MACRO-ECONOMIC FRAMEWORK STATEMENT

Overview of the economy

The Indian economy turned around in the second quarter of 2009-10 with a growth of real gross domestic product (GDP) at 7.9 per cent and is estimated to grow at 7.2 per cent for the full year 2009-10 as per the latest data — Advance Estimates (AE) of the Central Statistical Organisation (CSO) released on February 8, 2010. Following an uncertain period since the onset of the global financial crisis, which soon metamorphosed into a global economic recession that led to a slowdown in the Indian economy with quarterly growth at around 6 per cent in the third and fourth quarters of 2008-09 and the first quarter of the current fiscal, the sharp turnaround underscored the strong macroeconomic fundamentals and brightened the economic prospects for the medium term. The level of growth estimated for the current year was driven by a resurgent industrial sector and was achieved despite a decline in the agricultural sector, albeit a modest one. On the demand side of the GDP, the rise in gross capital formation in the second quarter of 2009-10 indicates a broad based recovery. The elevated levels of inflation in food and food articles attributable to a large extent to the supply side bottlenecks and precipitated by the deficient South West monsoon is a major concern as it could lead to generalised inflation through engendering of inflationary expectations. With a pickup in merchandise exports, as per the recent data, capital flows and bank/non-food credit, and with the return of vibrancy in financial markets, the economic recovery is well anchored.

2. GDP Growth

The CSO effected a revision in the base year of its National Accounts Statistics (NAS) from 1999-2000 to 2004-05 while presenting the Quick Estimates for 2008-09. As per the 2004-05 series, the economy is estimated to have grown by 6.7 per cent in 2008-09 following a growth of 9.2 per cent in 2007-08. The AE for 2009-10 places the growth in the GDP at factor cost and constant 2004-05 prices at Rs 44,53,064 crore and the GDP at current market prices at Rs 61,64,178 crore.

As per the revised series, in 2008-09, the structure of the economy changed with the shares in the GDP of agricultural and allied sector and service sectors at 15.7 per cent and 56.4 per cent as against the levels of 17.0 per cent and 57.3 per cent in the 1999-2000 series, respectively. The share of industry has risen from 25.8 per cent in the 1999-2000 series to 28.0 per cent in the new series in 2008-09, which imparts some measure of the required balance to the economic structure. With the given shares, the levels of growth of the various sectors in the current year determine the point contribution to growth. Considering the fact that agriculture is estimated to decline over the levels achieved last year by 0.2 per cent, the recovery of the economy required a growth of over 8.5 per cent in non-farm sectors in the current fiscal. As per the AE for 2009-10, with the exception of construction, all other sub-sectors are close to or exceed the above benchmark level. The rate of growth of electricity, gas & water supply, the community, social & personal services and trade, hotels, transport and communication at 8.2, 8.2 and 8.3 percent respectively for the year 2009-2010 are marginally below the benchmark. The level of output growth at 7.2 per cent in 2009-10 reflects the above.

On the demand side of the GDP, the decline in net indirect taxes (i.e. indirect taxes minus subsidies) in 2008-09 and the current fiscal (2009-10) indicate the impact of the fiscal stimulus through tax relief and increase in the level of subsidies. The change in the National Accounts Statistics (NAS) series has also brought about significant revision in the expenditure estimates of the GDP for 2008-09. For 2008-09, growth in government final consumption expenditure was revised downwards from over 20 per cent in 2008-09 on the old base to 16.7 per cent on the new base; whereas growth of the private final consumption expenditure in 2008-09 was revised upward from 2.9 per cent to 6.8 per cent. In 2009-10, growth in private final consumption expenditure is placed at 4.1 per cent and that in government final consumption expenditure at 8.2 per cent. Gross domestic savings and gross capital formation are usually expressed as proportions of the GDP at current market prices. As per the revised series, gross domestic savings is estimated at 36.4 per cent in 2007-08 and 32.5 per cent in 2008-09 and gross capital formation (rate of investment) at 37.7 per cent in 2007-08 and 34.9 per cent in 2008-09. However, gross fixed capital formation remains stable at 33.0 per cent in 2008-09 and 2009-10. Growth in gross fixed capital formation in 2009-10 is estimated to have recovered to 5.2 per cent from 4 per cent in 2008-09. However, it is necessary to watch the growth recovery in private investment in the third and fourth quarters of 2009-10 and the impact of the partial rollback of the stimulus measures. The contribution of net exports, which is now positive, may again turn negative as the demand for imports increases with a deepening of industrial recovery and a pick-up in domestic demand.

Agricultural production

As per Fourth Advance Estimates of agricultural production released by the Directorate of Economics & Statistics, the total foodgrains production in 2008-09 was estimated at 233.88 million tonnes as compared to 230.78 million tonnes in 2007-08. The deficiency in South West monsoon of 23 percent, compared to the long period average, severely affected the area sown during kharif 2009-10 season. The area sown under foodgrains declined by 6.5 per cent in the kharif 2009-10 compared to the same season previous year. As per the first advance estimates for 2009-10, the kharif foodgrains production is estimated at 98.83 million tonnes which indicates a decline of 16 per cent compared to the fourth advance estimates of 2008-09, with paddy being the most affected crop. A part of the losses in kharif acreage is expected to be made-up by the increased acreage in the rabi season. As per the latest available estimates, area sown under wheat, pulses and groundnut is more this year (upto February 4, 2010) compared to last year. Sugarcane production in 2009-10 is estimated at 249.48 million tonnes, which is 9 per cent lower in comparison to the previous year and 27 per cent vis-à-vis the targeted production for 2009-10. Cotton production in 2009-10 is estimated at 236.57 lakh bales (of 170 kg each), which is higher than the fourth advance estimates of 231.56 lakh bales in 2008-09 by 2.2 per cent. However, it is lower than the target set for 2009-10 by 9 per cent.

Industrial production

The recovery in the economy as gleaned from the quarterly estimates of the GDP is due to the resurgent industry. The latest information as per index of industrial production (IIP) also mirrors this. The IIP crossed the 10 per cent mark for the fourth time the current fiscal in December 2009. IIP grew by 16.8 per cent in December 2009 (compared to -0.2 per cent in December 2008) – the highest level of growth in the recent past. This follows growth of 10.6 per cent in August 2009, 10.3 per cent in October 2009 and 11.7 per cent in November 2009. Fourteen out of the 17 industry groups at the 2-digit level have shown positive growth during December 2009 as compared to December 2008. The cumulative growth in IIP during April-December 2009 was 8.6 per cent, as compared to a growth of 3.6 per cent during April-December 2008. This is composed of a growth of 9.0 per cent in manufacturing, 8.5 per cent in mining and 5.8 per cent in electricity in April-December 2009 as against levels of 3.6 per cent, 3.2 per cent and 2.7 per cent respectively in April-December 2008. Led by the robust growth momentum of the telecom services and spread across power, coal and other infrastructure like ports, civil aviation and roads, core industries and infrastructure services have also shown signs of recovery in 2009-10.

Inflation

Inflation, measured in terms of the wholesale price index (WPI) on a year-on-year basis, eased sharply from its peak of 12.8 per cent in August 2008 to 1.2 per cent in March 2009. Average annual inflation (April-December) stood at 1.6 per cent in 2009-10 compared to 10.2 per cent in 2008-09. The current financial year (2009-10) started with an inflation rate of 1.3 per cent in April 2009 and remained in negative territory from June to August 2009. In the month of December 2009, the year-on-year inflation was 7.3 per cent as against 6.1 per cent last year in the corresponding month. In December 2009, nearly 67 per cent of the overall WPI inflation could be attributed to food items (primary and manufactured), followed by 12 per cent in the fuel and power commodity group, the remaining 21 per cent being explained by manufactured non-food and primary non-food articles. Among food items the major contributors to inflation are milk (20 per cent), eggs, meat and fish (over 20 per cent), rice (about 10 per cent), wheat (6 per cent), pulses (about 9 per cent), potatoes (9 per cent) and tomatoes (6 per cent).

Inflation based on the consumer price index (CPI) for industrial workers showed an increase to 15 per cent on a year-on-year basis in December 2009 from 9.7 per cent a year ago. The recent period has witnessed significant divergence in the WPI and CPI inflation rates, principally on account of the larger weights assigned to the food basket in the CPIs and due to the fact that retail prices are relatively sticky downwards. Thus, due to the sharp increase in essential commodity prices, all the four CPIs remained elevated since March 2008, rising gradually from about 7 to 8 per cent (month-on-month) to around 15 to 17 per cent in December 2009.

A significant part of this inflation can be explained by supply-side bottlenecks in some of the essential commodities, precipitated by the delayed and sub-normal South West monsoon as well as drought-like conditions in some parts of the country. The delayed and erratic monsoon may have also prevented the seasonal decline in prices, normally seen during the period from October to March for most food articles other than wheat. Since December 2009, there have been signs of these high food prices, together with the gradual hardening of non-administered fuel product prices, getting transmitted to other non-food items, thus creating concerns about higher-than-anticipated generalized inflation over the next few months.

3. External Sector

India's merchandise exports have shown remarkable resilience in recent years with a growth rate of 20 per cent plus in US dollar terms since 2002-03. Growth in exports in 2008-09, as per the revised data, is placed at 13.6 per cent. The fiscal 2009-10 began with the full impact of the global recession in evidence. This, together with the higher base levels of export figures for the first half of 2008-09 led to greater levels of decline in exports (22.3 per cent in April-November 2008-09), year-on-year. In the month of November 2009, exports grew by 18.2 per cent after a nearly continuous 12-month spell of negative growth. However, this is again is due to the low base figure in November 2008 (at $11.2 billion compared to $14.1 billion in October 2008 and $13.4 billion in December 2008). In December 2009 also export growth rate over December 2008 was positive at 9.3 per cent. During 2009-10 (April-December) import growth was negative at 23.6 per cent accompanied by a decline in both POL and non-POL imports at 29.8 per cent and 20.7 per cent respectively. Gold and silver imports registered negative growth of 7.3 per cent. Non-POL non-bullion import declined by 22.4 per cent due to slowdown in industrial activity and exports. Import growth is positive in December 2009 at 27.2 per cent partly due to the base effect, partly due to the 42.8 per cent positive growth of POL products with the pick up in oil prices and industrial demand, and partly due to growth of non-POL items at 22.4 per cent including a high growth of gold and silver imports. Trade deficit fell to US$ 76.2 billion (as per customs data) in 2009-10 (April–December) from US$ 106 billion in the corresponding period of the previous year.

Services Export

Services export reached US$ 102 billion in 2008-09 with a moderate growth of 12.5 per cent over the previous year. Growth has been reasonably good in the miscellaneous services category which has increased its share by 16.1 percentage points to 76.4 per cent in 2008-09 compared to the level in 2000-01. While the share of software services increased by 6.5 percentage points to 45.5 per cent, the share of non-software services increased by 9.6 percentage points to 30.9 per cent. The compounded annual growth rate of miscellaneous services was very high at 33.4 per cent during 2000-01 to 2006-07 followed by annual growth rates of 21.3 per cent and 15.9 per cent respectively in 2007-08 and 2008-09. The impact of global recession was visible on India's services exports, the growth of which declined to 21.4 per cent in the first half of 2009-10 compared to the high growth of 27.6 per cent in the corresponding period of the previous year. Except insurance, all the items witnessed a negative growth.

Balance of Payments

As per the latest data for the fiscal 2009-10, exports and imports on BoP basis showed substantial decline during April-September (H1) of 2009-10 vis-à-vis the corresponding period in 2008-09. There has however been improvement in the balance of payment (BoP) scenario during H1 of 2009-10 over H1 of 2008-09, reflected in higher net capital inflows and lower trade deficit. The trade deficit was lower at US$ 58.2 billion during H1 (April-September) of 2009 as compared with US$ 64.4 billion in April-September 2008 mainly on account of decline in oil import. Exports on BoP basis posted a decline of 27.0 per cent in H1 (April-September 2009) of 2009-10 as against a growth of 48.1 per cent in the corresponding period of the previous year. Import payments declined by 20.6 per cent during April-September 2009 as against a sharp increase of 51.0 per cent in the corresponding period of the previous year. The decline in imports is mainly attributable to the base effect and decline in oil prices.

The net invisibles surplus (invisibles receipts minus invisibles payments) was lower at US$ 39.6 billion during April-September of 2009 as compared to US$ 48.5 billion during April-September 2008. The current account deficit increased to US $ 18.6 billion in April-September 2009, despite lower trade deficit, as compared to US $ 15.8 billion in April-September 2008, mainly due to lower net invisible surplus.

Net capital flows to India at US $ 29.6 billion in April-September 2009 was higher as compared with US $ 12.0 billion in April-September 2008. Under net capital flows, all the components except loans and banking capital, showed improvement during April-September 2009 from their level in the corresponding period of the previous year. Net inward FDI into India remained buoyant at US$ 21.0 billion during April-September 2009 (US $ 20.7 billion in April-September 2008) reflecting better growth performance of the Indian economy. Due to large inward FDI, the net FDI (inward FDI minus outward FDI) was marginally higher at US$ 14.1 billion in April-September 2009, reflecting better growth performance of the Indian economy. Portfolio investment mainly comprising foreign institutional investors (FIIs) investments and American depository receipts (ADRs)/global depository receipts (GDRs) witnessed large net inflows (US $ 17.9 billion) in April-September 2009 (net outflows of US $ 5.5 billion in April-September 2008) due to large purchases by FIIs in the Indian capital market reflecting revival in growth prospects of the economy and improvement in global investors' sentiment.

India's foreign exchange reserves comprise Foreign Currency Assets (FCA), Gold, SDRs and Reserve Tranche Position (RTP) in the International Monetary Fund (IMF). Beginning from a low level of US$ 5.8 billion at end-March 1991, India's foreign exchange reserves increased to peak of US$ 314.61 billion at end-May 2008. The reserves declined thereafter to US$ 252.0 billion at the end of March 2009. The level of foreign exchange reserves stood at US$ 281.0 billion at the end of January, 2010. In 2009-10, the Reserve Bank of India has concluded the purchase of 200 metric tonnes of gold from the IMF, under the IMF's limited gold sales programme at the cost of US$ 6.7 billion in the month of November 2009. Further, a general allocation of SDR 3,082 million (equivalent to US$ 4,821 million) and a special allocation of SDR 214.6 million (equivalent to US$ 340 million) were allocated to India by the IMF on August 28, 2009 and September 9, 2009, respectively. Besides this, inflows under FDI, portfolio investments and NRI deposits and also valuation gains due to weakness of the US dollar against major currencies were the major sources contributing to the increase in foreign exchange reserves in 2009-10.

In the fiscal 2009-10, with the signs of recovery and return of foreign institutional investors (FIIs) flows after March 2009, rupee has been strengthening against US dollar. The movement of exchange rate in the year 2009-10 indicated that the average monthly exchange rate of rupee against the US dollar appreciated by 11.5 per cent from Rs 51.23 per US dollar in March 2009 to Rs 45.96 per US dollar in the month of January 2009, mainly on account of weakening of US dollar in the international market.

4. Money, Banking and Capital Markets

Taking into account the need for monetary policy to respond to slackening economic growth, Reserve Bank of India's (RBI) Annual Policy Statement for 2009-10 announced in April 2009 sought to provide a policy regime that would provide adequate liquidity and enable credit expansion at viable rates while preserving credit quality so as to support the return of the economy to a high growth path and maintain a monetary and interest rate regime supportive of price stability and financial stability.

While the Reserve Bank maintained its accommodative monetary stance in the First Quarter Review of the Monetary Policy for 2009-10 (July 28, 2009), it made no changes in the policy rates. The Second Quarter Review of Monetary Policy 2009-10 (October 27, 2009) also left the Bank Rate (at 6 per cent), Repo & Reverse Repo rates (at 4.75 per cent and 3.25 per cent respectively) and the Cash Reserve Ratio (at 5.0 per cent) unchanged. However, minor modification was made in Statutory Liquidity Ratio (SLR) and it was restored to 25 per cent of net demand and time liabilities (NDTL) of scheduled commercial banks (SCBs) with effect from the fortnight beginning November 7, 2009 (SLR had been reduced to 24 per cent of NDTL of SCBs on November 7, 2008).

In the Third Quarter Review of Monetary Policy 2009-2010 (January 29, 2010), RBI's policy stance was shaped by the need to shift the policy stance from 'managing the crisis' to 'managing the recovery'. Though the inflationary pressures were ascribed by the RBI to supply side factors, it felt that there was need to check the pressures spilling over into a wider inflationary process, and therefore warranted due caution. The Cash Reserve Ratio of SCBs was raised by 75 basis points from 5.0 per cent to 5.75 per cent of their NDTL in two stages; the first stage of increase of 50 basis points effective the fortnight beginning February 13, 2010, followed by the next stage of increase of 25 basis points effective the fortnight beginning February 27, 2010, as it would impact on the prevalent excess liquidity in the system. As per the third quarter review, indicative projection for adjusted non-food credit growth for 2009-10, was 16 per cent. Indicative projections for M_3 growth in 2009-10 was 16.5 per cent, while aggregate deposits of scheduled commercial banks were projected to grow by 17 per cent.

Having regard to the emerging trends, broad money (M_3) growth on a year-on-year (y-o-y) basis, was 16.5 per cent as on January 15, 2010 as compared to 19.1 per cent a year ago. On financial year basis, growth in M_3 during 2009-10 (up to January 15, 2010) was 10.8 per cent as compared with 12.8 per cent during the corresponding period of the preceding year. The moderation in growth of broad money is largely on account of the deceleration in growth of bank credit to the commercial sector. Reserve money (M_0) on a financial year basis (till January 15, 2010) increased by 3.8 per cent as compared to a decline of 3.7 per cent a year ago, while on a year-on-year basis, it increased by 14.8 per cent as compared to 6.6 per cent last year.

During the current financial year the growth in bank credit has remained low. Non-food credit during the financial year (up to January 15, 2010) has recorded an increase of only 8.4 per cent pointing to the continued sluggishness in demand for credit by the productive sectors of the economy. Commercial banks' holding of SLR securities was 29.9 per cent of NDTL as on January 15, 2010 as against 28.1 per cent at end-March 2009 and 28.8 per cent a year ago. This was consistently higher than the stipulated level of 24 per cent of NDTL with effect of November 7, 2008 and 25 per cent with effect of November 7, 2009.

Liquidity constraint is not an issue at present as judged from the behaviour of call money rates, ruling within the repo and reverse repo corridor and with the money market players continuing to park their funds through reverse repo auctions. The policy/interest rates have remained stable in recent past. With larger volumes transacted and lower risk spreads, financial markets have exhibited vibrancy; equity markets remained buoyant with occasional volatility; orderly conditions prevailed in forex markets; and there was some upward pressure in G-Sec yields owing to large government borrowing.

5. Central Government Finances

Progress on the fiscal consolidation front has been satisfactory in the FRBM period till 2007-08. An expansionary policy stance in 2008-09 was warranted to boost aggregate demand. The Budget Estimates for 2009-10 envisaged the continuance of the expansionary stance with fiscal deficit at 6.8 per cent of GDP. A fiscal stimulus in a year of stress on the macro-economy is in line with international best practices. The gross tax-GDP ratio for the centre, which stagnated at around 8-10 per cent range in the pre-FRBM period, increased to 11.1 per cent in 2006-07 and further to 12.0 per cent of GDP in 2007-08. The Budget for 2009-10 estimated this at 10.9 per cent of GDP (10.4% of revised GDP) given the tax cuts announced as part of the stimulus and the impact of slowdown. Revenue expenditure increased by 16.5 per cent during April-December 2009-10 over the same period last year. Capital expenditure grew by 41.2 per cent during the period. In the first nine months of 2009-10, total expenditure was 69.3 per cent of Budget Estimates (BE). Non-debt receipts were sufficient to cover only 56.2 per cent of the expenditure leaving a fiscal deficit of Rs.3,09,980 crore. This is much higher as compared to the fiscal deficit of Rs.2,18,262 crore in 2008-09 during April-December. The revenue deficit for April-December 2009-10 was Rs.2,51,254 crore. This is also much higher as compared to the figure of Rs.1,73,830 crore in 2008-09 in the same period. Non-debt receipts during April-December 2009-10 increased by 4.9 per cent over 2008-09 corresponding period.

6. Prospects

There are visible signs of economic recovery having set in. This is a significant achievement given the decline of 0.2 per cent in agricultural output, which was the consequence of sub-normal monsoon. The recovery is anchored on the renewed momentum in the manufacturing sector; and is accompanied by the pickup in the growth rate of gross fixed capital formation, which had declined significantly in 2008-09. The fast-paced and broad based nature of recovery vindicated the policy stance of the Government in the aftermath of the crisis. The recent economic developments augur well for a gradual, sequenced and calibrated unwinding of the expansionary policy stance based on the emerging economic situation. India was one of the major economies that could emerge from the crisis faster with strong fundamentals and as such, strong growth of the Indian economy is important to the global economy in view of its large contribution on purchasing power parity basis. In the short term, under assumptions of continuance of the present trends, the prospects of India for reverting to the robust growth path that it was on before the global crisis slowed it down in 2008 are very bright. In the medium term, with a pickup in the global economy and with focussed attention on critical areas, it should be possible to scale up the growth rate to double digit levels.

Annex - I

MACROECONOMIC FRAMEWORK STATEMENT
(ECONOMIC PERFORMANCE AT A GLANCE)

Sl.	Item	Absolute value April-December		Percentage change April-December	
		2008-09	2009-10	2008-09	2009-10
	Real Sector				
1	GDP at factor cost (Rs. thousand crore)*				
	a) at current prices	5229 Q	5791 A	15.1 Q	10.8 A
	b) at 2004-05 prices	4155 Q	4453 A	6.7 Q	7.2 A
2	Index of Industrial Production (1993-94=100)	270.8	294.2	3.6	8.6
3	Wholesale Price Index (1993-94=100) @	235.8	239.7	10.2	1.6
4	Consumer Price Index: Industrial Workers (2001=100) @	144.0	160.0	9.0	11.4
5	Money Supply (M3) (Rs. thousand crore) $	4444	5209	19.9	17.2
6	Imports at current prices **				
	a) In Rs. crore	1126200	927969	52.2	-17.6
	b) In US $ million	253809	193829	44.4	-23.6
7	Exports at current prices **				
	a) In Rs. crore	652920	563304	42.4	-13.7
	b) In US $ million	147569	117587	29.6	-20.3
8	Trade Deficit (in US$ million) **	-106240	-76242	…	…
9	Foreign Exchange Reserves				
	a) In Rs. crore	1240161	1323235	14.3	6.7
	b) In US $ million	255968	283470	(-)7.0	10.7
10	Current Account Balance (In US$ million) (Apr-Sept)	(-)15849	(-)18618	...	...
	Government Finances #				
1	Revenue receipts	3,75,937	3,89,271	5.7	3.5
2	Tax revenue (Net)	3,09,927	3,07,591	4.7	-0.8
3	Non-tax revenue	66,010	81,680	10.7	23.7
4	Capital receipts (5+6+7)	2,21,279	3,18,269	86.6	43.8
5	Recovery of loans	2,974	3,983	-10.0	33.9
6	Other receipts	43	4,306	-99.9	9914.0
7	Borrowings and other liabilities	2,18,262	3,09,980	181.3	42.0
8	Total receipts (1+4)	5,97,216	7,07,540	25.9	18.5
9	Non-Plan expenditure (10+12)	4,26,419	4,97,381	26.5	16.6
	Of which:				
10	Revenue Account	4,03,758	4,60,970	44.2	14.2
	Of which:				
11	Interest payments	1,23,735	1,30,005	10.7	5.1
12	Capital Account	22,661	36,411	-60.3	60.7
13	Plan expenditure (14+15)	1,70,797	2,10,159	24.5	23.0
	Of which:				
14	Revenue Account	1,46,009	1,79,555	27.2	23.0
15	Capital Account	24,788	30,604	10.9	23.5
16	Total expenditure (9+13)	5,97,216	7,07,540	25.9	18.5
17	Revenue expenditure (10+14)	5,49,767	6,40,525	39.2	16.5
18	Capital expenditure (12+15)	47,449	67,015	-40.2	41.2
19	Revenue deficit (17-1)	1,73,830	2,51,254	343.3	44.5
20	Fiscal deficit {16-(1+5+6)}	2,18,262	3,09,980	181.3	42.0
21	Primary deficit (20-11)	94,527	1,79,975	-376.5	90.4

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

@ Average of April to December.

$ Data on M_3 is the outstanding as on December 18, 2009 for 2009-10 and December 19, 2008 for 2008-09.

*** 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.