VII. Macroeconomic Outlook

The output growth of the Indian economy has started to consolidate around the trend after a sharp recovery and the headline inflation also shows signs of peaking off. Going forward, various forward looking surveys conducted in the recent period suggest strong y-o-y growth. The Industrial Outlook Survey of the Reserve Bank also points to continuation of the growth momentum. The professional forecasters' survey of the Reserve Bank registered a marginal upward revision in the GDP growth rate for 2010-11, on the back of higher growth forecasts for agriculture and services sector. The overall outlook suggests that notwithstanding some recent moderation in headline inflation, the level of inflation remains above the comfort level. The Reserve Bank's policy stance is likely to be shaped by dual goals of maintaining the growth momentum in an atmosphere of global uncertainty, while striving to moderate inflation further.

VII.1 The robust recovery of the Indian economy since the second half of 2009-10 continued in the first quarter of 2010-11, mainly on account of buoyancy in the services sector and better performance of the agriculture sector. Even though the pace of growth of industrial sector was volatile, it remained in double digits (except in June and August 2010), thereby supporting the overall growth momentum. The business expectations surveys show an optimistic picture about the outlook. The Industrial Outlook Survey of the Reserve Bank indicates improvement in business situation for the assessment quarter (July-September 2010) as well as the expectation quarter (October-December 2010). The professional forecasters' survey also echoes this optimism.

Business Expectations Survey

VII.2 The forward looking surveys conducted by various agencies generally show significant y-o-y gains, though some of the surveys registered moderate decline in business expectations on a q-o-q basis (Table VII.1).

VII.3 All the four components of the business confidence index of the NCAER survey have shown remarkable improvement over the previous quarter, with the investment climate recording highest improvement compared with the previous round. At the sectoral level, consumer durables, consumer non-durables, intermediate and capital goods have shown increase in business optimism in the most recent round over the previous round.

VII.4 The Business Confidence Survey of the FICCI for the Q1:2010-11, suggests that 78 per cent of the companies felt that the overall economic conditions *vis-à-vis* last six months are 'moderately to substantially' better. Going ahead, around 72 per cent of the companies foresee an improvement in overall economic condition in the coming six months. The overall business confidence index, however, recorded a decline over the previous quarter on account of decline at three levels *viz.*, economy, industry and firm. The outlook for jobs has also been somewhat dormant, with about 64 per cent of the participants saying that they will maintain employment levels in their firms.

VII.5 In the Dun and Bradstreet Business Optimism Index (BOI) five out of the six optimism indices *viz.*, volume of sales, net profits, new orders, inventory levels and selling prices have registered an increase as compared to the previous quarter. Only employee level remained unchanged. The survey findings mention that the expected moderation in inflation might provide some respite to the consumers, thereby supporting domestic cosumption demand.

VII.6 The CII Business Confidence Index (CII-BCI) for October-December 2010-11 registered a decline over the previous survey. In the present survey, 70 per cent of the respondents indicated that exports may increase.

Table VII.1: Business Expectations Surveys

Period/Index	NCAER Mastercard Business Confidence Index Sept. 2010	FICCI Q1:2010-11 Overall Business Confidence Index	Dun & Bradstreet Q4: 2010 Business Optimism Index	CII Oct-Dec. 2010-11 Business Confidence Index
1	2	3	4	5
Current level of the Index	162.1	71.9	163.5	66.2
Index as per previous survey	155.9	74.8	150.0	67.6
Index levels one year back	143.7	67.2	143.2	66.1
% change (q-on-q) sequential	4.0	-3.9	9.0	-2.1*
% change (y-on-y)	12.8	7.0	14.2	0.2**

* : Percentage change over the previous survey.
** : Percentage change over October-March 2009-10 Survey.

VII.7 The seasonally adjusted HSBC Markit Manufacturing Purchasing Managers' Index (PMI) increased at the slowest pace in last ten months in September 2010, mainly reflecting slower growth in output and new orders. On the downside, the employment levels have remained stagnant since June 2009. Rising raw material prices drove the fast rise in input prices, leading to output price inflation. Notwithstanding the recent fall, the index has remained in the above neutral territory (*i.e.*, above 50) since April 2009.

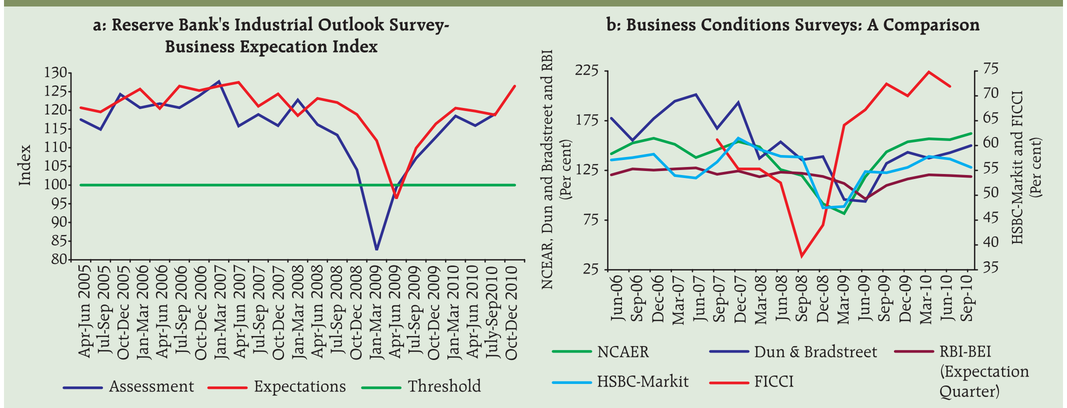
VII.8 Even though the pace of growth in the HSBC Markit Services PMI showed a moderation in September 2010, it continued to point to a substantial expansion of services sector output. The pace of new hiring in the services sector slowed down, though it remains in positive territory.

Reserve Bank's Industrial Outlook Survey

VII.9 The 51st round of the Industrial Outlook Survey of the Reserve Bank conducted during July-September 2010, based on a sample of 1,403 companies, showed an improvement for the assessment quarter (July-September 2010) as well as expectations for the October-December 2010 quarter. Moreover, both indices (*i.e.* assessment about the current quarter and expectation about the next quarter) remained in the growth terrain (*i.e.* above 100, which is the threshold that separates contraction from expansion) (Chart VII.1a). The findings of the survey are consistent with that of other surveys (Chart VII.1b).

VII.10 The Industrial Outlook Survey shows that the Indian manufacturers have an optimistic view about improvement in demand conditions *viz.* production, order books, capacity utilisation, exports and imports for both the assessment and expectation quarters, compared to previous quarter and the corresponding quarter a year ago. However, inventories are seen to be piling up for both the quarters under review. This indicates that part of the double digit growth in IIP was the result of inventory build-up, which may not persist, going forward. Manufacturers' pricing power was evident from expectations about higher selling prices. On the employment outlook,

Chart VII.1: Industrial Outlook Surveys



Indian manufacturers are expected to be net hirers (Table VII.2).

Survey of Professional Forecasters[1]

VII.11 The results of the thirteenth round of 'Survey of Professional Forecasters' conducted by the Reserve Bank in September 2010 shows a marginal upward revision in the overall (median) GDP growth rate for 2010-11 from 8.4 per cent to 8.5 per cent, mainly on account of upward revision of the growth forecast of agriculture and services sector (Table VII.3).

Table VII.2: Reserve Bank's Industrial Outlook Survey -Net Response on Expectations and Assessment about the Industrial Performance

Parameter	Optimistic Response	Oct-Dec 2009		Jan-Mar 2010		Apr-Jun 2010		July-Sept 2010		Oct-Dec 2010
		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	39.8	36.0	44.9	43.1	41.2	40.7	41.5	38.7	47.5
2. Overall financial situation	Better	33.5	29.5	39.3	35.8	36.3	32.2	34.1	30.6	39.6
3. Working capital finance requirement	Increase	30.4	28.8	32.7	30.5	27.7	29.9	31.1	29.3	34.8
4. Availability of Finance	Improve	26.1	23.0	29.2	25.7	26.8	26.4	28.5	26.6	31.3
5. Cost of external finance	Decrease		-14.7	-18.3	-15.9	-20.6	-21.9	-23.3	-28.3	-28.3
6. Production	Increase	35.0	28.9	40.0	36.5	35.9	35.4	40.2	40.0	49.1
7. Order books	Increase	32.3	25.9	35.8	31.9	33.4	31.3	36.3	36.1	44.8
8. Pending orders, if applicable	Below normal	11.0	11.6	5.7	8.8	6.4	6.9	4.2	5.1	1.5
9. Cost of raw material	Decrease	-38.4	-47.1	-44.3	-60.2	-48.6	-62.7	-49.3	-58.3	-49.3
10. Inventory of raw material	Below average	-1.2	-4.2	-3.6	-5.8	-2.6	-5.0	-5.1	-5.3	-6.6
11. Inventory of finished goods	Below average	-3.7	-4.3	-1.9	-4.3	-2.6	-4.1	-5.0	-4.3	-2.8
12. Capacity utilisation (Main product)	Increase	22.0	16.5	25.4	21.7	19.7	21.1	26.5	23.3	32.3
13. Level of capacity utilisation (Compared to the average in the preceding four quarters)	Above normal	-3.8	-3.9	1.3	3.0	1.6	2.5	5.8	3.1	7.2
14. Assessment of the production capacity (With regard to expected demand in the next six months)	More than adequate	6.5	5.3	5.0	6.4	7.1	3.1	4.1	3.3	5.6
15. Employment in the company	Increase	8.8	10.3	12.1	13.7	13.6	14.7	16.8	18.7	21.0
16. Exports, if applicable	Increase	12.5	9.2	20.2	12.7	18.5	15.3	20.7	20.0	26.1
17. Imports, if any	Increase	11.5	13.0	16.9	17.1	17.1	20.9	21.7	22.0	22.2
18. Selling prices are expected to	Increase	6.0	2.6	9.8	12.4	13.3	17.3	15.2	13.8	17.0
19. Increase in selling prices, if any, is expected	Increase at lower rate	19.4	19.3	16.8	21.6	19.7	17.4	14.3	15.2	13.0
20. Profit margin	Increase	-2.8	-9.9	1.1	-2.9	3.2	-4.8	3.1	-2.5	9.2

Note: 1. 'Net response' is measured as the percentage share differential between the companies reporting 'optimistic' (positive) and 'pessimistic' (negative) responses; responses indicating *status quo* (no change) are not reckoned. Higher 'net response' indicates higher level of confidence and *vice versa*.

2. E: Expectations and A: Assessment

3. 'Cost of external finance' is a newly added question from the 48th (October – December 2009) survey round.

[1] Introduced by the Reserve Bank from the quarter ended September 2007. The forecasts reflect the views of professional forecasters and not of the Reserve Bank.

Table VII.3: Median Forecasts of Select Macroeconomic Indicators by Professional Forecasters 2010-11 and 2011-12

	Actual 2009-10	Annual Forecasts				Quarterly Forecasts									
						2010-11						2011-12			
		2010-11		2011-12		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)	7.4R	8.4	8.5	8.5	8.5	8.2	8.2	8.5	8.7	8.4	8.3	8.3	8.1	–	8.5
a. Agriculture & Allied Activities	0.2R	4.1	4.6	3.0	3.2	4.0	4.2	6.0	6.5	3.9	5.1	3.0	3.2	–	3.0
b. Industry	10.4R	9.0	9.0	9.1	9.1	9.3	9.3	8.7	8.7	8.4	7.9	8.7	8.1	–	8.0
c. Services	8.3R	9.1	9.2	9.5	9.5	8.9	8.5	9.3	9.4	9.2	9.2	9.5	9.5	–	9.6
2. Gross Domestic Saving (per cent of GDP at current market price)	–	34.7	34.0	35.9	35.3	–	–	–	–	–	–	–	–	–	–
3. Gross Domestic Capital Formation (per cent of GDP at current market price)	–	36.0	36.0	37.8	37.0	36.8	36.0	36.3	35.5	36.1	37.5	37.3	36.0	–	36.5
4. Corporate profit after tax (growth rate in percent)*	28.8	22.5	20.0	21.0	23.0	18.0	10.0	18.9	15.0	25.0	20.0	25.0	20.0	–	20.0
5. Inflation WPI	3.6	8.6	8.1	6.0	5.6	9.5	8.9	8.1	7.4	7.0	6.0	6.4	5.4	–	5.9
6. Exchange Rate (INR/ USD end period)	45.1	44.5	44.5	43.5	43.5	45.5	45.0	44.8	45.0	44.5	44.4	43.8	44.3	–	43.5
7. T-Bill 91 days Yield (per cent-end period)	4.4	5.2	6.0	5.0	5.8	–	–	–	–	–	–	–	–	–	–
8. 10-year Govt. Securities Yield (per cent-end period)	7.8	7.8	7.9	7.5	7.9	–	–	–	–	–	–	–	–	–	–
9. Export (growth rate in per cent)!	-3.6	15.0	15.9	16.0	15.0	–	–	–	–	–	–	–	–	–	–
10. Import (growth rate in per cent)!	-5.6	17.9	19.7	15.0	15.7	–	–	–	–	–	–	–	–	–	–
11. Trade Balance (US$ billion)	-108.2	–	–	–	–	-34.5	-36.5	-36.5	-38.5	-33.0	-37.9	-35.9	-37.3	–	-36.9

E: Previous Round Projection. L: Latest Round Projection. R: Revised Estimate

– : Not Available. *: BSE listed companies. !: US$ on BoP basis.

Note : The latest round refers to thirteenth round for the quarter ended September 2010, while previous round refers to twelfth round for the quarter ended June 2010.

Source : Survey of Professional Forecasters, Second Quarter 2010-11.

Growth Projections of Different Agencies

VII.12 All available projections for GDP growth in 2010-11 generally project an optimistic picture (Table VII.4). Both IMF and ADB revised their growth projections upward for India recently.

Factors Influencing the Current Growth and Inflation Outlook

VII.13 The economic recovery, which became evident in the second half of 2009-10, has consolidated with further increase in real GDP growth in the first quarter of 2010-11. The outlook for continuation of the robust growth momentum derives support from the following factors: (a) the impact of the normal monsoon on *kharif* output which will be reflected in GDP growth of Q_2 and Q_3, (b) possibility of continuation of buoyancy in the industrial sector, notwithstanding the intermittent volatility, (c) sharp rise in excise duty collections which are indicative of strong economic activity, (d) sustained buoyancy in lead indicators of services activities, (e) strong growth in corporate sales,

Table VII.4: Agencies' Forecast for 2010-11

Agency	Latest Projection		Earlier Projection	
	Real GDP Growth (Per cent)	Month	Real GDP Growth (Per cent)	Month
1	2	3	4	5
Economic Advisory Council to the PM	8.5	Jul-10	8.2	Feb-10
Ministry of Finance	8.5 (+/-0.25)	Feb-10	..	..
IMF (calendar year) @	9.7	Oct-10	9.4	Jul-10
ADB	8.5	Sep-10	8.2	Jul-10
NCAER	8.4	Oct-10	8.1	Jul-10
OECD @	8.3	May-10	7.3	Nov-09

.. : Not available.
@ at market price, while others are at factor costs.

(f) improving business environment as suggested by the Industrial Outlook Survey of the Reserve Bank, (g) pick-up in private consumption expenditure and high growth in the production of consumer durables, (h) strong growth in non-oil imports, (i) high capital expenditure plans of firms, (j) increase in credit demand from the private sector and (k) higher flow of financing from non-banking sources.

VII.14 Certain downside risks to growth however remain, which include: (a) weakening of external demand conditions, given the recently revised outlook for recovery in advanced economies, which will dampen export growth, (b) real appreciation of the exchange rate could also weaken external price competitiveness of Indian exports, (c) pressure from capital inflows on the nominal exchange rate to appreciate, (d) recent survey based evidence of some moderation in capacity utilisation and (e) persistent inflationary pressures, especially in food items.

VII.15 The headline inflation, which moderated to 8.5 per cent in August 2010, before edging up to 8.6 per cent in September, continues to be a cause of policy concern and priority. The elevated levels of food prices, with pressures emanating from non-cereal protein-based items, highlight the structural dimension of food inflation, which would require long-term supply augmenting measures. Going forward, factors which may exert upward pressure on inflation are: (a) further strengthening of pricing power of corporates with the pick-up in private demand, (b) capacity constraints in several sectors, where supply response to high prices could be slow, and (c) oil and commodity prices, which have shown signs of increase in recent months.

VII.16 Notwithstanding these risks, the factors that may help in restraining the inflationary pressures include: (a) a good *kharif* crop, which may help in moderating the food price inflation, (b) weak external demand, which may increase supply in domestic market, (c) no risk to inflation in advanced economies due to large excess capacity and high unemployment, and (d) the impact of monetary policy actions already initiated by the Reserve Bank to contain inflation and anchor inflationary expectations.

VII.17 An overall assessment suggests that GDP growth is consolidating around the trend. This growth momentum, however, needs to be sustained through improved investment demand, particularly in manufacturing and infrastructure sector. The uncertain global outlook and the dominance of supply rigidities in certain sectors that impart rigidity to the inflation path, pose greater challenge for monetary policy to anchor inflationary expectations without hurting growth.