Economic Prospects: FY12 and FY13

The PM's Economic Advisory Council (PMEAC) has made certain projections for the economy for the current financial year as well as indicated prospects for the next one.

- The rate of growth in FY12 is estimated at 7.1%, which is marginally higher than the projection of 6.9% of CSO due to better growth in agriculture and construction.
    - Capital formation is to slip to 29.3%, which is a decline of almost 4 percentage points over the last four years. It had reached a peak of 32.9% in FY08 and dropped to 32.3% FY09 and then to 31.6% FY10 and 30.4% in FY11.
    - Farm sector growth to average 3% on record output for rice, wheat and strong trend growth in horticulture and animal husbandry.
    - Mining and quarrying sector likely to report negative growth on account of weak coal output growth, restrictions imposed on iron ore production, decline in natural gas production and negative growth in crude oil output.
    - Electricity sector to grow at 8.3%.
    - Manufacturing and construction to grow by 3.9% and 6.2% respectively.
    - Strong growth in the services sector at 9.4%.
- Balance of Payments (BoP) position will be tight and current account deficit to end at 3.6% for the year. The pressure both in regard to a larger than expected CAD and lower than expected net capital inflows resulted in a very sizeable depreciation of the rupee. In the fiscal year to date, the nominal terms of trade weighted 6-currency index fell by 14%, while in terms of the inflation adjusted effective exchange rate (REER) the decline was 11%. The decline of the rupee vis-à-vis the USD was 19% in April–December 2011. However, there has been some recovery in the course of January and February 2012, with the rupee recovering about 7.5%.
- WPI inflation projected to be around 6.5% and this has been enabled by both monetary and other public policies.
- Expansion of the fiscal deficit beyond its budgeted estimate of 4.6% of GDP is an area of concern. Government must strive to contain and improve the efficacy of subsidies.

Risks

- On the forex side, there are three issues. First, a sharp depreciation can impact the liability side of corporates to an extent and weaken its ability to invest. Second, capital inflows are a steady activity and if the impression gains ground that depreciation is likely to be recurring, investors will factor in this aspect in their valuation. Finally, the import of gold forms a large component in imports and impacts change in CAD.
- Inflation dropped to 9.1% in November, 7.5% in December and 6.55% in January. This will enable the RBI to adjust its monetary stance over the next several months. However, the continued pressure from the fiscal side will continue to impose some limitations.

Global Developments

- International conditions continued to worsen through 2011. The negative developments in the Euro zone outweighed the small improvements in evidence in the US which may still grow by around 1.8%.
- Large scale liquidity injection by the European Central Bank (ECB) since December 2011 has lowered yields on the government bonds though there is yet no resolution in sight for the affected countries.
    - Germany seems to be willing to provide extended support, partly as a result of which the European Central Bank (ECB) has provided large amount of finance through their banking system (€ 489 billion), which may go up further (to € 1 trillion).

Prospects for FY13

- Economy is likely to grow between 7.5 to 8% with mining and manufacturing to show substantial improvement.
- Inflationary pressure will ease 5-6%. Vigil to be kept on food prices-focus on production as well as rolling out of adequate food logistics network.
- Greater need to invest in the infrastructure for both capacity creation as well as operational performance in coal, power, roads and railways.
- Need to make adjustments on sale of refined petroleum products to reduce the huge burden of subsidy.
- CAD is projected to be around 3.0% of GDP. Efforts should be made to keep the CAD between 2.0 and 2.5% of GDP over the medium term.
- Dependence on capital receipts to increase: Inward FDI from $ 39.4 bn to $ 50 bn, FII from$ 4.9 bn to $ 10 bn and ECBs from $ 36.1 bn to $ 37.6 bn.

- Government must effectively lay out a road map to achieve fiscal consolidation. Government borrowing programme must not affect the financing needs of the private sector.

CARE's View

The growth projection for FY13 between 7.5-8% will require a big push from consumption, investment or government spending. Given that private sector investment has slowed down and that the RBI will only gradually lower interest rates during the year, there will be time lags for such fructification. Also fiscal consolidation will restrict the ability of the government to spend in large manner as the focus shifts towards tightening. Therefore increase in growth by around 1% point appears to be farily optimistic. Also the PMEAC assumes that manufacturing will rebound by 7.5% in FY13 and services maintain the 9% plus rate. While the latter appears to be feasible, industrial revival will be the clue to the GDP growth number.

The target for FDI at $ 50 bn appears also to be on the higher side given that reforms on the FDI front may not be coming about too soon to cause this sudden jump in inflows.

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