

ECONOMIC OUTLOOK INDIA 2004 -2006

**Prepared by
CDE-DSE Research Team**

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FORECAST HIGHLIGHTS

- **For 2003-04, GDP growth is estimated by us to be 7.6 percent as against 8.1 percent as per CSO Advance Estimates. In part, this is due to what is argued to be an overstatement of the decline in agricultural GDP due to drought conditions in 2002-03 and the consequent understatement of the base for the CSO growth estimates for 2003-04.**
- **With normal monsoons, GDP growth is forecast to be 6.6 percent in 2004-05 and 6.8 in 2005-06. Varying the assumptions about rainfall conditions in 2004-05 and 2005-06 yield GDP growth rates of between 5.6 and 6.9 percent for 2004-05 and between 5.7 and 7.7 percent for 2005-06.**
- **In the external sector, exports are forecast to grow at close to 15 percent in dollar terms in both 2004-05 and 2005-06, somewhat below the 17.7 percent growth in 2003-04. Growth in imports too is expected to slow down to around 20 percent in 2004-05 and 2005-06 compared to the 25 percent growth in 2003-04. The trade deficit is forecast to nearly double from US \$ 16.6 billion in 2003-04 to US \$ 32.2 billion in 2005-06.**
- **Deficit on merchandise trade is offset by the growth in net invisibles to yield a current account surplus. The size of the surplus, however, is forecast to decline to US \$ 3.2 billion in 2005-06 from US \$ 4.9 billion in 2003-04.**
- **Price inflation based on WPI is forecast to stay close to 5 percent in 2004-05 and 2005-06 and that based on CPI to stay well below 4 percent.**

These forecasts, developed as part of World Project LINK, are based on the CDE-DSE Macroeconometric Model for India. This model is maintained, updated and evaluated at the Centre for Development Economics, Delhi School of Economics by Professors K. Sundaram and Pami Dua of the Delhi School of Economics and Ms Vineeta (Lecturer in Economics, Kirori Mal College, DU and Research Associate in the Project), with the active support of Professor K. Krishnamurty (ASCI, Hyderabad) and Professor V. Pandit (Sri Sathya Sai Institute of Higher Learning, Prasanthinilayam).

Section 1: A Review of Developments

GDP Growth

After witnessing a sharp decline in the rates of growth of real GDP in the aggregate and in the component sectors and negative growth in agriculture, in 2002-03, the economy posted high GDP growth in the fiscal year 2003-04. This accelerated growth has been fuelled by good monsoons boosting agricultural output from a drought-hit low in 2002-03 and better capacity utilization thanks to a recovery in investment demand and a faster growth in consumer demand aided by low interest rates. On the external front, the economy witnessed a surplus on the current account with the rupee heading strong against the US dollar.

As per the Quarterly Estimates of GDP recently released by the Central Statistical Organization, the Indian economy has had a spectacular growth in almost all the sectors placing India among the fastest growing economies in the world.

Quarter three (year-on-year) growth rate for the agricultural sector stood at 16.9 percent, for manufacturing at 7.4 percent, 5.2 percent for electricity, gas and water supply, 5.1 percent for construction, 13.1 percent for trade, hotels, transport and communication, and 7.7 percent for financing, insurance, real estate and business services and a 10.4 percent growth in total GDP. It may, however, be noted that the stated high growth rates for the third quarter of 2003-04, as also for the full fiscal year (see below), have been achieved over a low base for the third quarter of 2002-03, when agricultural GDP suffered a sizeable decline due to drought conditions. The size of that decline and therefore of the rebound is further examined later in this report.

For the full fiscal year, the rate of growth of aggregate GDP based on CSO's Advance Estimates for 2003-04 over 2001-02 is placed at 8.1 percent and at 8.2 percent for the first three-quarters taken together.

GDP growth rates for the three quarters April through December and for the full fiscal year (based on CSO's Advance Estimates) for the component sectors are as below.

	April-December		Fiscal Year	
	2002-03	2003-04	2002-03*	2003-04**
GDP at factor cost	4.1	8.2	4	8.1
Agriculture, forestry and fishing	-4.8	9.4	-5.2	9.1
Mining and Quarrying	9.7	3.2	8.8	4
Manufacturing	5.9	7	6.2	7.1
Electricity, gas & water supply	4.3	4.3	3.8	5.4
Construction	8	5.7	7.3	6
Trade, hotels, transport & communication	6.8	11.5	7	10.9
Finance, Insurance, real estate, business services	9.3	7.3	8.8	6.4
Community, social & personal services	6.1	5.3	5.8	5.9

* *Quick Estimates*

** *Advance Estimates*

For the first three quarters taken together, the growth of agricultural GDP is placed at 9.4 percent, and, for the full fiscal year slightly lower at 9.1 percent, with both estimates taken on a base affected by drought conditions in 2002-03.

The industrial sector too, has shown accelerated growth on the back of a strong recovery in 2002-03 after a sharp slowdown in the fiscal year 2001-02. In line with the movements in IIP, for the fiscal year 2003-04 the CSO's Advance Estimates place the growth in manufacturing GDP at 7.1 percent with mining and quarrying growing at 4.0 percent, electricity, gas and water supply at 5.4 percent, and, construction at 6.0 percent. The growth estimates for the full fiscal year reflect a significant acceleration over the estimates for the first three-quarters in respect of electricity, gas and water supply, and a smaller rise in the case of mining and quarrying and construction.

For the services sector, the component-wise growth rates were reported at 10.9 percent for trade, hotels, transport and communication, 6.4 percent for finance, insurance, real estate and business services and 5.9 percent for community, social and personal services. These rates are somewhat lower than those for the first three quarters taken together in respect of trade, hotels, transport and communications, as well as finance, insurance, real estate and business services, and somewhat higher in the case of community, social and personal services.

Policy Stance

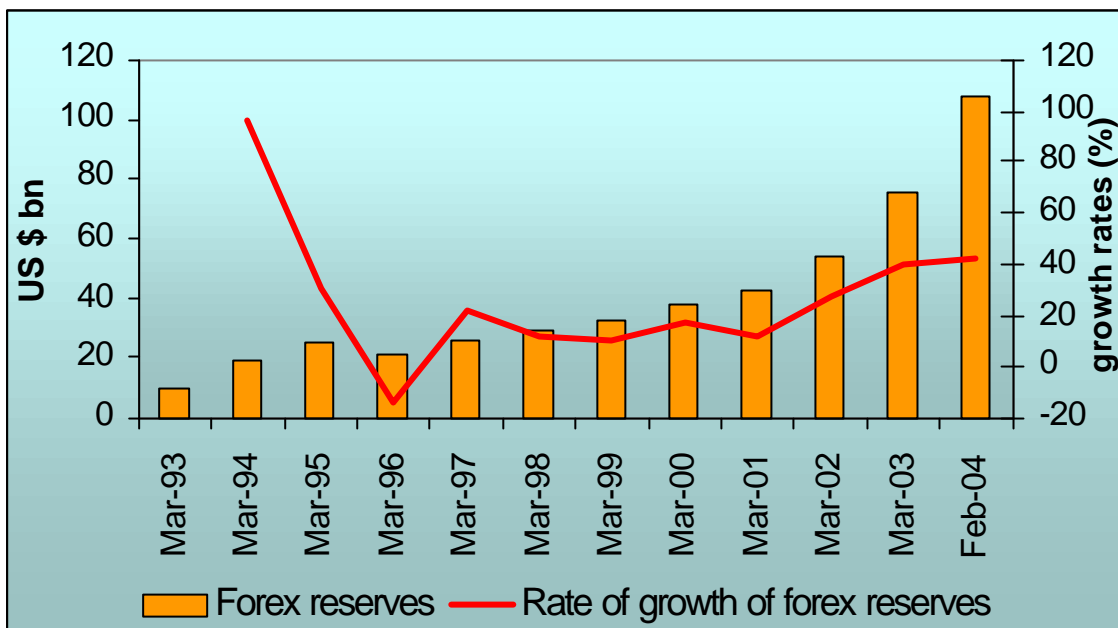
The monetary policy stance of the Reserve Bank of India continued to focus on ensuring adequate liquidity to meet credit growth and support investment demand in the economy with a policy preference for soft interest rates while continuing a vigil on movements in the price level. There is also a stated commitment to imparting greater flexibility to the interest rate structure in the medium term. Towards these goals, the RBI has utilized an array of discretionary instruments. These include changes in reserve requirements (a cut of 25 basis points in CRR to 4.5 percent of banks' net demand and time liabilities; June 14, 2003), open market operations (50 basis points cut in the repo rate to 4.5 percent; August 25, 2003) and interest rate signals in the form of changes in the bank rate to 6 percent (April 29, 2003).

The RBI has resorted to absorbing excess liquidity owing to large and persistent capital inflows, through a policy mix of outright Open Market Operations (OMO) and sales and repos under the Liquidity Adjustment Facility (LAF). Lately, the RBI has also sought to use alternative instruments like the Market Stabilization Bonds (MSBs) which act as a quasi CRR hike.

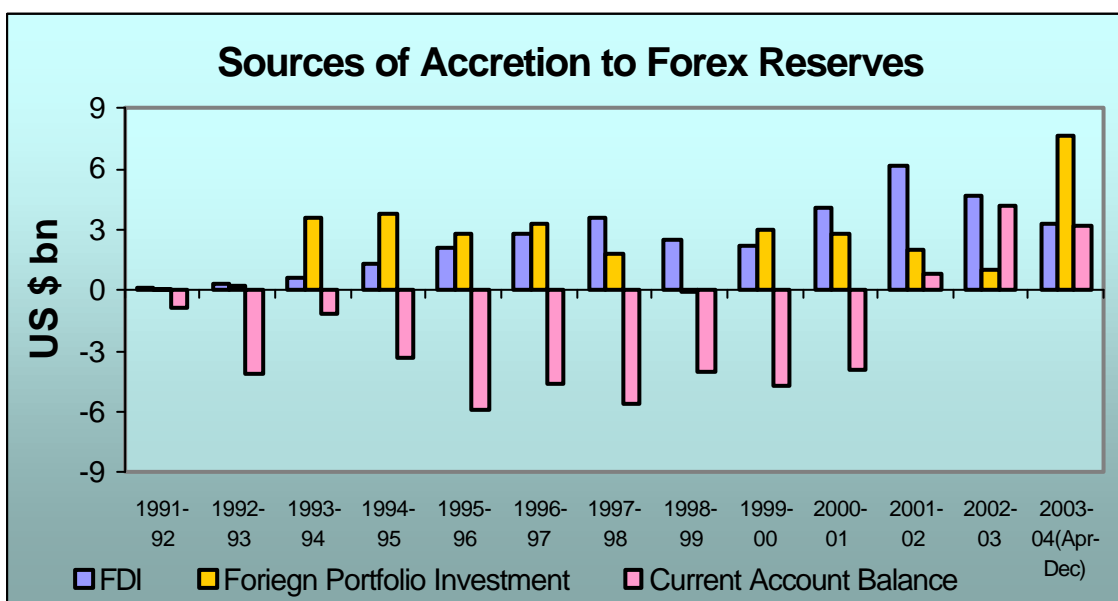
External Sector

During the year under review, there has been a significant appreciation of the Indian rupee vis-à-vis the US dollar, while there has been a measure of depreciation vis-à-vis the Euro and the Yen. The trade-weighted NEER has shown a small depreciation over the year. The year under review has also

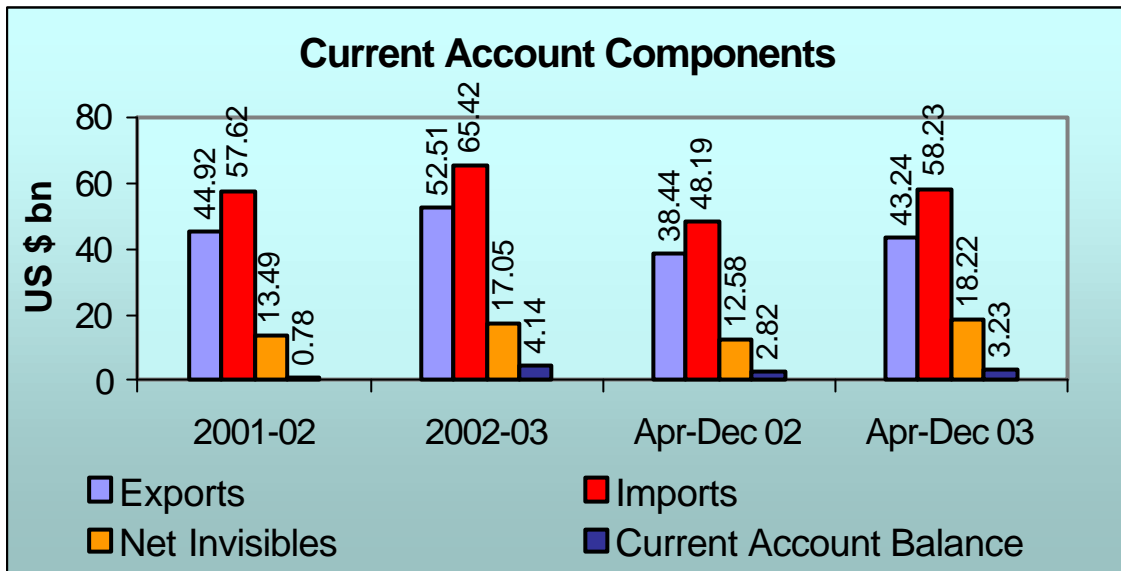
witnessed a sizeable accumulation of foreign exchange reserves, and currently (at the end of March 12, 2004) India holds US\$ 109.6 billion in reserves.



While foreign direct investment and foreign portfolio investment have grown steadily over the past decade, the Indian economy has also begun to observe surpluses on the current account from the fiscal year 2001-02 after witnessing sustained deficits throughout the decade of the nineties. Thus, the current account balance has become an incremental factor in the accumulation of foreign exchange reserves.



Balance of payments data up to December 2003 also show a robust 45 percent growth (an increase of US \$ 5.6 billion) in invisible earnings to yield a current account surplus of \$ 3.2 billion during April-Dec 2003.



Source: *Balance of Payments, RBI*

On the trade front, **DGCIS** data for the period April-March 2004 indicate robust growth of both merchandise exports at 17.3 percent in US \$ terms and merchandise imports at 25 percent over the levels for April-March 2002-03.

II. Looking Ahead: National Policy Assumptions and International Environment

Various national and international assumptions on key variables relating to national policy and the international economic environment are required for implementing the structural macro-econometric model underlying these forecasts. They relate to domestic weather conditions, domestic money supply, non-food credit, wholesale price of fuel, exports of POL etc; and further assumptions on world trade volume and unit values. These are listed below in Table 1.

Table 1
Forecast Assumptions

	2004	2005	2006
1. Weather	Above Normal	Normal	Normal
2. Share of Total Public Investment in GDP(%)	7.24	7.15	7.05
3. Share of Infrastructure in Total Public Investment (%)	56.0	58.0	60.0
4. Money Supply Growth Target(%)	14.0	14.0	14.0
5. Scheduled Comm. Bank Credit to Commercial Sectors: Growth Target(%)	18.0	20.0	20.0
6. Wholesale Price of Fuel Growth Target (%)	6.6	5.5	5.0
7. Exports of POL (in billion dollars)	2.50	2.60	2.70
8. Index of Procurement Price of Wheat and Rice (1993-94=100) Growth Target(%)	2.0	2.04	2.10
9. Gross Fiscal Deficit as % of GDPMP	12.00	10.80	10.00
10. Net Official Transfers (in bn dollars)	0.25	0.25	0.25
11. GDP Growth in Middle East(%) #	3.75	7.80	4.00
12. Exchange Rate (Rs/USD): Policy Target	45.80	44.80	45.00
13. Growth of World Trade Volume(%)	7.50	7.00	6.50
14. Change in World Trade Unit Values(%) \$			
Total	2.00	2.00	1.50
Edible			
Products	1.12	1.00	1.00
Material	5.00	-1.04	-1.00
Oil	2.34	-6.10	-5.70
Manufactures	2.00	2.00	1.00

The growth rates on GDP of the Middle East are based on UN World Economic Prospects, Jan 2004.

\$ The trade assumptions relate to the relevant calendar year and feed into the forecasts for the fiscal year beginning April.

The other national policy assumptions relate to money supply growth, the stipulated growth in commercial bank credit to commercial sectors, movements in the exchange rate, the level of gross fiscal deficit, increases in the procurement prices for rice and wheat and the size and structure of public sector investment.

Consider first the **growth in broad money - M3**. We have assumed a 14 percent growth in M3 for 2003-04, broadly in line with the realized M3 growth in the fiscal year. A similar policy stance with a M3 growth at 14 percent each is assumed for the fiscal years 2004-05 and 2005-06. It is also assumed that bank credit to commercial sectors would grow at 18 percent in 2003-04 and thereafter at 20 percent in the fiscal years 2004-05 and 2005-06.

As regards IPPWR (**Index of Procurement Price of Wheat and Rice**), it is assumed that this will grow at about 2 percent per annum, with no special “incentives” for drought coming into the picture because of a good agricultural performance.

As regards the **Gross Fiscal Deficit**, the budgets for fiscal year 2003-04 placed the combined GFD of the Centre and States at 12.0 percent of the GDP. In line with the expressed intention to reduce the GFD/GDP ratio, our forecasts for 2004-05 and 2005-06 are built on the assumption that the nominal gross fiscal deficit would be 10.8 percent of GDP in 2004-05 and reach the 10.0 percent level in 2005-06.

As regards **public investment**, the Quick Estimates for 2002-03 reveal a modest growth of public investment of 7.2 percent in **nominal terms** over the levels realized in the previous fiscal year. Our broad judgement is that, at least for the forecast period, resource constraints will limit the growth in public investment to about 7 percent per annum in nominal terms. However, **in terms of composition**, we expect an increase in the share of infrastructure sector activities by 2 percentage points each year.

The **exchange rate** of the Indian Rupee vis-à-vis the US dollar has shown a trend towards appreciation with respect to the dollar during the fiscal year 2003-04. From the average level of Rs.48.39 for 2002-03, on the basis of currently available trade data (up to February 2004) the average value of the rupee-dollar rate for the fiscal year 2003-04 is placed at 45.8. Given the rupee-dollar rate underlying exports in February 2004 (45.3), a small appreciation to 44.80 for 2004-05 appears plausible. On a judgement that strong GDP growth with emerging inflationary pressures in the US economy raises the possibility of a rise in the US interest rates, we expect the current trend towards

appreciation of the rupee vis-à-vis the US dollar to be arrested and possibly reversed, and have assumed a rupee-dollar rate of 45.00 for the fiscal year 2005-06.

The assumptions about GDP growth in the Middle East (rather, West Asian Oil Exporting Countries) and the year-on-year growth in **world trade volume and world trade unit values** are the latest set of LINK assumptions and pertain to the calendar year 2004, 2005 and 2006. For World Trade Unit Values in respect of Oil, we have assumed that during the calendar year 2004 the oil prices would be, on the average about 2.3 percent higher and that, from that level they would decline by roughly 6.1 percent in 2005 and by 5.7 percent in 2006 to reach levels roughly at par with the average for the calendar year 2003-04.

III. Forecasts

We turn now to our estimates/forecasts for the year ending 31st March 2004 (fiscal 2003-04) and the two years ahead (2004-05 and 2005-06).

Current trends and forecasts of major macroeconomic variables for the period 2002-03 through 2005-06 are reported in Table 2. For greater clarity, the presentation takes two forms. For all the variables we report both forecast values as well as the latest official available values in levels for 2002-03. For the remaining three years 2003-04, 2004-05 and 2005-06 only rates of increase on model forecast values are given. Current account balance is however reported for all years in current billion US dollars. Clearly, all results have to be seen along with major assumptions as reported in Table 1. With this introduction let us turn to the actual forecasts.

Table 2
Forecasts for Major Economic Indicators

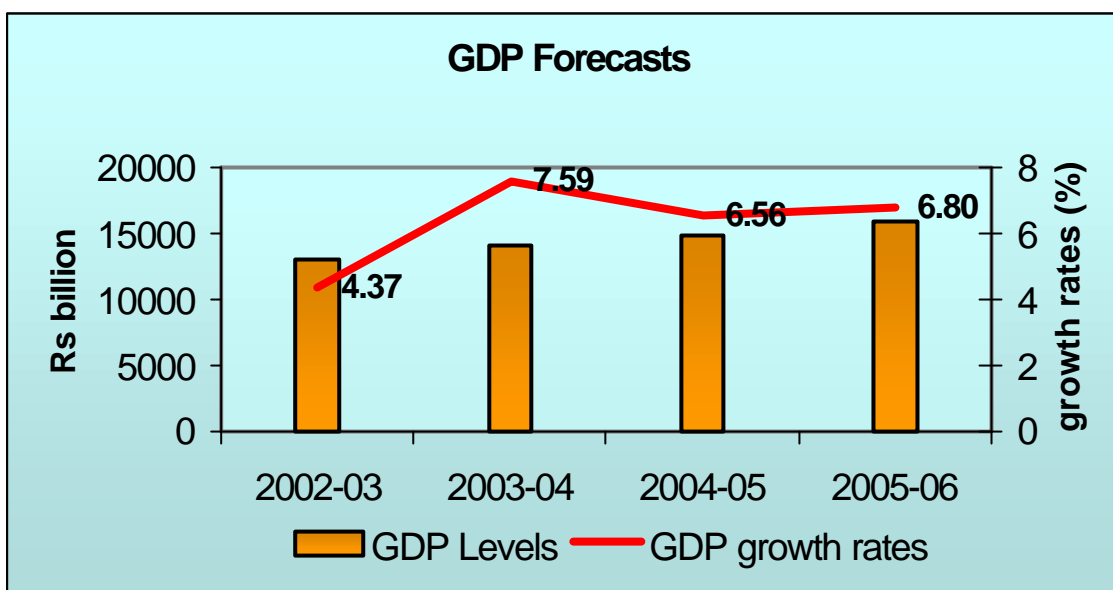
Variable	Level	Forecast level	Y-O-Y Increase (%)		
	2002-03	2002-03	2003-04	2004-2005	2005-06
Real GDP: Rs Billion (at 1993-94 prices)	13183.21	13045.48	7.59	6.56	6.80
Value Added in Industry: Rs Billion (at 1993-94 Prices)	4783.77	4687.88	6.55	7.44	7.70
Real Private Consumption: Rs. Billion (at 1993-94 Prices)	8972.43	8931.64	5.37	5.31	5.52
Real Government Consumption Expenditure: Rs. Billions (at 1993-94 Prices)	N.A	1825.73	6.36	7.01	6.98
Real Private Corporate Investment: Rs. Billion (at 1993-94 Prices)	840.92	822.80	5.06	11.74	11.87
Wholesale Price Index: (at 1993-94 prices)	166.8	166.22	5.54	5.07	5.11
Wholesale Price Nonfuel (at 1993-94 prices)	154.96	154.04	5.23	4.96	5.14
Consumer Price Index (at 1993-94=100)	186.8	186.66	3.77	3.30	3.05
Exports: DGCI & S (Billion US Dollars)	52.72	52.46	17.73	14.73	14.80
Imports: DGCI & S (Billion US Dollars)	61.41	62.70	25.01	19.93	20.73
C/A Balance: RBI*	4.14	4.21	4.88	4.16	3.24

* Levels in billion US Dollars

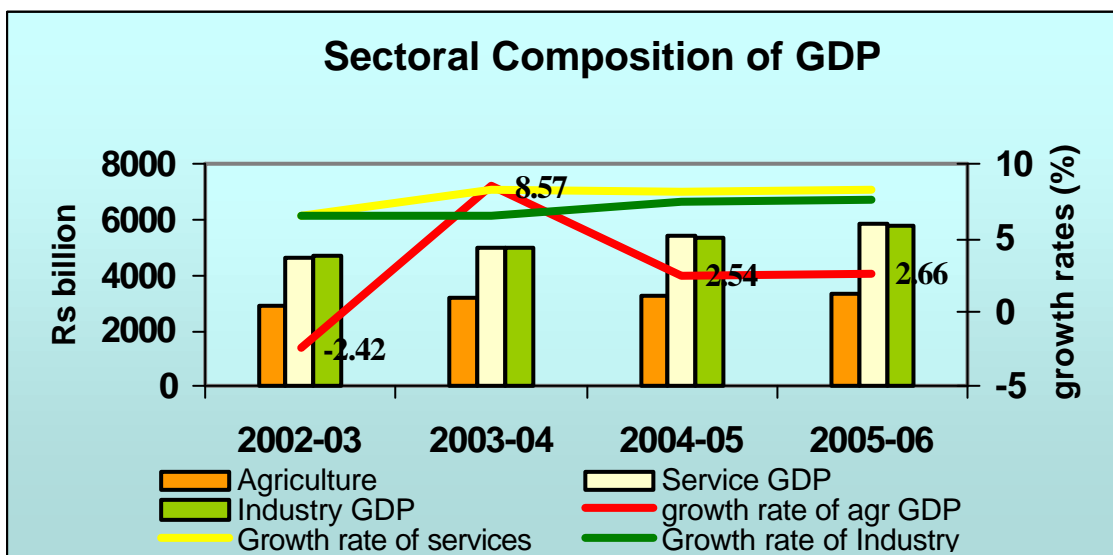
- Terms in bracket represent Y-on-Y increase with our forecasts for 2002-03 as the base

GDP and its Components

The forecast for the overall GDP indicates that the growth rates for 2003-04 would be 7.6 percent, 6.6 percent for 2004-05 and 6.80 percent for 2005-06.



The industry break up of the aggregate GDP shows that agricultural sector which, we estimate would grow at 8.6 percent during 2003-04, is forecast to grow at 2.5 percent in 2004-05 and 2.66 percent in 2005-06 on the assumption that normal weather conditions would prevail in both years.



Note that our growth rate for 2003-04 at 7.6 percent is lower than the 8.1 percent growth shown in the Advance Estimates released by the CSO and the 8.2 percent growth in the first three quarters of 2003-04 as per the quarterly estimates released by CSO.

In assessing the CSO estimates of growth rates for 2003-04, the level estimates for 2002-03 which provide the base for these growth estimates need a careful review. Specifically as per the quick estimates of the CSO, **agricultural GDP has recorded a 5.2 percent decline** over the preceding year, with overall GDP growth being knocked down to 4 percent from 4.4 percent earlier.

Table 3

Real GDP Growth

		Rs. Billion At 1993-94 Prices	Y-O-Y Increase (%)		
			2002-03	2003-04	2004-05
Total GDP	A	13045.48	7.59	6.56	6.80
	B	13183.21			
Agriculture	A	2919.44	8.57	2.54	2.66
	B	2893.86			
Manufacturing	A	2255.04	7.03	7.68	7.79
	B	2270.35			
Infrastructure	A	2432.84	6.10	7.22	7.61
	B	2513.42			
Industry	A	4687.88	6.55	7.44	7.70
	B	4783.77			
Services	A	4650.86	8.27	8.20	8.33
	B	4724.58			

A- Current Forecast

B- Latest Available Official Estimate.

Infrastructure- includes Mining and Quarrying, Construction, Electricity, Gas & Water and Transport etc.

Industry=Infrastructure+Manufacturing

Services=Other Services+Trade, hotels, transport

The y-o-y growth rates have as base on our forecasts for 2002-03.

In our reckoning the downturn in agriculture for 2002-03 will be under 2.5 percent. Since this is the key factor underlying the difference between our forecasts for aggregate GDP growth for 2003-04 and the Advance Estimates of CSO, a few further comments are in order.

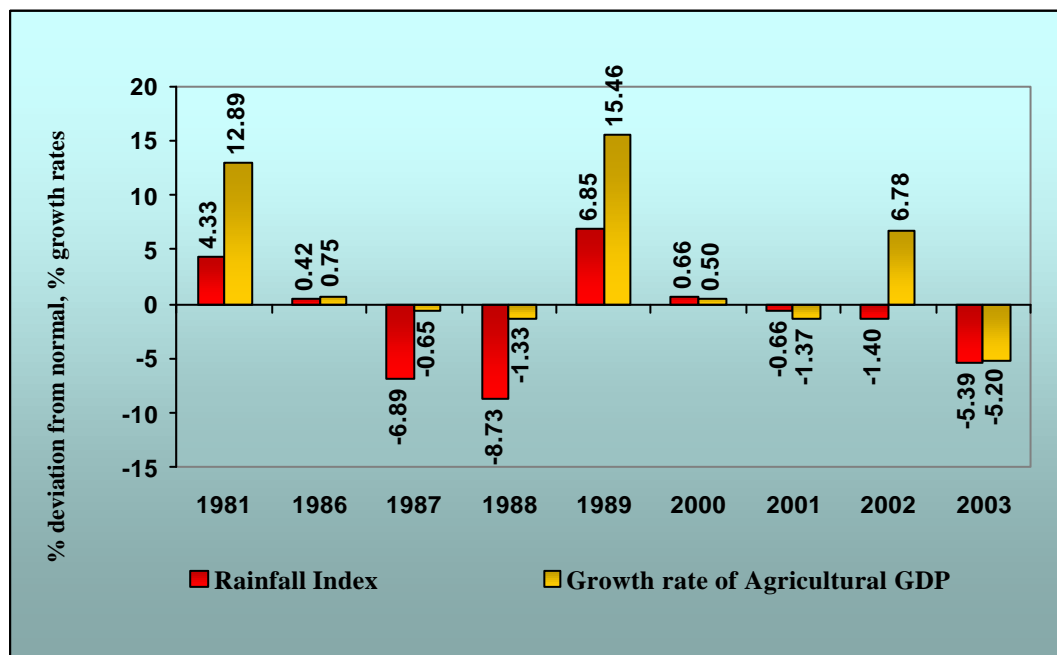
First, it is worth recalling that the drought conditions in 1987-88 (with which the fiscal year 2002-03 is being compared), resulted in a decline in agricultural GDP by 1.3 percent over the preceding year's level. In fact, over the period 1980-81 through 2001-02, in years characterized by adverse weather, the decline in agricultural GDP (over the preceding year) has ranged from 0.42 percent in 1999-2000 to 1.86 percent in 1997-98, so that a 5.2 percent decline indicated in the Revised Estimates for 2002-03 appears to be way out of line.

Second, 1987-88 was the **second successive year of drought** following a significantly below-normal monsoon in 1986-87 as well. So that, *prima facie*, the impact of deficient rainfall in 1987-88 may be expected to be sharper. Yet, even when we take 1985-86 – a weather-wise “normal” year – as the base, the agricultural GDP in 1987-88 was lower than that in 1985-86 by a little under 2 percent.

Thirdly, since the mid 1980s considerable gains have been made in providing irrigation cover for agricultural crops, both foodgrains and non-foodgrain crops.

The proportion of cropped area under foodgrains as a group that is irrigated has increased from 33.5 percent in 1987-88 to 42.4 percent in 1998-99. By 2002-03 this proportion would have risen further. For oil seeds also the proportion irrigated has gone up from 20.6 percent to 23.2 percent and for cotton from 32.0 percent to 34.9 percent between 1987-88 and 1998-99. The greater extent of irrigation cover should also dampen the adverse effect of short fall in rainfall on agricultural output and value added. To reflect this, we constructed a rainfall-deficiency index that factors-in the growth in irrigation cover, and this rainfall deficiency index is used as a key variable to forecast the output of kharif foodgrains, rabi foodgrains and non-food crops.

A mapping of the rainfall deficiency index for a year with the percentage change in agricultural GDP (over the previous year) brings out an interesting picture. **If the CSO estimates for agricultural GDP in 2002-03 are accepted, then, it would imply that, relative to 1987-88, a much smaller deficiency in rainfall (an index value –5.4 relative to –8.7 in 1987-88) has caused a much greater reduction in agricultural GDP (-5.2 percent in 2002-03 as against –1.3 percent in 1987-88 relative to 1986-87 and –1.96 percent relative to 1985-86.)**



It is our assessment that the quick estimates for 2002-03 are overestimating the decline in agricultural GDP, and thereby moderating the growth in overall GDP in

2002-03. By doing so, the Advance Estimates for 2003-04 also overestimate the likely GDP growth in 2003-04. As per our model estimates, the decline in agricultural GDP in 2002-03 would be of the order of 2.4 percent. Consequently, the overall GDP growth in 2002-03 (over 2001-02) is placed by us at 4.4. **On the higher base, our forecasts that have factored-in the rainfall conditions in 2003-04 indicate a growth of 8.6 percent in agricultural GDP with the overall GDP growth placed at 7.6 percent for the fiscal year 2003-04.**

Our forecasts for 2004-05 and 2005-06 are based on the assumption of normal monsoon conditions prevailing in both years. They indicate that overall GDP growth would be 6.6 and 6.80 percent respectively. How will these forecasts change if the assumptions about monsoon rains are altered?

To examine the sensitivity of our forecasts for the growth of agricultural GDP and of total GDP to variations in rainfall conditions, we ran a set of simulations by altering the assumptions about the weather conditions in fiscal years 2004-05 and 2005-06. As noted earlier, our baseline estimates of GDP growth for 2004-05 (6.55 percent) and for 2005-06 (6.8 percent) are premised on the assumption of monsoons being normal in both 2004-05 and 2005-06.

In the first simulation, we assume that 2004-05 would be as good as 2003-04 in terms of rainfall, with rainfall conditions in 2005-06 assumed to be normal as in the baserun. The second simulation alters the assumption for 2004-05 for rainfall, which is assumed to be as bad as it was in 2002-03, with 2005-06 again assumed to be a normal year as before. In the final set of simulations, rainfall conditions for 2005-06 are assumed to be above normal and at par with conditions in 2003-04. The results are tabulated below.

Years	Rate of Growth of	Assumption/Growth Rates		
2003-04		Actuals	Actuals	Actuals
	Agriculture	8.57	8.57	8.57
	GDP	7.59	7.59	7.59
2004-05		Good	Normal	Bad
	Agriculture	3.83	2.54	-1.20
	GDP	6.89	6.56	5.59
2005-06*		Normal	Normal	Normal
	Agriculture	1.68	2.66	5.65
	GDP	6.58	6.80	7.42
2005-06**		Good	Good	Good
	Agriculture	2.92	3.91	6.95
	GDP	6.90	7.11	7.74
2005-06***		Bad	Bad	Bad
	Agriculture	-1.93	-0.99	1.86
	GDP	5.67	5.88	6.50

* 2005-06 assumed to be normal with different assumptions on 2004-05.

** 2005-06 assumed to be good with different assumptions on 2004-05.

*** 2005-06 assumed to be bad with different assumptions on 2004-05.

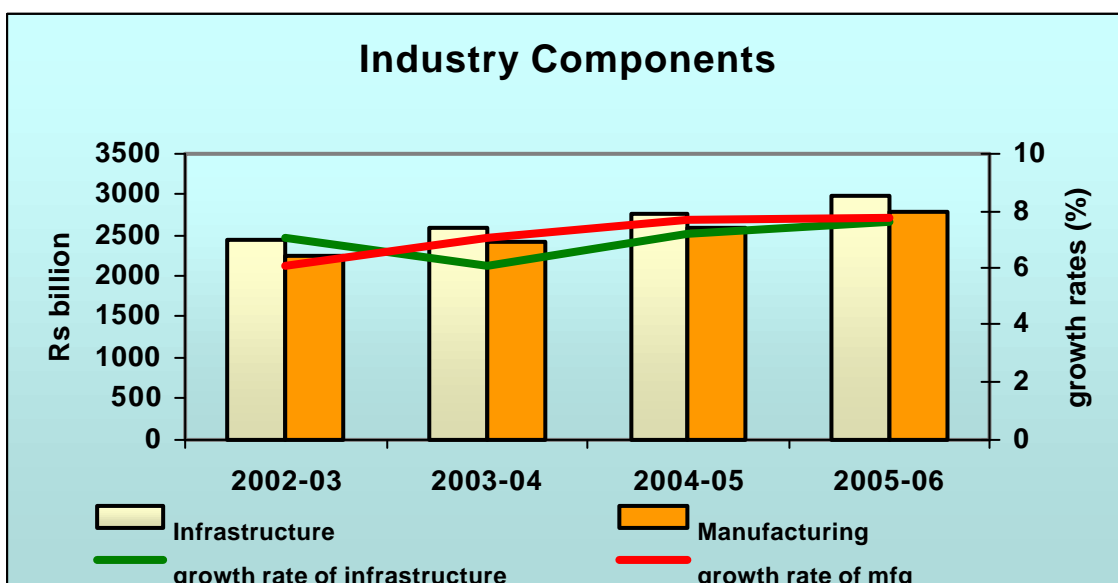
The simulations define a range within which the rates of growth of agricultural GDP and aggregate GDP would lie when the weather conditions are altered. Replication of the 2002-03 weather conditions in 2004-05 results in a decline of only 1.2 percent over the 2003-04 levels. This is in line with our assessment that the decline in agricultural GDP in 2002-03 (over 2001-02) is likely to have been significantly smaller than indicated by CSO's Quick Estimates for 2002-03.

It is equally noteworthy that, even on the assumption of monsoon conditions in 2004-05 remaining as favourable as in 2003-04, the rate of growth of agricultural GDP in 2004-05, is only raised to 3.8 percent from 2.5 percent on the assumption of normal monsoons in 2004-05. **The overall GDP growth, even with the assumption of rains in 2004-05 being as good as in 2003-04, at 6.9 percent is well below 7 percent.**

A return to normal rainfall conditions in 2005-06, from a good monsoon in 2004-05 (because of the base effect) **lowers** the agricultural and total GDP growth rates to 1.7 and 6.6 percent respectively. On a base affected by bad monsoons in 2004-05, the agricultural GDP & total GDP growth rates rebound to 5.7 and 7.4 percent respectively. If, on the lower base set by the adverse monsoon conditions in 2004-05, the rainfall conditions in 2005-06 are good and at par with 2003-04, the growth rate of agricultural GDP and aggregate GDP in 2005-06 would be, respectively, 6.95 percent and 7.7 percent.

Thus, the above exercise defines the range within which the growth rate of aggregate GDP is likely to stay. **So that in all the three years 2003-04 through 2005-06 the overall GDP growth, ranging between 7.6 percent (in 2003-04) & 6.6 percent in 2005-06 on the assumption of above normal rainfall in 2004-05 & normal rainfall in 2005-06 would be below the 8 percent target. This remains true even when we assume that monsoon conditions in 2005-06 are as favorable as they were in 2003-04.**

The forecast for Industry as a whole (i.e. Manufacturing plus the Infrastructure sector), for 2003-04 stands at 6.6 percent. These estimates are in line with the growth in IIP for the April – February 2003-04 period. This is forecast to grow at 7.5 percent in 2004-05 and at 7.7 percent in



2005-06. The forecast growth rates of the two components are presented in the graph.

In discussing the growth performance of the **Services sector**, we need to consider separately the GDP originating in public administration and defence and the GDP-contribution of other services - trade, hotels and restaurants, transport and communication; finance, insurance, real estate and business services; and, a residual category of community and personal services.

Our forecasts for the services sector (other than public administration and defence) for 2003-04 stand at 8.3 percent growth over 2002-03, and at 8.2 percent for 2004-05 and 8.33 percent for 2005-06.

Of the 8.3 percent growth in total services in 2003-04 over 2002-03, the growth of the component trade, hotels and restaurants and transport and communications is placed by us at 8.3 percent and other services at 8.1 percent. The CSO Advance Estimates for 2003-04 for the sector Trade, Hotels, Transport and Communication, however, indicate the rate of growth to be 10.9 percent over 2002-03, which appears less than convincing when we examine it by components.

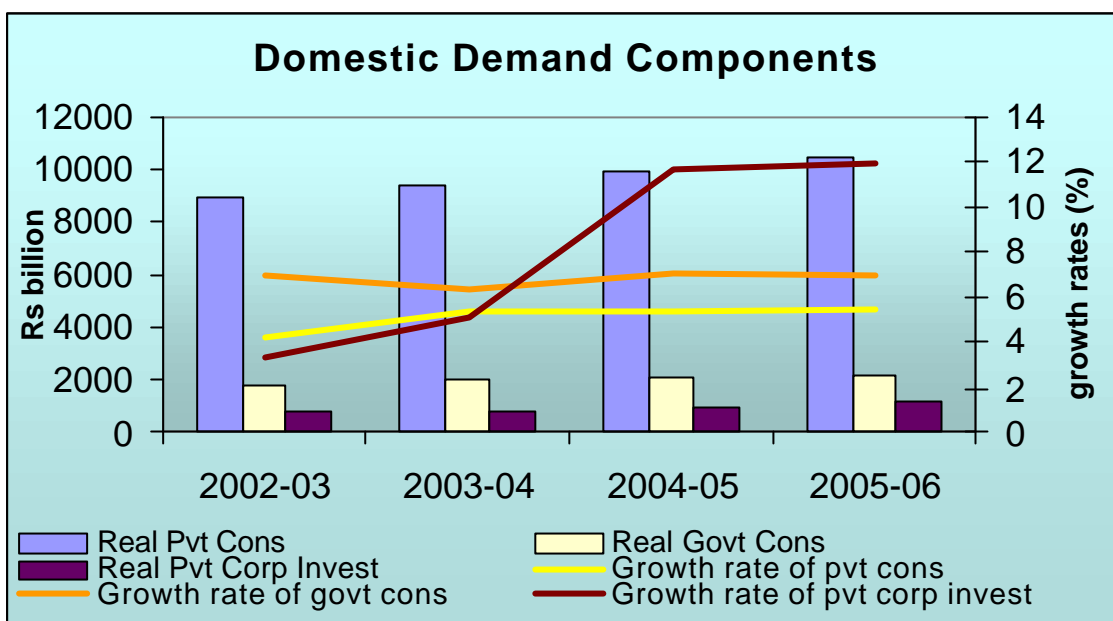
One, trade based service activities must be broadly in line with the commodity producing sectors, namely, agriculture, manufacturing and infrastructure. Taking these sectors collectively, the combined rate of growth for 2003-04 over 2002-03 works out to be approximately 8 percent.

Two, the transport subsector in part consists of railway traffic (showing 5.5 percent growth in net tonne kilometers and 3.7 percent in passenger kilometers) and cargo handled at major ports (showing 7.5 percent growth). As regards road transport & telecommunications, simple extrapolations from growth in number of Commercial vehicles & in telephone connections to GDP-originating in the two sectors that would appear to underlie CSO's Advance Estimates, would be quite inappropriate.

The second component in the services sector, public administration and defence, shows a growth rate of 6.1 percent in 2003-04 over 2002-03; of 6.6 percent in 2004-05 and 7.1 percent in 2005-06.

Going back to Table 2 let us have a look at the movements in **components of aggregate demand**, focusing on domestic demand. The important point to observe here is that growth of real private corporate sector investment, after slowing down to nearly 3 percent in 2002-03, is expected to grow at 5.1 percent 2003-04, 11.74 percent in 2004-05 and 11.9 percent in 2005-06. The combination of consumption led demand and lower interest rate regimes has led to opportunities for fresh capacity creation. This should once again raise the possibility of faster growth in the coming years.

On the other hand growth of real government final consumption expenditure (GFCE) had accelerated significantly from 2.4 percent in 2001-02 to nearly 6 percent in 2002-03. In 2003-04 they maintain a small acceleration to 6.4 percent and further to 7.0 percent in 2004-05 and 6.98 percent in 2005-06. As for private final consumption expenditure (PFCE), the forecast rate of growth for 2003-04 is 5.4 percent, in line with a sharp rise in the aggregate GDP. In 2004-05 and 2005-06 it will be range bound between 5.3 to 5.5 percent.



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Turning now to **price trends** (Table 4), we first note that the our experience over the past seven-eight years shows that a 4 to 5 percent annual increase in the wholesale price index of all commodities with seasonal variations has come to stay.

Table 4
WPI Based Inflation Rates: Percent Increase in Annual Averages

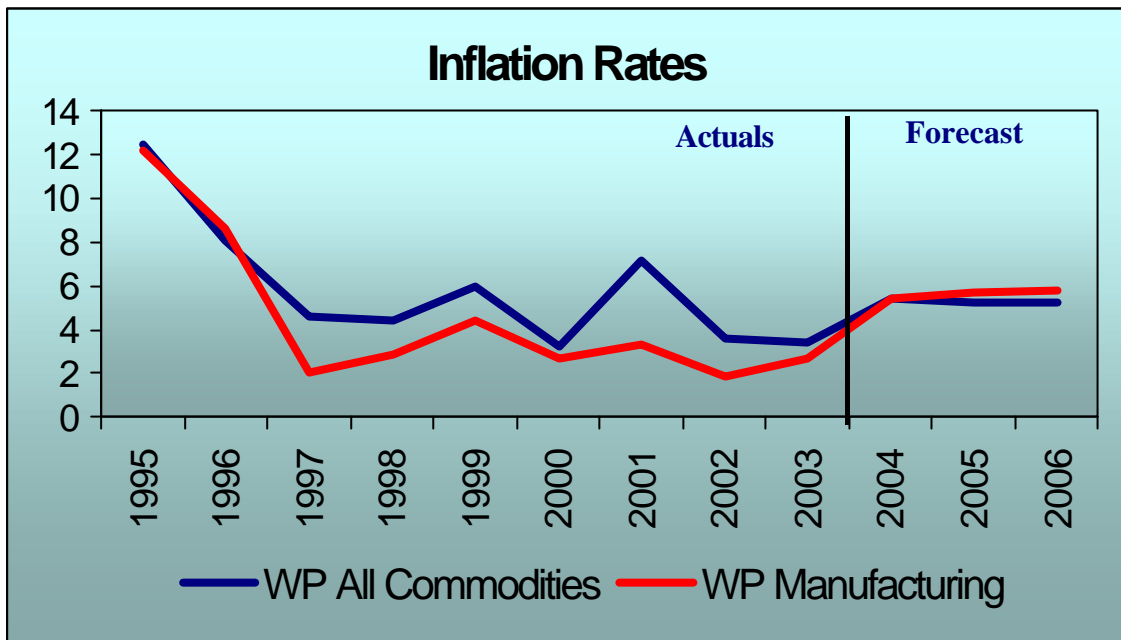
		2002-03	2003-04	2004-05	2005-06
Agricultural Commodities	A	177.00	4.82	3.84	3.87
	B	175.27			
Manufacturing	A	146.28	5.45	5.42	5.65
	B	148.10			
All Commodities	A	166.22	5.54	5.07	5.11
	B	166.80			
Implicit GDP Deflator	A	173.46	4.53	4.48	4.52
	B	170.63			
Consumer's Price Index	A	186.66	3.77	3.29	3.05
	B	186.80			

A-Current Forecast

B-Latest Available Official Estimate

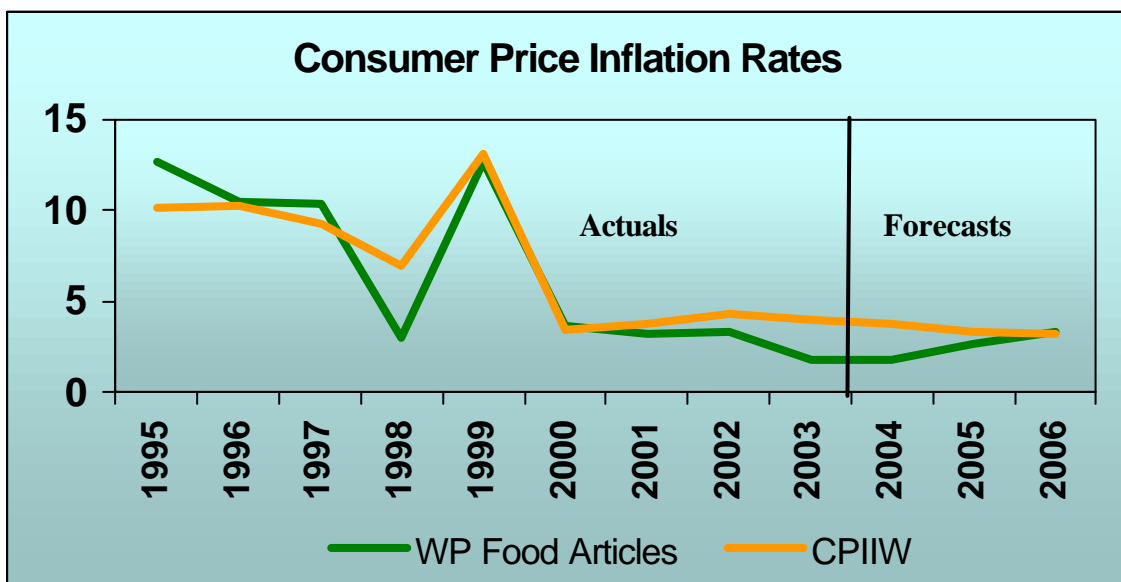
The y-o-y growth rates have as base our forecasts for 2002-03.

The annual rate of WPI inflation (year-on-year) for the fiscal 2003-04 (based on 52-week average ending March 27, 2004) turned out to be 5.4 percent. Our forecast estimates are slightly higher at 5.5 percent, and both are substantially higher than the 3.4 percent inflation in 2002-03. This reflects the interplay of demand effects from faster GDP growth in 2003-04 and the lagged supply side effects carried over from 2002-03.



Among components, the forecast for WPI based inflation for the agricultural sector (4.8 percent) with the growth rate of WPI food articles (52 weeks average ending March 27, 2004) at a low of 1.3 percent, while the WPI for non-food articles shows a sharp double digit rise of 12.4 percent.

The CPI inflation is expected to be 3.8 percent for 2003-04 over 2002-03, and then stay in a narrow margin of 3.3 to 3.1 percent in the next two years. With a substantial weight in CPIIW, movements in the price index for food articles tend to shape the movements in consumer price inflation.



This factor also carries with it a downside risk. Successful containment of food-price inflation in the past several years has been made possible by the presence of large stocks of foodgrains with the government. These have now been reduced substantially. A couple of bad harvests can severely test the ability of the government to manage food-price inflation by supply-side management. The presence of large foreign exchange reserves, however, does provide some risk cover.

One segment of the economy where the overall performance continues to be satisfactory is the **external sector**. The near stagnation of export earnings in 2001-02 has been followed by an estimated 19 percent growth in the last fiscal (2002-03). Our forecasts, in line with the latest available data, indicate that export growth in 2003-04 while not being as high as in 2002-03, would be strong at 17.7 percent, with a large part attributable to exports of manufactured goods (SITC 5-9). This has been realized against the background of Indian rupee appreciating against the US dollar though a measure of relief has been available in the shape of depreciation against the Euro and the Yen. Despite the likelihood of the rupee appreciating further against the US dollar, export growth is expected to be fairly robust at 14.7 percent in 2004-05 and at 14.8 percent in 2005-06.

Table 5
Merchandise Trade Flows: DGCI & S
(Billion US Dollars)

		2002-03	2003-04	2004-05	2005-06
Total Exports	A	52.46	61.76(17.73)	70.86(14.73)	81.35(14.80)
	B	52.72			
Export of Manufactures	A	38.11	44.58(16.99)	51.13(14.69)	58.62(14.66)
	B	38.40			
Total Imports	A	62.70	78.38 (25.01)	94.01 (19.93)	113.50(20.73)
	B	61.41			
Import of POL Products	A	17.59	20.37 (15.81)	23.50(15.37)	27.08(15.25)
	B	17.65			
Trade Balance	A	-10.24	-16.62	-23.15	-32.15
	B	-9.05			

A-Current Forecast

B-Latest Available Official Estimate

Terms in bracket represent Y-on-Y increase with our forecasts for 2002-03 as the base

Commensurate with the high rate of growth in aggregate GDP imports in 2003-04 are forecast to grow at 25 percent. Among the components, non-oil imports record a faster growth than oil imports. Trade deficit is forecast to widen from 16.6 billion US dollars in 2003-04 to nearly 32.2 billion US dollars by the end of 2005-06.

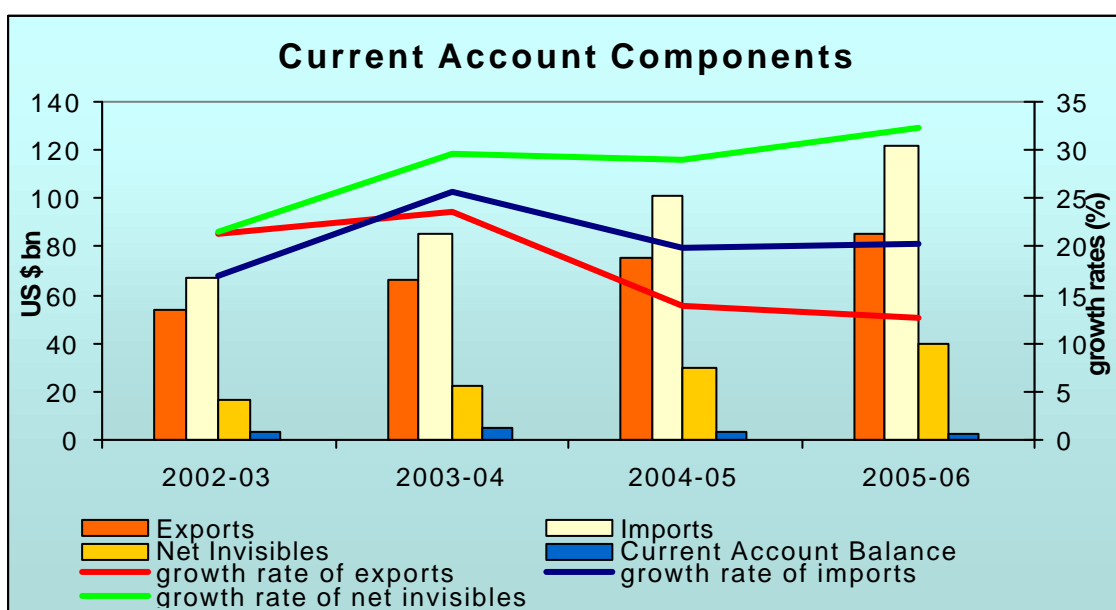
Table 6
Balance of Payments: RBI
(Billion US Dollars)

		2002-03	2003-04	2004-05	2005-06
Export Earnings	A	53.90	66.59 (23.54)	75.87 (13.94)	85.57 (12.78)
	B	52.51			
Import Bill	A	67.57	84.82(25.54)	101.51(19.67)	122.08(20.26)
	B	65.42			
Net Invisibles	A	17.87	23.11	29.80	39.64
	B	17.04			
Current A/C Balance	A	4.21	4.88	4.16	3.24
	B	4.14			
Exchange Rate(Rs./USD)		48.39	45.80	44.80	45.00

A-Current Forecast

B-Latest Available Official Estimate

Terms in bracket represent Y-on-Y increase with our forecasts for 2002-03 as the base



The current account is forecast to remain in a comfortable surplus situation throughout the forecast period, from 2003-04 to 2005-06. However, the size of the surplus is forecast to decline. Even with an enormous rise in the import growth rates, the growth in net invisibles has been sufficient to yield a net surplus on the current account of US \$ 4.9 billion in 2003-04. Broadly, the same holds for 2004-05 and 2005-06, but with a reduction in the size of the surplus to US \$ 4.2 billion in 2004-05 and further to US \$ 3.2 billion in 2005-06.

Conclusion

Our Forecasts of GDP growth for 2003-04 at 7.6 percent is below the current CSO estimates of over 8 percent because of the differences in our assessment about the extent of decline in agricultural GDP in 2002-03 and because the CSO's estimates of growth in GDP in the Trade, Hotels, Transport & Telecommunications appear to be on the high side.

For 2004-05, on the Forecast levels for 2003-04, depending on the assumptions about monsoons, the GDP growth will lie in a band between 5.6 percent if the rainfall deficiency was as bad as 2002-03 to 6.9 percent if 2004-05 has as good a monsoon as in 2003-04. If rainfall is normal,, then it would be 6.6 percent. Assuming normal monsoons for 2005-06, depending on the outcome for 2004-05, GDP growth in 2005-06 will lie in a range between 7.4 and 6.6 percent. Even with monsoon conditions in 2005-06 remaining as favorable as in 2003-04, GDP growth in 2005-06 too is forecast to grow at 7.7 percent only.

In all cases, for all the three years, the growth in GDP is forecast to be below 8 percent.

WPI based inflation rates, however, will be contained at 5 percent both in 2004-05 and in 2005-06, while consumer price inflation is forecast to be well below 4 percent in both years. Moderate price inflation with per capita income growth close to or above 5 percent per annum can be expected to make a measurable impact on poverty in India.