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Macro-Economic Framework Statement
Medium Term Fiscal Policy Statement
Fiscal Policy Strategy Statement

MACRO-ECONOMIC FRAMEWORK STATEMENT

OVERVIEW OF THE ECONOMY

Robust growth, for the fourth year in a row, and strong macroeconomic fundamentals, characterised developments in the Indian economy in 2006-07 so far. Growth is expected to be 9.2 per cent in 2006-07. However, there are some genuine concerns on the inflation front. While the up-and-down pattern in agriculture continued with growth estimated at 6.0 per cent and 2.7 per cent in the two recent years, and services maintained its vigorous growth performance, there were distinct signs of sustained improvements on the industrial front. External sector continued to remain strong and supportive of growth, with stable capital flows financing moderate current account deficits. Inflation, with its roots in supply-side factors, was on an upward trend from the beginning of the year. Measured by the wholesale price index (WPI), year-on-year, it peaked at 6.7 per cent on February 3, 2007. Inflation was accompanied by buoyant growth of money and credit in 2005-06 and 2006-07 so far. Rapid accretion in foreign exchange reserves, which grew from US$151.6 billion at end-March 2006 to US$185.1 billion on February 9, 2007, was reflected in rapid growth in money supply. Reserve accretion, in turn, reflected, apart from valuation gains, buoyant capital flows (particularly foreign investment) stimulated by bullish sentiments in the domestic capital markets. The Sensex, the bellwether stock-index of the Bombay Stock Exchange (BSE), rallied from a low of 8,929 on June 14, 2006 to an all-time intra-day high of 14,724 on February 9, 2007. With robust macroeconomic fundamentals, particularly with tangible progress towards fiscal consolidation, a strong balance of payments position, and upsurge in domestic savings and investment rates, the outlook is distinctly upbeat.

GDP GROWTH

The advance estimates (AE) of gross domestic product (GDP) for 2006-07, released by the Central Statistical Organisation (CSO) on February 7, 2007, places the growth of GDP at factor cost at constant (1999-2000) prices in the current year at 9.2 per cent. Growth in 2005-06, initially estimated by the CSO at the AE stage at 8.1 per cent in February 2006, was revised upwards to 8.4 per cent at the revised estimate stage in May 2006 and further to 9.0 per cent in the quick estimates released by the CSO on January 31, 2007. The ratcheting up of growth observed in recent years is reflected in the Eleventh Five Year Plan target of an average annual growth of 9 per cent relative to 8 per cent targeted by the Tenth Plan (2002-03 to 2006-07). The shortfall in the annual average growth of 7.6 per cent from the target of 8 per cent in the five years of the Tenth Plan is attributable to the disappointing 3.8 per cent growth in the first year of the Plan and its subsequent surge to 8.6 per cent, on average, in the last four years.

A notable feature of the current growth phase is the sharp rise in the rate of investment in the economy. The revival in gross domestic capital formation (GDCF) that commenced in 2002-03 has been followed by a sharp rise in the rate of investment in the economy for four consecutive years. The earlier estimates of GDCF for 2004-05 of 30.1 per cent, released by CSO in their AE, now stand upgraded to 31.5 per cent in the quick estimates. The rate of GDCF for 2005-06 is 33.8 per cent.

Services contributed as much as 68.6 per cent of the overall average growth in GDP in the last five years between 2002-03 and 2006-07, and with agriculture growing only at 2.3 per cent in the five-year period ending 2006-07, bulk of the residual contribution came from industry. Hence, the share of agriculture in GDP declined to 18.5 per cent, the share of industry and services improved to 26.4 per cent and 55.1 per cent, respectively. The importance of this higher contribution of industry in the recent four years is underscored by the fact that since 1951-52, and before 2004-05, industry has never consistently grown at over seven per cent per year for more than three years in a row. Industrial growth would have been even higher, had it not been for a relatively disappointing performance of the other two sub-sectors, namely, mining and quarrying; and electricity, gas and water supply. Services sector growth has continued to be broad-based. Among the three sub-sectors of services, 'trade, hotels, transport and communication services' has continued to boost the sector by growing at double-digit rates for the fourth successive year. Impressive progress in information technology (IT) and IT-enabled services, in both rail and road traffic, and fast addition to existing stock of telephone connections, particularly mobiles, played a key role in such growth. Growth in financial services (comprising banking, insurance, real estate and business services), after dipping to 5.6 percent in 2003-04 bounced back to 8.7 percent in 2004-05 and 10.9 per cent in 2005-06. The momentum has been maintained with a growth of 11.1 per cent in 2006-07.

EXTERNAL SECTOR

The growing strength of India's balance of payments (BoP) observed in the post-reform period since the crisis of 1991, continued in 2005-06, in spite of a widening of the current account deficit from US$2.5 billion in 2004-05 to US$9.2 billion, equivalent to 1.1 per cent of GDP. With a burgeoning trade deficit, primarily on account of rising oil prices, the reversal from current account surpluses witnessed between 2001-02 and 2003-04 to a current account deficit in 2004-05 appears to be continuing into 2006-07 so far. Rising foreign investment, both direct and portfolio, together with a sharp revival of inflows in non-resident deposits, in spite of the large repayment of India Millennium Deposits under external commercial borrowing (ECB), maintained a strong balance in the capital account, and even after financing the current account deficit, resulted in a reserve accretion of US$15.1 billion in 2005-06. India continued to be among the top nations with high levels of reserves at US $ 185.1 billion as on February 9, 2007.

India's exports (in US dollar terms and customs basis) have been growing at a high rate of more than 20 per cent since 2002-03. During 2005-06, with growth of 23.4 per cent, India's exports crossed the US$100 billion mark. Merchandise imports grew by 33.8 per cent to US$149.2 billion in 2005-06. This high growth in imports in value terms was primarily due to the high petroleum, oil and lubricants (POL) prices. While volume growth of POL imports declined from 6.4 per cent in the previous year to 6.1 per cent in 2005-06, with the price of Indian basket of crude oil increasing by 42.1 per cent, POL imports during 2005-2006 increased by 47.3 per cent to US$44 billion. Growth of non-POL imports in 2005-2006 was 28.8 per cent. With invisibles (net), comprising of non-factor services (like travel, transportation, software services and business services), investment income, and transfers, continuing to compensate the trade deficit to a large extent, the current account deficit was moderate at 1.1 per cent of GDP in 2005-06. Invisibles (receipts) have grown steadily from 2.4 per cent of GDP in 1990-91 to 11.5 per cent of GDP in 2005-06. The two most recent years have witnessed acceleration in such receipts, particularly under software and business services.

In 2005-06 and 2006-07 so far, capital flows into India remained strong on an overall basis, albeit with varying movements in the different components. Debt creating flows, particularly external assistance and ECB, which had turned into net outflows in 2002-03 and 2003-04, became positive inflows in 2005-06. Non-resident deposits (net) rebounded after an outflow of about US$1 billion in 2004-05 to an inflow of US$2.8 billion in 2005-06. There was strong growth in foreign direct investment flows (net), with three-quarters of such flows in the form of equity. The growth rate was 27.4 per cent in 2005-06 and as high as 98.4 per cent in April-September 2006 even after some gross outflows with domestic corporate entities seeking global presence to harness scale, technology and market access advantages through acquisitions overseas. Foreign institutional investment (FII) flows, the dominant variety of portfolio flows, after remaining buoyant until 2005-06, turned into net outflows in the first half of 2006-07. FII flows are reported to have turned positive again in the second half of the current year.

MONEY, BANKING AND CAPITAL MARKETS

Broad money (M_3), year-on-year, grew by 21.1 per cent on January 19, 2007. The industrial resurgence and upswing in investment was reflected in, and sustained by, growth of gross bank credit (as per data covering 90 per cent of credit by scheduled commercial banks), for example, to industry (medium and large) at 31.6 per cent and for housing loans at 38.0 per cent in 2005-06. It was also observed in year-on-year growth of gross bank credit at 32.0 per cent in September 2006, albeit marginally down from 37.1 per cent in 2005-06. Liquidity conditions remained fairly comfortable up to early-September 2006 with the unwinding of the Central Government surplus balances with the RBI and continued intervention in the foreign exchange market to maintain orderly conditions. During 2006-07, up to September 8, 2006, the continuous flow of funds under reverse-repo indicated a comfortable liquidity position. In 2005-06, the reverse repo rate had been raised by 25 basis points each time on April 29 and October 26, 2005, and on January 24, 2006 to reach 5.50 per cent. In 2006-07, it was raised again by 25 basis points each time on June 9 and July 25, 2006. With year-on-year inflation stubbornly above 5 per cent from early-August 2006, on October 31, 2006, the RBI announced more measures to stem inflationary expectations and also to contain the credit off-take at the desired growth rate of 20.0 per cent. Unlike the previous four times, when both the repo and the reverse repo rates were raised by the same 25 basis points, thereby keeping their spread constant at 100 basis points, on October 31, 2006, only the repo rate was raised by 25 basis points. With a repeat of this policy move on January 31, 2007, the repo rate reached 7.50 per cent with a spread of 150 basis points over the reverse repo rate. Since deposits are growing at a lower rate than credit, the higher repo rate signaled to the banks the higher price of accommodation they would have to pay in case of credit overextension.

The cash reserve ratio (CRR) was hiked by 25 basis points each time on December 23, 2006 (5.25 per cent) and January 6, 2007 (5.50 per cent). While a further increase of CRR of 25 basis points was effected on February 17, another similar increase of 25 basis points will follow on March 3, 2007. Sustained faster growth of M_3 relative to that of reserve money (M_0) observed in recent years continued in 2005-06 and 2006-07 so far with the money multiplier steadily increasing from 4.43 at end-March 2002 to 4.60 at end-March 2005, 4.76 at end-March 2006 and further to 4.79 on January 19, 2007. The increase in money-multiplier coincided with fast growth of M_0 at 17.2 per cent during 2005-06 and year-on-year at 20.0 per cent on January 19, 2007, and resulted in the rapid growth of M_3.

The change in the liquidity and inflation environment is reflected in the continuous hardening of interest rates in 2005-06 and in 2006-07 so far. With the high demand for credit not adequately matched by deposit growth, there was steady increase in the credit-deposit ratio and hardening of interest rates. For example, the yield on 10-year residual maturity Government securities, which had gone up by 84 basis points during 2005-06 to 7.53 per cent at end-March 2006, hardened further to 8.08 per cent on February 14, 2007. Movements in the call money rates also reveal a similar picture. The hardening of rates was more pronounced at the shorter end of the yield curve, suggesting concerns about inflation only in the short run.

The upbeat mood of the capital markets reflected the improved growth prospects of the economy. The rally in BSE Sensex from the 13,000 mark to the 14,000 mark in only 26 trading sessions was the fastest ever climb of 1,000 points. India with a market capitalization of 91.5 per cent of GDP on January 12, 2007 compared favourably not only with emerging market economies but also with Japan (96 per cent) and South Korea (94.1 per cent). The strength of the market micro-structure from large retail participation continued. Aggregate mobilization, especially through private placements and Initial Public Offerings (IPOs), grew by 30.5 per cent to Rs. 161,769 crore in calendar year 2006, with about 6 IPOs every month, on average. Net mobilisation of resources by mutual funds increased by more than four-fold from Rs. 25,454 crore in 2005 to Rs. 1,04,950 crore in 2006. The sharp rise in mobilisation by mutual funds was due to buoyant inflows under both income/debt oriented schemes and growth/ equity oriented schemes. The negative inflows in 2004 turned positive for the public sector mutual funds in 2005 and accelerated in 2006. Other indicators of market sentiments, such as equity returns and price/earnings ratio also continued to be strong and supportive of growth.

CENTRAL GOVERNMENT FINANCES

Progress in fiscal consolidation 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 3.8 per cent in 2006-07 (BE). While past efforts at fiscal consolidation in the pre-FRBM era, after an initial burst of progress, had faltered because the sectoral needs-driven demand on resources could not be resisted, the mandated FRBMA mechanism has proved more effective. The fiscal deficit of the Central Government, as a proportion of GDP, declined from 6.6 per cent in 1990-91 to 4.1 per cent in 1996-97, but this progress could not be sustained. Further, increase in the ratio of fiscal deficit to GDP during this period was also associated with an increase in the proportion of revenue deficit to fiscal deficit, which increased from 49.4 of fiscal deficit in 1990-91 to 79.7 per cent in 2003-04. Since FRBMA mandated a reduction in revenue deficit as well, gradual reduction in revenue deficit together with the reduction in fiscal deficit resulted in a decline in the proportion of revenue deficit to fiscal deficit by 22.7 percentage points in three years. The proportion of borrowed funds applied to assets creation, correspondingly, increased to 43 per cent in 2006-07 (BE).

The fiscal consolidation process underway in India, unlike the expenditure compression strategy in most other countries, has been essentially revenue-led and has involved reprioritisation of expenditure with a focus on outcomes. The tax-GDP ratio of the Centre has steadily risen from 8.8 per cent in 2002-03 to 10.3 per cent in 2005-06 and was 11.4 per cent in 2006-07(RE). After growing by 20.3 per cent and 22.7 per cent, respectively in 2005-06, corporate income tax and personal income tax have grown by 55.2 per cent and 30.3 per cent, respectively in April-December 2006 over April-December 2005. Buoyant growth in direct taxes revenue has helped take its share in total revenue to 49.0 per cent in 2006-07 (RE). In the reduction of revenue and fiscal deficits, buoyant revenue growth has been complemented by a discernible shift in the composition of expenditure. While as a proportion of GDP, total expenditure of the Centre declined from 16.8 per cent in 2002-03 to 14.1 per cent in 2005-06. Gross budgetary support to the Plan increased on a like-to-like basis from Rs. 113,500 crore to (including disintermediated loans to States) to Rs.172,500 crore. The balance from current revenues, which had remained negative till 2003-04, turned positive in 2004-05 and has strengthened to Rs. 22,332 crore in 2005-06. With non-Plan expenditure as a proportion of total expenditure declining from 73.0 per cent in 2002-03 to 69.4 per cent in 2006-07 (BE), there have been distinct signs of reprioritisation of expenditure.

PROSPECTS

The economy appears to have decidedly 'taken off' and moved from a phase of moderate growth to a new phase of high growth. Higher growth together with the demographic dividend (from a growing proportion of the population in the working age group) is likely to lead to a rise in the savings rate to finance more and more investment and hence reinforce growth itself. Concerns have been expressed about whether the country is growing beyond its growth potential thereby straining its labour force and capital stock, and hence engendering inflationary instabilities. The key to maintaining high growth with reasonable price stability lies in rapid capacity addition through investments, productivity improvements and ameliorating the skill shortages. While monetary policy will continue to play a critical role in maintaining price stability, the sustainability of high growth with moderate inflation will depend critically on bolstering the twin pillars of growth, namely fiscal prudence and high investment; and improving the effectiveness of Government intervention in critical areas such as education, health and support for the needy.

Annex

MACROECONOMIC FRAMEWORK STATEMENT
(ECONOMIC PERFORMANCE AT A GLANCE)

Sl. No	Item	Absolute value April - December 2005-06	Absolute value April - December 2006-07	Percentage change April-December 2005-06	Percentage change April-December 2006-07
Real Sector					
1	GDP at factor cost(Rs.thousand crore) *				
	a) at current prices	3250.9 Q	3717.5 A	13.8 Q	14.4 A
	b) at 1999-2000 prices	2604.5 Q	2844.0 A	9.0 Q	9.2 A
2	Index of industrial production (1) #	213.6	236.2	8.3	10.6
3	Wholesale price index (Base 1993-94=100)(2)	197.1	208.1	4.6	5.6
4	Consumer price index (1982=100)(3)	550	588	5.6	6.9
5	Money Supply (M_3)(Rs. thousand crore) $	2527.7	3018.6	17.8	19.4
6	Imports at current prices **				
	a) In Rs. crore	425667	598287	23.1	40.6
	b) In US $ million	96264	131212	26.2	36.3
7	Exports at current prices**				
	a) In Rs. crore	290411	408394	13.4	40.6
	b) In US $ million	65668	89489	16.3	36.3
8	Trade Deficit(in US$ million)**	-30596	-41723	54.6	36.4
9	Foreign currency assets				
	a) In Rs. crore	590497	752739	8.3	27.5
	b) In US $ million	13018	170187	4.7	29.2
10	Current Account Balance (In US$ million) @	-7160	-11683		
Government Finances ##			(Rs. crore)		
1	Revenue receipts	216746	280915	15.0	29.6
2	Tax revenue (Net)	168715	232171	19.4	37.6
3	Non-tax revenue	48031	48744	1.7	1.5
4	Capital receipts (5+6+7)	115753	102806	-16.3	-11.2
5	Recovery of loans	7408	7952	-83.6	7.3
6	Other receipts	11	0	-99.6	-100.0
7	Borrowings and other liabilities	108334	94854	20.1	-12.4
8	Total receipts (1+4)	332499	383721	1.7	15.4
9	Non-Plan expenditure	237904	272203	-3.1	14.4
10	Revenue Account	221552	253791	11.8	14.6
	Of which:				
11	Interest payments	80972	92634	1.4	14.4
12	Capital Account	16352	18412	-65.5	12.6
13	Plan expenditure	94595	111518	16.5	17.9
14	Revenue Account	74875	93901	40.6	25.4
15	Capital Account	19720	17617	-29.5	-10.7
16	Total expenditure (9+13)	332499	383721	1.7	15.4
17	Revenue expenditure (10+14)	296427	347692	17.9	17.3
18	Capital expenditure (12+15)	36072	36029	-52.1	-0.1
19	Revenue deficit (17-1)	79681	66777	26.5	-16.2
20	Fiscal deficit {16-(1+5+6)}	108334	94854	20.1	-12.4
21	Primary deficit (20-11)	27362	2220	164.3	-91.9

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)*

\# *Data relates to April-November.*

\# # *Figures as reported by Controller General of Accounts, Department of Expenditure, Ministry of Finance*

$ *Data relates to December 22, 2006.*

** *on Customs basis; comparison for current year is on provisional to provisional basis and for 2005-06 is on provisional over revised basis.*

@ *Period relates to April-September.*