MACRO-ECONOMIC FRAMEWORK STATEMENT

Sustained growth and resilience in the year of a global slowdown characterized the developments of the Indian economy in 2007-08. The economy has also been largely successful in containing domestic inflationary pressures despite global hardening of commodity prices and an upsurge in capital inflows, which had made liquidity management difficult. The overall macroeconomic fundamentals continue to inspire confidence and optimism. Buoyant growth of government revenues made it possible to strengthen fiscal consolidation as mandated under the Fiscal Responsibility and Budget Management Act (FRBMA). There was acceleration in domestic savings and investment rates to provide the resources for meeting the 9 per cent (average) growth target for the Eleventh Five-Year Plan.

ECONOMIC GROWTH

2. As per Central Statistical Organisation projections, GDP at factor cost at constant 1999-2000 prices is to grow at 8.7 per cent in 2007-08. This represents a moderate deceleration from high growth of 9.4 per cent in 2005-06 (provisional) and 9.6 per cent in 2006-07 (quick estimates). The deceleration in growth in 2007-08, though moderate, is 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 agricultural sector is attributed to a slackening in the growth of Rabi crops. Growth of Manufacturing and Construction, which was at 12 per cent in 2006-07, also 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. 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, which formed the basis for full year assessment of 2007-08.

3. 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. There was also an upward revision in growth for 2005-06 to 9.4 per cent (provisional) compared to a growth of 8.1 per cent as per the advance estimates released in February 2006. This suggests that upward adjustments in the 2007-08 projections are possible.

4. The observed growth of 7.8 per cent in the Tenth Five Year Plan (2002-2007), is the highest so far for any plan period and is only marginally short of the target of 8 per cent. A notable feature of growth during the Tenth Plan was the resurgence of manufacturing. There was a sharp acceleration in the growth of manufacturing from 3.3 per cent during the Ninth Plan to 8.6 per cent during the Tenth Plan. The growth in the services sector continued to be broad based.

5. From the demand side, investment emerged as the most important driver of growth. The growth of GDP at market prices accelerated from 3.8 per cent in 2002-03 to 9.7 per cent in 2006-07 and is projected to grow at 8.7 per cent in 2007-08. GDP at current market prices is projected at Rs 46,93,602 crore in 2007-08. Thus in the current fiscal year the size of the Indian economy at market exchange rate will cross US$ one trillion. At the nominal exchange rate (average of April-December 2007), the GDP is projected to reach US$ 1.16 trillion in 2007-08.

6. Economic growth, and in particular the growth in per capita income, is a broad quantitative indicator of the national well being of the people. There has been a sharp acceleration in the growth of per capita income which averaged 7.2 per cent per annum during 2003-04 to 2007-08, indicating that average per capita income would now double in a decade, well within one generation. Per capita private final consumption expenditure (PcPfce) also increased in line with per capita income. PcPfce growth averaged 5.1 per cent per year during 2003-04 to 2007-08 and is expected to be 5.3 per cent in 2007-08. The average growth of consumption is slower than the average growth of income primarily because of rising savings rates.

SAVINGS AND INVESTMENT

7. A notable feature of the recent GDP growth has been a sharply rising trend in gross domestic investment and savings. 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, resurgence in the manufacturing sector and 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 adjustments. This improved perceptions about 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 the foreign direct investment. As a result, the investment rate increased from 25.2 per cent of GDP in 2002-03 to 35.9 per cent of GDP in 2006-07. The higher investment was able to absorb the domestic savings and generate 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 Plan. The savings-investment gap which remained positive during 2001-2004 became negative thereafter. This reversal of the saving-investment balance should be viewed as a correction of the domestic supply-demand balance, occurring through higher than normal increase in demand during 2005-06 and 2006-07.

INCLUSIVE GROWTH

8. Faster economic growth has also begun to translate into more inclusive growth, both in terms of employment generation and poverty reduction. The 61st Round of NSSO Survey estimated that 47 million additional work opportunities were created during 1999-2000 to 2004-05, at an annual average of 9.4 million as against an annual average of 4 million job opportunities during 1993-94 to 1999-2000. Employment growth accelerated to 2.6 per cent per annum during this period. The labour force, however, grew at 2.8 per cent per year, 0.2-percentage points faster than the work force, resulting in an increase in the unemployment rate to 8.3 per cent in 2004-05. These rates, based on the current daily status 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 2.5 per cent in 2004-05.

9. The proportion of persons below 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 poverty line 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 indicate broadly similar growth across different rural and urban income classes, though it may have been less uniform for urban than for rural population.

INFLATION AND MONEY SUPPLY

10. The increase in the prices of primary articles and mineral oils in June 2006, had led to a firming up of inflation in 2006-07. Rate of inflation reached 6.7 per cent on January 27, 2007 and was 6.4 per cent on April 7, 2007, the first week of the current year. Inflation, however, started moderating from June 2007 onwards because of a number of reasons, including a roll back 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 on January 26, 2008 and February 2, 2008. 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. 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.

11. Government has been monitoring the prices of commodities on a regular basis, and the measures initiated in the last year and a half helped in maintaining price stability. The close monitoring of the prices and appropriate policy interventions also helped in reducing the impact of increase in global prices to the domestic consumers.

12. The Monetary policy stance of Reserve Bank of India continued to strike a balance between managing the transition of the economy to a higher growth path and containing inflationary pressures. The 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, as compared to 12.2 per cent on January 5, 2006. Thus, it is difficult to relate the annual or trend rate of growth of M3 to inflation that has been on a downtrend during this period. This is perhaps because of the parallel process of monetary deepening of the informal economy that is under way. In contrast to money supply, average credit growth slowed marginally to 26.8 per cent in 2006-07 and decelerated further in 2007-08. 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 until the corresponding date of 2007. This could partly be due to the deceleration in growth of manufacturing and construction sectors and the consequent slowdown in demand for credit.

13. 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 cut-off yield on 364 day (91 day) treasury bills averaged 7.0 (6.6) per cent during 2006-07. Yields rose to an average of 7.5 (7.0) 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 on 364 (91) day treasury bills almost (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 also led to a widening of the interest differential between domestic and global rates.

EXTERNAL SECTOR

14. The World Economic Outlook (WEO October 2007) reported that the recent expansionary phase, with average world growth of 5 per cent as the longest since the early 1970s. The update of WEO, January 2008, however, revised these estimates downwards. 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 US. Monetary policy actions by US and other developed countries seem to have contained its immediate impact.

15. The Indian economy has been progressively globalising since the 1990s 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. There was a surge in capital flows in 2007-08. Capital flows, as a proportion of GDP, an indicator of the growing influence of global developments on the Indian economy, have been on a clear uptrend, and reached a high of 5.1 per cent of GDP in 2006-07. This is a natural outcome of the improved investment climate and recognition of India’s strong macroeconomic fundamentals.

16. Even as the external environment remained conducive, the problem of managing a more open capital account with increasing inflows and exchange rate appreciation surfaced. With capital inflows exceeding financing requirements, reserve increase was of the order of US$ 36.6 billion in 2006-07. Thus, the rupee had started to face upward pressure since the second half of 2006-07. The excess of capital inflows rose to 7.7 per cent of GDP in the first half of 2007-08. Foreign exchange reserves increased by US $ 91.6 billion in the current year so far to reach US $ 290.8 billion on February 8, 2008. The rapid accretion of reserves and increased pressure on rupee, necessitated rising limits on the Market Stabilization Scheme. The revised fiscal cost of sterilization of inflows for 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.

17. The composition of capital flows has also been changing. The most welcome feature of increased capital flows was the 150 per cent increase in net foreign direct investment inflows to US$ 23 billion in 2006-07. The trend continued in the current financial year with gross FDI flows 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. The last two years heralded the globalisation of Indian enterprises being breakout years for the creation of Indian multinationals. Outward investment from India shot up to US$ 14.4 billion in 2006-07 from around US$ 2 billion in 2003-04 and the trend continued in the current year with outward investment of US$ 7.3 billion in April-September 2007. Increased volatility in Asian and global financial markets in 2006-07, affected the flow of portfolio investment. Net flows were US$ 7.1 billion in 2006-07 compared to US$12.1 billion in 2005-06. Euro equities, which were a relatively minor component of portfolio flows (less than US$ 1 billion 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$18.3 billion in April-September 2007, more than double the inflow during 2006-07. Notwithstanding the volatility of portfolio flows, the maximum net outflow in any year in recent past was a negligible US$ 219 million in 1998-99.

18. The current account deficit (CAD) mirrors the saving-investment gap in the national income accounts and thus constitutes foreign savings. The rise and fall of the current account balance as a ratio to GDP continued to be largely driven by the goods and services (G&S) trade balance. The surplus from factor income including remittances, which fluctuated between 2 and 3 per cent of GDP, however, helped moderate the deficit on the trade account.

19. The trade to GDP ratio, an indicator of trade openness, increased from 22.5 percent of GDP in 2000-01 to 34.8 percent of GDP in 2006-07. If services trade is included, this ratio increases further to 48 percent of GDP in 2006-07. India's merchandise exports and imports (in US$, on customs basis) grew by 22.6 per cent and 24.5 per cent respectively in 2006-07. In the first nine months of the current year, exports grew at 21.6 per cent and reached US$ 111 billion, nearly 70 percent of the year's export target. Major drivers of export growth during April-September 2007 were petroleum products, engineering goods and gems & jewellery. Imports grew by 25.9 per cent during April-December 2007, with non-POL imports growing at 31.9 percent, 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).

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 percent of merchandise exports in 2006-07. Services exports, due to a decline in value of non-software services, particularly business and communication services, grew by a moderate 8.6 per cent in April-September 2007.

RUPEE APPRECIATION

20, 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 twelve months on year-on-year basis (December 2007 over December 2006) at 13.2 per cent was even higher. The REER (6 currency, trade-based weights) that indicates the real competitiveness by factoring the relative price levels of competitors appreciated by 7.2 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 import of major trading partners like US affected exports of some sectors with low import intensity. To mitigate the effect and facilitate adjustment, the government announced relief measures to selected sectors.

FISCAL CONSOLIDATION

21. Progress on the fiscal consolidation front has been satisfactory in the post-FRBM period. The fiscal deficit of the Centre, as a proportion of GDP, has come down from 6.2 per cent in 2001-02 to 3.4 per cent in 2006-07 (Actual). The gross tax-GDP ratio increased to 11.4 per cent in 2006-07 (Actual) and is budgeted at 11.8 per cent of GDP in 2007-08. In the first nine months, gross tax receipts increased by 27.0 per cent and were 71.0 per cent of the budget estimates. Revenue expenditure increased by 13.6 per cent (April-December, 2007) and was 71.0 per cent of the budget estimates. There was an upsurge in capital expenditure with y-o-

y growth of 120 per cent, mainly because of the transaction relating to acquisition of equity of the State Bank of India held by Reserve Bank of India to the government. Revenue and fiscal deficit were 55 per cent and 51 per cent, respectively of budget estimates.

PROSPECTS

22. The rapid growth of the Indian economy in recent years has brought into sharp focus the urgent need to develop the physical and social infrastructure. There are clear signals that a rapid increase in the scale and quality of investment in physical infrastructure such as power, railways, roads, airports, ports, and communications is underway. The framework for encouraging public-private partnerships for developing physical infrastructure is also in place and is expected to yield positive results. The Eleventh Plan has also outlined a comprehensive programme for the development of the infrastructure sector.

23. The well-known ‘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 Plan focuses on ensuring better delivery of health care, generation of more employment opportunities and skill development improving employability of persons.

24. The circumstances today are favourable for sustained, rapid and a more inclusive growth of the economy. The responsiveness of the Indian private sector to economic liberalisation and increased international integration has been generally satisfactory and has imparted tremendous resilience to the economy. The changing composition of demand in recent times is indicative of addition to productive capacity, which is likely to support the further growth of the economy. The National Food Security Mission and Rashtriya Krishi Vikas Yojana are expected to provide the required impetus to agricultural growth. Investment in general is a forward-looking variable and its rise will reinforce the outlook for growth.

Annex - I

MACROECONOMIC FRAMEWORK STATEMENT
(ECONOMIC PERFORMANCE AT A GLANCE)

Sl. No.	Item	Absolute value April - December 2006-07	Absolute value April - December 2007-08	Percentage change April - December 2006-07	Percentage change April - December 2007-08
	Real Sector				
1	GDP at factor cost(Rs.thousand crore)*				
	a) at current prices	3790.1 Q	4283.0 A	15.7 Q	13.0 A
	b) at 1999-2000 prices	2864.3 Q	3114.4 A	9.6 Q	8.7 A
2	Index of industrial production (1)	239.8	261.4	11.2	9.0
3	Wholesale price index (Base 1993-94=100)(2)	208.7	216.0	5.9	3.5
4	Consumer price index (2001=100)(3)	127.0	134.0	6.9	5.5
5	Money Supply (M3)(Rs. thousand crore) $	3016.3	3702.8	19.3	22.8
6	Imports at current prices**				
	a) In Rs. crore	611522	682088	31.2	11.5
	b) In US $ million	134080	168803	27.3	25.9
7	Exports at current prices**				
	a) In Rs. crore	416176	448377	28.7	7.7
	b) In US $ million	91249	110965	24.8	21.6
8	Trade Deficit(in US$ million)**	-42831	-57838	32.9	35.0
9	Foreign currency assets				
	a) In Rs. crore	752738	1050485	27.5	39.6
	b) In US $ million	170187	266553	29.2	56.6
10	Current Account Balance (In US$ million) @	-10340	-10713		
	Government Finances #				
1	Revenue receipts	280915	355646	29.6	26.6
2	Tax revenue (Net)	232171	295994	37.6	27.5
3	Non-tax revenue	48744	59652	1.5	22.4
4	Capital receipts (5+6+7)	102806	118607	-11.2	15.4
5	Recovery of loans	7952	3304	7.3	-58.5
6	Other receipts	0	37725 *	-100.0	
7	Borrowings and other liabilities	94854	77578	-12.4	-18.2
8	Total receipts (1+4)	383721	474253	15.4	23.6
9	Non-Plan expenditure	272203	337090	14.4	23.8
10	Revenue Account	253791	280050	14.6	10.3
	Of which:				
11	Interest payments	92634	111764	14.4	20.7
12	Capital Account	18412	57040	12.6	209.8
13	Plan expenditure	111518	137163	17.9	23.0
14	Revenue Account	93901	114806	25.4	22.3
15	Capital Account	17617	22357	-10.7	26.9
16	Total expenditure (9+13)	383721	474253	15.4	23.6
17	Revenue expenditure (10+14)	347692	394856	17.3	13.6
18	Capital expenditure (12+15)	36029	79397	-0.1	120.4
19	Revenue deficit (17-1)	66777	39210	-16.2	-41.3
20	Fiscal deficit {16-(1+5+6)}	94854	77578	-12.4	-18.2
21	Primary deficit (20-11)	2220	-34186	-91.9	-1639.9

A-Advance estimates. Q-Quick estimates * Relates to full year.

(1) Base:1993-94=100
(2) End week of December (Point to point)
(3) End of December (Point to point)
 # Figures as reported by Controller General of Accounts, Department of Expenditure, Ministry of Finance
$ Data relates to December 21, 2007.
** Includes an amount of Rs 34,308.60 crores on account of transfer of profit on sale of RBI's stake in SBI.*
*** on Customs basis; comparision for current year is on provisional over revised basis.*
@ Period relates to April-September.