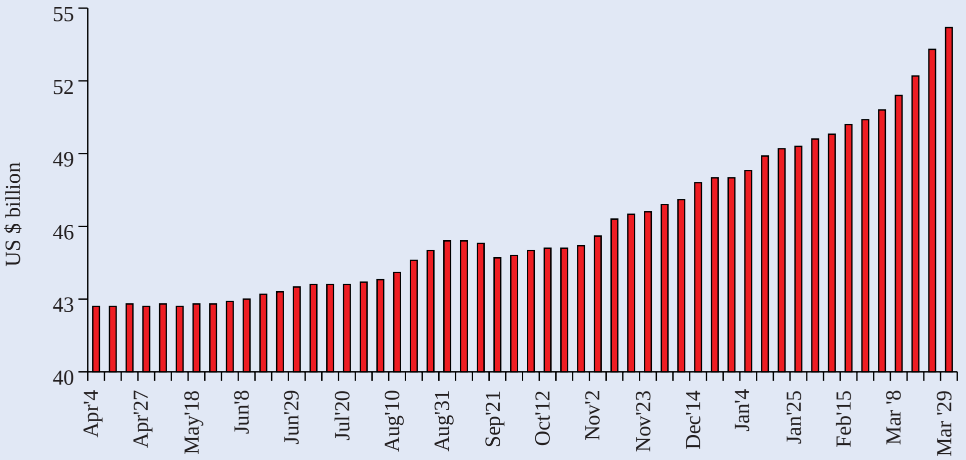
VI. The External Economy

The external sector exhibited strength during 2001-02, notwithstanding the sluggishness in exports. There was an increase in foreign exchange reserves to the tune of US $ 11.8 billion during the year reflecting abiding investor confidence in the fundamentals of the economy. The foreign exchange reserves comprising foreign currency assets, gold and SDRs stood at US $ 54.1 billion as at end-March 2002 with the import cover of reserves increasing from 8.6 months at end-March 2001 to around 11.5 months at end-March 2002 (Chart 65). By April 19, 2002, the foreign exchange reserves crossed the US $ 55 billon mark to reach US $ 55.1 billion.

Chart 65: Movements in Foreign Exchange Reserves: 2001-02

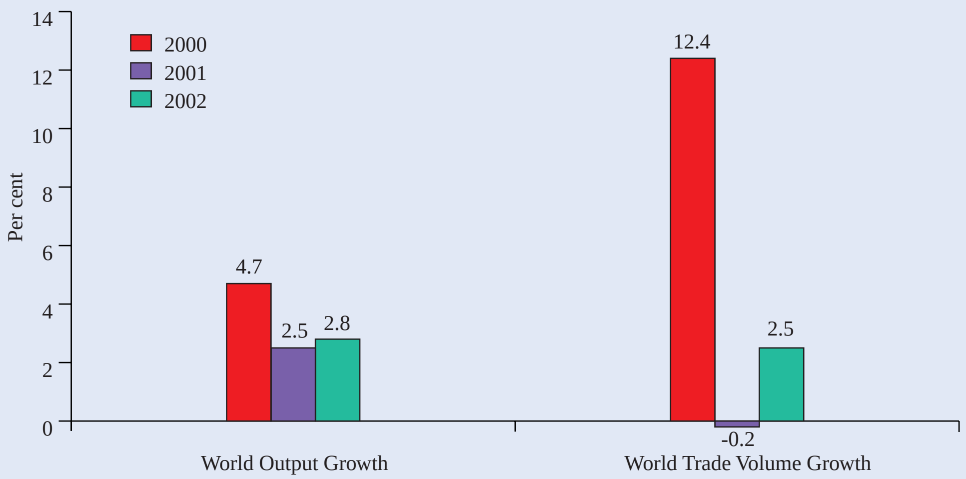


The current account deficit continued to remain modest. The external debt data for end-September 2001 indicate considerable improvement in terms of liquidity and sustainability. The exchange rate remained broadly stable during the year except for some short period of uncertainty in the aftermath of the September and December 2001 developments.

International Developments

The global slowdown that started in mid-2000 seems to have bottomed out and certain leading indicators of economic activity suggest the possibility of a recovery, led by the US, in mid-2002. The recovery in the global equity prices after the events of September 11, 2001 and the declines in risk aversion and spreads in both mature and emerging market economies indicate the market expectations of a faster recovery. The real effects of the September 11, 2001 incident also turned out to be moderate than what was anticipated. According to projections made by the International Monetary Fund (IMF) in April 2002, global growth may be modestly higher at about 2.8 per cent in 2002 with quarterly growth rising from 1.5 per cent in the last quarter of 2001 to 4.0 per cent by the end of 2002. The estimated growth in global output at about 2.5 per cent in 2001 and 2.8 per cent in 2002 would be significantly lower than that of 4.7 per cent achieved during 2000. World trade volume (both goods and services) growth exhibited an even sharper deceleration from 12.4 per cent during 2000 to a decline of 0.2 per cent during 2001, reflecting the effect of external demand slowdown on cross-border trade (Chart 66). According to the Institute of International Finance (IIF), net private capital flows to the emerging market economies fell from US $ 169 billion in 2000 to US $ 115 billion in 2001, the lowest in the last decade.

Chart 66: Growth in World Output and Trade Volume



Substantial easing of monetary policy, brought about by successive reductions in policy rates, resulted in one of the most benign interest rate environments in recent decades world over. Eleven successive reductions in the Federal Funds Rate target (from 6.5 per cent to the present target of 1.75 per cent) in the US during 2001 brought it to the lowest level seen during the last 40 years. While the Bank of Japan persisted with its near zero interest rate stance, both the European Central Bank and the Bank of England lowered their policy rates (refinancing rate and repo rate, respectively) during 2001 by 150 basis points and 200 basis points, respectively.

The negative externalities of a global downturn affected the prospects of developing countries through trade, capital flows and business confidence.

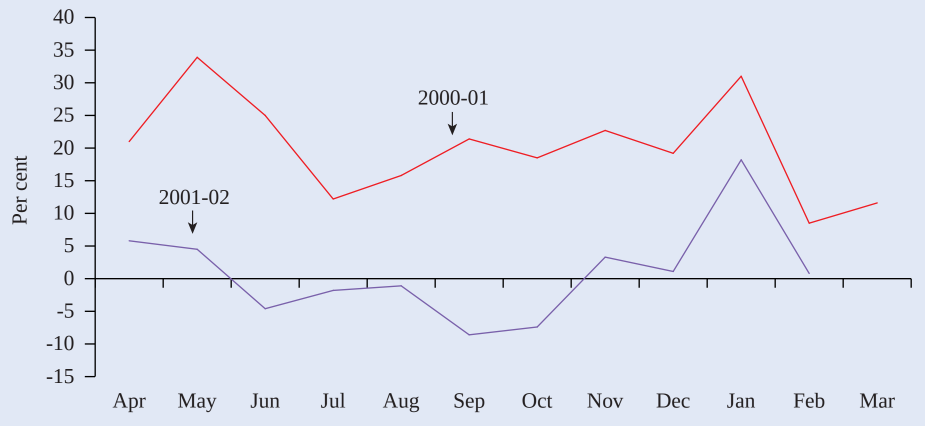
According to the IIF, the emerging market exports declined by 2.6 per cent in 2001 in contrast to a strong growth of 22.5 per cent in 2000. Nonetheless, the emerging market group continued to have a surplus in the current account as they recorded large decline in imports in the face of overall weak demand conditions. Projections made by the IMF in April 2002 indicate that developing countries, as a group, may witness a modest improvement in output growth to 4.3 per cent in 2002 over the subdued growth of 4.0 per cent in 2001.

Merchandise Trade (As per DGCI&S data)

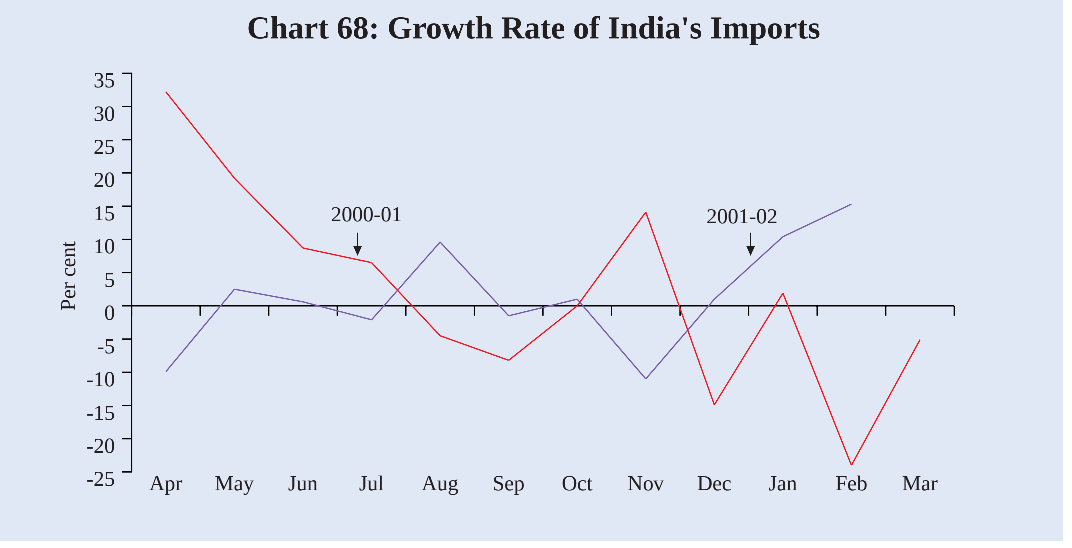
According to the provisional data released by the Directorate General of Commercial Intelligence and Statistics (DGCI&S) for April-February 2001-02, India's merchandise exports posted a growth rate of only 0.1 per cent in comparison with a growth of 20.6 per cent during the corresponding period of the previous year (Chart 67). Non-oil exports recorded a marginal decline of 0.5 per cent during April-February 2001-02 as against an increase of 15.7 per cent during the corresponding period of the previous year. POL exports recorded an increase of 12.7 per cent during April-February 2001-02. The deceleration in India's exports may be attributed to weak external demand in the wake of global slowdown. Commodity-wise data on exports for April-December 2001 indicate that all the major groups, excepting ores and minerals, chemicals & related products and petroleum products, recorded declines.

During April-February 2001-02, total imports recorded a growth of 2.1 per cent as against 1.6 per cent during the corresponding period of the previous year (Chart 68). In contrast to the sharp increasing trend of the preceding two

Chart 67: Growth Rate of India's Exports

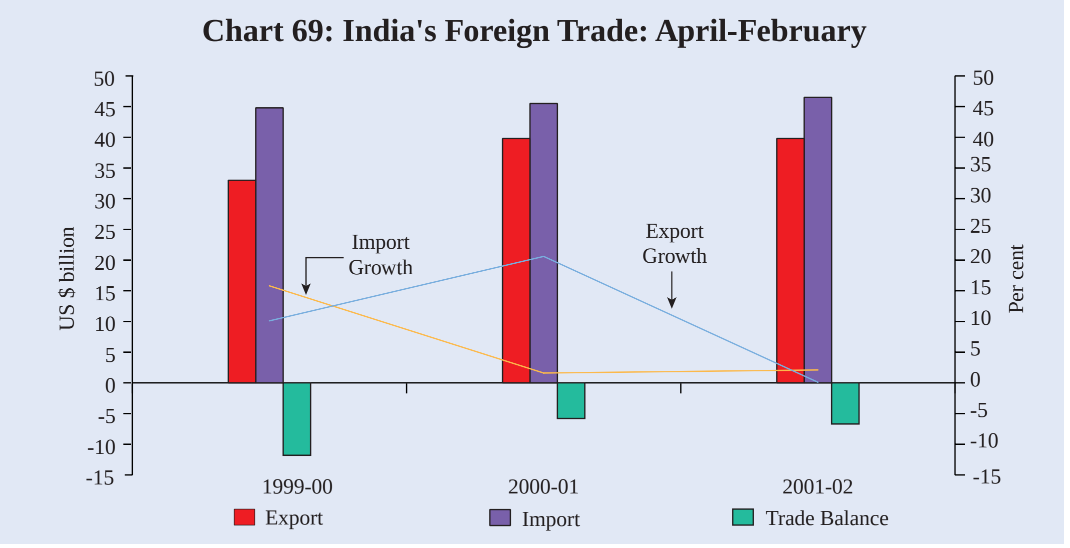


years, oil imports declined reflecting the softening of international crude oil prices which declined from an average of US $ 28.2 per barrel during calendar year 2000 to an average of US $ 24.3 per barrel during 2001. Most of this moderation was concentrated in the last quarter of 2001 with prices falling from US $ 25.9 per barrel in the period April-September 2001 to US $ 19.3 per barrel during October-December 2001. As a result, POL imports declined by 11.9 per cent during April-February 2001-02 as against a sharp increase of 55.0 per cent during the comparable period of 2000-01. The crude prices averaged US $ 20.9 per barrel during the quarter January-March 2002 as the prices hardened from March 2002 onwards.



Non-oil imports during April-February 2001-02, on the other hand, increased by 8.7 per cent as against a decline of 12.6 per cent during the corresponding period of the previous year. Commodity-wise data available for April-December 2001 indicate that the increase in non-oil imports was mainly due to capital goods (an increase of 4.1 per cent to US $ 6.8 billion), gold and silver (an increase of 17.7 per cent to US $ 3.9 billion), and bulk consumption goods (an increase of 43.8 per cent to US $ 1.6 billion). 'Non-oil non-gold' imports recorded an increase of 6.3 per cent during April-December 2001 in contrast to a decline of 6.4 per cent during the corresponding period of the previous year.

India's trade deficit (DGCI&S basis) was US $ 6.7 billion during April-February 2001-02 as against that of US $ 5.8 billion during the corresponding period of 2000-01 (Chart 69).

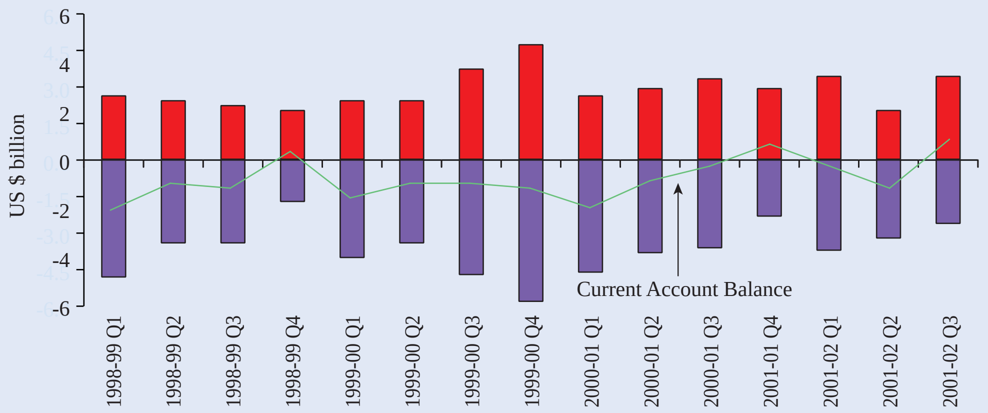


Region-wise break-up of India's total exports shows that during April-December, 2001 there was marked decline in exports to the OECD countries, particularly to Japan, the USA, France, Germany and Belgium. Exports to OPEC countries (Indonesia, Iran and Iraq) and developing countries of Asia (Bangladesh, Malaysia, Singapore and Thailand), however, showed increase. As regards imports, there was increase in imports from most of the OECD countries, namely, the USA, Australia, Switzerland and Germany while imports from Belgium, the UK and Japan declined during the period. Within the developing countries group, imports from Malaysia and Singapore declined.

Invisibles and Current Account

According to the balance of payments data available for the first three quarters of 2001-02 (April-December 2001), the current account deficit (CAD) narrowed to US $ 0.7 billion from US $ 3.2 billion during the corresponding period of the previous year. The reduction in the CAD was on account of the trade deficit which, on a balance of payment basis, was lower at US $ 9.5 billion during April-December 2001 as compared with US $ 12.0 billion in the corresponding period of the previous year. The surplus in invisibles continued to be a source of strength, with a net surplus of US $ 8.8 billion during April-December 2001 as against US $ 8.9 billion during the corresponding period of the previous year (Chart 70). The marginal decline in invisibles surplus during April-December 2001 was mainly on account of a lower surplus in 'services' and 'transfers' which declined to US $ 1.6 billion (as against US $ 1.8 billion during April-December 2000) and US $ 9.1 billion (as against US $ 10.0 billion), respectively. Receipts under 'services', comprising travel, transportation, financial

Chart 70: India's Current Account Balance



Note: Minus indicates deficit.

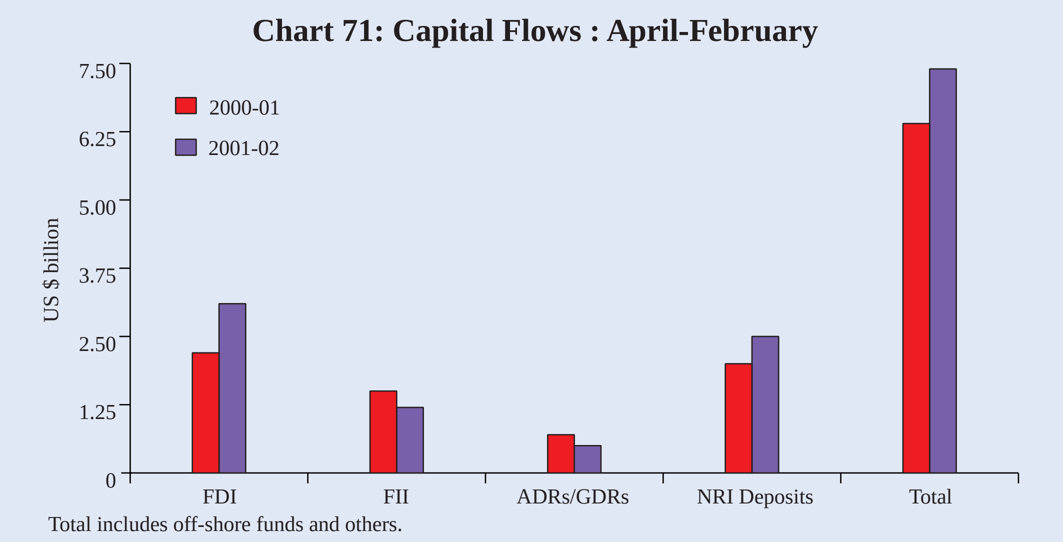
services and software exports *etc.*, increased from US $ 13.1 billion during April-December 2000 to US $ 15.3 billion in the April-December 2001 mainly due to an increase in miscellaneous receipts. Software exports shown under miscellaneous receipts rose by about 17.4 per cent to US $ 5.4 billion from US $ 4.6 billion in the first three quarters of 2000-01.

Capital Account

Net capital flows decreased to US $ 4.2 billion in April-December 2001 as compared with US $ 6.6 billion during April-December 2000 mainly on account of mobilization of US $ 5.5 billion under IMDs during April-December 2000. Excluding IMDs, net capital flows were significantly higher during April-December 2001. Net external assistance inflows during April-December 2001 were US $ 0.2 billion in contrast to an outflow of US $ 0.1 billion during the corresponding period of 2000. The demand for external commercial borrowings continued to be sluggish with net outflows at US $ 0.5 billion during April-December 2001 as against net inflows (including IMDs) of US $ 4.5 billion (an outflow of US $ 1.0 billion excluding mobilization of IMDs) during April-December 2000.

According to the latest information available for April-February 2001-02, foreign direct investment (FDI) inflows at US $ 3.1 billion were higher than those of US $ 2.2 billion during April-February 2000-01. During the same period, portfolio investment inflows were lower at US $ 1.7 billion than those of of US $ 2.3 billion during April-February 2000-01 as amounts raised under GDRs/ADRs declined to US $ 0.5 billion from US $ 0.7 billion and net inflows by FIIs declined to US $ 1.2 billion from US $ 1.5 billion. Inflows under NRI deposits during April-February 2001-02 amounted to US $ 2.5 billion as against US $ 2.0 billion during the corresponding period of the previous year (Chart 71).

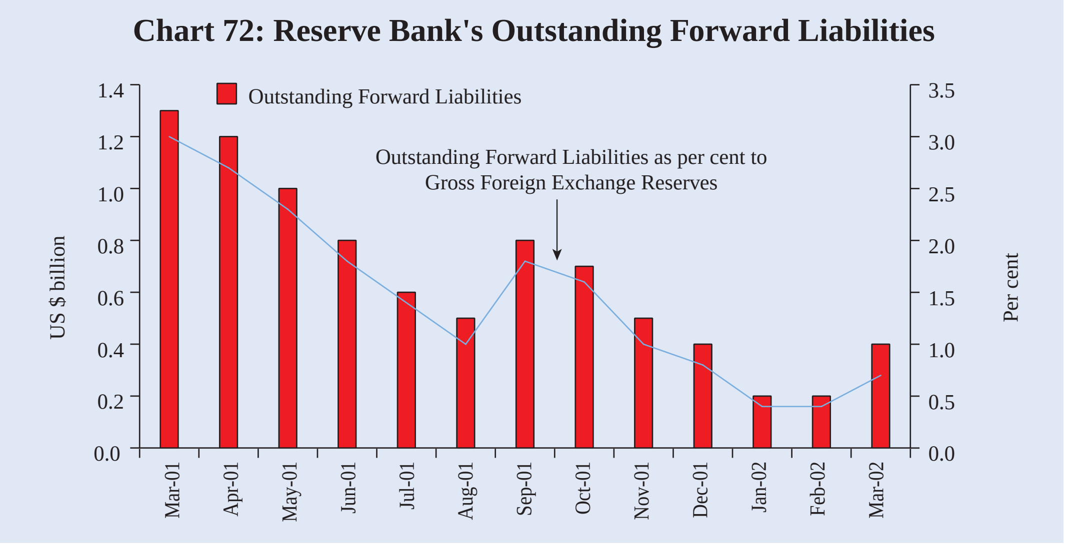
The reduction in the current account deficit resulted in the overall surplus in the balance of payments increasing to US $ 5.6 billion during April-December 2001 from US $ 2.7 billion in the corresponding period of 2000-01.



Foreign Exchange Reserves

India's foreign exchange reserves increased substantially during 2001-02 from US $ 42.3 billion as at end-March 2001 to US $ 54.1 billion as at end-March 2002 with a large part of the rise concentrated in the period since November 2001 (Chart 65). This was almost entirely on account of foreign currency assets which increased by US $ 11.5 billion to US $ 51.0 billion by end-March, 2002. The value of gold holdings of the Reserve Bank also increased by US $ 0.3 billion to US $ 3.0 billion during the same period. Reserve adequacy indicators indicated distinct improvement. The accumulation of foreign exchange reserves during the year is in line with the Reserve Bank's policy of maintaining an adequate level of foreign exchange reserves to meet import requirements, unforeseen contingencies and liquidity risks associated with different types of capital flows.

The outstanding forward liabilities of the Reserve Bank, which have been maintained at relatively low levels as a part of a prudent reserve management policy, significantly declined during the year from US $ 1.3 billion at end-March 2001 to US $ 0.4 billion at end-March 2002. The ratio of outstanding forward liabilities to gross foreign exchange reserves, therefore, declined sharply from 3.0 per cent at end-March 2001 to only 0.7 per cent at end-March 2002 (Chart 72).



External Debt

According to the provisional data, India's external debt at US $ 100.4 billion at end-September 2001 increased only marginally by 0.8 per cent from US $ 99.6 billion at end-March 2001 (Chart 73). Key indicators point towards sustainability of external debt. The concessional debt as a proportion to total debt increased marginally to 36.5 per cent at end-September 2001 from 36.0 per cent at end-March 2001. The size of short-term debt remained modest. As a proportion to total debt and foreign exchange reserves, it declined to 2.8 per cent and 6.2 per cent at end-September 2001 from 3.5 per cent and 8.2 per cent, respectively, at end-March 2001.