Update on Indian Economy

September 2006

Economic Snapshot

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Item	Units	August 2006	July 2006	August 2005	(%) Change [1] / [2]	[1]/[3]
		[1]	[2]	[3]	[4]	[5]
WPI -Index*	1993-94=100	204.7	203.6	195.1	0.54	4.9
WPI -Inflation**	Per cent	4.9	4.7	3.1	-	-
	Week ended	12.08.06	08.07.06	13.8.05		
IIP (93-94=100)	2 months lag	234.0	234.4	212.5	-0.17	10.12
		(June 06)	(May 06)	(June 05)		
INR / US$	Month End	46.55	46.51	44.04	0.08	5.7
M3	Rs. '000 Cr.	2880.36	2820.65	2405.82	2.12	19.72
[i] Agg. Deposits	Rs. '000 Cr.	2441.12	2382.46	2034.76	2.46	19.97
[ii] Currency	Rs. '000 Cr.	439.24	438.19	371.06	0.24	18.37
	(Outstanding as on)	18.08.06	07/07/06	19.08.05		
Call Money	% Range	5.25-6.25	5.00-6.00	0.60-6.15	-	-
(Lendings)	Week ended	18.08.06	14.07.06	19.08.05		

*Source: RBI Weekly Statistical Supplement Sep.01, 2006/Sep. 03, 2005 & Economic & Political Weekly August 19, 2006, *All Commodities. **Over the year.*

Editorial

A) Domestic

According to the report on economic outlook for 2006-07 prepared by the Prime Minister's Economic Advisory Council, the GDP growth has been projected at 7.9% which is a shade lower than the annual growth rate of 8.1% achieved during the last three years average upto 2005-06. However comfortable monetary situation and the regime of low interest rates both in India and at the global level seems to have changed, and this will impact the economic situation in India during 2006-07. The implications for this are that inflows from foreign institutional investors (FIIs) are likely to decline; in fact, during the first four months of this fiscal the net inflows from FIIs have shrunk by US$ 1 billion, and to this extent the Capital Market which was earlier crucially dependent upon the inflows from FIIs will slow the forward momentum of the market. Instead one could expect a substantial jump in the foreign direct investment (FDI) inflows during 2006-07 and the Council has estimated that this may amount to US$ 8.5 billion during 2006-07 from the level of US$ 5.7 billion in 2005-06. Other macro-economic parameters estimated by the Council are that merchandise trade deficit is projected at US$ 63 billion, but in contrast the net invisible receipts which were US$ 41 billion inclusive of US $ 22 billion from software in 2005-06 are now estimated at US$ 52 billion during 2006-07. Bulk of the increase in the net invisible receipts is likely to be from growth in software exports and modest increase in inward remittances.

On the eve of 60th Independence Day on August 14, 2006, The President, Dr. A.P.J. Abdul Kalam announced an agenda for "Development with Comprehensive Security" for the country. He called that there is a need to evolve three specific initiatives namely – (i) formulating an Energy Independence Bill, (ii) A citizens Security Bill incorporating a campaign for eradication of terrorism, and (iii) Adopting a resolution to transform the country into a "safe, prosperous and socio-economically developed nation before the year 2020."

In his address to the nation on the 60th Independence Day on August 15, 2006 the Prime Minister, Dr. Manmohan Singh indicated that India was on the march and growing over 8 per cent. He said that most effective way to banish poverty was to generate growth which, in turn, would create new opportunities for gainful employment.

B) International

A High Level Seminar on Crisis Prevention in Emerging Markets was organized during July 10-11 in Singapore and this focused on four key issues namely : (i) the genesis of capital account crises; (ii) effective macroeconomic management in countries with open capital accounts; (iii) options for country self-insurance and (iv) regional reserve pooling. Officials were drawn from about 40 emerging market countries including Singapore and this conference was organized jointly by the IMF Institute and the IMF's Policy Development and Review Department and the Government of Singapore. Highlights of the Conference are :

(i) Genesis of Capital Account crises

Countries which have mismatches on their private or public sector balance sheet in their assets and liabilities in terms of their maturities or currencies of denomination have become vulnerable to capital account crises. The relations of the crisis require a specific trigger, either external – contagion, or terms of trade shock or deterioration in market conditions, domestic such as macroeconomic policies which damage investor confidence. It is established that the emerging markets may seek to minimize balance sheet vulnerabilities and avoid the conditions which are likely to trigger a crisis.

(ii) Macroeconomic Management in Countries with Open Capital Accounts

The participants agreed that implicit guarantees by the Government might encourage risky currency exposure in private sector balance sheets, but there was less consensus on the appropriate exchange rate policy. The dominant view however, among Asian policymakers, was of favouring an intermediate regime with the discretion interventions in exchange rate markets. Further participants agreed with concurred were sound macroeconomic policies including fiscal cushion, adequate international reserves and adherence to transparency standards are necessary alongwith the quality of institutions are reinforced the credibility.

(iii) Options for Country Self-Insurance

It was generally agreed that reserved can play an important role in reducing crisis and with these should be sufficient to cover atleast debt payments due within a year. Regional pooling and the results was also seen at best as a complement to rather than a substitute to IMF.

(iv) Regional Reserve Pooling

It was proposed to have a contingent financing instrument. A financial instrument which would be flexible in nature and would ensure high access of line of credit to emerging markets that have strong macroeconomic policies but which remain vulnerable to shock.

It was generally agreed by both official and private sector participants that such instrument would need to provide significant access up-front in the event of market turbulence.

Capital Market Review

The Business Confidence Survey for the first quarter of the current financial year, i.e., 2006-07 shows that the rise in oil prices and hardening of interest rates have not dented much the overall business confidence, with the index being only a notch higher than that recorded in first quarter of 2005-06.

The Government of India has decided to reduce its stake in some key public sector power companies by 24% by offering its shares to the public through initial public offers (IPOs). This move is expected to help power companies to raise nearly Rs.3,800 crore through IPOs, which are expected to hit the market in the current fiscal year.

SEBI has permitted the domestic Mutual Funds to invest abroad. With this liberalization, Mutual Funds are now in a position to launch new schemes with a portfolio of global stocks to help Indian investors to diversity their investments into overseas securities.

The Securities and Exchange Board of India has issued detailed guidelines for the proposed capital protection schemes by Mutual Funds, under which the Asset Management Committees (AMCs) of Mutual Funds have been asked to clearly mention in their advertisements that such schemes are “oriented towards protection of capital” and “with no guarantee of returns”.

The Securities and Exchange Board of India would reportedly come out with a policy statement soon to allow short selling of shares by institutions. It is felt that this would help to increase liquidity in the market and reduce volatility.

The Foreign Institutional Investors which have been making net purchases in the Indian equity market. In recent months, these net purchases reached at the lowest level during April 2006, the month of May 2006 witnessed net sales which infact were very large but in the following months there was a turn around to net purchases. In July 2006, there was no significant rise in the net purchases. However, during the month of August 2006, the net purchases bounced back at US$ 1.2 billion. Part of the confidence of the FIIs in the Indian market was renewed due to the IPOs such as the GMR Infrastructure, and Tech Mahindra, the latter being heavily oversubscribed 104 times while the former GMR about 11 times. Again IPO of Voltamp Industries in August 2006 was oversubscribed by more than 17 times. Most of the bids which closed on August 29, 2006 came from institutional investors. In addition to the oversubscription of these IPOs, the first quarterly results of the Indian Corporate were all encouraging and this indicated that Indian Companies could provide a growth of 15-20% during the year 2006-07. The withdrawal of the draft public offer document by DLF did not seem to dampen market sentiment.

The BSE Sensex (30-share) rose from 10,743.88 on July 31, 2006 to 11,699.05 on August 31, 2006, and thereby recorded a gain of 955.17 points.

According to Reserve Bank, the Participatory Notes (PN) should be phased out. Participatory Notes are instruments through which Foreign Institutional Investors are making investment in the Indian equity market. These are derivative instruments in which the investors are not identified. Government intends to maintain a status quo in investment though PNs on the ground that these are derivative instruments. But if the status quo were to be maintained which it seems likely then one could expect further increase in investment by FIIs, and this will contribute to the gradual but steady increase in the stock market indices.

	August 2006	July 2006	August 2005	July 2005	(%) Change		
					[1] /[2]	[1] / [3]	[2] / [4]
	[1]	[2]	[3]	[4]	[5]	[6]	[7]
Major Indices							
BSE Sensex – Close	11778.02 (31.08.06)	10743.88 (31.07.06)	7805.43	7635.45	9.63	50.90	40.71
Monthly High	11778.02 (31.08.06)	10,930.09 (12.07.06)	7921.39	7635.45	7.76	48.69	43.15
Monthly Low	10751.66 (01.08.06)	10,007.34 (19.07.06)	7595.57	7145.13	7.44	41.55	40.06
S&P CNX Nifty –Close	3413.90	3,143.20	2384.65	2318.05	8.61	43.16	35.60
P/E Ratio : BSE – 30	20.36	18.74	16.25	15.81	8.64	25.29	18.53
FII Investments (Equity+ Debt)							
Inflows – Rs. Cr.	28395.20	26967.3	28358.6	25716.7	5.29	0.13	4.86
Outflows – Rs. Cr.	22948.00	25670.3	23737.2	17956.4	(10.60)	(3.32)	42.96
Net – Rs. Cr.	5447.6	1297.4	4621.2	7760.2	319.89	17.88	(83.28)
Cum. Net Inv–US$ Mn. (Month End)	45610.6	44438.2	39325.8	38263.5	2.64	15.98	16.14

The scrips which could be considered for investment are : **ACC, Maruti Udyog, BHEL, Moser Baer, Satyam, Tata Steel and Oriental Bank.**

Country : Japan

I Introduction :

After the Second World War, Japan remained a staunch allies of the US, and emerged as an economic power next only to US and China. The strong work ethic and government industry co-operation with comparatively small allocation towards defense, and adoption of high technology in manufacturing contributed to the emergence of Japan as a strong economic power despite a widely divergent land mass and vulnerability to the earthquakes. First, the economy grew with manufacturers, suppliers and distributors working together in a closely knit groups called Keiretsu. Secondly, the guarantee of lifetime employment in the Companies for the organized urban labour force has helped to achieve high rate of productivity. This is inspite of the fact that Japan's industrial sector is heavily dependent on imported raw material and fuel, whereas the strong agricultural sector is highly subsidies and has yields per acre which are perhaps the highest in the world.

II Overview of Japanese Economy

Japan has a population of 128 million and 20% of its population is old about the age of 65 years and above, and 14.2% is dependent in age of 0-14 years and the remaining 65.7% is in the age group of 15-64 years. The growth rate of population is slow as 0.02% but life expectancy on birth is high at 81-25 years. The gross domestic product on purchasing power parity is US$ 401.8 billion with per capita GDP of US$ 31,500. The real growth rate in GDP was 2.7% in 2005 nearly 72.5% of GDP is derived from services and only 1.7% from agriculture. The share of industry in GDP is 25.8%. the unemployment rate is low at 4.4% and the rate of gross fixed investment has remained at 23.2% of GDP in 2005.

In the last three decades, Japan experienced an overall real economic growth of the order of annual average rates of 10% during the 1960s, 9% during 1970s and 4% annual averaged during 1980s. There was a significant slow down in the rate of growth during the 1990s when the annual average was just about 1.7%. However during 2000-03, the slowing down of the US, European and Asian economies led also to the slow down in the Japanese growth rate. But during 2004 and 2005, the fears of deflation in prices and economic activity led to the improvement in the Japanese economy (Table 1).

Japan seems to be at a crossroads, but with recent policy initiatives, and generally supportive external environment, it should be able to achieve much higher growth rate in the coming decade. Indeed, several academic observers and market analysts now believe that Japan's trend productivity growth has accelerated and that overall GDP growth could reach 2-2.5 percent on a sustained basis even with a declining population. Achieving growth at such a pace would demonstrate the benefits of past reforms and could help create a virtuous circle to support the next set of structural reforms needed to safeguard the strong expansion.

Deflation has ended and the economy is on a strong recovery path. GDP growth in 2005 was around 2.6 percent, led mainly by private consumption and investment. Labour markets are becoming tighter and the unemployment rate is around an eight-year low. The GDP deflator continues to decline, but the deflator for domestic demand is rising marginally. However, other measures confirm the upward trend in price pressures.

Monetary policy remains appropriately accommodative. On March 9, 2006 the Bank of Japan shifted its strategy from targeting banks' excess reserves (quantitative easing) to targeting the overnight interest rate. The exit from quantitative easing was smooth, with limited volatility in short-term interest rates and pick up in private money market activity.

Fiscal consolidation is ahead of the authorities' schedule, but imbalances remain large, with net general government debt being about 90 percent of GDP, among the highest in advanced countries.

Table 1 : Japan - Important Macro-Economic Indicators

(Percentage growth)

	2003	2004	2005	Proj. 2006
1. Real GDP	1.8	2.3	2.6	2.9
2. Private consumption	0.6	1.9	2.1	2.1
3. Public consumption	2.3	2.0	1.7	0.9
4. Exports of goods and services	9.0	13.9	7.0	11.2
5. Imports of goods and services	4.0	8.5	6.3	10.3
6. Inflation				
(i) GDP deflator	-1.6	-1.2	-1.3	0.0
(ii) CPI	-0.3	0.0	-0.3	0.6
7. Unemployment rate (period average, percent)	5.3	4.7	4.4	4.1
8. Current account balance (US$ billion)				
(i) Billions of U.S. dollars	136.2	172.1	165.7	169.6
(ii) Percent of GDP	3.2	3.8	3.6	3.7
9. General government balances (percent of GDP, FY)				
(i) Balance including social security	-7.8	-5.6	-5.3	-5.0
(ii) Balance excluding social security	-8.0	-6.0	-4.9	-4.7
(iii)Structural balance	-6.9	-4.7	-5.0	-5.
10. Yen/dollar rate	115.9	108.2	110.2	113.2
11. 10-year government bond yield	1.00	1.51	1.39	1.87

Source : Global Insight, Nomura database and IMF staff estimates and projections

III Overall Japanese Trade

Exports of commodities is estimated at US$ 551 billion, a little over five times the export made by India. Major export partners are US (22.9%), China (13.4%), South Korea (7.8%), Taiwan (7.3%), Hong Kong (6.1%) and commodities comprising export are transport equipment, motor vehicles, semiconductors, electrical machinery, chemicals.
Total imports estimated are at US$ 451 billion nearly 3.5 times imports made by India. The countries which provide significant imports are China (21%), US (12.7%), Saudi Arabia (5.5%), UAE (4.9%), South Korea (4.7%). Major commodities imported are foodstuffs, textiles, chemicals, raw materials and machinery and equipment.

IV India-Japanese Trade

Indian exports to Japan were 1.7 billion in 1999-2000 and these gradually increased to 2.5 billion in 2005-06. As a share of total Indian exports these constituted 4.6% but their share has steadily declined to 2.39% in 2005-06 despite 46% the growth in export in value terms.

Imports from Japan were 2.5 billion in 1999-2000 and these increased to 3.6 billion in 2005-06; there was a quantum jump in imports after 2002-03 when these were lowest at 1.8 billion in 2002-03. Despite the slow down in imports initially than the rise during the last 3 years the share of imports from Japan to the total Indian imports declined from 5.1% in 1999-2000 to 2.5% in 2005-06. Presently, the total trade with Japan is around US$ 6 billion as compared to 4.2 billion in 1999-2000 (Table 2). As the percentage of the total Indian trade with Japan worked out to low of about 2.5%, and this indicates that there is a considerable scope for expansion of trade with Japan.

Table 2 : India's Trade with Japan : Exports & Imports

(US$ Million)

Year (April-March)	Exports to Japan (US $ mn)	Total Indian Exports (US $ mn)	Imports from Japan (US $ mn)	Total Indian Imports (US $ mn)	Share (percent) of total Indian		Total Trade with Japan (1+3)	India's Total Trade (2+4)
					Exports to Japan	Imports to Japan		
	1	2	3	4	5	7	8	9
1999-00	1685.4	36822.4	2535.8	49670.7	4.58	5.11	4221.2	86493.1
2000-01	1794.5	44560.3	1842.2	50536.5	4.03	3.65	3636.7	95096.8
2001-02	1510.4	43826.7	2146.4	51413.3	3.45	4.17	3656.8	95240.0
2002-03	1864.0	52719.4	1836.3	61412.1	3.54	2.99	3700.3	114131.5
2003-04	1709.3	63,842.6	2667.7	78,149.1	2.68	3.41	4377.0	141991.7
2004-05	2127.9	83,535.9	3235.1	111,517.4	2.55	2.90	5363.1	195053.3
2005-06	2458.7	102,725.1	3552.4	142,416.3	2.39	2.49	6011.1	245141.4

Source: RBI: (i) Handbook of Statistics on the Indian Economy 2004-05; (ii)RBI Bulletin, July 2006

Traditionally, Japan has been the second largest destination of Indian exports (major exports include gems, marine products, iron ore, and cotton yarn). India is also a major importer of goods from Japan, and its importance has been growing in recent years (major imports include machinery, plant-related products, transport equipment, and electronic machinery).

V India-Japanese Economic Relationship

With the turn around of the Japanese economy, and liberalisation and economic reforms being continued in India, the economic relationship between the two countries have received boost. The visit of Japanese Prime Minister to India in April 2005 resulted in the paradigm shift in the relationship between the two countries. The initiatives taken in the joint declaration by the two Prime Ministers aimed at working together and towards comprehensive economic co-operation. The result has been that Japan-India economic relationship has been expanding both in quality and quantity since the early 1990s but the big thrust came towards these relationship in 2005. A Joint Study Group (JSG) was established to undertake a comprehensive review of economic and commercial relations between India and Japan; JSG would give recommendations on upgrading the linkages between the two countries on a continuous basis.

VI Japanese Investment in India

Keeping in view the requirement for dissemination of information about investment climate in India to Japanese investors and also to provide them with one stop facilitation, a Japan Cell was set up in the Department of Industrial Policy & Promotion, Ministry of Commerce and Industry. The cell is closely working with Japanese investors and other organizations like JETRO, JCCI, etc.

India has been receiving a large number of business delegations from Japan. The prominent delegations include Keidaran and Fukuoka delegation in November 2005 and Kansai and the International Friendship Exchange Council (FEC) delegation in December 2005, and JETRO SME delegation in February 2006.

According to available data on the Foreign Direct Investment (FDI), Japan is the 4th largest investor in India. The cumulative inflow of FDIs from Japan during the period from August 1991 to January 2006 amounted to US$ 2.08 billion out of the total inflows of US$ 37.7 billion; and it constituted about 5.52% of total FDIs. The cumulative approvals from Japan during the period from August 1991 to January 2006 amounted to US$ 3.2 billion out of the total the approvals of US$ 69.3 billion. It would seem that the rate of FDI inflows as proportion of the approvals from Japan of FDIs is quite high at 65% which is probably on account of the strengthening economic co-operation between the two countries.

Majority of the Japanese companies surveyed indicated that they are making profits and are "positively considering further expansion of their operations". Maruti-Suzuki partnership in the automobile sector is classic example of strong bonding between the two countries. Only recently, it has been announced that the investment of the order of Rs.3,000 crore of additional investment will be made to expand production capacity to cater to both the domestic market and exports of cars.

Future Outlook

As for the future outlook, there are a few areas in which the Japanese economy could play an important part not only in relation to the world economy but also in building up economic relations with India :

First, the current economic recovery in Japan is hampered by the two problems one still persisting an aging population and second is the reform of the financial sector such as banking, insurance, delivery services which are planned to be privatized between 2007-2017.

Secondly, self-sustained growth in Japan would have significant global benefits. Growth in Japan, the world’s second-largest economy, would have knocked-on effects throughout Asia and the global economy and this will contribute to a more balanced pattern of global growth. It would also help to reduce global current account imbalances. The road is long, but Japan is now well poised to contribute to a stable and vibrant world economy.

Thirdly, both Japan and India are strongly committed to an "open and non-discriminatory rule-based multilateral trading system". Indo-Japanese trade relations and economic co-operation are becoming stronger by the years, though, if compared with neighboring China's trade with Japan, India's share in Japan's total trade does not give any impressive look. So also in the field of foreign direct investment. Japan, which is the fourth largest investor in India itself, is not happy with this rate. India has to do a lot to create an investor-friendly environment through speedier economic reforms and freeing the country from clutches of over regulation at the earliest.

However, to many of them, the inhibiting factors are due to differences in business practices, environment and culture, etc., but at the same time Japanese are aware of India's huge market potential, especially in IT and IT-related industries.

Japan wants to diversify its sources of supply of natural gas; because it currently relies on imports for 97 percent of its needs on Indonesia, Malaysia and Australia. According to government sources, Japan plans to start exploring for natural gas on its own in the area possibly in the summer months (June-August) and embark as early as next year on joint exploitation of natural gas led by the private sector. The Japanese government will start selecting private contractors for drilling and development of natural gas in the area. Natural gas from the field will be supplied to India via pipeline and be exported to Japan as well. The natural gas deal with India is also aimed at strengthening bilateral ties as Japan's ruling party hopes to use its strong partnership with India for checking China's increasing presence in western Asia. The deal also reflects a tie-up between Japan and India in their bids to become permanent members of the United Nations Security Council.

Fourthly, while Japan is implementing structural economic reforms, India is continuing its basic economic reforms, the Japan-India Joint Declaration of December 10, 2001 has set the ball rolling for things to shape up in Indo-Japanese relationship in the 21st century. To raise the bilateral relationship to a "qualitatively new level" is the ultimate of the Joint Declaration. Stronger Indo-Japanese bilateral relations would also mean a more stable and prosperous Asia. Broader and deeper economic relations between the countries would form the cornerstone of this bilateral relationship in future.

Other Markets

Debt Market

Banks were active in the debt market in July, with a number of PSU banks issuing Tier II bonds. Other issuers were HUDCO, Transmission Corporation of Andhra Pradesh Ltd., Punjab Financial Corporation NABARD, PNB Housing Finance Ltd. And Power Grid Corporation Ltd.

Name of the Issuer	Rate %	Duration	Rating	Amount Rs. Crore	Type of Instrument
I. BANKS					
Bank of India	9.35%	15 years	AA&A A+	500	Upper Tier II Bonds
Bank of Maharashtra	9.45%	10 years	AA	150+GS 25	Tier II Bonds
ICICI Bank	9%	10 years	AAA	200	Bonds
Indian Overseas Bank	9.10%	10 years	AA+	500	Lower Tier II Bonds
Nabard	8.05%	3 years	AAA	200	Bonds
	8.20%				
Oriental Bank of Commerce	9.25%***	15 years	AAA	250+GS 250	Upper Tier II Bonds
PNB Housing Finance Ltd.	9.25%	10 years	AA+	500+GS 500	Tier II Bonds
Punjab Financial Corporation	8.50%	10 years	NA	67	Bonds
Punjab & Sind Bank	9.25%	117 months	AA- &A+	100+GS 292	Lower Tier II Bonds
State Bank of India	9%##	15 years	AAA	500	Upper Tier II Bonds
Syndicate Bank	9.35%**	15 years	AA+ & AA	250	Upper Tier II Bonds
UCO Bank	9.25%	116 months	AA	250	Tier II Bonds
Vijaya Bank	9.25%	10 years	AA+	250	Lower Tier II Bonds
II OTHERS					
HUDCO	#	10 years			
Power Grid Corp. Ltd.	8.75%	16 years	AAA	600	Bonds
	9.25%				
Transmission Corporation of Andhra Pradesh Ltd.	8.70%$	10 years	A(SO)	200	Bonds

** 9.85% for the last 5 years if call is not exercised.*
*** 9.85% if call is not exercised.*
**** 9.75% if call not exercised after 10th year.*
9.50% if call not exercised at 10th year.
$8.95 if call not exercised after 10th year.
#coupon to be decided thru book building. The coupons would be in the range of 8.60-8.80%, 8.85-9.05%, 9.10-9.25% respectively for the call dates, in case the calls are not exercised.
Source : Credit Analysis & Research Ltd. August 2006.

Call Money Market

The call money market rate on August 11, 2006 in respect of borrowings ranged between 5.25% and 6.20% as compared to the rates of 3.50% - 5.65% on August 12, 2005 (i.e. a year ago) reflecting that there was a hardening of the rate during the year. The average daily turnover in the call money market was Rs.11,528 crore for the week ending August 11, 2006 and this daily turnover declined to Rs.10,556 crore in the week ending August 18, 2006.

Foreign Exchange Market

The exchange rate (RBI reference rate) on August 18, 2006 was Rs.46.48 per US dollar as compared to Rs.46.56 per US dollar on August 14, 2006, that is, a week ago; this reflected a nominal appreciation of the rupee vis-a-vis US dollar. Further, the six month forward premia was 1.44% on August 18, 2006 as compared to a premium of 1.22% on August 14, 2006 (a week ago), and this reflects that supply of dollars is likely to become more scarce in the forthcoming months. The foreign currency asset were US $ 158.04 billion on August 18, 2006, and inclusive of gold and SDRs and the reserve position in the Fund, the foreign exchange reserves aggregated to US$ 165.37 billion. From end-March 2006, the foreign exchange reserves registered a rise of US$ 13.75 billion. The market rate (buying) was Rs.46.62 per US dollar on August 31, 2006.

Important Policy Pronouncements

(A) The Reserve Bank of India released its Annual Report for the year 2005-06 on August 31, 2006. The highlights of the Report are as follows :

(i) The Report has expressed concern on the unchecked growth of Special Economic Zones (SEZs) across the country because it could lead to uneven development by shifting out resources from less developed areas. It observed that the revenue loss suffered by the State on account of tax breaks can be justified "only if the units in the SEZ establish backward and forward linkages with the domestic economy".

It may be recalled that the SEZ Act 2005 provides incentives to reduce transaction costs and improve the competitiveness of exports. The simplification of procedures and tax breaks, as envisaged by the Act, are expected to attract investments of about Rs.1,00,000 crore and help create 5,00,000 jobs. Developers are allowed to set up sector-specific and multi-product SEZs with a minimum area requirement of 1,000 hectares for multi-product and 100 hectares for service sector SEZs.

(ii) On the fiscal policy the rules of 2004 under Fiscal Responsibility and Budget Management Act, 2003 (FRBM), the RBI pointed out that revenue and gross fiscal deficits slipped in 2005-06 over the levels in the previous year. The Gross Fiscal Deficit (GFD) is budgeted to decline by 0.3 percentage point of GDP to 3.8 per cent of GDP during 2006-07 while the revenue deficit is budgeted to decline by 0.5 percentage point to 2.1 per cent of GDP. The budgeted reductions in revenue and fiscal deficits match the minimum threshold reductions stipulated in the FRBM Rules, 2004. The primary deficit is also budgeted to decline to 0.2 per cent of GDP from 0.5 per cent in 2005-06. The reduction in the deficit indicators is expected to be primarily on the basis of improved revenue performance and reprioritization of expenditure. Larger deficit cuts are a must to meet the FRBM targets in the next two years. It would require an improvement in tax revenues by widening of the tax base, and trimming and phasing out of tax exemptions.

(iii) The share investment in agriculture has declined from 2.2% in 1999-2000 to 1.7% in 2004-05 of GDP (at constant prices). The Report indicated that there is a need for a second green revolution.

(iv) The gross saving rate has increased to 29.1% in 2004-05 from 23% in the 1990s, and 25% in the mid 1990s of GDP.

(v) The Report, observed that, " In view of the international oil prices remaining high and volatile, the outlook on inflation as well as choice of the appropriate manner of dealing with the pass-through of oil prices remains clouded." However, inflation was contained to 4.1 per cent by end March 2006 within the indicative trajectory of 5-5.5 per cent during 2005-06.

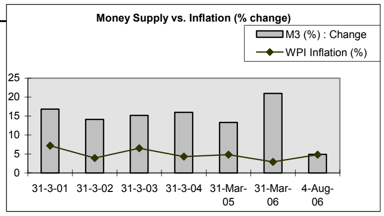
(vi) As to the outlook, early trends from industrial production, service sector indicators and corporate performance and other indicators support an overall optimistic near-term outlook.

(vii) The Reserve Bank transferred the surplus of Rs.8,404 crore to the Central Government for 2005-06, an increase of 56 per cent over the surplus of Rs.5400 crore in 2004-05. This was largely due to increase in foreign income resulting from increase in the level of Foreign Currency Asset and hardening of global short-term interest rates. In contrast, there was a decline in the domestic income by 13% to Rs.1,782 crore. The decline in the domestic income resulted from reduced profit on sale of securities and decline in the interest income on loans. Part of it was due to lower recourse to Ways and Means Advances (WMA) by the Central and State Government in the face of substantial cash balances.

(viii) On Liberalisation of foreign exchange, the Report indicated that while the Committee on Full Capital Account Convertibility had submitted its report last month, the RBI in its report said, "In regard to foreign exchange market, the calibrated liberalisation of capital account transactions will be continued."

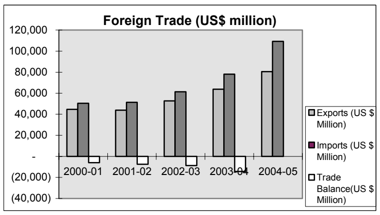
(B) Investment by Mutual Funds in Overseas Securities

Overseas Investments by Mutual Funds registered with the Securities and Exchange Board of India (SEBI) have been liberalized by enhancing the existing aggregate ceiling and expanding the avenues for investment. Presently, Mutual Funds registered with SEBI, are permitted to invest in ADRs / GDRs of Indian companies, rated debt instruments and also in the equity of overseas companies listed on a recognized stock exchange overseas and having a shareholding of at least 10 per cent in a listed Indian company.



	31-3-01	31-3-02	31-3-03	31-3-04	31-Mar-05	31-Mar-06	4-Aug-06
M3 (Rs. Crore)	13,13,220	14,98,355	17,25,222	20,03,102	22,53,938	27,29,535	28,63,340
M3 (%) : Change	16.82	14.1	15.14	15.95	13.30	21.00	4.90
WPI (Index) All Commodites#@	155.7	161.8	172.30	180.30	189	194.9^	204.30*
WPI Inflation (%)	7.16	3.92	6.49	4.29	4.83	2.91	4.82

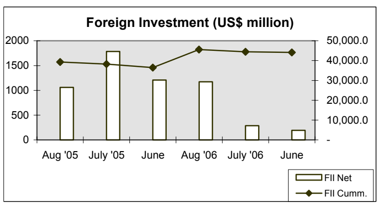
Source: RBI Bulletin August 2006; WSS: August 25, 2006 '#1993-94 = 100 @ year/month-end; ^August 06, 2005 *August 05, 2006



During the Year	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06*	2006-07*
Exports (US $ Million)	44,560	43,827	52,719	63,843	80,540	100,607	37,708
Imports (US $ Million)	50,537	51,413	61,412	78,149	109,173	140,238	54,424
Trade Balance(US $ Million)	(5,977)	(7,586)	(8,693)	(14,306)	(28,633)	(39,631)	(16,716)

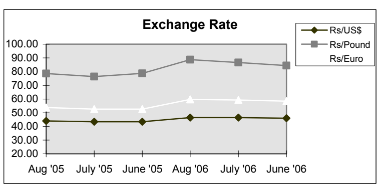
Source:RBI Bulletin, June 2006 : Revised figures for 2000-01 to 2004-05

**DGCI&S data for April to July 2006 (Press Release)*



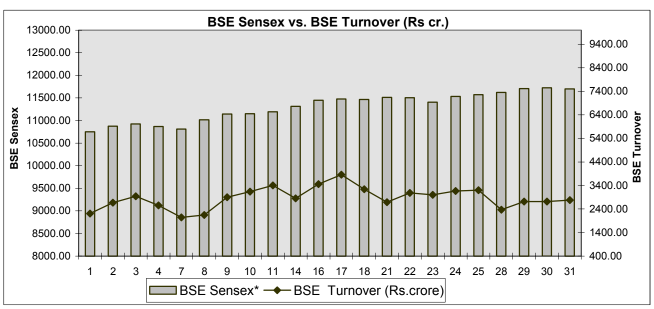
	2005-06 (US$ million)			2006-07 (US$ million)		
	Aug '05	July '05	June '05	Aug '06	July '06	June '06
FII Net	1,062.3	1,783.8	1,209.3	1,172.6	285.4	193.2
FII Cumm.	39,325.8	38,263.5	36,480.0	45,610.6	44,438.2	44,152.9

Source: SEBI - Diff. in total figures are due to rounding off.



	2005-06			2006-07		
	Aug '05	July '05	June '05	Aug '06	July '06	June '06
Rs/US$	44.04	43.49	43.51	46.55	46.51	46.08
Rs/Pound	78.58	76.34	78.75	88.72	86.65	84.45
Rs/Euro	53.80	52.73	52.68	59.71	59.31	58.54

Figures are for month-end



August 2006	BSE Sensex* Close	BSE Turnover (Rs.crore)
1	10751.66	2203.00
2	10876.19	2666.00
3	10923.16	2938.00
4	10866.51	2551.00
7	10812.64	2041.00
8	11014.97	2142.00
9	11145.18	2899.00
10	11149.17	3138.00
11	11192.46	3404.00
14	11312.99	2850.00
16	11448.31	3456.00
17	11477.48	3853.00
18	11465.72	3238.00
21	11511.68	2691.00
22	11502.62	3079.00
23	11406.65	2998.00
24	11531.95	3166.00
25	11572.20	3197.00
28	11619.52	2366.00
29	11706.85	2715.00
30	11723.92	2717.00
31	11699.05	2774.00

Annexure 1 : Select International Economic Indicators for Developed Industrialised Countries And India

Country	3-Month Money Mkt		CPI		Currency unit per US $		Union Budget	Real Rate	Currency
	As on 23.08.06	A Year ago	3- Month	A Year ago	As on 23.08.06	A Year ago	(+) / (-) % of GDP 2005	(Short-term) (1-3)	unit per Euro 23.08.06
	1	2	3	4	5	6	7	8	9
Euro-11	3.25	2.13	2.40	2.20	0.78	0.82	-2.30	0.85	1.00
			Jul						
U. S. A.	5.28	3.65	4.10	3.20	1.00	1.00	-3.60	1.18	1.28
			Jul						
Britain	4.92	4.56	2.40	2.30	0.53	0.56	-3.40	2.52	0.68
			Jul						
Japan	0.34	0.02	1.00	-0.50	117.00	110.00	-5.20	-0.66	149.00
			Jun						
Sweden	2.40	1.48	1.70	0.30	7.18	7.62	1.70	0.70	9.19
			Jul						
Switzerland	1.65	0.76	1.40	1.20	1.23	1.27	-0.20	0.25	1.58
			Jul						
India*	6.40^^	5.46^^^	6.47	4.59	46.48	46.56	-3.80	-0.15	59.59
	(August 18, 06)	(August 12, 05)	June 06 over June 05)	(2005-06 over 2004-05)	(August 18, 06)	(August 14, 06)	(2006-07)		

Source: The Economist London: August 26th - September 1st, 2006 *For India,RBI :Weekly Statistical Supplement, (WSS), August 25, 2006 and Union Budget 2006-07*

For India, RBI Bulletin, August 2006

 # CPI - (IUNW) June 2006 over June 2005 (RBI Bulletin, August 2006)
^^ Implicit yield 91 day 7 BS on date of issue (August 18, 2006)
'^^^ Implicit yield 91 day 7 BS on date of issue (August 12, 2005)

Annexure 2 : Important Indicators for Select Emerging Market Countries

Country	GDP	Industrial Production	Consumer Prices	Short-term Interest Rates	Foreign Exchange Reserves*	Exchange Rate			Trade Balance	Current Account
	% change on earlier year			% p. a.	US $ Billion	per US$		per Euro	Latest 12 Months $ Billion	
					23.08.06	23.08.06	a year ago	23.08.06		
	1	2	3	4	5	6	7	8	9	10
China	11.3	16.7	1.0	2.85	941.1	7.97	8.1	10.22	127.0	160.8
	Q2	Jul	Jul		Jun				Jul	2005
Hongkong	5.2	7.0	2.3	4.26	127.4	7.78	7.77	9.97	-14.0	20.8
	Q2	Q1	Jul		Jul				Jun	Q1
India	9.3	9.6	7.7	6.38	157.1	46.50	43.70	59.62	-41.3	-10.6
	Q1	Jun	Jun		Jul				Jul	Q1
Indonesia	5.2	-1.6	15.2	12.33	38.5	9100.0	10270.0	11666.67	33.5	3.8
	Q2	May	Jul		Jun				Jun	Q1
Malaysia	5.3	7.0	4.1	3.85	78.5	3.68	3.77	4.72	27.1	19.5
	Q1	Jun	Jul		Jun				Jun	Q1
Singapore	8.1	22.5	1.1	3.50	129.9	1.57	1.67	2.01	33.0	38.3
	Q2	Jun	Jul		Jul				Jul	Q2
South Korea	5.3	10.9	2.3	4.70	225.7	956.0	1028.0	1225.64	17.0	7.8
	Q2	Jun	Jul		Jul				Jul	Jun
Taiwan	4.6	7.9	0.8	1.79	260.4	32.80	32.30	42.05	11.3	20.6
	Q2	Jul	Jul		Jul				Jul	Q2
Thailand	6.0	6.1	4.4	5.40	56.4	37.60	41.10	48.21	-2.4	2.7
	Q1	Jun	Jul		Jun			Jun	Jun	Jun

Source: The Economist London: August 26th - September 1st, 2006 *@For India, RBI WSS, August 25, 2006* *Note : Quotes for currency units per Euro in Col 8 are derived one.*

**Excluding Gold and SDRs*

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September 8th 2006