

VII. Macroeconomic Outlook

The dampened investment climate may revive gradually following the demonstrated intent for fiscal policy reforms and commitment to much-awaited active policy to propel the economy forward. This will help improve business sentiments which remained cautious driven by uncertainties in the global and domestic economies. External agencies and professional forecasters have significantly revised their growth projections for India downwards. If the announced domestic reform measures are well-implemented and complemented by further reforms, the economy would turn around, despite the current expectations and sluggish global growth. In the interim, cautious calibration is needed so that macroeconomic risks are contained.

Recent actions by the government reduce macroeconomic risks, but implementation is important

VII.1 Domestic growth has averaged 5.4 per cent over the previous two quarters. This is lower than the 6.5 per cent in 2011-12 and the crisis-affected growth of 6.7 per cent in 2008-09. With an amalgamation of weaker economic indicators including falling savings and investment, rising twin deficits and inflation, potential growth also dropped by one percentage point in a little over a year.

VII.2 Part of the slowdown was due to weak global growth amidst debt and financial crises that has slowed down growth and trade across geographies. However, domestic factors have magnified the growth slowdown in India. High and persistent inflation which necessitated monetary policy action to contain inflation and anchor inflation expectations, partly contributed to this. Monetary tightening was needed to consolidate macroeconomic stability and foster growth in the medium run. But, beyond this, inadequate movement on the policy and implementation fronts worsened the investment climate that had already suffered due to global uncertainties and the cyclical downturn in the Indian economy.

VII.3 The slew of policy measures announced by the government, since mid-September 2012, have started

addressing these concerns (Table VII.1). These reforms measures by themselves are not sufficient to address the macro and structural problems constraining growth and delivering the needed reduction in twin deficits. Yet, they mark a significant directional change. Speedy implementation of the proposed measures and further progress to contain twin deficits would be needed for sustainable recovery to set in.

Economic downturn is getting arrested

VII.4 By reducing the macro-financial risks, the reforms should help arrest falling growth. Although, growth in Q2 of 2012-13 is unlikely to be significantly different, gradual recovery could follow later in the year.

VII.5 Growth in 2012-13 has slowed more than anticipated due to multiple factors. The *kharif* crop has been adversely impacted following deficient monsoon. Good rainfall in August and September has improved the soil moisture content and reservoir levels, thus raising the prospects for a good *rabi* crop. However, agriculture is likely to pull the overall growth down as *kharif* crop shortfall may not be entirely recovered.

VII.6 Contraction in mining sector continues following a clamp-down on illegal mining activity. Manufacturing output has stagnated as external demand as well as domestic investment and private final consumption expenditure have decelerated. Services sector growth has also slowed as activity in trade, transport, hotels and communication has been impacted given its linkages with the rest of the economy.

VII.7 While a modest recovery can be expected later in the year as the investment climate improves, growth in 2012-13 will fall short of the earlier projection.

Inflation risks persist, warranting cautious policy calibration

VII.8 Notwithstanding the growth deceleration, inflation remains significantly above comfort levels. This partly reflects the impact of past suppressed

Table VII.1: Key Reform Measures Since Mid-September 2012

Date of announcement	Reform measure and key features	Expected outcome	Whether approval pending
1	2	3	4
Sep. 13, 2012	Fuel price hike: <ul style="list-style-type: none"> Diesel price hike by ₹5/litre Capping subsidised LPG cylinders at 6 p.a./household 	Would reduce under-recoveries on sale of diesel by about ₹150 billion in 2012-13, making a small but significant contribution to fiscal consolidation. Would also lower suppressed inflation in the system, bringing medium-term benefits, even though inflation may rise in the near term.	No
Sep. 14, 2012	FDI liberalisation <ul style="list-style-type: none"> Up to 51% FDI in multi-brand and single brand retail subject to conditions Up to 74% FDI in teleports, mobile TV and sky-broadcasting services. Up to 49% FDI in aviation by foreign airlines. 	Moderate FDI inflows likely over next 1-3 years in retail. This will improve organised retail penetration, but its market share may still remain less than 10 per cent. Supply-chain management over the years should improve, helping to lower prices and improve consumer welfare. MSMEs would also benefit. Both exports and imports could rise. FDI in aviation would depend on restructuring and M&A. FDI in broadcasting may support digitisation through the cable and Direct-to-Home (DTH) segments over time.	No
Sep. 14, 2012	Disinvestment in PSUs Oil India Limited (10%), MMTC (9.33%), NALCO (12.15%) & Hindustan Copper (9.59%)	Raise ₹150 billion out of ₹300 billion budgeted for disinvestment in the Union Budget 2012-13. Also improve efficiency and market discipline and bring in greater shareholder accountability and better corporate governance in these PSUs.	No
Sep. 21, 2012	Reduction in withholding tax Reduced tax on overseas borrowings by domestic companies during July 2012-June 2015 to 5 % from 20%, Subject to conditions	Reduced cost for corporate borrowing abroad. This may increase debt inflows in the capital account.	No
Sep. 24, 2012	Financial restructuring of state distribution companies (Discoms)	Accumulated losses of discoms are estimated at ₹1.9 trillion as at the end of 2010-11. The restructuring package may face several difficulties in implementation, but it is a significant step towards containing the financial problems in the power sector.	No
Sep. 29, 2012	Proposal for National Investment Board (NIB) headed by the PM to clear infrastructure projects above a certain threshold.	Faster clearances of infrastructure investment would provide greater clarity and reduce uncertainty. It would also avoid delays in the implementation of projects.	Cabinet approval pending
Oct. 1, 2012	Package for insurance sector	Would help in capital infusion in insurance sector and also encourage domestic savings.	IRDA, CBDT and CEBC notifications pending
Oct. 4, 2012	Further FDI liberalisation (in insurance & pension) Foreign investment ceiling in the pension sector at 26% or such percentage as may be approved for the insurance sector, whichever is higher.	Would help tap a large pool of global savings to improve long-term growth in India. Such FDI would bring more stable capital inflows and bring about greater exchange rate stability.	Parliamentary approval necessary
Oct. 4, 2012	Twelfth Five-Year Plan Approved by cabinet for placing it before the National Development Council (NDC)	Would set the growth agenda for the next five years with plans covering large infrastructure investments.	NDC approval pending
Oct. 5, 2012	Pushing economic legislations: CCEA approval of amendments to the Companies Bill, 2011, the Forward Contracts (Regulation) Amendment Bill, 2010 and the Competition Act, 2002.	Diverse benefits from an improved legal framework	Parliamentary approval necessary

inflation that is now being reflected in current inflation numbers as administered prices are adjusted upwards. This has kept core inflation elevated in relation to the falling growth as cost-push pressures

are getting reflected in prices. In addition, some latent demand-side pressures still persist, as there have been large wage inflation pressures in the economy in recent years.

VII.9 Despite the recent moderation in the price of crude oil, liquidity impact of QE and geopolitical uncertainties constitute upward risks to commodity prices. On the domestic front, the reform measures-induced hike in administered prices would cause inflation to rise in the near-term but ease fiscal pressures in the medium-term, which will help soften inflation. Supply-side rigidities and less competitive market structures continue to put pressure on prices. For several commodities, the input cost pressures are significant. As a result inflation has now persisted for the third year, inspite of negative output gap, supported by the wage-price spiral that poses significant risk to medium-term inflation. In the short-run inflation may turn out to be slightly higher than anticipated. However, it is likely to soften from Q4 of 2012-13.

Business sentiments are weak, but recent policy actions may improve confidence

VII.10 Various business confidence surveys portray weak sentiment about business prospects in Q1 and Q2 of 2012-13. NCAER's Business Confidence Index shows a decline in overall confidence over Q1 of 2012-13, but no change over a year. FICCI's business confidence survey, likewise, reveals a fall in the overall business confidence index in Q1 of 2012-13. According to FICCI, weak demand, high cost of credit and worsening employment prospects emerged as constraints. The CII Business Confidence Index fell during Q2 of 2012-13, reflecting low business sentiments. Stagnation in reforms and credit availability constraint emerged as important (Table VII.2).

VII.11 Most of the responses for these surveys were received before the announcement of the reform measures. Those received later indicate improved business sentiments. The Dun & Bradstreet Business Optimism Index for Q3 of 2012-13 shows an improvement over the previous quarter, reflecting the improved sentiments.

VII.12 The seasonally adjusted HSBC Markit Purchasing Managers' Index for manufacturing remained flat during September 2012, while that for services recorded the fastest expansion in business activity in the past

Table VII.2: Business Expectations Surveys

Period Index	NCAER- Busi- ness Confi- dence Index Oct 2012	FICCI Overall Business Confidence Index Q1: 2012-13	Dun & Brad- street Business Opti- mism Index Q4: 2012	CII Busi- ness Confi- dence Index Q2: 2012- 13
1	2	3	4	5
Current level of the Index	125.4	51.8	140.8	51.3
Index as per previous survey	126.6	60.3	136.1	55.0
Index levels one year back	125.4	51.6	143.7	53.6
% change (q-o-q) sequential	-0.9	-14.1	3.5	-6.7
% change (y-o-y)	0.0	0.4	-2.0	-4.3

seven months. However, input prices continue to rise in both sectors, while business expectations fell to a six-month low in the services sector.

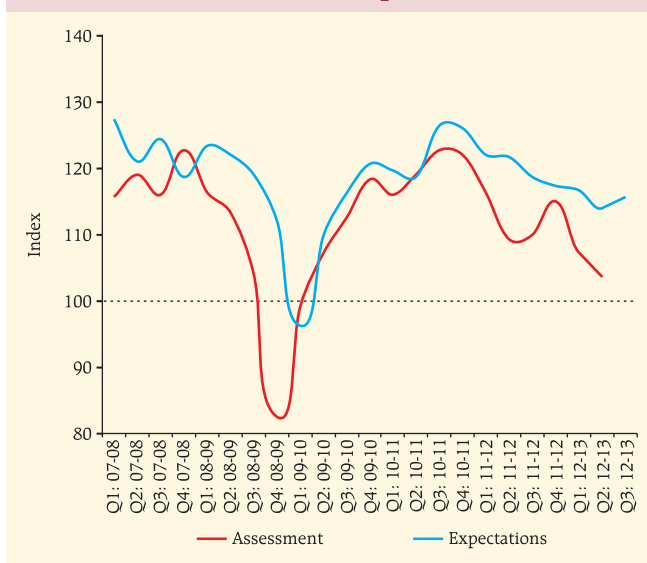
But there is a shift, however small, to a better outlook

VII.13 The Reserve Bank's 59th round of the Industrial Outlook Survey (<http://www.rbi.org.in/IOS59>) conducted during Q2 of 2012-13 showed further weakening in the business sentiments of the manufacturing sector during the quarter.

VII.14 The Business Expectation Index (BEI), a composite indicator based on several business parameters, declined to levels seen at the onset of the financial crisis in Q3 of 2008-09. However, the survey also revealed that the outlook for the ensuing Q3 of 2012-13 had improved marginally (Chart VII.1).

VII.15 Demand conditions, as reflected in the net responses for production, order books, capacity utilisation, exports and imports, appear to have further weakened in Q2. However, the outlook for Q3 showed marginal improvement, except for exports and imports (Table VII.3).

VII.16 The results also pointed to deterioration in the overall financial situation in Q2 of 2012-13, but showed a marginally improved outlook for the ensuing Q3. The cost of external finance is perceived to rise, but by a lower percentage of respondents. The cost of raw material is also expected to rise at a lower rate in the next quarter. The profit margin, which has been

Chart VII.1: Business Expectation Index

declining for the past few quarters, is expected to remain at the same level in Q3 of 2012-13.

Consumer confidence yet to revive

VII.17 The Reserve Bank's 10th round of the Consumer Confidence Survey (<http://www.rbi.org.in/CCS10>), conducted in September 2012 indicates a

decline in the index for the fourth quarter in succession, though the decline turned marginal in the latest quarter.

VII.18 The Current Situation Index, based on current perceptions of economic conditions, household circumstances, income, spending and price level, was estimated to be 106.2 compared with 106.7 in the preceding quarter. However, the Future Expectations Index, based on expectations of economic conditions, income, spending, price level, and employment prospects, declined substantially in this quarter (Chart VII.2).

External agencies revise India's growth projections downwards

VII.19 The latest forecasts of GDP growth by various agencies are in the range of 5.6 to 6.7 per cent (Table VII.4). These mark significant downward revision from their earlier estimates. The Asian Development Bank has lowered its growth forecast for India to 5.6 per cent from 6.5 per cent, citing delayed reforms contributing to falling investment and consumption, particularly in real estate and infrastructure.

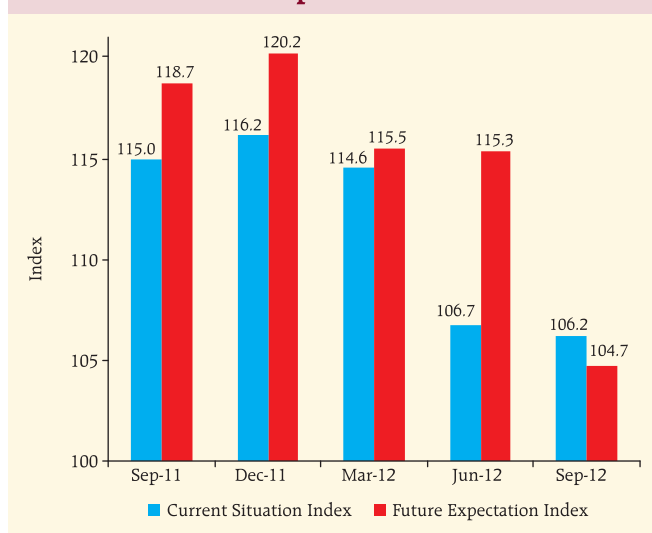
Table VII.3: Reserve Bank's Industrial Outlook Survey

Parameter	Optimistic Response	Net Response								
		2011-12				2012-13				
		Oct-Dec		Jan-Mar		Apr-Jun		Jul-Sep		Oct-Dec
		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	35.2	17.7	33.6	26.5	34.9	18.3	30.6	16.1	32.2
2. Overall Financial Situation	Better	26.3	11.2	25.2	18.5	27.7	14.2	23.6	12.2	25.8
3. Production	Increase	39.9	25.3	40.4	33.1	34.7	20.3	33.6	18.8	35.7
4. Order Books	Increase	33.4	18.4	31.3	24.8	29.5	16.9	29.9	12.0	30.3
5. Capacity Utilisation	Increase	22.2	10.8	24.3	16.7	19.9	8.6	18.4	6.3	20.0
6. Exports	Increase	22.1	11.5	18.6	14.2	20.7	10.8	20.5	10.0	18.0
7. Imports	Increase	16.9	11.6	15.5	14.4	15.7	11.6	15.5	9.8	14.0
8. Employment in the Company	Increase	16.5	11.3	13.6	12.9	14.6	10.0	12.3	8.3	13.3
9. Availability of Finance	Improve	20.2	10.4	19.0	15.8	22.9	15.0	20.4	13.8	21.3
10. Cost of External Finance	Decrease	-41.0	-50.6	-38.8	-37.4	-22.7	-30.5	-24.0	-27.4	-20.6
11. Cost of Raw Material	Decrease	-49.7	-61.2	-50.1	-59.4	-49.0	-63.1	-51.4	-59.6	-48.6
12. Selling Price	Increase	16.0	8.9	14.7	13.5	19.0	17.5	18.8	18.5	17.3
13. Profit Margin	Increase	-1.6	-17.3	-2.9	-11.3	-1.2	-17.9	-3.6	-15.1	-1.3

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.

E: Responses for expectation quarter. A: Responses for assessment quarter.

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



VII.20 The IMF also revised its growth projection for India downwards to 5.6 per cent in October 2012. In its World Economic Outlook, it noted that India's growth has suffered from waning business confidence amid slow approvals for new projects, sluggish structural reforms, policy rate hikes designed to rein in inflation, and flagging external demand. It added that given the high inflation, India cannot afford to loosen its monetary policy unless it slows down domestic demand with more fiscal adjustments.

Survey of professional forecasters¹

VII.21 Growth slowdown is also corroborated by the results of the 21st round of the 'Survey of Professional Forecasters' (<http://www.rbi.org.in/SPF21>) conducted by the Reserve Bank. The median growth forecast for 2012-13 has been revised downward to 5.7 per cent from the earlier 6.5 per cent. Overall, the GDP growth is expected to pick up from Q4 of 2012-13. Although, WPI inflation is expected to moderate from Q4 of 2012-13, it is expected to remain above 7 per cent till Q2 of 2013-14. The median forecasters also suggest some moderation in current account deficit (CAD), but a marked fiscal slippage in 2012-13 (Table VII.5).

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

Table VII.4: Agencies' Projections for 2012-13

Agency	Latest Projection		Earlier Projection	
	GDP Growth (Per cent)	Month	GDP Growth (Per cent)	Month
1	2	3	4	5
Economic Advisory Council to the PM	6.7	Aug-12	7.6	Feb-12
Finance Ministry	7.6 (+/-0.25)	Mar-12	-	-
ADB	5.6	Oct-12	6.5	Jul-12
IMF*	5.6	Oct-12	6.4	Jul-12
NCAER	6.4	Jul-12	7.3	Apr-12
OECD (at market prices)	7.3	May-12	7.5	Nov-11
World Bank	6.0	Oct-12	6.9	Jun-12

*: Corresponds to the latest World Economic Outlook projection of 4.9 per cent for GDP at market prices for calendar year 2012, revised downwards from 6.1 per cent in July 2012.

Inflation expectations of households decline

VII.22 The latest round of the Inflation Expectations Survey of Households (<http://www.rbi.org.in/IESH29>), indicates that the perception of the current quarter inflation (*i.e.*, July–September 2012), as well as the expectations on future inflation have decreased (q-o-q). The percentage of respondents expecting price rise 'more than current rate' in the next quarter has decreased. However, it has marginally increase in the case of expectation for the next year as compared with the last round. The survey was conducted before the diesel price hike.

Credible policy co-ordination key to push the economy into growth gear

VII.23 The policy actions announced by the government since September 2012 should be seen as major initiatives to reverse the course of the falling growth. As these measures are implemented and feed through the system, they will facilitate the recovery of India's realised as well as potential growth. Whether the recovery will be quick or slow-paced would depend on several factors, including global conditions, which at the moment are not very conducive despite some positive news on labour and housing markets in the US. However, the key to recovery lies in policy co-ordination among different government agencies and the removal of structural bottlenecks in infrastructure projects.

Table VII.5: Median Forecasts of Select Macroeconomic Indicators by Professional Forecasters 2012-13 and 2013-14

	Actual 2011-12	Annual Forecast				Quarterly Forecast									
		2012-13		2013-14		2012-13				2013-14					
						Q2		Q3		Q4		Q1		Q2	
		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 (in per cent)	6.5#	6.5	5.7	7.0	6.6	6.3	5.5	6.6	5.6	7.0	6.2	7.1	6.4	-	6.7
a. Agriculture & Allied Activities	2.8#	3.0	1.4	3.0	3.0	3.0	1.2	2.7	-0.3	2.9	1.5	2.8	2.4	-	2.5
b. Industry	2.6#	4.0	3.0	5.7	5.3	3.7	1.9	5.0	3.2	5.5	3.9	6.0	4.6	-	5.1
c. Services	8.5#	8.0	7.8	8.6	8.0	7.8	7.5	8.1	8.0	8.4	8.2	8.4	8.0	-	7.9
2. Gross Domestic Saving (per cent of GDP at current market price)	-	31.3	30.3	32.2	31.6	-	-	-	-	-	-	-	-	-	-
3. Average WPI-Inflation	8.9	7.3	7.7	6.8	6.7	7.6	7.6 ^a	7.4	8.0	7.2	7.7	6.5	7.0	-	7.0
4. Exchange Rate (INR/1USD end period)	51.2	53.0	52.0	51.0	50.8	55.0	52.7 ^a	54.5	52.5	53.0	51.5	52.5	51.5	-	51.3
5. 10-year Govt. Securities Yield (per cent-end period)	8.6	8.1	8.0	7.8	7.8	-	-	-	-	-	-	-	-	-	-
6. Export (growth rate in per cent)@	23.7*	12.0	0.0	17.0	12.0	-	-	-	-	-	-	-	-	-	-
7. Import (growth rate in per cent)@	31.1*	8.3	-0.9	14.3	12.7	-	-	-	-	-	-	-	-	-	-
8. Trade Balance (US\$ billion)	-189.8*	-	-	-	-	-45.5	-46.6	-46.2	-46.5	-47.3	-47.6	-45.6	-45.2	-	-47.0
9. Current Account Deficit (per cent of GDP)	4.2*	3.6	3.5	2.8	2.7	-	-	-	-	-	-	-	-	-	-
10. Central Government Fiscal Deficit (per cent of GDP)	5.1 [^]	5.5	5.7	5.1	5.3	-	-	-	-	-	-	-	-	-	-

E: Previous Round Projection.

L: Latest Round Projection.

#: Revised Estimate.

*: Preliminary.

- : Not Available.

&: Actual.

@: US\$ on BoP basis.

^: Budget Estimate.

Note : The latest round refers to Twenty First round for the quarter ended September 2012, while previous round refers to Twentieth round for the quarter ended June 2012.

Source : Survey of Professional Forecasters, Second Quarter 2012-13.

VII.24 It is also necessary to retain focus on further improvement in macroeconomic conditions by lowering the twin deficits. This requires staying on the path of fiscal consolidation, keeping a tab on private consumption demand and supplementing it with selective use of expenditure-switching policies to lower the CAD. It is also important to ensure that inflation stays below the threshold beyond which high growth cannot be sustained.

VII.25 The exchange rate is not a foolproof tool for addressing the challenges of structural inflation that we face today. Ultimately, fiscal policy needs to work

towards expediting supply-side responses and keeping private consumption demand under reasonable control.

VII.26 Monetary policy needs to be cautious in the interim, focussing on inflation while using the available space to support growth to the degree it can. Lowering inflation is important from consumer welfare and equity considerations, as also for sustainable growth over the medium-term. If risks to macroeconomy from inflation and twin deficit recede further, that could yield space down the line for monetary policy to respond to growth concerns.