II. Aggregate Demand*

Aggregate demand in the economy exhibited some improvement during Q2 of 2013-14 mainly on account of a surge in net exports. However, total consumption expenditure decelerated over the previous quarter on account of a decline in government consumption expenditure. Private consumption expenditure, the mainstay of aggregate demand stayed low in the face of high inflation with subdued discretionary demand. Investment demand improved somewhat during the quarter but the investment cycle is yet to witness a turnaround. On the whole, corporate sales improved during Q2, although some major industries continued to experience contraction in sales. Overall aggregate demand is expected to receive support in H2 of 2013-14 due to the favourable impact from rural demand and exports, though downside risks will emanate from public spending cuts. A pickup in demand in the coming year depends critically on the successful resolution of bottlenecks facing infrastructure projects. It is also important to create a fiscal space in 2014-15 to support public investment by restraining revenue spending, so as to crowd-in private investment.

Exports propelled aggregate demand in Q2 of 2013-14

II.1 During Q2 of 2013-14, GDP at market prices increased markedly to 5.6 per cent as against 2.4 per cent in Q1. This essentially reflected increased taxes and decline in subsidies due to deferment of outgo during the quarter. As a result of this, the overall growth rate picked up in H1 of 2013-14 as compared with H1 of last year (Table II.1).

Table II.1: Aggregate demand improved, although total final consumption expenditure decelerated during Q2

Expenditure-side GDP (2004-05 prices)

(Per cent)

Item	2011-12@	2012-13#	2012-13				2013-14		2012-13	2013-14
			Q1	Q2	Q3	Q4	Q1	Q2	H1	H1
1	2	3	4	5	6	7	8	9	10	11
Growth Rates (y-o-y)										
GDP at Market Prices	6.3	3.2	3.4	2.5	4.1	3.0	2.4	5.6	2.9	4.0
Total Final Expenditure	8.1	3.9	4.7	4.0	3.8	3.3	3.0	1.7	4.4	2.3
(i) Private	8.0	4.0	4.3	3.5	4.2	3.8	1.6	2.2	3.9	1.9
(ii) Government	8.6	3.9	7.2	6.9	2.2	0.6	10.5	-1.1	7.0	4.7
Gross Fixed Capital Formation	4.4	1.7	-2.2	1.1	4.5	3.4	-1.2	2.6	-0.6	0.7
Change in Stocks	-30.6	73.4	69.8	71.7	75.8	76.0	-0.4	2.3	70.7	0.9
Valuables	6.6	-12.0	-20.9	4.3	-6.9	-20.2	92.5	23.9	-10.0	58.0
Net Exports	-42.5	-17.3	-6.7	-21.4	-23.7	-16.4	-6.0	36.1	-14.1	16.4
Discrepancies	-100.3	152.0	-12.9	28.6	-128.5	-6.3	29.1	40.6	4.6	35.1
Relative Shares										
Total Final Expenditure	70.5	71.0	72.1	72.8	73.5	65.9	72.5	70.1	72.5	71.3
(i) Private	59.2	59.6	61.1	61.8	61.4	54.7	60.6	59.8	61.5	60.2
(ii) Government	11.3	11.3	11.0	11.0	12.1	11.2	11.9	10.3	11.0	11.1
Gross Fixed Capital Formation	33.7	33.2	33.8	34.6	32.0	32.6	32.6	33.6	34.2	33.1
Change in Stocks	2.3	3.8	3.9	4.0	3.7	3.8	3.8	3.8	4.0	3.8
Valuables	2.4	2.0	2.1	2.2	2.0	1.8	4.0	2.5	2.1	3.3
Net Exports	-8.8	-10.0	-9.6	-11.0	-11.3	-8.4	-9.9	-6.6	-10.3	-8.3
Discrepancies	0.0	0.0	-2.4	-2.6	0.1	4.2	-3.0	-3.4	-2.5	-3.2
Memo:										
GDP at market prices (₹ billion)	56314	58137	13702	13536	15062	15836	14034	14301	27238	28335

@: First Revised Estimates; #: Provisional Estimates.
Source: Central Statistics Office.

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

II.2 The pickup in growth in Q2 of 2013-14 essentially emanated from a surge in exports driven by the impact of rupee depreciation and improved growth in advanced economies. The contribution of exports to growth was placed at 4.1 percentage points in Q2, which was substantially higher than other components on the expenditure side (Table II.2). Gross fixed capital formation and private final consumption expenditure (PFCE) increased marginally while government final consumption expenditure (GFCE) declined during the period. Further, the growth rate of spending on valuables decelerated distinctly in Q2 as compared with Q1 reflecting moderation in gold imports.

Efforts to address infrastructure bottlenecks gain momentum, though revival of activity on the ground has been modest so far

II.3 The Cabinet Committee on Investment (CCI) (January 2013) and later the Project Monitoring Group (PMG) (June 2013) were constituted by the government to expedite key mega projects. So far the CCI has helped in the resolution of logjams for around 300 projects, worth above ₹5 trillion. The PMG alone has accepted 411 projects worth ₹19 trillion for consideration; of these issues relating to projects worth ₹4.9 trillion (138 projects) have been resolved. A majority of these resolved projects are in power (86), coal (21), petroleum (7), roads and railways (6 each) and shipping (5). The new legislation for Land Acquisition, Rehabilitation and Resettlement has been enacted with an objective to fast track stalled infrastructure projects. In addition, a series of measures, including delinking of environmental clearance from forest clearances, encouraging infrastructure debt funds and enhancing credit to infrastructure companies, initiated by the government during January-September 2013 are likely to boost infrastructure investments in general in the coming months. However, the time and cost overrun for central sector infrastructure projects (of ₹1.5 billion and above) continues to be high.

II.4 The performance of power generation during April-November 2013 was somewhat better than last year; mainly supported by increased hydel power generation on account of good rainfall and consequent high reservoir levels. Notwithstanding some improvement in coal supply position, the Plant Load Factor (PLF) in the thermal power sector at 65.4 per cent in November 2013 remains lower than 71.0 per

Table II.2: Exports played a major role in increasing overall growth

Contribution-weighted growth rates on the expenditure side GDP (2004-05 prices)*

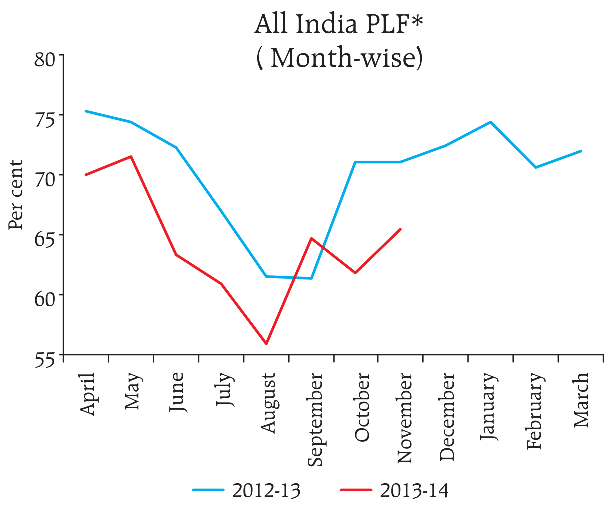
(Per cent)

Item	2012-13				2013-14		2012-13	2013-14
	Q1	Q2	Q3	Q4	Q1	Q2	H1	H1
1	2	3	4	5	6	7	8	9
1. Private Final Consumption Expenditure	2.6	2.2	2.6	2.1	1.0	1.3	2.4	1.2
2. Government Final Consumption Expenditure	0.8	0.7	0.3	0.1	1.2	-0.1	0.7	0.5
3. Gross Fixed Capital Formation	-0.8	0.4	1.4	1.1	-0.4	0.9	-0.2	0.2
4. Change in Stocks	1.7	1.7	1.7	1.7	0.0	0.1	1.7	0.0
5. Valuables	-0.6	0.1	-0.2	-0.5	2.0	0.5	-0.2	1.2
6. Net Exports (i-ii)	-0.6	-2.0	-2.3	-1.2	-0.6	4.0	-1.3	1.7
(i) Exports	3.0	1.2	-0.9	-0.2	-0.3	4.1	2.1	1.9
(ii) Less Imports	3.6	3.2	1.4	1.1	0.3	0.1	3.4	0.2
7. Sum 1 to 6	**3.0**	**3.1**	**3.5**	**3.2**	**3.1**	**6.7**	**3.1**	**4.9**
8. Discrepancies	0.4	-0.6	0.6	-0.3	-0.7	-1.1	-0.1	-0.9
9. GDP at Market Prices (7+8)	**3.4**	**2.5**	**4.1**	**3.0**	**2.4**	**5.6**	**2.9**	**4.0**

*: Contribution-weighted growth rate of a component of expenditure-side GDP is obtained as: y-o-y change in the component ÷ y-o-y change in GDP at constant market prices × y-o-y growth rate of GDP at constant market prices.

Source: Central Statistics Office.

Chart II.1: Low capacity utilisation in the thermal power sector is worrisome



* For coal and lignite based plants

cent last year due to moderation in demand in line with slowdown in economic activity (Chart II.1).

II.5 The government has been taking initiatives to revive the telecom sector. These include introduction of the National Telecom Policy 2012, simplifying the licensing regime, improving availability of spectrum and its allocation and raising the limit on foreign direct investment (FDI) in this sector from 74 per cent to 100 per cent. The Union Cabinet recently approved the finalisation of the reserve price for auction of spectrum in 1,800 MHz band for all service areas and for 900 MHz band in metro areas, which is likely to provide some impetus to telecom services.

II.6 In the roads sector, in the absence of an encouraging response from private developers, the government has shifted its focus of awarding road projects through 'Engineering, Procurement and Construction' (EPC). However, given the tight fiscal situation of the government, the sustainability of this approach requires a significant repurposing of government spending. Against this backdrop, the government has been organising investors' conclaves/ road shows in major centres abroad to promote infrastructure financing.

Corporate investment intentions showed nominal improvement

II.7 Corporate investment intentions in Q2 of 2013-14 showed some improvement over Q1. However, it still remained much lower than the level achieved in Q2 of 2012-13. Improvement in projects investment in Q2 of 2013-14 was observed for metal & metal products (Table II.3).

Aggregate sales growth (y-o-y) improved but profit margins low

II.8 Sales growth (y-o-y) of non-government non-financial listed companies improved in Q2 of 2013-14 after successive deceleration since Q3 of 2011-12. The upturn in sales growth was noticeable for the manufacturing and the IT sectors, while the slowdown continued in the non-IT services sector. Industries like fertilisers, coke & refined petroleum products, textiles and pharmaceuticals witnessed decent improvement in sales growth. However, the contraction continued in some major industries, such as motor vehicles, machinery, cement and iron & steel. The improvement in sales growth was, however, not reflected in profit

Table II.3: Institutionally assisted project investments showed marginal improvement

Institutionally assisted projects and their envisaged cost (Quarter-wise)*

(₹ billion)

Financial Year		No. of Projects	Envisaged Cost (Total)	*of which* Power industries	Metal & metal products industries
1		2	3	4	5
2011-12	Q1	147	749	284	231
	Q2	184	452	218	23
	Q3	137	462	242	14
	Q4	168	253	69	46
2012-13	Q1	110	413	240	36
	Q2	132	666	207	145
	Q3	89	256	157	15
	Q4	94	629	187	352
2013-14	Q1	96	254	76	17
	Q2	116	321	70	131

*: Data are provisional and may undergo changes due to modification/ cancellation of projects if reported subsequently.

Note: based on data reported by 39 banks/FIs usually active in project finance.

Table II.4: Corporate sales have improved during the quarter

Performance of non-government, non-financial companies

(Per cent)

	2012-13			2013-14	
	Q2	Q3	Q4	Q1	Q2
1	2	3	4	5	6
No. of Companies	2353				
	Growth rates (y-o-y)				
Sales	11.9	10.0	4.7	3.3	7.6
Value of Production	12.4	8.6	4.8	2.7	6.9
Expenditure, *of which*	12.7	8.6	5.5	2.8	8.2
Raw Materials	14.4	9.3	3.1	-1.5	6.2
Staff Cost	15.5	13.6	13.8	12.0	14.1
Power & Fuel	21.3	11.1	3.5	-0.2	0.6
Operating Profits (EBITDA)	10.5	8.7	0.2	2.3	-1.0
Other Income*	44.8	-0.8	4.0	26.3	0.1
Depreciation	10.0	10.3	8.3	8.5	11.7
Gross Profits (EBIT)	17.0	6.4	-1.1	5.1	-4.2
Interest	11.2	17.3	11.1	10.5	20.8
Tax Provision	9.2	6.2	-2.5	2.9	4.4
Net Profits	19.0	23.4	-13.5	-8.1	-19.9
	Ratios in per cent				
Interest Burden	26.9	32.3	29.8	33.5	34.0
EBITDA to Sales	13.4	12.9	12.8	12.9	12.4
EBIT to Sales	12.8	11.4	11.9	12.0	11.4
Net Profit to Sales	7.1	5.8	5.9	5.4	5.3

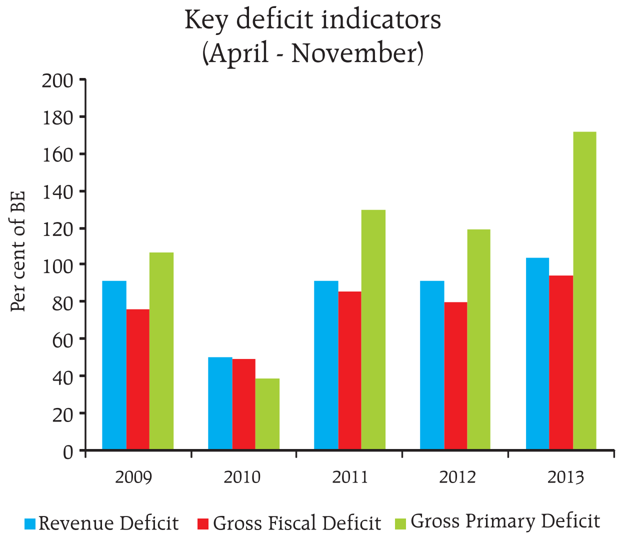
*: Other income excludes extraordinary income/expenditure if reported explicitly.

growth. Pricing power in terms of EBITDA and net profit margins declined in Q2 of 2012-13 as compared with the previous quarter (Table II.4). Early results for Q3 of 2013-14, from 194 companies show y-o-y sales growth at 12.4 per cent and EBITDA growth at 14.8 per cent.

Central government's key deficit indicators continue to rule high

II.9 The key deficit indicators of the central government during April-November 2013 as percentages to their budget estimates (BE) were the highest for the comparable period in the last five years (Chart II.2). During April-November 2013, the revenue deficit of the central government had already breached the BE and reached 103.5 per cent of BE for the full year, mainly on account of a sharp increase in revenue expenditure.

Chart II.2: Key deficit parameters of the government were the highest in the last five years



The widening of revenue deficit, coupled with higher capital expenditure resulted in a gross fiscal deficit of 93.9 per cent of BE during April-November 2013.

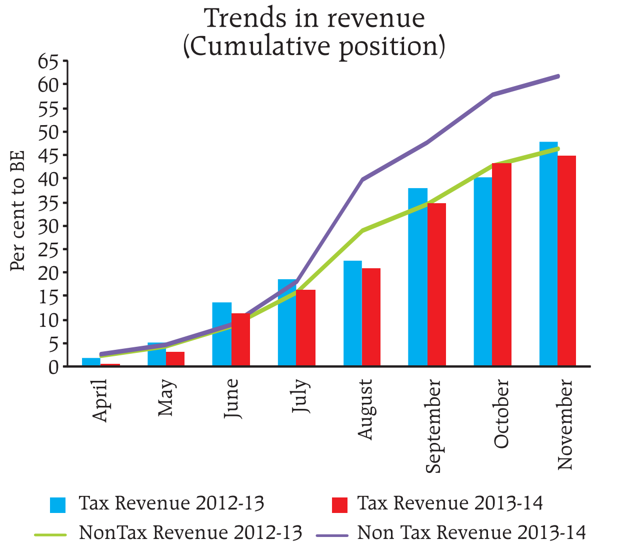
Growth slowdown affecting tax collections

II.10 The central government's gross tax revenue as per cent of BE was lower than a year ago, with a deceleration in revenue growth for income tax and service tax, and a decline in union excise duties during April-November 2013. Although corporation tax during the period registered a higher growth than last year, it was lower than budget estimates (Chart II.3).

Challenging task ahead for government to meet deficit targets in the face of higher expenditures

II.11 Total expenditure as a per cent of budget estimates in April-November 2013 was higher than a year ago, with both the revenue and capital expenditure contributing to the increase (Table II.5). Plan expenditure was significantly higher, both in terms of BE as well as growth rates, with a notable increase in expenditure on transport, and rural and urban development. Grants to states/UTs under central and centrally sponsored schemes were also higher in terms of BE than a year ago.

Chart II.3: Non-tax revenue was significantly higher as proportion to budget estimates



Need to strive for a deft balance between fiscal consolidation and economic growth by focusing on quality of government spending

II.12 Notwithstanding the widening of GFD in the first eight months of the current fiscal, the government has reiterated its commitment to meeting the budgetary target of 4.8 per cent of GDP in 2013-14. This may require further cutbacks in expenditure if the revenue and non-debt capital receipts do not meet budgetary targets. The additional provisions made for meeting subsidy payments this year may not be adequate to cover the gap between costs and administered prices of OMCs and fertiliser companies during 2013-14. In this milieu, it is important to focus on fiscal consolidation, keeping its quality uppermost in consideration. As per the amended FRBM rules, GFD/GDP ratio of the centre needs to be brought down by at least 0.5 percentage points each year to reach 3.0 per cent in 2016-17. The task remains challenging and, *inter alia*, will require poorly targeted subsidies such as cooking gas and diesel (centre) and electricity (states) to be rationalised. The progress in this direction so far has been partial. While diesel prices have been increased steadily, subsidy on gas cylinders remains large. Adhering to fiscal discipline hinges upon the ability to withstand pressures to increase subsidies, including those on fuel and public utilities. The power

Table II.5: Expenditure growth has been higher than revenue growth

Central government finances during April-November 2013

(In ₹ billion)

Item	Amount		Percentage to Budget Estimates		Growth Rate (per cent)	
	2012-13	2013-14	2012-13	2013-14	2012-13	2013-14
1	2	3	4	5	6	7
1. Revenue Receipts (i+ii)	**4458.2**	**5026.9**	**47.6**	**47.6**	**13.5**	**12.8**
i) Tax Revenue (Net)	3696.0	3961.7	47.9	44.8	15.3	7.2
ii) Non-Tax Revenue	762.2	1065.3	46.3	61.8	5.4	39.8
2. Non-Debt Capital Receipts	89.0	89.5	21.4	13.5	-38.7	0.5
3. Non -Plan Expenditure	6242.6	7302.0	64.4	65.8	15.7	17.0
of which						
i) Interest Payments	1828.6	2144.3	57.2	57.8	10.2	17.3
ii) Food Subsidies	620.0	749.1	82.7	83.2	40.7	20.8
iii) Fertiliser Subsidies	552.9	530.8	90.7	80.5	22.8	-4.0
iv) Petroleum Subsidies	403.2	548.7	92.5	84.4	73.0	36.1
4. Plan Expenditure	2433.9	2909.9	46.7	52.4	10.0	19.6
5. Revenue Expenditure	7653.2	8957.1	59.5	62.4	13.7	17.0
6. Capital Expenditure	1023.3	1254.9	50.0	54.8	17.0	22.6
7. Total Expenditure	**8676.5**	**10212.0**	**58.2**	**61.3**	**14.1**	**17.7**
8. Revenue Deficit	**3195.0**	**3930.2**	**91.2**	**103.5**	**13.9**	**23.0**
9. Gross Fiscal Deficit	**4129.3**	**5095.6**	**80.4**	**93.9**	**16.9**	**23.4**
10. Gross Primary Deficit	**2300.7**	**2951.2**	**118.7**	**171.8**	**22.7**	**28.3**

Source: Controller General of Accounts, Ministry of Finance, Government of India.

sector still needs to make progress on full recovery of costs while needing more investment.

Aggregate demand expected to recover in the near term

II.13 Aggregate demand increased during Q2 of 2013-14. In order to sustain it through H2 of 2013-14, support will be required from investment demand, as government final consumption expenditure may remain subdued in the face of policy-induced expenditure compression to meet fiscal deficit targets. The revival of large stalled projects cleared by the CCI is expected to provide necessary impetus to investments towards the close of the year. There has been significant deceleration in valuables with curbs on gold imports and this is expected to positively impact household financial savings and help restrain CAD.