State of the Economy

1

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.

Economic growth during 2008-09

Overall GDP growth

1.5 The overall growth of GDP at factor cost at constant prices in 2008-09, as per revised estimates released by the Central Statistical Organisation (CSO) (May 29, 2009) was 6.7 per cent. This is lower than the 7 per cent projection in the Mid-Year Review 2008-09 (Economic Division, Department of Economic Affairs (DEA), December 2008) and the advance estimate of 7.1 per cent, released subsequently by CSO in February 2009. With the CSO drastically reducing their estimate of GDP from agriculture (based on third advance estimates), and given that the DEA's 7 per cent estimate assumed normal agricultural growth, it would have had to be adjusted for any shortfall. The growth of GDP at factor cost (at constant 1999-2000 prices) at 6.7 per cent in 2008-09 nevertheless represents a deceleration from high growth of 9.0 per cent and 9.7 per cent in 2007-08 and 2006-07 respectively (Table 1.1).

1.6 The deceleration of growth in 2008-09 was spread across all sectors except mining & quarrying and community, social and personal services. The growth in agriculture and allied activities decelerated from 4.9 per cent in 2007-08 to 1.6 per cent in 2008-09, mainly on account of the high base effect of 2007-08 and due to a fall in the production of non-food crops including oilseeds, cotton, sugarcane and jute. The production of wheat was also marginally lower than in 2007-08.

1.7 The manufacturing, electricity and construction sectors decelerated to 2.4, 3.4 and 7.2 per cent respectively during 2008-09 from 8.2, 5.3 and 10.1 per cent respectively in 2007-08. The slowdown in manufacturing could be attributed to the combined impact of a fall in exports followed by a decline in domestic demand, especially in the second half of the year. The rise in the cost of inputs during the beginning of the year and the cost of credit (through most of the year) reduced manufacturing margins and profitability. The growth in production sectors, especially manufacturing, was adversely affected by the impact of the global recession and associated factors. The electricity sector continued to be hampered by capacity constraints and the availability of coal, particularly during the first half of the year. As long as the coal sector remains a public sector monopoly (the only remaining nationalized sector), it could remain a bottleneck for accelerated development of the power sector.

1.8 The construction industry consists of different segments like housing, infrastructure, industrial construction, commercial real estate, etc. While the industry went through a boom phase with growth as high as 16.2 per cent in 2005-06 and continued to grow thereafter (albeit with moderation), the increase in the costs of construction due to a rise in the prices of inputs like steel and cement and interest costs had started impacting the industry. In certain segments of the industry, there was an excessive price build up in the form of a speculative bubble, related to limited supply of urban land for those segments. The rise in interest rates and the slowdown in housing loans also moderated demand. The double squeeze on the costs, as well as the demand side, and the fall in the liquidity in mid-September 2008 precipitated a sharp downturn in this sector. There followed a period (in the second half of the year) when demand had already moderated, but costs remained high.

Table 1.1 : Rate of growth at factor cost at 1999-2000 prices (per cent)

	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09
Agriculture, forestry & fishing	10.0	0.0	5.8	4.0	4.9	1.6
Mining & quarrying	3.1	8.2	4.9	8.8	3.3	3.6
Manufacturing	6.6	8.7	9.1	11.8	8.2	2.4
Electricity, gas & water supply	4.8	7.9	5.1	5.3	5.3	3.4
Construction	12.0	16.1	16.2	11.8	10.1	7.2
Trade, hotels & restaurants	10.1	7.7	10.3	10.4	10.1	*
Transport, storage & communication	15.3	15.6	14.9	16.3	15.5	*
Financing, insurance, real estate & business services	5.6	8.7	11.4	13.8	11.7	7.8
Community, social & personal services	5.4	6.8	7.1	5.7	6.8	13.1
Total GDP at factor cost	8.5	7.5	9.5	9.7	9.0	6.7

Source : Central Statistical Organisation.

*** Trade, hotels & restaurants, transport & communication (together) grew at 9 per cent, 2008-09.**

1.9 The higher growth in community, social and personal services during 2008-09 was mainly due to an expansionary fiscal policy that was reflected in the demand side of GDP as higher growth of Government consumption expenditure.

Quarterly growth

1.10 The slowdown in growth of GDP is more clearly visible from the growth rates over successive quarters of 2008-09. In the first two quarters of 2008-09, the growth in GDP was 7.8 and 7.7 per cent respectively. The growth fell to 5.8 per cent in the third and in the fourth quarters of 2008-09 (compared to 9.3 and 8.6 per cent in Q3 and Q4 of 2007-08). The third quarter witnessed a sharp fall in the growth of manufacturing, construction, trade, hotels and restaurants. Agriculture growth also turned negative adding a further dampener. On the other hand, community, social and personal services showed a large increase from the second quarter, mainly due to a step up in government expenditure. The last quarter saw an added deterioration in manufacturing due to the deepening impact of the global crisis and a slowdown in domestic demand (Table 1.2).

Industry and infrastructure

1.11 Though growth of the industrial sector started to slow down in the first half of 2007-08, the overall growth during that year remained as high as 8.5 per cent. The index of industrial production for the year 2008-09 points towards a sharp slowdown with growth being placed at 2.4 per cent. Manufacturing growth was placed at 2.3 per cent in 2008-09 as compared to 9.0 per cent in 2007-08. Mining grew at 2.3 per cent in 2008-09 as against 5.1 per cent in 2007-08 while electricity showed a deceleration in growth from 6.4 per cent in 2007-08 to 2.8 per cent during 2008-09. Slower growth in all use-based categories, except consumer durables, contributed to the deceleration in the industrial sector.

1.12 The performance of six core industries comprising crude oil, petroleum refinery products, coal, electricity, cement and finished steel (carbon) grew at 2.7 per cent as compared to 5.9 per cent in 2007-08. The growth in index for crude oil turned negative 1.8 per cent as compared to positive 0.4 per cent in 2007-08. There was a deceleration in the growth of cement and finished steel reflecting the negative sentiments in the construction and manufacturing sectors.

Agriculture production

1.13 For three consecutive years (2005-06 to 2007-08), foodgrain production recorded an average annual increase of over 10 million tonnes. The total foodgrain production in 2007-08 was estimated at 230.78 million tonnes as against 217.3 million tonnes in 2006-07.

1.14 As per the third advance estimates, the production of foodgrains in 2008-09 is estimated to be 229.85 million tonnes. In the third advance estimates, there is an improvement of 1.97 million tonnes over the second advance estimates for 2008-

Table 1.2 : Quarterly estimates of GDP 2007-08 and 2008-09 (percentage change – y-o-y)

Sector(s)	2007-08				2008-09			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Agriculture, forestry & fishing	4.3	3.9	8.1	2.2	3.0	2.7	-0.8	2.7
Mining & quarrying	0.1	3.8	4.2	4.7	4.6	3.7	4.9	1.6
Manufacturing	10.0	8.2	8.6	6.3	5.5	5.1	0.9	-1.4
Electricity, gas & water supply	6.9	5.9	3.8	4.6	2.7	3.8	3.5	3.6
Construction	11.0	13.4	9.7	6.9	8.4	9.6	4.2	6.8
Trade, hotels, transport & communication	13.1	10.9	11.7	13.8	13.0	12.1	5.9	6.3
Financing, insurance, real estate & bus. services	12.6	12.4	11.9	10.3	6.9	6.4	8.3	9.5
Community, social & personal services	4.5	7.1	5.5	9.5	8.2	9.0	22.5	12.5
GDP at factor cost (total 1 to 8)	9.2	9.0	9.3	8.6	7.8	7.7	5.8	5.8

Source : Central Statistical Organisation.

09 but the estimates are still lower than the target of 233 million tonnes set out for the year and also the final estimates of 230.78 million tonnes for 2007-08.

1.15 The production of rice during 2008-09 is expected to be 99.37 million tonnes and that of wheat 77.63 million tonnes. The estimates for rice production are 2.68 million tonnes higher than the final estimates for 2007-08. However, the estimates for wheat production are marginally lower than the final production figures for 2007-08.The production of coarse cereals is expected to be 38.67 million tonnes which is lower than the final estimates for 2007-08 by 2.1 million tonnes. The production of pulses is expected to be 14.18 million tonnes, which is 0.58 million tonnes lower than the final estimates for 2007-08. The production of oilseeds (9 oilseeds) during 2008-09 is placed at 28.1 million tonnes, which is lower than the final estimates of 29.7 million tonnes for 2007-08 and short of target of 31.7 million tonnes set out for the year. The production of cotton estimated at 232.68 lakh bales is short of the final estimates of 258.84 lakh bales in 2007-08 but an improvement over the second advance estimates. The production of sugarcane during 2008-09 is estimated at 289.2 million tonnes, which is lower than the production of 348.2 million tonnes during 2007-08. The production of jute and mesta is also expected to be lower than the production in 2007-08. The stocks of wheat and rice in the Central pool by end-March 2009 were 35 million tonnes, which were more than double the buffer stock norms.

1.16 Overall, the third advance estimates for agricultural crops point to a situation where the production of foodgrains may be close to the level achieved in 2007-08. However, there is a shortfall in the case of non-food cash crops like sugarcane.

Aggregate demand and its composition

1.17 The most important contribution to demand growth during the Tenth Five Year Plan period (2002-07) had come from investment, while the external trade made negligible or negative contribution. During the Tenth Five Year Plan the contribution of gross capital formation was higher than consumption.

1.18 This pattern changed in 2007-08 when the growth on the demand side was driven mainly by consumption (Table 1.3). The contribution of consumption stood at 61.8 per cent while that of gross capital formation at 55.7 per cent. In 2008-09 the contribution of consumption stood at 59.5.

Table 1.3 : Demand side growth in GDP, growth contribution and relative share (figures in per cent at 1999-00 market prices)

	Growth of GDP					
	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09
GDP at market t prices	8.4	8.3	9.3	9.7	9.1	6.1
Consumption (pvt.)	5.9	5.2	7.1	6.3	8.5	2.9
Consumption (Govt)	2.6	3.6	6.2	5.5	7.4	20.2
Gross capital formation	17.6	21.8	19.5	13.2	14.7	na
Gross fixed capital formation	13.6	18.9	17.6	14.5	12.9	8.2
Change in stocks	-8.0	140.1	61.9	5.4	51.7	2.9
Exports	9.6	27.2	17.6	21.1	2.1	12.8
Imports	13.8	22.2	41.1	24.5	6.9	17.9
	Contribution to growth (per cent)					
Consumption (pvt.)	45.1	38.8	46.3	38.7	53.8	27.0
Consumption (Govt)	3.6	4.8	7.1	5.8	8.0	32.5
Gross capital formation	52.4	71.3	63.8	45.6	55.7	na
Gross fixed capital formation	38.4	56.4	51.3	43.9	43.6	42.5
Net exports	-6.3	10.1	-41.1	-13.2	-14.0	-29.5
	Relative share (per cent)					
Consumption (pvt.)	62.3	60.5	59.3	57.5	57.2	55.5
Consumption (Govt)	11.1	10.6	10.3	9.9	9.8	11.1
Gross capital formation	27.1	30.5	33.3	34.4	36.2	na

Source : Central Statistical Organisation.

Note : Does not add to 100 because only major items are included in the table.

Consumption

1.19 The contribution of private consumption to aggregate growth declined dramatically from 53.8 per cent in 2007-08 to 27 per cent in 2008-09. This decrease was cushioned by an increase in the contribution to growth by government consumption expenditure from a level of 8 per cent in 2007-08 to a level of 32.5 per cent in 2008-09. Consequently the overall contribution of consumption demand to growth was only marginally lower than that in 2007-08. This helped cushion the fall in economic growth on account of the worsening of the external trade account.

1.20 The share of private consumption in GDP at market prices has been on a declining trend during 2002-03 to 2008-09. It stood at 63.7 per cent in 2002-03 and declined to around 57 per cent in 2007-08. Private consumption expenditure had a share of 55.5 per cent of GDP in 2008-09 while government consumption expenditure accounted for about 11 per cent. The share of gross capital formation in the GDP has been on a rising trend, increasing from 27 per cent in 2003-04 to 36.2 per cent in 2007-08, supported mainly by an increase in gross fixed capital formation.

Consumption basket

1.21 Private final consumption expenditure at constant prices grew at 8.1 per cent per annum in 2007-08 as compared to 6.4 per cent in 2006-07. This higher growth was attributable to higher increase in growth in consumption expenditure on food, beverages & tobacco, clothing and footwear, and on miscellaneous goods and services that neutralized the decrease in growth of consumption expenditure on furniture, furnishings, medical care and health services, transport and communication (Table 1.4). The expenditure on food and beverages constituted 42.3 per cent of total private consumption expenditure followed by transport and communication with a share of 16.3 per cent. The 1.1 per cent point decline in share of food in 2007-08 from the 43.4 per cent average of the previous three years is consistent with the view that (via Engel elasticity) the poorer half of the population may also be sharing in the growth.

Per capita income and consumption

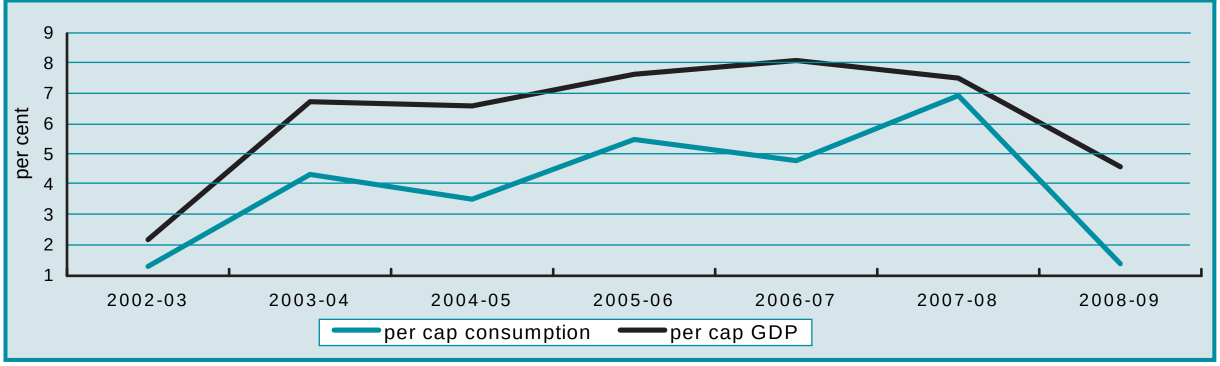
1.22 The per capita income in 2008-09, measured in terms of gross domestic product at constant 1999-2000 market prices, was Rs. 31,278. In 2007-08 this stood at Rs. 29,901. Per capita consumption in 2008-09 was Rs. 17,344 as against a level of

Table 1.4 : Private final consumption expenditure by items in domestic demand – annual growth and share at 1999-00 prices (in per cent)

	2003-04	2004-05	2005-06	2006-07	2007-08
Annual growth					
Food, beverages & tobacco	4.7	0.9	7.4	4.6	6.4
Clothing & footwear	-2.4	4.7	11.7	3.8	8.6
Gross rent, fuel & power	3.3	3.6	3.1	3.0	3.4
Furniture, furnishings etc.	8.1	12.2	11.6	11.6	9.9
Medical care & health services	3.3	12.5	11.0	9.5	7.3
Transport & communication	11.4	10.2	-0.4	8.8	7.4
Recreation, education & cultural services	12.0	13.9	11.4	12.9	12.2
Miscellaneous goods & services	9.5	12.4	11.8	8.8	17.6
Total private consumption	6.0	5.5	6.8	6.4	8.1
Share of total (per cent)					
Food, beverages & tobacco	45.5	43.5	43.8	43.0	42.3
Clothing & footwear	5.1	5.1	5.3	5.2	5.2
Gross rent, fuel & power	10.7	10.5	10.2	9.8	9.4
Furniture, furnishings etc.	3.4	3.6	3.8	4.0	4.0
Medical care & health services	5.1	5.4	5.6	5.8	5.7
Transport & communication	16.4	17.2	16.0	16.4	16.3
Recreation, education & cultural services	4.0	4.3	4.5	4.8	5.0
Miscellaneous goods & services	9.8	10.4	10.9	11.1	12.1
Total Private Consumption	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source : Central Statistical Organisation.

Figure 1.1 : Growth in per capita GDP & consumption



Rs. 17,097 in 2007-08. While there has been an increase in levels of per capita income and consumption, there has been a perceptible slowdown in their growth rate (Figure 1.1). The growth in per capita GDP decelerated from 8.1 per cent in 2006-07 to 4.6 per cent in 2008-09, while the per capita consumption growth declined from 6.9 per cent in 2007-08 to 1.4 per cent in 2008-09.

Savings and investment

1.23 A notable feature of the growth of the Indian economy from 2002-03 has been the rising trend in the gross domestic capital formation (GDCF). Gross capital formation (GCF), which was 25.2 per cent of the GDP in 2002-03, increased to 39.1 per cent in 2007-08. Much of this increase is attributable to a rise in the rate of investment by the corporate sector. The rise in the rate of investment has been on account of various factors, the most important being the transformation in the investment climate, coupled with an optimistic outlook for the growth prospects for the Indian economy.

Gross domestic savings

1.24 The growth in capital formation in recent years has been amply supported by a rise in the savings rate. The gross domestic savings as a percentage of GDP at current market prices stood at 37.7 per cent in 2007-08 as compared to 29.8 per cent in 2003-04 (Table 1.5). Private sector savings dominated

Table 1.5 : Ratio of savings and investment to GDP (% at current market prices)

	2003-04	2004-05	2005-06	2006-07	2007-08
Gross domestic saving	**29.8**	**31.7**	**34.2**	**35.7**	**37.7**
Public sector	1.1	2.2	2.4	3.3	4.5
Private sector	28.7	29.5	31.8	32.4	33.2
Household sector	24.1	22.8	24.1	24.1	24.3
Financial saving	11.4	10.1	11.7	11.7	11.7
Saving in physical assets	12.7	12.7	12.4	12.4	12.6
Private corporate sector	4.6	6.7	7.7	8.3	8.8
Gross capital formation (investment)	**27.6**	**32.1**	**35.5**	**36.9**	**39.1**
Public sector	6.3	6.9	7.6	8.0	9.1
Private sector	19.6	23.4	26.1	27.2	28.5
Corporate sector	6.8	10.8	13.7	14.8	15.9
Household sector	12.7	12.7	12.4	12.4	12.6
Gross fixed capital formation	**25.0**	**28.4**	**31.0**	**32.5**	**34.0**
Stocks	0.9	1.9	2.6	2.6	3.6
Valuables	0.9	1.3	1.2	1.2	1.1
Saving investment gap					
Public sector	-5.3	-4.7	-5.2	-4.6	-4.6
Private sector	9.2	6.1	5.7	5.2	4.7
Household sector	11.4	10.1	11.7	11.7	11.7
Private corporate sector	-2.2	-4.0	-6.0	-6.5	-7.0

Source : Central Statistical Organisation.

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

Figure 1.2(i) : Sectoral share in domestic savings (2007-08)

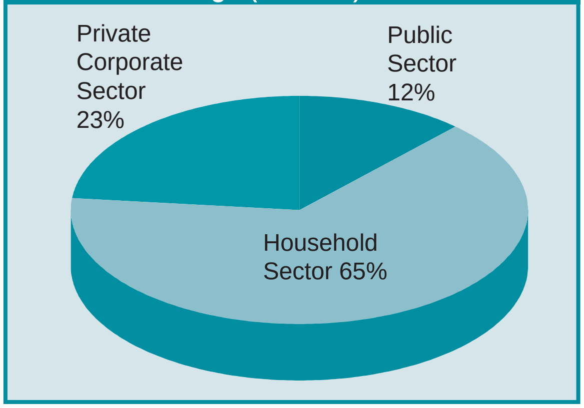
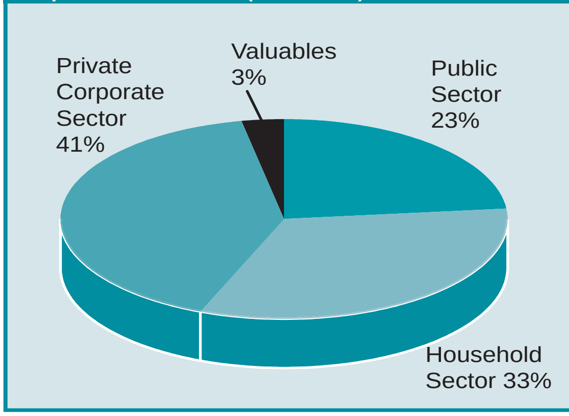


Figure 1.2(ii) : Sectoral share in gross capital formation (2007-08)



the total savings in 2007-08 and were at 33.2 per cent of GDP. Of this, the household sector savings was 24.3 per cent of GDP while the private corporate sector accounted for 8.8 per cent. Savings by the public sector was 4.5 per cent of GDP. The composition of savings by sectors as percentage of the gross domestic saving is shown in Figure 1.2(i) Figure 1.2(ii)

Capital formation

1.25 The gross capital formation (adjusted) as a percentage of GDP steadily moved up from 27.6 per cent in 2003-04 to 39.1 per cent of GDP in 2007-08. There has been an increase in the rate of investment in both the public and private sectors. For the public sector, the gross investment rate rose from 6.3 per cent in 2003-04 to 9.1 per cent in 2007-08 and for the private sector from 19.6 per cent in 2003.-04 to 28.5 per cent in 2007-08. Within the private sector, the share of the household sector has remained at the same level. However, the share of the corporate sector steadily increased to touch 15.9 per cent of GDP in 2007-08 The sectoral composition of gross domestic capital formation is shown in Figure 1.2ii.

1.26 It is also pertinent to note that the overall increase in investment has come about mainly from a rise in the rate of gross fixed investment. Gross fixed investment which was 25.0 per cent of GDP in 2003-04 increased to 34.0 per cent in 2007-08.

1.27 The saving investment gap in the public sector stood at (-) 5.3 per cent in 2003-04 that moderated to (-) 4.6 per cent in 2007-08. This reflected the narrowing gap between public sector capital formation and public sector gross domestic savings. For the household sector the gap has remained more or less constant reflecting no major change in the saving investment balance. In the case of the private corporate sector however, the saving investment gap widened to (-) 7.0 per cent in 2007-08 reflecting the high rate of capital formation over and above their internal savings.

Sectoral investment

1.28 The overall rate of growth of capital formation at constant prices was 15.6 per cent in 2007-08 as compared to 13.9 per cent in 2006-07. The growth rate of gross capital formation in different sectors is indicative of the direction of fresh investment. The rate of growth of capital formation during 2007-08 (as compared to 2006-07) increased in mining and quarrying, transport storage and communication, financing, insurance, real estate and business services and community personal and social services. However, the growth rate of gross capital formation slowed down during 2007-08 (in agriculture, manufacturing, electricity, gas and water supply, construction, and trade, hotels and restaurants) (Table 1.6).

1.29 At the disaggregated level, within the manufacturing sector there was an increase in the rate of growth of gross capital formation in the registered manufacturing sector, whereas in the unregistered manufacturing sector the rate of growth of gross capital formation declined to 2.9 per cent in 2007-08 as against a growth of 21.9 per cent in 2006-07. Within the trade, hotels and restaurants, trade recorded a decline in the rate of growth of gross capital formation to 1.2 per cent in 2007-08 as against a level of 41.7 per cent in 2006-07. Within the group transport, storage and communication, railways recorded an increase to 24.8 per cent in 2007-08 from a level of 14.7 per cent in 2006-07. However, storage saw negative growth in its capital formation in 2007-08.

Table 1.6 : Sector investment growth rates (at constant 1999-00 prices)

	2003-04	2004-05	2005-06	2006-07	2007-08
Agriculture, forestry & fishing	-3.8	8.0	14.2	10.9	8.2
Agriculture	-4.2	9.7	14.8	11.0	8.3
Forestry & logging	80.3	-47.4	25.6	19.3	-3.5
Fishing	-10.4	9.5	9.5	9.5	9.4
Mining & quarrying	69.2	53.9	0.6	-5.8	25.5
Manufacturing	22.5	54.6	22.7	17.8	13.3
Registered	13.9	64.1	32.7	16.3	17.3
Unregistered	41.6	37.8	1.3	21.9	2.9
Electricity, gas & water supply	22.8	-8.4	36.1	15.2	3.6
Construction	27.6	19.9	29.9	25.4	16.1
Trade, hotels & restaurants	167.4	4.9	-5.0	31.0	4.9
Trade	228.6	-3.9	-6.3	41.7	1.2
Hotels & restaurants	56.4	38.4	-1.7	3.8	17.3
Transport, storage & communication	-2.9	14.5	41.7	11.6	29.6
Railways	5.2	3.4	12.8	14.7	24.8
Transport by other means	10.2	16.0	-10.6	9.6	43.0
Storage	-12.2	-124.6	-158.6	8.5	-39.4
Communication	-47.1	36.1	348.1	13.0	16.4
Financing, insurance, real estate & business services	0.8	-11.4	19.4	1.1	15.6
Banking & insurance	71.7	-35.6	69.2	35.2	21.0
Real estate, ownership of dwellings & business services	-1.4	-10.1	17.5	-0.8	15.2
Community, social & personal services	2.9	22.6	-0.9	13.1	21.8
Public administration & defence	-0.7	18.4	25.0	13.0	23.9
Other services	8.5	28.3	-33.6	13.4	16.8
Total	**12.9**	**22.3**	**20.0**	**13.9**	**15.6**

Globalizaition of the Indian economy

1.30 The structure of the Indian economy has undergone considerable change in the last decade. These include increasing importance of external trade and of external capital flows. The services sector has become a major part of the economy with GDP share of over 50 per cent and the country becoming an important hub for exporting IT services. The share of merchandise trade to GDP increased to over 35 per cent in 2007-08 from 23.7 per cent in 2003-04. If the trade in services is included, the trade ratio is 47 per cent of GDP for 2007-08.

1.31 The rapid growth of the economy from 2003-04 to 2007-08 also made India an attractive destination for foreign capital inflows and net capital inflows that were 1.9 per cent of GDP in 2000-01 increased to 9.2 per cent in 2007-08. Foreign portfolio investment added buoyancy to the Indian capital markets and Indian corporates began aggressive acquisition spree overseas, which was reflected in the high volume of outbound direct investment flows.

1.32 Another important dimension has been the high degree of external dependence on imported energy sources, especially crude oil with the share of imported crude in domestic consumption exceeding 75 per cent. A major change in international crude prices is therefore bound to impact the Indian economy, as happened in early 2008-09.

Impact of global developments

1.33 The subprime crisis that surfaced around August 2007 had affected financial institutions in the United States and Europe including the shadow banking system comprising inter alia investment banks, hedge funds, private equity and structured investment vehicles. The collapse of the Lehman Brothers in mid-September 2008 further aggravated the situation leading to a crisis of confidence in the financial markets. The resulting heightened uncertainty cascaded into a full-blown financial crisis of global dimensions that stymied prospects of an early recovery.

1.34 India could not insulate itself from the adverse developments in the international financial markets, despite having a banking and financial system that had little to do with investments in structured financial instruments carved out of subprime mortgages, whose failure had set off the chain of events culminating in global crisis.

1.35 The effect on the Indian economy was not significant in the beginning. The initial effect of the subprime crisis was, in fact, positive, as the country received accelerated Foreign Institutional Investment (FII) flows during September 2007 to January 2008. This contributed to the debate on "decoupling," where it was believed that the emerging economies could remain largely insulated from the crisis and provide an alternative engine of growth to the world economy. The argument soon proved unfounded as the global crisis intensified and spread to the emerging economies through capital and current account of the balance of payments (BoP). The net portfolio flows to India soon turned negative as Foreign Institutional Investors (FIIs) rushed to sell equity stakes in a bid to replenish overseas cash balances. This had a knock-on effect on the stock market and the exchange rates through creating the supply-demand imbalance in the foreign exchange market. The current account was affected mainly after September 2008 through slowdown in exports. Despite setbacks, however, the BoP situation of the country continues to remain resilient.

1.36 The global crisis also meant that the economy experienced extreme volatility in terms of fluctuations in stock market prices, exchange rates and inflation levels during a short duration necessitating reversal of policy to deal with emergent situations.

1.37 Before the onset of the financial crisis, the main concern of the policymakers was excessive capital inflows, which increased from 3.1 per cent of GDP in 2005-06 to 9.3 per cent in 2007-08. While this led to increase in foreign exchange reserves from US$ 151.6 billion at end-March 2006 to US$ 309.7 billion at end-March 2008, it also contributed to monetary expansion, which fuelled liquidity growth. WPI inflation reached a trough of 3.1 per cent in October 2007, a month before global commodity price inflation zoomed to double digits from low single digits. The rising oil and commodity prices, contributed to a significant rise in prices, with annual WPI peaking at 12.8 per cent in August 2008. The monetary policy stance during the first half of 2008-09 was therefore directed at containing the prices rise.

1.38 The policy stance of the Reserve Bank of India (RBI) in the first half of the year was oriented towards controlling monetary expansion, in view of the apparent link between monetary expansion and inflationary expectations partly due to the perceived liquidity overhang. In the first six months of 2008-09, year-on-year growth of broad money was lower than the growth of reserve money (Figure 1.3i), The Government also took various fiscal and administrative measures during the first half of 2008-09 to rein in inflation.

1.39 The key policy rates of RBI thus moved to signal a contractionary monetary stance. The repo rate (RR) was increased by 125 basis points in three tranches from 7.75 per cent at the beginning of April 2008 to 9.0 per cent with effect from August 30, 2008. The reverse-repo rate (R-RR) was however left unchanged at 6.0 per cent (Figure 1.3ii). The cash

Figure 1.3(i) : Growth of M_3 and M_0 (Y-o-Y)

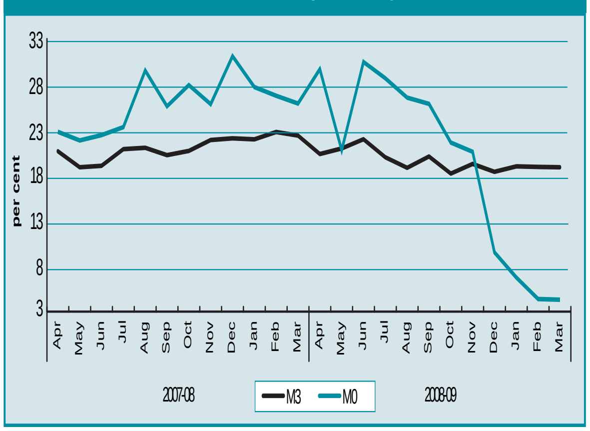
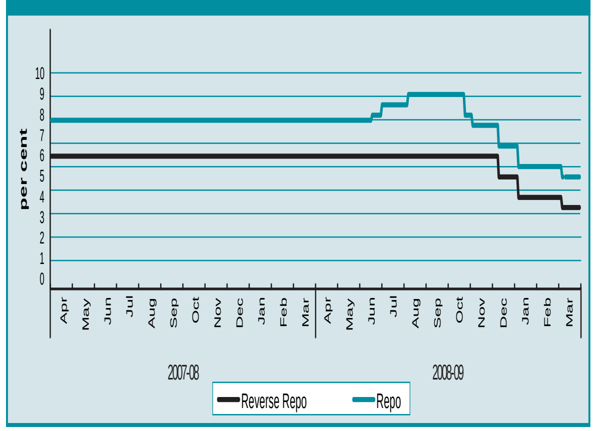


Figure 1.3(ii) : Repo and reverse repo rates



reserve ratio (CRR) was increased by 150 basis points in six tranches from 7.50 per cent at the beginning of April 2008 to 9.0 per cent with effect from August 30, 2008.

Exchange rate developments

1.40 The surge in the supply of foreign currency in the domestic market led inevitably to a rise in the price of the rupee. The rupee gradually appreciated from Rs. 46.54 per US dollar in August 2006 to Rs. 39.37 in January 2008, a movement that had begun to affect profitability and competitiveness of the export sector. The global financial crisis however reversed the rupee appreciation and after the end of positive shock around January 2008, rupee began a slow decline.

1.41 A major factor, which affected the emerging economies almost simultaneously, was the unwinding of stock positions by the FIIs to replenish cash balances abroad. The decline in rupee became more pronounced after the fall of Lehman Brothers in September 2008, requiring RBI intervention to reduce volatility. It is pertinent to note that a substantial part of the movement in the rupee-US dollar rate during this period has been a reflection of the movement of the dollar against a basket of currencies. The rupee stabilized after October 2008, with some volatility. With signs of recovery and return of FII flows after March 2009, rupee has again been strengthening against US dollar.

1.42 For the year as a whole, the nominal value of the rupee declined from Rs. 40.36 per US dollar in March 2008 to Rs. 51.23 per US dollar in March 2009, reflecting a 21.2 per cent depreciation during the fiscal 2008-09. The exchange rate was Rs. 51.20 per US dollar in March 2009. The annual average exchange rate during 2008-09 worked out to Rs. 45.99 per US dollar compared to Rs. 40.26 per US dollar in 2007-08.

Monetary policy developments

1.43 The outflow of foreign exchange, as a fallout of crisis, also meant tightening of liquidity situation in the economy. To deal with the liquidity crunch and the virtual freezing of international credit, the monetary stance underwent an abrupt change in the second half of 2008-09. The RBI responded to the emergent situation by facilitating monetary expansion through decreases in the CRR, repo and reverse-repo rates, and the statutory liquidity ratio (SLR). The repo rate was reduced by 400 basis points in five tranches from 9.0 in August 2008 to 5.0 per cent beginning March 5, 2009. The reverse-repo rate was lowered by 250 basis points in three tranches from 6.0 (as was prevalent in November 2008) to 3.5 per cent from March 5, 2009. The reverse-repo and repo rates were again reduced by 25 basis points each with effect from April 21, 2009 (Figure 1.3ii). SLR was lowered by 100 basis points from 25 per cent of net demand and time liabilities (NDTL) to 24 per cent with effect from the fortnight beginning November 8, 2008. The CRR was lowered by 400 basis points in four tranches from 9.0 to 5.0 per cent with effect from January 17, 2009.

1.44 The credit policy measures by the RBI broadly aimed at providing adequate liquidity to compensate for the squeeze emanating from foreign financial markets and improving foreign exchange liquidity. At the same time, it was necessary to ensure that the financial contagion arising from the global financial crisis did not permeate the Indian banking system. These measures were therefore supplemented by sector- specific credit measures for exports, housing, micro and small enterprises and infrastructure.

1.45 The monetary measures had a salutatory effect on the liquidity situation. The weighted average call money market rate, which had crossed the LAF corridor at several instances during the first half of 2008-09, remained within the LAF corridor after October 2008. Since mid-2008-09, the growth in reserve money decelerated after September 2008. The deceleration in M_0 was largely on account of the decline in net foreign exchange assets (NFA) of RBI (a major determinant of reserve money growth) due to reduced capital inflows. On the other hand, the net domestic credit (NDC) of the RBI expanded due to an increase in net RBI credit to the Central Government in the second half of the year. Taking the year as a whole, broad money (M_3) recorded an increase of 18.4 per cent during 2008-09, as against 21.2 per cent in 2007-08. The money multiplier, which is the ratio of M_3 to M_0 was 4.3 in end-March 2008 and increased to 5.0 in December 2008.

Fiscal developments

1.46 The extraordinary situation that emerged due to the crisis had led to a sharp shrinkage in the demand for exports. Domestic demand also had moderated considerably leading to a downturn in industry and in the services sector as seen in the GDP growth, especially for the third and the fourth quarters of 2008-09.

1.47 The situation necessitated a fiscal response beyond the measures enunciated in the 2008-09

Budget, the roll-out and actual outlays, however, took place in the second half of 2008-09. These included the payout of a part of the arrears to government employees, following the Sixth Pay Commission Report and the debt relief (farm loan waiver) package to alleviate the debt burden of the distressed farmers. By increasing the fiscal deficit, this expenditure, inter alia, helped to sustain domestic demand. These were supplemented by further measures during December 2008 to February 2009 consisting of increased plan expenditure, reduction in indirect taxes, sector-specific measures for textiles, housing, infrastructure, automobiles, micro and small sectors and exports and authorization to specified financial institutions like the India Infrastructure Investment and Finance Company Limited (IIFCL) to raise tax-free bonds to fund infrastructure projects.

1.48 With the release of provisional actual data on expenditure for the Union Government for 2008-09 and the revised estimates of GDP at market prices for 2008-09, the fiscal deficit to GDP ratio for 2008-09 works out to 6.2 per cent, while the revenue and primary deficit are estimated to be 4.6 per cent and 2.6 per cent respectively. Consequently, the fiscal measures taken together provided a fiscal stimulus of about 3.5 per cent of GDP. Further, below the line items can also be said to have contributed a stimulus of about 1.3 per cent of GDP, even though these merely offset the effect of the increase in the prices of oil and fertilizer imports on domestic income and demand.

1.49 The revenue and expenditure sides in the Interim Budget 2009-10, which was presented on February 16, 2009, were conditioned by the foregoing developments. Fiscal deficit for 2009-10 was estimated to go up to 5.5 per cent of GDP, thus providing a continuing stimulus, relative to 2008-09, of 2.8 per cent of GDP. Further tax reduction measures were announced by the Finance Minister during the discussions. These were of the order of 0.5 per cent of the GDP. The Finance Minister's speech also indicated that an additional fiscal stimulus of 0.5 per cent to 1 per cent of GDP as additional plan expenditure could be considered, if needed, to offset the shock induced declines in aggregate demand.

1.50 Apart from the measures taken to restore and revive the domestic economy, India continued to engage actively at various international fora like the G-20 group of countries (of which India is a member) and at the multilateral institutional mechanisms on the range of issues that arose from the global financial crisis. At the meeting in early April 2009, leaders of G-20 countries (including India), collectively committed themselves to take decisive, coordinated and comprehensive action to revive growth, restore stability of the financial system, restart the impaired credit markets and rebuild confidence in financial markets and institutions.

Credit

1.51 The intra-year changes in credit flow could be attributed to several factors. The demand for bank credit increased sharply during April-October 2008 as companies found that external sources of credit were drying up in the wake of the global financial crisis. There was also a sharp increase in credit to oil marketing companies. However, towards the latter part of 2008-09, credit growth declined abruptly reflecting the slowdown of the economy in general and the industrial sector in particular (Figure 1.3iv). Working capital requirements also came down because of a decline in commodity prices and a drawdown of inventories by the non-financial companies. The demand for credit by oil marketing companies also moderated. In addition, substantially

Figure 1.3(iii) : Stock price indices

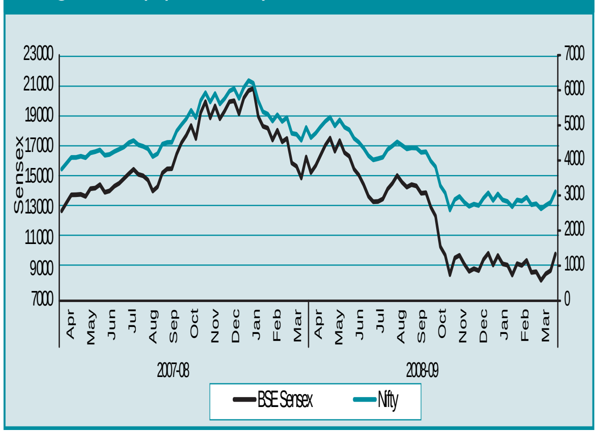
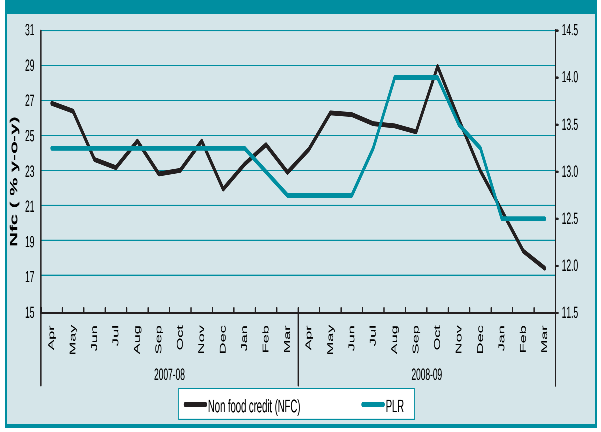


Figure 1.3(iv) : Prime lending rate & non-food credit growth



lower credit expansion by private and foreign banks muted the overall flow of bank credit during the year.

1.52 On a full year basis, bank credit growth fell from 22.3 per cent in 2007-08 to 17.3 per cent in 2008-09. Having regard to the structural rigidities associated with the money market, it was observed that the average PLR did not show much variation. From 12.5 per cent in April 2008, it increased to 13.9 per cent in September 2008 and thereafter declined to 12.0 per cent in March 2009.

Balance of payments

1.53 The overall balance of payments (BoP) situation remained resilient in 2008-09 despite signs of strain in the capital and current accounts, due to the global crisis. During the first three quarters of 2008-09 (April-December 2008), the current account deficit (CAD) was US$ 36.5 billion (4.1 per cent of GDP) as against US$ 15.5 billion (1.8 per cent of GDP) for the corresponding period of 2007-08. The capital account balance declined significantly to US$ 16.09 billion (1.8 per cent of GDP) as compared to US$ 82.68 billion (9.8 per cent of GDP) during the corresponding period in 2007-08.

1.54 A positive development was higher private transfers and software earnings and increase in non-resident deposit flows and foreign direct investment vis-à-vis the corresponding period last year. Higher FDI flows in 2008-09 were also a reflection of the confidence of foreign investors in the growth prospects of the Indian economy.

1.55 Together with lower crude oil prices and decline in imports, the overall impact on the balance of payments was somewhat muted. This is reflected in reserve decline of only US$ 20.4 billion on BoP basis (excluding valuation change) during 2008-09 (April-December 2008). The total foreign currency assets (FCA) had declined from US$ 299.2 billion on 31.3.2008 to US$ 241.4 billion on 31.3.2009, reflecting a fall of US$ 57.8 billion. However, more than two-thirds of the decline in FCA was due to a valuation change i.e. appreciation of US dollar against the international currencies in which reserves are maintained. The foreign exchange reserves stood at US$ 252 billion at end-March 2009.

Trade

1.56 The adverse effect of the global financial crisis was also felt on the export sector, first, on account

Figure 1.4(i) : Foreign investment inflows

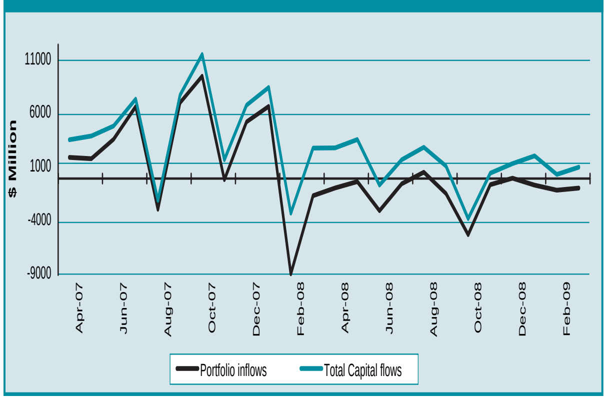


Figure 1.4(ii) : Foreign exchange reserves

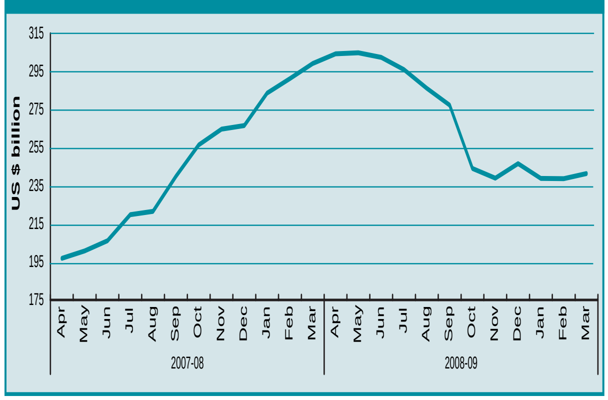


Figure 1.4(iii) : Exchange rate (Rupees/US$)

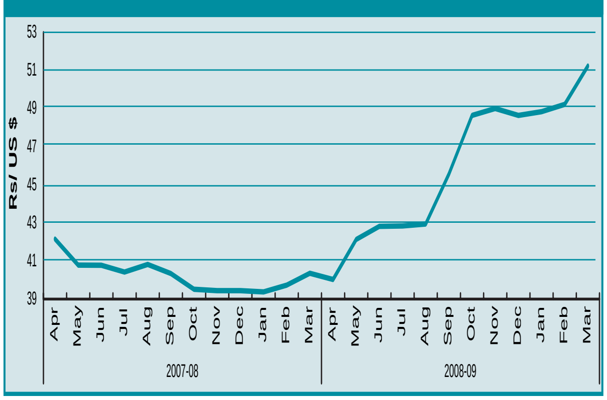
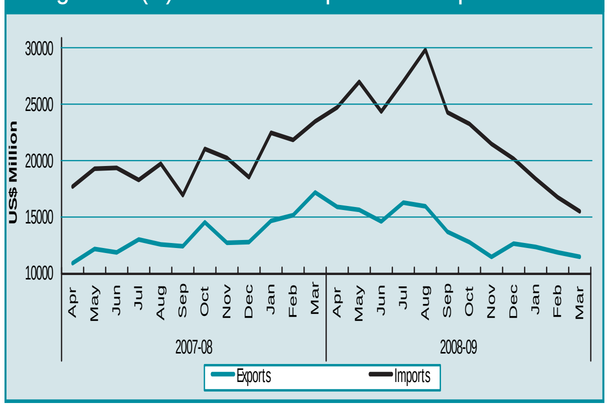


Figure 1.4(iv) : Trends in Exports and Imports



of the drying up of international financing and trade credit, followed by a fall in global demand.

1.57 During 2008-09, the growth in exports was robust till August 2008. However, in September 2008, export growth evinced a sharp dip and turned negative in October 2008 and remained negative till the end of the financial year. The continued decline in export growth was due to the recessionary trends in the developed markets where the demand had plummeted. For the year as a whole, the growth in merchandise exports during 2008-09 was 3.6 per cent in US dollar terms and 16.9 per cent in rupee terms (compared to 28.9 per cent and 14.7 per cent respectively in 2007-08). The large difference in growth in terms of the US dollar and in terms of the rupee was on account of the depreciation of rupee vis-à-vis US dollar during the year.

1.58 During the period (April-February) in 2008-09, the main drivers of exports growth were engineering goods and chemicals and related products. Petroleum products and textile exports witnessed a positive but low growth. However, handicrafts, primary products and gems and jewellery exports registered negative growth. The negative impact on the growth of India's exports becomes more evident from the fact that merchandise exports to the United States, which was the largest market, declined by 1.6 per cent during 2008-09 (April-February). On the other hand, merchandise exports to Asia (including ASEAN) grew by 6.9 per cent and to Europe by 10.2 per cent during this period. India's merchandise exports to South Asian countries also declined by 5.2 per cent.

1.59 Import growth began to decline from October 2008 (with one month lag from the decline in export growth) and was negative over the period January to March 2009. For the year as a whole i.e. 2008-09, the overall import growth was subdued at 14.4 per cent in US dollar terms and 29 per cent in rupee terms. Growth in POL and non-POL imports was 16.9 per cent and 13.2 per cent respectively (in US dollar terms). During 2008-09 (April-February) fertilizers and edible oils registered high import growth to meet domestic demand. The growth in the imports of POL was high in the first half of the year due to the unusually high prices but moderated in the second half of the year. The trade deficit increased from US$ 88.5 billion (as per customs data) in 2007-08 to US$ 119.1 billion in 2008-09.

1.60 The impact of global recession was relatively less on India's services exports till December 2008, though the growth rate of services export moderated to 16.3 per cent during April-December 2008-09. A negative growth in insurance and a sharp fall in the growth of travel services was registered during this period. Software services grew at 26 per cent, while financial services registered a robust growth of 45.7 per cent despite the global financial crisis and fall in growth rate in world financial services exports. Business services growth was, however at a lower rate of 3.9 per cent.

Prices

1.61 A positive fallout of decline in demand and fall in commodity prices due to the crisis was a sharp decline in headline inflation, as indicated by the WPI, which was 0.8 per cent at end-March 2009 on year-on-year basis for all commodities. However, there has been wide variation in the constituents of the Index, with WPI Food Index (combined) showing year-on-year inflation of 6.8 per cent at the same point of time, which has been a cause for concern. The average WPI inflation for 2008-09 was 8.4 per cent as against 4.7 per cent in 2007-08. There has also been significant variation in inflation rate in terms of WPI and the Consumer Price Indices (CPIs). Inflation rate as per Consumer Price Index for Rural Labourers (CPI-RL) was 9.7 per cent and on CPI for Industrial Workers (CPI-IW) was 8 per cent as of end-March 2009. The average inflation on CPI-RL and CPI-IW for the year 2008-09 was 10.2 and 9.1 per cent, respectively.

1.62 The implicit deflator for GDP_{MP} defined as the ratio of GDP at current prices to GDP at constant prices is the most comprehensive measure of inflation on an annual basis. Overall inflation, as measured by the aggregate deflator for GDP_{MP}, declined from 5.0 per cent in 2006-07 to 4.9 per cent in 2007-08 and is estimated at 6.2 per cent in 2008-09 as a result of the higher inflation experienced during most of the year.

Inclusive growth

1.63 Regardless of the impact of the global financial crisis on India, the fact remains that some of the challenges that India faces are of a continuing nature. These inter alia include eradicating poverty, improving its physical and social infrastructure, education and creating productive employment opportunities. In consonance with the commitment to ensure faster social development and achieving an inclusive pattern of growth, the government continued its focus on several initiatives and programmes towards that end.

1.64 Some of the major social sector initiatives for achieving inclusive growth and faster social sector development and to remove economic and social disparities in the Eleventh Five Year Plan, include the Bharat Nirman programme, Mid-day Meal Scheme, National Rural Health Mission, Jawaharlal Nehru National Urban Renewal Mission and the National Rural Employment Guarantee Scheme (NREGS). Central support for the social programmes has continued to supplement efforts made by the states.

1.65 Under NREGS, over four crore households were provided employment in 2008-09. This is a significant jump over the 3.39 crore households covered under the scheme during 2007-08. Out of the 215.63 crore person-days of employment created under the scheme during this period, 29 per cent and 25 per cent were in favour of SC and ST population respectively. 48 per cent of the total person-days of employment created went in favour of women. The agriculture debt waiver and relief scheme implemented during the year was able to restore institutional credit to farmers and helped to support demand and revive investment in the rural and the agriculture sector.

Summing-up

1.66 The fallout of the global financial crisis on the Indian economy has been palpable in the industry and trade sectors and has also permeated the services sector. While some segments, especially the export-oriented industries, suffered during the second half of the year, the Indian economy has withstood the adverse global economic situation and posted a growth rate of 6.7 per cent in 2008-09. The economy continues to face wide-ranging challenges— from improving its social and physical infrastructure to enhancing the productivity in agriculture and industry and addressing environmental concerns. Meeting these challenges will be critical for improving India's social and human development indicators and the quality of life.

1.67 At the same time, the Indian economy has shock absorbers that will facilitate early revival of growth. First, the banks are financially sound and well capitalized. The foreign exchange reserves position remains comfortable and the external debt position has been within the comfort zone. The rate of inflation has since abated and provides a degree of comfort on the cost side for the production sectors. Agriculture and rural demand continue to be strong and agriculture production prospects are normal.

1.68 While there are indications that the economy may have weathered the worst of the downturn, in part, due to the resilience of the economy and also various monetary and fiscal measures initiated during 2008-09, nevertheless, the situation warrants close watch on various economic indicators including the impact of the economic stimulus and developments taking place in the international economy. Taking policy measures that squarely address the short- and long-term challenges would help achieve tangible progress and ensure that the outlook for the economy remains firmly positive. Chapter 2 highlights some of these challenges, policy options and prospects for the Indian economy.

Key indicators

Item	Units	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09
1. GDP and related indicators							
GDP (current market prices)	Rs. crore	2754620	3149407	3586743	4129173	4723400	5321753 RE
Growth rate	%	12.2	14.3	13.9	15.1	14.4	12.7
GDP (constant market prices)	Rs. crore	2402727	2602065	2844942	3120029	3402716	3609425
Growth rate	%	8.4	8.3	9.3	9.7	9.1	6.1
Growth of GDP (factor cost, constant prices)	%	8.5	7.5	9.5	9.7	9.0	6.7
Savings Rate	% of GDP	29.8	31.7	34.2	35.7	37.7	na
Capital formation (rate)	% of GDP	27.6	32.1	35.5	36.9	39.1	na
Per cap NNP (factor cost & current prices)	Rs.	20871	23198	26003	29524	33283	37490
2. Production							
Foodgrains	Mill tonne	213.2	198.4	208.6	217.3	230.8	229.9 ^^
Index of Industrial production (growth)	Per cent	7.0	8.4	8.2	11.6	8.5	2.6
Electricity generation (growth)	Per cent	5.1	5.1	5.2	7.3	6.3	2.7
3. Prices							
Inflation (WPI) (52-week average)	%change	5.5	6.5	4.4	5.4	4.7	8.4
Inflation CPI (IW)	%change	3.9	3.8	4.4	6.7	6.2	9.1
4. External sector							
Export growth (US$)	%change	21.1	30.8	23.4	22.6	28.9	3.6
Import growth (US$)	%change	27.3	42.7	33.8	24.5	35.4	14.4
Current account deficit (CAD)/GDP	Per cent	2.3	-0.4	-1.2	-1.1	-1.5	-4.1 ^
Foreign exchange reserves	US$ bn.	113.0	141.5	151.6	199.2	309.7	252.0 @
Average exchange rate	Rs./US$	45.95	44.93	44.27	45.28	40.26	45.99
5. Money and credit							
(M_3) (annual)	%change	16.8	12.3	17.0	21.3	21.2	18.4
Scheduled commercial bank credit (growth)	%change	15.2	30.7	37.0	28.5	22.3	17.5
6. Fiscal indicators (Centre)							
Gross fiscal deficit	% of GDP	4.5	4.0	4.1	3.5	2.7	6.2 ##
Revenue deficit	% of GDP	3.6	2.5	2.6	1.9	1.1	4.6 ##
Primary deficit	% of GDP	0.0	0.0	0.4	-0.2	-0.9	2.6 ##
7. Population	Million	1072	1089	1106	1122	1138	1154

RE GDP figures for 2008-09 are Revised Estimates
na not yet available / released for 2008-09
^^ for 2008-09 the figures are the 3rd Advance Estimates
^ CAD to GDP ratio for 2008-09 is for the period Apr-Dec 2008
@ as of March 31, 2009
fiscal indicators for 2008-09 are based on the provisional actuals for 2008-09