State of the Economy and Prospects

CHAPTER 1

The Indian economy has emerged with remarkable rapidity from the slowdown caused by the global financial crisis of 2007-09. With growth in 2009-10 now estimated at 8.0 per cent by the Quick Estimates released on 31 January 2011 and 8.6 per cent in 2010-11 as per the Advance Estimates of the Central Statistics Office (CSO) released on 7 February 2011, the turnaround has been fast and strong. Growth is strong in 2010-11(as per the Advance Estimates) with a rebound in agriculture and continued momentum in manufacturing, though there was a deceleration in services caused mainly by the deceleration in community, social, and personal services, reflecting the base effect of fiscal stimulus in the previous two years. That there has been a deceleration in industry and manufacturing, in particular, as indicated by index of industrial production (IIP) data pertaining to November 2010 is a matter of some concern. However, buoyancy in other indicators of industrial performance and the short-run nature of the IIP slowdown suggest that the deceleration is more in the nature of road bumps than indication of any long-run problem. The medium- to long-run prospect of the economy, including the industrial sector, continues to be positive. On the demand side, a rise in savings and investment and pickup in private consumption have resulted in strong growth of the gross domestic product (GDP) at constant market prices at 9.7 per cent in 2010-11. A sequenced and gradual withdrawal of the monetary accommodation is helping contain inflationary pressures. Inflation which remained at elevated levels for a large part of the current fiscal was largely driven by food items, though the goods that were inflating at the start of the fiscal year were different from the goods for which prices are rising now. Notwithstanding the tightening money markets and moderate growth in deposits, the financial situation remained orderly with a pickup in credit growth, vibrant equity market and stable foreign exchange market. A moderation in the current account of balance-of-payments position is likely with deceleration in imports and acceleration in exports as per latest monthly merchandise trade data. Though downside risks of global events, particularly movement in prices of commodities like crude oil (exacerbated by political turmoil in the Middle East), remain, the Indian economy is poised to further improve and consolidate in terms of key macroeconomic indicators.

1.2 It is important to note here that during the immediate past three years, the Indian economy has been severely buffeted by, but has successfully withstood, two shocks in rapid succession: (a) a collapse in world growth, finances, and trade with the onset of the global financial crisis in 2007-09 whose ripple effects continued into 2009-10 and persisted into 2010-11 (with fiscal stresses in Europe); and (b) domestically, following a year of negative growth in agriculture and allied sectors in 2008-09, erratic monsoons resulted in a severe drought in 2009-10 and unseasonal late rains affecting the winter season crops in 2010-11.

1.3 This period of economic stress has severely tested citizens and policymakers alike. Yet the Indian economy is coming through with resilience and strength. While some clouds linger—such as

0.1 KEY INDICATORS

	Data categories and components	Units	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
1	**GDP and Related Indicators**							
	GDP (current market prices)	₹ crore	3692485	4293672	4986426	5582623[PE]	6550271[QE]	7877947[AE]
	Growth Rate	%	13.9	16.3	16.1	12.0	17.3	20.3
	GDP (factor cost 2004-05 prices)	₹ crore	3254216	3566011	3898958	4162509[PE]	4493743[QE]	4879232[AE]
	Growth Rate	%	9.5	9.6	9.3	6.8	8.0	8.6
	Savings Rate	% of GDP	33.5	34.6	36.9	32.2	33.7	na
	Capital Formation (rate)	% of GDP	34.7	35.7	38.1	34.5	36.5	na
	Per Cap. Net National Income (factor cost at current prices)	₹	27123	31198	35820	40605	46492	54527
2	**Production**							
	Foodgrains	Mn tonnes	208.6	217.3	230.8	234.5	218.1[a]	232.1[b]
	Index of Industrial Production [c] (growth)	Per cent	8.0	11.9	8.7	3.2	10.5	na
	Electricity Generation (growth)	Per cent	5.2	7.2	6.4	2.8	6.0	na
3	**Prices**							
	Inflation (WPI) (12 month average)	% change	4.3	6.5	4.8	8.0	3.6	9.4[d]
	Inflation CPI (IW) (average)	% change	4.4	6.7	6.2	9.1	12.4	11.0[d]
4	**External Sector**							
	Export Growth (US$)	% change	23.4	22.6	29.0	13.6	-3.5	29.5[e]
	Import Growth (US$)	% change	33.8	24.5	35.5	20.7	-5.0	19.0[e]
	Current Account Balance (CAB)/GDP	Per cent	-1.2	-1.0	-1.3	-2.3	-2.8	na
	Foreign Exchange Reserves	Us$ Bn.	151.6	199.2	309.7	252.0	279.1	297.3[f]
	Average Exchange Rate	₹ / US$	44.27	45.25	40.26	45.99	47.42	45.68[g]
5	**Money and Credit**							
	Broad Money (M_3) (annual)	% change	16.9	21.7	21.4	19.3	16.8	16.5[h]
	Scheduled Commercial Bank Credit (growth)	% change	30.8	28.1	22.3	17.5	16.9	24.4[h]
6	**Fiscal Indicators (Centre)**							
	Gross Fiscal Deficit	% of GDP	4.0	3.3	2.5	6.0	6.3[i]	4.8
	Revenue Deficit	% of GDP	2.5	1.9	1.1	4.5	5.1[i]	3.5
	Primary Deficit	% of GDP	0.4	-0.2	-0.9	2.6	3.1[i]	1.7
7	**Population** (Year-wise projected propultion as on 1st Oct.)	Million	1106 (2005)	1122 (2006)	1138 (2007)	1154 (2008)	1170 (2009)	1186 (2010)

AE GDP figures for 2010-11 are advance estimates; [PE] Provisional Estimates. [QE] quick estimates.

na not yet available / released for 2009-10.

[a] Final estimates.

[b] Second advance estimates.

[c] The annual growth rates have been recompiled from 2005-06 onwards since the indices have been recompiled from April 04 onwards using new seried of WPI for the IIP items reported in value terms.

[d] Average Apr.-Dec. 2010.

[e] Apr.-Dec. 2010.

[f] as of December 31, 2010.

[g] Average exchange rate for 2010-11 (Apr.-Dec. 2010).

[h] Provisional.

[i] fiscal indicators for 2009-10 are based on the provisional actuals for 2009-10.

continued high food inflation and a temporary slowdown in industrial growth the dynamism in overall growth is evident, even as a series of social protection measures have considerably strengthened the ability to withstand shocks. These results owe to the counter-cyclical macroeconomic policies, structural measures to promote growth, social spending to provide a stronger foundation to protect the poor and, as always with economic progress, some luck in the form of good weather and slow but steady recovery of the global economy. In each of these areas, enormous progress was made during this crisis, and valuable lessons learnt for the future.

1.4 The estimated level of growth in the GDP at constant 2004-05 prices at factor cost (real GDP) in 2010-11 was composed of: growth of 5.4 per cent in agriculture, which rebounded from a downturn in the previous year; growth of 8.1 per cent in industry, which had a growth of 8.0 per cent in 2009-10; and a decelerated growth of 9.6 per cent in services as against 10.1 per cent in 2009-10 (Table 1.1). On the demand side, the GDP at constant prices (2004-05) at market prices is estimated to grow by 9.7 per cent. Four distinct facts emerge out of the recent macroeconomic data. First, adjusted for the base effect on community, social, and personal services, the services sector with a share of 57.3 per cent in 2009-10 has finally started to gather momentum and given the fact that it has been the power house of the Indian growth story, this portends well for the medium-term prospects. Second, the savings rate has gone up to a level of 33.7 per cent and investment rate is up to 36.5 per cent of the GDP in 2009-10, which, given the incremental capital-output ratio of about 4, indicates prospects of sustained output growth. Third, there is a marked deceleration in industry as per recent monthly IIP data, decline in imports and signs of headline inflation remaining at elevated levels given the geopolitical risks in Middle East. All these could have implications for slowing down the momentum albeit in the short run. Fourth, fiscal policy is on the consolidation path with revenues doing well on the strength of the rebound in economic activity and, going forward, this is likely to yield growth dividends in the medium to long term setting in motion a virtuous cycle.

1.5 Headline inflation, year-on-year, as measured by the wholesale price index (WPI), remained at elevated levels from December 2009, even though it has, by and large, been on a downward trajectory since April 2010, when WPI inflation peaked at 11 per cent year-on-year. Inflation stood at 8.23 per cent in January 2011. The financial-year build-up (from March 2010) remained at 7.44 per cent upto January 2011. Inflation in primary articles, particularly food articles, was the main contributor to the elevated levels of WPI inflation. With diminishing base effect, there was gradual moderation in overall WPI inflation in November 2010 when it was placed at 7.48 per cent; there was a rise again in December 2010, driven mainly by certain food articles (fruits and vegetables, milk, egg, meat and fish) and also petroleum products. A series of steps, both structural and macroeconomic, was taken to combat the rising food inflation.

1.6 On the basis of weekly data on prices, inflation in food articles remained in double digits for 76 weeks from 5 June 2009; after briefly ruling below the double-digit mark for three weeks between 20 November 2010 and 4 December 2010, it again was in double digits trending higher with inflation at 17.05 per cent on 22 January 2011. Between 15 January 2010 and 19 June 2010 it was ruling above 20 per cent in 22 weeks out of 23. While food inflation had remained high even last year, compositionally the higher

Table 1.1 : Growth in GDP at factor cost at 2004-2005 prices (per cent)

	2005-06	2006-07	2007-08	2008-09[PE]	2009-10[QE]	2010-11[AE]
Agriculture, Forestry & Fishing	5.1	4.2	5.8	-0.1	0.4	5.4
Mining & Quarrying	1.3	7.5	3.7	1.3	6.9	6.2
Manufacturing	10.1	14.3	10.3	4.2	8.8	8.8
Electricity, Gas & Water Supply	7.1	9.3	8.3	4.9	6.4	5.1
Construction	12.8	10.3	10.7	5.4	7.0	8.0
Trade, Hotels, Transport & Communication	12.1	11.7	10.7	7.6	9.7	11.0
Financing, Insurance, Real Estate & Business Services	12.7	14.0	11.9	12.5	9.2	10.6
Community, Social & Personal Services	7.0	2.9	6.9	12.7	11.8	5.7
GDP at Factor Cost	9.5	9.6	9.3	6.8	8.0	8.6

Source : CSO.

inflation this year is different; last year the main drivers were pulses, cereals, and sugar which could be attributed to monsoon deficiency, whereas this year inflation seems to be driven by demand factors despite higher supply levels. Inflation as measured by consumer price indices, wherein greater weights are assigned to food items, rose sharply to reach peak levels in January 2010; thereafter it has moderated broadly in tandem with movements in WPI inflation.

1.7 The inflationary pressures on the domestic front are likely to be exacerbated by the higher levels of global commodity prices and also the easy money policy being followed in several industrial nations trying to jump-start their own economies. The International Monetary Fund (IMF) forecast (as per the January 2011 World Economic Outlook [WEO] update) indicates the likely continuance of high consumer price inflation for emerging and developing economies in 2011 due to continued robust demand and a sluggish supply response to tightening market conditions. The IMF has also upped its baseline projection for petroleum prices from US $ 79/bbl in WEO October 2010 to US $ 90/bbl in the January update of the WEO. Non-oil commodity prices are forecast to increase by 11 per cent in 2011. The update also indicated that near-term risks were now on the upside for most commodity classes and for some emerging economies that had grown rapidly there was danger of overheating on account of closing of output gaps.

1.8 The IMF has revised upwards the global growth projections, which are placed now at 4.4 per cent in 2011. The Indian economy is estimated to grow by 8.4 per cent in 2011 following a growth of 9.7 per cent in 2010 (in terms of GDP at constant market prices). Under the baseline scenario in which contagion from the financial turmoil in the euro area is contained, emerging market capital inflows are expected to remain strong and financial conditions robust. Key risks to emerging markets as per the update relate to overheating, a rapid rise of inflationary pressures, and the possibility of a hard landing.

Review of Economic Developments

Growth broad based, recovery on firmer footing

1.9 In its Quick Estimates released on 31 January 2011, the CSO revised growth in real GDP for 2009-10 from a level of 7.4 per cent to 8.0 per cent {these revisions take into account the new series of WPI with base 2004-05 and also subsequent revision in Index of industrial production (IIP)}. Growth in real GDP for 2008-09 also stands revised to 6.8 per cent (up by 0.1 percentage point). Compositionally, there are significant changes in the GDP as per the Quick Estimates with growth in agriculture at 0.4 per cent (0.2 per cent as per the Revised Estimates); growth in industry of 8.0 per cent as against 9.3 per cent in the Revised Estimates and a sharper rise in growth in services at 10.1 per cent as against the 8.5 per cent indicated in the Revised Estimates. Growth in GDP at factor cost current prices was placed at 16.1 per cent in the Quick Estimates as against a level of 12.2 per cent suggested by the Revised Estimates.

1.10 The Quick Estimates also indicate the extent of overall inflation as measured by the GDP deflator and the sectoral composition. Agriculture and allied activities were estimated to have grown by 17.3 per cent in terms of current prices in Quick Estimates 2009-10 (as against 11.8 per cent in Revised Estimates 2009-10). With growth in terms of constant prices at 0.4 per cent, the implicit inflation is placed at 16.8 per cent. In so far as the growth rates in industry are concerned, the revision was smaller and the implicit inflation is placed at 2.8 per cent in 2009-10. In services as per the revisions in growth in current and constant prices implicit inflation of 7.6 per cent in 2009-10 is indicated (3.8 per cent as per the Revised Estimates). The level of inflation as measured by the implicit GDP deflator have risen resulting in widening of the differential in growth between current and constant prices for key macroeconomic indicators (Figures 1.1 and 1.2).

1.11 The CSO has released the Advance Estimate of GDP for 2010-11 on 7 February 2011. The Indian economy grew robustly in the current financial year and is on firmer footing. With growth in real GDP at 8.6 per cent in 2010-11, which followed a revised growth of 8.0 per cent in 2009-10 and 6.8 per cent in 2008-09, the economy has moved closer to the pre-crisis levels. The decomposition of growth in 2010-11 indicated that it was relatively broad based across the major sub-sectors in industry and services, besides the rebound in agriculture. Agriculture is estimated to grow relatively rapidly on the strength of growth of 6.5 per cent in foodgrains; 11.9 per cent in oil seeds; 41.2 per cent in cotton; 15.2 per cent in sugarcane; 4.1 per cent in fruits; and 3.8 per cent in vegetables. This should help arrest the food price situation if demand does not rise at faster rates. Growth in industry was rapid in the first half of the

Figure 1.1 **Growth in GDP at FC at current and constant prices and inflation based on deflator**

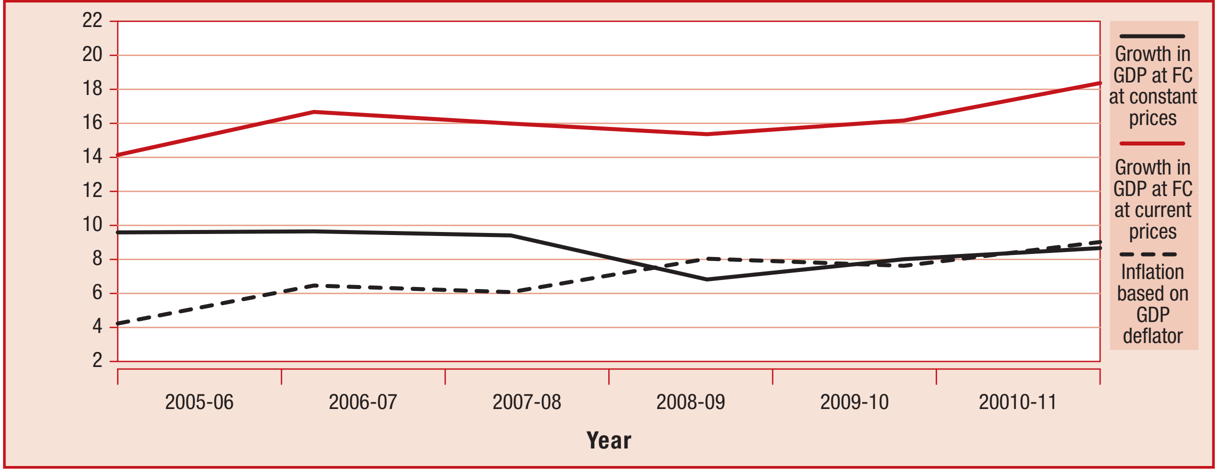
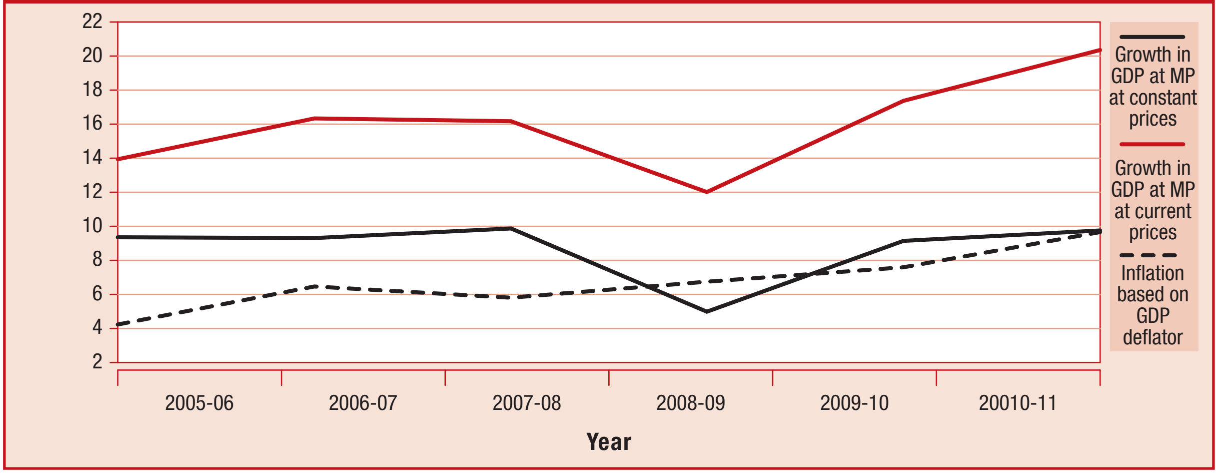


Figure 1.2 **Growth in GDP at MP at current and constant prices and inflation based on deflator**



current fiscal in terms of national accounts as well as the IIP. Robust performance in terms of key indicators in telecom services, civil aviation, and financial services and the level of growth in services excluding community, social, and personal services in the current fiscal indicates brighter prospects for next year. With manufacturing estimated to remain at about the same levels as last year and a pickup in the construction sector estimated to offset the deceleration in the other sub-sectors, growth in industry is estimated to remain at more or less the same levels of 8 per cent that obtained last year. A part of the deceleration in year-on-year growth as per the monthly IIP data owes to the large base effect; but the quarter-on-quarter sequential deseasonalized index movements also reflect a positive but weak momentum, which needs close monitoring.

Quarterly trend

1.12 The revisions to the annual GDP estimates between the Quick Estimates released on 31 January 2011 and the Revised Estimates for 2009-10 released in May 2010 indicate some likely revisions in the quarterly GDP estimates for the current and previous years. These revisions to quarterly GDP are likely to be made available at a later date. The available data (reported also in the Mid-year Analysis 2010) indicated a robust growth momentum with growth in real GDP at 8.9 per cent in each of the first two quarters as well as the first half of the current fiscal. The growth in real GDP and its broad based nature indicated that economic recovery that began in 2009-10 has gathered momentum and is at the robust level that obtained prior to the global crisis. Growth in the GDP at constant market prices is placed at 10.4 per cent in the first half of the current fiscal. That fiscal stimulus packages were central to the recovery as attested by the demand-side aggregates, was reported in detail in the Mid-year Analysis 2010.

Aggregate demand and its composition

Pickup in private consumption and investment driving rebound in demand

1.13 The expenditure estimates of the GDP (at constant market prices) reveal the dimensions of the impact of the global crisis on the Indian economy. Though the crisis deepened only in the second half of 2008-09, the demand-side GDP grew at much lower levels than the supply-side GDP (at constant prices at factor cost) on quarterly basis and year-on-year it was placed at one-half the levels of 2007-08. The revisions to the GDP data effected by the Quick Estimates for 2009-10 entailed a change in the dimensions of the impact of the crisis and the subsequent recovery that was documented in the earlier editions of the Economic Survey. The deceleration in growth in private final consumption expenditure was lower in 2008-09 than reported earlier; the fiscal stimulus was only moderate with growth in Government final consumption expenditure at 10.7 per cent in 2008-09 (as against 16.7 per cent in the Quick Estimates of 2008-09). The real impact of the fiscal stimulus measures was felt in 2009-10 with a growth in Government final consumption expenditure at 16.4 per cent. Gross capital formation was estimated to have fallen sharply in 2008-09 and recovered equally sharply in 2009-10, mainly attributable to change in stocks. Growth in exports was also revised downwards for 2008-09 and 2009-10. Imports were also estimated to have declined only marginally by 1.8 per cent as against 17.2 per cent indicated in the Advance Estimates.

1.14 Demand-side GDP as measured at constant market prices is estimated to grow by 9.7 per cent in 2010-11 (Table 1.2); in terms of current market prices (nominal GDP) it is placed at 20.3 per cent. At constant market prices, while total consumption expenditure and capital formation are estimated to decelerate year-on-year in 2010-11, with private final consumption expenditure picking up, Government final consumption expenditure decelerating sharply owing to base effect and a pickup in gross fixed capital formation and net exports compositionally positive shifts are indicated. Inflation measured by the GDP deflator implicit in the demand- side estimates for 2010-11 is at 9.6 per cent. Similar estimates based on the levels of growth in the GDP at factor cost at constant and current prices was at 9.0 per cent.

1.15 The levels of shares and contribution to growth of key demand-side aggregates do indicate that in 2008-09, the demand slowdown was largely explained by gross capital formation and net exports (Table 1.3). The rebound in demand-side GDP in 2009-10 was also explained by the two and was obtained in the face of reduced levels of contribution to growth from private final consumption expenditure. A decomposition of the growth in private final consumption expenditure indicates that the sub-group food, beverages and tobacco with a share of over 30 per cent in private final consumption

Table 1.2 : Growth in GDP at constant market prices

		2005-06	2006-07	2007-08	2008-09[PE]	2009-10[QE]	2010-11[AE]
1.	**Total final consumption expenditure**	8.6	7.6	9.3	8.2	8.7	7.3
	1.1 Private final consumption expenditure	8.5	8.3	9.3	7.7	7.3	8.2
	1.2 Government final consumption expenditure	8.9	3.7	9.5	10.7	16.4	2.6
2.	**Gross capital formation**	16.3	15.3	17.2	-3.1	13.8	8.8
	2.1 Gross fixed capital formation	16.2	13.8	16.2	1.5	7.3	8.4
	2.2 Changes in stocks	26.9	31.5	31.1	-48.6	90.8	7.1
	2.3 Valuables	-1.4	13.7	2.8	26.9	54.2	19.5
3.	**Exports**	25.8	20.0	5.9	14.4	-5.5	12.0
4.	**Less Imports**	32.5	21.3	10.2	22.7	-1.8	6.3
5.	**Discrepancies**	33.6	35.5	124.8	-140.9	-133.6	-220.2
	Growth in GDP at 2004-05 market prices	9.3	9.3	9.8	4.9	9.1	9.7

Source : CSO.

Table 1.3 : 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	9.3	9.8	4.9	9.1
Consumption (Private)		8.5	8.3	9.3	7.7	7.3
Consumption (Govt)		8.9	3.7	9.5	10.7	16.4
Gross Fixed Capital Formation		16.2	13.8	16.2	1.5	7.3
Change in Stocks		26.9	31.5	31.1	-48.6	90.8
Exports		25.8	20.0	5.9	14.4	-5.5
Imports		32.5	21.3	10.2	22.7	-1.8
Contribution to Growth						
Consumption (Private)		54.2	52.5	54.9	90.5	47.8
Consumption (Govt)		10.4	4.4	10.0	22.3	19.6
Gross Capital Formation		57.3	50.4	67.2	-44.3	72.3
Gross Fixed Capital Formation		49.9	45.5	52.4	10.4	26.2
Net Exports		-18.6	-10.2	-13.6	-57.6	-8.0
Relative Share						
Consumption (Private)	59.1	58.7	58.2	57.9	59.4	58.5
Consumption (Govt)	10.9	10.9	10.3	10.3	10.9	11.6
Gross Capital Formation	32.8	34.9	36.2	39.0	35.1	38.2
Gross Fixed Capital Formation	28.7	30.5	31.8	33.6	32.5	32.0

Source : CSO.
Note : Does not add to 100 because only major items are included in the table.

expenditure fell sharply in terms of growth in both 2008-09 and 2009-10; this sub-group and the sub-group furniture and furnishings were the only two that had decelerated in terms of growth, year-on-year (Table 1.4). The Economic Survey 2009-10 had indicated that sequencing the rollback of fiscal measures would be guided by recovery in investment and the latest data indicate that the pickup in gross fixed capital formation is not fuller in terms of the pre-crisis levels.

Table 1.4 : Private final consumption-annual growth and share at 2004-05 prices

	2004-05	2005-06	2006-07	2007-08	2008-09^{PE}	2009-10^{QE}
	Annual Growth (per cent)					
Food, Beverages & Tobacco		6.3	3.4	6.4	3.1	0.5
Clothing & Footwear		19.7	23.3	5.0	5.6	5.2
Gross Rent, Fuel & Power		3.8	3.8	4.7	4.3	5.9
Furniture, Furnishings Etc.		15.1	17.1	16.1	12.9	13.5
Medical Care & Health Services		8.8	8.7	4.5	6.9	8.9
Transport & Communication		5.2	8.1	7.4	9.2	14.2
Recreation, Education & Cultural Services		11.0	8.4	9.8	11.9	6.4
Miscellaneous Goods & Services		20.2	21.2	28.6	20.2	15.9
Total Private Consumption		8.4	8.5	9.1	7.6	7.4
	Share of Total (per cent)					
Food, Beverages & Tobacco	40.0	39.2	37.4	36.4	34.9	32.6
Clothing & Footwear	6.6	7.3	8.3	8.0	7.9	7.7
Gross Rent, Fuel & Power	13.8	13.2	12.7	12.2	11.8	11.6
Furniture, Furnishings, etc.	3.4	3.6	3.9	4.1	4.3	4.6
Medical Care & Health Services	5.0	5.0	5.0	4.8	4.7	4.8
Transport & Communication	19.3	18.7	18.7	18.4	18.6	19.8
Recreation, Education & Cultural Services	3.0	3.0	3.0	3.1	3.2	3.2
Miscellaneous Goods & Services	8.9	9.9	11.1	13.0	14.6	15.7
Total Private Consumption	100.0	100.0	100.0	100.0	100.0	100.0

Source : CSO.

Savings and investment

Movements in public-sector savings and corporate investment explain the slowdown and subsequent recovery

1.16 The CSO's Quick Estimates for 2009-10 placed gross domestic savings at 33.7 per cent of the GDP at current market prices (savings rate). The savings rate for 2008-09 was also revised from 32.5 per cent to 32.2 per cent. With private-sector savings more or less static, it was the savings of the public sector (essentially public enterprises) that went up from a revised level of 0.5 per cent in 2008-09 to 2.1 per cent in 2009-10 (Table 1.5). Private-sector savings had remained sticky in the range of 30.1 per cent to 31.9 per cent in the last six years and seemingly the global crisis had no significant impact.

1.17 Gross capital formation, as a proportion of the GDP at current market prices (investment rate) grew rapidly in the period 2004-05 to 2007-08. This reflected the process of fiscal consolidation undertaken by the Centre and the States, which allowed the economy to reap rich dividends in the form of higher investment rates and thus higher GDP growth rate. Investment rate was placed at 36.5 per cent in 2009-10, up from the crisis-affected levels of 34.5 per cent in 2008-09. However, gross fixed capital formation had not picked up in 2009-10. The fall in investment rate in 2008-09 was mostly due to its fall in the private sector, particularly the corporate sector. In 2009-10, as per the Quick Estimates, there has been a pickup in corporate-sector investment; household-sector investment that had shot up in 2008-09 changed tack and is back to pre-crisis levels. Thus the impact of the crisis in 2008-09 was manifest mainly in the levels of changes in stocks, which recovered in 2009-10. However, as per the Quick Estimates, gross fixed capital formation is placed at 30.8 per cent in 2009-10, which is a deceleration on a year-on-year basis.

Savings-investment gap narrows; but still wide

1.18 The overall savings-investment gap that was implicit in these estimates was 2.3 per cent in 2008-09 and 2.8 per cent in 2009-10. The gap in terms of sectors indicated a widening of the public-sector balance in 2008-09 to - 9.0 per cent, which subsequently moderated to - 7.0 per cent in 2009-10. This reflected the expansionary polices and was partly made up by the upward shift in the private-sector savings-investment balance on the component

Table 1.5 : Ratio of savings and investment to GDP (in per cent at current market prices)

	2004-05	2005-06	2006-07	2007-08	2008-09^{PE}	2009-10^{QE}
Gross Domestic Saving	32.4	33.5	34.6	36.9	32.2	33.7
Public Sector	2.3	2.4	3.6	5.0	0.5	2.1
Private Sector	30.1	31.0	31.0	31.9	31.7	31.6
Household Sector	23.6	23.5	23.2	22.5	23.8	23.5
Financial Saving	10.1	11.9	11.3	11.7	10.8	11.8
Saving in Physical Assets	13.4	11.7	11.9	10.8	13.1	11.7
Private Corporate Sector	6.6	7.5	7.9	9.4	7.9	8.1
Gross Capital Formation (Investment)	32.8	34.7	35.7	38.1	34.5	36.5
Public Sector	7.4	7.9	8.3	8.9	9.5	9.2
Private Sector	23.8	25.2	26.4	28.1	24.6	24.9
Corporate Sector	10.3	13.6	14.5	17.3	11.5	13.2
Household Sector	13.4	11.7	11.9	10.8	13.1	11.7
Gross fixed Capital Formation	28.7	30.3	31.3	32.9	32.0	30.8
Stocks	2.5	2.8	3.4	4.0	2.0	3.3
Valuables	1.3	1.1	1.2	1.1	1.3	1.7
Saving-investment Gap						
Public Sector	-5.1	-5.5	-4.7	-3.9	-9.0	-7.0
Private Sector	6.3	5.8	4.6	3.8	7.1	6.7

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

side and on the macroeconomic side reflected relatively stronger domestic demand vis-à-vis external demand. While the expansionary fiscal stance was considered apposite given the level of demand slowdown arising from fall in investment, going forward, the need to deepen the process of fiscal consolidation that has resumed in the Budget for 2010-11 cannot be overemphasized.

1.19 The rates of investment across sectors indicated the varying levels of impact of the crisis and recovery. Growth in investment in the agriculture sector, even after the revisions, was strong in 2007-08 and 2008-09, but appeared to have dipped in 2009-10 (Quick Estimates) with growth at 3.7 per cent (Table 1.6). Forestry and logging continues to decline--a process that began in 2007-08--but more sharply in 2009-10. Sectoral investment in fishing was relatively static. Investment in two sectors--mining and quarrying and construction--has picked up sharply in 2009-10. The following sectors evinced a decelerating trend in 2009-10: electricity, gas and water supply; railways; and communications. There was a decline in the rates of investment in trade, hotels, and restaurants with trade declining sharply; for the third year banking and insurance declined and real estate declined on base effect.

Production and Supply

Agriculture is critical for macroeconomic stability and sustained growth

1.20 The growth of agriculture and allied sectors continues to be a critical factor in the overall performance of the Indian economy. It might be recalled that this sector had grown in excess of 5.0 per cent on average annual basis in the triennium

Table 1.6 : Sectoral investment growth rates at 2004-05 prices

	Rate of growth of GCF				
	2005-06	2006-07	2007-08	2008-09	2009-10
Agriculture, Forestry & Fishing	13.8	4.7	15.8	22.5	3.7
Agriculture	13.9	4.2	17.0	23.9	3.4
Forestry & Logging	30.8	13.4	-20.2	-4.0	-13.5
Fishing	9.5	9.5	9.5	9.6	9.5
Mining & Quarrying	40.0	15.6	13.3	-13.4	62.1
Manufacturing	17.6	16.6	29.5	-31.6	34.8
Registered	39.3	11.0	37.3	-27.0	25.2
Unregistered	-36.7	47.4	-2.6	-58.8	134.1
Electricity, Gas & Water Supply	21.3	18.1	11.4	12.3	3.5
Construction	5.7	66.3	20.4	-24.7	16.8
Trade, Hotels & Restaurants	26.7	40.3	-17.7	29.9	-27.4
Trade	22.6	44.9	-22.8	35.8	-32.7
Hotels & Restaurants	49.2	19.5	10.4	7.0	-1.0
Transport, Storage & Communication	20.1	-7.4	25.9	37.6	0.9
Railways	14.6	12.9	13.7	22.5	9.3
Transport by Other Means	12.8	-14.8	29.6	12.8	-8.9
Storage	-285.7	14.9	7.1	62.4	-1.5
Communication	33.2	-7.8	30.1	86.7	6.6
Financing, Insurance, Real Estate & Business Services	6.2	-0.4	10.6	41.0	-3.3
Banking & Insurance	70.4	61.8	-6.8	-5.0	-26.1
Real Estate, Ownership Of Dwellings & Business Services	4.3	-3.3	12.0	44.0	-2.3
Community, Social & Personal Services	19.6	12.3	18.4	-3.6	12.3
Public Administration & Defence	17.3	14.0	13.4	3.3	11.1
Other Services	22.7	10.2	25.0	-11.9	14.0
Total	17.0	15.3	17.7	-3.9	12.2

Source : CSO

ending 2007-08 when real GDP grew in excess of 9 per cent. This sector accounted for 12.7 per cent of the real GDP in the first half of 2010-11. Despite experiencing the most deficient south-west monsoon since 1972 and a significant fall in the levels of kharif foodgrain production in 2009-10, the growth in agriculture marginally recovered to 0.4 per cent primarily due to a good rabi crop. Several measures taken in advance by the Government for raising the rabi crop output had the desired effect. The farming sector was also broadly supported by more remunerative prices and, earlier, by the waiver of loans and other measures taken. With above normal rainfall, the prospects for growth of the sector were bright in the current year with a growth of 3.8 per cent during the first half of 2010-11 as against 1.0 per cent during the first half of 2009-10. The Advance Estimates of the CSO placed the growth in agriculture and allied sectors at 5.4 per cent which implied an overall share of 14.2 per cent in real GDP in 2010-11. Even with the level of growth in the current fiscal, the full Eleventh Plan period target of 4 per cent per annum may not be realized.

1.21 For four consecutive years from 2005-06 to 2008-09, foodgrains production registered a rising trend and touched a record level of 234.47 million tonnes in 2008-09. The production of foodgrains declined to 218.20 million tonnes during 2009-10 (4th Advance Estimates) due to the long spells of drought in various parts of the country in 2009. The productivity of almost all the crops suffered considerably which led to decline in their production in 2009. As per the 1st Advance Estimates (covering only kharif crops), production of kharif foodgrains during 2010-11 is estimated at 114.63 million tonnes which is lower than the target of 125.31 million tonnes but higher than kharif foodgrain production of 103.84 million tonnes recorded during 2009-10 (4th Advance Estimates). The shortfall in the estimated kharif foodgrain production compared to the target in 2010-11 is mainly due to drought conditions reported in major rice-producing areas in the country.

1.22 The country has made great strides in increasing foodgrains production since the mid-1960s. Today India ranks high in the production of various commodities such as milk, wheat, rice, fruits, and vegetables. However, the agriculture sector in India is at a crossroads with rising demand for food items and relatively slower supply response in many commodities resulting in frequent spikes in food inflation. The technological breakthrough achieved in the 1960s is gradually waning. The need for a second green revolution is being recognized more than ever before. There is need to significantly step up both private and public investment in the agriculture sector to ensure sustained growth so as to achieve the target growth of around 4 per cent per annum. The rise in prices of agricultural produce would in part help incentivize production; the moot question remains what proportion of the rise accrues to the producer and what proportion gets appropriated by middlemen. The creation of more direct farm-to-fork supply chains in food items across the country would be critical in incentivizing the farmer with higher producer prices and at the same time would lower the prices for end-consumers.

Behaviour of prices and inflation

Inflation continues to be a cause for concern

1.23 Inflation continues to be a cause for concern. The year-on-year WPI inflation that started trending up in December 2009 continued through the current fiscal. The financial year 2010-11 started with a double-digit headline inflation of 11.0 per cent in April 2010. After remaining in double digits from April to July 2010, headline inflation came down to single digits and stood at 8.8 per cent in August 2010. Headline inflation in November 2010 was 7.5 per cent; but the trend reversed and in December 2010 it was 8.4 per cent. In spite of having a good monsoon this year, headline inflation at elevated levels owed to high levels of food inflation. The inflation in food articles which had moderated to single digit in November 2010 again jumped to double digits and stood at 13.6 per cent in December 2010.

1.24 The spurt in inflation in December 2010 could be attributed to supply bottlenecks especially in vegetables, onions, tomatoes, fruits, milk, eggs, and fish. A sudden spike in prices of onions during December 2010 was witnessed on account of damage to the onion crop. It may be mentioned that food price inflation during the last financial year was mainly driven by high inflation in pulses, cereals, and sugar due to bad monsoon. The rise in the purchasing power owing to the rapid growth of the economy and inclusive programmes like the Mahatma Gandhi National Rural Employment Guarantee Act (MNREGA) partly might have contributed to the upward trend in inflation. The average inflation in primary articles was reported at 18 per cent on an average during the period April 2010 to December 2010 as compared to 10 per cent last year for the same period. Recovery in the domestic economy led to demand-side pressure on inflation. The inflationary pressure persists both from domestic demand and higher global commodity prices on account of the global recovery.

1.25 Food has higher weight in consumer price indices than in the WPI. Overall consumer price index (CPI) for industrial workers (IW) inflation, year-on-year, ruled higher than WPI from November 2008; this continues through the current fiscal. In August 2010, inflation in terms of all price indices had come down to single digit after 15 consecutive months of double-digit inflation. Year-on-year inflation in the CPI-IW was 9.47 per cent in December 2010 as compared to 14.97 per cent in December 2009. On year-on-year basis, inflation in the consumer price indices for agriculture workers (CPI-AL) and rural workers (CPI-RL) was 7.99 per cent and 8.01 per cent respectively in December 2010 as compared to 17.21 and 16.99 per cent respectively in December 2009.

1.26 In terms of financial year build-up of inflation, that is per cent change in the WPI index in December 2010 over the levels in March 2010, a level of 6.11 per cent obtained as against 7.9 per cent last year in the same period. A decomposition of the year-on-year inflation in terms of base effect and price effect revealed the large base effect in the rise in the levels of inflation in 2010-11, albeit evincing a moderating trend in recent months. This was true also of a decomposition of the year-on-year inflation in primary articles.

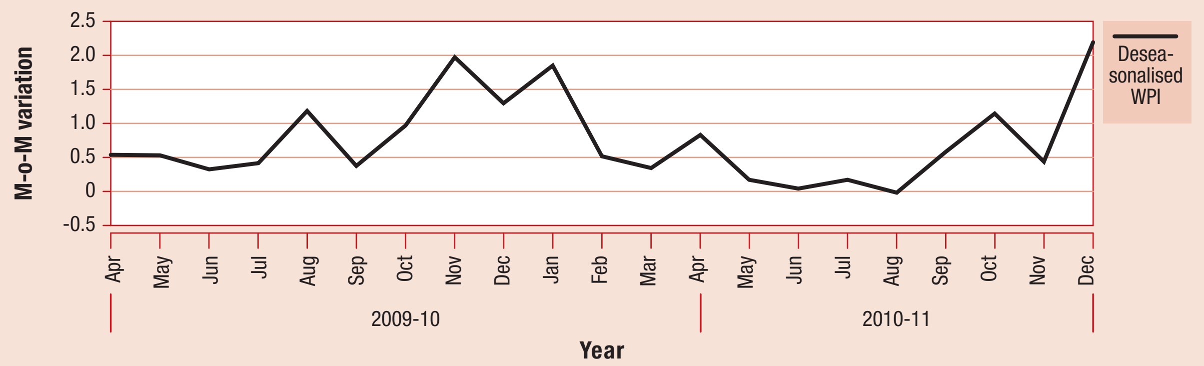
1.27 Therefore, it is instructive to monitor the emerging trend in inflation on a sequential month-on-month basis. As there are seasonalities associated with such a measure, a deseasonalization of the data would provide indications of the change if any in the direction and the momentum embedded in it. The seasonally adjusted sequential measure of headline inflation points to a spurt in September 2010 followed by a moderation in the next two months; in December 2010 there is again a massive build-up; indicating a much higher momentum (Figure 1.3). Core inflation also moved up in the current fiscal indicating that the inflation in food items might have spilled over into a more generalized phenomenon. Inflation in manufactured items with a weight of 65 per cent in the WPI has been above the 4 per cent mark since January 2010 and after reaching 6.4 per cent in April 2010 has evinced a moderating trend. The rise in wage goods and levels of inflation in intermediates has implications for the industrial output.

Industry and Infrastructure

Recent data indicate volatility and waning momentum

1.28 Growth in the industrial sector as per the IIP was buoyant during the first two quarters of the current financial year. The manufacturing sector, in particular, showed a remarkable robustness, growing at rates of 12.6 per cent and 9.7 per cent respectively during these two quarters. IIP data on monthly basis indicated that growth in IIP has decelerated sharply to a level of 2.7 per cent in November from 11.3 per cent in November 2009. For the current financial year (April-November), growth in the IIP was placed at 9.5 per cent as against the 7.4 per cent that obtained in the corresponding period last year. Data on the IIP has exhibited volatility in the current fiscal with growth varying widely in the range of 2.7 per cent to 16.6 per cent. While earlier the volatility was associated with capital goods in the use-based classification, components like consumer non-durables and basic goods were the main depressants in the deceleration in November 2010. The CSO has released the IIP data for the month of December 2010 on 11 February 2011. Year-on-year, the IIP has grown by 1.6 per cent in December 2010 and 8.6 per cent during April-December 2010.

Figure 1.3 Deseasonalised sequential month-on-month movement



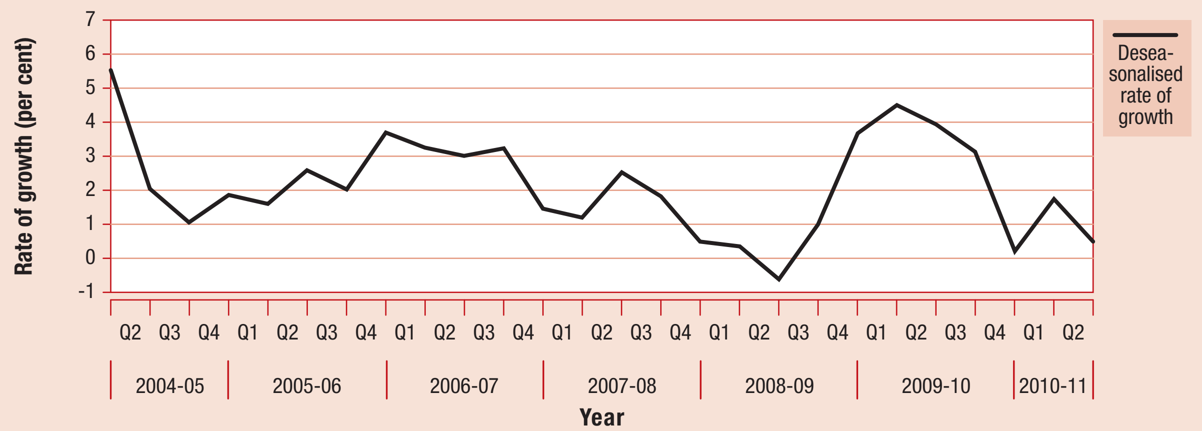
1.29 As per the IIP, manufacturing growth rate decelerated to 9.7 per cent in the second quarter of the current financial year. Compared to the peak growth of 16.8 per cent achieved during the fourth quarter (January-March) of the last financial year, this growth rate was moderate. Within the manufacturing sector, the capital goods segment has been the main driver of growth; it has shown extreme volatility as it registered a growth of 3.5 per cent in the first quarter of 2009-10, surged up to 45.7 per cent during the fourth quarter of the last financial year, and has continued to be in double digits since then.

1.30 Post recovery, industrial output growth has been largely driven by a few sectors such as the automotive sector along with a revival in cotton textiles, leather, food products, and metal products. Some sectors have exhibited extreme month-on-month output volatility. The impact of favourable monsoons on the domestic-demand-driven industrial sector has not been widespread. Its effect on the consumer non-durable segment in particular, though not discernible so far, is expected to materialize in the fourth quarter of this fiscal. However, a higher base effect may impact the industrial growth rate in the months of December 2010 and January 2011 and accordingly may moderate the industrial sector's contribution to the GDP for the current financial year. As there is a large base effect involved, it is useful to see the trend indicated by the quarter-on-quarter deseasonalized sequential growth momentum and direction. The quarter-on-quarter deseasonalized headline IIP indicated large volatility largely on account of the movements in capital goods and consumer goods (Figure 1.4). The short-run nature of the IIP slowdown suggests that the deceleration is more in the nature of road bumps than indication of any long-run problem.

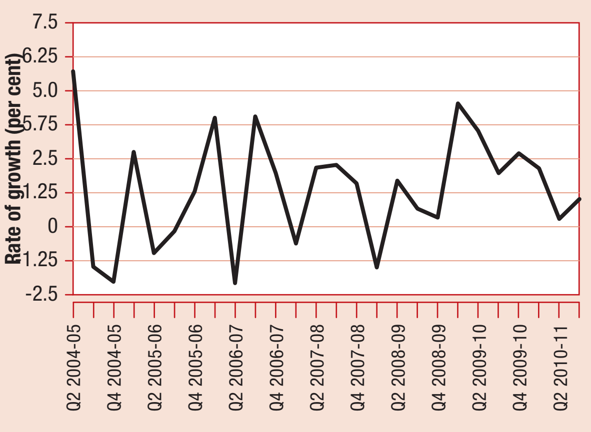
Six core industries growing; but not at full steam

1.31 Six core industries that have a large bearing on infrastructure and have a combined weight of 26.7

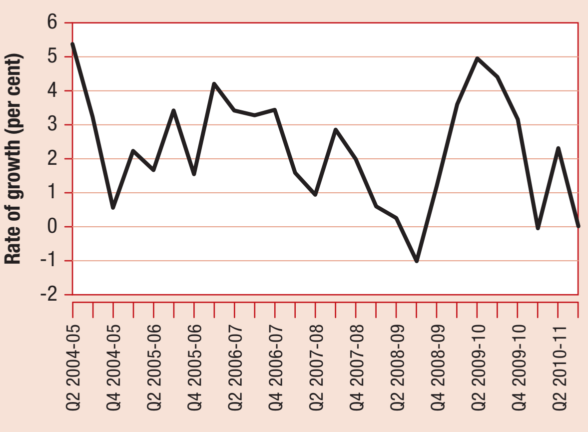
Figure 1.4 Sequential (deseasonalised) rate of growth (per cent) in IIP and its components

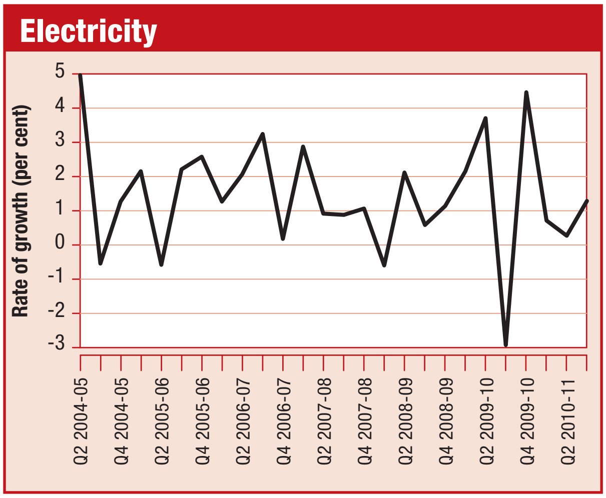


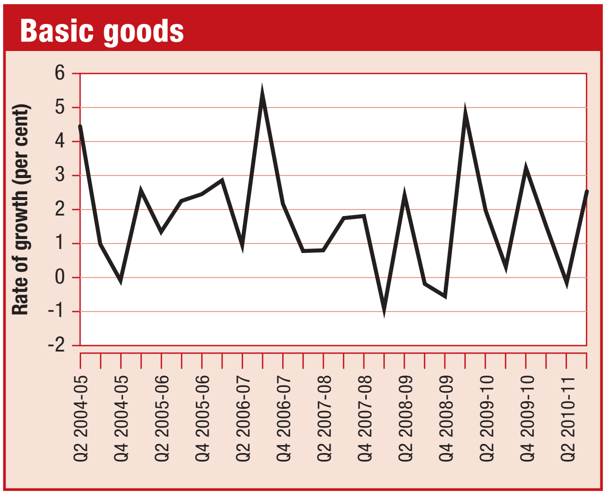
Mining

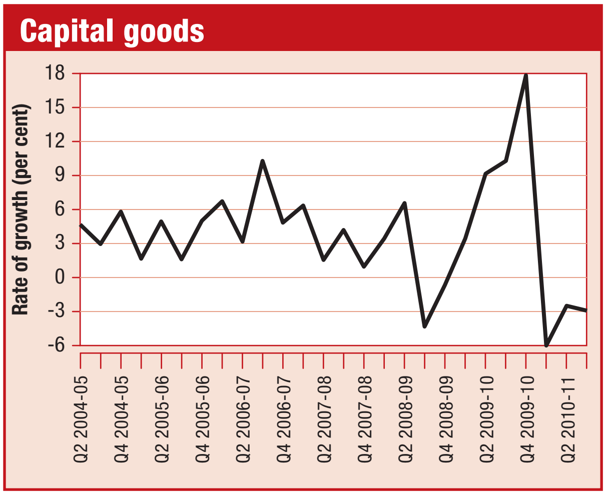


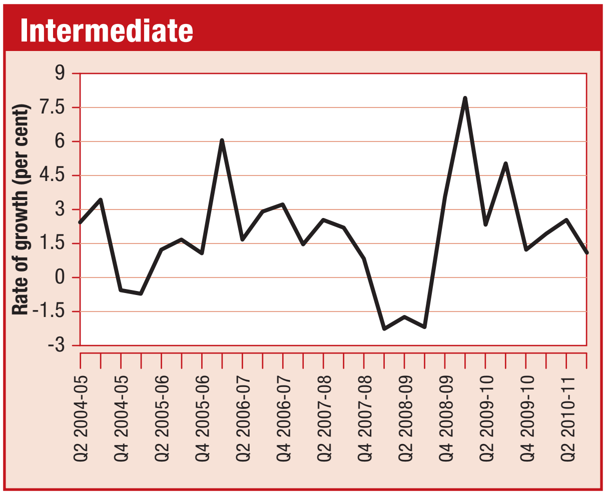
Manufacturing

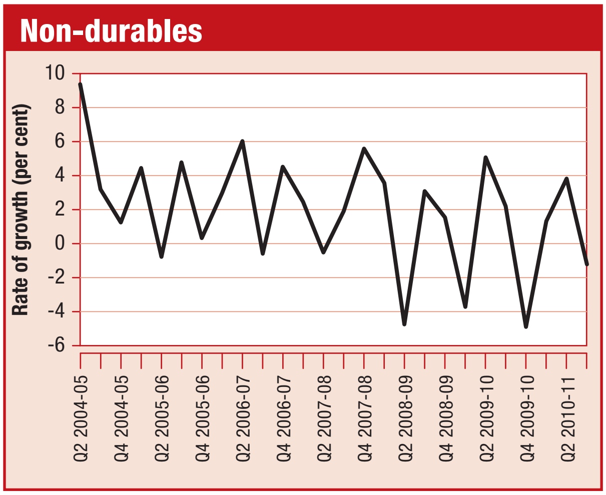


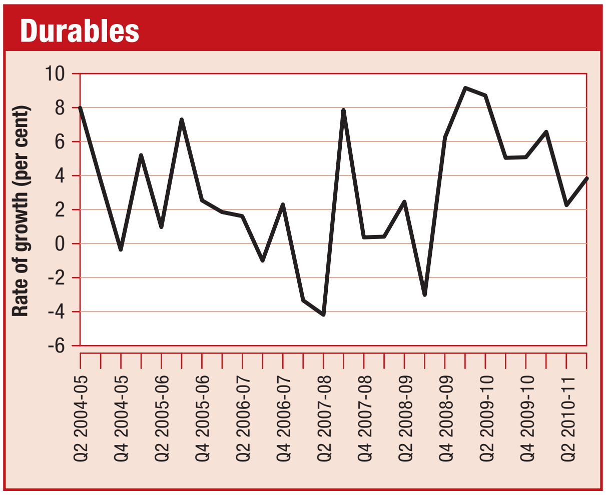












per cent in the IIP registered a growth of 6.6 per cent (provisional) in December 2010 compared to 6.2 per cent in December 2009. During April-December 2010-11, these industries registered a growth of 5.3 per cent (provisional) as against 4.7 per cent during the corresponding period of the previous year.

1.32 Electricity generation by power utilities during 2010-11 was targeted to go up by 7.7 per cent to 830.757 billion KWh. The growth of power generation during April-December 2010 was about 4.5 per cent as compared to about 6.2 per cent during April-December 2009. During April-December 2010, the generation from nuclear, hydro, and thermal units registered growth of 33 per cent, 8 per cent, and 3 per cent respectively. The overall plant load factor (PLF) of thermal power stations during April-December 2010, though lower than that achieved during April-December 2009, exceeded the target of 71.35 per cent for the first three quarters of the current financial year. During April-December 2010, the peak and total energy deficits came down to 10.2 per cent and 8.8 per cent respectively from 12.6 per cent and 9.8 per cent during the corresponding period in the previous year, mainly due to growth of availability of power exceeding the growth in its requirement.

1.33 During the current financial year (2010-11), production of crude oil is estimated at 37.96 million metric tonnes (MMT), which is about 12.67 per cent higher than the crude oil production of 33.69 MMT during 2009-10. The projected production of natural gas, including coal bed methane (CBM) for 2010-11 is 53.59 billion cubic metres (BCM) which is 12.80 per cent higher than the production of 47.51 BCM in 2009-10. The increase in natural gas production is primarily from KG deepwater block. The production of raw coal during April to November 2010 was 319.80 million tonnes (MT) against 317.79 MT in the same period of the previous year. Coking coal production during this period was 28.72 MT against 25.64 MT during the same period last year, registering a growth of 12.01 per cent.

1.34 Freight loading on Indian Railways in the period April-November, 2010 was 593.43 million tonnes as compared to 574.40 million tonnes in April-November 2009—an increase of 3.31 per cent. This was short of the proportionate target of 605.11 million tonnes by 11.68 million tonnes. The low growth was primarily on account of negative growth in iron ore. Iron ore loading has mainly been affected in the current year due to the restriction imposed by the State Governments of Orissa and Karnataka. Frequent bandhs by Naxalites adversely affected loading, particularly in the Bailadila sector on East Coast Railway.

Infrastructure – a mixed bag of performances

1.35 About 25 per cent of the total length of National Highways (NHs) is single lane / intermediate lane; about 52 per cent is two-lane standard; and the balance 23 per cent is four-lane standard or more. In 2010-11, the achievement under various phases of the National Highways Development Project (NHDP) up to November 2010 has been about 1007 km of road. During 2010-11, under the NHDP, projects have been awarded for a total length of about 3780 km up to November 2010.

1.36 In the civil aviation sector, the scheduled domestic passenger traffic at 51.53 million clocked a growth rate of 19 per cent during January-December 2010 as compared to a level of 43.3 million during the corresponding period in 2009. Domestic cargo transported by air increased from 3.4 million tonnes in 2009 to 4.7 million tonnes in 2010 registering a growth of 30 per cent. At present 12 scheduled airlines are operational (10 passenger and 2 cargo). The total number of aircraft in their fleet has risen to 419 at the end of December 2010. The total number of non-scheduled operators stood at 121 in December 2010 with 360 aircraft in their fleet.

1.37 With increasing private-sector participation, the share of the private sector in total telephone connections has increased to 84.5 per cent in November 2010 as against a meagre 5 per cent in 1999. Teledensity, an important indicator of telecom penetration, rose from 7.02 per cent in March 2004 to 64.34 per cent in November 2010. Rural teledensity which was above 1.57 per cent in March 2004 has increased to 30.18 per cent at the end of November 2010. Urban teledensity has increased from 20.74 per cent in March 2004 to 143.95 per cent at the end of November 2010.

1.38 There has been steady decline in the time and cost overruns of Central-sector projects costing ₹150 crore and above thanks to closer monitoring and systems improvements by the Ministries concerned. An examination of cost overruns in the last twenty years as against originally approved costs shows that the former declined from 61.6 per cent in March 1991 to 12.06 per cent in March 2008. There is, however, an upward trend from March 2008 as cost overruns reached 14.72 per cent in March 2010 and further climbed to 20.7 per cent in October 2010. The rise is partly due to exclusion of projects costing less than ₹150 crore from the monitoring system as these had lower cost overruns compared to the bigger projects. The increase is also partly due to steep rise in prices of steel and cement in 2006-07.

1.39 Overall, the infrastructure sector has had a mixed bag of performances; some like telecommunications have done exceedingly well and in some others there has been less than targeted achievement. During 2007-08 to 2009-10, capacity addition has been lower than target in power, roads (NHDP), new railway lines, and doubling of railway lines. The sub-sectors where physical achievements have been above or close to targets are telecommunications, villages electrified under the Rajiv Gandhi Grameen Vidyutikaran Yojana (RGGVY), railway lines electrification, railway gauge conversion, and new and renewal of roads construction under the Pradhan Mantri Gram Sadak Yojana (PMGSY). The investment in infrastructure has reached 7.18 per cent of the GDP in 2008-09 and is expected to increase to 8.37 per cent in the terminal year of the Eleventh Plan. Rapid reduction of the infrastructure deficit holds the key to competitiveness in an increasingly globalized economic environment.

Services Sector – the potential growth engine

1.40 The services sector has played a dominant role in the Indian economy with a 57.3 per cent share in the GDP; a growth of 10.1 per cent in 2009-10; a high share in FDI equity inflows with the financial and non-financial services category alone contributing 21 per cent during April 2000 to November 2010; and a 35 per cent share in total exports with 27.4 per cent export growth in the first half of 2010-11. A comparison of shares of the services sector in the GDP of different States and Union Territories shows that the services sector is also the dominant sector in most of the States of India.

1.41 High-growth services categories are financing, insurance, real estate, and business services and transport, storage, and communication with the latter overtaking the former in 2009-10 with a high growth of 15 per cent. Growth of trade, hotels, and restaurants which slowed down in 2008-09 has recovered moderately in 2009-10. Among the sub-categories, in 2008-09, double- digit growth was registered by communications (25.7 per cent), public administration and defence (22.1 per cent), banking and insurance (13.9 per cent), and storage (11.6 per cent). Negative growth was registered only by hotels and restaurants (-3.5 per cent). Among business services, the most important categories are computer-related service; and the category consisting of many services like research and development (R&D) services, market research, business and management consultancy, architectural engineering, and advertising., with shares in the GDP of 3.26 per cent and 0.88 per cent respectively. While computer-related services which grew by 21.2 per cent in 2008-09 registered a moderate growth of 5.2 per cent in 2009-10 due to the global crisis, R&D services registered good growth of 19.6 per cent and 19.9 per cent in both 2008-09 and 2009-10 respectively. Among other services, the two important services are education and medical health in terms of relative share of the GDP; they had growth rates of 13.9 per cent and 5.3 per cent in 2009-10 respectively. While total services including construction grew by 9.7 per cent, total services excluding construction grew by 10.1 per cent in 2009-10. In 2010-11(Advance Estimates), they grew by 9.4 per cent and 9.6 per cent respectively. The outlook for the services sector which had slightly dimmed due to the fallouts of the sub-prime crisis in US and the global financial crisis has once again brightened. Recent business performance indicators of different service firms in the different services also support this healthy prognosis. Even during the crisis years, annual services growth has been around the 10 per cent mark which it has maintained since 2005-06. This is in contrast to the overall GDP growth which fell to 6.8 per cent in 2008-09 from 9.3 per cent in 2007-08.

External-sector developments

Global economy on the upturn; to support growth momentum

1.42 The global economy was estimated to have grown rapidly in 2010 by 5.0 per cent according to the update of the WEO (25 January 2011); which was one of the highest rates of growth in recent years and compares favourably with the robust levels in the pre-crisis period. Growth in emerging economies remains strong, while advanced countries are growing slowly and facing uncertainty with large fiscal deficit and high public debt and unemployment levels. This indicated the two-paced nature of the global growth process in the current conjuncture. While growth in 2010 was partly a rebound from weak levels in 2009, the estimate for 2011 and 2012 at about 4.5 per cent indicated the prospects. The Market Update of the Global Financial Stability Report of the IMF (January 2011) observed that global financial stability is still to be assured and significant policy challenges remain to be addressed: slow progress in the as yet incomplete balance sheet restructuring process; interaction between the banking and sovereign credit risks in the euro area; and need for more regulatory reforms to the financial sector to anchor stability. In several emerging market economies (EMEs), however, there has been surge in capital inflows with the associated risk of bubbles in asset and credit markets. There have also been signs of rising inflation, in response to strong global demand, combined with supply constraints.

Trade developments

Imports slowing; exports gathering pace and trade deficit set to narrow

1.43 In tandem with world trade volumes, India's exports fell rapidly following the deepening of the global financial crisis midway through 2008-09; they rose in the second half of 2009-10, which continued through 2010-11 until June 2010. Thereafter growth decelerated till October 2010 and picked up subsequently to reach 36.4 per cent in December 2010, which is the highest growth in the last two years. Nevertheless cumulative export growth in April-December 2010-11 was at 29.5 per cent with cumulative exports reaching US $ 164.7 billion during this period. Current indications are that India would not only achieve the target of US$ 200 billion but surpass it in 2010-11. India's merchandise imports also affected by the global recession fell to US$288.4 billion with a negative growth of - 5.0 per cent in 2009-10. This was due to the fall in growth of petroleum, oil, and lubricants (POL) imports by 7.0 per cent and non-POL imports by 4.2 per cent. POL import growth was low mainly due to decline in import price of the Indian crude oil import basket by 16.5 per cent despite the increase in quantity by 7.7 per cent.

1.44 Trade deficit (on customs basis) increased by 2.4 per cent to US$ 82 billion in 2010-11 (April-December) from US$ 80.1 billion in the corresponding period of the previous year. Trade deficit reached a peak of US $ 118.4 billion in 2008-09 and moderated to US $ 109.6 billion in 2009-10. With lower levels of surpluses on the invisibles balance, the relatively higher import growth compared to export growth in the first half of 2010-11 raised concerns of unsustainable current account deficit levels. With import growth slowing down from October 2010 and exports picking up in November 2010, the concerns on the trade deficit have been allayed; the concerns on the moderation in levels of invisibles surplus remain as per the latest data on balance of payments (BoP), which are for April-September 2010 and need to be closely monitored.

BoP developments

Invisibles key to reduced deficit on the current account; capital flows easily absorbed without forex market intervention

1.45 The net invisibles surplus (invisibles receipts minus payments) was lower at US$ 39.1 billion during the first half of 2010-11 vis-a-vis US$ 42.5 billion during the first half of 2009-10. The lower invisible surplus combined with higher trade deficit resulted in widening of the current account deficit to US$ 27.9 billion during the first half of 2010-11 compared to US$ 13.3 billion in the first half of 2009-10. With merchandise trade indicators showing moderation in trade deficit, performance in transfers and information technology (IT) and IT-enabled services (ITeS) holds the key to anchoring the elevated levels of current account deficit to sustainable levels.

1.46 Net capital flows at US$ 36.7 billion in the first half of 2010-11 were higher as compared to US$ 23.0 billion in the first half of 2009-10. The increase was primarily composed of inflow of portfolio investment, mainly FIIs, short-term trade credits, and external commercial borrowings (ECBs). The large increase, however, was considerably offset by the moderation in net FDI inflows to India. Notwithstanding significant increase in net capital inflows, accretion to reserves during the first half of 2010-11 was lower, mainly due to more than doubling of current account deficit over the levels in the first half of 2009-10.

Foreign Exchange Reserves

1.47 Foreign exchange reserves increased from US$ 252 billion at the end of March 2009 to US$ 279.1 billion at the end of March 2010, showing a rise of US$ 27.1 billion. Of the total increase, US$ 13.6 billion was on account of valuation gain (due to decline of the US dollar in the international market) and the remaining US$ 13.5 billion on account of the BoP. During the current fiscal, reserves increased from US$ 279.6 billion at the end of April 2010 to US$ 292.4 billion at the end of November 2010. The reserves stood at US$ 297.3 billion at the end of December 2010, showing an increase of US$ 18.2 billion over the end-March 2010 level mainly on account of valuation changes.

Exchange Rate

1.48 During the current fiscal, the monthly average exchange rate of the rupee has generally been range bound, moving in the range of ₹44-47 per US dollar between April and December 2010. The exchange rate of the rupee depreciated by 1.5 per cent against the US dollar, from ₹44.50 per US dollar in April 2010 to ₹45.16 per US dollar in December 2010. The rupee also depreciated against other major international currencies such as the pound sterling (3.2 per cent) and Japanese yen (12.2 per cent) during the period.

External Debt

1.49 India's external debt stood at US$ 295.8 billion at the end of September 2010, recording an increase of US$ 33.5 billion (12.8 per cent) over the level of end-March 2010. The rise in debt was largely due to higher commercial borrowings, short-term trade credits, and multilateral Government borrowings. The valuation effect contributed to an increase of US$ 6.3 billion in the total increase. The maturity profile of India's external debt indicates the dominance of long-term borrowings with long-term debt accounting for 77.7 per cent of the total external debt at the end of September 2010.

1.50 In 2007-08, a surge in capital flows far in excess of the absorptive capacity and with implications for competitiveness had complicated monetary management on account of trade-offs involving the impossible trinity objectives—of open capital account, exchange rate stability, and monetary policy independence. However, with recovery in 2009-10 and in the current fiscal, the external sector broadly remained supportive as the elevated levels of current account deficits were easily financed by rising capital flows; though concerns of sustainability had emerged. Thus, with orderly conditions in the forex markets, the external sector remained supportive of the monetary policy setting.

Monetary and financial sector developments

Monetary policy in tightening mode—fighting inflationary pressure and supportive of growth; some volatility in securities markets with broad stability in financial markets

1.51 The Reserve Bank of India (RBI) had begun the process of withdrawing from the accommodative policy stance in October 2009 itself. In its Annual Monetary Policy Statement in April 2010, it had estimated that the economy would grow by 8.0 per cent with an upward bias and that inflation as per the WPI would decline to a level of 5.5 per cent by end-March 2011. The Policy Statement sought to balance the credit demands of the private sector and the need of Government borrowing as indicated in the Budget Estimates of 2010-11 with a broad money (M_3) growth of 17.0 per cent. Aggregate deposits of the scheduled commercial banks (SCBs) were estimated to grow by 18.0 per cent and credit growth was placed at 20.0 per cent. Economic events as they unfolded in the current fiscal in the form of rising food inflation and the risk of it impinging on inflationary expectations, necessitated revisions and, in a series of steps, key policy rates were raised. The RBI raised the policy rates six times during the current fiscal wherein the repo rates under its liquidity adjustment facility (LAF) was increased cumulatively by 175 basis points (bps) raising it to 6.5 per cent and the reverse repo rate was increased by 225 bps raising it to 5.5 per cent. The cash reserve ratio (CRR) was at 6 per cent of net demand and time liabilities (NDTL) of banks.

1.52 In its subsequent reviews of the monetary policy statement, the RBI has revised growth to 8.5 per cent and inflation to 7.0 per cent for end-March 2011. During the year 2010-11, the growth in reserve money (M_0) at 21.6 per cent as on 28 January 2011 was higher than in the preceding year while broad money (M_3) growth was lower at 16.6 per cent as on 14 January 2011.Year-on-year, non-food credit growth was up 24 per cent at the end of December 2010 and financed many sectors more broadly (from the agriculture rebound to the 3G [third generation] spectrum sales and private infrastructure projects), while the overall credit to GDP ratio rose to about 55 per cent, continuing its progress (but still structurally well below potential).

1.53 Reflecting the tightening of the policy rates and a pickup in credit demand, liquidity conditions tightened. The fiscal began with a gradual decline in the absorption mode in liquidity conditions ; and a switch to injection mode in May 2010 mainly on account of 3G spectrum and broadband wireless access (BWA) auctions and the resultant rise in Central Government's cash balance account with the RBI . The levels of injection grew in October and November 2010. The RBI moved in to address the problem of such frictional liquidity with a slew of measures like conduct of a special second LAF on 29 October and 1 November 2010, conduct of a special two-day repo auction under the LAF on 30 October 2010, and waiver of penal interest on shortfall in maintenance of the statutory liquidity ratio (SLR) (on 30-31October) to the extent of 1 per cent of NDTL for availing of additional liquidity support under the LAF.

1.54 Money markets remained orderly in the current fiscal with the call money rate remaining within the LAF corridor with some overshooting episodes. The rates in the collateralized segments have continued to move in tandem with the call rate, albeit below it, so far during 2010-11. India's financial markets continued to gain strength in recent years, following steady reforms since 1991. Prudent regulations and institutions protected the economy from the recent global financial shocks and its dynamism is now leading the current recovery. Domestic capital markets performed well in 2010, primary markets financing record levels, including the largest-ever initial public offer (IPO) (for Coal India), while secondary markets reached new highs. Record foreign inflows helped support the market. Pensions and insurance gained, with life insurance premium growing nearly 26 per cent and penetration doubling to 5.4 per cent of the GDP in 2009, from 2.3 per cent in 2000 (when insurance reforms started). Looking to the future, the twin challenges are to continue this ongoing progress on gradual financial reform and modernize regulations and institutions to ensure its continued safety and stability.

1.55 The past year saw banking deposit growth slow, as real interest rates were depressed, especially compared to returns in other fast-recovering asset markets (real estate, gold, and stock markets). The priority is to considerably extend the reach of banking to help mobilize more savings, add more depth, and more efficiently intermediate opportunities, including those in the traditional 'priority' sectors. To move ahead,(1) *financial inclusion* needs to be accelerated as a next crucial step; innovative solutions are needed in this regard; (2) similar efforts are needed to deepen *domestic capital markets* and the role of non-bank institutions, especially in corporate bond and debt markets; (3) the rapid *lowering of fiscal deficits* is needed to help crowd-in such developments; and (4) the Government and the RBI have already begun a series of essential *regulatory overhaul* aimed at updating the modern legislation underlying financial markets and improving macro-prudential safeguards and institutions. We need to continue along this path.

Fiscal developments

Fiscal consolidation on track in the current fiscal; reforms to drive the process in the medium term

1.56 With clear evidence of economic recovery in 2009-10 as indicated by the Advance Estimates of the GDP, the Budget for 2010-11 resumed the path of fiscal consolidation with a partial exit from the stimulus measures. As a proportion of the GDP, fiscal deficit was estimated at 5.5 per cent of the GDP by the Budget 2010-11 and the Medium Term Fiscal Policy Statement indicated a further reduction to 4.8 per cent and 4.1 per cent in 2011-12 and 2012-13. The fiscal outcome in the first nine months of the current financial year remained broadly on the consolidation track chalked out by the Budget. With growth reverting to pre-crisis levels in the current fiscal, revenues remaining buoyant, and a much higher than budgeted realization in non-tax revenues arising from telecom 3G/ BWA auctions, there was headroom for higher levels of expenditure at the given fiscal deficit targets.

1.57 The Budget for 2010-11 followed up on the Thirteenth Finance Commission (ThFC) recommendations on limiting the combined public debt to GDP ratio to 68 per cent by 2014-15 with a promise to analyse the issues in a Status Paper, which would also unveil the roadmap for the reduction. In pursuance of the announcement made in the Budget for 2010-11 to this effect, a status paper on government debt was presented in November 2010. The paper made a detailed analysis of the situation and chalked out a roadmap for reduction in overall debt as a percentage of the GDP for the General Government during the period 2010-11 to 2014-15. The Centre's debt was projected to come down to 43 per cent of the GDP in 2014-15 when the fiscal deficit would be limited to 3.0 per cent of the GDP. With combined debt of the State Governments estimated to decline from 24.8 per cent of the GDP in 2009-10 to 23.1 per cent in 2014-15, consolidated General Government debt was estimated to come down from 73 per cent of the GDP in 2009-10 to 64.9 per cent in 2014-15. The recent Budgets had indicated the reform measures that would drive the process, which included subsidy reforms in fertilizers and petroleum and public expenditure management, besides the tax reforms that are on the anvil.

1.58 The fiscal outcome in the first nine months of the current financial year being robust, there was headroom for higher levels of expenditure at the given fiscal deficit targets. In the first nine months of the current fiscal,with year-on-year growth in total expenditure at 11.2 per cent as against a level of 8.5 per cent envisaged for the full year by the Budget Estimates for 2010-11, fiscal and revenue deficits are placed at ₹ 171,249 crore and ₹116,309 crore respectively, which constituted 44.9 per cent and 42.1 per cent of the Budget Estimates. With nominal GDP placed at ₹78,77,947 crore for the year by the Advance Estimates of the CSO, the target for the current fiscal in terms of the fiscal deficit to GDP ratio is placed at 4.8 per cent and in terms of revenue deficit at 3.5 per cent.

Social-sector developments

Focus on aam aadmi *and higher funds for flagship programmes; implementation key to realizing the desired outcomes*

1.59 The Budget for 2010-11 had indicated that inclusive development is an act of faith for the government. The entitlements for individuals backed by legal guarantees provide ample testimony to this effect. Social-sector spending has progressively been stepped up and it stood at 37 per cent of the total plan outlay in 2010-11. Sector-specific priorities of the Government are reflected in the continued higher budgetary allocations in areas like rural development, education, medical and public health, family welfare, water supply and sanitation, housing, urban development, and welfare of Scheduled Castes (SCs), Scheduled Tribes (STs), and other Backward Classes (OBCs). The share of Central Government expenditure on social services including rural development in total expenditure (Plan and non-Plan) has increased from 13.75 per cent in 2005-06 to 19.27 per cent in 2010-11 (Budget Estimates). Similarly, the expenditure on social services by the General Government (Centre and States combined) has also shown increase in recent years reflecting higher priority to social services. The expenditure on social services as a proportion of total expenditure has increased from 21.1 per cent in 2005-06 to 23.8 per cent in 2008-09 and further to 25.2 per cent in 2010-11 (Budget Estimates).

1.60 On the employment front, the country has been able to withstand the adverse impact of the global crisis and generate employment since July 2009 as reported in the quarterly quick employment surveys conducted by the Labour Bureau. The upward trend in employment has been continuously observed since July 2009. During the quarter July to September 2010, the overall employment has been estimated to have increased by 4.35 lakh. A comparison of the results of the last four quarterly surveys, i.e. September 2010 over September 2009, indicates that overall employment has increased by 12.96 lakh, with the highest increase of 9.36 lakh in IT/business process outsourcing (BPO), followed by 0.79 lakh in textiles, 0.99 lakh in metals, 1.15 lakh in automobiles, and 0.39 lakh in gems and jewellery.

1.61 The progress under the MGNREGA that guarantees wage employment on an unprecedented scale has been satisfactory. During 2009-10, 5.26 crore households were provided employment under this scheme as against more than 4.51 crore during 2008-09. During 2010-11, about 4.10 crore households have been provided employment till December 2010. Out of the 145 crore person days created under the scheme during this period, 23 per cent and 17 per cent were accounted for by SC and ST population respectively and 50 per cent by women.

1.62 The Sarva Shiksha Abhiyan (SSA) being implemented in partnership with the States for addressing the needs of children in the age group of 6-14 years seeks, inter alia: enrolment of all children in school; setting up of Education Guarantee Centres (EGC), Alternate Schools, 'Back-to-School' camps; retention of all children till the upper primary stage by 2010; bridging of gender and social category gaps in enrolment with retention and learning; and ensuring that there is significant enhancement in the learning achievement levels of children at the primary and upper primary stage. The achievements under the SSA till September 2010 include 3,09,727 new schools, construction of 2,54,935 school buildings, 11,66,868 additional classrooms, 1,90,961 drinking water facilities, and 3,47,857 toilets, supply of free textbooks to 8.70 crore children, and appointment of 11.13 lakh teachers. Around 14.02 lakh teachers received in-service training under this programme. There has been a significant reduction in the number of out-of-school children on account of SSA interventions.

1.63 The National Rural Health Mission (NRHM) was launched in 2005 to provide accessible, affordable, and accountable quality health services to the rural areas with emphasis on poor persons and remote areas. It is being operationalized throughout the country, with special focus on 18 States which include 8 Empowered Action Group States (Bihar, Jharkhand, Madhya Pradesh, Chhattisgarh, Uttar Pradesh, Uttarakhand, Orissa, and Rajasthan), 8 north-eastern States, Himachal Pradesh, and Jammu and Kashmir. The achievements under the NRHM as on September 2010, include selection of 8.33 lakh accredited social health activists (ASHAs), employment of 1572 specialists, 8284 MBBS doctors, 26,734 Staff Nurses, 53,552 auxiliary nurse midwives (ANMs), 18,272 paramedics on contract basis and setting up of a total of 16,338 additional primary health centres (APHCs), primary health centres (PHCs), community health centres (CHCs) and other sub-district facilities made functional on 24 x 7 basis.

1.64 While the Government has consciously undertaken a large increase in budgetary allocations for anti-poverty programmes and employment generation schemes, the delivery mechanism needs to be bolstered and streamlined to facilitate the effective implementation of these programmes. To ensure that allocations result in outputs and outputs in outcomes, initiatives like the outcome budget and the setting up of the Unique Identification Authority of India by the Government are steps in the right direction.

Climate change

1.65 Climate Change as a result of greenhouse gas (GHG) emissions has been receiving intense political attention at domestic and international levels. The industrialized countries have the largest total emissions, and India's share of global GHG emissions is relatively small. Climate change has enormous implications for India. Various studies indicate that key sectors impacted by climate change are agriculture, water, natural ecosystem, biodiversity, and health. This is happening precisely at a time when India is confronted with huge development imperatives. A recent India-specific report warns of impacts such as sea-level rise, increase in cyclonic intensity, reduced crop yield in rainfed crops, stress on livestock, reduction in milk productivity, increased flooding, and spread of malaria.

1.66 Internationally, the United Nations Framework Convention on Climate Change (the Convention, entered into force in 1994) aimed to reduce emissions to sustainable levels and provide support to developing countries in terms of finance and technology. The Convention led to the adoption of the Kyoto Protocol in 1997.The Conference of Parties (CoP), which is the supreme body of the Convention, meets annually; during the 13th CoP held at Bali, Indonesia, in December 2007, a comprehensive programme called the Bali Action Plan was launched, followed by the 'Copenhagen Accord' in December 2009. The most recent negotiations held at Cancun during 29 November – 11 December 2010 have resulted in further decisions including mitigation adaptation, technology, and finance. The Cancun Agreements are widely perceived as a modest, small step forward and a reaffirmation of faith in the multilateral process. Decisions were taken at Cancun to set up a Green Climate Fund, a Technology Mechanism, and an Adaptation Committee at global level to support developing country actions for adaptation and mitigation.

1.67 India's determination in addressing climate change is evident from an indicative target of increasing energy efficiency by 20 per cent by 2016, now supplemented with the domestic mitigation goal of reducing emissions intensity of the GDP by 20-25 per cent of the 2005 level by 2020 through proactive policies. The resources required to achieve this objective will need to be mobilized from various sources. Studies in respect of a low carbon strategy are under way as one of the key pillars of the Twelfth Five Year Plan. Second, India is taking conscious steps for diversifying the energy fuel mix such as setting up of 20,000 MW of solar power-generating capacity by 2022, doubling the present 3 per cent share of nuclear power in the energy mix over the next decade, putting in place a major market-based programme to stimulate energy efficiency, imposing clean energy cess on coal for funding R&D of clean energy technologies even though coal will continue to play a key role in our future energy strategy, and aggressively expanding the use of natural gas in power production. Third, India has been pursuing aggressive strategies for forestry and has launched a major new programme on coastal zone management to address the adaptation challenges facing over 300 million people in our country who live in vulnerable areas near our coast. In addition, India implements a number of Central sector and Centrally sponsored schemes with many elements decidedly geared to adaptation. An exercise carried out for this Survey suggests India's expenditure on these adaptation-oriented schemes has increased impressively from 1.45 per cent of the GDP in the year 2000-01 to 2.82 per cent during 2009-10. India has also announced a National Action Plan on Climate Change (NAPCC) in June 2008—including eight national missions in the areas of solar energy, enhanced energy efficiency, sustainable agriculture, sustainable habitat, water, Himalayan ecosystem, increasing the forest cover, and strategic knowledge for climate change. State Action Plans are also under way

1.68 All actions to address climate change ultimately involve costs. Funding is vital in order for countries like India to design and implement adaptation and mitigation plans and projects. One of the important outcomes of the Cancun Agreements is the decision on 'fast start finance, long-term finance, and Green Climate Fund'. It was decided to set up a 'Green Climate Fund', approaching US$30 billion, for the period 2010-12, to be supported by an independent Secretariat and designed by a

Transitional Committee with 40 members—15 from developed countries and 25 from developing. It also recognized the goal of jointly mobilizing US$ 100 billion per year by 2020 as 'long-term finance' to address the needs of developing countries. The goal of US$100 billion falls short of developing countries' call for assessed contributions of 1.5 per cent of developed countries' GDP. Further, developing countries had been insisting on public funds as the major source, whereas the Cancun Agreements do not specify how the finances would be mobilized by the developed countries. In this context, India's initiatives will succeed if the global framework of actions is effective and supportive, including technology development and transfer efforts, built on sound principles of equity and common, but differentiated responsibilities.

Prospects, short term and medium term

1.69 Based on the performance of the economy over the last five years and analysis of the underlying trends of critical variables, India's real GDP is expected to grow by 9 per cent (+/- 0.25) in 2011-12. The Indian economy had grown at above 9 per cent for three consecutive years starting in 2005-06. So the economy is expected to revert to pre-crisis growth levels next year. The country's savings and investment rates had gone down a little during 2008-09 because of the deliberate decision by the Government to encourage consumption as an antidote to the economic downturn. The latest data on savings and investments, which pertain to 2009-10, show that these rates have turned around. In 2009-10 the savings rate was 33.7 per cent, up from the previous year's 32.3 per cent, and the investment rate had also risen and stood at 36.5 per cent. India's incremental capital-output ratio (ICOR) is estimated to be 4.1 for the Eleventh Plan. Given that the economy still has excess capacity, these two indicators lead to a projection of GDP growth just short of 9 per cent. Since savings and investments now show a positive momentum and the Government is implementing a gradual exit from the stimulus package, the savings and investment rates are likely to rise further. Hence it is expected that the economy's growth will breach the 9 per cent mark in 2011-12.

1.70 Growth forecasts and, for that matter, all forecasts in life, however carefully made, are subject to error. A sharp deterioration in weather conditions or a disproportionate spike in the price of crude petroleum can lead to slower growth. Equally, a sudden movement of these variables in a favourable direction can give a boost to the growth rate. Apart from the factors just mentioned, it should be pointed out that a certain amount of uncertainty continues to prevail over the economic conditions in Europe and the USA. Japan also has not yet shown definite signs of recovery from its long slowdown. The fiscal situation and level of sovereign debt in a large number of these industrialized nations are also in a somewhat tenuous situation. While India's growing trade and finance links with emerging economies provide some insurance against a downturn in industrialized nations, our economy has vital links with the industrialized nations. Hence India will be adversely hit in the event of a serious crisis in any of the major industrialized nations. However, the expectation is that there will not be a serious downturn in industrialized nations; or, more accurately, a second dip recession is a very low probability event. Hence the point expectation for India's growth is 9 per cent.

1.71 Looking further, into the medium to long term, the expectation is that India's pace of economic development will pick up even more. There are two reasons for this expectation. Given the momentum in the savings and investment rates and also the fact that India's demographic dividend is yet to peak and there is evidence that the savings rate for the working- age population of India, especially for those in the 30s and 40s, is disproportionately high, the ratio of investment to ICOR is expected to rise in the next half to one decade. Further, the fraction of investment that is going towards building up infrastructure has been rising. The importance of infrastructure for sustainable and inclusive development is now well recognized and the Planning Commission is scheduling to give this a large boost in the Twelfth Five Year Plan.

1.72 It is known that once an economy begins to operate close to its capacity, the savings and investment rates are no longer such effective drivers of GDP growth. Growth then depends much more on skill development and innovative activity in the country. Fortunately, there is awareness of this in India and efforts are afoot in terms of budgetary allocation and actual initiatives to boost the development of skill and human capital. Innovative activity in a nation is difficult to measure but, judging by patenting activity, there seems to be a pickup in research and innovation in India. Patent applications used, traditionally, to be few and far between. There is, however, a sharp rise in this over the last few years. In 2004-05, 17,466 patents were filed and 1911 granted. In contrast, in 2008-09, 36,812 patents were filed and 16,061 granted. There are also initiatives to bolster India's higher education system, including universities, institutes of technology, and centres of research. It is expected that these initiatives will gather steam and more than make up for eventually waning power of the savings rate as a driver of economic growth. As a consequence, the next two decades should see the Indian economy growing faster than it has done any time in the past and also faster than the growth in the next two years.