

**State of the Economy Seminar
Quarterly Review of the Economy**

Press Release

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National Council of Applied Economic Research, New Delhi

The quarterly seminar on the State of the Economy was held at NCAER on July 29, 2010. Mr. Suman Bery, Director General chaired the seminar. The seminar included presentation on the economy the NCAER team and comments by invited experts and discussion by the participants

The presentation by NCAER included a review of trends in the economy and an assessment of the prospects for 2010-11. A brief summary is provided below.

The industrial growth in the first two months of the year has set high expectations for overall economic growth for the current fiscal. From an estimated growth of 7.4 per cent last year, already a remarkable performance, the current fiscal has been projected to exceed that significantly. The government officials have expressed a view that the GDP growth would reach 9 per cent for 2010-11. The Prime Minister's Economic Advisory Council has projected a growth rate of 8.5 per cent. For the first quarter, the expectations are that the GDP growth would reach 9 per cent on the back of a strong industrial growth rate. The global economic recovery has also gained further momentum as indicated by the projection of higher world GDP growth for 2010 by IMF in July as compared to its projections in April. India has also unveiled its currency symbol, `.

Some of the gains from growth have been offset by the more visible high rate of inflation. In the first quarter of the current fiscal year, the WPI based annual inflation rate has exceeded 10 per cent. The opposition political parties have raised protests highlighting the sensitivity of the issue even at the political level. An important aspect of the expectations of high economic growth in the current year is the contribution of growth from the farm sector. On the back of a better monsoon, as compared to the last year, agricultural output growth may be significant as compared to the near stagnant level of output in 2009-10. The higher agricultural production would also arrest the steep increase in the prices of primary articles.

The prevailing high rate of inflation is as much a result of the 'base effect' of low rates of inflation during the early part of 2009-10, as it is the illustration of the need for easing supply constraints. Whether they are related to physical infrastructure or institutional constraints, the impact on raising output is the same. The high levels of Maoist violence in resource rich states, terrorist threats, violent regional neighbourhood imply that growth would not be evenly spread. The case for inclusive growth will become less feasible unless economic activities can be carried with less uncertainty and less transaction cost. The weaknesses in the management of vast

infrastructure are becoming more evident as the accidents and near accidents in the aviation and railways demonstrate. It is increasingly clear that one persistent constraint on economic growth, namely, capital is becoming less binding if the institutional arrangements are more efficient.

The move towards GST and the streamlining of direct tax process are two specific areas of reform which are likely to yield benefits over a long-term when implemented. Improving energy availability would be another key challenge which would relax one of the major constraints to economic activity. Progress in these areas will provide economic gains over long periods of time.

The need for attention to fiscal slippage experienced in the crisis years of 2008-09 and 2009-10 was recognised in the relatively small increase in expenditure growth of the central government in the current year's budget. However, fiscal pressures are evident in moving ahead with the price decontrol of at least one of the petroleum fuels from among those whose retail prices are administered. Without such measures, large subsidies may lead to rationing of fuels.

Against this background of policy concerns on sustaining higher economic growth and the urgent need to moderate inflationary pressures, we present a review of the major developments in the economy in the first quarter of 2010-11. This review also presents a forecast for the main macroeconomic indicators for the current fiscal year.

Agriculture, Industry and Services

Information up to the middle of July reveals that there has been some improvement in rainfall situation as compared to the deficiency in rainfall experienced in the month of June. At the agrometeorological level, 23 sub-divisions covering a little over 51 per cent of all districts had received normal to excess rainfall. The 13 sub-divisions, where rainfall had remained deficient up to the middle of July include - Assam and Meghalaya; Gangetic West Bengal; Orissa; Jharkhand; Bihar, Uttar Pradesh (East and West); Eastern Rajasthan; Madhya Pradesh (East and West); Gujarat region; Chhatisgarh; and coastal Karnataka.

A comparison of the performance of precipitation during the month of June as well as up to the middle of July with last year's monsoon rainfall during the same periods reveals that rainfall has been significantly better this year as against last year's performance, which of course was a year of severe rainfall deficiency.

Review of recent estimates of agricultural output shows that except for fibres, wheat and pulses, in all other major categories of crops, output had declined in 2009-10 as compared to the previous year. In the case of wheat and pulses also, the output was stagnant. What seems to have helped sustain the overall GDP level from agriculture and allied sectors in 2009-10 is the non-crop sector. A review of the prices shows that there is a softening trend in the prices of food items in the first quarter of the current fiscal, led by cereals, fruits, sugar and manufactured food products. Amidst the concerns over high farm product prices is the paradox of large foodgrain stocks with the government. The grain stock with the government may have reached 58 million tonnes at the end of June.

The progress of monsoon suggests that a larger crop harvest in the current year as compared to 2009-10 is more likely.

The expectations of a sustained high growth in the industrial output have also strengthened. In the first quarter of the year, the IIP growth is likely to be around 10 per cent. Manufacturing sector output has recovered rapidly from the crisis it experienced in 2008-09. Consumer durables and capital goods have shown double digit growth rates in the first two months of the year. The fiscal stimulus, in the form of reduction in tax rates, helped in the initial recovery for these sectors. However, return of investor and consumer confidence has led to sustained growth in the demand for these sectors.

In the case of services, telecom remains the out performer among the peers. GDP from the composite category of 'trade, hotels, transport and communication' grew at 12.4 per cent in Q4: 2009-10 as compared to the growth of overall GDP at 8.4 per cent. The service sector output is now driven by the productive sectors rather than the push given by government spending during the period of serious demand crisis in the economy.

Money and Prices

Monetary policy has returned its focus on inflationary pressures from its attention to reviving growth impulses. The Annual Monetary Policy Statement had provided a baseline expectation of overall GDP growth of 8 per cent and WPI based inflation on 5.5 per cent for 2010-11. As the inflation rate remained well above this mark in the first quarter of the year, tightening of policy rates was expected. The strong growth expectations imply that supply of funds will need to keep up with the increased demand. More expensive credit will have to be accompanied by a more efficient credit delivery system. Reforms leading to more transparent pricing of loans, financial inclusion, and expansion of banking sector are on the cards as articulate in the annual policy statement. The first financial stability report of the RBI has also highlighted the need for better supervision of systemically important NBFCs.

The coordinated approach to resolving the global financial crisis would not imply uniform measures across countries but strategies that are differentiated by the context. The fiscal-financial crisis in the Euro area appears to have been contained. But the risks from globalised financial system will need to be managed while benefitting from access to large capital supplies. The monetary policy will continue to be faced with the challenge of managing increased capital inflows at a time when interest rates remain high to deal with high inflation rate. Again, the issue is one of achieving more efficient supply system to facilitate growth.

The international commodity prices have begun to strengthen as global economic recovery takes hold. The higher prices are transmitted to domestic economy. The key commodities for India will remain minerals and crude. In the case of crude expectation is that the prices will remain around \$70 per barrel. The domestic inflation has been led by the primary articles. Favourable agricultural output scenario is one factor that is likely to provide relief from the prevailing double digit inflation rate.

Trade

The July 2010 update of World Economic Outlook by the IMF point to stronger global economic recovery than anticipated a quarter earlier. The developing Asian countries are now expected grow by 9.2 per cent in 2010 which is higher than 8.7 per cent forecast made in April 2010. The growth rates in China and India have been estimated at 10.5 and 9.4 per cent, respectively. World GDP, measured with purchasing power parity (PPP) weights, is likely to have declined by (-) 0.6 per cent in 2009 compared with 3 per cent growth in 2008. In 2010, this growth is expected to accelerate to 4.6 per cent. The volume of world trade which declined by (-) 11.3 per cent in 2009 is expected to grow by 9 per cent during 2010.

For India, the improved global outlook will have positive impact on its trade. The first two months of the current fiscal have posted growth of 35.7 per cent in exports compared with significant decline by (-) 82.8 per cent in April-May of 2008-09. The corresponding values for total imports are 40.9 per cent and (-) 81.8 per cent, respectively; and 31.3 per cent and (-) 80.4 per cent, respectively for non-oil imports. Going forward, trade performance is expected improve substantially both in merchandise and in services trade.

Public Finance

Two important areas in which the developments in quarter have significant implications to fiscal scenario are in the telecom and petroleum sectors. The government has reaped a bonanza from the 3G and BWA auction that was carried out in May 2010. It has been estimated that the government would receive `106,000 crore from the auction much higher than the initial estimate of ` 35,000 crore indicated in the Budget 2010-11. This would help the government to limit its market borrowing budgeted at Rs. 457,000 crore for current fiscal and would reduce fiscal deficit by 1 percentage point from budget estimates of 5.5 percent of GDP- unless of course there is increase in expenditure elsewhere. Second, the decontrol of retail price of petrol and increase in the prices of diesel, kerosene and LPG would mean a significant reduction in the direct or indirect burden of rising subsidies.

The high rate of industrial growth and corporate sector's financial performance should lead to better tax revenue collection during the year. Trends so far support this view. However, the service tax collections have not been very encouraging.

The Review expects that the central government's fiscal position would improve in the current fiscal year as compared to the last two fiscal years. The central tax revenue, particularly the indirect tax collection has improved significantly during the first two months of the current fiscal and it is expected that the trend will continue. There also appear to be measures to control Non-plan revenue expenditure. The successful 3G/BWA auction has offered an opportunity to reduce the fiscal deficit in the current year below the level projected in the budget estimates.

Forecast

Keeping in view the various factors that influence the course of the economy, this Review has projected estimates of some of the key macroeconomic indicators for 2010-11. The assessment includes quarterly estimates of GDP based on simple time series models and annual estimates based on more comprehensive macroeconometric model. The estimates provide a range for the GDP growth.

The overall GDP growth is projected to accelerate from 7.4 per cent in 2009-10 to a range of 8.1 to 8.4 per cent in 2010-11. The annual model provides a lower forecast of 8.1 per cent. GDP from industry is expected to increase by 8.8 per cent and services by 8.7 per cent. The main contributor to the acceleration in growth is agriculture, where GDP is projected to increase by 4.6 per cent. Given the stagnant output level in 2009-10 because of the inadequate and ill-distributed rainfall last year, the agricultural growth rate had suffered. With a normal rainfall this year, we expect agricultural output to show significant increase.

The average inflation rate is projected to double in 2010-11 as compared to 2009-10. However, it is still much lower than the experience in the first quarter so far, when prices have increased by 10.5 per cent. The model results indicate decline in the inflation rate during the course of the year, essentially because of the higher agricultural output and easing of the prices of primary articles. The 'base effect' of high prices of later period of 2009-10 will also bring down the inflation rate. The higher inflation rate has also taken into account the recent increase in the prices of the petroleum sector.

Assessment of the Macroeconomic Scenario for 2010-11

Item	2009-10 RE (for GDP)	2010-11 April	2010-11 July
% YOY change			
Real GDP			
- Agriculture	0.2	4.6	4.6
- Industry	9.3	8.5	8.8
- Services	8.5	8.7	8.7
Total GDP at Factor Cost	7.4	8.1	8.1
Exports (US \$, merchandise)	-3.6	7.2	17.0
Imports (US \$, merchandise)	-2.7	18.3	20.0
Inflation (WPI)	3.7	6.6	6.9
As % of GDP at market prices			
Fiscal deficit of the Centre	6.7	4.3	4.6
Current Account Deficit	2.9	2.8	2.9

Note: The estimates of fiscal deficit for the two projections are not comparable, because of changes in the estimated equations in the model, particularly in the accounting of expenditures. We have retained the previous projections for the sake of completeness in referencing.