

**RESERVE BANK OF INDIA**

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Macroeconomic and Monetary Developments in 2006-07

The Reserve Bank of India today released the document "Macroeconomic and Monetary Developments in 2006-07" to serve as a backdrop to the Annual Policy Statement for 2007-08 being announced on April 24, 2007.

The highlights of macroeconomic and monetary developments during 2006-07 are:

The Real Economy

- The Indian economy witnessed robust growth during 2006-07 for the fourth year in succession. According to the advance estimates released by the Central Statistical Organisation (CSO), real Gross Domestic Product (GDP) growth is estimated to accelerate from 9.0 per cent in 2005-06 to 9.2 per cent in 2006-07. The acceleration in growth during 2006-07 was driven by the continued momentum in the services and the manufacturing sectors, both of which are expected to record double-digit growth. 'Agriculture and allied activities' growth, however, slowed down from 6.0 per cent in 2005-06 to 2.7 per cent in 2006-07.
- According to the Third Advance Estimates, production of foodgrains during 2006-07 is likely to be 211.8 million tonnes, an increase of 1.5 per cent over the previous year.
- Industrial production continued its growth momentum during April-February 2006-07, with growth accelerating to 11.1 per cent from 8.1 per cent a year ago. The manufacturing sector grew by 12.1 per cent during April-February 2006-07.
- The services sector, with a growth rate of 10.7 per cent during April-December 2006 as compared with 9.8 per cent a year ago, continued to be the key driver of economic activity.
- Profits after tax of RBI sample non-Government non-financial companies increased by 48.7 per cent during April-December 2006 on top of 36.8 per cent growth recorded in the corresponding period of 2005. Ratio of profits after tax to sales improved to 11.0 per cent during the quarter ended December 2006 from 8.6 per cent a year ago

Fiscal Situation

- According to the revised estimates for 2006-07, the key deficit indicators of the Central Government, viz., revenue deficit, gross fiscal deficit and primary deficit, relative to GDP, at 2.0 per cent, 3.7 per cent and 0.1 per cent, respectively, were placed lower than their budgeted levels.
- According to the Reserve Bank records, actual gross market borrowings through dated securities by the Central Government amounted to Rs.1,46,000 crore during 2006-07. The weighted average yield of the dated securities issued during 2006-07 increased to 7.89 per cent from 7.34 per cent during the previous year. The weighted average maturity of the dated securities issued during the year fell to 14.72 years from 16.90 years during 2005-06.
- During 2006-07, revenue deficit and gross fiscal deficit of State Governments were budgeted at 0.1 per cent and 2.7 per cent, respectively, of GDP - a reduction of 0.4 percentage points and 0.5 percentage points, respectively, over the previous year.
- During 2006-07, the States raised market loans amounting to Rs.20,825 crore through auctions, with cut-off rates in the range 7.65-8.66 per cent.
- The liquidity position of the States remained comfortable during 2006-07. This was reflected in the weekly average investment by the States in the 14-day Treasury Bills which increased further during 2006-07 to Rs.43,075 crore from Rs.35,278 crore in the previous year. The weekly average utilisation of WMA and overdraft by the States at Rs.234 crore in 2006-07 was lower than that of Rs.482 crore in 2005-06.
- The Union Budget for 2007-08 proposes to continue the fiscal consolidation process, with the key deficit indicators as per cent of GDP budgeted to be lower in 2007-08 than in the previous year. The revenue deficit relative to GDP is budgeted to be reduced in 2007-08 by 0.5 percentage points, which is the minimum stipulated threshold limit under the FRBM Rule, 2004; therefore, a substantial correction in the revenue deficit of 1.5 percentage points would be required in 2008-09, the terminal year for meeting the FRBM target.

Monetary and Liquidity Conditions

- Broad money growth accelerated to 20.8 per cent (Rs.5,67,372 crore) (year-on-year) at end-March 2007 from 17.0 per cent (Rs.3,96,881 crore) a year ago.
- Non-food credit of scheduled commercial banks (SCBs) expanded by 28.0 per cent (Rs.4,10,285 crore), y-o-y, as on March 30, 2007 as compared with 31.8 per cent (Rs. 3,54,193 crore) a year ago.
- Deposits exhibited sharp growth and enabled financing of sustained high demand for credit. Deposits of SCBs increased by 23.0 per cent (Rs. 4,85,210 crore) (y-o-y) as on March 30, 2007 as compared with 18.1 per cent (Rs. 3,23,913 crore) a year ago.
- Reserve money expanded by 23.7 per cent (Rs.1,35,892 crore), y-o-y, as on March 31, 2007 as compared with 17.2 per cent (Rs.83,922 crore) a year ago. Adjusted for the first round effects of the hikes in the CRR, reserve money growth (y-o-y) was 18.9 per cent as on March 31, 2007.

- The Reserve Bank continued to modulate market liquidity with the help of repo and reverse repos under the liquidity adjustment facility (LAF), issuance of securities under the Market Stabilisation Scheme (MSS) and the cash reserve ratio (CRR). The task of liquidity management was complicated during 2006-07 due to large variations in market liquidity on account of variations in cash balances of the Governments and capital flows.

Price Situation

- Headline and core inflation remained at elevated levels in many economies during the first half of 2006-07 reflecting high commodity prices and strong demand conditions. Although headline inflation eased somewhat internationally from August 2006 levels in tandem with the softening of international crude oil prices and favourable base effects, it remains above the inflation targets/comfort zones in many economies. Many central banks continued with pre-emptive monetary tightening to mitigate the second round effects, especially in the face of continuing strong demand. Central banks in emerging market economies also raised cash reserve requirements to address concerns regarding excess liquidity arising, particularly from large external flows.
- In India, prices of primary food articles and manufactured products exerted upward pressures on headline inflation in 2006-07. Wholesale price inflation was generally within the Reserve Bank's indicative projections of 5.0-5.5 per cent up to mid-November 2006 and rose above the upper end of the band thereafter. The year-on-year (y-o-y) inflation was 5.7 per cent as on March 31, 2007 as compared with 4.0 per cent a year ago.
- Measures of consumer price inflation remained above the WPI inflation throughout the year, mainly reflecting the impact of higher food prices.
- The Reserve Bank continued with the policy of gradual withdrawal of monetary accommodation, using various instruments at its disposal flexibly to stabilise inflationary expectations. The Government also took fiscal and supply-side measures to contain inflation.

Financial Markets

- Indian financial markets remained generally orderly during most part of 2006-07. There were, however, some spells of volatility at different points of time during the year reflecting developments in liquidity conditions on account of large and sudden changes in capital flows and cash balances of the Governments.
- The call money rate edged up during the year in tandem with movements in policy rates. The call rate remained mostly within the corridor set by the Reserve Bank's repo and reverse repo rates during April-November 2006. In the subsequent months, there were a few brief episodes (last week of December 2006 and second half of March 2007) of higher volatility when the call rate exceeded the repo rate significantly.
- In the foreign exchange market, the Indian rupee exhibited two-way movements with a strengthening bias since mid-July 2006.
- Yields in the Government securities market hardened during the year and the yield curve flattened.

- Banks' deposit and lending rates edged up, especially in the second half of the year.

The External Economy

- According to the Directorate General of Commercial Intelligence and Statistics (DGCI&S) data, merchandise exports recorded a growth of 19.3 per cent during April-February 2006-07 as compared with 26.3 per cent during the corresponding period of 2005-06.
- Non-oil imports increased by 25.7 per cent during April-February 2006-07 as compared with 26.4 per cent during the corresponding period of 2005-06. Growth in oil imports remained high, reflecting partly the increase in volumes.
- Net invisibles surplus increased to US \$ 40.5 billion during the first three quarters of 2006-07 (from US \$ 28.1 billion a year ago), benefiting from continued growth in exports of services and remittances.
- Net invisibles surplus financed a large part of the deficit on the merchandise trade account. Current account deficit at US \$ 11.8 billion during April-December 2006 was marginally lower than that in April-December 2005 (US \$ 11.9 billion).
- Capital flows were substantially higher, led by foreign direct investment (FDI) flows. Outward FDI flows associated with acquisitions by Indian corporates abroad also increased. Capital flows (net) increased from US \$ 13.8 billion during April-December 2005 to US \$ 28.0 billion during April-December 2006.
- Foreign exchange reserves increased by US \$ 47.6 billion during 2006-07 to US \$ 199.2 billion. As on April 13, 2007, India's foreign exchange reserves were US \$203.1 billion.

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