A] REVIEW OF THE GENERAL ECONOMIC ENVIRONMENT AND THE INVESTMENT CLIMATE

General Economic Environment *

The Indian economy did not fully escape the slowdown of the world economy, the contagion effect of the East Asian crisis and the drop in the world commodity prices. It affected exports, which declined sharply, and put pressure on inflation and growth of economy. The flight of capital from the emerging markets affected foreign portfolio flows into India. Indeed, for the first time, the net portfolio flows by the FIIs were negative for the year; though there were sustainable signs of recovery towards the end of the year.

Based on the new GDP series with 1993-94 as the base year, India's GDP growth had decelerated in 1997-98 to 5.0 per cent from 7.8 per cent in 1996-97. In 1998-99, the growth was higher at 6 per cent, indicating that economic recovery has begun. The better performance in the year under review has been largely contributed by a substantial rise in the agricultural production, which increased by 7.6 per cent as against a fall of 5.6 per cent during 1997-98. The industrial segments such as basic goods, intermediate goods and consumer goods failed to repeat the performance of 1997-98 and their output growth was lower at 1.7 per cent, 5.8 per cent and 2.3 per cent, respectively during 1998-99 as against 6.5 per cent, 8.1 per cent and 5.7 per cent respectively during the previous year. A noticeable feature of GDP growth is the increasing share of services sector in overall growth. The services sector which contributed 46 per cent of total GDP in 1994-95 increased its share to about 48.6 per cent in 1997-98.

The gross domestic savings, however, has been showing discomforting trends. The decline in the saving rate coupled with the change in the distribution pattern of households savings are bound to have an adverse impact on the flow of funds into the securities market. The saving rate registered a decline from 24.4 per cent in 1996-97 to 23.1 per cent in 1997-98. The contraction in the saving rate was contributed by almost all the sectors. Thus the saving rate of households was lower at 18.3 per cent in 1997-98 from 18.8 per cent in 1996-97 whereas that of private corporate sector and public sector decreased from 4.1 per cent and 1.5 per cent respectively to 3.8 per cent and 1.0 per cent. This was also reflected in the overall investment ratio which slipped from 25.7 percent in 1996-97 to 24.8 per cent in 1997-98. (Table 1.2)

Table 1.2: Domestic Saving and Investment

Domestic Saving and Investment	***1994-95***	***1995-96***	***1996-97***	***1997-98***
Gross Domestic Savings as a percentage of GDP	24.2	24.1	24.4	23.1
(i) Household sector	19.3	17.4	18.8	18.3
(ii) Private corporate sector	3.4	4.8	4.1	3.8
(iii) Public sector	1.5	1.9	1.5	1.0
(iv) Gross investment	25.4	25.8	25.7	24.8

Source : Economic Survey 1998-99

More than the decline in the saving rate, the trend in the distribution of household savings in financial assets has implications for the expansion of the securities market. The analysis of the data shows that household sector which invested 10.2 per cent of their savings in equity shares and debentures in 1992-93, invested only 1.7 per cent in 1997-98. The investment by the households sector in units of Unit Trust of India declined from 7.0 per cent in 1992-93 to 0.3 per cent by 1997-98. During this period there was a significant shift in favour of bank deposits and claims on Government from 36.8 and 4.8 per cent, respectively in 1992-93 to 45.6 and 12.4 per cent in 1997-98 (Table 1.3).

Capital account position of the country has also a bearing on the financial system and in particular, on the capital market. Foreign inflows into the system not only adds to the liquidity of the country but also provide foreign savings to the economy. The foreign inflows on the capital account however, have shown deceleration in their growth during 1997-98 on a net basis (gross flows minus gross outflows). As such in 1997-98 the net inflows on capital account decreased to US $ 3.89 billion in 1997-98 from US $ 5.81 billion in 1996-97. The position might have been the same during 1998-99. The outlook for capital flows, particularly FIIs will be determined by the stable growth in the economy with better performance of current account position and the credibility of exchange rate policy. The financial crisis in East Asia which have re-emphasised the need for strong supervision and regulation of capital market and its further developments from the point of view of investor's protection, trade guarantee, transparency, better payment system, safe transactions and international accounting standards should serve as guiding indicators for FIIs to invest in Indian equity.

Table 1.3: Savings of the Households Sector in Financial Assets (Rs. in crore)

Item	***1992-93P***	***1993-94P***	***1994-95P***	***1995-96***	***1996-97P***	***1997-98 $***
Savings(Gross) of the Household Sector in Financial Assets of which	80,387	109,485	145,381	124,986	157,424	180,665
Currency	6,562	13,367	15,916	16,525	13,643	12,532
	(8.2)	(12.2)	(10.9)	(13.2)	(8.7)	(6.9)
Bank Deposits #	29,550	36,200	55,834	39,995	57,367	82,346
	(36.8)	(33.1)	(38.4)	(32.0)	(36.4)	(45.6)
Non-banking Deposits	6,035	11,654	11,547	13,198	21,411	7,775
	(7.5)	(10.6)	(7.9)	(10.6)	(13.6)	(4.3)
Life Insurance Fund**	7,114	9,548	11,370	13,894	16,188	19,513
	(8.8)	(8.7)	(7.8)	(11.1)	(10.3)	(10.8)
Provident and Pension Fund	14,814	18,226	21,295	22,292	26,248	32,668
	(18.4)	(16.6)	(14.6)	(17.8)	(16.7)	(18.1)
Claims on Government +	3,885	6,908	13,186	9,588	11,701	22,315
	(4.8)	(6.3)	(9.1)	(7.7)	(7.4)	(12.4)
Shares and Debentures ++	8,212	10,067	13,474	8,839	6,696	3,042
	(10.2)	(9.2)	(9.3)	(7.1)	(4.3)	(1.7)
Units of Unit Trust of India	5,612	4,705	3,908	262	3,776	595

	(7.0)	(4.3)	(2.7)	(0.2)	(2.4)	(0.3)

Figures in brackets indicate percentages to Financial Assets of households

 # Includes deposits with Co-operative non-credit societies.

*** Includes State / Central Government and postal insurance fund.*

+ Includes compulsory deposits

++ Includes investment in shares and debentures of credit / non-credit societies and public sector bonds.

$ Tentative Estimates

Source : Report on Currency and Finance, Vol.II, RBI.

Resource mobilisation by way of public and rights issues from the primary market during April – March 1998-99 amounted to Rs.5586.46 crore with 58 issues as compared with Rs. 4569.95 crore during the same period in 1997-98. Thus the year of 1998-99 showed somewhat better performance, though the capital raised was still substantially lower than the figure of Rs.20803.7 crore in 1995-96 and Rs.14275.98 crore during 1996-97. Though the rise in resources mobilised in 1998-99 has been higher by more than 22 per cent over 1997-98, more than 80 per cent of the capital mobilised during the year was on account of financial institutions, and the manufacturing and other sectors mobilised less than 20 per cent of it. A disappointing feature of the resource mobilisation was the share of listed companies was nearly 92 per cent of the total resources compared to 75 per cent in 1997-98. It implies that very few new companies entered the market.

The performance of mutual funds in terms of gross mobilisation was satisfactory as the aggregate gross resources raised by the mutual funds increased to Rs.22710.73 crore during 1998-99 from Rs. 15,171 crore during 1997-98. However, after adjusting for the repurchases and redemptions, there was a net outflow of Rs. 949.67 crore, largely on account of substantial disinvestment by investors in the Unit 64 scheme of UTI .

The monthly trend in net investment by the FIIs which was negative towards the end of 1997-98 continued in 1998-99. The cumulative net FIIs investment contracted by US$387m during the year from US$9284m at end of March 1997-98 to US $8897m at the end of March 1998-99. The net investment however turned positive towards the end of the year and the trend is expected to continue into 1999-2000.