MACRO-ECONOMIC FRAMEWORK STATEMENT

Overview of the Economy

The Indian economy is estimated to grow by 6.9 per cent in 2011-12 in terms of gross domestic product at factor cost at constant 2004-05 prices. This follows a growth of 8.4 per cent in 2010-11. Relative to high growth in the period 2003-04 to 2010-11 (with the exception of 2008-09), growth in 2011-12 is on the lower side. This is attributable mainly to weakening industrial growth in a milieu of persistent inflationary pressures and deterioration in the global economic situation. Monetary policy tightening to control inflation and inflationary expectations typically operates through a compression in aggregate demand and this was in evidence in 2011-12. The Reserve Bank of India (RBI) raised policy rates by 375 basis points since March 2010. The impact of tight monetary policy, particularly gets reflected in the quarterly growth rates of GDP. Growth in the first three quarters of the current fiscal came down successively. However, relative to many other economies in the world, growth of 6.9 per cent in India is among the highest. The slowdown in the economy, coupled with rising costs and narrowing profit margins of the corporate sector led to a lower-than budgeted growth in government revenues. On the other hand, higher than targeted public expenditure, mainly due to higher subsidy requirement, had implication for the level of fiscal deficit. The financial markets broadly reflected the impact of the global events and the impact of tightening monetary policy stance. The deterioration in global economy in the latter half of 2011-12 led to sharp capital outflows and put pressure on the exchange rate. This trend has reversed in January 2012. Inflation in terms of most indices has exhibited downward trends in the recent months as a result of the measures taken by the Government and the Reserve Bank of India (RBI). There are some signs that the slowdown in economic activity has bottomed out and a gradual upswing is expected in 2012-13.

GDP growth

As per the Advance Estimates released by the Central Statistics Office (CSO), the Indian economy is estimated to register a growth rate of 6.9 per cent in 2011-12 in terms of GDP at factor cost as against 8.4 per cent each in 2009-10 and 2010-11. The growth is on the lower side not only as compared to the recent past but also when seen in the context of growth trends since 2003-04. The slowdown in the growth of the economy in 2011-12 is mainly on account of the slowdown in the industrial sector which is estimated to grow at 3.9 per cent in 2011-12 as against 7.2 per cent in 2010-11 and lower growth of 2.5 per cent in agriculture sector on top of a high growth rate of 7 per cent achieved in 2010-11. Services sector is estimated to grow at robust rate of 9.4 per cent in 2011-12, which is more or less at the same level as in 2010-11. The slowdown can be attributed both to domestic and global factors. Global factors include, in particular, the crisis in the eurozone area and near-recessionary conditions prevailing in Europe; slow growth in many other industrialized countries, hardening of international prices of crude oil, etc. Domestic factors, namely the tightening of monetary policy, in order to control inflation resulted in slowing down of investment and growth, particularly in the industrial sector. In terms of contribution to growth, services sector accounted for nearly 79 per cent of growth with trade, hotels, transport and communications contributing over 44 per cent in the current year. On the other hand, contribution of industry and agriculture sectors to the overall growth in GDP was 16 per cent and 5 per cent respectively in 2011-12.

As per the quarterly data released by CSO, growth in the economy was 6.1 per cent in the third quarter of the current year. This growth has been the lowest since third quarter of 2008-09. The growth of agriculture, industry and services sectors is estimated to be 2.7 per cent, 2.6 per cent and 8.9 per cent respectively in the third quarter of 2011-12 as against 11.0 per cent, 7.6 per cent and 7.7 per cent respectively in the corresponding quarter of 2010-11. Cumulative growth in the first three quarters put together in the current year works out to 6.9 per cent as against 8.1 per cent in the corresponding period last year. The growth in industry and agriculture sectors was 3.6 per cent and 3.2 per cent, while it was 9.4 per cent in the services sector.

In terms of expenditure method of estimation, GDP at constant market prices is projected to register a growth of 7.5 per cent in 2011-12 as against a growth of 9.6 per cent in 2010-11. This slowdown in growth could be attributed to the three major components viz. the growth of consumption expenditure, gross fixed capital formation, exports that declined to 6.0 per cent, 5.6 per cent and 14.3 per cent respectively in real terms during the year 2011-12. The growth in respect of these indicators was 8.1 per cent, 7.5 per cent and 22.7 per cent respectively in 2010-11. The growth of investment in the economy is estimated to have registered a significant decline during the current year. This has been on account of a sharp increase in the policy rates that resulted in higher costs of borrowings. As per the Quick Estimates released by the CSO, gross domestic savings as a ratio of GDP at current market prices (savings rate) declined from 33.8 per cent in 2009-10 to 32.3 per cent in 2010-11. This decline is accounted for by a reduction in private savings, primarily the household savings in financial assets and somewhat by a reduction in corporate savings. Public savings on the other hand registered an increase during 2010-11.

Agricultural production

Agricultural production continues to be significantly influenced by southwest monsoon rainfall and with near normal rainfall following a year of deficient rainfall in the previous year, production of food grains rebounded in 2010-11. During the South west monsoon season of 2011, the country as a whole received 1 per cent more rainfall than the long period average (LPA); besides it was well distributed spatially. Growth in agriculture and allied sectors as per national account data is placed at 7.0 per cent in 2010-11 and is estimated at 2.5 per cent in 2011-12. Driven by increase in rice and wheat production, food production is estimated at an all-time record level of 250.42 million tonnes in 2011-12 as against a high level of 244.78 million tonnes in 2010-11. Thus, while growth in the current year might be lower than the previous year; this has been achieved against a high base level. As per the Second Advance Estimates released by Ministry of Agriculture, in 2011-12 the production of rice is placed at 102.75 million tonnes; wheat at 88.31 million tonnes and cotton at 34.09 million bales of 170 Kg each. However, production of pulses is estimated to decline to 17.28 million tonnes in the current year from a level of 18.24 million tonnes in 2010-11. The estimated production of sugarcane in 2010-11 at about 342.4 million tonnes, is expected to rise to 347.9 million tonnes in 2011-12. The production of oilseeds is estimated at 305.29 lakh tonnes in 2011-12 as against 324.79 lakh tonnes in 2010-11.

While the above indicates some improvement in the levels of production in recent years, growth in agriculture and allied sectors have fallen short of the Plan targets. Even in the Eleventh Plan period, average annual growth in agriculture and allied sector is placed at 3.3 per cent as against a target of 4.0 per cent. Given the obvious limitation in coverage of area, long-term growth primarily depends on yields in crops. This has been sought to be achieved through incremental productivity gains and technology diffusion across regions. Important factors affecting this are the level of gross capital formulation in agriculture. The proportion of gross capital formation (at constant 2004-05 prices) to the value added in agriculture sector rose to 20.1 per cent in 2010-11 from a level of 13.5 per cent in 2004-05. However, the share of agriculture and allied sector's gross capital formation in overall gross capital formation of the economy has exhibited an undulating trend. Government has also strived to enhance the flow of credit to agriculture sector, in recent years actual credit to agriculture sector exceeded the targets set in this regard. In 2010-11, as against a target of ₹ 3,75,000 crore, the actual credit to agriculture was placed at ₹ 4,46,779 crore. In 2011-12 as against a target of ₹ 4,75,000 crore, it was at ₹ 2,62,129 crore in the period April-October 2011-12.

Prices

The headline inflation measured in terms of Wholesale Price Index in 2011-12 (April-December) averaged 9.4 per cent as compared to 9.6 per cent during the corresponding period in 2010-11. Financial year 2011-12 started with a headline inflation of 9.7 per cent, which briefly touched double digits in September, 2011 before coming down to 7.5 per cent in December, 2011.

Inflation remained at elevated levels of around 9 per cent on account of three main factors, viz. (a) high food price inflation, that abated significantly for cereals and pulses with better availability but which generally remained at elevated levels and is prone to shocks, especially for fruits and vegetables and protein-rich items such as milk, eggs, fish and meat, as rising demand outpaced supply; (b) shifting focus of inflation to non-food manufacturing inflation, as inflationary pressure in food prices spilled over to manufactures; and (c) rising global commodity prices of food, industrial materials and fuels that were transmitted to domestic prices in a cost-push manner.

WPI food inflation (weight 24.31 per cent) however, declined significantly from 20.2 per cent in February 2010 to 2.6 per cent in December, 2011 mainly on account of improved availability of cereals and a seasonal fall in fruits & vegetable prices. Milk, eggs/meat/fish, gram and edible oils however, continued to remain major drivers of food inflation.

The Consumer Price Inflation (CPI) for the major indices generally followed a similar trend and declined to below 7 per cent in December 2011. CPI-IW inflation, after remaining in single digit from August 2010 to August 2011, briefly touched double digits at 10.1 per cent in September 2011 before declining to

6.5 per cent in December, 2011. Food inflation for all CPIs and the WPI moderated about 2 per cent in December, 2011.

Industry and Services

Industrial growth started decelerating from third quarter of 2008-09 largely on account of the global economic uncertainties. Overall industrial growth, measured in terms of Index of Industrial Production (IIP), remained negative from December, 2008 to June, 2009. However, due to timely intervention and the stimulus measures adopted by the Government, there was a recovery in the industrial growth. Overall industrial growth improved to 8.2 per cent in 2010-11 compared to 2.5 per cent in 2008-09 and 5.3 per cent in 2009-10. Fragile global economic recovery and subdued domestic sentiments, however, resulted in a persistence of moderate growth in 2011-12. In the first nine months of 2011-12 (April-December), the IIP registered a growth of 3.6 per cent compared to a growth of 8.3 per cent in the corresponding period of the previous year. The manufacturing sector, which has a weight of 75.5 per cent in IIP also witnessed a significant moderation in growth of 3.9 per cent in April-December 2011 as compared to a growth of 9.0 per cent in April-December, 2010. The output in the mining sector contracted by 2.7 per cent in April-December, 2011 as against a growth of 6.9 per cent in the corresponding period of the previous year. A negative growth in coal and natural gas sectors caused this contraction in output. Electricity sector, however, continued to remain buoyant with a growth of 9.4 per cent in April - December, 2011 compared to a growth of 4.6 per cent in corresponding period of previous year. In terms of the contribution to GDP, the services sector is the dominant sector of the Indian economy. As per the Advance estimates released by the CSO, the services sector is expected to realise a growth rate of 9.4 per cent in 2011-12 over and above 9.3 per cent growth achieved in 2010-11.

External sector

India's export and import growth that gained momentum, in 2010-11, continued to grow robustly during 2011-12. During 2011-12 (April-December), exports were valued at US $ 217.7 billion, registering a growth rate of 25.8 per cent over the level of US $ 173 billion in 2010-11 (April-December). Value of imports during this period was US $ 350.9 billion, which was 30.4 per cent higher than the level of US $ 269.2 billion in the corresponding period of 2010-11. Rising crude oil prices, along with increase in gold and silver prices have contributed significantly to the import bill. Of the total imports, POL imports accounted for US $ 105.6 billion (30.1 per cent of total import) in April-December 2011, which was 40.4 per cent higher than the level of US $ 75.2 billion in 2010-11 (April-December). Non-POL imports during 2011-12 (April-December) were valued at US $ 245.3 billion, which were 26.5 per cent higher than the level of US $ 194 billion in 2010-11 (April-December). Consequently, trade deficit for 2011-12 (April-December) increased to US $ 133.3 billion which was 38.5 per cent higher than the level of US $ 96.2 billion in 2010-11 (April-December).

While the merchandise trade data is available for the period April-December 2011, most information pertaining to balance of payments is available only for the first half of 2011-12, i.e. till September 2011. In India, generally, robust levels of exports of non-factor services result in smaller levels of deficit in the goods and services balance. In the first half of 2011-12, the deficit on goods and services was at US$ 54.7 billion. Led by private transfers (remittances) at US$ 30.9 billion in the first half of 2011-12, net invisibles surplus was US$ 52.9 billion. The Current Account Deficit (CAD) increased to US$ 32.8 billion in the first half of 2011-12, as compared to US$ 29.6 billion during the corresponding period of 2010-11, mainly on account of higher trade deficit.

The levels of capital inflows were sufficient for financing of the current account deficit in the first half of 2011-12. In net terms, capital inflows increased to US$ 41.1 billion in the first half of 2011-12 as against US$ 39.0 billion in the first half of 2010-11. Net foreign direct investment was higher at US$ 12.3 billion in the first half of 2011-12 as against US$ 7 billion in the corresponding half of 2010-11. However, net portfolio investment declined substantially from US$ 23.8 billion to US$ 1.3 billion during the same period on account of a major decline in FII flows to US$ 0.9 billion in 2011-12 from US$ 22.3 billion. Other capital flows, including ECBs and banking capital, increased sufficiently to compensate the less than adequate portfolio flows. Net accretion to reserves (reserve change on BoP basis) during the first half of 2011-12 was lower at US$ 5.7 billion as compared to US$ 7 billion in H1 of the previous year mainly due to widening of the CAD.

The rupee evinced a depreciating trend for some parts of 2011-12. The monthly average exchange rate of the rupee was in the range of ₹ 44.97 to ₹ 51.34 per US $. On point to point basis, rupee depreciated by 16.2 per cent from ₹ 44.67 per US dollar on March 31, 2011 to ₹ 53.26 per US dollar on December 30, 2011. Rupee reached a peak of ₹ 43.94 on July 27, 2011, and lowest at ₹ 54.23 per US dollar on December 15, 2011 indicating the depreciation 19.0 per cent. Similarly, monthly average exchange rate of rupee depreciated by 11.5 per cent against pound sterling, 9.1 per cent against euro and by 18.7 per cent against Japanese yen between March 2011 and December 2011. In 2011-12, the foreign exchange reserves increased by US$ 6.7 billion from US$ 304.8 billion at end March 2011 to US$ 311.5 billion at end September 2011. Foreign exchange reserves stood at US$ 296.7 billion, at the end of December, 2011. India's external debt stock stood at US$ 326.6 billion at end-September 2011, recording an increase of US$ 20.2 billion (6.6 per cent) over end March 2011 estimates of US$ 306.4 billion. This increase was primarily on account of higher commercial borrowings and short-term debt.

Money, Banking and Capital Markets

Reining in inflation was the primary objective of monetary policy during 2011-12. The RBI hiked the repo rate 13 times between March 2010 and January 2012, cumulatively by 375 basis points (bps). With supply-side factors feeding into food inflation and an uncertain economic scenario in advanced countries, the task of monetary policy calibration was particularly challenging. Tight monetary policy and in particular, successive increases in repo rate had an adverse impact on growth. However, the period from December 2011 to January 2012 marked a reversal of the cycle with the RBI in its Third Quarter Review of Monetary Policy keeping the repo and reverse repo rates unchanged at 8.5 per cent and 7.5 per cent respectively. The cash reserve ratio (CRR), however, was reduced from 6.0 to 5.5 per cent and subsequently to 4.75 per cent in order to ease the liquidity situation. Significant changes in the operating procedure of monetary policy have been effected. The weighted average overnight call money rate has been made the operating target and the repo rate specified as the only independently varying policy rate. A new Marginal Standing Facility (MSF) has been instituted under which Scheduled Commercial Banks (SCBs) have been allowed to borrow overnight at their discretion, up to 1 per cent of their respective net demand and time liabilities (NDTL), at 100 bps above the repo rate. The revised corridor has been defined with a fixed width of 200 bps and the repo rate placed in the middle of the corridor and reverse repo rate at 100 bps below it. The RBI, as a one-time technical adjustment on 13 February 2012, has further aligned the bank rate with the MSF rate of 9.5 per cent.

During 2011-12, the growth rate in reserve money (M0) has been 1.9 per cent (as on 10 February 2012) while broad money (M3) growth has been 10.2 per cent (as on 27 January 2012). Year-on-year, non-food credit growth was increased by 15.7 per cent at the end of December 2011. Liquidity conditions have generally remained in deficit during 2011-12.

Keeping in view progressive deregulation of interest rates, savings bank account interest rates were deregulated with effect from 25 October 2011, wherein banks will have to keep a uniform rate of interest for savings accounts with deposits up to ₹ 1 lakh, while differential interest rates could be set for savings deposits over ₹ 1 lakh. This is expected to enhance the attractiveness of savings accounts and encourage thrift behaviour in the economy by bringing savings deposit rates in sync with changing market conditions.

Subdued Foreign Institutional Investor (FII) inflows into the country led to a decline in Indian markets and contributed to the sharp depreciation of the rupee, though much of the depreciation was due to 'flight to safety' by foreign investors, given the meltdown in Europe and inflation in emerging market economies. Moderation in the growth rate of the economy has also affected market sentiments. Qualified Foreign Investors (QFIs) were allowed to directly invest in Indian equity markets in January 2012. This was done to widen the class of investors, attract more foreign funds, reduce market volatility, and deepen the Indian capital market. Earlier, only FIIs/sub-accounts and Non-Resident Indians (NRIs) were allowed to directly invest in Indian equity markets.

Central Government finances

The fiscal consolidation was substantial in 2010-11 with fiscal deficit declining to 4.9 per cent of GDP from 6.4 per cent in 2009-10 and accrued on the strength of larger than budgeted growth in tax and non-tax revenues and higher nominal GDP. The macroeconomic outlook at the time of the presentation of the Budget for 2011-12 was positive and the Budget for 2011-12 had set fiscal targets appropriately with fiscal deficit estimated to reduce to 4.6 per cent of GDP. However, the subsequent economic events turned out to be somewhat different. International crude prices hardened considerably. Economic crisis in Eurozone and political crisis in the middle-east impacted Indian Economy in several ways. A persistently high domestic inflation which manifested itself in adoption of a tight monetary policy stance resulted in a slower growth of output and demand, thereby impacting revenues. With higher than budgeted expenditure outgo, a slippage from the budgeted targets in terms of fiscal outcome became inevitable in 2011-12. As per the data made available by the Controller General of Accounts, revenue deficit and fiscal deficit had reached 93.1 per cent and 92.3 per cent respectively of BE levels by December, 2011. In the first nine months, gross tax revenue has grown by 12.2 per cent as against the BE target of 17.6 per cent. Among the major taxes, growth in corporation taxes at 6 per cent as against the 20.5 per cent envisaged in BE 2011-12 and union excise duties at 8 per cent as against the 18.7 per cent envisaged in BE 2011-12 inevitably impacted the Government finances. Growth in service tax at 37 per cent, customs at 15 per cent, and personal income tax at 16 per cent are either at par or above 2011-12 budget estimates. Growth in total expenditure in the first nine months of 2011-12 was 13.9 per cent, which comprised 15.4 per cent growth in Non-Plan expenditure and 10.8 per cent growth in Plan expenditure. The build-up of expenditure over the nine months and less than commensurate growth in revenue have led to high proportions of deficits in the first nine months. As a consequence the Revised Estimates place fiscal and revenue deficit at 5.9 per cent of GDP and 4.4 per cent of GDP, respectively in 2011-12.

Prospects

The financial crisis in Europe, along with certain exogenous shocks like increase in the international prices of crude oil and petroleum products resulted in a sharp global economic slowdown during 2011. At the domestic level, inflation remained at over 9 per cent for much of the year. In order to mitigate the inflationary pressures, the RBI had to tighten monetary policy. As a result the Indian economy has been adversely affected and its GDP growth is projected to decline to 6.9 per cent during 2011-12. There are signs that indicate that the growth rate in 2012-13 would be higher than what is likely in the current year. In the recent months inflation has been exhibiting downward trends. Further easing of inflation could lead to some reversal of tight monetary measures taken by the RBI, which could encourage investment activity. As fiscal consolidation gets back on track, savings and investment should also increase. These factors, along with the fact that despite slowdown, India's investment rate has been 35.1 per cent in 2010-11, should result in growth consolidating in 2012-13. As a result, it would be reasonable to expect the growth rate of real GDP for 2012-13 to be 7.6 (+/-0.25) per cent. It may be mentioned that these projections are contingent on conditions like normal rainfall, reasonably stable prices of petroleum products, etc.

Annex - I

MACROECONOMIC FRAMEWORK STATEMENT
(ECONOMIC PERFORMANCE AT A GLANCE)

Sl.	Item	Absolute value April-December		Percentage change April-December	
		2010-11	2011-12	2010-11	2011-12
	Real Sector				
1	GDP at factor cost (₹ thousand crore)*				
	a) at current prices	7157 Q	8280 A	17.5 Q	15.7 A
	b) at 2004-05 prices	4886 Q	5222 A	8.4 Q	6.9 A
2	Index of Industrial Production (2004-05=100)	161.0	166.8	8.3	3.6
3	Wholesale Price Index (2004-05=100) @	141.6	154.9	9.6	9.4
4	Consumer Price Index: Industrial Workers (2001=100)@	177.7	193.3	11.0	8.8
5	Money Supply (M3) (₹ thousand crore) $	6202	7199	17.3	16.0
6	Imports at current prices **				
	a) In ₹ crore	1228074	1651240	23.8	34.5
	b) In US $ million	269175	350936	29.8	30.4
7	Exports at current prices **				
	a) In ₹ crore	789069	1024707	29.6	29.9
	b) In US $ million	172965	217664	36.0	25.8
8	Trade Deficit (in US$ million) **	-96210	-133272	20.1	38.5
9	Foreign Exchange Reserves				
	a) In ₹ Billion	13324	15804	0.7	18.6
	b) In US $ million	297334	296688	4.9	-0.2
10	Current Account Balance (In US$ million) (Apr-Sept)	-29599	-32842	...	...
	Government Finances #				
1	Revenue receipts	584268	498491	50.1	-14.7
2	Tax revenue (Net)	391148	420414	27.2	7.5
3	Non-tax revenue	193120	78077	136.4	-59.6
4	Capital receipts (5+6+7)	202584	397870	-36.3	96.4
5	Recovery of loans	8591	14115	115.7	64.3
6	Other receipts	22744	2743	428.2	-87.9
7	Borrowings and other liabilities	171249	381012	-44.8	122.5
8	Total receipts (1+4)	786852	896361	11.2	13.9
9	Non-Plan expenditure	536898	619457	7.9	15.4
10	Revenue Account	487692	550692	5.8	12.9
	of which:				
11	Interest payments	146304	179429	12.5	22.6
12	Capital Account	49206	68765	35.1	39.7
13	Plan expenditure	249954	276904	18.9	10.8
14	Revenue Account	212885	233903	18.6	9.9
15	Capital Account	37069	43001	21.1	16.0
16	Total expenditure (9+13)	786852	896361	11.2	13.9
17	Revenue expenditure (10+14)	700577	784595	9.4	12.0
18	Capital expenditure (12+15)	86275	111766	28.7	29.5
19	Revenue deficit (17-1)	116309	286104	-53.7	146.0
20	Fiscal deficit {16-(1+5+6)}	171249	381012	-44.8	122.5
21	Primary deficit (20-11)	24945	201583	-86.1	708.1

A Advance estimate. *Q Quick estimate.* ** Relates to full year.* *@ Average of April to December.*

$ Data on M3 is outstanding as on December 31, 2010 for 2010-11 and December 30, 2011 for 2011-12.

*** On Customs basis; comparison for current year is on provisional over revised basis.*

 # Figures as reported by Controller General of Accounts, Department of Expenditure, Ministry of Finance.