(1935 - 2010)
प्लैटिनम् जयंती
PLATINUM JUBILEE

प्रेस प्रकाशनी PRESS RELEASE

भारतीय रिज़र्व बैंक
RESERVE BANK OF INDIA

संचार विभाग, केंद्रीय कार्यालय, एस.बी.एस.मार्ग, मुंबई 400001
DEPARTMENT OF COMMUNICATION, Central Office, S.B.S. Marg, Mumbai 400001
फोन/Phone: 91 22 2266 0502 फैक्स/Fax: 91 22 2270 3279

वेबसाइट : www.rbi.org.in/hindi
Website : www.rbi.org.in
इ-मेल email: helpdoc@rbi.org.in

August 27, 2009

RBI releases Annual Report for 2008-09

The Reserve Bank of India today released its Annual Report for 2008-2009.

Overall Performance

The Indian economy exhibited significant resilience in 2008-09 in the face of an intense global financial crisis and the subsequent severe global recession. In a globalised world, however, the natural process of transmission of contagion operating through the trade, capital flows and confidence channels affected the domestic economic and financial conditions. Real GDP growth, which had averaged at 8.8 per cent during 2003-08, decelerated to 6.7 per cent in 2008-09.

When the global markets turned dysfunctional in September 2008, with intense scramble for liquidity and subsequent credit freeze under the pressure of deleveraging, the Indian markets reverberated the shock, which was seen in the form of higher volatility in all segments of the financial markets and sharp corrections in stock prices. The macro-financial conditions remained exceptionally challenging from the stand point of the conduct of Reserve Bank's policies, as it had to respond to multiple challenges, starting from containment of inflation in the first half of the year to moderating the deceleration in growth, preserving the soundness of the banks and financial institutions, ensuring normal functioning of the credit market and maintaining orderly conditions in the financial markets in the second half. At times, the Bank had to operate on multiple fronts simultaneously, and in consultation and coordination with the Government, with the overriding objective of limiting the adverse effects of the global crisis to the extent possible. Consequently, the financial system functioned without disruptions and credit conditions did not operate as a constraint to growth. For the Government, the fiscal response involved temporary deviation from the fiscal consolidation process embodied in the Fiscal Responsibility and Budget Management (FRBM) Act. Reflecting the expansionary fiscal policy response to the slowdown in growth driven by sharp deceleration in private consumption demand, government consumption demand increased, and the contribution of government consumption expenditure to overall growth accordingly increased to 32.5 per cent in 2008-09 from an average of 5.9 per cent in the preceding five years.

ASSESSMENT OF 2008-09

Economic Growth

The deceleration in growth, which started with the cyclical slowdown in the first half of 2008-09, got magnified in the second half due to the contagion from the global crisis. Deceleration in growth to 5.8 per cent in two successive quarters in the second half of 2008-09 represented the weakest growth in recent period; more importantly, while industrial growth turned negative in the last quarter, the deceleration in services persisted in all successive quarters of the year.

The sharp moderation in GDP growth warranted appropriate fiscal and monetary policy response, which was delivered swiftly, that too in a forward looking manner in the second half of the year, in anticipation of the adverse ramifications of the global crisis on domestic growth.

The Fiscal Stance

The unprecedented magnitude and complexity of the challenge necessitated temporary deviation from the fiscal consolidation process embodied in the Fiscal Responsibility and Budget Management (FRBM) Act. The combined fiscal deficit of the Central and State Governments (including the special securities issued to oil marketing and fertiliser companies), thus, reached 10.7 per cent of GDP in 2008-09.

Financing of Fiscal Deficit

The challenge associated with financing of higher deficits emerged in the form of managing large borrowing programmes of the Governments without disrupting the markets, and more importantly, without exerting upward pressures on the interest rates. Significant moderation in inflation in the second half of the year; the deceleration in demand for non-food credit, reflecting the slowdown in growth; and the decline in non-bank sources of funding for the commercial sector created the headroom for smoother management of the borrowing programme.

The Monetary Stance

The accommodative monetary policy stance in the post-September 2008 period was reflected in 400 basis points reduction in CRR, 4.25 percentage point reduction in the repo rate, 2.75 percentage point reduction in reverse repo rate and several other conventional as well as non-conventional windows for access to liquidity (resulting in the availability of more than Rs.4,00,000 crore of additional actual/potential liquidity to the system by the end of the year), The Reserve Bank ensured ample surplus liquidity in the system to ensure flow of credit to productive sectors, within the prudence necessary for preserving the asset quality of the banks.

Inflation Divergence

Headline inflation, as measured by year-on-year variations in the WPI, declined sharply to 0.84 per cent by end-March 2009 from the peak of 12.91 per cent on August 02, 2008. The prices of food articles, however, continued to rule high, as a result of which the consumer price indices (CPIs) remained firm near double digit levels, given the higher weight of food articles in CPIs. The Reserve Bank's Annual Policy Statement in April 2009 recognised the emerging significant divergences between inflation in WPI and CPIs and emphasised that for policy purposes it continuously monitors the full array of price indicators.

External Contagion and Financial Markets

In the post-September 2008 period, the major concern for the Reserve Bank was to deal with the knock-on effects of the global financial crisis. Demand for liquidity had increased from many quarters, that too suddenly. Corporates had increased the demand for credit at home as a substitute for external financing in the face of global credit squeeze. Access to trade credit was becoming difficult, and the cost also had gone up. NBFCs and mutual funds, given the nature of their sources of funds, also faced major liquidity shortage. In view of the capital outflows and the pressures on the balance of payments in the third quarter of the year, the exchange rate came under pressure, which warranted intervention operations by the Reserve Bank to restore orderly conditions in the foreign exchange market. This, in turn, implied corresponding contraction in rupee liquidity in the banking system. The Reserve Bank, thus, had to ensure supply of adequate rupee as well as foreign currency liquidity to restore the call money rate within the LAF corridor and also to contain volatility in the exchange rate.

Reserve Bank’s Responses to the Contagion

For enhancing the availability of domestic liquidity, besides the usual reduction in CRR, greater access under the LAF through repos, and unwinding of the MSS securities, several other conventional as well as unconventional instruments were also used depending on the nature and expected magnitude of the demand for liquidity, such as a second LAF window providing access to liquidity in the afternoon as against the normal LAF access in the morning, special 14 days repo facility using SLR eligible securities up to 1.5 per cent of NDTL for meeting the liquidity needs of NBFCs, housing finance companies and mutual funds, advance release of money at the request of the Government to the banks towards Agricultural Debt Waiver and Debt Relief Scheme, increase in export credit refinance limit for commercial banks, and special refinance facilities for specialised financial institutions such as the SIDBI, NHB and EXIM Bank.

For dealing with the excess demand conditions in the foreign exchange market, given particularly the objective of containing excessive large volatility, a number of measures were initiated to ease the supply situation by partly assuring greater access to the Reserve Bank’s foreign reserves and partly by improving the inflows in response to specific measures.

Regulatory and Supervisory Stance

Recognising the difficult challenges in the credit market, the Reserve Bank had to balance the priorities of credit quality and improved credit delivery. As counter cyclical regulatory measures, the Reserve Bank reduced to normal levels the provisioning requirement for standard assets and risk weights for certain asset classes, which had been increased earlier during the period of rapid credit growth. With a view to further strengthening the domestic banking sector, the Reserve Bank also undertook a number of other regulatory initiatives.

Despite the risk of contagion from the global financial crisis, the Indian banking system remained sound and resilient, as evident from the soundness indicators like capital adequacy, asset quality and profitability for 2008-09. While the capital adequacy level for the banking system was at 13.2 per cent at the end of the year, each individual bank was above the minimum 9 per cent capital adequacy requirement prescribed by the Reserve Bank. Stress-testing findings of the Committee on Financial Sector Assessment (CFSA) also suggested the resilience of the financial system and the adequacy of capital levels.

The Resilient External Sector

The external sector of the economy exhibited resilience despite significant pressures on the balance of payments through the trade and capital flow channels, particularly in the third quarter of the 2008-09, when the reserve loss (excluding valuation) was US$ 18 billion in just one quarter. While net capital flows remained negative even in the fourth quarter of the year, the reserve loss was negligible because of surplus in the current account. For the year as a whole, the current account deficit widened to 2.6 per cent of GDP in 2008-09 from 1.5 per cent of GDP in 2007-08, with a total loss of reserves of US$ 20.1 billion (net of valuation).

PROSPECTS FOR 2009-10

The Uncertain Global Outlook

The IMF's assessment released in July 2009 suggests that global growth would contract by 1.4 per cent in 2009, and the volume of world trade would also decline by 12.1 per cent. The recovery is widely perceived to be gradual, and even with the upward revision to the IMF's growth outlook for 2010 at 2.5 per cent, that would represent just about half of the growth achieved in 2007. Moreover, despite diminishing uncertainty and improving confidence as well as receding financial stress, bank lending conditions remain tight, housing markets are yet to bottom out, and banks' balance sheets need to be cleansed further. In the second quarter of 2009, while the rate of contraction in the US and Euro-area GDP slowed down significantly, Japan, Hong Kong, Germany and France recovered from the recession, and China and Korea exhibited acceleration in growth. Emerging signs of improvement in the global macro-financial conditions, however, need to gain roots for ensuring a sustained global recovery.

The assessments of different international agencies indicate that trade, capital flows and remittances may take some time to revive to normal levels and contribute to growth. If the protectionist response of some countries continues, global recovery may not immediately lead to corresponding revival in world trade. Moreover, rebalancing of the global growth to correct the accumulated global imbalances of the past years may also affect the growth prospects of many countries.

Return to the High Growth Trajectory

Reverting to the high growth path at the earliest and ensuring an inclusive growth process represent the overarching priorities of the Government, and the macroeconomic policy environment has to respond to this broad overall objective. As external demand operates as a major drag on the recovery, growth impulses have to depend even more on domestic demand than in the past and public expenditure has to take the lead in boosting aggregate demand in the face of deceleration in private consumption demand and investment demand. This realisation is reflected in the increase in government expenditure by 33.1 per cent in 2008-09 and by 13.3 per cent over the high base of the previous year, as budgeted for 2009-10.

Domestic Savings and Investment

The relatively higher resilience of Indian growth to the global economic crisis was on account of the dominant role of domestic demand and domestic saving. The increase in savings rate from 23.5 per cent in 2001-02 to 37.7 per cent in 2007-08 largely allowed a sustainable investment driven high average growth of 8.8 per cent over 2003-08, besides the congenial productivity enhancing influence of reforms. In the process of reverting to the high growth path, same level of support from domestic saving may be required, which, however, may be difficult in the immediate run due to the operation of two factors. Public sector savings, which had been showing signs of improvement in recent years reflecting the disciplining influence of the FRBM, is expected to register some deterioration due to higher fiscal deficits as the outcome of using appropriate fiscal stimulus to contain the slowdown in growth, besides the expected subdued performance of the public sector enterprises in a phase of economic slowdown. Depressed corporate earnings associated with deceleration in aggregate demand could also lead to some erosion in savings of the private sector.

Aggregate Demand

The composition of aggregate demand had to tilt in favour of government demand, on account of the use of fiscal stimulus to contain the growth slowdown. In view of the payments made under the Farmer Debt Waiver Scheme, Sixth Pay Commission and fiscal stimulus measures, the share of government final consumption increased to over 11.1 per cent of GDP in 2008-09 from 9.8 per cent of GDP in the previous year. The revival in private consumption demand, however, is essential to not only stimulate investment demand but also to facilitate faster fiscal consolidation.

Agricultural and Allied Activities

The agricultural growth prospects in 2009-10 have to be assessed taking into account the output impact of deficient monsoon. With almost 60 per cent of the agricultural land being rain-fed, Indian agriculture is still dependent on the performance of the monsoon, particularly the South-West monsoon. According to the August 2009 revised monsoon rainfall projections of the India Meteorological Department (IMD), the rainfall deficiency in 2009 (during June-September) could be about 13 per cent. The actual position up to the second week of August 2009 shows that the cumulative shortage of rainfall is about 29 per cent in relation to the normal levels. Moreover, production weighted rainfall index of the Reserve Bank shows a shortfall of 36 per cent, which is higher than what is indicated by the cumulative rainfall pattern.

Industrial Sector

Despite positive growth and signs of recovery in the first quarter of 2009-10, the growth outlook for the industrial sector remains mixed. In view of the prevailing uncertainties, the Reserve Bank has set up an Industry Monitoring Group drawing members from external agencies as well as from concerned departments of the Bank in April 2009 to periodically assess the developments in Industry in relation to changes taking place in the global economy and the financial sector.

Services Sector

This sector has not only exhibited minimum growth of 9 per cent in the recent five years, but its share in aggregate GDP has also increased to about 64.5 per cent. Historically, the services sector has consistently showed resilience since 1990-91. The current global economic crisis being unprecedented in the recent history in terms of the magnitude of the impact as well its duration, the past resilience of the services sector could be tested in 2009-10.

Growth Outlook

The Reserve Bank's survey of professional forecasters conducted in June 2009 indicated an upward revision in the median growth outlook to 6.5 per cent from the earlier outlook of 5.7 per cent as per the previous Survey conducted in March 2009.

Taking into account the global developments as well as the developments in domestic aggregate demand and the recent output outlook for the three broad constituent components of GDP (i.e. agriculture, industry and services), the first quarterly review of the monetary policy for 2009-10 conducted on July 28, 2009 placed GDP growth for 2009-10 at "6.0 per cent with an upward bias".

Since the presentation of the policy statement, while the extent of rainfall deficiency associated with the South West monsoon has increased, the IIP figures for June 2009 released in August 2009 show significant recovery in industrial output.

Inflation Outlook

In 2008-09, India witnessed large volatility in headline inflation, which exceeded 12 per cent at one point and then fell to below 1 per cent by the end of the year. Since June 2009, year-on-year WPI inflation has remained negative, primarily reflecting the high base effect of the previous year that resulted from significant increases in the prices of food and international commodities in the first half of 2008-09. The base effect could be expected to fade gradually and then disappear by October 2009, after which the positive WPI inflation will become visible.

While WPI inflation has turned negative, other indicators of inflation based on CPI for June 2009 (point-to-point) continue to remain high at 11.5 per cent (for CPI-AL), 11.3 per cent (for CPI-RL), 9.6 per cent (for CPI-UNME) and 9.3 per cent (for CPI-IW). The significant divergent behaviour of the inflation is largely on account of the differences in the coverage of items and their weights in the WPI and CPI. At the disaggregated level, even within the WPI, inflation in food articles and essential commodities remain close to the inflation as per different indices of CPI. Moreover, inflation expectations have not declined as much as the fall in WPI inflation and expansionary fiscal stance with an accommodative monetary policy may not lead to sobering of inflation expectations, even if the headline inflation remains negative for a few months.

The first quarter review of monetary policy conducted in July 2009 revised the inflation projection for the end of the year to 5 per cent from 4 per cent projected in April 2009, recognising the imminent signs of inflationary pressures, while highlighting the medium-term objective of 3.0 per cent inflation.

The External Sector Outlook

The outlook for the external sector suggests that despite persistence of the global recession in 2009, the external sector is unlikely to cause concern for growth and stability in India. The latest available trends for 2009-10 indicate that current account deficit as percentage of GDP would be lower than that in 2008-09. Both exports and imports continued to decline in the first quarter of 2009-10, but the decline in imports has been sharper than the decline in exports, resulting in a narrowing down of trade deficit. However, global oil prices have increased in recent months, which, if sustained, may put some pressure on the trade and current account deficits. The relative stability in the software services exports and inward workers' remittances, as witnessed in the previous year, could impart resilience to the current account in 2009-10. Even though net capital flows to EMEs are expected to decline during 2009, capital flows to India may increase because of better medium-term growth and faster recovery prospects. Early indications for the first quarter of 2009-10 suggest that NRI deposits, FII portfolio inflows and inward FDI flows have generally been strong, as against the net capital outflows witnessed in the last two quarters of 2008-09.

Fiscal Consolidation

The fiscal stance of the Government in the face of deteriorating global conditions and weakening domestic growth impulses was guided by the need for preventing a sharp contraction in growth in both 2008-09 and 2009-10, while recognising the need to revert to the path of fiscal consolidation as soon as possible.

The quality of fiscal consolidation has to be given priority attention in view of the fact that even the post-FRBM improvements in key deficit indicators were possible primarily on account of the revenue buoyancy. The fiscal consolidation path may have to involve considerable and careful rationalisation of expenditure. A ceiling on the share of non-plan expenditure in total expenditure may be integrated into a medium-term plan for enhancing the quality of fiscal consolidation. Moreover, improving the productivity of public expenditure and quality of the public service should also be emphasised as an important part of the initiatives on expenditure-led fiscal consolidation.

Subsidies

Management of subsidy has posed a persistent policy challenge. The high fertiliser prices prevailing in global commodity markets during the first half of 2008-09 and the enhanced minimum support price for wheat and rice led to sharp increases in fertiliser and food subsidies in 2008-09 (RE) by Rs.44,863 crore and Rs.10,960 crore, respectively, over the budget estimates. Apart from these subsidies, which are explicitly provided for in the Budget, implicit subsidies provided for by way of issue of special securities to oil and fertiliser companies amounted to Rs.75,849 crore and Rs.20,000 crore, respectively, in 2008-09 so as to compensate for under recoveries. This has added to the subsidy burden of the Government. Without explicit mandated provisions to cap expenditure on subsidies, need for greater public investment in infrastructure, both physical and social, could be sacrificed as an outcome associated with higher subsidies.

Infrastructure

India's high growth trajectory has exerted significant pressures on the available physical infrastructure, and infrastructure deficit is widely recognised as a major constraint to attracting foreign investment and promoting efficiency in production in India. Public investment continues to dominate the infrastructure sector in India and when the Government is expected to go through an exit phase to revert to the fiscal consolidation path, accelerating the pace of public expenditure for infrastructure could become difficult. In attracting private investment to infrastructure projects, the challenge is to make the investment attractive enough in terms of expected return on capital while also being fair to the consumers and actual users of the infrastructure. Moreover, besides the current focus on growth, improving the quality of life through provision of modern physical and social infrastructure should also be given greater importance.

Technology and Innovations

For sustaining the high growth, there has to be significant emphasis on raising the productivity levels, for which innovations and adoption of technology would be critical. Factors ranging from education, rule of law, openness to trade and capital flows and institutional reforms could contribute to technological progress, besides innovations and adoption of new technology. For enhancing productivity, thus, expenditure on primary health, education, vocational training and R&D may be raised, besides facilitating larger flow of credit. Entrepreneurship needs to be incentivised for promotion of innovations.

Food and Energy Security

The global developments on the food and energy fronts in 2008 highlighted the importance of food and energy security for ensuring sustainable and inclusive high growth in India. Insulating the common man from the vulnerability associated with high food price inflation warrants a more robust food security system in India, which could allow high growth in agriculture without depressing the prices too much while also preventing escalation in food prices in the eventuality of production shortfalls.

The behaviour of energy prices in 2008-09 highlights the urgency that should be assigned to the issue of energy security. Significant dependence on imports for ensuring assured supply of POL products in the domestic market warrants adequate strategic policies to contain any potential risk to future growth path arising from possible emergence of sudden deficits in energy availability. Incentives to private investment and higher public investment on exploration and production of crude and natural gas would be necessary. Any fiscal measures to moderate the impact of high oil prices over a sustained period could drag the fiscal position to unsustainable levels. Decontrol of prices for all POL products by linking the pricing directly to international prices, and delivering subsidies explicitly as a cash outgo affecting the budget deficit contemporaneously, instead of through oil bonds, could be the first step towards promoting energy security. The next important steps could involve provision of sufficient fiscal incentives for promoting energy conservation and efficient use, for attracting private investment in generation and conservation of power, and more importantly, research and extension activities on non-conventional clean energy.

Employment

The employment effects of the global economic recession have been a key driving factor behind the use of large stimulus packages all over the world. While no information is available at the macro-level in India on the unemployment scenario arising from the slowdown in growth, unemployment very much remains a concern, and there are evidences of some increase in unemployment in certain sectors.

Financial Sector Reforms

While India's financial sector remained resilient in the face of global shocks, there are a number of areas where the reforms would be needed to promote stability and generate growth impulses for the real economy. An important challenge is to channelise more savings to the financial system, particularly in rural areas and from the urban informal sector. This would need further penetration of the banking system. The Reserve Bank's emphasis on financial inclusion is important in attaining this objective over time. Further reduction in the cost of banking services may require greater competition among product lines, improved delivery mechanisms and increasing use of information technology.

With a view to ensuring that domestic savings could finance long-term investment in projects having long gestation lags, the insurance and pension sectors, would be critical, due to the very nature of their liabilities, as well as a vibrant bond market.

Cross-border banking, in the post crisis period, has to be examined with greater caution, and future reforms in this area must be guided by progress on adequate mechanisms and systems to prevent the possibility of sudden and large external contagion creating systemic risks for the domestic financial system. For sustaining the high growth path, improving the investment climate and enhancing the absorptive capacity would be critical. In this context, financial sector reforms have to emphasise promoting financial inclusion, ensuring wide and deep financial markets and facilitating the growth of strong, competitive and sound financial institutions.

Financial Stability Architecture

The post-crisis revamping of the architecture for promoting financial stability as a precondition to growth could encompass macroeconomic policy issues as well as financial regulation and supervision.

In the sphere of monetary policy, alongside the predominant emphasis on inflation, asset price bubbles driven by credit boom and excessive use of leverage has to receive greater attention.

The fiscal policy stance has to recognise the limits of pro-cyclical fiscal stance, and the importance of adequate fiscal consolidation and sustainability as a necessary stimulus to high growth and stability. In the Indian context, adequate fiscal space has to be built up as a cushion over time to deal with future shocks to the growth process.

Leverage driven or export/capital flows dependent growth could increase the amplitude of the business cycle and the real costs of an external or financial sector shock could be disproportionately high.

In the sphere of regulatory and supervisory architecture, alongside the current emphasis on the soundness of individual banks and institutions as a means to ensure systemic stability, increasing emphasis has to be laid on macro-prudential regulation that could promote and strengthen systemic stability. In view of the interconnectedness between banks and institutions, financial markets, and the economy, systemic risk analysis would involve interpreting the changing dynamics between these three segments on a continuous basis. Any vulnerability in any small segment of these broad areas could amplify and become systemic in view of the strong inter-linkages. The emerging international standards and best practices would have to be carefully examined from the stand point of their relevance to India, while further strengthening the domestic financial stability framework to avoid systemic stress on the financial system.

POLICY CHALLENGES

The macroeconomic conditions in 2009-10 so far and the expected outlook for growth and inflation suggest that there are clear policy challenges for the Reserve Bank as well as for the economy in the near as well as medium-run.

A major near-term challenge for the Reserve Bank is to deal with the unpleasant combination of subdued growth with emerging risk of high inflation, which poses a complex dilemma on the appropriate stance of monetary policy. In such conditions, while withdrawal of monetary accommodation entails the risk of weakening recovery impulses, sustained accommodation and the associated protracted phase of high money growth can only increase inflation in future.

Secondly, large borrowing programmes and high fiscal deficits complicate the challenge even further by accentuating inflationary expectations, which could worsen the actual inflation situation over time while also putting upward pressure on interest rates.

Thirdly, for any early signs of recovery to gain momentum, private sector credit must grow. Better monetary policy transmission that could enhance the demand for credit is a key challenge, notwithstanding the usual dynamics of any credit market which may not respond to monetary policy actions.

Finally, with the return of capital inflows to the pre-crisis period and revival in demand for credit from the private sector, the costs of any delay in withdrawal of monetary accommodation and fiscal consolidation could increase.

For the Reserve Bank, there are other medium-term issues associated with globalisation as well international initiatives on revamping the architecture for promoting financial stability. While openness offers a number of benefits, it increases the risks from external demand and capital flows. Swings in capital flows and sudden stops can have a significant impact on exchange rates, domestic monetary and liquidity conditions and overall macroeconomic and financial stability.

For promoting financial stability, the new international initiatives in response to the global financial crisis have to be monitored and examined, with an emphasis on country-specific relevance, and the future approach to financial sector reforms may have to be based on lessons from the recent crisis.

The single mandate linked to inflation objective has often been highlighted as a necessity for ensuring a better inflation environment, but given the importance of other objectives for a country of India's size and diverse needs, the operational relevance of an inflation-centric mandate has to be examined carefully.

The exit options for fiscal policy have to be seen in the context of the fact that economic recovery in itself could allow the automatic stabilisers to operate, by raising the revenues, and creating scope for reduction in public expenditure. What would be more important, however, is the discretionary unwinding measures to ensure reverting to the fiscal consolidation path as an essential requirement for returning to the high growth path.

For the economy as a whole, the most critical challenge is to revert to the high growth path, which would be possible only with a faster recovery. The longer the growth impulses remain dampened, the fiscal policy will exhaust any available fiscal space, and the costs of large fiscal stimulus will also increase with time.

Deficient monsoon and the possible adverse effects on agricultural output may not only put pressure on food prices but also increase the demand for more subsidies and relief measures. The pressure on the fiscal situation could only increase if drought related policy response involves further expansion in government expenditure, and the additional costs associated with possible import of essential commodities to improve domestic supply conditions. Given the fact that food prices remain high, despite low overall WPI inflation, and that all CPI indices exhibit little moderation in inflation, the supply side of food management would assume critical significance for the Government.

The unemployment effects of a long phase of economic slowdown, with weakly developed social security system, suggest that the Government's preparedness for dealing with situations as in 2008-09 should be strengthened, which must include counter-cyclical fiscal stance allowing build up of significant cushion during periods of high growth. But despite the FRBM, fiscal consolidation process remained slow. More importantly, the public expenditure was also not reoriented to address constraints to high growth, such as physical and social infrastructure.

The manner in which Indian policies could manage the contagion from the global crisis would have further improved the global perception of India. The global crisis, when it started to spread, did not differentiate countries on the basis of soundness of their macroeconomic policies. In a globalised world, strengthened multilateral surveillance and effective global action to prevent the emergence of major global imbalances would have to be ensured so as to allow national policies the space for pursuing and achieving the high and sustainable growth objectives.

Overall, Indian growth continues to be driven by domestic demand and domestic saving, with foreign capital supplementing within the prudent approach to sustainable current account deficit. Thus, return to 9 per cent growth trajectory would largely be determined by the country's structural fundamentals and the responsive macro policy environment.

Alpana Killawala
Chief General Manager

Press Release : 2009-2010/320