MACRO-ECONOMIC FRAMEWORK STATEMENT 2014-15

Overview of the Economy

In the recent past, the Indian economy has had to overcome varied challenges in its resolve to sustain its economic success. The major challenges included: unsupportive external environment, domestic structural constraints, growth slowdown and inflationary pressures. The slowdown manifested in the decline in the growth of Gross Domestic Product (at factor cost at constant 2004-05 prices) from 8.9 per cent in 2010-11 to 6.7 per cent in 2011-12 and 4.5 per cent in 2012-13. With the economy projected to have registered a growth rate of 4.9 per cent in 2013-14, the declining trend in growth seems to have reversed. The growth slowdown in India is broadly in sync with trends in similar emerging economies. The sharp downturn in growth owes to the interface of domestic factors with the global economic environment of uncertainties and slow growth in many advanced economies. The growth of real GDP has generally shown a declining trend since the first quarter (Q1) of 2011-12, and is characterized by a moderation in services growth and a protracted slowdown in industry. The revival in agriculture on the back of a steady monsoon and robust growth in financial and business services led to a modest uptick in growth in 2013-14.

The option of a fiscal stimulus did not exist in face of the economic slowdown, post 2010-11, as the elevated levels of inflation precluded further fiscal space. Besides, factors including the slack in investment, exacerbated by delays in projects, signaled the emergence of bottlenecks that made new reforms an imperative to ease the structural constraints hampering growth. The Union Budget 2013-14 laid considerable emphasis, *inter alia,* on containment of inflationary pressures and mitigation of structural bottlenecks to growth.

The policy response of the Government to the present growth slowdown has been in the form of structural reforms aimed at reducing entry-barriers and boosting competition and productivity in various sectors; fiscal consolidation and reforms in administered prices; further strengthening of financial/ banking sectors; introduction of instruments to encourage financial savings of households; measures to restart the investment cycle through support to infrastructure financing and encouragement to micro, small and medium enterprises (MSMEs); steps to revive growth in manufacturing and reforms in energy pricing. These policies have gone hand-in-hand with macroeconomic stabilization that has had to balance the concerns of inflation and growth recovery, while managing a volatile external situation characterized by a sharp depreciation of the Rupee witnessed till the second quarter (Q2) of 2013-14.

The monetary policy stance of the Reserve Bank of India has been driven by the imperatives of keeping inflation in check and supporting growth revival while managing a complex external economic situation. With moderation in overall headline inflation, as per the Wholesale Price Index (WPI), during 2012-13 and during the first two quarters of 2013-14, there was a reduction in the repo rate by 25 basis points in May 2013. Headline WPI inflation averaged 6.16 per cent during 2013-14 (April-December) as compared to 7.56 per cent in the corresponding period of the previous year. Despite easing, the level of inflation is high, especially in terms of consumer price indices.

In the face of growing uncertainties in global financial conditions, monetary easing was paused in June 2013. However, there has been significant improvement in the external situation. With acceleration in the growth of exports and decline in imports, the trade deficit for 2013-14 (April-December) has narrowed considerably. Reduction in the trade deficit, complemented by a rise in net invisibles receipts, resulted in significant reduction in the current account deficit (CAD) in the first half (H1) of 2013-14. In response to these developments, and due to steps undertaken to moderate the CAD, the exchange rate, that breached the level of ₹ 68 per US$ in August 2013, recovered to 61.16 per US$ on October 11, 2013. The exchange rate of the rupee averaged 61.91 per US$ in December 2013.

On the fiscal front, the slowdown in growth affected tax collections and receipts from disinvestment of Public Sector Undertakings. However, the Government is on track to achieve the fiscal deficit to GDP target envisaged for 2013-14.

GDP Growth

As per the Advance Estimates released by the Central Statistics Office (CSO), the Indian economy is estimated to register a growth rate of 4.9 per cent in 2013-14 (in terms of GDP at factor cost at constant prices). This growth is significantly lower in comparison to the decadal average of 7.6 per cent during 2004-05 to 2013-14. The sub-5 per cent growth of the economy in 2013-14 is primarily the result of the continued slowdown in the industrial sector that is estimated to grow at 0.7 per cent in 2013-14 and lower growth in the 'trade, hotels, transport and communications' segment of the service sector. On the brighter side, sectors, viz. agriculture, electricity, gas & water supply, financial, insurance, real estate & business services and community, social & personal services are projected to have grown at faster rates in 2013-14 vis-à-vis 2012-13.

The economy recorded a modest pick-up in Q2 2013-14 with a growth of 4.8 per cent, compared to 4.4 per cent in Q1 this year. The growth of 4.6 per cent achieved in the first half of the current year, set against the growth of 4.9 per cent for the full year projected by the Advance Estimates, also indicates a further recovery in the second half of the year.

On the demand side, GDP at constant market prices is projected to register a growth of 4.6 per cent in 2013-14 as against a growth of 4.7 per cent in 2012-13. The growth of consumption expenditure, gross fixed capital formation and exports is estimated at 4.4 per cent, 0.2 per cent and 8.0 per cent respectively in real terms during 2013-14. The growth in these components was 5.2 per cent, 0.8 per cent and 5.0 per cent respectively in 2012-13. The growth of investment in the economy is estimated to have registered a decline during 2012-13 as compared to 2011-12. As per the First Revised Estimates released by the CSO, gross domestic savings as a ratio of GDP at current market prices (savings rate) declined from 31.3 per cent in 2011-12 to 30.1 per cent in 2012-13. This decline is primarily accounted for by a reduction in savings of the private corporate sector and savings by households in physical assets.

Agricultural Production

Agricultural production in India is significantly influenced by the southwest monsoon. As per the 4th Advance Estimates released by Ministry of Agriculture (as on 22.07.2013) food production is estimated at 255.36 million tonnes in 2012-13 as against 259.29 million tonnes in 2011-12 (final estimates).

During the southwest monsoon season of 2013, the country as a whole received 6 per cent higher rainfall than the long period average (LPA). As per the 1st Advance Estimates (covering only kharif crops) released on 24.09.2013 by the Ministry of Agriculture, the production of food grains during 2013-14 is placed at 129.32 million tonnes (rice at 92.32 million tonnes). The kharif production of pulses is estimated at 6.01 million tonnes, sugarcane at 341.77 million tonnes, oilseeds at 23.96 million tonnes and cotton at 35.30 million bales of 170 Kg each.

Agriculture credit flow increased to Rs. 6,07,375 crore (provisional) in 2012-13 in comparison to Rs. 5,11,029 crore in 2011-12 and Rs. 86,981 crore in 2003-04. The agriculture credit flow target has been enhanced to Rs. 7,00,000 crore for 2013-14.

Prices

Headline WPI inflation in 2013-14 (April-December) averaged 6.16 per cent vis-a-vis 7.56 per cent in the corresponding period last year. The financial year 2013-14 started with a headline WPI inflation of 4.77 per cent and is placed at 6.16 per cent in December 2013, declining from 7.52 per cent in November 2013.

Core (non-food manufacturing) inflation has also been showing signs of moderation backed by fall in inflation in metals and chemicals. It has moderated from a peak of 5.77 per cent in August 2012 to 2.81 per cent in December 2013.

Overall WPI food inflation comprising primary food articles and manufactured food products averaged 10.54 per cent in 2013-14 (April-December) as compared to 9.03 per cent in the corresponding period of the previous year. In December 2013, food inflation was 9.47 per cent as compared to 9.96 per cent in December 2012 and 13.81 per cent in November 2013, indicating some easing of inflationary pressures in food. While food inflation remained elevated, its drivers have been changing over time. In 2012-13, inflation remained elevated across the board for all major subgroups of food including cereals, pulses, vegetables, egg, meat & fish, sugar and edible oils etc. However, in the current year, the primary contributors include cereals, vegetables and egg, meat & fish.

Inflation measured in terms of consumer price indices remained at higher levels than WPI in the current year. Inflation for food items, which have a relatively higher weight in consumer price indices, kept

CPI inflation at a relatively higher level. All India general inflation for Consumer Price Index- New Series (CPI-NS) averaged 9.87 per cent in 2013-14 (April-December) as against 10.04 per cent in the same period last year. On the positive side, the inflation as per CPI-NS has come down from 11.16 per cent in November 2013 to 9.87 per cent in December 2013.

Various fiscal, monetary and administrative measures have been taken to reduce inflation. Some of the specific measures already in place include: reducing import duties for wheat, onion and pulses; banning export of some important edible oils and pulses; imposing stock limits in the case of select essential commodities; maintaining the Central Issue Price for rice (at Rs 5.65 per kg for BPL and Rs.3 per kg for AAY) and wheat (at Rs 4.15 per kg for BPL and Rs 2 per kg for AAY) since 2002; suspending futures trading in rice, urad and tur; allocation of rice and wheat under Open Market Sales Scheme; etc.

Industry and Services

The index of industrial production (IIP) [base: 2004-05] is the leading indicator of industrial performance. As per the IIP, industrial output growth rate was (-) 0.2 per cent during April-November 2013 as compared to 0.9 per cent during the same period of the previous year. A combination of global and domestic factors has led to deceleration in the industrial output. The contraction in the growth during current year was largely because of decline in mining sector, capital goods, and consumer goods. Manufacturing, the dominant sector in industry, witnessed contraction of 0.6 per cent during April-November 2013 as compared to a growth of 0.9 per cent in the corresponding period of the previous year. During 2012-13, manufacturing output had increased by 1.3 per cent.

The reasons for sluggishness in manufacturing are multiple. The rise in the policy rates, necessitated by the need to contain inflation, coupled with the bottlenecks facing large projects took toll on investments. The growth rate of gross fixed capital formation (GFCF) has been on the decline from around Q1 2010-11. Further, Indian manufacturing has not moved up the value chain over time. Due to low level of investment in research and development (R&D), India has not seized the growing opportunities available in high and medium technology sectors in the global market such as chemicals, machinery & equipment, electronic goods, etc.

Owing to the robust growth in electricity generation from hydel sources, the growth in overall electricity generation increased to 5.4 per cent during April-November 2013 as compared to 4.4 per cent during the same period of the previous year. Because of structural constraints, mining sector continued to drag overall industrial recovery with its output contracting by 2.2 per cent, compared to a contraction of 1.6 per cent in the corresponding period of the previous year. The output of the capital goods sector contracted by 0.1 per cent during April-November 2013 as compared to the contraction of 11.3 per cent during the corresponding period of the previous year, which indicates that deceleration in this sector may have started to bottom out. Overall manufacturing growth also suffered on account of negative spillover from the mining and capital goods sectors, lower demand for consumer durables, etc.

External sector

India's exports grew by 21.8 per cent in 2011-12 and then contracted by 1.8 per cent in 2012-13. During 2013-14 (April-December), exports were valued at US$ 230.3 billion, registering a growth of 5.9 per cent over the level of US$ 217.4 billion in 2012-13 (April-December). Value of imports during April-December 2013 was US$ 340.4 billion, showing a decline of 6.6 per cent compared with the level of US$ 364.2 billion in the corresponding period of 2012-13. Of the total imports, POL imports accounted for US$ 125.0 billion (36.7 per cent) in April-December 2013. This was 2.6 per cent higher than the level of US$ 121.8 billion in 2012-13 (April-December). Non-POL imports during 2013-14 (April-December), valued at US$ 215.4 billion, were 11.1 per cent lower than the level of US$ 242.4 billion in 2012-13 (April-December). The better outcome in exports and lower imports led to a contraction in trade deficit for 2013-14 (April-December) to US$ 110.0 billion from US$ 146.8 billion in 2012-13 (April-December).

While data on merchandise trade are available for the period April-December 2013, most information pertaining to balance of payments is available only for the first half (H1) of 2013-14. The trade deficit stood at US$ 83.8 billion in H1 2013-14, as against US$ 91.6 billion in H1 2012-13. Net invisible earnings were placed at US$ 56.8 billion as against US$ 53.4 billion in H1 2012-13. Contraction in the trade deficit coupled with a rise in net invisibles receipts resulted in a reduction of the Current Account Deficit (CAD) to US$ 27.0 billion in H1 of 2013-14 vis-à-vis US$ 38.2 billion in H1 of 2012-13.

Net inflows under the capital and financial account declined to US$ 15.1 billion in H1 2013-14 compared to US$ 37.3 billion in H1 2012-13 owing to net outflows of portfolio investment. Notwithstanding a lower CAD during H1 2013-14, there was a drawdown of foreign exchange reserves to the tune of US$ 10.7 billion as against an accretion of US$ 0.4 billion in H1 2012-13 primarily due to a decline in net capital inflows.

In 2013-14, foreign exchange reserves remained in the range of US$ 275.5 billion to US$ 293.9 billion. At the end of December 2013, foreign exchange reserves stood at US$ 293.9 billion, indicating an increase of US$ 1.9 billion over the level of US$ 292 billion at end-March 2013.

During April 2013 - December 2013, the monthly average exchange rate of rupee (RBI's reference rate) was in the range of 54–64 per US dollar. The daily exchange rate of the rupee breached the level of 68 per US dollar in August 2013 (68.36 per US dollar on August 28, 2013). However it recovered to 61.16 per US dollar on October 11, 2013, reflecting the impact of the measures taken to moderate CAD and boost capital flows. On month-to-month basis, the rupee depreciated by 12.1 per cent from 54.40 per US dollar in March 2013 to 61.91 per US dollar in December 2013**.**

India's external debt stock stood at US$ 400.3 billion at end-September 2013, registering a decline of US$ 9 million vis-a-vis the level at end-March 2013.

Money, Banking and Capital Markets

The RBI, in its Annual Monetary Policy Statement on May 3, 2013, announced a reduction in the policy repo rate by a further 25 bps from 7.50 per cent to 7.25 per cent to support growth in the face of gradual moderation of headline inflation. Apprehensions of likely tapering of Quantitative Easing (QE) by the US Federal Reserve in late May 2013 triggered outflows of portfolio investment. Recognising the risks to the economy from external developments as well as taking into account the evolving growth inflation dynamics, the RBI in its First Quarter Review of July 30, 2013 kept its key policy rates unchanged. The RBI began the process of calibrated withdrawal of the exceptional liquidity measures, undertaken to tackle exchange market pressures, in the Mid-Quarter Review on September 20, 2013, noting the improvement in the external environment and also considering the number of measures put in place to narrow the CAD and to ease its financing. The MSF rate was reduced by 75 basis points from 10.25 per cent to 9.5 per cent and the minimum daily maintenance of the CRR was reduced from 99 per cent of the requirement to 95 per cent effective from the fortnight beginning September 21, 2013. However, the rise in inflation and the need to provide a nominal anchor to help preserve the internal value of the rupee, the repo rate was increased by 25 basis points to 7.5 per cent.

Considering the evolving liquidity conditions, the RBI reduced the MSF rate by a further 50 basis points from 9.5 per cent to 9.0 per cent on October 7, 2013. Provision of additional liquidity through term repos of 7-day and 14-day tenor for a notified amount equivalent to 0.25 per cent Net Demand & Time Liabilities (NDTL) of the banking system through variable rate auctions on every Friday beginning October 11, 2013 was also announced.

The RBI, in the Second Quarter Review of October 29, 2013, carried forward the calibrated unwinding of exceptional measures with the reduction of the MSF rate further by 25 bps from 9.00 per cent to 8.75 per cent. The special repo window for mutual funds, instituted in July 2013 to enable banks to meet the liquidity requirements of mutual funds, was also wound up. With indications that both wholesale and consumer price inflation are likely to remain elevated in the months ahead, the key policy repo rate was increased by 25 basis points from 7.50 per cent to 7.75 per cent. Keeping in view the need to infuse liquidity into the system to normalise liquidity conditions, in addition to the reduction in MSF rate, the liquidity provided through term repos of 7-day and 14-day tenor was increased from 0.25 per cent of NDTL of the banking system to 0.5 per cent. These measures were intended to curb mounting inflationary pressures and manage inflation expectations in a situation of weak growth.

The Indian capital market, in line with global trends, was affected by the expectation of market participants regarding the tapering of the monthly bond purchase programme of the US Federal Reserve. However, the investor-friendly measures taken by the Government and the RBI gave a positive fillip to investors' sentiment in the Indian market. As a result, the Indian capital market has emerged as one of the better performing markets in the world in the year 2013, in comparison to the other emerging markets. Foreign Institutional Investors (FIIs) have also reposed their confidence in the Indian market manifested in positive net FII investment during the last four months of 2013, reversing the earlier trend of net outflow during the June-August period in the current year. The total net FII flows to India in the year 2013 stood at US$ 12.13 billion [(+) 20.10 billion in Equity and (-) 7.97 billion in Debt], with investment sentiments being mainly driven by equity flows.

Central Government Finances

In the post crisis fiscal consolidation regime, Government of India firmly abided by the budgeted level of the fiscal deficit except for the fiscal year 2011-12 when fiscal deficit was 5.7 per cent of GDP, 1.1 percentage point higher than the budget estimates. Adverse macro-economic developments, especially the overall economic slowdown of 2011-12 continued through 2012-13 which compelled the Government to push harder on reforms. The Central Government unveiled a list of reforms recommended by the Kelkar Committee (on Roadmap for Fiscal Consolidation) which resulted in containing the fiscal deficit at 4.9 percent, which was below the budgeted level of 5.1 per cent, in the fiscal year 2012-13.

Slowdown in growth, particularly in manufacturing, and subdued sentiments in financial markets in first half of 2013-14 put pressure on fiscal front, especially on tax collections and disinvestment receipts. The combined effect of shortfall in year-on-year growth of non-debt receipts and slightly higher year-on-year growth in total expenditure in H1 2013-14 in relation to implied growth in BE 2013-14 over RE 2012-13 resulted in higher fiscal deficit for H1 2013-14.

As per the data on Union Government Finances released by the Controller General of Accounts for April-December 2013, significant shortfall in growth in revenue receipts vis-à-vis envisaged growth in Budget 2013-14 has been observed. Gross tax revenue in April- December 2013 has grown year-on-year by 9.2 per cent to reach 7,43,709 crore. This level of growth is lower than that of 15.0 per cent in April- December 2012 and the growth envisaged in BE 2013-14. As a proportion of BE, gross tax revenue in April- December 2013 was 60.2 per cent, lower than the last five-years' average. Non-tax revenue in April- December 2013 is placed at 1,16,272 crore, which is 67.5 per cent of BE, well below the last five years' average. In non-debt capital receipts, there is significant shortfall as of April- December 2013 mainly on account of disinvestment receipts, as only 5,430 crore of the budgeted amount of 55,814 crore has been realized.

On the expenditure front, as against the implied year-on-year growth of 16.4 per cent envisaged by BE 2013-14 over RE 2012-13, growth in total expenditure in April- December 2013 has been 17.4 per cent. As a proportion of BE, non-plan revenue expenditure in April- December 2013 is placed at 73.6 per cent, which is lower than the five-year average of 77.6 per cent. However, major subsidies have grown rapidly in April- December 2013 to reach a figure of 1,88,899 crore (85.5 per cent of BE).

The Budget for 2013-14 estimated a fiscal deficit level of 5,42,499 crore. The slippage in the deficit target in April-December 2013-14 was mainly on account of slippage in non-debt receipts. Due to front loading of plan spending and lower tax and other receipts, the fiscal deficit, as a proportion of BE, at 95.2 per cent in April-December 2013 was higher than the previous years. However, with active fiscal policy stance for consolidation, including rationalization of expenditure and concerted efforts for mopping up resources, government steered back to the consolidation targets. Revised estimates place fiscal and revenue deficit at 4.6 per cent of GDP and 3.3 per cent of GDP respectively in 2013-14, re-affirming government's strong commitment towards fiscal prudence.

Prospects

The World Economic Outlook (WEO) update released by the International Monetary Fund in January 2014 has revised the growth projection for the world economy slightly upwards to 3.0 per cent and 3.7 per cent for 2013 and 2014 respectively. From 2014 onwards, global growth prospects are projected to improve over the medium term at a gradual pace. In India, several reform measures have been undertaken including clearance of several large projects by the Cabinet Committee on Investment. These steps could help in revival of investment and growth in the economy. In addition, resurgence of exports, prospects of revival in the global economy and moderation in inflation observed recently, point to a better outlook for the Indian economy in 2014-15 vis-à-vis 2013-14.

Annex - I

MACROECONOMIC FRAMEWORK STATEMENT
(ECONOMIC PERFORMANCE AT A GLANCE)

Sl.	Item	Absolute value April-December		Percentage change April-December	
		2012-13	2013-14	2012-13	2013-14
	Real Sector				
1	GDP at factor cost (₹ thousand crore)*				
	a) at current prices	9389[1R]	10540A	11.9[1R]	12.3A
	b) at 2004-05 prices	5482[1R]	5749A	4.5[1R]	4.9A
2	Index of Industrial Production (2004-05=100)^	166.8	166.5	0.9	-0.2
3	Wholesale Price Index (2004-05=100) @	166.7	176.9	7.56	6.16
4	Consumer Price Index: Industrial Workers (2001=100)@	212.7	235.3	10.00	10.66
5	Money Supply (M3) (₹ thousand crore) $	8032	9228	11.2	14.9
6	Imports at current prices **				
	a) In ₹ crore	1983941	2036568	15.7	2.7
	b) In US $ million	364242	340378	0.1	-6.6
7	Exports at current prices **				
	a) In ₹ crore	1184749	1386496	11.1	17.0
	b) In US $ million	217415	230336	-4.0	5.9
8	Trade Deficit (in US$ million) **	-146827	-110042	6.9	-25.1
9	Foreign Exchange Reserves				
	a) In ₹ billion	16194.23	18190.09	2.5	12.3
	b) In US $ billion	295.6	293.9	-0.4	-0.6
10	Current Account Balance (In US$ million) (Apr-Sept)	-38.2	-27.0	-	-
	Government Finances #		**₹ crore**		
1	Revenue receipts	570536	633933	14.5	11.1
2	Tax revenue (Net)	484156	517661	15.2	6.9
3	Non-tax revenue	86380	116272	10.6	34.6
4	Capital receipts (5+6+7)	420587	529858	5.7	26.0
5	Recovery of loans	7710	8038	-45.4	4.3
6	Other receipts	8178	5430	198.1	-33.6
7	Borrowings and other liabilities	404699	516390	6.2	27.6
8	Total receipts (1+4)	991123	1163791	10.6	17.4
9	Non-Plan expenditure	695233	812528	12.2	16.9
10	Revenue Account	625598	731159	13.6	16.9
	of which:				
11	Interest payments	201959	248464	12.6	23.0
12	Capital Account	69635	81369	1.3	16.9
13	Plan expenditure	295890	351263	6.9	18.7
	of which:				
14	Revenue Account	242975	274016	3.9	12.8
15	Capital Account	52915	77247	23.1	46.0
16	Total expenditure (9+13)	991123	1163791	10.6	17.4
17	Revenue expenditure (10+14)	868573	1005175	10.7	15.7
18	Capital expenditure (12+15)	122550	158616	9.6	29.4
19	Revenue deficit (17-1)	298037	371242	4.2	24.6
20	Fiscal deficit {16-(1+5+6)}	404699	516390	6.2	27.6
21	Primary deficit (20-11)	202740	267926	0.6	32.2

*1R: 1st Revised Estimate, A Advance Estimate. * Relates to Full Year. @ Average April-December. ^April-November*

$ Data on M3 is outstanding as on December 28, 2012 for 2012-13 and December 27, 2013 for 2013-14.

*** On Customs basis; comparison for current year is on provisional over revised basis.*

 # Figures as reported by Controller General of Accounts, Department of Expenditure, Ministry of Finance.