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Macroeconomic and Monetary Developments

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Summary

The Economic Advisory Council to the Prime Minister and the Reserve Bank of India have both released reports on the overall macroeconomic developments in the economy as a review of the first quarter of 2010-11. Highlights of the reports are presented-

Domestic Economy

- Both report downside risk to growth in agricultural output are low. Lead indicators for services activities shows continuation in growth momentum.
- Private investments showed recovery since last quarter of 2009-10. Total investment in fixed assets will continue to be strong, as supported by production trends in capital goods.

Fiscal Performance

- Government Final consumption to GDP hit a peak 12.3% in 2009-10, but is expected to fall to 10.3% in 2011-12, reflecting the fiscal consolidation programmed in the budget.

Monetary conditions

- Fund flows from capital market to commercial sector have been quite strong. Bond issuance growth has been relatively higher than issuance of equity.
- Reflecting increased demand for credit associated with recovery in growth, non-food credit growth to the private sector remained buoyant.
- The RBI identifies the implementation of base rates as a mechanism to improve transparency in loan pricing, promote competition in the credit market and improve transmission of monetary policy. The base rates set by major public sector banks were in the narrow range of 7.25-8.0 per cent.

Global Economy

- The exchange rate is expected to show stable, variations being within acceptable range.
- Global demand may weaken in the second half of 2010 if the pace of global recovery slows down due to possible escalation of the euro area fiscal stress and adoption of fiscal austerity measures by the advanced economies.

Economic Outlook 2010-11

The Economic Outlook 2010-11 was released by the Economic Advisory Council to the Prime Minister on Friday, 23rd July 2010. It stated that the performance of the Indian economy in 2009-10 greatly exceeded expectations. The global economic and financial condition is improving but both financial markets and business environment remain volatile. The strategy for India consequently has been identified as one of returning to the 9% growth trajectory with promotion of business confidence whilst facilitating investments.

Projections

- **The economy is projected to grow at 8.5% in 2010-11 and 9.0% in 2011-12.**
- **Growth of agricultural sector projected at 4.5% in 2010-11**, with a rebound in both Kharif and Rabi crop production; this growth rate is much above the actual growth rate of 0.2% in 2009-10 achieved on higher output in horticulture, animal husbandry, fisheries and cotton. **Sectoral growth for industries and services are projected to gradually increase to 9.7% and 8.9%.**
- Rising domestic savings and investment are being viewed as chief engines of growth. **Investments rate is projected at 37% and domestic savings rate at 34% in 2010-11.**
- **Current account deficit is provisionally placed at 2.7% of GDP in 2010-11**, with merchandise trade deficit (around 9% of GDP) increasing faster than invisibles trade surplus (around 6.3% of GDP). The oil import bill is expected to rise to \$103 billion, with increase in import volumes and oil prices (by almost 15%).
- **Inflation rate is projected at 6.5% by March 2011** based on expectations of normal monsoons combined with base effect (loss in farm sector output was overestimated the previous year).
- **Revenue Deficit as a ratio of GDP is expected to decline from 6.3% in 2009-10 to 4.6% in 2010-11.** Greater buoyancy in direct and indirect taxes, telecom auctions and decontrol of the petroleum products prices to provide additional cushion in this regard.

Concerns

- With credit having seen strong growth in the 1st quarter of 2010-11, there is a bias towards pursuing a tight monetary policy.
- Budgeted level of Fiscal Deficit and Revenue Deficit still beyond comfort zone.

Strategy

- The outlook recognized that controlling high inflation in the medium term is essential for sustainable growth.
- Exit from expansionary fiscal policy, both feasible and necessary.
- Improving farm productivity whilst available food stocks must be released to have a dampening effect on prices.
- Rationalizing food and fertilizer subsidies.
- Closing the large physical infrastructure deficit, especially in the power sector.
- Implementation of goods and services tax (GST) must be a priority.

Macroeconomic and Monetary Developments in the First Quarter of 2010-11

The Reserve Bank of India today released the document Macroeconomic and Monetary Developments: First Quarter Review 2010-11; a backdrop for the Monetary Policy Review to be held on 27th July 2010.

- Global output increased by over 5 per cent in Q1 of 2010, but the sovereign debt crisis of the Euro area has slowed the pace of global recovery. Emerging market economies are expected to continue to normalize monetary policy in the midst of inflationary pressures and risk of asset price build up.
- Reflecting the tight liquidity conditions in June 2010, interest rates at the short end of the term structure edged up, while medium to long-term yields moderated, in view of the improved fiscal position after 3G/BWA auction revenues.
- **GDP growth in 2010-11 can be expected to be higher than the 8.0 per cent projected in the April 2010 Monetary Policy Statement.** The Professional Forecasters' Survey conducted by the Reserve Bank in June 2010 places overall (median) GDP growth rate for 2010-11 at 8.4 per cent, higher than 8.2 per cent reported in the previous round of the survey.
- The report identifies private consumption and investment demand to be the two major drivers of growth during 2010-11
- With recovery of exports and return of capital flows the external sector conditions have improved. The current account deficit contributed to higher growth through greater absorption of foreign capital.

Given the risks to inclusive growth from high inflation, the monetary unwinding that started in October 2009 should continue till inflation expectations are firmly anchored and inflation is brought down.

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