February 2017

Economy Watch

Monitoring India's macro-fiscal performance

Building a better working world

Contents

List of abbreviations:

Sr. no	Indicator	Description
1	bbl.	barrel
2	CAB	Current account balance
3	CPI	Consumer Price Index
4	CSO	Central Statistical Organization
5	disc.	Discrepancies
6	EMDEs	Emerging market and developing economies
7	FII	Foreign investment inflows
8	FPI	Foreign portfolio investment
9	FRBM	Fiscal Responsibility and Budget Management
10	FY	Fiscal year (April–March)
11	GFCE	Government final consumption expenditure
12	GFCF	Gross fixed capital formation
13	GST	Goods and Services Tax
14	GVA	Gross value added
15	IDS	Income Declaration Scheme
16	IAD	Index of aggregate demand
17	IEA	International Energy Agency
18	IIP	Index of industrial production
19	MCLR	Marginal cost of funds based lending rate
20	m-o-m	Month-on-month
21	MPC	Monetary Policy Committee
22	NDU	Non Departmental Undertaking
23	NEXP	Net exports (exports minus imports of goods and services)
24	NPA	Non-performing asset
25	OPEC	Organization of Petroleum Exporting Countries
26	PFCE	Private final consumption expenditure
27	PMI	Purchasing Managers' Index (reference value = 50)
28	PSU	Public sector undertaking
29	WPI	Wholesale Price Index
30	WESP	World Economic Situation and Prospects
31	y-o-y	Year on year

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Foreword: responding to growth slowdown: the next steps

Available evidence, although still partial, confirms a growth slowdown in FY17 compared to FY16. This has been the result of an ongoing slowdown due to a noticeable investment and export slowdown accentuated by the short-term contractionary effects of demonetization. As per the Second Advance Estimates released by the CSO, this fall is of 0.8% points. As per the IMF, it could be about 1% point.

Two major opportunities to respond to this slowdown arose in the form of the Union Budget for FY18 and the monetary policy review in early February. The RBI kept the policy interest rate unchanged citing upside risks to inflation. The fiscal authorities provided for a small increase in the growth of capital expenditure and chose to deviate from the fiscal consolidation path by a margin of 0.2% points, which would otherwise have resulted in a fiscal deficit of 3% of GDP for FY18. The FRBM Review Committee, which had examined the fiscal consolidation path, had provided the scope for such a deviation up to 0.5% point subject to review by a "Fiscal Council." Both the fiscal and monetary authorities may review the policy stance during the course of FY18.

In the interim, economic signals need to be closely watched. We need to assess (1) whether the adverse effects of demonetization have begun to taper off, (2) whether the investment uptick reflected in the national income data in the third and fourth quarters of FY17 will be sustained, (3) whether the CPI inflation would continue to trend downward since global crude prices appear to be stabilizing at around US$55/bbl., (4) whether global developments would lead to an increase in India's export growth at least in the next few quarters and (5) whether there would be a shortfall in domestic indirect tax revenues in the short-term due to the introduction of GST.

While these are short-term considerations, the policy must also take into account the longer-term objective of uplifting the GDP growth rate to its potential, which is estimated by the Economic Survey at 8% plus. For this purpose, reliance will have to be placed on supporting domestic demand as well as productivity enhancing measures. The Government has already undertaken considerable supply side reforms covering the power, mining, transport and telecommunications sectors. The power supply situation in the country has improved significantly. Some of the infrastructure bottlenecks that had hitherto plagued the Indian industry are getting removed. GST implementation appears to be on course with a July 2017 launch, which will open up significant long-term efficiency-improving opportunities for the industry.

A follow-up on demonetization would involve pursuing clear cases of parallel economy operations and making the best use of the net additional bank deposits linked to demonetization. The combined effect of increased transparency from enhanced digital transactions and the GST should result in a tangible and sustainable increase in the tax-GDP ratio. The Government's policy matrix requires to be supplemented in two additional dimensions. First, there is a need to undertake expenditure-side reforms that go beyond reduction in explicit subsidies. There is considerable scope for reducing implicit subsidies that arise due to unrecovered costs of publically provided private services of a non-merit nature. Further, large-scale restructuring and downsizing of central ministries are called for in view of the abolition of the plan/non-plan distinction. Second, there has to be a stronger support to domestic demand through fiscal means aimed at augmenting the Government's capital expenditure, which is budgeted to grow by 10.7% in FY18. This may not be enough to increase the share of the Government capital expenditure in GDP, which is estimated to fall to 1.8% in FY18 as compared to 1.9% in FY17.

D.K. Srivastava, Chief Policy Advisor, EY India

Highlights

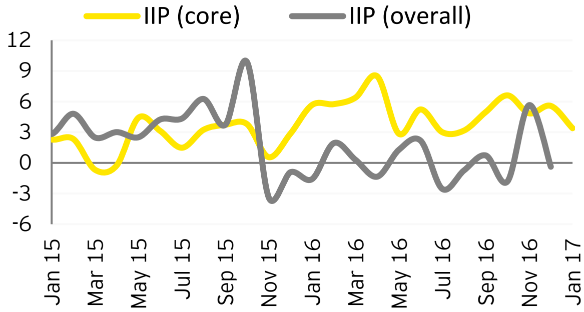
1. As per the CSO's Second Advance Estimates, **GDP and GVA growth rates have fallen by 0.8% points and 0.9% points, respectively, in FY17.**
2. **PMI signals marginal improvement in manufacturing as well as services,** which remained above the threshold of 50 in February 2017.
3. **Annual CPI inflation declined to a historic low of 3.2% in January 2017** due to a persistent fall in prices of food items.
4. **At 105.6% of the annual revised estimate, cumulated fiscal deficit up till January 2017 became higher than the RE for FY17** in absolute amount. The Center's cumulated revenue deficit also became 130.2% of the annual revised estimate during this period.
5. **Industrial credit continued its contractionary trend** as it fell by (-) 5.1% in January 2017.
6. **Growth in merchandise exports declined to 4.3% in January 2017** as compared to 5.7% in December 2016.
7. **The WESP 2017 estimated global growth at 2.2% in 2016,** the slowest rate of growth since the 2009 financial and economic crisis. Growth in China is estimated at 6.6% in 2016 and 6.5% in 2017.
8. **Global crude prices increased to US$54.4/bbl. in February 2017** as compliance with the agreement on restricting supply has been high at 90%.
9. **The IAD contracted by (-) 4.0% in December 2016** from (-) 3.6% in November.
10. **After demonetization, commodities/services that suffered** relatively more were motor vehicles, including two-wheelers, railway passenger traffic, **steel, food products, textiles, chemical and chemical products, and other non-metallic mineral products.**

1 Growth: core sector growth moderates in January

A. Industrial growth: core sector output signals further slowdown in January

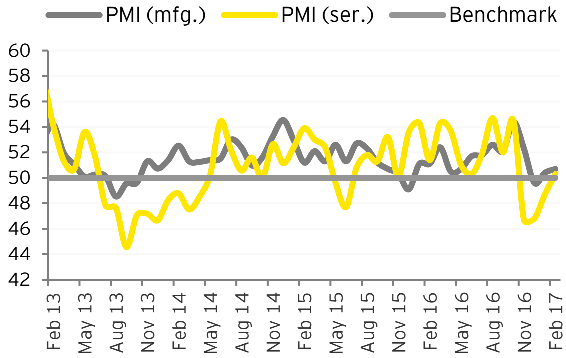
- IIP contracted by (-) 0.4% in December 2016 (y-o-y) from a growth of 5.7% in November 2016 (Chart 1) as growth in the manufacturing sector declined. A strong growth in November 2016 was attributed to a favorable base effect, which has now waned.
- The manufacturing sector, which accounts for over 75% of the overall IIP, contracted by (-) 2.0% in December 2016 as compared to a growth of 5.5% in November. However, both the electricity and the mining sectors grew by 6.3% and 5.2%, respectively, in December 2016.
- As per use-based industrial classification, the capital goods industry contracted by (-) 3.0% in December 2016 after posting a growth of 15.0% (y-o-y) in November 2016. The consumer goods industry declined by (-) 6.8% as compared to a growth of 5.6% in November.
- Growth in the output of eight core infrastructure industries slowed to a five-month low of 3.4% (y-o-y) in January 2017 from 5.6% in December 2016. This was on account of moderation in the growth of key industries including electricity (4.8%) and steel (11.4%) and contraction in the output of petroleum refineries [(-) 1.5%] and cement [(-) 13.3%].

Chart 1: IIP and core IIP growth (% y-o-y)



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

Chart 2: NIKKEI PMI



Source: NIKKEI PMI, Markit Economics

Growth in core sector output, having a weight of 38% in the overall IIP, moderated to 3.4% in January 2017 from 5.6% in December 2016, signaling a further slowdown in industrial activity. IIP growth contracted by (-) 0.4% in December 2016 from a growth of 5.7% in November.

C. PMI: marginal improvement in manufacturing and services in February 2017

PMI signals marginal improvement in manufacturing as well as services, which remained above the threshold of 50 in February 2017.

- Headline manufacturing PMI (sa) increased to 50.7 in February from 50.4 in January 2017 (Chart 2). New orders and output expanded for the second consecutive month in February, reflecting improved demand in domestic as well as external markets.
- After contracting for three consecutive months, headline services PMI (sa) at 50.3 in February 2017 edged marginally above the threshold of 50. New orders and output increased in the "financial intermediation" and "other services" categories, while the remaining categories continued to decline, although at a slower pace.
- Driven by some support from manufacturing, composite PMI Output Index (sa) crossed over from 49.4 in January to above 50 in February 2017.

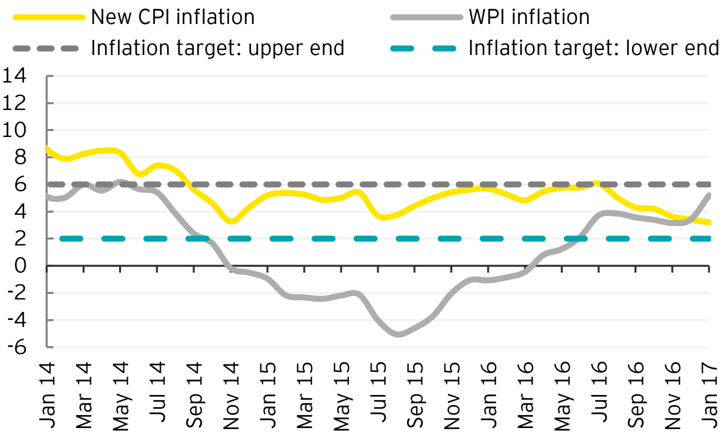
2 Inflation: declining food prices push CPI inflation to a historic low

Annual CPI inflation declined to a historic low of 3.2% in January 2017 due to a persistent fall in prices of food items such as vegetables and pulses.

- CPI-based inflation (Chart 3) further declined to 3.2% in January 2017 from 3.4% in December 2016.
- Core CPI inflation (excluding food and fuel) increased marginally to 5.1% after declining to 4.9% in December 2016 (y-o-y) primarily due to a sharp rise in the prices of transport and communication services as a result of rising crude prices.
- CPI-based consumer food inflation has been declining since July 2016, when it had reached a 23-month peak of 8.4%. It declined to 0.5% in January 2017.
- Fuel and lighting inflation declined to 3.4% in January after reaching a 10-month high of 3.8% in the previous month.
- According to the RBI, inflation in 4QFY17 is likely to be below 5%. Hardening crude prices, exchange rate volatility and the effects of house rent allowance under the 7th Central Pay Commission could impart an upside push to inflation in 2HFY18.

According to the Monetary Policy Review in February 2017, inflation is projected to be in the range of 4%–4.5% in 1HFY18 and around 4.5%–5% in 2HFY18.

Chart 3: inflation (y-o-y; %)



Source: Ministry Of Statistics and Programme Implementation (MOSPI)

WPI inflation increased to a 30-month high of 5.2% in January 2017 from 3.4% (y-o-y) in December 2016 because of a sharp rise in the price of fuel and power.

- WPI Inflation for fuel and power climbed to an 8-year high of 18.1% in January 2017 as compared to 8.7% in December 2016 partly due to base effect and partly due to rising crude prices. Inflation in diesel prices reached an 11-year high of 31.1% in January 2017.
- WPI inflation for primary articles increased marginally to 1.3% in January 2017 from 0.3% in December 2016. Inflation in non-food articles, including fibers and oilseeds, increased to 2.0% in January 2017 as compared to 0.6% in the previous month. Inflation in minerals reached a 58-month peak of 25.4%.
- WPI core inflation increased for the sixth successive month at 2.7% in January as compared to 2.2% in December 2016.
- Inflation in basic metals and alloys reached a 54-month peak of 8.0% in January 2017.
- WPI- and CPI-based inflation rates had started to diverge since February 2012. This divergence reached a peak of 9% points in September 2015. Since then, they started to converge gradually. In January 2017, the WPI crossed the CPI for the first time in five years.

3 Fiscal performance: cumulated fiscal deficit up to January 2017 exceeds the annual revised target

A. Tax and non-tax revenues

The Center's gross tax revenues grew by 17.7% during April–January FY17, driven by robust growth in revenues from income tax, union excise duties and service tax. Non-tax revenues contracted by (-) 4.6% during this period.

- The Center's revenue receipts during April–January FY17 were 70.9% of the annual revised target as compared to 73.1% during the same period of FY16.
- Growth in cumulated gross tax revenues was lower at 17.7% during April–January FY17 compared to 21.3% during the corresponding period of FY16 (Chart 4). Growth in indirect taxes was at 24.8% during April–January FY17, while that in direct taxes was at 9.7%.
- Within direct taxes, income tax revenues grew by 19.7% during April–January FY17 (Chart5) as compared to 12.6% during the same period of FY16. On the other hand, growth in corporation tax revenues remained sluggish at 3.2% during April–January FY17 as compared to the corresponding value of 10.2% in FY16. For realizing the revised estimates of revenues from income tax and corporation tax for FY17, a growth of 30.4% and 22.4%, respectively, is required during the remaining two months of the fiscal over the corresponding period of FY16.
- Among indirect taxes, Union excise duties witnessed a strong growth of 42.9% during April–January FY17. Growth in service tax revenues was also high at 23.3% during April–January FY17. There was a slowdown in the pace of expansion of excise duty and service tax collections in January 2017 compared to the first nine months ending December 2016.
- Growth in customs duties remained subdued at 5.2% during April–January FY17 as compared to 16.6% in the corresponding period of FY16.

Chart 4: growth in cumulated gross tax revenues up to January 2017

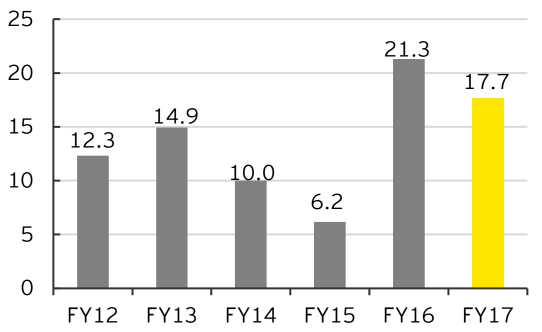
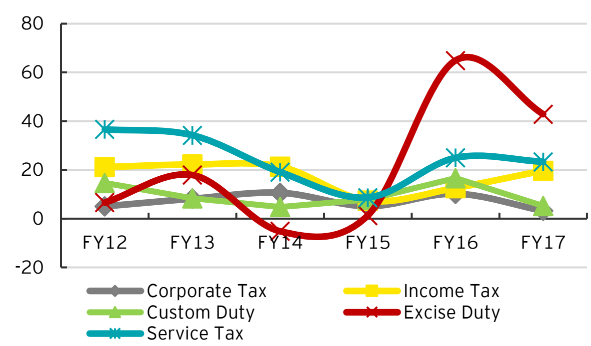


Chart 5: growth in cumulated tax revenues up to January 2017



Source: Monthly Accounts, Controller General of Accounts, Government of India

- Non-tax revenues contracted by (-) 4.6% during April–January FY17 as compared to a growth of 27.8% in the corresponding period of FY16. As a proportion of the annual revised estimate, non-tax revenues stood at 57.7% during this period as compared to 78.2% in the corresponding period of FY16.
- Disinvestment receipts stood at INR31,014 crore during April–January FY17, which is 68.2% of the annual revised estimate for FY17. For realizing the revised estimates of FY17 as given in Budget FY18, additional disinvestment amounting to INR14,486 crores would be required.

B. Expenditures: revenue and capital

- Total expenditure grew by 12.6% during April–January FY17 as compared to the corresponding value of 7.3% in FY16.

- Growth in revenue expenditure was 15.2% during April–January FY17 as compared to 2.7% during the same period in FY16 (Chart 6). This largely reflects the impact of salary and pension revisions based on the recommendations of the 7th Pay Commission.
- The Center's capital expenditure contracted by (-) 2.7% during April–January as compared to a growth of 45.5% in the corresponding period of FY16 (Chart 7). For realizing the revised estimates for FY17, capital expenditure must increase by 73.5% during the last two months of FY17 over the corresponding period of FY16.

The Center's revenue expenditure grew by 15.2% during April–December FY17, while capital expenditure contracted by (-) 2.7%.

Chart 6: growth in cumulated revenue expenditure up to January 2017

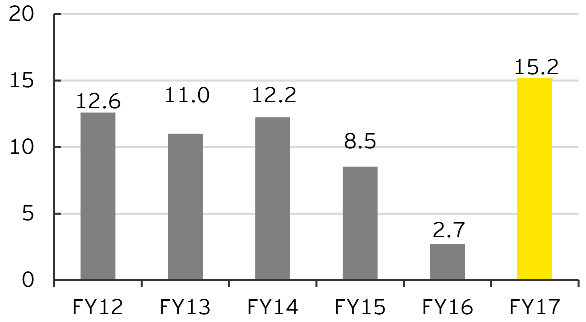
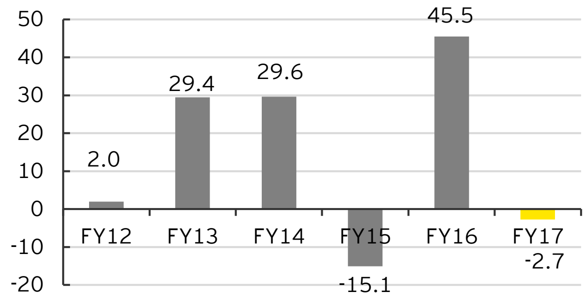


Chart 7: growth in cumulated capital expenditure up to January 2017



Source: Monthly Accounts, Controller General of Accounts, Government of India

C. Fiscal imbalance

- The Center's fiscal deficit stood at 105.6% of the annual revised target during April–January FY17 as compared to 99.5% in the corresponding period of FY16, largely due to increased revenue expenditure (Chart 8).
- The Center's revenue deficit increased to 130.2% of the annual revised target during April–January FY17 as compared to 101.3% during the same period in FY16 (Chart 9). This marked the highest share of revenue deficit in the first 10 months of a fiscal year since FY01.

As per revised estimates for FY17 given in Budget FY18, the fiscal deficit target of 3.5% of GDP would be met, facilitated by the seasonal pick-up in tax revenue inflows in February and March 2017, and expected revenues from disinvestment and dividends.

Chart 8: cumulated fiscal deficit up to January 2017 as a % of annual revised estimates for FY17

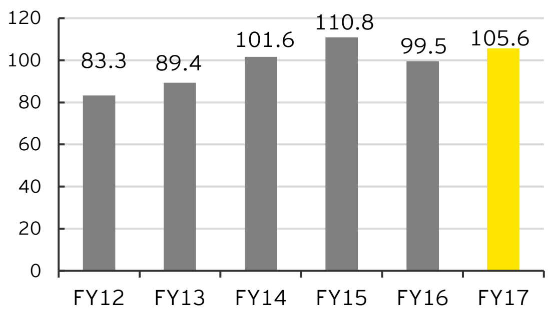
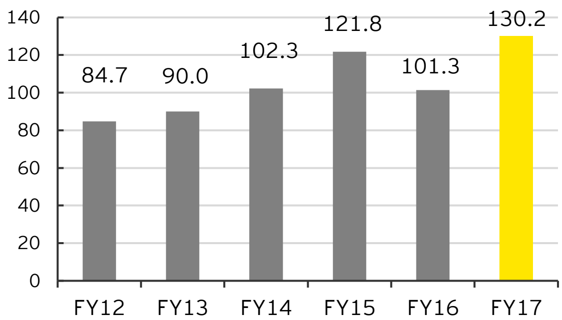


Chart 9: cumulated revenue deficit up to January 2017 as a % of annual revised estimates for FY17

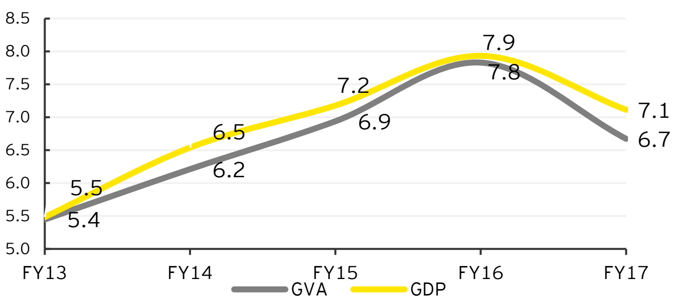


Source: Monthly Accounts, Controller General of Accounts, Government of India

4 In focus: impact of demonetization on India's GDP: capturing mixed signals

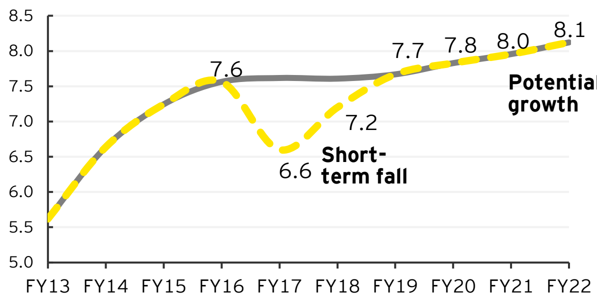
Economists and policymakers have generally agreed that the impact of demonetization on India's growth performance has been adverse in the short term. The official estimate provided by the CSO in its Second Advance Estimates is based mostly on data available for the first 9–10 months of FY17. Extrapolation has been done for the remaining months for preparing the advance estimates for the full year. Since demonetization took place on 8 November 2016, the basic information used by the CSO reflects the impact of demonetization for only close to two months. Some other international institutions such as the IMF have also estimated India's GDP growth for FY17. By comparing its earlier estimate (October 2016) for FY17 with the recent estimate (January 2017), we can get an idea of its assessment of the impact of demonetization on India's GDP growth. We note that in FY16, the CSO's estimates show a real GDP growth of 7.9% whereas the IMF estimated it at 7.6%. For FY17, in both cases, a fall is indicated from their respective estimates of the previous year. In the CSO's case, the fall is of 0.8% points whereas in the case of IMF, it is 1% point. Thus, as far as IMF estimates are concerned, India's GDP growth was only 6.6% in FY17 (Chart 11). The CSO's estimates may not fully reflect the impact of demonetization as its methodology uses information for seven pre-demonetization months and for slightly less than two months of the post-demonetization period. However, in the last quarter of the fiscal year, it is only the information for the post-demonetization months that is relevant.

Chart 10: CSO's estimate of real GVA and GDP growth (%)



Source (Basic Data): MOSPI, CSO

Chart 11: IMF-Annual GDP growth (%) up till FY22



Source (Basic Data): IMF

GVA growth, which reflects output growth, has been noticeably lower than GDP growth in the period from FY13 to FY17 (Chart 10). This reflects that net indirect taxes have grown faster than the GVA. The extent of the difference is the largest in FY17. Data on net indirect taxes on accounts basis was available for 9–10 months. Extrapolation of this data might also overestimate the performance of tax revenues in the last quarter.

Demonetization and the structure of demand and output

Demonetization did have a differential impact on sectoral output as well as the structure of demand (Table 1 and 2).

Table 1: real GDP growth (%)

AD component	4Q FY16	1Q FY17	2Q FY17	3Q FY17	4Q FY17
PFCE	10.6	7.2	5.1	10.1	6.5
GCE	3.6	15.5	15.2	19.9	18.1
GFCF	-0.03	-2.2	-5.3	3.5	6.5
EXP	-2.46	2.1	-0.9	3.4	4.4
IMP	-4.36	-2.7	-7.4	4.5	1.4
GDP	**8.6**	**7.2**	**7.4**	**7.0**	**7.0**
Of which					
% contribution of disc.	2.2	1.2	3.2	-1.2	-0.5

Source (Basic Data): CSO
Note: Growth rates for 4Q FY15-17 are based on numbers derived as the difference between the respective annual numbers and the numbers for the first three quarters as per the CSO release dated 28th February, 2017.

Table 2: sectoral real GVA growth (%)

Sector	4Q FY16	1Q FY17	2Q FY17	3Q FY17	4Q FY17
Agr.	1.7	1.9	3.8	6.0	5.0
Ming.	11.5	-0.3	-1.3	7.5	-0.7
Mfg.	10.8	9.0	6.9	8.3	6.8
Elec.	7.8	9.6	3.8	6.8	6.4
Cons.	3.0	1.7	3.4	2.7	4.8
Trans.	13.2	8.2	6.9	7.2	7.0
Fin.	8.9	8.7	7.6	3.1	5.9
Publ.	6.7	9.9	11.0	11.9	11.7
GVA	**8.2**	**6.9**	**6.7**	**6.6**	**6.5**

Source (Basic Data): CSO

Quarterly growth data relating to components of aggregate demand indicate that investment contraction reflected in the growth rate for GFCF started in 4QFY16 and the magnitude of contraction continued to increase until 2QFY17. This therefore preceded demonetization. After demonetization, a consumption slowdown is evident at least in 4QFY17. The pick-up in investment demand in the third and even more strongly in the fourth quarter is surprising, but it could possibly be due to an increase in the Government's capital expenditure as reflected in the annual revised estimates for FY17 in the Union Budget.

On the output side, signals are considerably mixed. There is a noticeable downturn in "mining and quarrying" and manufacturing in 4QFY17. There is a mild downturn in the case of "electricity, gas, water supply and other utilities" and "transport and communication." For the overall GVA, there is a steady slowdown through the quarters as its growth fell from 8.2% in 4QFY16 to 6.5% in 4QFY17, a fall of 1.7% points. Thus, comparing 4QFY17 to 4QFY16, there is a significant fall, both in GDP and GVA growth rates but it reflects the combined effect of an ongoing slowdown preceding demonetization and demonetization.

Supplementary slowdown signals

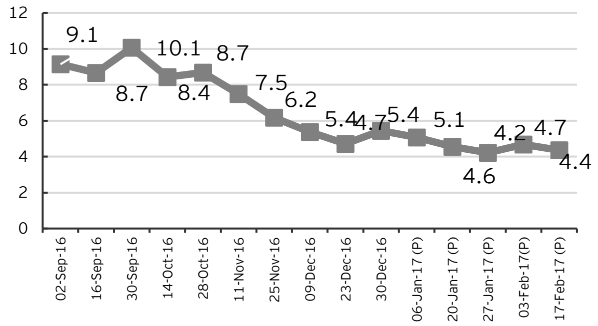
PMI data for manufacturing and services and credit growth data provide leading signals as to the direction of the economy's growth momentum. In terms of monthly data, PMI manufacturing reflected a slowdown/contraction starting November 2016 (Table 3). This trend continued at least up to February 2017. Further supplementary evidence is obtained from examining fortnightly data on credit growth. There has been a sharp and continued slowdown since end-October 2016 (Chart 12).

Table 3: PMI manufacturing and services

#	Indicator	Sep-16	Oct-16	Nov-16	Dec-16	Jan-16	Feb-17
1	Headline Manufacturing PMI	52.1	54.4	52.3	49.6	50.4	50.7
2	Headline Services PMI	52	54.5	46.7	46.8	48.7	50.3
3	Headline Composite Output Index	52.4	55.4	49.1	47.6	49.4	50.7

Source (Basic Data): NIKKEI PMI, Markit Economics

Chart 12: credit growth (%)



Source (Basic Data): RBI

Selected sectors in adversity

Latest available IIP data indicates that some sectors such as steel, food products, textiles, chemical and chemical products, other non-metallic mineral products and fabricated metal products clearly came into adversity in the post-demonetization months. In most cases, a sharp contraction is evident as indicated in Table 4. A noticeable contraction is also observed in the sales of motor vehicles, including two-wheelers, and railway passenger traffic (Table 5).

Table 4: IIP (%, y-o-y)

Month	Index of cement (core)	Food products and beverages	Textiles	Chemicals and chemical products	Other non-metallic mineral products	Fabricated metal products, except machinery and equipment
Oct-16	6.2	-0.5	-4.0	1.7	3.2	-10.8
Nov-16	0.5	7.1	3.8	1.0	-0.7	5.3
Dec-16	-8.7	-3.5	-6.6	-4.6	-9.2	-1.4

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

Table 5: motor vehicles sales and railway passenger traffic (%, m-o-m)

Year/Item	Motor vehicle sales	Railway passengers traffic
Oct-16	-3.2	-1.5
Nov-16	-25.8	5.5
Dec-16	-17.6	-5.4

Source: Society of Indian Automobile Manufacturers, Ministry of Railways

In conclusion, the following observations can be made:

1. In the annual GDP growth, there is a fall of 0.8%–1% points, according to CSO and IMF estimates. This is due to both pre-demonetization slowdown and demonetization.
2. In the 4QFY17 growth, which suffered the brunt of demonetization, the estimated fall, according to the CSO, is 1.6% points in GDP and 1.7% points in GVA.
3. Sectors that have suffered relatively more are motor vehicles, including two-wheelers, railway passenger traffic, steel, food products, textiles, chemical and chemical products, other non-metallic mineral products and fabricated metal products.

5 Money and finance: industrial credit continues to contract in January

A. Monetary sector

i. Monetary policy

- In the monetary policy review held in February 2017, the RBI's Monetary Policy Committee unanimously voted to retain the policy repo rate at 6.25% (Chart 13). The MPC decided to change the stance from accommodative to neutral while keeping the policy rate on hold and to assess the transitory effects of demonetization on inflation and growth.
- Demonetization-induced liquidity overhang weighed on domestic money markets in December 2016. Open market operations have been on a liquidity absorption mode since then. In order to ease the shortage of cash in the economy, rebalancing has been under way with the injection of new bank notes and expansion of currency in circulation.

Chart 13: movements in repo rate

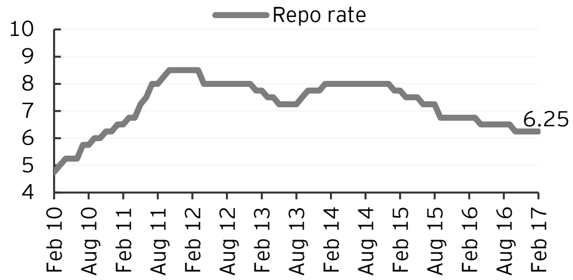
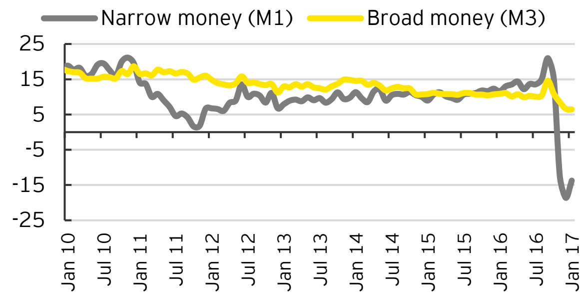


Chart 14: growth in narrow and broad money



Source: Data Base on Indian Economy, RBI

The RBI kept the policy repo rate unchanged at 6.25% in February 2017. After demonetization, the RBI's open market operations have been on a liquidity absorption mode.

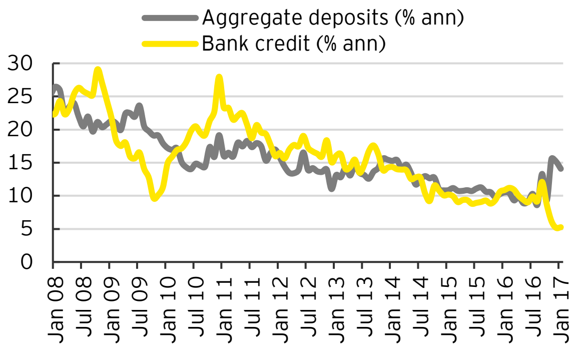
ii. Money stock

- Growth in broad money (M_3) continued to moderate as it fell to a historic low of 6.4% (y-o-y) in January 2017 from 6.6% in December 2016 (Table A4). Growth in time deposits, accounting for over 76% of the broad money stock, slowed further to 11.9% in January 2017 from 13.6% December 2016.
- Narrow money (M_1) contracted although at a slower pace of (-) 13.7% in January 2017 as compared to (-) 18.6% in December 2016 (Chart 14). Growth in currency in circulation declined for the third straight month to (-) 37.8% in January 2017. Despite the RBI's efforts to increase the supply of currency through injecting new bank notes, growth of currency in circulation remains constrained.

iii. Aggregate credit and deposits

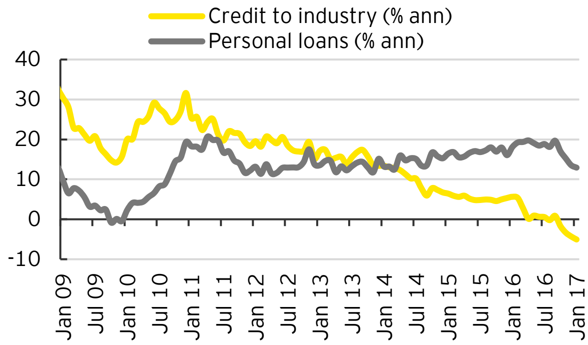
- Growth in bank credit improved marginally to 5.3% in January 2017 from a historic low of 5.1% in December 2016 (Chart 15). Non-food credit grew by 5.3% in January 2017, same as the growth seen in December 2016, while food credit grew by 2.3% in January from a contraction of (-) 5.4% in December.
- The y-o-y growth of personal loans, a key driver of non-food credit growth, fell to a 34-month low of 12.9% in January 2017 from 13.5% in December 2016 (Chart 16). Credit to industries continued its contracting trend as it fell to (-) 5.1% in January 2017 from (-) 4.3% in December 2016.
- Growth in aggregate bank deposits slowed further to14.1% (y-o-y) in January 2017 from 15.2% in December 2016.

Chart 15: growth in credit and deposits



Source: Data Base on Indian Economy, RBI

Chart 16: growth in industrial and personal loans



Source: Data Base on Indian Economy, RBI

B. Financial sector

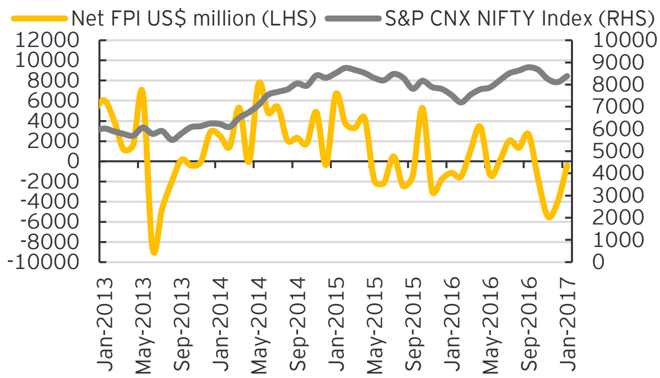
i. Interest rates

- The MCLR was lowered to 7.75% in January 2017 from 8.65% in December 2016. Since its introduction in April 2016, the MCLR has been cut down by a total of 1.20 basis points.
- Banks have lowered the interest rates on term deposits (>1 year) further to 6.75% in January 2017 as compared to 6.79% in December 2016.
- The average yield on 10-year Government bonds reversed its falling trend for the first time in 11 months as it increased to 6.79% in January 2017 as compared to 6.53% in December 2016. Downward revision of global growth outlook by the IMF and continued portfolio outflows from equity led to some volatility in bond yields during the month.

ii. FPI and stock market

- The benchmark S&P NIFTY recovered to 8,836 points (average) in January 2017, gaining nearly 272 points as compared to the average index value of 8,114 points in December 2016 (Chart 17). Optimism prevailed in the market as investors anticipated a fiscal stimulus in the FY18 Union Budget that was presented on 01 February 2017.
- As per provisional data, overall FIIs turned positive in January 2017 due to lower FPI outflows. FIIs registered a net inflow of US$2.9 billion in January 2017 as compared to a net outflow of US$1.3 billion in December 2016. Net FPI outflows moderated to US$0.4 billion in January 2017 as compared to US$4.1 billion in December 2016. Net FDI inflows increased to US$3.4 billion in January from US$2.7 billion in December.

Chart 17: stock market movement



6 External sector: growth in exports remain low but positive in January

A. CAB

CAB as percentage of GDP deteriorated to (-) 0.6% in 2QFY17 (Table 6, Chart 19) from (-) 0.1% in the previous quarter. Merchandise trade balance worsened to (-) US$25.6 billion in 2QFY17 from a seven-year low of (-) US$23.8 billion in 1QFY17.

Table 6: current account balance (US$ billion)

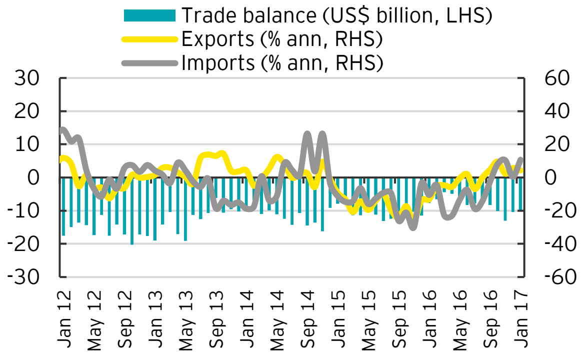
	CAB (- deficit/+surplus) (US$ billion)	CAB as a % of nominal GDP	Goods account net (US$ billion)	Services account net (US$ billion)	Income account net (US$ billion)	Transfers net (US$ billion)
FY13	-88.2	-4.8	-195.7	64.9	-21.5	64.0
FY14	-32.4	-1.7	-147.6	73.0	-23.0	65.3
FY15	-26.8	-1.3	-144.9	76.6	-24.1	65.7
FY16	-22.0	-1.1	-130.1	53.7	-17.8	47.7
3QFY16	-7.1	-1.3	-34.0	18.0	-6.4	15.3
4QFY16	-0.3	-0.1	-24.8	16.1	-6.6	15.1
1QFY17	-0.3	-0.1	-23.8	15.8	-6.2	14.2
2QFY17	-3.4	-0.6	-25.6	16.3	-7.9	14.0

Source: Database on Indian Economy, RBI

B. Merchandise trade and exchange rate

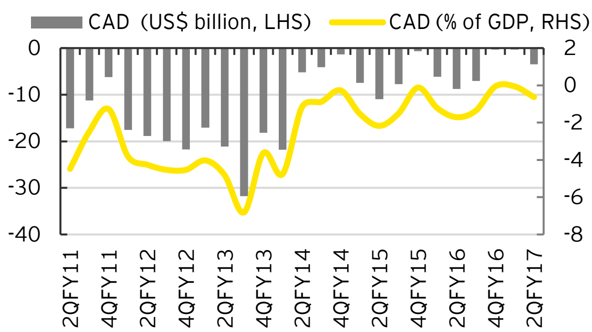
- Growth (y-o-y) in merchandise exports declined to 4.3% in January 2017 as compared to 5.7% in the previous month (Chart 18).
- The decline (y-o-y) was primarily due to a fall in exports of gems and jewelry by 4.5% and exports of drugs and pharmaceuticals by 11.6% besides a marginal slowdown in growth of engineering goods to 11.95% from 19.9% in the previous month.
- Growth (y-o-y) in overall imports rose sharply to 10.7% in January 2017 from 0.5% in December 2016 partly due to base effect.
- Growth (y-o-y) in oil imports improved to 61.1% in January 2017 from 14.6% in the previous month, contributing 10.7% points to the overall import growth.
- Due to a sharper decline (m-o-m) in imports as compared to exports, India's merchandise trade deficit declined marginally to US$9.8 billion as compared to US$10.4 billion in December 2016.
- The Indian rupee weakened to INR68.1 per US dollar in January 2017 from INR67.9 per US dollar in December 2016.

Chart 18: developments in merchandise trade



Source: Ministry of Commerce and Industry

Chart 19: CAD



Source: Data Base on Indian Economy, RBI

7 Global economy: further recovery in global crude prices

A. Global growth outlook

- The WESP 2017 estimated global growth at 2.2% in 2016, the slowest rate of growth since the 2009 financial and economic crisis. Weak investment and the resulting slowdown in productivity growth have primarily been responsible for this situation. Global growth is projected to increase to 2.7% in 2017 and 2.9% in 2018 (Chart 20).

- Developing countries, forecasted to grow by 4.4% in 2017 and 4.7% in 2018, will continue to be the major drivers of growth. Growth in the developed economies is expected to be 1.7% and 1.8% in 2017 and 2018, respectively.

The WESP 2017 estimated the global growth at 2.2% in 2016, the slowest rate of growth since the 2009 financial and economic crisis.

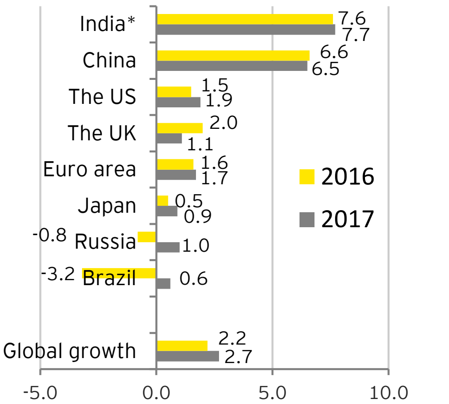
- GDP in the US increased by 1.6% in 2016, marginally faster than the estimate of 1.5% reported in the WESP 2017. Growth is projected at 1.9% in 2017. Business fixed investment has remained weak and may be further restrained due to uncertainty regarding the impact of announced and forthcoming policy changes. The US has already withdrawn from the Trans-Pacific Partnership (TPP) and plans to renegotiate the North American Free Trade Agreement (NAFTA).

- Growth in the Euro area is projected at 1.6% in 2016 and 1.7% in 2017. In the UK, GDP is projected to grow by 2% in 2016 and 1.1% in 2017 as a result of uncertainty due to Brexit, which has already adversely affected the business investment in some key sectors.

- Short-term economic prospects for Japan benefit from the additional fiscal and monetary easing measures introduced in 2016. However, longer-term prospects remain constrained by the large overhang of government debt, an ageing population, a slowdown in productivity growth and deflationary expectations.

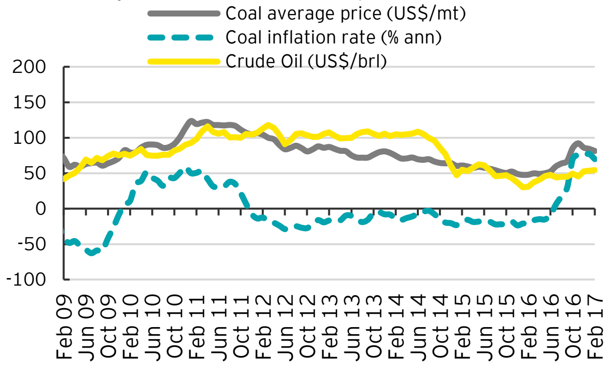
- Growth in China is estimated at 6.6% in 2016 and 6.5% in 2017, supported by a strong policy stance. Brazil and Russia are expected to come out of recession in 2017 on the back of gradually recovering commodity and crude prices. However, growth is expected to be sluggish in 2017 and 2018.

Chart 20: global growth projections



Source: World Economic Situation and Prospects 2017
*estimate/ forecast pertains to fiscal year, excludes the impact of demonetization

Chart 21: global crude and coal prices



Souce: World Bank, Pinksheet

B. Global energy prices

- Global crude prices increased to US$54.4/bbl in February 2017 from US$53.6/bbl in January (Chart 21) as significant output cuts were achieved. The IEA estimated that OPEC production in January was lower at 32.1 mb/d and that the cuts achieved a high compliance rate of 90%, with some producers, notably Saudi Arabia, restricting output by more than required. However, a significant increases in production is expected in 2017 by Brazil, Canada and the US. Global demand for crude oil is expected to increase in 2017 due to an improvement in the growth prospects of Europe, China and India.

- Average global coal prices declined for the third successive month to US$81.2/mt in February 2017 from US$84.2/mt in January. Coal prices are expected to average US$70/mt in 2017 because of supply additions and weakening import demand. China's coal policy will be a key determinant of global coal

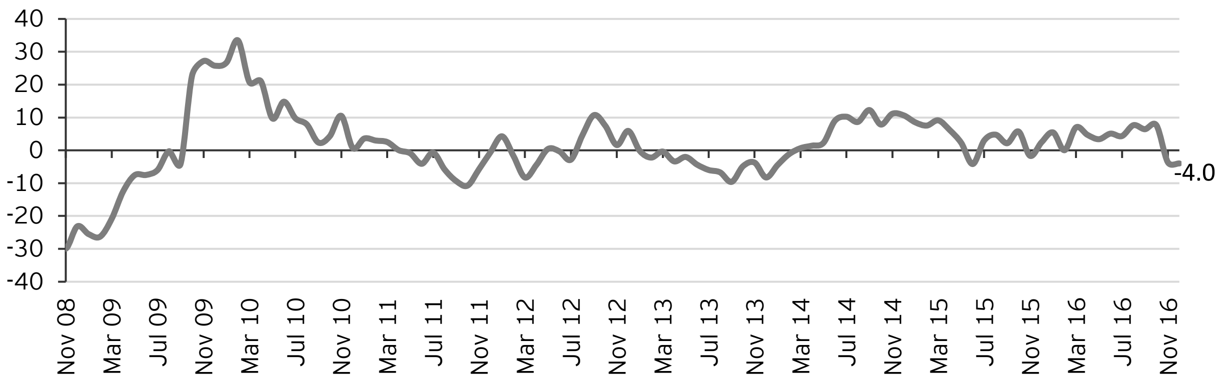
8 Index of aggregate demand: continues to contract

prices.

IAD continued its contractionary trend as it fell by (-) 4.0% in December 2016 from (-) 3.6% in November 2016. The cash crunch induced by demonetization has led to a sustained contraction in demand.

- An Index of Aggregate Demand (IAD) has been developed to reflect demand conditions in the agriculture, manufacturing and services sectors on a monthly basis. It takes into account movements in PMI for manufacturing and services, which traces 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 IAD contracted further by (-) 4.0% in December 2016 from (-) 3.6% in November 2016 (Chart 22). Growth in credit to the agricultural sector, a proxy for demand conditions in the farm sector, fell during November and December. Demonetization-linked slowdown was also seen in the industrial and services sectors, leading to a contraction in overall demand.

Chart 22: growth in IAD (y-o-y)



Source (Basic data): NIKKEI PMI - Markit Economics, RBI and EY estimates

Table 7: IAD

Month	Apr-16	May-16	Jun-16	July-16	Aug-16	Sep-16	Oct-16	Nov-16	Dec-16
IAD	120.9	118.6	117.6	119.0	122.8	122.1	126.3	110.3	112.2
Growth (% y-o-y)	4.7	3.4	5.1	4.3	7.7	6.4	7.7	-3.6	-4.0

9 Appendix: capturing macro-fiscal trends

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

Fiscal year/quarter/month	IIP	Mining	Manufacturing	Electricity	Core sector IIP	Fiscal year/quarter/month	PMI mfg.	PMI ser.
	% change y-o-y							
FY13	1.1	-2.3	1.3	4.0	6.5	FY13	53.7	54.3
FY14	-0.1	-0.6	-0.8	6.1	4.2	FY14	50.5	48.5
FY15	2.8	1.5	2.3	8.4	4.5	FY15	52.2	51.7
FY16	2.4	2.2	2.0	5.7	3.4	FY16	51.3	51.7
4Q FY16	0.2	2.2	-1.1	9.3	5.9	4QFY16	51.5	53.3
1Q FY17	0.7	2.5	-0.6	9.0	5.4	1QFY17	51.0	51.7
2Q FY17	-0.9	-2.9	-1.0	1.4	3.7	2QFY17	52.2	52.9
3Q FY17	1.0	2.8	0.2	5.2	5.7	3QFY17	52.1	49.3
Sep-16	0.7	-3.4	1.0	2.4	5.0	Nov-16	52.3	46.7
Oct-16	-1.8	-0.7	-2.4	1.1	6.6	Dec-16	49.6	46.8
Nov-16	5.7	3.7	5.5	8.9	4.9	Jan-17	50.4	48.7
Dec-16	-0.4	5.2	-2.0	6.3	5.6	Feb-17	50.7	50.3

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

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

Fiscal year/quarter/month	CPI	Food & beverage	Fuel & lighting	WPI	Food articles	Mfg. products	Fuel & power
	% change y-o-y			% change y-o-y			
FY13	9.9	11.2	9.7	7.4	9.9	5.4	10.3
FY14	9.4	11.9	7.7	6.0	12.8	3.0	10.2
FY15	5.9	6.5	4.2	2.0	6.1	2.4	-0.9
FY16	4.9	5.1	5.3	-2.5	3.3	-1.1	-11.6
4QFY16	5.3	5.8	4.4	-0.8	4.8	-0.5	-8.4
1QFY17	5.7	7.0	2.9	1.1	6.9	1.0	-4.9
2QFY17	5.1	6.0	2.8	3.8	9.3	2.3	2.0
3QFY17	3.7	2.8	3.1	3.5	2.8	3.2	6.7
Oct-16	4.2	3.7	2.8	3.4	4.3	2.7	6.2
Nov-16	3.6	2.6	2.8	3.2	1.5	3.2	7.1
Dec-16	3.4	2.4	3.8	3.4	-0.7	3.7	8.7
Jan-17	3.2	1.3	3.4	5.2	-0.6	4.0	18.1

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	Custom duty	Excise duty	Service tax	Fiscal deficit	Revenue deficit
	% change y-o-y						% of GDP	% of GDP
FY15	9.3	8.7	8.7	9.2	11.6	8.6	4.0	2.9
FY16	17.0	6.0	8.5	11.9	51.9	25.8	3.9	2.5
FY17 (RE)	17.0	9.0	22.8	3.2	34.5	17.1	3.5	2.1
FY18 (BE)	12.2	9.1	24.9	12.9	5.0	11.1	3.2	1.9
	Cumulated growth (% y-o-y)						% of budget target	
Jun-16	30.6	3.9	53.4	17.8	60.5	28.5	61.1	79.7
Jul-16	26.7	1.1	48.2	8.7	55.6	26.1	73.7	93.1
Aug-16	21.9	-1.4	31.9	6.5	50.8	24.4	76.4	91.8
Sep-16	16.6	2.3	17.8	5.3	47.9	22.8	83.9	92.1
Oct-16	18.0	4.5	19.3	4.9	46.4	24.5	79.3	92.6
Nov-16	21.5	9.0	20.9	6.8	46.0	27.1	85.8	98.4
Dec-16	18.3	4.8	20.5	4.9	43.7	25.0	93.8 (RE)	113.9 (RE)
Jan-17	17.7	3.2	19.7	5.2	42.9	23.3	105.6 (RE)	130.2 (RE)

Source: Monthly Accounts, Controller General of Accounts-Government of India, Union Budget Documents

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
FY13	7.50	FY13	9.2	13.6	16.6	13.7	8.2	19.8	26.9	292.0
FY14	8.00	FY14	8.5	13.4	14.9	14.2	8.4	21.6	4.8	304.2
FY15	7.50	FY15	11.3	10.9	11.0	12.1	8.3	31.3	42.2	341.6
FY16	6.75	FY16	13.5	10.1	9.7	10.5	7.7	36.0	-4.1	355.6
Jul-16	6.50	4Q FY16	13.5	10.1	11.0	10.1	7.6	8.8	-1.5	355.6
Aug-16	6.50	1Q FY17	13.7	10.3	9.5	9.3	7.5	4.1	2.1	360.8
Sep-16	6.50	2Q FY17	21.0	14.6	10.4	10.7	7.0	17.2	6.1	372.0
Oct-16	6.25	3Q FY17	-18.6	6.6	6.7	13.3	6.6	9.6	-11.4	360.3
Nov-16	6.25	Oct-16	15.2	10.9	8.7	9.2	6.8	2.3	-1.8	367.2
Dec-16	6.25	Nov-16	-12.3	8.5	6.2	15.6	6.6	4.6	-5.5	365.3
Jan-17	6.25	Dec-16	-18.6	6.6	5.1	15.2	6.5	2.7	-4.1	360.3
Feb-17	6.25	Jan-17	-13.7	6.4	5.3	14.1	6.8	3.4	-0.4	361.6

Source: Database on Indian Economy-RBI

Table A5: external trade and global growth

	External trade indicators (annual, quarterly and monthly growth rates)							Global growth (annual)		
Fiscal year/quarter/month	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$/mt		% change y-o-y		
FY13	-1.8	0.3	-190.3	54.5	103.2	86.6	2008	3.0	0.1	5.8
FY14	4.7	-8.3	-135.8	60.9	103.7	76.1	2009	-0.1	-3.4	2.9
FY15	-1.3	-0.5	-137.7	61.2	83.2	65.9	2010	5.4	3.1	7.5
FY16	-15.8	-15.4	-117.7	65.5	46.0	52.7	2011	4.2	1.7	6.3
4QFY16	-7.8	-13.3	-19.2	66.9	32.7	48.4	2012	3.5	1.2	5.3
1QFY17	-1.4	-14.7	-19.1	67.0	44.8	50.4	2013	3.3	1.2	5.0
2QFY17	-0.9	-12.2	-23.7	67.5	44.7	63.5	2014	3.4	1.9	4.6
3QFY17	1.0	-1.4	-33.5	68.1	49.1	87.7	2015	3.2	2.1	4.0
Oct-16	9.6	8.1	-10.2	66.7	49.3	85.2	2016*	3.1	1.6	4.1
Nov-16	2.3	10.4	-13.0	67.6	45.3	92.0	2017*	3.4	1.9	4.5
Dec-16	5.7	0.5	-10.4	67.9	52.6	86.0	2018*	3.6	2.0	4.8
Jan-17	4.3	10.7	-9.8	68.1	53.6	84.2	2019	3.7	1.8	5.0

Source: Database on Indian Economy- RBI, Pink Sheet-World Bank and IMF World Economic Outlook October 2016;
* Indicates forecasted data (IMF-WEO Update January 2017)

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

	Expenditure components						Output: aggregate and selected sectors			
Fiscal year/quarter	GDP (Real)	PCE	GCE	GFCF	EX	IM	GVA	Agri.	Ind.	Serv.
FY14 (3rd RE)	6.5	7.4	0.6	1.8	7.8	-8.1	6.2	5.6	4.2	7.7
FY15 (2nd RE)	7.2	6.8	9.4	4.1	1.7	0.8	6.9	-0.3	6.9	9.5
FY16 (1st RE)	7.9	7.3	2.9	6.1	-5.4	-5.9	7.8	0.8	8.2	9.8
FY17 (2nd AE)	7.1	7.2	17.0	0.6	2.3	-1.2	6.7	4.4	5.8	7.9
3QFY15	6.1	2.7	29.5	1.3	2.0	5.7	6.3	-1.7	3.6	11.9
4QFY15	6.7	6.6	-3.3	5.4	-6.3	-6.1	6.2	-1.7	5.7	9.3
1QFY16	7.8	4.9	0.5	9.6	-5.7	-5.2	7.8	2.6	7.4	9.5
2QFY16	8.4	6.7	3.9	12.4	-4.3	-3.6	8.4	2.3	7.4	10.4
3QFY16	6.9	6.8	3.7	3.2	-9.0	-10.2	7.0	-2.2	9.5	9.4
4QFY16	7.9	8.3	2.9	-1.9	-1.9	-1.6	7.4	2.3	7.9	8.7
1QFY17	7.2	7.2	15.5	-2.2	2.1	-2.7	6.9	1.9	6.1	8.8
2QFY17	7.4	5.1	15.2	-5.3	-0.9	-7.4	6.7	3.8	5.1	8.2
3QFY17	7.0	10.1	19.9	3.5	3.4	4.5	6.6	6.0	6.6	6.8

Source: National Accounts Statistics, MOSPI

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