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General Review

Review of developments

Macroeconomic overview

In a robust demonstration of its nascent strengths, the Indian economy, after growing at 8.5 per cent and 7.5 per cent in the two previous years, is projected to grow at 8.1 per cent in the current year 2005-06. Growth of Gross Domestic Product (GDP) at constant prices in excess of 8.0 per cent has been achieved by the economy in only five years of recorded history, and two out of these five are in the last three years. After dipping below 1.0 per cent in 2004-05, mostly on account of erratic rainfall, agricultural and allied sector's growth in 2005-06 is projected at 2.3 per cent. With a good kharif and bright rabi prospects, foodgrain production is expected to increase by 5 million tonnes (MT) in 2005-06. Some significant dimensions of the dynamic growth in recent years are: a new industrial resurgence; a pick up in investment; modest inflation in spite of spiraling global crude prices; rapid growth in exports and imports with a widening of the current account deficit; laying of some institutional foundations for faster development of physical infrastructure; progress in fiscal consolidation; and the launching of the National Rural Employment Guarantee (NREG) Scheme for inclusive growth and social security.

1.2 According to the national income data released by the Central Statistical Organisation (CSO) on February 7, 2006, the advance estimate (AE) for growth of GDP at factor cost at constant (1999-2000) prices in 2005-06 at 8.1 per cent was up 0.6 percentage points over the 7.5 per cent growth recorded in 2004-05 (Table 1.1). The CSO has changed the base year for calculation of national income aggregates at constant prices from 1993-94 to 1999-2000 (Box 1.1). The revised growth rate with base 1999-2000 is the same as or less than the rate with base 1993-94 for each of the four earlier years ending in 2003-04. For 2004-05, with the availability of detailed data at the sectoral level rather than some indicators that were available at the time when the advance estimate was made, growth of GDP at factor cost at 1999-2000 prices is 7.5 per cent (according to the quick estimate), up from the 6.9 per cent for GDP at factor cost estimated on February 7, and June 30, 2005.

1.3 Against the annual average growth rate of 8.0 per cent envisaged in the Tenth Five Year Plan (2002-03 to 2006-07), the average rate is estimated to have been 7.0 per cent in the first four years ending in 2005-06. Excluding the first year of the Plan (with a much lower growth of 3.8 per cent) results in an average growth rate of 8.0 per cent in the remaining three of the first four years. Maintenance of growth at or above 8 per cent in 2006-07 will yield a plan period annual average growth rate of at least 7.2 per cent.

1.4 The growth trend for the last three years appears to indicate the beginning of a new phase of cyclical upswing in the economy from 2003-04. The initial momentum to this new phase of expansion, in 2003-04, was provided by agriculture. After a somewhat subdued impetus from the farm sector in 2004-05, there is a moderate recovery in agricultural growth in 2005-06 (Table 1.2). This is partly because of a change in the rainfall pattern from erratic to a near-normal distribution.

Table 1.1 : Key indicators

Items	2002-03	2003-04	2004-05	2005-06	2002-03	2003-04	2004-05	2005-06
	Absolute values				percentage change over previous period			
Gross domestic product (at factor cost) (Rs. thousand crore)								
At current prices	2255.6	2543.4 P	2843.9 Q	3200.6 A	7.5	12.8 P	11.8 Q	12.5 A
At 1999-2000 prices	2052.6	2226.0 P	2393.7 Q	2586.6 A	3.8	8.5 P	7.5 Q	8.1 A
GDP–Agriculture and allied sectors (Rs. thousand crore) (at 1999-2000 prices)	448.7	493.7 P	497.4 Q	508.6 A	-6.9	10.0 P	0.7 Q	2.3 A
Gross national product (at factor cost) (Rs.thousand crore)								
At current prices	2238.9	2525.1 P	2826.0 Q	3178.8 A	7.8	12.8 P	11.9 Q	12.5 A
At 1999-2000 prices	2033.8	2208.2 P	2376.7 Q	2566.8 A	3.9	8.6 P	7.6 Q	8.0 A
Index of agricultural production(1)	150.4	181.0	179.2 P	—	-15.9	20.3	-1.0 P	—
Foodgrains production (million tonnes)	174.8	213.5	204.6 +	209.3++	-17.9	22.1	-4.2 P	2.3++
Index of industrial production(2)	176.6	189.0	204.8	215.4 ^	5.8	7.0	8.4	7.8 ^
Electricity generated (in billion kwh)	531.6	558.3	587.4	458.6 ^	3.2	5.0	5.2	4.7 ^
Wholesale price index(3)	172.3	180.3	189.5	196.2 #	6.5	4.6	5.1	4.1 #
Consumer price index for industrial workers(4)	487	504	525	550 $	4.1	3.5	4.2	5.6 $
Money supply (M_3)(5) (Rs. thousand crore)	1718.0	2005.7	2250.4	2551.9(6)	14.7	16.7	12.2	16.4(6)
Imports at current prices								
(in Rs. crore)	2,97,206	3,59,108	4,90,532	4,81,339***	21.2	20.8	36.6	24.1***
(in US $ million)	61,412	78,149	1,09,173	1,08,803***	19.4	27.3	39.7	26.7***
Exports at current prices								
(in Rs. crore)	2,55,137	2,93,367	3,61,879	3,31,771***	22.1	15.0	23.4	16.5***
(in US $ million)	52,719	63,843	80,540	74,978***	20.3	21.1	26.2	18.9***
Foreign currency assets (7)								
(in Rs. crore)	3,41,476	4,66,215	5,93,121	5,89,526 *	37.1	36.5	27.2	9.1 *
(in US $ million)	71,890	1,07,448	1,35,571	1,33,770 *	40.8	49.5	26.2	8.2 *
Exchange rate (Re./US $) (8)	48.40	45.95	44.93	44.25@	-1.5	5.3	2.3	2.1@

Note : Gross domestic product and Gross national product figures are at factor cost (new series base 1999-2000).

P-Provisional; Q-Quick estimates; A-Advance estimates; @ Average exchange rate for April-January, 2005-06.

*** At the end of January, 2006 ** At the end of December, 2004 *** April-January, 2005-06**

 # As on February 4, 2006. $ As on December, 2005. + 4th advance estimates 2004-05

^ April-December, 2005 ++ 2nd advance estimates 2005-06

1. Index of agricultural production (of 46 crops, including plantations) with base triennium ending 1981-82=100 (revised).
2. Index of industrial production; (base 1993-94=100).
3. Index (with base 1993-94 = 100) at the end of fiscal year.
4. Index (with base 1982 =100) at the end of fiscal year.
5. Outstanding at the end of financial year.
6. As on Janauary 20, 2006, year-on-year growth (net of conversion of a non-banking entity into a banking entity from October 11, 2004).
7. Outstanding at the end of financial year.
8. Percent change indicates the rate of appreciation (+)/depreciation (-) of the Rupee vis-á-vis the US Dollar.

Box 1.1 : New Series of National Accounts Statistics

The Central Statistical Organisation (CSO), mandated to prepare and release estimates of national income, consumption expenditure, saving and capital formation, prepared the first official estimates of national income with base year 1948-49 in 1956. To take into account the structural changes taking place in the economy, the base year has been shifted five times so far to 1960-61, 1970-71, 1980-81, 1993-94 and 1999-2000.

The choice of the latest base year 1999-2000 coincides with the year of the 55th round of the quinquennial survey on employment and unemployment by the National Sample Survey Organisation (NSSO). Besides using the 56th, 57th and 58th rounds of NSSO surveys on Unorganized Manufacturing, Services Sectors and Housing Conditions respectively, the new 1999-2000 series also uses All India Livestock Census, 2003, Population Census, 2001, and All India Census of Small Scale Industries, 2001-02. With a widening of the coverage, improvement in procedures and inclusion of long-term survey results, the change in base has resulted in some changes in the GDP estimates according to the New Series.

Gross Domestic Product at factor cost: New and Old Series

(Rs. crore)

Year	At curent prices			At constant prices			
	New series, base 1999-2000	Old series, base 1993-94	Difference in per cent	New series, base 1999-2000	Old series, base 1993-94	Growth in per cent: New series	Growth in per cent: Old series
1999-2000	17,92,292	17,61,838	1.7	17,92,292	11,48,367		
2000-01	19,30,184	19,02,999	1.4	18,70,388	11,98,592	4.4	4.4
2001-02	20,97,446	20,81,474	0.8	19,78,056	12,67,945	5.8	5.8
2002-03	22,55,574	22,54,888	0.0	20,52,586	13,18,362	3.8	4.0
2003-04	25,43,396	25,19,785	0.9	22,26,041	14,30,548	8.5	8.5
2004-05	28,43,897	28,30,465	0.5	23,93,671	15,29,408	7.5	6.9

There are no major changes in the overall growth rates of GDP at constant (1999-2000) prices with the change in the base year, although there are changes in growth rates at sectoral level.

1.5 In contrast to the sharp fluctuations in agriculture, industry and services have continued to expand steadily. Indeed, since the beginning of the Tenth Plan in 2002-03, with annual growth of 7.0 per cent or more (Table 1.2), industry and services have acted as the twin engines propelling overall growth of the economy. Over a somewhat longer horizon, in the six years between 2000-01 and 2005-06 (AE), on average, services with a share of 52.0 per cent of GDP, contributed 65.0 per cent of GDP growth, and increased its share in GDP from 49.8 per cent to 54.1 per cent. During the same reference period, on average, with a share of 25.8 per cent of GDP, industry, by contributing 28.0 per cent of GDP growth, increased its share in GDP from 25.9 per cent to 26.2 per cent.

1.6 Overall industrial recovery that commenced from the second quarter of 2002-03 continues. After an acceleration of growth of industrial GDP at factor cost at constant 1999-2000 prices from 7.0 per cent in 2002-03 to 7.6 per cent and 8.6 per cent in the next two years, the industrial resurgence is manifest in the projected step up in its growth to 9.0 per cent in the current year. In the current year, industrial growth is driven by robust performances from manufacturing and

Table 1.2 : Sectoral real growth rates in GDP at factor cost (at 1999-2000 prices)

Item	Percentage change over the previous year					
	2000-01	2001-02	2002-03	2003-04 (P)	2004-05 (Q)	2005-06 (A)
I. Agriculture & allied	**0.0**	**6.2**	**-6.9**	**10.0**	**0.7**	**2.3**
II. Industry	**6.3**	**2.7**	**7.0**	**7.6**	**8.6**	**9.0**
Mining & quarrying	2.5	1.8	8.7	5.3	5.8	1.0
Manufacturing	7.7	2.5	6.8	7.1	8.1	9.4
Electricity, gas & water supply	2.0	1.7	4.8	4.8	4.3	5.4
Construction	6.1	4.0	7.7	10.9	12.5	12.1
III. Services	**5.6**	**7.1**	**7.3**	**8.2**	**9.9**	**9.8**
Trade, hotels, transport & communication	7.1	9.2	9.1	12.0	10.6	11.1
Financial services	4.1	7.3	8.0	4.5	9.2	9.5
Community, social & personal services	4.7	3.9	3.8	5.4	9.2	7.9
IV. Total GDP at factor cost	**4.4**	**5.8**	**3.8**	**8.5**	**7.5**	**8.1**

P: Provisional Q : Quick estimates; A : Advance estimates;

Source : Central Statistical Organisation.

construction sectors (Table 1.2). Within industry, while manufacturing growth has accelerated steadily from 7.1 per cent in 2003-04 to 9.4 per cent in 2005-06, construction growth has been in double digits in each of the last three years. Substantive commercial bank credit flows to the housing and real estate and retail sectors continue to provide support to the boom in construction and consumer durables. On the negative side, a deceleration in the growth of mining and quarrying, partly due to a fall in the levels of crude oil production as a result of a fire accident in July 2005 at Mumbai High North Platform, has had a dampening impact on overall industrial growth.

1.7 Services sector growth continued to be broad-based. Among the three sub-sectors of services, 'trade, hotels, transport and communication services' continued to lead by growing at double-digit rates for the third successive year (Table 1.2). Impressive progress in expanding railway passenger network and production of commercial vehicles, and fast addition to existing stock of telephone connections, particularly mobiles, played key roles in such growth. Growth in financial services (comprising banking, insurance and real estate services), which after dipping in 2003-04 had bounced back in the following year, maintained the momentum with progressive maturing of Indian financial markets and the ongoing construction boom. However, community, social and personal services, which include public administration and defence, reflecting the process of fiscal consolidation and increasing efficiency of fiscal expenditure management, experienced a growth deceleration of more than a percentage point (Table 1.2).

1.8 A pick-up in investment, reflecting the high business optimism, not only strengthened industrial performance but also reinforced the growth outlook itself. The rally in gross domestic capital formation (GDCF) that had commenced in 2002-03 continues. GDCF, as a proportion of GDP at current market prices, had declined from 26.0 per cent in 1999-2000 to 23.0 per cent in 2001-02 before the commencement of the industrial recovery in 2002-03. Climbing back to 25.3 per cent and 27.2 per cent in the two subsequent years, the ratio reached a high of 30.1 per cent in 2004-05.

1.9 Stock market index returns of 11 per cent in 2004 followed by 36 per cent in 2005 provide a good measure of investor sentiments. The bell-weather BSE Sensex crossed the 10,000 mark on February 6, 2006. In 2005, Rs. 30,325 crore of resources were raised on the primary market for equity. The number of initial public offerings (IPOs) per year, on the rise since 2002, increased from 26 to 55 between 2004 and 2005. In line with the rally in investment, bank credit to the commercial sector increased by 22.8 per cent during 2004-05 and by a further 21.2 per cent between end-March 2005 and January 20, 2006.

1.10 Robust growth of the industrial sector and Government's conscious decision to increase credit to the agriculture sector led to rapid increases in bank credit. Non-food credit by Scheduled Commercial Banks (SCBs) expanded by Rs. 2,21,802 crore in 2004-05, substantially up from the increase of Rs. 1,25,088 crore in 2003-04. During the period (ending on January 20, 2006) of 2005-06, non-food credit expanded further by Rs.2,66,857 crore, up 25.2 per cent from Rs. 1,68,188 crore in the corresponding period of the previous year. Food credit by SCBs, after expanding by Rs. 5,159 crore in 2004-05 compared to a decline of Rs. 13,517 crore in the previous year, declined again by Rs. 2,778 crore during 2005-06 up to January 20, 2006 because of lower procurement and lower stocks of Food Corporation of India (FCI) after a lean agricultural year.

1.11 Bank credit disbursal during 2004-05 was well diversified across different sectors of the economy, with flows to housing and retail sector particularly strong and a substantial pick up in flows to agriculture. Strong industrial recovery was accompanied by much higher credit growth of 17.4 per cent to industry (medium and large) in 2004-05 compared to only 5.1 per cent in the previous year. During 2005-06, at end-October, 2005, the year-on-year growth (over end-October 2004) of credit to industry (medium and large) accelerated further by 45.7 per cent.

1.12 After growing by 24.7 per cent during the previous year, lending by SCBs to priority sectors increased sharply by 31.0 per cent during 2004-05. Total outstanding credit to priority sectors on March 31, 2005 was Rs. 3, 45,627 crore. In 2005-06, at end-October, 2005, SCBs' credit to priority sectors expanded by Rs. 1,43,407 crore over the level on the corresponding date of the previous year representing an increase of 49.4 per cent. Credit flow to priority sectors was driven mainly by agriculture and 'other priority sectors'. Outstanding credit balances to agriculture had more than doubled in the last three years from Rs. 60,761 crore at end-March 2002 to Rs. 1,22,370 crore at end-March 2005; at end-October, 2005, such outstanding credit balances were Rs. 1,41,612 crore.

1.13 As per the 'farm credit package' announced by Government of India on June 18, 2004, that the flow of credit to agriculture would be doubled in the ensuing three years, the target for institutional credit for agriculture by all agencies was fixed at Rs.1, 05,000 crore for the year 2004-05, ensuring 30 per cent growth over the previous year's achievement. During 2004-05, with an aggregate disbursement of Rs.1,25,309 crore to the agricultural sector, the target of Rs. 1,05,000 crore was exceeded by 19.3 per cent and was 44.1 per cent higher than previous years' level. During 2005-06, as against the target of Rs. 1,41,000 crore for the full year, the flow of institutional credit to agriculture up to end-December 2005, was Rs. 1,17,899 crore, representing 84 per cent of the annual target. Credit to small-scale industries, after increasing from Rs. 57,199 crore at end-March 2002 to Rs. 76,114 crore at end-March 2005, increased further to Rs. 78,780 crore at end-October, 2005.

1.14 The 5,39,365 new self-help groups (SHGs) credit-linked during 2004-05 represented an increase of 49 per cent over the previous year. As on March 31, 2005, the total of 16.18 lakh SHGs credit-linked by banks covered an estimated 242 lakh poor families, with an average loan disbursement per family of Rs.3, 044. Refinance support extended by NABARD amounted to Rs. 3,082 crore. A highlight of the programme was that about 90 per cent of the groups linked with banks were exclusively women groups. As against the target of linking 3 lakh SHGs for the whole year 2005-06, 2.11 lakh new SHGs were linked by December 2005.

1.15 From 1993-94 to 2003-04, net capital stock in industries (comprising mining, manufacturing and electricity sectors, and at constant prices), which proxies capacity addition, increased at an average rate of 6.66 per cent per annum. Going by the use-based classification of industries, the growth rate in the capital goods sector in April-December 2005 at 15.7 per cent indicated a substantial improvement over the growth of 13.8 per cent during the same period last year. Buoyant growth of imports of capital goods at 21 per cent in 2004-05, on top of the 40 per cent growth in 2003-04, reflected the higher domestic investment. Non-electrical machinery, transport equipment, manufacture of metals and machine tools were the main contributors of the rise in capital goods imports.

1.16 Inflation, in most parts of the world, showed a rising tendency on account of rising global crude oil prices. The sharp and spiraling increase in international oil prices from late 2003, combined with considerable week-to-week and even day-to-day volatility, posed considerable challenge in the maintenance of macroeconomic stability. Average headline world price of Indian basket of crude petroleum increased by 44.5 per cent, from US$37.3 per barrel in April-November 2004 to US$53.9 per barrel in April-November 2005, and was US$58.10 per barrel on February 13, 2005. Nevertheless, the virtuous expansion in the current phase of economic upturn has been maintained without an undue escalation of domestic prices. In India, inflation, measured by a point-to-point increase in the Wholesale Price Index (WPI) declined from 5.7 per cent on April 2, 2005, to a low of 3.3 per cent on August 27, 2005. Despite increasing thereafter, prices have remained at comfortable levels with the WPI-inflation at 4.1 per cent on February 4, 2006 vis-à-vis 5.0 per cent on February 5, 2005.

1.17 Like in the previous year, the fuel, power, light, and lubricants group, having a weight of 14.2 per cent in the WPI basket, contributed the most to price rises in the economy. As on February 4, 2006, the fuel group, with an inflation rate of 7.6 per cent, contributed 40.5 per cent to the overall inflation, which was marginally lower than 42.8 per cent a year ago. Much of the inflation in the fuel group is attributable to the 'pass through' effected in June and September 2005, in the form of enhanced retail prices of petrol and diesel, precipitated by the flare-up in global oil prices. While retail prices of kerosene canalised through the public distribution system (PDS), and domestic LPG were kept unchanged for softening the burden on consumers, the incomplete pass through, however, entailed adverse implications both for the finances of domestic oil marketing companies and for the exchequer because of the issue of 'oil bonds' to such companies.

1.18 The decelerating trend in inflation relating to manufactured products group observed since the last quarter of 2004-05 continued as the inflation rate for this group dropped from 4.5 per cent a year ago to 2.4 per cent on February 4, 2006. This deceleration in both wholesale and retail prices, in the aftermath of the introduction of value added tax (VAT) in most of the States with effect from April 1, 2005, helped to mobilise popular support behind a fundamental reform of State-level sales taxes – a reform termed by some as the most important tax reform in post-independent India. Inflation in manufactured products was under tight control with heightened competition in increasingly liberalised markets for such products.

1.19 Simultaneously, however, the low inflation in primary articles observed in the previous two years came to an end as the point-to-point inflation rate for this group increased from 1.2 per cent to 5.0 per cent between February 5, 2005 and February 4, 2006. This contrasting development in primary products reflected supply shortfalls in some commodities such as onions and potatoes, and a firming up of demand all over the world for minerals. Primary items with a weight of 22.0 per cent in WPI basket, contributed 26.3 per cent to overall inflation on February 4, 2006 significantly higher than 5.2 per cent a year ago. Among primary food items, apart from potatoes and onions, urad, gram, moong and fish-inland experienced higher inflation during the current year. Higher prices for some of the crops can be partly explained by output disruptions brought on by excessive rainfall in different parts of the country. Raw cotton prices, in line with international trends, recovered somewhat from the lows experienced in the previous year. Improved crop prospects succeeded in keeping oilseed prices at moderate levels.

1.20 Manufactures, as a group, had a lower contribution of 33.1 per cent to overall inflation of 4.1 per cent on February 4, 2006, compared to 51.6 per cent a year ago. Among manufactures, 'other non-ferrous metals' experienced the highest price rise (34.1 per cent), followed by wood and wood products (15.5 per cent) and rubber and plastic products (6.3 per cent).In the manufactured segment, domestic sugar prices remained firm on account of depleting stocks and a rise in world prices. With domestic producers frequently adjusting inventory levels in response to changes in international market conditions, domestic steel prices continued to reflect international prices. Increase in steel prices in the current year so far has been moderate compared to that in the previous year. The sharp rebound in construction activity resulted in cement prices increasing by 7.1 per cent during the year so far.

1.21 In April 2005, inflation, year on year, in terms of consumer price index for agricultural labourers (CPI-AL) and of consumer price index for industrial workers (CPI-IW) was 3 per cent and 5 per cent, respectively. Data available for CPI-AL for the first nine months of 2005-06, indicated that inflation in CPI-AL remained below that in CPI-IW for each of the months of the current financial year including December 2005. Furthermore, with inflation rate for food group (with a higher weight in CPI than in WPI) lower than that of overall inflation, CPI inflation (measured in terms of both CPI-AL and CPI-IW) remained below WPI-inflation until October 2005. Inflation in both CPI-AL and CPI-IW, after declining to 3.2 per cent and 3.4 per cent respectively – with some minor fluctuations – between April and August, 2005, revealed an upward trend. In December, 2005, inflation in CPI-IW was 5.6 per cent. The upward trend in consumer prices was primarily on account of hardening of retail prices of vegetables and pulses.

1.22 Maintaining price stability continued to be one of the main objectives of monetary policy. For achieving this, along with the other objective of providing an enabling environment for higher investment and growth, the policy variables were recalibrated appropriately. While the Bank Rate and the cash reserve ratio (CRR) were kept unchanged during the current year at 6.0 per cent and 5.0 per cent, respectively, the fixed reverse repo rate under the Liquidity Adjustment Facility (LAF) of the Reserve Bank of India (RBI) was raised three times, by 25 basis points each, to reach 5.50 per cent on January 24, 2006. With the given spread of 100 basis points vis-à-vis the reverse repo rate, the repo rate is pegged at 6.50 per cent since January 24, 2006. RBI's policy response was in line with the cautious approach in many other countries of moving policy interest rates in a measured way in the face of the threat of inflationary expectations firming up with high crude oil prices.

1.23 Growth in broad money (M_3) of 12.2 per cent at end-March 2005 was lower than both the 14.0 per cent projected by the RBI in its Annual Policy Statement for 2004-05 and 16.7 per cent observed at end-March 2004. Furthermore, during 2004-05, relative to the previous year, growth in sources of M_3 displayed some diversity with net domestic credit growing faster (13.3 per cent compared to 11.7 per cent during 2003-04) and net foreign exchange assets (NFA) of the banking sector growing slower (23.3 per cent compared to 33.7 per cent during 2003-04). Much of the net domestic credit expansion in 2004-05 was from growth in bank credit to the commercial sector (22.8 per cent) while net bank credit to government increased by only 0.4 per cent. Relative to end-March 2005, on January 20, 2006, M_3 was up by 13.2 per cent compared to 9.2 per cent observed in the corresponding period of the previous year. The year-on-year growth of M_3 at 16.4 per cent on January 20, 2006 was not only higher than the projected 14.5 per cent in RBI's Annual Policy Statement for 2005-06, but also higher than the rate observed a year ago. Price stability despite a rapid increase in money supply during the current year testified to the investment-driven nature of the credit growth and stability of inflation expectations based on confidence in the appropriate stance of monetary and fiscal policies.

1.24 The money-multiplier (the ratio of M_3 to reserve money, M_0) rose steadily from 4.59 at end-March 2004 to 4.61 at end-March 2005 and further to 4.77 on January 20, 2006. This reflected a decline in the reserve-deposit ratio — for example, from 0.064 to 0.061 between January 21, 2005 and January 20, 2006. Consequently, growth in reserve money (M_0) was slightly slower than that of M_3. Furthermore, M_0 growth had also decelerated from 18.3 per cent at end-March 2004 to 12.1 per cent at end-March 2005. Continuing the deceleration observed in the previous year, in the current financial year, on January 20, 2006, M_0 growth was 14.9 per cent compared to 15.3 per cent observed on the corresponding date of the previous year. The growth of NFA of the RBI dominated the evolution of M_0 in 2004-05.

1.25 In 2004-05, a part of this growth in NFA had to be sterilised by recourse to the Market Stabilisation Scheme (MSS) and Liquidity Adjustment Facility (LAF) and a resultant decline in net domestic assets (NDA) of the RBI. The relative importance of NFA vis-à-vis NDA of the RBI has changed sharply from 2004-05 to the current year so far. Between end-March and January 21/20, while NFA had grown by Rs. 75,930 crore in 2004-05, the corresponding increase was only Rs. 2,043 crore in 2005-06. With their extensive use to absorb liquidity and contain the impact of reserve inflows through the balance of payments in 2004-05, the outstanding balance under MSS and LAF (reverse repo) was Rs. 83,500 crore (3.7 per cent of M_3) on March 31, 2005.

1.26 With the decline in reserves in foreign currency terms, there was a diminution of NFA flows in rupee terms in 2005-06 up to January 20, 2006, in spite of the nominal depreciation of the currency. From mid-December 2005, signs of liquidity tightening were observed, partly on account of redemption of India Millennium Deposits (IMD) of the State Bank of India on December 29, 2005. Total outgo under IMD redemption was about Rs. 32,000 crore, and in anticipation of the liquidity tightening, on December 16, 2005, RBI had injected Rs. 1,085 crore under repo (LAF), and followed it up by further liquidity injections in the four days between December 27 and 30, 2005 of Rs. 21,415 crore, Rs. 26,685 crore, Rs. 30,110 crore and Rs. 29,795 crore, respectively. Between January 2, 2006 and January 13, 2006, RBI had injected, on an average Rs. 16,527 crore per day under repo (LAF). Nevertheless, unwinding of a part of the liquidity impounded through MSS and LAF through the year resulted in a decline in their outstanding balances to Rs. 40,178 crore (1.6 per cent of M3) on January 20, 2006.

1.27 The call money rates followed an upward trend to reach 4.94 per cent on April 30, 2005, when the fixed reverse-repo rate was raised by 25 basis points to 5.0 per cent. Thereafter, call money rates remained benign for a considerable period, before starting to pick up again, especially after the 25 basis point increase in the reverse repo rate by the RBI in October 2005. For the first time in the current financial year, call money rates crossed the 6 per cent barrier to reach 6.10 per cent on November 9, 2005 and further increased to 6.65 per cent on November 11, 2005. After remaining below the fixed reverse-repo rate (5.25 per cent) on December 2-3, 2005, call rates started to rise sharply, under pressure of advance tax payments and the ensuing IMD redemption, to reach 7.15 per cent on the redemption date of December 29, 2005. Call rates remained under pressure thereafter to reach 7.71 per cent on January 27, 2006, but moderated to 6.88 per cent on February 16, 2006.

1.28 In 2004-05, rising interest rates had an adverse effect on bond prices and reduced treasury profits of banks. SCBs' total income during 2004-05 grew at a slower rate of 1.5 per cent (net of conversion) than 6.7 per cent observed in 2003-04. Furthermore, with credit growing faster than deposits, recourse to funding sources like borrowing increased. Operating expenses in 2004-05, as a proportion of net income, rose to 49.1 per cent from 45.4 per cent in 2003-04; and as a proportion of total assets, declined marginally to 2.16 per cent from 2.21 per cent in the previous year. A significant improvement in recovery of NPAs combined with a significant increase in gross loans and advances by SCBs led to a sharp decline in the ratio of gross NPAs to gross advances to 5.2 per cent at end-March 2005 from 7.2 per cent at end-March 2004. The overall capital-to-risk-weighted assets ratio (CRAR) of SCBs at 12.8 per cent at end-March 2005 was marginally lower than the previous year's level (12.9 per cent).

1.29 In a marked departure from the trend observed in recent years, the pace of accretion to foreign exchange reserves has slowed sharply during the current year so far. Following accretion of US$28.5 billion during 2004-05, in the current year until February 10, 2006, there was a reduction of US$1.1 billion from the end-March 2005 level of US$141.5 billion of foreign exchange reserves. Three key factors were instrumental behind this turnaround: an outgo of US$7.1 billion on IMD redemption; valuation losses from a weakened dollar vis-à-vis other major currencies; and a widening deficit in the current account of the balance of payments (BOP).

1.30 The weakening of the US dollar vis-à-vis other major global currencies, which resulted in valuation losses of US$5.0 billion in reserves in the first half of 2005-06, also got reflected in the movements of the Rupee vis-à-vis the US dollar. During 2004-05, the Rupee had appreciated against the US dollar (2.2 per cent) in nominal terms, while depreciating against the Euro (-4.5 per cent), Pound (-6.3 per cent), and the Japanese Yen (-2.6 per cent). However, in the first ten months of 2005-06, on average, the Rupee has strengthened against all major currencies. The appreciation was the strongest vis-à-vis the Japanese Yen (6.4 per cent) followed by Pound (4.5 per cent), the Euro (4.3 per cent), and the US dollar (2.1 per cent). In 2005-06, in 5-country export-weighted nominal effective exchange rate (NEER) terms (base year 2000), the Rupee appreciated in all months until July 2005, and depreciated in subsequent months until December 2005. In 5-country export-weighted real effective exchange rate (REER) terms (base year 2000), the same pattern was observed, with the exception of November 2005, which witnessed a mild appreciation.

1.31 The embryonic deficit in the current account of the BOP, which emerged in 2004-05 after three consecutive years of surpluses, has assumed much larger dimensions during the current year. During April-September 2005-06, the current account deficit enlarged to around US$13.0 billion, which was more than twice the deficit (US$5.4 billion) in the whole of 2004-05. While net invisibles continued to rise, it was not enough to neutralize the rapidly expanding trade deficit, which at US$31.6 billion during April-September 2005-06 was only around US$5.0 billion less than that recorded in twelve months of 2004-05.

1.32 The sharp rise in current account deficit reflects the burgeoning trade deficit during the current year so far. Net invisibles increased, but was not enough to neutralize the expanding trade deficit. While the surge ahead in merchandise exports observed since 2002-03 continued, such growth was surpassed by an even faster rise in merchandise imports. Merchandise imports have been rising more rapidly than exports since 2003-04, reflecting perhaps the overall industrial recovery that commenced from the second quarter of 2002-03. Growth of GDP at factor cost at constant prices crossed 7.0 per cent in 2003-04 and has remained in excess of that rate ever since. The heavy demand for imports arising from increasing buoyancy and robustness of Indian industry may have led to a sustained rise in growth of merchandise imports.

1.33 India's merchandise exports (in US dollar terms and customs basis) have been recording annual growth rates of more than 20 per cent since 2002-03. In 2004-05, such exports grew by 26.2 per cent – the highest annual growth rate in the last three decades – to cross US$80 billion. Five major sectors – gems & jewellery, engineering goods, petroleum products, ores & minerals, and chemicals and related products – were the key drivers. Despite recording a somewhat lower rate of growth of 18.9 per cent, exports during April-January 2005-06 have already reached $74.9 billion and are well on their way to achieve the US$92 billion target set for 2005-06.

1.34 In 2004-05, merchandise imports (in US dollar terms and customs basis) had grown by 39.7 per cent – the highest growth in two and a half decades. On a decelerating mode in the current year, such imports grew by 26.7 per cent during April-January, 2005-06. The increase in imports has been driven, *inter alia*, by the sharp rise in global crude prices, which resulted in petroleum, oil and lubricants (POL) imports increasing by 46.9 per cent in April-January, 2005-06. Non-oil, non-bullion imports, increased by 30.8 per cent during April-October, 2005 – on top of a 29.9 per cent rise during the corresponding period of the previous year.

1.35 After growing by US$10.8 billion to US$27.8 billion in 2003-04, the increase in net invisibles, was limited to only US$3.4 billion in 2004-05, primarily on account of a drop of US$1.4 billion in private transfers. However, services exports – captured by net non-factor services, and including software and IT-enabled services – have continued to perform satisfactorily with unfailing regularity. Such exports (in US dollar terms), after growing by 71.3 per cent in 2004-05, increased further by 75.3 per cent in the first half of 2005-06. In addition to software and IT-enabled services, of late, business services, including professional services, have come to play a key role in enlarging services exports.

1.36 With robust inflows, during 2004-05, the surplus of US$31.6 billion recorded in the capital account more than compensated the current account deficit and resulted in an addition of more than US$26 billion, on BOP basis, to the existing stock of foreign exchange reserves. In April-September 2005, while the capital account surplus at US$19.5 billion remained higher than the current account deficit of US$13.0 billion, there was a slowdown in reserve accretion on BOP basis. The dominance of non-debt creating flows in the capital account continued. During April-September 2005, foreign investment flows at US$7.4 billion were nearly US$5.0 billion higher than such flows of US$2.5 billion in the first half of 2004-05. Within foreign investment, portfolio flows, comprising mainly foreign institutional investor (FII) investment, were the dominant variety. At US$4.2 billion during April-September 2005, FII flows (net) were higher than not only the FDI flows of US$2.3 billion, but also the FII flows of US$339 million in April-September 2004. FDI flows (net) during April-September 2005 were US$2.3 billion — up by only US$0.3 billion from such flows of US$2.0 billion in the first half of 2004-05.

1.37 Notwithstanding the dominance of non-debt creating flows in the capital account, the importance of debt flows appears to have increased with the emergence of a current account deficit since 2004-05. Both external assistance and external commercial borrowings (ECBs), which were net outflows during 2002-03 and 2003-04, became net inflows of US$1.9 billion and US$5.0 billion, respectively, during 2004-05. These flows continued to be positive in the first half of the current year. ECBs, in particular, increased from US$1.5 billion to US$2.7 billion between the first half of 2004-05 and the first half of 2005-06. Also, non-resident deposits, which had turned into outflows after rationalisation of interest rate premia on such deposits, turned into net inflows during the first half of the current year. At end-September 2005, India's external debt at US$124.3 billion was up by US$1.0 billion from its end-March 2005 level. The increase was primarily on account of a rise in short term external debt, like ECBs and trade credits availed by importers. The expected moderation in overall external debt from the redemption of IMDs will be captured in the data being compiled for December, 2005.

1.38 Infrastructural inadequacies continued to constrain the full potential for industrial resurgence, pick up in investment and buoyant exports. The growth of power generation in April-December 2005 at 4.7 per cent, for example, was lower than not only the annual target but also the 6.5 per cent achieved in the same period of the previous year. In the first three quarters of the current financial year, the overall index of six core industries – coal, electricity, crude petroleum, refinery throughput, steel, and cement – having a direct bearing on infrastructure, registered a growth of 4.5 per cent, which was lower than the 6.4 per cent registered during April-December, 2004. In the first half of 2005-06, crude oil production registered a decline, and there was deceleration in growth of coal, electricity and steel sectors. Growth of cement production, however, accelerated during this period.

1.39 While progress continued in attracting private investment into the infrastructure sectors of telecommunications, ports, and airports, there was a step up in budgetary outlays on roads financed through the enhanced road cess on motor spirit and high speed diesel. Nevertheless, overall investment in infrastructure continued to remain far below the requirement, and net capital stock, for example, in electricity, gas and water supply grew at a compound annual rate of 3.7 per cent between 1993-94 and 2003-04. The recently introduced public-private partnership (PPP) model had limited success in the area of electricity and mining, and the dominance of the public sector continued.

1.40 The pick up in investment reflected partly the progress in fiscal consolidation in the recent past, particularly since 2003-04, the year in which Fiscal Responsibility and Budget Management Act (FRBMA) was enacted. Reduction in preemption of credit by Government helped to maintain a benign interest rate regime and stimulate capital formation. The Rules under FRBMA mandate an annual minimum reduction of 0.3 per cent of GDP in fiscal deficit and 0.5 per cent of GDP in revenue deficit. From 2002-03, in the two subsequent years, there has been an annual average reduction of 0.9 per cent of GDP in each of the two indicators of fiscal health. This rapid front-loaded fiscal adjustment, noteworthy though, restored the status-quo-ante of the mid-nineties. The process of fiscal consolidation had to be paused in the Budget for 2005-06 consequent to the implementation of the Twelfth Finance Commission (TFC) award. However, a clear picture will emerge only after the RE for 2005-06 is revealed.

1.41 Indications are that the slower progress in fiscal consolidation at the Centre in the current year may be made up by faster progress on this front by the State Governments and result in an overall improvement in the financial health of the General Government, that is the Centre and the States combined. Up to February 2, 2006, 18 States had enacted fiscal responsibility legislations, and more were initiating action to follow suit. Most States had adopted the VAT, a non-cascading, self-enforcing, and harmonized commodity taxation regime, from April 1, 2005. Buoyant revenues in the States and significant improvement in the combined fiscal position of States in 2004-05 (RE) indicate that the process of deepening of the fiscal reforms and restructuring of public finances as envisaged by the TFC have had a head start. The revenue deficit of States declined to 1.4 per cent of GDP and fiscal deficit to 3.8 per cent of GDP in 2004-05 (RE). This has been carried forward in BE 2005-06 with targets of revenue deficit of 0.7 per cent of GDP and fiscal deficit of 3.1 per cent of GDP. These were very close to the target for 2008-09 set by the TFC and their achievement in the first year of the award itself indicates a significant front loading.

1.42 Maintaining its increasing trend since 1990-91, except in 1998-99, the share of direct taxes in central tax revenues increased from 19.1 per cent in 1990-91 to 43.3 per cent in 2004-05 (RE) and further to 47.9 per cent 2005-06 (BE). The Union Budget for 2005-06 has continued the process of raising revenues through reduction in rates, wider base and better compliance. Significant across the board reduction in personal income tax and a 5 percentage point reduction in basic corporate income tax are pointers to this. The peak rate of customs duty on non-agricultural items was reduced from 20 per cent to 15 per cent. Furthermore, customs duty on petroleum products and crude were reduced, and part of the excise duties on petroleum products were converted from ad valorem to specific to mitigate the cascading effect of rising world prices of petroleum on Indian consumers. A major announcement in the Union Budget for 2005-06 was the enabling provision assumed by the Central Government to partly remedy the anomalous situation of State levies applying only to domestic products and not on imports by end-users. This additional duty of customs is not to exceed 4 per cent.

Consumption, savings and investment

1.43 The increasing trend in gross domestic savings as a proportion of GDP observed since 2001-02 continued, according to the new series of national accounts, with the savings ratio rising from 26.5 per cent in 2002-03 to 28.9 per cent in 2003-04 and further to 29.1 per cent in 2004-05 (Table 1.3). In 2004-05, the rise in the savings rate was contributed by two of its three components: namely public and corporate savings. The third component, namely household savings, grew at 5.9 per cent – slower than the GDP growth rate – and made a negative contribution by coming down as a proportion of GDP.

1.44 The trend in public savings had reversed from negative (1998-99 to 2002-03) to positive in 2003-04. With progress in the implementation of FRBMA, this virtuous trend

Table 1.3 : Savings and investment

(New series base 1999-2000)

	1999-00	2000-01	2001-02	2002-03	2003-04 (P)	2004-05 (Q)
	(as per cent of GDP at current market prices)					
Gross Domestic Savings	**24.9**	**23.5**	**23.6**	**26.5**	**28.9**	**29.1**
a) Public	-0.9	-1.8	-2.0	-0.7	1.0	2.2
b) Private	25.7	25.3	25.6	27.2	27.9	26.8
i) Household	21.3	21.2	22.0	23.1	23.5	22.0
Financial	10.5	10.2	10.8	10.3	11.5	10.3
Physical	10.7	11.0	11.2	12.7	12.0	11.7
ii) Private Corporate	4.5	4.1	3.6	4.1	4.4	4.8
Gross Domestic Investment*	**26.0**	**24.2**	**23.0**	**25.3**	**27.2**	**30.1**
Public	7.5	6.9	6.9	6.2	6.5	7.2
Private	17.9	16.7	16.8	18.5	18.9	20.0
Valuables	0.8	0.7	0.6	0.6	0.9	1.3
GFCF	23.3	22.7	23.1	24.1	24.7	25.9
Change in stocks	2.0	0.9	0.6	0.6	0.7	1.4
Errors & Omissions	-0.1	-0.1	-1.3	0.1	1.0	1.6
Saving-Investment Gap@	**-1.1**	**-0.6**	**0.6**	**1.2**	**1.6**	**-1.0**
Public	-8.3	-8.7	-8.9	-6.8	-5.5	-5.0
Private	7.8	8.6	8.8	8.6	9.0	6.9

Note : (i) Gross domestic investment denotes gross domestic capital formation (GDCF).
(ii) Figures may not add up due to rounding off.
*** : adjusted for errors and omissions;**
@ : refers to the difference between the rates of savings and investment.
GFCF : Gross fixed capital formation.
P : Provisional; Q : Quick estimates;
Source : Central Statistical Organisation.

consolidated further with an increase in public sector savings from 1.0 per cent of GDP in 2003-04 to 2.2 per cent of GDP in 2004-05. The positive saving of Rs. 69,390 crore in 2004-05 (QE) was composed of lower dissavings of public authorities and higher savings from non-departmental enterprises.

1.45 Savings by the private corporate sector – reflecting the high retained earnings from their higher profits – grew rapidly (24.9 per cent) to increase its share in GDP from 4.4 per cent in 2003-04 to 4.8 per cent in 2004-05 (QE). There has been a continuing upward momentum in the savings of the private corporate sector for three years; as a proportion of GDP, it increased steadily from 3.6 per cent in 2001-02 to 4.8 per cent of GDP in 2004-05 (QE). The increase of 0.2 percentage points in gross domestic savings rate between 2003-04 and 2004-05 was considerably lower than the 2.4 percentage point rise in the previous year because of a decline in household savings, in both financial as well as physical assets, relative to GDP.

1.46 Private final consumption expenditure (PFCE), at current prices as a proportion of GDP, after declining from 64.6 per cent in 1999-2000 to 62.9 per cent in 2002-03, fell further to 62.4 per cent in 2003-04 and 60.6 per cent in 2004-05. Among the various components of PFCE, the share of food, beverages and tobacco in total expenditure came down from 46.8 per cent in 2000-01 to 40.6 per cent in 2004-05. The other major item of importance, namely, transport and communication, as a proportion of PFCE, rose from 14.3 per cent in 2000-01 to 18.2 per cent in 2004-05.

1.47 While consumption expenditure, when measured as a proportion of GDP, exhibited a declining trend both in public and private consumption categories, such expenditure continued to dominate the demand side of national income. As a proportion of GDP at current prices, Government final consumption expenditure (GFCE) declined from 12.9 per cent in 1999-2000 to 11.2 per cent in 2003-04. The proportion is estimated to have grown marginally to 11.3 per cent in 2004-05.

1.48 In line with the rise in the rate of gross domestic savings in 2002-03 and 2003-04, there was an increase in the rate of GDCF or investment (Table 1.3). However, the increase in GDCF was less than the increase in savings, leading to a current account surplus in BOP, as a proportion of GDP, of 1.2 per cent and 1.6 per cent, respectively. In 2004-05, reflecting the pick up in investment in the economy, GDCF increased by 2.9 percentage points of GDP, surpassing the 0.2 percentage point increase in the ratio of gross domestic savings to GDP. A current account deficit in BOP of 0.8 per cent of GDP largely bridged the savings-investment gap.

1.49 Gross domestic investment grew from 27.2 per cent in 2003-04 to 30.1 per cent in 2004-05 (Table 1.3), mainly on account of private investment growing at 19.7 per cent. In the revised series data, a new item "valuables" covering expenditure on acquisition of precious metals and stones as a store of value has been included as a component, separate from public and private, of GDCF on the basis of 1993 System of National Accounts of United Nations.

1.50 GDCF at constant prices (base: 1999-2000) as a proportion of GDP (Table 1.4) is consistently lower than the corresponding proportion at current prices (Table 1.3). But, irrespective of the choice of constant or current prices as the weights, the direction of change from year to year remains unaltered. The lower values of the change in GDCF as a proportion of GDP at constant prices, particularly in more recent years, may reflect the higher prices of capital goods relative to the general price level, with growing technological sophistication of the production processes in the economy in general and manufacturing in particular.

1.51 At constant 1999-2000 prices, the composition of GDCF for 2003-04 and 2004-05 reveals a faster growth in the public component than in the private. Furthermore, there is a faster growth in inventories and valuables in the latest two years, with gross fixed capital formation (GFCF) growing at a lower rate than gross domestic capital formation. This may partly reflect a process

Table 1.4 : Real gross domestic capital formation

	1999-2000	2000-01	2001-02	2002-03	2003-04 (P)	2004-05 (Q)
	(as percent of GDP at market prices, 1999-2000 prices)					
GDCF*	**26.0**	**23.9**	**22.3**	**25.0**	**26.7**	**28.5**
Public	7.5	6.9	6.8	6.1	6.3	6.8
Private	17.9	16.4	16.2	18.2	18.6	18.9
Private corporate	7.2	5.6	5.4	5.7	6.9	8.2
Household Sector	10.7	10.8	10.8	12.5	11.7	10.7
Valuables	0.8	0.7	0.6	0.6	0.9	1.3
GFCF	**23.3**	**22.4**	**22.4**	**23.7**	**24.4**	**24.6**
Public	6.6	6.4	6.3	6.3	6.6	6.6
Private	16.7	16.0	16.0	17.5	17.8	18.0
Change in stocks	**2.0**	**0.9**	**0.5**	**0.6**	**0.5**	**1.1**
Public	0.9	0.5	0.4	-0.1	-0.2	0.2
Private	1.1	0.4	0.1	0.7	0.7	0.8
	(growth rate in per cent)					
GDCF*		**-4.5**	**-1.9**	**16.5**	**15.8**	**15.7**
Public		-4.0	3.2	-6.0	11.8	16.7
Private		-4.6	3.8	16.9	10.3	10.4
GFCF		**0.0**	**5.0**	**9.9**	**11.3**	**9.5**
Public		1.3	3.9	2.2	13.7	8.6
Private		-0.6	5.5	13.0	10.5	9.8

Note : GDCF : Gross domestic capital formation; GFCF : Gross fixed capital formation;
Figures may not add up due to rounding off.
*** : adjusted for errors and omissions; P : Provisional; Q : Quick estimates;**

Source : Central Statistical Organisation

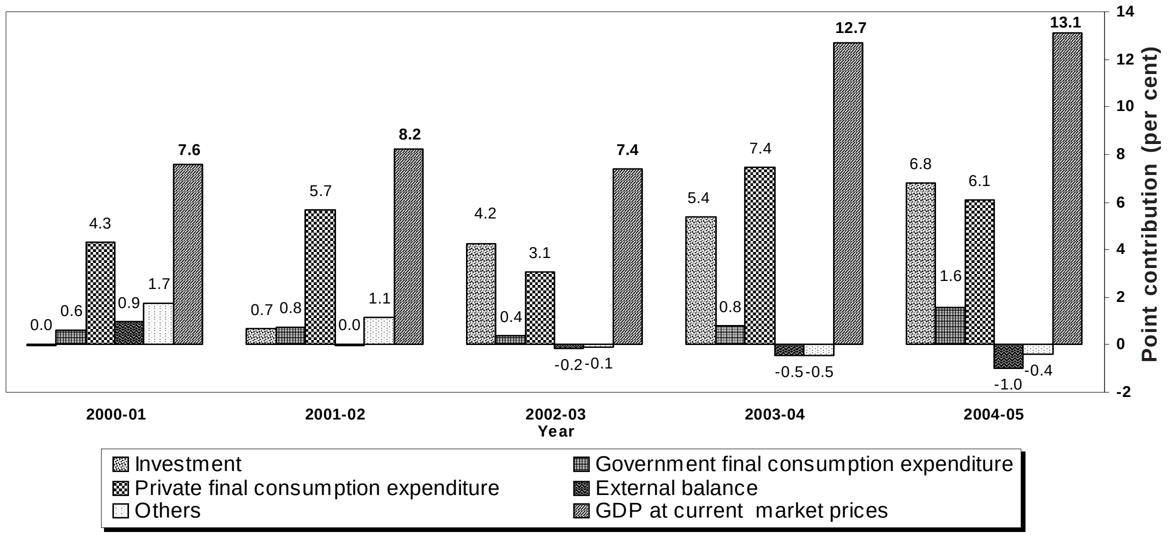
of adjustment to the rapid decline in the change in stocks as a proportion of GDP from 2.0 per cent in 1999-2000 to a low of 0.5 per cent in 2001-02 and the progressive liberalization of gold and silver imports.

1.52 In terms of contribution to growth of GDP at current market prices, from the demand side, there was a change in the pattern of PFCE providing the lead (Figure 1.2 and Table 1.5). PFCE contributed as much as 54.5 per cent of the growth in GDP at current market prices between 2000-01 and 2003-04. The percentage point contribution of private final consumption expenditure was as much as 7.4 out of the overall growth of 12.7 per cent in GDP in 2003-04. In the same year, the corresponding contribution of investment was 5.4. In an encouraging development, the percentage point contribution of investment at 6.8 out of 13.1 per cent growth in GDP in 2004-05 exceeded the corresponding contribution of private final consumption expenditure at 6.1 for the first time in recent years. Reflecting the higher growth of imports relative to exports, the negative contribution of external balance increased in 2004-05.

Production

1.53 As per the 4th advance estimates, total foodgrains production is estimated at 204.6 MT in 2004-05 compared to 213.5 MT in 2003-04. The first advance estimates of foodgrains production for 2005-06 released on September 19, 2005 placed kharif production at 105.3 MT, up by about 2 MT from the previous year's level. Rabi sowing is complete, and the weather remaining favourable, rabi output is expected to remain at 101.2 MT, the same as in Rabi 2004-05. As per the latest information available in

Fig. 1.2 **Point contribution to GDP growth at current market prices**



February 2006, total foodgrains production is projected to increase by 2.3 per cent from 204.6 MT in 2004-05 to 209.3 MT in 2005-06. Since the decline in output, particularly that of coarse cereals, in drought-affected 2004-05, the recovery to the record output of 2003-04 remains incomplete. The decline in the kharif output of coarse cereals since 2003-04 is expected to continue in the current year. Kharif oilseeds production for 2005-06 is estimated at 14.6 MT as per the first advance estimates. The rabi oilseeds production may reach the target level of 10.4 MT with favourable weather. The first advance estimates for 2005-06 put sugarcane output at 257.7 MT, a sharp turnaround from 232.3 MT in 2004-05. However, prospects of cotton, jute and mesta production in 2005-06 are not considered better than in 2004-05.

Table 1.5 : Disposition of gross domestic product (GDP)

Component	Percentage change over the previous year									
	(at current prices)					(at 1999-2000 prices)				
	2000-01	2001-02	2002-03	2003-04P	2004-05Q	2000-01	2001-02	2002-03	2003-04P	2004-05Q
Total final consumption expenditure	**6.3**	**8.4**	**4.5**	**11.0**	**10.4**	**1.9**	**5.2**	**1.2**	**7.0**	**6.7**
Government final consumption expenditure	4.8	6.0	3.0	6.6	14.2	0.3	1.7	-0.6	2.4	9.2
Private final consumption expenditure	6.7	8.9	4.7	11.8	9.8	2.3	5.9	1.6	7.9	6.3
Gross domestic capital formation of which:	**-0.1**	**2.9**	**18.5**	**21.2**	**24.9**	**-4.5**	**-1.9**	**16.5**	**15.8**	**15.7**
Gross fixed capital formation	4.7	10.2	11.8	15.7	18.3	0.0	5.0	9.9	11.3	9.5
Exports of goods and services	**22.1**	**4.5**	**22.3**	**14.7**	**45.1**	—	—	—	—	—
Less imports of goods and services	**12.0**	**4.5**	**22.2**	**16.7**	**47.7**	—	—	—	—	—
GDP at market prices	7.6	8.2	7.4	12.7	13.1	4.0	5.3	3.6	8.3	8.5

P - Provisional Q-Quick estimates
Source : Central Statistical Organisation.

1.54 The pick up in industrial output observed since the second quarter of 2003-04 has continued. As per the index of industrial production (IIP), during the period April-December, 2005, growth was 7.8 per cent compared to a growth of 8.6 per cent in the corresponding period of 2004. In the first half of 2005-06, however, on a cumulative basis (for example, April-May, April-June, etc.), IIP growth exceeded the corresponding growth in 2004-05. However, this superior performance was reversed from October 2005, and IIP growth for the first nine months of 2005-06 turned out to be lower than that in the corresponding period of 2004-05.

1.55 The current year has been characterised by vigorous growth of manufacturing, one of the three sub-sectors of industry. In three out of first nine months (May, June and October, 2005, with a record 13.2 per cent growth in June 2005), year-on-year growth was in double digits. The performance of the other two sub-sectors of mining and electricity within industry, however, was worse than in 2004-05. This disappointing performance of mining and electricity pulled down the overall performance of the industrial sector.

1.56 Within manufacturing, a faster growth of the capital goods sector at 15.7 per cent in April-December 2005 relative to the growth in 13.8 per cent in the corresponding period of the previous year provided strong corroborative evidence on the investment rally in the economy. Second only to capital goods, in the use-based classification of industries, durable consumer goods grew the fastest at 13.6 per cent in the first nine months of the current year. The continued rapid growth in consumer durables since 2003-04 may reflect the impact of fast expanding retail consumer credit in the banking sector. Consumer goods, both the durables and non-durables segments, recorded improved performance with double digit growth in the last two years.

1.57 Performance of 17 industries at the two-digit level during April-December 2005 underlined a fairly broad-based pattern of growth within manufacturing. Seven industries, accounting for almost 34 per cent of the total weight in IIP, grew at more than 10 per cent. The most striking performers were textile products (18.6 per cent), beverages (16.4 per cent) and basic metals (15.0 per cent). Five industries, contributing around 18 per cent of the IIP, experienced negative growth during the first nine months of the current year, out of which, wood products, metal products, leather products, and food products, experienced the sharpest drops.

1.58 Among individual industries, automobiles continued to expand with buoyant growth in all segments. Indian vehicles, particularly passenger cars and three-wheelers, are making significant inroads into overseas markets, with exports from such categories accounting for 18-19 per cent of current output levels. Output of passenger cars is expected to cross the million mark in the current year compared to 8,000 in 1950-51. While output of cotton textiles increased by 10.2 per cent in April-December 2005, that of other major textiles – made of wool, silk and manmade fibres – declined. There was acceleration in the growth of both output and exports of readymade garments, which were removed from the ambit of small-scale reservation from March 28, 2005.

1.59 Cement, buoyed by the resurgence in construction activity in the economy, grew by 10.9 per cent in April-December 2005, up from 6.9 per cent in the corresponding previous period. Steel production, on an upswing for three years, posted a growth of 7.1 per cent during April-December 2005, which was slightly lower than the 7.5 per cent recorded in the corresponding previous period; but is expected to improve in the last quarter of the current year because of the low base in the last quarter of the previous year. Among other core industries, some shortfalls were recorded for energy products, particularly in the petroleum segment. Crude oil production has declined during the current year on account of unanticipated supply shocks, while growth in coal production has also reduced to 5.7 per cent in April-December 2005-06 compared with 7.3 per cent in April-December 2004-05. Reduction in coal supply has reportedly affected electricity generation by pulling down growth in the thermal power segment.

Human development, poverty and unemployment

1.60 As per the United Nations Development Programme's (UNDP) Human Development Reports, the value of the Human Development Index (HDI) – a composite indicator based on income, education and health – has increased consistently over the years. However, India's relative global ranking on this index has remained at a low of 127 among 177 countries for three years in a row. The unsatisfactory relative progress, in spite of rapid growth in income, continued to underscore the need for accelerated improvements in education and health.

1.61 While the availability of data for recent periods remains a problem in both the areas of education and health, there are some indications of progress, albeit slow, on both fronts. For example, between 1991-95 to 2001-06, life expectancy at birth is estimated to have improved from 59.7 years to 63.9 years for males and from 60.9 years to 66.9 years for females. Similarly, in education, gross enrolment ratio – the proportion of children in the 6-14 years age group actually enrolled in elementary schools – is estimated to have increased progressively from 32.1 in 1950-51 to 82.4 in 2001-02 and further to 84.9 in 2003-04. As on October 2005, number of out-of-school children, as reported by States/ Union Territories (UTs), was down to 95 lakh from 320 lakh in 2001.

1.62 The latest available official estimate of poverty continues to be that relating to the year 1999-2000, when the 55th round large-scale quinquennial sample survey on household consumer expenditure was conducted by the National Sample Survey Organisation (NSSO). The survey had estimated a reduction in the incidence of poverty from 36.0 per cent in 1993-1994 to 26.1 per cent during 1999-2000. The comparability and the extent of actual decline were matters of some controversy due to a change in the methodology for data collection in 1999-2000. While the results of the 61st round of the large-scale NSSO survey conducted during 2004-2005 are still awaited, the annual thin-sample surveys available for the period beyond 1999-2000 point towards a continued reduction in the incidence of poverty. The results of the 61st round will clarify whether the rate of decline in poverty-incidence is in conformity with the trend required to achieve the Tenth Plan's targeted reduction in poverty to 19.3 per cent by 2007.

1.63 The results of the 60th round NSSO Survey on Employment and Unemployment situation conducted during January–June 2004 are now available. The sample size, which is neither large nor small by standards of the previous NSSO rounds, leaves scope for raising questions about sampling errors and conclusiveness of the evidence. Nevertheless, the 60th round estimates the unemployment rate, based on the current daily status, in 2004, for males at 9.0 per cent (up from 5.6 per cent in 1993-94) in rural areas and at 8.1 per cent (up from 6.7 per cent in 1993-94) in urban areas. The corresponding figures for females were 9.3 per cent (up from 5.6 per cent) in rural areas and 11.7 per cent (up from 10.5 per cent) in urban areas.

Issues and priorities

1.64 The encouraging signs of a pick up in investment and acceleration in growth pointed out by the last Survey have strengthened in 2005-06. Investment, as a proportion of GDP (at current prices), increased steadily from 23.0 per cent in 2001-02 to 30.1 per cent in 2004-05. Its continued buoyancy is manifest in the rapid rate of growth of credit and of production and import of capital goods; number and value of primary issues; and the stock price rally in secondary markets. Also, with an anticipated growth of 8.1 per cent in 2005-06, the compound average growth rate of the economy is likely to exceed 8.0 per cent in the last three years ending in 2005-06.

1.65 The odds are loaded heavily in favour of a continuation of the growth momentum observed in the last three years. A virtuous cycle of growth and savings, that appears to be already underway, is likely to continue for some years to come. Household savings rate will increase with accelerating income growth, particularly with the reinforcement of benign demographic dynamics. With the 'dependency ratio' on the decline and the growth rate on the rise, the proportion of people in the working age group will not only be higher but will also have much higher incomes to save from than the preceding generations. Thus, the household savings rate will increase further. With its well-known 'home-bias', domestic savings finances the bulk of domestic investment in any country. Thus, the investment rate in the Indian economy is likely to rise, *pari passu,* with rising domestic savings rate in the years to come. And, rising investment rate will feed back into higher growth, and reinforce the cycle. As the large gap between investment rate in India and that in East Asian countries during their take-off stage gets bridged, Indian economy should start posting growth rates close to the rates observed then in the East Asian countries.

1.66 The 'demographic dividend' will also pay off in terms of a larger and younger labour force gainfully employed in production, and generating a larger national income, particularly in a world where many countries are transiting to ageing societies. The suggestion by various empirical studies that, given its institutional strengths, India's per capita income should be four to five times of what it is now, portends a bright outlook for growth over the medium term. The multi-pronged challenge lies in providing an appropriate policy framework to harness the dormant talent pool of Indian work-force and entrepreneurs to position the economy on a sustained high-growth trajectory.

1.67 Speedy provision of quality infrastructure through appropriate policy stimulus constitutes the first and foremost component of this challenge. India's growth prospects are intricately intertwined with the rapid development of physical infrastructure such as power, roads, ports, and airports, and efficient delivery of such services.

1.68 On an approximate basis, power shortage, at around 12 per cent in peak and 8 per cent in average terms, is equivalent to around 50 billion units, or (at Rs. 3 per unit) Rs. 15,000 crore, of foregone generation from utilities. The simplistic assumption of 5 per cent power-intensity of aggregate output in the economy yields a supply-multiplier of 20 and an associated GDP-loss of Rs. 3,00,000 crore; but, it disregards the use of alternative – albeit more expensive – energy sources, such as captive power. Nevertheless, inadequate availability of power adversely affects in a major way not only the output of large industries, but also irrigation in agriculture and production of small and medium enterprises.

1.69 A reversal of the slowdown in the mining sector, particularly coal, is critical in this context. Coal meets about 60 per cent of the country's total commercial primary energy demand, and generates 70 per cent of all power. Nationalised during 1971-1973, the coal sector continues to be dominated by central public sector undertakings. During 2004-2005, with output growth of 5.6 per cent, there was a shortage of domestic coal, and several thermal power plants remained at the level of critical supply (3 days' feed-stock) through the year. In the current year, while with concerted attempts, including through imports of 10MT (equivalent to 18MT of domestic coal), the availability of coal for thermal plants has improved, the overall problem of shortage persists. The problem of rigidity of the pricing system that partly led to the shortfall in domestic supply relative to demand and resulted in shortages has been addressed in part by the introduction of e-marketing. During April-November 2005, Coal India Limited sold 10.2 MT of coal by auction through e-marketing. But, more needs to be done. There is a need for further liberalization, including: allowing an associated coal mining company engaged in captive mining to sell excess coal to any other eligible end-users; allocating coal blocks for captive mining through price-based auctions; and liberalization of FDI restrictions in joint ventures in captive mining.

1.70 The impact of roads on economic development is well-known. For example, in

Latin America, a ten per cent increase in the length of roads per worker has been estimated to increase GDP per worker by nearly two per cent. Without adequate roads in India, particularly in rural areas, the objective of agricultural diversification from cereals into perishables such as fruits and vegetables can not be achieved. Similarly, lack of an enabling infrastructure remains the single most important constraint to export growth. Achievement of the ambitious export target set in Foreign Trade Policy 2004-09 requires a projected augmentation of the installed capacity of ports by 140 per cent. Indian ports have a vessel turn-around time of 3-5 days as against only 4-6 hours in Singapore and Hong Kong. Improvement of airports, passenger amenities and emphasis on targeted tourist segments need to be vigorously pursued to ensure further sustained boost in the tourism sector.

1.71 The total investment required in infrastructure is enormous. The Committee on Infrastructure, headed by the Prime Minister, has estimated the investment requirements as: Rs. 1,72,000 crore in the National Highways sector by 2012; Rs. 40,000 crore for Airports by 2010; and Rs. 50,000 crore for Ports by 2012. A substantial share of this investment is expected to come from the private sector. India has an estimated potential to absorb US$150 billion of FDI in the next five years in the infrastructure sector alone. It is important that the India Infrastructure Finance Company Limited (IIFCL), incorporated on January 5, 2006, not only becomes operational but starts lending funds, especially debt of longer term maturity, directly to the eligible projects to supplement other resources from banks and financial institutions from an early date.

1.72 Policies and institutions need to be geared up to meet the specific requirements of the infrastructure sectors in India. A well-defined regulatory architecture has to be in place, to increase the comfort level of the different players in the market. Issues of span of control, and conflicting domains need to be delineated and fleshed out. For example, an energy regulator, cutting across line ministries, needs to be in harness to tap the synergy of the different sectors.

1.73 There was a step up in budgetary outlays on roads financed through the enhanced road cess on motor spirit and high speed diesel in 2004-05 and 2005-06. But, the need for faster consolidation as per the FRBMA to open up fiscal space for higher outlays on infrastructure, both physical and social, continues. The Budget for 2005-06 had to take recourse to a temporary pause in the process of fiscal consolidation, which, given the past experience of initial promising starts followed by subsequent set backs, has given rise to apprehensions of a reversal. However, the pause in the revenue deficit is a one-off measure to accommodate demand on resources as explained in the statement of the Finance Minister under section 7 of the FRBMA. Consolidation would resume in the Budget for 2006-07, and the eventual targets of fiscal and revenue deficits under FRBMA would be met by the terminal year 2008-09.

1.74 Following very low or marginal growth in the preceeding four years, Government final consumption expenditure (GFCE) at 1999-2000 prices grew at 9.2 per cent in 2004-05. This category of consumption expenditure includes all levels of government; Centre, States, local authorities and quasi-government bodies. After growing slower than its private counterpart successively in each of the preceeding four years, GFCE grew faster than PFCE in 2004-05. This reversal in trend need not necessarily be a source of concern if such an increase in GFCE is due to enhanced outlays on social infrastructure matched by commensurate outcomes. Furthermore, in the aftermath of the implementation of the Fifth Pay Commission's recommendations, the general government's fiscal deficit had increased in each of the five years to reach a peak of 9.9 per cent in 2001-02. With the announcement of the impending constitution of the Sixth Pay Commission, there is need to exercise caution to avoid a repetition of a similar deterioration in the medium term.

1.75 Given the rapid growth of public pension liabilities in recent years, the introduction of the new pension scheme (NPS) based on defined contribution and greater investment choice from January 1, 2004 is a welcome development. Relative to many other countries, India is well-placed, because of its demographic dynamics, for putting in place a robust pension architecture that is equitable and efficient. Addressing the concerns about the safeguards raised in the Report of the Standing Committee on the Pension Fund Regulatory and Development Authority Bill, submitted to Parliament on July 26, 2005, and the passage of the Bill will lay the institutional foundation for operationalising the NPS.

1.76 While significant progress has been made in the rationalisation of duties, reduction in the rates of taxes and other reforms, including procedural, the reform of the tax system still remains an unfinished task. To be competitive globally, the Indian industry needs to be unburdened from the high levels of taxes and the distortive exemptions that provide perverse incentives. The process of withdrawal or grand-fathering of exemptions is being speeded up and higher revenues have accrued even with unchanged or lower rates. The process of simplification and digitization of tax administration, which has been initiated, remains a pre-requisite for a transparent and hassle-free tax system.

1.77 In fulfillment of the promised mechanism for ensuring value for money in public expenditure in the Budget for 2005-06, an Outcome Budget was presented to the nation on August 25, 2005. It provides an operational framework through a set of monitorable indicators, and will become effective from the next fiscal year. Together with the Right to Information Act, it is expected to empower civil society to evaluate the performance through benchmarks of achievement that would emerge from various governance structures across the country. In this context, it is important to avoid the pitfalls of performance and zero-based budgeting in the past, and follow not only the letter but also the spirit of the Outcome Budget.

1.78 In the context of public finance, appropriate pricing of petroleum products assumes significance, particularly with the petroleum marketing sector dominated by public sector oil companies. The movement towards market-determined pricing in hydrocarbon sector has floundered pending the resolution of the issue of subsidy in domestic LPG and PDS kerosene. Kerosene prices have remained unchanged since April 1, 2002 despite the unprecedented increase in acquisition cost of crude and costs of refining.

1.79 Customs and excise on petroleum products constitute about 40 per cent of the total customs/excise collections of the Government. With an equally high sales tax, ranging from 12 per cent to 38 per cent, the tax component of the retail price of petrol and high speed diesel remains high. This has been further compounded by the duty differential across products, including on the basis of end-use, leading to problems of fuel-switching and other malpractices. The issue of harmonising state levies on petroleum products is being deliberated by the Empowered Committee of State Finance Ministers on VAT. A Committee on pricing and taxation of petroleum products headed by Dr. C. Rangarajan has recently submitted its recommendations for a new mechanism of pricing that promotes efficiency of the hydrocarbon sector on the one hand, and the concerns of maintaining affordability in prices of cooking fuel for the consumers on the other. With medium-term prospects of crude prices remaining high, the continuance of incomplete pass-throughs is not sustainable without serious consequences to the financial health of oil companies and the exchequer. Besides, the perverse incentives for fuel switching and distortions arising from differential tax rates need to be addressed. The management of the lingering oil crisis requires rapid and bold policy responses with a firm resolve.

1.80 The 60th NSSO round indicates unemployment rates in January-June 2004 that cause some concerns. Mandated by the NCMP, the enactment of the National Rural Employment Guarantee Scheme (NREGS) on September 7, 2005 to ensure 100 days of wage employment in a financial year to an adult member of every rural household who demands employment and is willing to do unskilled manual work is a landmark initiative in this context. If efficiently implemented, NREGS will decisively address the unemployment situation in the rural areas and change the poverty scenario in the country in a tangible manner. The choice of projects under the scheme is also crucial to ensure that need based and good quality assets and infrastructure are created in the rural areas. With the NREGS serving as a broad based safety net, the entire gamut of expenditure based on anti-poverty initiatives need to be revisited.

1.81 Wage employment programmes to provide employment on a day to day basis must get transformed to creation of permanent and quality jobs in the growth sectors and productive processes of the economy. It is in this context that labour reforms to accelerate investment, particularly in industry and export-oriented sectors, remain an unfinished important agenda. Addressing the underinvestment in IT capital in the domestic economy can enhance productivity and expand the scope for employment. Furthermore, there is need to vigorously pursue the development of the small and medium enterprises (SMEs) by facilitating provision of adequate bank credit and of clusters with adequate infrastructure; and through removal of limitations of scale by rapid removal of items from the ambit of small-scale reservation. There is a need for a paradigm shift to encourage the banks to look at provision of credit to SME and agriculture more as an opportunity for profit rather than as a social obligation under directed subsidised credit.

1.82 A number of major initiatives have been undertaken in the other areas of social sectors like health and education. The National Rural Health Mission has been launched to bring about a qualitative improvement in the public health care delivery in the rural areas. Allocation for elementary education sector has been increased substantially during the year. It is however important now to shift emphasis and focus attention on the quality of outcome of the various social sector programmes rather than their quantity or coverage. For example, the quality of education being imparted at the elementary level, rather than just access or only enrolment of children in school, needs to be emphasised through appropriate modifications in the guidelines and their implementation. This will ensure that the children passing out of the school system have a better chance of contributing productively to the economy. While universal coverage has been achieved in terms of opening of health centres in most states, the quality of public healthcare services both in the rural and urban areas need urgent improvement.

1.83 Efficient management and delivery of the social sector programmes necessitate adequate capacity building at all levels, decentralisation of implementation and transparency in delivery and accountability of the agencies involved. Evaluation studies repeatedly indicate that only those programmes tend to succeed which have elements of the above critical success parameters. Budget 2005-06 has emphasized that all Plan schemes need to be evaluated once in five years, and only then be eligible for carry forward in the next Plan.

1.84 While the worry about rapidly growing imports and the burgeoning current account deficit appears to be somewhat misplaced, the possible risks to an otherwise rosy outlook arise from: inflation; interest rate; and fiscal stance. In a capital-scarce economy like India, a current account surplus is symptomatic of insufficient investment. There is clear need to enhance investment. Higher investment is likely to result in higher imports of basic, intermediate and capital goods and trade and current account deficit. Such a deficit, however, is unlikely to pose a balance of payments problem as the commodity composition of non-oil imports, with the exception of gold and silver, is biased in favour of capital and other essential inputs and is likely to add to the export momentum in the future.

1.85 High and volatile international petroleum prices impart an element of uncertainty in the inflation outlook not only for India but also the world economy. With increasing dependence on imported crude and growing openness, India is no longer insulated from the rest of the world in price developments. This inflation uncertainty, together with the unresolved global macroeconomic imbalances, casts its shadow on the interest rate scenario. A continued firming up of global interest rates beyond a point poses the risk of dampening the domestic investment boom.

1.86 The fiscal risk, both at the Central and State levels, arise from the argument that the fiscal adjustment process in India has led to expenditure compression of the wrong kind. It is important to safeguard against this argument as the solution lies in not increasing the deficits, but in meeting squarely the challenge of improving the quality of expenditure. Expansionary fiscal policies of the past have resulted in the present expenditure profile and any solution for correction of the same through higher fiscal deficit is reductionism. Though there is no inviolable penal provision under FRBMA, with a promising economic outlook in a globalised milieu, the nation could ill afford to falter in its fiscal resolve without adverse consequences. The journey for sustained economic growth and stability is a long one and quick fix solutions for higher fiscal deficit to temporarily prop up growth through expansionary policies, albeit in increasing productive capacity, would prove to be counterproductive. Instead, there is much scope for better productivity in expenditure and greater growth dividend through deepening the reform process that could harness higher savings and investment.