

Overview

Gross Domestic Product (GDP) grew by 8.1 per cent in the first quarter (April-June) of this financial year. This comes on top of the 6.9 per cent growth in 2004-05.

The manufacturing sector, with 11.3 per cent growth, led first quarter growth. The services sector continued its good growth momentum, clocking 9.8 per cent growth. More importantly, despite a relatively bad monsoon last year, agriculture grew at two per cent.

Overall, therefore, the growth prospect looks good.

Agriculture: In terms of aggregate rainfall this year, the monsoon has been normal. But its monthly progress was inconsistent, with the result that it ended with below normal rainfall in the Eastern and Northern regions and above normal rainfall in the Western and Southern regions. However, prospects for the kharif season appear bright and we expect that kharif foodgrain production in 2005-06 would be around 108 million tonnes, up from 105.3 million tonnes last year. Similarly, kharif oilseeds and cotton production is expected to be around 4.0 million tonnes and 0.1 to 1.8 million bales higher than last year respectively.

Industry: The cyclical upturn in industrial activity that started in mid-2002, has sustained itself and gained further momentum. Beverages, tobacco and related products, textiles products, chemical and chemical products, basic metal and alloy industries, machinery and equip-

ment, and transport equipment and parts have performed well. According to NCAER's Business Expectations Survey (BES) capacity utilisation of the surveyed firms stood at 95 per cent in July-September 2005. A robust production growth of capital goods sector and surge in capital goods import, coupled with growth of infrastructure industries such as coal, cement and steel point to the fact that the pick up in investment demand hasn't lost momentum. Corporate sector performance in the first quarter of this year declined compared to last year. But it is still good. Profit after tax (PAT) of 3,483 companies increased by 22 per cent in the first quarter. However, if initial corporate results of the second quarter are any indication, second quarter corporate sector growth this year would be similar to last year.

Services: The trade, hotels, restaurants, transport, storage and communication sector, by clocking 12.4 per cent, led services sector growth in the first quarter. This sector compensated for the slower growth in community, social and personal services. High growth of the trade, hotels, restaurants, transport, storage and communication sector is in line with the performance of the sub-sectors of this sector. In the first half of this fiscal the cellular subscription base increased by more than 50 per cent. Cargo handled at ports grew by 13.6 per cent during the April-August period, similarly, domestic passenger traffic grew 17 per cent.

Manufacturing led first quarter GDP growth which was 8.1 per cent

World Outlook: Despite high crude oil prices, the global outlook remains good and the IMF's assessment of global outlook hasn't changed in the April and September forecasts. World output growth in 2005 is pegged at 4.3 per cent. Output growth of advanced economies in 2005 is projected to grow slower by 0.1 percentage points in the September forecast as compared to the April forecast. However, Japan is projected to grow by an additional 1.2 percentage points during the same period. The expected deceleration in advanced economies is compensated by the higher growth expectations both from India and China. Both these economies are projected to grow 0.5 percentage points faster in the September forecast compared to the April 2005 forecast.

Trade: According to the latest data made available by DGCIS, exports during the first six months of this fiscal have grown by 21 per cent. Imports during April-September 2005-06 grew by 33 per cent. Non-POL imports grew by 29 per cent during April-September 2005-06. Commodity-wise data, available only up to April-July, indicate that ores and minerals, manufactured products — mainly chemical and related products, engineering goods, carpets — and petroleum products were the main drivers of export growth.

Inflation: The first quarter of the financial year 2005-06 began with a high overall inflation rate of 5.9 per cent in April, followed by 5.5 per cent in May. Thereafter, it has been declining and stood at 3.1 per cent at the end of August 2005. But it has gone up to more than 3.5 percentage points now (weekly indices of WPI-all commodity in the month of September 2005). The rise was expected because of the recent hike in domestic fuel prices. The persistent high oil prices, and somewhat liberal monetary policy, suggest that the up-trend in inflation rate will continue.

Oil prices: The unusually high and volatile oil price has been the focal point of discussion in recent times. After crossing the US\$ 70 per barrel mark, it has come down to around US\$ 65 per barrel. This is the main factor responsible for the persistent 9.0 per cent or more inflation in the energy component of WPI. It now looks certain that there would be no improvement on the price front before 2007 at the earliest. There are two main factors for this uptrend, the foremost reason being the tightness across the supply chain on account of strong economic growth and the consequent unanticipated oil demand surge. Secondly, with the tightness in the refining capacity, production increases by OPEC or other suppliers would not lead to corresponding increase in supply of refined petroleum products. OPEC has already committed to big production increases and has taken up investment in capacity-expansion programmes. But the effect of this will be felt only at the beginning of 2007.

Money Market: RBI in its mid-term review of annual policy statement for the year 2005-06 raised reverse repo and repo rate by 25 basis points to 5.25 per cent and 6.25 per cent respectively and left bank rate and CRR untouched at 6 per cent and 5 per cent respectively. These rates are changed to keep inflation at the 5-5.5 per cent level. Status quo on bank rate signals that the medium-term interest rate outlook has not changed and medium-term outlook both on interest and inflation rate continues to remain benign. No change in CRR reflects that the liquidity is plausibly balanced.

Commodities: The robust demand for construction and manufacturing products in both USA and China is the primer for the surge in metal prices. The robust demand for construction and manufacturing products has caused sharp increase in iron ore prices. Copper prices rose by 20

According to the IMF, world output growth in 2005 will be 4.3 per cent

Deceleration in advanced economies will be offset by higher growth in India and China

With the tightness in the refining capacity, production increases by OPEC or other suppliers will not lead to improved supply until early 2007

per cent to an all-time high as copper inventory levels fell drastically and recent strikes by mining workers threatened world supplies. Uranium prices rose by 44 per cent following demand push due to newly constructed (and some planned for the future) nuclear reactors.

Fiscal outlook: The fiscal outlook for the first five months of this fiscal remains uncertain. This is mainly because the changes in the Budget make year to year comparison difficult. On the capital receipt account, two major developments this year — discontinuation of the debt swap scheme and treatment of disinvestment proceeds as an off-Budget item — makes YoY comparison harder and distorts the picture. Tax revenue collection has been good. Net tax revenue grew by nearly 28 per cent as against the targeted growth of 21 per cent. Corporation tax, customs and other taxes (mainly service tax) collection has been better than the targeted growth for the entire fiscal. In fact, customs collections were assumed to decline by 5.5 per cent this fiscal, whereas they grew by 29 per cent in the first five months of the fiscal. However, the performance of income tax and excise duties has been very disappointing. Despite the good growth in revenue receipts, total receipts declined by 16.5 per cent in the first five months of this fiscal compared to the same period last year, mainly due to a sharp decline in collection from non-debt capital receipt.

Growth projection: Factoring in these global and domestic developments we project a growth of 7.6 per cent in FY

2005-06, up from 7.1 per cent in our July forecast. The half-percentage point upward movement in the growth forecast mainly originates from expectations of a better agricultural year compared to the July 2005 forecast. We expect industry and services to grow at 8.0 and 9.0 per cent respectively in this year. Exports are predicted to remain buoyant, and expected to grow by nearly 22 per cent this year. Similarly, imports are likely to grow by more than 26 per cent. Prices are expected to rise slowly this fiscal as compared to last year at 5.9 per cent. The central government's fiscal deficit is expected to be 4.4 per cent of GDPMP. Relatively faster growth of imports, as compared to exports, may result in a current account deficit of around 0.4 per cent of GDPMP.

Likely growth in the Tenth Five Year Plan (TFYP) is expected to touch 6.9 per cent, which is 1.2 percentage points lower than the original TFYP target. This is same as the likely growth rate of Mid Term Appraisal with a modification of the first three years growth of TFYP as per the CSO. However, there are differences among sectoral level growth rates. According to MTA, the agriculture sector is likely to grow at 2.2 per cent, whereas according to NCAER it is likely to grow at 1.8 per cent in TFYP. Even industry is expected to grow 0.2 percentage points slower than the MTAs' assessment. In comparison to the MTA, the likelihood of slower growth of the agriculture and industrial sectors would be compensated by likely higher growth of the services sector.

Indian growth in 2005-06 is expected to increase to 7.6 per cent, up from 6.9 per cent last year

The Tenth Five Year Plan is expected to attain 6.9 per cent annual growth, 1.2 percentage points lower than the initial target