Confederation of Indian Industry

State of the ECONOMY

JULY 2007

HIGHLIGHTS

- The global economy has expanded at a rate of 5.4 per cent in 2006. The buoyancy in the world economy is expected to continue with slight moderation in the GDP growth. According to the World Economic Outlook-2007, the global economy during 2007 would grow by 4.9 per cent.
- Indian Economy during the fourth quarter of the financial year 2006-07 grew at 9.1 per cent compared to 10 per cent during the same period in 2005-06. The GDP growth rate for the financial year 2006-07 was 9.4 per cent as per the revised estimate by CSO.
- CII expects a moderation in growth of GDP to 9.2 per cent during 2007-08. Agriculture, Industry and Services are projected to grow by 3.0 per cent, 9.4 per cent and 11.2 per cent respectively.
- Index of Industrial Production registered growth of 13.6 per cent in the month of April 2007 with Mining; Manufacturing and Electricity sectors contributing with growths of 3.4 per cent, 15.1 per cent and 8.7 per cent, respectively. Basic goods, capital goods and consumer durables have witnessed deceleration and recorded growth of 8.9 per cent, 17.7 per cent and 5.3 per cent respectively.
- The Index of Six core-infrastructure industries having a combined weight of 26.7 per cent in the Index of Industrial Production (IIP) with base 1993-94 stood at 225.5 in April 2007 registering a growth of 7.4 per cent as compared to 7.3 per cent in April 2006. During 2006-07, six core-infrastructure industries registered a growth of 8.6 per cent against 6.2 per cent recorded in 2005-06.
- The growth in Broad Money (M3) in 2006-07 was 20.8 per cent as compared to 17 per cent in 2005-06.
- Inflation, measured by variations in the wholesale price index (WPI) on a year-on-year basis, increased from 4.1 per cent at end-March 2006 to an intra-year peak of 6.7 per cent by the end-January 2007. On an average basis, annual inflation increased from 4.4 per cent in 2005-06 to 5.4 percent in 2006-07. The week ending 16th June 2007, inflation has moderated to 4.02 per cent.
- The fiscal position has improved over the last year. Revenue deficit, Primary deficit and Fiscal deficit are estimated to be 2.1 percent, 0.2 per cent and 3.6 per cent respectively in 2006-07.
- During the year 2006-07, export growth rate has decelerated to 20.9 percent from 23.4 per cent in 2005-06. Total export has increased from $103 billion in 2005-06 to $124.5 billion in 2006-07. The import growth rate has also slightly decelerated from 28.6 per cent in 2005-06 to 26.4 per cent in 2006-07.The trade deficit has increased to $56.75 billion in the year 2006-07.

GLOBAL ECONOMIC SCENARIO

The global economy has expanded at a rate of 5.4 per cent in 2006 and it is expected to decline slightly to 4.9 per cent during 2007 as per the World Economic Outlook-2007 released recently. China and India have performed well recording a growth rate of 10.7 per cent and 9.2 per cent respectively during 2006. However, the projected slowdown in the US economy to 2.5 per cent in 2007 from 3.1 per cent recorded in 2006 is a cause for concern, as it will dampen the increasing growth of world trade. The Growth in total world trade volume is expected to decline from 9.2 per cent in 2006 to 7.0 percent in 2007 with the import growth declining significantly for advanced economies from 7.4 per cent in 2006 to 4.7 percent in 2007.

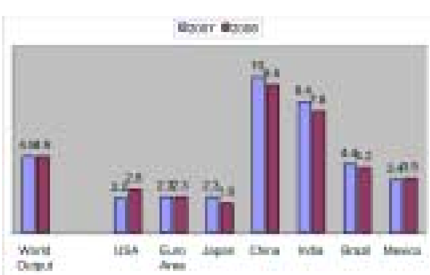
Growth Rates: Global Economic Scenario

	2005	2006	2007	2008
World Output	4.9	5.4	4.9	4.9
USA	3.2	3.3	2.2	2.8
Euro Area	1.4	2.6	2.3	2.3
Japan	1.9	2.2	2.3	1.9
China	10.4	10.7	10.0	9.5
India	9.2	9.2	8.4	7.8
Brazil	2.9	3.7	4.4	4.2
Mexico	2.8	4.8	3.4	3.5

Source: World Economic Outlook-2007

India and China, driven by investment and export growth, have been leading the world output growth. Strong growth and rising international oil prices in the first half of 2006 raised concerns about inflation, but inflationary pressures moderated in the second half, dampened by monetary policy tightening and the turnaround in oil markets. The oil price declines from August largely reflected some easing of security tensions in the Middle East, improved supply-demand balance in oil markets, and favorable weather conditions in the second half of 2006.

Growth Rates: Global Economic Scenario



Source: World Economic Outlook-2007

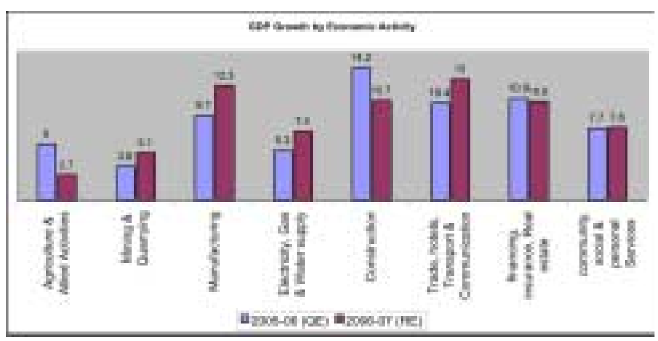
The world economy is expected to decline marginally in 2007 and 2008 from the rapid pace of 2006.The slowdown in growth in 2007 would be more pronounced in the United States. Emerging market and developing countries such as India and China are expected to continue to grow strongly, albeit at a slower pace than in 2006.

INDIAN ECONOMIC SCENARIO

A. GROSS DOMESTIC PRODUCTION:

The revised estimate of Gross Domestic Product for the financial year 2006-07, released by the Central Statistical Organisation (CSO), shows that the Indian economy has registered a growth rate of 9.4 percent in terms of GDP at factor cost at constant (1999-2000) prices. The sectors which have shown growth rates of 5 per cent or more, are 'mining and quarrying' (5.1 per cent), 'manufacturing' (12.3 per cent), 'electricity, gas and water supply' (7.4 per cent), 'construction' (10.7 per cent), 'trade, hotels, transport and communication' (13.0 per cent), 'financing, insurance, real estate and business services' (10.6 per cent), and 'community, social and personal services' (7.8 per cent).

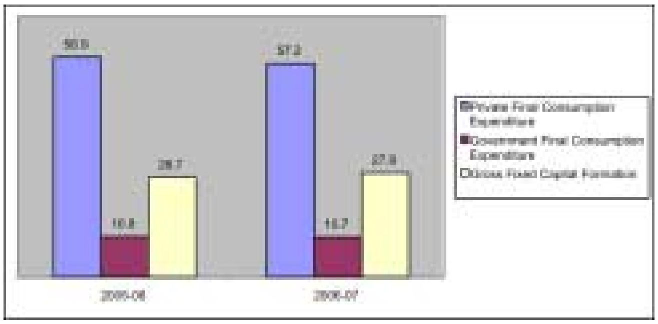
The quarterly estimates for Q4 (January – March), 2006-07 estimated GDP at Rs. 7,77,866 crore, as against Rs.7, 13,104 crore in Q4 of 2005-06, showing a growth rate of 9.1 per cent. GDP growth rates were 9.6 per cent, 10.2 per cent and 8.7 per cent for Q1, Q2 and Q3 of 2006-07 respectively.



Source: CSO

The CSO has also released for the first time, the estimates of expenditures of the GDP at current and constant (1999-2000) prices. Private Final Consumption Expenditure (PFCE) at constant (1999-2000) prices, is estimated at Rs. 17,78,697 crore in 2006-07 as against Rs. 16,75,025 crore in 2005-06.

The rate of PFCE in terms of GDP at market prices at constant (1999-2000) prices during 2006-07 is estimated at 57.2 per cent, as against the corresponding rates of 58.9 per cent in 2005-06. Government Final Consumption Expenditure (GFCE) at constant prices is estimated at Rs.3, 33,713 crore in 2006-07 as against Rs. 3,06,087 crore in 2005-06. In terms of GDP at market price, the rate of GFCE at constant (1999-2000) prices during 2006-07 is estimated at 10.7 per cent as against the corresponding rates of 10.8 per cent in 2005-06. Gross Fixed Capital Formation (GFCF) at constant prices is estimated at Rs. 8,68,618 crore in 2006-07 as against Rs. 7,57,806 crore in 2005-06. In terms of GDP it is estimated at 27.9 per cent in 2006-07 as against the corresponding rate of 26.7 per cent in 2005-06.



Source: CSO

CII expects a lower growth of 9.2 per cent in 2007-08 owing to factors such as global slowdown, inflation, falling demand as a consequence to rising interest rates, appreciating rupee and poor infrastructure. Agriculture is expected to improve its growth performance from 2.7 per cent to 3 per cent, mainly owing to low base of last year and attempts to increase production of primary articles to boost supply in order to contain rising prices. In view of RBI's tight monetary policy, the growth of Industry is expected to slowdown to 9.4 per cent. Services on the other hand is expected to grow at 11.2 per cent, marginally higher rate than the previous year owning to strong demand for services especially for Financial services, Business Services including IT & ITES during the year 2007-08. However, this projection is based on the assumption that the RBI would now ease on tightening the monetary policy significantly.

Sectoral GDP Growth (Per cent)

	2005-06	2006-07(R)	2007-08 F
Agriculture	6(19.7)	2.7(18.5)	3.0
Industry	9.6(26.1)	10.9(26.6)	9.4
Services	9.8(54.1)	11(54.9)	11.2
GDP at factor cost	9	9.4	9.2

Source: CSO.

Note: (1) Figures in parenthesis are respective shares in total GDP,

(2) R = CSO Revised estimate, F = CII forecast,

(3) Growth is calculated from GDP at factor cost and constant1999-2000 prices

1. AGRICULTURE

Agriculture, forestry & fishing as a sector has recorded a growth of 2.7 percent at constant prices in 2006-07 as compared to 6 per cent recorded in 2005-06, as per the revised estimates of GDP at factor cost by economic activities. In absolute value, the contribution is estimated to be Rs.525875 crore as against Rs.512147 crore in 2005-06.

Total Food grains production has been estimated at 211.78 million tones. Rice and Wheat production have been estimated at 91.05 and 73.70 million tonnes respectively. Sugarcane has recorded a production of 322.94 million tonnes. Total food grain production during the Kharif season has come down to 108.36 million tonne in 2006-07 from 109.87 million tonne in 2005-06. However, the food grain production in Rabi season has gone up to 103.42 million tonne from 98.73 million tones in 2005-06.

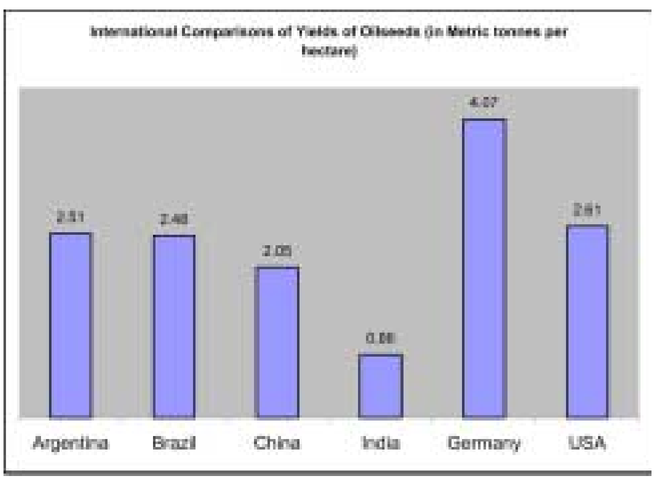
Agricultural Production

Crops	Growth (%) 2006-07*	Growth (%) 2005-06
Total Food grains	1.57	5.76
Rice	-0.81	10.40
Wheat	6.31	1.01
Coarse Cereals	-2.89	1.76
Total Cereals	1.08	6.25
Total Pulses	5.22	2.34
Total Oilseeds	-14.79	13.75
Total Fibres	4.87	14.33
Sugarcane	14.85	18.62
Tobacco	0.00	0.54
Non-Food grains	9.69	-3.06
All Principal Crops	6.95	5.39

Source: Ministry of Agriculture and Cooperation, GOI

Total oilseeds production has declined and recorded 23.26 million tonne mark against the target of 29.40 million tonne in 2006-07, registering a negative growth rate of 14.79 per cent. Decline in oilseeds production is a cause of concern, as it will lead to increase in the import of edible oil due to its reduced domestic production and rising demand because of the rising income levels and growing popularity of fast foods among the rich and upper middle class. Therefore, there is a need to restructure domestic pricing policy of various crops as farmers are switching from oilseeds crops like mustard to more lucrative alternatives like wheat and gram. The minimum support price offered to farmers for mustard has remained the same in 2006-07 at Rs.1715 per quintal as it was in 2005-06, while the minimum support price for wheat has increased to Rs.750 per quintal from Rs.650 per quintal in 2005-06.

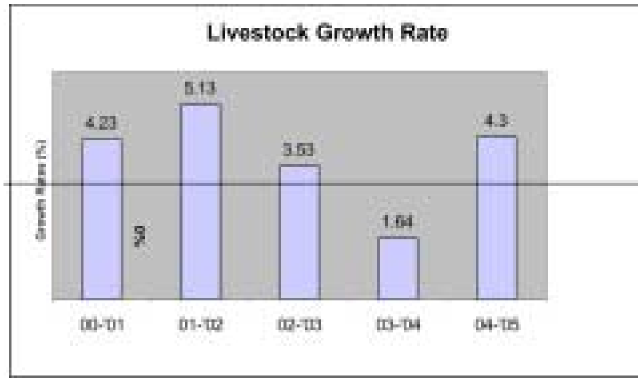
International comparison of yield of major oilseeds suggests that the yield per hectare is very low in comparison to other countries such as Argentina, Germany and Brazil. Yield in India is only 0.86 metric tonnes per hectare in comparison to China's 2.05 and Brazil's 2.48.



Source: Ministry of Agriculture and Cooperation, GOI

Keeping in view a very low productivity of oilseeds, there is an urgent need of inducting improved technology to enhance the productive efficiency of these crops.

Livestock is another area where India holds immense potential. As the most recent data suggests, the Livestock sector has grown at a rate 4.3Per cent in the year 2004-05.



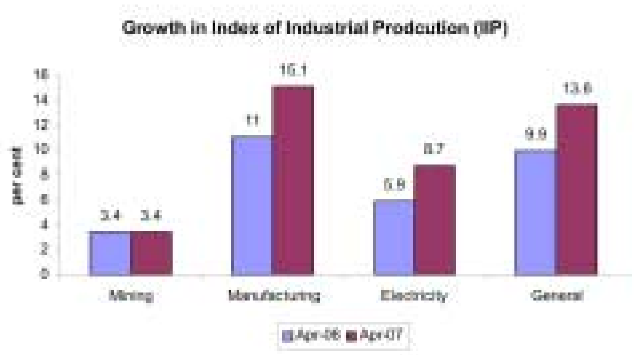
Source: Ministry of Agriculture and Cooperation, GOI

There is an alarming gap in the demand and supply of both dry and green fodder. The Department of Animal Husbandry, Dairying and Fisheries is setting up Livestock Food Production Corporation for promoting production and consumption of nutritious fodder and feed by the animals. There is an urgent need for maintaining complementary relationship between agriculture and livestock as rising prices of maize in the market is affecting the poultry industry.

2. INDUSTRIAL PRODUCTION

The growth rate in the manufacturing sector is 15.1 per cent in April 2007 as compared to the same month in 2006. It is a significant improvement from the growth rate of 12.5 per cent recorded in March 2007. The Electrical Sector has also registered a higher growth rate of 8.7 per cent. The increase in the growth rates in these two sectors has led the industrial growth rate to 13.6 per cent. In addition to the electrical sector, wood and wood products and food products have shown higher growth rates of 92.2 per cent and 55 per cent respectively. Other sectors, which have shown significantly higher growth rates, are Jute sector (17.7 per cent), Leather and leather products (14.7 per cent). Machinery and Equipment (19 per cent) and Basic Metals (18 per cent) The higher rate of growth in food products can be attributed to growing incomes, changing lifestyles and growth in organized retailing.

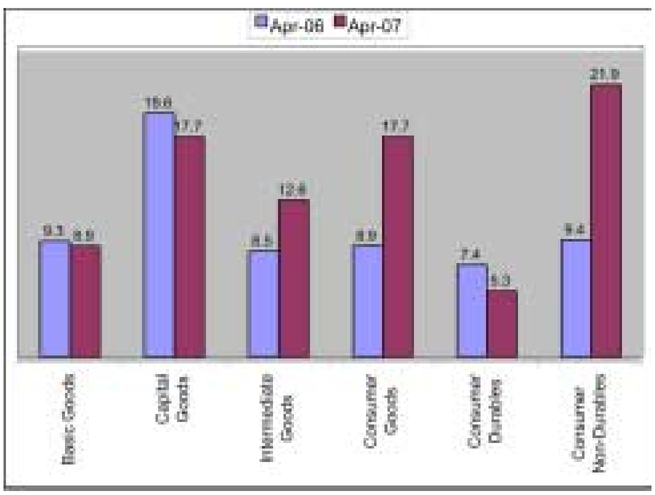
The high rates of IIP growth during the month of April 2007 was expected as a result of the increase in the investment rate, capital efficiency and overall productivity. With sustained productivity improvements, we could expect an upward trend in industrial growth even if we have a moderate increase in



Source : CSO

There are some sub sectors in manufacturing which have shown either negative or declining growth rates. The manufacturing industries categorized as 'other manufacturing industries' have shown –5.4 per cent growth rate. The declining growth rates in some sub sectors such as 'Transport Equipment' sector can be linked to the present tight monetary policies being followed by Reserve Bank of India. The Capital Goods sector and Consumer-non-durable sector have recorded lower growth rates of 17.7 per cent and 21.9 per cent respectively.

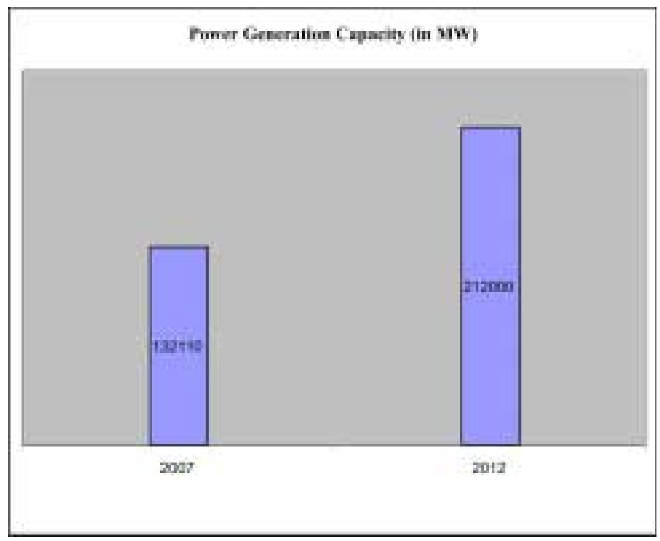
Use-based Growth (%) in Industrial Production



Source : CSO

The declining growth rate in the Capital Goods and Consumer-non-durable sectors, which are very essential for sustaining the momentum of high growth, can have negative impact on the overall growth of the economy. It is still too early to revise the overall GDP projection. The reason is that despite the tight monetary policy of RBI, the economy has recorded a higher growth rate in the fourth quarter that took the overall GDP growth rate to 9.4 per cent for the year 2006-07.

The growth trend is sustainable provided the infrastructure growth is maintained to keep the present growth in GDP going. The objective of achieving power for all by 2012 requires additional power generation capacity of 212000 MW. The present installed capacity is only 132110 MW. Another constraint to the ongoing growth momentum is the shortage of road networks and poorly maintained national highways. While India adds about 1.7 km of roads every day, China has added 8,500 kms of roads in the last one year. Hence, increasing connectivity will be one of the vital factors for sustaining current levels of growth. Infrastructure sector alone will need more than US $ 340 billion of investments in the next 5 years. This calls for financial sector reforms with focus on deepening the capital markets by bringing back the vibrancy in corporate debt market. Deepening the Corporate Debt would be a great enabler to finance infrastructure development.



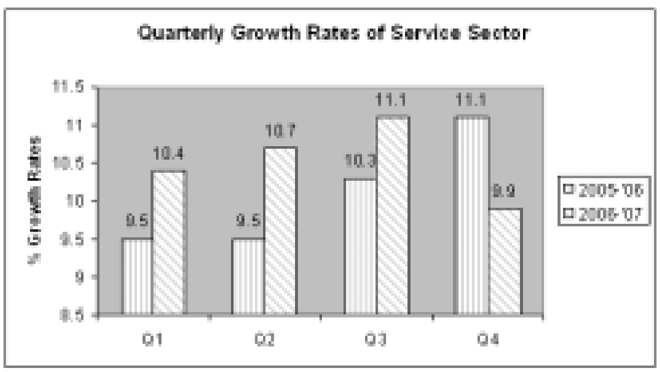
Source: Ministry of Power, GOI

We have already seen signs of decline in growth in consumer durables and capital good sector. While the impact of the increase in interest rates would have a lagged effect, the early signs of decline in growth in consumer durables sector is a testimony to the fact that increase in interest rates does affect growth in certain sector where demand is credit driven. In this light, RBI should not further increase interest rates and must look for other instruments to control prices.

The dip stick survey done by CII on behalf of National Manufacturing Competitive Council (NMCC) to assess the impact of the rise in interest rates, has reported negative impact on business due to the increase in cost of financing. Pumps, paints, machine tools, office automaton, chemicals are a few sectors which have reported high negative impact

3. SERVICES SECTOR

The services sector has registered an impressive growth rate of 10.8 per cent in the year 2006-07, well above 9 per cent rate recorded in 2005-06 and faster than the average annual growth of 8.2 per cent recorded in the first four years of the Xth Five Year Plan (2002-2006). The three major components of the service sector namely, ‘Trade, Hotels and Communications’, ‘Financing, Insurance, Real Estate and Business’ and ‘Community, Social and Personal Services’ grew at 13.0 per cent, 10.6 per cent and 7.8 per cent respectively. The surge in growth exhibited by the service sector in the first three quarters of 2006-07 has declined by a considerable margin as can be seen from the quarterly growth figures of this sector for the years 2005-06 and 2006-07.



Source: CSO

The decline is evident in the growth figures for the three major components of service sector as two of the three major sub sectors namely, ‘Financial, Insurance, Real Estate & Businesses services’ and ‘Community, Social and Personal Services’ experienced a deceleration while the growth of ‘Trade, Hotels, Transport and Communication.’ showed a marginal improvement to 12.4Per cent from 11.8Per cent a year ago.

The tourism sector has shown an improvement in 2006-07 with a growth rate of 14.4Per cent as compared to 12.1Per cent last year though the number of tourist arrivals in the country has fallen from 5.1 lakh in January 2007 to 3.3 lakh in April 2007. This is reflected in reduced foreign exchange earnings from US $ 745 million to US $ 555 million. In the automobile sector the commercial vehicles production has experienced a sharp rise with a staggering growth of 34.8Per cent in the April-January period as compared to 10Per cent in the corresponding period of the last year. But the production growth has drastically fallen in April 2007 registering a growth rate of 22.7Per cent as against 49.7Per cent a year ago because of increase in the interest rate

Quarterly Growth Figures of Major Components of Services Sector

Item	2005-06				2006-07			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Trade, Hotels, Transport & Commn.	10.2	9.5	10.0	11.8	13.1	13.8	13.0	12.4
Financing, Ins., Real est. & Bus.	8.9	10.6	9.8	10.4	9.0	9.5	11.6	9.3
Community, Social & Personal	7.5	7.9	8.3	7.2	7.4	6.9	7.5	5.7

Source: CSO

and tightening of lending rules on March 30, 2007 to curb inflation in the domestic economy resulting in the erosion of demand and sales. The growth rate of new cell phone connections has continued to be impressive at 96.4 per cent in the April 2006 to January 2007 period as against 68.0 per cent for the corresponding period last year reflecting the way telecom infrastructure has been penetrating into every layer of our society. Revised ceiling rates of roaming charges issued by TRAI across all segments, another notification of TRAI stating rental charges for roaming in any form to be abolished, revenue sharing by telecom firms, united licensing scheme have been some of the major factors responsible for reduction in call rates in India with the consequent increase in the number of mobile subscribers to 212 million in April 2007. As a result the teledensity now has increased to 18.31Per cent in March 2007 from 13.09Per cent in March 2006.

I. Indicators of Service Sector Activity (Growth rates in % terms)	2006-07	2005-06
1.Tourism (April-March)		
Tourist Arrivals (in numbers)	14.4	12.1
2.Transport		
Automobiles (April-January)		
Commercial vehicles production	34.8	10.0
Railways (April-January)		
Railway revenue earning freight traffic	9.4	10.4
Civil Aviation (April-March)		
Freight handled at international terminals	10.9	18.6
Freight handled at domestic terminals	10.1	22.2
Passengers handled at international terminals	15.1	16.7
Passengers handled at domestic terminals	38.5	24.2
Shipping (April-March)		
Cargo handled at major ports (in tones)	9.5	10.4
3.Communications (April 2007)		
New cell phone connections	96.4	68.0
4.Banking and Finance (April-May)		
Aggregate Deposits	0.4	0.8
Non-Food credits	-1.8	-1.2
5.Public Administration (April-February)	14.3	7.7
Central Govt. expenditure		

Sources: Data taken from respective government ministries, RBI and CMIE.

B. MONEY AND INFLATION

Supply of money

Broad money (M3) growth accelerated to 20.8 per cent during 2006-07 from 17.0 per cent in 2005-06. The M3 growth was much higher than the projected growth rate of 14.5 per cent. Amongst the major components of M3, growth in the demand deposits was 15.2 per cent in the year 2006-07 against 26.5 per cent a year ago. Growth in time deposits of banks accelerated to 22.8 per cent from15.3 percent during the same period. This significant increase in time deposits is attributed to higher economic activity, increase in interest rates on deposits and extension of tax benefits under Section 80C for deposits with maturity of five years and above.

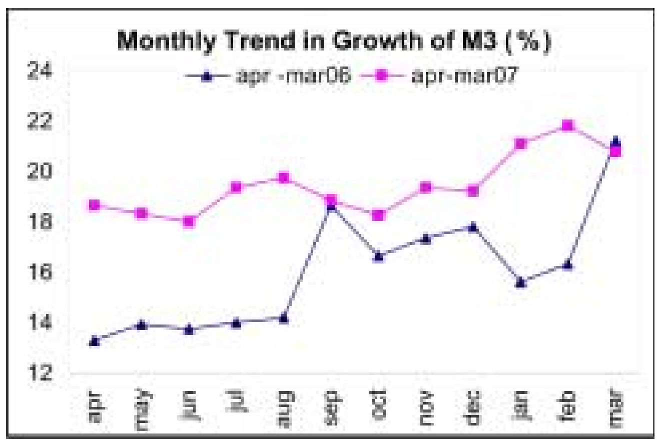
Component and Sources of M3

Items	2005-06	2006-07	Outstanding as on march 31, 2007 (Rs. in Crore)
Broad money (M3)	17	20.8	3296919
Currency with public	16.4	17.2	484171
Demand deposits with banks	26.5	15.2	468216
Time deposits with banks	15.3	22.8	2837045
Main Sources of change in M3			
Net bank credit to government	2.4	8.8	832867
Net bank credit to commercial sector	27.2	25.4	2123290
Net foreign exchange assets of banking sector	12.1	28.1	930319

Source: RBI

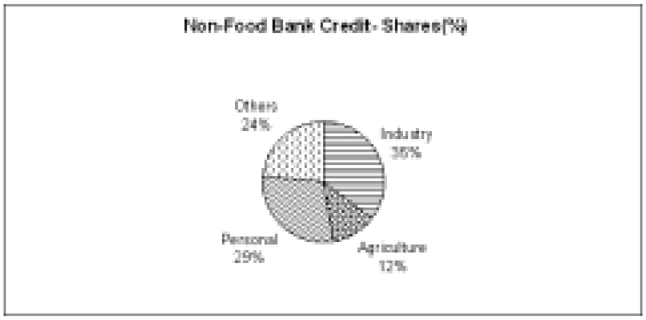
The major source of change in M3 was the acceleration in the net foreign exchange assets of banking sector from 12.1 per cent by the end of march 2006 to 28.1 per cent by the end of March 2007. Increasing growth in the net foreign exchange assets of banking sector reflects the high growth in FDI and FII inflows. The net bank credit to Government has also seen acceleration due to increase in commercial borrowing from the Government. The monthly trend in the growth rate of broad money in the year 2006-07 has been consistently (except for the month of September and march) higher than that in the year 2005-06.

Demand for bank credit has been quite high during 2006-07, *albeit* with a marginal deceleration. On a year-on-year basis, scheduled commercial banks' (SCBs) non-food credit registered a growth of 28.0 per cent by end-March 2007 against 31.8 per cent a year ago. The incremental credit-deposit ratio of SCBs, after remaining around 100 per cent for the most part between October 2004 and September 2006, has exhibited some moderation in subsequent months reflecting the combined impact of acceleration in deposit growth and modest deceleration in credit growth. By the end-March 2007, the incremental credit-deposit ratio reached around 86 per cent as compared to 110 per cent a year ago.



Source: CMIE

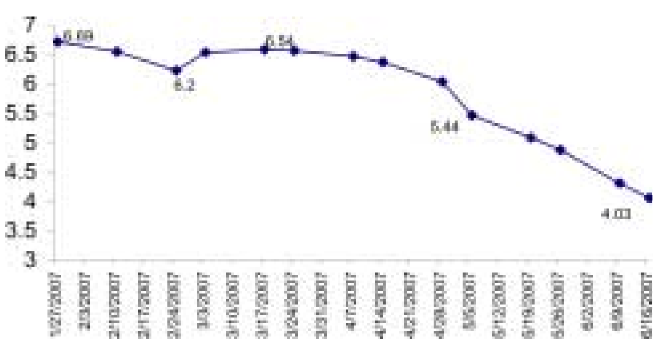
The disbursal of credit across different sector has been broad based. The latest data, which is available up to 22nd December 2006, shows that 35.33 per cent of the incremental non-food credit went to industry (of which 4.89 per cent went to small scale industries), 28.75 per cent went to personal loans (13.16 per cent of which was housing loans), 12.21 per cent to Agriculture and allied activities and 23.71 per cent to others (like trade, real estate etc).



Source: RBI

Inflation

Inflation, measured by variations in the wholesale price index (WPI) on a year-on-year basis, increased from 4.1 per cent at end-March 2006 to an intra-year peak of 6.7 per cent by the end-January 2007 and remained firm in the range of 6.1-6.6 per cent in the succeeding weeks. On an average basis, annual inflation increased from 4.4 per cent in 2005-06 to 5.4 percent in 2006-07. Prices of primary articles rose by 10.7 per cent as against 4.8 per cent a year ago, largely on account of rising prices of food articles such as wheat, pulses, fruits and milk, and posed upward pressures on headline inflation through 2006-07. Prices of manufactured products increased steadily to 5.8 per cent from 1.9 per cent a year ago. Inflation in terms of prices of manufactured products ruled consistently above 5.0 per cent from early November 2006 and generally above 6.0 per cent since end-January 2007. Prices of the 'fuel, power, light and lubricants' group increased by 1.0 per cent in 2006-07 as against 8.3 per cent a year ago. The average price of the Indian basket of international crude varieties increased from US $ 55.4 per barrel in 2005-06 to US $ 62.4 per barrel in 2006-07. Excluding mineral oils, WPI inflation works out to 6.6 per cent on March 31, 2007 as against 2.9 per cent a year ago.



Source: CMIE

Inflation rate has come down to 4.02 per cent in the week ending 16th June 2007, showing the effects of tight monetary policies However, sustaining growth above 9 per cent requires moderation of interest rate.

C. PUBLIC FINANCE

There has been a slight improvement in the fiscal and revenue deficit in terms of GDP in 2006-2007. Revenue deficit, Primary deficit and Fiscal deficit are estimated to be 2.1 percent, 0.2 per cent and 3.6 per cent respectively.

Year	2005-2006	2006-07
Revenue deficit	**2.7**	**2.1**
Primary deficit	**0.4**	**0.2**
Fiscal deficit	**4.1**	**3.6**
Rev deficit as a % of fiscal deficit	**64.7**	**57**

Source : Ministery of Finance, GOI

There has been a heavy increase in the revenue receipts, which is 24.8Per cent. During the last financial year the net tax revenue registered a growth of 30.1, while the non-tax revenue grew by 6.5Per cent. It was possible due to high growth rates in the manufacturing and the service sectors. The introduction of state level VAT has contributed to the development of uniform tax regime. The minimum alternative tax (MAT) rate was increased to 10Per cent of book profit in the current budget. The rationalization of the FBT and the tax on banking cash transaction over a certain threshold limit per day introduced in the current budget will help to increase the revenue further. The total revenue receipts which is measured as the sum of revenue receipts and non-debt capital receipts witnessed a growth of 23.1 per cent.

The tax collection in the last financial year was robust. Income tax collections rose to 35.6 per cent and corporate tax collections stood at a staggering rate of 41.6 per cent and the realization was 97.9 per cent of the budgetary estimate. Growth in indirect tax was also high due to the high growth in service tax, which stood at 62.8 per cent. The contribution of customs duty was also significant and registered a growth of 32.7 per cent. The overall tax collection grew at 29.4 per cent, which is necessary to meet the FRBM targets.

D. CORPORATE PERFORMANCE

The impressive performance of Corporate Sector continued in the last quarter of the financial year 2006-07, showing consistency with the GDP growth rate of 9.1 per cent achieved in that quarter (Q4). On almost all the parameters, Corporate Sector has done better during Q4 in comparison to the same quarter of the previous financial year. The analysis of the results of 3283 firms comprising of 1971 firms from manufacturing and 1312 firms from services shows that the net sales growth has recorded a growth rate of 19.35 per cent in Q4 from January to March as compared to the growth rate of 17.86 per cent achieved during the same quarter in financial year 2005-06. The profit after tax (PAT) has registered a significant increase in the growth from 13.68 per cent in Q4 of 2005-06 to 19.12 percent in Q4 of 2006-07. The only thing that can be reflective of the rising interest rate due to the tight monetary policies of RBI is the rising interest payment. The interest payment has recorded a substantial increase at the rate of 44.90 per cent in Q4 of 2006-07 as against the increase of 19.54 per cent in the same quarter of 2005-06.

Items	**2005-06**	**2006-07**
Net sales	17.86	19.35
Op. Expenditure	**20.78**	**16.63**
Raw materials	**21.68**	**18.30**
Personnel cost	**16.85**	**31.88**
Power & fuel	**24.59**	**3.49**
Other expenses	**15.80**	**7.51**
PBDIT	**15.54**	**28.94**
Interest	**19.54**	**44.90**
PBDT	**14.13**	**23.05**
Depreciation	**10.45**	**15.25**
PBT	**15.12**	**25.36**
PAT	**13.68**	**19.12**

Source: CMIE, Prowess. Sample Size: Corporate: 3283; Manufacturing = 1971; Services = 1312

The significant increase in the profitability of the corporate sector can also be explained by the improved efficiency parameters. The ratio of operating expenses to net sales declined from 82.6 per cent in Q4 of 2005-06 to 80.7 percent in Q4 of 2006-07 despite the increase in the interest as a ratio of sales from 6.9 per cent to 8.4 per cent. During the same period Manufacturing sector has shown an increase in the ratio from 88.6 per cent to 89.1 per cent; while Services has registered a significant decline from 65.2 to 57.7 percent during the same period. Therefore, it is very clear that the improved efficiency is the result of the better performance by the Services Sector.

	Corporate Sector		Manufacturing		Services	
	2005-06	2006-07	2005-06	2006-07	2005-06	2006-07
Op. Exp/net sale	82.6	80.7	88.6	89.1	65.2	57.7
Raw materials/net sale	56.2	55.7	68.0	68.6	21.9	20.3
Personnel cost/net sale	6.3	7.0	4.1	4.7	12.9	13.2
Power & fuel/net sale	1.8	1.6	2.3	2.0	0.7	0.6
Other expenses/net sale	16.2	14.6	12.4	12.2	27.2	20.9
PBDIT/net sale	25.6	27.6	18.7	18.5	45.5	52.5
Interest/ net sale	6.9	8.4	1.5	1.7	22.4	26.5
PBDT / net sale	18.7	19.2	17.1	16.8	23.2	26.0
Depreciation/net sale	3.3	3.2	3.6	3.4	2.2	2.4
PBT /net sale	14.0	14.7	13.5	13.3	15.6	18.6
PAT/net sale	10.3	10.3	9.8	9.0	12.0	14.0

Source: CMIE, Prowess. Sample Size: Corporate: 3283; Manufacturing = 1971; Services = 1312

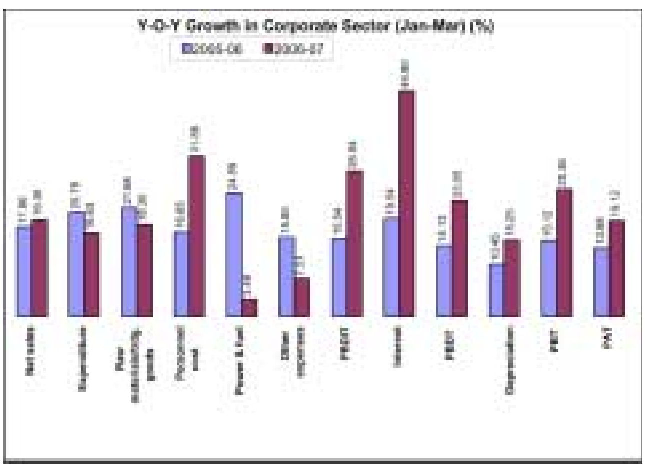
The Service Sector has shown a significant decline in the growth of operating expenditure from 16.33 per cent to 10.41 per cent while showing an increase in the growth rate in net sales from 16.48 per cent to 24.74 per cent. Though the interest payments has increased significantly showing a growth from 21.63 per cent to 47.68 per cent in Q4 of 2006-07, the services companies have registered growth rate in net profits to the extent of 45.68 per cent against the growth in profit at the rate of 10.32 per cent in the Q4 of 2005-06. The growth rate of net profits of manufacturing has declined during the same period from 15.17 per cent to 7.91 per cent.

Y-O-Y Growth in Manufacturing and Services (Jan-March) (Per cent)

	Manufacturing		Services	
Item	2005-06	2006-07	2005-06	2006-07
Net sales	18.35	17.49	16.48	24.74
Op. Expenditure	21.96	18.21	16.33	10.41
Raw materials	22.35	18.58	15.96	15.74
Personnel cost	11.23	36.55	22.49	27.63
Power & fuel	21.13	3.20	73.26	6.31
Other expenses	13.96	16.36	18.30	-4.14
PBDIT	14.95	16.35	16.25	43.86
Interest	10.04	30.98	21.63	47.68
PBDT	15.41	15.04	11.50	40.17
Depreciation	16.07	10.96	-10.21	35.66
PBT	15.23	16.12	14.85	48.39
PAT	15.17	7.91	10.32	45.68

Source: CMIE, Prowess. Sample Size: Corporate: 3283; Manufacturing = 1971; Services = 1312

It seems that the appreciation of the rupee had no significant impact on the corporate performance in the fourth quarter of the financial year 2006-07. However, it has started impacting the profit margin of textile and leather sectors. The appreciating rupee could significantly erode profit margin of textile & apparel as well as leather & leather products sector. The **CII survey** of textiles and apparel companies engaged in exports revealed that there has been a decline in total revenue, operating income and profit margin to the tune of 7.9Per cent, 8.9Per cent and 7.9Per cent respectively and further, there could be an erosion of profit margins to the extent of 10.4 percent during the next six months only on account of appreciation of the rupee. If we add the impact of rise in interest rates on the profit margins, it is a further decline of another 1.5 percent. This impact assumes that the exporters would maintain their export share. However, if we take into account the loss of market share, the impact would lead to further depletion in profit margins.



Source: CMIE, Prowess. Sample Size: Corporate: 3283; Manufacturing = 1971; Services = 1312

The impact of the appreciation is worse in the leather and leather products sector. The erosion of profits expected in the next 6 months is 13.7 percent and the industry is already facing an erosion of 8.8 percent on its profit margin. The erosion is higher in profits margin than in operating income due to impact of rising interest rates, which depletes a further 2 per cent off the profit margin. Moreover, this sector also faces an import threat from China, Bangladesh and Pakistan in the domestic markets. Leather and leather products units operate with very low margins and the impact of the rupee appreciation alone would lead to unsustainable loss on margins for the industry.

The erosion of the profits margin of textiles & Apparel and Leather & Leather products could have a long lasting impact on employment as these sectors are highly labor intensive. Moreover, if corrective actions are not taken at the earliest, we might even see credit defaults leading closure of the units. While the data above reveals the average erosion of margins, responses from the smaller players indicate even higher erosion in profit margins.

The appreciation of Indian Rupee by 11 per cent during the last twelve months has cast doubts on achieving the US $ 160 billion export target set for the current year. The exporters remain in a disadvantageous position especially in price sensitive international markets where competing Asian countries have experienced either significantly lower rates of appreciation of their respective currencies or their currencies have depreciated during the same period. For instance, Asian currencies like Chinese Yuan have appreciated by 4.6 per cent and on the other hand Pakistani Rupee and Bangladeshi Taka have depreciated by 1.4 and 0.43 percent respectively making their products more competitive in the international markets against Indian exports.

CII suggests the following initiatives that could counter the impact of the appreciating rupee on exports and provide a shield to exporters on a short-term basis to deal with the erosion of profit margins. (1) Duty Entitlement Pass Book (DEPB) and Duty Drawback rates may be enhanced by 5 per cent. (2) Rate of interest on pre-shipment and post-shipment credit be reduced for exporters to 6 per cent. (At present, the rate of interest charged is in the range of 9 to 11 per cent). (3) Exchange Earners' Foreign Currency (EEFC) Accounts may be made interest bearing. (As on date, EEFC Account deposited is stated as current account and interest on it discontinued since 2000). (4) Scheduled Commercial Banks may be mandated to meet 15Per cent export credit disbursement target. (5) Notify the Service Tax Exemption / Refunds for exports announced in the Foreign Trade Policy 2007 without further delay. (6) Export Credit & Guarantee Corporation (ECGC) will reduce its premia rates by up to 10Per cent to make exports more competitive. (7) A special concessional rate of interest to be charged by Banks for working capital loan requirements of exporters especially for the textiles & apparel and Leather & Leather products sector.

E. EXTERNAL SECTOR

The latest statistics on foreign trade of India shows the rising import of the non-oil items and increasing trade deficit. India's merchandise exports is estimated at US$ 22.4billion for the period April-May, 2007 as against US$ 18.6 billion during the same period last year, registering an increase of 20.37 per cent. The value of Import for the same period (April-May, 2007) is US$35.7 billion as against US$26.8 billion during the same period last year.

The total value of Oil imports for the same period stand at US$9.16 billion, which is 1.01Per cent higher than the Oil imports of US$ 9.07 billion in the corresponding period last year. Non-oil imports during April-May, 2007 are US$ 26.5 billion which is 49.42Per cent higher than the level of such imports valued at US$ 17.7 billion in April-May, 2006. The trade deficit for April-May, 2007 is estimated at US $ 13.2 billion, which is higher than the deficit at US $ 8.2 billion during April-May, 2006.

During the financial year 2006-07, there has been a deceleration of growth in the merchandise trade as compared to the financial year 2005-06. The growth of exports declined to 20.9 per cent from 23.4 per cent and import growth declined to 26.4 per cent from 28.6 per cent during the same period.

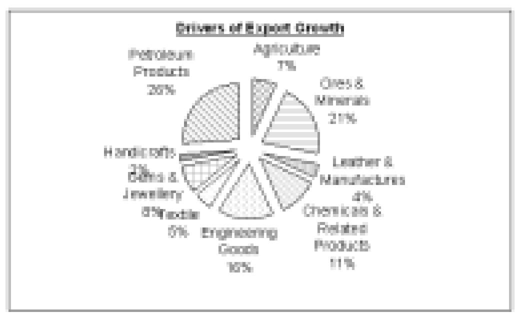
Cumulative exports during the period April-March, 2006-07 stood at US $ 124.6 billion thus achieving the export target set by the Government at US $ 125 billion. The month by month study of the export for the years 2005-06 and 2006-07 shows that the level of exports for each month was higher for the year 2006-07 as compared to the previous year.

Items	2005-06 (R)	2006-07 (P)
Exports	103,101 (23.4)	124,598 (20.9)
Imports	143,430 (28.6)	181,343 (26.4)
Oil Imports	43,963 (47.3)	57,308 (30.4)
Non-Oil Imports	99,466 (21.8)	124,035 (24.7)
Trade Balance	-40,329	-56,745

Source: DGCI&S

Note: Figures in parenthesis are the growth rates (Per cent) over the corresponding period of the previous year.

Commodity-wise data for 2006-07 (April-January) revealed that both primary products and manufactured products, in general, showed a moderation in export growth. At the same time, within the primary sector, tea, and spices, engineering goods in the manufacturing sector, and petroleum products maintained the growth momentum. Engineering goods, Ores and Minerals and petroleum products, which together contributed to 63 per cent of total export growth during April-January 2006-07 remained growth drivers. The moderation in the growth of primary products witnessed during 2006-07 (April-January) was mainly due to the decline in the exports of iron ore and marine products. Growth in the exports of manufactured products also showed deceleration on the back of sharp drop in the growth of textiles, gems and jewellery, chemicals and leather. Within the engineering goods (which recorded a 36.6 per cent growth), iron and steel was the major growth driver (51 .2 per cent) benefiting mostly from increased exports to the US, Belgium, Germany, Italy and UAE. As the RBI report on Foreign Trade suggests, the tilt in the commodity profile towards the exports of engineering goods, petroleum products and chemicals and related products reflect the growing competitiveness and technological sophistication of India's manufacturing exports. There is little hope of further improvement in agro export scenario as the agricultural production is not even sufficient to meet the domestic demands as reflected by the recent food price inflation.



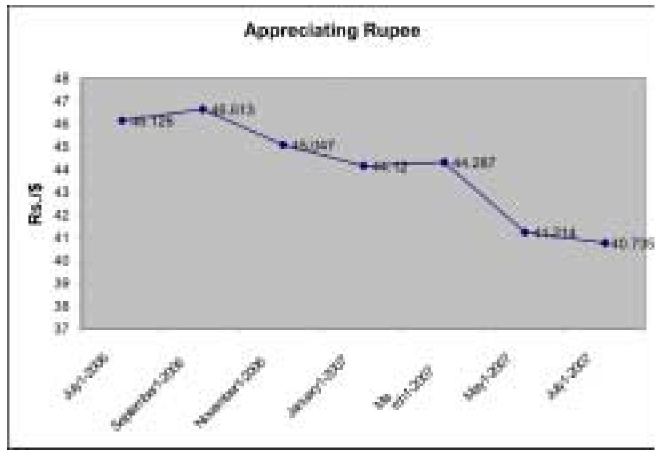
Source: DGCI&S

Import during April-March 2006-07 was at US $181.3 billion, higher by 26.4 per cent over 2005-06. Due to the rise in crude oil prices there has been a decline in the import of crude oil. The import of Petroleum products at US $4.6 billion showed a sharp decline in growth to 9.4 per cent as compare to 27.2 per cent a year ago. (The average crude oil price, Indian basket, at US $60.4 a barrel increased marginally by 1.3 per cent during March 2007 as against an increase of 22.1Per cent a year ago). Overall Petroleum products import during 2006-07 (April-March) stood at US $57.3 billion a growth of 30.4 per cent over US $44 billion a year ago. In volume terms, oil imports increased by 18.6 per cent during 2006-07 (April-January) as compare to 3.2 per cent growth a year ago. The cumulative non-oil imports during April-March 2006-07 also recorded a string growth of 24.7 per cent and contributed to 64.8 per cent of the total import growth this year. Capital goods accounted for 46 per cent of the non-oil import growth while the other major contributors being metal iron ores and metal scrap, gold and silver.

The trade deficit, during April-March 2006-07 stood at US $56.7 billion, 40.7 per cent increase compare to the last year. The Current Account Deficit (CAD) increased by 28.7 per cent during the period April-December, 2006 compare to 2005-06. Also the ratio of Invisibles to Trade Deficit went down by 6.4 per cent during this period. The export of software services has been expanding as revealed from the fact that it constitutes about 60 per cent of net Invisibles for the period April-December, 2006, rising from its previous year's figure 52.2 per cent. Thus expanding the knowledge and skill base of our economy would further boost it and thereby would improve the trade balance scenario. The capital Account has shown an increase of 16.8 per cent over its last year's level, reflecting greater inflow of foreign capital into our economy.

The foreign exchange reserves of India continue to grow in its size. At the beginning of June, 2007 it stood at US $209.547 billion. It was US $151.622 billion at the beginning of the financial year 2005-06. The Foreign Currency Assets then stood at US $145.108 billion, which now has increased to US $202.177 billion. Given this level of reserves the RBI can now afford to think about utilizing a portion of this huge fund could be leveraged to finance the much-coveted infrastructure and other social sector investments.

The rupee has significantly appreciated vis-à-vis US dollar ($) in the last one year. The appreciation of Indian Rupee by 11 per cent has cast concerns on achieving the US $ 160 billion export target set for the current year. The monetary tightening measures introduced to contain inflation have allowed Rupee to appreciate, as India is a net importer at an aggregate level. However, this has two major implications. One, direct impact on exports due to erosion in price competitiveness in international markets and Two, loss of market share due to cheaper imports competing in the domestic markets. Both of these could have a negative impact on production and employment in the short run and if appropriate measures are not taken this could have a severe impact in the medium term.



Source : RBI

The exporters remain in a disadvantageous position especially in price sensitive international markets where competing Asian countries have experienced either significantly lower rates of appreciation of their respective currencies or their currencies have depreciated during the same period. For instance, Asian currencies like Chinese Yuan have appreciated by 4.6 per cent only and on the other hand Pakistani Rupee and Bangladeshi Taka have depreciated by 1.4 and 0.43 percent respectively making their products more competitive in the international markets against Indian exports.

Disclaimer

The data used here are from various published and electronically available primary and secondary sources. We have taken care to verify and cross-check the accuracy of such data. However, despite due diligence, the source data may contain occasional errors. In such instances, CII is not responsible for such errors.

Study Team : Arvind K Shukla, Jayprakash Aggarwal, Sabyasachi Das, Arindam Mondal and G Srivastava.
For any query, please contact : Mr. G Srivastava, Head – Economic Policy

Confederation of Indian Industry
India Habitat Centre, 4th Floor, Core 4A, Lodi Road, New Delhi 110003, India
Tel:91-11-24682230-35, Fax: 91-11-24682229 email : g.srivatsava@ciionline.org, website : www.cii.in