

ANALYTIQUE



Vol. VI · No. 7 · Oct - Dec 2010

»» The Stage is Set for Takeovers to Take Over India

– Vaibhav Shukla

»» Economic Reform and Fiscal Management: the Indian Experience

– Ram Pratap Sinha

»» Debt Capital Markets In India and Some Recent Transaction Developments

– Mukesh Bhasin



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From the Editor's Desk

The consumer confidence index has placed India in a strong position as India's index of consumer confidence touched 129 for the April- June quarter as per the Second Quarter Review of Monetary Policy by RBI. In addition, the output numbers by the Central Statistical Organisation in October shows that the economy grew by 8.9% (year-on-year basis) in the July-September quarter, which is the highest in the past two years. During this period, manufacturing output increased by 9.8% and, thanks to a bountiful monsoon, farm output by 4.4%. The better-than-expected performance of trade, hotels, transport and communication sector also suggests that the economy is set to surpass the initial growth forecast of 8.5% for this fiscal year. It is said that the growth has not only gained momentum, but also become more broad-based. The official forecasts conclude that the economic recovery is now on a sustainable path.

However, critics keep arguing that there is no room for comfort as inflation continues to be a challenge. Also, it has been predicted that higher growth, coupled with the crisis in Europe, will attract more capital inflows, putting upward pressure on the rupee. The need to counter FII's dominance over the domestic capital market is the need for the hour and the Second Quarter Monetary Policy Review has not come out with any measures to prevent undesirable inflows. Again, the deposit growth, which continues to lag behind, will have its own consequences on banks' funds position.

To add to this debate, some nay sayers argue that our growth is still far from inclusive based on the following additional information. The recently released UNDP Human Development Report 2010 places India at a lowly 119th position in terms of Human Development Index (HDI) out of 139 countries. Another report by the Washington DC based International Food Policy Research Institute puts India amongst the worst hunger sufferers, ranking 67th out of 84 developing countries on its Global Hunger Index. According to Indian Readership Survey 2007 R2, in rural India 40% of households do not have electricity, 71% households do not have in-house bathing facility and 72% households do not have in-house toilets. According to Max-NCAER, India Financial Protection Survey (2008), 96% of Indian households can not survive for more than a year on their current savings if a major source of household income is lost. Only 24% households own a life insurance policy and only 1.2% families have health insurance.

All these indicate that economic growth doesn't automatically guarantee better lives or better health for the majority of Indians and that macro data can hide more than they reveal. We need to keep in mind that inclusive growth is more than a cliché or buzzword, and that it needs to be addressed no matter how spectacularly the economy may grow in terms of aggregates. We therefore look forward to 2011 in the hope that inclusive growth will be achieved thus improving the quality of life of millions of Indians.

Contents

By Invitation

- >>> Opinion on the last issue of Analytique
 – Manas Paul 02

Special Theme

- >>> The Stage is Set for Takeovers to Take Over India
 – Vaibhav Shukla 04
- >>> Economic Reform and Fiscal Management: the Indian Experience
 – Ram Pratap Sinha 11

Current Affairs

- >>> Debt Capital Markets In India and Some Recent Transaction Developments
 – Mukesh Bhasin 24

Current Economic Scenario

- >>> Quarterly Overview 31
- >>> Select Economic Indicators 50
- Notes for Contributors and Advertisement Tariff 56

Editorial Board

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Printed at Uchitha Graphic Printers Pvt. Ltd.

On the Last Issue of Analytique

Sumit K Majumdar, in his article draws attention to the differential impact of wage (share) on an exporting sector's foreign earnings (or exports). In his empirical exercise he studies two sectors – Indian pharmaceutical sector considered to be relatively more dependent on physical and technological capital (relatively physical capital intensive) and Indian services sector perceived to be relatively human intensive (or should we say relatively human capital intensive). Ultimately it is all about capabilities that matter in supporting exports. While in pharmaceutical industry there is more dependence on technological capability, capital intensity enhances capability and hence support higher foreign earnings whereas services sector being more human capital intensive, larger wage share in it (reflection of greater usage of human capital) supports higher foreign earnings. On one hand this explains the existence of skill induced wage differential across industries and on the other it remains in line with the notion of Heckscher-Ohlin theorem that a relatively labour (human capital) rich country like India would have the comparative advantage in exporting (in a free trade world) human capital intensive products. However, the exact reason behind choosing pharmaceutical sector (as a representation of capital intensive sector) is not clear in the paper. It would be interesting to see if the results hold for some of the other capital intensive sectors like India's engineering exports or labour intensive sectors like apparel (and Gems & Jewelry) exports.

Surajit Sinha in his paper makes a preliminary attempt to explore the relationship between growth and inflation in India based upon the simple juxtaposition of Phillips curve and Okuns law. The two juxtaposed together appears to convey that increases in output growth will be accompanied by rising inflation. Given India's tremendous pace of growth in recent past, this paper explores the existence of any causal relationship between growth and inflation in India. The causality tests do not find the existence of any linear causal relationship between growth and WPI inflation, which as the paper discusses could be attributed to policy successes in addressing some of the supply side rigidities of the economy over time. However, given that Phillips curve is more a short-run phenomenon and Okuns law more a long-run phenomenon (given the perception of potential growth and natural rate of unemployment ingrained it) the veracity of the logic of it's simple juxtaposition to arrive at a perceived relationship between growth and inflation possibly needs added justification. In this regard it might be more appropriate to look for statistically significant relationship between growth and inflation if phases of cyclical excesses i.e. when the growth is perceived to be in excess of sustainable level.

V. Shunmugam in his article discusses the usefulness of commodity derivatives as a strategic hedging device to address the risks of excessive price volatility across various segments in the economy, which has witnessed recent increases in a globalised world. In this background the paper emphasizes the need for developing commodity trading markets in India in terms of additional products to cover different types of risks faced by the market participants. The lack of products currently restrict hedging horizon (with standardized product in commodity exchanges) to less than three months and the absence of risk hedging products such as options do not allow risk hedging tailored to specific needs and risk appetite of existing participants. The paper attributes the lopsided development to the restrictive nature of Forward Contracts Regulation Act (1952) and calls for its amendment to bring markets and their regulation at par with the stakeholder's requirements in a dynamic world where India is expected to play a greater role. The paper falls short of addressing the specific shortfalls of the existing FC Act that needs a relook to make it work in the current evolving scenario.

Ram Pratap Sinha in his paper recounts the evolution and impact of priority sector lending in India. The paper points to the fact that India might not have been able to derive the full and desired benefit out of priority sector lending. There are issues about the distribution of funds motivated by political rather than economic goals followed by high rates of default and misallocation of resources. On one hand the impact of priority sector lending on the distribution of wealth and income on poorer section of the society is far from clear. On other, priority sector lending have affected the profitability of banks which even if they have been able to cope up with better in the post reforms area but not without the cost of reduced share of priority sector lending in total advances. Moreover, dilution in priority sector norms over time have also contributed to a reduced focus on underserved segments. Reports suggest that bulk of the increase in credit especially to agriculture actually includes activities that could be considered commercially viable. This along with high default rates (and their contribution to NPAs), and short-falls in priority sector lending are some of the challenges that Indian banking sector continues to face today.

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The Stage is Set for Takeovers to Take Over India

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Abstract

It is common irrefutable knowledge that the time is ripe for mergers and acquisitions to engulf the country as an acceptable method for domestic companies to grow and prosper. With this in mind, the regulations pertaining to takeover of companies as applicable in India is about to be revamped to give it a new, forward-looking and global appeal. This article aspires to highlight the various amendments proposed in the law, the rationale for the same, its consequences and measures that may be adopted by corporates today to shield themselves from blood-thirsty acquirers.

Introduction

As many of you readers may be aware, the legal provisions relating to takeovers in India are prescribed under the Securities and Exchange Board of India (SEBI) Substantial Acquisition of Shares and Takeovers Regulations, 1997 (for the sake of brevity the same may be referred to as "Takeover Regulations" hereinafter).

Bearing in mind the fact that the Takeover Regulations have undergone changes 23 times so far, since its enactment in the year 1997, it has been proposed that the same be substituted with a new revised legislation. To attain this end,

SEBI constituted a twelve-member committee called the Takeover Regulations Advisory Committee, (i.e. "TRAC") on September 4, 2009 under the Chairmanship of Mr. C. Achuthan.

A report was issued by the TRAC on July 19, 2010 circulating the draft text of the proposed Takeover Regulations declaring the same to be opened to public opinion till August 31, 2010. The suggested modifications to the prevailing law were prepared with a view to achieve the following:

- (i) To provide a legal framework which is equitable, just, transparent and hence facilitative of takeovers;
- (ii) To bring the Takeover Regulations in line with accepted global standards, established international practices and changing market dynamics;
- (iii) To balance the interests and concerns of the acquirer, the target company, its management and the public shareholders;
- (iv) To provide each shareholder with an exit opportunity when a substantial acquisition of shares in, or takeover of, a listed company takes place, on terms that are on an equal footing as those enjoyed by substantial shareholders; and

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(v) To ensure that only acquirers who are capable of fulfilling their obligations make open offers.

Key amendments proposed

Upon our analysis of the TRAC report we find that a number of changes to the Takeover Regulations have been recommended. We shall now deal with certain key amendments as proposed, draw a comparison with the corresponding provision as it prevails and subsists as on date and bring to light its significance in the current domestic scenario.

The vital amendments proposed to be made in the Takeover Regulations are as follows:

1. Trigger for Open Offer

Currently, the Takeover Regulations require a person who intends to acquire 15% or more voting rights in a target company to make an open offer.

The above provision is proposed to be amended to require the acquirer to make the open offer where an aggregate of 25% or more voting rights in a target company are being acquired.

The TRAC resolved to amend the regulation as indicated above based on various parameters, some of which are as under:

- (i) Recent trends in shareholding pattern of listed companies revealed that the existing trigger threshold of 15% had outlived its contextual relevance.
- (ii) The initial trigger points in countries around the globe such as UK, Singapore, Hong Kong, EU and South Africa were found to range between 30% to 35%.

(iii) Provisions of the Companies Act, 1956, which recognize that a promoter can exercise de facto control over the target company (by blocking special resolutions) so long as the promoter holding confers voting rights in excess of 25%.

This amendment would be welcomed by large investors (such as private equity investors, hedge funds, etc.) who could now acquire up to 24.99% equity stake in a target company without triggering an open offer obligation. Consequently, they may participate in critical corporate decisions of such target company. However, the flip side of the same coin would reveal that such critical corporate decisions may be blocked, and management of the target company may be rendered unstable, by such shareholders if they have disruptive ulterior motives.

2. Extent of Open Offer

As per the provisions of the subsisting Takeover Regulations, the acquirer is mandatorily required to make the open offer to holders of a minimum of 20% of the voting capital of the target company.

The proposed amendments to the Takeover Regulations prescribe that such open offer would be required to be given to 100% i.e. all the other shareholders of the target company. Further, consideration payable under the open offer will be required to be placed in an escrow account.

This recommendation of TRAC is based on international practices and feedback received from the public. This amendment is expected to have the following effects:

(i) Equitable exit opportunity to existing shareholders:

As per the prevailing provision of the Takeover Regulations, in case of over-acceptance of an open offer the shares tendered in response would have to be accepted on a proportionate basis. The result is that the public shareholder is currently unable to exit fully and realize the full premium, if any, on his entire share holding.

As there ought to be no reason for the law to pre-empt a complete exit, the above consequence of the existing provision is unjust. As a result, the TRAC has recommended enhancement of the extent of the open offer to 100% so as to treat all shareholders of the target company at par with the promoters from the perspective of exit opportunity as well as open offer price entitlement.

(ii) Funding

Since the consideration payable under the open offer (to the extent of 100%) is required to be deposited into an escrow account, there would be apprehensions with regard to funds. In India, there is a need to allow flexible norms for grant of loans for strategic investments in Indian listed entities. In the absence of such norms, there is an uneven playing field created in favour of foreign acquirers who are not, ordinarily, subjected to such regulatory restrictions under their respective jurisdictions.

As an assured measure, the TRAC has also recommended payment by means of non-cash consideration (in the form of securities).

(iii) Costs involved in takeover

While the proposed amendment is

favourable to the small shareholders, there is increasing debate regarding its effect on costs involved in the takeover. Certain voices have been raised against the amendment, as it may increase instances of hostile takeovers, could lead to some ongoing M&A decisions being reconsidered and may nullify the gains derived from a higher trigger point. On the contrary, some believe that the proposed amendment could boost mergers and acquisitions since it could pave way to a stronger and more robust regime.

(iv) Commitment to open offer

A necessary result of the amendment would be that only those persons capable of honouring the open offer obligation to the extent of 100% would come forward pursuant to the requirement of deposit of the consideration in an escrow account.

3. Delisting of Target Company – Minimum Public Shareholding Requirement

At present, the Takeover Regulations stipulate that, in the event the public shareholding in the target company falls below the minimum level required as per the listing agreement, by virtue of acquisition subsequent to an open offer, the acquirer would be required to take requisite action to ensure compliance with the relevant provisions thereof, within the time period specified therein.

The amendment to the above provision provides that in case an acquirer is mandatorily required to make an open offer, such acquirer ought to state upfront that pursuant to making such an open offer, if his shareholding in the target company (along with any persons

acting in concert) crosses the delisting threshold, the target company may be delisted.

The amended provision further lays down that in the event such an intention to delist is not stated by the acquirer upfront, or the response to the open offer is such that the public shareholding could fall below the minimum level required under the listing agreement, but remains above the delisting threshold, then the acquirer would be required to take either of the following measures:

- (i) bring his holding down to ensure compliance by the target company with the listing agreement, or
- (ii) proportionately reduce both his acquisitions under the agreement that triggered the open offer and the acquisitions under the open offer.

This proposed amendment aims to harmonise the Takeover Regulations with the delisting requirements applicable to the target company.

4. Non-Compete Fees

The Takeover Regulations require any amount paid towards non-compete fee in excess of 25% of the open offer price to be added to the same.

The TRAC observed that by virtue of the prevailing provision, payments were being made to controlling shareholders of the target company, without any such payments to the public shareholders, under the guise of non-compete fees.

In order to ensure equality of treatment to all shareholders, and to eliminate the scope of abuse of non-compete payments, the Takeover Regulations are proposed to be amended to explicitly

stipulate that consideration paid in any form to the selling shareholder concurrent with the purchase of shares, whether such payments are categorized as “control premium”, “non-compete fees” or otherwise, must be added to the negotiated price per share for the purpose of determining open offer pricing.

This will ensure that all shareholders are monetarily awarded on equal terms and no special consideration is assured or paid to the promoters through a private deal.

5. Role of Independent Directors

The Takeover Regulations currently provide that the board of directors of the target company may, if they so desire, send their unbiased comments and/or recommendations on the offer to the shareholders, in light of their fiduciary responsibility towards the shareholders.

The TRAC proposes to amend the above provision making it mandatory for the target company to constitute a committee of its independent directors to give its reasoned recommendations on the open offer. Such reasoned recommendations shall thereafter be required to be furnished to the stock exchange(s) where the shares of the target company are listed and be published in the newspapers where the relevant detailed public statement of the open offer was published.

This amendment is theoretically a good route to follow, since the same is in line with the best global practices and may bring to the fore new standards of corporate governance in the country. However, the recommendation has been received with some skepticism as

independent directors may not give an independent unbiased view.

6. Timeline

At present, the duration for completion of offer formalities is 95 calendar days. It is proposed that the same be reduced so as to complete the process for open offer within 57 business days from the date of public announcement.

7. Obligations of Target Company

The Takeover Regulations currently provide that, during the offer period, the target company shall not sell, transfer, encumber or otherwise dispose off assets of the company or of its subsidiaries or enter into any material contracts.

While retaining the above mentioned provision, the TRAC recommends that material transactions outside the ordinary course of business may be carried out, in so far as the consent of the shareholders has been procured through a special resolution. This will improve corporate governance norms in the target company.

8. Obligations of Acquirer

The Takeover Regulations currently provide that where the acquirer has not expressly declared his intention to dispose off or otherwise encumber any assets of the target company except in the ordinary course of business of the target company, the acquirer shall be barred from doing so for a period of 2 years from the date of closure of the public offer.

The TRAC recommends that the acquirer may alienate any material assets of the target company (and/or its subsidiaries) during the period of 2

years following the offer period so long as the following are complied with:

- (i) the acquirer has declared such intention in the detailed public statement and the letter of offer; and
- (ii) where such alienation is necessary, despite no such intention having been expressed by the acquirer, a special resolution has been passed by the shareholders of the target company by way of a postal ballot.

9. Disclosure Obligations

The current Takeover Regulations obligate any acquirer to disclose his aggregate shareholding or voting right to the company concerned and to the stock exchanges where shares of the company are listed:

- (i) at every stage of crossing the specified thresholds; and
- (ii) on an annual basis.

The TRAC recommends that the acquirer promoter/shareholders be asked to make such disclosures on periodic as well as transaction-specific basis. This would ensure transparency.

10. Tax implications

The present tax regime in India is more favorable towards shareholders acquiring shares through the stock exchange as against open offer transactions, as it considers the latter as an off-market deal. This is undesirable for the reason that off-market deals are entered into in a non-transparent and largely unregulated manner, while open offers are to the contrary. As the basic objective of an open offer is to benefit investors

at large by granting them a just and fair exit opportunity, it would not be correct to club such a regulated and investor friendly activity in the same bracket as an off-market deal.

The TRAC has therefore recommended that there is a need to bring parity in tax treatment given to shareholders who tender their shares in an open offer and those who sell the same in the open market.

11. Certain other amendments proposed:

- (i) **Voluntary Open Offer:** It is proposed that an acquirer be permitted to make a voluntary open offer of minimum 10% shares (instead of maximum 20% shares, as per the prevailing provision) without breaching the minimum public shareholding requirement.
- (ii) **Control:** The scope of the definition of the term “control” is proposed to be widened to include, not merely the “right” to appoint majority of the directors or to control the management or policy decisions, but also the “ability” to do so.
- (iii) **Exemptions from Open Offer:** The TRAC has recommended inclusion of certain additional transactions which are exempted from making an open offer. Further, SEBI has been conferred with a discretionary power to refer to a takeover panel, an application by an acquirer seeking exemption. At present, SEBI is mandatorily required to make such reference.

- (iv) **Computation of Offer Price:** The TRAC has recommended certain parameters, to replace the ones presently considered, in order to determine the offer price.

- (v) **Indirect Acquisitions:** The TRAC has recommended amendments to the prevailing provision relating to indirect acquisitions, particularly with regard to its timing and computation of offer price.

- (vi) **Withdrawal of Open Offer:** At present, certain grounds are prescribed for withdrawal of an open offer. It is proposed that an open offer may also be withdrawn where an agreement (attracting the open offer obligation) is rescinded due to non-fulfillment of a condition for reasons outside the reasonable control of the acquirer, so long as such conditions are disclosed in the detailed public statement and letter of offer.

- (vii) **Offer Conditional on Minimum Level of Acceptance:** The Takeover Regulations currently provide that an acquirer may make an open offer conditional as to the minimum level of acceptance of upto 20%, which limit is proposed to be removed.

Steps to avoid being an easy target for takeover

Having analysed the various amendments proposed to be made to the Takeover Regulations, we are of the view that companies ought to take certain measures in order to thwart takeover threats. The underlying

principle of each of the following measures is to reflect the true share price of a company, and the same ought not to be undervalued, so as to render it expensive for any acquirer to takeover such a company.

- (a) Dormant assets (particularly land) which do not reflect in the share price of a company must be avoided. In other words, it is advisable that a company either utilises such assets in the course of its business (thereby increasing the share value) or the said asset be used for another purpose (in which case, the asset would not be transferred to the acquirer alongwith the target company).
- (b) Avoid cash in the Balance Sheet. This is for the reason that, once consideration is paid by the acquirer on takeover of the target company, the cash of the target company will be remitted to the acquirer as a part of the assets of the target company. As a result, the target company receives a diminished consideration.
- (c) Increase size of the company in order to make it cumbersome and preclude the company from being subjected to an easy takeover.
- (d) Have a standby white knight with deep pockets to support in crisis.
- (e) Keep lenders on your side in order to make takeover expensive since the acquirer would have to repay the loan prior to takeover.
- (f) Share windfall gains with shareholders. This would render them satisfied and hence loyal,

making any attempt at takeover of such a company futile.

Conclusion

The amendments proposed to the Takeover Regulations are expected to take effect in April, 2011. The amendments are without a doubt, well deliberated with an aim to fine tune the code, in order to safeguard interests of all stakeholders, to feed the current and growing needs of Indian capital markets as well as to reign in accepted, established international practices into our regulations. We anticipate that the TRAC recommendations will pave way to a comprehensive legislation in the long run.

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Economic Reform and Fiscal Management: the Indian Experience

Ram Pratap Sinha*

Abstract

The process of fiscal management had a paradigm shift in the reform period consequent on the advent of fundamental policy reforms. Given this backdrop, the present paper seeks to discuss the shift in the mode of financing of fiscal programmes of the government which has taken place during the reform years and its implications for the real sector and the emerging issues relating to policy co-ordination in the event of growing financial openness. As such, the onslaught of economic reform has closed the options of monetisation of deficit and pre-emption of banking sector resources for the government. While the encouraging tax collection scenario has enabled the central government to meet the challenges to a great extent, the dependence on market borrowings has increased significantly in the recent past.

Introduction

During the forty year period 1951-91, the Indian economy operated under a regime of financial repression in which fiscal policy played a key role

in the economic development process. All other policies were subservient to the needs of the fiscal requirements of the state. The process of fiscal management, however, had a paradigm shift in the reform period consequent on the advent of fundamental policy reforms. Given this backdrop, the present paper seeks to encompass the following:

- (i) the shift in the mode of financing of fiscal programmes of the government which has taken place during the reform years and its implications for the real sector.
- (ii) the emerging issues relating to policy co-ordination in the event of growing financial openness.

Financial Repression and Fiscal Management

Since the initiation of Five Year Planning in India, fiscal policy played a major role in the process of socio-economic development. Given the low level of GDP (and per capita GDP) and insignificance of the capital market existing at that point of time, the scope for economic development through private initiative was extremely limited. Under the circumstances, the state had

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to shoulder the primary responsibility of developing the infrastructure and heavy industries as (in view of the long gestation periods and high capital-output ratios associated with such projects) private capital was simply not available. Since the state's ability to generate resources through direct and indirect taxation was limited, deficit financing and pre-emption of resources of the financial intermediaries played an extremely important role in financing the fiscal programmes of the government. The conduct of monetary policy was of secondary importance to the government as it depended on the size and mode of financing the fiscal deficit. In particular, monetary policy had to reconcile the objective of price stability within the broader context of deficit-financing led growth envisaged under the Five Year Plans.¹

Trends in Fiscal Indicators of The Central Government

Table 1 presents the key fiscal indicators of the central government for the period 1970-71 to 1990. The Table shows that during the seventies gross fiscal deficit of the central

government was 3.8% of GDP which had increased to 5.9% of GDP in the period 1980-85 and further to 7.7% of GDP during 1985-90. Further, what is more important, while the central government had surplus on revenue account during the seventies, it had experienced revenue deficit to the tune of 1.04% during 1980-85 and 2.43% during 1985-90.

Financing of Government Expenditure: Ad Hoc Treasury Bills

Ad hoc Treasury Bills originated in India during the Second World War. They were issued by the Government of India to the Reserve Bank with the objective of temporary financing of sterling debt repatriation. Since the Government's receipts through rupee loans did not always match the repatriation of sterling debt, ad hoc treasury bills were issued to provide the Reserve Bank with alternative eligible rupee assets. Such treasury bills were used (to a limited extent) during the First Five Year Plan to finance government budget deficit. However, the conclusion of an operational arrangement (between

Table 1: Key Fiscal Indicators of The Central Government (1970-1990)

Period	Revenue Deficit (₹ Crores)	Revenue Deficit as a % of GDP	Gross Fiscal Deficit (₹ Crores)	Gross Fiscal Deficit as a % of GDP	Net RBI Credit to Centre (₹ Crores)	Net RBI as a % of GDP
1970-80	-2262	-0.30	31962	3.8	5634	17.6
1980-85	10502	1.04	58038	5.9	20130	35
1985-90	45232	2.43	141799	7.7	40156	28

Source: RBI(2004): Handbook of Statistics on Indian Economy, 2003-04, www.rbi.org.in

the Government of India and the Reserve Bank of India) in 1955 led to the creation of ad hoc Treasury Bills to restore Central Government's cash balance to the minimum stipulated level (Rs.50 crores on Fridays and Rs.4 crores on other days) whenever required. By the end fifties, long term/undated government securities were being issued (at varying interest rates) to replace ad hoc treasury bills and ways and means advances. Table 2 provides the details regarding net issuance of ad hoc treasury bills and their conversion into central government dated securities for the period 1951-66 (first three Five Year Plans).

Table 2: Financing of Budget Deficit Through Ad Hoc Treasury Bills (1951-66)

(Figures in ₹ Crores)

Period	Net Creation of Ad Hoc Treasury Bills	Conversion of Ad Hoc Treasury Bills in to Dated Securities	Net Amount After Conversion
1951-56	250	0	250
1956-61	945	500	445
1961-66	800	275	525
Total (1951-66)	1995	775	1220

Source: G.Balachandran (1998), 'The Reserve Bank of India:1951-67'.

In 1982, the system of ad hoc treasury bill financing of budget deficit underwent a fundamental change. The ad hoc treasury bills now came to be converted in to undated non-marketable special securities carrying a fixed discount rate of 4.6%.

Pre-emption of Banking Sector Resources

The industrialisation initiatives undertaken during the Second and Third Five Year Plan led to substantial increases in capital expenditure on the part of the central government. Further increases in government expenditure became necessary since the mid-sixties to cope with the successive droughts and the war situation. The demand pull and the supply side constraints facilitated inflationary spirals in the Indian economy and the RBI had to adopt a tight money policy for achieving price stability. Since 1960 the 'quota-slab' system of refinancing was in existence which progressively raised the cost of banks' borrowing from the Reserve Bank. This was now accompanied by a series of increases in the bank rate. The increased cost of refinance, however, prompted the banks to seek portfolio readjustment whereby they undertook outright sale of Government securities for the deployment of resources elsewhere. In order to ensure that banks continue to hold Government securities, the Reserve Bank took two important measures: (i) replacement of the quota slab system by a system of net liquidity ratio based lending, (ii) modification in Statutory Liquidity Ratio requirements.

(i) Introduction of Net Liquidity Ratio Based Lending:

The RBI introduced the net liquidity ratio based lending in 1964 in which the RBI lending to commercial banks depended on net liquidity ratio (NLR)

of the relative banks in 1964.² Under this system, since calculation of net liquidity ratio took in to account the government securities held by the commercial banks, this effectively discouraged the banks from liquidating their Government security holdings. Furthermore, since NLR was computed by deducting all borrowings of a bank from RBI, SBI and IDBI for getting refinance from the Reserve Bank, it checked credit growth.

(ii) Modification in Statutory Liquidity Ratio Requirements:

The Statutory Liquidity Ratio (SLR) was introduced in 1949 whereby the banks were required to maintain a stipulated ratio of 'liquid assets' relative to their demand and time liabilities. The original definition of 'liquid assets' included cash and gold holdings of the respective commercial banks and their entire amount of balances with the Reserve Bank and current account balances with other banks and unencumbered Government and other approved securities. As a result of this whenever the CRR was raised, the banks indulged in CRR-G Sec trade off. In order to prevent this, the RBI amended the Banking Regulation Act, 1949 in 1962 to exclude the balances maintained under CRR for the computation of SLR. The nationalisation of 14 commercial banks in July 1969 and six more in 1980 facilitated further preemption of banking sector resources and the SLR was progressively raised until it reached its peak level of 38.5% in 1989.

Financing of Fiscal Deficit During The Pre-Reform Period: The Final Observations

In the pre-reform years tax revenue collection showed a relative stagnancy and in particular, direct tax collection relative to total tax collection exhibited a declining trend. Between 1980-81 and 1990-91, the share of direct tax revenue in total tax collection of the central government declined from 22.1% to 19.2%. Consequently, money financing of deficit played a major role in facilitating public spending. In the seventies, RBI credit to centre financed 17.6 per cent of the central government's gross fiscal deficit. This has increased to 35 per cent in 1980-85 but declined somewhat to 28 per cent during 1985-90. The conversion of ad hoc treasury bills into undated non-marketable special securities carrying an interest rate of 4.6% (fixed) enabled the central government to keep the interest outflow within 40-42% of revenue receipts (Table 3). For a further discussion on this matter one may refer to Sinha (2005).

Table 3: Interest Payments of The Central Government (1970-90)

Period	Interest Outflow (₹ Crores)	Interest Payments as a Percentage of Revenue Receipts
1970-80	12571	40.0
1980-85	20506	35.3
1985-90	60044	42.3

Source: RBI (2004): *Handbook of Statistics on Indian Economy, 2003-04*, www.rbi.org.in

Reforms in Fiscal Management Practices in the Nineties

The introduction of economic reform in 1991 was accompanied by some major changes in fiscal management practices. Inter alia, the following are important:

(i) **Tax Policy Reform:** The direct tax rules were rationalized and initiatives for tax rule compliance gathered momentum. Direct tax mobilisation as a percentage of total tax (direct and indirect) mobilized increased from 19.66% during 1980-90 to 31.36% during 1991-2001 and further to 42% during 2001-06 (Table 4).

(ii) **Reforms in G Sec Market:** The Statutory Liquidity Ratio (SLR) was reduced in phases to a level of 25%. Further, the yields on government securities were made market related. The RBI also took some concrete initiatives to develop the G Sec market in India. Table 5 provides an overview of the changes taking place during the reform years in the volume of transaction and

other key indicators in the G Sec market.

Table 5: The Government Securities Market in India (1992-2005)

Particulars	1992	1996	2002	2005
Outstanding stock (₹ billion)	769	1,375	5,363	8,953
Outstanding stock as ratio of GDP (per cent)	14.68	14.20	27.89	28.94
Average maturity of the securities issued during the year (in years)	–	5.70	14.90	14.13
Weighted average cost of the securities issued during the year (per cent)	11.78	13.77	9.44	6.11

Source: RBI (2006): Report on Currency and Finance, 2005-06, RBI, Mumbai.

(iii) **Increased Role of Market Borrowings:** The system of financing of central government's gross fiscal deficit through the issue of 91 days ad hoc treasury bill was discontinued by 1996-97. The central government now depended more on market borrowings for the financing of its fiscal deficit. Table 6 shows

Table 4: Tax Revenues of The Central Government: Pre-Reform Vs Reform Years

Period	Direct Tax Revenue (₹ Crores)	Indirect Tax Revenue (₹ Crores)	Total Tax Revenue (₹ Crores)	Direct Tax Revenue as a % of Total Tax Revenue
1980-81 to 1990-91	67475	275817	343292	19.66
1991-92 to 2000-01	374196	818979	1193175	31.36
2001-02 to 2005-06	560201	772571	1332773	42.03

Source: RBI (2006): Handbook of Statistics on Indian Economy, 2005-06, www.rbi.org.in

that the contribution of market borrowings in the financing of central government's gross fiscal deficit has increased from 23.56% during 1980-91 to 46.91% during 1991-01 which further climbed up to 64.03% during 2001-06 (Table 6).

Table 6: Financing of Fiscal Deficit Through Market Borrowings

Particulars	Gross Fiscal Deficit (₹ Crores)	Market Borrowings (₹ Crores)	Market Borrowings as a % of Gross Fiscal Deficit
1980-91	244469	57597	23.56
1991-01	747257	350528	46.91
2001-06	680676	435829	64.03

Source: RBI (2006): *Report on Currency and Finance, 2005-06*, RBI, Mumbai.

As a consequence of increasing dependence on market borrowings, the interest outgo of the central government as a percentage of revenue receipts has been in the order of 75-77% during the reform years. Table 7 provides the details regarding the growth in interest payments burden during the reform years.

(iv) Introduction of Fiscal Responsibility and Budget Management Act (2003): The Fiscal Responsibility and Budget Management (FRBM) Bill was introduced in December 2000 and was enacted on August 26, 2003. It was notified on July 5, 2004 along with the FRBM Rules, 2004. The Act set the medium term goal of reduction of fiscal deficit (to a level of 3.0 per cent of GDP) and elimination

Table 7: Interest Outflow of the Central Government During the Reform Years

Period	Interest Outflow (₹ Crores)
1992-97	221353
1997-02	441492
2002-06	606318

Source: Various Government Documents

of revenue deficit by March 31, 2008 (later extended to March 31, 2009 vide Finance Act, 2004). These deficits could, however, exceed the targets on grounds of national security, national calamity or other exceptional circumstances. The Act prohibits direct borrowings by the Centre from the Reserve Bank from the year 2006-07 onwards except by way of Ways and Means Advances to meet temporary mismatches in receipts and payments or under exceptional circumstances. The Reserve Bank may, however, buy and sell securities in the secondary market. The Act also stipulates quarterly reporting of the Central Government finances in relation to the budget estimates. The FRBM Rules, 2004 have set annual targets for phased reduction in key deficit indicators over the period ending March 31, 2008 and imposed ceilings on Government guarantees and additional liabilities.

RBI Financing of Gross Fiscal Deficit of The Central Government: The Empirical Results

The RBI Report on Currency and Finance (2006) mentions the results of an econometric study relating Gross Fiscal Deficit of the central government

with the net Reserve Bank credit to the Centre for the period 1971-2005. It is abundantly clear from the previous discussion that the importance of net RBI credit to the centre in the financing of its gross fiscal deficit has declined considerably in the reform years. Thus the relationship between the two variables has undergone some structural changes. Inter alia, two important developments facilitated the structural change: (i) The replacement of 91-day ad hoc Treasury Bills by Ways and Means Advances, (ii) the increase in cross-border capital inflows into India. In view of this, two variants of the model were used. In model 1, Net Reserve Bank Credit to the Government (NBRCG) was regressed on Gross Fiscal Deficit with a first order autoregressive component. In model 2, Net Accretion of Foreign Exchange Assets of the Reserve Bank (NFARB) was included as an additional explanatory variable.³

In both the models a strong positive association was found between Net Reserve Bank Credit to the Government and Gross Fiscal Deficit. However, Net Reserve Bank Credit to the Government was found to be negatively related to Net Accretion of Foreign Exchange Assets of the Reserve Bank.

In view of the expected structural change between Net Reserve Bank Credit to the Government and Gross Fiscal Deficit, the results are presented in Table 9:

Table 9: Chow's Break Point Test For Structural Change

Particulars	1997-98	2001-02	1997-98 & 2001-02
F Statistics	6.80 (0.00)	25.13 (0.00)	14.09 (0.00)

Source: RBI (2006): Report on Currency and Finance, 2005-06, RBI, Mumbai.

Table 8: FRBM Provisions Relating to Gross Fiscal Deficit and Revenue Deficit

Parameter	Provisions	Actual
Gross Fiscal Deficit (GFD)	Beginning 2004-05, GFD is to be reduced by 0.3% of more of GDP every year so as to reach the targeted level of 3% of GDP by 31/03/09	4.1 per cent of GDP for 2005-06 as against the targeted level of 4.1 per cent
Revenue Deficit(RD)	Revenue Deficit is to be reduced by 0.5 per cent of GDP (or more) from 2004-05 so as to eliminate RD by 31/03/09	2.6 per cent of GDP as against the targeted level of 2.7 per cent
Contingent Liabilities	The Central Government shall not give guarantees aggregating an amount exceeding 0.5 per cent of GDP in any financial year beginning 2004-05	—

Source: RBI (2006): Report on Currency and Finance, 2005-06, RBI, Mumbai.

Capital Account Openness and Fiscal Reform

In 2006, the Reserve Bank of India (RBI), in consultation with the Government of India, appointed, a Committee on March 20, 2006, to set out the Roadmap Towards Fuller Capital Account Convertibility under the chairmanship of Shri S.S. Tarapore. The Committee, in its recommendation identified fiscal consolidation as one of the key pre-conditions for full opening up of the capital account. Inter alia, the Committee made the following recommendations in this regard:

- (i) The Committee considered generation of revenue surplus to meet repayment of the marketable debt as a first step towards fiscal consolidation. A large fiscal deficit makes a country vulnerable to upward movement in the interest rates. In a regime with capital account openness, the adverse effects of an increasing fiscal deficit and a ballooning internal debt have a faster spillover effect and, therefore, the Committee felt it necessary to moderate the public sector borrowing requirement and also contain the total stock of liabilities.
- (ii) Currently, the system of meeting government's financing requirements is set out in terms of net borrowing (gross borrowing minus repayments). The approach of financing repayments out of fresh borrowings increases the risk of a vicious cycle of higher market borrowings at a relatively higher

cost, chasing higher repayments. While repayment obligations financed through gross borrowings would not affect the gross fiscal deficit for the particular year of borrowings, the rising interest burden would have its spill over effect on the revenue deficit as well as the gross fiscal deficit in subsequent years. In view of this, the Committee recommended that the gross borrowing programme (and not the net borrowing programme) which is to be related to the absorptive capacity of the market as also in assessing the potential borrowing costs of the government. The Committee recommended that a substantial part of the revenue surplus of the Centre should be assigned for meeting the repayment liability under the Centre's market borrowing programme as this will reduce the gross borrowing requirement.

- (iii) The Committee recommended that for the sake of better fiscal management, the Central Government and the States should switch over from the present system of computing the fiscal deficit to a measure of the Public Sector Borrowing Requirement (PSBR). The Committee felt that the RBI should attempt a preliminary assessment of the PSBR and make the information available for public consumption.
- (iii) For an effective functional separation enabling more

efficient debt management as also monetary management, the Committee recommends that the Office of Public Debt should be set up to function independently outside the RBI.

Fiscal Management in the Recent Years

In the present section we provide a very brief overview of the fiscal scenario during the NDA and UPA regimes. For this purpose we consider the period 1998-99 to 2009-10 which is divided into two sub-periods: 1998-99 to 2003-04 and 2004-05 to 2009-10. During the first sub-period the NDA government was in power while the second period belongs to the UPA. We examine the fiscal performance of the central government during the two sub-periods from three specific stand points: tax mobilization, government spending and deficit indicators. Tables 10 & 11 present the tax mobilization

scenario, Tables 12 and 13 deal with expenditure and capital formation while Tables 14 and 15 present the key fiscal deficit indicators. The Tables indicate the growing importance of direct taxes and significant improvements in tax-GDP ratio over the years which is a healthy sign. Fiscal deficit position also improved significantly between 2003-04 and 2007-08 but slipped thereafter leading to greater dependence on market borrowings. The proportion of gross capital formation to total expenditure has remained far from encouraging during the 12 year period under consideration.

Conclusion

Since 2001-02, there has been a continuous improvement in the fiscal scenario of the central government and this trend continued up to 2007-08. Thus the Gross Fiscal Deficit of

Table 10: Tax Mobilisation during the NDA regime

(Figures in ₹ Crores)

Year	Direct Tax	Indirect Tax	Total Net Tax Revenue	% of Direct Tax to Total Tax	Tax-GDP Ratio
1998-99	32120	72532	104652	31	1.83
1999-00	41436	86835	128271	32	2.12
2000-01	49651	87007	136658	36	2.36
2001-02	47703	85829	133532	36	2.09
2002-03	61612	96932	158544	39	2.52
2003-04	76590	110392	186982	41	2.78
Total	309112	539527	848639	36	–

Source: Public Finance Statistics, 2009-10, GOI, Ministry of Finance, DEA, Economic Division.

Table 11: Tax Mobilisation during the UPA regime

(Figures in ₹ Crores)

Year	Direct Tax	Indirect Tax	Total Net Tax Revenue	% of Direct Tax to Total Tax	Tax-GDP Ratio
2004-05	95944	128854	224798	43	2.94
2005-06	120692	149572	270264	45	3.18
2006-07	169738	181444	351182	48	3.84
2007-08	231509	208038	439547	53	4.68
2008-09	248152	195167	443319	56	N.A.
2009-10	281087	184016	465103	60	4.25
Total	1147122	1047091	2194213	52	-

Source: Public Finance Statistics, 2009-10, GOI, Ministry of Finance, DEA, Economic Division.

Table 12: Central Government Expenditure and Capital Formation during the NDA Regime

(Figures in ₹ Crores)

Year	Expenditure on Defence (1)	Expenditure on Subsidies (2)	Expenditure on Interest Payments (3)	Total Expenditure (4)	(5)=% of (1) + (2) + (3) to (4)	Gross Capital Formation (6)	(7)=% of Gross Capital Formation to Total Expenditure
1998-99	29861	23593	77882	279340	47.01654	20647	7.39
1999-00	35216	24487	90249	298053	50.31052	26075	8.75
2000-01	37238	26838	99314	325592	50.18244	22258	6.84
2001-02	38059	31210	107460	362310	48.77839	12634	3.49
2002-03	40709	43533	117804	413248	48.89219	21697	5.25
2003-04	43203	44323	124088	471203	44.90931	23997	5.09
Total	224286	193984	616797	2149746	48.14834	127308	5.92

Source: Public Finance Statistics, 2009-10, GoI, Ministry of Finance, DEA, Economic Division.

the central government declined from 6.19% of GDP in 2001-02 to 2.7% of GDP in 2007-08. Similarly, the revenue deficit also declined during the same period from a peak of 4.40% to 1.12% of GDP.

The fiscal position has, however, taken a U turn since 2008-09. The reasons behind the declining fiscal health of the central government are partly cyclical and partly structural.

While the slump in the global market (and the provision of fiscal incentive and the associated fall in tax collection) and the implementation of the recommendations of the 6th Pay Commission have undoubtedly contributed to the worsening fiscal situation, the rising burden of subsidies and the implementation of the loan waiver scheme have also been responsible for the scenario to

Table 13: Central Government Expenditure and Capital Formation during the UPA Regime

(Figures in ₹ Crores)

Year	Expenditure on Defence (1)	Expenditure on Subsidies (2)	Expenditure on Interest Payments (3)	Total Expenditure (4)	(5)=% of (1)+(2) + (3) to (4)	Gross Capital Formation (6)	(7)=% of Gross Capital Formation to (4)
2004-05	43862	45957	126934	498252	43.50269	27396	5.50
2005-06	48211	47522	132630	505738	45.15441	34450	6.81
2006-07	51682	57125	150272	583387	44.40946	36487	6.25
2007-08	54219	70926	171030	712671	41.55845	43651	6.12
2008-09	73305	129708	192204	883956	44.71003	55973	6.33
2009-10	88440	131025	219500	1021547	42.97061	63364	6.20
Total	359719	482263	992570	4205551	43.62216	261321	6.21

Source: Public Finance Statistics, 2009-10, GoI, Ministry of Finance, DEA, Economic Division.

Table 14: Key Deficit Indicators of Central Government (NDA Regime)

(Figures in ₹ Crores)

Year	Gross Fiscal Deficit (GFD)	Fiscal Deficit to GDP Ratio	Revenue Deficit	Financing Through Market Borrowings	% of GFD financed through market borrowing
1998-99	113349	5.11	66976	68988	60.86
1999-00	104716	5.36	67596	62076	59.28
2000-01	118816	5.65	85234	73431	61.80
2001-02	140955	6.19	100162	90812	64.43
2002-03	145072	5.91	107879	104126	71.78
2003-04	123273	4.48	98261	88870	72.09
Total	746181	—	526108	488303	65.44

Source: Public Finance Statistics, 2009-10, GoI, Ministry of Finance, DEA, Economic Division.

Table 15: Key Deficit Indicators of Central Government (UPA Regime)

(Figures in ₹ Crores)

Year	Gross Fiscal Deficit (GFD)	Fiscal Deficit to GDP Ratio	Revenue Deficit	Financing Through Market Borrowings	% of GFD financed through market borrowing
2004-05	125794	3.88	78338	50490	40.14
2005-06	146435	3.95	92299	106241	72.55
2006-07	142573	3.33	80222	114801	80.52
2007-08	126912	2.56	52569	130600	102.91
2008-09	336992	5.86	253539	246975	73.29
2009-10	414041	6.44	329061	394229	95.21
Total	1292747	—	886028	1043336	80.71

Source: Public Finance Statistics, 2009-10, GoI, Ministry of Finance, DEA, Economic Division.

a significant extent. In the present circumstances, worsening fiscal situation of the government and the prevalence of double digit inflation are the two major challenges before the government. It is well known that fiscal imbalances tend to promote inflationary situations. Thus more fiscal restraint is expected from the government which can only be possible by keeping a check on non-plan expenditure. How this will be done now remains to be seen.

Notes

1. The concept of deficit financing led growth can be easily understood in the context of a simple closed theoretical framework. We begin with the national income identity:

$$Y = C + I + G = E_p + G \dots\dots\dots (1),$$

where E_p = private expenditure

We take E_p to be a linear function of disposable income (Y-T): $E_p = b(Y-T)$

where b is the marginal / average propensity to spend out of disposable income.

Thus we can rewrite equation (1) as:

$$Y = b(Y-T) + G \dots\dots\dots(1a)$$

$$\text{Or, } (1-b)Y = (1-b)T + (G-T).$$

Rearranging, we have
 $(Y-T) = 1/(1-b) \cdot (G-T) \dots\dots\dots(2)$

$$\text{Or, } Y_d = m(G-T),$$

where Y_d = disposable income and

m = deficit financing multiplier = $1/(1-b)$

Since $0 < b < 1$, the value of m lies between 1 and ∞ .

2. Net Liquidity Ratio = [(Banks' Cash balances + Current Account Deposits with other banks + Balances with the Reserve Bank +

Investments in Government and other approved securities) – (total borrowings from the Reserve Bank, State Bank of India and Industrial Development Bank of India)]/ Aggregate demand and time liabilities.

3. The estimated equations are as under:

Model 1:

$$\begin{aligned} \text{NRBCG} &= 15019.95 + 0.78 * \text{GDFC} \\ &\quad (0.54) \quad (0.00) \\ &+ [\text{AR1} = 1.11] \dots\dots\dots(3) \\ &\quad (0.00) \end{aligned}$$

Adjusted R² = 0.75
 (Figures in parentheses indicate p values)

Model 2:

$$\begin{aligned} \text{NRBCG} &= 1758.63 + 0.22 * \text{GDFC} \\ &\quad (0.17) \quad (0.00) \\ &- 0.75 \text{NFARB} + [\text{AR1} = 0.31] \dots\dots\dots(3) \\ &\quad (0.00) \quad (0.11) \end{aligned}$$

Adjusted R² = 0.97
 (Figures in parentheses indicate p values)

4. In view of the expected structural change in the relationship between NRBCG and GFD, model 1 was subjected to Chow's (1960) breakpoint test for 1997-98 and 2001-02. This was examined by computing the F-statistic which involves comparison of restricted and unrestricted sum of squared residuals. Its values were statistically significant for both 1997-98 and 2001-02 indicating the existence of structural change in 1997-98 and 2001-02 in the relationship between the GFDC and variation in NRBCG. To further examine the stability of

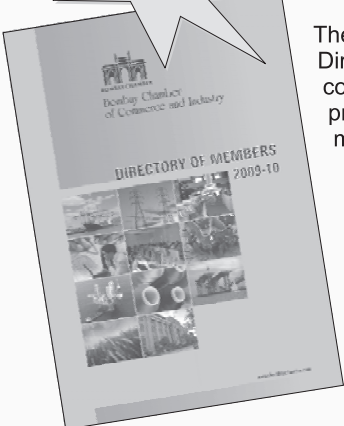
coefficients across the three sub-samples, following Kennedy (2003), the Chow test was carried out for both the periods (1998 and 2002) together which indicated presence of structural change in relationship between the two variables.

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Debt Capital Markets In India & Some Recent Transaction Developments

Mukesh Bhasin*

Abstract

The Debt Capital Markets in India have been painfully slow in developing compared to the Equity markets. This is despite several well-meaning reports and political assertions from time to time. The key obstacles to the development of the Debt Capital Markets are well known and commonly outlined by most knowledgeable experts: narrow investor base, illiquidity, crowding out of private sector by government borrowing, cumbersome issuance guidelines, inadequate credit information, inefficient clearing and settlement, poor enforcement laws, regulatory weaknesses etc etc. While this article provides a birds eye view of the key characteristics of India's Debt markets, it also aims to outline a silver lining in terms of some recent developments. These developments indicate that the development gap between the debt and equity markets is fast diminishing. It's a matter of time before the debt capital markets reach the size of the equity markets as well as Bank credit and perform a significant role in corporate balance sheets.

Introduction

There is no doubt that amid the recovering gloom in global markets,

India continues to shine. This is amply demonstrated by most yardsticks for comparison – be it GDP growth rates, the ever peaking equity capital markets, corporate performances, Indian professionals leading global companies, Indian Billionaires making front page news in US financial dailies, Bollywood raking in multiple of USD 100 mn for star movies etc etc. In spite of the successes, India continues to be still counted as a developing nation and has miles to catch up with the developed nations. Other developing nations such as China have raced ahead through sustained growth rates of over 10% while India is still referred to as the “Tortoise” trying to catch the “Hare”. One of the key drivers for growth is the massive need for physical as well as human capital and undoubtedly building physical capital involves tremendous amounts of economic capital --- “lots of money”. The booming Indian stock markets coupled with global Private Equity [PE] investor interest in India have ensured that there is no dearth of equity money required for growth. However, debt continues to be a challenge for “riskier” ventures and the state of Indian Debt Capital Markets [DCM] needs to improve significantly if India aims to quickly transition “the developing to

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developed gap”. Enough debate has happened over the last two decades of economic reforms on the constraints relating to DCM and what needs to be done. The objective of this article is not to repeat what has already been said by government appointed committees, regulators, senior business leaders and market professionals. What this article aims to achieve is to give an Investment Bankers [I-Banker] broad perspective on the Debt Markets including on some of the new kind of transactions that have taken place over the last couple of years.

The article is broadly presented to cover the key characteristics of the Indian Debt & Debt Capital markets, the key market participants, the recent developments in the market and finally concluding with what we see as the scenario over the next five years.

Key Characteristics of Indian Debt & Debt Capital Markets

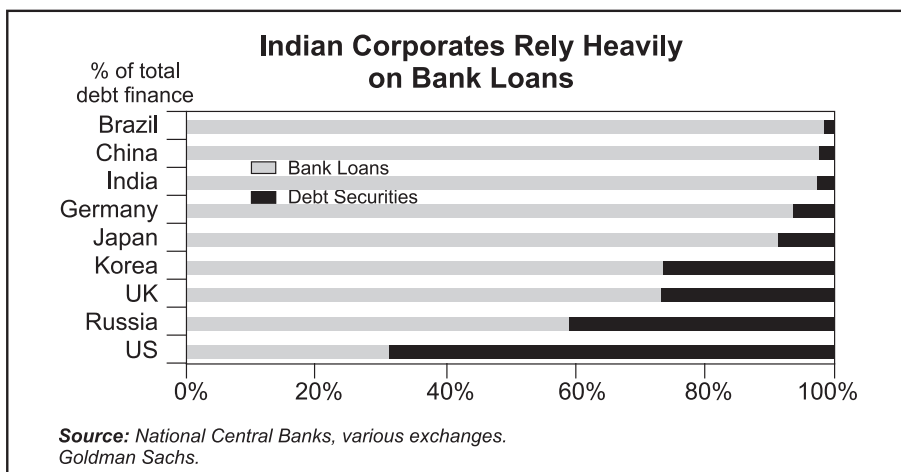
Debt is a very critical source of capital for most corporate entities who intend

to take on expansion for growth opportunities. This is on account of the limited equity funds available from internal sources as well as the relatively higher cost of equity capital. Given the relative importance of debt and the context of the current subject, it is prudent to first outline the key characteristics of the Indian Debt & Debt Capital Markets as follows:

First, Banks are the main providers of Debt: Unlike in developed countries, Banks contribute over 90% of the debt requirements of Corporates in India and less than 5% of the total debt is taken from the DCM. This is unlike most developed countries [such as US, UK etc] where DCM caters to upto 70% of the corporate debt requirements.

Second, Government is the largest issuer of Bonds: While the Indian DCM comprises of government as well as corporate bonds, government bonds are predominant (constituting over 75% of primary issuances and 90% of traded volume) and they are the most

Figure 1



liquid components of the Bond market. Table 1 below depicts the comparative growth of resource mobilization in the G-Sec [government bonds] and corporate bond markets in India

Table 1: Resource Mobilisation in the Bond Market

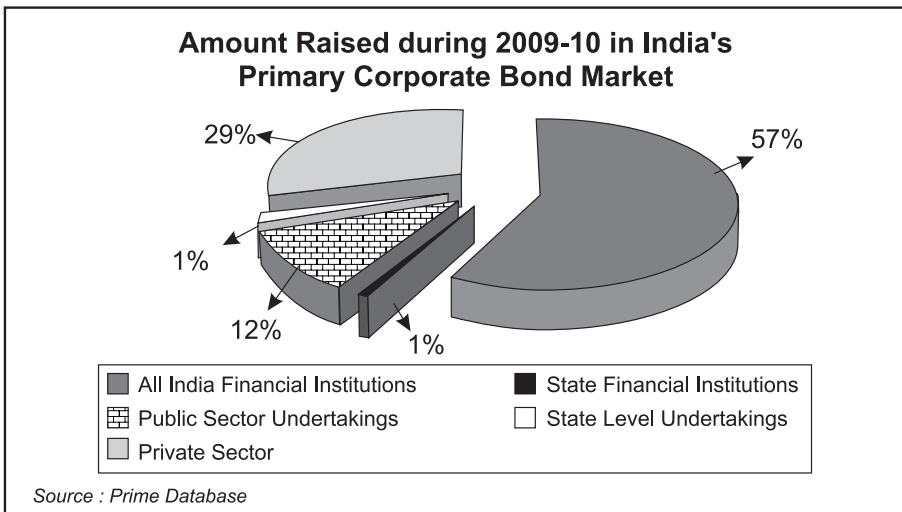
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Year	Central Government Securities	Corporate Bonds
FY2004	1215	484
FY2005	800	554
FY2006	1310	818
FY2007	1950	938
FY2008	1560	1154
FY2009	2610	1743
FY2010	3250	1025

Source : CCIL, Prime Database

Third, primary corporate bond market is dominated by high rated issuers such as All India Financial Institutions (FI), Public Sector Undertakings: During the year 2009-10, the top issuers of Corporate Debt in India included FI's such as Rural Electrification Corporation (Rs 14,254 crores, AAA rating), Power Finance Corporation (Rs 12,289 crores, AAA rating), ICICI (Rs 8,700 cr, AAA rating) and PSU's such as Powergrid Corporation (Rs 5478 crores, AAA rating), SAIL (Rs 3,153 crores), ONGC Videsh (Rs 2,340 crores). While issuances from Private Sector Bonds has increased from 9.7% of the total issuance in FY2006 to 29% in FY2010, a majority of Indian firms still view Bank finance is the main source of funding. Further, over 90% of Debt issuances carry a rating of AA or better.

Figure 2



Fourth, secondary market trading in Corporate Bonds has been picking up: Based on various regulatory initiatives and market bodies such as FIMMDA, there has been pickup in secondary trading of Corporate Bonds. One key development is the recent increase in FII limit for investments in Indian Bonds.

Traditional Market Participants in the Debt Markets: A Broad classification of the traditional market participants in the Indian Debt Markets can be made in terms of Issuers, Investors and Support institutions:

Some Recent Developments in the Indian Debt Capital Markets

1. Long Term Infrastructure Financing: Till a few years back, Corporate Bonds over 10 year tenors were extremely rare. However, there have been numerous issues of tenors ranging between 15 to 25 years in the last one year. The interesting point to note is that in some of these issues, the objective has been to refinance Banks due to availability of cheaper funds through DCM.

Figure 3

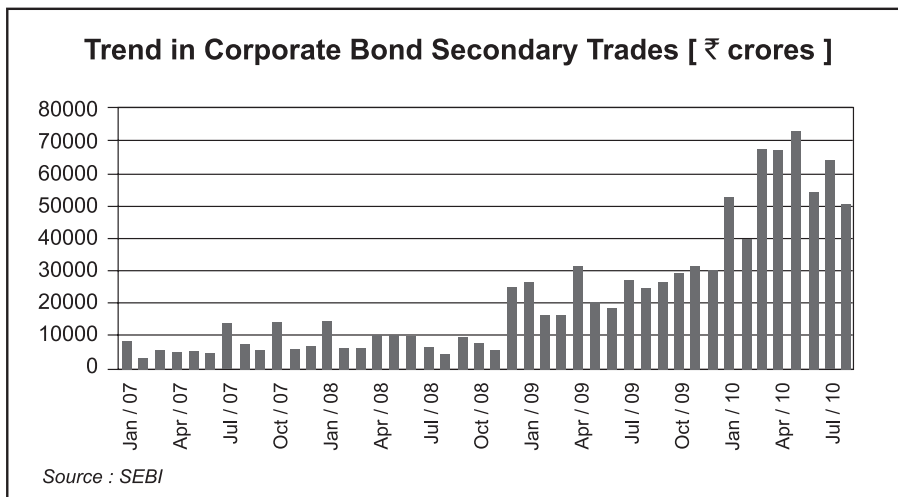


Table 2

Investors	Issuers	Support Institutions
Banks and Financial Institutions	All India Financial Institutions	Investment Banks
Insurance Companies	Public Sector Undertakings	Rating Agencies
Mutual Funds	Private Sector Corporates	Debenture / Security Trustees
Pension Funds	State Financial Institutions	Legal Counsels
Foreign Institutional Investors	State Level Undertakings	R&T Agents

Table 3: Some of the Rated Long Term Bond issuances over 15 year tenor during 2010

	Issuer	Amount (₹ crore)	Tenor	Issue Month
1	Rural Electrification Corporation	500	15 yrs	July 2010
2	Patel KNR Infrastructures Ltd	409	17 yrs	April 2010
3	Steel Authority of India Ltd	300	15 Years	August 2009
4	GMR Pochanpalli Expressways Ltd	650	16 years	March 2010
5	IFCI Ltd	250	20 yrs	May 2010
6	IFCI Ltd	1000	30 yrs	July 2010
7	IRFC	1100	25 yrs	May-10
8	NTPC	150	15 yrs	June 2010
9	IDFC	400	15 yrs	July & Aug 2010
10	IL&FS Ltd	150	25 yrs	Aug 2010

2. Real Estate Financing [Land acquisition, Construction Finance, Commercial Mortgage Backed Securities] : In India, Banks as well as top Housing Finance NBFC's have been regulated to stop any financing for Land acquisition to contain the so called "real estate bubble". In spite of this perception that real estate is a high risk option and the top real estate firms in the country struggling to get a A+ rating from rating agencies, there are innumerable deals happening in the Debt Capital Market. In most instances, the investors in such bonds are highly sophisticated institutional investors who transact with "the best of the available lot" real estate developers. In the bargain, they are able to squeeze out high returns in the 16-24% bracket for land acquisition bond deals and around 12-18% on the construction finance deals. Even deal sizes of Rs 500 crores and upwards are not undoable

for good quality firms and there are instances of investors/i-banks underwriting large deals on a syndicate basis. The next round of sophistication is expected to bring in internationally accepted DCM products such as CMBS and there are already multiple deals at the discussion stage

3. Promoter Financing: The practice of promoters pledging their shareholding in listed corporate entities for raising finance is not new to India. A number of institutions such as IL&FS have been catering to these requirements for close to two decades. During depressed stock markets, many large Indian promoters have often use this product for shoring up their holdings through creeping acquisitions, preferential allotments etc. In fact, even during times of peaking stock markets, promoters have leveraged their stock holdings to raise finances for acquisitions

and for investments in their other high growth businesses. The one notable development in the DCM relating to promoter finance has been the NBFC's facing competition from Mutual Funds, FII's and even HNI's for investment in the bonds issued by investment companies owned by the promoters. Promoter of reputed corporates such as Asian Paints, Zee Group, Max Healthcare Group, Ranbaxy, Unitech, Amtek Auto, Sun TV, Era Infrastructure, Crompton Greaves, Jindal Steel have raised funds through Bonds issued by their investment companies. While there was a brief period during 2008-09 wherein stocks of companies involving promoters share pledge witnessed bear hammering, it appears that the better quality promoters have been excused by the stock market to continue with their personal leverages as long as they continue the good job at their respective company level

4. High Networth Individuals Participation: The unpredictable stock market swings have influenced the most savvy equity swearing investors to look at alternate asset classes for investment. This accompanied by the growing breed of Indian super rich class has led to a highly focused breed of private wealth managers and family office advisory firms. These firms have done a decent job of educating the HNI investors to invest in fixed income

instruments that offer yields in the range of 12-16%, are relatively risk free and are available in tenors of upto three year tenors. It's not uncommon these days for private wealth management firms to push I-Bank/NBFC firms for originating bond deals that can be exclusively marketed to HNI investors. We have seen deals relating to real estate, promoter financing as well as the usual Bond market issuances getting lapped up by the HNI segment in no time

5. FII Investment in Indian Corporate Bonds: Arguably, Foreign Institutional Investors drive the Indian equity markets. As I write this article, FII's have infused over USD 25 Bn in Indian equities during 2010 and this has driven the Sensex to cross 21,000 already and rising. It isn't too difficult to predict that the same story appears set to repeat in the Indian Debt Capital Markets. The Government has recently hikes FII investment limits to USD 30 Bn. While the incremental USD 10 Bn hike comes with riders relating to sector [only Infrastructure financing allowed] and tenor [min 5 year residual maturity], most I-Bankers would agree to significantly higher FII interest in the Indian Debt markets. In spite of the restrictions on FII investment in only rated bonds; there have been instances of FII's being far more adventurous and having invested in Bonds with rating as low as BB-. Many local NBFC/Banks have also been

making significant fee incomes from warehousing bonds deals till listing [it typically takes upto 7 days from issuance date] and then downselling these bonds to FII's. This is inspite of some niggling issues such as withholding tax that is applicable for many FII's. Given the huge mismatch between demand and supply of capital in the country, and the close to zero interest rates in some large developed markets, the trend of FII investment in Indian Bonds would only see one way direction

6. NBFC Participation: Non Banking Finance Companies [NBFC's] are relatively the nimble footed financing entities who have been continuously evolving business models in India over the last two decades. NBFC's get into a niche business wherein they donot compete directly with Banks and build sustainable business models. As far as DCM is concerned, it started with NBFC's booking loan assets on Balance Sheet backed by downsell of the credit to investors. This business of converting Loan assets to rated tradeable Pass Through Certificates [PTC's] and then selling the same to investors resulted in over Rs 50,000 crores of business during 2005-08 till RBI came out with guidelines that restricted such transactions mainly on account of the mandatory one year seasoning requirement. The

new development is that some NBFC's are now booking loan assets as freely transferable Non Convertible Debentures and taking the risk on their books before offloading these to other investors. In some instances, NBFC's are even acting on informal back to back commitments from investors to subscribe to such NCD's before the primary funding is done

Conclusion

The Debt Capital Markets appear to be at an interesting stage of evolution in India. It appears all set to give the equity markets a tough competition in terms of growth prospects. As financial sector participants, we have more often than not heard of companies seeking Debt Equity in the ratio of 2:1 for their capital expenditure. Of late, there have been increasing cases of Bank debt being taken during the early stages of project risk and the same getting refinanced from Bond issuances as the projects near completion or start generating cashflows. This trend is expected to get far greater fillip with the government encouraging greather deepening of the markets. So, while the role of Banks in Corporate credit will not go away, we feel that it wont be too long before the 5% share of DCM moves to 50% making the corporate capital financing ratio to become 1:1:1 in favour of DCM: Bank Credit: Equity. We expect this scenario of emerge over the next five years in India.



In the assessment of risk in the global financial markets, the focus shifted from sovereign debt crisis to concerns regarding the slowdown in economy recovery. This change in assessment of risk of the global investors impacted Indian financial markets through two different channels, viz. appreciation of the Indian rupee and rise in equity prices due to sharp increase in portfolio flows. The lesson learnt for the purpose of policy has been its direct and indirect impact on the Indian economy. The financial system will have to be constantly assessed and appropriate corrective policy response may have to be taken to deal with any visible signs of uncertainty. It is in this backdrop a brief review is being made to capture some relevant issues on the current economic scenario. The analysis 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 fourth section concentrates on the financial markets. Finally, the conclusion section winds up the analysis.

I. An Overview:

- The Indian economy, which had exhibited a sharp recovery in the second half of 2009-10, witnessed further consolidation of growth in the first quarter of 2010-11. The current data and indicators of economic performance remain consistent with the 8.5 per cent growth projected in the July 2010.
- It seems from Table 1 the real GDP growth was broad based, with robust performance in all the major sectors.
- Agriculture and allied activities witnessed a strong pick-up over the previous four quarters, led by higher growth in allied activities.
- The growth in the industrial sector, though lower than in the previous two quarters, continued to be in double digits, primarily reflecting robust capital goods and consumer durables production.
- The services sector growth gathered further momentum during the first quarter of 2010-11.
- On the industrial front, despite some moderation in recent months, IIP grew by 10.6 per cent during April-August 2010, as compared to 5.9 per cent during the corresponding period of last year.

Table 1: Sectoral Growth Rates of GDP (2004-05 prices)

(Per cent)

Item	2008-09*	2009-10#	2009-10				2010-11
			Q1	Q2	Q3	Q4	Q1
1	2	3	4	5	6	7	8
1. Agriculture & allied activities	1.6	0.2	1.9	0.9	-1.8	0.7	2.8
2. Industry	3.1	10.4	4.6	9.0	12.3	15.1	11.4
2.1 Mining & quarrying	1.6	10.6	8.2	10.1	9.6	14.0	8.9
2.2 Manufacturing	3.2	10.8	3.8	9.1	13.8	16.3	12.4
2.3 Electricity, gas & water supply	3.9	6.5	6.6	7.7	4.7	7.1	6.6
3. Services	9.3	8.3	7.5	10.0	7.3	8.5	9.4
3.1 Trade, hotels, restaurants, transport, storage & communication, etc.	7.6	9.3	5.5	8.5	10.2	12.4	12.2
3.2 Financing, insurance, real estate & business services	10.1	9.7	11.8	11.5	7.9	7.9	8.0
3.3 Community, social & personal services	13.9	5.6	7.6	14	0.8	1.6	6.7
3.4 Construction	5.9	6.5	4.6	4.7	8.1	8.7	7.5
4. GDP at factor cost	6.7	7.4	6.0	8.6	6.5	8.6	8.8

*: Quick Estimates. #: Revised Estimates.

Source: Central Statistics Office.

- Table 2 shows the manufacturing sector which accounts for 79.4 per cent of weight in IIP, still recorded double digit growth. The manufacturing sector growth was propelled by high growth in capital goods and consumer durables segments.
- The high volatility in the data relating to the industrial sector in general and capital goods sector in particular, has raised issues about how eleven out of seventeen industries, accounting for about 51 per cent of the weight in the IIP, recorded higher growth during April-August 2010, than corresponding period of last year.
- The top five manufacturing industries, with a combined weight of 24.6 per cent in the IIP, grew at around 24 per cent, contributing about 76 per cent to the overall growth during this period, slightly higher than last year.

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

(Per cent)

Industry Group	Weight in the IIP	Growth Rate			Weighted Contribution #		
		April- March 2009-10	April-August		April- March 2009-10	April-August	
			2009-10	2010-11 P		2009-10	2010-11 P
1	2	3	4	5	6	7	8
Sectoral							
Mining	10.5	9.9	8.0	9.4	6.3	8.8	5.9
Manufacturing	79.4	10.9	5.6	11.3	88.8	81.8	90.8
Electricity	10.2	6.0	6.5	4.3	4.8	9.3	3.4
Use-Based							
Basic Goods	35.6	7.2	6.2	5.9	20.4	31.7	16.5
Capital Goods	9.3	19.2	3.4	29.0	24.7	7.2	33.1
Intermediate Goods	26.5	13.6	9.3	9.8	32.5	41.5	25.1
Consumer Goods (a + b)	28.7	7.3	3.6	8.6	22.4	19.7	25.4
a) Consumer Durables	5.4	26.2	18.8	27.0	19.3	24.5	21.9
b) Consumer Non-durables	23.3	1.3	-1.1	1.6	3.1	-4.9	3.5
General	100	10.5	5.9	10.6	100	100	100

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

Source: Central Statistics Office.

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

Table 3: Capacity Utilization in Infrastructure Sector

(Per cent)

Sector	April-August	
	2009-10	2010-11
1	2	3
Finished Steel (SAIL+ VSP+ Tata Steel)	88.9	87
Cement	84	77
Fertilizer	92.3	92.9
Petroleum Refinery Production	103.2	104.1

Source: Capsule Report on Infrastructure Sector Performance (April 2009-August 2010), Ministry of Statistics and Programme Implementation, GoI.

- Lead indicators of services sector like commercial vehicles production, cell phone connections, air cargo, and passengers handled at domestic and international terminals have increased at a robust pace during the year so far (Table 4).

Table 4: Indicators of Services Sector Activity

(Growth in per cent)

Indicators	2007-08	2008-09	2009-10	April- August	April- August
				2009-10	2010-11
1	2	3	4	5	6
Tourist arrivals \$	12.2	-3.3	3.5	-2.9	8.5
Commercial vehicles production \$	4.8	-24.0	35.9	-7.4	46.8
Cement	8.1	7.2	10.5	13.4	4.6
Steel	6.2	1.6	4.9	1.9	3.5
Railway revenue earning freight traffic \$	9.0	4.9	6.6	6.6	2.3
Cell phone connections	38.3	80.9	47.3	95.3	32.8
Cargo handled at major ports	12.0	2.2	5.7	1.8	0.6
Civil aviation					
Export cargo handled	7.5	3.4	10.4	4.0	21.3
Import cargo handled	19.7	-5.7	7.9	-9.0	28.2
Passengers handled at international terminals	11.9	3.8	5.7	1.8	13.0
Passengers handled at domestic terminals	20.6	-12.1	14.5	2.4	17.9

\$: Data pertain to April-September.

Source: Ministry of Tourism; Ministry of Statistics and Programme Implementation and Society of Indian Automobile Manufacturers (SIAM).

II. Aggregate Demand:

- Table 5 shows at a disaggregated level, the growth of private final consumption expenditure (PFCE) picked up moderately during the first quarter of 2010-11. The Government final consumption expenditure (GFCE) after remaining subdued for two quarters, accelerated sharply during the first quarter of 2010-11 which is in tandem with the growth in revenue expenditure of the Central Government.
- The slack in gross fixed capital formation during the first quarter of 2010-11, however, appears to be somewhat contrary to the buoyant trends witnessed in respect of capital goods segment in the IIP.

Table 5: Expenditure Side GDP (2004-05 Prices)

(Per cent)

Item	2008-09 *	2009-10 #	2009-10				2010-11
			Q1	Q2	Q3	Q4	Q1
1	2	3	4	5	6	7	8
Growth Rates							
Real GDP at market prices	5.1	7.7	5.2	6.4	7.3	11.2	10.0
Total Consumption Expenditure	8.3	5.3	4.7	9.6	4.8	2.6	5.5
(i) Private	6.8	4.3	2.9	6.4	5.3	2.6	3.8
(ii) Government	16.7	10.5	15.3	30.5	2.5	2.1	14.2
Gross Fixed Capital Formation	4.0	7.2	-0.7	1.6	8.8	17.7	7.6
Change in Stocks	-61.2	5.9	-0.9	4.2	8.7	11.1	7.0
Net Exports	40.2	-9.7	-27.4	6.1	-0.3	-113.4	20.5
Relative shares							
Total Consumption Expenditure	70.9	69.4	71.4	71.5	73.4	62.3	68.4
(i) Private	59.5	57.6	59.9	60.1	60.4	51.1	56.5
(ii) Government	11.5	11.8	11.5	11.3	13.1	11.2	11.9
Gross Fixed Capital Formation	32.9	32.8	31.2	33.2	31.9	34.6	30.5
Change in Stocks	1.3	1.3	1.3	1.4	1.3	1.3	1.3
Net Exports	-6.1	-5.1	-4.8	-8.7	-6.7	0.4	-5.2
Memo:							(₹ crore)
Real GDP at market prices	4,465,360	4,807,222	1,099,653	1,125,257	1,242,858	1,339,454	1,209,888

*: Quick Estimates. #: Revised Estimates.

Note: As only major items are included in the table, data will not add up to 100.

Source: Central Statistics Office.

- The position of Central Government finances improved significantly with Revenue Deficit (RD) and Gross Fiscal Deficit (GFD) during April- August 2010-11 turning out to be substantially lower, both in absolute terms and as a proportion of budget estimates, over the corresponding period of the previous year (Table 6).
- Improvement in finances of the Central Government during 2010-11 so far (April-August) was evident from substantial increase in revenue receipts (85.0 per cent), supported by tax and non-tax revenues.
- During April-August 2010-11, growth in revenue as well as capital expenditure was higher than in the corresponding period of 2009-10.

Table 6 : Central Government Finances: April-August 2010-11

Item	April-August (₹ crore)		Percentage to Budget Estimates for		Growth Rate (Per cent)	
	2009	2010	2009-10	2010-11	2009-10	2010-11
1	2	3	4	5	6	7
1. Revenue receipts	1,57,198	2,90,799	25.6	42.6	-2.7	85.0
i) Tax revenue (Net)	1,06,837	1,38,500	22.5	25.9	-14.8	29.6
ii) Non-tax revenue	50,361	1,52,299	35.9	102.8	39.6	202.4
2. Non-debt capital receipts	3,835	5,479	71.7	12.1	218.8	42.9
3. Non-plan expenditure	2,45,275	3,11,249	35.3	42.3	27.1	26.9
of which:						
i) Interest payments	72,133	85,621	32.0	34.4	9.6	18.7
ii) Defense	41,129	45,395	29.0	30.8	65.8	10.4
iii) Major subsidies	54,193	54,738	51.1	50.2	4.7	1.0
4. Plan expenditure	98,048	1,36,454	30.2	36.6	13.2	39.2
5. Revenue expenditure	3,12,283	3,91,151	34.8	40.8	20.4	25.3
6. Capital expenditure	31,040	56,552	25.1	37.7	53.6	82.2
7. Total expenditure	3,43,323	4,47,703	33.6	40.4	22.8	30.4
8. Revenue deficit	1,55,085	1,00,352	54.9	36.3	58.4	-35.3
9. Gross fiscal deficit	1,82,290	1,51,425	45.5	39.7	56	-16.9
10. Gross primary deficit	1,10,157	65,804	62.8	49.6	115.8	-40.3

Source: Controller General of Accounts, Ministry of Finance.

- An overview of the combined finances of the Central and State Governments budgeted for 2010-11 indicates that the key deficit indicators as per cent of GDP would moderate compared to the elevated levels in 2009-10 (Table 7).

Table 7: Key Fiscal Indicators

(Per cent to GDP)

Year	Primary Deficit	Revenue Deficit	Gross Fiscal Deficit	Outstanding Liabilities*
1	2	3	4	5
Centre				
2008-09	2.6	4.5	6.0	56.7
2009-10 RE	3.2	5.3	6.7	56.4
2010-11 BE	1.9	4.0	5.5	56.9
States #				
2008-09	0.6	-0.2	2.4	26.2
2009-10 RE	1.6	0.8	3.4	26.2
2010-11 BE	1.0	0.4	2.9	26.1
Combined				
2008-09	3.4	4.3	8.5	72.0
2009-10 RE	4.8	6.0	10.0	72.5
2010-11 BE	3.0	4.4	8.3	73.6

RE : Revised Estimates. BE: Budget Estimates.

* : Includes external liabilities at historical exchange rates.

: Data pertain to 27 State Governments.

Note : Negative sign indicates surplus.

- The turnaround in overall economic activity was reflected in the corporate sector performance. Sales of private corporate business sector witnessed significant improvement, recording a growth of 24.2 per cent (y-o-y) during the first quarter of 2010-11 (Table 8).

Table 8: Corporate Sector Financial Performance

(Growth rates/ratios in per cent)

Item	2008-09				2009-10				2010-11
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
1	2	3	4	5	6	7	8	9	10
No. of companies	2500	2386	2486	2561	2530	2531	2562	2565	2546
Sales	29.3	31.8	9.5	1.9	-0.9	0.1	22.5	29.1	24.2
Other income*	-8.4	-0.6	-4.8	39.4	50.2	6.0	7.4	10.3	-21.2
Expenditure	33.5	37.5	12.6	-0.5	-4.4	-2.5	20.6	30.7	29.0
Depreciation provision	15.3	16.5	16.8	19.6	21.5	20.7	21.6	20.1	19.9
Gross profits	11.9	8.7	-26.7	-8.8	5.8	10.9	60.0	36.7	8.2
Interest payments	58.1	85.3	62.9	36.5	3.7	-1.0	-12.3	-2.9	26.9
Profits after tax	6.9	-2.6	-53.4	-19.9	5.5	12.0	99.3	44.0	2.4
Select Ratios									
Change in stock-in-trade to sales #	2.9	2.2	-1.7	-1.8	0.6	2.3	0.8	1.1	2.9
Gross profits to sales	14.5	13.5	11.0	13.7	15.7	14.9	14.3	14.6	13.9
Profits after tax to sales	9.7	8.6	5.3	8.1	10.2	9.4	8.8	9	8.6
Interest to sales	2.4	2.9	3.8	3.2	2.8	3.1	2.7	2.4	2.9
Interest to gross profits	16.8	21.5	34.6	23.3	18.0	20.5	19.1	16.6	21.1
Interest coverage (times)	6.0	4.6	2.9	4.3	5.6	4.9	5.2	6.0	4.7

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

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

Note: 1. Growth rates are percentage changes in the level for the period under reference over the corresponding period of the previous year for common set of companies.

2. The quarterly data may not add up to annual data due to differences in the number and composition of companies covered, in each period.

III. The External Economy

- The asymmetry in growth relative to advanced economies would imply higher trade imbalance in India, which also has to recognize the risks from protectionism and exchange rate policies of other countries.
- The overall upbeat outlook for capital flows to Emerging Market Economies (EME) suggests that given the robust domestic growth outlook and the increasing interest rate differentials after the calibrated normalization of monetary policy, gross capital inflows in 2010-11 would be higher than what were expected a few months back.

- Stronger growth in both oil and nonoil imports relative to exports resulted in a wider merchandise trade deficit in India during April-September 2010 at US\$ 63.2 billion as compared with US\$ 46.9 billion during the corresponding period of the previous year (Table 9).

Table 9 : India's Merchandise Trade

(US\$ billion)

	April-March 2009-10 P		April-September 2009-10 R		2010-11 P	
	Absolute	Growth (%)	Absolute	Growth (%)	Absolute	Growth (%)
1	2	3	4	5	6	7
Exports	178.7	-3.6	80.9	-25.7	103.3	27.6
Oil	28.1	2.1	10.8	-42.5
Non-oil	150.5	-4.6	70.2	-22.2
Imports	286.8	-5.6	127.8	-30.9	166.5	29.9
Oil	87.1	-7	37.5	-40.8	40.7*	31.7*
Non-oil	199.7	-4.9	90.4	-25.8	101.2*	33.7*
Trade Balance	-108.2	-8.6	-46.9	-38.4	-63.2	34.8
Non-Oil Trade Balance	-49.2	-5.9	-20.2	-36

R: Revised. P: Provisional.

.. Not Available.

*: Figures pertain to April-August.

Source: Directorate General of Commercial Intelligence and Statistics (DGCI&S).

- The impact of the continuing asymmetry between robust growth in India and fragile recovery in the advanced economies was visible in the current account deficit, which expanded in the first quarter of 2010-11, relative to both previous quarter and corresponding quarter of the previous year (Table 10). The trade deficit on a BoP basis, was higher at US\$ 34.2 billion in the first quarter of 2010-11 as compared with US\$ 25.6 billion during corresponding period of 2009-10.

Table 10 : India's Balance of Payments

(US\$ billion)

	2008-09 Apr-Mar PR	2009-10 Apr-Mar P	2009-10				2010-11
			Apr-Jun PR	Jul-Sep PR	Oct-Dec PR	Jan-Mar P	Apr-Jun P
1	2	3	4	5	6	7	8
1 Exports	189	182.2	39.2	43.5	47.1	52.4	53.7
2 Imports	307.7	299.5	64.8	72.6	78.1	83.9	87.9
3 Trade Balance (1-2)	-118.7	-117.3	-25.6	-29.1	-31.1	-31.5	-34.2
4 Net Invisibles	89.9	78.9	21.2	20.4	18.9	18.5	20.5
5 Current Account Balance (3+4)	-28.7	-38.4	-4.5	-8.8	-12.2	-13	-13.7
6 Gross Capital Inflows	312.4	344.0	77.1	95.4	81.3	90.2	95.3
7 Gross Capital Outflows	305.2	290.4	73.1	76.6	66.6	74.1	76.9
8 Net Capital Account (6-7)	7.2	53.6	4.0	18.8	14.7	16.1	18.4
9 Overall Balance (5+8)#	-20.1	13.4	0.1	9.4	1.8	2.1	3.7

1	2	3	4	5	6	7	8
<i>Memo:</i>							
i. Export growth (%)	13.7	-3.6	-31.8	-18.9		36.2	37.2
ii. Import growth (%)	19.4	-2.7	-21.7	-21.7		43.0	35.7
iii. Net service exports growth (%)	27.7	-31.1	-3.1	-47.4		-24.5	-3.0
iv. Net Invisibles growth (%)	18.7	-12.2	-3.7	-23.3		-2.6	-3.4
v. Foreign Exchange Reserves (as at end Period)	252.0	279.1	265.1	281.3		279.1	275.7

P: Preliminary. PR: Partially Revised.

#: also includes errors & omissions.

- India's net surplus in the invisibles account (comprising services, income and transfers) declined during the first quarter of 2010-11 as compared to last year, mainly because of strong growth in services payments and decline in investment income receipts. The invisibles surplus financed about 60.0 per cent of the trade deficit during the quarter as against about 83.0 per cent during the corresponding quarter of the previous year (Table 11).

Table 11: Invisibles Gross Receipts and Payments

(US\$ billion)

1	Invisibles Receipts				Invisibles Payments			
	April-March		April-June		April-March		Apr-June	
	2008-09 PR	2009-10 P	2009-10 PR	2010-11 P	2008-09 PR	2009-10 P	2009-10 PR	2010-11 P
2	3	4	5	6	7	8	9	
1. Travel	10.9	11.9	2.3	3.0	9.4	9.3	2.0	2.3
2. Transportation	11.3	11.1	2.5	3.1	12.8	11.9	2.8	3.1
3. Insurance	1.4	1.6	0.4	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	0.1	0.1
5. Miscellaneous	77.7	68.7	16.0	19.6	27.9	36.5	5.7	10.2
<i>Of which :</i>								
Software	46.3	49.7	11.0	12.7	2.8	1.5	0.4	0.6
Non-Software	31.4	19.0	5.0	6.9	25.1	35.0	5.3	9.6
6. Transfers	47.5	54.4	13.3	13.8	2.7	2.3	0.5	0.7
<i>Of which :</i>								
Private Transfers	46.9	53.9	13.3	13.7	2.3	1.8	0.4	0.6
7. Income	14.3	13.0	3.0	2.9	18.8	20.4	5.0	5.5
<i>Investment Income</i>	13.5	12.1	2.7	2.6	17.5	18.7	4.7	5
<i>Compensation of Employees</i>	0.8	0.9	0.2	0.2	1.3	1.7	0.4	0.5
Total (1 to 7)	163.5	161.2	37.6	42.7	73.6	82.3	16.4	22.3

P: Preliminary. PR: Partially Revised.

- The net surplus in the capital account in the first quarter of 2010-11 exceeded the levels of the previous two quarters, as well as the financing need in the current account (Table 12).

Table 12 : Net Capital Flows

(US\$ billion)

	2008-09 Apr-Mar PR	2009-10 Apr-Mar	2009-10			
			Apr-Jun PR	Jul-Sep PR	Oct-Dec PR	Jan-Mar PR
1	2	3	4	5	6	7
1. Foreign Direct Investment (FDI)	17.5	19.7	6.1	6.5	3.9	3.2
Inward FDI	35.0	31.7	8.7	10.7	7.1	5.1
Outward FDI	17.5	12.0	2.6	4.2	3.2	1.9
2. Portfolio Investment	-14	32.4	8.3	9.7	5.7	8.8
Of which:						
FIIs	-15	29.0	8.2	7.0	5.3	8.5
ADR/GDRs	1.2	3.3	0.04	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	3.4	1.3	-0.4
7. Short-term Trade Credit	-1.9	7.7	-1.5	0.8	3.3	5.0
8. Rupee Debt Service	-0.1	-0.1	-0.02	-	-	-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	4.0	18.8	14.7	16.1

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

- Available information on certain lead indicators of capital flows for the period 2010-11 so far shows some moderation in inflows in the form of FDI and NRI deposits, but larger net inflows under FIIs and ECBs (Table I3). Although many other Asian EMEs have also seen large capital inflows recently, India runs a current account deficit as opposed to current account surpluses in many other Asian economies.

Table 13 : Capital Flows in 2010-11 so far

(US\$ billion)

Component	Period	2009-10	2010-11
1	2	3	4
FDI to India	April-September	17.8	13.5
FIIs (net)	April-October 22	18.9	51.0
ADRs/GDRs	April-September	2.7	1.6
ECB Approvals	April-September	7.2	10.6
NRI Deposits (net)	April-September	2.9	2.2

FDI : Foreign Direct Investment. NRI : Non Resident Indians. FII : Foreign Institutional Investors.
ADR : American Depository Receipts. ECB : External Commercial Borrowings. GDR : Global Depository Receipts.

- Since the valuation loss on account of the appreciation of the US dollar against major international currencies amounted to about US\$ 7 billion during April-June 2010, there was a net decline in the outstanding level of foreign exchange reserves by US\$ 3.3 billion. India's foreign exchange reserves stood at US\$ 295.4 billion as on October 22, 2010 (Table 14).

Table 14 : Composition of Foreign Exchange Reserves

(US\$ million)

Month	Gold	SDR	Foreign Currency Assets	Reserve Tranche Position in the IMF	Total (2+3+4+5)
1	2	3	4	5	6
9-Mar	9,577	1	241,426	981	251,985
10-Mar	17,986	5,006	254,685	1,380	279,057
10-Apr	18,537	4,982	254,773	1,341	279,633
10-May	19,423	4,861	247,951	1,309	273,544
10-Jun	19,894	4,875	249,628	1,313	275,710
10-Jul	19,278	5,006	258,551	1,348	284,183
10-Aug	20,008	4,974	256,227	1,932	283,142
10-Sep	20,516	5,130	265,231	1,993	292,870
Oct 10#	20,516	5,178	267,694	2,012	295,399

#: As on October 22, 2010.

- The Real Effective Exchange Rate (REER) indices for both 6-currency and 36-currency baskets had exhibited significant appreciation in 2009-10. During 2010-11 so far (April-October 22, 2010), the 6-currency REER has recorded higher appreciation as compared with 36-currency REER (Table 15). The 36-currency REER covers around 90 per cent of India's foreign trade.
- India's inflation differentials with respect to 6 major countries included in the 6-currency REER have been higher than that with respect to other EMEs in the 30-currency index.

Table 15 : Nominal and Real Effective Exchange Rates of the Indian Rupee (Trade Based Weights, Base: 1993-94=100)

(Per cent, appreciation + /depreciation -)

	Index October 22, 2010 P	2008-09	2009-10	2009-10 (Apr- Oct)	2010-11 (Apr- Oct 22) P
1	2	3	4	5	6
36-REER	100.1	-13.6	13.2	4.4	0.4
36-NEER	88.3	-10.3	9.3	4.5	0
30-REER	92.7	-6.9	4.1	1.3	-0.6
30-NEER	108.2	-2.6	2.7	1.2	0.3
6-REER	118.1	-14.0	20.0	8.8	3.1
6-NEER	66.5	-14.8	10.2	3.5	-0.1
Memo:					
Rs/US\$	44.47	-21.5	12.9	8.5	1.5

NEER: Nominal Effective Exchange Rate.

REER: Real Effective Exchange Rate. P: Provisional.

Note: Rise in indices indicates appreciation of the rupee and vice versa.

- Overall, India's balance of payments situation reflected the impact of robust domestic growth, which was visible in the wider current account deficit. The upbeat growth outlook of India and rising interest rate differentials have contributed to attract larger net capital inflows, which financed the current account deficit.
- The key debt sustainability indicators remained at comfortable levels as at end-June 2010 (Table 16).

Table 16: India's External Debt

(US\$ billion)

	End-March 2009	End-March 2010 PR	End-June 2010 P	Variation (June 2010 over March 2010)	
				Amount	Per cent
1	2	3	4	5	6
1. Multilateral	39.5	42.7	44.7	1.9	4.5
2. Bilateral	20.6	22.6	22.9	0.3	1.5
3. International Monetary Fund	1.0	6.0	5.9	-0.1	-2.6
4. Trade Credit (above 1 year)	14.5	16.9	17.6	0.7	4.2
5. External Commercial Borrowings	62.4	72.0	74.5	2.5	3.5
6. NRI Deposit	41.6	47.9	48.1	0.2	0.5
7. Rupee Debt	1.5	1.7	1.6	-0.1	-4.4
8. Long-term (1 to 7)	181.1	209.8	215.3	5.4	2.6
9. Short-term	43.4	52.5	57.8	5.4	10.2
Total (8+9)	224.5	262.3	273.1	10.8	4.1
					(Per cent)
Total Debt /GDP	20.5	18.9	-		
Short-term Debt/Total Debt	19.3	20.0	21.2		
Short-term Debt/Reserves	17.2	18.8	21.0		
Concessional Debt/Total Debt	18.7	16.7	15.9		
Reserves/Total Debt	112.2	106.4	101		
Debt Service Ratio	4.4	5.5	3.9		

∴ Not available. P: Provisional; PR: Partially Revised.

IV. Financial Markets

- Asset prices in EMEs registered significant gains as portfolio flows to these economies revived on the possibility of better returns in these countries. Their currencies also witnessed appreciation pressures (Table 17).
- Financial markets in India, besides reflecting the global trend, were largely conditioned by the domestic growth inflation outlook, monetary policy stance and the fiscal position.

Table 17 : Currency and Stock Price Movement in EMEs

(Per cent)

Items	End-March 2009 @	End-March 2010 @	End-Oct 27 2010*	Items	End-March 2009 @	End-March 2010 @	End-Oct 27 2010*
1	2	3	4	1	2	3	4
Appreciation (+)/Depreciation (-) of Currency per US Dollar				Stock Price Variations			
Argentine Peso	-14.8	-4.2	-2	Brazil (Bovespa)	-32.9	71.9	0.3
Brazilian Real	-23.8	24.6	5.4	China (Shanghai Composite)	-31.7	31.0	-3.6
Chinese Yuan	2.7	0.14	2	India (BSE Sensex)	-37.9	80.5	14.5
Indian Rupee	-21.6	12.9	1.4	Indonesia (Jakarta Composite)	-41.4	93.7	30.5
Indonesian Rupiah	-20.4	27	2.1	Malaysia (KLSI)	-30.1	51.3	13.5
Japanese Yen	2.0	5.2	14.2	Russia (RTS)	-66.4	128.0	0.7
Malaysian Ringgit	-12.6	11.4	5.3	Singapore (Straits Times)	-43.5	69.9	8.2
Mexican Peso	-24.8	14	-0.5	South Korea (KOSPI)	-29.2	40.3	12.8
Russian Ruble	-30.7	14.9	-3.5	Taiwan (Taiwan Index)	-39.2	52.0	4.7
South Korea Won	-28.0	21.7	1.2	Thailand (SET Composite)	-47.2	82.6	24.9
Thai Baht	-11.4	9.8	7.9				
Turkish Lira	-21.7	10.1	-23.2				

@: Year-on-year variation. * Variation over End-March.

- Strong domestic macroeconomic fundamentals and expectation of sustained high growth provided the necessary comfort to the markets. The transaction volumes in the markets remained range bound although the spreads/volatility generally declined (Table 18).

Table 18 : Domestic Financial Markets at a Glance

Year / Month	Call Money Market		Govt. Securities Market		Forex Market			Liquidity Management			Stock Markets		
	Daily Turnover (₹ crore)	Call Rates* (Per cent)	Daily Turnover (₹ crore)	10-Year@ (Per cent)	Daily Inter-bank Turnover (US\$ mn)	Exchange rate@ (₹ / US\$)	RBI's net purchase (+)/sale (-) (US\$ mn)	MSS Outstanding# (₹ crore)	Average Daily LAF (₹ crore)	Daily BSE Turnover (₹ crore)	Daily NSE Turnover (₹ crore)	BSE Sensex **	CNX Nifty**
1	2	3	4	5	6	7	8	9	10	11	12	13	14
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	12,303	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	15,585	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	10,911	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	13,046	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	14,782	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	14,635	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	14,415	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	16,338	4859
9-Oct	15,776	3.17	12,567	7.33	28,402	46.72	75	18,773	1,01,675	5,700	18,148	16,826	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	16,684	4954
9-Dec	13,302	3.24	14,110	7.57	27,439	46.63	0	18,773	68,522	4,671	13,948	17,090	5100
10-Jan	12,822	3.23	12,614	7.62	32,833	45.96	0	9,944	81,027	6,162	17,813	17,260	5156
10-Feb	13,618	3.17	12,535	7.79	34,040	46.33	0	7,737	78,661	4,125	12,257	16,184	4840
10-Mar	17,624	3.51	8,544	7.94	32,755	45.5	0	3,987	37,640	4,751	13,631	17,303	5178
10-Apr	16,374	3.49	14,242	8.01	36,821	44.5	0	2,737	57,150	4,696	13,828	19,679	5295
10-May	16,786	3.83	24,225	7.56	40,243	45.81	0	922	32,798	3,940	12,937	16,845	5053
Jun.-10	14,258	5.16	21,300	7.59	36,953	46.57	0	317	-47,347	4,204	13,005	17,300	5188
July.-10	18,954	5.54	13,691	7.69	33,978	46.84	0	254	-46,653	4,225	12,661	17,848	5360
Aug.-10	15,916	5.17	16,919	7.93	36,193	46.57	-	0	-1,048	5,131	14,182	18,177	5457
Sept.-10	17,212	5.5	16,215	7.96	37,249	46.06	-	0	-24,155	5,185	15,708	19,353	5811

* : 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.

P : Provisional. - : Not available. LAF : Liquidity Adjustment Facility.

MSS : Market Stabilisation Scheme. BSE : Bombay Stock Exchange Limited

NSE : National Stock Exchange of India Limited.

NOTE: In column 10(-) indicates injection of Liquidity, while (+) indicates absorption of Liquidity.

- Transaction volumes in the collateralised borrowing and lending obligation (CBLO) and market repo segments remained high during this period reflecting active market conditions (Table 19).

Table 19 : Activity in Money Market Segments

(₹ crore)

Year / Month	Average Daily Volume (One Leg)						Commercial Paper		Certificates of Deposit	
	Call	Market Repo	CBLO	Total (Col.2 to 4)	Money Market Rate (%)*	Term Money	Out-standing	WADR (%)	Out-standing	WADR (%)
1	2	3	4	5	6	7	8	9	10	11
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	6.2
9-Jun	8,960	21,694	53,553	84,207	2.69	335	68,721	5	2,21,491	4.9
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	5.3
9-Oct	7,888	23,444	58,313	89,645	2.7	225	98,835	5.06	2,27,227	4.7
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	5.4	2,48,440	4.92
10-Jan	6,411	14,565	50,571	71,547	2.97	404	91,564	4.8	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
10-Jul	9,477	12,011	29,102	50,590	5.33	385	1,12,704	6.93	3,24,810	6.69
10-Aug	7,958	15,553	45,181	68,692	5.05	281	1,26,549	7.32	3,41,616	7.17
10-Sep	8,606	15,927	53,223	77,756	5.29	617	1,12,003	7.82	3,37,322	7.34

CBLO : Collateralised Borrowing and Lending Obligation. WADR : Weighted Average Discount Rate.

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

- While the average maturity of debt issuances increased during 2010-11 (up to September 2010), the weighted average yield also firmed up as compared to the corresponding period of the previous year (Table 20).

Table 20 : Issuances of Central and State Government Dated Securities

	2007-08	2008-09	2009-10	2009-10\$	2010-11\$
1	2	3	4	5	6
Central Government					
Gross amount raised (₹ crore)	1,56,000	2,61,000	4,18,000	2,95,000	2,84,000
Devolvement on Primary Dealers (₹ crore)	957	10,773	7,219	6,050	3,563
Bid-cover ratio (Range)	1.6-4.8	1.2-4.5	1.4-4.3	1.4-3.6	1.4-3.9
Weighted average maturity (years)	14.9	13.8	11.2	10.9	11.3
Weighted average yield (per cent)	8.1	7.7	7.2	7.1	7.8
State Governments					
Gross amount raised (₹ crore)	67,779	1,18,138	1,31,122	63,212	49,362
Cut-off yield	7.9-8.9	5.8-9.9	7.0-8.6	7.0-8.4	8.1-8.6
Weighted average yield (per cent)	8.3	7.9	8.1	7.9	8.3

\$: Up to September 30.

- The yield on 91-day Treasury Bills firmed up by 81 basis points between June and September 2010, whereas the yield on both 182-day and 364-day Treasury Bills increased by 110 bps during the same period (Table 21).

Table 21 : Treasury Bills in the Primary Market

Year/ Month	Notified Amount (₹crore)	91-day	182-day	364-day
1	2	3	4	5
2008-09	2,99,000	7.1	7.22	7.15
2009-10	3,80,000	3.57	4.0	4.37
2010-11 (up to Sept. 30, 2010)	1,49,500	5.27	5.56	5.74
10-Apr	36,000	4.14	4.64	5.07
10-May	36,000	4.39	4.76	4.92
10-Jun	15,000	5.29	5.31	5.49
10-Jul	13,000	5.51	5.86	5.99
10-Aug	33,000	6.15	6.41	6.48
10-Sep	16,500	6.1	6.41	6.59

- As part of the calibrated exit, Reserve Bank increased its repo rate by 125 bps, reverse repo by 175 bps and CRR by 100 bps during February-September 2010. In response to these policy rate changes, 72 SCBs raised their deposit rates in the range of 25-125 bps during February- October 15, 2010 across various maturities (Table 22). On the lending side, the Benchmark Prime Lending Rates (BPLR) of SCBs remained unchanged between July 2009 and July 2010. Thereafter, several SCBs increased their BPLR in the range of 25-75 bps during July- September, 2010.

- In line with hike in policy rates, several banks increased their Base Rates by 10-50 basis points by October 2010. As many as 53 banks with a share of 94 per cent in total bank credit have fixed their Base Rates in the range of 7.50-8.50 per cent, indicating convergence in the Base Rates announced by banks.

Table 22 : Deposit and Lending Rates of Banks

(Per cent)

	Sep-09	Dec-09	Mar-10	Jun-10	15-Oct-10
1	2	3	4	5	6
1 Domestic Deposit Rate					
<i>Public Sector Banks</i>					
Up to 1 year	1.00-7.00	1.00-6.25	1.00-6.50	1.00-6.25	1.00-7.00
> 1year-3 years	6.50-8.00	6.00-7.25	6.00-7.25	6.00-7.25	7.00-7.75
> 3 years	7.00-8.50	6.25-7.75	6.50-7.75	6.50-7.75	7.00-8.00
<i>Private Sector Banks</i>					
Up to 1 year	2.00-7.50	2.00-6.75	2.00-6.50	2.00-6.50	2.50-7.25
> 1year-3 years	6.00-8.75	5.25-7.50	5.25-7.75	6.25-7.50	6.50-8.25
> 3 years	6.00-9.00	5.75-8.00	5.75-8.00	6.50-8.00	6.50-9.00
<i>Foreign Banks</i>					
Up to 1 year	1.80-8.00	1.25-7.00	1.25-7.00	1.25-7.00	1.25-7.30
> 1year-3 years	2.25-8.50	2.25-7.75	2.25-8.00	3.00-8.00	3.00-8.00
> 3 years	2.25-9.50	2.25-8.50	2.25-8.75	3.00-8.50	3.00-8.25
2 BPLR/Base Rate					
1. Public Sector Banks	11.00-13.50	11.00-13.50	11.00-13.50	11.00-13.50	7.50-8.50#
2. Private Sector Banks	12.50-16.75	12.50-16.75	12.50-16.75	12.50-16.75	7.00-9.00#
3. Foreign Banks	10.50-16.00	10.50-16.00	10.50-16.00	10.50-16.00	5.50-9.00#
3 Actual Lending Rate*					
1. Public Sector Banks	3.50-17.50	3.25-18.00	3.25-18.00	3.25-18.00	–
2. Private Sector Banks	4.10-26.00	3.50-25.84	3.00-28.00	2.80-26.00	–
3. Foreign Banks	2.76-25.50	3.50-22.00	3.60-23.00	3.60-25.00	–

* Interest rate on non-export demand and term loans above ₹ 2 lakh excluding lending rates at the extreme five per cent on both sides.

Base Rate system replaced BPLR system with effect from July 1, 2010.

- India, along with other EMEs experienced strong portfolio inflows as interest rate differential between these countries and advanced economies turned more lucrative. Strong macroeconomic fundamentals in the Indian markets, buoyancy in the industrial and services sector as also possibility of further increase in rural demand on expected better performance of the agricultural sector were some of the pull factors responsible for the FII inflows. As at end-September 2010, the Sensex and the Nifty both registered gains of 14.5 per cent and 14.9 per cent, respectively, over end-March 2010 (Table 23).

Table 23 : Key Stock Market Indicators

	Indicator	BSE				NSE			
		2008-09	2009-10	2009-10 (Apr-Sept)	2010-11 (Apr-Sept)	2008-09	2009-10	2009-10 (Apr-Sept)	2010-11 (Apr-Sept)
	1	2	3	4	5	6	7	8	9
1	BSE Sensex / S&PCNX Nifty								
	(i) End-period	9709	17528	17127	20069	3021	5249	5084	6030
	(ii) Average	12366	15585	14298	17866	3731	4658	4284	5361
2	Coefficient of Variation	24.2	11.9	12.5	4.9	23.2	11.3	11.6	4.9
3	Price-Earning Ratio (end-period)*	13.7	21.3	22.2	23.8	14.3	22.3	22.9	25.5
4	Price-Book Value Ratio	2.7	3.9	4.1	3.8	2.5	3.7	3.8	3.8
5	Market Capitalisation to GDP Ratio (per cent)@	55.4	98.9	91.6	102.7	52.0	96.4	85.9	100.3

* Based on 30 scrips included in the BSE Sensex and 50 scrips 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 continued to display signs of buoyancy during April- September 2010. The resources raised through public issues increased marginally during April-September 2010 as compared to the corresponding period last year (Table 24).

Table 24 : Resource Mobilisation from Capital Market

(₹ crore)

Category	2008-09 (Apr-Mar)	2009-10 (Apr-Mar)	2009-10 (Apr-Sept)	2010-11 (Apr- Sept)
1	2	3	4	5
A. Prospectus and Rights Issues*	14,671	32,607	13,617	14,058
1. Private Sector (a+b)	14,671	25,479	6,814	13,475
a) Financial	466	326	0	3,420
b) Non-financial	14,205	25,153	6,814	10,055
2. Public Sector	–	7,128	6,803	583
B. Euro Issues	4,788	15,967	12,645	7,443
C. Mutual Fund Mobilisation(net)@	-28,296	83,080	1,12,427	-452
1. Private Sector	-34,017	54,928	83,864	18,744
2. Public Sector #	5,721	28,152	28,563	-19,196

* : Excluding offer for sale. @ : Net of redemptions.

: Including UTI Mutual fund.

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

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

V. Conclusion:

Overall, although aggregate demand trends point to continuation of the momentum, investment demand needs to emerge as the key driver for sustainable robust growth. Going forward, while the growth rates in the services sector and agriculture are likely to remain elevated, sustainability of the recent buoyancy in the industrial sector would require alleviation of supply constraints, particularly in the infrastructure sector and sustained momentum in private demand. Notwithstanding the process of fiscal consolidation that is underway, Government spending continues to support growth, reflecting higher growth in both revenue and capital expenditures.

Reflecting the high growth in India relative to hesitant recovery in the advanced economies, the contribution of net exports to aggregate demand could be expected to remain negative during the year. Recent outlook for capital flows to EMEs suggests that after the temporary uncertainty created by the sovereign risk concerns in the Euro area, capital flows to EMEs will be stronger. Although financing of the current account deficit may not be a problem, possible increase in the magnitude of the deficit could pose sustainability risks. Sustainable current account deficit is important for stable growth and persisting high positive inflation differential will be a source of pressure on the external competitiveness of Indian exports. Containing inflation, thus, important even for improving the external balance position.



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Select Economic Indicators

Economic Growth

	Constant (2004-05) Prices				Current			
	2010-11		2009-10		2010-11		2009-10	
	Q1	Q2	Q1	Q2	Q1	Q2	Q1	Q2
GDP at Factor Cost (Rs. in Crore)	1,132,050 (8.9)*	1,146,637 (8.9)*	1,039,715 (6.3)*	1,053,057 (8.7)*	1,631,171 (20.9)*	1,664,088 (18.7)*	1,349,458 (8.2)*	1,401,815 (10.7)*
GDP at Market Prices (Rs. in Crore)	1,197,587	1,225,554	1,085,993	1,108,537	1,731,866	1,785,387	1,407,111	1,472,837
Growth Rate (Per cent)								
Private Final Consumption Expenditure	60.3	60.6	61.6	61.3	55.5	57	56.6	57.9
Government Final Consumption Expenditure	11.3	11.2	11.4	11.3	11.2	11.2	11.3	11.4
Gross Fixed Capital Formation	35	34.4	32.4	34.3	32.8	32.4	32.8	34
Change in Stocks	1.3	1.4	1.4	1.3	1.4	1.4	1.4	1.3
Valuables	1.3	1.5	1.1	1.4	1.3	1.5	1.1	1.3
Exports	22.1	22.1	22.1	22.3	20.4	20.4	20.7	20.9
Less Imports	27.9	28.9	27.8	30	25.7	27.1	25.8	28.3
Discrepancies	-3.3	-2.2	-2.2	-1.8	3.1	3.2	1.4	1.4

* Percentage Change over previous years

Agriculture & Industrial Production

Sector-wise Percentage Change over Previous Year

	Constant (2004-05) Prices				Current			
	2010-11		2009-10		2010-11		2009-10	
	Q1	Q2	Q1	Q2	Q1	Q2	Q1	Q2
Agriculture, Forestry & Fishing	2.5	4.4	1.9	0.9	26.7	25.4	8.4	9.8
Industry								
Mining and Quarrying	8.4	8	8.2	10.1	27.3	25.6	1.2	1.9
Manufacturing	13.0	9.8	3.8	8.4	19.8	15.4	4.1	7.9
Electricity, Gas & Water Supply	6.2	3.4	6.4	7.7	13.5	9.7	4.9	8.6
Services								
Construction	10.3	8.8	8.4	8.3	16.5	14.2	16.2	15.9
Trade, Hotels, Transport and Communication	10.9	12.1	5.6	8.2	20.5	20.1	4.4	6.8
Financing Institutions, Real Estates & Business Services	7.9	8.3	11.7	11.3	19.2	17.9	11.9	11.3
Community, Social & Personal Services	7.9	7.3	7.6	14	20.9	18.7	8.2	10.7

Source: Ministry of Statistics and Programme Implementation, Government of India. Estimates of Gross Domestic Product for Second Quarter (July- September) of 2010-11

Performance of Core-Industries (Q2)

Sector-wise Growth Rate (%) in Production	2009-10	2010-11
(Weight in IIP: 26.68%)		
Overall Index	4.63	3.53
Crude Oil	-1.13	14.5
Petroleum Refinery Products	-2.66	0.4
Coal	10.1	1.16
Electricity	7.13	2.46
Cement Production	12.6	2.2
Finished (CARBON) Steel Production	1.7	4.2

Overall Indices for this quarter includes date for the months – July, August and September 2010

Compiled by BCCI; Source of data Office of the Economic Advisor

External sector

Exports and Imports(in US \$ million)

Item	2008-09 (Apr-Mar)	2009-10 (Apr-Mar)	Sep-09	September 2010(P)	% Change in March, 2010
Exports	185295	178751	14624	18023	23.2
Imports	303696	288373	21527	27141	26.1
Oil Imports	91316	87136	6546	7490	14.4
Non-Oil Imports	212380	201237	14981	19652	31.2
Trade Balance	-118400	-109621	-6903	-9118	-

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)			
April, 2010	1133322	255023	-17456	88
May, 2010	1152893	248201	19571	-6822
June, 2010	1164431	249878	11538	1677
July, 2010	1202388	258801	37957	8923
August, 2010	1207494	256477	5106	-2324
Spetember, 2010	1192541	265481	-14953	9004
October, 2010	1199656	269343	7115	3862

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				
April, 2010	44.4995	68.2384	0.4763	59.6648
May, 2010	45.7865	67.1747	0.4969	57.6553
June, 2010	46.5443	68.6952	0.5122	56.9016
July, 2010	46.8373	71.515	0.5343	59.7636
August, 2010	46.5679	72.9736	0.5465	59.97
September, 2010	46.0616	71.6578	0.5454	60.0592
October, 2010	44.4583	70.3381	0.5428	61.7153

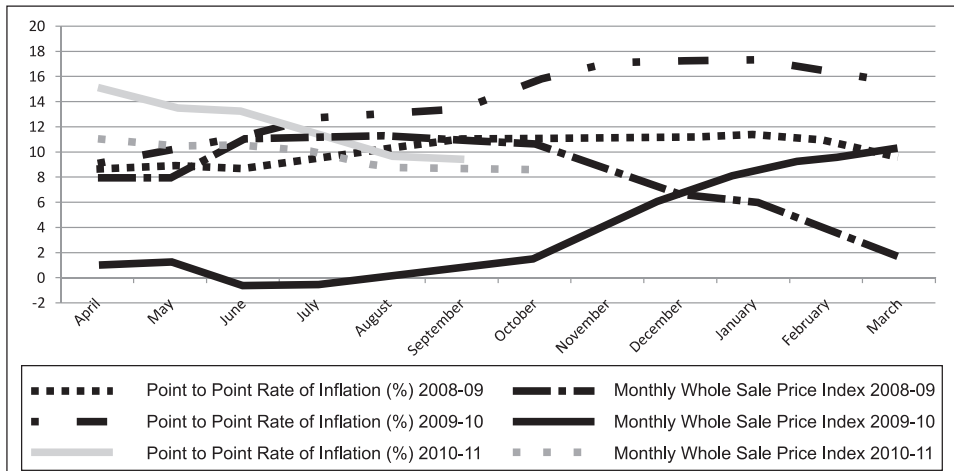
* FEDAI Indicative Market Rates (on Yearly/Monthly average basis)

Prices

Current price situation based on monthly Wholesale Price Index in October, 2010
(Base: 2004-05 = 100)

Items/Groups	Weight(%)	Inflation (%) variation during FY since March		Inflation (%) (Year-on-Year)		Inflation(%) Average of last 12 months)	
		2009-10	2010-11	2009-10	2010-11	2009-10	2010-11
All Commodities	100	4.34	5.93	8.58	1.48	8.98	2.37
Primary articles	20.12	9.22	14.36	16.68	10.3	18.9	8.8
Food Articles	14.34	10.09	16.37	14.13	12.47	19.95	12.65
Fuel and Power group	14.91	5.71	8.37	11.02	-6.78	10.26	-3.4
Manufactured Products	64.97	1.91	2.35	4.75	0.58	4.95	1.63

Point to Point Rate of Growth



Point to Point Rate of Inflation (%) Base 2001 = 100; =



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World Prices of Select Commodities										
Commodity	Unit	Annual Averages		Monthly Averages				Y-o-Y variation in prices(%)		
		Jan.-Dec.	Jan.-Dec.	Mar-10	Jun-10	Sep-10	Oct-10			
		2008	2009	2010	2010	2010	2010	2010	Jun-10	Sep-10
Energy										
Coal, Australia	\$/mt	128	72	94	98	95	97	37.6	40.3	36.1
Crude Oil, avg,spot	\$/bbl	97	62	79	75	76	82	8.1	11.4	10.3
Crude oil, Brent	\$/bbl	98	62	79	75	78	83	9.1	14.9	13.3
Crude oil, Dubai	\$/bbl	94	62	77	74	75	80	6.9	10.8	9.6
Natural gas, US	\$/mmbtu	9	4	4	5	4	3	26	31.8	-14.7
Agriculture										
Coffee, robusta	c/kg	232	164	148	170	179	188	4.2	10.1	16
Tea,auctions(3),average	c/kg	242	272	262	272	300	304	-2.3	-5.1	0.5
Coconut oil	\$/mt	1224	725	921	993	1275	1411	32.9	81.9	99.9
Groundnut oil	\$/mt	2131	1184	1380	1342	1270	1331	16.3	13.4	15.9
Palm oil	\$/mt	948	683	832	798	912	984	9.9	35.3	44.7
Palm kernel oil	\$/mt	1129	700	995	1051	1260	1410	41.8	79	93.8
Soybean meal	\$/mt	428	408	329	338	396	409	-24.3	-6.8	-0.8
Soybean oil	\$/mt	1257	849	915	859	1042	1154	-4.1	23.2	28.7
Maize	\$/mt	223	166	159	153	206	236	-14.9	36.9	40.9
Rice, Thailand, 5%	\$/mt	647	555	502	440	477	486	-23.4	-8.1	-1.4
Wheat, US, HRW	\$/mt	326	224	191	158	272	270	-38.6	42.2	35.9
Wheat US SRW	\$/mt	275	186	190	183	276	267	-9.5	74.5	52.3
Oranges	\$/mt	1108	909	955	1201	1047	1133	47.2	1.5	-1.7
Sugar,world	c/kg	28	40	41	35	50	54	-3.3	-2.4	8.7
Raw Materials										
Logs, Malaysia	\$/cum	292	287	250	261	311	316	-6.6	10.7	14.4
Plywood	c/sheets	648	565	557	567	575	578	0.7	2.6	3.4
Wood pulp	\$/mt	821	614	814	897	907	910	58.6	37.9	31.2
Cotton A Index	c/kg	158	138	189	205	231	279	51.5	63.5	89.5
Rubber,US	c/kg	284	215	357	371	376	423	97.8	51.2	59.7
Rubber, Singapore	c/kg	261	192	334	357	353	392	112.9	62.7	66.9
Fertilizers										
DAP	\$/mt	967	323	476	448	525	575	61.3	65.7	91.6
Phosphate rock	\$/mt	346	122	105	125	125	140	29	38.9	55.6
Potassium chloride	\$/mt	570	630	313	319	338	335	-55.5	-21.3	-23
Urea, E.Europe, bulk	\$/mt	493	250	279	229	315	329	-3.4	34.7	37.8
Metals and Minerals										
Aluminium	\$/mt	2573	1665	2206	1931	2162	2347	22.7	17.9	24.9
Copper	\$/mt	6956	5150	7463	6499	7709	8292	29.6	24.4	31.9
Gold	\$/toz	872	973	1113	1233	1271	1342	30.4	27.5	28.6
Iron ore	c/dmtu	136	117	101	167	212	182	65.4	110	80.3
Lead	c/kg	209	172	217	170	218	238	1.8	-0.9	6.2
Nickel	\$/mt	21111	14655	22461	19389	22643	23807	29.6	29.6	28.5
Silver	c/toz	1500	1469	1715	1853	2061	2347	26.4	25	35.9
Steel cr coil sheet	\$/mt	966	783	775	850	850	850	21.4	21.4	21.4
Steel hr coil sheet	\$/mt	883	683	675	750	750	750	25	25	25
Tin	c/kg	1851	1357	1755	1732	2270	2634	15.6	52.7	75.5
Zinc	c/kg	187	166	228	174	215	237	11.9	14.2	14.5

Source: World bank-The Pink Sheet

Government Accounts

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

	Budget Estimates	April-September		Col. 3 as % of	Col.4 as % of	% Change over preceding 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	244,471	398,234	39.8	58.4	-0.2	62.9
Gross tax revenue	746,651	258,880	324,397	40.4	43.4	-7.6	25.3
Tax (net to Centre)	534,094	185,669	233,415	39.2	43.7	-8.2	25.7
Non Tax	148,118	58,802	164,819	41.9	111.3	37.9	180.3
2. Capital Receipts of which:	426,537	204,377	139,743	50.3	32.8	96.2	-31.6
Recovery of loans	5,129	2,302	4,256	54.5	83.0	54.9	84.9
Other Receipts	40,000	4,300	2,235	383.9	5.6		
Borrowings and other liabilities	381,408	197,775	133,252	49.3	34.9	92.7	-32.6
3. Total Receipts(1+2)	1,108,749	448,848	537,977	44.0	48.5	28.6	19.9
4. Non-Plan Expenditure (a) + (b)	735,657	322,070	368,270	46.3	50.1	33.8	14.3
(a) Revenue Account of which:	643,599	301,291	328,308	48.7	51.0	31.3	9.0
Interest payments	248,644	86,669	102,779	38.4	41.3	0.7	18.6
Major Subsidies	108,667	66,013	64,036	62.5	58.9	20.2	-3.0
Pensions	42,840	21,271	25,015	60.8	58.4	73.7	17.6
(b) Capital Account	92,058	20,779	39,926	27.0	43.4	86.4	92.1
5. Plan Expenditure (i) + (ii)	373,092	126,778	169,707	39.0	45.5	16.9	33.9
(i) Revenue Account	315,125	108,163	144,847	38.9	46.0	15.4	33.9
(ii) Capital Account	57,967	18,615	24,860	39.8	42.9	26.4	33.5
6. Total Expenditure (4) + (5) = (a) + (b)	1,108,749	448,848	537,977	44.0	48.5	28.6	19.9
(a) Revenue Expenditure	958,724	409,454	473,155	45.6	49.4	26.7	15.6
(b) Capital Expenditure	150,025	39,394	64,822	31.9	43.2	52.3	64.5
7. Revenue Deficit	276,512	164,983	74,921	58.4	27.1	110.7	-54.6
8. Fiscal Deficit	381,408	197,775	133,252	49.3	34.9	92.7	-32.6
9. Primary Deficit	132,744	111,106	30,473	63.3	23.0	569.6	-72.6

Source: Review of Union Government Accounts, February 2010, Ministry of Finance.

Safety - Health - Environment

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Money & Banking

Money Stock - Components and Sources (Rs. Crore)

Item	Outstanding as on		Variation over (per cent)			
	2010		Financial year so far		Year on Year	
	31-Mar	22-Oct	2009-10	2010-11	2009	2010
M ₃	5,599,762	6,068,715	8.1	8.4	18.9	17.1
Components (i+ii+iii+iv)						
(i) Currency with the Public	768,033	840,806	7.1	9.5	16.7	17.9
(ii) Demand Deposits with Banks	722,739	734,364	1.2	1.6	15.3	23.4
(iii) Time Deposits with Banks	4,105,151	4,489,345	9.5	9.4	20.0	16.0
(iv) "Other" Deposits with Reserve Bank	3,839	3,924	-28.1	2.2	-20.5	-2.1
Sources (i+ii+iii+iv)						
(i) Net Bank Credit to Government (a+b)	1,667,096	1,781,617	14.6	6.9	47.8	21.7
(a) Reserve Bank	211,586	205,651				
(b) Other Banks	1,455,511	1,575,966	16.8	8.3	29.2	11.0
(ii) Bank Credit to Commercial Sector (a+b)	3,492,781	3,733,229	3.1	6.9	9.6	20.2
(a) Reserve Bank	1,328	1,477	-	-	-	-
(b) Other Banks	3,491,453	3,731,751	3.3	6.9	9.4	20.4
(iii) Net Foreign Exchange Assets of Banking Sector*	1,281,469	1,325,292	-0.5	3.4	3.1	-1.5
(iv) Government's Currency Liabilities to the Public	11,270	11,761	6.7	4.4	10.3	9.6
(v) Banking Sector's Net Non- Monetary Liabilities	852,854	783,183	-13.3	-8.2	-4.9	5.1
<i>of which</i>						
Net Non-Monetary Liabilities of RBI	301,615	333,267	-0.1	10.5	16.3	-14.0

*: 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 (Rs. Crore)		Percentage Variation			
	March 26, 2010	October 29, 2010	Financial year so far		Year on Year	
			2009-10	2010-11	2009	2010
1. Bank Credit	3,240,399	3,523,428	8.6	4.0	9.0	22.0
Non-Food Credits	3,191,909	3,472,745	8.8	5.0	10.0	21.4
2. Aggregate Deposits	4,486,574	4,955,150	10.3	9.1	19.0	18.5
3. Investments in Govt. and other approved securities	1,166,410	1,453,459	5.0	15.7	34.8	7.7

Policy Rates/ Interest Rates (per cent per annum)

Item/Week Ended	2009	2010
	30-Oct	29-Oct
Cash Reserve Ratio (per cent) (1)	5.00	6.00
Bank Rate	6.00	6.00
Repo Rate	4.75	6.00
Reverse Repo Rate	3.25	5.00
Prime Lending Rate (2)	11.00-12.00	7.50-8.50
Deposit Rate (3)	6.25-7.50	7.00-8.50
Call Money Rate (Low/High) (4)		
- Borrowings	2.00/3.35	2.75/12.00
- Lendings	2.00/3.35	2.75/12.00

(1) Cash Reserve Ratio relates to the Scheduled Commercial Banks (excluding Regional Rural Banks).

(2) Prime Lending Rate related to five major Banks.

(3) Deposit Rate related 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.

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