FINANCE INDIA

Vol. XXII No.1, March 2008
Pages – 31 – 56

State of the Indian Economy

MINISTRY OF FINANCE & COMPANY AFFAIRS, GOI*

Abstract

India's macro-economic fundamentals are inspiring confidence and investment climate. The economy has continued with a growth in GDP at market prices exceeding 8 % since 2003-04 with projected growth of 8.7 % for 2007-08. Per-capita private consumption expenditure has increased. Year to year changes in consumption also suggest that the rise in consumption is a more gradual and steady process as any sharp changes in income tend to get adjusted in the saving rate. Faster economic growth is translating into more inclusive growth both in terms of employment generation and poverty reduction. The increasing reserves and pressure on the rupee necessitates raising the limit on the market stabilization fund. Sustaining growth and resilience in the face of shocks such as global slowdown, high energy and commodity prices bring forth India's strength from domestic market-driven economic system.

I. State of the Economy

THE ECONOMY HAS moved decisively to a higher growth phase. Till a few years ago, there was still a debate among informed observers about whether the economy had moved above the 5 to 6 per cent average growth seen since the 1980s. There is now no doubt that the economy has moved to a higher growth plane, with growth in GDP at market prices exceeding 8 per cent in every year since 2003-04. The projected economic growth of 8.7 per cent for 2007-08 is fully in line with this trend. There was an acceleration in domestic investment and saving rates to drive growth and provide the resources for meeting the 9 per cent (average) growth target of the Eleventh Five-Year Plan. Macroeconomic fundamentals continue to inspire confidence and the investment climate is full of optimism. Buoyant growth of government

1 Reproduced from Economic Survey 2007-08, Government of India, Delhi, INDIA.

** Economic Division, Ministry of Finance & Company Affairs, North Block, Delhi 110001, INDIA

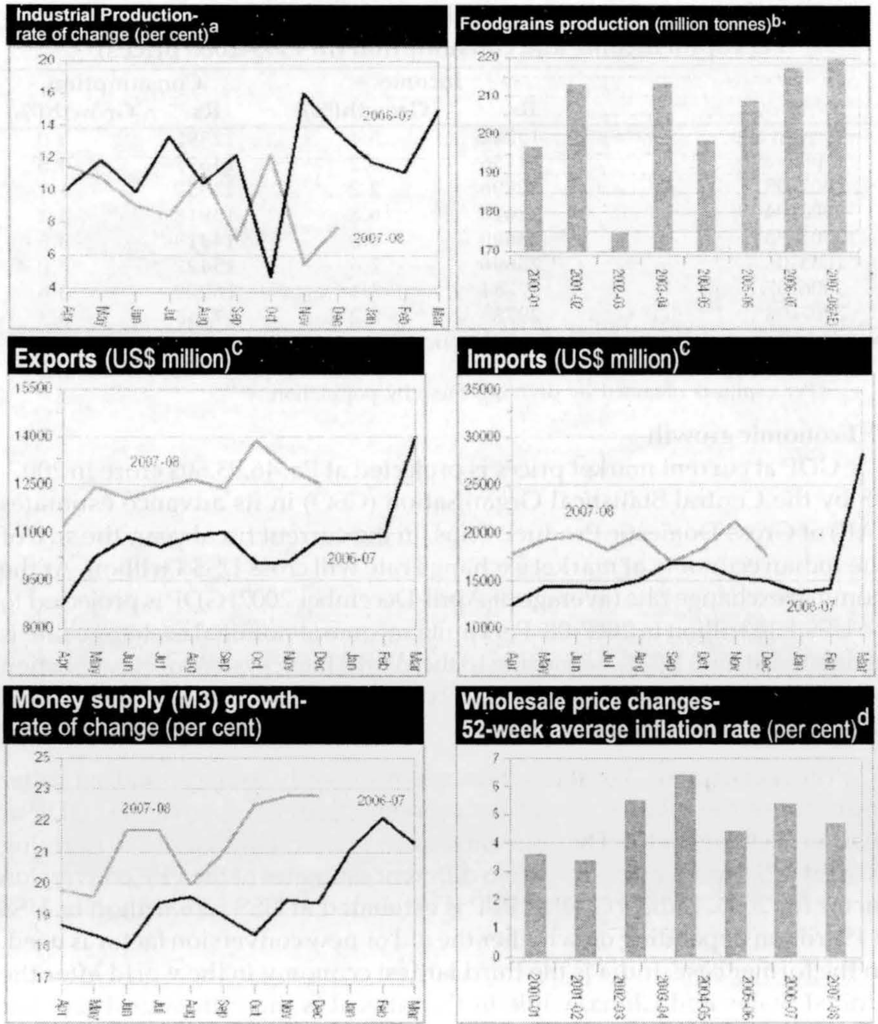
revenues made it possible to maintain fiscal consolidation as mandated under the Fiscal Responsibility and Budget Management Act (FRBMA). The decisive change in growth trend also means that the economy was, perhaps, not fully prepared for the different set of challenges that accompany fast growth. Inflation flared up in the last half of 2006-07 and was successfully contained during the current year, despite a global hardening of commodity prices and an upsurge in capital inflows. An appreciation of the rupee, a slowdown in the consumer goods segment of industry and infrastructure (both physical and social) constraints, remained of concern. Raising growth to double digit will therefore require additional reforms.

I. Per Capita Income and Consumption

Growth is of interest not for its own sake but for the improvement in public welfare that it brings about. Economic growth, and in particular the growth in per capita income, is a broad quantitative indicator of the progress made in improving public welfare. Per capita consumption is another quantitative indicator that is useful for judging welfare improvement. It is therefore appropriate to start by looking at the changes in real (i.e. at constant prices) per capita income and consumption

The pace of economic improvement has moved up considerably during the last five years (including 2007-08). The rate of growth of per capita income as measured by per capita GDP at market prices (constant 1999-2000 prices) grew by an annual average rate of 3.1 per cent during the 12-year period, 1980-81 to 1991-92. It accelerated marginally to 3.7 per cent per annum during the next 11 years, 1992-93 to 2002-03. Since then there has been a sharp acceleration in the growth of per capita income, almost doubling to an average of 7.2 per cent per annum (2003-04 to 2007-08). This means that average income would now double in a decade, well within one generation, instead of after a generation (two decades). The growth rate of per capita income in 2007-08 is projected to be 7.2 per cent, the same as the average of the five years to the current year.

Per capita private final consumption expenditure has increased in line with per capita income. The growth of per capita consumption accelerated from an average of 2.2 per cent per year during the 12 years from 1980-81 to 1991-92 to 2.6 per cent per year during the next 11 years following the reforms of the 1990s. The growth rate has almost doubled to 5.1 per cent per year during the subsequent five years from 2003-04 to 2007-08, with the current year's growth expected to be 5.3 per cent, marginally higher than the fiveyear average. The average growth of consumption is slower than the average growth of income, primarily because of rising saving rates, though rising tax collection rates can also widen the gap (during some periods). Year to year changes in consumption also suggest that the rise in consumption is a more gradual and steady process, as any sharp changes in income tend to get adjusted in the saving rate.



Note : a November 2007 (Provisional) b First advance estimates (Kharif only)
c Provisional d Provisional average April to December, 2007

Figure 1
Selected Economic Indicator

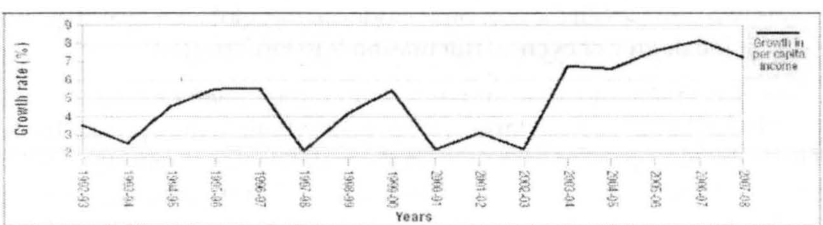


Figure 2
Growth in Per Capita Income

Table I
Per capita income and consumption (in 1999-2000 prices)

	Income		Consumption	
	Rs.	**Growth(%)**	**Rs.**	**Growth(%)**
IX plan avg.	19245	3.4	12392	3.0
X plan avg.	24156	6.2	14677	4.3
2002-03	20996	2.2	13352	1.1
2003-04	22413	6.8	13918	4.2
2004-05	23890	6.6	14413	3.6
2005-06	25696	7.6	15422	7.0
2006-07	27784	8.1	16279	5.6
2007-08	29786	7.2	17145	5.3

Note : Income is taken as GDP at market prices.
Consumption is PFCE.
Per capita is obtained by dividing these by population.

II. Economic growth

GDP at current market prices is projected at Rs. 46,93,602 crore in 2007-08 by the Central Statistical Organisation (CSO) in its advance estimates (AE) of Gross Domestic Product. Thus, in the current fiscal year, the size of the Indian economy at market exchange rate will cross US$ 1 trillion. At the nominal exchange rate (average of April-December 2007) GDP is projected to be US$ 1.16 trillion in 2007-08. Per capita income at nominal exchange rate is estimated at US$ 1,021. According to the World Bank system of classification of countries as low income, middle income and high income, India is still in the category of low income countries.

The (per capita) GDP at purchasing power parity is conceptually a better indicator of the relative size of the economy than the (per capita) GDP at market exchange rates. There are, however, practical difficulties in deriving GDP at PPP, and we now have two different estimates of the PPP conversion factor for 2005. India's GDP at PPP is estimated at US$ 5.16 trillion or US$ 3.19 trillion depending on whether the old or new conversion factor is used. In the former case, India is the third largest economy in the world after the United States and China, while in the latter it is the fifth largest (behind Japan and Germany).

GDP at factor cost at constant 1999-2000 prices is projected by the CSO to grow at 8.7 per cent in 2007-08. This represents a deceleration from the unexpectedly high growth of 9.4 per cent and 9.6 per cent, respectively, in the previous two years. With the economy modernizing, globalizing and growing rapidly, some degree of cyclical fluctuation is to be expected.

This was taken into account while setting the Eleventh Five Year Plan (2007-08 to 2011-12) growth target of 9 per cent (both in the approach paper and in the NDC approved plan). Given the over 9 per cent growth in the last two years of the Tenth Five Year Plan it was argued that the Eleventh Five Year Plan target could be set at 10 to 11 per cent as 9 per cent had already been achieved. Maintaining growth rate at 9 per cent will be a challenge and raising it to two digits will be an even greater one.

III. Sectoral Contribution

The deceleration of growth in 2007-08 is generally spread across most of the sectors except electricity, community services and the composite category "trade, hotels, transport & communications". The deceleration in the growth of the agriculture sector is attributed to the slackening in the growth of *rabi* crops. Manufacturing and construction, which grew at 12 per cent in 2006-07, decelerated by about 2.5 percentage points in 2007-08. The slower growth of consumer durables (as reflected in the IIP) was the most important factor in the slowdown of manufacturing. Cement and steel, the key inputs into construction, grew by 7.4 per cent and 6.5 per cent respectively, during April-November 2007- 08, down from 10.8 per cent and 11.2 per cent in the previous year,dampening the growth in the construction sector. There was also a deceleration in the growth of revenue earning freight traffic by railways, passengers handled at airports, and bank credit in April-November 2007-08, which formed the basis for the full year assessment.

Growth in 2006-07 initially estimated at 9.2 per cent in February 2007 was revised upwards to 9.4 per cent in May 2007 and further to 9.6 per cent in the Quick Estimates released by the CSO on January 31, 2008. This suggests that upward adjustments in the 2007-08 projections are possible.

The observed growth of 7.8 per cent in the Tenth Five Year Plan (2002-07), the highest so far for any plan period, is only marginally short of the target of 8 per cent. The dismal growth rate of 3.8 per cent during the first year of the plan was made up by an upsurge in growth in the next four years to an average of 8.8 per cent. A notable feature of growth during the Tenth Five Year Plan was the resurgence of manufacturing. There was a sharp acceleration in the growth of manufacturing from 3.3 per cent during the Ninth Five Year Plan to 8.6 per cent during the Tenth Five Year Plan. The average growth of manufacturing during the five years ending 2007-08 is expected to be about 9.1 per cent. The contribution of manufacturing to overall growth increased from about 9.6 per cent during the Ninth Five Year Plan to about 17.7 per cent during the Tenth Five Year Plan.

The growth in the services sector continued to be broad based. Among the subsectors of services, "transport and communication" has been the fastest growing with growth averaging 15.3 per cent per annum during the Tenth Five Year Plan period followed by "construction". The impressive progress in the telecommunication sector and higher growth in rail, road and port traffic played an important role in the growth of this sector. Besides manufacturing the two other sectors whose contribution to growth has increased over the two plans are construction and communications. The contribution of the construction sector increased to 10.8 per cent during the Tenth Five Year Plan from 7.5 per cent during the Ninth Five Year Plan, while that of telecom increased to 11.4 per cent from 6 per cent over the two plans. The growth of "financial services" comprising banking, insurance and business services, after declining to 5.6 per cent in 2003-04 bounced back to 8.7 per cent in 2004-05, 11.4 per cent in 2005-06 and 13.9 per cent in 2006-07. Manufacturing, construction and communication were the leading sectors in the acceleration of growth during the Tenth Five Year Plan, judged by their increased contribution to growth.

Agricultural growth, dependent as it is on the monsoon, continued to fluctuate, though the five-year period ending 2007-08 had the second lowest coefficient of variation (CV) since the five years ending 1956-57. The CV for the Tenth Five Year Plan was, however, higher than the 60- year average. The overall growth during the Tenth Five Year Plan was 2.5 per cent, the same as in the Ninth Five Year Plan. Weather induced fluctuations considerably influenced the GDP growth for agriculture. In 2002-03, the cumulative rainfall of North-East and South-West monsoon was -33 per cent and -19 per cent, respectively, of the long period averages (LPA). Similarly, in 2004-05, the cumulative rainfall was -13 per cent and -11 per cent from LPA for South-West and North-East monsoon, respectively. The secular decline in the share of agriculture sector in GDP continued, with a decline from 24 per cent in 2001-02 to 17.5 per cent in 2007-08.

Table II
Rate of growth of GDP at factor cost at 1999-2000 prices (per cent)

	IX plan	2002-03	2003-04	2004-05	2005-06	2006-07	Xplan	2007-08
Agriculture and Allied	2.5	-7.2	10.0	0.0	5.9	3.8	2.5	2.6
Mining	4.0	8.8	3.1	8.2	4.9	5.7	6.1	3.4
Manufacturing	3.3	6.8	6.6	8.7	9.0	12.0	8.6	9.4
Electricity	4.8	4.7	4.8	7.9	4.7	6.0	5.6	7.8
Construction	7.1	7.9	12.0	16.1	16.5	12.0	12.9	9.6
Trade and hotels	7.5	6.9	10.1	7.7	9.4	8.5	8.5	12.1
Transport & communication	8.9	14.1	15.3	15.6	14.6	16.6	15.3	
Financing, real est, hsng	8.0	8.0	5.6	8.7	11.4	13.9	9.5	11.7
Community Services	7.7	3.9	5.4	6.9	7.2	6.9	6.1	7.0
GDP	5.5	3.8	8.5	7.5	9.4	9.6	7.8	8.7

Note: Plan period is simple average.

IV. Aggregate Demand

The most important contribution to demand growth has come from investment, while the external trade made negligible or negative contribution. The growth of GDP at market prices accelerated from 3.8 per cent in 2002-03 to 9.7 per cent in 2006-07, giving an average annual growth of 7.9 per cent for the Tenth Five Year Plan. The average rate of growth of gross capital formation during the Tenth Five Year Plan has more than tripled to 17.3 per cent per year from an average growth of 5.3 per cent per annum in the Ninth Five Year Plan. Consequently, its contribution to overall demand, as measured by the increase in GDP at market prices, tripled from 19 per cent in the Ninth Five Year Plan to 65 per cent in the Tenth Five Year Plan. The most important component of investment, namely, gross fixed investment, grew by an average of 14.3 per cent per annum during the Tenth Five Year Plan period.

The relative share of private consumption in GDP was 60.9 per cent while gross fixed capital formation had a share of 27 per cent. Though the average growth of private consumption (PFCE) accelerated somewhat to 5.9 per cent per annum from 5 per cent, its contribution to growth of demand declined from 59 per cent to 46 per cent between the two plans. The contribution of net exports of goods and services to overall demand also declined between the two plans to a negative 5 per cent. Thus the external trade has had a dampening effect on aggregate demand during the just completed plan. Export growth, because of its spillover effects on productivity and efficiency, can, however, still act as a driver of growth.

NAS projections for 2007-08 show a deceleration in the GDP growth at market prices in line with its growth at factor cost. They also show a deceleration in the growth of consumption, both public and private, and an acceleration in the rate of growth of gross fixed capital formation. The higher growth in the gross capital formation is projected to improve its share in GDP at market prices to 32.6 per cent in 2007-08 compared to a share of 23.6 per cent in 2002-03. GDCF is projected to grow by 20 per cent and PFCE at 6.8 per cent in 2007-08, both of them above the average of the just completed plan.

Table III

Growth of GDP at 1999-2000 market prices (per cent) – annual and plan average

	IX plan	2002-03	2003-04	2004-05	2005-06	2006-07	X plan	2007-08
GDP at market prices	5.4	3.8	8.4	8.3	9.2	9.7	7.9	8.7
Consumption (Private)	5.0	2.7	5.8	5.2	8.7	7.1	5.9	6.8
Consumption (Govt)	7.9	-0.4	2.6	2.6	5.4	6.2	3.3	5.5
Gross Capital Formation	5.3	17.0	19.9	19.5	19.4	10.9	17.3	na
Gross Fixed Capital Formation	6.4	6.6	13.7	18.9	17.4	15.1	14.3	15.7
Change in stocks	–	–	-13.4	144.0	47.7	3.9	–	5.1
Exports	10.7	21.8	5.8	28.1	14.8	18.9	17.9	6.4
Imports	9.6	10.4	16.8	16.0	45.6	24.5	22.7	6.4
Contribution to growth (per cent)								
Consumption (Private)	59.2	45.5	44.2	39.0	56.6	43.9	45.8	45.8
Consumption (Govt)	16.7	-1.1	3.6	3.5	6.2	6.5	3.7	6.2
Gross Capital Formation	19.4	–	59.5	65.4	64.3	37.5	65.4	na
Gross Fixed Capital Formation	25.0	40.5	38.5	56.3	51.2	45.5	46.4	55.2
Net Exports	-0.1	40.5	-17.5	22.3	-51.7	-18.2	-4.9	-3.2
Relative share (per cent)								
Consumption (Private)	64.4	63.6	62.1	60.3	60.0	58.6	60.9	57.6
Consumption (Govt)	12.3	11.7	11.1	10.5	10.2	9.8	10.7	9.5
Gross Capital Formation	24.0	25.0	27.7	30.6	33.4	33.8	30.1	na
Gross Fixed Capital Formation	22.7	23.6	24.7	27.1	29.2	30.6	27.0	32.6

Note: a Change in stocks was negative during 2001-02 hence growth rate has not been calculated.

V. Savings and investment

A notable feature of the recent GDP growth has been a sharply rising trend in gross domestic investment and saving, with the former rising by 13.1 per cent of GDP and the latter by 11.3 per cent of GDP over five years till 2006-07. The average investment ratio for the Tenth Five Year Plan at 31.4

per cent was higher than that for the Ninth Five Year Plan, while the average saving rate was also 31.4 per cent of GDP higher than the average ratio of 23.6 per cent during the Ninth Five Year Plan.

The 1990s reforms transformed the investment climate, improved business confidence and generated a wave of entrepreneurial optimism. This has led to a gradual improvement in competitiveness of the entire corporate sector, a resurgence in the manufacturing sector and an acceleration in the rate of investment. The FRBMA mandated fiscal correction path was also helpful in raising the credibility of the Government with respect to fiscal deficits, in which India was at the bottom of global rankings. This has improved perceptions about the long-term macroeconomic stability of the economy. Moderate tax rates, coupled with buoyant sales growth, increased the internal accruals of the corporate sector. The improved investment climate and strong macro fundamentals also led to an upsurge in foreign direct investment. The combined effect of these factors was reflected in an increase in the investment rate from 25.2 per cent of GDP in the first year of the Tenth Five Year Plan to 35.9 per cent of GDP in the last year. The higher investment was able to absorb the domestic savings and also generated an appetite for absorption of capital inflows from abroad.

Gross domestic savings as a proportion of GDP continued to improve, rising from 26.4 per cent in 2002-03 to 34.8 per cent in 2006-07 with an average of 31.4 per cent during the Tenth Five Year Plan. The savings-investment gap which remained positive during 2001-04 became negative thereafter. In a modern economy, the excess of domestic saving over domestic investment suggests a deflationary situation in which demand has not kept pace with increased capacity. Thus the reversal of the saving-investment balance should be viewed as a correction of the domestic supply-demand balance, occurring through above normal (and welcome) increase in demand during 2005-06 and 2006-07.

VI. Savings

Both private and public savings have contributed to higher overall savings. Private savings have risen by 6.1 per cent points of GDP over the Tenth Five Year Plan period while public sector savings increased by 5.2 per cent of GDP. Both have increased steadily over this period, though private savings appear to have reached a plateau in 2005-06 (Table IV). The savings from the private corporate sector were particularly buoyant, while the turnaround in public sector savings from negative to positive from 2003-04 onwards is heartening. The increase in private savings is due to a (more than) doubling of the rate of corporate saving over the plan period. Savings of the household sector were stable at 23 to 24 per cent of GDP, averaging 23.7 per cent during the Tenth Five Year Plan. The physical and financial components of the household savings also remained stable. With the upsurge in private corporate and public sector savings, the share of the household sector in gross domestic savings declined from 94.3 per cent in 2001-02 to 68.4 per cent in 2006-07.

Table IV
Ratio of Savings and Investment to GDP
(per cent at current market prices)

	Ave IX plan	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	Ave X Plan
Gross Domestic Savings	23.6	23.5	26.4	29.8	31.8	34.3	34.8	31.4
Public Sector	-0.7	-2.0	-0.6	1.1	2.2	2.6	3.2	1.7
Private Sector	24.3	25.5	27.0	28.7	29.6	31.7	31.6	29.7
Household Sector	20.3	22.1	23.2	24.4	23.0	24.2	23.8	23.7
Financial	10.3	10.9	10.3	11.4	10.1	11.8	11.3	11.0
Physical	10.0	11.3	12.9	13.0	12.9	12.5	12.5	12.7
Corporate sector	4.0	3.4	3.9	4.4	6.6	7.5	7.8	6.0
Gross Capital formation (Investment)	24.3	22.8	25.2	28.2	32.2	35.5	35.9	31.4
Public sector	7.0	6.9	6.1	6.3	6.9	7.6	7.8	6.9
Private Sector	16.8	16.7	18.6	19.5	23.4	25.8	27.0	22.9
Corporate Sector	6.8	5.4	5.7	6.6	10.5	13.3	14.5	10.1
Household sector	10.0	11.3	12.9	13.0	12.9	12.5	12.5	12.7
Gross Fixed Capial Formation	23.1	23.6	23.8	24.9	28.4	31.0	32.5	28.1
Stocks	0.7	-0.10	.9	0.9	1.9	2.4	2.3	1.7
Valuables	0.4	0.6	0.6	0.9	1.3	1.2	1.2	1.0
Saving Investment Gap	-0.7	0.6	1.2	1.6	-0.4	-1.2	-1.1	0.0
Private	7.5	8.8	8.5	9.2	6.1	5.9	4.5	6.8
Public	-7.7	-8.9	-6.7	-5.3	-4.7	-5.0	-4.5	-5.3

Note: Totals may not tally due to adjustment for errors and omissions.

VII. Investment

In contrast to the increase in savings the increase in investment has been driven by private investment, which went up by 10.3 per cent of GDP over the five years of the Tenth Five Year Plan.

This improvement was in turn driven by private corporate investment, which increased by 9.1 per cent of GDP over these five years. Private corporate sector investment improved from 5.4 per cent of GDP in 2001-02 to 14.5 per cent in 2006-07.

The upsurge in private corporate investment has been visible even to the public as a "Capex" boom, and that is still continuing. Household investment remained close to the plan average of 12.7 per cent of GDP throughout the period, while the public sector investment increased by less than 1 per cent of GDP over the plan period.

The National Accounts provide the data of the gross domestic capital formation at constant 1999-2000 prices also. In terms of constant prices, the ratio of gross investment to GDP is estimated to have increased from 25 per cent in 2002-03 to 33.8 per cent in 2006-07.

The gross fixed capital formation accounted for more than 90 per cent of the investment. The ratio of fixed capital formation to GDP is estimated to have increased to 30.6 per cent in 2006-07.

Table V
Components of Domestic Investment
(per cent to GDP at 1999-00 market prices)

	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	Ave X Plan
Fixed Investment	22.9	23.6	24.7	27.1	29.2	30.6	27.0
Public sector	6.4	6.2	6.4	6.2	6.7	7.2	6.5
Private Sector	16.5	17.3	18.3	20.9	22.4	23.4	20.5
Corporate Sector	5.5	5.2	6.0	9.1	11.3	12.4	8.8
Household sector	11.0	12.1	12.4	11.8	11.1	11.0	11.7
Change in Stocks	-0.1	0.9	0.7	1.6	2.2	2.1	1.5
Public sector	0.4	-0.2	-0.3	0.2	0.4	0.1	0.1
Private Sector	-0.5	1.1	1.1	1.4	1.7	2.0	1.4
Corporate Sector	-0.3	0.5	0.6	1.2	1.5	1.7	1.1
Household Sector	-0.2	0.6	0.5	0.2	0.2	0.3	0.3
Valuables	0.6	0.6	0.9	1.3	1.2	1.2	1.0
Gross Investmenta	22.2	25.0	27.7	30.6	33.4	33.8	30.1
Public Sector	6.8	6.1	6.1	6.4	7.1	7.3	6.6
Private Sector	16.1	18.4	19.4	22.3	24.2	25.4	21.9
Corporate Sector	5.2	5.7	6.5	10.3	12.8	14.1	9.9
Household sector	10.9	12.7	12.9	12.0	11.4	11.3	12.0

Note : a Adjusted for errors and omissions.

VIII. Sectoral investment and ICOR

It is useful to examine the growth of gross capital formation (investment) by sectors to see how much of the sector's growth has been associated with expansion of capacity. Gross capital formation in manufacturing grew at a phenomenal 33.6 per cent per annum during the Tenth Five Year Plan period, the highest growth rate of any sector. This confirms that the boom in manufacturing growth rate is higher than for total GDP, which is backed by solid build up of capacity. The fact that the calculated ICOR for this period at 8.9 is the second highest after electricity suggests that there may be some build up of capacity ahead of and in anticipation of demand.

The 29.7 per cent per annum growth of investment in mining seems at first sight inconsistent with the relatively low growth of GDP from this sector. However, given the long gestation lags in many types of mining projects, the increased investment could be a precursor of faster growth in the Eleventh Five Year Plan, though the first year growth is not encouraging. Trade & hotels, with an annual growth of 26.4 per cent during the five years of the Tenth Five Year Plan, was the third fastest investor. With its very low ICOR of 0.7, it can play a vital role in generating higher employment with relatively low investment along with the construction sector (with the third lowest ICOR). Communication, a very fast growing sector in terms of value added, had the lowest ICOR of 0.6, confirming that competition-induced productivity growth has played a key role in this reasonably well regulated sector.

The traditionally high ICOR of 16.7 for the electricity sector re-emphasises the critical importance of efficient planning and implementation of capacity building as well as efficient use of this capacity and of the electricity produced from it. Railways and other transport and other services were the remaining sectors in which GCF growth exceeded 15 per cent (Table 1.6). Finance and business services, communication and agriculture and allied sectors recorded significantly lower growth. The ratio of gross capital formation to GDP averaged 31 per cent during the Tenth Five Year Plan. It, however, was 94.1 per cent for electricity sector followed by manufacturing at 76.5 per cent. Trade and hotels had the lowest gross capital formation to GDP ratio of 6.2 per cent.

IX. Consumption Basket

The National Accounts also provide data on disaggregated consumption expenditure of households in eight broad categories. With rising per capita consumption, simple Engel curve analysis would predict a decline in share of consumption on food and an increase in luxuries, which in our context include entertainment and durable goods. Food and beverages had the lowest average growth of 3.2 per cent during the Tenth Five Year Plan and its share declined from 48.1 per cent in 2001-02 to 42.1 per cent in 2006-07 (Table VI). The growth of transport and communication, education and recreation and miscellaneous services by more than 10 per cent and the rising share of furniture, appliances and services are also consistent with the Engel curve analysis.

The erratic pattern of change in consumption of clothing and footwear may be because the middle class households treat them as falling within a residual expenditure category. The high share of expenditure on health care, despite a large and nominally free public health care system stretching into the villages, has been of concern, as the pattern is found even among the less well off. The decline in share to 4.4 per cent in 2006-07 after a peak of 5.2 in 2002-03 could be a positive indicator.

Table VI

Sector Investment (1999-00 prices) and ICOR

	Rate of growth of GCF					GCF/ GDP	GDP Growth	ICOR
	2003-04	2004-05	2005-06	2006-07	X Plan	X Plan	X Plan	X Plan
Agriculture & Allied	-3.8	7.9	11.7	10.4	4.8	12.4	2.5	5.0
Mining	69.1	53.9	27.4	-2.0	29.7	37.2	6.1	6.1
Manufacturing	22.8	55.8	25.6	17.9	33.6	76.5	8.6	8.9
Electricity	22.7	-8.3	28.0	8.0	8.5	94.1	5.6	16.7
Construction	27.2	19.7	21.6	10.2	17.1	16.0	12.9	1.2
Trade & Hotels	152.7	6.0	7.6	6.7	26.4	6.2	8.5	0.7
Transport & Communication	-2.6	15.0	-10.9	14.0	7.7	32.2	15.3	2.1
Railways	5.2	3.4	9.4	40.4	17.2	34.3	7.4	4.6
Other Transport	10.3	13.5	-23.4	13.2	15.3	42.6	10.4	4.1
Communication	-46.4	56.7	30.6	0.9	2.3	16.5	26.5	0.6
Financial & Business Services	0.8	-11.4	17.3	5.1	1.3	31.7	9.5	3.3
Other Services	3.0	22.5	27.4	23.2	17.2	31.0	6.1	5.1
Total	12.7	22.4	19.1	14.3	15.9	31.0	7.8	4.0

X. Inclusive growth

Faster economic growth is also translating into more inclusive growth, both in terms of employment generation and poverty reduction. The Tenth Five Year Plan was formulated in the backdrop of the concerns over jobless growth. Employment growth slowed to 1.25 per cent per annum during 1993-

94 to 1999-2000 with 24 million work opportunities created during this period (annual average of 4 million). The Tenth Five Year Plan, therefore, set a target of creation of 50 million new opportunities on current daily status basis (CDS).

The 61st Round of NSSO Survey found that 47 million work opportunities were created during 1999-2000 to 2004-05, at an annual average of 9.4 million. Employment growth accelerated to 2.6 per cent during this period. The labour force, however, grew at 2.8 per cent per year, 0.2 per cent point faster than the workforce, resulting in an increase in the unemployment rate to 8.3 per cent in 2004-05 from 7.3 per cent in 1999-2000. These rates based on the CDS approach are higher than those obtained by the usual status and weekly status approaches, indicating a high degree of intermittent unemployment. Unemployment rate measured in terms of number of persons as per the usual principal and subsidiary status basis was only 2.5 per cent in 2004-05.

The proportion of persons below the poverty line declined from around 36 per cent of the population in 1993-94 to 28 per cent in 2004-05 as per the uniform recall period. Based on the mixed recall period, the number of persons below the poverty line has declined to 22 per cent in 2004-05 from 26 per cent in 1999-2000. Further, the growth of average monthly per capita expenditure at constant prices between 1993-94 and 2004-05 (61st Round of NSSO) also indicates broadly similar growth across different rural and urban income classes, though it may have been less uniform for urban than for rural population.

XI. Inflation

11.1 *GDP Deflators*

The implicit deflator for GDP MP and its demand components is the most comprehensive measure of inflation on an annual basis. Overall inflation, as measured by the aggregate deflator for GDP MP, is projected to decline from 5.6 per cent in 2006-07 to 4.1 per cent in 2007-08. Thus the inflation rate is

Table VII

Private Final Consumption- Annual growth and Share (in per cent)

	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
Food & Beverages	-3.4	5.9	-1.9	4.5	1.0	7.5	4.8
Clothing & Footwear	16.8	-2.9	4.5	-2.4	4.7	12.0	3.7
Rent, Fuel & Power	2.8	2.6	2.9	3.3	7.4	3.0	3.0
Furniture,appliances,service	7.2	3.5	4.0	8.1	12.2	11.6	13.5
Medical & Health care	11.6	14.2	5.3	3.3	3.4	2.0	0.7
Transport, Communication	14.3	6.6	10.6	11.4	10.2	10.4	12.2
Education & Recreation	11.8	7.3	4.5	12.0	13.9	12.4	15.8
Others	12.2	11.4	9.8	9.5	12.4	11.7	11.3
Total Private Consumption	3.4	5.9	2.6	5.9	5.5	8.3	7.2
Share of Total (per cent)							
Food & Beverages	48.1	48.1	45.9	45.3	43.4	43.1	42.1
Clothing & Footwear	6.0	5.5	5.6	5.1	5.1	5.3	5.1
Rent, Fuel & Power	11.4	11.0	11.0	10.8	11.0	10.4	10.0
Appliances	3.4	3.3	3.3	3.4	3.6	3.7	4.0
Medical & Health care	4.7	5.1	5.2	5.1	5.0	4.7	4.4
Transport	14.5	14.5	15.7	16.5	17.2	17.5	18.4
Education & Recreation	3.7	3.7	3.8	4.0	4.3	4.5	4.9
Others	8.4	8.9	9.5	9.8	10.4	10.8	11.2

projected to be identical to that in 2005-06. The counterpart of the consumer price index (CPI), the most commonly used inflation rate for monetary purposes, is the deflator for private final consumption expenditures (PFCE). Inflation, according to the PFCE deflator jumped from 3 per cent in 2005-06 to 5.1 per cent in 2006-07 and is projected to be 5.5 per cent in 2007-08. The projected decline in the overall inflation is therefore due to the deceleration in investment goods prices from 5.5 per cent growth in 2006-07 to 4.3 per cent growth in 2007-08. This should have a positive effect on investment.

11.2 *Prices*

Inflation as measured by the Wholesale Price Index (WPI) rose from 4.4 per cent in 2005-06 to 5.4 per cent in 2006-07 and is expected to return to around the 2005-06 rate for the full year 2007-08, based on the 10 months completed. The composition will, however, be different, with a much higher primary goods inflation, mainly because of primary non-food prices and a lower fuel price inflation because of low pass through of global oil prices. The latest flare up in prices started from a trough of around 4 per cent in February-March 2006 and (except for a short respite in July) continued to accelerate till it peaked in March 2007. Since then there is a declining trend till December 2007. Annual headline inflation was 4.1 per cent on February 2, 2008. On February 15, 2008, a hike in fuel prices was announced, whichas per preliminary estimates is expected to add 19 basis points to the inflation rate.

The increase in the prices of primary articles and mineral oils in June 2006 substantially contributed to this firming up. It started moderating from June 2007 onwards because of a number of reasons: These included a rollback in the increase in the prices of petrol and diesel at end November 2006 and mid-February 2007 to the pre-June 2006 levels, improved availability of primary articles, and fiscal and monetary measures. The year-on-year rate of inflation declined to less than 4 per cent in mid- August 2007 after a gap of 67 weeks. The overall inflation has remained below 4 per cent since then for 23 consecutive weeks, before inching up to 4.1 per cent in the last two weeks. Primary articles which had contributed to substantial increase in the inflation in 2006-07 and in the first five months of the current year were also the major contributors to the deceleration in the rate of inflation. The inflation of primary articles declined from 12.2 per cent on April 7, 2007, to 3.8 per cent on January 19, 2008, the lowest level since early November 2005. There was also deceleration in the prices of manufactured products from over 6 per cent in April 2007 to less than 4.5 per cent in the last 17 weeks (up to February 2, 2008).

The group "fuel and power" has, however, witnessed an increase in inflation in recent months. An increase in the prices of coal and domestic pass through of international price increase in crude oil to petroleum products, other than petrol and diesel, contributed to this firming up of inflation. At a disaggregated level, on January 19, 2008, the prices of 132 "manufactured products" with a weight of 29.7 per cent, 10 items of "fuel and power" with a weight of 10.1 per cent and 41 "primary articles" with a weight of 6.8 per cent were the same or lower than a year ago. The combined weight of these 183 commodities was 46.6 per cent. These commodities substantially contributed to moderation in the inflation in the current year.

The close monitoring of prices and appropriate policy interventions initiated in the last year and a half helped in maintaining price stability and reducing the impact of increase in global prices on domestic consumers.

Table VIII
Implicit deflators (per cent)

	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
GDP MP	3.5	3.0	3.8	3.6	5.6	4.1	5.6	4.1
PFCEdm	3.5	3.2	2.9	3.6	2.8	3.0	5.1	5.5
GFCF	4.7	4.9	1.8	3.5	9.6	5.6	5.5	4.3

Note : PFCEdm : Private Final consumption expenditure in domestic market.

XII. Money Supply

The Reserve Bank of India's monetary policy stance is to serve the twin objectives of managing the transition to a higher growth path and containing inflationary pressures. For policy purposes for 2007-08, the RBI assumed a real GDP growth of 8.5 per cent with inflation close to 5 per cent, and targeted the monetary expansion in the range of 17-17.5 per cent and credit expansion in the range of 20 to 24 per cent as consistent with envisaged growth and inflation. In its mid-term review, the RBI reiterated continuation of the policy stance announced in April 2007 with an additional resolve "to be in readiness to take recourse to all possible options for maintaining stability and the growth momentum in the economy in view of the unusual heightened global uncertainties, and the unconventional policy responses to the developments in financial markets".

Annual average growth of Money (M3) reached a trough of 13 per cent in 2003-04 and has been on an accelerating trend since then, reaching 19.5 per cent in 2006-07. The cumulative (FY to date) increase in the stock of M3 in 2007-08 has also remained above the cumulative growth in 2006-07 and was 13.3 per cent on January 4, 2008, compared to 12.2 per cent on January 5, 2006. Thus it is difficult to relate either the annual or trend rate of growth of M3 to inflation which has been on a down trend during this period, with two cycles peaking in August 2004 and March 2007. This is perhaps because of the parallel process of monetary deepening of the informal economy that is under way. The ratio of average M3 to GDP has increased from 44 per cent in 1990-91 to 71 per cent in 2006-07. This could be attributed to the spread of banking services and the saving habit, resulting in a rise of time deposits. The monetization of the economy as measured by the ratio of average M1 to GDP has increased from 15 per cent in 1990-91 to 21 per cent in 2006-07.

The average growth of bank credit to commercial sector (BCCS) also reached a low of 11.8 per cent in 2003-04 and rose in the next two years to 28 per cent in 2005-06. However, in contrast to money supply, average credit growth slowed marginally to 26.8 per cent in 2006-07 and has decelerated further in 2007-08. The cumulative (FY to date) increase in the credit extended by the banking sector to commercial sector during 2007-08 is less than in 2006-07. The cumulative increase in non-food credit by January 4, 2008, was 11.8 per cent, much slower than the 17.5 per cent increase till the corresponding date of 2007. This deceleration could be related to the deceleration in growth of manufacturing and construction sectors and the consequent slowdown in demand for credit.

Nominal interest rates, as measured by the cut-off yield at auction on 91-day and 364-day Treasury Bills have followed a pattern similar to that of money growth. The average cut-off yield on 364-day (91-day) Treasury Bills reached a trough of 4.7 (4.6) per cent in 2003-04 and has been rising since then. Yields averaged 7 (6.6) per cent during 2006-07. Yields have risen further to an average of 7.5 (7) per cent in April-December 2007 from 6.8 (6.3) per cent in April-December 2006. Real cut-off yields, as measured using the trailing 12 month increase in the WPI, have lagged this increase, by reaching a trough of -1.2 (-1.5) per cent in 2004-05 and rising thereafter to 1.6 (1.2) per cent in 2006-07. The latter were marginal higher than the average yield in 2005-06. Real cut-off yields on 364 (91) day treasury bills have (more than) doubled to an average of 3.2 (2.7) per cent in April-December 2007 from 1.7 (1.2) per cent in April-December 2006. The doubling of the real interest rate may have had a moderating effect on credit demand and consequently on both inflation and growth. It has also led to a widening of the interest differential between domestic and global rates.

During 2006-07, the yield on 10-year Gsec hardened by 45 basis points over the level observed on March 31, 2006, to reach 7.97 per cent on March 31, 2007. Yields moved to 8.32 per cent at end-June 2007 but softened subsequently to reach 7.77 per cent as on January 4, 2008, which was 20 basis points over the end-March 2007 level.

The acceleration in reserve money growth continued in 2007-08. The expansion in M0 (up to January 4, 2008) was 13.6 per cent compared to 9.1 per cent during the corresponding period of the previous year. The main driver of growth of M0 on financial year as well as on annual basis continued to be net foreign assets (NFA) of the RBI. NFA of the RBI expanded by 25.2 per cent in the current year (39.1 per cent on annual basis) compared to an expansion of 15.9 per cent (26.1 per cent on annual basis) during the same period of the previous year. The share of NFA in the aggregate reserve money increased to 122.2 per cent as on March 31, 2007, as against 117.4 per cent on March 31, 2006. This ratio further increased to 134.7 per cent on January 4, 2008. With the continuing surge in capital flows during 2007-08 and the need to regulate domestic liquidity, the MSS limits were revised upward four times to a level of Rs. 2,50,000 crore during the year. During April-December 28, 2007, liquidity absorbed under MSS was Rs. 96,742 crore with outstanding balances at Rs. 1,59,717 crore. The higher growth of the monetary variables (M0 and M3), despite the MSS operations, generated higher liquidity in the system. Short-term liquidity variations were addressed by RBI through the Liquidity Adjustment Facility.

XIII. Balance of Payments

The World Economic Outlook (WEO, IMF October 2007) observed that the recent expansionary phase in the global economy, with average growth of 5 per cent, was the longest since the early 1970s. The WEO update on January 2008 has, however, revised these estimates based on new PPP exchange rates from the 2005 international comparison programme (ICP). There is considerable uncertainty in quantifying the downside risk to global growth arising from the downturn in housing market and the sub-prime mortgage market crisis in the United States. Monetary policy actions by the United States and other developed countries seem to have contained its immediate impact, though more surprises in the next six months cannot be ruled out.

The Indian economy has been progressively globalizing since the initiation of reforms. Trade, an important dimension of global integration, has risen steadily as a proportion of GDP. Inward FDI has taken off and there is a surge in outward investment from a very low base, with net FDI continuing to grow at a good pace. The surge of capital flows in 2007-08 is a third indicator that testifies to the growing influence of global developments on the Indian economy. Capital flows, as a proportion of GDP, have been on a clear uptrend during this decade. They reached a high of 5.1 per cent of GDP in 2006-07 after a below trend attainment of 3.1 per cent in 2005-06. This is a natural outcome of the improved investment climate and recognition of robust macroeconomic fundamentals like high growth, relative price stability, healthy financial sector and high returns on investment. Even as the external environment remained conducive, the problem of managing a more open capital account with increasing inflows and exchange rate appreciation surfaced.

The current account has followed an inverted V shaped pattern during the decade, rising to a surplus of over 2 per cent of GDP in 2003-04. Thereafter, it has returned close to its post-1990s reform average, with a current account deficit of 1.2 per cent in 2005-06 and 1.1 per cent of GDP in 2006-07. The net result of these two trends has been a gradual rise in reserve accumulation to over 5 per cent of GDP in 2006-07. With capital inflows exceeding financing requirements, foreign exchange reserve accumulation was of the order of US$ 15.1 billion in 2005-06 and US$ 36.6 billion in 2006-07. Thus, the rupee faced upward pressure in the second half of 2006-07. Despite this, the rupee depreciated by 2.2 per cent on an overall yearly average basis. The excess of capital inflows has risen to 7.7 per cent of GDP in the first half of 2007-08. Foreign exchange reserves increased by US$ 91.6 billion to US$ 290.8 billion on February 8, 2008.

XIV. Components of Capital Account

The composition of capital flows is also changing. Among the components of capital inflows, foreign investment has been a relatively stable component, fluctuating broadly between 1 per cent and 2 per cent of GDP during this decade. However, it seems to have shifted to a higher plane from 2003-04 with the average for 2003-04 to 2006-07 roughly double that during 2000-01 to 2002-03. The relative stability of investment flows is primarily due to steadily rising FDI. In contrast, debt flows have fluctuated much more, with net outflows in the three years to 2003-04. The variations in debt flows have been primarily due to lumpy repayments on government guaranteed or related ECB. The ratio of debt flows to GDP was on a down trend till 2003-04 and a rising trend from 2004-05. Debt flows, primarily external commercial borrowings, shot up on a net basis in 2006-07 to a level of US$ 16.2 billion. The trend in net capital flows since 2003-04, therefore, seems to be broadly driven by the rising ratio of debt flows.

The most welcome feature of increased capital flows is the 150 per cent increase in net foreign direct investment inflows in 2006-07 to US$ 23 billion. The trend has continued in the current financial year with gross FDI inflows reaching US$ 11.2 billion in the first six months. FDI inflows were broad-based and spread across a range of economic activities like financial services, manufacturing, banking services, information technology services and construction. With FDI outflows also increasing steadily over the last five years, overall net flows (FDI balance in BoP) have grown at a slower rate.

The globalization of Indian enterprises and planting of the seeds for the creation of Indian multinationals have taken place in the last few years. Outward investment from India shot up to US$ 14.4 billion in 2006-07 from less than US$ 2 billion in the period 2003-04. The trend continued in the current year with outward investment of US$ 7.3 billion in April-September 2007. Net FDI flows were, therefore, a modest US$ 3.9 billion during this period. The proportion of payments to receipts under FDI into India was in the range of 0.7 per cent to 0.4 per cent in 2005-06 and 2006-07, respectively. This indicates the lasting and stable nature of FDI flows to India.

Increased volatility in Asian and global financial markets in 2006-07 affected the flow of portfolio investment. Net portfolio flows became negative in May-July 2006 (reflecting the slump in equity markets), picked up momentum in August-November 2006, only to slow again in March 2007.Net flows were, therefore, only US$ 7.1 billion in 2006-07 compared to US$ 12.1 billion in 2005-06. Euro equities, which were a relatively minor component of portfolio flows (less than a billion US dollars in the period 1997-98 to 2004-05), rose to US$ 3.8 billion in 2006-07 constituting 54.3 per cent of the total net portfolio flows. Net portfolio investment inflow was US$ 18.3 billion in April- September 2007, more than double the inflow during 2006-07. Underlying these were gross inflows of $ 83.4 billion and outflows of US$ 65.0 billion.

The rapid accretion of reserves and increased pressure on the rupee, necessitated raising the limit on the market stabilization fund. The annualized return on the multi-currency, multiasset portfolio of the RBI was 4.6 per cent in 2006-07, indicating that the effective fiscal cost of sterilization may be 3.2 per cent. The fiscal costs of sterilization in 2007-08 is placed at Rs. 8,200 crore. The search for an appropriate policy mix for balancing a relatively open capital account, monetary policy independence and flexible exchange rate continues.

XV. Current Account Components

The current account deficit (CAD) mirrors the saving-investment gap in the national income accounts and thus constitutes net utilized foreign savings. The challenge is to leverage foreign inflows (i.e. foreign savings and investment) to promote growth without having the long-term consequences of external payment imbalances. The distinction between gross capital inflows and net inflows is useful. As the latter must equal the CAD, there is no way in which net use of foreign saving can increase without an increase in the CAD. The gross inflow can, however, increase to the extent that it is offset by gross outflows in the form of build-up of foreign exchange reserves, reduction in government external debt or outward investment by entrepreneurs. Higher gross inflows have value even if net flows do not increase to the same extent, as they can improve competition in the real and financial sectors, improve the quality of intermediation and the average productivity of investment, and thus raise the growth rate of the economy. The challenge for policy is to maximize these benefits while minimizing the costs of exchange rate management.

The rise and fall of the current account balance (as a ratio to GDP) during this decade has been driven largely by the goods and services (G&S) trade balance, with the two having virtually the same pattern. The surplus from factor income including remittances, which fluctuated between 2 per cent and 3 per cent of GDP, has helped moderate the substantial deficit on the trade account. Both the trade (G&S) balance and the factor surplus improved between 2000-01 and 2003-04 leading to an improvement of the current account. Both reversed direction thereafter resulting in a declining trend in the current account. The peak values of the three as a proportion of GDP were -0.6 per cent, 2.9 per cent and 2.3 per cent. In the past two years the current account deficit, trade (G&S) deficit and factor surplus have averaged 1.15, 3.5 and 2.35 per cent of GDP, respectively.

The trends in the goods and services trade deficit have in turn been largely driven by the merchandise trade deficit since 2004-05. During 2000-01 to 2003-04 the merchandise trade deficit was around 2 per cent of GDP and the rising services surplus resulted in an improving trend in the overall G&S trade balance. From 2004-05 the merchandise trade balance has been deteriorating and despite the continued rise in the services surplus, the overall G&S balance had followed the deteriorating trend of the former.

Private transfer receipts (mainly remittances) shot up by 49.2 per cent in 2007-08 (April-September) over the first half of 2006-07 when they had increased by 19.2 per cent. Investment income (net), which reflects the servicing costs on the payments side and return on foreign currency assets (FCA) on the receipts side, grew by 60 per cent in 2007-08 (April-September) reflecting the burgeoning foreign exchange reserves. Net invisible surplus grew by 35.2 per cent to reach US$ 31.7 billion in 2007-08 (April-September), equivalent of 6.1 per cent of GDP. Thus, higher invisible surplus was able to moderate partly the higher and rising deficits on trade account. CAD was, therefore, placed at US$10.7 billion in 2007-08 (April-September), equivalent of 2 per cent of GDP for the half year.

XVI. External Trade

India's greater integration with the world economy was reflected by the trade openness indicator, the trade to GDP ratio, which increased from 22.5 per cent of GDP in 2000-01 to 34.8 per cent of GDP in 2006-07. If services trade is included, the increase is higher at 48 per cent of GDP in 2006-07 from 29.2 per cent of GDP in 2000-01, reflecting greater degree of openness.

India's merchandise exports and imports (in US$, on customs basis) grew by 22.6 per cent and 24.5 per cent respectively in 2006-07, recording the lowest gap between growth rates after 2002-03. Petroleum products (59.3 per cent) and engineering goods (38.1 per cent) were the fastest growing exports. The perceptible increase in share of petroleum products in total exports reflected India's enhanced refining capacity and higher POL prices. The rising share of engineering goods reflected improved competitiveness. The value of POL imports increased by 30 per cent, with volume increasing by 13.8 per cent and prices by 12.1 per cent in 2006-07. Non-POL import growth at 22.2 per cent was due to the 29.4 per cent growth of gold and silver and 21.4 per cent growth of non-POL non-bullion imports needed to meet industrial demand.

In the first nine months of the current year, exports reached US$111 billion, nearly 70 per cent of the year's export target. During April-September 2007, the major drivers of export growth were petroleum products, engineering goods and gems and jewellery. Machinery and instruments, transport equipment and manufactures of metals have sustained the growth of engineering exports. There was a revival of the gems and jewellery sector with export growth at 20.4 per cent for April-September 2007, after a deceleration in 2006-07.

Imports grew by 25.9 per cent during April-December 2007 due to non-POL imports growth of 31.9 per cent, implying strong industrial demand by the manufacturing sector and for export activity. The merchandise trade deficit in April-December 2007 at US$ 57.8 billion was very close to the trade deficit of US$ 59.4 billion for 2006-07 (full year). Despite the large overall trade deficit, there was a large (but declining) trade surplus with the United States and UAE, and a small surplus with the United Kingdom and Singapore (till 2006-07). The surplus with the first three has continued in 2007-08. The largest trade deficits are with Saudi Arabia, China and Switzerland. The trade deficit with China has increased further in April-September 2007.

A comparison of the commodity-wise growth of major exports to the United States, European Union and rest of the world provides a better idea of the impact of economic slowdown and rupee appreciation. Manufactured exports to the United States decelerated sharply in 2006-07 because of demand slowdown while dollar depreciation was an additional factor in 2007-08. The slowdown of exports to the European Union was marginal because both factors were absent. In contrast, there was a marginal acceleration in manufactured exports to the rest of the world in the first half of 2007-08. India's exports of textiles, leather & manufactures and handicrafts to US performed poorly in 2006-07, even though the rupee depreciated marginally. However, exports of all subcategories, including engineering goods and chemicals, have decelerated in the first half of 2007-08. In the case of EU, the sharp deceleration in textiles and poor performance in handicrafts were substantially offset by reasonable growth in other manufactures in 2006-07 and the first half of 2007-08. Leather and leather manufactures exports have performed well overall and to EU and other countries, while showing a decline in the case of United States. Thus, there seems to be a greater corelation between the demand in partner country and the bilateral exchange rate, on the one hand, and India's bilateral exports at a disaggregated level, on the other, than is visible for total Indian exports to the world.

Trade with the top 12 trading partners increased by over 11.2 percentage points since 2001-02 to 53.8 per cent of total in 2006-07. The share of the United States, the largest trading partner, declined by 2.5 per cent points to 9.8 per cent in 2006-07 while China became the second largest partner in 2006-07 with its share increasing by 5.2 percentage points over the decade. China's trade share during April-October 2007 is even higher than that of the United States by Rs. 600 crore.

India's export of services grew by 32.1 per cent to US$ 76.2 billion in 2006-07. Software services, business services, financial services and communication services were the main drivers of growth. Commercial services exports were almost 60 per cent of merchandise exports in 2006-07.

However, services exports grew by a disappointing 8.6 per cent in April-September 2007, due to a decline in value of non-software services, particularly business and communication services. 1.60 India has continued to favour multilateral trading arrangements which are both transparent and fair to the developing economies. After the suspension of negotiations in July 2006 due to differences in perceptions, safeguarding the interests of low income and resources poor agricultural producers along with making real gains in services negotiations and addressing growth and development concerns in industrial tariff negotiations.

XVII. Rupee Appreciation

With the demand for foreign exchange (debit side of BOP) not keeping pace with the supply of foreign exchange (credit side of BOP), the rupee appreciated by 8.9 per cent against the US dollar during the current financial year between April 3, 2007, and February 6, 2008. The rupee appreciation against the US dollar over the past 12 months on year-on-year basis (December 2007 over December 2006) at 13.2 per cent was even higher. While the rupee appreciated against other major currencies as well for most parts of the year, it was modest as compared to the rise against the US dollar. It even depreciated marginally against the Euro during the financial year (till February 6, 2008).

The appreciation of the rupee against the US dollar could be attributed to the effect of depreciation of the US dollar against all the major currencies and the surge in capital flows. The REER (6 currency, trade- based weights) that indicates the real competitiveness by factoring the relative price levels, after depreciating in 2006-07, appreciated by 7.8 per cent in April-January 2007-08. The appreciation of the rupee vis-à-vis the dollar, the main invoicing currency of exports, compared to the lower appreciation of competing countries coupled with the slow growth in imports of major trading partners like the United States, affected exports of some sectors with low import intensity. To mitigate the effect and facilitate adjustment, the government announced relief measures to selected sectors.

XVIII. Stock Markets

Stock markets are an important instrument of financial intermediation. They saw increased activity in 2007-08. Primary market issue of debt and equity increased along with private placement. The secondary market too showed a rising trend, notwithstanding intermittent ups and downs in the stock prices responding mainly to global developments. The Bombay Stock Exchange (BSE) Sensex rose from 13,072 at end-March 2007 to 18,048 as on February 18, 2008, while the National Stock Exchange (NSE) index Nifty 50 rose from 3,822 to 5,277 during the same period. Both the indices gave a return of around 38 per cent during this period. The higher net mobilization of resources by mutual funds showed that investors were realising the importance of using intermediaries in risky markets. All the other indicators of capital market such as market capitalization, turnover and price-earning ratio remained strong. The commodity market also showed signs of expansion in terms of turnover and number of transactions during the year.

XIX. Agriculture Production

The Directorate of Economics & Statistics in its second advance estimates of agricultural production (February 7, 2007) has placed total foodgrains production at 219.3 million tonnes, marginally higher than the 217.3 million tonnes in 2006-07 (final estimate). While the production of *kharif* foodgrains is expected to be 5.3 million tonnes (4.8 per cent) higher than the production in 2006-07, *rabi* production is expected to be lower by 3.3 million tonnes. The production of cereals is expected to be 205 million tonnes as against 203.1 million tonnes in 2006-07 (final estimate). The production of pulses, however, is expected to remain almost at the last year's level. The production of oilseeds is also expected to increase from 24.3 million tonnes in 2006-07 to 27.2 million tonnes in 2007-08. Similarly, the production of cash crops, particularly cotton, is likely to remain buoyant. 1.65 There has been a loss of dynamism in the agriculture and allied sectors in recent years. A gradual degradation of natural resources through overuse and inappropriate use of chemical fertilizers has affected the soil quality resulting in stagnation in the yield levels. Public investment in agriculture has declined and this sector has not been able to attract private investment because of lower/unattractive returns. New initiatives for extending irrigation potential have had a limited success during the Tenth Five Year Plan and only a little over 8 million ha could be brought under irrigation and only three-fourths of that could be utilized. The agricultural extension system has generally not succeeded in reducing the gap between crop yields that could have been obtained through improved practices. The Government of India has launched the National Food Security Mission and the Rashtriya Krishi Vikas Yojana to rejuvenate agriculture and improve farm income. Since these programmes have only been launched in the current year, it is not possible to assess their impact. A second green revolution, particularly in the areas which are rain-fed, may be necessary to improve the income of the persons dependent on the agriculture sector.

XX. Industry and Infrastructure

The industrial sector witnessed a slowdown in the first nine months of the current financial year. The growth of 9 per cent during April-December 2007, when viewed against the back drop of the robust growth witnessed in the preceding four years, suggests that there is a certain degree of moderation in the momentum of the industrial sector. The consumer durable goods sector in particular has shown a distinct slowdown. This is linked to the hardening of interest rates and therefore to the conditions prevailing in the domestic credit sector. In contrast, the capital goods industry has sustained strong growth performance during 2007-08 (April-December).

At the product group level, the moderation in growth has been selective. Industries like chemicals, food products, leather, jute textiles, wood products and miscellaneous manufacturing products witnessed acceleration in growth, while basic metals, machinery and equipments, rubber, plastic and petroleum products and beverages and tobacco recorded lower but strong growth during April-December 2007. Other industries including textiles (except jute textiles), automotives, paper, non-metallic mineral products and metal products slowed down visibly during the period. The slowdown in the case of less import-intensive sectors like textiles is coincident with the decline in the growth of exports arising from the sharp appreciation in the rupee vis-a-vis the dollar. Within automobiles, while passenger cars, scooters and mopeds witnessed buoyant growth, the production of motor cycles and three wheelers slackened. In a nutshell, the industrial sector has produced mixed results in the current fiscal.

The picture with regard to forward-looking variables such as investment, particularly in the corporate sector, has been encouraging. Corporate profitability during the first half of 2007-08 on the whole increased in the manufacturing sector except for certain groups like textiles, food products and beverages. Higher profits backed by sound balance sheets were also reflected in an increase in the planned corporate investment. The outstanding gross bank credit to the industrial sector which had increased (from end-March) very slowly during April-August 2007 picked up in later months to touch 8.3 per cent during April-November 2007. These developments are also reflected in the robust growth of the capital goods sector. The continued buoyancy in industrial and corporate investment thus reflects the confidence in the growth prospects of the industrial sector.

Accompanying the recent moderation in industrial growth, the growth performance of some segments of the infrastructure sector during April-December 2007-08 such as power generation and movement of railway freight, as also the production of universal intermediates like steel, cement and petroleum, have shown a subdued performance. In the power sector, though the planned capacity addition is unlikely to be achieved, the growth in capacity seen in the current year is distinctly higher than in the previous years. The movement of cargo handled by major ports and air cargo (exports and imports) has showed improved performance as compared to the corresponding period last year. With increased rural penetration of mobile telephony, the telecom sector has continued its strong growth.

The recent moderation in the growth of the industrial sector has raised concerns in some quarters about the sustainability of the high growth of the sector. To deal with the situation emerging from the slowdown of some export oriented sectors of relatively low import intensity including textiles, handicrafts, leather, etc, the Government took certain measures to tide over the situation in the short run. But it needs to be emphasised that, over the medium term, there is little choice but to improve productivity, even if there are issues pertaining to the exchange rate of currencies of competing countries.

XXI. Social Sectors

As per the UNDP's Human Development Report (HDR) 2007, in spite of the absolute value of the human development index (HDI) for India improving from 0.577 in 2000 to 0.611 in 2004 and further to 0.619 in 2005, the relative ranking of India has not changed much.

In consonance with the commitment to faster social sector development under the National Common Minimum Programme (NCMP), the Central Government has launched new initiatives for social sector development during 2007-08. Substantial progress was also made on the major initiatives launched in earlier years. The new initiatives include Aam Admi Bima Yojana and Rastriya Swasthya Bima Yojana. The share of the Central Government expenditure on social services, including rural development, in total expenditure (plan and non-plan), has increased from 10.97 per cent in 2001-02 to 16.42 per cent in 2007-08. The National Rural Health Mission has successfully provided a platform for community health action at all levels. Besides merger of the Departments of Health and Family Welfare in all States, NRHM has successfully moved towards a single State and District level

Health Society for effective integration and convergence. Concerted efforts at decentralized planning through preparation of District Health Action Plans under NRHM has helped in bringing about intra health sector and inter sectoral convergence for effectiveness and efficiency. In all the States, specific health needs of the people have been articulated for local action.

Since universalization of elementary education has become an important goal, it is also essential to push this vision forward to move towards universalization of secondary education. It has, therefore, been decided to launch a centrallysponsored scheme viz., Scheme for Universalization of Access to Secondary Education (SUCCESS) and improvement of quality at secondary stage during the Eleventh Five Year Plan. The main objective of the programme is to make secondary education of good quality available, accessible and affordable to all young students in the age group 15-16 years (classes IX and X).

The 'demographic dividend' will manifest itself as a rise in the working age population aged 15 to 64 years, from 62.9 per cent in 2006 to 68.4 per cent in 2026. To tap this dividend, the Eleventh Five Year Plan focuses on ensuring better delivery of healthcare, skill development and encouragement of labour intensive industries. Global warming and climate change

Issues like global warming and the resultant climate change have gained in importance in international discussions. Globally, carbon trading, has grown rapidly in recent years. There is, however, a need to balance the harmful effects of human activity on global warming against the need for poverty reduction and economic growth in developing and least developed countries. The issue of global social justice cannot be delinked from the issue of global public goods like the atmosphere. The costs and benefits to the people living in different countries and their respective contributions must be dealt with in an integrated way.

India is a party to the United Nations Framework Convention on Climate Change (UNFCCC) and its Kyoto Protocol. The Protocol provides for three mechanisms that enable the developed countries with quantified emission limitation and reduction commitments to acquire greenhouse gas reduction credits from activities outside their own boundaries at relatively lesser costs. These are Joint Implementation, Clean Development Mechanism (CDM) and Emission Trading. Only CDM is applicable to developing countries like India. Under the Clean Development Mechanism, a developed country would take up greenhouse gas reduction project activities in a developing country where the costs of greenhouse gas reduction project activities are usually much lower.

India's CDM potential represents a significant component of the global CDM market. As on 31 January 2008, 309 out of total 918 projects registered by the CDM Executive Board are from India, which so far is the highest from any country in the world. The Indian National CDM Authority has accorded Host Country Approval to 858 projects facilitating an investment of more than Rs. 71,121 crore. These projects are in the sectors of energy efficiency, fuel switching, industrial processes, municipal solid waste and renewable energy. If all these projects get registered by the CDM Executive Board, they have the potential to generate 448 million Certified Emission Reductions (CERs) by the year 2012.

Sustained growth and resilience in the face of shocks, such as high energy and commodity prices and a slow down in world growth and import demand, have characterised the Indian economy in the recent years. Indeed, in terms of growth, the fiscal period 2003-08 has been, perhaps, the best ever five year growth performance in the history of independent India. Yet, there are a number of challenges that need to be addressed if the current growth momentum has to be sustained in the coming years.

Table IX
Key Indicators

Items	2003-04	2004-05	2005-06	2006-07	2007-08	2004-05	2005-06	2006-07	2007-08
			Absolute values				percentage change over previous period		
Gross domestic product at factor cost (Rs. '000 crore)									
At current prices	2538	2878	3276	3799	4283[A]	13.4	13.8	15.7[Q]	13.0[A]
At 1999-2000 prices	2223	2388	2613	2864[Q]	3114[A]	7.5	9.4	9.6[Q]	8.7[A]
GDP at market prices (Rs. thousand crore) (at current prices)	2755	3149	3580	4146[Q]	4694[A]	14.3	13.7	15.8	13.2[A]
Gross national product at factor cost (Rs. '000 crore)									
At current prices	2520	2855	3250	3760Q	4263[A]	13.3	13.8	15.7[Q]	13.4[A]
At 1999-2000 prices	2205	2367	2598	2845Q	3102[A]	7.3	9.6	9.7[Q]	9.0[A]
Foodgrains production (million tonnes)	213.2	198.4	208.6	217.3	219.3[a]	-7.0	5.2	4.2	0.9[i]
Index of industrial productionc	189	204.8	221.5	247.1	261.4[b]	8.4	8.2	11.6	9.0[b]
Electricity generated (in billion kwh)	558.5	587.2	617.5	662.4	525.9[b]	5.1	5.2	7.3	6.6[b]
Wholesale price indexd	180.3	189.5	197.2	210.4	217.4[e]	5.1	4.1	5.9	4.1[e]
Consumer price index for industrial workersf	504	525	551	588	620[g]	4.2	4.9	6.7	5.5[g]
Money supply (M_3)[h] (Rs. thousand crore)	2005.7	2251.4	2729.5	3310.3	3750.3[i]	12.3	17.0	21.3[j]	22.4[i]
Imports at current prices									
(in Rs. crore)	3,59,108	5,01,065	6,60,409	8,40,506	6,82,088[k]	39.5	31.8	27.3	11.5[p]
(in US $ million)	78,150	111,516	149,167	1,85,747	1,68,803[k]	42.7	33.8	24.5	25.9[p]
Exports at current prices									
(in Rs. crore)	2,93,367	3,75,340	4,56,418	5,71,779	4,48,377[k]	27.9	21.6	25.3	7.7[p]
(in US $ million)	63,843	83,535	103,092	1,26,360	1,10,965[k]	30.8	23.4	22.6	21.6[p]
Foreign currency assetsl									
(in Rs. crore)	4,66,215	5,93,121	6,47,327	8,36,597	11,12,080[m]	27.2	9.1	29.2	41.7[m]
(in US $ million)	1,07,448	1,35,571	1,45,108	1,91,924	2,81,183[m]	26.2	7.0	29.4	57.9[m]
Exchange rate (Re./US$)n	45.95	44.93	44.27	45.25	40.41[o]	2.3	1.5	-2.2	12.0[o]

Note: GDP and GNP figures are at new series base 1999-2000.

Q Quick estimates; A Advance estimates;
a 2nd advance estimates 2007-08.
b April-December, 2007
c Index of industrial production; (base 1993-94=100).
d Index (with base 1993-94 = 100) at the end of fiscal year.
e As on February 2, 2008.
f Index (with base 1982 =100) at the end of fiscal year.
g As on December, 2007.
h Outstanding at the end of financial year.
i As on January 4,2008, year-on-year growth.
j Computed over data i.e. April 1, 2005 due to 27 fortnights during 2006-07
k April-December, 2007 (provisional).
l Outstanding at the end of financial year.
m At the end of February 8, 2008.
n Percent change indicates the rate of appreciation (+)/depreciation (-) of the Rupee vis-á-vis the US Dollar.
o Average exchange rate for April-December, 2007
p April-December, 2007 on provisional over revised basis.