

Quarterly Review of the Economy

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The Setting

The global demand conditions are expected to remain weak through the year 2009 and a recovery of economic growth is expected only in 2010. The rate at which the growth decelerated may be reducing but the turning point from this decline appears to be distant. However, for China and India, the two major developing countries of Asia, the outlook for growth is improving.

Indian economy bore the shocks of global crisis mainly in the second half the financial year 2008-09. Industrial output experienced decline on year-on-year basis towards the end of FY 09. The overall GDP growth for the full year was at respectable 6.7 per cent as a result of better performance in the first half of FY 09. The difference in the economic environment between the first and the second halves of FY 09 was sharp. The second half represented slow growth and decline in the inflation rate. In the first half both were at a high level. The policy responses were also in contrast. The first half saw continued tightness of monetary policy while the second half experienced reduction in interest rate and cash or liquidity requirements of the commercial banks. The fiscal policy remained expansive and it proved to be appropriate in the context of the weak demand conditions of the second half of the year.

The economic policy across the developed and developing countries was focused on stabilising financial markets and demand conditions. Designing and implementing fiscal stimulus has been a key pre-occupation of the governments. In India also, government spending increased sharply during FY 09. The increase was in sharp contrast to the deceleration in revenues leading to a large fiscal deficit of 6 per cent of GDP. While the government expenditure growth accelerated towards the end of the year, the impact of the expansion on industrial output was yet to be felt.

Following the general elections in April-May this year, the new government has assumed office at the Centre and the full budget for the current financial year 2009-10 has been presented to the Parliament. Although the budget was expected to remain supportive of the policies to revive the economic growth in a sustained manner, the choices available with respect to strategies were limited by the need to maintain the current growth momentum as well. In this sense, continuation of high deficit in the government account could not be avoided. The budget has projected a fiscal deficit of 6.8 per cent of GDP and increased expenditures well above Rs 60,000 crore over the Interim Budget presented in February. A key concern with respect to the strategy of maintaining expansionary expenditure path is the impact it may have on the recovery of private expenditure, particularly on investment.

While the global uncertainties on economic recovery remain, rainfall for the year has also been deficient in the first two months of the current monsoon. Although the availability of foodgrain supplies is not a concern, thanks to the 50 million tonnes plus stock with the government, the impact of a weak monsoon on rural demand would remain adverse.

These factors are shaping the development of the economy in the current year. In the various sections of this review we summarise the developments in the quarter ending June 2009 and discuss the prospects for the economy for the remainder of the economy.

Agriculture

Comparing the performance of monsoon rainfall up to the middle of July over the last five years, it turns out that rainfall this year, has been inadequate in the eastern and northern regions. At the all-India level the rainfall index for the period June 1 to the third week of July is 18 per cent below the long-term average. However, if the pick up of the monsoon in the recent weeks continues, it is likely that the agricultural sector may witness some growth in 2009-10.

The budget for the current year has allocated significant level of resources to rural development. However, the increase in resources is relatively modest when we compare to the actual expenditures of the previous year. However, the budget also provides some positive stimulus to agriculture in terms of focus on improving the flow of institutional credit and streamlining fertiliser subsidies.

Industry and Services

The deceleration in industrial growth has been sharp in the fiscal year 2008-09 and the output performance of the sector has remained weak in the first two months of the first quarter of the current fiscal. The IIP growth declined to 1.9 per cent during April-May 2009-10 as compared to 5.3 per cent during the corresponding period of 2008-09. Industrial production is expected to recover in the first quarter of 2009-10 due to strong domestic demand, signs of recovery by global macro economic indicators and stimulus packages of the government.

Across the diverse industrial sector, a few industries have performed well even in the difficult times of last year. Rural demand and infrastructure spending are said to be the factors which have sustained demand growth in these sectors.

Infrastructure has remained both a constraint and an opportunity for the economy. The incentives and development programs for the sector now available are an opportunity to build the infrastructure for the future. The output performance of the core or infrastructure industries in the first two months of FY 10 has exceeded the performance in the same period last year.

The services sector GDP has recorded a growth of 9.7 per cent even as agriculture and industry recorded steep decline in growth. However, within the services, the sectors that are closely associated with the industrial activity have seen significant decline in growth rates in the second half of FY 09. The government related services have shown sharp increase in the second half of the year.

There is some evidence in the pattern of growth in the industry and services sectors that the impact of the fiscal stimulus measures is yet to be fully transmitted as demand for their output. Such impact may be felt in the early months of the new financial year.

Money and Capital Markets

The international financial markets are getting back to work again slowly. The policies have attempted to stabilise these markets and also provide support to the sectors which have been adversely affected by the collapse of the financial markets. The reduction in interest rates, easier access to credit where needed have been some of the policy responses. In the Indian context the responses appear to be slow. Despite the reduction in head line WPI inflation rate now to near zero, the reduction in actual lending rate has not kept pace with the decline in inflation rate or the changes in global interest rates. Response of the market rates to policies has also not been easy to decipher. A reflection of these concerns has been a move by the RBI to set up a Working Group to review the present Benchmark Prime Lending Rate system to make credit pricing more transparent

There are some signs of change in the direction of the markets in the form of capital market indicators. The Sensex, after a prolonged bearish phase has made some recovery.

Prices

The divergence between WPI and Consumer Price Indices (CPI) are sharp. While the WPI trend is to the sub-zero zone, in the case of CPI, the double digit rates are not far off. Clearly, the primary articles and within this group the cereal items are keeping the consumer basket more expensive. The global price trends have followed

the boom and bust of the markets. The current trends provide a benign opportunity for adjustments in the economy to achieve greater competitiveness. However, the window of low inflation may not be open for long.

External Markets

Despite some signs of economic revival, the global economic growth is expected to contract by (-) 1.4 per cent in 2009, which is slightly lower than the forecast of (-) 1.3 per cent made by the IMF in April 2009. The volume of world trade is expected to dip in 2009 for the first time since 1982. The fall may be as high as (-) 12.2 per cent. This would have concomitant effect on exports of developing countries which would shrink by (-) 6.5 per cent though the major hit would be taken by the advanced countries with exports declining by (-) 15.0 per cent.

The slump in exports and high priced crude oil in the first half of the year meant high external imbalances. Merchandise trade deficit touched \$119.4 billion in 2008-09, up by 30.3 per cent over 2007-08. The current account deficit increased by 75 per cent, touching \$29.8 billion, i.e. 2.6 per cent of GDP. The net invisible receipts continued to narrow the gap in external accounts.

The capital flows in the form of FDI remained strong in FY 09.

The Central Budget does provide some support to the exporters who face weak markets. Their costs would have to be kept under check to maintain price margins. The budget measures aim to provide access to credit and reduce the cost of credit to the exporters.

Public Finance

With the many sectors of the economy in need of fiscal support, the budget could not have been completely insulated from these concerns. The large fiscal deficit is a reflection of the reality in terms of the projected weak revenue growth and the need for an expansionary fiscal policy in terms of maintaining expenditure growth. The need for a credible strategy to unwind the high deficit would clearly be linked to the prospects for growth. The two are strongly inter-linked and constant monitoring of the growth impact of fiscal position and timely responses are necessary for the success of the strategy.

Forecast

Taking into account the developments since the previous forecast for 2009-10 in April, this review presents a revised assessment of the prospects for the economy. Some of the key changes since the previous forecast are the deficient rainfall, more expansive Central government budget and further deterioration in the global market conditions. Incorporating these changes and revision of some of the other parameters, the overall real GDP growth for 2009-10 is projected at 7.2 per cent. Inflation rate, based on WPI, is projected at 3.7 per cent. The fiscal deficit of the Centre is projected at 6.2 per cent and current account deficit at 2.6 per cent of GDP. Details of the forecast are in Table 1.

Table 1: Re-assessing the macroeconomic scenario for 2009-10

Variables	Projections in April 2009 for 2009-10		Current Projections for 2009-10
	Base scenario	Alternative Scenario	
% Change YOY			
Real GDP at Factor Cost			
Agriculture	2.5	2.5	1.0
Industry	6.0	6.3	6.7
Service	7.9	8.5	9.4
Total	6.5	6.9	7.2
Goods Exports (\$ value)	9.1	9.1	12.0
Goods Imports (\$ vale)	5.0	10.0	5.5
Inflation (WPI based)	5.2	5.2	3.7
As % of GDP at Current Market Prices			
Fiscal deficit (Centre)	4.4	4.5	6.2
Current Account deficit	2.9	3.5	2.4