Re-assessing the Macro-economic Scene for 2013–14

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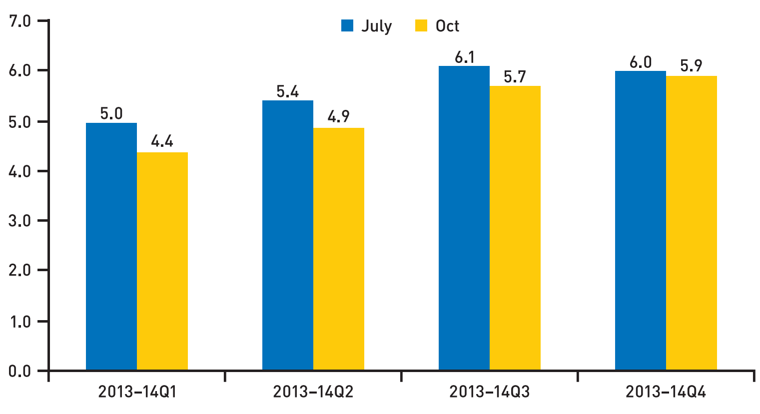
BACKDROP

THE ECONOMIC FUNDAMENTALS of the Indian economy continue to remain weak despite several policy initiatives taken by the government during the past few months. Official estimates show that the Gross Domestic Product (GDP) at factor cost in constant 2004–05 prices recorded a mere 4.4 per cent growth in Q1 of 2013–14. India's economic output contracted significantly during the first quarter of the current fiscal, largely due to steep fall in private investment as well as private consumption expenditure. While the GDP growth of industry and the services sector declined in Q1 of 2013–14 compared with the corresponding quarter of the previous fiscal year, agriculture registered fairly steady growth during the same period.

According to data released by the Centre for Monitoring Indian Economy (CMIE), new investment announcements at ₹784 billion were 32 per cent lower during 2013–14:Q1 than the average of ₹1.1 trillion for the comparable period of 2012–13, while in the manufacturing sector new proposals slipped by 47 per cent over its level a year ago. Weakening private investment is also explained by the continuous decline in business confidence. The NCAER-MasterCard Business Expectations Survey reveals that the business confidence index has been declining continuously since April 2012, mainly due to overall weak economic conditions and an unfavourable business environment. Gross fixed capital formation also registered negative growth owing to a policy logjam, an unfavourable business environment and a slowdown in economic growth. Private consumption, on the other hand, has been hammered down by persistent food inflation and a decline in real income.

Figure F.1: Quarterly GDP Growth Rate Forecast for 2013–14



Source: Data from CSO, Government of India.

Wholesale Price Index (WPI) inflation, after remaining low during the first few months of 2013, picked up and moved beyond six per cent in August 2013. As usual, the major driver of inflation is food inflation. The prices of food articles, which were around six per cent at the beginning of the current fiscal, increased nearly three times in August. Heavy rainfall and floods in different parts of the country have not only damaged crops but also disrupted the supply chain of commodities, leading to scarcity and price increases.

The economy also faces serious challenges on the external front where the Rupee plummeted to a historic low of 68.85 against the US dollar on August 28, 2013. Both domestic and external factors contributed to the depreciation of the Rupee. Weak domestic growth, large oil imports and global factors, such as the crisis in Syria and the likely tapering of quantitative easing in the United States, contributed to the decline of the Rupee. The depreciating rupee and rising international crude oil prices have put huge pressure on India's current account deficit given that the country imports nearly 80 per cent of its oil requirements. In addition, the steady rise in the oil subsidy bill will put an extra burden on the central government's finances and push the fiscal deficit beyond budget estimates.

To sum up, while the risk factors to growth have become amplified, the positive factors have weakened. The government and the central bank have taken a few policy initiatives to avoid the external crisis, but that may not be good enough to lift economic growth from its present lows.

ECONOMIC PROSPECTS FOR 2013–14

Two approaches were used to examine the emerging scenario for 2013–14: (1) a quarterly model GDP that incorporates some inter-sectoral relationships and the evolution patterns of variables over time and (2) a more detailed annual macro-econometric model.

QUARTERLY GDP GROWTH IN 2013–14

The quarterly projections for 2013–14 are based on several assumptions about the exogenous variables and also update high frequency exogenous variables up to July/August 2013, which are summarised in Figure F.1.

GDP growth rate at 2004–05 constant prices is estimated at 5.3 per cent for 2013–14, which is a downward revision of 0.4 percentage points over our July 2013 estimate of 5.7 per cent. There is a downward revision in the GDP growth rate in all three quarters compared to our previous estimate in July 2013. This is mainly due to a contraction of output in industry and services. While agricultural output is revised up from 3.3 per cent in July to 4.1 per cent in the current estimates due to better rainfall, industrial growth is revised down to 2.9 per cent from earlier estimates of 4.5 per cent in July 2013. The services sector growth rate is also revised down from 6.8 per cent in July 2013 to 6.6 per cent in the current estimates. In the current estimates, rainfall is assumed at three per cent above normal compared to our earlier assumption of a normal monsoon. We retain our earlier assumption of a marginally better capital market (BSE). Bank credit to the commercial sector assumes a lower growth rate of 15 per cent compared to our earlier assumption of around 16 per cent in the current fiscal on account of the recent hike in the policy rate. We retain our earlier assumption of 16.4 per cent year-on-year (yoy) growth in central government expenditure over the Revised Estimates of the previous fiscal. Our estimates show WPI inflation at 6.5 per cent for the current fiscal, up 0.4 percentage points over previous estimates.

ANNUAL ASSESSMENT FOR 2013–14

The current annual forecast (5.2%) is the second revision of real GDP growth rate for 2013–14 after the preliminary forecast presented in July 2013. We had projected real GDP growth at 5.9 per cent in July 2013. The current forecast incorporates changes in key macroeconomic parameters during the past three months.

The key assumptions on which the forecast is based are: 1) world GDP growth is assumed to decline to 2.9 per cent from the earlier estimate of 3.1 per cent in July; 2) international crude oil prices assume no yoy growth in October; 3) non-fuel commodity prices in the international markets also retain the earlier assumption of no yoy change; 4) foreign direct investment net inflows and net invisibles assume yoy 10 per cent and eight per cent increase, respectively, in 2013–14, while foreign institutional investment inflows are retained as earlier; 5) the domestic energy price index assumes yoy increase of 5.6 per cent in 2013–14; 6) the BSE Sensex retains the earlier assumption of five per cent yoy growth; and 7) interest rate retains its earlier assumption of no further moderation and LIBOR also retains the earlier assumption at 2.03 per cent, while exchange rate assumes a significant 9.5 per cent depreciation in the current estimate over July. We have retained the earlier assumption on government finances, subsidies and tax collection. In addition to the above assumptions, we have made an intercept adjustment in private investment functions to capture the decline in investment on account of the rising under-recovery of oil marketing companies.

The revised assessment of the key macroeconomic parameters for 2013–14 are summarised in Table F.1.

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Table F.1: GDP Forecast for 2013–14

Year-on-Year per cent Change	July 2013 Forecast	October 2013 Forecast
Real GDP		
- Agriculture	3.2	3.9
- Industry	4.3	3.9
- Services	7.1	6.1
Total	**5.9**	**5.2**
Exports ($ value)	9.4	11.0
Imports ($ value)	12.4	13.1
Per cent of GDP at Market Prices		
Inflation (WPI)	5.9	6.8
Current Account Balance*	-4.6	-4.5
Fiscal Deficit (Centre)	5.1	5.1

Note: Forecast based on Annual Model. * Surplus (+)/deficit (-)
Source: NCAER, New Delhi.