

External Sector

The growing influence of global developments on the Indian economy was manifest in the surge in capital inflows in 2007-08, a phenomenon observed earlier in other emerging market economies. This is a natural concomitant of the robust macroeconomic fundamentals like high growth, relative stability in prices, healthy financial sector and high returns on investment. Sometimes, it also reflects the rigidities in the economy, particularly the interest differentials. Even as the external environment remained conducive to the nation's growth, the problems of managing a more open capital account came to the fore in terms of the economy approaching the limits of its absorptive capacity with the pace of adjustment becoming somewhat difficult in the short run. On the other side, the nation's rapid growth, in

conjunction with other major emerging market economies, helped keep the global growth momentum strong.

6.2 Growth in world trade volume of goods and services decelerated from 9.2 per cent in 2006 to 6.6 per cent in 2007 and is projected to remain around the same levels in 2008 (Table 6.1). World trade prices, in contrast were projected to rise sharply for manufactures, but likely to moderate for oil and other commodities. However, with sharp rise in oil prices of late, the growth in value terms may remain high. With broad-based growth and relative stability, the pace of net private capital flows to emerging market economies and developing countries accelerated with a growth of 124 per cent in 2007, which posed adjustment problems in these economies.

**Table 6.1 External environment
(annual per cent change unless otherwise noted)**

Items	Projections			
	2005	2006	2007	2008
World trade volume (goods & services)	7.5	9.2	6.6	6.7
World trade prices (in US\$ terms)				
Manufactures	3.7	3.8	7.9	2.8
Oil	41.3	20.5	6.6	9.5
Non-fuel primary commodities	10.3	28.4	12.2	-6.7
Capital flows				
Emerging market and developing countries				
Private capital flows (net) in US\$ billion	271.1	220.9	495.4	291.3

Source: World Economic Outlook - October 2007, IMF.