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RESERVE BANK OF INDIA

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Macroeconomic and Monetary Developments First Quarter Review 2008-09

The Reserve Bank today released the document "Macroeconomic and Monetary Developments: First Quarter Review 2008-09" to serve as a backdrop to the First Quarter Review of Annual Policy Statement for 2008-09 being announced on July 29, 2008.

The highlights of this Review are:

The Real Economy

- According to the revised estimates released by the Central Statistical Organisation (CSO) in May 2008, the real GDP growth was placed at 9.0 per cent during 2007-08 as compared with 9.6 per cent in 2006-07. The deceleration in growth was on account of industry and services, offset partly by recovery in agriculture.
- According to the Fourth Advance Estimates, the foodgrains production during 2007-08 was placed at an all-time high of 230.7 million tonnes, exhibiting an increase of 6.2 per cent over the previous year (217.3 million tonnes) predominantly on account of *kharif* foodgrains production. Barring sugarcane, all foodgrains and non-foodgrains are estimated to reach an all-time record production during 2007-08.
- During April-May 2008 the index of industrial production recorded year-on-year expansion of 5.0 per cent as compared with 10.9 per cent during April-May 2007. The manufacturing sector recorded growth of 5.3 per cent during April-May 2008 (11.8 per cent during April-May 2007), while the electricity sector recorded growth of 1.7 per cent (9.0 per cent during April-May 2007).
- The infrastructure sector recorded growth of 3.5 per cent during April-May 2008 (6.9 per cent during April-May 2007), reflecting deceleration in all the sectors, except coal and crude petroleum.
- Available information on the leading indicators of services sector activity during 2008-09 so far suggest acceleration in growth in respect of some indicators such as railway revenue earning freight traffic, tourist arrivals and export cargo handled by civil aviation as compared with corresponding period of 2007-08. On the other hand, growth decelerated in respect of cargo handled at major ports, various indicators of civil aviation, excluding export cargo and commercial vehicles production.

Fiscal Situation

- Available information on Central Government finances during April-May 2008 indicates that revenue deficit and gross fiscal deficit were higher than a year ago, both in absolute terms and as proportion to budget estimates. Gross primary deficit in April-May 2008 was also higher than a year ago. The widening of fiscal deficit of the Central Government during April-May 2008 was mainly on account of a sharp rise in plan expenditure over April-May 2007. On the other hand, non-plan expenditure was contained mainly due to moderation in the growth of interest payments and major subsidies, and decline in defence expenditure.

- Gross and net market borrowings (dated securities and 364-day Treasury Bills) of the Central Government during 2008-09 (up to July 18, 2008) amounted to Rs.77,809 crore and Rs.42,819 crore, respectively, accounting for 44.3 per cent and 43.3 per cent, respectively, of the estimated market borrowings for the year. During the corresponding period of the previous year, gross and net borrowings accounted for 40.5 per cent and 33.5 per cent, respectively.
- The cash balance of the Central Government remained in surplus during 2008-09 (up to July 18, 2008). The surplus cash balance of the Central Government as on July 18, 2008 was Rs. 19,767 crore.
- During the current year so far (up to July 18, 2008), eight State Governments raised Rs.8,712 crore (14.8 per cent of gross allocation for the year) through auctions with a cut-off yield in the range 8.39-9.81 per cent as compared with Rs.7,153 crore by 13 State Governments (cut-off yield ranging from 8.30-8.57 per cent) during the corresponding period of the previous year.
- The average daily utilisation of WMA and overdraft by the States during 2008-09 (up to July 18, 2008) was Rs.351 crore as compared with Rs. 736 crore during the corresponding period of 2007-08.
- The average investments by the States in Treasury Bills during 2008-09 (up to July 18, 2008) amounted to Rs. 81,750 crore as compared with Rs. 70,608 crore during the corresponding period of 2007-08.

Monetary and Liquidity Conditions

- Growth in broad money (M_3), year-on-year (y-o-y), was 20.5 per cent (Rs. 7,04,046 crore) on July 4, 2008 as compared with 21.8 per cent (Rs. 6,17,118 crore) a year ago.
- Aggregate deposits of banks, y-o-y, expanded by 20.7 per cent (Rs.6,07,668 crore) on July 4, 2008 as compared with 23.1 per cent (Rs. 5,50,653 crore) a year ago.
- Non-food credit by scheduled commercial banks (SCBs) expanded by 25.9 per cent (Rs.4,85,709 crore), y-o-y, as on July 4, 2008 as compared with 24.6 per cent (Rs.3,69,109 crore) a year ago.
- Growth in reserve money, y-o-y, was 26.5 per cent on July 18, 2008 as compared with 29.0 per cent a year ago. Adjusted for the first round impact of the hike in the cash reserve ratio, reserve money growth was 18.4 per cent as compared with 21.6 per cent a year ago.
- Liquidity conditions continued to be influenced by movements in cash balances of the Central Government and capital flows. The Reserve Bank continued with the policy of active management of liquidity through appropriate use of cash reserve ratio (CRR) and open market operations (OMO), including MSS and LAF and other policy instruments at its command flexibly.

Price Situation

- Inflation has emerged as a global phenomenon in recent months.
- Headline inflation firmed up further in major economies during the first quarter of 2008-09, reflecting the combined impact of higher food and fuel prices as well as strong demand conditions, especially in emerging markets. Notwithstanding inflation remaining above the targets/comfort zones, the monetary policy responses during the quarter were mixed in view of growth implications of the persistence of financial market turmoil following the US sub-prime crisis.
- Global commodity prices firmed up further during the first quarter of 2008-09, led by a sharp increase in the prices of crude oil as well as food and agricultural raw materials. Metal prices, which had increased during 2007-08, witnessed some moderation during the first quarter of 2008-09. International crude oil prices, represented by the West Texas Intermediate (WTI), touched a high of US \$ 145.3 a barrel level on July 3, 2008. Food prices firmed up further during the first quarter of 2008-09, led by rice, maize and oilseeds/edible oils, reflecting surging demand (both consumption demand and demand for non-food uses such as bio-fuels production) and low stocks of major crops.

- Mirroring inflation trends in many advanced as well as emerging economies, various measures of inflation in India have also risen significantly since the beginning of this calendar year. Inflation based on the wholesale price index (WPI), increased from 7.7 per cent at end-March 2008 to 11.9 per cent by July 12, 2008, reflecting the impact of some pass-through of higher international crude oil prices to domestic prices as well as continued increase in the prices of iron and steel, basic heavy inorganic chemicals, machinery and machinery tools, oilseeds/edible oils/oil cakes and raw cotton on account of strong demand, international commodity price pressures and lower domestic 2007-08 *rabi* production of oilseeds. The seasonal hardening of vegetables prices as well as increase in prices of textiles has also contributed to inflation during 2008-09 so far.
- Primary articles prices, y-o-y, increased by 10.1 per cent on July 12, 2008 on top of 11.1 per cent a year ago (it was 9.7 per cent at end-March 2008), reflecting increase in prices of food articles, especially rice, wheat, fruits and milk, and non-food articles such as oilseeds and raw cotton.
- Fuel group inflation increased to 16.9 per cent on July 12, 2008 from 6.8 per cent at end-March 2008 (and a decline of 1.4 per cent a year ago), mainly reflecting the effect of some hikes in the prices of petrol, diesel and LPG in June 2008 as well as continued increase (15-51 per cent) in the prices of freely priced petroleum products such as naphtha, furnace oil, aviation turbine fuel, bitumen and lubricants over end-March 2008.
- Manufactured products inflation, year-on-year, rose further to 10.7 per cent on July 12, 2008 from 7.3 per cent at end-March 2008 (and 4.8 per cent a year ago), reflecting increase in the prices of edible oils, oil cakes, textiles, chemicals, basic metals, alloys and products, and machinery and machine tools. Prices of sugar and grain mill products, however, eased somewhat from end-March 2008.
- Consumer price inflation increased further during the first quarter of 2008-09 mainly due to increase in food prices and services (represented by the 'miscellaneous' group) prices. Various measures of consumer price inflation were placed in the range of 6.8-8.8 per cent during May/June 2008 as compared with 6.0-7.9 per cent in March 2008 and 5.7-7.8 per cent in June 2007.

Financial Markets

- Global financial markets witnessed generally uncertain conditions during April-July 2008. The financial market turbulence that had erupted in the US sub-prime mortgage market in mid-2007 gradually deepened towards early 2008. There was a cautious return of investor risk tolerance in the credit markets between mid-March 2008 and end-May 2008. Central banks continued to work together and also individually to improve liquidity conditions in financial markets. Financial markets, however, came under stress again in June 2008 and thereafter.
- Indian financial markets remained largely orderly during the first quarter of 2008-09.
- Interest rates in the money market mostly remained within the informal corridor set by reverse repo and repo rates during the quarter. Interest rates in the collateralised segment of the money market remained below the call rate during the quarter.
- In the foreign exchange market, the Indian rupee generally depreciated against major currencies during the first quarter of 2008-09. The rupee had appreciated during 2007-08.
- Yields in the Government securities market hardened during the quarter.
- Indian equity markets recovered somewhat during April-May 2008 but declined thereafter in tandem with the trends in major international equity markets as well as edging up of domestic inflation.

The External Economy

- India's balance of payments position remained comfortable during 2007-08. The merchandise trade deficit, on a balance of payments basis, widened from US \$ 63.2 billion in 2006-07 to US \$ 90.1 billion in 2007-08. As proportion to GDP, the trade deficit increased from 6.9 per cent to 7.7 per cent. Net surplus under invisibles (services, transfers and income taken together) expanded to US \$ 72.7 billion in 2007-08 from US \$ 53.4 billion in 2006-07. The net invisible surplus offset 80.7 per cent of the trade deficit during 2007-08 as compared with 84.5 per cent during 2006-07.
- During 2007-08, the widening of the trade deficit, mainly led by imports, resulted in a widening of current account deficit to US \$ 17.4 billion (1.5 per cent of GDP) from US \$ 9.8 billion (1.1 per cent of GDP) in 2006-07. The current account deficit was financed by capital flows which remained large during 2007-08.
- The strong momentum observed in FDI inflows during the year 2007-08 continued during 2008-09, with inflows during April-May 2008 amounting to US \$ 7.7 billion. In respect of FIIs, however, there were net outflows of US \$ 5.6 billion up to July 11, 2008. NRI deposits recorded net inflows of US \$ 292 million during April-May 2008 as against net outflows of US \$ 559 million during April-May 2007.
- According to the data released by the Directorate General of Commercial Intelligence and Statistics (DGCI&S), India's merchandise exports posted a growth of 21.7 per cent during April-May 2008 (24.2 per cent during April-May 2007). Imports grew at 31.8 per cent as compared with 37.9 per cent a year ago. Non-oil imports recorded an increase of 24.6 per cent (43.8 per cent a year ago); oil imports increased by 48.6 per cent during April-May 2008 as against 25.7 per cent in April-May 2007. Merchandise trade deficit during April-May 2008 increased to US \$ 20.7 billion from US \$13.9 billion a year ago.
- Foreign exchange reserves increased by US \$ 110.5 billion during 2007-08 to US \$ 309.7 billion. As on July 18, 2008, India's foreign exchange reserves were US \$ 307.1 billion.

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