,000 without any collateral and Rs.10,000 at the discretion of the branch manager, depending on the repaying capacity of the borrower.
Aug.	**2**	• Banks advised to issue necessary instructions to the Controlling Offices of currency chest branches for ensuring verification of balances as per the minimum periodicity stipulated in this regard and adherence to the essential safeguards in the internal control system (such as surprise verification/joint custody, *etc.*).
		• In view of the natural calamity and the need to provide immediate succour, banks instructed to observe minimum formalities for enabling such persons to open bank account quickly. Similar guidelines were issued to UCBs, StCBs and DCCBs on August 3, 2005.
	3	• Banks advised to formulate a detailed mid-term corporate plan for branch expansion for a three year period with the approval of the Board. The plan should cover all categories of branches/offices having customer contact, including specialised branches, extension counters and number of ATMs. The plan should be formulated district-wise giving number of branches proposed to be opened in metropolitan/urban/semi-urban/rural areas. The proposal for branch expansion with the above mentioned details should be submitted on an annual basis by December every year.
	4	• StCBs and DCCBs permitted to invest their genuine surplus funds in non-SLR securities without prior approval from the Reserve Bank on a case-to-case basis, subject to certain specified conditions.
	9	• In the case of UCBs, risk weight raised to: i) 125 per cent from 100 per cent in the case of loans extended against primary/collateral security of shares/debentures; ii) 127.5 per cent from 102.5 per cent in respect of investment in equities of All India Financial Institutions (AIFIs)/units of Unit Trust of India (UTI); iii) 125 per cent from 100 per cent in the case of commercial real estate.
	19	• In pursuance to the announcement made by the Union Finance Minister for stepping up credit to small and medium enterprises (SMEs), public sector banks were advised to take measures to improve the flow of credit to the sector. A reporting and monitoring system for the same was also prescribed. Similar guidelines were issued to private sector banks, foreign banks, regional rural banks (RRBs) and local area banks (LABs) on August 25, 2005.
	23	• Banks advised to make all out efforts in achieving the targets set for increasing the credit flow to SCs/STs under priority sector advances as well as under the Government sponsored schemes. Banks also instructed to ensure that sufficient publicity is given on the facilities extended to SCs/STs and all the instructions contained in the Master Circular on Credit Facilities to SCs/STs are strictly followed.
		• The Know Your Customer (KYC) procedure for opening accounts simplified further for those persons who intend to keep balances not Rs.50,000 in all their accounts taken together and the total credit in all the accounts taken together is not expected to exceed Rs.1,00,000 in a year. Banks may open accounts with introduction from another account holder (holding account for at least six months) who has been subjected to full KYC procedure or any other evidence as to identity and address of the customer to the satisfaction of the bank. Similar guidelines were also issued to RRBs, UCBs, StCBs and DCCBs on August 23, 2005 and to non-bank financial companies (NBFCs) on March 7, 2006.
	31	• Banks advised that for the purpose of Section 20 of the Banking Regulation Act, 1949, the term “loans and advances” shall not include line of credit / overdraft facilities extended by settlement bankers to CCIL to facilitate smooth settlement.
Sept.	**3**	• Guidelines on one time settlement scheme for SMEs accounts issued to public sector banks for recovery of NPAs below Rs.10 crore. The guidelines were made applicable to FIs from November 22, 2005.
	5	• Banks nominated to import gold allowed to extend Gold (Metal) Loans to domestic jewellery manufacturers, who are not exporters of jewellery, subject to certain conditions.
	6	• The periodicity of the ‘Quarterly return on important financial parameters of NBFCs not accepting/ holding public deposits and having assets size of Rs.500 crore and above’ changed from quarterly to monthly and the asset base for NBFCs covered under it changed from “Rs.500 crore and above” to “Rs.100 crore and above”.
	8	• The policy for authorisation of the branches of banks in India liberalised and rationalised. While considering applications for opening branches, weightage would be given to the nature and scope of banking facilities provided by banks to common persons, particularly in under-banked areas, actual credit flow to the priority sector, pricing of products and overall efforts for promoting financial inclusion, including introduction of appropriate new products and the enhanced use of technology for delivery of banking services.
		• Banks advised to implement a debt restructuring mechanism for units in the SME sector. Detailed guidelines were laid down relating to eligibility criteria, viability criteria, prudential norms for restructured accounts, treatment of additional finance, asset classification, and repeated restructuring. Similar guidelines were issued to UCBs on March 9, 2006.

Date of Announcement		POLICY ANNOUNCEMENTS
2005		**III. FINANCIAL SECTOR MEASURES** *(Contd.)*
Sept.	**9**	• Industrial Development Bank of India (IDBI) Limited excluded from the Second Schedule to the Reserve Bank of India Act, 1934 with effect from April 2, 2005.
	17	• Licensed and/or scheduled StCBs permitted to undertake, without risk participation, co-branded domestic credit card business with tie-up arrangement with one of the SCBs, already having arrangement for issue of credit cards, subject to their fulfilment of certain conditions. These conditions include, minimum positive net worth of Rs.50 crore,net profit for the last three years and not having accumulated losses, gross NPAs not exceeding 10 per cent, compliance with prudential and other norms of the Reserve Bank/NABARD and prior permission of the Reserve Bank.
	24	• Bank of Punjab merged with Centurion Bank with effect from October 1, 2005.
Oct.	**1**	• Conversion/rescheduling of loans in the case of natural calamities, when there is delay in declaration of *Annewari* by the State Government, may be extended following such declaration by the District Consultative Committee (DCC).
	6	• Certain categories of directors of UCBs excluded from the purview of the guidelines prohibiting extension of any loans and advances (both secured and unsecured) to the directors, their relatives and the firm/concern/companies in which they are interested.
	9	• The limit of consumption loan to be provided to the affected persons in the state of Jammu and Kashmir and other parts of north India in the wake of the earthquake increased up to Rs.5,000 without any collateral. This limit may be enhanced to Rs.10,000 at the discretion of the branch manager, depending on the repaying capacity of the borrower. Banks may also consider provision of financial assistance for the purpose of repairs/reconstruction of dwelling units damaged on account of earthquake.
	10	• Banks which have maintained capital of at least nine per cent of the risk weighted assets for both credit risks and market risks for both HFT and AFS categories as on March 31, 2006 permitted to treat the entire balance in the IFR as Tier I capital. For this purpose, banks may transfer the entire balance in the IFR 'below the line' in the Profit and Loss Appropriation Account to Statutory Reserve, General Reserve or balance of Profit and Loss Account.
	11	• KYC guidelines revisited in the context of the recommendations made by Financial Action Task Force on Anti-Money Laundering Standards and Combating Financing of Terrorism. The compliance with these standards was made equally applicable to persons authorised by NBFCs including brokers/agents *etc*. collecting public deposit on behalf of NBFCs.
	15	• Revised guidance note on management of operational risk issued to banks.
	17	• Banks advised to provide details to the customers in their Pass Book/Account Statement regarding the credits effected through ECS. Similar approach may be adopted for capturing the sender/remittance details for other electronic payment products such as EFT, SEFT, and RTGS.
Oct.	**20**	• UCBs carrying accumulated losses in their balance sheet not eligible to make donations.
	26	• Guidelines issued to all deposit taking NBFCs, including residuary non-banking companies (RNBCs) that all individual cases of frauds involving amount less than Rs.25 lakh may be reported to the respective regional offices of the Reserve Bank in whose jurisdiction registered office of the company is located; individual cases of frauds involving amount of Rs.25 lakh and above may be reported to Frauds Monitoring Cell, Department of Banking Supervision, Central Office, Mumbai.
Nov.	**2**	• SCBs (excluding RRBs) advised that while considering granting advances against jewellery they may keep in view the advantages of hallmarked jewellery and decide on the margin and rates of interest thereon. Similar guidelines were issued to RRBs on February 27, 2006, to UCBs on March 2, 2006 and to StCBs and DCCBs on March 9, 2006.
	4	• The general provisioning requirement for 'standard advances', with the exception of direct advances to agricultural and SME sectors, increased to 0.40 per cent from 0.25 per cent. Similar guidelines were issued to RRBs on November 8, 2005, to UCBs (Unit banks and UCBs having multiple branches within a single district with deposits base of Rs.100 crore and above, and all other UCBs operating in more than one district) on November 24, 2005, to financial institutions on December 6, 2005 and to StCBs and DCCBs on December 20, 2005.
	9	• Banks to set up Special Sub-Committees (SSCs) of District Level Co-ordination Committee (DLCC) in districts having credit deposit ratio of less than 40 per cent, in order to monitor the credit deposit ratio and to draw up Monitorable Action Plans (MAPs) to increase the credit deposit ratio. The districts having credit deposit ratio between 40 and 60 per cent will be monitored under the existing system by the DLCC.
	10	• Revised guidelines on Corporate Debt Restructuring mechanism issued. The major modifications included: extension of the scheme to entities with outstanding exposure of Rs.10 crore or more, requirement of support of 60 per cent of creditors by number in addition to the support of 75 per cent of creditors by value, discretion to the core group in dealing with wilful defaulters, linking the restoration of asset classification to implementation of the CDR package within four months, restricting the regulatory concession in asset classification and provisioning to the first restructuring, convergence in the methodology for computation of economic sacrifice, limiting Reserve Bank's role to providing broad guidelines for CDR mechanism, enhancing disclosures in the balance sheet, pro-rata sharing of additional finance requirement by both term lenders and working capital lenders, and allowing one-time settlement as a part of the CDR mechanism to make the exit option more flexible.

Date of Announcement		POLICY ANNOUNCEMENTS
2005		**III. FINANCIAL SECTOR MEASURES** *(Contd.)*
Nov.	**10**	• As regards CDR mechanism for SMEs involving wilful defaulters, banks may review the reasons for classification of the borrower as wilful defaulter (specially in old cases where the manner of classification of a borrower as a wilful defaulter was not transparent) and satisfy themselves that the borrower is in a position to rectify the wilful default provided he is granted an opportunity under the Debt Restructuring Mechanism for SMEs. Such exceptional cases may be admitted for restructuring with the approval of the Board of Directors of the banks only.
	11	• With a view to achieving the objective of greater financial inclusion, all banks advised to initiate steps, within one month, to make available a basic banking 'no-frills' account either with 'nil' or very low minimum balances as well as charges and report to the Reserve Bank on a quarterly basis. Banks also to give wide publicity to the facility of such a 'no-frills' account, including on their websites, indicating the facilities and charges in a transparent manner. Similar guidelines were issued to UCBs on November 24, 2005, to StCBs and DCCBs on December 13, 2005 and to RRBs (with a provision for small overdraft facility) on December 27, 2005.
	21	• Banks / NBFCs advised to have a well documented policy and a Fair Practices Code for credit card operations. The Fair Practices Code for credit card operations released by the IBA in March 2005 could be adopted by banks for this purpose. Guidelines include norms relating to issue of cards, interest rate and other charges, wrongful billing, use of agents, protection of customer rights, right to privacy, customer confidentiality, fair practices in debt collection, redressal of grievances, internal control and monitoring system, and right to impose penalty.
	22	• In order to smoothen the process of merger in the UCB sector, the acquirer UCB permitted to amortise the loss taken over from the acquired UCB over a period of not more than five years, including the year of merger.
	23	• Banks advised to develop appropriate delivery channels of electronic payment services using the payment systems developed by the Reserve Bank like RTGS, ECS, EFT, NEFT with no further delay. The service charges may also be reviewed keeping in mind the need for promotion of electronic payment culture.
Dec.	**5**	• Banks advised to take immediate measures to provide relief to the people affected by unprecedented rains and floods in Tamil Nadu, and consider increasing the limit of consumption loan to be provided to the calamity affected persons in Tamil Nadu up to Rs.5,000 without any collateral. This limit may be enhanced to Rs.10,000 at the discretion of the branch manager, depending on the repaying capacity of the borrower.
	6	• All private sector banks to ensure that they actively participate in the various fora under Lead Bank Scheme to increase the flow of credit to agriculture, priority sector and weaker sections of the society.
	12	• NBFCs (including RNBCs) with public deposits/deposits of Rs.50 crore and above were advised that it would be desirable if they stipulate that the partners of the Chartered Accountant firm conducting the audit be rotated every three years so that the same partner does not conduct audit of the company continuously for more than three years. The partner so rotated will be eligible for conducting the audit of the NBFC/RNBC after an interval of three years. Companies were advised to incorporate appropriate terms in the letter of appointment of the firm of auditors and ensure its compliance.
	21	• Profit making banks may make donations during a financial year (which can not be carried forward) aggregating upto one per cent of their published profits for the previous year; loss-making banks can make donations totalling Rs.5 lakh only in a financial year including donations to exempted entities/funds.
	27	• Guidelines for General Credit Card (GCC) scheme issued to banks (including RRBs) for issuing GCC to their constituents in rural and semi-urban areas, based on the assessment of income and cash flow of the household similar to that prevailing under normal credit card. Interest rate on the facility may be charged, as considered appropriate and reasonable. Banks may utilise the services of local post offices, schools, primary health centres, local government functionaries, farmers' associations/clubs, well-established community-based agencies and civil society organisations for sourcing of borrowers for issuing GCC.
		• For accelerating the flow of credit by RRBs, a number of measures were announced such as: i) provision of lines of credit by sponsor banks at a reasonable rate of interest, ii) borrowing from other RRBs including those sponsored by other banks subject to counter-party credit risk policy and limits, iii) setting up an off-site ATM in its area of operation after assessing the costs and benefits, iv) requests for opening of currency chests to be considered by the Reserve Bank, and v) allowing handling pension and other government business as sub-agents.
		• All SCBs (including RRBs and LABs) advised to provide a simplified mechanism for one-time settlement of loans where the principal amount is equal to or less than Rs.25,000 and which have become doubtful and loss assets as on September 30, 2005. In case of loans granted under government-sponsored schemes, banks may frame separate guidelines following a state-specific approach to be evolved by the SLBC. The borrowers whose accounts are settled under this mechanism will be fully eligible for fresh loans.
	28	• Banks to make available all printed material used by retail customers including account opening forms, pay-in-slips, passbooks in trilingual form *i.e.,* English, Hindi and the concerned regional language. Similar guidelines were issued to RRBs, StCBs and DCCBs on December 30, 2005.

Date of Announcement		POLICY ANNOUNCEMENTS
2006		**III. FINANCIAL SECTOR MEASURES** *(Contd.)*
Jan.	**9**	• UCBs to take the benefit of the scheme for "Small Enterprises Financial Centres" (SEFCs) on such terms as are mutually agreed to between them and SIDBI.
	20	• Banks advised to ensure filing of the returns under Banking Cash Transaction Tax (BCTT) every month and in case the particular bank has no collection under BCTT, a " NIL" Return may be filed.
	23	• Procedural modifications under Branch Authorisation Policy announced.
		• Banks (excluding RRBs) prohibited from crediting 'account payee' cheque to the account of any person other than the payee named therein. Where the drawer/payee instructs the bank to credit the proceeds of collection to any account other than that of the payee, the instruction being contrary to the intended inherent character of the 'account payee' cheque, banks should ask the drawer/payee to have the cheque or the account payee mandate thereon withdrawn by the drawer. This instruction would also apply with respect to the cheque drawn by a bank payable to another bank. Similar guidelines were issued to UCBs on January 30, 2006 and to StCBs and DCCBs on April 27, 2006.
	24	• The norms relating to giving prior public notice by the NBFCs about change in the control / management of the NBFCs (both deposit taking and non-deposit taking) were relaxed.
	25	• Banks allowed to augment their capital funds by issue of the following additional instruments: i) Innovative perpetual debt instruments (IPDI) eligible for inclusion as Tier I capital, ii) Debt capital instruments eligible for inclusion as Upper Tier II capital, iii) Perpetual non-cumulative preference shares eligible for inclusion as Tier I capital, and iv) Redeemable cumulative preference shares eligible for inclusion as Tier II capital.
		• FIIs registered with SEBI and NRIs permitted to subscribe to the issue of perpetual debt instruments eligible for inclusion as Tier I capital and debt capital instruments as upper Tier II capital subject to certain limits.
		• Guidelines issued to banks (including RRBs) for the use of Business Facilitator and Correspondent models to achieve greater financial inclusion and increasing the outreach of the banking sector.
	30	• It was clarified that in case of fully drawn term loans, where there is no scope for re-drawal of any portion of the sanctioned limit, UCBs may reckon the outstanding for arriving at credit exposure limit for the purpose of adhering to the exposure norms.
	31	• With effect from October 28, 2005, the name of 'ING Bank N.V.' excluded from the Second Schedule to the Reserve Bank of India Act, 1934.
Feb.	**2**	• Guidelines on securitisation of standard assets issued to all SCBs (excluding RRBs), FIs and NBFCs (including RNBCs). The guidelines cover definitions and norms relating to true sale, criteria to be met by special purpose vehicle (SPV), special features including representations and warranties and re-purchase of assets from SPVs, policy on provision of credit enhancement, liquidity and underwriting facilities, policy on provision of services, prudential norms for investment in the securities issued by SPV, accounting treatment of the securitisation transactions and disclosures.
	7	• In the light of the recommendations of the Working Group to Review Export Credit, SCBs (excluding RRBs) advised to review their existing procedures for export credit, Gold Card Scheme, export credit for non-star exporters and other issues on the lines prescribed in the notification in this regard.
	15	• SCBs advised to go through the provisions of Prevention of Money Laundering Act (PMLA), 2002 and the Rules notified thereunder and take all steps considered necessary to ensure compliance. The Rules include maintenance of records of transactions, preservation of information, reporting to Financial Intelligence Unit-India, *etc.* Similar guidelines were issued to StCBs and DCCBs on March 3, 2006, to RRBs on March 9, 2006, to UCBs on March 21, 2006 and to NBFCs, miscellaneous non-banking companies (MNBCs) and RNBCs on April 5, 2006.
	17	• In view of the difficulties in investing in the Government securities market, non-scheduled UCBs, having single branch-cum-head office or having multiple branches within a single district, having a deposit base of Rs.100 crore or less, exempted till March 31, 2008, from maintaining SLR in prescribed assets up to 15 per cent of their demand and time liabilities (DTL) on keeping the required amount, in interest bearing deposits, with State Bank of India, its subsidiary banks and the public sector banks including IDBI Ltd.
	20	• Loans to power distribution corporations/companies, emerging out of bifurcation/restructuring of SEBs, may also be classified as indirect finance to agriculture subject to certain conditions.
March	**1**	• SCBs while appraising loan proposals involving real estate, advised to ensure that the borrowers should have obtained prior permission from government/local governments/other statutory authorities for the project, wherever required.
	3	• SCBs advised to expedite the process of allotting Indian Financial System Codes (IFSC) to the branches. It was also decided that IFSC of the branch be printed just above the magnetic ink character recognition (MICR) band on the cheques preferably above the serial number of the cheque.

Date of Announcement		POLICY ANNOUNCEMENTS
2006		**III. FINANCIAL SECTOR MEASURES** *(Contd.)*
March	**6**	• The name of "Bank of Punjab Limited" excluded from the Second Schedule to the Reserve Bank of India Act, 1934 with effect from October 1, 2005. The name of 'Centurion Bank Limited' changed to 'Centurion Bank of Punjab Limited' in the Second Schedule to the Reserve Bank of India Act, 1934 with effect from October 17, 2005.
	9	• For grant of interest relief of two percentage points in the interest rate, as envisaged by Finance Minister in the Union Budget Speech (2006-07), on the principal amount up to Rs.1 lakh on crop loans availed by the farmers for Kharif and Rabi 2005-06, SCBs advised to credit the proposed relief to the farmer's account before March 31, 2006 and thereafter seek reimbursement.
	16	• The concessions/credit relaxations to borrowers/customers in the state of Jammu & Kashmir will continue to be operative for a further period of one year *i.e.*, up to March 31, 2007.
	17	• The name of 'UFJ Bank Ltd' excluded from the Second Schedule of the Reserve Bank of India Act, 1934 with effect from January 1, 2006. The name of 'The Bank of Tokyo - Mitsubishi, Ltd' changed to 'The Bank of Tokyo - Mitsubishi UFJ, Ltd' in the Second Schedule of the Reserve Bank of India Act, 1934 with effect from January 1, 2006.
	21	• Based on the half-yearly review by NABARD, StCBs/DCCBs advised to take appropriate action in certain areas such as, i) conduct of the half-yearly review of investment portfolio; ii) framing of investment policy; iii) preparation of approved panel of brokers; iv) placing of funds as deposits with PSU/Companies/Corporations/UCBs/NBFCs *etc*; v); submission of securities actually held to Reserve Bank; vi) irregularities in non-SLR investments; and vii) violation of the provisions of Section 19 of the Banking Regulation Act, 1949 (AACS) relating to investments in shares of other cooperative institutions.
	24	• Currency chest facility extended to (i) scheduled UCBs which are registered under Multi-State Cooperative Societies Act, 2002 and (ii) UCBs under the State Acts, where the State Governments concerned have assured regulatory co-ordination by entering into MoU with the Reserve Bank.
		• Norms relating to risk weight and exposure norms for bills discounted under letter of credit (LC) revised for SCBs. Accordingly, i) bills purchased/discounted/negotiated under LC (where the payment to the beneficiary is not made 'under reserve') will be treated as an exposure on the LC issuing bank and not on the borrower; ii) all clean negotiations as indicated above will be assigned the risk weight as is normally applicable to inter-bank exposures, for capital adequacy purposes; iii) in the case of negotiations 'under reserve' the exposure should be treated as on the borrower and risk weight assigned accordingly. Similar guidelines were issued to UCBs on April 19, 2006.
	29	• UCBs permitted on an ongoing basis to exceed the limit of 25 per cent of their total investments under HTM category provided: i) the excess comprises only of SLR securities; and ii) the total SLR securities held in the HTM category is not more than 25 per cent of their net demand and time liabilities (NDTL) as on the last Friday of the second preceding fortnight. Further relaxations include: i) as a special case the banks may shift securities from and to HTM once more on or before March 31, 2006; ii) where the market value is lower than the face value, the provision required would be the difference between book value and face value; iii) the provisioning may be made over the remaining period to maturity instead of five years; iv) in case as a result of valuation as above the provision already held by the bank is rendered surplus, the same should not be taken to the Profit and Loss account.
	31	• The exemption granted to RRBs from 'mark to market' norms in respect of their investments in SLR securities extended by one more year *i.e.*, for the financial year 2006-07.
		• The pattern of discretionary investments for RNBCs was modified. For the purpose of discretionary investments, the Aggregate Liability to Depositors (ALD) was bifurcated as ALD as on December 31, 2005 and the incremental ALD. Incremental ALD means the ALD, on a subsequent date, exceeding the ALD as on December 31, 2005. Under the modified pattern, RNBCs have been permitted to continue with the discretionary investments, not more than five per cent of the ALD as on December 31, 2005 or one time of net owned fund of the company whichever is less, in the prescribed manner, up to March 31, 2007. No discretionary investment is permitted on the incremental ALD. There will be no discretionary investment from April 1, 2007.
April	**4**	• SCBs advised that principal and interest due on working capital loans in poultry industry as also instalments and interest on term loans which have fallen due for payment on/after the onset of bird flu, *i.e.*, February 1, 2006 and remaining unpaid may be converted into term loans. The converted loans may be recovered in instalments based on projected future inflows over a period up to three years with an initial moratorium of up to one year. Similar advice was given to UCBs on April 20, 2006.
	5	• SCBs advised to instruct designated branches to strictly adhere to the direction that only one Bond Ledger Account (BLA) shall be opened in the name of each investor for operations in relief/savings bonds. The existing multiple BLAs, if any, in the name of the same investor should be reviewed and merged into one BLA.
		• Certain changes were made in the format of monthly return to be submitted by the NBFCs not accepting/holding public deposits and having assets size of Rs.100 crore and above to include parameters such as cumulative position in P&L account, age wise break up of NPAs, highest outstanding balance of working capital, additional information on capital market exposure of the company and foreign sources of funds.

Date of Announcement		POLICY ANNOUNCEMENTS
2006		**III. FINANCIAL SECTOR MEASURES** *(Contd.)*
April	**12**	• SCBs (excluding RRBs) to furnish annual return within one month in respect of non-SSI (sick/weak) industrial units in the revised format from the year March 31, 2006. As a one time measure, they were required to furnish data in the revised format for the period ending March 31, 2004 and March 31, 2005 by May 2006.
	13	• UCBs registered in States, which have signed MoU and those registered under the Multi-State Co-operative Societies Act, 2002 may enter into agreements with mutual funds for marketing their units subject to the certain conditions such as i) the bank should act as an agent of the customers, ii) the purchase of MF units should be at the customers' risk and without the bank guaranteeing any assured return, iii) the bank should not acquire such units of mutual fund from the secondary market, iv) the bank should not buy back units of mutual funds from the customers and v) compliance with extant KYC/anti-money laundering (AML) guidelines. Similar guidelines were issued to RRBs on May 17, 2006.
	28	• In order to enable better customer service, UCBs permitted to undertake following limited transactions at the extension counters: i) deposit/withdrawal transactions, ii) issue and encashment of drafts and mail transfers, iii) issue and encashment of travellers' cheques, iv) collection of bills, v) advances against fixed deposits of their customers (within the sanctioning power of the concerned officials at the extension counter), and vi) disbursement of other loans (only for individuals) sanctioned by the Head Office / base branch up to the limit of Rs.10 lakh only.
		• UCBs permitted to set up ATMs subject to the following eligibility criteria: i) minimum deposits of Rs.100 crore, ii) compliance with the prescribed CRAR, iii) net NPAs less than 10 per cent, and iv) consistent record of profitability and compliance with CRR/SLR. Among others, the requirement of prior Reserve Bank approval for network connectivity and/or sharing of the ATMs installed by UCBs has also been dispensed with.
May	**2**	• SCBs (excluding RRBs) advised about State/UT wise credit mobilisation target for the year 2006-07 under SGSY.
	16	• All commercial banks (including RRBs) to display and update, on their website, the details of various service charges in the prescribed format. SCBs are also to display the charges relating to certain services as prescribed in their offices/branches. This may also be displayed in the local language. Similar guidelines were issued to UCBs on May 26, 2006 wherein scheduled UCBs were required to put the details of various service charges on their website while all UCBs (including scheduled and non-scheduled) were to display the charges relating to certain services as prescribed in their offices/branches.
	23	• It was clarified that the interest subvention related to relief measures by banks to poultry industry will be calculated at four percentage points on the term loans and working capital loans outstanding as on March 31, 2006. All categories are eligible for relief by way of interest subvention and will cover term loans and working capital loans sanctioned for all activities relating to poultry industries as outlined therein. Similar guidelines were issued to UCBs on May 26, 2006.
	25	• The risk weight on SCBs' (excluding RRBs) exposure to the commercial real estate increased to 150 per cent from 125 per cent. Similar measure was introduced for UCBs on June 1, 2006. Furthermore, SCBs' total exposure to venture capital funds will form a part of their capital market exposure and, henceforth, a higher risk weight of 150 per cent will be assigned to these exposures.
	29	• The general provisioning requirement for SCBs (excluding RRBs) on standard advances in specific sectors, *i.e.*, personal loans, loans and advances qualifying as capital market exposures, residential housing loans beyond Rs.20 lakh and commercial real estate loans increased to 1.0 per cent from 0.40 per cent. The revised norms were made applicable for UCBs (Unit banks and banks having multiple branches within a single district with deposit of Rs.100 crore and above and all other UCBs operating in more than one district) on June 15, 2006.
		• SCBs (excluding RRBs) to disclose in the 'Notes on Account' details of break-up of provisions and contingencies as follows: i) provisions for depreciation on investment, ii) provision towards NPA, iii) provision towards standard assets, iv) provision made towards income tax, and v) other provision and contingencies (with details).
June	**5**	• Public sector banks (PSBs) and RRBs advised that pursuance to the announcement in the Union Budget, 2006-07, the Government will provide interest subvention of 2 per cent per annum to PSBs and RRBs in respect of short-term production credit up to Rs.3 lakh provided to farmers. This amount of subvention will be calculated on the amount of the crop loan disbursed from the date of disbursement/drawal up to the date of payment or up to the date beyond which the outstanding loan becomes overdue, *i.e.*, March 31, 2007 for Kharif and June 30, 2007 for Rabi, respectively, whichever is earlier. This subvention will be available to PSBs and RRBs on the condition that they make available short-term credit at ground level at 7 per cent per annum. In case of RRBs, this will be applicable only to short term production credit disbursed out of their own funds and will exclude such credit supported by NABARD refinance. Banks were advised to immediately provide their estimates of short-term production credit to farmers up to Rs.3 lakh for Kharif and Rabi 2006-07 (separately) to enable the Reserve Bank to provide Government with an estimate of the likely amount of subvention,
	6	• StCBs and DCCBs permitted to open savings bank accounts in the names of State Government departments/bodies/ agencies in respect of grants/subsidies released for implementation of various programmes/schemes sponsored by State Governments on production of an authorisation from the respective Government departments certifying that the concerned Government department or body has been permitted to open savings bank account.

Date of Announce-ment		POLICY ANNOUNCEMENTS
2006		**III. FINANCIAL SECTOR MEASURES** *(Concld.)*
June	**8**	• SCBs (excluding RRBs) advised not to enter into swap transactions involving conversion of fixed rate rupee liabilities in respect of innovative Tier I/Tier II bonds into floating rate foreign currency liabilities. Further, with regard to swaps already entered into, banks are to follow the specified procedure for accounting gains / losses arising out of such swap transactions.
	12	• Bureau of Indian Standards (BIS) has formulated a comprehensive building Code namely National Building Code (NBC) of India 2005 providing guidelines for regulating the building construction activities across the country. Banks' boards may consider this aspect for incorporation in their loan policies. Similar guidelines were issued to UCBs on June 19, 2006, to RRBs on June 22, 2006 and to StCBs and DCCBs on June 26, 2006.
	13	• The Empowered Committees (ECs) for RRBs, constituted by the Reserve Bank at its regional offices, would deliberate and make recommendation on the applications for opening, shifting or merger of branches of RRBs. The Reserve Bank would take into account the ECs' recommendation and dispose of such applications expeditiously. Similarly, requests from RRBs for conduct of foreign exchange business, as limited authorised dealers for current account transactions, would be considered by the Reserve Bank after clearance by the EC.
	22	• Revised norms issued to SCBs (excluding RRBs) on utilisation, creation, accounting and disclosures of floating provisions, *i.e.*, provisions which are not made in respect of specific NPAs or are made in excess of regulatory requirement for provisions for standard assets.
July	**11**	• Investments that may be made by UCBs on or after April 1, 2007 in the bonds issued by NHB / HUDCO shall not be eligible for classification under priority sector lending.
	12	• SCBs permitted to phase out the additional general provisioning on standard advances in specific sectors *i.e.*, personal loans, loans and advances qualifying as capital market exposures, residential housing loans beyond Rs.20 lakh and commercial real estate loans. Additional provisioning requirement over the financial year 2006-07 would stand at: (a) 0.55 per cent for the quarter ended June 2006; (b) 0.70 per cent for the half-year ended September 2006; (c) 0.85 per cent for the quarter ended December 2006; and (d) 1 per cent for the year ended March 2007.
	14	• SCBs not to associate themselves with interest based electronic purse schemes which are in the nature of acceptance of deposits which can be withdrawn on demand. Similar guidelines were issued to UCBs on July 26, 2006.
	17	• SCBs to ensure that farmer's loan accounts, which are overdue as on July 1, 2006, are rescheduled on the lines of the package of "Relief Measures to the Vidarbha Region in Maharashtra" announced by the Hon'ble Prime Minister and the interest thereon (as on July 1, 2006) is fully waived. Fresh finance may be ensured to such farmers. The total amount of credit of Rs.1,275 crore envisaged to be released by banks will be allocated by Bank of Maharashtra (as SLBC Convenor) among the banks functioning in the districts. Similar guidelines were issued to UCBs on July 21, 2006.
	20	• SCBs to place service charges and fees on the homepage of their website at a prominent place under the title of 'Service Charges and Fees' so as to facilitate easy access by the bank's customers. A complaint from, along with the name of the nodal officer for complaint redressal, may be provided in the homepage itself to facilitate complaint submission by customers. The complaint form should also indicate that the first point for redressal of complaints is the bank itself and that complainants may approach the Banking Ombudsman only if the complaint is not resolved at the bank level within a month. Similar guidelines were issued to UCBs on July 24, 2006.
		IV. CAPITAL MARKET POLICIES
2005		**a) Securities and Exchange Board of India (SEBI)**
April	1	• In order to bring uniformity in documentary requirements across different segments and exchanges and also to avoid duplication and multiplicity of documents, SEBI formulated uniform set of broker-client registration and agreement documents.
May	**20**	• The BSE (Corporatisation and Demutualisation) Scheme, 2005 was approved and notified.
July	**1**	• SEBI suspended fresh registrations for obtaining Unique Identification Number (UIN) and the requirement to obtain/ quote UIN under the Central Database of Market Participants Regulations/Circulars.
Aug.	**4**	• SEBI instructed stock exchanges (SEs) and brokers to maintain books of accounts and other documents for five years.
	11	• In order to facilitate the unit holders to claim the tax benefit associated with payment of securities transaction tax (STT), SEBI permitted Mutual Funds (MFs) to share the Unique Client Code (UCC) of their schemes/plans with their unit holders.

Date of Announcement		POLICY ANNOUNCEMENTS
2005		**IV. CAPITAL MARKET POLICIES** *(Contd.)*
Aug.	**29**	• The Corporatisation and Demutualisation schemes of ten stock exchanges, *viz*., The Calcutta Stock Exchange Association Limited (CSE), The Delhi Stock Exchange Association Limited (DSE), The Madras Stock Exchange Limited (MSE), The Uttar Pradesh Stock Exchange Association Limited (UPSE), The Madhya Pradesh Stock Exchange (MPSE), The Cochin Stock Exchange Limited (CoSE), The Bangalore Stock Exchange Limited (BgSE), Pune Stock Exchange Limited (PSE), The Guwahati Stock Exchange Limited (GSE) and The Hyderabad Stock Exchange Limited (HSE) were approved and notified.
Sept.	**2**	• In order to facilitate execution of large trades, SEBI redefined the definition of "bulk deal" on the stock exchanges to facilitate large trades, while permitting the stock exchanges to provide a separate trading window. A trade, with a minimum quantity of 5,00,000 shares or minimum value of Rs.5 crore executed through a single transaction on this separate window of the stock exchange will constitute a "block deal" as distinguished from "bulk deal" defined earlier. The said window will be kept open for trading for a limited time period of 35 minutes from the beginning of trading hours*, i.e.,* from 9.55 a.m. to 10.30 a.m. Also, orders may be placed in this window at a price not exceeding ± 1 per cent from the ruling market price / previous day's closing price. Every trade executed in this window must result in delivery and shall not be squared off or reversed. Disclosure of all trades in this window and its dissemination to general public has been mandated. The stock exchanges have to ensure that all appropriate trading and settlement practices as well as surveillance and risk containment measures, *etc*., as presently applicable to the normal trading segment are made applicable and implemented in respect of the proposed special window also.
	14	• SEBI permitted mutual funds to participate in the derivatives market, bringing them at par with foreign institutional investors (FII), in respect of position limits in index futures, index options, stock options and stock futures contracts.
	15	• The Corporatisation and Demutualisation schemes of eight more stock exchanges, *viz*., The Saurashtra Kutch Stock Exchange Limited (SKSE), The Stock Exchange - Ahmedabad (ASE), The Jaipur Stock Exchange Limited (JSE), The Vododara Stock Exchange Limited (VSE), Inter-connected Stock Exchange of India Limited (ISE), The Bhubaneswar Stock Exchange (BhSE), The Ludhiana Stock Exchange Association Limited (LSE) and The Magadh Stock Exchange Association (MSEA) were approved and notified. Over-the Counter Exchange of India (OTCEI) was notified as an already corporatised and demutualised stock exchange.
	19	• SEBI (Disclosure and Investor Protection) Guidelines, 2000 with respect to book building were amended to provide for specific allocation for Mutual Funds; discontinuation of discretionary allotment and introduction of proportionate allotment to QIBs; and margin requirement for QIBs.
Nov.	**9**	• Depository Participants (DPs) were advised not to levy any charges when a beneficiary owner (BO) transfers all the securities lying in his account to another branch of the same DP or to another DP of the same depository or another depository, provided the BO account/s at transferee DP and at transferor DP are one and the same, *i.e.,* identical in all respects.
2006		
Jan.	**12**	• SEBI (Custodian of Securities) Regulations, 1996 were amended to include safekeeping of gold or gold related instruments within the meaning of "custodial services". The regulations were amended with respect to introduction of gold exchange traded funds.
	19	• SEBI advised depositories to activate the ISINs of securities issued as Initial Public Offering (IPO) only on the date of commencement of trading of such securities on the stock exchanges.
	20	• SEBI revised the Trading Member/FII /MFs position limits for stock based derivatives.
		• SEBI revised the criteria for stocks for derivatives trading on account of corporate restructuring.
	24	• SEBI amended the SEBI (Mutual Funds) Regulations, 1996 to introduce Gold Exchange Traded Fund schemes by Mutual Funds.
	31	• SEBI amended the SEBI (Delisting of Securities) Guidelines, 2003 to ensure adequate and wide public notice of the fact of delisting and disclosure of the fair value through newspapers and notice boards/trading systems of the stock exchanges.
Feb.	**15**	• SEBI clarified that if a post restructured company comes out with an IPO, then the same prescribed criteria as currently applicable for introduction of derivatives on a company coming out with an IPO may be applied for introduction of derivatives on stocks of the post restructured company from its first day of listing.
March	**31**	• SEBI amended the SEBI 'Disclosure and Investment Protection' Guidelines, 2000 with respect to rationalisation of disclosure requirements, abridged letter of offer, disclosure of issue price, further issue of shares and lock-in provisions for listed companies making rights or public issue.

Date of Announcement		POLICY ANNOUNCEMENTS
2006		**IV. CAPITAL MARKET POLICIES** *(Concld.)*
April	**3**	• SEBI issued listing agreements for India Depository Receipts (IDR).
	13	• SEBI amended the Clause 40A and Clause 35 of Equity Listing Agreement with respect to the minimum level of public shareholding of all the listed companies and revision in the reporting format for shareholding pattern.
	24	• SEBI amended the SEBI (Discloser and Investment Protection) Guidelines, 2000 to permit unlisted companies to opt for grading of IPO from credit rating agencies and to ensure disclosure of all grades by it, including unaccepted grades.
May	**8**	• In order to provide an additional route for raising fund in the domestic market, SEBI permitted listed companies to raise funds in the form of “Qualified Institutional Placement” (QIP).
June	**16**	• SEBI asked the stock exchanges to make the existing margining system more stringent in the cash segment. SEBI directed exchanges to update risk arrays in the cash market at least five times in a day as is done in derivative market and accordingly, update applicable margin rates.
		(b) Government of India
2006		
Feb.	**28**	• The Union Budget, 2006-07 proposed the following measures: i) increase in FII investment limit in the Government securities to US $ 2 billion from US $ 1.75 billion, ii) increase in FII investment limit in corporate debt to US $ 1.5 billion from US $ 0.5 billion, iii) increase in ceiling on aggregate investment by mutual funds in overseas instruments to US $ 2 billion from US $ 1 billion and removal of requirement of 10 per cent reciprocal share holding, iv) limited number of qualified Indian MFs allowed to invest, cumulatively up to US $ 1 billion in overseas exchange traded funds, v) steps to create a single, unified exchange-traded market for corporate bonds, and vi) an investor protection fund under the aegis of SEBI.
		V. EXTERNAL SECTOR POLICIES
2005		**a) Trade Policy**
April	**8**	• Annual Supplement to Foreign Trade Policy 2004-09 announced so as to help Indian companies become globally competitive and simultaneously give Indian consumers world-class products and services. The policy renewal provided packages for several sectors including agriculture, marine products, export oriented units and service sectors; major procedural simplification initiatives to reduce transaction costs; setting up of an Inter State Trade Council to engage State Governments more actively in export effort; and proposals to abolish cess on export of all agricultural and plantation commodities levied under the Commodity Board Act. In a further boost to agri-exports, benefits under the ‘*Vishesh Krishi Upaj Yojana*’ extended to poultry and dairy products in addition to export of flowers, fruits, vegetables, minor forest produce and their value added products.
	28	• Additional Standard Input Output Norms (SION) notified for 27 new export items of which 25 norms related to the chemicals and allied products and one each related to engineering products and plastic products.
May	**10**	• Special economic zone (SEZ) units obtaining gold/silver/platinum from the nominated agencies on loan basis required to export that jewellery within 90 days from the date of release, except outright purchase.
	13	• Export Oriented Units (EOU)/ Electronic Hardware Technology Park (EHTP)/ Software Technology Park (STP)/ Bio-Technology Park (BTP) units allowed to sell finished products (except pepper and pepper products), which are freely importable under the policy in the Domestic Tariff Area (DTA) under intimation to the Development Commissioner against payment of full duties, provided they have achieved positive net foreign exchange earnings.
Aug.	**5**	• Service providers like Customs House Agents entitled for benefits under Served From India Scheme for the services exclusively rendered by them and for which the foreign exchange earnings are received and retained by them on this account, subject to certain conditions.
	31	• EOUs made eligible for benefits under *Vishesh Krishi Upaj Yojana* for physical exports made by them at par with such exports made by DTA units, in respect of items appearing in Appendix – 37A of Handbook of Procedures 2004-09.
Oct.	**10**	• Exporters given the flexibility to import the alternative input/product mentioned in the SION as long as the same can be used in the manufacture of the exported product under the Duty Free Replenishment Certificate (DFRC) scheme.
Dec.	**5**	• Supplies from domestic tariff area (DTA) to SEZs made eligible for benefits under Duty Free Entitlement Certificate (DFEC) and Target Plus Scheme subject to the specified conditions, provided the payments are realised in free foreign exchange.

Date of Announcement		POLICY ANNOUNCEMENTS
2005		**V. EXTERNAL SECTOR POLICIES** *(Contd.)*
Dec.	**8**	• Duty credits issued under *Vishesh Krishi Upaj Yojana* allowed to be utilised for payment of customs duty on import of inputs and goods, which are freely importable. This would include all freely importable items under Chapter 1 to 24 of ITC (HS) Classification of export and import items except a small negative list. Import of capital goods, however, not permitted against *Vishesh Krishi Upaj Yojana* scrips pending finalisation of list of such capital goods.
2006		
Feb.	**10**	• In exercise of the powers conferred by section 55 of the Special Economic Zone Act, 2005 (28 of 2005), the Central Government announced Special Economic Zones Rules (SEZs), 2006 containing definitions, procedures etc. regarding setting up and operation of SEZs.
April	**7**	• Annual Supplement 2006 to the Foreign Trade Policy (2004-09) announced. The Annual Supplement, 2006 envisaged the twin objectives of (i) putting the country's exports on a trajectory of quantum growth and (ii) creating employment opportunities, especially in the rural and semi-urban areas, within the broad contours of Foreign Trade Policy 2004-09 and the changing international trade scenario. Towards these objectives, the Annual Supplement introduced two new incentive schemes, Focus Product Scheme (FPS) and Focus Market Scheme (FMS), in addition to modifying the existing incentive schemes for promotion of India's merchandise trade. The Focus Product and Focus Market Schemes replaced the earlier Target Plus Scheme.
June	**14**	• It was clarified that import of motor cars, sports utility vehicles / all purpose vehicles would be allowed only to hotels, travel agents, tour operators or tour transport operators and companies owning/operating golf resorts subject to certain conditions.
July	**1**	• India notified the reduction of tariffs as per Article 7 of South Asian Free Trade Agreement (SAFTA). The SAARC Free Trade Agreement signed by the member states of South Asian Association for Regional Cooperation came into force from January 1, 2006.
	27	• A new system for issuance of Importer-Exporter Code (IEC) was introduced.
		b) Foreign Exchange Market
2005		
April	**25**	• Foreign insurance companies which have obtained prior approval from the Insurance Regulatory and Development Authority (IRDA) were allowed to establish liaison offices in India.
		• NGOs engaged in micro finance activities were permitted to raise external commercial borrowing (ECB) up to US $ 5 million during a financial year for permitted end-use, under the automatic route. NGOs engaged in micro finance activities having satisfactory borrowing relationship of at least three years with a scheduled commercial bank authorised to deal in foreign exchange and 'fit and proper' status of the board/management committee, would be eligible to avail ECB subject to conditions: (i) the designated Authorised Dealer (AD) will ensure that the ECB proceeds are utilised for lending to self-help groups or for micro-credit or for bonafide micro finance activity including capacity building, (ii) the designated AD has to ensure at the time of draw down that the forex exposure of the borrower is hedged, (iii) ECB funds should be routed through normal banking channel from internationally recognised sources, *viz.*, international banks, multilateral financial institutions and export credit agencies. Individuals and overseas organisations complying with Know Your Customer (KYC) guidelines and anti-money laundering (AML) safeguards may also lend. All other ECB parameters such as minimum average maturity, all-in-cost ceilings, issuance of guarantee, choice of security, parking of ECB proceeds, prepayment, refinancing of ECB and reporting arrangements under the automatic route should be complied with.
May	**12**	• The limit for overseas investment under the automatic route was raised from 100 per cent of net worth of the Indian entity to 200 per cent of its networth as on date of the last audited balance sheet, in any *bonafide* business activity. This ceiling is not applicable to investments made out of balances held in Exchange Earners' Foreign Currency (EEFC) accounts and out of the proceeds of ADR / GDR issue.
	13	• Earlier, NRIs/PIOs were permitted to remit an amount not exceeding US $ 1 million, per calendar year, out of balances held in Non-Resident Ordinary (NRO) account / sale proceeds of assets/ assets in India acquired by them by way of inheritance/legacy, on production of certain documents. The facility available under inheritance/legacy was extended to an arrangement under a "settlement" whereby the property is passed on to the legatees during the lifetime of the owner/parent who normally retains a life interest in the property since "settlement' is also a mode of inheritance from the parent, the only difference being that the property under the "settlement" passes to the beneficiary on the death of the owner/parent without any legal procedures/hassles. This helps in avoiding delay and inconvenience in applying for probate, *etc.* Accordingly, banks authorised to deal in foreign exchange may allow remittance facility to NRI/PIO under a deed of settlement made either by his parents or close relatives (as defined in Section 6 of the Companies Act, 1956). The remittance facility would be available only on demise of the settler.

Date of Announcement		POLICY ANNOUNCEMENTS
2005		**V. EXTERNAL SECTOR POLICIES** *(Contd.)*
May	**17**	• ADs were allowed to open foreign currency accounts for the project offices established under the general/specific approval of the Reserve Bank as well as to permit intermittent remittances by project offices, without approval of the Reserve Bank, subject to certain conditions. Inter-project transfer of funds shall, however, require prior approval of the concerned Regional Office of the Reserve Bank. In case of disputes between the project office and the project sanctioning authority or other Government/Non-Government agencies, *etc*., the balance held in such account shall be converted into Indian rupees and credited to a special account which shall be dealt with as per the settlement of the dispute.
June	**14**	• Prior permission from the Reserve Bank is not required by AD banks for issue of Store Value Cards/Charge Cards/ Smart Cards to residents travelling on private/business visit abroad which are used by residents to make payment to merchant establishment overseas and also for drawing cash from ATM terminals. However, the use of such cards is limited to permissible current account transactions and is subject to the limits prescribed under the current account transactions rules, as amended from time to time.
	23	• All forward contracts booked by residents to hedge current account transactions, regardless of tenor, were allowed to be cancelled and rebooked freely. However, this relaxation will not be applicable to forward contracts booked on past performance basis without documents and on forward contracts booked to hedge transactions denominated in foreign currency but settled in Indian rupee.
July	**12**	• Earlier, it was obligatory on the part of the ADs to follow up with the importers for submission of evidence of import where the value of foreign exchange remitted for import proceeds exceeds US $ 1,00,000. ADs were permitted not to follow up submission of evidence of import involving amount of US $ 1,00,000 or less provided they are satisfied about the genuineness of the transaction and the *bona fides* of the remitter. A suitable policy may be framed by the bank's Board of Directors in this regard and the ADs may set their own internal guidelines to deal with such cases.
	23	• Residents in India were allowed to enter into contracts in commodity exchanges or markets outside India to hedge the price risk on import/export of a commodity, subject to certain conditions and reporting requirements. Powers were delegated to select commercial banks satisfying minimum prescribed norms to grant general permission to companies listed on a recognised stock exchange to hedge the price risk in respect of any commodity except gold, silver, petroleum and petroleum products in the international commodity exchanges/markets. The company is required to submit a board resolution indicating that it understands the risks involved in such transactions, the nature of hedge transactions that it would undertake in the ensuing year and that it would undertake hedge transaction only where it is exposed to price risk. However, the AD may refuse to undertake any hedge transaction in case of doubt about the *bona fides* of the transaction or if the corporate is not exposed to price risk.
	29	• Foreign Direct Investment (FDI) up to 100 per cent was permitted under the automatic route in petroleum product marketing, oil exploration in both small and medium sized fields and petroleum product pipelines. In Air Transport Services (domestic airlines) sector, FDI up to 100 per cent was permitted under the automatic route by Non-Resident Indians and up to 49 per cent by others. No direct or indirect equity participation by foreign airlines is allowed.
Aug.	**1**	• The ECB policy was further liberalised as follows: (i) NBFCs permitted to raise ECB with a minimum average maturity of five years from certain category of lenders to finance import of infrastructure equipment for leasing to infrastructure projects under the approval route, (ii) housing finance companies satisfying certain criteria permitted to raise Foreign Currency Convertible Bonds (FCCBs) with prior approval of Reserve Bank, (iii) AD banks permitted to allow prepayment of ECB up to US $ 200 million against the existing limit of US $ 100 million, (iv) Domestic rupee denominated structured obligations credit enhanced by international banks/international financial institutions/joint venture partners (which earlier required approval of the Government of India) would be considered by the Reserve Bank under the approval route.
	11	• FDI and portfolio investment were permitted in an Indian company publishing newspapers and periodicals dealing with news and current affairs within a composite ceiling of 26 per cent of the paid-up capital of the company subject to the guidelines issued by the Ministry of Information and Broadcasting. As such, FIIs, NRIs and Foreign Venture Capital Investors were allowed to purchase shares of an Indian company engaged in print media sector.
	17	• FDI up to 100 per cent permitted in townships, housing, built-up infrastructure and construction development projects under the automatic route, subject to certain guidelines.
	25	• The procedure for obtaining prior approval of the Reserve Bank for transfer of security, by way of gift, from a person resident in India to a person resident outside India was modified. The applications would be considered subject to compliance with the conditions stipulated by the Reserve Bank in this regard.
	29	• In addition to the existing facility of making investment in Indian rupees, investments in Bhutan was allowed to be made in any freely convertible foreign currency. However, all dues receivable on such investments including winding up and sale proceeds should be repatriated to India in freely convertible currencies only.

Date of Announcement		POLICY ANNOUNCEMENTS
2005		**V. EXTERNAL SECTOR POLICIES** *(Contd.)*
Sept.	**5**	• In order to bring the ADR/GDR guidelines in alignment with the guidelines on domestic capital issues framed by SEBI, the Government of India amended the Foreign Currency Convertible Bonds and Ordinary Shares (through Depository Receipt Mechanism) Scheme, 1993. Accordingly, both listed and unlisted companies in India have to comply with the amended guidelines for issue of FCCBs and ADRs/GDRs.
	27	• ADs were allowed to permit airline companies to remit up to US $ 1 million per aircraft towards security deposits with lessor for payment of lease rentals for import of an aircraft/aircraft engine/helicopter on operating lease without a standby letter of credit/guarantee from a reputed international bank abroad/guarantee of an AD in India against a counter-guarantee of a reputed international bank abroad subject to certain conditions. However, in case of an airline company in the public sector or a Department/Undertaking of the Government of India/State Government/s, ADs were allowed to permit remittance up to US $ 1,00,000 per aircraft provided the company has obtained a specific waiver of bank guarantee from the Ministry of Finance, Government of India in addition to conditions applicable to other airline companies.
Nov.	**4**	• The ECB policy was liberalised further as follows: (i) Special Purpose Vehicles (SPVs) or any other entity notified by the Reserve Bank, set up exclusively to finance infrastructure companies/ projects to be treated as financial institutions and ECB proposals by such entities will be considered under the approval route on a case by case basis, (ii) Banks allowed to issue guarantees / standby letters of credit / letters of undertaking / letters of comfort in respect of ECB by textile companies for modernisation or expansion of their textile units after phasing out of Multi-Fibre Agreement. Such applications will also be considered under the approval route subject to prudential norms.
	11	• Persons / entities eligible under the FDI route other than FIIs were permitted to invest in the equity capital of Asset Reconstruction Companies (ARCs) registered with the Reserve Bank. Applications from eligible entities for investment in the ARCs would be considered by the Foreign Investment Promotion Board (FIPB) subject to certain conditions. FIIs registered with the SEBI were allowed to invest in security receipts (SRs) issued by ARCs registered with the Reserve Bank up to 49 per cent of each *tranche* of scheme of SRs subject to the condition that investment of a single FII in each *tranche* of scheme of SRs should not exceed 10 per cent of the issue. The policy of investment in ARCs under the FDI route and investment by FIIs in SRs issued by ARCs would be reviewed after a period of two years and one year, respectively.
Dec.	**2**	• Anti-Money Laundering (AML) guidelines were issued to enable authorised money changer (AMCs) to put in place the policy framework and systems for prevention of money laundering while undertaking money exchange transactions. All AMCs will formulate suitable policies and procedures for the AML measures which would include (i) Customer Identification Procedure – "Know your Customer" norms, (ii) Recognition, handling and disclosure of suspicious transactions, (iii) Appointment of Money Laundering Reporting Officer (MLRO), (iv) Staff training, (v) Maintenance of records, and (vi) Audit of transactions in accordance with the guidelines issued. AML policy framework and measures have to be approved by the Board of Directors of the AMC.
2006		
Jan.	**10**	• Powers were delegated to AD banks to grant GR approval in cases where goods are being exported for re-import after repairs / maintenance / testing / calibration, *etc.*, subject to the condition that the exporter shall produce relative bill of entry within one month of re-import of the item exported from India. However, where goods being exported for testing are destroyed during testing, AD banks, in lieu of bill of entry for import, may obtain a certificate issued by the testing agency that the goods have been destroyed during testing.
	23	• Multi-State Cooperative Societies engaged in manufacturing activities were allowed to raise ECB. The proposal for ECB by such societies will be considered by the Reserve Bank under the approval route, provided the Cooperative Society is financially solvent, submits its up-to-date audited balance sheet and the proposal complies with all other parameters of the ECB guidelines.
March	**6**	• A scheme for categorisation / re-categorisation and issue of authorisation to select entities to undertake release / remittance of foreign exchange for certain non-trade related current account transactions was decided. Such entities will be called as 'Authorised Dealers - Category II'. Accordingly, the Reserve Bank would consider granting licence to Full Fledged Money Changers (FFMCs), UCBs and RRBs - categorised as 'Authorised Dealers - Category II', to undertake release / remittance of foreign exchange for certain non-trade related current account transactions. The eligibility criteria would essentially focus on strong financials, good governance, regulatory / prudential comfort, adequate internal control mechanism and an overall assessment that the entity is fit and proper. These entities are also required to adhere to reporting requirements.
	27	• Earlier, only promoter corporates were permitted to offer guarantees on behalf of their WOS / JVs abroad under the automatic route while issue of personal, collateral and third party guarantees required prior approval of Reserve Bank. The scope of guarantees under the automatic route was enlarged and Indian entities were allowed to offer other forms of guarantee - corporate or personal / primary or collateral / guarantee by the promoter company / guarantee by group company, sister concern or associate company in India, subject to certain conditions.

Date of Announcement		POLICY ANNOUNCEMENTS
2006		**V. EXTERNAL SECTOR POLICIES** *(Concld.)*
March	**27**	• In order to enable companies to have operational flexibility, the automatic route of disinvestment was further liberalised. Accordingly, (i) cases where joint venture (JV) /wholly owned subsidiaries (WOS) are listed on the overseas stock exchanges, (ii) cases where the Indian promoter company is listed on a stock exchange in India and has a net worth of not less than Rs. 100 crore, and (iii) cases where the Indian promoter is an unlisted company and the investment in overseas venture does not exceed US $ 10 million were allowed to divest without prior approval of the Reserve Bank, subject to reporting requirement. Earlier, all investments involving write-off needed prior approval of the Reserve Bank.
		• Recognised star exporters constituted as proprietary / unregistered partnership firms, satisfying certain eligibility criteria, were allowed to set up a JV / WOS outside India with prior approval of the Reserve Bank.
April	**5**	• AD banks were allowed remittances for acquiring shares under employees stock option plan (ESOP) Schemes, irrespective of the method of the operationalisation of the scheme, *i.e.*, either the shares under the scheme are offered directly by the issuing company or indirectly through a trust / a special purpose vehicle (SPV) / step down subsidiary provided i) the company issuing the shares effectively, directly or indirectly, holds in the Indian company, whose employees / directors are being offered shares, not less than 51 per cent of its equity, ii) the shares under the ESOP Scheme are offered by the issuing company globally on uniform basis, and iii) an Annual Return is submitted by the Indian company to the Reserve Bank through the AD banks giving details of remittances / beneficiaries / etc. Foreign companies were also granted general permission to repurchase the shares issued to residents in India under any ESOP scheme provided (i) the shares were issued in accordance with the Rules / Regulations framed under Foreign Exchange Management Act, 1999, ii) the shares are being repurchased in terms of the initial offer document, and iii) an annual return is submitted through the AD banks giving details of remittances / beneficiaries / *etc*.
	21	• The limit of invoice value which AD banks are allowed to grant extension of time for realisation of export proceeds beyond prescribed period from the date of export was increased from US $ 100,000 to US $ 1 million subject to existing terms and conditions.
		• AD banks were permitted to allow remittance for expenses of branch offices opened abroad up to 10 percent for initial and up to five percent for recurring expenses of the average annual sales/income or turnover during last two accounting years subject to the existing terms and conditions.
June	**26**	• Anti-Money Laundering guidelines for AMCs were issued in December 2005. In view of the difficulties expressed by AMCs in implementing some of the guidelines, it was decided to amend certain instructions as follows: (i) for purchase of foreign exchange less than US $ 200 or its equivalent, photocopies of the identification document need not be kept on record. However, full details of the identification document should be maintained; (ii) for encashment of foreign exchange between US $ 200 and US $ 2,000 or its equivalent, the photocopies of the identification document should be maintained for one year and completion of statutory audit; (iii) for encashment in excess of US $ 2,000 or its equivalent, the photocopies of the identification document should be maintained for a minimum period of five years; and (iv) requests for payment in cash by foreign visitors / NRIs may be acceded to the extent of US $ 2,000 or its equivalent.

APPENDIX TABLE 1 : SELECT MACROECONOMIC AND FINANCIAL INDICATORS

Item	2001-02	2002-03	2003-04	2004-05	2005-06	Average 1996-97 to 2005-06 (10 years)
1	2	3	4	5	6	7
1. Real GDP (% change)	5.8	3.8	8.5	7.5 QE	8.4 RE	6.3
2. Industrial Production (% change)	2.8	5.8	7.0	8.4	8.1 P	6.0
3. Agricultural Production (% change)	7.6	-13.2	16.1	-2.7	7.5	1.9
4. Foodgrains Production (Million tonnes)	212.9	174.8	213.2	198.4	208.3 $	200.9
5. Gross Domestic Saving Rate (% of GDP)	23.6	26.5	28.9	29.1 QE	n.a.	24.9 ^
6. Gross Domestic Investment Rate (% of GDP)	23.0	25.3	27.2	30.1 QE	n.a.	25.3 ^
7. Central Government Finances (% of GDP)						
a) Total Revenue Receipts	8.8	9.4	9.6	9.8	9.9 RE	9.2
b) Total Expenditure	15.9	16.9	17.1	15.9	14.4 RE	15.7
c) Revenue Deficit	4.4	4.4	3.6	2.5	2.6 RE	3.4
d) Fiscal Deficit	6.2	5.9	4.5	4.0	4.1 RE	5.3
e) Net RBI Credit to Centre	-0.2	-1.2	-2.8	-1.9	0.8	-0.4
f) Interest Payments	4.7	4.8	4.5	4.1	3.7 RE	4.4
g) Domestic Debt	56.8	61.2	61.2	61.9	60.2 RE	54.4
8. Monetary Aggregates (% change)						
a) Broad Money (M_3)	14.1	12.7 @	16.7	12.1 #	17.0 £	16.0
b) Narrow Money (M_1)	11.4	12.0	22.2	11.9	20.9 £	13.9
c) Reserve Money (M_0)	11.4	9.2	18.3	12.1	17.2	11.5
9. Scheduled Commercial Banks (% change)						
a) Aggregate Deposits	14.6	13.4 @	17.5	12.8 #	18.1 £	16.4
b) Bank Credit	15.3	16.1 @	15.3	27.0 #	30.8 £	18.0
c) Non-Food Credit	13.6	18.6 @	18.4	27.5 #	31.8 £	18.0
d) Investments in Government Securities	20.9	27.3	25.1	7.9 #	-2.7 £	18.3
10. Wholesale Price Index (% change)						
a) Point-to-Point	1.6	6.5	4.6	5.1	4.1	4.9
b) Average	3.6	3.4	5.4	6.4	4.4	4.9
11. Consumer Price Index - Industrial Workers (% change)						
a) Point-to-Point	5.2	4.1	3.5	4.2	4.9	5.6
b) Average	4.3	4.0	3.9	3.8	4.4	5.7
12. BSE Sensitive Index (% change)	-3.7	-12.1	83.4	16.1	73.7	17.8
13. Trade and Balance of Payments						
a) Exports in US $ (% change)	-1.6	20.3	23.3	23.9	27.5	13.0
b) Imports in US $ (% change)	-2.8	14.5	24.1	48.5	31.6	14.7
c) Current Account (% of GDP)	0.7	1.3	2.3	-0.8	-1.3	-0.3
d) Capital Account (% of GDP)	1.8	2.1	2.8	4.4	3.1	2.6
14. Foreign Exchange Reserves* (US $ Million)	54716	76100	112959	141514	151622	–
15. External Debt*						
a) Debt-GDP Ratio	21.1	20.4	17.8	17.3	15.8	20.9
b) Debt-Service Ratio	13.6	16.0	16.3	6.1	10.2	15.7
16. Exchange Rate (Rupee / US$)						
a) High	46.56	47.51	43.45	43.36	43.30	–
b) Low	48.85	49.06	47.46	46.46	46.33	–

P : Provisional. n.a. : Not available. ^ : Latest available data pertain to 2004-05 and therefore averages are taken for nine years.
@ : Adjusted for the mergers in the banking system. £ : Variation over April 1, 2005. $: Fourth Advance Estimates.
* : As at the end of the period. # : Adjusted for the conversion in the banking system since October 11, 2004.
BE : Budget Estimates. RE : Revised Estimates. QE : Quick Estimates.

APPENDIX TABLE 2 : INTEREST RATE STRUCTURE OF SCHEDULED COMMERCIAL BANKS

(Per cent per annum)

Item	Rates as on												
	Jan. 07 2005	Sep .02, 2005	Dec. 2, 2005	Dec. 23, 2005	Jan. 13, 2006	Feb. 03, 2006	Feb. 10, 2006	Feb. 24, 2006	Mar. 17, 2006	Mar. 31, 2006	April 13, 2006	May 05, 2006	June 30 2006
1	2	3	4	5	6	7	8	9	10	11	12	13	14
A. Lending Rates													
Size of Credit Limit													
1. Up to Rs. 2 lakh	≤ BPLR	≤ BPLR	≤ BPLR	≤ BPLR	≤ BPLR	≤ BPLR	≤ BPLR	≤ BPLR	≤ BPLR	≤ BPLR	≤ BPLR	≤ BPLR	≤ BPLR
2. Over Rs. 2 lakh : (Benchmark Prime Lending Rate)*	10.25-10.75	10.25-10.75	10.25-10.75	10.25-10.75	10.25-10.75	10.25-10.75	10.25-10.75	10.25-10.75	10.25-10.75	10.25-10.75	10.25-10.75	10.75-11.25	10.75-11.25
B. Deposit Rates													
Category of Account													
1. Current	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil
2. Savings	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50
3. Term Deposits *													
a) Up to and including one year	3.00-5.00	2.00-5.00	2.00-5.25	2.00-5.50	2.00-5.50	2.25-5.80	2.25-5.50	2.25-5.50	2.25-5.50	2.25-5.50	2.25-6.00	3.00-6.00	3.00-6.00
b) 1-2 years	5.25-5.50	5.25-5.50	5.25-5.75	5.50-5.75	5.50-6.00	5.25-6.00	5.75-6.00	6.00-6.25	6.00-6.25	6.00-6.50	6.00-6.50	6.25-6.75	6.25-6.75
c) 2-3 years	5.50	5.50	5.50-6.00	5.50-6.00	5.75-6.00	5.50-6.25	6.00-6.25	6.00-6.25	6.00-6.50	6.00-6.50	6.00-6.50	6.25-6.75	6.25-6.75
d) > 3 years	5.75-6.25	5.75-6.25	5.75-6.25	5.75-6.50	6.00-6.50	5.75-6.50	6.25-6.50	6.25-6.50	6.25-7.00	6.25-7.00	6.25-7.00	6.50-7.00	6.50-7.00
Memo Item :													
Bank Rate	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00

* : Data relate to major public sector banks.
≤ : Not Exceeding.

APPENDIX TABLE 3 : INTEREST RATES ON EXPORT CREDIT

(Per cent per annum)

Export Credit	Rates Effective										
	January 01, 1998	April 30, 1998	August 06, 1998	April 01, 1999	October 29, 1999	May 26, 2000	January 06, 2001	May 05, 2001#	September 26, 2001#	May 18, 2004	May 01, 2006
1	2	3	4	5	6	7	8	9	10	11	12
1. Pre-shipment Credit											
i) Up to 180 days*	12.00	11.00	9.00	10.00	10.00	10.00	10.00	≤ PLR-1.5 PP	≤ PLR-2.5 PP	≤ BPLR-2.5 PP	BPLR-2.5 PP
ii) Beyond 180 days and up to 270 days	14.00	14.00	12.00	13.00	13.00	13.00	13.00	≤ PLR+1.5 PP	≤ PLR+0.5 PP	Free	Free
iii) Against incentives receivable from Government covered by ECGC Guarantee up to 90 days	12.00	11.00	9.00	10.00	10.00	10.00	10.00	< PLR-1.5 PP	< PLR-2.5 PP	< BPLR-2.5 PP	< BPLR-2.5 PP
2. Post-shipment Credit											
i) Demand Bills for transit period (as specified by FEDAI)*	≤ 11.00	≤ 11.00	9.00	≤ 10.00	≤ 10.00	≤ 10.00	≤ 10.00	≤ PLR-1.5 PP	≤ PLR-2.5 PP	≤ BPLR-2.5 PP	BPLR-2.5 PP
ii) Usance Bills (for total period comprising usance period of export bills, transit period as specified by FEDAI and grace period wherever applicable)											
a) Up to 90 days *	≤ 11.00	≤ 11.00	9.00	≤ 10.00	≤ 10.00	≤ 10.00	≤ 10.00	≤ PLR-1.5 PP	≤ PLR-2.5 PP	≤ BPLR-2.5 PP	BPLR-2.5 PP
b) Beyond 90 days and up to six months from the date of shipment	13.00	13.00	11.00	12.00	12.00	12.00	12.00	≤ PLR+1.5 PP	≤ PLR+0.5 PP	Free	Free
c) Beyond six months from the date of shipment	20.00$ (Min.)	—	—	—	—	—	—	—	—	—	—
d) Upto 365 days for exporters under the Gold Card Scheme										≤ BPLR-2.5 PP	≤ BPLR-2.5 PP
iii) Against incentives receivable from Government covered by ECGC Guarantee (up to 90 days)	≤ 11.00	≤ 11.00	9.00	≤ 10.00	≤ 10.00	≤ 10.00	≤ 10.00	≤ PLR-1.5 PP	≤ PLR-2.5 PP	≤ BPLR-2.5 PP	≤ BPLR-2.5 PP
iv) Against undrawn balance (up to 90 days)	≤ 11.00	≤ 11.00	9.00	≤ 10.00	≤ 10.00	≤ 10.00	≤ 10.00	≤ PLR-1.5 PP	≤ PLR-2.5 PP	≤ BPLR-2.5 PP	≤ BPLR-2.5 PP
v) Against retention money (for supplies portion only) payable within one year from the date of shipment (up to 90 days)	≤ 11.00	≤ 11.00	9.00	≤ 10.00	≤ 10.00	≤ 10.00	≤ 10.00	≤ PLR-1.5 PP	≤ PLR-2.5 PP	≤ BPLR-2.5 PP	≤ BPLR-2.5 PP
3. Deferred Credit Deferred credit for the period beyond 180 days	Free (FDA)	Free (FDA)	Free	Free	Free	Free	Free	Free	Free	Free	Free
4. Export Credit, not otherwise specified											
a) Pre-shipment credit		Free	Free	Free	Free	Free	Free	Free	Free	Free	@
b) Post-shipment credit	20.00 (Min.)	20.00 (Min.)	20.00 (Min.)	20.00 (Min.)	Free	25.00 (Min.)	Free	Free	Free	Free	@

FDA : From the date of advance. Min. : Minimum. PLR : Prime Lending Rate. BPLR : Benchmark Prime Lending Rate.
≤ : Not Exceeding. — : Not Applicable. PP : Percentage Points.
$: Chronic cases, *i.e.*, overdues as on July 1, 1997 are exempted. # : These are ceiling rates, banks would be free to charge any rate below the ceiliing rate.
* : Interest rates for the above-mentioned categories beyond the tenors as prescribed above are free effective May 1, 2006.
@ : ECNOS abolished w.e.f. May 1, 2006. Banks are free to set own interest rates.
Note : 'Free' means banks are free to charge interest rates keeping in view the BPLR and spread guidelines.

APPENDIX TABLE 4 : GROWTH RATES AND SECTORAL COMPOSITION OF REAL GROSS DOMESTIC PRODUCT

(At 1999-2000 Prices)

(Per cent)

Sector	Growth Rate					Share in real GDP			
	Average 2000-01 to 2004-05	2002-03	2003-04@	2004-05*	2005-06#	2002-03	2003-04@	2004-05*	2005-06#
1	2	3	4	5	6	7	8	9	10
1. Agriculture and Allied Activities	**2.0**	**-6.9**	**10.0**	**0.7**	**3.9**	**21.9 (-44.5)**	**22.2 (25.9)**	**20.8 (2.2)**	**19.9 (9.5)**
of which :									
Agriculture	2.0	-7.8	10.7	0.7	n.a.	19.8	20.2	18.9	n.a.
2. Industry	**5.9**	**6.8**	**6.6**	**7.4**	**7.6**	**19.9 (34.7)**	**19.5 (15.6)**	**19.5 (19.1)**	**19.3 (17.7)**
of which :									
a) Mining and quarrying	4.8	8.7	5.3	5.8	0.9	2.3	2.2	2.2	2.0
b) Manufacturing	6.5	6.8	7.1	8.1	9.0	15.2	15.0	15.1	15.1
c) Electricity, gas and water supply	3.5	4.8	4.8	4.3	5.3	2.4	2.3	2.2	2.2
3. Services	**7.7**	**7.3**	**8.5**	**10.2**	**10.3**	**58.3 (109.8)**	**58.3 (58.5)**	**59.7 (78.7)**	**60.7 (72.8)**
of which :									
a) Construction	8.2	7.7	10.9	12.5	12.1	6.1	6.2	6.5	6.7
b) Trade, hotels and restaurants	7.9	6.7	10.2	8.1	11.5 $	15.2	15.4	15.5	26.2 $
c) Transport, storage and communication	12.7	13.7	15.2	14.8	n.a.	8.8	9.3	10.0	0.0
d) Financing, insurance, real estate and business services	6.6	8.0	4.5	9.2	9.7	13.7	13.2	13.4	13.5
e) Community, social and personal services	5.4	3.8	5.4	9.2	7.8	14.5	14.1	14.3	14.3
4. Gross Domestic Product at factor cost	**6.0**	**3.8**	**8.5**	**7.5**	**8.4**	**100.0**	**100.0**	**100.0**	**100.0**

Memo:

(Rupees crore)

Sector	2002-03	2003-04@	2004-05*	2005-06#
1. Agriculture and Allied Activities	4,48,740	4,93,690	4,97,351	5,16,603
2. Industry	4,07,481	4,34,489	4,66,513	5,02,164
3. Services	11,96,365	12,97,862	14,29,807	15,76,574
4. Gross Domestic Product at factor cost	20,52,586	22,26,041	23,93,671	25,95,339

@ : Provisional Estimates. * : Quick Estimates. # : Revised Estimates. n.a. : Not available.

$: Corresponds to 'trade, hotels and restaurants' and 'transport, storage and communications'.

Note : Figures in parentheses indicate relative contribution of the sectors to the real GDP growth.

Source : Central Statistical Organisation.

APPENDIX TABLE 5 : QUARTERLY GROWTH RATES AND COMPOSITION OF REAL GROSS DOMESTIC PRODUCT
(At 1999-2000 Prices)

(Per cent)

Sector	2002-03				2003-04				2004-05				2005-06			
	Q_1	Q_2	Q_3	Q_4	Q_1	Q_2	Q_3	Q_4	Q_1	Q_2	Q_3	Q_4	Q_1	Q_2	Q_3	Q_4
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17
1. Agriculture and Allied Activities	**-1.2 (23.2)**	**-4.6 (18.5)**	**-11.9 (24.9)**	**-7.7 (20.6)**	**0.5 (22.1)**	**7.2 (18.2)**	**19.6 (26.7)**	**10.3 (21.0)**	**3.5 (21.2)**	**-0.2 (17.1)**	**-1.2 (24.7)**	**1.5 (19.7)**	**3.4 (20.2)**	**4.0 (16.4)**	**2.9 (23.6)**	**5.5 (19.0)**
2. Industry	**5.4 (19.8)**	**7.3 (21.1)**	**7.2 (19.1)**	**7.2 (19.6)**	**5.7 (19.8)**	**6.0 (20.5)**	**6.5 (18.2)**	**8.1 (19.7)**	**6.6 (19.6)**	**8.0 (20.8)**	**8.1 (18.4)**	**6.8 (19.4)**	**9.5 (19.7)**	**6.3 (20.4)**	**7.0 (18.3)**	**7.9 (19.1)**
of which :																
a) Manufacturing	4.6 (15.1)	7.3 (16.1)	7.4 (14.5)	7.9 (15.1)	6.3 (15.2)	7.1 (15.9)	7.2 (14.0)	7.8 (15.1)	6.6 (15.0)	8.3 (16.1)	9.2 (14.3)	8.1 (15.0)	10.7 (15.3)	8.1 (16.1)	8.3 (14.4)	8.9 (15.0)
b) Mining and quarrying	11.6 (2.3)	9.9 (2.4)	7.2 (2.2)	6.7 (2.3)	3.3 (2.2)	3.0 (2.2)	4.8 (2.1)	9.5 (2.3)	8.2 (2.2)	6.0 (2.2)	5.7 (2.1)	3.7 (2.2)	3.1 (2.1)	-2.6 (2.0)	0.0 (1.9)	3.0 (2.1)
c) Electricity, gas and water Supply	5.2 (2.4)	4.8 (2.6)	5.8 (2.3)	3.2 (2.2)	4.1 (2.4)	2.2 (2.4)	4.2 (2.1)	8.8 (2.2)	4.9 (2.3)	7.9 (2.4)	3.1 (2.1)	1.4 (2.1)	7.4 (2.3)	2.6 (2.3)	5.0 (2.0)	6.1 (2.0)
3. Services	**7.5 (57.0)**	**8.2 (60.4)**	**6.8 (56.1)**	**7.0 (59.8)**	**7.4 (58.1)**	**10.4 (61.2)**	**9.3 (55.0)**	**7.0 (59.3)**	**10.0 (59.2)**	**8.2 (62.2)**	**10.6 (56.9)**	**11.6 (61.0)**	**10.1 (60.0)**	**10.3 (63.2)**	**9.7 (58.1)**	**11.0 (61.9)**
of which :																
a) Construction	7.0 (6.2)	9.1 (6.4)	7.4 (5.8)	7.4 (6.0)	9.3 (6.4)	15.3 (6.8)	9.1 (5.7)	10.0 (6.1)	8.9 (6.5)	6.8 (6.8)	20.8 (6.4)	13.5 (6.4)	12.4 (6.7)	12.3 (7.0)	11.5 (6.7)	12.0 (6.6)
b) Trade, hotels, restaurants, transport, storage and communication	8.8 (23.7)	9.8 (24.4)	8.0 (23.7)	10.0 (24.2)	8.3 (24.3)	10.4 (24.8)	14.6 (24.3)	14.1 (25.6)	10.6 (24.9)	11.2 (25.8)	9.7 (25.0)	11.0 (26.2)	11.7 (25.7)	11.0 (26.4)	10.2 (25.6)	12.9 (27.1)
c) Financing, insurance, real estate and business services	8.7 (14.0)	8.9 (14.6)	7.9 (13.0)	6.7 (13.2)	3.9 (13.8)	4.5 (14.1)	4.6 (12.3)	5.0 (12.9)	8.8 (13.9)	7.5 (14.2)	9.7 (12.6)	10.7 (13.1)	8.8 (13.9)	10.5 (14.5)	8.9 (12.7)	10.5 (13.2)
d) Community, social and personal services	4.4 (13.1)	4.5 (15.0)	3.7 (13.6)	2.9 (16.3)	8.5 (13.5)	14.0 (15.7)	4.8 (12.8)	-3.1 (14.7)	10.7 (13.9)	4.8 (15.4)	8.5 (13.0)	12.7 (15.2)	7.3 (13.7)	8.0 (15.3)	8.4 (13.1)	7.6 (15.0)
4. Gross Domestic Product at factor cost	**5.0 (100.0)**	**5.4 (100.0)**	**1.5 (100.0)**	**3.6 (100.0)**	**5.5 (100.0)**	**8.9 (100.0)**	**11.3 (100.0)**	**7.9 (100.0)**	**7.9 (100.0)**	**6.7 (100.0)**	**7.0 (100.0)**	**8.6 (100.0)**	**8.5 (100.0)**	**8.4 (100.0)**	**7.5 (100.0)**	**9.3 (100.0)**
Memo:																(Rupees crore)
1. Agriculture and Allied Activities	1,13,273	87,175	1,34,839	1,13,453	1,13,864	93,477	1,61,209	1,25,142	1,17,804	93,249	1,59,270	1,27,027	1,21,804	96,961	1,63,829	1,34,010
2. Industry	96,510	99,285	1,03,329	1,08,358	1,01,992	1,05,262	1,10,065	1,17,169	1,08,688	1,13,701	1,18,932	1,25,195	1,18,971	1,20,896	1,27,201	1,35,095
3. Services	2,78,143	2,84,443	3,03,876	3,29,904	2,98,708	3,13,958	3,32,204	3,52,993	3,28,583	3,39,856	3,67,365	3,94,002	3,61,699	3,74,794	4,02,832	4,37,247
4. Gross Domestic Product at factor cost	4,87,926	4,70,903	5,42,045	5,51,715	5,14,565	5,12,697	6,03,477	5,95,303	5,55,075	5,46,807	6,45,567	6,46,223	6,02,474	5,92,651	6,93,864	7,06,351

Note : 1. Figures in parentheses are percentage share to GDP.
2. Quarters Q_1, Q_2, Q_3 and Q_4 denote April-June, July-September, October-December and January-March, respectively.

Source : Central Statistical Organisation.

APPENDIX TABLE 6 : AGRICULTURAL PRODUCTION

(Million tonnes)

Crop	2001-02	2002-03	2003-04	2004-05	2005-06#
1	2	3	4	5	6
1. All Crops: Annual Growth Rate (per cent) $	**7.6**	**-13.2**	**16.1**	**-2.7**	**7.9**
a) Foodgrains	9.4	-14.9	16.4	-7.2	4.4
b) Non-foodgrains	5.4	-11.1	15.6	2.6	11.8
2. Foodgrains (a+b)	**212.9**	**174.8**	**213.2**	**198.4**	**208.3**
i) Rice	93.3	71.8	88.5	83.1	91.0
ii) Wheat	72.8	65.8	72.2	68.6	69.5
iii) Coarse Cereals	33.4	26.1	37.6	33.5	34.7
iv) Pulses	13.4	11.1	14.9	13.1	13.1
a) Kharif	**112.1**	**87.2**	**117.0**	**103.3**	**109.7**
i) Rice	80.5	63.1	78.6	72.2	78.0
ii) Coarse Cereals	26.7	20.0	32.2	26.4	27.0
iii) Pulses	4.8	4.2	6.2	4.7	4.7
b) Rabi	**100.8**	**87.6**	**96.2**	**95.1**	**98.6**
i) Rice	12.8	8.7	9.9	10.9	13.0
ii) Wheat	72.8	65.8	72.2	68.6	69.5
iii) Coarse Cereals	6.7	6.1	5.4	7.1	7.7
iv) Pulses	8.5	7.0	8.7	8.4	8.5
3. Non-foodgrains					
i) Oilseeds ++	20.7	14.8	25.2	24.4	27.7
ii) Sugarcane	297.2	287.4	233.9	237.1	278.4
iii) Cotton @	10.0	8.6	13.7	16.4	19.6
iv) Jute and Mesta +	11.7	11.3	11.2	10.3	10.7
v) Tea*	853.9	838.5	878.1	982.9	928.0
vi) Coffee*	300.6	275.3	270.5	n.a.	n.a.

n.a. : Not available.
\# : Production based on Fourth Advance Estimates.
$: Based on Index of Agricultural Production with base triennium ending 1993-94=100.
++ : For nine oilseeds out of eleven in all.
@ : Million bales of 170 kg. each.
\+ : Million bales of 180 kg. each.
* : Million kilograms; data for tea on a calendar year basis.

Source : Ministry of Agriculture, Government of India.

APPENDIX TABLE 7 : PROCUREMENT, OFF-TAKE AND STOCKS OF FOODGRAINS

(Million tonnes)

Year	Procurement			Off-take			Stocks*		
	Rice	Wheat	Total	Rice	Wheat	Total	Rice	Wheat	Total #
1	2	3	4	5	6	7	8	9	10
1995-96	9.93	12.33	22.16	11.63	12.72	24.35	13.06	7.76	20.82
1996-97	11.88	8.16	20.04	12.31	13.32	25.63	13.17	3.24	16.41
1997-98	14.54	9.30	23.84	11.27	7.76	18.96	13.05	5.08	18.12
1998-99	11.55	12.65	24.20	11.83	8.90	20.73	12.16	9.66	21.82
1999-00	16.62	14.14	30.76	12.42	10.63	23.05	15.72	13.19	28.91
2000-01	18.93	16.36	35.29	10.42	7.79	18.21	23.19	21.50	44.98
2001-02	21.12	20.63	41.75	15.32	15.99	31.30	24.91	26.04	51.02
2002-03	19.00	19.03	38.03	24.85	24.99	49.84	17.16	15.65	32.81
2003-04	20.78	15.80	36.58	25.04	24.29	49.33	13.07	6.93	20.65
2004-05	24.04	16.80	40.84	23.20	18.27	41.47	13.34	4.07	17.97
2005-06	26.90	14.79	41.69	24.82	17.16	41.98	13.68	2.01	16.62
2006-07 $	5.73	9.23	14.96	3.69	2.07	5.76	11.95	9.32	22.30

* : Stocks as at end-March.

\# : Includes coarse grains.

$: Procurement up to August 1, 2006; off-take up to May 2006; stocks as at end-May 2006.

Source : Ministry of Food, Consumer Affairs and Public Distribution, Government of India.

APPENDIX TABLE 8 : TRENDS IN INDEX OF INDUSTRIAL PRODUCTION

(Base : 1993-94=100)

Sector	Mining & Quarrying		Manufacturing		Electricity		General	
Weight	10.473		79.358		10.169		100	
Period	Index	Growth Rate (per cent)	Index	Growth Rate (per cent)	Index	Growth Rate (per cent)	Index	Growth Rate (per cent)
1	2	3	4	5	6	7	8	9
2001-02	131.9	1.3 (3.7)	172.7	2.9 (86.6)	159.2	3.1 (10.8)	167.0	2.8 (100.0)
2002-03	139.6	5.8 (8.4)	183.1	6.0 (86.0)	164.3	3.2 (5.4)	176.6	5.8 (100.0)
2003-04	146.9	5.3 (6.2)	196.6	7.4 (86.4)	172.6	5.0 (6.8)	189.0	7.0 (100.0)
2004-05	153.4	4.4 (4.3)	214.6	9.2 (90.4)	181.5	5.2 (5.7)	204.8	8.4 (100.0)
2005-06 P	154.8	0.9 (0.9)	234.1	9.1 (93.2)	190.9	5.2 (5.8)	221.4	8.1 (100.0)
2004-05								
April-June	146.6	5.7	198.3	8.1	177.2	5.9	190.7	7.7
July-September	144.4	4.6	209.3	9.3	182.5	9.6	199.8	9.0
October-December	157.2	4.9	219.2	10.1	181.5	3.8	208.9	9.1
January-March	165.3	2.6	231.5	9.0	184.8	1.7	219.8	7.8
April-September	145.5	5.1	203.8	8.7	179.9	7.8	195.2	8.3
October-March	161.3	3.7	225.4	9.5	183.2	2.7	214.4	8.4
2005-06 P								
April-June	152.9	4.3	220.6	11.3	190.8	7.7	210.5	10.4
July-September	141.3	-2.1	225.6	7.8	186.2	2.0	212.8	6.5
October-December	156.0	-0.8	236.9	8.1	190.3	4.8	223.7	7.1
January-March	169.0	2.2	253.1	9.3	196.2	6.2	238.5	8.5
April-September	147.1	1.1	223.1	9.5	188.5	4.8	211.7	8.4
October-March	162.5	0.8	245.1	8.7	193.3	5.5	231.1	7.8
2006-07 P								
April-June	158.3	3.5	245.4	11.2	200.6	5.1	231.7	10.1

P : Provisional.

Note : Figures in parentheses are relative contributions, computed as the ratio (in percentage terms) of the change in the index of the respective industry group to the change in the overall index adjusted for the weight of the relative industry group.

Source : Central Statistical Organisation.

APPENDIX TABLE 9 : GROWTH IN INDEX OF SEVENTEEN MAJOR INDUSTRY GROUPS OF MANUFACTURING SECTOR

(Base : 1993-94=100)

Industry Group	Weight	Index		Percentage Variation		Relative Contribution (Per cent)	
		2004-05	2005-06 P	2004-05	2005-06 P	2004-05	2005-06 P
1	2	3	4	5	6	7	8
I. Acceleration	**41.10**						
1. Other manufacturing industries	2.559	221.2	276.6	17.3	25.0	6.2	9.2
2. Beverages, tobacco and related products	2.382	345.9	400.9	10.8	15.9	5.6	8.5
3. Basic metal and alloy Industries	7.453	196.1	226.9	5.5	15.7	5.3	14.8
4. Transport equipment and parts	3.984	283.7	319.7	3.9	12.7	3.1	9.3
5. Non-metallic mineral products	4.397	244.3	270.5	1.5	10.6	1.1	7.4
6. Cotton textiles	5.518	126.3	137.0	7.4	8.5	3.4	3.8
7. Rubber, plastic, petroleum and coal products	5.728	192.2	200.5	2.4	4.3	1.8	3.1
8. Food products	9.083	167.3	170.8	-0.9	2.1	-0.4	2.1
II. Deceleration	**28.95**						
9. Textile products (including wearing apparel)	2.537	219.6	255.5	19.2	16.3	6.3	5.9
10. Machinery and Equipment other than Transport Equipment	9.565	279.4	312.7	19.5	11.8	30.9	20.6
11. Chemicals and chemical products except Products of Petroleum & coal	14.002	238.6	258.2	14.3	8.2	29.6	17.7
12. Jute and other vegetable fibre textiles (except cotton)	0.590	107.2	107.7	3.7	0.5	0.2	0.0
13. Wool, silk and man-made fibre textiles	2.258	249.0	248.9	3.6	0.0	1.3	0.0
III. Negative	**9.30**						
14. Paper and Paper products and printing, Publishing and Allied Activities	2.652	230.7	228.5	9.7	-1.0	4.1	-0.3
15. Metal products and parts (except machinery and equipment)	2.810	166.3	164.4	5.7	-1.1	1.8	-0.3
16. Leather and Leather & fur products	1.139	156.9	147.9	6.9	-5.6	0.8	-0.7
17. Wood and wood products, furniture & fixtures	2.701	74.8	69.7	-9.1	-6.8	-1.3	-0.9
Manufacturing (Total)	**79.35**	**214.6**	**234.1**	**9.2**	**9.1**	**100.0**	**100.0**

P : Provisional.

Note : 1. The industry groups of manufacturing sector have been categorised according to their performance during 2005-06.

2. The relative contribution is computed as the ratio (in percentage terms) of the change in the index of the respective industry group to the change in the overall index adjusted for the weight of the relevant industry group.

Source : Central Statistical Organisation.

APPENDIX TABLE 10 : FREQUENCY DISTRIBUTION OF GROWTH RATES OF SEVENTEEN MAJOR INDUSTRY GROUPS OF MANUFACTURING SECTOR - 2001-02 to 2005-06

(Number of years)

Industry Group	Weight	Negative	0-5 %	5-10 %	10-15 %	15+ %	Above 5% (Col. 5+6+7)
1	2	3	4	5	6	7	8
1. Food products	9.08	3	1	0	1	0	1
2. Beverages, Tobacco and related products	2.38	0	0	1	2	2	5
3. Cotton textiles	5.52	3	0	2	0	0	2
4. Wool, Silk and Man-made fibre textiles	2.26	0	3	1	0	0	1
5. Jute and other Vegetable Fibre Textiles (except cotton)	0.59	2	2	1	0	0	1
6. Textile products (including wearing apparel)	2.54	1	1	0	1	2	3
7. Wood and Wood products, Furniture & Fixtures	2.70	4	0	1	0	0	1
8. Paper and Paper products and Printing, Publishing and Allied Activities	2.65	1	1	2	0	1	3
9. Leather and Leather & Fur products	1.14	3	0	2	0	0	2
10. Basic Chemicals & chemical products (except products of petroleum & coal)	14.00	0	2	2	1	0	3
11. Rubber, Plastic, Petroleum and Coal products	5.73	0	3	1	1	0	2
12. Non-metallic Mineral products	4.40	0	3	1	1	0	2
13. Basic Metal and Alloy Industries	7.45	0	1	3	0	1	4
14. Metal products and parts (except machinery and equipment)	2.81	2	1	2	0	0	2
15. Machinery and Equipment other than Transport Equipment	9.57	0	2	0	1	2	3
16. Transport equipment and parts	3.98	0	1	1	2	1	4
17. Other Manufacturing Industries	2.56	0	1	2	0	2	4

Source : Based on data from the Central Statistical Organisation.

APPENDIX TABLE 11 : USE-BASED CLASSIFICATION OF INDUSTRIAL PRODUCTION

(Base : 1993-94=100)

Industry Group	Weight	Index			Growth Rate (Per cent)					
		2003-04	2004-05	2005-06 P	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06 P
1	2	3	4	5	6	7	8	9	10	11
1. Basic Goods	35.57	168.6	177.9	189.7	3.6 (24.3)	2.7 (31.6)	4.8 (27.4)	5.5 (25.0)	5.5 (20.9)	6.7 (25.3)
2. Capital Goods	9.26	201.5	229.6	265.7	1.7 (3.5)	-3.4 (-11.5)	10.5 (16.2)	13.6 (18.0)	13.9 (16.5)	15.7 (20.1)
3. Intermediate Goods	26.51	199.0	211.1	216.1	4.7 (27.6)	1.6 (15.9)	3.9 (19.3)	6.4 (25.4)	6.1 (20.3)	2.3 (8.0)
4. Consumer Goods (a+b)	28.66	200.9	224.4	251.5	8.0 (46.0)	6.0 (63.1)	7.1 (37.0)	7.2 (31.0)	11.7 (42.6)	12.0 (46.8)
a) Consumer Durables	5.36	265.4	303.5	349.5	14.6 (20.4)	11.5 (31.1)	-6.3 (-8.9)	11.6 (11.9)	14.3 (12.9)	15.2 (14.9)
b) Consumer Non-durables	23.30	186.1	206.2	228.9	5.8 (25.4)	4.1 (32.1)	12.0 (45.9)	5.8 (19.2)	10.8 (29.6)	11.0 (31.9)
IIP - General	**100.00**	**189.0**	**204.8**	**221.4**	**4.9** **(100.0)**	**2.8** **(100.0)**	**5.8** **(100.0)**	**7.0** **(100.0)**	**8.4** **(100.0)**	**8.1** **(100.0)**

P : Provisional.

Note : Figures in parentheses are relative contributions, computed as the ratio (in percentage terms) of the change in the index of the respective industry group to the change in the overall index adjusted for the weight of the relative industry group.

Source : Central Statistical Organisation.

APPENDIX TABLE 12 : GROWTH OF SIX INFRASTRUCTURE INDUSTRIES

(Base : 1993-94=100)

Industry	Weight	Index		Growth Rate (Per cent)				
		2004-05	2005-06 P	2001-02	2002-03	2003-04	2004-05	2005-06 P
1	2	3	4	5	6	7	8	9
1. Electricity	10.17	181.5	190.9	3.1 (35.9)	3.2 (23.7)	5.0 (30.1)	5.2 (32.0)	5.2 (35.5)
2. Coal	3.22	153.1	164.0	4.2 (12.5)	4.5 (8.8)	5.1 (8.0)	6.2 (10.1)	7.1 (13.0)
3. Finished Steel	5.13	263.5	284.2	3.6 (26.8)	7.3 (35.4)	9.8 (39.6)	8.4 (37.0)	7.8 (39.4)
4. Cement	1.99	229.5	257.8	7.4 (18.9)	8.8 (15.0)	6.1 (8.7)	6.6 (10.0)	12.3 (20.9)
5. Crude Petroleum	4.17	125.8	119.2	-1.2 -(4.6)	3.4 (7.8)	0.7 (1.3)	1.8 (3.4)	-5.2 -(10.2)
6. Petroleum Refinery Products	2.00	238.1	243.2	3.7 (10.6)	4.9 (9.1)	8.2 (12.4)	4.3 (6.9)	2.1 (3.8)
Composite Index of Infrastructure Industries #	**26.68**	**193.0**	**203.1**	**3.2 (100.0)**	**5.0 (100.0)**	**6.1 (100.0)**	**5.8 (100.0)**	**5.3 (100.0)**

P : Provisional. # : Estimate based on weighted industry-wise index.

Note : Figures in brackets are relative contributions. The relative contribution is computed as the ratio (in percentage terms) of the change in the index of the respective industry group to the change in the overall index adjusted for the weight of the relative industry group.

Source : Office of the Economic Adviser, Ministry of Commerce and Industry, Government of India.

APPENDIX TABLE 13 : GROSS DOMESTIC SAVING AND INVESTMENT

(Base Year : 1999-2000)

Item	Per cent of GDP (at current market prices)				Amount in Rupees crore		
	Average 1999-2000 to 2001-02	2002-03	2003-04 @	2004-05*	2002-03	2003-04@	2004-05 *
1	2	3	4	5	6	7	8
1. Household Saving *of which :*	**21.5**	**23.1**	**23.5**	**22.0**	**5,65,408**	**6,48,634**	**6,87,079**
a) Financial Assets	10.5	10.3	11.5	10.3	2,53,256	3,16,444	3,20,777
b) Physical Assets	11.0	12.7	12.0	11.7	3,12,152	3,32,190	3,66,302
2. Private Corporate Sector	**4.1**	**4.1**	**4.4**	**4.8**	**99,767**	**1,20,852**	**1,50,947**
3. Public Sector	**-1.5**	**-0.7**	**1.0**	**2.2**	**-16,181**	**28,026**	**69,390**
a) Government Administration	-5.5	-5.2	-3.7	-2.7	-1,28,194	-1,01,206	-84,552
b) Departmental (Commercial) Enterprises	0.9	0.5	0.5	0.5	13,119	14,494	16,468
c) Non-Departmental Enterprises	3.1	4.0	4.2	4.4	98,894	1,14,738	1,37,474
4. Gross Domestic Saving	**24.0**	**26.5**	**28.9**	**29.1**	**6,48,994**	**7,97,512**	**9,07,416**
5. Net Capital Inflow	**0.4**	**-1.2**	**-1.6**	**1.0**	**-28,486**	**-45,380**	**32,139**
6. Gross Domestic Capital Formation	**24.4**	**25.3**	**27.2**	**30.1**	**6,20,508**	**7,52,132**	**9,39,555**
7. Errors and Omissions	**-0.5**	**0.1**	**1.0**	**1.6**	**1,494**	**26,502**	**50,310**
8. Gross Capital Formation *of which :*	**24.9**	**25.3**	**26.3**	**28.5**	**6,19,014**	**7,25,630**	**8,89,245**
a) Public Sector	7.1	6.2	6.5	7.2	1,51,246	1,80,228	2,25,319
b) Private Corporate Sector	6.1	5.8	6.8	8.2	1,41,659	1,88,728	2,57,478
c) Household Sector	11.0	12.7	12.0	11.7	3,12,152	3,32,190	3,66,302
d) Valuables #	0.7	0.6	0.9	1.3	13,957	24,484	40,146
Memo: GDP at Market Prices (at current prices)					24,49,736	27,60,224	31,21,414

@ : Provisional Estimates. * : Quick Estimates.

\# : Valuables cover the expenditures made on acquisition of valuables, excluding works of art and antiques.

Source: Central Statistical Organisation.

APPENDIX TABLE 14 : FINANCIAL SAVING OF THE HOUSEHOLD SECTOR (GROSS)

Item	Per cent to Total Financial Saving			Rupees crore		
	2003-04P	2004-05P	2005-06#	2003-04P	2004-05P	2005-06#
1	2	3	4	2	3	4
Financial Saving (Gross)	**100.0 (13.8)**	**100.0 (14.0)**	**100.0 (16.7)**	**3,80,090**	**4,35,706**	**5,88,656**
a) Currency	11.2 (1.5)	8.5 (1.2)	8.8 (1.5)	42,675	36,977	51,954
b) Deposits	38.3 (5.3)	37.0 (5.2)	47.4 (7.9)	1,45,657	1,61,416	2,78,985
i) With Banks	37.4	36.4	46.7	1,41,973	1,58,393	2,74,704
ii) With Non-banking Companies	1.0	0.8	0.8	3,803	3,370	4,567
iii) With Cooperative Banks and Societies	0.0	0.0	0.0	-6	-134	-64
iv) Trade Debt (Net)	0.0	0.0	0.0	-114	-213	-222
c) Shares and Debentures	0.1 (0.0)	1.1 (0.2)	4.9 (0.8)	492	4,967	29,008
i) Private Corporate Business	1.1	1.4	1.3	4,275	6,124	7,851
ii) Banking	0.0	0.1	0.0	111	263	290
iii) Units of Unit Trust of India	-2.3	-0.7	-0.1	-8,586	-3,146	-444
iv) Bonds of Public Sector undertakings	0.0	0.0	0.0	173	176	172
v) Mutual Funds (Other than UTI)	1.2	0.4	3.6	4,519	1,550	21,139
d) Claims on Government	23.0 (3.2)	24.4 (3.4)	14.7 (2.5)	87,372	1,06,420	86,755
i) Investment in Government securities	7.5	4.9	2.4	28,469	21,313	14,390
ii) Investment in Small Savings, *etc.*	15.5	19.5	12.3	58,903	85,106	72,364
e) Insurance Funds	13.7 (1.9)	16.0 (2.2)	14.2 (2.4)	52,240	69,572	83,340
i) Life Insurance Funds	13.0	15.1	13.5	49,427	65,577	79,426
ii) Postal Insurance	0.3	0.3	0.2	1,098	1,414	1,215
iii) State Insurance	0.5	0.6	0.5	1,715	2,581	2,699
f) Provident and Pension Funds	13.6 (1.9)	12.9 (1.8)	10.0 (1.7)	51,655	56,354	58,615
Memo: GDP at Market Prices (at current prices)				27,60,224	31,21,414	35,31,451

P : Provisional. # : Preliminary Estimates.

Note : 1. Figures in parentheses are percentage to GDP at current market prices.
2. Components may not add up to the totals due to rounding off.

APPENDIX TABLE 15 : VARIATIONS IN RESERVE MONEY

(Amount in Rupees crore)

Item	Outstanding as on March 31, 2006	Variations							
		Financial year				April-June			
		2004-05		2005-06		2005-06		2006-07	
		Absolute	Per cent	Absolute	Per cent	Absolute	Per cent	Absolute	Per cent
1	2	3	4	5	6	7	8	9	10
Reserve Money (C.1+C.2+C.3 = S.1+S.2+S.3+S.4+S.5-S.6)	**573066**	**52623**	**12.1**	**83930**	**17.2**	**7177**	**1.5**	**15215**	**2.7**
Components									
C.1. Currency in Circulation	430676	41633	12.7	62015	16.8	19877	5.4	23268	5.4
C.2. Bankers' Deposits with the RBI	135511	9631	9.2	21515	18.9	-10680	-9.4	-7204	-5.3
C.3. 'Other' Deposits with the RBI	6879	1359	26.5	401	6.2	-2021	-31.2	-849	-12.3
Sources									
S.1. Net RBI Credit to Government (a+b)	8136	-62882		26111		9275		53	
a) Net RBI credit to Central Government (i-ii)	**5160**	**-60177**		**28417**		**14600**	**-62.8**	**3071**	**59.5**
i) Claims on Central Government	70563	12380	27.9	13876	24.5	8181	14.4	-27601	-39.1
ii) Deposits of Central Government	65404	72558		-14541		-6419	-8.0	-30672	-46.9
b) Net RBI credit to State Governments (i-ii)	2977	-2705	-33.9	-2306	-43.7	-5324	-100.8	-3018	-101.4
i) Claims on State governments	2977	-2705	-33.9	-2306	-43.7	-5283	-100.0	-2977	-100.0
ii) Deposits of State governments	0	0		0		41		41	
S.2. RBI's Claims on Commercial and Co-operative banks	5795	-161	-3.0	537	10.2	1155	22.0	-3135	-54.1
of which: Loans and Advances to Scheduled Commercial Banks*	1488	95		1393		-95		-1486	
S.3. RBI's Credit to Commercial Sector	1387	-672	-32.6	-3	-0.2	0	0.0	0	0.0
S.4. Net Foreign Exchange Assets of the RBI	**672983**	**128377**	**26.5**	**60193**	**9.8**	**-14595**	**-2.4**	**71845**	**10.7**
S.5. Government's Currency Liabilities to the Public	8754	152	2.1	1306	17.5	384	5.2	64	0.7
S.6. Net Non-monetary Liabilities of the RBI	123990	12191	11.3	4215	3.5	-10957	-9.1	53612	43.2
S.7. Net Domestic Assets of the RBI (S.1+S.2+S.3+S.5-S.6)	**-99918**	**-75754**		**23737**	**-19.2**	**21771**	**-17.6**	**-56631**	**56.7**

– : Not applicable.

* : Excluding RBI's additional subscription to capital of State Bank of India.

Note : Data are provisional.

APPENDIX TABLE 16 : RESERVE BANK OF INDIA SURVEY

(Amount in Rupees crore)

Item	Outstanding as on March 31, 2006	Variations							
		Financial year				April-June			
		2004-05		2005-06		2005-06		2006-07	
		Absolute	Per cent	Absolute	Per cent	Absolute	Per cent	Absolute	Per cent
1	2	3	4	5	6	7	8	9	10
Components									
C.I Currency in Circulation	430676	41633	12.7	62015	16.8	19877	5.4	23268	5.4
C.II Bankers' Deposits with the RBI	135511	9631	9.2	21515	18.9	-10680	-9.4	-7204	-5.3
C.II.1 Scheduled Commercial Banks	127061	9343	9.6	20402	19.1	-10672	-10.0	-6738	-5.3
C.III 'Other' Deposits with the RBI	6879	1359	26.5	401	6.2	-2021	-31.2	-849	-12.3
Reserve Money (C.I+C.II+C.III = S.I + S.II+ S.III - S.IV - S.V)	**573066**	**52623**	**12.1**	**83930**	**17.2**	**7177**	**1.5**	**15215**	**2.7**
Sources									
S.I RBI's Domestic Credit (S.I.1+S.I.2+S.I.3)	**15319**	**-63715**		**26646**		**10430**	**-92.1**	**-3082**	**-20.1**
S.I.1 Net RBI credit to the Government (S.I.1.1+S.I.1.2)	8136	-62882		26111		9275		53	
S.I.1.1 Net RBI credit to the Central Government (S.I.1.1.1+S.I.1.1.2+S.I.1.1.3+S.I.1.1.4-S.I.1.1.5)	5160	-60177		28417		14600		3071	
S.I.1.1.1 Loans and Advances to the Central Government	0	0		0		0		0	
S.I.1.1.2 Investments in Treasury Bills	0	0		0		0		0	
S.I.1.1.3 Investments in dated Government Securities	70409	12323	27.9	13869	24.5	8221	14.5	-27610	-39.2
S.I.1.1.3.1 Central Government Securities	69362	14272	35.0	14340	26.1	8221	14.9	-27610	-39.8
S.I.1.1.4 Rupee Coins	154	57	63.9	7	4.9	-40	-27.1	9	5.9
S.I.1.1.5 Deposits of the Central Government	65404	72558		-14541		-6419	-8.0	-30672	-46.9
S.I.1.2 Net RBI credit to State Governments	2977	-2705		-2306		-5324		-3018	
S.I.2 RBI's Claims on Banks	2797	105		1467		-93	-7.0	-1557	-55.6
S.I.2.1 Loans and Advances to Scheduled Commercial Banks	1488	95		1393		-95		-1486	
S.I.3 RBI's Credit to Commercial Sector	4385	-938	-15.0	-932	-17.5	1248	23.5	-1578	-36.0
S.I.3.1 Loans and Advances to Primary Dealers	0	0		0		0		0	
S.I.3.2 Loans and Advances to NABARD	2998	-266	-6.4	-929	-23.7	1248	31.8	-1578	-52.7
S.II Government's Currency Liabilities to the Public	8754	152	2.1	1306	17.5	384	5.2	64	0.7
S.III Net Foreign Exchange Assets of the RBI	**672983**	**128377**	**26.5**	**60193**	**9.8**	**-14595**	**-2.4**	**71845**	**10.7**
S.III.1 Gold	25674	1471	8.1	5988	30.4	-567	-2.9	6875	26.8
S.III.2 Foreign Currency Assets	647327	126907	27.2	54205	9.1	-14028	-2.4	64971	10.0
S.IV Capital Account	**116647**	**14461**	**13.9**	**-1870**	**-1.6**	**-19637**	**-16.6**	**43736**	**37.5**
S.V Other Items (net)	**7343**	**-2270**		**6085**		**8680**		**9877**	

Note : Data are provisional.

APPENDIX TABLE 17 : VARIATIONS IN MONEY STOCK

(Amount in Rupees crore)

Item	Outstanding as on March 31, 2006	Variations							
		Financial Year				April-June			
		2004-05		2005-06		2005-06		2006-07	
		Absolute	Per cent	Absolute	Per cent	Absolute	Per cent	Absolute	Per cent
1	2	3	4	5	6	7	8	9	10
Broad Money (M_3) (C.1+C.2+C.3 = S.1+S.2+S.3+S.4-S.5)	**2729535**	**245773 (242260)**	**12.3 (12.1)**	**396868**	**17.0**	**27,448**	**1.2**	**58060**	**2.1**
Components									
C.1. Currency with the Public	413143	40892	13.0	58272	16.4	20492	5.8	25795	6.2
C.2. Aggregate Deposits with Banks (a+b)	2309514	203522	12.1	338037	17.1	8819	0.4	33115	1.4
a) Demand Deposits	405224	26528	10.3	83861	26.1	-21953	-6.8	-41704	-10.3
b) Time Deposits	1904290	176994 (173481)	12.4 (12.2)	254176	15.4	30772	1.9	74818	3.9
C.3. 'Other' Deposits with the RBI	6879	1359	26.5	560	8.9	-1862	-29.5	-849	-12.3
Sources									
S.1. Net Bank Credit to Government (A+B)	**769093**	**13863 (1670)**	**1.9 (0.2)**	**20386**	**2.7**	**17398**	**2.3**	**20090**	**2.6**
A. Net RBI Credit to Government (a+b)	8136	-62882		35799		18963		53	
a. Net RBI Credit to Central Government	5160	-60177		33374		19556		3071	
b. Net RBI Credit to State Governments	2977	-2705		2425		-593		-3018	
B. Other Banks' Credit to Government	760956	76745	11.0	-15413	-2.0	-1565	-0.2	20037	2.6
S.2. Bank Credit to Commercial Sector (a+b)	**1690961**	**264098 (231216)**	**26.0 (22.8)**	**359703**	**27.2**	**10235**	**0.8**	**21879**	**1.3**
a) RBI's Credit to Commercial Sector	1387	-672	-32.6	-3	-0.2	0	0.0	0	0.0
b) Other banks' Credit to Commercial Sector	1689574	264770	26.1	359706	27.0	10235	0.8	21879	1.3
S.3. Net Foreign Exchange Assets of Banking Sector (a+b)	**726194**	**122669**	**23.3**	**78291**	**12.1**	**-12026**	**-1.9**	**71845**	**9.9**
a) RBI's Net Foreign Exchange Assets	672983	128377	26.5	61545	10.1	-13243	-2.2	71845	10.7
b) Other Banks' net Foreign Exchange Assets	53211	-5709	-13.5	16746	45.9	1217	3.3	0	0.0
S.4. Government's Currency Liabilities to the Public	**8754**	**152**	**2.1**	**1306**	**17.5**	**384**	**5.2**	**64**	**0.7**
S.5. Banking Sector's Net Non-Monetary Liabilities (a+b)	**465466**	**155008**	**54.0**	**62817**	**15.6**	**-11456**	**-2.8**	**55818**	**12.0**
a) Net Non-Monetary Liabilities of RBI	123990	12191	11.3	776	0.6	-14395	-11.7	53612	43.2
b) Net Non-Monetary Liabilities of Other Banks (residual)	341476	142817	79.5	62041	22.2	2939	1.1	2206	0.6
Memo : Select Monetary Ratios									
1. M_3 Multiplier	4.8								
2. Bank Reserves to Aggregate Deposits Ratio	6.6								
3. Currency to Aggregate Deposits Ratio	17.9								
4. Narrow Money (M_1)[C.1+C.2(a)+C.3]	825245	68779	11.9	142692	20.9	-3324	-0.5	-16758	-2.0

Note :
1. Data are provisional.
2. Data reflect redemption of India Millenniun Deposits (IMDs) on December 29, 2005.
3. Figures in parentheses exclude the impact of conversion of a non-banking entity into a banking entity on October 11, 2004.
4. Variation during 2005-06 is worked out from April 1, 2005, whereas variations during 2004-05 and 2006-07 are worked out from March 31, 2004 and March 31, 2006, respecitively.

APPENDIX TABLE 18 : NEW MONETARY AGGREGATES

(Amount in Rupees crore)

Item	Outstanding as on March 31, 2006	Variations							
		Financial year				April-June			
		2004-05		2005-06		2005-06		2006-07	
		Absolute	Per cent	Absolute	Per cent	Absolute	Per cent	Absolute	Per cent
1	2	3	4	5	6	7	8	9	10
Monetary Aggregates									
M_1 (C.I+C.II.1+C.III)	829139	74845	13.0	141702	20.6	-3233	-0.5	-16838	-2.0
NM_2 (M_1+C.II.2.1)	1655020	148325	12.5	262387	18.8	10072	0.7	15410	0.9
NM_3 (NM_2+C.II.2.2+C.IV = S.I+S.II+S.III-S.IV-S.V)	**2747575**	**282988 (244300)**	**14.4 (12.5)**	**421114**	**18.1**	**25333**	**1.1**	**57814**	**2.1**
Components									
C.I Currency with the Public	**413166**	**41089**	**13.1**	**58322**	**16.4**	**20502**	**5.8**	**25828**	**6.3**
C.II Aggregate Deposits of Residents (C.II.1+C.II.2)	**2244386**	**195687**	**12.1**	**351009**	**18.5**	**7696**	**0.4**	**29844**	**1.3**
C.II.1 Demand Deposits	409094	32397	12.6	82820	25.4	-21873	-6.7	-41817	-10.2
C.II.2 Time Deposits of Residents (C.II.2.1+C.II.2.2)	1835292	163291 (159778)	12.0 (11.8)	268188	17.1	29568	1.9	71662	3.9
C.II.2.1 Short-term Time Deposits	825882	73481	12.0	120685	17.1	13306	1.9	32248	3.9
C.II.2.1.1 Certificates of Deposits (CDs)	44499	6201		28972		3589	23.1	14946	33.6
C.II.2.2 Long-term Time Deposits	1009411	89810	12.0	147504	17.1	16263	1.9	39414	3.9
C.III 'Other' Deposits with the RBI	**6879**	**1359**	**26.5**	**560**	**8.9**	**-1862**	**-29.5**	**-849**	**-12.3**
C.IV Call/Term Funding from Financial Institutions	**83144**	**44853 (9678)**	**181.8 (39.2)**	**11224**	**15.6**	**-1002**	**-1.4**	**2990**	**3.6**
Sources									
S.I Domestic Credit (S.I.1+S.I.2)	**2595123**	**265204**	**13.8**	**367521**	**16.5**	**33136**	**1.5**	**50323**	**1.9**
S.I.1 Net Bank Credit to the Government (S.I.1.1+S.I.1.2)	760129	3808 (-8385)	0.5 (-1.1)	19014	2.6	16897	2.3	20087	2.6
S.I.1.1 Net RBI Credit to the Government	8136	-62882		35799		18963		53	
S.I.1.2 Credit to the Government by the Banking System	751993	66690	9.5	-16785	-2.2	-2066	-0.3	20035	2.7
S.I.2 Bank Credit to the Commercial Sector (S.I.2.1+S.I.2.2)	1834994	261397 (228515)	22.3 (19.5)	348507	23.4	16239	1.1	30325	1.6
S.I.2.1 RBI Credit to the Commercial Sector	4385	-938	-15.0	-918	-17.3	1262	23.8	-1578	-36.0
S.I.2.2 Credit to the Commercial Sector by the Banking System	1830609	262335	22.5	349425	23.6	14977	1.0	31814	1.7
S.I.2.2.1 Other Investments (Non-SLR Securities)	144303	5384	3.6	-11838	-7.6	-2730	-1.7	11810	8.2
S.II Government's Currency Liabilities to the Public	8754	152	2.1	1306	17.5	384	5.2	64	0.7
S.III Net Foreign Exchange Assets of the Banking Sector (S.III.1+S.III.2)	627368	110751	26.0	91186	17.0	-15300	-2.9	51542	8.2
S.III.1 Net Foreign Exchange Assets of the RBI	672983	128377	26.5	61545	10.1	-13243	-2.2	71845	10.7
S.III.2 Net Foreign Currency Assets of the Banking System	-45616	-17626		29640		-2057		-20304	
S.IV Capital Account	318544	43534	18.7	39911	14.3	2182	0.8	53167	16.7
S.V Other Items (net)	165125	49586	31.2	-1012	-0.6	-9295	-5.6	-9053	-5.5

Note : 1. Data are provisional.

2. Data reflect redemption of India Millenniun Deposits (IMDs) on December 29, 2005.

3. Variation during 2005-06 is worked out from April 1, 2005, whereas variations during 2004-05 and 2006-07 are worked out from March 31, 2004 and March 31, 2006, respecitively.

APPENDIX TABLE 19 : LIQUIDITY AGGREGATES

(Rupees crore)

Month/Year	NM_3	Postal Deposits	L_1	Liabilities of Financial Institutions				L_2	Public Deposits with NBFCs	L_3
				Term Money Borrowings	CDs	Term Deposits	Total			
1	**2**	3	**4=(2+3)**	5	6	7	8=(5+6+7)	**9=(4+8)**	10	**11=(9+10)**
2004-05										
April	**2015525**	72445	**2087970**	1653	609	3582	5844	**2093814**		
May	**2019707**	73880	**2093587**	1726	583	3447	5756	**2099343**		
June	**2029709**	75446	**2105155**	1659	930	3873	6462	**2111617**	19224	**2130841**
July	**2039266**	76941	**2116207**	1476	905	3867	6248	**2122455**		
August	**2057376**	78361	**2135737**	3081	231	3517	6829	**2142566**		
September	**2049006**	79668	**2128674**	3026	231	3538	6795	**2135469**	19244	**2154713**
October	**2124187**	81000	**2205187**	1427	85	289	1801	**2206988**		
November	**2130979**	82114	**2213093**	1191	85	258	1534	**2214627**		
December	**2140764**	83647	**2224411**	1564	85	248	1897	**2226308**	19898	**2246206**
January	**2187976**	84808	**2272784**	1421	85	247	1753	**2274537**		
February	**2210228**	85868	**2296096**	1319	85	247	1651	**2297747**		
March	**2243174**	88647	**2331821**	1848	30	245	2123	**2333944**	19840	**2353785**
2005-06										
April	**2329999**	89718	**2419717**	2474	30	245	2749	**2422466**		
May	**2340363**	91306	**2431669**	3027	31	245	3303	**2434972**		
June	**2351794**	92870	**2444664**	2954	30	242	3226	**2447890**	20797	**2468687**
July	**2367507**	94376	**2461883**	2978	31	243	3252	**2465135**		
August	**2395530**	95885	**2491415**	2991	31	246	3268	**2494683**		
September	**2480351**	97248	**2577599**	2655	31	235	2921	**2580520**	21694	**2602214**
October	**2487996**	98418	**2586414**	2656	31	245	2932	**2589346**		
November	**2500696**	99771	**2600467**	2656	31	245	2932	**2603399**		
December	**2526097**	101199	**2627296**	2656	31	245	2932	**2630228**	21694	**2651922**
January	**2566932**	101832	**2668764**	2656	31	245	2932	**2671696**		
February	**2595593**	102121	**2697714**	2656	31	245	2932	**2700646**		
March	**2747575**	103789	**2851364**	2656	31	245	2932	**2854296**	21694	**2875990**
2006-07										
April	**2785261**	103789	**2889050**	2656	31	245	2932	**2891982**		
May	**2787956**	103789	**2891745**	2656	31	245	2932	**2894677**		
June	**2805389**	103789	**2909178**	2656	31	245	2932	**2912110**	21694	**2933804**

CDs : Certificates of Deposit; L_1, L_2 and L_3 : Liquidity Aggregates; NBFCs : Non-Banking Financial Companies.

Note: 1. Postal Deposits comprise post office savings bank deposits, post office time deposits, post office recurring deposits, other deposits and post office cumulative time deposits.

2. Financial Institutions (FIs), here, comprise IFCI, EXIM Bank, IIBI, SIDBI, NABARD, NHB, TFCI and IDFC. Since October 2004, data on FIs do not include that of IDBI reflecting its conversion into a banking entity.
3. Since July 2001, the term money borrowings of the FIs comprise borrowings from corporate and others.
4. Since August 2002,Term Deposits include CP and Others.
5. Estimates of public deposits are generated on the basis of returns received from all NBFCs with public deposits of Rs. 20 crore and more as had been recommended by the Working Group.
6. While L_1 and L_2 are compiled on a monthly basis, L_3 is compiled on a quarterly basis.
7. Data are provisional. Wherever data are not available, the estimates for the last available month have been repeated.

APPENDIX TABLE 20 : IMPORTANT BANKING INDICATORS - SCHEDULED COMMERCIAL BANKS

(Amount in Rupees crore)

Item	Outstanding as on March 31, 2006	Variations							
		Financial year				April-June			
		2004-05		2005-06		2005-06		2006-07 P	
		Absolute	Per cent	Absolute	Per cent	Absolute	Per cent	Absolute	Per cent
1	2	3	4	5	6	7	8	9	10
1. Gross Demand and Time Liabilites (2+3+4+6)	**24,56,137**	**2,97,873**	**17.2**	**3,31,212**	**15.6**	**-31,774**	**-1.5**	**32,698**	**1.3**
2. Aggregate Deposits (a+b)	**21,09,049**	**1,95,782 (1,92,269)**	**13.0 (12.8)**	**3,23,913**	**18.1**	**7,949**	**0.4**	**36,450**	**1.7**
a. Demand deposits	3,64,640	23,005	10.2	78,623	27.5	-22,249	-7.8	-39,951	-11.0
b. Time deposits	17,44,409	1,72,777 (1,69,264)	13.5 (13.2)	2,45,291	16.4	30,198	2.0	76,401	4.4
3. Other Borrowings #	83,144	44,853	181.8	11,224	15.6	-1,002	-1.4	2,990	3.6
4. Other Demand and Time Liabilities	1,88,780	44,676	30.2	1,763	0.9	-37,238	-19.9	-1,705	-0.9
5. Borrowings from the RBI	1,488	50	–	1,393	–	-95	–	-1,486	-99.9
6. Inter-bank Liabilities	75,165	12,562	23.1	-5,688	-7.0	-1,483	-1.8	-5,038	-6.7
7. Bank Credit (a+b)	**15,07,077**	**2,59,643 (2,26,761)**	**30.9 (27.0)**	**3,54,868**	**30.8**	**8,994**	**0.8**	**16,091**	**1.1**
a. Food Credit	40,691	5,159	14.3	675	1.7	4,788	12.0	607	1.5
b. Non-food Credit	14,66,386	2,54,484 (2,21,602)	31.6 (27.5)	3,54,193	31.8	4,206	0.4	15,484	1.1
8. Investments (a+b)	**7,17,454**	**61,566 (49,373)**	**9.1 (7.3)**	**-22,809**	**-3.1**	**-1,988**	**-0.3**	**26,320**	**3.7**
a. Government securities	7,00,742	64,224 (52,031)	9.8 (7.9)	-19,514	-2.7	-1,457	-0.2	20,395	2.9
b. Other approved securities	16,712	-2,658	-11.6	-3,295	-16.5	-532	-2.7	5,925	35.4
9. Cash in hand	13,046	574	7.3	2,897	28.5	-38	-0.4	-1,111	-8.5
10. Balances with the RBI	1,27,061	19,108	27.7	34,077	36.6	3,003	3.2	-6,739	-5.3
11. Inter-Bank Assets	54,392	3,118	6.5	-5,133	-8.6	-1,958	-3.3	-935	-1.7
12. Credit-Deposit Ratio (%)	71.5		132.6 (117.9)		109.6		113.1		44.1
13. Non-food Credit-Deposit Ratio (%)	69.5		130.0 (115.3)		109.3		52.9		42.5
14. Investment-Deposit Ratio (%)	34.0		31.4 (25.7)		-7.0		-25.0		72.2

P : Provisional.

\# : Other than from RBI/ IDBI/ NABARD/ EXIM Bank.

Note : 1. Figures in parentheses exclude the impact of conversion of a non-banking entity into a banking entity from October 11, 2004.

2. Variation during 2005-06 is worked out from April 1, 2005, whereas variations during 2004-05 and 2006-07 are worked out from March 19, 2004 and March 31, 2006, respecitively.

APPENDIX TABLE 21 : COMMERCIAL BANK SURVEY

(Amount in Rupees crore)

Item	Outstanding as on March 31, 2006	Variations							
		Financial year				April-June			
		2004-05		2005-06		2005-06		2006-07	
		Absolute	Per cent	Absolute	Per cent	Absolute	Per cent	Absolute	Per cent
1	2	3	4	5	6	7	8	9	10
Components									
C.I Aggregate Deposits of Residents (C.I.1+C.I.2)	**2049773**	**194980**	**13.6**	**340789**	**19.9**	**7145**	**0.4**	**33458**	**1.6**
C.I.1 Demand Deposits	364640	23005	10.2	78623	27.5	-22249	-7.8	-39951	-11.0
C.I.2 Time Deposits of Residents (C.I.2.1+C.I.2.2)	1685133	171975 (168462)	14.3 (14.0)	262167	18.4	29394	2.1	73409	4.4
C.I.2.1 Short-term Time Deposits	758310	77389	14.3	117975	18.4	13227	2.1	33034	4.4
C.I.2.1.1 Certificates of Deposits (CDs)	44,499	6201		28972		3589		14946	
C.I.2.2 Long-term Time Deposits	926823	94586	14.3	144192	18.4	16167	2.1	40375	4.4
C.II Call/Term Funding from Financial Institutions	**83144**	**44853 (9678)**	**181.8 (39.2)**	**11224**	**15.6**	**-1002**	**-1.4**	**2990**	**3.6**
Sources									
S.I Domestic Credit (S.I.1+S.I.2)	**2364241**	**326410**	**19.7**	**322807**	**15.8**	**11405**	**0.6**	**52256**	**2.2**
S.I.1 Credit to the Government	700742	64224 (52031)	9.8 (7.9)	-19514	-2.7	-1457	-0.2	20395	2.9
S.I.2 Credit to the Commercial Sector (S.I.2.1+S.I.2.2+S.I.2.3+S.I.2.4)	1663499	262186 (229304)	26.1 (22.8)	342321	25.9	12862	1.0	31861	1.9
S.I.2.1 Bank Credit	1507077	259643	30.9	354868	30.8	8994	0.8	16091	1.1
S.I.2.2 Net Credit to Primary Dealers	4369	-499		2586		7130		-1963	
S.I.2.3 Investments in Other Approved Securities	16712	-2658	-11.6	-3295	-16.5	-532	-2.7	5924	35.4
S.I.2.4 Other Investments (in non-SLR Securities)	135340	5699	4.1	-11838	-8.0	-2730	-1.9	11810	8.7
S.II Net Foreign Currency Assets of Commercial Banks (S.II.1-S.II.2-S.II.3)	**-45616**	**-17626**		**29640**		**-2057**		**-20304**	
S.II.1 Foreign Currency Assets	43493	-8295	-24.1	14059	47.8	-2179	-7.4	-13887	-31.9
S.II.2 Non-resident Foreign Currency Repatriable Fixed Deposits	59275	802	1.1	-16876	-22.2	804	1.1	2992	5.0
S.II.3 Overseas Foreign Currency Borrowings	29834	8529	49.8	1295	4.5	-925	-3.2	3425	11.5
S.III Net Bank Reserves (S.III.1+S.III.2-S.III.3)	**138619**	**19632**	**25.5**	**35581**	**34.5**	**3060**	**3.0**	**-6363**	**-4.6**
S.III.1 Balances with the RBI	127061	19108	27.7	34077	36.6	3003	3.2	-6738	-5.3
S.III.2 Cash in Hand	13046	574	7.3	2897	28.5	-38	-0.4	-1110	-8.5
S.III.3 Loans and Advances from the RBI	1488	50		1393		-95		-1486	
S.IV Capital Account	**177727**	**29135**	**27.9**	**40320**	**29.3**	**20359**	**14.8**	**9432**	**5.3**
S.V. Other Items (net) (S.I+S.II+S.III-S.IV-C.I-C.II)	**146600**	**59448**	**48.9**	**-4304**	**-2.9**	**-14094**	**-9.3**	**-20291**	**-13.8**
S.V.1 Other Demand and Time Liabilities (net of S.II.3)	158946	36146	27.6	468	0.3	-36312	-22.9	-5130	-3.2
S.V.2 Net Inter-Bank Liabilities (other than to PDs)	25141	8945	108.4	2031	8.8	7605	32.9	-6066	-24.1

Note : 1. Data are provisional.
2. Data reflect redemption of Indian Millennium Deposits (IMDs).
3. Variation during 2005-06 is worked out from April 1, 2005, whereas variations during 2004-05 and 2006-07 are worked out from March 19, 2004 and March 31, 2006, respecitively.

APPENDIX TABLE 22 : SECTORAL DEPLOYMENT OF GROSS BANK CREDIT

(Amount in Rupees crore)

Sector	Outstanding as on			Variations during			
	March 19, 2004	March 18, 2005	March 31, 2006	2004-05		2005-06	
				Absolute	Per cent	Absolute	Per cent
1	2	3	4	5	6	7	8
I. Gross Bank Credit (II + III)	764383	1040909	1445837	193229	25.3	404928	38.9
II. Food Credit	35961	41121	40691	5160	14.3	-430	-1.0
III. Non-Food Gross Bank Credit (1 to 6)	728422	999788	1405146	188069	25.8	405358	40.5
1. Agriculture and Allied Activities	90541	125250	172292	31774	35.1	47042	37.6
2. Industry (Small, Medium and Large)	313065	426892	549057	62014	19.8	122165	28.6
of which, Small Scale Industries	65855	74588	90239	8051	12.2	15651	21.0
3. Services	n.a.	30584	48137	n.a.	n.a.	17553	57.4
3.1 Transport Operators	n.a.	9599	16101	n.a.	n.a.	6502	67.7
3.5 Professional and Other Services	n.a.	13261	16070	n.a.	n.a.	2809	21.2
4. Personal Loans	n.a.	245080	353777	n.a.	n.a.	108697	44.4
4.1 Consumer Durables	8274	9083	8783	108	1.3	-300	-3.3
4.2 Housing	n.a.	128728	186429	n.a. (23,192)	n.a. (44.6)	57701	44.8
of which, Priority Sector Housing	n.a.	90848	133360	n.a.	n.a.	42512	46.8
4.3 Advances against Fixed Deposits (including FCNR (B), NRNR Deposits *etc.*)	26346	29850	34897	3259	12.4	5047	16.9
4.5 Credit Card Outstandings	n.a.	5760	9177	n.a.	n.a.	3417	59.3
4.6 Education	n.a.	5119	10057	n.a.	n.a.	4938	96.5
5. Trade	24867	57948	81402	31262	125.7	23454	40.5
6. Others	299949	114034	200481	n.a.	n.a.	86447	75.8
6.1 Real Estate Loans	5577	13302	26682	7622	136.7	13380	100.6
6.2 Non-Banking Financial Companies	16802	22484	30942	2501	14.9	8458	37.6
Memo Item:							
7. Priority Sector	263834	381476	509910	106235	40.3	128434	33.7

n. a. : Not available.

Note :
1. Data are provisional and pertain to 52 selected scheduled commercial banks for March 2005 and March 2006 as compared to 47 banks for March 2004.
2. Gross bank credit data include bills rediscounted with Reserve Bank, IDBI, EXIM Bank, other approved financial institutions and inter-bank participations.
3. Owing to reclassification of sectors/industries and increase in coverage of banks, data for 2005-06 are not strictly comparable with earlier data.
4. Data on housing loans for 2005-06 are also inclusive of loans less than 15 lakhs.
5. Figures in parentheses for 2004-05 pertain only to housing loans of above Rs. 15 lakh.
6. Data in this statement may not match with those quoted elsewhere in the report due to differences in the data source.

APPENDIX TABLE 23 : INDUSTRY-WISE DEPLOYMENT OF GROSS BANK CREDIT

(Amount in Rupees crore)

Sector	Outstanding as on			Variations during			
	March 19, 2004	March 18, 2005	March 31, 2006	2004-05		2005-06	
				Absolute	Per cent	Absolute	Per cent
1	2	3	4	5	6	7	8
1. Insustries (Small, Medium and Large Scale)	313065	426892	549057	62014	19.8	122165	28.6
2. Mining and Quarrying (including Coal)	2800	2170	4431	-684	-24.4	2261	104.2
3. Food Processing	20676	24433	30843	1109	5.4	6410	26.2
4. Beverage and Tobacco	891	2091	3584	783	87.9	1493	71.4
5. Textiles	34158	43977	57716	4648	13.6	13739	31.2
6. Leather and Leather Products	3167	3305	4419	83	2.6	1114	33.7
7. Wood and Wood Products	n.a.	438	1424	n.a.	n.a.	986	225.1
8. Paper and Paper Products	5990	6882	9218	-228	-3.8	2336	33.9
9. Petroleum, Coal Products and Nuclear Fuels	13431	15569	24103	1426	10.6	8534	54.8
10. Chemicals and Chemical Products	30629	39492	48935	1661	5.4	9443	23.9
11. Rubber, Plastic and their Products	2593	3666	6989	717	27.7	3323	90.6
12. Glass and Glass Ware	n.a.	390	1811	n.a.	n.a.	1421	364.4
13. Cement and Cement Products	5689	8059	7578	569	10.0	-481	-6.0
14. Basic Metals and Metal Products	34463	47637	64821	5058	14.7	17184	36.1
15. All Engineering	26348	29396	34666	273	1.0	5270	17.9
16. Vehicles, Vehicle Parts and Transport Equipments	5302	11862	18667	2900	54.7	6805	57.4
17. Gems and Jewellery	9178	14306	19866	3013	32.8	5560	38.9
18. Construction	5978	8122	13867	1708	28.6	5745	70.7
19. Infrastructure	51314	79009	108787	21829	42.5	29778	37.7
20. Other Industries	60458	86088	87332	16465	27.2	1244	1.4

n.a. : Data not available as these categories were not shown separately under the old classification.

Note :
1. Data are provisional and pertain to 52 selected scheduled commercial banks for March 2005 and March 2006 as compared to 47 banks for March 2004.
2. Due to reclassification of industries and increase in coverage of banks, data for the 2005-06 are not strictly comparable with earlier data.

APPENDIX TABLE 24 : RESERVE BANK'S ACCOMMODATION TO SCHEDULED COMMERCIAL BANKS

(Amount in Rupees crore)

Item	2006-07	2005-06				2004-05
	June	March	December	September	June	March
1	2	3	4	5	6	7
1. Export Credit Refinance						
A) Limit	**6,514**	**6,051**	**5,195**	**4,815**	**4,884**	**4,928**
B) Outstanding	**2**	**1,568**	**460**	**800**	**0**	**50**
Memo Items:						
1. Aggregate Export Credit $	93,067	86,207	81,965	75,391	70,434	69,059
2. Export Credit Eligible for Refinance	43,423	40,338	34,632	32,096	32,561	32,854
3. Aggregate Export Credit as Percentage of Net Bank Credit	6.1	5.7	6.1	5.9	6.0	6.3

$: Inclusive of Rupee export credit, preshipment credit in foreign currency (PCFC), rediscounting of export bills abroad (EBR) and overdue export credit.

Note : 1. Data pertain to the last reporting Friday of the month.

2. Effective April 1, 2002, ECR facility is being provided to the banks to the extent of 15 per cent of the outstanding export credit eligible for refinance as at the end of second preceding fortnight.

APPENDIX TABLE 25 : VARIATIONS IN INDEX NUMBERS OF WHOLESALE PRICES (BASE : 1993-94 = 100)

(Per cent)

Major Group/Sub-group/ Commodity	Weight	Variations				End-June	
		Point-to-point basis		Average basis		Point-to-point basis	
		2004-05	2005-06	2004-05	2005-06	2005-06	2006-07 P
1	2	3	4	5	6	7	8
All Commodities	**100.000**	**5.1**	**4.1**	**6.4**	**4.4**	**4.3**	**4.8**
I. Primary Articles	**22.025**	**1.3**	**5.4**	**3.7**	**2.9**	**1.1**	**7.1**
1. Food articles	15.402	3.0	6.6	2.7	4.8	4.1	7.5
a) Cereals	4.406	2.9	6.2	0.9	4.5	5.3	4.8
i) Rice	2.449	2.9	2.7	-0.4	3.8	5.0	0.8
ii) Wheat	1.384	-1.1	12.9	1.4	3.9	3.4	8.5
b) Pulses	0.603	-2.6	33.2	-1.2	11.5	7.4	33.3
c) Fruits and vegetables	2.917	11.6	2.1	4.4	7.4	9.9	2.3
d) Milk	4.367	-1.7	1.9	4.3	0.3	0.3	7.8
e) Eggs, fish and meat	2.208	7.3	14.3	4.1	12.0	6.2	8.0
f) Condiments and spices	0.662	-12.8	12.0	-8.2	-6.2	-14.7	24.8
g) Other food articles	0.239	22.1	11.0	19.1	4.5	-3.3	27.8
i) Tea	0.157	12.2	-2.2	21.0	-10.8	-12.3	24.7
ii) Coffee	0.082	43.2	33.7	14.9	39.5	18.7	33.7
2. Non-food articles	6.138	-6.9	-1.9	0.8	-4.5	-5.5	1.2
a) Fibres	1.523	-19.2	-0.7	-6.0	-10.4	-17.8	2.0
Raw cotton	1.357	-23.8	-1.4	-8.2	-13.0	-21.6	1.7
b) Oilseeds	2.666	-6.5	-7.8	1.7	-7.6	-4.5	-5.3
3. Minerals	0.485	68.0	43.6	110.0	26.4	-5.4	47.2
II. Fuel, Power, Light and Lubricants	**14.226**	**10.5**	**8.9**	**10.1**	**9.5**	**9.8**	**7.9**
1. Coking coal	0.241	26.9	0.0	23.0	5.2	2.8	0.0
2. Mineral oils	6.990	16.0	13.2	15.0	14.0	14.0	14.3
3. Electricity	5.484	0.8	4.5	1.7	4.0	5.9	-0.6
III. Manufactured Products	**63.749**	**4.6**	**1.7**	**6.2**	**3.1**	**3.6**	**2.8**
1. Sugar, *Khandsari* and *Gur*	3.929	17.5	6.2	17.2	9.5	11.1	7.6
i) Sugar	3.619	19.7	6.6	19.1	10.6	12.5	8.8
ii) *Khandsari*	0.173	30.2	15.6	26.0	20.4	23.5	9.7
iii) *Gur*	0.060	31.2	4.1	41.9	11.3	13.1	-5.0
2. Edible oils	2.755	-8.4	-2.4	-0.9	-6.6	-6.0	-0.5
3. Cotton textiles	4.215	-12.7	1.1	1.1	-8.3	-11.2	-1.3
4. Chemicals and chemical products	11.931	3.9	3.6	2.5	3.6	3.8	3.9
5. Cement	1.731	10.2	13.0	3.8	9.0	7.0	19.3
6. Iron and steel	3.637	21.3	-7.5	28.4	7.7	9.2	-5.1
7. Machinery and tools	8.363	7.1	3.9	5.7	5.1	7.9	3.4
8. Transport equipment and parts	4.295	6.2	1.2	4.6	3.7	5.8	1.1

P : Provisional.

Source : Office of the Economic Adviser, Ministry of Commerce and Industry, Government of India.

APPENDIX TABLE 26 : VARIATIONS IN WHOLESALE PRICES - WEIGHTED CONTRIBUTIONS (BASE : 1993-94 = 100)

(Per cent)

Major Group/Sub-group/ Commodity	Weight	Point-to-point basis		Average basis		End-June Point-to-point basis	
		2004-05	2005-06	2004-05	2005-06	2005-06	2006-07 P
1	2	3	4	5	6	7	8
All Commodities	**100.000**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
I. Primary Articles	**22.025**	**5.5**	**28.3**	**13.1**	**14.4**	**5.5**	**31.9**
1. Food articles	15.402	8.9	24.2	6.7	16.7	14.6	23.9
a) Cereals	4.406	2.4	6.5	0.6	4.2	5.1	4.1
i) Rice	2.449	1.3	1.4	-0.2	1.9	2.6	0.4
ii) Wheat	1.384	-0.3	4.3	0.3	1.2	1.1	2.3
b) Pulses	0.603	-0.3	4.4	-0.1	1.5	1.0	3.9
c) Fruits and vegetables	2.917	6.4	1.6	2.2	5.3	7.4	1.6
d) Milk	4.367	-1.5	1.9	2.9	0.3	0.3	6.7
e) Eggs, fish and meat	2.208	3.1	7.9	1.5	6.2	3.4	3.9
f) Condiments and spices	0.662	-1.8	1.8	-1.0	-0.9	-2.4	3.0
g) Other food articles	0.239	0.6	0.4	0.4	0.2	-0.1	0.9
i) Tea	0.157	0.2	-0.1	0.3	-0.3	-0.3	0.5
ii) Coffee	0.082	0.3	0.5	0.1	0.4	0.2	0.4
2. Non-food articles	6.138	-8.8	-2.7	0.8	-6.2	-8.1	1.4
a) Fibres	1.523	-5.8	-0.2	-1.4	-3.2	-6.2	0.5
Raw cotton	1.357	-6.5	-0.4	-1.8	-3.5	-6.7	0.4
b) Oilseeds	2.666	-3.4	-4.5	0.7	-4.4	-2.7	-2.6
3. Minerals	0.485	5.3	6.8	5.7	3.9	-0.9	6.5
II. Fuel, Power, Light and Lubricants	**14.226**	**42.7**	**47.9**	**32.2**	**45.7**	**47.8**	**36.2**
1. Coking coal	0.241	1.3	0.0	0.9	0.3	0.2	0.0
2. Mineral oils	6.990	34.9	39.8	25.4	37.2	37.3	37.0
3. Electricity	5.484	1.2	8.2	2.0	6.7	10.3	-0.9
III. Manufactured Products	**63.749**	**52.0**	**23.2**	**54.7**	**39.8**	**47.0**	**31.9**
1. Sugar, *Khandsari* and *Gur*	3.929	11.1	5.5	8.3	7.3	8.5	5.6
i) Sugar	3.619	10.3	4.9	7.6	6.8	8.0	5.4
ii) *Khandsari*	0.173	0.8	0.6	0.5	0.7	0.8	0.3
iii) *Gur*	0.060	0.3	0.1	0.3	0.1	0.2	-0.1
2. Edible oils	2.755	-4.0	-1.3	-0.4	-3.4	-3.2	-0.2
3. Cotton textiles	4.215	-10.4	1.0	0.7	-7.1	-10.4	-0.9
4. Chemicals and chemical products	11.931	9.1	10.2	4.6	9.4	10.3	9.1
5. Cement	1.731	2.9	4.8	0.9	2.9	2.3	5.8
6. Iron and steel	3.637	17.0	-8.7	16.5	7.8	9.8	-5.0
7. Machinery and tools	8.363	8.6	6.1	5.6	7.2	11.2	4.4
8. Transport equipment and parts	4.295	4.3	1.1	2.6	2.9	4.7	0.8

P : Provisional.

Source : Office of the Economic Adviser, Ministry of Commerce and Industry, Government of India.

APPENDIX TABLE 27 : ANNUALISED VARIATIONS IN PRICE INDICES
(Point-to-Point Basis)

(Per cent)

Year/ Month	Wholesale Price Index@	CPI for Industrial Workers#	CPI for Urban Non-manual Employees+	CPI for Agricultural Labourers*
1	2	3	4	5
2000-01	4.9 (7.2)	2.5 (3.8)	5.6 (5.6)	-2.0 (-0.3)
2001-02	1.6 (3.6)	5.2 (4.3)	4.8 (5.1)	3.0 (1.1)
2002-03	6.5 (3.4)	4.1 (4.0)	3.8 (3.8)	4.9 (3.2)
2003-04	4.6 (5.4)	3.5 (3.9)	3.4 (3.7)	2.5 (3.9)
2004-05	5.1 (6.4)	4.2 (3.8)	4.0 (3.6)	2.4 (2.6)
2005-06	4.1 (4.4)	4.9 (4.4)	5.0 (4.7)	5.3 (3.9)
2004-05				
April	4.3	2.2	2.9	1.5
May	5.6	2.8	2.9	1.8
June	7.0	3.0	3.4	1.8
July	8.0	3.2	3.1	2.1
August	8.7	4.6	4.0	3.0
September	7.3	4.8	4.0	3.3
October	7.0	4.6	4.0	3.6
November	7.3	4.2	4.0	3.3
December	6.6	3.8	3.6	3.0
January	5.1	4.4	3.8	2.7
February	5.1	4.2	3.8	2.4
March	5.1	4.2	4.0	2.4
2005-06				
April	5.7	5.0	4.2	3.0
May	5.3	3.7	4.2	3.0
June	4.3	3.3	3.9	2.7
July	4.2	4.1	4.8	3.6
August	3.3	3.4	4.3	3.2
September	4.3	3.6	4.8	3.2
October	4.8	4.2	4.5	3.2
November	4.5	5.3	5.5	4.7
December	4.6	5.6	5.7	4.7
January	4.0	4.7	5.0	4.7
February	4.2	4.9	4.8	5.0
March	4.1	4.9	5.0	5.3
2006-07				
April	3.9	5.0	5.0	5.6
May	5.0	6.3	5.8	6.4
June	4.8 P	7.7	6.5	7.2

P : Provisional. @ : Base : 1993-94=100.
: Base : 1982=100 up to December 2005 and Base : 2001=100 from January 2006.
+ : Base : 1984-85=100. * : Base : 1986-87=100.

Note : Figures in parentheses are on an average basis.

Source : 1. Office of the Economic Adviser, Ministry of Commerce and Industry, Government of India.
2. Labour Bureau, Ministry of Labour and Employment, Government of India.
3. Central Statistical Organisation, Ministry of Statistics and Programme Implementation, Government of India.

APPENDIX TABLE 28 : MEASURES OF DEFICIT OF THE CENTRAL GOVERNMENT

(Rupees crore)

Year	Fiscal Deficit		Primary Deficit		Net RBI Credit+	Revenue Deficit
	Gross	Net	Gross	Net		
1	2	3	4	5	6	7
1995-96	60,243	42,432	10,198	10,806	19,855	29,731
	(50,253)		(208)			
1996-97	66,733	46,394	7,255	9,022	1,934	32,654
	(56,242)		-(3,236)			
1997-98	88,937	63,062	23,300	22,748	12,914	46,449
	(73,204)		(7,567)			
1998-99	1,13,348	79,944	35,466	32,138	11,800	66,976
	(89,560)		(11,678)			
1999-2000	1,04,716	89,909	14,467	33,555	-5,588	67,596
2000-01	1,18,816	1,07,854	19,502	41,351	6,705	85,234
2001-02	1,40,955	1,23,074	33,495	51,152	-5,150	1,00,162
2002-03	1,45,072	1,33,829	27,268	53,647	-28,399	1,07,879
2003-04	1,23,273	1,15,558	-815	30,008	-76,065	98,261
2004-05	1,25,202	1,25,660	-1,732	31,090	-60,177	78,338
2005-06 RE	1,46,175	1,46,458	16,143	37,671	28,417	91,821
2006-07 BE	1,48,686	1,47,825	8,863	27,265	..	84,727
As percentage to GDP at current market prices						
1995-96	5.07	3.57	0.86	0.91	1.67	2.50
	(4.23)		(0.02)			
1996-97	4.88	3.39	0.53	0.66	0.14	2.39
	(4.11)		(-0.24)			
1997-98	5.84	4.14	1.53	1.49	0.85	3.05
	(4.81)		(0.50)			
1998-99	6.51	4.59	2.04	1.85	0.68	3.85
	(5.14)		(0.67)			
1999-2000	5.35	4.59	0.74	1.71	-0.29	3.45
2000-01	5.64	5.12	0.93	1.96	0.32	4.04
2001-02	6.18	5.39	1.47	2.24	-0.23	4.39
2002-03	5.92	5.46	1.11	2.19	-1.16	4.40
2003-04	4.47	4.19	-0.03	1.09	-2.76	3.56
2004-05	4.01	4.03	-0.06	1.00	-1.93	2.51
2005-06 RE	4.14	4.15	0.46	1.07	0.80	2.60
2006-07 BE	3.76	3.74	0.22	0.69	..	2.14
Average						
1995-96 to 2004-05	4.99 *	4.45	0.51 *	1.51	-0.27	3.41

RE : Revised Estimates. BE : Budget Estimates. **..** : Not available.

\+ : As per RBI records.

* : Net of States' share in small savings.

Note : 1. The revenue deficit denotes the difference between revenue receipts and revenue expenditure. The net RBI credit to the Central Government is the sum of increase in the RBI's holdings of i) Treasury Bills, ii) Government of India dated securities, iii) rupee coins and iv) loans and advances from the Reserve Bank to Centre since April 1, 1997 adjusted for changes in Centre's cash balances with the Reserve Bank. The gross fiscal deficit is the excess of total expenditure including loans, net of recoveries over revenue receipts (including external grants) and non-debt capital receipts.The net fiscal deficit is the difference between gross fiscal deficit and net lending.The gross primary deficit is the difference between the gross fiscal deficit and interest payments. The net primary deficit denotes net fiscal deficit minus net interest payments.

2. Figures in parentheses are excluding States' share in small savings as per the system of accounting followed since 1999-2000.

3. Negative sign (-) indicates surplus.

Source : Central Government budget documents and Reserve Bank records.

APPENDIX TABLE 29 : MAJOR ITEMS OF RECEIPTS AND EXPENDITURES OF THE CENTRAL GOVERNMENT

(Rs. Crore)

Item	Average 1995-96 to 2004-05	2001-02	2002-03	2003-04	2004-05	2005-06 (BE)	2005-06 (RE)	2006-07 (BE)
1	2	3	4	5	6	7	8	9
1. Total Receipts (2+5)		3,63,806	4,11,365	4,75,146	5,05,812	5,11,205	4,93,668	5,63,991
	(15.61)	(15.95)	(16.79)	(17.21)	(16.20)	(14.68)	(13.98)	(14.27)
2. Revenue Receipts (3+4)		2,01,306	2,30,834	2,63,813	3,06,013	3,51,200	3,48,474	4,03,465
	(9.19)	(8.82)	(9.42)	(9.56)	(9.80)	(10.09)	(9.87)	(10.21)
3. Tax Revenue (Net to Centre)		1,33,532	1,58,544	1,86,982	2,24,798	2,73,466	2,74,139	3,27,205
	(6.54)	(5.85)	(6.47)	(6.77)	(7.20)	(7.85)	(7.76)	(8.28)
4. Non-tax Revenue		67,774	72,290	76,831	81,215	77,734	74,335	76,260
of which :	(2.65)	(2.97)	(2.95)	(2.78)	(2.60)	(2.23)	(2.10)	(1.93)
i) Interest Receipts		35,538	37,622	38,538	32,364	25,500	21,245	19,263
	(1.54)	(1.56)	(1.54)	(1.40)	(1.04)	(0.73)	(0.60)	(0.49)
ii) Dividends and Profits		17,290	21,230	21,160	22,939	23,500	25,481	27,500
	(0.56)	(0.76)	(0.87)	(0.77)	(0.73)	(0.67)	(0.72)	(0.70)
5. Capital Receipts		1,62,500	1,80,531	2,11,333	1,99,799	1,60,005	1,45,194	1,60,526
	(6.42)	(7.12)	(7.37)	(7.66)	(6.40)	(4.60)	(4.11)	(4.06)
6. Total Expenditure (7+8)		3,62,310	4,13,248	4,71,203	4,97,682	5,14,344	5,08,705	5,63,991
	(15.74)	(15.88)	(16.87)	(17.07)	(15.94)	(14.77)	(14.40)	(14.27)
7. Revenue Expenditure		3,01,468	3,38,713	3,62,074	3,84,351	4,46,512	4,40,295	4,88,192
of which :	(12.60)	(13.21)	(13.83)	(13.12)	(12.31)	(12.82)	(12.47)	(12.35)
i) Interest Payments		1,07,460	1,17,804	1,24,088	1,26,934	1,33,945	1,30,032	1,39,823
	(4.47)	(4.71)	(4.81)	(4.50)	(4.07)	(3.85)	(3.68)	(3.54)
ii) Subsidies		31,210	43,533	44,323	43,653	47,432	46,874	46,213
	(1.34)	(1.37)	(1.78)	(1.61)	(1.40)	(1.36)	(1.33)	(1.17)
iii) Defence		38,059	40,709	43,203	43,862	48,625	48,625	51,542
	(1.64)	(1.67)	(1.66)	(1.57)	(1.41)	(1.40)	(1.38)	(1.30)
8. Capital Disbursements		60,842	74,535	1,09,129	1,13,331	67,832	68,410	75,799
of which :	(3.14)	(2.67)	(3.04)	(3.95)	(3.63)	(1.95)	(1.94)	(1.92)
Capital Outlay		26,558	29,101	34,150	51,746	62,180	56,993	66,938
	(1.21)	(1.16)	(1.19)	(1.24)	(1.66)	(1.79)	(1.61)	(1.69)
9 Developmental Expenditure*		1,59,364	1,84,197	1,95,428	2,14,955	2,27,262	2,32,698	2,62,515
of which :	(7.08)	(6.99)	(7.52)	(7.08)	(6.89)	(6.53)	(6.59)	(6.64)
Social Sector		44,538	58,606	61,178	62,614	70,616	74,275	81,605
	(1.82)	(1.95)	(2.39)	(2.22)	(2.01)	(2.03)	(2.10)	(2.06)
10 Non-Developmental Expenditure*		2,15,456	2,42,749	2,43,298	2,62,904	3,02,331	2,90,264	3,16,081
	(8.86)	(9.44)	(9.91)	(8.81)	(8.42)	(8.68)	(8.22)	(8.00)
Memo :								
1. Interest Payments as per cent of Revenue Receipts	48.79	53.38	51.03	47.04	41.48	38.14	37.31	34.66
2. Revenue Deficit as per cent of Gross Fiscal Deficit	63.36	71.06	74.36	79.71	62.57	63.06	62.82	56.98
3. Net RBI Credit to Centre as per cent of Gross Fiscal Deficit	-7.19	-3.65	-19.58	-61.70	-48.06	..	19.44	..

RE : Revised Estimates. BE : Budget Estimates. .. : Not available.

* : Data on developmental and non-developmental expenditure include gross expenditure of Commercial Departments.

Note : Figures in parentheses are percentages to GDP.

Source : Central Government budget documents and Reserve Bank records.

APPENDIX TABLE 30 : DIRECT AND INDIRECT TAX REVENUES OF THE CENTRAL AND THE STATE GOVERNMENTS

(Rupees crore)

Year		Centre (Gross)			States@			Centre and States Combined		
		Direct	Indirect	Total	Direct	Indirect	Total	Direct	Indirect	Total
1		2	3	4	5	6	7	8	9	10
1995-96		33,563	77,661	1,11,224	8,040	55,587	63,627	41,603	1,33,248	1,74,851
	(a)	30.2	69.8	100.0	12.6	87.4	100.0	23.8	76.2	100.0
	(b)	2.8	6.5	9.4	0.7	4.7	5.4	3.5	11.2	14.7
2001-02		69,197	1,17,863	1,87,060	13,592	1,13,878	1,27,470	82,789	2,31,741	3,14,530
	(a)	37.0	63.0	100.0	10.7	89.3	100.0	26.3	73.7	100.0
	(b)	3.0	5.2	8.2	0.6	5.0	5.6	3.6	10.2	13.8
2002-03		83,085	1,33,181	2,16,266	18,151	1,24,526	1,42,677	1,01,236	2,57,707	3,58,943
	(a)	38.4	61.6	100.0	12.7	87.3	100.0	28.2	71.8	100.0
	(b)	3.4	5.4	8.8	0.7	5.1	5.8	4.1	10.5	14.7
2003-04		1,05,082	1,49,266	2,54,348	20,531	1,40,703	1,61,234	1,25,613	2,89,969	4,15,582
	(a)	41.3	58.7	100.0	12.7	87.3	100.0	30.2	69.8	100.0
	(b)	3.8	5.4	9.2	0.7	5.1	5.8	4.6	10.5	15.1
2004-05 *		1,32,761	1,72,197	3,04,958	24,043	1,65,045	1,89,088	1,56,804	3,37,242	4,94,046
	(a)	43.5	56.5	100.0	12.7	87.3	100.0	31.7	68.3	100.0
	(b)	4.3	5.5	9.8	0.8	5.3	6.1	5.0	10.8	15.8
2005-06 *		1,77,077	1,92,948	3,70,025	21,516	1,88,770	2,10,286	1,98,593	3,81,718	5,80,311
BE	(a)	47.9	52.1	100.0	10.2	89.8	100.0	34.2	65.8	100.0
	(b)	5.1	5.5	10.6	0.6	5.4	6.0	5.7	11.0	16.7
2005-06*		1,70,077	2,00,064	3,70,141	29,907	1,93,193	2,23,100	1,99,984	3,93,257	5,93,241
RE	(a)	45.9	54.1	100.0	13.4	86.6	100.0	33.7	66.3	100.0
	(b)	4.8	5.7	10.5	0.8	5.5	6.3	5.7	11.1	16.8
2006-07		2,10,684	2,31,469	4,42,153	30,044	2,17,406	2,47,450	2,40,728	4,48,875	6,89,603
BE	(a)	47.6	52.4	100.0	12.1	87.9	100.0	34.9	65.1	100.0
	(b)	5.3	5.9	11.2	0.8	5.5	6.3	6.1	11.4	17.4
Memo :										
(Average)										
1995-96 to	(a)	35.8	64.2	100.0	11.6	88.4	100.0	26.6	73.4	100.0
2004-05	(b)	3.2	5.8	9.0	0.6	4.9	5.5	3.9	10.6	14.5

RE : Revised Estimates. BE : Budget Estimates.

@ : Excluding States' share in Central Taxes as reported in Central Government budget documents.

* : Data regarding State Governments are provisional (see Notes to Appendix Table 32 for details).

(a) : Represents percentages to total tax revenue.

(b) : Represents percentages to GDP.

Source : Budget Documents of the Central and the State Governments.

APPENDIX TABLE 31 : FINANCING OF GROSS FISCAL DEFICIT OF THE CENTRAL GOVERNMENT

(Rupees crore)

Year	Internal Finance				External Finance	Total Finance/ Gross Fiscal Deficit (5+6)
	Market Borrowings #	Other Borrowings @	Draw down of cash balances +	Total (2+3+4)		
1	2	3	4	5	6	7
1990-91	8,001	22,103	11,347	41,451	3,181	44,632
	(17.9)	(49.5)	(25.4)	(92.9)	(7.1)	(100.0)
1995-96	34,001	16,117	9,807	59,925	318	60,243
	(56.4)	(26.8)	(16.3)	(99.5)	(0.5)	(100.0)
2001-02	90,812	46,038	-1,496	1,35,354	5,601	1,40,955
	(64.4)	(32.7)	(-1.1)	(96.0)	(4.0)	(100.0)
2002-03	1,04,126	50,997	1,883	1,57,006	-11,934	1,45,072
	(71.8)	(35.2)	(1.3)	(108.2)	(-8.2)	(100.0)
2003-04	88,870	51,833	-3,942	1,36,761	-13,488	1,23,273
	(72.1)	(42.0)	(-3.2)	(110.9)	(-10.9)	(100.0)
2004-05	50,939 $	67,640	-8,130	1,10,449	14,753	1,25,202
	(40.7)	(54.0)	(-6.5)	(88.2)	(11.8)	(100.0)
2005-06(BE)	1,03,791 $	34,557	3,140	1,41,488	9,656	1,51,144
	(68.7)	(22.9)	(2.1)	(93.6)	(6.4)	(100.0)
2005-06 (RE)	1,01,082 $	22,541	15,037	1,38,660	7,515	1,46,175
	(69.2)	(15.4)	(10.3)	(94.9)	(5.1)	(100.0)
2006-07 (BE)	1,13,778 $	26,584	0	1,40,362	8,324	1,48,686
	(76.5)	(17.9)	(0.0)	(94.4)	(5.6)	(100.0)

RE : Revised Estimates. BE : Budget Estimates.

: Includes dated securities and 364-day Treasury Bills.

@ : Other borrowings comprise small savings, state provident funds, special deposits, reserve funds, Treasury Bills excluding 364-day Treasury Bill, etc. With effect from 1999-2000 to 2001-02, small savings and public provident funds are represented through National Small Savings Fund's (NSSF) investment in Central government special securities. Also includes NSSF's investment of redemption proceeds in Central Government special securities since 2003-04.

+ : Prior to 1997, represents variations in 91-day Treasury Bills issued net of changes in cash balances with RBI. These figures represent draw down of cash balances.

$: Exclusive of amount raised under Market Stabilisation Scheme.

Note : 1. Figures in parentheses represent percentages to total finance (gross fiscal deficit).

2. Since 1999-2000, gross fiscal deficit excludes the States' share in small savings.

Source : Central Government budget documents and Reserve Bank records.

APPENDIX TABLE 32 : BUDGETARY OPERATIONS OF THE STATE GOVERNMENTS

A : Measures of Deficit of State Governments

(Rupees crore)

Year	Fiscal Deficit		Primary Deficit		Net RBI Credit*	Conventional Deficit	Revenue Deficit
	Gross	Net	Gross	Net			
1	2	3	4	5	6	7	8
1990-91	18,787	14,532	10,132	8,280	420	-72	5,309
1995-96	31,426	26,695	9,494	10,556	16	-2,849	8,201
2004-05 P	109,256	97,981	21,267	19,462	-2,705	651	36,423
2005-06 (RE) P	113,978	102,615	24,984	23,287	-2,306	331	17,284
2006-07 (BE) P	105,895	95,978	6,449	6,180	..	3,891	1,786
As Percentage to GDP at Current Market Prices							
1990-91	3.30	2.56	1.78	1.46	0.07	-0.01	0.93
1995-96	2.65	2.25	0.80	0.89	0.00	-0.24	0.69
2004-05 P	3.50	3.14	0.68	0.62	-0.09	0.02	1.17
2005-06 (RE) P	3.23	2.91	0.71	0.66	-0.07	0.01	0.49
2006-07 (BE) P	2.68	2.43	0.16	0.16	..	0.10	0.05

B : Select Budgetary Variables of State Governments

(Per cent)

Item	1990-00 (Avg)	2004-05 P	2005-06 P (RE)	2006-07 P (BE)
1	2	3	4	5
1. GFD / Total Expenditure (excluding recoveries)	21.4	21.7	19.5	16.7
2. Revenue Deficit / Revenue Expenditure	9.3	8.9	3.7	0.4
3. Conventional Deficit / Aggregate Disbursements	-0.1	0.1	–	0.6
4. Revenue Deficit / GFD	34.8	33.3	15.2	1.7
5. Non-Developmental Revenue Expenditure / Revenue Receipts	39.6	49.4	43.7	43.4
6. Interest Payments/Revenue Receipts	16.5	23.6	19.6	19.4
7. Developmental Expenditure / GDP	10.2	9.4	10.3	9.7
of which :				
Social Sector Expenditure / GDP	5.7	5.4	6.0	5.8
8. Non-Developmental Expenditure / GDP	4.6	6.0	5.8	5.8
9. States' Own Tax Revenue/GDP	5.3	6.1	6.4	6.4
10. States' Own Non Tax Revenue / GDP	1.7	1.5	1.3	1.3

RE : Revised Estimates. BE : Budget Estimates. - : Negligible. .. : Not available.

GFD : Gross Fiscal Deficit. P : Provisional data. (-) : Indicates surplus in deficit indicators

* : Data pertain to State Governments having accounts with the Reserve Bank of India.

Note : 1. The net RBI credit to State Governments refers to variations in loans and advances given to them by the RBI net of their incremental deposits with the RBI.

2. Data for 2004-05 (Accounts), 2005-06 (RE) and 2006-07 (BE) pertain to Budgets of 29 State Governments, of which 4 are *Vote-on-Accounts*. All data are provisional.

Source : Budget Documents of the State Governments and the Reserve Bank Records.

APPENDIX TABLE 33 : COMBINED RECEIPTS AND DISBURSEMENTS OF THE CENTRAL AND STATE GOVERNMENTS*

(Rupees crore)

Item	2001-02 (Accounts)	2002-03 (Accounts)	2003-04 (Accounts)	2004-05 (Accounts)	2005-06 (Revised Estimates)	2006-07 (Budget Estimates)
1	2	3	4	5	6	7
I. Total Disbursements (A+B+C)	**6,44,746**	**7,04,904**	**7,96,384**	**8,69,755**	**10,09,665**	**11,03,534**
of which						
A. Developmental (i +ii +iii)	**3,32,224**	**3,59,329**	**4,17,834**	**4,45,352**	**5,46,795**	**5,91,683**
i) Revenue	2,62,395	2,88,431	3,18,444	3,42,516	4,17,544	4,54,766
ii) Capital	44,165	50,633	69,070	78,936	1,05,290	1,18,721
iii) Loans	25,664	20,265	30,320	23,900	23,960	18,196
B. Non-Developmental (i+ii+iii)	**3,07,864**	**3,39,523**	**3,71,651**	**4,16,340**	**4,52,768**	**4,99,054**
i) Revenue	2,92,458	3,22,357	3,52,676	3,79,824	4,14,307	4,54,418
of which :						
Interest Payments	1,42,387	1,59,060	1,77,573	1,92,312	2,05,962	2,26,600
ii) Capital	14,661	15,038	17,603	34,368	37,034	43,409
iii) Loans	745	2,128	1,371	2,147	1,427	1,227
C. Others **	**4,658**	**6,052**	**6,899**	**8,063**	**10,101**	**12,798**
II. Total Receipts	**6,42,817**	**7,07,634**	**7,99,162**	**8,78,536**	**9,94,959**	**11,07,432**
of which :						
A. Revenue Receipts	**4,00,161**	**4,53,850**	**5,18,611**	**6,15,643**	**7,32,848**	**8,35,469**
i) Tax Receipts (a + b + c)	3,13,844	3,58,224	4,13,981	4,92,481	5,91,641	6,88,103
a) Taxes on commodities and services	2,29,794	2,56,440	2,87,729	3,35,019	3,90,950	4,46,642
b) Taxes on Income and Property	83,505	1,01,211	1,25,595	1,56,804	1,99,984	2,40,728
c) Taxes of Union Territories (Without Legislature)	545	573	658	658	707	733
ii) Non-Tax Receipts	86,317	95,626	1,04,630	1,23,162	1,41,207	1,47,365
of which :						
Interest Receipts	17,164	17,781	18,856	11,063	9,041	7,529
B. Non-debt Capital Receipts (i+ii)	**18,160**	**16,067**	**43,271**	**19,393**	**13,621**	**10,977**
i) Recovery of Loans & Advances	14,514	12,916	26,318	14,969	11,265	6,137
ii) Disinvestment proceeds	3,646	3,151	16,953	4,424	2,356	4,840
III. Gross Fiscal Deficit [I - (IIA + IIB)]	**2,26,425**	**2,34,987**	**2,34,502**	**2,34,719**	**2,63,195**	**2,57,088**
Financed by :						
A. Institution-wise (i+ii)	**2,26,425**	**2,34,987**	**2,34,502**	**2,34,719**	**2,63,195**	**2,57,088**
i) Domestic Financing (a+b)	2,20,824	2,46,921	2,47,990	2,19,966	2,55,680	2,48,764
a) Net Bank Credit to Government #	77,610	86,958	66,381	13,863	12,326	..
of which :						
Net RBI Credit to Government	-1,699	-31,499	-75,772	-62,882	26,111	..
b) Non-Bank Credit to Government	1,43,214	1,59,963	1,79,959	2,06,103	2,43,354	..
ii) External Financing	5,601	-11,934	-13,488	14,753	7,515	8,324
B. Instrument-wise (i+ii)	**2,26,425**	**2,34,987**	**2,34,502**	**2,34,719**	**2,63,195**	**2,57,088**
i) Domestic Financing (a to g)	2,20,824	2,46,921	2,47,990	2,19,966	2,55,680	2,48,764
a) Market Borrowings (net) @	1,08,061	1,32,610	1,36,156	83,849	1,18,993	1,36,013
b) Small Savings (net) &	43,773	52,261	67,642	87,690	89,800	86,500
c) State Provident Funds (net)	12,150	11,816	12,014	13,344	13,733	14,190
d) Reserve Funds	7,293	7,197	8,883	10,827	6,870	6,089
e) Deposits and Advances	16,665	5,208	9,705	4,529	4,097	10,285
f) Cash Balances ^	1,929	-2,728	-2,778	-8,781	14,706	-3,891
g) Others &&	30,953	40,557	16,368	28,508	7,480	-422
ii) External Financing	5,601	-11,934	-13,488	14,753	7,515	8,324
IV. I as per cent of GDP	**28.3**	**28.8**	**28.9**	**27.9**	**28.6**	**27.9**
V. II as per cent of GDP	**28.2**	**28.9**	**29.0**	**28.1**	**28.2**	**28.0**
VI. IIA as per cent of GDP	**17.5**	**18.5**	**18.8**	**19.7**	**20.8**	**21.1**
VII. IIA (i) as per cent of GDP	**13.8**	**14.6**	**15.0**	**15.8**	**16.8**	**17.4**
VIII. III as per cent of GDP	**9.9**	**9.6**	**8.5**	**7.5**	**7.5**	**6.5**

* : Data pertaining to State governments from 2004-05 onwards are provisional and relate to budgets of 29 State governments of which four are vote-on-accounts.
** : Represent compensation and assignments by States to local bodies and *Panchayati Raj* institutions.
# : As per RBI records.
@ : Borrowing through dated securities and 364-day Treasury Bills.
.. : Budget estimates are not available.
& : Represent net investment in Central and State Governments' special securities by the National Small Savings Fund (NSSF).
^ : Include Ways and Means Advances of the State governments.
&& : Includes Treasury Bills (excluding 364-day Treasury Bills), loans from financial institutions, insurance and pension funds, remittances, cash balance investment account *etc.*
(-) : Indicates Surplus/net outflow.

Note : Total disbursements/receipts are net repayments of the Central Government (including repayments to the NSSF) and State governments. Total receipts are net of variation in cash balances of the Central and State governments.

Source : Budget Documents of Central and State Governments.

APPENDIX TABLE 34 : OUTSTANDING LIABILITIES OF THE CENTRAL GOVERNMENT

(Rupees crore)

Year	Internal Debt	Small Savings, Deposits, Provident Funds and Other Accounts	Reserve Funds and Deposits	Total Internal Liabilities (2+3+4)	External Liabilities *	Total Liabilities (5+6)
1	2	3	4	5	6	7
1990-91	1,54,004	1,07,107	21,922	2,83,033	31,525	3,14,558
	(27.1)	(18.8)	(3.9)	(49.8)	(5.5)	(55.3)
1995-96	3,07,869	2,13,435	33,680	5,54,984	51,249	6,06,233
	(25.9)	(18.0)	(2.8)	(46.7)	(4.3)	(51.0)
2001-02	9,13,061	3,08,668	73,133	12,94,862	71,546	13,66,408
	(40.0)	(13.5)	(3.2)	(56.8)	(3.1)	(59.9)
2002-03	10,20,689	3,98,774	80,126	14,99,589	59,612	15,59,201
	(41.7)	(16.3)	(3.3)	(61.2)	(2.4)	(63.6)
2003-04	11,41,706	4,56,472	92,376	16,90,554	46,124	17,36,678
	(41.4)	(16.5)	(3.3)	(61.2)	(1.7)	(62.9)
2004-05	12,75,971 $	5,64,584	92,989	19,33,544	60,878	19,94,422
	(40.9)	(18.1)	(3.0)	(61.9)	(2.0)	(63.9)
2005-06 (RE)	13,55,943 $	6,69,882	1,01,170	21,26,995	68,392	21,95,387
	(38.4)	(19.0)	(2.9)	(60.2)	(1.9)	(62.2)
2006-07 (BE)	15,22,031 $	7,60,908	1,13,907	23,96,846	76,716	24,73,562
	(38.5)	(19.3)	(2.9)	(60.6)	(1.9)	(62.6)

RE : Revised Estimates. BE : Budget Estimates.

* : At historical exchange rate.

$: Includes amount raised under Market Stabilisation Scheme (MSS).

Note : 1. Figures in parentheses represent percentages to GDP.

2. Beginning 1999-2000 Centre's share in small saving collection has been converted into Central Government special securities and are part of Internal Debt.

Source : Budget Documents of Government of India.

APPENDIX TABLE 35: MARKET BORROWINGS OF THE CENTRAL AND STATE GOVERNMENTS

(Rupees crore)

Government/Authority	Gross			Repayments			Net		
	2004-05	2005-06	2006-07 BE	2004-05	2005-06	2006-07 BE	2004-05	2005-06	2006-07 BE
1	2	3	4	5	6	7	8	9	10
1. Central Government (a+b)	1,06,501	1,60,018	1,81,875	60,452	61,781	68,097	46,050	98,237	1,13,778
a) Dated Securities	80,350	1,31,000	1,55,018	34,316	35,630	39,079	46,034	95,370	1,15,939
b) 364-day Treasury Bills	26,151	29,018	26,857	26,136	26,151	29,018	16	2,867	-2,161
2. State Governments *	39,101	21,729	23,663	5,123	6,274	6,551	33,978	15,455	17,112
Grand Total (1+2)	**1,45,602**	**1,81,747**	**2,05,538**	**65,575**	**68,055**	**74,648**	**80,028**	**1,13,692**	**1,30,890**

BE : Budget Estimates.
* : Includes additional borrowings of Rs.35 crore in 2006-07 in respect of one State.
Source : Reserve Bank records.

APPENDIX TABLE 36: FINANCING OF GROSS FISCAL DEFICIT AND OUTSTANDING LIABILITIES OF STATE GOVERNMENTS

A. Financing of Gross Fiscal Deficit of State Governments (Rupees crore)

Year	Market Borrow-ings	Loans from Centre	Loans against Securities issued to NSSF	Loans from LIC, NABARD, NCDC, *etc.*	State Provident Funds	Reserve Funds	Deposits and Advances	Suspense and Miscell-aneous	Remmit-ances	Overall Surplus (+)/ Deficit (-)	Others #	Gross Fiscal Deficit (2 to12)
1	2	3	4	5	6	7	8	9	10	11	12	13
1990-91	2,556	9,978	-	241	2,488	1,120	1,670	376	-154	74	438	18,787
	(13.6)	(53.1)	-	(1.3)	(13.2)	(6.0)	(8.9)	(2.0)	(-0.8)	(0.4)	(2.3)	(100.0)
1995-96	5,888	14,801	-	635	4,201	2,101	2,947	3,096	-338	2,850	-4,754	31,426
	(18.7)	(47.1)	-	(2.0)	(13.4)	(6.7)	(9.4)	(9.9)	(-1.1)	(9.1)	(-15.1)	(100.0)
2000-01	12,519	8,396	32,606	4,550	10,846	3,099	7,136	2,355	1,032	2,346	4,647	89,532
	(14.0)	(9.4)	(36.4)	(5.1)	(12.1)	(3.5)	(8.0)	(2.6)	(1.2)	(2.6)	(5.2)	(100.0)
2001-02	17,249	10,974	35,648	6,285	7,977	4,521	4,996	-2,452	-427	-3,426	14,649	95,994
	(18.0)	(11.4)	(37.1)	(6.5)	(8.3)	(4.7)	(5.2)	(-2.6)	(-0.4)	(-3.6)	(15.3)	(100.0)
2002-03	28,484	-932	52,243	4,858	7,195	4,799	711	1,212	93	4,611	-1,151	1,02,123
	(27.9)	(-0.9)	(51.2)	(4.8)	(7.0)	(4.7)	(0.7)	(1.2)	(0.1)	(4.5)	(-1.1)	(100.0)
2003-04	47,286	14,117	20,813	4,132	7,122	6,377	-374	-5,429	1,850	-1,164	28,340	1,23,070
	(38.4)	(11.5)	(16.9)	(3.4)	(5.8)	(5.2)	(-0.3)	(-4.4)	(1.5)	(-0.9)	(23.0)	(100.0)
2004-05 P	32,910	-16,529	72,649	60	8,034	7,127	8,074	-10,649	1,240	651	5,689	1,09,256
	(30.1)	(-15.1)	(66.5)	(0.1)	(7.4)	(6.5)	(7.4)	(-9.7)	(1.1)	(0.6)	(5.2)	(100.0)
2005-06 (RE) P	17,911	2,668	74,035	5,490	9,045	3,343	-558	-918	957	331	1,672	1,13,978
	(15.7)	(2.3)	(65.0)	(4.8)	(7.9)	(2.9)	(-0.5)	(-0.8)	(0.8)	(0.3)	(1.5)	(100.0)
2006-07 (BE) P	22,235	5,135	56,623	7,133	8,233	4,365	-728	1,777	1,975	3,891	-4,745	1,05,895
	(21.0)	(4.8)	(53.5)	(6.7)	(7.8)	(4.1)	(-0.7)	(1.7)	(1.9)	(3.7)	(-4.5)	(100.0)

B. Outstanding Liabilities of State Governments (Rupees crore)

Year	Market Loans	Loans and Advances from Centre	NSSF	Loans from Banks and FIs	Provident Funds, etc.	Reserve Funds	Deposits and Advances	Others +	Total Out-standing Liabilities (2 to 9)	Total Out-standing Liabilities as Percentage to GDP
1	2	3	4	5	6	7	8	9	10	11
1990-91	15,652	73,521	–	2,513	16,861	4,734	12,769	2,105	1,28,155	22.5
1995-96	37,088	1,30,618	–	4,838	38,216	10,577	26,654	2,899	2,50,889	21.1
2000-01	86,767	2,43,910	59,022	29,213	93,629	22,868	59,328	7,336	6,02,073	28.6
2001-02	1,04,027	2,54,884	94,670	40,894	1,03,815	27,389	64,325	10,520	7,00,524	30.7
2002-03	1,33,066	2,53,952	1,46,914	51,198	1,13,678	32,188	65,036	2,889	7,98,921	32.6
2003-04	1,79,466	2,68,069	1,67,726	60,990	1,23,003	38,565	64,662	21,941	9,24,422	33.5
2004-05 P	2,12,376	2,51,541	2,40,375	65,416	1,31,886	45,692	72,736	23,788	10,43,809	33.4
2005-06 (RE) P	2,30,288	2,54,209	3,14,410	71,546	1,42,309	49,035	72,178	23,501	11,57,476	32.8
2006-07 (BE) P	2,52,522	2,59,344	3,71,034	79,577	1,52,038	53,400	71,450	22,096	12,61,461	31.9

RE : Revised Estimates. BE : Budget Estimates. P : Provisional. – : Not applicable.

: Includes miscellaneous capital receipts, Contingency Fund, Inter-State Settlement, *etc.*

+ : Includes WMA from RBI, Contingency Funds, Compensation and Other Bonds.

Note :
1. Figures in brackets are percentages to the Gross Fiscal Deficit.
2. Data on outstanding liabilities of the State Governments have been revised by broadening its composition to include Reserve Funds, Deposits and Advances and Contingency Funds.
3. Overall surplus/deficit would be matched by increase/decrease in cash balance since 2003-04. This is due to Cash Balance Investment Account now included under 'Suspense and Miscellaneous' while WMA/OD from RBI is included under 'Internal Debt'.
4. Data for 2004-05 (Accounts), 2005-06 (RE) and 2006-07 (BE) pertain to Budgets of 29 State Governments, of which 4 are *Vote-on-Accounts*. All data are provisional.

Source : Budget Documents of State Governments and Combined Finance and Revenue Accounts of the Union and State Governments.

APPENDIX TABLE 37 : REVERSE REPO / REPO AUCTIONS UNDER LIQUIDITY ADJUSTMENT FACILITY

(Amount in Rupees crore)

LAF Date	Repo/ Reverse Repo period (Day (s))	Repo (Injection)					Reverse Repo (Absorption)					Net Injec-tions (+)/ absorp-tion(–) of liquidity	Outstanding Amount@
		Bids received		Bids Accepted		Cut-Off Rate %	Bids Received		Bids Accepted		Cut-Off Rate %		
		Number	Amount	Number	Amount		Number	Amount	Number	Amount			
1	2	3	4	5	6	7	8	9	10	11	12	13	14
2005-06													
1-Apr-05	3	-	-	-	-	-	56	38930	56	38930	4.75	-38930	38930
4-Apr-05	1	-	-	-	-	-	41	31865	41	31865	4.75	-31865	31865
5-Apr-05	1	-	-	-	-	-	38	34265	38	34265	4.75	-34265	34265
6-Apr-05	1	-	-	-	-	-	34	31165	34	31165	4.75	-31165	31165
7-Apr-05	1	-	-	-	-	-	37	25220	37	25220	4.75	-25220	25220
8-Apr-05	3	-	-	-	-	-	35	27015	35	27015	4.75	-27015	27015
11-Apr-05	1	-	-	-	-	-	42	31435	42	31435	4.75	-31435	31435
12-Apr-05	1	-	-	-	-	-	40	33205	40	33205	4.75	-33205	33205
13-Apr-05	2	-	-	-	-	-	46	32935	46	32935	4.75	-32935	32935
15-Apr-05	4	-	-	-	-	-	33	25125	33	25125	4.75	-25125	25125
19-Apr-05	1	-	-	-	-	-	39	31725	39	31725	4.75	-31725	31725
20-Apr-05	1	-	-	-	-	-	37	31450	37	31450	4.75	-31450	31450
21-Apr-05	4	-	-	-	-	-	36	31745	36	31745	4.75	-31745	31745
25-Apr-05	1	-	-	-	-	-	34	29515	34	29515	4.75	-29515	29515
26-Apr-05	1	-	-	-	-	-	39	32610	39	32610	4.75	-32610	32610
27-Apr-05	1	-	-	-	-	-	39	32625	39	32625	4.75	-32625	32625
28-Apr-05	1	-	-	-	-	-	43	31375	43	31375	4.75	-31375	31375
29-Apr-05	3	-	-	-	-	-	41	27650	41	27650	5.00	-27650	27650
2-May-05	1	-	-	-	-	-	42	32900	42	32900	5.00	-32900	32900
3-May-05	1	-	-	-	-	-	44	34160	44	34160	5.00	-34160	34160
4-May-05	1	-	-	-	-	-	43	27480	43	27480	5.00	-27480	27480
5-May-05	1	-	-	-	-	-	41	24615	41	24615	5.00	-24615	24615
6-May-05	3	-	-	-	-	-	42	27010	42	27010	5.00	-27010	27010
9-May-05	1	-	-	-	-	-	38	20375	38	20375	5.00	-20375	20375
10-May-05	1	-	-	-	-	-	37	20070	37	20070	5.00	-20070	20070
11-May-05	1	-	-	-	-	-	32	17410	32	17410	5.00	-17410	17410
12-May-05	1	-	-	-	-	-	29	16850	29	16850	5.00	-16850	16850
13-May-05	3	-	-	-	-	-	28	11840	28	11840	5.00	-11840	11840
16-May-05	1	-	-	-	-	-	32	20020	32	20020	5.00	-20020	20020
17-May-05	1	-	-	-	-	-	35	21900	35	21900	5.00	-21900	21900
18-May-05	1	-	-	-	-	-	39	23515	39	23515	5.00	-23515	23515
19-May-05	1	-	-	-	-	-	32	18080	32	18080	5.00	-18080	18080
20-May-05	4	-	-	-	-	-	32	14285	32	14285	5.00	-14285	14285
24-May-05	1	-	-	-	-	-	42	23900	42	23900	5.00	-23900	23900
25-May-05	1	-	-	-	-	-	48	31220	48	31220	5.00	-31220	31220
26-May-05	1	-	-	-	-	-	43	29015	43	29015	5.00	-29015	29015
27-May-05	3	-	-	-	-	-	54	33120	54	33120	5.00	-33120	33120
30-May-05	1	-	-	-	-	-	37	20275	37	20275	5.00	-20275	20275
31-May-05	1	-	-	-	-	-	39	22880	39	22880	5.00	-22880	22880
1-Jun-05	1	-	-	-	-	-	44	27460	44	27460	5.00	-27460	27460
2-Jun-05	1	-	-	-	-	-	47	24765	47	24765	5.00	-24765	24765
3-Jun-05	3	-	-	-	-	-	42	26385	42	26385	5.00	-26385	26385
6-Jun-05	1	-	-	-	-	-	44	27345	44	27345	5.00	-27345	27345
7-Jun-05	1	-	-	-	-	-	37	20900	37	20900	5.00	-20900	20900
8-Jun-05	1	-	-	-	-	-	37	18095	37	18095	5.00	-18095	18095
9-Jun-05	1	-	-	-	-	-	30	12170	30	12170	5.00	-12170	12170
10-Jun-05	3	-	-	-	-	-	29	13620	29	13620	5.00	-13620	13620
13-Jun-05	1	-	-	-	-	-	22	12020	22	12020	5.00	-12020	12020
14-Jun-05	1	-	-	-	-	-	28	10745	28	10745	5.00	-10745	10745
15-Jun-05	1	-	-	-	-	-	25	8230	25	8230	5.00	-8230	8230
16-Jun-05	1	-	-	-	-	-	23	10235	23	10235	5.00	-10235	10235
17-Jun-05	3	-	-	-	-	-	25	9145	25	9145	5.00	-9145	9145
20-Jun-05	1	-	-	-	-	-	25	8305	25	8305	5.00	-8305	8305
21-Jun-05	1	-	-	-	-	-	29	15915	29	15915	5.00	-15915	15915
22-Jun-05	1	-	-	-	-	-	30	14075	30	14075	5.00	-14075	14075
23-Jun-05	1	-	-	-	-	-	31	11550	31	11550	5.00	-11550	11550
24-Jun-05	3	-	-	-	-	-	23	9670	23	9670	5.00	-9670	9670
27-Jun-05	1	-	-	-	-	-	16	4125	16	4125	5.00	-4125	4125
28-Jun-05	1	3	210	3	210	6.00	12	3640	12	3640	5.00	-3430	3430
29-Jun-05	1	-	-	-	-	-	13	5760	13	5760	5.00	-5760	5760
30-Jun-05	4	2	575	2	575	6.00	15	6470	15	6470	5.00	-5895	5895
4-Jul-05	1	-	-	-	-	-	15	10785	15	10785	5.00	-10785	10785
5-Jul-05	1	-	-	-	-	-	25	17930	25	17930	5.00	-17930	17930
6-Jul-05	1	-	-	-	-	-	17	9470	17	9470	5.00	-9470	9470
7-Jul-05	1	-	-	-	-	-	25	13875	25	13875	5.00	-13875	13875
8-Jul-05	3	-	-	-	-	-	16	5800	16	5800	5.00	-5800	5800
11-Jul-05	1	-	-	-	-	-	14	3360	14	3360	5.00	-3360	3360
12-Jul-05	1	-	-	-	-	-	14	3625	14	3625	5.00	-3625	3625
13-Jul-05	1	-	-	-	-	-	13	3675	13	3675	5.00	-3675	3675

APPENDIX TABLE 37 : REVERSE REPO / REPO AUCTIONS UNDER LIQUIDITY ADJUSTMENT FACILITY *(Contd.)*

(Amount in Rupees crore)

LAF Date	Repo/ Reverse Repo period (Day (s))	Repo (Injection)					Reverse Repo (Absorption)					Net Injections (+)/ absorption(–) of liquidity	Outstanding Amount@
		Bids received		Bids Accepted		Cut-Off Rate %	Bids Received		Bids Accepted		Cut-Off Rate %		
		Number	Amount	Number	Amount		Number	Amount	Number	Amount			
1	2	3	4	5	6	7	8	9	10	11	12	13	14
14-Jul-05	1	-	-	-	-	-	18	7985	18	7985	5.00	-7985	7985
15-Jul-05	3	-	-	-	-	-	20	7365	20	7365	5.00	-7365	7365
18-Jul-05	1	-	-	-	-	-	35	17450	35	17450	5.00	-17450	17450
19-Jul-05	1	-	-	-	-	-	33	19530	33	19530	5.00	-19530	19530
20-Jul-05	1	-	-	-	-	-	31	18470	31	18470	5.00	-18470	18470
21-Jul-05	1	-	-	-	-	-	28	12170	28	12170	5.00	-12170	12170
22-Jul-05	3	-	-	-	-	-	32	10485	32	10485	5.00	-10485	10485
25-Jul-05	1	-	-	-	-	-	24	11495	24	11495	5.00	-11495	11495
26-Jul-05	3	-	-	-	-	-	24	12745	24	12745	5.00	-12745	12745
29-Jul-05	3	-	-	-	-	-	35	18895	35	18895	5.00	-18895	18895
1-Aug-05	1	-	-	-	-	-	46	30880	46	30880	5.00	-30880	30880
2-Aug-05	1	-	-	-	-	-	55	44605	55	44605	5.00	-44605	44605
3-Aug-05	1	-	-	-	-	-	55	50610	55	50610	5.00	-50610	50610
4-Aug-05	1	-	-	-	-	-	56	45880	56	45880	5.00	-45880	45880
5-Aug-05	3	-	-	-	-	-	62	47980	62	47980	5.00	-47980	47980
8-Aug-05	1	-	-	-	-	-	48	31295	48	31295	5.00	-31295	31295
9-Aug-05	1	-	-	-	-	-	51	38540	51	38540	5.00	-38540	38540
10-Aug-05	1	-	-	-	-	-	56	42625	56	42625	5.00	-42625	42625
11-Aug-05	1	-	-	-	-	-	51	37545	51	37545	5.00	-37545	37545
12-Aug-05	4	-	-	-	-	-	50	37050	50	37050	5.00	-37050	37050
16-Aug-05	1	-	-	-	-	-	45	35680	45	35680	5.00	-35680	35680
17-Aug-05	1	-	-	-	-	-	48	38155	48	38155	5.00	-38155	38155
18-Aug-05	1	-	-	-	-	-	48	36345	48	36345	5.00	-36345	36345
19-Aug-05	3	-	-	-	-	-	43	25935	43	25935	5.00	-25935	25935
22-Aug-05	1	-	-	-	-	-	44	29195	44	29195	5.00	-29195	29195
23-Aug-05	1	-	-	-	-	-	41	32000	41	32000	5.00	-32000	32000
24-Aug-05	1	-	-	-	-	-	43	35030	43	35030	5.00	-35030	35030
25-Aug-05	1	-	-	-	-	-	39	29060	39	29060	5.00	-29060	29060
26-Aug-05	3	-	-	-	-	-	41	25435	41	25435	5.00	-25435	25435
29-Aug-05	1	-	-	-	-	-	35	22255	35	22255	5.00	-22255	22255
30-Aug-05	1	-	-	-	-	-	43	28070	43	28070	5.00	-28070	28070
31-Aug-05	1	-	-	-	-	-	40	25780	40	25780	5.00	-25780	25780
1-Sep-05	1	-	-	-	-	-	40	26555	40	26555	5.00	-26555	26555
2-Sep-05	3	-	-	-	-	-	45	30885	45	30885	5.00	-30885	30885
5-Sep-05	1	-	-	-	-	-	50	51390	50	51390	5.00	-51390	51390
6-Sep-05	2	-	-	-	-	-	49	48755	49	48755	5.00	-48755	48755
8-Sep-05	1	-	-	-	-	-	47	49090	47	49090	5.00	-49090	49090
9-Sep-05	3	-	-	-	-	-	51	47495	51	47495	5.00	-47495	47495
12-Sep-05	1	-	-	-	-	-	43	41820	43	41820	5.00	-41820	41820
13-Sep-05	1	-	-	-	-	-	48	47150	48	47150	5.00	-47150	47150
14-Sep-05	1	-	-	-	-	-	48	46975	48	46975	5.00	-46975	46975
15-Sep-05	1	-	-	-	-	-	45	35870	45	35870	5.00	-35870	35870
16-Sep-05	3	-	-	-	-	-	42	30780	42	30780	5.00	-30780	30780
19-Sep-05	1	-	-	-	-	-	35	18945	35	18945	5.00	-18945	18945
20-Sep-05	1	-	-	-	-	-	34	17810	34	17810	5.00	-17810	17810
21-Sep-05	1	-	-	-	-	-	32	14205	32	14205	5.00	-14205	14205
22-Sep-05	1	-	-	-	-	-	22	11115	22	11115	5.00	-11115	11115
23-Sep-05	3	-	-	-	-	-	21	9725	21	9725	5.00	-9725	9725
26-Sep-05	1	-	-	-	-	-	34	18460	34	18460	5.00	-18460	18460
27-Sep-05	1	-	-	-	-	-	41	22880	41	22880	5.00	-22880	22880
28-Sep-05	1	2	1640	2	1640	6.00	35	20415	35	20415	5.00	-18775	18775
29-Sep-05	1	1	1000	1	1000	6.00	35	25705	35	25705	5.00	-24705	24705
30-Sep-05	3	-	-	-	-	-	50	24505	50	24505	5.00	-24505	24505
3-Oct-05	1	-	-	-	-	-	28	18865	28	18865	5.00	-18865	18865
4-Oct-05	1	-	-	-	-	-	35	23215	35	23215	5.00	-23215	23215
5-Oct-05	1	-	-	-	-	-	37	30770	37	30770	5.00	-30770	30770
6-Oct-05	1	-	-	-	-	-	37	27675	37	27675	5.00	-27675	27675
7-Oct-05	3	-	-	-	-	-	30	21510	30	21510	5.00	-21510	21510
10-Oct-05	1	-	-	-	-	-	28	18050	28	18050	5.00	-18050	18050
11-Oct-05	2	-	-	-	-	-	29	17915	29	17915	5.00	-17915	17915
13-Oct-05	1	-	-	-	-	-	31	18590	31	18590	5.00	-18590	18590
14-Oct-05	3	-	-	-	-	-	22	9255	22	9255	5.00	-9255	9255
17-Oct-05	1	-	-	-	-	-	33	17205	33	17205	5.00	-17205	17205
18-Oct-05	1	-	-	-	-	-	31	19000	31	19000	5.00	-19000	19000
19-Oct-05	1	-	-	-	-	-	28	15605	28	15605	5.00	-15605	15605
20-Oct-05	1	-	-	-	-	-	31	17220	31	17220	5.00	-17220	17220
21-Oct-05	3	-	-	-	-	-	28	15980	28	15980	5.00	-15980	15980
24-Oct-05	1	-	-	-	-	-	29	14275	29	14275	5.00	-14275	14275
25-Oct-05	1	-	-	-	-	-	24	12215	24	12215	5.00	-12215	12215
26-Oct-05	1	-	-	-	-	-	37	19205	37	19205	5.25	-19205	19205

APPENDIX TABLE 37 : REVERSE REPO / REPO AUCTIONS UNDER LIQUIDITY ADJUSTMENT FACILITY *(Contd.)*

(Amount in Rupees crore)

LAF Date	Repo/ Reverse Repo period (Day (s))	Repo (Injection)					Reverse Repo (Absorption)					Net Injections (+)/ absorption(–) of liquidity	Outstanding Amount@
		Bids received		Bids Accepted		Cut-Off Rate %	Bids Received		Bids Accepted		Cut-Off Rate %		
		Number	Amount	Number	Amount		Number	Amount	Number	Amount			
1	2	3	4	5	6	7	8	9	10	11	12	13	14
27-Oct-05	1	-	-	-	-	-	40	26510	40	26510	5.25	-26510	26510
28-Oct-05	3	-	-	-	-	-	38	20840	38	20840	5.25	-20840	20840
31-Oct-05	2	-	-	-	-	-	21	10840	21	10840	5.25	-10840	10840
2-Nov-05	1	-	-	-	-	-	16	7835	16	7835	5.25	-7835	7835
3-Nov-05	1	-	-	-	-	-	15	8250	15	8250	5.25	-8250	8250
4-Nov-05	3	-	-	-	-	-	17	6785	17	6785	5.25	-6785	6785
7-Nov-05	1	-	-	-	-	-	13	6190	13	6190	5.25	-6190	6190
8-Nov-05	1	-	-	-	-	-	11	5955	11	5955	5.25	-5955	5955
9-Nov-05	1	1	200	1	200	6.25	8	3345	8	3345	5.25	-3145	3145
10-Nov-05	1	15	5175	15	5175	6.25	7	2005	7	2005	5.25	3170	-3170
11-Nov-05	3	10	2440	10	2440	6.25	7	1500	7	1500	5.25	940	-940
14-Nov-05	2	3	1900	3	1900	6.25	6	835	6	835	5.25	1065	-1065
16-Nov-05	1	8	3600	8	3600	6.25	1	100	1	100	5.25	3500	-3500
17-Nov-05	1	5	2500	5	2500	6.25	4	605	4	605	5.25	1895	-1895
18-Nov-05	3	3	1250	3	1250	6.25	3	680	3	680	5.25	570	-570
21-Nov-05	1	-	-	-	-	-	5	1465	5	1465	5.25	-1465	1465
22-Nov-05	1	-	-	-	-	-	14	7075	14	7075	5.25	-7075	7075
23-Nov-05	1	-	-	-	-	-	19	8140	19	8140	5.25	-8140	8140
24-Nov-05	1	-	-	-	-	-	23	8215	23	8215	5.25	-8215	8215
25-Nov-05	3	-	-	-	-	-	21	3685	21	3685	5.25	-3685	3685
28-Nov-05	1	-	-	-	-	-	16	4620	16	4620	5.25	-4620	
$	1	-	-	-	-	-	11	1625	11	1625	5.25	-1625	6245
29-Nov-05	1	-	-	-	-	-	14	4975	14	4975	5.25	-4975	
$	1	-	-	-	-	-	6	570	6	570	5.25	-570	5545
30-Nov-05	1	-	-	-	-	-	7	1195	7	1195	5.25	-1195	
$	1	-	-	-	-	-	8	1760	8	1760	5.25	-1760	2955
1-Dec-05	1	-	-	-	-	-	10	2660	10	2660	5.25	-2660	
$	1	-	-	-	-	-	18	3990	18	3990	5.25	-3990	6650
2-Dec-05	3	-	-	-	-	-	14	9665	14	9665	5.25	-9665	
$	3	-	-	-	-	-	19	7210	19	7210	5.25	-7210	16875
5-Dec-05	1	-	-	-	-	-	19	15320	19	15320	5.25	-15320	
$	1	-	-	-	-	-	27	5315	27	5315	5.25	-5315	20635
6-Dec-05	1	-	-	-	-	-	22	17460	22	17460	5.25	-17460	
$	1	-	-	-	-	-	21	9780	21	9780	5.25	-9780	27240
7-Dec-05	1	-	-	-	-	-	15	13500	15	13500	5.25	-13500	
$	1	-	-	-	-	-	11	4030	11	4030	5.25	-4030	17530
8-Dec-05	1	-	-	-	-	-	10	8450	10	8450	5.25	-8450	
$	1	-	-	-	-	-	13	2325	13	2325	5.25	-2325	10775
9-Dec-05	3	-	-	-	-	-	13	6335	13	6335	5.25	-6335	
$	3	-	-	-	-	-	29	5125	29	5125	5.25	-5125	11460
12-Dec-05	1	-	-	-	-	-	8	2680	8	2680	5.25	-2680	
$	1	-	-	-	-	-	6	1345	6	1345	5.25	-1345	4025
13-Dec-05	1	-	-	-	-	-	5	560	5	560	5.25	-560	
$	1	-	-	-	-	-	2	380	2	380	5.25	-380	940
14-Dec-05	1	-	-	-	-	-	4	550	4	550	5.25	-550	
$	1	-	-	-	-	-	3	485	3	485	5.25	-485	1035
15-Dec-05	1	-	-	-	-	-	3	545	3	545	5.25	-545	
$	1	-	-	-	-	-	3	5205	3	5205	5.25	-5205	5750
16-Dec-05	3	-	-	-	-	-	5	3390	5	3390	5.25	-3390	
$	3	3	1085	3	1085	6.25	1	20	1	20	5.25	1065	2325
19-Dec-05	1	9	5240	9	5240	6.25	2	225	2	225	5.25	5015	
$	1	3	220	3	220	6.25	1	300	1	300	5.25	-80	-4935
20-Dec-05	1	8	2140	8	2140	6.25	3	480	3	480	5.25	1660	
$	1	4	745	4	745	6.25	2	355	2	355	5.25	390	-2050
21-Dec-05	1	6	1580	6	1580	6.25	2	1120	2	1120	5.25	460	
$	1	7	1460	7	1460	6.25	3	805	3	805	5.25	655	-1115
22-Dec-05	1	22	9160	22	9160	6.25	2	100	2	100	5.25	9060	
$	1	1	300	1	300	6.25	10	3850	10	3850	5.25	-3550	-5510
23-Dec-05	3	5	1330	5	1330	6.25	2	150	2	150	5.25	1180	
$	3	1	170	1	170	6.25	16	7220	16	7220	5.25	-7050	5870
26-Dec-05	1	22	10925	22	10925	6.25	1	125	1	125	5.25	10800	
$	1	19	6755	19	6755	6.25	1	10	1	10	5.25	6745	-17545
27-Dec-05	1	36	17835	36	17835	6.25	-	-	-	-	-	17835	
$	1	8	3580	8	3580	6.25	2	480	2	480	5.25	3100	-20935
28-Dec-05	1	36	22165	36	22165	6.25	3	900	3	900	5.25	21265	
$	1	11	4520	11	4520	6.25	2	1115	2	1115	5.25	3405	-24670
29-Dec-05	1	36	24365	36	24365	6.25	-	-	-	-	-	24365	
$	1	16	5745	16	5745	6.25	3	3220	3	3220	5.25	2525	-26890
30-Dec-05	3	38	23085	38	23085	6.25	-	-	-	-	-	23085	
$	3	11	6710	11	6710	6.25	3	2040	3	2040	5.25	4670	-27755

APPENDIX TABLE 37 : REVERSE REPO / REPO AUCTIONS UNDER LIQUIDITY ADJUSTMENT FACILITY *(Contd.)*

(Amount in Rupees crore)

LAF Date	Repo/ Reverse Repo period (Day (s))	Repo (Injection)					Reverse Repo (Absorption)					Net Injections (+)/ absorption(–) of liquidity	Outstanding Amount@
		Bids received		Bids Accepted		Cut-Off Rate %	Bids Received		Bids Accepted		Cut-Off Rate %		
		Number	Amount	Number	Amount		Number	Amount	Number	Amount			
1	2	3	4	5	6	7	8	9	10	11	12	13	14
2-Jan-06	1	22	15650	22	15650	6.25	1	500	1	500	5.25	15150	
$	1	2	120	2	120	6.25	4	3470	4	3470	5.25	-3350	-11800
3-Jan-06	1	-	-	-	-	-	1	500	1	500	5.25	-500	
$	1	1	50	1	50	6.25	6	1440	6	1440	5.25	-1390	1890
4-Jan-06	1	-	-	-	-	-	4	750	4	750	5.25	-750	
$	1	-	-	-	-	-	8	2415	8	2415	5.25	-2415	3165
5-Jan-06	1	-	-	-	-	-	1	500	1	500	5.25	-500	
$	1	-	-	-	-	-	11	2855	11	2855	5.25	-2855	3355
6-Jan-06	3	-	-	-	-	-	3	120	3	120	5.25	-120	
$	3	2	420	2	420	6.25	18	3590	18	3590	5.25	-3170	3290
9-Jan-06	1	18	8820	18	8820	6.25	-	-	-	-	-	8820	
$	1	15	4605	15	4605	6.25	3	515	3	515	5.25	4090	-12910
10-Jan-06	2	34	16400	34	16400	6.25	1	25	1	25	5.25	16375	
$	2	19	8120	19	8120	6.25	3	600	3	600	5.25	7520	-23895
12-Jan-06	1	37	20630	37	20630	6.25	1	20	1	20	5.25	20610	
$	1	17	7585	17	7585	6.25	3	825	3	825	5.25	6760	-27370
13-Jan-06	3	39	26135	39	26135	6.25	1	25	1	25	5.25	26110	
$	3	18	7155	18	7155	6.25	4	690	4	690	5.25	6465	-32575
16-Jan-06	1	32	16625	32	16625	6.25	2	45	2	45	5.25	16580	
$	1	17	6530	17	6530	6.25	4	810	4	810	5.25	5720	-22300
17-Jan-06	1	21	10235	21	10235	6.25	2	30	2	30	5.25	10205	
$	1	18	5560	18	5560	6.25	3	345	3	345	5.25	5215	-15420
18-Jan-06	1	19	8395	19	8395	6.25	1	15	1	15	5.25	8380	
$	1	17	4810	17	4810	6.25	2	255	2	255	5.25	4555	-12935
19-Jan-06	1	22	9985	22	9985	6.25	1	10	1	10	5.25	9975	
$	1	18	4440	18	4440	6.25	1	210	1	210	5.25	4230	-14205
20-Jan-06	3	26	12440	26	12440	6.25	2	20	2	20	5.25	12420	
$	3	11	1805	11	1805	6.25	6	455	6	455	5.25	1350	-13770
23-Jan-06	1	32	14400	32	14400	6.25	1	15	1	15	5.25	14385	
$	1	13	4795	13	4795	6.25	3	330	3	330	5.25	4465	-18850
24-Jan-06	1	32	15170	32	15170	6.25	1	40	1	40	5.25	15130	
$	1	13	4145	12	3345	6.50	2	310	2	310	5.50	3035	-18165
25-Jan-06	2	41	19310	41	19310	6.50	1	30	1	30	5.50	19280	
$	2	17	4135	17	4135	6.50	2	350	2	350	5.50	3785	-23065
27-Jan-06	3	38	18060	38	18060	6.50	1	25	1	25	5.50	18035	
$	3	8	2535	8	2535	6.50	1	15	1	15	5.50	2520	-20555
30-Jan-06	1	28	10955	28	10955	6.50	-	-	-	-	5.50	10955	
$	1	8	2285	8	2285	6.50	4	3035	4	3035	5.50	-750	-10205
31-Jan-06	1	24	8920	24	8920	6.50	-	-	-	-	5.50	8920	
$	1	8	2710	8	2710	6.50	6	2925	6	2925	5.50	-215	-8705
1-Feb-06	1	29	9200	29	9200	6.50	1	25	1	25	5.50	9175	
$	1	12	4500	12	4500	6.50	3	2115	3	2115	5.50	2385	-11560
2-Feb-06	1	31	12685	31	12685	6.50	1	500	1	500	5.50	12185	
$	1	7	980	7	980	6.50	6	1950	6	1950	5.50	-970	-11215
3-Feb-06	3	13	3060	13	3060	6.50	1	1000	1	1000	5.50	2060	
$	3	7	2055	7	2055	6.50	6	1505	6	1505	5.50	550	-2610
6-Feb-06	1	33	14605	33	14605	6.50	-	-	-	-	-	14605	
$	1	16	3315	16	3315	6.50	1	100	1	100	5.50	3215	-17820
7-Feb-06	1	33	12610	33	12610	6.50	-	-	-	-	5.50	12610	
$	1	12	2215	12	2215	6.50	1	70	1	70	5.50	2145	-14755
8-Feb-06	2	33	13510	33	13510	6.50	-	-	-	-	5.50	13510	
$	2	13	3940	13	3940	6.50	1	100	1	100	5.50	3840	-17350
10-Feb-06	3	31	14445	31	14445	6.50	-	-	-	-	5.50	14445	
$	3	20	5050	20	5050	6.50	1	180	1	180	5.50	4870	-19315
13-Feb-06	1	37	16230	37	16230	6.50	-	-	-	-	5.50	16230	
$	1	18	4865	18	4865	6.50	3	385	3	385	5.50	4480	-20710

APPENDIX TABLE 37 : REVERSE REPO / REPO AUCTIONS UNDER LIQUIDITY ADJUSTMENT FACILITY *(Contd.)*

(Amount in Rupees crore)

LAF Date	Repo/ Reverse Repo period (Day (s))	Repo (Injection)					Reverse Repo (Absorption)					Net Injections (+)/ absorption(–) of liquidity	Outstanding Amount@
		Bids received		Bids Accepted		Cut-Off Rate %	Bids Received		Bids Accepted		Cut-Off Rate %		
		Number	Amount	Number	Amount		Number	Amount	Number	Amount			
1	2	3	4	5	6	7	8	9	10	11	12	13	14
14-Feb-06	1	36	18695	36	18695	6.50	-	-	-	-	5.50	18695	
$	1	14	5450	14	5450	6.50	2	130	2	130	5.50	5320	-24015
15-Feb-06	1	34	17520	34	17520	6.50	-	-	-	-	5.50	17520	
$	1	4	1575	4	1575	6.50	4	505	4	505	5.50	1070	-18590
16-Feb-06	1	19	8275	19	8275	6.50	-	-	-	-	5.50	8275	
$	1	10	2055	10	2055	6.50	3	165	3	165	5.50	1890	-10165
17-Feb-06	3	18	7295	18	7295	6.50	-	-	-	-	5.50	7295	
$	3	10	2150	10	2150	6.50	7	525	7	525	5.50	1625	-8920
20-Feb-06	1	29	18530	29	18530	6.50	-	-	-	-	5.50	18530	
$	1	11	3010	11	3010	6.50	2	35	2	35	5.50	2975	-21505
21-Feb-06	1	29	18320	29	18320	6.50	-	-	-	-	5.50	18320	
$	1	6	1780	6	1780	6.50	2	30	2	30	5.50	1750	-20070
22-Feb-06	1	28	14525	28	14525	6.50	-	-	-	-	5.50	14525	
$	1	9	3455	9	3455	6.50	2	50	2	50	5.50	3405	-17930
23-Feb-06	1	25	12185	25	12185	6.50	-	-	-	-	5.50	12185	
$	1	11	3055	11	3055	6.50	3	255	3	255	5.50	2800	-14985
24-Feb-06	3	14	7585	14	7585	6.50	-	-	-	-	5.50	7585	
$	3	21	5190	21	5190	6.50	2	60	2	60	5.50	5130	-12715
27-Feb-06	1	17	6090	17	6090	6.50	-	-	-	-	5.50	6090	
$	1	3	1255	3	1255	6.50	5	795	5	795	5.50	460	-6550
28-Feb-06	1	10	3675	10	3675	6.50	-	-	-	-	5.50	3675	
$	1	4	840	4	840	6.50	4	880	4	880	5.50	-40	-3635
1-Mar-06	1	7	1325	7	1325	6.50	-	-	-	-	-	1325	
$	1	6	3030	6	3030	6.50	4	880	4	880	5.50	2150	-3475
2-Mar-26	1	6	995	6	995	6.50	-	-	-	-	-	995	
$	1	3	290	3	290	6.50	5	530	5	530	5.50	-240	-755
3-Mar-06	3	5	1140	5	1140	6.50	-	-	-	-	-	1140	
$	3	22	5865	22	5865	6.50	6	645	6	645	5.50	5220	-6360
6-Mar-06	1	20	9110	20	9110	6.50	-	-	-	-	-	9110	
$	1	9	3535	9	3535	6.50	3	135	3	135	5.50	3400	-12510
7-Mar-06	1	19	7460	19	7460	6.50	-	-	-	-	-	7460	
$	1	2	750	2	750	6.50	3	150	3	150	5.50	600	-8060
8-Mar-06	1	15	5270	15	5270	6.50	-	-	-	-	-	5270	
$	1	5	1835	5	1835	6.50	2	125	2	125	5.50	1710	-6980
9-Mar-06	1	14	5690	14	5690	6.50	-	-	-	-	-	5690	
$	1	5	760	5	760	6.50	2	50	2	50	5.50	710	-6400
10-Mar-06	3	16	6790	16	6790	6.50	-	-	-	-	-	6790	
$	3	4	1125	4	1125	6.50	3	935	3	935	5.50	190	-6980
13-Mar-06	1	8	2020	8	2020	6.50	1	60	1	60	5.50	1960	
$	1	3	170	3	170	6.50	5	1525	5	1525	5.50	-1355	-605
14-Mar-05	2	1	250	1	250	6.50	3	170	3	170	5.50	80	
$	2	1	975	1	975	6.50	15	4615	15	4615	5.50	-3640	3560
16-Mar-06	1	-	-	-	-	-	1	140	1	140	5.50	-140	
$	1	-	-	-	-	-	24	10170	24	10170	5.50	-10170	10310
17-Mar-06	3	1	65	1	65	6.50	1	170	1	170	5.50	-105	
$	3	9	4915	9	4915	6.50	4	660	4	660	5.50	4255	-4150
20-Mar-06	1	23	15090	23	15090	6.50	1	120	1	120	5.50	14970	
$	1	17	7935	17	7935	6.50	2	140	2	140	5.50	7795	-22765
21-Mar-06	1	23	22860	23	22860	6.50	1	100	1	100	5.50	22760	
$	1	12	3215	12	3215	6.50	2	75	2	75	5.50	3140	-25900
22-Mar-06	1	24	20635	24	20635	6.50	1	100	1	100	5.50	20535	
$	1	14	4220	14	4220	6.50	1	15	1	15	5.50	4205	-24740
23-Mar-06	1	24	15315	24	15315	6.50	1	100	1	100	5.50	15215	
$	1	15	4965	14	4765	6.50	3	1240	3	1240	5.50	3525	-18740
24-Mar-06	3	18	11645	18	11645	6.50	1	70	1	70	5.50	11575	
$	3	7	1605	7	1605	6.50	4	1385	4	1385	5.50	220	-11795
27-Mar-06	1	8	2920	8	2920	6.50	-	-	-	-	-	2920	
$	1	1	500	1	500	6.50	5	1575	5	1575	5.50	-1075	-1845
28-Mar-06	1	-	-	-	-	-	2	1350	2	1350	5.50	-1350	
$	1	-	-	-	-	-	11	3395	11	3395	5.50	-3395	4745
29-Mar-06	2	-	-	-	-	-	1	55	1	55	5.50	-55	
$	2	2	6000	2	6000	6.50	10	3600	10	3600	5.50	2400	-2345
31-Mar-06	3	12	8470	12	8470	6.50	5	2305	5	2305	5.50	6165	
$	3	5	1140	5	1140	6.50	10	3275	10	3275	5.50	-2135	
$$	3	4	2905	4	2905	6.50	34	14185	34	14185	5.50	-11280	7250

APPENDIX TABLE 37 : REVERSE REPO / REPO AUCTIONS UNDER LIQUIDITY ADJUSTMENT FACILITY *(Contd.)*

(Amount in Rupees crore)

LAF Date	Repo/ Reverse Repo period (Day (s))	Repo (Injection)					Reverse Repo (Absorption)					Net Injections (+)/ absorption(–) of liquidity	Outstanding Amount@
		Bids received		Bids Accepted		Cut-Off Rate %	Bids Received		Bids Accepted		Cut-Off Rate %		
		Number	Amount	Number	Amount		Number	Amount	Number	Amount			
1	2	3	4	5	6	7	8	9	10	11	12	13	14
2006-07													
3-Apr-06	1	2	1030	2	1030	6.50	1	50	1	50	5.50	980	
$	1	1	35	1	35	6.50	19	9860	19	9860	5.50	-9825	8845
4-Apr-06	1	1	65	0	0	6.50	8	4300	8	4300	5.50	-4235	
$	1	2	60	2	60	6.50	26	17740	26	17740	5.50	-17680	21980
5-Apr-06	2	-	-	-	-	-	14	9710	14	9710	5.50	-9710	
$	2	-	-	-	-	-	32	20280	32	20280	5.50	-20280	29990
7-Apr-06	3	-	-	-	-	-	13	6020	13	6020	5.50	-6020	
$	3	-	-	-	-	-	37	26695	37	26695	5.50	-26695	32715
10-Apr-06	2	-	-	-	-	-	25	17530	25	17530	5.50	-17530	
$	2	1	300	1	300	6.50	38	32630	38	32630	5.50	-32330	49860
12-Apr-06	1	-	-	-	-	-	24	18915	24	18915	5.50	-18915	
$	1	-	-	-	-	-	39	30775	39	30775	5.50	-30775	49690
13-Apr-06	4	-	-	-	-	-	31	26075	31	26075	5.50	-26075	
$	4	-	-	-	-	-	50	30975	50	30975	5.50	-30975	57050
17-Apr-06	1	-	-	-	-	-	22	15980	22	15980	5.50	-15980	
$	1	-	-	-	-	-	28	19225	28	19225	5.50	-19225	35205
18-Apr-06	1	-	-	-	-	-	19	9180	19	9180	5.50	-9180	
$	1	-	-	-	-	-	46	46790	46	46790	5.50	-46790	55970
19-Apr-06	1	-	-	-	-	-	29	22660	29	22660	5.50	-22660	
$	1	-	-	-	-	-	41	38030	41	38030	5.50	-38030	60690
20-Apr-06	1	-	-	-	-	-	36	28520	36	28520	5.50	-28520	
$	1	-	-	-	-	-	31	29185	31	29185	5.50	-29185	57705
21-Apr-06	3	-	-	-	-	-	34	27670	34	27670	5.50	-27670	
$	3	-	-	-	-	-	31	34405	31	34405	5.50	-34405	62075
24-Apr-06	1	-	-	-	-	-	36	33700	36	33700	5.50	-33700	
$	1	-	-	-	-	-	35	33300	35	33300	5.50	-33300	67000
25-Apr-06	1	-	-	-	-	-	39	39815	39	39815	5.50	-39815	
$	1	-	-	-	-	-	28	27655	28	67655	5.50	-27655	67470
26-Apr-06	1	-	-	-	-	-	34	33650	34	33650	5.50	-33650	
$	1	-	-	-	-	-	38	29875	38	29875	5.50	-29875	63525
27-Apr-06	1	-	-	-	-	-	33	38755	33	38755	5.50	-38755	
$	1	-	-	-	-	-	29	25625	29	25625	5.50	-25625	64380
28-Apr-06	4	-	-	-	-	-	26	20795	26	20795	5.50	-20795	
$	4	-	-	-	-	-	37	27010	37	27010	5.50	-27010	47805
2-May-06	1	-	-	-	-	-	22	16735	22	16735	5.50	-16735	
$	1	-	-	-	-	-	31	40825	31	40825	5.50	-40825	57560
3-May-06	1	-	-	-	-	-	32	27865	32	27865	5.50	-27865	
$	1	-	-	-	-	-	39	42855	39	42855	5.50	-42855	70720
4-May-06	1	-	-	-	-	-	33	41060	33	41060	5.50	-41060	
$	1	-	-	-	-	-	31	30940	31	30940	5.50	-30940	72000
5-May-06	3	-	-	-	-	-	24	17145	24	17145	5.50	-17145	
$	3	-	-	-	-	-	38	32400	38	32400	5.50	-32400	49545
8-May-06	1	-	-	-	-	-	30	24665	30	24665	5.50	-24665	
$	1	-	-	-	-	-	45	42195	45	42195	5.50	-42195	66860
9-May-06	1	-	-	-	-	-	32	27270	32	27270	5.50	-27270	
$	1	-	-	-	-	-	45	42105	45	42105	5.50	-42105	69375
10-May-06	1	-	-	-	-	-	31	24115	31	24115	5.50	-24115	
$	1	-	-	-	-	-	44	39960	44	39960	5.50	-39960	64075
11-May-06	1	-	-	-	-	-	34	35190	34	35190	5.50	-35190	
$	1	-	-	-	-	-	35	26465	35	26465	5.50	-26465	61655
12-May-06	3	-	-	-	-	-	30	21990	30	21990	5.50	-21990	
$	3	-	-	-	-	-	46	27855	46	27855	5.50	-27855	49845
15-May-06	1	-	-	-	-	-	30	31980	30	31980	5.50	-31980	
$	1	-	-	-	-	-	30	19265	30	19265	5.50	-19265	51245
16-May-06	1	-	-	-	-	-	31	29375	31	29375	5.50	-29375	
$	1	-	-	-	-	-	35	23780	35	23780	5.50	-23780	53155
17-May-06	1	-	-	-	-	-	34	33490	34	33490	5.50	-33490	
$	1	-	-	-	-	-	36	29395	36	29395	5.50	-29395	62885
18-May-06	1	-	-	-	-	-	33	33790	33	33790	5.50	-33790	
$	1	-	-	-	-	-	40	30525	40	30525	5.50	-30525	64315
19-May-06	3	-	-	-	-	-	34	36465	34	36465	5.50	-36465	
$	3	-	-	-	-	-	41	25350	41	25350	5.50	-25350	61815

APPENDIX TABLE 37 : REVERSE REPO / REPO AUCTIONS UNDER LIQUIDITY ADJUSTMENT FACILITY *(Contd.)*

(Amount in Rupees crore)

LAF Date	Repo/ Reverse Repo period (Day (s))	Repo (Injection)					Reverse Repo (Absorption)					Net Injections (+)/ absorption(–) of liquidity	Outstanding Amount@
		Bids received		Bids Accepted		Cut-Off Rate %	Bids Received		Bids Accepted		Cut-Off Rate %		
		Number	Amount	Number	Amount		Number	Amount	Number	Amount			
1	2	3	4	5	6	7	8	9	10	11	12	13	14
22-May-06	1	-	-	-	-	-	31	34650	31	34650	5.50	-34650	
$	1	-	-	-	-	-	40	30720	40	30720	5.50	-30720	65370
23-May-06	1	-	-	-	-	-	32	37850	32	37850	5.50	-37850	
$	1	-	-	-	-	-	41	29540	41	29540	5.50	-29540	67390
24-May-06	1	-	-	-	-	-	29	35675	29	35675	5.50	-35675	
$	1	-	-	-	-	-	40	29325	40	29325	5.50	-29325	65000
25-May-06	1	-	-	-	-	-	28	30435	28	30435	5.50	-30435	
$	1	-	-	-	-	-	43	31400	43	31400	5.50	-31400	61835
26-May-06	3	-	-	-	-	-	30	32755	30	32755	5.50	-32755	
$	3	-	-	-	-	-	53	24490	53	24490	5.50	-24490	57245
29-May-06	1	-	-	-	-	-	25	33455	25	33455	5.50	-33455	
$	1	-	-	-	-	-	32	26475	32	26475	5.50	-26475	59930
30-May-06	1	-	-	-	-	-	34	37345	34	37345	5.50	-37345	
$	1	-	-	-	-	-	37	28750	37	28750	5.50	-28750	66095
31-May-06	1	-	-	-	-	-	32	36780	32	36780	5.50	-36780	
$	1	-	-	-	-	-	32	25250	32	25250	5.50	-25250	62030
1-Jun-06	1	-	-	-	-	-	38	37995	38	37995	5.50	-37995	
$	1	-	-	-	-	-	39	29115	39	29115	5.50	-29115	67110
2-Jun-06	3	-	-	-	-	-	32	38385	32	38385	5.50	-38385	
$	3	-	-	-	-	-	41	27785	41	27785	5.50	-27785	66170
5-Jun-06	1	-	-	-	-	-	30	35550	30	35550	5.50	-35550	
$	1	-	-	-	-	-	41	35095	41	35095	5.50	-35095	70645
6-Jun-06	1	-	-	-	-	-	33	40875	33	40875	5.50	-40875	
$	1	-	-	-	-	-	46	31425	46	31425	5.50	-31425	72300
7-Jun-06	1	-	-	-	-	-	31	31670	31	31670	5.50	-31670	
$	1	-	-	-	-	-	41	34875	41	34875	5.50	-34875	66545
8-Jun-06	1	-	-	-	-	-	31	27140	31	27140	5.50	-27140	
$	1	-	-	-	-	-	46	30875	46	30875	5.50	-30875	58015
9-Jun-06	3	-	-	-	-	-	26	26675	26	26675	5.75	-26675	
$	3	-	-	-	-	-	56	20845	56	20845	5.75	-20845	47520
12-Jun-06	1	-	-	-	-	-	24	30355	24	30355	5.75	-30355	
$	1	-	-	-	-	-	33	18880	33	18880	5.75	-18880	49235
13-Jun-06	1	-	-	-	-	-	29	32655	29	32655	5.75	-32655	
$	1	-	-	-	-	-	31	15615	31	15615	5.75	-15615	48270
14-Jun-06	1	-	-	-	-	-	26	31040	26	31040	5.75	-31040	
$	1	-	-	-	-	-	34	19635	34	19635	5.75	-19635	50675
15-Jun-06	1	-	-	-	-	-	26	25810	26	25810	5.75	-25810	
$	1	-	-	-	-	-	34	21675	34	21675	5.75	-21675	47485
16-Jun-06	3	-	-	-	-	-	24	23070	24	23070	5.75	-23070	
$	3	-	-	-	-	-	34	17495	34	17495	5.75	-17495	40565
19-Jun-06	1	-	-	-	-	-	26	21570	26	21570	5.75	-21570	
$	1	-	-	-	-	-	33	17250	33	17250	5.75	-17250	38820
20-Jun-06	1	-	-	-	-	-	29	22465	29	22465	5.75	-22465	
$	1	-	-	-	-	-	36	19730	36	19730	5.75	-19730	42195
21-Jun-06	1	-	-	-	-	-	27	21795	27	21795	5.75	-21795	
$	1	-	-	-	-	-	36	20855	36	20855	5.75	-20855	42650
22-Jun-06	1	-	-	-	-	-	27	21745	27	21745	5.75	-21745	
$	1	-	-	-	-	-	41	20510	41	20510	5.75	-20510	42255
23-Jun-06	3	-	-	-	-	-	23	10355	23	10355	5.75	-10355	
$	3	-	-	-	-	-	48	19955	48	19955	5.75	-19955	30310
26-Jun-06	1	-	-	-	-	-	23	20705	23	20705	5.75	-20705	
$	1	-	-	-	-	-	33	19115	33	19115	5.75	-19115	39820
27-Jun-06	1	-	-	-	-	-	23	17580	23	17580	5.75	-17580	
$	1	-	-	-	-	-	34	21780	34	21780	5.75	-21780	39360
28-Jun-06	1	-	-	-	-	-	21	15015	21	15015	5.75	-21015	
$	1	-	-	-	-	-	34	27375	34	27375	5.75	-27375	42390
29-Jun-06	1	-	-	-	-	-	23	22180	23	22180	5.75	-22180	
$	1	-	-	-	-	-	35	22115	35	22115	5.75	-22115	44295
30-Jun-06	3	-	-	-	-	-	18	17805	18	17805	5.75	-17805	
$	3	-	-	-	-	-	41	24760	41	24760	5.75	-24760	42565
3-Jul-06	1	-	-	-	-	-	25	27085	25	27085	5.75	-27085	
$	1	-	-	-	-	-	44	27530	44	27530	5.75	-27530	54615
4-Jul-06	1	-	-	-	-	-	30	36265	30	36265	5.75	-36265	
$	1	-	-	-	-	-	36	24105	36	24105	5.75	-24105	60370

APPENDIX TABLE 37 : REVERSE REPO / REPO AUCTIONS UNDER LIQUIDITY ADJUSTMENT FACILITY *(Concld.)*

(Amount in Rupees crore)

LAF Date	Repo/ Reverse Repo period (Day (s))	Repo (Injection)					Reverse Repo (Absorption)					Net Injections (+)/ absorption(–) of liquidity	Outstanding Amount@
		Bids received		Bids Accepted		Cut-Off Rate %	Bids Received		Bids Accepted		Cut-Off Rate %		
		Number	Amount	Number	Amount		Number	Amount	Number	Amount			
1	2	3	4	5	6	7	8	9	10	11	12	13	14
5-Jul-06	1	-	-	-	-	-	35	41765	35	41765	5.75	-41765	
$	1	-	-	-	-	-	40	22945	40	22945	5.75	-22945	64710
6-Jul-06	1	-	-	-	-	-	39	41800	39	41800	5.75	-41800	
$	1	-	-	-	-	-	43	29135	43	29135	5.75	-29135	70935
7-Jul-06	3	-	-	-	-	-	32	33910	32	33910	5.75	-33910	
$	3	-	-	-	-	-	45	24365	45	24365	5.75	-24365	58275
10-Jul-06	1	-	-	-	-	-	29	30630	29	30630	5.75	-30630	
$	1	-	-	-	-	-	36	22255	36	22255	5.75	-22255	52885
11-Jul-06	1	-	-	-	-	-	34	35465	34	35465	5.75	-35465	
$	1	-	-	-	-	-	30	18840	30	18840	5.75	-18840	54305
12-Jul-06	1	-	-	-	-	-	21	15495	21	15495	5.75	-15495	
$	1	-	-	-	-	-	35	27615	35	27615	5.75	-27615	43110
13-Jul-06	1	-	-	-	-	-	30	31685	30	31685	5.75	-31685	
$	1	-	-	-	-	-	25	13725	25	13725	5.75	-13725	45410
14-Jul-06	3	-	-	-	-	-	28	25500	28	25500	5.75	-25500	
$	3	-	-	-	-	-	23	14185	23	14185	5.75	-14185	39685
17-Jul-06	1	-	-	-	-	-	14	13920	14	13920	5.75	-13920	
$	1	-	-	-	-	-	37	28240	37	28240	5.75	-28240	42160
18-Jul-06	1	-	-	-	-	-	25	29810	25	29810	5.75	-29810	
$	1	-	-	-	-	-	27	15265	27	15265	5.75	-15265	45075
19-Jul-06	1	-	-	-	-	-	24	28875	24	28875	5.75	-28875	
$	1	-	-	-	-	-	30	14565	30	14565	5.75	-14565	43440
20-Jul-06	1	-	-	-	-	-	29	25465	29	25465	5.75	-25465	
$	1	-	-	-	-	-	38	21750	38	21750	5.75	-21750	47215
21-Jul-06	3	-	-	-	-	-	24	22055	24	22055	5.75	-22055	
$	3	-	-	-	-	-	46	24015	46	24015	5.75	-24015	46070
24-Jul-06	1	-	-	-	-	-	24	23860	24	23860	5.75	-23860	
$	1	-	-	-	-	-	26	13165	26	13165	5.75	-13165	37025
25-Jul-06	1	-	-	-	-	-	12	6845	12	6845	5.75	-6845	
$	1	-	-	-	-	-	41	36480	41	36480	6.00	-36480	43325
26-Jul-06	1	-	-	-	-	-	26	27745	26	27745	6.00	-27745	
$	1	-	-	-	-	-	37	17330	37	17330	6.00	-17330	45075
27-Jul-06	1	-	-	-	-	-	23	27275	23	27275	6.00	-27275	
$	1	-	-	-	-	-	36	17560	23	17560	6.00	-17560	44835
28-Jul-06	3	-	-	-	-	-	25	24595	25	24595	6.00	-24595	
$	3	-	-	-	-	-	33	19560	33	19560	6.00	-19560	44155
31-Jul-06	1	-	-	-	-	-	20	23285	20	23285	6.00	-23285	
$	1	-	-	-	-	-	39	21385	39	21385	6.00	-21385	44670
1-Aug-06	1	-	-	-	-	-	23	24780	23	24780	6.00	-24780	
$	1	-	-	-	-	-	41	24410	41	24410	6.00	-24410	49190
2-Aug-06	1	-	-	-	-	-	25	27070	25	27070	6.00	-27070	
$	1	-	-	-	-	-	43	22620	43	22620	6.00	-22620	49690
3-Aug-06	1	-	-	-	-	-	25	27115	25	27115	6.00	-27115	
$	1	-	-	-	-	-	40	21690	40	21690	6.00	-21690	48805
4-Aug-06	3	-	-	-	-	-	24	24800	24	24800	6.00	-24800	
$	3	-	-	-	-	-	51	23555	51	23555	6.00	-23555	48355
7-Aug-06	1	-	-	-	-	-	23	28735	23	28735	6.00	-28735	
$	1	-	-	-	-	-	29	18095	29	18095	6.00	-18095	46830
8-Aug-06	1	-	-	-	-	-	26	30280	26	30280	6.00	-30280	
$	1	-	-	-	-	-	28	14670	28	14670	6.00	-18670	44950
9-Aug-06	1	-	-	-	-	-	25	29840	25	29840	6.00	-29840	
$	1	-	-	-	-	-	28	11240	28	11240	6.00	-11240	41080
10-Aug-06	1	-	-	-	-	-	22	27965	22	27965	6.00	-27965	
$	1	-	-	-	-	-	27	11140	27	11140	6.00	-11140	39105
11-Aug-06	3	-	-	-	-	-	18	21740	18	21740	6.00	-21740	
$	3	-	-	-	-	-	19	9250	19	9250	6.00	-9250	30990

@ : Net of overnight repo. $: Second LAF auction introduced with effect from November 28, 2005. $$: Additional LAF on March 31, 2006.

Note : With effect from October 29, 2004, nomenclature of repo and reverse repo has been interchanged as per international usage. Till October 28, 2004, repo indicates absorption of liquidity whereas reverse repo indicates injection of liquidity by the Reserve Bank.

APPENDIX TABLE 38 : ISSUE OF CERTIFICATES OF DEPOSIT BY SCHEDULED COMMERCIAL BANKS

(Amount in Rupees crore)

Fortnight ended		Total Outstanding	Rate of Discount (Per cent) @	Fortnight ended		Total Outstanding	Rate of Discount (Per cent) @	Fortnight ended		Total Outstanding	Rate of Discount (Per cent) @
1		2	3	4		5	6	7		8	9
2004				**2005**				**2006**			
January	9	4,457	3.87-6.00	January	7	7,033	3.91-6.26	January	6	34,432	4.40-7.75
	23	4,419	3.57-6.11		21	4,236	4.01-6.25		20	34,521	5.40-7.75
February	6	4,826	3.92-5.06	February	4	8,202	4.50-6.32	February	3	33,986	4.35-7.90
	20	4,656	3.75-6.00		18	9,214	4.25-6.12		17	34,487	4.35-8.16
March	5	4,831	3.59-5.75	March	4	10,310	5.25-6.31	March	3	36,629	5.85-8.50
	19	4,461	3.87-5.16		18	12,078	4.21-6.34		17	36,931	4.35-8.81
April	2	4,626	3.75-5.16	April	1	14,975	4.75-6.60		31	43,568	6.50-8.94
	16	4,813	4.64-6.00		15	14,106	4.10-6.60	April	14	38,568	6.00-8.90
	30	4,725	3.50-4.45		29	16,602	4.24-6.50		28	44,059	6.00-8.45
May	14	4,703	4.08-4.61	May	13	17,420	4.29-6.75	May	12	48,515	6.50-7.90
	28	4,860	1.09-4.73		27	17,689	4.29-6.75		26	50,228	6.37-8.67
June	11	5,065	4.70-5.00	June	10	18,503	5.47-7.00	June	9	53,863	5.75-7.96
	25	5,438	3.96-6.75		24	19,270	5.58-7.50		23	56,390	5.50-8.16
July	9	5,529	4.14-6.75	July	8	20,509	4.50-7.00	July	7	57,256	6.00-8.70
	23	5,478	4.02-6.75		22	20,768	4.25-7.00				
August	6	4,605	4.30-6.75	August	5	21,062	4.75-7.00				
	20	4,480	4.50-5.00		19	23,568	4.66-7.00				
September	3	4,842	4.50-5.75	September	2	23,646	4.66-7.00				
	17	5,112	4.09-5.09		16	25,604	4.66-7.75				
October	1	5,164	3.50-5.50		30	27,641	4.39-7.00				
	15	4,837	4.00-5.75	October	14	27,626	4.66-7.75				
	29	4,785	4.50-6.26		28	29,193	5.25-7.75				
November	12	5,425	3.90-7.00	November	11	29,345	5.25-6.50				
	26	6,118	4.45-6.00		25	27,457	5.25-7.50				
December	10	7,121	4.19-6.20	December	9	30,445	5.35-7.75				
	24	6,103	3.96-6.75		23	32,806	5.50-7.25				

@ : Effective discount rate range per annum.

APPENDIX TABLE 39 : COMMERCIAL PAPER*

(Amount in Rupees crore)

Fortnight ended		Total Outstanding	Typical Effective Rates of Discount (Per cent)	Fortnight ended		Total Outstanding	Typical Effective Rates of Discount (Per cent)
1		2	3	4		5	6
2004							
January	15	9,525	4.63 – 6.00	May	15	16,078	5.38 – 6.65
	31	9,562	4.70 – 5.75		31	17,182	5.40 – 6.65
February	15	9,355	4.73 – 6.75	June	15	17,522	5.42 – 6.65
	29	9,379	4.60 – 7.50		30	17,797	5.45 – 6.51
March	15	9,342	4.81 – 5.90	July	15	18,207	5.57 – 7.50
	31	9,131	4.70 – 6.50		31	18,607	5.25 – 7.50
April	15	9,911	4.66 – 6.20	August	15	20,117	5.50 – 7.50
	30	10,362	4.50 – 6.50		31	19,508	5.45 – 7.50
May	15	10,644	4.47 – 5.95	September	15	20,019	5.50 – 6.56
	31	11,038	4.56 – 7.00		30	19,725	5.45 – 6.65
June	15	10,614	4.50 – 6.05	October	15	18,702	5.69 – 7.50
	30	10,950	4.60 – 6.20		31	18,725	5.63 – 7.50
July	15	10,794	4.63 – 7.00	November	15	17,903	5.75 – 6.60
	31	11,038	4.61 – 5.65		30	18,013	5.90 – 6.79
August	15	11,296	4.65 – 6.50	December	15	17,431	6.21 – 7.75
	31	11,002	4.60 – 7.69		31	17,234	6.20 – 7.75
September	15	11,183	4.68 – 7.00				
	30	11,371	4.55 – 6.50	**2006**			
October	15	10,929	4.95 – 7.25	January	15	17,415	6.50 – 7.75
	31	10,409	5.10 – 6.30		31	16,431	6.65 – 8.50
November	15	9,903	5.10 – 6.23	February	15	16,203	7.03 – 8.50
	30	10,719	5.40 – 7.00		28	15,876	7.22 – 8.75
December	15	13,330	5.35 – 6.75	March	15	12,877	7.75 – 8.95
	31	13,272	5.10 – 7.10		31	12,718	6.69– 9.25
				April	15	12,968	6.77 – 8.95
2005					30	16,550	6.35 – 9.25
January	15	12,998	5.40 – 6.35	May	15	17,264	6.32 – 7.95
	31	13,092	5.10 – 6.30		31	17,067	6.40 – 9.25
February	15	13,383	5.21 – 6.33	June	15	18,843	6.44 – 9.25
	28	13,189	5.37 – 7.33		30	19,550	6.59 – 9.25
March	15	13,995	5.50 – 6.76	July	15	21,452	6.25 – 8.30
	31	14,235	5.20 – 7.25		31	20,602	6.50 – 8.25
April	15	15,214	5.55 – 6.33				
	30	15,598	5.50 – 6.65				

***** : Issued at face value by companies.

APPENDIX TABLE 40: INDICES OF REAL EFFECTIVE EXCHANGE RATE (REER) AND NOMINAL EFFECTIVE EXCHANGE RATE (NEER) OF THE INDIAN RUPEE

Year/Month	36 - Currency Trade based weights (Base : 1993-94=100)		6 - Currency Trade based weights (Base : 1993-94 = 100)	
	REER	NEER	REER	NEER
1	2	3	4	5
1993-94	100.00	100.00	100.00	100.00
1994-95	104.32	98.91	105.71	96.86
1995-96	98.19	91.54	101.14	88.45
1996-97	96.83	89.27	100.97	86.73
1997-98	100.77	92.04	104.24	87.80
1998-99	93.04	89.05	95.99	77.37
1999-00	95.99	91.02	97.52	77.04
2000-01	100.09	92.12	102.64	77.30
2001-02	100.86	91.58	102.49	75.89
2002-03	98.18	89.12	97.43	71.09
2003-04	99.56	87.14	98.85	69.75
2004-05	100.09	87.31	101.35	69.26
2005-06 (P)	102.49	89.85	106.66	71.41
2004-05				
April	101.43	90.43	101.79	72.12
May	99.63	88.66	99.95	70.30
June	99.86	87.62	100.10	69.35
July	98.89	86.21	99.30	68.24
August	99.54	86.03	100.22	68.13
September	100.46	86.52	101.28	68.49
October	99.36	86.15	100.46	68.33
November	99.46	85.75	100.87	68.03
December	100.03	86.92	101.48	68.68
January	100.68	87.55	103.41	69.66
February	101.15	88.20	103.92	70.09
March	100.56	87.72	103.46	69.68
2005-06				
April	100.59	88.92	102.63	70.22
May	102.23	90.10	104.62	71.18
June	103.72	91.17	106.82	72.36
July	105.07	92.02	108.38	73.04
August	104.05	90.86	107.39	72.08
September	104.14	90.45	107.27	71.57
October	102.71	89.40	106.43	70.90
November	101.62	88.36	106.18	70.27
December	100.66	87.97	105.98	70.22
January	101.73	89.51	107.57	71.46
February	101.88	89.92	108.61	72.03
March	101.46	89.47	108.09	71.61
2006-07 (P)				
April	98.56	88.20	104.09	70.22
May	96.38	88.20	101.57	67.95
June	n.a.	n.a.	101.81	67.39

n.a. : Not available. P : Provisional.

Note : For detailed methology of compilation of indices, see "Revision of Nominal Effective Exchange Rate (NEER) and Real Effective Exchange Rate (REER) Indices", *Reserve Bank of India Bulletin*, December 2005.

APPENDIX TABLE 41: INTER-BANK AND MERCHANT TRANSACTIONS IN THE FOREIGN EXCHANGE MARKET

(US $ million)

Month	Inter-bank							Merchant						
	Spot			Forward/Swap				Spot			Forward			
	Purchases	Sales	Net	Purchases	Sales	Net	Turnover	Purchases	Sales	Net	Purchases	Sales	Net	Turnover
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
2005														
Jan	29057	27615	1442	30231	34039	-3808	173159	13636	13343	293	6395	5833	562	61755
Feb	38610	41037	-2427	51125	47820	3306	231650	15961	13440	2521	8851	5861	2990	64792
Mar	38825	39029	-204	43822	38875	4947	237011	19957	18015	1942	9304	6978	2326	88641
Apr	21065	20011	1054	30933	34493	-3560	167965	13928	14187	-259	5072	5452	-381	65072
May	31421	30410	1011	36274	35240	1034	211736	15449	15935	-487	9426	7325	2101	81569
June	34588	34161	427	37023	39286	-2263	239169	20969	17939	3030	6877	8110	-1233	92694
July	28851	29676	-825	34304	33776	528	231071	17874	17623	251	8341	6843	1498	91245
Aug	36374	37015	-640	48821	48765	56	258471	18873	19355	-482	10070	8730	1340	98706
Sept	31937	30365	1572	31393	31598	-205	210830	17803	17797	6	7246	8946	-1700	90727
Oct	45540	43899	1641	42703	42610	92	261732	19290	21708	-2418	10356	14421	-4065	105729
Nov	36898	35495	1403	37549	39579	-2030	235796	18137	17878	259	7365	10836	-3471	101620
Dec	46441	44071	2370	53081	65929	-12848	303766	20631	21703	-1072	10471	12933	-2462	120738
2006														
Jan	46977	45957	1020	63550	78930	-15380	350971	21448	21670	-223	10029	11289	-1259	128121
Feb	39105	38832	273	57192	73721	-16530	315952	21000	19998	1002	6564	8207	-1644	102999
Mar	46582	54533	-7951	76707	97281	-20574	404797	31723	26404	5318	9554	10795	-1241	141231
Apr (P)	45511	47256	-1745	58672	73856	-15184	351480	27144	23863	3281	8573	12792	-4219	128699
May (P)	57426	55846	1580	67602	73209	-5607	411878	25283	28995	-3712	13705	14030	-325	157870
June (P)	52268	51362	906	48174	54819	-6645	319260	23124	24160	-1036	11177	11889	-712	122304
July (P)	44370	42904	1466	43032	47665	-4633	295411	19710	20205	-495	10445	12245	-1800	116881

P : Provisional.

Note : 1. Merchant turnover includes cross-currency (*i.e.* foreign currency to foreign currency, both spot & forward) transactions and cancellation of forward contracts.

2. Inter-bank turnover includes cross-currency (*i.e.* foreign currency to foreign currency, both spot & forward) transactions.

APPENDIX TABLE 42: SECONDARY MARKET TRANSACTIONS IN GOVERNMENT SECURITIES

(Amount in Rupees crore)

Instruments	Apr-05	May-05	Jun-05	Jul-05	Aug-05	Sep-05	Oct-05	Nov-05	Dec-05	Jan-06	Feb-06	Mar-06	Apr-06	May-06	Jun-06	Jul-06
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17
I. Outright Transaction																
1. Central Government Securities	45,020	58,984	102,099	57,317	65,711	78,100	43,626	49,709	45,691	47,954	36,177	34,147	55,280	55,029	33,870	34,770
	(53.45)	(68.37)	(84.42)	(81.20)	(70.91)	(80.96)	(70.47)	(78.63)	(79.27)	(81.97)	(83.54)	(74.39)	(83.56)	(79.63)	(71.03)	(78.09)
2. State Government Securities	981	2,685	2,706	1,254	1,644	2,506	1,574	1,066	1,140	894	920	2,267	426	2,519	1,070	708
	(1.16)	(3.11)	(2.24)	(1.78)	(1.77)	(2.60)	(2.54)	(1.69)	(1.98)	(1.53)	(2.12)	(4.94)	(0.64)	(3.64)	(2.24)	(1.59)
3. Treasury Bills	38,224	24,597	16,132	12,017	25,317	15,866	16,703	12,440	10,808	9,656	6,210	9,487	10,453	11,562	12,747	9,050
	(45.38)	(28.51)	(13.34)	(17.02)	(27.32)	(16.45)	(26.98)	(19.68)	(18.75)	(16.50)	(14.34)	(20.67)	(15.80)	(16.73)	(26.73)	(20.32)
(a) 91 days	16,162	7,275	6,383	4,573	6,765	3,285	5,512	3,404	2,340	1,641	1,772	2,421	1,097	3,222	2,885	2,863
	(19.19)	(8.43)	(5.28)	(6.48)	(7.30)	(3.41)	(8.90)	(5.38)	(4.06)	(2.81)	(4.09)	(5.27)	(1.66)	(4.66)	(6.05)	(6.43)
(b) 182 days	1,446	1,073	1,266	1,594	2,635	2,044	2,939	2,610	2,422	1,597	1,008	1,444	1,023	2,212	4,171	2,071
	(1.72)	(1.24)	(1.05)	(2.26)	(2.84)	(2.12)	(4.75)	(4.13)	(4.20)	(2.73)	(2.33)	(3.15)	(1.55)	(3.20)	(8.75)	(4.62)
(c) 364 days	20,616	16,249	8,484	5,850	15,917	10,537	8,252	6,427	6,046	6,418	3,430	5,622	8,333	6,128	5,691	4,116
	(24.48)	(18.84)	(7.01)	(8.29)	(17.18)	(10.92)	(13.33)	(10.17)	(10.49)	(10.97)	(7.92)	(12.25)	(12.60)	(8.87)	(11.93)	(9.24)
Total (1+2+3)	84,225	86,266	120,937	70,588	92,672	96,472	61,903	63,215	57,640	58,505	43,306	45,902	66,159	69,110	47,687	44,527
	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)
II. Repo Transaction																
1. Central Government Securities	66,188	89,220	92,656	99,398	1,37,958	1,29,342	1,09,087	1,07,897	1,40,350	1,24,832	1,13,655	1,60,530	93,578	1,90,987	2,07,409	1,67,715
	(72.49)	(84.10)	(71.98)	(70.85)	(83.48)	(91.38)	(83.20)	(73.13)	(84.45)	(84.58)	(82.03)	(82.50)	(78.08)	(81.80)	(75.44)	(69.73)
2. State Government Securities	2,061	4,277	5,541	2,655	1,899	2,204	2,078	1,842	2,000	5,689	7,769	9,557	2,259	6,182	7,241	5,372
	(2.26)	(4.03)	(4.30)	(1.89)	(1.15)	(1.56)	(1.58)	(1.25)	(1.20)	(3.85)	(5.61)	(4.91)	(1.88)	(2.65)	(2.63)	(2.22)
3. Treasury Bills	23,054	12,586	30,524	38,245	25,411	9,991	19,955	37,805	23,834	17,067	17,124	24,489	24,017	36,300	60,300	68,678
	(25.25)	(11.86)	(23.71)	(27.28)	(15.38)	(7.06)	(15.22)	(25.62)	(14.34)	(11.56)	(12.36)	(12.59)	(20.04)	(15.55)	(21.93)	(28.41)
(a) 91 days	10,313	6,207	11,761	8,109	4,516	2,602	5,121	10,926	893	1,377	2,134	729	1,840	10,063	23,773	21,894
	(11.30)	(5.85)	(9.14)	(5.78)	(2.73)	(1.84)	(3.91)	(7.41)	(0.54)	(0.93)	(1.54)	(0.37)	(1.54)	(4.31)	(8.65)	(9.06)
(b) 182 days	361	359	500	1,666	331	273	2,870	4,597	3,855	2,033	1,955	4,127	4,311	6,571	9,379	7,778
	(0.40)	(0.34)	(0.39)	(1.19)	(0.20)	(0.19)	(2.19)	(1.2)	(2.32)	(1.38)	(1.41)	(2.12)	(3.60)	(2.81)	(3.41)	(3.22)
(c) 364 days	12,380	6,020	18,263	28,470	20,564	7,117	11,964	22,283	19,086	13,656	13,034	19,633	17,866	19,666	27,149	39,006
	(13.56)	(5.67)	(14.19)	(20.29)	(12.44)	(5.03)	(9.12)	(15.1)	(11.48)	(9.25)	(9.41)	(10.09)	(14.91)	(8.42)	(9.87)	(16.13)
Total (1+2+3)	91,302	1,06,084	1,28,721	1,40,298	1,65,269	1,41,537	1,31,119	1,47,544	1,66,184	1,47,586	1,38,548	1,94,576	1,19,854	2,33,470	2,74,951	2,41,765
	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)
III. GRAND TOTAL (I+II)	**1,75,527**	**1,92,350**	**2,49,658**	**2,10,887**	**2,57,941**	**2,38,009**	**1,93,022**	**2,10,759**	**2,23,824**	**2,06,091**	**1,81,854**	**2,40,478**	**1,86,012**	**3,02,579**	**3,22,638**	**2,86,293**
Percentage of I to III	47.98	44.85	48.44	33.47	27.37	40.53	32.07	29.99	25.75	(28.39)	(23.81)	(19.09)	(35.57)	(22.84)	(14.78)	(15.55)
Percentage of II to III	52.02	55.15	51.56	66.53	72.63	59.47	67.93	70.01	74.25	(71.61)	(76.19)	(80.91)	(64.43)	(77.16)	(85.22)	(84.45)

Note : 1. Figures in brackets indicate percentages to total outright/ repo transactions. Repos transactions exclude second leg of transactions.
2. 182-day Treasury Bills have been re-introduced from the year 2005-06.

APPENDIX TABLE 43 : NEW CAPITAL ISSUES BY NON-GOVERNMENT PUBLIC LIMITED COMPANIES

(Amount in Rupees crore)

Security and Type of Issue	2003-04		2004-05		2005-06	
	No. of Issues	Amount	No. of Issues	Amount	No. of Issues	Amount
1	2	3	4	5	6	7
1) Equity Shares (a+b)	**35**	**2,323**	**51**	**12,004**	**128**	**20,899**
	(24)	**(1,613)**	**(46)**	**(11,049)**	**(118)**	**(18,793)**
a) Prospectus	14	1,470	25	8,389	92	16,801
	(9)	(1,087)	(24)	(8,010)	(89)	(15,355)
b) Rights	21	853.0	26	3,615	36	4,098
	(15)	(526)	(22)	(3,039)	(29)	(3,439)
2) Preference Shares (a+b)	**–**	**–**	**–**	**–**	**1**	**10**
a) Prospectus	–	–	–	–	1	10
b) Rights	–	–	–	–	–	–
3) Debentures (a+b)	**–**	**–**	**–**	**–**	**2**	**245**
a) Prospectus	–	–	–	–	1	127
b) Rights	–	–	–	–	1	118
Of which:						
i) Convertible (a+b)	–	–	–	–	–	–
a) Prospectus	–	–	–	–	–	–
b) Rights	–	–	–	–	–	–
ii) Non-Convertible (a+b)	–	–	–	–	2	245
a) Prospectus	–	–	–	–	1	127
b) Rights	–	–	–	–	1	118
4) Bonds (a+b)	**3**	**1,352**	**3**	**1,478**	**–**	**–**
a) Prospectus	3	1,352	3	1,478	–	–
b) Rights	–	–	–	–	–	–
5) Total (1+2+3+4)	**38**	**3,675**	**54**	**13,482**	**131**	**21,154**
a) Prospectus	17	2,822	28	9,867	94	16,938
b) Rights	21	853	26	3,615	37	4,216

– : Nil/Negligible.

Note :
1. Data are provisional.
2. Data exclude bonus shares, offers for sale and private placements.
3. Figures in brackets indicate data in respect of premium on capital issues. These are included in respective totals.
4. Preference shares include cumulative convertible preference shares and equi-preference shares.
5. Convertible debentures include partly convertible debentures.
6. Non-convertible debentures include secured premium notes and secured deep discount bonds.
7. Data are compiled from prospectus/circulars/advertisements issued by companies, replies given by the companies to the Reserve Bank's questionnaires, information received from stock exchanges, press reports, *etc.*

APPENDIX TABLE 44 : ASSISTANCE SANCTIONED AND DISBURSED BY FINANCIAL INSTITUTIONS

(Rupees crore)

Institutions	2003-04		2004-05 P		2005-06 P	
	Sanctions	Disbursements	Sanctions	Disbursements	Sanctions	Disbursements
1	2	3	4	5	6	7
A. All India Development Banks (1to 5)	**21,708**	**14,633**	**26,304**	**16,185**	**50,015**	**28,266**
1. IDBI	3,938	4,986	10,799	6,183	27,442	12,984
2. IFCI	1,392	278	–	91	–	187
3. IDFC	5,720	2,703	6,414	3,723	10,631	6,045
4. SIDBI	8,246	4,414	9,091	6,188	11,942	9,050
5. IIBI	2,412	2,252	–	–	–	–
B. Specialised Financial Institutions (6 to 8)	**440**	**396**	**111**	**72**	**132**	**86**
6. IVCF	–	–	–	–	–	–
7. ICICI Venture	380	361	n.a.	n.a.	n.a.	n.a.
8. TFCI	60	35	111	72	132	86
C. Investment Institutions (9 to 10)	**23,197**	**16,989**	**10,403**	**8,972**	**15,165**	**11,200**
9. LIC	21,974	15,782	9,340	7,954	15,165	11,200
10. GIC $	1,223	1,207	1,063	1,018	n.a.	n.a.
D. Total Assistance by All-India Financial Institutions (A+B+C)	**45,345**	**32,018**	**36,818**	**25,299**	**65,312**	**39,552**
E. State-level Institutions (11 and 12)	**1,134**	**857**	**n.a.**	**n.a.**	**n.a.**	**n.a.**
11. SFCs	1,134	857	n.a.	n.a.	n.a.	n.a.
12. SIDCs	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
F. Total Assistance by All Financial Institutions (AFIs) [D+E]	**46,479**	**32,875**	**36,818**	**25,299**	**65,312**	**39,552**

P : Provisional. – : Nil/Negligible. n.a. : Not available.

$: Data include GIC and its subsidiaries.

Source : Respective financial instiutions.

APPENDIX TABLE 45 : TRENDS IN DOMESTIC STOCK INDICES

Year/Month	BSE Sensitive Index (Base: 1978-79=100)				S&P CNX Nifty (Base: 03.11.1995 = 1000)			
	Average	High	Low	End of the Year/Month	Average	High	Low	End of the Year/Month
1	2	3	4	5	6	7	8	9
2003-04	**4492 (40.1)**	**6194**	**2924**	**5591 (83.4)**	**1428 (37.6)**	**1982**	**924**	**1772 (81.2)**
2004-05	**5741 (27.8)**	**6915**	**4505**	**6493 (16.1)**	**1805 (26.5)**	**2169**	**1389**	**2036 (14.9)**
2005-06	**8280 (44.2)**	**11307**	**6135**	**11280 (73.7)**	**2513 (39.2)**	**3419**	**1903**	**3403 (67.1)**
2005								
January	6301	6679	6103	6556	1978	2115	1910	2058
February	6595	6714	6530	6714	2067	2103	2043	2103
March	6679	6915	6368	6493	2096	2169	1984	2036
April	6379	6606	6135	6154	1987	2069	1903	1903
May	6483	6715	6195	6715	2002	2088	1917	2088
June	6926	7194	6656	7194	2134	2221	2065	2221
July	7337	7635	7145	7635	2237	2391	2179	2312
August	7726	7860	7596	7805	2358	2403	2318	2385
September	8272	8650	7876	8634	2512	2611	2406	2601
October	8220	8800	7686	7892	2487	2663	2316	2371
November	8552	8995	7944	8789	2575	2712	2387	2652
December	9162	9398	8816	9398	2773	2843	2661	2837
2006								
January	9540	9920	9238	9920	2893	3001	2809	3001
February	10090	10370	9743	10370	3019	3075	2941	3075
March	10857	11307	10509	11280	3236	3419	3117	3403
April	11742	12043	11237	12043	3494	3574	3346	3558
May	11599	12612	10399	10399	3437	3754	3071	3071
June	9935	10609	8929	10609	2915	3128	2633	3128
July	10557	10930	10007	10774	3092	3197	2933	3143

Note : Figures in parentheses are percentage variations over the previous year.
Source : The Stock Exchange, Mumbai (BSE) and the National Stock Exchange of India Ltd. (NSE).

APPENDIX 46 : MAJOR INDICATORS OF DOMESTIC EQUITY MAKRETS

Year/Month	The Stock Exchange, Mumbai (BSE)					National Stock Exchange of India Ltd. (NSE)				
	Coefficient of Variation @	Dispersion (Range) @	Price/ Earning Ratio $	Market Capitalisation (Rupees crore)	Turnover (Rupees crore)	Coefficient of Variation @	Dispersion (Range) @	Price/ Earning Ratio $	Market Capitalisation (Rupees crore)	Turnover (Rupees crore)
1	2	3	4	5	6	7	8	9	10	11
2002-03	**4.9**	**678.14**	**14.51**	**5,72,198**	**3,14,073**	**5.2**	**223.80**	**15.24**	**5,37,133**	**6,17,989**
2003-04	**23.0**	**1,844.79**	**16.03**	**12,01,207**	**5,03,053**	**23.3**	**1,057.85**	**14.59**	**11,20,976**	**10,99,535**
2004-05	**11.2**	**2,409.93**	**16.56**	**16,98,428**	**5,18,715**	**11.3**	**780.00**	**14.79**	**15,85,585**	**11,40,071**
2005-06	**16.7**	**5,172.18**	**16.98**	**30,22,191**	**8,16,074**	**15.6**	**1,516.45**	**15.69**	**28,13,201**	**15,69,556**
2005										
January	2.7	576.46	16.29	16,61,532	43,888	3.1	206.0	14.41	15,57,444	99,732
February	0.7	183.80	15.75	17,30,940	49,686	0.8	60.05	14.41	16,14,597	99,989
March	2.6	547.23	16.05	16,98,428	59,528	2.8	185.1	14.95	15,85,585	1,13,055
April	2.4	471.55	15.25	16,35,766	37,809	2.8	166.8	14.16	15,17,908	82,718
May	2.1	519.96	14.94	17,83,221	43,359	2.3	170.8	13.77	16,54,995	86,802
June	2.3	538.29	15.75	18,50,377	58,480	2.1	155.95	14.02	17,27,502	1,11,397
July	1.9	490.29	16.01	19,87,170	61,899	1.8	139.7	14.31	18,48,740	1,23,008
August	1.0	263.96	16.00	21,23,901	75,933	1.0	85.1	14.61	19,57,491	1,45,731
September	3.0	774.02	17.11	22,54,378	81,291	2.6	205.45	15.58	20,98,263	1,45,393
October	4.0	1,114.32	16.77	20,65,612	59,102	4.1	347.3	15.26	19,27,645	1,20,810
November	3.3	1,050.84	16.75	23,23,065	52,694	3.5	325.25	15.47	21,66,823	1,09,578
December	2.1	582.40	18.09	24,89,386	77,356	2.1	182.10	16.72	23,22,392	1,49,908
2006										
January	2.0	682.36	18.54	26,16,194	79,316	1.8	191.90	17.27	24,34,395	1,49,442
February	1.5	627.66	18.64	26,95,543	70,070	1.2	134.10	17.97	25,12,083	1,35,374
March	2.0	798.19	20.05	30,22,191	1,18,765	2.6	302.25	19.25	28,13,201	2,09,395
April	1.9	805.33	21.35	32,55,565	87,487	1.8	228.00	20.59	29,90,200	1,77,372
May	6.8	2213.77	20.41	28,42,049	95,820	7.0	683.20	19.53	26,12,639	2,01,409
June	4.3	1679.81	17.90	27,21,677	72,013	4.3	495.40	16.65	25,24,659	1,51,051
July	2.5	922.75	19.02	27,12,143	54,699	2.6	264.35	17.95	25,14,261	1,18,698

@ : Based on BSE Sensex and S&P CNX Nifty, respectively.

$: Based on scrips included in the BSE Sensex and the S&P CNX Nifty respectively.

Source : The Stock Exchange, Mumbai (BSE) and the National Stock Exchange of India Ltd. (NSE).

APPENDIX TABLE 47 : TURNOVER IN THE EQUITY DERIVATIVES MARKET

(Rupees crore)

Year/Month	The Stock Exchange, Mumbai (BSE)				The National Stock Exchange of India Ltd. (NSE)				
	Index Futures	Index Options $	Stock Futures	Stock Options $	Index Futures	Index Options $	Stock Futures	Stock Options $	Interest Rate Futures
1	2	3	4	5	6	7	8	9	10
2002-03	**1,811**	**2**	**644**	**21**	**43,952**	**9,247**	**286,532**	**1,00,133**	**–**
2003-04	**6,572**	**0**	**5,171**	**332**	**5,54,446**	**52,816**	**13,05,939**	**2,17,207**	**202**
2004-05	**13,600**	**2,297**	**213**	**3**	**7,72,147**	**1,21,943**	**14,84,056**	**1,68,836**	**–**
2005-06	**6**	**3**	**1**	**0**	**15,13,755**	**3,38,469**	**27,91,697**	**1,80,253**	**0**
2004-05									
April	76	0	9	0	79,555	7,315	1,21,044	12,376	0
May	0	0	39	0	82,149	10,292	92,629	9,690	0
June	0	0	0	0	64,018	8,473	78,392	7,423	0
July	0	0	0	0	61,124	9,912	94,009	10,293	0
August	0	0	0	0	57,924	7,384	99,590	11,104	0
September	834	228	32	0	49,497	7,444	1,07,123	14,308	0
October	2,775	514	1	0	47,188	8,530	1,11,695	14,806	0
November	4,193	482	20	0	38,277	8,792	1,13,524	15,205	0
December	4,454	443	50	0	58,331	9,711	1,79,385	20,794	0
January	1,091	298	24	2	76,146	12,976	1,59,561	16,600	0
February	135	149	21	0	71,544	13,122	1,51,741	17,135	0
March	42	184	17	0	86,394	17,992	1,75,363	19,102	0
2005-06									
April	0	3	0	0	65,595	13,274	1,06,128	10,966	0
May	0	0	0	0	70,465	14,782	1,12,878	10,250	0
June	0	0	0	0	77,215	16,133	1,63,097	14,797	0
July	0	0	0	0	77,395	16,770	1,99,637	14,358	0
August	0	0	0	0	1,00,805	21,992	2,34,817	14,685	0
September	0	0	0	0	1,18,904	27,921	2,36,941	15,984	0
October	0	0	0	0	1,70,096	35,584	2,14,396	13,575	0
November	0	0	0	0	1,35,474	31,074	2,16.524	12,773	0
December	0	0	0	0	1,83,290	42,988	2,80,280	17,245	0
January	0	0	0	0	1,66,126	38,522	2,65,037	17,895	0
February	1	0	0	0	1,56,358	32,332	2,88,712	15,262	0
March	5	0	1	0	1,92,032	47,097	4,73,250	22,463	0
2006-07									
April	1	0	0	0	2,04,236	52,421	4,60,552	20,623	0
May	0	0	0	0	2,57,326	58,789	4,09,401	16,874	0
June	18	0	0	0	2,43,572	57,969	2,43,950	11306	0
July	0	0	0	0	1,86,760	54,711	2,22,539	13,245	0

$: Notional turnover for call and put options. – : Negligible/Not available.

Note : Index futures were introduced in June 2000, index options in June 2001, stock options in July 2001 and stock futures in November 2001 both in the BSE and NSE.

Source : The Stock Exchange, Mumbai (BSE) and the National Stock Exchange of India Ltd. (NSE).

APPENDIX 48 : SELECT ECONOMIC INDICATORS – WORLD

Item	1999	2000	2001	2002	2003	2004	2005	2006$	2007$
1	2	3	4	5	6	7	8	9	10
I. World Output (Per cent change)	3.7	4.8	2.6	3.1	4.1	5.3	4.8	4.9	4.7
i) Advanced economies	3.4	3.9	1.2	1.6	2.0	3.3	2.7	3.0	2.8
ii) Other emerging market and developing countries	4.1	6.1	4.4	5.1	6.7	7.6	7.2	6.9	6.6
a) Developing Asia	6.3	7.0	6.1	7.0	8.4	8.8	8.6	8.2	8.0
b) Africa	2.6	3.1	4.2	3.6	4.6	5.5	5.2	5.7	5.5
c) Middle East	2.0	5.4	3.2	4.3	6.6	5.4	5.9	5.7	5.4
d) Western Hemisphere	0.5	3.9	0.5	–	2.2	5.6	4.3	4.3	3.6
II. Inflation-CPI (Per cent change)									
i) Advanced economies	1.4	2.2	2.1	1.5	1.8	2.0	2.3	2.3	2.1
ii) Other emerging market and developing countries	10.1	7.1	6.6	5.8	5.8	5.7	5.4	5.4	4.8
a) Developing Asia	2.4	1.8	2.6	2.0	2.5	4.2	3.6	3.9	3.5
III. Fiscal Balance #									
i) Advanced economies	-1.0	0.1	-0.9	-2.4	-3.0	-2.8	-2.4	-2.4	-2.4
ii) Other emerging market and developing countries (Weighted Average)	-3.8	-2.9	-3.1	-3.4	-2.7	-1.6	-0.8	-0.9	-0.8
IV. Net Capital Flows* (US $ billion)									
Emerging market and developing countries**									
i) Net private capital flows (a+b+c)	80.8	74.3	75.6	97.3	160.4	230.6	254.0	178.8	153.8
a) Net private direct investment	177.6	167.5	180.3	149.5	157.5	184.3	212.3	220.6	217.5
b) Net private portfolio investment	72.7	17.6	-70.6	-78.6	-3.7	34.5	38.5	-4.7	-3.2
c) Net other private capital flows	-169.5	-110.8	-34.1	26.5	6.6	11.8	3.2	-37.1	-60.5
ii) Net official flows	26.4	-46.0	-0.1	9.0	-61.5	-81.5	-138.6	-161.3	-163.6
V. World Trade @									
Imports									
i) Advanced economies	8.1	11.6	-0.5	2.5	4.1	8.9	5.8	6.2	5.6
ii) Newly industrialised Asian economies	8.4	17.6	-5.7	8.8	9.7	16.8	7.2	7.9	7.5
Exports									
i) Advanced economies	5.6	11.7	-0.6	2.2	3.3	8.5	5.3	6.6	6.1
ii) Newly industrialised Asian economies	9.4	17.1	-3.8	10.0	13.4	17.7	9.3	9.0	7.6
Terms of Trade									
i) Advanced economies	-0.3	-2.6	0.5	0.8	1.1	-0.1	-1.3	-0.9	0.2
ii) Newly industrialised Asian economies	-2.4	-3.2	-0.6	–	-1.7	-2.0	-2.5	-1.5	-0.3
VI. Current Account Balance (US $ billion)									
i) Advanced economies	-116.5	-268.4	-219.8	-237.4	-217.2	-283.9	-510.7	-602.7	-615.7
ii) Other emerging market and developing countries	-13.0	91.1	44.2	84.5	148.5	219.8	423.3	486.7	473.2
a) Developing Asia	48.4	46.1	40.6	72.2	86.3	94.7	155.4	159.5	171.9

$: Projections.

: Central Government Balance as percentage of GDP.

* : Net capital flows comprise net direct investment, net portfolio investment, and other long-term and short term net investment flows, including official and private borrowings.

** : Emerging Market and Developing Countries include countries in transition, Korea, Singapore, Taiwan Province of China, Israel, Hong kong.

@ : Annual percentage change in world trade volume of goods and services.

Source : World Economic Outlook, IMF, April 2006.

APPENDIX TABLE 49 : INDIA'S OVERALL BALANCE OF PAYMENTS

Item	Rupees crore			US $ million		
	2003-04 R	2004-05 PR	2005-06 P	2003-04 R	2004-05 PR	2005-06 P
1	2	3	4	5	6	7
A. CURRENT ACCOUNT						
1. Exports, f.o.b.	3,03,915	3,68,427	4,64,233	66,285	82,150	1,04,780
2. Imports, c.i.f.	3,67,301	5,32,969	6,92,196	80,003	1,18,779	1,56,334
3. Trade Balance	-63,386	-1,64,542	-2,27,963	-13,718	-36,629	-51,554
4. Invisibles, Net	1,27,369	1,39,756	1,81,107	27,801	31,229	40,942
a) 'Non-Factor' Services	46,381	63,519	98,437	10,144	14,199	22,265
of which : Software Services	*56,606*	*74,140*	*98,678*	*12,324*	*16,526*	*22,262*
b) Income	-20,708	-17,157	-24,969	-4,505	-3,814	-5,599
c) Private Transfers	99,165	90,744	1,06,830	21,608	20,253	24,095
d) Official Transfers	2,531	2,650	809	554	591	181
5. Current Account Balance	63,983	-24,786	-46,856	14,083	-5,400	-10,612
B. CAPITAL ACCOUNT						
1. Foreign Investment, Net (a+b)	62,842	54,260	80,759	13,744	12,147	18,222
a) Direct Investment	10,944	14,639	25,424	2,388	3,240	5,733
i) In India	19,830	25,159	34,106	4,322	5,589	7,691
Equity	*10,213*	*16,741*	*25,549*	*2,229*	*3,714*	*5,759*
Reinvested Earnings	*6,710*	*6,776*	*7,420*	*1,460*	*1,508*	*1,676*
Other Capital	*2,907*	*1,642*	*1,137*	*633*	*367*	*256*
ii) Abroad	-8,886	-10,520	-8,682	-1,934	-2,349	-1,958
Equity	*-5,155*	*-5,649*	*-4,332*	*-1,122*	*-1,261*	*-978*
Reinvested Earnings	*-2,536*	*-3,146*	*-1,612*	*-552*	*-700*	*-364*
Other Capital	*-1,195*	*-1,725*	*-2,738*	*-260*	*-388*	*-616*
b) Portfolio Investment	51,898	39,621	55,335	11,356	8,907	12,489
In India	51,898	39,621	55,335	11,356	8,907	12,489
Abroad	0	0	0	0	0	0
2. External Assistance, Net	-13,032	8,525	6,405	-2,858	1,923	1,438
Disbursements	15,311	16,988	15,157	3,350	3,809	3,415
Amortisation	28,343	8,463	8,752	6,208	1,886	1,977
3. Commercial Borrowings, Net	-13,260	22,456	6,427	-2,925	5,040	1,591
Disbursements	23,979	38,279	59,512	5,228	8,546	13,451
Amortisation	37,239	15,823	53,085	8,153	3,506	11,860
4. Short term Credit, Net	6,679	16,957	7,591	1,419	3,792	1,708
5. Banking Capital,						
of which:	27,782	17,083	5,795	6,033	3,874	1,373
NRI Deposits, Net	*16,869*	*-4,784*	*12,457*	*3,642*	*-964*	*2,789*
6. Rupee Debt Service	-1,756	-1,858	-2,557	-376	-417	-572
7. Other Capital, Net @	7,972	20,945	4,101	1,699	4,668	933
8. Total Capital Account	77,227	1,38,368	1,08,521	16,736	31,027	24,693
C. Errors & Omissions	2,783	2,325	4,231	602	532	971
D. Overall Balance [A(5)+B(8)+C]	**1,43,993**	**1,15,907**	**65,896**	**31,421**	**26,159**	**15,052**
E. Monetary Movements (F+G)	-1,43,993	-1,15,907	-65,896	-31,421	-26,159	-15,052
F. IMF, Net	0	0	0	0	0	0
G. Reserves and Monetary Gold (Increase -, Decrease +)	**-1,43,993**	**-1,15,907**	**-65,896**	**-31,421**	**-26,159**	**-15,052**

R : Revised.
PR : Partially Revised.
P : Preliminary.
@ : Includes delayed export receipts, advance payments against imports.

Note : 1. Gold and silver brought by returning Indians have been included under imports, with a contra entry in private transfer receipts.
2. Data on exports and imports differ from those given by DGCI&S on account of differences in coverage, valuation and timing.

APPENDIX TABLE 50 : INDIA'S FOREIGN TRADE

Item	Rupees crore			US $ million			SDR million		
	2003-04	2004-05	2005-06 P	2003-04	2004-05	2005-06 P	2003-04	2004-05	2005-06 P
1	2	3	4	5	6	7	8	9	10
I. Exports	**2,93,367 (15.0)**	**3,75,340 (27.9)**	**4,54,800 (21.2)**	**63,843 (21.1)**	**83,536 (30.8)**	**1,02,725 (23.0)**	**44,663 (12.3)**	**56,081 (25.6)**	**70,523 (25.8)**
a. POL @	16,397 (31.5)	31,404 (91.5)	50,979 (62.3)	3,568 (38.5)	6,989 (95.9)	11,515 (64.7)	2,496 (28.4)	4,692 (88.0)	7,905 (68.5)
b. Non-oil	2,76,969 (14.1)	3,43,935 (24.2)	4,03,821 (17.4)	60,274 (20.2)	76,547 (27.0)	91,211 (19.2)	42,167 (11.4)	51,389 (21.9)	62,618 (21.9)
II. Imports	**3,59,108 (20.8)**	**5,01,065 (39.5)**	**6,30,527 (25.8)**	**78,149 (27.3)**	**1,11,517 (42.7)**	**1,42,416 (27.7)**	**54,672 (18.0)**	**74,866 (36.9)**	**97,772 (30.6)**
a. Oil and POL	94,520 (10.7)	1,34,094 (41.9)	1,94,640 (45.2)	20,569 (16.6)	29,844 (45.1)	43,963 (47.3)	14,390 (8.1)	20,036 (39.2)	30,182 (50.6)
b. Non-oil	2,64,588 (24.9)	3,66,971 (38.7)	4,35,887 (18.8)	57,580 (31.5)	81,673 (41.8)	98,453 (20.5)	40,282 (21.9)	54,830 (36.1)	67,590 (23.3)
III. Trade Balance (I-II)	**-65,741**	**-1,25,725**	**-1,75,727**	**-14,307**	**-27,981**	**-39,691**	**-10,009**	**-18,785**	**-27,249**
a. Oil Balance (I.a-II.a)	-78,123	-1,02,690	-1,43,661	-17,001	-22,855	-32,449	-11,894	-15,343	-22,277
b. Non-oil Balance (I.b-II.b)	12,382	-23,035	-32,066	2,694	-5,127	-7,243	1,885	-3,442	-4,972

P : Provisional. @ : Petroleum, oil and lubricants.

Note : Figures in parentheses relate to percentage variation over the previous year.

Source : DGCI&S.

APPENDIX TABLE 51 : INDIA'S EXPORTS OF PRINCIPAL COMMODITIES

Commodity Group	Rupees crore					US $ million				
				Percentage Variation					Percentage Variation	
	2003-04	2004-05	2005-06P	(2)/(3)	(3)/(4)	2003-04	2004-05	2005-06P	(7)/(8)	(8)/(9)
1	2	3	4	5	6	7	8	9	10	11
I. Primary Products	**45,500 (15.5)**	**60,897 (16.2)**	**72,556 (16.0)**	**33.8**	**19.1**	**9,902 (15.5)**	**13,553 (16.2)**	**16,388 (16.0)**	**36.9**	**20.9**
A. Agricultural & Allied Products	**34,616 (11.8)**	**38,078 (10.1)**	**45,154 (9.9)**	**10.0**	**18.6**	**7,533 (11.8)**	**8,475 (10.1)**	**10,199 (9.9)**	**12.5**	**20.3**
of which :										
1. Tea	1,637	1,840	1,632	12.4	-11.3	356	410	369	14.9	-10.0
2. Coffee	1,086	1,069	1,577	-1.6	47.5	236	238	356	0.7	49.7
3. Rice	4,168	6,769	7,174	62.4	6.0	907	1,506	1,620	66.1	7.6
4. Oil Meal	3,348	3,178	4,826	-5.1	51.9	729	707	1,090	-2.9	54.1
5. Marine Products	6,106	6,469	6,356	6.0	-1.8	1,329	1,440	1,436	8.4	-0.3
B. Ores & Minerals	**10,885 (3.7)**	**22,819 (6.1)**	**27,401 (6.0)**	**109.6**	**20.1**	**2,369 (3.7)**	**5,079 (6.1)**	**6,189 (6.0)**	**114.4**	**21.9**
II. Manufactured Goods	**2,22,829 (76.0)**	**2,72,872 (72.7)**	**3,17,953 (69.9)**	**22.5**	**16.5**	**48,492 (76.0)**	**60,731 (72.7)**	**71,816 (69.9)**	**25.2**	**18.3**
of which :										
A. Leather & Manufactures	**9,939 (3.4)**	**10,881 (2.9)**	**11,626 (2.6)**	**9.5**	**6.8**	**2,163 (3.4)**	**2,422 (2.9)**	**2,626 (2.6)**	**12.0**	**8.4**
B. Chemicals & Related Products	**43,405 (14.8)**	**55,911 (14.9)**	**64,255 (14.1)**	**28.8**	**14.9**	**9,446 (14.8)**	**12,444 (14.9)**	**14,513 (14.1)**	**31.7**	**16.6**
1. Basic Chemicals, Pharmaceuticals & Cosmetics	26,862	32,077	39,566	19.4	23.3	5,846	7,139	8,937	22.1	25.2
2. Plastic & Linoleum	8,054	13,627	12,220	69.2	-10.3	1,753	3,033	2,760	73.0	-9.0
3. Rubber, Glass, Paints & Enamels *etc.*	6,837	7,906	9,306	15.6	17.7	1,488	1,760	2,102	18.3	19.5
4. Residual Chemicals & Allied Products	1,652	2,302	3,163	39.3	37.4	360	512	715	42.5	39.5
C. Engineering Goods	**57,005 (19.4)**	**77,949 (20.8)**	**95,397 (21.0)**	**36.7**	**22.4**	**12,405 (19.4)**	**17,348 (20.8)**	**21,547 (21.0)**	**39.8**	**24.2**
D. Textiles and Textile Products	**58,779 (20.0)**	**60,906 (16.2)**	**71,012 (15.6)**	**3.6**	**16.6**	**12,791 (20.0)**	**13,555 (16.2)**	**16,039 (15.6)**	**6.0**	**18.3**
of which :										
1. Cotton Yarn, Fabrics, Made-ups, *etc.*	15,600	15,502	17,102	-0.6	10.3	3,395	3,450	3,863	1.6	12.0
2. Natural Silk Yarn, Fabrics Madeups *etc.* including silk waste	1,745	1,820	1,906	4.3	4.7	380	405	430	6.6	6.3
3. Manmade Yarn, Fabrics, Made-ups, *etc.*	8,093	8,819	8,498	9.0	-3.6	1,761	1,963	1,919	11.4	-2.2
4. Readymade Garments	28,634	29,481	37,209	3.0	26.2	6,231	6,561	8,404	5.3	28.1
5. Jute & Jute Manufactures	1,114	1,241	1,304	11.4	5.1	242	276	295	14.0	6.6
6. Coir & Coir Manufactures	357	474	594	32.7	25.3	78	106	134	35.7	27.2
7. Carpets	2,691	2,860	3,670	6.3	28.3	586	636	829	8.7	30.2
E. Gems & Jewellery	**48,586 (16.6)**	**61,834 (16.5)**	**68,830 (15.1)**	**27.3**	**11.3**	**10,573 (16.6)**	**13,762 (16.5)**	**15,547 (15.1)**	**30.2**	**13.0**
F. Handicrafts	**2,296 (0.8)**	**1,696 (0.5)**	**1,817 (0.4)**	**-26.1**	**7.2**	**500 (0.8)**	**377 (0.5)**	**410 (0.4)**	**-24.5**	**8.8**
III. Petroleum Products	**16,397 (5.6)**	**31,404 (8.4)**	**50,979 (11.2)**	**91.5**	**62.3**	**3,568 (5.6)**	**6,989 (8.4)**	**11,515 (11.2)**	**95.9**	**64.7**
IV. Others	**8,640 (2.9)**	**10,166 (2.7)**	**13,312 (2.9)**	**17.7**	**30.9**	**1,880 (2.9)**	**2,263 (2.7)**	**3,007 (2.9)**	**20.3**	**32.9**
Total Exports (I+II+III+IV)	**2,93,367**	**3,75,340**	**4,54,800**	**27.9**	**21.2**	**63,843**	**83,536**	**1,02,725**	**30.8**	**23.0**

P : Provisional.

Note :
1. Figures in brackets represent percentage to total exports.
2. Leather & manufactures include finished leather, leather goods, leather garments, footwear of leather & its components and saddlery & harness.
3. Engineering goods comprise ferro alloys, aluminium other than products, non-ferrous metal, manufactures of metals, machine tools, machinery and equipments, transport equipments, residual engineering items, iron and steel bar/rod *etc.*, primary and semi-finished iron and steel, electronic goods, computer software and project goods.
4. Textiles and Textile Products includes: (a) cotton yarn, fabrics, made-ups etc., (b) natural silk yarn, fabrics made-ups etc. including silk waste, (c) manmade yarn, fabrics, made-ups etc., (d) manmade staple fibre, (e) woolen yarn, fabrics, made-ups etc., (f) readymade garments, (g) jute & jute manufactures, (h) coir & coir manufactures and (i) carpets.

Source : DGCI&S.

APPENDIX TABLE 52 : INDIA'S IMPORTS OF PRINCIPAL COMMODITIES

Commodity Group	Rupees crore					US $ million				
				Percentage Variation					Percentage Variation	
	2003-04	2004-05	2005-06P	(2)/(3)	(3)/(4)	2003-04	2004-05	2005-06P	(7)/(8)	(8)/(9)
1	2	3	4	5	6	7	8	9	10	11
I. Bulk Imports	**1,35,380**	**1,90,513**	**2,68,594**	**40.7**	**41.0**	**29,462**	**42,401**	**60,667**	**43.9**	**43.1**
	(37.7)	**(38.0)**	**(42.6)**			**(37.7)**	**(38.0)**	**(42.6)**		
A. Petroleum, Petroleum Products & Related Material	**94,520**	**1,34,094**	**1,94,640**	**41.9**	**45.2**	**20,569**	**29,844**	**43,963**	**45.1**	**47.3**
	(26.3)	**(26.8)**	**(30.9)**			**(26.3)**	**(26.8)**	**(30.9)**		
B. Bulk Consumption Goods	**14,120**	**13,949**	**11,869**	**-1.2**	**-14.9**	**3,073**	**3,105**	**2,681**	**1.0**	**-13.6**
	(3.9)	**(2.8)**	**(1.9)**			**(3.9)**	**(2.8)**	**(1.9)**		
1. Cereals & Cereal Preparations	89	119	154	33.4	30.1	19	26	35	36.4	32.0
2. Edible Oil	11,683	11,077	8,716	-5.2	-21.3	2,543	2,465	1,969	-3.0	-20.1
3. Pulses	2,285	1,778	2,347	-22.2	32.0	497	396	530	-20.4	34.0
4. Sugar	63	976	652	–	–	14	217	147	–	–
C. Other Bulk Items	**26,740**	**42,469**	**62,084**	**58.8**	**46.2**	**5,819**	**9,452**	**14,023**	**62.4**	**48.4**
	(7.4)	**(8.5)**	**(9.8)**			**(7.4)**	**(8.5)**	**(9.8)**		
1. Fertilisers	3,312	6,188	9,159	86.8	48.0	721	1,377	2,069	91.1	50.2
a) Crude	615	1,301	1,350	111.5	3.8	134	289	305	116.3	5.4
b) Sulphur & Unroasted Iron Pyrites	396	576	545	45.4	-5.3	86	128	123	48.7	-3.9
c) Manufactured	2,301	4,311	7,263	87.4	68.5	501	960	1,641	91.6	71.0
2. Non-Ferrous Metals	4,360	5,887	8,157	35.0	38.6	949	1,310	1,842	38.1	40.6
3. Paper, Paperboard & Mgfd. incl. Newsprint	3,022	3,269	4,168	8.2	27.5	658	728	941	10.6	29.4
4. Crude Rubber, incl. Synthetic & Reclaimed	1,290	1,839	1,814	42.5	-1.4	281	409	410	45.7	0.1
5. Pulp & Waste Paper	1,880	2,199	2,471	17.0	12.4	409	490	558	19.6	14.0
6. Metalliferrous Ores & Metal Scrap	5,955	11,091	16,693	86.3	50.5	1,296	2,468	3,771	90.5	52.7
7. Iron & Steel	6,921	11,995	19,622	73.3	63.6	1,506	2,670	4,432	77.3	66.0
II. Non-Bulk Imports	**2,23,727**	**3,10,552**	**3,61,933**	**38.8**	**16.5**	**48,688**	**69,117**	**81,749**	**42.0**	**18.3**
	(62.3)	**(62.0)**	**(57.4)**			**(62.3)**	**(62.0)**	**(57.4)**		
A. Capital Goods	**83,994**	**1,12,935**	**1,40,245**	**34.5**	**24.2**	**18,279**	**25,135**	**31,677**	**37.5**	**26.0**
	(23.4)	**(22.5)**	**(22.2)**			**(23.4)**	**(22.5)**	**(22.2)**		
1. Manufactures of Metals	3,169	4,128	5,316	30.2	28.8	690	919	1,201	33.2	30.7
2. Machine Tools	2,114	2,788	4,730	31.8	69.7	460	620	1,068	34.8	72.2
3. Machinery except Electrical & Electronics	21,797	30,633	43,806	40.5	43.0	4,744	6,818	9,894	43.7	45.1
4. Electrical Machinery except Electronics	4,008	5,369	6,472	34.0	20.5	872	1,195	1,462	37.0	22.3
5. Electronic Goods incl. Computer Software	36,253	47,895	62,367	32.1	30.2	7,889	10,659	14,087	35.1	32.2
6. Transport Equipments	14,833	19,444	13,940	31.1	-28.3	3,228	4,327	3,149	34.1	-27.2
7. Project Goods	1,820	2,679	3,613	47.2	34.8	396	596	816	50.6	36.9
B. Mainly Export Related Items	**58,436**	**76,812**	**82,053**	**31.4**	**6.8**	**12,717**	**17,095**	**18,533**	**34.4**	**8.4**
	(16.3)	**(15.3)**	**(13.0)**			**(16.3)**	**(15.3)**	**(13.0)**		
1. Pearls, Precious & Semi-Precious Stones	32,757	42,338	40,469	29.2	-4.4	7,129	9,423	9,141	32.2	-3.0
2. Chemicals, Organic & Inorganic	18,527	25,610	30,501	38.2	19.1	4,032	5,700	6,889	41.4	20.9
3. Textile Yarn, Fabric, *etc.*	5,780	7,060	8,994	22.1	27.4	1,258	1,571	2,031	24.9	29.3
4. Cashew Nuts, raw	1,372	1,805	2,090	31.6	15.8	299	402	472	34.6	17.5
C. Others	**81,297**	**1,20,804**	**1,39,635**	**48.6**	**15.6**	**17,692**	**26,886**	**31,539**	**52.0**	**17.3**
	(22.6)	**(24.1)**	**(22.1)**			**(22.6)**	**(24.1)**	**(22.1)**		
of which :										
1. Gold & Silver	31,506	50,099	49,540	59.0	-1.1	6,856	11,150	11,189	62.6	0.4
2. Artificial Resins & Plastic Materials	4,972	6,546	9,895	31.7	51.2	1,082	1,457	2,235	34.6	53.4
3. Professional Instruments *etc.* except electrical	5,653	6,876	8,747	21.6	27.2	1,230	1,530	1,976	24.4	29.1
4. Coal, Coke & Briquittes *etc.*	6,483	14,371	16,380	121.7	14.0	1,411	3,198	3,700	126.7	15.7
5. Medicinal & Pharmaceutical Products	2,958	3,169	4,515	7.1	42.5	644	705	1,020	9.6	44.6
6. Chemical Materials & Products	2,902	3,681	4,600	26.8	24.9	632	819	1,039	29.7	26.8
7. Non-Metallic Mineral Manufactures	1,504	2,120	2,761	40.9	30.2	327	472	624	44.1	32.1
Total Imports (I+II)	**3,59,108**	**5,01,065**	**6,30,527**	**39.5**	**25.8**	**78,149**	**1,11,517**	**1,42,416**	**42.7**	**27.7**

P : Provisional.

Note : Figures in brackets represent percentage to total imports.

Source : DGCI&S.

APPENDIX TABLE 53 : INVISIBLES BY CATEGORY OF TRANSACTIONS

Item	Rupees crore			US $ million		
	2003-04 R	2004-05 PR	2005-06 P	2003-04 R	2004-05 PR	2005-06 P
1	2	3	4	5	6	7
I. Non Factor Services, net	**46,381**	**63,519**	**98,437**	**10,144**	**14,199**	**22,265**
Receipts	1,23,175	2,06,082	2,68,706	26,868	46,031	60,610
Payments	76,794	1,42,563	1,70,269	16,724	31,832	38,345
Travel, net	6,520	4,361	6,085	1,435	985	1,368
Receipts	23,054	29,105	34,580	5,037	6,495	7,789
Payments	16,534	24,744	28,495	3,602	5,510	6,421
Transportation, net	4,026	1,163	-4,980	879	259	-1,117
Receipts	14,714	21,526	27,815	3,207	4,798	6,277
Payments	10,688	20,363	32,795	2,328	4,539	7,394
Insurance, net	250	835	221	56	187	57
Receipts	1,922	4,084	4,606	419	909	1,042
Payments	1,672	3,249	4,385	363	722	985
G.N.I.E., net	129	304	-773	28	67	-175
Receipts	1,105	1,476	1,356	240	328	305
Payments	976	1,172	2,129	212	261	480
Miscellaneous , net	35,456	56,856	97,884	7,746	12,701	22,132
Receipts	82,380	1,49,891	2,00,349	17,965	33,501	45,197
Payments	46,924	93,035	102,465	10,219	20,800	23,065
II. Income, net	**-20,708**	**-17,157**	**-24,969**	**-4,505**	**-3,814**	**-5,599**
Receipts	17,909	20,436	25,076	3,904	4,547	5,651
Payments	38,617	37,593	50,045	8,409	8,361	11,250
III. Private Transfers, net	**99,165**	**90,744**	**1,06,830**	**21,608**	**20,253**	**24,095**
Receipts	1,01,798	92,541	1,08,861	22,182	20,653	24,553
Payments	2,633	1,797	2,031	574	400	458
IV. Official Transfers, net	**2,531**	**2,650**	**809**	**554**	**591**	**181**
Receipts	2,531	2,792	2,961	554	623	667
Payments	0	142	2,152	0	32	486
V. Invisibles, net (I to IV)	**1,27,369**	**1,39,756**	**1,81,107**	**27,801**	**31,229**	**40,942**
Receipts	2,45,413	3,21,851	4,05,604	53,508	71,854	91,481
Payments	1,18,044	1,82,095	2,24,497	25,707	40,625	50,539

R : Revised.
PR : Partially Revised.
P : Preliminary.
GNIE : Government Not Included Elsewhere.

APPENDIX TABLE 54 : COMPOSITION OF CAPITAL INFLOWS

Item	1990-91	1995-96	2001-02	2002-03	2003-04R	2004-05PR	2005-06P
1	2	3	4	5	6	7	8
Total Capital Inflows (Net) US $ million	**7,056**	**4,089**	**8,551**	**10,840**	**16,736**	**31,027**	**24,693**
of which:							(in per cent)
1. Non- Debt Creating Inflows	**1.5**	**117.5**	**95.2**	**55.5**	**93.7**	**46.7**	**81.7**
a) Foreign Direct Investment **	1.4	52.4	71.6	46.5	25.8	18.0	31.1
b) Portfolio Investment	0.1	65.1	23.6	9.0	67.9	28.7	50.6
2. Debt Creating Inflows	**83.3**	**57.7**	**12.4**	**-12.3**	**-6.0**	**30.6**	**29.9**
a) External Assistance	31.3	21.6	14.1	-28.6	-16.5	6.5	6.2
b) External Commercial Borrowings #	31.9	31.2	-18.6	-15.7	-17.5	16.3	7.8
c) Short term Credits	15.2	1.2	-9.3	8.9	8.5	12.2	6.9
d) NRI Deposits $	21.8	27.0	32.2	27.5	21.8	-3.1	11.3
e) Rupee Debt Service	-16.9	-23.3	-6.1	-4.4	-2.2	-1.3	-2.3
3. Other Capital @	**15.2**	**-75.2**	**-7.6**	**56.8**	**12.3**	**22.7**	**-11.6**
4. Total (1 to 3)	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Memo:							
Stable flows +	**84.7**	**33.7**	**85.6**	**82.0**	**23.7**	**59.1**	**42.5**

R : Revised. PR : Partially Revised. P : Preliminary.

** : Data on FDI have been revised since 2000-01 with expanded coverage to approach international best practices. FDI data for previous years would not be comparable with these figures.

: Refers to medium and long-term borrowings.

$: Including NR (NR) Rupee Deposits.

@ : Includes leads and lags in exports (difference between the custom and the banking channel data), Banking Capital (assets and liabilities of Banks excluding NRI deposits), loans to non-residents by residents, Indian investment abroad and India's subscription to International Institutions and quota payments to IMF.

+ : Stable flows are defined to represent all capital flows excluding portfolio flows and short-term trade credits.

APPENDIX TABLE 55 : EXTERNAL ASSISTANCE

Item	Rupees crore			US $ million		
	2003-04R	2004-05R	2005-06P	2003-04R	2004-05R	2005-06P
1	2	3	4	5	6	7
1. Loans	15,276	14,662	14,600	3,418	3,350	3,271
2. Grants	2,077	2,490	2,654	465	569	595
3. Gross Utilisation (1+2)	17,353	17,152	17,255	3,883	3,919	3,866
4. Repayments	27,970	9,580	6,998	6,249	2,186	1,566
5. Interest Payments	3,843	3,261	3,156	860	744	706
6. Net (3-4-5)	-14,460	4,311	7,101	-3,226	989	1,594

P : Provisional. R : Revised.

Note :
1. Loans are inclusive of non-government loans but exclusive of suppliers' credits and commercial borrowings.
2. Grants are exclusive of PL 480-II grants.
3. Repayments include amortisation of civilian debt owed to Russia and hence do not tally with the data given in Appendix Table 49.

Source : Controller of Aid, Accounts and Audit, Government of India.

APPENDIX TABLE 56 : INDIA'S EXTERNAL DEBT

(As at end-March)

Item	Rupees crore			US $ million		
	2004R	2005R	2006P	2004R	2005R	2006P
1	2	3	4	5	6	7
I. Multilateral	**1,31,069**	**1,38,915**	**1,45,230**	**29,288**	**31,702**	**32,558**
A. Government borrowing	1,20,073	1,27,782	1,33,544	26,826	29,161	29,939
i) Concessional	1,01,490	1,05,114	1,05,651	22,674	23,988	23,686
a) IDA	1,00,065	1,03,671	1,04,258	22,356	23,659	23,374
b) Others #	1,425	1,443	1,393	318	329	312
ii) Non-concessional	18,583	22,668	27,893	4,152	5,173	6,253
a) IBRD	14,074	16,500	19,587	3,144	3,765	4,391
b) Others ##	4,509	6,168	8,306	1,008	1,408	1,862
B. Non-Government borrowing	10,996	11,133	11,686	2,462	2,541	2,619
i) Concessional	0	0	0	0	0	0
ii) Non-concessional	10,996	11,133	11,686	2,462	2,541	2,619
a) Public sector	7,916	8,000	8,494	1,770	1,826	1,904
IBRD	4,402	4,462	4,585	984	1,018	1,028
Others ##	3,514	3,538	3,909	786	808	876
b) Financial institutions	2,828	2,789	2,624	634	636	588
IBRD	380	252	629	85	57	141
Others ##	2,448	2,537	1,995	549	579	447
c) Private sector	252	344	568	58	79	127
IBRD	0	0	0	0	0	0
Others	252	344	568	58	79	127
II. Bilateral	**77,085**	**74,174**	**70,403**	**17,278**	**16,930**	**15,784**
A. Government borrowing	58,121	57,458	54,488	12,988	13,113	12,216
i) Concessional	57,742	57,207	54,363	12,901	13,055	12,188
ii) Non-concessional	379	251	125	87	58	28
B. Non-Government borrowing	18,964	16,716	15,915	4,290	3,817	3,568
i) Concessional	8,876	7,472	6,926	1,983	1,705	1,553
a) Public sector	5,759	5,653	5,273	1,287	1,290	1,182
b) Financial institutions	3,117	1,819	1,653	696	415	371
c) Private sector	0	0	0	0	0	0
ii) Non-concessional	10,088	9,244	8,989	2,307	2,112	2,015
a) Public sector	4,852	4,354	3,698	1,110	995	829
b) Financial institutions	3,120	2,844	2,372	710	649	532
c) Private sector	2,116	2,046	2,919	487	468	654
III. International Monetary Fund	**0**	**0**	**0**	**0**	**0**	**0**
IV. Trade Credit	**20,480**	**21,798**	**23,755**	**4,680**	**4,980**	**5,326**
a) Buyers' credit	11,002	12,900	15,929	2,532	2,948	3,571
b) Suppliers' credit	4,457	3,923	3,098	1,026	897	695
c) Export credit component of bilateral credit	5,021	4,975	4,728	1,122	1,135	1,060
d) Export credit for defence purposes	0	0	0	0	0	0
V. COMMERCIAL BORROWING	**96,016**	**1,18,243**	**1,14,011**	**22,101**	**27,024**	**25,560**
a) Commercial bank loans	50,611	60,448	70,895	11,650	13,815	15,894
b) Securitised borrowings $ (including FCCBs)	41,616	54,152	39,773	9,579	12,376	8,917
c) Loans/securitised borrowings, *etc.* with multilateral/bilateral guarantee and IFC(W)	3,789	3,643	3,343	872	833	749
d) Self Liquidating Loans	0	0	0	0	0	0

(Continued)

APPENDIX TABLE 56 : INDIA'S EXTERNAL DEBT *(Concld.)*

(As at end-March)

Item	Rupees crore			US $ million		
	2004R	2005R	2006P	2004R	2005R	2006P
1	2	3	4	5	6	7
VI. NRI and FC (B and O) Deposits (above one-year maturity)	**1,35,618**	**1,43,267**	**1,56,715**	**31,216**	**32,743**	**35,134**
VII. Rupee Debt *	**11,860**	**10,070**	**9,059**	**2,721**	**2,301**	**2,031**
a) Defence	10,543	8,887	7,989	2,427	2,031	1,791
b) Civilian +	1,317	1,183	1,070	294	270	240
VIII. Total Long-term Debt (I to VII)	**4,72,128**	**5,06,467**	**5,19,173**	**1,07,284**	**1,15,680**	**1,16,393**
IX. Short-term Debt	**19,251**	**32,922**	**39,199**	**4,431**	**7,524**	**8,788**
a) NRI deposits (upto 1 year maturity)	1,321	0	0	304	0	0
b) Others (trade related)**	17,930	32,922	39,199	4,127	7,524	8,788
X. GRAND TOTAL	**4,91,379**	**5,39,389**	**5,58,372**	**1,11,715**	**1,23,204**	**1,25,181**
Concessional Debt	1,79,968	1,79,863	1,75,999	40,279	41,049	39,458
As percentage of Total Debt	36.1	33.3	31.5	36.1	33.3	31.5
Short Term Debt						
As percentage of Total Debt	4.0	6.1	7.0	4.0	6.1	7.0
Memo:						
Debt Indicators :						
1. Debt Stock-GDP Ratio (per cent)	17.8	17.3	15.8	17.8	17.3	15.8
2. Debt-Service Ratio (per cent) (for fiscal year) (including debt-servicing on non-civilian credits	16.3	6.1	10.2	16.3	6.1	10.2

P : Provisional. R : Revised.

\# : Refers to Debt outstanding to Institutions like IFAD, OPEC & EEC(SAC).

\#\# : Refers to debt outstanding against loans from ADB.

$: Includes net investment by 100 per cent FII debt funds and India Millennium Deposits (IMDs).

* : Debt owed to Russia denominated in Rupees and converted at current exchange rates, payable in exports.

\+ : Includes Rupee suppliers' credit from end-March 1990 onwards.

** : This does not include suppliers credits of up to 180 days.

Note : Multilateral loans do not include revaluation of IBRD pooled loans and exchange rate adjustment under IDA loans for pre-1971 credits.

APPENDIX TABLE 57 : INDIA'S FOREIGN EXCHANGE RESERVES

End of Month	Foreign Exchange Reserves (Rupees crore)					Foreign Exchange Reserves (US $ million)					Total Foreign Exchange Reserves (in SDR million)	Movement in Foreign Exchange Reserves (in SDR million)@
	SDRs	Gold $	Foreign Currency Assets	Reserve Tranche Position in IMF	Total (2+3+4+5)	SDRs	Gold $	Foreign Currency Assets	Reserve Tranche Position in IMF	Total (7+8+9+10)		
1	2	3	4	5	6	7	8	9	10	11	12	13
Mar-94	339	12,794	47,287	938	61,358	108	4,078	15,068	299	19,553	13,841	6,595
Mar-95	23	13,752	66,005	1,050	80,830	7	4,370	20,809	331	25,517	16,352	2,511
Mar-96	280	15,658	58,446	1,063	75,447	82	4,561	17,044	310	21,997	15,054	-1,298
Mar-97	7	14,557	80,368	1,046	95,978	2	4,054	22,367	291	26,714	19,272	4,218
Mar-98	4	13,394	1,02,507	1,117	1,17,022	1	3,391	25,975	283	29,650	22,200	2,929
Mar-99	34	12,559	1,25,412	2,816	1,40,821	8	2,960	29,522	663	33,153	24,413	2,213
Mar-00	16	12,973	1,52,924	2,870	1,68,783	4	2,974	35,058	658	38,694	28,728	4,315
Mar-01	11	12,711	1,84,482	2,873	2,00,077	2	2,725	39,554	616	42,897	34,034	5,306
Mar-02	50	14,868	2,49,118	2,977	2,67,013	10	3,047	51,049	610	54,716	43,876	9,842
Mar-03	19	16,785	3,41,476	3,192	3,61,472	4	3,534	71,890	672	76,100	55,394	11,518
Mar-04	10	18,216	4,66,215	5,688	4,90,129	2	4,198	1,07,448	1,311	1,12,959	76,298	20,904
Jun-04	8	18,655	5,24,865	5,980	5,49,508	2	4,057	1,14,151	1,301	1,19,511	81,509	5,211
Sep-04	7	19,349	5,26,605	6,015	5,51,976	1	4,192	1,14,083	1,303	1,19,579	81,403	5,105
Dec-04	22	19,969	5,45,466	6,221	5,71,678	5	4,582	1,25,164	1,427	1,31,178	84,467	8,169
Mar-05	20	19,686	5,93,121	6,289	6,19,116	5	4,500	1,35,571	1,438	1,41,514	93,666	17,368
Jun-05	18	19,375	5,75,864	6,791	6,02,048	4	4,453	1,32,352	1,561	1,38,370	94,995	1,329
Sep-05	19	20,727	6,02,309	6,260	6,29,315	4	4,712	1,36,920	1,423	1,43,059	98,698	5,032
Dec-05	20	23,770	5,90,497	4,096	6,18,383	5	5,274	1,31,018	909	1,37,206	95,997	2,331
Mar-06	12	25,674	6,47,327	3,374	6,76,387	3	5,755	1,45,108	756	1,51,622	1,05,231	11,565
Jun-06	2	28,479	7,18,701	3,518	7,50,700	–	6,180	1,55,968	764	1,62,912	1,10,123	4,892

– : Negligible.

$: Gold has been valued close to international market price.

@ : Variations over the previous March.

Note : 1. Gold holdings include acquisition of gold worth US $ 191 million from the Government during 1991-92, US $ 29.4 million during 1992-93, US $ 139.3 million during 1993-94, US $ 315.0 million during 1994-95 and US $ 17.9 million during 1995-96. On the other hand, 1.27 tonnes of gold amounting to Rs. 43.55 crore (US $ 11.97 million), 38.9 tonnes of gold amounting to Rs 1,485.22 crore (US $ 376.0 million) and 0.06 tonnes of gold amounting to Rs. 2.13 crore (US $ 0.5 million) were repurchased by the Central Government on November 13, 1997, April 1, 1998 and October 5, 1998 respectively for meeting its redemption obligation under the Gold Bond Scheme.

2. Conversion of foreign currency assets into US dollar was done at exchange rates supplied by the IMF up to March 1999. Effective April 1, 1999, the conversion is at New York closing exchange rate.

APPENDIX TABLE 58 : PROFILE OF TREASURY BILLS

(Amount in Rupees crore)

	2002-03	2003-04	2004-05	2005-06
1	2	3	4	5
1. Implicit Yield at Cut-Off Price (Per cent)				
91-day Treasury Bills				
Minimum	5.10	4.16	4.37	5.12
Maximum	7.00	5.47	5.61	6.69
Weighted Average	5.73	4.63	4.89	5.51
182-day Treasury Bills				
Minimum	..	..	..	5.29
Maximum	..	..	..	6.74
Weighted Average	..	..	..	5.65
364-day Treasury Bills				
Minimum	5.35	4.31	4.43	5.58
Maximum	6.98	5.49	5.77	6.81
Weighted Average	5.93	4.67	5.15	5.87
2. Gross Issues				
91-day Treasury Bills	26,402	36,789	1,00,592 (67,955)	1,03,424 (52,057)
182-day Treasury Bills	..	..	..	26,828 (13,078)
364-day Treasury Bills	26,126	26,136	47,132 (20,981)	45,018 (16,000)
3. Net Issues				
91-day Treasury Bills	4,626	2,485	20,653 (19,500)	-11,474 (-19,500)
182-day Treasury Bills	..	..	..	9,771 (3,000)
364-day Treasury Bills	6,538	10	20,997 (20,981)	-2,114 (-4,981)
4. Outstanding at Year/Period End				
91-day Treasury Bills	9,627	7,139	27,792 (19,500)	16,318 (0)
182-day Treasury Bills	..	..	..	9,771 (3,000)
364-day Treasury Bills	26,126	26,136	47,132 (20,981)	45,018 (16,000)

.. : Not applicable.

Note : 1. Figures in parentheses indicate issuances under the MSS.

2. Auction of 182-day Treasury Bills were introduced since April 6, 2005.

3. Non-competitive bids allowed to certain entities like State Governments result in the difference between notified amount and actual amounts issued and outstanding.

APPENDIX TABLE 59 : ISSUANCES OF CENTRAL GOVERNMENT DATED SECURITIES

(Amount in Rupees crore)

Auction Particulars					Bids/Application Received				Bids / Application Accepted					Allocation to		Gross Amount Raised (14+15+16)	Cut-off Price (Rs.) / Yield (%)	Nomenclature of Loan
Date of Auction	Date of Issue	Tenor (Years)	Re-sidual Matu-rity (years)	Notified Amount	Competitive		Non-Competitive		Competitive		Non-Competitive		Total (11+13)					
					No.	Face Value	No. +	Face Value	No.	Face Value	No. +	Face Value		PDs (Devlmt)	RBI (Devlmt/–PP)			
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19
2005-06																		
5-Apr-05	6-Apr-05	10	6.98	5000	316	10755.50	9	19.68	136	4980.32	9	19.68	5000.00	-	-	5000.00	100.25/6.8044	6.85 %GS, 2012 $ **
5-Apr-05	6-Apr-05	30	27.39	3000	135	5983.50	6	14.00	71	2986.00	6	14.00	3000.00	-	-	3000.00	101.75/7.7933	7.95 %GS, 2032 $ **
19-Apr-05	20-Apr-05	15	11.74	5000	165	9670.90	11	39.88	86	4960.00	11	39.88	5000.00	-	-	5000.00	104.50/7.4847	8.07 % GS, 2017 $ ** U
19-Apr-05	20-Apr-05	30	29.31	2000	163	4935.56	6	9.41	37	1991.00	6	9.41	2000.00	-	-	2000.00	95.00/7.9406	7.50% GS, 2034 $ **
03-May-05	04-May-05	8	5.03	6000	387	21535.00	12	28.81	68	5971.19	12	28.81	6000.00	-	-	6000.00	102.33/6.9916	7.55% GS, 2010 $ **
03-May-05	04-May-05	30	29.27	2000	220	6368.48	9	55.29	25	1944.72	9	55.29	2000.00	-	-	2000.00	94.58/7.9796	7.50% GS, 2034 $ **
24-May-05	25-May-05	20	16.05	4000	255	10467.00	58	55.27	1	3944.73	58	55.27	4000.00	-	-	4000.00	110.30/7.2825	8.35% GS, 2022 $ **
06-Jun-05	07-Jun-05	20	15.98	4000	148	7507.06	24	29.86	99	3970.14	24	29.86	4000.00	-	-	4000.00	125.71/7.4677	10.25% GS, 2021$**
06-Jun-05	07-Jun-05	12	8.86	6000	306	11590.96	44	52.20	125	5947.80	44	52.20	6000.00	-	-	6000.00	103.00/6.9096	7.37% GS, 2014 $ **
23-Jun-05	24-Jun-05	15	10.81	5000	336	11323.00	62	62.43	156	4937.57	62	62.43	5000.00	-	-	5000.00	104.60/6.9120	7.49%GS, 2017 $ **
05-Jul-05	06-Jul-05	11	8.16	6000	320	11357.68	28	39.51	190	5960.49	28	39.51	6000.00	-	-	6000.00	101.26/7.0619	7.27 % GS, 2013 $ **
05-Jul-05	06-Jul-05	20	15.90	4000	250	8183.52	26	30.16	130	3969.84	26	30.16	4000.00	-	-	4000.00	124.57/7.5658	10.25 % GS, 2021 $ **
18-Jul-05	19-Jul-05	20	15.86	5000	408	12914.25	27	22.15	31	4977.85	27	22.15	5000.00	-	-	5000.00	122.00/7.8058	10.25 % GS, 2021 $ **
11-Aug-05	12-Aug-05	30	28.99	3000	148	6354.77	70	81.16	5	2918.84	70	81.16	3000.00	-	-	3000.00	100.65/7.4449	7.50% GS, 2034 $ **
11-Aug-05	12-Aug-05	15	11.43	5000	287	9015.82	74	74.00	116	4926.00	74	74.00	5000.00	-	-	5000.00	107.17/7.1403	8.07%GS, 2017 $ **
18-Aug-05	19-Aug-05	12	8.66	5000	292	10455.95	19	21.34	122	4978.66	19	21.34	5000.00	-	-	5000.00	102.11/7.0383	7.37%GS, 2014 $ **
18-Aug-05	19-Aug-05	30	28.98	3000	129	4889.00	17	15.21	86	2984.79	17	15.21	3000.00	-	-	3000.00	99.44/7.5476	7.50% GS, 2034 $ **
25-Aug-05	26-Aug-05	9	1.76	6000	154	9214.00	4	4.59	101	5995.41	4	4.59	6000.00	-	-	6000.00	109.59/6.0467	11.90%GS,2007 $@
08-Sep-05	09-Sep-05	15	13.04	5000	198	7535.00	21	23.13	137	4976.87	21	23.13	5000.00	-	-	5000.00	87.12/7.2313	5.69% GS, 2018 $ **
08-Sep-05	09-Sep-05	30	30.00	3000	100	6494.00	19	19.79	25	2980.21	19	19.79	3000.00	-	-	3000.00	7.4000	7.40% GS, 2035 # U
06-Oct-05	07-Oct-05	30	29.92	3000	104	4606.50	17	21.15	43	2978.85	17	21.15	3000.00	-	-	3000.00	97.00/7.6560	7.40% GS, 2035 # **
06-Oct-05	07-Oct-05	15	9.10	6000	235	7596.00	24	27.66	0	0.00	0	0.00	0.00	-	-	0.00	- (*)	11.83% GS, 2014 # **
08-Nov-05	09-Nov-05	15	11.44	5000	187	8889.00	48	57.94	115	4942.06	48	57.94	5000.00	-	-	5000.00	101.25/7.3257	7.49% GS, 2017 $ ** U
08-Nov-05	09-Nov-05	30	29.83	3000	151	6349.00	33	37.04	132	2962.96	33	37.04	3000.00	-	-	3000.00	96.18/7.7282	7.40% GS, 2035 $ **
24-Nov-05	25-Nov-05	20	16.47	5000	344	14016.58	73	55.80	11	4944.20	73	55.80	5000.00	-	-	5000.00	108.65/7.4304	8.35% GS, 2022 $ **
06-Dec-05	07-Dec-05	15	11.11	5000	291	8823.90	51	51.80	145	4948.20	51	51.80	5000.00	-	-	5000.00	106.24/7.2411	8.07% GS, 2017 $ **
06-Dec-05	07-Dec-05	30	29.76	3000	283	8623.90	42	45.65	5	2954.35	42	45.65	3000.00	-	-	3000.00	98.16/7.5547	7.40% GS , 2035 $ **
09-Jan-06	10-Jan-06	10	5.48	6000	222	10015.89	38	31.81	137	5968.20	38	31.81	6000.00	-	-	6000.00	112.18/6.6964	9.39% G.S., 2011 $ **
09-Jan-06	10-Jan-06	30	29.66	4000	258	11605.78	60	75.90	10	3924.10	60	75.90	4000.00	-	-	4000.00	99.60/7.4323	7.40% G.S., 2035 $ **
07-Feb-06	08-Feb-06	15	11.56	3000	152	7443.25	49	39.94	92	2960.06	49	39.94	3000.00	-	-	3000.00	100.60/7.3811	7.46% G.S., 2017 $ **
07-Feb-06	08-Feb-06	30	29.59	3000	202	7475.35	27	26.27	150	2973.73	27	26.27	3000.00	-	-	3000.00	97.27/7.6330	7.40 % G.S., 2035 $ **
	06-Mar-06	30	29.51	10000	-	-	-	-	-	-	-	-	-	-	10000	10000.00	95.72/7.77	7.40% G.S., 2035 $ P
2006-07																		
10-Apr-06	12-Apr-06	10	10.00	5000	208	11286.20	21	27.56	78	4972.44	21	27.59	5000.00	-	-	5000.00	7.5900	7.59 % G.S., 2016 # **
10-Apr-06	12-Apr-06	30	28.33	3000	119	6410.00	8	11.90	21	2664.00	8	11.90	2675.90	324.10	-	3000.00	94.73/7.9701	7.50 % G.S., 2034 $ **
25-Apr-06	26-Apr-06	10	6.02	6000	224	11593.00	14	12.46	126	5987.54	14	12.46	6000.00	-	-	6000.00	101.64/7.0604	7.40 % G.S., 2012 $ **
25-Apr-06	26-Apr-06	30	26.34	4000	160	9399.50	14	18.15	61	3981.85	14	18.15	4000.00	-	-	4000.00	99.33/8.0038	7.95 % G.S., 2032 $ **
04-May-06	05-May-06	10	9.94	6000	284	11304.11	23	29.20	145	5970.80	23	29.20	6000.00	-	-	6000.00	100.26/7.5512	7.59 % G.S., 2016 $ **
04-May-06	05-May-06	30	28.26	4000	185	8638.61	5	4.75	97	3995.25	5	4.75	4000.00	-	-	4000.00	92.90/8.1442	7.50 % G.S., 2034 $ **
23-May-06	24-May-06	15	15.00	5000	153	11368.50	22	28.65	69	4971.35	22	28.65	5000.00	-	-	5000.00	7.9400	7.94 % G.S., 2021 # ** U
06-Jun-06	07-Jun-06	30	30.00	4000	96	8778.50	3	1.33	28	3998.67	3	1.33	4000.00	-	-	4000.00	8.3300	8.33 % G.S., 2036 # ** U
06-Jun-06	07-Jun-06	10	5.07	6000	194	14732.00	11	9.93	60	5990.07	11	9.93	6000.00	-	-	6000.00	108.33/7.3877	9.39 % G.S.,2011 $ **
22-Jun-06	23-Jun-06	12	7.81	5000	216	8168.00	7	2.98	164	4997.02	7	2.98	5000.00	-	-	5000.00	96.84/7.9171	7.37 % G.S., 2014 $ **
22-Jun-06	23-Jun-06	15	14.92	4000	112	6632.98	31	16.28	86	3983.72	31	16.28	4000.00	-	-	4000.00	95.65/8.4573	7.94 % G.S., 2021 $ ** U
11-Jul-06	12-Jul-06	10	9.75	5000	159	7571.00	25	24.38	20	1590.00	25	24.38	1614.38	3385.62	-	5000.00	95.36/8.2902	7.59 % G.S., 2016 $ ** U
11-Jul-06	12-Jul-06	30	28.08	2000	64	4085.00	4	1.47	15	104.00	4	1.47	105.47	1894.54	-	2000.00	86.99/8.7504	7.50 % G.S., 2034 $ ** U
27-Jul-06	28-Jul-06	8	3.79	4000	218	9035.50	26	18.46	109	3981.54	26	18.46	4000.00	-	-	4000.00	99.53/7.6898	7.55 % G.S., 2010 $ **
8-Aug-06	9-Aug-06	10	4.90	6000	239	15317.01	21	21.85	61	5978.15	21	21.85	6000.00	-	-	6000.00	105.76/7.9436	9.39% G.S., 2011$**
8-Aug-06	9-Aug-06	10	9.68	3000	219	9714.00	18	22.34	25	2977.66	18	22.34	3000.00	-	-	3000.00	95.51/8.2706	7.59%G.S., 2016 $**

** : Allotment to non-competitive bidders at weighted average yield/price of competitive bids.
$: Reissues.
(*) : All the bids were rejected.
+ : Number of applicants.
@ : Issued under Market Stabilisation Scheme (MSS).
U : Uniform price.
: Yield based auction.
P : Private placement with RBI.

APPENDIX TABLE 60 : A PROFILE OF CENTRAL GOVERNMENT DATED SECURITIES

(Amount in Rupees crore)

Item	2003-04	2004-05	2005-06
1	2	3	4
1. Gross Borrowing	1,21,500	80,350	1,31,000
2. Repayments	32,693	34,316	35,631
3. Net Borrowing	88,806	46,034	95,370
4. Weighted Average Maturity (in years)	14.94	14.13	16.90
5. Weighted Average Yield (per cent)	5.71	6.11	7.34
6. A. Maturity Distribution- Amount			
(a) Up to 5 Years	6,500	3,000	0
(b) Above 5 and Up to 10 Years	22,000	15,000	34,000
(c) Above 10 Years	93,000	62,350	97,000
Total	1,21,500	80,350	1,31,000
B. Maturity Distribution (per cent)			
(a) Up To 5 Years	5	4	0
(b) Above 5 and Up to 10 Years	18	19	26
(c) Above 10 Years	77	77	74
Total	100	100	100
7. Price Based Auctions - Amount	74,000	72,350	1,25,000
8. Yield - Per cent			
(a) Minimum	4.69 (4 years)	4.49@ (12 years)	6.69 (5 years, 6 months)
(b) Maximum	6.34 (20 years)	8.24 (27 years ,10 months)	7.98 (29 years , 3 months)
9. Yield-Maturity Distribution - wise			
(a) Less than 10 Years			
Minimum	4.62 (9 years)	5.47 (9 years)	6.69 (5 years, 6 months)
Maximum	5.76 (8 years)	7.20 (5 years, 6 months)	7.06 (8 years, 2 months)
(b) 10 Years			
Minimum	5.32	nil	nil
Maximum		nil	nil
(c) Above 10 Years			
Minimum	5.96 (10 years, 3 months)	4.49 (12 years)	6.91 (10 years, 10 months)
Maximum	6.32 (29 years, 4 months)	8.24 (27 years,10 months)	7.98 (29 years, 3 months)
Memo Item :			
1. Initial Subscription by RBI	21,500	350	10,000
2. Open Market Operations by RBI- Net Sales	41,849	2,899	3,913
3. Ways and Means Advances to the Centre (Outstandings) (as on March 31)	nil	nil	nil

@ : Pertains to FRBs.

Note : Figures in parentheses represent residual maturity.

APPENDIX TABLE 61: MARKET BORROWINGS PROGRAMME OF STATE GOVERNMENTS : 2005-06

(Rupees crore)

Sr. No.	Name of the State	Gross Allocation (=4+5+6)	Repayment	Net Allocations	Additional Allocation	Amount Raised by Auction	Amount Raised by Tap	Gross Borrowings (=7+8)	Net Borrowings (=9-4)
1	2	3	4	5	6	7	8	9	10
1.	Andhra Pradesh	1956	573	1383	–	1174	783	1956	1383
2.	Arunachal Pradesh	47	5	19	24	7	40	47	42
3.	Assam	880	163	418	300	655	225	880	718
4.	Bihar	1076	380	696	–	233	494	728	348
5.	Chhattisgarh	432	86	346	–	–	–	–	-86
6.	Goa	144	18	127	–	50	33	83	66
7.	Gujarat	858	256	602	–	–	602	602	346
8.	Haryana	521	134	387	–	166	355	521	387
9.	Himachal Pradesh	469	44	425	–	56	413	469	425
10.	Jammu & Kashmir	298	71	152	75	75	223	298	227
11.	Jharkhand	364	128	236	–	197	167	364	236
12.	Karnataka	1582	243	1339	–	–	415	415	171
13.	Kerala	1808	346	773	689	1385	423	1808	1462
14.	Madhya Pradesh	1551	315	791	445	493	768	1261	946
15.	Maharashtra	1580	426	1154	–	984	595	1580	1154
16.	Manipur	205	16	74	115	149	56	205	189
17.	Meghalaya	158	27	81	50	50	108	158	131
18.	Mizoram	115	15	35	65	50	65	115	100
19.	Nagaland	254	40	145	69	45	209	254	214
20.	Orissa	1169	401	594	174	–	506	506	105
21.	Punjab	1199	221	398	580	1199	–	1199	978
22.	Rajasthan	1363	394	968	–	500	541	1041	647
23.	Sikkim	104	16	12	77	66	38	104	88
24.	Tamil Nadu	1650	403	1246	–	1419	200	1619	1215
25.	Tripura	137	18	94	25	65	72	137	119
26.	Uttar Pradesh	3096	1034	2062	–	599	2497	3096	2062
27.	Uttaranchal	568	55	288	225	476	92	568	513
28.	West Bengal	2324	447	1267	609	449	1265	1714	1267
	Total	**25909**	**6274**	**16112**	**3522**	**10544**	**11186**	**21729**	**15455**

APPENDIX TABLE 62 : MARKET BORROWINGS OF STATE GOVERNMENTS RAISED THROUGH AUCTIONS : 2005-06

(Amount in Rupees crore)

Sr. No.	Date of Auction	State	Notified Amount	Amount Accepted	Market Rate (%)@	No of Bids Received	Amount Offered	Weighted Average Rate	Cut Off Rate (%)	Spread (Percentage points)
1	2	3	4	5	6	7	8	9	10	11(=10-6)
1.	20-04-2005	Kerala	300	300	7.07	60	811	-	7.45	0.38
2.	14-06-2005	Andhra Pradesh	482	482	6.90	113	1981	7.36	7.39	0.49
3.	14-06-2005	Arunachal Pradesh	7	7	6.90	4	15	7.39	7.39	0.49
4.	14-06-2005	Assam	147	147	6.90	14	307	7.39	7.39	0.49
5.	14-06-2005	Bihar	233	233	6.90	26	599	7.39	7.39	0.49
6.	14-06-2005	Himachal Pradesh	56	56	6.90	19	170	7.38	7.39	0.49
7.	14-06-2005	Jharkhand	79	79	6.90	13	166	7.38	7.39	0.49
8.	14-06-2005	Maharashtra	407	407	6.90	79	1543	7.38	7.39	0.49
9.	14-06-2005	Madhya Pradesh	293	293	6.90	31	792	7.39	7.39	0.49
10.	14-06-2005	Manipur	27	27	6.90	5	65	7.39	7.39	0.49
11.	14-06-2005	Tamil Nadu	300	210	6.90	106	1752	7.32	7.35	0.45
12.	14-06-2005	West Bengal	449	449	6.90	67	1287	7.38	7.39	0.49
13.	04-08-2005	Kerala	250	250	6.97	70	1244	7.32	7.32	0.35
14.	27-09-2005	Assam	209	209	7.08	13	510	7.46	7.50	0.42
15.	27-09-2005	Jharkhand	118	118	7.08	15	382	7.45	7.50	0.42
16.	27-09-2005	Kerala	146	146	7.08	66	1076	7.39	7.42	0.34
17.	27-09-2005	Maharashtra	290	290	7.08	68	1438	7.42	7.45	0.37
18.	27-09-2005	Manipur	37	37	7.08	8	145	7.44	7.45	0.37
19.	27-09-2005	Tripura	40	40	7.08	8	142	7.43	7.45	0.37
20.	17-11-2005	Andhra Pradesh	375	375	7.12	98	1786	7.34	7.34	0.22
21.	15-12-2005	Kerala	361	361	7.11	56	1172	7.27	7.33	0.22
22.	19-01-2006	Andhra Pradesh	317	317	7.12	107	2313	7.32	7.32	0.20
23.	19-01-2006	Haryana	166	166	7.12	66	1305	7.33	7.33	0.21
24.	27-02-2006	Assam	200	200	7.35	4	440	7.65	7.65	0.30
25.	27-02-2006	Goa	50	50	7.35	14	129	7.65	7.65	0.30
26.	27-02-2006	Kerala	328	328	7.35	27	734	7.68	7.75	0.40
27.	27-02-2006	Madhya Pradesh	200	200	7.35	6	282	7.65	7.65	0.30
28.	27-02-2006	Maharashtra	287	287	7.35	24	794	7.68	7.70	0.35
29.	27-02-2006	Punjab	619	619	7.35	33	1508	7.67	7.67	0.32
30.	27-02-2006	Rajasthan	500	500	7.35	27	1208	7.64	7.65	0.30
31.	27-02-2006	Sikkim	66	66	7.35	5	128	7.66	7.70	0.35
32.	27-02-2006	Tamil Nadu	600	600	7.35	42	1256	7.65	7.68	0.33
33.	27-02-2006	Tripura	25	25	7.35	4	60	7.66	7.70	0.35
34.	27-02-2006	Uttaranchal	250	250	7.35	18	652	7.70	7.70	0.35
35.	27-02-2006	Uttar Pradesh	599	599	7.35	26	720	7.78	7.85	0.50
36.	27-03-2006	Assam	100	100	7.38	7	245	7.73	7.75	0.37
37.	27-03-2006	Jammu & Kashmir	75	75	7.38	9	235	7.71	7.75	0.37
38.	27-03-2006	Manipur	85	85	7.38	8	245	7.71	7.74	0.36
39.	27-03-2006	Meghalaya	50	50	7.38	7	170	7.70	7.70	0.32
40.	27-03-2006	Mizoram	50	50	7.38	8	175	7.70	7.71	0.33
41.	27-03-2006	Nagaland	45	45	7.38	5	105	7.69	7.69	0.31
42.	27-03-2006	Punjab	580	580	7.38	43	1205	7.75	7.79	0.41
43.	27-03-2006	Tamil Nadu	640	609	7.38	47	729	7.74	7.79	0.41
44.	27-03-2006	Uttaranchal	226	226	7.38	28	913	7.71	7.72	0.34

@ : Secondary market yield of Central Government securities of similar maturity.

APPENDIX TABLE 63: MARKET BORROWINGS OF STATE GOVERNMENTS RAISED THROUGH TAP ISSUANCES : 2005-06

(Rupees crore)

Sr. No.	State	May 17-18, 2005, 7.7% 10 yrs	September 13, 2005, 7.53% 10 yrs	January 16, 2006, 7.61% 10 yrs	Total Raised
1	2	3	4	5	6
1.	Andhra Pradesh	783	–	–	783
2.	Arunachal Pradesh	7	9	24	40
3.	Assam	225	–	–	225
4.	Bihar	494	–	–	494
5.	Chhattisgarh	–	–	–	–
6.	Goa	33	–	–	33
7.	Gujarat	348	–	254	602
8.	Haryana	190	165	–	355
9.	Himachal Pradesh	200	213	–	413
10.	Jammu & Kashmir	95	128	–	223
11.	Jharkhand	167	–	–	167
12.	Karnataka	415	–	–	415
13.	Kerala	423	–	–	423
14.	Madhya Pradesh	418	50	300	768
15.	Maharashtra	595	–	–	595
16.	Manipur	26	–	30	56
17.	Meghalaya	39	69	–	108
18.	Mizoram	20	29	15	65
19.	Nagaland	60	125	24	209
20.	Orissa	506	–	–	506
21.	Punjab	–	–	–	–
22.	Rajasthan	541	–	–	541
23.	Sikkim	18	9	11	38
24.	Tamil Nadu	200	–	–	200
25.	Tripura	30	–	42	72
26.	Uttar Pradesh	997	1500	–	2497
27.	Uttaranchal	92	–	–	92
28.	West Bengal	632	633	–	1265
	Total	**7554**	**2931**	**701**	**11186**

RESERVE BANK OF INDIA
BALANCE SHEET AS AT 30TH JUNE 2006

ISSUE DEPARTMENT

(Rupees Thousands)

2004-05	LIABILITIES		2005-06	2004-05	ASSETS		2005-06
	Notes held in the				**Gold Coin and Bullion:**		
12,97,72	**Banking Department**	**11,60,96**		15828,39,88	(a) Held in India	**23265,67,29**	
378467,68,09	**Notes in circulation**	**440977,00,18**		–	(b) Held outside India	**–**	
				361033,08,40	**Foreign Securities**	**416525,46,17**	
378480,65,81	**Total Notes issued**		**440988,61,14**	376861,48,28	**Total**		**439791,13,46**
				101,94,35	**Rupee Coin**		**151,04,68**
				1517,23,18	**Government of India Rupee Securities**		**1046,43,00**
				–	**Internal Bills of Exchange and other Commercial Paper**		**–**
378480,65,81	**Total Liabilities**		**440988,61,14**	378480,65,81	**Total Assets**		**440988,61,14**

BANKING DEPARTMENT

2004-05	LIABILITIES	2005-06	2004-05	ASSETS	2005-06
5,00,00	**Capital paid-up**	**5,00,00**	12,97,72	**Notes**	**11,60,96**
6500,00,00	**Reserve Fund**	**6500,00,00**	4,33	**Rupee Coin**	**10,32**
	National Industrial Credit		2,97,93	**Small Coin**	**4,16,82**
14,00,00	**(Long Term Operations) Fund**	**15,00,00**			
	National Housing Credit			**Bills Purchased and Discounted :**	
188,00,00	**(Long Term Operations) Fund**	**189,00,00**	–	(a) Internal	–
			–	(b) External	–
			–	(c) Government Treasury Bills	–
	Deposits		195675,14,64	**Balances Held Abroad**	**278498,41,58**
	(a) Government				
72080,93,54	(i) Central Government	**33395,23,29**			
41,16,97	(ii) State Governments	**41,17,69**			
	(b) Banks		90087,46,43	**Investments**	**65538,16,23**
101361,60,23	(i) Scheduled Commercial Banks	**126129,85,51**			
1938,60,16	(ii) Scheduled State Co-operative Banks	**1827,03,54**			
1953,58,90	(iii) Other Scheduled Co-operative Banks	**2207,55,33**			
61,36,38	(iv) Non-Scheduled State Co-operative Banks	**50,68,59**			
3548,97,15	(v) Other Banks	**4053,46,63**			
15920,99,91	**(c) Others**	**20613,91,74**		**Loans and Advances to :**	
			–	(i) Central Government	–
			345,02,00	(ii) State Governments	**105,74,00**
378,41,96	**Bills Payable**	**429,44,80**		**Loans and Advances to:**	
			100,00,00	(i) Scheduled Commercial Banks	**2,06,00**
			1,90,00	(ii) Scheduled State Co-operative Banks	**–**
			–	(iii) Other Scheduled Co-operative Banks	–
			–	(iv) Non-Scheduled State Co-operative Banks	–
			3632,95,77	(v) NABARD	**2962,87,96**
			36,86,50	(vi) Others	**34,23,00**
100356,27,02	**Other Liabilities**	**172373,79,72**		**Loans, Advances and Investments from National Industrial Credit (Long Term Operations) Fund:**	
				(a) Loans and Advances to:	
			–	(i) Industrial Development Bank of India	**–**
			–	(ii) Export Import Bank of India	**–**
			–	(iii) Industrial Investment Bank of India Ltd.	**–**
			–	(iv) Others	**–**
				(b) Investments in bonds/debentures issued by:	
			–	(i) Industrial Development Bank of India	**–**
			–	(ii) Export Import Bank of India	**–**
			–	(iii) Industrial Investment Bank of India Ltd.	**–**
			–	(iv) Others	**–**
				Loans, Advances and Investments from National Housing Credit (Long Term Operations) Fund:	
			50,00,00	(a) Loans and Advances to National Housing Bank	**50,00,00**
			–	(b) Investments in bonds/ debentures issued by National Housing Bank	**–**
			14403,56,90	**Other Assets**	**20623,79,97**
304348,92,22	**Total Liabilities**	**367831,16,84**	304348,92,22	**Total Assets**	**367831,16,84**

Significant Accounting Policies and Notes to the Accounts as per Annex.

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 30TH JUNE 2006

(Rupees Thousands)

2004-05	INCOME		2005-06
12215,26,71	**Interest, Discount, Exchange, Commission *etc.* [1]**		**14257,09,61**
12215,26,71	**Total**		**14257,09,61**
	EXPENDITURE		
1386,27,61	**Interest**		**1524,41,09**
1653,16,59	**Establishment**		**919,88,29**
1,29,73	**Directors' and Local Board Members' Fees and Expenses**		**1,19,11**
17,16,62	**Remittance of Treasure**		**17,01,03**
1824,16,88	**Agency Charges**		**1833,55,04**
1443,56,51	**Security Printing (Cheque, Note forms *etc.*)**		**1034,86,21**
15,68,62	**Printing and Stationery**		**17,50,64**
28,48,40	**Postage and Telecommunication Charges**		**46,70,75**
55,27,60	**Rent, Taxes, Insurance, Lighting *etc.***		**59,10,63**
1,73,14	**Auditors' Fees and Expenses**		**1,88,91**
1,49,05	**Law Charges**		**2,95,27**
166,87,97	**Depreciation and Repairs to Bank's Property**		**179,25,59**
216,07,99	**Miscellaneous Expenses**		**210,77,05**
6811,26,71	**Total**		**5849,09,61**
5404,00,00	**Available Balance**		**8408,00,00**
	Less: Contribution To:		
	National Industrial Credit (Long Term Operations) Fund	1,00,00	
	National Rural Credit (Long Term Operations) Fund [2]	1,00,00	
	National Rural Credit (Stabilisation) Fund [2]	1,00,00	
	National Housing Credit (Long Term Operations) Fund	1,00,00	
4,00,00			**4,00,00**
5400,00,00	**Surplus Payable to Central Government**		**8404,00,00**

1. After making the usual or necessary provisions in terms of Section 47 of the Reserve Bank of India Act, 1934 amounting to Rs.12063,21,12 thousands (2004-05 - Rs.6813,00,61 thousands).
2. These funds are maintained by National Bank for Agriculture and Rural Development (NABARD).

Prabal Sen	**Usha Thorat**	**Shyamala Gopinath**	**V. Leeladhar**	**Rakesh Mohan**	**Y. V. Reddy**
Chief General Manager	Deputy Governor	Deputy Governor	Deputy Governor	Deputy Governor	Governor

REPORT OF THE AUDITORS

TO THE PRESIDENT OF INDIA

We, the undersigned auditors of Reserve Bank of India (hereinafter referred to as the Bank), do hereby report to the Central Government upon the Balance Sheet of the Bank as at June 30, 2006 and the Profit and Loss Account for the year ended on that date.

We have examined the Balance Sheet of the Bank as at June 30, 2006 and the Profit and Loss Account of the Bank for the year ended on that date and report that where we have called for information and explanations from the Bank, such information and explanations have been given to our satisfaction.

These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in India. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion and according to the best of our information and explanations given to us and as shown by the books of account of the Bank, the Balance Sheet read with Significant Accounting Policies and Notes to the Accounts is a full and fair Balance Sheet containing all necessary particulars and is properly drawn up in accordance with the Reserve Bank of India Act, 1934 and Regulations framed thereunder so as to exhibit a true and correct view of the state of the Bank's affairs, in conformity with the accounting principles generally accepted in India.

Shivji K. Vikamsey	S. N. Nanda	S.R.Ananthakrishnan	V.K.Issar	A. D. Shenoy	S.Neelakantan
(M. No. 2242)	(M. No. 5909)	(M. No. 18073)	(M. No. 9519)	(M. No. 11549)	(M. No.18961)
Khimji Kunverji & Co.,	**S. N. Nanda & Co.,**	**J. L. Sengupta & Co.,**	**Rajendra K.Goel & Co.,**	**Ford, Rhodes, Parks & Co.,**	**M. K. Dandeker & Co.,**
Chartered Accountants	Chartered Accountants	Chartered Accountants	Chartered Accountants	Chartered Accountants	Chartered Accountants

Dated August 10, 2006

ANNEX

RESERVE BANK OF INDIA

SIGNIFICANT ACCOUNTING POLICIES AND NOTES TO THE ACCOUNTS FOR 2005–06

SIGNIFICANT ACCOUNTING POLICIES

1. CONVENTION

The financial statements are prepared in accordance with the Reserve Bank of India Act, 1934 and the notifications issued thereunder and in the form prescribed by the Reserve Bank of India General Regulations, 1949 and are based on historical cost, except where it is modified to reflect revaluation.

The accounting practices and policies followed in the financial statements are consistent with those followed in the previous year, unless otherwise stated.

2. REVENUE RECOGNITION

Income and expenditure are recognised on accrual basis except penal interest and dividend, which are accounted for on receipt basis. Only realised gains are recognised. Provision for outstanding expenditure is made for unpaid bills in respect of cases of Rs.1 lakh and above.

Balances unclaimed and outstanding for more than three consecutive years in certain transitory accounts including Drafts Payable Account, Payment Orders Account, Sundry Deposits Account, Remittance Clearance Account and Earnest Money Deposit Account are reviewed and written back to income. Claims in this respect are considered and charged against income in the year of payment.

Income and expenditure in foreign currency are recorded at the exchange rates prevailing on the last business day of the preceding week / preceding month / year-end rates as applicable.

Profit / loss on sale of rupee securities is recognised with respect to the book value.

3. GOLD AND FOREIGN CURRENCY ASSETS AND LIABILITIES

(a) Gold

Gold is valued at the end of the month at 90 per cent of the daily average price quoted at London for the month. The rupee equivalent is determined on the basis of exchange rate prevailing on the last business day of the month. Unrealised gains / losses are adjusted to the Currency and Gold Revaluation Account (CGRA).

(b) Foreign Currency Assets and Liabilities

All foreign currency assets and liabilities are translated at the exchange rates prevailing on the last business day of the week as well as on the last business day of the month.

At the year-end, assets and liabilities in foreign currencies are translated at the exchange rates prevailing on the last business day except in cases where rates are contractually fixed. Foreign securities other than Treasury Bills are valued at lower of book value or market price prevailing on the last business day of each month. The depreciation is adjusted against current income. Foreign Treasury Bills are valued at cost. Forward exchange contracts are evaluated half-yearly and net loss, if any, is provided for.

Profit / loss on sale of foreign currency assets is recognised with respect to the book value. Exchange gains and losses arising from translation of foreign currency assets and liabilities are accounted for in Currency and Gold Revaluation Account and remain adjusted therein.

4. RUPEE SECURITIES

Rupee securities, other than Treasury Bills, held in the Issue and Banking Departments, are valued at lower of book value or market price. Where the market price for such securities is not available, the rates are derived based on the yield curve prevailing on the last business day of the month. The depreciation in the value, if any, is adjusted against current interest income.

Treasury Bills are valued at cost.

5. SHARES

Investments in shares are valued at cost.

6. FIXED ASSETS

Fixed Assets are stated at cost less depreciation.

Depreciation on computers (including software costing Rs.1 lakh and above), motor vehicles, office equipments, furniture and electrical fittings, *etc.*, is provided on straight-line basis.

Depreciation on other assets including premises and fixtures is provided on written-down value basis.

Software costing less than Rs.1 lakh and other Fixed Assets costing less than Rs.10,000 are charged to Profit & Loss Account in the year of acquisition.

Depreciation is provided on year end balances of the Fixed Assets.

7. RETIREMENT BENEFITS

The liability on account of retirement benefits and leave encashment to employees is provided based on an actuarial valuation.

8. CONTINGENCY RESERVE AND ASSET DEVELOPMENT RESERVE

Contingency Reserve represents the amount set aside on a year-to-year basis for meeting unexpected and unforeseen contingencies including depreciation in value of securities, exchange guarantees and risks arising out of monetary/ exchange rate policy compulsions.

In order to meet the internal capital expenditure and make investments in subsidiaries and associate institutions, a further specified sum is provided and credited to the Asset Development Reserve.

NOTES TO THE ACCOUNTS

1. SURPLUS TRANSFER TO GOVERNMENT OF INDIA

Surplus transferable to the Government includes Rs.2,106.00 crore representing interest differential pertaining to the period April 1, 2005 – March 31, 2006 on account of conversion of Special Securities into marketable securities.

2. EARMARKED SECURITIES

Reserve Bank has earmarked certain Government securities from its Investments Account in order to cover the liabilities in Provident Fund, Superannuation Fund and encashment of ordinary leave, details thereof are as under:

(Rupees crore)

Sr. No.	Category	Particulars of securities earmarked	Book value of securities earmarked	
			as on June 30, 2005	as on June 30, 2006
1	2	3	4	5
1.	Bank's Investment Account – Provident Fund	11.43% 2015 10.25% 2021	1,591.72 -	1,623.50 182.40
2.	Bank's Investment Account – Superannuation Fund	10.70% 2020 11.43% 2015 10.25% 2021	3,292.27 551.90 -	3,292.27 777.61 373.05
3.	Encashment of Ordinary Leave	11.43% 2015 10.25% 2021	205.88 -	199.86 61.30
	TOTAL		**5,641.77**	**6,509.99**

3. RESERVE FUND

Reserve Fund comprises initial contribution of Rs.5.00 crore made by the Government of India and appreciation of Rs.6,495.00 crore on account of revaluation of Gold up to October 1990. Subsequent gains/ losses on monthly revaluation of Gold are taken to Currency and Gold Revaluation Account (CGRA).

4. DEPOSITS

4.1 Deposits of Central Government include Rs.33,294.50 crore (previous year Rs.71,680.65 crore) on account of operations under Market Stabilisation Scheme (MSS).

4.2 Details of Deposits – Others:

(Rupees crore)

	Particulars	As at June 30	
		2005	2006
	1	2	3
I.	Rupee Deposits from Foreign Central Banks and Foreign Financial Institutions	4,486.86	4,810.03
II.	Deposits from Indian Financial Institutions	233.71	198.25
III.	Accumulated Retirement Benefits	5,483.38	6,254.61
IV.	Surplus transferable to Government of India	5,400.00	8,404.00
V.	Miscellaneous	317.05	947.03
	Total	**15,921.00**	**20,613.92**

5. DETAILS OF OTHER LIABILITIES

(Rupees crore)

Particulars	As at June 30	
	2005	2006
1	2	3
I. Contingency Reserve		
Balance at the beginning of the year	56,218.76	62,344.68
Add : Accretion during the year	6,125.92	10,936.42
Balance at the end of the year	**62,344.68**	**73,281.10**
II. Asset Development Reserve		
Balance at the beginning of the year	5,778.94	6,466.03
Add : Accretion during the year	687.09	1,126.79
Balance at the end of the year	**6,466.03**	**7,592.82**
III. Currency and Gold Revaluation Account		
Balance at the beginning of the year	62,283.04	26,906.21
Add : Net Accretion (+)/ Net depletion (-) during the year	(-)35,376.83	59,882.97
Balance at the end of the year	**26,906.21**	**86,789.18**
IV. Exchange Equalisation Account		
Balance at the beginning of the year	5.65	0.50
Transfer from Exchange Account	–	3.28
Add : Net Accretion(+)/ Net Utilisation(-) during the year	(-) 5.15	(-) 0.50
Balance at the end of the year	**0.50**	**3.28**
V. Provision for Outstanding Expenses	**1,873.95**	**1,914.87**
VI. Miscellaneous	**2,764.90**	**2,792.55**
Total (I to VI)	**1,00,356.27**	**1,72,373.80**

6. RBI GENERAL ACCOUNT

Other Liabilities include Rs.607.81 crore (previous year Rs.999.65 crore) in respect of inter-office transactions and balances under reconciliation, which is at various stages of reconciliation and necessary adjustments are effected, as and when ascertained.

7. RUPEE INVESTMENTS

Securities sold (Reverse Repo) under Liquidity Adjustment Facility (LAF) are reduced from 'Investments'. As at the year end, the outstanding Reverse Repos amounted to Rs.42,565.00 crore.

8. DETAILS OF FOREIGN CURRENCY ASSETS

(Rupees crore)

Particulars	As at June 30	
	2005	2006
1	2	3
I. Held in Issue Department	3,61,033.08	4,16,525.46
II. Held in Banking Department		
a) Included in Investments	19,155.43	23,677.31
b) Balances Held Abroad	1,95,675.15	2,78,498.41
Total	**5,75,863.66**	**7,18,701.18**

Note: (i) As on June 30, 2006, there were no outstanding US$/ Rupee forward exchange contracts, position being the same as at June 30, 2005.

(ii) Uncalled amount on partly paid shares of the Bank for International Settlements as at June 30, 2006 was Rs.82.08 crore.

9. DETAILS OF OTHER ASSETS

(Rupees crore)

Particulars	As at June 30	
	2005	2006
1	2	3
I. Fixed Assets (net of accumulated depreciation)	497.05	476.36
II. Gold	3,546.70	5,213.19
III. Income accrued but not received	7,954.29	11,424.51
IV. Miscellaneous	2,405.53	3,509.74
Total	**14,403.57**	**20,623.80**

10. INTEREST, DISCOUNT, EXCHANGE, COMMISSION, *etc.*

Interest, Discount, Exchange, Commission, *etc.* include the following:

(Rupees crore)

Particulars	Year ended	
	June 30, 2005	June 30, 2006
1	2	3
I. Profit on sale of Foreign and Rupee Securities	4,625.50	3,959.29
II. Net profit on sale of Bank's property	0.92	6.46
III. Dividend from subsidiaries & associate institutions	345.77	393.60

LIST OF ABBREVIATIONS

ACH	-	Automated Clearing Houses
ACU	-	Asian Clearing Union
ADs	-	Authorised Dealers
ADB	-	Asian Development Bank
ADRs	-	American Depository Receipts
AFS	-	Available for Sale
AIBP	-	Accelerated Irrigation Benefit Programme
AIFI	-	All India Financial Institution
ALD	-	Aggregate Liability to Depositors
ALM	-	Asset-Liability Management
AMCs	-	Authorised Money Changers
AML	-	Anti-Money Laundering
APL	-	Above Poverty Line
APM	-	Administered Price Mechanism
ARC	-	Asset Reconstruction Company
AS	-	Accounting Standard
ATM	-	Automated Teller Machine
ACU	-	Additional Competitive Underwriting
BCBS	-	Basel Committee on Banking Supervision
BCSBI	-	Banking Codes and Standards Board of India
BCTT	-	Banking Cash Transaction Tax
BE	-	Budget Estimates
BFS	-	Board for Financial Supervision
BIFR	-	Board for Industrial and Financial Reconstruction
BIS	-	Bank for International Settlements
BLA	-	Bond Ledger Account
BoP	-	Balance of Payments
BOS	-	Banking Ombudsman Scheme
BPL	-	Below Poverty Line
BPLR	-	Benchmark Prime Lending Rate
BPO	-	Business Process Outsourcing
BPSS	-	Board for Payment and Settlement Systems
BRBNMPL	-	Bharatiya Reserve Bank Note Mudran Private Limited
BSE	-	The Stock Exchange, Mumbai
BSR	-	Basic Statistical Returns
BTC	-	Bankers Training College
CA	-	Certification Authority
CA	-	Concurrent Audit
CAB	-	College of Agricultural Banking
CBLO	-	Collateralised Borrowing and Lending Obligation
CBS	-	Consolidated Banking Statistics
CCC	-	Central Complaints Committee
CCIL	-	Clearing Corporation of India Limited
CCP	-	Central Counter Party
CCRS	-	Currency Chest Reporting System
CD	-	Certificate of Deposit
CDR	-	Corporate Debt Restructuring
CENVAT	-	Central Value Added Tax
CFMS	-	Centralised Funds Management System
CGRA	-	Currency and Gold Revaluation Account
CIB	-	Capital Indexed Bond
CIBIL	-	Credit Information Bureau of India Limited
CIC	-	Central Information Commissioner
CoR	-	Certificate of Registration
CAPIO	-	Central Assistant Public Information Officer
CPC	-	Cheque Processing Centre
CPDO	-	Centralised Public Debt Office
CPI	-	Consumer Price Index
CPI-IW	-	Consumer Price Index for Industrial Workers
CPIO	-	Chief Public Information Officer
CP	-	Commercial Paper
CPPAPS	-	Committee on Procedures and Performance Audit on Public Services
CRAR	-	Capital to Risk Weighted Assets Ratio
CRR	-	Cash Reserve Ratio
CSAA	-	Control Self Assessment Audit
CSGL	-	Constituents' Subsidiary General Ledger
CSF	-	Consolidated Sinking Fund
CSO	-	Central Statistical Organisation
CTR	-	Cash Transaction Report
CTS	-	Cheque Truncation System
CVPS	-	Currency Verification and Processing System
CWBN	-	Cylinder Mould Vat Watermarked Bank Note
DAD	-	Deposit Accounts Department
DAPM	-	Department of Administration and Personnel Management
DBIE	-	Database on Indian Economy
DBOD	-	Department of Banking Operations and Development

LIST OF ABBREVIATIONS

DBS	-	Department of Banking Supervision
DCCB	-	District Central Cooperative Bank
DCM	-	Department of Currency Management
DEAP	-	Department of Economic Analysis and Policy
DEBC	-	Department of Expenditure and Budgetary Control
DEIO	-	Department of External Investments and Operations
DESACS	-	Department of Statistical Analysis and Computer Services
DFEC	-	Duty Free Entitlement Certificate
DFHI	-	Discount and Finance House of India
DFIs	-	Development Finance Institutions
DFRC	-	Duty Free Replenishment Certificate
DGBA	-	Department of Government and Bank Accounts
DGCI&S	-	Directorate General of Commercial Intelligence and Statistics
DGFT	-	Directorate General of Foreign Trade
DICGC	-	Deposit Insurance and Credit Guarantee Corporation
DIT	-	Department of Information Technology
DLCC	-	District Level Consultative Committee
DMA	-	Direct Marketing Agent
DNBS	-	Department of Non-Banking Supervision
DRG	-	Development Research Group
DRS	-	Disaster Recovery System
DSA	-	Direct Selling Agent
DSS	-	Debt Swap Scheme
DRT	-	Debt Recovery Tribunal
DTA	-	Domestic Tariff Area
DTL	-	Demand and Time Liabilities
D*v*P	-	Delivery *versus* Payment
ECB	-	External Commercial Borrowing
ECB	-	European Central Bank
ECR	-	Export Credit Refinance
ECS	-	Electronic Clearing Services
EDI	-	Entrepreneurship Development Institute
EEFC	-	Exchange Earners' Foreign Currency
EEPC	-	Engineering Export Promotion Council
EFT	-	Electronic Funds Transfer
EKMS	-	Enterprise Knowledge Management System
EMEs	-	Emerging Market Economies
EOU	-	Export Oriented Unit
ESOP	-	Employees Stock Option Plan
EU	-	European Union
FBT	-	Fringe Benefit Tax
FCCB	-	Foreign Currency Convertible Bond
FCI	-	Food Corporation of India
FCNR(B)	-	Foreign Currency Non-Resident (Banks)
FCRA	-	Forward Contract Regulation Act
FDI	-	Foreign Direct Investment
FEDAI	-	Foreign Exchange Dealers' Association of India
FED	-	Foreign Exchange Department
FEMA	-	Foreign Exchange Management Act
FFMCs	-	Full Fledged Money Changers
FIs	-	Financial Institutions
FIIs	-	Foreign Institutional Investors
FIMMDA	-	Fixed Income Money Market and Derivatives Association of India
FIPB	-	Foreign Investment Promotion Board
FLU-IND	-	Financial Intelligence Unit-India
FMD	-	Financial Markets Department
FMS	-	Focus Market Scheme
FOB	-	Free on Board
FPS	-	Focus Product Scheme
FRA	-	Forward Rate Agreement
FRB	-	Floating Rate Bond
FRBM	-	Fiscal Responsibility and Budget Management
FTP	-	Financial Transaction Plan
GAAP	-	Generally Accepted Accounting Principles
GATS	-	General Agreement on Trade in Services
GB	-	Giga-bytes
GCC	-	General Credit Card
GDP	-	Gross Domestic Product
GDR	-	Global Depository Receipt
GDS	-	Gross Domestic Saving
GFCF	-	Gross Fixed Capital Formation
GFD	-	Gross Fiscal Deficit
GIPSA	-	General Insurer's (Public Sector) Association of India
GLC	-	General Line of Credit
GoI	-	Government of India

LIST OF ABBREVIATIONS

GRF	-	Guarantee Redemption Fund
HFCs	-	Housing Finance Companies
HFT	-	Held for Trading
HRDD	-	Human Resources Development Department
HRMS	-	Human Resources Management System
HTM	-	Held to Maturity
IAS	-	Integrated Accounting System
IASC	-	Inspection and Audit Sub-Committee
IBA	-	Indian Banks' Association
IBS	-	International Banking Statistics
ICC	-	International Credit Card
ICCOMS	-	Integrated Computerised Currency Operation and Management System
IDBI	-	Industrial Development Bank of India
IDMD	-	Internal Debt Management Department
IDR	-	Indian Depository Receipt
IDRBT	-	Institute for Development and Research in Banking Technology
IEA	-	International Energy Agency
IES	-	Integrated Establishment System
IFC	-	International Finance Corporation
IIFCL	-	India Infrastructure Finance Company Limited
IIP	-	Index of Industrial Production
IIT	-	Indian Institute of Technology
IMD	-	India Millennium Deposits
IMF	-	International Monetary Fund
IMFC	-	International Monetary and Financial Committee
INFINET	-	Indian Financial Network
IPDI	-	Innovative Perpetual Debt Instrument
IPO	-	Initial Public Offering
IRB	-	Internal Rating Based
IRDA	-	Insurance Regulatory and Development Authority
IRF	-	Interest Rate Future
IRS	-	Interest Rate Swap
IS	-	Information System
ISO	-	International Organisation for Standardisation
ITES-BPO	-	Information Technology Enabled Services and Business Process Outsourcing
JPC	-	Joint Parliamentary Committee
JV	-	Joint Venture
KCC	-	Kisan Credit Card
KYC	-	Know Your Customer
LAB	-	Local Area Bank
LAF	-	Liquidity Adjustment Facility
LAN	-	Local Area Network
LaR	-	Liquidity at Risk
LBS	-	Locational Banking Statistics
LC	-	Letter of Credit
LIC	-	Life Insurance Corporation of India
LIBOR	-	London Inter Bank Offered Rate
LVPS	-	Large Value Payment Systems
M&A	-	Merger and Acquisition
MA&SI	-	Management Audit & Systems Inspection
MAT	-	Minimum Alternate Tax
MBS	-	Mortgage-Backed Securities
MF	-	Mutual Fund
MFI	-	Micro Finance Institution
MICR	-	Magnetic Ink Character Recognition
MIS	-	Management Information System
MMBCS	-	Magnetic Media Based Clearing System
MoU	-	Memorandum of Understanding
MPI	-	Macro-Prudential Indicator
MSS	-	Market Stabilisation Scheme
MSP	-	Minimum Support Price
MUC	-	Minimum Underwriting Commitment
MW	-	Mega Watts
NABARD	-	National Bank for Agriculture and Rural Development
NASSCOM	-	National Association of Software and Services Companies
NAV	-	Net Asset Value
NBC	-	National Building Code
NBER	-	National Bureau of Economic Research
NBFCs	-	Non-Banking Financial Companies
NCAER	-	National Council of Applied Economic Research
NDA	-	Net Domestic Assets
NDS	-	Negotiated Dealing System
NDS - OM	-	Negotiated Dealing System – Order Matching
NDTL	-	Net Demand and Time Liabilities
NEER	-	Nominal Effective Exchange Rate

LIST OF ABBREVIATIONS

NEFT	-	National Electronic Funds Transfer
NEP	-	National Electricity Policy
NER	-	North – Eastern Region
NFA	-	Net Foreign Assets
NFEA	-	Net Foreign Exchange Assets
NFFWP	-	National Food for Work Programme
NGO	-	Non-Government Organisations
NHB	-	National Housing Bank
NIBM	-	National Institute of Bank Management
NIF	-	National Investment Fund
NOF	-	Net Owned Funds
NPAs	-	Non-Performing Assets
NPC	-	National Payments Council
NPV	-	Net Present Value
NREG	-	National Rural Employment Guarantee Act
NRI	-	Non-Resident Indian
NRO	-	Non-Resident Ordinary
NSC	-	National Statistical Commission
NSDL	-	National Securities Depository Limited
NREGF	-	National Rural Employment Guarantee Fund
NSE	-	National Stock Exchange
NSE-MIBOR	-	National Stock Exchange-Mumbai Inter-bank Offer Rate
NSSO	-	National Sample Survey Organisation
NSS	-	National Settlement System
NSSF	-	National Small Saving Fund
OBC	-	Other Backward Class
OBU	-	Offshore Banking Unit
OCBs	-	Overseas Corporate Bodies
OLTAS	-	Online Tax Accounting System
OMO	-	Open Market Operation
OMS	-	Open Market Sales
OPEC	-	Organisation of Petroleum Exporting Countries
ORFS	-	Online Returns Filing System
OTC	-	Over-the-Counter
OTCEI	-	Over-the-Counter Exchange of India
OTS	-	One-Time Settlement
OWS	-	Other Welfare Schemes
PACS	-	Primary Agricultural Cooperative Societies
PAIS	-	Personal Accident Insurance Scheme
PAT	-	Profit After Tax
PBT	-	Profit Before Tax
PCA	-	Prompt Corrective Action
PDs	-	Primary Dealers
PDO	-	Public Debt Office
PDS	-	Public Distribution System
P/E ratio	-	Price Earnings ratio
PIOs	-	Persons of Indian Origin
PKI	-	Public Key Infrastructure
P&L	-	Profit and Loss
PMLA	-	Prevention of Money Laundering Act
POL	-	Petroleum Oil and Lubricants
PPP	-	Public Private Partnership
PSBs	-	Public Sector Banks
PSUs	-	Public Sector Undertakings
QIB	-	Qualified Institutional Buyer
QIP	-	Qualified Institutional Placement
QIS	-	Quantitative Impact Study
R&D	-	Research & Development
RBS	-	Risk-Based Supervision
RBSB	-	Reserve Bank Services Board
RBSC	-	Reserve Bank Staff College
RC	-	Reconstruction Company
RCC	-	Regional Complaints Committee
RD	-	Revenue Deficit
RE	-	Revised Estimates
REER	-	Real Effective Exchange Rate
RIA	-	Right to Information Act
RIDF	-	Rural Infrastructure Development Fund
RNBCs	-	Residuary Non-banking Companies
RPCD	-	Rural Planning and Credit Department
RRBs	-	Regional Rural Banks
RTGS	-	Real Time Gross Settlement
RTP	-	Reserve Tranche Position
SAARC	-	South Asian Association for Regional Cooperation
SACP	-	Special Agricultural Credit Plan
SAFTA	-	South Asian Free Trade Agreement
SARFAESI	-	Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest
SBI	-	State Bank of India
SBS	-	Shredding and Briquetting System
SC	-	Scheduled Caste

LIST OF ABBREVIATIONS

SCB	-	Scheduled Commercial Bank
SCRA	-	Securities Contracts (Regulation) Act
SDDS	-	Special Data Dissemination Standard
SDL	-	State Development Loan
SDR	-	Special Drawing Right
SEB	-	State Electricity Board
SEBI	-	Securities and Exchange Board of India
SEFT	-	Special Electronic Funds Transfer
SEZs	-	Special Economic Zones
SFMS	-	Structured Financial Messaging Solution
SGSY	-	Swarnajayanti Gram Swarozgar Yojana
SHGs	-	Self-Help Groups
SIDBI	-	Small Industrial Development Bank of India
SIPS	-	Systemically Important Payment Systems
SLAF	-	Second Liquidity Adjustment Facility
SLBC	-	State Level Bankers Committee
SLCC	-	State Level Coordination Committee
SLR	-	Statutory Liquidity Ratio
SLRS	-	Scheme of Liberation and Rehabilitation of Scavengers
SMEs	-	Small and Medium Enterprises
SPV	-	Special Purpose Vehicle
SR	-	Security Receipt
SSCs	-	Special Sub-Committees
SSIs	-	Small Scale Industries
SSSs	-	Securities Settlement Systems
StCB	-	State Cooperative Bank
STP	-	Straight Through Processing
STR	-	Suspicious Transaction Report
STRIPS	-	Separate Trading for Registered Interest and Principal of Securities
ST	-	Scheduled Tribe
STT	-	Securities Transaction Tax
TAFCUBs	-	Task Forces for Urban Cooperative Banks
TBs	-	Treasury Bills
TFC	-	Twelfth Finance Commission
TPDS	-	Targeted Public Distribution System
UBD	-	Urban Banks Department
UCBs	-	Urban Cooperative Banks
UNCTAD	-	United Nations Conference on Trade and Development
UNSNA	-	United Nation System of National Accounts, 1993
URRBCH	-	Uniform Regulations and Rules for Bankers' Clearing House
VaR	-	Value at Risk
VAT	-	Value Added Tax
VCF	-	Venture Capital Funds
WADR	-	Weighted Average Discount Rate
WAN	-	Wide Area Network
WAP	-	Wireless Application Protocol
WDM	-	Wholesale Debt Market
WGC	-	World Gold Council
WI	-	When Issued
WMA	-	Ways and Means Advance
WOS	-	Wholly Owned Subsidiaries
WSS	-	Weekly Statistical Supplement
WTI	-	West Texas Intermediate
WTO	-	World Trade Organisation
Y-o-Y	-	Year on Year
YTM	-	Yield-to-Maturity
ZTC	-	Zonal Training Centre

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