Balance of Payments

6
CHAPTER

Fiscal 2009-10 has witnessed a global recovery after a crisis of severe worldwide proportions. The risks of double-dip recession, however remain, with need for caution in dealing with high public debt and unwinding of fiscal and monetary stimuli. The Indian economy also saw a turnaround, registering 7 per cent growth during H1 (April –September 2009) of 2009-10, after touching a low of 5.8 per cent in the third and fourth quarters of 2008-09. The balance-of-payments (BoP) situation improved on the back of a surge in capital flows and rise in foreign exchange reserves, which have been accompanied by rupee appreciation.

The Global Crisis and Beyond

6.2 The last two and a half years have been the most turbulent for the global economy since World War II. The crisis that began in a small corner of the financial system, i.e. the sub-prime mortgage market in the United States spread like wildfire to engulf the entire global financial system. The fall of Lehman in September 2008 was the proverbial last straw, making the crisis truly global in terms of outreach, impact and severity for both advanced and developing countries.

6.3 Countries have, however, been affected by the crisis differently and in varying degrees. Advanced economies as a group have been more severely affected with 3.2 per cent negative growth forecast for 2009 (IMF *World Economic Outlook,* January 2010). All rich countries, with the exception of Australia, experienced decline, before a likely upturn in 2010 in most economies.

6.4 Developing countries are likely to grow by 2.1 per cent in 2009 and 6.0 per cent in 2010, led by India and China, which remained the most resilient to the crisis. The impact on the emerging world was through reversal of capital flows, fall in stock markets, depreciation of local currency, decline in exports and general risk aversion, which affected consumption and investment. The social impact of the crisis, though, has been more severe for the emerging economies, as they have fewer cushions against shocks.

6.5 The response to the crisis, however, has been equally swift, with concerted and coordinated efforts by governments and monetary authorities, through conventional and non-conventional fiscal and monetary instruments. As a result, there are signs of recovery in the global economy with the US, Euro Zone and Japan already out of recession and the momentum of growth picking up in emerging economies (Table 6.1).

6.6 Risks however remain, with rich countries continuing to be more vulnerable to double-dip recession. First, levels of unemployment remains high despite expansionary polices. Second, the extensive use of fiscal policy has meant a sizeable increase in fiscal deficit with the gross public debt to gross domestic product (GDP) ratio in advanced economies likely to rise from 75 to 115 per cent during 2008-2014. Third, the timing of *exit* is important. An early exit could increase the risk of another recession, while late exit could worsen public debt ratios, crowd out private investment and fuel inflationary expectations. Fourth, return of recession could cause havoc. With most policy toolkits already exhausted, public debt ratios skyrocketing and the balance sheets of central banks stretched, little ammunition remains for dealing with another crisis.

6.7 As emerging economies are ahead on the recovery curve, a major fallout has been large flows of capital from rich countries seeking to benefit from

Table 6.1 : Selected Economic Indicators : World

Sl. No.	Items	2008	2009 Projection	2010 Projection
I	**World Output (per cent change) #**	3.0	-0.8	3.9
	a Advanced Economies	0.5	-3.2	2.1
	b Other Emerging Market and Developing Countries	6.1	2.1	6.0
	of which			
	Developing Asia	7.9	6.5	8.4
	China	9.6	8.7	10.0
	India	7.3	5.6	7.7
II	**Net Capital Flows to Emerging Market and Developing Countries (US$ billion)**			
	i Net Private Capital Flows (a+b+c)	129.5	-52.5	28.3
	(a) Net Private Direct Investment	425.0	279.0	269.5
	(b) Net Private Portfolio Investment	-85.4	-99.8	-110.4
	(c) Net Other Private Capital Flows	-210.1	-231.6	-130.8
	ii Net Official Flows	-105.7	50.3	-14.2
III	**World Trade @**			
	i Trade Volume	3.0	-11.9	2.5
	ii Export Volume	2.8	-11.4	2.6
IV	**Current Account Balance (per cent to GDP)**			
	i US	-4.9	-2.6	-2.2
	ii China	9.8	7.8	8.6
	iii India	-2.2	-2.2	-2.5
	iv Middle East	18.3	2.6	7.9

Source : For item I-International Monetary Fund (IMF), World Economic Outlook, January 2010; for items II to IV–*World Economic Outlook*, October 2009.

 # growth rates are based on GDP at purchasing power parities

@ Average of annual percentage change for world exports and imports of goods and services.

Box 6.1 : Asset price bubbles in emerging economies

There are strong signs of recovery in the global economy. The emerging economies, particularly in Asia, are, however, ahead on the recovery curve. This has negative fallout for emerging economies by way of outsized inflows of capital to take advantage of higher returns.The higher returns are due to both interest differentials and stock market returns, with the Emerging Market MSCI Index rising by 77.1 per cent during 2009. The rush of portfolio investment that is not supported by fundamentals like high economic growth is fuelling the rise in stock markets.

A major fallout of the capital inflow is appreciation of domestic currency through creating a supply-demand imbalance in the foreign exchange market. The implication is similar to 'Dutch disease', a concept that owes its origin to offshore natural gas finds in the Netherlands in the 1960s, which led to a surge in capital flows and domestic currency appreciation that made exports uncompetitive and affected domestic industry through cheaper imports. The large inflows are more serious for countries with current account deficits, as domestic currency appreciation generally worsens the deficit. Together with loss of international competitiveness due to pegged exchange rates in some countries, the currency appreciation may make the recovery process more difficult in many emerging economies.

The sharp increase in stock market prices also increases speculative activity, besides contributing to market volatility. The boom and bust cycle in stock markets, since the onset of the crisis, has followed surge and reversal of capital flows to a significant extent. Such price volatility is detrimental for the orderly development of the capital markets and for stock markets to be a viable source for financing capital expenditure.

Another area of asset price bubble is commodities (oil, metals and agricultural), which have emerged as an 'asset class' due to high returns, their role as a hedge against inflation and diversification benefits on account of low correlations. A number of instruments like exchange traded funds (ETFs) are available, which make commodity investment accessible to institutional and individual investors. The rise in the global price of oil, however, could affect nascent recovery in oil- importing emerging economies. Besides, many emerging economies like India are being affected by the high food prices, where apart from domestic supply factors, investment demand appears to be playing a contributory role. A key element in the speculative flows is 'carry trade', which is characterized by borrowing in currencies with low interest and investment in higher interest currencies to take advantage of interest differentials. The carry trade money has also been flowing into stock markets in emerging economies to take advantage of higher returns. Record low interest rates in the US and other advanced countries are reportedly behind the trade. Carry trade and its unwinding have contributed significantly to currency volatility in the international markets during the recent past. The same mechanism is now fuelling asset price bubbles in emerging economies and leading to domestic currency appreciation.

interest rate differentials and a stock market boom. As such outsized inflows are not supported by economic fundamentals, they are contributing to asset price bubbles and appreciation of domestic currency, which may affect the process of recovery (Box 6.1).

6.8 The Indian economy was initially affected through a reversal of capital flows, rupee depreciation and stock market decline. Thereafter, especially after the collapse of Lehman Brothers, the real sector was affected through a fall in exports and general risk aversion. The decline, however, was partly offset by the resilience of the rural economy due to improvement in the agricultural terms of trade because of higher support prices for agricultural produce, income generated through the National Rural Employment Guarantee Scheme, agriculture loan waivers, building up of rural infrastructure under the Bharat Nirman programme and increasing awareness through media and mobile phone penetration. Together with the fact that it is largely domestic demand driven, (merchandise exports account for 15 per cent of the GDP), the Indian economy has exhibited considerable resilience in the face of the crisis.

Balance of Payments (BoP)

6.9 Under current account of the BoP, transactions are classified into merchandise (exports and imports) and invisibles. Invisible transactions are further classified into three categories, namely(a) Services–travel, transportation, insurance, Government not included elsewhere (GNIE) and miscellaneous, which latter encompasses communication, construction, financial, software, news agency, royalties, management and business services, (b) Income, and (c) Transfers (grants, gifts, remittances, etc.) which do not have any quid pro quo.

6.10 Capital inflows can be classified by instrument (debt or equity) and maturity (short or long term). The main components of capital account include foreign investment, loans and banking

Table 6.2 : Balance of payments : Summary

(US$ million)

Sl. No.	Items	2004-05	2005-06	2006-07	2007-08	2008-09	Apr-Sep. 2008	Apr-Sep. 2009
						PR	PR	P
1	Exports	85206	105152	128888	166162	189001	111085	81139
2	Imports	118908	157056	190670	257629	307651	175483	139356
3	Trade Balance	-33702	-51904	-61782	-91467	-118650	-64398	-58217
4	Invisibles (net)	31232	42002	52217	75731	89923	48549	39599
	Non-factor Services	15426	23170	29469	38853	49631	25110	15371
	Income	-4979	-5855	-7331	-5068	-4507	-1646	-2353
	Private Transfers	20525	24493	29825	41706	44567	25091	26695
5	Goods and Services Balance	-18276	-28734	-32313	-52614	-69019	-39288	-42846
6	Current Account Balance	-2470	-9902	-9565	-15737	-28728	-15849	-18618
7	External Assistance (net)	1923	1702	1775	2114	2637	869	571
8	External Commercial Borrowings (net)	5194	2508	16103	22609	7941	3166	745
9	Non -resident Deposits (net)	-964	2789	4321	179	4290	1072	2864
10	Foreign Investment (net) of which	13000	15528	14753	43326	3467	8349	32088
	(i) FDI (net)	3713	3034	7693	15893	17498	13867	14142
	(ii) Portfolio (net)	9287	12494	7060	27433	-14030	-5518	17946
11	Other Flows (net)[a]	9476	2427	9219	39673	-9687	-106	-8117
12	Total Capital Account (net) (including errors and omission)	28629	24954	46171	107901	8648	13350	28151
13	Reserves [increase (-) / decrease (+)]	(-)26159	(-)15052	(-)36606	(-)92164	(+)20080	(+)2499	(-)9533

Source : RBI PR: Partially Revised P: Preliminary
a Includes, among others delayed export receipts and errors and omissions.

capital. Foreign investment comprising foreign direct investment (FDI) and portfolio investment represents non-debt liabilities, while loans (external assistance, external commercial borrowings and trade credit) and banking capital including non-resident Indian (NRI) deposits are debt liabilities.

6.11 India's BoP exhibited considerable resilience during fiscal 2008-09 despite one of the severest external shocks. The current account balance [(-) 2.4 per cent of GDP in 2008-09 vis-à-vis (–) 1.3 per cent in 2007-08] remained well within the sustainable limits and there was limited use of foreign exchange reserves, despite massive decline in net capital flows to US$ 7.2 billion in 2008-09 as against US$ 106.6 billion in 2007-08. As per the latest BoP data for fiscal 2009-10, exports and imports showed substantial decline during April-September (H1) of 2009-10 vis-à-vis the corresponding period in 2008-09. There has been improvement in the BoP scenario during H1 of 2009-10 over H1 of 2008-09, reflected in higher net capital inflows and lower trade deficit. However, the invisible surplus declined and current account deficit widened vis-a-vis the corresponding period last year (Table 6.2).

Current Account

Merchandise (exports and imports)

6.12 The impact of the global financial crisis was transmitted to India through various external sector transactions, mainly the trade and financial routes. The transmission of external demand shocks was much more swift and severe on export growth, which, on a BoP basis, declined from a peak of 57 per cent in Q1 (April-June 2008) of 2008-09 to (-) 8.4 per cent in Q3 (October – December 2008) and further to (-)20 per cent in Q4 (January – March 2009) of 2008-09—a fall for the first time since 2001-02. Import growth, which remained robust till the Q2 (July – September 2008) of 2008-09, declined by 20.8 per cent in Q3 over Q2 and 20.1 per cent in Q4 over Q3, moving in tandem with the slowdown in domestic industrial demand and sharp decline in international crude oil and other primary commodity prices. Thus trade deficit generally expanded in the first two quarters of 2008-09 due to the combined effect of a high crude oil prices-driven increase in imports and the collapse in external demand. However, in Q4 of 2008-09, with the pace of decline in imports outpacing that in exports, trade deficit narrowed down significantly to US$ 20.2 billion as compared to US$ 25.3 billion in Q1, US$ 39.1 billion in Q2 and US$ 34.0 billion in Q3. For the full fiscal 2008-09, however, trade deficit witnessed a marked expansion to US$ 118.7 billion (9.7 per cent of GDP) as compared to US$ 91.5 billion (7.4 per cent of GDP) in 2007-08.

6.13 India's current account position during the first half of 2009-10 (April-September) continued to reflect the impact of the global economic downturn and deceleration in world trade witnessed since the second half of 2008-09. Growth in exports and imports continued its declining trend during the first half of 2009-10. On a BoP basis, India's merchandise exports, which started falling in October 2008, recorded a decline of 27.0 per cent in H1 (April-September 2009) of 2009 as against a significant increase of 48.1 per cent during the corresponding period of the previous year.

6.14 Similarly, the declining trend in imports, which began during the third quarter of 2008-09, after a gap of almost seven years, continued during the first half of 2009-10. Import payments, on a BoP basis, registered a decline of 20.6 per cent during H1 of 2009-10 as compared to robust growth of 51.0 per cent in the corresponding period of the previous year.

6.15 According to the Directorate General of Commercial Intelligence and Statistics (DGCI&S) data, oil imports recorded a decline of 45.0 per cent in April-September 2009 as against a significant rise of 83.0 per cent during April-September 2008. During the same period, non-oil imports showed a relatively modest decline of 26.3 per cent (as against an increase of 43.8 per cent in April-September 2008). In absolute terms, oil imports accounted for about 26 per cent of total imports during April-September 2009 (34.2 per cent in the corresponding period of the previous year). According to the data released by the Gem & Jewellery Export Promotion Council, total import of gems and jewellery declined by 12 per cent during April-September 2009 as against an increase of 33.6 per cent during the corresponding period of the previous year.

6.16 Trade deficit, however, remained lower at US$ 58.2 billion during April-September 2009 as compared to US$ 64.4 billion in April-September 2008 (9.6 per cent decline), mainly on account of the decline in oil imports. A detailed analysis of India's trade performance occurs in the next chapter.

Invisibles

6.17 Two components of the current receipts, which remained relatively resilient in the face of the

global economic meltdown, were software services and workers' remittances, mainly responsible for higher invisible surplus. The invisibles account reflects the combined effects of transactions relating to international trade in services, income associated with non-resident assets and liabilities, labour and property and cross-border transfers, mainly workers' remittances. India's net invisibles (invisible receipts minus payments) increased by 18.7 per cent in 2008-09, led mainly by receipts under private transfers and software services. The net invisibles surplus increased from US$ 75.7 billion (6.1 per cent of GDP) in 2007-08 to US$ 89.9 billion (7.4 per cent of GDP) during 2008-09.

6.18 Services have shown relative resilience as compared to other components of India's BoP in the face of the global economic slowdown, with the net services surplus expanding from US$ 38.9 billion during 2007-08 to US$ 49.6 billion during 2008-09, led primarily by software services exports. Services exports, however, declined in the last quarter of 2008-09, after a long phase of sustained growth. The impact of the global economic shocks on India's software exports was evident during 2008-09, especially in the second half of the year. Notwithstanding this, software exports during 2008-09 (US$ 43.5 billion) recorded a growth of 17.7 per cent (27.2 per cent during 2007-08). Among other major services, travel receipts were adversely affected during 2008-09 as the growth of tourist arrivals in the country significantly went down. Against the backdrop of slowdown in global trade, business services exports declined marginally in 2008-09, with growth remaining volatile over the quarters and exhibiting significant decline in the second half of the year.

6.19 Reflecting the adverse impact of continuing global financial crisis, invisible receipts, comprising services, current transfers and income, recorded a decline of 11.6 per cent (US$ 75.4 billion) during H1 of 2009-10 as compared to an increase of 32.5 per cent (US$ 85.3 billion) in H1 of 2008-09, mainly attributable to the lower receipts under almost all components of services. However, private transfer receipts, which had marginally declined during the second half of 2008-09, increased by 4.3 per cent in the first half of 2009-10.

6.20 Private transfers are mainly in the form of (i) inward remittances from Indian workers abroad for family maintenance, (ii) local withdrawal from NRI rupee deposits, (iii) gold and silver brought through passenger baggage, and (iv) personal gifts/donations to charitable/religious institutions. Private transfer receipts, comprising mainly remittances from Indians working overseas, increased to US$ 27.5 billion in H1 of 2009 as compared to US$ 26.4 billion in the corresponding period of the previous year. Private transfer receipts constituted 17.6 per cent of current receipts in April-September 2009 (13.4 per cent in the corresponding period of the previous year).

6.21 NRI deposits, when withdrawn domestically, form part of private transfers because once withdrawn for local use these become unilateral transfers and do not have any *quid pro quo*. Such local withdrawals/ redemptions from NRI deposits cease to exist as liability in the capital account of the BoP and assume the form of private transfers, which are included in the current account of the BoP. Under NRI deposits, both inflows as well as outflows remained steady. A major part of outflows from NRI deposits is in the form of local withdrawals. These withdrawals, however, are not actually repatriated but are utilized domestically. During April-September 2009, the share of local withdrawals in total outflows from NRI deposits was 63.4 per cent as compared to 64.9 per cent in April-September 2008.

6.22 Under private transfers, inward remittances for family maintenance accounted for 53.3 per cent of total private transfer receipts, while local withdrawals accounted for 43.0 per cent in April-September 2009 as against 52.6 per cent and 42.3 per cent respectively in April-September 2008.

6.23 Software receipts at US$ 21.4 billion in April-September 2009 showed a decline of 11.5 per cent as against a growth of 35.3 per cent in April-September 2008. Miscellaneous receipts, excluding software exports, stood at US$ 7.8 billion in April-September 2009 (US$ 14.9 billion in April-September 2008). Receipts under non-software miscellaneous services like business services, construction and royalties, copyrights and licence fees declined.

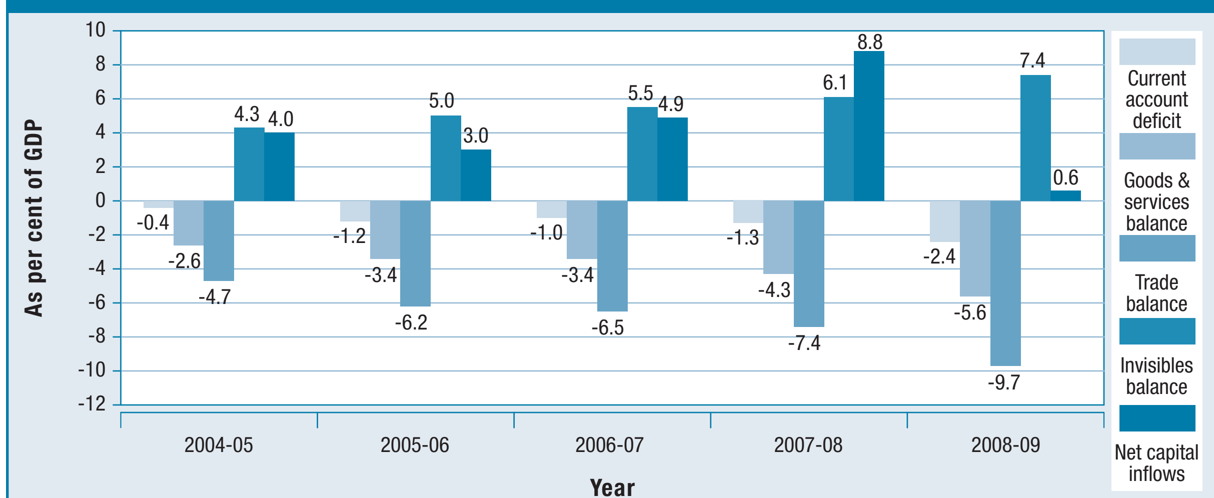
6.24 The key components of business services receipts and payments were trade-related services, business and management consultancy services, architectural, engineering and other technical services and services relating to maintenance of offices. Receipts of architectural, engineering and other technical services, maintenance of offices abroad and business and management consultancy services declined while payments related to these services rose moderately, resulting in decline in net exports of these services. Investment income receipts amounted to US$ 7.3 billion in April-

Table 6.3 : Selected indicators of the external sector

Sl. No.	Items	2004-05	2005-06	2006-07	2007-08	2008-09	Apr-Sep. 2008	Apr-Sep. 2009
1	Growth of Exports – BoP (%)	28.5	23.4	22.6	28.9	13.7	48.1	-27.0
2	Growth of Imports – BoP (%)	48.6	32.1	21.4	35.1	19.4	51.0	-20.6
3	Growth of Non-factor Services (Credit) (%)	61.0	33.3	28.0	22.4	12.5	29.1	-21.4
4	Growth of Non-factor Services (Debit) (%)	66.4	24.0	28.5	16.2	1.1	20.3	-4.6
5	Exports/Imports—BoP (%)	71.7	67.0	67.6	64.5	61.4	63.3	58.2
6	Exports/Imports of Goods and Services (%)	87.5	85.0	86.2	83.0	80.8	80.5	73.9
7	Import Cover of FER (No. of months)	14.3	11.6	12.5	14.4	9.8	10.8	12.4
8	External Assistance (net)/ TC (%)	6.9	6.7	3.9	2.0	30.5	6.5	2.0
9	ECB (net)/TC (%)	18.5	9.8	35.6	21.2	91.8	23.7	2.6
10	NRI Deposits / TC (%)	-3.4	11.0	9.6	0.2	49.6	8.0	10.2
		As per cent of GDPmp						
11	Exports	11.8	12.6	13.6	13.5	15.4	18.9	14.5
12	Imports	16.5	18.8	20.1	21.0	25.1	29.8	24.9
13	Trade Balance	-4.7	-6.2	-6.5	-7.4	-9.7	-10.9	-10.4
14	Invisible Balance	4.3	5.0	5.5	6.1	7.4	8.3	7.1
15	Goods and Services Balance	-2.6	-3.4	-3.4	-4.3	-5.6	-6.7	-7.7
16	Current Account Balance	-0.4	-1.2	-1.0	-1.3	-2.4	-2.7	-3.3
17	ECBs	0.7	0.3	1.7	1.8	0.7	0.5	0.1
18	FDI (net)	0.5	0.4	0.8	1.3	1.4	2.3	2.5
19	Portfolio Investment (net)	1.3	1.5	0.7	2.2	-1.2	-0.9	3.2
20	Total Capital Account (net)	4.0	3.0	4.9	8.8	0.6	2.3	5.0
21	External Debt	18.1	16.7	17.5	18.1	20.5	-	-

Source: RBI
TC: Total Capital Flows (net);
FER: Foreign Exchange Reserves;
ECBs: External Commercial Borrowings;
GDPmp: Gross Domestic Product at current market prices.

Figure 6.1 **Current account deficit, goods & services balance, trade balance, invisibles balance and net capital inflows as a per cent of GDP during 2004-05 to 2008-09**



September 2009 and remained at almost the same level as of the previous year.

6.25 Invisibles payments have also shown a decline of 2.6 per cent in April-September 2009 (against an increase of 15.0 per cent in April-September 2008). This decline is mainly due to lower payments towards travel, transportation, non-software services and private transfers. Lower transportation payments in April-September of 2009 (a decline of 29.4 per cent) mainly reflected the lower volume of imports. In addition, lower payments may also be attributed to the lower freight rates on international shipping as compared to the corresponding period of last year. Investment income payments, reflecting mainly interest payments on commercial borrowings, external assistance, non-resident deposits and reinvested earnings of FDI enterprises operating in India, amounted to US$ 9.4 billion in April-September 2009 higher than that of US$ 8.7 billion during April-September 2008. The increase in investment income payments was mainly due to a rise in reinvestment earnings of the FDI companies.

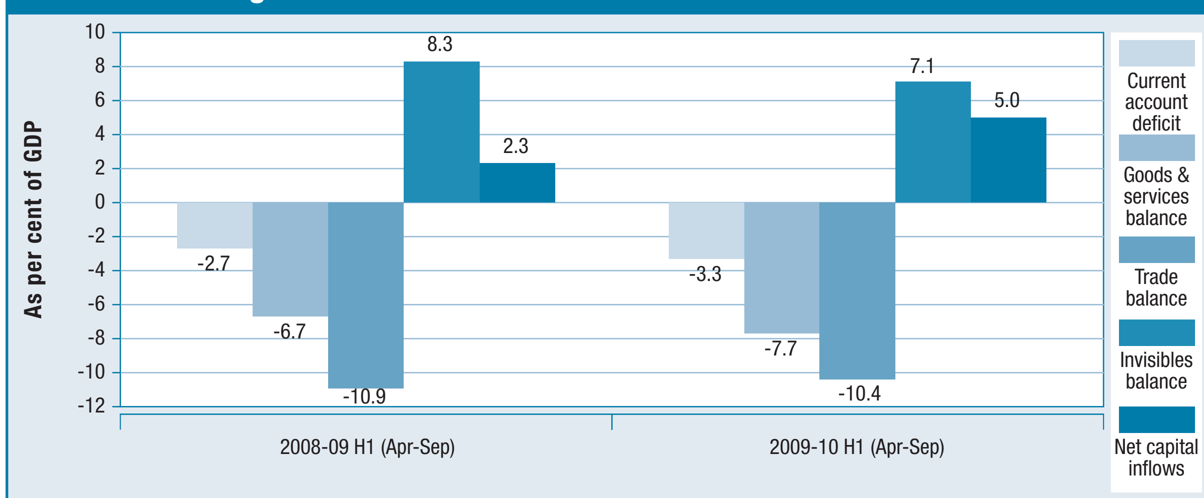
6.26 Consequently, net invisibles (invisibles receipts minus invisibles payments) stood lower at US$ 39.6 billion during April-September 2009 as compared to US$ 48.5 billion during April-September 2008. At this level, the invisibles surplus financed about 68.0 per cent of trade deficit during April-September 2009 as against 75.4 per cent during April-September 2008. (Table 6.3 and Figure 6.1).

Current Account Balance

6.27 The trade channel of the BoP played an important role in transmitting global economic shocks to India. A swifter impact of the slowdown in global demand on exports and relatively lagged response of imports to domestic demand slowdown tended to widen the trade deficit, notwithstanding the sharp decline in international crude oil prices in the second half of 2008-09. Some of the adverse impact of the considerable widening of the trade deficit on the overall current account during the year was, however, partly contained by the relative resilience of software services exports and remittances from overseas Indians. A notable feature in the last quarter of 2008-09, however, was significant narrowing down of the trade deficit on account of a larger decline in imports relative to exports, which along with the sustained invisibles surplus led to a significant reduction in the current account deficit (CAD). However, for fiscal 2008-09, despite the higher invisibles surplus of US$ 89.9 billion (7.4 per cent of GDP), the CAD increased to US$ 28.7 billion (2.4 per cent of GDP), mainly on account of the widening trade deficit, as compared to US$ 15.7 billion (1.3 per cent of GDP) in 2007-08.

6.28 The CAD, despite lower trade deficits, increased to US$ 18.6 billion in H1 (April-September) of 2009-10 from US$ 15.8 billion in April-September 2008 mainly due to a lower net invisibles surplus. (Figure 6.2)

Figure 6.2 Current account deficit, goods & services balance, trade balance, invisibles balance and net capital inflows as a per cent of GDP during H1 of 2008-09 and 2009-10



Capital Account

6.29 The impact of the global financial crisis through the financial channel was reflected in the sharp turnaround in the capital flows cycle from a sustained phase of surges in inflows to large outflows, particularly in Q3 (October-December 2008) of 2008-09. The early signs of the impact of the financial crisis on capital inflows were evident in the portfolio outflows that started in February 2008. Following the failure of Lehman Brothers, there was a sudden change in the external environment, characterized by a global liquidity squeeze and increased risk aversion on the part of international investors. As in the case of other major emerging market economies (EMEs) there was a withdrawal of funds from the domestic equity markets by portfolio investors as part of the global deleveraging process as also a significant reduction in the access of Indian corporates to overseas financing. Thus there were large capital outflows by portfolio investors during September-October 2008, with concomitant pressures in the foreign exchange market.

6.30 The deteriorating external financing conditions also rendered Indian firms' access to external commercial borrowings and trade credits somewhat difficult. The resilience shown by FDI inflows, however, reflects the continued confidence in the Indian economy as a long-term investment destination.

6.31 On the whole, the adverse impact of the global financial market turmoil was reflected in lower capital inflows during 2008-09. There was massive decline in net capital flows from US$ 106.6 billion in 2007-08 (8.8 per cent of GDP) to US$ 7.2 billion (0.6 per cent of GDP) in 2008-09. The decline was mainly due to net outflows under portfolio investment including foreign institutional investments (FIIs), American depository receipts (ADRs)/ global depository receipts (GDRs) (US$ 14.0 billion), banking capital including NRI deposits (US$ 3.2 billion) and short-term trade credit (US$ 1.9 billion). However, notwithstanding these adverse developments, the resilience of FDI inflows (US$ 17.5 billion in 2008-09) reflected the growing perception of India as one of the favourite long-term investment destinations.

6.32 The revival in capital flows witnessed during Q1 of 2009-10 gathered momentum during Q2 of 2009-10. Net capital flows at US$ 29.6 billion in April-September 2009 remained higher as compared to US$ 12.0 billion in April-September 2008. All the components under net capital flows, except loans and banking capital, showed improvement during April-September 2009 from their levels in the corresponding period of the previous year. In banking capital, net inflows under non-resident deposits remained higher during April-September 2009 as compared to their previous year's level.

6.33 Net inward FDI into India remained buoyant at US$ 21.0 billion during April-September 2009 (as against US$ 20.7 billion in April-September 2008) reflecting the continuing liberalization and better growth performance of the Indian economy. During this period, FDI was channeled mainly into manufacturing (21.4 per cent) followed by communication services (12.8 per cent) and the real estate sector (12.6 per cent). Net outward FDI of India at US$ 6.8 billion in April-September 2009 remained at almost the same level as that of the corresponding period of 2008-09. Due to the large inward FDI, the net FDI (inward minus outward) was marginally higher at US$ 14.1 billion in April-September 2009. Portfolio investment mainly comprising FIIs and ADRs/ GDRs witnessed large net inflows (US $ 17.9 billion) in April-September 2009 (net outflows of US $ 5.5 billion in April-September 2008). This was mainly due to large purchases by FIIs in the Indian capital market reflecting revival in the growth prospects of the economy and improvement in global investors' sentiment. The inflows under ADRs/GDRs increased to US$ 2.7 billion in April-September 2009 (as against US$ 1.1 billion in April-September 2008).

6.34 The net external commercial borrowings (ECBs) inflow remained lower at US$ 0.7 billion in April-September 2009 than the US $ 3.2 billion in April-September 2008. Banking capital (net) amounted to US$ 1.1 billion in April-September 2009 as compared to US$ 5.0 billion in April-September 2008. Among the components of banking capital, NRI deposits witnessed higher net inflows of US$ 2.9 billion in April-September 2009 as compared to US$ 1.1 billion in April-September 2008. Short-term trade credit recorded a net outflow of US$ 0.6 billion (inclusive of suppliers' credit up to 180 days) during April-September 2009 as against a net inflow of US$ 4.9 billion during the same period of the previous year. Other capital includes leads and lags in exports, special drawing rights (SDR) allocation, funds held abroad, advances received pending issue of shares under FDI and other capital not included elsewhere (n.i.e). Other capital recorded a lower net outflow of US$ 4.3 billion in April-September 2009 as compared to US$ 10.3 billion in April-September 2008.

Box 6.2 : Dubai Financial Crisis and the Indian Economy

Dubai World, the flagship holding company of the Dubai Government with active participation in some large real estate projects, sought a debt restructuring and six-month standstill in its debt repayment (estimated at US$ 59 billion as of August 2009) on November 25, 2009. Although there was initial reaction in the domestic foreign currency and Indian stock markets, the impact was insignificant and short-lived. The primary capital market remained unaffected and there was no visible effect of the Dubai news on the money and government securities markets. The markets recovered immediately, backed by the news of 7.9 per cent GDP growth in Q2 of 2009-10.

As regards its impact on the real sector, a quick assessment suggests that it may be modest. There could be some impact on India's exports and imports, keeping in view the significant share of the UAE in India's international trade. As Indian expatriates comprise a large percentage of the total workforce in Dubai, the crisis may lead to salary cuts or job losses for Indian workers in the construction sector with consequent effect on remittances and NRI deposits. The UAE accounts for 10 per cent of total remittances and 11.3 per cent of NRI deposits.

Subsequent developments indicate that the impact of the Dubai crisis on financial markets around the world has been contained, following the announcement by the UAE central bank that it would stand behind UAE banks and branches of foreign banks operating in the UAE. Furthermore, the Government of Abu Dhabi and the UAE central bank agreed to provide financial support to Dubai World. The Government of Abu Dhabi has agreed to grant US$ 10 billion to the Dubai Financial Support Fund for meeting a series of upcoming obligations of Dubai World including *sukuk* (Islamic bond) obligations of US$ 4.1 billion, which fell due on December 14, 2009. These assurances to trade creditors and contractors have provided confidence to the financial markets.

Foreign Exchange Reserves

6.35 Foreign exchange reserves are an important component of the BoP and an essential element in the analysis of an economy's external position. India's foreign exchange reserves comprise foreign currency assets (FCA), gold, special drawing rights (SDRs) and reserve tranche position (RTP) in the International Monetary Fund (IMF). The level of foreign exchange reserves is largely the outcome of the RBI's intervention in the foreign exchange market to smoothen exchange rate volatility and valuation changes due to movement of the US dollar against other major currencies of the world. Foreign exchange reserves are accumulated when there is absorption of the excess foreign exchange flows by the RBI through intervention in the foreign exchange market, aid receipts, interest receipts, and funding from the International Bank for Reconstruction and Development (IBRD), Asian Development Bank (ADB), International Development Association (IDA), etc. Both the US dollar and euro are intervention currencies. Foreign currency assets are maintained in major currencies like the US dollar, euro, pound sterling, Australian dollar and Japanese yen. Foreign exchange reserves are denominated and expressed in the US dollar only.

6.36 Beginning from a low level of US$ 5.8 billion at end-March 1991, foreign exchange reserves increased gradually to US$ 25.2 billion by end-March 1995, US$ 38.0 billion by end-March 2000, US$ 113.0 billion by end-March 2004 and US$ 199.2 billion by end-March 2007. They reached their peak at US$ 314.6 billion in end-May 2008. The reserves declined thereafter to US$ 252.0 billion at the end of March 2009. The decline in reserves in 2008-09 was inter alia a fallout of the global crisis and strengthening of the US dollar vis-à-vis other international currencies and the fact that our reserves are measured in dollar terms. During 2009-10, the level of foreign exchange reserves increased from US$ 252.0 billion at the end of March 2009 to US$ 283.5 billion at the end of December 2009, mainly on account of valuation gain as the US dollar depreciated against most of the other major international currencies in 2009. The component-wise details of foreign exchange reserves from 1950-51 to 2009-10 (up to December 2009) in rupees and US dollars are given in Appendix 6.1 (A) and 6.1 (B).

6.37 In fiscal 2008-09, the widening of the CAD coupled with net capital outflows resulted in the drawdown of foreign exchange reserves of US$ 20.1 billion (excluding valuation) as against an accretion of US$ 92.2 billion in 2007-08. During 2009-10, the accretion in foreign exchange reserves on a BoP basis (i.e. excluding valuation) was US$ 9.5 billion in H1 (April-September 2009) of 2009-10 as against a decline of US$ 2.5 billion during the corresponding period of the previous year. This was mainly on account of higher capital inflows to the tune of US$ 17.9 billion in the form of portfolio investment vis-a-vis an outflow of US$ 5.5 billion in H1 (April-September 2008) of 2008-09.

6.38 Taking into account the valuation effect, India's foreign exchange reserves recorded a decline of US $ 57.7 billion during 2008-09 to US $ 252.0 billion as at end-March 2009. Valuation loss arising out of depreciation of major currencies against the US dollar, at US$ 37.6 billion, accounted for 65.2 per cent of the total decline in foreign exchange reserves during 2008-09. However, in 2009-10 foreign

Table 6.4 : Sources of variation in foreign exchange reserves on BoP basis and valuation effect (US$ billion)

Sl.No.	Items	2007-08	2008-09	April-September 2008-09	April-September 2009-10
I	**Current Account Balance**	**(-) 15.7**	**(-) 28.7**	**(-)15.8**	**(-)18.6**
II	**Capital Account (net) (a to g)**	**107.9**	**8.6**	**13.4**	**28.2**
a	Foreign Investment (i+ii)	43.3	3.5	8.3	32.1
	(i) FDI	15.9	17.5	13.9	14.1
	(ii) Portfolio Investment of which:	27.4	(-) 14.0	(-)5.5	17.9
	FIIs	20.3	(-) 15.0	(-)6.6	15.3
	ADRs/GDRs	6.6	1.2	1.1	2.7
b	External Commercial Borrowings	22.6	7.9	3.2	0.7
c	Banking Capital	11.8	(-)3.2	5.0	1.1
	of which: NRI Deposits	0.2	4.3	1.1	2.9
d	Short-term Trade Credit	15.9	(-)1.9	4.9	(-) 0.6
e	External Assistance	2.1	2.6	0.9	0.6
F	Other Items in Capital Account*	11.0	-1.5	(-)10.3	(-)4.3
g	Errors and Omissions	1.3	1.4	1.4	-1.4
h	Overall balance (I+II)	92.2	(-)20.1	(-) 2.5	9.5
III	**Reserve Change on BoP Basis (Increase - / Decrease +)**	**(-) 92.2**	**(+) 20.1**	**(+) 2.5**	**(-)9.5**
IV	**Valuation Change**	**18.4**	**(-) 37.6**	**(-) 20.9**	**19.8**
	Total Reserve Change (III+IV) (Increase in reserves (+) / Decrease in reserves (-))	**110.6**	**(-) 57.7**	**(-) 23.4**	**29.3**

Source: RBI.
Note: * : 'Other items in capital account' include SDR allocations, leads and lags in exports, funds held abroad, advances received pending issue of shares under FDI and transactions of capital receipts not included elsewhere.
As per the BoP compilation practice, an increase in reserves is indicated by (-) sign and a decrease by (+) sign. For other items (+) sign indicates increase and (-) sign means decrease.

exchange reserves recorded an increase of US$ 29.3 billion in H1 (April-September 2009) of which US$ 19.8 billion was on account of valuation gain (Table 6.4).

Table 6.5 : Summary of changes in foreign exchange reserves (US$ billion)

Sl. No.	Year	Foreign exchange reserves at the end of financial year (end March)	Total Increase / decrease in reserves	Increase/decrease in reserves on a BoP basis	Increase/decrease in reserves due to valuation effect
1	2004-05	141.5	+ 28.6	+26.2 (91.6%)	+ 2.4 (8.4%)
2	2005-06	151.6	+ 10.1	+15.0 (148.5%)	(-) 4.9 (- 48.5%)
3	2006-07	199.1	+ 47.5	+36.5 (76.8%)	+ 11.0 (23.2%)
4	2007-08	309.7	+ 110.6	+92.2 (83.4%)	+ 18.4 (16.6%)
5	2008-09	252.0	- 57.7	-20.1 (34.8%)	- 37.6 (65.2%)
6	2009-2010 (upto Dec. 2009)	283.5	+31.5	+11.2 (35.6%)	+ 20.3 (64.4%)

Source: RBI.
Note: Figures in parentheses indicate percentage share in total change.

6.39 A summary of changes in the foreign exchange reserves since 2004-05 with a breakdown into increase/decrease on a BoP basis and valuation effect is presented in Table 6.5.

6.40 In 2009-10, three major developments have taken place in the area of foreign exchange reserves management. The first relates to investment of foreign exchange reserves in infrastructure projects. Pursuant to the announcement made in the Union Budget 2007-08 about using a part of the foreign exchange reserves for financing domestic infrastructure requirements without the risk of monetary expansion, the India Infrastructure Finance Company Limited was set up as a wholly owned subsidiary in London, UK, called IIFC (UK) in April 2008. The subsidiary will borrow up to US$ 5 billion in tranches from the RBI by issuing US dollar-denominated bonds and on-lend the resources to Indian infrastructure companies for meeting their capital expenditures outside India. It has already raised the first tranche of US$ 250 million. The second development relates to the IMF's allocation of SDRs to member countries including India. A general allocation of SDRs for an amount equivalent to US$ 250 billion and a special SDR allocation pursuant of the fourth amendment of the IMF's Articles of Agreement, amounting to US$ 33 billion, was made by the IMF to member countries on August 28, 2009 and September 9, 2009 respectively. India received SDR 3,082 million (equivalent to US$ 4,821 million) under general allocation and SDR 214.6 million (equivalent to US$ 340 million) under special allocation from the IMF. These SDR allocations have resulted in an increase of US$ 5.2 billion in India's foreign exchange reserves. The third major development was the purchase of gold from the IMF by the RBI (Box 6.3).

Box 6.3 : RBI purchase of gold from the IMF

The Executive Board of the IMF, on September 18, 2009 announced its decision to sell 403.3 metric tonnes of gold as a central element of its New Income Model and in order to increase its resources for lending to low-income countries. The IMF also decided that the initial offer of the sale would be directly to official holders, including central banks. Consequent of this, the RBIconcluded the purchase of 200 metric tonnes of gold from the IMF, under the IMF's limited gold sales programme, at the cost of US$ 6.7 billion, in November 2009, as part of its foreign exchange reserves management operation. The purchase was an official- sector off-market transaction and was executed over a two-week period during October 19-30, 2009 at market-based prices. With this purchase, gold holdings in the country's foreign exchange reserves have increased from 357.7 tonnes to 557.7 tonnes, which is about 6 per cent of the reserves. Post–purchase, India has become the 10th largest official gold-holding country in the world.

6.41 In line with the principles of preserving the long-term value of the reserves in terms of purchasing power and minimizing risk and volatility in returns, the RBI holds foreign currency assets (FCAs) in major convertible currencies instruments. These include deposits of other-country central banks, the Bank for International Settlements (BIS) and top-rated foreign commercial banks, and in securities representing debt of sovereigns and supranational institutions with residual maturity not exceeding 10years, to provide a strong bias towards capital preservation and liquidity. The annualized rate of return, net of depreciation, on the multi currency-multi asset portfolio of the RBI and gold declined marginally to 4.2 per cent in 2008-09 from 4.8 per cent in 2007-08.

6.42 Country-wise details of foreign exchange reserves reveal that India is the fourth largest foreign exchange reserves holder in the world, after China, Japan and Russia (Table 6.6).

Table 6.6 : Foreign exchange reserves of some major countries

Sl. No.	Country	Foreign exchange reserves during 2009 (US$ billion)
1	China (December 2009)	2399.2
2	Japan (December 2009)	1049.4
3	Russia (December 2009)	439.0
4	India (December 2009)	283.5
5	Korea (December 2009)	270.0
6	China P R Hong Kong (November 2009)	256.3
7	Brazil (December 2009)	238.5
8	Germany (November 2009)	189.5
9	Singapore(November 2009)	188.9
10	Italy (November 2009)	140.1
11	France (November 2009)	139.1

Source: IMF except China.

Table 6.7 : International comparison of foreign exchange reserves (US $ billion) and ratio of reserves to imports of goods & services

Country/ Country Group	2005	2006	2007	2008	2009 (Proj.)
Country					
Russia	176.5 (107.4)	296.2 (141.7)	467.6 (165.5)	413.4 (112.3)	380.7 (163.2)
China	822.5 (115.5)	1069.5 (125.4)	1531.3 (148.0)	1950.3 (158.2)	2240.0 (227.8)
India	132.5 (72.8)	171.3 (75.5)	267.6 (95.1)	248.0 (73.6)	263.1 (81.1)
Brazil	53.3 (54.4)	85.2 (70.7)	179.5 (113.8)	192.9 (87.6)	219.8 (129.6)
Mexico	74.1 (30.5)	76.3 (27.4)	87.1 (28.5)	95.1 (28.5)	93.5 (36.3)
Country Group					
Developing Asia (excluding China & India)	202.8 (38.4)	250.7 (42.3)	332.6 (49.0)	339.3 (41.8)	363.8 (53.6)
Middle East	357.7 (87.4)	491.1 (99.3)	695.6 (112.8)	825.9 (101.1)	870.3 (113.0)

Source : World Economic Outlook Database, October 2009.

Note : Reserves are based on offical holding of gold valued at SDR 35 an ounce. This convention results in a marked underestimation of reserves for countries that has substantial gold holdings.

India's FOREX reserves were US$ 283.5 billion (end of December 2009) and US$ 252.0 billion at the end of March 2009.

Figures in parentheses indicate ratio of reserves to imports of goods and services.

6.43 A comparative picture of foreign exchange reserves and import cover as measured by the ratio of foreign exchange reserves to import of goods and services for select country groups and countries including India is presented in Table 6.7. Among the country groups, "Developing Asia" and the "Middle East" accumulated reserves during the period 2005- 09, leading to steady improvement in the ratio of reserves to import of goods and services.

Exchange Rate

6.44 The exchange rate policy is guided by the broad principles of careful monitoring and management of exchange rates with flexibility, while allowing the underlying demand and supply conditions to determine its movements over a period in an orderly manner. Subject to this predominant objective, RBI intervention in the foreign exchange market is guided by the goals of reducing excess volatility, preventing the emergence of destabilizing speculative activities, maintaining adequate levels of reserves, and developing an orderly foreign exchange market.

6.45 In fiscal 2008-09, the rupee depreciated against major international currencies, except the pound sterling, due to deceleration in capital flows and widened trade deficit. The annual average exchange rate of the rupee in 2008-09 was Rs 45.99 per US dollar, Rs 64.98 per euro and Rs 46.22 per 100 yen, indicating depreciation by 12.5 per cent, 12.2 per cent and 23.5 per cent respectively over the annual average exchange rate during 2007-08. However, annual average exchange rate of the rupee per pound sterling of 78.29 in 2008-09 indicated appreciation by 3.2 per cent over 2007-08.

6.46 In fiscal 2009-10, the rupee has strengthened against the US dollar on the back of significant turnaround in FII inflows, continued inflows under FDI and NRI deposits, better macroeconomic performance of the Indian economy and weakening of the US dollar in international markets. Additionally, the outcome of the general elections, which generated expectations of political stability, buoyed the market sentiment and strengthened the rupee, especially in the second half of May 2009. The rupee exhibited significant strength against the US dollar in October 2009. However, since then it has generally been range-bound moving in the range of Rs 46-47 per US dollar. As a result, the rupee/US dollar exchange rate, which was Rs 50.95 per dollar in end-March 2009, appreciated to Rs 46.64 per dollar as on January 1, 2010. At this level, the Indian rupee has appreciated by 9.2 per cent over its March 31, 2009 level. Over the same period, the rupee recorded an appreciation of 1.0 per cent against the euro and 3.5 per cent against the Japanese yen. However, it depreciated by 3.4 per cent against the pound sterling. Movement in exchange rate of the rupee vis-à-vis major international currencies, month-wise, during 2009-10 (up to December 2009) is presented in Figure 6.3.

Figure 6.3 Month on month appreciation(+)/depreciation(-) of rupee against major international currencies during 2009-10

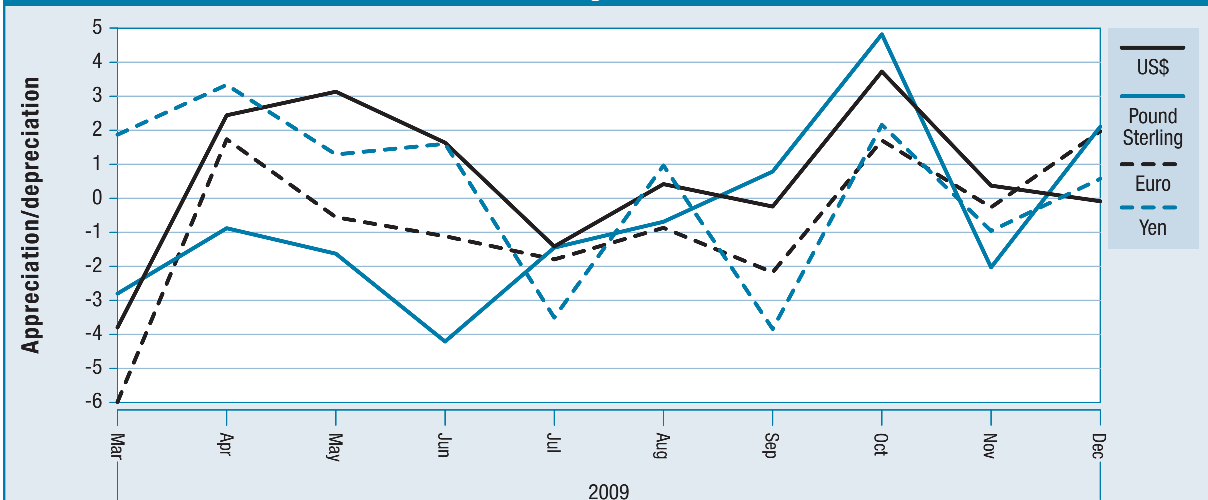
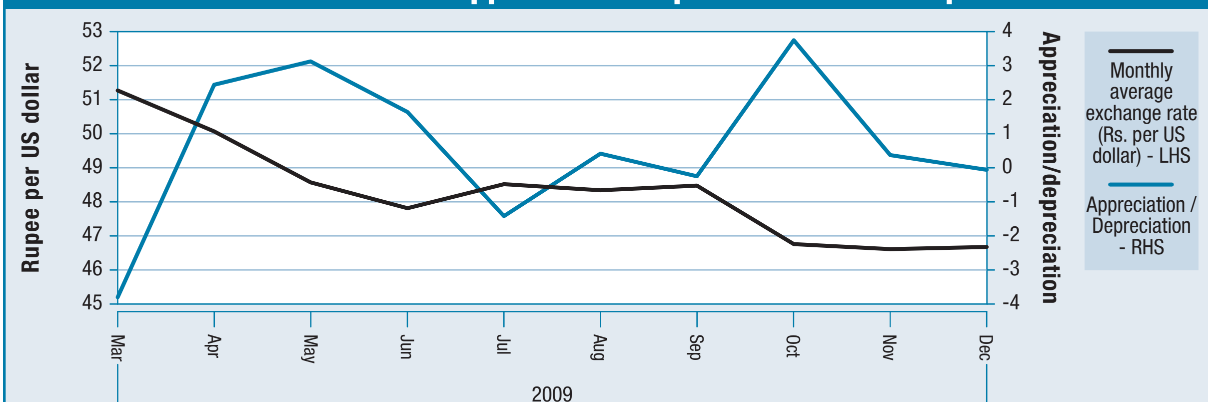


Figure 6.4 Monthly average exchange rate (Rupee per US dollar) during Mar - Dec 2009 and appreciation/depreciation over the previous month



6.47 In 2009-10, on a month-on-month basis, the average monthly exchange rate of the rupee appreciated during April-June, August and October-November while it depreciated during July, September and December. The average monthly exchange rate of the rupee strengthened from Rs 51.23 per US dollar during March 2009 to Rs 46.63 per US dollar during December 2009 (Figure 6.4).

6.48 The month-wise details of the exchange rate of the rupee against major international currencies and the RBI's sale/purchase of foreign currency in the foreign exchange market during 2009-10 are indicated in Table 6.8.

6.49 The exchange rate of the rupee vis-à-vis select international currencies since 1980-81, year-wise, and during 2009-10, month-wise, is indicated in Appendix 6.5.

6.50 During 2008-09, the US dollar generally appreciated against most currencies, except the Japanese yen and Chinese yuan. During 2009-10 so far, the appreciating trend has been reversed because of declining safe haven flows to the US, large-scale quantitative easing in the US and change in market sentiment against the dollar. However, the dollar gained some strength against major currencies, especially in December 2009, on the back of various

Table 6.8 : Exchange rates and RBI's sale/purchase of foreign currency in the exchange market during 2009-10

Month	Monthly average exchange rates (Rupee per foreign currency)*, US$	Pound Sterling	Euro	Yen**	RBI Net sale (-) / purchase (+) (US$ million)
Average 2008-09	45.99 (-12.46)	78.29 (3.24)	64.98 (-12.20)	46.22 (-23.53)	- -
March 2009	51.23 (-3.84)	72.90 (-2.85)	66.92 (-6.03)	52.51 (1.83)	(-) 3,388
2009-10					
April 2009	50.03 (2.39)	73.58 (-0.92)	65.81 (1.69)	50.84 (3.29)	(-) 2,487
May 2009	48.53 (3.09)	74.83 (-1.67)	66.20 (-0.60)	50.22 (1.25)	(-) 1,437
June 2009	47.77 (1.59)	78.16 (-4.25)	66.98 (-1.16)	49.45 (1.56)	(+) 1,044
July 2009	48.48 (-1.46)	79.35 (-1.50)	68.24 (-1.85)	51.26 (-3.55)	(-) 55
August 2009	48.30 (0.37)	79.93 (-0.73)	68.87 (-0.92)	50.80 (0.92)	(+) 181
September 2009	48.44 (-0.29)	79.35 (0.74)	70.44 (-2.22)	52.85 (-3.89)	(+) 80
October 2009	46.72 (3.68)	75.73 (4.78)	69.29 (1.66)	51.76 (2.12)	(+) 75
November 2009	46.57 (0.33)	77.33 (-2.07)	69.50 (-0.31)	52.28 (-1.0)	(-) 36
December 2009	46.63 (-0.13)	75.76 (2.06)	68.18 (1.93)	52.00 (0.52)	

Source : RBI
*** FEDAI indicative rate; ** Per 100 Yen.**
Figures in parentheses indicate appreciation (+) and depreciation (-) over the previous month/year.

indicators suggesting a pick-up in economic activity in the US and financial market conditions turning more conducive to economic growth. Between end-March and end-December 2009, the US dollar

Table 6.9 : Exchange rate of US dollar against international currencies during 2009-10

Month / Year (End month)	GBP/USD	Euro/USD	USD/JPY	AUD/USD
March 2009	1.4327	1.3249	98.84	0.6921
April 2009	1.4787	1.3226	98.57	0.7252
May 2009	1.5511	1.3690	96.79	0.7656
June 2009	1.6466	1.4036	96.33	0.8070
July 2009	1.6721	1.4250	94.68	0.8354
August 2009	1.6276	1.4249	95.18	0.8321
September 2009	1.6257	1.4506	90.85	0.8544
October 2009	1.6202	1.4772	90.18	0.8949
November 2009	1.6570	1.4886	88.08	0.9156
December 2009	1.6278	1.4696	89.65	0.9044
US$ Appreciation (+) / Depreciation (-) (End December 2009 over March 2009)	-11.99	-9.85	-9.30	-23.47

Source: RBI

depreciated by 12.0 per cent against the pound sterling, 9.9 per cent against the euro, 9.3 per cent against the Japanese yen and 23.5 per cent against the Australian dollar. Among Asian currencies, it depreciated against the Indian rupee, Indonesian rupiah, Malaysian ringgit, South Korean won and Thai Baht. The exchange rate of the US dollar vis-a-vis other major international currencies, namely pound sterling, euro, Japanese yen and Australian dollar is presented in Table 6.9.

6.51 The nominal effective exchange rate (NEER) and real effective exchange rate (REER) indices are used as indicators of external competitiveness of the country over a period of time. NEER is the weighted average of bilateral nominal exchange rates of the home currency in terms of foreign currencies. REER is defined as a weighted average of nominal exchange rates adjusted for home and foreign country relative price differentials. REER captures movements in cross-currency exchange rates as well as inflation differentials between India and its major trading partners. The RBI has been constructing six currency (US dollar, euro for eurozone, pound sterling, Japanese yen, Chinese renminbi and Hong Kong dollar) and 36 currency indices of NEER and REER.

6.52 The rupee appreciated against the US dollar by 10.0 per cent during 2009-10 till November 2009. The rupee appreciation was, however, modest at 3.23 per cent against the six-currency trade-weighted NEER during 2009-10 (March to November 2009). The average six-currency trade-weighted REER (base:1993-94=100) increased from 98.58 in April 2009 to 104.94 in November 2009 mainly on account of appreciation of the rupee against the US dollar and increase in inflation differentials between India and its trading partners (Table 6.10 and Appendix 6.6).

The G-20

6.53 The G-20 is taking up the cause of global stability, policy coordination and growth at global level. The details of G-20 summits held in 2009 are as under:

London Summit (UK): April 2, 2009

6.54 The summit was held against a backdrop of economic and financial crisis of enormous proportions. The leaders resolved to restore confidence, growth and jobs; repair the financial system to restore lending; strengthen financial regulation to rebuild trust; fund and reform the international financial institutions; promote global trade and investment and reject protectionism; and build an inclusive and sustainable recovery.

6.55 The 'Global Plan for Recovery and Reform' brought out at the Summit, inter alia, pledged significant reforms towards:

Table 6.10 : Movement of rupee and indices of NEER and REER during 2009-10

Month/Year	Rs per US dollar	Appreciation (+)/ depreciation (-) in Rs per dollar over previous month	NEER *	REER *	Appreciation (+)/ depreciation (-) in NEER over previous month	Appreciation (+)/ depreciation (-) in REER over previous month
2008-09 (April-March)	45.99		64.87	104.47		
March 2009	51.23		60.35	95.68		
2009-10						
April 2009 (P)	50.03	2.39	61.49	98.58	1.89	3.03
May 2008 (P)	48.53	3.09	62.31	101.37	1.33	2.83
June 2009 (P)	47.77	1.59	62.43	101.11	0.19	(-) 0.26
July 2009 (P)	48.48	(-) 1.46	61.36	100.64	(-) 1.71	(-) 0.46
August 2009 (P)	48.30	0.37	61.22	101.52	(-) 0.23	0.81
September 2009 (P)	48.44	(-) 0.29	60.61	101.25	(-) 1.00	(-) 0.27
October 2009 (P)	46.72	3.68	62.40	103.84	2.95	2.56
November 2009 (P)	46.57	0.33	62.30	104.94	(-) 0.16	1.05
December 2009 (P)	46.63	(-) 0.13				

Source : RBI

*** Six-Currency Trade Based Weights- Base: 1993-94 (April-March) =100**

- Restoring growth and jobs;
- Strengthening financial supervision and regulation;
- Strengthening our global financial institutions;
- Resisting protectionism and promoting global trade and investment; and
- Ensuring a fair and sustainable recovery for all.

6.56 As per the London communique the leaders have agreed to treble resources available to the IMF to $ 750 billion, to support a new SDR allocation of $ 250 billion, to support at least $100 billion of additional lending by the multilateral development banks (MDBs), to ensure $ 250 billion of support for trade finance, to use the additional resources from agreed IMF gold sales for concessional finance for the poorest countries and to constitute an additional $ 1.1 trillion programme of support to restore credit, growth and jobs in the world economy.

Box 6.4 : What is the G-20?

The Group of Twenty (G-20) Finance Ministers and Central Bank Governors was established in 1999 in Berlin to bring together systemically important industrialized and developing economies to discuss key issues in the global economy. The member countries of the G-20 are Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the United Kingdom, the United States of America and the European Union represented by rotating Council presidency and the European Central Bank. To ensure that global economic fora and institutions work together, the Managing Director of the IMF and the President of the World Bank, plus the chairs of the International Monetary and Financial Committee and Development Committee of the IMF and World Bank, are ex-officio members of the G-20. Together G-20 member countries represent 90 per cent of global gross national product, 80 per cent of world trade as well as two-thirds of the world's population.

Pittsburgh Summit (USA): September 24-25, 2009

6.57 The summit of G-20 leaders was held in the midst of a critical transition from crisis to recovery to turn the page on an era of irresponsibility and to adopt a set of policies, regulations and reforms to meet the needs of the 21st century global economy. The Summit declaration, inter alia, pledged to sustain a strong policy response until a durable recovery is secured and to adopt the policies needed to lay the foundation for strong, sustained and balanced global growth in the 21st century. The G-20 leaders agreed to:

- Launch a framework that lays out the policies and the way we act together to generate strong, sustainable and balanced global growth.
- Make sure the regulatory system for banks and other financial firms reins in the excesses that led to the crisis.
- Reform the global architecture to meet the needs of the 21st century.
- Take new steps to increase access to food, fuel and finance among the world's poorest while clamping down on illicit outflows.
- Phase out and rationalize over the medium term inefficient fossil fuel subsidies while providing targeted support for the poorest.
- Maintain openness and move toward greener, more sustainable growth.

6.58 The Pittsburgh Summit agreed that the G-20 would be the premier forum for international economic issues. The Summit agreed on an at least 5 per cent shift in the IMF quota to underrepresented countries and on a new framework for global macro-balances that includes contributions that individual countries can make through their own policies, with a process of peer review. The objective is that members agree on shared policy objectives, set out medium-term policy frameworks and work together to assess the collective implications of national policy for global growth, identifying potential risks to financial stability and based on mutual assessment, and agree on actions to meet common goals.

6.59 The G-20 leaders also announced that there would be two meetings in 2010, in Canada in June 2010 and in Korea in November 2010 to coincide with the APEC Summit, and annual summits thereafter.

St Andrews Meeting (Scotland): November 7, 2009

6.60 G20 Finance Ministers and Central Bank Governors observed that though the economic and financial conditions have improved following coordinated response to the crisis, the recovery is uneven and remains dependent on policy support, with high unemployment being a major concern. To restore the global economy and financial system to

health, it was agreed to maintain support for the recovery until it is assured.

6.61 To underscore the new approach to economic cooperation, the G20 has launched a 'Framework for Strong, Sustainable and Balanced Growth', adopted a detailed timetable and initiated a new consultative mutual assessment process to evaluate whether policies will collectively deliver the agreed objectives. The first challenge in using the Framework is the transition from crisis response to stronger, more sustainable and balanced growth, consistent with the goals of sustainable public finances; price stability; stable, efficient and resilient financial systems; employment creation; and poverty reduction. The International Financial Institutions (IFIs) will play an important role in supporting the work to secure sustainable growth, stability, job creation, development and poverty reduction. In addition to strengthening the global financial system, the G-20 agreed to work with the Financial Stability Board (FSB) to maintain the momentum of the programme of reforms, and ensure its full, timely and consistent implementation and a level playing field.

Achievements of the G-20

6.62 The G-20 has made considerable progress over a range of issues since 1999, including agreement about policies for growth, reducing abuse of the financial system, dealing with financial crises and combating terrorist financing. The G-20 also aims to foster the adoption of internationally recognized standards through the example set by its members in areas such as transparency in fiscal policy and combating money laundering and the financing of terrorism. In 2004, G-20 countries committed to new higher standards of transparency and exchange of information on tax matters. This aims to combat abuses of the financial system and illicit activities including tax evasion. The G-20 also aims to develop a common view among members on issues related to further development of the global and financial system.

6.63 To tackle the financial and economic crisis that spread across the globe in 2008, the G-20 members were called upon to further strengthen international cooperation. Since then, the concerted and decisive actions of the G-20 have helped the world deal effectively with the current financial and economic crisis. The G-20 has already delivered a number of significant and concrete outcomes. For example, it committed to implementing the unprecedented and most coordinated expansionary macroeconomic policies, including fiscal expansion of US$ 5 trillion and establishment of the FSB, and substantially strengthening the IFIs, including the expansion of resources and the improvement of their precautionary lending facilities.

6.64 Reflecting on these achievements and recognizing that more needs to be done to ensure a strong, sustained and balanced global recovery, the G-20 leaders at Pittsburgh designated the G-20 as the premier forum for international economic cooperation.

External Debt

6.65 India's external debt stock stood at US $ 224.59 billion (Rs 1,142,618 crore) in end-March 2009, that is fractionally higher than its previous year's level of US$ 224.41 billion (Rs 897,314 crore).

6.66 During the first half of 2009-10, total external debt increased by US$ 18.2 billion (8.1 per cent) to US$ 242.8 billion (Rs 1,166,217 crore). Long-term debt posted an increase of US$ 19.2 billion (10.6 per cent) to stand at US$ 200.4 billion, while short-term debt fell by US$ 985 million (-2.3 per cent) to stand at US$ 42.4 billion. The share of long-term debt was higher at 82.5 per cent in end-September 2009 as against 80.7 per cent in end-March 2009. Concomitantly, the share of short-term debt declined to 17.5 per cent in end-September 2009 from 19.3 per cent in end-March 2009.

6.67 The valuation effect arising due to depreciation of the US dollar against major international currencies contributed an increase of US$ 8.3 billion in the total increase of US$ 18.2 billion in external debt as in end-September 2009 over the end-March 2009 level. Excluding the valuation effect, the increase in external debt would have been US$ 9.9 billion.

6.68 Commercial borrowings remained the largest component of external debt with a share of 27.5 per cent in end-September 2009 (27.8 per cent in end-March 2009). Reflecting the impact of an increase in NRI deposits attributable to an upward revision in interest rate ceiling on these deposits, there was an improvement in their share from 18.5 per cent in end-March 2009 to 18.9 per cent in end-September 2009. Multilateral debt accounted for 17.4 per cent of total external debt, followed by bilateral debt (9.1 per cent), export credits (6.3 per cent), IMF representing SDR allocations (2.6 per cent) and rupee debt (0.7 per cent) as in end-September 2009.

Table 6.11 : India's external debt

Components	(US$ billion)						
	End March					End-June 2009 PR	End-Sept. 2009 QE
	2005	2006	2007R	2008 R	2099 PR		
Long-term Debt	116.28	119.58	144.23	178.68	181.23	187.75	200.45
Short-term Debt	17.72	19.54	28.13	45.74	43.36	42.03	42.38
Total External Debt	134.00	139.11	172.36	224.41	224.59	229.78	242.82
(Rupee crore)							
Long-term Debt	5,08,777	5,33,367	6,28,771	7,14,433	9,21,710	9,01,840	9,62,640
Short-term Debt	77,528	87,155	1,22,631	1,82,881	2,20,908	2,01,234	2,03,577
Total External Debt	5,86,305	6,20,522	7,51,402	8,97,314	1,142,618	1,103,074	1,166,217

R: Revised; PR: Partially Revised; QE: Quick Estimates.

Trade-related credits at US$ 39.3 billion constituted 92.8 per cent of total short-term debt and 16.2 per cent of total external debt at the end of September 2009.

Box 6.5 : External commercial borrowing (ECB) policy measures during 2009-10

The broad ECB policy stance towards liberalization continued during the first half of 2009-10. However, it has been decided to roll back some of the policy measures which were introduced against the backdrop of tightness in financial markets during the period of financial crisis. These policy measures have become effective from January 1, 2010.

Non-banking financial companies (NBFCs), exclusively involved in financing of the infrastructure sector, were allowed to avail of ECBs from multilateral/regional financial institutions and Government-owned development financial institutions for on-lending to borrowers in the infrastructure sector under the approval route, subject inter alia to the condition that the direct lending portfolio of these lenders vis-à-vis their total ECB lending to NBFCs, at any point of time, should not be less than 3:1 (January 2, 2009). On a review of the policy, it was decided to dispense with this condition with effect from July 1, 2009 (June 30, 2009). Furthermore, it has been decided with immediate effect to allow NBFCs exclusively involved in financing infrastructure projects to avail of ECB from the recognized lender category including international banks under the approval route, subject to complying with the prudential standards prescribed by the Reserve Bank and the borrowing entities fully hedging their currency risk (December 9, 2009).

Payment for obtaining licence/permit for the 3G Spectrum was allowed as an eligible end-use for the purpose of ECB under the automatic route (October 22, 2008). It has been decided to permit eligible borrowers in the telecommunication sector with immediate effect to avail of ECB for the purpose of payment for spectrum allocation (December 9, 2009).

It was decided to extend the permission granted to corporates engaged in the development of integrated township to avail of ECBs under the approval route until December 31, 2009. This has been extended further to December 31, 2010 (December 9, 2009).

Keeping in view the prevailing market conditions, the all-in-cost ceilings applicable to ECBs under the approval route were dispensed with until June 30, 2009 (January 2, 2009). On considering the continuing pressure on credit spreads in the international markets, it was decided in June 2009 to extend the relaxation in all-in-cost ceilings under the approval route until December 31, 2009. However, in view of the improvement in credit market conditions and narrowing credit spreads in the international markets, it has been decided to withdraw the existing relaxation with effect from January 1, 2010. The all-in-cost ceilings under the approval route for ECBs, where loan agreements have been signed on or after January 1, 2010, will be 300 basis points and 500 basis points over six month Libor for an average maturity period of three years and up to five years and more than five years, respectively (December 9, 2009).

Buy-back/pre-payment of foreign currency convertible bonds (FCCBs)

The procedure relating to premature buyback of FCCBs by Indian companies, both under the automatic and approval routes was liberalized on December 6, 2008, by which the Reserve Bank could consider proposals from Indian companies for buyback of FCCBs under the approval route subject to the buyback value of the FCCB being at a minimum discount of 25 per cent on the book value and use of funds out of internal accruals of the company. Total amount of buyback under the approval route is subject to a limit of US$ 50 million of the redemption value per company. The date for completing the entire procedure for buyback of FCCBs was extended from March 31, 2009 to December 31, 2009. Keeping in view the prevailing macroeconomic conditions and global developments, especially the improvement in the stock prices, it has recently been decided to discontinue the facility with effect from January 1, 2010 (December 9, 2009).

Table 6.12 : Currency composition of India's external debt and sovereign external debt (as per cent of total external debt)

Sl. No.	Currency	Total external debt				Sovereign external debt			
		As at the end of							
		March 2008R	March 2009R	June 2009PR	Sept. 2009QE	March 2008R	March 2009R	June 2009PR	Sept. 2009QE
1.	US Dollar	55.3	54.1	52.3	51.4	26.7	29.6	29.1	25.8
2.	SDR	10.5	9.8	10.0	12.0	40.8	39.5	39.2	44.2
3.	Indian Rupee	16.2	15.4	16.3	16.6	7.9	5.7	6.7	6.8
4.	Japanese Yen	12.0	14.3	14.5	13.6	18.6	19.9	19.8	18.4
5.	Euro	3.5	4.1	4.3	3.9	5.9	5.2	5.2	4.8
6.	Pound Sterling	2.2	2.0	2.2	2.1	0.1	0.1	0	0
7.	Others	0.3	0.3	0.4	0.4	0	0	0	0
	Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

R: Revised PR: Partially Revised. QE Quick Estimates

6.69 Short-term debt by residual maturity, which comprises principal repayments during a one-year reference period under medium- and long-term debt liabilities, and short-term debt with original maturity of one year or less are important indicators of debt sustainability in volatile financial market conditions. Short-term external debt by original maturity stood at US$ 42.4 billion in end-September, while total short-term debt by residual maturity was US$ 93.2 billion, accounting for 38.4 per cent of total external debt outstanding in end-September 2009. NRI deposits maturing within a period of one year at US$ 36.7 billion worked out to 39.4 per cent of total short-term debt by residual maturity. However, 69.3 per cent of these deposits are denominated and payable in Indian rupees. The observed redemption pattern of NRI deposits indicates that these are generally locally withdrawn and are also renewed by NRIs. Between end-March and end-September 2009, there was an improvement in the ratio of short-term debt by residual maturity to foreign exchange reserves from 37.0 per cent to 33.1 per cent.

6.70 Government debt stood at US$ 65.7 billion in end-September 2009 while non-Government debt amounted to US$ 177.1 billion. The share of Government debt in total external debt declined from 40.6 per cent in end-March 2004 to 24.9 per cent in end-March 2009, before rising to 27.1 per cent in end-September 2009. The external assistance component of Government debt at US$ 55.1 billion in end-September 2009 was higher than its end-March 2009 level of US$ 51.8 billion. Other Government external debt also recorded an increase from US$ 4.1 billion in end-March 2009 to US$ 10.6 billion in end-September 2009, attributable mainly to additional SDR allocations of 3,082.51 million under general allocation on August 28, 2009 and 214.57 million under special allocation on September 9, 2009 by the IMF. The ratio of Government debt to GDP remained around 5.0 per cent in the last three years.

6.71 US dollar-denominated debt accounted for 51.4 per cent of total external debt in end-September 2009, followed by Indian rupee (16.6 per cent), Japanese yen (13.6 per cent), SDR (12.0 per cent), Euro (3.9 per cent) and pound sterling (2.1 per cent) denominated debt. The currency composition of Government debt indicates predominance of SDR-denominated debt, which is attributable to borrowing from the International Development Association (IDA), that is the soft loan window of the World Bank under the multilateral agencies and inclusion of SDR allocations by the IMF as an external debt liability of the Government. The share of the Japanese yen in Government debt is also higher on account of borrowing from Japan, which is denominated in Japanese yen.

6.72 The debt sustainability indicator, that is ratio of foreign exchange reserves to total external debt showed an improvement from 112.1 per cent in end-March 2009 to 115.4 per cent in end-June 2009 and further to 115.8 per cent in end-September 2009. The ratio of short-term external debt to foreign exchange reserves, which had increased from 14.8 per cent in end-March 2008 to 17.2 per cent in end-March 2009, was also lower at 15.1 per cent in end-September 2009. The concessional debt portion of external debt has declined steadily and worked out

Table 6.13 : India's key external debt indicators (per cent)

Year	External debt (US$ billion)	Ratio of total external debt to GDP	Debt-service ratio@	Ratio of foreign exchange reserves to total external debt	Ratio of concessional debt to total external debt	Ratio of short-term debt to foreign exchange reserves	Ratio of short-term debt to total debt
1990-91	83.8	28.7	35.3	7.0	45.9	146.5	10.2
1995-96	93.7	27.0	26.2	23.1	44.7	23.2	5.4
2001-02	98.8	21.1	13.7	54.7	35.9	5.1	2.8
2003-04 R	112.7	18.0	16.1**	100.3	35.8	3.9	3.9
2004-05 R	134.0	18.1	5.9 ^	105.6	30.7	12.5	13.2
2005-06 R	139.1	16.7	10.1#	109.0	28.4	12.9	14.1
2006-07 R	172.4	17.5	4.7	115.6	23.0	14.1	16.3
2007-08 R	224.4	18.1	4.8	138.0	19.7	14.8	20.4
2008-09PR	224.6	20.5	4.4	112.1	18.7	17.2	19.3
End-June 2009 PR	229.8	-	-	115.4	18.9	15.9	18.3
End-Sept. 2008 PR	225.1	-	-	127.2	18.4	17.7	22.5
End-Sept. 2009 QE	242.8	-	-	115.8	18.4	15.1	17.5

R: Revised; PR: Partially Revised; QE: Quick Estimates.
- Not worked out for the broken period.
@ Debt-service ratio is the proportion of gross debt service payments to External Current Receipts (net of official transfers).
** Works out to 8.2 per cent, with the exclusion of pre-payment of US$ 3,797 million and redemption of Resurgent India Bonds (RIBs) of US$ 5,549 million.
^ Works out to 5.7 per cent with the exclusion of pre-payment of US$ 381 million.
# Works out to 6.3 per cent, with the exclusion of IMDs repayments of US$ 7.1 billion and pre-payment of US$ 23.5 million.

Table 6.14 : International comparison of top 20 debtor developing countries 2007

Sl No.	Countries	External debt stock (US $ million)	External debt to GNI (per cent)	Short-term debt to external debt (per cent)	Foreign exchange reserves to external debt (per cent)	Concessional debt to total external debt (per cent)
1	Argentina	1,27,758	49.7	29.8	36.1	1.3
2	Brazil	2,37,472	18.7	16.5	75.9	1.0
3	Chile	58,649	40.3	22.7	28.7	0.4
4	China	3,73,635	11.6	54.5	413.9	10.1
5	Colombia	44,976	22.5	11.9	46.6	2.1
6	Croatia	48,584	97.7	10.5	28.1	2.1
7	India	2,20,956	18.9	19.8	125.2	21.7
8	Indonesia	1,40,783	33.9	24.8	40.4	26.2
9	Kazakhstan	96,133	103.7	12.2	18.4	1.0
10	Malaysia	53,717	29.4	28.4	189.9	6.1
11	Mexico	1,78,108	17.7	5.1	49.0	0.6
12	Philippines	65,845	41.9	10.8	51.2	20.0
13	Poland	1,95,374	47.7	30.9	33.6	0.4
14	Romania	85,380	51.5	35.7	46.8	1.6
15	Russian Federation	3,70,172	29.4	21.4	129.1	0.4
16	South Africa	43,380	15.8	38.2	75.9	-
17	Thailand	63,067	26.5	34.3	138.7	9.6
18	Turkey	2,51,477	38.8	16.6	30.4	2.1
19	Ukraine	73,600	52.9	31.1	44.1	2.2
20	Venezuela	43,148	18.7	27.1	78.2	0.5
	All developing countries	**34,66,045**		**24.5**		

Source : Global Development Finance 2009, World Bank.

to 18.4 per cent in end-September 2009 as against 18.7 per cent in end-March 2009 (Table 6.13).

International Comparison level

6.73 A cross-country comparison of external debt of 20 most indebted developing countries, based on the data given in World Bank's publication titled Global Development Finance, 2009 showed that India was the fifth most indebted country in 2007 in terms of stock of external debt. The ratio of India's external debt stock to gross national income (GNI) as of 2007 at 18.9 per cent was the sixth lowest with China having the lowest ratio at 11.6 per cent. The element of concessionality in India's external debt portfolio was the second highest after that of Indonesia.

6.74 In terms of the cover of external debt provided by foreign exchange reserves, India's position was the fifth highest at 125.2 per cent after China, Malaysia, Thailand and the Russian Federation. A comparison of the share of short-term debt in total external debt across countries reveals that India's position was the eighth lowest with Mexico having the lowest ratio.

Challenges

6.75 Indian economy has been one of the least affected by the global crisis. In fact, India is one of the growth engines, along with China, in facilitating faster turnaround of the global economy. Risks, however, remain. *Firstly*, despite recovery, advanced countries continue to face risk of double-dip recession with high unemployment rate, growing fiscal deficit and high public debt - GDP ratios. Such risks can have direct implications for the Indian economy, which is increasingly integrated with the rest of the world.

6.76 *Secondly*, with interest rates at historic low in most advanced economies, capital flows from these countries are finding their way into the fast growing Asian economies including India. The issues that arise are whether the inflows are in excess of the domestic absorptive capacity and whether they could lead to overheating of the economy. The related issue is the need to balance the competing objectives of price and exchange stability. This can also be looked at as the "impossible trinity" dilemma of policy choice between price stability, exchange rate stability and capital mobility.