ANALYTIQUE

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Quarterly Journal of the Bombay Chamber of Commerce and Industry Trust for Economic and Management Studies

Bombay Chamber of Commerce & Industry

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From the Editor's Desk

Three months ago, we began by reporting the RBI's action of increasing the repo rate to 7.5%. As we go to press the same rate now stands at 8.5%. Ostensibly and admittedly, RBI is aiming at controlling inflation through tight monetary policy at all costs. However, its actions have not been enough and the problem refuses to go away. Especially troubling is, of course, food inflation, which stands now at 11.81%. Food inflation has a decidedly greater negative impact on the poor, and therefore inability to tame it will always be a test of a credibility for a government's pro-poor stance.

The RBI has, however, signalled that this may well be the end of the road as far as raising interest rates is concerned. But experts believe that the negative impact on economic growth has been transmitted already around the economy. Estimates of the growth rate for the year have been scaled down once again and we can now hear murmurs that it may end up below 7% for the year. Most observers fear what may happen if oil prices go up significantly, exerting further pressure on the rupee.

The RBI has also made a very major change in policy that is bound to make an impact in the economy by freeing savings bank rates from its control. At least two major private sector banks have responded immediately by raising interest rates on savings bank deposits by as much as 2 percentage points even while major nationalized banks maintain that there will be no change in their rates. There seems to be a major disagreement on the effects of this change. Some observers argue that the experience in other countries has been of a major change in the capital markets. We will have to wait and watch who is right.

The key to the performance of the economy depends largely on business confidence, especially in the medium and small sectors. In this connection, the Chamber has decided to carry out a survey among its MSME members to track business confidence and attitude towards capacity expansion and investment. We hope to report on this in the next issue of the Analytique.

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On The Securities Transaction Tax

*Ashith Kampani and Rajgopal Narasimhan**

Abstract

Since the introduction of Securities Transaction Tax (STT) in 2004, there has been a wide debate with regards to the effect it has had on the Indian capital markets. Subsequent to its introduction in 2004, the STT rate was hiked in 2006 for the various segments in the capital markets. In its current form, STT rates are highest for equity delivery based transactions while it is the least for the derivatives segment.

Owing to this, there has been a drop in retail participation in the delivery based equity transactions in India and a visible shift is seen towards the derivatives segment owing to a lower STT.

A STT that is rationalized and is uniform across all segments in the market will help boost retail participation in the Indian markets thereby facilitating better participation in the India growth story.

Introduction:

Prior to 2004, while the capital markets in India were still evolving, the tax structure on gains from equity trading were restricted to taxing the profits. However this practice led to a unique situation wherein, certain market players never declared profits in order to avoid paying any tax.

Also, certain large players, who were domiciled in tax havens (countries with which Indian government had signed double taxation avoidance treaties), enjoyed a completely tax free return on their investments in the Indian capital markets. This indicated that they were able to benefit from the India growth story with hardly any contribution to the Indian exchequer.

To address this anomaly and also to create a level playing field for all market participants, in the year 2004, the then Finance Minister Mr. P Chidambaram introduced the Securities Transaction Tax (STT) as a tax payable on the purchase and sale of securities, irrespective of the transaction resulting in a profit or loss. Securities Transaction Tax (STT) also became applicable to transactions in units of equity-oriented mutual funds.

The expected effect of the introduction of STT were,

- In the words of Mr. P Chidambaram, "STT is a neat, efficient and easy-to-administer tax and it has the great advantage of virtually eliminating tax avoidance".
- Uniform taxing of all the market participants irrespective of the outcome of their transaction.
- Securities Transaction Tax ultimately increased the cost of trading, as the tax was included by the brokers during at the time of purchase or sale of the security.
- Introduction of Securities Transaction Tax helped reduce the incidents of "Noise Trading". Noise trading refers to the trading behavior based on market rumors which may be true or false.

Table 1 shows the STT structure in India.

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Table 1
Transactions In Recognized Stock Exchange in India

Rate of STT	Purchase of Equity Shares, Units of Equity Oriented Mutual Fund (delivery based)	Sales of Equity Shares, Units of Equity Oriented Mutual Fund (delivery based)	Sales of Equity Shares, Units of Equity Oriented Mutual Fund (non-delivery based)	Sale of Derivatives	Sale of Unit of an Equity Oriented Fund to the Mutual Fund
October 1,2004 to May 31,2005	0.075%	0.075%	0.015%	0.01%	0.15%
June 1,2005 to May 31,2006	0.1%	0.1%	0.02%	0.0133%	0.2%
June 1,2006 to May 31,2008	0.125%	0.125%	0.025%	0.017%	0.25%
June 1,2008 onwards	0.125%	0.125%	0.025%	0.017% of option premium in the case of sale of option, 0.125% of settlement price in the case of sale of an option where option is exercised, 0.017% of the price in the case of sale of futures.	0.25%

Tax Treatment on Introduction (October 2004)

- **If the Shares Purchased are Shown as Investment (For Investor)**

If STT is paid on the sale of equity shares, units of equity oriented mutual fund and the period of holding is more than 12 months then the gain on such transaction is treated as long term capital gain and is exempt U/s.10(38) ,long term capital loss if any shall be ignored.

If STT is paid on the sale of equity shares, units of equity oriented mutual fund and the period of holding is less

than 12 months then the gain on such transaction treated as short term capital gain and is taxable @10% under section 111A.

- **In the Case of Day-Traders, Arbitrageurs and Derivative Traders**

Who pay income-tax on business profits, for non-delivery-based and delivery-based transactions, credit for STT rebate will be available U/s.88E against the income-tax payable on business income thereon.

- **Present Tax Treatment**

In the year 2006, the STT rate was raised and equity delivery based transactions were taxed at 0.125 the intraday transaction at 0.025% only on the sell side and for F&O transactions the rate was increased to 0.017%.

In 2008, the rate of tax on short term capital gains (on which STT paid) was increased from 10% to 15%. Further, the income from frequent trading began to be treated as a business income which would be taxed at 30 percent. STT paid by assessees who show share trading as business income will be deductible U/s.36 as an expense instead of earlier deduction from tax in form of rebate u/s.88E.

- **The Inconsistency Created by the Present Structure of STT:**

A simple example to compare the STT paid by an investor when he uses different modes of the trading mechanism is stated in the example depicted in Table 2.

From the said example, it is clear that the STT paid in a Cash delivery transaction is 14.7 times the STT paid in Futures.

Table 2

Comparison of STT Paid by Different Market Participants on Buying & Selling Shares in Company A

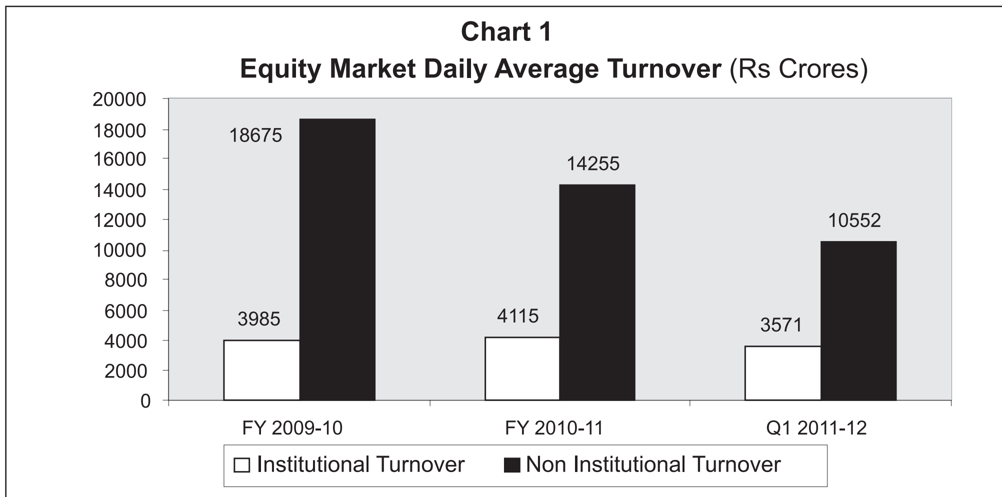
Company A	Futures	Delivery	Cash-Intraday	Roll Over (for 1 year)
	1 lot=1000 shares		1000 shares	1000 shares
Buy/Sell Quantity		1000 shares		
Last Traded Price	Rs. 200	Rs. 200	Rs. 200	Rs. 200
	(1000*200)=			
Transaction Value	Rs. 2, 00,000	Rs. 2, 00,000	Rs. 2, 00,000	Rs. 2, 00,000
STT Rate	0.017%	0.25% (0.125*2)	0.025%	0.017%
Total STT	**Rs. 34**	**Rs. 500**	**Rs. 50**	**Rs. 374**

- **Outcome of 'Discriminatory' Rates Levied Under Securities Transaction Tax on Different Segments:**

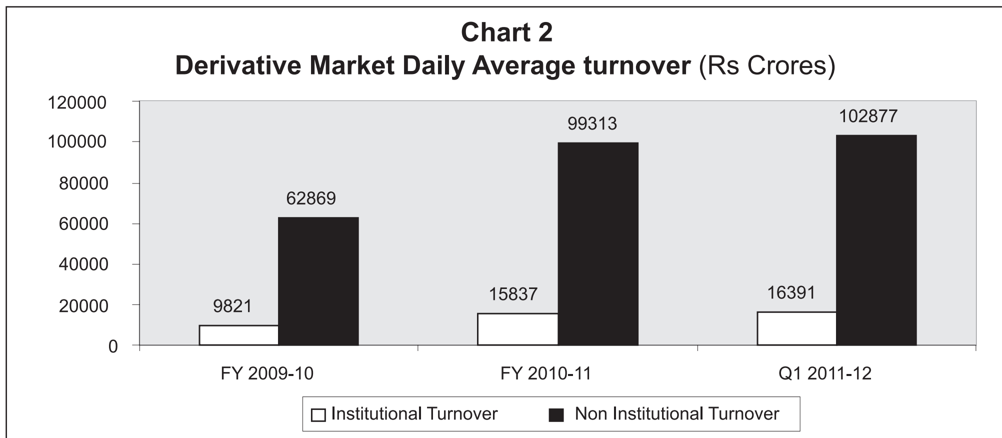
The below charts look at the recent trends in the average daily turnover in the equity and the derivatives segment:

Chart 1 highlights the average daily volume in the equities market from 2009-10 upto the first quarter of 2011-12, which has been bifurcated between Institutional and Non Institutional segments.

The Average Daily Market turnover in the Institutional segment of Equity Cash Segment in Q1 of 2011-12 when compared to FY 2009-10 has shown a fall of 10% (from Rs.3,965 Crores to Rs.3571 Crores). Also significant fall is seen in the same period for Non Institutional Segment which



Source: NSE, BSE & SEBI



Source: NSE, BSE & SEBI

has dropped a phenomenal 43% in the average daily turnover during this period (from Rs.18,675 Crores to Rs.10,552 Crores).

Inversely the turnover in the Non Institutional segment, incase of derivatives, daily average turnover has been consistently growing. With a daily average turnover of Rs.62,869 Crores in 2009-10, the turnover has grown to Rs.1,02,877 Crores in Q1 FY 2011-12 (an increase of 63%). Interestingly the daily average turnover in the Institutional side has grown significantly from a daily average of Rs.9,821 Crores to Rs 16,391 Crores for the corresponding period.

So comparing the Non Institutional Investment pattern during this period clearly highlights a 63% increase in the derivatives turnover when the cash market daily turnover saw a decline of 43%.

In a nutshell, the following is the systemic impact of STT -

- **Declining Retail Participation & Delivery Based Volumes**

The fall in the delivery based volumes in cash segment & falling retail participation in the market is a matter of concern. The shift in interest from delivery based investing to Futures & Options is happening simply because participants find it more advantageous both on the cost & volume front (investors can have higher exposure in a stock with a smaller amount of margin). Although arguably it increases the liquidity in F&O segment but it also increases the risk for a retail participant who unsuspectingly finds himself exposed to the unsystematic risk in F&O space.

- **Death-knell For the Arbitrage Business**

Arbitrageurs are providers of liquidity in the market. Arbitrageurs constantly take advantage of the difference in the prices in stock exchanges and in the process keep buying and selling stocks. This in turn provides for immense liquidity to the market. Arbitrageurs operate with a very small margin of profits. The change of STT treatment from an advance tax figure to an expense directly increased the cost for arbitrageurs & made many of arbitrage opportunities unviable.

This not only negatively impacted arbitrage business but also impacted markets by reducing the much needed liquidity and market inefficiencies. Post these changes, the margins on arbitraging opportunities have been squeezed to an extent that it has made their business unsustainable and resulted in significant job losses.

- **Double Incidence of Transaction Tax for Mutual Fund Unit Holders**

The cost of carrying and holding securities for market participants like Mutual Funds representing a very large number of small and common retail investors are being penalized. Investors pay the STT while redeeming the units and the fund pays STT while buying/ selling the securities that are invested in

the scheme. Funds pay 0.125% as STT while buying and selling equities while investors pay 0.25% while redeeming their units amounting to double taxation.

The sheer size of Mutual Funds industry in India (equity funds had AUM of Rs 1.90 lakh Crores in end-January, 2011) reflects the representation of the common retail investors who are being penalized by this double taxation. The small, retail investors end up paying transaction taxes twice both in a direct and indirect manner. Directly while redeeming the units of Mutual Funds and indirectly when fund managers purchase and sells securities on their behalf.

- **Competitive Disadvantage to Indian Market**

While the objective of the financial sector policy is to have low transactions costs, the STT directly increases cost of carrying the security, to the extent that Indian financial markets face competitive disadvantages. Infosys ADRs trading in the US or Nifty Futures traded in Singapore where there is neither STT nor Capital Gain Tax puts India at a competitive disadvantage. Nifty Futures traded on Singapore exchange may very well see a significant portion of volumes moving overseas. Lower transaction costs due to lower taxation will likely result in Singapore emerging as the destination of choice for trading in Nifty Futures.

- **Impacting Market Liquidity and Price Discovery**

Market Liquidity is provided by intermediaries, such as dealers and market makers. With a tax on the purchase or sale in the markets, the willingness to provide liquidity to the markets gets hampered.

An STT would reduce intermediaries' profits and discourage them from trading unless spreads between bid and ask prices widened by at least the amount of the tax.

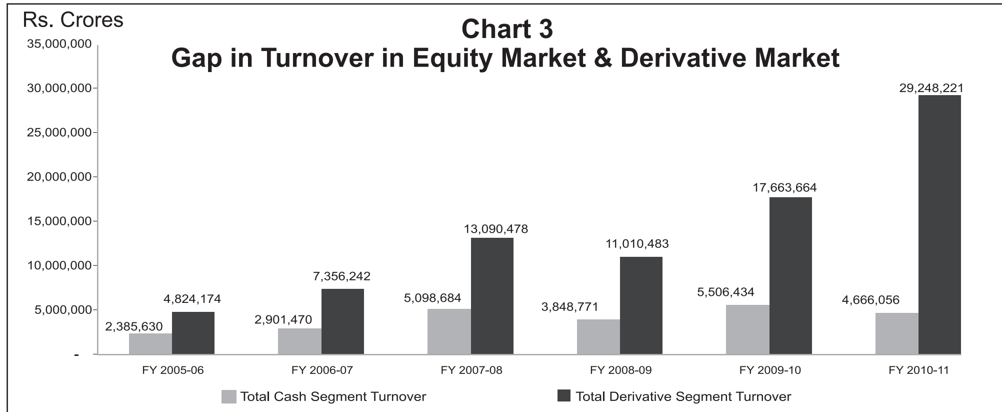
The price of a stock is determined by flow of information which may have an impact both positively or negatively on the company's future or current earnings potential. Investor trade based on such information that affects their estimate of the fundamental value of a firm. To overcome the increased cost of trading, investors would require a higher expected rate of return before they trade. That is, to act on new information, investors would require either a greater discrepancy between the stock's current market price and their new estimate of the fundamental value of the firm, or more certainty surrounding their estimate. The tax's barrier to trading would result in less interaction between buyers and sellers. Generally, greater interaction in markets results in more accurate price discovery.

- **Shift from Equity Segment to Futures & Options**

With the introduction of a higher STT in the Equity Delivery Based Transactions, the gap in turnover between the Equity Market and F&O market has been increasing at a larger pace.

Chart 3 shows which has the total turnover for each segment plotted from the period 2005-06 upto FY 2010-11, highlights how the Derivatives Market turnover to Equity Markets turnover which was 2.02 times has grown to 6.27 times in 2010-11.

Also, the total Equity turnover has



Source: NSE, BSE & SEBI

Table 3
Global Comparison of Taxes of a Similar Nature

Country	Equity	Options	Futures	Bonds/Loans
Argentina	Federal Stamp Duty on Share Transfers Abolished 2001	NA	NA	Provincial Stamp Tax, usually at 1%, may affect bonds and debentures.
Australia	State-level Taxes may apply to Shares	NA	NA	State-level Taxes may apply to Loans and Bonds.
Brazil	1.5% Tax on Equity issued abroad as Depository Receipts (reduced from 3% 2008)	NA	NA	1.5% Tax on Loans (reduced from 3% in 2008).
China	0.1% of Principal	NA	NA	NA
France	15-30 bps Tax abolished 1/1/2008	NA	NA	NA
Germany	NA	NA	NA	NA
India	0.25% on Stock Price; 0.025% on intraday sell Transactions; local Stamp taxes may also apply	0.017% on premium; 0.125% on strike	0.017% of delivery price	Local Stamp Duties may apply
Indonesia	0.1% on value of Shares; local Stamp Duties may also apply.	NA	NA	Local Stamp Duties may apply
Italy	0.01-0.14% of Shares Traded off exchange.	NA	NA	0.25-2% on Loan Principal
Japan	NA	NA	NA	NA
Russia				Capital Duty of 0.2% of Value of new Bond Issues, but not upon formation or IPO of Company

Source: International Monetary Fund (IMF) Working paper on "Taxing Financial Transactions: Issues and Evidence", by Thornton Matheson

grown from Rs.2,385,630 Crores in 2005-06 to Rs.4,666,056 Crores (1.95 times) and the total Derivatives turnover has grown from Rs.4,824,174 Crores to Rs.29,248,221 Crores (6.06 times).

This clearly exhibits a phenomenal increase in the Derivatives Market turnover as compared to the growth in Equities Market.

A working paper on 'Taxing Financial Transactions: Issues and Evidence' by the International Monetary Fund (IMF) highlights the costs of trading in equity in various countries across the globe. Purchasing Equity in India is a mighty costly affair when compared with other economies. While the cost of buying Equity worth Rs. One crores in the US and Europe is around Rs. 500 including brokerage, it is as high as Rs. 1,300 in India. This includes Rs. 850 paid by way of STT. While Rs. 200 goes to the stock exchange by way of fees, Rs. 200 is paid as Stamp Duty and Rs. 21 as Service Tax. Also, Rs. 10 is collected by the Regulator, the Securities and Exchange Board of India. In addition, there is a brokerage. If trades are delivery-based, they attract depository and demat charges as well.

While it may seem minuscule in percentage terms, it is a major burden, as traders can make profit in India only after 28 ticks, while in the US and the UK, just one favorable tick on Index Futures can generate a profit for traders. In the US, the spread on the S&P contract, or one tick, is 25 cents. So, if a trader gets just one tick right, he can take home 20 cents, as the trading cost there is just five cents. This is the reason why the US markets are more liquid.

• The Failed Swedish STT Experiment

In January 1984, Sweden introduced a 50bps tax on the purchase/ sale of an equity security. Thus a purchase & sale transaction attracted a 100-basis-point tax. The tax applied to all trades in Sweden using local brokerage services and to stock options. It did not apply to gifts or bequests.

In July 1986 the rate was doubled.

Impact:

- Fall in Trading Volumes
- As taxable trading volumes fell, so did revenues from Capital Gains Taxes, almost entirely offsetting revenues from the Equity Transactions Tax that had grown to 4,000 million Swedish kroner by 1988.
- Another reason for the reduction in Capital Gains Taxes was the decline in share prices associated with the initial announcement of the Tax and later its increase. On the day that the Tax was announced, share prices fell by 2.2%. But there was leakage of information prior to the announcement, which might explain the 5.35% price

decline in the 30 days prior to the announcement. When the Tax was doubled, prices again fell by another 1%. These declines were in line with the capitalized value of future tax payments resulting from expected trades.

- With the 1986 announcement that the Equity Tax would double, 60% of the trading volume of the 11 most actively traded Swedish share classes, accounting for one-half of all Swedish Equity Trading, moved to London; thus 30% of all Swedish Equity Trading moved offshore. By 1990, more than 50% of all Swedish trading had moved to London.
- Foreign investors reacted to the Tax by moving their trading offshore while domestic investors reacted by reducing the number of their Equity Trades.

Subsequently the Securities Transaction Tax was Phased out in Sweden. WIFO (Wösterreichisches Institut Für Irtschaftsforschung), a research study by the Austrian Institute of Economic Research commissioned by Ecosocial Forum Europe, co-financed by Federal Ministry of Finance and Federal Ministry of Economics and Labour supports the above mentioned facts.

Conclusion

- In order to encourage retail participation in Delivery Based Investments and to boost Mutual Fund Markets, the present study proposes the following changes to be brought about by the government.
  - First, by completely eliminating STT on redemption of Mutual Funds Unit, so as common retail investors could be protected against the incidence of double taxation.
  - Secondly STT should be reduced and made consistent across all market segments. This should attract significant delivery based cash volumes and help overall liquidity in the market. Most importantly, this should encourage retail investors to invest & take delivery in cash segment of the market rather than speculate and over expose themselves in F&O space.
  - Finally, reverting back to the earlier structure wherein STT was treated as an advance tax rather than an expense will encourage all segments of investors (specially the trading community) to induce much needed liquidity in the market. Since STT as advance tax cannot be carried forward to next year it will not impact government tax revenue.

Thus conclusion of the impact of a reduced and rationalized STT rate can be summarised as

- The **volumes** may potentially go up with the STT rates being

rationalized and brought down from the current rates. This will be attributed to the renewed retail participation and also boost to the intraday trading which will help increase the volumes in the Securities Markets. This will in turn lead to increased revenue to the government in the form of Tax.

- Higher participation will lead to a more liquidity and **vibrancy** in the market which will also bring larger transparency and smoother information flow among market participants. Providers of capital will be encouraged to participate in the secondary market.

- A strong, liquid and vibrant market will ultimately improve the **general degree of confidence** on the markets and the general economy. This in turn would lead to larger confidence building on the emerging countries like India.

- India's Goal to improve the existing infrastructure would require about $550 billion according to the Planning Commission. A vibrant Securities Market would be a key to help raise most of these funds locally. A lower STT will not only **attract foreign investments** into the secondary markets but also will lead global funds to invest into large infrastructure projects and other spheres through the private route.

- Higher participation and increased vibrancy in the Securities Market, will lead to creation of **more jobs** in the finance sector. With introduction of technology in major financial hubs in the world, there has been a renewed need for more talent in each sphere of work. The revival of retail participation and other segments of traders would help create many new jobs in the economy.

- Larger participation and higher liquidity will aid **governments disinvestment plans.** Demand for governments upcoming IPO/ FPO issuances will naturally increase with a more visible and vibrant Secondary Market.

- Traders and Investors would be able to enter and exit the markets with greater ease. Higher participation would indirectly lead to **quicker price realization.** Also Block / Large ticket exits would be smoother with limited impact costs.

- **Advanced economies are generally known for their transparent and vibrant financial markets. Higher participation and greater liquidity will help India achieve an advanced financial eco-system.**

Understanding The True Value Of Gold

*Mehrab Irani**

Abstract

Although Gold has been regarded as a commodity over the last three decades, for thousands of years gold was the world's purest form of money and, being nobody's liability, the indisputable store and measure of value. We may know the price of Gold but what is the value of Gold. How do we determine the value of Gold. We can value a commodity based on the cash flows it generates like interest on a bond, rent on a real estate property or free cash flows for equities, but Gold does not generate any cash flow- infact it may have negative cash flow in the form of storage costs. This article tries to answer these difficult questions on what determines the value of Gold, is Gold really an investment, is it an asset or a commodity, how is the turmoil in the global currency and asset markets affecting Gold and what might be the future course of action for Gold.

Introduction

Investments, although very difficult for most of us to theoretically understand, practically apply and emotionally stick to as to what asset allocation should we follow (stocks, bonds, real estate, commodities etc) or what time frame to adhere to and what are the risks attached to it; but there is one thing which most of us, particularly we Indians love and also believe they understand it – is Gold. A common person may not understand the benefits of investing in stocks for long term wealth creation or bonds to enhance the purchasing power in a deflationary environment or hoard cash to preserve capital in an uncertain economic world but the same person might easily understand and believe that he / she knows the value of Gold. And we Indians have traditionally been the largest consumers of Gold. Importantly, most of us believe that Gold prices can just go up – our parents have taught us to invest in Gold because that is one thing which never falls and financial advisors recommend Gold as a hedge against inflation. Now, let us really understand whether this is true or a myth. Let us understand how to value Gold and if we cannot value it then how is the value of Gold determined. And let us appreciate the fact that whether Gold prices can also fall or it is some sacred investments which can never go down.

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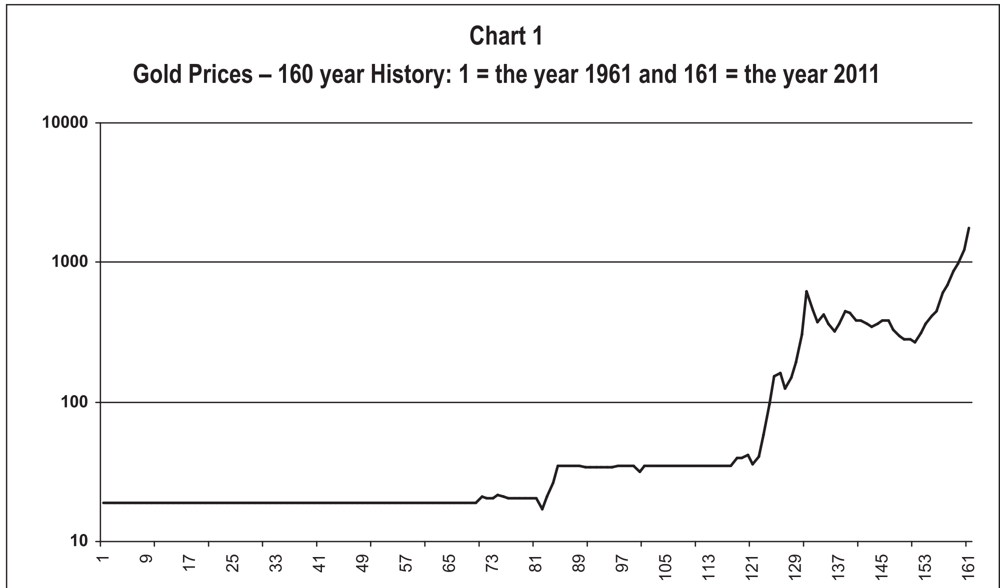
The History of Gold Prices

When investors are hungry for gold, the metal has a habit of rising exponentially which has no parallel amongst metals. While base metals still have to adhere to some form of analysis along the lines of "supply less demand = inventory", gold has decades of inventory lying in Central Banks and so that consideration doesn't enter the equation, unless banks wish to sell that inventory. The last time they did that, and swapped their hard-asset gold for cash, it turned out to be the wrong option. I do not believe that they will go that route in a hurry again. In fact, I believe it is that hard-lesson learned which makes them even more keen holders of gold and this has tightened up the market significantly. Added to that, equity investors nowadays often express dissatisfaction when gold companies hedge their gold and so that big negative, prominent in the nineties, has also been removed.

Gold rose 2300% over the nine years that ended in 1980, one of the most spectacular runs that any major financial asset class has ever recorded. While gold initially rose because the US Government was unable to maintain its price fixed at US$35 an ounce in 1971, it continued climbing sharply and so fast because the gold market is tiny in the immense global financial ocean : a relatively small amount of investor interest was able to make it surge as stocks and bonds languished. Today, following the long years since 1980 during which gold has generally lagged other investments, the effect would be far more dramatic because the US$140 trillion global asset markets is so much larger. All the gold in the world is worth US$7.5 trillion, yet only a small fraction of that amount is traded on financial markets. If just 1% of the global value of stocks and bonds – roughly US$ 960 billion – went into gold the precious metal would skyrocket. The amount is 18 times what the mining industry produces and substantially more than what is traded on gold markets during an entire year. There simply wouldn't be enough gold available at the current price.

Gold has risen from US$18.93 per ounce in the year 1850 to US$1750 per ounce currently, giving a CAGR return of just 2.9%. This is hardly impressive. Compare this with the US Dow Jones Industrial Average. Since, its inception at 41 in the year 1896, the Dow has delivered CAGR returns of 5%. This has resulted in the Dow / Gold ratio which was 2.2 in the year 1896 to currently jump to 6.5. Now, whether this means that currently gold is under priced or that gold deserves to remain an under performer, there does not seem to be any easy answer to that. Now, if we compute the return of gold from the year 1971 from when Bretton woods was abolished till date, the return is a CAGR of 9.9% as compared to Dow's CAGR return of 12.7% during the same period – the Dow still out performs Gold although the out performance narrowed down.

The value of any asset is the cash flows which is produces during its lifetime



Source: nma. org

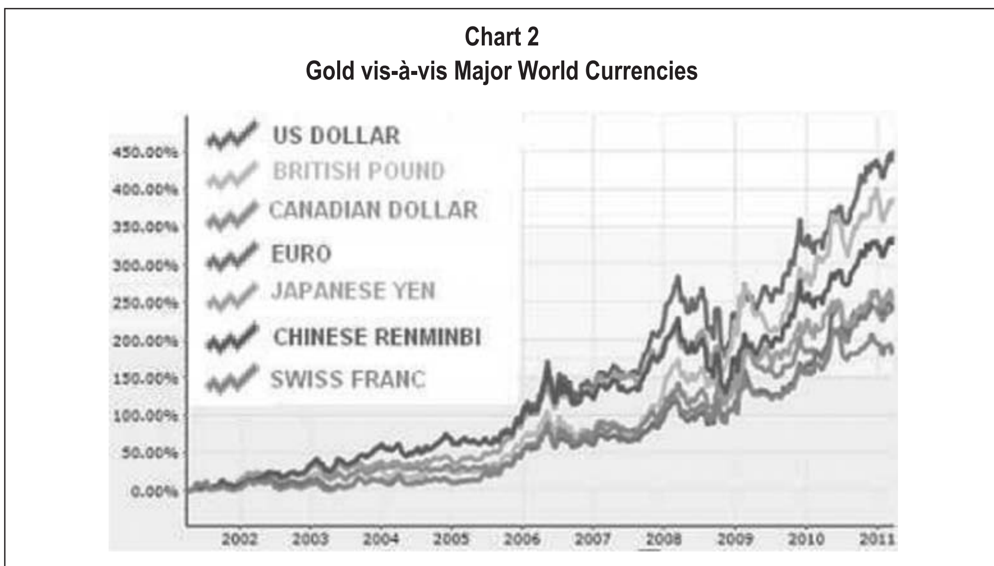
and then discounted to present value. If that is too difficult to understand or compute, then simply the current and future earnings capacity of the asset and then applying a proper Price / Earnings ratio or capitalization rate. Different assets produce different types of cash flows. For example, a bond (fixed deposit) gives interest, equities give dividends, house gives rent etc. But, what cash flow does Gold give – probably nothing. Infact, it has negative cash flow in the form of storage costs. Most assets have some use like steel is used in construction and auto industry, oil in running autos and factories, power in running machines, copper in making wires etc but what is the industrial use of Gold. Besides making "golden tooth", the industrial use of Gold is practically nothing. Then what is the value of Gold – why is it so costly – why do we pay thousands of rupees to buy few grams of Gold. Its simply because we believe the value of Gold will go up in future, we will be able to sell it in future at a higher price to another buyer (the greater fool theory) or more better we don't ever need to sell Gold – it will be passed on to our children and the future generation. In that sense, Gold is a totally speculative commodity with negligible real use and whose value is because of it being treated as a safe heaven – as an alternate currency. Its value is high because Governments and Central Banks (led by the US Fed) are running their money printing machines continuously, relentlessly and at a brisk speed. The US Dollar has lost 97% of its value against Gold over the past 38 years! Hence, its not Gold which has gone up but it's the US Dollar which has gone down because of the discriminate money printing by the US Fed. And since, internationally Gold is valued in US Dollar terms, if the value of US Dollar goes down then naturally the value of Gold has to go up and that is what has happened. In an effort to illuminate a different aspect of the

gold story that somebody might have probably not seen, let's focus on other currencies. Let us compare the price of Gold with other major international currencies over the past decade. Take a look at Chart 2, which shows the percentage gains of gold priced in US Dollar and six other major currencies.

It's kind of difficult to digest, but there's a huge disparity between the US dollar's loss of goldpurchasing power (more than 450%), and the Swiss Franc's loss of gold purchasing power (less than 200%). Hence, the price of Gold is nothing but as expressed as a percentage of some international currency and globally it is a general practice to express it as against the US Dollar.

Now, has Gold risen consistently over the past few decades. No, not at all. Youngsters would have not seen more than 10-years price history and even the elderly persons would not remember it more than 30 years – and that is the time when "Indian" Gold prices have been stable to upward. I say "Indian" Gold prices because it would be a matter of shock to many Indians to note that international Gold prices crashed from US$850 per ounce in 1981 to US$250 per ounce in 2001, negative return over a long 20-year period. However, the "rupee value" of Gold was up during the same period – why is it magic. No. Simply, because the Indian Rupee which was Rs.8 per US Dollar in the year 1981 crashed to Rs.45 by the year 2001 (Kindly note, rupee going up against the dollar means the rupee weakening against the greenback and vice versa). Hence, because the Indian currency lost significant value against the US Dollar, that's why Indian Gold prices in rupee terms went up while actual international Gold prices in US Dollar terms crashed during the same period. And has Gold given great returns over

Chart 2
Gold vis-à-vis Major World Currencies



Source: nma. org

a long term 20-year period. No. Indian Gold prices are up by 8.9% CAGR over the last 20-years while the BSE Sensex has given returns of 15.3% CAGR over the same period. Infact, over the past 20-years Bank FD might have given better returns than Gold.

Gold – A Hedge Against Inflation?

Lot of the so called financial experts will educate you that Gold is a hedge against inflation. However, that may not necessarily be the case. Its not directly related to inflation but to "real interest rates" (nominal interest rates – inflation) of US Dollar denominated assets like US Treasuries. When the real interest rates is down and close to inflation – Gold is likely to appreciate in value because to hold Gold (which does not give any cash flow), the investor has to forego interest on his / her investments and hence real interest rates have to be low or negative so as to induce the investor to hold onto something which does not give any real cash flow.

Table 1 brings out the last 30-year history of US real interest rates, gold prices and US stock markets. It clearly brings out the fact that Gold performs well when real interest rates are very low to negative and vice versa.

What Determines the Value of Gold

The following factors determine the value of Indian Gold:

- **Value of the US Dollar:** Since Gold is internationally quoted in US Dollar, the weaker the US Dollar, the higher the price of Gold and vice versa.
- **Real Interest Rates in US Dollar denominated assets:** Low or negative real interest rates results in higher Gold prices and vice versa.
- **Indian rupee vis-a-vis US Dollar:** Since, Indians buy Gold in Indian rupees, the weaker the Indian rupees against the US Dollar, the higher will be the price of Gold and vice versa.

Understanding the Determinants of the Value of Gold

The US Dollar – It's Just a Currency-Not Real Money

The year 1971 totally changed the rules of the game. The Nixon Shock was a series of economic measures

Table 1
Gold Rises In Value

Period	US Real Interest Rate	Gold Price	US S&P 500*
1973-80	-1.15%	+32% p.a.	-7% p.a.
1981-2001	+2.7%	-3.5% p.a.	+7% p.a.
2002-11	-0.4%	+18.5% p.a.	-3% p.a.

Source: US Federal Reserve, ** Excluding Dividends*

taken by U.S. President Mr. Richard Nixon in 1971 including unilaterally cancelling the direct convertibility of the United States dollar to gold that essentially ended the existing Bretton Woods system of international financial exchange. Because of this very important change, the US Dollar no longer remained money – it became a currency. It basically signified the death of money as there was a fundamental change in the nature of business transactions based on a complex, electronically managed system of valuations used for stocks, bonds, insurance policies, and other financial contracts that go beyond the simple, historic notion of money representing physical reserves. A simple view of this concept is that if everyone decides to cash out their bank account on a single day, there is no longer enough paper money to represent it.

Now, all monetary value is being ultimately measured in US Dollar, the quantity of which are no longer limited by physical gold as had been required under the Bretton Woods monetary system that effectively collapsed. Being the premier currency in virtually all of the World's Central Banks, the US Dollar is the de facto foundation of the global monetary system, the metric used to weigh all other currencies, and hence the final measure of the value of everything that has a price. However, remember that it is just a currency and not real money. And it is a very weak currency. The US Dollar being the world's currency is probably at an exorbitant privilege since it forces other nations to absorb American liabilities and fund its deficits. The US Debt has grown more than 300% of its GDP, a level last approached when thousands of banks were collapsing in the 1930s, which makes this picture all the more striking. The US GDP is not falling today as it did in the thirties, but its liabilities are rising at a brisk pace. Five Dollars in debt are added for each dollar in American GDP.

And while Government liabilities are surging, what is happening to American consumers, who cannot raise taxes or lay off their spouses, is far more troubling. Household debt has more than doubled over the past 10-years while inflation adjusted wages have been stagnant for years. Debt payments each year are taking a larges share of American paychecks, which are already battered by sky-rocketing healthcare costs. When consumer debt keeps rising, the US Federal Reserve brushes aside it by saying the value of the assets, primarily real estate, is growing at a faster pace. But to think that credit growth and not income growth can make anyone richer is disastrous as we saw with the sub-prime crisis in US in the year 2008. The US is no longer winning its race with debt – perhaps it is a time to take a long, hard look at the American Balance Sheet instead of expecting that easy liquidity or QE-3 or any such other mechanism by the Federal Reserve will bail the US out. The US Government and its people are in a Balance Sheet recession and not a P&L recession which can be bailed out by printing money, easy liquidity or fiscal measures. These measures will not ignite consumers in borrowing

and spending. And how can we expect the US consumer to continue borrowing and spending when the US unemployment figure is within kissing distance of the double digit figure. It is perhaps that kind of recession which happened in Japan during the 1990s or in the US itself during the 1930s. Central Banks have been forced to absorb trillions of deficit driven dollars in new reserves over the past few years, injecting more liquidity into their own economies in an effort to maintain competitive currencies. Doing so has been vital – exporters to the US need their Governments to maintain what has become a vendor financing system – amassing dollars and lending Americans more money so that they can continue buying attractively priced foreign products!

Approximately, 60% of the "paper dollars" circulate outside the US and the majority of US Treasury bonds are owned by foreigners. Today, America relies on the world's confidence more than ever before. And going a step further, more than confidence, it is the lack of alternative which has forced investors to stay with the US Dollar as the reserve currency. Although, US Dollar does remain a global reserve currency, but it cannot become money – which remain with Gold. Kindly note, Gold rises when the risks inherent in holding paper currency increase, as they are doing now, and when stocks, bonds, and other investment returns are insufficient to compensate for climbing risks in the financial markets. Currently, bond yields remain at historical low levels with the 10-year US Treasury at 2.3%. Currently, the Dividend Yield on the US S&P 500 Index is more than the US 10-year Treasury Yield- which is a rare occurrence, its happening only for the second time since the year 1970. This would mean equity markets are demanding high yields since they see higher risks, companies not able to deploy cash properly and implying lower valuation multiples. With all these reasons Gold has been surging high and almost touched US $1800 per ounce recently.

The Supply Side of Gold

Gold mining production peaked in the year 2001 and the average global cost of producing a refined ounce of the ever-harder-to-find precious metal doubled in just seven years. There are regular strikes in the South African gold, diamond and coal mines. World's Central Banks are ever increasing their reserves of Gold as they realize that they cant hold all their assets in the ever depreciating US Dollar.

The Demand for Gold

Although the supply of Gold has weakened, new avenues of demand have arisen, thanks mostly to gold exchange trade funds which allow more and more investors around the globe to buy and hold representative amounts of gold with the click of a mouse. Gold ETFs only began trading in the year 2004, and they are now present on several markets throughout Europe and Asia and will soon be bought and sold on major exchanges. The growing

affluence of India, the world's largest market for gold, has increased demand. And in 2007, Chinese citizens, proportionately the world's biggest savers, were allowed to trade gold legally for the first time.

Conclusion

I am here not trying to predict the future price of Gold because as mentioned earlier it's a speculative commodity with no real industrial usage whose value depends on the value of US Dollar, real interest rates in the US which in turn depend on nominal interest rates and inflation over there and then the value of Indian rupee against the US Dollar. Till the US Fed continues to print money the US Dollar will remain weak, till there is uncertainty in the global economy the money printing will continue, till the US Dollar remains weak some shift from Asian Central Banks like China, India etc will happen from US Dollar denominated securities to hard asset like Gold, till there is uncertainty around people will move to the so called safe heaven of Gold, till the US Government and consumer moves out of Balance Sheet recession the prospects of Gold remain bright, till the Indian rupee remains structurally weak against the US Dollar over the long term, Indian Gold prices would be supported in rupee terms and till the woman in India keep loving Gold ornaments there would be demand for Gold which otherwise hardly has any real industrial use. So, the next time you invest in Gold, weigh all these factors before doing it – and remember that Gold may go up in value like any other asset – but it is certainly not a sacred asset that its value will never come down – like any other asset its value will go up and also come down depending on the conditions which affect its prices. And if I have to compulsorily predict Indian Gold prices, then I feel that international Gold prices might almost double over the next few years from around US$1800 per ounce currently to US$3000 per ounce while the Indian Gold prices might under perform with increase from current Rs.2600 per gram to around Rs.3750 per gram over the next few years after which Gold might enter a prolonged and long term bear market.

Non Banking Finance Companies – Time to Introspect!

*Naresh Makhijani**

Abstract

Over the last few years the Non Banking Finance Companies (NBFC) sector has gained significant advantages over the banking system in supplying credit under-served and un-banked areas given their reach and niche business model. However, off late the Reserve Bank of India has introduced and suggested various changes in the existing regulatory norms governing NBFCs with a view to bring NBFCs regulations at par with the banks. The ongoing and proposed regulatory changes for the NBFCs in terms of increased capital adequacy, tougher provision norms, removal from priority sector status and changes in securitization guidelines could bring down the profitability and growth of the NBFC sector. NBFCs will need to introspect and rethink their business models as they will now not only have to combat stringent regulatory norms but also have to face the challenge of rising cost of funds, scare capital and direct competition from banks.

Introduction

The NBFC sector in India has undergone much transformation over the past decade and created its own niche in supplying credit to retail customers in the relatively under-served and un-banked areas. In fact, the sector is playing an active and complementary role to the banking system by driving the agenda of financial inclusion and diversification of the financial sector.

Off late, but, many questions have been raised around the regulatory imperatives concerning the NBFC sector and the risks arising from regulatory gaps, arbitrage and systemic inter-connectedness. This has called for increased regulatory attention and the Reserve Bank of India (RBI) has issued specific regulations concerning NBFCs at regular intervals meant to strengthen this segment. The major thrust of the proposed changes is to bridge the regulatory arbitrage between banks and NBFCs by bringing NBFCs' regulations at par with the banks.

The ongoing and proposed regulatory changes for NBFCs in terms of increased capital adequacy, tougher provision norms, removal from priority sector status and changes in securitization guidelines could not only have far-reaching changes to the existing regulatory and supervisory framework of NBFCs, but also on viability and profitability of the NBFCs business model. We have tried to examine some of major implications arising out of recently and ongoing regulatory changes proposed by the RBI.

The Analysis

In August 2011, the Usha Thorat Committee Report on guidelines on

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NBFCs proposed to increase the Tier-1 capital to 12% from 7.5% at present in a phased manner over the next three years. Earlier, in Feb 2011 the RBI increased the capital adequacy requirement for all NBFCs from 12% to 15% by March 2012. Moreover, there could be a possible regulatory change in terms of higher capital requirement on assets assigned by NBFCs to banks. These measures, if implemented, will increase the equity capital need for NBFCs and, hence, bring down the sustainable leverage on the balance sheets of the NBFCs.

The Committee also proposes recognition and provisioning norms for standard assets and non-performing assets (NPA) for NBFCs to be brought at par with banks in a phased manner. The proposed changes in NPA recognition and provisioning norms (moving from 180 days to 90 days) are likely to increase the provisioning costs for NBFCs. This will inherently affect the profitability and return ratios of the NBFCs more from an accounting perspective. Given that fact that a lender's Tier-1 capital is based on accounting profits rather than cash flows, the change in accounting profit will directly impact the capital adequacy levels of NBFCs. This in turn will also call for higher equity infusion.

Over the last few years the banking sector found it easier to fulfill their priority sector obligations through NBFCs, given the fact that the NBFC sector has grown faster than the banking system. But, in a series of measures over the past year, the RBI has changed the guidelines related to priority sector lending and has removed bank loans to gold loan NBFCs in any form (including buying portfolio from NBFCs) from priority sector in Feb 2011; also removed bank loans to all NBFCs from priority sector in May'11 except microfinance NBFCs (but capped interest rates charged by microfinance NBFCs). The RBI has also set up a committee in Aug'11 which apart from redefining priority sector will also decide whether indirect lending through NBFCs should be part of priority sector or not. This has not only increased the cost of funds for NBFCs but has also made availability of funds relatively difficult for NBFCs, especially as they are not allowed to access public deposits as the banks do.

More recently, the RBI's revised draft guidelines on securitization requires NBFCs to keep loans on their books for six months (instead of three to four months currently) if the installment is made monthly or 12 months if the installments are quarterly or less frequent. The guideline also recommends first loss cover provided plus loans retained by the originator (NBFCs) to be 10% of the total loan portfolio. This means that the portfolio available for securitization by the NBFCs would shrink to some extent, leading to drying up of the source of priority loans for the NBFC sector.

The RBI's proposition of NBFCs converting into banks or forming a new bank, if pursued by any of the eligible NBFC will help it to enjoy the benefits of lower cost of funds but the cost of higher employee expenses, the capex in opening branches, the system up-gradation expenses would be all front loaded. Moreover, for transferring existing NBFC businesses under the new bank and

prior regulatory approval for any change in ownership of NBFC is expected to create complex issues especially while restructuring businesses.

In addition, the committee has suggested that for an NBFC to be eligible for registration and supervision, it will need total assets of all NBFCs in a group to be INR100 crore and above. The proposed rules around registration and supervision norms will also not make life difficult for vast number of existing NBFCs that have assets less than INR 50 crore, as they will be fit for deregistration if the Committee's recommendations are accepted

On the positive side, it is proposed that NBFCs should be given the benefit of the SARFAESI Act, 2002. This we believe would made possession and sale of delinquent assets easier for NBFCs.

The impact of all these new and proposed regulations on reported profitability and, hence, capital adequacy of the NBFC sector, is expected to significantly change the way NBFCs conduct their business. NBFCs could be more cautious in the lending businesses that do not have a set pattern for cash flows, especially segments like fleet owners and truck operators. NBFCs will also be required to beef up and/or change their recovery and collection processes along with building robust reporting and compliance requirements. This will lead to increase in operational costs for various NBFCs and decline in lending to high yield assets.

Conclusion

Thus, the proposed capital regulations and other regulatory measures would definitely help towards the improved functioning of the NBFC sector from the systemic risk perspective in the long term, but what needs to be considered is the complementary role and niche focus of the NBFCs compared to the banks in the country's overall financial system. The NBFC sector has played a major role in filling the important gap of supplying credit to the retail customers in rural and semi-urban areas and relatively under – served segments like small town truck operators, equipment and tractor financing etc., whereas commercial banks have largely focused on funding the needs of large corporates and retail credit. Today, the NBFCs have built sound capabilities around underwriting norms, penetrative market knowledge, cost-effective operations and highly personalized good quality customer service.

To conclude, for NBFCs it's also a time to introspect and re-think their strategy on how they could sustain or evolve their existing business models both from a viability and regulatory prespective.

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Quarterly Overview

In a baseline scenario, growth in India in 2011-12 is likely to be somewhat below trend. Inflationary pressures are strong and persistent due to structural rigidities, continuing strong demand and the adaptive nature of inflation expectations. With falling global commodity prices partly offset by rupee depreciation, the risks to inflation projections are now balanced. Monetary transmission has helped raise deposit and lending rates, correct the mismatch between deposit and credit growth and dampen aggregate demand.It is in this backdrop, a brief review of the Indian economy of the second quarter of 2011-12 being made to capture some relevant issues of the present economy. The analysis is organised in five different sections. The first section provides an overview of the domestic macroeconomic development while the second one captures the issues related to the aggregate demand, section three considers the external economy and fourth section concentrates on the financial markets. Finally, the conclusion section winds up the analysis.

1. An overview

Global recovery looked healthy till recently, but slowing momentum has been witnessed. On the domestic point, moderation in activity is apparent in industry, though the fall is exacerbated by a few volatile components. The services sector has been resilient so far but construction, which is important for its large employment potential, is cooling off.

Financial instability arising from unresolved sovereign debt issues, especially in the euro area, is impacting business and consumer confidence, leading to risk aversion and dampening of demand and supply of credit.

At the sectoral level, agriculture growth was supported by improved rabi crop for 2010-11, while the slackening of industrial growth was reflected in the 'mining and quarrying' and 'manufacturing' sectors. The services sector witnessed moderation on account of a fall in growth rate of all its sub-components except 'trade, hotels, transport and communication'. The sharp deceleration in the growth of the construction sector, in particular, is likely to negatively impact capital formation, going forward **(Source: Central Statistics Office).**

Latest data available from the consumer expenditure survey of 2009-10 conducted by the National Sample Survey Office (NSSO) suggests that there has been a structural change in food consumption pattern towards protein-rich food items, both in rural and urban areas. Simultaneously, the share of cereals in food has declined **(Source: Ministry of Agriculture, Government of India).**

The sharp moderation in manufacturing growth was reflective of deceleration in production of both capital and intermediate goods. There has been significant volatility in the production of capital goods in the recent period. Volatility measured by standard deviation is 3.2 for IIP excluding capital goods, which is lower than 4.6 for the overall IIP during the period April 2009 to August 2011 **(Source: Central Statistics Office).**

The core infrastructure sector grew by 5.3 per cent during April-August 2011 compared with 6.1 per cent growth during the corresponding period of the previous year **(Source: Central Statistics Office).** The performance of core industries during the year is mainly supported by the robust performance of the electricity and steel sectors. Capacity utilisation differed across various infrastructure industries during the first four months of 2011-12. While it was over stretched in petroleum refinery products; cement, fertiliser and finished steel industries showed lower capacity utilisation in relation to 2010-11 **(Source: Capsule Report on Infrastructure Sector Performance, Ministry of Statistics and Programme Implementation, GoI).**

The sharp moderation in construction and 'community, social and personal services' notwithstanding, the services sector grew by 8.9 per cent in Q1 of 2011-12, higher than the previous two quarters. The relatively better growth in 'trade, hotels, transport and communication' and 'financing, insurance, real estate and business services', contributed to the overall momentum in the sector. More recent data, however, indicates a deterioration in indicators for telecom and construction (**Source: Ministry of Tourism; Ministry of Statistics and Programme Implementation and CMIE).**

II. Aggregate Demand

Corporate investment intentions in new projects declined sharply and remain subdued. Private consumption has started to dampen with rising interest rates, but is still reasonably strong. However, risks to demand management persist from overshooting of government expenditures leads to investment falling more than anticipated, and consumption responding less than intended.

- **Falling investment a concern as it lowers potential output**

Information from the corporate sector, the banking system's capex funding, housing transactions as well as falling construction activity suggest that investment has been adversely impacted.

- **External demand likely to weaken**

Aggregate demand may remain weak in the second half of 2011-12 as external demand is likely to weaken as a result of slowing global economy. Despite an increase in the growth rate of net exports (as against a contraction in the previous two quarters), the contribution of net exports to aggregate

demand reduced even further in the first quarter of 2011-12 **(Source: Central Statistics Office).**

- **GDP growth improves even as private consumption growth moderates**

Real GDP growth at market prices improved to 8.5 per cent during Q1 of 2011-12 compared with 7.7 per cent observed in the previous quarter, solely on account of the investment component. Even so, the growth rates of GDP at market prices and all its components were lower in Q1 of 2011-12 than in the corresponding quarter of the previous year **(Source: Central Statistics Office).** More specifically, the Private Final Consumption Expenditure (PFCE), the largest component of aggregate demand, moderated during the first quarter of 2011-12. The moderation in PFCE growth is mainly due to tapering of demand in interest rate sensitive sectors. This is evident in the slackening of growth in the consumer durables segment of the IIP and, in particular, the dip in the sales of passenger cars in recent months, reflecting the combined impact of persistent inflationary pressures and monetary policy actions. Government final consumption expenditure also moderated in Q1 of 2011-12.

- **Sales growth remains healthy though profits are under pressure**

In terms of sectoral breakdown, sales of manufacturing companies were higher at 25 per cent compared to those of IT companies (19 per cent) and companies in the services sector (14 per cent). While profit margins of manufacturing and non-IT services companies dipped in Q1 of 2011-12 compared with the corresponding quarter of last year, it remained the same for IT companies.

- **Fiscal slippages may complicate the task of aggregate demand management**

The Central government's key deficit indicators have widened during 2011-12 (April-August) in comparison with the levels during the corresponding period of the previous year. Although total expenditure growth was lower during 2011-12 (April-August) than in the corresponding period of 2010-11, it remained above the budgeted growth. The Central government has announced an additional borrowing of nearly Rs.53,000 crore in the second half of 2011-12, taking into account the shortfall in other sources of financing of fiscal deficit, mainly National Small Savings Fund (NSSF) and lower than budgeted opening cash balance.

- **Subsidies likely to overshoot budget estimates**

Based on the current assessment of under recoveries of Oil Marketing Companies (OMCs) for 2011-12 as a whole, expenditure on petroleum subsidies could range between 0.74 per cent and 0.87 per cent of GDP depending on the extent of burden sharing by the Central government as compared with the budget estimate

of 0.26 per cent of GDP for 2011-12. There are further upside risks to GFD on account of revenue shortfall for the Centre of around 0.29 per cent of GDP due to changes in the duty structure of petroleum products. Similarly, there are signs of pressures emerging in respect of expenditures on fertiliser subsidies, evident from the data on Central government finances during April-August 2011.

- **State finances expected to remain on track**

It may be noted that 12 States announced reduction in rates of value added tax (VAT) on petroleum products during June-July 2011 to provide relief to the consumers in the wake of upward revision in administered prices on select petroleum products. During 2011-12 (April-August), States received lower grants from the Centre than a year ago, even though tax devolution has been on track.

III. The External Sector

Despite a surge in exports and higher net invisibles receipts, the current account deficit (CAD) increased during Q1 of 2011-12 reflecting strong import growth on account of higher oil prices and sharp increase in imports of gold & silver, machinery and electronics. The composition of capital inflows shifted with a sharp fall in FII inflows and rise in FDI.

- **Widening CAD poses risks amidst uncertain global conditions**

The wider CAD was financed comfortably with an improvement in capital flows, particularly on account of a marked increase in FDI in flows **(Source: DGCI&S).**

- **Trade deficit widened in spite of high export growth**

The rise in exports was particularly on account of engineering goods (103 per cent) and petroleum & oil products (53 per cent). However, during this period, there was a sharp rise in imports as well, which led to the widening of the trade deficit. The high growth in imports stemmed from an increase in oil imports (42 per cent) and non-oil import items, viz., gold and silver (80 per cent), machinery (34 per cent), electronics (33 per cent) and organic and inorganic chemicals (26 per cent). Notably, non-oil trade deficit remained unchanged in nominal terms **(Source: DGCI&S).**

- **Exports may slowdown ahead in a tougher climate**

India's export growth has shown unexpected buoyancy in recent months, despite the slowdown in advanced economies (AEs) and rising global uncertainty. This among others, was a reflection of the continued diversification of India's exports to other emerging and developing economies (EDEs) where growth buoyancy was still intact as also the domestic trade policies intended to support exports. However, the slowing of AEs, with some weakening of growth prospects of EDEs, may weigh on India's exports in subsequent months.

- **Global trade may decelerate on weakening global demand and rising risk aversion**

The growth in global trade has remained volatile reflecting the uncertain global environment . Both the IMF and the WTO have projected a lower growth in world trade volume reflecting weakening global demand. The IMF has reduced its earlier forecast for world goods and services trade from 8.2 per cent to 7.5 per cent for 2011 and further to 5.8 per cent for 2012. The WTO has lowered its forecast for merchandise trade volume growth to 5.8 per cent in 2011 from its previous estimate of 6.5 per cent **(Source: WTO).**

- **Growth in services exports may also decelerate**

The surplus on account of invisibles continued to finance around 60 per cent of the merchandise trade deficit in Q1 of 2011-12. Within services, export of software services continued to grow in Q1, though at a lower rate than during the previous quarter. Private transfers, representing workers' remittances from abroad, remained marginally higher in Q1 than in the corresponding quarter of the previous year despite uncertainties in source countries. The decline in investment income, reflecting lower interest rates abroad, also impacted the overall net receipts on account of invisibles In the coming quarters, a slowdown in the US and the euro area may have some impact for exports of invisibles, particularly software services, as was evident during Q4 of 2008-09 to Q2 of 2009-10 **(Source: WTO).**

- **Sharp decline in FII flows largely offset by strong FDI flows in Q2 of 2011-12**

So far in 2011-12, capital inflows have exhibited an uptrend, mainly on account of robust FDI inflows and rise in external commercial borrowings (ECBs) and trade credit. FDI inflows were almost double the level recorded during the corresponding period of 2010-11 while ECBs also registered healthy growth . However, net FII inflows have not only been volatile but also significantly low up to October 14, 2011. Volatility in FII inflows witnessed in Q2 mainly reflected concerns of a double-dip recession in the US and a worsening debt crisis in the euro area. During Q1 of 2011-12, the surplus on capital account at US$ 20.9 billion was more than adequate for financing the higher CAD at US$ 14.5 billion.

- **Overall capital flows to emerging markets entering an uncertain phase**

Emerging & Developing Economies (EDEs) are facing a general rise in volatility of capital flows with resurfacing of global downside risks. The possibility of contagion from the euro area banking system to the EDEs remains high. This can operate through adverse impact on the balance sheets of the subsidiaries of European banks operating in the EDEs and due to investment funds liquidating their positions because of any losses on assets in AEs. Going forward, in context of India, buoyancy in FDI in

flows may continue during the second half of 2011-12, as projects attracting significant FDI are already in the pipeline.

- **Debt creating capital flows also uncertain in spite of widening interest rate differential**

During 2011-12 so far, ECBs registered healthy growth and NRI deposits also showed marginal increase. The ECB policy was further rationalised and liberalised in September 2011. The increase in the annual limit for eligible borrowers under the automatic route may help in sustaining the uptrend in ECBs in the coming quarters of 2011-12. However, euro imbroglio, if continues, may affect the availability and cost of debt creating flows.

- **Rupee sees significant nominal and real depreciation in Q2 of 2011-12**

Based on narrow as well as broad currency baskets (i.e., 6, 30 and 36 currency baskets), the Indian rupee depreciated sharply over end-March 2011 both in nominal and real terms.

- **External vulnerability indicators portray a mixed picture**

India's external debt stock as at end-June 2011 showed an increase of US$10.4 billion over the level as at end-March 2011 mainly on account of ECBs reflecting interest rate differential and short-term trade credit reflecting surge in imports. The key debt sustainability indicators, such as ratio of short-term debt to total external debt, ratio of short-term debt to reserves and debt service ratio marginally worsened due to the continued dominance of debt creating flows. However, other indicators, viz., reserves cover for imports and debt service payments improved during Q1 of 2011-12. Going forward, debt flows may increase further due to persistence of interest rate differentials, higher annual ceiling for ECBs under the automatic route for corporates in specified sectors and liberalisation of investment by FIIs in corporate bonds for the infrastructure sector.

IV. Financial Markets

Indian equity and foreign exchange markets, unlike the debt and money markets, showed greater volatility in Q2 of 2011-12 than in the previous quarter. This mainly reflected risk aversion arising out of the deepening euro area sovereign debt crisis.

- **Spillover pressures witnessed in Indian equity and currency markets**

Taking cues from the global turmoil, Indian financial market segments that have a high degree of cross-border linkages turned volatile, while the other segments without strong linkages remained orderly. As a result, increased volatility was evidenced in the equity and currency markets since September 2011 .

In line with the global markets, the Indian equity prices continued their declining trend in Q2 of 2011-12. The rise in equity indices at the beginning of Q2 due to FII inflows could not sustain the momentum owing to global

developments and net sales by FIIs ensued. The two key Indian equity indices, Sensex and Nifty, declined (y-o-y) by about 14.5 per cent and 14.7 per cent, respectively, as on October 19, 2011. Nonetheless, the decline in Indian equity markets was relatively less than that in many emerging and developing economies (EDEs). P-E ratio of Indian equities remained higher than other EDEs as at end September 2011 **(Source: Bloomberg).**

- **FII investments decline**

FII investments declined during Q2 of 2011-12. FIIs made net sales in the equity segment while making net purchases in the debt segment. Mutual Funds (MFs) made net purchases in both equity and debt segments. The turnover in equity derivatives segment increased substantially over the year. FII investments in equity derivatives increased significantly during Q2 as compared to the previous quarter.

Resource mobilisation in the primary segment of the domestic capital market was lower during 2011-12 (up to September). Dampened secondary market conditions and poor performance of the IPOs after their listing also affected investor and promoter sentiment. Resource mobilisation by MFs, however, improved **(Source: SEBI, BSE, NSE).**

- **Bank CDS spreads widen following the downgrade of the largest PSB**

Credit rating agency Moody's downgraded the largest public sector bank (PSB) on October 4, 2011 on account of the asset quality and capital adequacy concerns. CDS spreads of that bank, which had started to widen sharply from early August, widened further by 10 bps that day. The difference in spreads between the largest private and public sector banks, which had seen range bound movements for most part of the previous quarter, widened in September 2011, partly reflecting investor concerns about contagion risk **(Source: Bloomberg).**

- **Money market tracks monetary policy signals**

The monetary policy stance continued to favour deficit liquidity conditions in Q2 of 2011-12 for effective monetary policy transmission. Against the backdrop of tight liquidity conditions in the system, the call rate rose at the beginning of Q2 and firmed up thereafter, in line with the 75 bps hike in the policy rate.

The call rate generally hovered around the policy (repo) rate during Q2. The money market remained orderly without exhibiting signs of stress.

Again, the collateralised segment (i.e. CBLO and market repo) accounts for more than 80per cent of the overnight money market volume and constitutes the bulk of money market. Reflecting active market conditions, the transaction volumes in this segment remained high. Banks and primary dealers continued to be the most significant borrowers, while the MFs continued as the major group of lenders followed by banks in this segment.

However, the share of MFs in the total lending declined significantly to below 50 per cent in Q2.

In the absence of credit funding pressures and given reasonable retail deposit mobilization in Q2, banks' issuance of certificates of deposits (CDs) declined. Consequently the rate of interest on CDs declined.

The average fortnightly issuance of commercial paper (CP) declined in Q2 of 2011- 12 (up to August) as compared to that of the previous quarter. 'Leasing and finance' and 'manufacturing companies' continued to be the major issuers of CPs.

Primary yields on Treasury Bills (TBs) firmed up consistent with the spurt in overnight rates during Q2 of 2011-12 . The upward movement in rates reflected the marked increase in Government short-term borrowing through issuance of TBs and cash management bills (CMBs) to finance unanticipated cash-flow mismatches coupled with tight liquidity conditions.

- **Additional market borrowing puts pressure on yields**

Yield movements, which remained generally range bound during July 1-September 28, 2011 rose thereafter, factoring in the announced increase in the Government's market borrowings by `52,872 crore over and above the amount budgeted for 2011-12. The hardening of primary yields was associated with an increase in the weighted average maturity during 2011-12 so far. Reflecting the impact of the unanticipated increase in Government market borrowing, the spread of 5-year corporate bonds over comparable G-secs decreased.

- **Monetary transmission strengthens with rates hardening in the credit market**

During Q2 of 2011-12, banks increased their deposit rates across all maturities, with the sharpest rise in maturities up to 1 year for all categories of banks. The increase in modal deposit and base rates for the quarter was about 40 bps and 75 bps, respectively.

- **The rupee depreciated significantly reflecting global uncertainty**

During April-July 2011, the Indian rupee exhibited two-way movement. However, since August 2011, it witnessed depreciation against all four major international currencies, reflecting prevailing global market sentiment led FII-sell-offs. Nevertheless, in comparison to some of the EDEs, the depreciation in the Indian rupee during Q2 of 2011-12 has been less stark. The average daily turnover in the merchant segment as well as interbank segment of the forex market was lower than that in the preceding quarter. The volume in value terms in the currency derivative market - both options and futures - which increased up to August 2011, showed some deceleration in September 2011.

- **Housing prices rise amidst falling transaction volumes in Q1 of 2011-12**

Despite falling volumes, property prices,

as captured by the **Reserve Bank's Quarterly House Price Index (HPI),** firmed up in Q1 of 2011-12. The price index increased by about 8 per cent for the second successive quarter at an all-India level, while the transactions volume index that had fallen sharply in Q2 and Q3 of 2010-11 dipped by about 7 per cent in Q1 of 2011-12 negating the increase in the preceding quarter. House prices increased in five of the seven major cities on a quarter-over-quarter basis in Q1 of 2011-12, but declined in Kolkata and remained flat in Chennai.

On the other hand, the data on volume of transactions show that the number of transactions have fallen in six cities, except Kolkata. On a y-o-y basis, there has been a rise in housing prices and fall in housing transactions in Q1 of 2011-12 in six cities, barring Chennai.

V. Conclusion

Growth in 2011-12 is likely to moderate to below trend. Agriculture prospects remain encouraging with the likelihood of a record Kharif crop. However, moderation is visible in industrial activity and some services, mainly construction and community, social and personal services. Given the linkage of domestic industrial growth with global cycle, capacity constraints seem to be easing in some manufacturing activity, especially cement, fertilizers and steel. Construction activity has slowed and leading indicators suggest that services growth may slightly weaken ahead.

Indications are that investment demand is softening as a result of combination of factors including monetary tightening, hindrances to project execution and deteriorating business confidence. Planned corporate fixed investment in new projects declined significantly since the second half of 2010-11. Consequently, the pipeline of investment is likely to shrink, putting 2012-13 growth at risk. Private consumption is also starting to soften in parts, but it still remains robust as is evident from corporate sales performance.

The Current Account Deficit (CAD) widened in Q1 of 2011-12. Exports are expected to decelerate in H2 of 2011-12. The Indian rupee has seen significant nominal and real depreciation in Q2 of 2011-12. However, this trend has been in line with that of other emerging market currencies, which too depreciated significantly as US dollar appreciated with flight to safety amidst rising risk aversion.

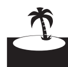
Though during Q2 of 2011-12, Base money has decelerated as currency growth moderated. Money (M3) growth, however, moderated less sharply as the money multiplier increased. Bank credit growth is also presently above the indicative trajectory. This has been supplemented by increased resource flows from non-banking sources.

The US sovereign rating downgrade and the deteriorating sovereign debt situation in the euro area caused significant pressures in global financial markets during Q2 of 2011-12. Rising

risk aversion caused credit spreads to widen, and most markets experienced increased volatility. Volatility spillovers impacted domestic equity and currency markets, but were contained by providing adequate rupee and forex liquidity. Rupee depreciation and the fall in equity indices in Q2 of 2011-12 were comparable to the patterns in most other emerging markets. Money market rates remained in line with policy signals, while G-sec yields hardened after the announcement of additional market borrowing.

Overall,upside risks to inflation persist in EDEs which have experienced elevated inflation for more than a year. Global commodity prices have eased, but the levels remain high, especially for crude oil. Financialisation of commodities has made the future commodity price path uncertain. With incomplete pass-through of the earlier rise in global commodity prices, the favorable impact, arising from the transmission of falling global commodity prices is also likely to be limited. Moreover, the benefit from the recent fall in global oil prices has been offset by rupee depreciation. Domestic price pressures still remain significant and broad-based. Food price inflation remains high as a result of structural mismatches in non-cereal primary food articles and large MSP revisions. Real wage inflation has been significant in 2010-11 and the wedge between wage inflation and CPI inflation has increased further in Q1 of 2011- 12. In sum, the inflation challenge remains significant.

Growth risks have increased on account of global headwinds and domestic factors. The baseline inflation path still remains sticky and broadly unchanged from earlier projections. This has made policy choices more complex. On the current assessment the growth in 2011-12 is likely to moderate slightly from that projected earlier. Various surveys conducted suggest that business expectations have suffered, while inflation expectations remain high. In this backdrop, any economic policy will need to be guided by the emerging growth-inflation dynamics even as transmission of the past actions is still unfolding.



Select Economic Indicators

Economic Growth

	Constant (2004-05) Prices		Current	
	2011-12	2010-11	2011-12	2010-11
	Q1	Q1	Q1	Q1
GDP at Factor Cost (Rs. in Crore)	1226339 (7.7)*	1138286 (8.8)*	1937123 (16.7)*	1659708 (21.3)*
GDP at Market Prices (Rs. in Crore)	1,315,395	1,937,123	2,061,940	1,755,341
Growth Rate (Per cent)				
Private Final Consumption Expenditure	60.5	61.7	58.1	58.7
Government Final Consumption Expenditure	10.4	11.1	10.5	11.1
Gross Fixed Capital Formation	31.2	31.4	28.4	29.2
Change in Stocks	3.5	3.6	3.4	3.5
Valuables	3.1	2.4	3.9	2.3
Exports	24.3	24.3	24	20.8
Less Imports	33	28.9	29.2	25.8
Discrepancies	-0.1	-2.5	1	0.2

* *Percentage Change over previous years.*

Source : Ministry of Statistics and Programme Implementation, Government of India. Estimates of Gross Domestic Product for First Quarter(April-June) of 2011-12.

Agriculture & Industrial Production

Sector-wise Percentage Change over Previous Year

Item	Constant (2004-05) Prices		Current Prices	
	2011-12	2010-11	2011-12	2010-11
	Q1	Q1	Q1	Q1
Agriculture, Forestry & Fishing	3.9	2.4	16.7	26.3
Industry				
Mining and Quarrying	1.8	7.4	14.4	26.9
Manufacturing	7.2	10.6	13.8	18.3
Electricity, Gas & Water Supply	7.9	5.5	8.2	12.7
Services				
Construction	1.2	7.7	10.7	19
Trade, Hotels, Transport and Communications	12.8	12.1	20.5	20.4
Financing Institutions, Real Estates & Business Services	9.1	9.8	19.1	21.2
Community, Social & Personal Services	5.6	8.2	15.3	21.1

Source : Ministry of Statistics and Programme Implementation, Government of India. Estimates of Gross Domestic Product for First Quarter(April-June) of 2011-12.

Agriculture & Industrial Production *(Contd.)*

Performance of Core-Industries		
Sector-wise Growth Rate (%) in Production (Weigth in IIP: 37.90%)	2011	2010
Overall Index	5.3	6.1
Coal	-2.4	0.6
Crude Oil	6.1	9.8
Natural Gas	-8.9	27.8
Petroleum Refinery Products	4.7	5.3
Fertilizers	1.2	-2.8
Steel	9.3	6.6
Cement Production	2.8	4.6
Electricity	9.3	4.5

Overall Indices form April-August 2010 & 2011.

Source: Office of the Economic Advisor, GoI.

External Sector

Exports and Imports (in US $ million)

Item	2009-10 (Apr-Mar)	2010-11 (Apr-Mar)	July-11	July-11	% Change in July 2011
Exports	178751	245868	16142	29344	81.8
Imports	288373	350695	26681	29213	51.5
Oil Imports	87136	101689	25883	11445	37.0
Non-Oil Imports	201237	249006	18328	28981	58.1
Trade Balance	-109621	-104827	-10539	-11082	–

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

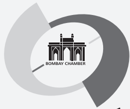
Foreign Currency Assets

	Amount		Variation	
	Rs. Crore	US $ Million	Rs. Crore	US $ Million
At the end of			(over last year)	
March 2008	1196023	299230	359426	107306
March 2009	1231340	241676	35317	-57554
March 2010	1150778	254935	-80562	13259
March 2011	1225999	274580	75221	19645
2011-12			(over last month)	
April 2011	1252790	282287	26791	7707
May 2011	1259881	279787	7091	-2500
June 2011	1268744	283708	8863	3921
July 2011	1264787	286410	-3957	2702
August 2011	1317478	286284	52691	-126

Source: Reserve Bank of India, GoI.

Rupees Per Unit of Foreign Currency*				
	US Dollar	Pound Sterling	Japanese Yen	Euro
March 2008	40.3561	80.8054	0.4009	62.6272
March 2009	51.2287	72.9041	0.5251	66.9207
March 2010	45.4965	68.4360	0.5018	61.7653
March 2011	44.9684	72.7070	0.5498	62.9660
2011-12				
April 2011	44.3700	72.7237	0.5331	64.2505
May 2011	44.9045	73.4103	0.5532	64.4833
June 2011	44.8295	72.7881	0.5565	64.5157
July 2011	44.4174	71.6485	0.5591	63.4602
August 2011	45.2538	74.1083	0.5868	64.9380

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



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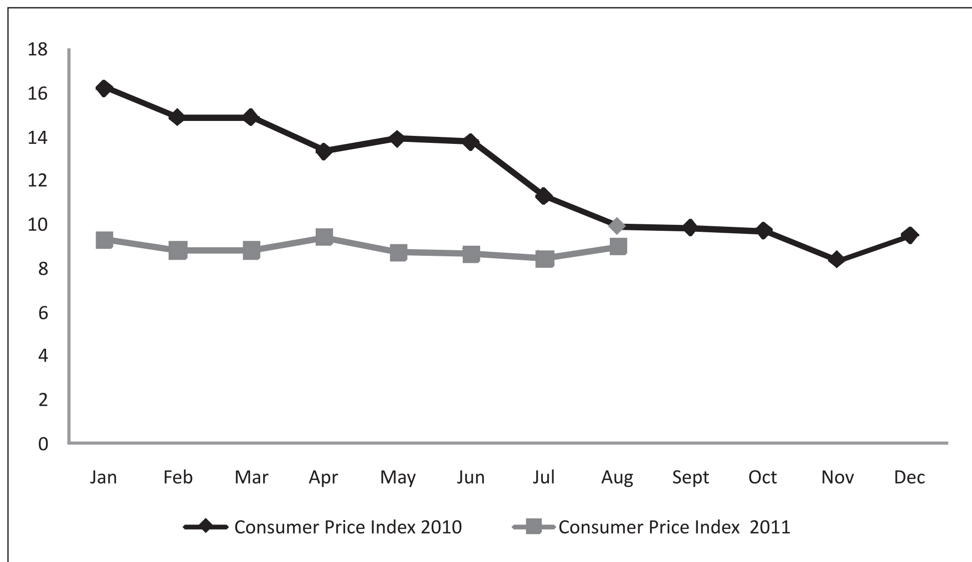
Prices

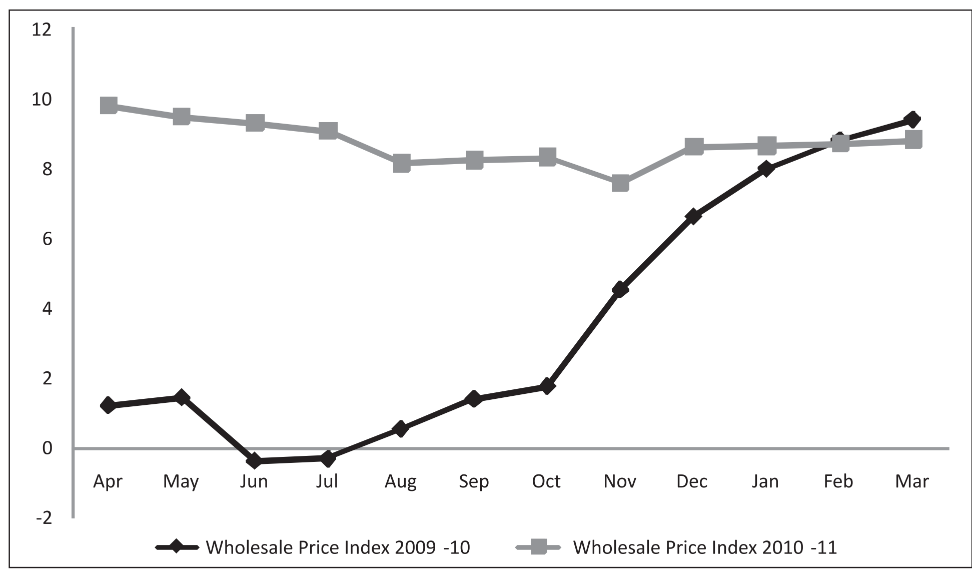
Current Price Situation based on Monthly Wholesale Price Index in September, 2010 (Base: 2004-05=100)							
Items/Groups	Weight(%)	Latest Month over Month		Build up From March		Year on Year	
		2010-11	2011-12	2010-11	2011-12	2010-11	2011-12
All Commodities	**100**	**0.64**	**0.58**	**4.18**	**4.21**	**8.98**	**9.72**
Primary articles	20.11	1.97	1.3	8.98	7.44	18.17	11.84
Food Articles	14.33	1.81	1.45	9.96	9.78	16.29	9.23
Fuel and Power group	14.91	-0.27	0.84	5.35	6.85	11.06	14.09
Manufactured Products	64.97	0.31	0.22	1.98	2.21	4.98	7.69

Point to Point Rate of Growth

CPI (Base Rate 2001 = 100)



WPI (Base - 2004-05 = 100)



World Prices of Select Commodities

Commodity	Unit	Annual Averages			Monthly Averages		
		Jan-Dec 2009	Jan-Dec 2010	Jan-Aug 2011	Jun 2010	Jul 2011	Aug 2011
Energy							
Coal, Australia	$/mt	71.84	98.97	123.22	119.28	120.00	118.80
Crude Oil, average	$/bbl	61.76	79.04	104.73	105.85	107.92	100.49
Crude oil, Brent	$/bbl	61.86	79.64	111.57	113.76	116.46	110.09
Crude oil, Dubai	$/bbl	61.75	78.06	105.99	107.52	109.98	105.06
Crude oil, West Texas Int.	$/bbl	61.65	79.43	96.62	96.25	97.31	86.32
Natural gas, US	$/mmbtu	8.71	8.29	10.13	10.26	10.99	10.81
Agriculture							
Coffee, robusta	¢/kg	317.1	432.0	619.5	606.2	590.9	595.2
Tea, auctions(3), average	¢/kg	272.4	288.5	297.4	301.8	310.1	304.0
Food							
Coconut oil	$/mt	725	1124	1916	1803	1662	1454
Copra	$/mt	480	750	1284	1186	1121	985
Groundnut oil	$/mt	1184	1404	1860	1980	2120	2100
Palm oil	$/mt	683	901	1171	1133	1089	1083
Palm kernel oil	$/mt	700	1184	1845	1765	1371	1375
Soybean meal	$/mt	408	378	414	394	400	401
Soybean oil	$/mt	849	1005	1331	1324	1337	1330
Soybeans	$/mt	437	450	560	558	559	558
Grains							
Barley	$/mt	128.3	158.4	205.5	210.1	210.1	206.1
Maize	$/mt	165.5	185.9	299.6	310.6	310.6	310.2
Rice,Thailand, 5%	$/mt	458.1	441.5	475.6	473.8	473.8	531.7
Wheat, Canada	$/mt	300.5	312.4	456.4	486.8	486.8	434.9
Sugar, world	¢/kg	40.0	46.9	58.7	55.6	55.6	61.2
Raw Materials							
Logs, Malaysia	$/cum	287.2	278.2	375.7	417.6	417.6	450.0
Plywood	¢/sheets	564.6	569.1	600.9	607.7	607.7	619.2
Cotton A Index	¢/kg	138.2	228.3	381.4	317.8	317.8	251.5
Rubber, RSS3	¢/kg	192.1	365.4	531.4	493.8	493.4	467.6
Metals and Minerals							
Aluminium	$/mt	1665	2173	2530	2558	2525	2379
Copper	$/mt	5150	7535	9387	9067	9650	9001
Gold	$/toz	973	1225	1500	1529	1572	1757
Iron ore, spot, cfr China	$/dmt	80.0	145.9	176.7	170.9	173.0	177.5
Steel cr coilsheet	$/mt	783	816	888	900	900	900

Source: World bank-The Pink Sheet.

Government Accounts

Trends in Central Government Finances: April-Feburary 2010-11

	Budget Estimates	April-Feburary		Col. 3 as % of	Col.4 as % of	% Change over preceeding year	
	2011-12	2010-11	2011-12	2010-11 BE	2011-12 BE	2010-11	2011-12 (4/3)
(Rs. Crore)							
1. Revenue Receipts	**7,89,892**	**238,524**	**137,155**	**35.0**	**17.4**	**126.4**	**-42.5**
Gross Tax Revenue	**9,32,440**	**173,444**	**190,463**	**23.2**	**20.4**	**27.5**	**9.8**
Tax(net to Centre)	6,64,457	112,821	114,078	21.1	17.2	30.7	1.1
Non Tax	1,25,435	125,703	23,077	84.9	18.4	559.2	-81.6
2. Capital Receipts of which:	**4,67,837**	**94,176**	**238,010**	**22.1**	**50.9**	**-41.1**	**152.7**
Recovery of Loans	15,020	2,103	8112.0	41.0	54.0	60.3	285.7
Other Receipts	40,000	1,158	1,145	3	3	-1	
Borrowings and Other Liabilities	4,12,817	90,915	228,753	23.8	55.4	-42.7	151.6
3. Total Receipts(1+2)	**12,57,729**	**332,700**	**375,165**	**30.0**	**29.8**	**25.4**	**12.8**
4. Non-Plan Expenditure (a)+(b)	**8,16,182**	**222,900**	**263,497**	**30.3**	**32.3**	**14.4**	**18.2**
(a) Revenue Account of which:	7,33,558	194,141	234,595	30.2	32.0	7.2	20.8
Interest Payments	2,67,986	58,376	67,541	23.5	25.2	12.0	15.7
Major Subsidies	1,34,211	41,914	47,440	31.2	35.3	-15.0	13.2
Pensions	54,521	15,403	19,907	36.0	36.5	21.9	29.2
(b) Capital Account	82,624	28,759	28,902	31.2	35.0	109.6	0.5
5. Plan Expenditure (i) +(ii)	**4,41,547**	**109,800**	**111,668**	**29.4**	**25.3**	**56.0**	**1.7**
(i) Revenue Account	3,63,604	94,458	97,480	30.0	26.8	60.1	3.2
(ii) Capital Account	77,943	15,342	14,188	26.5	18.2	35.0	-7.5
6. Total Expenditure (4)+(5)=(a)+(b)	**12,57,729**	**332,700**	**375,165**	**30.0**	**29.8**	**25.4**	**12.8**
(a) Revenue Expenditure	10,97,162	288,599	332,075	30.1	30.3	20.2	15.1
(b) Of which Grants for Creation of Capital Assets	1,46,853	10,916	30,539	34.9	20.8	75.8	179.8
(c Capital Expenditure	160,567	44,101	43,090	29.4	26.8	-62.8	-2.3
7. Revenue Deficit	**307,270**	**50,075**	**194,920**	**18.1**	**63.4**	**-42.7**	**289.3**
8. Effective Revenue Deficit	**1,60,417**	**39,159**	**164,381**	**16.0**	**102.5**	**-69.4**	**319.8**
8. Fiscal Deficit	**4,12,817**	**90915.0**	**228753.0**	**23.8**	**55.4**	**126.4**	**151.6**
9. Primary Deficit	**1,44,831**	**32,539**	**161,212**	**24.5**	**111.3**	**27.5**	**395.4**

Source: Review of Union Government Accounts, Apr-Jul 2011, Ministry of Finance, GoI.

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Money & Banking

Money Stock - Components and Sources (Rs. Crore)

Item	Outstanding as on		Variation over			
	2011		Financial Year so Far		Year on Year	
	Mar.31	Aug.26	2010-11	2011-12	2010	2011
M3	64,99,548	68,35,013	4.5	5.2	15.6	16.7
Components (i+ii+iii+iv)						
(i) Currency with the Public	9,14,197	9,42,873	7.3	3.1	21.2	14.5
(ii) Demand Deposits with Banks	7,17,660	6,34,861	–5.6	–11.5	13.8	–6.3
(iii) Time Deposits with Banks	48,63,979	52,53,667	5.7	8.0	14.9	20.8
(iv) "Other" Deposits with Reserve Bank	3713	3611	4.4	–2.7	–26.3	–9.9
Sources (i+ii+iii+iv)						
(i) Net Bank Credit to Government (a+b)	19,82,771	21,49,286	5.9	8.4	23.1	21.5
(a) Reserve Bank	3,96,555	3,68,132				
(b) Other Banks	15,86,216	17,81,155				
(ii) Bank Credit to Commercail Sector (a+b)	42,35,406	43,35,825	3.7	2.4	18.9	19.7
(a) Reserve Bank	2164	1839	—	—	—	—
(b) Other Banks	42,33,242	43,33,987	3.7	2.4	19.3	19.7
(iii) Net Foreign Exchange Assets of Banking Sector*	13,93,327	14,95,774	4.2	7.4	–2.7	12.0
(iv) Government's Currency Liabilities to the Public	12724	12959	5.5	1.8	13.2	9.0
(v) Banking Sector's Net Non- Monetary Liabilities	11,24,680	11,58,832	3.7	3.0	10.5	31.4
of which:						
Net Non-Monetary Liabilities of RBI	3,68,274	4,46,303	12.5	21.2	–18.4	31.5

** : Includes Investments in foreign currency denominated bonds issued by IIFC(UK) since March 20, 2009.*
Note: Government balances as on March 31, 2011 are after closure of accounts.

Select Scheduled Commercial Banks - Business in India

Item	2011-12 Outstanding as on (Rs.Crore)		Percentage Variation			
			Financial Year So Far		Year on Year	
	March 25, 2011	August 26, 2011	2009-10	2010-11	2010	2011
1. Bank Credit	3,938,659	4,044,862	3.4	2.6	19.5	20.6
Non-Food Credits	3,874,376	3,971,280	3.5	2.5	19.8	20.2
2. Aggregate Deposits	5,204,703	5,509,100	4.0	5.8	14.5	17.9
3. Investments in Govt. and other approved securities	1,500,039	1,700,423	6.7	13.2	8.2	15.1

Policy Rates/ Interest Rates (per cent per annum)

Item/Week Ended	2011	2011
	Sep 3	Sep2
Cash Reserve Ratio (per cent) (1)	6.00	6.00
Bank Rate	6.00	6.00
Repo Rate	5.75	8.25*
Reverse Repo Rate	4.50	7.25*
Prime Lending Rate (2)	7.50/8.00	10.00/10.75
Deposit Rate (3)	6.75-7.75	8.50-9.50
Call Money Rate (Low/High) (4)		
– Borrowings	4.83	8.01
– Lendings	4.83	8.01

(1) Cash Reserve Ratio relates to the Scheduled Commercial Banks (exclusing 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.

Notes for Contributors

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