VI. THE EXTERNAL ECONOMY

India's external sector has continued to register robust performance during 2006-07 so far. Merchandise exports have exhibited strong growth, notwithstanding some deceleration. Non-oil imports recorded a deceleration mainly on account of decline in imports of gold and silver, and pearls, precious and semi-precious stones; imports of capital goods, however, remained buoyant. Growth in oil imports remained high, *albeit* lower than last year. Sustained growth in exports of services and remittances continued to provide buoyancy to the surplus in the invisibles account, which enabled financing a large part of the deficit on the merchandise trade account. Although, the current account deficit widened in the wake of higher oil imports, it was easily financed by normal capital flows. Foreign exchange reserves have increased by US $ 26.5 billion during 2006-07 (up to January 19, 2007).

International Developments

The global economy continued to expand at a robust pace in the third quarter of 2006, *albeit* with some moderation in the growth momentum (Table 43). Real GDP growth in the US slowed further in the third quarter, primarily on the back of drop in residential investment, acceleration in imports and deceleration in consumer spending for services. The Japanese economy also witnessed a deceleration in growth in the third quarter, attributable to a fall in domestic demand. Economic activity in the euro area, on the other hand,

Table 43: Growth Rates – Global Scenario

(Per cent)

Country	2004	2005	2006 P	2007 P	2005		2006		
					Q3	Q4	Q1	Q2	Q3
1	2	3	4	5	6	7	8	9	10
Advanced Economies									
Euro Area	2.1	1.3	2.4	2.0	1.6	1.8	2.2	2.7	2.7
Japan	2.3	2.6	2.7	2.1	2.6	2.8	3.6	2.5	1.6
Korea	4.7	4.0	5.0	4.3	4.5	5.3	6.1	5.3	4.8
UK	3.3	1.9	2.7	2.7	1.9	1.8	2.2	2.6	2.9
US	3.9	3.2	3.4	2.9	3.4	3.1	3.7	3.5	3.0
OECD Countries	3.3	2.8	3.1	2.9	2.8	3.0	3.3	3.4	3.0
Emerging Economies									
Argentina	9.0	9.2	8.0	6.0	9.2	9.1	8.6	7.9	8.7
Brazil	4.9	2.3	3.6	4.0	1.0	1.4	3.4	1.2	3.2
China	10.1	10.2	10.0	10.0	9.4	9.9	10.2	11.3	10.6
India	7.5*	8.4#	8.3	7.3	8.4	7.5	9.3	8.9	9.2
Indonesia	5.1	5.6	5.2	6.0	5.6	4.9	4.7	5.2	5.5
Malaysia	7.2	5.2	5.5	5.8	5.3	5.2	5.3	5.9	5.9
Thailand	6.2	4.5	4.5	5.0	5.5	4.3	6.1	5.0	4.7

* : FY 2004-05. # : FY 2005-06. P : IMF Projections.

Source : International Monetary Fund; The Economist; and the OECD.

continued to expand, led by strong domestic demand. Amongst emerging economies, economic activity in China continued to exhibit double-digit growth in the third quarter of 2006, though with some moderation from the pace recorded in the first half of 2006.

According to the International Monetary Fund (IMF), global economic activity will remain buoyant in 2007, led by emerging economies. In terms of exchange rates based on purchasing power parities, global economy will expand by 4.9 per cent in 2007, marginally lower than that of 5.1 per cent in 2006 (Table 44). Growth prospects, however, remain subject to downside risks from uncertainties regarding the persistent global macroeconomic imbalances, the underlying inflationary pressures on account of limited spare capacity, emerging wage pressures, possibility of renewed rise in crude oil prices and possibility of re-pricing of risks in global financial markets.

Global trade exhibited a modest deceleration during 2006, mainly on account of slowdown in developing countries (Table 45). World exports in US dollar terms grew by 14.1 per cent in the first nine months of 2006 as compared

Table 44: Select Economic Indicators - World

Item	2001	2002	2003	2004	2005	2006 P	2007 P
1	2	3	4	5	6	7	8
I. World Output (Per cent change) #	2.6 (1.5)	3.1 (1.8)	4.1 (2.7)	5.3 (3.9)	4.9 (3.4)	5.1 (3.8)	4.9 (3.5)
i) Advanced economies	1.2	1.5	1.9	3.2	2.6	3.1	2.7
ii) Other emerging market and developing countries	4.4	5.1	6.7	7.7	7.4	7.3	7.2
of which: Developing Asia	6.1	7.0	8.4	8.8	9.0	8.7	8.6
II. Consumer Price Inflation (Per cent)							
i) Advanced economies	2.1	1.5	1.8	2.0	2.3	2.6	2.3
ii) Other emerging market and developing countries	6.5	5.7	5.8	5.6	5.3	5.2	5.0
of which: Developing Asia	2.7	2.0	2.5	4.1	3.5	3.8	3.6
III. Net Capital Flows* (US $ billion)							
i) Net private capital flows (a+b+c)	64.6	77.3	165.6	205.9	238.5	211.4	182.2
a) Net private direct investment	179.4	150.6	159.1	176.9	255.9	263.3	246.1
b) Net private portfolio investment	-78.2	-91.7	-10.9	13.9	3.2	-31.1	-4.6
c) Net other private capital flows	-36.6	18.4	17.3	15.1	-20.6	-20.8	-59.2
ii) Net official flows	-3.3	-4.3	-53.1	-64.7	-151.8	-238.7	-174.1
IV. World Trade (Per cent change)@							
i) Volume	–	3.4	5.3	10.6	7.4	8.9	7.6
ii) Price Deflator (in US dollars)	-3.2	1.2	10.5	9.7	5.4	4.6	2.2
V. Current Account Balance (Per cent to GDP)							
i) US	-3.8	-4.5	-4.8	-5.7	-6.4	-6.6	-6.9
ii) China	1.3	2.4	2.8	3.6	7.2	7.2	7.2
iii) Middle East	6.2	4.6	8.3	11.9	18.5	23.2	22.5

P : IMF Projections.
: Growth rates are based on exchange rates at purchasing power parities. Figures in parentheses are growth rates at market exchange rates.
* : Net capital flows to emerging market and developing countries.
@ : Average of annual percentage change for world exports and imports of goods and services.
Source : World Economic Outlook, IMF, September 2006.

Table 45: Growth in Exports - Global Scenario

(Per cent)

Region/Country	2005	2005	2006
		January-October	
1	2	3	4
World	**13.9**	**15.5 ***	**14.1 ***
Industrial Countries	**8.4**	**10.3 ***	**11.2 ***
USA	10.8	10.1	14.8
France	3.5	6.8	8.2
Germany	7.3	9.3	12.8
Japan	5.2	5.8	8.0
Developing Countries	**21.8**	**23.0 ***	**17.9 ***
Non-Oil Developing Countries	**19.2**	**20.6 ***	**19.4 ***
China	28.4	31.3 *	26.5 *
India	29.8	30.2 #	21.7 #
Indonesia	18.2	20.4	20.5
Korea	12.0	11.6 $	14.0 $
Malaysia	12.0	11.1	13.2
Singapore	15.6	27.3 #	19.9 #
Thailand	14.5	15.5	18.2

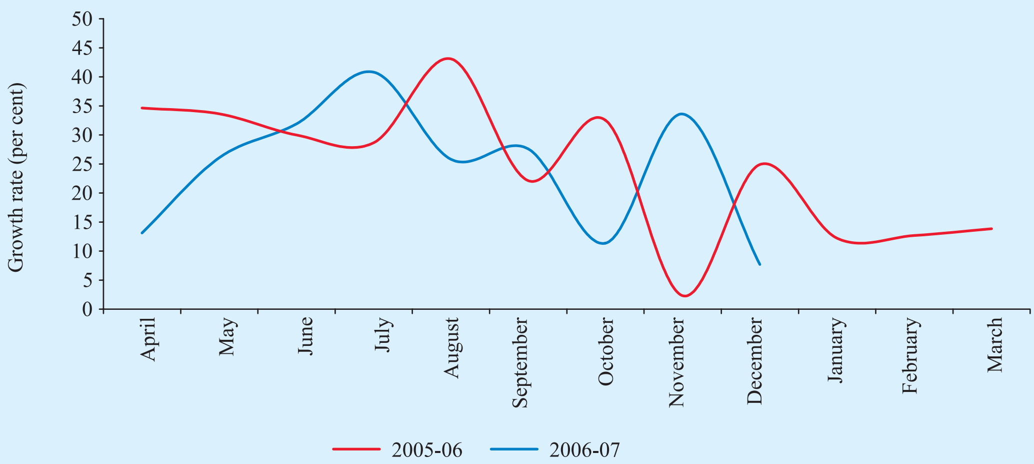
* : January-September. # : January-November. $: January-August.
Source : International Financial Statistics, International Monetary Fund, January 2007; DGCI&S for India.

with 15.5 per cent in the corresponding period of 2005. Exports of industrial countries, on the other hand, accelerated, led by the US.

Merchandise Trade

According to the provisional data released by the Directorate General of Commercial Intelligence and Statistics (DGCI&S), India's exports recorded a growth of 22 per cent during April-December 2006 as compared with 30 per cent registered a year ago (Chart 51).

Chart 51: India's Merchandise Exports



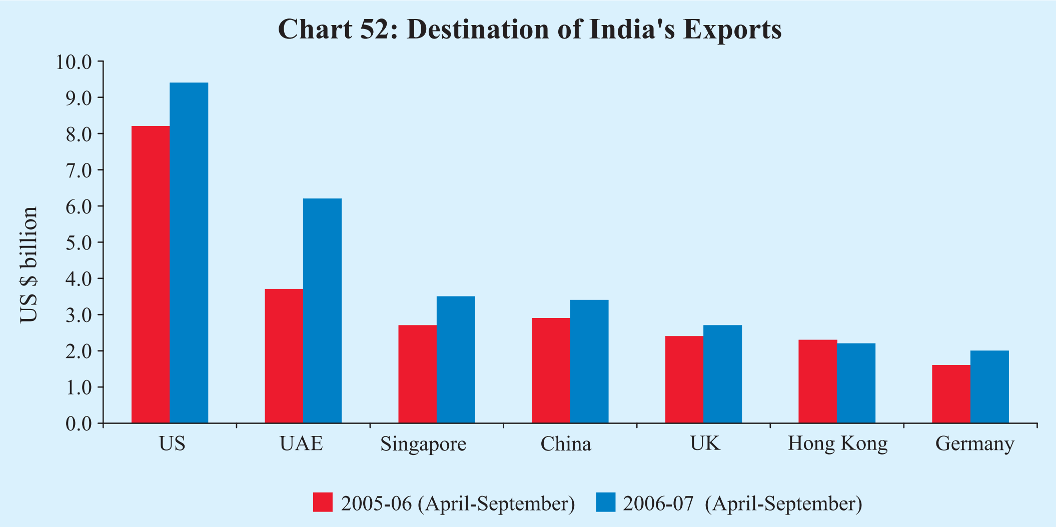
Commodity-wise data available for April-September 2006 reveal that exports of all major groups, with the exception of petroleum products and engineering goods, recorded deceleration (Table 46). Exports of petroleum products registered substantial growth reflecting the increase in both price and quantity. In volume terms, exports of petroleum products increased by 60 per cent during April-September 2006. The deceleration in primary products was mainly due to decline in exports of iron ore. However, exports of agriculture and allied products maintained the growth momentum on the back of large increase in exports of raw cotton and sugar. Among the traditional agricultural products, exports of tea, coffee, tobacco, spices and oil meals recorded a strong growth, while that of rice, wheat, cashew and marine products posted a decline/ low growth. Within manufactured products, exports of engineering goods, basic chemicals and pharmaceuticals maintained their growth momentum. On the other hand, exports of gems and jewellery and handicrafts recorded a decline while those of 'leather and manufactures' and textiles exhibited a deceleration.

Destination-wise, the US was the largest export market for India during April-September 2006 with a share of 15.3 per cent in India's total exports followed by the UAE (10.1 per cent) and Singapore (5.8 per cent) (Chart 52). Amongst major markets, India's exports to the Organisation of Petroleum Exporting Countries (OPEC) recorded a growth of 56 per cent with exports to the UAE growing by 65 per cent. Exports to the US, Singapore, Germany, UK and China recorded a deceleration, while exports to Hong Kong declined.

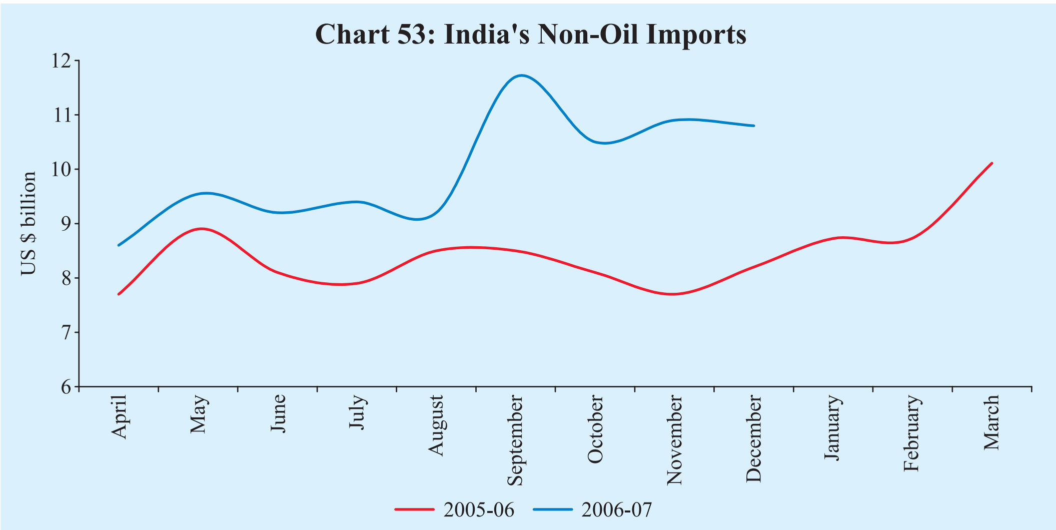
Table 46: Exports of Principal Commodities

Commodity Group	US $ billion			Variation (per cent)		
	2005-06	2005-06	2006-07	2005-06	2005-06	2006-07
		April-September			April-September	
1	2	3	4	5	6	7
1. Primary Products	**16.4**	**7.2**	**8.5**	**20.8**	**38.3**	**18.1**
of which:						
a) Agriculture and Allied Products	10.2	4.5	5.6	20.5	24.1	23.9
b) Ores and Minerals	6.2	2.7	2.9	21.4	71.1	8.2
2. Manufactured Goods	**72.2**	**34.6**	**41.0**	**18.9**	**28.8**	**18.6**
of which:						
a) Chemicals and Related Products	14.8	6.8	8.2	18.6	30.1	21.2
b) Engineering Goods	21.5	10.2	14.3	23.7	38.6	40.5
c) Textiles and Textile Products	16.3	7.7	8.5	20.6	21.1	10.4
d) Gems and Jewellery	15.5	7.8	7.8	12.8	26.4	-0.7
3. Petroleum Products	**11.5**	**4.9**	**9.8**	**64.9**	**67.2**	**100.4**
4. Total Exports	**103.1**	**48.0**	**61.2**	**23.4**	**33.4**	**27.5**
Memo:						
Non-oil Exports	91.6	43.1	51.4	19.6	30.5	19.2

Source : DGCI&S.



Growth in India's merchandise imports decelerated during April-December 2006 to 25 per cent from 38 per cent a year ago. Imports of petroleum, oil and lubricants (POL) increased by 39 per cent during April-December 2006, reflecting both higher prices and volumes. In volume terms, oil imports increased by 18 per cent during April-September 2006 as against a decline of 0.4 per cent a year ago. Non-oil imports, after remaining subdued in the beginning of current fiscal year, have picked up since September 2006 (Chart 53). Nonetheless, the overall growth in non-oil imports at 19 per cent during April-December 2006 was substantially lower than that of 34 per cent



recorded during the corresponding period of the previous year, mainly reflecting the decline in the imports of gold and silver, and pearls, precious and semi-precious stones (Table 47). Imports of capital goods remained buoyant, posting a growth of 39 per cent during April-September 2006 on top of 48 per cent in the corresponding period of 2005 in consonance with strong investment activity in the economy.

Country-wise, China was the largest source for India's imports during April-September 2006 with a share of 9.2 per cent in India's total imports, followed by Saudi Arabia (8.2 per cent), the US (5.8 per cent) and the UAE (5.1 per cent). Region-wise, developing countries (including OPEC) accounted for 66 per cent of India's imports; OPEC countries alone accounted for 33 per cent of India's total imports during April-September 2006.

The trade deficit widened to US $ 41.6 billion during April-December 2006 from US $ 31.7 billion a year ago (Table 48). The trade deficit on the oil account increased by US $ 3.7 billion during April-September 2006, while the non-oil trade deficit declined by US $ 0.3 billion.

Table 47: Imports of Principal Commodities

Commodity Group	US $ billion			Variation (per cent)		
	2005-06	2005-06	2006-07	2005-06	2005-06	2006-07
		April-September			April-September	
1	2	3	4	5	6	7
POL	44.0	21.0	29.5	47.3	43.7	41.0
Edible Oils	2.0	1.2	1.0	-17.9	-3.6	-11.8
Fertilisers	2.1	1.0	1.5	54.5	88.4	43.9
Iron and Steel	4.6	2.5	2.9	71.3	123.0	16.8
Capital Goods	37.7	14.2	19.7	49.9	47.8	38.8
Pearls, Precious and Semi-Precious Stones	9.1	5.4	3.6	-3.1	37.5	-32.8
Chemicals	7.0	3.5	3.9	22.5	48.9	9.1
Gold and Silver	11.3	7.0	6.7	1.5	58.5	-3.6
Total Imports	**149.2**	**70.8**	**87.3**	**33.8**	**47.0**	**23.4**
Memo:						
Non-oil Imports	105.2	49.8	57.8	28.8	48.5	16.1
Non-oil Imports excluding Gold and Silver	93.9	42.8	51.1	33.1	47.0	19.2
Mainly Industrial Imports*	87.5	39.5	47.3	34.7	48.2	19.7

* : Non-oil imports net of gold and silver, bulk consumption goods, manufactured fertilisers and professional instruments.

Source : DGCI&S.

Table 48: India's Merchandise Trade

(US $ billion)

Item	2004-05	2005-06	2005-06 April-December	2006-07 April-December
1	2	3	4	5
Exports	83.5	103.1	73.4	89.5
Imports	111.5	149.2	105.1	131.2
Oil	29.8	44.0	31.5	43.8
Non-oil	81.7	105.2	73.6	87.4
Trade Balance	-27.9	-46.1	-31.7	-41.6
Non-oil Trade Balance	-5.1	-13.6	-6.7*	-6.3*
				Variation (per cent)
Exports	30.8	23.4	29.9	22.0
Imports	42.7	33.8	37.8	24.8
Oil	45.1	47.3	46.9	39.2
Non-oil	41.8	28.8	34.3	18.7

* : April-September.
Source : DGCI&S.

Current Account

Earnings from exports of services and inflows under remittances remained buoyant during the second quarter (July-September) of 2006-07. Amongst major services, net surplus under software services amounted to US $ 6.1 billion during the quarter ended September 2006, an increase of 23 per cent from a year ago (Table 49). Private transfers at US $ 5.5 billion during

Table 49: Invisibles Account (Net)

(US $ million)

Item	2005-06 PR	2005-06 PR			2006-07		
	April-March	April-June	July-Sept.	April-Sept.	April-June PR	July-Sept. P	April-Sept. P
1	2	3	4	5	6	7	8
Services	23,881	5,647	6,079	11,726	7,744	6,554	14,298
Travel	1,389	87	185	272	257	-17	240
Transportation	-1550	-396	-286	-682	-164	219	55
Insurance	22	-14	240	226	111	162	273
Government, not included elsewhere	-197	-26	-63	-89	-24	-62	-86
Software	22,262	4,853	4,989	9,842	5,947	6,138	12,085
Other Services	1,955	1,143	1,014	2,157	1,617	114	1,731
Transfers	24,284	5,511	4,990	10,501	5,690	5,521	11,211
Investment Income	-4,921	-670	-1365	-2,035	-865	-921	-1,786
Compensation of Employees	-589	-121	-122	-243	-116	-149	-265
Total	**42,655**	**10,367**	**9,582**	**19,949**	**12,453**	**11,005**	**23,458**

PR : Partially Revised. P : Preliminary.

July-September 2006 were nine per cent higher than a year ago. Investment income deficit narrowed from a year ago, on account of higher earnings on India's external assets. On balance, the net surplus under invisibles (services, transfers and income taken together) increased from US $ 9.6 billion during July-September 2005 to US $ 11.0 billion during July-September 2006. The cumulative surplus increased to US $ 23.5 billion during the first half of 2006-07 from US $ 19.9 billion a year ago.

The net invisible surplus financed 61 per cent of the merchandise trade deficit during July-September 2006. However, in view of the large expansion in the merchandise trade deficit, the current account deficit widened to US $ 6.9 billion from US $ 3.6 billion a year ago. The current account deficit during the first half of 2006-07 (April-September 2006) at US $ 11.7 billion was also higher than that of US $ 7.2 billion a year ago (Table 50 and Chart 54).

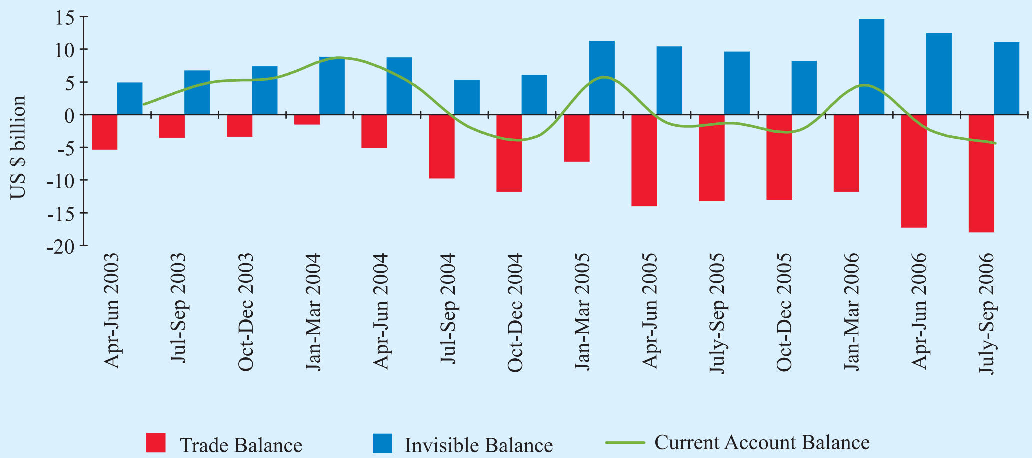
Table 50: India's Balance of Payments

(US $ million)

Item	2005-06 PR	2005-06 PR			2006-07		
	April-March	April-June	July-Sept.	April-Sept.	April-June PR	July-Sept. P	April-Sept. P
1	2	3	4	5	6	7	8
Exports	1,05,152	23,998	25,257	49,255	29,674	30,876	60,550
Imports	1,56,993	37,947	38,417	76,364	46,882	48,809	95,691
Trade Balance	-51,841 (-6.5)	-13,949	-13,160	-27,109	-17,208	-17,933	-35,141
Invisible Receipts	92,294	19,926	19,678	39,604	24,809	26,126	50,935
Invisible Payments	49,639	9,559	10,096	19,655	12,356	15,121	27,477
Invisibles, net	42,655 (5.3)	10,367	9,582	19,949	12,453	11,005	23,458
Current Account	-9,186 (-1.2)	-3,582	-3,578	-7,160	-4,755	-6,928	-11,683
Capital Account (net)*	24,238 [29,738]@	4,829	8,834	13,663	11,133	9,196	20,329
of which:							
Foreign Direct Investment	4,730	1,203	926	2,129	1,689	2,529	4,218
Portfolio Investment	12,494	972	4,441	5,413	-527	2,141	1,614
External Commercial Borrowings $	2,723 [8,223]@	1,116	1,809	2,925	3,838	1,255	5,093
Short-term Trade Credit	1,708	-151	1,123	972	417	1,521	1,938
External Assistance	1,682	212	197	409	48	310	358
NRI Deposits	2,789	-108	341	233	1,231	798	2,029
Change in Reserves #	-15,052	-1,247	-5,256	-6,503	-6,378	-2,268	-8,646

PR : Partially Revised. P : Preliminary.
* : Includes errors and omissions.
$: Medium and long-term borrowings.
: On a balance of payments basis (excluding valuation); (-) indicates increase.
@ : Excluding the IMD redemption.
Note : Figures in parentheses are per cent to GDP.

Chart 54: Current Account Balance



Capital Flows

Capital flows, both debt and non-debt, during 2006-07 so far have been higher than a year ago, reflecting growing investor interest in the Indian economy on the back of strong growth prospects and buoyant investment demand. Within non-debt flows, foreign direct investment (FDI) inflows at US $ 8.6 billion during April-November 2006 were almost twice the inflows in the corresponding period of the previous year (Table 51). FDI was channelled mainly into financial services, manufacturing, banking services, information technology services and construction. Mauritius, the US and Singapore remain the dominant sources of FDI to India. As regards portfolio equity flows, foreign institutional investors (FIIs) made large purchases in the Indian stock market during August-November

Table 51: Capital Flows

(US $ million)

Components	Period	2005-06	2006-07
1	2	3	4
Foreign Direct Investment into India	April-November	4,461	8,552
FIIs (net)	April-January *	5,790	2,491
ADRs/GDRs	April-November	1,715	1,850
External Assistance (net)	April-September	409	358
External Commercial Borrowings (net) (Medium and long-term)	April-September	2,925	5,093
Short-term Trade Credits (net)	April-September	972	1,938
NRI Deposits (net)	April-November	476	2,715

* : Up to January 12.

Note : Data on FIIs presented in this table represent inflows into the country. They may differ from data relating to net investment in stock exchanges by FIIs.

2006, more than offsetting the outflows witnessed during May-July 2006. During December 2006, however, FIIs registered outflows against the backdrop of volatility in Asian equity markets subsequent to the tightening of capital controls by Thailand. On the whole, net FII inflows during 2006-07 so far (up to January 12, 2007) amounted to US $ 2.5 billion. Resources mobilised through the issuances of American depository receipts (ADRs)/global depository receipts (GDRs) abroad were also higher during April-November 2006.

Amongst debt flows, demand for external commercial borrowings (ECBs) continued to remain strong in consonance with buoyant domestic investment activity. Net inflows under various NRI deposits during April-November 2006 were substantially higher than a year ago, partly attributable to higher interest rates on various deposit schemes. The ceiling interest rate on NRE deposits was raised by 25 basis points each in November 2005 and April 2006 to "LIBOR/SWAP rates of US dollar plus 100 basis points". The ceiling interest rate on FCNR(B) deposits was also raised by 25 basis points to "LIBOR/SWAP rates for the respective currency/ maturity" in March 2006 from "LIBOR/ SWAP rates *minus* 25 basis points".

Foreign Exchange Reserves

India's foreign exchange reserves have increased by US $ 26.5 billion during 2006-07 so far (up to January 19, 2007) to US $ 178.1 billion, mainly due to an increase in foreign currency assets (Table 52). India holds the fifth largest stock of reserves among the emerging market economies. The overall approach to the

Table 52: Foreign Exchange Reserves

(US $ million)

Period	Gold	SDR	Foreign Currency Assets	Reserve Position in the IMF	Total (2+3+4+5)
1	2	3	4	5	6
March 1995	4,370	7	20,809	331	25,517
March 2000	2,974	4	35,058	658	38,694
March 2005	4,500	5	135,571	1,438	141,514
March 2006	5,755	3	145,108	756	151,622
April 2006	6,301	6	153,598	772	160,677
May 2006	7,010	–	156,073	785	163,868
June 2006	6,180	–	155,968	764	162,912
July 2006	6,557	7	157,247	766	164,577
August 2006	6,538	1	158,938	767	166,244
September 2006	6,202	1	158,340	762	165,305
October 2006	6,068	7	160,669	648	167,392
November 2006	6,494	1	167,598	548	174,641
December 2006	6,517	1	170,817	546	177,251
January 2007 *	6,517	1	171,068	542	178,128

– : Negligible.
* : As on January 19, 2007.

management of India's foreign exchange reserves in recent years reflects the changing composition of the balance of payments and the 'liquidity risks' associated with different types of flows and other requirements. Taking these factors into account, India's foreign exchange reserves continued to be at a comfortable level and consistent with the rate of growth, the share of external sector in the economy and the size of risk-adjusted capital flows.

External Debt

India's total external debt was placed at US $ 136.5 billion at end-September 2006, an increase of US $ 4.3 billion over end-June 2006. The increase during the quarter was mainly on account of higher external commercial borrowings, NRI deposits and short-term trade credits. Higher commercial borrowings and short-term credits could be attributed to increased investment and import demand, while the rise in NRI deposits was, *inter alia*, on account of the upward revision in interest rates on these deposits. Sustainability indicators such as the ratio of short-term to total debt and short-term debt to reserves recorded a modest rise during the quarter but are still placed at quite low and comfortable levels (Table 53). Foreign exchange reserves remain in excess of the stock of external debt.

Table 53: India's External Debt

(US $ million)

Indicator	End-March 1995	End-March 2005	End-March 2006	End-June 2006	End-Sept 2006
1	2	3	4	5	6
1. Multilateral	28,542	31,702	32,559	33,101	33,594
2. Bilateral	20,270	16,930	15,727	15,834	15,734
3. International Monetary Fund	4,300	0	0	0	0
4. Trade Credit	6,629	4,980	5,395	5,498	5,663
5. External Commercial Borrowings	12,991	27,024	26,849	31,099	32,462
6. NRI Deposit	12,383	32,743	35,134	35,651	36,563
7. Rupee Debt	9,624	2,301	2,031	1,915	1,921
8. Long-term (1 to 7)	94,739	1,15,680	1,17,695	1,23,098	1,25,937
9. Short-term	4,269	7,524	8,696	9,105	10,579
Total (8+9)	**99,008**	**1,23,204**	**1,26,391**	**1,32,203**	**1,36,516**
Memo:					(Per cent)
Total debt/GDP	30.8	17.3	15.8	..	..
Short-term/Total debt	4.3	6.1	6.9	6.9	7.7
Short-term debt/Reserves	16.9	5.3	5.7	5.6	6.4
Concessional debt/Total debt	45.3	33.0	31.2	30.1	29.3
Reserves/Total debt	25.4	114.9	120.0	123.2	121.1
Debt Service Ratio*	25.9	6.1	10.2	..	..

* : Relates to the fiscal year.
.. : Not Available.