Savings and investment

1.16 A notable feature of the recent GDP growth has been a sharply rising trend in gross domestic investment and saving, with the former rising by 13.1 per cent of GDP and the latter by 11.3 per cent of GDP over five years till 2006-07. The average investment ratio for the Tenth Five Year Plan at 31.4 per cent was higher than that for the Ninth Five Year Plan, while the average saving rate was also 31.4 per cent of GDP higher than the average ratio of 23.6 per cent during the Ninth Five Year Plan.

1.17 The 1990s reforms transformed the investment climate, improved business confidence and generated a wave of entrepreneurial optimism. This has led to a gradual improvement in competitiveness of the entire corporate sector, a resurgence in the manufacturing sector and an acceleration in the rate of investment. The FRBMA mandated fiscal correction path was also helpful in raising the credibility of the Government with respect to fiscal deficits, in which India was at the bottom of global rankings. This has improved perceptions about the long-term macroeconomic stability of the economy. Moderate tax rates, coupled with buoyant sales growth, increased the internal accruals of the corporate sector. The improved investment climate and strong macro fundamentals also led to an upsurge in foreign direct investment. The combined effect of these factors was reflected in an increase in the investment rate from 25.2 per cent of GDP in the first year of the Tenth Five Year Plan to 35.9 per cent of GDP in the last year. The higher investment was able to absorb the domestic savings and also generated an appetite for absorption of capital inflows from abroad.

1.18 Gross domestic savings as a proportion of GDP continued to improve, rising from 26.4 per cent in 2002-03 to 34.8 per cent in 2006-07 with an average of 31.4 per cent during the Tenth Five Year Plan. The savings-investment gap which remained positive during 2001-04 became negative thereafter. In a modern economy, the excess of domestic saving over domestic investment suggests a deflationary situation in which demand has not kept pace with increased capacity. Thus the reversal of the saving-investment balance should be viewed as a correction of the domestic supply-demand balance, occurring through above normal (and welcome) increase in demand during 2005-06 and 2006-07.

Savings

1.19 Both private and public savings have contributed to higher overall savings. Private savings have risen by 6.1 per cent points of GDP over the Tenth Five Year Plan period while public sector savings increased by 5.2 per cent of GDP. Both have increased steadily over this period, though private savings appear to have reached a plateau in 2005-06 (Table 1.5). The savings from the private corporate sector were particularly buoyant, while the turnaround in public sector savings from negative to positive from 2003-04 onwards is heartening. The increase in private savings is due to a (more than) doubling of the rate of corporate saving over the plan period. Savings of the household sector were stable at 23 to 24 per cent of GDP, averaging 23.7 per cent during the Tenth Five Year Plan. The physical and financial components of the household savings also remained stable. With the upsurge in private corporate and public sector savings, the share of the household sector in gross domestic savings declined from 94.3 per cent in 2001-02 to 68.4 per cent in 2006-07.

Investment

1.20 In contrast to the increase in savings the increase in investment has been driven by private investment, which went up by 10.3 per cent of GDP over the five years of the Tenth Five Year Plan. This improvement was in turn driven by private corporate investment, which increased by 9.1 per cent of GDP over these five years. Private corporate sector investment improved from 5.4 per cent of GDP in 2001-02 to 14.5 per cent in 2006-07. The upsurge in private corporate investment has been visible even to the public as a “Capex” boom, and that is still continuing. Household investment remained close to the plan average of 12.7 per cent of GDP throughout the period, while the public sector investment increased by less than 1 per cent of GDP over the plan period.

1.21 The National Accounts provide the data of the gross domestic capital formation at constant 1999-2000 prices also. In terms of constant prices, the ratio of gross investment to GDP is estimated to have increased from 25 per cent in 2002-03 to 33.8 per cent in 2006-07. The gross fixed capital formation accounted for more than 90 per cent of the investment. The ratio of fixed capital formation to GDP is estimated to have increased to 30.6 per cent in 2006-07.

Table 1.5 Ratio of Savings and Investment to GDP (per cent at current market prices)

	Ave IX plan	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	Ave X Plan
Gross Domestic Savings	23.6	23.5	26.4	29.8	31.8	34.3	34.8	31.4
Public Sector	-0.7	-2.0	-0.6	1.1	2.2	2.6	3.2	1.7
Private Sector	24.3	25.5	27.0	28.7	29.6	31.7	31.6	29.7
Household Sector	20.3	22.1	23.2	24.4	23.0	24.2	23.8	23.7
Financial	10.3	10.9	10.3	11.4	10.1	11.8	11.3	11.0
Physical	10.0	11.3	12.9	13.0	12.9	12.5	12.5	12.7
Corporate sector	4.0	3.4	3.9	4.4	6.6	7.5	7.8	6.0
Gross Capital formation (Investment)	24.3	22.8	25.2	28.2	32.2	35.5	35.9	31.4
Public sector	7.0	6.9	6.1	6.3	6.9	7.6	7.8	6.9
Private Sector	16.8	16.7	18.6	19.5	23.4	25.8	27.0	22.9
Corporate Sector	6.8	5.4	5.7	6.6	10.5	13.3	14.5	10.1
Household sector	10.0	11.3	12.9	13.0	12.9	12.5	12.5	12.7
Gross Fixed Capial Formation	23.1	23.6	23.8	24.9	28.4	31.0	32.5	28.1
Stocks	0.7	-0.1	0.9	0.9	1.9	2.4	2.3	1.7
Valuables	0.4	0.6	0.6	0.9	1.3	1.2	1.2	1.0
Saving Investment Gap	-0.7	0.6	1.2	1.6	-0.4	-1.2	-1.1	0.0
Private	7.5	8.8	8.5	9.2	6.1	5.9	4.5	6.8
Public	-7.7	-8.9	-6.7	-5.3	-4.7	-5.0	-4.5	-5.3

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

Sectoral investment and ICOR

1.22 It is useful to examine the growth of gross capital formation (investment) by sectors to see how much of the sector's growth has been associated with expansion of capacity. Gross capital formation in manufacturing grew at a phenomenal 33.6 per cent per annum during the Tenth Five Year Plan period, the highest growth rate of any sector. This confirms that the boom in manufacturing growth rate is higher than for total GDP, which is backed by solid build up of capacity. The fact that the calculated ICOR for this period at 8.9 is the second highest after electricity suggests that there may be some build up of capacity ahead of and in anticipation of demand.

1.23 The 29.7 per cent per annum growth of investment in mining seems at first sight inconsistent with the relatively low growth of GDP

Table 1.6 Components of Domestic Investment (per cent to GDP at 1999-00 market prices)

	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	Ave X Plan
Fixed Investment	22.9	23.6	24.7	27.1	29.2	30.6	27.0
Public sector	6.4	6.2	6.4	6.2	6.7	7.2	6.5
Private Sector	16.5	17.3	18.3	20.9	22.4	23.4	20.5
Corporate Sector	5.5	5.2	6.0	9.1	11.3	12.4	8.8
Household sector	11.0	12.1	12.4	11.8	11.1	11.0	11.7
Change in Stocks	-0.1	0.9	0.7	1.6	2.2	2.1	1.5
Public sector	0.4	-0.2	-0.3	0.2	0.4	0.1	0.1
Private Sector	-0.5	1.1	1.1	1.4	1.7	2.0	1.4
Corporate Sector	-0.3	0.5	0.6	1.2	1.5	1.7	1.1
Household Sector	-0.2	0.6	0.5	0.2	0.2	0.3	0.3
Valuables	0.6	0.6	0.9	1.3	1.2	1.2	1.0
Gross Investment[a]	22.2	25.0	27.7	30.6	33.4	33.8	30.1
Public Sector	6.8	6.1	6.1	6.4	7.1	7.3	6.6
Private Sector	16.1	18.4	19.4	22.3	24.2	25.4	21.9
Corporate Sector	5.2	5.7	6.5	10.3	12.8	14.1	9.9
Household sector	10.9	12.7	12.9	12.0	11.4	11.3	12.0

[a]Adjusted for errors and omissions.

from this sector. However, given the long gestation lags in many types of mining projects, the increased investment could be a precursor of faster growth in the Eleventh Five Year Plan, though the first year growth is not encouraging. Trade & hotels, with an annual growth of 26.4 per cent during the five years of the Tenth Five Year Plan, was the third fastest investor. With its very low ICOR of 0.7, it can play a vital role in generating higher employment with relatively low investment along with the construction sector (with the third lowest ICOR). Communication, a very fast growing sector in terms of value added, had the lowest ICOR of 0.6, confirming that competition-induced productivity growth has played a key role in this reasonably well regulated sector.

1.24 The traditionally high ICOR of 16.7 for the electricity sector re-emphasises the critical importance of efficient planning and implementation of capacity building as well as efficient use of this capacity and of the electricity produced from it. Railways and other transport and other services were the remaining sectors in which GCF growth exceeded 15 per cent (Table 1.6). Finance and business services, communication and agriculture and allied sectors recorded significantly lower growth. The ratio of gross capital formation to GDP averaged 31 per cent during the Tenth Five Year Plan. It, however, was 94.1 per cent for electricity sector followed by manufacturing at 76.5 per cent. Trade and hotels had the lowest gross capital formation to GDP ratio of 6.2 per cent.

Consumption Basket

1.25 The National Accounts also provide data on disaggregated consumption expenditure of households in eight broad categories. With rising per capita consumption, simple Engel curve analysis would predict a decline in share of consumption on food and an increase in luxuries, which in our context include entertainment and durable goods. Food and beverages had the lowest average growth of 3.2 per cent during the Tenth Five Year Plan and its share declined from 48.1 per cent in 2001-02 to 42.1 per cent in 2006-07 (Table 1.7). The growth of transport and communication, education and recreation and miscellaneous services by more than 10 per cent and the rising share of furniture, appliances and services are also consistent with the Engel curve analysis.

1.26 The erratic pattern of change in consumption of clothing and footwear may be because the middle class households treat them as falling within a residual expenditure category. The high share of expenditure on health care, despite a large and nominally free public health care system stretching into the villages, has been of concern, as the pattern is found even among the less well off. The decline in share to 4.4 per cent in 2006-07 after a peak of 5.2 in 2002-03 could be a positive indicator.

Table 1.7 Sector Investment (1999-00 prices) and ICOR

	Rate of growth of GCF					GCF/ GDP	GDP Growth	ICOR
	2003-04	2004-05	2005-06	2006-07	X Plan	X Plan	X Plan	X Plan
Agriculture & Allied	-3.8	7.9	11.7	10.4	4.8	12.4	2.5	5.0
Mining	69.1	53.9	27.4	-2.0	29.7	37.2	6.1	6.1
Manufacturing	22.8	55.8	25.6	17.9	33.6	76.5	8.6	8.9
Electricity	22.7	-8.3	28.0	8.0	8.5	94.1	5.6	16.7
Construction	27.2	19.7	21.6	10.2	17.1	16.0	12.9	1.2
Trade & Hotels	152.7	6.0	7.6	6.7	26.4	6.2	8.5	0.7
Transport & Communication	-2.6	15.0	-10.9	14.0	7.7	32.2	15.3	2.1
Railways	5.2	3.4	9.4	40.4	17.2	34.3	7.4	4.6
Other Transport	10.3	13.5	-23.4	13.2	15.3	42.6	10.4	4.1
Communication	-46.4	56.7	30.6	0.9	2.3	16.5	26.5	0.6
Financial & Business Services	0.8	-11.4	17.3	5.1	1.3	31.7	9.5	3.3
Other Services	3.0	22.5	27.4	23.2	17.2	31.0	6.1	5.1
Total	12.7	22.4	19.1	14.3	15.9	31.0	7.8	4.0

Table 1.8 Private Final Consumption- Annual growth and Share (in per cent)

	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
Food & Beverages	-3.4	5.9	-1.9	4.5	1.0	7.5	4.8
Clothing & Footwear	16.8	-2.9	4.5	-2.4	4.7	12.0	3.7
Rent, Fuel & Power	2.8	2.6	2.9	3.3	7.4	3.0	3.0
Furniture,appliances,service	7.2	3.5	4.0	8.1	12.2	11.6	13.5
Medical & Health care	11.6	14.2	5.3	3.3	3.4	2.0	0.7
Transport, Communication	14.3	6.6	10.6	11.4	10.2	10.4	12.2
Education & Recreation	11.8	7.3	4.5	12.0	13.9	12.4	15.8
Others	12.2	11.4	9.8	9.5	12.4	11.7	11.3
Total Private Consumption	3.4	5.9	2.6	5.9	5.5	8.3	7.2
Share of Total (per cent)							
Food & Beverages	48.1	48.1	45.9	45.3	43.4	43.1	42.1
Clothing & Footwear	6.0	5.5	5.6	5.1	5.1	5.3	5.1
Rent, Fuel & Power	11.4	11.0	11.0	10.8	11.0	10.4	10.0
Appliances	3.4	3.3	3.3	3.4	3.6	3.7	4.0
Medical & Health care	4.7	5.1	5.2	5.1	5.0	4.7	4.4
Transport	14.5	14.5	15.7	16.5	17.2	17.5	18.4
Education & Recreation	3.7	3.7	3.8	4.0	4.3	4.5	4.9
Others	8.4	8.9	9.5	9.8	10.4	10.8	11.2

Table 1.9 Implicit deflators (per cent)

	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
GDP MP	3.5	3.0	3.8	3.6	5.6	4.1	5.6	4.1
PFCEdm	3.5	3.2	2.9	3.6	2.8	3.0	5.1	5.5
GFCF	4.7	4.9	1.8	3.5	9.6	5.6	5.5	4.3

PFCEdm : Private Final consumption expenditure in domestic market.