# II. Aggregate Demand

*Aggregate demand* decelerated in Q4 of 2010-11 mainly due to investment slowdown. Corporate investment intentions also moderated significantly during H2 of 2010-11. There are no signs of improvement in investment during 2011-12 as yet. Private consumption demand may be adjusting downwards, but still remains strong. Corporate sales growth remained robust during Q4 of 2010-11 and is expected to stay so in Q1 of 2011-12. Profits, however, decelerated in 2010-11 with margins coming under pressure from rising interest and raw material costs. A rebalancing of demand from government consumption spending to private consumption spending occurred during 2010-11. Going forward, some rebalancing towards investment is required to sustain the growth momentum. Though fiscal indicators improved during 2010-11, high growth in subsidies led to a moderation in GDP at market prices. Despite recent initiatives to downsize petroleum subsidies, there is a likelihood of fiscal slippage in 2011-12.*

## Investment soft patch continues

II.1 Expenditure side data of GDP indicates a significant slowdown in gross fixed capital formation, as well as inventory formation during Q4 of 2010-11 (Table II.1). While these numbers could be possibly revised, there is evidence to suggest that investment entered a soft patch during H2 of 2010-11. Updated information on corporate investment intentions, as captured by projects sanctioned financial assistance by banks and financial institutions, suggest that project expenditure on new projects, that were sanctioned assistance, was strong during H1 of 2010-11, but dipped sharply in H2 of 2010-11. While the envisaged corporate investment in 2010-11 was marginally higher than that in the previous year, the slowdown was perceptible with a 43 per cent drop in the second half from the level of first half of 2010-11.

II.2 This slowdown since Q3 of 2010-11 is a concern, requiring some rebalancing of aggregate demand

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

(Per cent)

| | 2009-10 Q.E. | 2010-11 R.E. | 2009-10 | | | | 2010-11 | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | Q1 | Q2 | Q3 | Q4 | Q 1 | Q2 | Q3 | Q4 |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 |
| (Growth Rate) | | | | | | | | | | |
| Real GDP at Market Prices | 9.1 | 8.8 | 6.5 | 7.6 | 9.2 | 12.6 | 9.4 | 9.1 | 9.2 | 7.7 |
| Total Final Consumption Expenditure | 8.7 | 8.0 | 9.3 | 12.2 | 7.4 | 6.5 | 8.6 | 8.5 | 7.4 | 7.5 |
| Private | 7.3 | 8.6 | 7.3 | 8.5 | 7.0 | 6.6 | 8.9 | 8.9 | 8.6 | 8.0 |
| Government | 16.4 | 4.8 | 21.3 | 37.5 | 9.6 | 6.2 | 6.7 | 6.4 | 1.9 | 4.9 |
| Gross Fixed Capital Formation | 7.3 | 8.6 | -0.4 | 0.3 | 8.7 | 19.2 | 17.4 | 11.9 | 7.8 | 0.4 |
| Change in Stock | 90.8 | 7.4 | 78.9 | 86.1 | 95.4 | 102.1 | 11.7 | 9.0 | 5.1 | 4.6 |
| Net Exports | 10.2 | -15.3 | 5.4 | -21.1 | 15.0 | 70.8 | 33.8 | 14.1 | -52.6 | -34.8 |
| (Share in GDP) | | | | | | | | | | |
| Total Final Consumption Expenditure | 70.1 | 69.5 | 73.1 | 71.4 | 73.6 | 63.2 | 72.6 | 71.0 | 72.3 | 63.1 |
| Private | 58.5 | 58.3 | 61.8 | 60.2 | 60.5 | 52.4 | 61.6 | 60.1 | 60.1 | 52.6 |
| Government | 11.6 | 11.2 | 11.3 | 11.2 | 13.1 | 10.8 | 11.0 | 10.9 | 12.2 | 10.5 |
| Gross Fixed Capital Formation | 32.0 | 32.0 | 30.4 | 31.9 | 30.9 | 34.5 | 32.6 | 32.7 | 30.5 | 32.1 |
| Change in Stock | 3.5 | 3.5 | 3.5 | 3.6 | 3.5 | 3.5 | 3.6 | 3.6 | 3.3 | 3.4 |
| Net Exports | -7.2 | -5.6 | -6.3 | -7.3 | -8.8 | -6.5 | -7.7 | -7.6 | -3.8 | -3.9 |
| ***Memo:*** | | | | | | | | | | (₹ crore) |
| Real GDP at Market Prices | 48,69,317 | 52,98,129 | 11,12,318 | 11,37,985 | 12,55,040 | 13,63,974 | 12,17,270 | 12,41,332 | 13,70,188 | 14,69,339 |

Q.E.: Quick Estimates. R.E. : Revised 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.

towards investment. In 2010-11, 796 projects were sanctioned assistance for planned project expenditures of ₹4,60,000 crore versus 754 projects that were sanctioned assistance in 2009-10 for planned project expenditures of ₹4,56,000 crore. Corporate investments are driven by the power sector followed by metal and metal products and telecommunication and have still not become broad-based. While some adverse impact on investment may come from high interest rates that have become necessary to combat inflation, better implementation can help in improving investment. The Government has made clear its intentions to remove constraints in investment and also encourage FDI in certain sectors such as multi-brand retail.

## *Private consumption demand decelerates but remains strong*

II.3 The drivers of growth from the expenditure side revealed the continued predominance of private final consumption expenditure (PFCE). The buoyancy in private consumption was largely driven by improved agriculture growth and support from the consumer durables segment (Table II.1).

## *Corporate sales growth remains robust but profits moderate*

II.4 Reflecting strong private consumption demand, sales of non-government non-financial (NGNF) listed companies grew by around 20 per cent during 2010-11 as also in the fourth quarter of the year (Table II.2). Further, in anticipation of better demand, companies accumulated stocks leading to a rise in stock-in-trade to sales ratio (Chart II.1). Operating profits and net profits, however, decelerated in 2010-11, due to higher input and interest costs. With decline in profit margins and increase in interest outflow, the interest coverage ratio, which indicates the number of times gross profits cover the interest payment, also declined in 2010-11 compared to the previous year. Earnings forecasts for Q1 of 2011-12, suggest a robust top line growth, indicating that the demand environment remains good. However, margin compression may decelerate profits somewhat. Early results are broadly in line with these expectations (Table II.3).

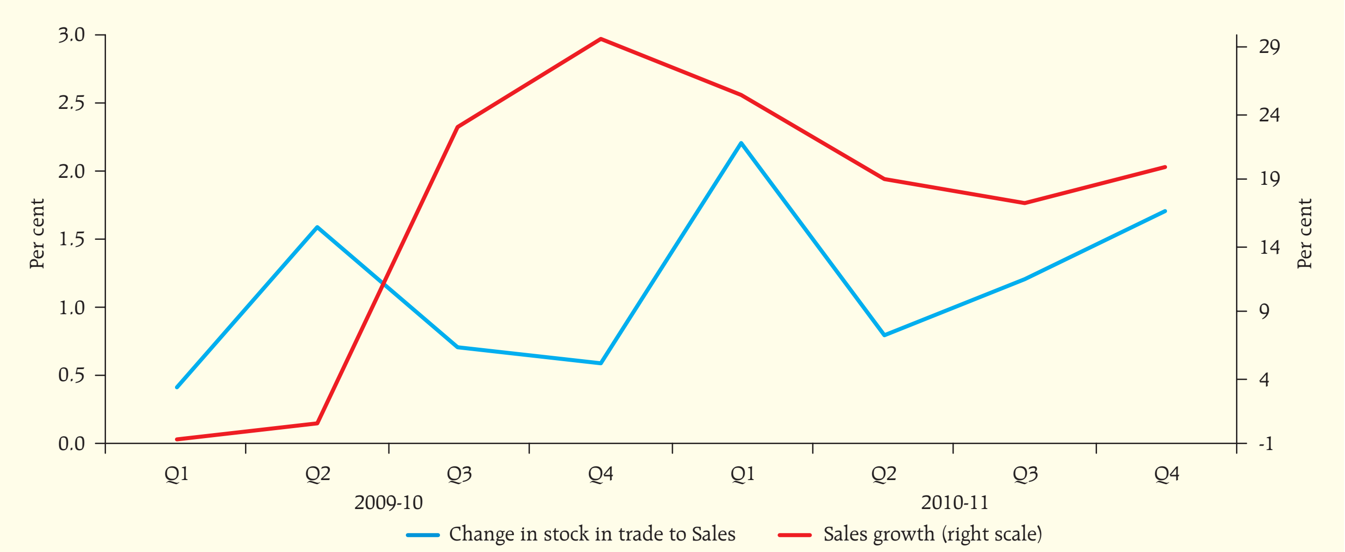
**Table II.2: Corporate Sector- Financial Performance**

(Per cent)

| | 2009-10 | 2010-11 (P) | 2009-10 | | | | 2010-11 | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | Q1 | Q2 | Q3 | Q4 | Q 1 | Q2 | Q3 | Q4 |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 |
| No. of Companies | 2196 | | | | | | | | | |
| **Growth rates in per cent** | | | | | | | | | | |
| Sales | 12.8 | 19.7 | -0.8 | 0.6 | 23.0 | 29.8 | 25.3 | 19.2 | 17.1 | 19.9 |
| Other Income* | 15.5 | 3.8 | 51.5 | 3.4 | 7.8 | 8.3 | -23.0 | 56.2 | 8.4 | -24.7 |
| Expenditure, *of which* | 10.6 | 22.3 | -4.8 | -2.3 | 20.6 | 30.9 | 29.8 | 20.5 | 19.1 | 22.4 |
| Raw Material | 13.2 | 25.7 | -13.8 | -4.2 | 33.5 | 43.7 | 37.7 | 21.5 | 19.7 | 26.6 |
| Staff Cost | 8.5 | 18.4 | 8.4 | 6.3 | 5.3 | 14.0 | 16.3 | 20.0 | 20.5 | 20.0 |
| Operating Profits (PBDIT) | 27.8 | 11.5 | 6.7 | 14.4 | 59.3 | 39.4 | 15.4 | 7.8 | 10.5 | 14.6 |
| Depreciation | 22.0 | 15.3 | 22.4 | 21.2 | 23.2 | 21.2 | 20.2 | 16.7 | 13.1 | 13.3 |
| Interest | -3.8 | 20.0 | 5.5 | -0.2 | -13.6 | -3.9 | 29.9 | 5.7 | 21.9 | 29.5 |
| Net Profits (PAT) | 32.4 | 7.5 | 7.6 | 12.9 | 91.0 | 43.4 | 1.6 | 9.2 | 9.1 | 11.9 |
| **Ratios in per cent** | | | | | | | | | | |
| Change in stock# to Sales | 1.0 | 1.7 | 0.4 | 1.6 | 0.7 | 0.6 | 2.2 | 0.8 | 1.2 | 1.7 |
| PBDIT to Sales | 16.8 | 15.7 | 17.5 | 17.3 | 16.8 | 15.9 | 16.2 | 15.6 | 15.9 | 15.1 |
| PAT to Sales | 9.4 | 8.5 | 10.4 | 9.5 | 9.0 | 9.1 | 8.5 | 8.6 | 8.3 | 8.4 |
| Interest to Sales | 2.6 | 2.6 | 2.7 | 2.9 | 2.6 | 2.3 | 2.9 | 2.6 | 2.7 | 2.5 |
| Interest to Gross Profits | 17.6 | 19.6 | 17.2 | 19.8 | 17.6 | 16.1 | 21.1 | 19.1 | 19.7 | 19.1 |
| Interest Coverage (Times) | 5.7 | 5.1 | 5.8 | 5.1 | 5.7 | 6.2 | 4.8 | 5.2 | 5.1 | 5.2 |

* : Other income excludes extraordinary income/expenditure if reported explicitly.
# : For companies reporting this item explicitly.
PBDIT : Profit before depreciation, interest and tax. PAT : Profit after tax.
**Note :** 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 Stock-in-Trade to Sales Ratio**




## *External demand improves, but uncertainty remains*

II.5 There has been some improvement in net external demand during Q4 of 2010-11. With exports growing at a faster pace than imports, the extent of negative contribution of net exports to GDP declined. Going forward, there is some uncertainty about external demand given the renewed global growth concerns, but typically, external demand has been a small contributor to aggregate demand in India.

**Table II:3 Early Results for Q1:2011-12**

| | 2010-11 | | 2011-12 |
|---|---|---|---|
| | Q1 | Q4 | Q1 |
| 1 | 2 | 3 | 4 |
| No. of companies | 127 | | |
| **Growth rates in per cent** | | | |
| Sales | 27.3 | 26.1 | 27.1 |
| Other Income* | -15.1 | 17.3 | 85.4 |
| Expenditure, of which | 35.8 | 29.6 | 25.0 |
| Raw Material | 50.9 | 34.9 | 29.8 |
| Staff Cost | 15.4 | 25.8 | 26.3 |
| Operating Profits (PBDIT) | 16.2 | 23.5 | 24.4 |
| Depreciation | 5.1 | 26.1 | 27.4 |
| Interest | | 26.8 | 26.6 |
| 14.6 | | | |
| Net Profits (PAT) | 12.4 | 33.8 | 29.2 |
| **Ratio in per cent** | | | |
| Change in stock# to Sales | 4.6 | 1.5 | 2.2 |
| PBDIT to Sales | 18.7 | 19.3 | 18.3 |
| PAT to Sales | 13.1 | 15.1 | 13.3 |
| Interest to Sales | 1.3 | 1.2 | 1.2 |
| Interest to Gross Profits | 7.4 | 6.1 | 6.6 |
| Interest Coverage (Times) | 13.5 | 16.3 | 15.1 |

#: For companies reporting this item explicitly.
*: Other income excludes extraordinary income/expenditure if reported explicitly.
**Note :** Provisional data.

## *Improvement in deficit indicators augurs well for growth rebalancing*

II.6 Provisional accounts of the Central government for 2010-11 turned out to be significantly better than the revised estimates (RE). Key deficit indicators showed an improvement over the RE reflecting higher realisation of tax and non-tax revenues and lower plan expenditure for both revenue and capital components. Preliminary indications are that the combined fiscal deficit of the Centre and States had narrowed to 7.7 per cent of GDP in 2010-11 (Tables II.4 and II.5). The combined revenue deficit had also fallen significantly. The higher than anticipated revenues in 2010-11 were utilised by the Centre for financing increased outlays in key priority areas (rural infrastructure, implementation of the Right to Education Act, plan assistance to States and recapitalisation of public sector banks).

## *Subsidies likely to overshoot budget estimates*

II.7 Notwithstanding improvements during 2010-11 concerns about possible fiscal slippage during 2011-12 remain. The government's budgetary stance of expenditure-driven fiscal correction for 2011-12 was viewed as a move towards fiscal consolidation and

**Table II.4 : Key Fiscal Indicators**

(Per cent to GDP)

| Year | Primary Deficit | Revenue Deficit | Gross Fiscal deficit | Outstanding Liabilities |
|---|---|---|---|---|
| 1 | 2 | 3 | 4 | 5 |
| **Centre** | | | | |
| 2009-10 | 3.1 | 5.2 | 6.4 | 53.7 |
| 2010-11 RE | 2.0 | 3.4 | 5.1 | 49.9 |
| | (1.7) | (3.1) | (4.7) | |
| 2011-12 BE | 1.6 | 3.4 | 4.6 | 48.5 |
| **States*** | | | | |
| 2009-10 | 1.1 | 0.5 | 2.8 | 22.7 |
| 2010-11 RE | 0.9 | 0.3 | 2.5 | 21.0 |
| 2011-12 BE | 0.6 | -0.2 | 2.1 | 20.6 |
| **Combined** | | | | |
| 2009-10 | 4.5 | 5.7 | 9.2 | 68.9 |
| 2010-11 RE | 3.2 | 3.7 | 7.7 | 64.0 |
| 2011-12 BE | 2.4 | 3.3 | 6.8 | 62.7 |

RE: Revised Estimates. BE: Budget Estimates.

* : Data in respect of States pertains to 24 State governments of which four are Vote on Accounts.

**Note:** Figures in parentheses are from the provisional accounts released by the Controller General of Accounts on May 31, 2011.

**Source:** Budget documents of the Central and State Governments.

anchoring inflation expectations. However, the lower gross fiscal deficit (GFD)-GDP ratio budgeted for 2011-12 is challenging on account of sizeable upside risks to subsidies and downside risks to revenues from moderation in growth.

II.8 Although the petroleum subsidy has been budgeted lower in 2011-12 than the RE for 2010-11, the actual level of petroleum subsidy is expected to exceed the budgeted level for 2011-12. It could overshoot by about 0.5 per cent of GDP even after partial upward revision in domestic prices of diesel, PDS kerosene and domestic LPG in June 2011 as the under-recoveries could still be close to ₹1,10,000 crore. Furthermore, payments undertaken for compensation of under-recoveries of oil marketing companies for the fourth quarter of 2010-11 would also add another 0.2 per cent of GDP to the subsidy burden of the current fiscal year. The elimination/reduction of customs/excise duty on petroleum products is estimated to also cause revenue losses to the Centre to the extent of nearly 0.3 per cent of GDP and impact the fiscal balance of the Central government. The total fiscal slippage for the Centre from oil sector, could thus be about 1 per cent of GDP. In addition, there could be spillover in fertiliser subsidies. Therefore, for durable correction in revenue account, tax buoyancy must recover to the pre-crisis level and administered pricing of diesel, kerosene and LPG needs to be phased out at the earliest. Besides, fertiliser subsidies need to be contained.

II.9 During April-May 2011, the revenue deficit and the GFD of the Central government turned out to be higher than during the corresponding period of the

**Table II.5 : Combined 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 | 15.8 | 21.7 | 6.5 | 28.0 | 28.4 | 26.5 |
| 2. Revenue Expenditure | 16.4 | 20.0 | 6.4 | 23.9 | 23.9 | 22.3 |
| 3. Capital Expenditure | 12.2 | 32.2 | 7.3 | 4.1 | 4.5 | 4.2 |
| 4. Non-Developmental Expenditure | 20.7 | 14.3 | 9.9 | 11.7 | 11.1 | 10.7 |
| 5. Development Expenditure | 12.5 | 26.9 | 4.1 | 16.0 | 16.9 | 15.4 |
| 6. Revenue Receipts | 8.4 | 32.6 | 7.7 | 18.3 | 20.1 | 19.0 |
| i) Tax Revenue (net) | 6.3 | 25.6 | 17.1 | 15.0 | 15.6 | 16.1 |
| ii) Non-tax Revenue | 18.8 | 63.9 | -25.0 | 3.3 | 4.5 | 3.0 |

previous year mainly due to decline in revenue receipts. Lead information for the first quarter of 2011-12 indicates that although gross direct tax collections have increased, the substantial amount of corporation tax refunds have resulted in a decline in net tax collections over April-June 2010.

## *State finances appear to be on track*

II.10 State governments also reverted to the process of fiscal consolidation in 2010-11, after a setback during 2008-10. The RE for 2010-11, based on the 2011-12 budgets of 24 States received so far, confirms that at the consolidated level, States could broadly achieve the budgeted reduction in key deficit ratios in 2010-11. This indicates increasing credibility of State governments' commitment towards fiscal consolidation.

II.11 A disaggregated analysis shows that the budgeted improvement in revenue account of States in 2011-12 is mainly due to decline in revenue expenditure while revenue receipts-GDP ratio is expected to remain stable at 11.7 per cent. However, the moderation in revenue expenditure growth is attributable to a sharp deceleration in growth of development expenditure (comprising social and economic services) to 9.0 per cent in 2011-12, from 26.0 per cent in 2010-11 (RE). In line with the improvement in the revenue account, States' GFD-GDP ratio is budgeted to be lower in 2011-12. However, capital outlay to GDP ratio, budgeted at 2.1 per cent in 2011-12, is yet to revert to the high levels achieved during 2006-09. With several States reducing their State levies on petroleum products, there could be some impact on State finances.

II.12 Overall, States seem to be committed to bring their finances on a sustainable path in the medium-term and the present pace of fiscal consolidation appears to be in tandem with the path suggested by the Thirteenth Finance Commission. Thus, the fiscal position of the States appears encouraging, but the challenge lies in translating intentions into outcomes of fiscal consolidation, while not compromising on the quality of the fiscal correction process.

## *Moderation in demand in 2011-12 is likely*

II.13 There are chances of further moderation in both investment and consumption as high inflation erodes real consumption and monetary policy actions to restrain demand in the short run work through the system. The slowdown in consumption has been restricted so far to interest rate sensitive sectors like car sales getting impacted. Some re-balancing of demand towards investment would be helpful, and industrial policy action and execution could go a long way to help bring about this rebalancing. Firm commitment towards fiscal consolidation by the government would also help the rebalancing of aggregate demand.