Economy Watch

Monitoring India's macro-fiscal performance

August 2018

EY
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Contents

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Highlights

1. The **RBI hiked its repo rate by 25 basis points to 6.5% in August 2018.**
2. **Both IIP and PMI have signaled strong growth momentum** in June and July 2018, respectively.
3. **IIP growth increased to 7% in June 2018** supported by broad based improvement across sectors.
4. Manufacturing PMI increased to 52.3 while **services PMI increased even more to 54.2 in July 2018.**
5. The **CPI inflation moderated to a nine-month low of 4.2% in July 2018.**
6. **WPI inflation eased to 5.1% in July 2018** from 5.8% in June 2018 primarily driven by moderation in inflation in vegetables.
7. **Center's fiscal deficit in 1QFY19 was 68.7% of the annual budgeted target** reflecting an improvement over the corresponding number of 80.8% in 1QFY18.
8. Among the BRICS economies, **India is projected to have the highest fiscal deficit-GDP ratio in FY19 barring Brazil.**
9. **Growth in non-food credit averaged around 11.1% in May and June 2018** (y-o-y) as credit to services sector continued to remain strong.
10. **The current account deficit was 1.9% of GDP in 4QFY18,** which was also the average for FY18. The **IMF expects it to deteriorate to 2.6% in FY19.**

Foreword

Emerging market currencies under pressure: India's perspective

International economic news is currently dominated by the steep fall in the Turkish Lira. The Turkish Lira has fallen from an average of TRY 3.7/US$ in January 2018 to TRY 6.9/US$ by mid-August 2018 (14 August), a fall of nearly 80%. In the ongoing tariff wars, Turkey was also on the receiving end with the US raising the tariffs on imports of Turkish steel and aluminum. The fall in Lira was largely on account of concerns about the reluctance of Turkey's President to hike the interest rates despite rising inflation. The US economic policies have now started to bite the emerging market economies significantly. In the comparable period, based on data drawn from the respective central banks, it is seen that against the US$, the Chinese Yuan depreciated by nearly 7%, the Brazilian Real by 22.7%, Russian Rubble by 18.4% and Iranian Rial by 15.1%. From an average of INR63.6/US$ in January 2018, the Indian Rupee also depreciated by almost 10% to INR70/US$ by mid-August 2018.

There is an accelerated inflow of dollars into the US economy attracted by strong domestic performance. Investment in the US has become more attractive due to the sharp reduction in the corporate income tax rate. The US has increased tariffs on imports from a number of countries including China, the European countries and India, among other countries. As a result, the domestic economic activity in the US is expected to pick up in an effort to substitute for the displaced imports from China and other countries. Countries that have a healthy record of maintaining macroeconomic balances consisting of fiscal deficit, current account deficit and inflation would emerge better amidst the on-going international churn of economic forces.

The Reserve Bank of India (RBI) has been intervening with a view to cushion the volatility in the exchange rate while allowing the INR to depreciate on trend basis. With these interventions, foreign exchange reserves have declined by more than 20% to US$404.2 billion by end-July 2018 from a peak of US$424.4 billion by end-March 2018. The depreciation of Rupee up to this level however, may not be considered as a cause of concern because the Indian inflation rate has been higher than that in the US by margins of 3% points or more in the past few years. There was a period during January 2017 to January 2018 when the INR appreciated on an average on the basis of monthly figures, which was out of line with the differential inflation rate profiles of India and the US. Considering the relative inflation trends, an exchange rate of INR70/US$ may be considered as a new normal. This might adversely affect the import bill particularly that of crude but Indian exports might get benefitted by this depreciation. Once the international economic uncertainty settles down, we may find that India has fared better than most Emerging Market Economies (EMEs).

In respect of inflation, the positive news is that both CPI and WPI inflation have started to fall. As per available estimates from MOSPI, both CPI and WPI inflation fell significantly on y-o-y basis to 4.2% and 5.1%, respectively in July 2018. On the growth front, there are clear positive signals coming from IIP and PMI numbers. IIP growth accelerated to a five-month high of 7% in June 2018. Manufacturing PMI expanded for the 12th consecutive month in July 2018 while services PMI increased sharply to 54.2, its highest level since October 2016.

Centre's fiscal deficit during 1QFY19 stood at 68.7% of the FY19 annual budgeted target which is lower as compared to 80.8% in 1QFY18. The corresponding number for revenue deficit was 84.8% which is an improvement as compared to the corresponding period of FY18 when it had reached nearly 120%. India has shown a robust record of maintaining its macro balances so far. However, given the uncertain international climate relating to investment, tariffs and currencies, India's current account deficit is likely to come under pressure. The IMF in its Country Report on India (released on 6 August 2018) has projected India's current account deficit at 2.6% for FY19.

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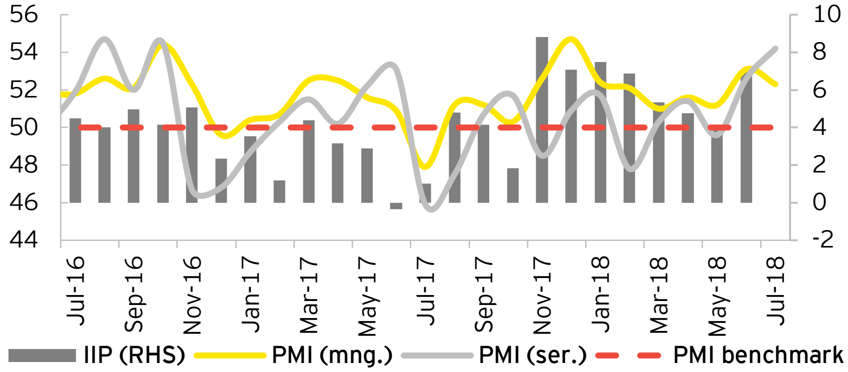
1. Growth: IIP growth increased to a five-month high of 7% in June 2018

A. IIP growth: Increased to 7.0% in June 2018 supported by broad based improvement across sectors

- IIP growth accelerated to a five-month high of 7% (y-o-y) in June 2018 as compared to 3.9% in May 2018 (Chart 1). This was partly due to favorable base effect as the destocking by business prior to the introduction of GST had dragged down the overall IIP in June 2017.
- Manufacturing sector output (accounting for 77.6% of overall IIP) grew to 6.9% in June 2018 as compared to 3.7% (revised) in May 2018. Output of both mining and electricity also grew at a faster pace of 6.6% and 8.5%, respectively in June 2018 (Table A1).
- Output growth of capital goods industry, a proxy for investment demand in the economy, recovered to 9.6% in June 2018 from 6.9% (revised) in May 2018. Growth in the output of consumer durables increased to 13.1% in June 2018 while that in infrastructure/construction sectors improved to 8.5%.
- Growth in the output of eight core infrastructure industries increased to a seven-month high of 6.7% (y-o-y) in June 2018. Growth in the output of petroleum refinery (12.0%), cement (13.2%) and steel (4.4%) improved during June 2018 while that of crude oil [(-) 3.4%)] and natural gas [(-) 2.7%)] contracted.

Chart 1: IIP and PMI



IIP growth accelerated to a five-month high of 7% in June 2018 supported by broad based improvement across sectors.

Source: Office of the Economic Adviser, Ministry of Commerce and Industry, IHS Markit PMI, Markit Economics.

B. PMI: Signaled an expansion in both manufacturing and services, with stronger growth in services in July 2018

- Headline manufacturing PMI (seasonally adjusted (sa)) at 52.3 in July 2018 remained above the threshold of 50 for the 12th consecutive month, although slightly lower than 53.1 registered in June (Chart 1).
- Headline services PMI (sa) increased to 54.2 in July 2018 from 52.6 in June 2018, led by an improvement in demand conditions as indicated by an increase in new business inflows.

In July 2018, manufacturing PMI continued to expand for the 12th consecutive month. Services PMI showed the sharpest expansion since October 2016.

- Composite PMI Output Index (sa) increased to 54.1 in July 2018 from 53.3 in June 2018, reflecting marked expansion in both manufacturing and services sectors, with a stronger growth in the latter.

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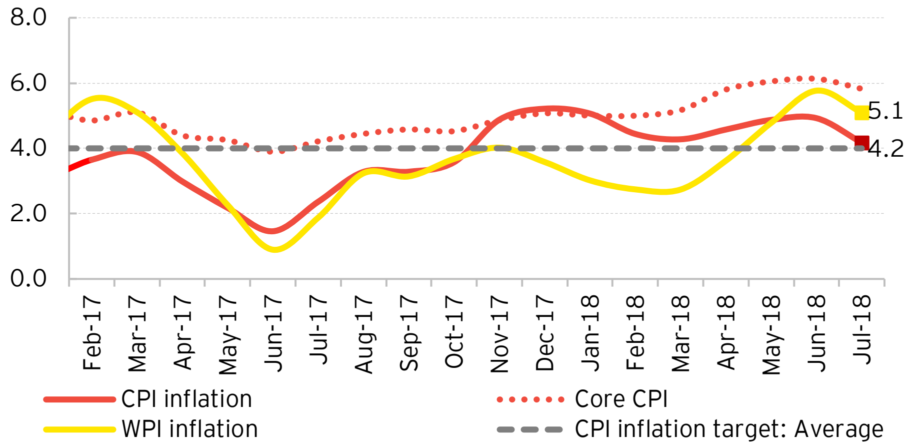
2. Inflation: CPI inflation moderated to a nine-month low of 4.2% in July 2018

CPI inflation fell to a nine-month low of 4.2% (y-o-y) in July 2018 from 4.9% in June 2018 (Chart 2) as vegetable prices contracted by (-) 2.2% in July 2018.

- The pace of contraction in tomato prices reached an all-time high of (-) 50.1% in July 2018 (2011-12 series) from (-) 6.1% in June 2018 mainly on account of a favorable base effect.
- Inflation in transportation and communication services increased for the sixth successive month reaching a 50-month high of 6.6% in July 2018 from 6.2% in June 2018 due to rising petroleum prices.
- Fuel and light-based inflation strengthened to an eight-month high of 8.0% in July 2018 from 7.2% in June 2018 due to rising LPG prices.
- Housing inflation continued to remain elevated at 8.3% in July 2018 as compared to 8.4% in June 2018.
- Core CPI inflation [1] marginally eased to 5.8% in July 2018 from a 47-month high of 6.1% in June 2018.

Chart 2: Inflation (y-o-y, %)



Source: MOSPI, Office of the Economic Advisor, GoI

Despite a significant fall in both headline CPI and WPI inflation, core CPI and core WPI inflation remained at elevated levels of 5.8% and 4.7%, respectively in July 2018.

WPI inflation eased to 5.1% in July 2018 from a 54-month high of 5.8% in June 2018 primarily on account of moderation in inflation in vegetables and fruits (Chart 2).

- Inflation in vegetables turned negative at (-) 14.1% in July 2018, the fastest pace of contraction seen in the last 13 months, from a four-month high of 8.1% in June 2018.
- Prices of food articles contracted by (-) 2.2% in July 2018 as compared to a growth of 1.8% in June. However inflation in manufactured food products marginally rose to 1.7% from 1.1% over the same period.
- WPI fuel and power-based inflation strengthened to a 16-month high of 18.1% in July 2018 from 16.2% in June 2018 on account of rising inflation in petrol and diesel.
- WPI core inflation remained elevated at 4.7% in July 2018 as compared to a 63-month high of 4.8% in June 2018.

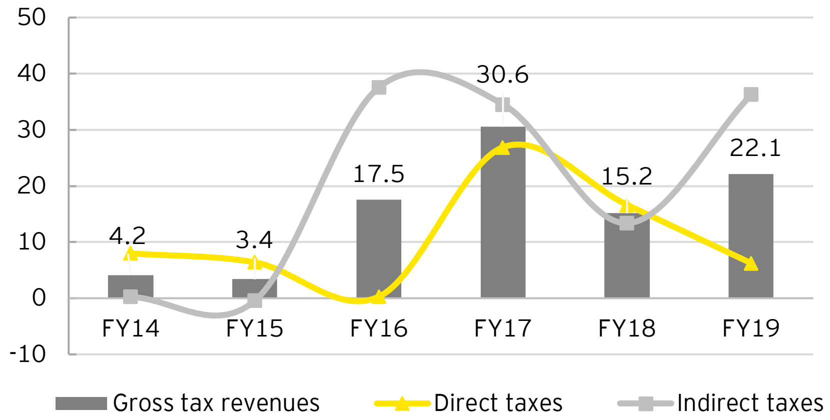
[1] Core CPI inflation is measured in different ways by different organizations/agencies. Here, it has been calculated by excluding food and fuel and light from the overall index.

3. Fiscal performance: Fiscal deficit during 1QFY19 stood at 69% of the annual budgeted target

A. Tax and non-tax revenues

- As per CGA, gross central taxes grew by 22.1% during 1QFY19, higher than 15.2% in 1QFY18 (Chart 3).
- During April-June FY19, gross taxes stood at 17.4% of the FY19 annual budgeted target, slightly higher than the three-year average (FY16 to FY18) of 16% during April-June as a percentage of annual actuals.
- Corporate income tax showed a negative growth of (-) 1.2% during April-June FY19 as compared to a growth of 24.3% during the corresponding period of FY18, indicating the impact of tax refunds made in May 2018.
- Growth in personal income tax was slightly higher at 12.8% during April-June FY19, compared to 10.6% in the corresponding period of FY18.
- Indirect taxes (comprising union excise duties, service tax, customs duty, CGST, UTGST, IGST and GST compensation cess) grew by 36.3% during 1QFY19 as compared to 13.4% in the corresponding period of FY18.
- The centre's GST collection (CGST, UTGST, IGST* and GST compensation cess) during 1QFY19 stood at INR1,62,210 crore which was 21.8% of the FY19 budget estimate (BE).

Chart 3: Growth in cumulated central tax revenues up to June 2018



As per CGA, centre's gross tax revenues grew by 22.1% during 1QFY19 compared to 15.2% in the corresponding period of FY18 on account of higher growth in indirect taxes.

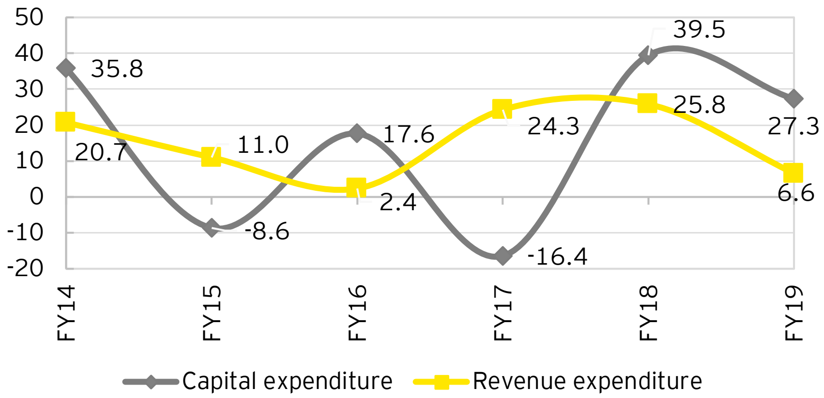
Source: Monthly Accounts, Controller General of Accounts, Government of India
Note: Direct taxes include personal income tax and corporation tax, and indirect taxes include union excise duties, service tax, customs duty, CGST, UTGST, IGST and GST compensation cess from July 2017 onwards; * IGST revenues are subject to final settlement.

- The centre's non-tax revenues grew by 39.3% during April-June FY19 as compared to a contraction of (-) 6.5% in the corresponding period of FY18.
- According to the Department of Disinvestment, the disinvestment proceeds up to 5 July 2018 stood at INR9,219.91 which was 11.5% of the FY19 annual budgeted target.

B. Expenditures: Revenue and capital

- Center's total expenditure during 1QFY19 grew by 8.7% as compared to 27.1% in 1QFY18 (Chart 4). During 1QFY19, total expenditure stood at 29% of the FY19 annual budgeted target.
- Growth in revenue expenditure was low at 6.6% during April-June FY19 as compared to 25.8% in the corresponding period of FY18.
- Center's capital expenditure grew by 27.3% during April-June FY19, lower than 39.5% in the corresponding period of FY18.

Chart 4: Growth in cumulated central government expenditure up to June 2018



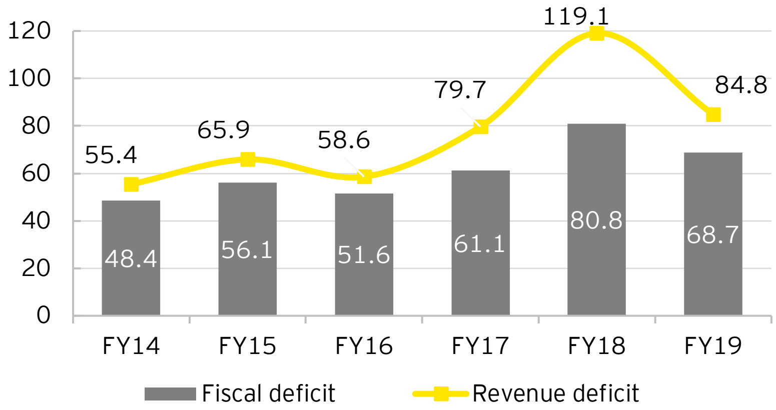
Growth in center's capital expenditure was at 27.3% during 1QFY19 while that in revenue expenditure was low at 6.6%.

Source (basic data): Monthly Accounts, Controller General of Accounts (CGA), Government of India

C. Fiscal imbalance

- The centre's fiscal deficit during 1QFY19 stood at 68.7% of the FY19 annual budgeted target as compared to 80.8% in the corresponding period of FY18 (Chart 5).
- The centre's revenue deficit stood at 84.8% of the FY19 annual budgeted target during 1QFY19 as compared to 119.1% in the corresponding period of FY18.

Chart 5: Cumulated fiscal and revenue deficit up to June 2018 as percentage of annual budgeted target



Center's fiscal deficit during 1QFY19 was 68.7% of its FY19 annual budgeted target. The corresponding number for revenue deficit was 84.8%.

Source: Monthly Accounts, Controller General of Accounts, Government of India, Medium-term Fiscal Policy Statement, Union Budget FY19 and CSO.

4. India in a comparative perspective: Status and prospects

General government financial balances

According to OECD, barring Brazil, India is projected to have the highest fiscal deficit-GDP ratio in FY19 amongst the selected major countries

- Except for the US, fiscal deficit as percentage of GDP is projected to narrow in 2018 in most of the selected set of major countries as compared to 2017.
- Fiscal deficit-GDP ratio is forecasted to remain unchanged at 3% in 2018 in China as the fiscal policy remains broadly neutral. In Russia, a surplus of 0.3% of GDP is projected in 2018 as well as in 2019 on account of rising oil prices.
- In the US, significant fiscal easing by way of a permanent reduction in the marginal corporate income tax rate and higher government spending limits is expected to keep the fiscal deficit-GDP ratio elevated in 2018 and 2019, uplifting growth in the short run.
- Fiscal easing is also projected in many European countries such as Germany.
- In India, fiscal deficit-GDP ratio is expected to reduce to 6% in FY20 after remaining above 6% until FY19.

Table 1: General government financial balances (% of nominal GDP) - Major economies

Country	2016	2017	2018 (f)	2019 (f)
Brazil	-9.0	-7.8	-7.6	-7.1
India*	**-6.3**	**-6.5**	**-6.3**	**-6.0**
US	-5.0	-3.6	-5.5	-6.1
South Africa	-3.5	-4.0	-3.7	-3.6
Japan	-3.4	-3.5	-3.0	-2.5
China	-3.0	-3.0	-3.0	-3.2
UK	-3.3	-1.8	-1.4	-1.3
Euro area	-1.5	-0.9	-0.6	-0.4
Russia	-3.6	-1.5	0.3	0.3

Source (Basic data): OECD Economic Outlook, June 2018;*Data is based on fiscal year (FY19 and FY20, respectively); (f) stands for forecast.

Current account balance

According to OECD, India's Current Account Deficit is projected to widen in 2018 and 2019

- Among the selected set of advanced and emerging economies, Euro area, Japan, Russia and China show a surplus on the current account, while Brazil, India, South Africa and the US show a deficit.
- In the US, strong demand growth is likely to boost growth in imports leading to a widening of the current account deficit in 2018 and 2019.
- In India, current account deficit is projected to widen to 2.5% of GDP in 2018. It may increase further due to rising oil prices.
- Rising oil prices have improved the external position of Russia, where current account surplus is expected to increase from 1.9% in 2016 to 3.1% in 2019 (f).

Table 2: Current account balance (as % of GDP) - Major economies

Country	2016	2017	2018 (f)	2019 (f)
Euro area	3.7	4.0	4.0	3.9
Japan	3.8	4.0	3.7	4.1
Russia	1.9	2.1	3.0	3.1
China	1.8	1.3	1.2	1.2
Brazil	-1.3	-0.5	-0.9	-0.9
India*	-0.7	-1.8	-2.5	-2.7
South Africa	-2.8	-2.4	-2.8	-3.2
US	-2.4	-2.4	-2.8	-3.1

Source (Basic data): OECD Economic Outlook, June 2018;*Data is based on fiscal year (FY19 and FY20, respectively); (f) stands for forecast
Note: Surplus (+) or deficit (-) as percentage of nominal GDP.

5. In focus: Simmering petroleum prices: Role of central and state taxes

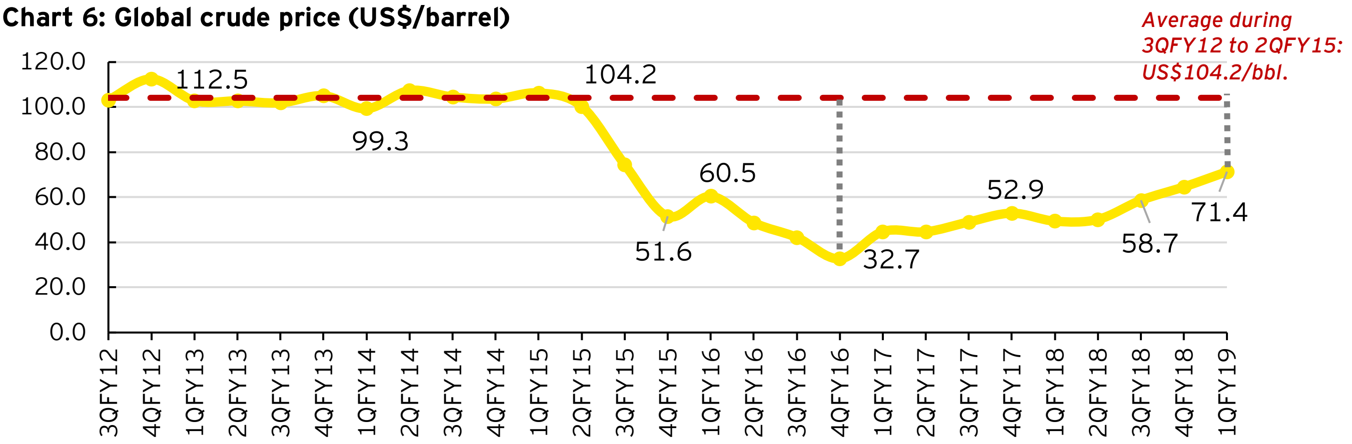
Introduction

The changes in global crude price are reflected in a nearly commensurate change in the price of the Indian crude basket [2]. The refined petroleum products include petrol, diesel, LPG and kerosene. Over 12 months preceding June 2019, the retail price of petrol in Delhi has risen by 20.1%, of which 18.9% points is contributed by the Indian crude basket. Such a steep rise in petroleum prices impacts the economy, both directly and indirectly, amongst other channels, through increasing inflation levels, worsening trade deficit and deteriorating government finances.

Global Crude Prices: Political economy drives

The global crude prices averaged around US$104/bbl. during 3QFY12 to 2QFY15. From that peak, it fell sharply and touched a low of US$32.7/bbl. in 4QFY16. Compared to the average of US$104/bbl., it represented a fall of US$71.4 (Chart 6). This long period of fall provided a windfall to Indian policymakers. The central government only marginally allowed the retail prices to fall and converted this gain into an increase in excise tax revenues. Since then, the global crude prices have been rising although these are likely to remain well below the previous average that exceeded US$100/bbl.

Chart 6: Global crude price (US$/barrel)

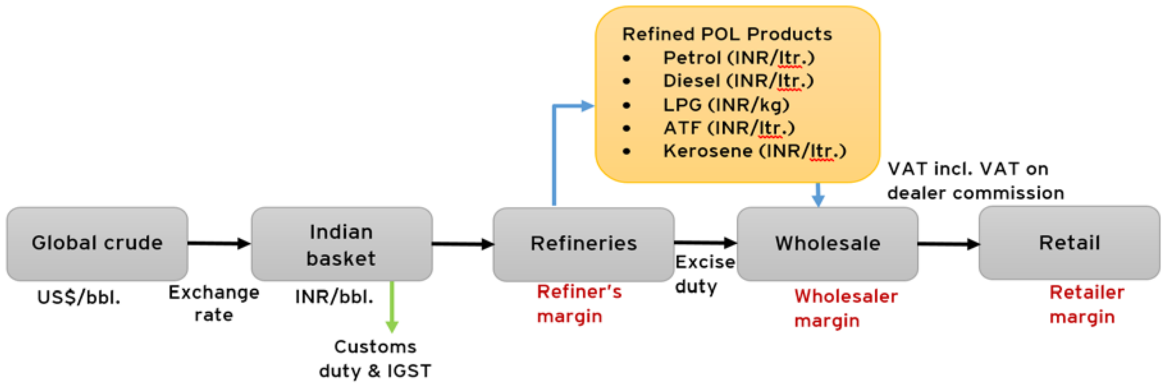


Source (basic data): World Bank Commodity Prices

Impact of global crude prices on domestic fuel prices

Retail prices of the petroleum products in India are based on a cost-mark up system reflecting margins of refiners, wholesalers and retailers, and taxes that cascade, covering customs, central excise and VAT. The process of transition from global crude to domestic retail pricing is summarized in Chart 7.

Chart 7: Process of transition from global crude to retail selling price



Source: Prepared by Authors

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[2] Since April 2017, the Indian basket of crude oil represents a derived basket comprising of sour grade (Oman and Dubai average) and sweet grade (brent dated) of crude oil processed in Indian refineries in the ratio of 72.38:27.62 (Petroleum Planning and Analysis Cell, Ministry of Petroleum and Natural Gas, GoI)

Table 3: Price build-up of petrol and diesel in Delhi on 20 August 2018

Sr. No.	Elements	Unit	Price		Share in final price (%)	
			Diesel	Petrol	Diesel	Petrol
1	C&F Price of crude (Moving average basis)	$/bbl	88.0	82.6		
2	Average exchange rate	INR/$	69.1	69.1		
3	C&F Price of crude for refiners (OMCs)	INR/ltr	38.3	35.9	55.4	46.3
4	Refiner's cost, margin and other costs	INR/ltr	2.8	2.0	4.0	2.6
5=3+4*	Price charged to dealers (excluding Excise duty and VAT)	INR/ltr	41.0	37.9	59.4	48.9
6	Central taxes (excise duty)	INR/ltr	15.3	19.5	22.2	25.1
7	Dealer commission (Average)	INR/ltr	2.5	3.6	3.6	4.7
8	State taxes (VAT including VAT on dealer commission)	INR/ltr	10.2	16.5	14.7	21.3
9=5+6+7+8	**Retail selling price at Delhi**	**INR/ltr**	**69.0**	**77.5**	**100.0**	**100.0**

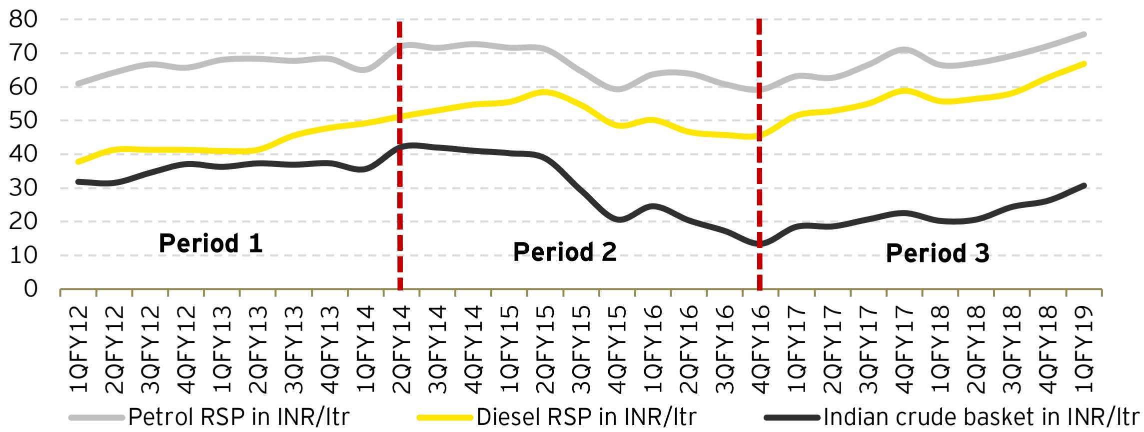
Source: PPAC, Indian Oil (https://www.iocl.com/Products/PetrolDieselPrices.aspx)
* Fifth element is the sum of the third and fourth element

Table 3 provides, illustratively, the price build up and the relative share of taxes and other cost components in respect of petrol and diesel.

Role of taxes in domestic petrol price movement

Central taxes consist of basic excise duty, additional duty of excise levied as a cess and special additional duty of excise levied as a surcharge and education cess. The basic excise duty is sharable with the states while the remaining three components are not. Except education cess, all the others are levied on a specific basis upon the price charged to dealers. State VAT is levied mainly as an ad-valorem tax on the value arrived at by adding the central taxes inclusive of the price charged to the dealer and the dealer commission. By virtue of being ad-valorem in nature, State VAT tends to fall as the price of crude falls, given the specific excise duty rate.

Chart 8: Co-movement in domestic fuel prices and Indian crude basket in INR/ltr.

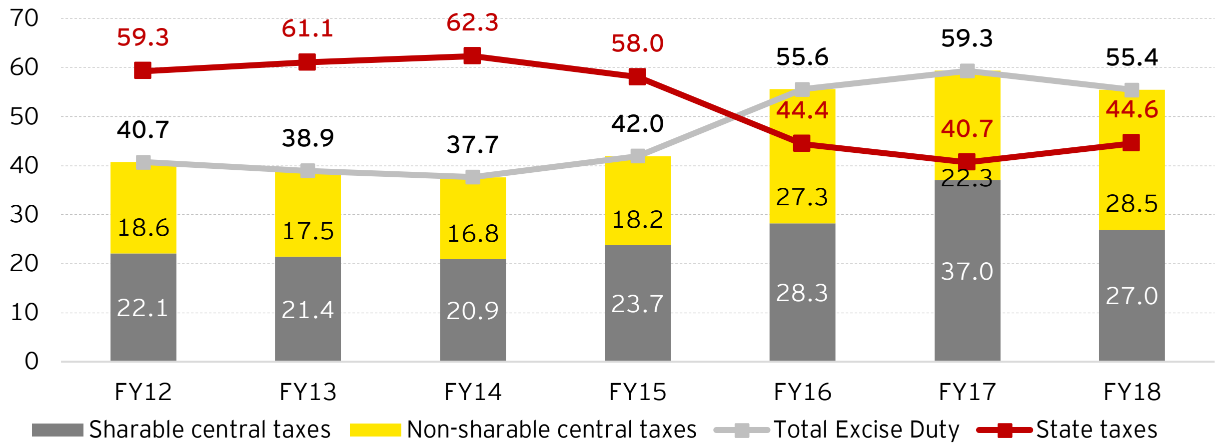


Source: PPAC, Ministry of Petroleum and Natural Gas, GoI

Chart 8 shows two clearly visible trends: one, the difference between the retail prices of diesel and petrol has progressively narrowed and two, the gap between the Indian crude basket (ICB) price and the retail prices has widened over a period of time. A distinction is made among three periods as marked in Chart 8. The ICB price in period 2 (2QFY14 to 4QFY16) compared to period 1 (1QFY12 to 2QFY14) fell but the gap between the retail prices and the ICB prices increased mainly due to the larger tax component. In period 3 (4QFY16 to 1QFY19), the ICB prices have started to increase but they have not reached the levels prevalent during period 1 while the gap between the ICB and the retail prices remained almost as large as it was before.

Chart 9 shows the relatively larger share of central taxes [3] in the period covering FY16 to FY18, reversing their relative position in the prior years. Prior to FY16, the state taxes [4] accounted for a much larger share ranging from 59.3% in FY12 to 58% in FY15. The central taxes can be divided into two parts, namely, taxes that are sharable with states and taxes that are not. In FY18, the non-sharable portion of central taxes has increased.

Chart 9: Share of the center and state in total tax revenues from petroleum, oil and lubricants (POL) products (%)



Source: PPAC, Ministry of Petroleum and Natural Gas, GoI; Union Budgets 2013-14 to 2018-19

Oil prices: Impact on India's macro economy

India's macro economy is quite vulnerable to increasing global crude prices. The influence of global crude prices is transmitted through a high import bill and an increase in the cost of production of all goods and services where POL products are used as inputs. The oil prices affect sectors such as transportation and communication and the direct and indirect effects of oil prices spread quickly throughout the economy, putting pressure on the general price level as well as on growth. The four key macro parameters namely growth, inflation, current account balance and fiscal deficit are all adversely impacted by increasing crude prices. Different estimates of the impact of a US$10/bbl. rise in crude prices on the above-mentioned macro parameters of the Indian economy are summarized in Table 4.

Table 4: Estimates of impact of a US$10/barrel rise in crude price on the Indian economy

#	Impacted Parameter	RBI [5]	Economic Survey 2017-18	SBI [6]	Nomura [7]
1	Growth ((-) impact)	0.15% points	0.2-0.3% points	0.16% points	
2	Inflation (+ impact)	CPI: 0.30% points	WPI: 1.7% points	CPI: 0.3% points	CPI: 0.6-0.7% points
3	Current account balance ((-) impact)		US$ 9-10 billion	0.27% points	0.4% points
4	Fiscal deficit ((-) impact)			0.08% points	0.1% points

[3] Central taxes include basic excise duty, additional excise duty, special additional excise duty, and education cess on excise duty. It excludes customs duty, cess on crude oil, service tax levied prior to GST, and CGST and IGST
[4] State taxes include only state VAT levied on Petroleum, Oil and Lubricants (POL) products but excludes entry tax, octroy and electricity duty paid on inputs
[5] Monetary Policy Report, October 2017
[6] *Oil on boil: It's time we understand oilnomics better*, SBI Ecowrap, Issue No. 12, FY19 dated 21 May 2018
[7] https://www.livemint.com/Politics/QpeXAepvLtLg9DO3z76y2M/Higher-crude-oil-prices-will-worsen-fiscal-balance-Nomura-r.html

While the estimates of the impact differ, there is no ambiguity in its direction. As far as fiscal deficit is concerned, a rise of US$10/bbl. in crude prices is estimated to increase the fiscal deficit by close to 0.1% points. As shown in Chart 6, there was a steady upward increase of US$22/bbl. in the crude price from 1QFY18 to 1QFY19. This implies an estimated increase in the fiscal deficit-GDP ratio, ceteris paribus of 0.22% points. This also partly explains why there was a slippage in the budgeted fiscal deficit target of 3.2% of GDP, which turned out to be nearly 3.5%, due largely to this unanticipated increase in the global crude prices.

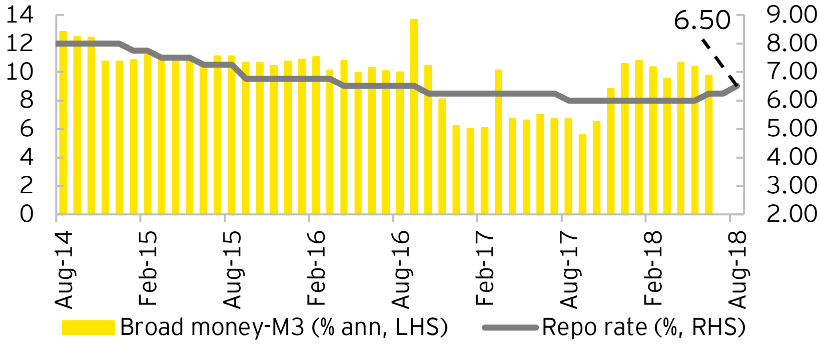
6. Money and finance: Repo rate hiked by 25 basis points to 6.50% for the second time in FY19

A. Monetary sector

Monetary policy

- In its third bi-monthly monetary policy review held on 1 August 2018, the RBI increased its policy repo rate by 25 basis points to 6.50% due to sustained inflationary pressures (Chart 10).
- According to the RBI, risks to CPI inflation could emanate from several factors namely, (a) Continued volatility in global crude prices and its upward bias, (b) Significantly higher inflation expectations of the households, (c) Hardening of input prices, (d) Persistent volatility in global financial markets, (e) The possibility of a fiscal slippage by the center or state governments and its adverse implications, (f) Uncertainty about the impact of recent revisions to the MSP and (g) The staggered impact of HRA revisions by the state governments.

Chart 10: Growth in broad money and movements in repo rate



Due to rising CPI inflation and increased inflation expectations of the households, the RBI hiked its repo rate to 6.5% in August 2018.

Source: Database on Indian Economy, RBI.

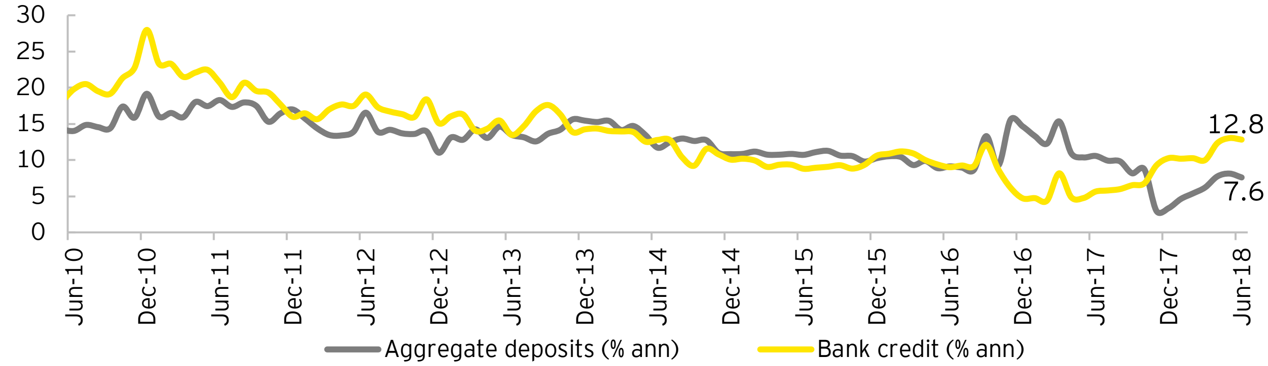
Money stock

- Growth in broad money stock (M3) fell for the second straight month to 9.8% (y-o-y) in June 2018 from 10.4% in May 2018 (Chart 10). Time deposits, which account for over 76% of the broad money stock, grew at a slower pace of 7.5% in June 2018 as compared to 7.7% in May 2018.
- Growth in narrow money (M1) also moderated to 18.1% in June 2018 from 20.7% in May 2018.

Aggregate credit and deposits

- Bank credit growth marginally moderated to 12.8% in June 2018 from 13.0% in May 2018 (Chart 11). Although credit growth had gradually improved during the last eight to ten months, further growth is likely to be constrained due to high levels of NPAs.

Chart 11: Growth in credit and deposits



Source: Database on Indian Economy, RBI.

- Growth in non-food credit averaged around 11.1% in May and June 2018 (y-o-y) as credit to services sector continued to remain strong.

- The share of personal loans in total non-food credit has gradually increased to 22.6% in FY18 from 18.3% in FY14.
- Credit growth to housing sector increased to 15.8% in June 2018 from 15.5% in May 2018.
- Growth in aggregate bank deposits dipped for the second consecutive month to 7.6% (y-o-y) in June 2018 from 8.1% in May 2018.

B. Financial sector

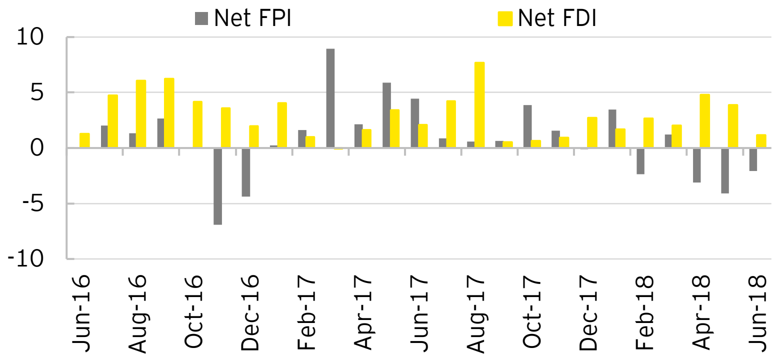
Interest rates

- As per the data released by the RBI, interest rates offered by banks on term deposits with a maturity of more than one year marginally increased to 6.63% (average) in July 2018 from 6.60% in June 2018.
- Banks have also increased their marginal cost of fund-based lending rate (MCLR) for the second successive month to average around 7.95% in July 2018 from 7.93% in June 2018.
- The average yield on 10-year government securities eased marginally to an average around 7.80% in July 2018 as compared to a 42-month high of 7.94% in June 2018.

FDI and FPI

- As per the provisional data released by the RBI, the overall foreign investment inflows remained negative reflecting higher outflows amounting to US$0.9 billion in June 2018 as compared to outflows of US$0.3 billion in May 2018.

Chart 12: Net FDI and FPI inflows



Source: Database on Indian Economy, RBI.

Net foreign portfolio investment (FPI) inflows continued to remain negative for the third consecutive month in June 2018, although these were lower at US$2.1 billion.

- Net FDI inflows moderated to US$1.2 billion in June 2018 as compared to US$3.9 billion in May 2018 (Chart 12). Gross FDI inflows were also lower at US$4.1 billion in June 2018 moderating from US$6.1 billion in May 2018.
- Net FPI inflows continued to remain negative for the third straight month, but these moderated to US$2.1 billion in June 2018 from US$4.1 billion in May 2018. FPI outflows continued due to concerns over the growing protectionism following trade tensions between the US and China, coupled with a gradual pick up in global crude prices.

7. Trade and CAB: Merchandize trade deficit reached a 62-month high in July 2018

A. CAB: Current Account Deficit (CAD) remained elevated at 1.9% of GDP in 4QFY18

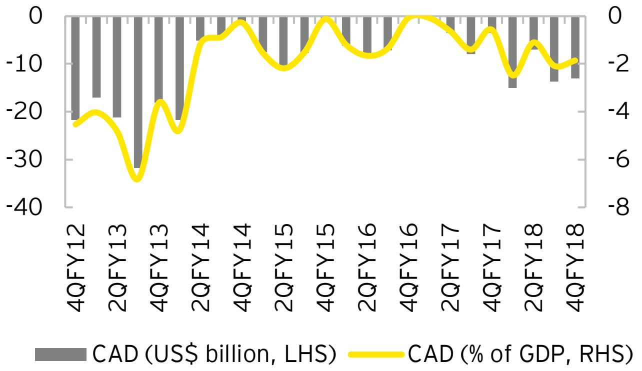
- CAD in 4QFY18 remained elevated due to the combined effect of a high net merchandize trade deficit at US$41.6 billion and lower net invisible receipts at US$28.6 billion. This was driven largely by rising crude prices. On an annual basis, CAB in FY18 deteriorated significantly to (-) 1.9% GDP from (-) 0.7% of GDP in FY17 (Table 5).

Table 5: Components of CAB in US$ billion

	CAB (-deficit/ +surplus)	CAB as a % of nominal GDP	Goods account net	Services account net
FY15	-26.8	-1.3	-144.9	76.6
FY16	-22.2	-1.0	-130.1	69.7
FY17	-15.3	-0.7	-112.4	67.5
FY18	-48.7	-1.9	-160.0	77.6
1QFY18	-15.0	-2.5	-41.9	18.3
2QFY18	-7.0	-1.1	-32.5	18.4
3QFY18	-13.7	-2.1	-44.0	20.7
4QFY18	-13.1	-1.9	-41.6	20.2

Source: Database on Indian Economy, RBI.

Chart 13: CAD



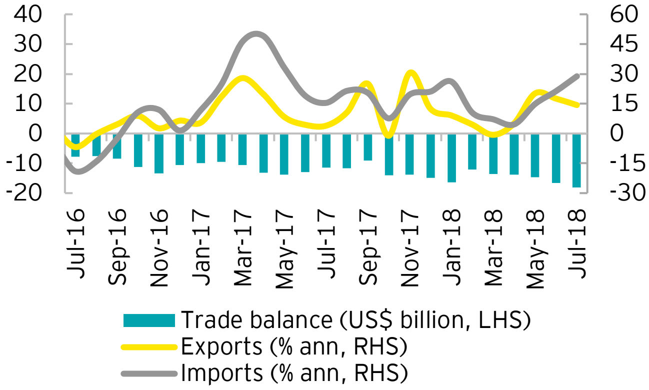
Source: Database on Indian Economy, RBI.

B. Merchandize trade and exchange rate

In July 2018, growth in merchandize exports slowed down to 14.3% but growth in merchandise imports increased to 28.8%, leading to a widening trade deficit.

- Merchandize export growth moderated to 14.3% in July 2018 from 17.6% in June 2018 (Chart 14) as growth in exports of oil and engineering goods eased.

Chart 14: Developments in merchandize trade



Source: Ministry of Commerce and Industry, GoI

- Growth in oil exports fell to 30.1% in July 2018 from 52.5% in June 2018, partly due to base effect.
- Growth in the exports of engineering goods eased to a four-month low of 9.1% in July 2018 from 14.2% in June 2018. Growth in gems and jewelry exports accelerated to an eight-month high of 24.6% in July 2018 from 2.7% in June 2018.
- Imports growth reached a 14-month high of 28.8% in July 2018 from 21.3% in June 2018.
- Growth in oil imports inched up to a 16-month high of 57.4% in July from 56.6% in June 2018. Growth in imports of gold, pearls and precious stones turned positive at 40.9% and 11.4% respectively, after remaining negative for six and three successive months, respectively.
- Merchandize trade deficit reached a five-year high of US$18.0 billion in July due to the rising import bill.
- The Indian Rupee depreciated to an all-time low of INR68.7 per US$ in July 2018 from INR67.8 per US$ in May 2018 partly on account of sustained foreign portfolio investments outflows.

8. Global growth: IMF projected global growth at 3.9% in 2018 with differing prospects across countries

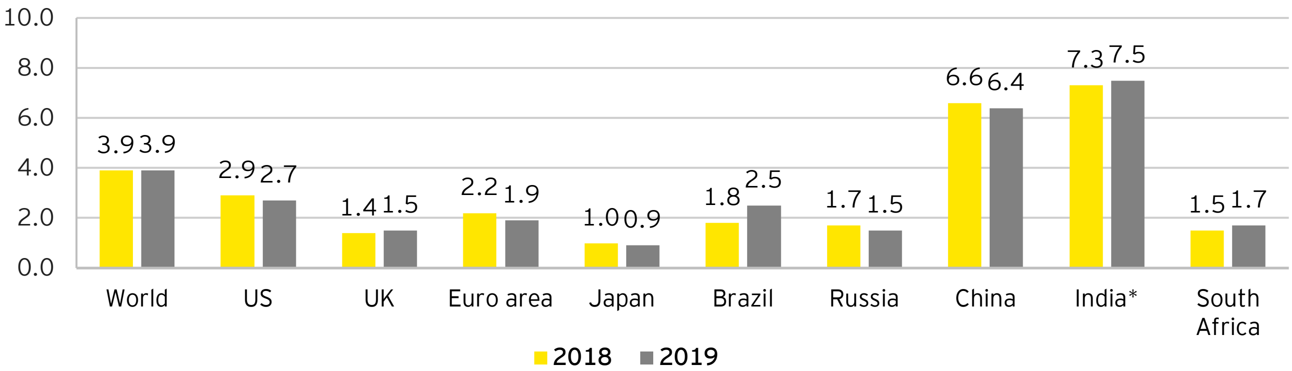
A. Global growth outlook

- According to the IMF [World Economic Outlook Update (WEO), July 2018], global growth is projected at 3.9% for 2018, unchanged from the April 2018 WEO (Chart 15).
- Growth in advanced economies is projected at 2.4% in 2018, easing to 2.2% in 2019. The forecast for 2018 is lower by 0.1% point compared to the April 2018 WEO, reflecting greater than expected growth moderations in the Euro area, Japan and the UK in early 2018.
- In the US, GDP growth is projected at 2.9% in 2018 and 2.7% in 2019. Substantial fiscal stimulus together with robust private final demand is expected to uplift the output growth and lower the unemployment rate creating additional inflationary pressures.

The IMF projected the global growth at 3.9% in 2018. Growth projections have been revised downward for the Euro area, Japan and the UK as compared to the April 2018 WEO.

- The US Federal Reserve raised the target range for the federal funds rate by 25 basis points in June 2018, while signaling two additional rate hikes in 2018 and three in 2019, a steeper schedule than what was indicated in March 2018.
- Growth in the Euro area is projected to slow gradually from 2.4% in 2017 to 2.2% in 2018 and further to 1.9% in 2019, a downward revision of 0.2 % point for 2018 and 0.1% point for 2019.
- Growth in China is projected to moderate from 6.9% in 2017 to 6.6% in 2018 and 6.4% in 2019, as regulatory tightening of the financial sector continues and external demand softens.
- India's growth rate is projected at 7.3% in 2018 and 7.5% in 2019, 0.1% and 0.3% point lower for 2018 and 2019, respectively than in the April 2018 WEO, reflecting negative effects of higher oil prices on domestic demand and faster than anticipated monetary policy tightening due to higher expected inflation.

Chart 15: Global growth projections



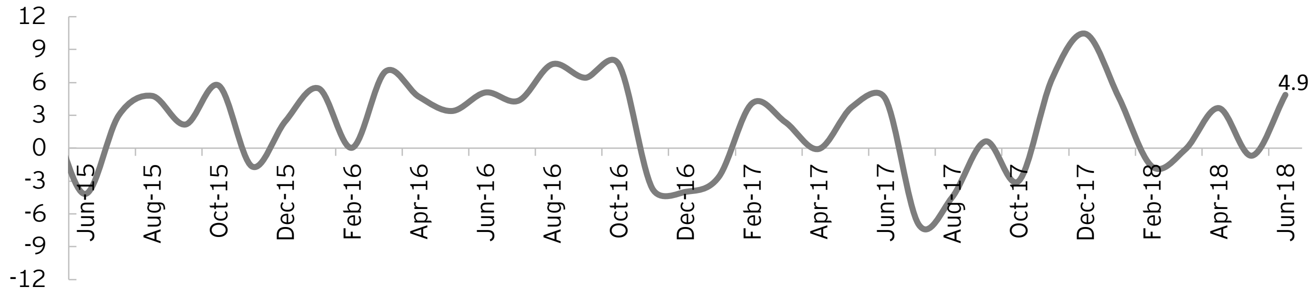
Source: IMF World Economic Outlook, July 2018
* Growth rates pertain to FY19 and FY20

9. Index of Aggregate Demand (IAD): Pointed to recovery in demand conditions in June 2018

Growth in IAD recovered to 4.9% in June 2018 following a contraction in May 2018

- An IAD has been developed to reflect the combined demand conditions in the agriculture, manufacturing and services sectors on a monthly basis. It takes into account movements in PMI for manufacturing and services, both measured in non-seasonally adjusted terms, tracing the demand conditions in these sectors. Demand conditions in the agricultural sector have been captured by movements in monthly agricultural credit off-take.
- The sectoral weights in constructing the IAD are based on their respective shares in nominal GVA in the base year (2011−12): Agriculture **(18.4)**, industry **(33.1)** and services **(48.5).**
- The y-o-y growth in the index of aggregate demand increased to 4.9% in June 2018 from a contraction of (-) 0.7% in May 2018 (Chart 16). The recovery was broad based as growth in all three sub components improved during the month with demand conditions in agricultural and services sectors showing strong growth (Table 6).

Chart 16: Growth in IAD (y-o-y)



Source (Basic data): IHS Markit PMI, RBI and EY estimates

Table 6: IAD

Month	Oct-17	Nov-17	Dec-17	Jan-18	Feb-18	Mar-18	Apr-18	May-18	Jun-18
IAD	122.5	117.2	123.9	121.7	119.0	124.1	125.2	122.2	128.9
Growth (% y-o-y)	-3.0	6.3	10.4	4.6	-1.7	-0.1	3.7	-0.7	4.9
Growth in agr. credit	5.5	8.4	9.5	9.4	9.0	3.8	5.9	6.4	6.5
Mfg. PMI**	0.5	3.1	4.5	0.0	2.0	1.6	2.2	1.7	2.7
Ser. PMI**	2.9	-4.6	0.9	1.4	-3.2	1.8	2.7	-0.1	5.8

**Values here indicate deviation from benchmark value of 50. A positive value indicates expansion while a negative value implies contraction in demand.

Source (Basic data): IHS Markit PMI, RBI and EY estimates.

10. Capturing macro-fiscal trends: Data appendix

Table A1: Industrial growth indicators (annual, quarterly and monthly growth rates, y-o-y)

Fiscal year/Quarter /Month	IIP	Mining	Manufacturing	Electricity	Core IIP	Fiscal year/Quarter /Month	PMI mfg.	PMI ser.
	% change y-o-y							
FY 15	4.0	-1.3	3.8	14.8	4.9	FY15	52.2	51.7
FY 16	3.3	4.3	2.9	5.7	3.0	FY16	51.3	51.7
FY 17	4.6	5.3	4.3	5.8	4.8	FY17	51.6	51.0
FY 18	4.4	2.3	4.7	5.3	4.3	FY18	51.5	50.0
2Q FY 18	3.3	7.1	2.5	6.1	4.0	2Q FY18	50.1	48.0
3Q FY 18	5.9	0.8	7.0	3.8	5.2	3Q FY18	52.5	50.4
4Q FY 18	6.5	1.1	7.5	6.1	5.3	4Q FY18	51.8	49.9
1Q FY 19	5.2	5.5	5.3	4.9	5.2	1Q FY19	52.0	51.2
Mar-18	5.3	3.1	5.7	5.9	4.5	Apr-18	51.6	51.4
Apr-18	4.8	4.0	5.3	2.1	4.6	May-18	51.2	49.6
May-18	3.9	5.8	3.7	4.2	4.3	Jun-18	53.1	52.6
Jun-18	7.0	6.6	6.9	8.5	6.7	Jul-18	52.3	54.2

Source: Office of the Economic Adviser- Ministry of Commerce and Industry and IHS Markit Economics

Table A2: Inflation indicators (annual, quarterly and monthly growth rates, y-o-y)

Fiscal year/Quarter/Month	CPI	Food Price Index	Fuel and light	Core CPI	WPI	Food Price Index	Mfg. products	Fuel and power	Core WPI
	% change y-o-y				% change y-o-y				
FY15	5.9	6.4	4.2	5.8	1.3	4.3	2.6	-6.1	2.7
FY16	4.9	4.9	5.3	4.9	-3.7	1.2	-1.8	-19.7	-1.8
FY17	4.5	4.2	3.3	4.9	1.7	5.9	1.3	-0.3	-0.1
FY18	3.6	1.8	6.2	4.6	2.9	1.9	2.7	8.2	3.0
2QFY18	3.0	0.8	5.1	4.4	2.8	2.9	2.5	8.2	2.6
3QFY18	4.6	3.7	7.5	4.8	3.8	3.5	2.7	9.1	3.1
4QFY18	4.6	3.6	6.8	5.1	2.8	0.6	3.1	4.7	3.8
1Q FY19	4.8	2.9	6.1	6.0	4.7	1.2	3.8	12.2	4.4
Apr-18	4.6	2.8	5.2	5.8	3.6	0.8	3.3	8.0	3.8
May-18	4.9	3.1	5.8	6.1	4.8	1.2	3.8	12.7	4.5
Jun-18	4.9	2.9	7.2	6.1	5.8	1.6	4.2	16.2	4.8
Jul-18	4.2	1.4	8.0	5.8	5.1	-0.9	4.3	18.1	4.7

Source: Office of the Economic Adviser, Ministry of Commerce and Industry and MOSPI

Table A3: Fiscal indicators (annual growth rates, cumulated monthly growth rates, y-o-y)

Fiscal year/Month	Gross tax revenue	Corporate tax	Income tax	Direct taxes*	Indirect taxes**	Fiscal deficit	Revenue deficit
						% of GDP	% of GDP
FY15	9.3	8.7	8.7	8.7	9.8	4.0	2.9
FY16	17.0	6.0	8.5	6.9	30.1	3.9	2.5
FY17	17.9	6.7	21.5	12.3	21.6	3.5	2.1
FY18 (RE over budget actuals FY17)	13.4	16.3	21.0	18.3	8.6	3.5	2.6
	Cumulated growth (%, y-o-y)					% of budgeted target	
Nov-17	16.5	12.4	15.3	13.7	18.3	112.0	152.2
Dec-17	17.3	17.1	17.0	17.1	17.3	113.6	139.5
Jan-18	17.0	19.0	17.5	18.4	15.6	113.7	109.4
Feb-18	15.8	19.7	17.7	18.8	13.0	120.3	119.5
Mar-18	11.8	17.8	19.9	18.6	6.0	99.5	101.1
Apr-18	58.7	24.0	2.5	5.9	130.3	24.3	25.5
May-18	29.9	-82.7	4.8	-13.7	59.3	55.3	68.0
Jun-18	22.1	-1.2	12.8	6.2	36.3	68.7	84.8

Source: Monthly Accounts, Controller General of Accounts-Government of India, Union Budget documents
*Includes corporation tax and income tax **includes customs duty, excise duty, service tax, CGST, UTGST, IGST and GST compensation cess.
For the months from January 2018 to March 2018 fiscal deficit and revenue deficit values are estimated as percentage of revised estimates.

Fiscal year/ Month	CGST	UTGST	IGST	GST compensation cess	Total GST (Centre)
	INR crore				
FY18 (RE)	2, 21, 400	-	1, 61, 900	61, 331	4, 44, 631
FY19 (BE)	6, 03, 900	-	50, 000	90, 000	7, 43, 900
	Monthly tax collection (INR crore)				
Nov-17	23,839	75	18,627	7,103	49,644
Dec-17	24,215	216	17,142	7,899	49,472
Jan-18	23,133	193	19,402	8,024	50,752
Feb-18	43,091	89	19,725	8,197	31,652
Mar-18	27,399	973	13,651	7,569	49,592
Apr-18	32,089	90	19,996	8,503	60,678
May-18	28,119	54	16,932	7,201	52,306
Jun-18	30,936	62	10,212	8,016	49,226

Source: Monthly Accounts, Controller General of Accounts-Government of India, Union Budget documents
Note: IGST revenues are subject to final settlement.

Table A4: Monetary and financial indicators (annual, quarterly and monthly growth rates, y-o-y)

Fiscal year/ Month	Repo rate (end of period)	Fiscal year/Quarter/Month	M1	M3	Bank credit	Agg. deposits	10 yr. Govt. B Yield	Net FDI	Net FPI	FX reserves
	%		% change y-o-y				%	US$ billion	US$ billion	US$ billion
Sep-17	6.00	FY15	11.3	10.9	11.0	12.1	8.3	31.3	42.2	341.6
Oct-17	6.00	FY16	13.5	10.1	9.7	10.5	7.7	36.0	-4.1	355.6
Nov-17	6.00	FY17	3.1	10.1	7.9	11.6	7.0	35.6	7.6	370.0
Dec-17	6.00	FY18	22.1	9.5	7.5	7.5	7.0	30.3	22.1	424.4
Jan-18	6.00	2Q FY18	1.6	5.6	6.1	9.3	6.6	12.4	2.1	399.7
Feb-18	6.00	3Q FY18	45.8	10.6	8.8	4.9	7.1	4.3	5.3	409.4
Mar-18	6.00	4Q FY18	22.1	9.5	10.1	5.4	7.5	6.4	2.3	424.4
Apr-18	6.00	1Q FY19	18.1	9.8	12.7	7.8	7.8	9.8	-9.3	406.1
May-18	6.00	Mar-18	22.1	9.5	10.0	6.2	7.6	2.1	1.2	424.4
Jun-18	6.25	Apr-18	22.0	10.6	12.3	7.7	7.5	4.8	-3.1	420.4
Jul-18	6.25	May-18	20.7	10.4	13.0	8.1	7.8	3.9	-4.1	412.8
Aug-18	6.50	Jun-18	18.1	9.8	12.8	7.6	7.9	1.2	-2.1	406.1

Source: Database on Indian Economy-RBI

Table A5: External trade and global growth

Fiscal year/Quarter/Month	External trade indicators (annual, quarterly and monthly growth rates)							Global growth (annual)		
	Exports	Imports	Trade balance	Ex. rate (avg.)	Crude prices (avg.)	Coal prices (avg.)	Calendar year	World GDP	Adv. econ.	Emer. econ.
	% change y-o-y		US$ billion	INR/US$	US$/bbl.	US$/mt		% change y-o-y		
FY15	-1.3	-0.5	-137.7	61.1	83.2	65.9	2012	3.5	1.2	5.3
FY16	-15.6	-15.2	-117.7	65.5	46.0	52.7	2013	3.3	1.2	5.0
FY17	5.1	0.9	-108.2	67.1	47.9	70.4	2014	3.4	1.9	4.6
FY18	10.0	19.9	-156.8	64.5	55.7	85.6	2015	3.4	2.1	4.3
2Q FY18	13.4	19.1	-32.1	64.3	50.2	85.9	2016	3.2	1.7	4.4
3Q FY18	13.1	16.1	-42.7	64.7	58.7	90.0	2017	3.8	2.3	4.8
4Q FY18	3.9	13.9	-42.0	64.3	64.6	91.2	2018**	3.9	2.4	4.9
1Q FY19	14.2	13.5	-44.9	67.0	47.4	61.2	2019**	3.9	2.2	5.1
Apr-18	5.2	4.6	-13.7	65.6	68.8	87.6	2020*	3.8	1.7	5.1
May-18	20.2	14.9	-14.6	67.5	73.4	95.9	2021*	3.8	1.7	5.1
Jun-18	17.6	21.3	-16.6	67.8	NA	NA	2022*	3.7	1.5	5.0
Jul-18	14.3	28.8	-18.0	68.7	NA	NA	2023*	3.7	1.5	5.0

Source: Database on Indian Economy - RBI, Pink Sheet - World Bank and IMF World Economic Outlook April 2018 and IMF World Economic Outlook Update, July 2018; * indicates projections as per the April 2018 database and **indicates projections as per July 2018 database

Table A6: Macroeconomic aggregates (annual and quarterly real growth rates, % change y-o-y)

Fiscal year/Quarter	Output: Major sectors									IPD inflation
Fiscal year/Quarter	GVA	Agr.	Ming.	Mfg.	Elec.	Cons.	Trans.	Fin.	Publ.	GVA
FY15	7.2	-0.2	9.7	7.9	7.2	4.3	9.4	11.0	8.3	3.6
FY16	8.1	0.6	13.8	12.8	4.7	3.7	10.3	10.9	6.1	1.0
FY17 (1st RE)	7.1	6.3	13.0	7.9	9.2	1.3	7.2	6.0	10.7	2.9
FY18 (PE)	6.5	3.4	2.9	5.7	7.2	5.7	8.0	6.6	10.0	3.0
Q4FY16	8.7	1.0	12.3	14.2	7.6	4.6	13.1	8.8	6.1	2.6
Q1FY17	8.3	4.3	10.5	9.9	12.4	3.0	8.9	10.5	7.7	1.2
Q2FY17	7.2	5.5	9.1	7.7	7.1	3.8	7.2	8.3	8.0	2.3
Q3FY17	6.9	7.5	12.1	8.1	9.5	2.8	7.5	2.8	10.6	2.8
Q4FY17	6.0	7.1	18.8	6.1	8.1	-3.9	5.5	1.0	16.4	5.1
Q1FY18	5.6	3.0	1.7	-1.8	7.1	1.8	8.4	8.4	13.5	2.3
Q2FY18	6.1	2.6	6.9	7.1	7.7	3.1	8.5	6.1	6.1	2.9
Q3FY18	6.6	3.1	1.4	8.5	6.1	6.6	8.5	6.9	7.7	3.8
Q4FY18	7.6	4.5	2.7	9.1	7.7	11.5	6.8	5.0	13.3	2.9

	Expenditure components						IPD inflation
Fiscal year/Quarter	GDP	PFCE	GFCE	GFCF	EX	IM	GDP
FY15	7.4	6.4	7.6	2.6	1.8	0.9	3.3
FY16	8.2	7.4	6.8	5.2	-5.6	-5.9	2.1
FY17 (1st RE)	7.1	7.3	12.2	10.1	5.0	4.0	3.5
FY18 (PE)	6.7	6.1	10.9	7.6	4.4	9.9	3.0
Q4FY16	9.0	11.8	2.4	3.9	-1.6	-3.7	1.6
Q1FY17	8.1	8.3	8.3	15.9	3.6	0.1	2.7
Q2FY17	7.6	7.5	8.2	10.5	2.4	-0.4	2.9
Q3FY17	6.8	9.3	12.3	8.7	6.7	10.1	3.8
Q4FY17	6.1	3.4	23.6	4.2	6.6	6.6	4.5
Q1FY18	5.6	6.9	17.6	0.8	5.9	18.5	2.6
Q2FY18	6.3	6.8	3.8	6.1	6.8	10.0	3.0
Q3FY18	7.0	5.9	6.8	9.1	6.2	10.5	3.8
Q4FY18	7.7	6.7	16.8	14.4	3.6	10.9	2.9

Source: National Accounts Statistics, MOSPI

List of abbreviations

Sr. no.	Abbreviations	Description
1	AD	Aggregate demand
2	ADB	Asian Development Bank
3	Agr.	Agriculture, forestry and fishing
4	bbl.	Barrel
5	BE	Budget Estimate
6	CAB	Current account balance
7	CGA	Comptroller General of Accounts
8	CGST	Central Goods and Services Tax
9	Cons.	Construction
10	CPI	Consumer Price Index
11	CSO	Central Statistical Organization
12	Disc.	Discrepancies
13	dmtu	Dry metric ton unit
14	Elec.	Electricity, gas, water supply and other utility services
15	EMEs	Emerging Market Economies
16	EMDEs	Emerging market and developing economies
17	EXP	Exports
18	FC	Finance Commission
19	FII	Foreign investment inflows
20	Fin.	Financial, real estate and professional services
21	FMCG	Fast moving consumer goods
22	FPI	Foreign portfolio investment
23	FY	Fiscal year (April–March)
24	GDP	Gross Domestic Product
25	GFCE	Government final consumption expenditure
26	GFCF	Gross fixed capital formation
27	GoI	Government of India
28	GST	Goods and Services Tax
29	GVA	Gross value added
30	IAD	Index of Aggregate Demand
31	ICB	Indian Crude Basket
32	IGST	Integrated Goods and Services Tax
33	IIP	Index of Industrial Production
34	IMI	Index of Macro Imbalance
35	IMP	Imports
36	IPD	Implicit price deflator
37	LAF	Liquidity adjustment facility
38	MCLR	Marginal cost of funds based lending rate
39	Ming.	Mining and quarrying
40	Mfg.	Manufacturing
41	m-o-m	Month-on-month
42	mt	Metric ton
43	MPC	Monetary Policy Committee
44	NDU	Non-departmental undertaking
45	NEXP	Net exports (exports minus imports of goods and services)
46	OECD	Organisation for Economic Co-operation and Development
47	PFCE	Private final consumption expenditure
48	PMI	Purchasing Managers' Index (reference value = 50)
49	POL	Petroleum, Oil and Lubricants
50	RE	Revised estimate

51	ToR	Terms of Reference
52	Trans.	Trade, hotels, transport, communication and services related to broadcasting
53	UTGST	Union territory goods and services tax
54	WPI	Wholesale Price Index
55	y-o-y	Year on year

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