Overview

The Indian economy is going through the golden phase of economic growth. The advance estimate released by the Central Statistical Organisation (CSO) has pegged growth for 2005-06 at 8.1 per cent. The average growth of triennium ending 2005-06 has been more than 8 per cent, surpassing the previous best by 0.4 percentage point (triennium ending 1990-91). The notable feature of 8.1 per cent growth in 2005-06 is that it was the first year when 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 agriculture sector.

Both industry and services sectors are registering higher growth from 2003-04, growth of industry in the last 10 quarters, from the second quarter of 2003-04, has been in excess of 7 per cent. Similarly, barring fourth quarter of 2003-04, services sector growth from the second quarter of 2003-04 has been in excess of 8.4 per cent. The performance of agriculture with its dependence on monsoon has been lacklustre and for the first time its share in GDP has reduced to below 20 per cent (19.7 per cent in 2005-06). The industrial sector's robust growth in the last four years has helped increase its share in GDP by one percentage point at 26.2 per cent.

The data released by the CSO show that the GDP grew at 7.9 per cent during the first three-quarters of 2005-06 as against 7.2 per cent in the first three-quarters of last year. This implies that in order to attain 8.1 per cent growth in 2005-06, GDP in the fourth quarter has to grow at 8.4 per cent. Given the performance of IIP growth in January and February 2006, and exports growth, attaining 8.4 per cent in the fourth quarter of 2005-06 does not seem difficult.

The Economic Survey (ES) presented in Parliament, warned that although the economic growth has been strong this year, in order to sustain this growth speeding up of economic reforms is needed. The ES says that the risks of inflation, interest rate, and fiscal deficit are obstacles towards attaining sustained economic growth. The ES has pitched for unburdening of the Indian industry from high level of taxes and distortive exemptions that provide perverse incentive, levying user charges, cutting unwanted subsidies, and a transparent and hassle-free tax administration. The ES identified power shortage as the single-most obstacle to growth and pegged losses to GDP due to this at Rs 3,00,000 crore. It pleads for liberalisation of FDI regime for captive mining, especially coal, because of its importance to power generation. The ES stresses on the public-private partnership for infrastructure development and states that a

For the first time the share of agriculture in GDP has gone below 20 per cent in 2005-06 (19.7 per cent)

The industrial sector's robust growth in the last four years has helped increase its share in GDP by one percentage point at 26.2 per cent in 2005-06 substantial share of investment for infrastructure development should come from private sector.

Going ahead from here in 2006-07, the downside risk to growth can originate mainly from high crude prices, electricity shortage and infrastructure bottlenecks. The Union Budget (UB) 2006-07 tries to address some of the issues related to infrastructure by allocating higher budgetary support for rural development, transport, energy, roads, railways and Bharat Nirman. However, to spend increased allocation on these flagship programmes, fiscal discipline particularly at Central government level, has to improve. With FRBM targets to achieve in the next two years, increased revenue realisation/ mobilisation is a pre-condition. The budget has pegged gross tax revenue growth at 19.5 per cent in 2006-07 (2006-07 BE over 2005-06 RE). This is 1.5 percentage points lower than the growth achieved last year (2005-06 RE over 2004-05 RE). Going by the present trend, it looks feasible for the government to achieve this target if the present industrial buoyancy continues. However, at sectoral level, the revenue targets for corporation tax and custom duty collection appear optimistic and the income tax and excise duty targets seem pessimistic. With both widening and deepening of service tax and growth momentum of services sector, service tax target is also pessimistic. However, in order to achieve FRBM targets, fiscal consolidation in this year has to be better than proposed in the budget as with more committed expenditure, it would be difficult to reduce revenue deficit by 1.1 and 1 per cent of GDP in the next two years.

There are sufficient reasons to believe that the industrial upturn would continue. The IIP growth after slowing down in few months in 2005 bounced back in January and February 2006. There are sufficient reasons to believe that the investment activity in the economy hasn't petered out and would continue for some more time. The IIP of capital goods sector grew by 16.5 per cent during April-February 2005-06 compared to 12.7 per cent during the same period last year. The monthly growth of capital goods sector in 2005-06 has been in excess of 11.5 per cent for all months. The capital goods exports during April-December 2005-06 grew by 41 per cent compared to 29.2 per cent during the same period last year. The growth of IIP of machinery and equipment other than transport equipment during April-December 2005-06 has been 11.7 per cent, over 20 per cent the same period last year. Despite upturn in interest rate, sustained growth of this segment from two-digit industrial classification, and higher business expectations coupled with more respondents opining that investment climate is positive and capacity utilisation rate at 97 per cent suggests that investment demand would continue. Moreover, more than three-fifth firms contacted in business expectations survey in March 2006 opined that they were planning to invest in 2006-07 compared to slightly more than half last year. Even the industrial investment intention that peaked in 2004 at nearly double the value of best year since 1991 grew by more than 30 per cent in 2005.

Even the survey of investment plans conducted in January 2006 by the Centre for Monitoring Indian Economy (CMIE), fresh investments announced by Indian companies during Q4 2005-06 aggregated to about Rs 2,90,000 crore. This was much higher than the whole financial year of any of the preceding eight years, which ranged between Rs 1,50,000 to Rs 2,00,000 crore.

Although the aggregate corporate balance sheets of listed companies look gloomy for industrial sector, bearish sentiments originate from the petroleum sector.

The downside risk to growth in 2006-07 can originate mainly from high crude prices, electricity shortages and infrastructure bottlenecks

IIP growth after slowing down in November and December 2005 bounced back in January and February 2006

The aggregate profit after tax (PAT) of registered and listed corporates excluding petroleum sector grew by 28 per cent during April-December 2005 compared to 53 per cent during the same period last year. This clearly reflects that there is enough demand in the system to push corporate profits up. However, the worrying part is the reversal of trend of interest expenditure of corporate sector; the rate of decline in interest expenditure was slowing down quarter after quarter and in the third quarter of 2005-06, it actually increased by 1.4 per cent. Even the wages of corporate sector have increased by more than 10 per cent during the same period. Increased wages and interest expenditure in an era of high crude prices and cut-throat competition are mainly responsible for declining profit margins.

Inflation has remained in a comfort zone in most part of 2005-06. It followed a general declining trend during the year, mainly because of non-revision of retail prices of petroleum products since September 2005. Of late, there has been some pressure on prices of wheat and its products, sugar and minerals. Since, global crude oil prices are showing no sign of abating, sooner or later, the government has to revise retail prices of petroleum products upwards, which would put pressure on inflation. The government should take advantage of prevailing low level of inflation to make adjustment on retail prices of petroleum products.

As far as the money market is concerned, the annual policy statement for 2006-07 has left repo rate, reverse repo rate, bank rate and cash reserve ratio unchanged. The annual policy has its focus on credit quality and financial market conditions for maintaining macroeconomic financial stability. The adjusted non-food credit is projected to grow by around 20 per cent. The policy also stresses for maintaining appropriate liquidity to meet legitimate credit requirements, consistent with price and financial stability. It also increased provisioning for standard advances to one per cent for personal loans, capital market exposures, residential housing beyond Rs 20 lakh and commercial real estate loans. Risk weight on exposures to commercial real estate raised to 150 per cent. The overall stance of monetary policy is:

- to ensure a monetary and interest rate environment that enables continuation of the growth momentum consistent with price stability while being in readiness to act in a timely and prompt manner on any signs of evolving circumstances impinging on inflation expectations,

- to focus on credit quality and financial market conditions to support export and investment demand in the economy for maintaining macroeconomic, in particular, financial stability to respond swiftly to evolving global developments.

On the external trade front, Indian exports in USD terms increased by 24.7 per cent during 2005-06. The continued surge in exports is more significant as this has been attained in spite of appreciation of rupee, 36-country real effective exchange rate (REER), which during April-December 2005 appreciated by 3.2 per cent. The exports of agriculture and allied products and manufactured goods accelerated during April-December 2005-06. Within manufactured goods, exports of readymade garments and handicrafts exhibited smart acceleration. However, exports of ores and minerals and petroleum and crude products decelerated during the first three quarters of 2005-06. Backed by strong growth of Indian economy, imports also fared well

The aggregate profit-after-tax of registered and listed corporates excluding the petroleum sector grew by 28 per cent during April-December 2005, compared to 53 per cent during the same period last year

The annual policy statement for 2006-07 has left the repo rate, the reverse repo rate, the bank rate and the cash reserve ratio unchanged during 2005-06 and increased by 31.5 per cent during 2005-06 compared to 36.4 per cent during 2004-05. Due to robust performance of both exports and imports, India has moved one place up to emerge as the world's 29th largest exporter of goods and jumped seven ranks to become the 17th largest importer of goods in global trade during 2005.

At the same time, India is now the world's tenth largest importer and exporter of commercial services, compared to 15th and 16th respectively in 2004. However, despite 36.4 per cent growth in net invisible receipts in April-December 2005, current account deficit shot up to $13.5 billion compared to $5.9 billion during the same period last year. The Annual Supplement, 2006, to the Foreign Trade Policy, 2004-09, which was announced recently, has set export target of about $120 billion for 2006-07, which is expected to exceed $150 billion by 2009.

As the economy gets further integrated with the global economy, growth prospects elsewhere in the world will be critical for driving India's export growth. According to the World Economic Outlook (WEO) of IMF, April 2006 - notwithstanding higher oil prices and natural disasters, global growth has continued to exceed expectations, aided by benign financial market conditions and continued accommodative macroeconomic policies. According to the WEO, the baseline forecast for 2006 is for continued strong growth, although risks remain slanted to the downside, the more so since the key vulnerabilities — notably the global imbalances — continue to increase. The global growth in the second half of 2005 was stronger than projected earlier by IMF, despite higher oil prices and natural disaster, particularly among emerging countries. The global industrial production has picked up markedly from mid-2005; the services sector remains resilient; global trade growth is close to double-digit levels; consumer confidence and labour market conditions are strengthening; and forward-looking indicators, notably business confidence, have risen.

The expansion in 2005 is more broad-based and the United States remains the main engine of growth, but the Japanese expansion is well established, and there are signs of a more sustained recovery in euro area. The growth in most emerging and developing countries remains solid, with the buoyancy of activity in China, India and Russia — which together accounted for two-thirds of the upward revision to global growth in 2005. The world output in 2006 is projected to grow at 4.9 per cent, compared to 4.8 per cent in 2005. The output growth in 2006 is projected to decline for the US, Spain, central and Eastern Europe, Russia, developing Asia including India and China, and the Middle East. However, projected output growths for 2006, between September 2005 and April 2006, for Russia, China and India are substantially differennt and revised upwards.

World output in 2006 is projected to grow at 4.9 per cent, compared to 4.8 per cent in 2005

The improved growth and fiscal performance, and the country's prospects of handling its debt burden better led Standard & Poor's revising its outlook on the India's sovereign credit rating to positive from stable.

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

Thus, on the whole, in view of strong macro fundamentals such as controlled inflation, stable interest rates and rising foreign exchange reserves, it is unlikely that the economy will suffer any major setback on the growth front. Moreover, initial indications are that the monsoon this year is going to be normal. Taking into account the latest domestic and global developments, our first growth estimate for FY 2006-07 is 7.7 per cent.