

# **Mid-Year Review of the Indian Economy 2009-2010**

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**Biswajit Dhar**



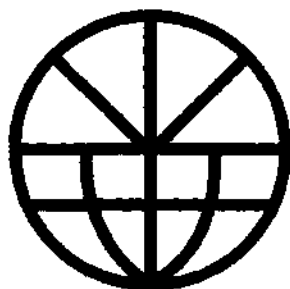
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## Preface

The *Mid-Year Review of the Indian Economy* is the outcome of an annual seminar organized by the India International Centre in collaboration with the Malcolm and Elizabeth Adiseshiah Trust. The present *Review* assumes a special importance as 2010 will mark the birth centenary of Malcolm Adiseshiah. It is, therefore, fitting that we recall the contribution of this distinguished Indian as we present this volume. Dr. Adiseshiah, a Life Trustee of the IIC, was deeply involved in the Centre's financial management and took a special interest in the activities of the Economic Affairs Group.

Malcolm Adiseshiah (1910-1994) was among the band of post-independence humanists who contributed to the emergence of India as a modern nation. In 1970, Dr. Adiseshiah returned to India after a 25-year stint at UNESCO where he rose to be its Deputy Director-General. He then devoted himself to building institutions of excellence, the promotion of education, community development and to devising programmes in the broad area of economics – teaching and research, both fundamental and applied. The Trust he founded now supports several awards and projects, of which the annual *Mid-Year Review of the Indian Economy* is an important example.

The 2009-2010 *Review* was presented by Dr. Biswajit Dhar, Director-General of the Research and Information System for Developing Countries (RIS). A panel of eminent economists (Dr. Mythili Bhusnurmath of the *Economic Times* and Dr. Matthew Joseph, Senior Consultant at ICRIER) commented on various aspects of this presentation. Dr. Saumitra Chaudhuri, Member, Planning Commission, chaired and steered the proceedings. The audience, comprising of economists, journalists, academics

and interested citizens, participated vigorously in the question and answer session at the end of each segment of the seminar.

Held on 7 November 2009, soon after the figures for the third quarter of the financial year were released, the *Review* was among the first to analyze the trends and projections for the coming year. It focused on the global economic downturn and the extent of its impact on the Indian economy. It also considered the effect of this on the fiscal stimulus provided by the government and the budget of 2009-2010. These included the government's policy initiatives to alleviate rural unemployment and agricultural distress in the wake of a bad monsoon year. The *Review*, based on exhaustive analysis, looked at infrastructure project delays, rising food prices, trade imbalances, the impact of a weak monsoon, among other issues.

The Centre is grateful to all those who were involved with the arrangements for this seminar and to the participants for their help in editing the proceedings of the seminar. This has made it possible for us to bring out the *Mid-Year Review of the Indian Economy* within six weeks of it being held. The Centre also owes special thanks to Dr. Ajit Mozoomdar for his sterling tributes to Dr. Adiseshiah in his inaugural remarks.

We hope this volume will result in a healthy public debate in the media and the institutions concerned with issues of development and national economy. With the wealth of analytic material, we are certain that it will be of great use to policy planners, research scholars, as well as all those with an interest in India's trade and industry sector.

Ira Pande  
Editor

## **Acknowledgements**

The author would like to thank Mythili Bhusnurmath and Mathew Joseph, the two discussants, and the participants of the seminar for their useful comments. The IIC is not responsible for the views presented or any errors that remain.



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## **Introduction**

In September 2008, the collapse of Lehman Brothers brought with it the spectre of the worst global economic downturn since the depression of the 1930s. The crisis that the financial sector, particularly in the U.S., had faced could not be contained and the resultant contagion reversed the growth momentum that the global economy had seen over the past several years. According to IMF estimates, the advanced economies had experienced an unprecedented 7.5 per cent decline in real GDP during the fourth quarter of 2008, and output continued to fall almost as fast during the first quarter of 2009.

The crisis impacted global trade flows quite severely. The World Trade Organization (WTO) predicted that the collapse in global demand brought on by the biggest economic downturn in decades would drive exports down by roughly nine per cent in volume terms in 2009, the biggest such contraction since the Second World War. The steep contraction faced by the developed economies meant that the developing countries, that were dependent on their markets, ended up importing the crisis. Leading the group of such countries were the countries in the South East Asian region, which faced declining GDP growth rates for the first time since the financial meltdown of the late 1990s.

The larger economies, namely India and China, remained relatively less affected by the crisis. Their domestic markets provided them with an ideal antidote to overcome the crisis and, as a result, the growth rates of these countries have only moderated since the occurrence of the crisis. The India-China experience has raised an interesting debate among the policy analysts concerning the importance of the domestic markets

to smoothen out the downside risks and uncertainties of the global contagion.

But what will be discussed for a long time will be the profound changes that the crisis brought about in the ways in which the economies are allowed to function. Faced with the imminent collapse of the market, the activist state had to re-appear once again. The most forceful argument for policy intervention was made by the IMF in its World Economic Outlook of April 2009. IMF argued that the difficult and uncertain outlook requires forceful action on both the financial and macroeconomic policy fronts. The organization hastened to add that past episodes of financial crisis have shown that delays in tackling the underlying problem mean an even more protracted economic downturn and even greater costs, both in terms of taxpayer money and economic activity.

Even before the year had ended, governments in the developed countries had already moved with alacrity to stem the tide. The coffers were opened for the markets to be stabilized. More importantly, the taxpayers' money was used to stimulate the demand in the markets that were woefully short of confidence.

The results of the intervention are being felt almost a year since the governments started intervening. Early signs of recovery are being seen, but most analysts remain concerned about the sustainability of the recovery process. The critical issue arises from the ability of the governments to provide ever more resources, particularly when most of them faced enormous budget constraints. But the critical aspect of the government intervention is that it has allowed some time to understand and find remedies for some of the more structural ills of the economy, including those that arise from the lack of effective institutions that would ensure the smooth functioning of the markets.

As was mentioned at the outset, the Indian economy has not been affected by the global economic downturn as much as many of the other developing countries. Analysis of the performance of the Indian economy, therefore, becomes an interesting issue for it provides an opportunity to understand

the dimensions of the economy and particularly its management that played a role in ensuring relative stability. At the same time, it is important to make an assessment of the vulnerability of the Indian economy to the downside risks that observers of the global economic dynamics have been alluding to, more so in the context of the (fragile) recovery that is taking place.

The study looks at the various facets of the Indian economy and its functioning, especially in recent months. It must be emphasized that the study is a first attempt to highlight some of the more important aspects of the Indian economy.

The study covers the following broad themes:

1. Growth Performance and Prospects in 2009-10
2. The Fiscal Situation
3. The Price Situation
4. Monetary Policy and Financial Markets
5. The External Sector



## Growth Performance and Prospects in 2009-10

### Performance in 2008-09: An Overview

The onset of the global economic crisis had caused a moderation of India's economic growth during 2008-09. The economy that had grown at an average rate of nearly nine per cent during 2004-05 and 2007-08 could not keep its growth momentum going as tribulations of the global markets made its impact felt on India. According to the revised estimates provided by the Central Statistical Organization (CSO), the Indian economy grew by 6.7 per cent during the previous financial year, which impeded the growth momentum of the past few years quite considerably. While the impact on the slow-down was felt on all sectors of the economy, it was the real sector that took the biggest hit as both agriculture and manufacturing recorded far lower rates of growth in 2008-09.

**Table 1.1.** Rate of growth at factor cost (at 1999-2000 prices)

(Figs. in %)

| <i>Industry</i>                                       | 2005-06 | 2006-07 | 2007-08 | 2008-09 |
|---|---------|---------|---------|---------|
| Agriculture, Forestry & Fishing                       | 5.8     | 4.0     | 4.9     | 1.6     |
| Mining & Quarrying                                    | 4.9     | 8.8     | 3.3     | 3.6     |
| Manufacturing   | 9.1     | 11.8    | 8.2     | 2.4     |
| Electricity, Gas & Water Supply                       | 5.1     | 5.3     | 5.3     | 3.4     |
| Construction  | 16.2    | 11.8    | 10.1    | 7.2     |
| Trade, Hotels & Restaurants                           | 12.1    | 12.8    | 12.4    | 9.0     |
| Transport, Storage & Communication                    |         |         |         |         |
| Financing, Insurance, Real Estate & Business Services | 11.4    | 13.8    | 11.7    | 7.8     |
| Community, Social & Personal Services                 | 7.1     | 5.7     | 6.8     | 13.1    |
| Total GDP at Factor Cost                              | 0.0     | 9.7     | 9.0     | 6.7     |

Source: CSO

Despite being the soft under-belly of the Indian economy and having been plagued by the low-growth syndrome for years, agriculture had, in the recent past, raised the hope of doing better than the four per cent target that the Eleventh Plan had set. Between 2005-06 and 2007-08, the growth rates realized by the sector had exceeded all expectations as it had grown at an annual average rate of nearly five per cent. More importantly, production of food grains increased consistently during all these years resulting in an average annual increase of over 10 million tonnes. The total food grain production in 2007-08 was estimated at 230.78 million tonnes as against 217.3 million tonnes in 2006-07. This trend was reversed in 2008-09: the revised estimates provided by the CSO indicate that the sector grew by just 1.6 per cent. This slow down in agricultural growth rate has taken place despite the fact that 4th advance estimates put the production of food grains during 2008-09 at 233.87 million tonnes, which exceeded the target of 233 million tonnes set for the year. This growth in food grains' production notwithstanding, the performance of Indian agriculture during 2008-09 brings into sharp focus the need to improve the level of efficiencies in agricultural production and marketing in Indian agriculture so as to provide market-based incentives to the producers.

The industrial sector was directly impacted by the global slow down. The fall in exports, together with the second order impact of the global economic crisis on the Indian economy, led to a slowing down of consumer demand, thus affecting the growth momentum of the industrial sector. The sector had grown by nearly nine per cent in 2007-08, which was, in itself, a moderate rate of growth as compared to the 12 per cent expansion it has experienced in 2006-07. In 2008-09, the sector grew by less than three per cent. The slow down in the industrial sector occurred as only two of the industry groups (at two-digit level of NIC) in the industrial sector recorded substantial expansion, while eight industry groups experienced negative growth for the entire year. Included in the latter group were sectors like food products, rubber, plastic and petroleum and cotton textiles, which have a combined weight of nearly

25 per cent in the index of industrial production (IIP). Among industry groups that recorded low growth were sectors like chemicals and chemical products and textiles, in which India has a large presence in the global market.

The construction industry went through a boom phase in the middle of the current decade with its growth rate exceeding 16 per cent in 2005-06. The sector did maintain the growth momentum, albeit at lower rates, in the following years, but a series of negative impulses dragged its growth rate down and in 2008-09, the industry grew by just over seven per cent. The first was the impact of the increase in the costs of construction due to a rise in the prices of inputs like steel and cement and

**Table 1.2. Industrial Growth by Industry Groups**

| Two-Digit Level Groups                      | Weight       | 2007-08    | 2008-09    |             |            |
|---|--------------|------------|------------|-------------|------------|
|   |              |            | H1         | H2          | Full Year  |
| <b>Overall Manufacturing</b>                | <b>100.0</b> | <b>9.0</b> | <b>5.3</b> | <b>-0.5</b> | <b>2.3</b> |
| <b>High growth in 2008-09</b>               |              |            |            |             |            |
| Beverages, Tobacco                          | 3.0          | 12.0       | 20.3       | 11.3        | 15.6       |
| Machinery & Equipment                       | 12.1         | 10.4       | 10.1       | 7.4         | 8.7        |
| <b>Growth between Nil and 5% in 2008-09</b> |              |            |            |             |            |
| Basic Metals & Alloys                       | 9.4          | 12.1       | 6.7        | 1.4         | 4.0        |
| Textile Products                            | 3.2          | 3.7        | 5.2        | 2.2         | 3.7        |
| Chemicals & Products                        | 17.6         | 10.6       | 6.1        | -0.3        | 2.9        |
| Transport Equipments                        | 5.0          | 2.9        | 12.2       | -6.8        | 2.2        |
| Paper & Paper Products                      | 3.3          | 2.7        | 4.6        | -1.8        | 1.3        |
| Non-Met. Mineral Products                   | 5.5          | 5.7        | 0.6        | 1.4         | 1.0        |
| Miscellaneous Manufacture                   | 3.2          | 19.8       | -1.1       | 1.8         | 0.5        |
| <b>Negative Growth in 2008-09</b>           |              |            |            |             |            |
| Wool, Silk & Man-made Textiles              | 2.8          | 4.8        | -0.9       | 0.3         | -0.3       |
| Rubber, Plastic, Petroleum                  | 7.2          | 8.9        | -4.0       | 0.9         | -1.5       |
| Cotton Textiles                             | 7.0          | 4.3        | 0.1        | -5.7        | -2.8       |
| Metal Products                              | 3.5          | -5.6       | 1.9        | -9.3        | -4.0       |
| Leather Products                            | 1.4          | 11.7       | -1.8       | -12.0       | -7.0       |
| Food Products                               | 11.4         | 7.0        | -1.0       | -14.8       | -9.6       |
| Jute Textiles                               | 0.7          | 33.1       | -5.4       | -14.6       | -10.0      |
| Wood Products                               | 3.4          | 40.5       | -6.1       | -14.7       | -10.3      |

Source: CSO

interest costs. Secondly, the high growth and the resultant overheating was manifested in the form of a speculative bubble that affected the market. And, finally, the rise in interest rates and the slow down in housing loans also moderated demand.

In overall terms, the service sector was the least affected, although as was to be expected, the group of industries that includes financial, business and real estate services grew the least. The uncertainties that the financial sector has been undergoing since the third quarter of 2008-09, was reflected in the growth performance of this sector. Business services, the other major component of this industry group, were also severely affected by the global economic downturn as the demand for India's business process outsourcing activities, particularly from the U.S., declined in the wake of the crisis.

The global economic downturn made a major impact on India's external sector. Beginning in August 2008, India's exports of merchandise started declining and this trend was maintained until the end of the financial year 2008-09. The declining exports affected several manufacturing sectors that were establishing themselves in a number of markets in the immediate past.

The decline in exports reversed the trend of the rapid increase in exports that India had experienced during the past several years. In this phase, India's trade performance has surpassed those of most of the major economies in the emerging markets. Riding on the back of this performance, India has been able to double its share in the global merchandise trade, while its share in the global trade in commercial services is well above two per cent. India's trade performance came in the wake of the policy decision taken a few years back to embark on a 'look east' policy. By so doing, India was able to link itself up with the most dynamic region of the global economy, a region that holds the key to global prosperity in the ensuing decades.

2008-09, therefore, brought with it uncertainties for the Indian economy for which the government had to provide effective policy instruments. Unlike in most major economies where the governments had to announce stimulus packages, the Government of India did not have to take recourse to



such measures. Two factors influenced the decision of the government: first, Indian economy did not have to put any of its sectors on a 'life support system' since none of the sectors faced meltdown as was the case in countries like the U.S. The second reason was that the Indian economy started showing signs of recovery much earlier than most other major economies. Thus, while some of the packages providing incentives to specific sectors of the economy may still be needed to ensure that the revival not only can be sustained, but perhaps more importantly, there are no possibilities of reversal of the upturn. It must, however, be stated that the revival is not likely to be immediate and that India would have to wait for the major markets to find their feet.

### **Prospects for 2009-10**

The growth momentum of the Indian economy seems to have returned much before many would have predicted. In May 2009, the IMF Survey has predicted that India's GDP growth would be markedly slow in 2009 before it starts to rebound toward year end. The Fund added that although India's relatively low dependence on exports will contain the transmission of the global demand shock, India will be particularly affected by the financial shock, because the strong investment growth in recent years owed much to the favourable credit conditions. The Fund's prognosis was that investment growth is expected to be severely curtailed, and so is GDP growth since external financing has tightened and the domestic credit cycle has turned adverse. Many of these predictions of the Fund, particularly those concerning the financial market conditions, have since changed quite appreciably and this has provided a positive impetus to the Indian economy.

Half-yearly results available for 2009-10 indicate that the decline experienced by most sectors of the Indian economy has not only bottomed out, the bounce back has well and truly begun. Estimates provided by the CSO for the first two quarters of current financial year indicate that GDP growth is likely to exceed seven per cent. It may be pointed out that

the performance of the economy during Q1 and Q2 of 2009-10 cannot be compared with that in the corresponding period of the previous fiscal, since the current year is witnessing the revival of the economy while in 2008-09, India was not affected by the global downturn till well into the second quarter.

GDP growth in Q2 of 2009-10 was a result of strong performance by all sectors, with the exception of agriculture. Starting with Q1 of 2009-10, manufacturing had reversed its dismal performance in the second half of 2008-09 during which the sector had witnessed a 0.5 per cent decline in the industrial sector. In terms of the overall growth rates, the sector was still lagging behind with a 3.4 per cent growth in Q1. However, in Q2, manufacturing saw a rapid upturn resulting in a 9.2 per cent growth. But it was the performance of the service sectors that kept India's GDP growth from sagging when the real sector was going through the trough. In the past few months both financial services and real estate seem to have overcome the shock and have started reviving.

An interesting feature of the GDP growth rate registered in 2009-10 was the emergence of a large gap in the growth rates determined on the basis of factor cost and market prices. The

**Table 1.3.** GDP Growth in Q1 and Q2 of 2009-10

| Sector  | Rates Of GDP at Factor Cost (%) |      |         |      |
|---|---------------------------------|------|---------|------|
|   | 2008-09                         |      | 2009-10 |      |
|   | Q1                              | Q2   | Q1      | Q2   |
| 1. Agriculture, Forestry & Fishing                | 3.0                             | 2.7  | 2.4     | 0.9  |
| 2. Mining & Quarrying                             | 4.6                             | 3.7  | 7.9     | 9.5  |
| 3. Manufacturing                                  | 5.5                             | 5.1  | 3.4     | 9.2  |
| 4. Electricity, Gas & Water Supply                | 2.7                             | 3.8  | 6.2     | 7.4  |
| 5. Construction                                   | 8.4                             | 9.6  | 7.1     | 6.5  |
| 6. Trade, Hotels, Transport & Communication       | 13.0                            | 12.1 | 8.1     | 8.5  |
| 7. Financing, Ins., Real Est. & Business Services | 6.9                             | 6.4  | 8.1     | 7.7  |
| 8. Community, Social & Personal Services          | 8.2                             | 9.0  | 6.8     | 12.7 |
| GDP at Factor Cost                                | 7.8                             | 7.7  | 6.1     | 7.9  |

Source: CSO

Table 1.4. Difference in GDP Growth at Market Prices and Factor Cost

|      | 2007-08 |        | 2008-09 |        | 2008-09 |        | 2009-10 |        | 2008-09 |        | 2009-10 |        |
|------|---------|--------|---------|--------|---------|--------|---------|--------|---------|--------|---------|--------|
|      | At      | At     | At      | At     | At      | At     | At      | At     | At      | At     | At      | At     |
|      | Factor  | Market | Factor  | Market | Factor  | Market | Factor  | Market | Factor  | Market | Factor  | Market |
| Cost | Prices  | Prices | Cost    | Prices | Cost    | Prices | Cost    | Prices | Cost    | Prices | Cost    | Prices |
|      |         |        |         |        | Q1      | Q1     | Q2      | Q2     | Q1      | Q1     | Q2      | Q2     |
| 9    | 9.1     | 6.1    | 6.7     | 6.1    | 7.8     | 8.2    | 7.7     | 7.8    | 6.1     | 6.0    | 7.9     | 6.7    |

Source: CSO

Q2 GDP growth at factor cost increased by nearly eight per cent over the corresponding period in the previous year, but while measures in terms of market prices, GDP growth was still less than 7 per cent. As the following table shows, this difference in the two sets of GDP estimates has been highest during Q2 of 2009-10. This difference between the two sets of GDP estimates can be explained by the economic stimulus provided by the Central government that has taken the form of tax sops in the main (see the following chapter for details). The relatively high GDP growth (at factor cost) registered in Q2 of 2009-10 thus indicates that the impact of the stimulus has had a positive impact in taking the GDP growth closer to the trend rate of 8-9 per cent registered in the period immediately preceding the economic crisis.

While most sectors have recovered from the downturn in 2008-09, revival of agriculture remains uncertain. This scenario arises because of unfavourable monsoon conditions during 2009, which has affected the kharif crops. As compared with the five preceding years, monsoon conditions in the current year were the most unfavourable.

In the south-west monsoon season of 2009, normal/excess rainfall was recorded in only 13 of the 36 meteorological sub-divisions (36 per cent of total) and deficient/scanty in the remaining 23 sub-divisions (64 per cent). In sharp contrast, almost 77 per cent of the total meteorological sub-divisions received normal/excess rainfall during the 2004-2008 south-west monsoon seasons. In fact, the situation in 2008-09 was more favourable than that prevailing in 2004-08, with more

**Table 1.5.** South-West Monsoon in the Meteorological Sub-divisions  
(in millimetres)

| <i>Rainfall levels</i> | 2004 | 2005 | 2006 | 2007 | 2008 | 2004-08 | 2009 |
|------------------------|------|------|------|------|------|---------|------|
| Excess/Normal          | 24   | 31   | 23   | 31   | 29   | 28      | 13   |
| Deficient/Scanty/Nil   | 12   | 5    | 13   | 5    | 7    | 8       | 23   |
| Total                  | 36   | 36   | 36   | 36   | 36   | 36      | 36   |

Source: Ministry of Agriculture and Cooperation

than thirty per cent of the meteorological sub-stations receiving more than the normal rainfall.

The situation in 2009 was particularly damaging for kharif paddy as the scanty rainfall period till end of July affected the sowing of this crop. Although there was some recovery of rainfall in August, this was inadequate to make up for lost time.

The consequences of the shortfall in monsoon were reflected in the sowing patterns of the crops in the kharif season, which were well below the normal levels for most of the major crops. The largest shortfall was registered in case of kharif paddy: sowing in the 2009 season was nearly 17 per cent below the norm.

**Table 1.6.** Actual and Normal Precipitation in the four months of South-West Monsoon, 2009

| <i>Rainfall Levels</i> | <i>June</i> | <i>July</i> | <i>August</i> | <i>September*</i> | <i>June to Sept.</i> |
|------------------------|-------------|-------------|---------------|-------------------|----------------------|
| Actual                 | 85.7        | 260.6       | 190           | 175.5             | 689.5                |
| Normal                 | 162.4       | 293.4       | 262.1         | 210.2             | 892.2                |
| Deviation              | -47.2       | -11.2       | -27.5         | -16.5             | -22.7                |

Source: Ministry of Agriculture and Cooperation

**Table 1.7.** Status of Sowing of Selected Kharif Crops  
(as on 16 October 2009)

(In lakh hectares)

| <i>Crops</i>      | <i>Normal<br/>Sown Area</i> | <i>Actual Sown Area</i> |                    |             |                    |
|-------------------|-----------------------------|-------------------------|--------------------|-------------|--------------------|
|                   |                             | <i>2008</i>             | <i>% of Normal</i> | <i>2009</i> | <i>% of Normal</i> |
| Paddy             | 393.0                       | 388.7                   | -1.2               | 327.4       | -16.7              |
| Maize             | 68.0                        | 70.5                    | 3.7                | 71.1        | 4.6                |
| Total Cereals     | 621.6                       | 594.9                   | -4.3               | 534.8       | -14.0              |
| Total Food grains | 733.3                       | 690.9                   | -5.8               | 636.1       | -13.3              |
| Total oilseeds    | 169.1                       | 184.43                  | 9.1                | 174.9       | 3.4                |
| Sugarcane         | 44.0                        | 43.8                    | -0.5               | 42.5        | -3.5               |
| All crops         | 1041.6                      | 1011.0                  | -2.9               | 956.6       | -8.2               |

Source: Ministry of Agriculture and Cooperation

That the industrial sector had effectively reversed the downturn experienced in the second half of 2008-09 was confirmed by its performance in the following months. Between April and August, the index of industrial production had increased to nearly 5.8 per cent, which was essentially due to its robust performance during August 2009. During this month, the industrial sector expanded by more than ten per cent – the double-digit growth rates that the Indian economy was so familiar with until 2007-08 was back again.

Double-digit growth in the industrial sector was recorded during August 2009 in all the three sectors, namely mining, manufacturing and electricity. In other words, all sectors of industry were feeding into the process of revival of the Indian economy that is currently taking place. As regards the use-based industrial groups, the performance of the capital goods sector was more muted than those seen in case of the other industry groups.

While the broad industrial groups have showed signs of sustaining the recovery, some of the narrowly defined industrial groups (at two-digit NIC) have shown, at best, weak signs of

**Table 1.8. Industrial Sector Growth Rates**

| Industry Group                     | (Figs. in %) |         |         |         |               |               |
|------------------------------------|--------------|---------|---------|---------|---------------|---------------|
|                                    | 2007-08      | 2008-09 | Sep. 08 | Sep. 09 | April-Sep. 08 | April-Sep. 09 |
| General Index                      | 8.5          | 2.6     | 6.0     | 9.1     | 5.0           | 6.5           |
| Mining                             | 5.1          | 2.6     | 5.8     | 8.6     | 3.8           | 8.2           |
| Manufacturing                      | 9.0          | 2.6     | 6.2     | 9.3     | 5.3           | 6.3           |
| Electricity                        | 6.4          | 2.8     | 4.4     | 7.9     | 2.5           | 6.8           |
| <b>Use-based Industrial Groups</b> |              |         |         |         |               |               |
| Basic Goods                        | 7.0          | 2.6     | 5.0     | 6.7     | 3.9           | 6.7           |
| Capital Goods                      | 18.0         | 7.1     | 20.8    | 12.8    | 10.7          | 5.3           |
| Intermediate Goods                 | 9.0          | -2.0    | -2.5    | 10.8    | 0.4           | 9.5           |
| Consumer Goods                     | 6.1          | 4.6     | 7.4     | 8.2     | 7.6           | 4.3           |
| Durables                           | -1.0         | 4.5     | 14.7    | 22.2    | 7.2           | 18.9          |
| Non-durables                       | 8.6          | 4.6     | 4.8     | 2.6     | 7.7           | -0.5          |

Source: CSO

revival. Cotton, leather and metal products, all of which have their roles to play in sustaining the revival of the industrial sector, have yet to see the return of the growth momentum. Specific policy measures may, therefore, be necessary for ensuring that these industrial groups get back onto the growth path as the economy revives.

As is to be expected, India's GDP growth in the past three quarters has been led by government expenditure. In fact, the quarter ending September saw the highest push by the government, when the year-on-year growth of government expenditure expanded by nearly 27 per cent. The sagging of consumer spending was a concern in Q4 of 2008-09 and Q1 of 2009-10; however, this component of the GDP registered an increase in the latest quarter.

Given that the major sectors have turned around in the first quarter of 2009-10 financial year, forecasts of a 6.5 per cent growth has been made by the Economic Advisory

**Table 1.9. Demand Components of GDP**

| <i>Components</i>                        | <i>2007-08</i>        | <i>2008-09</i> | <i>2008-09</i> |           | <i>2009-10</i> |           |
|--|-----------------------|----------------|----------------|-----------|----------------|-----------|
|  | <i>Financial Year</i> |                | <i>Q1</i>      | <i>Q4</i> | <i>Q1</i>      | <i>Q2</i> |
| <b>Year-on-Year Growth Rate (%)</b>      |                       |                |                |           |                |           |
| Private Final Consumption Expenditure    | 8.5                   | 2.9            | 4.5            | 2.7       | 1.6            | 5.6       |
| Government Final Consumption Expenditure | 7.4                   | 20.2           | (-) 0.2        | 21.5      | 10.2           | 26.9      |
| Gross Fixed Capital Formation            | 12.9                  | 8.2            | 9.2            | 6.4       | 4.2            | 7.3       |
| Net Exports                              | (-) 36.7              | (-) 41.2       | (-) 75.9       | (-) 30.8  | 231.8          | -57.6     |
| <b>Share in GDP (%)</b>                  |                       |                |                |           |                |           |
| Private Final Consumption Expenditure    | 57.2                  | 55.5           | 58             | 51.4      | 55.6           | 54.9      |
| Government Final Consumption Expenditure | 9.8                   | 11.1           | 9.6            | 13.4      | 9.9            | 9.8       |
| Gross Fixed Capital Formation            | 31.6                  | 32.2           | 32.2           | 31.6      | 31.6           | 34.7      |
| Net Exports                              | (-) 4.3               | (-) 5.8        | (-) 1.3        | (-) 2.9   | 1.6            | -4.2      |

Source: CSO

Council (EAC) to the prime minister. This projection assumes a substantial recovery in the growth momentum of both the manufacturing and the mining sector, while assuming negative growth rate for agriculture. A higher growth of the manufacturing sector than has been projected by the EAC can be expected if the global demand expands in the near term, and which can trigger a more sustained growth in India's exports.

As regards the global markets, the IMF has shown cautious optimism in commenting on the revival of the global economy. While it has indicated that the global economy appears to be expanding again, aided by the strong performance of Asian economies and stabilization or modest recovery elsewhere, the Fund has also hastened to add that the pace of recovery is likely to be slow, and that the economic activity at the present juncture remains far below pre-crisis levels, considering that the IMF has indicated in its World Economic Outlook that global economy has already started showing signs of turning around.



**Annex 1.1. Performance of Industries (Two-digit NIC)**

| Sectors   | Aug. 2009 | Sep. 2009 | 2009-2010 |           |
|---|-----------|-----------|-----------|-----------|
|   |           |           | Apr.-Aug. | Apr.-Sep. |
| Food Products   | -9.6      | -10.2     | -12.6     | -11.6     |
| Beverages, Tobacco & Related Products                                     | 1.1       | -3.8      | -3.3      | -2.6      |
| Cotton Textiles   | 5         | 1.7       | 0.7       | 0.9       |
| Wool, Silk & Man-made Fibre Textiles                                      | 15.7      | 6.5       | 11.9      | 11.7      |
| Jute & other Vegetable Fibre Textiles (except cotton)                     | -10.2     | -15.3     | -16.4     | -16.2     |
| Textile Products (including Wearing Apparel)                              | 16.4      | 0.8       | 9.5       | 9         |
| Wood & Wood Products; Furniture & Fixtures                                | -3.6      | 2.9       | 11.8      | 6.8       |
| Paper & Paper Products; Printing, Publishing & Allied Industries          | 1.9       | -2.2      | 2.7       | 1.5       |
| Leather; Leather & Fur Products   | 1.2       | 1         | 1.3       | 1.1       |
| Basic Chemicals & Chemical Products (except products of Petroleum & Coal) | 14.7      | 20.1      | 5         | 7.5       |
| Rubber, Plastic, Petroleum & Coal Products                                | 21.5      | 10.1      | 13.2      | 12.6      |
| Non-Metallic Mineral Products   | 7.4       | 2.9       | 7.6       | 7.2       |
| Basic Metal & Alloy Industries  | 8.5       | 5.5       | 7.1       | 6.8       |
| Metal Products & Parts, except Machinery & Equipment                      | 3.4       | -7.6      | -0.2      | -1.6      |
| Machinery & Equipment other than Transport Equipment                      | 14.2      | 16.5      | 9.5       | 11        |
| Transport Equipment & Parts   | 13.8      | 8.9       | 9.1       | 9.1       |
| Other Manufacturing Industries  | 10.6      | 24.5      | 10.8      | 13.9      |
| Mining & Quarrying  | 12.9      | 8.6       | 8.4       | 8.2       |
| Manufacturing   | 10.2      | 9.3       | 5.5       | 6.3       |
| Electricity   | 10.6      | 7.9       | 6.6       | 6.8       |
| General Index   | 10.4      | 9.1       | 5.8       | 6.5       |

Source: CSO



## **The Fiscal Situation**

The country's fiscal situation had improved dramatically since the adoption of the Fiscal Responsibility and Budget Management Act of 2003. The Act, which required the Central Government FRBM Act, 2003 (as amended), which became effective from 5 July 2004, required the Central government to take appropriate measures to reduce the fiscal deficit and revenue deficit so as to eliminate revenue deficit by 31 March 2008 and thereafter build up an adequate revenue surplus. The end-date for meeting the target of eliminating the revenue deficit as set in FRBMA was subsequently put back by a year.<sup>1</sup> One of the important elements of the FRBMA was that it put strict limits on the ability of the Central government to fall back on the RBI for meeting its deficit.

The period since 2004-05 saw a robust performance in terms of fiscal consolidation. This is evident from the Table that follows, which shows that by 2007-08 the Central government was able to substantially reduce the revenue deficit to peg it at a level just more than one per cent of the GDP as compared to more than 3.6 per cent in 2003-04, the year from which the FRBMA was implemented. During the corresponding year, the fiscal deficit declined to 2.7 per cent from 4.5 per cent five years ago.

The fiscal consolidation of the Central government was possible because of the impressive performance of the states taken as a whole. In 2006-07, the states ended with a revenue surplus, albeit a nominal 0.6 per cent of the GDP, and in the two subsequent years, it was expected that this level of revenue surplus would be maintained. As a result of this relatively

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1. Budget Speech, 2008-09, paragraph 121.

Table 2.1. Trends in Deficits of Central Government

(in %)

| <i>Year</i>          | <i>Fiscal Deficit</i> | <i>Revenue Deficit</i> | <i>Primary Deficit</i> | <i>Revenue Deficit as per cent of Fiscal Deficit</i> |
|----------------------|-----------------------|------------------------|------------------------|--|
| 1990-91              | 6.6                   | 3.3                    | 2.8                    | 49.4   |
| 1991-92              | 4.7                   | 2.5                    | 0.7                    | 52.7   |
| 1992-93              | 4.8                   | 2.5                    | 0.6                    | 51.7   |
| 1993-94              | 6.4                   | 3.8                    | 2.2                    | 59.2   |
| 1994-95              | 4.7                   | 3.1                    | 0.4                    | 64.6   |
| 1995-96              | 4.2                   | 2.5                    | 0                      | 59.2   |
| 1996-97              | 4.1                   | 2.4                    | -0.2                   | 58.2   |
| 1997-98              | 4.8                   | 3.1                    | 0.5                    | 63.5   |
| 1998-99              | 5.1                   | 3.8                    | 0.7                    | 74.8   |
| 1999-2000            | 5.4                   | 3.5                    | 0.7                    | 64.6   |
| 2000-01              | 5.7                   | 4.1                    | 0.9                    | 71.7   |
| 2001-02              | 6.2                   | 4.4                    | 1.5                    | 71.1   |
| 2002-03              | 5.9                   | 4.4                    | 1.1                    | 74.4   |
| <b>Post-FRBM Act</b> |                       |                        |                        |  |
| 2003-04              | 4.5                   | 3.6                    | 0.0                    | 79.7   |
| 2004-05              | 4.0                   | 2.5                    | -0.1                   | 62.6   |
| 2005-06              | 4.1                   | 2.6                    | 0.4                    | 63.0   |
| 2006-07              | 3.4                   | 1.9                    | -0.2                   | 56.3   |
| 2007-08              | 2.7                   | 1.1                    | -0.9                   | 41.4   |
| 2008-09 (RE)         | 6.1                   | 4.5                    | 2.5                    | 73.9   |
| 2009-10 (BE)         | 6.8                   | 4.8                    | 3.0                    | 70.5   |

Source: Budget Documents, various years

better performance by the states and the steadily improving performance of the Centre, the combined gross fiscal deficit of the Centre and states fell from a level of 8.5 per cent of GDP in 2003-04 to a level of 5.2 per cent of GDP in 2007-08.

Much of the progress made in terms of fiscal consolidation was reversed in 2008-09. The fiscal deficit deteriorated due to a couple of measures taken by the Central government to counter the uncertainties faced by the domestic constituencies of the uncertainties in the global marketplace, and the shortfall in revenue receipts resulting from the fact that the domestic economy was off its recent highs.

A series of expenditure hikes caused by a combination of the high subsidies bill, the loan waiver scheme for farmers and the implementation of the recommendations of the Sixth Pay Commission increased Central government expenditure by more than two per cent of the GDP. These heads of expenditure contributed to a 19.4 per cent increase in non-plan expenditure (provisional estimates) in 2008-09 as compared to that in the previous fiscal (accounts). Most of this spending turned out to be the fiscal stimuli that the economy urgently needed. While the subsidies bill helped in cushioning the price shock resulting from the high prices of petroleum products, the loan waiver scheme and the Sixth Pay Commission recommendations handed additional liquidity to the beneficiaries, which was manifest in the marketplace in the form of higher consumer demand.

At the same time, revenue accruals of the Central government were adversely affected because of the economic slow down. The result was a sharp decline in the fiscal deficit from 2.7 per cent in 2007-08 to 6.2 per cent in 2008-09. And, the primary deficit, which had disappeared since 2005-06, not only reappeared but also had reached a level comparable with the level recorded in 1990-91. However, the Central government can take succour from the fact that at least two of the three components of expenditure that have caused the spike are one-off measures and, perhaps, more importantly, the Indian economy seems to have beaten back the downturn faster than most other major economies have been able to, and, therefore, the revenue shortfall is expected to be a transient phenomenon.

The loan-waiver scheme for farmers and the increase in subsidies were reflections of the Central government's response to economic exigencies faced by the country that were accentuated by inflation of commodity prices in the international markets and the ensuing global economic downturn. The loan waiver, which was designed to ameliorate the conditions of the Indian peasantry, was adopted following the findings of the Expert Group on Agricultural Indebtedness under the chairmanship of Dr. R. Radhakrishna. Farmers in India faced an excessive burden of indebtedness resulting from the stagnation in agriculture, increasing production and marketing risks, an

institutional vacuum and the lack of alternative livelihood opportunities. The loan-waiver scheme that was announced awarded a complete waiver of all loans that were overdue on 31 December 2007 and which remained unpaid until 29 February 2008 for small and marginal farmers. In respect of other farmers, a one-time settlement (OTS) scheme for all loans that were overdue on 31 December 2007 and which remained unpaid until February 29, 2008, was announced. This scheme which, according to government estimates was expected to benefit about three crore small and marginal farmers, and about one crore other farmers, would have resulted in a waiver of overdue loans estimated at Rs. 50,000 crore, and the OTS relief on the overdue loans was estimated at Rs. 10, 000 crore.

The Economic Survey of 2008-09 has argued that the increase in subsidies arises from the fact that the market mechanism often results in under-consumption of goods and services by the vulnerable sections, either because of their high prices, or because of the competing claims of other goods and services on their incomes. In India, the subsidies regime has historically played a much larger role than merely supporting the vulnerable sections. While food subsidies have, over time, been provided to the sections of the society below the poverty line, petroleum and fertilizer subsidies have been provided to support economic activities that meet the needs of a growing economy with an agricultural sector that is focused on meeting the food security needs of a billion-plus population. Given these objectives, the administered prices of food, fertilizer and petroleum products continued to be well below their economic costs.

The rising commodity prices in the global markets since 2007 put enormous pressure on the subsidies granted by the Central government, and primarily on the three sets of commodities mentioned above. The following Table shows that in 2008-09 (provisional estimates), the total outgo on account of subsidies increased by more than 85 per cent as compared to that in the immediately preceding year. As a proportion of the GDP, subsidies from the Central government coffers increased to 2.3 per cent, up from 1.5 per cent in 2007-08. Thus, while in 2007-08 subsidies, as a proportion of GDP, were

comparable to the level they had reached in the late 1990s, i.e. around 1.2 per cent, in 2008-09, the subsidies to GDP figure had exceeded the previous high of 1.8 per cent reached in 2003-04 by a considerable margin. The last fiscal's figures show that

**Table 2.2.** Union Budget 2009-10 at a Glance

(Amount in Rs. crore)

| Items                             | 2007-08          | 2008-09<br>(RE)  | 2009-10<br>(BE)   | Growth rate (%) |         |
|-----------------------------------|------------------|------------------|-------------------|-----------------|---------|
|                                   |                  |                  |                   | 2008-09         | 2009-10 |
| 1. Revenue Receipts (i+ii)        | 541864<br>(11.5) | 562173<br>(10.5) | 614497<br>(10.5)  | 3.7             | 9.3     |
| i) Tax Revenue (Net)              | 439547<br>(9.3)  | 465970<br>(8.6)  | 474218<br>(8.1)   | 6.0             | 1.8     |
| ii) Non-Tax Revenue               | 102317<br>(2.2)  | 96203<br>(1.8)   | 140279<br>(2.4)   | -6.0            | 45.8    |
| 2. Non-Debt Capital Receipts      | 9586<br>(0.2)    | 12265<br>(0.2)   | 5345<br>(0.1)     | 27.9            | -56.4   |
| 3. Non-Plan Expenditure of which: | 472058<br>(10.0) | 617996<br>(11.6) | 695689<br>(11.9)  | 30.9            | 12.6    |
| i) Interest Payments              | 171030<br>(3.6)  | 192694<br>(3.6)  | 225511<br>(3.9)   | 12.7            | 17.0    |
| ii) Defence Expenditure           | 91681<br>(1.9)   | 114600<br>(2.2)  | 141703<br>(2.4)   | 25.0            | 23.7    |
| iii) Subsidies                    | 70926<br>(1.5)   | 129243<br>(2.4)  | 111276<br>(1.9)   | 82.2            | -13.9   |
| 4. Plan Expenditure               | 205082<br>(4.3)  | 282957<br>(5.3)  | 325149<br>(5.6)   | 38.0            | 14.9    |
| 5. Revenue Expenditure            | 594433<br>(12.6) | 803446<br>(15.0) | 897232<br>(15.3)  | 35.1            | 11.7    |
| 6. Capital Expenditure            | 82707<br>(1.8)   | 97507<br>(1.8)   | 123606<br>(2.1)   | 17.9            | 26.8    |
| 7. Total Expenditure              | 677140<br>(14.3) | 900953<br>(16.9) | 1020838<br>(17.4) | 33.1            | 13.3    |
| 8. Revenue Deficit                | 52569<br>(1.1)   | 241273<br>(4.4)  | 282735<br>(4.8)   | 359.0           | 17.2    |
| 9. Gross Fiscal Deficit           | 125690<br>(2.7)  | 326515<br>(6.0)  | 400996<br>(6.8)   | 159.8           | 22.8    |
| 10. Gross Primary Deficit         | -45340           | 133821           | 175485            | -395.1          | 31.1    |

Source: Budget Documents, various years

the subsidies are threatening to assume alarming proportions, notwithstanding the fact that the anomalies in the international markets had caused this unprecedented increase.

The increase in spending on subsidies by record proportions has brought with it suggestions to review the basis for subsidies. While there is a case of reviewing the administrative mechanisms in order to arrest leakages and for better monitoring of the subsidies in cases where the subsidies are meant for targeted sections of the population, there seems to be little economic basis for a re-look at the entire subsidies discipline *per se*. It may be argued that when global markets are rife with distortions arising from a variety of reasons ranging from policy interventions and fiscal support for special interest groups by the governments on the one hand, to the abuse of market power by some of the dominant entities in several industries encompassing both goods and services on the other, the use of subsidies may be seen as positive externalities. These arguments need to be strengthened since subsidies on energy products (read petroleum products) have been in focus, particularly in the context of the discussions on climate change, and this process is likely to see large consumers of fossil fuels like India come under increasing pressure to justify the high levels of subsidies that are being used to support their ever increasing consumption levels of these fuels.<sup>2</sup>

The pattern of expenditure holds the key to determining future growth prospects, particularly in an economy that is targeting the maintenance of a nine per cent growth in the near term. In the wake of the economic downturn, which has slowed the growth momentum, the pattern of fund deployment by the Central government has become even more critical for additional efforts would be required to get back to the growth trajectory that the policy makers are aiming for. Viewed differently, expenditure patterns provide a fairly accurate indicator as to efficiency of resource use. Efficiency in the use of financial resources assumes further importance given that these resources are raised through debt creation, and the servicing of the debt has implications for the sustainability of

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2. G-20 Summit in Pittsburgh, U.S.A.



the growth process. Budgetary resources should, therefore, be focused on the creation of productive assets so as to provide the wherewithal for future revenue generation.

In the past decade, the Central government has been mindful of the need to improve the creation of productive assets by steadily enhancing the spending on capital expenditure and plan revenue expenditure. As a proportion of GDP, plan revenue expenditure had remained in the range of 2.3 per cent to 3.4 per cent in the period 1997-98 to 2006-07. It was increased to 3.7 per cent of GDP in 2007-08 and was budgeted at 3.9 per cent of GDP in 2008-09. Capital expenditure, on the other hand, remained in the range of 2.6 per cent to 1.9 per cent of GDP in the same period. It stood at 2.5 per cent of GDP in 2007-08 and was budgeted at 1.7 per cent of GDP in 2008-09.

A further positive impulse to the medium to long-term growth prospects that the Central government has provided in recent years is by reining in the non-plan revenue expenditure. As a proportion of GDP, non-plan expenditure remained in the range of 9.5 per cent to 10.9 per cent during 1997-98 to 2006-07 and in the budget for 2008-09; this component of expenditure was brought down to 8.9 per cent in 2007-08. The declining trend in the non-plan expenditure was maintained in the budget for 2008-09, in which it was pegged at 8.4 per cent of GDP.

The declining importance of non-plan revenue expenditure was evident in the fact that its share in the total expenditure of the Central government has declined through this decade. While in 2002-03, the share of non-plan revenue in the total expenditure was about 66 per cent, in the more recent years its share has declined to around sixty per cent.

The economic downturn severely impacted on the revenue accruals of the Central government. While the budget estimates for 2008-09 had predicted an increase in revenue receipts of nearly 15 per cent over the revised estimates of 2007-08, provisional figures for the previous fiscal show that receipts were down by nearly 10 per cent from the projected levels. Besides an 11 per cent decline in the gross tax collections by the Centre as against the projections for the year, revenue receipts during 2008-09 were adversely affected by the fact that the disinvestment

programme for the year could not take off because of adverse market conditions. Thus, against a target of Rs. 38,795 crore, only Rs. 546 crore could be realized during the full year through disinvestment.

As a proportion of GDP, gross tax revenue declined from a level of 12.6 per cent in 2007-08 to 11.5 per cent in 2008-09, and this marked a reversal of a rising trend that saw its share increase from a level of 9.2 per cent in 2003-04. This was caused by the less than expected realization as compared to the budget estimates of all major taxes.

Corporation tax had maintained a robust growth since 2003-04, which could not be maintained in 2008-09 due to the economic uncertainties. However, the accruals on this account grew by almost 11 per cent during 2008-09 as compared to the previous fiscal. But at the same time, corporation tax accruals were nearly six per cent below the level projected in the budget estimates for 2008-09. Almost a similar pattern was replicated in the case of personal income tax and service tax. While the former recorded a growth of almost 21 per cent in 2008-09, service tax revenue grew at 18.6 per cent during the year. In both cases, the increasing trends were maintained, although the growth rates were sharply lower than those recorded in the recent past. The lower growth rates meant that the revenue accruals fell short of the expected realization (budget estimates) by a significant margin. In case of personal income tax, the shortfall was nearly 12 per cent, while for service tax, the corresponding figure was about six per cent.

The impact of the economic downturn was most visible in the traditional sources of indirect taxes, namely, central excise and customs. The global shocks and the fiscal stimuli necessitated cuts in the rates of both these taxes, resulting in declines in their revenue accruals. During 2008-09, revenue from excise duties declined by 12 per cent and customs by 4.1 per cent.

Viewed in terms of a narrowly focused fiscal performance, 2008-09 witnessed several reversals from the past trends. Most of the developments, as indicated above, were in the nature of responses to the economic downturn, which affected India's

growth momentum. While intervention by the government for overcoming the downside risks was the order of the day, it would appear that the Central government took measures that were more than mere short-term measures. Thus, increase in the subsidies bill and loan waivers to the farmers were coupled with improvements in spending on investment projects. In other words, direct impetus to consumer spending through moderating price shocks was combined with the efforts to maintain investment growth. And, this focus of Central government expenditure was more than evident in the budget that was to follow.

### **Fiscal 2009-2010**

While presenting the budget for 2009-10, the finance minister indicated that the policies that the Central government would have to adopt must be based on a medium-term development perspective of the Indian economy. A number of key targets were highlighted which include: (i) sustained GDP growth of at least nine per cent per annum; (ii) four per cent per annum agricultural growth; (iii) creation of 12 million new job opportunities per year; (iv) reduction of the proportion of people living below poverty line to less than half from current levels by 2014; (v) increasing investment in infrastructure to more than nine per cent of GDP by 2014; (vi) supporting Indian industry to meet the challenge of global competition and sustain the growth momentum in exports, and (vii) taking steps towards providing energy security by pursuing an Integrated Energy Policy. Besides stimulating the economy in order to meet the economic targets, the finance minister laid emphasis on the development of the social sector by strengthening the delivery mechanism for primary health care facilities with a view to improve the preventive and curative health care in the country and creating a competitive, progressive and well-regulated education system of global standards that meets the aspiration of all segments of society.

Given these focus areas, the finance minister announced a slew of measures aimed at increased public expenditure with a special emphasis on provisions for social sector programmes

and the creation of rural as well as urban infrastructure in the 2009-10 budget. The budget estimates for 2009-10 provides for additional plan expenditure for various urban and rural development schemes.<sup>3</sup> It was expected that enhanced provisions for these schemes would boost demand, generate employment in the domestic economy as well as create infrastructure in rural and urban areas. The enhanced provision on social sector and health sector programmes are aimed at giving necessary comfort to the vulnerable sections of society.

The schemes announced by the finance minister necessitated a major increase in budgetary expenditure during 2009-10. The total expenditure of the Central government is slated to increase by over 13 per cent in the current fiscal. At this level, the growth in total expenditure for 2009-10 is substantially lower than the 33 per cent increase that was provided for in the previous year. The lowering of the growth in total expenditure during 2009-10 arises largely from a steep decline in the growth of non-plan revenue expenditure. Contributing to this reduced level of expenditure is the anticipated fall in fertilizer subsidies, which is expected to be reduced by one-third as compared to the previous fiscal's level. The major items contributing to the growth of revenue expenditure in 2009-10 are interest payments, defence and non-plan grants to the states, which together would account for over sixty per cent of the increase in revenue expenditure.

What would improve the prospects of the Indian economy reverting to the nine per cent growth path over the next three years is the enhanced capital expenditure mainly on account of a higher growth in capital outlay, which is budgeted to increase by 33.6 per cent as against a decline of 22.1 per cent in 2008-09. Capital expenditure, as a whole, is expected to increase by nearly 27 per cent over the revised estimates of 2008-09. This emphasis on capital expenditure seems critical given that in the previous fiscal the government did not perform well enough. Responding to the economic downturn, the government had revised targets for capital expenditure during the year by more

3. like NREGS, PMGSY, RGGVY, NRHM, AIBP, JNNURM, RKVY, TUFSS etc.

Table 2.3. Expenditure Pattern of the Central Government

|   | 2002-<br>2003 | 2003-<br>2004 | 2004-<br>2005 | 2005-<br>2006 | 2006-<br>2007 | 2007-<br>2008 | 2008-<br>2009 | 2009-<br>2010 |
|---|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| <b>NON-PLAN EXPENDITURE</b>   |               |               |               |               |               |               |               |               |
| Revenue Expenditure   | 43.5          | 42.6          | 44.1          | 40.5          | 40.6          | 41.5          | 42.6          | 36.4          |
| Interest Payments   | 16.1          | 15.3          | 14.8          | 14.7          | 15.0          | 14.1          | 12.8          | 14.0          |
| Defence   | 14.7          | 17.2          | 14.8          | 14.4          | 13.4          | 14.2          | 15.9          | 18.0          |
| Subsidies   | 7.1           | 6.3           | 6.6           | 10.3          | 10.3          | 10.0          | 9.7           | 7.8           |
| Grants to State and U.T. Governments  | 5.6           | 5.3           | 5.4           | 5.9           | 6.2           | 6.1           | 5.6           | 5.7           |
| Pensions  | 3.1           | 2.9           | 3.4           | 3.7           | 4.0           | 3.6           | 3.5           | 4.1           |
| Police  | 0.6           | 0.6           | 0.5           | 0.5           | 0.4           | 0.5           | 0.4           | 0.4           |
| Assistance to States from National Calamity Contingency Fund  | 3.3           | 3.9           | 4.0           | 4.1           | 3.7           | 4.1           | 4.0           | 3.9           |
| Economic Services (Agriculture, Industry, Power, Transport, Communications, Science & Technology, etc.) | 3.0           | 2.8           | 3.2           | 2.7           | 3.0           | 2.7           | 2.6           | 3.0           |
| Other General Services (Organs of State, Tax Collection, External Affairs, etc.)                        | 2.5           | 2.4           | 2.3           | 2.3           | 2.5           | 2.4           | 2.3           | 5.4           |
| Social Services (Education, Health, Broadcasting, etc.)   | 0.4           | 0.4           | 0.5           | 0.4           | 0.4           | 0.4           | 0.2           | 0.9           |
| Postal Deficit  | 0.5           | 0.5           | 0.6           | 0.7           | 0.6           | 0.5           | 0.5           | 0.5           |
| Expenditure of Union Territories without Legislature  | -0.6          | -0.6          | -0.5          | -0.5          | -0.4          | -0.5          | -0.4          | -0.4          |
| Amount met from National Calamity Contingency Fund  | 0.2           | 0.2           | 0.3           | 0.3           | 0.4           | 0.4           | 0.3           | 0.3           |
| Grants to Foreign Governments   | 65.8          | 65.9          | 61.5          | 64.3          | 61.1          | 56.4          | 59.7          | 60.6          |
| Share of non-plan revenue expenditure in total expenditure by the Central Government                    |               |               |               |               |               |               |               |               |

Source: Budget Documents, various years

than five per cent over the level provided in budget estimates. However, the actual spending on this account, as revealed by the provisional figures, was almost eight per cent below the revised target.

The tax realizations of the Central government have been pegged at rather conservative levels in view of the slowing down of the economy and the proposed reductions in direct and indirect taxes. Net tax revenue of the Central government was expected to increase by only 1.5 per cent over the revised estimates of 2008-09. Overall, the tax revenue was seen to be making smaller contribution than in the past – gross tax revenue is budgeted to decline to 10.9 per cent of the GDP during 2009-10 from 11.8 per cent during 2008-09, while net tax-GDP ratio was expected to decline to around eight per cent, as against 8.6 per cent in 2008-09. The non-tax revenue, on the other hand, is slated to increase by nearly fifty per cent over the previous fiscal's level.

Two sources have made up for this increase: first, the auctioning of the 3G spectrum, expected to net about Rs. 35,000 crore and a 58 per cent increase (amounting to over Rs. 10,500 crore) in the dividend/surplus of Reserve Bank of India, the nationalized banks and financial institutions. The finance minister has been careful not to rely on the disinvestment route for garnering additional resources during 2009-10. This move seems to be on expected lines given that the Central government disinvestment plans had not materialized during 2008-09. With the stock markets recovering strongly from the depths they have reached a year back, the government has started exploring the possibilities of putting its disinvestment programme back on track. And, this may well provide the much needed windfall that could help the government make up for the tax revenue shortfall.

As a result of these anticipated changes on the receipts side, the revenue accruals of the Central government are likely to increase by about nine per cent. But with a 13 per cent increase in total expenditure, the fiscal deficit is expected to increase to about 6.8 per cent of the GDP. Consequently, the deficit indicators, namely, revenue deficit, fiscal deficit and primary

deficit, are budgeted higher than those in 2008-09 (revised estimates). While revenue deficit would be at its highest level ever, primary deficit would reach the highest in India's post-reform period. The increase in revenue deficit is mainly on account of higher growth in revenue expenditure, which more than offset the increase in revenue receipts. With capital outlay also increasing substantially, fiscal deficit is budgeted to increase over both the revised estimates and provisional accounts for 2008-09.

### **Central Government Accounts during April-September 2009**

The state of Central government accounts during the first six months of the current fiscal needs to be observed for it provides some indications about the likely state of fiscal discipline during the current financial year. This is an extremely important aspect, given that the Central government needs to rein in the fiscal deficit that has reached critical proportions.

The figures show that during the first six months of 2009-10, the Central government was able to collect a somewhat smaller share of the revenue receipts that are projected for the year as a whole. While in 2008-09, 40.6 per cent of the projected total revenue receipts for the entire year were collected up to September, revenue receipts between April-September 2009 have been less than forty per cent. In sharp contrast, total receipts of the Central government have improved in the current fiscal largely because the disinvestment programme has taken off this year with Rs. 4299.90 crore having been raised in the first six months.

Improvements in the receipts position of the Central government in the first six months implies that the fiscal deficit may, in fact, remain within the limits that have been indicated in the budget estimates for the current financial year.

Since Central government finances provide a useful indication about the health of the economy, a reading of the first six months' accounts for the current financial year should provide evidence as to whether the Indian economy has been

**Table 2.4.** Government Accounts at a Glance:  
As at the end of September 2009

(Figs. in %)

| Items                      | Budget<br>Estimates<br>(2009-10) | Up to<br>September<br>2009 | % of Actuals to<br>Budget Estimates |       |
|----------------------------|----------------------------------|----------------------------|-------------------------------------|-------|
|                            | Rs. crore                        | Rs. crore                  | Current                             | COPPY |
| Revenue Receipts           | 614497                           | 244471                     | 39.8                                | 40.6  |
| Tax Revenue (Net)          | 474218                           | 185669                     | 39.2                                | 39.9  |
| Non-Tax Revenue            | 140279                           | 58802                      | 41.9                                | 44.5  |
| Non-Debt Capital Receipts  | 5345                             | 6602                       | 123.5                               | 10.4  |
| Recovery of Loans          | 4225                             | 2302                       | 54.5                                | 33.0  |
| Other Receipts             | 1120                             | 4300                       | 383.9                               | 0.4   |
| Total Receipts             | 619842                           | 251073                     | 40.5                                | 39.9  |
| Non-Plan Expenditure       | 695689                           | 322070                     | 46.3                                | 47.4  |
| On Revenue Account         | 618834                           | 301291                     | 48.7                                | 51.2  |
| Of which Interest Payments | 225511                           | 86669                      | 38.4                                | 45.1  |
| On Capital Account         | 76855                            | 20779                      | 27.0                                | 18.8  |
| Of which Loans disbursed   | 985                              | 270                        | 27.4                                | 46.8  |
| Plan Expenditure           | 325149                           | 126778                     | 39.0                                | 44.6  |
| On Revenue Account         | 278398                           | 108163                     | 38.9                                | 44.7  |
| On Capital Account         | 46751                            | 18615                      | 39.8                                | 43.8  |
| Of which Loans disbursed   | 11354                            | 4793                       | 42.2                                | 64.3  |
| Total Expenditure          | 1020838                          | 448848                     | 44.0                                | 46.5  |
| Fiscal Deficit             | 400996                           | 197775                     | 49.3                                | 77.0  |
| Revenue Deficit            | 282735                           | 164983                     | 58.4                                | 141.9 |
| Primary Deficit            | 175485                           | 111106                     | 63.3                                | -28.8 |

Source: GOI, Controller General of Accounts

able to recover from the economic downturn. The April-September accounts provide a mixed picture: the lower revenue receipts of the Central government in 2009-10, as compared to the collections during 2008-09, could imply that the economic activities are still on a low-ebb, and that the impact of the downturn is still being felt. It must be noted in this context that by September 2008 the effects of the downturn were being felt by the Indian economy and, therefore, economic activities



were facing the squeeze. In other words, the recovery of the Indian economy has yet to gather momentum.

In contrast, the disinvestment of public sector undertakings that has taken off the ground points to the fact that the market conditions are much better than they were a year earlier. This, in our view, would not have been possible if the Indian economy had not recovered from the downturn of 2008-09.

## **Appendix I: Fiscal Stimulus in 2009-10 Budgets**

### *Measures aimed at promoting exports:*

The budget for 2009-10 proposed several measures to provide stimuli to India's export sector. The stimuli took the form of a large variety of initiatives that were aimed at helping the exporters overcome short-term disadvantages. The specific measures are listed below:

- (a) An adjustment assistance scheme to provide enhanced Export Credit and Guarantee Corporation (ECGC) cover at 95 per cent to badly hit sectors had been initiated in December 2008 to mitigate the difficulties faced by the exporters. In view of the continuing contraction in exports, I propose to extend the benefits of this scheme up to March 2010.
- (b) The Market Development Assistance Scheme provides support to exporters in developing new markets. With many traditional markets still under financial stress, greater effort is required to identify and develop new markets. I propose to enhance the allocation for this scheme by 148 per cent over BE 2008-09 to Rs.124 crore.
- (c) With a view to insulating the employment-oriented export sectors from the global meltdown, the government had provided an interest subvention of two per cent on pre-shipment credit for seven such sectors. These sectors are textiles including handlooms, handicrafts, carpets, leather, gems and jewellery, marine products, and small and medium exporters. I propose to extend the interest subvention beyond the current deadline of 30 September 2009 to 31 March 2010.

- (d) Micro, Small and Medium Enterprises (MSMEs) have been affected by the slowdown in exports and the indirect effect of the global crisis on domestic demand. To support this sector, I propose to facilitate the flow of credit at reasonable rates, by providing a special fund out of Rural Infrastructure Development Fund (RIDF) to Small Industries Development Bank (SIDBI). This fund of Rs. 4, 000 crore will incentivize Banks and State Finance Corporations (SFCs) to lend to Micro and Small Enterprises (MSEs) by refinancing fifty per cent of incremental lending to MSEs during the current financial year.
- (e) In February, 2009 the Print Media was given a stimulus package comprising waiver of 15 per cent agency commission on DAVP advertisements and a 10 per cent increase in the DAVP rates to be paid as a 'special relief' subject to documentary proof of loss of revenue in non-governmental advertisements. Since the Print Media is still passing through difficult times, I have decided to extend the stimulus package for another six months from 30 June 2009 to 31 December 2009.

### **Other Measures**

The government announced a series of fiscal stimulus packages, one of the key elements of which was the sharp reduction in the ad valorem rates of central excise duty for non-petroleum products by four percentage points across the board on 7 December 2008, and by another two percentage points in the mean CENVAT rate on 24 February 2009.

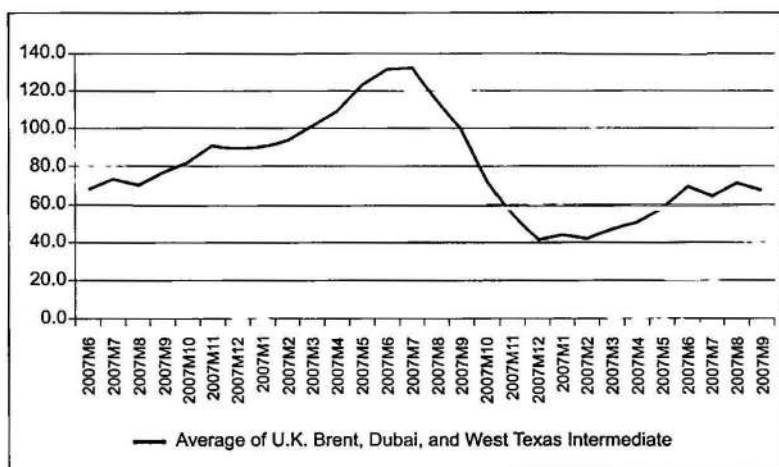
## **The Price Situation**

Inflationary pressures that existed in most countries during 2007 and 2008, sparked by the high levels of commodity prices, particularly those of major cereals and crude oil and oil products, eased considerably in 2009 due to a sharp drop in economic activity and rise in output gaps. As reported by the IMF, in the global markets, year-over-year inflation declined to about one per cent in July 2008, down from more than six per cent a year earlier. In most developed countries, headline inflation dipped to negative levels since May 2009, as petroleum prices continued to remain far below the levels a year earlier. Since May, as oil prices have remained far below levels a year earlier, core inflation has eased to 1.2 per cent, down from just over two per cent a year earlier. Similarly, headline and core inflation in the emerging economies have moderated, falling to 4.2 per cent in July and 0.4 per cent in June, respectively.

Contributing to the decline were the declining prices of crude oil in the international markets, which, in September 2009, were almost 50 per cent below the July 2008 peak.

The lowering of the crude oil prices made their impact felt in the prices of most commodities. By end-September 2009, prices of most of the major commodities were considerably below the levels that existed in the corresponding period of 2008.

The gradual pace of recovery points to a prolonged period of subdued inflation and vulnerability to mild deflation. Although the risks of sustained deflation have diminished over the past quarter, deflation pressures—as gauged by a broad indicator that comprises various price indicators, estimates of capacity utilization, and asset prices for most G20 economies—are expected to remain relatively high over the coming year.



**Figure 3.1.** Crude Oil Prices (Average of U.K. Brent, Dubai, and West Texas Intermediate)

For the United States and the Euro area, for example, IMF staff estimates suggest that potential output growth has fallen, is currently close to zero, and will pick up only slowly to about two per cent and 1¼ per cent, respectively, over the medium run. Nonetheless, large output gaps are opening, typically measuring about three–five per cent of potential GDP.

Accordingly, inflation in advanced economies is projected to be close to zero in 2009 and to accelerate very modestly to about one per cent in 2010, largely reflecting rising commodity prices. Prices for many manufactured goods will probably continue to decline for some time. Fortunately, inflation expectations have generally remained well anchored, providing some protection against sustained large price declines. In emerging economies, inflation is forecast to hover around five per cent in 2009–10, down from more than nine per cent in 2008.

These projections seem reasonable given the fact that the consumer price inflation for most of the major economies, barring Russia and India, has remained in negative territory in September 2009, measured on a year-on basis. Interestingly, the consumer price index in China continues to remain below

Table 3.1. Commodity Price Trends in Global Markets

| Commodities                   | Units    | 2006  | 2007  | 2008  | 08 Q4 | 09 Q1 | 09 Q2 | 09 Q3 | Aug-09 | Sep-09 | Change since<br>end-2008 |
|-------------------------------|----------|-------|-------|-------|-------|-------|-------|-------|--------|--------|--------------------------|
| Wheat                         | \$/MT    | 192   | 255   | 326   | 228   | 232   | 248   | 209   | 210    | 191    | -41.4                    |
| Maize                         | \$/MT    | 122   | 163   | 223   | 168   | 167   | 176   | 151   | 152    | 151    | -32.3                    |
| Rice                          | \$/MT    | 304   | 332   | 700   | 579   | 625   | 556   | 598   | 576    | 594    | -15.1                    |
| Barley                        | \$/MT    | 117   | 172   | 200   | 129   | 116   | 130   | 122   | 122    | 104    | -48.0                    |
| Soybeans                      | \$/MT    | 217   | 317   | 453   | 329   | 347   | 414   | 385   | 409    | 349    | -23.0                    |
| Soybean oil                   | \$/MT    | 551   | 800   | 1134  | 739   | 717   | 821   | 770   | 810    | 749    | -34.0                    |
| Palm oil                      | \$/MT    | 417   | 719   | 863   | 453   | 536   | 719   | 642   | 687    | 636    | -26.3                    |
| Sunflower oil                 | \$/MT    | 713   | 673   | 1694  | 1569  | 1027  | 1029  | 1041  | 1079   | 1021   | -39.7                    |
| Rapeseed Oil                  | \$/MT    | 851   | 1012  | 1424  | 1044  | 780   | 871   | 863   | 876    | 857    | -39.8                    |
| Sugar (Free market)           | cts/lb   | 14.8  | 10    | 12.5  | 11.6  | 12.8  | 15.2  | 21    | 21.7   | 23.5   | 88.0                     |
| Coffee (Robusta)              | cts/lb   | 70    | 88    | 106   | 89    | 82    | 76    | 76    | 75     | 77     | -27.4                    |
| Tea                           | cts/kg   | 242   | 212   | 270   | 251   | 265   | 284   | 347   | 328    | 374    | 38.5                     |
| Cotton                        | cts/lb   | 58    | 63    | 71    | 58    | 55    | 60    | 64    | 64     | 64     | -9.9                     |
| Rubber                        | cts/lb   | 96    | 104   | 119   | 74    | 66    | 75    | 90    | 93     | 99     | -16.8                    |
| <b>Metals</b>                 |          |       |       |       |       |       |       |       |        |        |                          |
| Aluminium                     | \$/MT    | 2573  | 2640  | 2578  | 1828  | 1366  | 1494  | 1813  | 1928   | 1836   | -28.8                    |
| Iron Ore                      | cts/DMTU | 77    | 85    | 141   | 141   | 101   | 101   | 101   | 101    | 101    | -28.4                    |
| Nickel                        | \$/MT    | 24126 | 37136 | 21141 | 10923 | 10561 | 13019 | 17602 | 19376  | 17405  | -17.7                    |
| <b>Energy</b>                 |          |       |       |       |       |       |       |       |        |        |                          |
| Spot crude 3/                 | \$/bbl   | 64.3  | 71.1  | 97    | 56.1  | 44.2  | 59.2  | 68.2  | 71.6   | 68.4   | -29.5                    |
| <b>Coal</b>                   |          |       |       |       |       |       |       |       |        |        |                          |
| Australian, export markets    | \$/MT    | 52.6  | 70.4  | 136.2 | 99.6  | 77.3  | 71.2  | 76.4  | 77.7   | 72.5   | -46.8                    |
| South African, export markets | \$/MT    | 50.7  | 62.6  | 120.6 | 92.1  | 68    | 60.2  | 61.9  | 64     | 61.1   | -49.3                    |

Source: IMF

**Table 3.2.** Cross-country CPI Inflation

| Country   | (in %)         |            |                |
|-----------|----------------|------------|----------------|
|           | September 2008 | March 2009 | September 2009 |
| U.S.      | 4.9            | (-)0.4     | (-)1.3         |
| U.K.      | 5.2            | 2.9        | 1.1            |
| Euro Area | 3.6            | 0.6        | (-)0.3         |
| Australia | 5.0            | 2.5        | 1.5            |
| Japan     | 2.1            | (-)0.3     | (-)2.2         |
| China     | 4.6            | (-)1.2     | (-)0.8         |
| India     | 9.8            | 8.0        | 11.7           |
| Korea     | 5.1            | 3.9        | 2.2            |
| Brazil    | 6.3            | 5.6        | 4.3            |
| Russia    | 15.0           | 14.0       | 10.7           |

Source: IMF

the corresponding period in 2008, despite the turn-around that the economy has seen in the past several months.

Analysts have, however, pointed out that the countries would have to guard against facing the risk of inflation. The inflation risk comes from two sources. First, potential output may have slowed more than appreciated, just as during the late 1970s, following a prolonged slowdown in activity that policymakers mistook as cyclical rather than structural. Underlying inflation pressure would then be higher than apparent in current inflation data, and could be exacerbated if the recovery surprises on the upside. Second, the large build up of excess central bank reserves generated by unconventional monetary policy actions could feed a surge in credit growth when the recovery gains strength. For a number of emerging economies, by contrast, inflation risks seem more pressing. Inflation pressures have not eased as much as in the advanced economies, except in some emerging Asian and European economies. At the same time, output gaps are smaller and the rebound has been stronger in a number of these economies. Also, higher commodity prices tend to spill over faster into generalized wage pressures. Adding to these concerns, some economies are already seeing large asset price increases in response to low interest rates and easy credit, and

such pressures could be exacerbated by strong capital inflows attracted by their dynamic performance.

## The Indian Scenario

General level of prices remained extremely volatile for most commodities during 2008-09. The spike in agricultural commodities that were seen in 2007 continued to influence the prices of food products during 2008-09 during the first two

**Table 3.3.** Quarterly Inflation in WPI by Major Heads

| Commodity Groups/Commodities   | 2008-09 (%) |      |      |      |             |
|--------------------------------|-------------|------|------|------|-------------|
|                                | Quarter     |      |      |      |             |
|                                | I           | II   | III  | I    | April-March |
| All Commodities                | 9.6         | 12.5 | 8.6  | 3.2  | 8.4         |
| Primary Articles               | 9.7         | 11.3 | 11.8 | 7.5  | 10.1        |
| Food Articles                  | 5.7         | 6.9  | 10.1 | 9.3  | 8.0         |
| Non-food Articles              | 14.0        | 17.0 | 11.7 | 2.6  | 11.2        |
| Minerals                       | 46.0        | 48.3 | 42.2 | 10.6 | 34.9        |
| Fuel, Power, Light, Lubricants | 10.3        | 17.0 | 6.7  | -3.7 | 7.4         |
| Coal Mining                    | 9.8         | 9.8  | 7.6  | -0.3 | 6.6         |
| Mineral Oils                   | 15.4        | 26.8 | 9.4  | -6.2 | 11.1        |
| Electricity                    | 1.4         | 1.4  | 1.4  | 0.0  | 1.0         |
| Manufactured Products          | 9.2         | 11.3 | 7.9  | 4.1  | 8.1         |
| Food Products                  | 11.7        | 14.2 | 6.1  | 8.4  | 10.0        |
| Beverages, Tobacco & Products  | 8.9         | 10.7 | 9.0  | 9.4  | 9.5         |
| Textiles                       | -0.7        | 7.4  | 8.2  | 9.3  | 6.0         |
| Wood & Products                | 5.3         | 9.8  | 9.8  | 9.3  | 8.5         |
| Paper & Products               | 2.8         | 4.0  | 5.9  | 5.0  | 4.4         |
| Leather & Products             | 1.3         | 0.6  | 0.6  | 1.8  | 1.1         |
| Rubber & Plastic Products      | 5.7         | 6.8  | 4.0  | 2.3  | 4.7         |
| Chemicals & Products           | 8.4         | 10.2 | 7.9  | 2.2  | 7.2         |
| Non-metallic Mineral Products  | 5.5         | 4.1  | 3.4  | 2.1  | 3.8         |
| Basic Metals Alloys & Products | 21.1        | 22.4 | 15.6 | -0.4 | 14.4        |
| Machinery & Machine Tools      | 5.7         | 5.7  | 5.0  | 2.6  | 4.7         |
| Transport Equipment & Parts    | 6.2         | 6.6  | 5.5  | 2.8  | 5.2         |

Source: GOI, Office of the Economic Adviser, Ministry of Commerce and Industry

quarters, before it eased in the third quarter. Alongside, the high prices of petroleum and petroleum products caused a more generalized price increase, culminating in double-digit inflation from June to mid-October and remained above eight per cent up to end-November, 2008.

After a year of extreme price volatility, the Indian economy followed the global trends in respect of inflation during fiscal 2009-10. WPI inflation in India exhibited a strong downward trend since August 2008 and reached 0.8 per cent by end-March 2009, driven by the reduction in the administered prices of petroleum products and electricity, as well as decline in prices of freely priced mineral oil items, iron and steel, oilseeds, edible oils, oil cakes and raw cotton. A significant part of the reduction in WPI inflation during this period could also be attributed to the base effect, reflecting the rapid increase in inflation recorded during the last quarter of 2007-08.

Year-on-year WPI inflation for all commodities remained subdued during 2009-10. Till the week ending 17 October, WPI was only 0.2 per cent above that registered in the corresponding week of 2008, while the index for manufactured products was 0.8 per cent higher than that in the corresponding in 2008. The situation on the price front is completely different in case of the essential commodities. Food grain prices were almost 14 per cent higher in 2009-10, and fruits and vegetables were 15 per cent higher.

**Table 3.4.** WPI Inflation During Fiscal 2009-10 (up to 17 October 2009)

| <i>Commodity Groups</i>  | <i>Year on Year</i> | <i>Week on Week 2009</i> | <i>Fiscal 2009-10</i> |
|--------------------------|---------------------|--------------------------|-----------------------|
| All Commodities          | 0.2                 | 0.2                      | 3.5                   |
| Primary                  | 7.3                 | 0.3                      | 4.7                   |
| Food                     | 11.7                | 0.4                      | 6.6                   |
| Food grains              | 13.5                | 0.3                      | 4.1                   |
| Fruits & Vegetables      | 14.9                | 0.5                      | 10.3                  |
| Non-food                 | -0.5                | 0.1                      | 3.6                   |
| Fuel, Power & Lubricants | -8.5                | 0.2                      | 3.8                   |
| Manufactures             | 0.8                 | 0.1                      | 2.7                   |

*Source:* GOI, Office of the Economic Adviser, Ministry of Commerce and Industry



That inflation could emerge as a problem in the ensuing period is indicated by the figures for the increase in WPI for the current fiscal. The index has risen at a much higher rate since end of March 2009. Here again, the relatively high levels of increase in food-related items is a cause for concern, for it could have a serious impact on the distributional aspects, particularly at a time when the country is grappling with the problem of increasing job-losses in the wake of the economic downturn.

The behaviour of the consumer price index (CPI) in recent months also indicates that the lower income groups could be worse hit from the current trends in inflation. CPI for industrial workers was nearly 12 per cent higher in August 2009 as compared to the level a year earlier. The urban manual workers face more adverse conditions, with the relevant CPI increasing by nearly 13 per cent during the 12 months following August 2008. The agricultural labourers find themselves in the most adverse situation with a CPI inflation exceeding 13 per cent.

Although some analysts have been alluding to the impending threat of inflation in the major countries, the likelihood of such an occurrence seems remote pending a strong recovery of their economies. However, India finds itself in a completely different situation given that the downturn it faced went almost unnoticed, and, perhaps more importantly, the economy has started showing signs of early recovery. This recovery could be stymied largely because the inflation barrier could restrict the policy space available with the government. For instance, the cheap money policy of the RBI could be

**Table 3.5.** Behaviour of Consumer Price Index for Various Groups of Workers

| <i>Consumer Price Indices (CPIs)</i> | <i>September 2008</i> | <i>September 2009</i> |
|--------------------------------------|-----------------------|-----------------------|
| CPI - Industrial Workers #           | 9.0                   | 11.7                  |
| CPI - Urban Non-manual Employees #   | 8.5                   | 12.9                  |
| CPI - Agricultural Labourers         | 11.0                  | 13.2                  |
| CPI - Rural Labourers                | 11.0                  | 13.0                  |

# Pertains to August.

Source: RBI

severely challenged by the rising pressure of inflation and the central bank may feel persuaded to change its policies in the face of rising inflationary pressures.

Inflation brings with it concerns about its impact on redistribution, as mentioned above. Coming as it does when the economy is only beginning to recover, inflation could bring an additional burden of adjustment on the labour force that is still trying to grapple with the problems of job-losses.

## The Financial Markets

The U.S. sub-prime crisis that surfaced in 2007 caused the tailspin in the global financial markets that was in evidence during most of 2008, and in 2009. The implications of the financial meltdown were displayed most vividly by the steep decline in world equity market valuations from mid-May 2008 until early March 2009. According to some estimates, the loss in financial assets and real estate values has reached more than US\$ 50 trillion.

Several surveys now report that financial stability has improved significantly in the past six months. With systemic risks having been reduced as a result of this turnaround in the financial markets, all economic indicators have registered a marked improvement. However, agencies like the IMF have

**Table 4.1.** Change in Market Value of Largest G10 Banks  
(in US\$ billion)

| <i>Countries</i> | <i>2009*</i> | <i>2008</i> | <i>2007</i> | <i>2006</i> |
|------------------|--------------|-------------|-------------|-------------|
| United States    | -46.0        | -333.7      | -295.6      | 175.6       |
| United Kingdom   | 76.1         | -256.7      | -72.8       | 109.0       |
| Italy            | 0.6          | -178.0      | 73.2        | 61.4        |
| France           | 36.8         | -158.0      | -31.7       | 108.8       |
| Belgium          | 7.1          | -125.9      | 5.6         | 33.5        |
| Japan            | -9.3         | -107.5      | -112.3      | -49.5       |
| Switzerland      | 16.7         | -101.5      | -44.4       | 55.8        |
| Canada           | 46.3         | -97.4       | 12.2        | 31.1        |
| Germany          | 12.2         | -80.0       | -3.7        | 34.1        |
| Sweden           | 14.3         | -59.0       | -4.3        | 26.7        |
| Netherlands      | -0.3         | -0.7        | 0.5         | 0.5         |
| G10 total        | 154.5        | -1,498.3    | -473.2      | 587.0       |

Source: IMF

warned that the risk of reversal remains significant and that the indicators of financial stress remain elevated at the core of the financial system and in some market segments. Some observers are less optimistic about the sustainability of the turnaround. According to them, the recent upswing is more in the nature of a bear market rally than a longer-term upward trend, and economic indicators have not yet unambiguously confirmed that the 'green shoots' will lead to a sustained improvement.

The financial sector has become the centrepiece of the much-anticipated recovery of the global economy. There is almost an unanimous view that for the stimulus packages to run their entire course and deliver the desired results on a sustained basis, the existence of a well-functioning financial sector is crucial. This perspective has driven the spate of policy actions that have been initiated in several developed countries, particularly those taken for providing lifelines to the troubled entities in the financial sector. These recent rescue plans have certainly contributed to the recent rebound, which the Pittsburgh Summit of the G20 members announced in a full-throated manner, as investors have now perceived them as more credible, sustainable and comprehensive.

However, uncertainty looms large among the investors as to how the policy support would affect debt and equity holders in the medium to long run. Questions are also being asked as to whether additional policy measures will affect the valuation of particular asset classes, like home mortgages. The uncertainties facing the financial sector also stem from the extent to which governments would be willing to support their recovery. This dimension assumes importance in view of the fact that the recent pickup in bank shares, as reflected in the market valuation gains, is perceived as only temporary and has been driven by some recently reported positive profits and profit expectations by a few major banks that have benefited from the largesse of the government. However, the statement of the G20 leaders' summit in Pittsburgh pledging to sustain the strong policy response until a durable recovery is secured and to avoid any premature withdrawal of stimulus should soothe the taut nerves of the financial system.

Credit constraints have remained in the developed country markets as bank balance sheets remain under pressure and securitization markets are impaired. Current expectations are that credit growth in the developed country markets is likely to remain muted, as banks and securitization markets remain in the process of turning around from the crisis levels.

Emerging markets, particularly those in the Asian region, have shown more encouraging signs of sustaining the recovery process, and by so doing they have succeeded in reversing outflows of foreign investment. As a consequence, there has been a return of the risk appetite that has supported the assets in these countries.

## **Indian Scenario**

Responding to the global developments that were casting a long shadow of uncertainty on the domestic market, the RBI took monetary policy measures that were aimed at containing the adverse impact of the global economic downturn on the Indian economy. One of the key steps taken in this regard was to adopt policies that helped maintain an adequate level of liquidity in the system. The adequacy of the liquidity in the system was also reflected in the large build up of reverse repo balances with the RBI.

Since 11 October 2008, RBI has reduced CRR by a cumulative 400 basis points to 5.0 per cent, repo rate by 425 basis points to 4.75 per cent and the reverse repo rate by 275 basis points to 3.25 per cent. The policy rates were reduced further by 25 basis points in April 2009. The deposit rates of scheduled commercial banks softened further during April-October 2009 (up to 15 October). During this period, interest rates on term deposits moderated across the maturity spectrum for private sector banks and to a lesser extent in the case of public sector banks. Benchmark prime lending rates (BPLRs) of PSBs and foreign banks declined by 50 and 25 basis points respectively between April and October 2009. Importantly, the private sector banks did not effect any change in their lending rates and the upper end of the spread remained at a high of 16.27 per cent.

**Table 4.2.** Deposit Rates of Banks (2008-09)

|                                 | October<br>2008<br>(%) | March<br>2009<br>(%) | 20 April<br>2009<br>(%) | 15<br>October<br>2009 (%) | Variation as on<br>15 October 2009<br>(basis points) |                          |
|---------------------------------|------------------------|----------------------|-------------------------|---------------------------|--|--------------------------|
|                                 |                        |                      |                         |                           | Over<br>October<br>2008                              | Over 20<br>April<br>2009 |
| <b>Term Deposit Rates</b>       |                        |                      |                         |                           |  |                          |
| <b>Public Sector Banks</b>      |                        |                      |                         |                           |  |                          |
| a) Up to 1 year                 | 2.75-<br>10.25         | 2.75-<br>8.25        | 2.75-<br>8.00           | 1.00-<br>6.75             | 175-<br>350  | 125-<br>175              |
| b) 1 year up to<br>3 years      | 9.50-<br>10.75         | 8.00-<br>9.25        | 7.00-<br>8.75           | 6.25-<br>7.50             | 325  | 75-<br>125               |
| c) Over 3 years                 | 8.50-<br>9.75          | 7.50-<br>9.00        | 7.25-<br>8.50           | 6.50-<br>8.00             | 175-<br>200  | 50-<br>75                |
| <b>Private Sector Banks</b>     |                        |                      |                         |                           |  |                          |
| a) Up to 1 year                 | 3.00-<br>10.50         | 3.00-<br>8.75        | 3.00-<br>8.50           | 2.00-<br>7.00             | 100-<br>350  | 100-<br>150              |
| b) 1 year up to<br>3 years      | 9.00-<br>11.00         | 7.50-<br>10.25       | 7.50-<br>9.50           | 5.25-<br>8.00             | 300-<br>375  | 150-<br>225              |
| c) Over 3 years                 | 8.25-<br>11.00         | 7.50-<br>9.75        | 7.50-<br>9.25           | 5.75-<br>9.25             | 250-<br>275  | 100-<br>175              |
| <b>Five Major Foreign Banks</b> |                        |                      |                         |                           |  |                          |
| a) Up to 1 year                 | 3.50-<br>9.50          | 2.50-<br>8.00        | 2.50-<br>8.00           | 2.25-<br>6.50             | 125-<br>300  | 25-<br>150               |
| b) 1 year up to<br>3 years      | 3.60-<br>10.00         | 2.50-<br>8.00        | 2.50-<br>8.00           | 2.25-<br>7.50             | 135-<br>250  | 25-50                    |
| c) Over 3 years                 | 3.60-<br>10.00         | 2.50-<br>8.00        | 2.50-<br>8.00           | 2.25-<br>7.50             | 135-<br>250  | 25-50                    |
| <b>BPLR</b>                     |                        |                      |                         |                           |  |                          |
| Public Sector<br>Banks          | 13.75-<br>14.75        | 11.50-<br>14.00      | 11.50-<br>13.50         | 11.00-<br>13.50           | 125-<br>275  | 50                       |
| Private Sector<br>Banks         | 13.75-<br>17.75        | 12.75-<br>16.75      | 12.50-<br>16.75         | 12.50-<br>16.75           | 100-<br>125  | 0                        |
| Five Major Foreign<br>Banks     | 14.25-<br>16.75        | 14.25-<br>15.75      | 14.25-<br>15.75         | 14.25-<br>15.50           | 125  | 25                       |

Source: RBI

Bank credit to the commercial sector was sluggish in the quarter ending December 2008, but has picked up in the following quarter. During the second half of 2008-09, non-food credit increased by about nine per cent as compared to nearly 16 per cent in 2007-08. The decline in the demand for credit was typical of an economy going through a period of uncertainty. It also mirrors the situation in the international markets that saw a slump in the credit markets.

The slow-down in the credit market continues to be a problem in the current financial year. Credit advanced by scheduled commercial banks (SCBs) decelerated significantly, with the growth rate (year-on-year basis) falling to 10.8 per cent this year (as on 9 October 2009) from 29.5 per cent a year earlier. On a financial-year basis (up to 9 October 2009) too, the growth in scheduled commercial banks' credit at 4.1 per cent is significantly lower than the growth of 10.5 per cent in the corresponding period of last year.

As on 15 October 2009, credit flow from the foreign banks was nearly 16 per cent lower than the level existing in the corresponding period of 2008. It is to be noted that if credit flow from each segment is compared on a year-to-year basis in July and October, a perceptible decline can be seen in the latter period. These are some of the discordant signs in a period that has generally seen a turnaround of the Indian economy.

**Table 4.3.** Credit Flow from Scheduled Commercial Banks

| <i>Type of Banks</i>            | <i>Year-on-Year Variation (%)</i> |                              |                               |                              |
|---------------------------------|-----------------------------------|------------------------------|-------------------------------|------------------------------|
|                                 | <i>As on 4<br/>July 2008</i>      | <i>As on 3<br/>July 2009</i> | <i>As on 10<br/>Oct. 2008</i> | <i>As on 9<br/>Oct. 2009</i> |
| Public Sector Banks             | 26.3                              | 21.9                         | 32.7                          | 15.3                         |
| Foreign Banks                   | 33.3                              | -7.1                         | 32.9                          | (-) 15.9                     |
| Private Banks                   | 22.3                              | 4.2                          | 19.7                          | 2.5                          |
| All Scheduled Commercial Banks* | 25.5                              | 16.3                         | 29.5                          | 10.8                         |

\*Including RRBs

Source: RBI

The sectoral flow of credit shows a mixed pattern in the current financial year. The flow of credit to agriculture and the micro and small enterprises have increased in the period up to August 2009 as compared to the corresponding period in the previous fiscal. However, industry as a whole received less credit as NBFCs and the real estate sector have become less attractive destinations.

**Table 4.4. Business of Scheduled Commercial Banks**

(Rs. crore)

| Item            | Outstanding as on 9 Oct. 2009 | Variation over Financial year so far |                   | Year-on-year       |                    |
|-----------------|-------------------------------|--------------------------------------|-------------------|--------------------|--------------------|
|                 |                               | 2008-09                              | 2009-10           | 2008               | 2009               |
| Bank Credit     | 28,90,316                     | 2,47,775<br>(10.5)                   | 1,14,766<br>(4.1) | 5,94,220<br>(29.5) | 2,80,627<br>(10.8) |
| <b>Of which</b> |                               |                                      |                   |                    |                    |
| Food Credit     | 42,721                        | 4,496                                | -3,490            | 11,876             | -6,174             |
| Non-Food Credit | 28,47,595                     | 2,43,280                             | 1,18,257          | 5,82,344           | 2,86,801           |

Source: RBI

**Table 4.5. Sectoral Flow of Credit**

| Sectors         | As on 29 August 2008<br>(y-o-y) |                     |                   | As on 29 August 2009<br>(y-o-y) |                     |                   |
|-----------------|---------------------------------|---------------------|-------------------|---------------------------------|---------------------|-------------------|
|                 | Amount<br>(Rs.crore)            | % Share<br>in total | Variations<br>(%) | Amount<br>(Rs.crore)            | % Share<br>in total | Variations<br>(%) |
| Agriculture     | 41,185                          | 8.5                 | 18.6              | 67,228                          | 21.8                | 25.6              |
| Industry        | 2,30,229                        | 47.5                | 32.9              | 1,66,121                        | 53.8                | 17.9              |
| <b>Of which</b> |                                 |                     |                   |                                 |                     |                   |
| Micro and Small | 23,865                          | 4.9                 | 20.1              | 40,146                          | 13.0                | 28.1              |
| Real Estate     | 20,580                          | 4.2                 | 43.1              | 28,353                          | 9.2                 | 41.5              |
| Housing         | 29,872                          | 6.2                 | 12.4              | 14,668                          | 4.8                 | 5.4               |
| NBFCs           | 26,443                          | 5.5                 | 51.8              | 23,837                          | 7.7                 | 30.8              |
| Overall Credit  | 4,84,805                        | 100.0               | 26.5              | 3,08,718                        | 100.0               | 13.3              |

Source: RBI



India's equity market was one of the better performing markets during the first half of 2009. This performance was backed by considerable gains in the secondary market, although the primary market has remained considerably subdued in 2009-10. The FIIs were somewhat circumspect until August 2009 when their net investments in the BSE were still in the negative territory, although they had net inflows into the India stock markets taken as a whole. The subsequent period, however, witnessed a surge in net FII inflows as a result of which FIIs' net purchases in the Indian equity market in this financial year (up to 21 October 2009) was US\$ 13.8 billion as against net sales of US\$ 8.6 billion in the corresponding period of 2008-09.

**Table 4.6.** Behaviour of Equity Market Indices in Major Markets  
(Figures indicate period on period per cent change)

| Countries        | 2009  |      | 2008  |       |       |       |
|------------------|-------|------|-------|-------|-------|-------|
|                  | Q1    | Q2   | Q1    | Q2    | Q3    | Q4    |
| World            | -12.5 | 19.7 | -9.5  | -2.5  | -15.7 | -22.2 |
| Emerging Markets | 0.5   | 33.6 | -11.3 | -1.6  | -27.6 | -27.9 |
| Brazil           | 11.9  | 39.2 | -5.7  | 17.7  | -38.2 | -38.2 |
| China            | 1.3   | 33.3 | -23.7 | -4.7  | -25.7 | -11.0 |
| India            | -1.6  | 59.3 | -27.1 | -20.0 | -14.4 | -30.1 |
| Korea            | -1.5  | 25.0 | -14.1 | -7.7  | -24.3 | -26.5 |
| United Kingdom   | -11.9 | 24.9 | -11.7 | -1.8  | -21.8 | -27.1 |
| United States    | -11.1 | 15.2 | -9.8  | -2.5  | -9.6  | -22.7 |
| Switzerland      | -16.2 | 15.2 | -2.6  | -6.5  | -13.3 | -13.3 |
| France           | -16.0 | 18.4 | -8.4  | -6.0  | -19.1 | -21.0 |
| Germany          | -19.8 | 20.2 | -12.0 | -4.7  | -20.6 | -20.9 |
| Singapore        | -9.2  | 43.1 | -7.5  | -2.6  | -23.1 | -27.2 |

Source: IMF

**Table 4.7.** Listing of Issues through BSE

(Rs. Crore)

| Months  | Capital Listed During the Month |                        |                      | IPO Issues           |         | Offers made by Existing Companies |              |
|---------|---------------------------------|------------------------|----------------------|----------------------|---------|-----------------------------------|--------------|
|         | Existing Companies              | Newly Listed Companies | Total Issues offered | No. of amount raised | Total   | No. of Issues                     | Total amount |
| Jan.-09 | 4376.25                         | 695.25                 | 5071.5               | 0                    | 0       | 1                                 | 0.48         |
| Feb.-09 | 11038.11                        | 171.7                  | 11209.81             | 0                    | 0       | 1                                 | 3.5          |
| Mar.-09 | 9831.07                         | 608.35                 | 10439.42             | 1                    | 23.84   | 4                                 | 639.84       |
| Apr.-09 | 1918.96                         | 103.73                 | 2022.69              | 0                    | 0       | 0                                 | 0            |
| May-09  | 3262.75                         | 0                      | 3262.75              | 0                    | 0       | 1                                 | 8.96         |
| Jun.-09 | 7602.36                         | 1492.54                | 9094.9               | 1                    | 29.7    | 1                                 | 5.29         |
| Jul.-09 | 5177.83                         | 712.99                 | 5890.82              | 1                    | 277.96  | 0                                 | 0            |
| Aug.-09 | 6343.26                         | 4150.9                 | 10494.16             | 3                    | 3178.69 | 2                                 | 198.08       |
| Sep.-09 | 4307.77                         | 1786.22                | 6093.99              | 4                    | 8984.2  | 10                                | 2451.46      |

Source: Bombay Stock Exchange

**Table 4.8.** FII's Participation in the Indian Capital Markets

(Rs. Crore)

| Months  | Net FIIs Investments<br>in Secondary Market<br>in BSE | Net FIIs Investments<br>in Secondary Market<br>(Equity) (All-India)+ | Net FIIs Investments<br>in Secondary Market<br>(Debt) (All-India)+ |
|---------|---|--|--|
| Sep.-07 | 4117  | 16133  | 2655   |
| Oct.-07 | 2347  | 20591  | 2499   |
| Nov.-07 | -2662   | -5850  | -469   |
| Dec.-07 | -1589   | 5579   | 3312   |
| Jan.-08 | -6269   | -13036   | 1954   |
| Feb.-08 | -308  | 1734   | 2497   |
| Mar.-08 | -898  | -1971  | 11882  |
| Apr.-08 | -744  | 1075   | -1702  |
| May-08  | -952  | -5012  | -163   |
| Jun.-08 | -2495   | -10096   | -999   |
| Jul.-08 | -1305   | -1837  | 3619   |
| Aug.-08 | -2241   | -1212  | 1258   |
| Sep.-08 | -3974   | -8278  | 3204   |
| Oct.-08 | -3225   | -15347   | -1858  |
| Nov.-08 | -1507   | -2598  | 4215   |
| Dec.-08 | -355  | 1750   | 627  |
| Jan.-09 | -1745   | -4245  | 803  |
| Feb.-09 | -978  | -2437  | -688   |
| Mar.-09 | -893  | 530  | -6420  |
| Apr.-09 | -120  | 6508   | 2490   |
| May-09  | 5267  | 20117  | -2712  |
| Jun.-09 | -1245   | 3830   | 1069   |
| Jul.-09 | -1066   | 11064  | 2115   |
| Aug.-09 | -1502   | 4903   | -379   |

Source: Bombay Stock Exchange



## **The External Sector**

The downturn that the global economy has been experiencing for nearly two years has appeared more enduring now that its effect is being felt on global trade flows. In its World Economic Outlook (WEO) of April 2009, the IMF had predicted that the global trade in goods and services would decline by 11 per cent in 2009 as compared to over seven per cent recorded in 2007, the year in which signs of the economic crisis first emerged. These estimates were revised downwards in the following edition of the WEO in which the Fund predicted that world trade would decline by 12 per cent. The Secretariat of the WTO reported that 'the collapse in global demand brought on by the biggest economic downturn in decades will drive exports down by roughly nine per cent in volume terms in 2009, the biggest such contraction since the Second World War'.<sup>1</sup> The World Bank, on the other hand, projected a much lower level of decline. In its assessment unveiled in March 2009 the Bank indicated that world trade in goods and services could decline by about six per cent in 2009. While the decline in developing countries' exports was expected to be much lower than those of the developed countries, the former set of countries could eventually be worse off since many among them have high dependence on export earnings that have dwindled in the aftermath of the crisis.

The anticipated collapse of trade in goods and services was a result of the interplay of at least three sets of factors. The first

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1. WTO (2009), "WTO sees 9% global trade decline in 2009 as recession strikes", Press Release, 22 March (accessed from: [http://www.wto.org/english/news\\_e/pres09\\_e/pr554\\_e.htm](http://www.wto.org/english/news_e/pres09_e/pr554_e.htm))

was the unprecedented fall in global demand triggered by the collapse of the financial system, particularly in the advanced countries. The second was the shortage of trade finance that caused supply side constraints to export growth. The third and possibly the most significant of the causes, one that would have a bearing on the prospects of recovery, is the sharp increase in protectionist tendencies in recent months. The Report of the WTO Director-General to the Trade Policy Review Body on the financial and economic crisis and trade-related developments increase has brought out the fact that WTO members have resorted to increases in border protection measures through higher levels tariffs and imposition of new non-tariff measures. Besides, these countries have also increased the use of trade defence measures such as anti-dumping actions. The Report has further observed that while the financial and fiscal stimulus packages that have been introduced to tackle the crises have generally included elements that could help restore the rate of growth of global trade, some of these packages include elements – state aids, other subsidies and ‘buy/lend/invest/hire local’ conditions – that favour domestic goods and services at the expense of imports. The increase in the protectionist sentiments, as is reflected by the above-mentioned measures, should cause consternation particularly because these measures have been adopted by most of the prominent members of the WTO.<sup>2</sup>

In the initial phase, developing countries like India were not affected by the downturn. Indian economy remained buoyant as foreign capital inflows continued to increase even after the onset of the downturn in the major economies. Between September 2007 and January 2008, India received huge Foreign Institutional Investment (FII) inflows of US\$ 22.5 billion during

2. Many WTO members are facing increased pressure to take protectionist actions. At the start of this year, most WTO members appeared to have successfully kept these pressures under control. 33 WTO members (individual EU members are not counted) had taken the measures to stimulate their economies as also to protect their domestic industries from facing import competition. For details, see, WTO (2009), ‘Report to the TRPB from the Director-General on the Financial and Economic Crisis and Trade-Related Developments’, JOB(09)/30, 26 March.

September 2007 to January 2008, as against US\$ 11.8 billion during April-July 2007. But with the financial markets in the developed countries, in particular the United States, coming under increasing stress after the collapse of Lehman Brothers in September 2008, the contagion spread to India. The initial impact on the external sector was felt through the reversal of portfolio flows – net outflow on this account was recorded at US\$ 11.3 billion during April-December 2008.

The real impact of the global economic downturn was felt in India when the merchandise exports started slowing down from the second quarter of 2008-09. The slowing down of the developed countries, particularly during 2008, reversed the growth in India's merchandise exports that had been increasing quite consistently since the beginning of the current decade. In fact, the growth rates recorded by India during the past few years ranks it amongst the best performing countries in the developing world. As a result, India's share in global merchandise exports, which had been stagnating at around 0.7 per cent for some years, increased to above one per cent in 2007-08.

The downturn in exports began in August 2008. The downturn was so severe that, for the next nine months, exports from India declined continuously. When the trough was reached in April 2009, the level of exports was more than 34 per cent off the month-wise peak that was reached in July 2008. Between April and August 2009, exports reversed the declining

**Table 5.1.**

| Countries | CAGR    | Annual Growth (%) |      |      |      | Share in World Exports (%) |      |      |  |
|-----------|---------|-------------------|------|------|------|----------------------------|------|------|--|
|           | 2000-05 | 2006              | 2007 | 2008 | 2000 | 2006                       | 2007 | 2008 |  |
| China     | 25.0    | 27.2              | 25.6 | 17.3 | 3.9  | 8.0                        | 8.8  | 9.1  |  |
| Malaysia  | 7.5     | 14.0              | 9.6  | 19.1 | 1.5  | 1.3                        | 1.3  | 1.3  |  |
| Thailand  | 9.8     | 18.7              | 17.0 | 12.9 | 1.1  | 1.1                        | 1.1  | 1.1  |  |
| Singapore | 10.8    | 18.4              | 10.1 | 13.0 | 2.2  | 2.2                        | 2.2  | 2.1  |  |
| India     | 18.6    | 21.3              | 20.3 | 20.7 | 0.7  | 1.0                        | 1.1  | 1.1  |  |
| Brazil    | 16.5    | 16.3              | 16.6 | 23.2 | 0.9  | 1.1                        | 1.2  | 1.3  |  |

Source: IMF

trend before it reversed the trend once again in September 2009. Even when they were growing in 2009-10, exports were way below the level they had reached in 2008-09. In August 2009, exports were nearly a quarter of the level registered in the corresponding period during 2008.

The decline in the absolute value of exports, beginning August 2008, impacted export growth quite drastically. According to the data released by DGCI&S, the growth of exports recorded in 2008-09 was just around 12 per cent, which was well below the 29 per cent growth that was experienced before the onset of the economic crisis, i.e., in 2007-08. Exports registered a modest upturn from May 2009, but after August exports have experienced a slight downward trend.

**Table 5.2.** India's Export of Principal Commodity Groups

(\$ Million)

| <i>Commodity</i>              | <i>Apr.-Mar.<br/>2008</i> | <i>Apr.-Mar.<br/>2009 (P)</i> | <i>%<br/>Growth</i> | <i>%<br/>Share</i> |
|-------------------------------|---------------------------|-------------------------------|---------------------|--------------------|
| Plantation                    | 970.76                    | 1,074.81                      | 10.72               | 0.59               |
| Agriculture & Allied Products | 13,546.02                 | 14,299.78                     | 5.56                | 7.83               |
| Marine Products               | 1,721.30                  | 1,535.90                      | -10.77              | 0.84               |
| Ores & Minerals               | 9,124.26                  | 7,799.84                      | -14.52              | 4.27               |
| Leather & Manufactures        | 3,504.21                  | 3,555.11                      | 1.45                | 1.95               |
| Gems & Jewellery              | 19,688.31                 | 27,704.98                     | 40.72               | 15.17              |
| Sports Goods                  | 134.18                    | 143.53                        | 6.97                | 0.08               |
| Chemicals & Related Products  | 22,375.20                 | 23,827.96                     | 6.49                | 13.05              |
| Engineering Goods             | 33,726.61                 | 40,000.53                     | 18.6                | 21.9               |
| Electronic Goods              | 3,511.72                  | 7,127.54                      | 102.96              | 3.9                |
| Project Goods                 | 145.14                    | 136.12                        | -6.22               | 0.07               |
| Textiles                      | 18,488.41                 | 19,241.58                     | 4.07                | 10.54              |
| Handicrafts                   | 508.49                    | 299.06                        | -41.19              | 0.16               |
| Carpets                       | 943.79                    | 774.91                        | -17.89              | 0.42               |
| Cotton Raw, Including Waste   | 2,203.08                  | 623.1                         | -71.72              | 0.34               |
| Petroleum Products            | 28,376.95                 | 26,829.56                     | -5.45               | 14.69              |
| Unclassified Exports          | 4,015.48                  | 7,656.21                      | 90.67               | 4.19               |
| Total                         | 1,62,983.91               | 1,82,630.50                   | 12.05               | 100                |

Source: DGCI&S, Department of Commerce



The decline in the growth rate of exports was triggered by modest growth, or even decline, in some of the leading exporting sectors. The most significant of the sectors that registered negative growth in exports was petroleum (POL) products, which had emerged as the leading sector in India's export surge during the past few years. This was mainly due to the fall in international crude oil prices since August 2008 and partly due to the slowdown in the volume of POL imports. Gems and jewellery balked this trend of low to negative export growth among major sectors by registering a forty per cent increase in 2008-09 as compared to the immediately preceding year.

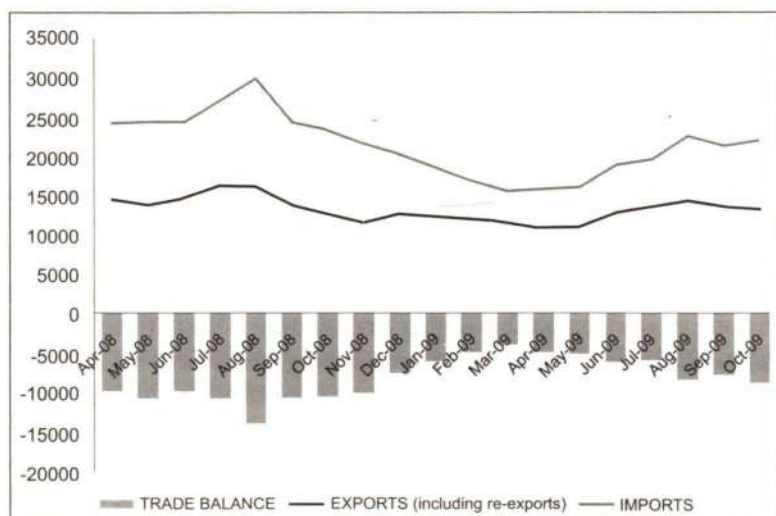
Interestingly, the monthly trends in imports during 2008-09 largely followed the pattern that was seen in case of exports. As in the case of exports, imports too started declining in August 2008. But with the Indian economy showing signs of recovering faster than has been the case with the rest of the world, the rebound in India's imports was more pronounced than that seen in the case of exports. Again, mirroring the monthly trend in exports, imports declined in September 2009. What this latest figure implies in terms of the upswing of the Indian economy can only be commented on after the import performance in the subsequent months is observed.

**Table 5.3. India's Import of Principal Commodities**

(\$ Million)

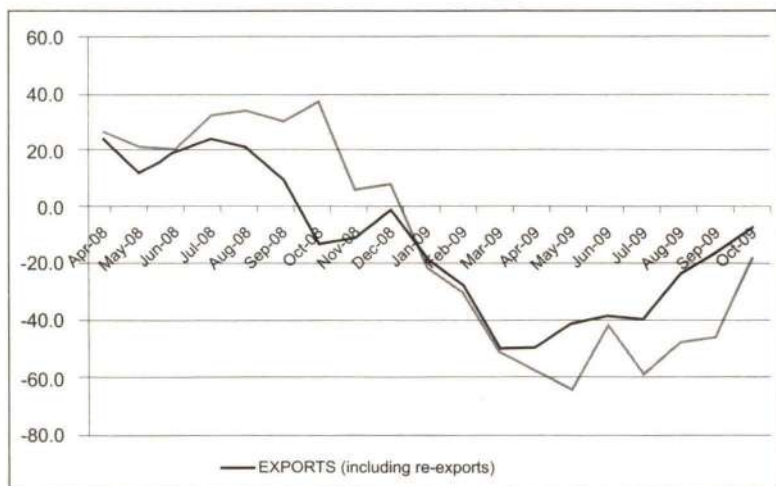
| <i>Commodity</i>                           | <i>Apr.-Mar.<br/>2008</i> | <i>Apr.-Mar.<br/>2009 (P)</i> | <i>%<br/>Growth</i> | <i>%<br/>Share</i> |
|--|---------------------------|-------------------------------|---------------------|--------------------|
| Bulk Imports                               | 1,12,159.71               | 1,34,825.25                   | 20.21               | 46.26              |
| Pearls, Precious &<br>Semi-Precious Stones | 7,975.52                  | 14,439.10                     | 81.04               | 4.95               |
| Machinery                                  | 45,072.60                 | 39,795.73                     | -11.71              | 13.65              |
| Project Goods                              | 1,294.18                  | 3,127.36                      | 141.65              | 1.07               |
| Others                                     | 85,060.26                 | 99,287.15                     | 16.73               | 34.06              |
| Total                                      | 2,51,562.27               | 2,91,474.56                   | 15.87               | 100                |

Source: DGCI&S, Department of Commerce



**Figure 5.1.** India's Foreign Trade (April 2008 to October 2009)

Source: DGCI&S, Department of Commerce



**Figure 5.2.** Export and Import Growth Rates (April – October 2009)

Source: DGCI&S, Department of Commerce

Despite the steep fall in the growth of exports during 2008-09, India managed to register an above-average expansion in export growth with some of its major trading partners. The most impressive of the export growth measured in terms of the destinations, was that with the U.A.E. During the past few years, the U.A.E. has emerged as one of India's major export destinations and in 2008-09, it had become the single largest destination for India's exports. Importantly for India, the U.A.E. that offers an expanding market for the country has, in recent years, seen impressive GDP growth, although its economic expansion during the two years has been moderate.

Table 5.4. Major Destinations of India's Exports

| Region/Countries         | (\$ Million)      |                       |          |         |
|--------------------------|-------------------|-----------------------|----------|---------|
|                          | Apr.-Mar.<br>2008 | Apr.-Mar.<br>2009 (P) | % Growth | % Share |
| <b>EU Countries (27)</b> | 34,507.04         | 38,952.88             | 12.88    | 21.33   |
| Of which:                |                   |                       |          |         |
| U.K.                     | 6,701.49          | 6,594.64              | -1.59    | 3.61    |
| GERMANY                  | 5,118.89          | 6,343.90              | 23.93    | 3.47    |
| NETHERLANDS              | 5,228.12          | 6,279.86              | 20.12    | 3.44    |
| <b>Africa</b>            | 11,546.29         | 11,230.05             | -2.74    | 6.15    |
| <b>North America</b>     | 21,988.04         | 22,176.25             | 0.86     | 12.14   |
| Of which:                |                   |                       |          |         |
| U.S.A.                   | 20,722.17         | 20,818.38             | 0.46     | 11.4    |
| <b>Latin America</b>     | 5,660.54          | 6,008.33              | 6.14     | 3.29    |
| <b>ASEAN</b>             | 16,384.25         | 18,890.83             | 15.3     | 10.34   |
| Of which:                |                   |                       |          |         |
| SINGAPORE                | 7,371.15          | 8,206.97              | 11.34    | 4.49    |
| <b>WANA</b>              | 30,372.02         | 40,835.12             | 34.45    | 22.36   |
| Of which:                |                   |                       |          |         |
| U.A.E.                   | 15,634.56         | 23,921.12             | 53       | 13.1    |
| SAUDI ARABIA             | 3,708.30          | 4,987.94              | 34.51    | 2.73    |
| <b>NE Asia</b>           | 26,450.00         | 25,279.90             | -4.42    | 13.84   |
| Of which:                |                   |                       |          |         |
| CHINA PRP                | 10,834.08         | 9,275.55              | -14.39   | 5.08    |
| KOREA RP                 | 2,853.19          | 3,990.49              | 39.86    | 2.19    |
| <b>South Asia</b>        | 9,621.95          | 8,438.30              | -12.3    | 4.62    |
| <b>Total</b>             | 1,62,983.91       | 1,82,630.50           | 12.05    | 100     |

Source: DGCI&S, Department of Commerce

Yet another feature of India's export performance in 2008-09 has been that the growth in exports has been better than the average in case of two of its most recent Free Trade Agreements (FTA) partners. The trade expansion with Korea has been particularly significant with a near forty per cent expansion having been recorded in the past fiscal. And, with Asia showing early signs of recovery according to the recent assessment made by the IMF, India's exports could rebound sooner than expected.

**Table 5.5.** India's Sources of Imports

(\$ Million)

| <i>Region/Countries</i>       | <i>Apr.-Mar.<br/>2008</i> | <i>Apr.-Mar.<br/>2009 (P)</i> | <i>% Growth</i> | <i>% Share</i> |
|-------------------------------|---------------------------|-------------------------------|-----------------|----------------|
| <b>1) Europe</b>              | 51,625.71                 | 55,713.24                     | 7.92            | 19.11          |
| <b>1.1 EU Countries (27)</b>  | 38,432.47                 | 41,652.70                     | 8.38            | 14.29          |
| 1) GERMANY                    | 9,874.52                  | 11,694.28                     | 18.43           | 4.01           |
| <b>1.2 Other WE Countries</b> | 13,157.46                 | 14,029.36                     | 6.63            | 4.81           |
| 1) SWITZERLAND                | 9,833.46                  | 11,447.19                     | 16.41           | 3.93           |
| <b>2) Africa</b>              | 14,949.04                 | 18,585.67                     | 24.33           | 6.38           |
| <b>2.2 West Africa</b>        | 9,745.30                  | 10,908.47                     | 11.94           | 3.74           |
| 1) NIGERIA                    | 7,619.82                  | 8,695.92                      | 14.12           | 2.98           |
| <b>3.1 North America</b>      | 23,002.74                 | 20,614.27                     | -10.38          | 7.07           |
| 1) U.S.A.                     | 21,029.58                 | 18,162.92                     | -13.63          | 6.23           |
| <b>3.2 Latin America</b>      | 6,561.06                  | 9,744.14                      | 48.51           | 3.34           |
| <b>4) Asia &amp; ASEAN</b>    | 149,840.60                | 178,957.88                    | 19.43           | 61.4           |
| <b>4.1 East Asia</b>          | 8,381.15                  | 9,109.27                      | 8.69            | 3.13           |
| 1) AUSTRALIA                  | 7,840.78                  | 8,423.15                      | 7.43            | 2.89           |
| <b>4.2 ASEAN</b>              | 22,674.58                 | 25,773.33                     | 13.67           | 8.84           |
| 1) SINGAPORE                  | 8,121.61                  | 7,431.48                      | -8.5            | 2.55           |
| <b>4.3 WANA</b>               | 71,917.01                 | 85,498.60                     | 18.89           | 29.33          |
| 1) U. A. E.                   | 13,477.10                 | 20,604.75                     | 52.89           | 7.07           |
| 2) SAUDI ARABIA               | 19,410.63                 | 19,492.97                     | 0.42            | 6.69           |
| 3) IRAN                       | 10,920.69                 | 12,133.72                     | 11.11           | 4.16           |
| <b>4.4 NE Asia</b>            | 44,755.43                 | 56,785.31                     | 26.88           | 19.48          |
| 1) CHINA PRP                  | 27,115.66                 | 31,333.86                     | 15.56           | 10.75          |
| 2) KOREA RP                   | 6,040.58                  | 8,591.34                      | 42.23           | 2.95           |
| 3) JAPAN                      | 6,326.33                  | 7,606.57                      | 20.24           | 2.61           |
| <b>5) CIS &amp; Baltics</b>   | 3,780.18                  | 6,557.86                      | 73.48           | 2.25           |
| <b>Total</b>                  | 251,562.27                | 291,474.56                    | 15.87           | 100            |

Source: DGCI&S, Department of Commerce

## Invisibles

India's invisibles receipts have been increased quite substantially since the beginning of the current decade. Net inflows on the invisibles account increased from nearly US\$ 28 billion in 2003-04 to more than US\$ 74.5 billion in 2007-08. This increase in the net inflows by two and a half times in five years, has played a key role in keeping the current account deficit within manageable limits during a phase in which India's trade deficit increased by nearly seven fold between 2003-04 and 2007-08.

As regards the different components making a contribution to the growth in invisibles' earnings, transfers were the most important component in 2007-08, contributing to more than 56 per cent, but services became the largest component in 2008-09 contributing as much as transfers contributed a year earlier. But even when their share in net earnings of invisibles had declined, transfer receipts had increased by over US\$ 2 billion during 2007-08 and 2008-09.

Software services receipts grew at an annual average rate of thirty per cent during 2005-06 and 2007-08. Net receipts on account of software services recorded a rise of 28 per cent in 2007-08, which was slower than the 32 per cent increase registered during 2005-06 and 2007-08. Net earnings on the services account were made up almost entirely by the earnings of the Information Technology and IT-enabled services sectors in 2007-08. Other remaining components of non-factor services in the invisibles account of BoP: namely, travel, transportation,

**Table 5.6.** Net Invisibles Flows into India

(\$ Million)

| <i>Years</i> | <i>Invisibles (net)</i> | <i>Non-Factor Services</i> | <i>Income</i> | <i>Pvt. Transfers</i> |
|--------------|-------------------------|----------------------------|---------------|-----------------------|
| 2003-04      | 27801                   | 10144                      | -4505         | 21608                 |
| 2004-05      | 31232                   | 15426                      | -4979         | 20525                 |
| 2005-06      | 42002                   | 23170                      | -5855         | 24493                 |
| 2006-07      | 52217                   | 29469                      | -7331         | 29825                 |
| 2007-08      | 74592                   | 37565                      | -4917         | 41705                 |

Source: RBI

insurance, financial services, communication services and business services contributed only eight per cent of the surplus in services trade in 2007-08. Travel receipts (net) grew at an average rate of growth of 24 per cent during 2005-06 to 2007-08, reflecting the attractiveness of India as a tourist destination.

In 2008-09, gross invisibles receipts and payments slowed down significantly during the third quarter of 2008-09, and by the fourth quarter of the year, negative growth was recorded. The impact of the global economic downturn was thus being felt on this account as well. The decline in invisibles receipts during the fourth quarter of 2008-09 occurred due to decline in all the three major components: namely, services, private transfers and investment income. The impact of this decline in the growth of invisibles receipts during the fourth quarter was, however, not felt on the total receipts for the year as a whole: invisibles receipts recorded a positive growth, supported mainly by the export of software services and private transfer receipts. Invisibles payments recorded a decline during the fourth quarter of 2008-09, resulting from significant decline in payments under transportation, software services, business services and financial services accounts. For the year as a whole, invisibles payments showed a marginal negative growth. These trends in the invisibles account resulted in an improvement of the relative significance of net invisibles during 2008-09 from the level a year ago: it improved to 7.7 per cent of the GDP as against 6.4 per cent of GDP a year earlier.

With the trade deficit declining during 2008-09, the surplus on the invisibles account financed about 75.0 per cent of trade deficit during 2008-09 as against 81.4 per cent during 2007-08. As indicated earlier, the lowering of the trade deficit took place on account of a steeper decline in imports relative to exports.

Net flows of invisibles were lower in the first quarter of 2009-10 on account of a decline in earnings from services in the first quarter of 2009-10. As is to be expected, there was a decline in the earnings from the services sector as a whole, contributed largely by an 11 per cent fall in the export of software-related to software-service exports. Among the service sectors, transportation service was the only major

**Table 5.7.** Invisibles Receipts and Payments

(\$ Million)

| Item                      | Invisibles Receipts |                     |                    | Invisibles Payments |                     |                    |
|---------------------------|---------------------|---------------------|--------------------|---------------------|---------------------|--------------------|
|                           | 2008-09<br>(P)      | 2008-09<br>(Q1)(PR) | 2009-10<br>(Q1)(P) | 2008-09<br>(P)      | 2008-09<br>(Q1)(PR) | 2009-10<br>(Q1)(P) |
| Services                  | 101224              | 23059               | 22389              | 51406               | 11441               | 13351              |
| Travel                    | 10894               | 2504                | 2286               | 9432                | 2164                | 2004               |
| Transportation            | 11066               | 2611                | 2490               | 12777               | 3328                | 2777               |
| Insurance                 | 1409                | 350                 | 387                | 1131                | 228                 | 314                |
| G.N.I.E.                  | 389                 | 130                 | 100                | 791                 | 110                 | 103                |
| Miscellaneous:            | 77466               | 17464               | 17127              | 27275               | 5611                | 8153               |
| Of which:                 |                     |                     |                    |                     |                     |                    |
| Software                  | 47000               | 12156               | 10764              | 2814                | 857                 | 391                |
| Non-Software              | 30466               | 5308                | 6362               | 24461               | 4754                | 7762               |
| Transfers                 | 47025               | 12307               | 13344              | 2746                | 654                 | 466                |
| Private                   | 46380               | 12159               | 13298              | 2333                | 547                 | 360                |
| Official                  | 645                 | 148                 | 46                 | 413                 | 107                 | 107                |
| Income                    | 14307               | 3573                | 2951               | 18818               | 4438                | 4688               |
| Investment                | 13482               | 3418                | 2723               | 17499               | 4108                | 4350               |
| Income                    |                     |                     |                    |                     |                     |                    |
| Compensation of Employees | 825                 | 155                 | 227                | 1319                | 330                 | 338                |
| Total                     | 162556              | 38939               | 38684              | 72970               | 16533               | 18505              |

Source: RBI

sector to have made a positive contribution to the net services exports in 2008-09.

### Balance of Payments

During 2008-09, export growth, on balance of payments basis, declined to 5.4 per cent after registering an impressive growth of 28.9 per cent in the immediately preceding year. Import growth also declined sharply to 14.3 per cent from 35.2 per cent during the same period. India's trade deficit on a BoP basis, therefore, widened to 10.3 per cent of the GDP as compared to 7.8 per cent of GDP in 2007-08. However, trade deficit became progressively lower as the impact of the global

economic downturn affected India's domestic economy, and current deficit, after recording a deficit in three successive quarters of 2008-09, turned surplus in the last quarter. But despite the third-quarter performance, India's current-account deficit during 2008-09 deteriorated sharply in 2008-09.

India's external account has, therefore, remained comfortable during the first quarter of the current financial year. This reflects the fact that while the global downturn had not deepened enough during the first quarter of 2008-09, April-June 2009-10 was the period that saw the bottoming out of the decline of India's trade that started in August 2008. In this period, trade deficit had narrowed down to US\$ 26.0 billion as against US\$ 31.4 billion in the first quarter of 2008-09. However, trade deficit during April-June 2009-10 was higher than US\$ 14.6 billion in last quarter of 2008-09, which was partly due to a rise in crude oil prices. Reflections of the trends in the trade account were also seen in the current account. The current account deficit at US\$ 5.8 billion in the first quarter of 2009-10 was also lower compared to the deficit of US\$ 9.0 billion during the same period of 2008-09. The capital account showed a turnaround from a negative balance in the last two quarters of 2008-09 to a positive balance of US\$ 6.7 billion during April-June of 2009-10.

**Table 5.8.** India's Balance of Payments

(\$ Million)

| Item                    | April-March     |                | April-June      |                |
|-------------------------|-----------------|----------------|-----------------|----------------|
|                         | 2007-08<br>(PR) | 2008-09<br>(P) | 2008-09<br>(PR) | 2009-10<br>(P) |
| Exports                 | 166163          | 175184         | 49120           | 38789          |
| Imports                 | 257789          | 294587         | 80545           | 64775          |
| Trade Balance           | -91626          | -119403        | -31425          | -25986         |
| Invisibles, net         | 74592           | 89587          | 22406           | 20179          |
| Current Account Balance | -17034          | -29817         | -9019           | -5808          |
| Capital Account Balance | 109198          | 9737           | 11254           | 5923           |
| Change in Reserves      | -92164          | 20080          | -2235           | -115           |

Source: RBI



## Foreign Exchange Reserves

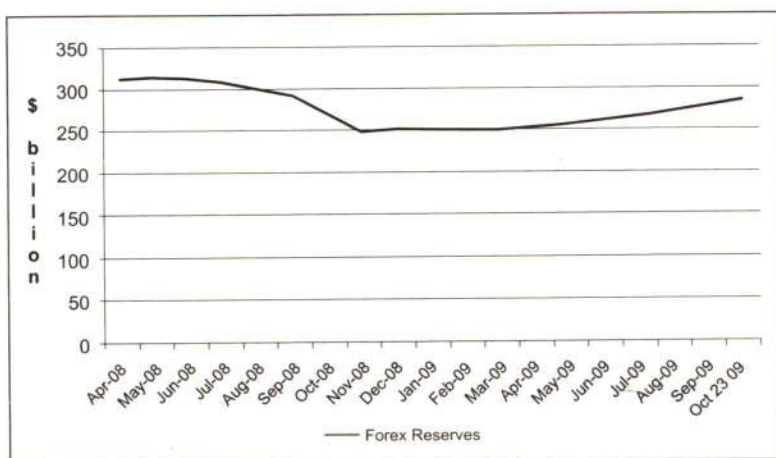
India's foreign exchange reserves reached a new high during 2008-09, peaking at US\$ 314.6 billion at end-May 2008. The financial year also saw the foreign exchange reserves decline by nearly US\$ 58.0 billion, down from US\$ 309.7 billion as at the end of March 2008, to US\$ 251.7 billion as at end-March 2009. Of this decline of US\$ 58.0 billion, US\$ 37.9 billion was on account of valuation changes, and the balance of US\$ 20.1 billion decline reflected the financing needs of the BoP. Thus, the impact of an unprecedented external shock on India's BoP was managed with reserve loss of only US\$ 20.1 billion, without resorting to any extraordinary measure. In fact, the capital account was further liberalized in certain areas such as outward FDI and buyback of FCCBs.

Despite net capital outflows, the foreign exchange reserves on BoP basis (i.e., excluding valuation) increased marginally by US\$ 0.3 billion during the fourth quarter of 2008-09, mainly due to a modest surplus achieved in the current account. This was in contrast to significant drawdown of reserves witnessed in the previous two quarters of 2008-09 (see Chart). India's foreign exchange reserves, which had declined to US\$ 251.7 billion at end-March 2009, however, increased subsequently to over US\$ 285 billion by 23 October 2009, which occurred largely as a result of the reversal of the portfolio flows reversing the earlier trend and turning significantly positive during 2009-10.

**Table 5.9.** Variation in Foreign Exchange Reserves

| <i>Period</i>                            | <i>Variation (\$ Billion)</i> |
|--|-------------------------------|
| <b>Full Year</b>                         |                               |
| 2004-05                                  | 28.6                          |
| 2005-06                                  | 10.1                          |
| 2006-07                                  | 47.6                          |
| 2007-08                                  | 110.5                         |
| 2008-09                                  | (-)57.7                       |
| <b>Financial Year (up to 23 October)</b> |                               |
| 2008-09                                  | (-)35.8                       |
| 2009-10                                  | 38.6                          |

Source: RBI



**Figure 5.3.** Looking Beyond to Stimulate India's Export Efforts

Source: RBI

As the global economy shows signs of recovery, India will have to make serious efforts to enter into this highly competitive market. At least two sets of initiatives have been taken by the government during the past few months to position Indian exports in the global market. On the one hand, the government has concluded two FTAs, with ASEAN and Korea, both of which will help India to exploit the markets in what are universally recognized as the growth centres of the world economy. The second policy initiative has come in the form of the Foreign Trade Policy (FTP) that provides a medium-term perspective to India's efforts at increasing its presence in the global economy. Thus, it recognizes that in the era of global competitiveness, there is an imperative need for Indian exporters to upgrade their technology and reduce their costs. The FTP underlines support that the government would be providing to the exporters for technological upgradation. Furthermore, the FTP provided that for upgradation of export sector infrastructure, 'Towns of Export Excellence' and units located therein would be granted additional focused support and incentives.

Going beyond the immediate once again, the FTP has recognized the need to reduce the transaction cost and institutional bottlenecks by implementing the e-trade project in a time-bound manner to bring all stakeholders on a common platform. The FTP has also announced that additional ports/locations would be enabled on the Electronic Data Interchange over the next few years.



## **Concluding Remarks**

It is now well recognized that the impact of the economic downturn that has affected the global economy for close to two years now has not impacted the growth prospects of the Indian economy in a major way. The slowdown in GDP growth rates that was seen during 2008-09 seems to be passé, and, as the results of the second quarter of 2009-01 unveiled recently have shown, the growth rate has been hovering around eight per cent. Most of the industrial sectors have left the worst behind them. A better performance from the agricultural sector, which has been hit by one of the worst droughts in recent years, would have provided an added dimension of optimism about the Indian economy.

It would appear that the ability of the Indian economy to avoid the contagion of the global economic slowdown has played the key role in the economic performance of the past year and a half. In the first place, prudent policies to protect the economy from the financial meltdown that had brought the country's stock market and other asset markets, in particular, the real-estate sector, have played a significant part in the avoidance of the crisis. In fact, this is the second time in the decade that the ability of the 'systems' put in place by India has been able to protect the country's economy from being afflicted by a global financial meltdown. These systems, of course, include the regulations on the capital account that India has continued to impose despite the pressures for dismantling them.

The importance of a resilient domestic economy has finally been recognized as an important 'insurance' against the downturns that seem to have become a feature of the global economy. The rapid integration of the economies,

which has been taken to dimensions not anticipated even a few years back by the rapid flows of international finance, has brought with it the malaise of contagion that has brought an added dimension of uncertainty for the developing countries. The most recent episode of the global economic downturn has clearly exposed the vulnerability of the countries that have been more dependent on the external sector, thus forcing policy analysts to explore the virtues of the domestic market in times of crisis. While smaller developing countries may find it difficult to adopt policies based on domestic market considerations alone, for large economies like India and China, the current crisis has certainly brought forth an important dimension in the policy framework.

As regards India, the economic crisis offers an important opportunity to focus on the vulnerabilities that could have an impact on the sustainability of the growth momentum. Topping this list of areas is agriculture, which poses problems on both the demand and the supply-side for the Indian economy. As regards the demand-side, agriculture under-performance has prevented the manufacturing and the service sectors from finding additional avenues of growth. The above-average performance of Indian agriculture in the recent past had provided the much needed momentum to the industrial sector, with the FMCG sectors gaining the most. This impetus to the industry is unlikely, given that the failing monsoon would add to the woes of the agricultural sector, thus resulting in less-than-average performance of this sector.

Although agriculture has been beset with supply-side constraints for quite some time now, this fact is being recognized only recently as large demand-supply imbalances that have appeared in a number of key food crops have started to manifest themselves in high market prices. The supply-side constraints have been caused by a combination principally of falling productivity and decreasing cropping area. In addition, inconsistencies in the administered price policy of the government have also provided erroneous signals to the producers. But the most critical factor that has affected the fortunes of the agricultural sector has been that most farmers,

particularly those that are operating at the margins, do not have the possibility of taking advantage of the market prices since the middle-men have crowded the producers out of the market. The absence of a well-functioning market has been the 'Achilles heel' of the Indian agricultural sector, and the responsibility squarely lies with the government to ensure that agricultural markets do become a reality so as to allow the producers to get the right incentives from the marketplace.

The direction that the government needs to provide through fiscal policies must, therefore, seek to address some of the critical bottlenecks faced by the various sectors of the economy. This dimension was largely unaddressed in the economic stimulus package, although the government has made some efforts in the last budget, to promote the much-needed infrastructural facilities. Backing these efforts by focusing on the institutional imperatives would provide the country with the initial conditions for sustained economic growth.

The financial sector has functioned in a quasi-regulated structure. While in the recent years, the monetary management by the Reserve Bank of India has had its salutary effects; the experience of the past year and a half does call for closer monitoring of the financial system. The banking sector has faced no undue pressures despite concerns being expressed about their financial health. This aspect should benefit from a higher degree of transparency that ought to be in place if crises like those seen in some of the matured economies are to be avoided by countries like India. One of the major elements of the crisis management plan adopted by governments the world over, and which is to stimulate the economy through cheap-money policy, has not functioned well enough as the commercial banks have been unwilling to lend at lower rates, i.e. at rates that would help consumers to take advantage of the cheap-money policy pursued by the Reserve Bank of India.

The external sector had seen a prolonged phase of export contraction (September '08 to April '09) caused by the shrinking domestic demand in OECD countries. However, in more recent months, exports have shown a mixed trend. After reversing the declining trend between May and July, exports have started

sagging in the following period. There is clearly a need for Indian policy makers to explore ways in which export growth can pick up. In the short run, this would require focusing on short-term measures, in particular those that are necessary for lowering the costs of doing business. At the same time, the government will have to provide the necessary impetus that will help in undertaking the structural changes required for sustained increase in the country's exports.



## Discussions

### Ajit Mozoomdar

I first met Malcolm when I returned to India from a stint in the World Bank in 1985, and at that time the *Mid-Year Review* had already been in existence for some years. I am not quite sure when it started but it has always been, and has remained since then, an event in the IIC calendar. Now Malcolm, whom I didn't really know personally, I really came to admire as an economist of a curious kind. I think only India produces that kind of economist. He had been, for some years, with UNESCO and before that he must have had some academic background in India, but his remarkable ability to gather and marshal economic facts and analyze them and put them in an intelligible form for the layman was, I think, almost unique because what Dr. Dhar will now present us with is an institutional effort. We now have this *Mid-Year Review of the Indian Economy* put up by somebody who has the backing of several researchers.

Malcolm was a one-man research institute. And we must remember that we are not talking about a time when current economic statistics were very poor. Our statistical system at that time, the CSO system, was much less sophisticated than it has since become. In fact, CSO's GDP figures, quarterly and so on, I continue to mistrust because of the inadequacy of the back-up statistical material on which it is based. Although our flow of statistics is much improved, some of the basic figures – savings and investment figures – are still one year late. So when you are trying to create this kind of an analysis as Malcolm did on the basis of inadequate figures, figures that had to be collated

and checked and made to give some kind of sense, he did a marvellous one-man job.

The earlier reviews have since now become a mid-year review of the developments in the economy. And since the official economic survey was annual, the ability at the midpoint of the year to take a focus on how the year was doing was Malcolm's particular contribution to the economic thinking in this country. What Malcolm instituted was at that time unique. He then went on to draw in to the *Review* his personal assessment of the progress of investments – savings and investments – particularly investments attempting something like a mid-year planning review. So he would add to the *Mid-Year Economic Review*, a Mid-Year Planning Review, again done personally of course, with his contacts and his ability to understand these facts. And I can only say that he was the kind of economist whom I particularly admire, that is a rational, non-ideological analyst, who tends to give an overall picture as he sees it, and he never made any bones about that it was his personal assessment. When I say non-ideological, I should of course say that he was moderately left-of-centre, which is, I suppose, partly the reason why I admired him very much because his point of view coincided with my own. So when Malcolm died suddenly, this institution, this annual function, would have been discontinued perhaps but for the fact that he particularly left from his trust – the trust named after his wife and himself – a grant to the IIC for continuing this work. So I think we should recognize his contribution to the India International Centre and to many of us personally on this occasion.

### **Mathew Joseph**

Thank you, Chair. I should, first of all, compliment Biswajit Dhar for flagging the important issues that are emerging at a time when India is now coming out of the global crisis, and there are now very clear signs of revival. Biswajit has been able to pinpoint certain important issues, which need to be taken into account as we go forward. He started with talking about the prospects of growth this year and mentioned the GDP

estimates of the prime minister's Economic Council, of which Saumitra is a member. But Biswajit did not put a number to what he thinks exactly will be the actual rate of growth this year. Of course he has pointed out agriculture, which is the real villain now, but he did not exactly take that into account and give an actual number of what would be the growth rate this year. He flagged the issue of the emerging fiscal situation and inflation and also noted some signals, indicating that India has quite a problem with regard to demand. That is something to which I would like to return and explore further. Biswajit also indicated the possibility of trade diversification as a strategy for sustaining India's growth at a time when the global markets have collapsed, particularly of the developed markets.

My take on the growth prospects this year, taking into account the more than expected fall in agricultural growth, is in the range of 5.5-6 per cent. Agriculture, in fact, has been underplayed, as Biswajit correctly said, and the official estimate for agricultural growth in the kharif season came out with a long lag. Normally, it should have come by the middle of September. It was delayed by almost one and a half months this year. But I believe it indicates, if you consider food grains as well as non-food grains, a decline in the agricultural output of 12-15 per cent. Officially, it is mentioned that the rabi crop will be somewhat better. But, normally, a bad kharif crop is followed by a bad rabi crop. We had the worst drought since 1972. We had drought in almost half of the country. That would definitely affect the moisture level of the land and the productivity of the rabi crop. Taking that into account, agricultural production for the year as a whole would fall by 4-6 per cent, or about five per cent decline. Given that the non-agricultural sector is definitely recovering and we think it will recover further in the rest of the year, there would be a growth of slightly above eight per cent in the non-agricultural sector. Overall the GDP growth would be 5.5-6 per cent.

Coming to the fiscal situation, we are not yet sure if the high fiscal deficit envisaged in the budget 2009-10 will be overshoot or undershot. Biswajit's numbers indicate that revenue receipts are below target, and I too feel that expenditure is overshooting

the estimate. The only silver lining is the possibility of some disinvestment receipts, which were not envisaged in the budget, and that could come to the rescue. So one is not very sure whether finally the fiscal deficit will overshoot or undershoot the budget estimates. But I want to put it in the context of fiscal stimulus, which, in fact, had supported the growth of the economy last year.

In the current year, the growth of the expenditure in the budget estimates is about 13 per cent compared to about 33 per cent last year. And the receipts have been estimated to grow by about nine per cent compared to nearly four per cent last year. So taking these into account, the additional fiscal stimulus in this budget is almost minimal. So I don't think, going forward, we could get much growth stimulus from the fiscal in the current year. We have seen the huge impact of the fiscal stimulus last year. Government consumption expenditure went up by more than fifty per cent in one quarter, that is, the third quarter of last year. Then it went up by 25 per cent in the last quarter of last year. But in the first quarter this year, the impact has been about only about ten per cent and I think the impact is petering out. This year there won't be much impact of the fiscal stimulus on growth.

A major factor in India's growth is private investment that is not really picking up. We have data about investment up to the first quarter of this financial year. Investment had been growing by about 12-15 per cent in the previous number of years, and it has come down to five per cent in the second half of last year, and it has even gone below five per cent in the first quarter of this year. So it appears that there is no sign that the private investment is reviving. It continues to remain low.

What about private consumption expenditure? There has been a real collapse of the private consumption expenditure after the crisis. We used to have about eight-nine per cent growth in private consumption expenditure in real terms. That has come down to just about two per cent and in the second half of last year and in the first quarter of 2009-10, it has come down even further to below two per cent. There was in fact in the last year a support from the rural sector. Rural demand had been

held high and that has been one of the factors that had really supported the growth last year. After the poor harvest of this year, we don't expect that there would be a revival of demand, as the rural demand would definitely have come down.

Biswajit has already mentioned that the credit growth has been dismal. There has been substantial growth in the capital market mobilization. The problem is that the large corporates are mobilizing funds from the capital market but SMEs are not really getting funds from the credit market. And we are not very sure whether it is because banks are afraid to lend, or there is no demand for bank credit. It may be a combination of both. In short, there is no evidence that demand has picked up and there is no evidence that bank credit is growing.

And finally, I was not going to pronounce a final judgment on what would be the GDP growth this year before I saw the corporate results of Q2 FY 2009-10. But now the corporate results are out, and they indicate a huge increase in profitability but there is no increase in sales. The sales growth has been negative and it is more negative than in the previous quarter. The sales growth, so far, for about 2500 companies who have announced their results in the first quarter of this year, is negative – about seven per cent. This indicates that there is no proof that the demand has revived. So what we notice in India now is the continued lack of consumer confidence, and continued lack of business confidence.

So, in this context, what would be the driver of growth? So far, the collapse in external demand really has not impacted Indian growth because the decline in exports is more than compensated by a higher decline in imports. As a result, net exports have turned positive and contributed to growth. But what is driving the economy down this year is the fall in agricultural production. But then, if we look forward, the performance of the international economy is not expected to be encouraging. Indian economy is reviving, but we can't expect the growth to be similar to what we had in previous years. Net exports have been positive so far this year. But, in the years ahead, the growth impulse from the foreign sector will not be much.

So in this context what should we do to drive the growth of the economy? I think that we should come back to what we have been talking for long about the need for reforms. And Biswajit has made a mention about reforms needed in the agricultural sector. However, we need reform not only in the agricultural sector, but in a whole lot of areas including infrastructure, education, and also in the particular area of business environment or investment climate. There are a number of regulatory constraints, that have to be removed and that would pave the way for larger investments and high growth in the economy.

Finally, the performance of the government has also to be mentioned in this context. Delivery of public services has to be improved substantially. We have to improve the delivery mechanism by reducing the leakages in the system and improving the efficiency of the government. All these reforms are critical if you want to increase the rate of growth of the economy to eight per cent and above. You don't expect much impulse from the international economy and we don't expect much – at least this year from the agricultural sector. So we need to have a 'big-bang reform' as a strategy to be started as soon as possible.

### **Mythili Bhusnurmath**

Thank you, Saumitra. First of all let me also start by congratulating Biswajit Dhar on an excellent job. He has really summed up what has been happening in the economy as of now, whatever the figures are, but as Dr. Mozoomdar said, the fact remains that nowadays we have so many such *Mid-Year Reviews* coming from various forums, whether it is EAC or the RBI, NCAR, etc., and with even greater frequency than once a year, I think where one could distinguish and keep the *Mid-Year Review* of the IIC a little apart, a little better than the others, is by fleshing out the arguments a bit more. Though you have given an excellent presentation, I feel if there was bit more discussion of some of the issues, it would have been better.

Also, even if the *Mid-Year Review* was a bit more forward looking, because now with the wealth of data that we have, a lot of it is already known. And, so, what one really looks forward to in the *Mid-Year Review* is: the outlook, what is your perception, where we are, how are we going to move from here on. What I find somewhat disconcerting about most mid-year reviews is that I see them a bit like the credit-rating agencies – you don't see much divergence. And given the fact that there is a raging debate about what kind of recovery we are going to see, is it going to be L, is it going to be U, V, W, every letter of the alphabet almost, surely there must be different perceptions about what the rate of growth is going to be like.

So I find a strange convergence towards some kind of lowest common denominator, or whatever you want to call it: is it because people are apprehensive about sticking their necks out and saying something very different from the others? There is safety in numbers. So if we are wrong, we are all wrong together, and nobody can point a finger at us. What I would have liked to see is what is your take, what kind of growth are you seeing, particularly given the fact that there are so many uncertainties that people talk about and there are different ways of looking at the same thing.

Coming to the specific areas that I think the review would benefit from: let me give you a few examples. The first is regarding prices. There is a huge debate on at the moment about whether there is another asset price bubble building up. So, do we take cognizance of that, or should we go only by product prices? After the financial crisis there is a greater realization that product prices alone are not an indicator of what any policy measure – whether monetary or any other policy – should do. You also need to keep asset prices somewhere in your radar. In which case, are there signs of fresh asset price bubbles building up, whether it is in the stock market, commodity market, real estate, etc.? I would have liked to see a little bit more discussion on that.

Similarly, regarding the variance between CPI and WPI: perhaps what one would have liked to see is whether this variance signals anything in terms of policy. What does it mean?

Does the government or the RBI need to take any kind of action based on these huge differences? And what about the change in the frequency of the WPI: does it really mean anything? Are we going to get better data, or is it just that we are going to get bad data less frequently? So, is the change being envisaged because you don't want people to get alarmed, or is the quality of the data going to improve materially, is it going to help in policy making?

You have spoken about the lack of demand, but if you look at the data it is not uniform. Yes, there do seem to be signs of a lack of demand but both Maruti and Hyundai have reported the best figures ever – I repeat best figures ever – not just in the last few years. So, clearly, there are sectors which are growing 'much too rapidly' and certain other sectors which are not. Exports, as you have rightly pointed out, have not done so well. So do we need to go in for a sectoral approach? Is there something we are missing by looking only at the macro picture? I would have liked a bit more discussion on that.

On the external front you have done a disaggregated analysis, because you have given a little bit more thought to the disaggregated picture, but here again maybe you could have incorporated some discussion on non-oil imports. This is because looking at imports as a whole we often miss what is happening to non-oil imports, and since we are seventy per cent dependent on imports of oil, I think a better indicator of what is happening on the import front might come from looking at non-oil imports. So that again is something that I would have liked to see.

Talking of the external sector, some more discussion on capital flows would have been good, given that capital flows are increasingly becoming, if not as important, maybe even more important for both balance of payments and more for macro-economic stability. So far it looks as if we are going to see more inflows than ever before. What does this mean for policy? Does it mean we will again have to go in for building up reserves, followed by sterilization? What does that mean in terms of policy?



There has been a lot of talk about a Tobin tax; do we need anything like that? Recently, Brazil imposed a tax on capital inflows. Do we also need to think about such restrictions? Especially since the entire world is now rethinking many of the things that we took as gospel truths. Capital account convertibility was a gospel truth until recently, now even the IMF is arguing that yes, you do need to rethink these things from first principles.

On the subject of the fiscal deficit, the discussion is very good. But there again I thought maybe the review would benefit from more discussion on the quality of the fiscal deficit. There is no dispute that yes, you did need a fiscal stimulus and you cannot be fundamentalist about the size of the fiscal deficit, but certainly you need to be a little wary about the quality of the fiscal deficit. The fact remains that today our revenue deficit is about seventy per cent of our fiscal deficit and clearly that is very worrisome because when your revenue deficit is so high, what you are doing essentially is borrowing for current consumption. Your borrowing is not giving you any return at all, except that you are helping to keep the wolf from the door for many poor people, among other issues. Nevertheless, it does raise the issues of what it does mean for future borrowing. Does the size of the borrowing keep increasing? Are we anywhere near a debt trap?

I would also have liked to see some discussion on employment, given that the biggest issue in India, whether you talk about the good years or the bad years, is the lack of growth of employment. This is a cause of worry particularly in a country like India where we have so many poor. And though it seems very far away from the Naxal problem, the fact remains that, ultimately, social distress does have an economic underpinning. When employment doesn't grow and prices are rising, people take to whatever means they can to redress their grievances. And that is certainly worrisome because whatever growth you may achieve, it is all going to come to nought if you are not able to carry people along with you by giving them greater economic security. So some discussion on employment and on infrastructure, which is, perhaps, one of biggest

constraints on the India growth story would have made the *Review* more complete.

Coming very specifically to some of the issues that you have raised: you say there are no possibilities of reversal of the upturn. I am not so sure whether the signs are so unambiguous that there are no possibilities of a reversal of the upturn. A lot depends on what happens internationally, and internationally the signs are far from clear. So, although we have seen signs of revival in India, it maybe a little premature to say that we cannot foresee any possibility of a reversal in the upturn.

Again, when we are talking about the fiscal consolidation that has happened in the government, you say it has been possible because of the impressive performance of the states. Frankly, I would think that the improvement in the government's fiscal position was driven primarily by the tax buoyancy, driven by the huge burst in economic growth that we saw, tax revenues really shot up dramatically. So yes, states have managed their resources far better; you could argue that they were not spending – that is a different argument – but the fact remains that there the centre's improvement in the fiscal deficit was largely driven by much better tax revenues than foreseen.

On the subsidies issue, when we are talking about government's expenditure, you say there seems to be little economic basis for a relook at the entire subsidies discipline. I am not so sure that is the case. Subsidies, it is now widely accepted, are a very inefficient way of trying to ameliorate distress. Apart from the benefits not going to the deserving, they lead to misallocation of resources. It might be better to have an outright cash grant, given that our subsidies are so poorly targeted. For instance, there is no reason why middle-class people can't pay the market price for their gas cylinder. India still continues to be the largest consumer of gold at over Rs. 16,000, but at the same time people are not willing to pay for their LPG cylinder. So, clearly, there is some disconnect.

Yes, subsidies have positive externalities. But I would think that subsidies for education have more positive externalities than subsidies for LPG. When you subsidize LPG and petrol,

you are actually sending a very wrong price signal. So, instead of people cutting back on their petrol consumption, they might even be increasing their petrol consumption because they do not feel the pinch. So I am not sure the argument stands on subsidies.


Then, again, when you talk about monetary policy, there is mention of the fact that rates have not come down commensurately in the case of commercial banks but perhaps you may need to incorporate some discussion about the transmission mechanism: on why is it that rates have not come down? If credit is not growing, is it only because rates have not come down or, is it because there is no demand from corporates? If you look at credit numbers again, credit has grown year on year by about 15 per cent on a very high base of 32 per cent last year. When the economy is growing at about 67 per cent a credit growth of about 16-15 per cent is not really low; it's almost two and a half times the growth of the economy. So, is there a danger in credit growing too fast by compelling banks directly or indirectly to lend; would they be lending to people who are not viable; would you have an increase in non-performing assets as a consequence? Are we incentivizing a fresh bubble?

On the external front, what is a 'build up' in reserves? Is it a good thing? Is it a bad thing? What does it mean? During the financial crisis a build up of reserves served us well but now when we already have US\$ 285 billion, do we really need to build up any more reserves? If not, then what do we do when capital inflows increase?

Having said that, I think this is really a very good effort because it is a comprehensive bird's-eye view of the economy to date. It just requires a little bit of fleshing out, a little more discussion – forward-looking discussion – but otherwise all said and done, it is a really excellent piece of work.

In this *Mid-Year Review of the Indian Economy*, the well-known economist, Biswajit Dhar examines the current situation and the impact of the global economic meltdown on the Indian economy. Although India and China have not been affected by this global economic downturn as much as several other developing countries, it is imperative to analyze the performance of the Indian economy for several reasons.

Dhar examines the government's policy initiatives to alleviate rural employment and agricultural distress in the wake of an inadequate monsoon. Based on exhaustive analysis, the *Review* analyzes infrastructure project delays, rising food prices, trade imbalances, among other issues. He also shows how the results of state intervention are being felt almost a year after the government started taking measures to stabilize the national economy. Although early signs of recovery are visible, yet most analysts remain concerned about the sustainability of the recovery process once state subsidies are reduced.



The *Review* provides an opportunity to understand several such dimensions of our economic situation and particularly its management, which played a role in ensuring a relative stability. At the same time, it makes an important assessment of the vulnerability of the Indian economy to the downside risks that observers of the global economic dynamics have been alluding to, more so in the context of the fragile pace of this recovery.

**Biswajit Dhar** is Director General, Research and Information System for Developing Countries. Dr. Dhar has been working extensively on the theme of trade and development, researching and writing on issues that are of policy relevance. For more than two decades, Dr. Dhar has been researching on the implications of the global economic integration of developing countries in general and India, in particular. He has been nominated by the Government of India as a member of expert groups for providing advice on trade and development strategies.

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