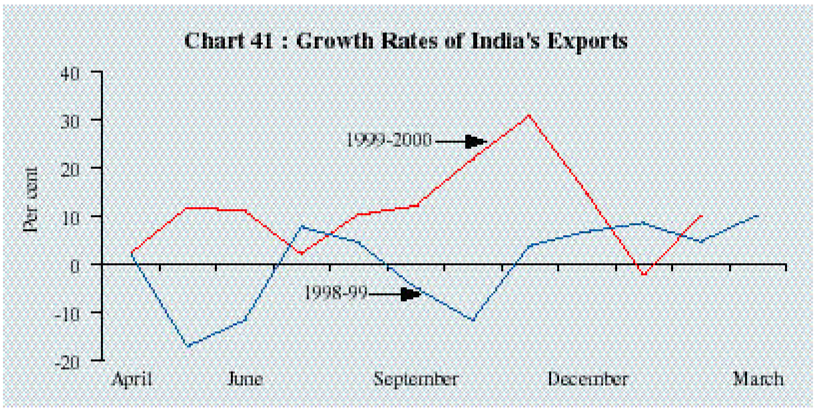
V. The External Economy

The world economic outlook strengthened further with the projected output growth rate for 1999 and 2000 being revised upwards to 3.3 per cent and 4.0 per cent from 2.9 per cent and 3.4 per cent, respectively. Advanced economies are projected to record stronger growth, driven by continued expansion in the US economy and a more robust recovery in the Euro area. There seems to be an upside risk that growth in advanced countries may exceed the projections. Developing countries are projected to grow at 5.1 per cent in 2000 as against 3.7 per cent in 1999. The crisis affected emerging Asian markets seem to have recovered faster than expected, with the ASEAN-4 growth forecasts for 2000 placed at 4.2 per cent in contrast to a negative 9.5 per cent growth in 1998. Successful policies of macroeconomic adjustment together with evolving prudential standards have contributed to substantial improvement in financial and macroeconomic conditions in emerging market economies as reflected in the return of exchange rate stability and rally in equity prices.

The volume of world trade in goods and services is projected to increase by 7.2 per cent in 2000 as against 4.7 per cent in 1999. While the inflation rate in advanced economies at 1.4 per cent in 1999 and 1.9 per cent (projected) in 2000 ruled low, that in respect of developing countries is expected to decelerate to 5.7 per cent from 6.6 per cent in 1999 and 10.1 per cent in 1998. World manufacturing prices in US dollars are expected to bottom out in 2000 and record an increase of 1.4 per cent in 2000 after a continuous decline in the preceding four years. This is an encouraging sign for the developing countries' export growth. High crude oil prices, which broke through US $ 30 per barrel in February 2000 – the highest since the Gulf war days - are, however, a major cause for concern. The oil prices have moderated in the recent weeks but still remain firm in relation to previous years. *S*ome other areas of concern are: the possibility of lop sided growth among principal currency areas creating increased payments imbalances, seemingly misaligned exchange rates among several key currencies relative to fundamentals and the downside risk of the current high level of stock valuations.

Gross private capital flows to the emerging market economies remained subdued in 1999. Despite a moderate increase to US $ 172.9 billion in 1999 from US $ 149.8 billion in 1998, they remained below the average of US $ 258 billion during 1996 and 1997. On account of large repayments, net flows rose marginally from the decade low of US $ 60 billion in 1998 to US $ 64.4 billion in 1999. Net capital flows, too, are projected to remain subdued in 2000.

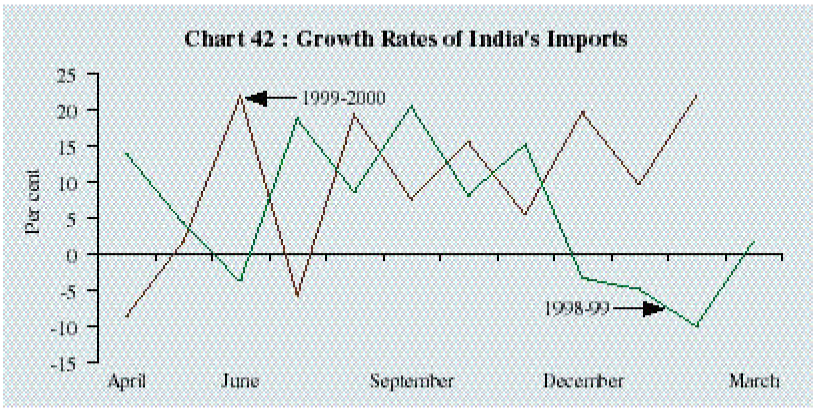


The matrix of international economic factors - barring the uptrend in oil prices - remain favourable to the Indian economy. The balance of payments (BoP) situation remained comfortable during the year despite a number of adverse developments in the form of domestic uncertainty, border tensions and a spurt in international crude prices. Foreign currency assets of the Reserve Bank enlarged by US $ 5.5 billion during 1999-2000 on top of an increase of US $ 3.5 billion in the previous year. The foreign exchange market remained generally stable and was, in fact, characterised by excess supply conditions on account of a turnaround in export growth coupled with portfolio investment inflows. Reflecting the favourable developments in the foreign exchange market, the average six-month forward premia eased to under 5 per cent as against around 8 per cent during 1998-99.

The BoP data available for the first three quarters (April-December) of 1999-2000 indicate marked buoyancy in private transfers and software exports. The recovery in merchandise exports coupled with robust growth in software earnings and continuing buoyancy in private transfers suggest that the current account deficit in 1999-2000 would be well below 1.5 per cent of GDP, which could easily be financed through normal capital flows, despite higher POL imports on account of the increase in crude oil prices.

Merchandise Trade

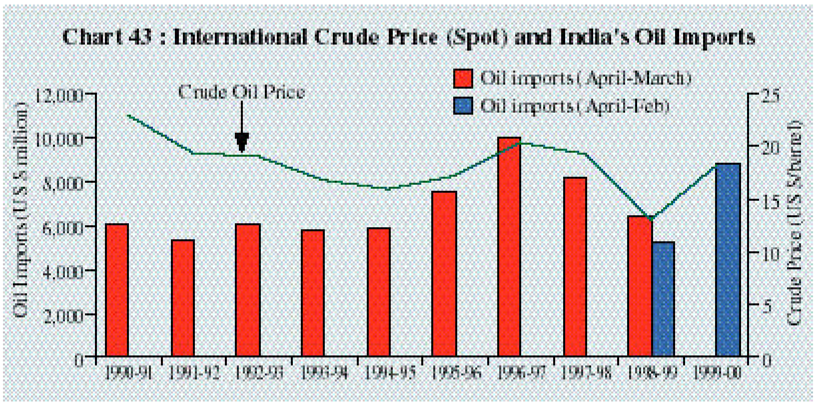
The trade deficit at US $ 8.7 billion during 1999-2000 (up to February 2000) was higher than that of US $ 8.1 billion in the corresponding period of 1998-99 according to the Directorate General of Commercial Intelligence and Statistics (DGCI&S) data, as export growth was largely offset by a sharp increase in oil imports.



Exports recorded a growth of 11.1 per cent during 1999-2000 (up to February 2000) in sharp contrast to a decline of 1.9 per cent during the corresponding period of 1998-99, largely on account of a recovery in manufactured goods' exports. Exports showed a sustained increase from the beginning of the year breaking the declining trend witnessed in the previous year. Export growth, after reaching the peak of 30.7 per cent in November 1999, decelerated in December 1999, turned negative in January 2000 and then recovered to 9.7 per cent in February 2000 (Chart 41).

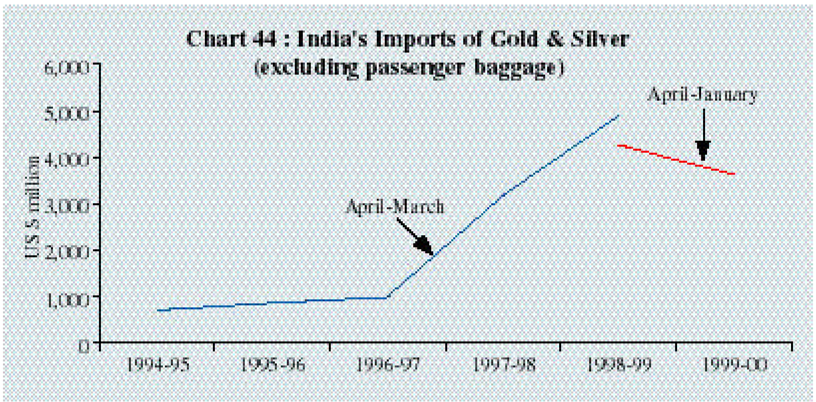
Import growth at 10.2 per cent during 1999-2000 (up to February 2000) remained higher than 3.1

per cent during the corresponding period of 1998-99 (Chart 42). The oil import bill surged by 66.4 per cent during 1999-2000 (up to February 2000) in contrast to a decline of 25.2 per cent during the corresponding period of 1998-99 with the increase in international oil prices by about 39 per cent during 1999 over the level in 1998 (Chart 43). On year-on-year basis, the oil price rose from US $ 11.45 a barrel during January 1999 to US $ 25.31 a barrel during January 2000, showing an increase of 121.0 per cent. Non-oil imports, on the other hand, decelerated to 1.1 per cent during 1999-2000 (up to February 2000) from an increase of 9.8 per cent during the corresponding period of 1998-99. Capital goods imports declined by 20.2 per cent during 1999-2000 (up to January 2000) in contrast to an increase of 9.5 per cent in the comparable period of the previous year. The decline in capital goods imports has growth implications as imported capital goods could be technology embodied in nature and could accompany flow of foreign investment. Imports of gold and silver, which had increased at a very fast rate during 1997-98 and 1998-99, declined by 14.8 per cent during 1999-2000 (up to January 2000). Even with this decline, imports of gold and silver remained at a very substantial level of US $ 3.6 billion during 1999-2000 (up to January 2000) as against US $ 4.3 billion during the corresponding period of 1998-99 (Chart 44). Non-oil non-gold imports recorded a marginal increase of 2.4 per cent during 1999-2000 (up to January 2000) as against 5.3 per cent during the corresponding period of the previous year.



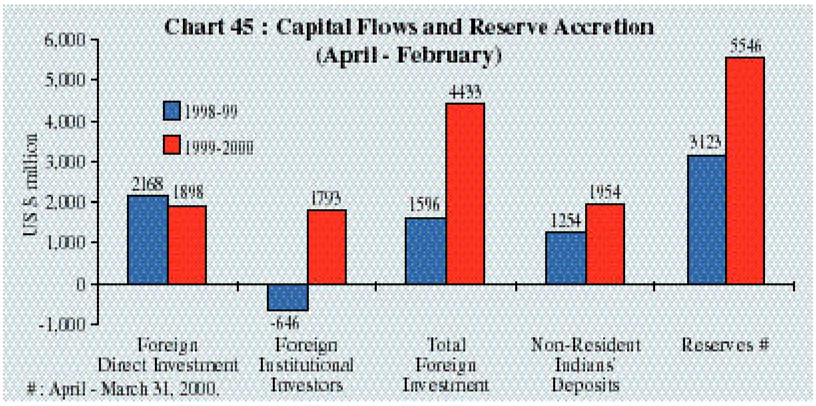
Current Account

The current account deficit at US $ 4.1 billion during 1999-2000 (up to December 1999) was marginally lower than that of US $ 4.3 billion during the corresponding period of 1998-99. The net invisible surplus at US $ 7.2 billion during April - December 1999 was the same as that during the corresponding period of last year. Higher miscellaneous invisible payments were compensated by a 17.0 per cent increase in private transfers to US $ 8.9 billion and a 58.7 per cent surge in software exports to US $ 2.9 billion.



Capital Account

Capital flows, led by portfolio inflows and non-resident deposits, continue to remain strong, enabling the build-up of reserves. Foreign investment inflows during 1999-2000 (up to February 2000) at US $ 4.4 billion were significantly higher than that of US $ 1.6 billion in the corresponding period of 1998-99 on account of higher portfolio inflows (Chart 45). Foreign institutional investor (FII) inflows amounted to US $ 1.8 billion during 1999-2000 (up to February 2000) in contrast to an outflow of US $ 0.6 billion during the comparable period of the previous year. Similarly, the resources raised under GDRs/ADRs increased to US $ 0.6 billion during 1999-2000 (up to February 2000) from US $ 15 million during the corresponding period of the previous year. Direct investment inflows during 1999-2000 (up to February 2000) at US $ 1.9 billion, however, were lower as compared with the corresponding period of 1998-99 (US $ 2.2 billion). Drawals under external commercial borrowings (ECBs) at US $ 2.2 billion during 1999-2000 (up to December 1999), were almost the same as in the corresponding period of 1998 (excluding RIBs). The demand for ECBs, notwithstanding the decline in average six-month forward premia from 8.2 per cent during April-December 1998 to 5.2 per cent during April-December 1999, was sluggish partly reflecting the attractiveness of borrowing from domestic sources. Inflows under NRI deposits during 1999-2000 (up to February 2000) at US $ 2.0 billion were significantly higher than that of US $ 1.3 billion in the corresponding period of 1998-99. The proportion of FCNRB deposits swapped into rupees continued to be within reasonable limits.



Reserves

Total foreign exchange reserves as on March 31, 2000 amounted to US $ 38.0 billion or around eight months of imports. The foreign currency assets of the Reserve Bank increased to US $ 35.1 billion as on March 31, 2000, on account of the turnaround in export growth and portfolio investment despite the surge in POL imports. The value of monetary gold increased marginally by US $ 14 million to US $ 3.0 billion over the same period. Forward liabilities at US $ 0.7 billion as on March 31, 2000 worked out to less than 2.0 per cent of the outstanding foreign currency assets, reflecting the conscious policy of the Reserve Bank to contain such liabilities at a manageable level in relation to the size of reserves.