MACRO-ECONOMIC FRAMEWORK STATEMENT

Overview of the economy

The Indian economy is estimated to grow robustly in the current financial year with growth in gross domestic product (GDP) at factor cost at constant 2004-05 prices (Real GDP) at 8.6 per cent. This follows a revised growth of 8.0 per cent in 2009-10 indicating a rapid recovery from the crisis and consolidation. The decomposition of real GDP in 2010-11 indicates that growth is estimated to be higher and relatively broad based across the major sectors/ sub-sectors, namely, agriculture, manufacturing, construction, 'trade, hotels, transport and communication' and 'financing, insurance, real estate & business services', which together account for a share of 82.6 per cent of the GDP in 2009-10. Growth in industries was rapid in the first half of the current fiscal in terms of national accounts as well as the index of industrial production (IIP); but there are indications of deceleration in the recent months, which are more in the nature of a road bump and not structural. With robust performance in terms of key indicators like telecom services, civil aviation and financial services, there has been a recovery in most services with the exception of 'community, social and personal services' in the current fiscal. This has helped nudge the GDP growth close to the robust levels evidenced prior to the crisis. External sector developments by and large remained supportive, financial markets were on even keel and fiscal consolidation resumed in the current fiscal(2010-11). Data on agricultural production indicates a growth revival with productivity gains from a near normal monsoon. The elevated levels of inflation as measured by the wholesale price index (WPI) in the current fiscal was initially driven by food items reflecting demand –supply mismatches; but exhibited a tendency to spill over into a more generalized phenomenon. This combination of high levels of aggregate demand with elevated levels of inflation (not only in terms of WPI but also in terms of implicit GDP deflator) created a complex economic challenge and called for a well calibrated policy stance to preserve the gains from growth and at the same time prevent further erosion of purchasing power of the masses in the near term. Monetary policy stance reflected the need to arrest engendering of inflation and together with administrative and fiscal measures, helped in containing inflation which, barring a late surge on account of some seasonal items in December 2010, broadly exhibited a declining trend. With the ripple effects of the global crisis dissipating, the outlook for the medium term remains bright.

GDP growth

The quarterly real GDP estimates of the Central Statistics Office (CSO) for the first two quarters indicated a robust growth of 8.9 per cent each in the current fiscal. However, subsequent to the revisions in the levels of growth for 2009-10 by the Quick Estimates released on January 31, 2011, growth in 2010-11 on a quarterly basis is also likely to be revised. The CSO in its Quick Estimates for 2009-10 revised the growth in real GDP to 8.0 per cent (from the earlier level of 7.4 per cent). This indicated a sharper economic recovery in 2009-10 from the crisis affected growth of 6.8 per cent in 2008-09. In its Advance Estimates, released on February 7, 2011, the CSO has placed growth in real GDP at 8.6 per cent indicating the consolidation phase. This level of growth was composed of a growth of 5.4 per cent in agriculture, 8.1 per cent in industry and 9.6 per cent in services.

The composition of the estimated growth in real GDP for 2010-11 indicated that the major sectors/sub-sectors with a share of 82.6 per cent in the total grew year-on-year at higher levels, which reflected the broad-based nature. Following negative and very low growth in 2008-09 and 2009-10 respectively, agriculture and allied sector has rebounded in the current fiscal contributing about 9.2 per cent to overall GDP growth. However, as the level of growth in agriculture continues to be lower than overall GDP growth, share of agriculture is estimated to come down to 14.2 per cent in 2010-11. The headline growth in services at 9.6 per cent in 2010-11 indicates a decline from the levels of over 10.0 per cent recorded in the last 5 years including crisis affected years. However, the year-on-year growth in the two major components, namely, 'trade, hotels, transport and communication' and financing, insurance, real estate and business services in 2010-11 indicate a real recovery in services led by the private sector; the deceleration in "community, social and personal services, which broadly corresponds to Government activities is due to base effect. Industry is estimated to grow at about the same levels reflecting a pickup in construction sector (which is yet to recover to the pre-crisis levels) and an intra-year mix of high and low growth in manufacturing. Overall the key sectors/sub-sectors are estimated to grow at higher levels which indicate a consolidation of growth and are below the pre-crisis robust levels.

In terms of expenditure method of estimation, GDP at constant market prices is projected to grow by 9.7 per cent in 2010-11, which follows a growth of 9.1 per cent in 2009-10 (Quick Estimates). Private final consumption expenditure that had decelerated in the last two years is estimated to pick up in the current fiscal even as Government final consumption expenditure has decelerated sharply on base effect and partial withdrawal of the stimulus. A deceleration year-on-year in gross capital formation owes to the fact that growth in 'changes in stock' and 'valuables' sharply decelerated on base effect offsetting the sizeable pickup in gross fixed capital formation. With growth in exports at constant prices estimated to grow almost twice that of imports, the draft of net exports on overall GDP is likely to be lower. The Quick Estimates for 2009-10 had indicated that gross domestic savings rate was 33.7 per cent and investment rate was 36.5 per cent which, given the levels of growth in gross fixed capital formation for the current fiscal, points to similar levels of investment rate in 2010-11.

Agricultural Production

The Eleventh Five Year Plan had projected an annual average growth of 4 per cent for the agricultural sector. The average annual growth in the four years of the Plan (2007-11) was 2.9 per cent. The lower levels of growth of agricultural GDP was primarily due to the fall in the production of agricultural crops such as oilseeds, cotton, jute and mesta, and sugarcane. The gross capital formation in agriculture and allied sectors as a proportion of the agricultural GDP stagnated around 14 per cent during 2004-05 to 2006-07. However, there is a marked improvement in this figure during the current Five Year Plan. The proportion has increased to 16.03 per cent in 2007-08 and further to 19.67 per cent in 2008-09 (provisional) and to 20.30 per cent in 2009-10 (Quick Estimates).

The production of food grains after reaching a record level of 234.47 million tonnes in 2008-09 declined to a level of 218.11 million tonnes in 2009-10. As per the Second Advance Estimates released by Ministry of Agriculture on February 9, 2011, production of foodgrains during 2010-11 is estimated at 232.07 million tonnes compared to 218.11 million tonnes last year. This is only marginally below the record production of foodgrains in 2008-09. The country is likely to achieve record production of wheat (81.47 million tonnes), pulses (16.51 million tonnes) and cotton (33.93 million bales of 170 kg. each) this year. This high level of production has been achieved despite crop damage due to drought in Bihar, Jharkhand, Orissa and West Bengal and the effects of cyclones, unseasonal and heavy rains, and cold wave and frost conditions in several parts of the country.

Prices

The year-on-year WPI inflation that started trending up in the last quarter of 2009-10 continued through the current fiscal. Food price inflation during the last financial year was mainly driven by high inflation in pulses, cereals, and sugar due to bad monsoon. In spite of having a good monsoon this year, headline inflation at elevated levels owed to high levels of food inflation. The financial year 2010-11 started with a double-digit headline inflation of 11.0 per cent in April 2010. A series of steps, both administrative and macroeconomic, were taken to combat the rising food inflation. After remaining in double digits from April to July 2010, headline inflation came down to single digits and stood at 8.8 per cent in August 2010. Headline inflation in November 2010 was 8.1 per cent; but the trend reversed and in December 2010 it was 8.4 per cent. The inflation in food articles which had moderated in November 2010 again jumped to 13.6 per cent in December 2010. The spurt in inflation in December 2010 could be attributed to supply bottlenecks especially in vegetables, onions, tomatoes, fruits, milk, eggs, and fish. A sudden spike in prices of onions during December 2010 was witnessed on account of damage to the onion crop. The average inflation in primary articles was reported at 18 per cent on an average during the period April 2010 to December 2010 as compared to 10 per cent last year for the same period. Recovery in the domestic economy led to demand-side pressure on inflation. The inflationary pressure persists both from domestic demand and higher global commodity prices on account of the global recovery. As food has a higher weight in consumer price indices than in the WPI, inflation measured by consumer price indices (CPIs) also remained high as compared to WPI from November 2008 onwards; this continues through the current fiscal. In August 2010, inflation in terms of all price indices had come down to single digit after 15 consecutive months of double-digit inflation. Year-on-year inflation in the CPI-IW was 9.47 per cent in December 2010 as compared to 14.97 per cent in December 2009. On year-on-year basis, inflation in the CPIs for agriculture workers (CPI-AL) and rural workers (CPI-RL) was 7.99 per cent and 8.01 per cent respectively in December 2010 as compared to 17.21 and 16.99 per cent respectively in December 2009.

Industry and services

The rapid and strong recovery of the economy in 2009-10 owed to the strong growth in the manufacturing sector. The Index of Industrial Production (IIP) grew by 10.5 per cent in 2009-10 as against a level of 3.2 per cent in 2008-09. In fact, the IIP was in double digits during November 2009 to March 2010. There has been some volatility in growth in the current fiscal with four out of nine months registering double digits growth and in three months growth was lower than 5 per cent. This is partly on account of base effect. As per the data on IIP released by CSO for December 2010, the index grew by 1.6 per cent and growth year-on-year during April-December 2010 was placed at 8.6 per cent. The deceleration on base effect is in the nature of a road bump and the momentum in growth as evidenced by deseasonalised measures of IIP growth indicates a recovery. The manufacturing sector, which has a weight of 79.35 per cent in the IIP, is the key driver. Manufacturing output growth has dipped from a peak of 18 per cent in April 2010 to 1.0 per cent in December 2010, as a result of which IIP growth has also come down from 16.6 per cent in April 2010 to 1.6 per cent in December 2010. Despite wide fluctuations, the April–December 2010 cumulative growth rate has remained at a robust 9.1 per cent for the manufacturing sector. With a share of 57.8 per cent in real GDP, the services sector has remained the key driver of the robust growth process. India's services GDP growth has been continuously above overall GDP growth, pulling up the latter since 1997-98. Together with a share of 35 per cent in total exports and a growth of 27.4 per cent therein during the first half of 2010-11 and a high share in FDI equity inflows, services sector is important in overall economic activity including in terms of employment.

External Sector

With robust inflows financing the elevated levels of current account deficit, the external sector developments remained supportive of the growth momentum in the current fiscal. However there are concerns on the composition of the inflows. Data on balance of payments available for the first half of the current fiscal indicated a current account deficit of US $ 27.9 billion as against a level of US $ 13.3 billion in April-September 2009. Lower levels of net invisible surplus at US $ 39.1 billion together with higher trade deficit levels of US $ 66.9 billion accounted for this widening. Net capital flows at US$ 36.7 billion in the first half of 2010-11 were higher as compared to US$ 23.0 billion in the first half of 2009-10. The increase was primarily composed of inflow of portfolio investment, mainly FIIs, short-term trade credits, and external commercial borrowings (ECBs). The large increase, however, was considerably offset by the moderation in net FDI inflows to India. Notwithstanding significant increase in net capital inflows, accretion to reserves during the first half of 2010-11 was lower, mainly due to more than doubling of current account deficit over the levels in the first half of 2009-10. Foreign exchange reserves increased from US$ 252 billion at the end of March 2009 to US$ 279.1 billion at the end of March 2010, showing a rise of US$ 27.1 billion. During the current fiscal, reserves increased from US$ 279.6 billion at the end of April 2010 to US$ 292.4 billion at the end of November 2010. The reserves stood at US$ 297.3 billion at the end of December 2010, showing an increase of US$ 18.2 billion over the end-March 2010 level mainly on account of valuation changes. During the current fiscal, the monthly average exchange rate of the rupee has generally been range bound, moving in the range of ₹44-47 per US dollar between April and December 2010. The exchange rate of the rupee depreciated by 1.5 per cent against the US dollar, from ₹ 44.50 per US dollar in April 2010 to ₹45.16 per US dollar in December 2010. The rupee also depreciated against other major international currencies such as the pound sterling (3.2 per cent) and Japanese yen (12.2 per cent) during the period.

Money, Banking and Capital Markets

In view of rising food inflation and the risk of it impinging on inflationary expectations alongside the consolidating recovery, the Reserve Bank adopted a clear shift in stance from 'managing the crisis' to 'managing the recovery' and announced the first phase of exit from the expansionary monetary policy in the Second Quarter Review of October 2009 by terminating some sector-specific facilities and restoring the statutory liquidity ratio (SLR) of scheduled commercial banks to its pre-crisis level. As there were clear signs that the recovery was consolidating, it was felt that main policy instruments were at levels more consistent with a crisis situation than with a fast recovering economy and it was imperative to carry forward the process of exit from an accommodative policy stance. Taking into account the above consideration, during 2010-11 the Reserve Bank of India raised the policy rates six times wherein the repo and reverse repo rates under LAF have been increased. Since March 2010, repo rates and reverse repo rates have been increased cumulatively by 175 basis points (bps) and 225 bps, respectively. The repo rate stands at 6.5 per cent and the reverse repo at 5.5 per cent at present. The cash reserve ratio (CRR) now stands at 6 per cent of net demand and time liabilities (NDTL) of banks. Thus, in 2010-11 persistently high inflation above the comfort level of Reserve Bank together with growth buoyancy ensured that monetary policy focus remained on containing inflation and inflationary expectations.

Year-on-year non-food credit growth was up 24 percent at end-December 2010, and financed many sectors more broadly (from the agriculture rebound to the 3G spectrum sales and private infrastructure projects), and the overall credit to GDP ratio rose to about 47.8 percent. Domestic capital markets performed well in 2010, primary markets financing record levels, including the largest ever IPO (for Coal India), while secondary markets reached new highs. A surge in foreign institutional inflows, year-on-year, in the first seven months of the fiscal helped support the market. Pensions and insurance gained, with life insurance premium growing nearly 26 percent and penetration doubling to 5.4 percent of GDP in 2009, from 2.3 percent in the year 2000. The past year saw banking deposit growth slow, as real interest rates were depressed, especially compared to returns in other fast recovering asset markets (real estate, gold, and stock markets).

Central Government Finances

With clear evidence of economic recovery in 2009-10 as indicated by the Advance Estimates of the GDP, the Budget for 2010-11 resumed the path of fiscal consolidation with a partial exit from the stimulus measures. As a proportion of the GDP, fiscal deficit was estimated at 5.5 per cent in the Budget 2010-11 and the Medium Term Fiscal Policy Statement indicated a further reduction to 4.8 per cent and 4.1 per cent in 2011-12 and 2012-13 respectively. The fiscal outcome in the first nine months of the current financial year remained broadly on the consolidation track chalked out in the Budget. Owing to higher than estimated revenue from telecom 3G/BWA auctions and indirect taxes, there has been a 50 per cent increase in revenue receipts, year-on-year, during the first nine months of the current fiscal. Thus, there was headroom for higher levels of expenditure at the given fiscal deficit targets. With year-on-year growth in total expenditure in the first nine months of the current fiscal at 11.2 per cent as against a level of 8.5 per cent envisaged for the full year in the Budget Estimates for 2010-11, fiscal and revenue deficits are placed at ₹1,71,249 crore and ₹1,16,309 crore respectively, during this period, which constituted 44.9 per cent and 42.1 per cent of the Budget Estimates. With nominal GDP placed at ₹78,77,947 crore for the year by the Advance Estimates of the CSO, the revised target for the current fiscal (2010-11) in terms of the fiscal deficit to GDP ratio is placed at 5.1 per cent and revenue deficit at 3.4 per cent in RE 2010-11.

Prospects

The CSO's Advance Estimates of growth in real GDP at 8.6 per cent for 2010-11 is considered appropriate as it is based on the trends in indicators in the various sectors of the economy. The deceleration in IIP in December 2010 is largely a reflection of base effect and there is an underlying growth momentum on a month-on-month deseasonalised basis as per the IIP data for December 2010. With a pick up in the key sub-sectors of services, and assuming a normal monsoon, real GDP is expected to grow by 9 per cent (+/- 0.25 per cent) in 2011-12. The downside risks to growth estimate are sub-normal monsoons, a sharp rise in commodity prices, particularly crude petroleum and the emerging global economic situation particularly those in advanced economies in the absence of fiscal stimulus. Higher growth could accrue from higher capital formation given the levels of incremental capital output ratio of 4.1 per cent estimated for the Eleventh Plan as well as gains in terms of total factor productivity. In the next five to ten years the former would be important and once the economy begins to operate close to its capacity, skill development and innovative activity in the country are expected to replace savings and investment rates as effective drivers of GDP growth.

Annex - I

MACROECONOMIC FRAMEWORK STATEMENT
(ECONOMIC PERFORMANCE AT A GLANCE)

Sl.	Item	Absolute value April-December		Percentage change April-December	
		2009-10	2010-11	2009-10	2010-11
	Real Sector				
1	GDP at factor cost (Rs. thousand crore)*				
	a) at current prices	6133 Q	7257 A	16.1 Q	18.3 A
	b) at 2004-05 prices	4494 Q	4879 A	8.0 Q	8.6 A
2	Index of Industrial Production (1993-94=100)	304.7	331.0	8.6	8.6
3	Wholesale Price Index (2004-05=100) @	128.8	140.9	1.7	9.4
4	Consumer Price Index: Industrial Workers (2001=100)	160.1	177.7	11.3	11.0
5	Money Supply (M3) (Rs. thousand crore) $	5285	6202	17.7	17.4
6	Imports at current prices **				
	a) In Rs. crore	991605	1126513	-12.0	13.6
	b) In US $ million	207315	246724	-18.3	19.0
7	Exports at current prices **				
	a) In Rs. crore	608882	751633	-6.7	23.4
	b) In US $ million	127182	164707	-13.8	29.5
8	Trade Deficit (in US$ million) **	-80133	-82017	-24.6	2.4
9	Foreign Exchange Reserves				
	a) In Rs. crore	1323235	1332353	6.7	0.7
	b) In US $ million	283470	297334	10.7	4.9
10	Current Account Balance (In US$ million) (Apr-Sept)	-13339	-27881	...	...
	Government Finances #				
1	Revenue receipts	389271	584268	3.5	50.1
2	Tax revenue (Net)	307591	391148	-0.8	27.2
3	Non-tax revenue	81680	193120	23.7	136.4
4	Capital receipts (5+6+7)	318269	202584	43.8	-36.3
5	Recovery of loans	3983	8591	33.9	115.7
6	Other receipts	4306	22744	9914.0	428.2
7	Borrowings and other liabilities	309980	171249	42.0	-44.8
8	Total receipts (1+4)	707540	786852	18.5	11.2
9	Non-Plan expenditure (10+12)	497381	536898	16.6	7.9
	Of which:				
10	Revenue Account	460970	487692	14.2	5.8
	Of which:				
11	Interest payments	130005	146304	5.1	12.5
12	Capital Account	36411	49206	60.7	35.1
13	Plan expenditure (14+15)	210159	249954	23.0	18.9
	Of which:				
14	Revenue Account	179555	212885	23.0	18.6
15	Capital Account	30604	37069	23.5	21.1
16	Total expenditure (9+13)	707540	786852	18.5	11.2
17	Revenue expenditure (10+14)	640525	700577	16.5	9.4
18	Capital expenditure (12+15)	67015	86275	41.2	28.7
19	Revenue deficit (17-1)	251254	116309	44.5	-53.7
20	Fiscal deficit {16-(1+5+6)}	309980	171249	42.0	-44.8
21	Primary deficit (20-11)	179975	24945	90.4	-86.1

A-Advance estimates. *Q-Quick estimates* ** Relates to full year.*

@ *Average of April to December.*

$ *Data on M3 is the outstanding as on January 1, 2010 for 2009-10 and December 31, 2010 for 2010-11.*

** *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.