

Reserve bank of india – annual report

[Finance](#), [Banks](#)



Report of the Central Board of Directors on the working of the Reserve Bank of India for the year ended June 30, 2011 submitted to the Central Government in terms of Section 53(2) of the Reserve Bank of India Act, 1934

RESERVE BANK OF INDIA ANNUAL REPORT 2010-2011 CENTRAL BOARD /

LOCAL BOARDS GOVERNOR D. Subbarao DEPUTY GOVERNORS Shyamala

Gopinath¹ Usha Thorat² K. C. Chakrabarty Subir Gokarn Anand Sinha³ H. R.

Khan⁴ MEMBERS OF LOCAL BOARDS WESTERN AREA Y. H. Malegam K.

Venkatesan Dattaraj V. Salgaocar Jayantilal B.

Patel DIRECTORS NOMINATED UNDER SECTION 8 (1) (b) OF THE RBI ACT,

1934 Y. H. Malegam Suresh D. Tendulkar⁵ U. R. Rao Lakshmi Chand

DIRECTORS NOMINATED UNDER SECTION 8 (1) (c) OF THE RBI ACT, 1934 H.

P. Ranina Azim Premji Kumar Mangalam Birla Shashi Rajagopalan⁶ Suresh

Neotia A. Vaidyanathan M. M. Sharma Sanjay Labroo EASTERN AREA Suresh

D. Tendulkar⁵ A. K. Saikia Sovan Kanungo Md. Sohrab⁹ NORTHERN AREA

Mitha Lal Mehta¹⁰ U. R. Rao Ram Nath Pritam Singh Kamal Kishore Gupta¹¹

Mihir Kumar Moitra¹²

DIRECTOR NOMINATED UNDER SECTION 8 (1) (d) OF THE RBI ACT, 1934

Ashok Chawla⁷ R Gopalan⁸ 1 2 3 4 5 6 Term expired on June 20, 2011 Term

expired on November 9, 2010 Assumed office on January 19, 2011 Assumed

office on July 4, 2011 Expired on June 21, 2011 Expired on August 5, 2011

SOUTHERN AREA Lakshmi Chand C. P. Nair M. Govinda Rao Devaki Jain⁷ 8 9

10 11 12 Retired on January 31, 2011 Appointed on February 15, 2011

Ceased to be in Office w. e. f. May 13, 2011 Term ended on September 23,

2010 Appointed on August 26, 2010 Appointed on September 24, 2010

Position for the year 2010-11 (updated till August 11, 2011)

<https://assignbuster.com/reserve-bank-of-india-annual-report/>

PRINCIPAL OFFICERS (As on August 11, 2011) EXECUTIVE DIRECTORS

.....
.....
.....
.....
.....
.....
.....
.....
.....
.....

..... V. K. Sharma V. S. Das G.
Gopalakrishna Deepak Mohanty S. Karuppasamy R. Gandhi P. Vijaya Bhaskar
B. Mahapatra G. Padmanabhan Rajesh Verma, Chief General Manager
Deepak Singhal, Chief General Manager-in-Charge G. Jaganmohan Rao, Chief
General Manager-in-Charge A. I. Killawala, Press Relations Officer (Gr. F) N.
Krishna Mohan, Chief General Manager B. M. Misra, Officer-in-Charge Deepa
Srivastava, Chief General Manager M. S. Deb, Chief General Manager A. K.
Bera, Chief General Manager-in-Charge A. S.

Ramasastri, Chief General Manager Uma Subramaniam, Chief General
Manager-in-Charge Vijay Chugh, Chief General Manager A. B. Chakraborty,
Officer-in-Charge G. Mahalingam, Chief General Manager Rabi N. Mishra,
Chief General Manager Meena Hemchandra, Chief General Manager-in-
Charge Sandip Ghose, Chief General Manager-in-Charge Karuna Sagar, Chief
General Manager K. K. Vohra , Chief General Manager G. S. Hegde, Principal
Legal Adviser Janak Raj, Adviser-in-Charge K. R. Ananda, Chief General

Manager Ramakant K. Gupta, Deputy General Manager Deepali Pant Joshi,
Chief General Manager-in-Charge Grace E.

Koshie, Chief General Manager & Secretary A. Udgata, Chief General
Manager-in-Charge Kaza Sudhakar PRINCIPALS Kamala Rajan J. Sadakkadulla
REGIONAL DIRECTORS N. S. Vishwanathan Salim Gangadharan J. B. Bhorla
Chandan Sinha Sudarshan Sen Uma Shankar P. K. Panda B. K. Bhoi Jasbir
Singh Surekha Marandi A. S. Rao B. P. Kanungo K. K. Saraf Bazil Shaikh
Amarendra Sahoo Phulan Kumar M. K. Singh Suma Varma OFFICERS-IN-
CHARGE A. K. Pandey, General Manager S. Bhatnagar, General Manager V. S.
Bajwa, General Manager E. E. Karthak, General Manager C. V. George,
General Manager M. A. R.

Prabhu, General Manager Nirmal Chand, General Manager H. N. Panda,
General Manager R. Gurumurthy, General Manager D. P. Sharma, Deputy
General Manager CENTRAL OFFICE Customer Service Department
..... Department of Banking Operations
and Development Department of Banking Supervision
..... Department of Communication
..... Department of Currency
Management

Department of Economic and Policy Research
Department of Expenditure and Budgetary Control
Department of External Investments and Operations
Department of Government and Bank Accounts
Department of Information Technology

Department of Non-Banking Supervision	
Department of Payment and Settlement Systems	
Department of Statistics and Information Management	
Financial Markets Department	
Financial Stability Unit	
Foreign Exchange Department	
Human Resource Management Department	
Inspection Department	
Internal Debt Management Department	
Legal Department	
Monetary Policy Department	
Premises Department	
Rajbhasha Department	Rural
Planning and Credit Department	Secretary's
Department	
Urban Banks Department	CHIEF
VIGILANCE OFFICER	COLLEGES
College of Agricultural Banking, Pune	
Reserve Bank Staff College, Chennai	
OFFICES Chennai	
.....	Kolkata
.....	

Mumbai New
Delhi
BRANCHES Ahmedabad
..... Bangalore
..... Bhopal
.....
Bhubaneswar

Chandigarh
Guwahati
Hyderabad
Jaipur
Jammu
Kanpur

Lucknow
Nagpur
Patna
Thiruvananthapuram
.....
Agartala

Belapur
Dehradun
Gangtok
Kochi

Panaji

Raipur

Ranchi

Shimla

Srinagar

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157 LIST OF ABBREVIATIONS AACS AD ADB A. E. AEs ALM AMA AML ASEAN

Advanced Access Content System Authorised Dealer Asian Development

Bank Advance Estimates Advanced

Economies Assets Liability Management Advance Measurement Approach

Anti Money Laundering Association of Southeast Asian Nations CCP

ASSOCHAM ATBs ATM BC BCBS BCP BCSBI BE BFS BI BIFR BIS BO BPL BPLR

bps BPSS BRBNMPL BSE BWA CAB CACP CAD CAFL Associated Chambers of

Commerce and Industry of India Auction Treasury Bills Automated Teller

Machine CDR Business Correspondent CDs Basel Committee on Banking

Supervision Business Continuity Planning Banking Codes and Standards

Board of India Budget Estimates Board for Financial Supervision Business

Intelligence Board for Industrial and Financial Reconstruction Bank for

International Settlements Banking Ombudsman Below Poverty Line

Benchmark Prime Lending Rate Basis Points Board of Payment and

Settlement System Bharatiya Reserve Bank Note Mudran Private Limited
Bombay Stock Exchange Broadband Wireless Access Current Account
Balance Commission for Agricultural Costs and Prices Current Account Deficit
Centre for Advanced Financial Learning CPSUs CRA CRAR CRCS CRM CPIO
CPIOs CPSS CPI CPI-IW CDS CGA CIC CII CIP CMBs CODs CoR CP CPADS Credit
Default Swap Controller General of Accounts Core Investment Company
Confederation of Indian Industry Central Issue Price Cash Management Bills
Central Office Department Certificate of Registration Commercial Paper
Centralised Public Account Department Systems Consumer Price Index
Consumer Price Index for Industrial Workers Chief Public Information Officer
Central Public Information Officers Committee on Payment and Settlement
Systems Central Public Sector Undertakings Credit Rating Agencies Capital to
Risk-weighted Assets Ratio Central Registrar of Co-operative Societies
Customer Relationship Management Certificates of Deposit Corporate Debt
Restructuring CCs CDBS Central Counter Parties Currency Chests Currency
Disintegration and Briquetting System CAS CBLO CBRC CBS CCBs CCIL
CAFRAL Centre for Advanced Financial Research and Learning Central
Account Section Collateralized Borrowing and Lending Obligation China
Banking Regulatory Commission Core Banking Solutions Central Cooperative
Banks Clearing Corporation of India Ltd. viii LIST OF ABBREVIATIONS CRR CSF
CSO CTS CVPS DCCBs DEPR DGA DGCI DICGC DIF DIT DR DRM DSIM DSS
DTC DTL DWM EBT ECB ECCS ECS EKP EMDEs EMEs EMS ERER ETL FAO FC
FCI Cash Reserve Ratio Consolidated Sinking Fund Central Statistics Office
Cheque Truncation System Currency Verification and Processing System
District Central Co-operative Banks Department of Economic and Policy

Research Duration Gap Analysis FITF Directorate General of Commercial Intelligence and Statistics Deposit Insurance and Credit Guarantee Corporation Deposit Insurance Fund Department of Information Technology Disaster Recovery Dispute Resolution Mechanism Department of Statistics and Information Management Decision Support Systems Direct Tax Code Demand and Time Liabilities Dynamic Working Model Electronic Benefit Transfer External Commercial Borrowings Express Cheque Clearing System Electronic Clearing Services Enterprise knowledge Portal Emerging Market and Developing Economies Emerging Market Economies Estate Management System Equilibrium Real Exchange Rate Extract Transform and Load Food and Agriculture Organization Finance Commission Food Corporation of India GFCF GFD GoI FLCCs FMC FMD FMI FPS FRAs FRBM FRBs FRLs FSB FSDC FSF FST GCC GCF GDP GDS GFCE FII FIIs FIMMDA Financial Inclusion Technology Fund Financial Inclusion Index Foreign Institutional Investors Fixed Income Money Market and Derivatives Association of India Financial Literacy and Credit Counseling Centres Forwards Markets Commission Financial Market Department Financial Market Infrastructures Fair Price Shops Forward Rate Agreements Fiscal Responsibility and Budget Management Floating Rate Bonds Fiscal Responsibility Legislations Financial Stability Board Fiscal Stability and Development Council Financial Stability Forum Financial Sector Technology General Purpose Credit Cards Gross Capital Formation Gross Domestic Product Gross Domestic Savings Government Final Consumption Expenditure Gross Fixed Capital Formation Gross Fiscal Deficit Government of India FCNR(B) FDI FEMA FI FICCI FIF FCMD Financial Conglomerates Monitoring Division Foreign Currency Non-Resident Accounts (Banks) Foreign

Direct Investment Foreign Exchange Management Act Financial Institutions
 Federation of Indian Chambers of Commerce & Industry Financial Inclusion
 Fund ix LIST OF ABBREVIATIONS

GPS GRF G-sec GST HLCCFM HTM IADI IAS IBA ICCL ICOR ICT IDRBT IES IFCs
 IFRS IFTP IGIDR IIBM IIFCL IIM IIP IIT IMD IMF INFINET IOSCO IPCs IRDA IRF IRS
 Global Positioning System Guarantee Redemption Fund Government
 Securities Goods and Services Tax High Level Coordination Committee on
 Financial Markets Held to Maturity International Association of Deposit
 Insurance Integrated Accounting System Indian Banks Association Indian
 Clearing Corporation Limited Incremental Capital Output Ratio Information
 and Communication Technology Institute for Development and Research in
 Banking Technology Integrated Establishment System Infrastructure Finance
 Companies International Financial Reporting Standards Inter-bank Funds
 Transfer Processor Indira Gandhi Institute of Development Research Indian
 Institute of Bank Management India Infrastructure Finance Company Ltd.
 Indian Institute of Management Index of Industrial Production Indian Institute
 of Technology India Meteorological Department International Monetary Fund
 Indian Financial Network International Organisation of Securities
 Commissions Irrevocable Payment Commitments Insurance Regulatory and
 Development Authority Interest Rate Futures Interest Rate Swaps IT ITBs
 ITeS JLG JV/WOS KCCs KVP KYC LABs LAF LAN LC LCR LTV M3 MCX MCX-SX
 MENA MFIs MFs MIBOR MICR MIS MMS MoF MoU MPLS MQRs MSE MSF MSME
 MSP MSS MURI ISMS ISO Information Security Management System
 International Organisation for Standardisation Information Technology

Intermediate Treasury Bills Information Technology enable Services Joint Liability Group Joint Ventures/ Wholly Owned Subsidiaries Kisan Credit Cards Kisan Vikas Patra Know Your Customer Local Area Banks Liquidity Adjustment Facility Local Area Network Letter of Credit Liquidity Coverage Ratio Loan to Value Ratio Broad Money Multi Commodity Exchange MCX Stock Exchange Middle East and North Africa Micro-Finance Institutions Mutual Funds Mumbai Inter-bank Offered Rate Magnetic Ink Character Recognition Management Information System Mail Messaging Solution Ministry of Finance Memorandum of Understanding Multi Protocol Label Switching Mid Quarter Reviews Micro and Small Enterprises Marginal Standing Facility Micro, Small and Medium Enterprises Minimum Support Prices Market Stabilisation Scheme Minimum Unemployment Rate of Inflation

x LIST OF ABBREVIATIONS

NAB NABARD NAIRU NASSCOM NBFCs NBS NCAF NCD NDF NDTL NECS NEFT NEL NFA NFSB NHB NIBM NIM NOC NOF NPAs NPS NR(E)RA NREGA NRIs NSC NSCCL NSE NSFR NSM NSSF NSSO OBCs New Agreements to Borrow National Bank for Agriculture and Rural Development Non-Accelerating Inflation Rate of Unemployment National Association of Software and Services Company Non-Banking Financial Companies Nutrient Based Subsidy Net Capital Adequacy Framework Non-Convertible Debenture Non-Deliverable Forwards Net Demand and Time Liabilities National Electronic Clearing Services PDS National Electronic Fund Transfer Net External Liabilities Net Foreign Currency Assets National Food Security Bill National Housing Bank National Institute of Bank Management Net Interest Margin No Objection Certificate Net Owned Fund Non-Performing Assets New Pension Scheme Non-Resident

(External) Rupee Account National Rural Employment Guarantee Act Non Resident Indians National Savings Certificate National Security Clearing Co-operation Limited National Stock Exchange Net Stable Funding Ratio Note Sorting Machines National Small Savings Fund National Sample Survey Office Other Backward Classes RCS RD RE RECS REER RIA RIDF RNBCs ROs PI PIOs PNs POS PPP PSS Q. E.

QIS RBI RBSC RCCP PFCE PGPBF Public Distribution System Private Final Consumption Expenditure Post Graduate Programme in Banking and Finance Participant Interface Persons of Indian Origin Participatory Notes Points of Sale Public-Private Partnership Payment and Settlement System Quick Estimates Quantitative Impact Study Reserve Bank of India Reserve Bank Staff College Recommendations for Central Counterparties Registrar of Co-operative Societies Revenue Deficit Revised Estimates Regional Electronic Clearing Service Real Effective Exchange Rate Right to Information Act Rural Infrastructure Development Fund Residuary Non-Banking Companies Regional Offices OD OIS OLS OMO ORFS OTC OTS PACS PAD PAR PCR PDO-NDS Over Draft Overnight Index Swap Ordinary Least Square Open Market Operation Online Return Filing System Over-the-Counter One Time Settlement Primary Agricultural Credit Societies Public Account Department Performance Appraisal Reports Provisional Coverage Ratio Public Debt Office-Negotiated Dealing System xi LIST OF ABBREVIATIONS

RoA RoE RR RRBs RSSS RTGS RTI SACP SCBs SCEPR SCs SCSS SDL SEBI SEZ SGL SHG SIDBI SIFI SLAF SLBC SLR SMEs SPMCIL SPVs Return on Assets Return on Equity Revenue Rules Regional Rural Banks Recommendations for

Securities Settlement Systems Real Time Gross Settlement Right to Information Special Agricultural Credit Plan Scheduled Commercial Banks Steering Committee on Economic and Policy Research Scheduled Castes Senior Citizens' Saving Scheme State Development Loan Securities and Exchange Board of India Special Economic Zone Subsidiary General Loan Self-Help Group Small Industries Development Bank of India Systemically Important Financial Institutions Second Liquidity Adjustment Facility State Level Bankers Committees Statutory Liquidity Ratio Small and Medium Enterprises Security Printing and Minting Corporation of India Special Purpose Vehicles STC StCBs STCRC STOs STs TAC TAFcUBs TAG T-Bills TGA UCBS USE UTs VAR VAT VECM VGF VVVF WMA WPI XBRL XML Y-o-Y ZCBs ZCYC ZTCS ST CCS Short-term Rural Cooperative Credit Societies Short-term Trade Credit State Co-operative Banks Short-term Co-operative Rural Credit Sub Treasury Officers Scheduled Tribes Technical Advisory Committee Task Force for Cooperative Urban Banks Technical Advisory Group Treasury Bills Traditional Gap Analysis Urban Cooperative Banks United Stock Exchange Union Territories Vector Auto Regression Value Added Tax Vector Error Correction Mechanism Viability Gap Funding Variable Voltage Variable Frequency Ways and Means Advances Wholesale Price Index Extensible Business Reporting Language Extensive Mark Up Year on Year Zero Coupons Bonds Zero Coupon Yield Curve Zonal Training Centres This Report can also be accessed on Internet URL : www.rbi.org.in xii THE ANNUAL REPORT ON THE WORKING OF THE RESERVE BANK OF INDIA For the Year July 1, 2010 to June 30, 2011* PART ONE: THE ECONOMY – REVIEW AND PROSPECTS I ASSESSMENT AND PROSPECTS The Indian economy returned to a high

growth path in 2010-11. However, challenges emerged as the year progressed.

First, investment activity slowed in the second half of the year as business confidence was impacted by high commodity prices, tight monetary policy, political factors and execution issues. Second, while headline fiscal numbers improved during the year, the improvement was led by cyclical and one-off factors, leaving its sustainability in question. Third, though monetary policy was tightened through the year, inflation remained sticky on the back of new pressures. It also turned broad-based in the later part of the year with cost-push and demand-pull factors feeding into producer prices. This prompted the Reserve Bank to take aggressive policy actions during May-July 2011. Going ahead, global uncertainty, sticky inflation, hardening interest rates and high base, especially for agriculture, could moderate growth in 2011-12.

On the other hand, though global commodity prices appear to have plateaued, inflation is likely to be elevated in near term and fall only towards the later part of the year as monetary transmission works through further.

For medium-term growth sustainability, it is important to rebalance demand from private and government consumption to private and public investment, while inflation is lowered on an enduring basis through better supply responses. Continued focus on development of infrastructure and agriculture technology through public policy would facilitate improved supply response.

I. 1 The Indian economy rebounded strongly in 2010-11 from the moderation induced by global financial crisis. However, several macroeconomic factors posed new challenges in 2010-11.

During the preceding year and a half, the Reserve Bank had to carefully calibrate its monetary policy as the global financial crisis and the consequent slowdown in the global growth adversely impacted India's real and financial economic conditions. Both, fiscal and monetary policies worked in tandem to pull the Indian economy quickly and firmly out of the slowdown. 1. 2 Even as growth reverted to its trend, new challenges emerged. First, the headline inflation accelerated from the negative levels in mid-2009 to double digits during March-July of 2010. The whole of 2010-11 was marked by inflation persistence, with headline inflation averaging 9. 6 per cent. The Reserve Bank responded to the inflation challenge by raising repo rate seven times during the year by 25 basis points (bps) each.

Despite these actions, inflation remained elevated due to both newer supply-side shocks and demand factors. As input costs rose and were passed on substantially amidst strong consumption demand, inflation became generalised since December 2010. 1. 3 In response to the generalisation, the Reserve Bank raised its policy rate - the repo rate - more aggressively in 2011-12. It hiked the rate by 50 bps in * While the Reserve Bank of India's accounting year is July-June, data on a number of variables are available on a financial year basis, i. e. , April-March, and hence, the data are analysed on the basis of the financial year. Where available, the data have been updated beyond March 2011 based on information available till mid-August.

For the purpose of analysis and for providing proper perspective on policies, reference to past years as also prospective periods, wherever necessary, has been made in this Report. 1 ANNUAL REPORT May, 25 bps in June and again

by 50 bps in July. With this, operational policy rate has been raised by 475 bps in less than 17 months since March 2010, when the rate hikes began. Monetary transmission improved considerably in the latter half of 2010-11 after sustained tight liquidity prompted banks to raise deposit and lending rates. It continued into 2011-12, helping avert inflation gathering further momentum amidst high inflation expectations and persistence of pricing power of the producers, reflecting strong demand. I. Second, even as overall GDP growth increased supported by strong private consumption demand, investment slowed down during the second half of 2010-11 and has shown no signs of improvement yet. Considering that investment intentions in the new projects declined significantly in the second half of 2010-11 on a sequential basis, maintaining corporate investment levels in 2011-12 could turn out to be difficult. Corporate fixed investment, as captured by phasing details of the projects sanctioned financial assistance, which showed a seven fold jump during 2003-04 to 2009-10, also turned flat in 2010-11, with a sharp dip in the second half. Public investment in relation to the size of the economy declined during 2008-09 and 2009-10.

With revenue deficit, despite some improvement during 2010-11 remaining above the levels that prevailed during 2004-05 to 2007-08, fiscal space to support investment in the economy remains limited. This underscores the importance of focusing on quality of fiscal consolidation. Meanwhile, in an uncertain interest rate environment, it remains to be seen how far the momentum in investment can be sustained ahead. As such, in the short run, investment cycle can be elongated by focusing on better execution of pipeline investment and improved governance at all levels, internal and

external to a firm. Why did inflation persist and was this predictable? I. The year 2010-11 was marked by strong inflation exhibiting persistence on the back of elevated inflation expectations, spike in vegetable prices with unseasonal rains post-monsoon and rising global commodity prices that resulted in significant cost-push and demand-pull pressures since December 2010. Drivers of inflation changed during 2010-11. Food products were the main drivers of price rise during April-July 2010, accounting for about two-fifths of increase in WPI. Their share declined during August-November, when non-food primary products turned out to be the main drivers. However, these price pressures spilled over to manufactured non-food products during December 2010-March 2011, which accounted for 61 per cent of the price rise in this period. I. 7 Inflation became difficult to predict in face of this changing pattern, where new unforeseen price pressures emerged.

The declining trend in inflation during first half of 2010-11 was disrupted by sharper-than-expected rise in global commodity prices and structural factors constraining the decline in food prices in spite of normal monsoon. An unforeseen spike in vegetable prices due to unseasonal rains followed the good monsoon. Finally, as inflation spilled over to the manufactured non-food products, producers were able to pass on a large share of the input cost pressures reflecting strong demand. Was monetary tightening adequate and did it help fight inflation? I. 8 Cumulative monetary tightening by raising operational policy rates by 475 bps since mid-March 2010 has been one of the sharpest around the world. Of this, hikes of 325 bps occurred during 2010-11.

The hikes were in smaller but frequent doses as the frequency of scheduled policy decisions was increased to eight from four, enabling a smoother adjustment of the financial markets to monetary policy actions. The magnitude of these rate hikes was small 2 ASSESSMENT OF 2010-11 I. 5 In assessing the macroeconomic performance of 2010-11, some questions are central to the overall assessment as set out below. ASSESSMENT AND PROSPECTS as the nature of inflation was largely supply-driven for the larger part of the year. Also, liquidity conditions were already unusually tight following the unexpectedly large 3G/BWA spectrum auction revenues that resulted in large government cash balances with the Reserve Bank for a major part of 2010-11. I. 9 Policy choices toughened during the second half of the year.

Inflation had become generalised towards the later part of the year, even as the headline IIP growth numbers available then on the basis of old index (base: 1993-94) suggested a distinct deceleration. The Reserve Bank assessed that this deceleration was exacerbated by few volatile components. The deceleration was much less if these volatile components were excluded from the growth. Furthermore, related indicators such as credit expansion, corporate profitability, exports and imports, trend in tax collections did not corroborate the slowdown. Monetary policy was tightened further in face of persistence of high inflation. However, the hikes remained small in quantum as headline and core inflation were expected to trend down.

Also, uncertain inferences on growth due to data quality prompted a cautious view. The new IIP numbers (base: 2004-05) released subsequently reinforced

the RBI view that growth had not decelerated during the second half of 2010-11. I. 10 In face of a series of supply-side shocks, monetary tightening helped to keep some check on the spillover effects and high inflation expectations. However, monetary policy was constrained by the extraordinarily large stimulus given in the wake of global financial crisis. Large surplus liquidity needed to be siphoned out first, before rate hikes could begin to gain traction. Both, the rate and quantum channels of monetary transmission were weak in the first half.

Banks started responding to monetary signals in the second half of the year by raising deposit and lending rates, helping restrain inflationary pressures from spiraling up further. 3 Did the growth rebound of 2010-11 lose steam in the second half? I. 11 It is now clear that the growth did not lose momentum in the second half of 2010-11. IIP growth accelerated to 8.2 per cent in 2010-11 from 5.3 per cent in the previous year. It grew at about the same pace in the second half as in the first half. I. 12 Agricultural growth rebounded in the second half due to record Kharif crop on back of normal monsoon. The consequent rise in farm incomes supported demand conditions and with linkages with industry and services, kept the overall growth momentum.

Services remained buoyant, except 'community, social and personal services' where policy-induced deceleration was visible as fiscal consolidation resumed. I. 13 Overall growth in 2010-11 is currently estimated at 8.5 per cent and is likely to turn higher after factoring in the new base IIP in the GDP data revisions. The above trend growth in 2010-11 was supported

by strong aggregate demand conditions primarily emerging from high private consumption. As a result, the supply-side price pressures spilled over to generalised inflation. Was the fiscal consolidation in 2010-11 temporary or permanent? I. 14 Fiscal deficit ratios in 2010-11 turned out to be better than envisaged in the Union budget.

Centre's gross fiscal deficit (GFD) was 4.7 per cent of GDP against 5.5 per cent budgeted. Compared with a GFD of 6.4 per cent of GDP in 2009-10, this was a huge swing. I. 15 A qualitative assessment of fiscal correction during 2010-11, however, raises concerns. Not only did the correction in revenue account reflect more than anticipated non-tax revenues from spectrum auctions, there has been a spillover of subsidy expenditure from the last quarter of 2010-11 to the current fiscal year. Although the share of capital ANNUAL REPORT expenditure in total expenditure increased in 2010-11 from 2009-10, it was marginally lower than the budget estimates.

In particular, capital outlay-GDP ratio fell short of the budgeted ratio in 2010-11 and is still significantly lower than that achieved during pre-crisis period. Consequently, in outstanding terms, the Central government's capital outlay (as ratio to GDP) as at end-March 2011 was lower at 12.9 per cent than 13.8 per cent a year ago. I. 16 Improved fiscal position had a large temporary component arising from a business cycle upswing and one-off revenue gains. This resulted in the improvement in headline deficit numbers. Not counting for the revenue proceeds of two main one-off items – spectrum auction and the disinvestment – the GFD/GDP ratio works out to be 6.3 per cent of GDP during 2010-11.

Also, revenue buoyancy was supported by a cyclical upswing that led to above trend growth. So the one-off gains and higher growth in nominal GDP of 20 per cent against the budgeted 12.5 per cent contributed largely to lower deficits, while the permanent component of fiscal consolidation was rather weak. I. 17 Clearly, a more enduring fiscal consolidation strategy that focuses on expenditure compression by restraining subsidies as well as revenue enhancement by implementing Direct Taxes Code (DTC) and Goods and Services Tax (GST) needs to be put into place without any further delay.

Why did the CAD improve and is this improvement sustainable? I. 8 The improvement in the current account gap is more sustainable than the fiscal gap. The improvement came about by cyclical upswing in global trade and turnaround in invisibles. The Current Account Deficit (CAD) improved markedly in the second half of 2010-11 on back of a strong pick-up in exports from November 2010. Diversification of trade in terms of composition as well as direction helped in achieving strong export performance. Trade policy supporting exports through schemes such as Focus 4 Market Scheme (FMS), Focus Product Scheme (FPS) and Duty Entitlement Passbook Scheme (DEPB) also helped. I. 19 The CAD improved to 2.6 per cent in 2010-11 from 2.8 per cent in 2009-10.

Going forward, there could be some pressure on CAD if the global economy weakens significantly and affects exports. With adequate foreign exchange reserves, India remains capable of handling any pressures emanating from the external sector in the near term. However, from a medium to long term perspective, it is important to improve resilience of external account by pursuing policies that shift the composition of capital flows so as to reduce

dependence on its volatile components. Augmenting FDI further could bring about a better balance between different components of capital flows and reduce the possibility of volatile currency movements and any pressure on reserves in the face of contagion risks. Have financial markets mitigated risks postcrisis? I. 0 Financial markets across the world have witnessed significant deleveraging in the post-crisis period. However, balance sheet risks still remain. Effective market discipline is not getting reestablished. Assurances that multilateral backstops have the capacity to facilitate an orderly deleveraging without triggering further fiscal or bank funding lack credibility. Against this backdrop, it is important to look at whether financial risks have been sufficiently mitigated in India, should another round of contagion occur. I. 21 A strong payment and settlement system architecture with central counterparties and Delivery versus Payment (DvP) is in place in India.

While in the post-Lehman crisis, NBFCs and Mutual Funds came under some stress, banks proved to be largely resilient. Since then regulators have taken several measures to strengthen regulation and supervision, increase transparency and reduce settlement risks for derivatives and other financial instruments. ASSESSMENT AND PROSPECTS Despite these measures there still remain areas of concern. I. 22 The OTC interest rate derivative market in India display a significant degree of concentration, with domination by a few banks. The growth of derivatives as off-balance sheet items of Indian banks is also a source of risk. The absence of a liquid 3month or 6-month funds market has led to the absence of a term benchmark curve.

This is hindering trading in Forward Rate Agreements (FRAs) as also in swaps. However, recent emergence of a deep and liquid Certificates of Deposit (CDs) market with significant secondary market trading could alleviate this issue. I. 23 India continues to promote orderly development of the financial markets. In particular, efforts have been made to develop a vibrant interest rate futures (IRF) market to support long-term debt financing in India. In March 2011, the Reserve Bank permitted IRF trading in 91-day Treasury bills with cash settlement in rupees. Guidelines for 5-year and 2-year IRFs are being finalised in consultation with the Securities and Exchange Board of India (SEBI).

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