# VII. Macroeconomic Outlook

*Indian economy has moved to a higher growth trajectory with the outlook remaining optimistic. Various forward looking surveys also indicate receding downside risks to growth in the near term. This is broadly corroborated by the Reserve Bank's Industrial Outlook Survey and the Professional Forecasters' Survey. Persistence of inflation at a high level and widening current account deficit are the two major policy concerns at the present juncture. While sensitivity of inflation to past monetary policy measures has remained subdued due to the very nature of the inflation process, larger capital inflows have met the financing need of the current account. Going forward, waning risks to the robust growth outlook and visible upside risks to the inflation outlook would shape the stance of monetary policy in the near term.*

## Growth optimism continues but high inflation could dent the process

VII.1 The robust growth momentum seen so far and the lead indications that this performance would be sustained in the near future are reflected in the forward looking surveys conducted by various agencies, which generally show significant y-o-y gains. The Reserve Bank's Industrial Outlook Survey also mirrors the optimism, especially regarding improvement in demand and overall financial conditions. The Professional Forecasters' Survey shows an improvement in (median) GDP growth rate to 8.7 per cent from 8.5 per cent reported in the previous survey. The growth projections of various domestic and international agencies also reflect the buoyant optimism.

## Business expectations surveys exhibit optimism

VII.2 Various business expectations surveys show an optimistic picture about the near-term outlook (Table VII.1). Factors which provided a boost to the overall business expectations include possibility of improvement in exports (the CII Survey) and buoyant future demand conditions, alongwith rise in volume of sales and new orders (Dun and Bradstreet Survey). Factors that affected the business sentiment adversely include: (i) deterioration in investment climate and financial position of the firm relative to the previous round (the NCAER Survey), and (ii) concerns regarding the mounting inflationary pressures (the Dun and Bradstreet Survey and NCAER Survey).

VII.3 The seasonally adjusted HSBC Markit Manufacturing Purchasing Managers' Index (PMI) witnessed a slowdown in December 2010 even though the survey indicated strong momentum in manufacturing sector and rapid growth in order books. The survey, however, suggests that tight capacity constraints are getting reflected in higher outstanding business orders, lengthening of delivery times and increase in both input and output prices.

VII.4 The pace of growth in the HSBC Markit Services PMI showed a moderation in December 2010, even though the outlook about future business prospects remained generally optimistic. On the downside, the input costs as well as the output prices of the services

**Table VII.1: Business Expectations Surveys**

| Period Index | NCAER- Jan. 2011 Business Confidence Index | FICCI Q2:2010-11 Overall Business Confidence Index | Dun & Bradstreet Q1: 2011 Business Optimism Index | CII Oct.-Dec. 2010-11 Business Confidence Index |
|---|---|---|---|---|
| 1 | 2 | 3 | 4 | 5 |
| Current level of the Index | 158.5 | 76.2 | 171.2 | 66.2 |
| Index as per previous survey | 162.1 | 71.9 | 163.5 | 67.6 |
| Index levels one year back | 153.8 | 72.4 | 137.3 | 66.1 |
| percentage change (q-on-q) | -2.2 | 6.0 | 4.7 | -2.1* |
| percentage change (y-on-y) | 3.1 | 5.2 | 24.7 | 0.2** |

* : Change over the previous survey.

** : Change over October-March 2009-10 survey.

sector rose substantially, suggesting that Indian companies passed on higher costs to customers.

### *The Industrial Outlook Survey of the Reserve Bank shows improvement in demand and overall financial conditions*

VII.5 The 52nd round of the Industrial Outlook Survey of the Reserve Bank conducted during October-December 2010, based on a sample of 1,561 companies, showed an improvement for the assessment quarter (October–December 2010) and a marginal moderation for the expectation quarter (January-March 2011) (Chart VII.1a and b). The modest moderation at a high level of the index suggests expectations of sustained buoyancy in economic activities. The indices for both assessment and expectation quarter remained in the growth terrain (*i.e.* above 100, which is the threshold that separates contraction from expansion).

VII.6 The survey shows that the Indian manufacturing sector has an optimistic view about improvement in demand conditions *viz.* production, order books, capacity utilisation and exports for the assessment quarter. However, a slight moderation is indicated for the expectation quarter. Overall financial situation, working capital finance requirement as well as availability of finance showed improvement for both assessment and expectation quarters, *albeit* at higher costs. The survey results suggest that manufacturers expect selling prices and profit margins to increase despite expectations of rising input costs, which reflect their pricing power. On the employment outlook, Indian manufacturers were perceived to be net hirers (Table VII.2).

### *Survey of Professional Forecasters*[1]

VII.7 The results of the 14th round of 'Survey of Professional Forecasters' conducted by the Reserve Bank in December 2010 shows overall (median) GDP growth rate for 2010-11 at 8.7 per cent, as against 8.5 per cent reported in the previous survey (Table VII.3).

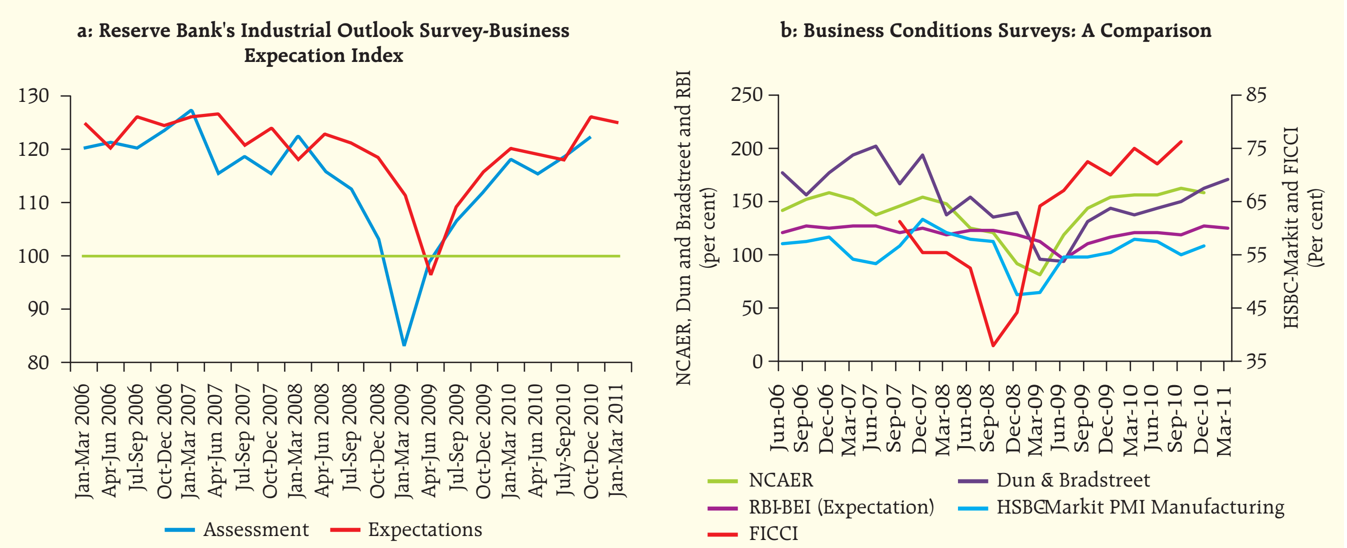
### *Projections of different agencies peg growth in the range of 8.4 to 9.1 per cent*

VII.8 All available projections for GDP growth in 2010-11 generally suggest an optimistic picture (Table VII.4). Recently, the IMF and World Bank revised their growth projections for India upwards.

### *While downside risks to growth have receded, upside risks to inflation have increased*

VII.9 The outlook for growth remains buoyant. The inflation persistence led by stubbornly high food inflation in double digits for close to two years, however, remains a major concern. Going forward, the factors that may lend further support to the growth momentum include: (a) improved *kharif* production (that will be reflected in Q3 GDP data) and favourable

**Chart VII.1: Industrial Outlook Surveys**




[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.2: Reserve Bank's Industrial Outlook Survey**

| Parameter | Optimistic Response | Net Response | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | Apr-Jun 2010 | | July-Sep 2010 | | Oct-Dec 2010 | | Jan-Mar 2011 |
| | | E | A | E | A | E | A | E |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 |
| 1 Overall business situation | Better | 41.2 | 40.7 | 41.5 | 38.7 | 47.5 | 45.9 | 50.1 |
| 2 Overall financial situation | Better | 36.3 | 32.2 | 34.1 | 30.6 | 39.6 | 37.1 | 41.1 |
| 3 Availability of finance | Improve | 26.8 | 26.4 | 28.5 | 26.6 | 31.3 | 30.3 | 32.3 |
| 4 Cost of external finance | Decrease | -20.6 | -21.9 | -23.3 | -28.3 | -28.3 | -33.9 | -31.3 |
| 5 Production | Increase | 35.9 | 35.4 | 40.2 | 40.0 | 49.1 | 43.9 | 48.6 |
| 6 Order books | Increase | 33.4 | 31.3 | 36.3 | 36.1 | 44.8 | 37.9 | 44.0 |
| 7 Cost of raw material | Decrease | -48.6 | -62.7 | -49.3 | -58.3 | -49.3 | -63.9 | -53.6 |
| 8 Capacity utilisation | Increase | 19.7 | 21.1 | 26.5 | 23.3 | 32.3 | 27.9 | 33.1 |
| 9 Employment in the company | Increase | 13.6 | 14.7 | 16.8 | 18.7 | 21.0 | 19.4 | 20.6 |
| 10 Selling prices | Increase | 13.3 | 17.3 | 15.2 | 13.8 | 17.0 | 20.2 | 18.6 |
| 11 Profit margin | Increase | 3.2 | -4.8 | 3.1 | -2.5 | 9.2 | -0.4 | 8.3 |

**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.

prospects of *rabi* production on account of satisfactory north-east monsoon and higher reservoir levels, (b) robust growth in lead indicators of services sector, (c) sharp rise in tax revenues indicating strong economic activity, (d) stronger growth in corporate sales and earnings, (e) improvement in employment indicators, (f) pick-up in private consumption demand, (g) continuing strong credit growth, especially to the infrastructure sector, (h) buoyancy in various business expectation surveys, (i) possibility of fiscal

**Table VII.3: Professional Forecasters' Survey**

| | Actual 2009-10 | Annual Forecasts | | | | Quarterly Forecast | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | 2010-11 | | 2011-12 | | 2010-11 | | | | 2011-12 | | | | | |
| | | | | | | Q3 | | Q4 | | Q1 | | Q2 | | Q3 | |
| | | 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 | 8.5 | 8.7 | 8.5 | 8.5 | 8.7 | 8.9 | 8.3 | 8.5 | 8.1 | 8.4 | 8.5 | 8.5 | - | 8.3 |
| a. Agriculture & Allied Activities | 0.2R | 4.6 | 5.0 | 3.2 | 3.3 | 6.5 | 6.8 | 5.1 | 5.0 | 3.2 | 3.5 | 3.0 | 3.1 | - | 3.4 |
| b. Industry | 10.4R | 9.0 | 9.0 | 9.1 | 8.7 | 8.7 | 8.5 | 7.9 | 7.3 | 8.1 | 7.6 | 8.0 | 8.1 | - | 8.8 |
| c. Services | 8.3R | 9.2 | 9.6 | 9.5 | 9.5 | 9.4 | 9.8 | 9.2 | 9.6 | 9.5 | 9.5 | 9.6 | 9.5 | - | 9.6 |
| 2. Gross Domestic Saving (per cent of GDP at current market price) | - | 34.0 | 34.0 | 35.3 | 35.5 | - | - | - | - | - | - | - | - | - | - |
| 3. Gross Domestic Capital Formation (per cent of GDP at current market price) | - | 36.0 | 36.0 | 37.0 | 37.0 | 35.5 | 35.1 | 37.5 | 36.3 | 36.0 | 35.7 | 36.5 | 35.9 | - | 36.8 |
| 4. Corporate profit after tax (growth rate in per cent)* | 28.8 | 20.0 | 20.0 | 23.0 | 21.2 | 15.0 | 12.8 | 20.0 | 15.8 | 20.0 | 17.5 | 20.0 | 14.1 | - | 16.0 |
| 5. Inflation WPI (Avg.) | 3.6 | 8.1 | 8.5 | 5.6 | 6.6 | 7.4 | 7.8 | 6.0 | 6.6 | 5.4 | 6.4 | 5.9 | 6.9 | - | 7.0 |
| 6. Exchange Rate (INR/US$ end period) | 45.1 | 44.5 | 44.5 | 43.5 | 43.5 | 45.0 | 44.9 | 44.4 | 44.5 | 44.3 | 44.1 | 43.5 | 43.9 | - | 43.9 |
| 7. T-Bill 91 days Yield (per cent-end period) | 4.4 | 6.0 | 6.8 | 5.8 | 6.9 | - | - | - | - | - | - | - | - | - | - |
| 8. 10-year Govt. Securities Yield (per cent-end period) | 7.8 | 7.9 | 8.0 | 7.9 | 8.0 | - | - | - | - | - | - | - | - | - | - |
| 9. Exports (growth rate in per cent)! | -3.6 | 15.9 | 18.0 | 15.0 | 17.8 | - | - | - | - | - | - | - | - | - | - |
| 10. Imports (growth rate in per cent)! | -5.6 | 19.7 | 20.0 | 15.7 | 18.0 | - | - | - | - | - | - | - | - | - | - |
| 11. Trade Balance (US$ billion) | -108.2 | - | - | - | - | -38.5 | -31.5 | -37.9 | -35.7 | -37.3 | -38.1 | -36.9 | -40.7 | - | -41.2 |

E: Previous Round Projection. L: Latest Round Projection. R: Revised Estimate
P: Preliminary Value - : Not Available. *: BSE listed companies. !: US$ on BoP basis.
**Note**: The latest round refers to fourteenth round for the quarter ended December 2010, while previous round refers to the thirteenth round for the quarter ended September 2010.
**Source**: Survey of Professional Forecasters, Third Quarter 2010-11.

**Table VII.4: Agencies' Projections 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 |
| World Bank | 8.7 | Jan-11 | 8.5 | Jun-10 |
| IMF | 8.8 | Jan-11 | 8.0 | Feb-10 |
| Ministry of Finance | 8.8(+/-0.35) | Dec-10 | 8.5(+/-0.25) | Feb-10 |
| OECD@ | 9.1 | Nov-10 | 8.3 | May-10 |
| NCAER | 8.4 | Oct-10 | 8.1 | July-10 |
| ADB | 8.5 | Sep-10 | 8.2 | July-10 |
| Economic Advisory Council to the PM | 8.5 | July-10 | 8.2 | Feb-10 |

@: At market prices, while others are at factor cost.

consolidation, which would reduce crowding out risks and (j) easing of liquidity conditions, as the government spends more from its surplus balances, which in turn may ease the concerns of liquidity stress impacting flow of credit.

VII.10 However, certain downside risks to growth remain, which include: (a) sovereign debt risks spreading from the Euro zone periphery, which may adversely affect external demand, (b) strong capital inflows beyond the absorptive capacity putting pressure on the exchange rate, which could also weaken price competitiveness of Indian exports, (c) volatile industrial growth, which adds to uncertainty to the industrial growth outlook, (d) growth in core infrastructure lagging behind GDP growth as well as industrial growth and, (e) inflationary pressures.

VII.11 The persistence of inflation at an elevated level and the significant pick-up in December 2010 suggest the amplification of upside risks to inflation. Going forward, factors which may exert further upward pressure on inflation are: (a) higher international commodity prices, especially oil, (b) increase in global food prices and the regional outlook suggesting continuation of the trend, which could further limit the import option as countries may ban/restrict exports to ease potential pressures on their domestic inflation, (c) return of pricing power to corporates, (d) improving bargaining power of both organised and unorganised labour, with MGNREGS contributing to the wage pressures in the farming and unorganised manufacturing sectors, (e) capacity constraints in several sectors, particularly farm products, where supply response to high prices may continue to be slow, (f) continuous upward revision in minimum support prices reflecting rising input costs, (g) risk of suppressed inflation becoming open, resulting from revision of diesel and other administered petroleum product prices, when the implicit subsidy burden increases significantly and (h) prevalence of high inflationary expectations.

VII.12 Notwithstanding these risks, factors that may help in restraining the inflationary pressures include: (a) government measures to improve bottlenecks in the supply chain from farm gate to retail, (b) expected moderation in food inflation with a good *rabi* crop, (c) subdued risk to inflation in advanced economies due to large excess capacity and high unemployment, even though in the Euro-area and the UK headline inflation has edged up in the recent period and (d) the impact of monetary policy actions taken by the Reserve Bank, particularly after the strengthening of transmission in recent months.

VII.13 To sum up, while growth prospects remain robust, persistence of high inflationary expectations poses a complex challenge for the conduct of monetary policy. The challenge is exacerbated by the fact that inflationary pressures are emanating from sources that are not very sensitive to monetary policy measures. Growing demand-supply imbalances in several non-cereal food items have led to sharp relative price changes, which in turn have pushed up the headline inflation. While non-food manufactured inflation has been stable in a range of 5.1-5.9 per cent, the month-over-month increase in price index in recent months reflects emerging demand side pressures as well as rising input costs. In an environment of high food and fuel inflation, the risk of spillover to the core inflation through higher input costs and inflationary expectations, remains. As long as the structural factors underpinning the relative price pressures persist, the impact of anti-inflationary monetary policy could remain dampened. The 300 basis points effective increase in the policy rate from March 2010 so far, was carefully calibrated by the Reserve Bank reflecting the need for sensitivity of monetary policy to both growth and inflation objectives. Since persistent high inflation could endanger the growth objective and also amplify risks to inclusive growth, containing inflation will have to remain as the predominant objective of monetary policy in the near-term.