VII. MACROECONOMIC OUTLOOK

Going forward, macroeconomic outcomes crucially hinge on evolving macro-financial conditions and domestic policy response. These conditions worsened during Q1 of 2013-14 as financial volatilities, which were set off from signals that the global interest rate cycle may start to turn, disrupted capital inflows to the EMDEs. If these trends amplify, there may be a risk to both growth recovery and inflation moderation. Business confidence remains low, as is evident from recent expectations surveys. Growth is expected to pick only slowly as the year progresses. While headline inflation has moderated, high consumer price inflation remains a concern. While recent measures to address exchange rate volatility have provided a temporary breather, it is important that structural reforms are pushed through to support growth revival and reduce CAD.

Recovery may take time, although growth is expected to improve as the year progresses

VII.1 After two years of deceleration, growth appears to be stabilising. Growth in Q4 of 2012-13 was broadly the same as in the previous quarter. Early indications for Q1 of 2013-14 suggest that the recovery is yet to shape in the economy. IIP growth stagnated during April-May 2013 recording a growth of 0.1 per cent. The contraction in May has been large on a seasonally adjusted basis. However, there are emerging signs that the downturn could be getting contained. Agricultural prospects for 2013-14 are encouraging given the good monsoon so far. Revival in mining and manufacturing will take some more time but some improvement is likely later in the year. The robust rural demand on the back of a good monsoon is likely to render some support. Meanwhile, the deceleration in services sector activity has added to the growth worries and lead indicators for the services sector suggest that services activity remains weak.

VII.2 The well-distributed rainfall so far, that has been excess or normal in all regions except Haryana, east and north east, raises the prospects of improved agricultural growth and a pick-up in demand for consumer goods. The increase in the water storage levels in the reservoirs would also enable the hydro-power sector to enhance their capacity utilisation and contribute to improved electricity output. However, growth revival would require a pick-up in a range of services activities that fall under construction and 'trade, hotels, transport and communications'. Overall, revival will not materialise until stable policy and regulatory regimes supportive of industrial activity are firmly in place and the envisaged plans to remove structural bottlenecks are quickly and fully implemented.

Sustainable recovery requires control over consumer price inflation

VII.3 India's consumer price inflation has been hovering around the double digits for 15 consecutive months. Such high inflation is a source of internal and external disequilibrium. It causes real consumption demand to fall along with lowering of household savings that provide the bulk of financial surpluses to support private and public investments. High consumer price inflation does not help public finances either as it puts pressure for larger fiscal subsidies. As domestic savings get eroded, it widens the external gap reflected in the CAD. High inflation also means large inflation differential *vis-à-vis* global trading partners which then makes the economy vulnerable to currency pressures. India's current macroeconomic deterioration to a large extent, reflects the three years of high inflation, which is well above the threshold at which it turns detrimental to growth. While the fall in headline WPI inflation affords some comfort, it is important to bring consumer price inflation under control.

VII.4 Going forward, inflation risks remain. The recent rupee depreciation of about 9 per cent in Q1 of 2013-14 is likely to put some fresh pressure on domestic inflation as pass-through occurs. Fuel under-recoveries have risen sharply due to the exchange rate depreciation and domestic price rigidities. Given the wide CAD, it is important to keep fiscal deficits under check. Therefore, it is necessary to pass on increases and adjust administered prices in the energy sector, including coal and electricity. However, in the short-run it poses challenges for inflation management.

Surveys show business confidence continues to weaken

VII.5 Recent surveys on business expectations show that business confidence has weakened further. There has been moderation on a y-o-y and q-o-q basis in the key indices that capture business prospects (Table VII.1). According to the FICCI survey, stiff global economic outlook, weak demand and the cost of credit continue to be concerns. The Dunn and Bradstreet Business Confidence Index declined by 7.8 per cent compared to the previous quarter due to uncertainty in economic outlook, both external and domestic, and constrained pricing power due to weak demand. According to CII, economic and political instability, high levels of corruption and infrastructure and institutional shortages are the three top concerns of firms. The latest NCAER survey shows some improvement on a q-o-q basis, but a decline on a y-o-y basis. While the seasonally adjusted HSBC Markit Purchasing Managers' Index (PMI) for manufacturing improved marginally during June 2013, the PMI for services declined although it remained in expansionary mode. The input and output price indices for both the sectors increased.

Business expectations remain weak

VII.6 The 62nd Round of the Industrial Outlook Survey (http://www.rbi.org.in/IOS62) conducted during Q1 of 2013-14 showed a weakening of business sentiments with the Business Expectations Index (BEI) for Q1 of 2013-14 touching the lowest level in the past three financial years. However, the index showed improvement for Q2 of 2012-13 (Chart VII.1).

VII.7 An analysis of the net responses among various components of demand conditions shows that sentiments on production, order books, capacity utilisation and exports dropped substantially, whereas the sentiments on imports remained broadly unchanged. However, their outlook for Q2 of 2013-14 shows slightly improved optimism.

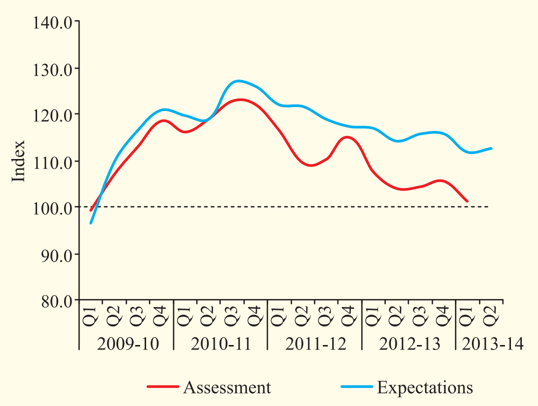
VII.8 The results also pointed to deterioration in the overall financial situation which dropped for Q1 of 2013-14 but showed improved

Table VII.1: Business Expectations Surveys

Period Index	NCAER- Business Confidence Index July 2013#	FICCI Overall Business Confidence Index Q4:2012-13	Dun & Bradstreet Business Optimism Index Q3: 2013	CII Business Confidence Index Q1: 2013-14
1	2	3	4	5
Current level of the Index	117.7	57.4	130.6	51.2
Index as per previous survey	114.1	61.2	141.6	51.3
Index level one year back	126.6	60.3	136.1	55.0
% change (q-on-q) sequential	3.2	-6.2	-7.8	-0.2
% change (y-on-y)	-7.0	-4.8	-4.0	-6.9

to be released.

Chart VII.1: Business Expectation Index



optimism for Q2 of 2013-14. Although the cost of external finance is perceived to rise, the percentage of respondents expecting this rise has been declining since Q4 of 2011-12. Sentiments remained broadly unchanged for availability of finance. While the cost of raw material is expected to rise, there is a marginal drop in sentiments for rise in selling price in Q2 of 2013-14. The perception on profit margins continued to remain in negative terrain, but showed some improvement for Q2 of 2013-14 (Table VII.2).

Consumer confidence on current situation remains weak, although optimism about the future improves

VII.9 The 13th Round of the Consumer Confidence Survey (http://www.rbi.org.in/CCS13) conducted by the Reserve Bank in June 2013 indicated subdued consumer confidence with the Current Situations Index (CSI) remaining at the same level as in the previous quarter. However, Future Expectations Index (FEI) indicates some improvement in consumer confidence, with an increase in positive perceptions on income and employment (Chart VII.2). The CSI and FEI have been estimated based on current and future perceptions of economic conditions, household

Table VII.2 : Reserve Bank's Industrial Outlook Survey

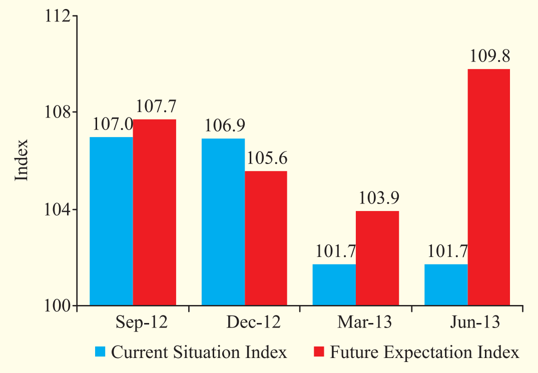
Parameter	Optimistic Response	Net Response[1]								
		Jul -Sep 2012		Oct-Dec 2012		Jan-Mar 2012		Apr-Jun 2013		Jul-Sep 2013
		E	A	E	A	E	A	E	A	E
1	2	3	4	5	6	7	8	9	10	11
1. Overall Business Situation	Better	30.6	16.1	32.2	17.2	37.5	18.4	29.6	12.8	30.0
2. Overall Financial Situation	Better	23.6	12.2	25.8	12.7	27.0	11.8	21.9	9.5	24.1
3. Production	Increase	33.6	18.8	35.7	18.6	37.1	18.6	24.4	9.8	28.5
4. Order Books	Increase	29.9	12.0	30.3	12.9	29.8	14.0	22.3	9.7	25.3
5. Capacity Utilisation	Increase	18.4	6.3	20.0	5.7	21.7	7.8	11.7	2.3	15.9
6. Exports	Increase	20.5	10.0	18.0	9.3	18.4	10.8	16.7	8.6	18.6
7. Imports	Increase	15.5	9.8	14.0	8.8	13.5	8.3	11.9	8.0	11.2
8. Employment in the Company	Increase	12.3	8.3	13.3	6.7	10.3	5.5	8.0	3.2	7.7
9. Availability of Finance (from internal accruals)*	Improve						12.1	18.7	10.8	17.2
10. Availability of finance (from banks and other sources)*	Improve						13.4	15.3	12.1	15.2
11. Availability of finance (from overseas)*	Improve						3.4	6.3	5.0	7.0
12. Cost of External Finance	Decrease	-24.0	-27.4	-20.6	-24.4	-18.1	-17.6	-14.3	-14.5	-12.4
13. Cost of Raw Material	Decrease	-51.4	-59.6	-48.6	-50.7	-45.0	-53.5	-45.6	-49.9	-43.4
14. Selling Price	Increase	18.8	18.5	17.3	10.2	15.8	9.1	14.9	7.3	12.1
15. Profit Margin	Increase	-3.6	-15.1	-1.3	-16.7	-2.0	-15.3	-4.9	-18.4	-3.7

[1] *Net response* is the percentage difference between the *optimistic* (positive) and *pessimistic* (negative) responses; responses indicating status quo (no change) are not reckoned. Higher 'net response' indicates higher level of optimism and *vice versa*.

*: These questions are newly added by splitting the questions on availability of finance (both internal and external sources) in the 61st Round (Jan-Mar 2013).

E: Responses for Expectation quarter A: Responses for Assessment quarter

Chart VII.2: Current Situation Index and Future Expectation Index



circumstances, income, spending, price level and employment situation.

External agencies revise India's growth projections downwards

VII.10 Most external agencies have revised India's growth projections downwards. These include the International Monetary Fund (IMF), the World Bank, the Organisation for Economic Co-operation and Development (OECD) and the Asian Development Bank (ADB). The external agencies' growth projections range between 5.3 and 6.7 per cent (Table VII.3).

Survey of Professional Forecasters indicates expectations of higher growth during 2013-14[1]

VII.11 The Reserve Bank's 24th Round of the Survey of Professional Forecasters outside the Reserve Bank (http://www.rbi.org.in/SPF24) expects recovery in growth from 5.0 per cent during 2012-13 to 5.7 per cent during 2013-14. Growth is expected to rise further to 6.5 per cent in 2014-15. Average WPI inflation is expected to moderate to 5.3 per cent during 2013-14. The twin deficits are also expected to improve during 2013-14 (Table VII.4).

Table VII.3: Agencies' Projections for 2013-14

Agency	Latest Projection		Earlier Projection	
	Real GDP Growth (per cent)	Month/ Year	Real GDP Growth (per cent)	Month/ Year
1	2	3	4	5
Finance Ministry	6.1 to 6.7	Feb. 2013	-	-
PMEAC	6.4	Apr. 2013	-	-
IMF	5.6	July 2013	5.8	Apr. 2013
World Bank	5.7	Jun. 2013	6.1	Apr. 2013
OECD*	5.3	May. 2013	5.9	Dec. 2012
ADB	5.8	Jul. 2013	6.0	Apr. 2013
NCAER	6.2	May. 2013	6.2	Jan. 2013

* GDP at market prices.

Inflation Expectations Survey of Households

VII.12 The latest round of the Inflation Expectations Survey of Households (IESH Round 32) (http://www.rbi.org.in/IESH32), conducted across 5,000 households in 16 cities and 7 occupational classes during June 2013, indicates that the three-month ahead and one-year ahead median inflation expectations remain at similar levels as in the previous quarter (Chart VII.3). However, the proportion of respondents expecting a price increase *'more than current rate'* in the one-year ahead period has diminished for all product groups (food products, non-food products, household durables, housing and cost of services). In the case of the three-month ahead period, those proportions have marginally diminished for food products and cost of services.

Amplifying macro-financial risks warrant a cautious monetary policy stance

VII.13 Although headline inflation has receded in Q1 of 2013-14 and the CAD has moderated during Q4 of 2012-13, macro-financial risks increased distinctly during Q1 of 2013-14. Faced with exchange market pressures, the Reserve Bank responded in July 2013 with

[1] The forecasts reflect the views of professional forecasters and not of the Reserve Bank.

Table VII.4: Median Forecasts of Select Macroeconomic Indicators by Professional Forecasters 2013-14 and 2014-15

	Actual 2012-13	Annual forecasts				Quarterly Forecast									
		2013-14		2014-15		2013-14								2014-15	
						Q1		Q2		Q3		Q4		Q1	
		E	L	E	L	E	L	E	L	E	L	E	L	E	L
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
1. Real GDP growth rate at factor cost (%)	5.0	6.0	5.7	-	6.5	5.5	5.0	5.8	5.4	6.2	6.1	6.4	6.2	-	6.1
a. Agriculture & Allied Activities	1.9	3.0	3.0	-	3.0	2.7	2.5	3.0	3.1	3.3	3.5	3.0	3.3	-	3.0
b. Industry	1.2	4.4	3.6	-	5.5	3.7	3.0	4.1	3.7	4.4	4.0	4.7	3.8	-	4.6
c. Services	6.8	7.1	7.1	-	7.6	6.8	6.4	7.0	6.8	7.4	7.2	7.7	7.4	-	7.5
2. Gross Domestic Saving (% of GDP at current market price)	-	30.0	30.3	-	31.3	-	-	-	-	-	-	-	-	-	-
3. Average WPI-Inflation (%)	7.4	6.5	5.3	-	5.7	-	-	6.0	4.8	6.5	5.4	6.8	5.5	-	5.6
4. Exchange Rate (₹/US$ end period)	54.4	-	-	-	-	-	-	54.8	60.0	54.4	59.5	54.0	59.5	-	59.5
5. 10-year Central Govt. Securities Yield (% end period)	8.0	7.7	7.4	-	7.0	-	-	-	-	-	-	-	-	-	-
6. Export (growth rate in %)!	-1.0	8.7	4.4	-	9.0	-	-	-	-	-	-	-	-	-	-
7. Import (growth rate in %)!	0.5	7.4	3.9	-	7.0	-	-	-	-	-	-	-	-	-	-
8. Trade Balance (US$ billion)	-195.7	-	-	-	-	-48.6	-50.6	-52.0	-50.0	-59.6	-55.2	-56.6	-47.6	-	-55.0
9. Current Account Deficit (% of GDP)	4.8	4.5	4.4	-	3.9	-	-	-	-	-	-	-	-	-	-
10. Central Government Fiscal Deficit (% of GDP)	4.9	5.0	4.8	-	4.7	-	-	-	-	-	-	-	-	-	-

E: Previous Round Projection. L: Latest Round Projection. - : Not Available. !: US$ on BoP basis

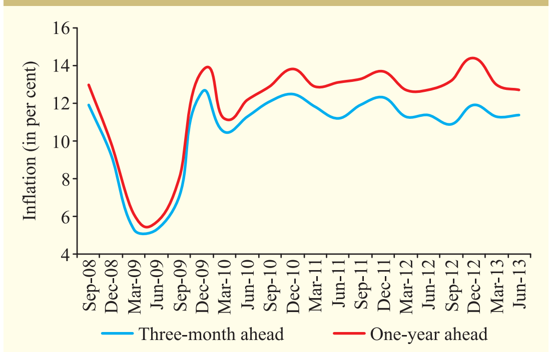
Note: Latest round refers to 24th Round for the quarter ended June 2013, while Previous Round refers to the 23rd Round for the quarter ended March 2013.

Source: Survey of Professional Forecasters, First Quarter 2013-14.

measures designed to curtail rupee liquidity with a view to curb the volatility in the rupee exchange rate. The immediate reaction of the measures has been rupee positive.

VII.14 However, macro-financial risks could still amplify further under a number of possible developments. First, financial market conditions could tighten further with, or in anticipation of, partial withdrawal of monetary stimulus in AEs. This, in turn, could trigger further portfolio shifts of capital from EMDEs to AEs and magnify the impact. Second, recovery in AEs could falter again with fiscal multipliers feeding through to slacken growth on the back of expenditure cuts and tax increases. Third, growth in key EMDEs, especially China, could slow further if rising inflation and financial sector fragilities force monetary prudence. Fourth, global trade deceleration may get extended if global growth slows again. Fifth, if domestic growth continues to decelerate, it could have a spiraling effect on the fiscal deficit, as revenues will fall. This could pose

Chart VII.3: Three-month and one-year ahead median inflation expectations- Inflation Expectation Survey of Households



risk to macroeconomic and financial stability, especially if wider fiscal deficit spills over to the current account gap. Sixth, fiscal deficit could widen if the exchange rate pass-through is constrained by holding back administered price revisions. Seventh, sustained high consumer price inflation could slow real demand and savings in the economy. Finally, political uncertainties could rise as part of the electoral cycle, which could affect the macroeconomy through different channels.

VII.15 Macroeconomic conditions have distinctly weakened during Q1 of 2013-14. There is no evidence yet of recovery in growth even as headline inflation has moderated. Consumer price inflation, especially food inflation, remains high, although a good monsoon should help in this regard. Business confidence remains low, as is evident from recent expectations surveys. The external sector is under stress. While recent liquidity tightening measures instituted by the Reserve Bank to curb volatility in the exchange rate provide at best some breathing time, it is important to push through structural reforms necessary to inspire the trust and confidence of both domestic and foreign investors. The priority for monetary policy now is to restore stability in the currency market so that macro-financial conditions remain supportive of growth. This strategy will succeed only if reinforced by structural reforms to reduce the CAD and step up savings and investment.