Editorial

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Incomplete insulation

Exercise caution on the external front

THE slowdown in India's GDP growth to 8.9% in the current year and further to 8.5% projected for the next fiscal, as highlighted by the Prime Minister's Economic Advisory Council in its review of the economy, should surprise nobody. Such signs have been apparent for many months now, and trendwatchers such as the World Bank have put forth a similar outlook. But what was unanticipated is the accentuating trends in the external sector, many of which could have a negative impact on business sentiment and economic buoyancy ahead. High on the list is the software sector's slowdown that is displaying a tendency towards stark stagnation. Net earnings of the software industry, which more than doubled over the last two years to $32.1 billion in 2006-07, are now only expected to trudge their way up to $32.8 billion in 2007-08, according to the Council's report. This represents a major climbdown from the $41 billion figure it had projected in July last year. Though the review refrains from pinning the stagnation on anything specific, the strengthening rupee is probably the main culprit. Perhaps this industry, so used to being in boom, could use the bad times ahead to reformulate its growth path and rationalise runaway salaries. As for the macroeconomic picture, the Council's report offers the reassurance that the shortfall in software earnings will be more than made up by a sharp increase in remittances from Indians living overseas, from $27 billion last year to $47 billion this year. This will help pay for the larger than previously anticipated trade deficit and even lower the current account deficit to 1.3% of GDP, a few notches below what was earlier projected.

Even sharper are the variations in the new estimates of capital flows. The current year's total portfolio inflows of $33 billion are close to treble the earlier projections. This, together with larger borrowings and banking capital flows from abroad, will raise net capital inflows to $103 billion, which is almost double the previous projection. While it is reassuring to note that foreign investors' confidence in the Indian economy remains intact despite the deceleration in both merchandise and service exports, it would be prudent to guard against the negative implications of these trends on overall demand conditions within India.