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IMF Country Report No. 08/51

India: 2007 Article IV Consultation—Staff Report; Staff Statement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for India

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2007 Article IV consultation with India, the following documents have been released and are included in this package:

- The staff report for the 2007 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on November 12, 2007, with the officials of India on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 26, 2007. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A staff statement of January 17, 2008 updating information on recent developments.

- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its January, 23, 2008 discussion of the staff report that concluded the Article IV consultation.

- A statement by the Executive Director for India.

The document listed below has been or will be separately released.

Selected Issues Paper

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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INDIA

Staff Report for the 2007 Article IV Consultation

Prepared by the Staff Representatives for the 2007 Article IV Consultation with India

Approved by Kalpana Kochhar and Matthew Fisher

December 26, 2007

- **Discussions:** Mumbai, October 29–November 2; Delhi, November 5–12.
- **Team:** Ms. Kochhar (head), Mr. Kramer, Ms. Poirson, Ms. Richter-Hume, Ms. Oura, Ms. Topalova (all APD), Mr. Jobst (MCM), Mr. Felman (Senior Resident Representative), Ms. Kohli, and Mr. Mohapatra (Resident Representative office).
- **Focus of the consultation:** Managing financial globalization; addressing the supply constraints to inclusive growth.
- **Selected issues:** Monetary policy challenges from financial globalization; monetary policy communication; pattern of corporate financing; social safety net; derivatives market development; competitiveness; inclusive growth.
- **Exchange rate regime:** Managed float. India is an Article VIII country but maintains restrictions subject to approval under Article VIII.
- **Outreach:** Staff seminars at the Reserve Bank of India and the Ministry of Finance.
- **Consultation cycle:** The mission recommended a continued 12-month cycle.
- **Pre-brief meeting:** September 24, with FAD, MCM, PDR, and RES.
- **Economic statistics:** are adequate for surveillance purposes, but weaknesses remain. The mission discussed shortcomings of balance of payments data.
- **Thrust of policy changes since 2006 consultation:** The authorities and the Fund have generally agreed on broad policy priorities. In concluding the 2006 consultation, Executive Directors agreed that vigilance was needed to guard against overheating risks, called for further progress in reducing public debt, and urged greater progress in addressing structural obstacles to job-intensive, inclusive growth. The authorities have tightened monetary policy, and public debt/GDP has come down (mainly due to rapid growth), but limited progress has been made in structural reform.

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EXECUTIVE SUMMARY

India's dream run of strong growth and macroeconomic stability is a tribute to its sound macroeconomic policies and past structural reforms. The economy expanded at an average rate of about 8½ percent for four years running, on the back of rising productivity and investment. After rising sharply in early 2007, inflation has ebbed, and the current account deficit is moderate. India's bright prospects have attracted record capital inflows amidst heightened global uncertainties and slowing U.S. growth.

Swelling capital inflows have highlighted the key policy challenges: managing financial globalization and tackling the supply constraints to growth.

- Large capital inflows are exacerbating tensions in the monetary policy framework among exchange rate management, monetary independence, and financial openness. The RBI's stance of accommodating increased exchange rate volatility, actively managing liquidity, and liberalizing outflows is appropriate. However, the use of capital controls could dampen investment, raise doubts about the government's commitment to fuller capital account convertibility, and pose questions about the exit strategy from new controls. Strengthened monetary operations and communications along with greater exchange rate flexibility could be a better way to increase monetary policy effectiveness and deal with uncertainty in global financial markets.

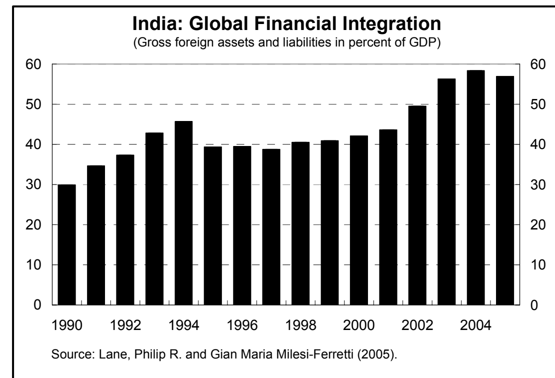
- Sizeable cross-border movements of capital require broader and deeper financial markets to channel capital to its most productive use, accommodate higher exchange rate volatility, and support financial stability. In this regard, a domestic corporate bond market will provide an important alternative source of funds, while better-developed onshore derivatives markets will enable corporations to better manage the risks associated with India's financial integration.

- Further fiscal consolidation is important for sustaining growth as well as managing financial globalization. Despite impressive revenue performance, fiscal consolidation has stalled and public debt remains high, squeezing the fiscal space needed for public investment in physical and social infrastructure. Both expenditure and revenue measures are needed, including rationalizing subsidies, cutting tax exemptions, enhancing tax administration, and broadening the tax base. A tighter fiscal stance could also limit the inflationary impact of capital inflows.

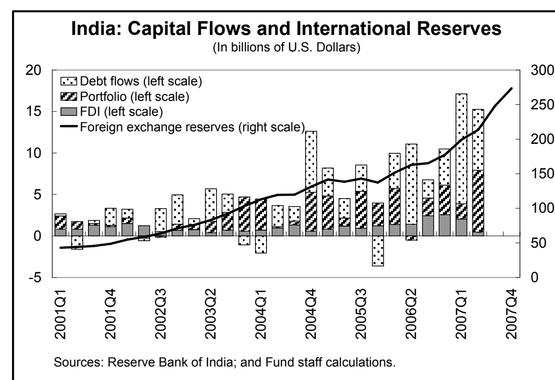
- Structural reforms can ease real sector rigidities, boost competitiveness, and ensure that the benefits of growth are widely shared. The government's "inclusive growth" agenda has rightly identified as top priorities: bridging infrastructure gaps (through active private sector participation), ensuring access to social services, and promoting a competitive environment that supports private sector investment and job creation.

I. Economic and Political Context

1. **India's macroeconomic performance is impressive, the result of sound macroeconomic policies and steady reforms since 1991.** Growth averaged about 8½ percent in the four years through 2006/07, and is set to record 8¾ percent this year, making India one of the world's fastest-growing economies. The poverty rate fell from 36 percent in 1993/94 to under 28 percent in 2004/05. The productivity-driven growth boom and India's increasing financial integration have attracted record capital inflows. With global portfolio weights on India rising, the inflows appear set to continue.



2. **However, capital inflows are raising the tensions of the "impossible trinity."** Inflows have put upward pressure on the exchange rate. Concerns about competitiveness have arisen, and the authorities have intervened in the foreign exchange market. The expansion in domestic liquidity required monetary tightening, which in turn has maintained a wide interest-rate differential.



3. **Supply constraints are the critical challenge to sustained growth with stability.** Rapid growth is worsening already serious shortages of infrastructure (especially electricity) and skilled labor. Pressures on skilled wages are widening income inequality, potentially eroding support for growth-oriented reforms (Box 1).[1] Reforms are needed to spur job-intensive growth, further alleviate poverty, absorb the growing working-age population, and sustain the reduction in public debt, as well as to manage appreciation pressures by bolstering productivity.

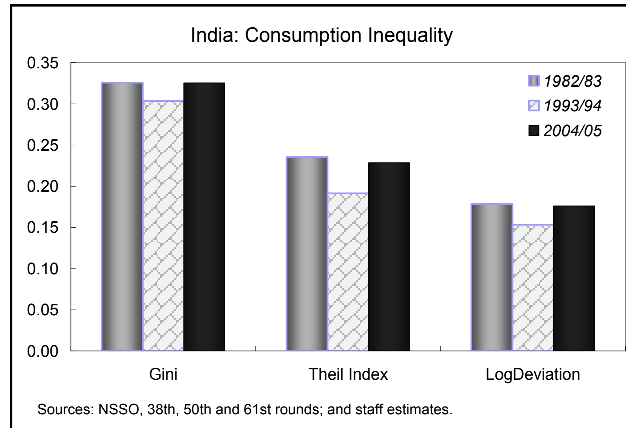
4. **The authorities have been successful at maintaining macroeconomic stability but critical structural reforms have lagged.** Fiscal consolidation and monetary stability are cornerstones of macroeconomic policy. In recent years, the budget deficit has fallen, thanks to strong growth and the Fiscal Responsibility and Budget Management Act (FRBMA), and price stability has been maintained. To cope with capital inflows, the authorities have

[1] See the Selected Issues paper.

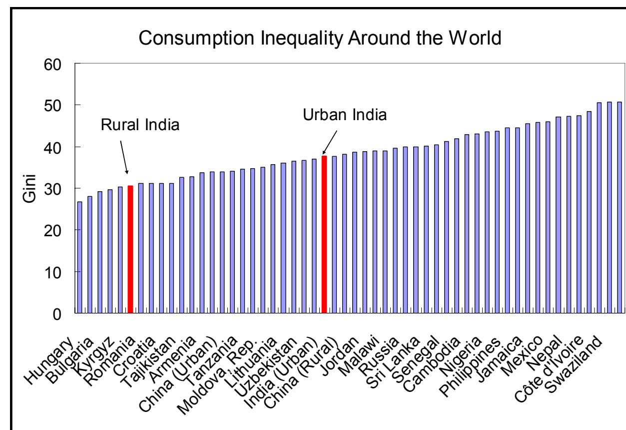
Box 1. Inclusive Growth

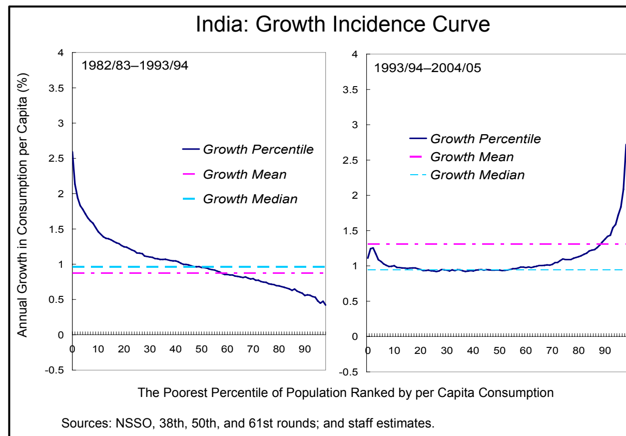
Rapid growth has reduced poverty, but inequality has risen although it is still low by international standards. The share of the population living below the poverty line fell from 45 percent in 1983, to 36 percent in 1993/94, and then to 27½ percent in 2004/05.[1/] However, inequality began to rise in the 1990s. Between 1993/94 and 2004/05, the gap between average monthly per capita consumption in rural and urban India widened. The increase in income and wealth inequality is potentially much larger, as the prices of major sources of wealth, held by a small segment of the population, have risen sharply.

The shift in consumption growth is particularly notable and suggests that growth has become less inclusive. From 1983 to 1993/94, growth in per capita consumption at the bottom of the income distribution outpaced growth at the top. During the 1990s, the shape of the growth incidence curve reversed, with much faster growth at the top—particularly in urban India, reflecting the pickup in manufacturing and services compared with agriculture. In the 1990s, despite faster growth, the bottom 50 percent of India's population, experienced slower consumption growth than in the previous decade.



Sources: NSSO, 38th, 50th and 61st rounds; and staff estimates.





Sources: NSSO, 38th, 50th, and 61st rounds; and staff estimates.

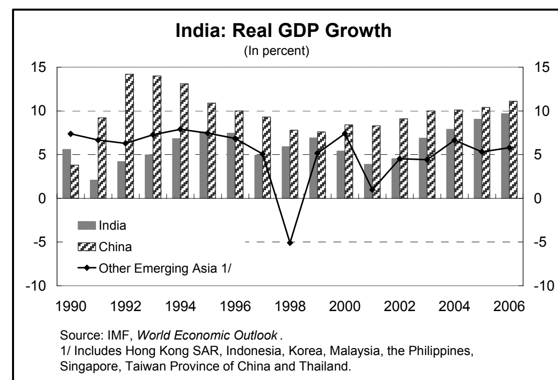
1/ An alternative measure of consumption that uses different recall periods places India's poverty rate at 21 percent in 2004/05, down from 26 percent in 1999/2000. Comparable estimates for earlier years are unavailable under this measure.

allowed greater flexibility in the rupee, enhanced prudential measures, tightened selected capital controls, and hiked reserve requirements. The 11th Plan envisions significant hikes in infrastructure and education spending, along with labor market reforms. However, coalition politics complicate reforms, with initiatives by the coalition-leader Congress Party resisted by its partners on the left.

5. **The 2007 Article IV consultation discussions focused on policies needed to manage financial globalization and tackle supply constraints to sustained growth**. Discussions centered on macroeconomic policies (monetary, exchange rate, fiscal), capital account policy, financial stability, and structural reform.

II. Economic Backdrop

6. **Growth remains strong, led by investment and productivity (Figure 1**). During July-September 2007, real GDP rose by 8.9 percent y/y. Capacity utilization and business confidence remain high. Total factor productivity growth has averaged about 3⅓ percent in recent years, within Asia exceeded only by China. High-frequency data point to a recent deceleration in consumption, but investment indicators remain strong, fed by robust corporate profits.



Source: IMF, *World Economic Outlook*.
1/ Includes Hong Kong SAR, Indonesia, Korea, Malaysia, the Philippines, Singapore, Taiwan Province of China and Thailand.

7. **Headline WPI inflation has ebbed** from about 6¾ percent y/y earlier this year to about 3½ percent y/y partly due to decelerating food and manufacturing prices and appropriate monetary tightening. Core inflation (excluding food and energy) has eased to about 4¾ percent y/y. CPI inflation exceeds WPI inflation by over 2 percentage points, reflecting the CPI's higher weight on food.

8. **Capital inflows are swelling (Figure 2).** Capital inflows reached a record $45 billion in 2006/07, and (as in other emerging markets) accelerated this fiscal year (Box 2). Portfolio inflows from foreign institutional investors (FIIs) rose appreciably but accounted for less than a quarter of inflows. Capital inflows more than finance the current account deficit (projected at about 1½ percent of GDP in 2007/08, versus a capital account surplus of 9½ percent of GDP). Export growth remains robust at over 20 percent y/y in U.S. dollar value, but buoyant imports (led by raw materials and capital goods) have pushed up the trade deficit.

9. **Capital inflows have lifted financial markets.** Overseas investors bought a net $18.8 billion of stocks and bonds during January-November 2007, compared to the previous record of $9.5 billion in the same period in 2006. Equity markets recovered quickly from the

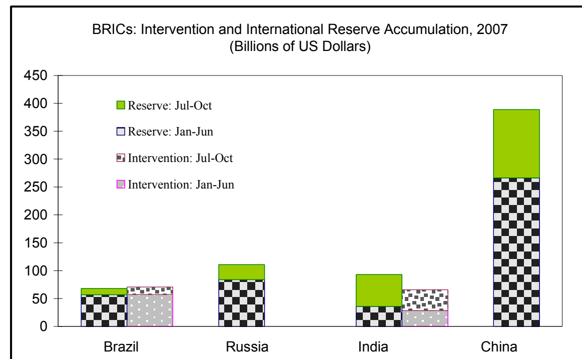
Box 2. Comparing BRICs: Exchange Rate, Capital Flows, and Macroeconomic Policy

Rising capital inflows have put upward pressure on currencies in Brazil, Russia, India and China (the BRICs). This box discusses the experience in the BRICs, including how policies have adapted.

BRICs: Exchange Rate Appreciation

	Dec. 2006–Aug. 2007			Average y/y Change 2005–2006	
	LC/USD	REER	NEER	REER	NEER
	(In percent change)				
India	-8.6	7.1	7.5	1.4	-0.7
Brazil	-8.5	9.0	8.3	17.5	14.9
China	-3.2	5.3	2.2	0.9	1.4
Russia	-2.5	4.9	0.3	9.1	1.7

Source: INS



Since the start of 2007, the BRICs (Brazil, Russia, India, and China) have experienced significant REER appreciation. Most of the real appreciation in 2007 for India and Brazil came from nominal appreciation, whereas China and Russia had inflation-led appreciation. In China and India, the appreciation is a recent phenomenon, while in Brazil and Russia, the exchange rate appreciation in 2007 comes on top of sharp rises in 2005–06.

India is not unique with respect to the size of inflows over the past two years, but stands out as the only one in the group with a current account deficit. All BRICs have had rising balance of payment inflows. For India Brazil and (in 2007) Russia, it has been mostly from capital inflows, and for China, mostly from the current account surplus (Table). High commodity prices supported inflows through the trade balance in Russia and Brazil. Brazil experienced the largest increase in portfolio inflows in percent of GDP, followed by India. Net portfolio inflows were smaller in both China and Russia, partly reflecting outward investment. The Indian corporate sector and Russian banks and corporations increased overseas borrowing. In the second half of 2007, the pace of capital inflows appears to have picked up more in India than the in other countries, as suggested by the more rapid reserve accumulation (chart).

The BRICs' policy responses put different emphases on inflation, exchange rates, and the capital account.

- *Intervention*: Regardless of their exchange rate regimes, all of the BRICs intervened heavily in foreign exchange markets: Brazil is an independent floater, India and Russia are managed floaters with no predetermined path, and China maintains a crawling peg.

- *Sterilization:* Both India and China partially sterilize their foreign exchange intervention, but India does so at a higher rate than China. In Brazil, intervention is fully sterilized consistent with its inflation target. In Russia, sterilization is limited to the oil-fund related inflows.

Box 2. Comparing BRICs: Exchange Rate, Capital Flows, and Macroeconomic Policy (concluded)

- *Monetary policy*: India and Brazil put greater emphasis on containing inflation, as indicated by larger contributions of NEER changes to real appreciation. Russia's monetary policy is accommodative with base money growth accelerating to about 40 percent. China has attempted to absorb liquidity mainly through increases in reserve requirements and administrative measures to curb credit growth.

- *Capital account*: India has liberalized outflows, and selectively restricted inflows. In recent years (mostly through mid-2006), Brazil increased outflows by expediting external debt repayments, and then liberalized some outflows. China restricts capital inflows other than FDI, but has also liberalized outflows.

- *Supporting the export sector*: Brazil and India provided some incentives to selected sectors, including through import tariff exemptions and subsidized credit (India).

- *Fiscal policy*: In India, staff expect higher revenues to be fully spent, while Brazil and China are taking advantage of revenue over-performance to achieve better-than-budgeted fiscal balances. In Russia, the government has spent more of its oil-revenues since 2005, with a decline in the non-oil fiscal balance.

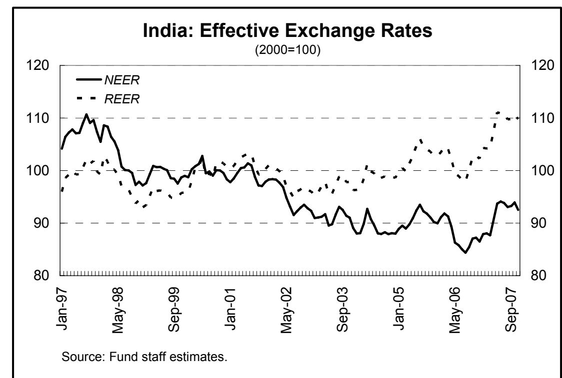
BRICs: Balance of Payments

	India		Brazil		China		Russia	
	2006	2007 1H	2006	2007 1H	2006	2007 1H	2006	2007 1H
	(In billions of USD)							
Current	-9.4	-2.1	13.6	4.6	341.4	162.9	96.1	39.0
Capital and financial	37.8	32.4	16.0	60.0	49.0	90.2	3.9	61.2
FDI, net	7.8	2.5	-9.4	24.3	91.2	50.9	7.4	1.9
FDI, in	17.5	10.2	18.8	20.9	115.4	58.3	30.5	27.9
FDI out	-9.7	-7.7	-28.2	3.5	-24.2	-7.4	-23.2	-26.0
Portfolio, net	9.5	9.3	9.6	24.0	-96.8	-4.8	15.4	5.4
Other, net 1/	20.4	20.6	15.8	11.6	54.5	44.1	-18.8	53.9
Overall	29.4	31.7	30.6	61.6	369.1	266.1	107.5	98.5
	(In percent of GDP)							
Current	-1.2	-0.5	1.3	0.8	13.0	11.8	9.7	7.2
Capital and financial	4.7	6.9	1.5	10.0	1.9	6.5	0.4	11.2
FDI, net	1.0	0.5	-0.9	4.0	3.5	3.7	0.7	0.3
FDI, in	2.2	2.2	1.8	3.5	4.4	4.2	3.1	5.1
FDI out	-1.2	-1.6	-2.6	0.6	-0.9	-0.5	-2.3	-4.8
Portfolio, net	1.2	2.0	0.9	4.0	-3.7	-0.3	1.6	1.0
Other, net 1/	2.6	4.4	1.5	1.9	2.1	3.2	-1.9	9.9
Overall	3.7	6.7	2.9	10.2	14.0	19.2	10.9	18.1

Sources: IFS, CEIC, EMED, and staff calculation.
1/ Calculated as residual in capital and financial account.

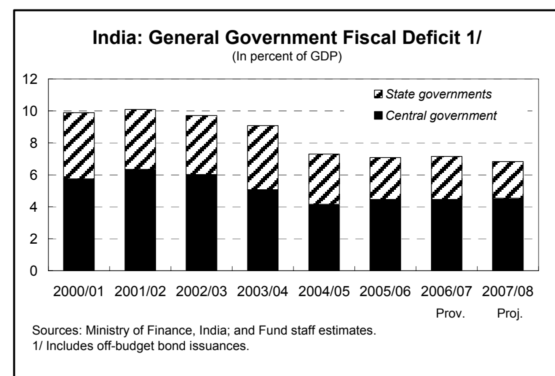
subprime crisis. Long-term interest rates range around 8 percent. Real estate markets have been buoyant, although cooling recently.

10. **Strong capital inflows have put upward pressure on the rupee (Figure 2).** After remaining roughly stable since 2000, the rupee appreciated by 7 percent in real effective terms and by 7½ percent in nominal effective terms between December 2006 and August 2007, with most of this appreciation occurring between March and May 2007. This REER appreciation was exceeded only by the Canadian dollar (8½ percent) and Brazilian real (9 percent). The RBI accrued $65 billion in reserves (purchasing foreign currency) between end-May and end-November, when intervention picked up amid growing concerns about competitiveness after the sharp rise in the rupee. Rupee flexibility is roughly comparable to that of other large emerging-markets currencies and the yen (see Figure 3).



11. **In addition to the exchange rate appreciation, several steps were taken since October 2006 to tighten monetary conditions.** The cash reserve ratio has risen 200 bps, while the repo (lending) rate was hiked twice by 25 bps (the last time in April). With WPI inflation ebbing and real estate prices and credit growth slowing, the RBI left policy rates on hold at its October 2007 policy meeting, but raised the cash reserve ratio (CRR) by 50 basis points to 7.5 percent.

12. **Fiscal consolidation slowed in 2006/07.** Including off-budget bond issuance, the general government deficit held steady at about 7¼ percent of GDP.[2] The central government deficit remained at 4½ percent of GDP, with buoyant tax revenue offset by higher expenditure. The states' aggregate fiscal deficit rose marginally to 2¾ percent of GDP. Revenues performed well, though expenditure rose faster on the back of rising public investment. Public debt remains high, at roughly 80 percent of GDP in March 2007.



[2] The central government issued bonds amounting to 1 percent of GDP to oil companies and the Food Corporation of India to offset subsidy-related losses. Staff treats these quasi-fiscal outlays as budgetary expenditure.

13. **Banks are profitable and liquid** (Table 8). At end-March 2007, the aggregate capital adequacy ratio (CAR) stood at 12.4 percent, remaining stable above the regulatory rate of 9.0 percent (Box 3). Amid strong credit growth, the ratio of scheduled commercial banks' gross non-performing loans (NPLs) to advances has fallen to 2.7 percent from 10.4 percent at March 2002, even as prudential norms have been tightened, in part because rising real estate prices have facilitated repayment of problem loans. However, NPL provisioning averaged 56 percent over the last year–well below the 150 percent and higher in comparable emerging market countries. At the same time, there are concerns about the sharp past rise in real-estate prices and sub-standard loans. In addition, delinquencies on unsecured retail loans (which account for about 10 percent of all loans, and which require 100 percent provisioning) are rising for some banks.

Banking Sector Performance and Soundness (2006-2007)
(In percent)

	Return on Assets	Gross NPL 1/	Provisioning 2/
India	**0.9**	**2.5**	**56.1**
Emerging Markets			
Brazil	2.1	4.0	153.0
Korea	1.1	0.8	177.7
South Africa	1.4	1.1	64.3
Mature Markets			
Australia	1.6	0.2	204.5
Japan	0.4	2.5	30.3
U.S.	1.2	0.8	129.9

Sources: IMF, *Global Financial Stability Report (2007);* and Fund staff estimates, RBI, Report on Trends and Progress of Banking in India (2007).
1/ Ratio of gross non-performing loans to gross advances.
2/ Provisions to non-performing loans ratio (NPL).

III. Outlook and Risks

14. **Staff expects growth to moderate toward potential in the near term**. Weaker external demand will moderate exports. Consumption growth may slow due to the past rise in real interest rates, but investment should remain brisk—supported by robust business confidence, high capacity utilization in the capital goods sector, and buoyant corporate profits. A favorable monsoon should deliver above-average agricultural growth. GDP growth would moderate to 8¾ percent in FY2007/08 and further to 8¼ percent in FY2008/09, with inflationary pressures contained. The current account deficit should register around 2 percent of GDP, as growing services and remittances offset a widening trade deficit.

15. **Near-term risks are on both sides:**

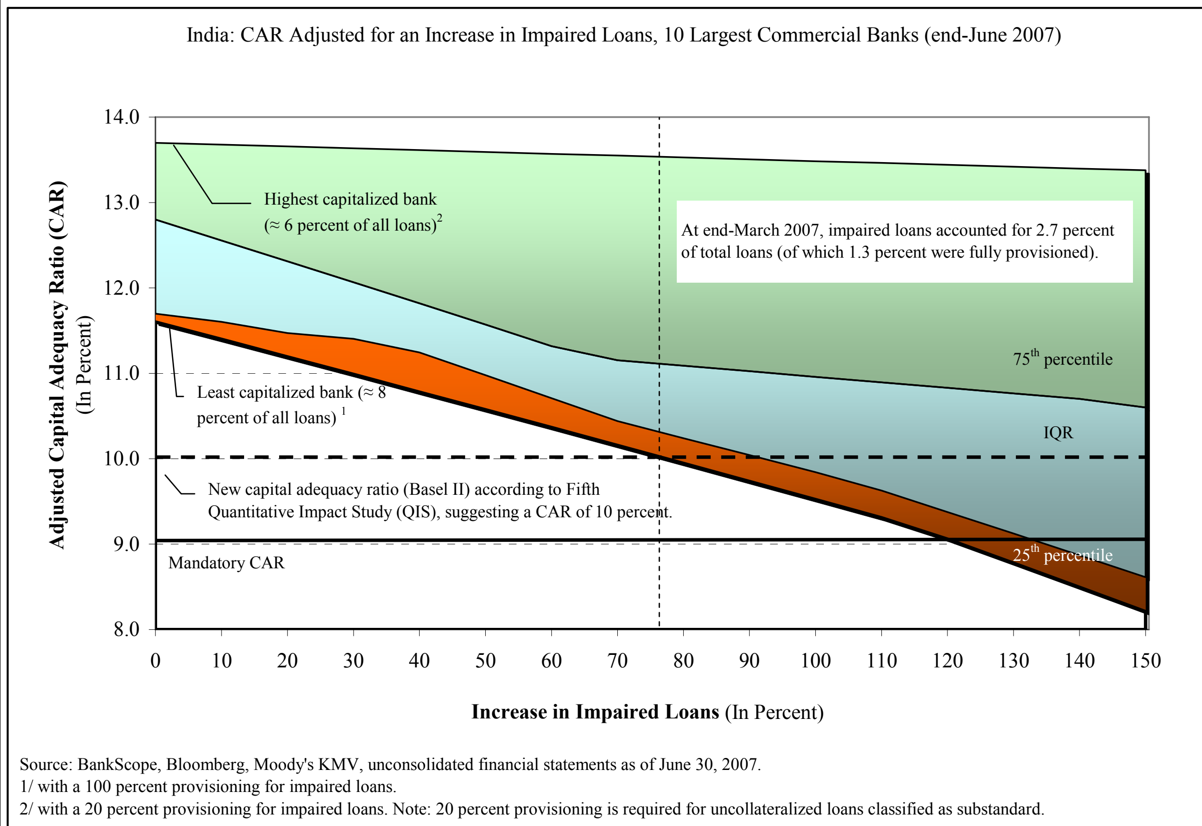
- *Risks to growth are broadly balanced*. A sharper-than-expected slowdown in developed economies could dampen exports, although increasing export diversification to fast-growing Asian and Gulf economies limits this risk. Moreover, investment could surprise on the upside, given strong corporate profits and domestic savings.

Box 3. Sensitivity Analysis of Banking System Credit Risk

Sensitivity analysis of the ten largest banks reveals modest credit risk exposure at current capital levels. The impact of higher default rates on capital adequacy ratios (CAR) is estimated by assuming that impaired loans are fully provisioned, and reducing risk-weighted assets and capital at a rate equivalent to the increase of the NPL ratio. The effects of various increases in NPLs are assessed.

A sizeable increase in NPLs would be needed to reduce the weakest bank's capital adequacy below the regulatory threshold (figure below). The capitalization of the lowest quartile of banks drops below the regulatory CAR threshold of nine percent (the solid black line) if impaired loans rise to more than twice the current gross NPL ratio. Thus the least capitalized bank, representing eight percent of total loans, can withstand more than a doubling of current NPLs before breaching statutory capital requirements. Similarly, the average and median capitalization of the banking system remains well above the existing CAR even if NPLs double in magnitude. However, once Basel II takes effect, the regulatory threshold for capital would rise to 10 percent, and a 75 percent increase in NPLs would push the weakest bank below that threshold.

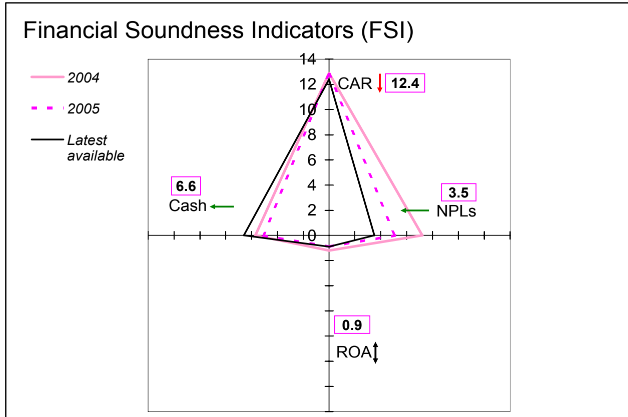
India: CAR Adjusted for an Increase in Impaired Loans, 10 Largest Commercial Banks (end-June 2007)

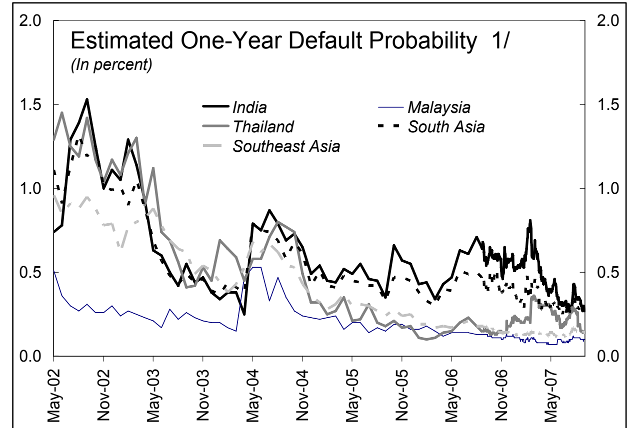


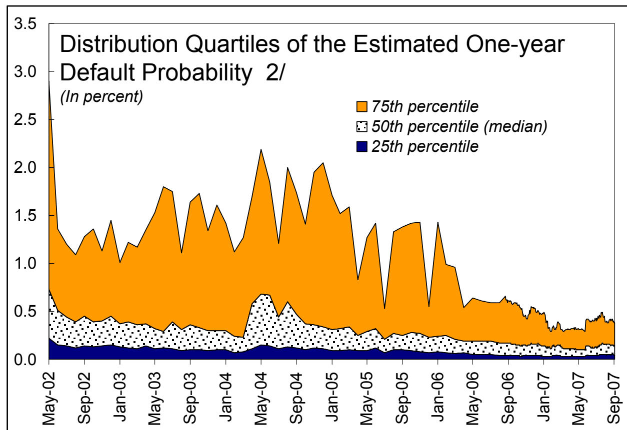
Source: BankScope, Bloomberg, Moody's KMV, unconsolidated financial statements as of June 30, 2007.
1/ with a 100 percent provisioning for impaired loans.
2/ with a 20 percent provisioning for impaired loans. Note: 20 percent provisioning is required for uncollateralized loans classified as substandard.

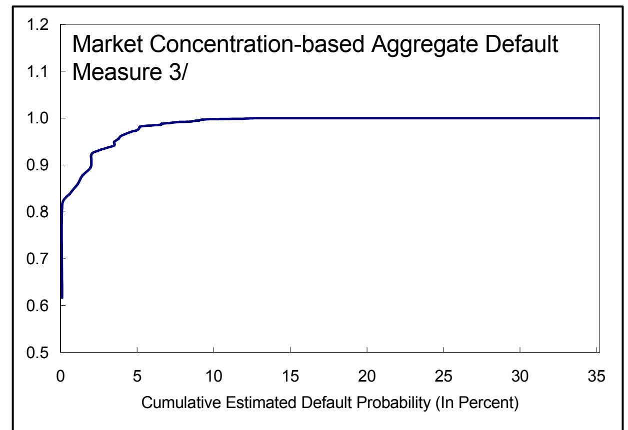
Market data indicate that bank risk has declined and the largest banks have a low implied probability of default. That said, the range has increased in recent months, and India's bank risk is at the higher end of the range for Asian markets.

Box 3. Credit Risk in the Banking System: A Sensitivity Analysis (concluded)









Sources: Data provided by Indian authorities, Moody's KMV CreditEdge Plus; and Fund staff estimates.

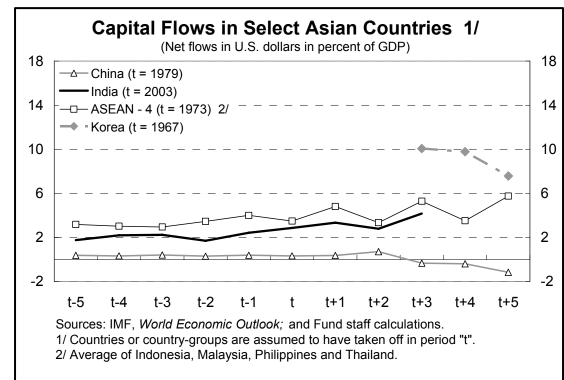
1/ Estimates show the implied risk-neutral default probability based on the adapted Black-Scholes-Merton (BSM) framework.
2/ Estimates show the implied risk-neutral default probability (by quartile) based on the adapted Black-Scholes-Merton (BSM) framework.
3/ The chart shows the cumulative, one-year implied probability of default (PD) of all 70 publicly listed banks. Banks are ordered by market share. For example, 98 percent of all banks (total bank assets) have a probability of less than five percent to default within the next year.

- *Inflation risks are to the upside*. Domestic liquidity remains ample (owing in part to intervention), capacity remains constrained, skilled wages are rising sharply, and continued rapid growth could increasingly expose the infrastructure deficit. Also, soaring international food and fuel prices could stoke domestic price pressures.[3]

- *On financial risks*, reflecting the past boom in retail credit, some increase in NPLs may be in prospect. However, banks' sizeable capital buffers indicate that the credit cycle is likely to be manageable, and risk measures have improved (Box 3)[4]. Corporate leverage is rising but remains low.

- *Fiscal consolidation* is subject to downside risks. Soaring global commodity prices will boost food, fuel, and fertilizer subsidies, while public compensation may rise significantly during FY 2008/09. In addition, tax collections may slow as growth eases.

- *The external position is sustainable and robust to significant shocks* (Figure 4 and Table 9). Capital inflows could moderate as global liquidity eases, especially if risk aversion increases or if the growth outlook disappoints. However, given India's vibrant baseline outlook and sizeable capital demands, inflows will likely remain strong, consistent with the experience in other Asian countries around growth takeoffs. Any volatility in flows is unlikely to generate external instability: external debt is low; external commercial borrowings (ECBs) are subject to restrictions on end-use, maturity, and amount; and the projected medium-term current account is consistent with debt sustainability. Reserves are ample, exceeding total external debt.



16. **Medium-term prospects are for sustained growth, contained inflation, and continued economic and financial stability.** GDP growth would moderate to 8 percent, staff's estimated potential growth.[5] Inflation should range around 4 percent. The current account deficit would remain around 2 percent of GDP, comfortably financed by private capital inflows, and at a level consistent with a broadly unchanged net external debt position. Strong growth would help reduce the general government deficit to about 4½ percent of GDP.

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[3] Fuel prices are administered. Full oil-price pass-through would add 3⅓ percentage points to WPI inflation.

[4] NPLs would have to roughly double to push the capital adequacy ratio of the weakest banks below the statutory level of 9 percent (Box 3).

[5] See Oura, *Wild or Tamed? India's Potential Growth*, IMF Working Paper 07/224.

India: Summary of Medium-term Projection

(In percent of GDP unless otherwise indicated)

	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13
Real GDP growth at factor costs (% change)	7.5	9.0	9.4	8.7	8.3	8.2	8.2	8.1	8.0
Agriculture (% change)	0.0	6.0	2.7	3.3	2.6	2.6	2.7	2.7	2.7
Industry (% change)	9.8	9.6	10.9	9.4	8.9	8.8	8.8	8.8	8.8
Services (% change)	9.6	9.8	11.0	10.2	9.8	9.5	9.4	9.1	9.0
WPI (% change)	6.5	4.4	5.5	3.6	3.6	3.9	3.9	3.9	3.9
CPI (% change)	3.8	4.4	6.7	5.9	4.3	3.9	3.9	3.9	3.9
				(In percent of GDP)					
Central government balance - authorities 1/	-4.0	-4.1	-3.5	-3.3	-3.0	-3.0	-3.0	-3.0	-3.0
Central government balance - augmented 2/	-4.2	-4.4	-4.4	-4.5	-3.9	-3.3	-3.2	-3.2	-3.1
General government balance- augmented 2/	-7.3	-7.1	-7.2	-6.8	-6.4	-5.8	-5.4	-5.0	-4.6
General government debt	85.7	82.9	79.0	75.2	72.4	69.5	66.8	64.1	61.4
Current account balance	-0.4	-1.1	-1.1	-1.5	-1.9	-1.9	-1.9	-1.9	-1.8
Trade balance	-4.8	-6.4	-7.1	-7.4	-8.3	-8.4	-8.5	-8.6	-8.6
Capital account balance	4.1	3.0	5.1	9.5	5.4	4.8	4.4	4.2	3.9
FDI (net)	0.5	0.6	0.9	2.0	1.7	1.7	1.6	1.6	1.6
Portfolio flows (net)	1.3	1.6	0.8	2.6	1.8	1.3	1.0	1.0	0.8
ECB (net)	0.7	0.3	1.8	1.4	0.7	0.7	0.8	0.8	0.7
Memodandum items									
External debt stock (In billions of USD)	124	128	156	210	237	267	299	333	369
External debt stock (In percent of GDP)	17.8	15.8	17.1	17.9	18.3	18.5	18.7	18.9	19.0

Source: Fund staff estimates.

1/ Divestment is treated as financing from 2006/07 onwards; excludes off-budget bond issuance.
2/ Divestment is treated as financing; includes off-budget bond issuance.

IV. Policy Discussions

17. **Discussions focused on how the policy framework should evolve to maintain India's impressive macroeconomic performance and stability in the face of sustained inflows**:

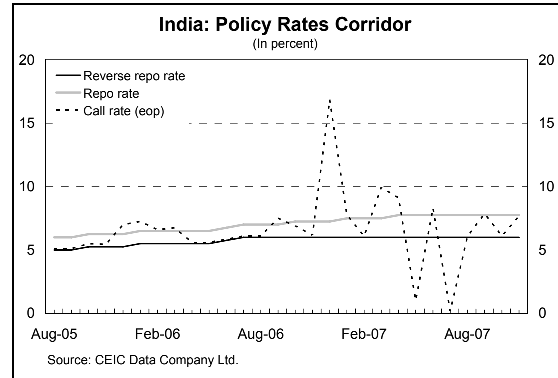
- Monetary and exchange rate policy calibrated to increasing financial openness;
- Deepening and broadening capital markets—while maintaining financial stability—to intermediate capital inflows smoothly and finance infrastructure;
- Fiscal consolidation to facilitate inclusive growth and cope with appreciation pressures; and
- Structural reforms to enhance economic flexibility and productivity.

18. **The mission outlined the preferred approach to dealing with capital inflows in the current favorable growth conjecture.** This included a package of measures comprising consistent monetary policy actions to address the impossible trinity, more ambitious fiscal consolidation, continued liberalization of outflows, financial sector reforms to prepare for a more open capital account, and structural reforms to increase the absorptive capacity of the economy (each described in detail in the sections below). The authorities generally agreed on the broad objectives of policies. However, given uncertainties in the global economic and financial environment and the constraints on reforms imposed by coalition politics, staff's view is that the current eclectic approach was likely to continue.

A. Calibrating Monetary and Exchange Rate Policy to Financial Globalization

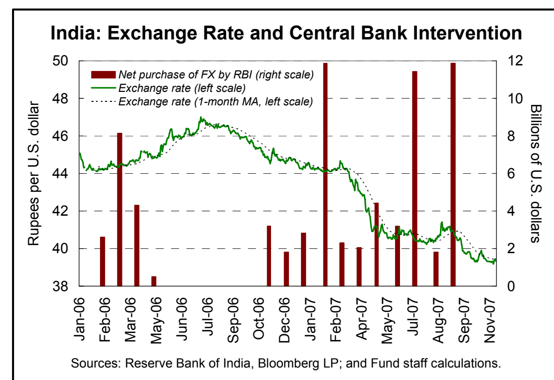
Background and Staff Views

19. **With the balance of inflation risks tilted to the upside, vigilance is warranted**. WPI inflation—the RBI's preferred measure—is set to remain below the RBI's end-year forecast of 5 percent this fiscal year. The mission agreed that it was appropriate to leave policy rates unchanged for now, in view of conflicting signals about prices (from the CPI) and demand growth. If money and economic activity did not slow as expected, the mission saw a case for further rate hikes to moderate credit expansion and anchor inflation expectations.



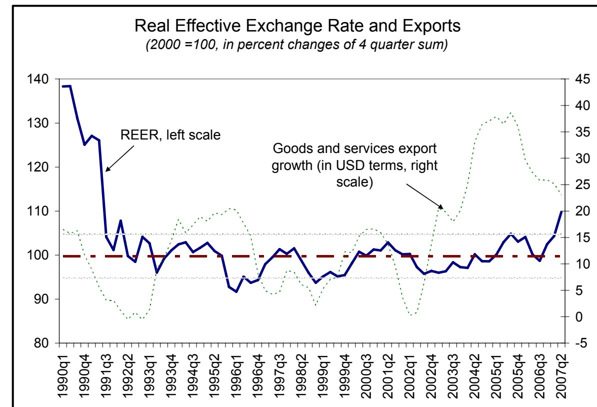
20. **The mission assessed the rupee as in line with fundamentals (Box 4).** So far, the rupee's rise has not broadly hampered competitiveness, with the level of the rupee appropriate from a medium-term perspective, and exports and profits remaining strong. While selected industries are affected, the appropriate response could be targeted, time-bound support—e.g., offering affected workers training and temporary financial assistance—to facilitate adjustment. In addition, enhanced labor market flexibility, improvements in power and transport infrastructure, and removal of small scale reservations would reduce business costs and increase economic flexibility. Benefits of appreciation (e.g., lower inflation and cheaper imports) also need to be better communicated.

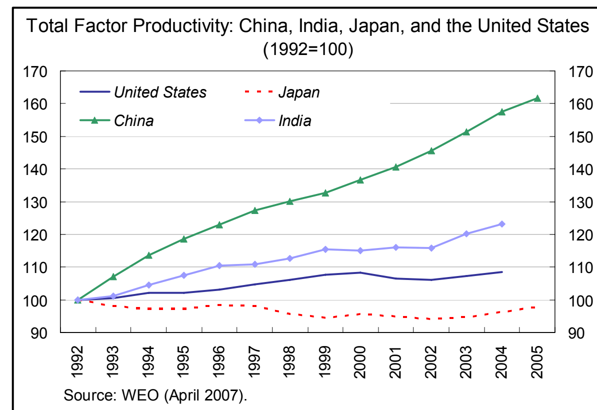
21. **Large capital inflows are complicating the conduct of monetary policy,** creating excess liquidity and pressuring the rupee. Partially sterilized intervention to smooth volatility has maintained a wide interest differential, which in turn has aggravated inflows, thereby placing further pressure on the exchange rate. More generally, inflows are exacerbating tensions in the policy framework among exchange rate stability, monetary independence, and financial openness—the "impossible trinity."



22. **Further rupee flexibility would be the most effective way to address the "trinity."** The stated policy of a managed but market determined exchange rate with no target path, and intervention only to curb short-term volatility remains appropriate. Within this

Box 4. Competitiveness

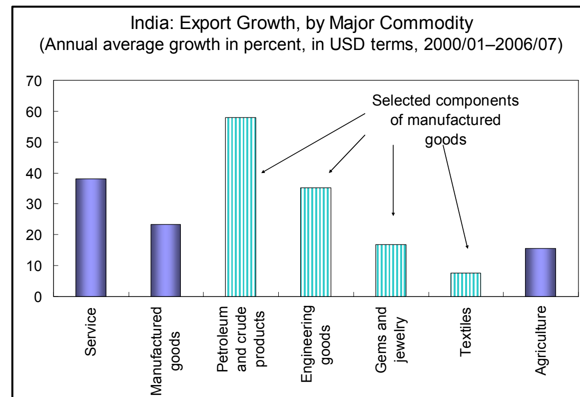




The recent rupee appreciation has fueled concerns about competitiveness. During January-November 2007, the rupee rose over 11 percent against the U.S. dollar. On a REER basis, the rupee is now outside of the ±5 percent range observed since the early 1990s. Sharp appreciation has led to strong calls to support the export sector.

At the same time, the September 2007 CGER exercise puts the rupee "close to equilibrium."[1/] India's cyclically adjusted medium-term current account deficit is close to its fundamental level (3 percent of GDP), as downward pressure on the deficit from favorable demographic trends are broadly offset by fiscal deficits and strong growth. Strong growth also supports a sustainable net foreign liabilities position, allowing India to comfortably run current account deficits.

Equilibrium rupee appreciation is also supported by rapid productivity growth. India's total factor productivity (TFP) growth averaged about 3⅓ percent in recent years, compared with peak decade averages of 2⅓ percent for Japan or newly industrialized countries in the past four decades.[2/] Consistent with buoyant productivity, India's share in world exports of goods and services has risen about ½ percentage point since 2000.



However, some industries are clearly making losses and have led the public call for action by the authorities to stem exchange rate appreciation or to offer some form of protection. The recent upward movement in the exchange rate highlights an interesting pattern in export growth. In general, industries experiencing the lowest export growth are those with low import content, and high labor intensity (and thus covered by the rigid labor laws or by small scale industry reservations). These industries have had significant protection over the years and have faced little incentive to become efficient and to raise productivity. In contrast, services exports and more capital intensive manufacturing exports have been expanding more briskly, and gaining market share globally. The key is to pursue labor market reforms and upgrade infrastructure to bolster productivity and lower costs for labor intensive sectors so that they too can adjust to the stronger currency.

[1/] Using data from August 22 to September 19.

[2/] World Economic Outlook, September 2006, "Asia Rising."

framework and in light of the large net inflows faced by India and other large emerging markets, the mission noted that avoiding large and prolonged foreign currency purchases would reduce the need for costly sterilization and limit the potential buildup of speculative inflows.[6] Moreover, a more flexible rupee, along with better-developed derivatives markets, would encourage private entities to hedge.[7]

23. **The mission welcomed steps taken to liberalize capital outflows in 2006 and 2007** (Box 2 discusses international experiences with capital flows). Continuing to liberalize outflows—including by large domestic institutional investors—would signal the commitment to fuller capital account convertibility. While local investors may not initially take full advantage of broader opportunities to invest overseas, over time outflows will rise as part of portfolio diversification, reducing net inflows.

24. **However, using capital controls for macroeconomic management could affect investment and growth adversely**. These risks were demonstrated by the recent experience with tightening restrictions on external commercial borrowings, which have not curbed overall flows, but have raised concerns about investment financing. Such restrictions are likely to be effective only temporarily. Moreover, further restrictions on capital inflows could foster uncertainty about the government's commitment to fuller capital account convertibility and about the authorities' "exit strategy."

25. **The temporary space provided by existing controls should be used to prepare for a more open capital account**. In particular, the flexibility and effectiveness of monetary policy would be enhanced by strengthening the monetary framework.[8]

- On *monetary operations*, the mission welcomed the heightened use of market sterilization instruments in 2007 and urged further reliance on open market operations (OMOs), with a broad range of maturities, rather than the CRR—which taxes banks.

- On *communications,* the mission welcomed improvements—such as the 2005 shift from annual to quarterly reviews and the increasingly forward-looking analysis in policy documents. Further increasing the frequency of policy meetings would reduce the need for inter-meeting measures. Monetary policy reviews could elaborate further on the inflation and demand-supply outlook, including through eventual publication of the

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[6] Staff estimates annualized sterilization costs and the tax on the banking system from higher reserve requirements at about $3 billion (0.2 percent of GDP).

[7] Evidence consistent with this notion is presented in Patnaik and Shah, "Does the Currency Regime Shape Unhedged Currency Exposure" (NIPFP Working Paper, 2007).

[8] See the Selected Issues paper.

inflation expectations survey, to guide expectations.[9] In addition, focusing policy on a broad-based CPI would orient policy around a clearer measure of the cost of living.

Authorities' Plans and Views

26. **The authorities saw the current conjuncture and outlook as favorable**. While demand pressures remained strong, the supply response had helped allay concerns about overheating and credit growth to sectors such as real estate had moderated, owing to the prudential measures taken in 2006/07. However, they remain vigilant, given abundant liquidity and high international oil and wheat prices. They also reiterated their preference for a multiple-indicators approach to formulating monetary policy, in light of ongoing structural change in the economy and the RBI's mandate for financial stability as well as price stability. On inflation measures, officials noted that given India's economic diversity, it is not possible to construct a meaningful single CPI. The survey of inflation expectations is in the pilot-testing stage, with no timetable for its release.

27. **The stance of monetary policy remains unchanged and focused on domestic concerns**. The RBI reiterated its policy of withdrawing monetary accommodation through active liquidity management. They noted that their approach of using varied instruments to sterilize was aimed at distributing costs among the RBI, the banking system (through the CRR) and the budget (interest on the stabilization bonds). The authorities agreed that, with inflation signals mixed, cutting policy rates would be premature.

28. **On the approach to exchange rate management, the RBI reiterated that intervention aims at smoothing volatility**. The focus was not on the real effective exchange rate, but on maintaining orderly conditions in the bilateral U.S. dollar/rupee market, particularly in response to externally-induced volatility. Over the past year, intervention had been one-way (purchases of foreign exchange) because there had been no net capital outflows since May 2006. With risks to capital flows on both the upside and downside, the rupee could weaken as well as strengthen; in this connection, they stressed that the rupee had been on a weakening trend as recently as 2006. For the medium term, the authorities agreed that higher exchange rate flexibility could help India adjust to increasingly globalized financial markets.

29. **The authorities did not dispute the staff's assessment that the exchange rate appears to be in line with its medium-term equilibrium value but noted that it is too early to assess the effects of the recent appreciation**. Notwithstanding the small current account deficit, the authorities see the sizable trade deficit as a potential sign of loss of competitiveness due to exchange rate appreciation. At the same time, when providing

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[9] See the Selected Issues paper.

assistance to the sectors worst affected by appreciation, the authorities have publicly stressed the need for Indian companies to adapt to a stronger rupee, by strengthening productivity.

30. **The authorities stressed that formulating a response to rapid capital inflows was difficult given the present global environment**. The authorities saw the current monetary framework and communications as adequate to maintain price and financial stability. They noted that costs of sterilized intervention had to be weighed against the benefits of financial stability and smoothing exchange rate volatility given limited real-sector flexibility. On communications, the RBI viewed its approach as well understood in markets, and noted its efforts to increase transparency. The authorities also considered the current frequency of policy meetings, with the Committee of the Central Board meeting weekly, alongside its quarterly reviews, to be adequate. On capital flows, the RBI considered that excessive inflows had resulted from the "unusual heightened global uncertainties" surrounding the disruption in global credit markets, and in particular, the policy response by major-country central banks to the credit turbulence. They saw the surge in FII inflows since September in the aftermath of the sub-prime crisis as temporary, with India (among other countries) becoming a haven for capital flows. These massive capital inflows—far in excess of the economy's absorptive capacity—were complicating monetary management. Continued inflows could create financial sector vulnerabilities, and restrictions on selected capital inflows had helped to preserve a favorable macroeconomic environment. They did not consider liberalizing outflows as an adequate solution as such steps would only attract more inflows while not resulting in significant balancing outflows. In light of these risks, they stated that all possible options for maintaining stability would be considered, including non-monetary measures such as active capital account management (capital controls).

31. **In the medium term, the government's intent remains to move toward fuller capital account convertibility**. The approach would remain gradual, with a hierarchy of preferences according to stability of flows (with FDI and equity first), and, as noted above, some role for existing controls to preserve financial stability. At the same time, the government shared staff's doubts about the long-term effectiveness of controls and concerns about the impact of ECB restrictions on investment. On outflows, they noted that ceilings on overseas investments of corporates, mutual funds, and individuals had been increased, but so far these measures had not resulted in significant outflows.

B. Strengthening the Financial System

Background and Staff Views

32. **India's financial globalization necessitates development of broader and deeper financial markets, as well as increased efficiency and continued stability in the financial system.** Better developed financial markets would help to intermediate capital inflows, expand risk management toolkits, and finance India's large investment needs. In the financial

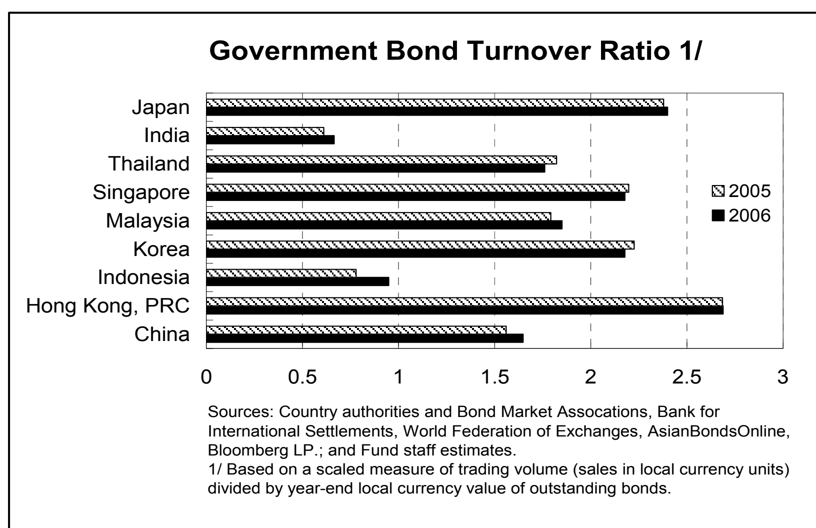
system, continued deregulation, with appropriate strengthening of prudential rules, can improve the efficiency of intermediation while preserving stability.[10]

Financial markets

33. **The priorities are developing India's government debt, corporate bond, and derivatives markets.** A more liquid government debt market would provide a better foundation for pricing financial instruments (and would strengthen the monetary transmission mechanism). A robust, rupee-denominated corporate debt market would allow corporations to avoid currency mismatches while providing a venue for infrastructure finance (the banking system lacks the balance-sheet capacity to provide it). Well-developed derivatives markets would provide financial institutions and corporations with tools needed to manage risks accompanying financial globalization.

34. **The government yield curve is illiquid, undercutting its role as a pricing benchmark.** The turnover ratio of government debt is about 70 percent—lower than in Indonesia and Vietnam, and about half that in countries such as Thailand and Malaysia. Only four issues are traded more than four times a week. Reasons include (i) a narrow investor base; (ii) stringent short selling rules (positions may remain open for no more than five days; failure to deliver faces harsh penalties, including banning from trading); and (iii) the Statutory Liquidity Ratio (SLR) requires banks to maintain in cash, gold, or government and other approved securities at least 25 percent of demand and time deposits.[11]

35. **The corporate debt market is underdeveloped,** amounting to less than 5 percent of GDP, compared with over 20 percent of GDP in Thailand, Chile and Mexico, and



Sources: Country authorities and Bond Market Assocations, Bank for International Settlements, World Federation of Exchanges, AsianBondsOnline, Bloomberg LP.; and Fund staff estimates.
1/ Based on a scaled measure of trading volume (sales in local currency units) divided by year-end local currency value of outstanding bonds.

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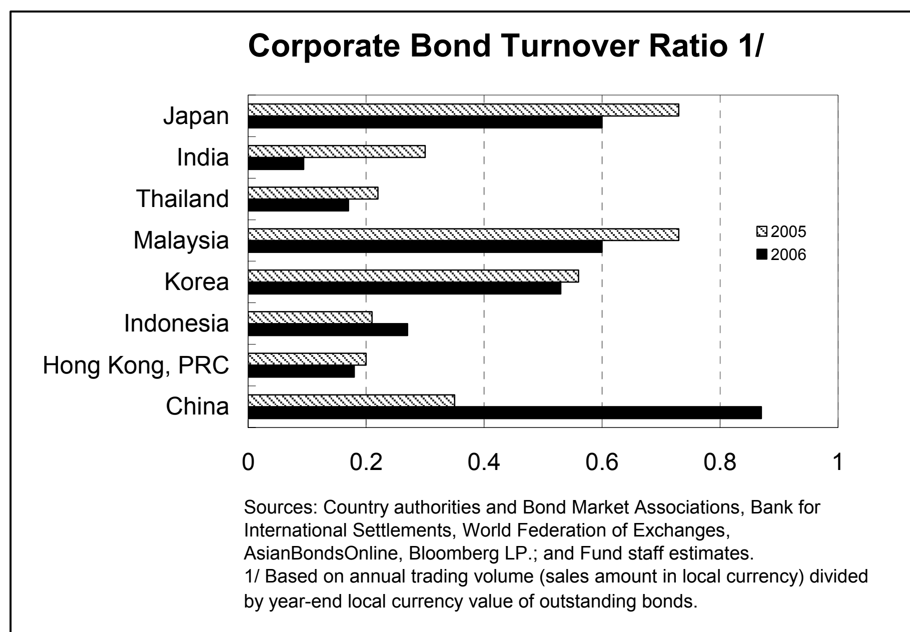
[10] See the Selected Issues paper.

[11] Lowering the SLR would require offsetting monetary operations to avoid a sharp rise in liquidity.

50-100 percent of GDP in more advanced economies. Impediments to a vibrant market include quantitative limits on institutional investors such as pension funds and FIIs;[12] restrictive issuance procedures (including a requirement for two investment-grade ratings); tax deduction at source and stamp duties; the lack of a repo market; and low price transparency (with most trading OTC).



36. **Augmented exchange-traded interest-rate and foreign-exchange derivatives would complement growing OTC markets**.[13] While OTC markets turnover has risen threefold during 2004–2007 to over $8 billion per day, OTC markets lack the centralized risk management and inherent transparency of exchanges. In addition, legal uncertainty exists about settlement in OTC markets, particularly closeout netting (which limits the risk that a defaulting counterparty will demand payment on contracts that are in his favor while refusing to pay those on which he owes money). However, attempts to introduce exchange-traded interest-rate contracts had limited success, partly due to imperfect contract design and restricted participation, while currency futures are presently disallowed.

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[12] Pension funds are allowed to invest up to ten percent of annual accruals in corporate bonds, while total FII investment is capped at $1.5 billion.

[13] See the Selected Issues paper.

Financial efficiency and stability

37. **The main risks to financial stability—rapid growth in credit and strong capital inflows—appear to be manageable at present, but warrant close monitoring**. Financial soundness indicators are in prudent ranges, and overall credit growth is decelerating. However, growth in credit to real estate remains elevated, at almost 70 percent y/y, and is concentrated in new private sector banks (accounting for more than 30 percent of their loan books). Also, the rapidly growing retail segment is relatively new to Indian banks. In addition, Indian corporates' foreign currency borrowing has risen, and data on the extent of hedging are unavailable but anecdotes suggest that it is far from complete. In this environment, close supervisory attention would be needed to banks' careful management of retail credit portfolios, and to their exposure to corporates that have unhedged foreign exchange exposures.[14] Going forward, stress tests of banks' exposures, and strengthened supervision under Basel II, will help to maintain the stability of the banking system.

38. **There is also scope to improve the efficiency of the banking system.** Public ownership accounts for about 70 percent of scheduled commercial bank assets. The banking system is fragmented, including 82 commercial banks. Return on assets of domestic banks is low compared with other emerging and developed markets. Impediments to greater efficiency include credit targets to "priority sectors" (including agriculture, small scale industries, self employed); these loans tend to be small (thus costly to administer), with higher default rates than other loans.[15] Rates on savings deposits and small loans, short-term agricultural loans, and export credits are regulated. In addition, the CRR taxes banks. Foreign ownership, which could boost competition and introduce new products and technologies, is subject to limits (to be reviewed in 2009).

Authorities' Plans and Views

Financial market development

39. **The authorities agree on the need for a more liquid government securities yield curve.** They have been gradually consolidating benchmark issues to reduce fragmentation, through swaps and buybacks, and by concentrating issues on benchmark maturities. In addition, the Government Securities Act of 2006, which came into force on December 1, 2007, allows inter alia stripping and reconstitution of government securities.

40. **Steps are underway to develop corporate bond markets.** The fixed-income industry group (FIMMDA) has developed a trade-reporting platform to improve price transparency. In addition, the RBI would introduce corporate bond repos once an efficient

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[14] Banks face regulatory limits on their own foreign exchange exposure.

[15] McKinsey Global Institute, 2006, "Accelerating India's Growth Through Financial System Reform."

and safe settlement system based on delivery versus payment and electronic straight-through processing is implemented. Meanwhile, the Securities and Exchange Board of India has introduced smaller lot sizes for trading, and in December 2007 reduced the number of required ratings to one and allowed sub-investment grade debt.[16]

41. **The RBI has clarified the regulatory environment for derivatives.** Comprehensive guidelines on derivatives (April 2007) stipulated eligibility criteria for participation as either market-maker or end-user, broad principles (including sound risk management), permissible instruments, documentation, and prudential limits. Draft guidelines on credit default swaps (May 2007) specified permitted structures, eligible counterparties, prudential norms, and risk management, accounting, and reporting requirements.

42. **Work is underway to expand derivatives markets.** On currency derivatives, the RBI's October 2007 mid-term policy review proposed to permit authorized dealers to run options books and allow corporates to buy and write covered options. A November 2007 report of the RBI's Internal Working Group on Currency Futures recommended creation of a dedicated exchange, with participation initially limited to residents. Meanwhile, a sub-group of the RBI Technical Advisory Committee on Markets is considering how to reactivate the interest rate futures market, and whether to expand foreign participation.

Financial efficiency and stability

43. **The RBI made the following points in response to staff comments.** They noted that bank efficiency had improved over time, including for the public banks, while NPLs have fallen over time. Going forward, however, banks would need to raise capital, particularly to meet the enhanced demands of Basel II (for foreign banks and Indian banks with foreign activities from March 2008), which would require an increase in capital equivalent to about one percent of risk-weighted assets. Foreign ownership of banks would be reviewed in 2009 as earlier planned; one option being considered could be to grant subsidiaries of foreign banks the same treatment as Indian banks. The RBI's roadmap for foreign bank participation is consistent with India's WTO commitments, and it has proposed that foreign participation go beyond the existing WTO commitment of 12 branches per year. Regulations on priority-sector lending were defined broadly, and formulated to promote financial inclusion.

44. **The RBI is carefully monitoring bank risk exposures**. Including in the context of its Supervisory Review Process, in which banks with substantial exposures to sensitive sectors are subject to special scrutiny, it frequently inspects banks' credit and market risk books, cognizant that banks have not experienced a full retail credit cycle. It has found no basis for concern, with rising income levels supporting retail credit quality; in the real estate

[16] "Developing Debt Markets in India," speech by RBI Governor Y.V. Reddy, October 18 2007.

sector, rapid growth has partly reflected the low initial base. In addition, banks have been advised to monitor the unhedged currency exposures of their corporate clients, and the RBI is working to put in place a supervisory process for globally-active bank-led conglomerates. More generally, the pending move to Basel II will provide an opportunity to further strengthen risks management and the supervisory review process. The RBI has also worked with banks to strengthen stress testing, including credit risk in derivatives books, and closely watches banks' derivatives exposures.

45. **A Committee on Financial Sector Assessment is undertaking a self-assessment of financial stability and development.** Four advisory panels are addressing financial stability and stress testing; financial regulation and supervision; institutions and market structure; and transparency standards, and will issue separate reports. The first group will conduct macro-prudential surveillance, including system-wide stress tests, and make recommendations for strengthening the financial system. The other groups will undertake assessments of relevant standards and codes and suggest measures to bridge identified gaps. The Committee is expected to complete its work by March 2008.

C. Achieving Debt Reduction While Financing Priorities

Background and Staff Views

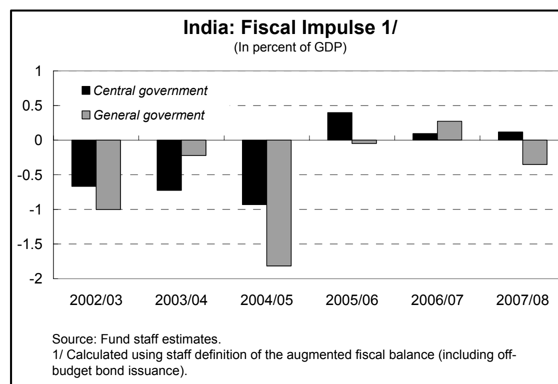
India: Recent Budgetary Performance
(In percent of GDP)

	2006/07	2007/08
Official budget 1/		
Authorities	-3.5	-3.3
Staff	-3.5	-3.3
Augmented budget 2/	-4.4	-4.5
o/w: Off-budget subsidies	-1.0	-1.2
States	-2.7	-2.4
General government (augmented) 2/	-7.2	-6.8

Sources: Data provided by the Indian authorities; and Fund staff estimates and projections

1/ Uses authorities' definition: excludes off-budget bonds.
2/ Staff definition: includes off-budget bonds as quasi-fiscal expenditure.

46. **Progress in consolidation has been mixed, with significant revenue gains eroded by expenditure overruns.** Tax performance has been underpinned by rapid economic growth, high corporate profits, base broadening, and improved administration. States' VATs (now in all states but Uttar Pradesh) have bolstered revenues, supplemented by higher central government transfers. But revenue gains have been offset by sharp increases in subsidies and higher-than-budgeted interest payments, reflecting soaring commodity prices and rising sterilization costs respectively. Overall fiscal consolidation has therefore stalled; on staff's definition (including off-budget bond issuance), the general government deficit has hovered at just over 7 percent of GDP since 2004/05.



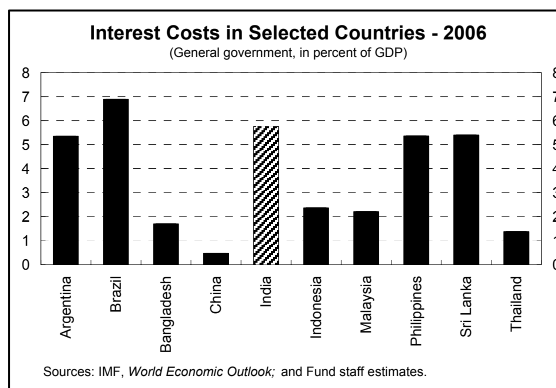
Source: Fund staff estimates.
1/ Calculated using staff definition of the augmented fiscal balance (including off-budget bond issuance).

47. **The central government's deficit target for this year—3.3 percent of GDP—is likely to be met.** Tax revenue is likely to overperform the budget target by a wide margin,

but expenditure is also expected to overshoot due to above-budget subsidy and interest costs. Including off-budget quasi-fiscal expenditure, staff projects the augmented deficit at 4½ percent of GDP, about the same as last year.[17] Looking to 2008/09, the FRBMA sets the challenging objective of revenue balance (and reduction of the overall deficit to 3 percent of GDP). Based on the staff's augmented definition of the budget deficit, achieving revenue balance would require consolidation of 2¾ percentage points of GDP (and about 1½ percentage points of GDP to achieve an overall deficit of 3 percent of GDP).[18] As discussed in Annex I, the staff baseline assumes that off-budget subsidy-related bond issuance will be phased out gradually, suggesting that achievement of current balance will be delayed by a few years.

48. **Given the rapid growth in revenue, fiscal consolidation could have been more ambitious.** This would not only have accelerated debt reduction, but also increased the contribution of fiscal policy to absorbing the inflationary impact of capital inflows, a burden which has been borne disproportionately by monetary policy (given the positive fiscal impulse).[19]

49. **There are risks to this baseline.** Spending risks include the persistence of high fertilizer and fuel subsidy costs (given the global commodity price outlook) and increased government wages and pensions from the Sixth Pay Commission (SPC) award.[20] Recent wage hikes and past cost of living increases would limit the rise in salary costs and phasing in pay increases would ease the fiscal burden. On revenues, rapid growth since 2004/05 (averaging 23 percent annually) largely reflects corporate profits, which are already slowing. Moreover, tax losses from Special Economic Zones, which grant full income tax exemption for five years (and 50 percent exemption for the following five years), could rise to 1½ percent of GDP per year.



Sources: IMF, *World Economic Outlook;* and Fund staff estimates.

50. **On a longer view, fiscal consolidation remains important for achieving India's inclusive growth objectives and coping with financial globalization.** Debt servicing costs

[17] Bond issuance (in compensation for losses related to commodity subsidies) is expected to reach 1.2 percent of GDP this year, primarily to oil producers (0.8 percent of GDP) and fertilizer producers (0.3 percent of GDP).

[18] Staff projects this year's revenue deficit at 0.8 percent of GDP. However, this includes a one-off special dividend payment from the RBI amounting to 0.7 percent of GDP.

[19] See WP/07/268.

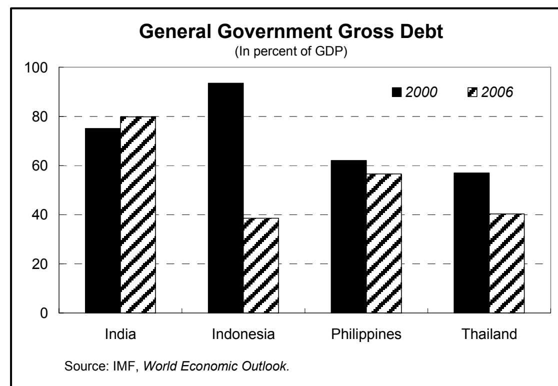
[20] Pay Commissions make recommendations on government pay scales every ten years. The SPC's recommendation is expected by April 2008.

(over 5 percent of GDP) absorb fiscal space needed for priority social and infrastructure projects. Consolidation would also reduce the risks of crowding out and set the stage for further financial openness.

51. **Bold expenditure reforms are needed to make space for social spending.** Revamping subsidies is a key priority: they are expensive and poorly targeted.[21] A phased re-alignment of domestic fuel prices to international levels, paired with a shift to a rule-based pricing and burden-sharing mechanism for petrol and diesel, would reduce the fiscal burden and improve transparency. Staff welcomed the government's plans to improve targeting and reduce diversion of food and fuel subsidies and other social assistance, as well as efforts to broaden the social safety net (including extending social insurance to informal-sector workers and old-age pensions to the poor).[22]

52. **Revenue reforms are needed as well.** In 2006/07, foregone revenue from exemptions amounted to 5.7 percent of GDP (roughly half of actual tax collections). The authorities' GST (planned for April 2010) would streamline the tax structure and bolster revenue in the medium term. Early announcement of a roadmap—including a timetable for merging VAT-like taxes and broadening the services tax—would help taxpayers prepare. A single point of collection (as in most federal OECD countries) would be easier to administer than a dual-tier system. On non-tax revenue, there is considerable potential to raise collections from user fees, but this will require significantly improved service delivery.

53. **The FRBMA should be supplemented by an explicit framework for medium-term debt reduction.** The Act implicitly targets further debt reduction beyond March 2009, which staff sees as achievable (staff projects general government debt to fall to 62 percent of GDP by 2012, a decline of almost 20 percentage points (see Annex I)). Adoption of an explicit, ambitious medium-term debt reduction target could bolster the government's commitment to



[21] Government studies find that 58 percent of subsidized food goes to non-poor families and that subsidized liquefied petroleum gas is widely used by middle-class households.

[22] See the Selected Issues paper.

debt reduction, guide public expectations about fiscal policy, and relieve appreciation pressures.[23] The target should encompass the consolidated government, including non-financial public enterprises.

54. **Aggregate state finances are sound.**[24] Thanks to fiscal responsibility legislation (adopted in all but two states), as well as high transfers and debt forgiveness by the central government, fiscal consolidation targets set out under the 12th Finance Commission are likely to be met ahead of schedule. Going forward, however, several risks exist:

- The anticipated slowdown in central government tax collections (which are shared with the states) requires states to enhance revenues, particularly given potential SPC costs.
- With education and health spending (primarily a state responsibility) expected to rise, constraints on implementation and ensuring the quality of spending could become more acute. Monitoring and evaluation need improvement.
- State liquidity management could be improved further; cash-rich states could use excess revenue to consolidate debt more quickly.

Authorities' Plans and Views

55. **The authorities remain committed to FRBMA targets.** This year, significant revenue overperformance (especially by corporate taxes) was expected to offset higher-than-budgeted interest payments and subsidies, thus allowing the central government deficit target to be met.[25] The authorities acknowledged that achieving revenue balance by March 2009 would be challenging, given persistent expenditure pressures.

56. **At the same time, the government plans to ramp up priority spending significantly in coming years, with a particular focus on the social sector.** Under the 11th Plan (2007–2012), spending on education and health is set to triple to 6 percent and 9 percent of GDP, respectively, mostly coming from the public sector. Total infrastructure investment is targeted to rise from about 5¾ percent of GDP to 9 percent of GDP, with an increased private-sector share. To avoid undermining fiscal consolidation, the government aims to contain non-priority spending growth. Relatedly, Planning Commission officials

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[23] The FRBM Rules (2004) set out annual reductions in the revenue and overall deficits. While the aim of the FRBMA is to achieve revenue balance (and an overall deficit of 3 percent of GDP) by March 2009, the annual deficit reduction targets are set in perpetuity.

[24] The fiscal condition of some states remains worrisome, however.

[25] In this connection, they acknowledged that the official deficit was understated, though they noted that subsidy-related bonds are considered extra-budgetary because India's fiscal accounts are on a cash basis.

expressed concern that pushing for revenue balance by March 2009 would constrain priority spending, thereby jeopardizing inclusive growth objectives.[26]

57. **The Ministry of Finance shared the staff's view that reforms are needed to secure lasting fiscal consolidation.** The government is committed to reducing the subsidy bill and is evaluating reform options; but the timing of these politically-difficult reforms is unclear. On revenues, they agreed that tax buoyancy would moderate as growth eased, but noted the contribution of ongoing compliance improvements and base-broadening.

58. **The authorities were cautiously optimistic about the outlook for state finances.** While recognizing the significant recent improvement in states' fiscal balances, they highlighted the large role of central government transfers and the need for states to strengthen their own revenue-raising capabilities. Expenditure may have been consolidated too quickly in some cases, with critical labor shortages in education and health resulting from across-the-board hiring freezes. Looking forward, improving service delivery at state and local levels will be critical for inclusive growth.

59. **On medium-term fiscal issues:**

- The recently appointed 13th Finance Commission is preparing a road map for GST introduction (a dual-tier system with a common tax base would be the likely outcome) and will make recommendations for medium-term fiscal policy.

- The authorities downplayed concerns about SPC expenditure risks, noting that the award was unlikely to be as high as in 1997 because cost-of-living hikes have been granted more frequently in recent years. Increases would likely be phased in, and the states' improved fiscal positions would help them absorb the costs.

- On financing infrastructure, the government plans to increase significantly the role of public-private partnerships.

D. Addressing Supply Constraints to Sustain Growth

Background and Staff Views

60. **Strong and more inclusive growth is the basis for India's economic stability.** Productivity needs to be bolstered in order to maintain competitiveness in the face of appreciation pressures. Strong growth is also needed to support fiscal sustainability, currently riding on buoyant revenues. Inclusive growth will also be essential to build political

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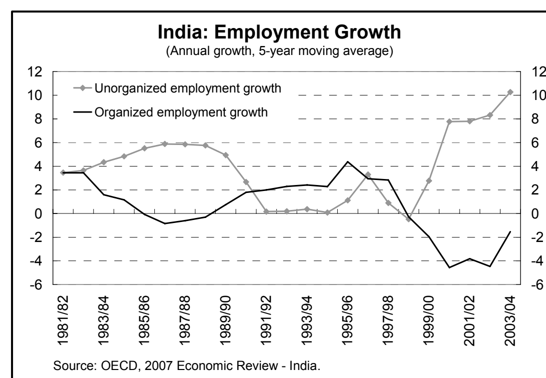
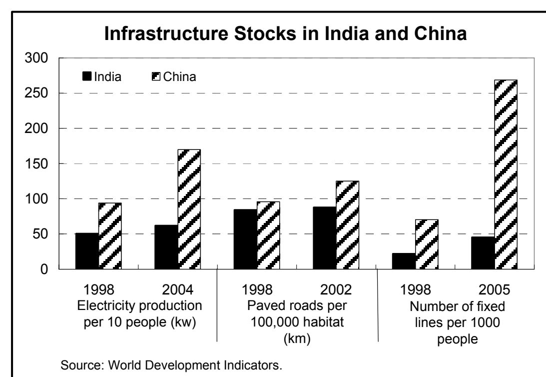
[26] They also noted that because some central government transfers to states are classified as revenue expenditure when they actually finance capital expenditure (in education and health), the revenue deficit was overstated.

consensus for growth-oriented reforms, given growing perceptions of rising inequalities and the lack of a well-functioning social safety net.

61. **Education and labor-market reforms can both accelerate growth and ensure that its benefits are distributed widely.** Skill premia, and correspondingly consumption inequality, are growing, especially in urban areas. India registered one of the highest increases in skilled wages in the world; wages of managerial and supervisory staff rose 16 percent during 2007, with a similar increase expected in 2008. Yet, unemployment rates among the young rise steeply with educational achievement, suggesting serious mismatches between education provision and market needs.[27] More flexible labor regulations could increase formal sector employment, which has stagnated even as employment in the informal sector grows. The reallocation of labor from weaker performing to stronger sectors in the economy could generate substantial productivity gains, while allowing a larger share of the population to enjoy the benefits of growth.



62. **Major shortcomings exist in infrastructure,** which are estimated to reduce GDP growth by 1 percent per annum. Power shortages are acute and growing: the average firm reports power outages on 85 days per year, and the peak deficit reached a 10-year high of 14½ percent this year. The government estimates that some $500 billion in infrastructure investment will be needed over the medium term in power and other sectors. A prerequisite for private investment in the power sector is a more predictable and transparent regulatory framework (particularly for pricing and payment collections). Streamlining FDI regulations, developing a corporate bond market and tapping global capital markets (including by limiting restrictions on ECBs) would help mobilize the financing needed.



63. **The mission encouraged the authorities to continue with gradual trade liberalization.** The overall average tariff has come down from 32.3 percent in 2002 to 15.8 percent in 2006, although average agricultural tariffs stand at 40.8 percent. In the

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[27] Among 26–30 year olds, unemployment rates rise from 0.5 percent for the illiterate to 15.4 percent for those with postgraduate education and above.

2007/08 budget, the government announced a further reduction of the peak nonagricultural rate from 12.5 percent to 10 percent (subject to certain exemptions).

Authorities' Plans and Views

64. **"Faster and more inclusive growth" is the guiding objective of the 11th Plan.** Priorities include ensuring access to social services, augmenting physical infrastructure, and promoting a competitive environment that supports private sector investment and job creation, including in agriculture.

65. **The Plan envisions enhanced education and labor market flexibility.** In particular, a stronger focus on secondary, higher and technical education would better align the skills of graduates with market needs, and limit widening income disparities. The 11th Plan envisages a tripling of public spending on education to 6 percent of GDP, with further private sector involvement. The government is well aware of the need for a greater emphasis on quality of services provision, with enhanced monitoring, evaluation and accountability. Allowing FDI in the education sector is under consideration. The authorities recognize that rigid labor regulations stifle organized-sector employment, and the 11th Plan includes, for the first time, recommendations to make labor regulations more flexible, though their political feasibility remains unclear.

66. **The government is relying on public-private partnerships (PPPs) to help bridge infrastructure gaps.** So far, progress in PPPs has varied across sectors, with telecom, ports and road sectors attracting the bulk of private investment. In the power sector, regulatory hurdles regarding payment mechanisms remain the biggest obstacle. Model concession agreements in key infrastructure sectors are moving towards allocating a greater share of the risk to the public sector. The authorities also plan to increase public investment significantly.

67. **The authorities remain committed to multilateral trade liberalization**. Tariff reductions have lowered the costs of key capital goods and raw materials, and in tandem with complementary structural reforms, have spurred domestic competition, pushing firms in India to align their cost structures with firms globally. While the government plans to reduce tariffs to ASEAN levels by 2009, domestic concerns and corresponding tariffs and non-tariff barriers of major trading partners may influence the degree of reductions. The authorities were hopeful for progress in the Doha Development round, though they expressed concern that the focus on development was fading. In the meantime, India is pursuing further trade liberalization through FTAs with key nations.

V. Staff Appraisal

68. **India's impressive macroeconomic performance pays tribute to its sound macroeconomic policies and steady structural reforms over the past 16 years.** Growth

has brought further reductions in poverty while prudent macroeconomic policies have supported financial and economic stability.

69. **Sustaining this performance requires tackling two challenges.** First, rapid capital inflows are bringing out tensions in the policy framework associated with the "impossible trinity." Resolving these tensions will require an evolution of monetary policy, further exchange rate flexibility, and deeper and broader capital markets. Second, sustained, inclusive growth is needed to maintain economic stability. The necessary structural reforms will both underpin growth and increase economic flexibility and competitiveness.

70. **Monetary operations and communications are adapting to financial globalization, and this process can usefully be stepped up.** The RBI has managed liquidity more actively, improved communication, and accommodated increased exchange rate volatility. Greater use of open market operations would enhance the flexibility and effectiveness of monetary policy and decrease reliance on the tax of the CRR. Meanwhile, further elaboration on the inflation outlook in more frequent monetary policy reviews would help guide expectations.

71. **Staff judge rupee appreciation as an equilibrium phenomenon, reflecting strong economic fundamentals**. The rupee is appropriately valued from a medium-term perspective. A market-determined rupee, and the policy of a managed float with some intervention to curb volatility but no target or preannounced path, remain appropriate. Looking ahead, further exchange rate flexibility will give monetary policy greater room to focus on containing inflation, and reduce the costs of exchange rate management. In combination with better-developed derivatives markets, a more flexible rupee would encourage hedging and avoid a buildup of speculative inflows.

72. **The use of capital controls for macroeconomic management should be avoided, as they could affect investment adversely.** These risks are demonstrated by the recent experience with tightening ECBs restrictions, which have not curbed overall flows but have raised concerns about investment financing. Moreover, while the government remains committed to fuller capital account convertibility, imposing further restrictions on inflows may create confusion about that commitment and about the authorities' "exit strategy." A preferable strategy would be to make capital account liberalization a deliberate process. The temporary space provided by existing restrictions should be used to prepare for a more open capital account. Steps taken to liberalize capital outflows in 2006 and 2007 are welcome, and further bolder steps would be warranted, to reduce net inflows over time.

73. **Broader and deeper financial markets could better intermediate capital inflows, accommodate adjustments in the exchange rate, and finance India's large investment requirements.** Developing the corporate bond and derivatives markets onshore will be crucial to funding massive infrastructure investment needs and providing corporations with the tools they need to manage the risks associated with India's financial globalization.

Another priority is developing exchange-traded currency and interest rate derivatives markets to complement the growing OTC markets.

74. **The efficiency of financial institutions can be enhanced.** Key steps would include opening up further to foreign banks, phasing out directed lending, further loosening interest rate restrictions, and reducing the CRR. In addition, further liberalizing FDI in financial services would spur competition and bring innovation and advanced financial technologies.

75. T**he RBI appropriately maintains a strong focus on preserving financial stability.** Thanks to the RBI's close scrutiny of banks' credit portfolios and its efforts to improve bank risk management, the risks posed by a turn in the credit cycle are likely to be manageable. In addition, the pending adoption of Basel II will further strengthen bank risk management. The ongoing review of financial stability and development appropriately emphasizes macro-prudential surveillance, including system-level stress testing, and staff looks forward to publication of the report in March 2008.

76. **Further fiscal consolidation is essential to sustain inclusive growth and cope with financial globalization.** The interest costs of high public debt absorb fiscal space needed for priority social and infrastructure spending. Consolidation would also reduce the risks of crowding out and set the stage for further financial openness. Finally, a tight fiscal stance can shoulder some of the burden of adjusting to the inflationary impact of capital inflows.

77. **Measures are needed on both spending and revenues.** On spending, the authorities are rightly concerned about the growing fuel subsidy burden. A phased reduction in fuel subsidies and a gradual alignment of domestic prices to international levels is warranted, and a more rule-based pricing and burden-sharing mechanism would improve transparency. Meanwhile, food and fertilizer subsidies can be better targeted. On revenues, cutting exemptions would substantially boost the tax take. Plans to introduce the GST are welcome; early announcement of a roadmap would help taxpayers to prepare. Collections from user fees could be raised, but will require significantly improved service delivery.

78. **State's aggregate fiscal performance remains impressive, providing fiscal space to raise social spending.** Fiscal responsibility laws, large central government transfers, and introduction of the VAT have spurred rapid deficit reduction. However, liquidity management could be improved further. Looking ahead, a priority is to improve the quality and quantity of state social spending.

79. **The FRBMA could be augmented to provide an explicit framework for future debt reduction.** An explicit medium-term debt reduction target for consolidated government could bolster the commitment to further debt reduction.

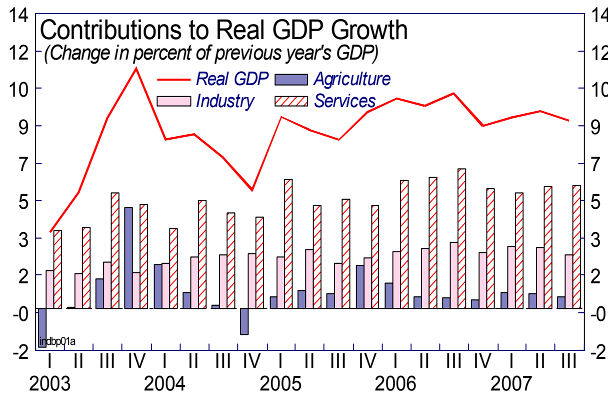
80. **Structural reforms to make the economy more flexible will be key to competitiveness and inclusive growth.** Sustained productivity growth will be essential to

maintain competitiveness. Meanwhile, widening disparities reflect rapid growth in skilled wages owing to skills shortages, which in turn reflect gaps in education. In addition, infrastructure gaps and labor market rigidities will increasingly constrain growth. In the power sector, a more predictable regulatory environment is warranted to mobilize private sector funding. Higher—and more effective—public spending on education is also essential. FDI in education could play a supportive role, with a clearer regulatory regime. More flexible labor regulations can facilitate the reallocation of labor to stronger sectors.

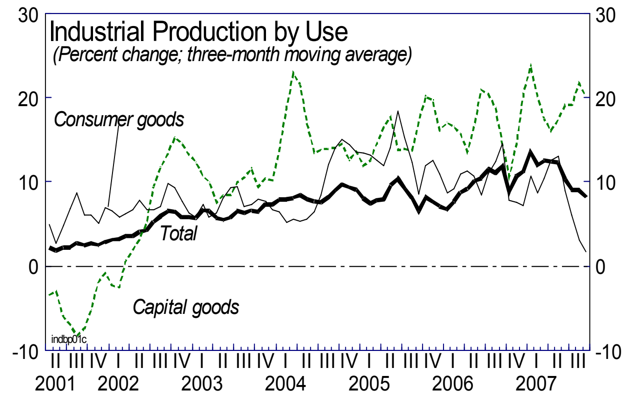
81. **Further trade liberalization can facilitate growth.** Tariff reductions have reduced the costs of key capital goods and raw materials, and in tandem with complementary structural reforms, have spurred domestic competition. Accordingly, staff supports the aim to reduce tariffs to ASEAN levels and welcomes the authorities' commitment to multilateral trade liberalization.

Figure 1. India: Growth

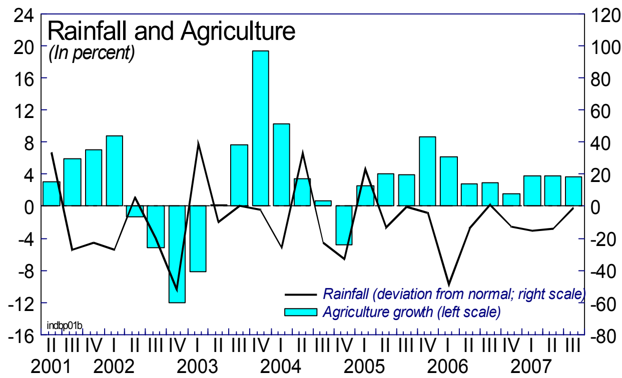
Growth has been robust…



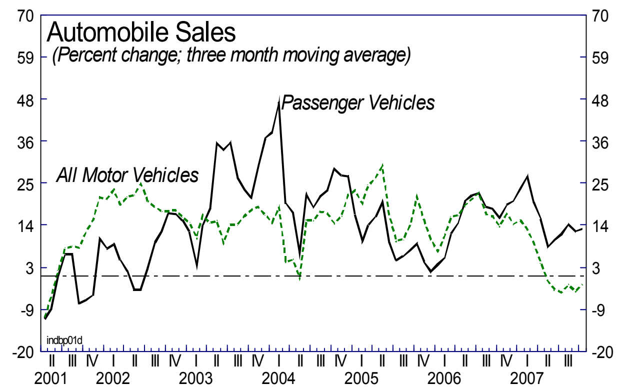
…helped by industrial production indicating buoyant investment…



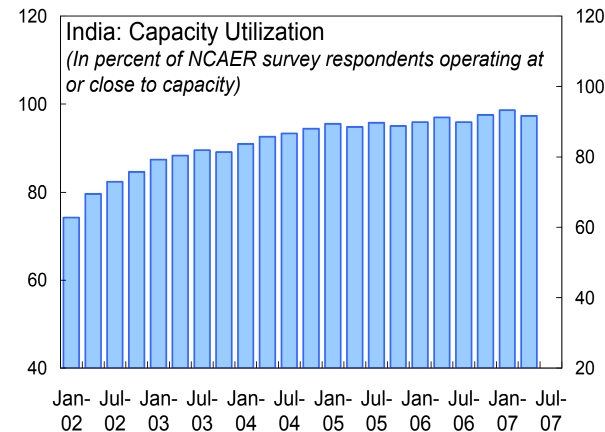
…and a normal monsoon...



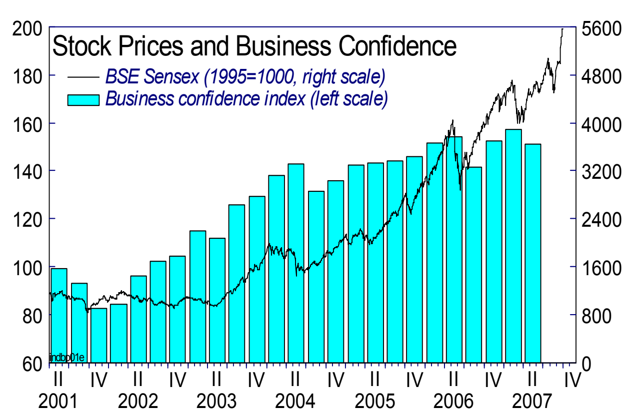
…despite somewhat softer household spending.



Stronger growth is reflected in higher capacity utilization…



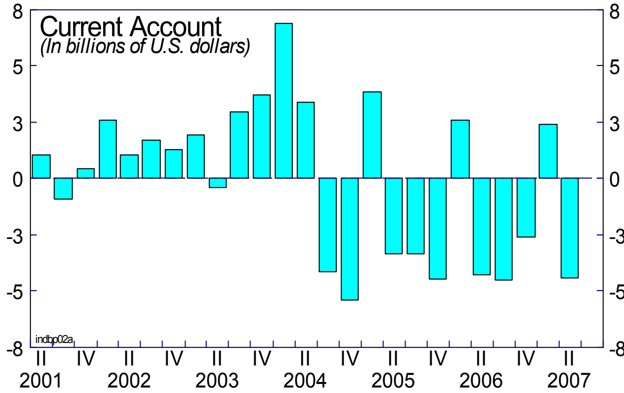
…increasing stock prices and resilient business confidence.



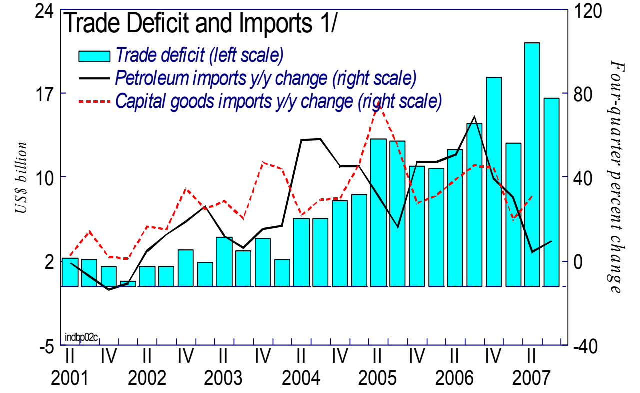
Sources: Data provided by the Indian authorities; CEIC Data Company Ltd; NCAER; and Fund staff projections.

Figure 2. India: External Sector

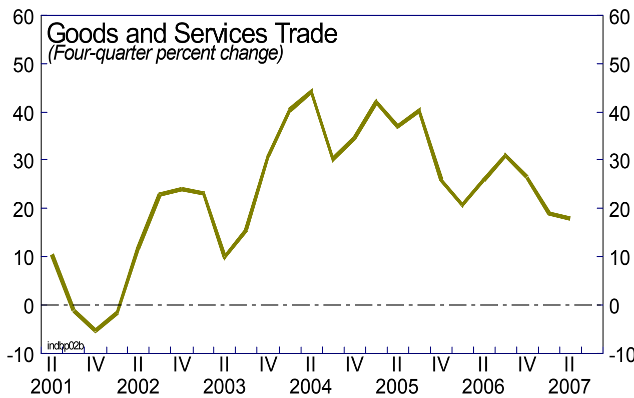
The current account is in deficit…



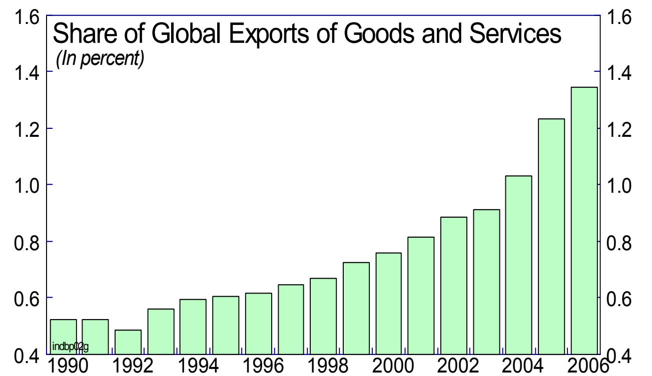
…on the back of a rising trade deficit, reflecting strong domestic demand.



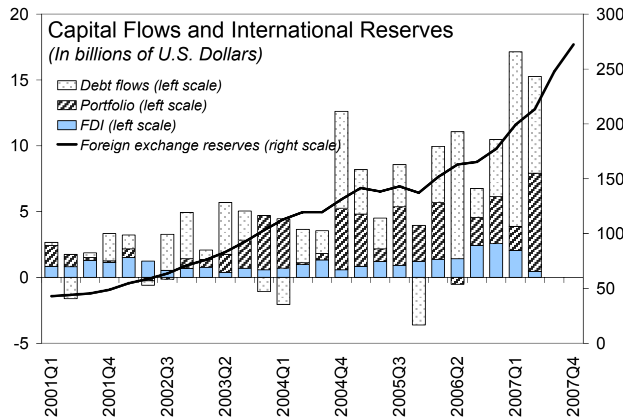
Export growth is easing from recent highs, but remains strong…



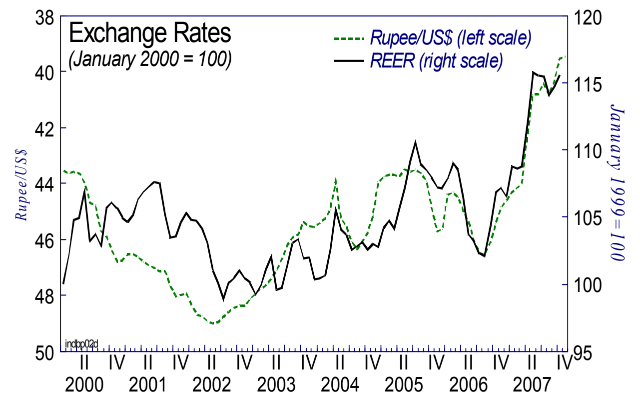
…expanding gains in world market share.



Reserves continue to rise…



…yet the exchange rate has appreciated sharply.

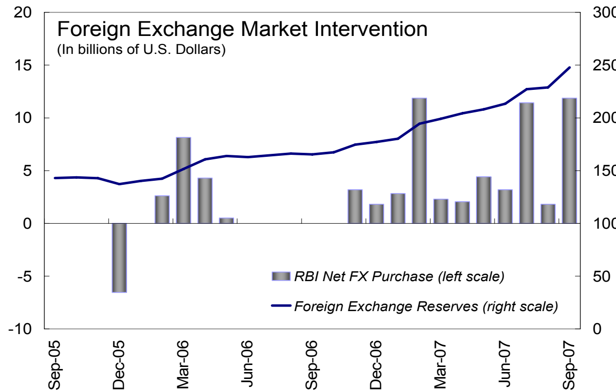


Sources: Data provided by the Indian authorities; CEIC Data Company Ltd; and IMF, *WEO*.

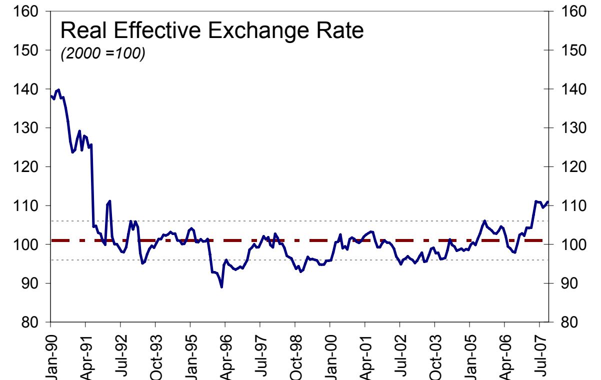
1/ Customs data; based on U.S. dollar values, up to September 2007.

Figure 3. India: Exchange Rate Highlights

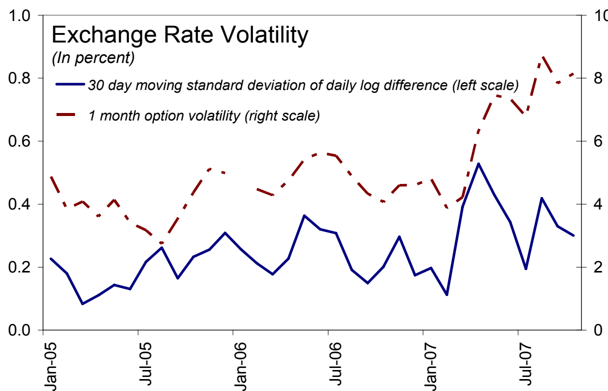
Notwithstanding intervention…



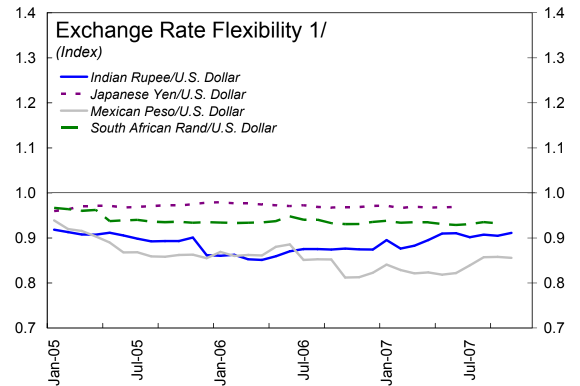
… the REER has appreciated above its recent historical range…



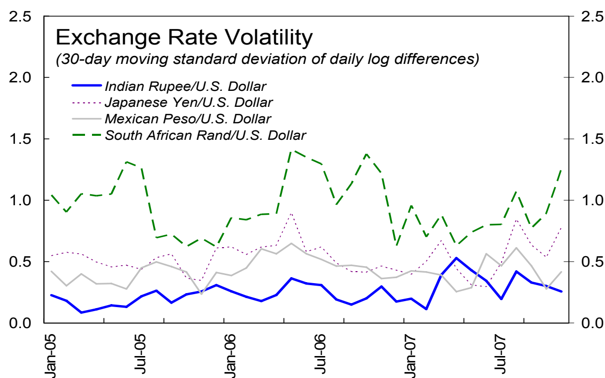
…and the rupee's volatility has remained elevated….



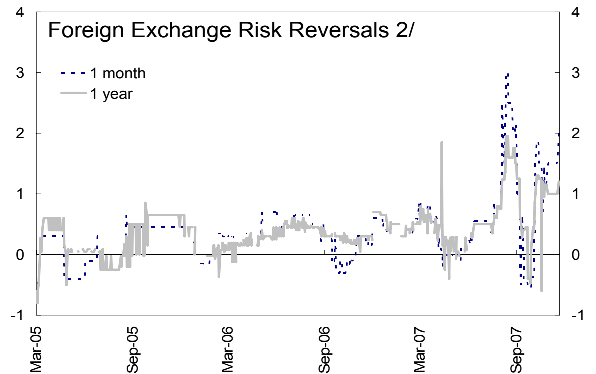
The exchange rate regime's flexibility is similar to that of other large emerging markets…



…as is volatility…



…and the option market currently prices in a higher chance of depreciation of the currency.



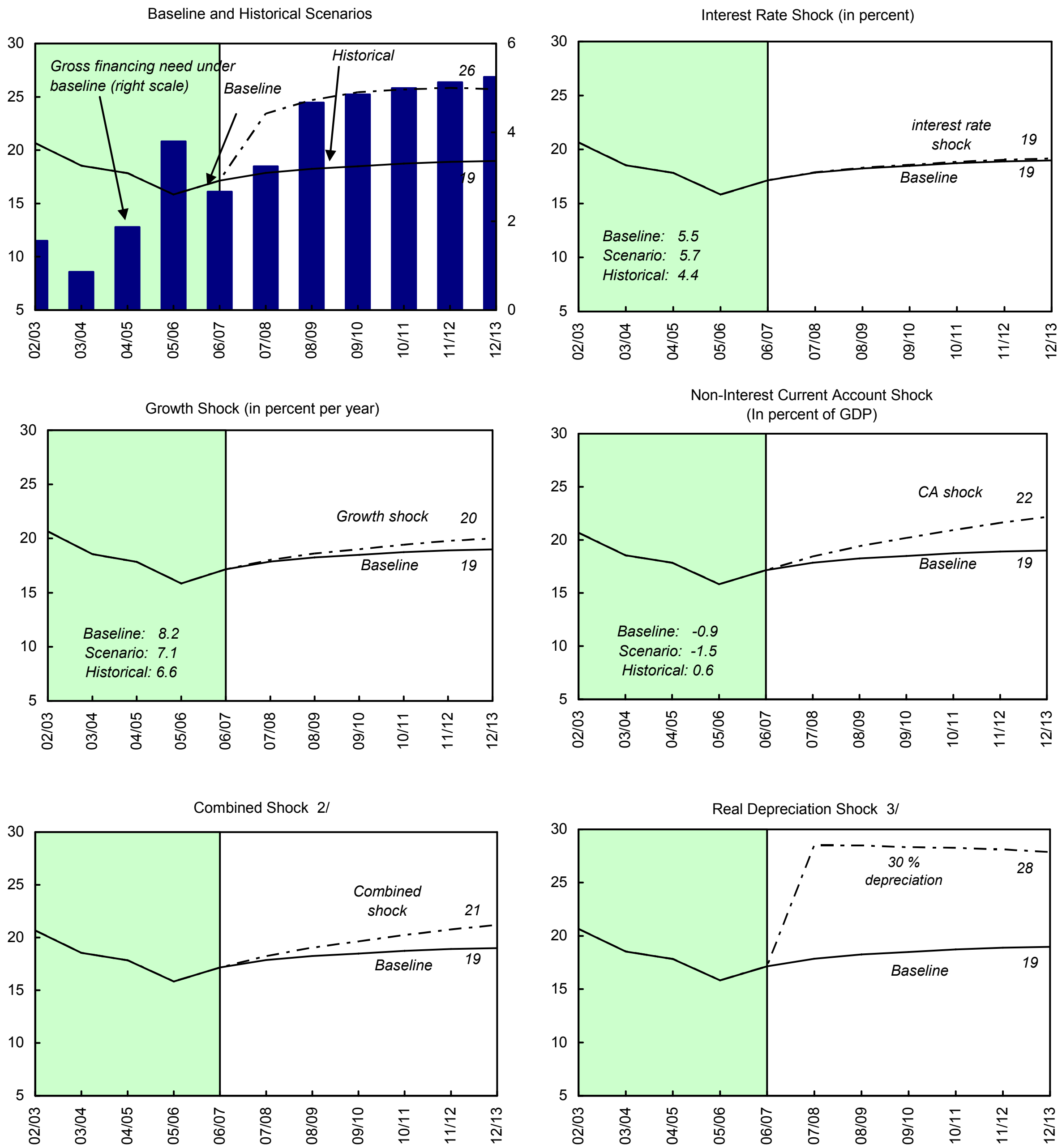
Sources: Data provided by the Indian authorities; CEIC Data Company Ltd; Bloomberg LP; and Fund staff estimates.

1/ The index is calculated by dividing the standard deviation of exchange rate movements by an index of exchange market pressure (the sum of exchange rate volatility and volatility in reserves, normalized by lagged base money). It takes values from zero to one. A lower value signifies relative inflexibility, with zero indicating a peg or a high commitment to inflation targeting.

2/ Positive number implies markets assigning a greater probability (or premium) to INR depreciating than to appreciating against U.S. dollar.

Figure 4. India: External Debt Sustainability: Bound Tests 1/

(External debt, in percent of GDP)



Sources: IMF, *country desk data and staff estimates* .

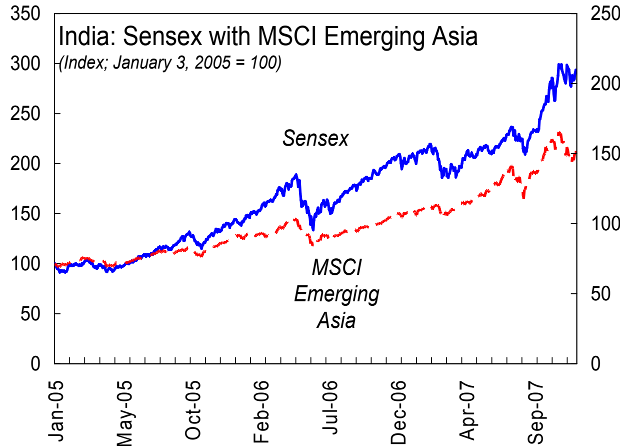
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

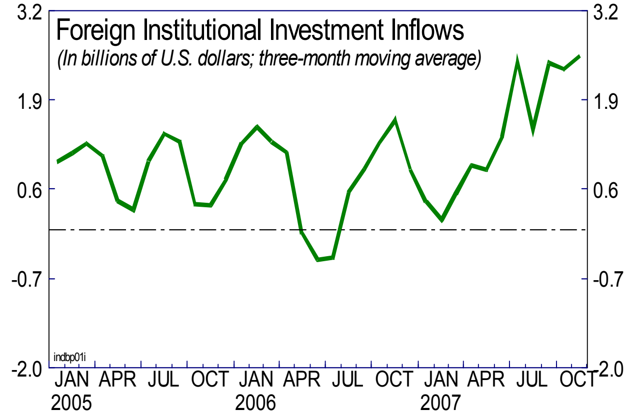
3/ One-time real depreciation of 30 percent occurs in 2007/08.

Figure 5. India: Asset Market

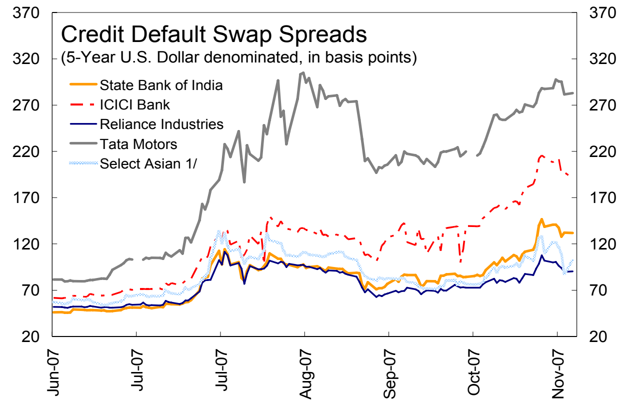
Stock prices have recovered from summer turbulence...



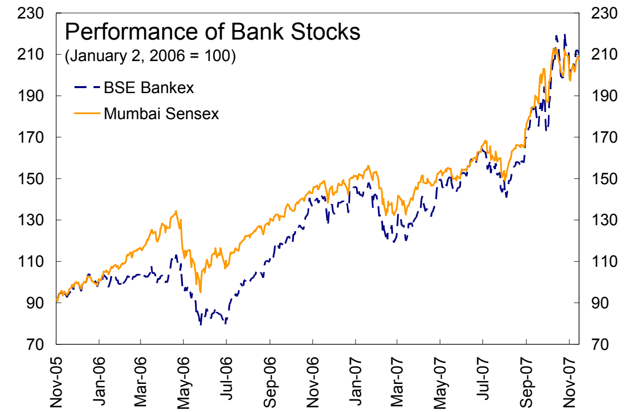
... as have inflows.



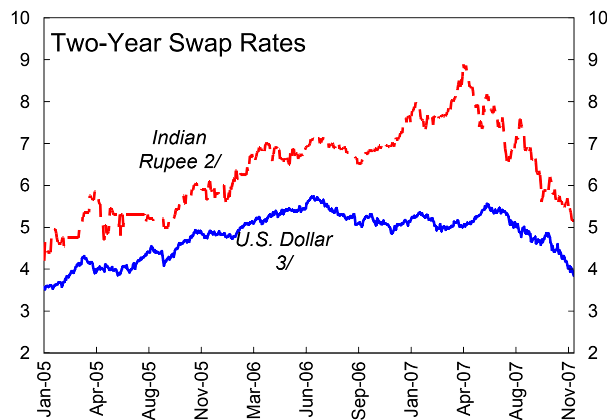
Credit default swap spreads have been volatile...



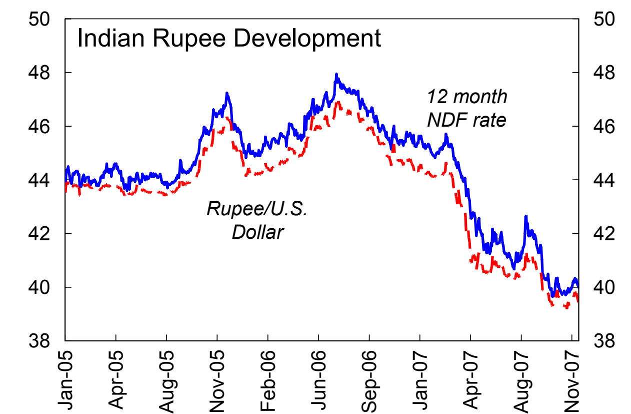
…but, bank stocks have recovered.



The spread versus U.S. dollar interest rates has eased…



... as reflected in the lower forward premium.

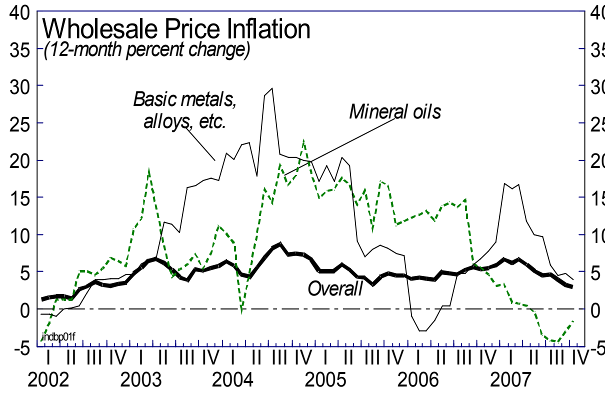


Sources: Data provided by the Indian authorities; and Bloomberg LP.

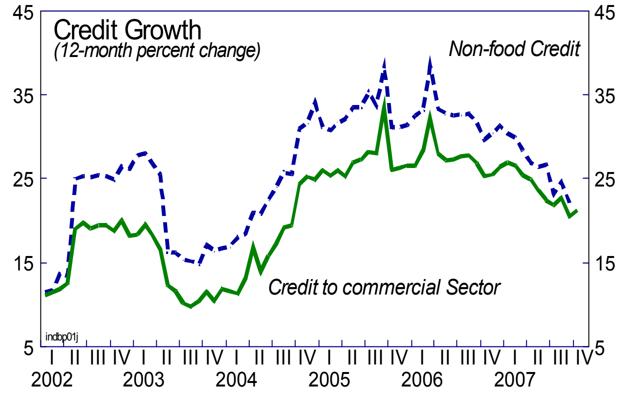
1/ Average spread of Indonesia, Korea, Malaysia, Philippines and Thailand.
2/ Non deliverable forwards.
3/ Semi-annually fixed rate versus 3 month U.S. Dollar LIBIOR.

Figure 6. India: Money and Inflation

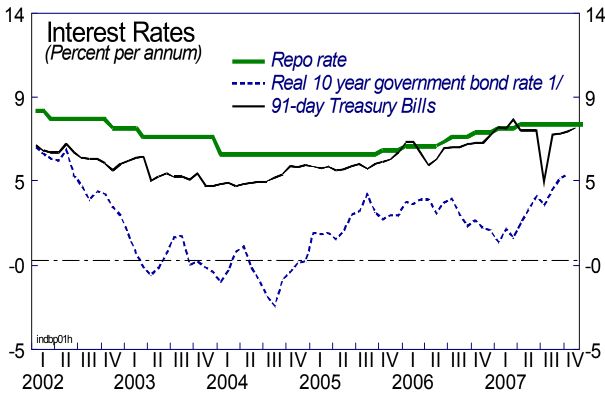
Headline inflation has declined…



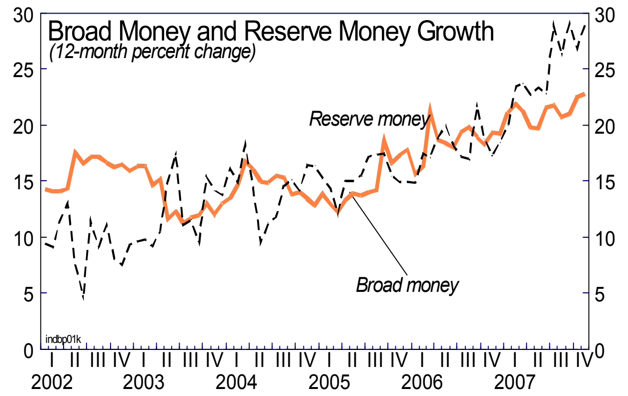
… as has credit growth.



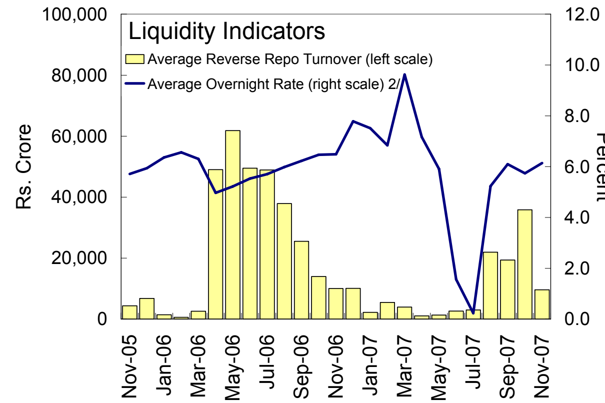
…amid rising interest rates…



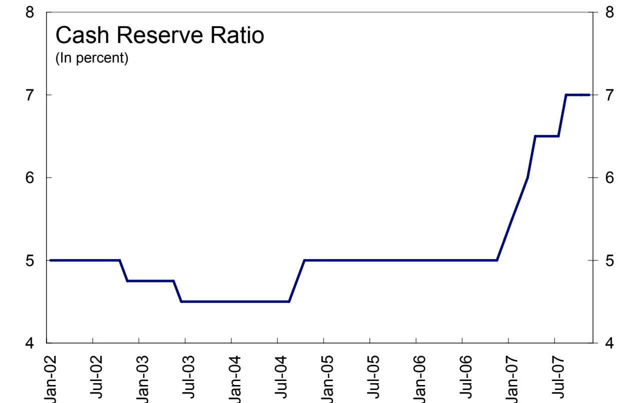
…but money supply growth is strong...



…and the liquidity conditions remain accommodative…



…prompting the RBI to raise reserve requirements in line with market expectations.

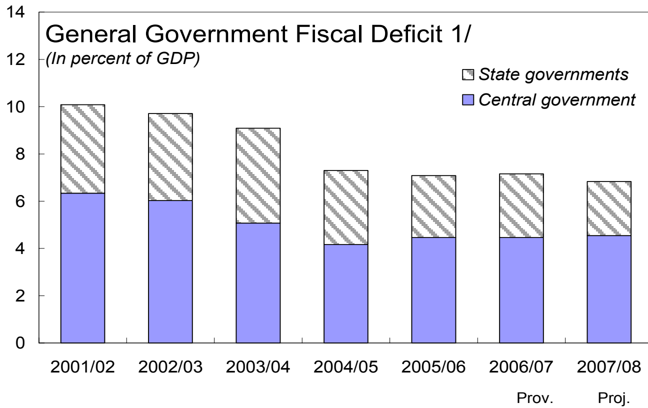


Sources: Data provided by the Indian authorities; CEIC Data Company Ltd; and Fund staff projections.

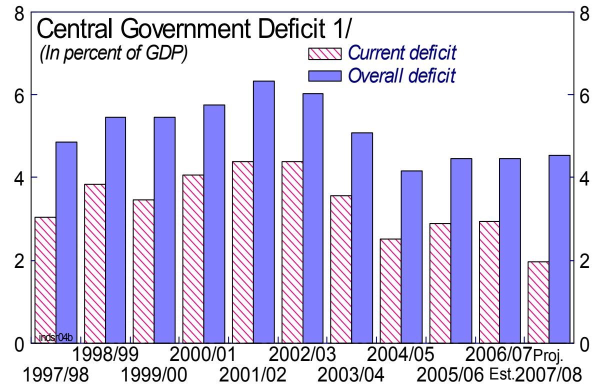
1/ Deflated by the WPI.
2/ Average of daily weighted call money borrowing rates.

Figure 7. India: Fiscal Trends

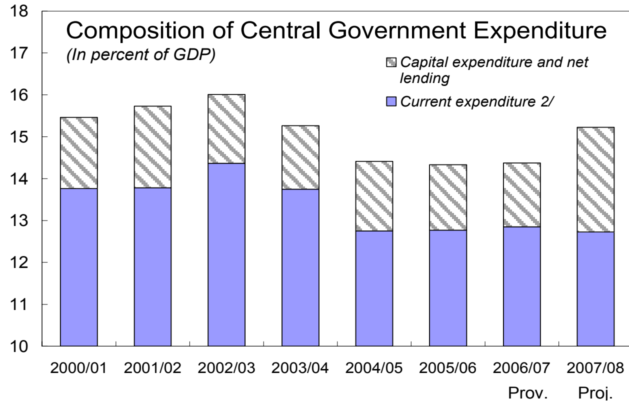
Fiscal consolidation has slowed…



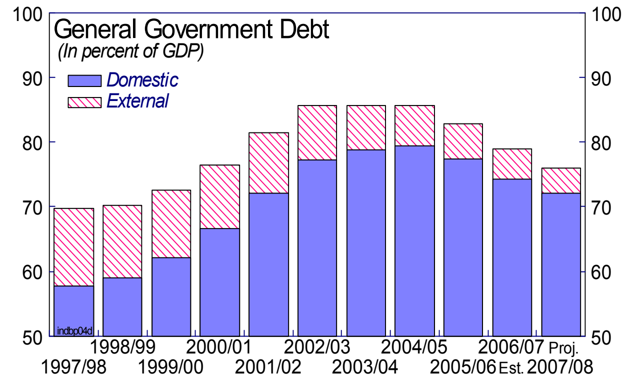
…partly reflecting modest deficit reduction at the central government level…



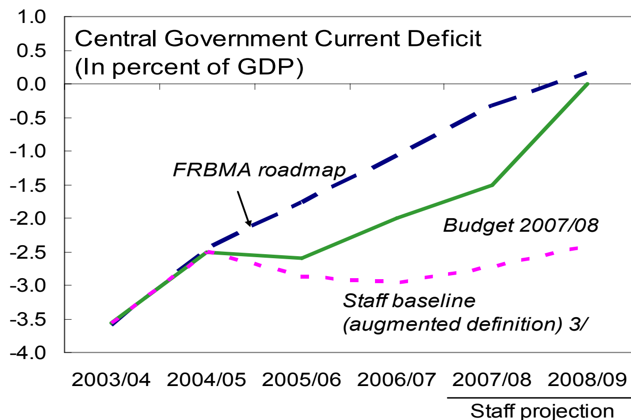
…and the slow pace of current expenditure reform.



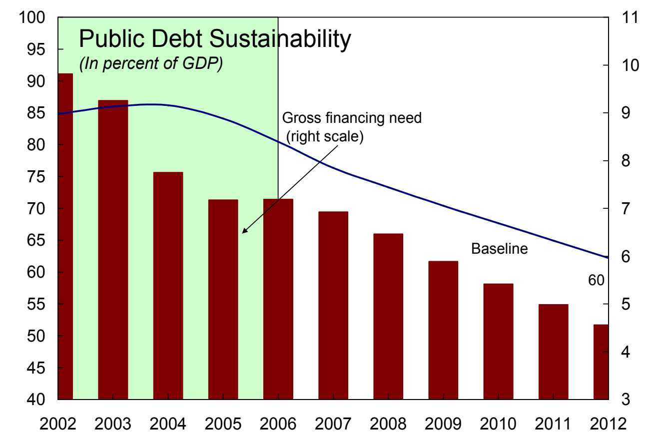
As a result, public debt remains high.



Achieving the FRBMA current balance target will require significant adjustment.



But even the baseline scenario entails significant medium-term debt reduction.



Sources: Data provided by the Indian authorities; and Fund staff projections.

1/ Includes off-budget bond issuance.
2/ Excludes off-budget subsidy related bonds.
3/ Augmented definition includes off-budget subsidy related bond issuance. For 2007/08, excludes a non-recurrent dividend from the Reserve Bank of India amounting to 0.7 percent of GDP.

Table 1. India: Millennium Development Goals, 1990–2006 1/

	1990	1995	2001	2004	2006
Eradicate extreme poverty and hunger 2/					
Income share held by lowest 20 percent	...	...	…	8.1	…
Malnutrition prevalence, weight for age (percent of children under 5)	63.9	...	...	...	…
Poverty gap at $1 a day (PPP) (percent)	...	10.7	…	7.9	…
Poverty headcount ratio at $1 a day (PPP) (percent of population)	…	41.8	…	34.3	…
Poverty headcount ratio at national poverty line (percent of population)	...	36.0	28.6	...	…
Prevalence of undernourishment (percent of population)	…	25.0	...	20.0	…
Achieve universal primary education 3/					
Literacy rate, youth total (percent of people ages 15–24)	64.3	...	...	…	76.4
Persistence to grade 5, total (percent of cohort)	...	...	61.4	78.9	…
Primary completion rate, total (percent of relevant age group)	68.2	77.1	75.8	88.5	…
School enrollment, primary (percent net)	...	...	81.4	89.7	…
Promote gender equality 4/					
Proportion of seats held by women in national parliament (percent)	5.0	...	9.0	9.0	8.3
Ratio of girls to boys in primary and secondary education (percent)	69.5	...	77.5	86.9	…
Ratio of young literate females to males (percent ages 15–24)	73.9	...	...	…	80.5
Women employed in the nonagricultural sector (percent of total nonagricultural employment)	12.7	14.4	16.8	17.3	…
Reduce child mortality 5/					
Immunization, measles (percent of children ages 12–23 months)	56.0	72.0	58.0	58.0	58.0
Mortality rate, infant (per 1,000 live births)	80.0	74.0	66.0	61.6	56.0
Mortality rate, under-5 (per 1,000)	123.0	104.0	94.0	…	74.0
Improved maternal health 6/					
Births attended by skilled health staff (percent of total)	...	34.2	42.5	...	…
Maternal mortality ratio (modeled estimate, per 100,000 live births)	...	...	…	...	…
Combat HIV/AIDS, malaria, and other diseases 7/					
Children orphaned by HIV/AIDS	...	...	...	...	…
Contraceptive prevalence (percent of women ages 15–49)	44.9	...	47.0	...	…
Incidence of tuberculosis (per 100,000 people)	167.8	...	...	…	…
Prevalence of HIV, female (percent ages 15–24)	...	...	…	…	…
Prevalence of HIV, total (percent of population ages 15–49)	...	...	…	0.9	0.9
Tuberculosis cases detected under DOTS (percent)	...	0.3	23.8	57.1	61.3
Ensure environmental sustainability 8/					
CO2 emissions (metric tons per capita)	0.8	1.0	1.1	1.2	…
Forest area (percent of land area)	21.5	...	22.7	…	22.8
GDP per unit of energy use (constant 2000 PPP $ per kg of oil equivalent)	4.0	4.3	5.0	5.5	…
Improved sanitation facilities (percent of population with access)	14.0	...	…	33.0	…
Improved water source (percent of population with access)	70.0	...	…	86.0	…
Nationally protected areas (percent of total land area)	...	...	...	…	…
Develop a global partnership for development 9/					
Aid per capita (current US$)	1.6	1.9	1.6	0.6	1.6
Debt service (PPG and IMF only, percent of exports of G&S, excl. workers' remittances)	…	…	…	…	…
Fixed line and mobile phone subscribers (per 1,000 people)	6.0	12.9	43.6	84.5	127.7
Internet users (per 1,000 people)	0.0	0.3	6.8	32.4	54.8
Personal computers (per 1,000 people)	0.3	1.3	5.8	12.1	15.5
Total debt service (percent of exports of goods, services and income)	31.9	29.7	14.7	19.1	…
Unemployment, youth female (percent of female labor force ages 15–24)	...	8.0	10.2	10.8	…
Unemployment, youth male (percent of male labor force ages 15–24)	...	8.4	10.1	10.4	…
Unemployment, youth total (percent of total labor force ages 15–24)	...	8.3	10.1	10.5	…
General indicators					
Fertility rate, total (births per woman)	3.8	3.4	3.1	2.9	2.8
GNI per capita, Atlas method (current US$)	390.0	380.0	460.0	630.0	730.0
GNI, Atlas method (current US$) (billions)	330.6	349.6	478.7	680.4	804.1
Gross capital formation (percent of GDP)	24.1	26.5	24.5	31.0	33.4
Life expectancy at birth, total (years)	59.1	61.4	62.9	63.4	63.5
Literacy rate, adult total (percent of people ages 15 and above)	49.3	...	...	…	61.0
Population, total (millions)	849.5	932.2	1,032.5	1,079.7	1,094.6
Trade (percent of GDP)	15.7	23.2	27.6	40.1	44.7

Source: *World Development Indicators* , April 2007.

1/ In some cases the data are for earlier or later years than those stated.

2/ Halve, between 1990 and 2015, the proportion of people whose income is less than one dollar a day.

3/ Ensure that, by 2015, children everywhere, boys and girls alike, will be able to complete a full course of primary schooling.

4/ Eliminate gender disparity in primary and secondary education preferably by 2005 and to all levels of education no later than 2015.

5/ Reduce by two-thirds, between 1990 and 2015, the under-five mortality rate.

6/ Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.

7/ Have halted by 2015, and begun to reverse, the spread of HIV/AIDS. Have halted by 2015, and begun to reverse, the incidence of malaria and other major diseases.

8/ Integrate the principles of sustainable development into country policies and programs and reverse the loss of environmental resources. Halve, by 2015, the proportion of people without sustainable access to safe drinking water. By 2020, to have achieved a significant improvement in the lives of at least 100 million slum dwellers.

9/ Develop further an open, rule-based, predictable, non-discriminatory trading and financial system. Address the Special Needs of the Least Developed Countries. Address the Special Needs of landlocked countries and small island developing states. Deal comprehensively with the debt problems of developing countries through national and international measures in order to make debt sustainable in the long term. In cooperation with developing countries, develop and implement strategies for decent and productive work for youth. In cooperation with pharmaceutical companies, provide access to affordable, essential drugs in developing countries. In cooperation with the private sector, make available the benefits of new technologies, especially information and communications.

Table 2. India: Selected Economic Indicators, 2003/04–2007/08 1/

Nominal GDP (2006/07): US$912 billion
Population (2006/07): 1.13 billion
GDP per capita (2006/07): US$809
Quota: SDR 4,158.2 million

	2003/04	2004/05	2005/06	2006/07	2007/08 2/	2007/08							
				Prov.	Proj.	Apr.	May	Jun.	Jul.	Aug.	Sep.	Oct.	Nov. 3/
Growth (y/y percent change)													
Real GDP (at factor cost)	8.5	7.5	9.0	9.4	8.7	...	...	...	...	...	...	...	...
Industrial production	7.0	8.4	8.2	11.3	...	11.3	10.6	8.9	8.3	10.7	6.8	11.8	...
Prices (y/y percent change, period average for annual data)													
Wholesale prices (1993/94 weights)	5.4	6.5	4.4	5.5	3.6	6.0	5.2	4.5	4.7	3.9	3.4	3.0	3.7
Consumer prices - industrial workers (2001 weights)	3.9	3.8	4.4	6.7	5.9	6.7	6.6	5.7	6.5	7.3	6.4	5.5	...
Saving and investment (percent of GDP)													
Gross saving 4/	30.4	31.2	32.6	34.2	35.6	...	...	...	...	...	...	...	...
Gross investment	28.0	31.5	33.8	35.3	37.0	...	...	...	...	...	...	...	...
Fiscal position (percent of GDP)													
Central government balance - authorities 5/	-4.5	-4.0	-4.1	-3.5	-3.3	-0.6	-1.4	-1.7	-2.0	-1.5	-1.0	-1.1	...
Central government balance - staff 6/	-5.1	-4.2	-4.4	-4.4	-4.5								
General government balance - staff 6/	-9.1	-7.3	-7.1	-7.2	-6.8	...	...	...	...	...	...	...	...
General government debt	85.7	85.7	82.9	79.0	75.2	...	...	...	...	...	...	...	...
Money and credit (y/y percent change, end-period)													
Broad money	16.7	12.3	21.2	21.3	…	19.8	19.7	21.6	21.8	20.7	21.0	22.5	22.8
Credit to commercial sector	13.0	26.0	32.2	25.4	…	24.9	23.6	22.5	21.9	22.7	20.5	21.2	21.7
Financial indicators (percent, end-period)													
91-day treasury bill yield	4.2	5.3	6.1	8.0	...	7.4	7.1	7.2	6.2	6.9	7.1	7.2	7.5
10-year government bond yield	5.1	6.7	7.5	8.0	...	8.2	8.1	8.2	7.8	7.9	7.9	7.8	7.9
Stock market (y/y percent change, end-period)	83.4	16.1	73.7	15.9	…	15.2	39.9	38.1	44.7	30.9	38.8	53.0	41.4
External trade 7/													
Exports of goods (US$ billions)	66.3	85.2	105.2	127.1	154.4	11.0	12.2	11.9	12.5	12.7	12.8	13.3	...
y/y percent change	23.3	28.5	23.4	20.9	21.5	28.1	21.9	14.1	18.5	18.9	19.3	35.6	...
Imports of goods (US$ billions)	80.0	118.9	157.0	192.0	241.9	17.8	19.2	19.2	17.5	19.6	17.2	20.8	...
y/y percent change	24.1	48.6	32.0	22.3	26.0	41.8	34.4	36.7	20.4	32.6	2.3	24.3	...
Net oil imports (US$ billions)	17.0	22.9	32.3	41.3	50.3	2.3	2.5	3.6	5.0	6.0	5.5	6.1	...
Balance of payments (US$ billions)													
Current account balance	14.1	-2.5	-9.2	-9.6	-17.4	...	...	...	...	...	...	...	...
(in percent of GDP)	2.3	-0.4	-1.1	-1.1	-1.5	...	...	...	...	...	...	...	...
Foreign direct investment, net	2.4	3.7	4.7	8.4	23.5	1.6	2.1	1.2	0.7	0.8	...	...	...
Portfolio investment, net (equity and debt)	11.4	9.3	12.5	7.1	30.6	1.8	1.3	0.3	5.5	-1.8	4.6	5.7	-1.5
Overall balance	31.4	26.2	15.1	36.6	93.9	...	...	...	...	...	...	...	...
External indicators													
Gross reserves (US$ billions end-period)	113.0	141.5	151.6	199.2	296.1	204.1	208.4	213.5	227.1	228.9	247.3	262.5	273.5
(In months of imports) 8/	9.2	8.7	7.6	7.8	9.8	6.5	6.7	7.0	7.6	7.8	8.7	9.4	9.9
External debt (percent of GDP, end-period) 9/	18.5	17.8	15.8	17.1	17.9	...	...	...	...	...	...	...	...
Of which : short-term debt 10/	1.8	3.1	2.0	2.1	2.9	...	...	...	...	...	...	...	...
Ratio of gross reserves to short-term debt (end-period)	10.7	6.5	9.5	10.5	12.2	8.4	8.6	8.8	9.3	9.4	10.2	10.8	11.2
Gross reserves to broad money (percent; end-period)	24.6	27.5	24.8	26.3	...	25.3	25.4	25.7	26.6	27.0	27.5	28.6	29.5
Debt service ratio 11/	16.0	6.0	9.7	5.1	5.5	...	...	...	...	...	...	...	...
Real effective exchange rate													
(y/y percent change, period average for annual data)	1.0	2.2	4.4	-2.2	…	5.3	11.7	12.0	12.9	12.0	9.7	7.9	6.3
Exchange rate (rupee/US$, end-period)	43.6	43.7	44.6	43.5	...	41.2	40.6	40.7	40.4	40.9	39.8	39.3	39.6
Memorandum items (in percent of GDP):													
Off-budget subsidy related bonds 12/	0.0	0.0	0.3	1.0	1.2	…	…	…	…	…	…	…	…

Sources: Data provided by the Indian authorities; CEIC Data Company Ltd.; and Fund staff estimates and projections.

1/ Data are for April-March fiscal years.
2/ Current staff projections.
3/ Latest available figures.
4/ Differ from official data due to revisions in the current account.
5/ Divestment proceeds are treated as revenue until 2005/06 (included); excludes off-budget bond issuance.
6/ Divestment is treated as financing; includes off-budget bond issuance.
7/ Monthly data are on a customs basis; annual data are on a projected balance of payments basis.
8/ Imports of goods and services projected over the following twelve months.
9/ Data are reported relative to staff's estimated annual GDP.
10/ Residual maturity basis, except contracted maturity basis for medium and long-term non-resident Indian accounts.
11/ In percent of current account receipts excluding grants.
12/ Issued by the central government to FCI, the state-owned oil refining/distribution companies, and fertilizer companies as compensation for losses incurred from the provision of price subsidies.

Table 3. India: Balance of Payments, 2003/04–2007/08 1/

(In billions of U.S. dollars)

	2003/04	2004/05	2005/06	2006/07 Prov.	2007/08 Proj.
Current account balance	14.1	-2.5	-9.2	-9.6	-17.4
Merchandise trade balance	-13.7	-33.7	-51.8	-64.9	-87.5
Merchandise exports	66.3	85.2	105.2	127.1	154.4
Merchandise imports	80.0	118.9	157.0	192.0	241.9
Oil	20.6	29.9	44.0	57.3	71.0
Non-oil	59.4	89.0	113.0	134.7	170.9
Of which: customs based 2/	57.7	76.8	105.2	124.1	…
Non-factor services balance	10.1	15.4	23.9	32.7	40.0
Receipts	26.9	43.2	61.4	81.3	103.3
Of which: software services	12.8	17.2	23.6	13.0	...
Payments	16.7	27.8	37.5	48.6	63.2
Income, net	-4.5	-5.0	-5.5	-4.8	-5.4
Transfers, net	22.2	20.8	24.3	27.4	35.4
Capital account balance	16.7	28.0	23.4	44.9	110.7
Direct investment, net	2.4	3.7	4.7	8.4	23.5
Of which: direct investment in India	4.3	6.0	7.7	19.4	35.3
Portfolio investment, net	11.4	9.3	12.5	7.1	30.6
Government borrowing, net	-2.9	1.9	1.7	1.8	2.6
Commercial borrowing, net	-2.9	5.2	2.7	16.1	16.5
Short-term credit, net	1.4	3.8	1.7	3.3	12.1
NRI deposits, net	3.6	-1.0	2.8	3.9	10.6
Rupee debt	-0.4	-0.4	-0.6	-0.2	-0.2
Other capital, net 3/	4.1	5.5	-2.2	4.6	15.0
Errors and omissions	0.6	0.6	0.8	1.3	0.6
Overall balance	31.4	26.2	15.1	36.6	93.9
Valuation change	5.4	2.4	-5.0	11.0	3.0
Increase in gross reserves (-)	-36.9	-28.5	-10.1	-47.6	-96.9
Memorandum items:					
Change in forex reserves (includes valuation)	36.9	28.5	10.1	47.6	96.9
Foreign exchange reserves	113.0	141.5	151.6	199.2	296.1
In months of next year's imports (goods and servic	9.2	8.7	7.6	7.8	9.8
Current account balance (percent of GDP)	2.3	-0.4	-1.1	-1.1	-1.5
Merchandise trade balance (percent of GDP)	-2.3	-4.8	-6.4	-7.1	-7.4
Overall balance (percent of GDP)	5.2	3.8	1.9	4.0	8.0

Sources: CEIC Data Company Ltd.; and Fund staff estimates and projections.

1/ Data are for April-March fiscal years. Indian authorities' presentation, including new methodology to estimate direct investment.

2/ Noncustoms imports include defense related items.

3/ Net other capital is sum of net banking capital (RBI format) and net other capital (RBI format) less net NRI deposits.

Table 4. India: Reserve Money and Monetary Survey, 2003/04–2007/08 1/

	2003/04	2004/05	2005/06	2006/07	2007/08						
					Apr.	May	Jun.	Jul.	Aug.	Sep.	Oct.
Reserve money					(In billions of rupees, end-period)						
Reserve money	4,365	4,891	5,731	7,090	7,305	7,260	7,207	7,520	7,463	7,812	7,699
Net domestic assets of RBI	-479	-1,237	-999	-1,571	-1,076	-1,046	-1,427	-1,418	-1,891	-2,016	-2,130
Claims on government (net)	449	-180	81	58	185	63	-197	219	-629	-744	-1,371
Center	369	-233	52	21	180	55	-197	210	-643	-643	-643
States	80	53	30	36	6	8	0	9	13	-102	-728
Claims on commercial sector	21	14	14	15	14	14	14	14	14	14	14
Claims on banks	54	53	58	76	53	44	13	0	1	1	…
Other items (net)	-1,003	-1,123	-1,152	-1,721	-1,328	-1,167	-1,256	-1,651	-1,277	-1,287	…
Net foreign assets of RBI	4,844	6,128	6,730	8,662	8,381	8,306	8,634	8,939	9,355	9,828	9,828
					(Contribution to reserve money growth)						
Reserve money	18.3	12.1	17.2	23.7	22.7	23.3	22.9	29.0	26.4	29.1	26.9
Net domestic assets of RBI	-15.9	-17.4	4.9	-10.0	2.7	8.2	2.7	6.2	-2.4	-8.4	-11.0
Claims on government (net)	-20.5	-14.4	5.3	-0.4	0.1	-0.2	-4.8	4.0	-10.5	-14.1	-24.4
Net foreign assets of RBI	34.2	29.4	12.3	33.7	20.0	15.2	20.2	22.8	28.9	37.4	37.9
Monetary survey					(In billions of rupees,end-period)						
Broad money (M3)	20,057	22,514	27,295	33,103	33,218	33,274	33,865	34,539	34,756	35,744	36,082
Currency with public	3,150	3,559	4,131	4,835	5,034	5,041	5,010	4,957	4,869	4,871	5,065
Deposits	16,856	18,891	23,096	28,193	28,114	28,179	28,784	29,458	29,836	30,818	30,968
Non-bank deposits at RBI	51	65	69	75	70	54	71	123	50	56	48
Net domestic assets	14,791	16,022	20,034	23,971	24,366	24,497	24,912	25,282	25,340	26,273	26,184
Domestic credit	17,591	20,370	24,596	29,615	29,542	29,383	29,545	30,288	30,417	31,046	30,851
Net credit to government	7,429	7,568	7,666	8,382	8,649	8,621	8,630	9,169	8,786	8,727	8,528
Of which: RBI	449	-180	81	58	185	63	-197	219	-629	-744	-1,371
Credit to commercial sector 2/	10,162	12,802	16,930	21,234	20,893	20,762	20,915	21,119	21,631	22,319	22,323
Of which: commercial bank len	8,408	11,004	15,071	19,289	18,878	18,837	19,175	19,145	19,601	19,601	19,601
Nonfood	8,048	10,593	14,664	18,824	18,380	18,389	18,747	18,735	19,216	19,216	19,216
Other items (net)	-2,800	-4,348	-4,562	-5,644	-5,176	-4,885	-4,633	-5,007	-5,077	-4,772	-4,667
Net foreign assets	5,266	6,493	7,262	9,132	8,852	8,777	8,952	9,257	9,416	9,471	9,898
					(Twelve-month percent change)						
Broad money (M3)	16.7	12.3	21.2	21.3	19.8	19.7	21.6	21.8	20.7	21.0	22.5
Net domestic assets	11.7	8.3	25.0	19.7	21.8	23.4	24.5	24.2	20.2	20.6	22.5
Domestic credit	11.7	15.8	20.7	20.4	19.3	18.8	18.3	19.3	18.7	16.9	16.3
Net credit to government	9.8	1.9	1.3	9.3	7.4	8.5	9.2	13.6	9.9	8.5	5.1
Credit to commercial sector 2/	13.0	26.0	32.2	25.4	24.9	23.6	22.5	21.9	22.7	20.5	21.2
Of which: commercial bank len	15.3	30.9	37.0	28.0	27.1	26.1	26.1	23.0	24.2	18.0	18.5
Nonfood	18.4	31.6	38.4	28.4	26.9	26.4	26.7	23.2	24.6	18.0	18.8
Net foreign assets	33.7	23.3	11.9	25.7	14.6	10.5	14.1	15.7	22.1	22.1	22.6
					(Contribution to broad money growth)						
Net domestic assets	9.0	6.1	17.8	14.4	15.7	16.7	17.6	17.4	14.5	15.0	16.4
Net credit to government	3.9	0.7	0.4	2.6	2.2	2.4	2.6	3.9	2.8	2.3	1.4
Of which: RBI	-4.4	-3.1	1.2	-0.1	0.0	-0.1	-1.0	0.8	-2.1	-2.9	-5.0
Credit to commercial sector 2/	6.8	13.2	18.3	15.8	15.0	14.3	13.8	13.4	13.9	12.9	13.3
Net foreign assets	7.7	6.1	3.4	6.9	4.1	3.0	4.0	4.4	6.2	6.0	6.2

Sources: Reserve Bank of India; and Fund staff estimates.

1/ Data are for April - March fiscal years.

2/ Starting in May 2002, figures include ICICI, formerly a large development finance institution, which merged with ICICI Bank Ltd. to form a new commercial bank.

Table 5. India: Central Government Operations, 2003/04–2007/08

	2003/04	2004/05	2005/06	2006/07 Budget	2006/07 Est.	2007/08 Budget	2007/08 Staff proj.
	(In billions of rupees)						
Total revenue and grants	2,818	3,204	3,636	4,196	4,499	5,424	5,622
Net tax revenue	1,886	2,264	2,721	3,287	3,531	4,057	4,312
Gross tax revenue	2,543	3,050	3,662	4,422	4,734	5,481	5,826
Of which: corporate tax	636	827	1,013	1,330	1,433	1,684	1,909
income tax	414	493	636	774	865	988	1,148
excise taxes	908	991	1,112	1,190	1,177	1,302	1,220
customs duties	486	576	651	771	863	988	1,010
other taxes	100	163	250	357	396	520	539
Less: States' share	658	786	940	1,134	1,203	1,425	1,514
Nontax revenue 1/	911	910	884	882	943	1,346	1,289
Grants	22	31	30	26	25	21	21
Total expenditure and net lending	4,222	4,506	5,113	5,683	5,930	6,934	7,181
Current expenditure 2/	3,802	3,987	4,555	5,043	5,301	5,739	6,004
Of which: interest payments	1,241	1,269	1,326	1,398	1,496	1,590	1,695
wages and salaries	322	352	373	398	400	448	448
subsidies 3/	443	437	475	462	535	543	609
Capital expenditure and net lending 4/ 5/	420	519	557	640	629	1,195	1,177
Overall balance	-1,404	-1,302	-1,477	-1,487	-1,431	-1,509	-1,558
Overall balance (authorities' definition) 6/	-1,234	-1,258	-1,461	-1,487	-1,431	-1,509	-1,558
Overall balance (augmented) 7/	...	...	-1,576	-1,890	-1,834	-1,913	-2,126
Financing	1,404	1,302	1,477	1,487	1,431	1,509	1,558
External (net)	-135	148	75	83	85	91	91
Domestic (net)	1,539	1,154	1,402	1,404	1,346	1,418	1,467
	(In percent of GDP)						
Total revenue and grants	10.2	10.2	10.2	10.5	10.9	11.7	11.9
Net tax revenue	6.8	7.2	7.6	8.2	8.6	8.8	9.1
Gross tax revenue	9.2	9.8	10.3	11.1	11.5	11.8	12.3
Of which: corporate tax	2.3	2.6	2.8	3.3	3.5	3.6	4.0
income tax	1.5	1.6	1.8	1.9	2.1	2.1	2.4
excise taxes	3.3	3.2	3.1	3.0	2.9	2.8	2.6
customs duties	1.8	1.8	1.8	1.9	2.1	2.1	2.1
other taxes	0.4	0.5	0.7	0.9	1.0	1.1	1.1
Less: States' share	2.4	2.5	2.6	2.8	2.9	3.1	3.2
Nontax revenue 1/	3.3	2.9	2.5	2.2	2.3	2.9	2.7
Grants	0.1	0.1	0.1	0.1	0.1	0.0	0.0
Total expenditure and net lending	15.3	14.4	14.3	14.2	14.4	15.0	15.2
Current expenditure 2/	13.7	12.8	12.8	12.6	12.8	12.4	12.7
Of which: interest payments	4.5	4.1	3.7	3.5	3.6	3.4	3.6
wages and salaries	1.2	1.1	1.0	1.0	1.0	1.0	0.9
subsidies 3/	1.6	1.4	1.3	1.2	1.3	1.2	1.3
Capital expenditure and net lending 4/ 5/	1.5	1.7	1.6	1.6	1.5	2.6	2.5
Overall balance	-5.1	-4.2	-4.1	-3.7	-3.5	-3.3	-3.3
Overall balance (authorities' definition) 6/	-4.5	-4.0	-4.1	-3.7	-3.5	-3.3	-3.3
Overall balance (augmented) 7/	...	...	-4.4	-4.7	-4.4	-3.3	-4.5
Financing	5.1	4.2	4.1	3.7	3.5	3.3	3.3
External (net)	-0.5	0.5	0.2	0.2	0.2	0.2	0.2
Domestic (net)	5.6	3.7	3.9	3.5	3.3	3.1	3.1
Of which: market borrowing	3.2	1.5	2.7	2.8	3.1	2.4	2.3
small savings (net of states' share)	0.2	0.1	0.2	0.2	0.1	0.3	0.3
divestment receipts	0.6	0.1	0.0	0.1	0.0	0.0	0.0
Memorandum items:							
Military expenditure	2.2	2.4	2.3	2.2	2.1	2.1	2.0
Primary balance	-0.6	-0.1	-0.4	-0.2	0.1	0.2	0.3
Current balance 6/ 8/	-3.6	-2.5	-2.6	-2.1	-2.0	-0.7	-0.7
Current balance (augmented) 7/ 8/	...	...	-2.9	-3.1	-2.9	-0.7	-2.0
Central government debt 9/	62.8	63.8	63.4	61.9	61.5	59.3	60.4
Food Corporation of India bonds 10/	...	...	...	0.4	0.4	0.0	0.1
Oil bonds 10/	...	...	0.3	0.6	0.6	0.0	0.8
Fertilizer bonds 10/				...	...	...	0.3
Nominal GDP (in Rs. billion)	27,655	31,266	35,672	39,952	41,257	46,317	47,193

Sources: Data provided by the Indian authorities; and Fund staff estimates and projections.

1/ In 2007/08, includes a special dividend payment from the RBI amounting to 0.7 percent of GDP. The authorities include this item under "other capital receipts" rather than non-tax revenue.
2/ Includes the surcharge on Union duties transferred to the National Calamity Contingency Fund.
3/ Excludes off-budget subsidy-related bond issuance.
4/ Authorities' treatment of state debt swap scheme (DSS) in 2002-05 shows the prepayment by States of on-lent funds to the center as net lending. The Center's prepayment of its debt to the National Small Savings Fund (NSSF) is treated as a capital expenditure.
5/ In 2007/08, includes roughly 0.7 percent of GDP for the government's purchase of SBI shares from the RBI.
6/ Authorities' definition treats divestment as a revenue item until 2005/06 (included); excludes off-budget subsidy related bond issuance.
7/ Staff's definition treats divestment receipts as a below-the-line financing item and includes off-budget subsidy-related bond issuance.
8/ In 2007/08, the authorities' definition of the current deficit (which classifies the special dividend from the RBI as "other capital receipts"), the budget target for the current deficit is 1.5 percent of GDP. Staff includes this item under non-tax revenue.
9/ External debt measured at historical exchange rates.
10/ Issued by the central government to FCI, fertilizer producers, and the state-owned oil refining/distribution companies as compensation for losses incurred from the subsidized provision of commodities.

Table 6. India: General Government Operations, 2003/04–2007/08 1/

	2003/04	2004/05	2005/06	2006/07		2007/08	
				Staff proj.	Est. 2/	Budget	Staff proj. 3/
	(In billions of rupees)						
Total revenue and grants	5,171	6,127	7,189	8,648	8,702	10,365	10,652
Tax revenue 4/	4,143	4,941	5,910	7,298	7,304	8,543	8,888
Nontax revenue 5/ 6/	1,006	1,156	1,250	1,326	1,373	1,800	1,743
Grants	22	31	30	25	25	21	21
Total expenditure and net lending 7/ 8/	7,683	8,410	9,600	11,214	11,251	12,942	13,289
General government balance	-2,512	-2,283	-2,411	-2,566	-2,549	-2,577	-2,636
Financing	2,512	2,283	2,411	2,566	2,549	2,577	2,636
External (net)	-135	148	75	79	85	91	91
Domestic (net)	2,647	2,136	2,336	2,487	2,464	2,486	2,545
Disinvestment receipts	170	44	0	0	0	0	0
	(In percent of GDP)						
Total revenue and grants	18.7	19.6	20.2	21.0	21.1	22.4	22.6
Tax revenue 4/	15.0	15.8	16.6	17.7	17.7	18.4	18.8
Nontax revenue 5/ 6/	3.6	3.7	3.5	3.2	3.3	3.9	3.7
Grants							
Total expenditure and net lending 7/ 8/	27.8	26.9	26.9	27.2	27.3	27.9	28.2
General government balance	-9.1	-7.3	-6.8	-6.2	-6.2	-5.6	-5.6
(including disinvestment receipts)	-8.5	-7.2	-6.8	-6.2	-6.2	-5.6	-5.6
(augmented with off-budget bonds)	...	...	-7.1	-7.2	-7.2	-5.6	-6.8
Domestic financing (net)	9.6	6.8	6.5	6.0	6.0	5.4	5.4
Memorandum items:							
Primary balance	-2.7	-1.2	-1.0	-0.6	-0.4	-0.1	0.0
Nondefense capital expenditure	3.1	2.9	2.7	0.8	3.1	4.2	3.7
Net interest payments	6.4	6.1	5.8	5.6	5.8	5.5	5.6
General government balance	-9.1	-7.3	-6.8	-6.2	-6.2	-5.6	-5.6
Central government	-5.1	-4.2	-4.1	-3.6	-3.5	-3.3	-3.3
State and union territory governments	-4.5	-3.5	-2.5	-2.7	-2.7	-2.4	-2.4
Consolidation items 9/	0.4	0.4	-0.1	0.1	0.0	0.1	0.1
Off-budget subsidy-related bond issuance	...	...	0.3	1.0	1.0	0.0	1.2
General government debt	85.7	85.7	82.9	79.3	79.0	76.6	75.2

Sources: Data provided by the Indian authorities; state level data from the *RBI State Finance Bulletin.* Fund staff amalgamate and prepare projections.

1/ The consolidated general government comprises the central government (CG) and state governments.
2/ Based on RBI's estimate of provisional outturn for state finances.
3/ Based on staff's projection of state finances.
4/ Tax revenue = Tax revenue of central government (CG), including NCCF and states' share, plus state tax revenue.
5/ Nontax revenue = Nontax revenue of CG, less interest payments by states on CG loans, plus nontax revenue of states.
6/ In 2007/08, includes a special dividend payment from the RBI amounting to roughly 0.7 percent of GDP. The authorities include this item under "other capital receipts".
7/ Expenditure and net lending = Total expenditure and net lending of CG (authorities' definition excluding off-bduget bonds), less net loans and grants to states and union territories, plus total expenditure of states (excluding interest payments on CG loans).
8/ In 2007/08, includes 0.7 percent of GDP for the government's purchase of SBI shares from the RBI.
9/ Above-the-line items in the CGA, which cancel out in the consolidation (e.g., loans to states).

Table 7. India: Macroeconomic Framework, 2003/04–2011/12 1/

	2003/04	2004/05	2005/06	Prov. 2006/07	Projections 2007/08	2008/09	2009/10	2010/11	2011/12
Growth (percent change)									
Real GDP (at factor cost)	8.5	7.5	9.0	9.4	8.7	8.3	8.2	8.2	8.1
Real GDP (at factor cost, on calendar year basis)	6.9	7.9	9.0	9.7	8.9	8.4	8.2	8.2	8.1
Prices (percent change, period average)									
Wholesale prices (1993/94 weights)	5.4	6.5	4.4	5.5	3.6	3.6	3.9	3.9	3.9
Consumer prices	3.9	3.8	4.4	6.7	5.9	4.3	3.9	3.9	3.9
GDP deflator	3.8	4.4	4.4	5.8	5.3	3.9	4.5	4.3	4.2
Interest rate on general government domestic debt (percent)	8.9	8.6	8.0	8.3	8.3	7.1	7.6	7.8	8.0
Saving and investment (percent of GDP)									
Gross saving 2/	30.4	31.2	32.6	34.2	35.6	36.0	36.8	37.0	37.2
Gross investment 3/	28.0	31.5	33.8	35.3	37.0	38.0	38.6	38.9	39.1
Fiscal position (percent of GDP)									
Central government balance - authorities 4/	-4.5	-4.0	-4.1	-3.5	-3.3	-3.0	-3.0	-3.0	-3.0
Central government balance - staff 5/	-5.1	-4.2	-4.5	-4.5	-4.5	-3.9	-3.3	-3.2	-3.2
General government balance - staff 5/	-9.1	-7.3	-7.1	-7.2	-6.8	-6.4	-5.8	-5.4	-5.0
General government debt	85.7	85.7	82.9	79.0	75.2	72.4	69.5	66.8	64.1
External trade (percent change, BOP basis)									
Merchandise exports (in U.S. dollar terms)	23.3	28.5	23.4	20.9	21.5	15.9	12.4	13.1	14.9
Merchandise imports (in U.S. dollar terms)	24.1	48.6	32.0	22.3	26.0	18.6	12.1	13.0	13.7
Balance of payments (in billions of U.S. dollars)									
Current account balance	14.1	-2.5	-9.2	-9.6	-17.4	-25.1	-26.8	-29.7	-32.8
(in percent of GDP)	2.3	-0.4	-1.1	-1.1	-1.5	-1.9	-1.9	-1.9	-1.9
(in percent of GDP, calendar year basis)	1.5	0.1	-1.0	-1.1	-1.4	-1.8	-1.9	-1.9	0.0
Foreign direct investment, net	2.4	3.7	4.7	8.4	23.5	22.1	24.5	25.5	28.2
Portfolio investment, net (equity and debt)	11.4	9.3	12.5	7.1	30.6	22.7	18.7	15.9	16.7
Overall balance	31.4	26.2	15.1	36.6	93.9	45.5	42.9	40.3	41.2
External indicators									
Gross reserves (US$ bn. end-period)	113.0	141.5	151.6	199.2	296.1	341.6	384.5	424.8	466.0
(in months of imports) 6/	9.2	8.7	7.6	7.8	9.8	10.0	9.9	9.6	9.0
External debt (percent of GDP, end-period)	18.5	17.8	15.8	17.1	17.9	18.3	18.5	18.7	18.9
Of which : short-term debt 7/	1.8	3.1	2.0	2.1	2.9	3.3	3.6	3.9	4.3
Ratio of gross reserves to short-term debt (end-period)	10.7	6.5	9.5	10.5	12.2	11.2	10.2	9.2	8.3
Debt service (percent of current acct. receipts)	16.0	6.0	9.7	5.1	5.5	6.1	6.4	6.4	6.3
Memorandum items (in percent of GDP):									
Off-budget subsidy related bond issuance 8/	0.0	0.0	0.3	1.0	1.2	0.9	0.3	0.2	0.2

Sources: Data provided by the Indian authorities; CEIC Data Company Ltd.; and Fund staff estimates and projections.

1/ Data are for April-March fiscal years.
2/ Differ from official data due to revisions in the current account.
3/ Statistical discrepancy adjusted.
4/ Divestment proceeds are treated as revenue until 2005/06 (included); excludes off-budget bond issuance.
5/ Divestment is treated as financing; includes off-budget bond issuance.
6/ Imports of goods and services projected over the following twelve months.
7/ Residual maturity basis, except contracted maturity basis for medium and long-term non-resident Indian accounts.
8/ Issued by the central government to FCI, the state-owned oil refining/distribution companies, and fertilizer companies as compensation for losses incurred from the provision of subsidies.

Table 8. India: Indicators of Financial System Soundness, 2003/04–2007/08

	2003/04	2004/05	2005/06	2006/07	2007/08 Q1 (Prov.
Measures of financial strength and performance 1/					
Risk-weighted capital adequacy ratio (CAR)	12.9	12.8	12.3	12.3	12.6
Public sector banks	13.2	12.9	12.2	12.4	12.9
Old Private Sector Banks	13.7	12.5	11.7	12.1	13.0
New Private Sector Banks	10.2	12.1	12.6	12.0	11.6
Foreign banks	15.0	14.0	13.0	12.4	12.3
Number of institutions not meeting 9 percent CAR	1	2	3	1	…
Public sector banks	0	0	0	0	…
Old Private Sector Banks	0	2	3	1	…
New Private Sector Banks	1	0	0	0	…
Foreign banks	0	0	0	0	…
Net nonperforming loans (percent of outstanding net loans) 2/ 3/	2.8	2.0	1.2	1.0	1.2
Public sector banks	3.1	2.1	1.3	1.1	1.2
Old Private Sector Banks	3.8	2.7	1.7	1.0	0.9
New Private Sector Banks	1.7	1.9	0.8	1.0	1.3
Foreign banks	1.5	0.8	0.8	0.7	0.8
Gross nonperforming loans (percent of outstanding loans) 3/	7.2	5.2	3.3	2.5	2.8
Public sector banks	7.8	5.5	3.6	2.7	2.9
Old Private Sector Banks	7.6	6.0	4.4	3.1	3.1
New Private Sector Banks	5.0	3.6	1.7	1.9	2.5
Foreign banks	4.6	2.8	1.9	1.8	2.0
Number of institutions with net NPLs above 10 percent of advances	9	4	4	1	…
Public sector banks	0	0	0	0	…
Old Private Sector Banks	2	0	0	0	…
New Private Sector Banks	1	0	0	0	…
Foreign banks	6	4	4	1	…
Net profit (+)/loss (-) of commercial banks 4/	0.8	0.9	0.9	0.9	1.0
Public sector banks	1.1	0.9	0.6	0.8	0.9
Old Private Sector Banks	0.2	0.0	0.3	0.5	1.1
New Private Sector Banks	-0.6	0.8	0.6	0.6	0.8
Foreign banks	1.4	2.0	1.5	1.9	2.2
Balance sheet structure of all scheduled banks					
Loan/deposit ratio	57.0	65.5	72.0	74.6	71.5
Investment in government securities/deposit ratio	44.9	43.5	34.3	30.5	31.5
Lending to sensitive sectors (in percent of loans and advances)					
Real estate	1.8	12.7	17.2	…	…
Capital market	0.4	1.4	1.5	…	…
Commodities	1.1	0.2	0.3	…	…

Sources: Reserve Bank of India; and Fund staff calculations.

1/ Some loan classification and provisioning standards do not meet international standards.
2/ Gross nonperforming loans less provisions.
3/ Starting in 2001/02, figure includes ICICI, formerly a large development finance institution, which merged with ICICI Bank Ltd. in 2002.
4/ In percent of total assets.

Table 9. India: Indicators of External Vulnerability, 2003/04–2007/08 1/

	2003/04	2004/05	2005/06	2006/07	2007/08	2/
Financial indicators						
General govenment debt (percent of GDP)	85.7	85.7	82.9	79.0	75.2	(Projection)
Broad money (percent change, 12-month basis)	16.7	12.3	21.2	20.8	22.8	As on 11/23/07
Private sector credit (percent change, 12-month basis)	13.0	26.0	32.2	25.4	21.7	As on 11/23/07
91 day T-bill yield (percent; end period)	4.2	5.3	6.1	8.0	7.4	As on 12/18/2007
91 day T-bill yield (real, percent; end period) 3/	-1.1	-1.1	1.6	2.4	3.6	As on 12/18/2007
External indicators						
Exports (percent change, 12-month basis in US$) 4/ 5/	23.3	28.5	23.4	20.9	35.6	(October 2007)
Export volume (percent change, 12-month basis) 5/	10.7	11.7	15.5	16.5	15.3	(Projection)
Imports (percent change, 12-month basis in US$) 4/ 5/	24.1	48.6	32.0	22.3	24.3	(October 2007)
Import volume (percent change, 12-month basis) 5/	8.8	28.0	20.0	13.5	13.2	(Projection)
Terms of trade (percent change, 12 month basis) 5/	-1.6	-2.9	-4.2	-1.2	-1.3	(Projection)
Current account balance (percent of GDP)	2.3	-0.4	-1.1	-1.1	-1.5	(Projection)
Capital and financial account balance (percent of GDP)	2.8	4.0	2.9	4.9	9.4	(Projection)
Of which: net portfolio investment (debt and equity)	1.9	1.3	1.6	0.8	2.6	(Projection)
Other investment (loans, trade credits, etc.)	2.1	1.2	3.5	5.2	2.8	(Projection)
Net foreign direct investment	0.4	0.5	0.6	0.9	2.0	(Projection)
Foreign currency reserves (billions of US$)	113.0	141.5	151.6	199.2	273.5	(November 2007)
RBI forward liabilities (billions of US$)	1.4	0.0	0.0	0.0	0.0	(October 2007)
Official reserves in months of imports (of goods and services)	9.2	8.7	7.6	7.8	9.8	(Projection)
Ratio of foreign currency reserves to broad money (percent)	24.6	27.5	24.8	26.3	28.8	(October 2007)
Total short-term external debt to reserves (percent)	9.3	15.5	10.6	9.5	8.2	(Projection)
Total external debt (percent of GDP)	18.5	17.7	15.7	17.1	17.9	(Projection)
Of which: public sector debt	8.3	7.5	6.7	6.1	4.9	(Projection)
Total external debt to exports of goods and services (percent)	119.9	95.9	75.9	75.0	81.5	(Projection)
External interest payments to exports of goods and services (percent)	4.7	3.7	3.1	3.1	3.1	(Projection)
External amortization payments to exports of goods and services (percent)	15.7	4.8	8.3	2.9	3.4	(Projection)
Exchange rate (per US$, period average)	45.9	44.9	44.3	45.2	40.5	As on 12/18/2007
REER (y/y change in percent; end period) 6/	1.5	1.5	4.2	0.2	6.3	(November 2007)
Financial market indicators						
Stock market index (end period)	5,591	6,493	11,280	13,072	19,080	As on 12/18/2007
Foreign currency debt rating						
Moody's Investor Services	Baa3	Baa3	Baa3	Baa3	Baa2	(November 2007)
Standard and Poor's	BB	BB+	BB+	BBB-	BBB-	(November 2007)
Fitch Ratings	BB	BB+	BB+	BBB-	BBB-	(November 2007)

Sources: Data provided by the Indian authorities; Bloomberg LP; IMF, *Information Notice System;* and Fund staff estimates and projections.

1/ April-March fiscal year.
2/ Latest date available or staff estimate, as noted.
3/ Nominal yield is less than actual WPI inflation, when negative.
4/ Data on BOP basis.
5/ Merchandise trade only; volumes are derived from partner country trade price deflators from the WEO database.
6/ Source: IMF, Information Notice System.

Table 10. Comparative Size of Capital Markets (2006)
(In billions of U.S. dollars and percent of GDP) 1/

	Stock Market Capitalization		Debt Securities						Bank Assets 2/		Bonds, Equities, and Bank Assets 3/	
			Public		*Private*		*Total*					
Australia	929	*123.1*	107	*14.1*	751	*99.5*	858	*113.6*	1,381	*182.9*	3,167	*419.6*
Canada	1,472	*116.0*	702	*55.3*	633	*49.9*	1,336	*105.3*	2,033	*160.2*	4,841	*381.4*
Japan	4,865	*111.4*	6,751	*154.6*	1,969	*45.1*	8,719	*199.6*	6,617	*151.5*	20,201	*462.5*
New Zealand	42	*40.2*	22	*21.0*	5	*5.1*	27	*26.1*	154	*149.3*	223	*215.6*
United States	17,436	*131.6*	6,234	*47.1*	20,502	*154.8*	26,736	*201.9*	10,285	*77.7*	54,457	*411.2*
China	1,144	*43.5*	791	*30.1*	422	*16.0*	1,213	*46.1*	4,126	*156.9*	6,483	*246.5*
Hong Kong, PRC	1,715	*905.0*	20	*10.6*	95	*50.3*	115	*60.9*	847	*446.9*	2,678	*1,412.8*
India	**816**	***92.1***	**305**	***34.4***	**41**	***4.6***	**346**	***39.0***	**757**	***85.4***	**1,919**	***216.4***
Indonesia	137	*37.7*	85	*23.4*	20	*5.6*	106	*29.0*	149	*41.0*	392	*107.7*
Korea	815	*91.8*	468	*52.6*	643	*72.4*	1,111	*125.1*	1,058	*119.1*	2,984	*336.0*
Malaysia	235	*155.8*	63	*41.7*	116	*76.6*	179	*118.3*	297	*196.7*	711	*470.8*
Philippines	68	*58.1*	65	*56.0*	12	*9.9*	77	*65.9*	68	*58.5*	213	*182.5*
Singapore	364	*275.3*	56	*42.6*	68	*51.4*	124	*94.0*	337	*254.7*	825	*624.0*
Taiwan, POC	650	*182.6*	104	*29.3*	119	*33.4*	223	*62.8*	729	*204.9*	1,602	*450.3*
Thailand	138	*66.8*	76	*36.8*	46	*22.3*	122	*59.1*	228	*110.8*	488	*236.6*
Chile	169	*116.1*	18	*12.6*	32	*21.8*	50	*34.4*	112	*76.9*	330	*227.4*
Mexico	369	*43.9*	213	*25.4*	189	*22.4*	402	*47.8*	239	*28.4*	1,010	*120.2*
Peru	48	*51.4*	12	*13.1*	5	*5.9*	18	*19.0*	26	*27.9*	92	*98.4*
Russia	1,030	*105.2*	63	*6.4*	61	*6.3*	124	*12.7*	348	*35.5*	1,502	*153.4*

Sources: World Federation of Exchanges, Bank for International Settlements, Bankscope, Bloomberg LP.

1/ Percent of GDP are in italics.

2/ Commercial bank assets, end-2006.

3/ Sum of the stock market capitalization, debt securities, and bank assets.

Table 11. India: External Debt Sustainability Framework, 2003/04–2012/13

(In percent of GDP, unless otherwise indicated)

	Actual				Projections						
	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	Debt-stabilizing non-interest current account 6/
Baseline: external debt	18.5	17.8	15.8	17.1	17.9	18.3	18.5	18.7	18.9	19.0	-3.2
Change in external debt	-2.1	-0.7	-2.0	1.3	0.7	0.4	0.2	0.2	0.2	0.1	
Identified external debt-creating flows (4+8+9)	-7.7	-3.9	-3.4	-2.6	-4.3	-2.9	-2.5	-2.1	-2.1	-1.9	
Current account deficit, excluding interest payments	-3.1	-0.3	0.5	0.3	0.8	1.1	1.0	0.9	0.9	0.8	
Deficit in balance of goods and services	0.6	2.6	3.5	3.5	4.0	4.2	3.9	3.7	3.6	3.4	
Exports	15.5	18.5	20.7	22.9	21.9	23.6	24.5	25.5	26.6	28.0	
Imports	16.1	21.1	24.1	26.4	25.9	27.9	28.4	29.3	30.2	31.4	
Net nondebt creating capital inflows (negative)	-2.3	-1.9	-2.1	-1.7	-4.6	-3.5	-3.0	-2.6	-2.5	-2.4	
Automatic debt dynamics 1/	-2.3	-1.7	-1.8	-1.2	-0.5	-0.5	-0.5	-0.4	-0.4	-0.3	
Contribution from nominal interest rate	0.7	0.7	0.6	0.7	0.7	0.8	0.9	1.0	1.0	1.0	
Contribution from real GDP growth	-1.5	-1.3	-1.4	-1.3	-1.1	-1.3	-1.3	-1.4	-1.4	-1.4	
Contribution from price and exchange rate changes 2/	-1.6	-1.1	-1.0	-0.6	...	...	...	...	...	...	
Residual, including change in gross foreign assets (2-3) 3/	5.6	3.2	1.4	3.9	5.0	3.3	2.7	2.3	2.2	2.0	
External debt-to-exports ratio (in percent)	119.9	96.7	76.6	75.0	81.5	77.3	75.3	73.4	71.0	67.8	
Gross external financing need (in billions of U.S. dollars) 4/	5.2	13.0	30.6	24.3	38.0	60.7	69.9	79.7	90.3	102.0	
In percent of GDP	0.9	1.9	3.8	2.7	3.2	4.7	4.9	5.0	5.1	5.2	
Scenario with key variables at their historical averages 5/					23.4	24.7	25.4	25.7	25.8	25.7	-2.6
Key macroeconomic assumptions underlying baseline											
Real GDP growth at market prices (in percent)	8.4	8.3	9.2	9.4	8.6	8.3	8.2	8.2	8.1	8.0	
GDP deflator in US dollars (change in percent)	9.4	6.7	6.0	3.5	18.7	2.0	2.5	2.3	2.2	2.1	
Nominal external interest rate (in percent)	4.2	4.2	4.1	5.1	5.1	4.9	5.3	5.8	6.0	6.0	
Growth of exports goods and services (U.S. dollar terms, in percent)	25.0	37.9	29.7	25.1	23.6	19.1	15.3	15.1	15.2	16.1	
Growth of imports goods and services (U.S. dollar terms, in percent)	18.6	51.7	32.6	23.7	26.8	18.7	13.1	14.0	14.0	14.8	
Current account balance, excluding interest payments	3.1	0.3	-0.5	-0.3	-0.8	-1.1	-1.0	-0.9	-0.9	-0.8	
Net non-debt creating capital inflows	2.3	1.9	2.1	1.7	4.6	3.5	3.0	2.6	2.5	2.4	

Source: Fund staff projections.

1/ Derived as [r - g - ρ(1+g) + ea(1+r)]/(1+g+ρ+gρ) times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in U.S. dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

INTERNATIONAL MONETARY FUND

INDIA

Staff Report for the 2007 Article IV Consultation—Informational Annex

Prepared by the Asia and Pacific Department
(In consultation with other departments)

December 26, 2007

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ANNEX I: INDIA—MEDIUM-TERM DEBT SUSTAINABILITY ANALYSIS

Macroeconomic assumptions under the baseline scenario. Economic growth is forecast to ease to potential (8 percent), and real interest rates to rise modestly (see Table 7). Fiscal consolidation will remain on hold following achievement of the FRBMA target for an overall fiscal deficit of 3 percent of GDP (see further discussion below). These policies, combined with progress in structural areas, are expected to support growth and help contain inflation.

Other working assumptions for fiscal policy include:

- *Revenue.* Medium-term projections assume continued healthy growth in tax revenue, though with some slowdown in line with the turn in the profit cycle. The baseline does not assume any significant reduction in tax exemptions; policy reforms in this direction could raise revenue by a few percentage points of GDP. Similarly, the baseline does not assume any significant reforms in nontax revenue (e.g., on user fees); thus, government receipts from this source fall as a share of GDP.

- *Expenditure.* Staff projections are based in large part on official projections published in the 11th Plan Approach Paper (December 2006).[1] These include raising expenditure on education, health, and infrastructure, and reining in spending on nonpriority items (including subsidies). Military expenditure is forecast to remain constant in real terms. With regards to wages and salaries (for which the Sixth Pay Commission will make a recommendation by April 2008), staff assume an increase of 30 percent, phased in over two years. Because government spending on wages and salaries has been falling in real terms, this award is not projected to have a major impact on the budget deficit.

- *Off-budget bond issuance.* Staff's baseline assumption is that issuance of such bonds will diminish after 2007/08, in line with the government's commitment to reduce expenditure on subsidies. For fuel subsidies, the baseline assumes a gradual increase in administered prices in 2008/09 (such that one-third of the additional subsidy cost is borne by consumers, as was the case in 2006/07), and a return to market-based pricing of diesel, gasoline, and LPG in 2009/10. The price of kerosene, which is primarily consumed by the poor, would not be adjusted. For fertilizer subsidies, the baseline assumption is that off-budget subsidies will be cut in half in 2008/09, and eliminated in 2009/10.

FRBMA targets. Using the authorities' definition of the budget, the central government is on track to meet its overall deficit target for 2008/09 (3 percent of GDP), but may find it

[1] Updated projections for the 11th Plan are being finalized, but are not expected to show significant changes.

more difficult to reach the target of central government revenue balance by 2008/09. However, there are upside risks to tax revenue that would accelerate fiscal consolidation. Based on provisional fiscal data for the states, the overall borrowing requirement of the general government—for which the FRBMA set a target of 6 percent of GDP for 2008/09—is projected to be met in 2007/08, a year ahead of schedule.

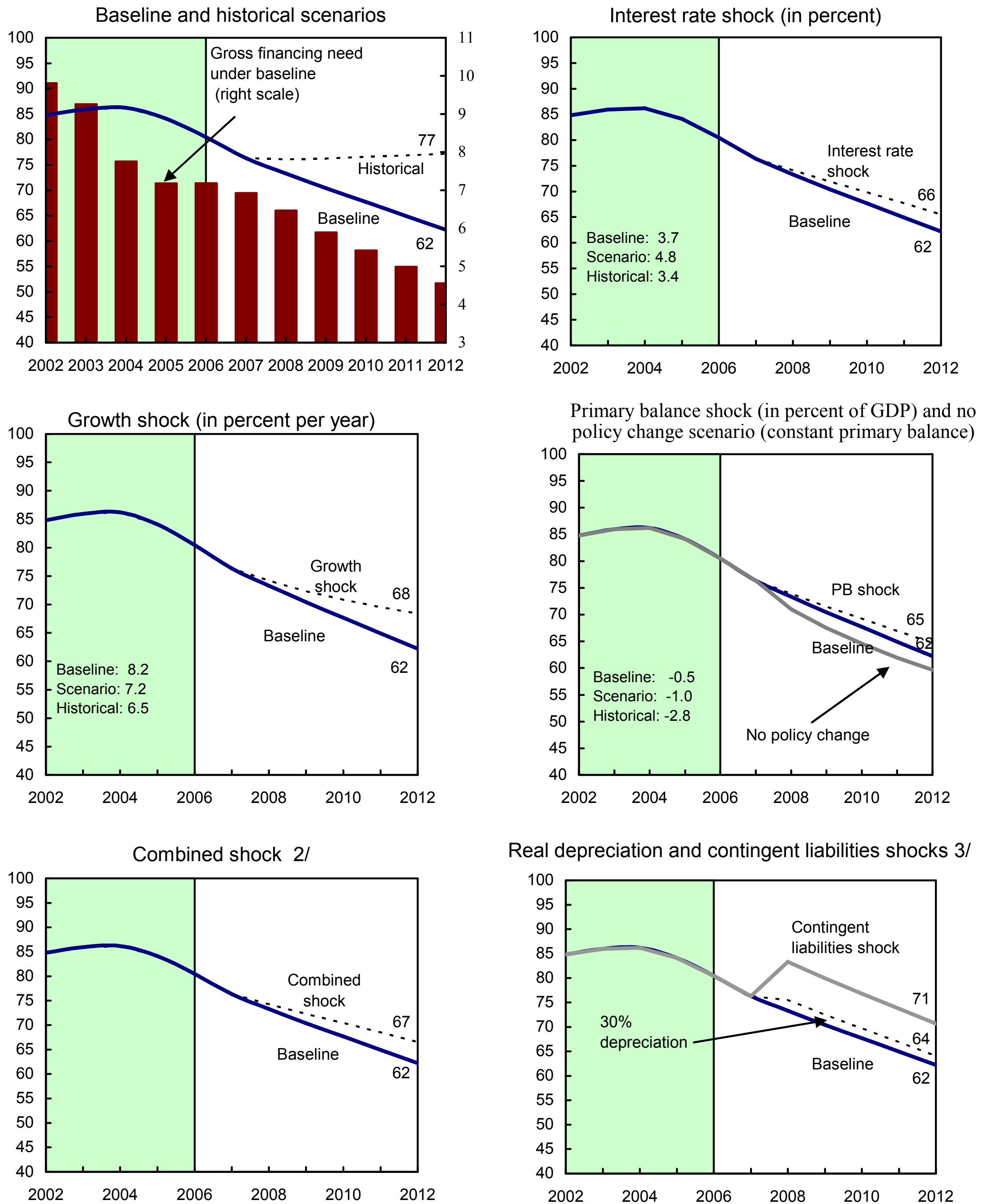
Using an augmented definition of the budget deficit, which includes off-budget, subsidy-related bond issuance that staff consider quasi-fiscal expenditure, attainment of the FRBMA targets would be more difficult. Under the assumptions for subsidies described above, staff's baseline projection for the augmented central government balance in 2008/09 is 3.9 percent of GDP, suggesting that measures of about 1¼ percent of GDP would be needed to meet the deficit target. Achieving revenue balance would require measures of 2½ percent of GDP.[2]

Debt path. Under the baseline scenario, which projects an augmented general government deficit of 7 percent of GDP in 2007/08 and a 0.3 percentage point of GDP average annual adjustment thereafter, gross public debt would decline over five years to 62 percent of GDP.

Sensitivity analysis. A gradual decline in the debt-to-GDP ratio would still occur under various shocks, including in a scenario where the growth-interest-differential returns to its historical average (Figure I.1 and Table I.1). Only in the case of a return to historical averages for the primary balance, real GDP growth, and real interest rates would the debt ratio rise over the medium term.

[2] In 2007/08, a special (non-recurring) dividend received from the RBI, which staff include under nontax revenue (and the authorities include under capital receipts), lowers the revenue deficit by 0.7 percent of GDP.

Figure I.1. India: Public Debt Sustainability: Bound Tests 1/
(Public debt, in percent of GDP)



Source: Fund staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2008, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table I.1. Country: Public Sector Debt Sustainability Framework, 2002–2012
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						Debt-stabilizing
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	primary balance 9/
Baseline: Public sector debt 1/	84.8	86.0	86.2	84.1	80.5	**76.0**	**73.0**	**69.9**	**67.0**	**64.2**	**61.8**	**-2.3**
o/w foreign-currency denominated	8.8	7.7	6.3	5.7	5.0	4.3	3.6	3.5	3.3	3.2	3.1	
Change in public sector debt	4.4	1.1	0.2	-2.1	-3.6	-4.4	-3.0	-3.1	-2.9	-2.8	-2.5	
Identified debt-creating flows (4+7+12)	4.0	-0.2	-2.1	-2.7	-2.0	-3.9	-3.1	-3.2	-3.0	-2.8	-2.6	
Primary deficit	3.4	2.8	1.5	1.3	1.5	0.8	0.4	0.0	0.1	-0.1	-0.2	
Revenue and grants	18.1	18.7	19.5	19.9	21.0	22.6	23.3	23.8	24.4	24.9	25.3	
Primary (noninterest) expenditure	21.6	21.5	21.0	21.1	22.4	23.4	23.6	23.9	24.5	24.9	25.1	
Automatic debt dynamics 2/	0.5	-2.6	-3.8	-4.2	-5.4	-4.8	-3.5	-3.3	-3.1	-2.7	-2.4	
Contribution from interest rate/growth differential 3/	0.5	-2.1	-3.4	-4.4	-5.3	-4.8	-3.5	-3.3	-3.1	-2.7	-2.4	
Of which contribution from real interest rate	3.9	3.1	2.6	2.4	1.8	1.4	2.1	2.0	2.0	2.1	2.2	
Of which contribution from real GDP growth	-3.4	-5.3	-6.0	-6.9	-7.1	-6.2	-5.6	-5.3	-5.1	-4.8	-4.6	
Contribution from exchange rate depreciation 4/	0.0	-0.4	-0.3	0.2	-0.1	...	...	...	...	...	...	
Other identified debt-creating flows	0.1	-0.5	0.2	0.3	1.8	0.1	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	-0.1	-0.6	-0.1	0.0	0.0	-0.9	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.2	0.1	0.3	0.3	1.8	1.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g., bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	0.4	1.4	2.3	0.6	-1.6	-0.5	0.1	0.1	0.1	0.0	0.1	
Public sector debt-to-revenue ratio 1/	467.5	460.4	441.9	423.5	384.1	336.5	313.7	293.2	274.4	257.7	243.7	
Gross financing need 6/	9.8	9.3	7.8	7.2	7.2	6.9	6.4	5.9	5.4	5.0	4.5	
in billions of U.S. dollars	48.6	53.3	51.7	55.9	62.8	76.0	81.2	81.8	83.3	84.7	85.5	
Scenario with key variables at their historical averages 7/						**76.0**	**76.6**	**77.1**	**77.6**	**78.0**	**78.5**	**-2.3**
Scenario with no policy change (constant primary balance) in 2007-2012						**76.0**	**70.9**	**67.4**	**64.1**	**61.0**	**58.4**	**-2.1**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	4.5	6.9	7.9	9.0	9.7	8.9	8.4	8.2	8.2	8.1	8.0	
Average nominal interest rate on public debt (in percent) 8/	8.6	8.4	8.2	7.9	8.1	8.2	8.1	8.0	8.0	8.1	8.3	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	5.4	4.4	3.7	3.6	3.0	2.5	3.5	3.5	3.5	3.8	4.2	
Nominal appreciation (increase in US dollar value of local currency, in percent)	0.3	5.3	4.6	-3.3	1.9	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	3.2	4.0	4.4	4.3	5.1	5.7	4.6	4.5	4.4	4.2	4.1	
Growth of real primary spending (deflated by GDP deflator, in percent)	4.9	6.7	5.4	7.9	13.0	12.5	11.4	12.2	11.4	9.9	9.3	
Primary deficit	3.4	2.8	1.5	1.3	1.5	0.8	0.4	0.0	0.1	-0.1	-0.2	

Source: Fund staff estimates, calendar year data.

1/ General government debt covers central and state governments.

2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1+g)$ and the real growth contribution as -g.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.

5/ For projections, this line includes exchange rate changes.

6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ Derived as nominal interest expenditure divided by previous period debt stock.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

ANNEX II: INDIA—RELATIONS WITH THE FUND
(As of October 31, 2007)

I. **Membership Status**: Joined 12/27/45; Article VIII.

II. **General Resources Account**

	SDR Million	% Quota
Quota	4,158.20	100.00
Fund holdings of currency	3,875.99	93.21
Reserve position in Fund	282.24	6.79

III. **SDR Department**:

	SDR Million	% Allocation
Net cumulative allocation	681.17	100.00
Holdings	8.36	1.23

IV. **Outstanding Purchases and Loans**: None

V. **Financial Arrangements**:

Type	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
Stand-By	10/31/1991	06/30/1993	1,656.00	1,656.00
Stand-By	01/18/1991	04/17/1991	551.93	551.93
EFF	11/09/1981	05/01/1984	5,000.00	3,900.00

VI. **Projected Obligations to Fund** (SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2007	2008	2009	2010	2011
Charges/interest	6.80	26.08	26.06	26.07	26.07
Total	6.80	26.08	26.06	26.07	26.07

VII. **Exchange Rate Arrangement**:

Since March 1, 1993, the Indian rupee has floated against other currencies, although the Reserve Bank of India intervenes in the market periodically. As per the Annual Report on Exchange Arrangements and Exchange Restrictions (AREAER), the exchange rate in India is classified as managed floating with no pre-announced path for the exchange rate. On August 20, 1994, India accepted the obligations of Article VIII, Sections 2, 3, and 4 of the IMF Articles of Agreement. India maintains the following restrictions on the making of payments and transfers for current international transactions, which are subject to Fund approval under Article VIII, Section 2(a): restrictions related to the non-transferability of balances under the India-Russia debt agreement; restrictions arising from unsettled balances under inoperative bilateral payments arrangements with two Eastern European countries; and a restriction on the transfer of amortization payments on loans by non-resident relatives. The Executive Board has not approved these restrictions.

VIII. **Article IV Consultation**:

The previous Article IV consultation discussions were held in October 2006. The staff report (IMF Country Report No. 07/63) was discussed by the Executive Board on December 20, 2006.

IX. **FSAP Participation and ROSCs**:

The data model of the ROSC (IMF Country No. 04/96) was issued in April 2004; a fiscal transparency ROSC was issued in February 2001.

X. **Technical Assistance**:

Department	**Purpose**	**Date of Delivery**
MAE	Government securities market	2/94
MAE	Foreign exchange market	2/95
FAD	Expenditure control	5/95
FAD	Public expenditure management	8/95
FAD	Public expenditure management (follow-up)	5/96
MAE	Government securities market (follow-up)	7/96
STA	SDDS and statistics	12/96
STA	Balance of payments statistics	12/97
STA	SDDS and statistics	2/98
FAD	State level fiscal database and debt register	11/04
FAD	Pilot study on public private partnerships	12/04
STA	Balance of payments statistics	09/05

XI. **Outreach and Other Activities**:

Department	**Purpose**	**Date of Delivery**
OAP/APD/NCAER	Conference: A Tale of Two Giants: India's and China's Experience with Reform and Growth	11/03
FAD	Conference: International Experiences with Fiscal Reform	1/04
APD/FAD	Seminar: Decentralization: International Experiences with Subnational Debt Controls	1/04
APD	Training: Applying Debt Sustainability Templates to Indian States	3/04
APD	Training: Revenue Forecasting	5/05
APD	Seminar: Going Global: India's Emerging Role in the World Economy at Centro di Studi Internazionali sull'Economia e lo Sviluppo	6/06
APD	Book: *India Goes Global: Its Expanding Role in the World Economy"*	8/06
APD	Brookings Institution Panel: Is India's High Growth Sustainable?	4/07

XI. **Resident Representative**:

A resident representative's office was opened in November 1991. Mr. Joshua Felman has been Senior Resident Representative since August 2006.

ANNEX III: INDIA—RELATIONS WITH THE WORLD BANK GROUP

In (Indian) FY2006–07 (April 1-March 31), Bank lending to India reached $2.45 billion, up from $1.89 billion in FY05-06.[3] World Bank support to India in Bank FY2008 is expected to increase and again reach its targeted level consistent with the CAS. IFC also recorded a strong commitment in Bank FY2007 of $1.047 billion. The World Bank Group's program of support combines policy dialogue with diversified IBRD/IDA lending, IFC investments and analytical and advisory activities in the sectors that are important to reducing poverty and sustaining growth.

The Bank Group's Board of Directors discussed a new Country Strategy (CAS) for India on August 26, 2004. The CAS jointly covers the programs of IBRD/IDA and IFC for the period of FY05–08. An update to the Strategy was presented to the Board on May 9, 2007. With over one-quarter of the world's poor in India, the overarching challenge is how to scale up the impact of Bank Group assistance in order to help India move closer to achieving its development goals—including the goal of halving poverty by 2015.

Scaling up assistance will entail a strengthened Bank Group program at the Center, as well as more lending to the states compared to recent years. For state level lending, the strategy is to retain an essentially reform and performance-based approach to the states, but also seek new opportunities for engagement with the largest and poorest states in India in order to help strengthen the environment for reform. The expansion in lending will primarily be for investment in infrastructure development, human development and rural livelihoods. Through adjustment lending, continued emphasis is also being placed on support to fiscal and governance reforms at the state level.

Adjustment lending to finance state level reforms will be limited to 15 percent of total IBRD/IDA lending for the CAS period. Overall lending levels will fall within an upper bound of $2.15 billion per year for IBRD, on average for the four years of the CAS, and the IDA limits for India established by the IDA Deputies. Financial operations since 1998/99 are summarized below.

[3] In Bank FY2007 (July 1–June 30), Bank lending totaled $3.75 billion, up from $1.42 billion in FY2006.

ANNEX IV: INDIA—RELATIONS WITH THE ASIAN DEVELOPMENT BANK

The Asian Development Bank (AsDB) operations in India began in 1986. Cumulative public sector loan commitments totaled $17.13 billion as of December 5, 2007 for 98 loans. With an additional $0.8 billion in private sector loans (the latter without government guarantee), total loan commitments amounted to $17.93 billion. These funds have been provided from the Bank's ordinary capital resources (OCR). Also, AsDB has approved equity investments amounting to $0.2 billion. AsDB's lending and equity activities are summarized below.

India: Asian Development Bank Financial Operations

(In millions of U.S. dollars, as of December 5, 2007)

Calendar Year	OCR Loan Commitments	Private Equity	Disbursements
1986–90	2,318	15.9	339
1991–95	3,472	59.5	2,131
1996	763	...	592
1997	563	15.5	645
1998	250	--	620
1999	625	--	605
2000	1,330	--	487
2001	1,500	--	270
2002	1,164	25	577
2003	1,430	0.65	658
2004	1,200	29.7	381.4
2005	367	20.60	641
2006	1260	72.6	720
2007	890	---	1,282
Total	17,132	239.45	9,948.4

Source: Asian Development Bank.

AsDB's is currently preparing its Country Partnership Strategy (CPS) for 2008–12. Core operational strategy in India will continue to focus on poverty reduction through infrastructure-led growth. More than 75 percent of its ongoing and proposed assistance focuses on transport (national highways, state roads, and rural roads), urban (water and sanitation, waste management, urban transport, city planning, and municipal reforms), and energy (power sector reforms, investments for upgrading transmission and distribution systems, hydropower generation, and improvement in energy efficiency) sector operations.

ANNEX V: INDIA—STATISTICAL ISSUES

1. Macroeconomic statistics are adequate for surveillance, but weaknesses remain in the timeliness and coverage of certain statistical series. India has an elaborate system for compiling economic and financial statistics and produces a vast quantity of data covering virtually all sectors of the economy. India subscribed to the SDDS on December 27, 1996 and started posting its metadata on the Dissemination Standards Bulletin Board on October 30, 1997. It is currently in observance of the SDDS, although it uses flexibility options for timeliness of data on general government operations and on the periodicity and timeliness of labor market data.

2. The data module of the Report on Observance of Standards and Codes (ROSC, IMF Country Report No. 04/96) was published in April 2004. It assesses India's data dissemination practices against the SDDS requirements and assesses the quality of six datasets based on the Data Quality Assessment Framework (DQAF) developed by STA.

3. **National accounts**: The Central Statistical Organization (CSO) has recently reduced the dissemination lag for quarterly releases from three to two months and released a new series of national accounts, with base year 1999–2000 in February 2006.

4. **Price statistics**: The consumer price indices (CPIs) are based on weights that are over ten years old and do not fully capture price developments in the economy. However, since January 2006, the Labour Bureau has published a revised CPI for industrial workers with a 2001 base year and a Working Group is engaged in the revision of the current producer price index to a new base. Presently, there are four CPIs, each based on the consumption basket of a narrow category of consumers (namely industrial workers, urban and nonmanual employees, agricultural laborers, and rural laborers). The CPIs are published with a lag of about one month. A wholesale price index (1993/94=100) is published weekly with a lag of two weeks and is subject to large revisions, especially in periods of rising inflation. In addition, the representativeness of the index may be undermined by the collection of prices from a relatively small sample of products and the infrequent updating of weights.

5. **External sector statistics**: While the concepts and definitions used to compile balance of payments statistics are broadly in line with the fifth edition of the *Balance of Payments Manual (BPM5)*, the Reserve Bank of India's (RBI) presentation does not strictly follow the *BPM5*. Furthermore, trade data have quality, valuation, timing, and coverage problems, and data on trade prices, volumes, and composition are not regularly available on a timely basis. Bilateral data on services exports to the United States and other developed countries are manifold higher than counterpart services imports published by these same countries. External debt statistics are available on a quarterly basis with a one quarter lag. Estimates of short-term external debt are presented in the debt statistics on an original maturity basis. The short-term maturity attribution on a residual maturity basis is only available annually (and excludes residual maturity of medium- and long-term nonresident Indian accounts). The international investment position (IIP) statistics cover the sectors prescribed in the *BPM5* and these data are disseminated within six months of the reference

period in respect of annual data. Coverage of direct investment positions data is hampered by the absence of appropriate legal or institutional authority. India began disseminating the Data Template on International Reserves and Foreign Currency Liquidity as prescribed under the SDDS in December 2001. The more up-to-date information on certain variables, such as total foreign reserves, foreign currency assets, gold, and SDRs, are available on a weekly basis and are disseminated as part of a weekly statistical supplement on the RBI website.

6. **Monetary and financial statistics**: The RBI website and the *RBI Bulletin* publish a wide array of monetary and financial statistics, including reserve money and its components, RBI's survey, monetary survey, liquidity aggregates (outstanding amounts), interest rates, exchange rates, foreign reserves, and results of government securities auctions. The frequency and quality of data dissemination have improved substantially in recent years.

7. Concepts and definitions used by the RBI to compile monetary statistics are in broad conformity with the guidelines provided in the *Monetary and Financial Statistics Manual (MFSM)*. Nevertheless, the following concepts and principles deviate from the *MFSM*. First, the resident sector data do not provide sufficient information on the sectoral distribution of domestic credit. Specifically, under their present sectorization scheme, the authorities subdivide the resident nonbank sector data by (i) central government, (ii) state government, and (iii) the commercial sector (including other financial corporations, public and other nonfinancial corporations, and other resident sectors). Second, commercial banks add accrued interest to credit and deposit positions on a quarterly basis only (instead of the prescribed monthly basis).

8. The RBI reports monetary data for *IFS* on a regular basis. Since October 2006, the RBI has initiated the electronic reporting of monetary data, which is a major improvement from the previous paper-based reporting which were prone to errors and delays. India has also submitted to STA test data (starting from December 2001 data) on the Standardized Report Forms (SRFs) that have been developed to implement the methodology outlined in the *MFSM.* STA is working with the authorities in resolving the outstanding data issues on the development of the SRFs.

9. **Fiscal operations**: The Ministry of Finance (MoF) posts selected central government monthly fiscal data and quarterly debt data on its website. However, no monthly data on fiscal performance at the state level are available, and annual data are available only with an eight- to ten-month lag. Consolidated information is unavailable on local government operations. In addition, data on the functional and economic classification of expenditures are available with considerable lag. There is also scope to improve the analytical usefulness of the presentation of the fiscal accounts. For example, classification of government expenditure between developmental/nondevelopmental and plan/nonplan obscures the economic nature and impact of fiscal actions. The MoF reports central government data (on a cash basis) for publication in the *Government Finance Statistics Yearbook (GFSY)* (latest reported data correspond to 2006). Some limited general government data has been reported for 2002.

Table V.1. India—Table of Common Indicators Required for Surveillance

As of December 7, 2007

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]	Memo Items[7]:	
						Data Quality – Methodological soundness[7]	Data Quality – Accuracy and reliability[8]
Exchange Rates	12/07/07	12/07/07	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	11/30/07	12/07/07	W	W	W		
Reserve/Base Money	11/30/07	12/07/07	W	W	W	O, O, LO, LO	O, O, O, O, O
Broad Money	11/23/07	12/07/07	BW	BW	W		
Central Bank Balance Sheet	Jun. 07	08/30/07	A	A	A		
Consolidated Balance Sheet of the Banking System	Mar. 07	11/27/07	A	A	A		
Interest Rates[2]	12/07/07	12/07/07	D	D	D		
Consumer Price Index	Oct. 07	11/30/07	M	M	M	O, LNO, O, O	LNO, LO, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Mar. 07	10/01/07	A	A	A	LNO, LO, O, O	O, O, O, O, LO
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	Oct. 07	11/30/07	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Mar. 07	10/01/07	A	A	A		
External Current Account Balance	Apr-Jun. 07	09/28/07	Q	Q	Q	LO, O, LO, O	LO, O, O, O, LO
Exports and Imports of Goods and Services	Apr-Jun. 07	09/28/07	Q	Q	Q		
GDP/GNP	Jul-Sep. 07	11/30/07	Q	Q	Q	LO, LNO, LO, LO	LNO, LNO, O, O, LO
Gross External Debt	Apr-Jun. 07	09/28/07	Q	Q	Q		

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially determined, including discount rates, money market rates, and rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state governments.
[5] Including currency and maturity composition.
[6] Daily (D), Weekly (W), Biweekly (BW), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).
[7] Reflects the assessment provided in the data ROSC (published on April 2, 2004, and based on the findings of the mission that took place during May 13–30, 2002) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).
[8] Same as footnote 7, except referring to international standards concerning source data, statistical techniques, assessment and validation of source data, assessment and validation of intermediate data and statistical outputs, and revision studies.

Statement by the Staff Representative on India
January 23, 2008

1. This statement contains information that has become available since the staff report was circulated to the Executive Board on December 27, 2007. This information does not alter the thrust of the staff appraisal.

2. **While some recent data suggest that the Indian economy is slowing as anticipated, the overall growth momentum remains intact.** Industrial production growth eased to 5⅓ percent y/y in November, partly owing to seasonal effects. While goods exports have held up well, services export growth slowed sharply to 5½ percent during April-September 2007. Looking ahead, exports are expected to soften given the global slowdown, but domestic demand should remain strong. Accordingly, staff have maintained a GDP growth projection of 8¾ percent for 2007/08 and 8¼ percent for 2008/09. On the inflation front, the WPI edged up to 3½ percent y/y in late December, as non-administered fuel prices picked up. Staff has revised its annual inflation projection to 3.9 percent for 2007/08.

3. **Financial markets and capital inflows remain buoyant, despite deepening global turbulence**. The rupee has remained close to a nine-year high since late September, while the Sensex has set new records. However, with reserve accumulation slowing in December (to $3.5 billion, compared to a monthly average of $9.1 billion between April and November), capital inflows may have eased recently. As of January 4, reserves stand at $276 billion. Monetary conditions remain accommodative. In December, M3 grew by 23 percent and non-food credit by 24 percent, while reserve money growth rose to 30 percent (all y/y). Short-term rates have fallen 150 basis points over the last month (and are now at the bottom of the policy rate corridor), reflecting expectations of a rate cut at the RBI's January 29 meeting.

4. **Tax revenues have been stronger than expected.** Corporate taxes have continued to grow at an annual rate of about 40 percent in recent months, and personal incomes taxes at about 35 percent. The central government's fiscal deficit may come in below the budget target. Better-than-budgeted fiscal performance is also likely at the state level. With its introduction in Uttar Pradesh on January 1, 2008, all Indian states now have the VAT, an important prerequisite for the introduction of the GST.

5. **Additional steps are in train to further develop financial markets**. Beginning on February 1, institutional investors (including foreign ones), in addition to retail investors, will be allowed to short sell equities. In the corporate debt market, proposed regulatory changes would simplify the primary issuance process for publicly listed firms and require the exchange listing of private placements.

Statement by Adarsh Kishore, Executive Director for India and Deepak Mohanty, Advisor to Executive Director January 23, 2008

1. We thank staff for their assessment of the recent performance of the Indian economy and their suggestions to sustain the growth momentum while addressing the challenges arising out of increasing integration of the Indian economy with the global economy. The staff report captures the views of our authorities on a number of important issues that came up for discussion in the course of Article IV consultations. There, however, appears to be some difference of perception, particularly on management of the capital account and exchange rate. We briefly highlight the macroeconomic outlook for 2007-08 in the context of various risks and focus on some medium-term challenges.

Recent Performance and Outlook for 2007-08

2. **In the current decade there has been a noticeable acceleration in economic growth.** During the five years of the Tenth Plan period (2002-07) real GDP growth averaged 7.6 percent per annum. In the last two years (2005-07), real GDP growth accelerated even further averaging 9.2 percent. In the first half of 2007-08, real GDP has increased by 9.1 percent over the corresponding period of the previous year. Growth has been more broad-based with a near double digit growth in industrial production and a pick up in agricultural growth. It is expected that the current momentum would be sustained through the year as a whole.

3. **Growth acceleration is well supported by increase in investment demand.** At 1999-2000 market prices, the share of investment in GDP is estimated to have increased from 30.7 percent in 2005-06 to 32.2 percent in 2006-07 and further to 34.6 percent in the first half of 2007-08. As the current account deficit remains modest, the bulk of the investment demand is financed by increase in domestic saving. The steady increase in investment gives the cause for optimism that the economy may be moving into a high growth trajectory.

4. **Inflation remains contained.** During 2006-07 a major concern was possible overheating and risks of a build up of inflationary pressures. India, being a net importer of crude oil and a major consumer of foodgrains, remains vulnerable to both domestic and international supply shocks. Despite the sharp increase in international oil prices and high food prices, the headline inflation, as measured by year-on-year variation in the wholesale price index (WPI), has come down to 3.5 percent by December 2007 as compared with 5.9 percent in the corresponding period of the previous year. Even the consumer price index for industrial workers (CPI-IW), which has a larger share of food items, has come down from 6.3 percent in November 2006 to 5.5 percent by November 2007. The moderation in the inflation outlook reflects liquidity management, and the effect of fiscal measures such as import duty reductions, and administrative measures including import of essential commodities. The policy endeavour is to contain headline inflation close to 5 percent in 2007-08, which is likely to be achieved if there are no major supply and liquidity shocks.

5. **Fiscal performance is expected to show further improvement.** In 2006-07 both the gross fiscal deficit and revenue deficit of the Central Government turned out to be lower than budgeted. During 2007-08 so far revenue receipts have maintained their trend. Despite some front loading of expenditure, in absolute terms, fiscal deficit decreased by 11 percent and revenue deficit decreased by 17.2 percent during April-November 2007 compared with the corresponding period of the previous year. It is expected that the end-year fiscal and revenue deficit targets would be met and would be consistent with the Fiscal Responsibility and Budget Management (FRBM) road map. Most state governments have adopted rule based fiscal regime by enacting fiscal responsibility legislations. The combined gross fiscal deficit of state governments is budgeted to moderate from 2.8 percent of GDP in 2006-07 to 2.3 percent in 2007-08. More importantly, the state governments are expected to generate a revenue surplus during 2007-08. While the outlook for the combined fiscal position of the Centre and States for 2007-08 seems positive, our authorities are aware that the risk of overrun of expenditures remains.

6. **The balance of payments remain manageable though trade deficit continues to expand.** In 2006-07 merchandise exports, in US dollar terms, increased by 22.6 percent while imports expanded by 24.5 percent resulting in a trade deficit of over US $ 59 billion. This was largely offset by services exports and private remittances. Consequently, the current account deficit was moderate at US $ 9.8 billion, 1.1 percent of GDP. During the first eight months of 2007-08, both export and import growth rates have moderated over the corresponding period of the previous year. Consequently, the trade deficit continues to expand. Despite widening of the trade deficit, the current account deficit remained contained at US $10.7 billion during the first half of 2007-08, almost at the same level of the corresponding period of the previous year. For the year as a whole, the current account deficit is expected to remain moderate. However, deceleration of export growth rate and widening of trade deficit have raised concerns about the competitiveness of exports arising out of the appreciation of the Indian Rupee.

7. **There has been a surge in capital inflows.** Capital inflows nearly doubled from US $ 25 billion in 2005-06 to US $ 46 billion in 2006-07. In fact net capital inflows have crossed the US $ 50 billion mark during the first half of 2007-08 and staff projections show that such inflows would reach US $ 110 billion during 2007-08. Thus it is important to recognize that net capital inflows have more than quadrupled in a span of two years. Undoubtedly the fundamentals of the Indian economy have strengthened but at this stage it is not clear as to how much of capital inflows reflect the spillover of extraordinary liquidity injection in advanced markets. Given the uncertainties associated with the current context of global financial markets, our authorities prefer to exercise prudence before concluding that there is a substantial structural shift in the trend of capital inflows. Large capital inflows, however, have provided the opportunity to enhance the transparency of the source of portfolio inflows into the economy. Moreover, the pace of liberalisation of capital outflow has also been hastened. Actual capital flows (gross) due to external commercial borrowings (ECB) were much higher at US $ 13.7 billion during the first half of 2007-08 as compared with US $ 7.5 billion in the corresponding period of the previous year, despite the change in ECB norms. Thus, the ECB measures need to be viewed in the context of modulating debt-creating flows, depending on the domestic investment requirement, rather than an exercise to stopping such flows. Moreover, active management of capital inflows has not restrained

investment activity. The overall investment rate remains high which is largely financed by domestic saving, with only about a quarter of net capital inflows during the last three years being absorbed.

8. **Capital inflows have complicated monetary and exchange rate management.** At the current juncture, the major policy challenge is the management of capital flows and the attendant implication for liquidity and overall stability. Sharp increase in capital inflows has had three primary effects. Firstly, the exchange rate has appreciated. For example, the rupee has already appreciated by around 10 percent against the US dollar between March 2007 and January 2008. The exchange rate policy has been guided by broad principles of careful monitoring and management of exchange rates with flexibility without any predetermined target. Secondly, capital inflows in excess of the immediate absorptive capacity of the economy have translated into an increase in reserves. During 2007-08 so far, foreign exchange reserves increased by US $ 76.1 billion, to reach US $ 275.3 billion by end-December 2007. It is important to recognize that India runs trade and current account deficits in its balance of payments. The reserve accumulation has taken place despite significant deficits. Given the current uncertainties in global financial markets and the spillover of liquidity into emerging markets, it is a matter of judgment as to how much of the capital inflows are of enduring nature. In absence of a reasonable answer to the determination of nature of liquidity, it is also a matter of judgment how greater an exchange rate flexibility will actually aid the process of easing the tensions of impossible trinity without damaging the competitive efficiency of the economy. Finally, reserve accumulation has had a liquidity impact. The expansionary monetary impact has, however, been largely sterilized by the Reserve Bank of India (RBI) through deployment of multiple instruments – issuance of bonds under the Market Stabilisation Scheme (MSS), increase in cash reserve ratio (CRR) and daily open market operations (OMO). Despite the sterilization operations, growth of money supply remains relatively high. However, credit growth has decelerated and currently remains within the projected trajectory of the RBI. With the moderation of credit growth, it is expected that aggregate demand would remain contained during 2007-08.

9. **Costs of sterilization need to be weighed against the imperatives of stability.** The determination of costs and benefits of sterilization is a complex issue. In the Indian context, the financial costs of sterilization through issuance of MSS have been transparently set out in the Government Budget. CRR and OMO being monetary instruments would in any case be used to maintain appropriate liquidity to retain monetary control. While different objectives of policy would have associated tradeoffs, on balance, reasonable stability has been maintained in the domestic real and financial sectors, thus contributing to global growth and stability. In the present context, given the multiple objectives, monetary policy retains the flexibility to respond to events on a continuous basis. This has been made clear in the periodic detailed quarterly reviews and is well understood by market participants.

10. **Financial market conditions are generally stable.** The overnight interest rate showed some volatility in the early part of 2007-08 reflecting excess liquidity conditions and global developments. With appropriate policy measures, it has reverted to the interest rate corridor set by the Liquidity Adjustment Facility (LAF) since August 2007. The yields on long-term government bonds have edged down reflecting stable inflationary expectations. While the sub-prime crisis in the US so far has had no major impact in the Indian financial

markets, the RBI has sensitized the market participants with an emphasis on vigilance and preparedness in the context of global uncertainties. The buoyant conditions in the Indian capital markets witnessed over the last few years continue to be supported with large investment by Foreign Institutional Investors (FIIs).

Medium-term Challenges and Outlook

11. **Reforms remain imperative**. While the recent performance of the Indian economy has been impressive, our authorities are deeply conscious of the developmental challenges. There is a clear recognition in the Approach to Eleventh Plan (2007-12) that without significant new policy initiatives the current growth momentum cannot be sustained. There is, therefore, a need to persevere with reforms to attain faster and more inclusive growth.

Inclusive Growth

12. **The growth acceleration has had a favourable impact on the living standard of people**. The percentage of persons below poverty line has declined from 36 percent of the population in 1993-94 to 28 percent in 2004-05. About 47 million additional work opportunities were created during 1999-2000 to 2004-05. Notwithstanding these positive developments, far too many people still lack access to basic services such as health, education, clean drinking water and sanitation facilities. Accordingly, the Eleventh Plan (2007-12) sets out the vision to restructure policies to make economic growth more broad-based and inclusive while maintaining the pace of growth. The average GDP growth is projected at 9 percent with acceleration through the plan period to end with a rate of around 10 percent. This would imply that with population growing at 1.5 percent per year, real per capita income could double in 10 years.

Agriculture

13. **There is considerable emphasis on reinvigorating the agricultural sector** which provides employment to nearly 60 percent of the labour force. Agricultural growth has been sluggish reflecting declining investment and absence of major technological breakthrough. The Eleventh Plan envisages a doubling of agricultural growth rate to 4 percent per annum through a step up in investment, expansion in irrigated areas, diversion into high value products, easy access to credit, improvement in incentive structure and functioning of markets. The Government is committed to an expenditure of Rs. 250 billion through public investment in agricultural sector in the next four years. The Government has targeted a disbursal of institutional agricultural credit of Rs. 2,250 billion during 2007-08. The reform of the cooperative sector which is under way would further increase the flow of credit to the agricultural sector on a sustainable basis. The challenges of providing rural infrastructure are being addressed through a flagship government programme (*Bharat Nirman*).

Industry and Infrastructure

14. The recent buoyancy in industrial performance reflects the competitiveness and productivity of industry in an increasingly open economy amidst significant reduction in tariffs. There is need for continued high growth of industry to absorb the disguised labour force dependent on the agricultural sector. The demographic dividend could be realized only

if the labour force is provided with gainful employment. **The Government recognizes the shortage of skilled manpower and inadequate infrastructure as the most critical barriers to the growth of the manufacturing sector.** Accordingly, the Eleventh Plan envisages raising public spending in education to 6 percent of GDP and ensuring elementary education to all children by 2010. There is emphasis on significantly expanding vocational education and skill developments both through public investment and public private partnership (ppp).

15. Given the large infrastructure requirement of the country, development of infrastructure has been accorded high priority. Planning Commission have estimated the investment required for infrastructure at Rs.20 trillion or US $ 500 billon. **Preliminary exercises suggest that investment in infrastructure would need to increase from the current level of 5 percent of GDP to 9 percent.** These investments are to be achieved through a combination of public investment, ppp and exclusive private investment.

Achieving Fiscal Sustainability

16. **The Government is committed to achieving the FRBM targets on schedule.** With a buoyancy in tax revenues, the Government has comfortably met the half yearly target of total non-debt receipts for 2007-08. With the fiscal deficit target of 3.3 percent in 2007-08 in sight, the FRBM target of 3 percent by 2008-09 appears feasible. Despite pressure on resources, the Government has remained committed to the path of fiscal prudence and discipline.

17. **The Government recognizes the need to contain subsidies in order to achieve the revenue deficit target.** Apart from explicit subsidies, the issuance of bonds to oil companies, Food Corporation of India and fertilizer units have fiscal implications though these are considered cash neutral as there is no immediate cash outgo. The main objective of reform of the subsidy regime is to make them explicit, transparent and work for the poor. Policy options in the subsidy regime are aimed at improving the delivery with better targeting.

18. **The approach to direct tax reforms has been towards creating an increasingly efficient, liberal and equitable tax system** through reasonable tax rates, fewer exemptions and wider tax base. In the case of indirect taxes, the policy has been to over time reduce customs duty rates to ASEAN levels with significant reductions from year to year. The strategy with regard to excise duty has been to continue the policy of expanding the tax base rather than raise rates with an eventual move towards a single CENVAT rate. The tax base has been broadened by bringing several new services into the tax net. As regards state governments, the introduction of VAT has been a success. The reforms have resulted in steady increase in tax to GDP ratio. The next major step in the reform of indirect taxation is to move towards a national level Goods and Services Tax (GST) integrating the national Excise Duties and Service Tax with state VAT by 2010.

19. **The tax administration has been strengthened** through creation of new large taxpayers units, expansion of mandatory electronic filing of returns, extension of e-payment facility and making the permanent account number (PAN) as the sole identification number

for all participants in the securities market. These measures have resulted in a large increase in income-tax assessees.

20. **As regards the expenditure policy, emphasis has shifted from outlays to outcomes** so as to ensure that the budgetary provisions are not only spent within the year but the intended outcomes are actually achieved. There is a proposal to consolidate outcome budgets of various ministries of the Government for transparency and better accountability. Further, a set of austerity measures such as ban on creation of new posts has been implemented. While the focus is on moderation of non-developmental expenditure, in view of the growing need for expenditure on social sector and physical infrastructure, the approach to fiscal consolidation continues to be revenue driven.

Ensuring Financial Stability

21. As regards financial sector policy, **the emphasis has been to develop a sound, efficient and diversified financial system** to facilitate a smooth transmission of monetary policy with financial inclusion. The RBI has consistently emphasized the importance of developing financial markets as well as operational flexibility of market participants in various segments secured by effective regulation and oversight. Keeping in view the increasing complexities and innovations in the organizational structures and processes in the Indian banking system, the cross-border mergers and acquisitions by the Indian banks and corporates and financial globalization, the RBI has taken several initiatives to provide greater sophistication and refinement to its supervisory and regulatory processes. Some of those initiatives are strengthening of the monitoring mechanism for the financial conglomerates in coordination with the other peer regulators, reviewing the supervisory policy for the banks which are the holding companies for the subsidiary entities in the Financial Conglomerates, issues of discussion paper on an appropriate conglomerate structure in the Indian financial system etc. There are also moves to put in place appropriate institutional arrangements for cross-border supervision and supervisory cooperation.

22. **The emphasis in financial market has been to facilitate the ongoing integration of various segments** through expansion of instruments and focus on the underlying legal framework. The recent initiatives include extension of short sales in government securities, introduction of 'When Issued' market in central government securities and expansion of hedging facilities in the foreign exchange market. The Reserve Bank of India Act has been amended to strengthen the legal framework for regulation of OTC derivatives including credit derivatives. Simultaneously, the credit delivery mechanism has been augmented with a focus on agriculture, small and medium enterprises and inclusive growth.

23. **The banking system remains sound and well capitalized.** In March 2007, the capital adequacy ratio stood at 12.3 percent, well above the international norm. Indian banks with international presence and foreign banks operating in India would be switching over to Basel II in March 2008 followed by other banks by March 2009. Even with a migration to Basel II, the present level of capital is considered comfortable as the additional capital requirement is estimated at 1 percent. Despite strong credit growth for three years in succession, the asset quality of banks continues to improve. The ratio of net NPAs to net assets ratio stood at 1 percent in March 2007. However, the RBI has exercised great caution

and raised risk weights and provisioning requirements for real estate sector. The assets of the banks in India continue to expand with an increase in the share of private sector and foreign banks. Government ownership has not compromised the commercial character of functioning of public sector banks. The return on total assets (RoA) of banks has improved over the years to reach 0.9 percent in March 2007. The efficiency parameters of the Indian banking system are comparable to many advanced countries. As on December 2007, 29 foreign banks were operating in India with 273 branches besides 35 banks with representative offices. The extent of presence of foreign banks exceeds the commitment made under the World Trade Organisation (WTO). Moreover, both the public sector and private sector banks have significant foreign share holdings.

INTERNATIONAL MONETARY FUND
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International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2007 Article IV Consultation with India

On January 23, 2008, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with India.[1]

Background

India's economy continues to expand at a robust pace, with the growth rate averaging about 8½ percent in the four years through 2006/07 (April 2006-March 2007). Growth is fueled by strong momentum in investment reflecting high capacity utilization, buoyant corporate profits and business confidence, and a rise in productivity, within Asia surpassed only by China. A favorable monsoon should deliver above average agricultural growth. Staff projects growth of 8¾ percent in 2007/08, moderating toward potential in the near term as external demand weakens and past increases in interest rates dampen consumption growth.

After rising sharply in early 2007, Wholesale Price Index (WPI) inflation has ebbed to 3¼ percent due to decelerating food and manufacturing prices. While core inflation (excluding food and energy) is also contained, Consumer Price Index (CPI) inflation exceeds WPI inflation by over 2 percentage points. Staff projects WPI inflation to remain in the 3½−4 percent range in the near term, though inflation risks are to the upside due to rising international food and fuel prices, ample domestic liquidity, tight capacity utilizations, and rising skill premia.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

Export growth remains robust at over 20 percent year-on-year in U.S. dollar value, but buoyant imports boosted by strong investment growth are projected to widen the trade deficit and raise the current account deficit to 1½ percent of GDP in 2007/08.
Swelling capital inflows more than finance the current account deficit. Capital inflows reached a record US$45 billion in 2006/07, and (as in other emerging markets) accelerated appreciably this fiscal year, pushing the capital account into a projected surplus of 9½ percent of GDP in 2007/08. Given India's vibrant growth outlook and sizeable capital demands, inflows will likely remain strong. Nevertheless, with low levels of external debt, ample reserves and limits on the amount and end-use of foreign debt financing, India's external position is sustainable and robust to significant shocks.

Capital inflows have lifted financial markets. Equity markets recovered quickly from the effects of the U.S. subprime crisis. The real estate market in India has been buoyant, although lending to this sector has been cooling recently reflecting past prudential measures by the Reserve Bank of India (RBI) to curb speculative pressures.

Strong capital inflows have put upward pressure on the rupee. After remaining roughly stable since 2000, the rupee appreciated by 7 percent in real effective terms between December 2006 and August 2007, with most of the appreciation occurring in the first half of the year. The RBI has accrued US$73 billion in reserves between end-March and end-November 2007, intervening (purchasing foreign currency) to smooth volatility under the managed float. Rupee flexibility is around a level comparable to other large emerging-markets currencies and the level of the rupee remains in line with fundamentals.

Large capital inflows are complicating the conduct of monetary policy, creating excess liquidity and pressuring the rupee. In addition to the exchange rate appreciation, several steps were taken to tighten monetary conditions. Since October 2006, the cash reserve ratio (CRR) has risen 200 basis points, while the repo (lending) rate was hiked twice by 25 basis points in the 12 months prior to the October 2007 policy meeting. With WPI inflation ebbing and real estate prices and credit growth slowing, the RBI left policy rates on hold at its October 2007 policy meeting, but raised the CRR by 50 basis points to 7.5 percent. As capital inflows swell, tensions in the monetary policy framework between exchange rate stability, monetary independence and financial openness are beginning to emerge.

Fiscal consolidation has been mixed, and slowed in 2006/07. Including off-budget bond issuance, the general government deficit held steady at about 7¼ percent of GDP. The central government deficit remained at 4½ percent of GDP, with buoyant tax revenue offset by higher expenditure. The states' aggregate fiscal deficit rose marginally to 2¾ percent of GDP. Revenues performed well, though expenditure rose faster on the back of rising public investment. Public debt remains high, at nearly 80 percent of GDP in March 2007.

Banks' balance sheets remain healthy according to standard indicators of financial soundness. While retail and real estate credit have grown significantly, risk measures have improved and banks' sizeable capital buffers indicate that the credit cycle is likely to be manageable. Corporate leverage is rising but remains low.

Executive Board Assessment

Executive Directors commended India's outstanding economic performance and its success in reducing poverty, a tribute to the authorities' sound macroeconomic policies and structural reforms. India's economy has been resilient in the face of heightened global uncertainties, slowing U.S. growth, and high world oil prices, and is expected to expand by 8¾ percent this fiscal year as a result of rising productivity and investment. India's favorable outlook has attracted record capital inflows, which help finance investment but also present challenges to managing capital markets integration.

The key challenge facing the authorities is to sustain rapid and inclusive growth, foster job creation, and maintain macroeconomic and financial stability in the context of large capital inflows. Directors endorsed the authorities' policy priorities, which are to manage financial globalization and tackle supply constraints through an enhanced monetary framework, financial sector development, fiscal consolidation, and removal of structural bottlenecks.

Directors commended the authorities' success in containing inflation and maintaining domestic financial stability. They observed that large capital inflows have exacerbated tensions among exchange rate stability, monetary independence, and financial openness. They supported the central bank's active management of liquidity and accommodation of increased exchange rate volatility, while noting the appreciation pressures on the rupee. Directors concurred that rupee appreciation reflected strong fundamentals and increasing productivity, and saw the policy of a managed float as remaining appropriate. A number of Directors, however, expressed concern that rupee appreciation has adversely affected India's external competitiveness in certain labor-intensive sectors. These Directors supported the authorities' cautious and pragmatic approach to managing capital flows, including through temporary capital controls, while commending the authorities' intention to move to fuller capital account convertibility gradually over the medium term. Some Directors cautioned against restrictions on capital inflows, emphasizing that increased exchange rate flexibility, strengthened monetary operations, and more effective communication with markets could be a better way to increase monetary policy effectiveness in a more financially open environment.

Directors emphasized that broader and deeper financial markets could better intermediate capital inflows, accommodate exchange rate volatility, and support financial stability and economic growth. They encouraged the authorities to press ahead with developing domestic corporate bond and derivatives markets, and to implement more market-based monetary operations. Enhancing banks' efficiency can also improve financial intermediation.

Directors welcomed the Reserve Bank of India's focus on preserving financial stability through close scrutiny of banks and efforts to improve banks' risk management. While they commended the overall soundness of the financial system, Directors called for continued vigilance, particularly in light of the rapid growth of real estate credit. Directors welcomed the forthcoming implementation of the Basel II supervisory framework, and looked forward to the publication of the authorities' self-assessment of financial stability and development.

On the fiscal front, Directors welcomed the continued buoyancy of tax revenues, but noted that with public expenditure and debt still relatively high, more rapid fiscal consolidation is warranted.

A tighter fiscal stance could also help offset the liquidity impact of buoyant capital inflows and thus relieve appreciation pressures. Directors stressed that expenditure reforms are needed to create space for priority spending. In this connection, they noted the growing fuel subsidy burden and the need to adapt to higher international oil prices through a phased reduction in subsidies for most fuel products, while ensuring that adequate and well-targeted safety nets are in place to protect the poor. Directors welcomed plans for a national goods and services tax, and noted that cutting tax exemptions, increasing user fees and further improving tax administration would improve the tax base.

Directors urged greater progress in structural reforms to ease real sector rigidities, boost productivity and competitiveness, and ensure that the benefits of growth are widely shared. They concurred with the priorities identified in the government's "inclusive growth" agenda: bridging infrastructure gaps with private sector participation, ensuring access to social services, and promoting a competitive environment that supports private sector investment and job creation. Toward these goals, Directors emphasized that more flexible labor regulations can facilitate the reallocation of labor to stronger sectors, while higher and more effective public spending on education is needed to address the skills gap.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The staff report (use the free Adobe Acrobat Reader to view this pdf file) for the 2007 Article IV Consultation with India is also available.

India: Selected Economic Indicators 1/

	2003/04	2004/05	2005/06	2006/07 Prov.	2007/08 2/ Proj.
Growth (y/y percent change)					
Real GDP (at factor cost)	8.5	7.5	9.0	9.4	8.7
Industrial production	7.0	8.4	8.2	11.3	...
Prices (y/y percent change, period average for annual data)					
Wholesale prices (1993/94 weights)	5.4	6.5	4.4	5.5	3.9
Consumer prices - industrial workers (2001 weights)	3.9	3.8	4.4	6.7	6.0
Saving and investment (percent of GDP)					
Gross saving 3/	30.4	31.2	32.6	34.1	36.0
Gross investment	28.0	31.5	33.8	35.3	37.3
Fiscal position (percent of GDP)					
Central government balance - authorities 4/	-4.5	-4.0	-4.1	-3.5	-3.1
Central government balance - staff 5/	-5.1	-4.2	-4.5	-4.5	-4.3
General government balance - staff 5/	-9.1	-7.3	-7.1	-7.2	-6.2
General government debt	85.7	85.7	82.9	79.0	74.8
Money and credit (y/y percent change, end-period)					
Broad money	16.7	12.3	21.2	21.3	…
Credit to commercial sector	13.0	26.0	32.2	25.4	…
Financial indicators (percent, end-period)					
91-day treasury bill yield	4.2	5.3	6.1	8.0	...
10-year government bond yield	5.1	6.7	7.5	8.0	...
Stock market (y/y percent change, end-period)	83.4	16.1	73.7	15.9	…
External trade 6/					
Exports of goods (US$ billions)	66.3	85.2	105.2	126.2	155.2
y/y percent change	23.3	28.5	23.4	20.0	22.9
Imports of goods (US$ billions)	80.0	118.9	157.0	192.0	241.4
y/y percent change	24.1	48.6	32.0	22.3	25.7
Net oil imports (US$ billions)	17.0	22.9	32.3	41.3	48.9
Balance of payments (US$ billions)					
Current account balance	14.1	-2.5	-9.2	-11.1	-16.1
(in percent of GDP)	2.3	-0.4	-1.1	-1.2	-1.4
Foreign direct investment, net	2.4	3.7	4.7	8.9	10.6
Portfolio investment, net (equity and debt)	11.4	9.3	12.5	7.1	33.4
Overall balance	31.4	26.2	15.1	36.6	82.9
External indicators					
Gross reserves (US$ billions end-period)	113.0	141.5	151.6	199.2	290.3
(In months of imports) 7/	9.2	8.7	7.6	8.1	9.9
External debt (percent of GDP, end-period) 8/	18.5	19.1	17.1	17.2	17.4
Of which: short-term debt 9/	1.8	3.1	2.0	2.2	3.0
Ratio of gross reserves to short-term debt (end-period)	10.7	6.5	9.5	10.5	11.9
Gross reserves to broad money (percent; end-period)	24.6	27.5	24.8	26.3	...
Debt service ratio 10/	16.0	6.0	9.7	5.1	5.1
Real effective exchange rate					
(y/y percent change, period average for annual data)	1.0	2.2	4.4	-2.2	…
Exchange rate (rupee/US$, end-period)	43.6	43.7	44.6	43.5	...
Memorandum items (in percent of GDP): 11/					
Off-budget subsidy related bonds	0.0	0.0	0.3	1.0	1.2

Sources: Data provided by the Indian authorities; CEIC; and IMF staff estimates and projections.
1/ Data are for April-March fiscal years.
2/ Current staff projections.
3/ Differ from official data due to revisions in the current account.
4/ Divestment proceeds are treated as revenue until 2005/06 (included); excludes off-budget bond issuance.
5/ Divestment is treated as financing; includes off-budget bond issuance.
6/ Monthly data are on a customs basis; annual data are on a projected balance of payments basis.
7/ Imports of goods and services projected over the following twelve months.
8/ Data are reported relative to staff's estimated annual GDP.
9/ Residual maturity basis, except contracted maturity basis for medium and long-term non-resident Indian accounts.
10/ In percent of current account receipts excluding grants.
11/ Issued by the central government to FCI, the state-owned oil refining/distribution companies, and fertilizer companies as compensation for losses incurred from the provision of universal government price subsidies.