

ANALYTIQUE



Vol. VI · No. 6 · Jul - Sep 2010

➤➤➤ **Capability Leverage versus Body Shopping: The Relationship between Foreign Earnings and Wages for Pharmaceutical and Service Sector Firms in India**

– *Sumit K. Majumdar*

➤➤➤ **Does Inflation Affect Indian Economic Growth?**

– *Surajit Sinha*

➤➤➤ **Commodity Price Volatility and Corporate Bottomlines: The Case of 2008-10**

– *V. Shunmugam*

➤➤➤ **Priority Sector Financing in India: Past, Present and Future**

– *Ram Pratap Sinha*



Bombay Chamber of Commerce & Industry

The Bombay Chamber of Commerce and Industry is India's premier Chamber of Commerce and Industry situated in Mumbai, the industrial, financial and commercial capital of India. Established in 1836, it is one of the oldest chambers in the country and has a long and illustrious history of continuous service to Trade and Industry.

The Chamber can boast not only of its longevity but also of its impeccable lineage. With more than 3000 prime companies as its members, the Chamber represents the cream of Indian Industry, Commerce and Services. While the name 'Bombay Chamber' conjures images of an organization representing exclusively a city-based membership, in reality it represents a wide spectrum of highly reputed and professionally run companies which are based in the city of Mumbai, but whose manufacturing facilities and commercial influence spread not only all over India but also internationally.

The Chamber uniquely represents large and medium sized corporations, banking and financial institutions, professional consulting companies and a large number of multinationals. It comes as no surprise that today the Bombay Chamber's membership represents as much as a third of the country's GDP in the manufacturing and service sectors.

Bombay Chamber of Commerce and Industry

Mackinnon Mackenzie Building, Ballard Estate, Mumbai 400 001

Tel: 2261 4681, Fax: 2262 1213,

E-mail: bcci@bombaychamber.com

Website: www.bombaychamber.com

From the Editor's Desk

As we go to the press with our third issue of *Analytique*, the Indian economic recovery seems to be consolidating. Recent developments augur well for the economy. Industrial production is rising and the Index of Industrial Production continues to show double digit growth. There has been more than adequate rainfall in major parts of the country which augurs well for agricultural production and therefore for the economy overall. Current account deficit stands at a modest 3% of GDP. All of these have perhaps contributed to a positive outlook for the economy. Though inflation is still at uncomfortable levels, this has not deterred the stock market from rising continuously. As we write this, the Sensex has regained the peak it had earlier reached on 10th January, 2008. The economic condition is more reassuring than it was a quarter ago.

A few words of caution are also appropriate. First, the volatility in the index of industrial production over the past few months raises doubts about how effectively the index tracks the underlying performance of the industrial sector. Secondly, though the new series of the WPI (with 2004-05 base year) gives a slightly lower rate of inflation, overall the rate remains high, and may be considered unacceptable by the poor who are always the worst hit by high inflation. It also leaves the room for the criticism that India's growth is lopsided and that it has failed to percolate to the poorer sections of society. Thirdly, appreciation of the rupee has meant that we are now running a bigger trade deficit since imports have grown faster than exports.

Considering all these aspects, while India's economy continues to thrive even as most Western economies are only just recovering, we need to acknowledge that impressive as the performance may be it needs to be more inclusive if the country is to make a serious dent in reducing the percentage of poor people. Moreover, in the short run, the need to moderate inflationary pressures is paramount.

Contents

Special Theme

- >> Capability Leverage versus Body Shopping: The Relationship Between Foreign Earnings and Wages for Pharmaceutical and Service Sector Firms in India
– **Sumit K. Majumdar** 03
- >> Does Inflation Affect Indian Economic Growth?
– **Surajit Sinha** 08

Current Affairs

- >> Commodity Price Volatility and Corporate Bottomlines: The Case of 2008-10
– **V. Shunmugam** 17
- >> Priority Sector Financing in India: Past, Present and Future
– **Ram Pratap Sinha** 25

Current Economic Scenario

- >> Quarterly Overview 37
- >> Select Economic Indicators 55

Editorial Board

Dr. Atindra Sen
Manju Sood
Sugeeta Upadhyay
Pravin Rane

Disclaimer - The articles published in *Analytique* do not necessarily reflect the views of the Bombay Chamber of Commerce and Industry Trust for Economic and Management Studies.

Printed at Uchitha Graphic Printers Pvt. Ltd.

On the Last Issue of Analytique

A careful reading of the June 2010 issue of *Analytique* shows the care with which the editorial board has crafted the issue.

The article by **Manas Paul** touches upon the on-going policy debate on agricultural land acquisition, an issue of significant policy relevance in India today. The paper analyses the linkages between agriculture, industry and services in India and finds evidence of growth in industry and services causing agriculture growth. The result is somewhat contrary to earlier results on the issue, even though this is not unexpected especially during globalization. As expected, during globalization the industry and the services sector do necessarily derive their growth impetus from the rest-of-the-world and not necessarily from exogenous agricultural shocks. The results perhaps indicate stronger supply linkages of industry or services growth or both and the obvious policy choice is in terms of prioritizing non-agricultural growth aiding higher agricultural growth. However, this need not demean the immense importance of supply constraints faced by agriculture in attaining its growth potential.

The second special article by **Rajnarayan Gupta** analyses rising consumerism in India. For the purpose, consumerism is analysed using NSS data on consumption of durable goods and their share in the consumer's budget for the period 1987-88 to 2004-2005. The study reaches a mixed conclusion: even though consumerism seems to have increased in terms of consumption of durable goods, their share in consumers' budget is still not predominant. The rise in expenditure on consumer durables by urban households is sharper than in case of rural households in 2004-05, but there is no concomitant rise of these goods in consumers' budget for both the groups in 2004-2005. Such national averages however tend to hide more than they reveal. As a result it would be worthwhile to look at regional variations in the pattern of consumerism in terms of aggregate consumption of durable consumer goods, their share in consumer's budget and commodity-wise consumption pattern of consumer durables.

The current affairs article on current "worrisome" inflation by **Dharmakirti Joshi** analyses rising trends in inflation in general and food price inflation in particular. The article highlights the continuing importance of good monsoons in moderating inflation. Joshi could have provided conjectures on the impact of such an inflationary trend particularly in a year of hesitant economic recovery.

The other current affairs article by **Dinesh Gautama** highlights the pitfalls in the emerging "Rotterdam rules" and correctly observes their implications for the maritime activity, international trade and the financial sector.

Even though the current economic scenario section provides a detailed delineation of the money and financial sectors, it leaves much scope for widening its coverage. This section can briefly highlight the emerging trends in India's macroeconomy with forecasts of major macro indicators over the next two quarters, which would necessarily reflect the views of the Bombay Chamber of Commerce and Industry.

Saikat Sinha Roy, Ph.D.

Associate Professor, Department of Economics

Editor, Trade and Development Review (<http://tdrju.net>)

Jadavpur University, Kolkata - 700 032, INDIA

Telefax: +91 - 33 - 24146328, E-mail: saikat@jueconomics.in, Web: www.jueconomics.in

Capability Leverage versus Body Shopping: The Relationship between Foreign Earnings and Wages for Pharmaceutical and Service Sector Firms in India

Sumit K. Majumdar*

Abstract

This article evaluates the relationship between foreign earnings and wage share for a large number of pharmaceutical and service sector firms in India. The results show that the foreign earnings and wage share relationship is negative and significant for Indian pharmaceutical sector firms while it is positive and significant for Indian service sector firms that engage in bodyshopping. These results highlight the existence of substantial heterogeneities in firm behavior that are consistent with expectations.

Introduction

Recent literature (Krugman, 2008) shows that rising globalization is associated with increase in wage inequalities. This is a big picture finding dealing with the consequences of globalization. This finding is associated with an important contemporary issue, at an aggregate level, as to whether the increasing pace of globalization has depressed wages in countries that have high levels of imports because imports from low wage

countries will reduce wages in the importing country as the manufacturing of items as well as the provision of services is transferred overseas.

But we know little about what happens within the firms in exporting countries? Do firms that export more, thereby participating more extensively in the global economy, utilize the services of cheap labor, or, in other words, do they engage in bodyshopping? Or, do they actually engage in foreign trade on the basis of the capabilities that are encapsulated in their human capital? In the context of a labor-rich country such as India, exports will embody human capital inputs rather than physical capital inputs, if one takes note of the Heckscher-Ohlin (Heckscher, 1950; Ohlin, 1933) reasoning.

Nevertheless, the capabilities of firms are equally important, and these capabilities are important for growth across several dimensions (Mankiw, et al. 1992) enabling firms to engage in comprehensive global trade and investment activities (Helpman, 1984). Thus, different patterns will be noted in different sectors of the economy since some sectors will utilize the

* Sumit K. Majumdar is Professor, Technology Strategy, School of Management, University of Texas at Dallas, USA. He can be reached at majumdar@utdallas.edu

abundant manpower pool available while others will utilize the knowledge embodied in such human assets to expand overseas.

This article compares the relationship between the foreign earnings and the proportion of a firm's product that is distributed as the wage share, among employees, for several hundred firms, which are the key firms, in India's pharmaceutical and service sectors. The wage share is an important economic performance indicator as it measures the proportion of a firm's product that is distributed to its human capital pool. Firms that incur a higher wage share ratio, therefore, have less to spend on technology and other corporate overheads.

In the pharmaceutical sector firms may employ relatively few highly trained but considerably more physical capital and technology assets, that actually embody important knowledge capabilities, and will display a lower wage share than the service sector where the performance rationale is driven by the benefits of engaging of large numbers of relatively cheap, abundant and fungible manpower in generating firms' revenues in the marketplace, whether domestic or global. Thus, the relationship between the wage share and foreign earnings of pharmaceutical firms may be negative while that for service sector firms may be positive.

Analysis

Data:

To evaluate the relationship between wage share and foreign earnings of

pharmaceutical and service sector firms, data drawn from a Reserve Bank of India database on financial accounts of non-government public limited companies were used. The Reserve Bank of India database is an extremely elaborate and consistent database on Indian companies maintained by the Reserve Bank of India since the financial year 1950-51 onwards, based on the balance sheets, profit and loss accounts and annual reports of the companies.

The data are widely perceived to have representative coverage of most sub-segments of the Indian corporate sector. The Reserve Bank of India public limited company data represents approximately eighty five per cent of the paid-up capital of eighty six three-digit industries (Feinberg and Majumdar, 2001). The consistent coverage over a long period has contributed to database quality. In the recent past, from 2000-01, service sector firms have been added to the database. Additionally, the data have been standardized into a common format, by the Reserve Bank of India, across companies and time, to maintain consistency.

To conduct the analysis, data on unbalanced panels of eight hundred and seventeen service sector firm level observations, for the period 2000-01 to 2005-06, and one thousand two hundred and twenty nine pharmaceutical sector firm level observations, for the period 1991-92 to 2005-06, were used. The analysis was confined to panels for two separate

sectors. The effect of the business cycle and institutional factors such as credit availability, impact of fiscal policy and fluctuations in interest and exchange rates would be similar for the public limited firms in each of the sectors.

Variables:

The dependent variable was foreign earnings (*foreign earnings*), measured in the standard way as the ratio of foreign earnings to total sales. The key independent variable was firms' wage structures measured as the ratio of the total expenditures for compensation to sales (*wage share*), a common measure of wage share in the literature (Katz and Murphy, 1992).

A number of control variables were included in the estimation. An important control variable was the level of firms' capital intensities (*capital intensity*) measured as the ratio of net fixed assets to total assets. Other factors were firms' size (*size*) measured as the log of total sales revenues, the leverage ratio (*leverage*) which was used as a control variable since lender pressures could influence firms' strategies to engage in overseas operations, the ratio of firms' imports to sales (*imports*), introduced as a control variable since firms that had acquired better quality inputs from overseas could engage more easily in overseas ventures, and a variable for the research and development spending ratio of the firms (*R&D*) as these expenditures incurred by the innovative firms could alter overseas market demand of firms positively.

Results

Estimation:

The error components two-stage least squares approach (EC2SLS), considered more efficient than the standard two-stage least squares approach most commonly used to deal with issues of endogeneity, was used. The intuition behind the EC2SLS estimator is that where the standard random effects estimator is a weighted average of the between and within estimators, the EC2SLS estimator is a weighted average of 2SLS estimation of a between estimator and 2SLS estimation of a within estimator (Baltagi, 2008).

The *wage share* variable was treated as endogenous and the instruments incorporated in the model for the pharmaceutical sector firms' were overhead costs incurred and the profits of the firms. The profits variable (*profits*) was measured by the ratio of profit after tax to sales. The overhead cost (*overheads*) variable was measured as the ratio of *overheads* costs to total costs. The *overheads* variable and the *profits* variable would be related to the *wage share* variable since the three variables, in sum, would yield an accounting identity. As one of these variables go up, the others go down. These variables were also used as instruments in the model for the service sector firms. Additional instruments used for these firms were variables denoting participation by firms in sectors such as equipment and transport rental, information technology and professional services as each sector would have different influence on the *wage share* variable.

Discussion:

The mean values of the variables are given in panel (A) of Table 1. The results of the regression are given in panel (B) Table 1. The first column reports the results for firms in the pharmaceutical sector. The second column reports the results for firms in the services sector. The estimate for the *wage share* variable for the

pharmaceutical sector is negative and significant (*t* statistic 2.16; $p < 0.05$). The estimate for the *capital intensity* variable is positive and significant (*t* statistic 2.25; $p < 0.05$). Pharmaceutical firms in India leverage their capabilities that are encapsulated in their physical capital to tap overseas markets, as is expected in a sector like pharmaceuticals, and use relatively less human capital to do so.

Table 1: Results of the Error Components Two-Stage Least Squares Estimation

Panel (A): Mean Values of the Variables				
	Pharmaceutical Sector		Services Sector	
Foreign Earnings	16.651		30.418	
Wage Share	10.416		23.366	
Capital Intensity	32.943		32.229	
Size	13.008		12.745	
Leverage	4.691		2.628	
Imports	9.824		4.389	
R&D	1.052		0.200	
Panel (B): Regression Results				
Dependent Variable: Foreign Earnings				
	Pharmaceuticals Sector Firms		Services Sector Firms	
Coefficient	Coefficient (Standard Error)	<i>t</i> statistic	(Standard Error)	<i>t</i> statistic
Constant	-72.116 (9.792)	7.36 ***	-67.913 (23.725)	2.86 **
Wage Share#	-0.288 (0.133)	2.16 **	0.487 (0.223)	2.18 **
Capital Intensity	0.085 (0.037)	2.25 **	-0.247 (0.123)	2.01 **
Size	6.693 (0.771)	8.68 ***	7.571 (1.695)	4.47 ***
Leverage	-0.016 (0.048)	0.33	-0.508 (0.336)	1.51 *
Imports	0.397 (0.045)	8.74 ***	0.047 (0.142)	0.33
R&D	0.169 (0.187)	0.90	1.436 (1.834)	0.78
R ²	0.228		0.100	
N	1,229		817	

*** $p < 0.01$, ** $p < 0.05$, and * $p < 0.10$; # Instrumental variables used for the *wage share* variable in the pharmaceutical sector model are *profits* and *overhead costs* and for the service sector model are *profits* and *overhead costs* and segment participation dummies for *equipment and transport rental, information technology services* and *professional services*.

Comparatively, the wage share variable for the service sector firms is positive and significant (t statistic 2.18; $p < 0.05$) while the estimate for the *capital intensity* variable is negative and significant (t statistic 2.01; $p < 0.05$). These results are the opposite of those noted for the pharmaceutical sector. Service sector firms in India engage in bodyshopping by using larger quantities of human capital to conduct business overseas and generate overseas earnings, a finding in consonance with the Hecksher-Ohlin contention that a labor-rich country like India will have large quantities of exports that will embody cheap human capital inputs rather than physical capital inputs.

On the other hand, the Indian pharmaceutical sector, while certainly using the critical capabilities that are encapsulated in their human capital, do not engage in bodyshopping by using large quantities of cheaper human capital and thereby incurring a higher wage share, but are equally able to leverage physical and technological capabilities for generating earnings from foreign markets. The different patterns noted, in how firms in different sectors of the economy generate foreign earnings, suggest the existence of heterogeneities in how firms utilize the manpower pool in India.

Conclusion

This analysis has evaluated the relationship between wage share and foreign earnings for a large number of pharmaceutical and service sector firms in India. The results show that the wage share and foreign earnings relationship is negative and significant for Indian pharmaceutical firms and positive and significant for Indian

service sector firms. Pharmaceutical firms in India leverage physical and technological capital in generating foreign earnings while service sector engage in bodyshopping, a logical strategy given India's abundant manpower pool. These results shed light on important relationships between wage share and foreign earnings for firms in two important sectors of Indian industry and highlight the existence of substantial heterogeneities in firm behavior which are, nevertheless, consistent with the expectations for firms belonging to these sectors.

References

1. Baltagi, B. (2008): *Econometrics Analysis of Panel Data*, New York: Wiley, 4th Edition.
2. Feinberg, S. and Majumdar, S. K. (2001): Technology Spillovers from Foreign Direct Investment in the Indian Pharmaceutical Industry, *Journal of International Business Studies*, 32, 3, 421-438.
3. Heckscher, E. (1950): The Effects of Foreign Trade on Distribution and Income, in Ellis, H. S. and Metzler, L. A., Eds, *Readings in The Theory of International Trade*, London: Allen and Unwin.
4. Helpman, E. (1984): A Simple Theory of International Trade with Multinational Corporations, *Journal of Political Economy*, 92, 451-471.
5. Katz, L. and Murphy, K. (1992): Changes in Relative Wages, 1963-1987: Supply and Demand Factors, *Quarterly Journal of Economics*, 107, 1, 35-78.
6. Krugman, P. R. (2008): Trade and Wages, Reconsidered, *Brookings Papers on Economic Activity*, 1, 103-154.
7. Mankiw, N. G., Romer, D. and Weil, D. N. (1992): A Contribution to the Empirics of Economic Growth, *Quarterly Journal of Economics*, 107, 407-437.
8. Ohlin, B. (1933): *Interregional and International Trade*, Oxford: Oxford University Press.



Does Inflation Affect Indian Economic Growth?

Surajit Sinha*

Abstract

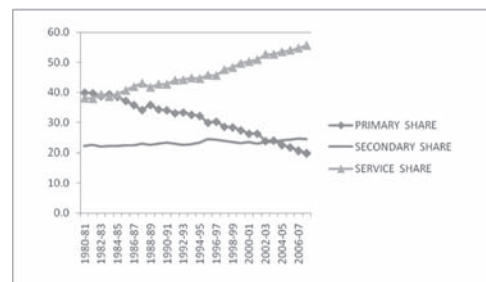
Cyclical macroeconomic theory often assumes an inverse relationship between inflation and unemployment, popularly known as the Phillips Curve. Okun's Law on the other hand has empirically demonstrated the exact empirical relationship between increase in output growth and reduction in the unemployment rate in countries like US. The two together therefore imply that increases in growth rate of output will be accompanied by rising inflation rate. This is not the only truth. Stagflation is also quite well known in the western world where falling growth rate of output is coupled with rising inflation rate. Is there any systematic relationship between inflation and output growth in India since the modern phase of the Indian economy began in the early 1980s? This paper makes a preliminary attempt to unravel this relationship.

Introduction

People often talk about remarkable changes that have taken place in the Indian economy since the structural reforms were initiated in mid-1991.¹ Let us consider some figures first. At the end of the first year of the new

Sixth Plan in 1980-81 which saw the beginning of the modernization phase in the Indian economy, the respective shares of the three major sectors in real GDP (at factor cost, 1999-2000 prices) were Primary (40%), Secondary (22%) and Service sector (38%). After twenty seven years of various kinds of efforts toward modernization and liberalization, these respective shares in 2007-08 stood at 20%, 24% and 56%. Therefore, the share of the Primary sector in the Indian economy has halved since 1980-81, whereas the Service sector has grown to above 50 percent of our GDP while the Secondary Sector has managed only marginal gains. This undoubtedly indicates the trend of our economy towards a predominately service economy with an approximately equal share among the other two sectors.

Figure 1



An earlier version of this paper was presented in the national seminar on 'Impact of Inflation on Indian Economy' held at DAV College, Kanpur in November, 2009.

* Surajit Sinha is Professor of Economics, HSS Department, IIT, Kanpur. He can be reached at surajiti@iitk.ac.in

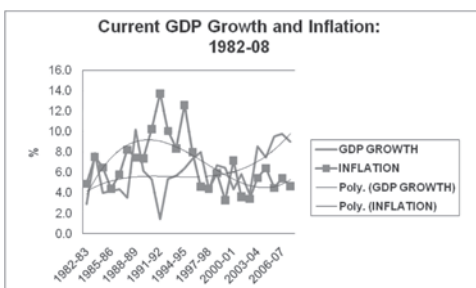
Table 1: Average Growth and Variance

	Primary	Secondary	Service	GDP
Average 1981-92	3.3	5.4	6.4	5.0
Average 1992-2008	3.5	7.2	8.4	6.8
Average 1981-2008	3.4	6.5	7.6	6.1
Std Dev 1981-92	5.2	3.0	1.3	2.4
Std Dev 1992-2008	4.0	3.0	1.8	1.9
Std Dev 1981-2008	4.4	3.1	1.8	2.2

Source: Economic Survey, 2008-09

The average annual real GDP growth was 1.8 percentage points higher during the post-reform period (1992-08) over 1981-92. The variability in GDP growth had also come down by half a percentage point. The quadratic trend in Figure 2 clearly shows an upward trend from the late 1990s.²

Figure 2



Let us assume that the effects of the structural reform process on the Indian economy could be realized earliest in 1992-93. During the first 10 years from 1981-82 till 1991-92 and then in the next 16 years till 2007-08, the growth rates of the Primary sector

were remarkably steady: 3.3 and 3.5, respectively. However, that is not the case with the other two sectors. For the Secondary sector, the numbers were 5.4 and 7.2, respectively. In the case of the Service sector, they were 6.4 and 8.4, respectively. Hence, one can safely conclude that the structural reforms and the fiscal measures of the Government of India along with the monetary initiatives of the RBI have significantly improved the growth of the Secondary and the Service sectors. The reforms had hardly any effect on the growth of the Primary sector.

The standard deviation of annual growth rates reveals a different picture.³ During 1981-92, the standard deviations of annual growth rates were as follows: Primary Sector (5.2), Secondary Sector (3.0) and Service Sector (1.3). These numbers during 1992-08 became 4.0, 3.0 and 1.8 respectively. Therefore, the year to year fluctuations in the growth rate of the Primary sector had substantially reduced during the post-reform years although it was still above the other two sectors. The variance in the Secondary sector had not changed at all despite the reforms, and that of the Service sector was the lowest although it had marginally increased in the latter years by half a percentage point.⁴

During the post-reform years the (weekly) average WPI inflation (1993-94=100) was 1.5 percentage points lower. The quadratic trend in the WPI inflation clearly shows a downward trend from the early 1990s. The variability in the inflation rate, however,

remained quite steady during these two time periods (Table 2 and Figure 2).⁵

Table 2: Average WPI Inflation and Variance

Average 1982-08	Average 1982-92	Average 1992-08	Std Dev 1982-08	Std Dev 1982-92	Std Dev 1992-08
6.7%	7.6%	6.1%	2.7	2.7	2.6

Source: Various issues of Economic Survey

Statistical Relationship

Is there any causal relationship from WPI inflation to output growth in India?

This issue can be statistically resolved using a two stage procedure. First, the variables concerned have to be checked for their stationarity property. Once they are found stationary, in the second stage the Granger Causality Test can be conducted. The Dickey-Fuller Test (henceforth DF Test) is used to test the stationarity properties of the variables. Suppose Y is an AR (1) process. Adding a constant term, a time trend t and a white noise error term ϵ_t with zero mean and constant variance, we shall run the following regression.

$$Y_t = \alpha + \beta t + \gamma Y_{t-1} + \epsilon_t \quad \dots (1)$$

Under the DF test, the estimated value of γ is tested for a value one. The DF test statistic is

$$d = \frac{\hat{\gamma} - 1}{SE(\hat{\gamma})} \quad \dots (2)$$

The critical values are given in Dickey and Fuller (1979). In our case with a sample range from 23-26, we shall

use -4.38 as the critical value to test whether $\hat{\gamma}$ (estimated value of γ) is statistically different from one at 1% level of significance. If the null hypothesis of one cannot be rejected, the data series will be differenced and the regressions will be re-run until the null ($\gamma = 1$) is rejected.

Table 3: d Values

GDP	WPI Inflation	Primary	Secondary	Service
-4.84	-2.90	-8.83	-3.92	-3.79
	-8.32 (differenced once)		-5.88 (differenced once)	-7.77 (differenced once)

Critical value: -4.38

In Table 3, three variables were found non-stationary: WPI inflation, Secondary sector growth and Service sector growth. They had to be differenced once to obtain stationarity.

Next, we test for Granger causality from WPI inflation to GDP growth, and all three sectoral growths. We ignore the details of these findings to save space except to mention that there was no causal relationship between GDP and all three sectoral growths and WPI inflation. The Granger Causality Test was conducted with the help of the following regression equation.

$$Y_t = \alpha + \beta Y_{t-1} + \gamma X_{t-1} + \delta X_{t-2} + \epsilon_t \quad \dots (3)$$

Acceptance of the null hypothesis $\gamma = \delta = 0$ imply that X does not Granger cause Y in the sense that inclusion of X in the regression does

not add any significant explanatory power to the right-hand side of the equation over past values of Y . In all our regressions the above null hypothesis with respect to GDP growth and sectoral growth was accepted.

Economic Theory

What does economic theory suggest about possible relationships between output growth and price change?

Prices and output are generally assumed to be endogenously determined in a macroeconomic model. Persistent rise in prices that we call 'inflation' may result from two broad reasons: persistent increase in demand for goods and services and/or persistent shortfall in the supply of goods and services. In a liberalized economic environment one expects firms to produce in a more competitive market with better technologies. Therefore, supply curves are expected to shift out. However, the net effect on prices will depend upon the relative shift in the demand and supply curves.

Demand factors

Demand for goods can increase due to a variety of reasons. First, consumption demand for domestic goods as well as foreign goods is expected to increase through rationalization of various indirect taxes including customs duties. Second, availability of goods improves substantially with the opening up of the economy. Third, increased disposable income with the households due to reduction in direct taxes and rising real income will shift demand for domestic

as well as imported goods. Fourth, private investment affects demand for both factors and goods. There are two competing hypotheses that decide how inflation and investment interact in a country. Present inflation can raise 'inflationary expectations' which in turn lower expected real interest rate provided nominal interest rate does not adjust immediately to hold real interest rate at some pre-determined level. This will act positively on present and future investment activities. On the other hand, current inflation can adversely affect current household demand for goods if households expect future inflation rate to increase. This lack of confidence in household spending can reduce the strength of 'investment accelerators' which says that investment depends positively on the change in sales of firms. Fifth, increased government spending on economic and social infrastructure increases demand for goods and services. Finally, increased export earnings cause demand for a range of goods to go up.

Supply factors

There can be several supply side factors that can affect output and prices in the economy. First, upward wage revisions will compel even competitive industries to raise their prices of products in the short run at least. As Keynesian short run macroeconomic model suggests, nominal wage increases will shift the short run aggregate supply function backwards. In the medium and long run tax cuts and technological improvements can counter these inflationary potentials.

Second, agricultural sector under-performance will accentuate upward pressure on prices of food and raw materials (particularly when the rest of the economy is witnessing reasonable growth, as is the case with our secondary and service sectors – a combination of supply and demand factors accentuate price rise). Third, ongoing moderate amount of inflation in the economy may serve as an incentive to the producers to expect higher profit margins from goods produced today and sold tomorrow at relatively higher prices. (However, as mentioned above under demand factors, very high level of inflation has the potential to lower real income in the economy substantially to shrink domestic demand for goods, in which case firms may feel reluctant to produce more for the future even if their profit margins are expected to increase in the future). Fourth, liberalized licensing system allows more firms to enter an industry, thereby increase competition and shift out the industry supply curve. In monopolistically competitive industries, any price reduction by one firm to gain market share compel other firms to follow suit. Fifth, technological improvements always shift out supply curves thereby put downward pressure on prices. Sixth, improved industrial relations always improve worker productivity that eventually lower product prices although real wages may increase. Finally, infrastructural developments help firms to improve their cost efficiency which result in lower prices or slowing down of their product price increases.

In short, the net effect on prices and inflation in a country will depend upon the relative strength of the demand and supply factors. If the demand side factors dominate, output increases are accompanied by rising prices and inflation. On the other hand, if the supply side factors dominate, output increases are accompanied by falling inflation rate and even falling prices, as is the case with many durable products in India.

Economic Policy

Let us now look at the inflation and output data from the Indian economy once again. Figure 3 and 4 clearly show there is no indication that either the contemporaneous WPI inflation or one-period lagged inflation and GDP growth have largely moved together or moved in the opposite direction. In some years they have moved in the opposite direction, and in other years they seem to have moved together in the same direction. Therefore, depending upon the relative strength of the demand side vis-à-vis supply side factors, the price movements have been decided accordingly for the Indian economy.

Figure 3

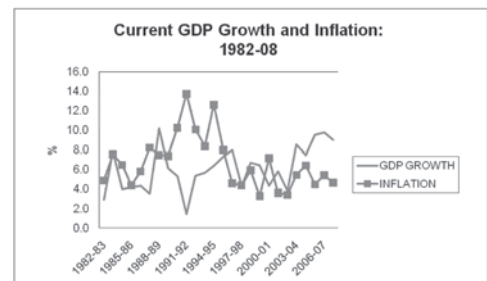


Figure 4



What has been the history of economic policy in India since the Sixth Plan?

The Sixth Plan (1980-85) document clearly stated that India should try to achieve 'self reliance' through increasing role of the public sector in industrial development. At the same time, the Industrial Policy statement of July 1980 focused on promoting competition, technological upgradation and modernization through induction of advanced technology, automatic growth in sectors that had direct linkage with the core sectors and long term export potential, development of R&D Institutions, etc. Some initiatives were also undertaken toward liberalizing licensing policy in a few private initiatives like computers and electronic items and manufacture of telecommunication equipments. Even the exemption limit of assets of MRTP companies was raised from Rs. 20 crores to Rs. 100 crores.

It is said that the Sixth Plan annual growth in GDP above 5% was achieved mainly due to good agricultural performance and rapid growth of the service sector. At the end of the Plan, the major drawbacks of the economy that had been persisting since the Third Plan however remained intact.

To mention a few

- (a) protection from foreign competition and severe curtailment of domestic competition allowed Indian industries to neglect efficiency, cost and quality;
- (b) in many industries (consumer goods and producer goods) high factor prices, inferior quality of inputs, power shortage and inadequate demand did not allow them to achieve target output levels;
- (c) prolonged labour unrest remained a persisting problem for industries;
- (d) public sector projects continued to experience cost and time overruns and obsolescence of technology; and
- (e) world recession did not allow exports to grow at anticipated rates.

Did the Seventh Plan overcome some of these shortcomings?

The Seventh Plan objectives were growth in food grains, increase employment opportunities and increase productivity. Industrial policy shifted away from massive investments in new facilities to capacity and productivity enhancing improvements in existing facilities. Industry was asked to restructure towards high technology, high value added and knowledge-based industries like electronics and telecommunications. Private sector was encouraged to develop 'sunrise' industries, such as telecommunications, computers, microelectronics etc. Power sector also received extra attention.

Annual average GDP growth of over 5% and average IIP growth of 8.5% per annum during the Seventh Plan were primarily attributed to

- (i) improved performance of infrastructure industries like power, coal etc;
- (ii) liberalized licensing procedures;
- (iii) import of technology and capital goods; and
- (iv) better utilization of installed capacities.

Among other achievements, shareholding of several PSEs were offered to mutual funds, financial institutions, general public and workers to enhance their accountability and operational efficiency. A large number of PSEs established their in-house R&D facilities.

Disaster struck at the end of the Seventh Plan in the form of domestic political uncertainties, government overspending that resulted in shipping of gold to Bank of England to meet external payment obligations, and sharp rise in oil price due to the Gulf War.

What were so unique about the structural reform process that began in the 1990s?

The Industrial Policy of July 1991 focused on 5 areas:

- Industrial licensing
- Foreign investment
- Foreign technology
- Public sector reforms
- MRTP Act

The measures included abolition

of compulsory licensing in many industries, FDI was allowed up to 51% in high priority industries, automatic permission for foreign technology agreements in high priority industries, automatic clearance for import licenses, many goods became freely importable with foreign exchange from the market, no prior permission for hiring foreign technicians, opening up of reserved areas to the private sector including infrastructure industries, greater disinvestment in several PSEs and several amendments in the MRTP Act which allowed MRTP companies to freely expand, takeover, merge etc.

In addition, several fiscal and monetary measures were also undertaken. For instance, drastic reductions in customs duties, rationalization of excise duties, tax holiday for some industries like solar energy, reduction of CRR, SLR and minimum lending rates of banks, reduction in corporate tax and personal income tax, were some of them.

Thus, the so called structural reforms initiated a very big leap forward to the forward looking liberalized policies of the Sixth and the Seventh Plans. These reforms were important not because all of them were initiated for the first time in India, but they were grouped in a package that surpassed both in quantum and quality any measures that were initiated earlier. The comprehensive nature of these reforms proved to be very effective in promoting high GDP growth and controlling inflation in India in the years that followed.

These reforms were later supplemented

by a set of Second Generation Reforms in the next two Plans: the Ninth and the Tenth Plan. For instance, in the Ninth Plan the licensing reforms were extended to many more industries, more disinvestment of PSEs followed, 100% FDI approvals were handed over to foreign companies even in infrastructure industries like oil refining and power, further rationalization of excise duties were achieved, CRR and bank rate were again lowered and so on.

Thus, one can conclude the following. First, the bulk of the policies since the Sixth Plan and particularly since July 1991 had focused on improving the supply side of the economy by creating more opportunities for companies to grow in an enhanced competitive environment. Second, they were supplemented by some demand side policies like reduction in personal income tax, rationalization of indirect taxes like sales tax and custom duties, enhanced credit availability, greater investment opportunities for the private sector, and so on that had shifted the demand curves also to the right. These supply and demand shifts had not only achieved steady GDP growth, at the same time inflationary potentials were kept under check with a downward trend in WPI inflation.

V. Conclusion

Neither the data nor the statistical tests could demonstrate any linear effect of WPI inflation on Indian growth patterns since the early 1980s. In the context of a macroeconomic model, output increases

can be accompanied by either rising prices or falling prices, depending upon the relative strengths of the demand and supply shifts in the economy in any given time period. The structural reforms had unambiguously established upward trend in output growth and downward trend in WPI inflation.

Finally, a few words of caution before we close our discussion. One needs to check whether GDP growth and the sectoral growths in the Indian economy have followed any *nonlinear* relationship with WPI inflation. This paper has not attempted any such investigations except for obtaining the cubic trend paths of GDP growth and inflation. Second, the structural reforms have undoubtedly benefitted the Service sector and to some extent also the Secondary sector. Unless, the Primary sector, in particular the Agricultural sector manages to keep up with the other two sectors, food shortages and rising food prices will deprive a large section of the society of the real gains of our GDP growth. Inflation to this section of the people is revealed through CPI instead of WPI. The cost of living index measured in terms of CPI is more relevant to the common people than WPI that the organized sector of the economy and the government is so obsessed with. Therefore, an important issue that remains to be investigated is whether there exists any important relationship between GDP growth and CPI inflation. There are various measures of CPI in India. One will have to select a specific CPI to study how that has

behaved in relation to our GDP growth and sectoral growths across different time periods.

Notes

1. We discuss structural reforms later in the paper.
2. The only year during 1981-2008 when the annual GDP growth touched double digit figure (10.2%) was in 1988-89.

The polynomial trend of GDP growth has $R^2 = 0.312$ and that of the WPI inflation has $R^2 = 0.437$.

3. Standard deviation is measured as

$$\sqrt{\frac{\sum(x-\bar{x})^2}{n-1}}$$

4. I have a suspicion that in our modern times, the Service sector is most susceptible to business cycles than any other sector. The recent recession has also affected the Secondary sector, and there is hope now that its revival is signaling end of the recession.
5. The weightage of items under WPI (1993-94=100) are as follows: Primary articles (22.03%), Fuel etc (14.23%) and Manufactured products (63.75%). Manufactured Food products account for 11.54%.



"E-Information Service"

Bombay Chamber of Commerce and Industry Trust for Economic and Management Studies

The "E-Information Service" provided by the Bombay Chamber of Commerce and Industry Trust for Economic and Management Studies disseminate useful information affecting business and commerce in India. The information contains important Govt. Notifications and Circulars on Banking, Taxation, International Trade, Labour Laws and Shipping as issued by the respective Departments of the Government of India, State Government and Ministries.

Any interested organisation including non-members of the Chamber can subscribe to the service on application and payment of prescribed fees. For further information please click the link below:

http://www.bombaychamber.com / services_offered.aspx

Commodity Price Volatility and Corporate Bottomlines: The Case of 2008-10

V. Shunmugam*

Abstract

Commodity price volatility has been on the rise since 2008, having an adverse impact on multiple entities in the economy. The risk posed by commodity price volatility has been impacting the profit levels of companies, producing volatility in the corporate bottom-lines. Companies have tried various strategies to shield the effect of this volatility on their profitability, with varying degrees of success. An effective risk-hedging approach is provided by exchange-traded commodity derivatives. While many companies in India and abroad have used commodity futures to effectively and cheaply lock-in input and output prices, the market in India is limited by a dearth of products which could meet the de-risking requirements of many stakeholders. The reason behind such lopsided development of the derivatives market is the FC(R) Act, 1952 under which commodity derivatives markets and products are regulated in India. Amendment of this Act is highly essential to bring markets and their regulation at par with stakeholders' requirements and provide an effective risk-mitigating instrument to the Indian corporates.

Introduction

While price volatility is an integral part of commodity markets, the volatility spike seen during 2008 and 2009 (the period of the worst global financial crisis since World War II) was unprecedented. The annualised volatility in Reuters/Jefferies CRB Index (one of the leading global commodity indices), which never breached 20 per cent in the past forty years, registered an annualised volatility of 31.4 and 25.9 per cent in 2008 and 2009 respectively. In fact, the volatility had over these four decades largely been confined within the 15 per cent barrier, exception being 1973 (18.7 percent), 1974 (19.9 percent), 1975 (15.1 percent) and 2006 (16.7 percent). Similarly, the annualized volatility in India's MCX COMDEX rose by more than 100 per cent between 2007 and 2008. Various factors ranging from supply issues to changes in global consumption and demand pattern have been cited and debated as the reasons behind the unparalleled commodity price volatility seen in 2008-2009. More importantly, such high commodity price volatility has a direct bearing on all the stakeholders of the economy.

* V. Shunmugam is Chief Economist at Multi Commodity Exchange of India Ltd., Mumbai. He can be reached at v.shunmugam@mcxindia.com

Therefore, if left unchecked, it can have more devastating effect on the overall economy than the volatility in other financial markets. From the point of view of a corporate or an immediate commodity stakeholder, various commodity price levels mean two contrasting situations: profit or loss, depending on which side of the market they are on at any given price.

Volatility as a source of risk

The economic downturn that initially sparked as a sub-prime mortgage crisis in the US in August 2007 has affected all regions of the world, pushing many nations into a deep economic recession. The global economic outlook deteriorated dramatically in September 2008, following the default of a large investment bank and the government bailout of the largest insurance company in the US. As the global economic output fell by one per cent in 2009, the focus was more on the developed nations. However, the commodity-oriented developing nations too suffered a major setback on the back of marked decline in their growth rates compared with the developed nations – thanks to the spiralling volatility in the prices of primary commodities that the developing nations were largely dependent on.

Following a period of steadily rising prices after the turn of the millennium, commodity markets were hit by severe turbulence during 2008. Prices of a number of commodities reached their historic peaks by mid-2008, in nominal terms – and in real terms

those of metals, minerals and crude oil. Soon, commodity prices experienced a sharp fall that was closely linked to heightened global economic uncertainties and the shocks emanating from the financial markets that had impacted the real economy sharply. Despite the slump, the volatility in commodity prices in most markets continued to remain well above the comfort level for related companies and immediate stakeholders. That is why, since the beginning of the financial crisis of 2008-2009 we have seen more instability in commodity prices, particularly in those of energy sources and basic feedstocks such as oil and natural gas, the ripple effects of which were visible in related markets for chemicals to basic metals to plastics. While raw material costs generally could not be transferred quickly and efficiently down the value chain, the volatility led to weaker and more unpredictable earnings, which in turn got reflected in depressed share prices. In these two years, we witnessed a long list of commodity-related industries that missed their earnings targets simply because they were unable to cope with the commodity price/volatility risk effectively. No wonder, a Washington-based Corporate Executive Board's January 2010 survey ranks commodity price risk as No. 1 among the top 10 risks faced by corporate participants.

Impact of volatility on corporate bottomlines

Just imagine this scenario: what would

have happened to companies (dealing in or their business linked to various commodities) in the times of high fluctuations in commodity prices, as witnessed during 2008-2009, with no risk (arising from price volatility) mitigating mechanism in place to cope with the turbulence? The answer: the volatility would have not only disrupted their planning and fund flows, but also posed a serious threat to the economic viability of their business.

The degree to which a company depends on a particular commodity varies from industry to industry and so does the impact of price volatility on its corporate bottomline. But the volatility of last two years tested the ability of virtually all companies, irrespective of sectors, to effectively respond to the stress emanating from commodity markets. In an instance, an aluminium products manufacturer set price ceilings for customers without capping the supplier contracts and was, therefore, unable to pass on the raw material price increase to its customers. And when its input costs rose to unprecedented levels, the company's financials collapsed, market capitalisation slumped by around 35 per cent and it lost \$1.1 billion over four years. Another among many companies that were badly affected by the commodity price volatility was Tyson Foods Inc. The company reported a loss of US\$5 million in the second quarter of 2008, because of the high and volatile input costs (corn and soybean) in its chicken segment, compared with a profit of \$68 million in the same period a year earlier.

Another major commodity-centric corporate entity, Procter & Gamble Co., reported that higher commodity and energy costs, arising out of highly volatile commodity prices, reduced its gross margins by over 220 basis points in the first quarter of 2008. The adverse impact of commodity price volatility has not been confined to major international markets only; it has had its toll on the Indian corporate sector as well. The example of Halonix Ltd. is a testimony to the extent of the blow taken by them in 2008-09. During 2008-09, Halonix's net profit nosedived to Rs. 162.76 lakh from the 2007-08 figure of Rs. 4,800.38 lakh, courtesy the volatility in raw material prices. In what can be cited another example, Hindustan Unilever Limited's Annual Report for 2008-09 read: "...another major issue we had to contend with during the year was unprecedented volatility in the price of commodities...."

Macro impact of price volatility

Apart from having its instant impact on companies and immediate stakeholders, the unchecked high price volatility is also a risk for the macro-economy of both commodity-exporting and -importing countries. As for an exporting country, high commodity price volatility instils instability in its budgetary allocation besides adversely impacting investment planning and technology upgrade. On the other hand, for net commodity-importing countries, it creates difficulties in making provision for the necessary foreign exchange to pay for their

imports, besides generally adding to their import cost. Additionally, highly volatile commodity prices have severe social impact as in absence of an appropriate risk (arising from volatility) mitigating tool, volatility finally tends to result in higher risk margins charged by intermediaries and other value chain participants of a given commodity. In such situations, both the ends of the value chain — the producer and the consumer — get badly impacted.

In short, high and uncontrolled volatility leads to a 'lose-lose' situation for all stakeholders in an economy, except intermediaries of the commodities that are volatile. Hence, along with corporate which will definitely need to turn the commodity price risk into opportunities through its management, even the sovereign should look into possibility of hedging of commodity prices wherever possible and pass on the benefits to its citizens, besides inculcating risk management culture among commodity stakeholders through an enabling policy environment.

Coping with commodity price volatility

How has the corporate world reacted to commodity price volatility? Companies across the globe have been resorting to a slew of both traditional and innovative practices to beat input price volatility. Some of the ways by which this has been done in recent months, with varying degrees of success, are:

a. Passing on volatility to consumers

This traditional approach is difficult to follow in a competitive environment and in product segments where the market demand is elastic. Nevertheless, the world No. 1 in food products, Nestle, increased their prices across the board by over 3 per cent on 2007 and 2008, while those never exceeded 2 per cent during the previous three years. Similarly, Dow Chemical Company, facing a 42 per cent increase in energy costs in the first quarter of 2008, increased prices by almost 20 per cent – the biggest one-time hike in the company's 111-year history.

b. Risk-mitigating input pricing

Companies often enter into long-term contracts with input suppliers on mutually agreeable pricing principles. A fixed pricing contract, for example, provides a complete proof against price volatility, but makes the purchaser bear the risk of any downside movement of prices. A 'collar pricing' contract, on the other hand, entails a band of volatility and risk sharing between the buyer and the supplier.

c. Making supply chain more efficient

This has been attained by companies, such as P&G, by basing manufacturing sites closer to consumer centres or sources of primary raw materials, in order to reduce transportation costs. Wal-Mart's famed hub and spoke model of sourcing has enabled it to remain cost-competitive and at the top position in the list of Fortune 500 companies year after year. Many

companies also entered into strategic relationships with their suppliers or procurers, investing in the supply chain of the latter to make it more efficient and reap the resultant economies of scale.

d. Substituting expensive with cheap inputs

Many companies are known to have stepped up their R&D efforts in search of inputs that can substitute the existing ones suffering high price volatility, or redesigning products, or even reengineering production processes that can entail saving on input requirements. For example, as grapefruit oil prices shot up from \$10 a pound to \$70, following a series of weather-induced supply shocks in the US in 2008, beverage and fragrance producers that used grapefruit oil as a key ingredient were forced to find alternatives. Many of them successfully reformulated their recipes using other ingredients. Today, these companies have attained long-term risk mitigation on this front, even as the natural grapefruit oil market has subsequently stabilised. Many such substitutions have been witnessed, particularly in the chemicals sector.

e. Strategic sourcing

Companies have resorted to 'strategic' sourcing of raw materials to get over volatility shocks. They have typically done this through long-term contracts with suppliers with favourable pricing, while providing the latter with incentives to increase capacity. General Motors, for example,

has an agreement with its suppliers to adjust prices monthly for parts made from aluminium on the basis of the spot price of aluminium on the New York Mercantile Exchange. An extreme form of strategic sourcing is backward integration, where a buyer acquires its primary commodity supplier for procuring its inputs at the lowest possible cost. The classic example of this approach was Ford Motor Company acquiring steel factories to iron ore mines to be a 'fully integrated company'. Although this is a costly option for most businesses, some companies find that backward integration is the only competitive option at their disposal. For example, a major US textile firm, facing a growing demand for products made from organic cotton, acquired a stake in an Indian organic cotton farm, securing a long-term supply while providing farmers new capital to cultivate more cotton and gain organic certification for cotton supply.

Commodity derivatives as a strategic hedging device

Some of the approaches to managing commodity price volatility, while being effective, fall in the realm of tactical practices within companies, rather than strategic principles. An effective strategy to cushion the impact of commodity price volatility on corporate bottomline has been the use of commodity derivatives. Suitable derivative products, especially when transacted through the transparent mechanism of a commodity exchange, enable a company to pass on its risk

of price volatility to all the market participants. A study in 2008, covering cross-country experiences, concluded that the use of financial derivatives reduces both total and systematic risks for companies.¹ Take the classic example of Southwest Airlines in the US. While rising oil prices were wreaking havoc on the airline industry, Southwest's aggressive – and somewhat complicated² – hedging practices helped it to pay an average of \$26 per barrel in 2009, while the market price topped \$70. Today, Southwest is the only US airline to display profit consistently on its balance sheet.

Exchange-traded commodity derivatives are becoming increasingly popular in the Indian corporate sector too. Large requirements of numerous price hedgers and price volatility have meant that derivatives have proven to be an effective de-risking instrument for many Indian companies that have tested this effective risk-hedging instrument. The volumes of physical commodities traded by Indian companies, reflecting the risks that these companies are exposed to, have meant that exchange-traded derivatives are meeting a big unmet demand to hedge their risks at low costs. This has led to tremendous growth of the derivatives market, and within six years of its launch, the biggest commodity derivative exchange in India, Multi Commodity Exchange of India, is already the sixth largest in the world in terms of the number of contracts traded. A survey conducted by Ernst and Young in 2008 across 45 Indian companies, in various

sectors, found most respondents to have understood the implications of volatile commodity prices on their bottomlines and viewed hedging as a tool to lock in input costs at a pre-fixed target level. Over 81 per cent of the respondents were also found to be using standardized exchange-traded products such as futures – a testimony to remarkable popularity of exchange-traded derivatives. Moreover, many respondents used signals coming in the form of futures prices for forming views about the market and as a trigger for decision making.

Derivatives as hedge: the unfinished agenda in India

While corporate India has been using derivatives to hedge risks, it has to be content with only a few basic derivative instruments that barely cover all its risks. The Ernst and Young survey found that less than 9 per cent of the respondents used derivatives instruments beyond plain vanilla futures and forwards. Such products could hardly cover all their risks – a fact they were well aware of. As a result, more than 68 per cent of the respondents had a hedging horizon of less than three months, indicating that the full potential of hedging to protect long-term business cash flows was not available in India.

Part of the reason for uncovered risks is the absence of suitable hedging products, many of which are not allowed in the Indian markets. Thus, many risk-hedging products, such as options and indices, which

can be tailored to the risk appetite of diverse investor classes and are hedges against specific risks, are currently not permitted in India. Similarly, participation by financial institutions and foreign entities is barred in our markets, whereas it is well-recognized that participation of these entities would lend much-needed liquidity, depth and popularity to the commodity futures market. The commodity derivatives market in India is still guided by the Forward Contracts (Regulation) Act, 1952, which was enacted in the backdrop of wartime shortages, a context far-removed from the realities and demands of today's economy. Unsurprisingly, recognizing the pressing demand of the Indian corporate class to hedge its risks, even the Reserve Bank of India had allowed Indian companies to trade in offshore exchanges products such as carbon futures and indices such as freight index. Ironically, while the country's central bank, known for its conservatism (which prevented the Indian financial sector from being drawn into many a crisis), understands the pressing need for financial hedge for Indian companies, the latter are forced to seek avenues for hedging in markets overseas. With a 'strong regulator within a liberal policy environment', which is the avowed objective of Indian economic liberalisation agenda, commodity derivatives can indeed emerge as the most effective hedging avenue for Indians for risks arising out of continuing commodity price volatility.

Be so as it may, there are some

strategic initiatives that companies can themselves, even with such constraints, take to reap the full benefits of commodity derivatives. These initiatives lie at the heart of weaving the opportunities thrown by the derivatives market into a company's vision. Companies have to recognise the criticality of commodity price-oriented risk management into their business operations. To that extent, a commodity-oriented risk management policy has to be formulated by companies exposed to such risks, in sync with their risk philosophy and risk appetite. While explicit recognition of risks arising from commodity price volatility is given by India Inc, taking this recognition to company policy levels is crucially missing in many companies. In fact, applying an integrated commodity management policy to procurement and sales can help make volatility itself a key differentiator to the company: positioning it to gain a competitive advantage, satisfy crucial stakeholders and thrive in a challenging global marketplace. As observed by Deloitte Consulting LLP, "the greater the volatility, the greater the potential for companies to differentiate themselves from competitor", it means companies can turn price volatility in raw materials and finished products into a key differentiator, giving them more opportunity to reduce costs, achieve higher average profitability and expand market share. Proper price risk management and scenario planning can provide companies with predictive insights they can use in

crafting and executing strategies to overcome volatility perils. Appropriate adoption of risk management practice by a company can not only shield it against the perils of price volatility but also enhance its bottomline. A case in point is PepsiCo's 2008 second-quarter results, where the company delivered earnings per share (EPS) of \$1.05, up by 13 per cent on Q-o-Q basis. But excluding its current and prior year mark-to-market gains on commodity positions would have dipped its EPS to \$1.03.

Conclusion and outlook

Many observers opine that the persistent volatility in commodity prices is a long-term phenomenon, a result of rising incomes of youthful populations in the engines of rapid economic growth like India and China, stagnating agricultural production and supply capacity falling short of demand. Such fundamental changes in commodity market dynamics, coupled with the phenomenal development of ICT in a globalised world, have meant that uncertainties in any part of the world will continue to have their ripple effects felt in other parts, resulting in high volatility in commodity prices. Yet, there is scarce little that individual companies or even nations can do to reverse this trend. Hence, it is imperative to take long-term visionary initiatives to absorb the price shocks before they hit the real economy and corporate bottomlines. Companies

need to look at commodity price risk management as an integral part of their business strategies to manage their bottomlines. State policy ought to support and augment such efforts through strengthening of institutions that absorb and prevent price shocks from impacting the real sector, most notably, the institution of exchange-traded commodity derivatives. Globalisation has brought the menace of commodity price volatility at the doorstep of India Inc. It is time the opportunities thrown open by globalisation too are harnessed in designing an innovative policy framework towards managing this menace.

Notes

1. Brown, Gregory W. and Conrad, Jennifer; University of North Carolina, "The Effects of Derivatives on Firm Risk and Value" (June, 2008). They studied annual reports of 6,888 non-financial firms operating in 47 countries, including 40 companies in India.
2. When low crude prices ruled the roost, Southwest Airlines locked in an aggressive hedging strategy that allowed it to buy oil at \$32 a barrel for 65 percent of its fuel needs in 2006, \$31 a barrel for 45 percent of its needs in 2007, \$33 a barrel for 30 percent of its needs in 2008, and \$35 a barrel for one-fourth of its needs in 2009.



Priority Sector Financing in India: Past, Present and Future

Ram Pratap Sinha*

Abstract

In the post-world war II period, most of the less developed countries adopted a policy of financial repression involving substantial government intervention in the financial markets. In particular, countries like Japan and South Korea achieved considerable success with their policy of government intervention in financial systems. Directed allocation of resources and control on lending and deposit rates were essential ingredients of such policy. In the Indian context, the pattern of priority sector lending has, however, undergone major changes during the past few decades because of changes in regulatory stance. The banking sector in India is facing the dilemma of widening access of the less privileged sector to financial resources on the one hand and maintaining profitability and meeting prudential regulatory norms of the market regulator on the other.

Introduction

Economic development of a nation requires rapid and sustained increase in the real output over a reasonable period of time. It is well recognised that the key to this process is an appreciable rise in the saving-income

ratio of the relative economy. Rostow, (1960), pointed out that one of the pre-conditions of the take off into self sustained growth is to increase the saving and investment ratio from 5-7% of national income to at least 10% of national income. Lewis (1959), had put forward similar arguments. This, however, requires mobilisation of financial resources by the financial institutions on a reasonably high scale.

Unfortunately, in the aftermath of the second world war, the developing economies inherited financial systems which were not conducive to the mobilisation of resources to the desired extent. This was perhaps one of the major reason for the adoption of substantial government intervention in the financial markets. In particular, countries like Japan and South Korea achieved considerable success with their policy of government intervention in financial systems. Directed allocation of resources and control on lending and deposit rates were essential ingredients of such policy.

The Rationale For Priority Sector Lending

There are several reasons why the developing countries opted for directed lending (to priority sectors) and

* Ram Pratap Sinha is Associate Professor of Economics, Government College of Engineering and Leather Technology, Kolkata. He can be reached at rp1153@rediffmail.com

interest rate controls for acceleration of their growth process. Broadly speaking, the following arguments can be cited in favour of financial repression:

- (a) The developing country financial markets are characterised by market failures. Thus deserving borrowers (in the absence of government intervention) fail to attract resources. Allocation of financial resources to them on a privileged basis (and at less than market clearing rates) would promote economic growth.
- (b) The existence of directed lending also facilitates mobilisation of resources for the public sector.
- (c) The financial system including the intermediaries require strict regulation. The existence of directed lending enable the monetary authorities to maintain a stringent control on the money supply.

Directed Lending-Industry vs Agriculture

Calomiris and Himmelberg (1993) examined the impacts of directed lending programmes to agriculture and industry both from theoretical and empirical standpoints. They pointed out that the motives behind government programmes to provide directed credit to agriculture and industry can be traced to problems of asymmetric information in capital markets leading to rationing and mispricing of credit under the free market system.

In the agricultural sector, farmers may have to approach non-institutional sources of financing in the absence of state support. The exorbitant rates of interest charged by the village moneylenders are likely to create repayment problem for the farmers leading ultimately to debt traps. Thus directed credit programmes that help farmers accumulate sufficient wealth to own the land they cultivate are essentially welfare enhancing.

However, while evaluating the directed credit programmes in agriculture, one needs to take into consideration the social costs of such programmes as well. In particular, the distribution of funds has been motivated by political rather than economic goals. The directed credit programmes are usually associated with high rates of default and misallocation of resources. Such policies may also destabilize local land markets and thus make farm ownership even more difficult for worthy borrowers who are denied access to such credit facilities. In this context, Calomiris and Himmelberg (1993) argued that for increasing the efficiency of government credit support to agriculture, it is essential to develop local incentive structure for peer screening and monitoring of borrowers. The successes achieved by Thailand and Bangladesh in this matter are particularly notable.

In the industrial sector, the benefits of government credit may include product and factor market externalities as well as the direct benefits from relaxing borrowing constraints. In the post-second world war period, countries

like Japan and South Korea obtained substantial benefits from directed credit to the industrial sector. In Japan, the Japan Export-Import Bank and the Japan Development Bank were the two most important vehicles for providing credit assistance to industry. The industrial assistance programmes, were, however, so designed as to facilitate the market economy. As such, the directed credit system was utilized to expand the emerging sector and to shrink the declining industries. In South Korea also credit was not allocated on the basis of market criteria but discretionary judgement of government bureaucrats. However, the government controlled financial system mimicked a free market allocation of resources and contrary to expectations, directed allocation of resources did not lead to efficiency losses.

These two examples do not constitute a blanket endorsement of government interventions in industrial credit markets. In many cases, government interventions have generated large costs through the funding of inefficient industrial borrowers and the crowding out of private credit intermediaries. But then the divergence in cross country evidence emerges due to the heterogeneity in the institutional mechanisms through which policy objectives are translated into directed credit programmes.

Institutional Lending to the Priority Sector: the Indian Experience

Fisher and Shriram (2002) identified three distinct phases in the

development initiatives in India through the supply of credit to the less privileged sector of the economy:

The first phase started in 1935 with the establishment of the Agricultural Department of the Reserve Bank of India. During this phase developmental initiatives focused primarily on the cooperatives as the chosen vehicles of change. This phase culminated in the sixties.

The second phase was visible with the adoption of a new credit policy by RBI in 1967-68 (which contained a formal statement of the need to ensure flow of credit to the priority sectors of the economy including agriculture, exports and small scale enterprises). This coincided with the nationalisation of 14 commercial banks in July 1969 and the introduction of Lead Bank Scheme thereby starting a process of district credit plans and coordination among financial intermediaries. In 1980-81 the government introduced the Integrated Rural Development Programme (IRDP) to provide disbursed to pro-poor self employed

The policy of mass banking initiated during the phase had a significant impact on the supply of rural credit: the proportion of rural credit supply from the commercial banks and cooperatives increased from 29.2 per cent in 1971 to 61.2 per cent in 1981 which however slipped to 56.6 per cent in 1991. However, the incidence of overdue / default has been higher in respect of directed credit. The statistics released by the RBI revealed the following:

- a) In 1992 directed credit accounted for 35 percent of lending but 55 percent of overdues.
- b) In respect of small scale industries 17 percent of bank credit was locked up in sick units in 1990. The comparable figure for large scale and medium sized industries has been 12 percent.
- c) In respect of agriculture the ratio of loan recovery to loan demand in 1992 was only 53.3 percent.

The above figures indicate that priority sector lending has been one of the major reasons for declining bank profitability. The problem has been more acute in respect of the Regional Rural Banking Sector (RRBS). The total interest income loss on account of priority sector lending for the public sector banks increased from Rs.34.13 crores in 1974 to Rs.973.25 crores in 1990-91.

The third phase commenced after the financial crisis of the 1990s which led to the adoption of prudential regulations in the banking sector. During this phase the system directed credit has been reviewed by the Committee on Financial System (CFS-1991) and the Committee on Banking Sector Reform (CBSR, 1998). The CFS (1991) advocated in favour of gradual phasing out of directed credit programmes. While the committee recognised the need to provide special credit support to the priority sector for the time being, it favoured modification in the definition of the priority sector, reduction in the quota and gradual phasing out of the concessional rate of interest. The system of directed

credit was again reviewed by the Committee on Banking Sector Reform (1998). The committee recognised that the small & medium farmers & the tiny sector of industry and small business have problems with regard to obtaining credit and some earmarking may be necessary for this sector. The committee thus opined that the current practice may continue.

During the third phase the commercial banks and the Regional Rural Banks were restructured and interest rates were decontrolled (consequent on the recommendation of the R V Gupta Committee). The government also took a slew of measures for the supply of credit to the priority sector. Inter alia, these included consolidation of the self employment programmes into Swarna Jayanti Swarozgar Yojana (SJSY), the introduction of Local Area Banks (in 1996) catering to three contiguous districts modeled on similar banks in Indonesia and the introduction of autonomous Mutually Aided Cooperated Societies (MACS) by various states.

The Quantum of Priority Sector Financing: The Priority Sector Lending Quota

In July 1968, the National Credit Council decided that commercial banks should increase their involvement in the financing of priority sectors, viz., agriculture and small scale industries. The description of the priority sectors was, however, formalised only in 1972 on the basis of the report submitted by the Informal Study Group on Statistics

relating to advances to the Priority Sectors set up by the Reserve Bank in May 1971. Initially, no specific targets were fixed regarding priority sector lending. In November 1974, however, the banks were advised to increase the share of the priority sectors in their aggregate advances to the level of 33.33 per cent by March 1979. Subsequently, all commercial banks were advised to achieve the target of priority sector lending at 40 per cent of aggregate bank advances by 1985. Sub-targets were also

specified for lending to agriculture and the weaker sections within the priority sector. Since then, there have been several changes in the scope of priority sector lending and the targets and sub-targets applicable to various bank groups (Table 1).

Growth in Priority Sector Advances

During the pre-reform phase there has been a secular upward movement

Table 1: Priority Sector Lending Quota in India

Particulars	Target For Domestic commercial banks	Target For Foreign banks
Overall Priority Sector Advances	40 per cent of Adjusted Net Bank Credit (ANBC) or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher.	32 per cent of ANBC or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher.
Total Agricultural Advances	18 per cent of ANBC or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher.	Not Applicable
Small Enterprises Advances	Advances to small enterprises sector will be reckoned in computing performance under the overall priority sector target of 40 per cent of ANBC or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher.	10 per cent of ANBC or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher.
Micro Enterprises Within Small Enterprises Sector	(i) 40 per cent of total advances to small enterprises to be allocated to micro (manufacturing) enterprises (investment in plant and machinery up to Rs 5 lakh) and micro (service) enterprises (investment in equipment up to Rs. 2 lakh); (ii) 20 per cent of total advances to small enterprises to be allocated to micro (manufacturing) enterprises with investment in plant and machinery above Rs 5 lakh and up to Rs. 25 lakh, and micro (service) enterprises with investment in equipment above Rs. 2 lakh and up to Rs. 10 lakh. (Thus, 60 per cent of small enterprises advances should go to the micro enterprises).	Same as for domestic banks.
Export Credit	Export credit is not a part of priority sector for domestic commercial banks.	12 per cent of ANBC or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher.

Source: RBI(2005): Draft Technical Paper by the Internal Working Group on Priority Sector Lending, September 2005, www.rbi.org.in.

in the proportion of priority sector advances to total bank credit. Table 2 provides the details regarding the share of priority sector advances in bank credit for the period 1969-91. However, there has been a significant deterioration in the quality of priority sector asset quality during the period.

The General Economic Impact Of Priority Sector Lending in The Pre-Reform Era

The economic impact of directed credit can be judged from several stand points:

(a) Impact of Priority Sector Lending on Sectoral Growth:

It is not very easy assess the impact of priority sector lending on sectoral growth including growth in output, input use and employment. This is because collection of statistical data in this respect is extremely difficult. However, there are at least two econometric investigations which sought to assess the impact of directed credit on sectoral growth in quantitative terms.

The econometric investigation of Binswanger and Khandekar (1995) is

regarding the impact of formal finance on the Indian rural economy. As per their investigation, the expansion of the rural financial system did have substantial effect on non-farm employment and output. However, the impact of directed credit on agricultural output was rather modest and the impact on farm employment negligible. Nevertheless, the increased flow of formal finance promoted consumption of agricultural inputs significantly and also facilitated fixed capital investments in the agricultural sector. Thus the overall impact of directed lending on the rural sectoral growth was on the positive side.

The impact of directed institutional credit on the small corporate sector was examined by Kohli (1997). For this, they considered firm level data for the period 1965-78.

(i) The change in banking sector attitude towards the small scale sector following bank nationalisation resulted in a more even distribution of bank credit across the firms. The policy of mass banking also encouraged the entry of small borrowers in the credit market.

Table 2: Advances To The Priority Sector as a Proportion of Total Bank Credit: :1969-91 (Figures in Rs. Crores)

Sector	June 1969	Dec. 1976	Dec. 1980	Dec. 1985	June 1991
Agriculture	5.3	10.1	15.6	18.3	16.0
Small Scale Industrial Units	8.6	13.0	16.5	19.5	15.8
Other Priority Sector	0.7	2.6	3.8	5.0	8.2
Priority Sector Adv / Total Adv.	14.6	25.7	35.9	42.8	40

Source: Various RBI Documents

(ii) For several types of small scale industries, increases in the flow of bank credit resulted in faster growth rate for the respective industries. The industries included, among others, electrical machinery & pharmaceutical sector which grew relatively faster during the period under consideration.

(b) Impact of Priority Sector Lending on The Distribution of Income and Wealth

A significant part of the institutional credit went to the rural sector under various poverty alleviation programmes for the creation of assets by the rural poor. Empirical evidences regarding such programmes can give an idea about the efficacy of directed credits in generating adequate income and wealth for the poorer section of the society (The Concurrent Evaluation of IRDP, 1996, Joshi and Little 1997).

The important findings of the studies conducted to evaluate the efficacy of such programmes are as follows:

- (i) The targeting of credit programmes had been poor; only 3.9 percent of the IRDP beneficiaries received training under TRYSEM and as much as 47.2 percent of the TRYSEM trained beneficiaries could not undertake economic activities. In many cases poor households were excluded but rich households were included.
- (ii) Utilisation of credit has not been satisfactory. In many cases assets acquired by the house holds by virtue of IRDP loans were of

poor quality. In many other cases loans were used for meeting consumption requirements.

- (iii) The income generated by IRDP is insecure and risky and poor households do not have the required debt repayment capacity. Consequently, IRDP borrowing resulted in higher level of indebtedness among the poor households.
- (iv) The recovery performance under IRDP has been extremely poor. One of the major cause of poor recovery has been wilful default by the borrowers expecting loan waiver by the government.
- (v) On equity grounds also the IRDP credit programmes failed. The survey conducted by the Agricultural Credit Review Committee (1989) showed that the poorest house holds (assets less than Rs.1000) met only 9 percent of their credit requirements from institutional sources. Most of the rural credit were obtained by medium and large farmers. The study also revealed that only 30 percent of the rural families had access to institutional credit.
- (vi) The lack of inter agency coordination was found to have a major role in the poor performance of IRDP credit programme.

Priority Sector Lending in The Reform Era

During the reform years progressive tightening of the asset classification,

provisioning and capital adequacy norms have resulted in a relative neglect of the priority sector by the Indian commercial banks (Table 3). Further, the flow of credit to the conventional segments of the priority sector has probably declined during the period with a progressive widening of the definition of the priority sector (Shajahan 1998, 1999). However, during the reform period the Indian commercial banks have successfully

tackled the priority sector Non Performing Assets (NPA) problem (Table 3).

The Composition of Priority Sector Lending

In order to understand about the nature of credit flow to the different sub-sectors under the priority sector, Tables are presented below (Tables 4, 5 & 6) which correspond to the public, private and foreign banks.

Table 3: Priority Sector Advances and Priority Sector NPA of Public Sector Commercial Banks (1996-97 to 2004-05) (Rs. in Crores)

Particulars	1996-97	1998-99	2000-01	2002-03	2004-05
Total Priority Sector Advances	79131	107200	146596	176264	294216
Priority Sector Advances as a % of Gross Advances	32.4	32.9	33.2	30.5	34.4
Priority Sector NPA	20774	22606	24159	24939	23397
Priority Sector NPA Ratio(%)	26.25	21.09	16.48	14.15	7.95

Source: RBI: Statistical Tables Relating to Banks in India, various years.

Table 4: Advances to the Priority Sectors by Public Sector Banks (amount outstanding in Rs. in Crore)

Particulars	June 1969	March 2006	March 2007	March 2008	March 2009
Direct Agricultural Advances	40	112126	202614	177259	215643
Indirect Agricultural Advances	122	43093	58242	72138	82569
Small Scale Sector	257	82434	102550	151137	191307
Other Priority Sector Advances	22	163756	206661	209842	230507
Of which					
(i) Retail Trade	N.A.	N.A.	N.A.	40519	43061
(ii) Micro Credit	N.A.	N.A.	N.A.	2707	3943
Bank Net Credit	N.A.	N.A.	N.A.	19748	26913
(iv) Housing	N.A.	N.A.	N.A.	146868	156590
Total Priority Sector Advances	441	409748	521376	610450	720083

Source: RBI(2009): Trend and Progress of Banking in India, 2008-09.

Table 5: Advances to the Priority Sectors by Private Sector Banks (Rs. in Crores)

Particulars	March 2007	March 2008	March 2009
Agricultural Advances	52034	58567	76062
Small Scale Sector	13136	46912	47916
Other Priority Sector Advances	76919	58589	66059
Of which			
(i) Retail Trade	N.A.	8037	7325
(ii) Micro Credit	N.A.	2494	4612
(iii) Education	N.A.	509	797
(iv) Housing	N.A.	47516	53463
Total Priority Sector Advances	144549	164068	190027

Source: RBI(2009): *Trend and Progress of Banking in India, 2008-09.*

Table 6: Advances to the Priority Sectors by Foreign Banks (Rs. in Crores)

Particulars	March 2007	March 2008	March 2009
Export Credit	20711	28954	31511
Small Scale Sector	11637	15489	18138
Others	5483	5811	5834
Priority Sector Advances	37831	50254	55483

Source: RBI(2009): *Trend and Progress of Banking in India, 2008-09.*

Priority Sector Lending for the Development of Rural Infrastructure

In 1995-96, the Central Government launched the Rural Infrastructure Development Fund (RIDF) with an initial corpus of Rs 2000 crores with contributions from both public and private sector banks. The RIDF was created with the twin objectives of infrastructure development in the rural areas and assisting commercial banks

to meet their priority sector targets (Rajeev, 2008).

Priority Sector Non Performing Assets (NPA): The Relative Contributions of Different Sub-Sectors

Table 7 provides information relating to the relative contribution of different sub-sectors in priority sector NPA for end March 2009. The Table indicates that the problem is mostly

Table 7: Composition of Priority Sector NPA (2009)

(Rs. in Crores)

Bank Group	Agriculture	Small Scale Industries	Others	Total Priority Sector NPA	Total NPA
Public Sector Banks	5708	6984	11626	24318	44042
Private Sector Banks	1441	670	1529	3640	16887
Foreign Banks	-	220	429	649	7155

Source: RBI(2009): *Trend and Progress of Banking in India, 2008-09*

concentrated in the public sector banks as they have to primarily shoulder the responsibility to provide access to financial resources to the vulnerable section of the society.

Priority Sector Lending in India: The Challenges

(a) Shortfalls

In the reform period while the flow of credit to the priority sector has increased significantly, credit disbursement to the agricultural sector and weaker section in the recent years is characterized by shortfalls. Table 8 presents the target achievement status attained by the public and private sector banks as in March 2009. The Table shows that 46% of the public sector banks and 63% of the private sector banks fell short of meeting the agricultural sector sub-quota. In case of the weaker section sub-quota, the relative figures are 43% and 82% respectively.

(b) Relatively High Default Rate

In spite of the improvement in asset quality in the priority sector, the sector is characterized by relatively high NPA ratio. For the public sector banks, priority sector advances contributed 55% of the total NPA while priority sector advances contributed only 42% of the net bank credit.

(c) Dilution of Primary Objective

In the post-reform phase the number of segments qualifying as priority sector has increased significantly. The dilution was necessitated by the lack of lending opportunities available to the commercial banks in the context of the then existing lending norms. The Committee on Financial Sector Reforms (2009) noted with great concern that "Dilution in priority sector norms also contributed to a reduced focus on underserved

Table 8: Achievement of Priority Sector Targets (2009)

Bank Group	Agriculture	Weaker Sections	Overall
Public Sector Banks			
Exhibiting a Shortfall	13 (28)	12(28)	3(28)
Private Sector Banks			
Exhibiting a Shortfall	14 (22)	18 (22)	14 (22)

Source: RBI(2009): *Trend and Progress of Banking in India, 2008-09*.

segments. The bulk of increase in credit to agriculture was accounted for by increase in indirect finance to agriculture, which includes activities that can be considered commercially viable”.

(d) Implications of Basel II

The introduction of Basel II capital adequacy norm is likely to have significant impact on priority sector lending. Inter alia, the new capital adequacy framework has paved the way for internal assessment of credit risk by the commercial banks and has enhanced the penalty for poor quality lending in an unprecedented manner. This can have serious macro economic consequences. Nachane, Ghosh and Ray(2006) had argued in terms of a theoretical model (which has been subjected to empirical testing on the basis of Indian commercial banking sector data for the period 1996-2004) that the revised capital accord will result in asymmetric differences in the efficacy of monetary policy in bank lending. In particular, the revised accord could pose serious challenge for the monetary authorities if their goal is to simultaneously provide credit to the economy and manage interest rates.

Reference

1. Binswanger, H. & Khandekar, S. (1995): The impact of formal finance on rural economy of India, *Journal of Development Studies*, 32(2), 234–265.
2. Calomiris C.W & C.P. Himmelberg (1993) : `Directed Credit Programs For Agriculture & Industry - Arguments from Theory & Fact' in 'Proceedings of the Annual Bank Conference on Development Economics', World Bank, Washington D.C.
3. Committee on Financial Sector Reforms (2009) : A Hundred Small Steps-Report of the Committee on Financial Sector Reforms, Sage Publications, New Delhi.
4. Fisher Thomas and M.S. Shriram(2002): 'Beyond Micro-Credit: Putting Development Back in to Micro-Finance', Vistaar Publications, New Delhi.
5. Joshi V and I.M.D. Little (1997): *India's Economic Reforms : 1991-2001*, Oxford University Press, New Delhi.
6. Kohli Renu (1997): Directed Credit and Financial Reform, *Economic and Political Weekly*, October 18.
7. Lewis W.A.(1959): *The Theory of Economic Growth*, London.
8. Nachane D.M., Saibal Ghosh and Partha Ray(2006): Basel II and Bank Lending Behaviour: Some Likely Implications For Monetary Policy, *Economic and Political Weekly*, Vol XLI, No 11, March 18.
9. Rajeev Meenakshi (2008): Rural Infrastructure Development Fund: Need For A Track Change, Working Paper No- 195, Institute of Social and Economic Change, Nagarbhavi, Bangalore.
10. Rostow W.W. (1960): *The Stages of Economic Growth*, Cambridge.

11. Reserve Bank of India (2005): Draft Technical Paper by the Internal Working Group on Priority Sector Lending, September 2005, www.rbi.org.in.
12. Reserve Bank of India: Statistical Tables Relating to Banks in India, various years, www.rbi.org.in.
14. Reserve Bank of India :Trend and Progress of Banking in India, various years, www.rbi.org.in.
15. Reserve Bank of India (1998): Report of the Committee on Banking Sector Reforms, RBI, Mumbai.
16. Reserve Bank of India (1991): 'Report of the Committee to Review the Working of the Financial System', RBI, Mumbai.
17. Shajahan, K.M. (1999): Priority Sector Lending: How useful?, Economic and Political Weekly, December 18, pp 3572-74
18. Shajahan K.M.(1998): Non Performing Assets of Banks: Have They Really Declined? And on Whose Account?, Economic and Political Weekly, March 21, pp 671-74.



Advertisement Tariff for ANALYTIQUE

Size of Publication : 6.5" x 9.5"

Size of advertisement : 6" x 9"

Position	Single Insertion	Two Insertions	Four Insertions
Back Cover	15,000/-	25,000/-	45,000/-
Inside Covers [Front / Back]	12,500/-	21,250/-	37,500/-
Special Position Full Page	7,500/-	12,750/-	22,500/-
Full Page (RH)	6,000/-	10,200/-	18,000/-
Full Page	5,000/-	8,500/-	15,000/-

- Address for communication:

Dr. Sugeeta Upadhyay

Bombay Chamber of Commerce and Industry Trust for Economic and Management Studies

Bombay Chamber of Commerce and Industry

Mackinnon Mackenzie Building, Ballard Estate, Mumbai - 400 001

Tel. : 2261 4681 (Extn. 436) • Fax : 2262 1213

E-mail : analytique@bombaychamber.com, upadhsu@bombaychamber.com

Various forward looking surveys conducted in the recent period suggest an overall improvement of growth for India in 2010-11. The general conclusion of those studies indicate that the recovery in investment demand to have been sustained in 2010-11. This is in spite of the fact that the external conditions have turned more uncertain after the sovereign debt related stress in the euro area. It is in this background, a brief review of the Indian economy of the first quarter of 2010-11 is being made to capture some relevant issues on the current economic scenario. It is organized in five different sections. The first section provides an overview of the domestic macroeconomic development. The second section captures the issues related to the aggregate demand, Section three considers the external economy and the last or fourth section concentrates on the financial markets. Finally, the conclusion section winds up the analysis.

I. An Overview

- The real GDP growth for 2009-10 was revised upwards to 7.4 per cent from the earlier estimate of 7.2 per cent, mainly on account of strong growth of 8.6 per cent in the fourth quarter as well as upward revision in growth figures for earlier quarters (Table 1).
- The acceleration in Q4 of 2009-10 resulted despite weak agriculture sector performance as well as tapering off of the stimulus measures' impact on the "community, social and personal services" sector.
- Since food inflation has remained high despite rising stock of food grains much above the buffer norms, the policy on food management has to focus on better supply management in relation to demand besides addressing the structural capacity constraints in food items.

Table 1: Growth Rates of Real GDP@

(in per cent)

Sector	2008-09*	2009-10#	2008-09				2009-10			
			Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Agriculture and Allied Activities	1.6 (15.7)	0.2 (14.6)	3.2	2.4	-1.4	3.3	1.9	0.9	-1.8	0.7
Industry	3.1 (20.0)	10.4 (20.5)	5.2	4.9	1.7	0.8	4.6	9	12.3	15.1
Mining & Quarrying	1.6	10.6	2.6	1.6	2.7	-0.3	8.2	10.1	9.6	14
Manufacturing	3.2	10.8	5.9	5.5	1.3	0.6	3.8	9.1	13.8	16.3
Electricity, Gas & Water Supply	3.9	6.5	3.3	4.3	4	4.1	6.6	7.7	4.7	7.1
Services	9.3(64.4)	8.3(64.9)	9.8	9.3	10	8	7.5	10	7.3	8.5
Trade, Hotels, Restaurants, Transport, Storage & Communication	7.6	9.3	10.8	10	4.4	5.7	5.5	8.5	10.2	12.4
Financing, Insurance, Real Estate and Business Services	10.1	9.7	9.1	8.5	10.2	12.3	11.8	11.5	7.9	7.9
Community, Social & Personal Services	13.9	5.6	8.7	10.4	28.7	8.8	7.6	14	0.8	1.6
Construction	5.9	6.5	9.8	7.2	1.1	5.7	4.6	4.7	8.1	8.7
Real GDP at Factor Cost	6.7(100)	7.4(100)	7.8	7.5	6.1	5.8	6	8.6	6.5	8.6
Memo: (Amount in Rupees Crore)										
Real GDP at Factor Cost (2004-05)	41,54,973	44,64,081								
GDP at current market prices	55,74,449	62,31,171								

@ at 2004-05 prices

* Quick Estimates

Revised Estimates

Source: Central Statistical Organization

- On the industrial front, increasingly manufacturing growth is being led by capital goods industries and consumer durables (Table 2).

Table 2: Index of Industrial Productions: Sectoral and Use-Based Classification of Industries

(in per cent)

Industry Group	weight in the IIP	Growth Rate			Weighted Contribution#			
		April-March, 2009-10	April-May			April-March 2009-10	April-May	
			2009-10	2010-11 (P)			2009-10	2010-11 (P)
Mining	10.5	9.8	3.4	10.2	6.3	14.2	5	
Manufacturing	79.4	10.9	1.1	15.1	88.9	59.3	91	
Electricity	10.2	6	4.8	6.6	4.8	25.2	4.1	
Use-Based								
Basic Goods	35.6	7.1	4.1	8.5	20.4	76	18.5	
Capital Goods	9.3	19.2	-4.7	50.9	24.5	-33.1	38.7	
Intermediate Goods	26.5	13.6	7.3	10.4	32.7	116.1	20.3	
Consumer Goods(a+b)	28.7	7.3	-2.9	10	22.4	-59.3	22.7	
Consumer Durables	5.4	26.2	15.3	28.1	19.4	70.1	16.8	
Consumer Non-durables	23.3	1.3	-8.0	3.5	3.0	-129.1	5.8	
General	100	10.4	1.6	14	100	100	100	

P Provisional, #Figures may not add up to 100 due to rounding off

Source: Central Statistical Organization

- During the period April 2009-February 2010, capacity utilization levels in the infrastructure sector showed a mixed trend. While finished steel and fertilizer sectors recorded higher utilization as compared with the same period last year, cement and refinery production of petroleum sector witnessed lower utilization for the same period (Table 3).

Table 3: Capacity Utilization in Infrastructure Sector

(in per cent)

Sector	(April-February)	
	2008-09	2009-10
Finished Steel		
(SAIL+VSP+Tata Steel)	85.9	89.3
Cement	86	83
Fertiliser	83.3	94.7
Refinery Production-Petroleum	107.7	107.3

Source: Capsule Report on Infrastructure Sector Performance (April 2009-February 2010)MOSPI,GOI

- Even though a decline was observed during the first quarter of 2009-10, the employment situation improved in the next two quarters and showed a marginal rise in the last quarter of 2009-10 (Table 4).

Table 4: Changes in Estimated Employment

(in lacs)

Industry / Group	June 2009 over March 2009	September 2009 over June 2009	December 2009 over December 2009	March 2010 over December 2009	March 2010 over March 2009
Textiles including apparels	-1.54	3.18	0.16	-1.19	0.61
Leather	0.07	-0.08	0.09	0	0.08
Metals	-0.01	0.65	0.23	0.04	0.91
Automobiles	0.23	0.24	0.06	0.29	0.82
Gems & Jewellery	-0.2	0.58	0.07	0.24	0.69
Transport	-0.01	0	-0.02	-0.02	-0.05
IT/BPO	-0.34	0.26	5.7	1.29	6.91
Handloom/Powerloom	0.49	0.15	0.09	-0.05	0.68
Overall	-1.31	4.98	6.38	0.61	10.66

Source: Sixth Quarterly Quick Employment Survey, December 2009-March 2010, Labour Bureau.

- Data of lead indicators of services sector activities like tourist arrivals, commercial vehicles production and railway freight traffic suggest continuation of the buoyancy in 2010-11 (Table 5).

Table 5: Indicators of Services Sector Activity

(Growth in per cent)

Indicators	2007-08	2008-09	2009-10	2009-10 (April-June)	2010-11 (April-June)
Tourist arrivals	12.2	-3.3	3.5	-1.9	8.4
Commercial vehicles production	4.8	-24.0	58.9	-18.5	57.1
Cement#	8.1	7.2	10.5	11.8	8.7
Steel#	6.2	1.6	4.9	0.8	4.7
Railway revenue earning freight traffic	9.0	4.9	6.6	5.1	8.3
Cell phone connections##	38.3	80.9	47.3	83.5	42.0
Cargo handled at major ports##	12.0	2.2	5.7	-1.2	2.7
Civil aviation					
Export cargo handled##	7.5	3.4	10.4	0.7	13.1
Import cargo handled##	19.7	-5.7	7.9	-17.2	29.9
Passengers handled at international terminals##	11.9	3.8	5.7	0.4	6.9
Passengers handled at domestic terminals##	20.6	-12.1	14.5	-17.1	27.0

: Data pertain to April-May.

: Data up to April.

Source: Ministry of Tourism; Ministry of Commerce and Industry; Ministry of Statistics and Programme Implementation; Reserve Bank of India.

II. Aggregate Demand

- On the domestic front, the growth in private consumption demand witnessed deceleration from 6.8 per cent in 2008-09 to 4.3 percent in 2009-10, reflecting the economic slowdown on the one hand and weak agriculture production and high food prices on the other. The slowdown in private consumption demand was particularly sharp during the fourth quarter of 2009-10 (Table 6).

Table 6: Expenditure Side of GDP (At 2004-05 Prices)

(in per cent)

Item	2008-09*	2009-10#	2008-09				2009-10			
			Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Growth Rates										
Real GDP at market prices	5.1	7.7	7.3	6.9	3.0	3.8	5.2	6.4	7.3	11.2
Total Consumption Expenditure	8.3	5.3	7.7	7.6	13.2	4.6	4.7	9.6	4.8	2.6
(i) Private	6.8	4.3	8.4	7.6	6.4	5.1	2.9	6.4	5.3	2.6
(ii) Government	16.7	10.5	3.7	7.5	59.0	2.5	15.3	30.5	2.5	2.1
Gross Fixed Capital Formation	4.0	7.2	6.5	7.3	-0.1	2.7	-0.7	1.6	8.8	17.7
Change in Stocks	-61.2	5.9	-60.2	-60.3	-61.9	-62.2	-0.9	4.2	8.7	11.1
Net Exports	40.2	-9.7	31.1	101.0	77.7	-29.4	29.8	6.1	-0.3	-113.4
Relative Shares										
Total Consumption Expenditure	70.9	69.4	71.8	69.4	75.2	67.5	71.4	71.5	73.4	62.3
(i) Private	59.5	57.6	61.3	60.1	61.5	55.4	59.9	60.1	60.4	51.1
(ii) Government	11.5	11.8	10.5	9.2	13.7	12.2	11.5	11.3	13.1	11.2
Gross Fixed Capital Formation	32.9	32.8	33.0	34.8	31.5	32.7	31.2	33.2	31.9	34.6
Change in Stocks	1.3	1.3	1.4	1.4	1.3	1.3	1.3	1.4	1.3	1.3
Net Exports	-6.1	-5.1	-5.2	-8.8	-7.3	-3.5	-6.5	-8.7	-6.7	0.4

*Quick Estimates. # : Revised Estimates.

- The slowdown in government consumption expenditure continued through the fourth quarter of 2009-10, reflecting the high base in the second half of the previous year owing to the crisis induced fiscal stimulus. The sluggish growth in both private and government consumption demand has led to moderation in their respective contributions to growth in aggregate demand during the fourth quarter of 2009-10. The y-o-y growth in gross fixed capital formation during the fourth quarter of 2009-10 at 17.7 per cent represented a significant acceleration.
- With a view to supporting the recovery momentum, fiscal policy continued its expansionary stance during 2009-10. Reflecting this, the revenue deficit (RD) and gross fiscal deficit (GFD) expanded over the previous year (RE) (Table 7).

Table 7: Key Fiscal Indicators

(Per cent to GDP)

Year	Primary Deficit	Revenue Deficit	Gross Fiscal Deficit	Outstanding Liabilities
		Centre		
2008-09 (Actual)	2.6	4.5	6.0	56.7
2009-10 RE	3.1	5.3	6.6	56.4
2010-11 BE	1.9	4.0	5.5	56.9
		States*		
2008-09 (Actual)	0.6	-0.2	2.4	26.2
2009-10 RE	1.7	1.0	3.6	26.3
2010-11 BE	1.2	0.6	3.0	-
		Combined		
2008-09 (Actual)	3.4	4.4	8.5	71.6
2009-10 RE	4.9	6.2	10.1	72.4
2010-11 BE	3.2	4.6	8.5	-

RE : Revised Estimates. BE : Budget Estimates.

* : Based on Budget documents of 24 State Governments.

- : Not available.

Note: Minus sign against deficit parameters indicates surplus.

- The correction in deficit indicators has been envisaged in the Union Budget for 2010-11 to come through a combination of factors, viz., higher revenue receipts, greater disinvestment proceeds, and curtailment of growth in revenue expenditure, especially in the non-plan component (Table 8).

Table 8: Central Government Finances

Item	Growth rate (per cent)			Per cent to GDP		
	2008-09	2009-10 (RE)	2010-11 (BE)	2008-09	2009-10 (RE)	2010-11 (BE)
1. Total Expenditure	24.0	15.6	8.5	15.9	16.4	16.0
2. Revenue Expenditure	33.5	14.2	5.8	14.2	14.5	13.8
3. Capital Expenditure	-23.7*	27.8	30.2	1.6	1.8	2.2
4. Non-Plan Expenditure	19.9	16.0	4.1	10.9	11.3	10.6
5. Plan Expenditure	34.2	14.5	18.4	4.9	5.1	5.4
6. Revenue Receipts	-0.3	6.9	18.2	9.7	9.3	9.8
i) Tax Revenue (net)	0.9	4.9	14.8	8.0	7.5	7.7
ii) Non Tax Revenue	-5.3	15.7	32.0	1.7	1.8	2.1

RE : Revised Estimates. BE : Budget Estimates.

* : The sharp decline essentially reflects the higher base of the previous year (2007-08), on account of acquisition of the RBI's stake in the State Bank of India by the Government of India.

- The Table 9 reflects the continued expansionary fiscal stance of both the Central and State Governments on account of the envisaged path of fiscal consolidation (Table 9).

Table 9: Combined Finances

Item	Growth rate (per cent)			Per cent to GDP		
	2008-09	2009-10 (RE)	2010-11 (BE)	2008-09	2009-10 (RE)	2010-11 (BE)
1. Total expenditure	20.4	19.6	8.4	28.4	30.4	29.6
2. Revenue Expenditure	25.7	20.0	7.4	24.2	25.9	25.0
3. Capital Expenditure	-3.0	17.4	13.9	4.3	4.5	4.6
4. Non-Developmental Expenditure	7.1	22.5	11.2	11.3	12.4	12.4
5. Development expenditure	31.5	17.8	6.1	16.8	17.7	16.8
6. Revenue Receipts	3.9	11.4	15.6	19.8	19.7	20.5
i) Tax Revenue	5.2	7.5	16.3	16.6	15.9	16.7
ii) Non Tax Revenue	-2.6	31.1	12.3	3.2	3.8	3.8

RE : Revised Estimate. BE : Budget Estimate.

Note: The data pertains to the Central Government and 24 State Governments.

- The pickup in overall economic activity was evident from the corporate sales data as well. During the fourth quarter of 2009-10, the year-on-year sales growth of the select non-financial non-government listed companies was around 29 per cent, which turned out to be the highest in last six quarters (Table 10). Net profits also increased by 44 per cent as against a sharp decline during the corresponding period of the preceding year.

Table 10: Performance of Non-Government Non-Financial Listed Companies

(Growth rate/ratios in per cent)

Item	2008-09	2009-10	2008-09				2009-10			
			Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Sales	17.2	11.7	29.3	31.8	9.5	1.9	-0.9	0.1	22.5	29.1
Other Income*	6.6	6.3	-8.4	-0.6	-4.8	39.4	50.2	6.0	7.4	10.3
Expenditure	19.5	9.6	33.5	37.5	12.6	-0.5	-4.4	-2.5	20.6	30.7
Depreciation provision	17.4	22.2	15.3	16.5	16.8	19.6	21.5	20.7	21.6	20.1
Gross profits	-4.2	24.9	11.9	8.7	-26.7	-8.8	5.8	10.9	60.0	36.7
Interest payments	57.3	-3.2	58.1	85.3	62.9	36.5	3.7	-1.0	-12.3	-2.9
Profits after tax	-18.4	28.8	6.9	-2.6	-53.4	-19.9	5.5	12.0	99.3	44.0
Select Ratios										
Change in Stock [#] to Sales	0.4	1.0	2.9	2.2	-1.7	-1.8	0.6	2.3	0.8	1.1
Gross Profits to Sales	13.3	14.8	14.5	13.5	11.0	13.7	15.7	14.9	14.3	14.6
Profits After Tax to Sales	8.1	9.4	9.7	8.6	5.3	8.1	10.2	9.4	8.8	9.0
Interest to Sales	3.1	2.7	2.4	2.9	3.8	3.2	2.8	3.1	2.7	2.4
Interest to Gross Profits	23.6	18.2	16.8	21.5	34.6	23.3	18.0	20.5	19.1	16.6
Interest Coverage (Times)	4.2	5.5	6.0	4.6	2.9	4.3	5.6	4.9	5.2	6.0

* : Other income excludes extraordinary income/expenditure if reported explicitly.

: For companies reporting change in stock-in-trade explicitly.

Note: 1. Growth rates are year-on-year percentage changes for common set of companies.

2. Quarterly data may not add up to annual data due to differences in number and composition of sample covered in each period.

III. The External Economy

- For the full year 2009-10, there was a net decline in imports. In the first quarter of 2010-11, import growth, however, has exceeded export growth (Table 11).

Table 11: India's Merchandise Trade

Item	April-March 2009-10 P		April-May			
			2009-10 R		2010-11 P	
	Absolute (US\$ billion)	Growth (%)	Absolute (US\$ billion)	Growth (%)	Absolute (US\$ billion)	Growth (%)
Exports	178.7	-3.6	24.8	-33.3	33.0	33.2
Oil	28.1	2.1	3	-45.9	-	-
Non-oil	150.5	-4.6	21.8	-31.0	-	-
Imports	286.8	-5.6	39.2	-34.3	54.7	39.5
Oil	87.1	-7.0	10.0	-48.3	16.9	68.5
Non-oil	199.7	-4.9	29.2	-27.6	37.8	29.6
Trade Balance	-108.2	-8.6	-14.4	-36.1	-21.7	50.3
Non-Oil Trade Balance	-49.2	-5.9	-7.4	-15.3	-	-

R: Revised. P: Provisional. - Not Available. Source: DGCI&S.

- The deficit in the current account expanded to 2.9 per cent of GDP in 2009-10 from 2.4 per cent of GDP in 2008-09. In absolute terms, current account deficit rose in both quarters of the second half of 2009-10 over the quarters in the first half of the year, which coincided with stronger domestic recovery in growth, ahead of the global recovery (Table 12).

Table 12: India's Balance of Payments

(US\$ billion)

	2008-09 Apr-Mar PR	2009-10 Apr-Mar P	2008-09 Jan-Mar PR	2009-10			
				Apr-Jun PR	Jul-Sep PR	Oct-Dec PR	Jan-Mar P
1 Exports	189.0	182.2	38.5	39.2	43.5	47.1	52.4
2 Imports	307.7	299.5	58.7	64.8	72.6	78.1	83.9
3 Trade Balance (1-2)	-118.7	-117.3	-20.2	-25.6	-29.1	-31.1	-31.5
4 Net Invisibles	89.9	78.9	19.0	21.2	20.4	18.9	18.5
5 Current Account Balance (3+4)	-28.7	-38.4	-1.2	-4.5	-8.8	-12.2	-13.0
6 Gross Capital Inflows	312.4	344.0	59.4	77.1	95.4	81.3	90.2
7 Gross Capital Outflows	305.2	290.4	58.0	73.1	76.6	66.6	74.1
8 Net Capital Account (6-7)	7.2	53.6	1.4	4.0	18.8	14.7	16.1
9 Overall Balance (5+8)#	-20.1	13.4	0.3	0.1	9.4	1.8	2.1

	2008-09	2009-10	2008-09	2009-10			
	Apr-Mar PR	Apr-Mar P	Jan-Mar PR	Apr-Jun PR	Jul-Sep PR	Oct-Dec PR	Jan-Mar P
Memo:							
i. Export growth (%)	13.7	-3.6	-20.0	-31.8	-18.9	19.3	36.2
ii. Import growth (%)	19.4	-2.7	-20.8	-21.7	-21.7	6.3	43.0
iii. Trade balance (as a % of GDP)	-9.8	-8.9					
iv. Net invisibles growth (%)	18.7	-12.2	-15.8	-3.7	-23.3	-15.6	-2.6
v. CAD as a % of GDP	2.4	2.9					
vi. Foreign Exchange Reserves (as at end of the period)	252.0	279.1	252.0	265.1	281.3	283.5	279.1

P: Preliminary. PR: Partially Revised, #: Includes errors and omissions. CAD: Current Account Deficit.

- Invisibles surplus was lower in 2009-10 from in 2008-09, mainly due to decline in receipts under transportation, business, financial and communication services coupled with significant increase in payments of miscellaneous services such as business and financial services (Table 13).

Table 13: Invisibles Gross Receipts and Payments

(US\$ billion)

	Item	Invisibles Receipts				Invisibles Payments			
		April-March		Jan-March		April-March		Jan-March	
		2008-09 PR	2009-10 P	2008-09 PR	2009-10 P	2008-09 PR	2009-10 P	2008-09 PR	2009-10 P
1.	Travel	10.9	11.9	2.7	3.4	9.4	9.3	2.6	2.6
2.	Transportation	11.3	11.1	2.9	3.1	12.8	11.9	2.5	3.6
3.	Insurance	1.4	1.6	0.3	0.4	1.1	1.3	0.3	0.3
4.	Govt. not included elsewhere	0.4	0.4	0.1	0.1	0.8	0.5	0.4	0.2
5.	Miscellaneous	77.7	68.7	17.7	19.9	27.9	36.5	7.3	12.2
	<i>of which:</i>								
	Software	46.3	49.7	10.8	14.3	2.8	1.5	0.5	0.3
	Non-Software	31.4	19.0	6.9	5.6	25.1	35.0	6.8	11.9
6.	Transfers	47.5	54.4	10.0	13.2	2.7	2.30	0.4	0.6
	<i>of which</i>								
	Private Transfers	46.9	53.9	9.8	13.1	2.3	1.8	0.3	0.5
7.	Income	14.3	13.0	3.4	2.7	18.8	20.4	4.6	4.8
	Investment Income	13.5	12.1	3.2	2.5	17.5	18.7	4.3	4.3
	Compensation of Employees	0.8	0.9	0.2	0.2	1.3	1.7	0.3	0.5
	Total (1 to 7)	163.5	161.2	37.1	42.8	73.6	82.3	18.1	24.4

P: Preliminary. PR: Partially Revised.

- The surplus in the capital account increased during the fourth quarter of 2009-10 mainly due to large inflows under portfolio investments and short-term trade credits. However, net external commercial borrowings (ECBs) remained low and inflows under foreign direct investment witnessed some moderation. For the year as a whole, net capital flows were significantly higher mainly due to large inflows under FDI, portfolio investments and short-term trade credits (Table 14).

Table 14: Net Capital Flows

(US\$ billion)

	2008-09 Apr-Mar	2009-10 Apr-Mar	2009-10			
			Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar
	PR	P	PR	P	PR	P
1. Foreign Direct Investment (FDI)	17.5	19.7	6.1	6.5	3.9	3.2
Inward	35.0	31.7	8.7	10.7	7.1	5.1
Outward	17.5	12.0	2.6	4.2	3.2	1.9
2. Portfolio Investment	-14.0	32.4	8.3	9.7	5.7	8.8
of which:						
FIIs	-15.0	29.0	8.2	7.0	5.3	8.5
ADR/GDRs	1.2	3.3	0.0	2.7	0.5	0.1
3. External Assistance	2.6	2.0	0.1	0.5	0.6	0.8
4. External Commercial Borrowings	7.9	2.5	-0.5	1.2	1.7	0.1
5. NRI Deposits	4.3	2.9	1.8	1.0	0.6	-0.6
6. Banking Capital excluding NRI Deposits	-7.5	-0.8	-5.2	3.3	1.3	-0.4
7. Short-term Trade Credits	-1.9	7.7	-1.5	0.8	3.3	5.0
8. Rupee Debt Service	-0.1	-0.1	-	-	-	-0.1
9. Other Capital	-1.5	-12.7	-5.2	-4.3	-2.4	-0.9
Total (1 to 9)	7.2	53.6	4	18.8	14.7	16.1

P: Preliminary. PR: Partially Revised. - : Negligible.

- Available information during 2010-11 so far shows some moderation in capital inflows (Table 15). There has been a perceptible slowdown in net FII inflows and inflows under NRI deposits, but FDI to India remains stable reflecting the confidence of global investors in India's growth prospects.

Table 15: Recent Trends in Capital Flows

(US\$ billion)

Component	Period	2009-10	2010-11
FDI to India	April-May	4.4	4.4
FIIs (net)	April - July 16	8.7	6.2
ADRs/GDRs	April-June	0.04	1.0
ECB Approvals	April-June	2.7	5.3
NRI Deposits (net)	April-June	1.8	1.3
FDI : Foreign Direct Investment.	NRI : Non Resident Indians.		
FII : Foreign Institutional Investors.	ADR : American Depository Receipts.		
ECB : External Commercial Borrowings.	GDR : Global Depository Receipts.		

- Some depreciation of the rupee against the US dollar in the first quarter of 2010-11 due to volatile portfolio flows, the appreciation of the real effective exchange rate continued, reflecting high inflation differentials between India and its trading partners (Table 16).

Table 16: Nominal and Real Effective Exchange Rates of the Indian Rupee (Trade Based Weights, Base : 1993-94 = 100)

	Index June 2010 P	(Per cent, appreciation + /depreciation -)			
		2008-09	2009-10 P	2009-10 (Apr-Jun) P	2010-11 (Apr- Jun) P
36-REER	101.2 ^	-13.6	13.3	1.7 #	1.4 #
36-NEER	89.6 ^	-10.3	9.3	4.6 #	1.5 #
6-REER	118.3	-14.0	20.0	5.8	3.3
6-NEER	67.6	-14.8	10.2	3.5	1.4
Rs/USD	47.1 @	-21.5	12.9	5.2 *	-4.2 *

NEER : Nominal Effective Exchange Rate.
 REER : Real Effective Exchange Rate.
 P: Provisional. #: April-May. ^: May 2010. *: Up to July 20.
 @: Rupee-US dollar exchange rate as on July 20, 2010
 Note: Rise in indices indicates appreciation of the rupee and vice versa.

- Including the valuation effects, India's foreign exchange reserves increased by US\$ 27.1 billion during 2009-10 to reach the level of US\$ 279.1 billion as at end-March 2010 (Table 17).

Table 17: Foreign Exchange Reserves

(US\$ million)

Month (End Period)	Gold	SDR	Foreign Currency Assets	Reserve Position in the IMF	Total (2+3+4+5)
March-09	9,577	1	241,426	981	251,985
March-10	17,986	5,006	254,685	1,380	279,057
July 16, 2010	19,894	4,987	255,677	1,343	281,901

- As at end March 2010, India's external debt stock stood at US \$261.4 billion, an increase of US\$ 36.9 billion over its level at end-March 2009. The increase was mainly on account of increase in long term debt, such as external commercial borrowings, NRI deposits and SDR related liabilities (Table 18).

Table 18: India's External Debt

(US\$ billion)

Item	End March	End March	End March	Variation (March 2010 over March 2009)	
	2008	2009 PR	2010 P	Amount	Per cent
1. Multilateral	39.5	39.5	42.7	3.2	8.1
2. Bilateral	19.7	20.6	22.6	2.0	9.6
3. International Monetary Fund	1.1	1.0	6.0	5.0	493.4
4. Trade Credit (above 1 year)	10.3	14.5	16.9	2.4	16.5
5. External Commercial Borrowings	62.3	62.4	71.0	8.6	13.7
6. NRI Deposit	43.7	41.6	48.1	6.5	15.7
7. Rupee Debt	2.0	1.5	1.6	0.1	8.5
8. Long-term (1 to 7)	178.7	181.2	209	27.8	15.4
9. Short-term	45.7	43.4	52.5	9.1	21.0
Total (8+9)	224.4	224.5	261.4	36.9	16.5

(in per cent)

Total Debt /GDP	18.1	20.5	18.9
Short-term Debt/Total Debt	20.4	19.3	20.1
Short-term Debt/Reserves	14.8	17.2	18.8
Concessional Debt/Total Debt	19.7	18.7	16.8
Reserves/Total Debt	138.0	112.2	106.7
Debt Service Ratio	4.8	4.6	5.5

P: Provisional. PR: Partially Revised.

- India's net international liabilities increased by US\$ 34.5 billion during the fourth quarter of 2009-10 mainly due to increase in net inflows under portfolio and foreign direct investment to India.

IV. Financial Markets

- Increased volatility in international markets was rapidly transmitted to India and other EMEs through volatile capital flows during Q2 of 2010. Reflecting the impact of global market uncertainty, capital inflows to India moderated, led by portfolio flows. This, in turn, led to depreciation of the rupee and moderation in stock prices (Table 19).

Table 19: Currency and Stock Price Movement in EMEs

(in per cent)

Items	End-March 2009 @	End-March 2010 @	July 19, 2010*	Items	End-March 2009 @	End-March 2010 @	July 19, 2010*
Appreciation (+)/Depreciation (-) of the US Dollar				Stock Price Variations			
Japanese Yen	-2.0	-4.9	-6.5	Indonesia	-41.4	93.7	7.7
Chinese Yuan	-2.6	-0.1	-0.8	(Jakarta Composite)			
Russian Ruble	44.3	-13.0	3.3	Brazil (Bovespa)	-32.9	71.9	-11.4
Turkish Lira	27.7	-9.1	1.1	Thailand (SET Composite)	-47.2	82.6	5.0
Indian Rupee	27.5	-11.4	3.7	India (BSE Sensex)	-37.9	80.5	2.4
Indonesian Rupiah	25.6	-21.3	-0.7	South Korea (KOSPI)	-29.2	40.3	2.7
Malaysian Ringgit	14.4	-10.3	-2.0	China	-31.7	31.0	-22.0
South Korea Won	38.9	-17.8	6.5	(Shanghai Composite)			
Thai Baht	12.8	-8.9	-0.1	Taiwan (Taiwan Index)	-39.2	52.0	-3.2
Argentine Peso	17.3	4.4	1.5	Russia (RTS)	-66.4	128.0	-11.6
Brazilian Real	31.2	-19.8	-1.5	Malaysia (KLSE)	-30.1	51.3	1.2
Mexican Peso	32.9	-12.3	3.9	Singapore (Straits Times)	-43.5	69.9	2.4

@: Year-on-year variation. * Variation over End-March. Source: Bloomberg, IFS, IMF

- The concerns in domestic financial markets shifted from the large fiscal deficit and rising inflation in 2009-10 to escalated uncertainties in the global markets and the associated risks to global recovery in Q1 of 2010-11. Nevertheless, several segments of financial markets witnessed further recovery in trading volumes in Q1 of 2010-11, although marked by some increase in price volatility (Table 20). Except for some increase in spread/volatility in certain segments, overall financial market conditions remained stable.

Table 20: Domestic Financial Markets at a Glance

Year / Month	Call Money		Govt. Securities Market		Foreign Exchange Market			Liquidity Management		Stock Markets			
	Daily Turn over (Rs. crore)	Call Rates* (Per cent)	Daily Turn-over ^ (Rs. crore)	10-Year Yield@ (Per cent)	Daily Inter-bank Turnover (US\$ mn)	Ex-change rate@ (Rs./ US\$)	RBI's net FC purchase (+) / sale (-)	MSS Outstanding# (Rs. crore)	Average Daily LAF (Rs. crore)	Daily BSE Turn-over (Rs. crore)	Daily NSE Turn-over (Rs. crore)	BSE Sensex **	CNX Nifty **
2008-09	22,436	7.06	10,879	7.54	34,812	45.92	-34,922†	1,48,889	2,885	4,498	11,325	12303	3713
2009-10	15,924	3.24	14,426	7.23	30,107	44.95	-2,635†	23,914	1,00,015	5,651	16,959	15585	4658
9-Apr	21,820	3.28	15,997	6.55	27,796	50.06	-2,487	75,146	1,01,561	5,232	15,688	10911	3360
9-May	19,037	3.17	14,585	6.41	32,227	48.53	-1,437	45,955	1,25,728	6,427	19,128	13046	3958
9-Jun	17,921	3.21	14,575	6.83	32,431	47.77	1,044	27,140	1,23,400	7,236	21,928	14782	4436
9-Jul	14,394	3.21	17,739	7.01	30,638	48.48	-55	22,159	1,30,891	6,043	18,528	14635	4343
9-Aug	15,137	3.22	9,699	7.18	27,306	48.34	181	19,804	1,28,275	5,825	17,379	14415	4571
9-Sep	16,118	3.31	16,988	7.25	27,824	48.44	80	18,773	1,21,083	6,211	18,253	16338	4859

Year / Month	Call Money		Govt. Securities Market		Foreign Exchange Market			Liquidity Management		Stock Markets			
	Daily Turn over (Rs. crore)	Call Rates* (Per cent)	Daily Turn-over ^ (Rs. crore)	10-Year Yield@ (Per cent)	Daily Inter-bank Turnover (US\$ mn)	Exchange rate@ (Rs./ US\$)	RBI's net FC purchase (+)/ sale (-)	MSS Outstanding# (Rs. crore)	Average Daily LAF (Rs. crore)	Daily BSE Turn-over (Rs. crore)	Daily NSE Turn-over (Rs. crore)	BSE Sensex **	CNX Nifty **
9-Oct	15,776	3.17	12,567	7.33	28,402	46.72	75	18,773	1,01,675	5,700	18,148	16826	4994
9-Nov	13,516	3.19	17,281	7.33	27,599	46.57	-36	18,773	1,01,719	5,257	16,224	16684	4954
9-Dec	13,302	3.24	14,110	7.57	27,439	46.63	0	18,773	68,522	4,671	13,948	17090	5100
10-Jan	12,822	3.23	12,614	7.62	32,833	45.96	0	9,944	81,027	6,162	17,813	17260	5156
10-Feb	13,618	3.17	12,535	7.79	34,040	46.33	0	7,737	78,661	4,125	12,257	16184	4840
10-Mar	17,624	3.51	8,544	7.94	32,755	45.50	0	3,987	37,640	4,751	13,631	17303	5178
10-Apr	16,374	3.49	14,242	8.01	36,242 P	44.50	0	2,737	57,150	4,696	13,828	19679	5295
10-May	16,786	3.83	24,225	7.56	39,997 P	45.81	0	922	32,798	3,940	12,937	16845	5053
10-Jun	14,258	5.16	21,300	7.59	36,216 P	46.57	..	317	-47,347	4,204	13,005	17300	5188

* : Average of daily weighted call money borrowing rates.

^ : Average of daily outright turnover in Central Government dated securities.

@ : Average of closing rates. #: Average of weekly outstanding MSS. **: Average of daily closing indices.

† : Cumulative for the financial year. LAF : Liquidity Adjustment Facility. MSS: Market Stabilization Scheme.

BSE : Bombay Stock Exchange Limited. NSE : National Stock Exchange of India Limited. P: Provisional. .. : Not available.

Note : In column 10, (-) indicates injection of liquidity, while (+) indicates absorption of liquidity.

- Coming to the money market, it can be observed that the liquidity conditions in the inter-bank market tightened significantly in June 2010 (Table 21). The collateralized segment of the money market accounted for around 87 per cent of the total volume during Q1 of 2010-11.

Table 21: Activity in Money Market Segments

(Rupees crore)

Year / Month	Average Daily Volume (One Leg)						Commercial Paper		Certificates of Deposit	
	Call	Market Repo	CBLO	Total (2 to 4) Rate (%)*	Money Market	Term Money	Out-standing	WADR (%)	Out-standing	WADR (%)
9-Apr	10,910	20,545	43,958	75,413	2.41	332	52,881	6.29	2,10,954	6.48
9-May	9,518	22,449	48,505	80,472	2.34	338	60,740	5.75	2,18,437	6.20
9-Jun	8,960	21,694	53,553	84,207	2.69	335	68,721	5.00	2,21,491	4.90
9-Jul	7,197	20,254	46,501	73,952	2.83	389	79,582	4.71	2,40,395	4.96
9-Aug	7,569	23,305	57,099	87,973	2.62	461	83,026	5.05	2,32,522	4.91
9-Sep	8,059	27,978	62,388	98,425	2.73	381	79,228	5.04	2,16,691	5.30
9-Oct	7,888	23,444	58,313	89,645	2.70	225	98,835	5.06	2,27,227	4.70
9-Nov	6,758	22,529	54,875	84,162	2.87	191	1,03,915	5.17	2,45,101	4.86
9-Dec	6,651	20,500	55,338	82,489	2.91	289	90,305	5.40	2,48,440	4.92
10-Jan	6,411	14,565	50,571	71,547	2.97	404	91,564	4.80	2,82,284	5.65
10-Feb	6,809	19,821	63,645	90,275	2.95	151	97,000	4.99	3,09,390	6.15
10-Mar	8,812	19,150	60,006	87,968	3.22	393	75,506	6.29	3,41,054	6.07
10-Apr	8,187	20,319	50,891	79,397	3.03	423	98,769	5.37	3,36,807	5.56
10-May	8,393	17,610	42,274	68,277	3.72	330	1,09,039	6.85	3,40,343	5.17
10-Jun	7,129	9,481	31,113	47,723	5.22	447	99,792	6.82	3,21,589	6.37

CBLO: Collateralized Borrowing and Lending Obligation.

WADR: Weighted Average Discount Rate.

* : Weighted average rate of call, market repo and CBLO.

- The volume in commercial paper (CP) market picked up, as corporates increasingly took recourse to CPs for financing their working capital requirements, which is evident from a significant rise in the share of 'manufacturing companies' in the outstanding amount of CPs (Table 22).

Table 22: Major Issuers of Commercial Paper

(Rupees crore)

End of Period	Leasing and Finance		Manufacturing		Financial Institutions		Total Outstanding
	Amount	Share (%)	Amount	Share (%)	Amount	Share (%)	
1	2	3	4	5	6	7	8=(2+4+6)
9-Mar	27,183	61.5	12,738	28.8	4,250	9.6	44,171
9-Jun	34,437	50.1	23,454	34.1	10,830	15.8	68,721
9-Sep	31,648	39.9	31,509	39.7	16,071	20.3	79,228
9-Dec	36,027	39.9	42,443	47.0	11,835	13.1	90,305
10-Mar	39,477	52.3	22,344	29.4	13,685	18.1	75,506
10-Jun	42,572	42.7	43,330	43.4	13,890	13.9	99,792

- The Reserve Bank continued with the policy of front-loading of market borrowings during the first half of 2010-11. Accordingly, the Government would complete a major part (about 63 per cent) of the gross market borrowing programme for 2010-11 in the first half of the year so as to limit any crowding out concerns in the latter half of the year when the private credit demand is normally strong (Table 23).

Table 23: Issuances of Central and State Government Dated Securities

	2008-09	2009-10	2009-10\$	2010-11\$
Central Government				
Gross amount raised (Rs. crore)	2,61,000	4,18,000	1,62,000	1,51,000
Devolvement on Primary Dealers (Rs. crore)	10,773	7,219	1,873	1,834
Bid-cover ratio (Range)	1.2-4.5	1.4-4.3	1.52-3.51	1.39-3.87
Weighted average maturity (years)	13.8	11.2	11.9	10.3
Weighted average yield (per cent)	7.69	7.23	6.93	7.62
State Governments				
Gross amount raised (Rs. crore)	1,18,138	1,31,122	20,266	23,322
Cut-off yield (per cent)	5.80-9.90	7.04-8.58	7.04-7.89	8.05-8.58
Weighted average yield (per cent)	7.87	8.11	7.52	8.31

\$. Up to June 30.

- Due to outflow of liquidity from the banking system on account of 3G/ BWA auctions and rise in policy rates, there was an upward movement in the primary market yields of Treasury Bills except for 364- day T-bills which showed a slight moderation initially (Table 24).

Table 24 : Treasury Bills in the Primary Market

Year / Month	Notified Amount (Rupees crore)	Average Implicit Yield at Minimum Cut-off Price (%)		
		91-day	182-day	364-day
2008-09	2,99,000	7.10	7.22	7.15
2009-10	3,80,000	3.57	4.00	4.37
2010-11	87,000	4.66	4.90	5.21
April-10	36,000	4.14	4.64	5.07
May-10	36,000	4.39	4.76	4.92
June-10	15,000	5.29	5.31	5.49

- Coming to the credit market, bank deposit rates have started moving upward, reflecting not only the competition for attracting deposits but also a change in the interest rate environment reflected in gradually rising policy rates (Table 25). During Q1 of 2010-11, a few banks raised their deposits rates in the range of 75-100 basis points. On the lending side, the benchmark prime lending rates (BPLRs) of SCBs have remained unchanged since July 2009.

Table 25: Deposit and Lending Rates of Banks

(in per cent)

	Mar-10	Sep-10	Dec-10	Mar-10	Jun-10
1. Domestic Deposit Rate					
<i>Public Sector Banks</i>					
Up to 1 year	2.75-8.50	1.00-7.00	1.00-6.25	1.00-6.50	1.00-6.25
> 1year-3 years	8.25-9.25	6.50-8.00	6.00-7.25	6.00-7.25	6.00-7.25
> 3 years	8.00-9.00	7.00-8.50	6.25-7.75	6.50-7.75	6.50-7.75
<i>Private Sector Banks</i>					
Up to 1 year	2.50-9.25	2.00-7.50	2.00-6.75	2.00-6.50	2.00-6.50
> 1year-3 years	7.25-9.25	6.00-8.75	5.25-7.50	5.25-7.75	6.25-7.50
> 3 years	7.25-9.75	6.00-9.00	5.75-8.00	5.75-8.00	6.50-8.00
<i>Foreign Banks</i>					
Up to 1 year	2.25-9.25	1.80-8.00	1.25-7.00	1.25-7.00	1.25-7.00
> 1year-3 years	3.50-9.75	2.25-8.50	2.25-7.75	2.25-8.00	3.00-8.00
> 3 years	3.60-9.50	2.25-9.50	2.25-8.50	2.25-8.75	3.00-8.50
2. BPLR					
1. Public Sector Banks	12.25-13.50	11.00-13.50	11.00-13.50	11.00-13.50	11.00-13.50
2. Private Sector Banks	13.00-16.50	12.50-16.75	12.50-16.75	12.50-16.75	12.50-16.75
3. Foreign Banks	10.00-15.50	10.50-16.00	10.50-16.00	10.50-16.00	10.50-16.00
3. Actual Lending Rate*					
1. Public Sector Banks	4.00-17.75	3.50-17.50	3.25-18.00	3.25-18.00	
2. Private Sector Banks	4.00-24.00	4.10-26.00	3.50-25.84	3.00-28.00	
3. Foreign Banks	5.00-28.00	2.76-25.50	3.50-22.00	3.60-23.00	

* : 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.

- The sustained growth in equity prices that was witnessed in 2009-10, exhibited some correction in Q1 of 2010-11, mainly due to transmission of shocks from global markets (Table 26), though there has been some recovery in July 2010.

Table 26: Key Stock Market Indicators

Indicator	BSE				NSE			
	2008-09	2009-10	2009-10 (Apr- Jun)	2010-11 (Apr-Jun)	2008-09	2009-10	2009-10 (Apr-Jun)	2010-11 (Apr-Jun)
1. BSE Sensex / S&PCNX Nifty								
(i) End-period	9709	17528	14494	16945	3021	5249	4291	5313
(ii) Average	12366	15585	13078	17268	3731	4658	3964	5177
2. Coefficient of Variation	24.2	11.9	13.1	2.8	23.2	11.3	12.3	2.7
3. Price-Earning Ratio (end-period)*	13.7	21.3	19.0	21.1	14.3	22.3	20.0	22.3
4. Price-Book Value Ratio	2.7	3.9	3.5	3.4	2.5	3.7	3.6	3.8
5. Market Capitalisation to GDP Ratio (%)	59.0	106.5	92.2	82.0	55.4	103.8	89.8	76.5

*: Based on 30 scripts included in the BSE Sensex and 50 scripts included in the S&P CNX Nifty. @: As at end-period.
Source: Bombay Stock Exchange Ltd. (BSE) and National Stock Exchange of India Ltd. (NSE).

- The activity in the primary segment of the domestic capital market displayed signs of revival in Q1 of 2010-11. Resources raised through public issues increased considerably (Table 27). The resource mobilization by mutual funds was, however, lower due to tight liquidity conditions and subdued stock markets.

Table 27: Resource Mobilization from Capital Market

(Rupees in Crore)

Category	2008-09 (Apr-Mar)	2009-10 (Apr-Mar)	2009-10 (Apr-Jun)	2010-11 (Apr- Jun)
A. Prospectus and Rights Issues*	14,671	32,607	236	7,737
1. Private Sector (a+b)	14,671	25,479	236	7,737
a) Financial	466	326	-	2,550
b) Non-financial	14,205	25,153	236	5,187
2. Public Sector	-	7,128	-	-
B. Euro Issues	4,788	15,967	215	4,844
C. Mutual Fund Mobilization (net)@	-28,296	83,080	1,00,403	3,547
1. Private Sector	-34,017	54,928	81,456	14,109
2. Public Sector #	5,721	28,152	18,947	-10,562

*: Excluding offer for sale @: Net of redemptions. #: Including UTI Mutual fund.

Note: Data exclude funds mobilized under Fund of Funds Schemes.

Source: Mutual Fund data are sourced from Securities and Exchange Board of India.

- A sustained and rapid rise in housing prices over successive quarters remains an area of concern from the standpoint of their possible spillover to demand pressures and the general price level as well as financial stability (Table 28).

Table 28: House Price Index (Base=Q4: 2008-09)*

(Per cent)

Quarter	Bangalore		Ahmedabad		Delhi#		Mumbai#	
	Index	Price Change (Q-on-Q)	Index	Price Change (Q-on-Q)	Index	Price Change (Q-on-Q)	Index	Price Change (Q-on-Q)
Q4: 2008-09	100.0	–	100.0	–	100.0	–	100.0	–
Q1: 2009-10	103.6	3.6	101.4	1.4	101.9	1.9	116.0	16.0
Q2: 2009-10	101.7	-1.9	104.2	2.7	103.2	1.3	131.0	12.9
Q3: 2009-10	100.8	-0.9	117.3	12.6	107.4	4.1	135.1	3.1
Q4: 2009-10	98.5	-2.3	124.3	5.9	136.4	27.0	136.4	1.0

* : Based on weights obtained from number of transactions

: Delhi and Mumbai indices are shifted to common base.

Source: Department of Registration and Stamps of the respective State Governments.

V. Conclusion

To sum up, GDP growth in the last quarter of 2009-10 was higher than previously expected, and going by the lead indicators, this growth rate seems sustainable. Continuing resilience of the services sector, coupled with buoyancy of the industrial sector would lend further support to this growth momentum. Demand side factors like revival of private consumption demand and pick-up in private investment are expected to offset the slowdown in government consumption due to the gradual exit from the fiscal stimulus measures. On the aggregate demand front, while private consumption demand was subdued in 2009-10, trends in corporate sales, production of consumer durables and non-durables and automobile sales point to significant pick-up in private consumption demand in recent months. Increase in investment demand is also expected to continue as suggested by the production trends in capital good, non-oil imports and corporate profits. Thus, despite increasing global market uncertainties the overall trends in fiscal sustainability so far suggest stronger growth in India relative to the global recovery.

Select Economic Indicators

Economic Growth					
	Q1 of 2010-11 (Revised)	Q1 of 2009-10	Q1 of 2008-09	Q1 of 2010-11 (Revised)	Q1 of 2009-10
	at Factor Cost			at market prices	
Gross Domestic Product at Constant(2004-05) Prices, April-June, (Q1), 2010-2011					
GDP at factor cost (Rs. in Crore)	1132778	1040949	981887	21.7	7
GDP at 2004-05 market prices (Rs. Crore)	1,209,888	1,099,653	1,045,200	100	100
Growth Rate (Per cent)					
GDP at factor cost	8.8	6	7.8		
GDP at 2004-05 market prices	100	100	100	100	
Private Final Consumption Expenditure	56.5	59.9	61.3	58.2	57.4
Government Final Consumption Expenditure	11.9	11.5	10.5	11.4	11.5
Gross Fixed Capital Formation	30.5	31.2	33	29.8	31.3
Change in Stocks	1.3	1.3	1.4	1.1	1.4
Valuables	1.2	1.2	1.1	1.1	1.2
Exports	20.4	21.3	26.7	20.4	21.2
Less Imports	25.6	26	32	25.6	26
Discrepancies	3.8	-0.3	-2.1	3.7	2

Source: Central Statistical Organisation, Government of India

Agriculture & Industrial Production					
Sector-wise Percentage Change over Previous Year					
	(at 2004-05 constant prices)			at Factor Cost	
Agriculture, forestry & fishing	2.8	1.9	3.2	12.7	8
Industry					
Mining & Quarrying	8.9	8.2	2.6	28.4	-0.2
Manufacturing	12.4	3.8	5.9	17.5	5.2
Electricity,gas &water supply	6.6	6.6	3.3	18.5	3.8
Services					
Construction	7.5	4.6	9.8	12	3.1
Financing,institutions, real estates & Business services	8	11.8	9.1	24.4	11.5
Community, social & Personal services	6.7	7.6	8.7	23	11.5

Source: Central Statistical Organisation, Government of India

Performance of Core Industries					
Sector-wise Growth Rate(%) in Production					
(Weight in IIP : 26.68%)					
Overall Index	5.2*	4.42	4.49		
Crude Oil Production	5.94	-1.13	-0.14		
Petroleum Refinery Products	5.3	-4.2	3.4		
Coal	-0.44	12.65	8.43		
Electricity	5.57	6.06	1.96		
Cement Production	7.97	12.14	5.8		
Finished(CARBON) Steel Production	3.57	1.7	7.97		

* Overall Indices for this quarter includes data for only two months - April & May, 2010
 Compiled by the BCCI: Source of data Ministries/Departments/Organisation(s)

External Sector

Exports and Imports(in US \$ million)

Item	2008-09	2009-10 (April-March)	Mar-09	March 2010(P)	% Change in March,2010
Exports	185295	178662	13606	17745	30.4
Imports	303696	286823	23013	28299	23
Oil Imports	93667	87121	6601	8354	26.5
Non-Oil Imports	210029	199702	16412	19946	21.5
Trade Balance	-118401	-108161	-9408	-10554	-

Source: Provisional data as per the Press Note of the Ministry of Commerce and Industry

Foreign Currency Assets

At the end of	Amount		Variation	
	Rs. Crore	\$ Million	Rs. Crore	\$ Million
March, 2006	647327	145108	54206	9537
March, 2007	836597	191924	189270	46816
March, 2008	1196023	299230	359426	107306
March, 2009	1231340	241676	35317	-57554
March, 2010	1150778	254935	-80562	13259
2010-11	(over last month)			
Apr-10	1133322	255023	-17456	88
May-10	1152893	248201	19571	-6822
Jun-10	1164431	249878	11538	1677
Jul-10	1202388	258801	37957	8923

Source: Reserve Bank of India

Rupees Per unit of Foreign Currency*

	US Dollar	Pound Sterling	Japanese Yen	Euro
March, 2007	44.026	85.6763	0.3754	58.2684
March, 2008	40.3561	80.8054	0.4009	62.6272
March, 2009	51.2287	72.9041	0.5251	66.9207
March, 2010	45.4965	68.436	0.5018	61.7653
2010-11				
Apr-10	44.4995	68.2384	0.4763	59.6648
May-10	45.7865	67.1747	0.4969	57.6553
Jun-10	46.5443	68.6952	0.5122	56.9016
Jul-10	46.8373	71.515	0.5343	59.7636

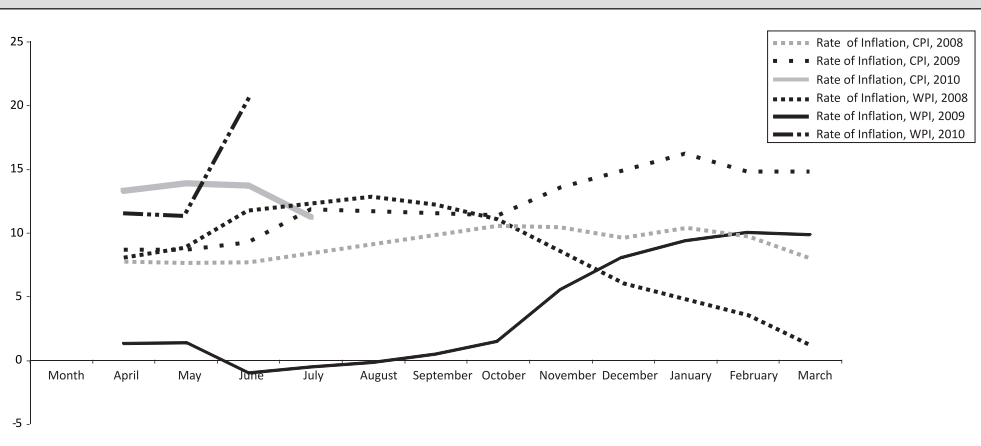
* FEDAI Indicative Market Rates(on Yearly/Monthly average basis)

Prices

Current Price Situation Based on Monthly Wholesale Price Index(Base: 1993-94)

Items/Groups	Weight(%)	Cumulative Change from March		Inflation (Year-on-Year)		Inflation (Average of last 12 months)	
		In July		In July		In April	
		2009-10	2010-11	2009-10	2010-11	2009-10	2010-11
All Commodities	100	4.6	3.59	-0.54	9.97	4.96	7.34
Primary Articles	22.02	7.86	4.84	7.64	14.94	8.95	14.31
Fuel and Power Group	14.23	5.33	6.8	-10.37	14.29	0.25	5.16
Manufactured Products	63.75	2.94	1.76	0.1	6.15	5.17	5.15

Point to Point Rate of Growth



Source : For WPI, Office of Economic Advisor, Ministry of Commerce, for CPI, Labour Bureau, GoI.

Notes for Contributors

- ANALYTIQUE welcomes original articles or essays on any subject of interest related to commerce and industry such as macro economy, industrial performance, international trade, banking and finance, etc.
- Contributions must be no more than 4,000 words, including notes and references. And must be accompanied by an abstract of a maximum of 150 words in MS word. Tables, Graphs should be in MS Excel format.
- Contributions should be sent by e-mail at analytique@bombaychamber.com
- Contribution should not have been simultaneously submitted for publication to another Journal.
- Authors are requested to provide full details for correspondence: postal address, day-time phone numbers and e-mail address for our records. Only author's affiliation and e-mail address will be published along with the articles unless otherwise directed.

World Prices of Select Commodities

World Prices of Select Commodities								
Monthly averages								
Commodity	Unit	July	July	July	July	10-Apr	10-Jul	Y-o-Y variation in prices(%)
		2006	2007	2008	2009	2010	2010	10-Jul
Energy								
Coal, Australia	\$/mt	52.8	67.3	180	73.8	100.2	96.44	30.68
Crude Oil, avg,spot	\$/bbl	72.5	73.6	132.8	64.7	84.2	74.6	15.33
Crude oil,Brent	\$/bbl	73.9	77.2	133.9	64.9	85	74.7	15.14
Crude oil,Dubai	\$/bbl	69	69.5	131.2	65	83.1	72.7	11.83
Natural gas, US	\$/mmbtu	6.3	6.2	11.1	3.4	4	4.6	36.47
Agriculture								
Coffee,robusta	c/kg	142.2	203.9	254	158	157.7	188	18.96
Tea,auctions(3),average	c/kg	200.5	213	275.9	295.9	260.7	286.4	-3.19
Coconut oil	\$/mt	583.3	929	1436	685	939	1031	50.51
Groundnut oil	\$/mt	930	1342	2536.4	1149	1361	1300	13.14
Palm oil	\$/mt	471	811	1128	639	830	807	26.29
Palm kernel oil	\$/mt	557	924	1272	666	1020	1059	59.01
Soybean meal	\$/mt	201.8	289.4	508	429	340	356	-17.02
Soybean oil	\$/mt	630	885.4	1511	836	903	907	8.49
Maize	\$/mt	114	146.8	265.3	151.6	157.1	163.8	8.04
Rice,Thailand,25 or 5%	\$/mt	286.6	306.8	731.8	572	475.7	442.8	-22.6
Wheat, US, HRW	\$/mt	202.4	238.4	328.2	224.9	192.9	195.8	-12.91
Wheat US SRW	\$/mt	143.9	225.6	245.4	175.6	187.8	222.3	26.56
Oranges	\$/mt	734.4	1142.5	1431.7	715.4	949.6	1302.4	82.06
Sugar,world	c/kg	35.4	22.4	31.4	40.6	36.4	38.5	-5.26
Raw Materials								
Logs,Malaysia	\$/cum	236.1	263.1	275.8	281.4	246	274.9	-2.32
Plywood	c/sheets	635.4	649.7	647.9	561.9	564.7	569.7	1.38
Wood pulp	\$/mt	728.8	746.1	878.4	596.2	825	915	53.47
Cotton A Index	c/kg	122.1	149.6	170.4	142.9	193.6	185.5	29.88
Rubber,US	c/kg	273.4	232.2	337.1	191.4	398.8	349.7	82.72
Rubber, Singapore	c/kg	251.7	210.1	321.6	174.9	394.8	327.4	87.18
Fertilizers								
DAP	\$/mt	261.3	436.3	1185.4	293.3	466	461.3	57.26
Phosphate rock	\$/mt	45.5	80	367.5	90	125	125	38.89
Potassium chloride	\$/mt	173.8	203.1	560	655.5	314.4	320	-51.18
Urea,E.Europe,bulk	\$/mt	202.3	267.9	760	243.7	252.7	249.5	2.38
Metals and Minerals								
Aluminium	\$/mt	2512.7	2732.4	3071.2	1668	2316.7	1988.3	19.2
Copper	\$/mt	7712.1	7972.6	8414	5215.5	7745.1	6735.3	29.14
Gold	\$/toz	633.7	665.4	939.8	934.2	1148.7	1193	27.7
Iron ore	c/dmtu	77.4	84.7	140.6	101	176.5	167	65.43
Lead	c/kg	105.2	308.3	194.5	167.9	226.5	183.7	9.43
Nickel	\$/mt	26586	33417	20160	15985	26031	19518	22.1
Silver	c/toz	1121.2	1293.4	1806.4	1338.6	1816.8	1794	34.02
Steel cr coil sheet	\$/mt	700	650	1100	700	812.5	850	21.43
Steel hr couil sheet	\$/mt	600	550	1000	600	712.5	750	25
Tin	c/kg	841.9	1473.8	2313.9	1403.9	1868.4	1819.1	29.58
Zinc	c/kg	334	354.6	185.2	157.9	236.7	184.4	16.8

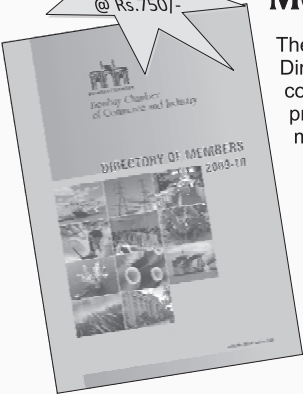
Source: World bank-The Pink Sheet

Government Accounts

Trends in Central Government Finances: April-June 2009-10

	Budget Estimates	April-June		Col. 3 as % of	Col.4 as % of	% Change over preceeding year	
	2010-11	2009-10 (Rs. Crore)	2010-11	2009-10 (BE)	2010-11 (BE)	2009-10	2010-11 (4/3)
1. Revenue Receipts	682,212	71,995	199,810	11.7	29.3	-12.5	177.5
Gross tax revenue	746,651	1,00,648	129,478	15.7	17.3	-11.4	28.6
Tax(net to Centre)	5,34,094	63,341	83,994	13.4	15.7	-15.2	32.6
Non Tax	148,118	8,654	115,816	6.2	78.2	14.2	1238.3
2. Capital Receipts	426,537	1,24,976	42,398	30.8	9.9	44.3	-66.1
of which:							
Recovery of loans	5,129	674	1,124	16	22	35.3	66.8
Other Receipts	40,000	0	1,078	0	2.7		
Borrowings and other liabilities	381,408	1,24,302	40,196	31	10.5	44.3	-67.7
3. Total Receipts(1+2)	1,108,749	1,96,971	242,208	19.3	21.8	16.6	23
4. Non-Plan Expenditure (a) + (b)	735,657	1,42,185	154,148	20.4	21	33.2	8.4
(a) Revenue Account	643,599	1,32,521	133,770	21.4	20.8	28.3	0.9
of which:							
Interest payments	248,664	35,444	40,223	15.7	16.2	-1.3	13.5
Major Subsidies	108,667	35,862	25,853	34	23.8	34.4	-27.9
Pensions	42,840	9,012	10,922	26	26	66.4	21.2
(b) Capital Account	92,058	9,664	20,378	13	22	177	110.9
5. Plan Expenditure (i) + (ii)	373,092	54,786	88,060	16.8	23.6	-12	60.7
(i) Revenue Account	315,125	47,064	76,617	16.9	24.3	-15.3	62.8
(ii) Capital Account	57,967	7,722	11,443	17	20	17.5	48.2
6. Total Expenditure (4) + (5) = (a) + (b)	1,108,749	1,96,971	242,208	19.3	21.8	16.6	23
(a) Revenue Expenditure	958,724	1,79,585	210,387	20	21.9	13	17.2
(b) Capital Expenditure	150,025	17,386	31,821	14.1	21.2	72.7	83
7. Revenue Deficit	276,512	1,07,590	10,577	38.1	3.8	40.5	-90.2
8. Fiscal Deficit	381,408	1,24,302	40,196	31	10.5	44.3	-67.7
9. Primary Deficit	132,744	88,858	-27	50.6	0	77	-100

Source: Review of Union Government Accounts, April-June 2010, Ministry of Finance.



AVAILABLE FOR SALE @ Rs.750/-

Bombay Chamber's Membership Directory 2009-10

The latest edition of the Bombay Chamber Membership Directory 2009-10 is your primary source of business contact information. It is a biennial publication that provides contact details and in-depth description of each member company as well as other useful information.

The **MEMBERSHIP DIRECTORY** provides:

- An Authentic Database
- Detailed Membership Profiles
- Product - wise Categorisation

The **MEMBERSHIP DIRECTORY 2009-10** is available at **Rs. 750/- per copy.**

For further enquiries, please contact Accounts Department - Tel: 2261 4681 Extn.: 403

Money & Banking

Money Stock - Components and Sources (Rs. crore)

Item	Outstanding as on		Growth Rates (in per cent)			
	2010		Financial year so far		Year on Year	
	Mar.31	Jul.30	2009-10	2010-11	2009	2010
M3	55,99,762	57,91,002	5.3	3.4	20.6	14.7
Components (i+ii+iii+iv)						
(i) Currency with the Public	7,68,033	8,14,057	1.6	6.0	14.3	20.4
(ii) Demand Deposits with Banks	7,22,739	6,85,291	-0.4	-5.2	14.2	16.9
(iii) Time Deposits with Banks	41,05,151	42,86,544	7.0	4.4	22.9	13.3
(iv) "Other" Deposits with Reserve Bank	3,839	5,110	-23.7	33.1	-16.4	20.2
Sources (i+ii+iii+iv-v)						
(i) Net Bank Credit to Government (a+b)	16,67,096	17,38,039	11.3	4.3	46.5	22.2
(a) Reserve Bank	2,11,586	2,22,635				
(b) Other Banks	14,55,511	15,15,404	14.7	4.1	33.1	8.7
(ii) Bank Credit to Commercial Sector (a+b)	34,92,781	36,06,610	0.9	3.3	15.3	18.5
(a) Reserve Bank	1,328	1,325				
(b) Other Banks	34,91,453	36,05,285	1.0	3.3	14.9	18.9
(iii) Net Foreign Exchange Assets of Banking Sector*	12,81,469	13,41,454	0.1	4.7	3.0	-0.9
(iv) Government's Currency Liabilities to the Public	11,270	11,508	3.6	2.1	9.5	10.5
(v) Banking Sector's Net Non-Monetary Liabilities	8,52,854	9,06,609	-9.2	6.3	4.6	16.1
of which :						
Net Non-Monetary Liabilities of RBI	3,01,615	3,58,236	8.8	18.8	47.6	-15.1
* : Includes investments in foreign currency denominated bonds issued by IIFC (UK) since March 20, 2009.						
Note: Government Balances as on March 31, 2010 are before closure of accounts						

Select Scheduled Commercial Banks - Business in India

Item	Outstanding as on		Percentage Variation			
	26-Mar-10	30-Jul-10	Financial year so far		Year on Year	
	Mar.31	Jul.30	2010-11	2009-10	2009	2010
1. Bank Credit	3240399	3357265	3.50	1.10	15.7	19.7
Non-Food Credit	3191909	3305839	3.57	1.26	16.7	19.9
2. Aggregate Deposits	4486574	4639595	3.30	6.2	21.8	14.0
3. Investments in Govt. and other approved securities	1382684	1444571	4.3	14.5	33.3	8.1

Policy Rates/Interest Rates (per cent per annum)

Item / Week Ended	2009	2010
	31-Jul	30-Jul
Cash Reserve Ratio (per cent) (1)	5.00	6.00
Bank Rate 6.00	6.00	
Repo Rate 4.75	5.75	
Reverse Repo Rate	3.25	4.50
Prime Lending Rate (2)	11.00-12.00	7.50-8.00
Deposit Rate (3)	6.50-7.75	6.00-7.50
Call Money Rate (Low / High) (4)		
- Borrowings	1.50/3.30	2.90/5.81
- Lendings	1.50/3.30	2.90/5.81

- (1) Cash Reserve Ratio relates to Scheduled Commercial Banks (excluding Regional Rural Banks).
(2) Prime Lending Rate relates to five major Banks.
(3) Deposit Rate relates to major Banks for term deposits of more than one year maturity.
(4) Data cover 90-95 per cent of total transactions reported by participants.

With Best Compliments From



Mahindra Finance

AUTO LOAN * PERSONAL LOAN * REFINANCE

FIXED DEPOSITS * INSURANCE * MUTUAL FUNDS

Sadhana House, 2nd Floor, Behind Mahindra Towers, 570 P. B. Marg, Worli, Mumbai 400 018, India. Tel.: 022-66526000

www.mahindrafinance.com



Mazagon Dock Limited



S h i p b u i l d e r s t o t h e N a t i o n

Dockyard Road, Mumbai 400 010, India. Tel.: 91 (022) 2378 1561 Website: www.mazagondock.gov.in