

Monetary and Banking Developments

Developments in the monetary sector during 2006-07 continued to reconcile the twin needs of facilitating the momentum of economic growth and containing inflation. This is to be viewed in the context of the performance of the economy in the immediately preceding year. Growth at 9.0 per cent in 2005-06 surpassed expectations of around 7.0 per cent and in the range of 7.0-7.5 per cent projected by the Reserve Bank of India (RBI) at the time of formulation of monetary policy in the Annual Policy Statement of 2005-06 in April, 2005 and the Mid-term Review of the Policy Statement in October 2005, respectively. In the first two quarters of the current year also, growth at 8.9 per cent and 9.2 per cent respectively has come as a pleasant surprise. Headline inflation, on a point-to-point basis and measured by the wholesale price index (WPI), remained at 4.1 per cent at end-March 2006, below the range of 5.0-5.5 per cent projected by RBI in April 2005. In spite of the benign impact of softening world crude oil prices in the current year, inflation continued to show some stubborn supply-side-induced hardening tendencies and reached a peak of 6.73 per cent on February 3, 2007.

3.2 Reflecting the higher economic growth, growth in broad money (M_3) at 17.0 per cent during 2005-06 was higher than the 12.3 per cent observed during 2004-05 (Table 3.1). The gathering momentum of growth got reflected and was also sustained by growth in credit to the commercial sector, up from the robust 26.0 per cent during the previous year to 27.0 per cent in 2005-06. Based on the emerging trends, for the purposes of monetary policy formulation for 2006-07, RBI had factored in real GDP growth in the range of 7.5-8.0 per cent and year-on-year inflation rate in the range of 5.0-5.5 per cent, and projected M_3 expansion at around 15.0 per cent.

3.3 With indications that growth was buoyant, in the Mid-Term Review of the Annual Policy Statement (October, 2006), projection for real GDP growth for 2006-07 was revised by RBI to around 8.0 per cent. Simultaneously, the overshooting of inflation beyond the expected path required a careful calibration of policy to tame inflation without hurting the gathering momentum of growth.

3.4 Monetary developments in 2006-07 so far have been characterised by (a) continued robust expansion in the credit—particularly non-food credit by scheduled commercial banks (SCBs); (b) a pick-up in the growth of deposits with SCBs but lower than the corresponding growth in credit; (c) a turn around in investment in approved securities for the purpose of the statutory liquidity ratio (SLR), from a declining to an increasing trend between 2005-06 and 2006-07; and (d) continued growth in foreign exchange assets of the banking sector through inflows of foreign exchange reserves.

3.5 During the current year, on January 19, 2007, year-on-year growth in M_3 and credit to the commercial sector at 21.1 per cent and 26.9 per cent, respectively were considerably higher than not only the 15.6 per cent and 26.6 per cent respectively observed on January 20, 2006, but also higher than 15.0 per cent and 20.0 per cent, respectively envisaged in the Annual Policy Statement for 2006-07. There have been some recent signs of the steady expansion in credit running into a situation of tight liquidity. During December, 2006, with liquidity injected under repo [liquidity adjustment facility (LAF)] at Rs.358,955 crore and that absorbed under reverse-repo at Rs. 314,865 crore, the net injection of liquidity in the system was Rs. 44,090 crore.