

## FOREWORD

Over the last 10 years, many emerging market economies have made significant efforts to strengthen their domestic financial systems, including various segments of the financial market. A well-functioning financial market is a key to sustained economic growth. Financial markets also facilitate effective implementation of monetary policy by serving as a link in the transmission mechanism between monetary policy and the real economy. In India, although financial markets have existed for a long time, they remained relatively underdeveloped *vis-a-vis* some emerging market economies for a variety of reasons. Concerted efforts to develop the financial markets towards global standards began in the early 1990s as a part of broader financial sector reforms.

Reforms in the financial markets encompassed all segments - the money market, the credit market, the government securities market, the foreign exchange market, the equity market and the private corporate debt market. The development of financial markets has been pursued for bringing about a transformation in the structure, efficiency and stability of markets. Some of the major measures that have been initiated to develop the financial markets include market determined pricing of various financial assets, removal of restrictions on participants, introduction of electronic trading platforms and introduction of new instruments. All these measures have had a significant impact on the structure and efficiency of financial markets. However, financial markets in India are not yet fully developed. There are several issues that remain to be addressed. The need for developed financial markets has never been felt so strong as at this point of time for several reasons such as sustaining the present high rate of economic growth; improving transmission mechanism of monetary policy; developing a diversified financial system and maximising gains from globalisation while minimising its costs.

Ever since the introduction of theme based **Report on Currency and Finance** in 1998-99, the Department of Economic Analysis and Policy has released seven Reports encompassing several important contemporary issues concerning central banking and macroeconomic issues relating to India. The current Report is in continuation of the themes addressed in the previous Reports and attempts to address the issue of financial market development. An effort has been made in this Report to cover the vast canvas of financial market operations as they have emerged in India. The thrust of the Report is to consider approaches for making financial markets in India more developed, efficient and integrated in the light of our own experience gained so far and keeping in view the international best practices, while recognising country context, especially that India is an emerging market economy. The pace of change in financial market development will necessarily have to be guided by the predominant imperative of maintaining macroeconomic and financial stability, while enabling growth inclusive.

The Report has been prepared in the Department of Economic Analysis and Policy with the active involvement of operational departments. The Report has been prepared under the guidance and supervision of Janak Raj, Adviser. R.K.Pattnaik, Adviser was also involved.

The core team involved in the drafting of the Report comprised Rajiv Ranjan, Dhritidyuti Bose, R.K Jain, Rajan Goyal, Muneesh Kapur, A.Karunakaran, Kumudini Hajra, M.Ramaiah, Sharat Dhal, Deepa S Raj, Indranil Bhattacharyya, Binod B Bhoi, Satyananda Sahoo, Siddhartha Sanyal, Atri Mukherjee, S.Suraj, S.M.Lokare, Sangita Misra, Jai Chander, Raj Rajesh, V.Dhanya, Harendra Behera, Amar Nath Yadav, A.K.Shukla, Pallavi Chavan, Samir Behera, Rajeev Jain, B.S.Misra, Sunil Kumar and Indrani Manna.

Dr. P.D.Jeromi, who unfortunately passed away while the work of preparing the Report was in progress, made a valuable contribution.

The team benefited from the significant suggestions from V. Leeladhar, Shyamala Gopinath, Usha Thorat, V.K. Sharma, K.Kanagasabapathy and G.S.Bhati.

Notable contributions were made at various stages of preparation of the Report by officers from the operational departments, viz., Himadri Bhattacharya, Prasant Saran, Salim Gangadharan, Michael D. Patra, Chandan Sinha, G. Mahalingam, Mridul Saggar, Himanshu Joshi, Partha Ray, T. Rabishankar, T.B.B. Verma, Deepak Kumar and Mohua Roy.

These apart, impressive contributions by operational departments, viz., Monetary Policy Department, Department of Banking Operations and Development, Financial Markets Department, Foreign Exchange Department, Department of External Investments and Operations are highly appreciated. Almost every Division in the Department of Economic Analysis and Policy contributed in the preparation of the chapter on 'Recent Economic Developments' (Chapter II).

I hope that the analysis presented and suggestions made in the Report would guide us in our endeavour to further develop the financial markets.

I take this opportunity to place on record my deep appreciation of the professional skills and utmost dedication of the officials of the Department of Economic Analysis and Policy, without which it would not have been possible to bring out this Report.

May 24, 2007

Rakesh Mohan  
Deputy Governor