

18th December, 2009

To : **All Members**
Members of the General Committee
Banking and Finance Expert Committee

Dear Sir/Madam,

The Union Finance Minister Shri. Pranab Mukherjee to-day presented the Mid-Year Review 2009-10 in the Parliament.

We are pleased to circulate herewith a copy of the PIB Press Release dated 18th December, 2009 for your information.

With kind regards

T.S. Sampath Kumar
Secretary General

MID-YEAR REVIEW 2009-10

Finance Minister Shri Pranab Mukherjee presented the 'Mid-Year Review 2009-10' in the Parliament, here today. This is as per the provisions of the Fiscal Responsibility and Budget Management (FRBM) Act, 2003 which requires that review in trend of receipts and expenditure be undertaken in relation to the budget on a quarterly basis. The mid-year review document is the second quarterly review. The following are the salient features of the mid- year review showing major developments in the economy:

- (i) The macro economic situation confirms signs of a turnaround for the economy. The first quarter GDP released on August 31, 2009 had hinted at a recovery with growth in real GDP being placed at 6.1 per cent (up from a level of 5.8 per cent each in Q3 and Q4 of 2008-09). The growth in real GDP in Q2 was 7.9 per cent. GDP growth in the first half (H1) of 2009-10 is now placed at 7.0 per cent.
- (ii) While there is a deceleration in the growth of agriculture and allied activities from a level of 2.7 percent in second quarter (Q2) of 2008-09 to 0.9 per cent in of 2009-10, the levels of growth in industry at 8.3 per cent (6.1 per cent in Q2 of 2008-09) and services at 9.3 per cent (9.8 per cent in Q2 of 2008-09) indicate the broad based nature of recovery.

- (iii) While analysis of real GDP based on year-on-year comparisons is useful, it cannot however reveal the full picture for a complex economy like India, recovering from a major global shock. It is, therefore, useful to analyse the sequential growth (quarter to quarter, month to month comparisons) to gauge the process of recovery. Even though there was stagnation in the agriculture sector, the sequential quarterly growth rate over previous quarter of macro indicators confirms recovery of almost the entire economy and having regard to this broad-based nature of growth, the clouds of uncertainty have lifted.
- (iv) Headline inflation as measured by the Wholesale Price Index (WPI) remained subdued in the current year reflecting the base effect and some correction in prices of non-food items. Within the headline measures of WPI inflation, the food items (food articles and manufactured food) have exhibited high inflation. An important development in the current year in measurement of inflation was that the Government, on October 19, 2009 decided to release the current series of WPI on a monthly basis to overcome the low response associated with the weekly series.
- (v) The rise in the prices of primary articles of consumption of the common man observed in recent times is indeed a cause of concern, and this needs to be attended to on an urgent basis. The current episode of increase in prices does not appear to be a product of aggregate demand expansion in the economy. Its dominant cause is the supply-side constraint, due to reduced food production or, more accurately, the expectations of a reduction in food production over the next months that the drought and poor monsoon in India have inevitably given rise to.
- (vi) Government has taken a number of measures to address the price rise in essential commodities. These include reducing import duties to zero in wheat, pulses, crude petroleum and maize; reducing import duties in some edible oils; import of raw sugar at zero duty under open general license (OGL); removal of levy obligation in respect of raw/refined sugar, and administrative control measures; and monetary measures by the Reserve Bank of India (RBI). While imports and administrative measures could help tide over the problem in the short run, a longer term and sustainable solution would be in addressing the structural constraints and by increasing productivity and levels of agricultural production across the country.
- (vii) Monetary policy had remained accommodative in the wake of the impact of the global financial crisis since the second half of last fiscal. The continuance of the policy stance was considered apposite in the current context thus far, with the objective of providing for credit expansion at

viable rates while preserving credit quality so as to support the return of the economy to a steady growth path. RBI's second quarter review of monetary policy 2009-10 (October 27, 2009) expressed the dilemma of inflationary concerns calling for an early exit from accommodative monetary policy as contrasted with growth drivers warranting a delay in such exit.

- (viii) Growth in bank credit has remained low during the first two quarters of the current financial year. A slow pick up in credit is not unusual in a recovery and may not act as a brake on growth momentum. While the overall credit demand of the manufacturing sector from the banking sector has slowed down, corporates had been able to access non-bank domestic sources of funds and external financing at lower costs.
- (ix) Easy liquidity conditions and lower credit offtake helped in anchoring the expansionary fiscal policy without any crowding out of the resources for the private sector. The Central Government front-loaded the borrowing and conducted in a non-disruptive manner. The Government completed a large part (84.68 percent) of the budgeted gross market borrowing programme (including amounts raised through de-sequestering of MSS balances) during April to November 2009.
- (x) Given the higher interest rates and the return of investor confidence in global financial markets, there has been a revival of net capital flows to emerging market economies. The revival of net FII inflows this year was marked by a rise in the equity market indices. The BSE SENSEX rose by 73.6 per cent between end-March 2009 and November 11, 2009. Net FII inflows and positive domestic factors including investor confidence in India's growth prospects and better than expected performance of corporates and banks were the main factors behind this performance.
- (xi) The fiscal performance in the first half of the fiscal year 2009-10 meets the FRBM target in respect of the benchmark of non-debt receipts, which was placed at 40.5 per cent of the BE 2009-10. Fiscal deficit and revenue deficit at 49.3 per cent and 58.4 per cent respectively were higher than the prescribed FRBM benchmark of 45 per cent of Budget Estimate. These owe to the on-going fiscal stimulus measures, revenue receipts being primarily back-loaded and the outgo of arrears in H1 consequent on the Sixth Pay Commission recommendations.
- (xii) The levels of fiscal expansion undertaken by the Government are short-term responses (conforming to international best practices), but are not sustainable on a long-term basis. The medium term fiscal policy statement

2009-10 has provided the roadmap with fiscal deficit declining to 5.5 per cent of GDP in 2010-11 and further to 4.0 per cent of GDP in 2011-12. The timing of the exit and the pace at which it should be carried out will depend on the strength of the recovery and its sustainability without fiscal stimulus. The report of the Thirteenth Finance Commission and the proposed goods and services tax coupled with the initiative on direct taxes code could provide the right impetus to fiscal consolidation process.

The Mid Year Review notes that there is enough evidence to suggest that the fiscal policy measures undertaken by the Government have worked. There is need to observe the growth in major components for a couple of quarters to confirm the self-sustaining nature of this recovery process. Furthermore, the Review has cautioned that it would not be appropriate to be complacent; on the other hand, there is need to be ever vigilant. As of now, despite uncertainties, both real sector and financial sector of the economy are doing well and seem set on the recovery path.

The Review has flagged important issues needing attention including, inter-alia, rising prices of primary articles, the need to increase agricultural productivity, the need to continue with the policy of opening up of the capital account in a gradual, sequenced and calibrated manner to address the long-term financing need and at the same time guard against loss of competitiveness of exports, return to the path of fiscal consolidation by paying attention to expenditure outcomes and convergence of various plan schemes and effective delivery systems. The review also notes the ongoing process of global coordination through G-20 and the need for policy support to sustain the global recovery.

Bangalore Chamber of Industry and Commerce