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QUARTERLY REVIEW 2013-14 (APRIL-JUNE)

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QUARTERLY REVIEW 2013-14
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CONTENTS

1		**ECONOMIC GROWTH**
	1	Global Context
	2	Recent Growth Experience of India
	3	Performance during the First Quarter of 2013-14
	4	Reasons for the Recent Slowdown, Savings and Investment
	5	Current Priorities and Steps taken by the Government in Recent Months
	6	GDP Outlook
2		**PRICE SITUATION**
	9	Disaggregated WPI inflation
	10	Food Inflation
	11	Items to be monitored closely
	13	Inflation Outlook
3		**TRADE AND EXTERNAL SECTOR**
	14	Trade
	15	Balance of Payments (BoP) position, Foreign Exchange Reserves, Exchange Rate and External Debt
	17	Measures taken to improve the Trade Balance
	19	Recent developments
	22	External Debt
4		**FISCAL POLICY AND PUBLIC FINANCE**
	24	Budget 2012-13: BE, RE and Provisional Actuals
	26	Efforts at Fiscal Consolidation
	27	Fiscal Marksmanship
	28	Budget 2013-14
	28	Recent trends
	29	Outlook

5 **MONETARY POLICY AND FINANCIAL SECTOR**

29 Monetary policy

30 Performance under Money and Banking during the current financial year

30 Scheduled Commercial Banks (SCBs): Business in India

6 **AGRICULTURE & ALLIED SECTORS**

31 Rainfall Distribution in 2013

31 Agricultural Production

31 Food Management

32 Minimum Support Prices

7 **INDUSTRIAL SECTOR**

33 Mining and electricity sectors

34 Manufacturing sector

35 Persisting weakness in the capital goods sector

35 Industrial Sector Outlook

8 **SERVICES SECOTR**

38 Services GDP

9 **SOCIAL SECTOR**

38 Employment

39 Poverty

1. ECONOMIC GROWTH

Global Context

1.1 In contrast to the greater than 5.0 per cent growth seen in the global economy during 2005-07, global growth slowed down and averaged 2.9 per cent during 2008-2012. The slowdown was largely universal across advanced economies . with sub-par growth in the United States and Europe following the financial meltdown and the repercussions that followed. Emerging economies have not remained immune to these developments and have been affected via a number of channels. From Figure 1, it is clear that changes in the direction of India's GDP growth rate broadly coincided with that in USA and Euro-area, though India's post crisis recovery, as well as the recent decline in growth, has been steeper.

1.2 Many emerging economies, particularly India and China, registered strong recovery in 2009. However, a combination of domestic factors coupled with the sovereign debt crisis in the Euro-zone that unfolded in 2010-11 (and the subsequent recession in the Euro-area) prevented a sustainable recovery, and has negatively affected growth prospects. While growth in advanced economies remains subdued, many emerging economies including China, India, Brazil and Russia, among others, experienced lower growth rates in 2012 vis-à-vis that witnessed in 2010. In this context, the slowdown in the growth rate of real GDP witnessed in India in 2011-12 and 2012-13, while disappointing, is not out of sync with developments in many similar emerging economies.

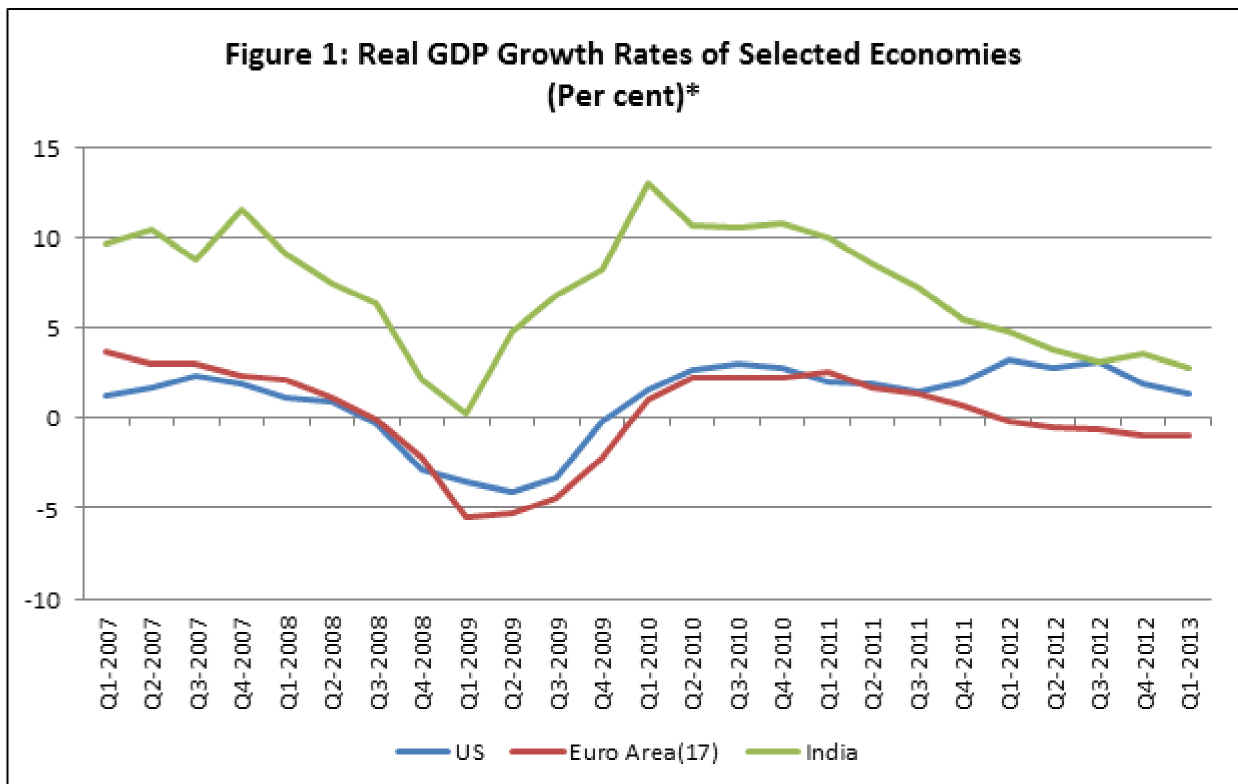


Figure 1: Real GDP Growth Rates of Selected Economies (Per cent)*

Source: OECD Database. * Data reported is on calendar year basis, and is seasonally adjusted. India's GDP is also from the OECD database and pertains to GDP at market prices.

Recent Growth Experience of India

1.3 India's GDP growth is driven, to a large extent, by the services sector. As seen in Figure 2, the period between 2005-06 and 2007-08 when the annual growth rate of GDP was over 9.0 per cent, the performance of services and industry was particularly strong. Following the global financial crisis in 2008-09, the Indian economy responded strongly to fiscal and monetary stimulus and achieved a growth rate of 8.6 per cent and 9.3 per cent respectively in 2009-10 and 2010-11. However, the recovery was short-lived with growth slowing to 6.2 per cent in 2011-12 and further to 5.0 per cent in 2012-13.

1.4 The slowdown in growth was broad-based across all sectors. The agriculture sector witnessed a steady decline in growth rate from 7.9 per cent in 2010-11 to 3.6 per cent in 2011-12 and further to 1.9 per cent in 2012-13. Within the industry sector, mining and manufacturing sectors have decelerated significantly over the period 2010-11 and 2012-13. Growth in services which had averaged 10 per cent for six years slowed to 8.2 per cent in 2011-12 and further to 7.1 per cent in 2012-13. Within the services sector, transport (particularly railways) and communications, as well as banking and insurance, slowed in 2012-13 vis-à-vis 2011-12.

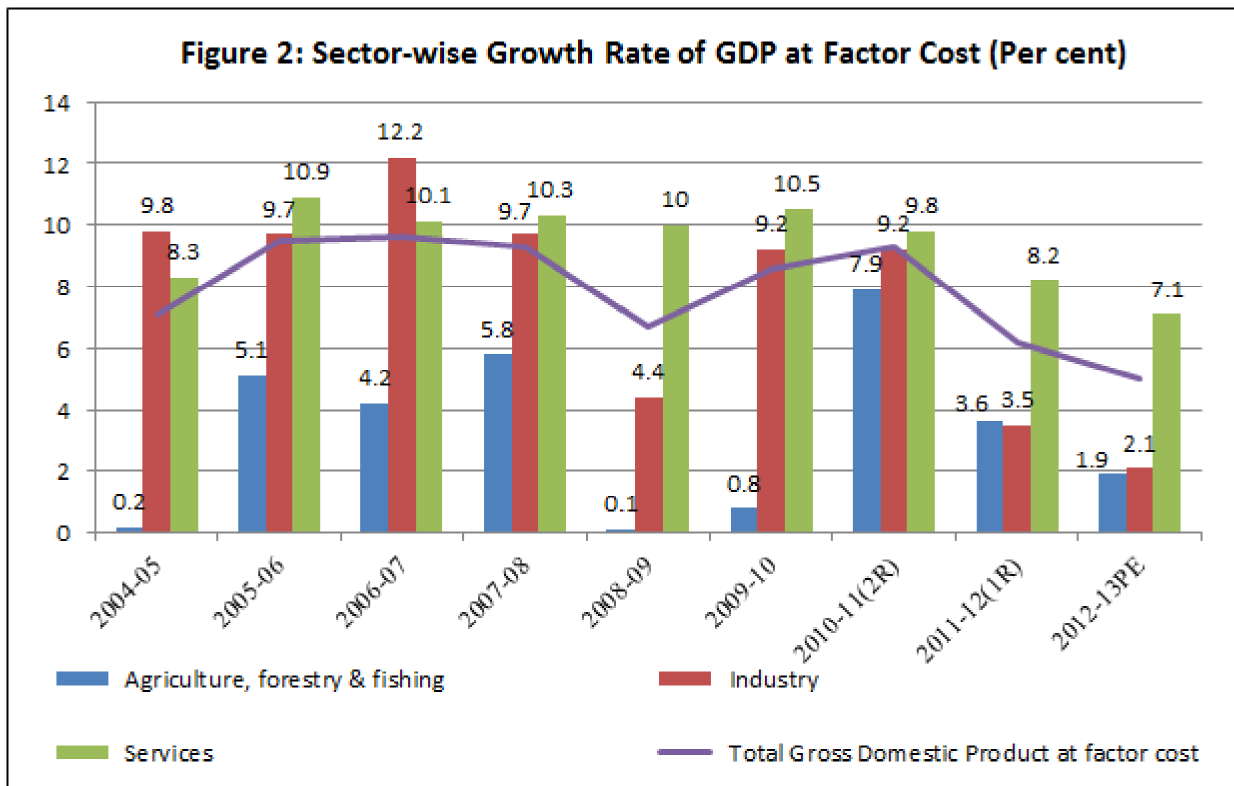


Figure 2: Sector-wise Growth Rate of GDP at Factor Cost (Per cent)

1.5 Trends in quarterly GDP growth rates (Table 1) reveal that while the industrial slowdown was the dominant factor in 2011-12, the overall growth slowdown became more broad-based in 2012-13 with deceleration in the services sector as well as in agriculture.

Table 1 : Quarterly Growth Estimate of GDP (Year-on-year in per cent)

		2011-12				2012-13				2013-14
	Sector	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
1.	**Agriculture, forestry & fishing**	**5.4**	**3.2**	**4.1**	**2.0**	**2.9**	**1.7**	**1.8**	**1.4**	**2.7**
2.	**Industry**	**5.7**	**3.8**	**2.6**	**2.1**	**1.8**	**1.3**	**2.5**	**2.7**	**0.2**
	a Mining & quarrying	-0.4	-5.3	-2.6	5.2	0.4	1.7	-0.7	-3.1	-2.8
	b Manufacturing	7.4	3.1	0.7	0.1	-1.0	0.1	2.5	2.6	-1.2
	c Electricity, gas & water supply	6.6	8.4	7.7	3.5	6.2	3.2	4.5	2.8	3.7
	d Construction	3.8	6.5	6.9	5.1	7.0	3.1	2.9	4.4	2.8
3.	**Services**	**8.9**	**8.5**	**8.3**	**7.3**	**7.7**	**7.6**	**6.7**	**6.6**	**6.6**
	a Trade, hotels, transport & communication	9.5	7.0	6.9	5.1	6.1	6.8	6.4	6.2	3.9
	b Financing , insurance, real estate & business services	11.6	12.3	11.4	11.3	9.3	8.3	7.8	9.1	8.9
	c Community, social & personal services	3.5	6.5	6.8	6.8	8.9	8.4	5.6	4.0	9.4
4.	**GDP at factor cost**	**7.5**	**6.5**	**6.0**	**5.1**	**5.4**	**5.2**	**4.7**	**4.8**	**4.4**

Source: Based on Information from CSO.

Performance during the First Quarter of 2013-14

1.6 The Indian economy registered a growth rate of 4.4 per cent in the first quarter (Q1) of 2013-14 as against 5.4 per cent in the first quarter of 2012-13. This is also the lowest growth rate since Q4 of 2008-09 when the growth rate was 3.5 per cent. The main factor behind the low growth is the near stagnant industry sector that registered a growth of 0.2 per cent in Q1 of 2013-14 over Q1 of 2012-13. Within the industry sector, the mining and manufacturing sectors registered negative growth. Apart from the slowdown in the industry sector, one of the major contributors to the recent slowdown has been the low growth in the trade, hotels, transport & communications segment of the services sector. This sub-sector accounts for nearly 28 per cent of the total GDP (its share is more than that of the entire industry sector) and the 3.9 per cent growth witnessed in this sub-sector, to a great extent explains the low growth of 4.4 per cent.

1.7 The demand side GDP i.e. GDP at constant market prices (2004-05) is estimated to have grown at 2.4 per cent in Q1 of 2013-14 as against a level of 3.4 per cent in Q1 of 2012-13. Growth in real fixed capital formation (fixed investment) is estimated at (-) 1.2 per cent in Q1 of 2013-14 as against (-) 2.2 per cent in Q1 of 2012-13. As a ratio of GDP at current market prices, gross fixed capital formation was 28.6 per cent in Q1 of 2013-14 as against 29.9 per cent in Q1 of 2012-13.The rate of growth of private final consumption expenditure was 1.6 per cent. The growth of exports was negative (at constant 2004-05 prices).

Reasons for the Recent Slowdown, Savings and Investment

1.8 To counter the economic slowdown arising from the global crisis, the government and RBI injected fiscal and monetary stimulus during 2008-09. These helped in restoring consumption and investment, with the growth rate of GDP, private final consumption expenditure (PFCE) and gross fixed capital formation (GFCF) picking up from Q1 of 2009-10 (Figure 3). However, a rebound in the real sector growth was followed by a rise in inflation that necessitated monetary tightening during 2010-11 and most of 2011-12. The rise in policy rates coupled with bottlenecks facing large projects such as obtaining environmental clearances, land acquisition, and fuel supply took its toll on investments. As is evident from Figure 3, the growth rate of Gross Fixed Capital Formation started to decline around the Q1 of 2010-11 and this continued in Q1 of 2013-14 at (-) 1.2 per cent. The other components of aggregate demand viz. private (as well as Government) consumption expenditure, exports, etc. also slowed in 2012-13.

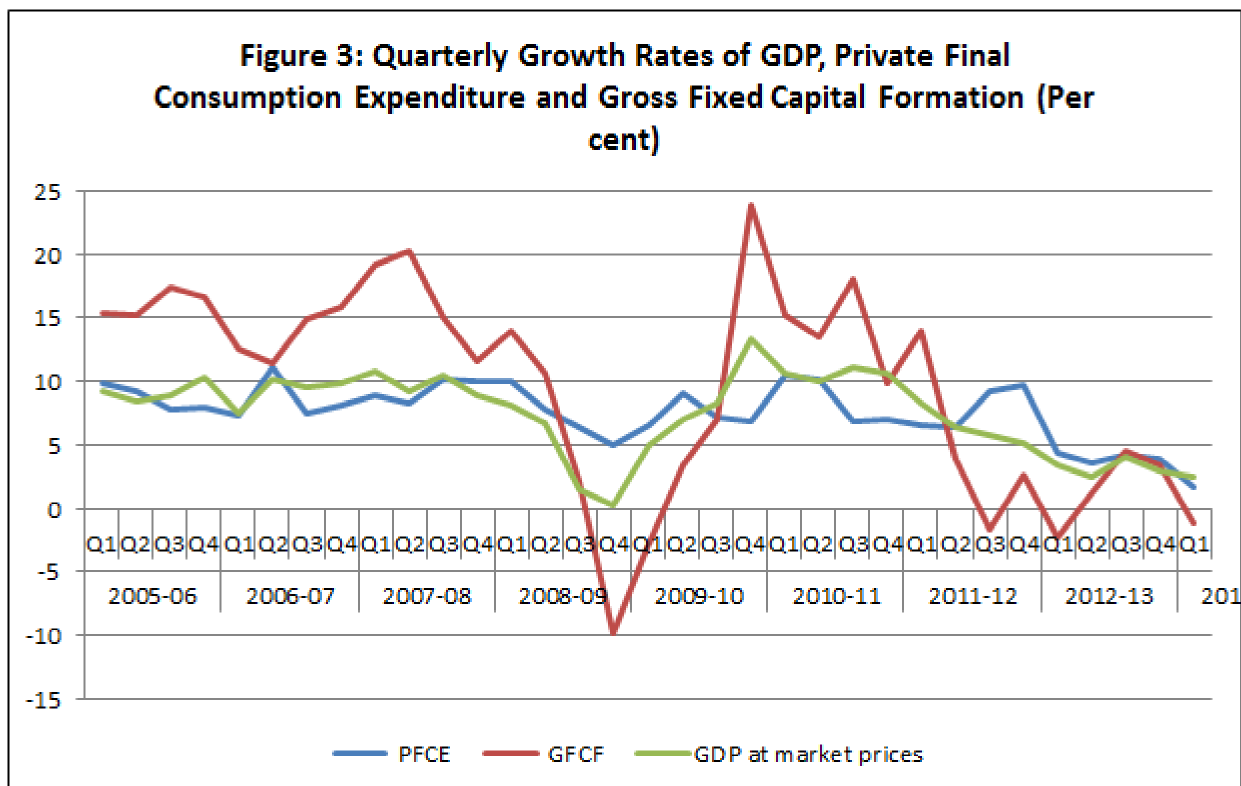


Figure 3: Quarterly Growth Rates of GDP, Private Final Consumption Expenditure and Gross Fixed Capital Formation (Per cent)

1.9 The overall investment rate slowed to 35.0 per cent in 2011-12 from the peak of 38.1 per cent in 2007-08 while the *rate* of Gross Fixed Capital Formation slowed to 29.6 per cent in 2012-13 from 30.6 per cent in 2011-12 and a high of 32.9 per cent in 2007-08. Growth in private final consumption expenditure declined to 4.0 per cent in 2012-13 from 8.0 per cent in 2011-12.

1.10 Alongside a fall in investment, latest data indicate that the domestic savings rate has fallen to 30.8 per cent in 2011-12 from 34.0 per cent in 2010-11. The slowdown in savings is across the key components - lower household financial savings, corporate savings and greater government dis-savings . all of which have led to a widening of the saving-investment gap in recent years (Table 2).

Table 2: Ratio of Savings and Investment to GDP (at current market prices per cent)*

	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11[2R]	2011-12[1R]
1.Gross Domestic Saving	**32.4**	**33.4**	**34.6**	**36.8**	**32.0**	**33.7**	**34.0**	**30.8**
Public sector	2.3	2.4	3.6	5.0	1.0	0.2	2.6	1.3
Private sector	30.1	31.0	31.0	31.8	31.1	33.5	31.5	29.5
2.Gross Domestic Capital Formation	**32.8**	**34.7**	**35.7**	**38.1**	**34.3**	**36.5**	**36.8**	**35.0**
Public sector	7.4	7.9	8.3	8.9	9.4	9.2	8.4	7.9
Private sector	23.8	25.2	26.4	28.1	24.8	25.4	26.5	24.9
3.Gross Fixed Capital Formation	**28.7**	**30.3**	**31.3**	**32.9**	**32.3**	**31.7**	**31.7**	**30.6**
4.Saving-Investment Gap (1-2)	**-0.4**	**-1.3**	**-1.1**	**-1.3**	**-2.3**	**-2.8**	**-2.8**	**-4.2**

Source: CSO. 1R: 1st Revised Estimate, 2R: 2nd Revised Estimate. ** Data on Investment and Savings rates are available up to 2011-12.*

1.11 In response to the slowdown, the Government has undertaken several economic reform measures since September 2012 to revive growth in the economy by addressing the structural bottlenecks, attempting to restart the investment cycle by boosting the confidence of both domestic and global investors, and outlined steps to increase the financial savings of households.

Current Priorities and Steps taken by the Government in Recent Months

1.12 In context of the present economic situation, the policy priorities in the Indian economy are the following:

1. Controlling the fiscal deficit to 4.8 per cent of GDP in 2013-14 by reining in expenditures.
2. Reducing the Current Account Deficit to US$ 70 billion in 2013-14, and ensuring safe financing.
3. Augmenting foreign exchange reserves.
4. Reviving the investment cycle by expediting project implementation.
5. Incentivizing PSUs to boost capital expenditure.
6. Though public sector banks in India are well capitalized, injecting capital into such banks to further boost confidence.
7. Reaping the benefits of good monsoons; ensuring support to maximize agricultural production in the form of credit, gas allocation to the fertilizer sector, etc.
8. Encouraging manufacturing growth.
9. Boosting exports.
10. Addressing issues faced by the coal and iron-ore sectors especially facilitation of production, streamlining allocations, etc.

1.13 A number of actions have been taken towards each of these 10 objectives. For instance, the setting up of the Cabinet Committee on Investment (CCI) under the chairmanship of the Prime Minister to fast track large investment projects has resulted in projects worth over ₹ 384 thousand crore being cleared (up to August 27, 2013). The effects of these clearances on investment will be realized in coming quarters.

1.14 To encourage foreign direct investment, the government has recently amended the sectoral caps and/or entry routes in some sectors viz. petroleum & natural gas; commodity exchanges; power exchanges; stock exchanges, depositories and clearing corporations; asset reconstruction companies; credit information companies; tea sector including tea plantations; single brand product retail trading; test marketing; telecom services; courier services and defence.

1.15 The recent deregulation of the sugar sector, the new gas pricing guidelines, the signing of coal fuel supply agreements, and the commencement of work on the Delhi-Mumbai Industrial Corridor and other freight corridors would help encourage investments and manufacturing activity.

1.16 The Union Budget 2013-14 outlined various initiatives to facilitate investment in infrastructure via encouragement to Infrastructure Debt Funds, enhancement of credit to infrastructure companies, raising the corpus of Rural Infrastructure Development Fund (RIDF), introduction of investment allowance for *new* high value investments.

1.17 To reverse the declining trend in the rate of household financial savings, the Government in consultation with the RBI, has taken the decision to launch Inflation Indexed Bonds (IIBs) as instruments that would incentivize households to save in financial instruments. Thus far, these instruments have largely been sold to institutional investors and have been indexed to wholesale price index (WPI), but a direct sale of consumer price index (CPI) linked instruments to the public is also proposed.

1.18 Key sectoral measures include the extension of incentives to help industries in difficult areas through Plan Schemes of Transport Subsidy, special package of incentives for Special Category States, North-East Industrial & Investment Promotion Policy, 2007, and specific programmes like Industrial Infrastructure Upgradation Scheme, Indian Leather Development Programme, etc. Various schemes including Credit Guarantee Scheme and Prime Minister's Employment Generation Programme (PMEGP); Entrepreneurial Skill Development Programme (ESDP); Management Development Programmes (MDPs); Skill Development Programme in tool engineering and related areas; Credit Linked Capital Subsidy Scheme (CLCSS); Micro and Small Enterprise Cluster Development Programme; Procurement Preference Policy and Marketing Development Assistance (MDA); and steps viz. establishment of Micro and Small Enterprise Facilitation Councils in States are some of the major policies being implemented by the Government to encourage the Micro, Small and Medium Enterprises sector.

GDP Outlook

1.19 India's GDP growth slowed to a decadal low of 5 per cent in 2012-13. As mentioned in the Economic Survey 2012-13, the reasons behind the sharp deceleration in growth that followed the post-crisis stimulus period of growth rate of more than 8.5 per cent include factors such as (i) policy constraints impacting investments, (ii) tight monetary policy in response to rising inflation which took a toll on investment as well as consumption and (3) growing external headwinds.

1.20 However, despite the low growth in 2012-13, fiscal 2013-14 began with a few hopeful signs. On the consumption side, it was expected that with inflation easing, monetary policy would be more accommodative. On the investment side, the investment climate was expected to improve with Cabinet Committee on Investment clearing projects. Assuming a normal monsoon and global economic recovery, the Economic Survey had anticipated the growth to be in the range of 6.1 to 6.7 per cent for 2013-14.

1.21 However, in contrast to expectations of a pick-up in economic activity, current macro trends indicate that a combination of global and domestic developments is likely to result in a shallow ±U¢shaped recovery in 2013-14. Following three quarters of sub 5 per cent growth, growth is expected to pick up from second quarter of 2013-14 resulting in full year growth of around 5.5 per cent (See Box 1). Alternative methods of estimating GDP are also being suggested (Box 2).

Box 1: Updating the GDP growth forecast

The in-house exercises carried out predicted a growth rate in the range of 6.1-6.7 per cent in 2013-14 in February 2013 based on a normal monsoon, pick up in global growth, moderation in inflation and consequently policy rates, revival of stalled projects. All this would also lead to a rise in both business and consumer confidence which in turn would have a positive impact on private investment and consumption. In two alternative scenarios the model predicted a real GDP growth of ~5.4 per cent (pessimistic) and 6.9 per cent (optimistic).

Updating the model for changes in the global and domestic macroeconomic environment the real GDP growth is now likely to be 5.0-5.5 per cent in 2013-14.

Key factors that are responsible for lowering the growth forecast are: downgrade in the global growth forecast by the IMF, backlog of stalled projects and the uncertainty created by currency volatility. Further, various high frequency indicators from the industrial sector such as industrial production, manufacturing PMI and auto sales suggest that the sluggish trend in the industrial sector is likely to continue for some more time.

Nonetheless, above normal monsoon and the ensuing pick up in agricultural growth and rural demand are likely to support growth. Further, incipient signs of pick up in coal supply, signing of coal fuel supply agreements (FSA) and the anticipated integration of the southern (electricity) grid with the national grid are likely to increase power supply and bolster the industrial sector going forward. Finally, exports are likely to pick up with the currency depreciation and increase in partner country growth.

Box 2: Estimating GDP on the basis of electronically filed tax returns[1]

The Task Force on Goods and Services Tax set-up by the Thirteenth Finance Commission had in its Report to the Commission observed that %t is obvious that the CSO estimation of gross value of output seems to be an under estimation. Consequently, the estimation of GDP, private final consumption etc., by the CSO also appears to be under stated.+Subsequently, this view has also been echoed by Governor, RBI on the RBI¢s Statistics Day in 2011. Hence there is a strong case for re-visiting the estimation of the GDP. One such estimation exercise carried out on the basis of data from electronically filed income tax returns is discussed here. Levels of gross value added (GVA) in the %commercial core sector+(comprising non-departmental and private enterprises) are **substantially higher** than the amount estimated by CSO in all the six years (Table below). The difference between the two estimates increases from 16.5 per cent in 2006-07 to 35.3 per cent in 2010-11 (Row 2c). The GDP (factor cost, current prices) is re-calculated by keeping the GVA in all other sectors (i.e. the whole of the unorganized sector, Government sector and the organized %commercial residual sector+) at the same level as estimated by CSO (Row 3b). Since the difference in the levels of the revised GDP and the estimates of CSO vary year to year, the overall nominal GDP growth rate is substantially different from those estimated by CSO (Row 4). The increase in the levels of the revised GDP may have implications for various macro-economic indicators like resulting in lower fiscal deficit to GDP, current account deficit to GDP and debt-GDP ratios.

[1] *Based on note prepared by Arbind Modi with support from Supriyo De, Rohini Malkani and Aman Mohunta.*

Table: Estimates of GDP using income tax return data.

Sl. No	Description	Units	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
1	Gross Value Added (as per CSO)								
a	Organized Sector								
i	Government Sector	₹ in crores		418878	445235	587298	755418	844269	964645
ii	Commercial Residual Sector	₹ in crores		80420	89788	105291	122400	146503	146503
iii	Total [a(i) + a(ii)]	₹ in crores		499298	535023	692589	877818	990772	1111148
b	Unorganized Sector	₹ in crores		2171058	2521899	2926330	3329588	3262149	4596040
c	Total [a + b]	₹ in crores		2670356	3056922	3618919	4207406	4252921	5707188
2	Gross Value Added in the Commercial Core Sector								
a	CSO	₹ in crores		1282920	1525164	1684648	1905098	2271377	2646307
b	Estimated * (based on e-filed Tax Returns)	₹ in crores		1494057	1862427	2225160	2569094	3074191	3362979
c	Increase in Revised Estimate	in percent		16.46	22.11	32.08	34.85	35.34	27.08
3	GDP at Factor Cost at current prices								
a	CSO [1(c) + 2(a)]	₹ in crores	3390503	3953276	4582086	5303567	6108904	7266966	8353495
b	Estimated * [1(c) + 2(b)]	₹ in crores	NA	4164413	4919349	5844079	6772900	8069780	9070167
c	Increase in Revised Estimate	in per cent		5.34	7.36	10.19	10.87	11.05	8.58
4	GDP Growth Rate (Nominal)								
a	CSO	in per cent	14.1	16.60	15.91	15.75	15.18	18.96	14.95
b	Estimated*	in percent	NA	NA	18.13	18.80	15.89	19.15	12.40

** Authors' Estimates*

1.22 Looking at the production side, the numbers are likely to be aided by positive trends in agriculture. The 2013 monsoons started on a good note with rainfall for the period June to August (up to August 28) being 11 per cent above normal, along with 9.1 per cent increase in crop sowing area. Continuation of these trends coupled with the base effect, is likely to result in an above average growth of 4.5 per cent in agricultural and allied sectors in the current fiscal.

1.23 However, the improvement in the growth prospects for agriculture sector is likely to be offset by weak trends in other sectors. While current trends in industry are weak, recent project clearances and the pickup in coal production in recent months bodes well for mining and manufacturing activity. Consequently, it is expected that the overall industry growth is likely to be 1.9 per cent as against 2.1 per cent in 2012-13. As regards services, trends in cargo handled at ports and cellular subscriptions have been weak in the first quarter of the current fiscal. This is corroborated in the service sector PMI - now at sub 50 levels. However, taking into account a pick-up in rural demand and increased freight movement by the railways, the overall services sector is expected to register a growth of 6.8 per cent, which is marginally lower than the 7.1 per cent print last year.

2. PRICE SITUATION

2.1 Headline WPI inflation which had averaged 8.9 per cent in 2011-12 and 7.4 per cent in 2012-13 eased to sub 5 per cent levels in the first quarter of 2013-14. This was mainly due to the fall in global commodity prices (leading to lower non-food manufacturing inflation) and lower fuel inflation. WPI has however breached 5 per cent level to reach 5.79 per cent in July 2013.

2.2 Unlike the decline in WPI inflation, CPI inflation has remained sticky at near double digit levels in 2012-13 and the first quarter of 2013-14. This has been mainly on account of higher food (that has much larger weightage in CPI than in WPI) inflation, leading to a higher gap between WPI and CPI. Key to note is that unlike last year when proteins were the key contributor to food inflation, this year the pressure is mainly from cereals. On the other hand, inflation in milk and other protein items registered a decline in first quarter of current financial year. Quarterly inflation as measured by different price indices in India is given in Table 3.

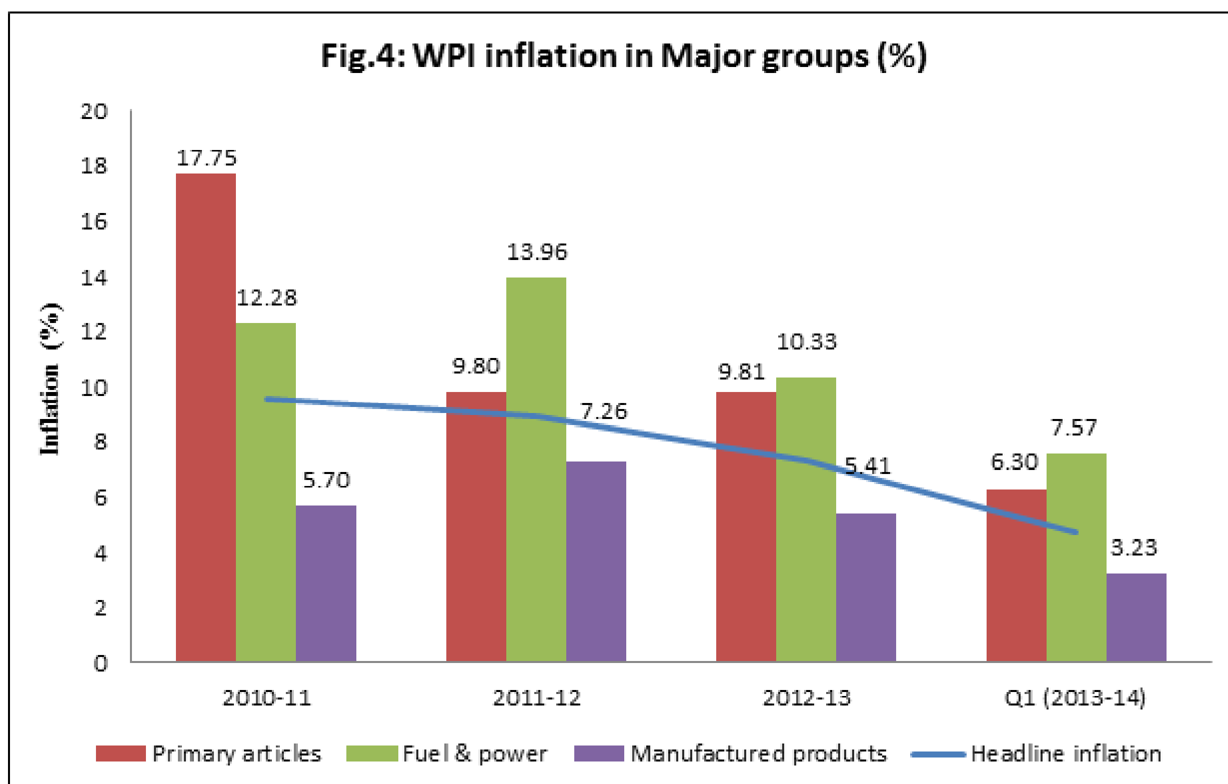
Table 3: Quarterly general inflation for different price indices in India

	WPI (2004-05)	CPI-NS (2010)	CPI-IW (2001)	CPI-RL (1986-87)	CPI-AL (1986-87)
2012-13					
Q1	7.54	10.18	10.14	8.22	7.88
Q2	7.87	9.87	9.76	9.41	9.08
Q3	7.29	10.07	10.10	10.54	10.50
Q4	6.74	10.69	11.71	12.47	12.55
Average	**7.35**	**10.21**	**10.44**	**10.19**	**10.03**
2013-14					
Q1	4.73(P)	9.52	10.66	12.43	12.62
July 2013	5.79(P)	9.64(P)	-	12.61	12.80

P: Provisional, IW: Industrial Workers, AL: Agricultural Labourers, RL: Rural Labourers, NS: New Series

Disaggregated WPI inflation

2.3 The main contributors to the 9.56 per cent WPI inflation numbers in 2010-11 were primary articles (up 17.75 per cent) and fuel (up 12.28 per cent). Fuel inflation remained in double digits from 2010-11 to 2012-13. Manufactured products recorded inflation of above 5 per cent during 2010-11 to 2012-13. It peaked at 7.25 per cent in 2011-12 due to elevated inflation in manufactured food products and has declined gradually to 3.23 per cent in first quarter of 2013-14. Core inflation (Non-food Manufactured) has been continuously showing signs of moderation in the last three quarters backed by a fall in metals and chemicals inflation. Core WPI has moderated from a peak of 5.71 per cent in Q2 of 2012-13 to 2.35 per cent in Q1 of 2013-14. The movement of group-wise WPI inflation is presented in Figure 4.



Food Inflation

2.4 There has been a divergence in the movement of food inflation between wholesale level and retail levels. After averaging 9.28 per cent in 2012-13, the average WPI food inflation comprising primary food articles and manufactured food products moderated to 7.59 per cent in Q1 of 2013-14 led by lower inflation in pulses, vegetables, fruits, milk, tea and coffee. On the other hand, at the retail level, food inflation as measured by the CPI-AL/RL which averaged over 9 per cent in 2012-13, increased to above 12.5 per cent in the first quarter of 2013-14.

2.5 The overall WPI inflation for proteins, comprising pulses, eggs, meat, fish and milk, softened to 7.25 per cent in Q1 of 2013-14 from 11.36 per cent in 2012-13 and further to 4.63 per cent in July 2013. In case of vegetables, inflation, which averaged 17.20 per cent in 2012-13, declined to 4.39 per cent in Q1 of 2013-14. However, it increased to 46.59 per cent in July 2013 on account of increase in onion prices, seasonal effect and weather driven supply disruption. Inflation for different commodity groups within food is given in Table 4.

Table 4: Breakup of WPI food inflation since 2010-11

	Weight (%)	2010-11	2011-12	2012-13	2013-14 (Q1)	July 2013
All Food (A+B))	**24.31**	**11.10**	**7.24**	**9.28**	**7.59**	**9.54**
(A) Food articles	*14.34*	*15.60*	*7.30*	*9.90*	*8.03*	*11.91*
Cereals	3.37	5.26	3.87	13.42	16.22	17.66
Pulses	0.72	3.20	2.52	19.57	5.92	-7.39
Vegetables	1.74	12.99	-1.95	17.20	4.39	46.59
Fruits	2.11	19.83	14.21	1.30	0.28	-4.80
Milk	3.24	20.13	10.31	7.24	4.08	2.35
Eggs, meat & fish	2.41	25.51	12.73	14.08	11.36	10.94
Condiments & spices	0.57	33.56	-2.65	-11.80	14.80	13.48
Other food (Tea & coffee)	0.18	-7.25	18.97	11.89	3.29	-0.46
(B) Food products	*9.97*	*3.72*	*7.12*	*8.13*	*6.77*	*5.04*
Other composite groups						
Protein Food	6.37	19.78	10.32	11.36	7.25	4.63

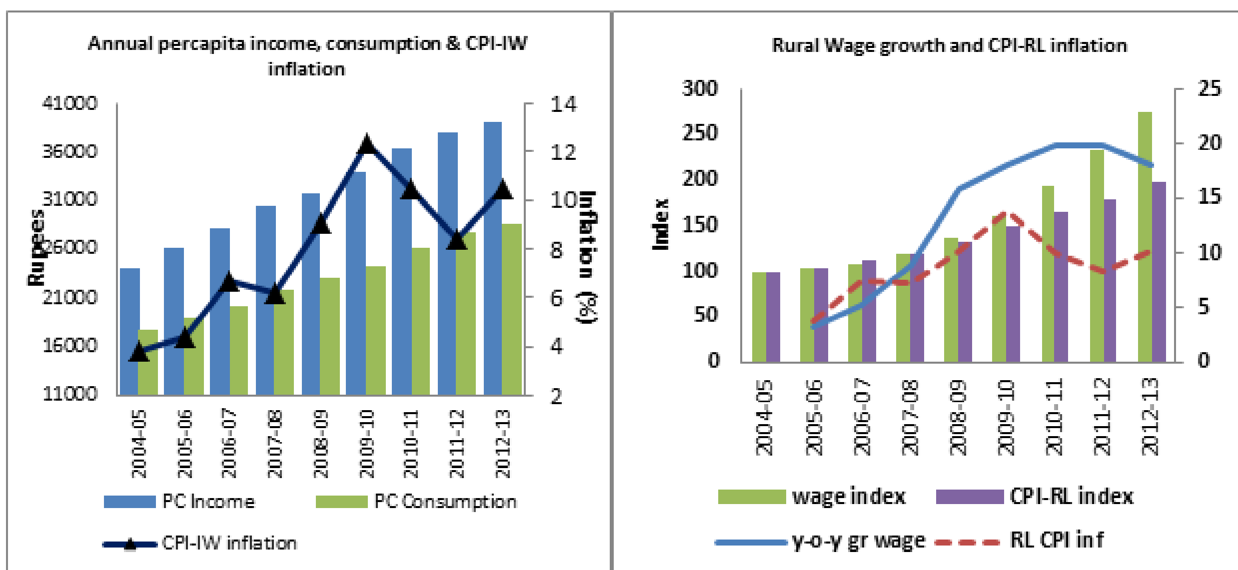
Items to be monitored closely

2.6 18 commodities having 17.08 per cent weight in WPI have contributed more than 60 per cent of the inflation in the first quarter of the current financial year. One of the commodities is High Speed Diesel (HSD) that has a 50 per cent weight in overall mineral oil basket and 80 per cent of its domestic demand is met by imports. Apart from having a high weight in the WPI, it is an important item on account of its cascading effect on prices of food items in particular. The recent depreciation of Indian rupee against US dollar has had significant impact on crude oil prices in Rupee terms. The government's decision to periodically raise the prices of HSD in order to reduce the subsidy burden and fiscal deficit has released a part of suppressed inflation. High speed diesel oil contributed more than 20 per cent to headline inflation in first quarter, which is five times higher than its weight (4.67 per cent) in WPI.

2.7 Apart from HSD, food items like rice, onion, fish, brinjal, wheat, tapioca, tea leaf (unblended), wheat flour, poultry chicken and sugar, which have higher contribution to overall inflation than their WPI weights, need to be monitored closely in the coming months. Non-food items like raw cotton, fodder, crude petroleum, electricity (domestic, industry & agricultural) also having higher contribution than their weights, need to be monitored closely. The inflation in consumer price indices is higher than WPI due to higher weightage of food in CPI basket, upward revision in rural wages and growth in support price of agricultural products **(Box 3).**

Box 3: Consumer inflation and increase in incomes

One of the factors behind the rise in CPI (IW) inflation is rising income levels, particularly in low and middle income groups. Income elasticity of demand is generally high for these groups. The increased income in these groups has resulted in increased private final consumption expenditure (PFCE) by about 60 per cent from 2004-05 to 2012-13. Rural wages have risen post the initiation of Mahatma Gandhi National Rural Employment Guarantee Scheme of Union Government and as a result of increased demand for labour in construction. Incomes of farmers have also risen due to an increase in support prices of agricultural products.



Box 4: Measures taken to contain Inflation

The Government has taken a number of fiscal and administrative measures to contain the food inflation. Some of the specific measures are:

- **Duties**: Import duties for wheat, onion and pulses have been reduced to zero. For refined edible oil, it has been reduced to 7.5 per cent.
- **Export Bans**: Exports of most edible oils has been banned (except coconut oil, forest based oil and edible oils in branded consumer packs upto 5 Kg with a minimum export price of US$ 1500/MT). Similarly, exports have been banned for pulses except kabuli chana and organic pulses and lentils upto maximum of 10000 tonnes per annum.
- **Stock Limits**: Stock limits have been imposed for select essential commodities such as pulses, edible oil, and edible oilseeds for a period upto 30.9.2013 and for paddy and rice upto 30.11.2013.

Other Measures:

- Central Issue Price (CIP) for rice has been maintained at ₹5.65 per kg for BPL and ₹3 per kg for AAY. For wheat CIP has remained at ₹4.15 per kg for BPL and ₹2 per kg for AAY since 2002.
- Government allocated 195000 tonnes of rice and 327000 tonnes of wheat for distribution to retail consumers under Open Market Sales Scheme Domestic [OMSS(D)] for the period upto March, 2014.
- The scheme for subsidized imported edible oils has been extended upto 30.09.2013 with subsidy of ₹15/Kg for import of upto 10 lakh tonnes of edible oils for this period.

Recent decisions to ensure adequate availability of onions

Onions are a sensitive commodity within the vegetables group. Though the weight assigned to onion is small, high increase in its prices has resulted in high contribution to overall inflation. Some of the steps taken to deal with rise in onion prices are as follows:

- Minimum Export Price of USD 650 per tonne has been introduced.
- NAFED will import onion from other countries for domestic consumption.

É NAFED will procure onion at best prevailing rates from mandis at Lasalgaon/ Pimpalgaon in Nasik District in Maharashtra and offer it to all State marketing and supply federations at a nominal service charge of 2 per cent.

Steps by RBI

As part of its demand management policy, the Reserve Bank of India (RBI) had raised the policy rates by 375 basis points (bps) from March 2010 to October 2011 to contain inflation. Following the moderation in headline WPI and in particular core inflation coupled with the growth inflation dynamics, the RBI has eased policy rates by 125 bps but there has been a pause since May 2013. Global developments including Fed tapering fears have resulted in increased pressure on the rupee. In a bid to contain volatility, the RBI has taken measures to tighten liquidity which include; a) increase in the rate for Marginal Standing Facility to 10.25 per cent b) ceiling of ₹75000 crore on funding under LAF later revised to 0.5% of the NDTL of the banks c) making it mandatory for banks to have 99% of the CRR on daily basis d) auction of ₹22000 crore Cash Management Bills (CMB) every week. Liquidity tightening measures, though intended to check speculation in the currency market, would also have salutary impact of moderating inflation.

Inflation outlook

2.8 The inflation outlook is likely to be determined by the interplay of commodity prices and the currency as well as the release of suppressed inflation through the revisions in administered prices, particularly of coal, mineral oils and electricity. Price movement in these commodities spills over to general price-level. Though international commodity prices have generally softened, the domestic prices of petroleum products and other tradable like metals, edible oils and pulses would be affected by the depreciation of the Indian rupee vis-à-vis US dollar. Estimates reported in the Macroeconomic and Monetary Developments First Quarter Review 2013-14 of the RBI indicate that a 10 per cent depreciation in the rupee lead to a 1.0 percentage point increase in WPI inflation.

2.9 While food-grain production in 2012-13 has been marginally lower at 255.36 million tonnes as compared to 259.32 million tonnes in 2011-12, the good 2013 monsoon augurs well for lower food inflation in the post-harvest period of 2013-14.

2.10 Based on current trends and the wearing of the base effect post October, WPI inflation is expected to be in the range of 6.5 to 7.2 per cent at the end of 2013-14.

2.11 The Reserve Bank of India in its First Quarter Review of Monetary Policy 2013-14 has projected the inflation to be at a level of 5.0 per cent by March 2014, keeping in view the domestic demand-supply balance, the outlook for global commodity prices, and on the expectation that spatial and temporal distribution of the monsoon during the rest of the season will be normal.

3. TRADE AND EXTERNAL SECTOR

Trade

3.1 Exports declined by 1.8 per cent (on customs basis) to US$ 300.4 billion in 2012-13 from US$ 306 billion in 2011-12. The contraction in exports was more on account of decline in exports of manufactured goods (especially engineering goods) and labour intensive goods such as gem and jewellery. Further, export of iron ore and minerals registered a decline of 33.0 per cent in 2012-13. Unlike exports, imports recorded a marginal increase of 0.3 per cent to US$ 490.7 billion in 2012-13 from US$489.3 billion in 2011-12. The top five items of imports are Petroleum, Oil and Lubricants (POL) items; gold and silver; machinery; electronic goods and pearl, precious & semi-precious stones. Notwithstanding a marginal decline in international prices of crude oil (Indian basket) Imports of POL increased by 5.9 per cent to US$ 164.0 billion in 2012-13 from US$ 155.0 billion in 2011-12, reflecting growing domestic consumption of petroleum products. POL imports accounted for 33.4 per cent of total imports in 2012-13. However in 2012-13, gold imports declined by 9.5 per cent to US$ 55.8 billion from US$ 61.6 billion in 2011-12. Though gold imports declined, it still accounted for 11.4 per cent of total imports. Imports of electronic goods (- 4.0 per cent) and pearl, precious & semi-precious stones (- 19.6 per cent) have also shown negative growth in 2012-13.

3.2 The trade deficit increased to US$ 190.3 billion (10.3 per cent of GDP) in 2012-13 as compared to US$ 183.4 billion (9.8 per cent of GDP) during 2011-12.

3.3 Quarterly growth performance of exports and imports (Table 5) shows that the growth of POL exports, while strong, continued to decelerate from Q3 of 2012-13 to the first quarter of 2013-14. Since the first quarter of 2012-13, non POL exports have registered negative growth, except for the positive growth in Q4 of 2012-13.

Table 5: Growth rate of exports and imports (in %)

Year		Exports			Imports					Trade
		POL Exports	Non POL Exports	Total Exports	POL Imports	Non POL Imports	Gold &Silver	Non POL & NonGold	Total Imports	Balance
2011-12	FY	35.1	19.2	21.8	46.2	26.7	44.7	23.3	32.3	54.6
2012-13	FY	8.6	-4.2	-1.8	5.9	-2.3	-9.5	-0.7	0.3	3.8
2012-13	Q1	-13.7	-1.4	-3.9	-0.2	-7.3	-47.3	3.8	-5.0	-6.9
	Q2	2.1	-10.8	-8.5	12.2	-6.3	-12.5	-5.3	-0.7	13.3
	Q3	32.6	-6.4	0.7	18.3	1.1	24.0	-3.6	6.2	14.5
	Q4	17.5	1.8	4.5	-4.0	3.4	6.3	2.8	0.8	-5.5
2013-14(P)	Q1	5.0	-3.2	-1.7	6.6	4.7	89.3	-7.3	5.3	17.4
2013-14(P)	(Apr.-Aug)			3.9	5.6	-0.3	33.5	-4.6	1.7	-1.7

Note: FY stands for full year and P stands for Provisional
Source: Calculated from the data of Department of Commerce

3.4 On the other hand, POL import growth has shown large fluctuations in various quarters of 2012-13. In the Q1 of the 2013-14, these registered a growth of 6.6 per cent. However, growth rate of non-POL imports, that remained in negative territory in the first two quarters of 2012-13, registered a positive growth in Q3 and Q4 of 2012-13 and in Q1 of 2013-14. This increase is mainly due to higher growth of imports of gold and silver. Growth of non-POL non-gold & silver imports (which reflects the import of capital goods and inputs needed for exports and industrial activity) has mostly remained negative since Q2 of 2012-13, reflecting the slowdown in manufacturing sector in the same period.

3.5 **Direction of Trade**: In the first quarter of 2013-14, the share of India's exports to Asia declined marginally to 49.2 per cent from 50.8 per cent in 2012-13 while that to US increased from 12.0 per cent to 13.8 per cent during the same period. India's exports to Europe and USA have registered a growth of 0.8 per cent and 3.1 per cent respectively in Q1 of 2013-14.

3.6 India's imports from Europe, America (both North and South America) and Africa registered a growth of 21.5 per cent, 10.6 per cent and 11.9 per cent respectively in the first quarter of 2013-14. India's imports from USA registered a growth of 1.5 per cent while imports from Asia registered negative growth of 0.8 per cent in the first quarter of 2013-14. Overall, UAE has emerged as the top trading partner of India and the top export destination is USA.

3.7 **Trade in services:** The share of services exports to total exports improved from 31.5 per cent in 2011-12 to 32.2 per cent in 2012-13. Growth of exports from services declined from 30.2 per cent in 2010-11 to 13.1 per cent in 2011-12 and 3.4 per cent in 2012-13. Services import growth declined from 35.3 per cent in 2010-11 to - 4.5 per cent in 2011-12 but then picked up to 5.0 per cent in 2012-13.

3.8 Sector wise in 2012-13, growth of the export of construction and other business services was 24.9 per cent and 15.8 per cent respectively. On the other hand, the growth of computer services exports was 5.9 per cent while transport, travel, and financial services registered negative growth in 2012-13.

Balance of Payments (BoP) position, Foreign Exchange Reserves, Exchange Rate and External Debt

3.9 The balance of payments position improved significantly in the fourth quarter (January -March 2013) with current account deficit (CAD) at US$ 18.2 billion (3.6 per cent of GDP) as against US$ 31.8 billion (6.5 per cent of GDP) in the third quarter (October – December 2012) of 2012-13. Despite this, India's balance of payment continued to be under stress during the fiscal 2012-13 as both trade and current account deficit widened. However, unlike 2011-12, capital flows were sufficient to finance the CAD as also result in accretion to reserves on a BoP basis in 2012-13 (Table 6).

Table 6: Selected Indicators of Balance of Payments

(US$ billion)

Sl. No.	Items	2011-12(PR)	2012-13(P)
1	**2**	**3**	**4**
1	Exports	309.8	306.6
2	Imports	499.5	502.2
3	**Trade Balance**	**-189.7**	**-195.7**
4	Net Invisibles	111.6	107.5
5	**Current Account Balance**	**-78.2**	**-88.2**
6	External Assistance (Net)	2.3	1.0
7	Commercial Borrowing (Net)	10.3	8.5

Sl. No.	Items	2011-12(PR)	2012-13(P)
1	2	3	4
8	FDI (Net)	22.1	19.8
9	Portfolio	17.2	26.9
10	Errors & Omissions	- 2.4	2.7
11	Capital Account Balance (including Errors & Omission)	65.4	92.0
12	**Change in Reserves (-indicates increase; + indicates decrease) (on BOP Basis)**	12.8	-3.8
	Memo Items/Assumptions		
1	Trade Balance / GDP (%)	(-) 10.1	(-) 10.6
2	Invisible Balance / GDP (%)	6.0	5.8
3	**Current Account Balance / GDP (%)**	**(-) 4.2**	**(-) 4.8**
4	**Net Capital Flows / GDP (%)**	**3.5**	**5.0**

Source : RBI : PR: Partially Revised, P: Preliminary Note: Totals may not tally due to rounding off

3.10 The global factors (such as unfolding of euro zone crisis, the austerity measures in advanced economies, recession in many euro zone countries, risk on/ risk off behaviour of investors and the uncertainty surrounding the future of euro zone) and domestic factors (such as halt in mining activity, supply side bottlenecks in manufacturing) have adversely affected Indiaqs balance of payments. The impact was evident through trade, financial and confidence channels. The fallout for the Indian economy was a sharp deceleration in exports. Despite slowdown, the import bill however did not decline because of the high international oil prices. The high value of gold imports, driven mainly by the ±safe havenq demand for gold also contributed to the high import bill and widening of the trade deficit.

3.11 Net invisible balance registered a decline of 3.7 per cent to US$ 107.5 billion in 2012-13 from US$ 111.6 billion in 2011-12, mainly due to the sizeable increase in outflows on account of net investment income payments from US$ 16.0 billion in 2011-12 to US$ 21.5 billion in 2012-13, while net services and transfer showed modest increase of 1.3 per cent and 0.9 per cent respectively in 2012-13. Even then, the net invisible surplus financed a large proportion of the trade deficit.

3.12 As a consequence of the widening of trade deficit and lower net invisible surplus, current account deficit (CAD) widened to US$ 88.2 billion (4.8 per cent of GDP) in 2012-13 as compared to US$ 78.2 billion (4.2 per cent of GDP) in 2011-12. The increase in CAD-GDP ratio also resulted from a decline in nominal GDP in dollar terms to US$ 1.84 trillion in 2012-13 from US$ 1.87 trillion in 2011-12 on account of depreciation of rupee.

3.13 Net capital inflows rose significantly by 40.8 per cent to US$ 92.0 billion (5.0 per cent of GDP) during 2012-13 from the level of US$ 65.4 billion (3.5 per cent of GDP) in 2011-12, mainly due to a surge in portfolio flows, short term trade credit and NRI deposits. Among the components, net FDI (inward FDI minus outward FDI) was US$ 19.8 billion in 2012-13 as compared to US$ 22.1 billion in 2011-12. Inward FDI moderated to US$ 27.0 billion in 2012-13 vis-à-vis US$ 33.0 in 2011-12. Similarly, outward FDI declined to US$ 7.1 billion in 2012-13 from US$ 10.9 billion in 2011-12. However, portfolio investment witnessed substantial increase to US$ 26.9 billion in 2012-13 as against US$ 17.2 billion during 2011-12 due to an increase in FII inflows to US$ 27.6 billion in 2012-13 from US$ 16.8 billion in 2011-12. In particular, equity investment by FIIs increased significantly while debt investment was lower as compared to the preceding year. Short term trade credit increased to 21.7 billion in 2012-13 from US$ 6.7 billion in

2011-12. Banking capital, including NRI deposits witnessed marginal increase to US$ 16.6 billion (inclusive of NRI deposits of US$ 14.8 billion) in 2012-13 as against US$ 16.2 billion (including NRI deposits of US$ 11.9 billion) in 2011-12. Net external commercial borrowings (ECBs) decreased to US$ 8.5 billion in 2012-13 as against US$ 10.3 billion in 2011-12 mainly due to increased payments.

3.14 As the capital account surplus was more than the current account deficit, there was an accretion in foreign exchange reserves (on BoP basis) of US$ 3.8 billion in 2012-13 as against a drawdown of US$ 12.8 billion in 2011-12. The extent of financing of the CAD by key net capital flows is detailed in the table below.

Table 7: CAD and Net Capital Flows

Items	2007-08	2008-09	2009-10	2010-11	2011-12(PR)	2012-13(P)
			(US$ billion)			
CAD	15.7	27.9	38.2	48.1	78.2	88.2
Net Capital flows	106.6	7.4	51.6	63.7	67.8	92.0
		As proportion of net capital flows (in per cent)				
FDI net	14.9	302.5	34.8	18.6	32.6	21.5
Portfolio net	25.7	- 189.7	62.7	47.5	25.3	29.2
ECB net	21.2	106.3	3.9	19.1	15.3	9.2
Short term debt net	14.9	- 26.8	14.6	18.9	9.8	23.5
All other items	23.3	- 92.3	- 16.0	-4.1	17.0	16.6

PR : Partially Revised; P : Preliminary

Source: Based on information from RBI.

3.15 The extent of the components of capital flows financing CAD varied across the years. Portfolio flows (net) has been a major source of financing CAD; but exhibit volatility. Short-term debt (net) has been a stable component except in 2008-09. Thus, FDI (net) and ECB (net) which correspond to long-term stable nature of flows are important source of financing CAD in the years when other flows are significantly volatile.

Measures taken to improve the Trade Balance

3.16 Raising the level of exports is important for reducing current account deficit as well as the volatility of the exchange rate. This would not only depend on policy frame work prevailing in the country, but also on the global economic situation. A slowdown in the global economy, particularly if there is a slowdown in the major trading partners, would tend to reduce the demand for exports. The policy has to aim at tapping alternative markets, and improving supply response and supply chains so as to minimise the adverse impact of the global economic situation.

3.17 The Government has taken a slew of initiatives to boost exports and to contain imports to lower trade deficit and thereby CAD. Under the Annual Supplement 2012-13 to the Foreign Trade Policy 2009-14, the Government announced a number of initiatives in June and December 2012 to boost exports. These mainly included extension of interest subvention, extension of Export Promotion Capital Goods (EPCG) Scheme, extension of Focus Market Scheme (FMS) and Special FMS Scheme, increased coverage under Focus Product Scheme, introduction of pilot scheme of 2 per cent interest subvention for project exports through EXIM Bank for countries of SAARC region, etc.

3.18 In the Annual Supplement 2013-14 to the Foreign Trade policy 2009-14 released on April 18, 2013 Government announced a number of measures to boost exports and to revive investors’ interest in SEZs. These included:

- Zero Duty Export Promotion Capital Goods (EPCG) scheme and 3 per cent EPCG scheme have been combined into one scheme which will be zero duty EPCG scheme covering all sectors subject to certain conditions.
- Export obligation for domestic sourcing of capital goods has been reduced by 10 per cent to promote domestic manufacturing of capital goods.
- Interest subvention scheme has been further widened to include more items.
- Scope of Market and Product Diversification Schemes has been broadened. The total number of countries under Focus Market Scheme and Special Focus Market Scheme becomes 125 and 50 respectively.
- Approximately, 126 new products have been added under Focus Product Scheme. These products include items from engineering, electronics, and chemicals, pharmaceuticals and textiles sector. Similarly, more products and countries have been have been added under Market Linked Focus Product Scheme (MLFPS).
- The scope of Incremental Export Incentivisation Scheme has been increased. This scheme, available for exports made to USA, EU and Asia, has been extended for the year 2013-14. The Government has identified 53 countries of Latin America and Africa to increase India’s exports in these markets.

3.19 In July 2013, Government increased the rate of interest subvention from 2 per cent to 3 per cent to benefit the exporters of small and medium enterprises and also for the most of the labour intensive sectors.

3.20 In order to lower the import of gold, the Government had raised the import duty from 2 per cent to 4 per cent on gold in the Budget 2012-13, which was enhanced to 6 per cent in January 2013, 8 per cent in June 2013 and further to 10 per cent on August 13, 2013. It further linked the gold imports with the gold exports, whereby 20 per cent of the imported gold has to be channelized to gold exporters. Import duty on silver and other non-essential items was also increased. Further, RBI has also taken number of steps to lower the import demand for gold. These include;

- All gold loan NBFCs shall maintain a loan to value (LTV) ratio, not exceeding 60 per cent for loans granted against the collateral of gold jewellery. This would ensure that these NBFCs maintain reasonable risk cover against such loans.

  In the Annual Policy Statement for 2013-14, the Reserve Bank also proposed to restrict the facility of advances against the security of gold coins weighing up to 50 grams per customer.

- Inflation Indexed Bonds has been introduced in June, 2013 to wean away investors from the gold to other savings instruments and help in moderating gold demand.

3.21 Further, the Reserve Bank of India (RBI) announced a number of measures to promote exports. These included;

- Deregulation of interest rates on export credit in May 2012
- Introduction of US-Dollar swap facility to support incremental pre-shipment export credit in foreign currency up to June 28, 2013, etc.

3.22 Apart from these measures, the Government has revised diesel prices and capped subsidized LPG cylinders to consumers to contain the fiscal burden of subsidies. In January 2013, oil marketing companies were permitted to raise diesel prices in small measures periodically. These measures are also expected to moderate the demand for oil imports. Diesel consumption in April-July 2013 was 23.9 million tonnes as against 24.2 million tonnes in April-July 2012.

Recent developments

3.23 India's BoP data comes with a lag of 3 months. The data for the first quarter (April-June 2013) of 2013-14 will be available at the end of September 2013. However, it would be useful to look at higher frequency indicators of trade, services and capital inflows that are available.

Merchandise trade

3.24 In the first quarter of 2013-14, exports totalled US$ 72.3 billion down 1.7 per cent vis-à-vis first quarter of 2012-13. On the other hand, imports were at US$122.7 billion, up by 5.3 per cent. Consequently, the trade deficit at US$ 50.5 billion was higher by 17.4 per cent in the first quarter of 2013-14. In 2013 (April-June), export of petroleum, chemicals & related products and textiles registered growth of 5.0 per cent, 6.2 per cent and 9.0 per cent respectively. However, growth of exports of items like gems and jewellery, agriculture & allied products and engineering goods was (-) 7.7 per cent, (-) 6.8 per cent and (-) 7.3 per cent respectively.

3.25 Exports growth (y-o-y) rose to 13.0 per cent in August 2013, while imports declined by 0.7 per cent. Consequently, the trade deficit in April-August 2013, at US$ 73.4 billion, was lower by US$ 1.3 billion as compared to the corresponding period of the previous year.

3.26 **Services:** Provisional figures show that, services exports have shown increase every month since April 2013 and overall service exports grew by 6.2 per cent while imports fell by 1.0 per cent in first quarter of 2013-14, resulting in net services export growing to US$ 17.4 billion, growth of 16.2 per cent vis-à-vis first quarter of 2012-13.

3.27 **Capital flows:** During April-June 2013, foreign direct investment to India (inward FDI) was US$ 7.6 billion vis-à-vis US$ 5.9 billion in April-June 2012. FDI by India (outward FDI) was US$ 0.9 billion in April-June 2013 as against US$ 2.1 billion in April-June 2012. Net FDI inflows were US$ 6.7 billion in April-June 2013 vis-à-vis US$ 3.8 billion in April-June 2012. During 2013-14 (up to August 23, 2013), FIIs recorded net outflow of US$ 7.1 billion as against net inflow of US$ 1.4 billion in same period of previous year. Capital Inflows under NRI deposits amounted to US$ 5.5 billion in April-June 2013 as compared to US$ 6.6 billion in April-June 2012.

3.28 **Foreign Exchange Reserves**: The foreign exchange reserves stood at US$ 275.5 billion at end August 2013, indicating a decline of US$ 16.5 billion from the level of US$ 292.0 billion at end March 2013. A large part of the decline in reserves could be attributed to the valuation loss on account of appreciation of US dollar against other major international currencies.

3.29 **Exchange Rate:** In recent times, the most significant development in external sector has been the movement in the exchange rate of rupee. As on April 03, 2012, the exchange rate of the rupee was ₹ 50.58 per US dollar. Between August 2012 and May 2013, the exchange rate of the rupee remained stable in the range of ₹53-55 per US dollar. After May 2013, however, the monthly average exchange rate of the rupee started depreciating and stood at ₹58.40 per US dollar in June 2013, ₹59.78 per US dollar in July 2013 and ₹63.21 per US dollar in August 2013. The monthly average exchange rate of the rupee during 2013-14, month-wise, is given in Table 8.

Table 8: Monthly average exchange rate (Rupee per foreign currency)*

Month	US$	Pound Sterling	Euro	Japanese Yen**
1	2	3	4	5
2013-14				
April 2013	54.38	83.20	70.77	55.71
May 2013	55.01	84.11	71.38	54.51
June 2013	58.40	90.47	77.07	59.99
July 2013	59.78	90.78	78.20	60.00
August 2013	63.21	97.87	84.18	64.57

** RBI's Reference Rate*

*** Per 100 Yen; Source: Reserve Bank of India.*

3.30 The fall in the value of the rupee in the recent period can be explained by the supply-demand imbalance due to elevated levels of current account deficit (CAD) and volatility in capital flows, particularly FII inflows, strengthening of US dollar due to the *safe haven* status of US Treasuries, heightened risk aversion and deleveraging due to the euro area crisis that impacted financial markets across advanced and emerging market economies along with ±isk-offqinvestor sentiment triggered by apprehensions of possible tapering off of quantitative easing by the US Federal Reserve Bank. Another contributory factor is the strengthening of the US dollar vis-à-vis other international currencies. Apart from the global factors, domestic factors like higher inflation have also added to the weakening trend of the rupee.

3.31 Rupee depreciation has been broadly in line with other emerging market currencies, which have also weakened, as financial markets across the globe re-priced risks. Despite Government measures for addressing it (Box-5), the rupee has remained weaker than warranted by BoP indicators.

Box 5: Initiatives to Contain Current Account Deficit and Promote Capital Inflows

There has been considerable concern about the volatility in the currency market and the elevated level of current account deficit (CAD). While financing the CAD in 2011-12, there was draw upon of reserves to the extent of USD 12.8 billion. In 2012-13, though the CAD was at higher level (4.8 per cent of GDP) as compared to 2011-12 (4.2 per cent of GDP), it was safely financed and there was accretion of US$ 3.8 billion to the reserves. The concerns of CAD are reflected in the pressure on the exchange rate. Initiatives have also been taken by the Government and the RBI to contain the CAD, reduce volatility in the currency market and stabilise the Indian rupee.

Recently, there have been extensive consultations among the Ministry of Finance, the Ministry of Commerce & Industry, Ministry of Petroleum & Natural Gas and the Reserve Bank of India. The CAD in the current year is expected to be fully and safely financed in the current year. The measures taken to reduce the CAD include: (i) compression in import of gold and silver, (ii) compression in demand for oil, and (iii) compression in certain imports (non-essential nature). As a result of these measures, it is expected that the CAD will be contained at USD 70.0 billion

Measures have also been initiated to promote capital inflows, which include: (i) raising quasi-sovereign bonds by public sector Financial Institutions to finance long term infrastructure, (ii) liberalising ECB guidelines, (iii) raising of additional funds by PSU oil companies through ECBs and trade finance, and

(iv) liberalising NRE/FCNR deposit schemes. These measures are estimated to raise additional capital inflows to the tune of US$ 11 billion in 2013-14. Combined with the shrinkage in CAD, and assuming no net FII inflows over the year, there will be a small accretion to the reserves at the end of the current year.

3.32 To a large extent, the recent currency depreciation is an emerging market phenomenon. Both current account surplus and deficit countries have witnessed depreciation in their respective currencies. However, the rate of depreciation in currencies of countries with current account deficit (e.g. Brazil and India) has been higher than in countries with current account surplus.

Table 9: Movement in Exchange Rates of Select EMEs against US Dollar - Appreciation (+) / Depreciation (-) in per cent

Sl. No.	Currency	end-March 2011@	end-March 2012 @	end-March 2013 @	August 22 2013 over end-March 2013
	Deficit Countries				
1	Brazilian Real	9.7	-10.8	-9.2	-16.5
2	Indian Rupee	1.1	-12.7	-5.9	-16.9
3	Mexican Peso	4.3	-7.0	3.8	-6.2
4	South African Rand	8.0	-11.5	-16.6	-10.9
5	Turkish Lira	-4.8	-10.5	-1.5	-9.1
	Surplus Countries				
1	Argentina	-4.3	-7.5	-14.5	-8.7
2	Indonesian Rupiah*	4.7	-5.1	-5.5	-10.2
3	Malaysian Ringgit	8.2	-1.4	-1.1	-6.5
4	South Korea Won	2.2	-2.7	2.6	-0.8
5	Thai Baht	6.7	-1.8	5.4	-8.8
6	Russian Rouble	3.4	-2.8	-5.4	-6.6
7	Euro	5.4	-6.0	-4.1	4.0
8	China	4.1	4.2	0.3	1.7

@: Appreciation and depreciation are calculated on year-on-year basis.

** Since Q4 of 2011, Indonesia has turned into a current a/c deficit country*

3.33 In addition to the recent announcements, various policy measures have been undertaken by the Government of India and Reserve Bank of India over the last several months to improve capital inflows and reduce volatility in the foreign exchange market. These, *inter alia*, include; liberalization of norms for FDI in certain sectors, RBI's intervention in the foreign exchange market, enhancing FII limits in government and corporate debt market, enhancement of all-in-cost ceilings for trade credit, increase in ECB limit for Non-Banking Financial Companies NBFC-IFCs under the automatic route, liberalisation of interest rates on foreign currency non-resident deposits and measures to curb speculation in the foreign exchange market.

External Debt

3.34 India's external debt stock stood at US$ 390.0 billion at end-March 2013, recording an increase by US$ 44.6 billion (12.9 per cent) over the end-March 2012 level of US$ 345.5 billion. The rise in external debt during the period was primarily on account of short-term trade credit, external commercial borrowings and NRI deposits. India's external debt has remained within manageable limits as indicated by the external debt to GDP ratio of 21.2 per cent and debt service ratio of 5.9 per cent in 2012-13.

3.35 Long-term external debt at US$ 293.4 billion accounted for 75.2 per cent of the total external debt, while the remaining 24.8 per cent was short-term debt at end-March 2013 (More about short term debt in **Box 6**). Government (Sovereign) external debt at US$ 81.7 billion, accounted for 20.9 per cent of the total external debt (23.7 per cent at end-March 2012). The share of concessional debt in total external debt stood at 11.7 per cent as compared to 13.9 per cent at end-March 2012.

3.36 The US dollar denominated debt accounted for 57.2 per cent of the total external debt stock followed by Indian rupee (24.0 per cent), SDR (7.5 per cent) and Japanese Yen (6.3 per cent).

3.37 Key indicators of total external debt namely debt to GDP ratio, ratio of short-term to total debt and short-term to foreign exchange reserves are shown in Table 10.

Box 6: Short term debt by Residual Maturity

Recently, some economic analysts expressed concern about increase in external sector repayments alluding to the short term debt by residual maturity which was estimated by RBI to be around US$ 172.3 billion at end March 2013, indicating rising external sector vulnerability. Short term debt includes (i) trade credit up to 180 days as well as above 180 days and up to 1 year, (ii) FII investments in Government Treasury Bills and corporate securities, (iii) investments by foreign central banks and international institutions in Treasury Bills, and (iv) external debt liabilities of central bank and commercial banks. Short term debt by residual maturity of US$ 172.3 billion at end March 2013 (as estimated by RBI) include short term debt by original maturity (US$ 96.7 billion) that accounts for 56.2 per cent of short term debt and long-term debt payable within one year.

While short-term debt by residual maturity of US$ 172.3 billion looks large, being a stock figure on a particular date, it would be useful to look at the biggest component, namely, trade credit in terms of flows on a day-to-day basis. Trade credits account for US$ 86.8 billion of external debt, which represents only the repayment side of the flows. On a day-to-day basis, some trade credits accrue on a gross basis that help in the repayment of these obligations contracted earlier. On BoP basis, in 2012-13, India repaid US$ 101.0 billion of trade credits from a fresh inflow of trade credits of US $ 122.7 billion, yielding a net inflow of US$ 21.7 billion.

With the exception of 2008-09 when there was a diminution in inflows relative to outflows, there has been a net inflow under short-term trade credits on BoP basis. In 2008-09 the net outflows for the year as a whole were minimal, despite what many analysts call a near 'sudden stop'. As such, a large part of the short-term debt by residual maturity is being financed without recourse to any drawdown of reserves or dipping into other forms of capital flows. While in terms of traditional vulnerability indicators, a rising short-term trade credit would imply greater vulnerability to sudden stop, the level of reserves is adequate to meet the financing needs as effectively as was done in 2008.

The other major component of short-term debt by residual maturity is NRI deposits, which accounted for 28.5 per cent of short-term debt by residual maturity at end March 2013. These have been typically rolled over year-after-year. Besides, NRI deposits, of which withdrawals are partly done in rupee terms domestically, constitute an important source of the capital flows on a net basis that help finance CAD.

Another major component is ECB, accounting for 12.2 per cent of short-term debt by residual maturity at end March 2013. ECBs are essentially long term debt and, as a matter of policy, preferred to short-term debt. Some of these do mature in 2013-14. However, as long as such flows are positive on a net basis (BoP accounts), these are going to help finance the current account deficit (CAD).

Though India's external debt increased during 2012-13, it remained within manageable limits as indicated by external debt - GDP and debt service ratios.

Table 10: Key External Debt Indicators (per cent)

Year	External Debt (US$ million	Debt Service Ratio	Ratio of Foreign Exchange Reserves to Total Debt	Ratio of Total External Debt to GDP	Ratio of Concessional Debt to Total Debt	Ratio of Short-term Debt to Foreign Exchange Reserves	Ratio of Short-term Debt to Total Debt
1	2	3	4	5	6	7	8
2004-05	134,002	5.9 [a]	105.6	18.1	30.7	12.5	13.2
2005-06	139,114	10.1 [b]	109.0	16.8	28.4	12.9	14.0
2006-07	172,360	4.7	115.6	17.5	23.0	14.1	16.3
2007-08	224,407	4.8	138.0	18.0	19.7	14.8	20.4
2008-09	224,498	4.4	112.2	20.3	18.7	17.2	19.3
2009-10	260,935	5.8	106.9	18.2	16.8	18.8	20.1
2010-11	305,861	4.4	99.7	17.5	15.5	21.3	21.2
2011-12PR	345,498	6.0	85.2	19.7	13.9	26.6	22.6
2012-13QE	390,048	5.9	74.9	21.2	11.7	33.1	24.8

PR: Partially Revised; QE: Quick Estimates.

[a] *Works out to 5.7 per cent, with the exclusion of pre-payment of US$ 381 million.*

[b] *Works out to 6.3 per cent, with the exclusion of India Millennium Deposits (IMDs) repayments of US$ 7.1 billion and pre-payment of US$ 23.5 million.*

3.38 The cross-country comparison of external debt based on the World Bank’s annual publication titled ‘International Debt Statistics 2013’ which contains the external debt data for the year 2011 indicates that India continues to be among the less vulnerable countries. India’s position was fourth highest in terms of absolute external debt stock, after China, Russian Federation and Brazil in 2011. However, the ratio of India’s external debt stock to gross national income (GNI) at 18.3 per cent was the third lowest, with China having the lowest ratio at 9.4 per cent.

4. FISCAL POLICY AND PUBLIC FINANCE

4.1 Union Government Budget 2013-14 was presented in the midst of multi-pronged uncertainties arising from both domestic and global economic dynamics. High level of twin deficits (fiscal deficit and current account deficit), besides slow growth in the previous quarters along with moderate growth forecast in 2013-14 were major challenges before the Government. In the post-crisis recovery period, disciplined approach to fiscal deficit was needed to check persistent inflation, to anchor inflationary expectations and to provide sufficient cushion to monetary policy to bring back interest rates to a level where positive and pro-growth market sentiments could be generated to boost investment.

Budget 2012-13: BE, RE and Provisional Actuals

4.2 At the time of budget 2012-13, fiscal deficit was estimated to be 5.1 per cent of GDP and the revised estimate came in at 5.2 per cent which was in line with the target recommended by the Kelkar Committee in September 2012 (Table 11). The provisional data for the year 2012-13 show a significant consolidation with the fiscal deficit declining to 4.9 per of GDP. Correspondingly revenue deficit and primary deficit also declined to 3.6 per cent and 1.8 per cent respectively. This was achieved through higher non-debt receipts and compression in non-essential expenditure (Figure 5).

Table 11: Major Deficit Indicators of Union Government (As per cent of GDP)

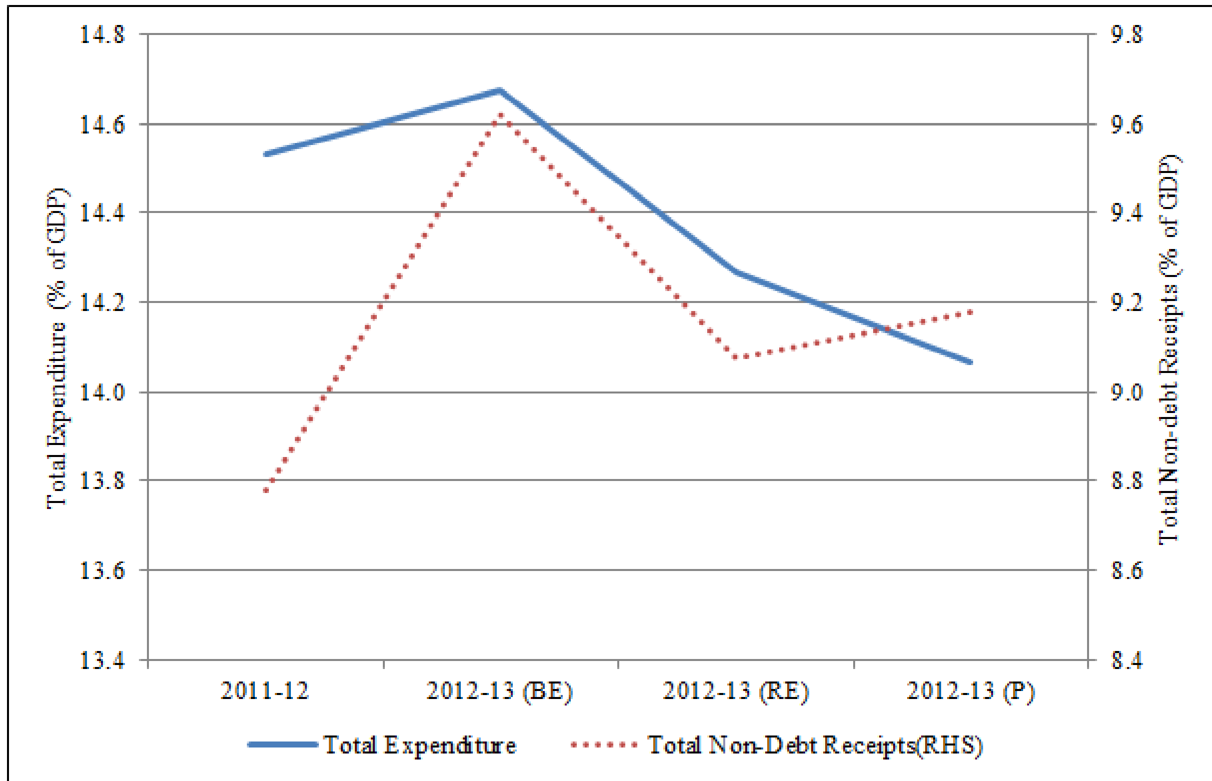
Year	Revenue Deficit	Fiscal Deficit	Primary Deficit
2012-13(BE)	3.4	5.1	1.9
2012-13(RE)	3.9	5.2	2.0
2012-13(P)	3.6	4.9	1.8
2013-14(BE)	3.3	4.8	1.5

Source: Budget documents and Controller General of Accounts.

Notes:1.BE= Budget estimates; RE= Revised Estimates; P=Provisional Actual.

2.The ratios to GDP at current market prices are based on CSO’s National Accounts 2004-05 series.

Figure 5: Movement of Total Expenditure and Total Non-debt Receipts



4.3 The upward revision of total non-debt receipts was led by spurt in non-tax revenue whereas downward revision in total expenditure was mainly on account of decline in non-plan and plan expenditure in provisional actual over revised estimates of 2012-13 (Table 12).

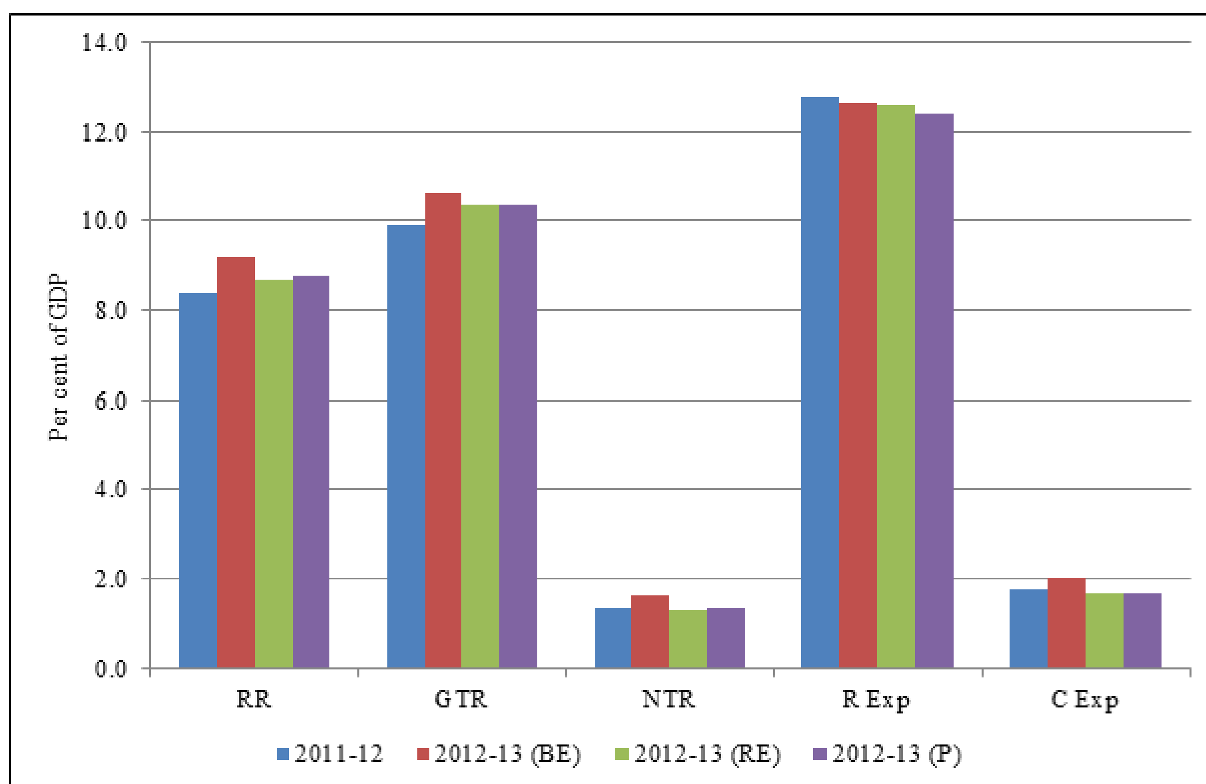
Table 12: Budget 2012-13: BE, RE and Provisional Actuals (₹ in crore)

Items	2011-12 Actual	2012-13			Provisional 2012-13 as per cent of BE	Provisional 2012-13 as per cent of RE	per cent change 2012-13 (P) over 2011-actual
		BE	RE	Provisional			
1	2	3	4	5	6	7	8
1. Revenue Receipts	751437	935685	871828	878804	93.92	100.8	16.9
Gross tax revenue	889176	1077612	1038037	1036719	96.21	99.9	16.6
2.Tax (net to Centre)	629486	771071	742115	741062	96.11	99.9	17.7
3.Non-Tax Revenue	121672	164614	129713	137742	83.68	106.2	13.2
4. Non-Debt Capital Receipts	36938	41650	38073	40728	97.79	107.0	10.3
5. Total Expenditure	1304365	1490925	1430825	1409422	94.53	98.5	8.1
(a) On Revenue Account	1145785	1286109	1263072	1242263	96.59	98.4	8.4
(b) On Capital Account	158580	204816	167753	167159	81.61	99.6	5.4
6. Revenue Deficit	394348	350424	391244	363459	103.72	92.9	-7.8
7. Effective Revenue Deficit	262045	185752	266969	247755	133.38	92.8	-5.5
8. Fiscal Deficit	515990	513590	520924	489890	95.39	94.0	-5.1
9. Primary Deficit	243119	193831	204250	177894	91.78	87.1	-26.8

Efforts at Fiscal Consolidation

4.4 During 2012-13, fiscal consolidation remained the main priority of the Central Government. Government imposed measures such as rationalisation of expenditure and optimisation of available resources with a view to improve overall macroeconomic environment. This includes 10 per cent mandatory cut in non-plan expenditure in the current financial year, ban on creation of plan and non-plan posts, restriction on foreign travel, restriction on re-appropriation of funds, observance of discipline in fiscal transfers to States, Public Sector Undertakings, Autonomous Bodies, etc (See Box-7). A comparative graph (Figure 6) of various budgetary indicators as per cent of GDP elaborates the path of fiscal consolidation in the second half of the financial year 2012-13 vis-à-vis 2011-12 actuals and budget estimates of 2012-13.

Figure 6: Various Budgetary Indicators as Per cent of GDP



RR : Revenue Receipts, GTR : Gross Tax Revenue, NTR : Non-Tax Revenue, R Exp : Revenue Expenditure, C Exp : Capital Expenditure

Notes: 1. BE : Budget Estimate; RE : Revised Estimate; P : Provisional Actual.

2. The ratio to GDP at current market prices are based on CSO's National Account 2004-05 series

Box 7: Steps Taken by Central Government for Fiscal Consolidation

i. Based on the Kelkar Committee recommendations on fiscal consolidation, the Government adopted the following measures:

   a. new measures for disinvestment of residual stake in some companies that were privatised earlier.

   b. rationalisation of schemes and strict control and monitoring of expenditure to contain and economise on expenditure, both on plan and non-plan.

   c. efforts to avoid parking or idling of funds but without compromising on funds made for essential expenditure.

ii. Restricted expenditure on central subsidies and partially deregulated the diesel prices.

iii. Modest beginning on Direct Benefit Transfer scheme by covering about 11 lakh beneficiaries.

iv. Setting forth a three-year rolling target for expenditure indicators in the 'Medium-term Expenditure Framework Statement' with a view to undertake a *de-novo* exercise for allocating resources for prioritized schemes and weeding out others that have outlived their utility.

v. Streamline and reduce the number of Centrally Sponsored Schemes and to address plan and non-plan classifications while implementing the 12th Five Year Plan based on the recommendations made by the Expert Committee in this regard. The Central Plan Scheme Monitoring System would be expanded to facilitate better tracking and utilization of funds released by the Central Government.

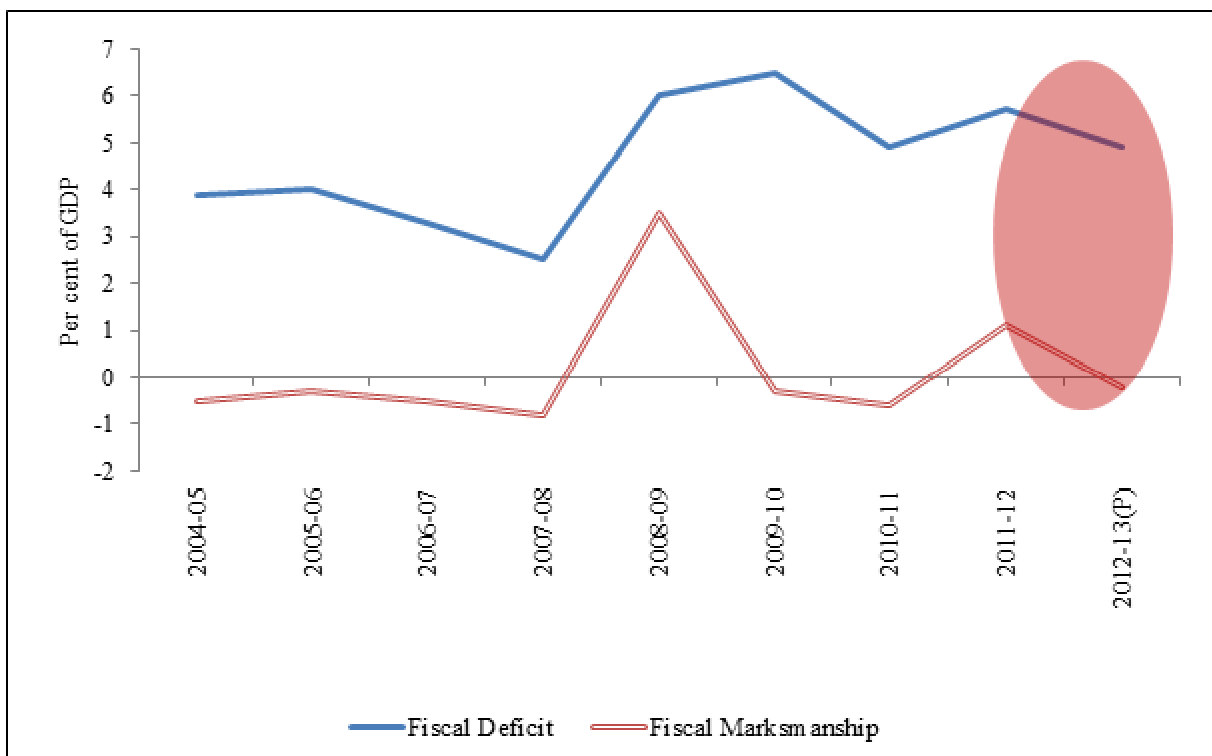
vi. As a combined result of the various measures, the Government expects fiscal deficit to come down as follows during the remaining four years of the 12th Five Year Plan period.

Year	Fiscal Deficit (As per cent of GDP)
2013-14	4.8
2014-15	4.2
2015-16	3.6
2016-17	3.0

Fiscal Marksmanship

4.5 Fiscal Marksmanship is defined as fiscal deficit (actual) minus fiscal deficit budgeted, as a proportion of GDP. It is an indicator to measure the consistency between fiscal targets announced in the budget and post-budget efforts of the government to bring the actual outcomes closer to budget estimates. It would be useful to note that in the post-FRBM period, fiscal marksmanship of the Central Government has been one of over performance except in 2008-09 and 2011-12. While overshooting of the deficit targets in 2008-09 was a conscious decision to obviate the adverse impact of the global financial crisis, the slippage in year 2011-12 was mainly on account of a confluence of adverse economic outcomes arising from global and domestic factors. Consequent to the various steps taken by the Government (mentioned in Box-7) on fiscal consolidation in the second half of 2012-13, fiscal deficit of the Central Government has been brought down to 4.9 per cent of the GDP which is reflected in restoring healthy fiscal marksmanship (Figure 7).

Figure 7: Trend of Fiscal Deficit and Fiscal Marksmanship



Budget 2013-14

4.6 Fiscal deficit, revenue deficit and effective revenue deficit for the year 2013-14 is estimated at 4.8, 3.3 and 1.8 per cent of GDP respectively at the time of Budget 2013-14. Budget 2013-14 also reiterated that the fiscal deficit would be reduced to 3 per cent, revenue deficit to 1.5 per cent and effective revenue deficit to zero by 2016-17. The emphasis is also on the quality of expenditure and that will be ensured by re-prioritisation of expenditure for developmental purposes and cautiously curtailing the growth in non-developmental expenditure without harming the planned growth path. Total expenditure is estimated to be brought down to 14.6 per cent of GDP in 2013-14 (BE). In the medium term projection, it is estimated to further decline to 13.7 per cent of GDP in 2014-15 and 13.1 per cent of GDP in 2015-16.

Recent trends

Review of First Quarter of FY 2013-14

4.7 According to the data released by Controller General of Accounts on 31st July 2013 Gross Tax Revenue (GTR) recorded positive but low growth of 4.2 per cent in the first quarter of 2013-14 over the corresponding period of the last financial year (Table 13). Despite positive growth in GTR, the Tax Revenue (net to Centre) and Revenue Receipts recorded a negative growth in this period mainly on account of higher devolution to States as compared to the first quarter of 2012-13. The first quarter realisation for both revenue receipts and GTR as per cent of Budget Estimates is one of the lowest since 2005-06, which is probably an outcome of overall economic slowdown.

4.8 On expenditure front, data of the first quarter of FY 2013-14 shows that non-plan expenditure and plan expenditure are at 24.1 and 20.7 per cent of BE respectively which are higher than last five years moving average of 21.5 and 20.3 per cent respectively. The receipts of the Central Government in the first quarter of FY 2013-14 were only sufficient to cover 31.2 per cent of the total expenditure of the central Government, leaving a deficit of ₹ 262,823 crore which is at 48.4 per cent of BE. The fiscal deficit has gone up by ₹ 72,363 crore compared to that in April-June 2012 and to finance the fiscal deficit, an internal debt of ₹ 136,616 crore was raised along with other sources of financing (Table 13).

Table 13: First Quarter Budgetary Indicators at Glance

	Budget Estimates	April-June		Per cent change over preceding year	
	2013-14	2012-13	2013-14	2012-13	2013-14
		(₹ crore)			
1. Revenue Receipts	1056330	118720	117234	30.6	-1.3
Gross tax revenue	1235870	169994	177066	25.0	4.2
2. Tax (net to Centre)	884078	104505	101910	32.8	-2.5
3. Non-Tax Revenue	172252	14215	15324	16.3	7.8
4. Non-Debt Capital Receipts	66468	2402	2172	-68.58	-9.58
5. Total Expenditure	1665297	311582	382229	19.3	22.7
(a) Revenue Account	1436168	271432	327709	20.3	20.7
(b) Capital Account	229129	40150	54520	-9.4	63.9
6. Revenue Deficit	379838	152712	210475	13.4	37.8
7. Effective Revenue Deficit	205182	130026	173293	18.7	33.3
8. Fiscal Deficit	542499	190460	262823	17.1	38.0
9. Primary Deficit	171815	129830	201342	15.4	55.1

4.9 The latest data indicate that the overall tax collections increased by 13.1 per cent in July 2013 primarily due to strong trends in direct taxes. Negative growth in excise tax which is a reflection of slowdown in manufacturing sector remains a cause of concern. On the expenditure front, in contrast to the more than 20 per cent increase in April-June 2013, the expenditure growth moderated to 10.5 per cent in July which resulted in cumulative expenditure growth in April-July at 19.2 per cent, marginally higher than the budgeted growth of 18%.

Outlook

4.10 The achievements on fiscal consolidation and fiscal marksmanship in the FY 2012-13 set the bench mark for the current fiscal year to bring the economy on the track of inclusive, sustained and faster economic growth with moderate level of inflation. This has been the core objective of many recent policy initiatives. The performance of the Central Government in the first quarter of the current fiscal may not sound optimistic, but, overshooting of government expenditure and underperformance of revenue receipts in the first quarter is a reflection of the current macroeconomic environment and as per the trends in the first quarter for most of the previous years.

5. MONETARY POLICY AND FINANCIAL SECTOR

Monetary policy:

5.1 The monetary policy stance of Reserve Bank of India for 2013-14 released on May 3, 2013, was based on its projection of macroeconomic parameters for 2013-14. In its Monetary Policy Statement for 2013-14, RBI expected GDP growth at 5.7 per cent. WPI inflation was expected to range around 5.5 per cent and M3 growth was projected at 13.0 per cent. Aggregate deposits of scheduled commercial banks (SCBs) were projected to grow by 14.0 per cent and the growth in non-food credit of SCBs was projected at 15.0 per cent. Further, on the basis of assessment of the macroeconomic situation, the RBI reduced the Repo rate under the LAF by 25 basis points from 7.50 per cent to 7.25 per cent, the Reverse repo rate under the LAF, determined with a spread of 100 basis points below the repo rate, stood adjusted to 6.25 per cent and the Marginal Standing Facility (MSF) rate, determined with a spread of 100 basis points above the repo rate, also stood adjusted to 8.25 per cent. Cash reserve ratio (CRR) of scheduled banks was retained at 4.0 per cent of their net demand and time liabilities (NDTL).

5.2 In its First Mid Quarter Review of June 17, 2013, RBI kept the Policy rates unchanged.

5.3 The market perception of likely tapering of US Quantitative Easing (QE) triggered outflows of portfolio investment, particularly from the debt segment. Consequently, the Rupee depreciated markedly in the last six weeks. Countries with large current account deficits, such as India, have been particularly affected. The exchange rate pressure partly signalled increase in speculative demand for foreign currency. In order to restore stability to the foreign exchange market, since early July, RBI has taken various steps to

curb the volatility in the INR including restricting banks from trading currency derivatives, cutting net open positions on currency futures and raising related margin requirements.

i. This was followed by a host of measures on **July 15**, which include; (i) raising the Marginal Standing Facility (MSF) rate by 200 bp, to 10.25 per cent. (banks generally access the MSF window if they cannot meet their funding requirements via the LAF), (ii) consequently raising the Bank Rate, which is linked to the MSF rate and is normally used as a benchmark for the penal interest rate if banks fall short on their required reserves to 10.25 per cent (iii) limiting the overall borrowing under the LAF to 1.0 per cent of the Net Demand and Time Liabilities (NDTL) or Rs. 750 billion and (iv) Announcing open market sales to the tune of Rs. 120 billion.

ii. On **July 23,** the RBI modified the liquidity tightening measures where-in it capped individual banks access to the LAF window at 0.5 per cent of its own NDTL and made it mandatory for banks to maintain 99 per cent of the cash reserve ratio (CRR), on a daily basis, against the earlier 70 per cent.

iii. On **August 8**, the RBI announced the auction of 35 days & 34 days Government of India Cash Management Bills (CMB) totalling Rs 220 billion in a bid to further tighten liquidity and keep the short end of the interest rate curve high.

Performance under Money and Banking during the current financial year

5.4 Money Stock: Broad money (M_3) (up to June 28, 2013) increased by 4.3 per cent as compared to 5.3 per cent during the corresponding period of the last year. The year-on-year growth, as on June 28, 2013 was 12.8 per cent as compared to 13.7 per cent last year.

5.5 During the financial year 2013-14, reserve money (M_0) (up to July 5, 2013) showed increase of 0.7 per cent as compared to 0.6 per cent in the corresponding period of the previous year. An important source of reserve money, namely, net foreign exchange assets (NFA) of the RBI showed increase of 6.3 per cent (during the financial year) as on June 28, 2013 as compared to increase of 6.0 per cent in the same period last year.

Scheduled Commercial Banks (SCBs): Business in India

5.6 Bank credit increased by 2.9 per cent in 2013-14 (up to June 28, 2013) as compared to increase of 1.2 per cent during the corresponding period of last year. Non-Food credit during this period increased by 2.7 per cent as compared to increase of 0.6 per cent during the corresponding period of last year. The aggregate deposits with Scheduled Commercial Banks(SCBs) increased by 5.0 per cent (as on June 28, 2013) as against an increase of 2.7 per cent in the corresponding period of last year.

SECTORAL DEVELOPMENTS

Having discussed the major macro-economic issues, some of the sectoral developments of the first quarter of 2013-14 are discussed below.

6. AGRICULTURE & ALLIED SECTORS

6.1 Agriculture plays the significant role in the all-round socio economic development of the country, however, its share in GDP has been declining over the years to 13.7 per cent currently. The average annual growth rate of 3.3 per cent during the 11th Five Year Plan has fallen short of the 4 per cent growth target, but has been much faster than the 9th and 10th Five Year Plan annual average growth rate of 2.5 and 2.4 per cent respectively. The growth target set for agriculture for the 12th Five Year Plan is 4 per cent. The good monsoons in 2013-14 bode well for strong agricultural output this fiscal.

Rainfall Distribution in 2013

6.2 Given limited area under irrigation, Indian agriculture is dependent on the monsoons. The June . September monsoons accounts for 75 per cent of total annual rainfall. During 2013 south-west monsoon season so far (as on 24.7.2013), the country as a whole received rainfall 16 per cent above the long period average (LPA). At the meteorological sub-division level, out of 36, 18 met sub-divisions received excess rainfall, 11 met sub-divisions received normal rainfall and 7 met sub-divisions received deficit rainfall. The good monsoons this year is expected to further improve the farm gains with early indications of a 9 per cent year-on-year increase in sown area. As per latest information available on sowing of crops, as on 16.8.2013, area sown under kharif crops taken together has been reported to be 930.52 lakh hectares at All India level as compared to 852.60 lakh hectares in the corresponding period of last year.

Agricultural Production

6.3 As per the 4th advance estimates released by Ministry of Agriculture on 22.7.2013, production of food grains during 2012-13 is estimated at 255.36 million tonnes compared to 259.29 million tonnes (Final estimates) in 2011-12. Crop wise, (comparing the fourth advance estimates) there is a slight increase in the production of rice from 104.32 million tonnes in 2011-12 to 104.40 million tonnes in 2012-13. However, the production of wheat has declined marginally from 93.90 million tonnes to 92.46 million tonnes in the same period. Sugarcane production has been 357.67 million tonnes and 338.96 million tonnes as per these two estimates respectively.

Food Management

6.4 The governmentɋs food management policy continues to make satisfactory progress in terms of procurement, off take and building stocks. Procurement of rice as on 3rd June, 2013 was 34.13 million tonnes in Kharif Marketing Season as against 32.86 million tonnes procured last year in the corresponding period. Wheat procurement during Rabi Marketing Season 2013-14 is 25.03 million tonnes as compared to 34.77 million tonnes during the corresponding period last year. Stocks of food-grains (rice and wheat) held by FCI as on July 1, 2013 were 73.91 million tonnes, as compared 80.52 million tonnes as on July 1, 2012.

6.5 Off-take of rice during the month of May, 2013 was 23.84 lakh tonnes. This comprises 21.67 lakh tonnes under TPDS and 2.17 lakh tonnes under other schemes. In respect of wheat, the total off take was 18.95 lakh tonnes comprising 15.23 lakh tonnes under TPDS and 3.72 lakh tonnes under other schemes.

6.6 Increasing the production and productivity of Indian agriculture and ensuring food security are among the key priority areas of the government. To increase the production of agricultural crops and ensure food security for the growing population in the country, the government is implementing various crop development schemes/ programmes such as National Food Security Mission (NFSM), Rashtriya Krishi Vikas Yojana (RKVY), Macro Management of Agriculture (MMA), Integrated Scheme of Oilseeds, Pulses, Oil Palm & Maize (ISOPOM), etc.

Minimum Support Prices

6.7 The government's price policy for agricultural produce seeks to ensure remunerative prices to growers for their produce with a view to encouraging higher investment and production as well as safeguarding the interest of consumers by making available supplies at reasonable prices. Considering the relevant factors, that include encouraging farmers with remunerative prices, the government fixed the MSPs of kharif crops for the year 2013-14 (Table 14).

6.8 The average annual increase in MSPs in the past few years has been substantial. While this has benefitted the farmers, a moderation of MSP increase would be useful to reduce pressure on food inflation. Other measures to ease food prices include efforts to enhance the production and productivity of agricultural crops.

6.9 The actual stock position in the central pool in recent years has been considerably higher than the minimum buffer norms. This provides an additional instrument to stabilize food prices by way of offloading excess stock in the domestic market through open market sales or for exports. Open market sales will therefore continue to be important, as well as policies encouraging greater private warehousing and stocks in non-food grain crops to promote diversification.

Table 14 : Minimum Support Prices (Rs. Per quintal)

	2011-12	2012-13	2013-14	Difference between 2013-14 and 2012-13 Prices
Kharif Crops				
Paddy (Common)	1080	1250	1310	60
Paddy (Gr.A)	1110	1280	1345	65
Jowar (Hybrid)	980	1500	1500	0
Jowar (Maldandi)	1000	1520	1520	0
Bajra	980	1175	1310	135
Maize	980	1175	1310	135
Ragi	1050	1500	1500	0
Arhar (Tur)	3200	3850	4300	450
Moong	3500	4400	4500	100
Urad	3300	4300	4300	0
Groundnut in shell	2700	3700	4000	300
Sunflower	2800	3700	3700	0
Soyabean (Black)	1650	2200	2500	300
Sesamum	3400	4200	4500	300
Nigerseed	2900	3500	3500	0
Cotton (Medium staple)	2800	3600	3700	100
Cotton (Long staple)	3300	3900	4000	100
Rabi Crops				
Wheat	1120	1285	1350	65
Barley	780	980	980	0
Gram	2100	2800	3000	200
Masur (lentil)	2250	2800	2900	100
Rapeseed/mustard	1850	2500	3000	500
Safflower	1800	2500	2800	300

Note: i) Inclusive of bonus wherever applicable, ii) Recommended prices by CACP, wherever prices are yet to be fixed.Source: Department of Agriculture and Cooperation, CACP

7. INDUSTRIAL SECTOR

7.1 After a tepid 0.1 per cent growth in the first half of the 2012-13, industrial output saw a mild recovery with growth averaging 2.2 per cent in the second half which resulted in the full year growth of 1.1 per cent in 2012-13. This is attributed to subdued global business sentiment and domestic consumer confidence which translated in to lower investment, slower credit off take and decline in exports. During the first quarter of the current financial year, industrial output decelerated further mainly due to structural constraints in mining, lower capacity utilisation in electricity sector and sluggish demand for some segments of manufacturing. IIP based industry sector output declined by 1.1 per cent during Q1 of 2013 (Table 15).

Table 15 : IIP based industrial sector growth (per cent)

Sector	2011-12	2012-13	April-June	
			2012	2013
Mining	-2.0	-2.3	-1.6	-4.6
Manufacturing	3.0	1.3	-0.8	-1.2
Electricity	8.2	4.0	6.4	3.5
Basic goods	5.5	2.3	3.3	-0.4
Capital goods	-4.0	-6.0	-20.1	-3.0
Intermediates	-0.6	1.6	0.8	1.6
Consumer goods	4.4	2.4	4.0	-2.4
i. Durables	2.6	2.0	8.0	-12.8
ii. Non-durables	5.9	2.8	0.6	6.7
General IIP	**2.9**	**1.1**	**-0.2**	**-1.1**

Source : CSO

Mining and electricity sectors

7.2 Broad sector level analysis of the estimates of the IIP shows that the mining sector continues to be stagnant mainly due to structural constraints. Coal, crude petroleum, iron ore and natural gas output account for more than 90 per cent of the country‘s mining output. There are several operational hurdles facing the coal sector. Environmental issues, land acquisition and resettlement & rehabilitation issues, evacuation constraints and law and order problems in some coalfields are the critical constraints in enhancing coal production. Even captive coal blocks have failed to meet the production targets because of these reasons. Production of crude oil, iron ore and natural gas declined significantly during 2012-13 with weak trends continuing in the current fiscal.

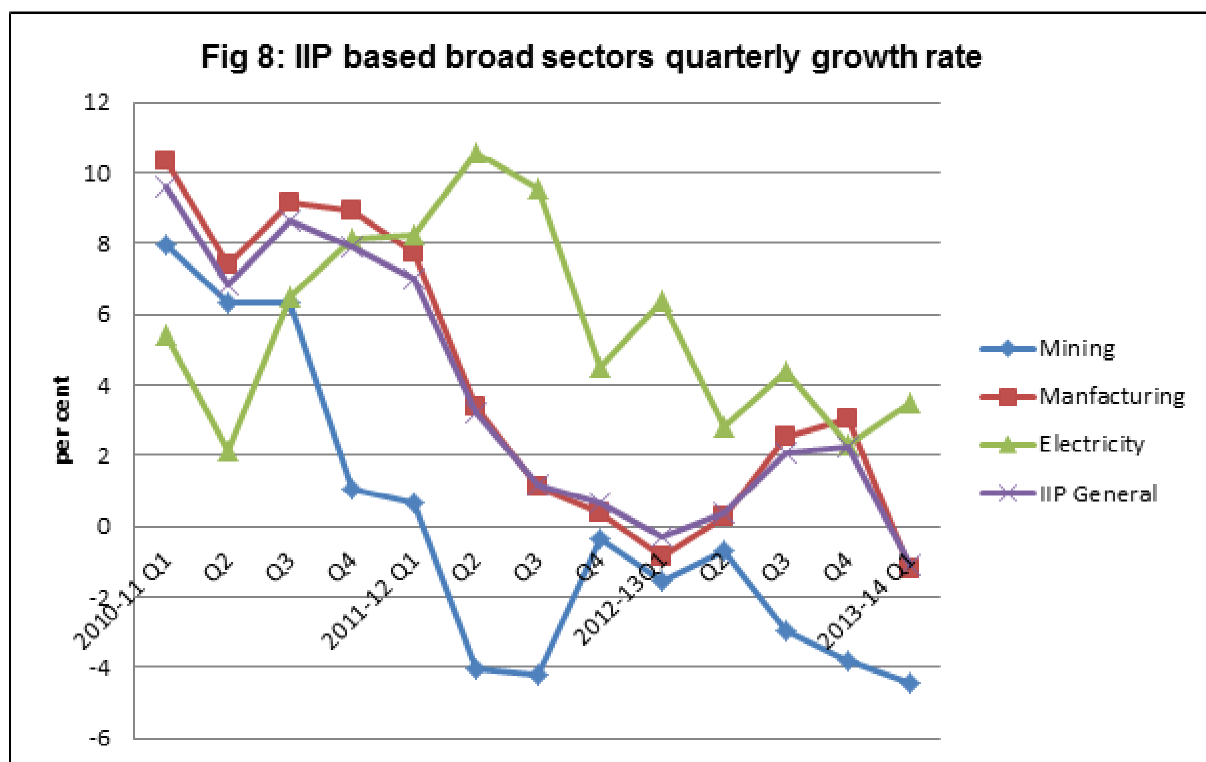
7.3 Growth in electricity generation has slowed due to shortfall of coal and natural gas. Thermal based electricity generation during April-June 2013 increased by 2.9 per cent. Plant load Factor (PLF) in thermal sector was 68.75 per cent during this period and for gas based power plants PLF was 29.0 per cent, mainly due to extreme shortfall of natural gas as input.

7.4 Coal India Limited (CIL) has guaranteed to supply 90 per cent of Annual Contract Quantity (ACQ) for Thermal Power Plants (TPPs) commissioned prior to 31.03.2009 and 80 per cent of ACQ for TPPs commissioned after 31.3.2009. The supply of 343.79 million tonnes (MTs) to power utilities in the country in 2012-13 was 91.5 per cent of commitment under Fuel Supply Agreement (FSA). In the current year, up to June 2013, coal supply to power utility sector has been 86.39 MTs which is 87.8 per cent of commitment under FSA/MOU of 96.41 MTs. Domestic coal availability during 2013-14 is estimated to be about 614.55 MT as against the estimated demand for coal of 769.65 MTs. The gap between domestic availability and demand will be filled by imports. Total coal imports during 2012-13 were 140.60 MTs.

7.5 Hydro power generation during April-June 2013 increased 6 per cent and it was 101 per cent of the targeted hydro based electricity generation during the first quarter.

Manufacturing sector

7.6 Being the dominant segment of Indian industry, manufacturing sector performance has moved in tandem with the overall IIP. Overall manufacturing output increased by 1.3 per cent during 2012-13. The growth rate in the third and fourth quarters of 2012-13 did improve to 2.5 per cent and 3.1 per cent respectively. However, during April-June 2013-14, growth rate of manufacturing declined to 1.2 per cent (Figure 8).



7.7 Analysis based on the detailed data shows the slowdown has spread to more sectors in Q1 of 2013-14. As per the use-based classification, other than intermediate goods, production of basic goods, consumer goods and capital goods output had contracted compared to the first quarter of the previous year. The reasons are multiple. Manufacturing has suffered on account of the negative spill over from the mining and electricity sectors, lower consumer demand for some sub-sectors such as consumer durables, structural constraints of sectors such as fertilisers, decline in exports, etc. Indian manufacturing sector has not moved up the value chain overtime. Due to low level of investment in R&D, India has not seized the growing opportunities available in the high and medium technology sectors of the global market such as chemicals, machinery and equipment, electrical machinery, electronic goods and medical and optical instruments.

7.8 On the positive side, favourable raw material prices, revival of domestic demand and rise in exports during the second half of the year led to revival of textile and leather sectors. Apparels (ready-made garments) have registered recovery in the fourth quarter of 2012-13 and continue to grow robustly.

7.9 After years of boom, auto sector production declined during 2012-13 mainly on account of the decline in domestic and global demand. Weak business sentiment, increasing cost of fuel and higher

interest rate charged from auto buyers by the banks are some of the reasons cited by the industry for the slowdown in auto sector. Decline in overall investment has also impacted demand for commercial vehicles. Except for the robust increase in the production of utility vehicles, the output of other auto sector segments moderated during 2012-13 and has decelerated further during Q1 of 2013. Commercial vehicles production growth rate had shown the sign of revival from March 2013 onwards. However, it has slipped into negative territory from June 2013 with a contraction of 15 per cent during the month.

Persisting weakness in the capital goods sector

7.10 Like mining sector, the contribution of the capital goods sector to growth of IIP has been negative for the past two years. Declining trends in investment, fall in the growth of credit off take and low level of investment in R&D have contributed to reduced growth rate of capital goods sector from the high of 48.5 per cent in 2007-08 to contraction of 4.0 per cent and 6.3 per cent in 2011-12 and 2012-13 respectively. During April-June 2013 capital goods production declined by 3.3 per cent. The only capital goods segment that has shown recovery in domestic production is the electrical machinery and apparatus segment showing robust growth of 11.9 per cent during April-June 2013.

Industrial sector outlook

7.11 The situation is grim as lead indicators do not hint at quick revival of the industrial sector. The HSBC seasonally adjusted manufacturing Purchase Managersq Index (PMI) moderated from 51 in April 2013 to 48.5 in August 2013 (a value lower than 50 suggests contractionary conditions). Gross collection of indirect tax revenue has increased by modest 2.9 per cent in the first four months of the current financial year with a decline of 11.0 per cent in excise collection during this period. The Business Expectation Index (BEI), which is computed by RBI as a weighted average of net responses on nine select performance parameters and gives a single snapshot of the industrial outlook in each quarter, has dropped by 4.0 points (111.6 from 115.6) in Q1 of 2013-14. The BEI is sticky around the levels seen at crisis period of Q2:2008-09. The 61st round of Industrial Outlook Survey conducted by RBI during February-March 2013, had hinted at moderation in demand conditions for Q1 of 2013-14.There is, however, a ray of light - railways freight earnings have increased by 4.9 per cent during the first four months of the current financial year.

7.12 Despite monetary easing, RBI data on sector-wise gross credit deployment show that monthly credit deployment growth rate declined during the year 2012-13 for all industry sectors except electricity. The trend has not improved during the current financial year either. On a year-on-year basis, credit to industry increased by 15.5 per cent in May 2013, 14.1 per cent in June 2013 and by 15.9 per cent in July 2013. During the current financial year, the credit flow to industry till July 2013 has increased by 2.1 per cent only. Deceleration in credit growth to industry was observed in all the major sub-sectors, barring food processing, textiles, leather & leather products, wood & wood products, cement & cement products, gems &jewellery and infrastructure. Credit flow rate to large and medium sector industries has been lower as compared to micro and small industries.

7.13 The near term industrial sector revival now depends on the post monsoon upswing in the output of mining and power sectors, strengthening of domestic demand during the festival season and further improvement in the global demand for exports. IIP based in-house forecast shows moderation in industrial output till October 2013 and modest recovery thereafter (Figure 9).

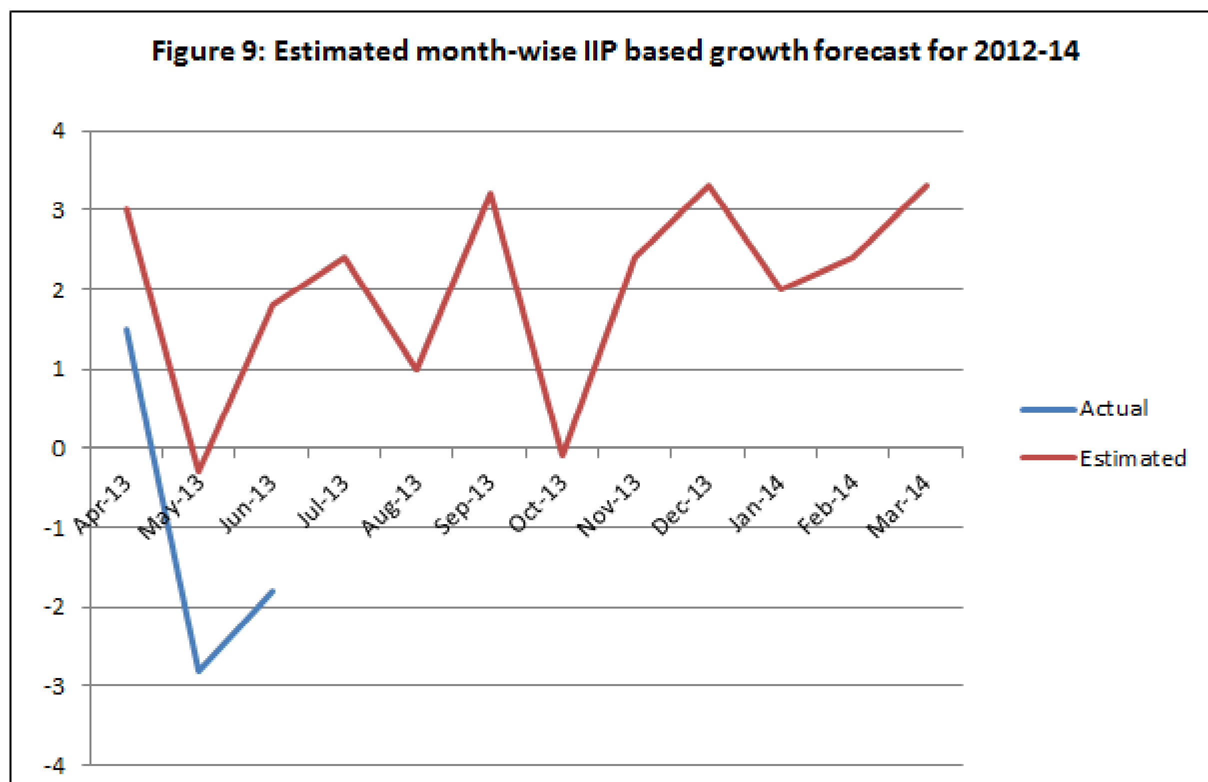


Figure 9: Estimated month-wise IIP based growth forecast for 2012-14

Box -8 Estimating manufacturing output using excise data[2]

The monthly industrial production (IIP, published by the CSO) series has been volatile, raising concerns that it might mis-report actual output. We undertook an exercise to estimate growth in the organized manufacturing sector using historical industry wise excise data. The key advantage of using the excise data is that it includes every manufacturing unit in the organized sector unlike IIP which is based on a sample set compiled from FY 2005 data. Thus, ex ante, we expect the excise based estimates to give a more robust estimate of the growth in manufacturing output. However, the limited history of the excise data constrains the analysis.

Key takeaways:

1. The average difference between excise-based and IIP-based (CSO) growth rate for the weighted basket of 10 key sectors[2] is approximately 2% (with excise-based being higher) and they move in the same direction (Figures 1 and 2). Nonetheless, the excise based estimate of manufacturing growth rate could be used as a cross check for the monthly growth rate estimated by the IIP, especially in times of high volatility.

2. Visual inspection of the charts broken down into sectors suggests that among the sectors, for chemicals, rubber and plastic and textiles, the ±excise-dataqbased growth rates have been steadily higher than the IIP based growth rates.

3. Interestingly, the sectors which have relatively larger share of small to medium enterprises show larger divergence between the excise based and IIP based growth rates such as textile, rubber and plastic among others.

4. Further, the excise based estimates can be calculated almost 2 weeks before the IIP data is released by the CSO thus giving a head start on the IIP data.

5. Interestingly, the monthly growth rate based on the excise data is much more volatile than we expected, although much less than the IIP data. This suggests that manufacturing output in India is actually highly volatile, which can be a topic for further research.

6. The overall basket that we created is based on the same weights as used in the IIP basket. Consequently, the impact of any increase/decrease in the value addition of any particular sector to overall output is not captured in this analysis.

Figure 1: IIP and Excise based mfg. growth rate^ (annual)

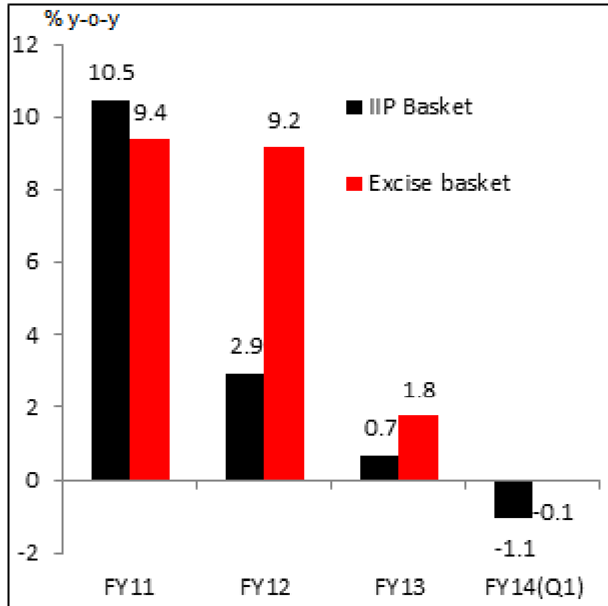
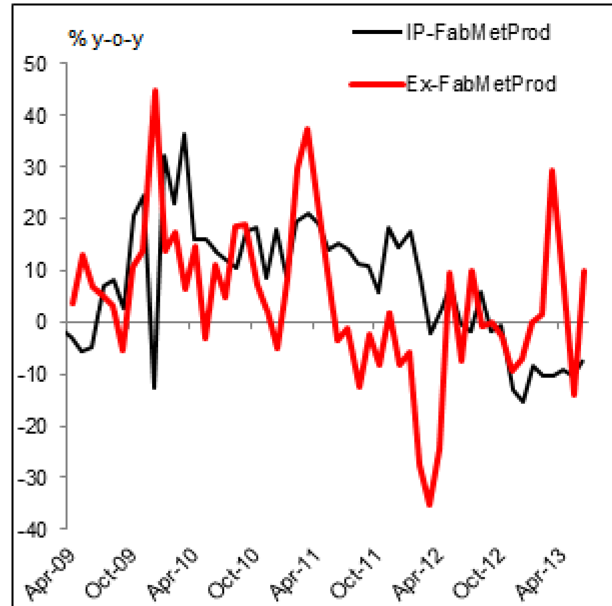


Fig 2: IIP and excise based mfg. growth rate^ (monthly)



Note: ^ comprises only the 10 sectors mentioned earlier. Sources: CEIC and Authors estimates

Table: Extent of over/under estimation

Weight in IIP basket	Sector	Average over/ under estimation in monthly growth rates (+ve sign: excise growth is higher)	Correlation b/w IIP and Excise growth rates	Remarks
10.1	Chemicals	5.9	-0.4	*Excise data steadily shows*
3.7	Machinery & equipment	4.6	0.7	*a higher growth rate*
6.2	Textiles	9.6	0.1	
2.0	Rubber & Plastics	8.8	0.7	
4.3	Other Non-Metallic Mineral	0.9	0.5	
4.1	Motor Vehicles, Trailers.	-1.5	0.8	
11.3	Basic Metals	-0.8	0.6	
2.0	Electrical machinery	3.3	0.1	
3.1	Fabricated Metal Products ex M&E	-4.5	0.3	*Excise data steadily shows*
7.3	Food Products & Beverages	-5.7	0.2	*a lower growth rate*
54.0	Combined basket	2.0	0.7	

Source: CEIC and Author's estimates

[1] The authors (Supriyo De, Aman Mohunta, Rohini Malkani and Rohan Manthani) would like to thank Mr JM Kennedy and his team in Tax Research Unit for providing us with the excise data and their guidance all through the study.

[2] Chemicals, Machinery & equipment, Textiles, Rubber & Plastics, Other Non-Metallic Mineral, Motor Vehicles, Trailers.., Basic Metals, Electrical Machinery, Fabricated Metal Products ex M&E, Food Products & Beverages. Coke and petroleum sector have been excluded owing to the complexity in the tax rates on individual petroleum items.

8. SERVICE SECTOR

Services GDP

8.1 The service sector remains the growth engine of the Indian economy. Among the major services, growth of ‘real estate, ownership of dwellings’ and ‘community social and personal services’ accelerated to 9.3 per cent and 6.6 per cent in 2012-13 from 6.0 per cent and 4.3 per cent recorded in 2011-12. Despite the deceleration, the growth of ‘trade’ and ‘banking & insurance’ at 9.5 per cent and 7.9 per cent was relatively good. However, rate of growth in ‘transport, storage & communication’ decelerated to a low of 1.9 per cent in 2012-13. The quarterly estimates of services sector growth during 2012-13 show a decelerating trend from Q1 to Q4. (Table 16)

Table 16: Sector-wise share & growth rate of Service Sector

Sector/Sub Sector	Share (at current prices)	Growth Rate (at constant prices)					
				Q1	Q2	Q3	Q4
	2012-13P	2010-11	2012-13P	2012-13	2012-13	2012-13	2012-13
Total Services (excluding construction)	56.9	9.8	7.1	7.7	7.6	6.7	6.6
Trade, hotels & restaurant	18.7	11.5	9.1	6.1	6.8	6.4	6.2
Trade	17.2	11.5	9.5	·	·	·	·
Hotels & restaurants	1.5	10.8	4.9	·	·	·	·
Transport, storage & communication	6.8	13.8	1.9	·	·	·	·
Financing, insurance, real estate & business services	17.1	10.1	8.6	9.3	8.3	7.8	9.1
Banking & insurance	5.9	14.9	7.9	·	·	·	·
Real estate, Ownership of dwellings	11.2	6.0	9.3	·	·	·	·
Community, social & personal. Services	14.3	4.3	6.6	8.9	8.4	5.6	4.0
Public administration & defence	6.1	0.0	3.3	·	·	·	·
Other services	8.2	8.0	9.1	·	·	·	·
Overall GDP	100	9.3	5.0	5.4	5.2	4.7	4.8

Source: Computed from CSO data

9. SOCIAL SECTOR

Employment

9.1 Quarterly quick employment surveys are being conducted by the Labour Bureau since January 2009 for selected sectors namely textiles including apparels, leather, metals, automobiles, gems and jewellery, transport, information technology (IT)/business process outsourcing (BPO) and handloom/ powerloom. The latest survey is the 17th in the series and covers the period March 2013 over December, 2012. Comparing the results of last four quarterly surveys, the overall level of employment has increased by 3.48 lakh between March, 2012 to March 2013 for the selected sectors, with highest increase of 1.40

lakh in textiles including apparel followed by 1.19 lakh in IT/BPO, 0.39 lakh in metals, 0.22 lakh in automobiles, 0.15 lakh in gems and jewellery and 0.14 lakh in leather during the reference quarter.

Poverty

9.2 The Planning Commission has computed poverty lines and poverty ratio based on the Tendulkar methodology for the year 2011-12 based on the latest data of quinquennial survey on household consumer expenditure collected by National Sample Survey Organization (NSSO) in its 68th round conducted during 2011-12. Based on monthly per capita consumption expenditure (MPCE), the new poverty line at all India level is calculated at 816 per person per month for rural areas and 1000 per person per month for urban areas in 2011-12. The number and percentage of poor based on this method are given in Table 17.

Table 17: Number and Percentage of Poor*

Year	Poverty ratio (%)		
	Rural	Urban	Total
1993-94 (50th NSS round)	50.1	31.8	45.3
2004-05 (61st NSS round)	41.8	25.7	37.2
2011-12 (68th NSS round)	25.7	13.7	21.9
Annual Average Decline : 1993-94 to 2004-05 (percentage points per annum)	0.75	0.55	0.74
Annual Average Decline : 2004-05 to 2011-12 (percentage points per annum)	2.32	1.69	2.18

*Source: Planning Commission, * Estimated by Tendulkar Method.*

9.3 The poverty ratio declined by 16.1 percentage points in rural areas, 12.0 percentage points in urban areas and 15.3 percentage points in the country as a whole in 2011-12 over 2004-05 as compared to decline of 8.3 percentage points, 6.1 percentage points and 8.1 percentage points respectively in 2004-05 over 1993-94. Thus the annual average pace of reduction in the proportion of those living below the poverty line during 2004-05 to 2011-12 has been thrice as high as it was during the period 1993-94 to 2004-05.

9.4 A large number of commentators have suggested that the poverty line is too low and therefore tends to underestimate the extent of poverty in the country. There are others who argue that the official estimates also tend to overstate the extent of reduction in poverty. It may be mentioned that official poverty estimates are based on a methodology suggested by an Expert Committee headed by Prof. Suresh Tendulkar and is updated after taking into account inflation over time. For example, the poverty line for rural areas in 2004-05 was Rs. 446.68 per person per month while for urban areas it was Rs. 578. 80 per person per month. In 2011-12, it was Rs. 816 per capita per month and Rs. 1000 per capita per month for rural and urban areas respectively. The broader point is that changes in where the poverty line is set will not affect the broad pattern of a substantial reduction in poverty.