Overview

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With three months of this fiscal having gone by, we have a little more data to go on. In our last review of the economy in April we had projected a 7.2 per cent growth rate for financial year (FY) 2005-06. The only information we had during the last forecast was about the expected rainfall: that it would be 98 per cent of the long-period average. The monsoon did arrive, albeit a week late showed signs of weakening during the first half of June, only to revive later.

Factoring in these developments we now project a real GDP growth of 7.1 per cent for FY 2005-06. The major reason for this slight downward revision is the lower agricultural GDP growth of 2.5 per cent. It is, however, too early yet to predict agricultural growth for the whole year. A better assessment can be made after the monsoon is over when we have information about total precipitation and its spread across different regions of India.

The main downside risks originate from global commodity prices. Global metal prices have started being cooling down, but crude oil prices are still very high and volatile. With the slowing down of the US and Chinese economies, global oil demand is expected to slow down a bit. According to the International Energy Agency, global oil demand growth is expected to slump by 200 kb/d to 1.58 mb/d, from 1.78 mb/d forecast earlier for 2005. Global oil demand growth in 2004 was 2.70 mb/d, up from 1.77 mb/d in 2003. Although it is difficult to make any assessment about movement of crude prices, slower growth in demand may help cooling/stabilising crude oil prices.

Buoyancy in industrial growth witnessed in the last couple of years continued in the first two months of this fiscal and the index of industrial production (IIP) general grew by 9.6 per cent. The IIP manufacturing grew by 10.5 per cent in April-May 2005. This buoyancy is also noticeable in the latest round of NCAER's Business Expectations Survey (BES). It shows that the Business Confidence Index (BCI), which in October 2004 was at 136.0, has jumped to an impressive 143.1 in April 2005. This is the highest level the BCI has attained since December 1995. Moreover, the impetus provided by the Budget 2005-06 to rural infrastructure, irrigation etc. should further add to the positive outlook. Investment spending, particularly by corporate entities, has also picked up. The IIP of capital goods grew by 18.9 per cent in the first two months of this fiscal. Non-food credit witnessed 33.8 per cent growth during April-May 2005. All this suggests that the economy is doing well on the industrial investment cycle.

Real GDP growth in FY 2005-06 is expected to be 7.1 per cent

The fiscal deficit for 2004-05 was lower than the revised estimates presented in the Budget. The initial indications of the fiscal health of the central government are positive. The surge in capital goods imports has led to an increase in customs collections by 36 per cent, up to the end of the first quarter. Service tax collection, too, has registered a 34 per cent growth. But the buoyancy in manufacturing growth is not in line with excise collection, which grew by a paltry five per cent in the first quarter. However, in June 2005, excise collection grew by 12 per cent compared to June 2004.

The main downside risks originate from global commodity prices

Exports growth in US dollar terms has been 19.5 per cent during April-June 2005. This comes on top of the 24.4 per cent growth in 2004-05 and the fact that the rupee has been appreciating in real terms (36-country Real Effective Exchange Rate). Increased industrial activity has resulted in imports growing by 38 per cent during the first three months of this fiscal.

Despite persistent increases in the US interest rate, Indian interest rates are expected to remain stable. A low-interest regime is the need of the hour to give a further boost to increased investment and industrial activity.

Inflation is expected to remain stable in the four to five per cent range in next few months.