

Forecast

The Central Statistical Organisation (CSO) in its advance estimates for 2005-06 has pegged GDP growth at 8.1 per cent, which is higher than 7.5 per cent attained in 2004-05. FY 2005-06 has been the third consecutive year with 7.5 per cent and plus growth recorded. Prior to this, Indian economy grew between 7.25-7.84 per cent during the period 1994-95 to 1996-97. The present period is probably the best recorded in the post-Independence history of the Indian economy. The notable feature of 8.1 per cent growth in 2005-06 is that it was the first year the economy grew at more than 8 per cent without major contribution from agriculture. All previous four instances of more than 8 per cent aggregate growth (1967-68, 1975-76, 1988-89 and 2003-04) coincide with the double-digit growth of the sector.

During the period 2003-04 to 2005-06, some other long-established facts about Indian economic growth were broken. India used to have a cycle of bad agricultural year followed by a bad industrial year. 2002-03 and 2004-05 were bad agricultural years but industrial growth both in the form of IIP as well as GDP in 2003-04 and 2005-06 was phenomenal. Similarly, whenever twin shocks of high oil prices and bad monsoon struck Indian economy together, growth rate used to decline. However, Indian economy came out of these problems. What can be con-

cluded from these incidences? Has the Indian economy become more robust? Has the Indian economy increased its ability to absorb shocks? It is too early to say that whether we are able to come out of these rigidities, even if we have one off incidences. The robustness of the economy will be judged if the Indian economy be able to perform better vis-à-vis these shocks more times.

What are the factors responsible for this turnaround in the performance of Indian economy? Have the government policies changed so much? Or, the Indian entrepreneurs have improved their efficiency? Or, the Indian economy is also part of easy liquidity available globally, which is the driving demand throughout the globe? No single factor is responsible for this turnaround, but all factors mentioned above contributed towards better and robust economic growth.

Reform process initiated in the early 90s certainly had major impact on improving the performance of the Indian economy. As economy became a part of global economy, Indian entrepreneurs also started not only improving their balance sheet but also the quality of their products. As a result, Indian exports registered more than 20 per cent growth in the last four years (2002-03 onwards). At present, Indian manufacturers are not only catering to the domestic demand (which has potential to grow further) but also to the global

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demand. Improvement in quality with cost advantage among its peers led Indian manufacturing sector register good growth in terms of value added (GDP) and exports.

Backed by huge unmet domestic demand, and use of Indian professionals and service providers by global players, Indian services sector has been registering smart growth over the years. Barring the fourth quarter of 2003-04, services sector growth from the second quarter of the FY 2003-04 has been in excess of 8.4 per cent. Services sector has thus been the major contributor to overall growth in the last three years of high growth (Table F.1).

Over the last couple of years, there has been considerable fiscal consolidation. Fiscal consolidation at central level is on track, however, a lot has to be done at state level. Although, non-performing assets of banks are still high, they are coming down for all types of banks. Savings rate has been growing steadily in the last couple of years and this turnaround was made possible by the public sector, turning from dis-saver to saver. Backed by high capital flows and remittances, foreign exchange reserves are

sufficient for nearly one year's of import, a marked turnaround from the 1991 situation. FDI inflows are slowly increasing, and the external debt position is very comfortable. Investment demand is strong and shows no sign of abating in the short run. However, there has been some hardening of interest rates; interest rate on call money market increased from 4.76 per cent (average) in April 2005 to 6.53 per cent (average) in March 2006. At the same time, interest rate on 91-day and 364-day has hardened. Movement of interest rate has been in sync with repo and reverse repo rate.

All these have brightened the growth prospects for next year. However, high level of fiscal deficit (central and state), rising internal debt, infrastructural bottlenecks, high oil prices and interest rate (to some extent) could be the obstacles for sustaining high growth rate.

Although, growth performance in the last three years has been good, doubts are raised whether this performance will be sustained? And, are we witnessing a growth slowdown? Even in the third quarter (2005-06), GDP growth declined to 7.6 per

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Table F.1: Quarterly GDP Growth (per cent at 1999-00 prices)

Year and Quarter	Agriculture	Industry	Services	Total
2002-03: Q1	-1.2	5.8	7.6	5.0
2002-03: Q2	-4.6	7.7	8.1	5.4
2002-03: Q3	-11.9	7.2	6.8	1.5
2002-03: Q4	-7.7	7.2	6.9	3.6
2003-04: Q1	0.5	6.5	7.2	5.5
2003-04: Q2	7.2	8.2	9.8	8.9
2003-04: Q3	19.6	7.1	9.3	11.3
2003-04: Q4	10.3	8.6	6.7	7.9
2004-05: Q1	3.5	7.4	10.1	7.9
2004-05: Q2	-0.2	8.0	8.4	6.7
2004-05: Q3	-1.2	11.4	9.4	7.0
2004-05: Q4	1.5	7.7	11.4	8.4
2005-06: Q1	1.4	10.6	9.6	8.1
2005-06: Q2	2.4	8.1	9.7	8.0
2005-06: Q3	3.4	8.2	9.4	7.6

cent from 8 per cent in the second quarter and growth of IIP-General in December 2005 declined to 5.3 per cent before growing at 7.9 per cent and 8.8 per cent in January and February 2006 respectively. Exports during 2005-06 grew by 24.7 per cent, though February 2006 exports growth declined to 12.31 per cent, it bounced back in March 2006 (20.6 per cent). Although, month-to-month or quarter-over-quarter fluctuations are not important, because of seasonality associated with them, they are general pointers towards future.

Leading Indicators

The leading indicators provide advance signals on the direction of growth

momentum of the economy. In the absence of monthly data on GDP, monetary variables such as bank credit, credit-deposit ratio, currency with public non-POL import, production of commercial vehicles, production of cement and BSE SENSEX are used as leading indicators for judging direction of movement of Indian economy (Table F.2).

In line with slower GDP growth in the third quarter of last year, year-on-year growth of cyclical components of most of the leading indicators was depicting declining trend since August 2005. However, this trend was reversed from December 2005, and all the leading indicators except non-POL imports in dollar terms were reflecting

All leading indicators, except non-POL imports, in dollar terms reflect an increasing trend in the last two months

Table F.2: Year-on-Year Growth of Cyclical Components of Leading Indicators (%)

Months	Bank Credit (Rs crore)	Bank Credit to Commercial Sector (Rs crore)	Credit to Deposit Ratio	Currency with the Public (Rs crore)	Non-Food Credit (Rs crore)	NON-POL Imports in Dollar Terms	Production of Commercial Vehicles ('000)	Production of Cement ('000 Tonnes)	BSE SENSEX (Index)
Apr-04	-0.8	-3.0	-0.9	2.5	2.2	14.9	52.9	-0.5	79.5
May-04	0.4	-2.3	0.8	2.0	3.3	16.4	54.9	-3.2	60.5
Jun-04	1.2	-1.1	1.8	1.6	3.9	25.6	38.3	-5.5	43.7
Jul-04	2.8	0.7	3.5	1.4	5.3	26.0	22.8	-4.7	34.6
Aug-04	4.2	1.9	5.3	1.6	6.3	27.7	14.7	0.0	32.1
Sep-04	6.5	3.8	7.6	0.9	8.4	22.8	14.5	1.6	24.9
Oct-04	8.5	5.6	10.1	1.3	10.2	31.6	13.5	4.7	25.5
Nov-04	10.8	7.2	11.7	0.9	12.4	33.9	20.2	4.1	21.1
Dec-04	11.1	7.9	12.3	1.2	12.6	49.0	17.7	2.9	20.8
Jan-05	10.7	7.9	11.9	0.1	12.2	26.8	17.9	-0.3	19.3
Feb-05	10.1	7.9	12.7	-0.2	11.7	19.7	16.8	-0.9	20.4
Mar-05	10.0	7.8	12.7	-0.3	11.9	20.4	8.6	-0.7	18.3
Apr-05	10.7	8.5	13.3	0.3	12.8	36.5	6.7	3.7	25.3
May-05	11.1	8.9	13.1	0.6	13.4	34.8	2.8	6.8	36.9
Jun-05	12.2	9.4	13.7	1.0	14.6	33.1	9.6	4.9	51.3
Jul-05	12.1	9.1	13.3	1.2	14.6	26.1	14.1	6.0	54.3
Aug-05	12.9	10.2	12.5	0.5	15.3	15.9	17.6	2.1	55.9
Sep-05	11.7	9.5	10.8	0.7	13.9	7.6	22.5	3.6	52.8
Oct-05	11.0	8.8	9.2	0.2	13.1	4.2	18.0	0.4	49.4
Nov-05	9.1	7.4	8.3	1.4	11.3	7.0	6.0	3.1	45.6
Dec-05	9.4	7.7	8.9	1.9	11.7	25.3	N.A.	5.1	49.8
Jan-06	10.0	8.5	10.2	3.3	12.3	24.5	N.A.	7.8	54.2

increasing trend in the last two months. The reversal of trend suggests that the economy is back on the growth path, and some downturns, which we have witnessed in the last few months of 2005, are over.

Business and Political Confidence

The Business Confidence Index (BCI) in round 56 (January-March 2006), gained 1.7 per cent over the previous round, and increased to 154, which is the highest since November 1994 (159.4). The rating for macro indicators — overall economic conditions and the investment climate — increased by 2.5 percentage points and 2.2 percentage points, respectively. The rating for firm level indicator — the financial position of the firm — deteriorated by 0.7 percentage points, whereas rating for other micro indicator — capacity utilisation — increased by 1.1 percentage points.

Barring consumer durables and services sectors, rest of the sectors exhibited strong positive sentiments. The capital goods sector witnessed the maximum gain followed by the intermediate goods sector. Firms from all regions, except southern, reported upward swing in the business confidence. Firms belonging to the top category (more than Rs 500 crore) showed the highest gain of 21 per cent in business confidence. Public sector and public limited firms pushed up the growth of BCI in this round, whereas partnership/individually-owned firms pulled it down.

In comparison to previous rounds, at aggregate level, one per cent less firms expect their sales to decline in the next six months. Three per cent less firms believe that their production will go up in the next six months. Overall, 0.6 per cent more firms expect an increase in their exports in the next six months. 59 per cent

of the firms believe that their pre-tax profit (PBT) in the next six months will increase, compared to 63 per cent in the previous round. At the same time, 0.6 per cent less firms expect their profits to go down.

More than 75 per cent firms are satisfied with the corporate tax proposals of the Union Budget 2006-07; the same are for excise duty and import duty proposals, and 72.7 per cent and 73.3 per cent, respectively. More than 30 per cent firms believe that the Union Budget 2006-07 has positive impact on their investment plans, while 61 per cent opined otherwise. Nearly 64 per cent firms plan to invest in 2006-07, compared to 50.4 per cent post-Union Budget 2005-06. Of those who want to invest, 40 per cent are planning for capacity expansion, 20 per cent for new business line and 40 per cent for quality/efficiency improvement.

The Political Confidence Index (PCI) improved by 17.2 percentage points and touched all-time high of 127.3. Perception of firms with regard to managing economic growth, government finances, unemployment, conducive political climate and external trade negotiation also touched all-time high. Only, perception regarding pushing economic reforms forward deteriorated in the present round. Firms from consumer durables, non-durables and intermediate goods sector, from eastern and western regions, of size less than Rs 1 crore and more than Rs 500 crore, and from private limited and partnership/individually-owned firms are pulling down the aggregated rating of the 'pushing economic reforms forward' in this round.

Forecast for FY 2006-07

This is our first assessment of GDP growth for FY 2006-07. As men-

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Nearly 64 per cent of the firms plan to invest in 2006-07, compared to 50.4 per cent post-Union Budget 2005-06

tioned earlier, benign inflation, bullish stock market, robust industrial and export performances (with fluctuations) have all helped brighten prospects. However, the only information available on monsoon, which has direct impact on agriculture, is that this year it may be normal. This assessment is based on the initial observations with regard to La Nina effect in the Pacific. La Nina, unlike the deadly El Nino, will bring good rain in India. On the basis of La Nina effect, we have assumed a normal rainfall for 2006-07. Other key assumptions in the forecast for the year 2006-07 are:

- Increase in gross irrigated area by two million hectares;
- Foreign direct investment would be \$6.6 billion;
- The rupee is assumed to depreciate vis-à-vis the dollar by two per cent;
- World income growth of 4.9 per cent;
- Domestic oil prices would grow by 8 per cent;
- The bank rate will remain at the same base level;
- Public investment in agriculture will grow by 12 per cent. In rest of the sectors, it will grow by five to 15 per cent;
- Net invisible would grow by 18 per cent.

Growth in FY 2006-07 is expected to decline to 7.7 per cent, from 8.1 per cent last year (Table F.3). All three major sectors are expected to have slow growth compared to last fiscal. It is beginning of the fiscal, and as things would unfold both domestically and globally, they would have an impact on the growth of the Indian economy. Exports are expected to

Table F.3: Growth Prospects of Indian Economy in 2006-07 (per cent)

Variables	2005-06	2006-07
Real GDP	8.1	7.7
- Agriculture	2.3	2.1
- Industry	9.0	8.3
- Services	9.8	9.6
Exports (\$ Term)	24.7	18.9
Imports (\$ Term)	31.5	25.2
Inflation	4.4	4.3
As percentage of GDPMP		
Fiscal Deficit	4.1	3.9
Current Account Balance	-1.7 *	-1.7

* for April-December 2005

remain buoyant but in dollar terms to decline from 24.7 per cent in 2005-06 to 18.9 per cent this year. Similarly, imports growth may also decline from 31.5 per cent to 25.2 per cent during the same period.

Prices are expected to rise marginally compared to last year. Average inflation is expected to be 4.3 per cent, however, inflation would depend on global crude prices and how much of it is passed to the domestic market. At present, we have factored 8 per cent rise in domestic crude prices. The fiscal deficit is expected to decline but marginally higher than the budget estimate; the recently-announced trade policy has added to some of the fiscal consolidation problems. The faster growth of imports, compared to exports, may result in current account deficit of 1.7 per cent of GDPMP. Although this is high, it may not pose any serious problem. The high level of foreign exchange reserves, the continuing flow of foreign exchange from portfolio investments, the buoyant goods and services exports are good cushions.

Real GDP in 2006-07 is expected to grow at 7.7 per cent