Macroeconomic and Monetary Developments in 2005-06

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April 18, 2006

Reserve Bank of India

Mumbai

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Contents

I. THE REAL ECONOMY

Growth Rates

The Indian economy exhibited a strong performance during 2005-06, led by sustained growth in the industry and the services sectors. According to the advance estimates of the Central Statistical Organisation (CSO), real GDP growth accelerated from 7.5 per cent in 2004-05 to 8.1 per cent in 2005-06 (Table 1). Growth in industry was propelled by the manufacturing activity which more than offset the deceleration in 'mining and quarrying'. The services sector, which recorded double-digit growth for the second successive year, continued to be the major driver of economic activity, contributing almost three-fourth of overall real GDP growth during 2005-06 (Chart 1). Within the services sector, 'trade, hotels, transport and communication' and

Table 1: Growth Rates of Real GDP
(Base Year: 1999-2000)

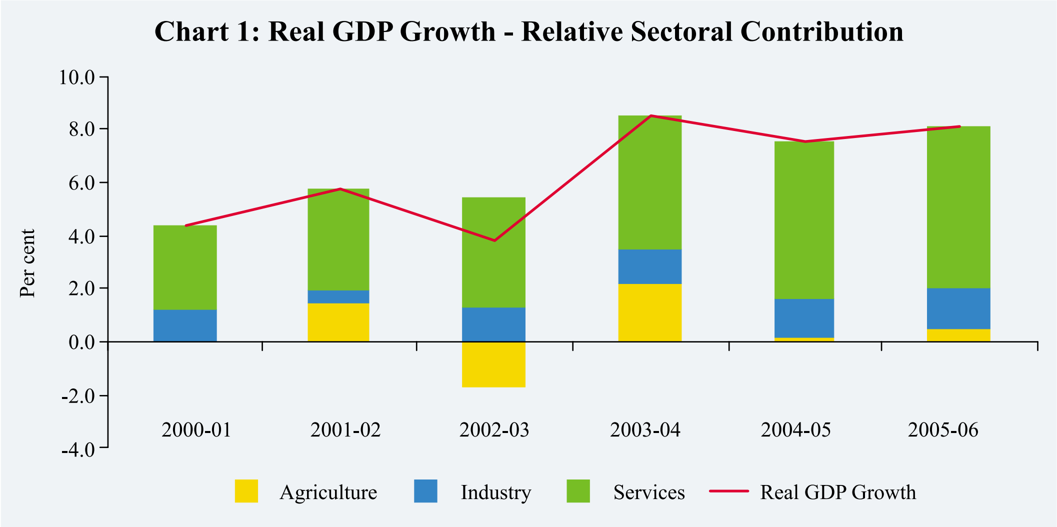
(Per cent)

Sector	2000-01 to 2002-03 (Average)	2003-04*	2004-05#	2005-06@	2004-05			2005-06			First Three Quarters	
					Q1	Q2	Q3	Q1	Q2	Q3	2004-05	2005-06
1	2	3	4	5	6	7	8	9	10	11	12	13
1. Agriculture and Allied Activities	**-0.2 (24.7)**	**10.0 (22.2)**	**0.7 (20.8)**	**2.3 (19.7)**	**3.5**	**-0.2**	**-1.2**	**1.4**	**2.4**	**3.4**	**0.5**	**2.5**
1.1 Agriculture	-0.5	10.7	0.7	..								
2. Industry	**5.2 (19.6)**	**6.6 (19.5)**	**7.4 (19.5)**	**8.0 (19.5)**	**6.6**	**8.0**	**8.1**	**9.9**	**6.7**	**7.1**	**7.6**	**7.9**
2.1 Mining and Quarrying	4.4	5.3	5.8	1.0	8.2	6.0	5.7	3.7	-1.9	0.6	6.6	0.8
2.2 Manufacturing	5.7	7.1	8.1	9.4	6.6	8.3	9.2	11.3	8.6	8.4	8.1	9.4
2.3 Electricity, Gas and Water Supply	2.8	4.8	4.3	5.4	4.9	7.9	3.1	6.9	2.2	4.4	5.3	4.5
3. Services	**6.6 (55.8)**	**8.5 (58.3)**	**10.2 (59.7)**	**10.1 (60.9)**	**10.1**	**8.4**	**10.7**	**10.0**	**10.0**	**9.7**	**9.7**	**9.9**
3.1 Trade, Hotels, Restaurants, Transport, Storage and Communication	8.5	12.0	10.6	11.1	10.6	11.2	9.7	11.7	11.2	10.3	10.5	11.0
3.2 Financing, Insurance, Real Estate and Business Services	6.5	4.5	9.2	9.5	8.8	7.5	9.7	8.7	9.8	9.1	8.7	9.2
3.3 Community, Social and Personal Services	4.1	5.4	9.2	7.9	10.7	4.8	8.5	7.0	7.3	8.1	7.9	7.5
3.4 Construction	5.9	10.9	12.5	12.1	9.9	7.9	22.0	12.4	12.3	11.5	13.3	12.0
4. Real GDP at Factor Cost	**4.6**	**8.5**	**7.5**	**8.1**	**7.9**	**6.7**	**7.0**	**8.1**	**8.0**	**7.6**	**7.2**	**7.9**

* : Provisional Estimates. # : Quick Estimates. @ : Advance Estimates.
.. : Not available separately.

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

Source : Central Statistical Organisation.



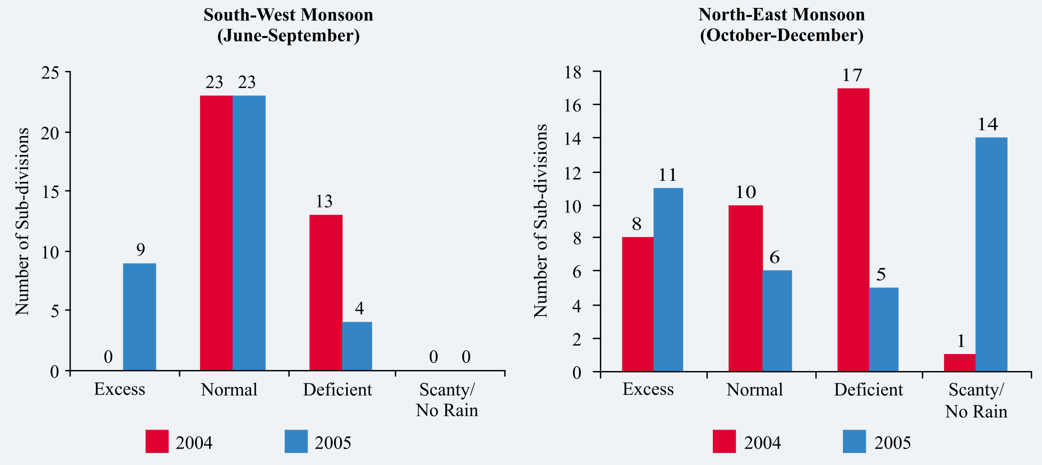
'construction' sub-sectors exhibited double-digit growth rates for the third consecutive year. Growth of real GDP originating from 'agriculture and allied activities' is expected to register a modest pick-up, following satisfactory spatial distribution of South-West monsoon and higher *kharif* production.

Agricultural Situation

Agricultural production during 2005-06 is expected to improve due to satisfactory rainfall and moisture conditions during the year. According to the India Meteorological Department, the cumulative rainfall during the South-West monsoon 2005 was one per cent below normal (*i.e.*, Long Period Average) as compared with 13 per cent below normal during the previous year. Although the rainfall was initially weak, it picked up from the last week of June 2005, offsetting the deficiency registered during the early part of the season. Of the 36 meteorological sub-divisions, cumulative rainfall was excess/normal in 32 sub-divisions (23 sub-divisions during last year). The progress of the North-East monsoon (October 1 to December 31) was also satisfactory with the cumulative rainfall at 10 per cent above normal as compared with 11 per cent below normal during the previous year. Of the 36 meteorological sub-divisions, cumulative rainfall was excess/normal in 17 sub-divisions (18 sub-divisions during last year) and deficient/scanty/no rain in 19 sub-divisions (18 sub-divisions during last year) (Chart 2). The total reservoir capacity as on April 7, 2006 in the 76 major reservoirs[1] monitored by the Central Water Commission at 45.3 billion cubic meters (BCM) was 34 per cent of the full reservoir level (FRL) and 147 per cent of the last year's level.

[1] These reservoirs account for 63 per cent of the total reservoir capacity of the country.

Chart 2: Monsoon Conditions



The satisfactory progress of monsoon during 2005-06 facilitated some improvement in area coverage under crops. While the area under *kharif* crops was 1.2 per cent higher than a year ago, that under *rabi* crops was 4.1 per cent higher (Table 2).

Table 2: Progress of Area under Crops - 2005-06

(Million Hectares)

Crop	Normal Area	Area Coverage 2004	Area Coverage 2005	Variation (2005 over 2004) (Per cent)
1	2	3	4	5
***Kharif* Crops**				
Rice	39.9	35.5	37.1	4.6
Coarse Cereals	22.9	22.5	21.9	-2.5
of which:				
Bajra	9.3	9.1	8.2	-9.4
Jowar	4.6	3.9	3.8	-3.3
Maize	6.0	7.0	7.3	5.2
Pulses	10.6	11.2	11.4	1.4
Oilseeds	15.1	18.0	17.6	-2.6
of which:				
Groundnut	5.5	5.8	5.6	-3.1
Soyabean	6.3	8.0	7.7	-3.1
Sesamum	1.6	2.0	1.9	-6.4
Niger	0.5	0.5	0.4	-15.8
Cotton	8.3	8.6	8.6	0.0
Sugarcane	4.3	3.8	4.1	10.3
All Crops	**101.9**	**100.4**	**101.6**	**1.2**

Crop	Normal Area	Area Coverage 2004	Area Coverage 2005	Variation (2005 over 2004) (Per cent)
1	2	3	4	5
***Rabi* Crops (As on March 27, 2006)**				
Wheat	26.3	26.5	26.7	0.8
Rice	3.8	4.0	4.9	23.1
Coarse Cereals	6.5	7.0	6.9	2.3
of which:				
Jowar	5.1	5.1	5.1	-1.1
Maize	0.7	0.7	0.7	-1.7
Barley	0.7	0.7	0.8	18.1
Oilseeds	7.8	10.8	11.4	4.0
of which:				
Rapeseed and Mustard	5.1	7.1	7.3	2.8
Groundnut	0.8	1.0	1.2	18.2
Sunflower	1.0	1.3	1.4	5.4
Sesamum	1.6	0.3	0.3	-4.4
Linseed	0.5	0.6	0.6	0.0
All Crops	**55.5**	**61.1**	**63.6**	**4.1**

Source : Ministry of Agriculture, Government of India.

Table 3: Agricultural Production

(Million Tonnes)

Crop	2003-04		2004-05		2005-06	
	T	A	T	A $	T	A $$
1	2	3	4	5	6	7
Rice	87.0	88.3	93.5	85.3	87.8	87.9
Wheat	72.1	72.1	79.5	72.0	75.5	73.1
Coarse Cereals	37.8	38.1	36.8	33.9	36.5	34.0
Pulses	15.2	14.9	15.3	13.4	15.2	14.4
Kharif	112.0	116.9	113.8	103.3	109.9	108.2
Rabi	100.0	96.6	111.3	101.3	105.1	101.2
Total Foodgrains	**212.1**	**213.5**	**225.1**	**204.6**	**215.0**	**209.3**
Oilseeds						
Kharif	17.0	16.8	16.3	14.9	16.2	16.0
Rabi	8.1	8.5	9.9	11.2	10.4	10.4
Total Oilseeds	**25.1**	**25.3**	**26.2**	**26.1**	**26.6**	**26.4**
Sugarcane	236.2	237.3	270.0	232.3	237.5	266.9
Cotton #	13.8	13.9	15.0	17.0	16.5	16.5
Jute and Mesta ##	11.2	11.2	11.8	10.5	11.3	10.7

T : Target A : Achievement. $: Fourth Advance Estimate.
$$: Second Advance Estimate. # : Million bales of 170 kgs each. ## : Million bales of 180 kgs each.
Source : Ministry of Agriculture, Government of India.

Total foodgrains production during 2005-06 is estimated at 209 million tonnes, an increase of 2.3 per cent over the previous year led by higher output of rice, wheat, maize and pulses. Among non-foodgrains crops, the production of sugarcane, oilseeds and jute is expected to increase, whereas that of cotton and mesta is likely to be lower than the previous year (Table 3).

Food Management

Total procurement of rice and wheat during 2005-06 (up to March 27, 2006) aggregated 41.1 million tonnes, marginally higher (0.9 per cent) than the previous year. The off-take of rice and wheat during 2005-06 (April 1 to January 31, 2006) was 33.0 million tonnes, which was 1.1 per cent lower than a year ago (33.3 million tonnes). The total stock of foodgrains with the Food Corporation of India (FCI) and the State agencies was 19.5 million tonnes as on February 1, 2006, 9.5 per cent lower than a year ago. The decline was mainly on account of wheat stocks, which fell to 4.9 million tonnes from 7.3 million tonnes a year ago. The stock of foodgrains as on February 1, 2006 was lower than the buffer norm of 20 million tonnes. While the stock of rice was higher than the norm (11.8 million tonnes), the stock of wheat was 3.3 million tonnes less than the norm (8.2 million tonnes) (Table 4).

Table 4: Management of Food Stocks

(Million Tonnes)

Month	Opening Stock of Foodgrains			Procurement of Foodgrains			Foodgrains Off-take					Closing Stock	Norms
	Rice	Wheat	Total	Rice	Wheat	Total	PDS	OWS	OMS - Domestic	Exports	Total		
1	2	3	4	5	6	7	8	9	10	11	12	13	14
2004													
January	11.7	12.7	25.0	3.5	0.0	3.5	2.4	0.9	0.2	0.4	3.8	24.0	16.8
February	12.4	11.0	24.0	2.2	0.0	2.2	1.9	1.1	0.1	0.5	3.7	22.8	
March	13.6	8.6	22.8	2.1	0.0	2.1	2.5	1.2	0.1	0.4	4.2	20.6	
April	13.1	6.9	20.6	1.2	14.5	15.7	2.0	0.5	0.0	0.3	2.9	32.4	15.8
May	12.7	19.0	32.4	1.3	1.7	3.0	2.3	0.6	0.0	0.1	3.0	32.3	
June	12.3	19.4	32.3	0.9	0.5	1.4	2.3	1.0	0.0	0.1	3.5	30.6	
July	10.8	19.2	30.6	0.4	0.1	0.5	2.4	1.0	0.0	0.1	3.6	27.2	24.3
August	9.1	17.4	27.2	0.5	0.0	0.2	2.4	1.0	0.0	0.1	3.4	23.0	
September	7.1	15.8	23.0	0.2	0.0	0.2	2.5	1.0	0.0	0.1	3.7	20.3	
October	6.1	14.2	20.3	7.4	0.0	6.5	2.4	0.8	0.0	0.0	3.2	23.7	18.1
November	11.0	12.6	23.7	1.9	0.0	2.7	2.4	0.6	0.0	0.0	3.1	21.8	
December	11.1	10.7	21.8	3.2	0.0	2.6	2.6	0.7	0.0	0.0	3.4	21.7	
2005													
January	12.8	8.9	21.7	3.9	0.0	3.9	2.7	0.8	0.0	0.0	3.5	21.5	16.8
February	14.2	7.3	21.5	2.3	0.0	2.3	2.7	0.9	0.0	0.0	3.7	20.0	
March	13.7	5.8	20.0	1.7	0.0	1.7	2.7	1.7	0.0	0.0	4.4	18.0	
April	13.3	4.1	18.0	1.2	12.8	14.0	2.4	1.0	0.0	0.0	3.4	28.5	16.2
May	13.0	15.1	28.5	1.2	2.0	3.1	2.5	0.8	0.0	0.0	3.3	27.9	
June	11.6	15.7	27.9	0.8	0.1	0.9	2.5	1.7	0.0	0.0	4.2	25.1	
July	10.1	14.5	25.1	0.4	0.0	0.4	2.8	0.8	0.1	0.0	3.6	21.4	26.9
August	8.0	13.0	21.4	0.9	0.0	0.9	2.6	0.8	0.1	0.0	3.4	18.4	
September	6.4	11.6	18.4	0.4	0.0	0.4	2.7	0.7	0.1	0.0	3.5	15.5	
October	4.8	10.3	15.5	7.6	0.0	7.6	2.2	0.5	0.0	0.0	2.7	19.8	16.2
November	10.3	9.1	19.8	2.7	0.0	2.7	1.8	0.5	0.1	0.0	2.4	19.0	
December	11.1	7.6	19.0	3.4	0.0	3.4	2.3	0.7	0.2	0.0	3.2	19.3	
2006													
January	12.6	6.2	19.3	3.8	0.0	3.8	2.3	0.8	0.1	0.0	3.2	19.5	20.0
February	14.0	4.9	19.5	2.5	0.0	2.5	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	
March*	N.A.	N.A.	N.A.	1.5	0.0	1.5	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	

PDS : Public Distribution System. OWS : Other Welfare Schemes. OMS : Open Market Sales.
N.A. : Not Available.
* : Procurement up to March 27, 2006.

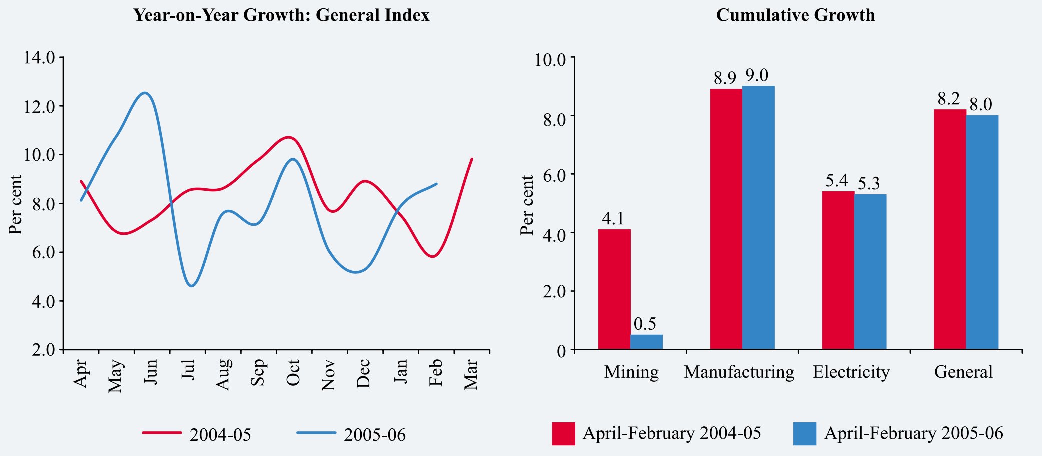
Notes : Closing stock figures may differ from those arrived at by adding the opening stocks and procurement and deducting off-take, as stocks include coarse grains also.

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

Industrial Performance

Industrial production registered strong growth during April-February 2005-06 on the back of robust and broad-based manufacturing activity (Chart 3). The manufacturing sector recorded a growth of 9.0 per cent in 2005-06 (April-

Chart 3: Index of Industrial Production (IIP) - Growth Rate



February) on top of 8.9 per cent rise a year ago. It accounted for 93.4 per cent of the overall industrial sector growth. The mining sector witnessed a sharp deceleration in growth, largely attributable to the decline in production of crude oil on account of break-out of fire in the Mumbai-High oil field in July 2005 as well as subdued mining activity in respect of some metallic minerals. The electricity sector recorded a marginal deceleration, reflecting shortage of coal and gas.

In terms of the use-based classification, capital and consumer goods sectors maintained their high growth momentum during April-February 2005-06 (Chart 4). In consonance with the pick-up in investment activity in the economy,

Chart 4: IIP: Use Based Classification - Growth Rate

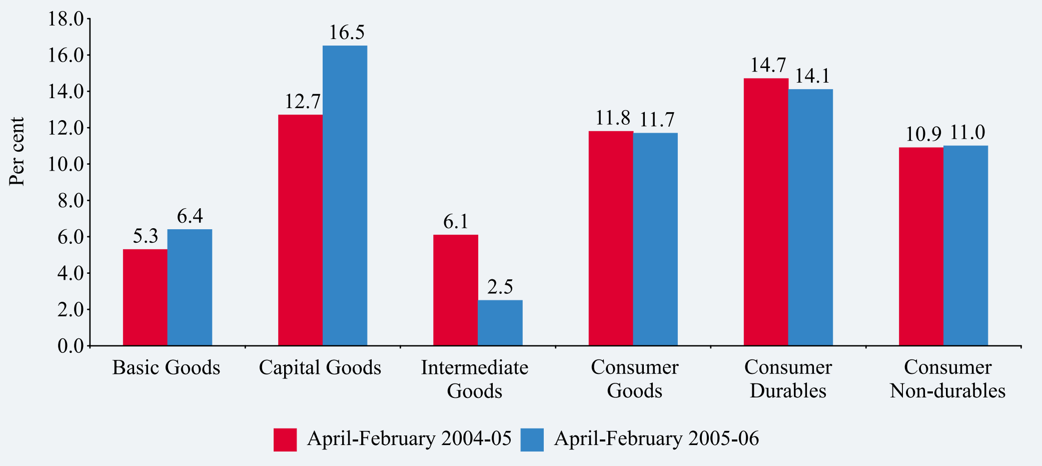


Table 5: Performance of Manufacturing Industry Groups: 2005-06 (April-February)

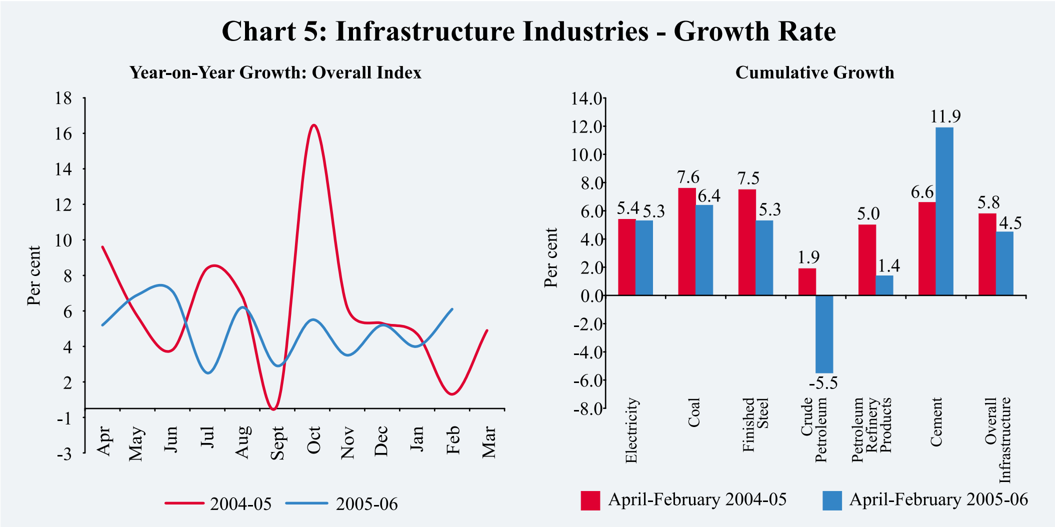
Acceleration in Growth	Deceleration in Growth	Negative Growth
1. Other manufacturing industries (24.3)	1. Machinery and equipment other than transport equipment (11.7)	1. Metal products and parts (except machinery and equipment) (-1.3)
2. Textiles products (including apparels) (18.8)	2. Chemicals and chemical products (8.5)	2. Leather and leather and fur products (-5.0)
3. Beverages, tobacco and related products (14.8)	3. Jute and other vegetable fibre (1.0)	3. Wood and wood products, furniture and fixtures (-5.6)
4. Basic metal and alloy industries (14.7)	4. Paper and paper products and printing, publishing and allied activities (0.6)	
5. Transport equipment and parts (12.6)	5. Wool, silk and man-made fibre textiles (0.5)	
6. Non-metallic mineral products (10.2)		
7. Cotton textiles (9.4)		
8. Rubber, plastic, petroleum and coal products (4.3)		
9. Food products (0.7)		

growth of the capital goods sector accelerated to 16.5 per cent – the highest growth for April-February period since 1993-94. Higher production of power distribution transformers, turbines, textile machinery, boilers, material handling equipment, ship building and repair, locomotives, cranes, lifts and laboratory and scientific instruments propelled the growth of the capital goods sector. Basic goods recorded a marginal pick-up, benefiting from higher production of carbon steel, structurals, ferro silicon and copper metal. The intermediate goods sector witnessed a subdued performance largely on account of negative growth of items such as yarn, finished leather, light diesel oil, LPG cylinders, tin metal containers, spun pipes and T.V. picture tubes.

At the two-digit level manufacturing groups, 14 out of 17 groups recorded a positive growth during April-February 2005-06 (Table 5). 'Other manufacturing' industries recorded the highest growth at 24.3 per cent followed by textile products (including wearing apparel) at 18.8 per cent.

Infrastructure

The infrastructure sector continued to record sluggish growth during 2005-06. The growth of the core infrastructure industries – with a weight of 26.7 per cent in the index of industrial production – decelerated from 5.8 per cent during April-February 2004-05 to 4.5 per cent during April-February 2005-06 (Chart 5). The slowdown was mainly a reflection of decline in the production



of crude petroleum and deceleration in growth in finished steel and petroleum refinery products. As noted earlier, decline in crude petroleum largely reflected the effects of fire at Mumbai-High oil field while deceleration in electricity could be attributed to shortage of coal and gas. Slowdown in steel sector could be attributed to decline in production of bars and rods, cold-rolled sheets and coils coupled with deceleration in steel exports. Cement production recorded strong growth, reflecting growing demand from the housing and the infrastructure sectors as well as higher exports – cement exports rose by 41.8 per cent during April-December 2005.

Business Expectations Surveys

Business expectations surveys conducted by various agencies suggest that the industrial sector is likely to continue its strong performance in the near term. Dun and Bradstreet's composite business optimism index for the quarter January-March 2006 improved by 21.1 per cent over the same quarter of the previous year. The index, however, declined by 10.3 per cent over the previous quarter (October-December 2005) reflecting the base effect – the index was at an all time high in October-December 2005. According to the survey conducted in December 2005, business expectations remain high with around 90 per cent of the respondents expecting an increase in sales in the forthcoming quarter. Almost 85 per cent of the respondents anticipated higher profits and 46 per cent respondents were of the opinion that there would be an increase in their selling prices. According to FICCI's latest Business Confidence Survey conducted during February 2006, the confidence level of the Indian corporate sector improved, with the Business Confidence Index recording its highest value in the last 15 quarters.

Table 6: Business Expectations Surveys

Agency	Business Expectations		Growth over previous round (Per cent)
	Expectation for	Index	
1	2	3	4
Dun & Bradstreet	January-March 2006	Business Optimism Index	-10.3
CII	September 2005-March 2006	Business Confidence Index	1.5
FICCI	April-September 2006	Business Confidence Index	1.9
NCAER	January-June 2006	Business Confidence Index	3.7
RBI	April-June 2006	Business Expectations Index	-4.1

Results show an improvement in the respondents' assessment of the current overall economic conditions as well as their perception of the country's economic performance in the next six months. Amongst the three industry sectors – services, heavy industry and light industry – the services sector is the most optimistic with 90 per cent of the participating companies looking forward to a 'moderately to substantially' better performance of their sector in the coming two quarters followed by the light industry (78 per cent of the respondents) and the heavy industry (68 per cent of the respondents). Although the respondents anticipate some moderation in their sales, profits and exports, there are signs of a further pick-up in investments in the next six months. Nearly 71 per cent of the companies reported capacity utilisation in excess of 75 per cent (Table 6).

According to the Reserve Bank's latest Industrial Outlook Survey conducted during January-February 2006, the Business Expectations Index, based on expectations for April-June 2006 quarter, declined by 4.1 per cent over the previous quarter (Chart 6). The index was, however, almost the same as a year

Chart 6: Reserve Bank's Industrial Outlook Survey: Business Expectations Index

Table 7: Net Response on 'A Quarter Ahead' Expectations about Industrial Performance Over the Latest Five Quarterly Rounds of the Reserve Bank's Industrial Outlook Survey

(Per cent)

	Parameter	Response	April-June 2005 (987)	July-Sept. 2005 (816)	Oct-Dec. 2005 (961)	Jan-March 2006 (934)	April-June 2006 (1086)
	1	2	3	4	5	6	7
1.	Overall business situation	Better	44.3	45.5	51.3	49.8	46.3
2.	Financial situation	Better	36.7	36.7	42.3	40.7	40.4
3.	Working capital finance requirement	Increase	27.2	28.8	32.7	31.9	30.6
4.	Availability of finance	Improve	30.8	30.7	34.1	34.1	33.8
5.	Production	Increase	38.7	40.7	46.9	46.3	42.5
6.	Order books	Increase	37.4	39.6	43.7	41.0	39.1
7.	Pending orders, if applicable	Below normal	–	–	0.8*	-1.4	-0.1
8.	Cost of raw material	Decrease	-36.7	-43.6	-30.0	-35.9	-37.3
9.	Inventory of raw material	Below average	-4.3	-4.2	-6.9	-6.8	-5.0
10.	Inventory of finished goods	Below average	-3.1	-4.2	-3.3	-4.7	-4.5
11.	Capacity utilisation	Increase	27.7	25.4	31.1	29.6	24.8
12.	Level of capacity utilisation	Above normal	8.1	7.6	10.9	11.4	9.4
13.	Assessment of the production capacity	More than adequate	5.7	5.3	5.0	4.9	4.1
14.	Employment in the company	Increase	7.7	7.8	12.7	13.3	14.5
15.	Exports, if applicable	Increase	30.2	32.5	33.3	31.8	31.0
16.	Imports, if any	Increase	20.3	23.7	19.2	20.8	22.7
17.	Selling prices are expected to	Increase	11.0	13.3	7.8	10.8	12.4
18.	If increase expected in selling prices	Increase at lower rate	13.5	14.0	16.6	16.3	12.0
19.	Profit margin	Increase	6.3	7.1	9.6	12.6	9.3

* : Question on Pending Orders was included in the July-September 2005 round.

Note : 1. Figures in parentheses represent number of companies covered in the report.

2. 'Net response' is measured as the per cent share differential between the companies reporting 'optimistic' (positive) and 'pessimistic' (negative) responses; responses indicating *status quo* (no change) are not reckoned. Higher 'net response' indicates higher level of confidence and *vice versa*.

ago. The expectations index based on the assessment for January-March 2006 also declined by 2.8 per cent over the previous quarter after showing a rise of 8.2 per cent during October-December 2005, the highest since the inception of the survey. Survey results indicate that the expectations of various indicators in April-June 2006 are better than that in the corresponding quarter of 2005 although lower than that in the immediately preceding quarter (Table 7).

Services Sector

Growth in the services sector accelerated to 9.9 per cent during April-December 2005 from 9.7 per cent during April-December 2004, benefiting from robust growth in the major sub-sectors *viz.*, 'trade, hotels, transport and communication', 'financing, insurance, real estate and business services' and 'construction'. The 'trade, hotels, transport and communication' sector recorded double-digit growth, benefiting from expansion in exports and imports,

Table 8: Indicators of Service Sector Activity

(Growth rates in per cent)

Sub-sector	April-January 2004-05	April-January 2005-06
1	2	3
Tourist arrivals (April-February)	23.7	11.7
Commercial vehicles production (April-December)	32.3	9.7
Railway revenue earning freight traffic	7.8	10.4
New cell phone connections	17.1	68.0
Cargo handled at major ports	10.8	11.7
Civil aviation		
a) Export cargo handled	12.4	7.3
b) Import cargo handled	28.6	13.5
c) Passengers handled at international terminals	15.6	12.8
d) Passengers handled at domestic terminals	25.3	22.9
Roads: Upgradation of Highways	19.0	-20.9
Cement (April-February)	6.6	11.9
Steel (April-February)	7.5	5.3
Aggregate deposits (end-March, year-on-year)	14.8	16.9
Non-food credit (end-March, year-on-year)	28.8	30.8
Central Government expenditure (April-February)	5.6	1.7

improvement in performance indicators of railways, cargo handled at major ports as well as by civil aviation, passengers handled by civil aviation, rise in domestic and international tourism and robust growth in the cellular subscriber base (Table 8). Healthy growth in bank deposits, sustained acceleration in non-food credit and increased exports of information technology enabled services buoyed up the sub-sector 'financing, insurance, real estate and business services'. Indian software and services continued to perform well.

Savings and Investment

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, led by higher public sector saving resulting from lower dis-saving of public authorities and improvement in savings of non-departmental enterprises. Private corporate saving also improved reflecting higher profits. On the other hand, savings of the household sector declined by 1.5 percentage points during 2004-05 to 22.0 per cent. Although the overall savings rate increased by 0.2 percentage points of GDP, the overall investment rate increased by 2.9 percentage points of GDP to 30.1 per cent in 2004-05 reflecting a recourse to higher foreign savings – net capital inflows of 1.0 per cent of GDP in 2004-05 in contrast to net outflows of 1.6 per cent of GDP during 2003-04 (Table 9).

The buoyancy in manufacturing and services sector activities and the positive business confidence and expectations suggest that the recent growth

Table 9: Gross Domestic Saving and Investment

(Per cent of GDP at current market prices)

	1999-00	2000-01	2001-02	2002-03	2003-04 (PE)	2004-05 (QE)
1	2	3	4	5	6	7
1. Household Saving	21.3	21.2	22.0	23.1	23.5	22.0
of which :						
a) Financial Assets	10.5	10.2	10.8	10.3	11.5	10.3
b) Physical Assets	10.7	11.0	11.2	12.7	12.0	11.7
2. Private Corporate Saving	4.5	4.1	3.6	4.1	4.4	4.8
3. Public Sector Saving	-0.9	-1.8	-2.0	-0.7	1.0	2.2
4. Gross Domestic Saving	24.9	23.5	23.6	26.5	28.9	29.1
5. Net Capital Inflow	1.1	0.6	-0.6	-1.2	-1.6	1.0
6. Gross Domestic Capital Formation	26.0	24.2	23.0	25.3	27.2	30.1
7. Gross Capital Formation	26.1	24.3	24.3	25.3	26.3	28.5
of which :						
a) Public Sector	7.5	6.9	6.9	6.2	6.5	7.2
b) Private Corporate Sector	7.2	5.7	5.6	5.8	6.8	8.2
c) Household sector	10.7	11.0	11.2	12.7	12.0	11.7
d) Valuables+	0.8	0.7	0.6	0.6	0.9	1.3
8. Total Consumption Expenditure (a+b)	77.5	76.6	76.7	74.7	73.5	71.8
a) Private Final Consumption Expenditure	64.6	64.1	64.5	62.9	62.4	60.6
b) Government Final Consumption Expenditure	12.9	12.5	12.3	11.8	11.2	11.3
Memo:						
9. Saving-Investment Balance (4-6)	-1.1	-0.6	0.6	1.2	1.6	-1.0
10. Public Sector Balance#	-8.3	-8.7	-8.9	-6.8	-5.5	-5.0
11. Private Sector Balance#	7.8	8.6	8.8	8.6	9.0	6.9
a) Private Corporate Sector	-2.7	-1.6	-2.0	-1.7	-2.5	-3.4
b) Household Sector	10.5	10.2	10.8	10.3	11.5	10.3

PE : Provisional Estimates. QE : Quick Estimates.
+ : 'Valuables' covers the expenditures made on acquisition of valuables, excluding works of art and antiques.
# : Investment figures are not adjusted for errors and omissions.
Source : Central Statistical Organisation.

momentum in the Indian economy is likely to be maintained in 2006-07, as has also been projected by different agencies (Table 10).

Table 10: Projections of Real Gross Domestic Product for India by Various Agencies: 2006-07

Agency	Growth Projections for 2006-07 (Per cent)				Month of Projections
	Overall Growth	Agriculture	Industry	Services	
1	2	3	4	5	6
ADB	7.6	–	–	–	April 2006
CDE-DSE	7.7	2.8	9.4	8.9	January 2006
CMIE	8.0	–	–	–	March 2006
ESCAP	7.9	–	–	–	March 2006
ICRA	7.4-8.2	2.0	8.2-9.7	9.1-9.7	January 2006
IMF	6.8	–	–	–	February 2006
Planning Commission*	7.7	3.2	8.9	8.8	December 2005

– : Not Available. * : Base year 2001-02, Mid-Term Appraisal of Tenth Five-Year Plan.
ADB : Asian Development Bank; CDE-DSE: Centre for Development Economics - Delhi School of Economics;
CMIE : Centre for Monitoring Indian Economy; ESCAP : Economic and Social Commission for Asia and the Pacific;
ICRA : Investment Information and Credit Rating Agency of India; and, IMF: International Monetary Fund.

II. FISCAL SITUATION

Centre's Fiscal Position: 2005-06

The revised estimates for 2005-06 placed the key deficit indicators of the Central Government lower than the budgeted levels (Table 11). This was enabled mainly by compression undertaken in non-Plan expenditures in respect of interest payments, subsidies, grants to the States and defence expenditure. The Government could contain the key deficit indicators in spite of the additional resource requirements for implementing the recommendations of the Twelfth Finance Commission (TFC), which had necessitated the Union Budget for 2005-06 to set a 'pause' in the fiscal correction process prescribed under the Fiscal Responsibility and Budget Management (FRBM) Rules, 2004.

Revenue receipts in the revised estimates are placed at 9.9 per cent of GDP as compared with 10.1 per cent in budget estimates, showing a shortfall of 0.8 per cent over the budgeted level for 2005-06 on account of lower non-tax revenue (4.4 per cent less than the budgeted level). The gross tax revenue, on the other hand, remained almost at the same level as in the budget estimates as the shortfalls in the corporation tax, personal income tax and excise duties were offset by higher collections from customs duties, service tax and new taxes (Chart 7).

The shortfall in non-tax revenue was mainly on account of interest receipts, which were lower by Rs.4,256 crore (16.7 per cent) than the budget estimates reflecting the impact of rescheduling of loans of the Centre to the States under the TFC's award. Among the non-debt capital receipts, recovery of loans was marginally lower (2.5 per cent) than the budgeted level. The revised estimates show an amount of Rs.2,356 crore under disinvestment proceeds (Table 12).

Table 11: Deficit Indicators of the Centre

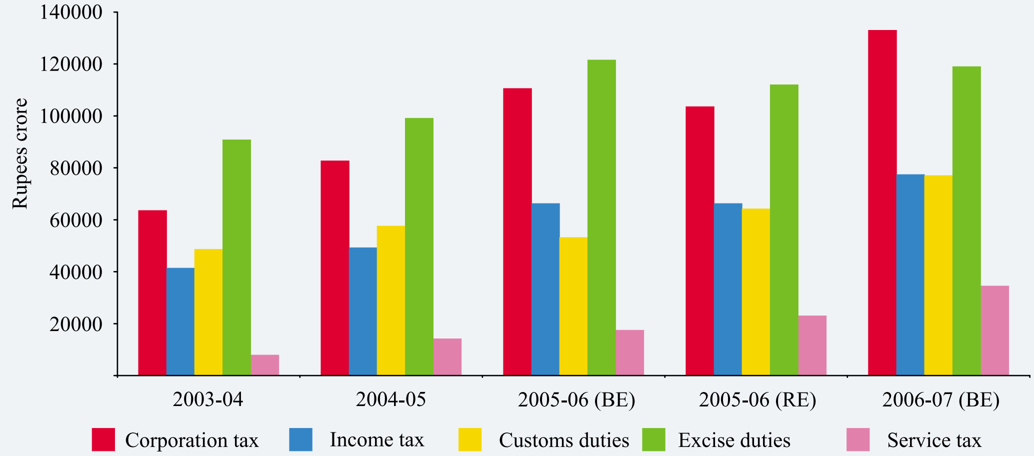
(Amount in Rupees crore)

Item	2004-05	2005-06 (BE)	2005-06 (RE)	Variation (4 over 3)	
				Amount	Per cent
1	2	3	4	5	6
1. Gross Fiscal Deficit	1,25,202 (4.0)	1,51,144 (4.3)	1,46,175 (4.1)	-4,969	-3.3
2. Revenue Deficit	78,338 (2.5)	95,312 (2.7)	91,821 (2.6)	-3,491	-3.7
3. Gross Primary Deficit	-1,732 (-0.1)	17,199 (0.5)	16,143 (0.5)	-1,056	-6.1

RE : Revised Estimates. BE : Budget Estimates.

Note : Figures in parentheses are percentages to GDP.

Chart 7: Gross Tax Revenue



Aggregate expenditure in the revised estimates for 2005-06 was 1.1 per cent lower than the budgeted level, mainly on account of compression in non-Plan expenditure under interest payments, grants to States, food subsidy and defence. Plan expenditure was marginally higher than the budgeted level on account of the Central Assistance for State and Union Territory (UT) Plans, reflecting provision for pass-through of the loan component of externally aided projects (Table 13).

Table 12: Receipts of the Centre

(Amount in Rupees crore)

Item	2004-05	2005-06 (BE)	2005-06 (RE)	Variation (4 over 3)	
				Amount	Per cent
1	2	3	4	5	6
1. Total Receipts (2+3)	4,97,682 (15.9)	5,14,344 (14.8)	5,08,705 (14.4)	-5,639	-1.1
2. Revenue Receipts (i+ii)	3,06,013 (9.8)	3,51,200 (10.1)	3,48,474 (9.9)	-2,726	-0.8
i. Tax Revenue	2,24,798 (7.2)	2,73,466 (7.9)	2,74,139 (7.8)	673	0.2
ii. Non-tax Revenue	81,215 (2.6)	77,734 (2.2)	74,335 (2.1)	-3,399	-4.4
3. Capital Receipts	1,91,669 (6.1)	1,63,144 (4.7)	1,60,231 (4.5)	-2,913	-1.8
of which:					
i. Market Borrowings	50,940	1,03,792	1,01,082	-2,710	-2.6
ii. Recovery of Loans	62,043	12,000	11,700	-300	-2.5
iii. Disinvestment proceeds	4,424	0	2,356	2,356	–

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

Table 13: Aggregate Expenditure of the Centre

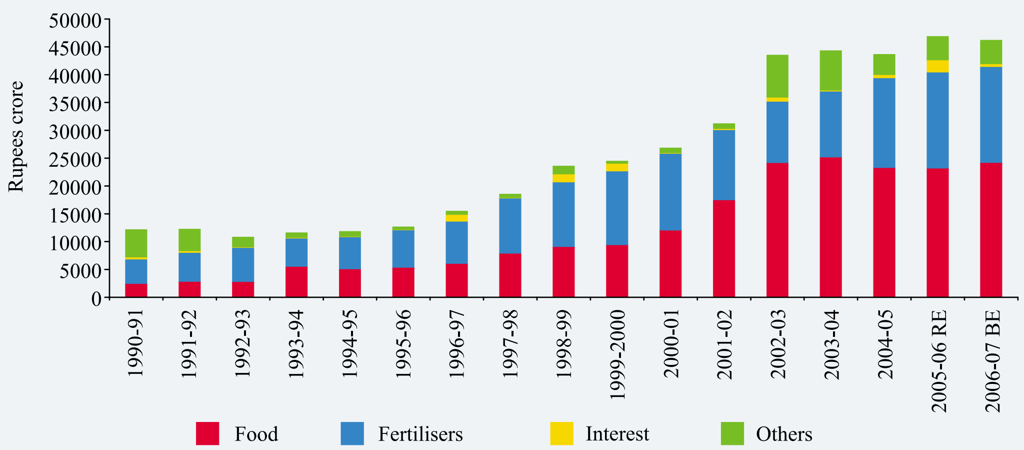
(Amount in Rupees crore)

Item	2004-05	2005-06 (BE)	2005-06 (RE)	Variation (4 over 3)	
				Amount	Per cent
1	2	3	4	5	6
1. Total Expenditure (2 + 3 = 4 + 5)	4,97,682 (15.9)	5,14,344 (14.8)	5,08,705 (14.4)	-5,639	-1.1
2. Non-Plan Expenditure	3,65,406 (11.7)	3,70,847 (10.7)	3,64,914 (10.3)	-5,933	-1.6
of which:					
Interest Payments	1,26,934 (4.1)	1,33,945 (3.8)	1,30,032 (3.7)	-3,913	-2.9
Defence	75,856 (2.4)	83,000 (2.4)	81,700 (2.3)	-1,300	-1.6
Subsidies	43,653 (1.4)	47,432 (1.4)	46,874 (1.3)	-558	-1.2
3. Plan Expenditure	1,32,276 (4.2)	1,43,497 (4.1)	1,43,791 (4.1)	294	0.2
4. Revenue Expenditure	3,84,351 (12.3)	4,46,512 (12.8)	4,40,295 (12.5)	-6,217	-1.4
5. Capital Expenditure	1,13,331 (3.6)	67,832 (1.9)	68,410 (1.9)	578	0.9

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

The total expenditure on subsidies in the revised estimates for 2005-06 at Rs.46,874 crore was lower by 1.2 per cent than budgeted, reflecting the Government's policy of rationalising and containing expenditure through proper targeting (Chart 8). Expenditure on food subsidies could be contained mainly on account of lower carrying cost of foodgrain stocks. Expenditure on interest subsidies, however, exceeded the budget estimates by Rs.1,799 crore on account of provision for interest subsidy to farmers.

Chart 8: Composition of Subsidies



Financing of the Union Budget

Gross and net market borrowings (dated securities and 364-day Treasury Bills) of the Centre for 2005-06 were budgeted at Rs.1,65,467 crore and Rs.1,03,791 crore, respectively. In the revised estimates, the net market borrowings were placed lower at Rs.1,01,082 crore, reflecting mainly a reduction in the gross fiscal deficit (GFD). At this level, net market borrowings financed 69.2 per cent of GFD as compared with 68.7 per cent in the budget estimates. Apart from market borrowings, draw down of cash balances financed 10.3 per cent of GFD as compared with 2.3 per cent of GFD in the budget estimates. In the public account, while reserve funds and State provident funds financed a higher proportion of GFD than the budgeted level, deposits and advances financed a lower proportion.

The Central Government continued to maintain surplus cash balances with the Reserve Bank during 2005-06 – Rs.48,928 crore as on March 31, 2006 as compared with Rs.26,202 crore a year ago. This reflected essentially the parking of surplus cash by the State Governments in the 14-day intermediate Treasury Bills during the greater part of the year. Reflecting the comfortable liquidity position, the Centre availed ways and means advances (WMA) from the Reserve Bank only twice during 2005-06 (May 3, 2005 and June 4, 2005).

During 2005-06, the Government of India raised Rs.1,31,000 crore through the issuances of dated securities (excluding issuances under the Market Stabilisation Scheme) as compared with Rs.1,41,000 crore scheduled in the calendar for 2005-06 (Table 14). This was on account of (i) a reduction in the notified amount from Rs.4,000 crore (as per the issuance auction calendar) to Rs.2,000 crore for maturity of 29.27

Table 14: Central Government Dated Securities Issued during 2005-06

Date of Auction	Notified Amount (Rupees crore)	Residual Maturity (Years)	Cut-off Yield (Per cent)	Date of Auction	Notified Amount (Rupees crore)	Residual Maturity (Years)	Cut-off Yield (Per cent)
1	2	3	4	1	2	3	4
April 5, 2005	5,000	6.98	6.80	August 18, 2005	5,000	8.66	7.04
April 5, 2005	3,000	27.39	7.79	August 18, 2005	3,000	28.98	7.55
April 19, 2005	5,000	11.74	7.48	September 8, 2005	5,000	13.04	7.23
April 19, 2005	2,000	29.31	7.94	September 8, 2005	3,000	30.00	7.40
May 3, 2005	6,000	5.03	6.99	October 6, 2005	3,000	29.92	7.66
May 3, 2005	2,000	29.27	7.98	November 8, 2005	5,000	11.44	7.33
May 24, 2005	4,000	16.05	7.28	November 8, 2005	3,000	29.83	7.73
June 6, 2005	4,000	15.98	7.47	November 24, 2005	5,000	16.47	7.43
June 6, 2005	6,000	8.86	6.91	December 6, 2005	5,000	11.11	7.24
June 23, 2005	5,000	10.81	6.91	December 6, 2005	3,000	29.76	7.55
July 5, 2005	6,000	8.16	7.06	January 9, 2006	6,000	5.48	6.70
July 5, 2005	4,000	15.90	7.57	January 9, 2006	4,000	29.66	7.43
July 18, 2005	5,000	15.86	7.81	February 7, 2006	3,000	11.56	7.38
August 11, 2005	3,000	28.99	7.44	February 7, 2006	3,000	29.59	7.63
August 11, 2005	5,000	11.43	7.14	March 6, 2006 *	10,000	29.51	7.77

* : Privately placed with the Reserve Bank.

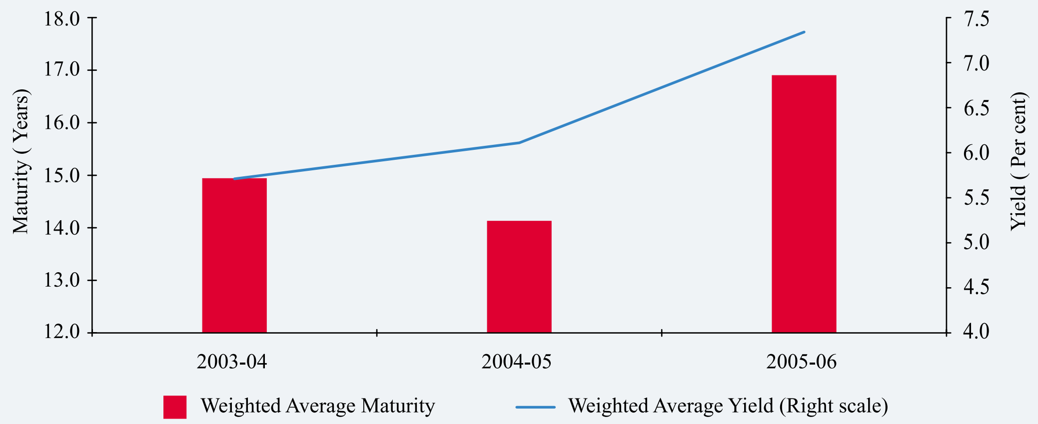
years in the auction of May 3, 2005; (ii) rejection of bids for an issue of Rs.6,000 crore on October 6, 2005; (iii) cancellation of the auction of dated securities scheduled for October 18-25, 2005 for an amount of Rs.4,000 crore based on review of the then borrowing requirements of the Government of India; (iv) reduction in the notified amount from Rs.6,000 crore to Rs.3,000 crore in the auction of a dated security with a tenor of 11.56 years on February 7, 2006; and (v) cancellation of the auction of dated securities scheduled for February 14-22, 2006 for an amount of Rs.5,000 crore. As against this, the Government 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. According to the Reserve Bank records, gross and net market borrowings (including dated securities, 364-day Treasury Bills and 182-day Treasury Bills) of the Centre amounted to 97.3 per cent and 94.3 per cent of the budget estimates as compared with 70.6 per cent and 51.0 per cent, respectively, a year ago.

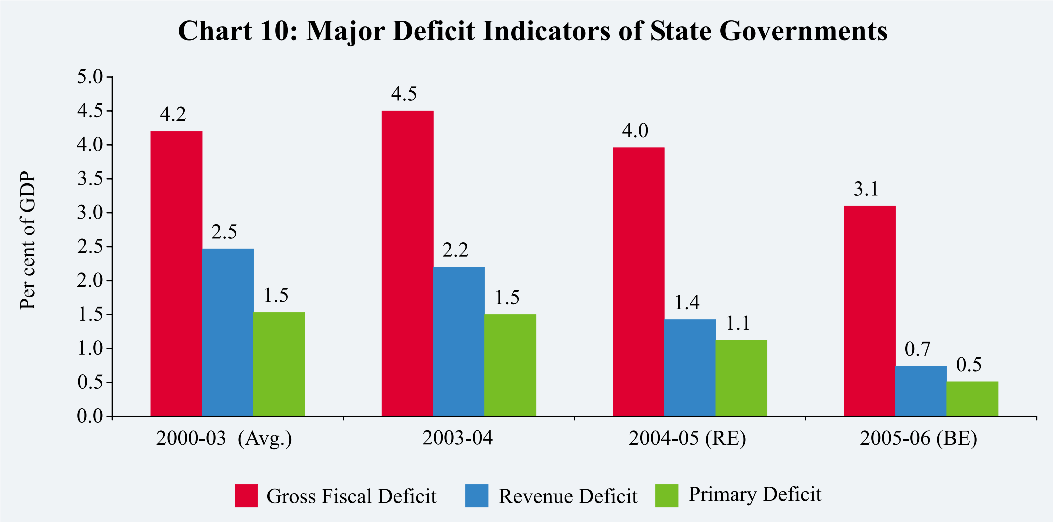
The weighted average maturity of dated securities issued by the Central Government increased from 14.13 years in 2004-05 to 16.90 years in 2005-06. The weighted average yield of the dated securities issued during the year increased from 6.11 per cent in 2004-05 to 7.34 per cent in 2005-06 (Chart 9). In this context, it may be noted that secondary market yield on 10-year Central Government securities increased from 6.65 per cent as at end-March 2005 to 7.52 per cent as at end-March 2006.

State Finances: 2005-06

The budget estimates for 2005-06 reveal an endeavour of the State Governments to carry forward fiscal correction and consolidation through progressive implementation of fiscal and institutional reforms at the State level. The submission of the Report by the Twelfth Finance Commission (TFC) and

Chart 9: Yield and Maturity of the Dated Securities of the Centre - Primary Auctions

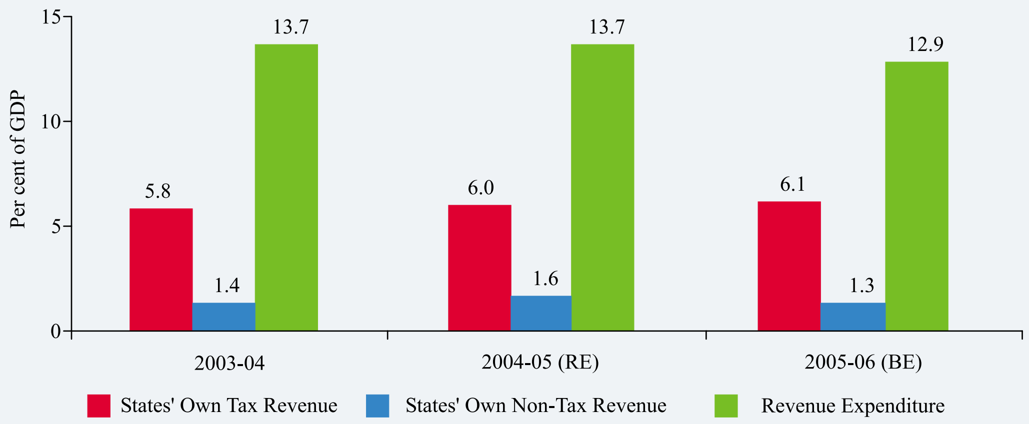




general acceptance of its recommendations by the Government of India was a major development, as it would form the basis of fiscal federal relations over the five-year period beginning 2005-06. Implementation of the Value Added Tax (VAT) by a majority of States with effect from April 1, 2005 was also a landmark development in respect of tax reform at the State level. In their budgets for 2005-06, many State Governments have envisaged carrying forward the process of fiscal correction and consolidation through the enactment of fiscal responsibility legislation (FRL), introduction of new taxes and modification of the existing ones, expenditure rationalisation, institutional reforms and introduction of new pension scheme based on defined contributions. Accordingly, the revenue deficit (RD) and gross fiscal deficit (GFD) are budgeted to decline by 44.0 per cent and 11.0 per cent, respectively, during 2005-06 over the previous year. The RD and GFD as ratio to gross domestic product (GDP) are placed at 0.7 per cent and 3.1 per cent, respectively, in 2005-06 – a reduction of 0.7 and 0.9 percentage points, respectively, over the previous year (Chart 10).

The correction in the revenue account in 2005-06 is sought to be achieved primarily through containment of non-interest revenue expenditure which, as a ratio to GDP, is budgeted to decline by 0.6 percentage points over the previous year. This, in turn, will be through the containment of the developmental expenditure (budgeted to grow by 3.0 per cent), while non-developmental expenditure will grow at a relatively higher rate of 9.2 per cent. Growth in the revenue receipts is, however, budgeted to decelerate from 21.5 per cent in 2004-05 to 11.9 per cent in 2005-06. Accordingly, in terms of GDP, revenue receipts have been envisaged to decline marginally. This would be on account of States' own non-tax revenue, which is budgeted to decline by 0.3 percentage points of GDP, mainly as a result of a sharp decline in interest receipts (Chart 11).

Chart 11: States' Own Revenue Receipts and Revenue Expenditure



The decomposition of GFD indicates that the share of the revenue deficit is expected to decline further during 2005-06, while that of capital outlay is expected to increase further. On the financing side, small savings (NSSF) will remain the largest financing source for GFD followed by loans from the Centre and market borrowings (Table 15).

Table 15: Decomposition and Financing Pattern of GFD of States

(Per cent)

	1990-95 (Average)	1995-2000 (Average)	2000-03 (Average)	2003-04	2004-05 (RE)	2005-06 (BE)
1	2	3	4	5	6	7
Decomposition (1+2+3)	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
1. Revenue Deficit	24.7	44.7	58.5	49.7	35.8	22.5
2. Capital Outlay	55.3	43.2	34.7	42.6	55.2	69.7
3. Net Lending	20.0	12.1	6.8	7.7	9.0	7.8
Financing (1 to 11)	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
1. Market Borrowings	16.0	16.1	19.9	38.4	26.4	14.6
2. Loans from Centre	49.0	40.6	6.6	11.5	4.7	15.8
3. Loans against Securities issued to NSSF	–	28.9*	41.6	16.9	43.4	47.8
4. Loans from LIC, NABARD, NCDC, SBI and other banks	1.8	2.8	5.5	3.4	2.3	7.3
5. State Provident Funds	14.3	13.4	9.2	5.8	7.8	7.2
6. Reserve Funds	6.8	5.5	4.3	5.2	5.0	3.8
7. Deposits and Advances	9.8	9.8	4.6	-0.3	-1.0	-2.5
8. Suspense and Miscellaneous	4.3	2.7	0.4	-4.4	0.5	-1.3
9. Remittances	-1.4	-3.6	0.3	1.5	-0.8	1.5
10. Increase (+)/Decrease (-) in Cash Balances	4.4	-2.6	1.2	-0.9	-5.5	1.0
11. Others	-5.0	9.5	6.4	23.0	17.1	4.7

BE : Budget Estimates. RE : Revised Estimates. – : Not applicable.

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

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

2. 'Others' (item no.11) includes miscellaneous capital receipts, Contingency Fund, Inter-State Settlement, *etc.* Data for 2003-04 also includes issuance of power bonds of Rs. 18,767 crore under One-Time Settlement Scheme by the States for dues of State Electricity Boards.

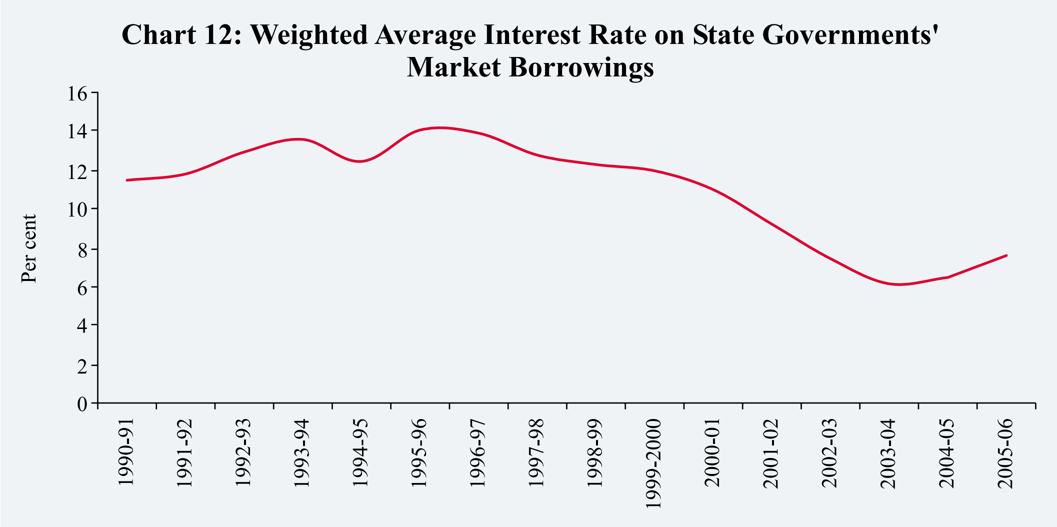
Source : Budget Documents of State Governments.

Market Borrowings

The net allocation under market borrowing programme for State Governments was provisionally placed at Rs.16,112 crore during 2005-06. Taking into account the repayments of Rs.6,274 crore and additional borrowing allocation of Rs.3,522 crore, the gross allocation amounted to Rs.25,909 crore. During 2005-06, the States raised Rs.21,729 crore, *i.e.*, 84 per cent of their gross allocation (Table 16). The weighted average interest rate of market loans firmed up to 7.63 per cent during 2005-06 from 6.45 per cent during the previous year (Chart 12).

Table 16: Market Borrowings of State Governments during 2005-06

Item		Date	Cut-off Rate (per cent)	Tenor (Years)	Amount Raised (Rupees crore)
1		2	3	4	5
A. Tap Issues (i to iii)					**11,185**
i.	First Tranche	May 17-18, 2005	7.77	10	7,554
ii.	Second Tranche	September 13, 2005	7.53	10	2,931
iii.	Third Tranche	January 16, 2006	7.61	10	700
B. Auctions (i to xxiv)					**10,544**
i.	First	April 20, 2005	7.45	10	300
ii.	Second	June 14, 2005	7.39	10	2,181
iii.	Second	June 14, 2005	7.35	10	210
iv.	Third	August 4, 2005	7.32	10	250
v.	Fourth	September 27, 2005	7.45	10	367
vi.	Fourth	September 27, 2005	7.42	10	146
vii.	Fourth	September 27, 2005	7.50	10	327
viii.	Fifth	November 17, 2005	7.34	10	375
ix.	Sixth	December 15, 2005	7.33	10	361
x.	Seventh	January 19, 2006	7.32	10	317
xi.	Seventh	January 19, 2006	7.33	10	166
xii.	Eighth	February 27, 2006	7.65	10	950
xiii.	Eighth	February 27, 2006	7.67	10	619
xiv.	Eighth	February 27, 2006	7.68	10	600
xv.	Eighth	February 27, 2006	7.70	10	628
xvi.	Eighth	February 27, 2006	7.75	10	328
xvii.	Eighth	February 27, 2006	7.85	10	599
xviii.	Ninth	March 27, 2006	7.69	10	45
xix.	Ninth	March 27, 2006	7.70	10	50
xx.	Ninth	March 27, 2006	7.71	10	50
xxi.	Ninth	March 27, 2006	7.72	10	226
xxii.	Ninth	March 27, 2006	7.74	10	85
xxiii.	Ninth	March 27, 2006	7.75	10	175
xxiv.	Ninth	March 27, 2006	7.79	10	1,189
Grand Total (A+B)					**21,729**



The weekly average utilisation of WMA and overdraft by the States during 2005-06 amounted to Rs.482 crore, significantly lower than that of Rs.2,749 crore in the previous year (Chart 13). Nine States resorted to overdraft during 2005-06 as compared with 13 States during 2004-05.

The improvement in the overall cash position of the States was also reflected in their investments in 14-day intermediate Treasury Bills which increased sharply to Rs.35,559 crore (weekly average) during 2005-06 from Rs.10,561 crore in the previous year (Chart 14).

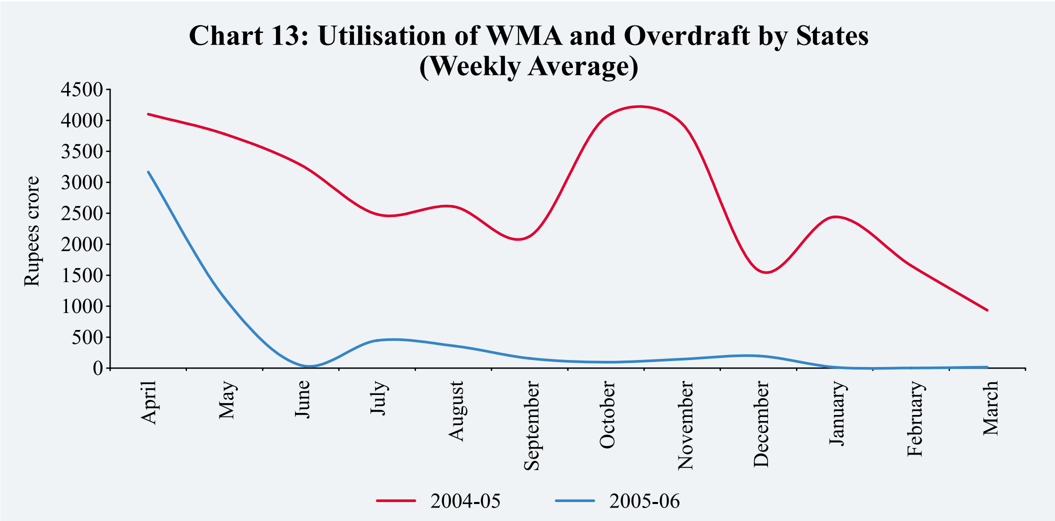
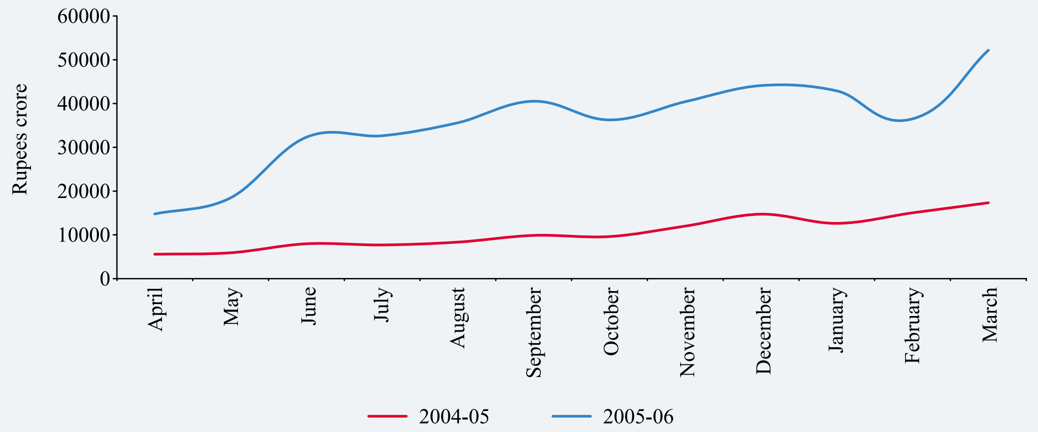


Chart 14: Investments in 14-day Intermediate Treasury Bills by State Governments (Weekly Average)



Combined Government Finances: 2005-06

Reflecting the improvement in the fiscal position of the States, combined Government finances were budgeted to improve in 2005-06, with all key fiscal ratios placed lower than 2004-05 (Table 17). Reduction in the various deficit indicators was envisaged to be achieved through higher revenue mobilisation and moderation in the growth of expenditure. Concomitantly, the combined debt-GDP ratio of the Centre and the States was budgeted to decline from 82.1 per cent in 2004-05 to 80.7 per cent in 2005-06 (Chart 15).

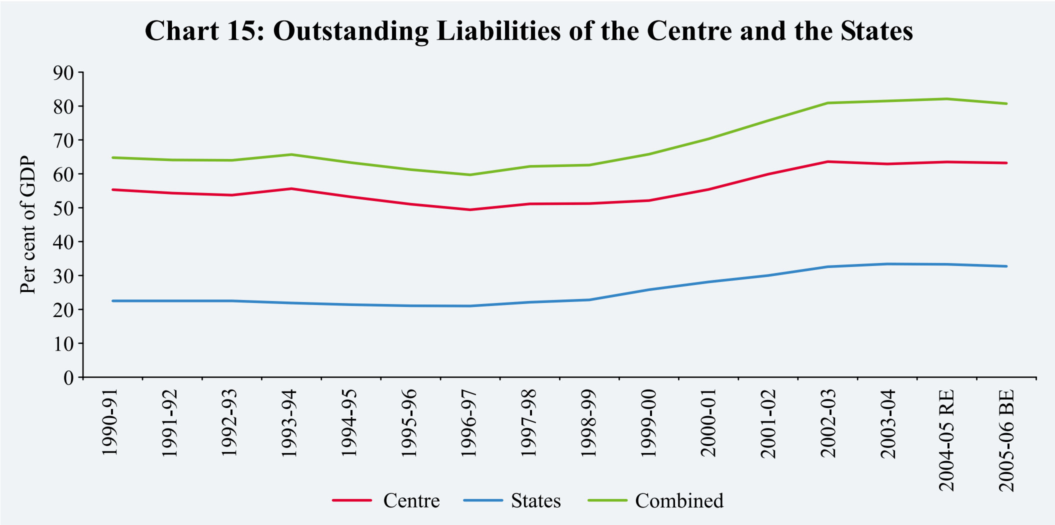
The combined fiscal deficit during 2005-06 was budgeted to be financed primarily from domestic sources. Market borrowings were budgeted to finance 44.3 per cent of the GFD during 2005-06 (29.9 per cent a year ago), while ‘other liabilities’ (small savings, provident funds and deposits) were budgeted to finance 52.2 per cent (66.6 per cent in 2004-05). External sources in the form of external assistance were budgeted to finance 3.6 per cent of the combined fiscal deficit during 2005-06 as compared with 3.4 per cent in 2004-05 (Chart 16).

Table 17: Combined Government Finances: Key Fiscal Indicators

(Per cent to GDP)

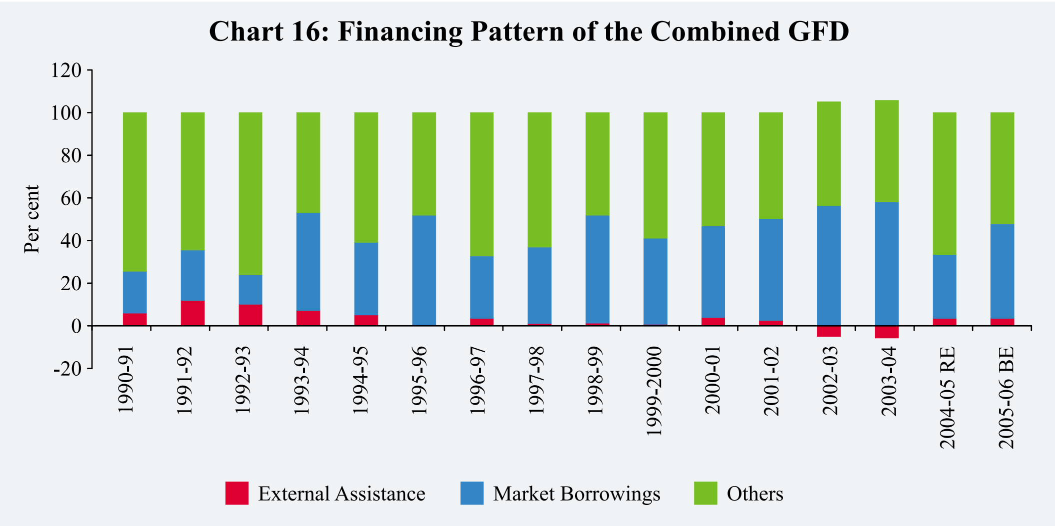
Year	Primary Deficit	Revenue Deficit	Gross Fiscal Deficit
1	2	3	4
2002-03	3.1	6.7	9.6
2003-04	2.1	5.8	8.5
2004-05 (RE)	2.3	4.1	8.4
2005-06 (BE)	1.8	3.4	7.7

RE : Revised Estimates. BE : Budget Estimates.



Fiscal Outlook: 2006-07

The Union Budget 2006-07 committed to resume the path of fiscal consolidation under the FRBM so as to eliminate the revenue deficit by 2008-09. The Budget sought to adopt a strategy of fiscal correction with substantial reductions in revenue deficit slated for 2007-08 and 2008-09. While it is admitted in the Budget that it is a 'challenging' task, it is nevertheless indicated that continued buoyancy in revenues on the back of higher growth trajectory and consolidating efforts in further containment of non-developmental revenue expenditure will facilitate the achievement of the FRBM Rules target. The key deficit indicators, *viz.*, gross fiscal deficit (GFD), revenue deficit (RD) and primary



deficit (PD), as per cent of GDP, are budgeted to be lower in 2006-07 than the previous year's level (Table 18). The order of the budgeted reductions is similar to the minimum threshold limits stipulated under the FRBM Rules, 2004. The roadmap envisages a revenue-led correction along with reprioritisation of expenditure to augment allocation for improvement in the social and physical infrastructure, particularly in the rural areas. The fiscal deficit is budgeted to be lower than the Plan Expenditure in 2006-07, reflecting the Government's commitment not to finance the Plan entirely through borrowings.

The gross tax-GDP ratio (including transfers to the States) is budgeted to improve to 11.2 per cent in 2006-07 from 10.5 per cent in 2005-06 (RE), reflecting continued growth momentum as well as the impact of measures taken for widening the tax base, rationalising exemptions and efforts to improve tax compliance. The gross tax-GDP ratio during 2006-07 will be the highest since 1990-91, reflecting the improvement in direct tax revenues (Table 19). A salient feature of

Table 18: Union Budget 2006-07 at a Glance

(Amount in Rupees crore)

Item	2005-06(RE)	2006-07(BE)	Growth rate (per cent)	
			2005-06	2006-07
1	2	3	4	5
1. Revenue Receipts (i+ii)	3,48,474 (9.9)	4,03,465 (10.2)	13.9	15.8
i) Tax Revenue	2,74,139 (7.8)	3,27,205 (8.3)	21.9	19.4
ii) Non-tax Revenue	74,335 (2.1)	76,260 (1.9)	-8.5	2.6
2. Non-Plan Expenditure	3,64,914	3,91,263	-0.1	7.2
of which:	(10.3)	(9.9)	[9.7]	
i) Interest Payments	1,30,032 (3.7)	1,39,823 (3.5)	2.4	7.5
ii) Defence	81,700 (2.3)	89,000 (2.3)	7.7	8.9
iii) Subsidies	46,874 (1.3)	46,213 (1.2)	7.4	-1.4
3. Plan Expenditure	1,43,791 (4.1)	1,72,728 (4.4)	8.7	20.1
4. Revenue Expenditure	4,40,295 (12.5)	4,88,192 (12.4)	14.6	10.9
5. Capital Expenditure	68,410 (1.9)	75,799 (1.9)	-39.6 [-15.2]	10.8
6. Revenue Deficit	91,821 (2.6)	84,727 (2.1)	17.2	-7.7
7. Gross Fiscal Deficit	1,46,175 (4.1)	1,48,686 (3.8)	16.8	1.7
8. Gross Primary Deficit	16,143 (0.5)	8,863 (0.2)		

Note : 1. Figures in ( ) in columns 2 and 3 are percentages to GDP.
2. Figures in [ ] in column 4 are growth rates over values net of repayments to National Small Savings Fund.

Table 19: 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.

the budget estimates is the deceleration in revenue expenditure, both non-Plan and Plan components. The total capital expenditure is budgeted to increase by 10.8 per cent in 2006-07 as against a reduction of 39.6 per cent (15.2 per cent over its level adjusted for repayments to National Small Savings Fund in 2004-05) in 2005-06.

During 2006-07, net market borrowings (dated securities and 364-day Treasury Bills) are budgeted to increase from Rs.1,01,082 crore in 2005-06 (RE) to Rs.1,13,778 crore. Inclusive of repayments of Rs.65,939 crore, gross market borrowings are placed at Rs.1,79,716 crore. Net market borrowings would finance 76.5 per cent of the GFD in 2006-07 as compared with 69.2 per cent in the revised estimates for 2005-06. Deposits and advances would finance 7.4 per cent of GFD in 2006-07 as compared with 3.2 per cent in the revised estimates for 2005-06. Financing pattern from other sources would broadly remain similar during 2006-07.

III. MONETARY AND LIQUIDITY CONDITIONS

Monetary Survey

Monetary and liquidity conditions remained largely comfortable during 2005-06 although there was some tightness in liquidity conditions during the last four months of 2005-06 reflecting partly the impact of the redemption of India Millennium Deposits (IMDs). The Reserve Bank, therefore, injected liquidity through unwinding of the Market Stabilisation Scheme (MSS) and repo operations under the liquidity adjustment facility (LAF) along with some private placement of the Central Government securities. As a result, the banking system was able to meet the sustained pick-up in credit demand from the commercial sector. However, in the face of the rising demand for commercial credit, banks restricted their incremental investments in Government paper. Strong growth in deposits as well as access to non-deposit sources also enabled the banking system to meet the enhanced demand for commercial credit. Liquidity injecting operations of the Reserve Bank led to a rise in its net domestic assets (NDA) and a higher order of expansion of reserve money during 2005-06. Concomitantly, the year-on-year (y-o-y) broad money (M_3) growth as on March 31, 2006 – at 16.2 per cent – was above the indicative growth of 14.5 per cent projected in the Annual Policy Statement in the beginning of the year (April 2005). In this context, it may be noted that data on fiscal year variation for 2005-06 are not comparable with those of the previous years as the data for 2005-06 include 27 fortnights while usually the data for a year include 26 fortnights. Moreover, the last reporting Friday of 2005-06 coincided with March 31, the closing day for banks' accounts, thereby giving rise to the phenomenon of year-end bulge in aggregate deposits and credit (Table 20). Expansion in the new monetary aggregate (NM_3) was higher than M_3 on account of net outflows under foreign currency deposits, reflecting redemption of IMDs. Based on the recommendations of the Working Group on Money Supply (Chairman: Dr. Y.V. Reddy), NM_3 is compiled on a residency basis by not directly reckoning banks' non-resident repatriable foreign currency fixed deposits such as the balances under the FCNR (B) scheme and IMDs. Expansion in liquidity aggregates (L_1, L_2 and L_3) was also higher than a year ago. Liquidity aggregates encompass select liabilities of the postal savings, financial institutions and NBFCs in addition to that of the banking sector.

Demand for currency recorded a higher growth during 2005-06, in consonance with acceleration in economic activity. Currency demand generally

Table 20: Monetary Indicators

(Amount in Rupees crore)

Item	Outstanding as on March 31, 2006	Variation							
		Fiscal year				Year-on-year			
		2004-05		2005-06		As on April 1, 2005		As on March 31, 2006	
		Amount	Per cent	Amount	Per cent	Amount	Per cent	Amount	Per cent
1	2	3	4	5	6	7	8	9	10
I. Reserve Money	5,73,043	52,623	12.1	83,907	17.2	58,998	14.2	98,399	20.7
II. Broad Money (M_3)	27,09,905	2,42,260	12.1	4,58,456	20.4	2,84,284	13.9	3,77,238	16.2
a) Currency with the Public	4,14,404	40,892	13.0	58,541	16.5	39,894	12.7	59,533	16.8
b) Aggregate Deposits	22,88,587	2,00,009	11.9	3,99,479	21.1	2,42,443	14.1	3,17,111	16.1
i) Demand Deposits	3,87,877	26,528	10.3	1,02,723	36.0	43,585	15.7	66,514	20.7
ii) Time Deposits	19,00,710	1,73,481	12.2	2,96,757	18.5	1,98,857	13.7	2,50,597	15.2
of which: Non-Resident Foreign Currency Deposits	58,976	802	1.1	-17,429	-22.8	2,049	2.8	-17,175	-22.6
III. NM_3	27,28,782	2,44,300	12.5	4,85,608	21.6	2,85,894	14.3	4,02,321	17.3
of which: Call Term Funding from Financial Institutions	83,681	9,678	39.2	14,158	20.4	11,077	43.2	11,761	16.4
IV. a) L_1	28,30,903	2,61,559	12.9	4,99,082	21.4	2,61,559	12.9	4,99,082	21.4
of which: Postal Deposits	1,02,121	17,259	24.2	13,474	15.2	17,259	24.2	13,474	15.2
b) L_2	28,33,835	2,57,437	12.6	4,99,891	21.4	2,57,437	12.6	4,99,891	21.4
of which: FI Deposits	2,932	-4,122	-66.0	809	38.1	-4,122	-66.0	809	38.1
c) L_3	28,55,529	2,57,555	12.5	5,01,745	21.3	2,57,555	12.5	5,01,745	21.3
of which: NBFC Deposits	21,694	118	0.6	1,854	9.3	118	0.6	1,854	9.3
V. Major Sources of Broad Money									
a) Net Bank Credit to the Government (i+ii)	7,77,526	1,670	0.2	20,760	2.7	6,776	0.9	28,819	3.8
i) Net Reserve Bank Credit to Government	12,617	-62,882		30,592		-50,941		40,280	
of which: to the Centre	12,573	-60,177		35,830		-50,813		40,787	
ii) Other Banks' Credit to Government	7,64,909	64,552	9.2	-9,833	-1.3	57,717	8.2	-11,460	-1.5
b) Bank Credit to Commercial Sector	16,86,509	2,31,216	22.8	4,06,260	31.7	2,54,035	24.3	3,55,251	26.7
c) Net Foreign Exchange Assets of Banking Sector	7,13,865	1,22,669	23.3	64,610	10.0	1,18,428	22.4	65,962	10.2
Memo Items:									
Scheduled Commercial Bank's Aggregate Deposits	20,87,670	1,92,269	12.8	3,87,471	22.8	2,30,214	14.8	3,02,534	16.9
Scheduled Commercial Bank's Non-food Credit	14,54,687	2,21,602	27.5	3,95,379	37.3	2,41,433	28.8	3,42,493	30.8

FIs : Financial Institutions. NBFCs : Non-Banking Financial Companies.

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 + All deposits with the post office saving banks (excluding National Saving Certificates)

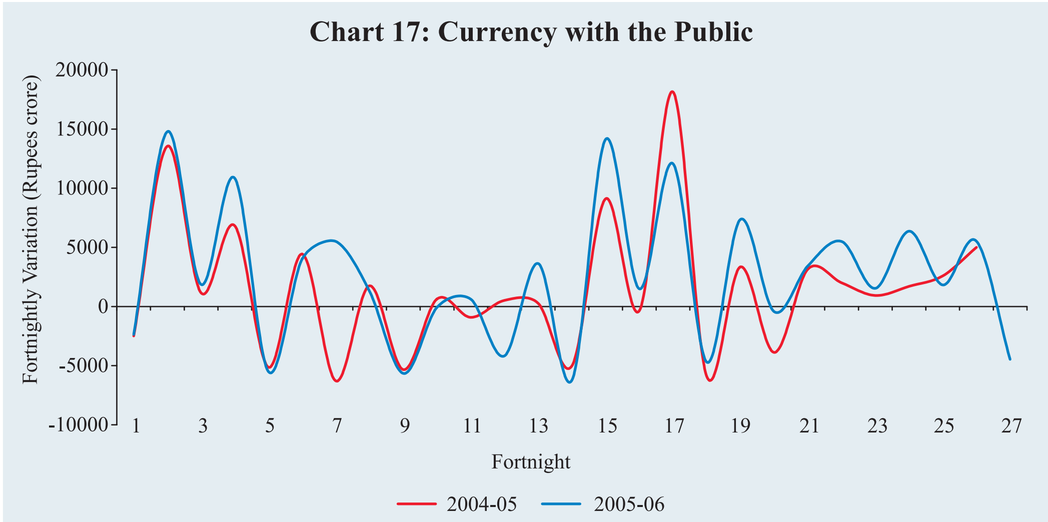
L_2 = L_1 + Term deposits with term lending institutions and refinancing institutions (FIs) + Term borrowing by FIs + Certificates of deposits issued by FIs.

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

Note :
1. Data are provisional. Data in respect of L_3 pertain to December 2005.
2. Variations of select aggregates are adjusted for the effect of conversion of a non-banking entity into a banking entity effective October 11, 2004.
3. Data on fiscal year variation for 2005-06 are not comparable with those of the previous years as the data for 2005-06 include 27 fortnights while usually the data for a year include 26 fortnights. Moreover, the last reporting Friday of 2005-06 coincided with March 31, the closing day for banks' accounts.

exhibited the usual intra-year seasonal pattern, typically increasing during festival seasons and the initial part of the month (Chart 17).

Aggregate deposits accelerated during 2005-06, led by both demand and time components. Growth rate of demand deposits exceeded that of time deposits



and accordingly, there was a rise in the contribution of demand deposits in growth of broad money (Chart 18). Demand deposits expansion mirrored the sustained pick-up in non-food credit and a buoyant primary capital market, with funds getting temporarily parked in demand deposits (Table 21).

Scheduled commercial banks' time deposits growth at 16.1 per cent (y-o-y) as on March 31, 2006 was higher than that recorded a year ago (14.6 per cent; net of the conversion effect) reflecting higher interest rates as well as the base effect. The slowdown in time deposits in January 2006 reflected the one-shot repayment of the proceeds under India Millennium Deposits (IMDs). Concomitantly, mobilisation under small savings schemes decelerated to 15.7 per cent by end-February 2006 from a peak of 23.3 per cent in December 2004. Thus, the growth rate of small savings,

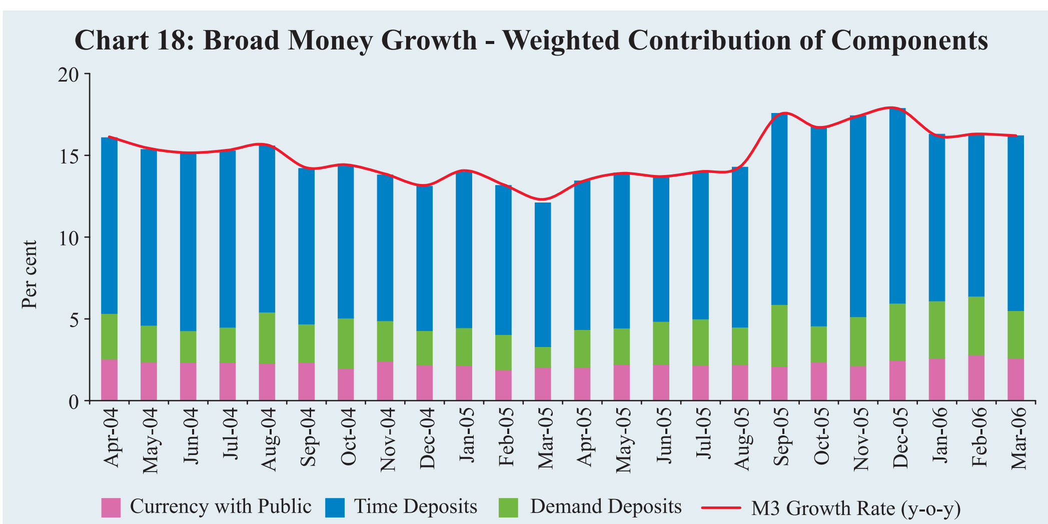


Table 21: Monetary Aggregates - Variations

(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
M3 (=1+2+3 = 4+5+6+7-8)	2,45,773	4,58,456	69,831	16,999	53,458	1,05,485	1,08,666	1,23,864	45,215	1,80,711
	(2,42,260)				(49,945)					
Components										
1. Currency with the Public	40,892	58,541	14,540	-3,098	15,422	14,027	19,500	-10,594	29,901	19,735
2. Aggregate Deposits with Banks	2,03,522	3,99,479	56,754	19,342	37,725	89,701	91,188	1,33,697	16,056	1,58,539
2.1 Demand Deposits with Banks	26,528	1,02,723	-14,038	2,094	15,721	22,751	14,256	41,653	-3,173	49,987
2.2 Time Deposits with Banks	1,76,994	2,96,757	70,792	17,248	22,004	66,949	76,932	92,044	19,229	1,08,553
	(1,73,481)				(18,491)					
3. 'Other' Deposits with RBI	1,359	436	-1,463	755	310	1,757	-2,021	761	-742	2,437
Sources										
4. Net Bank Credit to Govt. Sector	13,863	20,760	12,986	-11,798	-4,524	17,199	9,339	-3,551	-4,216	19,188
	(1,670)				(-16,717)					
4.1 RBI's Net Bank Credit to Govt. Sector	-62,882	30,592	-34,143	-6,179	184	-22,744	9,275	-25,251	19,879	26,689
4.1.1 RBI's Net Credit to Central Govt.	-60,177	35,830	-30,029	-4,499	203	-25,852	14,600	-25,251	19,812	26,669
4.2 Other Bank Credit to Govt. Sector	76,745	-9,833	47,129	-5,619	-4,708	39,943	63	21,700	-24,095	-7,501
5. Bank Credit to Commercial Sector	2,64,098	4,06,260	38,057	40,093	1,07,789	78,160	61,245	114,289	63,713	1,67,013
	(2,31,216)				(74,907)					
6. Net Foreign Exchange Assets of Banking Sector	1,22,669	64,610	49,206	-1,335	32,891	41,907	-13,378	24,062	27,701	26,224
6.1 Net Foreign Exchange Assets of RBI	1,28,377	60,193	57,525	-5,260	31,462	44,651	-14,595	24,823	23,741	26,224
7. Governments' Currency Liabilities to the Public	152	1,247	37	9	89	17	384	910	-100	54
8. Net Non-Monetary Liabilities of Banking Sector	1,55,008	34,421	30,454	9,969	82,788	31,798	-51,077	11,846	41,884	31,768
Memo items										
1. Non-resident Foreign Currency Deposits	802	-17,429	953	-189	-654	692	550	-447	1,602	-19,134
2. SCBs' Call-term Borrowing from Financial Institutions	44,853	14,158	5,409	530	35,464	3,451	1,395	7,359	1,836	3,568
	(9,677)				(288)					
3. Overseas Borrowing by Scheduled Commercial Banks	8,529	5,530	3,012	-658	6,267	-90	1,948	6,008	384	-2,809

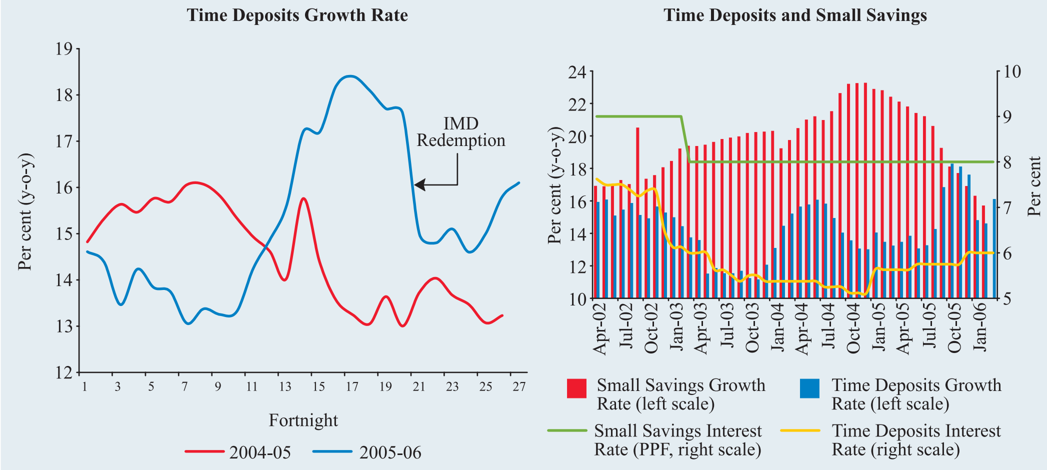
Note : Figures in parentheses are adjusted for the effect of conversion of a non-banking entity into a banking entity on October 11, 2004.

which was significantly higher than that of time deposits over the previous three years, turned out to be close to that of time deposits in 2005-06 (Chart 19).

Credit growth remained strong for the second successive year on account of acceleration in credit to commercial sector. Food credit increased by Rs.1,771 crore as on March 31, 2006 (y-o-y) – reflecting a lower order of procurement of foodgrains – in contrast to an increase of Rs.3,043 crore during the previous year. On the other hand, non-food credit growth was broad-based reflecting strengthening of economic activity. Non-food credit, on a year-on-year basis, registered a growth of 30.8 per cent as on March 31, 2006 on top of a base as high as 28.8 per cent a year ago. Despite a higher order of accretion to deposits, incremental credit-deposit ratio of SCBs remained above 100 per cent (Chart 20).

The corporate sector continued to augment its recourse to bank credit with a variety of other sources. Resources raised from ADR/GDR issuances more than doubled during April-February 2005-06 as compared with the corresponding

Chart 19: Scheduled Commercial Banks' Time Deposits



period of the previous year. Equity issuances in the domestic market were also higher during the year, benefiting from buoyancy in the secondary market. Mobilisation through issuances of commercial papers, however, was subdued and declined during the second half of the year, mainly on account of tight liquidity conditions in domestic markets. After some moderation in the first quarter of 2005-06, funds raised through external commercial borrowings (ECBs) turned buoyant. Internal sources – backed by strong corporate sector profitability – also constituted a significant source of funds for the corporate sector (Table 22).

With credit demand continuing to record strong growth and outpacing deposit growth, banks liquidated their existing investments in Government

Chart 20: Scheduled Commercial Banks' Credit

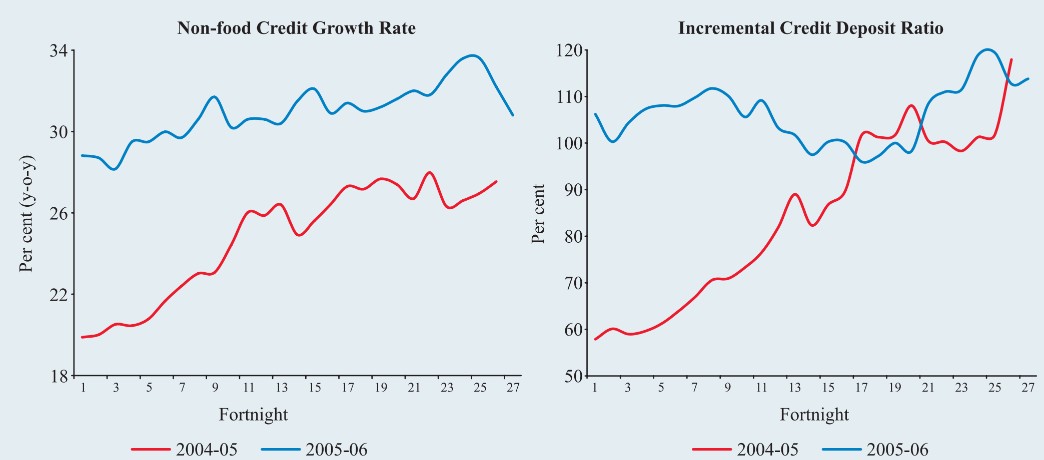


Table 22: Select Sources of Funds to Corporates

(Rupees crore)

Item	2004-05	2005-06	2004-05				2005-06			
	April-February		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4^ ^
1	2	3	4	5	6	7	8	9	10	11
A. Bank Credit to Industry	35,485 #	66,480 #	6,636	11,186	13,733	21,680	11,148	28,061	24,484	2,787 @
B. Flow from Non-banks to Corporates										
1. Capital Issues * (i+ii)	9,597	12,661	228	4,529	3,214	2,495	1,264	2,758	5,549	3,090
i) Non-Government Public Ltd. Companies (a+b)	6,913	12,288	228	4,529	530	2,495	1,264	2,758	5,549	2,717
a) Bonds/Debentures	0	118	0	0	0	0	118	0	0	0
b) Shares	6,913	12,170	228	4,529	530	2,495	1,146	2,758	5,549	2,717
ii) PSUs and Government Companies	2,684	373	0	0	2,684	0	0	0	0	373
2. ADR/GDR Issues +	2,475	6,445	770	597	872	721	789	739	3,643	1,274
3. External Commercial Borrowings (ECBs) $	26,353	25,707	12,077	3,795	10,481	13,164	3,789	12,740	9,178	–
4. Issue of CPs	5,104 ^	-1,542 ^	1,819	421	1,901	963	3,562	1,928	-2,491	-4,541 &
C. Depreciation Provision ++	14,020 £	21,227 £	5,504	5,836	5,731	6,106	7,137	7,617	7,748	–
D. Profit after Tax ++	31,066 £	51,364 £	10,396	13,004	13,196	16,798	16,726	18,169	18,790	–

* : 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.
\+ : Excluding issuances by banks and financial institutions.
$: Including short-term credit. Data for 2005-06 are exclusive of the IMD redemption.
@ : Data pertain to January 2006. £ : Data pertain to April-December. & : January-March.
^ : Data pertain to April-March. # : Data pertain to April-January. ^ ^ : Data pertain to January-February 2006.
++ : Data are based on audited/ unaudited abridged results of select sample of non-financial non-Government companies. Data for nine months period (April-December) are derived by adding the quarterly data on common companies for the first three quarters.
Note : Data are provisional.

papers as well as non-SLR securities. The gilt portfolio of commercial banks registered a decline of Rs.15,562 crore as on March 31, 2006 (y-o-y) in contrast to an increase of Rs.42,473 crore (net of the conversion effect) during the previous year. Consequently, commercial banks' holding of Government securities declined to nearly 32 per cent of their net demand and time liabilities (NDTL) as on March 31, 2006 from around 38 per cent a year ago (Chart 21). Banks also

Chart 21: SLR Investments by Scheduled Commercial Banks

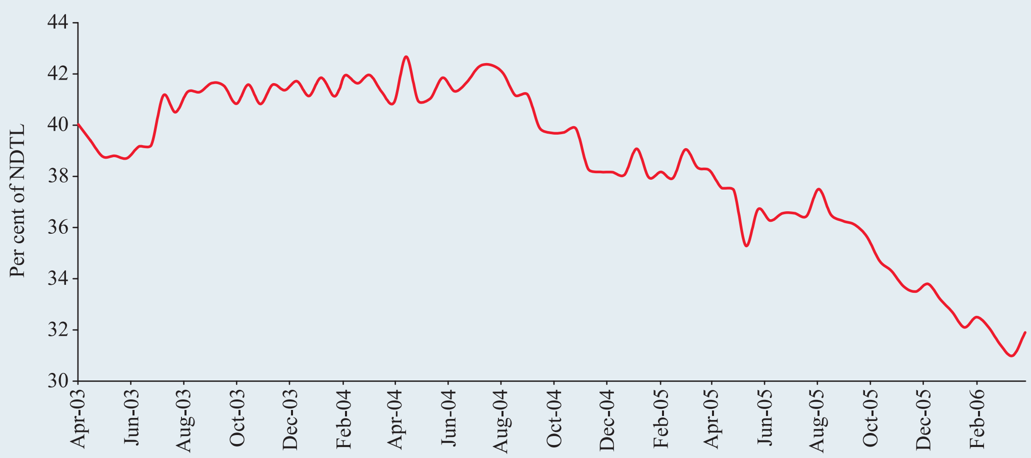


Table 23: Scheduled Commercial Banks' Survey

(Amount in Rupees crore)

Item	Variation (year-on-year)			
	As on April 1, 2005		As on March 31, 2006	
	Amount	Per cent	Amount	Per cent
1	2	3	4	5
Sources of Funds				
I. Aggregate Deposits	2,30,214	14.8	3,02,534	16.9
II. Call Term Funding from Financial Institutions	11,077	43.2	11,761	16.4
III. Overseas Foreign Currency Borrowings	11,712	69.6	2,657	9.3
IV. Capital and Reserves	24,957	22.2	48,886	35.6
Uses of Funds				
I. Bank Credit	2,44,476	27.9	3,44,264	29.9
II. Investments in Government Securities	42,473	6.4	-15,562	-2.2
III. Investments in Other Approved Securities	-2,622	-11.6	2,876	14.4
IV. Investments in Non-SLR Securities	2,670	1.8	-12,820	-8.7
V. Foreign Currency Assets	-3,253	-10.0	11,296	38.4
VI. Balances with Reserve Bank	14,715	18.8	34,077	36.6

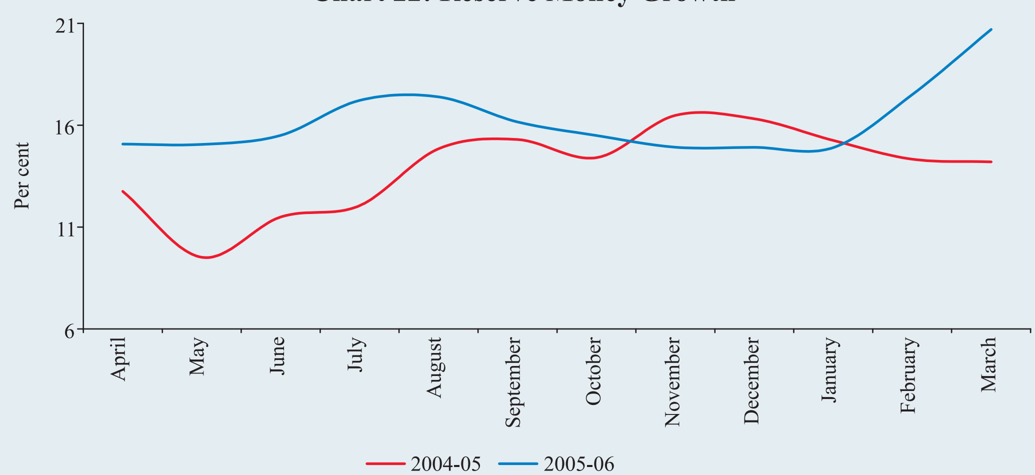
Note : 1. Data are provisional.
2. Variations of select aggregates are adjusted for the effect of conversion of a non-banking entity into a banking entity on October 11, 2004.

liquidated their non-SLR investments (*i.e.*, investments in commercial papers, bonds and debentures) by Rs.12,820 crore. Continued access to call-term funding from financial institutions, raising of funds through equity issuances in the primary market as well as higher internal reserves also helped banks to fund credit demand (Table 23).

Reserve Money Survey

Reserve money growth at 20.7 per cent as on March 31, 2006 (y-o-y) was higher than the previous year (14.2 per cent) (Chart 22). Apart from the base

Chart 22: Reserve Money Growth



effect, the higher order of reserve money expansion reflected liquidity injection operations of the Reserve Bank during the year in the wake of higher credit demand and redemption of IMDs (Table 24).

The Reserve Bank's foreign currency assets (net of revaluation) recorded a lower order of increase during 2005-06, partly reflecting the redemption of IMDs on December 29, 2005 out of its foreign exchange reserves. The increase in the NFEA during 2005-06 was concentrated in the three-week period during July 23 – August 12, 2005 and during February-March 2006 (Chart 23).

Mirroring the liquidity injection operations as well as private placement, the Reserve Bank's net credit to the Centre registered an increase of Rs.35,830 crore during the fiscal 2005-06 in contrast to a decline of Rs.60,177 crore during 2004-05 (Table 25). The increase during the year was mainly on account of unwinding of the balances under the MSS which led to a decline of Rs.21,954 crore in the Centre's deposits with the Reserve Bank in contrast to an increase of Rs.72,558 crore on account of large issuances under the scheme during 2004-05. Furthermore, the balances under the LAF reverse repos declined by Rs.12,080 crore during 2005-06 reflecting injection of liquidity through LAF operations. This coupled with the private placement of Rs.10,000 crore resulted in an increase

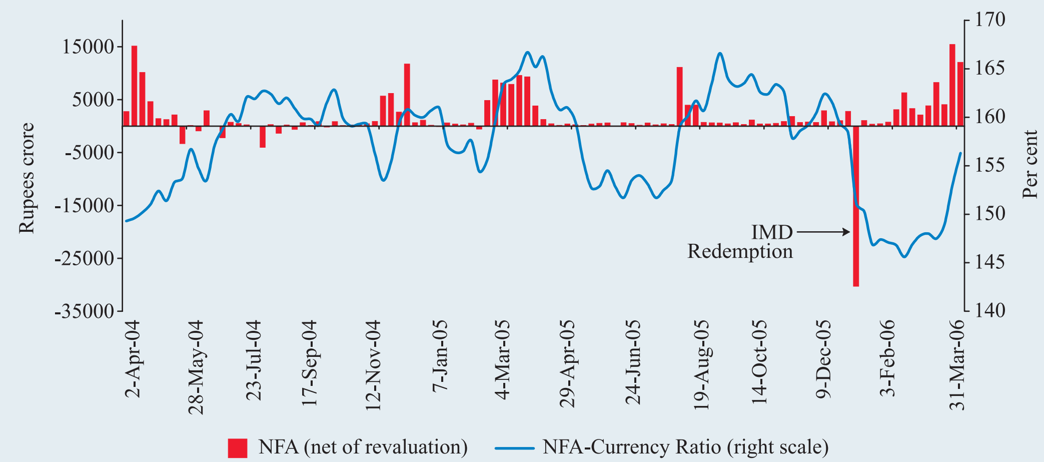
Table 24: Variation in Major Components and Sources of Reserve Money

(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	83,907	-6,812	-6,285	31,546	34,174	7,177	1,062	25,446	50,223
Components										
1. Currency in circulation	41,633	61,956	14,317	-4,166	16,467	15,015	19,877	-9,479	29,154	22,403
2. Bankers' Deposits with RBI	9,631	21,515	-19,665	-2,874	14,769	17,401	-10,680	9,780	-2,967	25,382
3. Other Deposits with RBI	1,359	436	-1,463	755	310	1,757	-2,021	761	-742	2,437
Sources										
1. RBI's net credit to Government	-62,882	30,592	-34,143	-6,179	184	-22,744	9,275	-25,251	19,879	26,689
of which: to Central Government	-60,177	35,830	-30,029	-4,499	203	-25,852	14,600	-25,251	19,812	26,669
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	1,247	37	9	89	17	384	910	-100	54
5. Net Non-Monetary Liabilities of RBI	12,191	8,660	27,245	-5,885	3,916	-13,085	-10,957	-2,450	18,175	3,892
Memo:										
1. Net Domestic Assets	-75,754	23,714	-64,336	-1,025	84	-10,477	21,771	-23,760	1,705	23,998
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)	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 : Data are based on March 31 for Q4 and last reporting Friday for all other quarters.



of the Reserve Bank's holding of dated securities. The increase in the Reserve Bank credit to the Centre, thus, largely reflected liquidity management operations of the Reserve Bank rather than passive financing of the Centre's fiscal gap.

Table 25: Net Reserve Bank Credit to the Centre - Variations

(Rupees crore)

Item	2004-05	2005-06	2004-05 Q1	Q2	Q3	Q4	2005-06 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)	**-60177**	**35,830**	**-30,029**	**-4,499**	**203**	**-25,852**	**14,600**	**-25,251**	**19,812**	**26,669**
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	-21,954	30,525	23,443	13,799	4,791	-6,419	7,974	-277	-23,232
*Memo Items**										
1. 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
2. Reserve Bank's Primary Subscription to Dated Securities	1,197	10,000	0	847	0	350	0	0	0	10,000
3. 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
4. Net Open Market Sales +	2,899	3,913	429	427	871	1,171	1,543	941	261	1,168
5. Mobilisation under MSS	64,211	-35,149	37,812	14,444	353	11,602	7,470	-4,353	-19,174	-18,552
6. Primary Operations $	-6,625	-25,915	37,353	-30,484	-36,984	23,490	18,205	-24,689	-38,715	19,284

* : At face value. + : Excluding Treasury Bills but including Consolidated Sinking Funds (CSF) and other investments.
# : Excluding Treasury Bills. $: Adjusted for MSS and Centre's surplus investment.
Note : Quarterly variations are based on March 31 for Q4 and last reporting Fridays for other quarters.

Liquidity Management

In the face of strong credit demand and the lower order of accretion of the foreign exchange reserves to the Reserve Bank during 2005-06, the Reserve Bank injected 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 26). Between end-March 2005 and up to July 22, 2005, banks curtailed their investments in Government securities following the widening of the trade deficit, outflows by the FIIs during April-May 2005, currency demand and buoyant credit demand. The concomitant unwinding of balances under reverse repos led to net injection of primary liquidity into the system.

During July 23 - August 12, 2005 liquidity in the system increased following the spurt in foreign exchange inflows and a reduction in the Centre's surplus investment balances with the Reserve Bank. This resulted in a sharp increase in absorption of liquidity 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 on August 3, 2005. In the third phase (August 13 – October 28), the Reserve Bank's purchase of foreign exchange assets moderated. Government surplus balances with the Reserve Bank also started building up following the advance tax outflows leading to some tightness in liquidity. Consequently, this phase experienced unwinding of LAF reverse repo balances (Rs.16,210 crore) (Table 27 and Chart 24). On the whole, liquidity conditions were broadly stable and comfortable. Call money rates, therefore, generally stayed within the reverse repo and the repo rate corridor. In

Table 26: Phases of Reserve Bank's Liquidity Management Operations

(Rupees crore)

	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
1	2	3	4	5	6
A. Drivers of Liquidity (1+2+3)	**-6,587**	**27,406**	**-14,678**	**-60,516**	**21,336**
1. RBI's Foreign Currency Assets (adjusted for revaluation)	6,412	19,348	5,193	-21,696	59,577
2. Currency with the Public	-15,125	-1,914	-7,490	-12,695	-21,317
3. Others (residual)	2,126	9,972	-12,381	-26,125	-16,924
3.1 Surplus Cash balances of the Centre with the Reserve Bank	6,053	5,972	-7,421	-24,357	-2,973
B. Management of Liquidity (4+5+6+7)	**1,329**	**-24,567**	**16,187**	**72,235**	**-7,215**
4. Liquidity impact of LAF Repos	8,845	-26,565	16,210	48,595	-35,005
5. Liquidity impact of OMO* (net) and private placement	0	0	0	0	10,740
6. Liquidity impact of MSS	-7,516	1,998	-23	23,640	17,050
7. First round liquidity impact due to CRR change	0	0	0	0	0
C. Bank Reserves # (A+B)	**-5,258**	**2,839**	**1,510**	**11,720**	**14,121**

+ : 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).

Table 27: Liquidity Overhang

(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
2004				
April	73,075	22,851	0	95,926
May	72,845	30,701	0	103,546
June	61,365	37,812	0	99,177
July	53,280	46,206	0	99,486
August	40,640	51,635	7,943	100,218
September	19,245	52,255	21,896	93,396
October	7,455	55,087	18,381	80,923
November	5,825	51,872	26,518	84,215
December	2,420	52,608	26,517	81,545
2005				
January	14,760	54,499	17,274	86,533
February	26,575	60,835	15,357	102,767
March	19,330	64,211	26,102	109,643
April	27,650	67,087	6,449	101,186
May	33,120	69,016	7,974	110,110
June	9,670	71,681	21,745	103,096
July	18,895	68,765	16,093	103,753
August	25,435	76,936	23,562	125,933
September	24,505	67,328	34,073	125,906
October	20,840	69,752	21,498	112,090
November	3,685	64,332	33,302	101,319
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

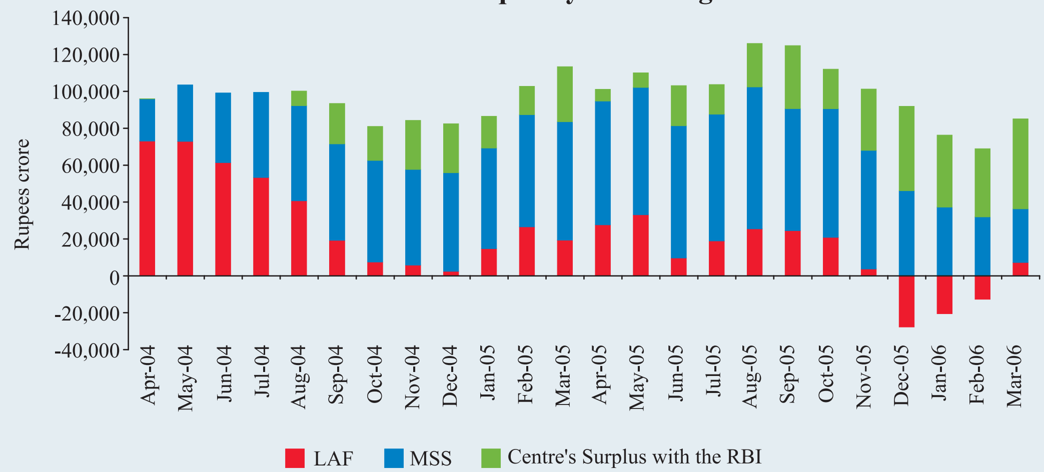
: Negative sign indicates injection of liquidity through LAF repo.

@ : Excludes minimum cash balances with the Reserve Bank.

view of comfortable liquidity conditions, 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.

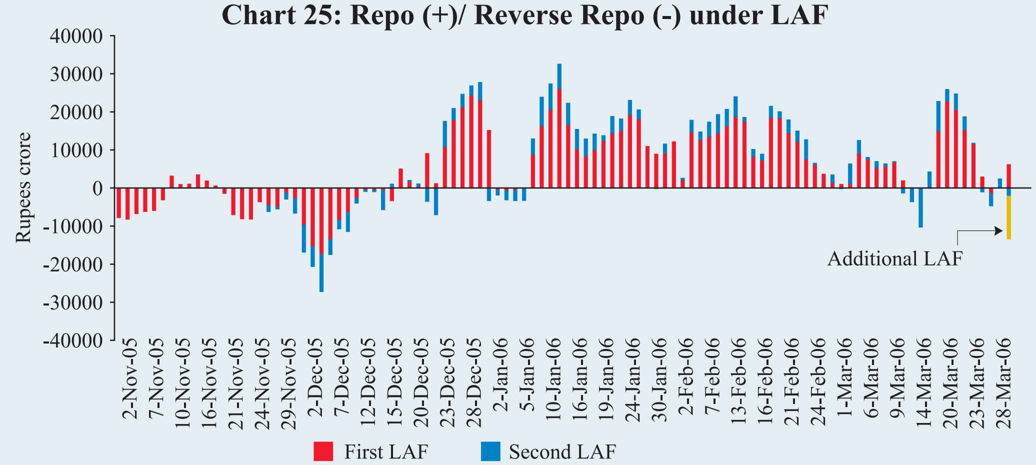
Between end-October, 2005 and March 2006, the banking system faced some tightness with liquidity pressures emanating from a host of factors such as festival season currency demand, scheduled auctions, advance tax outflows and redemption of IMDs against the backdrop of a continuing strong demand for commercial credit. In view of tight liquidity conditions, the Reserve Bank provided liquidity on a net basis to the market through repo operations during November 9-18, 2005 (daily average net injection of Rs.1,142 crore). Furthermore, in order to assuage the liquidity conditions, auctions of Treasury Bills (TBs) under the MSS were cancelled effective November 16, 2005. 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 25).

Chart 24: Liquidity Overhang



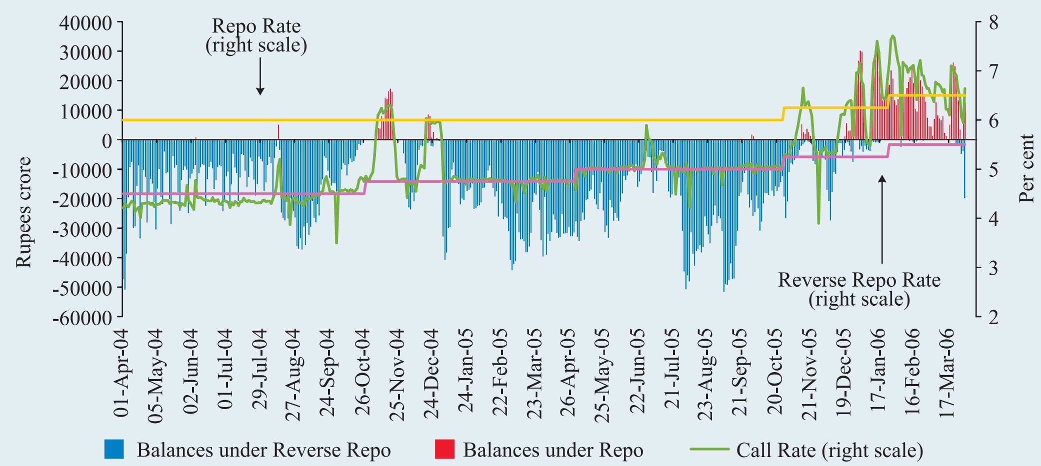
Liquidity conditions became tighter from mid-December 2005 due to IMD redemptions and build-up of Centre's cash balances. To ensure smooth redemption of IMDs, the Reserve Bank sold foreign exchange of US $ 7.1 billion out of its foreign exchange reserves to the State Bank of India during December 27-29, 2005 against equivalent rupees (Rs.31,959 crore). On a review of the prevalent macroeconomic, monetary and liquidity 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, between end-October 2005 and end-March 2006, there was an unwinding of balances held under the MSS (around Rs.40,690 crore). The Reserve Bank also injected liquidity

Chart 25: Repo (+)/ Reverse Repo (-) under LAF



Note : (+) indicates injection of liquidity in to the banking system while (-) indicates absorption of liquidity from the banking system.

Chart 26: Liquidity Adjustment Facility and Call Rate



through repo operations (on a net basis) averaging Rs.15,386 crore during January 2006, Rs.13,532 crore during February 2006 and Rs.6,017 crore during March 2006 (Chart 26). 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 about 70 per cent of the market volumes - remained below the repo rate. Illustratively, in February 2006, when call rates had averaged 6.93 per cent, the average rates for market repo and CBLO at 6.41 per cent and 6.43 per cent, respectively, were well within the indicative reverse repo - repo rate corridor.

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 in addition to LAF operations had a positive impact on the liquidity conditions. 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 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 lower to below the repo rate. 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. Liquidity conditions improved further during April 2006 with liquidity absorption at Rs.49,690 crore as on April 12, 2006. Call rates eased further to 5.55 per cent on April 12, 2006.

IV. PRICE SITUATION

Headline inflation firmed up in a number of economies during 2005-06 on account of international crude oil prices reaching a record high and remaining at elevated levels. Accordingly, many central banks tightened monetary policy during 2005-06 in order to contain inflation and inflationary expectations, especially in view of the fact that a significant part of the increase in international crude oil prices is increasingly viewed as somewhat permanent. Nonetheless, compared to the previous oil shocks, the impact of higher oil prices on economic activity and inflation expectations seems to have been largely contained reflecting a variety of factors such as increased competition due to globalisation, fall in intensity of oil usage in advanced economies, continuous pre-emptive monetary tightening through measured increases in policy rates and, in case of many emerging market economies, less-than-complete pass-through.

In India, headline inflation and inflation expectations remained well-contained during 2005-06, despite continued dominance of supply-side factors. Fiscal and monetary measures undertaken since mid-2004 to reduce the impact of imported price pressures on domestic inflation and to stabilise inflationary expectations were successful in containing inflation towards the desired trajectory during 2005-06.

Global Inflation

Headline inflation firmed up in the second half of 2005 in a number of economies in tandem with the movements in international crude oil prices. With oil prices reaching a record high of US $ 70.8 a barrel in August 2005, headline inflation edged up sharply in major advanced economies in September 2005 reaching 4.7 per cent in the US, 2.6 per cent in the Euro area and 2.5 per cent in the UK. In the subsequent months, headline inflation edged somewhat lower as oil prices retreated from their record high level. Nonetheless, inflation still remains at elevated levels. With oil prices remaining high and volatile, major central banks have, therefore, resorted to pre-emptive monetary tightening in order to contain inflationary expectations. Reflecting the strong economic activity and the incipient inflationary pressures, the US Federal Reserve persevered with its measured pace of monetary tightening raising its target Federal Funds rate to 4.75 per cent – an increase of 375 basis points since the tightening began in June 2004 (25 basis points hike at each of its 15 meetings) (Table 28 and Chart 27). According to the US Federal Open Market Committee (FOMC), although possible increases in resource utilisation and elevated prices of energy and other commodities have the potential to add to inflation pressures, inflation expectations in the US remain contained. The FOMC believes that some further policy firming may be needed to keep the risks to the attainment

Table 28: Inflation Indicators - Developed Economies

(Per cent)

Country/ Region	Key Policy Rate	Policy Rates (Latest)	Changes in Policy Rates (bp) (since end-March 2005)	Inflation		Growth (y-o-y)	
				2005 (February)	2006 (February)	2004 (Q4)	2005 (Q4)
1	2	3	4	5	6	7	8
Australia	Cash Rate	5.50	0	2.6 *	2.8 *	1.5	2.7
Canada	Overnight Rate	3.75	125	2.1	2.2	3.3	2.9
Euro area	Interest Rate on Main Refinancing Operations	2.50	50	2.1 #	2.2 #	1.6	1.6
Japan	Uncollateralised Overnight Call Rate	0	**	-0.3	0.5	0.5	4.3
UK	Repo Rate	4.50	(-)25	1.7	2.0	2.7	1.8
US	Federal Funds Rate	4.75	200	3.0	3.6	3.8	3.2

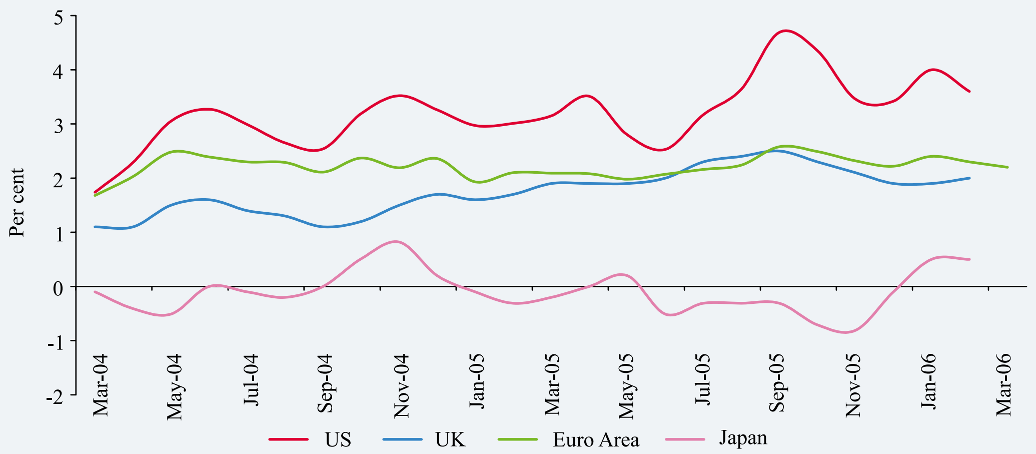
y-o-y : year-on-year. * : Q4. # : March.

** : 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 : International Monetary Fund, websites of respective central banks, the OECD and the Economist.

of both sustainable growth and price stability roughly in balance. Similarly, recognising upside risks due to the potential second-round effects in wage and price setting behaviour from oil market developments and further increases in administered prices and indirect taxes, the European Central Bank (ECB), after maintaining rates at historically low levels for two and a half years, raised the key policy rate by 50 basis points during 2005-06 – 25 basis points each in December 2005 and March 2006 – to keep medium to long-term inflation expectations in the Euro area anchored to levels consistent with price stability. In the UK, on the other hand, the Bank of England cut the policy repo rate by 25 basis points on August 4, 2005 in response to the weakening of economic activity.

Chart 27: Consumer Price Inflation - Developed Economies



In Japan, year-on-year consumer price inflation turned positive in January 2006. With output gap gradually narrowing and firms and households shifting up their expectations for inflation, the Bank of Japan (BoJ) expects year-on-year changes in the consumer price index to remain positive. The BoJ, therefore, 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. With inflation continuing to remain low, the BoJ indicated that it will encourage the uncollateralised overnight call rate to remain at effectively zero per cent.

Amongst major Asian economies, inflation in Indonesia increased sharply from 9.1 per cent at end-September 2005 to 18.4 per cent in November 2005 before moderating to 15.7 per cent in March 2006; in Thailand, inflation edged higher from less than three per cent in early 2005 to 6.2 per cent by October 2005 before easing marginally to 5.7 per cent in March 2006. With inflation expected to remain high, these central banks continued to tighten their monetary policies. The Bank Indonesia has raised the policy rate by 425 basis points since July 2005 – 25 basis points in August 2005, 125 basis points in September 2005, 100 basis points in October 2005, 125 basis points in November 2005 and 50 basis points in December 2005 – to 12.75 cent. The Bank of Thailand has raised policy interest rates by 250 basis points from June 2005 to 4.75 per cent. With inflation above the target, the Bank of Philippines raised the policy reverse repo rate by 75 basis points to 7.5 per cent – 25 basis points each in April 2005, September 2005 and October 2005. In Korea, even though inflation remains modest, latent inflationary pressures are seen due to economic recovery and high oil prices. The Bank of Korea has accordingly raised the policy rate by 75 basis points since end-September 2005 to 4.00 per cent – 25 basis points each in October 2005, December 2005 and February 2006 (Table 29 and Chart 28). On

Table 29: Inflation Indicators - Emerging Market Economies

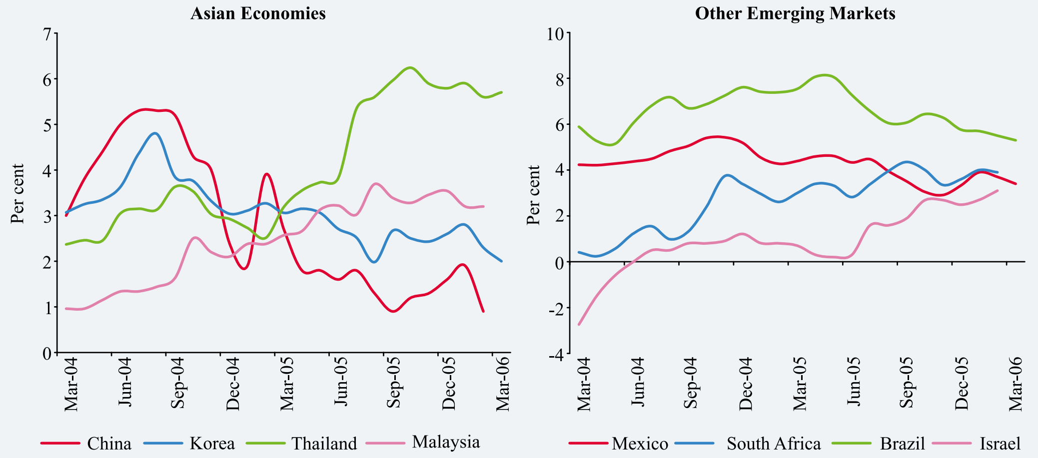
(Per cent)

Country/ Region	Key Policy Rate	Policy Rates (Latest)	Changes in Policy Rates (bp) (since end-March 2005)	Inflation		Growth (y-o-y)	
				2005 (March)	2006 (March)	2004 (Q4)	2005 (Q4)
1	2	3	4	5	6	7	8
Brazil	Selic Rate	16.50	(-) 275	7.5	5.3	4.9	1.4
China	M2			3.9 @	0.9 @	9.5	9.9
India	Reverse Repo Rate	5.50	75	4.2 @	5.0 @	7.0	7.6
Indonesia	BI Rate	12.75	4.25 *	8.7	15.7	6.7	4.9
Israel	Key Policy Rate	5.00	150	0.8 @	3.1 @	4.8	4.8
Korea	Overnight Call Rate	4.00	75	3.1	2.0	3.3	5.3
Philippines	Reverse Repo Rate	7.50	75	8.5	7.6	5.4	6.1
South Africa	Repo Rate	7.00	(-) 50	2.6 @	3.9 @	4.7	4.5
Thailand	14-day Repo Rate	4.75	250	3.2	5.7	5.1	4.7

* : Change since July 2005. @ : February.

Source: International Monetary Fund, websites of respective central banks and The Economist.

Chart 28: Consumer Price Inflation - Emerging Market Economies

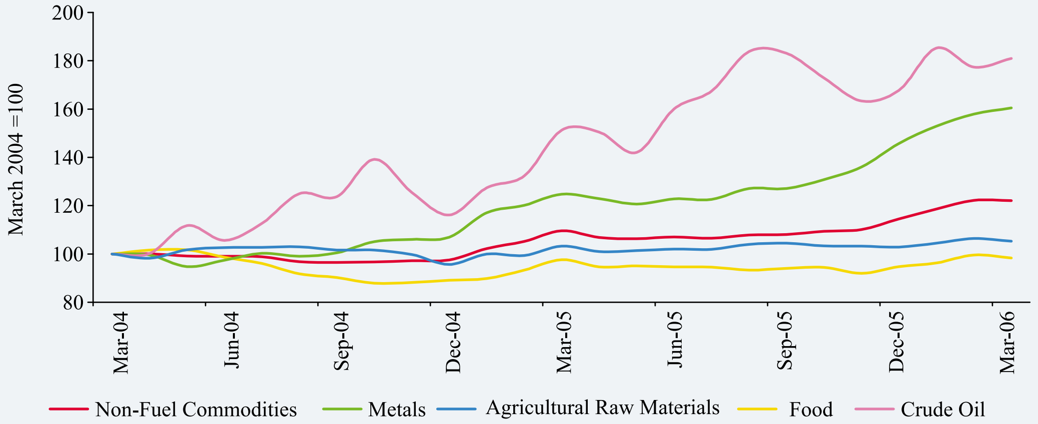


the other hand, consumer price inflation in China decelerated to 0.9 per cent in February 2006 from 3.9 per cent a year ago, mainly due to incomplete pass-through of higher oil prices and declines in the prices of poultry products, clothing, and transport and communications.

Global Commodity Prices

Sharp increase in international crude oil prices to record highs were witnessed during 2005-06 (Chart 29). Non-fuel commodities also increased led by metals and sugar while oilseeds, edibles oils and cotton prices recorded a decline during 2005-06.

Chart 29: International Commodity Prices



Source: International Monetary Fund.

Strong growth in global demand, economic resilience to higher energy costs, hurricane-related supply disruptions in the US (hurricanes Katrina and Rita during August-September 2005) and a three decade low global oil spare capacity pushed up oil prices during 2005-06, despite periodic increases in supply by the Organisation of the Petroleum Exporting Countries (OPEC). Besides, concerns over stability of supplies from the Middle East due to geo-political uncertainties as well as 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 reached successive record highs during 2005 – the US West Texas Intermediate (WTI) crude prices rose to an all-time peak of US $ 70.8 a barrel on August 30, 2005 in the immediate aftermath of Hurricane Katrina. Prices in the subsequent months have remained high and volatile. Crude oil prices initially moderated to below US $ 60 a barrel during November-December 2005 due to (i) concerted efforts by the International Energy Agency (IEA) to release emergency stocks of 2 million barrels a day (mb/d) of crude and products to compensate for the outage in the US Gulf Coast due to Hurricane Katrina; (ii) OPEC's decision to make available existing spare capacity in member countries of around 2 mb/d for a three-month period in its Vienna meeting during September 19-20, 2005; (iii) signs of slowing global oil demand growth; (iv) significant recovery from hurricane damages to oil production in the Gulf of Mexico; and (v) relatively warmer weather during October-November 2005. Prices, however, 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. On the whole, international crude oil prices have surged by about 81 per cent from US $ 33.7 per barrel in March 2004 to US $ 60.9 per barrel in March 2006 (Table 30). After some moderation during February 2006, international crude oil

Table 30: 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
June 2005	51.0	54.3	56.4	53.9	52.4
September 2005	56.5	63.0	65.5	61.7	59.3
December 2005	53.1	56.8	59.4	56.5	54.7
January 2006	58.3	63.6	65.5	62.5	60.6
February 2006	57.6	59.9	61.6	59.7	58.6
March 2006	57.7	62.3	62.9	60.9	59.6

Source : International Monetary Fund and the World Bank.

prices again edged up sharply in the first half of April 2006 on concerns over Iran's nuclear programme and continuing supply disruptions in Nigeria. WTI prices again crossed US $ 69 a barrel on April 11, 2006.

With limited spare global crude oil production capacity and the U.S. oil production and refining industries still to recover fully, oil prices are expected to remain firm in the near future (Table 31). The Energy Information Administration (EIA) of the US, for instance, expects WTI prices to average US $ 65 per barrel in 2006.

Non-fuel commodity prices were led by higher metal prices which reached record/multi-year highs. Metal prices firmed up further during 2005 and the uptrend gathered pace during the first quarter of 2006 on the back of robust construction and manufacturing demand from China and the US. The rally in metal prices has been led by copper, zinc and aluminium (Table 32). With inventories falling to historical lows, copper prices in the first quarter of 2006 (January-March) were 51 per cent higher than that during the corresponding period of 2005. Similarly, zinc and aluminium prices in the first quarter of 2006 were higher by 71 per cent and 28 per cent, respectively, than their levels a year ago. 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 weeks.

As regards food articles, wheat prices firmed up from the second half of 2005. According to the Food and Agriculture Organisation (FAO), wheat prices are expected to moderate in view of good harvest for the 2005 crop and favourable prospects for the newly-sown 2006 crop. Rice prices which increased in 2005 are expected to moderate in the coming months on the back of a record 2005 paddy

Table 31: World Supply-Demand Balance of Oil

(Million barrels per day)

Item	2003	2004	2005	2006 (P)	2006 P			
					Q1	Q2	Q3	Q4
1	2	3	4	5	6	7	8	9
Demand								
1. OECD	48.7	49.5	49.6	50.1	50.1	49.0	50.0	51.0
2. Non-OECD	31.2	33.0	34.1	35.1	34.6	34.6	34.9	36.3
of which: China	5.6	6.5	6.9	7.4	7.2	7.4	7.4	7.7
3. Total (1+2)	79.9	82.5	83.6	85.2	84.7	83.6	84.9	87.3
Supply								
4. Non-OPEC	48.9	50.1	50.2	51.0	50.6	50.5	51.1	51.8
5. OPEC	30.7	32.9	33.9	34.3	33.8	34.1	34.6	34.5
6. Total (4+5)	79.6	83.1	84.1	85.3	84.4	84.6	85.7	86.3
Stock Changes	0.3	-0.6	-0.5	-0.1	0.3	-1.0	-0.8	1.0

P : Projections.
Source : US Energy Information Administration, April 2006.

Table 32: International Commodity Prices

Commodity	Unit	2004	2005	2005 Jan-Mar	2005 Apr-Jun	2005 Jul-Sep	2005 Oct-Dec	2006 Jan-Mar	2006 Mar
1	2	3	4	5	6	7	8	9	10
Energy									
Coal	$/mt	53.0	47.6	51.3	51.2	48.4	39.6	46.9	49.8
Crude oil (Average)	$/bbl	37.7	53.4	46.2	50.8	60.0	56.6	61.0	60.9
Non-Energy Commodities									
Palm oil	$/mt	471.3	422.1	413.3	421.7	415.0	438.3	436.4	440.0
Soybean oil	$/mt	616.0	544.9	521.3	548.0	551.7	558.7	535.3	539.0
Soybeans	$/mt	306.5	274.7	270.8	290.7	278.3	258.9	256.7	256.0
Rice	$/mt	237.7	286.3	289.9	292.0	281.6	281.6	298.8	303.5
Wheat	$/mt	156.9	152.4	151.9	142.0	151.0	164.5	173.8	174.4
Sugar	c/kg	15.8	21.8	19.6	19.3	22.0	26.3	37.5	38.1
Cotton A Index	c/kg	136.6	121.7	117.6	122.6	120.4	126.1	131.1	129.3
DAP	$/mt	221.2	247.0	226.4	235.6	261.6	264.5	259.6	256.6
Urea	$/mt	175.3	219.0	198.1	241.6	211.7	224.7	219.2	244.1
Aluminium	$/mt	1715.5	1898.3	1899.0	1789.8	1828.8	2075.6	2420.8	2429.1
Copper	$/mt	2865.9	3678.9	3267.7	3389.2	3756.6	4302.0	4940.0	5102.8
Gold	$/toz	409.2	444.8	427.1	427.3	439.5	485.6	554.0	557.1
Silver	c/toz	669.0	733.8	699.9	718.2	708.8	808.3	969.4	1037.5
Steel products index	1990=100	121.5	137.9	132.7	141.6	138.6	138.6	138.6	138.6
Steel cold rolled coilsheet	$/mt	607.1	733.3	683.3	750.0	750.0	750.0	750.0	750.0
Steel hot rolled coilsheet	$/mt	502.5	633.3	583.3	650.0	650.0	650.0	650.0	650.0
Tin	c/kg	851.3	738.0	807.7	796.3	704.7	643.2	760.6	794.0
Zinc	c/kg	104.8	138.1	131.5	127.3	129.7	164.0	224.2	241.7

$: US dollar. c : US cent. bbl : barrel. mt : metric tonne. kg : Kilogram. toz : troy oz.
Source : World Bank.

output. Prices of oilseeds, which edged up during March-June 2005 due to sudden deterioration of production prospects in South America, have eased since August 2005 with the waning of weather concerns and record carryover stocks at the close of the marketing season (October-September). On the other hand, notwithstanding some easing during the second half of 2005, prices of edible oils and fats are expected to strengthen due to strong consumption demand from China and India and demand for non-food uses such as biodiesel from the EU and the US.

After remaining broadly stable during April-June 2005, sugar prices have firmed up sharply since September 2005. Prices during the first quarter of 2006 were 91 per cent higher than that during the corresponding period of 2005, reflecting declining global inventories. Although global production in the 2005-06 season (October-September) is expected to increase led by higher production in Brazil and India, higher global sugar consumption, especially from the developing countries of the Far East and Latin America and declining stocks are likely to keep sugar prices firm in the coming months. Global cotton prices, which had declined till August 2005 reflecting a rebound in production, have increased since October 2005 on the back of strong demand. According to the International Cotton Advisory Committee (ICAC), global demand is estimated to increase by about four per cent during 2005-06 and this is expected to keep prices firm.

Inflation Conditions in India

Headline inflation, based on movement in the wholesale price index (WPI), was 4.0 per cent as at end-March 2006 as compared with 5.1 per cent a year ago (Table 33). Inflation initially increased during 2005-06 to an intra-year high of 6.0 per cent on April 23, 2005 reflecting increases 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 remaining

Table 33: Wholesale Price Inflation in India (year-on-year)

(Per cent)

Commodity	Weight	2004-05 (March 26) Inflation	2004-05 (March 26) WC	2005-06 (March 25) Inflation	2005-06 (March 25) WC
1	2	3	4	5	6
All Commodities	**100.0**	**5.1**	**100.0**	**4.0**	**100.0**
1. Primary Articles	**22.0**	**1.3**	**5.5**	**5.3**	**28.5**
Food Articles	15.4	3.0	8.9	6.3	23.8
i. Rice	2.4	2.9	1.3	2.5	1.4
ii. Wheat	1.4	-1.1	-0.3	12.3	4.2
iii. Pulses	0.6	-2.6	-0.3	26.4	3.6
iv. Vegetables	1.5	11.9	2.3	14.1	3.7
v. Fruits	1.5	11.5	4.1	-3.0	-1.5
vi. Milk	4.4	-1.7	-1.5	1.9	2.0
vii. Eggs, Fish and Meat	2.2	7.3	3.1	13.5	7.6
Non-Food Articles	6.1	-6.9	-8.8	-1.5	-2.2
i. Raw Cotton	1.4	-23.8	-6.5	-0.6	-0.1
ii. Oil Seeds	2.7	-6.5	-3.4	-7.6	-4.5
iii. Sugarcane	1.3	-0.7	-0.2	0.7	0.3
Minerals	0.5	68.0	5.3	43.4	7.0
i. Iron Ore	0.2	119.1	5.2	59.7	7.0
2. Fuel, Power, Light and Lubricants	**14.2**	**10.5**	**42.7**	**8.9**	**49.1**
i. Mineral Oils	7.0	16.0	34.9	13.2	40.8
ii. Electricity	5.5	0.8	1.2	4.5	8.4
iii. Coal Mining	1.8	17.1	6.4	0.0	0.0
3. Manufactured Products	**63.8**	**4.6**	**52.0**	**1.5**	**22.1**
i. Food Products	11.5	0.4	0.9	2.4	6.3
of which: Sugar	3.6	19.7	10.3	7.3	5.6
Edible Oils	2.8	-8.4	-4.0	-2.4	-1.3
Oil Cakes	1.4	-17.4	-6.4	-9.7	-3.6
ii. Cotton Textiles	4.2	-12.7	-10.4	0.8	0.7
iii. Man Made Fibre	4.4	0.6	0.3	-4.9	-2.7
iv. Chemicals and Chemical Products	11.9	3.9	9.1	1.8	5.4
of which : Fertilisers	3.7	3.3	2.2	0.2	0.1
v. Basic Metals, Alloys and Metal Products	8.3	17.1	28.4	-2.9	-6.8
of which: Iron and Steel	3.6	21.3	17.0	-7.5	-9.0
vi. Non-Metallic Mineral Products	2.5	11.4	4.7	8.5	4.8
of which: Cement	1.7	10.2	2.9	13.0	4.9
vii. Machinery and Machine Tools	8.4	7.1	8.6	3.3	5.4
viii. Transport Equipment and Parts	4.3	6.2	4.3	1.1	1.0
Memo:					
Food Items (Composite)	**26.9**	**1.9**	**9.8**	**4.7**	**30.1**
WPI Excluding Food	**73.1**	**6.3**	**90.2**	**3.7**	**69.9**
WPI Excluding Fuel	**85.8**	**3.7**	**57.3**	**2.6**	**50.9**

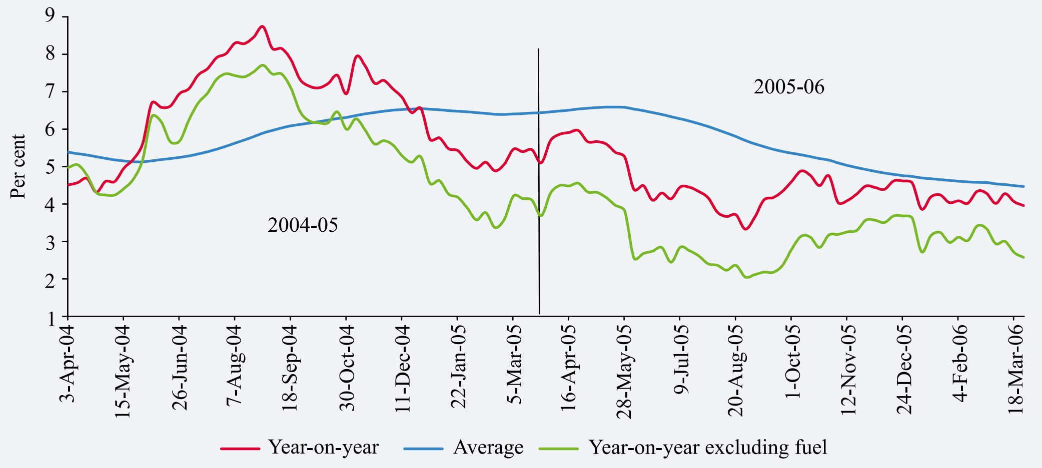
WC : Weighted Contribution.
Note : Data for 2005-06 are provisional.

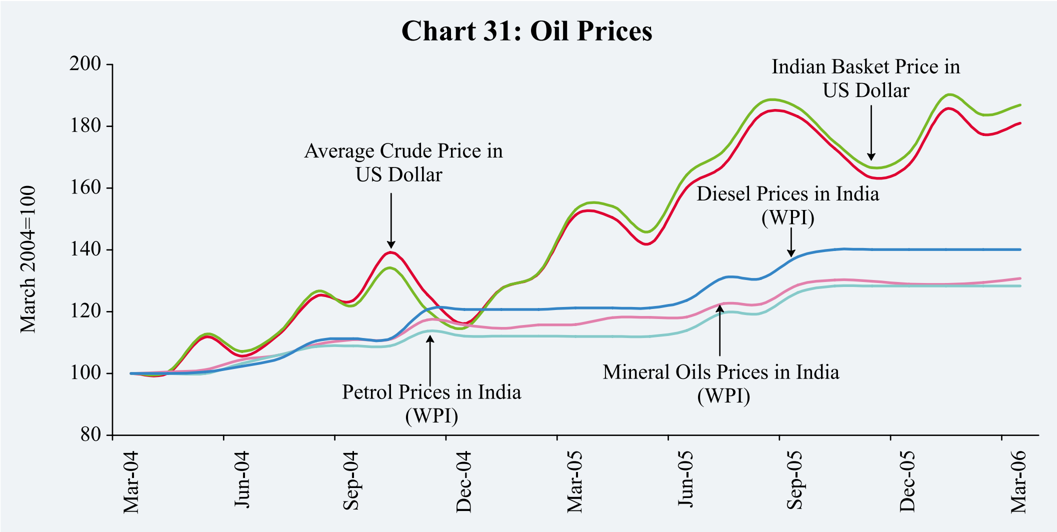
below 5.0 per cent – under the impact of the hike in petrol and diesel prices in early September 2005 as also a rise in vegetables and cotton prices. Vegetable prices remained high for most part of the third quarter of 2005-06 due to damage to the standing crops from excessive rains/floods in various parts of the country. With the easing of vegetables prices from early December 2005 as well as reduction in domestic iron and steel prices in January 2006, inflation moderated to 3.9 per cent on January 7, 2006. It edged marginally higher to reach 4.3 per cent on March 11, 2006 on the back of higher non-ferrous metal, furnace oil and electricity prices before easing to 4.0 per cent as on March 25, 2006. The average WPI inflation rate eased to 4.5 per cent during 2005-06 from 6.4 per cent a year ago. WPI inflation (y-o-y) was 3.5 per cent as on April 1, 2006.

The inflation outcome during 2005-06 was influenced mainly by the price movements of petroleum products. Mineral oils inflation alone contributed about 41 per cent to the headline inflation. Accordingly, the y-o-y WPI inflation excluding the fuel group at 2.6 per cent remained well below the headline rate (Chart 30).

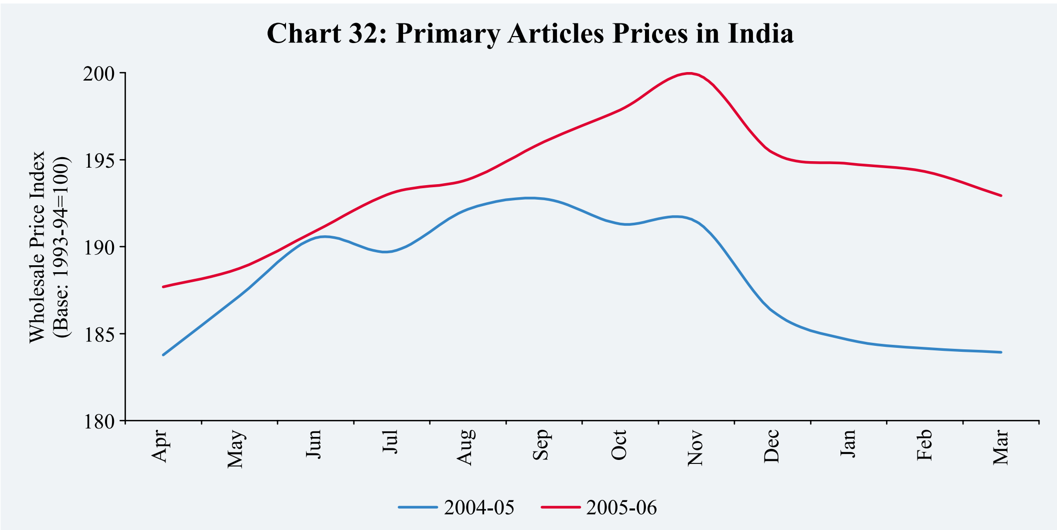
Although fuel prices were the key driver of domestic inflation during 2005-06, domestic petroleum products prices still lag the increase in international crude oil prices. The pass-through of higher international oil prices has been restricted mainly to petrol and diesel (hike of 7-8 per cent each in June and September 2005). Domestic prices of liquefied petroleum gas (LPG) and kerosene oil remained unchanged during 2005-06. As compared with an increase of about 87 per cent from US $ 31.9 a barrel to US $ 59.6 a barrel in international crude oil prices (the Indian basket) between March 2004 and March 2006, domestic mineral oil prices in the WPI basket have increased by about 31 per cent over the same period – petrol by 28.4 per cent and high-speed diesel by 40.1 per cent (Chart 31).

Chart 30: Annual Wholesale Price Inflation





Apart from fuel prices, prices of primary food articles posed some upward pressures on inflation during 2005-06 (Chart 32). Wheat prices firmed up during the second half of 2005-06 on reports of fall in stocks. Prices of pulses, 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 in tandem with international trends. Oilseeds prices have moderated since November 2005 on account of improved crop prospects. The prices had hardened somewhat during the first half of 2005-06, reflecting last year's shortfall in domestic *kharif* production and worries about a poor ensuing crop due to the unsatisfactory progress of the South-West monsoon. On the



whole, primary articles inflation increased from 1.3 per cent at end-March 2005 to 5.3 per cent at end-March 2006.

Manufactured products inflation remained modest, falling from 4.6 per cent at end-March 2005 to 1.5 per cent at end-March 2006 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. Upward pressures from sugar and other food products, cement and non-ferrous metals were offset by easing of prices of manmade fibres, edible oils, oil cakes and iron and steel. Domestic sugar prices remained firm during the year in line with international trends, notwithstanding higher sugarcane output in the country. Domestic metal prices during 2005-06 moved in tandem with trends in international prices. Iron and steel prices in India declined by 7.5 per cent during 2005-06 as against a sharp increase of 21.3 per cent during the previous year. In contrast, non-ferrous metal prices rose sharply. Prices of copper and zinc increased by 40.8 per cent and 39.6 per cent, respectively, during 2005-06 (Chart 33).

In brief, domestic WPI inflation during 2005-06 was dominated by a few items, especially mineral oil prices, which alone contributed almost 41 per cent of the headline inflation. Accordingly, the contribution of the fuel group to y-o-y overall WPI inflation as at end-March 2006 was 49.1 per cent (higher than that of 42.7 per cent a year ago). Manufactured products contribution fell to 22.1 per cent (52.0 per cent), largely on account of a decline in iron and steel prices. On the other hand, primary articles' contribution to the overall inflation increased to 28.5 per cent (5.5 per cent) mainly due to higher prices of wheat, pulses, vegetables and eggs, meat and fish (Chart 34).

Chart 33: Metals Prices

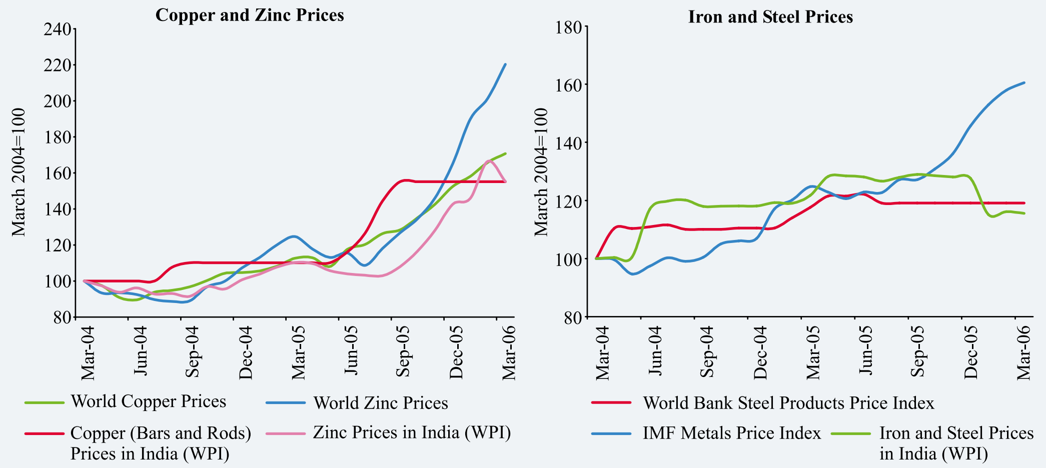
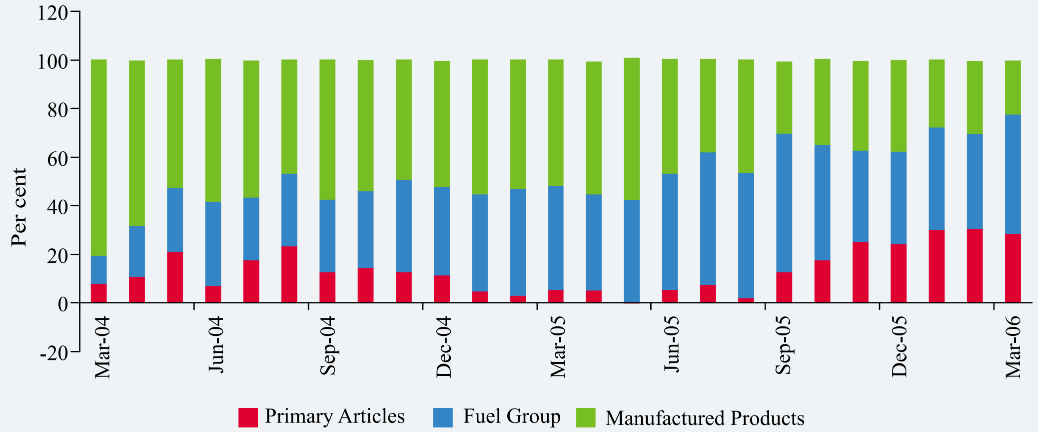


Chart 34: Major Groups' Weighted Contribution to WPI Inflation (year-on-year)



Consumer Price Inflation

Consumer price inflation for industrial workers (CPI-IW) was 5.0 per cent during February 2006 as compared with 4.2 per cent during March 2005 (Table 34). Disaggregated information on CPI-IW available up to December 2005 shows that food prices firmed up from the March 2005 level. Services inflation – proxied by the miscellaneous group in the CPI-IW – edged up mainly reflecting increase in the prices of medical care and 'education, recreation and amusement'. 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 from its March 2005 level (Table 35).

Asset Prices

Equity and gold prices recorded sharp increases during 2005-06. Buoyancy in equity markets continued on the back of better prospects for economic activity, strong

Table 34: Consumer Price Inflation (CPI) in India (year-on-year)

(Per cent)

Inflation Measure	March 2003	March 2004	March 2005	June 2005	September 2005	December 2005	January 2006	February 2006
1	2	3	4	5	6	7	8	9
CPI-IW	4.1	3.5	4.2	3.3	3.6	5.6	4.4	5.0
CPI- UNME	3.8	3.4	4.0	3.9	4.8	5.7	5.0	4.8
CPI-AL	4.9	2.5	2.4	2.7	3.2	4.7	4.7	5.0
CPI-RL	4.8	2.5	2.4	2.7	3.2	4.9	4.7	4.7
Memo:								
WPI Inflation	6.5	4.6	5.1	4.3	4.3	4.6	4.0	4.3

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

Table 35: Consumer Price Inflation for Industrial Workers (year-on-year)

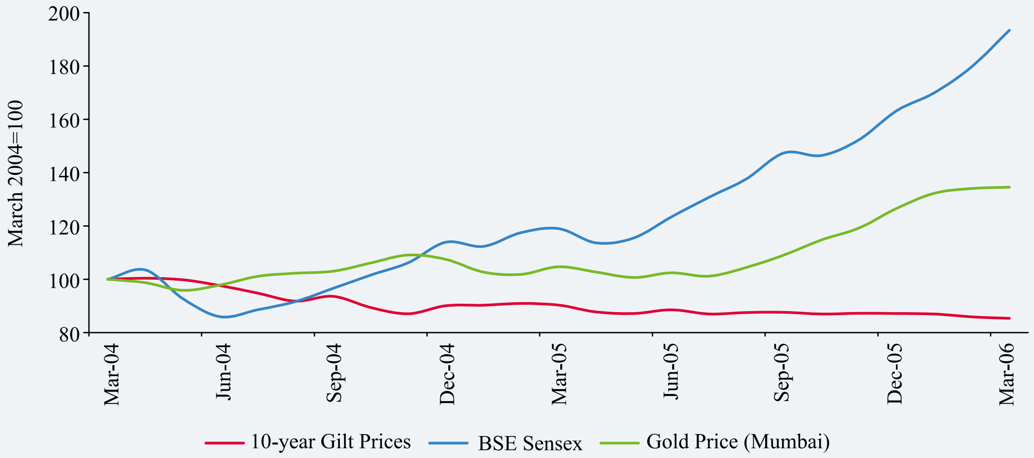
(Per cent)

Group/Item	Weight	March 2005 Inflation	March 2005 WC	December 2004 Inflation	December 2004 WC	December 2005 Inflation	December 2005 WC
1	2	3	4	5	6	7	8
General Index	**100.0**	**4.2**	**100.0**	**3.8**	**100.0**	**5.6**	**100.0**
1. Food Group	**57.0**	**1.6**	**21.7**	**1.8**	**27.0**	**6.7**	**66.8**
i. Cereals and Products	20.5	0.7	2.9	0.0	0.0	4.4	14.1
ii. Pulses and Products	3.6	-2.0	-1.9	2.7	2.8	12.8	9.0
iii. Oils and Fats	5.0	-7.1	-6.9	-0.8	-0.8	-5.8	-4.0
iv. Meat, Fish and Eggs	4.3	5.0	6.3	8.1	10.8	5.0	4.7
v. Milk and Products	6.5	1.7	2.5	2.9	4.4	2.2	2.2
vi. Condiments and Spices	3.2	-9.0	-7.6	-4.1	-3.8	12.5	7.3
vii. Vegetables and Fruits	5.7	6.5	8.2	-1.4	-2.1	22.9	22.4
viii. Other Foods	8.3	7.8	17.7	6.9	17.0	5.8	10.0
2. Pan, Supari, Tobacco and Intoxicants	**3.2**	**2.1**	**2.1**	**3.2**	**3.5**	**1.5**	**1.1**
3. Fuel and Light	**6.3**	**4.9**	**8.7**	**9.3**	**17.5**	**-5.6**	**-7.6**
4. Housing	**8.7**	**20.4**	**50.0**	**11.7**	**31.0**	**11.7**	**22.7**
5. Clothing, Bedding and Footwear	**8.5**	**2.3**	**3.3**	**2.4**	**3.6**	**2.0**	**2.1**
6. Miscellaneous Group (Services)	**16.4**	**3.9**	**15.6**	**3.3**	**14.6**	**4.9**	**14.7**
i. Medical Care	2.6	4.4	3.2	3.9	3.1	6.0	3.3
ii. Education, Recreation and Amusement	3.1	5.1	3.4	3.6	2.6	7.1	3.6
iii. Transport and Communication	2.7	6.8	5.0	4.4	3.6	6.3	3.6
iv. Personal Care and Effects	3.3	3.2	2.5	4.1	3.5	2.5	1.5
v. Others	4.7	1.7	1.8	1.2	1.5	3.7	2.9

WC : Weighted Contribution.

corporate performance and liquidity support by FIIs and mutual funds (Chart 35). Domestic gold prices remained firm in line with international trends. International gold prices have risen sharply since mid-2005, crossing US $ 600 per ounce in April 2006. Gilt prices fell marginally during the year, with intra-year movements influenced by trends in domestic inflation and liquidity conditions.

Chart 35: Asset Price Movements



V. FINANCIAL MARKETS

International financial market conditions during 2005-06 continued to remain favourable, 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 following tightening of monetary policy to anchor inflationary expectations in view of pressures emanating from higher energy prices, long-term nominal rates remained largely benign with real long-term interest rates ruling at very low levels. Equity markets remained buoyant, especially in emerging market economies (EMEs), on steady improvement in the fundamentals, improved growth prospects and increased appetite for risk. Emerging market spreads continued to hover around record low levels, 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.

Short-term rates increased in a number of economies during 2005-06 as central banks raised their policy rates to ward off inflationary pressures from higher international crude oil prices in an environment of strong demand (Table 36). Amongst the advanced economies, the US recorded the maximum increase in rates, reflecting hikes by the Federal Open Market Committee (FOMC) in the federal funds rate target in each of its meetings held since June 2004. In some

Table 36: Short-term Interest Rates

(Per cent)

Region/Country	March 2004	March 2005	June 2005	September 2005	December 2005	March 2006
1	2	3	4	5	6	7
Advanced Economies						
Euro Area	1.96	2.15	2.10	2.15	2.48	2.80
Japan	0.03	0.02	0.02	0.02	0.02	0.04
Sweden	2.12	1.97	1.48	1.46	1.68	1.99
UK	4.31	4.95	4.75	4.56	4.59	4.58
US	1.04	2.90	3.33	3.85	4.23	4.77
Emerging Market Economies						
Argentina	2.88	4.56	6.94	6.69	8.00	9.63
Brazil	16.02	19.25	19.74	19.51	18.03	16.54
China	n.a.	2.25	2.30	4.38	2.90	2.40
Hong Kong	0.17	2.79	3.36	4.12	4.18	4.47
India	**4.24**	**5.37**	**5.37**	**5.49**	**6.02**	**6.11**
Malaysia	3.00	2.82	2.87	2.92	3.20	3.51
The Philippines	9.19	7.25	5.88	8.13	7.69	7.38
Singapore	0.69	2.06	2.06	2.34	3.22	3.44
South Korea	3.90	3.54	3.52	3.94	4.07	4.26
Thailand	1.31	2.64	2.75	3.90	4.50	5.10

n.a. : Not available.

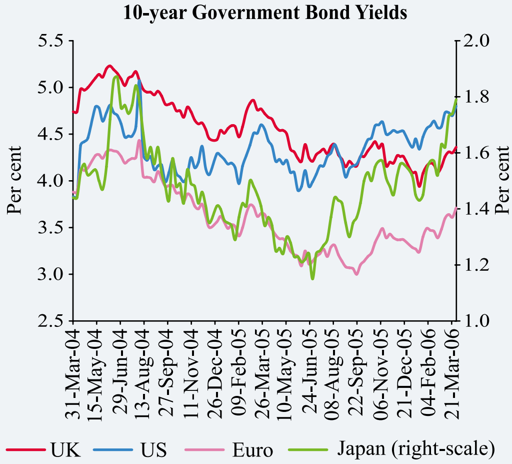
Note : Data for India refer to 91-day Treasury Bills rate and for other countries 3-month money market rates.

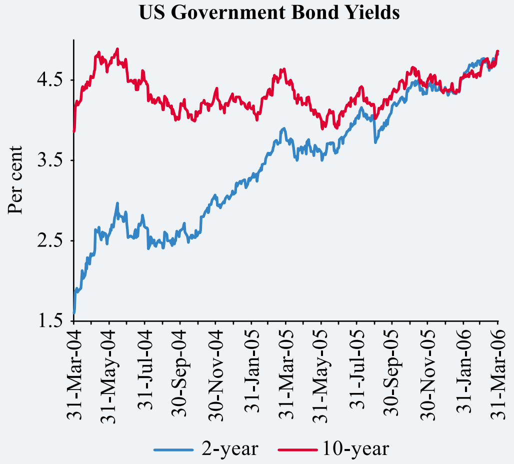
Source : The Economist.

economies such as the UK short-term rates eased in response to weakening of economic activity.

In contrast to the uptrend in short-term rates, long-term Government bond yields in the US as well as in the Euro area remained largely range-bound during 2005-06. Structural factors such as increased demand for fixed income products from pension funds and insurance companies in response to regulatory changes provided support to long-term gilts. Excess of global savings over global investment and reduction in inflation risk premium also contributed to the flattening of the long-term yields during 2005-06. Yields in the US declined initially during April-June 2005 on expectations that monetary authorities could slow down policy tightening due to fragility in the economic recovery. The US 10-year Treasury yield was at a 14-month low at 3.8 per cent in early-June 2005. Yields, however, firmed up during July 2005 in the run up to the widely anticipated revaluation of the Chinese currency on July 21, 2005. With the Chinese authorities continuing to manage the renminbi tightly, the yields reversed their increasing trend. Long-term Government bond yields increased in the third quarter of 2005-06 in the US and in the Euro area in tandem with sharp rise in headline inflation and higher short-term rates which increased expectations regarding future policy rates. In the second half of December 2005, 10-year yields eased again and by the close of December, the yield curve in the US became inverted (Chart 36). Yields again increased from the second week of January 2006. The 10-year yield rose to 4.86 per cent on March 31, 2006, the highest since June 2004 on the back of strong data and expectations that the US FOMC may push the federal funds rate target higher than expected. In the Euro area, the increase in long-term yields was also on account of improved economic outlook. In Japan, long-term yields increased, reflecting recovery in domestic demand and better economic prospects. The

Chart 36: Interest Rates – Advanced Economies





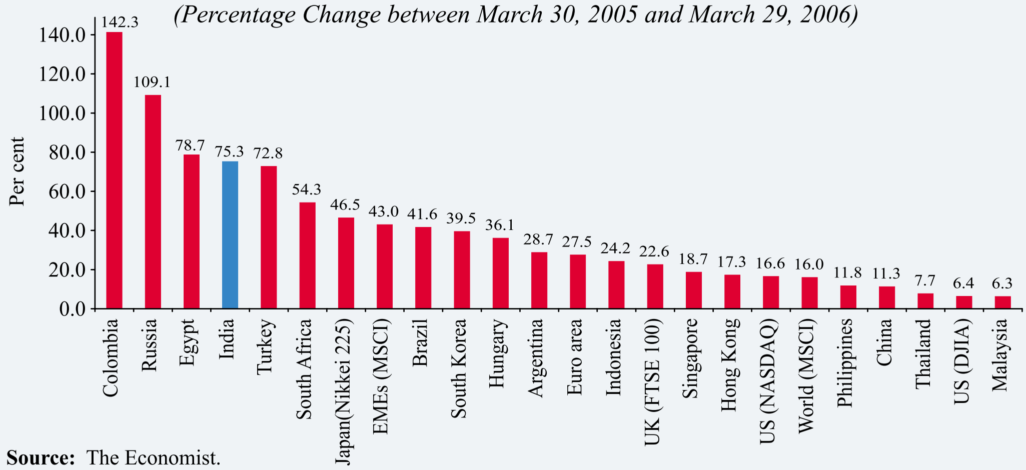
decision of the Bank of Japan in March 2006 to change the operating target of money market operations from the outstanding balance of current accounts at the Bank to the uncollateralised overnight call rate also pushed up yields in Japan. In the UK, the yields eased marginally during 2005-06 in tandem with short-term rates.

Equity markets in many economies, especially EMEs, exhibited buoyancy during 2005-06. Improvements in the fundamentals of EMEs as well as higher risk appetite in an environment of very low long-term real interest rates also increased foreign investors' enthusiasm for emerging market equities, pushing up valuations sharply and in some cases to new highs. Intra-year movements in equity prices were influenced by concerns over oil prices led by inflationary pressures and the likely future course of monetary policy. In the wake of sharp increase in inflation during September 2005 and the prospects of a faster pace of monetary tightening, equity prices declined in October 2005 around the world. Equity markets, however, bounced back in November 2005 on signs of robust economic activity in the US and some moderation in international crude oil prices. During 2005-06, the Indian equity markets outperformed major international equity markets except Colombia, Russia and Egypt (Chart 37). Equity markets in the US, however, under-performed significantly as equities struggled to cope with the impact of higher US interest rates and increasing activity by the US investors in overseas markets. Equity markets in Asia witnessed some decline in the second week of April 2006 on concerns that higher commodity prices could lead to further monetary tightening.

Notwithstanding concerns over the widening current account deficit in the US, the US dollar appreciated during 2005-06 benefiting from the growing interest and growth differential in favour of the US and a year-long tax break designed to encourage US multinationals to repatriate cash held overseas (Chart 38).

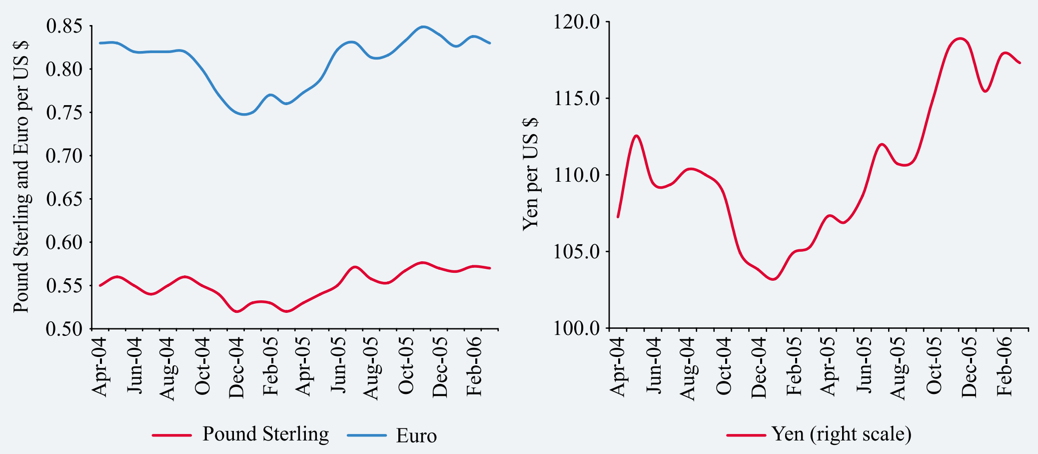
Chart 37: International Stock Markets

(Percentage Change between March 30, 2005 and March 29, 2006)



Source: The Economist.

Chart 38: Exchange Rate of Major Currencies per US dollar



Indian financial markets remained orderly during 2005-06 even as interest rates edged up across the spectrum. Liquidity conditions turned tight from mid-December 2005 due to the redemption of the India Millennium Deposits (IMDs) in the wake of sustained credit growth and some build-up of cash balances by the Government of India. Reflecting the liquidity conditions, call money rates which had remained generally close to the reverse repo rate during the most part of the first half of 2005-06 crossed the repo rate during the fourth quarter. Interest rates in the collateralised segment of money markets also edged up during the year, although they remained below the repo rate during the fourth quarter. The foreign exchange market remained more or less orderly, exhibiting two-way movements. Yields in the Government securities market hardened during 2005-06, with the increase at the longer end less than at the short-end. 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. Resources raised by the Indian corporates through domestic as well as Euro issues increased substantially. The stock indices reached record highs, driven by increased interest by domestic as well as foreign investors on the back of strong macroeconomic fundamentals (Table 37).

Money Market

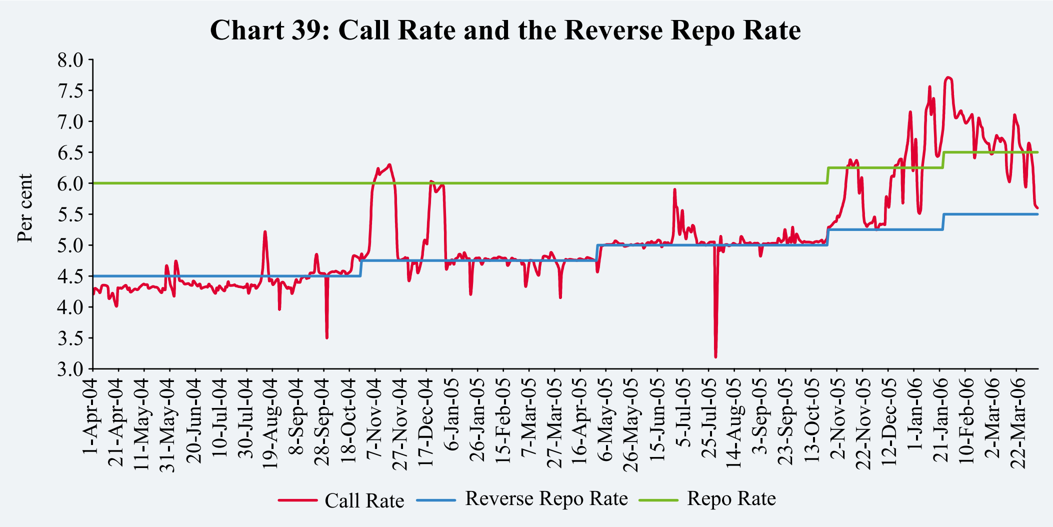
Money market conditions, which remained comfortable up to October 2005, turned somewhat tight thereafter. During April 2005, the Reserve Bank supplemented reverse repo operations with the sale of Government paper under the Market Stabilisation Scheme (MSS) to absorb liquidity and balance market conditions. Average daily call money borrowing rates ruled at sub-reverse repo

Table 37: Domestic Financial Markets at a Glance

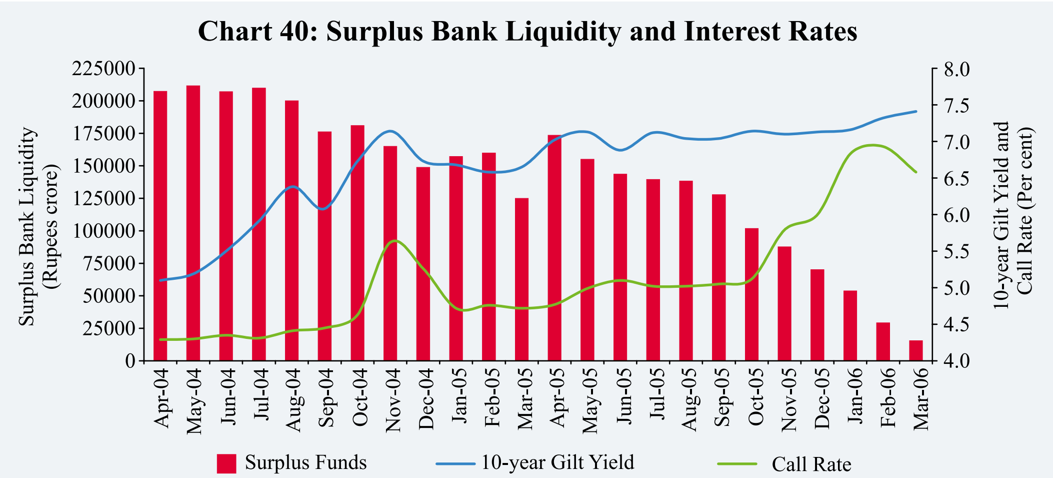
Month	Call Money		Government Securities		Foreign Exchange				Liquidity Management		Equity			
	Average Daily Turnover (Rs. crore)	Average Call Rates* (Per cent)	Average 10-Year Yield@ (Per cent)	Average Turnover in Govt. Securities (Rs. crore)+	Average Daily Inter-bank Turnover (US $ million)	Average Exchange Rate (Rs. per US $)	RBI's net Foreign Currency Sales(-)/ Purchases (+) (US $ million)	Average Forward Premia 3-month (Per cent)	Average MSS Out-standing# (Rs. crore)	Average Daily Reverse Repo (LAF) Out-standing (Rs. crore)	Average Daily BSE Turnover (Rs. crore)	Average Daily NSE Turnover (Rs. 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														
April	12,916	4.29	5.10	10,029	10,302	43.93	7,427	- 0.35	14,296	75,006	2,243	5,048	5809	1848
May	10,988	4.30	5.19	6,202	8,882	45.25	-220	-1.33	27,518	74,502	2,188	4,710	5205	1640
June	10,974	4.35	5.50	5,860	7,847	45.51	-413	0.93	35,283	61,981	1,681	3,859	4824	1506
July	8,632	4.31	5.91	4,206	7,756	46.04	-1,180	2.25	43,739	59,594	1,793	4,265	4973	1568
August	11,562	4.41	6.38	4,173	5,947	46.34	-876	2.85	48,541	42,692	1,736	3,948	5144	1615
September	17,088	4.45	6.08	5,854	7,348	46.10	19	2.20	52,421	31,589	1,800	4,023	5423	1692
October	16,666	4.63	6.73	3,636	7,262	45.78	-99	2.87	53,660	10,805	1,730	3,785	5702	1795
November	13,820	5.62	7.14	2,607	9,930	45.13	3,792	2.20	54,157	-5,066	1,787	4,102	5961	1874
December	19,526	5.28	6.72	4,305	9,447	43.98	1,393	2.02	52,058	7,570	2,184	5,026	6394	2022
January	16,534	4.72	6.68	3,566	9,114	43.75	0	2.50	53,790	18,721	2,310	5,249	6307	1978
February	16,041	4.76	6.58	4,640	11,583	43.68	4,974	1.99	58,141	19,895	2,484	4,999	6595	2067
March	15,294	4.72	6.65	2,835	11,286	43.69	6,030	1.82	63,737	29,809	2,706	5,139	6679	2096
2005-06														
April	17,213	4.77	7.02	3,001	9,880	43.74	0	1.96	65,638	30,675	1,890	4,136	6379	1987
May	15,269	4.99	7.13	3,805	10,083	43.49	0	1.57	68,539	22,754	1,971	3,946	6483	2002
June	20,134	5.10	6.88	6,807	10,871	43.58	-104	1.40	70,651	13,916	2,543	4,843	6926	2134
July	20,046	5.02	7.13	3,698	11,003	43.54	2,473	1.56	70,758	10,754	3,095	6,150	7337	2237
August	16,158	5.02	7.04	4,239	11,749	43.62	1,552	0.69	71,346	34,832	3,452	6,624	7726	2358
September	16.292	5.05	7.04	5,207	11,040	43.92	0	0.62	67,617	31,570	3,871	6,923	8272	2512
October	17,164	5.12	7.13	2,815	13,087	44.82	0	0.69	68,602	18,608	2,955	6,040	8220	2487
November	22,620	5.79	7.10	3,314	11,228	45.73	0	0.67	67,041	3,268	2,635	5,480	8552	2575
December	21,149	6.00	7.13	2,948	13,632 P	45.64	-6,541	1.51	52,040	1,452	3,516	6,814	9162	2773
January	17,911	6.83	7.16	3,094	16,365 P	44.40	0	2.60	40,219	-15,386	3,966	7,472	9540	2893
February	13,497	6.93	7.32	2,584	15,644 P	44.33	2,614	2.85	33,405	-13,532	3,687	7,125	10090	3019
March	18,290	6.58	7.41	2,203	n.a.	44.48	n.a.	3.11	29,652	-6,017	5,398	9,518	10857	3236

* : Average of daily weighted call money borrowing rates.
@ : Average of daily closing rates.
MSS : Market Stabilisation Scheme.
\# : Average of weekly outstanding MSS.
\+ : Average daily outright turnover in Central Government dated securities.
** : Average of daily closing indices.
BSE : The Stock Exchange, Mumbai.
P : Provisional
LAF : Liquidity Adjustment Facility.
NSE : National Stock Exchange of India Ltd.
n.a. : Not available.
Note : In column 11, (+) indicates absorption and (-) indicates injection of liquidity.

rate levels on many occasions. 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. Liquidity conditions improved by the second half of July 2005 due to cancellation of some scheduled Treasury Bills auctions and return of advance tax payments to the banking system. Large foreign currency purchases from the authorised dealers during July-August 2005 also improved liquidity conditions. This was reflected in a jump in average balances under LAF reverse repos from Rs.10,754 crore in July to Rs.34,832 crore in August 2005. The call money market, thus, remained broadly stable during August 2005 and first half



of September 2005. During the second half of September 2005, the call money market witnessed mild pressure, on account of advance tax outflows and scheduled auctions. For the most part of October 2005, the call money rate hovered around the reverse repo rate as liquidity conditions remained comfortable (Charts 39 and 40). 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. The notified amount of Treasury Bills auctions under the MSS was also cancelled.



Surplus Funds: Net demand and time liabilities in excess of statutory pre-emptions and credit off-take.

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.

Beginning with the second half of December 2005, call money rates again edged up as the market witnessed frictional liquidity pressures emanating from sustained large credit offtake and quarter-end advance tax payments amidst uncertainty relating to the redemption of IMDs. The call money rates hovered above the repo rate for the most part of the fourth quarter of 2005-06. In contrast, the interest rates in the collateralised segments of the money market – which account for a growing and predominant share (about 70 percent) of the total money market turnover – remained below the repo rate (Chart 41). For instance, the rates in the Collateralised Borrowing and Lending Obligation (CBLO) segment averaged 6.23 per cent during January-February 2006, lower than that of 6.88 per cent in the call money market. The higher call money rates during the last quarter of 2005-06 reflected not only liquidity pressures but also the divergent nature of the overnight markets between the collateralised and uncollateralised segments. The call rates eased from the second half of March 2006, reflecting improvement in liquidity conditions. The call money rate was 5.55 per cent as on April 12, 2006. The turnover in the call/notice money market during 2005-06 remained range-bound, in contrast to the uptrend in the collateralised segments. This reflected the relatively higher rates in the call money market as well as the process of phasing out of non-bank participants from the call money market, which was completed on August 6, 2005 (Table 38). The supply of funds in the CBLO segment has been augmented by the participation of banks, mutual funds and financial institutions. Members operating in the CBLO segment of the Clearing Corporation of India Limited (CCIL) increased from 110 as on March 31, 2005 to 152 as on March 31, 2006.

Chart 41: Money Markets – Interest Rates and Turnover

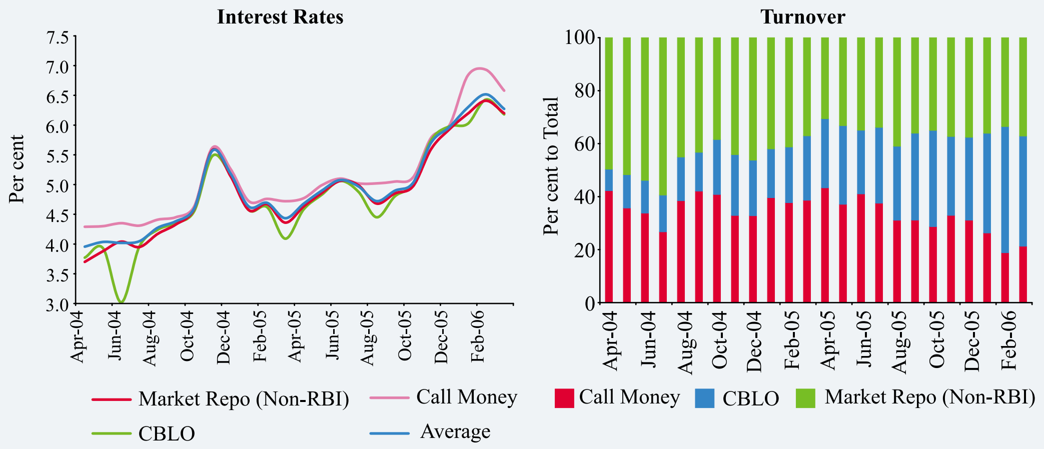


Table 38: Activity in Money Market Segments

(Rupees crore)

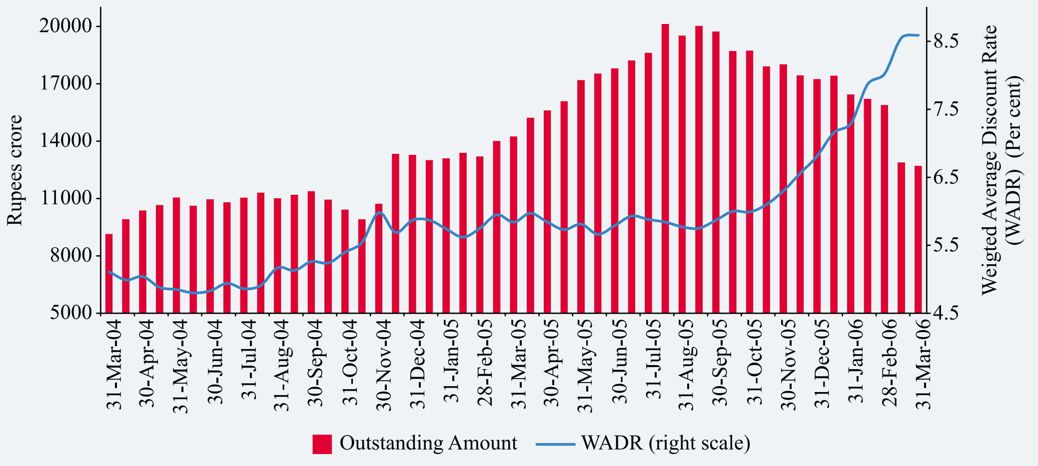
Month	Average Daily Turnover				Outstanding Amount		Forward Rate Agreements/ Interest Rate Swaps (Notional Amount)
	Call Money Market	Term Money Market	Repo Market (Outside the LAF)	Collateralised Borrowing and Lending Obligation (CBLO)	Commercial Paper	Certificates of Deposit	
1	2	3	4	5	6	7	8
2004-05							
April	12,916	325	15,195	2,496	10,362	4,725	5,76,808
May	10,988	372	15,932	3,872	11,038	4,860	6,11,595
June	10,974	274	17,517	4,015	10,950	5,438	6,04,669
July	8,632	445	19,226	4,508	11,038	5,478	5,90,118
August	11,562	311	13,561	4,962	11,002	4,480	6,40,173
September	17,088	487	18,178	6,149	11,371	5,112	8,53,195
October	16,666	539	15,719	8,466	10,409	4,785	9,25,175
November	13,820	407	18,560	9,651	10,719	6,118	9,50,151
December	19,526	504	21,922	9,962	13,272	6,103	9,75,135
January	16,534	514	17,556	7,701	13,092	4,236	10,14,442
February	16,041	878	17,562	8,952	13,189	9,214	9,46,293
March	15,294	1,253	14,688	9,625	14,235	12,078	10,62,242
2005-06							
April	17,213	661	12,174	10,370	15,598	16,602	10,76,513
May	15,269	545	13,688	12,233	17,182	17,689	10,72,684
June	20,134	534	17,163	11,792	17,797	19,270	10,93,367
July	20,046	717	18,103	15,292	18,607	20,768	12,18,072
August	16,158	754	21,325	14,544	19,508	23,568	13,15,084
September	16,292	1,116	18,872	17,143	19,725	27,641	13,17,829
October	17,164	734	20,980	21,763	18,726	29,193	13,42,335
November	22,620	917	25,660	20,496	18,013	27,457	14,75,384
December	21,149	775	25,574	21,265	17,234	32,806	13,92,606
January	17,911	1,089	24,596	25,634	16,431	34,521	13,16,351
February	13,497	813	24,096	34,162	15,876	33,986	13,37,720
March	18,290	1,338	31,964	35,775	12,693 *	36,931 #	n.a.

n.a. : Not available. * : Provisional. # : As on March 17, 2006.

Other Money Market Instruments

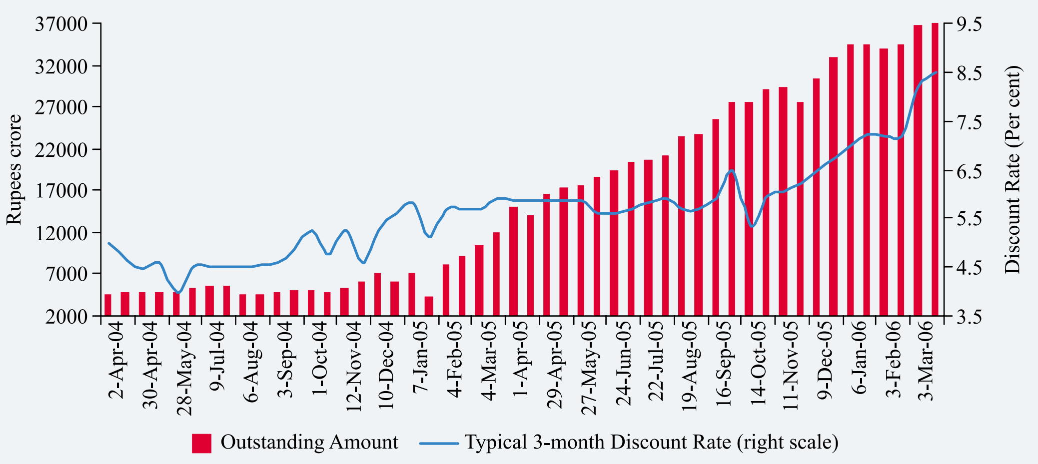
Issuances of commercial paper (CP), which had exhibited sustained increases till mid-September 2005, witnessed a slowdown during the second half of 2005-06, reflecting tight liquidity conditions. Outstanding CPs after increasing from Rs.14,235 crore at end-March 2005 to Rs.20,019 crore by mid-September 2005 declined to Rs.12,693 crore by end-March 2006 (Chart 42). 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. Leasing and finance companies with their share at 74.1 per cent (as on March 31, 2006) continued to be the largest issuers of CPs, partly reflecting the policy of phasing out the access to these companies to public deposits. Manufacturing and other companies and financial institutions are the other major issuers with shares of 15.4 per cent and 10.5 per cent, respectively, as on March 31, 2006.

Chart 42: Commercial Paper



Issuances of certificates of deposit (CDs) increased sharply during 2005-06, reflecting banks' demand for funds in the wake of acceleration in demand for bank credit (Chart 43). The amount of CDs outstanding nearly trebled during 2005-06 from Rs.12,078 crore at end-March 2005 to Rs.36,931 crore by March 17, 2006 (constituting 4.3 per cent of aggregate deposits of issuing banks, broadly the same as a year ago). The increase in the outstanding amount was mainly on account of higher issuances by some private sector banks, reflecting the cost attractiveness of the CDs to the banks *vis-à-vis* time deposits. The higher recourse to CDs was also driven by reduction in the minimum maturity period to seven days. The typical three-month discount rate on CDs at 8.50 per cent on March

Chart 43: Certificates of Deposit



17, 2006 was higher by 263 basis points over its level at end-March 2005. As in the case of CPs, mutual funds have emerged as key investors in CDs.

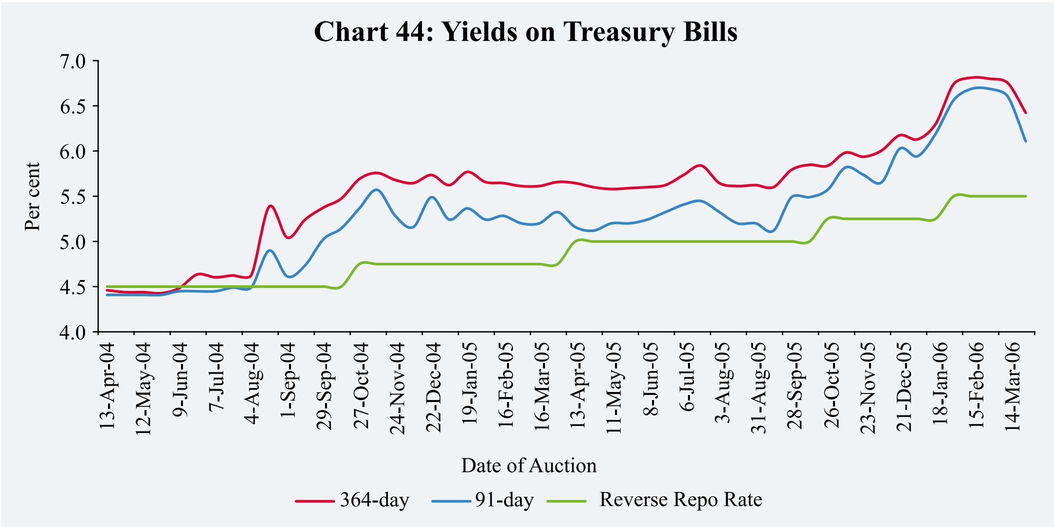
Treasury Bills

Yields in Treasury Bills (TB) auctions increased during 2005-06, reflecting tight liquidity conditions. After remaining generally range-bound during the first half of 2005-06, the yields edged higher in the subsequent months. In view of the prevalent liquidity conditions, the Reserve Bank rejected all the bids for the Treasury Bills auctions under the MSS scheduled on November 9, 2005 and discontinued the auctions under the MSS from November 16, 2005. The yields after having recorded a sharp increase during January-February 2006, however, eased during March 2006 reflecting improvement in liquidity conditions. Yields in March 2006 were 103-127 basis points higher over their March 2005 levels. The yield spread between the 91-day and 364-day TBs was 15 basis points during March 2006 as compared with 39 basis points during March 2005 (Table 39 and Chart 44).

Table 39: Treasury Bills in the 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
2004-05							
April	13,500	4.38		4.44	2.15		2.47
May	12,000	4.39		4.33	2.93		2.46
June	14,000	4.44		4.55	2.61		1.28
July	10,000	4.46		4.60	2.39		2.06
August	10,000	4.76		5.00	1.81		3.36
September	12,000	4.72		5.14	2.51		2.83
October	16,000	5.15		5.46	1.82		2.75
November	5,500	5.47		5.71	2.80		2.64
December	9,500	5.30		5.69	2.69		2.81
January	12,000	5.31		5.69	2.19		2.06
February	12,000	5.25		5.65	2.99		2.81
March	12,000	5.24		5.63	2.31		2.74
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	18,000	5.29	5.37	5.61	1.54	2.42	1.81
July	11,500	5.46	5.67	5.81	1.21	2.58	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	5.87	5.96	2.12	1.97	2.30
December	5,000	5.89	6.04	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

Note : 182-day TBs were reintroduced with effect from April 2005.



Foreign Exchange Market

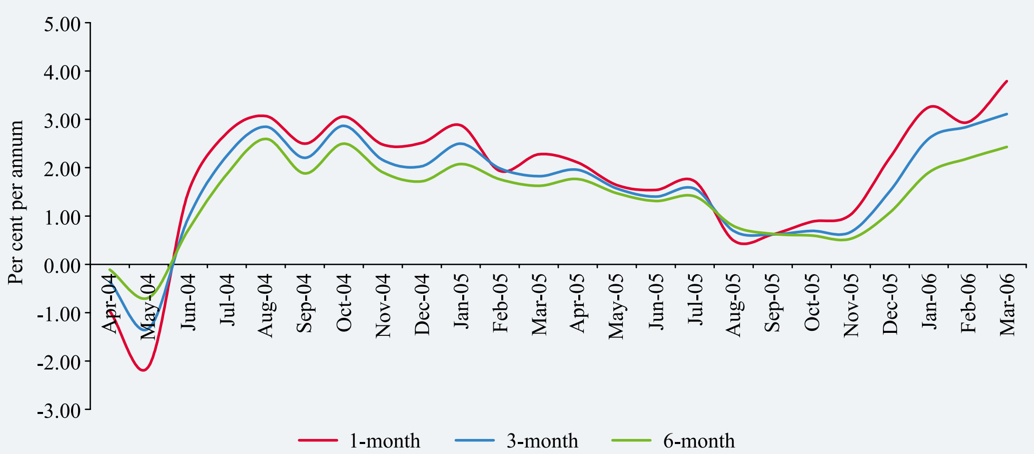
In the foreign exchange market, the Indian rupee exhibited two-way movement *vis-à-vis* the US dollar during 2005-06, moving in a range of Rs.43.30–46.33 per US dollar. The rupee initially appreciated against the US dollar from Rs.43.76 at end-March 2005 to Rs.43.30 per US dollar on May 12, 2005, despite outflows by FIIs and a higher merchandise trade deficit. Subsequently, the rupee depreciated reaching Rs.43.76 per US dollar on June 2, 2005 due to strengthening of the US dollar in the international markets. With the revaluation of the Chinese renminbi on July 21, 2005, there were appreciation pressures and 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. The rupee again came under pressure from end-August 2005 under the impact of high 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. It touched Rs.44.07 per US dollar on January 31, 2006. During February-March 2005, the rupee was largely range-bound and stood at Rs.44.61 per US dollar as on March 31, 2006 and at this level, the Indian rupee depreciated by 1.9 per cent over its level on March 31, 2005. Reflecting cross-currency movements, the rupee, however, appreciated against the other major international currencies during 2005-06, *i.e.*, 4.4 per cent against the Euro, 5.5 per cent against the Pound sterling and 7.3 per cent against the Japanese yen (Chart 45). The exchange rate of the Indian rupee was Rs. 44.92 per US dollar as on April 12, 2006.

Forward premia declined during the first half of 2005-06 in tandem with the narrowing of interest differential following the higher pace of monetary

Chart 45: Movement of Rupee *vis-a-vis* Major Currencies

tightening in the US. The premia, however, increased during December 2005-March 2006, reflecting higher domestic call money rates (Chart 46).

Chart 46: Movement in Forward Premia



Credit Market

The demand for credit from the commercial sector strengthened further during 2005-06. The non-food credit extended by scheduled commercial banks as on March 31, 2006 grew (year-on-year) by 30.8 per cent on top of 28.8 per cent growth a year ago (net of conversion). Demand for bank credit was broad-based led by agriculture, industry and personal loans (housing, credit cards, education) sectors (Table 40). Disaggregated data show that almost 26 per cent of incremental non-food credit during April-January 2005-06 went to the industrial sector, while almost

Table 40: Deployment of Non-food Bank Credit

(Amount in Rupees crore)

Sector/Industry	Outstanding as on January 20, 2006	Financial Year Variations			
		2004-05 (Apr-Jan)		2005-06 (Apr-Jan)	
		Absolute	Per cent	Absolute	Per cent
1	2	3	4	5	6
Non-food Gross Bank Credit (1 to 6)	**12,56,368**	**1,34102**	**18.4**	**2,56,580**	**25.7**
1. Agriculture and Allied Activities	**1,53,339**	**17,155**	**18.9**	**28,089**	**22.4**
2. Industry (Small, Medium and Large)	**4,93,372**	**35,485**	**11.3**	**66,480**	**15.6**
Small Scale Industries	82,041	3,211	4.9	7,453	10.0
3. Services	**42,633**	n.a.	n.a.	**12,049**	**39.4**
Transport Operators	11,589	n.a.	n.a.	1,990	20.7
Professional & Others	14,774	n.a.	n.a.	1,513	11.4
4. Personal Loans	**3,13,466**	n.a.	n.a.	**68,386**	**27.9**
Housing	1,66,159	n.a. (20,581)	n.a. (39.6)	37,431	29.1
Advances against Fixed Deposits	32,228	-585	-2.2	2,378	8.0
Credit Cards	8,832	n.a.	n.a.	3,072	53.3
Education	9,003	n.a.	n.a.	3,884	75.9
Consumer Durables	8,863	-211	-2.6	-220	-2.4
5. Trade	**71,923**	**6,601**	**26.5**	**13,975**	**24.1**
6. Others	**1,81,635**	**74,861**	**25.0**	**67,601**	**59.3**
Real Estate Loans	24,527	4,150	74.4	11,225	84.4
Non-Banking Financial Companies	28,507	-24	-0.1	6,023	26.8
Memo:					
Priority Sector	**4,59,648**	**48,303**	**18.3**	**78,172**	**20.5**
Industry (Small, Medium and Large)	**4,93,372**	**35,485**	**11.3**	**66,480**	**15.6**
Food Processing	28,311	187	0.9	3,878	15.9
Textiles	52,966	2,823	8.3	8,989	20.4
Paper & Paper Products	8,532	-283	-4.7	1,650	24.0
Petroleum, Coal Products & Nuclear Fuels	17,772	1,609	13.1	2,203	14.1
Chemical and Chemical Products	44,757	-460	-1.5	5,265	13.3
Rubber, Plastic & their Products	6,069	298	11.5	2,403	65.5
Iron and Steel	43,842	1,147	4.4	7,841	21.8
Other Metal & Metal Products	13,682	1,349	16.5	2,046	17.6
Engineering	32,309	-904	-3.4	2,913	9.9
Vehicles, Vehicle Parts and Transport Equipments	16,826	556	10.5	4,964	41.8
Gems & Jewellery	18,582	1,678	18.3	4,276	29.9
Construction	11,818	1,838	30.7	3,696	45.5
Infrastructure	1,01,726	16,884	32.9	22,717	28.8

n.a. : Not available.

Note : 1. Data are provisional and relate to select scheduled commercial banks which account for about 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 lakhs. Data on housing loans for 2005-06, on the other hand, are also inclusive of loans less than Rs.15 lakhs.

15 per cent of incremental non-food credit was on account of housing loans and another 11 per cent of incremental credit was absorbed by the agricultural sector and allied activities. The increase in industrial credit in consonance with sustained growth in domestic industrial production was mainly on account of infrastructure (*viz.*, power, roads, ports and telecommunications), textiles, iron and steel, chemicals, vehicles, gems and jewellery, food processing and construction. Infrastructure sector alone accounted for more than a third of incremental credit to the industry, while textiles and iron and steel industries absorbed another one-fourth of the incremental credit to the industry. Credit to agriculture recorded a robust growth, reflecting the impact of various policy initiatives to improve the flow of credit to the sector. Credit to the housing sector continued to be strong, benefiting from low interest rates and tax incentives. Apart from housing, strong credit demand emanated for education and other personal loans as well as from credit card holders. Credit to the commercial real estate increased sharply, although it still constitutes only a small part - less than two per cent of outstanding non-food bank credit and around four per cent of incremental non-food credit. Loans to shipping and tourism related companies also recorded a sharp rise.

As noted in Section III, banks were able to finance the sustained credit demand through liquidation of their investments in Government as well as non-SLR securities, continuous access to funding from FIs, raising of capital through equity issuances, higher internal resources and higher deposit mobilisation.

During the second half of 2005-06, banks increased their deposit rates by about 75-100 basis points across various maturities (Table 41). As regards lending rates, some private sector banks increased their Benchmark Prime Lending Rates (BPLRs), while some other banks revised upwards their sub-PLRs.

Government Securities Market

Yields in the Government securities market hardened during 2005-06, with the increase being more pronounced at the short-end of the market. Intra-year movements in yields were influenced by domestic liquidity conditions, inflationary expectations, volatility in crude oil prices and movements in US yields. Yields edged higher in the second week of April 2005, reflecting concerns arising from the persistent rise in international crude oil prices, higher than expected inflation and the hike in the reverse repo rate. The 10-year benchmark yield firmed up from 6.65 per cent on March 31, 2005 to 7.31 per cent on April 30, 2005. With the easing of headline WPI inflation, yields softened during May 2005 touching 6.94 per cent in early June 2005. The yields edged up again during the first half of July 2005 reaching 7.23 per cent on July 13, driven by higher crude oil prices, liquidity concerns and anticipation of an increase in the reverse repo rate. With the reverse repo rate being left unchanged on July 26, 2005 in the First Quarter Review of the Annual Statement on Monetary Policy and comfortable

Table 41: Movements in Deposit and Lending Rates

(Per cent)

Interest Rate	March 2004	March 2005	June 2005	September 2005	December 2005	March 2006@
1	2	3	4	5	6	7
1. Domestic Deposit Rate						
Public Sector Banks						
Up to 1 year	3.75-5.25	2.75-6.00	2.75-6.00	2.00-6.00	2.00-6.00	2.25-6.25
More than 1 year and up to 3 years	5.00-5.75	4.75-6.50	5.25-6.25	5.25-6.25	5.50-6.50	5.50-6.50
More than 3 years	5.25-6.00	5.25-7.00	5.50-6.50	5.50-6.00	5.80-7.00	6.25-7.00
Private Sector Banks						
Up to 1 year	3.00-6.00	3.00-6.25	3.00-6.25	3.00-6.25	3.50-6.25	3.50-7.00
More than 1 year and up to 3 years	5.00-6.50	5.25-7.25	5.00-7.00	5.00-7.00	5.50-7.00	5.50-7.75
More than 3 years	5.25-7.00	5.75-7.00	5.50-7.25	5.75-7.25	6.00-7.25	5.75-7.75
Foreign Banks						
Up to 1 year	2.75-7.75	3.00-6.25	3.00-5.50	3.00-5.75	3.00-5.75	3.00-6.15
More than 1 year and up to 3 years	3.25-8.00	3.50-6.50	3.50-6.50	3.50-6.50	4.25-6.00	3.65-6.50
More than 3 years	3.25-8.00	3.50-7.00	4.00-7.00	4.00-7.00	5.00-7.00	4.05-6.50
2. Benchmark Prime Lending Rate						
Public Sector Banks	10.25-11.50	10.25-11.25	10.25-11.25	10.25-11.25	10.25-11.25	10.25-11.25
Private Sector Banks	10.50-13.00	11.00-13.50	11.00-13.50	11.00-13.50	11.00-13.50	11.00-14.00
Foreign Banks	11.00-14.85	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	4.00-16.00	2.75-16.00	3.35-16.50	4.00-16.50	4.00-16.50	n.a.
Private Sector Banks	3.00-22.00	3.15-22.00	3.15-24.94	3.15-20.22	3.15-20.50	n.a.
Foreign Banks	3.75-23.00	3.55-23.50	4.00-25.00	2.86-25.00	2.86-24.00	n.a.

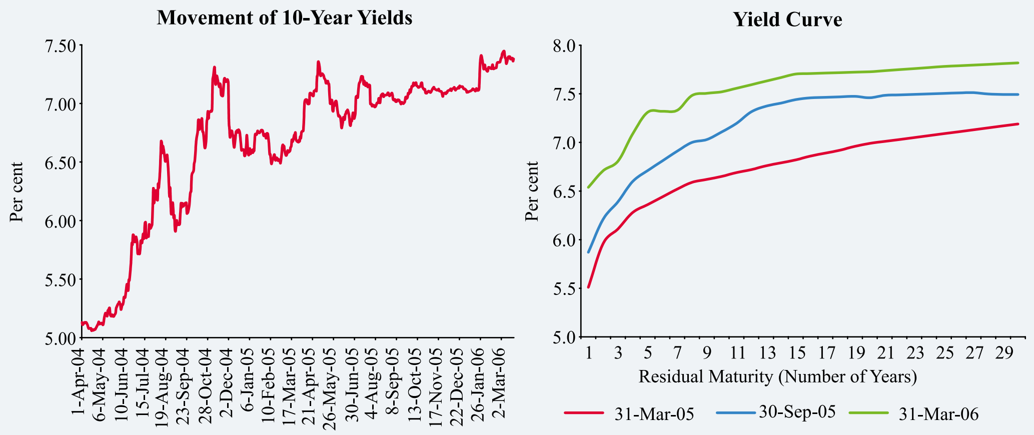
n.a. : Not available. @ : As on March 17, 2006.

* : 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.

liquidity conditions, yields softened, reaching 6.98 per cent on July 29, 2005. Although the reverse repo rate was increased by 25 basis points in the Mid-Term Review (October 25, 2005) and the money markets were marked by liquidity tightness during November-December 2005, the yields remained broadly stable - hovering at around seven per cent - during August-December 2005 on the back of easing of headline inflation. The yields edged up during January 2006 in tandem with an increase in the reverse repo rate by 25 basis points in the Third Quarter Review (January 24, 2006) and remained largely range bound during February-March 2006. The 10-year yield was 7.52 per cent on March 31, 2006, 87 basis points higher than its end-March 2005 level. 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), 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), reflecting increased appetite for long-term securities from non-bank participants such as insurance companies and pension funds (Chart 47). The 10-year yield was 7.56 per cent as on April 12, 2006.

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-

Chart 47: Yields on Central Government Securities

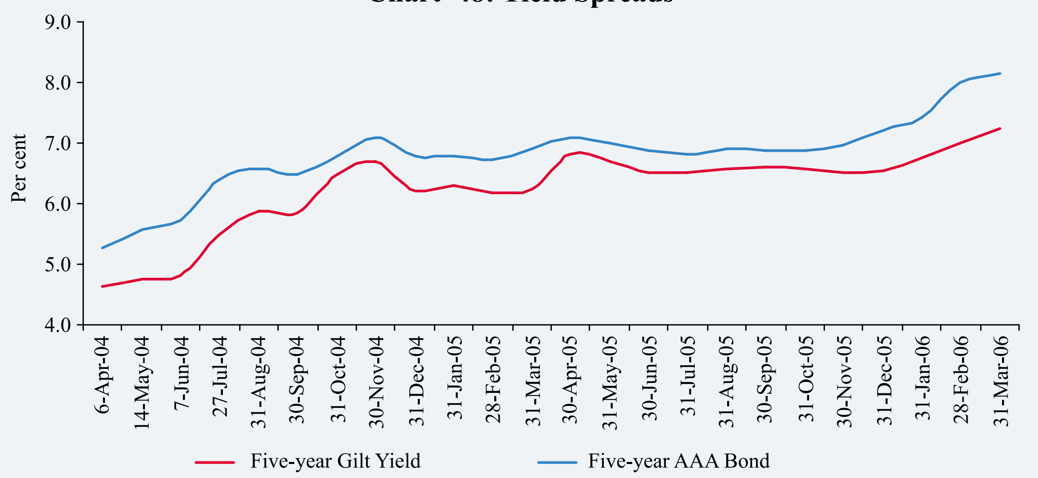


year Government securities - after remaining broadly stable at 30 basis points during April-October 2005 - increased to 98 basis points at end-March 2006 from 67 basis points at end-March 2005 (Chart 48).

Equity Market

The capital market exhibited buoyancy during 2005-06, with the benchmark stock indices reaching record highs driven by strong support from foreign institutional investors (FIIs) and domestic mutual funds on the back of robust macroeconomic fundamentals, congenial investment climate and strong corporate profitability. Resources raised by the Indian corporates through initial

Chart 48: Yield Spreads



public offerings, private placements and Euro issues increased significantly. Resource mobilisation by mutual funds also increased sharply.

Primary Market

Resources raised through the public issues increased by 50.5 per cent to Rs.25,649 crore during April-February 2005-06 (Table 42). However, the average size of issue declined to Rs.217 crore from Rs.370 crore during the corresponding period of the previous year. Non-Government public limited companies (private sector) accounted for the bulk (77.4 per cent) of the resources mobilised. Out of 118 issues, 67 issues were initial public offerings (IPOs), constituting 47.0 per cent of resource mobilisation as compared with 19 out of 46 issues being IPOs during the corresponding period of the last year (constituting 25.2 per cent of resource mobilisation). All the IPOs in the current financial year so far have been by companies in the private sector, barring one which was from a public sector non-financial company. Resource mobilisation by way of debt issues during April-February 2005-06 was less than one per cent of total resource mobilisation from the public issues market.

Table 42: Mobilisation of Resources from the Primary Market

(Amount in Rupees crore)

Item	April-February 2004-05		April-February 2005-06 P	
	No. of Issues	Amount	No. of Issues	Amount
1	2	3	4	5
A. Prospectus and Rights Issues*				
1. Private Sector (a+b)	**43**	**12,020**	**111**	**19,863**
a) Financial	9	5,108	9	7,575
b) Non-financial	34	6,912	102	12,288
2. Public Sector (a+b+c)	**3**	**5,018**	**7**	**5,786**
a) Public Sector Undertakings	-	-	-	-
b) Government Companies	1	2,684	1	373
c) Banks/Financial Institutions	2	2,334	6	5,413
3. Total (1+2)	**46**	**17,038**	**118**	**25,649**
Of which:				
(i) Equity	43	13,729	117	25,531
(ii) Debt	3	3,309	1	118
B. Private Placement +				
1. Private Sector	**533**	**25,543**	**672**	**29,547**
a) Financial	198	13,894	281	18,242
b) Non-financial	335	11,649	391	11,305
2. Public Sector	**121**	**23,345**	**108**	**37,741**
a) Financial	79	14,320	84	25,477
b) Non-financial	42	9,025	24	12,264
3. Total (1+2)	**654**	**48,887**	**780**	**67,288**
Memo:				
Euro Issues	**11**	**2,606**	**43**	**10,099**

P : Provisional. * : Excluding offers for sale. – : Nil/Negligible. + : April-December 2005.

Mobilisation of resources through private placement increased by 37.6 per cent during April-December 2005 as compared with an increase of 15.4 per cent during April-December 2004 (Table 42). This was mainly on account of a turnaround in resources mobilised by public sector entities - an increase of 61.7 per cent during April-December 2005 as against a decline of 21.1 per cent during April-December 2004. Public sector entities accounted for 56.1 per cent of total mobilisation through private placement during April-December 2005 as compared with 47.8 per cent during the same period of last year. Resources raised by financial intermediaries (both from public sector and private sector) accounted for 65.0 per cent of the total mobilisation by private placement during April-December 2005 (57.7 per cent during April-December 2004).

In addition to domestic issuances, the Indian corporates also took a large recourse to Euro issues – American Depository Receipts (ADRs), Global Depository Receipts (GDRs) and Foreign Currency Convertible Bonds (FCCBs). Amounts mobilised through the euro issues more than trebled to Rs.10,099 crore during April-February 2005-06 (Table 42).

Net mobilisation of funds (net of redemptions) by mutual funds also increased substantially by 591.0 per cent to Rs.44,973 crore during April-February 2005-06 over the corresponding period of the previous year (Table 43). Net inflows were witnessed in the case of both income/debt-oriented schemes and growth/equity-oriented schemes.

Secondary Market

The stock markets witnessed bullish conditions during 2005-06 with the benchmark indices touching all time high levels, driven mainly by support from the FIIs on the back of strong macroeconomic fundamentals of the Indian economy, congenial investment climate, sound business outlook and robust corporate earnings (Table 44). Profits after tax of sample 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 profitability decelerated, but still remains high given the strong base of the previous

Table 43: Resource Mobilisation by Mutual Funds

(Rupees crore)

Mutual Fund	2004-05 (April-February) Gross Mobilisation	Net Mobilisation @	Net Assets *	2005-06 (April- February) Gross Mobilisation	Net Mobilisation @	Net Assets *
1	2	3	4	5	6	7
Private Sector	6,51,929	9,192	1,21,114	8,00,735	32,756	1,67,021
Public Sector	50,244	216	11,303	97,019	9,628	23,067
UTI	40,006	-2,899	20,836	63,996	2,589	27,619
Total	**7,42,179**	**6,509**	**1,53,253**	**9,61,750**	**44,973**	**2,17,707**

@ : Net of redemptions. * : As at end of February.
Source : Securities and Exchange Board of India.

Table 44: Corporate Financial Performance

(Growth rates in per cent)

	2003-04	2004-05	2004-05 (April-December)	2005-06 (April-December)	2004-05 Q1	2004-05 Q2	2004-05 Q3	2004-05 Q4	2005-06 Q1	2005-06 Q2	2005-06 Q3
1	2	3	4	5	6	7	8	9	10	11	12
Sales	15.4	25.2	25.9	15.7	24.8	23.7	24.1	21.0	18.5	16.4	13.2
Expenditure	12.5	24.0	24.9	15.3	23.4	22.4	24.3	19.8	18.0	16.3	12.7
Gross Profit	26.6	38.9	37.8	24.1	36.0	35.8	30.5	35.3	32.0	19.1	21.2
Interest Cost	-11.5	-2.0	-2.1	-6.4	-3.2	2.1	-13.0	-5.4	-13.5	-8.0	4.6
Profits After Tax	57.9	53.8	48.0	35.0	51.2	45.3	45.5	51.4	54.2	27.5	27.0
Memo:											
(Amount in Rupees crore)											
No. of Companies	2,201	1,273	895	2,010	1,255	1,353	1,464	1,301	2,355	2,361	2,366
Sales	4,28,072	5,68,476	3,63,140	5,77,271	1,35,156	1,53,040	1,62,193	1,79,632	1,94,608	2,12,693	2,19,098
Expenditure	4,06,838	4,90,204	3,11,105	4,95,121	1,15,656	1,31,227	1,40,574	1,56,647	1,66,972	1,83,717	1,88,934
Gross Profit	48,852	72,406	47,591	77,286	17,234	20,448	20,017	23,736	25,577	27,620	28,135
Interest Cost	14,724	12,528	7,831	12,140	3,597	3,584	3,273	3,177	4,241	4,467	4,555
Profits After Tax	26,281	47,333	31,066	51,364	10,396	13,004	13,196	16,798	16,726	18,169	18,790

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) which are based on audited balance- sheets for 2003-04.

quarters. Liquidity support from mutual funds, firm trends in the major international equity markets and surge in ADR prices also buoyed up stock markets. Positive measures announced in the Union Budget, 2006-07 such as raising FII investment limit in Government securities and corporate debt, treating open-ended and close-ended equity-oriented schemes on par for dividend distribution tax, rationalisation of excise duties and relaxation in fringe benefit tax also helped to boost the market sentiment. Reflecting all these factors, the BSE Sensex reached an all time high level of 11,747 on April 5, 2006 (Chart 49).

Chart 49: Indian Stock Markets

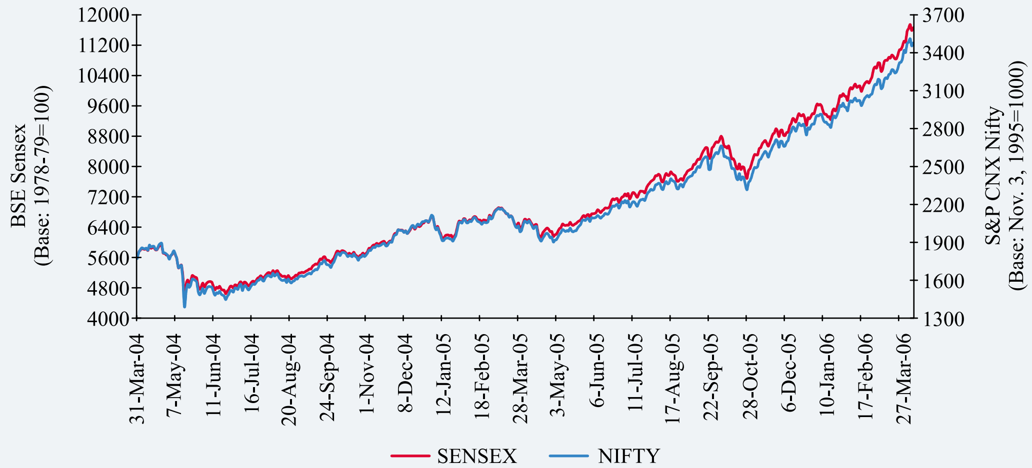


Table 45: Stock Market Indicators

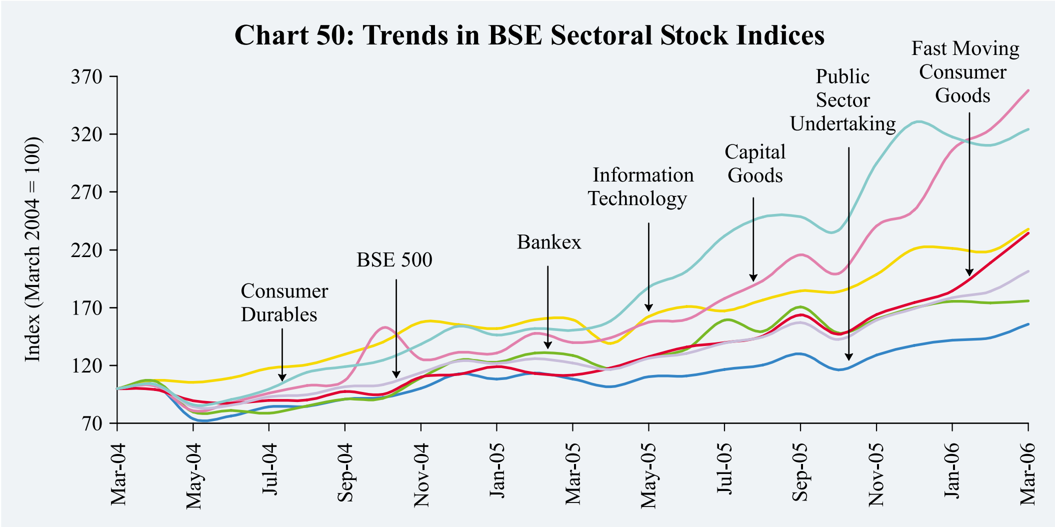
Indicators	BSE			NSE		
	2003-04	2004-05	2005-06	2003-04	2004-05	2005-06
1	2	3	4	5	6	7
BSE Sensex / S&P CNX Nifty						
End-period	5591	6493	11280	1772	2036	3403
Average	4492	5741	8280	1428	1805	2517
Volatility (CV)	22.95	11.16	16.68	23.30	11.28	15.59
P/E Ratio (End-period)*	18.57	15.61	20.92	20.70	14.60	20.26
Turnover (Rupees crore)	5,03,053	5,18,716	8,16,074 P	10,99,535	11,40,071	15,69,555
Market Capitalisation (Rupees crore) (End-period)	12,01,207	16,98,429	30,22,189	11,20,976	15,85,585	28,13,201

P: Provisional. CV: Coefficient of Variation.
* : For 30 scrips included in the BSE Sensex and 50 scrips included in the S&P CNX Nifty.
Source : The Stock Exchange, Mumbai (BSE) and National Stock Exchange of India Ltd. (NSE).

The market witnessed some correction on April 12, 2006 and the BSE Sensex was 11,356 as on April 12, 2006.

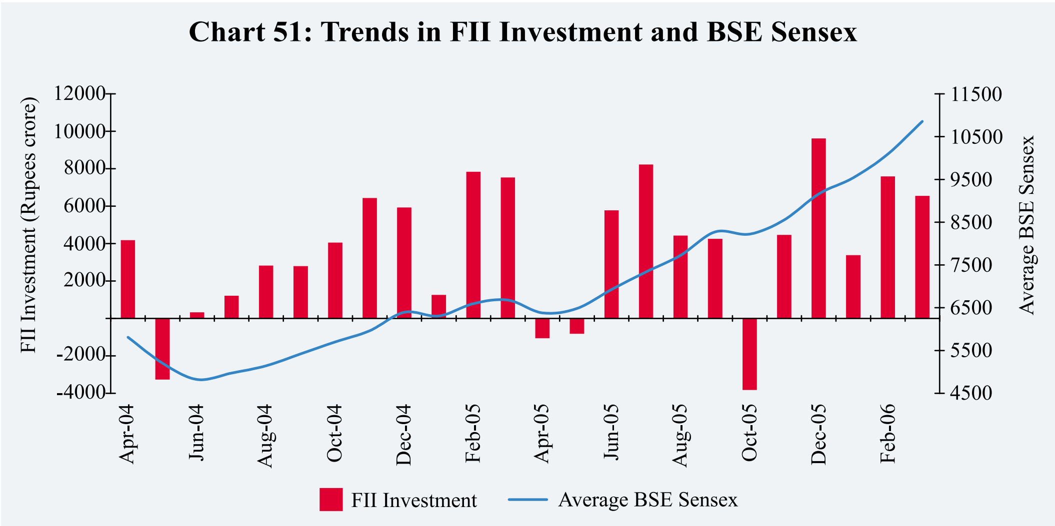
The BSE Sensex increased by 73.7 per cent between end-March 2005 and end-March 2006, while the S&P CNX Nifty increased by 67.2 per cent over the same period. The price-earnings (P/E) ratios increased during the year; for instance, the P/E ratio for the 30 scrips included in the BSE Sensex increased from 15.6 at end-March 2005 to 20.9 at end-March 2006. The total turnover in the cash segment increased sharply during 2005-06. The market capitalisation also surged on account of increase in stock prices as well as listing of new securities. The volatility in terms of coefficient of variation increased during 2005-06 as compared with the previous year (Table 45).

The rally in the stock markets during 2005-06 was wide-spread (Chart 50). On a point-to-point basis, while BSE 500 increased by 65.2 per cent, BSE Small-cap and BSE Mid-cap increased by 76.9 per cent and 73.6 per cent, respectively. Amongst the major sectors, BSE capital goods index registered the highest gain (156.0 per cent), followed by consumer durables (115.4 per cent), fast moving consumer goods (FMCG) (109.9 per cent), IT sector (49.2 per cent), public sector undertakings (PSUs) (44.0 per cent) and banking sector (36.8 per cent). Gains by the capital goods stocks reflected the pick-up in investment activity and the Government's emphasis on infrastructure developments in the Union Budget, 2006-07. The consumer durables stocks were buoyant on the back of strong growth in sales, good financial results of some of the companies and mergers and acquisitions in the sector. The FMCG stocks benefited from the normal progress of monsoon and its positive effect on sales, and abolition of excise duty on branded foods and reduction in excise duty from 16 per cent to 8 per cent on select fast food items in the Union Budget, 2006-07. Banking sector scrips gained due to several factors such as pick up in non-food credit of the banks and permission to banks to issue perpetual bonds and other hybrid instruments. Favourable proposals in the Union



Budget, 2006-07 relating to the banking sector such as conversion of non-tradable special securities into tradable SLR Government of India dated securities, and inclusion of fixed deposits of scheduled banks of maturity not less than 5 years in Section 80C of the Income Tax Act also boosted the banking sector scrips.

According to the Securities and Exchange Board of India (SEBI) data, foreign institutional investors (FIIs) made net investment of Rs.48,487 crore (US $ 10.9 billion) in the equity market during 2005-06 on top of net purchases of Rs.40,991 crore (US $ 9.1 billion) during the previous year (Chart 51). Mutual funds also made net purchases in equities of Rs.14,308 crore during 2005-06 as compared with net purchases of only Rs.448 crore during the previous year.



VI. THE EXTERNAL ECONOMY

India's balance of payments position remained comfortable during 2005-06, despite record high international crude oil prices. Growth of merchandise exports continued to be robust. The surplus on the invisibles account remained buoyant led by exports of services and private remittances, thereby financing a large part of the trade deficit. Nonetheless, the current account deficit widened during the first nine months of 2005-06, in line with the growth in investment demand in the economy. Capital flows continued to remain large, reflecting increased appetite for domestic financial assets. As a result, the overall balance of payments remained comfortable with foreign exchange reserves increasing by US $ 10.1 billion during the fiscal 2005-06, despite an outgo of US $ 7.1 billion during December 2005 from the reserves on account of the redemption of India Millennium Deposits (IMDs). External debt recorded a decline reflecting the IMD redemption.

International Developments

The world economy exhibited strong growth in 2005 supported by benign financial market conditions and conducive macroeconomic policies. After experiencing relatively robust growth in 2004, the US economy witnessed a moderate deceleration in 2005, reflecting the adverse one-off effects of the late summer hurricanes. The growth momentum attained in the Japanese economy during the first quarter of 2005 got broad-based during the year. The recovery, initially driven by exports and fixed investment, is now being supported by household spending, including residential investment. The Euro area also exhibited some modest pick-up in the second half of 2005, although growth was lower than in 2004, driven by slowdown in Germany and France. Developing countries led by China and India continued to witness a strong momentum in GDP growth, which spurred global growth in 2005 (Table 46). According to estimates by the Asian Development Bank, developing Asia recorded a growth of 7.4 per cent during 2005 on top of 7.8 per cent growth during 2004.

The world economy is projected to continue with its growth momentum in 2006. The global growth prospects are, however, vulnerable to the growing concerns relating to high oil prices and global imbalances. Oil prices continue to remain high and volatile. After easing from Katrina-induced record high, crude oil prices again rebounded in early 2006 on account of geo-political uncertainties. Persistence of global financial imbalances continues to be another key risk to global growth. The most visible aspect of the global imbalances has been the growing deficit in the current account of the balance of payments of the US and correspondingly large surpluses in the external accounts of other countries, including oil exporters such as Russia and Saudi Arabia, Japan and the countries

Table 46: Growth Rates

(Per cent)

Country	2004	2005	2005-Q1	2005-Q2	2005-Q3	2005-Q4
1	2	3	4	5	6	7
Advanced Economies						
Euro Area	2.1	1.3	1.4	1.1	1.6	1.6
Japan	1.7	2.7	1.4	2.6	2.9	4.3
OECD Countries	3.3	2.7	2.6	2.6	2.9	2.9
UK	3.1	1.8	2.1	1.5	1.7	1.8
US	4.2	3.5	3.6	3.6	3.6	3.2
Emerging Economies@						
Argentina	9.0	9.1	8.0	10.1	9.2	9.1
Brazil	5.2	2.2	2.6	3.9	1.0	1.4
China	9.5	9.6	9.4	9.5	9.4	9.9
India	7.5*	8.1#	7.0	8.1	8.0	7.6
Indonesia	5.1	5.5	6.4	5.5	5.3	4.9
Malaysia	7.1	5.1	5.7	4.1	5.3	5.2
South Korea	4.6	4.0	2.7	3.3	4.5	5.3
Thailand	6.9	4.4	3.3	4.4	5.3	4.7

* : FY 2004-05. # : FY 2005-06.
Source : World Economic Outlook, September 2005, IMF; The Economist; and the OECD.

of emerging Asia, and most particularly China. The US current account deficit widened from 5.7 per cent of GDP in 2004 to 6.4 per cent in 2005 and is estimated by the Organisation of Economic Cooperation and Development (OECD) to reach 7.0 per cent in 2007. A disorderly adjustment of the financial imbalances may prove to be costly and disruptive to global growth. More recently, Avian flu is another potential risk to the global economy, particularly the Asian region. The World Bank estimates that a year-long pandemic could cost the world economy US $ 800 billion (equivalent to 2.0 per cent of global GDP).

According to the Institute of International Finance (IIF), net private capital flows to emerging market economies increased from US $ 329 billion in 2004 to all time high of US $ 400 billion in 2005. The increase in capital flows during 2005 was led by portfolio equity flows and commercial bank lending, while direct equity investment and bond flows maintained the high levels of 2004. The IIF has estimated that capital flows will remain robust at US $ 357 billion in 2006. The moderation over the previous year is largely on account of the opportunity taken by many borrowers to pre-finance their obligations due in 2006 in the year 2005 itself.

World exports in US dollar terms are estimated to have increased by 12.1 per cent during 2005 as compared with 21.2 per cent last year (Table 47). Developing countries registered higher growth (18.1 per cent) than the industrial countries (7.9 per cent), although the growth decelerated in both the economies. According to the United Nation's *World Economic Situation and Prospects 2006*, world trade in volume terms is projected to grow by 7.2 per cent in 2006 as compared with 6.6 per cent growth in 2005. During 2006, export volume growth of developing countries (8.7 per cent) is projected to be higher than that of developed countries (6.0 per cent).

Table 47: Growth in Exports: Global Scenario

(Per cent)

Region/ Country	2004	2005
1	2	3
World	**21.2**	**12.1**
Industrial Countries	**17.3**	**7.9**
USA	12.9	10.8
Germany	21.3	7.3
Japan	19.9	5.2
Developing Countries	**27.3**	**18.1**
China	35.5	28.4
India	28.2	25.9
Korea	31.0	12.0
Singapore	24.6	17.6
Malaysia	26.5	12.0
Thailand	19.8	14.4

Source : International Financial Statistics On-line Service, International Monetary Fund, April 2006; and DGCI&S.

Merchandise Trade

During 2005-06, India's exports continued to maintain the momentum of high growth for the fourth year in succession in an environment of favourable global demand conditions and growing competitiveness of the domestic manufacturing. According to the Directorate General of Commercial Intelligence and Statistics (DGCI&S), India's exports registered a strong growth of 24.7 per cent in 2005-06 on top of 26.4 per cent growth a year ago (Chart 52).

Export growth was broad-based across major commodity sectors and destinations. Engineering goods, textiles, chemicals, gems and jewellery and

Chart 52: Trends in India's Exports

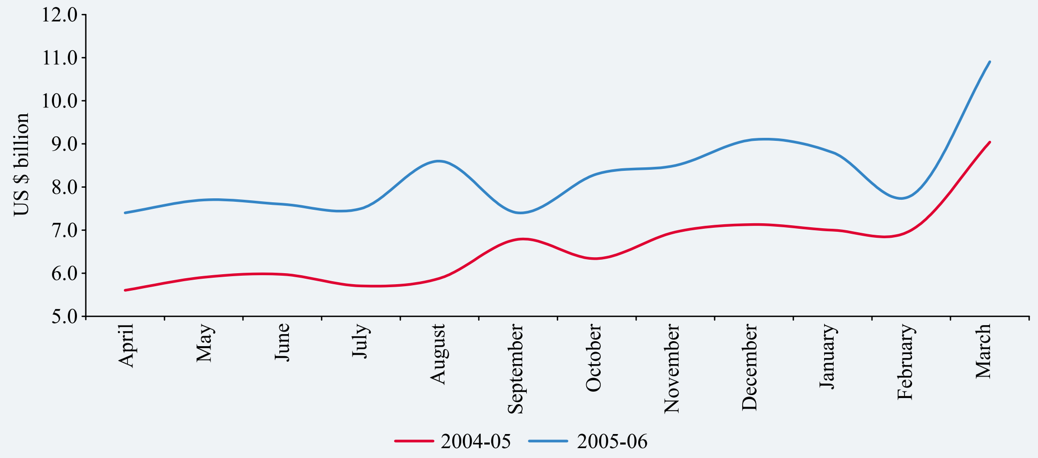


Table 48: Exports of Principal Commodities (April-December)

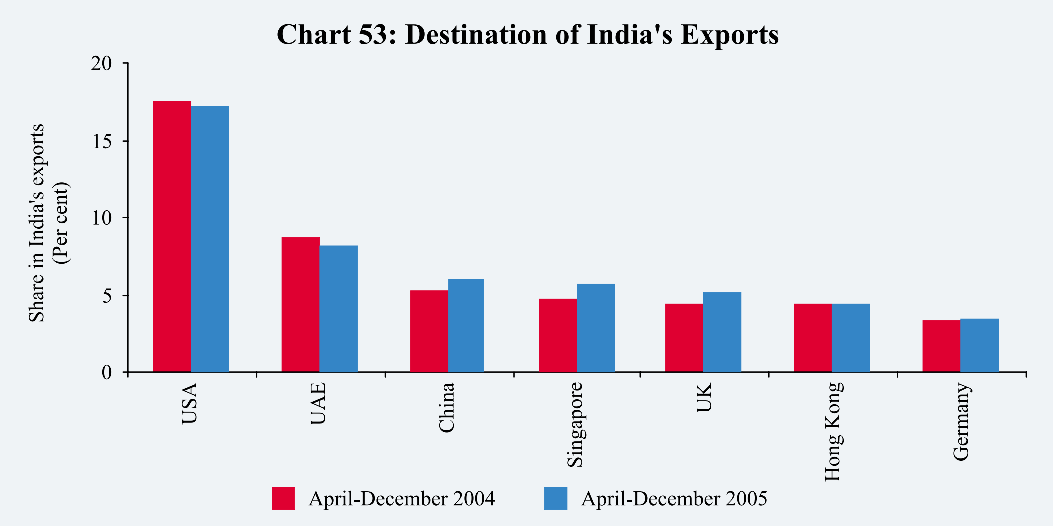
	US $ billion		Variation (per cent)	
Commodity Group	2004-05	2005-06	2004-05	2005-06
1	2	3	4	5
1. Primary Products	**8.6**	**11.1**	**31.7**	**28.8**
of which:				
a) Agriculture and Allied Products	5.8	7.1	13.8	22.6
b) Ores and Minerals	2.8	4.0	94.9	41.8
2. Manufactured Goods	**41.4**	**50.5**	**21.2**	**22.1**
of which:				
a) Chemicals and Related Products	8.5	10.1	29.7	19.4
b) Engineering Goods	11.5	14.9	35.3	28.9
c) Textiles and Textile Products	9.4	11.4	6.0	21.7
d) Gems and Jewellery	9.4	11.1	19.2	18.0
3. Petroleum Products	**5.0**	**8.1**	**95.2**	**63.4**
4. Total Exports	**56.5**	**72.2**	**27.1**	**27.9**

Source : DGCI&S.

petroleum products were the key drivers of export growth (Table 48). Within primary products, exports of agricultural and allied commodities accelerated, led by rice, cotton, coffee and marine products. Within engineering goods, technology intensive products such as machinery and instruments, transport equipments and manufactures of metals were the mainstay. Acceleration in exports of textiles and textile products was due to a pick-up in demand in the major markets such as the US and EU – readymade garments accounted for 73.2 per cent of the expansion in textile exports during April-December 2005. Gems and jewellery exports maintained the growth momentum led by demand from the major markets. Exports of petroleum products increased by 63.4 per cent during April-December 2005 on top of 95.2 per cent increase a year ago, mainly reflecting the impact of elevated international prices of petroleum products.

Country-wise, the US continued to be a significant market for India with a share of 17.2 per cent in total exports during 2005-06 (April-December), followed by the UAE (8.2 per cent) and China (6.0 per cent) (Chart 53). Amongst these top three markets, exports to China increased by 45.9 per cent followed by the US (25.8 per cent) and the UAE (20.4 per cent). Amongst major regions, the European Union maintained the dominant position, with a share of 21.7 per cent in India's total exports. India's exports to developing countries continued to grow sharply, which was reflected in the share of exports to this group increasing to 38.5 per cent during April-December 2005 from 36.8 per cent a year ago. Latin America was the fastest growing destination of India's exports during April-December 2005, with a growth of 48.5 per cent.

Imports maintained the tempo of high growth at 31.5 per cent during 2005-06, led by both oil and non-oil imports, in an environment of buoyant economy. The



increase in petroleum, oil and lubricants (POL) imports (46.8 per cent) in 2005-06 reflected the impact of sharp increase in international crude oil prices (Chart 54). The Indian basket crude oil price averaged US $ 55.4 per barrel during 2005-06, witnessing a rise of 42.4 per cent. In volume terms, oil import growth, however, slowed down to 3.2 per cent during April-December 2005 from 5.5 per cent a year ago.

Non-oil imports posted a growth of 25.6 per cent during 2005-06, maintaining the momentum of growth of 33.3 per cent a year ago in tandem with the sustained investment demand in the economy (Chart 55). Capital goods imports remained buoyant, led by an acceleration in imports of machinery (except electrical and electronics), transport equipments, manufactures of metals and

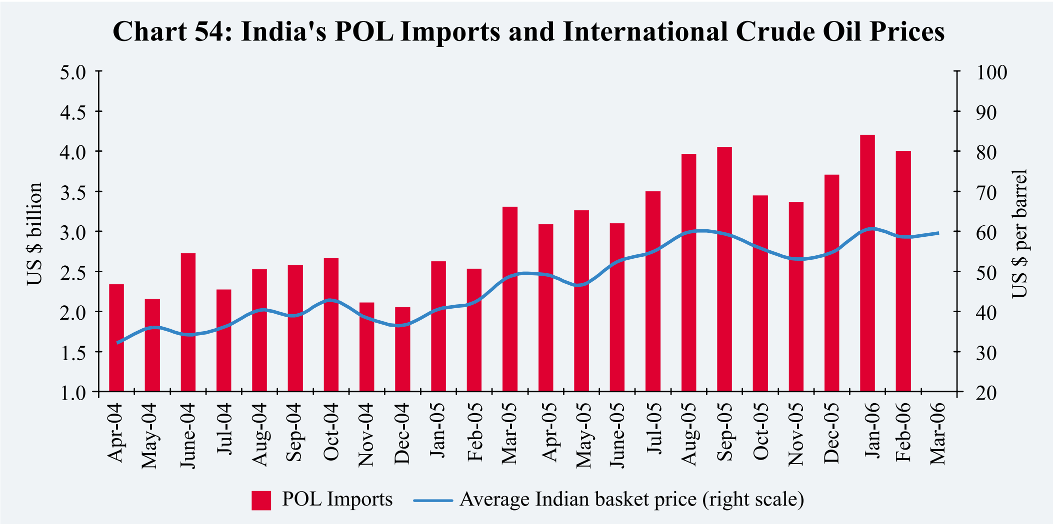
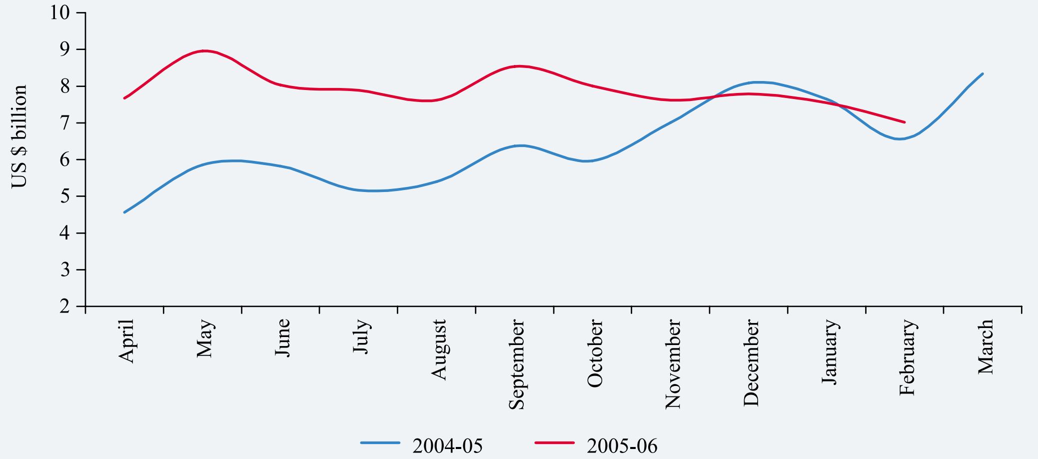


Chart 55: Non-oil Imports



machine tools. Imports of '*mainly*' industrial inputs (non-oil imports net of gold and silver, bulk consumption goods, manufactured fertilisers and professional instruments) maintained high growth in April-December 2005 at 36.6 per cent as compared with 35.7 per cent a year ago. Gold and silver imports, on the other hand, witnessed a deceleration, which could be attributed, *inter alia*, to the surge in international gold prices (Table 49).

During April-December 2005, China was the major source of imports with a share of 7.4 per cent in India's total imports, followed by the US (5.6 per cent), Switzerland (4.8 per cent), Germany (4.1 per cent) and Belgium (3.6 per cent).

Table 49: Imports of Principal Commodities (April-December)

	US $ billion		Variation (per cent)	
Commodity Group	2004-05	2005-06	2004-05	2005-06
1	2	3	4	5
POL	21.4	31.5	45.7	46.9
Edible Oils	1.8	1.5	-7.1	-14.9
Iron and Steel	1.8	3.5	68.7	93.4
Capital Goods	16.1	22.7	32.3	41.0
Pearls, Precious and Semi-Precious Stones	6.2	7.4	23.9	19.9
Chemicals	3.9	5.0	35.3	28.8
Gold and Silver	7.4	8.5	46.9	15.7
Total Imports	**76.3**	**104.3**	**37.4**	**36.8**
Memo :				
Non-oil Imports excluding Gold and Silver	47.5	64.3	32.7	35.5
Mainly Industrial Imports*	43.5	59.5	35.7	36.6

* : Non oil imports net of gold and silver, bulk consumption goods, manufactured goods, fertilisers and professional instruments.

Source : DGCI&S.

Table 50: India's Merchandise Trade

(US $ billion)

Item	2004-05	2005-06
1	2	3
Exports	80.7 (26.4)	100.6 (24.7)
Imports	106.6 (36.4)	140.2 (31.5)
Oil	29.9 (45.2)	43.8 (46.8)
Non-oil	76.8 (33.3)	96.4 (25.6)
Trade Balance	-26.0	-39.6
Memo :		
Non-oil Trade Balance*	-3.3	-8.7

* : April-December.

Note : Figures in parentheses show percentage change over the corresponding period of the previous year.

Source : DGCI&S.

Reflecting higher imports, trade deficit at US $ 39.6 billion during 2005-06 was higher by 52.7 per cent than the previous year (Table 50). Non-oil trade balance was in deficit at US $ 8.7 billion during April-December 2005 as compared with a deficit of US $ 3.3 billion a year ago.

Current Account

Net surplus under the invisibles account continued to remain sizeable during April-December 2005 (Table 51). Gross invisible receipts during April-December 2005 recorded a rise of 28.1 per cent over the position a year ago due to sustained growth in travel earnings and continuing pace of export of software and other business and professional services and stable remittances from overseas Indians. Private transfers contributed about 28 per cent of gross invisible receipts.

Table 51: Invisibles Account (Net)

(US $ million)

Item	2004-05 April-March	2004-05				2005-06			
		April-June	July-Sept.	Oct.-Dec.	April-Dec.	April-June	July-Sept.	Oct. Dec.	April-Dec.
1	2	3	4	5	6	7	8	9	10
Travel	985	-62	24	453	415	154	219	578	951
Transportation	259	272	-21	26	277	-141	-101	-49	-291
Insurance	187	-32	50	77	95	13	253	-51	215
Government, not included elsewhere	67	61	5	19	85	-15	-51	32	-34
Software Services	16,526	3,710	3,859	4,157	11,726	4,853	4,989	5,236	15,078
Other Services	-3,825	-927	-959	-1,745	-3,631	531	671	-1,267	-65
Transfers	20,844	5,890	4,330	4,204	14,424	5,727	4,990	6,436	17,153
Investment Income	-2,669	-527	-903	-560	-1,990	-682	-1,240	-2,421	-4,343
Compensation of Employees	-1,145	-231	-256	-341	-828	-143	-146	-319	-608
Total	**31,229**	**8,154**	**6,129**	**6,290**	**20,573**	**10,297**	**9,584**	**8,175**	**28,056**

Table 52: India's Balance of Payments

(US $ million)

Item	2004-05 April-March	2004-05				2005-06			
		April-June	July-Sept.	Oct.-Dec.	April-Dec.	April-June	July-Sept.	Oct. Dec.	April-Dec.
1	2	3	4	5	6	7	8	9	10
Exports	82,150	17,840	18,875	20,888	57,603	23,180	24,001	26,400	73,581
Imports	1,18,779	22,980	28,503	32,620	84,103	38,040	38,643	38,429	1,15,112
Trade Balance	-36,629	-5,140	-9,628	-11,732	-26,500	-14,860	-14,642	-12,029	-41,531
Invisible Receipts	71,854	16,708	14,635	17,714	49,057	19,910	19,673	23,261	62,844
Invisible Payments	40,625	8,554	8,506	11,424	28,484	9,613	10,089	15,086	34,788
Invisibles, net	31,229	8,154	6,129	6,290	20,573	10,297	9,584	8,175	28,056
Current Account	-5,400	3,014	-3,499	-5,442	-5,927	-4,563	-5,058	-3,854	-13,475
Capital Account*	31,559	4,556	2,865	12,036	19,457	5,809	10,314	-872	15,251
Change in Reserves #	-26,159	-7,570	634	-6,594	-13,530	-1,246	-5,256	4,726	-1,776

* : Includes errors and omissions.
# : On balance of payments basis (excluding valuation); (-) indicates increase.

Gross invisibles payments during April-December 2005 registered a rise of 22.1 per cent on account of outbound tourist traffic, transportation and insurance payments, rising import demand for business services and higher interest payments. On the whole, the net invisible surplus during April-December 2005 at US $ 28.1 billion was higher than that of US $ 20.6 billion in the corresponding period of the previous year. While the net invisible surplus expanded by US $ 7.5 billion during April-December 2005, the merchandise trade deficit, on payments basis, expanded by US $ 15.0 billion to US $ 41.5 billion during April-December 2005. The current account deficit, therefore, widened to US $ 13.5 billion from US $ 5.9 billion a year ago (Table 52).

Capital Flows

Capital flows to India remained strong during 2005-06, led by foreign investment flows. Foreign direct investment (FDI) inflows into India at US $ 5.8 billion during 2005-06 (April-January) were 31 per cent higher than in the corresponding period of the previous year, on the back of sustained growth in activity and positive investment climate. FDI was channelled mainly into manufacturing, business and computer services. Mauritius, the US and the UK continued to remain the dominant sources of FDI to India. Foreign institutional investors (FIIs) after remaining subdued during April-May 2005 made large purchases in the Indian stock markets in the subsequent months. Cumulative FII inflows during April-February 2005-06 amounted to US $ 8.2 billion, 19 per cent higher than a year ago. 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

Table 53: Capital Flows

(US $ million)

Item	Period	2004-05	2005-06
1	2	3	4
Foreign Direct Investment into India	April-January	4,478	5,843
FIIs (net)	April-February	6,858	8,176
ADRs/GDRs	April-January	442	2,141
External Assistance (net)	April-December	673	914
External Commercial Borrowings (Medium and long-term) (net)	April-December	2,857	-1,555 (3,945*)
Short-term Trade Credits (net)	April-December	2,963	1,697
NRI Deposits (net)	April-January	-771	1,666

* : Excluding the IMD redemption.

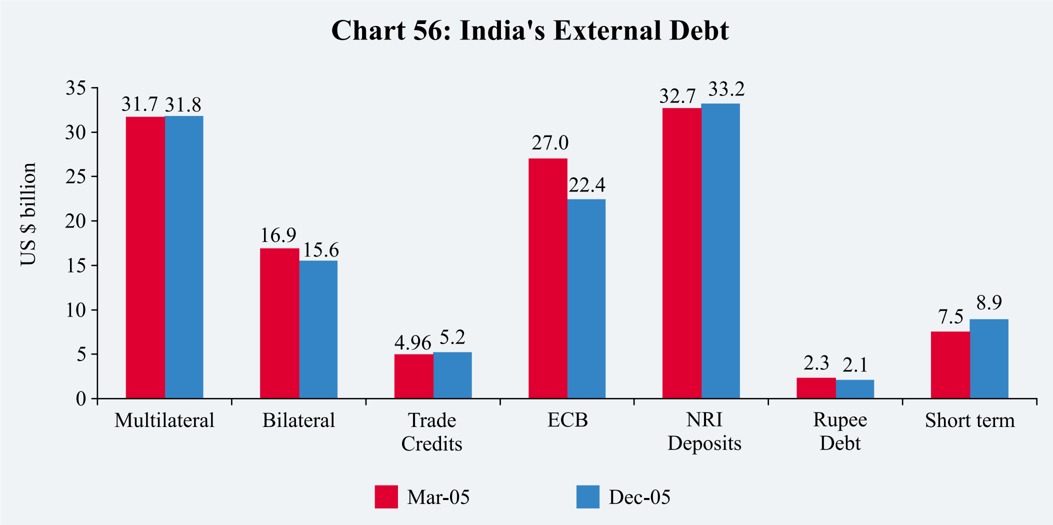
the opportunity to issue equities abroad. Reflecting the increased domestic investment activity, demand for external commercial borrowings (ECBs), including foreign currency convertible bonds (FCCBs), remained high. Non-Resident Indian deposit accounts recorded inflows during April-January 2005-06 in contrast to net outflows in the previous year (Table 53).

Foreign Exchange Reserves

During April-December 2005, the current account deficit – despite a substantial widening - was more than offset by surplus in the capital account, resulting in an accretion to the foreign exchange reserves of the order of US $ 1.8 billion on a balance of payments basis (*i.e.*, excluding valuation effects).

India's foreign exchange reserves were US $ 151.6 billion as on March 31, 2006; at this level, they were US $ 10.1 billion higher over end-March 2005 level. This was despite an outgo of US $ 7.1 billion on account of redemption of India Millennium Deposits (IMDs) on December 29, 2005. The Reserve Bank sold foreign exchange aggregating US $ 7.1 billion during December 27-29, 2005 to the State Bank of India (SBI) to meet the IMD redemption. SBI had raised equivalent of US $ 5.5 billion in the year 2000 under the IMD scheme from non-resident deposits and the maturity amount (principal and interest payment) aggregated US $ 7.1 billion.

India holds the fifth largest stock of reserves among the emerging market economies and the sixth largest in the world. The overall approach to the management of India's foreign exchange reserves in recent years reflects the changing composition of the balance of payments and the 'liquidity risks' associated with different types of flows and other requirements. Taking these factors into account, India's foreign exchange reserves continued to be at a comfortable level and consistent with the rate of growth, the share of external sector in the economy and the size of risk-adjusted capital flows.



External Debt

India's total external debt declined by US $ 4.0 billion (3.3 per cent) during April-December 2005 to US $ 119.2 billion at end-December 2005. The decline primarily reflected the redemption of the IMDs which more than offset higher recourse to normal commercial borrowings (Chart 56).

The ratios of short-term to total debt and short-term debt to foreign exchange reserves at end-December 2005 remained modest, notwithstanding some increase during the period. India's foreign exchange reserves exceeded the external debt by 15.1 per cent at end-December 2005. The share of concessional debt continued to be a significant proportion of the total external debt, especially by international standards. The decline in the recent period reflects a gradual increase in non-concessional private debt (Table 54).

Table 54: Indicators of Debt Sustainability

(Per cent)

Indicator	March 2004	March 2005	December 2005
1	2	3	4
Concessional debt/Total debt	36.1	33.3	32.7
Short-term/Total debt	4.0	6.1	7.5
Short-term debt/Reserves	3.9	5.3	6.5
Reserves/Total debt	101.1	114.8	115.1