

INDIA

The Indian economy has shown healthy growth over the past few years, and should continue this trend in 2000 and 2001. However, higher interest rates, rising inflation, a weakening currency, and a large fiscal deficit point to uncertainties in the economic outlook.

Economic Indicator (percent)	1997	1998	1999	2000	2001
GDP growth	5.0	6.8	6.4	7.0	7.0
Inflation rate	4.4	5.9	3.3	7.0	5.0
Current account/GDP	-1.3	-1.0	-0.9	-1.2	-1.0

Economic Assessment. India's economy, growing at above 6 percent a year since 1998, has been one of the better performing economies in the region. Revised GDP estimates show that growth, earlier expected to be 5.9 percent, actually came in at 6.4 percent in 1999. Indications so far for 2000 suggest slightly higher growth due to better climatic conditions for agriculture, as well as a reasonable improvement in the industry sector and robust growth in the service sector.

With a favorable monsoon that had set in by end-July in practically the whole country, agriculture is expected to grow by 4–5 percent this year. The industry sector is forecast to attain a growth rate of nearly 7.5 percent in 2000. This upturn is likely to be maintained by strong growth in some subsectors, such as machinery, motorcycles, beverages, and cotton textiles. The service sector is expected to continue its strong performance achieved in the previous year. In general, the nonagriculture sector—accounting for almost 75 percent of GDP—is expected to expand by 7.5–8.0 percent in 2000.

Helped by the recovery in world trade and the depreciation of the rupee, exports recorded double-digit growth in 1999 after three consecutive years of sluggish performance. If the export growth achieved during April to June 2000 can be sustained, the target of double-digit export growth in 2000 will be reached. On the other hand, there has been a surge in the import bill as the cost of imported crude oil and petroleum products has almost doubled, reflecting the oil price hike. However, with exports growing slightly faster than imports and expected higher net invisible earnings, the current account deficit will remain at around a manageable 1 percent of GDP in the current fiscal year.

The macroeconomic environment appears less favorable this year than last. In recent years, the Reserve Bank of India (RBI) has maintained a policy of low interest rates and sufficient provision of liquidity to industry. This policy stance facilitated industrial recovery in 1999 and early 2000. The RBI tightened its monetary stance in the latter half of July 2000 by raising the bank rate and the cash reserve ratio. This was done in the wake of a weakening exchange rate and increasing fears of inflationary pressures. Inflation is likely to be higher at 7.0 percent in 2000, primarily on account

2000 refers to fiscal year 2000/2001, ending 31 March.

of rising fuel prices. Industrial recovery may be constrained by the likely increase in prime lending rates as commercial banks follow the RBI's lead.

Structural Issues. India's healthy economic performance over the past few years should not be taken as proof that the economy is fully utilizing its growth potential. In particular, the deteriorating fiscal health of central and state governments is significantly undermining the economy's long-term growth potential. Rising revenue deficits increase the cost of capital for private investment, thereby adversely affecting growth.

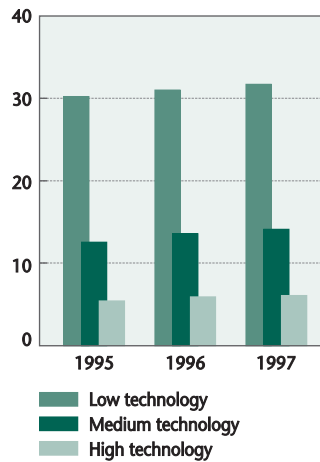
In agriculture, wide swings in production and low agricultural productivity have been largely the result of declining investment in irrigation. While Indian agriculture has the capability to grow at more than 4 percent annually, the performance of the sector has fallen far short of this due mainly to lack of capital. In fact, the rate of capital formation in agriculture declined to 9.2 percent in the 1990s from 21 percent in the 1970s and 1980s.

While industrial growth has recovered from its low point of about 4 percent in 1998 to 8 percent in 1999, it is unlikely that the industry sector will be the engine of sustained growth in the foreseeable future. Part of the reason is that the quality of basic infrastructure services is very poor. The situation is expected to worsen because of the severe financial difficulties of most state governments. In this regard, in July 2000 the Eleventh Finance Commission recommended a structural reform along with other fiscal changes designed to help state governments achieve zero revenue deficits by 2005.

However, India is progressing rapidly toward a service-oriented economy underpinned by a domestic and global boom in the information technology sector and facilitated by the Government's open economy policy. The changing nature of the economy will mean that growth in India will be increasingly driven by expansion in service activities such as call centers, back-office operations, retail chains, and telecommunications networks and not primarily by exports of manufactured goods, as in traditional export-oriented growth models.

Forecast. With favorable weather conditions for agriculture and a strongly growing service sector, the economy is likely to achieve the official growth target of 7.0 percent in 2000. Higher interest rates, rising inflation, and a weakening currency, however, as well as a persistently large fiscal deficit, cloud the economic horizon. The RBI will have to deal with a more complex situation in providing an adequate supply of credit to the productive sectors, preventing a further decline in the value of the rupee and keeping inflation below 7 percent. The fiscal deficit for 2000 is targeted at 5.1 percent of GDP compared with 5.6 percent of GDP actually recorded in 1999. The main challenge, however, is how to revive the economy's long-term growth potential and put it firmly on a path of higher growth of 8 percent or more.

Technology Exports as Share of Total (percent)



Ratio of Reserves to Short-Term External Debt (percent)

