

RESERVE BANK OF INDIA

**Macroeconomic and
Monetary Developments
Second Quarter Review 2011-12**

**Issued with the Second Quarter Review of
Monetary Policy 2011-12**



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Macroeconomic and
Monetary Developments
Second Quarter Review 2011-12

Reserve Bank of India
Mumbai



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MACROECONOMIC AND MONETARY DEVELOPMENTS SECOND QUARTER REVIEW 2011-12

Overview

During Q3 of 2011, global growth prospects further deteriorated, which may have an adverse impact on the Indian economy. The intensity of the impact will depend on how deep is the global downturn which, in turn, is related to how the current and future financial stress in global markets are addressed. In a baseline scenario, growth in India in 2011-12 is likely to be somewhat below trend.

2. Inflationary pressures are strong and persistent due to structural rigidities, continuing strong demand and the adaptive nature of inflation expectations. The path of inflation is sticky and remains broadly in line with earlier projections. With falling global commodity prices partly offset by rupee depreciation, the risks to inflation projections are now balanced.

3. Monetary policy has been tightened considerably with an effective 500 bps rate hike cumulatively and a 100 bps reserve requirement increase in a span of 20 months since February 2010. Monetary transmission has helped raise deposit and lending rates, correct the mismatch between deposit and credit growth and dampen aggregate demand. Though the risks to growth are becoming visible, the challenge of bringing down inflation to an acceptable level on a sustainable basis still remains significant.

Global Economic Conditions

Global growth risks intensify as debt crisis erodes confidence

4. Global growth prospects appear to be declining, even though recovery has not stalled. There have been significant downward revisions

in growth projections for the advanced economies. Risks to global growth have amplified with business and consumer confidence dampening on the back of the deepening sovereign debt crisis in Europe. Private sector balance sheets are at risk and significant banking sector weakness is re-emerging as a result. Importantly, financial stress could extend beyond euro area boundaries. If the euro area slows down further, as currently expected, it may have a domino effect on the global economy with spillovers to emerging markets.

5. In its World Economic Outlook of September 2011, the International Monetary Fund (IMF) significantly lowered its global growth forecast by 0.3 percentage points for 2011 and 0.5 percentage points for 2012. The world economy is still expected to grow at 4.0 per cent in both these years. The cuts in growth projections were deeper for advanced economies (AEs), but were also pervasive among emerging and developing economies (EDEs). The IMF also lowered its growth forecast for India. Its current projections of 7.8 per cent for 2011 and 7.5 per cent for 2012 in market prices correspond to a projection of 7.6 per cent growth at factor cost for 2011-12 and 2012-13.

Global commodity prices softening, but consumer inflation persists

6. Global commodity prices, especially those of metals, have softened significantly. However, even after some correction, the current Brent crude oil price is still over 25 per cent higher than its average for 2010-11. The IMF has

