PREFACE

The Fiscal Responsibility and Budget Management (FRBM) Act, 2003 and the Fiscal Responsibility and Budget Management Rules, 2004 made under Section 8 of the Act have come into force with effect from 5th July, 2004. In sync with the changed Macro-economic circumstances after Global Financial Crisis, the FRBM (Amendment) Act, 2012 was passed by the Parliament and got the assent of the President of India on 28.05.2012. Accordingly, revised targets were set for various Fiscal Indicators. New Rules under the Amended FRBM Act, 2012 were notified on May, 2013.

In compliance with the relevant provisions of the said Act and Rules, the Central Government is required to lay before the Houses of Parliament, Macro-Economic Framework Statement, Medium Term Fiscal Policy Statement and Fiscal Policy Strategy Statement along with the Annual Financial Statement and Demands for Grants.

Under Section 7 of the Act, no deviation is permissible in meeting the obligations cast on the Central Government under the Act, without the approval of Parliament. In the event of a deviation, the Finance Minister should make a Statement in both the Houses of Parliament explaining the circumstances that have led to such a deviation; explaining whether such deviation is substantial and relates to actual or potential budgetary outcomes; and detailing the remedial measures the Government proposes to take.

With moderation in economic growth from the level of 9 per cent in 2010-11 to 4.5 per cent in 2012-13, there was general consensus that sustained high levels of fiscal deficit lead to various forms of macroeconomic imbalances and calls for immediate corrective fiscal policy response. Accordingly, as part of mid-year course correction, government successfully reduced fiscal deficit and laid down path for fiscal consolidation. Government was steadfast in its commitment towards fiscal rectitude and consolidated further in FY 2013-14.

However, varied challenges in terms of unfavorable external environment, domestic structural constraints, growth slowdown and inflationary pressures pose threat to the fiscal reform process. The economic growth rate has remained below 5 per cent level for past two successive years. Prevailing macro-economic situation strains the government resources, with tax revenues underperforming due to slowdown in the economy. At the same time there are diverse demands on application of resources. Revival of growth in the economy requires higher capital spending by the government, while adverse macro-economic conditions call for higher spending on social and welfare sectors to protect vulnerable sections of the society.

General Budget 2014-15 is being presented against early signs of economic recovery. There is sentiment of hope and expectation of economic activity picking up with exports and industrial production growing. Government has re-affirmed its commitment to the unfinished task of fiscal consolidation. Budget 2014-15 is a step towards fulfilling the commitment set in the new FRBM regime. However, there is need to improve the quality of spending to achieve revenue deficit, and effective revenue deficit, targets. Correction in the composition of expenditure mix to achieve the set targets is necessary. This calls for changes in the program implementation mode to achieve higher capital formation either directly by government or through implementing agencies.

This document which contains the three Statements referred to above explaining grounds for deviation from the obligations cast on the Central Government under the Act, is therefore laid before both Houses of Parliament in compliance with the above statutory requirements.

MACRO-ECONOMIC FRAMEWORK STATEMENT 2014-15

Overview of the Economy

Growth of gross domestic product (GDP) at factor cost at constant 2004-05 prices declined from 8.9 per cent in 2010-11 to 6.7 per cent in 2011-12 and further to 4.5 per cent in 2012-13. Among the factors that contributed to the slowdown included structural constraints viz. delays in projects, bottlenecks in environmental approvals and land acquisition, elevated inflation and external imbalances, in addition to uncertain global economic situation. There was a marginal improvement in 2013-14 with GDP growing at 4.7 per cent. The phase of sub 5 percent growth in the last two years is characterized by a moderation in services growth and a protracted slowdown in industry. Higher growth in agriculture on the back of a steady monsoon and robust growth in financial and business services helped the modest uptick in growth in 2013-14.

Macroeconomic stabilization in 2013-14 had to balance the concerns of containing elevated inflation and promoting growth. It also involved managing a volatile external situation characterized by a sharp depreciation of the Rupee witnessed till the second quarter (Q2) of 2013-14. While the balance of payment situation has improved to an extent, achieving higher growth by raising investment level and price stability along with fiscal consolidation will be major priority areas in 2014-15. The turnaround in the external situation (characterized by a decline in the current account deficit to 1.7 per cent of GDP in 2013-14 from 4.7 per cent in 2012-13 and gradual strengthening of the Rupee in the second half of 2013-14) and improvement on the fiscal front (with the fiscal deficit to GDP ratio declining from 4.9 percent of GDP in 2012-13 to 4.5 per cent in 2013-14) augur well for macroeconomic stabilization. During 2013-14, the monetary policy stance of the RBI was driven by the imperatives of keeping inflation in check and supporting growth revival while managing a complex external economic situation. With moderation in overall headline inflation, as per the Wholesale Price Index (WPI), during 2012-13 and during the first two quarters of 2013-14, there was a reduction in the repo rate by 25 basis points in May 2013. On the face of growing uncertainties in global financial conditions, monetary easing was paused in June 2013 and subsequently tightened to contain inflation. Headline WPI inflation averaged 5.98 per cent during 2013-14 as compared to 7.35 per cent in the previous year. In the *Second Bi –monthly Monetary Policy Statement 2014-15* (June, 2014), the RBI, *inter-alia*, kept the policy repo rate under the Liquidity Adjustment Facility (LAF) unchanged at 8 per cent.

GDP Growth

As per the provisional estimates released by the Central Statistics Office (CSO), the Indian economy grew at 4.7 per cent in 2013-14 (in terms of GDP at factor cost at 2004-05 prices). The sub-5 per cent growth of the economy in 2013-14 was primarily the result of the slowdown in industry for the second year in succession, that registered a growth rate of 0.4 per cent in 2013-14, and significantly lower growth in the ‘trade, hotels, transport and communications’ segment of the services sector. On the other hand sectors, viz. agriculture, electricity, gas & water supply, financial, insurance, real estate & business services have grown at faster rates in 2013-14 vis-à-vis 2012-13.

As per the quarterly estimates of GDP, growth in GDP recorded a modest pick-up in Q2 2013-14 with a growth of 5.2 per cent, compared to 4.7 per cent in Q1 2013-14. This declined to 4.6 per cent each in Q3 and Q4 of 2013-14. The contraction in manufacturing, noticed in all quarters, except Q2 of 2013-14, remains a cause for concern.

On the demand (expenditure) side, GDP at constant (2004-05) market prices registered a growth of 5.0 per cent in 2013-14 as against a growth of 4.7 per cent in 2012-13. The growth of consumption expenditure, gross fixed capital formation and exports stood at 4.8 per cent, (-) 0.1 per cent and 8.4 per cent respectively, in real terms, during 2013-14. The growth in these components was 5.0 per cent, 0.8 per cent and 5.0 per cent respectively in 2012-13. As per the First Revised Estimates released by the Central Statistics Office, gross domestic capital formation as a ratio of GDP at current market prices (investment rate) was 34.8 per cent in 2012-13 as against 35.5 per cent in 2011-12, while gross domestic savings as a ratio of GDP at current market prices (savings rate) declined from 31.3 per cent in 2011-12 to 30.1 per cent in 2012-13. The decline in the latter was primarily led by a reduction in savings of the private corporate sector and household savings in physical assets.

Agricultural Production

During the southwest monsoon season of 2013, the country received 6 per cent higher rainfall than the long period average (LPA). As per the 3rd Advance Estimates (15.05.2014), the production of food grains during 2013-14 is placed at 264.38 million tonnes (rice at 106.29 million tonnes and wheat at 95.85 million tonnes) vis-a-vis 257.13 million tonnes in 2012-13 (final estimates). The production of pulses is estimated at 19.57 million tonnes, sugarcane at 348.38 million tonnes, oilseeds at 32.41 million tonnes and cotton at 36.50 million bales of 170 Kg each.

The flow of agriculture credit increased to ₹6,07,375 crore in 2012-13 in comparison to ₹5,11,029 crore in 2011-12 and ₹ 86,981 crore in 2003-04. The agriculture credit flow target for 2013-14 was fixed at ₹ 7,00,000 crore with achievement outstripping the target to reach ₹7,30,765 crore.

Prices

Headline WPI inflation moderated to 5.98 per cent in 2013-14 due to lower international commodity prices and sharp correction in vegetable prices in December 2013 and January 2014. Overall WPI food inflation (comprising primary food articles and manufactured food products) remained elevated and averaged 9.43 per cent in 2013-14 as compared to 9.28 per cent in 2012-13. Core (non-food manufactured products) inflation remained mostly benign, and declined to 2.94 per cent during 2013-14.

While food inflation remained elevated, its drivers have been changing over time. In 2012-13, inflation remained elevated across the board for all major subgroups of food including cereals, pulses, vegetables, egg, meat & fish, sugar and edible oils etc. However, in 2013-14, the primary contributors included cereals, vegetables and egg, meat & fish. Food inflation moderated to 6.98 per cent in May 2014 from a peak of 13.61 per cent in November 2013.

All India general inflation for Consumer Price Index- New Series (CPI-NS) averaged 9.49 per cent in 2013-14 as against 10.21 per cent in 2012-13. The inflation as per CPI-NS has declined from a peak of 11.16 per cent in November 2013 to 8.28 per cent in May 2014.

Industry and Services

As per the index of industrial production (IIP), industrial output declined by 0.1 per cent during 2013-14 as compared to a growth of 1.1 per cent in the previous year. The contraction during 2013-14 was largely accounted for by the decline in mining, capital goods, and consumer goods. Manufacturing, the dominant sector within industry, witnessed contraction of 0.8 per cent in 2013-14 as compared to a growth of 1.3 per cent in the previous year. The output of the capital goods sector contracted by 3.6 per cent in 2013-14 vis-à-vis a contraction of 6.0 per cent in the previous year.

There are a number of reasons for sluggishness in manufacturing. The rise in the policy rates, necessitated by the need to contain inflation, coupled with the bottlenecks facing large projects impacted investment. The growth rate of gross fixed capital formation (GFCF) has been generally on decline from around Q1 2010-11. Overall manufacturing growth suffered on account of negative spill over from the mining and capital goods sectors, lower demand for consumer durables, etc.

Owing to the robust growth in electricity generation from hydel sources, the growth in overall electricity generation increased to 6.1 per cent in 2013-14 as compared to 4.0 per cent during the previous year. As a result of structural constraints, the mining sector continued to drag overall industrial recovery.

External sector

During 2013-14 exports were valued at US$ 312.6 billion, registering a growth of 4.1 per cent over the level of US$ 300.4 billion in 2012-13. Value of imports during 2013-14 was US$ 450.1 billion, showing a decline of 8.3 per cent compared with the level of US$ 490.7 billion in the corresponding period of 2012-13. POL imports accounted for 36.7 per cent of the total import in 2013-14. Non-POL imports during 2013-14 were 12.8 per cent lower than the level of US$ 326.7 billion in 2012-13. Higher exports and lower imports led to a contraction in trade deficit for 2013-14 to US$ 137.5 billion vis-à-vis US$ 190.3 billion in 2012-13.

On BoP basis, the value of exports and imports was US$ 318.6 billion and US$ 466.2 billion respectively in 2013-14, yielding a trade deficit of US$ 147.7 billion. Net invisible receipts increased by 7.2 per cent to US$ 115.2 billion in 2013-14 from US$ 107.5 billion in 2012-13. Contraction in trade deficit, coupled with a rise in net invisibles receipts, resulted in reduction of the current account deficit (CAD) to US$ 32.4 billion (1.7 per cent of GDP) in 2013-14 from US$ 88.2 billion (4.7 per cent of GDP) in 2012-13. The reduction in CAD also signals the success of the measures undertaken to contain non-essential imports like gold. Net capital inflows, however, declined to US$ 47.9 billion in 2013-14 from US$ 92.0 billion in 2012-13 owing to lower portfolio inflows, net repayment of loans and trade credit & advances. At end-March 2014, foreign exchange reserves stood at US$ 304.2 billion, indicating an increase of US$ 12.2 billion over the level of US$ 292.0 billion at end-March 2013. In August 2013, foreign exchange reserves had declined to US$ 275.5 billion.

The daily exchange rate of the rupee breached the level of 68 per US dollar in August 2013 (68.36 per US dollar on August 28, 2013). However it recovered to 60.10 per US dollar on March 28, 2014 reflecting the impact of the steps taken by the Government and the RBI to moderate the CAD and boost capital flows and greater clarity on US Federal Reserve taper. The annual average exchange rate of rupee for 2013-14 was 60.50 per US dollar.

Money, Banking and Capital Markets

The RBI, in its Annual Monetary Policy Statement on May 3, 2013, announced a reduction in the policy repo rate by 25 bps from 7.50 per cent to 7.25 per cent to support growth in the face of gradual moderation of headline inflation. Apprehensions of likely tapering of Quantitative Easing (QE) by the US Federal Reserve in late May 2013 triggered outflows of portfolio investment. Recognizing the risks to the economy from external developments and taking into account the evolving growth inflation dynamics, the RBI in its First Quarter Review of July 30, 2013 kept the key policy rates unchanged.

The RBI began the process of calibrated withdrawal of the exceptional liquidity measures in the Mid-Quarter Review on September 20, 2013, noting the improvement in the external environment and also considering the number of measures put in place to narrow the CAD and to ease its financing. The MSF rate was reduced from 10.25 per cent to 9.5 per cent and the minimum daily maintenance of the CRR was reduced from 99 per cent of the requirement to 95 per cent effective from the fortnight beginning September 21, 2013. However, keeping in view the rise in inflation and the need to provide a nominal anchor to help preserve the internal value of the rupee, the repo rate was increased by 25 basis points to 7.5 per cent.

Considering the evolving liquidity conditions, the RBI reduced the MSF rate from 9.5 per cent to 9.0 per cent on October 7, 2013. Provision of additional liquidity through term repos of 7-day and 14-day tenor for a notified amount equivalent to 0.25 per cent Net Demand & Time Liabilities (NDTL) of the banking system through variable rate auctions on every Friday beginning October 11, 2013 was also announced.

In the Second Quarter Review of October 29, 2013, the RBI carried forward the calibrated unwinding of exceptional measures with the reduction of the MSF rate from 9.00 per cent to 8.75 per cent. The special repo window for mutual funds, instituted in July 2013 to enable banks to meet the liquidity requirements of mutual funds, was also wound up. With indications that inflation is likely to remain elevated in the months ahead, the key policy repo rate was increased from 7.50 per cent to 7.75 per cent.

In the Third Quarter Review of Monetary Policy on January 28, 2014, the repo rate was hiked further to 8 per cent on account of upside risks to inflation, to anchor inflation expectation and set the economy securely on a disinflationary path.

During 2013-14, Indian capital market, in line with global trends, was affected by the market expectation regarding the tapering of quantitative easing of the US Federal Reserve, the US Federal government shutdown in October 2013 and developments in Ukraine. However, foreign Institutional Investors (FIIs) have reposed confidence in the Indian market, which manifested in positive net FII investment during the last four months of 2013, reversing the earlier trend of net outflows during June-August 2013. In 2013-14, total net FII investment in the Indian markets was US$ 8.9 billion. Net FII investment during January-May 2014 is US$ 15.3 billion as compared to US$ 12.1 billion in 2013. In May 2014 alone, Indian markets have seen a net FII inflow of US$ 5.7 billion.

Central Government Finances

In the post crisis fiscal consolidation regime, the Government generally abided by the budgeted level of the fiscal deficit except for 2011-12 when the deficit was 5.7 per cent of GDP (1.1 percentage point higher than the budget estimates). Adverse macro-economic developments, especially elevated level of inflation in 2011-12 and 2012-13, led the Government to push harder on fiscal reforms. Fiscal deficit was contained at 4.9 percent in 2012-13 (below the budgeted level of 5.1 per cent) and 4.5 per cent in 2013-14 (provisional) (below the budgeted/targeted level of 4.8 per cent).

Slowdown in growth, particularly in manufacturing, and subdued sentiments in financial markets in 2013-14 resulted in lower than budgeted tax collections and disinvestment receipts. As per the data released by the Controller General of Accounts for 2013-14, significant shortfall in growth in revenue receipts vis-à-vis envisaged growth in Budget 2013-14 has been observed. Gross tax revenue grew, year-on-year, by 9.9 per cent in 2013-14 to reach ₹11,38,882 crore. As a proportion of BE, gross tax revenue was 92.1 per cent in 2013-14. Non-tax revenue in 2013-14 was placed at ₹ 1,99,233 crore, that was 115.7 per cent of BE. In non-debt capital receipts, there was significant shortfall mainly on account of disinvestment receipts, as only ₹ 27,555 crore of the budgeted amount of ₹ 55,814 crore was realized.

On the expenditure front, as against the year-on-year growth of 16.3 per cent envisaged by BE 2013-14 over RE 2012-13, growth in total expenditure in 2013-14 was 10.9 per cent. As a proportion of BE, non-plan revenue expenditure was placed at 103 per cent in 2013-14. This was on account of higher outgo on major subsidies which stood at ₹ 2,47,596 crore in 2013-14 (112 per cent of BE). As per provisional actual figures of CGA, the major subsidies accounted for 2.2 per cent of GDP that was above the budgeted level of 1.9 per cent.

The combined fiscal deficit of Centre and States was 6.9 per cent of GDP in 2013-14 (BE) as against 7.4 per cent in 2012-13 (RE).

Prospects

There have been some positive developments in 2013-14 that auger well for macroeconomic stabilization, the most significant being the dramatic improvement in the external economic situation with the current account deficit declining to 1.7 per cent of GDP and the economy firmly on trajectory of fiscal prudence. However, inflation, especially food inflation, needs to be reduced further. The urgent task of policy is to kick-start the investment cycle in order to raise the growth rate in manufacturing. On the expectation of moderate global recovery, modest recovery in manufacturing, improved sentiments witnessed in recent months and absence of large upshots in international energy prices, the economy can be expected to register real GDP growth in the range of 5.4 to 5.9 per cent in 2014-15.

Annex - I

MACROECONOMIC FRAMEWORK STATEMENT
(ECONOMIC PERFORMANCE AT A GLANCE)

		Absolute value April-March		Percentage change April-March	
Sl.	**Item**	**2012-13**	**2013-14**	**2012-13**	**2013-14**
	Real Sector				
1	GDP at factor cost (₹ thousand crore)				
	a) at current prices	9389[1R]	10473[PE]	11.9[1R]	11.5[PE]
	b) at 2004-05 prices	5482[1R]	5742[PE]	4.5[1R]	4.7[PE]
2	Index of Industrial Production (2004-05=100)	172.2	172.1	1.1	-0.1
3	Wholesale Price Index (2004-05=100) @	167.6	177.6	7.35	5.98
4	Consumer Price Index: Industrial Workers (2001=100)(Average)	215	236	10.44	9.68
5	Money Supply (M3) (₹ thousand crore)	8392	9507	13.6	13.3
6	Imports at current prices *				
	a) In ₹ crore	2669162	2714182	13.8	1.7
	b) In US $ million	490737	450068	0.3	-8.3
7	Exports at current prices *				
	a) In ₹ crore	1634319	1894182	11.5	15.9
	b) In US $ million	300401	312610	-1.8	4.1
8	Trade Deficit (in US$ million) *	-190336	-137458	3.8	-27.8
9	Foreign Exchange Reserves				
	a) In ₹ crore	1588418	1828375	5.5	15.1
	b) In US $ million	292046	304223	-0.8	4.2
10	Current Account Balance (In US$ million)	-88163	-32397	12.8	-63.3
	Government Finances #		**₹ crore**		
1	Revenue receipts	**877613**	**1015279**	**16.8**	**15.7**
2	Tax revenue (Net)	740256	816046	**17.5**	**10.2**
3	Non-tax revenue	137357	199233	**12.9**	**45.0**
4	**Capital receipts (5+6+7)**	**532754**	**548206**	**-3.6**	**2.9**
5	Recovery of loans	16268	12502	**-13.7**	**-23.1**
6	Other receipts	25890	27555	**43.1**	**6.4**
7	**Borrowings and other liabilities**	**490596**	**508149**	**-4.9**	**3.6**
8	**Total receipts (1+4)**	**1410367**	**1563485**	**8.1**	**10.9**
9	**Non-Plan expenditure**	**996742**	**1110400**	**11.7**	**11.4**
10	Revenue Account	914301	1023047	**12.6**	**11.9**
	of which:				
11	Interest payments	313169	377502	**14.7**	**20.5**
12	Capital Account	82441	87353	**3.1**	**6.0**
13	**Plan expenditure**	**413625**	**453085**	**0.3**	**9.5**
	of which:				
14	Revenue Account	329208	352543	**-1.4**	**7.1**
15	Capital Account	84417	100542	**7.3**	**19.1**
16	**Total expenditure (9+13)**	**1410367**	**1563485**	**8.1**	**10.9**
17	Revenue expenditure (10+14)	1243509	1375590	**8.5**	**10.6**
18	Capital expenditure (12+15)	166858	187895	**5.2**	**12.6**
19	Revenue deficit (17-1)	365896	360311	**-7.2**	**-1.5**
20	Fiscal deficit {16-(1+5+6)}	490596	508149	**-4.9**	**3.6**
21	Primary deficit (20-11)	177427	130647	**-26.9**	**-26.4**

*1R : 1st Revised Estimate, PE: Provisional Estimate, @ : 52-Week Average. * On Customs basis.*

 # Figures as reported by Controller General of Accounts, Department of Expenditure, Ministry of Finance.