Economic Outlook 2013/14

Economic Advisory Council to the
Prime Minister
New Delhi

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ECONOMIC ADVISORY COUNCIL TO THE PRIME MINISTER

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Economic Advisory Council to the Prime Minister
Hall-E
Vigyan Bhawan
Maulana Azad Road
New Delhi

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ECONOMIC OUTLOOK 2013-14

I – ECONOMIC PERFORMANCE AND GROWTH OUTLOOK

Economic Performance in 2011-12 & 2012-13

1. The performance of the economy over the past two years has been disappointing. The projections made by the Council in the respective Outlooks for both of these two years have been belied. The growth of 5.0 per cent in 2012-13 has hugely underperformed the modest growth rate of 6.7 per cent projected in the Outlook of August 2012.

2. In the Review by the Council published in April 2013, we have tried to place our understanding of the various interconnected factors that have driven the growth rate down to such a disconcerting extent. Low growth, disappointing corporate results and weak business confidence feed into each other in a negative feedback loop. In addition, a large current account deficit, high domestic inflation and a fiscal stance that was widening till last year compounded the litany of woes facing the economy. To an extent there was the fallout of adverse developments in the international arena, the most direct consequence of which was weak demand in world export markets – especially our traditional markets in the developed West, in Europe and USA. The steep rise in commodity prices, especially of oil, after 2010 adversely impacted both our trade balance, domestic inflation and also the fiscal position on account of the subsidy regime that was in place for refined petroleum products and fertilisers.

3. However, a large part of the factors responsible for undoing the astonishingly rapid recovery the Indian economy made in 2009-10 and 2010-11, immediately on the heels of the global crisis, flowed from domestic developments.

4. The two mostly economic factors that became a problem was first the overstaying of part of the fiscal stimulus rolled out during the crisis, namely, the concession rates of excise duty. At that time, in 2009 and 2010, one ought to recollect that the prospect of a "double dip" recession or a second leg of the 2008 crisis was a fear that was shared across policy circles over the globe. The second

was the poor monsoon of 2009 – the worst in 28 years – which led to a surge in domestic prices of cereals via expectations about a massive shortfall in output and assisted by the massive increase in world prices of food products in 2010 and 2011. This along with the increase in global prices for oil, natural gas, metals and other commodities, combined with inadequacies in the domestic institutional development of markets and supply chains for perishable farm produce, helped fuel an inflationary cycle that lasted for over three years. The consequence was a rise in costs across the board and erosion in both corporate profitability and the growth of real disposable incomes.

5. The second part, and possibly the larger part of the factors, that resulted in the abrupt decline in growth from 8.6 per cent in 2009-10 and 9.3 per cent in 2010-11 to 6.2 and 5.0 per cent in the two subsequent years, flowed from non-economic factors. These created a climate of uncertainty resulting in hold-ups in projects awaiting clearances and a general deterioration in the investment climate.

The Present Position

6. Over the past year, two exacerbating factors have been brought under control. First, the fiscal trajectory has been reset in the desirable direction, even if it meant cutting back on Plan expenditure in 2012-13. There is a calibrated adjustment for oil subsidies the element in the Centre's subsidy bill that inadvertently expanded to become the largest one – especially if one includes the amounts contributed to it by the public sector oil companies. Inflation as measured by the Wholesale Price Index (WPI) has also come off since March 2013 and is presently at around 5 per cent. The inflation reported by the consumer price indices is much higher, partly on account of the much higher weight of cereals in these indices. Later in this report we have analyzed and discussed the differences in the WPI and CPI inflation rates.

7. With the fiscal balance on track to stabilization, and inflation coming off and with that the raison d'être of the monetary stance, the economy seemed to be setting in for a recovery. However, the other imbalance, namely the current account deficit (CAD) which had yet to be reined in, kicked in creating a new, source of instability in the external payments situation.

Weaker Emerging Market Outlook

8. There is a context which is necessary to understand this. Over the past two years, the shine of emerging and developing countries or emerging markets (EM) as they are commonly termed has worn off. In the pre-Crisis era, both the developed market (DM) and EM countries grew, but growth in the latter very much outpaced the former. In 2000, the EM world accounted for 20 per cent of global GDP. In 2008, their share had risen to 31 per cent, and that of the DM world fell from 80 to 69 per cent. In 2010 the respective shares had changed further to 35 and 65 per cent for the EM and DM world respectively.

9. The crisis of 2008 did not seem to impact the EM countries badly. And from 2009, EM countries, particularly India, China and Brazil made a very rapid recovery – that was quite astonishing. The average growth in the three calendar years following on the crisis year, namely 2009, 2010 and 2011 in India was 8.0 per cent and that in China was 9.7 per cent. For EM countries excluding India and China the figure was 3.6 per cent. For the three years (2009, 2010 & 2011) together the averages for other BRIC countries were lower still: 3.3 per cent for Brazil, 1.7 per cent for South Africa and 0.3 per cent for Russia. The average for 2010 and 2011 only for Brazil was 5.1 per cent, for South Africa 3.3 per cent and Russia 4.4 per cent.

10. In sharp contrast, the developed market (DM) economies were badly hit by the crisis of 2008 & 2009 and were struggling to recover in 2010 and 2011. The DM world as a whole grew by (-) 3.5 per cent in 2009. In 2010 with the aid of exceptional fiscal and monetary stimulus they grew by 3.0 per cent, but fell back once again to 1.6 per cent in 2011. In addition, the Eurozone was afflicted by its own problems with several member countries in very serious difficulties.

11. The contrast to the EM world could not have been sharper. The inference many made was that the EM world was on a good wicket and would be able to deliver strong and sustained growth, even as the DM world struggled to come out from the woes of the crisis and the post-crisis.

12. However, the EM story started to sour in 2011 and did so substantively in 2012. India, China, Brazil and many other EM economies began to show large imbalances and

a deceleration of growth. In 2012, for EM as a whole, growth fell from 6.4 in the previous year to 5.1 per cent. More pertinently it fell sharply from 9.3 to 7.8 per cent in China and from 7.5 per cent in 2010 to 2.7 per cent in 2011 to 0.9 per cent in 2012 in Brazil. In Argentina, it dropped from 9.2 and 8.9 per cent in 2010 and 2011 to 1.9 per cent in 2012. In Turkey growth fell from 9.2 per cent in 2010 and 8.5 per cent in 2011 to 2.6 per cent in 2012. In India, as we have noted, growth dropped from 9.3 per cent in 2010-11 to 6.2 per cent in 2011-12 and then to 5.0 per cent in 2012-13.[1]

13. On the other hand, the economic condition in the DM world began to stabilize and improve. Canada, Australia, Sweden and a few other developed economies had in any case not been hit too much by the crisis of 2008. Even as the Eurozone remained tied up in the difficulties of adjustment and the negotiations on the mutualisation of burdens, the US economy in late 2011 and early 2012 began to show signs of distinct improvement. The revised figures for GDP show that the US grew by 2.8 per cent in 2012 (up from 2.2 per cent provisional estimates). Even though growth in the first half of 2013 has been around 1.5 per cent, most indicators show a consistent upturn, even if gradual, an improvement which is likely to be expressed more strongly in the second half of 2013 and in 2014. The US current account deficit has also been contained and is averaging little over $105 billion per quarter or 2.7 per cent of GDP in 2012 and 2.6 per cent in the first quarter of 2013.[2] The Eurozone is a current account surplus region.

14. In the EM world as growth rates fell, current account imbalances began to exacerbate in the traditionally deficit countries. In India, the CAD as a ratio of GDP increased from 2.8 in 2010-11, to 4.2 in 2011-12 and then to 4.8 per cent in 2012-13. In South Africa, the CAD rose from 3.4 per cent in 2011 to 6.3 and 6.4 per cent in 2012 and 2013 respectively. In Turkey it was 9.7 per cent in 2011, 5.9 per cent in 2012 and is estimated to be 6.8 per cent in 2013. In commodity exporting Brazil, where the CAD has tended to be modest and often in surplus, the CAD expanded to over 2 per cent and is projected to exceed 3 per cent in 2014.[3]

[1] Data from World Economic Outlook database, IMF
[2] From the USBureau of Economic Analysis
[3] World Economic Outlook database, IMF

15. Lower growth means a decline in the attractiveness of assets in that country and therefore one would expect lower volumes of capital flows as a consequence of weakening growth conditions. Thus, the combination of lower growth in EM countries and widening CAD in some economies appeared particularly troubling.

16. It is easier in this light to understand the developments in the currency space in 2013, particularly since late May and most prominently in late June, July and August. The existence of an imbalance does not necessarily mean that the cost of it is borne immediately, but the troubles are triggered by events, sometimes related, sometimes unrelated and it has a habit of making an appearance at the most inconvenient of times.

17. Thus, in India the problems on the currency front has particularly queered the pitch in the summer of 2013, a time when a renewed focus on reviving growth was needed and other economic conditions appeared positive. The currency problems have momentarily interrupted the process of revival of growth, which is all the more reason that the currency situation be stabilized as early as possible.

Assessment of Economic Growth in 2013-14

18. The pace of economic growth in the first quarter of 2013-14 was quite weak, at 4.4 per cent. The second quarter should be stronger. However, if overall economic growth for the year has to top that of the previous year, growth in the second half has to show distinct improvement. Can it? The answer is a qualified "yes". The monsoon has been very good and the *kharif* planting has been extraordinarily good. With good rains and reservoir position, the *rabi* harvest should also be strong. Last year because of poor rains in many areas, farm sector growth had been low at 1.9 per cent. Significant improvement over this in the current fiscal can be expected. That will also lift the rural economy as a whole and improve the demand for manufactures – both durable and non-durable consumer goods.

19. The large number of clearances and the resolutions made in the infrastructure sector should with a lag bring about an improvement in economic activity in the third quarter (Oct to Dec 2013) onwards. However, considering the general stress on corporate balance sheets and the difficulties in raising funds in this situation, the pick up may be more muted than otherwise.

20. Overall, given these considerations, the Council is looking at a rate of economic growth of 5.3 per cent in 2013-14, lower than that indicated (6.4 per cent) in its April 2013 Review of the Economy.

21. The reasons for the lower estimate are primarily two fold. First, the currency related disruptions that broke out in June 2013 and is continuing to date, has undercut the momentum for recovery in many ways – on the policy front, the balance sheet effects on corporates, banks and financial institutions and on capital markets. Second, as was pointed out in the April Review, the trend of decline of margins and profitability seemed to have bottomed out by the quarter ended December 2012. However, corporate results for March 2013 ending quarter, show further stress – not so much in operating margins, but in post-tax profitability. In other words, the recovery will take a little longer and will be somewhat slower.

22. The overall expectation about growth and the sector wise break up is given at Table 1.1. As may be observed, growth in the industrial sector is projected to show only a very small improvement from 2.1 per cent in the previous year to 2.8 per cent in 2013-14. The service sector is expected to grow slower, on account of some slowing in the trade, hotels, restaurants, transport & communication sector. Non-farm sector growth in 2013-14 is expected to slow slightly from the previous year's level of 5.5 per cent to 5.4 per cent. The main factor pushing growth up is the farm sector directly on account of faster growth of farm incomes and indirectly by lifting rural demand for manufactures.

23. The Mining & Quarrying sector is still being impacted by the decline in natural gas output from the KG basin, even though the decline there seems to have bottomed out. Lower than expected production from Mumbai High oil fields is also adversely impacting total domestic production of crude petroleum. The output of coal that had recorded good growth in 2012-13 suffered some setbacks during part of the first quarter of 2013-14, but is expected to improve in the remaining part of the current fiscal year. The mining of iron ore remains restrained on account of regulatory issues. Overall growth in GDP arising in the Mining & Quarrying sector is expected to be flat in the full year.

24. The Index of Industrial Production (IIP) suggested slightly negative growth for manufacturing in the first quarter of 2013-14. The rate of growth of quarterly GDP arising in manufacturing has been placed at (–) 1.2 per cent. Some improvement can realistically be expected in the second quarter and more so in the two subsequent quarters. In the first quarter of 2013-14, manufacturing activity has been particularly beaten down by sizeable negative growth in consumer durables, particularly automobiles. Some moderation in declines, followed by small improvements should enable a small improvement in the growth in manufacturing activity. In consumer non-durables, the anecdotal evidence suggests that the first quarter was reasonably alright and that advance orders up to the third quarter also show reasonable growth.

25. Construction activity is a function of both private and public sector expenditures. Government is committed to step up spending in infrastructure activities and this should provide a boost to construction. Hence, even as the first quarter growth in construction was weak at 2.8 per cent, significant improvement can be realistically expected in coming quarters. The service sector broadly reflects the movement in the real sector and it has shown depressed performance in line with the material producing sectors in the first quarter, which also should show improvement.

26. While we expect some improvement in some parts of the service sector, particularly software and related business, there is likely to be a some slowing in trade, hotels, restaurants, transport & communication and the financial sector that has been stressed by slowing of the economy and the developments in the summer of 2013.

27. There may be upsides on account of better than forecast growth in the farm sector and also in both industrial and service sectors. However, bearing in mind the disappointments in the past few years and the continuing pressures on the external value of the currency and hence also on the financial sector and corporate balance sheets, it is advisable to go with a conservative view on the outlook for 2013-14.

Table 1.1
GDP Growth - Actual & Projected
At constant 2004-05 prices

	ANNUAL RATES	2005-06	Average of 2005-06 to 2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
					P	*QE*	*Rev AE*	*Projected*
1	Agriculture & allied activities	5.1	3.8	0.8	7.9	3.6	1.9	4.8
2	Mining & Quarrying	1.3	3.7	5.9	4.9	–0.6	–0.6	0.1
3	Manufacturing	10.1	9.8	11,3	9.7	2.7	1.0	1.5
4	Electricity, Gas & Water Supply	7.1	7.3	6.2	5.2	6.5	4.2	5.2
5	Construction	12.8	9.8	6.7	10.2	5.6	4.3	5.0
6	Trade, Hotels, Transport, Storage & Communication	12.0	10.5	10.4	12.3	7.0	6.4	5.1
7	Finance, insurance, real estate & business services	12.6	12.6	9.7	10.1	11.7	8.6	8.4
8	Community & personal services	7.1	7.3	11.7	4.3	6.0	6.8	7.3
9	**Gross Domestic Product (factor cost)**	**9.5**	**8.8**	**8.6**	**9.3**	**6.2**	**5.0**	**5.3**
10	Industry (2+3+4+5)	9.7	3.8	9.2	9.2	3.5	2.1	2.7
11	Services (6+7+8)	10.9	9.0	10.5	9.8	8.2	7.1	6.6
12	Non-agriculture (9–1)	10.5	10.3	10.1	9.6	6.6	5.5	5.4
14	**GDP (factor cost) per capita**	**7.8**	**9.9**	**7.1**	**7.8**	**4.8**	**3.7**	**4.0**
15	GDP at factor cost - 2004/05 prices in Rs lakh crore (or Trillion)	32.5	37.2	45.2	49.4	52.4	55.1	58.0
16	GDP market & current prices in Rs lakh crore (or Trillion)	36.9	46.5	64.8	78.0	89.7	100.2	112.2
17	GDP at market & current prices in US$ Billion	834	1,064	1,370	1,715	1,865	1,841	1,826
18	Population in Million	1,106	1,130	1,170	1,186	1,202	1,217	1,232
19	GDP at market prices per capita at current prices	33,394	41,070	55,366	65,728	74,667	82,339	91,083
20	GDP at market prices per capita in US$	754	940	1,171	1,446	1,551	1,513	1,482

Global Situation

28. The IMF *World Economic Outlook* of April 2013 and the July Update to it has basically stated that the economic performance in 2013 for the world as a whole and most national economies and regions will not be better than they had in 2012. In its July Update to the WEO, the IMF has marked down global output growth by 0.2 percentage points. It has also cut back its forecast for 2014 by the same amount. The forecast growth for DM economies has been reduced by 0.1 percentage points and that for EM economies by 0.3 percentage points – for both 2013 and 2014.

29. Global output growth is now forecast to grow at the same pace (3.1 per cent) in 2013 as it had in 2012. This is so for the developed (DM) countries (1.2 per cent in both 2012 and 2013) and almost so for emerging & developing (EM) world (5.0 per cent in 2013 vis-à-vis 4.9 per cent in 2012). The IMF in its July 2013 Update to the WEO is a bit more hopeful of 2014, where it sees global output ramping up by 3.8 per cent, DM by 2.1 per cent and EM by 5.4 per cent.

30. The US economy is now forecast to grow by 1.7 per cent in 2013 (the April 2013 estimate had been 1.9 per cent). That is however lower than the 2.2 per cent in 2012 and considerably lower than the revised figure for the year of 2.8 per cent. The broader Eurozone is forecast to remain in recession with –0.6 per cent growth, (unchanged from 2012 and improving marginally to 0.9 per cent in 2014), although Germany is projected to register positive growth. Japan and the United Kingdom are expected to do better in 2013.

31. In the US, there are clear signs that the economy is on the mend. The growth rate for 2012 has been recently revised up to 2.8 per cent in end-July. There seems to have been an across-the-board revival, from personal consumption expenditure to fixed investment and also in net exports (broadly the counterpart to the current account balance). The positive expectations about the USA are manifest in its asset markets.

32. The equity markets have gone through new highs – well above pre-Crisis highs and in the bond markets prices have fallen, leading to an increase in longer dated bond yields. In Europe too, notwithstanding the difficulties within the Eurozone, equity markets have risen with the Frankfurt DAX index going past its pre-Crisis highs and the UK FTSE closing in on its pre-Crisis highs. Other major markets such as the French CAC

and the Swiss Market (SMI) have also been able to wipe out much of the losses from their pre-Crisis highs. It is likely that actual growth conditions in the DM world may turn out to be better than discussed, with US topping 2 per cent growth.

33. The EM world as discussed earlier has lost some of its sheen, particularly in the context when the prospects for growth and asset prices in the DM world are looking better. That major EM economies have problems is clear, but they are rather different from each other and the resolution appears to be cloudy. In consequence, the perception of the near term prospects for the EM world has been significantly dented, even as their longer term prospects are still considered to be good.

34. Going forward, the apprehension of shocks has receded considerably. The Eurozone appears to have settled into some kind of acceptance in-principle of mutualisation of support and hence of pain; the large liquidity cushion extended by the European Central Bank into the system seems to have warded off fears of any disorderly unwinding and hence of shocks from that quarter. For the EM world, it is unfortunate that the focus of concern about shocks and negative surprises has shifted towards it.

Energy & Commodity Prices

35. Oil consumption in 2013 is projected to expand by 1 per cent to 90.7 million barrels per day (mbpd). Over the past several years, as demand from OECD, especially Europe, has declined, the increase in oil demand from the EM world, especially China has not only compensated for it, but has accounted for the overall net increase in demand. Between 2000 and 2012, demand for oil in the OECD fell by 2.6 mbpd, while that from the rest of the world increased by 15.4 mbpd. Of this, the oil exporting countries of West Asia and North Africa accounted for about 3 mbpd, China for 5 mbpd, Latin America accounted for 1.6 mbpd, India for 1.5 mbpd and the rest of Asia another 2.5 mbpd.

36. More than half of the matching incremental output (including bio-fuels) came from outside of the traditional oil exporting OPEC countries. Over this period (2000 to 2012) the incremental supply, including natural gas liquids (NGL) from OPEC was 6.8 mbpd, while that from non-OPEC countries was 7.4 mbpd, including 1.9 mbpd of bio-fuels. In the last decade, Russia and other countries of the former Soviet Union (FSU),

accounted for the bulk of output increase which rose from 7.9 mbpd in 2000 to over 13.3 mbpd in 2008, since when further increases have been marginal.

37. Over the past few years, unconventional oil in the USA and oil sands in Canada have significantly added to global supply – 2.7 mbpd between 2010 and 2013 (expected). The prospect for further ramping up of output from these sources over the near to medium term is considerable.

38. Offsetting this increase, between 2010 and 2013, output from the North Sea is expected to be lower by 0.9 mbpd, while slightly lower output is expected in West Asia, North & West Africa.

39. The increase in output from North America combined with the rather modest increases in global demand for oil has resulted in some stability though at a fairly high level of oil prices that have ruled in the region of $106 to 114 per barrel for the better part of the past two-and-a-half years. Stagnant output levels in the OPEC region possibly contributed. In the 32 months between January 2011 and August 2013, the median price of Brent crude was $110.5 per barrel, about what it was till recently before the most likely temporary spike caused by the prospect of a US strike on Syria. The very large gap between the US marker (WTI) and Brent has closed in recent months on account of higher refinery runs, better pipeline movement on account of completion of two pipeline expansion in the US mid-west, more rail car movement and flood-caused supply temporary disruptions in the Canadian oil sands.

40. That the weakening of EM economies which over the past decade has accounted for global incremental demand and the new output from North America (plus the knock-on effects of cheap shale gas) co-exists with a fairly high level of world prices should not surprise. The characteristics of the world crude oil market are odd: (a) Some 80 per cent of reserves are in OPEC countries, which proportionately accounts for a much lower share of output, namely 39 per cent, (b) all of the spare (idle) production capacity being in OPEC countries, mostly Saudi Arabia, (c) most non-OPEC oil sources also being the costliest to produce and (d) the increased fiscal burden in important Arab OPEC members from much higher social expenditure following on the unrest in the region in the winter of 2010 and 2011. The apprehensions from dislocation of supplies from West Asia due to conflict are real and constantly underpin the state of affairs in the oil market and the built in hair trigger for prices to rise.

41. In 2014, the International Energy Agency (IEA) sees strong incremental output of oil from outside the OPEC of 1.3 mbpd, the strongest since 2002. Most of this will be from the USA & Canada (about 1 mbpd) and the balance from Brazil and Central Asia. The IEA is at the moment forecasting incremental global oil demand in 2014 at 1.2 mbpd. On the basis of this they see small reductions in oil supply from the OPEC. However, there is likelihood that demand growth may be somewhat slower and just marginally greater than the 0.93 mbpd of 2013. In both situations, non-OPEC supply increments are likely to exceed global demand increases and the pressure on prices will be downwards, which will have to be offset by small production cuts from the OPEC in order to maintain prices. Unless of course there are real or prospective supply disruptions or in case the world economy does unexpectedly better in 2014.

42. Had the increase in oil output in North America not materialized, crude oil prices could have been significantly higher than they are at present. It is possible that if the logistics constraints to evacuation from the unconventional and oil sands deposits of North America are eased in the course of this decade, the resultant additional supply can be a factor in restraining oil prices from spiking up much further.

43. Other fuel markets – natural gas and coal – are not as deeply concentrated as is the case for oil. Shale gas output in the US has increased rapidly and the recovery in prices to over $4 per million British Thermal Units (mmbtu) is positive for renewed exploration efforts. Shale gas production in Canada is hampered by logistics constraints on evacuation, but that should ease over this decade. The prospect for shale gas discoveries in the rest of the world appears quite large and this source is looking to be an increasingly important one both for cleaner and cheaper fuel – vis-à-vis oil. Coal prices have come off their 2010 highs, much more so in North America under the impact of competition from shale gas and regulation. Even Asian supplies from Australia have shown a decline in prices – from $ 129 per tonne in July 2010 to $ 89 per tonne in June 2013.

44. The Food & Agriculture Organization (FAO) food price index was flat in 2013, with the average increase in the first seven months being just 0.3 per cent. There was a decline of 7 per cent in the course of 2012. However, the increases in 2010 and 2011 of 18 and 24 per cent were very painful, in particular the increase in the price of cereals by 40 per cent in 2011. The political agitations in the Middle East of 2011 was not

entirely unrelated to the rapid increase in the price of cereals (36 per cent), edible oils (35 per cent) and sugar (42 per cent) registered over the course of a brief seven months between August 2010 and March 2011.

45. World dollar prices of ores and metals have declined in response to weakening demand from the EM world, especially China. The price of gold has dropped sharply. In mid-2007, before the Crisis it was barely $670 per ounce (oz). After that it rose sharply to a peak of $1,900 per oz in September 2011. Thereafter it has steadily come down. In the summer of 2012 it was around $1,550–1,625 per oz, and continued in that region through the winter of 2012-2013. In April 2013, in the course of a few days gold prices fell dramatically to a low of $1,380 per oz. It rallied to a limited extent later in the month and in May. After dipping again in the second half of June and touching a low of $1,192 per oz. on 28 June 2013, it slowly recovered in the second half of July and is presently ruling in the region of $1,350 to 1,400 per oz and the potential is believed to be on the downside.

46. The rush to gold was very expensive for India. As gold (and silver) imports surged from $30 billion in 2009/10 to $62 billion in 2011/12, the effects were massively deleterious, on two separate counts: (a) First, it expanded the trade deficit and hence the CAD by some $29 billion[4] in two years; (b) Second, it reduced the availability of domestic savings in the domestic economy by an equivalent amount, namely 1.5 per cent of GDP.

Domestic Inflation

47. WPI inflation eased to 5.7 per cent in March 2013, after elevated inflation rates for 39 months (December 2009 to February 2013) having a median value of 9 per cent, with a quarter of the period seeing inflation of 9.7 per cent or higher.

48. Inflation in primary food articles have come off a lot, but remains elevated at 8 to 9 per cent at the present, primarily on account of higher cereal and vegetable prices. The cereals issue is primarily on account of rice and wheat. Up to May 2013, wheat prices were actually falling relative to the level in November and December 2012, but there was an uptick in June 2013. In the case of rice, the increase in prices has been

[4] After netting out higher gold jewelry exports, the increase in the net import of gold and silver is about $29 billion between 2009-10 and 2011-12

quite steady. If one looks at the price movement over the past two to three years, it would appear that the market price increases over the last one year is for the most part a delayed effect of the large increases in Minimum Support Prices (MSP) that was given in 2010-11 and 2011-12. The modest increases in MSP levels for both *rabi* 2012-13 and *kharif* 2013-14 should show easing over the rest of the current fiscal year. The price of pulses had again risen sharply in the summer of 2012, a consequence of weak output expectations on account of poor monsoon in the drier regions of central and southern India which are major producers of pulses. However, output of pulses in 2012-13 has hit a new record of 18.5 million tonnes on account of better seed and other support. In consequence, market prices of pulses have been coming off from its peak in September 2012 – with June 2013 price levels being 12 per cent lower. The good monsoon of 2013, including in most of the rainfed parts of the country augurs well for pulse production and price levels are likely to remain subdued. As indeed that of other foodgrains.

49. Manufactured goods inflation has expectedly come off significantly. It had averaged 5.7 per cent in 2010-11, 7.2 per cent in 2011-12 and 5.7 per cent in the first nine months of 2012-13. In March 2013, it had dropped to 4.3 per cent and it had fallen further to 2.8 per cent (provisional) in June 2013. Inflation for manufactured goods other than manufactured food is still lower. The sharp decline in the price index of manufactures, particularly in the backdrop of the virtual flat growth of output, speaks to the weakness of demand – both domestic and external – and the erosion of pricing power of producers.

50. In its 30 July 2013 monetary policy statement, the Reserve Bank of India (RBI) has placed expected WPI inflation at 5.0 per cent in March 2014. The Council expects that it may be around 5.5 per cent.

External Payments

51. In 2011-12 and then again in 2012-13, the merchandise trade deficit expanded to 10.2 and then to 10.6 per cent of GDP. This was the principal reason for the Current Account Deficit (CAD) to escalate to hit a record level of 4.2 and 4.8 per cent of GDP in the two years respectively.

52. The two principal factors that contributed to the record merchandise trade deficit and hence the record level of CAD in terms of changes between 2010-11 and 2012-13 were:

(a) A big rise in the value of *net* petroleum imports (import of crude, products & LNG *less* export of refined products) between 2010-11 and 2012-13 by nearly $44 billion or by 2.3 per cent of GDP, and

(b) A massive expansion of *net* gold imports (total imports of gold & silver *less* gold for jewellery export) by nearly $13 billion or by 0.7 per cent of GDP.

53. That is, between 2010-11 and 2012-13, the combined impact of higher *net* oil and net gold imports on the CAD was almost $57 billion or 3.0 percentage points of GDP. Over this two year period, this was equivalent to 87 per cent of the aggregate deterioration in the merchandise trade balance of $65 billion (or 3.4 per cent of GDP).

54. Pertinently, the increase in the value of net imports of oil and gold in this two year period was $57 billion. This was much larger than the overall deterioration in the CAD of $42 billion.

55. Despite sluggish external markets for IT related services (ITES) and the higher level of servicing foreign debt and equity, the overall increase in net invisible earnings to an extent cushioned the adverse impact of increase in net oil and gold imports on the CAD in both 2011-12 and 2012-13. IT-related service exports plus private remittances expanded by 8 per cent in 2010-11 and by 20 per cent in 2011-12. Though the pace of expansion slowed to 2 per cent in 2012-13, the increment of $31 billion over three years helped compensate for the some of the adverse movement on the merchandise trade front.

56. In 2012-13 the value of merchandise exports was $300.6 billion as per the trade statistics, which on Balance of Payments (BoP) basis came to $306.6 billion. The value of merchandise imports as per trade statistics was $491.5 billion and on BoP basis was $502.2 billion.

57. The Balance of Payments, actual position up to 2012-13 and that projected for 2013-14 is presented at Table 1.2.

58. Export (dollar value) growth in the first four months (April to July) of 2013-14 was 1 per cent, with the entire improvement being in July which saw exports rise by 11.8 per cent. It is not certain that the relatively strong growth in exports experienced in July will be repeated in coming months. Global demand is still weak. Under these circumstances, we are projecting a trade basis export figure for 2013-14 of $307 billion (growth of 2.2 per cent), which on BoP basis will be about $310 billion. It could turn out to be better. Likewise the trade basis import figure is projected at $488 billion which on BoP basis would be $495 billion. That would leave a BoP merchandise trade deficit of $185 billion, lower than the $196 billion of 2012-13 and slightly less than the level in 2011-12.

59. Export growth in ITES-related services and in private remittances combined has been taken at 8 per cent, higher than the 2 per cent of last year, but much lower than the 20 per cent recorded in 2011-12. The projected growth of ITES exports of 13.6 per cent corresponds to the estimates made by NASSCOM, the industry body for the current fiscal year. On remittances, the projection is a low growth of 2.6 per cent. This at one level may be an underestimate since a part of the overseas earnings of ITES companies that involve personnel normally resident in India are reported under remittances. However, the current unsettled conditions may also result in lower remittances of the traditional type from Indians working in the Middle East, North America and Europe. The depreciation of the rupee may however have a favourable effect.

60. The projections made in Table 1.2, represents what might happen if a part, even if not all, of the interventions to contain the CAD and enhance capital inflows do materialize. That gives us a CAD of $70 billion or 3.8 per cent of expected GDP in 2013-14. However, if (a) exports do a bit better and (b) if more of the initiatives to contain imports of gold and oil and increase exports of iron ore were to materialize, some more improvement in the CAD can be expected.

61. Success in restraining the CAD to $70 billion or lower for the full year 2013-14, even considering that five months of the year has already elapsed would greatly ease the task of financing the CAD.

Table 1.2

Balance of Payments

Unit: US$ billion or % GDP where % indicated

	2009-10	2010-11 PR	2011-12 PR	2012-13 P	2013-14 Proj.
Merchandise Exports	182.4	256.2	309.8	306.6	309.7
Merchandise Imports	300.6	383.5	499.5	502.2	494.7
of which: Oil	87.1	106.0	155.0	169.3	180.0
Gold & Silver	29.8	42.6	61.6	55.8	40.0
of which: Gold only	28.8	40.7	56.5	53.8	38.0
Merchandise Trade Balance	-118.2	-127.3	-189.8	-195.7	-185.0
	-8.6%	*-7.6%*	*-10.2%*	*-10.6%*	*-10.1%*
Net Invisibles	80.0	79.3	111.6	107.5	115.0
	5.8%	*4.9%*	*6.0%*	*5.8%*	*6.3%*
o/w Software & BPO	41.5	49.6	60.1	61.6	70.0
Private Remittances	53.6	53.1	63.5	64.3	66.0
Investment Income	-7.2	-16.4	-16.5	-22.4	-24.0
Current Account Balance	**-38.2**	**-48.1**	**-78.2**	**-88.2**	**-70.0**
	-2.8%	*-2.8%*	*-4.2%*	*-4.8%*	*-3.8%*
Foreign Investment	50.4	38.0	39.2	46.7	24.4
o/w FDI (net)	18.0	11.8	22.1	19.8	21.7
Inbound FDI	33.1	29.0	33.0	27.0	27.6
Outbound FDI	15.1	17.2	10.9	7.1	5.9
Portfolio capital	32.4	30.3	17.2	26.9	2.7
Loans	12.4	29.1	19.3	31.1	22.0
of which: ECB	2.0	11.9	10.3	8.5	7.5
Banking capital	2.1	5.0	16.2	16.6	18.0
Other capital	-13.2	-12.4	-6.9	-5.0	-3.0
Capital Account Balance	**51.6**	**63.7**	**67.8**	**89.4**	**61.4**
	3.9%	*3.7%*	*3.6%*	*4.9%*	*3.4%*
Errors & Omissions	-0.0	-2.6	-2.4	2.7	0.0
Accretion to Reserves	13.4	13.1	-12.8	3.8	-8.6

Note : The projections for 2013-14 factor in a certain level of success in both containing the CAD and also in efforts to secure additional capital inflows.

62. On the Capital Account side, India received $89 billion of inflows in 2012-13, the second highest level to date. However, in the current year, getting capital inflow is much harder and a significantly smaller level will also be a challenge.

63. Government has embarked on a wide ranging array of reforms. Many of them are targeted at easing the inflow of Foreign Direct Investment (FDI) that had been discouraged by the pace of movement in policy and also of legislation. However, the overall environment is not the most conducive to FDI inflows, but partial materialization will still be an improvement. On this basis, we are projecting FDI inflows of $28 billion, marginally more than that in 2012-13, but much less than the $33 billion achieved in 2011-12. FDI outflows remain subdued compared to 2010-11 and 2011-12 and may be a little lower than even that in the previous fiscal. Projected FDI outflows (which includes reinvestment of profits of Indian owned overseas entities) of $5.9 billion would leave net FDI of $22 billion, comparable to the previous two years.

64. With the policy changes that have been made and the low external value of the Indian currency, we believe that actively courting large prospective investors can result in larger FDI inflows – which is partly considered in the projections made at Table 1.2. Actively courting FDI and other investors will have to be a part of the agenda for this fiscal, given the extent of negative perceptions surrounding the EM region and India.

65. Portfolio capital inflows which were positive in the first two months of 2013-14, turned negative in June and continued on this trajectory even as of August. Even if things settle down and stabilize in September portfolio flows are likely to be negative in the second quarter. With further improvement, net inflows may be expected to resume in the third and fourth quarters of the year, but any reasonable expectation can at most be modest. Total net portfolio capital inflows for the full year are placed at $2.7 billion, a tenth of that recorded in the previous year.

66. With maturities coming up in previously issued ECB's and conditions difficult for issuance, the net inflow on ECB has been modest at $8.5 billion in 2012-13 and is projected to be slightly below this level in 2013-14.

67. Banking transactions and NRI deposit issuance is placed at $18 billion in 2013-14 which is marginally higher than it was in 2012-13 ($16.6 billion) and in 2011-12 ($16.2 billion). The main source of net inflows is deposits made by Non Resident Indians (NRI).

68. It is possible to conceive of additional issuance of bonds by PSUs engaged in the infrastructure business in favourable geographies. A step up in mobilizing NRI deposits under a special scheme is also possible.

69. There is an appetite for stocks presently lodged in SUUTI (Specified Undertaking of Unit Trust of India). Part of this is for the moment not being considered for sale. But a part could be put up for sale. In addition further divestment of PSU stock can be considered.

70. Total net capital inflows in 2013-14 are placed at $61 billion, which would entail a draw down of reserves to the extent of nearly $9 billion.

71. However, additional focused steps to increase net capital inflows can result in up to $10 to 15 billion more inflows during the year, ramping it up to over $75 billion, which in combination with a restrained CAD would enable some reserve rebuilding.

72. The point here is that in this context it is vitally necessary to both compress the CAD through active intervention and to seek higher capital inflows at the same time. The latter cannot happen without the first, and success in the first will facilitate the latter. Getting more capital inflows is in many ways a consolidation of the CAD compression exercise since it will complete the cycle and restore faith in the perception that India holds for investors – both foreign and domestic.

Measures Suggested to Improve Economic Conditions

73. A number of growth friendly measures have already been taken over the last year, particularly in this calendar year, such as liberalizing FDI investment norms, resolution of some tax issues of concern to industry, fast tracking of public sector investment, starting construction on the dedicated freight corridor, fuel subsidy reform, and improving the investment policy regime across a number of sectors like sugar, urea, gas, roads, banking, etcetera. A Cabinet Committee on Investments (CCI) has been set up to expedite project implementation and fast track various key projects involving investment of Rs. 1,000 crore or more. The CCI has so far been successful in de-bottlenecking 209 stalled projects with an aggregate investment of Rs. 384,203 crore. The impact of these measures should be felt during the second half of the current financial year.

74. The focussed attention that is being given to achieving the production and capacity creation targets in coal, power, road and railways should generate higher growth. In

effect, the public sector would act as the driver of growth and crowd in private sector activities.

75. Action has also been taken to streamline the mechanism for timely resolution and restructuring of the non-performing loans (NPL) of banks that have been rising since 2007-08. This is critical for keeping economic activity robust and sustainable over the long-run. The recent enactment of the Companies Act 2013 would enable more empowered and effective resolution structures in the form of new tribunals, namely the National Company Law Tribunal (NCLT) and the National Company Law Appellate Tribunal (NCLAT). These, together with the increase of the FDI limit in Asset Reconstruction Companies from 49 to 74 per cent, would pave the way for reducing the time taken to resolve and restructure bank Non Performing Assets (NPA).

76. With all these measures it should be possible to increase growth relatively quickly even at the current rate of investment. According to the latest data available, even in 2012-13 the Gross Fixed Capital Formation rate was nearly 30 per cent of GDP. Under normal circumstances, keeping in view recent ICOR trends, this should have given us a growth rate of 7.0 to 7.5 per cent but the actual rate turned out to be just 5.0 per cent. This may be because projects have not been completed in time or complementary investments have not been forthcoming. In some cases, this could also be due to non-availability of critical inputs such as coal and power. Special attention also needs to be given to timely environmental and other clearances, so that projects are not held up. The high level of investment rate offers hope that if we take actions to speedily complete on-going projects, we can get higher growth rate even in the shorter run.

77. Over the medium to long-term, more initiatives are required to boost private confidence, both domestic and external, and revive animal spirits to kick-start a new cycle of investment. Government has received several suggestions from various industry associations that underscore the importance of reviving investments and industrial growth.

78. These measures include a role for government consumption and investment as important tools for encouraging value addition in the domestic manufacturing sector by crowding in private investment through its procurement policies and using the surplus cash balances with PSUs to make fresh investments. This would help in kick-starting investments from the private sector.

79. This however means creation of fiscal space for public investment. As pointed out in earlier sections, mid-term corrective measures were taken in the last fiscal to keep the deficit more or less within budgeted limits. Keeping within the budgeted fiscal deficit during the current year would be more challenging. It is therefore important that government consumption expenditure, in particular subsidies, is recalibrated downwards to adjust to the decline in revenue receipts so that fiscal targets are met. New initiatives in the pipelines that could further add to the subsidy burden should at the very least be put on hold till the state of public finances is brought back to a sustainable level.

80. The large magnitude of subsidies has created serious macroeconomic distortions with economy-wide ramifications on investment and growth. It is therefore imperative that subsidies are transparent, well targeted and designed for effective implementation, and are within prudent fiscal limits. Only such short-term expenditure reform can create the fiscal space to ensure that growth enhancing public expenditure is not compressed and crowded out from the government budget at a time of falling economic growth. In short, fiscal consolidation needs to be growth friendly.

81. India needs to improve manufacturing capabilities in order to achieve its goal of faster growth in employment. Although globally manufacturing is moving towards a system of global production chains that is increasing the imported content of manufacturing, large economies nevertheless need to improve domestic supply chains and increase value addition while remaining globally competitive to reduce external vulnerabilities. In India this is particularly required in the electronics industry, where value addition remains less than 10 per cent. Tax issues specific to this sector need to be addressed.

82. A rapidly growing low income developing country like India needs to have an assured supply of appropriately skilled labour as low skilled agricultural and self-employed workers move into modern industries. The associated productivity gains accelerate poverty reduction and increase the trend rate of economic growth. Government policies must actively facilitate this productivity shift, as it has indeed been doing.

83. The Central Board of Direct Taxes (CBDT) has announced guidelines for Skill Development Companies approving Skill Development under section 35CCD. This is however limited to only those companies with training institutions affiliated to NCVT

(National Council for Vocational Training) /SCVT (State Council for Vocational Training) under Ministry of Labour and Employment and the respective State Government. For larger participation of the private sector the provision could be extended to those training institutions which are affiliated to the NSDC and the Sector Skill Council also.

84. Industry associations and investors have repeatedly underscored the urgent need for improving the ease of doing business by streamlining procedures, making tax policies more predictable and putting in place a transparent dispute resolution mechanism for both direct and indirect taxes. When bold fresh policy decisions are taken, it is important that details are fleshed out before they are announced. Investors should not be surprised later through fine print. The rules and regulations that follow policy initiatives should be finalized through widespread consultations with key stakeholders to ensure that expected outcomes are forthcoming.

85. In the recent period, environmental and land acquisition concerns have come to forefront. Setting up of every power plant and large project is faced with enormous difficulties on these counts. Over the medium term, these issues need to be resolved quickly for investment in new projects. There is a compelling need for a suitable compromise between compulsions of growth and concerns for the environment. A strong inter-ministerial mechanism needs to be worked out to address the issue. The Cabinet Committee on Investment could, in addition to monitoring implementation and fast tracking large projects, review the rules and procedures followed by Ministries to grant or refuse clearances. Faster procedures used for specific projects should be universalised and not remain limited to a few projects, as review of procedures falls within the mandate of the CCI. Since these problems are of a local nature, active involvement of concerned chief ministers in the process could be considered.

86. Foreign investment plays a critical role in supplementing domestic savings to enhance growth. It is also critical for financing the current account deficit on a sustainable basis. There is no reason why foreign investors should not find India an attractive destination over the medium to long-term in view of India's growth potential. There was a large net outflow of foreign portfolio capital from India, as from other emerging markets, in June 2013 following the first indications given by the US Federal Reserve regarding a shift in its monetary stance. The outflows continued in July, but on a much reduced basis, and net outflows in August have been much lower still.

87. While to a great extent foreign investors respond to the same set of policy initiatives as domestic investors, they need the additional confidence that short-term

macro-economic management does not reverse the overall trend in the calibrated opening up of the economy. It is therefore important that there is no 'policy overshoot' that aggravates the very problem sought to be addressed in response to the fall in the value of the rupee, as currency corrections are known to overshoot over the short-term. It is important to keep in mind that both inflation and the current account deficit have moderated over the near term, and this should help stabilize the rupee.

88. Transfer pricing is one of the most contentious tax issues and directly relevant to foreign investment, with 70 per cent of the world's transfer pricing litigation emanating from India. These include domestic transfer pricing, share valuation, valuation of intangibles, interest on inter-company loans and guarantee fees, multiple year data etc. It is crucial that the issue is addressed for encouraging investments. Removal of tax uncertainty is critical for investment, both domestic and foreign.

89. The weakening of the Indian Rupee is a development which has hurt confidence, but it can also have a positive impact on the CAD. Ceteris paribus, it makes Indian exports, both manufacturing and services, that have a low import content and large component of domestic value addition, more competitive. It also pressures importers to turn to domestic sources of supply where these are available, thereby adding to domestic demand, and leads to a reduction in price sensitive imports. A significant component of our import basket, especially oil, is however relatively price-insensitive and therefore inelastic on account of regulated prices. Greater pass through of international oil prices can make these imports more price elastic.

90. A focussed strategy for manufacturing exports needs to be quickly finalised to improve competitiveness. Simplified procedures, easy availability of export finance and reducing transaction costs have all been widely discussed and suggestions made by various bodies. These measures need to be implemented without further delay. E-commerce provides enhanced coverage of regions as the supplier is visible the world over. Retail exports through E-commerce could be given the same benefits of normal exports with minimal checks. Further, exports should be exempted from Service Tax, as the present pay and claim refund increases transaction costs, time and unpredictability. Software exports could be accelerated by easing domestic movement of people between STPs and SEZs and making inward visas easier and taking up the case for easier access to US visas for Indian IT firms.

91. Industry associations have underscored the need for reducing interest rates. With wholesale price inflation coming down to manageable levels, and non-food inflation at below 3 per cent, it should have been possible to ease monetary policy to revive industrial growth, even though consumer price inflation remained above the acceptable threshold. However the big current account deficit and the tightening of US monetary policy has put fresh pressure on the rupee, thereby restricting the policy space available. It should however be possible to have a more accommodative monetary policy once the pressure on the rupee eases.

92. Alongside boosting investment, it is also necessary to arrest and reverse the recent trend in decline in the savings rate, and in particular household financial savings. This will also help in reducing the current account deficit, which is the excess of domestic investment over domestic savings. Both monetary and fiscal policies have a role to play in this regard. Income tax exemption for investments in long term financial assets is currently capped at Rs 1 lakh per annum. A substantial increase to, say Rs 5 lakh per annum, for long term investments of 5 years, could be contemplated.

93. It is an accepted fact that investment in gold is made by households as a hedge for inflation. Already various measures including hike in custom duties have been put in place to contain import of gold. Measures to curb gold imports need to be supplemented with deposit rates that give a reasonable return in real terms as otherwise these measures risk spilling the demand for gold into illicit channels. Proactive and speedy implementation of the Modified Gold Deposit Scheme by identified banks over a wider range of branches would help mobilize privately held gold stocks and direct them into the hands of financial institutions which could utilize the gold thus mobilized at least in part to sell gold to meet the demand of users, thereby reducing gold imports. Households would also benefit from the unnecessary hazard of keeping gold at their homes. Issuance of reliable, easily accessible inflation adjusted financial instruments could also counter the demand for gold and increase the role of financial assets in the deployment of household savings. Since a good part of gold demand emanates from rural India, inflation indexed small saving instruments distributed through post offices in the country could be considered.

Sector Specific Recommendations

Agriculture Sector

94. The Council's recommendations on promoting High Value Agriculture are contained in Appendix I. Agricultural marketing policies also need to be streamlined to make the functioning of the market more efficient. State Agricultural Produce Marketing Committee (APMC) Acts have had the unintended effect of disincentivising private investment in market infrastructure and preventing development of competing markets and marketing channels. The process of ensuring greater efficiency in agricultural markets can be catalysed and facilitated through appropriate state reforms and central policies to aid development of competing, well-regulated private market operations.

95. To this end, states may provide for state-wide licensing, setting up of private agriculture produce markets through a simple registration procedure, lower levies on agricultural commodities to encourage private buyers in commodities for which government procures, support farmer producer organisations through amendments to the state APMC Acts and in other ways, and provide for registered contract farming with safeguards to secure farmer interests.

96. In addition, government may consider dispensing with movement and stock limit restrictions under the *Essential Commodities Act* for private buyers buying at the Minimum Support Price (MSP). To promote warehouse-based selling, strengthening of warehouse infrastructure for integrating with the agricultural marketing network, coupled with priority sector lending for accredited warehouses, is recommended. Agriculture trade policy must liberalise both export and import restrictions, do away with quantitative restrictions, and move towards a low, stable, tariff-based structure. However, trade policy in food grains may be dealt with in a more cautious manner.

Developing Bond Markets

97. A deep and well-functioning bond market is necessary to build depth in the financial system and to help the private sector in easing financial constraints both in terms of costs as well as access. It is of particular relevance in respect of longer dated bonds for funding infrastructure assets. The lack of liquidity and transparency are among

the reasons for investor non-participation in corporate bond market including retail investors. The role of Credit Rating Agencies and the efficiency of intermediation in the process of market-making are also important. To strengthen development of the bond market, placement by commercial banks as also corporate entities through Qualified Institutional Placement (QIP) should be encouraged. The public issuance of bonds by corporate entities in 2012-13 was only Rs 17,000 crore half of that issued in 2011-12. However, in 2012-13 total issuance under "private placement"/QIP route followed by listing on the exchange amounted to Rs 361,000 crore (previous year Rs 261,000 crore). However, these securities are mostly short dated with tenors rarely exceeding two to three years. Part of the problem is that the futures market in government securities has not taken off impeding active trading in longer dated securities – a problem which surely can be resolved.

Public-Private Partnerships in Defence Procurement

98. Defence acquisitions of capital equipment in India are of the order of Rs. 80,000 crore per annum. In addition, procurement of ammunition and high-tech consumables (revenue procurement) accounts for another Rs. 40,000 crore per annum. Thus, the total business opportunity is sizeable and if even a fraction of this activity is directed at Indian manufacturing, it will have a significant impact on growth and employment. The Defence Production Policy 2011 provides that preference will be given to indigenous design, development and manufacture of defence equipment and commits the Government to pro-actively encourage larger involvement of the Indian private sector in design, development and manufacture of defence equipment. For this, the Policy commits the Government to undertake all viable approaches such as public-private partnerships. However, Defence Procurement Procedure does not contain any preferences for domestic manufacturing and procurement from indigenous sources.

99. The ongoing reform of Defence Procurement Procedures needs to address this gap and provide a mechanism for prioritising Indian suppliers and system integrators. Further, while the Ministry has a Long Term Integrated Perspective Plan for procurement, it has no corresponding plan for defence manufacturing and R&D. If joint working groups involving important stakeholders including Indian industry and R&D establishments are set up to convert the Long Term Integrated Perspective Plan into a defence manufacturing and R&D plan, Indian industry and R&D establishments would be in readiness at the time of procurement.

Promoting MSMEs

100. Micro, Small and Medium Enterprises (MSMEs) are acknowledged globally as the prime movers of growth and employment. The Committee on Angel Investment and Early Stage Venture Capital (2012), set up by the Planning Commission, has estimated the potential for creation of 2,500 successful Indian high-growth ventures by 2022, generating revenues of Rs. 10 lakh crore (US$ 200 billion) and generating 140 million new jobs over the decade. Small businesses have lesser resources and entrepreneurial energies to meet regulatory compliance requirements. The costs of such compliance may render the business unviable and also tilt the playing field in favour of larger enterprises. Currently, the regulatory regime for the entire organised sector is uniform.

101. There is an economic case to subject MSMEs to less onerous regulatory requirements. For example, MSMEs could be allowed approvals, clearances etc. on self-assessment basis as the default mode. They could also be exempted from the requirement to annually obtain consent to run, even when for a green industry. Another area for such two-tier regulation could be in respect of various labour laws for notification of vacancies, filing of returns, etc.

102. Once an 'in-principle' view is taken in this regard, an inter-departmental task force involving experts as well could identify specific areas for such two-tier regulation, whereupon suitable overriding legislative provisions could be instituted through appropriate amendments to the MSME Act. If the threshold for minimum investments in new plant and machinery to qualify for the investment allowance announced in last year's budget is reduced from Rs.100 crore to Rs.10 crore this would benefit MSMEs. SIDBI could also offer a repo window to market-makers dealing with SME bonds to give them greater access to financial markets.

Strategic Interventions in the Energy Sector

103. India has a large and growing structural energy deficit fuelled by rising population, economic growth and urbanization that constrains growth, competitiveness and the management of the external sector. The report of the Committee on the Production Sharing Contract Mechanism in Petroleum Industry has recommended a pricing policy for natural gas, which will remove uncertainties regarding pricing and attract investment for exploration and production of natural gas in India.

104. The Committee also recommended a new production sharing formula to attract more investment in, and thereby increase domestic production of, oil and gas. The government has approved the adoption of the gas pricing formula recommended by the Committee with effect from 1 April 2014. This would go a long way in boosting long-term gas supply. An early decision needs to be taken on the production sharing regime to improve the overall investment climate.

105 For augmenting coal production, devising a PPP policy framework with Coal India Limited as one of the partners, currently under active consideration, needs to be expedited. The responsibility of fulfilling the coal supply in the country primarily rests with Coal India Limited. In order to meet the growing demand for coal as well as to reduce import of coal and reduce the current account deficit CIL needs to raise its production in its existing mines in the short run. Development of new coal blocks is beset with problems of land acquisition, rehabilitation issues, environmental and forestry clearances etc. as well as addressing the coal evacuation problems. Early development of these blocks will go along way in meeting the demand-supply gap.

II – INTERNATIONAL ECONOMIC AND FINANCIAL CONDITIONS

Emerging World Suffers Reversal in Perceptions

106. A persistent development of the first decade of the twenty first century was an asymmetric improvement in the perception of the emerging markets (EM) world. In the two decades before 2000 the big improvements in South East Asia and in Mainland China had nurtured ideas of the "Asian Miracle". But the Asian Currency Crisis of 1997-98 largely washed it away. However, the events of the next decade put the EM story back in front and centre. The share of world output, trade and investment moved visibly towards the EM and in particular towards developing Asia. The most evocative symbolism of the change in perceptions was the idea of "BRIC" – Brazil, Russia, India and China – articulated by Jim O'Neill in 2001, Chief Economist of Goldman Sachs at London. The manner in which events moved in the years ahead gave substance and greatly embellished the perceptiveness of the idea. The world was convinced – both the interlocutors in the developed West as well as the objects of the concept in the EM world.

107. The Global Crisis of 2008 threatened to set back the global economy by many years. The developed world, especially the USA and West Europe were sucked into the Crisis. The EM world mostly escaped unscathed. This polished the narrative even more and dangerously. Many in the EM world grew convinced of the inevitability of this particular course of development, where nothing stood in the way of the forward march of EM economies and the diminishing role of the developed West.

108. Inevitability is alien to the course of human achievement and over confidence is always fraught with danger. After the *Asian Currency Crisis*, developing economies learnt many valuable lessons of the value of prudence in macroeconomic management and the desirability of a degree of self-insurance – building foreign currency reserves being one of them.

109. In the post-Crisis world, even as the EM world came out strong from the stresses of the global crisis, they became vulnerable to several kinds of dislocation.

110. The short term fiscal expansion that was needed to cushion the shock of the 2008 Crisis became a longer drawn out business, especially in those economies which had a natural proclivity to an expansive fiscal stance – India being one of them. Other

EM countries who did not restrict their fiscal opening to 2009 included South Africa and several oil exporting countries, in both Middle East and Latin America. To a lesser extent Brazil, Argentina, Mexico in Latin America and Malaysia & Vietnam in Asia also did not switch back to their pre-Crisis fiscal trajectory after 2009.

111. After briefly dampening down in 2009, inflation rebounded in several EM countries, especially in those who were historically more prone to higher inflation – a group that includes India. Brazil saw inflation move up between 2009 and 2012 – notwithstanding the sharp appreciation of the currency in this period. Some others, including Vietnam, Egypt, Turkey and Venezuela also saw an increase in the pace of inflation. Even in China where the turbo-charged supply machine has kept inflation under wraps, there was a pick up to 5.4 per cent in 2011. The sharp rise in world prices of commodities, particularly oil, undoubtedly assisted in causing this spurt, but that the effects were not uniform across EM countries underscores the idiosyncratic nature of inflation in emerging market economies.

112. Trade deficits also mounted in several EM countries, hit simultaneously by weak export markets and rising prices of imported energy. The Current Account Deficits (CAD) of most EM countries worsened after 2009. For 30 major EM economies excluding oil exporters, the median value of the CAD as a proportion of GDP rose from (–) 0.2 per cent in the period 2000 to 2007 to (–) 2.2 per cent for the period 2009 to 2013. Some of the current account surplus countries in the group saw the extent of their surpluses decline – for instance Russia, Argentina and to a lesser extent China. In several EM countries the increase in the CAD in recent years was significant.

113. Rapid rate of economic growth is the great elixir which cures imbalances. As long as growth was strong, markets tended to overlook some of the growing problems in the EM world – though not without unease.

114. Since late 2009 the Greece imbroglio, followed with by difficulties in Portugal, Spain and Italy and the general conniptions of the Eurozone occupied observers and the markets. The fear through 2010 and 2011 was a shock coming out of the Eurozone and the developing problems of the EM world stayed in the background.

115. In 2012, while the Eurozone problem remained, the prospect of a crisis coming out of it more-or-less receded. The sharp improvement in the US economy came to dominate considerations. The fact that the Eurozone had held out without going into convulsions calmed attitudes. Even more so the seemingly well-managed resolution of several individual country problems helped restore confidence. Finally, the worst effected countries were beginning to show some results indicating recovery.

116. Thus, the current account balance of the most affected Eurozone countries has showed considerable improvements (see Tables 2.2 & 2.3). By 2012, Italy, Portugal and Spain had reduced their respective CAD to 1.5 per cent of GDP and less, while Greece had been able to cut it down to 2.9 per cent of GDP. In 2013, Italy, Portugal and Spain are all projected to have small current account surpluses, while the deficit for Greece is projected to be reduced to a mere 0.3 per cent of GDP. In absolute terms the current account balance for these four countries would have dropped from a *deficit* of $189 billion in 2010 to one of $36 billion in 2012 to a *surplus* of $21 billion in 2013.

117. The fiscal imbalance also seems to be on the path to cure. The fiscal deficit (see Table 2.4) of Italy is down from 5.4 per cent in 2009 to 3.0 per cent in 2012. That of Greece is down from 15.6 per cent of GDP in 2009 to 6.4 per cent in 2012 and is projected to be 4.6 per cent in 2013. For Portugal it is down from 10.2 per cent in 2009 to 4.9 per cent in 2012 and that for Spain from 11.2 per cent in 2009 to 6 per cent in 2012 and is projected to be 5.7 per cent in 2013.

118. It is not a case of being entirely out of the woods, but significant evidence of a palpably painful mend. It has been achieved by a combination of demand destruction, enormous fiscal squeeze, economic reforms and considerable hardship. It is not surprising in forming perceptions, the continued recessionary conditions in the Eurozone, have been greatly offset by the forward movement on the ground.

119. In this backdrop the troubles in the EM world became sharply contrasted and magnified, acquiring ominous overtones of mean reversal to the past. It is now hard to entertain the notion or presumption that EM economies would lead the global recovery in the post-Crisis period.

120. With growth coming off in the EM economies in the latter half of 2011 and weakening further in 2012, all of the woes recounted earlier came to the forefront. As may be seen from Table 2.1, EM economies as a class saw growth drop from 7.5 per cent in 2010 to 6.2 per cent in 2011 to 4.9 per cent in 2012. Growth in Latin America slowed very sharply and that in developing Asia was also down significantly. The worst part of it was the problems that were facing the EM world were different and specific to the countries concerned. This makes expectations of a simple resolution as had transpired during the 2008 Crisis, unrealistic.

Table 2.1
Economic Growth and Projections made by the IMF

Regions / Countries	2009	2010	2011	2012	2013	2014
World Output (at market exchange rates)	**–2.2**	**4.2**	**2.9**	**2.4**	**2.4**	**3.2**
World Output (at PPP exchange rates)	**–0.6**	**5.3**	**3.9**	**3.1**	**3.1**	**3.8**
Advanced Economies	**–3.6**	**3.2**	**1.7**	**1.2**	**1.2**	**2.1**
U.S.A.	–3.1 (–2.8)	2.4 (2.5)	1.8	2.2 (2.8)	1.7	2.7
Eurozone	–4.3	1.9	1.5	–0.6	–0.6	0.9
Germany	–5.1	3.6	3.1	0.9	0.3	1.3
France	–2.6	1.7	2.0	0.0	–0.2	0.8
Italy	–5.2	1.8	0.4	–2.4	–1.8	0.7
Spain	–3.7	–0.1	0.4	–1.4	–1.6	0.0
Netherlands	3.5	1.6	1.0	–0.9	–0.5	1.1
Japan	–5.5	4.4	–0.6	1.9	2.0	1.2
U.K.	–4.9	2.1	1.0	0.3	0.9	1.5
Canada	–2.5	3.2	2.5	1.7	1.7	2.2
Australia	1.4	2.6	2.4	3.6	3.0	3.2
Korea, South	0.3	6.3	3.6	2.0	2.8	3.1
Taiwan	–1.8	10.8	4.1	1.3	3.0	3.1
Singapore	–1.0	14.8	5.2	1.3	2.0	5.1
Emerging & Developing Economies	**2.8**	**7.5**	**6.2**	**4.9**	**5.0**	**5.4**
Developing Asia	**7.1**	**9.7**	**7.8**	**6.5**	**6.9**	**7.0**
Latin America	**–1.6**	**6.2**	**4.6**	**3.0**	**3.0**	**3.4**
Sub-Saharan Africa	**2.7**	**5.3**	**5.4**	**4.9**	**5.1**	**5.9**
China	9.2	10.4	9.3	7.8	7.8	7.7
India	6.6	10.8	6.3	3.2†	5.6	6.3
ASEAN 5	1.7	7.0	4.5	6.1	5.6	5.7
Brazil	–0.3	7.5	2.7	0.9	2.5	3.2
Russia	–7.8	4.3	4.3	3.4	2.5	3.3
South Africa	–1.5	2.9	3.5	2.5	2.0	2.9
Turkey	–4.8	9.2	8.5	2.6	3.4	3.7

Note: † For calendar year 2012 at constant market prices as also for all other years. At constant prices and factor cost, GDP growth in calendar 2012 was 5.1 per cent.
ASEAN 5 are Indonesia, Thailand, Philippines, Malaysia and Vietnam. For all countries the reference period is calendar year, not fiscal year
US growth for 2012 in parentheses latest release by US Census Bureau end July 2013

Source: Update to World Economic Outlook, IMF, July 2013 and WEO Database April 2013

121. The expectations of improvement in economic and financial conditions, particularly in the US naturally began to shape anticipation of a change in the US Federal Reserve's stance on the extraordinary monetary easing that it has conducted, which saw 10 year bond yield brought down from 3.75 per cent in early 2011 to less than 1.5 per cent in the summer of 2012, achieved by large purchase of dated securities. The issue therefore is the prospect of a reversal of this suppression of long term bond yields, much before short term rates rise, brought by the real or expected reduction in bond purchase – called the "taper". In anticipation of this the 10 year bond yield has risen to over 2.50 per cent in the summer of 2013 and has crossed the 2.80 per cent level recently.

122. Starting in 2012, EM assets started being re-priced downwards and the process had acquired considerable momentum by March 2013, when the fears flowing from the expected "taper" and other factors began to work in concert, a process that got into full gear with the FOMC monetary policy statement on 19 June 2013, which many interpreted as the beginning of the end of the "taper".

123. EM currencies have taken a hammering in 2013, especially since June. Most impacted were those which were seen to have greater problems – mostly growth and trade balance related. That currencies of countries which had current account surpluses also got hit (such as Malaysia) speaks to the contagion that has come to envelope EM as a class.

124. Japan has emerged as a potential new source of liquidity, as also the current account surplus Eurozone in a context where liquidity withdrawal is underway in the US. How that picture will shape up in the months and years ahead is hard to predict.

125. A summary of the IMF's growth projections for major regions/countries is at Table 2.1. Given the discussion about rebalancing (namely, lowering of both the current account surpluses as well as deficits), the IMF projections for the current account balance is placed at Table 2.2 (absolute levels) and Table 2.3 (percentage of GDP). The projections for India are based on the estimates of the Council for the calendar years 2012 and 2013. The fiscal picture is summarized at Table 2.4.

Table 2.2
Current Account Balance in US dollars Billion
Actual & Projections by IMF

	2008	2009	2010	2011	2012	2013	2014
Advanced Economies							
U.S.A.	**–677**	**–382**	**–442**	**–466**	**–475**	**–474**	**–517**
Eurozone	**–97**	**31**	**64**	**78**	**221**	**295**	**303**
Germany	226	197	207	224	238	219	208
France	–50	–35	–40	–54	–63	–35	–39
Italy	–66	–42	–73	–67	–11	7	5
Spain	–154	–70	–62	–55	–14	15	30
Netherlands	38	41	60	82	65	70	74
Japan	**160**	**147**	**204**	**119**	**59**	**63**	**98**
U.K.	–27	–28	–58	–33	–42	–86	–106
Canada	2	–41	–58	–53	–67	–65	–65
Australia	–47	–42	–37	–34	–56	–88	–97
NIC – Asia	**89**	**127**	**144**	**145**	**150**	**140**	**142**
of which Korea, S.	3	33	29	26	43	35	32
Emerging & Developing Economies							
China	421	243	238	202	214	238	287
India	–31	–26	–52	–63	–92	–80	–70
ASEAN 5	35	67	47	47	15	12	8
Brazil	–28	–24	–47	–52	–54	–58	–85
Russia	104	50	70	98	81	56	39
South Africa	–20	–12	–10	–14	–24	–24	–25
Turkey	–42	–13	–45	–75	–47	–58	–64
OPEC countries	**433**	**87**	**234**	**466**	**462**	**402**	**347**
Major Oil Exporters	**663**	**217**	**393**	**680**	**658**	**560**	**480**

Note: The current account figures are IMF staff estimates and projections. For India the figures are based on RBI data for previous years and projections of the Council for calendar years.

1. NIC - Asia comprise of Korea, Taiwan, Singapore and Hong Kong
2. ASEAN 5 countries are Indonesia, Thailand, Philippines, Malaysia and Vietnam
3. OPEC members are Algeria, Angola, Ecuador, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, UAE and Venezuela
4. Major Oil (18) exporters taken above include the OPEC 12 and Bahrain, Brunei, Malaysia, Norway, Oman and Russia

Source: World Economic Outlook, IMF, April 2013 - publication & database

Table 2.3
Current Account Balance as percent of GDP
Actual & Projections by IMF

	2008	2009	2010	2011	2012	2013	2014
Advanced Economies							
U.S.A.	–4.7	–2.7	–3.0	–3.1	–3.0	–2.9	–3.0
Eurozone	–0.7	0.2	0.3	0.5	0.6	1.8	2.3
Germany	6.2	6.0	6.2	6.2	7.0	6.1	5.7
France	–1.7	–1.3	–1.6	–2.0	–2.4	–1.3	–1.4
Italy	–2.9	–2.0	–3.5	–3.1	–0.5	0.3	0.3
Spain	–9.6	–4.8	–4.5	–3.7	–1.1	1.1	2.2
Netherlands	4.3	5.2	7.7	9.7	8.3	8.7	9.0
Japan	3.3	2.9	3.7	2.0	1.0	1.2	1.9
U.K.	–1.0	–1.3	–2.5	–1.3	–3.5	–4.4	–4.3
Canada	0.1	–3.0	–3.6	–3.0	–3.7	–3.5	–3.4
Australia	–4.5	–4.2	–3.0	–2.3	–3.7	–5.5	–6.0
NIC – Asia[1]	5.1	7.9	7.5	6.9	6.9	6.0	5.8
of which Korea, South	0.3	3.9	2.9	2.3	3.7	2.7	2.4
Emerging & Developing Economies							
China	9.3	4.9	4.0	2.8	2.6	2.6	2.9
India	–2.4	–2.1	–3.2	–3.4	–5.1	–5.0	–4.6
ASEAN 5	2.7	5.3	3.0	2.6	0.8	0.6	0.4
Brazil	–1.7	–1.5	–2.2	–2.1	–2.3	–2.4	–3.2
Russia	6.2	4.1	4.6	5.2	4.0	2.5	1.6
South Africa	–7.2	–4.0	–2.8	–3.4	–6.3	–6.4	–6.5
Turkey	–5.7	–2.2	–6.2	–9.7	–5.9	–6.8	–7.3
OPEC countries	17.3	4.0	8.9	15.6	13.8	12.2	10.5
Major Oil Exporters	13.4	5.3	8.0	11.8	10.5	8.6	7.2

Note: The current account figures are IMF staff estimates and projections. For India the figures are based on RBI data for previous years and projections of the Council for calendar years.

1. NIC - Asia comprise of Korea, Taiwan, Singapore and Hong Kong
2. ASEAN 5 countries are Indonesia, Thailand, Philippines, Malaysia and Vietnam
3. OPEC members are Algeria, Angola, Ecuador, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, UAE and Venezuela
4. Major Oil (18) exporters taken above include the OPEC 12 and Bahrain, Brunei, Malaysia, Norway, Oman and Russia

Source: World Economic Outlook, IMF, April 2013 - publication & database

Table 2.4
General Government Net Lending/Borrowing or Fiscal Balance as a proportion of GDP
*Projections for 2013 and 2014 by IMF**

	2008	2009	2010	2011	2012	2013	2014
U.S.A.	**–6.7**	**–13.3**	**–11.1**	**–10.0**	**–8.5**	**–6.5**	**–5.4**
Eurozone	–2.1	–6.4	–6.2	–4.1	–3.6	–2.9	–2.6
Germany	–0.1	–3.1	–4.2	–0.8	0.2	–0.3	–0.1
France	–3.3	–7.6	–7.1	–5.2	–4.6	–3.7	–3.5
Italy	–2.7	–5.4	–4.3	–3.7	–3.0	–2.6	–2.3
Spain	–4.2	–11.2	–9.3	–8.5	–6.0	–5.7	–5.7
Netherlands	0.4	–5.6	–5.1	–5.0	–4.5	–4.9	–4.9
Greece	–9.9	–15.6	–10.7	–9.4	–6.4	–4.6	–3.4
Portugal	–3.7	–10.2	–9.8	–4.4	–4.9	–5.5	–4.0
Japan	–4.1	–10.4	–9.3	–9.9	–10.2	–9.8	–7.0
U.K.	–5.1	–11.4	–10.1	–7.9	–8.3	–7.0	–6.4
Canada	–0.3	–4.8	–5.2	–4.0	–3.2	–2.8	–2.3
Australia	–0.8	–4.1	–4.7	–4.2	–2.9	–1.1	–0.2
China	–0.7	–3.1	–1.5	–1.3	–2.2	–2.1	–1.8
India	–8.5	–10.1	–8.7	–8.4	–8.3	–8.3	–8.4
Brazil	–1.4	–3.1	–2.7	–2.5	–2.8	–1.2	–1.7
Russia	4.9	–6.3	–3.4	1.5	0.4	–0.3	–1.0
South Africa	–0.4	–5.5	–5.1	–4.0	–4.8	–4.8	–4.2
Turkey	–2.3	–5.6	–2.3	–0.4	–1.5	–2.2	–2.3

Note: * Figures for 2013 and 2014 are estimates

Source: Fiscal Monitor database IMF, April 2013

III – STRUCTURAL FACTORS

126. In the Review of the Economy, released in April 2013, the Council had noted and discussed the issue as to how and why the rate of economic growth had slowed to an extent that was not consistent with the still high rates of domestic investment and savings. The investment rate and the gross domestic capital formation rate have both been around 35.0 per cent for the past two years, only slightly below the 36.5–37.0 per cent recorded in 2009-10 & 2010-11. The rate of fixed investment has also slipped by only 1 percentage point of GDP. A rate of capital formation of 35 per cent cannot be reconciled with a rate of economic growth of 5 or 6 per cent. The only explanation is that the assets that have been created for some reason have not been able to augment sufficiently the current output. That can of course happen in the absence of adequate demand, which was palpably not the case in this instance. Much of the investment has been in infrastructure and infrastructure services – power, roads, ports etc – are not languishing for lack of demand.

127. The Incremental Capital Output Ratio (ICOR) is a measure that allows us to see how incremental income has arisen from increments to capital stock in past periods. It also allows us to prospectively assess the resources required for defined or planned growth trajectories.

128. Capital stock, of course, is not the sole source of economic growth. However, in a supply constrained developing economy like ours, it has been, and continues to be, the major determinant of growth on account of the paucity of infrastructure and manufacturing capacities. The data for India over the past fifty years suggests that, on average, the value of ICOR has shown considerable stability, except in the seventies when it was elevated.

129. The analysis showed that in the past there were several years where the ICOR was elevated, but these till 1990 were years with harvest failures. In 1991, the driving factor was the balance of payments crisis, accentuated by an extended loose fiscal stance and price shocks from oil following on the invasion of Kuwait by Iraq.

130. On the question, of why did India perform so weakly in 2011-12 and 2012-13, the Council felt that it was a combination of weak external conditions, withdrawal of both fiscal and monetary stimuli starting 2010 which curbed growth somewhat, but most importantly "the principal source of the problem" was the "issue of clearances that have stalled projects and undermined conditions for investment". The Council had opined that the "only way to get the economy to move ahead to a higher growth trajectory by overcoming investment and implementation bottlenecks over the short term is to pursue reforms with energy and expedite clearances through the newly constituted Cabinet Committee on Investment".

131. Over the past six months the Cabinet Committee on Investment (CCI) has cleared a very large number of projects and significant progress has been made on that score. However, there is a lead time before the clearances result in actual economic activity on the ground. The expectation was that this would begin to materialize in the second half of 2013-14 and that this would result to a pick-up of economic growth in this period, setting the ground for a strong revival in the next fiscal year.

Investment and Savings Rates

132. The fixed investment rate fell to 29.6 per cent (prelim) in 2012-13 from 31.7 per cent in 2010-11, the peak value being 32.9 per cent in 2007-08. That is, a decline of about 3 percentage points of GDP since the pre-Crisis period. However, while that would have under any circumstances presaged a drop in the rate of growth of current output, it should have implied at most a 1.5 to 2.0 percentage point drop - not what has actually transpired. The overall investment rate stayed up higher at about 35 per cent, partly on account of the high level of investment in "valuables", i.e. gold.

133. Domestic savings fell faster from 36.8 per cent of GDP in 2007-08 to 30.8 per cent in 2011-12 and possibly a shade lower in 2012-13. The decline in the domestic savings rate of 6 percentage points of GDP between 2007-08 and 2011-12, came from a combination of a fall of 3.7 percentage points in public sector savings, which dropped from 5.0 to 1.3 per cent of GDP and a fall of 2.2 percentage points in private corporate savings (retained earnings) from 9.4 to 7.2 per cent of GDP.

Table 3.1

Broad Macroeconomic Parameters

	Investment Rate	Gross Dom Capital Formation	Gross Fixed Capital Formation	Dom Savings Rate	Final Consumption Rate		Current Account Balance	Gross Domestic Capital Formation (GDCF)		Gross Fixed Capital Formation (GFCF)		Final Consuption Expenditure		
					Pvt.	Govt		Total	Pvt. Corp.	Total	Pvt. Corp.	Private	Govt	Total
			Ratio to GDP at market prices					Growth rate at Constant Prices						
2000/01	24.3	24.2	22.7	23.7	64.0	12.6	–0.6	–4.0	–28.3	–0.0	–11.0	3.6	0.9	3.2
2001/02	22.8	24.2	23.6	23.5	64.5	12.4	0.6	3.8	8.6	7.4	3.6	5.7	2.3	5.2
2002/03	25.2	25.2	23.8	26.3	63.3	11.9	1.2	10.9	17.1	6.8	3.5	2.8	-0.4	2.3
2003/04	27.6	26.8	25.0	29.8	61.8	11.3	2.2	12.9	24.6	13.6	23.2	6.0	2.6	5.5
2004/05	32.8	32.5	28.7	32.4	59.1	10.9	–0.4	22.3	68.1	18.9	62.8	5.5	3.6	5.2
2005/06	34.7	34.3	30.3	33.5	58.3	10.9	–1.2	17.0	45.0	16.2	43.1	8.5	8.9	8.6
2006/07	35.7	35.9	31.3	34.6	57.7	10.3	–1.1	15.3	19.1	13.8	17.9	8.7	3.8	7.9
2007/08	38.1	38.0	32.9	36.8	57.0	10.3	–1.3	17.7	32.8	16.2	27.7	9.2	9.6	9.3
2008/09	34.3	35.5	32.3	32.0	57.7	10.9	–2.3	–2.5	–29.5	3.5	–21.9	7.2	10.4	7.7
2009/10	36.5	36.3	31.7	33.7	57.2	11.9	–2.8	10.9	19.0	7.7	9.3	7.4	13.9	8.4
2010/11	36.8	37.0	31.7	34.0	55.8	11.4	–2.8	15.3	26.0	14.0	24.2	8.6	5.9	8.1
2011/12 QE	35.0	35.4	30.6	30.8	56.3	11.5	–4.2	1.1	–12.8	4.4	–3.6	8.0	8.6	8.1
2012/13 Rev	35.0*	35.6	29.6	30.2*	56.8	11.5	–4.8	6.3	11.6*	1.7	2.7*	4.0	3.9	3.9
2013/14 Proj	34.7	34.7	30.0	31.0	57.0	11.0	–3.7	5.1	3.1	5.5	3.6	6.0	5.0	5.8

Note: * Estimated. The rest of the figures are derived from the CSO Press Release on GDP, May 2013.

134. The savings rate of households (including unincorporated business) has remained almost unchanged at around 22 per cent of GDP between 2007-08 and 2011-12, but there has been a big change in the composition of this savings, with net financial assets declining by 3.6 percentage points and savings in the form of physical assets increasing by a similar magnitude. This has adverse implications for the deepening and the development of the financial sector.

135. The enlarged gap between the investment and the domestic savings rate has of course by accounting identity resulted in the swelling of the current account deficit from 1.3 per cent of GDP in 2007-08 to 4.2 per cent in 2011-12 and then to 4.8 per cent in 2012-13.

136. The disposition of domestic savings as investment in valuables – almost entirely in the form of gold – has increased dramatically. From 1.1 per cent of GDP in 2007-08 to 2.7 per cent in 2011-12, a jump of 1.6 percentage points of GDP. One effect of this was that total capital formation (GDCF) has not fallen as sharply as have other ratios. The other effect was to enlarge the trade and current account deficit by the same magnitude. When households buy gold, it reduces its financial assets (bank deposit, cash in hand etc) and since the product is imported, the payment eventually leaves the country, leading to an export of a potential financial saving.

137. In the case of sales of other kinds of assets, the action involves transfer of assets between Indian residents, so that it does not make a difference in the aggregate. If instead of buying gold, the household exchanges its cash for financial assets like a bank deposit, insurance policy, mutual fund, bond, share or real estate, (a) financial resources remain in circulation within the economy, and (b) the asset is included as part of domestic savings and to that extent enhances domestic capital formation.

138. The fall in the net financial savings of households from 11–12 per cent in years prior to 2010-11 to a mere 8 per cent in 2011-12 is mostly an outcome of the

deployment of financial savings into investment in gold. This reduces the domestic financial resources available for supporting capital formation at home, while at the same time increasing the merchandise trade and current account deficits.

Looking at Growth Issues from other Perspectives

139. It had been pointed out last year, that there were significant variations between the growth trends in manufacturing output as reported in the Index of Industrial Production (IIP) and that reported by the more exhaustive Annual Survey of Industries (ASI). The IIP data is available with a lag of six weeks, while the ASI report comes in with a lag of eighteen months. Hence, it is the IIP data that is used for estimation of both quarterly and annual national income data and is subject to revision once the ASI data is available.

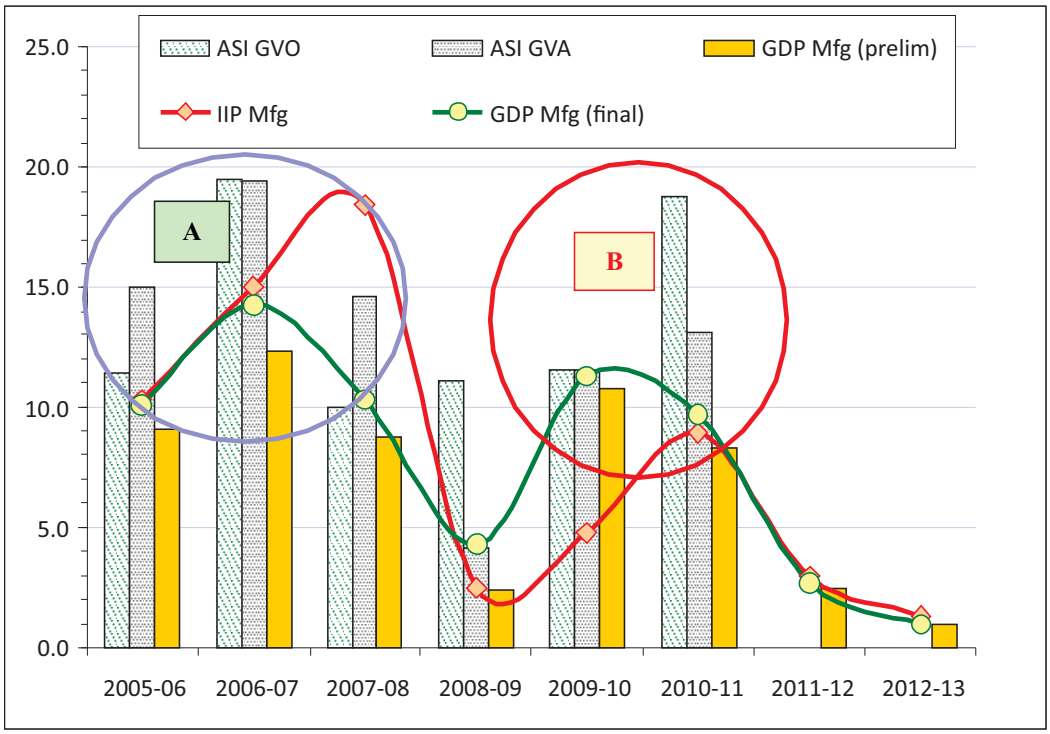
140 The ASI data is in current rupees and can be converted to constant price rupees by simply applying a deflator derived from the Wholesale Price Index (WPI). The real growth rates can be derived from these constant price rupees for ASI presented using the manufactured WPI index as deflator[5]. The underestimation resulting from using the IIP was large and significant in 2009-10 as well as in 2010-11. It is of course the gross value added (GVA), and not the gross value of output (GVO), that really counts. The net sales data from manufacturing corporates can also be taken from corporate data bases (CMIE, RBI and others) and deflated using WPI (Manufactured).

141. At Chart 3.1, the growth rates derived from the different measures discussed above are presented. That is, the IIP (manufacturing); the GDP growth rate published immediately after the end of the financial year in May; and the growth rate of GVO and GVA from the ASI that becomes available almost two years later. The underestimation is marked by circles "A" and "B"; it is large for the concerned years. For 2011-12 and 2012-13, we will have to wait for the ASI results to see whether there is a repetition in these years and if so, what the magnitude of this was.

[5] That is without adjusting for differences in intra-index weights and other refinements that are normally done by the CSO.

Chart 3.1

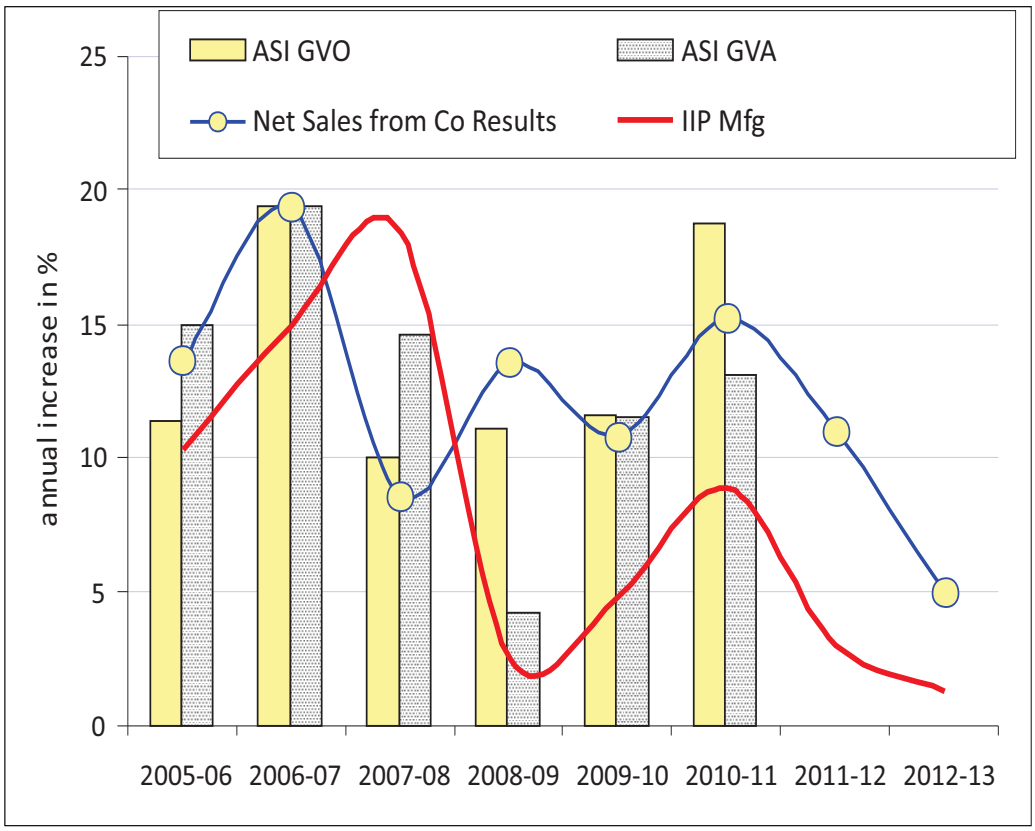
Growth rates from GDP (Manufacturing) initial and final, ASI with IIP



142. At Chart 3.2, growth rates of IIP (manufactured), the ASI (GVO) and ASI (GVA), are plotted together with derived real growth rates of net sales of manufacturing companies. It may be seen that the derived real company Net Sales growth matches that of the ASI GVO more closely than the IIP (manufacturing) does – at least for the years up to 2010-11. It remains to be seen whether this was true for 2011-12 and 2012-13. In the event if the older trend persists into the two most recent years it will have an upward bias in the revision for the GDP growth rates of 6.2 and 5.0 as we have them now.

Chart 3.2

Movement in Activity Indicators from ASI, IIP & Company Data



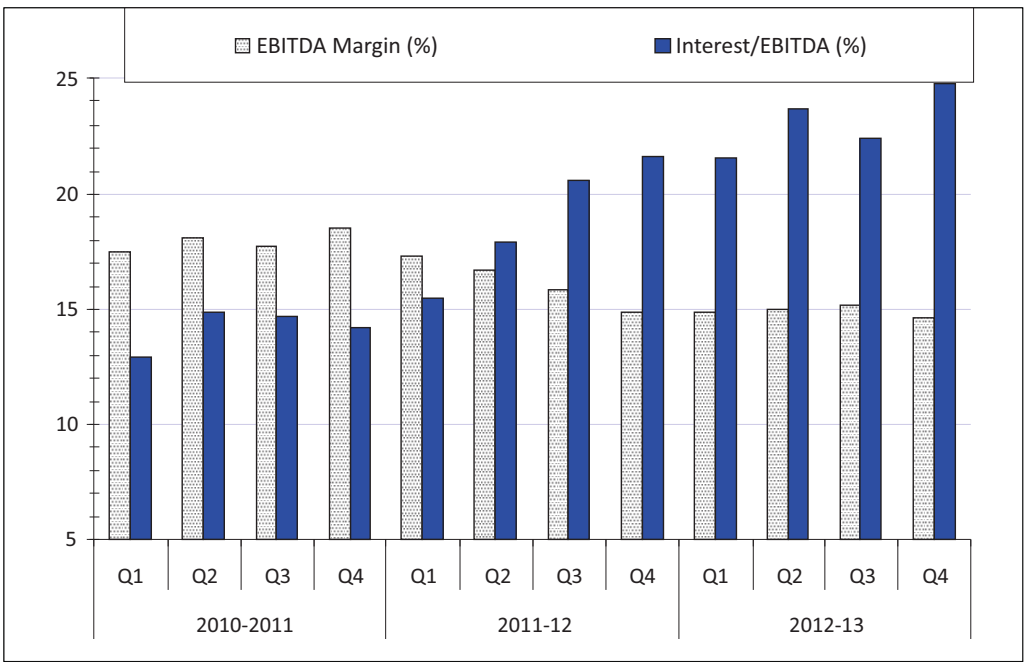
143. Indian companies have been seeing a drop in their operating margins, which however seems to have tapered off in the latter part of 2012-13. However, in combination of increased leverage and higher interest costs, the pre-emption of EBITDA (earnings before interest, tax and depreciation) by interest expense has increased massively. Charts 3.3 bring out the decline in operating margins and the heightened pre-emption of EBITDA by interest expense. Such conditions are not conducive for risk taking, that is, investment and highlights the balance sheet constraints that Indian corporate face in maintaining the pace of investments necessary to support economic growth.

144. Reduction of leverage can take place either by infusion of equity or improvement in profitability sustained over some years. In effect the former works only when the latter appears likely, provided the pricing is right. The reduction of interest expense pre-emption of EBITDA happens either with a replacement of debt or a re-pricing of the same (reduction in interest rates) or with reducing leverage over a period of time. However, an improvement in the profit dynamics of Indian corporates would be necessary for them to respond strongly to growth prospects.

Chart 3.3

Operating Margin & Interest Pre-emption thereof

Non Financial Companies in the BSE-500



IV – MONSOON & FARM SECTOR

South West Monsoon 2013

145. The South West (SW) monsoon 2013 set in quite early in much of the country and has provided precipitation in excess (11 per cent) of the normal for the country as a whole and for most parts with the exception of the North East and some of the Eastern States. In the rain dependant semi to slightly arid areas of Western, Southern and Central India, rains so far has been well in excess of the normal. It has also been in excess of the normal in Punjab and Uttar Pradesh, which are among the important agricultural areas. It has been very deficient in the North Eastern States (–35 to –40 per cent). Rainfall has been deficient in Bihar (–28 per cent) and Jharkhand (–21 per cent) as on 30 August 2013.

Table 4.1

South West Monsoon 2013: Precipitation 1 June to 30 August 2013

Region	Actual	Normal	Departure
		Millimetres	
East & North East India	809.5	1,132.2	–29%
North West India	602.1	498.5	21%
Central India	1,012.4	784.4	29%
South Peninsula	642.5	554.2	16%
Country as a whole	**781.3**	**706.7**	**11%**

Note: *East & NE India* includes: Assam, Meghalaya, Arunachal, Nagaland, Manipur, Mizoram, Tripura, Sikkim, Sub Himalayan West Bengal, Gangetic West Bengal, Bihar and Jharkhand.
North West India includes: East & West UP, Uttarakhand, Haryana & Delhi, Punjab, Himachal, J&K and West & East Rajasthan.
South Peninsula includes: Coastal Andhra, Telengana, Rayalseema, Tami Nadu & Puducherry, North & South Karnataka, Kerala, Lakshadeep and Andaman & Nicobar.
Central India: Rest of the country

Source: Indian Meteorological Department

146. With most of the active season over, the South West Monsoon 2013 has been unqualifiedly good for most of the country. The deficiencies in the East & NE should be seen in the context of the usually high rainfall that characterises these areas, and also the fact that over the past years there has been a steady decline in rainfall in some of the NE States, with adverse consequences for the availability of drinking water.

147. The reservoir position is 29 per cent better than that of the average of the last 10 years. The only basin with shortfall is the Kutch rivers basin. Important reservoirs in the Ganga, Narmada, Krishna and Godavari basins are between 6 and 70 per cent better than the average of the past 10 years (Table 4.2). Compared to the position at the same time last year, overall reservoir storage is better by a factor of 29 per cent.

Table 4.2
Storage Position in Reservoirs – Basin Wise
Week ending 29 August 2013

Unit: Billion Cubic Meters

Name of Basin	Live Cap. At FRL	This Year's Storage	Last Year's Storage	Last 10 Year's Avg. Storage	Departure vis-à-vis the Average of Past 10 years
Ganga	28.10	21.77	18.73	12.76	70.6%
Indus	14.73	13.32	9.20	10.47	27.3%
Narmada	17.43	16.10	15.73	10.28	56.6%
Tapi	7.39	5.13	5.10	5.10	0.6%
Mahi	4.01	3.55	3.61	2.75	29.2%
Sabarmati	0.74	0.37	0.26	0.36	3.4%
Rivers of Kutch	0.89	0.31	0.10	0.41	–24.9%
Godavari	15.09	11.78	5.70	7.65	54.0%
Krishna	31.55	25.75	15.57	24.17	6.5%
Mahanadi & Neighbouring EFRS	13.18	9.31	9.67	9.28	0.3%
Kaveri & Neighbouring EFRS	8.19	5.76	3.18	4.87	18.5%
West Flowing Rivers of South	13.60	12.70	6.67	9.17	38.5%
Total	**154.88**	**125.84**	**93.51**	**97.27**	**29.4%**

Source: Bulletin of the Central Water Commission. 30 Aug 2013

Agricultural Output in 2012-13

148. The *Fourth Advance Estimates* of crop output in 2012-13 are summarised at Table 4.3. Foodgrain production was 255.4 million tonnes (MT), slightly lower than the record harvest of 259.3 MT (final estimate) in 2011-12. The reduction by 3.9

MT was a result of declines in wheat of 2.4 MT, in rice of 0.9 MT and in coarse cereals output of 2.0 MT, which was partially offset by an increase of 1.4 MT in pulses output.

149. Output of the nine major oilseeds recovered a little in 2012-13, but was lower by 1.5 MT compared to the peak output level of 32.5 MT reached in 2010-11. Cotton output was marginally lower by 1.2 million bales (-3.4 per cent), while sugarcane production was higher by 22.1 MT (6.1 per cent).

Table 4.3

Farm Crop Output

			2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
Rice	million tonnes	Kharif	72.23	78.27	80.17	82.66	84.91	75.92	80.65	92.78	92.76
		Rabi	10.90	13.52	13.18	14.03	14.27	13.18	15.33	12.52	11.64
		Total	**83.13**	**91.79**	**93.35**	**96.69**	**99.18**	**89.09**	**95.98**	**105.30**	**104.40**
Wheat		**Rabi**	**68.64**	**69.35**	**75.81**	**78.57**	**80.68**	**80.80**	**86.87**	**94.88**	**92.46**
Coarse Cereals		Kharif	26.36	26.73	25.61	31.89	28.54	23.83	33.08	32.44	29.54
		Rabi	7.10	7.33	8.31	8.87	11.49	9.72	10.32	9.58	10.52
		Total	**33.46**	**34.06**	**33.92**	**40.76**	**40.03**	**33.55**	**43.40**	**42.01**	**40.06**
Pulses		Kharif	4.72	4.87	4.80	6.40	4.69	4.20	7.12	6.06	5.91
		Rabi	8.41	8.52	9.40	8.36	9.88	10.46	11.12	11.03	12.54
		Total	**13.13**	**13.39**	**14.20**	**14.76**	**14.57**	**14.66**	**18.24**	**17.09**	**18.4**
Foodgrain		Kharif	103.31	109.87	110.57	120.95	118.14	103.95	121.18	131.27	128.20
		Rabi	95.05	98.73	106.71	109.83	116.33	114.16	123.60	128.01	127.16
		Total	**198.36**	**208.60**	**217.28**	**230.78**	**234.47**	**218.11**	**244.78**	**259.29**	**255.36**
Oilseeds (nine major)	lakh tonnes	Kharif	141.49	167.68	140.12	207.13	178.08	157.29	219.22	206.91	208.60
		Rabi	102.05	112.11	102.77	90.42	99.11	91.53	105.57	91.08	101.46
		Total	**243.54**	**279.79**	**242.89**	**297.55**	**277.19**	**248.82**	**324.79**	**297.99**	**310.06**
Cotton	Lakh bales 170 Kg		164.3	185.0	226.3	258.8	222.8	242.2	330.0	352.0	340.0
Jute	Lakh bales 180 Kg		94.0	99.7	103.2	102.2	96.3	112.3	100.1	107.4	106.8
Sugarcane	Lakh tonnes		2,371	2,812	3,555	3,482	2,850	2,923	3,424	3,610	3,390

Outlook for 2013-14

150. The early and strong monsoon has had a hugely positive impact on sowing activity. Up to 30 August 2013, the area under *kharif* crops was reported to have increased by 6.4 million hectares or by 6.8 per cent, compared to the same period of last year. The largest increases have been in pulses (15.3 per cent), coarse cereals (13.3 per cent) and oilseeds (12.6 per cent). The area under rice, the most important crop, was up by almost 1.0 million hectares (2.9 per cent). A small decline was reported for sugarcane and a marginal change in the acreage under cotton. The data thus presages significant improvement in the *kharif* harvest, both for cereals, pulses and oilseeds on account of area augmentation. Better rainfall also is likely to improve yields in lands that were under the same crop last year, especially in rain dependant regions.

151. Good rainfall and reservoir position is indicative of a good *rabi* harvest as well, subject to the usual caveats about weather conditions near harvest time.

152. Overall, thus 2013-14 is likely to see higher output in rice and wheat, and significant gains in coarse cereals and pulses. Output of pulses may be en route to crossing 20 MT – the highest output level ever recorded, and nearly double the production level of a decade ago. Thus, output of foodgrain can be expected to hit a new record this year. Oilseeds output should also be able to recover, to approach, if not exceed the 2010-11 levels of 32.5 MT. Cotton output too should exceed the 35 million bales produced in 2011-12.

153. Output of horticultural produce (fruits & vegetables) and animal husbandry (milk, eggs & meat) as well as that of fisheries is likely to remain in its upward trajectory with annual growth of around 4 to 5 per cent.

154. Overall, thus the Council assesses that farm sector GDP will see strong growth in 2013-14. It may be recollected that in recent years the trend rate of growth of the farm sector has risen to over 3.5 per cent. Growth in the farm sector in 2013-14 will be higher than this trend level. Accordingly, the Council has estimated farm sector growth in 2013-14 at 4.8 per cent.

V – INDUSTRY AND SERVICES

155. The Index of Industrial Production (IIP) used to have a base year 1993-94 which was revised to base year 2004-05. The method of preparation of the index which is a combination of sample data on fixed frame basis and aggregate industrial data has had some problems on account of which it is under examination by an expert committee. The IIP is a monthly index and a vitally important data input into the tracking of the economy. In the industrial sector the Annual Survey of Industries (ASI) is a much more comprehensive measure. However, first it is annual and comes out with a considerable lag. Till that point, the guidance for the computation of the national accounts remains the IIP. The latter is an output measure, not one of value added and that is also a problem in years when the two may not move in parallel, as for instance in 2008-09. This has been discussed in a previous section.

156. The IIP (along with other measures of the "real" economy, such as agriculture and mining) is used to validate estimation of some service sector GDP estimates, which may be initially worked out on the basis of direct measures – which is in itself eminently sensible. However, if the estimates of the manufacturing sector for some reason are themselves somewhat off the mark, the error is amplified.

Industrial Output Projection for 2013-14

157. The performance of industrial, particularly manufacturing output in 2012-13 was a severe disappointment. Overall for the year as a whole, manufacturing output grew by a mere 1.3 per cent. The second half did see a small improvement with 2.3 per cent growth, as against (–) 0.7 per cent in the first. However, the improvement in the fourth quarter of 2012-13 did not continue into the first quarter of 2013-14 which has recorded (–) 1.2 per cent growth, subject to revision. One of the worst effected sectors, namely the automobile sector, has seen some output expansion in July. It is expected that there will be slight improvement in the rest of the year and overall for 2013-14 manufacturing output will show an increase of 1.5 to 2.0 per cent. This has been factored into the estimate of growth of GDP arising from the sector.

158. The quarterly GDP data shows that the manufacturing sector had a negative growth of 1.2 per cent, broadly in line with the IIP indicator. The Council feels that the data will show an improvement in manufacturing output starting from the second quarter (July-Sept) which will pick up momentum in the subsequent quarters. It may be noted that core sector growth for July has been placed at 3.1 per cent. Overall for the year 2013-14 the estimate is that manufacturing GDP will increase by 1.5 per cent, marginally higher than the 1.0 per cent recorded in 2012-13.

159. Mining & quarrying will continue to be weak on account of large negative growth in natural gas and small declines in crude oil output. Although coal output growth in the first quarter has been poor some improvement is expected during the course of the rest of the year. The GDP arising in this sector in the first quarter has shown negative growth of 2.8 per cent, which is expected to moderate in the second quarter. Overall the mining sector is expected to show flat growth in 2013-14.

160. Electricity generation growth in the first quarter was weak at 3.7 per cent. However, since then it has improved to 4.9 per cent in July and 5.2 per cent in August (up to 25 August). For the year as a whole power generation is expected to increase by 5.2 per cent.

161. Construction activity generated GDP growth of 4.3 per cent in 2012-13, much lower than previous years. In the first quarter it was weaker still at 2.8 per cent. Since then government contracting for roads has picked up and it will strengthen further in the months to come. It is also expected that with work on so many cleared projects being restarted combined with much higher level of contract awards for roads & highways and other public infrastructural work, there will be a pick up in construction activity. Accordingly the growth rate for the year has been projected at 5.0 per cent, more than last year, but less than that in 2010-11.

Services Sector

162. Service sector growth has been decelerating from its double digit level since 2010-11, and we do not expect a reversal of this trend in 2013-14. While we expect some improvement in most of the sub-segments of the service sector, including software and related businesses, there is likely to be some slowing in the large hotels, restaurants, transport, storage & communication sector, as also to a lesser extent in the financial sector.

163. Trade, hotels, restaurants, transport, storage & communication in the first quarter showed very low growth of 3.9 per cent. Notwithstanding expected improvement in the second quarter onwards, overall growth in this sector is expected to be 5.1 per cent less than that of last year (6.4 per cent). While the financial sector may grow at a pace slightly slower than last year on account of the stressed conditions in the financial markets, the real estate and BPO sub-sectors are likely to show improvement. Overall the sector is expected to grow by 8.4 per cent, marginally less than last year. Community health & personal services are projected to expand at a pace above that last year, in line with the estimates made for the first quarter. To a great extent the service sector also broadly reflects the movement in the material production sector.

Overall GDP

164. This gives us a projected growth for the aggregate industrial sector of 2.7 per cent (previous year 2.1 per cent) and that for the service sector of 6.6 per cent (previous year 7.1 per cent). Growth in the non-farm sector is projected at 5.4 per cent marginally less than last year. Higher projected growth for the farm sector of 4.8 per cent (previous year 1.9 per cent) thus gives us 5.3 per cent projected for 2013-14.

VI – TRADE AND EXTERNAL SECTOR

Current Account – Review of 2012-13

165. In April 2013, the Council had estimated for 2012-13, merchandise exports on Balance of Payments (BoP) basis of $301 billion, with imports of $501 billion and the merchandise trade deficit of $200 billion (10.9 per cent of projected GDP). In the event, actual exports stood at $307 billion, imports at $502 billion, merchandise trade deficit at $196 billion (10.6 per cent of GDP), that is, $4 billion less than had been estimated by the Council. Net invisible earnings were estimated at $106 billion, against which the actual realization was $108 billion. The estimated CAD for 2012-13 was $94 billion (5.1 per cent of GDP), as against which the actual CAD turned out to be $88 billion (4.8 per cent of GDP) – that is $6 billion less: $4 billion from merchandise balance and $2 billion from net invisible earnings.

166. The expansion of the trade deficit in 2012-13 was largely due to what happened with gold & silver. The Council in August 2012 had expected that the value of imports to come down from $62 billion in 2011-12 to $44 billion in 2012-13. The actual value of imports however stood at $56 billion, that is, $12 billion higher. On the net invisible earnings side, software exports & private remittances were both $2 billion less than what had been projected last year and investment income outgo was $2 billion more than had been estimated.

167. In the Review of the Economy released in April 2013, the Council had expressed its concern at the widening of the CAD, given the continued weakness in the export market and the huge increase in the value of imported gold and petroleum. It had estimated that in 2013-14, the merchandise trade deficit may climb to $213 billion taking the CAD to $100 billion. To finance this level of CAD exceptional efforts for raising capital would have been required.

Current Account – Outlook for 2013-14

168. In April 2013, world gold prices fell sharply. Possibly in a reaction of bottom-feeding, the domestic demand for gold sky-rocketed, with imports nearly topping $16 billion (including silver) in the two months of April & May. That took the monthly trade deficit to $18 and $20 billion – setting an unfavourable backdrop for the problems that were to crop up in June. Export growth was non-existent in the first

quarter, but has shown some resilience in July and August. The trade deficit for the first quarter was elevated at $50 billion on account of the spurt in gold imports in the first two months.

169. The combination of weak domestic economic conditions, very sharp weakening of the currency and focused efforts to discourage import of gold has reined in the value of imports in June, July and August. With some life showing in exports in July and August, the trade deficit has been maintained around $12.5 billion for three months in a row – June through August. Even though, over the coming months there may be some widening of the deficit, extrapolating from this level of trade deficit, the resultant annual number is about $165–170 billion, to which the out-of-control deficit excesses of April & May need to be added.

170. A level of $185 billion of merchandise trade deficit, less the $115 billion of net invisible earnings, yields a CAD of $70 billion (3.8 per cent of GDP), which is not exactly low, but apparently financeable. The prudent level of 2.0 – 2.5 per cent of GDP would be $40–50 billion in a full year at the present value of GDP.

Merchandise Imports

171. Several steps have been taken to discourage import of gold and encourage exports. Some more may be taken. Factoring all of that in, the Council expects that merchandise imports on BoP basis will be around $495 billion, of which oil imports are expected to be $180 billion (last year $169 billion) and gold & silver imports $40 billion.

172. In 2012-13, the domestic demand for petroleum products grew by 4.9 per cent to 155.4 MT. In the first nine months of 2012-13, diesel consumption grew by 8.3 per cent, but this slowed down to 2.7 per cent in the last quarter – a consequence of the price reforms in diesel. Overall growth in petroleum consumption fell to 3.5 per cent in the final quarter of 2012-13 compared to the 5.4 per cent in the first nine months. It is expected that in 2013-14, domestic consumption will grow by 3.5–4.0 per cent to about 160–161 MT. Slower domestic consumption growth in the background of some capacity increases should see higher refinery throughputs of 223–224 MT combined with an increase in exports of refined petroleum products. Imports of refined petroleum products (mostly LPG for cooking gas cylinders) are likely to remain unchanged at about 16 MT. The expansion of re-gasification capacities will see large imports of Liquefied Natural Gas (LNG) of 8.0–8.5 MT, bringing total imports up to 19–20 MT.

173. The average Brent crude price for the first five months of 2013-14 was little under $105 per barrel. Current prices till the possibility of a US strike on Syria pushed it up to

$115 per barrel, were ruling slightly higher at $110 per barrel. Even if prices normalize in time, they may harden as winter approaches. For the full year 2013-14, the average price that has been taken is little under $110 per barrel, with winter prices of $114 per barrel. Based on the *inter se* change in crude oil prices from last year's average for Brent (110.15 per barrel) and taking average LNG price at $14 per mmbtu, the value of the projected oil import bill in 2013-14 works out to be $180 billion. Against this the projected export of surplus product is expected to have a value of little over $65 billion, that is, 9.1 per cent higher than last year.

174. Non-petroleum, non-gold and non-gems imports contracted in 2012-13 and were significantly negative in the second and third quarters of the year. In the first quarter of 2013-14, imports other than oil, bullion & gems contracted by 9.2 per cent and in July by 4.8 per cent. There is expected to be a slow reversal in favour of industrial intermediates and capital goods in the months ahead. For the 2013-14 as a whole, the value of imports other than oil, bullion & gems is projected at $243 billion, about the same level as that in the previous year.

Merchandise Exports

175. Merchandise exports in 2013-14 are likely to be in the region of $310 billion, of which, refined petroleum products are placed at $65 billion, about 9 per cent more than last year. Gems & jewellery are expected to show negative growth and non-oil, non-jewellery exports are expected to increase by just over 2 per cent.

176. In the first four months of 2013-14, the value of export of refined petroleum product was 10.5 per cent higher with respect to the comparable period of the previous year. Export of cotton yarn, fabrics & made-ups were higher by 14 per cent, that of ready made garments by 13 per cent, leather & leather manufactures by 10.6 per cent. The improvement in export performance in all these three categories began in late 2012 and early 2013. The momentum is likely to continue. Export of marine products was up by 36 per cent, owing more to poor performance last year and that of rice by 44 per cent, flowing from the much larger volumes being exported. Wheat exports have also gained sharply. However, the export value of tea & coffee has declined, while export of pharmaceuticals, chemicals and plastics, are higher by 1, 3 and 5 per cent respectively. Notably, the export of engineering goods – the single largest category after petroleum

products – is still showing decline of more than 5 per cent. The export of gems & jewellery is lower by 10.6 per cent and this trend is likely to be maintained for the full year.

177. The export of iron ore at its peak quantity and price fetched over $6 billion in 2009-10. Since then it has declined and in 2012-13 exports stood at a mere $1.6 billion. Undoubtedly world prices of iron ore has fallen, but the main reason has been restrictions placed on iron ore mining and export by the higher Courts. In the first four months of 2013-14 the value of exported iron ore has fallen further by 59 per cent. There is a clear urgency to move the higher Courts for a review of the present restrictions on production and exports, not just for restoration of exports but also for the development of the steel industry in the country.

178. For the record the growth in the rupee value of exports in the second half of 2012-13 was 10.0 per cent and that in the first four months of 2013-14 was 6.3 per cent. In July 2013, the increase in the rupee value of exports was 20.3 per cent.

179. Increase in exports between June and July 2013 was $2.1 billion or nearly by 9 per cent. It was largely on account of higher export of refined petroleum products ($1.4 billion) and engineering goods ($225 million). The higher level of exports of refined petroleum products is likely to carry through for most of the rest of the year in view of the expected lower growth of domestic demand. Engineering goods export has been going through a weak phase since October 2011, despite occasional good months in subsequent 22 months. The 12 per cent increase in passenger car exports in July 2013, may presage a similar improvement in the large automotive component export business. A pick up in engineering goods export is overdue and the improvement in economic conditions in the developed western economies that are the main markets for this sector will hopefully result in improvement through the rest of this fiscal year.

180. In the April 2013, Review of the Economy, the Council had looked at a possible level of exports of $328 billion (trade basis), which would have entailed a 9 per cent growth over 2012-13. The projected export numbers in this report is lower at $307 billion (trade basis), that is growth of barely 2.2 per cent. This outlook is coloured by the disappointments of the recent period. A commodity wise breakdown and using that in the forecast yields total export figures that is higher and in the region of $315 to $320 billion.

Table 5.1
Balance of Payments

Unit: US$ billion

	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Merchandise Exports	85.2	105.2	128.9	166.2	189	182.4	256.2	309.8	306.6	309.7
Merchandise Imports	118.9	157.1	190.7	257.6	308.5	300.6	383.5	499.5	502.2	494.7
Merchandise Trade Balance	–33.7	–51.9	–61.8	–91.5	–119.5	–118.2	–127.3	–189.8	–195.7	–185.0
	–4.7%	*–6.2%*	*–6.5%*	*–7.4%*	*–9.8%*	*–8.6%*	*–7.4%*	*–10.2%*	*–10.6%*	*–10.1%*
Net Invisibles	31.2	42	52.2	75.7	91.6	80.0	79.3	111.6	107.5	115.0
	4.3%	*5.0%*	*5.5%*	*6.1%*	*7.5%*	*5.8%*	*4.6%*	*6.0%*	*5.8%*	*6.3%*
o/w Software & BPO	14.7	23.8	27.7	37.2	47.0	41.5	49.6	60.1	61.6	70.0
Private Remittances	20.5	24.5	29.8	41.7	44.6	53.6	53.1	63.5	64.3	66.0
Investment Income	–4.1	–4.1	–6.8	–4.4	–6.6	–7.2	–16.4	–16.5	–22.4	–24.0
Current Account Balance	**–2.5**	**–9.9**	**–9.6**	**–15.7**	**–27.9**	**–38.2**	**–48.1**	**–78.2**	**–88.2**	**–70.0**
	–0.3%	*–1.2%*	*–1.0%*	*–1.3%*	*–2.3%*	*–2.8%*	*–2.8%*	*–4.2%*	*–4.8%*	*–3.8%*
Foreign Investment	13.0	15.5	14.8	43.3	8.3	50.4	38.0	39.2	46.7	24.4
o/w FDI (net)	3.7	3.0	7.7	15.9	22.3	18.0	11.8	22.1	19.8	21.7
Inbound FDI	6.0	8.9	22.7	34.7	41.7	33.1	29.0	33.0	27.0	27.6
Outbound FDI	2.3	5.9	15.0	18.8	19.4	15.1	17.2	10.9	7.1	5.9
Portfolio capital	9.3	12.5	7.1	27.4	–14.0	32.4	30.3	17.2	26.9	2.7
Loans	10.9	7.9	24.5	40.7	8.3	12.4	29.1	19.3	31.1	22.0
Banking capital	3.9	1.4	1.9	11.8	–3.2	2.1	5.0	16.2	16.6	18.0
Other capital	0.7	1.2	4.2	11.0	–5.9	–13.2	–12.4	–6.9	–5.0	–3.0
Capital Account Balance	**28.0**	**25.5**	**45.2**	**106.6**	**7.4**	**51.6**	**63.7**	**67.8**	**89.4**	**61.4**
	3.9%	*3.1%*	*4.8%*	*8.6%*	*0.6%*	*3.8%*	*3.7%*	*3.6%*	*4.9%*	*3.4%*
Errors & Omissions	0.6	–0.5	1.0	1.3	0.4	0.0	–2.6	–2.4	–2.7	–
Accretion to Reserves	**26.2**	**15.1**	**36.6**	**92.2**	**–20.1**	**13.4**	**13.1**	**–12.8**	**3.8**	**–8.6**

Note: Percentages are with respect to GDP

Invisible Earnings

181. The three principal components of invisible earnings are ITES related service exports, private remittances from Indians abroad and the net balance on investment income. The fourth, which in India is not large, but could become one, is tourism and air & marine transportation services.

182. The net positive balance on ITES-related services grew very rapidly in the pre-Crisis period, but has since slowed down. In both 2010-11 and 2011-12 it expanded by 20 per cent, but then slowed down to 2.5 per cent in 2012-13. The industry association NASSCOM has projected export revenue growth in dollar terms of 13 per cent which has been so far borne out by the corporate performance to date. The Council has used this figure of 13 per cent for export growth of ITES related services in 2013-14 and thus expects the total net export revenue in 2013-14 to touch $70 billion (previous year $61.6 billion).

183. Private remittances have a somewhat heterogeneous character both in terms of geography and motivation. There is the traditional remittances of Indian workers in the Middle East, that from Indian origin workers and professionals in Europe and North America and there is the earnings of IT professional working for Indian companies at offshore locations. Since 2008-09, the rate of expansion in private remittances has seen a cyclical pattern, with good growth in one year, followed by low growth and even contraction in the next. Remittances increased by 20 per cent in 2009-10, improving on the 7 per cent of the previous year. It declined by 1 per cent in 2010-11, only to rise by nearly 20 per cent in 2011-12 and then drop to 1 per cent growth in 2012-13. By extension there could be a bounce in 2013-14, but the Council is not expecting more than 2.5 per cent growth and places the value of remittances at $66 billion (previous year $64.3 billion).

184. As the stock of foreign owned assets in India grows, the outgoes on account of debt service and dividends can only rise. The principal source of inflows is the earnings on the foreign currency assets of the RBI which has however not grown in the past several years. The net balance has risen from about $7 billion in 2008-09 and 2009-10 to $16 billion in 2010-11 and 2011-12. It has risen to $22 billion in 2012-13 and is projected to rise to $24 billion in 2013-14. It ought to be noted that all of this does not constitute cash outflows since the reinvested profits in foreign owned companies that are shown as FDI on the capital account side have

also to be debited on the current account side under investment income. That is also true for reinvested earnings of Indian owned enterprises abroad which get symmetrical treatment.

185. The net balance on invisible earnings was $107.5 billion in 2012-13, lower than that of the previous year ($111.6 billion). The total of net invisible earnings projected for 2013-14 is placed at $115 billion, the composition having been discussed above.

Capital Account – Review of 2012-13

186. Total net capital inflow in 2012-13 was $89.4 billion which was the highest since 2007-08. It was able to finance the enlarged CAD of $88.2 billion and contribute $3.8 billion to reserve accumulation. This large inflow of capital was possible primarily on account of a total of $27 billion of portfolio inflows by Foreign Institutional Investors (FII) of which $23 billion was in equity and another $4 billion into debt securities. India has been able to get large inflows of FII equity inflows in the past as well as in more recent years. These flows were $17 billion in 2011-12, $30 billion in 2010-11and $32 billion in 2009-10. However, the big increase was from short-term trade credit type of debt which stood at $22 billion in 2012-13, up from $7 billion in 2011-12 and $11 billion in 2010-11. There was also higher FII investment in debt securities – both of government and of corporate securities.

187. Inflows on account of Foreign Direct Investment (FDI) in 2012-13 amounted to $27 billion while outbound FDI was $7.1 billion. It should be noted that these flows include reinvested profits – both of foreign enterprises in India and Indian enterprises overseas. The net inflow of FDI thus was $19.8 billion which was slightly lower than that of previous year ($22.1 billion), but much better than the $11.8 billion of 2010-11.

188. Inflow into NRI deposits of the commercial banking system at $14.9 billion in 2012-13 was sizeable. It was greater than the $11.9 billion of 2011-12 and considerably more than the $3.2 billion in 2010-11.

189. Net inflows through External Commercial Borrowings (ECB) have been small, not withstanding the fairly large issuance. This is on account of maturity of past ECB issuance and prepayment & repayment of foreign currency convertible bonds (FCCB) that had to be redeemed. Net inflow in 2012-13 was $8.5 billion, slightly smaller than the $10.3 billion in 2011-12 and lower still than the $12.6 billion of 2010-11.

Capital Account – Outlook for 2013-14

190. FDI inflows in the first quarter of 2013-14 stood slightly higher at $7.6 billion (last year same period $5.9 billion), while outbound FDI was lower at $0.9 billion (last year same period $2.1 billion). The net FDI inflow was thus significantly better at $6.3 billion (last year same period $1.9 billion). For 2013-14 as a whole, the Council is placing FDI inflows at $27.6 billion (last year $27.0 billion) and outbound FDI at $5.9 billion (last year $7.1 billion).

191. In the first two months of 2013-14, total FII inflows was $7.2 billion, of which $5.0 billion was in equity and the balance in debt securities. However, things begun to sour in the last week of May and in June when there were large outflows of $1.9 billion in equity and $5.7 billion in debt, a total of $7.5 billion. The trend has persisted since. In July 2013 with net selling of $1 billion in equity and $2 billion in debt. In the month of August 2013, the sell-off had slowed a bit, to aggregate $2.5 billion ($903 million in equity and $1,554 million in debt).

192. The unsettled conditions that prevail are not conducive to capital flows in general and portfolio flows in particular. However, investors still see India as an attractive destination, notwithstanding the recent negative developments. So inflows will resume after some time, but it may not be as strong as it had been in recent years. Beginning from the year-to-date net inflows of (-) $4.6 billion, the Council is placing aggregate net inflows for the full year at $2.7 billion, which implies positive inflows of $7.3 billion in the course of the rest of the year.

193. The inflow into NRI bank deposits are likely to improve further on account of the liberalization of the rules governing interest rate fixation and the like. Total inflows in 2013-14 are projected at $17 billion, about $3 billion more than in 2012-13, and there are upside prospects to this.

194. Net inflows from ECB issuance in 2013-14 has been placed at $7.5 billion, slightly less than that of last year, factoring in the difficult conditions that may face private issuers this year. However, if a focused effort is made to raise capital, especially through the agency of quasi sovereign companies and in carefully chosen market segments and geographies, significantly more capital could be raised.

195. A decline is seen in short-term credits to $13 billion (last year $22 billion). However, this kind of capital is not planned and spikes occur in unfavourable circumstances where commitments have been made and normal financing does not come through.

196. Overall in 2013-14 the net balance on capital flows is placed at $61 billion, which would fall short of the projected CAD of $70 billion, requiring a draw down of $9 billion from the reserves – roughly about what has already happened to date. It is possible that there may be more draw down in the weeks ahead, but the opportunity to rebuild some of this will be there later in the fiscal after conditions stabilize.

197. With focused effort, through attracting greater amount of FDI – and progress has been made here; by pursuing enhanced PSU issuance of ECB and higher NRI deposit mobilization – it is entirely possible to lift total capital inflows by $10 billion or more. That will be hugely helpful to stabilize the financial conditions internally and help in the revival of economic growth. A part of the stocks currently held by SUUTI (Specified Undertaking of Unit Trust of India) could be put up for sale. In addition further divestment of PSU stock can be considered. These steps have the potential of encouraging more capital inflows.

External Value of the Currency

198. The Indian Rupee has been under pressure on account of an elevated and rising current account deficit, high inflation and more recently of declining capital inflows. Over the past year, EM currencies have been under pressure just as their asset prices have been. Economies that were running large CAD were particularly vulnerable, but the fact is that some who were current account surplus also saw erosion in the external value of their currencies.

199. It may be seen from Table 5.2, that currencies have undergone considerable fluctuation over the past years. In the run up to the global crisis of 2008, many EM currencies and also the Euro, UK Pound and Japanese yen strengthened considerably through 2007. After the Crisis hit, there was a flight to the US dollar, and in 2008 and 2009, almost all currencies – in both the EM and DM world – lost value vis-à-vis the US dollar. In 2010, the problems of the Eurozone caused the Euro and

other West & East European currencies to retreat. However, in calendar year 2011, the US dollar gained against most currencies, including DM economies that had strengthened on their resource exports (such as Australia, Canada & Norway), as well as East Asian currencies of East Asian economies that were exporters with current account surpluses and the EM en bloc. In that sense, the first stage of the adjustment in dollar strength transpired in 2011. In the next year, 2012, there was relative calm, followed by great turbulence in 2013. To get a sense of what has happened in the medium run, avoiding the unusual year 2007, we present the change between end-December 2006 to date in the last column on the right. This is the combined result of differential inflation, trade imbalances (large CADs or large surpluses), capital flows expectations of near term growth and a degree of excessive movement in the past two months.

200. Looking at the matter in isolation, had the exchange rate been determined simply by the current account deficit and inflation differential with a reference advanced economy the rupee should have steadily depreciated against that currency, from some time in 2011. Actually it did in the second half of 2011, but not in isolation as may be seen from Table 5.2.

Table 5.2

Change in the Value of National Currencies vis-à-vis US dollar

		2008 & 2009	2010	2011	2012	Jan to Mar 2013	Apr to June 2013	July to 23 Aug 2013	Dec 2006 to 23 Aug 2013
ADVANCED ECONOMIES									
1	Euro	–2.11	–7.07	–3.52	1.19	–2.27	2.15	2.10	1.40
2	Japanese Yen	18.96	11.75	7.10	–12.54	–6.90	–4.77	–0.11	20.18
3	U.K. Pound Sterling	–19.03	–2.54	–0.08	3.74	–6.54	0.72	2.44	–20.51
4	Swiss Franc	7.94	9.03	0.74	1.81	–3.19	0.77	2.18	31.98
5	Canadian Dollar	–4.50	3.87	–1.47	2.86	–2.98	–3.09	–0.33	10.82
6	Swedish Krona	–9.28	5.18	–1.54	4.71	–0.12	–2.94	2.77	5.20
7	Norwegian Krone	–5.53	–2.27	–2.17	6.87	–4.47	–3.36	–0.54	3.21
8	Danish Krone	–1.95	–7.22	–3.30	0.87	–2.46	2.36	2.10	1.37
9	Australian dollar	3.41	10.58	2.52	1.11	–0.40	–11.04	–2.87	13.85
10	New Zealand dollar	–5.21	4.37	3.14	5.43	0.41	–6.98	0.81	11.18
11	Israeli N. Sheqel	2.73	5.90	–8.29	3.00	2.38	0.83	0.84	17.75
N I C									
12	Korean Won	–19.17	2.55	–2.03	8.10	–4.01	–3.52	2.26	–17.32
13	Singapore Dollar	2.86	8.67	–0.15	5.29	–1.68	–1.71	–1.16	19.81
14	Taiwan Dollar	2.54	9.64	–2.21	–2.55	–0.50	–0.50	–2.09	8.93
CHINA & RUSSIA									
15	Chinese Yuan	6.59	3.12	5.10	0.17	0.25	1.55	0.12	26.54
16	Russian Rouble	–16.96	–3.04	–5.73	6.00	–2.01	–5.24	–1.05	–20.34

Table 5.2

Change in the Value of National Currencies vis-à-vis US dollar

		2008 & 2009	2010	2011	2012	Jan to Mar 2013	Apr to June 2013	July to 23 Aug 2013	Dec 2006 to 23 Aug 2013
Eastern Europe									
17	Czech Koruna	–2.28	–2.04	–6.79	3.18	–4.04	1.25	3.25	8.63
18	Hungarian Forint	–7.42	–9.79	–15.80	10.61	–7.12	5.44	1.33	–14.15
19	Polish Zloty	–13.14	–3.91	–14.29	10.69	–5.39	–1.21	4.74	–8.11
Latin America									
20	Brazilian Real	2.80	4.42	–9.84	–10.34	1.14	–7.60	–10.68	–12.61
21	Chilean Peso	–1.51	8.51	–9.39	8.21	0.59	–6.22	–1.91	4.05
22	Mexican Peso	–15.13	4.58	–10.59	7.62	3.14	–5.14	0.20	–16.82
23	Argentine Peso	–17.01	–4.05	–8.05	–12.49	–4.00	–4.88	–4.21	–45.40
24	Colombian Peso	–0.42	6.23	–0.64	8.81	–3.94	–4.67	–0.01	15.79
25	Uruguayan Peso	10.25	–4.11	1.32	1.40	3.13	–8.07	–8.70	3.92
EM Asia & Africa									
26	Indian Rupee	–14.61	3.03	–15.62	–2.34	0.05	–8.89	–7.71	–31.63
27	Indonesian Rupiah	1.13	3.70	–2.22	–5.07	–0.50	–2.12	–8.47	–16.85
28	Malaysian Ringgit	–2.42	10.68	–2.48	3.40	–2.17	–2.36	–3.86	6.78
29	Pakistani Rupee	–27.67	–1.25	–4.93	–7.45	–1.07	–0.66	–4.38	–41.23
30	Philippine Peso	–12.18	6.02	0.02	6.99	–0.10	–5.47	–1.84	10.71
31	Sri Lanka Rupee	–5.10	3.15	–2.60	–10.56	0.39	–2.39	–1.44	–18.32
32	Thai Baht	0.99	10.72	–4.47	3.61	3.80	–6.05	–2.60	13.94
33	S. African Rand	–6.18	9.69	–18.08	–5.64	–6.59	–7.98	–2.43	–31.96
34	Turkish Lira	–22.25	–2.60	–18.91	6.95	–1.42	–5.88	–2.91	–28.59

Source: Computed from data in the IMF exchange rate database, US Federal Reserve exchange rate statistics; Turkish Lira from Central Bank of Turkey and Argentina peso from Central Bank of Argentina databases. Market sources for data on a few currencies for 2006 and 2007

201. There are so many cross rates, counter currents and differentiating issues, along with multi-directional capital flows, that one to one correspondence between trade and other imbalances and the exchange rate is hard to discern. However, if there is a large trade imbalance and high domestic inflation, at some point things do catch up and they do so often at the most inconvenient moment.

202. After sliding in the third quarter of fiscal year 2011-12, the rupee recovered in the next quarter. Thereafter, after easing back to between Rs 54–55 to the US dollar, the rupee remained at about that level for nearly a year, till the events of May and June 2013.

203. These short-term fluctuations around a basically stable nominal exchange rate were largely a response to surges and spikes in capital inflows. It needs to be however borne in mind that while the nominal exchange rate remained stable, the real effective exchange rate (REER) appreciated steadily during this period on account of the large inflation differential between India and other advanced economies.

204. The Indian rupee depreciated sharply since 22 May 2013, when the Chairman of the US Federal Reserve first indicated that tapering of QE could be anticipated. There was an outflow of $13.8 billion through the FII route (mostly debt) between 23 May and 30 August 2013. During this period the yield on one year US treasury bonds rose sharply from 1.94 to 2.90 per cent, before falling back somewhat, triggering a sell-off in emerging markets, especially in the fixed income segment. The rupee breached Rs. 60 to the US$ by end-June, Rs. 61 by end-July 2013 and crossed Rs 68 to the US$ on 28 August, but recovered somewhat to Rs 66.57 on 30 August 2013. It has thus depreciated by nearly 20 per cent in nominal terms between 22 May and 30 August 2013.

205. It needs to be underscored that the currencies of most major emerging markets that have a combination of large current account deficits, high inflation and weakening growth have depreciated the most.

206. The real effective exchange rate (REER) of the rupee is now at a level much below neutral (100), if WPI inflation is taken as reference.[6] While there is little that Government or the RBI can do about the monetary policies of other countries that have an impact on the dynamics of cross border capital flows, they can certainly act on

[6]Although it may be closer to neutral if CPI inflation is considered. However for trade activities the bill of expenses more closely approximates the WPI basket.

factors within their control. The most important elements of which are to ensure stable price inflation and a modest level of current account deficits. The short-term problem is that of financing the large current account deficit, while the medium term issue is to compress the large current account deficit to within a more sustainable level of around 2.5 per cent of GDP.

207. Government and RBI are taking steps to stabilize the rupee through a combination of direct intervention in the foreign exchange market, squeezing rupee liquidity, raising the short end of the yield curve, liberalizing policies relating to capital inflow (both debt and equity), and reducing avoidable imports – particularly of gold. Some of these issues have been discussed previously. Stability in relation to the rupee will return as capital flows resume to normal levels and as the current account deficit begins to fall.

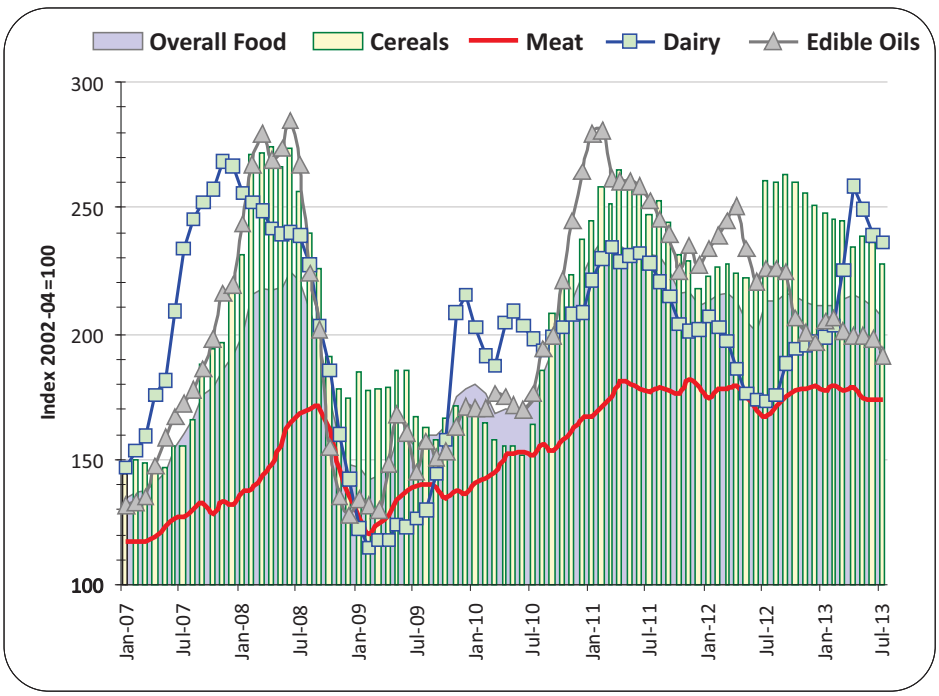
VII – PRICES, INFLATION MANAGEMENT & MONETARY POLICY

Global Price Situation

208. Consumer prices inflation has continued to remain subdued in most of the advanced world, flowing from the weak state of demand, excess supply capacity and flat labour costs. Commodity prices that had seen a big run up in late 2009 onwards have come off their highs. However, crude oil prices after having dipped last summer and remaining in the range of $100–105 per barrel (Brent) has hardened since and are not likely to soften, notwithstanding the new supply coming from North America and other non-OPEC producers.

Chart 7.1

Price Levels from FAO Food Price Indices



209. The FAO food price index shows that food prices which had escalated since the summer of 2010, have retreated considerably (Chart 7.1). However, they are close to their pre-Crisis levels – which were historical highs. However, the retreat of food prices since it touched a peak in February 2011 – not perhaps entirely coincidental with the "Arab spring" – has been fairly steady in the two and a half years since.

Domestic Inflation – Trends

210. At home, inflationary trends as measured by the Wholesale Price Index (WPI)[7] turned sharply upwards in the latter half of 2008, peaked in 2010 but have since moderated, though they remain a source of concern. The headline WPI inflation rate in 2012-13 averaged 7.4 per cent, significantly lower than in 2011-12 (9.0 per cent) and closed favourably at 5.7 per cent in March 2013. In the first three months of 2013-14 it has been below 5 per cent, but picked up to 5.8 per cent in July 2013, primarily on account of higher refined petroleum product prices, higher foodgrain and vegetable prices. Manufactured goods inflation remained low in July 2013 at 2.8 per cent and that excluding manufactured food was also subdued at 2.4 per cent.

211. The Consumer Price Inflation indices however continue to report inflation at close to double digits or even higher. However, Consumer Price Inflation remained at an elevated level of 9 to 10 per cent during 2012-13 and in the first quarter of 2013-14. The difference between the two measures has also been widening in recent months and is primarily attributable to both differences in coverage and differing weights of common items. With food items having a weight of 49.7 per cent in the CPI, but only 24.3 per cent in the WPI, a pick-up in food inflation shows up in a widening differential between the two indices. The reasons underlying the divergence between WPI and CPI are analysed in some detail in Appendix II.

212. In studying the factors underlying the inflationary process in recent years it may be useful to attempt a broader discussion of the common factors which affect the overall inflation rate and more or less influence all sectors, and the specific factors whose effect is concentrated on particular sectors.

[7] Computed and released by the office of the Economic Advisor, Department of Industry, Ministry of Industry & Commerce in the middle of each month.

213. Common Factors: Among the common factors which are conventionally regarded as important influences on inflation, we may note (i) the external value of the domestic currency (ii) the monetary policy stance and (iii) the fiscal outlook.

214. External value of the Rupee: The external value of the rupee has emerged as an issue of concern in recent months. Between the beginning of August 2011 and the end of July 2013, the rupee has depreciated by nearly 37 per cent vis-à-vis the US dollar. Currency depreciation can have overall inflationary consequences via a rise in import prices, though in the Indian case the pass-through is somewhat moderated, especially in the case of petroleum products and food items where prices are partly administered. The primary weaknesses stem from the trade imbalance, the stagnation of Indian exports in the face of a tepid global recovery and slackening productivity at home, and decline in the growth rate of invisibles. While capital inflows were sufficient to finance the CAD in 2012-13, there are major downside risks to these flows over the ensuing fiscal year, stemming from the signals from the US Federal Reserve on "tapering" of the monetary stimulus, that is, its asset purchase programme and the resultant uncertainty that this has created in markets.

215. Financial markets have been in anticipation of the taper, been reallocating and re-pricing assets over the past year. The problem is the difficulty to work out the pace at which this happens and that is the principal factor behind the massive volatility in the fixed income and hence by extension to the currency markets. RBI took several measures in July 2013 to shore up the rupee, such as increasing the short end of the yield curve, the first step in which was raising the marginal standing facility rate and bank rate, and limiting the Liquidity Adjustment Facility (LAF) to 1 per cent of the net demand and time liability (NDTL) and open market sales of government securities to the tune of Rs. 12,000 crore. But these measures though providing a required respite can at best be partial measures and on balance the outlook for the rupee will remain stressed. Improvement in the trade deficit and some resumption of capital flows will help the situation in a more fundamental manner.

216. Monetary Policy Stance: Monetary policy in India tries to strike a delicate balance between three principal policy objectives viz. inflation, growth and financial stability. This it tries to do via two major instruments viz. the repo rate and the CRR, with occasional

recourse to other instruments such as the bank rate, SLR or risk-weight adjustments. The repo rate is a powerful instrument affecting growth and inflation. On the policy front the RBI has maintained a monetary policy that is neutral between inflation and growth. The sharp depreciation of the rupee, however, may constrain the RBI's options in promoting growth.

217. Fiscal Policy: The general outlook on inflation is also shaped by developments on the fiscal front. Fiscal consolidation in 2012-13 was achieved in spite of a decline in tax revenues, on account of declines in collections from Union excise duties, and corporation tax, telecommunications receipts and disinvestment realizations, by way of scaling down of Plan expenditures. The fiscal deficit as percentage of GDP in 2012-13 was contained at 4.9 per cent (provisional actual) compared to 5.8 per cent in 2011-12 (accounts). The budgeted estimate for 2013-14 at 4.8 per cent of GDP, will be a challenge if tax revenues, telecommunication receivables and disinvestment receipts face shortfalls. The government's borrowing programme is however expected to proceed as per schedule in the first half of the current fiscal, thereby keeping the yields on government securities range-bound. Overall, no serious upside risk is envisaged to inflation from a possible fiscal overhang.

218. Composition of Inflation: We now turn to the sectoral dimensions of inflation and the specific factors affecting particular sectors. From Table 7.1, it is evident that the major sectors contributing to inflation are: (i) primary food articles and manufactured food products; (ii) fuel & power and (iii) among manufactured products – chemicals & chemical products and basic metals, alloys and metal products.

219. Food Articles & Food Products: As may be seen from Table 7.1, food articles & manufactured food products together account for a significant portion of overall inflation, particularly in 2012-13 and in period April-July 2013-14. Even as wholesale headline inflation declined from a high of 8.1 per cent in September 2012 to 4.9 per cent in June 2013, wholesale food inflation remained steady at 8.1 per cent. From the welfare perspective, food inflation imposes severe costs on those with lower incomes in society.

Table 7.1

Composition of WPI Inflation

		Weight	2010-11	2011-12	2012-13	April-July 2013-14
	ALL COMMODITIES	**100.00**	**9.6%**	**8.9%**	**7.4%**	**5.0%**
1	**PRIMARY ARTICLES**	20.1181	17.7%	9.8%	9.8%	7.0%
	Contribution†		*4.2*	*2.5*	*2.5*	*1.8*
A	Food Articles	14.3371	15.6%	7.3%	9.9%	9.0%
	Contribution		*2.7*	*1.3*	*1.8*	*1.6*
B	Non-Food Articles	4.2576	22.3%	9.6%	10.5%	6.4%
	Contribution		*1.0*	*0.5*	*0.5*	*0.3*
C	Minerals	1.5235	24.8%	26.6%	8.2%	–3.7%
	Contribution		*0.6*	*0.7*	*0.3*	*–0.1*
2	**FUEL & POWER**	14.9102	12.3%	14.0%	10.3%	8.5%
	Contribution		*1.8*	*2.2*	*1.7*	*1.4*
3	**MANUFACTURED PRODUCTS**	64.9716	5.7%	7.3%	5.4%	3.1%
	Contribution		*3.5*	*4.3*	*3.1*	*1.8*
A	Manufactured Food Products	9.9740	3.7%	7.1%	8.1%	6.3%
	Contribution		*0.4*	*0.7*	*0.8*	*0.6*
B	Chemicals & Chemical Products	12.0177	5.3%	8.6%	6.6%	3.4%
	Contribution		*0.6*	*0.9*	*0.7*	*0.4*
C	Basic Metals, Alloys & Metal Prod	10.7478	8.7%	11.1%	6.3%	–2.0%
	Contribution		*0.9*	*1.2*	*0.7*	*0.2*
D	Machinery & Machine Tools	8.9315	2.8%	3.1%	2.6%	2.6%
	Contribution		*0.2*	*0.2*	*0.2*	*0.2*

Note: †*Contribution to overall rate in percentage points* means the component of the overall headline rate that is attributable to that product or category

220. In recent months, cereals have become a large (0.68 percentage point, July 2013) contributor to high WPI food inflation. However, fruit & vegetables continue to contribute more to headline inflation (1.0 percentage point, July 2013). High

cereal inflation is due to rice and wheat as may be seen at Chart 7.2 as pulses prices are soft.

221. If WPI inflation rate comes down, the CPI inflation will follow, sooner or later, and vice versa, even though there can be periods where there is substantial variation.

222. In the first four months of 2013-14, inflation in perishable farm produce goods was relatively low, except for vegetables. Inflation in vegetables was 17 and 47 per cent in June and July 2013, compared to 50 and 24 per cent in the same months of the previous year. Inflation in milk was down to 3.7 and 2.3 per cent in June & July 2013, much lower than the 7.5 and 8.0 per cent for the same months of last year. It does seem that prices of perishable farm produce seem to have stabilized barring prices of vegetables (see Chart 7.3).

Chart 7.2

Price Movement in Cereals

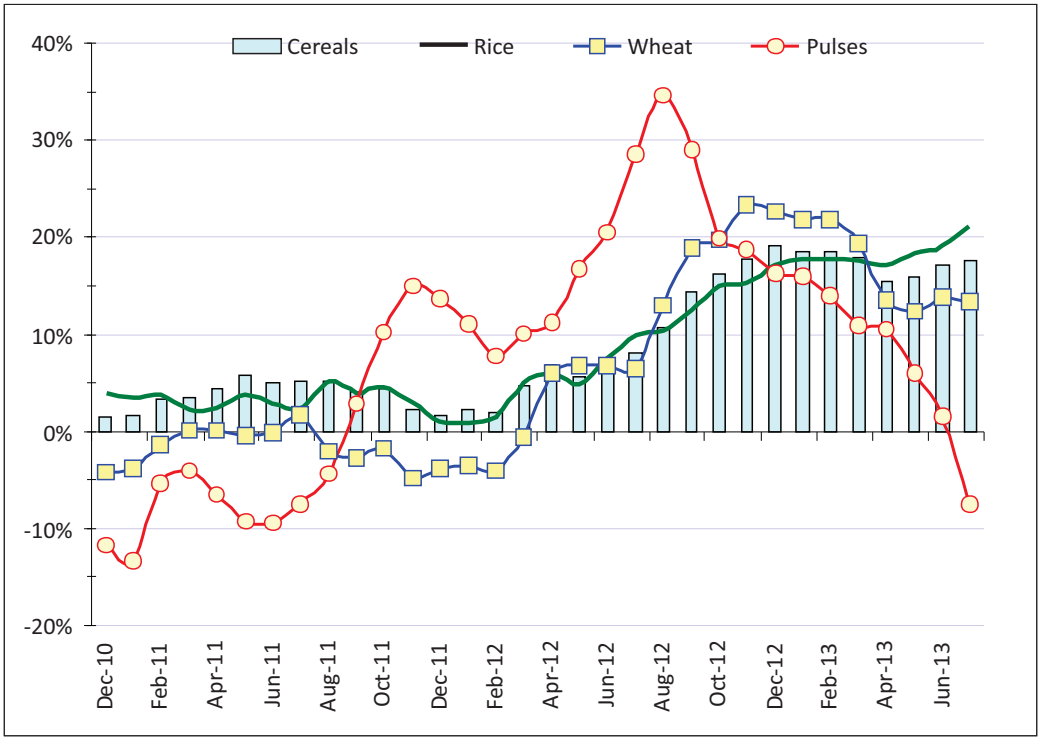
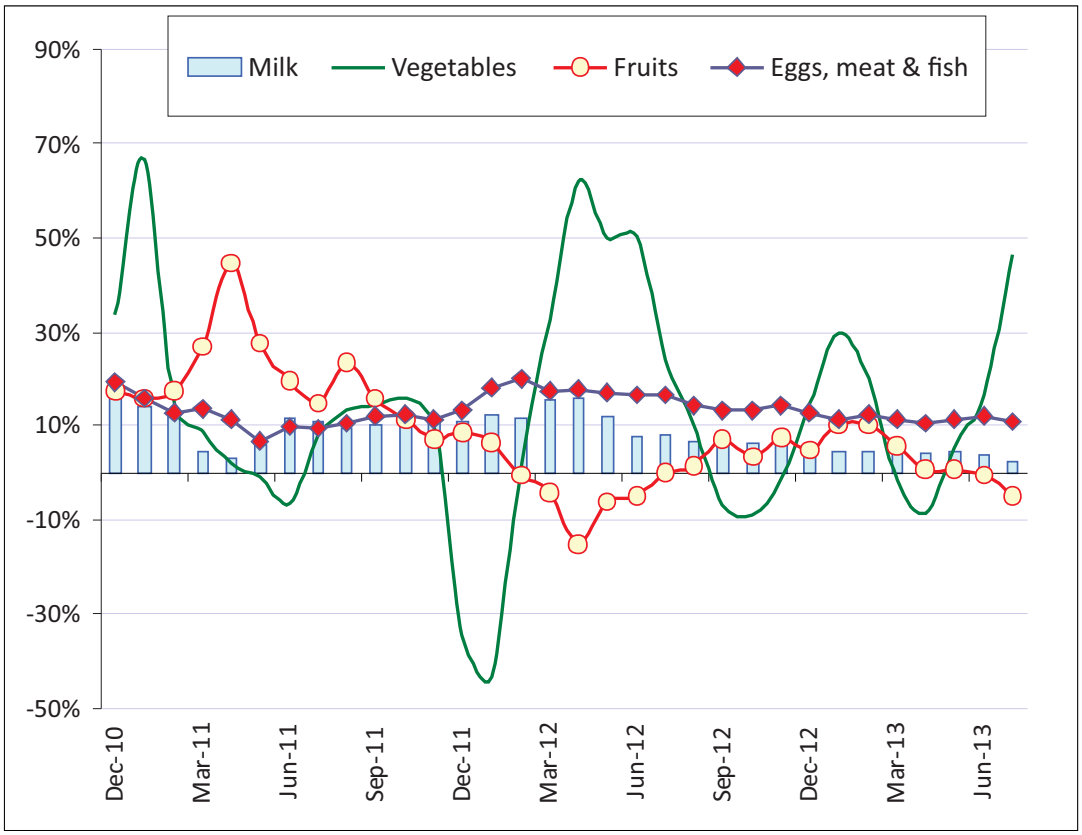


Chart 7.3

Inflation Rate in Perishable Farm Produce



223. While the rate of inflation for primary food articles, especially fresh produce (Chart 7.3), continues to be high and vulnerable to spikes, the rate of output increase in these products have been quite strong, ranging from 4.5 per cent per annum for milk and 7 to 8 per cent for horticultural produce. With market access expanding on account of better road networks, production by farmers for the market has expanded and will continue to expand, since such items embody more potential earnings and are well-suited for the small land holdings that are the norm in India. State governments are also encouraging farmers to pursue horticulture and animal husbandry by way of extension services, planting material and financing assistance for shade houses, micro-irrigation

and other productivity enhancing measures. However, the supply chain and market structure remains antiquated and this results in huge wastage, high handling and transport costs and unjustifiably high price mark-ups. The farmer secures only a fraction of the high price that the consumer eventually pays.

224. The structural factors affecting food inflation are: (i) rising demand for high-value food products in many EM countries including India, flowing from improved living standards combined with inelastic supply response and/or logistic inadequacies; (ii) shift in terms of trade in favour of agriculture; (iii) continued monsoon dependence of agriculture.; (iv) level of, and changes in, minimum support prices for agricultural products; and (v) global energy & food prices.

225. For 2013-14 indications are favourable. First, as noted the monsoon set in before time and is above normal. But food prices have often risen in the past in spite of favourable monsoons, owing to factors such as increases in Minimum Support Prices (MSP) or global food inflation. There was a sharp increase in MSP in past years for cereals (paddy, *jowar*, *bajra* & maize) and pulses (*tur*, *moong* & *urad*) (see Table 7.2). This partly explains the persistent increase in prices in the past years of rice and wheat, despite the record harvests. For other crops MSP is not operational as there is hardly any official procurement and MSP acts only as a price signal. In many of these crops – as in the case of pulses – open market prices have generally ruled above MSP. But MSP for the 2013-14 *kharif* season has seen only modest upward revisions.

226. It has been previously noted that the steady trend of decline in global food prices, even as they continue to be at fairly high levels in the historical context. However, the pressure on food prices at present is soft. For the first six months of calendar 2013, the average inflation as per the FAO food price index was 0.3 per cent and that for cereals was 4.8 per cent. Crude oil prices shape food prices, not just since fossil fuels are a direct input into agriculture, but on account of the linkage through diversion of grain for production of bio-fuels.

227. On balance the Council's assessment is that domestic food inflation is likely to be moderated in the near term.

Table 7.2

Minimum Support Prices for Agricultural Crops

Unit: Rs per quintal

Commodity	Variety	2010-11	2011-12	2012-13	2013-14
Paddy	Common	1,000	1,080	1,250	1,310
	Grade A	1,030	1,110	1,280	1,345
Jowar	Hybrid	880	980	1,500	1,500
Bajra		880	980	1,175	1,250
Maize		880	980	1,175	1,310
Ragi		965	1,050	1,500	1,500
Tur / Arhar		3,000	3,200	3,850	4,300
Moong		3,170	3,500	4,400	4,500
Urad		2,900	3,300	4,300	4,300
Groundnut (in shell)		2,300	2,700	3,700	4,000
Sunflower seed		2,350	2,800	3,700	3,700
Soybean	Black	1,400	1,650	2,200	2,500
Rabi Crops					
Wheat		1,120	1,285	1,350	
Barley		780	980	980	
Gram		2,100	2,800	3,000	
Masur		2,250	2,800	2,900	
Rapeseed/Mustard		1,850	2,500	3,000	
Other Crops					
Cotton*	Med. Staple	2,600	2,800	3,600	3,700
	Long Staple	3,150	3,300	3,900	4,000
Sugarcane		139	145	170	

Note: * Cotton MSP is in terms of Rs per bale of 170 kgs each

228. Fuel & Power: Petroleum product prices in India are aligned to world prices, which is especially necessary given our import dependence for crude oil and increasingly for natural gas. Motor spirit is deregulated and reform of diesel pricing is taking place, albeit slowly. Over half the output of refined petroleum products is not regulated. The pricing of natural gas as proposed by the Rangarajan Committee will bring a closer and continuous link to world prices of natural gas.

229. As we import more thermal coal, the average price of coal feedstock is also rising. As new plants come on line, the cost of electricity generated is also increasing on the fixed cost side and on account of more expensive fuel on the variable cost side too. Even with higher efficiencies, the supply price of energy – whether primary or of electricity – is set to continuously rise in both the short and medium term. Renewable sources of energy are in general more costly than the conventional type, even as there are other large gains in externalities of the public good type involved.

230. Chemicals & Chemical Products: The Indian chemicals industry is the eighth largest in the world, but is a net importer. Thus, global prices play an enhanced role. Depressed demand conditions in Europe and the USA, cheap natural gas in the USA, and some slack in manufacturing activity in China, have kept global chemical prices subdued. The situation may change with the gradual global recovery in progress. The principal inputs are naphtha and natural gas. As has been discussed oil prices have hardened and may rise more in the winter. Overall chemical prices may thus rise, considering both the demand and supply factors.

231. Basic Metals & Metal Products: Manufacturing inflation is conditioned by the cost of metallic inputs. Of note is global copper price, as India's import dependence on copper is substantial and is expected to rise to about 90 per cent of its total requirements by 2017. Though India is a large manufacturer of steel, domestic prices are to an extent set on import parity price basis and the level of international prices influences domestic prices. Metal prices after reaching their peak in 2011 had been on the decline (Table 7.3), but picked up in the first quarter of calendar year 2013, to dip again beginning May 2013 on fears of "tapering" in the US. The metal prices outlook is strongly correlated to developments in China – a major consumer. As the Chinese economy becomes more service oriented, Chinese demand for metals like copper is expected to moderate. Steel prices have turned soft. Copper prices though continue to be elevated

because of supply bottlenecks. Aluminium prices have been low following large investments in aluminium smelters in China and the Middle East.

Table 7.3

World Prices of Food and Metals

Commodity	Units	2011	2012	2013 Jan to Mar	May-13	Jun-13
		Food Items				
Wheat	$ per tonne	316	313	321	319	314
Maize	-do-	292	298	305	295	297
Rice	-do-	552	580	571	552	546
Barley	-do-	207	238	239	231	231
Soybeans	-do-	484	538	533	542	560
Palm oil	-do-	1,077	940	780	763	763
Sunflower oil	-do-	1,622	1,490	1,494	1,467	1,472
Rapeseed oil	-do-	1,367	1,239	1,196	1,118	1,116
Groundnuts	-do-	1,724	1,885	2,274	2,158	2,326
Poultry	US cents / pound	87	94	100	104	106
Sugar	-do-	26	21	19	17	17
Coffee	-do-	273	188	155	151	139
Tea	-do-	346	349	319	272	254
		Metals				
Copper	$ per tonne	8,824	7,959	7,922	7,249	7,000
Aluminium	-do-	2,401	2,023	2,001	1,833	1,815
Iron Ore	-do-	168	129	148	124	115
Tin	-do-	26,051	21,109	24,038	20,782	20,267
Nickel	-do-	22,909	17,542	17,305	14,948	14,280
Zinc	-do-	2,196	1,950	2,030	1,831	1,839
Lead	-do-	2,401	2,064	2,291	2,032	2,100
Uranium	US$ / pound	56	49	43	41	40

Source: IMF, Commodity Market Monthly, 12 July 2013

232. Globally, the outlook on metal prices seems to be on the softer side, with the exception of lead and zinc.

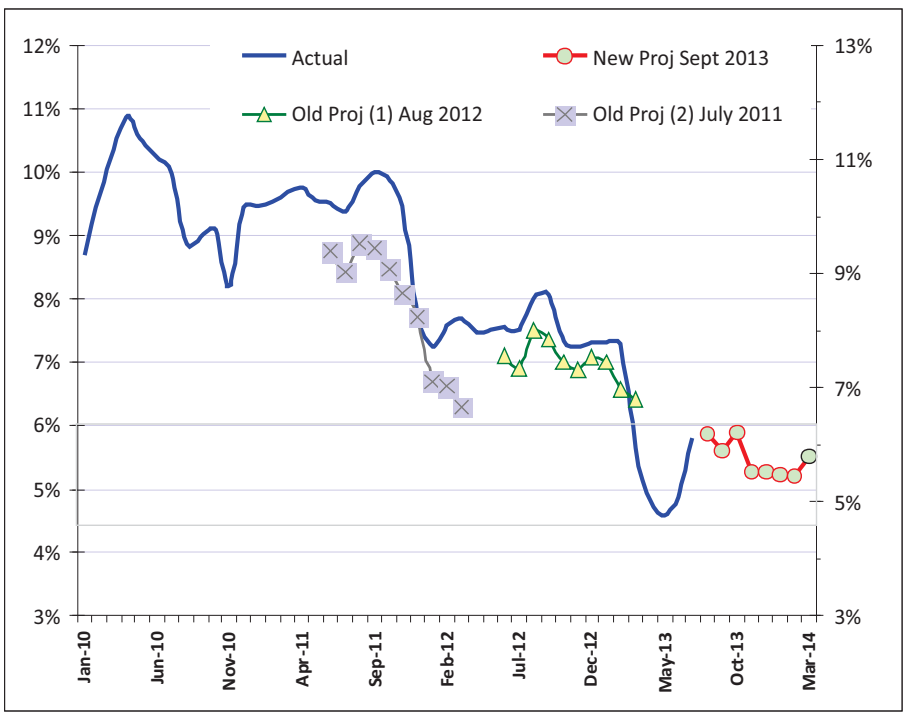
Inflation Outlook in 2013-14

233. In the Council's assessment, the main risks to Indian inflation at this juncture come from the weakness of the rupee. The current stance of both monetary and fiscal

policies is supportive of containing inflation. Most of the domestic supply side factors affecting inflation also appear to be more favourably disposed, at least in the short term. Given the favourable monsoon and the easing of global food prices, food inflation can be expected to moderate. The global situation as regards crude oil, natural gas and base metals is also favourable, though some firming up on these fronts is possible as global demand recovers slowly. However, the uncertain situation in West Asia and more particularly the possibility of a US Strike on Syria could lead to crude prices rising.

Chart 7.4

Headline WPI Inflation Rate – Actual and Projected



234. The Council expects that wholesale price inflation will remain at 5.0 to 5.5 per cent. The current level in the first four months of 2013-14 stands at 5.0 per cent. The expected decline in food inflation is likely to be offset by increase in non-food goods due to rupee depreciation. Consumer price inflation, which has a much larger weight for food is also expected to decline from current levels, thereby narrowing the gap with wholesale price inflation.

235. Overall for 2013-14, WPI inflation rate is expected to average a little over 5 per cent and that at the end of the year (March 2014) is likely to be about 5.5 per cent. The actual and projected trajectory of WPI headline inflation rate, along with the estimates made by the Council in previous years is placed at Chart 7.4 and described as "current projections", along with projections underlying the Council's estimates of August 2012 and July 2011 and described in the chart as "old (1)" and "old (2)" projections respectively.

Monetary Policy

236. The Indian monetary authorities have been caught in the classic dilemma between inflation and growth in the last two years. In a situation where inflation is high but output growth is reasonable and is close to the potential, inflation control becomes the dominant objective of monetary policy. Similarly, if output growth is below potential but inflation is subdued, monetary authorities once again do not face any difficulty. Stimulating growth becomes the major concern. The dilemma arises only when inflation remains high and output growth is also significantly below the potential.

237. In 2009-10 while inflation remained high, output growth was still high. As recently as 2010-11, the Indian economy was growing at the rate of 9.3 per cent. It was therefore not surprising that RBI raised the repo rate by 375 basis points between March 2010 and October 2011, when wholesale inflation remained around 9 per cent most of the time. Of course, even then some concerns were expressed about raising the repo rate. But the situation certainly called for tightening and in fact RBI could have tightened more strongly, and with greater speed, rather than being spread over a period of time in small steps.

238. At that time, a question that was raised was whether the RBI was justified in increasing the policy rate when inflation was primarily triggered by supply side factors, more particularly in relation to agricultural commodities. Food inflation, if it persists long enough, gets generalised. In fact, manufacturing inflation rose from 5.3 per cent in March 2010 to 8.2 per cent in November 2011 and therefore policy tightening was very much warranted.

239. The position changed in 2011-12 and more particularly in 2012-13. In 2011-12, inflation continued to remain high with average WPI inflation for the year being 9 per cent. Simultaneously, growth started slackening and the GDP growth rate for 2011-12 fell to 6.2 per cent, posing a clear dilemma to monetary authorities. As inflation continued to remain well above what was regarded as the acceptable level, RBI did not relax its

policy of tightening. However, in April 2012, when wholesale inflation came down to 7.5 per cent, RBI went in for easing by reducing the repo rate by 50 basis points. While WPI inflation was coming down, consumer price inflation continued to remain high and RBI did not act till January 2013 when the repo rate was cut by 25 basis points. Two further cuts of 25 basis points each were made in March and May 2013, as growth concerns became dominant. In 2012-13, overall GDP growth fell to 5 per cent and growth in manufacturing was a mere 1 per cent. It was the easing of WPI inflation and more particularly non-food manufacturing inflation that induced the RBI to lower the repo rate.

240. But it is important to remember that consumer price inflation all along had continued to remain high and as recently as June 2013 it stood at 9.5 per cent. The dominant objective of the central bank has to be maintenance of price stability. This does not mean that growth is unimportant. It has to balance various objectives. However, for the sake of clarity, it must have a hierarchy of objectives. Naturally, in this hierarchy, price stability takes precedence.

241. In any case, recognising the steady decline in wholesale inflation and the need for stimulating economic growth, the RBI policy was moving towards a more easy stance. But this was interrupted by the sharp depreciation of the rupee, particularly after 22 May 2013. When the domestic currency was under pressure, it was inevitable that the monetary authorities had to undertake a policy of tightening the availability of liquidity to curb speculative activities. A series of measures were undertaken by RBI. They had some impact on the rupee. Direct intervention in the foreign exchange market combined with tightening of liquidity will have to play their role in such a situation. Stability will come back to the foreign exchange market once capital flows start returning.

242. Several measures have recently been announced for containing the CAD in the short run. Capital inflows however are also dependent on external factors. What is happening to India in this respect is not unique. In many ways, it is a global phenomenon. The current stance of monetary policy has to continue until stability in the rupee is achieved. Thereafter, if the current trend in the moderation of wholesale price inflation continues, which is in fact expected, the monetary authorities can switch to a policy of easing. The timeframe for this is very difficult to specify but much depends on the return of stability to the rupee.

VIII – FISCAL POLICY AND MANAGEMENT

243. The overall budgetary position of the Centre has been under strain in recent years. The fiscal deficit of the Centre, including off-budget liabilities, declined to 3.1 per cent of GDP in 2007-08, putting it on track to achieving the FRBM target of 3 per cent of GDP. However, owing to the international financial crisis of 2008, and the consequent slowdown of the Indian economy, the Centre's fiscal deficit, including off-budget liabilities, ballooned to 8.2 per cent in 2008-09. There has been some reduction in the deficit in subsequent years, particularly following the mid-year course corrections in the last financial year, but the figure continues to be high.

244. The Centre's fiscal deficit is to be limited to 4.8 per cent of GDP in this year's budget. While this is well above the FRBM norm of 3 per cent of GDP, it is only 20 basis points higher than what was proposed in the revised fiscal roadmap for 2013-14 by the Kelkar Committee. However, data available for the first four months of the current financial year suggests that containing the fiscal deficit within the budgetary limit could be a challenge as revenue, and particularly tax, receipts were significantly below, and total expenditure substantially above, the five years moving average. As a result, the fiscal deficit during the first four months of the current financial year has already reached 62.8 per cent and expenditure on major subsidies was 51.3 per cent of the budgetary provision for the full financial year. Discretionary expenditure that has been budgeted may need to be compressed, and subsidies restructured, in the remaining months of the financial year in a growth friendly manner to limit slippages from the revised fiscal roadmap.

245. The finances of the States now appear to be relatively better placed as compared to the Centre. The fiscal deficit of all states put together was 2.8 per cent of GDP in 2009-10, and moderated further to 2.1 per cent in 2012-13 (BE). A slow but steady growth of tax and non-tax receipts has helped in the process of fiscal consolidation in the states. Although there are large inter-state variations across states in terms of their fiscal position, the combined revenue deficit of the states in recent years has been negative, indicating that the entire fiscal deficit is on account of capital expenditure that is necessary to sustain rapid growth.

Table 8.1

Fiscal Position in India

Unit: per cent of GDP

	Centre			States			Consolidated		
Year	Rev. Deficit	Fiscal Deficit*	Primary Deficit	Rev. Deficit	Fiscal Deficit	Primary Deficit	Rev. Deficit	Fiscal Deficit*	Primary Deficit
2002-03	4.40	6.04	1.11	2.33	3.88	1.25	6.64	9.71	3.02
2003-04	3.57	4.62	–0.03 ‡	2.19	4.27	1.46	5.79	8.65	1.95
2004-05	2.42	3.90	–0.04	1.21	3.11	0.66	3.54	7.26	1.12
2005-06	2.50	4.73	0.37	0.19	2.33	0.16	2.69	7.26	0.79
2006-07	1.87	4.27	–0.18	–0.58	1.82	–0.37	1.29	6.32	–0.33
2007-08	1.05	3.11	–0.88	–0.86	1.49	–0.49	0.19	4.65	–1.02
2008-09	4.54	8.20	2.59	–0.21	2.40	0.57	4.33	10.62	3.45
2009-10	5.18	6.61	3.14	0.37	2.80	1.03	5.54	9.41	3.99
2010-11	3.29	4.87	1.82	–0.03	2.07	0.45	3.26	6.94	2.13
2011-12	4.39	5.75	2.71	–0.06	2.28	0.74	4.33	8.07	3.41
2012-13 PA	3.63	4.89	1.78	–0.42†	2.15†	0.60†			
2013-14 BE	3.34	4.77	1.51						

Note: * Fiscal deficit includes off budget liabilities; PA: Provisional Actual; BE: Budget Estimate.

† Budget Estimates (BE) for the States

‡ Negative Deficit means a Surplus on that account.

Source: 1. Public Finance Statistics, Ministry of Finance, Government of India; 2. Budget documents of central and State governments.

246. Rapid growth in turn creates fiscal space through higher tax revenue for increasing investment to put in place the modern physical and social infrastructure critical to sustain high growth and to make it more inclusive. Under extant constitutional arrangements states are principally responsible for providing education and health facilities to their residents. While expenditure on social infrastructure has increased in recent times, cross country data nevertheless reveals that some developing countries with lower per capita income have significantly better social sector indicators than India. The fiscal consolidation recently recorded in the

states may therefore need critical re-examination to ensure that state expenditures are properly prioritized in the process of fiscal consolidation. The 14th Finance Commission that was constituted in January 2013 to examine the availability of resources with the central and state governments, as well as the demands on these resources, is perhaps best suited to do so.

247. The combined tax to GDP ratio of the Centre and states stood at 16.6 per cent in 2011-12, of which direct taxes constituted 6.0 per cent while indirect taxes constituted the balance of 10.6 per cent. Direct taxes comprised about 16 per cent of the total tax revenue of the Centre and the states in 1991-92. Over the years, major reforms to moderate rates, broaden the base, and limit exemptions, have led to a steady growth in the relative share of direct taxes that now form about 36 per cent of the total tax revenue. It is imperative that these reforms are carried to their logical conclusion through first, an early enactment and implementation of the proposed Direct Tax Code; and second, through improved tax implementation with a comprehensive data base and state of the art and user friendly procedures that encourage voluntary compliance on the part of honest tax payers. The draft Direct Tax Code has undergone a number of changes since it was first conceived. It is important that the final version retains its original objective of low rates and minimum exemptions so that the tax base is broadened and its buoyancy to GDP improved.

248. Indirect taxes, comprising Excise and Customs at the Central level and Sales taxes, among others, in the states, have been the mainstay of India's tax system. Comprising 3.81 per cent of GDP in 1950-51, these taxes grew to more than 13 per cent of GDP by the late 1980s, but declined somewhat in the post reform years after 1991 owing to rationalization of excise duties, and realignment of customs duties. Owing to historical reasons there are multiple forms of excise duties and sales taxes that lead to cascading, thereby negating the objective of a rational and buoyant indirect tax system. The presence of Central sales tax acts as a constraint on inter-state movement of goods and services and goes against the idea of a unified common market. The complex tax structure, and lack of tax harmonization, undermines efficiency, provides incentive for evasion and distorts prices and resource allocation.

249. For nearly a decade now the Government has been seriously considering implementing a comprehensive Goods and Services Tax (GST) based on the value added tax (VAT) principle that would replace the existing multiple tax structures at the Centre and the States. A system of generalized goods and services tax is in operation in

more than 130 countries of the world and would enable taxation of goods and services in an integrated manner which is required in a modern economic environment. This would remove the distortions caused by the existing complex tax structure and would also help in strengthening the common national market. The GST was expected to be a single rate that would subsume within it the present Central Excise duty, additional excise duty, service tax, additional duty of customs (equivalent to excise), State VAT, entertainment tax, taxes on lotteries, betting and gambling and entry tax, in the main. The current proposal has undergone some changes, such as a dual (Central and State) instead of a single GST, a floor rate with a band instead of a single rate, keeping the entry tax outside the GST, and doing away with declared goods and the independent dispute resolution authority.

250. It is however important that all products are included in the constitutional amendment, with inclusions and exclusions decided by the GST Committee of Finance Ministers, so that the data base created is as comprehensive as possible. Nevertheless most technical issues are now resolved, at least in principle, and the IT enabled GST computer network is also being set up in all the States through a Special Purpose Vehicle. If the constitutional amendment is passed by Parliament and the States it should therefore be possible to roll out the GST in the next financial year. This would both improve revenue collection through greater tax buoyancy and also give a boost to flagging economic growth.

251. In this context, we may note some of the comments made by the Standing Committee on Finance of the Fifteenth *Lok Sabha*. It has noted that the proposed Bill envisages harmonization of the indirect tax regime by subsuming a variety of taxes levied by the Centre and the States. This would avoid the multiple layers of taxation that currently exist in India. It has proposed the creation of a GST Compensation Fund to allay the apprehension of the States about revenue losses after the implementation of GST. It has also emphasized that flawless implementation of GST presupposes appropriate IT infrastructure, uniform administrative arrangements across States, and unified tax credit clearing mechanisms, among other major requirements. In the event of disputes among States, it has suggested that there should be voting instead of consensus for decisions of the GST Council. It is of the view that a system of having a band with a floor rate and a ceiling rate should be adopted, and States should have some elbow

room within the stipulated limit to calibrate the rate of tax depending on their specific requirements.

252. Given the fiscal strain the country is facing at the moment it is desirable to increase tax revenue collection by about three to four percentage points of GDP, to about 20 per cent of GDP, through rationalization of the direct and indirect tax systems as detailed above, better implementation and the consequential broadening of the tax base, including through a more complete coverage of services, presently the most dynamic sector of the economy. This will allow the government to channelize more resources into basic economic and social infrastructure.

253. The above measures would increase tax revenues through broadening of the tax base, and increasing tax buoyancy and compliance, rather than by increasing tax rates and/or levying new taxes that could further undermine growth at the current juncture. One of the key factors that enabled the Indian economy to grow at more than 9 percentage points during 2005-06 to 2007-08 was the high savings rate which enabled a high rate of gross capital formation or investment. The latter peaked at 38.1 per cent of GDP in 2007-08, the year in which gross domestic saving stood at 36.8 per cent. The savings rate has been eroded substantially in subsequent years. It stood at 30.8 per cent in 2011-12, a drop as large as 6 percentage points of GDP. This has resulted in a widening saving-investment gap which is straining the current account and pressuring the rupee, thereby distracting the central bank from adequately addressing concerns arising out of falling growth. A major reason for this growing gap is the drop in public sector savings during this period from 5 per cent down to 1.3 per cent, which needs to be addressed as pointed out above. Another reason is the sharp dip in household financial savings and a movement away to assets such as gold that further worsen the current account. The underlying reason for the shift away from financial savings, namely negative or low real interest rates, may have to be countered by new financial instruments and/or more fiscal incentives, to make financial savings more attractive.

APPENDIX I

Measures to Promote High Value Agriculture

I. Importance of High Value Agriculture

A remarkable change has taken place in Indian agriculture in the last two decades. The composition of agricultural output has changed substantially. The value of the crop sector has declined and the value of output from horticulture, animal husbandry, poultry and fisheries, termed High Value Agriculture (HAV) has risen. HVA currently accounts for nearly 63% of agriculture GDP. As the importance of the grain sector declines, HVA will be the future source of growth in agriculture. Already, it is the more dynamic part of Indian agriculture.

The growth of HVA is demand driven. With the increase in income, demand for food grains progressively declines and demand for fruits, vegetables, dairy, meat and fishery products rises, indicating the need for diversification to other crops or allied activities. In the export sector also, demand for these products is rising, particularly in the emerging economies.

Additionally, these sub-sectors are labour intensive and quite suited to the resource endowment of small farmers. The share of small farmers in fruits and vegetable growing, and in dairying, is large relative to their share in land holdings. In some of the sub-sectors, e.g. dairying, women play a dominant role.

Despite their importance from the consumers as well as the producers perspective, HVA sectors have not received as much attention as the grain sector, and allocation of resources to these sectors has not been commensurate with their importance, and even what was allotted was not fully utilized. The constraints facing HVA as well as the overall policy and strategic initiatives needed to accelerate the pace of growth of HVA are detailed below.

II. Constraints in increasing supplies:

Horticulture: Researchers estimate that horticulture crops can generate as much as seven times more income per unit of land compared with cereals, and require two to seven times as much labour. They also make a positive contribution to poverty reduction. Yet the target of 5 per cent increase per year in fruit & vegetable

production in the Eleventh Plan, could barely be met, with the actual achievement a mere 4.8 per cent.

The main reasons were inadequate attention to post-harvest management and market development. The net result has been frequent and sharp fluctuations in the prices of fruits and vegetables in the domestic market. Even the tax system is biased against fresh produce. One of the major constraints which inhibits the development of processing of HVA produce is the skewed taxation structure at the Central and State level applicable to the sector. Unfortunately, agro processing is seen as a luxury product and taxed at several points, leading to a cascading effect on the final prices of the processed product. This is the reason why no large scale value chains have evolved in India to process the variety of HVA available.

Non-availability of credit and appropriate insurance covers are additional handicaps. Higher capital intensity and greater gestation lag in fruit production seem to deter the small farmer with low capital base, low access to credit and low capacity to bear risk. For necessary investments in critical productivity-enhancing infrastructure, such as drip irrigation, poly houses, shade net etc, a separate limit could be earmarked within the overall agricultural credit stream for HVA, targeting small producers.

Lack of processing facilities has emerged as a major handicap. The Twelfth Plan has noted that although India ranks second in world production of fruits and vegetables, only 6 to 7 per cent of this is processed, compared to 65 per cent in the US and 23 per cent in China.

The attention paid to post-harvest management and market development and processing is grossly inadequate. . The Mid Term Appraisal of the Eleventh Plan noted that only 11 states have taken the initiative in establishing cold storages and eight states have established *apni mandis*. There is virtually no progress in establishment of wholesale markets except in Kerala.

Animal Husbandry: Livestock comprises 25 per cent of gross value added in agriculture and provides self-employment to 21 million people. Growth in the Twelfth Plan is targeted at 4.8 per cent per annum. Milk accounts for about 70 percent of the total output of the Livestock Sector. Milk production grew at an annual rate of 4.5 per cent during the 1990s, elevating India to the Number 1

position in milk production in the world, and improving the availability of milk and milk products for our burgeoning population. But during the first decade of the new millennium, the rate of growth has declined to 3.8 per cent.

India has the largest cattle and buffalo population in the world. But average milk yields lag the world average. A large chunk of additional output (43 per cent) between 1992 and 2010 was contributed by an increase in the population of milch animals rather than a rise in yield. Lack of organized marketing and veterinary services is the major constraint in augmenting milk yield. Growing deficit in feed and fodder is another hurdle.

The dairy sector has undergone significant structural changes. These are reflected in the changes in the composition of livestock population, marketing of liquid milk and increased participation of the private sector. Despite all these changes, the status of dairy infrastructure, as well as delivery of services, continues to be unsatisfactory.

To boost milk production, innovative approaches in breeding, feeding and management on the production side, and more emphasis on marketing and processing, with a strong link of small producers to the organized sector, are required. Concerted efforts should be made to ensure the required improvements. Rise in productivity is the only viable alternative for accelerated and sustainable growth of the Indian dairy sector. The strengthening of market linkages, either through expansion of cooperatives or producers' organizations or facilitating contract farming arrangements will go a long way in improving milk productivity.

Meat: No central assistance is available to this sector. Even the incentive given to this sector in the form of export subsidy etc., has been gradually withdrawn. India's comparative advantage may not be sustained once quality norms become stricter in importing countries. Future prospects are not bright due to problems such as non-availability of grazing land, inadequate genetic up-gradation, disease and difficulties in migration.

Poultry: Over the years the poultry sector has been transformed from a predominantly backyard enterprise to a well-organized industry. Poultry meat and eggs were among the highest growing component of Agricultural GDP rising from 4 per cent per annum during the 1990s to over 5% during the 10th and 11th Plan.

Besides eggs, the commercial poultry sector also produces over 2 million tons of broiler meat, which is an increasing part of total meat production of about 5 million tons. There are vast unexploited opportunities in this sector.

The poultry sector is handicapped by disease and lack of availability of feed. We must ensure a better feed conversion ratio (FCR) and improved protection against avian influenza and other newer diseases. The organized sector of the poultry industry is poised to achieve a high rate of growth. The unorganized poultry sector, however, needs financial, infrastructural, and technological support to raise the present growth rate from 2 to 3 per cent.

Fisheries: Growth in Fisheries in the Eleventh Plan was targeted at 6 per cent. However the actual growth was 3.6 per cent. The growth in this sector has been decelerating since the mid-1990s. The main reason is the stagnation in marine fishery, where there seems to be no further scope to raise output. Major growth is expected in inland fisheries. But here too there are problems regarding availability of quality fish seeds and other critical inputs, as well as poor processing and marketing facilities.

There is strong and growing domestic demand for fish products, apart from good prospects for increasing exports. Fish prices more than doubled during the Eleventh Plan, a higher increase compared to that of crops or any other livestock segment. Fresh water aquaculture, which contributed to the 'Blue Revolution' in the country in the late 1970s, seems to have run its course in terms of species diversification and yield rate. Future challenges are sustainable management of resources and rehabilitation of threatened resources.

III. Needed Interventions

Apart from sector specific programs there are certain common measures, which will impact all the sectors constituting HVA. These include: larger investment and efficient service delivery; improving organizational efficiency in the supporting institutions; efficient marketing arrangements; and, aggregation of small producers.

It is hoped that overall investment will be revived in the 12th Plan and HVA will get its due share. There are critical constraints in each of the sectors, as indicated above. These constraints must be removed on a priority basis.

Large investments are required to develop agricultural markets, for grading and standardization, quality certification, warehousing, cold storage and post-harvest management of produce. Besides, investment in processing facilities must be augmented. Investment need not come from the public sector alone. There is a vast scope for private participation in these activities. Conditions should be created to encourage investment by the private sector.

There are dedicated organizations and programs in the public domain for each of the sectors. The National Horticulture Mission, the National Dairy Development Board, and the Fresh Water Fish Farmers Agency are examples of such institutions. The functioning of these institutions should be carefully examined and they should be made accountable. As a corollary they should have the required resources and autonomy in their functioning.

One of the major handicaps faced by these sectors is the weak supply chain. This leads to high post-harvest losses, averaging between 10 to 25 per cent, (this is particularly high in horticulture, livestock, and fisheries) and also leads to periodical gluts and scarcities. The main sufferers are the consumers as well as the small producers. Concerted efforts will have to be made to develop modern logistics, processing and organized retailing. Apart from investment in organizing these facilities, attention needs to be given to market reforms in agriculture. The elements of reforms are clear, yet not many states have taken the initiative in implementing these reforms. While the reforms in APMC are important, alternative marketing models such as linking producers directly with customers, e.g. *Rythu Bazar*, as well as organized retailing by large players, should also receive due attention.

Another reason for the uneven growth of HVA is the complicated legal situation related to land tenancy. While there is a lot of interest among corporates and enterprising farmers to enter into HVA, the absence of transparent and enforceable legal provisions for leasing of land blocks significant investments in HVA. There is a need to bring State Governments on board to relax tenancy provisions to facilitate legal access to leased land, protecting both the rights of title holders as well as lessee.

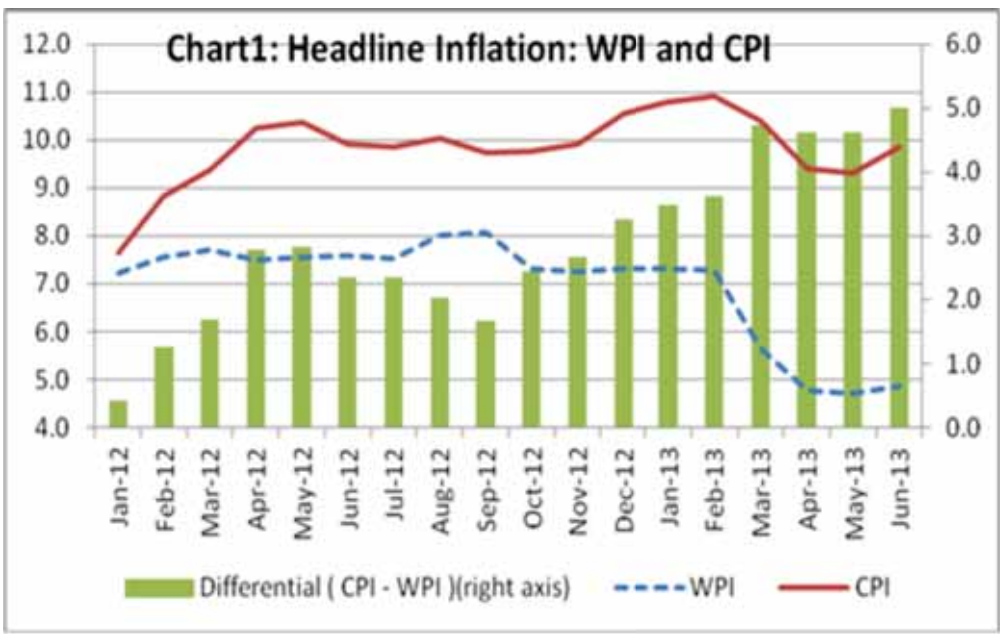
As mentioned above, small farmers and small fishermen are the major producers of HVA. Currently they suffer from weak farm-firm linkage, the only exceptions being

when they are organized in cooperatives or producer companies or associated with large processors through contract farming. The number of such farmers who are aggregated in one form or other is miniscule. Concerted efforts by the government, the private sector and by civil society institutions are needed to help them come together and facilitate their linkages with larger entities in their respective sectors. Without some degree of aggregation, the potential benefit of HVA will not percolate to a large number of producers. Promoting farmers organizations should form the corner stone of the strategy for diversification to HVA.

APPENDIX II

Widening differential between Whole sale and Retail Inflation – An Explanation

1. The widening differential between wholesale and retail inflation in the recent period has become a cause of concern for policy makers. In June, 2013 CPI inflation (9.9 per cent) was almost twice the level of WPI Inflation (4.9 per cent). A year ago the differential was 2.3 per cent. Over a period from Jan, 2012 to June, 2013, the differential widened from 0.4 per cent to 5.0 per cent (Appendix Chart-1). The reasons for the divergence derived from two separate statistical factors, viz. Item differences, and difference in weights of common items, in the basket of two indices.



Due to difference in Item Baskets of the two indices:

2. The WPI item basket mainly consists of goods (agricultural and manufactured) produced in our country, while the CPI basket consists of goods and services consumed by the Indian households. Therefore the CPI basket includes services like Housing, education, medical care, recreation and amusement, transport and communication, household requisites like domestic servant, domestic cook etc.

Since these non-tradable items are not part of the WPI basket any upward/downward movement in the fares/prices of these items will widen the gap between wholesale and retail inflation. The increasing divergence between WPI and CPI could therefore partly reflect a rise in the price of non tradables relative to tradables over this period.

3. However, the percentage weighted contribution of most of these items to the headline inflation showed a sluggish downward trend from Jan 2012 to June 2013 (*table 1*). For example, in Jan 2012, the percentage contribution of Housing to headline inflation was 16 per cent (1.2 out of 7.8), but this declined to 11 per cent over this period. So clearly, the price movement in these items, which are not the part of WPI Item basket, may not be the reason behind the widening of the gap between CPI and WPI inflation.

4. There are certain items in the WPI basket, such as minerals, basic metals and their products, chemical products, machinery and tools, heavy transport equipment and parts that are not directly consumed by households, and hence not included in the CPI basket. So price movements in these items, which directly affect wholesale inflation, may not have any impact on CPI inflation over the short-run. They may, however, indirectly affect CPI inflation in the medium to long run because of their lagged effect on the price of the consumer goods. The analysis shows that the items that contributed to the latest dip in the overall wholesale inflation from 8 per cent in September 2012 to 4.7 per cent in May 2013 were minerals, crude petroleum, and some non- food manufacturing items like chemicals and chemical products, Basic metals like ferrous metals and their products (*table 2*). Since these items are not in the CPI basket, the downward trend in their prices did not affect CPI inflation, thereby widening the inflation differential between the two indices.

Difference in weights of common items in the basket of two indices:

5. Most of the food items, specifically food articles and food products, are common to the baskets of both the indices. But their weights are different. Food items have a total weight of 49.7 per cent in CPI, while their weight in WPI is 24.3 per cent (including the weights of food products). In both the indices the composition of weights in the different food items differs very significantly. The difference in the weights of some of the food items in CPI and WPI is shown below in Appendix Table 3:

Appendix Table 3: Weights of Food Items in CPI and WPI

Food Items (Weight)	CPI	WPI
Cereals	14.6	3.4
Pulses	2.7	0.7
Vegetables	5.4	1.7
Fruits	1.9	2.1
Milk	7.7	3.2
Eggs, Meat & Fish	2.9	2.4
Condiments & Spices	1.7	0.6

6. Since the weights of these food items, except for fruits, are comparatively higher in CPI, the impact of upward movement in prices of these items will be much higher in CPI as compared to WPI. In May, 2013 cereals inflation in both the indices was at 17 per cent. Since the weights of cereals in both the indices are significantly different the weighted contributions of cereals in the total inflation differed significantly. Thus in May 2013, cereals contributed only 13 per cent to the overall WPI inflation while it contributed 25 per cent to overall CPI inflation. This means that simply the difference in the weights of cereals in the two indices added an additional 1.8 per cent to the overall CPI overall inflation in June, 2013. This difference was around only 0.4 per cent one year ago. Appendix Table 4 depicts the addition to overall CPI inflation due to the weight difference in cereals.

Appendix Table 4: Contribution of Cereals to CPI and WPI Inflation

Month	Cereals contribution to overall CPI inflation	Cereals contribution to overall WPI inflation	Difference in Cereals contribution
May-12	0.6	0.2	0.4
Jun-12	0.7	0.3	0.4
Jul-12	0.9	0.3	0.6
Aug-12	1.2	0.4	0.8
Sep-12	1.4	0.5	0.9
Oct-12	1.6	0.6	1.0
Nov-12	1.7	0.7	1.1
Dec-12	1.9	0.7	1.2
Jan-13	2.1	0.7	1.4
Feb-13	2.4	0.7	1.7
Mar-13	2.5	0.7	1.9
Apr-13	2.4	0.6	1.8
May-13	2.3	0.6	1.7
June-13	2.5	0.7	1.8

7. High cereals inflation is one of the main reasons behind the widening inflation deferential between wholesale and retail inflation in recent months. In terms of other food items like vegetables, milk and eggs, meat and fish, this difference is positive but not as high as compared to cereals. (Appendix Tables 1 & 2).

Appendix II table 1 : Commodity wise contribution to CPI Headline Inflation

Commodity Description	Weight	Jan-12	Feb-12	Mar-12	Apr-12	May 12	June 12	July 12	Aug-12	Sep-12	Oct-12	Nov-12	Dec-12	Jan-13	Feb-13	March 13	April 13	May 13	June 13
		7.8	**8.9**	**9.5**	**10.3**	**10.5**	**10.1**	**10.0**	**10.1**	**9.9**	**9.8**	**9.9**	**10.6**	**10.7**	**11.0**	**10.4**	**9.4**	**9.3**	**9.9**
A.1) Food, beverages & tobacco	**49.71**	**2.2**	**3.4**	**4.1**	**5.1**	**5.3**	**5.4**	**5.8**	**6.1**	**5.9**	**5.8**	**5.9**	**6.5**	**6.6**	**6.7**	**6.2**	**5.4**	**5.4**	**6.0**
A.1.1) Cereals and Products	14.59	0.4	0.3	0.3	0.5	0.6	0.7	0.9	1.2	1.4	1.6	1.7	1.9	2.1	2.4	2.5	2.4	2.3	2.5
A.1.2) Pulses and Products	2.65	0.1	0.1	0.1	0.1	0.2	0.2	0.3	0.4	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.2	0.2
A.1.3) Oils and Fats	3.90	0.6	0.5	0.6	0.8	0.8	0.7	0.8	0.8	0.8	0.8	0.8	0.7	0.7	0.6	0.5	0.3	0.2	0.2
A.1.4) Egg, Fish and Meat	2.89	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.4	0.4	0.3	0.4	0.4	0.5	0.4	0.4	0.4	0.4
A.1.5) Milk and Products	7.73	1.4	1.3	1.3	1.2	1.1	1.0	1.0	0.9	0.9	0.8	0.7	0.7	0.7	0.7	0.6	0.6	0.6	0.6
A.1.6) Condiments and Spices	1.71	0.2	0.2	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1
A.1.7) Vegetables	5.44	-1.1	-0.2	0.5	1.3	1.5	1.6	1.7	1.3	0.8	0.6	0.8	1.4	1.4	1.1	0.6	0.3	0.5	0.9
A.1.8) Fruits	1.89	0.2	0.2	0.1	0.1	0.1	0.2	0.2	0.2	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.1	0.2
A.1.9) Sugar etc.	1.91	0.0	0.1	0.1	0.1	0.1	0.1	0.2	0.3	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.1	0.1
A.1.10) Non-Alcoholic Bev	2.03	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
A.1.11) Prepared Meals etc.	2.83	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
A.1.12) Pan, Tobac & Intoxicants	2.13	0.4	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.3	0.3	0.2	0.2	0.3	0.2	0.2	0.2
A.2) Fuel and Light	**9.49**	**1.3**	**1.3**	**1.2**	**1.1**	**1.0**	**1.0**	**0.7**	**0.7**	**0.7**	**0.7**	**0.7**	**0.8**	**0.8**	**0.8**	**0.8**	**0.8**	**0.8**	**0.8**
A.3) Housing	**9.77**	**1.2**	**1.3**	**1.4**	**1.4**	**1.5**	**1.0**	**1.0**	**1.0**	**1.0**	**1.0**	**1.0**	**1.0**	**1.0**	**1.0**	**1.0**	**1.0**	**1.0**	**1.0**
A.4) Clothing, Bedding, Footwear	**4.73**	**0.7**	**0.7**	**0.6**	**0.6**	**0.6**	**0.6**	**0.5**	**0.5**	**0.5**	**0.5**	**0.6**	**0.5**	**0.6**	**0.6**	**0.5**	**0.5**	**0.5**	**0.5**
A.4.1) Clothing & Bedding	4.05	0.6	0.6	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.4	0.4
A.4.2) Footwear	0.68	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
A.5) Miscellaneous	**26.31**	**2.3**	**2.2**	**2.2**	**2.1**	**2.1**	**2.1**	**1.9**	**1.7**	**1.7**	**1.8**	**1.7**	**1.7**	**1.7**	**1.8**	**1.9**	**1.7**	**1.5**	**1.5**
A.5.1) Medical Care	5.69	0.4	0.4	0.4	0.4	0.4	0.4	0.3	0.3	0.3	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
A.5.2) Education, Stationary	3.35	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
A.5.3) Recreation, Amusement	1.43	0.1	0.1	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
A.5.4) Transport & Comm.	7.57	0.7	0.6	0.6	0.6	0.6	0.6	0.5	0.5	0.4	0.4	0.4	0.4	0.4	0.5	0.6	0.5	0.4	0.4
A.5.5) Personal Care & Effects	2.92	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
A.5.6) Household Requisites	4.30	0.6	0.5	0.5	0.5	0.5	0.5	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.3	0.3	0.2	0.2	0.2
A.5.7) Others	1.06	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1

Appendix Table 2: Commodity wise contribution to WPI Headline Inflation

Commodity Description	Weight	Jan-12	Feb-12	Mar-12	Apr-12	May 12	June 12	July 12	Aug-12	Sep-12	Oct-12	Nov-12	Dec-12	Jan-13	Feb-13	March 13	April 13	May 13	June 13
		7.2	**7.6**	**7.7**	**7.5**	**7.5**	**7.5**	**7.5**	**8.0**	**8.1**	**7.4**	**7.2**	**7.3**	**7.3**	**7.2**	**5.7**	**4.8**	**4.7**	**4.9**
1. Primary Articles	**20.1**	**0.7**	**1.8**	**2.6**	**2.5**	**2.7**	**2.5**	**2.7**	**2.9**	**2.4**	**2.0**	**2.5**	**2.7**	**2.9**	**2.7**	**1.9**	**1.3**	**1.8**	**2.1**
1.1 Food Articles	**14.3**	**-0.1**	**1.1**	**1.7**	**1.9**	**1.9**	**1.9**	**1.8**	**1.7**	**1.5**	**1.2**	**1.6**	**1.9**	**2.1**	**2.1**	**1.5**	**1.1**	**1.5**	**1.8**
1.1.1 Cereals	3.4	0.1	0.1	0.2	0.3	0.2	0.3	0.3	0.4	0.5	0.6	0.7	0.7	0.7	0.7	0.7	0.6	0.6	0.7
1.1.1.1 Rice	1.8	0.0	0.0	0.1	0.1	0.1	0.1	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.4	0.4
1.1.1.2 Wheat	1.1	0.0	-0.1	0.0	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.2	0.2	0.2	0.2
1.1.2 Pulses	0.7	0.1	0.1	0.1	0.1	0.1	0.2	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.0
1.1.3 Vegetables	1.7	-1.3	0.0	0.5	1.0	0.9	0.9	0.5	0.2	-0.2	-0.2	0.0	0.2	0.5	0.3	0.0	-0.2	0.1	0.4
1.1.4 Fruits	2.1	0.1	0.0	-0.1	-0.5	-0.2	-0.1	0.0	0.0	0.2	0.1	0.2	0.1	0.2	0.2	0.1	0.0	0.0	0.0
1.1.5 Milk	3.2	0.5	0.5	0.6	0.6	0.5	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.2
1.1.6 Eggs,Meat & Fish	2.4	0.6	0.6	0.5	0.5	0.5	0.5	0.5	0.5	0.4	0.4	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4
1.1.7 Condiments & Spices	0.6	-0.2	-0.2	-0.1	-0.1	-0.2	-0.2	-0.1	-0.1	-0.1	-0.2	-0.2	-0.1	0.0	0.0	0.0	0.1	0.1	0.1
1.1.8 Other Food Articles	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
1.2 Non-food Articles	**4.3**	**0.0**	**-0.1**	**0.0**	**0.1**	**0.4**	**0.4**	**0.6**	**0.7**	**0.5**	**0.6**	**0.7**	**0.7**	**0.6**	**0.5**	**0.5**	**0.4**	**0.3**	**0.4**
1.3 Minerals	**1.5**	**0.8**	**0.9**	**0.9**	**0.5**	**0.4**	**0.2**	**0.3**	**0.5**	**0.4**	**0.3**	**0.2**	**0.2**	**0.1**	**0.1**	**-0.1**	**-0.1**	**0.0**	**0.0**
1.3.1 Crude Petroleum	0.9	0.6	0.6	0.8	0.4	0.2	0.0	0.1	0.3	0.2	0.1	0.1	0.1	0.1	0.1	-0.1	-0.2	0.0	0.1
2. Fuel & Power	**14.9**	**2.6**	**2.3**	**2.0**	**1.9**	**1.8**	**1.9**	**1.3**	**1.4**	**1.9**	**1.9**	**1.6**	**1.7**	**1.5**	**1.8**	**1.3**	**1.4**	**1.2**	**1.2**
3. Manufactured Products	**65.0**	**3.9**	**3.4**	**3.0**	**3.1**	**3.1**	**3.1**	**3.4**	**3.7**	**3.7**	**3.4**	**3.1**	**2.9**	**2.9**	**2.8**	**2.5**	**2.1**	**1.8**	**1.6**
3.1 Food Products	10.0	0.5	0.5	0.6	0.6	0.6	0.6	0.7	0.9	1.0	0.9	0.9	0.8	0.8	0.8	0.7	0.7	0.6	0.6
3.2 Non-food Manufacturing	**55.0**	**3.4**	**2.9**	**2.4**	**2.5**	**2.5**	**2.6**	**2.7**	**2.8**	**2.7**	**2.5**	**2.2**	**2.1**	**2.0**	**1.9**	**1.7**	**1.4**	**1.2**	**1.0**
3.2.1 Beverages, Tobacco & Tobacco Products	1.8	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
3.2.2 Textiles	7.3	0.1	0.0	-0.2	-0.2	-0.2	-0.1	0.1	0.2	0.3	0.3	0.3	0.3	0.2	0.2	0.3	0.3	0.2	0.2
3.2.3 Wood & Wood Products	0.6	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
3.2.4 Paper & Paper Products	2.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
3.2.5 Leather & Leather Products	0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
3.2.6 Rubber & Plastic Products	3.0	0.1	0.1	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
3.2.7 Chemicals & Chemical Products	12.0	1.0	0.8	0.8	0.7	0.8	0.8	0.8	0.8	0.8	0.7	0.6	0.6	0.6	0.6	0.5	0.4	0.3	0.3
3.2.8 Non-metallic Mineral Products	2.6	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.2	0.1	0.1	0.1	0.1
3.2.9 Basic Metals, Alloys & Metal Products	10.7	1.3	1.1	1.1	1.2	1.1	1.1	1.0	0.9	0.8	0.7	0.5	0.3	0.3	0.2	0.1	-0.1	-0.2	-0.2
3.2.10 Machinery & Machine Tools	8.9	0.2	0.2	0.2	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.1
3.2.11 Transport, Equipment & Parts	5.2	0.1	0.1	0.1	0.1	0.2	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.1