I. OUTPUT

Global uncertainties and domestic cyclical and structural factors resulted in growth slowing down considerably to the estimated level of 6.9 per cent during 2011-12. All three sectors of the economy – agriculture, industry and services – slowed down. Moderation in agriculture growth notwithstanding, the year witnessed an all-time high foodgrains output. The services sector moderated reflecting the slowdown in construction, while industrial growth slackened due to the disappointing performance of mining and manufacturing sub-sectors. However, some indicators such as non-food credit off-take, cement production and the Reserve Bank's services sector composite indicator suggest that growth may have bottomed out in Q3 of 2011-12. Output growth is expected to gradually recover in 2012-13, albeit modestly.

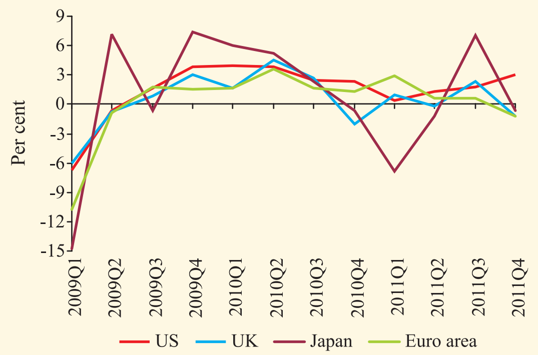
Global growth decelerates in 2011, likely to remain on slow recovery path in 2012

I.1 Global growth slowed in 2011, but the world economy stayed on the path of slow recovery, reducing the likelihood of a double-dip recession. Growth prospects for 2012 remain uncertain, with growth petering out in the euro area and losing steam in the emerging markets, while a better-than-expected recovery is shaping up in the US. The baseline scenario suggests that global growth may continue to be low in 2012, with a recession in the euro area as the region makes the needed fiscal adjustment.

I.2 There have been some positive developments in relation to advanced economies (AEs) over the previous quarter. The US economy expanded 3.0 per cent in Q4 of 2011 – the highest pace since Q2 of 2010. The Institute for Supply Management's (ISM) reading of the US manufacturing PMI for March 2012 indicates expansion in the manufacturing sector for the 32nd consecutive month. The US services sector also expanded briskly in March 2012, while the ISM index for non-manufacturing activity remained above the average for the previous 12 months. The April 2012 beige book of the Federal Reserve also notes that there was modest to moderate pace of economic expansion from mid-February through late March. Prospects for current pace of recovery extending into 2012 remain encouraging.

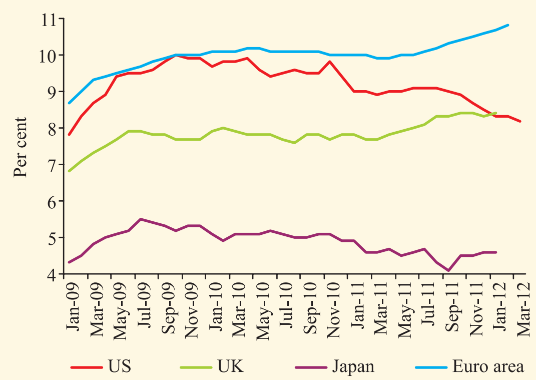
I.3 In contrast, other AEs such as the UK, Japan and the euro area registered negative q-o-q growth in Q4 of 2011 (Chart I.1). According to the interim forecast of the European Commission, the euro area will undergo a mild recession in 2012 with output contracting by 0.3 per cent. The composite PMI for the euro area, which combines services and manufacturing, fell steadily from 50.4 in January to 49.3 in February and 49.1 in March 2012, indicating contraction. While a small contraction in the euro area would have spillover effects to other regions, its fall out could be contained if the US continues to recover. Outside the euro area, the UK remains on a weak expansion path but on current assessment is likely to avert a recession. Japan is likely to continue on a slow expansion path driven by reconstruction investment and inventory rebuilding in 2012. Recent PMIs indicate that both services and manufacturing are expanding in Japan.

Chart I.1: GDP Growth in AEs



Source: Eurostat.
Unit: Annualized percentage change over previous period.

Chart I.2: Unemployment Rate



Source: Eurostat

I.4 The US unemployment rate fell to a three-year low of 8.2 per cent in March 2012, though the number of new jobs generated dipped (Chart I.2). The unemployment rate in the euro area, however, rose to a record high of 10.8 per cent in February 2012. Spain performed the worst, with an unemployment rate of 23.6 per cent and more than half the youth population unemployed.

Emerging and developing economies show signs of slowdown

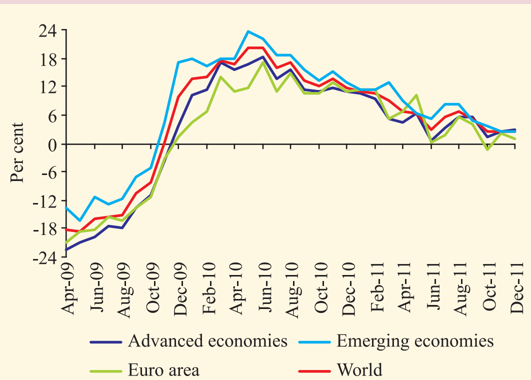
I.5 Risks to AE growth ahead also arise from the slowing emerging and developing economies (EDEs) as this may slow down their external demand. After growing at 9.2 per cent in 2011, China has reduced its growth forecast for 2012 to 7.5 per cent. Though growth is likely to exceed this pace, there are clear indications that the economy is slowing down as the growth rate has been decelerating for five successive quarters. China's economy grew at its weakest pace in nearly three years in Q1 of 2012 registering 8.1 per cent y-o-y growth. There was a modest trade surplus of US$ 0.7 billion in Q1 of 2012. Growth is also slowing in other key EDEs including India. The Brazilian economy grew by 2.7 per cent in 2011, compared with growth of 7.5 per cent in 2010, though it could moderately improve later this year on the back of a strong monetary stimulus. Russia is likely to stay with moderate growth of around 4 per cent due to fiscal stimulus, large credit expansion and high oil prices this year.

I.6 Going forward, growth in most EDEs is likely to be impacted by changes in external demand from the AEs and China. The global PMI for new export orders, while still below its long-term average, points towards a gradual recovery in the momentum of global trade (Chart I.3).

Growth of the Indian economy may have bottomed out in Q3 of 2011-12

I.7 After two successive years of fairly robust growth of 8.4 per cent, GDP is estimated to decelerate sharply to 6.9 per cent during 2011-12, with a marked slowdown in agriculture, mining and quarrying, manufacturing and construction sectors. Data relating to Q3 of 2011-12 shows that growth moderated for the fourth successive quarter to 6.1 per cent, recording the lowest rate in the last eleven quarters (Table I.1). While the moderation of growth in agriculture was largely on account of the base effect and structural impediments, the slowdown in industry reflected a number of factors including domestic policy uncertainties, cumulative impact of monetary tightening and slackening of external demand. The growth rate during July-December 2011 was below trend (Chart I.4). The momentum indicator corroborates the slowdown (Chart I.5).

Chart I.3: Growth in Export Volume (y-o-y)



Note: Calculations based on CPB World Trade Monitor Index.

Table I.1: Sectoral GDP Growth (2004-05 prices)

(Per cent)

Item	2010-11*	2011-12#	2010-11 Q1	2010-11 Q2	2010-11 Q3	2010-11 Q4	2011-12 Q1	2011-12 Q2	2011-12 Q3	2010-11 (Apr-Dec)	2011-12 (Apr-Dec)
1	2	3	4	5	6	7	8	9	10	11	12
1. Agriculture & allied activities	**7.0**	**2.5**	**3.1**	**4.9**	**11.0**	**7.5**	**3.9**	**3.2**	**2.7**	**6.8**	**3.2**
2. Industry	**6.8**	**3.6**	**8.2**	**5.6**	**7.2**	**5.3**	**6.6**	**2.8**	**0.8**	**7.0**	**3.3**
2.1 Mining & quarrying	5.0	-2.2	6.9	7.3	6.1	1.7	1.8	-2.9	-3.1	6.7	-1.4
2.2 Manufacturing	7.6	3.9	9.1	6.1	7.8	5.5	7.2	2.7	0.4	7.6	3.4
2.3 Electricity, gas & water supply	3.0	8.3	2.9	0.3	3.8	7.8	7.9	9.8	9.0	2.3	8.7
3. Services	**9.2**	**8.8**	**9.8**	**8.7**	**7.8**	**8.6**	**8.9**	**8.7**	**8.7**	**8.8**	**8.8**
3.1 Construction	8.0	4.8	8.4	6.0	8.7	8.2	1.2	4.3	7.2	7.7	4.2
3.2 Trade, hotels, transport, storage and communication, *etc.*	11.1	11.2	12.7	10.8	9.8	9.3	12.7	9.8	9.2	11.1	10.6
3.3 Financing, insurance, real estate and business services	10.4	9.1	10.0	10.4	11.2	9.0	9.0	10.5	9.0	10.6	9.5
3.4 Community, social & personal services	4.5	5.9	4.4	4.5	-0.8	7.0	5.6	6.6	7.9	2.7	6.7
4. GDP at factor cost	**8.4**	**6.9**	**8.5**	**7.6**	**8.3**	**7.8**	**7.7**	**6.9**	**6.1**	**8.1**	**6.9**

*: Quick Estimates. #: Advance Estimates.
Source: Central Statistics Office.

I.8 However, current indications are that growth may have bottomed out in Q3 of 2011-12. Given the general slack in capacity utilisation in most industries, production can be scaled up substantially. There has been strong credit off-take in February and March 2012, accounting for about 40 per cent of the total non-food credit during the year. Though the PMI for both manufacturing and services registered a deceleration in February and March, the indices remain high indicating expansion. The implicit growth rate for Q4 of 2011-12 works out to 6.9 per cent, essentially reflecting some improvement in industrial activity and the resilience of the services sector. In this context, the two-step lowering of the cash reserve ratio in January and March 2012 and the peaking of the interest rate cycle should provide some momentum.

Monsoon risk on agriculture growth remains muted

I.9 The North-East monsoon during October-December 2011 was 48 per cent below normal

Chart I.4: GDP Growth

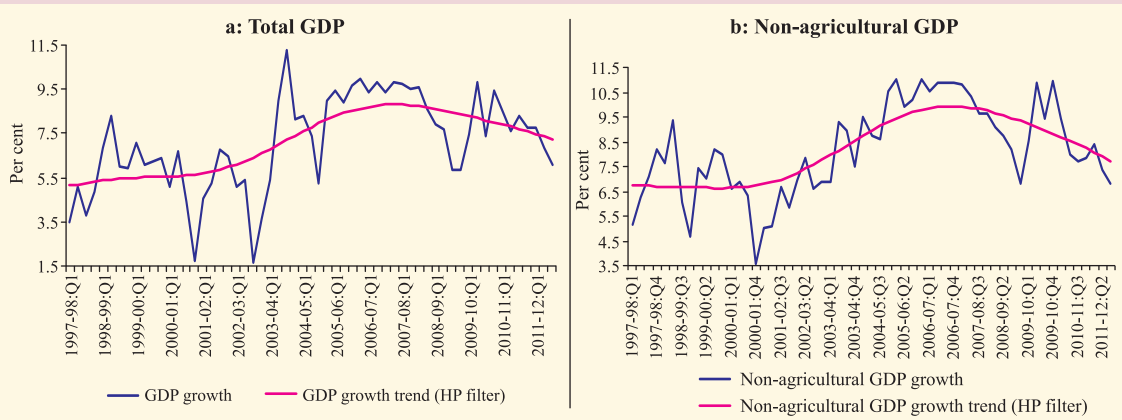


Chart I.5: Momentum Indicator of Growth

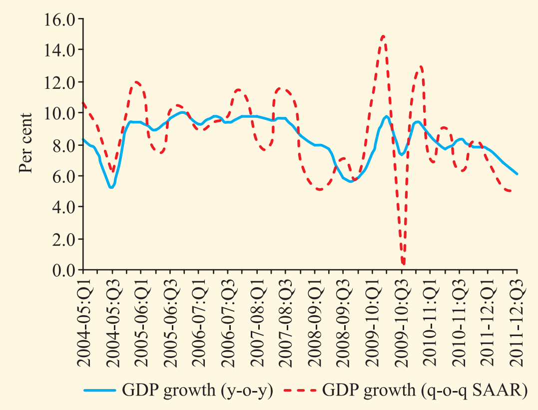


Table I.2: Agricultural Production – 2011-12

(Million tonnes)

Crop	2010-11 Final Estimates	2011-12 2nd Advance Estimates	Per cent growth in output in 2011-12
1	2	3	4
Foodgrains	244.8	250.4	2.3
Rice	96.0	102.8	7.1
Wheat	86.9	88.3	1.6
Coarse Cereals	43.7	42.1	-3.7
Pulses	18.2	17.3	-4.9
Oilseeds	32.5	30.5	-6.2
Cotton #	33.0	34.1	3.3
Jute & Mesta # #	10.6	11.6	9.4
Sugarcane (Cane)	342.4	347.9	1.6

#: Million bales of 170 kgs. each.
##: Million bales of 180 kgs. each.
Source: Ministry of Agriculture, GoI.

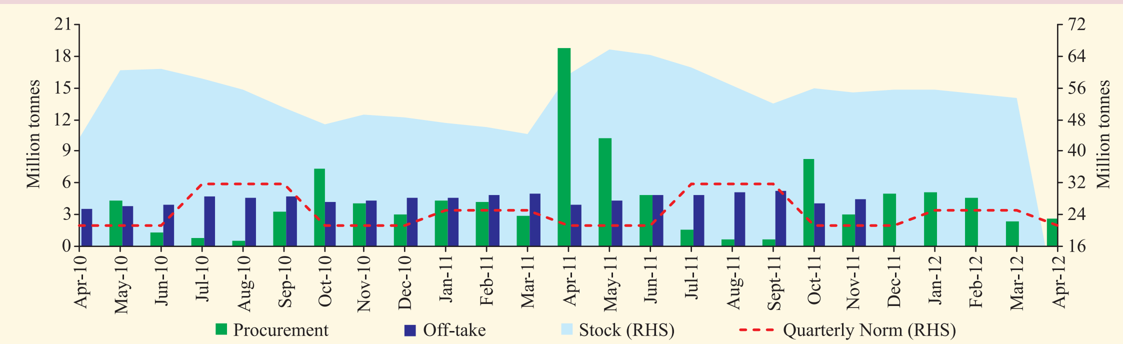
as against 21 per cent above normal in the previous year. This was the most acute deficiency in the winter monsoon in the last decade. The adverse impact of the deficient North-East monsoon on overall agricultural production is, however, not likely to be severe. While production of foodgrains during 2011-12 is estimated to reach a record level, that of pulses and oilseeds is expected to be lower than in the previous year (Table I.2).

Food management likely to be a challenge

I.10 The current stock of foodgrains, at 53 million tonnes, continues to be much higher than the quarterly buffer and security reserve requirements. This level of food stock is sufficient to meet the off-take requirement under the Targeted Public Distribution System and other welfare/poverty alleviation schemes (Chart I.6). However, the National Food Security Bill, which is currently in the Parliament, has far reaching implications for food management. It envisages legal entitlement to foodgrains at subsidised rates to up to 75 per cent of the rural population and 50 per cent of the urban population by ensuring access to adequate quantity of quality food at affordable prices.

I.11 Effective implementation of the Bill necessitates substantially higher foodgrains production in the county. This would require revitalisation of agriculture sector with large

Chart I.6: Food Stock and its Determinants



Note: 1. Data for off-take is upto November 2011, and stock as on March 31, 2012.
2. Procurement and off -take data are monthly figures.
3. Procurement for April 2012 is as on April 11, 2012.

Table I.3: Index of Industrial Production: Sectoral and Use-based Classification of Industries

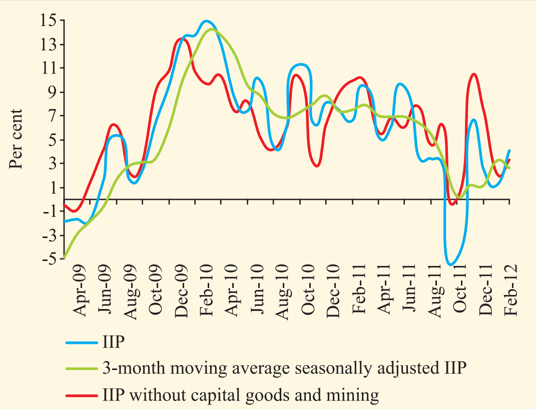
(Per cent)

Industry Group	Weight in the IIP	Growth Rate			Weighted Contribution#		
		Apr-Mar 2010-11	April-February		Apr-Mar 2010-11	April-February	
			2010-11	2011-12 P		2010-11	2011-12 P
1	2	3	4	5	6	7	8
Sectoral							
Mining	14.2	5.2	5.8	-2.1	7.3	8.2	-6.8
Manufacturing	75.5	9.0	8.7	3.7	86.7	85.9	85.1
Electricity	10.3	5.5	5.3	8.7	5.9	5.9	21.6
Use-Based							
Basic Goods	45.7	6.0	5.9	5.9	29.1	29.4	66.5
Capital Goods	8.8	14.8	14.7	-1.8	25.2	25.0	-7.3
Intermediate Goods	15.7	7.4	7.8	-0.9	12.5	13.5	-3.6
Consumer Goods (a+b)	29.8	8.6	8.1	4.8	33.3	32.2	44.1
a) Consumer Durables	8.5	14.2	14.1	2.7	24.0	24.3	11.5
b) Consumer Non-durables	21.3	4.3	3.5	6.5	9.4	7.9	32.6
General	**100**	**8.2**	**8.1**	**3.5**	**100**	**100**	**100**

P : Provisional. # : Figures may not add up to 100 due to rounding off.
Source: Central Statistics Office.

investment to support agricultural research, development of water resources, infrastructure, particularly, power, storage and transportation. In this regard, as per the Union Budget 2012-13, three million tonnes of storage capacity was to be created during 2011-12 and another five million tonnes in 2012-13, under the Private Entrepreneur's Guarantee Scheme. Also, creation of two million tonnes of storage capacity in the form of modern silos has been approved. The creation of storage capacity would boost construction activity in the country, in addition to facilitating better management of food stock.

Chart I.7: IIP Growth (y-o-y)

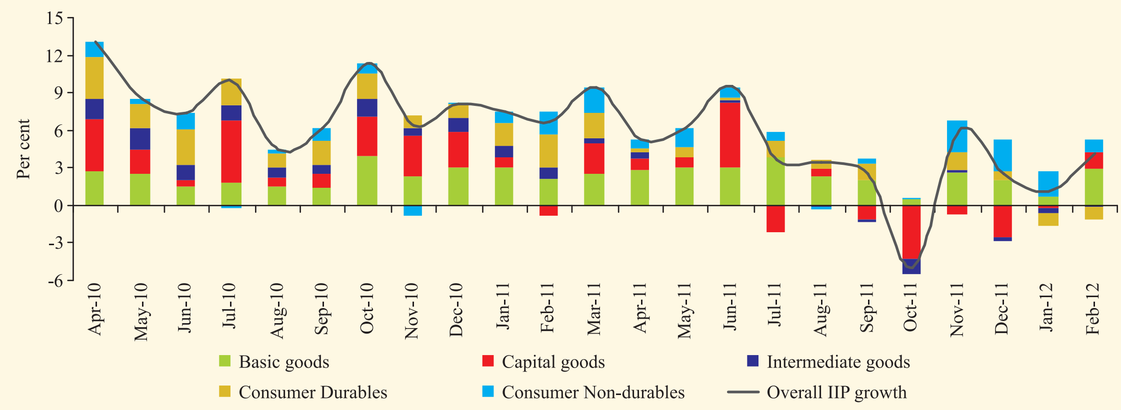


Industrial slowdown persists amidst volatility

I.12 Industrial growth slowed down sharply during 2011-12, led by contraction in mining and poor performance of the manufacturing sub-sector (Table I.3 and Chart I.7). Industrial activity lost steam on account of weak demand for consumer durables, reflecting interest rate sensitivity, deceleration in external demand and subdued investment demand due to decline in business confidence.

I.13 As per the use-based classification, moderation in growth was seen in all categories, except basic goods and consumer non-durables. Dampening of investment sentiment was manifested in the contraction of capital and intermediate goods. Moreover, industrial growth exhibited high volatility due to sharp fluctuations in the growth of capital goods (Chart I.8). Volatility, measured by standard deviation, is 3.3 for IIP excluding capital goods compared with 4.7 for the overall IIP during the period April 2009 to February 2012. Hence,

Chart I.8: Contribution to overall IIP growth



volatility in growth was primarily on account of a few items which contributed to the unevenness in the overall IIP growth.

I.14 As such, manufacturing sector growth remained volatile and highly concentrated, with seven out of the twenty two industry groups showing negative growth during April-February 2011-12. The five fastest growing manufacturing industries, with a combined weight of 18.3 per cent in manufacturing, grew at around 15.6 per cent, contributing about 68.5 per cent to the overall growth during April-February 2011-12 (Chart I.9).

I.15 With slow-paced global economic recovery extending into 2012, barring in the euro area, there could be a positive impact on domestic industrial growth. This is on account of the strong co-movement between the domestic and the global IIP series, reflected in terms of a correlation coefficient of 0.8 for the period April 2008 to January 2012 (Chart I.10).

Core industries remain a drag on industrial growth

I.16 The eight core industries grew at a subdued pace of 4.4 per cent during April-February 2011-12 compared to 5.8 per cent during the corresponding period of the previous year. This is mainly on account of contraction in natural gas and poor performance of coal and fertiliser industries (Chart I.11).

I.17 Coal output has, however, shown some improvement in the recent months. Initiatives taken by the government recently to ensure adequate coal supply to power plants is likely

Chart I.9: Growth Concentration in Manufacturing Sector

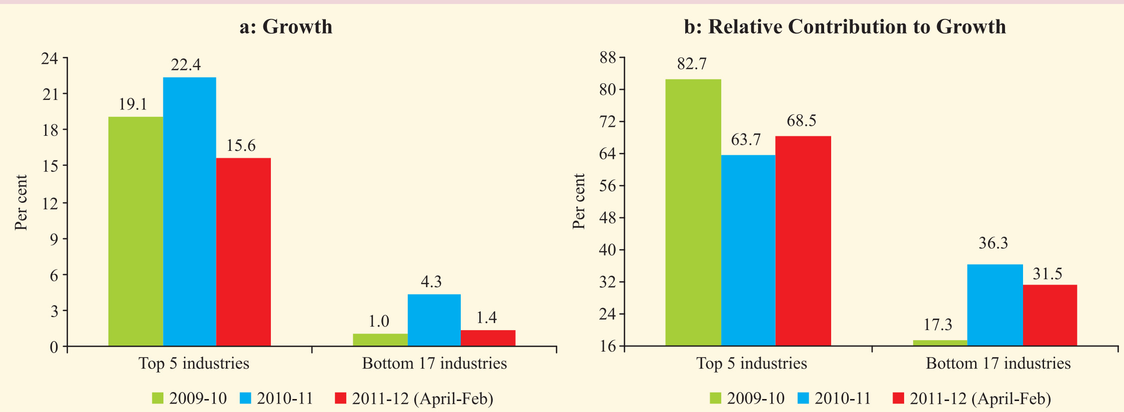


Chart I.10: Global IIP growth (y-o-y)

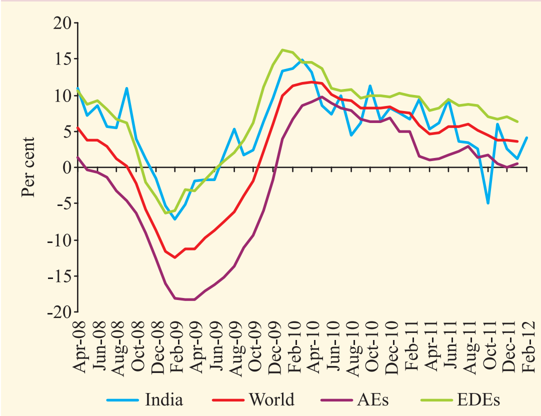


Table I.4: Capacity Utilisation in Infrastructure Sector

(Per cent)

Sector	2009-10	2010-11	2011-12*
1	2	3	4
Finished Steel (SAIL+VSP+ Tata Steel)	90.7	92.0	87.3
Cement	82.0	76.0	72.0
Fertiliser	93.6	94.5	94.4
Refinery Production-Petroleum	107.4	109.3	104.2
Thermal Power	77.7	75.1	71.6

*: Data pertains to April-November 2011.
Source: Capsule Report on Infrastructure Sector Performance, Ministry of Statistics and Programme Implementation, GoI.

to improve coal production and fuel industrial growth.

Slack evident in capacity utilisation

I.18 The Order Books, Inventory and Capacity Utilisation Survey (http://www.rbi.org.in/OBICUS16) by the Reserve Bank indicates that the y-o-y growth in new orders in Q3 of 2011-12 was lower than in Q3 of the previous two years. Even though there was a narrowing of slack in Q3 of 2011-12 compared to Q2, capacity utilisation remained well below the peak reached in 2010-11 (Chart 1.12). Also, there is a strong co-movement between capacity utilisation and manufacturing IIP.

I.19 Reflecting the decelerating output growth, capacity utilisation in various infrastructure industries slackened. During April-November 2011, excess capacity was reported in cement and thermal power (Table I.4).

Slight moderation in employment generation

I.20 The quarterly quick surveys of employment situation conducted by the Labour Bureau in select sectors of the economy indicate that employment generation slowed in Q3 of 2011-12 compared to Q2, though was marginally higher than in Q3 of 2010-11. However, employment in export units increased at a higher rate, compared to the non-export units, which could be on account of optimism engendered by a weaker rupee. Employment generation

Chart I.11: Growth in Infrastructure Industries

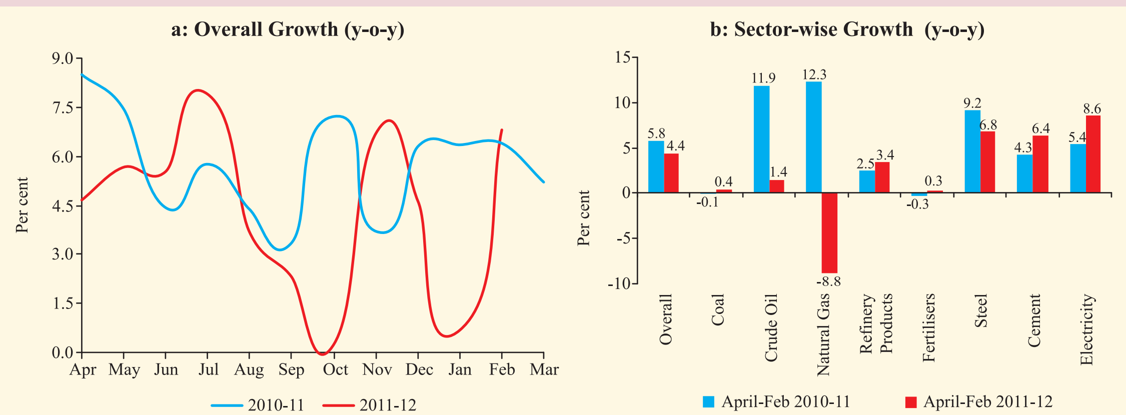


Chart I.12: OBICUS

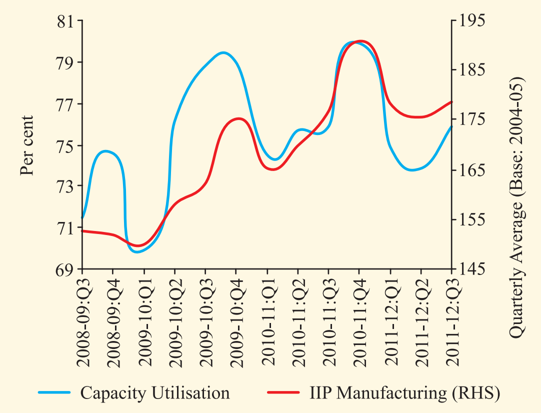
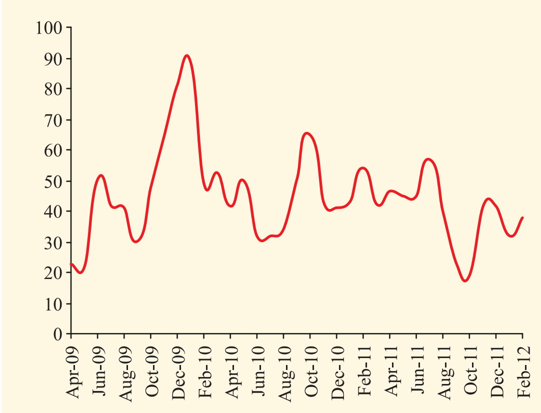


Chart I.13: Services Sector Composite Indicator



remained heavily concentrated in the IT/BPO sector (Table I.5).

Services sector growth sustains but shows weakening momentum

I.21 A services sector composite indicator based on growth in indicators of construction, trade and transport, and finance, developed by the Reserve Bank bottomed out in October 2011 and improved thereafter (Chart I.13). Construction may improve further during 2012-13 as road tendering, that proceeded at a high pace in recent quarters, translates into ground activity. A direct reading of lead indicators, however, points towards a weakening of telecom and international travel, while railway freight and domestic passenger traffic show increase (Table I.6).

I.22 A revival in domestic industrial activity and improving prospects in the US could have a favourable impact on the services sector. This should help the sector absorb any adverse impact on demand arising from the near all-encompassing tax levied in the Union budget.

Output gap likely to stay but shrink in 2012-13

I.23 On current assessment, the year 2012-13 is likely to be a year when the economy starts to recover slowly from the large negative output gap created by growth falling significantly below trend. The growth in H1 of 2012-13 may be dragged down by low pipeline investment. However, demand conditions may improve slowly. On a lower base, the odds favour an improvement in agriculture growth

Table I.5: Changes in Estimated Employment

(in million)

Industry/Group	2010-11 April-Dec	2011-12 April-Dec	2010-11 Q3	2011-12 Q2	2011-12 Q3
1	2	3	4	5	6
1. Textiles including apparels	0.22	0.09	0.04	0.04	0.08
2. Leather	0.04	-0.01	0.02	0.00	-0.01
3. Metals	0.07	0.09	0.00	0.04	0.00
4. Automobiles	0.10	0.03	0.02	0.02	-0.01
5. Gems and jewellery	0.00	0.03	-0.01	0.01	0.01
6. Transport	-0.01	0.03	0.00	-0.01	0.03
7. IT/BPO	0.38	0.48	0.14	0.20	0.11
8. Handloom / Powerloom	0.01	0.02	0.00	0.01	0.01
Overall	**0.81**	**0.76**	**0.21**	**0.31**	**0.22**

Source: Thirteenth Quarterly Quick Employment Survey, Oct 2011-Dec 2011, Labour Bureau.

Table I.6: Indicators of Services Sector Activity

(Growth in per cent)

Services Sector Indicators	2009-10	2010-11	April-Feb 2010-11	April-Feb 2011-12
1	2	3	4	5
Tourist arrivals	4.4	8.3	9.1@	8.5@
Cement	10.5	4.5	4.3	6.4
Steel	6.0	8.9	9.2	6.8
Railway revenue earning freight traffic	6.6	3.8	3.4#	4.8#
Cell phone connections (in millions) $	192.5	227.3	167.9*	82.3*
Cargo handled at major ports	5.8	1.6	1.1#	-0.3#
Civil aviation				
Domestic cargo traffic	24.3	23.7	27.0*	-5.4*
International passenger traffic	8.8	10.3	10.9*	7.2*
Domestic passenger traffic	15.6	18.1	16.8*	17.7*

@ Data pertains to April-March.
* Data pertains to April-December. # Data pertains to April-January.
$: Refers to wireless subscriber additions in actual numbers.
Source: Ministry of Statistics and Programme Implementation, Ministry of Tourism and CMIE.

during 2012-13. A combination of factors, *viz.*, some improvement in external climate and measures to address the supply-side bottlenecks would support improved industrial performance. If fiscal pressures are contained, the interest rate cycle could turn, supporting a pick-up in investment demand. Persistence of high global oil prices and slowing growth in the euro area and China, however, pose downside risks.