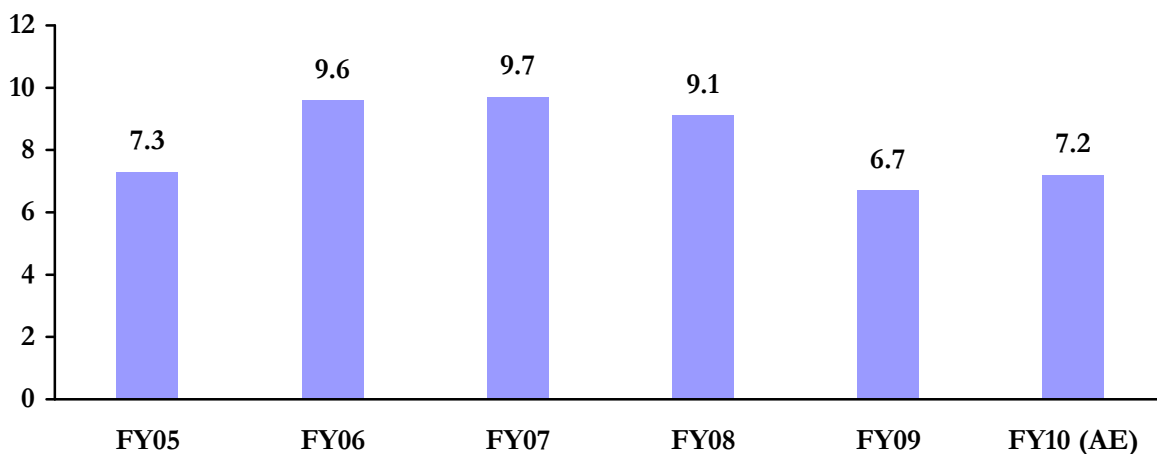


**MACROECONOMIC BACKDROP****Economic scenario**

The most significant feature providing a backdrop to the Union Budget 2010-11 is the global economy showing signs of stabilization, largely led by government spending after the unprecedented slowdown in major economies around the world in mid-September 2008. India too felt the spill-over effects of this global financial crisis, consequently the growth of Gross Domestic Product (GDP) at constant prices slowed from a four-year average of 9.0% in FY05-08 to 6.7% in FY09 as per revised estimates of the Central Statistical Organization (CSO). As per the FY10 Advanced Estimates (AE) of CSO, the growth in GDP at constant prices is expected to be at 7.2% as shown in Diagram 1.

*Diagram 1: Annual growth in GDP (%)*

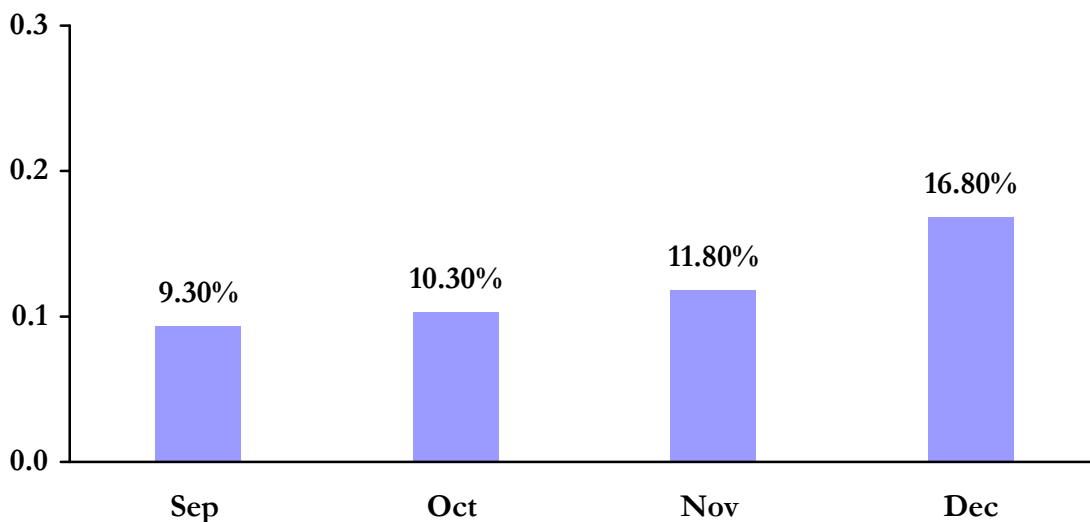


The expected recovery in the GDP growth is mainly led by revival in the industrial sector. As per the advanced estimates the industrial sector is expected to grow 8.6% as against 3.9% last year. A major part of this recovery is due to the demand reviving measures undertaken as a part of the Fiscal Stimulus packages provided by the Central Government.

This optimistic growth rate is however underlined by a poor performance in the agriculture sector, which is expected to show a decline in production by 0.2% as per the advanced estimates. Consequently supply-side inflationary pressures have emerged leading to a double-digit primary article inflation rate.

Recovery in the service sector appears nascent with an estimated 8.7% growth in FY10 as against 9.8% growth in FY09 as per CSO. Further nurturing of private investment will prove to be a key factor in sustaining the sector's growth.

*Diagram 2: Growth in IIP in 2009 (%)*



The Index of Industrial Production (IIP) has been showing a strong growth since October 2009 as evident in the Diagram 2, however underlined by a low base year effect. In order to substantiate the growth fundamentals of IIP we study trend of three key components of IIP namely Consumer Non

Durables (which is a direct indicator of retail consumption), Intermediate Goods (which is an indicator of prospects of future production in industry) and Capital Goods (which is an indicator of investment levels in the economy).

Capital goods have been showing an increasing trend however investment sustainability is yet to be discerned. Intermediate goods have shown a steady trend, indicating that the existing capacity is being utilized and no significant step-up in near future production plans can be inferred. Consumer non-durables have shown some signs of revival off-late however the same appear nascent and supply-side inflationary pressures could prove a dampener.

Hence growth recovery appears uneven and would require policy measures towards spurring private investments, sustaining domestic demand and achieving price stability.

**Government Finances:**

(Rs '000 crore)

	FY06	FY07	FY08	FY09	FY10	FY11	FY06- FY10	FY11
	(A)	(A)	(A)	(A)	(RE)	(BE)	CAGR	growth
Revenue Receipts	347.5	434.4	541.9	540.3	577.3	682.2	13.5%	18.2%
a) Net Tax Revenue of CG	270.3	351.2	439.5	443.3	465.1	534.1	14.5%	14.8%
b) Non-tax Revenue	77.2	83.2	102.4	96.9	112.2	148.1	9.8%	32.0%
Revenue Expenditure	439.8	514.6	594.5	793.8	906.4	958.7	19.8%	5.8%
Capital Receipts	158.7	149.0	170.8	343.7	444.3	426.5	29.3%	-4.0%
a) Recoveries of Loans	10.6	5.9	5.1	6.1	4.2	4.3	-20.5%	0.7%
b) Other Receipts	1.6	0.5	38.8	0.6	26.0	40.0	100.7%	54.1%
c) Borrowing & other Liabilities	146.4	142.6	126.9	337.0	414.0	381.4	29.7%	-7.9%
Capital Expenditure	66.4	68.8	118.2	90.2	115.2	150.0	14.8%	30.2%
Total Receipts	506.1	583.4	712.7	884.0	1021.5	1108.7	19.2%	8.5%
Total Expenditure	506.1	583.4	712.7	884.0	1021.5	1108.7	19.2%	8.5%
Revenue Deficit	92.3	80.2	52.6	253.5	329.1	276.5	37.4%	-16.0%
Fiscal Deficit	146.4	142.6	126.9	337.0	414.0	381.4	29.7%	-7.9%
Primary Deficit/(Surplus)	13.8	-7.7	-44.1	144.8	194.5	132.7	93.8%	-31.8%

The key challenge for the Government of India (GoI) during this post crisis recovery period is an efficient fiscal consolidation, while maintaining the growth trajectory. As per the GoI finances, in FY10 (RE) the revenue receipts grew by a mere 7% as against a Compounded Annual Growth Rate (CAGR) for FY06-10 of 13.5%. However as per FY11 (BE), GoI estimates a substantial growth of around 18.2% in its revenue receipts. This growth is expected to be led by a 32% rise in Non-tax Revenue of GoI and revival in revenue from tax receipts with a growth of 14.8% as against 4.9% in FY10 (RE). Going forward, the revenue expenditure which has been growing at a CAGR of 19.8% for FY06-10, and reported a growth of 14.2% in FY10 (RE) is expected to significantly moderate as per the budget estimates for FY11 to a growth of 5.8%. Given the development expenditure commitments of the Government under the various government flagship programmes and infrastructure projects, and other key recurring expenditure commitments, actual expenditure pressure in FY11 could turn out to be higher than budgeted.

GoI is estimating a Revenue Deficit of Rs.3,29,061 crore in FY10 (RE) and Rs.2,76,512 crore in FY11 (BE), which forms around 4% of the GDP (as per advanced estimates of CSO). GoI estimates the gross fiscal deficit (excluding oil and fertilizer subsidies) to around 6.7% of the GDP in FY10 (RE) and at 5.5% in FY11 (BE). The fiscal improvement budgeted assumes a strong revival in tax revenue receipts consequent to a robust economic growth, a gradual withdrawal of Government stimuli along with rationalization of subsidies and effective implementation of divestment programmes.