

Overview

The two successive years of 9 per cent growth, in 2005-06 and 2006-07 have raised the possibility of sustaining these rates over the medium-term. The objective of accelerating economic growth, articulated in the Approach Paper to the Eleventh Five Year Plan looks much more feasible now. However, the rise in the inflation rate in 2006-07 has pointed to the need for more careful assessment of the options available to minimise the risks that may destabilise the growth momentum.

The global economic scenario that is unfolding points to the likely slow down in the pace of growth at the aggregate level. While this presents greater challenges to economies that use exports to drive output growth, the projected decline in crude oil prices in international markets is a relief to consumers. The private capital flows to developing economies in 2007 are projected to be slightly lower than in 2006, although FDI flows are projected to be greater.

The rise in average WPI in 2006-07 over its level in the previous year is likely to be above 5 percent mark. Starting in November 2006, the YOY increase in WPI has been 5.5 per cent or higher. The rise in primary articles has now touched double digit level. The increase in CPI for Industrial Workers in 2006-07 can now be expected to be above six percent. The triggers for the price rise have been the supply side shocks, namely, the oil price rise and

the poor crop output. However, easy liquidity conditions globally meant that demand pressures would remain high even in the face of price rise. In the Indian context rise in manufactured product prices to above six per cent on YOY basis implies that supply constraints are now beginning to be binding.

On the output front, however, the industrial production continues to show strong growth. The IIP for the manufacturing sector is expected to cross 10 per cent mark in annual growth 2006-07. The recovery of growth in the intermediates sector has offset the deceleration in sectors such as capital goods and consumer goods. The industrial sector is marked by a positive assessment of the future opportunities for growth. The restructuring of capital and new alliances signal the potential for achieving greater efficiency in the economy. While growth of electricity output has accelerated, it has not kept pace with the growth of industrial output. Despite the improvement, the power sector conditions continue to be an indicator of poor infrastructure conditions.

The indicators of output in the service sector remain positive. Transportation, telecommunication and financial services indicators point to sustained growth momentum in 2006-07. Although service sector can not be independent of the growth of the other sectors, new developments such as the expansion of the

organised sector in retail marketing may provide a new impetus to the growth of the services sector in the years to come.

In the short-term, inflation is a major concern. The monetary policy response in the form of higher interest rates and tight money policy would adversely affect the sectors where credit is a critical input as in the case of housing and new investments. There have been fiscal measures in the form of lower duties and taxes to provide some relief from high prices. However, the medium-term solution lies in improving supply response. Whether it is agriculture, infrastructure or industry, there is need for new investments and policies will need to enable such investments. While policy initiatives such as SEZ may act as catalysts to specific sectors, improving supply response at the overall economy level would be necessary to sustain high rates of economic growth.

The uncertainties associated with the high inflation and the likely response of monetary policy were reflected in the volatility in stock markets also. While the output growth numbers have remained fairly positive, the hikes in interest rates and tightening of money supply have meant that growth would be adversely affected at least in the short-term. The financial sector would have to respond to the new scenario by supplying credit with greater efficiency.

India's Merchandise exports crossed the \$ 100-billion mark for the first time in 2005-06; its share in the GDP increased to around 13 per cent, compared to 6 per cent in 1990-91. The annual rate of growth of merchandise exports has been impressive in the last three years. The annual growth was 30.8 per cent in 2004-05, 23 per cent during 2005-06 and likely to be about 20 per cent in 2006-07.

India's total merchandise imports, including both oil and non-oil imports grew by 27.7 per cent in 2005-06 compared to

42.7 per cent in 2004-05. Total imports declined sharply to 27.8 per cent during April-February 2006-07, in contrast to the growth of 35.9 per cent in the corresponding period of the previous year. One of the reasons for the slower growth of imports in 2006-07 is the decline in the value of oil imports as international oil prices stabilised. However, there has been slower growth of non-oil imports as well. The overall position on external balances, however, remains strong. The FDI inflows in 2006-07 are estimated to be above \$10 billion. The forex reserves swelled by another \$40 billion during the year.

The Union Budget for 2007-08 highlighted the success in raising tax to GDP ratio during the year. The gross Central Government tax to GDP ratio is now projected at 12 per cent in 2007-08. The budget also indicates the feasibility of bringing fiscal deficit to GDP ratio down to three per cent by 2008-09. The changes in tax rates have been small and the budget presents a greater focus on fiscal consolidation.

Based on the various developments in different sectors of the economy, we have presented a forecast of the key macroeconomic indicators for 2007-08. The real GDP growth for the year is forecast at 8.3 per cent with agriculture, industry and services growth rates at 2.6, 8.7 and 9.9 per cent, respectively. The WPI based inflation rate is projected to be stable (growth of average price index for the year, YOY basis) at 5.3 per cent. The export growth is projected to be slower at 15.7 per cent given the projected decline in World GDP growth by 0.5 percentage points and slower rise in international prices. The merchandise imports are also projected to grow at a slower rate of 18.5 per cent. With the growth of the net invisibles by 20 per cent, current account balance is projected to be in a surplus.