II. AGGREGATE DEMAND

Aggregate demand accelerated further in 2010-11. Private consumption and investment were the key drivers of growth in 2010-11, even though investment moderated somewhat in Q3. Government consumption expenditure has decelerated and this rebalancing should be maintained by focusing on fiscal consolidation. In this context, it is important to contain subsidies that are at risk of overshooting the budgetary provisions as global oil prices rise.*

Demand conditions remain supportive of growth

II.1 Aggregate expenditure, in real terms, accelerated in 2010-11 with private consumption as well as investment expenditure growing at a brisk pace (Table II.1). Going forward, private expenditure is likely to continue to be the main driver of growth, though some moderation can be expected in response to high inflation and demand-side policy measures. Government consumption expenditure has decelerated significantly in 2010-11 and this rebalancing could be maintained this year by staying on the path of fiscal consolidation. Investment expenditure is expected to remain moderate. Recovery in investment expenditure from the soft patch in Q3 of 2010-11 would depend on pick-up in execution of large infrastructure projects.

Saving rate driven up by public sector, investment rate by private corporates

II.2 Both saving and investment rates improved in 2009-10. Improvement in the overall saving rate has been led by the public sector while the investment rate has been boosted mainly by private corporate sector (Table II.2).

Table II.1 : Expenditure Side of GDP (2004-05 Prices)

(Per cent)

	2009-10 Q.E.	2010-11 A.E.	2009-10			2010-11			2009-10	2010-11
			Q1	Q2	Q3	Q1	Q2	Q3	Apr-Dec	Apr-Dec
1	2	3	4	5	6	7	8	9	10	11
					Growth Rate					
Real GDP at market prices	9.1	9.7	6.5	7.6	9.2	10.2	10.4	9.7	7.8	10.1
Total final consumption expenditure	8.7	7.3	9.3	12.2	7.4	7.4	8.9	6.9	9.5	7.7
(i) Private	7.3	8.2	7.3	8.5	7.0	7.0	8.6	9.0	7.6	8.3
(ii) Government	16.4	2.6	21.3	37.5	9.6	9.1	10.4	-3.0	20.5	4.7
Gross fixed capital formation	7.3	8.4	-0.4	0.3	8.7	25.7	17.8	6.0	2.9	16.1
Changes in stocks	90.8	7.1	78.9	86.1	95.4	6.4	8.2	4.0	86.8	6.1
Net Exports	10.2	-9.5	11.1	-21.4	14.8	6.2	13.8	-59.4	-0.4	-18.4
					Relative Share					
Total final consumption expenditure	70.1	68.5	73.1	71.4	73.6	71.3	70.4	71.7	72.7	71.1
(i) Private	58.5	57.6	61.8	60.2	60.4	60.1	59.2	60.1	60.8	59.8
(ii) Government	11.6	10.8	11.3	11.2	13.1	11.2	11.2	11.6	11.9	11.3
Gross fixed capital formation	32.0	31.6	30.4	31.9	30.9	34.6	34.1	29.8	31.1	32.7
Changes in stocks	3.5	3.5	3.5	3.6	3.5	3.4	3.6	3.3	3.5	3.4
Net Exports	-7.2	-6.0	-6.6	-7.2	-8.7	-6.4	-7.5	-3.2	-7.6	-5.6
Memo:										₹ Crore
Real GDP at Market Prices	48,69,317	53,42,571	11,12,505	11,37,893	12,55,103	12,25,551	12,56,776	13,76,242	35,05,500	38,58,568

Q.E.: Quick Estimates. A.E.: Advance Estimates.

Note: As only major items are included in the table, data will not add up to 100. **Source:** Central Statistics Office.

* Despite well-known limitations, expenditure side GDP data are being used as proxies for components of Aggregate Demand.

Table II.2: Gross Domestic Saving and Gross Domestic Capital Formation

(Per cent to GDP at current market prices)

Item	2007-08	2008-09	2009-10 QE
1	2	3	4
1. Gross Domestic Saving	36.9	32.2	33.7
1.1 Household Sector	22.5	23.8	23.5
Financial saving	11.7	10.8	11.8
Saving in physical assets	10.8	13.1	11.7
1.2 Private Corporate Sector	9.4	7.9	8.1
1.3 Public Sector	5.0	0.5	2.1
2. Gross Domestic Capital Formation*	38.1	34.5	36.5
2.1 Household Sector	10.8	13.1	11.7
2.2 Private Corporate Sector	17.3	11.5	13.2
2.3 Public Sector	8.9	9.5	9.2

* : Adjusted for errors and omissions. QE : Quick Estimates.

Key fiscal indicators budgeted to improve in 2011-12

II.3 The key fiscal indicators of the Central Government showed an improvement in 2010-11 (RE) attributable mainly to larger than expected proceeds from telecom spectrum auctions. The Government chose to utilise these excess receipts to increase allocations for rural infrastructure, implementation of Right to Education Act, plan assistance to States and recapitalisation of public sector banks. The Budget intends to carry forward the process of fiscal consolidation in 2011-12 through reduction in expenditure growth. Recognising that the windfall benefit of one-off non-tax revenues of 2010-11 would not be available during 2011-12, the revenue deficit as a ratio to GDP is budgeted to remain unchanged. Nonetheless, the gross fiscal deficit (GFD) as ratio to GDP is budgeted to decline reflecting compression in capital expenditure in 2011-12 (Table II.3).

Fiscal consolidation process to continue but quality and pace matter

II.4 Over the medium term, the Government has envisaged a gradual reduction in key deficit indicators in consonance with its macroeconomic projections and conservative stance on revenue collections. However, key deficit indicators are likely to remain higher than the prescribed path of the Thirteenth Finance Commission and accordingly, the Government would not be able to achieve revenue balance by 2013-14. Although the Government focuses

Table II.3: Key Fiscal Indicators of the Central Government

(Per cent to GDP)

Year	Primary Deficit	Revenue Deficit	Gross Fiscal deficit
1	2	3	4
2009-10	3.1	5.2	6.4
2010-11 BE	1.9	4.0	5.5
2010-11 RE	2.0	3.4 (2.3)	5.1
2011-12 BE	1.6	3.4 (1.8)	4.6
13th FC	-	2.3	4.8
2012-13 (Rolling targets)			
MTFP	-	2.7 (1.1)	4.1
13th FC	-	1.2	4.2
2013-14 (Rolling targets)			
MTFP	-	2.1 (0.5)	3.5
13th FC	-	0.0	3.0

BE: Budget Estimates. RE: Revised Estimates.
MTFP: Medium Term Fiscal Policy Statement. 13th FC: Thirteenth Finance Commission.
Note: Figures for 'effective revenue deficit' are indicated in brackets.
Source: Union Budget 2011-12 and 13th FC.

on reducing 'effective revenue deficit', which excludes capital grants to States, the headline revenue deficit, as a ratio to GFD, is expected to remain higher in 2011-12. This indicates that a larger portion of GFD would emanate from revenue deficit, reducing the availability of resources to undertake capital outlays.

Tax buoyancy helps though tax cut roll-back was partial

II.5 The Central Government is calibrating the roll-back of taxes/duties towards the pre-crisis levels recognising the emerging inflationary situation. The growth in gross tax revenues, however, is budgeted to be lower for 2011-12 as compared with 2010-11 (Table II.4). By keeping the standard rates for excise duty and service tax unchanged, the Government intends to stay on course towards introduction of goods and services tax. With the implementation of direct tax code in 2012-13, the tax buoyancy is expected to improve and raise the gross tax-GDP ratio gradually to 11.3 per cent by 2013-14, though lower than its pre-crisis peak of 11.9 per cent in 2007-08.

Focus on quality of expenditure important in fiscal consolidation

II.6 Sharp moderation in revenue expenditure growth and marginal decline in budgeted capital expenditure are expected to contain expenditure growth this year. The fiscal consolidation strategy for 2011-12 is primarily expenditure driven, reflecting the impact of lower growth in expenditure on salary and pensions and subsidies. While controlling non-plan revenue expenditure growth is a positive feature, the compression in capital expenditure poses concerns regarding the quality of fiscal consolidation.

Capping of expenditure on subsidies is subject to upside risks

II.7 The Budget's lower projection of subsidies for 2011-12 is subject to the underlying assumption of no major variation in international fertiliser and petroleum prices during the entire span of 2011-12, which may not hold (Table II.5). There is an upside risk in the case of fertiliser subsidy as fertiliser input prices have increased. Fertiliser subsidies are

Table II.4 : Central Government Finances

Item	Growth rate (per cent)			Per cent to GDP		
	2009-10	2010-11 (RE)	2011-12 (BE)	2009-10	2010-11 (RE)	2011-12 (BE)
1	2	3	4	5	6	7
1. Total Expenditure	15.9	18.7	3.4	15.6	15.4	14.0
2. Revenue Expenditure	14.9	15.6	4.1	13.9	13.4	12.2
3. Capital Expenditure	25.0	44.6	-1.4	1.7	2.1	1.8
4. Non-Developmental Expenditure	20.1	10.5	9.5	7.8	7.2	6.9
5. Development Expenditure	12.1	26.5	-0.9	8.1	8.5	7.4
4. Non-Plan Expenditure	18.5	13.9	-0.7	11.0	10.4	9.1
5. Plan Expenditure	10.2	30.2	11.8	4.6	5.0	4.9
6. Revenue Receipts	6.0	36.8	0.8	8.7	9.9	8.8
i) Tax Revenue (net)	3.0	23.5	17.9	7.0	7.2	7.4
ii) Non Tax Revenue	19.9	89.3	-43.0	1.8	2.8	1.4
7. Gross Tax Revenue	3.2	26.0	18.5	9.5	10.0	10.4
i) Direct Tax	13.1	18.1	19.4	5.8	5.7	5.9
ii) Indirect Tax	-9.0	38.0	17.3	3.8	4.3	4.5
Memo:						
Primary Deficit	41.9	-22.0	-9.6	3.1	2.0 (1.9)	1.6
Revenue Deficit	33.7	-20.4	13.9	5.2	3.4 (4.0)	3.4
Gross Fiscal Deficit	24.2	-4.2	2.9	6.4	5.1 (5.5)	4.6

Note: Figures in bracket are budget estimates for 2010-11 as per cent of GDP.
Source: Union Budget 2011-12.

Table II.5: Major Subsidies

(Amount in ₹ crore)

Items	2009-10 Amount	2009-10 per cent to GDP	2010-11 RE Amount	2010-11 RE per cent to GDP	2011-12 BE Amount	2011-12 BE per cent to GDP
1	2	3	4	5	6	7
Total Subsidies	1,41,351	2.2	1,64,153	2.1	1,43,570	1.6
of which:						
i. Food	58,443	0.9	60,600	0.8	60,573	0.7
ii. Fertiliser	61,264	0.9	54,976	0.7	49,998	0.6
iii. Petroleum	14,951	0.2	38,386	0.5	23,640	0.3
iv. Interest subsidy	2,687	0.0	5,223	0.1	6,869	0.1
v. Others	4,006	0.1	4,968	0.1	2,490	0.0

Source: Union Budget 2011-12.

likely to exceed budgetary provisions unless urea price is decontrolled or Nutrient-Based Fertiliser Subsidy scheme succeeds in effectively capping the total fertiliser subsidies. Further, the rising international oil prices may generate pressures on the fiscal situation in case there is a delay in the corresponding adjustment in domestic prices, leading to larger subsidy expenditure towards under-recoveries of downstream oil public sector units. Furthermore, the introduction of National Food Security Bill may also have additional expenditure implications.

Robust sales growth points to enduring demand conditions

II.8 Corporate sales growth remained robust during Q3 of 2010-11 and together with inventory movements signalled continued buoyancy in demand. However, profit margin came under pressure, on account of higher input and interest costs (Table II.6). All components

Table II.6: Corporate Sector-Financial Performance

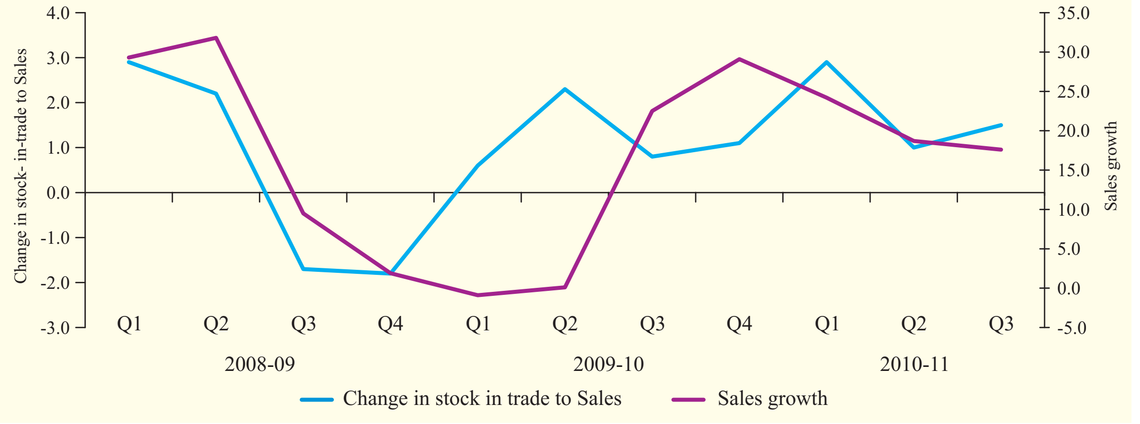
Item	2009-10 Q1	2009-10 Q2	2009-10 Q3	2009-10 Q4	2010-11 Q1	2010-11 Q2	2010-11 Q3
1	2	3	4	5	6	7	8
							(Growth rates in per cent)
No. of Companies	2530	2531	2562	2565	2546	2586	2643
Sales	-0.9	0.1	22.5	29.1	24.2	18.7	17.6
Other Income*	50.2	6.0	7.4	10.3	-21.2	58.5	14.7
Expenditure	-4.4	-2.5	20.6	30.7	29.0	19.9	19.6
of which:							
Raw Material	-13.6	-4.0	34.2	44.0	37.8	21.6	19.9
Staff Cost	8.1	6.3	5.2	13.7	16.7	20.5	21.5
Power and Fuel	-13.2	-16.1	-5.1	10.7	15.3	12.1	17.3
Depreciation provision	21.5	20.7	21.6	20.1	19.9	16.8	13.6
Gross profits	5.8	10.9	60.0	36.7	8.2	10.3	11.0
Interest payments	3.7	-1.0	-12.3	-2.9	26.9	5.9	22.4
Profits after tax	5.5	12.0	99.3	44.0	2.4	10.8	10.3
						(Ratios in per cent)	
Change in stock# to Sales	0.6	2.3	0.8	1.1	2.9	1.0	1.5
Gross Profits to Sales	15.7	14.9	14.3	14.6	13.9	13.6	13.6
Profits After Tax to Sales	10.2	9.4	8.8	9.0	8.6	8.5	8.3
Interest to Sales	2.8	3.1	2.7	2.4	2.9	2.7	2.8
Interest to Gross Profits	18.0	20.5	19.1	16.6	21.1	19.9	20.6
Interest Coverage (Times)	5.6	4.9	5.2	6.0	4.7	5.0	4.9

* : Other income excludes extraordinary income/expenditure if reported explicitly

\# : For companies reporting this item explicitly.

Note: 1. Data pertain to listed non-government non-financial companies.
2. Growth rates are percentage changes in the level for the period under reference over the corresponding period of the previous year for common set of companies.

Chart II.1: Sales Growth and Change in Stock-in-Trade to Sales Ratio (%)



of input costs *viz*., expenses on raw materials, power & fuel and staff costs witnessed significant increase. Reflecting the tightening of monetary policy rates, interest payments have increased. Companies accumulated stocks as reflected in the rise in stock-in-trade to sales ratio. This may at the current juncture of cycle indicate that producers anticipate a pick-up in demand (Chart II.1). Early results for Q4 from a small sample of companies suggest that sales accelerated during the quarter.

Investment intentions of corporates moderate further in Q3 of 2010-11

II.9 Investment intentions of corporates witnessed a further slowdown in Q3 of 2010-11 after beginning to moderate from the previous quarter. Out of total costs of projects sanctioned in financial year 2010-11 (April-December), the largest share is envisaged to be invested in the power sector followed by the telecommunication sector and metal and metal products.

Demand conditions may soften a little, helping to rebalance growth

II.10 The pick-up in private spending in 2010-11 helped in sustaining growth recovery from the slowdown seen in the immediate aftermath of the global financial crisis. This was essential as the recovery in the initial phases was driven by fiscal stimulus that resulted in large government spending. Nevertheless, the pick-up in private consumption and fiscal consolidation has enabled rebalancing of demand. Restraint on subsidies in the wake of high global oil prices, and maintenance of investment demand are critical for sustaining private demand.