External Sector

The world economy grew by 5.1 per cent in 2004, with growth in the volume of international trade (goods and services) touching 10.3 per cent (Table E.1). Global growth is expected to slip to 4.3 per cent in 2005 and the volume of international trade to seven per cent. While the inflation in oil prices would be higher in 2005, it is expected to be less for manufactures and non-oil primary commodities (Table E.2). The world economy is expected to grow at the same rate in 2006 as in 2005[1].

There has been a deceleration in the major developed economies and some emerging economies in Latin America and East Asia. The slowdown in the advanced economies has been widespread and has affected performance of the United States, Japan and the Euro area. While the slowdown in the US economy may be temporary, Japan and the Euro area have lacked the dynamism needed to redress domestic imbalances. But this may be changing.

One of the major concerns about global economic prospects is the increase in oil prices. The price per barrel has been hovering around US$ 63 as on October 12 2005 up from US$ 49 in January 2005. The recent surge in oil prices has had a strong impact on the oil-importing developing economies, especially countries where industrialization has led to a greater dependence on oil imports. This might lead to inflationary pressures and imply risks for sustainability of the growth process.

Global current account imbalances have increased further. Driven by higher oil prices and continued relatively strong domestic demand, the US current account deficit is projected to rise to over six per cent in 2005. However, the US dollar has appreciated modestly in trade-weighted terms during the 9-month period from January to September 2005. The large global current account imbalances represent the greatest short-term risk for stable growth in the world economy.

Global growth in 2005 is expected to be 4.3 per cent, compared to 5.1 per cent in 2004

India's Merchandise Trade

Despite a continuous appreciation in the real effective exchange rate (REER), India's merchandise exports grew at an average annual rate of 17.1 per cent per annum during the last five years (2000-01 to 2004-05). The 36-country REER for India has been appreciating since 2000-01, both in terms of export-based as well as trade-based weights. The appreciation has been relatively high at 3.9 per cent per annum on the average during the four-year period from 2000-01 to 2003-04. 2004-05 has again posted REER appreciation of 4.0 per cent (Table E.3). Notwithstanding this, India has posted remarkable success on merchandise exports during the years 2000-01 to 2004-05, except for the year 2001-02.

International trade growth is expected to be seven per cent in 2005

[1] Discussion in this section draws upon World Economic Outlook, September 2005, IMF and Trade and Development Report, 2005, UNCTAD.

Exports, measured in US dollars, grew by more than 20 per cent in 2002-03 and 2003-04 and by 24.4 per cent in 2004-05.

However, the remarkable success of India's merchandise exports during the last three years (2002-03 to 2004-05) loses some of its fizz if one takes into account the depreciation of the US dollar in the international market. The dollar has not only depreciated against the Indian rupee but also against other major international currencies, including the Euro. Consequently, the dollar has depreciated against the IMF's measure of the Standard Drawing Rights (SDRs) by an average rate of 5.7 per cent per annum during the three-year period 2002-03 to 2004-05. Export growth measured in SDR terms represents a measure closer to the growth in volume terms. Hence, the volume of India's exports, assuming the SDR to be a proxy, increased by 15.4 per cent in 2002-03, 13.4 per cent in 2003-04 and by 20.2 per cent in 2004-05.

Exports have been decelerating during recent months. Their growth rate during April-September 2005-06 is relatively low at 20.5 per cent when compared to the 32.2 per cent registered during the corresponding period of 2004-05. In terms of SDRs, India's exports posted a growth rate of 19.6 per cent in April-September 2005-06.

Composition of India's Exports

Composition of India's merchandise exports is now available for the period April to July 2005-06 (Table E.4). There has been deceleration in exports of ores and minerals from 73.8 per cent growth in April-July 2004-05, to 41.3 per cent in April-July 2005-06. Within manufactured goods, smart acceleration has been posted by chemicals and related products. Another positive sign is that there has been acceleration in exports of readymade garments. Exports of textiles, however, have suffered sharp deceleration. There has been a debate with regard to inappropriate recording of exports (by the DGCI&S) of textiles and garments. There is no doubt that India needs to be watchful on its export performance in these categories under the quota-free post-MFA world.

Direction of India's Exports

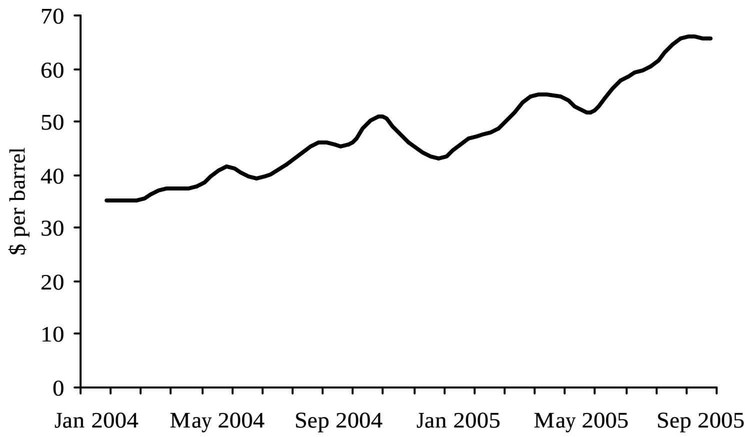
India's exports have posted deceleration to its top-four export destination countries in April-July 2005-06 compared with April-July 2004-05 (Table E.5). There has been sharp deceleration in India's exports to the UAE, Singapore and Belgium. However, impressive acceleration is witnessed in India's exports to the United Kingdom and Japan.

Export growth during April-September 2005 slowed down to 20.5 per cent compared to 32.2 per cent during April-September 2004

Imports

Merchandise imports have also posted strong growth during the three-year period: 2002-03 to 2004-05 (Table E.3). The oil import bill has risen mainly because of a significant increase in the international price of oil (Fig E.1). However, importantly non-oil imports, contributing about 73 per cent of total imports, posted a rapid acceleration during this period. Non-oil imports in US dollars accelerated from a growth rate of 17 per cent in 2002-03, to 31.7 per cent in 2003-04, and further to

Fig E.1: Average Oil Price
(Average of UK Brent, Dubai and WTI)



33.6 per cent in 2004-05. Measured in SDR terms, the corresponding growth rates were 12.1, 23.8 and 29.4 per cent, respectively. Such acceleration of the volume of non-oil imports is indicative of rapidly increasing domestic economic activity.

Non-oil imports have grown by 37.2 per cent in April-July 2005-06 up from 23.9 per cent growth posted in April-July 2004-05. All import categories, except for food and related items, have posted positive growth rates in 2005 and all are higher than the corresponding values of 2004-05 (Table E.6). The most impressive acceleration has been posted by imports of export-related items.

India's Balance of Payments

During 1950-51 to 2000-01, with the exception of eight surplus years, the Indian economy has always posted a deficit on the current account. Five of these eight "surplus years" occurred during the early 1950s, that is, prior to the commencement of the Second Five-Year Plan. The remaining three were in the five years of export boom of 1973-74 to 1977-78. More recently, India witnessed three years of current account surplus during the triennium ending (TE) 2003-04. However, the current account recorded a deficit of US$ 6.4 billion in 2004-05.

The data available for the first quarter (April-June) of 2005-06 records a deficit of US$ 6.2 billion on India's current account (Table E.7). Deficit on merchandise trade (US$ 15.8 billion) has turned out to three times its corresponding value of 2004-05 (US$ 5.2 billion).

India's net earnings on account of invisibles have grown by about 12 per cent from US$ 8.6 billion in 2004-05 to 9.6 billion in 2005-06 (Table E.8).

Mis-invoicing in India's Merchandise Trade

Right reporting of merchandise trade is an important input for enabling governments to take major policy decisions impacting its trade flows. Discrepancies in reporting values of merchandise trade may arise because of three reasons:

- To earn rewards from evasion if there are trade and capital account restrictions in force;
- Unintentional discrepancies arising out of loss of accurate data-keeping, arising from a large component of international trade being transhipped through foreign ports of Hong Kong, Singapore and Dubai. Colombo is also an important port of transhipment for India's trade[2]; and
- Corruption in customs collection.

India's exports to the world were underreported by 4.5 per cent on the average during 1991 to 2004

We have noticed some major discrepancies in reporting of India's bilateral merchandise trade with the world and some of its major trading partners like Japan, EU, US and China (Tables E.9-E.10). It is observed that both exports and imports have been underreported by India. However, the magnitude of underreporting of India's trade with the world is much smaller compared to the magnitude of underreporting with the individual countries/ regions. India's exports to the world were underreported by 4.5 per cent on the average during 1991 to 2004. Imports from the world were underreported by only 2 per cent during the same period. India's exports to Japan were underreported by 19.1 per cent on the average during 1991 to 2004. The corresponding export underreporting figures were 9.8 per cent for EU, 6.3 per cent for the US and 44.2 per cent for China. India also appears to have underreported merchandise imports from these four coun-

The current account deficit during April-June 2005 touched US$ 6.2 billion mark

[2] More than 50 per cent of India's international trade is estimated shipped through foreign ports.

tries. India's imports from Japan were underreported by 15.9 per cent on an average during 1991 to 2004. The corresponding import underreporting figures were 23.7 per cent for EU, 11.7 per cent for the US and 57.7 per cent for China. It is important that India should look into these discrepancies not only in the interest of accurate housekeeping but also using the right numbers while it is rapidly emerging as a player on signing bilateral free trade agreements (FTAs).

Prognosis

India's export performance has been consistently good during the recent period. While the excellent performance during 2004-05 might have been the result of brisk international trade activity, the current fiscal also seems to be posting marked export performance despite deceleration in world trade volume and value. Given the current tempo, India might touch the 20 per cent merchandise-export growth mark in 2005-06.

Merchandise imports during the current fiscal have risen at a rate much faster than that of exports. However, this should not be a cause for worry as this is to be expected when international crude oil prices have been increasing and there has been increased import of export-related items, capital goods and raw-materials and intermediates. This only indicates brisk domestic economic activity, rather than something to worry about. However, it would be prudent for India to devise steps for optimal use of oil-powered energy through conservation, efficiency and right pricing techniques.

Though the current fiscal is expected to end with a high deficit in merchandise trade, it will be partially offset by the impressive growth in earnings from invisibles, including net private transfers and commercial services like travel and miscellaneous. Miscellaneous services include the category of "software services", the sunrise service export sector of India.

India has placed itself on the fast track in negotiating bilateral FTAs with many countries. Apart from cautions of likely trade diversion, it would be appropriate for India to address the issue of mis-reporting/mis-invoicing of merchandise trade because many of the trade negotiations would be based on the current as well the recent past bilateral trade data.

Table E.1: Growth of World Output and Trade and Consumer Prices (% change, y-o-y)

Country/Region	2003	2004	2005	2006
A .World Output	4.0	5.1	4.3	4.3
I. Advanced Economies	1.9	3.3	2.5	2.7
US	2.7	4.2	3.5	3.3
Japan	1.4	2.7	2.0	2.0
European Union, *of which*	1.3	2.5	1.6	2.1
France	0.9	2.0	1.5	1.8
Germany	-0.2	1.6	0.8	1.2
Italy	0.3	1.2	-	1.4
United Kingdom	2.5	3.2	1.9	2.2
NIEs of Asia	3.1	5.6	4.0	4.7
II. Other Emerging Market and Developing Countries	6.5	7.3	6.4	6.1
Developing Asia	8.1	8.2	7.8	7.2
China	9.5	9.5	9.0	8.2
Russia	7.3	7.2	5.5	5.3
India	7.4	7.3	7.1	6.3
III. World Growth Based on Market Exchange Rates	2.6	4.0	3.1	3.2
B. World Trade (Goods & Services)				
I. Volume	5.4	10.3	7.0	7.4
II. Price Deflator in US $	10.3	9.6	5.6	0.5
in SDR	2.0	3.7	5.6	2.2
III. Imports				
i) Advanced Economies	4.1	8.8	5.4	5.8
ii) Other Emerging Market and Developing Countries	11.1	16.4	13.5	11.9
IV. Exports				
i) Advanced Economies	3.1	8.3	5.0	6.3
ii) Other Emerging Market and Developing Countries	10.8	14.5	10.4	10.3
C. Consumer Prices				
i) Advanced Economies	1.8	2.0	2.2	2.0
ii) Other Emerging Market and Developing Countries	6.0	5.8	5.9	5.7

Note: Values for 2005 and 2006 are IMF projections unless otherwise specified
Source: IMF, *World Economic Outlook*, September 2005

Table E.2: Growth in World Trade Prices (per cent)

World Prices	2003	2004	2005*	2006*
1. World Trade Prices in US $				
Manufactures	14.4	9.7	6.0	0.5
Oil	15.8	30.7	43.6	13.9
Non-fuel Primary Commodity	6.9	18.5	8.6	-2.1
2. World Trade Prices in SDR				
Manufactures	5.8	3.7	6.0	2.2
Oil	7.1	23.6	43.7	15.8
Non-fuel Primary Commodity	-1.2	12.1	8.6	-0.4
3. World Trade Prices in EURO				
Manufactures	-4.4	-0.2	5.5	3.5
Oil	-3.3	18.9	43.0	17.3
Non-fuel Primary Commodity	-10.8	7.8	8.1	0.8

* current projections

Source: IMF, *World Economic Outlook*, September 2005

Table E.3: India's Foreign Trade (US$ Million) and Currency Movement (% change, y-o-y)

Year	US Dollar vis-à-vis SDR* (%)	REER # (%)	Exports	Growth rate (%)	Oil imports	Growth rate (%)	Non-oil imports	Growth rate (%)	Total imports	Growth rate (%)	Trade balance
2000-01	-4.1	4.6	44560.3	21.0	15650.1	24.2	34886.4	-5.9	50536.5	1.7	-5976.2
2001-02	-3.2	3.0	43826.7	-1.6	14000.3	-10.5	37413.0	7.2	51413.3	1.7	-7586.6
2002-03	4.9	5.5	52719.4	20.3	17639.5	26.0	43772.6	17.0	61412.1	19.4	-8692.7
2003-04	7.9	2.6	63978.8	21.4	20599.2	16.8	57651.7	31.7	78250.9	27.4	-14272.1
2004-05	4.2	4.0	79593.6	24.4	29084.9	41.2	77036.3	33.6	106121.2	35.6	-26527.6
April-September											
2004-05	4.9	3.0	35863.1	32.2	14577.5	58.2	33171.6	30.9	47749.0	38.2	-11886.0
2005-06	0.9	7.5	43223.5	20.5	20833.8	42.9	42716.5	28.8	63550.4	33.1	-20326.8

* A negative/positive sign indicates appreciation/depreciation of the US Dollar vis-à-vis SDR

A positive/negative sign indicates appreciation/depreciation of the Indian Rupee

Note: REER is the index of real effective exchange rate of Indian Rupee vis-à-vis USD based on 36 country bilateral export weights

REER for April-September 2005-06 corresponds to the period April-July 2005-06

Source: DGCI&S, in RBI, *Handbook of Statistics on Indian Economy*, 2003-04

GOI, Ministry of Commerce and Industry, Press Release, April 29 & October 17, 2005

Table E.4: Share and Growth of India's Major Export Commodities (April-July, %, $ Value)

Commodity/ Commodity Groups	Share in Total Exports		Growth Rate	
	2004-05	2005-06	2004-05	2005-06
I. Agricultural & Allied Products	10.9	10.0	18.7	13.8
II. Ores & Minerals	4.6	5.2	73.8	41.3
III. Manufactured Goods *of which*	73.8	71.7	21.7	20.4
1. Leather & Leather Manufactures	3.2	2.7	13.1	6.2
2. Chemicals & Related Products	9.5	9.8	12.5	28.0
3. Engineering Goods	19.9	20.7	28.9	29.0
4.Textiles (excl RMG)	8.3	6.6	9.3	-1.5
5. Readymade Garments (RMG)	8.7	8.2	10.8	16.2
6. Gems and Jewellary	16.5	16.5	31.7	23.9
7. Handicrafts	0.5	0.5	-19.4	14.2
8. Carpets	0.7	0.8	-9.0	36.9
9. Other Manufactured Products	6.4	5.8	43.8	11.3
IV.Petroleum & Crude Products	7.7	9.6	74.5	54.1
V. Other Commodities	3.1	3.5	41.1	42.1
All Commodities	100.0	100.0	26.6	23.9
USD per SDR*			4.7	1.3
REER (Appreciation/ Depreciation)#			3.7	7.5

* A negative/positive sign indicates appreciation/depreciation of the US Dollar vis-à-vis SDR

A positive/negative sign indicates appreciation/depreciation of the Indian Rupee

Source: DGCI&S

Table E.5: Share and Growth of India's Exports to Major Destinations
(April-July, %, $ Value)

Country	Share in Total Exports		Growth Rate	
	2004-05	2005-06	2004-05	2005-06
U S A	17.6	16.0	18.5	12.5
U Arab Emirates	9.0	7.7	61.3	5.8
Singapore	4.8	6.6	141.8	70.1
China Peoples Republic	4.6	5.5	65.3	48.0
U K	4.2	5.0	8.9	47.3
Hong Kong	4.6	4.9	22.1	29.6
Germany	3.6	3.3	9.0	13.4
Belgium	3.1	2.8	29.2	12.9
France	2.4	2.5	58.6	30.8
Japan	2.5	2.5	2.2	25.9
Italy	2.6	2.4	14.6	12.7
Netherland	1.7	2.1	-8.1	52.5
Sri Lanka DSR	1.8	2.1	2.5	47.7
Saudi Arab	1.9	1.9	25.0	28.4
Bangladesh PR	2.0	1.7	-15.8	9.6
ROW	33.6	32.9	25.5	21.3
ASEAN	4.6	4.0	24.2	7.3
NIEs	11.5	13.6	53.4	46.6
EU	21.0	21.8	16.4	28.3
Total	100.0	100.0	26.6	23.9
USD per SDR*			4.7	1.3
REER (Appreciation/ Depreciation)#			3.7	7.5

* A negative/positive sign indicates appreciation/depreciation of the US Dollar vis-à-vis SDR
# A positive/negative sign indicates appreciation/depreciation of the Indian Rupee
Note: Values are sorted on exports for April-July 2005
ASEAN includes Indonesia, Malaysia, Phillipines, Thailand
NIEs includes Hong Kong, Korea, Taiwan, Singapore
EU includes Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, UK
Source: DGCI&S

Table E.6: Share and Growth of India's Imports of Major Non-oil Commodities
(April-July, %, $ Value)

Commodities	Share in Total Imports		Growth Rate	
	2004-05	2005-06	2004-05	2005-06
I. Food & related items	4.5	3.0	-17.5	-9.5
II. Export related items	20.2	20.4	19.6	38.3
III. Capital goods	30.1	28.6	24.9	30.4
IV. Raw materials & intermediaries	30.1	30.9	30.4	41.0
V. Manufactured goods	10.4	11.4	34.5	49.7
VI. Other commodities	4.7	5.8	36.9	69.5
Total Non-Oil Imports	100.0	100.0	23.9	37.2
USD per SDR*			4.7	1.3
REER (Appreciation/ Depreciation)#			3.7	7.5

* A negative/positive sign indicates appreciation/depreciation of the US Dollar vis-à-vis SDR
# A positive/negative sign indicates appreciation/depreciation of the Indian Rupee
Source: DGCI&S

Table E.7: Overall Balance of Payment in India, Net Credit (US$ Million)

	2003-04	2004-05	April-June	
			2004-05	2005-06
A. Current account				
1. Merchandise Trade Balance	-15454	-38130	-5174	-15809
2. Net Invisible Receipts *of which*	26015	31699	8564	9608
a) Services	6591	14630	3249	4280
b) Private Transfers	22833	20459	5880	6117
Current Account Balance	10561	-6431	3390	-6201
B. Capital account				
1. Foreign investment *of which*	14776	11944	798	1916
a) FDI in India	4674	5526	1359	1838
b) FII in India	11378	8907	81	864
2. External assistance	-2742	1922	36	204
3. Commercial borrowings (including short term credit)	-106	9739	2850	694
4. Banking capital	6231	4002	1753	1224
5. Rupee debt service	-376	-417	-277	-142
6. Other capital	2759	4985	-694	3154
Capital Account Balance	20542	32175	4466	7050
C. Error & omissions	318	415	-286	398
D. Overall balance	31421	26159	7570	1247
E. Monetary movements	-31421	-26159	-7570	-1247
1. I.M.F	0	0	0	0
2. Foreign exchange reserves (increase -/ decrease +)	-31421	-26159	-7570	-1247
USD per SDR (% change)*	7.9	4.2	4.4	2.2
REER (Appreciation/ Depreciation) (% change)#	2.6	4.0	4.4	6.1

* A negative/positive sign indicates appreciation/depreciation of the US Dollar vis-à-vis SDR
# A positive/negative sign indicates appreciation/depreciation of the Indian Rupee
Source: RBI Monthly Bulletin, various issues

Table E.8: India's Invisibles on Current Account, Net Credit (US$ Million)

	2003-04	2004-05	April-June	
			2004-05	2005-06
Invisibles	26015	31699	8564	9608
Services	6591	14630	3249	4280
Travel	611	-497	-335	-560
Transportation	929	509	385	-18
Insurance	57	294	12	44
G.n.i.e	70	142	95	-5
Miscellaneous *of which*	4924	14182	3092	4819
Software services	11750	16626	3732	5036
Transfers	23396	21048	5959	6235
Official	563	589	79	118
Private	22833	20459	5880	6117
Income	-3972	-3979	-644	-907
USD per SDR (% change)*	7.9	4.2	4.4	2.2
REER (Appreciation/ Depreciation) (% change)#	2.6	4.0	4.4	6.1

* A negative/positive sign indicates appreciation/depreciation of the US Dollar vis-à-vis SDR
# A positive/negative sign indicates appreciation/depreciation of the Indian Rupee
Source: RBI Monthly Bulletin, various issues

Table E.9: Mis-invoicing* of India's Exports vis-à-vis Major Trading Partners (%)

Year	EU	US	China	Japan	World
1989	6.8	27.8	35.6	17.3	-4.6
1990	-11.0	-14.3	-384.8	-12.8	-5.3
1991	-10.4	-5.6	-124.4	-18.9	-5.6
1992	-3.0	-3.6	-73.0	-20.3	-1.3
1993	-17.6	-11.1	-30.7	-24.2	-10.1
1994	-20.0	-9.4	-34.5	-24.0	-9.4
1995	-15.2	-3.3	-26.5	-23.2	-3.9
1996	-19.6	5.0	-19.3	-23.5	-11.6
1997	-10.1	-2.9	-16.7	-24.2	-6.6
1998	-12.0	-9.7	-63.5	-14.3	-7.8
1999	-6.3	-6.6	-45.4	-20.5	-5.6
2000	-4.0	-9.3	-60.3	-34.3	0.0
2001	1.0	1.0	1.0	1.0	4.7
2002	-2.8	-8.7	-19.0	-5.9	2.5
2003	-5.0	-8.9	-41.2	-11.9	1.2
2004	-12.6	-15.2	-65.4	-23.0	-9.9
Average (1991-2004)	-9.8	-6.3	-44.2	-19.1	-4.5
Average (1991-1997)	-13.7	-4.4	-46.4	-22.6	-6.9
Average (1998-2004)	-6.0	-8.2	-42.0	-15.6	-2.1

* Mis-invoicing of exports is the ratio of the difference between exports reported by India and imports reported by the trading partner to exports reported by India

Note: Imports of the trading partner have been adjusted to account for f.o.b by a factor of 0.9

The difference between India's mis-invoicing with the world vis-à-vis other trading partners for the year 2001, may be due to non-availability of India's destination-wise exports

Source: IMF, DOTS, CD-ROM September 2005

Table E.10: Mis-invoicing* of India's Imports vis-à-vis Major Trading Partners (%)

Year	EU	US	China	Japan	World
1989	-39.2	-17.3	-376.8	-47.8	-24.2
1990	-14.6	-3.8	-519.6	-4.5	-4.4
1991	-28.7	-16.5	-658.0	-23.0	-7.5
1992	-6.2	6.7	-85.8	-8.8	0.0
1993	-21.8	-40.2	-8.5	-22.8	-25.2
1994	-43.9	-3.9	-1.2	-22.5	-18.7
1995	-51.4	-8.4	-3.7	-25.2	-12.7
1996	-39.0	-14.5	-9.3	-25.6	-19.6
1997	-19.9	-7.2	-0.3	-12.7	-8.7
1998	-5.6	-6.5	-1.4	-11.1	-0.8
1999	-11.6	-12.6	-3.1	-6.0	-3.2
2000	-24.5	-27.5	-18.5	-35.8	1.5
2001	0.0	0.0	0.0	0.0	22.1
2002	-20.2	-9.2	-12.9	-7.4	14.6
2003	-24.3	-12.2	1.6	-7.1	13.6
2004	-35.4	-12.1	-7.3	-14.6	16.5
Average (1991-2004)	-23.7	-11.7	-57.7	-15.9	-2.0
Average (1991-1997)	-30.1	-12.0	-109.5	-20.1	-13.2
Average (1998-2004)	-17.4	-11.4	-5.9	-11.7	9.2

* Mis-invoicing of imports is the ratio of the difference between imports reported by India and exports reported by the trading partner to imports reported by India

Note: Exports of the trading partners have been adjusted to account for c.i.f by a factor of 1.1

The difference between India's mis-invoicing with the world vis-à-vis other trading partners for the year 2001, may be due to non-availability of India's source-wise imports

Source: IMF, DOTS, CD-ROM September 2005