

State of the Economy and Prospects

1

CHAPTER

The fiscal year 2009-10 began as a difficult one. There was a significant slowdown in the growth rate in the second half of 2008-09, following the financial crisis that began in the industrialized nations in 2007 and spread to the real economy across the world. The growth rate of the gross domestic product (GDP) in 2008-09 was 6.7 per cent, with growth in the last two quarters hovering around 6 per cent. There was apprehension that this trend would persist for some time, as the full impact of the economic slowdown in the developed world worked through the system. It was also a year of reckoning for the policymakers, who had taken a calculated risk in providing substantial fiscal expansion to counter the negative fallout of the global slowdown. Inevitably, India's fiscal deficit increased from the end of 2007-08, reaching 6.8 per cent (budget estimate, BE) of GDP in 2009-10. A delayed and severely sub-normal monsoon added to the overall uncertainty. The continued recession in the developed world, for the better part of 2009-10, meant a sluggish export recovery and a slowdown in financial flows into the economy. Yet, over the span of the year, the economy posted a remarkable recovery, not only in terms of overall growth figures but, more importantly, in terms of certain fundamentals, which justify optimism for the Indian economy in the medium to long term.

1.2 The real turnaround came in the second quarter of 2009-10 when the economy grew by 7.9 per cent. As per the advance estimates of GDP for 2009-10, released by the Central Statistical Organisation (CSO), the economy is expected to grow at 7.2 per cent in 2009-10, with the industrial and the service sectors growing at 8.2 and 8.7 per cent respectively. This recovery is impressive for at least three reasons. First, it has come about despite a decline of 0.2 per cent in agricultural output, which was the consequence of sub-normal monsoons. Second, it foreshadows renewed momentum in the manufacturing sector, which had seen continuous decline in the growth rate for almost eight quarters since 2007-08. Indeed, manufacturing growth has more than doubled from 3.2 per cent in 2008-09 to 8.9 per cent in 2009-10. Third, there has been a recovery in the growth rate of gross fixed capital formation, which had declined significantly in 2008-09

as per the revised National Accounts Statistics (NAS). While the growth rates of private and Government final consumption expenditure have dipped in private consumption demand, there has been a pick-up in the growth of private investment demand. There has also been a turnaround in merchandise export growth in November 2009, which has been sustained in December 2009, after a decline nearly twelve continuous months.

1.3 The fast-paced recovery of the economy underscores the effectiveness of the policy response of the Government in the wake of the financial crisis. Moreover, the broad-based nature of the recovery creates scope for a gradual rollback, in due course, of some of the measures undertaken over the last fifteen to eighteen months, as part of the policy response to the global slowdown, so as to put the economy back on to the growth path of 9 per cent per annum.

Key indicators							
Data categories and components	Units	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
1 GDP and Related Indicators							
GDP (current market prices)	Rs crore	3239224	3706473	4283979	4947857	5574449 ^{QE}	6164178 ^{AE}
Growth Rate	%	...	14.4	15.6	15.5	12.7	10.6
GDP (factor cost 2004-05 prices)	Rs crore	2967599	3249130	3564627	3893457	4154973 ^{QE}	4453064 ^{AE}
Growth Rate	%		9.5	9.7	9.2	6.7	7.2
Savings Rate	% of GDP	32.2	33.1	34.4	36.4	32.5	na
Capital Formation (rate)	% of GDP	32.7	34.3	35.5	37.7	34.9	na
Per Cap. Net National Income (factor cost at current prices)	Rs	24095	27183	31080	35430	40141	43749
2 Production							
Foodgrains	Mn tonnes	198.4	208.6	217.3	230.8	233.9 ^a	na
Index of Industrial Production (growth)	Per cent	8.4	8.2	11.6	8.5	2.6	na
Electricity Generation (growth)	Per cent	5.1	5.2	7.3	6.3	2.7	na
3 Prices							
Inflation (WPI) (52-week average)	%change	6.5	4.4	5.4	4.7	8.4	1.6 ^b
Inflation CPI (IW) (average)	%change	3.8	4.4	6.7	6.2	9.1	11.4 ^b
4 External Sector							
Export Growth (US\$)	%change	30.8	23.4	22.6	29.0	13.6	-20.3 ^c
Import Growth (US\$)	%change	42.7	33.8	24.5	35.5	20.7	-23.6 ^c
Current Account Balance (CAB)/GDP	Per cent	-0.4	-1.2	-1.0	-1.3	-2.4	-3.3 ^d
Foreign Exchange Reserves	Us\$ Bn.	141.5	151.6	199.2	309.7	252	283.5 ^e
Average Exchange Rate	Rs/ US\$	44.93	44.27	45.25	40.26	45.99	47.94 ^f
5 Money and Credit							
Broad Money (M ₃) (annual)	%change	12.0	16.9	21.7	21.4	18.6	16.5 ^g
Scheduled Commercial Bank Credit (growth)	%change	27.0	30.8	28.1	22.3	17.5	13.9 ^g
6 Fiscal Indicators (Centre)							
Gross Fiscal Deficit ⁱ	% of GDP	3.9	4.0	3.3	2.6	5.9 ^h	6.5 ^j
Revenue Deficit ⁱ	% of GDP	2.4	2.5	1.9	1.1	4.4 ^h	4.6 ^j
Primary Deficit ⁱ	% of GDP	0.0	0.4	-0.2	-0.9	2.5 ^h	2.8 ^j
7 Population							
	Million	1089	1106	1122	1138	1154	1170

^{AE} GDP figures for 2009-10 are advance estimates; ^{QE} quick estimates

^{na} not yet available / released for 2009-10

^a for 2008-09 the figures are the 4th advance estimates as on July 21, 2009.

^b Average Apr.-Dec. 2009.

^c Apr.-Dec. 2009.

^d CAB to GDP ratio for 2009-10 is for the period Apr.-Sept. 2009

^e as of December 31, 2009

^f Average exchange rate for 2009-10 (Apr.-Dec. 2009).

^g As on January 15, 2010.

^h fiscal indicators for 2008-09 are based on the provisional actuals for 2008-09.

ⁱ fiscal indicators are as per revised GDP at current market prices based on National Accounts 2004-05 series.

^j fiscal deficit, revenue deficit and primary deficit were envisaged at 6.8, 4.8 and 3.0 per cent of GDP respectively at the time of presentation of the 2009-10 Budget.

1.4 A major concern during the year 2009-10, especially in the second half, was the emergence of high double-digit food inflation. On a year-on-year basis, wholesale price index (WPI) headline inflation in December 2009 was 7.3 per cent but for food items (primary and manufactured) with a combined weight of 25.4 per cent in the WPI basket, it was 19.8 per cent. Thus, unlike the first half of 2008-09 when global cost-push factors resulted in WPI inflation touching nearly 13 per cent in August 2008, with inflation in primary and manufactured products just below the overall average and that in the fuel and power group at over 17 per cent, the upsurge in prices in the second half of 2009-10 has been more concentrated and confined to food items only. As of the week ending January 30, 2010 the inflation in primary food articles stood at 17.9 per cent, and that in fuel, power light and lubricants at 10.4 per cent. 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 monsoons. 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 some concerns about higher-than-anticipated generalized inflation over the next few months.

1.5 At global level, following one of the deepest downturns in recent times, economic growth took root and extended to advanced economies in the second half of 2009. The pace and shape of recovery, however, remains uncertain. The International Monetary Fund's (IMF) World Economic Outlook update of January 26, 2010 suggests that following a sharp decline of 3.2 per cent in 2009, output in the advanced economies has begun to expand since

the second half of 2009 and is now expected to grow by 2.1 per cent in 2010. In the case of emerging and developing economies, the modest 2.1 per cent output growth in 2009 is expected to be followed by a rise of about 6 per cent in 2010. For the world as a whole an output decline of 0.8 per cent in 2009 is projected to turn into a growth of 3.9 per cent in 2010. The rapid rebound in world output has been driven by the extraordinary amount of policy stimulus, monetary as well as fiscal. The concern about the recovery losing momentum, once the stimulus is withdrawn, remains. High unemployment rates, growing fiscal deficit and contraction of credit to productive sectors are areas of concern for the developed economies. For the emerging economies, which are already on the path to recovery, there are challenges emanating from increased capital flows with ramifications for monetary growth, inflation and exchange rate uncertainty, along with policy implications for the capital account.

ECONOMIC GROWTH DURING 2009-10

Overall GDP growth

1.6 With the release of the Quick Estimates of National Income for 2008-09, the CSO has effected a revision in the base year of its NAS from 1999-2000 to 2004-05. It includes changes on account of certain refinements in definitions of some aggregates, widening of coverage, inclusion of long-term survey results and the normal revision in certain data in respect of 2008-09. While there are no major changes in the overall growth rate of GDP at constant 2004-05 prices, except for 2007-08 where it has been revised upward from 9.0 to 9.2 per cent, there are some changes in growth rates at sectoral level and in the level estimates of GDP. Thus, for instance,

Table 1.1 : Rate of growth at factor cost at 1999-2000 prices (per cent)

	2005-06	2006-07	2007-08	2008-09	2009-10
Agriculture, Forestry & Fishing	5.2	3.7	4.7	1.6	-0.2
Mining & Quarrying	1.3	8.7	3.9	1.6	8.7
Manufacturing	9.6	14.9	10.3	3.2	8.9
Electricity, Gas & Water Supply	6.6	10.0	8.5	3.9	8.2
Construction	12.4	10.6	10.0	5.9	6.5
Trade, Hotels & Restaurants	12.4	11.2	9.5	5.3	8.3*
Transport, Storage & Communication	11.5	12.6	13.0	11.6	
Financing, Insurance, Real Estate & Business Services	12.8	14.5	13.2	10.1	9.9
Community, Social & Personal Services	7.6	2.6	6.7	13.9	8.2
GDP at Factor Cost	9.5	9.7	9.2	6.7	7.2

Source : CSO.

* Transport & communication included for 2009-10 in trade, hotels and restaurants.

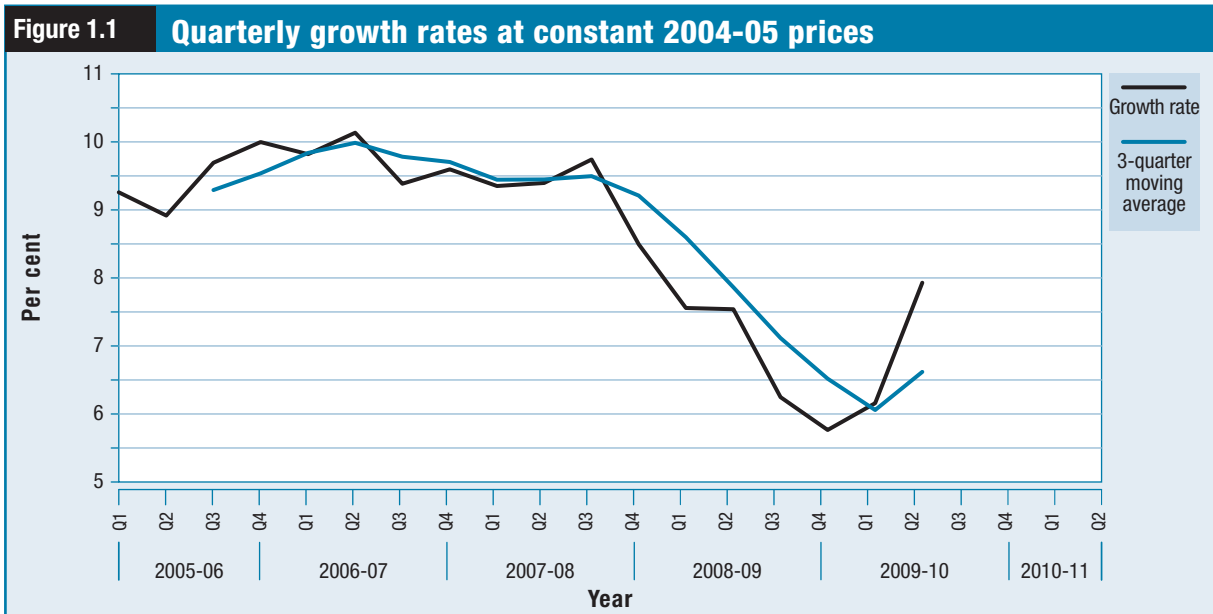
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the contribution of the agriculture sector to the GDP at factor cost in 2004-05 has declined from 17.4 per cent in the old series to 15.9 per cent in the new series. Similarly, while the contribution of registered manufacturing has declined from 10.9 per cent in the old series to 9.9 per cent in the new series, that of unregistered manufacturing has increased from 4.9 to 5.4 per cent. There is also an increase in the contribution of real estate, ownership of dwellings and business services from 8.2 per cent to 8.9 per cent. In the case of level estimates of GDP at current prices, the difference ranges from 3.1 per cent in 2004-05 to 6 per cent in 2008-09. As a result, there are also changes in the expenditure estimates of the GDP, which, as can be seen in the following paragraphs, has altered the analysis related to the impact of the global slowdown on the Indian economy as presented in the Economic Survey 2008-09.

1.7 The advance estimate of GDP growth at 7.2 per cent for 2009-10, falls within the range of 7 +/- 0.75 projected nearly a year ago in the Economic Survey 2008-09. With the downside risk to growth due to the delayed and sub-normal monsoons having been contained to a large extent, through the likelihood of a better-than-average rabi agricultural season, the economy has responded well to the policy measures undertaken in the wake of the global financial crisis. While the GDP at factor costs at constant 2004-05 prices, is placed at Rs 44,53,064 crore, the GDP at market prices, at constant prices, is estimated at Rs 47,67,142 crore. The corresponding figures at current prices are Rs 57,91,268 crore and Rs 61,64,178 crore respectively. It is worthwhile to note here that the

growth rates of GDP at market prices, at constant 2004-05 prices, in 2008-09 and 2009-10 at 5.1 per cent and 6.8 per cent have been considerably lower than the growth rates of GDP at factor cost. This is due to the significant decline in net indirect taxes (i.e. indirect taxes minus subsidies) in the said years on account of the fiscal stimulus implemented by the Government, which included tax relief to boost demand and increase in the expenditure on subsidies.

1.8 The recovery in GDP growth for 2009-10, as indicated in the advance estimates, is broad based. Seven out of eight sectors/sub-sectors show a growth rate of 6.5 per cent or higher. The exception, as anticipated, is agriculture and allied sectors where the growth rate is estimated to be minus 0.2 per cent over 2008-09. Sectors including mining and quarrying; manufacturing; and electricity, gas and water supply have significantly improved their growth rates at over 8 per cent in comparison with 2008-09. The construction sector and trade, hotels, transport and communication have also improved their growth rates over the preceding year, though to a lesser extent. However, the growth rate of community, social and personal services has declined significantly, though it continues to be around its pre-global crisis medium-term trend growth rate. Financing, insurance, real estate and business services have retained their growth momentum at around 10 per cent in 2009-10. In terms of sectoral shares, the share of agriculture and allied sectors in GDP at factor cost has declined gradually from 18.9 per cent in 2004-05 to 14.6 per cent in 2009-10. During the same period, the share of industry has



remained the same at about 28 per cent, while that of services has gone up from 53.2 per cent in 2004-05 to 57.2 per cent in 2009-10.

Quarterly trend

1.9 As per the revised quarterly GDP data on the new series of NAS, it now turns out that the GDP growth rate for Q3 2008-09 was 6.2 per cent as against 5.8 per cent on the old series. Thus the growth rates in the three quarters following the flare-up of the global financial crisis in September 2008, were 6.2, 5.8 and 6.1 per cent. As anticipated in the Economic Survey 2008-09, the economy exhibited a sharp 'V'-shaped recovery within a span of a few months of the stimulus measures, both fiscal and monetary, working through the system. The turnaround in the growth momentum was confirmed with the Q2 2009-10 estimates, when the economy recorded a GDP growth of 7.9 per cent as against 7.5 per cent in the corresponding quarter of 2008-09. The recovery was broad based with mining and quarrying; manufacturing; and electricity, gas and water supply recording impressive growth rates. Understandably, as a consequence of the continued fiscal expansion, and in particular with the release of 60 per cent of the Sixth Pay Commission arrears in September 2009, community, social and personal services recorded a significant pick-up in growth. The partial data available since Q2 estimates on industrial growth, agriculture, as well as exports indicate the

continued momentum in the recovery, which is reflected in the advance estimates for 2009-10.

Per capita growth

1.10 The growth rates in per capita income and consumption, which are gross measures of welfare in general, have declined in the last two years. This is a reflection of the slowdown in the overall GDP growth. While the growth in per capita income, measured in terms of GDP at constant market prices, has declined from a high of 8.1 per cent in 2007-08 to 3.7 per cent in 2008-09 and then recovered to 5.3 per cent in 2009-10, per capita consumption growth as captured in the private final consumption expenditure (PFCE) shows a declining trend since 2007-08 with its growth rate in 2009-10 falling to one-third of that in 2007-08 (Table 1.3). The growth rate

Table 1.3 : Per capita income and consumption at 2004-05 prices

	Income		Consumption	
	Rs	(%) Growth	Rs	(%) Growth
2004-05	29,745		17,620	
2005-06	32,012	7.6	18,909	7.3
2006-07	34,533	7.9	20,168	6.7
2007-08	37,328	8.1	21,841	8.3
2008-09	38,695	3.7	23,012	5.4
2009-10	40,745	5.3	23,626	2.7

Source: CSO.

Note: Income is taken as GDP at market prices, Consumption is PFCE.

Table 1.2 : Quarterly growth rates of GDP at constant 2004-05 prices

Sectors	2007-08					2008-09					2009-10		
	AN	Q1	Q2	Q3	Q4	AN	Q1	Q2	Q3	Q4	AN	Q1	Q2
Agriculture, Forestry & Fishing	4.7	3.1	3.9	8.7	2.1	1.6	3.2	2.4	-1.4	3.3	-0.2	2.4	0.9
Mining & Quarrying	3.9	1.1	4.6	4.5	5.1	1.6	2.6	1.6	2.8	-0.3	8.7	7.9	9.5
Manufacturing	10.3	12.1	10.3	10.7	8.3	3.2	5.9	5.5	1.3	0.6	8.9	3.4	9.2
Elec., Gas & Water Supply	8.5	10.2	9.1	7.1	7.8	3.9	3.3	4.3	4.0	4.1	8.2	6.2	7.4
Construction	10.0	10.7	13.1	9.6	7.1	5.9	7.1	8.0	3.0	5.6	6.5	7.1	6.5
Trade, Hotels, Transport and Communication	10.7	11.9	9.5	10.7	10.9	7.6	10.8	10.0	4.4	5.7	8.3	8.1	8.5
Financing, Insurance, Real Estate & Business Services	13.2	14.0	13.8	13.3	11.9	10.1	9.1	8.5	10.2	12.3	9.9	8.1	7.7
Community, Social & Personal Services	6.7	4.2	7.0	5.3	9.8	13.9	8.7	10.4	28.7	8.8	8.2	6.8	12.7
GDP at Factor Cost	9.2	9.3	9.4	9.7	8.5	6.7	7.6	7.5	6.2	5.8	7.2	6.1	7.9

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of per capita consumption was lower than that of per capita income up to 2007-08; however since then it was higher in two years and became lower again in 2009-10. The average growth in per capita consumption over the period 2005-06 to 2009-10 was slower at 6.08 per cent than that in per capita income at 6.52 per cent. These year to year differences in growth rates can be explained by the rising savings rate and also the rise in tax collections that have been observed in some of these years.

Aggregate demand and its composition

1.11 The change in the NAS series from the old base of 1999-2000 to the new base of 2004-05 has brought about significant revision in the expenditure estimates of the GDP for 2008-09. While growth of the PFCE in 2008-09 was revised upward from 2.9 per cent to 6.8 per cent, 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. In 2009-10 a growth of 4.1 per cent is expected in private final expenditure and 8.2 per cent in Government final expenditure. There is therefore a significant decline in the growth

of consumption expenditure in 2009-10. However, the overall share of consumption expenditure, both private as well as Government in GDP at market prices, at constant 2004-05 prices, has declined only marginally from 70.9 per cent in 2008-09 to 69.6 per cent in 2009-10 (Table 1.4).

1.12 At the same time, the growth rate of gross fixed capital formation in 2008-09 has also undergone a revision due to the change in the NAS base year. It was revised downward from 8.2 per cent in the earlier base to 4 per cent in the revised base for 2008-09. It is, however, estimated to grow by 5.2 per cent in 2009-10. Moreover, gross capital formation adjusted shows a negative 4 per cent growth in 2008-09 in the new NAS base. This is because of a significant decline in inventories (change in stocks) from Rs1,08,739 crore in the old base to Rs 59,812 crore in the new base. The share of gross fixed capital formation in GDP remains nearly the same at 32.5 per cent in 2009-10 and 32.9 per cent in 2008-09.

1.13 Thus it now appears that moderation in the decline in GDP growth rate, in the second half of

Table 1.4 : Demand side growth of GDP, growth contribution and relative share at 2004-05 market prices (per cent)

	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
GDP at Market Prices		9.3	9.4	9.6	5.1	6.8
Consumption (Private)		9.0	8.2	9.8	6.8	4.1
Consumption (Govt)		8.3	3.8	9.7	16.7	8.2
Gross Capital Formation		14.7	14.5	16.9	-4.0	na
Gross Fixed Capital Formation		15.3	14.3	15.2	4.0	5.2
Change in Stocks		24.8	35.0	15.1	-61.2	4.7
Exports		25.9	21.8	5.2	19.3	-15.8
Imports		32.5	22.0	10.0	23.0	-17.2
Contribution to Growth						
Consumption (Private)		57.3	51.3	59.7	78.2	36.0
Consumption (Govt)		9.8	4.4	10.4	33.6	13.9
Gross Capital Formation		51.4	52.6	62.7	-29.6	na
Gross Fixed Capital Formation		47.3	46.1	50.1	25.8	25.5
Net Exports		-18.6	-8.0	-15.0	-36.2	20.4
Relative Share						
Consumption (Private)	59.2	59.1	58.4	58.5	59.5	58.0
Consumption (Govt)	11.0	10.9	10.3	10.3	11.5	11.6
Gross Capital Formation	32.7	34.2	35.8	38.2	34.9	na
Gross Fixed Capital Formation	28.8	30.3	31.7	33.3	32.9	32.5

Source: CSO.

Note: Does not add to 100 because only major items are included in the table. Figures for 2009-10 are based on advance estimates.

2008-09, was primarily a result of the boost provided by the fiscal stimulus to consumption demand, both private as well as Government, rather than the continued buoyancy in investment growth, as indicated in the Economic Survey 2008-09. This in fact was the intended purpose of the fiscal stimulus, which was not captured by the earlier NAS data. It implies that expansion in investments in the manufacturing sector may have declined a lot faster and, perhaps, earlier than the estimates for 2008-09 suggested in May 2009. This is, for example, reflected in the data on contribution to growth (Table 1.4), where the contribution of consumption, private as well as Government, to growth saw a steep rise in 2008-09 while that of gross capital formation declined. Further, though the growth in gross fixed capital formation (a proxy for investment growth) in 2009-10 has recovered to 5.2 per cent from 4 per cent in 2008-09, it is still below the GDP growth rate unlike in the pre-global crisis phase. This makes it necessary, therefore, to watch the growth recovery in private investment in the third and fourth quarters, in sequencing the rollback of the stimulus measures. Moreover, the contribution of net exports has become positive in 2009-10, after a considerable period of time. It may again turn negative as the demand for imports increases with a deepening of industrial recovery and a pick-up in domestic demand.

1.14 With growth in private expenditure on food, beverages and tobacco falling behind the overall growth in private consumption expenditure, the share of expenditure on food items has gradually been declining over the years. As per the CSO data, it was 35.3 per cent in 2008-09 as against 39.6 per cent in 2004-05. At the same time, the growth in expenditure on transport and communication and miscellaneous goods and services has been increasing, though with occasional aberrations, with the result that together they account for nearly the same share in total private consumption as the expenditure on food items.

PRODUCTION AND SUPPLY

Agriculture

1.15 Total foodgrains production in 2008-09 was estimated at 233.88 million tonnes as against 230.78 million tonnes in 2007-08 and 217.28 million tonnes in 2006-07. In the agricultural season 2009-10, the impact of the delayed and sub-normal monsoon is reflected in the production and acreage data for kharif crops. As per the first advance estimates, covering only the kharif crop, production of foodgrains is estimated at 98.83 million tonnes in 2009-10, as against the fourth advance estimates of 117.70 million

Table 1.5 : Private final consumption : Annual growth and share at 2004-05 prices

	2004-05	2005-06	2006-07	2007-08	2008-09
	Annual Growth (per cent)				
Food, Beverages & Tobacco		7.5	3.8	7.2	2.7
Clothing & Footwear		24.0	23.2	8.1	-0.6
Gross Rent, Fuel & Power		3.4	4.0	4.8	3.4
Furniture, Furnishings Etc.		14.1	15.9	14.6	3.7
Medical Care & Health Services		5.8	4.5	2.5	8.1
Transport & Communication		5.0	7.6	8.8	12.3
Recreation, Education & Cultural Services		8.9	7.0	13.2	5.4
Miscellaneous Goods & Services		15.9	21.2	25.6	19.3
Total Private Consumption		8.6	8.3	9.6	6.8
	Share of Total (per cent)				
Food, Beverages & Tobacco	39.6	39.2	37.6	36.8	35.3
Clothing & Footwear	6.6	7.6	8.6	8.5	7.9
Gross Rent, Fuel & Power	13.0	12.4	11.9	11.4	11.0
Furniture, Furnishings, etc.	3.4	3.5	3.8	4.0	3.9
Medical Care & Health Services	5.0	4.8	4.7	4.4	4.4
Transport & Communication	19.6	19.0	18.9	18.7	19.7
Recreation, Education & Cultural Services	3.4	3.4	3.4	3.5	3.4
Miscellaneous Goods & Services	9.4	10.0	11.2	12.8	14.4
Total Private Consumption	100.0	100.0	100.0	100.0	100.0

Source: CSO.

Table 1.6 : Production of selected kharif crops

	2007-08(4th advance estimates)	2008-09 (4th advance estimates)	2009-10 (1st advance estimates)	Difference between 2009-10 and 2007-08
Coarse Cereals	31.89	28.34	22.76	-9.13
Cereals	114.55	112.92	94.41	-20.14
Pulses	6.40	4.78	4.42	-1.98
Foodgrains	120.95	117.70	98.83	-22.12
Oilseeds	20.71	17.88	15.23	-5.48

(million tonnes)

tonnes for the kharif crop in 2008-09 and a target of 125.15 million tonnes for 2009-10. Overall production of kharif cereals in 2009-10 has shown a decline of 18.51 million tonnes over 2008-09. Both for rice and coarse cereals, there has been a shortfall as compared to the targeted production and also the production level achieved in the previous year. In the case of rice the decline is about 15 per cent over the 2008-09 level and 17 per cent in comparison with the target for 2009-10. The decline in kharif coarse cereals in 2009-10 in comparison with 2008-09 is nearly 20 per cent and the shortfall with respect to the target for kharif 2009-10 is nearly 10 million tonnes. Total production of kharif pulses is estimated at 4.42 million tonnes in 2009-10, which is 8 per cent lower than the production during 2008-09 and 32 per cent lower than the targeted production for 2009-10. Similarly, total kharif production of the nine oilseeds in 2009-10 is about 15 per cent lower than the kharif production in 2008-09.

1.16 Sugarcane production in 2009-10 is estimated at 249.48 million tonnes, which is 9 per cent lower than the previous year and 27 per cent lower than 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.

1.17 In terms of acreage, the kharif 2009-10 season saw a decline of nearly 6.5 per cent or 46.18 lakh ha in the area covered under foodgrains. Almost the entire decline in this acreage was confined to the kharif rice crop. While the decline in kharif acreage under pulses was 5.63 per cent, the area under the nine oilseeds declined by 5.14 lakh ha. Some of this decline in acreage may have been made up by the increased acreage in the rabi season. As per the available estimates, wheat, pulses and groundnut

have seen an increase in acreage as compared to last year.

1.18 During the south-west monsoon of 2009, the country as a whole received 23 per cent less rainfall as compared to the long period average (LPA). Central India, north-east India, north-west India and the southern peninsula experienced 20 per cent, 27 per cent, 36 per cent and 4 per cent deficient rainfall respectively. At district level, 9 per cent of the districts in the country received excess rainfall, 32 per cent normal rainfall, 51 per cent deficient rainfall and 8 per cent scanty rainfall. Monsoon rainfall over the country as a whole was 53 per cent of the LPA during June, 96 per cent during July, 73 per cent in August and 79 per cent during September. Some of this shortfall was made up during the post-monsoon season (October-December) of 2009, when the country as a whole received 8 per cent excess rainfall.

1.19 The total designed storage capacity at full reservoir level (FRL) of 81 major reservoirs in the country monitored by the Central Water Commission is 151.77 billion cubic metres (BCM). At the end of monsoon 2009, total water availability in the reservoirs was 90.48 BCM, which is less than the water availability of 113.74 BCM at the end of monsoon 2008 and the average of 100.95 BCM for the last 10 years.

Industry and Infrastructure

1.20 The cyclical slowdown in the industrial sector which began in 2007-08 got compounded by the global commodity price shock and the impact of the global slowdown during the course of calendar year 2008 was arrested at the beginning of 2009-10. After the first two months of the current fiscal, there were clear signs of recovery. This is evident from the NAS data as well as the index of industrial production

(IIP). While the CSO's advance estimates place industrial-sector growth at 8.2 per cent, as against 3.9 per cent in 2008-09, the IIP industrial growth is estimated at 7.7 per cent for the period April-November 2009-10, significantly up from 0.6 per cent during the second half of 2008-09. The manufacturing sector, in particular, has grown at the rate of 8.9 per cent in 2009-10.

1.21 Growth in the major industrial groups has been a mixed bag. There was strong growth in automobiles, rubber and plastic products, wool and silk textiles, wood products, chemicals and miscellaneous manufacturing; modest growth in non-metallic mineral products; no growth in paper, leather, food and jute textiles; and a slump in beverages and tobacco products in 2009-10. In terms of use-based classification, there was strong growth in consumer durables and intermediate goods (partly aided by the base effect); moderate growth in basic and capital goods; and sharp deceleration in consumer non-durables.

1.22 The improvement in the cost structure of manufacturing companies seems to have catalysed the recovery. As the data on gross capital formation are available with a considerable lag, the investment picture is not yet clear. Growth in the production of capital goods, a proxy for investment, is improving, but different components of the "capital goods" group reflect a mixed picture during the current year. The strength of the recovery so far has been helped by the favourable base effect and mild inflation in manufacturing articles, especially of industrial inputs. The declining trend in the number of mandays lost because of strikes and lockouts witnessed in recent years has continued in 2009-10.

1.23 Core industries and infrastructure services, led by the robust growth momentum of telecom services and spread across power, coal and other infrastructure like ports, civil aviation and roads, have also shown signs of recovery in 2009-10. In the current fiscal, electricity generation emerged from the lacklustre growth witnessed in the previous year and equalled its performance in 2007-08. That this was achieved despite constraints imposed by the inadequate availability of coal and the dismal hydel-generation scenario due to the sub-normal monsoon, attests well to its potential. During April-December 2009, the peak deficit and total energy deficit came down considerably to 12.6 per cent and 9.8 per cent respectively from 13.8 per cent and 10.9 per cent during the corresponding period of the previous year.

This happened mainly due to the increase in the growth in electricity generation. The availability of gas from the KG basin (D6) and surplus utilization of gas available on fallback basis resulted in better utilization of capacity and higher plant load factor (PLF) as also high growth in electricity generated from gas-based plants. The overall PLF also improved during April-December 2009.

1.24 The domestic supply of crude oil remained around 34 million metric tonnes (mmt) and natural gas at about 32 billion cubic metric tonnes during the past five years. With 15 new oil and gas discoveries during 2009-10, the domestic availability is expected to improve. During 2009-10, the projected production for crude oil is 36.7 mmt, which is about 11 per cent higher than the actual crude oil production of 33.5 mmt in 2008-09.

1.25 Better resource management, through increased wagon load, faster turnaround time and a more rational pricing policy, led to perceptible improvement in the performance of the railways. There has been no across-the-board increase in freight rates in recent years. Railways have taken a number of steps to attract additional traffic, one of which is the dynamic pricing policy through which differential tariff is charged to take care of skewed demand during different periods of the year and between different regions. A new class of non-stop super fast passenger-carrying "Duronto" trains has been introduced in September 2009. Seven Duronto trains have already been launched.

1.26 In 2009-10, as against the stipulated target of developing about a 3,165 km of national highways under various phases of the National Highway Development Project (NHDP), the achievement up to end November 2009 has been about 1,490 km. Similarly, as against the 2009-10 target of about 9,800 km for awarding projects under various phases of the NHDP, projects totalling a length of about 1,285 km have been awarded up to end November 2009.

1.27 The opening of the telecom sector has not only led to rapid growth in subscriber base, but has also significantly helped in maximization of consumer benefits, particularly in terms of price discovery, following the forbearance approach in tariffs. From only 54.6 million telephone subscribers in 2003, the number increased to 429.7 million at the end of March 2009 and further to 562 million as of October 31, 2009 showing an addition of 96 million subscribers during the period from March to December 2009.

Table 1.7 : Ratio of savings and investment to GDP

(Per cent at current market prices)

	2004-05	2005-06	2006-07	2007-08	2008-09
Gross Domestic Saving	32.2	33.1	34.4	36.4	32.5
Public Sector	2.3	2.4	3.6	5.0	1.4
Private Sector	29.9	30.7	30.9	31.4	31.1
Household Sector	23.3	23.2	22.9	22.6	22.6
Financial Saving	9.8	11.4	10.9	11.2	10.4
Saving in Physical Assets	13.5	11.8	11.9	11.5	12.2
Private Corporate Sector	6.6	7.5	8.0	8.7	8.4
Gross Capital Formation (Investment)	32.7	34.3	35.5	37.7	34.9
Public Sector	7.4	7.9	8.4	8.9	9.4
Private Sector	23.8	25.3	26.4	27.6	24.9
Corporate Sector	10.3	13.5	14.5	16.1	12.7
Household Sector	13.5	11.8	11.9	11.5	12.2
Gross fixed Capital Formation	28.8	30.4	31.4	33.0	33.0
Stocks	2.5	2.8	3.4	3.5	1.3
Valuables	1.3	1.1	1.2	1.1	1.3
Saving-investment Gap					
Public Sector	-5.1	-5.5	-4.8	-3.9	-8.0
Private Sector	6.1	5.4	4.4	3.8	6.2

Source: CSO.

Note: Totals may not tally due to adjustment for errors and omissions.

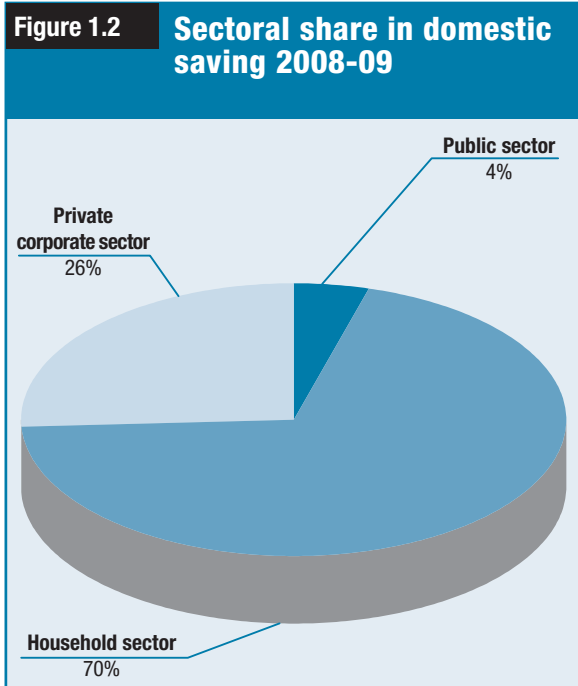
Service Sector

1.28 The service sector which has been India's workhorse for well over a decade has continued to grow rapidly. Following the NAS classification, it comprises the sub-sectors trade, hotels, transport and communications; financing, insurance, real estate and business services; and community, social and personal services. As against a growth of 9.8 per cent in 2008-09 it grew at 8.7 per cent in 2009-10. While there has been a significant dip in the growth of community social and personal services in 2009-10, the other sub-sectors have either retained their growth momentum or improved upon it. A comparison between the old and the new series of NAS reveals considerable difference in the level estimates of the value added of service sub-sectors to GDP at current prices. Thus, for instance, there has been a decline, ranging from around 8 per cent in 2004-05 to 30 per cent in 2008-09, in the communication sub-sector. This has been partly offset by the increase in the level estimates of value added in real estate, ownership of dwellings, business and legal services, ranging from 11.6 per cent in 2004-05 to nearly 34.4 per cent in 2008-09.

Savings and investments

Gross domestic savings

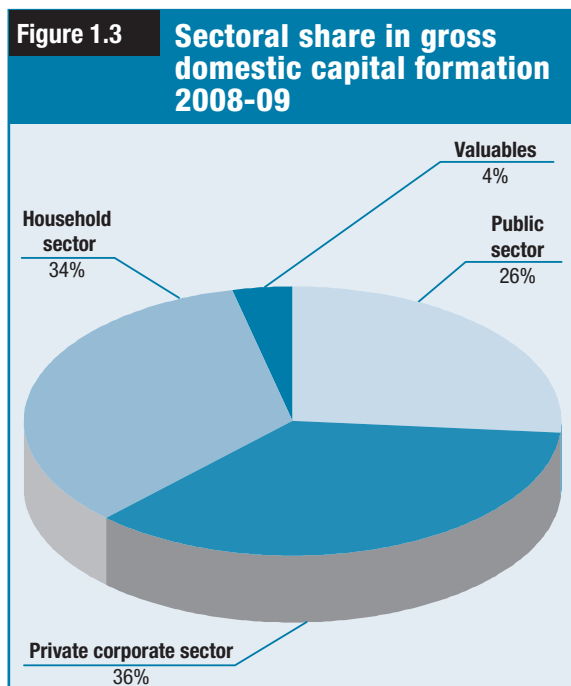
1.29 Gross domestic savings (GDS) at current prices in 2008-09 were estimated at Rs 18,11,585 crore, amounting to 32.5 per cent of GDP at market



prices as against 36.4 per cent in the previous year. The fall in the rate of GDS has mainly been due to the fall in the rates of savings of the public sector (from 5.0 per cent in 2007-08 to 1.4 per cent in 2008-09) and private corporate sector (from 8.7 per cent in 2007-08 to 8.4 per cent in 2008-09). In respect of the household sector, the rate of saving has remained at the same level of 22.6 per cent in 2007-08 and 2008-09. Indeed, the change in the NAS series has had the most conspicuous effect on the savings and investment rates. The rate of GDS on the new series increased from 32.2 per cent in 2004-05 to 36.4 per cent in 2007-08 before declining to 32.5 per cent in 2009-10, as against the old series where it rose from 31.7 per cent in 2004-05 to 37.7 per cent in 2007-08. Thus, from 2005-06 to 2007-08, the GDS rate was overestimated in the NAS old series by an average of 1.3 per cent. Definitional refinements, better estimates of savings and a higher denominator due to an increase in the level estimates of GDP have contributed to the lowering of the rate of GDS in the new NAS series.

Capital formation

1.30 Gross domestic capital formation(GDCF) at current prices (adjusted for errors and omissions) increased from Rs18,65,899 crore in 2007-08 to Rs19,44,328 crore in 2008-09 and at constant (2004-05) prices, it decreased from Rs16,22,226 crore in 2007-08 to Rs15,57,757 crore in 2008-09. The rate of gross capital formation at current prices rose from 32.7 per cent in 2004-05 to 37.7 per cent in 2007-08 before declining to 34.9 per cent in 2008-09.



1.31 At sectoral level, the rate of gross capital formation or simply the investment rate has increased in both the public and private sectors. In the former it rose continuously from 7.4 per cent in 2004-05 to 9.4 per cent in 2008-09, whereas in the latter, it increased from 23.8 per cent in 2004-05 to 27.6 per cent in 2007-08 before falling to 24.9 per cent in 2008-09. Between 2007-08 and 2008-09, the investment rate for the private corporate sector declined significantly from 16.1 per cent to 12.7 per cent, whereas that of the household sector increased from 11.5 to 12.2 per cent.

1.32 The sectoral savings-investment gap, reflecting the gap between gross domestic savings and gross capital formation of a sector, declined significantly for the public sector as its savings increased until 2007-08. However, with a sudden drop in its savings rate by nearly 4 percentage points in 2008-09, this gap shot to a negative 8 per cent. In the case of the private corporate sector, the savings-investment gap has been consistently positive and has risen in 2008-09 to 6.2 per cent after falling to 3.8 per cent in 2007-08 from 6.1 per cent in 2004-05.

Sectoral investment

1.33 The sectoral investment rate is a useful indicator of the direction of new investments. While the overall growth of investment in India was in the range of 15 to 16 per cent per annum during the last few years, it plunged to - 2.4 per cent in 2008-09 as a result of the external shock-led slowdown. At sectoral level, there has been a welcome rebound in the growth rate of investment in the agricultural sector, which grew at 16.5 per cent and 26.0 per cent in 2007-08 and 2008-09 respectively. This is in contrast to the growth rate of 1.4 per cent recorded in 2006-07. Growth of investment in the industrial sector has been more than the total investment growth up to 2007-08. However, in 2008-09, this was reversed, when investment in the industrial sector declined by - 17.6 per cent as compared to a decline of - 2.4 per cent in total investment. Within the industrial sector, the decline was more prominent in manufacturing and the construction sector. Investment in the unorganized manufacturing sector declined by a negative 42 per cent, indicative, perhaps, of the difficulty faced by the sector in accessing credit due to the tight market conditions in the post financial-crisis phase. Investment in the services sector registered a growth of 20.2 per cent in 2006-07, which suddenly declined to - 16.0 per cent in 2007-08 as a result of a decline in investment in the trade, hotels

Table 1.8 : Sectoral investment growth rates at 2004-05 prices

	Rate of growth of GCF			
	2005-06	2006-07	2007-08	2008-09
Agriculture, Forestry & Fishing	18.1	1.4	16.5	26.0
Agriculture	18.7	0.5	17.7	27.4
Forestry & Logging	27.3	16.0	-20.0	16.0
Fishing	9.5	9.5	9.5	9.5
Mining & Quarrying	40.0	3.5	14.6	-7.8
Manufacturing	14.8	25.5	19.8	-21.9
Registered	39.1	18.8	24.4	-17.6
Unregistered	-40.6	61.5	1.4	-42.5
Electricity, Gas & Water Supply	28.6	23.7	8.7	1.3
Construction	0.7	45.5	23.5	-22.8
Trade, Hotels & Restaurants	26.3	20.2	-16.0	19.4
Trade	24.9	23.2	-21.0	23.9
Hotels & Restaurants	33.6	5.4	12.2	1.7
Transport, Storage & Communication	14.7	1.0	26.3	30.3
Railways	10.6	15.8	14.0	17.5
Transport by Other Means	6.8	-2.0	27.8	13.7
Storage	-268.5	19.3	8.4	32.8
Communication	27.0	-4.4	34.1	65.1
Financing, Insurance, Real Estate & Business Services	5.7	1.3	16.8	10.5
Banking & Insurance	46.3	38.3	1.4	-18.0
Real Estate, Ownership Of Dwellings & Business Services	4.4	-0.4	17.8	12.0
Community, Social & Personal Services	18.0	12.3	16.4	6.2
Public Administration & Defence	16.0	13.9	15.7	8.5
Other Services	20.8	10.2	17.4	3.0
Total	16.0	16.1	15.2	-2.4

Source : CSO.

and restaurants sub-sector. This decline in the said sub-sector was made up in 2008-09 when, on the strength of a growth of 19.4 per cent, there was a revival in investment growth rate in the services sector as a whole. Within the services sector, the global financial crisis has had a dampening effect on investment growth in the banking and insurance sub-sector in 2008-09.

Behaviour of Prices and Inflation

1.34 The year-on-year WPI inflation rate has been fairly volatile in 2009-10. It was 1.2 per cent in March 2009 and then declined continuously to become negative during June-August 2009, assisted in part by the large statistical base effect from the previous year. It turned positive in September 2009 and accelerated to 4.8 per cent in November 2009 and further to 7.3 per cent in December 2009. For the fiscal year so far (March over December 2009) WPI inflation is estimated at 8 per cent.

1.35 Year-on-year inflation in the composite food index (with a weight of 25.4 per cent) at 19.8 per cent in December 2009 was significantly higher than 8.6 per cent last year. In respect of food articles, inflation on year-on-year basis in December was 19.2 per cent and on fiscal-year basis (i.e. over March 2009) it was 18.3 per cent. At the same time, the composite non-food inflation within the manufactured group of the WPI (with a weight of 53.7 per cent) at 2.4 per cent in December 2009, was lower than the 6.7 per cent recorded last year. This suggests concentrated inflation. Indeed, for several months, rapidly rising food inflation has been a cause for concern.

1.36 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).

1.37 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, while 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, WPI inflation first went up from around 8 per cent in March 2008 to 13 per cent in August 2008, then declined to about 1 per cent in March 2009, turned negative during June to August 2009 before rising again to over 7 per cent in December 2009.

1.38 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 monsoons as well as drought-like conditions in some parts of the country. The delayed and erratic monsoons may also have prevented the seasonal decline in prices, normally seen during the period from October to March for most food articles other than wheat, from setting in. At the same time, it could be argued that excessive hype about kharif crop failure, not taking into account the comfortable situation in respect of food stocks and the possibility of an improved rabi crop, may have exacerbated inflationary expectations encouraging hoarding and resulting in a higher inflation in food items. This is supported by the estimates on shortfall in production / availability of major food items in 2009-10 for rice and wheat, as also for some other items, except pulses. In the case of sugar, delay in the market release of imported raw sugar may have contributed to the overall uncertainty, thereby allowing prices to rise to unacceptably high levels in recent months.

1.39 The implicit deflator for GDP at market prices defined as the ratio of GDP at current prices to GDP at constant prices is the most comprehensive measure of inflation on annual basis. Unlike the WPI, the GDP deflator also covers prices in the services sector which now accounts for well over 55 per cent of the GDP. Overall inflation, as measured by the aggregate deflator for GDP_{MP}, increased from 4.7 per cent in 2005-06 to 5.6 per cent in 2006-07 and then declined to 5.3 per cent in 2007-08, before rising

again to 7.2 per cent in 2008-09. It has been estimated at 3.6 per cent in 2009-10 as per the advance estimates.

1.40 Similarly, in the absence of an economy-wide consumer price index, it is useful to look at the deflator for the PFCE as a more comprehensive measure of consumer inflation on an annual basis. It is defined as the ratio of PFCE at current prices to PFCE at constant prices. Thus consumer inflation, as measured by the deflator for the PFCE, increased from 2.9 per cent in 2005-06 to 5.9 per cent in 2006-07, followed by a decline in 2007-08 to 4 per cent, before rising again to 7 per cent in 2008-09 and estimated at 6.4 per cent in 2009-10, as per the advance estimates.

External-sector Developments

1.41 The global economy, led by the Asian economies especially China and India, has shown signs of recovery in fiscal 2009-10. While global trade is gradually picking up, the other indicators of economic activity such as capital flows, assets and commodity prices are more buoyant.

BOP developments H1 2009-10

1.42 As per the latest data for fiscal 2009-10, exports and imports showed substantial decline during April-September (H1) of 2009-10 vis-à-vis the corresponding period in 2008-09. However, there has been improvement in the balance of payments (BoP) situation 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 to US\$ 64.4 billion in April-September 2008 mainly on account of decline in oil import.

1.43 Merchandise exports on a 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 attributed to the base effect and decline in oil prices.

1.44 The net invisibles surplus (invisibles receipts minus invisibles payments) stood 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 a lower trade deficit, as compared to US \$ 15.8 billion in April-September 2008, mainly due to the lower net invisibles surplus.

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1.45 Net capital flows to India at US \$ 29.6 billion in April-September 2009 remained higher as compared to US \$ 12.0 billion in April-September 2008. All the components, except loans and banking capital, that comprise net capital flows showed improvement during April-September 2009 from the 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.

Trade

1.46 Given the uncertain global context, the Government did not fix an export target for 2009-10, instead the Foreign Trade Policy (FTP) 2009-14 set the objective of an annual export growth of 15 per cent with an export target of US\$ 200 billion by March 2011. With the deepening of the global recession, the beginning of 2009-10 saw acceleration in the fall of export growth rate. The upwardly revised export figures for the first half of 2008-09 also contributed to the faster decline in the growth rate. While the export growth rate was a negative 22.3 per cent in April-November 2008-09, in November 2009, it became a positive 18.2 per cent after a 13-month period of negative growth. This significant turnaround is due to the low base figures in November 2008 (at \$11.2 billion compared to \$14.1 billion in October 2008 and \$13.4 billion in December 2008). The export growth rate in November 2009 over October 2009 was marginally positive at 0.04 per cent. In December 2009 the recovery in export growth has continued with a positive year-on-year growth of 9.3 per cent and a growth of 10.7 per cent over the previous month.

1.47 During 2009-10 (April-December) import growth was a negative 23.6 per cent accompanied by a decline in both POL and non-POL imports of 29.8 per cent and 20.7 per cent respectively. Gold

and silver imports registered negative growth of 7.3 per cent primarily on account of the volatility in gold prices. The continuous rise in prices of gold also dampened the demand. Non-POL non-bullion imports declined by 22.4 per cent reflecting slowdown in industrial activity and lower demand for exports. Import growth was at a positive 27.2 per cent in December 2009 due partly to the base effect and partly the 42.8 per cent increase in the growth of POL products with the pick-up in oil prices and industrial demand. Non-POL items also registered a significant growth in imports at 22.4 per cent, despite a high negative growth of gold and silver imports.

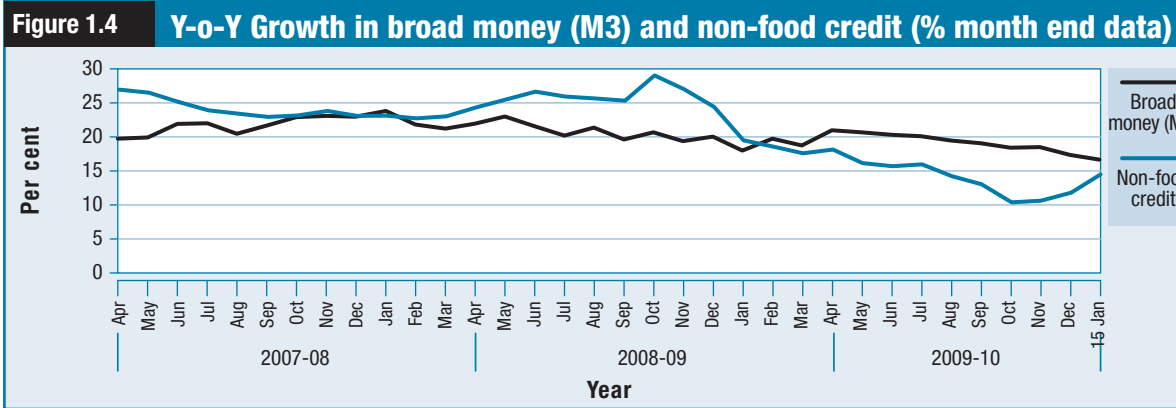
1.48 Trade deficit fell by 28.2 per cent to US\$ 76.2 billion (as per customs data) in 2009-10 (April-December) from US\$ 106 billion in the corresponding period of the previous year. There have been significant changes in the composition and direction of both exports and imports in this period.

Foreign Exchange Reserves

1.49 During fiscal 2009-10, foreign exchange reserves increased by US\$ 31.5 billion from US\$ 252.0 billion in end March 2009 to US\$ 283.5 billion in end December 2009. Out of the total accretion of US\$ 31.5 billion, US\$ 11.2 billion (35.6 per cent) was on BoP basis (i.e. excluding valuation effect), because of higher inflows under FDI and portfolio investments, while accretion of US\$ 20.3 billion (64.4 per cent) was on account of valuation gain due to weakness of the US dollar against major currencies. Besides, the Reserve Bank of India (RBI) 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 made to India by the IMF on August 28, 2009 and September 9, 2009 respectively.

Exchange Rate

1.50 In fiscal 2009-10, with the signs of recovery and return of FII flows after March 2009, the rupee has been strengthening against the US dollar. The movement of the exchange rate in the year 2009-10 indicated that the average monthly exchange rate of the rupee against the US dollar appreciated by 9.9 per cent from Rs 51.23 per US dollar in March 2009 to Rs 46.63 per US dollar in December 2009, mainly on account of weakening of the US dollar in the international market.



Conduct of Monetary Policy

1.51 Since the outbreak of the global financial crisis in September 2008, the RBI has followed an accommodative monetary policy. In the course of 2009-10, this stance was principally geared towards supporting early recovery of the growth momentum, while facilitating the unprecedented borrowing requirement of the Government to fund its fiscal deficit. The fact that the latter was managed well with nearly two-thirds of the borrowing being completed in the first half of the fiscal year not only helped in checking undue pressure on interest rates, but also created the space for the revival of private investment demand in the second half of the year.

1.52 The transmission of monetary policy measures continues to be sluggish and differential in its impact across various segments of the financial markets.

The downward revisions in policy rates announced by the RBI post-September 2008 got transmitted into the money and G-Sec markets; however, the transmission has been slow and lagged in the case of the credit market. Though lending rates of all categories of banks (public, private and foreign) declined marginally from March 2009 (with benchmark prime lending rates [BPLR] of scheduled commercial banks [SCBs] having declined by 25 to 100 basis points), the decline was not sufficient to accelerate the demand for bank credit. Consequently, while borrowers have turned to alternate sources of possibly cheaper finance to meet their funding needs, banks flush with liquidity parked their surplus funds under the reverse repo window.

1.53 There has been continuous moderation in the growth in broad money (M_3) from around 21 per cent

Table 1.9 : Deployment of gross bank credit by major sectors

Sector	% Variation (year-on-year)	
	2008-09(Nov. 21)	2009-10(Nov. 20)
<i>Non-food Gross Bank Credit (1 to 4)</i>	28.0	10.4
1. Agriculture and Allied Activities	21.5	21.4
2. Industry	37.0	14.2
3. Personal Loans	13.2	0.7
Housing	9.1	7.3
Advances against Fixed Deposits	27.7	-11.8
Credit Card Outstanding	25.7	-24.7
Education	38.3	31.0
Consumer Durables	-9.8	-11.8
4. Services	32.9	7.9
Transport Operators	24.4	10.6
Professional Services	80.1	7.0
Trade	20.5	14.4
Real Estate Loans	49.0	15.3
Non-banking Financial Companies	54.0	19.5
<i>Priority Sector</i>	22.6	15.4

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at the beginning of the fiscal year to 16.5 per cent as of mid-January 2010 and it has remained below the indicated growth projection for the period. While in the first half of the year, credit to the Government remained the key driver of money growth, since the third quarter of 2009-10 that too has moderated.

1.54 Demand for bank credit/non-food credit remained muted during 2009-10. It was only from November 2009 that some signs of pick-up became evident. On financial-year basis (over end March), growth in non-food credit remained negative till June 2009. It picked up thereafter, only to hover between 0.0 to 1.8 per cent till mid-September 2009. Consistent growth in non-food credit was recorded only after November 2009. As per the latest available data, non-food credit has recorded an increase of 8.7 per cent on financial-year basis (till January 15, 2010). It is also noteworthy that growth in aggregate deposits has remained higher than the growth in bank credit during 2009-10. The lower expansion in credit relative to the significant expansion in deposits during 2009-10 has resulted in a decline in the credit-deposit ratio from 72.4 in end March 2009 to 70.8 in mid-January 2010, though with some signs of revival since December 2009.

1.55 Growth in sectoral deployment of gross bank credit on a year-on-year basis (as on November 20, 2010) shows that retail credit has not picked up during 2009-10 (Table 1.9). While growth in credit to agriculture remained more or less the same as on the corresponding date of the preceding year, for the other broad sectors—industry, personal loans and services—growth in credit decelerated as compared to the corresponding period of the preceding year. The personal loans category has fared the worst with credit deployment showing negative variation for sub-categories like (i) Advances against Fixed Deposits, (ii) Credit Card Outstanding and (iii) Consumer Durables. It would be necessary to monitor these indicators for an improvement in credit growth, while sequencing measures to roll back the stimulus.

1.56 There has been significant increase by Rs 50,000 crore during April-January 2009-10 in the availability of non-banking resources, which has helped industry meet its credit needs. Thus adjusted non-food credit that accounted for nearly 48 per cent of the total flow of funds to the commercial sector in 2008-09 (April-January), accounted for only 39 per cent of the flow of funds in 2009-10 (April-January). On the other hand, the contribution of non-bank sources increased from 52 per cent in 2008-09 to nearly 61 per cent in 2009-10 for the same period. This increase in flow of funds from non-banking sources was both from domestic and foreign sources and is indicative of structural rigidities that affect the monetary transmission mechanism (Table 1.10) particularly in respect of the credit markets.

Fiscal Policy Developments

1.57 The fiscal expansion undertaken by the Central Government as a part of the policy response to counter the impact of the global economic slowdown in 2008-09 was continued in fiscal 2009-10. The expansion took the form of tax relief to boost demand and increased expenditure on public projects to create employment and public assets. The net result was an increase in fiscal deficit from 2.6 per cent in 2007-08 to 5.9 per cent of the revised GDP (new series) in 2008-09 (provisional) and 6.5 per cent in the budget estimates for 2009-10 (as against 6.8 per cent of the GDP on the old series, reported earlier). Thus the fiscal stimulus amounted to 3.3 per cent of the GDP in 2008-09 and 3.9 per cent in 2009-10 from the level of the fiscal deficit in 2007-08.

1.58 As part of the fiscal stimulus, the Government also enhanced the borrowing limits of the State Governments by relaxing the targets by 100 basis points. As a result, the gross fiscal deficit of the States combined rose from 1.4 per cent of the GDP in 2007-08 to 2.6 per cent in 2008-09 (revised estimates [RE]) and was estimated at 3.2 per cent of the GDP in 2009-10 (BE).

Table 1.10 : Contribution to total flow of resources to commercial sector (per cent)

	2007-08	2008-09	2008-09 (Apr.-Jan.)	2009-10
Adjusted Non-food Bank Credit*	44.2	45.7	47.7	39.2
Flow from Non-banks	55.8	54.3	52.3	60.8
Domestic Sources	25.4	34.0	28.1	33.0
Foreign Sources	30.4	20.3	24.2	27.8

Source: RBI.

* Includes Non-food Credit and Non-SLR Investment by SCBs.

1.59 In implementing the fiscal stimulus, the Central Plan expenditure was frontloaded. This is evident from its growth of 34.3 per cent and 18.0 per cent in 2008-09 and 2009-10 (BE), respectively. As a proportion of the GDP, the Plan expenditure at 5.3 per cent of the GDP in 2009-10 (BE) was the highest in recent years. Non-Plan expenditure grew by 19.4 per cent and 14.8 per cent respectively in 2008-09 and 2009-10 (BE).

1.60 The relative success of the fiscal stimulus in supporting effective demand, particularly the consumption demand, in 2008-09 and 2009-10 could be traced to its composition. The approach of the Government was to increase the disposable income in the hands of the people, for instance by effecting reductions in indirect taxes (excise and service tax) and by expanding public expenditure on programmes like the National Rural Employment Guarantee Act (NREGA) and on rural infrastructure. The implementation of the Sixth Pay Commission recommendations and the debt relief to farmers also contributed to this end. The fact that the approach worked is attested to by the GDP growth rate and more specifically by the growth in private consumption demand in 2008-09 and also in 2009-10 as reflected in the relevant data on the NAS new series. Consumption expenditure, by its very nature, has short lags, and affects demand quickly, with little or no effect on productivity, while productive infrastructure expenditure takes much longer to translate into effective demand. The recovery having taken root now necessitates a review of public spending. It has to be geared towards building medium-term productivity of the economy and making up for the decline in investment growth in certain sectors of the economy.

1.61 The recommendations of the Thirteen Finance Commission (FC-XIII) have to be taken on board in shaping the fiscal policy for 2010-11 and in the medium term. The FC-XIII has recommended a calibrated exit strategy from the expansionary fiscal stance of 2008-09 and 2009-10 as the main agenda of the Central Government. Further, it has suggested that the revenue deficit of the Centre needs to be progressively reduced and eliminated, followed by emergence of revenue surplus by 2014-15. Perhaps for the first time, a cap on the overall debt of the Government has been recommended. It has suggested a target of 68 per cent of the GDP for the combined debt of the Centre and the States to be achieved by 2014-15. Thus the fiscal consolidation

path embodies steady reduction in the augmented debt stock of the Centre to 45 per cent of the GDP by 2014-15, and that of the States to less than 25 per cent of the GDP by 2014-15. The FC-XIII has also suggested the need for the FRBM Act to specify the nature of shocks that would require a relaxation of targets under the Act. It has recommended that the share of States in the net proceeds of shareable Central taxes be 32 per cent in each of the financial years from 2010-11 to 2014-15. (see Box 1.1)

Social-sector Development

1.62 Fiscal 2009-10 saw the strengthening of several public initiatives and programmes with a view to cushioning the impact of the global slowdown on the more vulnerable segments of the population in the country. While some of these programmes were a part of the ongoing interventions to give effect to a more inclusive development strategy, there were some measures that were undertaken as a direct response to the slowdown of growth, especially in the tradable sectors of the economy. Thus emphasis in favour of higher allocation to social-sector development given in recent years continued to be reflected in the allocations under the Union Budget 2009-10. The share of Central Government expenditure on social services including rural development in total expenditure (Plan and non-Plan) increased to 19.46 per cent in 2009-10 (BE) from about 10.46 per cent in 2003-04. Similarly, expenditure on social services by General Government (Centre and States combined) as a proportion of total expenditure increased from 19.9 per cent in 2004-05 to 23.8 per cent in 2009-10 (BE). Further, sector-specific increases including in education, health and rural development were reinforced in the Budget allocations for 2009-10.

1.63 A major concern was regarding the possibility of a rise in unemployment due to the slowdown of the economy. While comprehensive employment data for the current financial year are not available, some sample surveys conducted by the Labour Bureau, Ministry of Labour and Employment, Government of India, indicated job losses in the wake of the global financial crisis, which seem to have been reversed in recent months. Thus employment is estimated to have declined by 4.91 lakh during the third quarter (October-December) of 2008; it increased by 2.76 lakh during January-March 2009, followed by a decline of 1.31 lakh during April-June 2009, and then an increase of 4.97 lakh during the second quarter (July-September) 2009. On the whole, for the period October 2008 to September

Box 1.1 : Thirteenth Finance Commission

Following the mandate under the Presidential Order indicating the terms of reference, which flow from the articles 270, 275 and 280 of the Indian Constitution, the FC-XIII submitted its report on December 30, 2009. The FC-XIII's overall approach was to foster "inclusive and green growth promoting fiscal federalism". Observing that as against the level of 75 per cent targeted by the Twelfth Finance Commission, the combined debt-GDP ratio was 82 per cent in the terminal year (2009-10), the FC-XIII focused on anchoring the fiscal consolidation process in a medium-term debt reduction framework. The FC-XIII proposes reducing the combined debt-GDP ratio to 68 per cent by 2014-15 with the Centre's debt-GDP ratio declining to 45 per cent. It recommended a calibrated exit strategy from the expansionary fiscal stance of 2008-09 and 2009-10.

The FC-XIII has recommended fiscal consolidation through the elimination of revenue deficit as the long-term target for both the Centre and States. Following a design similar to that adopted by the recent Finance Commissions, the FC-XIII indicated a normative discipline for both Centre and States; with equal treatment which entailed no automatic priority for any level of Government and a focus on equalization (and not equity). The latter signalled the intent of the FC-XIII to ensure that States and local bodies have the fiscal potential to provide comparable levels of public service at reasonably comparable levels of taxation. This principle does not guarantee uniformity in public services across the country; but it addresses the fiscal requirements of each jurisdiction to enable such uniformity.

Terming the goods and services Tax (GST) as a game-changing tax reform measure which will significantly contribute to the buoyancy of tax revenues and acceleration of growth as well as generate positive externalities, the FC-XIII proposed a grand bargain. The six elements of the grand bargain for the GST included: 1. the design; 2. operational modalities; 3. binding agreement between the Centre and States with contingencies for change in rates and procedures; 4. disincentives for non-compliance; 5. the implementation schedule and; 6. the procedure for States to claim compensation. For this purpose, the FC-XIII recommended the sanction of Rs 50,000 crore as compensation for revenue losses of States on account of the implementation of the GST. This amount would shrink to Rs 40,000 crore were the implementation to take place on/after April 1, 2013 and further to Rs 30,000 crore were it to take place on/after April 1, 2014.

The following are some of the key recommendations of the FC-XIII:

- The share of States in net proceeds of shareable Central taxes shall be 32 per cent every year for the period of the award.
- Revenue accruing to a State is to be protected to the levels that would have accrued to it had service tax been a part of the shareable Central taxes, if the 88th Amendment to Constitution is notified and followed up by a legislations enabling States to levy service tax.
- Centre is to review the levy of cesses and surcharges with a view to reducing their share in its gross tax revenue.
- The indicative ceiling on overall transfers to States on revenue account may be set at 39.5 per cent of gross revenue receipts of the Centre.
- The Medium Term Fiscal Plan (MTFP) should be a statement of commitment rather than intent.
- New disclosures have been specified for the Budget/MTFP including on tax expenditure, public-private partnership liabilities and the details of variables underlying receipts and expenditure projections.
- The Fiscal Responsibility and Budget Management (FRBM) Act needs to specify the nature of shocks that would require relaxation of the targets thereunder.
- States are expected to be able to get back to their fiscal correction path by 2011-12 and amend their FRBM Acts to the effect.
- State Governments are to be eligible for the general performance and special area performance grants only if they comply with the prescribed stipulation in terms of grants to local bodies.
- The National Calamity Contingency Fund (NCCF) should be merged with the National Disaster Response Fund (NDRF) and the Calamity Relief Fund (CRF) with the State Disaster Response Funds (SDRFs) of the respective States.
- A total non-Plan revenue grant of Rs 51,800 crore is recommended over the award period for eight States. A performance grant of Rs 1500 crore is recommended for three special category States that have graduated from a non-Plan revenue deficit situation.
- An amount of Rs 19,930 crore has been recommended as grant for maintenance of roads and bridges for four years (2011-12 to 2014-15).
- An amount of Rs 24,068 crore has been recommended as grant for elementary education.
- An amount of Rs 27,945 crore has been recommended for State-specific needs.
- Amounts of Rs 5,000 crore each as forest, renewable energy and water sector-management grants have been recommended.
- A total sum of Rs 3,18,581 crore has been recommended for the award period as grants-in-aid to States.

2009, there may have been a net addition of 1.51 lakh jobs in the sectors covered under the said surveys.

1.64 Under the NREGA, which is a major rural employment initiative, during the year 2009-10, 4.34 crore households have been provided employment so far. Out of the 182.88 crore person days created under the scheme during this period, 29 per cent and 22 per cent were in favour of Scheduled Caste and Scheduled Tribe population respectively and 50 per cent in favour of women.

Climate change

1.65 While engaging constructively with the international community on the issue of climate change, India has pursued a strong domestic agenda for addressing the issue. The Copenhagen conference on climate change (CoP 15) was held from December 7-18, 2009 to discuss and reach an outcome on climate change issues. At the Copenhagen conference, the Danish Presidency of CoP15 had invited some of the participating countries for a discussion on relevant aspects of climate change and presented the results to the CoP in the form of a "Copenhagen Accord". The CoP did not adopt the results of the discussion and only took note of the "Accord". It has been decided to continue the negotiations with a view to concluding them at the next CoP scheduled in Mexico from November 29 to December 10, 2010. India recognizes that a strategy for addressing climate change has to be based on sustainable development. This is reflected in many of the major programmes addressing climate variability concerns. Current Government expenditure in India on adaptation to climate variability exceeds 2.6 per cent of the GDP, with agriculture, water resources, health and sanitation, forests, coastal zone infrastructure and extreme events being specific areas of concern.

Prospects, Short Term and Medium Term

1.66 There are several factors that have emerged from the performance of the economy in the last 12 months, which, combined with an analysis of performance over the last couple of years, augur well for the Indian economy. There are some deep changes that have taken place in India, which suggest that the economy's fundamentals are strong. First, the rates of savings and investment have reached levels that even ten years ago would have been dismissed as a pipedream for India. On this important dimension, India is now completely a part of the world's fast-

growing economies. In 2008-09 gross domestic savings as a percentage of GDP were 32.5 per cent and gross domestic capital formation 34.9 per cent. These figures, which are a little lower than what had been achieved before the fiscal stimulus was put into place, fall comfortably within the range of figures one traditionally associated with the East Asian economies. In 2007 South Korea had a savings rate of 30 per cent, Japan 28 per cent, Malaysia 38 per cent and Thailand 33 per cent. Since these indicators are some of the strongest correlates of growth and do not fluctuate wildly, they speak very well for India's medium-term growth prospects. It also has to be kept in mind that, as the demographic dividend begins to pay off in India, with the working age-group population rising disproportionately over the next two decades, the savings rate is likely to rise further. Second, the arrival of India's corporations in the global market place and informal indicators of the sophisticated corporate culture that many of these companies exhibit also lend to the optimistic prognosis for the economy in the medium to long run.

1.67 In the medium term it is reasonable to expect that the economy will go back to the robust growth path of around 9 per cent that it was on before the global crisis slowed it down in 2008. To begin with, there has been a revival in investment and private consumption demand, though the recovery is yet to attain the pre-2008 momentum. Second, Indian exports have recorded impressive growth in November and December 2009 and early indications of the January 2010 data on exports are also encouraging. Further, infrastructure services, including railway transport, power, telecommunications and, more recently but to a lesser extent, civil aviation, have shown a remarkable turnaround since the second quarter of 2009-10. The favourable capital market conditions with improvement in capital flows and business sentiments, as per the RBI's business expectations survey, are also encouraging. Finally, and even though it is too early to tell if this is a trend, the manufacturing sector has been showing a buoyancy in recent months rarely seen before. The growth rate of the index of industrial production for December 2009—the latest month for which quick estimates are available—was a remarkable 16.8 per cent. There is also a substantial pick-up in corporate earnings and profit margins.

1.68 Hence, going by simple calculations based on the above-mentioned variables, coupled with the

fact that agriculture did have a set-back this year and is only gradually getting back to the projected path, a reasonable forecast for the year 2010-11 is that the economy will improve its GDP growth by around 1 percentage point from that witnessed in 2009-10. Thus, allowing for factors beyond the reach of domestic policymakers, such as the performance of the monsoon and rate of recovery of the global economy, the Indian GDP can be expected to grow around 8.5 +/- 0.25 per cent, with a full recovery, breaching the 9 per cent mark in 2011-12.

1.69 Given the steadily improving fundamentals of the economy discussed at the start of this subsection, over and above the short-term improvements that occurred during the current fiscal year, the medium-term prospects of the Indian economy are really strong. If, in addition to this, there

are improvements in infrastructure, both urban and rural, and reform in governance and administration, which cuts down bureaucratic transactions costs that slow down enterprise in India and breed corruption, it is entirely possible for India to move into the rarefied domain of double-digit growth and even attempt to don the mantle of the fastest-growing economy in the world within the next four years. If this can be coupled with targeted Government interventions, some of which have recently been undertaken and some that are on the agenda, to include the marginalized segments of the population in this development process, then the ultimate aim of rapid growth, which is to raise the standard of living of the disadvantaged and to eradicate poverty, should also be within reach in the not-too-distant future.

