State of the Economy

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CHAPTER

Economic growth decelerated in 2008-09 to 6.7 per cent. This represented a decline of 2.1 per cent from the average growth rate of 8.8 per cent in the previous five years (2003-04 to 2007-08). The five years of high growth has raised the expectations of the people. Few remember that during the preceding five-year period from 1998-99 to 2002-03 average growth was only 5.4 per cent, while the highest growth rate achieved during the period was 6.7 per cent (in 1998-99). Per capita GDP growth, a proxy for per capita income, which broadly reflects the improvement in the income of the average person, grew by an estimated 4.6 per cent in 2008-09. Though this represents a substantial slowdown from the average growth of 7.3 per cent per annum during the previous five years, it is still significantly higher than the average 3.3 per cent per annum income growth during 1998-99 to 2002-03.

1.2 Despite the slowdown in growth, investment remained relatively buoyant, growing at a rate higher than that of GDP. The ratio of fixed investment to GDP consequently increased to 32.2 per cent of GDP in 2008-09 from 31.6 per cent in 2007-08. This reflects the resilience of Indian enterprise, in the face of a massive increase in global uncertainty and risk aversion and freezing of highly developed financial markets. A decline in all major elements of private demand, including exports and consumption, necessitated a compensating widening of the fiscal deficit above the Fiscal Responsibility and Budget Management Act (FRBMA) target. The new, higher expenditures announced during the 2008-09 budget, which would have been offset by greater revenue mobilization, had to be supplemented by an additional fiscal expansion. This got reflected in an increase of 20.2 per cent in government final consumption expenditure during 2008-09. The effect of this and subsequent fiscal stimuli (e.g. excise and service tax reduction) on private demand would be expected to appear gradually with a lag. Needless to say it is an imperative to return to the FRBM targets for the fiscal deficit at the earliest, possibly by 2010-11.

1.3 A noteworthy development during the year was a sharp rise in Wholesale Price Index (WPI) inflation followed by an equally sharp fall, with the WPI inflation falling to unprecedented level of close to zero per cent by March 2009. This was driven largely by the rapid rise and equally rapid fall in global commodity prices during January 2008 to March 2009. Global food prices also went through a similar cycle, but have not declined to the same extent. Though domestic food prices are partially delinked from global prices, these global developments affected domestic prices to some extent. Domestic food price inflation, as measured by the WPI food sub-index, though declining, remains much higher than overall inflation.

1.4 The global financial meltdown and consequent economic recession in developed economies have clearly been major factor in India's economic slowdown. Given the origin and dimension of the crisis in the advanced countries, which some have called the worst since the Great Depression, every developing country has suffered to a varying degree. No country, including India, remained immune to the global economic shock.