

# Overview

The global economic recovery from the shocks of crisis in 2008 and 2009 has been gradual. There have been challenges and risks in managing the recovery in different countries. China and India have managed to climb back to close to the high rate of growth which they had achieved before the crisis. In the advanced economies, there is expectation of significant growth in 2010.

The World Economic Outlook for October 2010 lists two fundamental rebalancing acts to achieve the goal of strong, balanced and sustained world recovery: an internal rebalancing by which the fiscal support during the crisis would give way to private spending; and the second, excessive external account imbalances are rectified to achieve balanced growth of domestic and export demand. The first of the imbalance was a consequence of the crisis whereas the second was one of the causes of the crisis. The global economic crisis has reinforced the need for strengthening national economic systems as much as the global economic arrangements. The need to take signals of economic imbalances seriously has been an important lesson of the crisis.

In the Indian context the global markets were just beginning to open up significant opportunities for both investment and trade when the crisis struck. The economy has now shown signs of strong recovery although sustaining this recovery over the medium term will require

addressing the bottlenecks in the supply systems. Domestic demand will continue to play a major role in sustaining growth over the medium term and one of the bottlenecks is the inequalities that persist in the performance of across regions, social groups and sectors that were highlighted when the Eleventh Five Year Plan was launched three years back.

High rate of inflation continues to be the central policy concern now. Although various social safety net programs do exist, the impact of high inflation rate is far reaching. The favourable monsoon is expected to bring some relief on the price front. But what is needed is a longer term response that makes the supply side of the economy more responsive to the price signals.

In this review we present the major trends and patterns of variables in the major sectors of the economy. We begin with an assessment of the overall macroeconomic scenario for 2010-11 in the section "Forecast". The production trends in agriculture, industry and services are covered in their respective sections. The money and finance section presents a review of the main monetary aggregates and prices in the financial and capital markets. The external trade is presented in the subsequent section. Developments in the price scenario and public finances during the quarter are presented in the final two sections.

### **Agriculture, Industry and Services**

The most important factor that has a bearing on the prospects of Indian agriculture in the short term is the rainfall during the monsoon season. The monsoon in the current year was somewhat erratic but it is likely to produce a much larger crop harvest than what was obtained last year. The review notes that 'of the total 36 agro-meteorological sub-divisions, 31 sub-divisions covering about 69 per cent of all districts in the country for which data were available have received normal to excess rainfall'. There was significant deficiency in rainfall relative to the 'normal' level in some of the eastern regions and there were floods in the northwest and west.

The overall impact of the monsoon rainfall this year is expected to boost the *kharif* season crop output and also provide enough water resources for a good *rabi* harvest as well. Most importantly, the harvest may also ease the inflationary pressures in the coming months.

In the quarter that ended in September 2010, industrial growth was driven by capital goods and consumer durables. The business expectations surveys and capital goods production trends reveal considerable improvement in investment climate. Data is available on industrial output trends only upto August. The growth of consumer durables sector for the first five months of the current fiscal year also points to the improvement in consumer confidence. Some of the impetus to the revival of demand may have come from fiscal incentives to sectors such as infrastructure but some changes may also indicate the re-balancing in the economy that may be under way: greater reliance on domestic demand than the external demand for sustaining output growth.

The services sector output has shown less volatility than the industrial sector. The GDP from services sector- includ-

ing construction- increased by 9.4 per cent in Q1: 2010-11 over Q1: 2009-10. The growth was led by trade, hotels, transportation and communication. The construction sector has shown significant improvement in output growth starting from the second half of 2009-10. The two sub-sectors where there is deceleration in output growth in Q1: 2010-11 as compared to Q1: 2009-10 are finance and community, social, and personal services. The latter sector is significantly influenced by government spending. The prospects for the services sector for the current fiscal remain stable as the infrastructure sectors are likely to provide support for the growth of several of the services.

### **External trade**

The expected return to positive growth in world output and world trade volumes improves the outlook for both developing and developed economies. It has also been projected by the IMF in its World Economic Outlook, October 2010 that the commodity prices would post increase in 2010 over 2009 though would not yet touch their high values of 2008.

After a strong growth during 2004-05 to 2007-08, when exports grew by an average 26.4 per cent per year, India's total merchandise exports posted sharp deceleration in 2008-09 when exports grew by 13.7 per cent. The year 2009-10 posted absolute decline of (-) 3.6 per cent in India's exports. Total merchandise exports reached \$178.7 billion in 2009-10, lower than the previous year's mark. However, the first five months of 2010-11 have turned the scenario around registering growth in exports of 28.6 per cent during April-August.

Imports, inclusive of oil imports, which grew at an average rate of 34.1 per cent during 2004-05 to 2007-08 decelerated in 2008-09 posting slower growth rate of 20.8 per cent followed by absolute decline

of (-) 5.6 per cent in 2009-10. As in the case of exports, imports in 2009-10 were lower than in the previous year. They have now regained momentum in April-August 2010 registering growth of 33.1 per cent.

In the first quarter of 2010-11, the service sector exports have registered growth of 22.5 per cent over the previous year.

The overall merchandise trade deficit has widened to \$ 34 billion in Q1: 2010-11. The current account deficit for Q1: 2010-11 is 13.7 billion as compared to \$ 4.5 billion in the same period last year.

There was a slackening of both net FII and FDI capital inflows during the first quarter of the current financial year as compared to the experience in the same period in the previous year.

### **Money, Finance and Prices**

With the new WPI in operation, the measurement of headline inflation is more comprehensive than before. The new index has broader coverage of the goods produced in the economy and there are more price quotations per item than before.

The headline inflation, however, has remained at a high level of just under nine percent in September on annual basis. The primary article prices showed an increase of 15 per cent in September over the same period in the previous year. Although the good crop harvest in *kharif* is expected to provide the much needed relief, the need for attending to the supply side of the economy is intense. All the gains in growth will remain poorly distributed if inflation remains high.

The monetary policy is now more focused on the need to bring down the prevailing high rate of inflation. At the time of the mid-quarter review of the economy in September last month, the repo rate and reverse repo rate were increased. These fol-

low the previous four increases in these rates in this calendar year. Although the headline price inflation is still held high by the prices of primary articles and fuels, there has been a concern that the prices of manufactured products would not remain immune to the cost increases too long. With greater confidence in the continuation of strong growth in the industrial sector and a robust growth in the agricultural sector, the focus on inflation is appropriate.

The monetary policy concerns have also included the rising capital inflows. Although the first quarter has not been significant in this respect, the FII inflows have been substantial in the subsequent period. The stock prices have returned to the pre-crisis level on the back of FII interest. The fresh issues of capital indicate increasing investor confidence in the medium term prospects of the economy.

The monetary scene is also marked by higher growth in commercial credit and slowing down of bank credit to central government.

The economic recovery and high rate of inflation have meant rising interest rates, widening the spread between domestic and international cost of capital. The capital flows have also put pressure on rupee although this may not be a unique position of the Indian currency. However, managing liquidity in the face of heightened capital inflows remains an important macroeconomic challenge at this time.

### **Public Finance**

With the recovery of industrial activity, the public finances have improved. Both the direct and indirect tax revenues have improved. More importantly, the non-tax revenues have made the exit from 'fiscal stimulus' less destabilising for the economy.

On the reforms side of policy, the adoption of Direct Tax Code is a positive development. Its implementation is expected only in 2012 after the bill is passed by the parliament. However, on the GST, there is likely to be further wait as the consensus among the states and between the states and the centre is elusive so far.

The optimism on the economy and on the fiscal front may provide the much needed push for other policy reforms. A medium-term goal of sustained high rate of economic growth can be achieved only when the supply side bottlenecks are removed before the constraints take effect.

### **Forecast**

The overall assessment of the economic activity provided in the official estimates of GDP for Q1: 2010-11 present a picture of robust growth. The GDP growth is placed at 8.8 per cent over the same period in the previous year. This overall growth is higher than the growth seen in the fourth quarter of 2009-10 on account of higher growth rates in agriculture and services. Within industry, manufacturing sector has retained a strong growth momentum seen in the fourth quarter of last fiscal. On the expenditure side, investment has shown significant improvement over its performance in Q1: 2009-10.

The quarterly assessment of growth prospects provides an overall growth estimate of 8.3 per cent for 2010-11. The more detailed assessment based on the macroeconomic model provide a slightly higher growth projection of 8.4 per cent for 2010-11. The revised growth estimates are higher than our previous projection of 8.1 per cent presented in July 2010. The improved growth has come entirely from the higher growth estimated in the case of agricultural output. The revised estimate of growth rate for agriculture and allied sector GDP is 6.6 percent. The growth rate of industry including construction is projected at 8.8 per cent and services GDP growth is projected at 8.7 per cent.

The projected annual average inflation rate of 6.9 per cent for 2010-11 is considerably lower than its current level. The higher agricultural output has a significant impact on the price level of primary articles in the analytical framework which influences the projections. The quarterly assessment based on major components of WPI provides a higher estimate of 8.3 per cent for the headline inflation. The inflation rate therefore is likely to be in the range of 6.9 to 8.3 per cent.

The fiscal deficit of the centre is projected at 4.7 per cent and current account deficit is projected to increase to 3.3 per cent.