Overview

The financial year 2005-06 is coming to an end, and the news is encouraging. Despite infrastructure bottlenecks, the economy has continued to grow.

Growth in the first half of this fiscal has been 8.1 per cent. This is the highest half yearly growth (barring the second half of 2003-04) since 1997-98.

Both aggregate and industrial GDP growth in the last nine quarters has been in excess of 6.4 per cent. The services sector has been continuously growing in excess of 6.2 per cent for the last 18 quarters.

But agriculture, with its continued heavy reliance on rainfall, is dragging aggregate growth down. Food grains production this fiscal is expected to be below the official target of 215 million tonnes. It will be between 207-214 million tonnes, up from 205 million tonnes last year. The output of cotton and jute & mesta may experience a decline over last year. However, sugarcane output is expected to grow by 11 per cent this year. As a result, agriculture growth in this fiscal is expected to be around 3.5 per cent.

Industrial recovery continued in the first half of this year. GDP from industry grew at 8.6 per cent, the highest since 1997-98 — quarterly GDP data is available only from 1996-97 — surpassing the previous best of 8.0 per cent in the first half of 2000-01 by 0.6 percentage points.

Our Business Expectations Survey reflects this buoyancy. The Business Confidence Index (BCI) for the next six months, which was 146 in July-September, increased to 151.4 during October-December. This is the highest level since November 1994.

The key point is that after a gap of three rounds, all four components of the BCI have shown an improvement. The rating for macro indicators — overall economic conditions and the investment climate — increased by 3.1 and 5.6 percentage points, respectively. The rating for firm level indicators — the financial position of the firm and capacity utilisation — also increased by 1.2 and 0.9 percentage points respectively.

Aggregate and industrial GDP growth in the last nine quarters have both been in excess of 6.4 per cent

The Political Confidence Index (PCI) improved marginally by 0.9 percentage points and at 110.1 reflects a stable outlook from the business community with regard to the overall performance of the government. In comparison to the previous round, the performance of the UPA government has improved with regard to managing overall economic growth, government finances, the exchange rate and pushing economic reforms forward. However, performance has deteriorated with regard to managing inflation, unemployment, the political climate and external trade negotiations.

Infrastructure industries grew only by 4.5 per cent in April-December 2005, compared to 6.4 per cent growth in the same period last year

The worrying part is that infrastructure industries, which have a weight of 26.88 per cent in IIP, grew only by 4.5 per cent in April-December, compared to 6.4 per cent growth in the same period last year.

The Real Effective Exchange Rate

(REER) has appreciated by 5.4 per cent during the April-November 2005. This rate of appreciation is much higher than the rates (between 3 and 3.4 per cent) seen in the previous three years.

Despite this appreciation of REER and the decline in exports in November 2005, export growth during April-December has been a healthy 18 per cent.

Imports grew at 27 per cent during the same period. Oil and non-oil import growth has been 20 and 45 per cent respectively. The higher import growth compared to export growth has resulted in the current account deficit in first half swelling to $13 billion.

The overall inflation rate rose to 4.5 per cent at the end of December 2005, higher than the previous month's 4.3 per cent. On a disaggregated basis, the group price index of primary articles has been on the rise since August 2005.

The real problem is the price of oil. After crossing the US $70 per barrel mark, it has come down to around US $ 65 per barrel and is mainly responsible for the persistent 9 per cent or more inflation in the energy component of the WPI.

Inflation on account of manufactured goods has been hovering around the 3 per cent mark since October 2005. Except textiles, all other constituents within this group are increasing.

The inflation rates on account of basic and intermediate were higher at the end of December 2005. The tight supply situation, both on the domestic as well as international fronts, is the principal reason for this. The absence of this factor in the case of capital goods is reflected in more benign inflation for it.

In the Mid-term Review of Annual Policy, the RBI had increased both the reverse repo rate and the repo rate by 25 basis points. This was raised again on January 25 by a further 25 basis points on the grounds that inflation lies just round the corner.

Central government finances are under severe strain. With committed expenditure in the form of the rural employment guarantee programme and Bharat Nirman, revenue growth has not been able to keep pace with expenditure growth.

It is thus likely that the fiscal deficit will be higher than expected in the Budget. However, with profitable public sector firms agreeing to pay special dividends to the government and better growth prospects, the amount of slippage may be small.

In the global arena, year 2005 ended with some success for multilateralism. The Hong Kong ministerial was expected to fail but managed to set dates for the removal of export subsidies on agriculture by 2013.

Contrary to general belief that high oil prices are making a dent on global growth, the OECD Economic Outlook of December 2005 observes that global growth has been broadening over the past few months. While the growth momentum had already been strong in the United States and most of Asia, economic momentum appeared well established in Japan with Europe also. Low long-term interest rates, euro depreciation and buoyant export markets have all contributed.

Thus, global growth in 2005 has been impressive and virtually all countries have maintained price stability despite the international oil price hike from about $42 a barrel in January 2005 to about $57 a barrel in December 2005.

Taking into account the latest domestic and global developments, our final growth estimate for FY 2005-06 is 7.8 per cent, up from 7.6 per cent projected in October 2005.

The 0.2 percentage point additional growth is expected to originate from the services sector.

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Real GDP in India FY 2005-06 is expected to grow at 7.8 per cent

We expect agriculture, industry and services sector to grow at 3.4 per cent, 8.0 per cent and 9.3 per cent respectively in 2005-06.

Exports and imports are expected to grow at 19.5 per cent and 23.9 per cent respectively.

The average inflation rate is expected to be 5.3 per cent and the year may end with fiscal deficit of 4.4 per cent of GDP.

The relatively faster growth of imports may cause the current account to remain in deficit to the tune of 2.8 per cent of GDP.