Macroeconomic and Monetary Developments in 1999-2000

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I. Growth, Saving and Investment

According to the advance estimates of the Central Statistical Organisation, the real GDP growth, having recovered to 6.8 per cent in 1998-99, is expected to slow down to 5.9 per cent in 1999-2000. The deceleration in real GDP led entirely by GDP originating from agriculture and allied sector masks the improvement expected from the industry and services sectors (Table 1 and Chart 1). Real GDP from agriculture and allied activities is estimated to show a sharp deceleration to 0.8 per cent in 1999-2000 from 7.2 per cent in 1998-99. Industry, on the other hand, is projected to exhibit recovery with a growth of 6.4 per cent as against 3.7 per cent in 1998-99. The estimated growth rate of GDP from the services sector (including construction) at 8.3 per cent is marginally higher than that of 8.0 per cent in 1998-99.

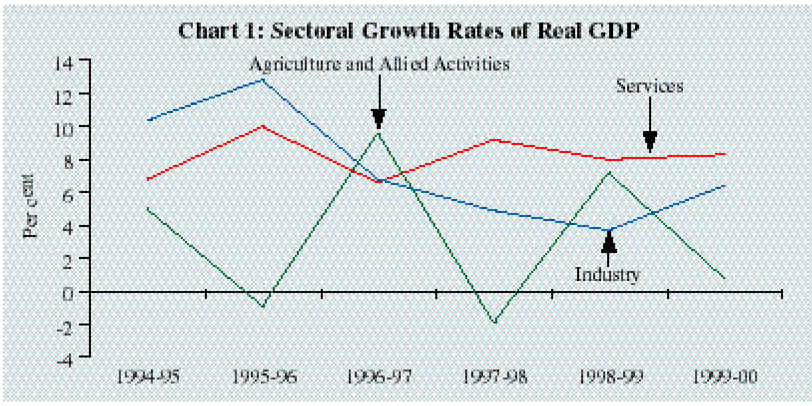
Table 1: Growth Rates and Sectoral Composition of GDP
(at 1993-94 prices)

(Per cent)

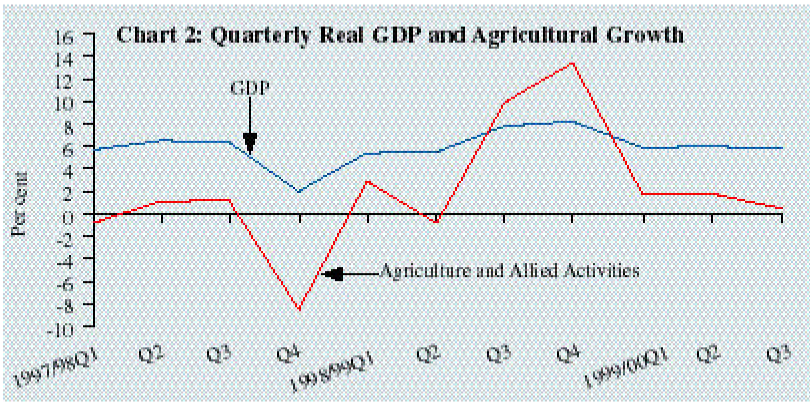
	1998-99	1999-2000

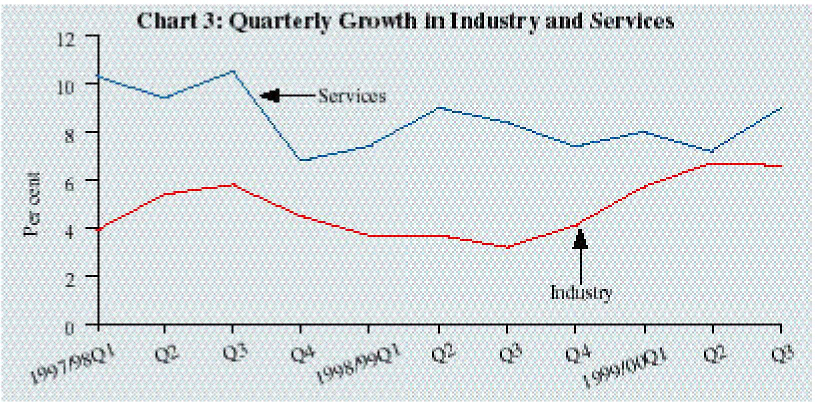
	(Quick Estimates)		(Advance Estimates)	
	Growth Rate	Share in GDP	Growth Rate	Share in GDP
1	2	3	4	5
Agriculture and Allied Activities	7.2	26.8	0.8	25.5
Industry (excluding construction)	3.7	22.0	6.4	22.1
Services (including construction)	8.0	51.2	8.3	52.3
Gross Domestic Product	6.8	100.0	5.9	100.0

The quarterly estimates of real GDP indicate that the 'highs' and 'troughs' in the GDP growth coincided with the fluctuations in the agricultural growth (Chart 2). The quarterly GDP growth rate reached the peak of 8.2 per cent in the fourth quarter of 1998-99, with the growth in agriculture and allied activities reaching its highest point at 13.4 per cent in the same quarter. In the first three quarters of 1999-2000 growth in agriculture and allied activities dipped to 1.7 per cent, 1.8 per cent and 0.5 per cent, respectively, pushing down the real GDP growth rate to 5.9 per cent, 6.0 per cent and 5.8 per cent in these quarters. Industry maintained a steady pace of expansion since the final quarter of 1998-99 (Chart 3). Services sector, which showed some deceleration in 1998-99, recovered by the third quarter of 1999-2000.



The recent trends in real GDP growth highlight three distinct though inter-related developments in the real economy. First, there has been a significant decline in the overall saving and investment rates in the economy since they peaked in 1995-96, largely on account of a sharp decline in public saving. While the gross domestic saving rate declined from 25.5 per cent of GDP in 1995-96 to 22.3 per cent in 1998-99, the gross domestic capital formation rate fell from 27.2 per cent to 23.4 per cent during this period (Table 2). The public saving rate declined from 2.0 per cent in 1995-96 to near zero in 1998-99. While household saving rate remained flat at 18.5 per cent, between 1995-96 and 1998-99, the private corporate saving rate moved down from 5.0 per cent to 3.8 per cent.





Available indicators imply a mixed prospect in the saving front for 1999-2000. The rates of expansion of both currency and aggregate deposits in 1999-2000 have been lower than those in the previous year. On the positive side, the household saving is expected to get a boost from the revival of equity market and a substantial increase in small savings (gross) and provident fund collections.

Table 2: Saving and Investment Rates

(as percentage of GDP at current market prices)

	1993-94	1994-95	1995-96	1996-97	1997-98 @	1998-99 *
1	2	3	4	5	6	7
Household Saving	18.4	19.8	18.5	17.1	19.0	18.5
Financial	11.0	12.0	8.9	10.4	10.4	10.9
Physical	7.4	7.8	9.6	6.7	8.6	7.6
Private Corporate Saving	3.5	3.5	5.0	4.5	4.3	3.8
Public Sector Saving	0.6	1.7	2.0	1.7	1.4	negligible
Gross Domestic Saving	22.5	25.0	25.5	23.3	24.7	22.3
Gross Domestic Capital Formation	23.1	26.1	27.2	24.6	26.2	23.4

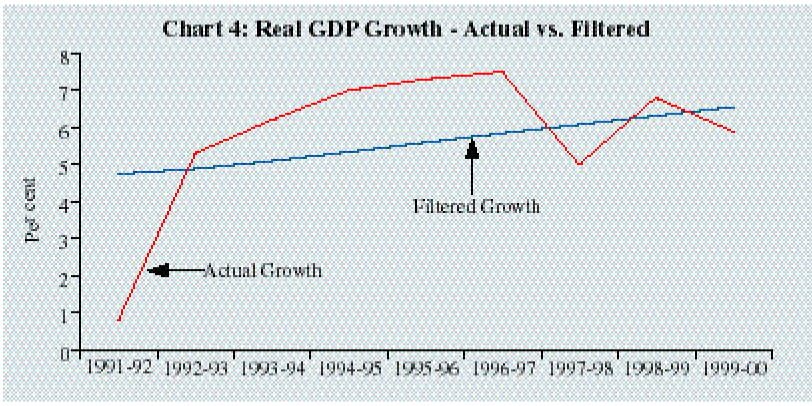
@ Provisional Estimates * Quick Estimates

The private corporate saving is expected to improve in 1999-2000 given the early trends in profit after tax. On the other hand, the saving performance of the public sector may exhibit a further deterioration as revealed by the large increase in the revenue deficit of the central government in the revised estimates of 1999-2000. The advance estimates of GDP growth for 1999-2000 has been placed at 5.9 per cent. Implicit in this estimate would be an investment rate of 22 to 24 per cent that would be consistent with the trend value of the incremental capital-output ratio (ICOR).

Secondly, growth impulses in recent years seem to have emerged from productivity growth in the economy. The underlying permanent component of ICOR[1] is estimated to move down from 4.1 in 1995-96 to 3.9 in 1998-99. There has also been evidence of significant improvement in total factor productivity in the economy during 1990s. Thirdly, cyclical factors, both in the demand and supply sides have played a relatively large role in the growth experience of recent years. While supply cycles reflected fluctuations in agricultural growth, demand cycles have largely followed the trends in consumption and investment of the private and public sectors. Private consumption demand witnessed a decline from 72.1 per cent of GDP in 1980-81 to 63.7 per cent of GDP in 1995-96 and further to 63.3 per cent of GDP in 1998-99. Public consumption, on the other hand, has remained steady at around 10 to 12 per cent of GDP in 1980s and 1990s. Investment demand has fallen sharply in the public sector from over 10 per cent of GDP in 1980s to around 6 to 7 per cent in the second half of 1990s which was only partly corrected by increase in the private investment demand (from around 10 to 14 per cent of GDP in 1980s to 15 to 18 per cent in the second half of 1990s).

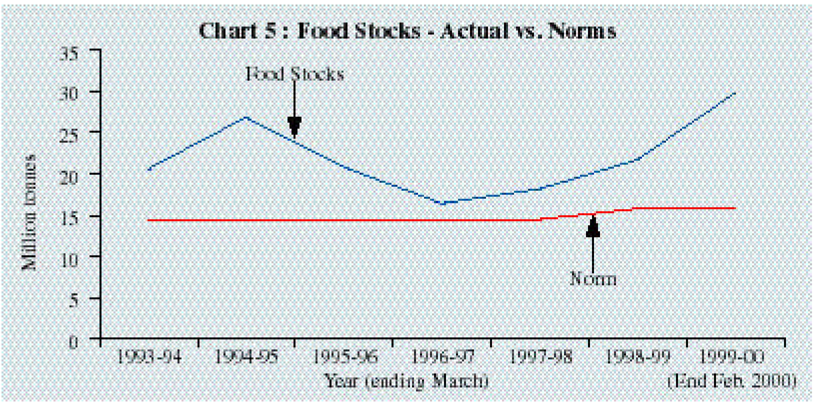
These structural and cyclical factors in the growth dynamics have implications for monetary policy in terms of their impact on the potential and actual output. While the developments in the potential output have a bearing on the medium to long-term stance of monetary policy, the monetary policy would itself matter to the growth outcomes in the short-run through credit, interest rate, exchange rate and other mechanisms.

In India, the estimates of potential output are not very firm, because of the lack of adequate information on employment, capacity utilisation, *etc.*, and the fact that the potential output itself changes from year-to-year depending on the investment and productivity situation. Given the data limitations, one of the ways to draw inference on the behaviour of output gap would be to look at the trend in the permanent component of growth, after filtering out the influences of temporary factors[2]. A comparison of the filtered estimates with the actual growth showed that the real GDP growth was in the neighbourhood of its potential in 1998-99. The actual growth has stayed above the potential in most of the post-reform period (Chart 4). Extrapolating this trend would show that the estimated growth stayed below the potential in 1999-2000.



Food Situation

An impressive agricultural growth performance in 1998-99 was followed by a sharp deceleration in 1999-2000. Foodgrain production has been estimated to decline by 0.7 per cent to 201.6 million tonnes in 1999-2000 from the record production of 203 million tonnes in 1998-99. This should not, however, pose a problem to the food availability condition given the current high level of food stocks as compared to the norms (Chart 5). Foodgrain stocks with public sector agencies as at end-February 2000 stood at 29.74 million tonnes, which is higher by 30.7 per cent than those at end-February 1999 (22.75 million tonnes). Stocks of both wheat and rice have registered considerable increases and presently the stock levels are at about twice the norm specified for end-March (15.8 million tonnes). The current high level of foodgrain stocks is due to the substantial rise in procurement of wheat and rice and the relatively low off-take.



Reflecting the record level of food stocks, food credit from scheduled commercial banks recorded an increase of Rs. 8,875 crore (52.8 per cent) to Rs.25,691 crore during 1999-2000 as compared with an increase of Rs.4,331 crore (34.7 per cent) in the previous year. The movements in food credit recorded the usual seasonal pattern of substantial increases during the first and third quarters on account of *rabi* and *kharif* procurements, respectively, followed by declines during the second and the fourth quarters. During the first quarter, food credit recorded an increase of Rs.5,405 crore on account of a substantial increase in wheat procurement. After declining by Rs.1,689 crore during the second quarter, food credit again recorded an increase of Rs.5,066 crore during the third quarter, owing to the increased procurement of rice. The outstanding amount of food credit reached the peak at Rs.26,056 crore on January 28, 2000.

Minimum Support Price

Apart from the food availability conditions, developments in the minimum support price (MSP) have a bearing on the food price situation as well as the overall rate of inflation in the economy. During 1999-2000, the MSP for paddy was raised by 11.4 per cent which is the highest rate of increase recorded in the past five years. While a large increase in MSP has a favourable impact on the terms of trade for agriculture, it also affects the food price inflation and the inflationary expectations in the economy. Table 3 provides data on annual increases in MSP and the overall inflation rate in the economy since 1995-96. The rate of increase in MSP has been generally higher than the annual rate of inflation. The impact of the increase in MSP on the overall inflation rate in 1999-2000 has, however, remained subdued so far. As of March 25, 2000 prices of rice and wheat increased by 1.0 per cent and 4.5 per cent, respectively, as against 15.7 per cent and 23.0 per cent during the corresponding period of 1998-99.

Table 3 : Minimum Support Price

	M S P Wheat (Common) (Rs./Quintal)	Per cent Increase	MS P Paddy (Rs./Quintal)	Per cent Increase	Annual Inflation (point-to-point) (%)
1	2	3	4	5	6
1995-96	360	2.9	360	5.9	5.0
1996-97	380	5.6	380	5.6	6.9
1997-98	475	25.0	415	9.2	5.3
1998-99	510	7.4	440	6.0	4.8
1999-2000	550	7.8	490	11.4	3.7
2000-2001	580	5.5	N.A.	_	_

Industrial Recovery

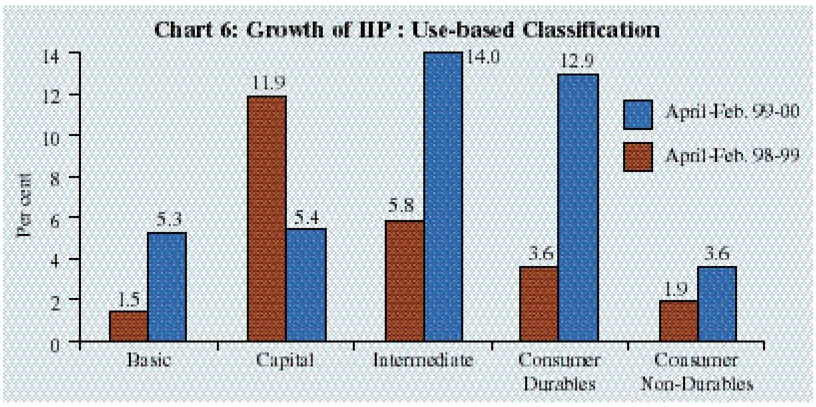
Industrial production after recording a relatively low growth of 4.0 per cent in 1998-99, showed a definite turnaround during 1999-2000. The Index of Industrial Production (IIP) (Base: 1993-94=100) grew at a higher rate of 7.9 per cent during April-February 1999-2000 than 3.8 per cent during the corresponding period of 1998-99. The acceleration in the industrial growth rate has been shared by manufacturing and electricity sectors, which recorded growth rates of 8.8 per cent and 7.4 per cent, respectively, during April-February 1999-2000, as against 4.2 per cent and 6.5 per cent during April-February 1998-99. On the other hand, output from mining and quarrying recorded a marginal growth of 0.5 per cent during this period. The relative contribution of various sectors to the overall growth in the IIP reveals that manufacturing sector contributed 90.3 per cent, thereby leading the process of recovery in industry (Table 4).

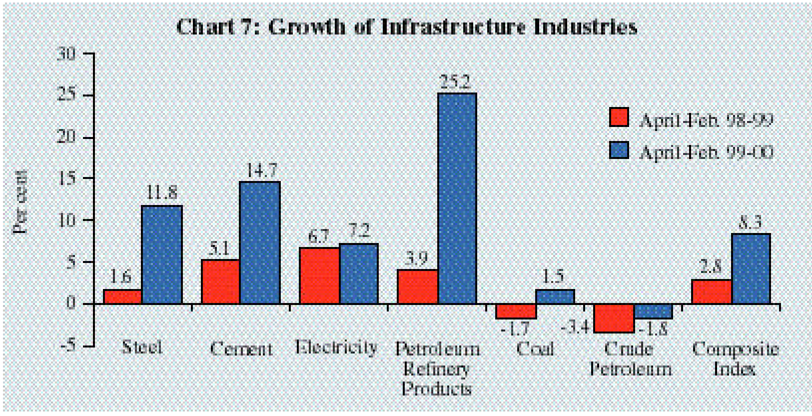
Table 4: Growth of Industrial Production and Relative Contribution of the Sectors

(Per cent)

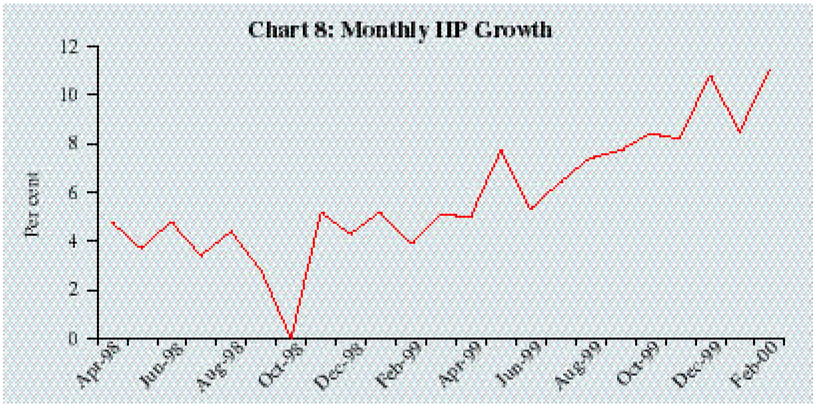
Sectors	Weight	Growth April-Feb. 98-99	Growth April-Feb. 99-00	Relative Contribution April-Feb. 98-99	Relative Contribution April-Feb. 99-00
1	2	3	4	5	6
General Index	100.0	3.8	7.9	100.0	100.0
Manufacturing	79.3	4.2	8.8	87.3	90.3
Mining & Quarrying	10.5	-1.5	0.5	-3.5	0.5
Electricity	10.2	6.5	7.4	16.2	9.2

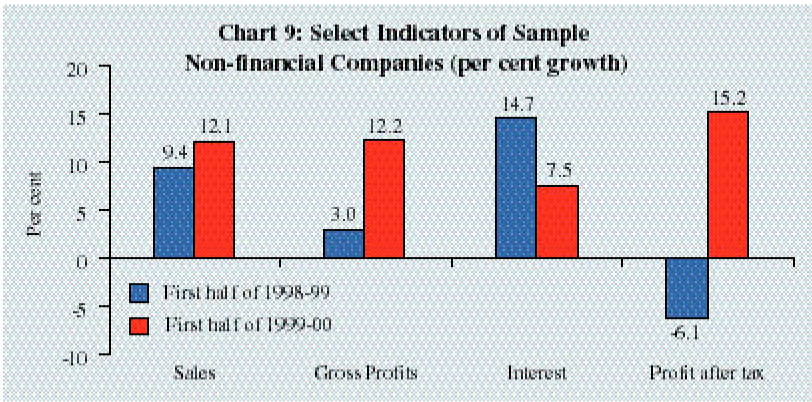
The use-based classification of industrial output data reveals a somewhat unbalanced pattern of growth. Intermediate goods sector has led the recovery by posting a growth of 14.0 per cent during April-February 1999-2000 as against 5.8 per cent during April-February 1998-99, hence increasing its contribution to the overall industrial growth to 51.0 per cent. The basic goods and consumer durables showed increases of 5.3 per cent (against 1.5 per cent during the corresponding period of 1998-99) and 12.9 per cent (against 3.6 per cent), respectively, during April-February 1999-2000 (Chart 6). However, the growth in capital goods sector has slowed down to 5.4 per cent during April-February 1999-2000 from 11.9 per cent during the corresponding period of the previous year.





Of interest in this context is a clear improvement in the performance of infrastructure industries during 1999-2000. The composite index (Base: 1993-94=100) of six infrastructure industries *viz*., electricity, coal, steel, crude oil, petroleum refinery products and cement recorded a higher growth of 8.3 per cent during April-February 1999-2000 than 2.8 per cent in the corresponding period of the previous year. Strong growth trends were evident in cement (14.7 per cent), steel (11.8 per cent) and petroleum refinery products (25.2 per cent).





While electricity recorded a marginally higher growth (7.2 per cent), coal and crude petroleum showed low and negative growth, respectively (Chart 7).

Chart 8 reveals that deceleration in the industrial growth bottomed out in October 1998. Since then, there has been a general acceleration especially after April 1999. Among the factors that have facilitated pick up in industrial performance, the major ones are: the strong growth of agricultural sector in 1998-99 boosting rural demand; resurgence in export growth and resultant stimulus from the external demand; enabling interest rate and credit availability conditions; and strong revival of capital market. As indicated by the half-yearly performance of the select non-financial private sector companies, the financial health of industries has recorded an improvement during 1999-2000 (Chart 9). The profits after tax of 921 non-financial companies have turned around and shown a growth of 15.2 per cent during the first half of 1999-2000 in contrast to a decline of 6.1 per cent in respect of 953 such companies in the first half of 1998-99. Sales have risen by 12.1 per cent during the first half of 1999-2000 against 9.4 per cent in the comparable period of the previous year. Further, there has been a noticeable decline in the growth of interest payments by these companies in 1999-2000, bringing down the interest burden on gross profit to 40.4 per cent in the first half of 1999-2000 from 42.2 per cent in the corresponding period of 1998-99.

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[1] The actual ICOR is computed as a ratio of rate of real gross domestic capital formation and growth rate of real GDP. The ICOR could be seen as having two components *viz*., a permanent component capturing the underlying trend in productivity and a cyclical component capturing the temporary shocks. An idea about the trend component of ICOR can be had by filtering out the effects of cyclical component from the actual ICOR. The Hodrick-Prescott (HP) filter is a commonly used method to estimate the trend component of a series. The HP filter is easy to implement and tractable for policy purposes. The estimates of trend component of ICOR presented here follow the HP method, using the sample data of saving, investment and growth rate for the Indian economy for the period 1980-81 to 1998-99.

[2] Permanent component of output growth in this exercise has been generated by using the HP filter (see footnote 1).