Economy Watch

Monitoring India's macro-fiscal performance

February 2018

Building a better working world

Contents

Prepared by Macro-fiscal Unit, Policy Advisory Group, EY India
D. K. Srivastava, Chief Policy Advisor, EY: dk.srivastava@in.ey.com
Muralikrishna Bharadwaj, Manager, EY: muralikrishna.b@in.ey.com
Tarrung Kapur, Manager, EY: tarrung.kapur@in.ey.com
Ragini Trehan, Senior Consultant, EY: ragini.trehan@in.ey.com

Highlights

1. **Overall IIP growth at 7.1% in December 2017 confirms that economic recovery is on course.**

2. **Overall CPI inflation remained high at 5.1% in January 2018,** although slightly lower than the 17-month high of 5.2% it had reached in December 2017. Core inflation too remained high at 5.0%.

3. **The RBI** in its policy review held on 7 February 2018 **retained the policy repo rate at 6.0%.** Further, its CPI inflation forecast ranged between 5.1% and 5.6% in 1HFY19. With elevated CPI inflation expectations, the RBI has hinted at the possibility of a rate hike during the latter half of FY19.

4. As per CGA data, **gross central tax revenues grew by 17.3% during April-December FY18**, while non-tax revenues contracted sharply by (-) 37.8% during this period.

5. There is **a significant improvement in direct tax buoyancy reflected in FY18 (RE).**

6. The **Center's fiscal deficit was revised upward from 3.2% to 3.5% of GDP in FY18 (RE).** The slippage was largely due to excess revenue expenditure, which could not be offset by a cut in capital expenditure or an increase in disinvestment proceeds and net tax revenues.

7. **The FRBM Act is being amended through the Finance Bill 2018 so as to shift the 3.0% fiscal deficit target to 2020-21.** Furthermore, the revenue deficit target is being given up and the policy anchor is being changed to keeping the Center's debt-GDP ratio at 40% or below, which should be achieved by 2024-25.

8. **Merchandise exports growth fell to 9.1% and import growth rose to 26.1% in January 2018.** As a result, the current account balance is expected to further deteriorate.

9. There is a broad-based improvement in credit offtake across sectors. **Credit growth by scheduled commercial banks increased to a 15-month high of 10.6% in December 2017.**

Foreword

Strengthening growth momentum

Economic discourse in the current month has been dominated by the Union Budget FY19 and the RBI's February 7 monetary policy announcement. The key macro-fiscal features of the Budget relate to (a) amendment of the FRBM Act, shifting the main anchor of fiscal policy to managing the debt-GDP ratio, (b) postponement of the fiscal deficit to GDP target of 3% to FY21 from FY18 and (c) dropping the attainment of revenue account balance as a target. Although there has been some slippage in indirect tax revenues compared to the Budget estimates primarily because of issues related to the transition to GST, there has been a healthy compliance-based improvement in the buoyancy of direct taxes. The underlying philosophy of the Budget seems to focus on aggregate demand for supporting growth. Not only the revenue expenditure of the central government in FY18 revised estimate (RE) grew at a faster pace than what was budgeted but an ambitious expenditure based support to growth has been planned for FY19 that is to be financed by both budgetary and extra-budgetary resources. A detailed overview of these initiatives is given in this month's In Focus section.

RBI's monetary policy continued with the existing repo rate at 6% in the light of heightened inflation risks. Consequently, the reverse repo rate under the LAF remains at 5.75%, and the marginal standing facility (MSF) rate and the Bank Rate at 6.25%. CPI inflation excluding food and fuel increased significantly in November and December and remained elevated in January, largely on account of increase in housing inflation following the implementation of higher house rent allowances (HRA) for government employees under the 7th Central Pay Commission (CPC) award. Households' inflation expectations, measured by the Reserve Bank's survey of households, remained elevated for both three-month ahead and one-year ahead horizons. Recognizing the potential impact of global crude prices among other factors, the RBI estimated CPI inflation for 2018-19 in the range of 5.1%—5.6% in H1. Such outlook for CPI inflation would imply reduced prospects for any repo rate reduction in the near future. Instead, the possibility of a rate hike may emerge in the near future.

Global growth outlook is benign and augurs well for India, particularly for its export prospects. Both the IMF and the World Bank note a tangible improvement in the growth prospects of the US, the Euro Area and Japan. As per the World Bank (Global Economic Prospects, January 2018), global growth is estimated to pick up from 2.4% in 2016 to 3% in 2017 and further to 3.1% in 2018. This recovery is broad-based and largely attributable to a rebound in global investment. Growth in advanced economies is projected to moderate during 2019-20 while that in emerging market and developing economies (EMDEs) is expected to increase further to 4.5% in 2018 and average at 4.7% in 2019-2020. In the Euro area, growth is estimated to improve to 2.4% in 2017 with broad-based improvements across member countries supported by policy stimulus and strengthening external demand. In Japan, GDP growth is estimated to recover to 1.7% in 2017 supported by a recovery in consumer spending and investment as well as the implementation of a fiscal stimulus package but growth is projected to slow down to 1.3% in 2018 as fiscal stimulus is withdrawn and export growth moderates.

In this background, India's growth prospects have become stronger both in the short and the medium term. The World Bank has assessed India's growth in FY19 at 7.3% while the IMF has estimated it to be 7.4%. The IMF sees the medium-term growth prospect for India at 7.8%. Achieving these growth levels seems feasible in the light of the supporting fiscal policy environment as well as the improved outlook for private investment and exports. The prospects for India reemerging as a global growth leader and sustaining this position in the foreseeable future seem strong.

D.K. Srivastava
Chief Policy Advisor, EY India

Home

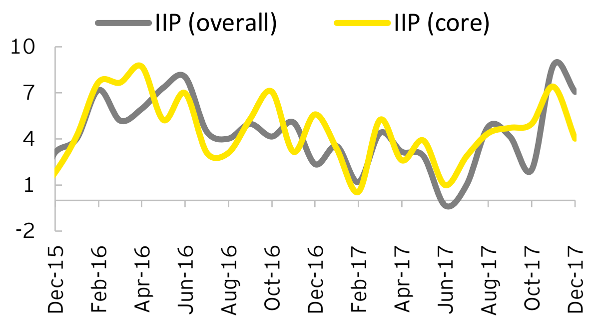
1. Growth: Continued recovery in the industrial sector

A. Industry growth : IIP growth remained strong in December 2017

Overall IIP growth remained strong in December 2017, confirming that economic recovery is on course.

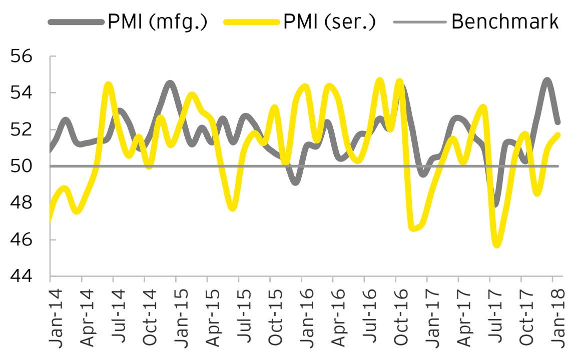
- Growth in IIP remained strong at 7.1% (y-o-y) in December 2017, although marginally lower than 8.8% in November 2017 (Chart 1). There was broad based improvement in the growth of mining and electricity output, while growth in the manufacturing sector was marginally lower. IIP growth in 3QFY18 was the highest in the last six quarters at 5.9%.
- The manufacturing sector output (accounting for 77.6% of overall IIP) grew by 8.4% in December 2017, slightly lower than the 10.7% (revised) growth in November 2017. Growth in the output of both electricity and mining improved further to 4.4% (3.9% in November) and 1.2% (1.1%) respectively in December 2017.
- Growth in the output of the capital goods industry (a proxy for investment demand) accelerated to 16.4% in December 2017 from 10.0% in November 2017. Growth in consumer durables remained robust at 16.5% in December 2017 but was lower than the growth of 23.4% in November 2017. Growth in the infrastructure/construction sector slowed to 6.7% in December 2017 from 13.9% in November.
- After reaching a 19-month peak of 7.4% (revised) in November 2017, growth in the output of eight core infrastructure industries fell to a five-month low of 4.0% (y-o-y) in December 2017. Slower growth in the output of petroleum refinery products (6.6%), electricity (3.3%), steel and natural gas (2.6%) coupled with a contraction in the growth of crude oil ((-) 2.1%) and coal ((-) 0.2) output led to a fall in the overall core sector growth during the month.

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



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

Chart 2: IHS Markit PMI



Source: IHS Markit PMI, Markit Economics.

B. PMI: Signaled recovery but at a slow pace in manufacturing and services in January

In January 2018, manufacturing PMI remained above the threshold of 50 but fell from the peak achieved in December 2017. On the other hand, services PMI improved but remained below its long-term average.

- From a five-year high of 54.7 in December 2017, headline manufacturing PMI (sa) fell to 52.4 in January 2018 (Chart 2). Although there was slower growth in output, new orders and employment during the month, these PMI indicators showed continued expansion maintaining the ongoing recovery. New export orders increased at the strongest pace since September 2016. According to the February 2018 Nikkei India Manufacturing PMI report released by IHS Market, the upward revision in the duty drawback rates on 102 items on 25 January 2018 is expected to enhance India's international competitiveness, possibly leading to stronger external demand in the coming months.
- Headline services PMI (sa) improved to 51.7 in January 2018 from 50.9 in December 2017. However, it still remained lower than its long-run average.

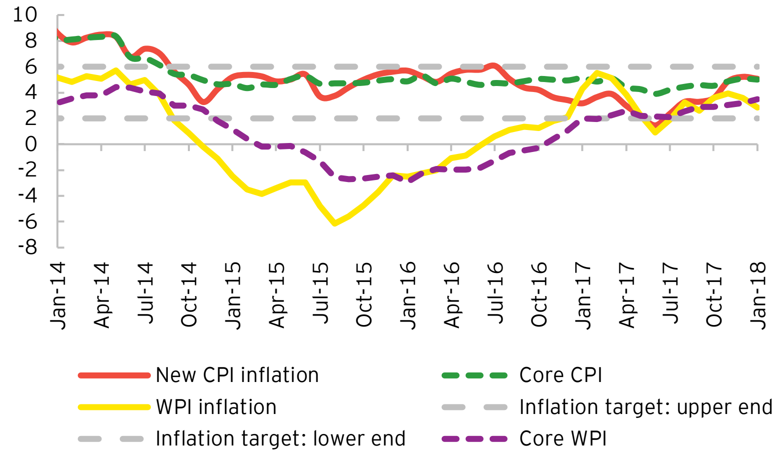
2. Inflation: CPI inflation remained elevated at 5.1% in December as vegetable prices remained high

Home

Overall CPI inflation remained high at 5.1% in January, although slightly lower than its 17-month high of 5.2% in December. Core inflation too remained high at 5.0%.

- Growth in vegetable prices declined marginally to 27.0% in January from a four-year high of 29.1% (y-o-y) in December due to a moderation in inflation in tomato prices to 50.1% in January from 90.5% in December 2017. The share of contribution of vegetables to overall inflation at around 30% over the last three months is the highest over the last four years.
- Growth in onion prices was high at 153.5% in January (159.2% in December). Potato prices fell by (-) 2.7% as compared to (-) 11.7% in December, its slowest pace of contraction in the last 13-months.
- The Consumer Food Price Index based inflation moderated to 4.7% in January from a 16-month high of 5.0% in December.
- Fuel and light-based inflation remained elevated at 7.7% in January as compared to 7.9% in December, close to the four-year high of 8.2% reached in November 2017 on account of higher inflation in LPG prices as a result of the subsidy reduction started by the Government earlier during the year. Despite rising petroleum prices in January reflecting lagged pass-through of higher crude prices, inflation in transport and communication remained muted at 2.0% as compared to 2.2% in December due to a high base effect.
- Core CPI inflation (excluding food and fuel and light) was high at 5.0% in January as compared to 5.1% in December due to high housing-based inflation following the implementation of higher house rent allowances (HRA) for government employees under the 7th Central Pay Commission (CPC) award.

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



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

CPI inflation, while remaining high in January 2018 at 5.1%, fell marginally from its December level. WPI inflation fell more sharply to 2.8% in January from 3.6% in December.

WPI-based inflation declined to a six-month low of 2.8% in January 2018 from 3.6% in December 2017 on account of a decline in inflation in vegetables and fuel and power

- Inflation in vegetables declined to 40.8% in January from 56.5% in December 2017 as inflation in tomato prices fell drastically to 31% from 135.6% in the previous month. Earlier, inflation in tomato prices had reached an all-time high (based on 2011-12 series) of 269.4% in November 2017.
- As a result, inflation based on the newly constructed WPI Food Price Index, consisting of primary food articles and manufactured food products, declined to a seven-month low of 1.6% in January from 3.0% in December 2017.
- Fuel and power-based inflation moderated to a 14-month low of 4.1% in January from 9.2% in December 2017 as inflation in petrol prices and diesel prices declined to 1.2% (8.8% in December) and 7.1% (12.7% in December) respectively. Further, the pace of contraction in electricity prices increased to (-) 5.1% from (-) 0.1% in the previous month.
- WPI core inflation increased marginally to 3.5% from 3.2% primarily due to an increase in inflation in basic metals to 12.9% from 10.0% in December.

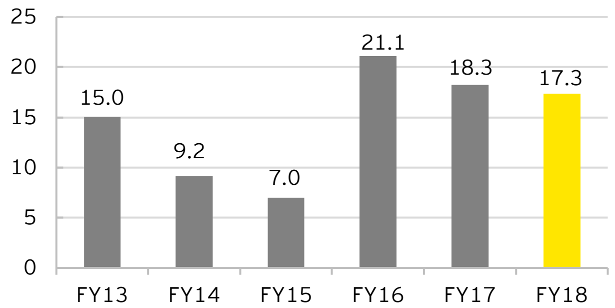
3. Fiscal performance: Fiscal deficit revised to 3.5% of GDP in FY18 (RE)

A. Tax and non-tax revenues

As per CGA data, gross central tax revenues grew by 17.3% during April-December FY18, while non-tax revenues contracted sharply by (-) 37.8% during this period.

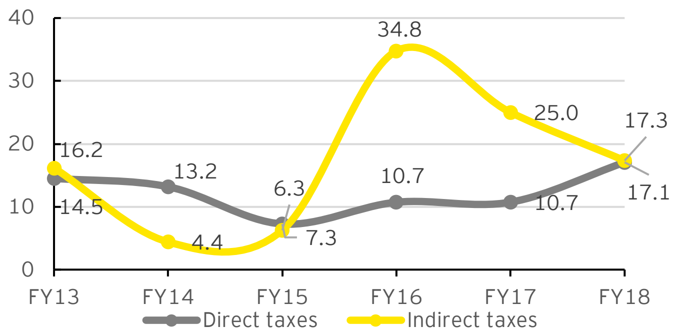
- Gross central taxes grew by 17.3% during April-December FY18, slightly lower than 18.3% in the corresponding period of the previous year (Chart 4).
- However, gross central taxes up to December 2017 stood at 68.7% of the FY18 revised estimates (the revised estimates were higher than the budgeted target) as compared to the three-year average of 65.5% achieved up to December as a percentage of the annual actuals.
- Growth in direct taxes (comprising personal income tax and corporation tax) during April-December FY18 was higher at 17.1% as compared to 10.7% in the same period of FY17 (Chart 5).
- Among the direct taxes, growth in personal income tax during April-December 2017 was at 17.0% as compared to 20.5% in the corresponding period of the previous fiscal year. Corporation tax revenues grew by 17.1% during this period as compared to just 4.8% in the corresponding period of FY17.
- Growth in indirect taxes (comprising union excise duties, service tax, customs duty, CGST, UTGST, Center's share of IGST and GST compensation cess) was high at 17.3% during April–December FY18, although it was lower than the corresponding value of 25.0% in FY17.
- Tax collection on account of GST (CGST, Center's share of IGST and GST compensation cess) during April-December 2017 amounted to INR304,233 crore, which is 68.4% of the annual revised estimates.

Chart 4: Growth in cumulated gross tax revenues up to December 2017



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

Chart 5: Growth in cumulated tax revenues up to December 2017



Note: Direct taxes include personal income tax and corporation tax, and indirect taxes include union excise duties, service tax, customs duty and CGST, UTGST, IGST and GST compensation cess from July 2017 onward.

- The Center's non-tax revenues contracted by (-) 37.8% during April-December 2017 as compared to a growth of 0.5% in the same period of FY17. This was largely due to a significant fall in dividends and profits.
- The Center's non-tax revenues up to December 2017 stood at 48.1% of the FY18 revised estimates, which were lower than the budgeted target. This was much lower than the three-year average of 71.4% achieved up to December as a percentage of the annual actuals.
- The revised estimate of total receipts from disinvestment for FY18 stood at INR100,000 crore, overachieving the budgeted target of INR72,500 crore.

B. Expenditures: Revenue and capital

- Total expenditure grew by 15.6% during April-December FY18 as compared to the corresponding value of 11.9% in FY17.
- Growth in revenue expenditure fell to 13.5% up to December FY18 from 14.5% in the same period of FY17 (Chart 6). Revenue expenditure up to December 2017 stood at 75.2% of the FY18 revised estimates, which were higher than the budgeted target, close to the three-year average of 75% achieved up to December as a percentage of the annual actuals.
- Growth in the Center's capital expenditure was at 30.8% during April–December FY18 as compared to a contraction of (-) 3.8% in the corresponding period of FY17 (Chart 7). Capital expenditure up to December 2017 stood at 86.5% of the FY18 revised estimate as compared to the three-year average of 72.5% achieved up to December as a percentage of the annual actuals.
- The Center's total major subsidies (food, nutrient-based fertilizer, urea and petroleum subsidy) grew by 0.2% during April-December FY18. Total subsidies up to December 2017 stood at 89.4% of the FY18 annual budgeted target.

The Center's total expenditure up to December 2017 stood at 76.6% of the FY18 (RE) (which was higher than the BE), close to the three-year average of 74.6% achieved up to December as a percentage of the annual actuals.

Chart 6: Growth in cumulated revenue expenditure up to December 2017 (%, y-o-y)

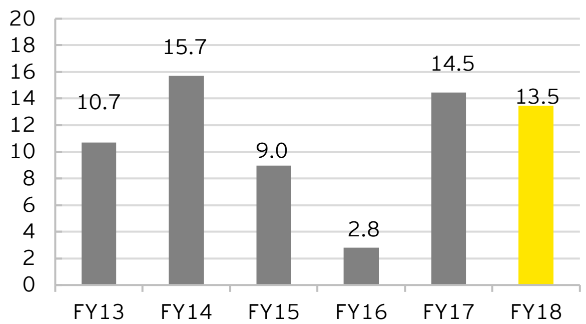
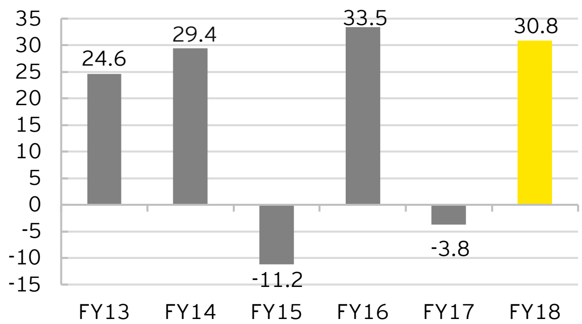


Chart 7: Growth in cumulated capital expenditure up to December 2017 (%, y-o-y)



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

C. Fiscal imbalance

- Fiscal deficit during April-December FY18 stood at 104.4% of the annual revised estimate as compared to 93.8% in the corresponding period of FY17 (Chart 8).
- The Center's revenue deficit up to December 2017 stood at 102.2% of the annual revised estimate as compared to 113.9% during the corresponding period of FY17 (Chart 9).

The Center's FY18 fiscal deficit estimate was revised upward from 3.2% to 3.5% of GDP. The slippage was largely due to excess revenue expenditure, which could not be made up by a cut in capital expenditure or an increase in disinvestment proceeds and net tax revenues. The FY18 revenue deficit estimate was also revised from 1.6% to 2.6% of GDP.

Chart 8: Fiscal deficit up to December 2017 as a % of annual revised estimate for FY18

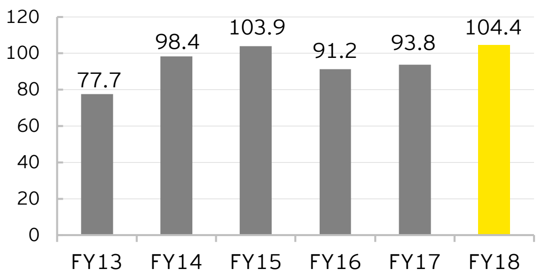
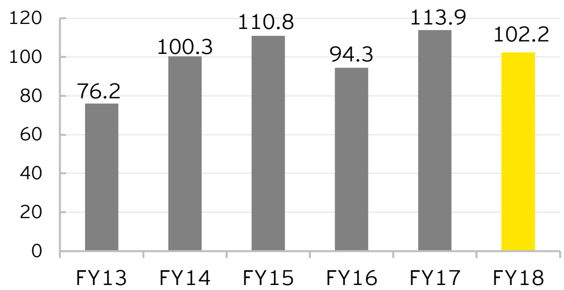


Chart 9: Revenue deficit up to December 2017 as a % of annual revised estimate for FY18



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

4. India: Comparative economic performance and prospects

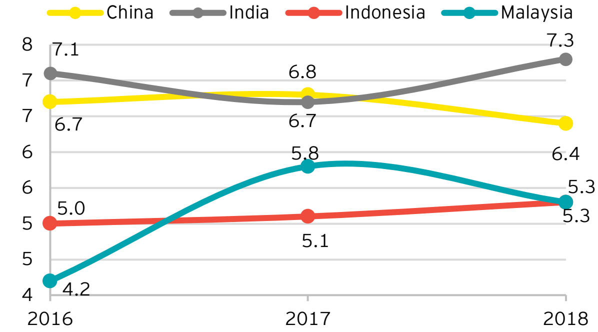
GDP Growth: India is projected to re-emerge as a global growth leader in 2018

- As per the ADB, GDP growth in developing Asia, consisting of 45 major Asian countries, is projected to improve from 5.8% in 2016 to 6.0% in 2017 partly due to the ongoing global recovery and a rebound in global commodity prices. It is expected to however fall to 5.8% in 2018.
- GDP growth in China is projected to decline to 6.4% in 2018 from 6.8% in 2017 with consumption remaining the growth driver, while structural and cyclical factors may decelerate investment growth, and net exports contribution is likely to turn negative.
- As per the ADB, India's GDP is forecasted to grow at 6.7% in 2017 and at 7.3% in 2018, even as increasing crude oil prices in 2018 may add to fiscal pressure and private investment growth may remain soft.
- Except for India and Indonesia, where growth is likely to increase, growth in all other selected economies is projected to either decline or remain stable in 2018. GDP growth in Malaysia, which is expected to sharply recovery to 5.8% in 2017 from 4.2% in 2016, is projected to slide back to 5.3% in 2018 due to a higher base effect in 2017.

Table 1: GDP growth (%)

Country	2016	2017 (f)	2018 (f)
Developing Asia *of which:*	**5.8**	**6.0**	**5.8**
South Asia *of which:*	**6.7**	**6.5**	**7.0**
India*	7.1	6.7	7.3
East Asia *of which:*	**6.0**	**6.2**	**5.8**
China	6.7	6.8	6.4
Southeast Asia *of which:*	4.6	5.2	5.2
Indonesia	5.0	5.1	5.3
Malaysia	4.2	5.8	5.3
Singapore	2.0	3.2	2.9
Thailand	3.2	3.8	3.8

Chart 10: GDP growth – selected countries



Source (Basic Data): Asian Development Outlook Supplement;*Data is based on fiscal year, (f) indicates forecast.

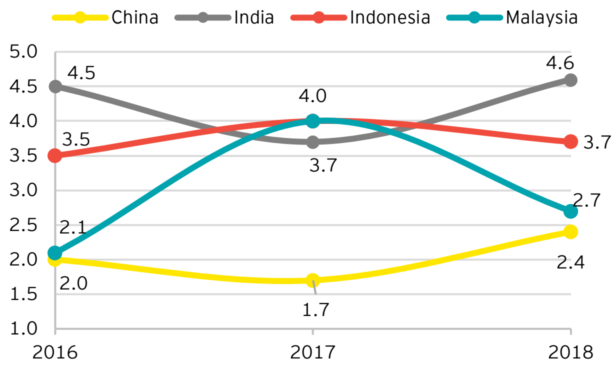
Inflation: *India is projected to have the highest inflation rate among its Asian peers in 2018*

- The ADB inflation forecasts assume that Brent crude would increase to US$58/barrel in 2018 from an expected US$54/barrel in 2017 and that Food price index would decline slightly in 2017 before edging back to 1.0% in 2018.
- Inflation in developing Asia is expected to remain stable at 2.4% in 2017 before increasing to 2.9% in 2018.
- In China, CPI-based inflation is forecasted to pick up to 2.4% in 2018 from 1.7% in 2017 on account of strong consumer demand, higher wages, and continued price deregulation.
- In Malaysia inflation is expected to rise to 4.0% in 2017 from 2.1% in 2016 because of a one-off adjustment to fuel prices in 1H2017 and the pass-through of rising international fuel prices in 2H2017, before dropping to 2.7% in 2018.
- In India, inflation is projected to fall from 4.5% in 2016 to 3.7% in 2017, partly due to lower food prices and subdued demand. It is projected to pick up to 4.6% in 2018, partly reflecting the impact of higher crude prices.

Table 2: CPI-based inflation (%)

Country	2016	2017 (f)	2018 (f)
Developing Asia *of which:*	2.5	2.4	2.9
East Asia of which:	1.9	1.7	2.3
China	2.0	1.7	2.4
South Asia of which:	4.5	4.0	4.7
India*	4.5	3.7	4.6
Southeast Asia of which:	2.1	3.0	3.1
Indonesia	3.5	4.0	3.7
Malaysia	2.1	4.0	2.7
Singapore	-0.5	0.6	1.0
Thailand	0.2	0.7	1.5

Chart 11: CPI-based inflation – selected countries



Source (Basic Data): Asian Development Outlook Supplement;*Data is based on fiscal year, (f) indicates forecast.

General government revenue: *India's general government revenue as a % of GDP is much lower than of the major G20 EMEs.*

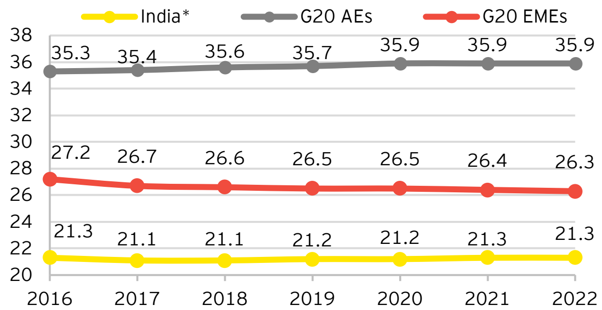
- Amongst the selected countries, general government revenue as a % of GDP is the highest in the UK in 2017 at 36.5% although for the Euro area (excluding UK) it is far higher at 46.2%.
- As % of GDP, general government revenue in G20 Emerging Market Economies (EMEs) is expected to have dropped from 27.2% in 2016 to 26.7% in 2017. It is expected to further fall to 26.3% by 2022 while over the same period it is expected to increase to 35.9% in G20 advanced economies (AEs) from 35.3% in 2016.
- At 21.1% of GDP in 2017, India's general government revenue is 5.6% points lower than the average of G20 EMEs, between 8-12% points lower than the revenue of commodity-export dependent economies of Russia and Brazil and 6.4% points lower than that of China. Further, it is projected to increase only marginally to 21.3% by 2022.

Table 3: General Government revenue (% of GDP)

Country	2016	2017	2018	2019	2020	2021	2022
Euro Area	46.1	46.2	46.1	45.9	45.8	45.7	45.6
UK	36.4	36.5	36.7	36.8	36.7	36.5	36.3
Russia	32.8	32.8	32.0	31.8	31.9	32.2	32.4
US	31.2	31.4	31.7	31.9	32.2	32.3	32.4
Brazil	30.2	29.4	28.9	28.9	29.1	29.6	29.5
China	28.2	27.5	27.5	27.4	27.1	27	26.8
India	21.3	21.1	21.1	21.2	21.2	21.3	21.3
Indonesia	14.3	14.3	14.3	14.3	14.3	14.3	14.4
G20 AEs	***35.3***	***35.4***	***35.6***	*35.7*	*35.9*	*35.9*	*35.9*
G20 EMEs	***27.2***	***26.7***	***26.6***	*26.5*	*26.5*	*26.4*	*26.3*

Source (Basic Data): Fiscal Monitor, October 2017, IMF
*Data pertains to fiscal year, (f) indicates forecast.

Chart 12: General government revenue (% of GDP) – Selected countries



General government expenditure: *India lags other major EMEs in terms of expenditure by the government as a % of GDP*

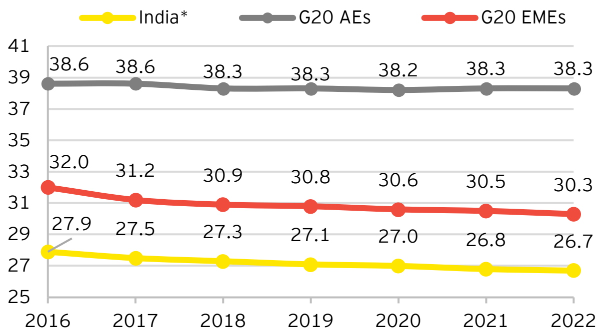
- The share of government expenditure in GDP, which is indicative of the size of the government, is the highest in the Euro area among major advanced and emerging economies, at 47.5% in 2017.
- In major EMEs, general government total expenditure as a % of GDP is much lower as compared to major advanced economies. As per Fiscal Monitor October 2017, with low tax revenues, many EMEs face a difficult choice between financing redistributive direct transfers to reduce current poverty and increasing spending on education and health to enhance growth and reduce future poverty and income inequality.
- At 27.5%, India's general government expenditure as a % of GDP in 2017 was 3.7% points lower than that of China as well as the G20 EME average. It is expected to remain low in the medium term.

Table 4: General government expenditure (% of GDP)

Country	2016	2017	2018	2019	2020	2021	2022
Euro Area	47.7	47.5	47.0	46.6	46.1	45.9	45.7
UK	39.3	39.4	39.0	38.3	37.9	37.7	37.6
Brazil	39.3	38.6	38.1	37.7	37.5	37.1	36.8
US	35.6	35.8	35.5	35.9	36.2	36.5	36.7
Russia	36.4	34.9	33.5	32.8	32.4	31.8	32.0
China	31.9	31.2	31.2	31.2	31.1	31.1	31.0
India	27.9	27.5	27.3	27.1	27.0	26.8	26.7
Indonesia	16.8	17.0	16.8	16.8	16.8	16.8	16.9
G20 AEs	*38.6*	*38.6*	*38.3*	*38.3*	*38.2*	*38.3*	*38.3*
G20 EMEs	*32.0*	*31.2*	*30.9*	*30.8*	*30.6*	*30.5*	*30.3*

Source (Basic Data): Fiscal Monitor, October 2017, IMF
*Data pertains to fiscal year, (f) indicates forecast.

Chart 13: General government expenditure (% of GDP) – Selected countries



General government overall balance as a % of GDP: *India's general government overall balance is projected to improve significantly by 2022*

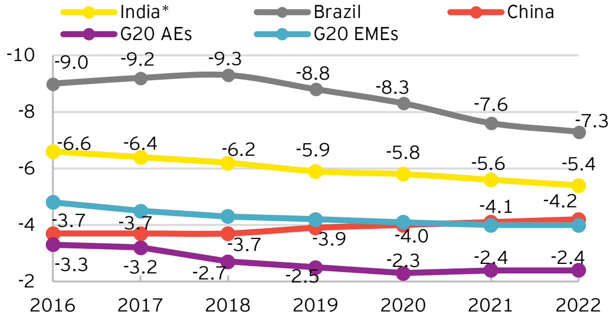
- The general government overall balance represents the net lending (+) or borrowing (-) by a country or, in other words, the fiscal balance. Among the set of selected advanced and EMEs, Brazil has the highest fiscal deficit at 9.2% in 2017, followed by India at 6.2% and the US at 3.7%.
- Fiscal policy in advanced economies is expected to remain accommodative till 2022, even as the fiscal deficit tapers to 4.0% in 2022 from 4.8% in 2016.
- In India, the general government fiscal deficit-GDP ratio is projected to decrease marginally from 6.6% in 2016 to 6.4% in 2017. By 2022, the fiscal deficit level in India is expected to decline to 5.4%.
- In China, the general government fiscal deficit is projected to remain stable during 2017–18 and gradually increase thereafter, reflecting the continuance of the accommodative fiscal policy stance adopted by the Government in recent years.

Table 5: General government overall balance (% of GDP)

Country	2016	2017	2018	2019	2020	2021	2022
Brazil	-9.0	-9.2	-9.3	-8.8	-8.3	-7.6	-7.3
India	-6.6	-6.4	-6.2	-5.9	-5.8	-5.6	-5.4
US	-4.4	-4.3	-3.7	-4.0	-4.0	-4.2	-4.3
China	-3.7	-3.7	-3.7	-3.9	-4.0	-4.1	-4.2
UK	-2.9	-2.9	-2.3	-1.4	-1.2	-1.2	-1.2
Indonesia	-2.5	-2.7	-2.5	-2.5	-2.5	-2.5	-2.5
Russia	-3.7	-2.1	-1.5	-1.0	-0.5	0.3	0.5
Euro area	-1.5	-1.3	-1.0	-0.7	-0.3	-0.2	-0.1
G20 AEs	-4.8	-4.5	-4.3	-4.2	-4.1	-4.0	-4.0
G20 EMEs	-3.3	-3.2	-2.7	-2.5	-2.3	-2.4	-2.4

Source (Basic Data): Fiscal Monitor, October 2017, IMF
*Data pertains to fiscal year, (f) indicates forecast.

Chart 14: General government overall balance (% of GDP) – selected countries



General government gross debt: *India's general government gross debt is much higher than that of other EMEs but is expected to fall in the medium term*

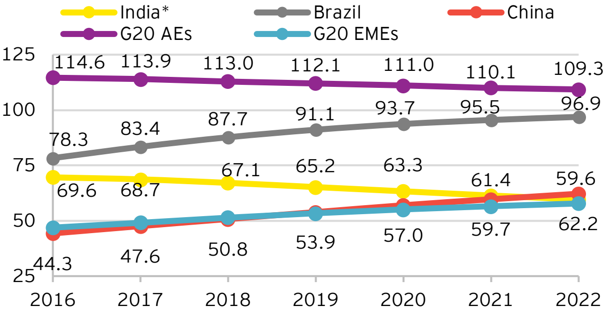
- Among all major AEs and EMEs, Japan has the highest general government gross debt ratio, at 240.3% in 2017, followed by the US at 108.1%. Debt levels in AEs increased significantly after the 2008 global economic crisis due to the expansionary fiscal policies followed by them.
- At 49.2% of GDP, government debt level of EMEs is less than half of AEs, but is expected to significantly increase to 57.8% by 2022 even as the debt level in AEs is expected to marginally fall over the same period.
- Among selected EMEs, government gross debt ratio in India is the second highest at 68.7% in 2017 followed by China at 44.3%. By 2022, however, their position is expected to interchange as debt levels fall to 59.6% in India and rise to 62.2% in China.

Table 6: General government gross debt (% of GDP)

Country	2016	2017	2018	2019	2020	2021	2022
Japan	239.3	240.3	240.0	238.5	237.2	235.7	233.9
US	107.1	108.1	107.8	107.9	108.3	108.8	109.6
UK	89.3	89.5	89.7	88.9	87.6	86.7	85.6
Euro Area	89.0	87.4	85.6	83.5	81.1	78.8	76.3
Brazil	78.3	83.4	87.7	91.1	93.7	95.5	96.9
India	69.6	68.7	67.1	65.2	63.3	61.4	59.6
China	44.3	47.6	50.8	53.9	57.0	59.7	62.2
Russia	15.6	17.4	17.7	18.2	18.2	18.0	17.9
G20 AEs	**114.6**	**113.9**	**113.0**	**112.1**	**111.0**	**110.1**	**109.3**
G20 EMEs	**46.9**	**49.2**	**51.4**	**53.3**	**55.0**	**56.5**	**57.8**

Source (Basic Data): Fiscal Monitor, October 2017, IMF
*Data pertains to fiscal year, (f) indicates forecast.

Chart 15: General government gross debt (% of GDP) – Selected countries



Home

5. In focus: Budget FY19 – demand-based stimulation to growth

Introduction

The underlying thrust of Budget FY19 is to stimulate growth by supporting aggregate demand. This has been achieved by putting forward an ambitious spending program that is to be financed by both budgetary and extra-budgetary resources. We look at Budget FY19 for (a) highlighting the key contours of the Budget, (b) policy thrust areas for budgetary support, (c) financing of outlays by budgetary and extra-budgetary resources, (d) amendment of the FRBM Act and (e) the growth outlook in the light of these budgetary developments.

1. Key contours of Budget FY19

The revised fiscal deficit estimate for FY18 in comparison to the corresponding budget estimate is higher by INR48,317 crore. This is on account of additional government expenditure pushing aggregate demand in the system. It favors current expenditures rather than capital expenditures and allows for realistic revenue-sided adjustments (Table 1). Increase in aggregate demand by additional government expenditure has a growth-supporting role.

Table 1: Fiscal deficit arithmetic

Amounts in INR lakh crore; percent to GDP					INR crore; % to GDP
Head/Year	FY17 (Act.)	FY18 (BE)	FY18 (RE)	FY19 (BE)	Deviation FY18 (RE - BE)
Revenue expenditure	16.91	18.37	19.44	21.42	107,371
% to GDP	11.08	10.90	11.58	11.44	0.64
Capital expenditure	2.85	3.10	2.73	3.004	-36,356
% to GDP	1.87	1.84	1.63	1.60	-0.22
Net tax revenues	11.01	12.27	12.69	14.806	42,440
% to GDP	7.22	7.28	7.56	7.91	0.25
Non-tax revenues	2.73	2.89	2.36	2.451	-52,783
% to GDP	1.79	1.71	1.41	1.31	-0.31
Fiscal deficit	5.36	5.47	5.95	6.243	48,317
% to GDP	3.51	3.24	3.54	3.33	0.29
Non-debt capital receipts *of which*	0.65	0.84	1.17	0.922	33,040
Disinvestment	0.48	0.73	1.00	0.800	27,500
Memo					
Revenue deficit	3.16	3.21	4.39	4.160	117,714
% to GDP	2.07	1.91	2.61	2.22	0.70
GDP (nominal)	152.54	168.47	167.85	187.22	1,67,84,679

The structure of expenditure shows a significant push to aggregate demand if we look at total expenditures excluding interest payments and pensions, which are in the nature of transfer payments. Non-pension primary expenditure in the RE of FY18 at 9.2% of GDP is 0.3 percentage points higher than the actuals of FY17 (Table 2). This reflects an overall push to demand.

Table 2: Center's expenditure – steady increase in revenue expenditure

Amounts in INR lakh crore; percent to GDP					INR crore; % to GDP
Head/Year	FY17 (Act.)	FY18 (BE)	FY18 (RE)	FY19 (BE)	Deviation FY18 (RE - BE)
Revenue expenditure	16.91	18.37	19.44	21.42	1,07,371
% to GDP	11.08	10.90	11.58	11.44	0.64
Interest payments	4.81	5.23	5.31	5.76	7,825
% to GDP	3.15	3.10	3.16	3.08	0.05
Pensions	1.31	1.31	1.47	1.68	16,186
% to GDP	0.86	0.78	0.88	0.90	0.10
Subsidies of which	2.35	2.73	2.64	2.93	-8,781
% to GDP	1.54	1.62	1.57	1.56	-0.05
Non-pension primary expenditure	13.63	14.93	15.40	16.98	47,004
% to GDP	8.94	8.86	9.17	9.07	0.28
Capital expenditure	2.85	3.10	2.73	3.004	-36,356
% to GDP	1.87	1.84	1.63	1.60	-0.22

In terms of capital expenditure undertaken through the Central Government's Budget, there has been a progressive decline from FY17, when it was 1.87% of GDP. It fell to 1.63% in FY18 (RE) and is further budgeted at 1.65 % of GDP in FY19.

However, we note that the Government undertakes considerable capital expenditure through public sector enterprises that is financed by internal and extra budgetary resources (IEBR).

Table 3: Tax buoyancy

Amounts in INR lakh crore					INR crore; % to GDP
Head/Year	**FY17 (Act.)**	**FY18 (BE)**	**FY18 (RE)**	**FY19 (BE)**	**Deviation FY18 (RE-BE)**
Gross tax revenue	17.16	19.12	19.46	22.71	34,540
Buoyancy	1.65	1.04	1.34	1.45	0.21
Direct tax *of which*	8.50	9.80	10.05	11.50	25,000
Buoyancy	1.14	1.33	1.82	1.25	0.15
Corporation tax	4.85	5.39	5.64	6.21	25,000
Buoyancy	0.62	0.77	1.62	0.88	0.15
Taxes on income	3.65	4.41	4.41	5.29	0.00
Buoyancy	1.99	2.12	2.09	1.72	0.00
Indirect taxes*	8.6	9.3	9.4	11.2	9475
Buoyancy	1.99	0.75	0.86	1.66	0.06
Nominal GDP growth	*10.82*	*11.75*	*10.04*	*11.54*	

Source (Basic Data): Union Budget 2018-19; NAS - MOSPI, EY Analysis.

There is an improvement in direct tax buoyancy reflected in FY18 (RE) (Table 3). This is largely attributable to both personal income taxes where buoyancy has improved steadily since FY17. For corporation income tax, buoyancy improved only in FY18 (RE). In FY18 (RE), disinvestment proceeds were not only at their highest level historically but also exceeded the Budget estimates by a significant margin (Table 4).

Table 4: Disinvestment receipts – target and achievement

						INR crores
Disinvestment	**2013-14**	**2014-15**	**2015-16**	**2016-17**	**2017-18**	**2018-19**
Target (BE)	55,814	63,425	69,500	56,500	72,500	80,000
Actual/RE	29,368	37,737	42,132	47,743	100,000 (RE)	-
Achievement (as a % of target)	52.6	59.5	60.6	84.5	137.9	-

Source: Department of Investment and Public Asset Management, GoI.

2. Policy thrust areas for budgetary support

The sectors receiving additional priority through central and centrally sponsored schemes in the Budget expenditure of FY19 are housing, transport and agriculture (Table 5). These reflect the Government's sectoral priorities. These sectors are known to have high multiplier effects, and additional purchasing power being imparted to these sectors is likely to have both a direct and an indirect positive impact on growth.

Table 5: Relative importance of central sector and centrally sponsored schemes

				(percent to total revenue expenditure)
Head/Year	**FY16**	**FY17**	**FY18 (RE)**	**FY19 (BE)**
General services *of which*				
Other general services	2.46	1.15	1.05	1.04
Social services *of which*				
General education	2.59	2.45	2.26	2.25
Medical and public health	1.54	1.59	1.86	1.76
Housing	0.11	1.13	1.02	1.11
Other social services	3.48	3.43	3.95	3.90
Economic services *of which*				
Agriculture	1.32	2.49	2.20	2.28
Rural development	5.14	5.82	5.80	5.50
Energy	0.45	0.73	0.89	0.85
Industry and minerals	7.33	2.41	2.61	2.27
Transport	0.24	0.71	0.59	0.84
Other economic services	10.82	12.61	12.52	13.04
Total*	35.48	34.52	34.76	34.84
Total (INR lakh crore)	5.46	5.84	6.76	7.46

Source (Basic Data): Union Budget 2018-19, EY analysis.

3. Financing of outlays by budgetary and extra-budgetary resources

Total outlays for three focus areas of the Government — namely, agriculture and rural livelihoods, infrastructure and education, health and social sectors – for FY19 amount to 11.6% of GDP (Table 6). These are to be funded by both budgetary and extra budgetary resources. The Government has used the budgetary resources to leverage much larger extra budgetary resources for these sectors. In the case of agriculture and rural livelihood programs, the leverage factor, calculated as total outlay upon budgetary support, is 6.1 and in the case of infrastructure, it is 3.8. This implies an extremely large push to demand financing activities in these sectors relative to the budgetary resources utilized for these purpose.

Table 6: Role of budgetary and extra budgetary resources — FY19

S. no.	Sector/Heads	GBS (INR crore)	EBR (INR crore)	Total outlay (INR crore)	Total outlay as a % of GDP
1	Agriculture and rural livelihood programs	236,127	1,198,190	1,434,317	7.7
1.1	% of total outlay	16.5	83.5		
2	Capital outlay on infrastructure	157,208	439,935	597,143	3.2
2.1	% of total outlay	26.3	73.7		
3	Schematic outlays for Education, Health and Social Protection Sectors	NA	NA	137,981	0.7
4	Total outlay			2,169,441	11.6

Source: Annexure I, Annexure II, Annexure III, Budget speech of Union Finance Minister 2018-19.

Fiscal risks may also be higher with the greater reliance on extra-budgetary resources for financing a number of the ambitious government spending programs. In the Budget for 2018-19, total outlays for the three focus areas of the Government amount to 11.6% of GDP as per Annexures 1,2 and 3 of the Finance Minister's speech. These are to be funded by both budgetary and extra-budgetary resources. Budgetary resources constitute only 16.4 % of the total outlay for agriculture and rural livelihood programs. The balance of 83.6% is to be raised as extra-budgetary resources by the concerned public sector enterprises, special purpose vehicles and other similar institutions. Thus, the extra-budgetary resources are meant to contribute nearly 9.7% of GDP to finance the stipulated outlays as detailed in the Annexures to the Finance Minister's speech. A substantial part of this may be based on borrowing as the relevant bodies may have only limited surpluses. Any dependence on borrowing for these extra-budgetary resources along with the borrowing requirements of the state governments while the saving rate is falling can potentially put considerable pressure on the interest rate.

4. Amendment of the FRBM Act

a. Resetting the fiscal responsibility framework

After the enactment of the FRBM Act in 2003 and the related FRBM Rules in 2004, the target fiscal deficit to GDP ratio of 3% for the Union Government was achieved only once, in the year 2007-08, when it was 2.5% of GDP. Since then, that target has not been achieved again. The FRBM Act was amended in 2012 and again in 2015. The revisions in 2015 shifted the date for achieving the 3% target to 2017-18. By this year, the amended revenue deficit target was put at 2% of GDP.

Budget 2018-19 has proposed to amend the FRBM Act again. This amendment shifts the target of 3% fiscal deficit-GDP ratio to end-2021. The revenue deficit target has been given up altogether. The new statutory anchors relate to the general and Central Government debt-GDP ratios that are to be reduced to 60% and 40% of GDP by 2024-25, based on the recommendations of the report of the FRBM Review Committee headed by N.K. Singh. However, only a modified version of their recommendations has been accepted.

b. Implications of continuously revising targets

As per the requirement of the FRBM Act of 2003, as amended in 2015, a medium term fiscal policy statement has been presented by successive governments in each budget giving three-year rolling targets for fiscal deficit, revenue deficit, effective revenue deficit and outstanding debt of the Central Government. A review of these rolling targets and corresponding achievements highlights that these targets for all the four variables could not be achieved. Thus, with reference to the new anchor of the Center's debt-GDP ratio, the target set in the 2015-16 Budget was 42.8% for 2017-18. In the 2016-17 budget, it was reset to 46.8%. The RE for 2017-18 show the debt-GDP ratio at 49.1%. Thus, the deviation of the target from the FY18 (RE) was 6.3 percentage points of the GDP when it was first set; and even after resetting in the next year, it was 2.3 percentage points. There was only one exception when the target of 3.5% for 2016-17 set in 2015-16 equaled the corresponding realization. However, in the 2017-18 (RE), we have remained at the 3.5% level.

The average annual rate, in terms of percentage points, at which different governments have reduced the fiscal and revenue deficits relative to GDP has been quite low. The average annual rate of reduction over two different regimes, namely, from 2009-10 to 2013-14 and 2014-15 to 2018-19, for fiscal deficit relative to GDP was 0.3 percentage points per year in the first period and 0.2 percentage points per year for the second period. The same margins applied for revenue deficit reduction. For the Center's debt-GDP ratio, the average reduction margin was 1.1 percentage points and 0.5 percentage points per year for the two periods, respectively. The current Budget has retained fiscal deficit at 3.5% of GDP, missing the budgeted target of 3.2% of GDP, which was itself a deviation from the stipulated target of 3% of GDP for 2017-18 in the amended FRBM Act. A slippage margin of 50 basis points implies a delay in reaching the debt-GDP target of 40% by two-and-a-half years given the average margin of reduction of 0.2 percentage points per year. With the absence of improvement in the fiscal deficit level in 2017-18, the debt-GDP ratio has increased to 49.1% in 2017-18 from 48.7% in 2016-17 rather than falling, which was the trend until recently.

c. Modifying the review committee recommendations

In the proposed amendment to the FRBM Act, a number of key recommendations of the Review Committee were not accepted. First, the Review Committee had recommended the target at which the fiscal deficit to GDP ratio was to be stabilized at 2.5%. The Review Committee had derived the 2.5% target by reference to the annual estimate of available investible resources at 10% of GDP consisting of surplus savings of the household sector and sustainable net capital inflows. They assessed that half of it, that is, 5%, could be pre-emptively shared equally by the Central and state governments, keeping their fiscal deficits at 2.5% of GDP each, leaving the balance of 5% for the public sector and corporate borrowing. Since then, the available surplus savings of the household sector may have fallen further. However, the Government chose to continue with the 3% target. If this was to be the case, we might as well have continued with the present FRBM Act. In fact, it can be shown that if the Government were to abide by the 3% mandate beyond 2020-21, the debt to GDP ratio will come down to 40% by 2024-25 with a nominal GDP growth assumption of 11.5%. Thus, specifying the fiscal deficit target of 3% would have been enough to achieve the debt target.

Second, the Review Committee had not given up on the desirability of achieving revenue account balance. It had specified a revenue deficit glide path, reaching 0.8% by 2022-23. This was also not accepted. The target of revenue account balance is well recognized in the so-called "golden rule" wherein a country may borrow as long as the entire borrowing is used for capital spending. This can only be achieved by keeping revenue deficit to zero. In the Indian context, revenue deficit with some adjustments reflects government dis-savings. Unless government dis-savings are eliminated, it might be difficult to reverse the trend of a falling saving rate.

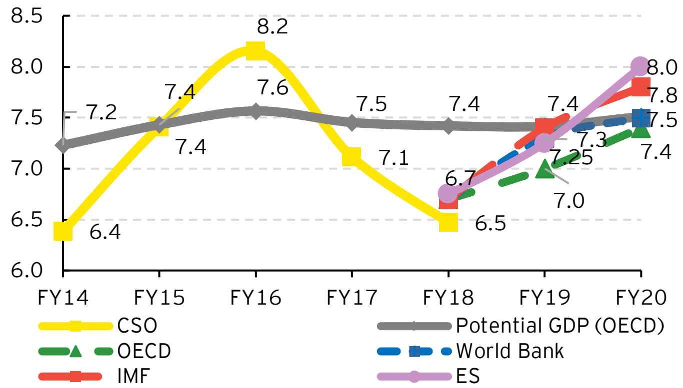
Third, the Central Government also did not accept the recommendation of the Review Committee to set up a Fiscal Council, which could independently examine the economic case and justification for deviating from the specified targets. Unconstrained fiscal flexibility both in approach and statutory provisions adds to a climate of avoidable fiscal risks.

Fourth, the debt-GDP levels of 60% and 40% of GDP for the general and Central governments were to be achieved by 2022-23 in the Committee's recommendations. These target dates have been shifted to 2024-25.

d. Growth outlook

The temporary effects of demonetization and GST transition are firmly behind us. A strong recovery started from 2QFY18. The World Bank and the IMF project a 7.3%–7.4% growth rate for FY19 and a growth close to 8% in two to three years (Chart 1). The Budget FY19 and its demand stimulation would support this growth impetus through directly supporting sectors such as infrastructure, construction, agriculture and health, which are job-creating sectors and will have multiplier effects.

Chart 1: India's GDP growth: — actual vs. potential



Source (Basic Data): National Accounts Statistics, Ministry of Statistics and Programs Implementation; OECD; World Bank; Economic Survey 2017-18, Ministry of Finance, Government of India.

The IMF projected a strongly positive outlook for global growth, which would support India's export demand. Export growth strengthened in 2HFY18. Private investment demand has started to improve from 1HFY18. Although private and government consumption expenditure showed a slight deceleration in 2HFY18, these trends are likely to be reversed soon because of the strong demand push being introduced through the budget.

Home

6. Money and finance: Repo rate left unchanged at 6% in February 2018

A. Monetary sector

The RBI estimated CPI inflation to average around 5.1% in 4QFY18, higher than its earlier estimates. Consequently, it retained its policy repo rate unchanged at 6.0%.

Monetary policy

- The RBI, for the third consecutive time, left the policy repo rate unchanged at 6.0% during its sixth bi-monthly policy review held on 7 February 2018 (Chart 16) as inflation expectations remain elevated. In the RBI's assessment, CPI inflation is likely to be influenced by firming up of international crude oil prices, uptick in global non-oil industrial raw material prices and the fiscal slippage.
- The RBI raised its CPI inflation forecast to be in the 5.1%–5.6% range in 1HFY19 and 4.5%–4.6% in 2HFY19. Such outlook on CPI inflation implies reduced prospects of any repo rate reduction in the near future. Instead, the possibility of a rate hike may emerge.

Chart 16: Movements in repo rate

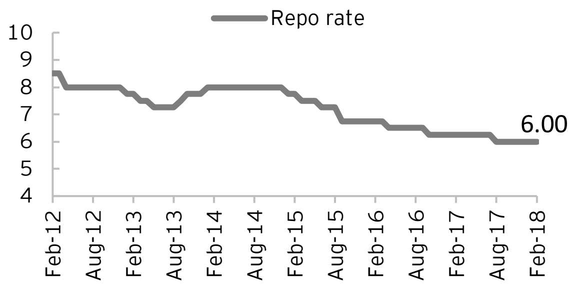
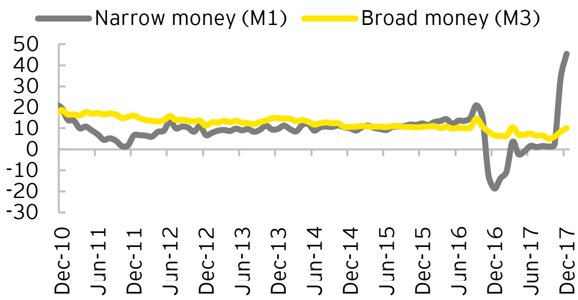


Chart 17: Growth in narrow and broad money



Source: Database on Indian Economy, RBI.

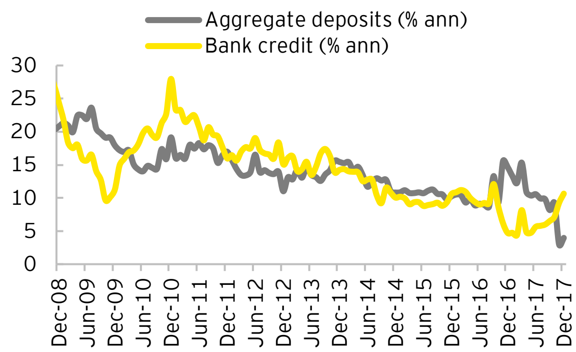
Money stock

- Growth in broad money stock (M3) crossed the 10% mark for the first time in eight months as it grew by 10.8% (y-o-y) in December 2018 as compared to 8.8% in November 2017 (Chart 17). Owing to unfavorable base effect, growth in time deposits (accounting for over 76% of the broad money stock) rose to 3.5% in December 2017, marginally higher than 3.3% in November 2017.
- Narrow money (M1) growth increased further to 45.8% (y-o-y) in December 2017 from 35.0% in November 2017. This sharp increase in the growth of M1 is largely attributable to a favorable base effect as the growth of currency in circulation had contracted to its lowest levels in December 2016. Currency in circulation (excluding non-demonetized currency) as a percentage of the total demonetized currency (indicating the extent of re-monetization) reached close to 97% by 2 February 2018, increasing from 94.6% on 5 January 2018.

Aggregate credit and deposits

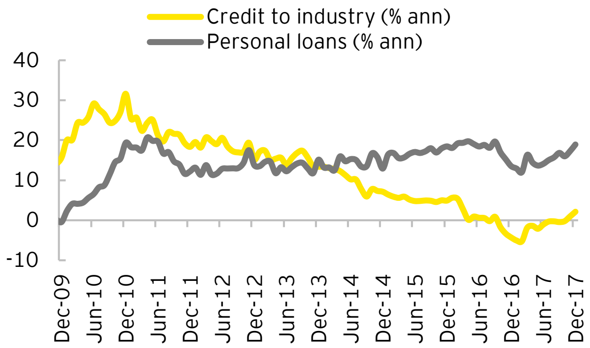
- Growth in credit by scheduled commercial banks increased to a 15-month high of 10.6% (y-o-y) in December 2017 from 9.3% in November 2017 (Chart 18). Improving credit growth points to a recovery in domestic demand.
- Non-food credit growth increased to 10.0% in December 2017 from 8.8% in November 2017 led by broad based improvement in credit offtake across sectors. Credit growth to the services sector rose to 14.7% in December 2017 as compared to 14.0% in November 2017. Growth in credit to industries increased further to 2.1% in December 2017 from 1.0% in November 2017, suggesting an uptick in industrial sector's performance.
- Personal loans, a key driver of retail sector credit, grew to a 15-month high of 18.9% in December 2017 as compared to 17.3% in November 2017 as demand for housing loans improved further during the month (Chart 19).
- With base effect continuing to remain unfavorable, growth in aggregate bank deposits remained subdued at 4.0% (y-o-y) in December 2017 as compared to 3.0% in November 2017.

Chart 18: Growth in credit and deposits



Source: Database on Indian Economy, RBI.

Chart 19: Growth in industrial and personal loans



Source: Database on Indian Economy, RBI.

B. Financial sector

Net FDI inflows touched a four-month high in December 2018 while net FPIs turned negative.

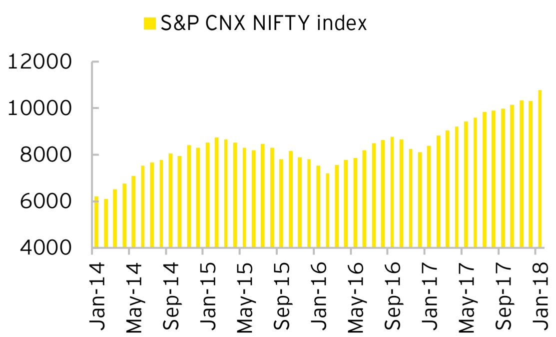
Interest rates

- Banks maintained the interest rates offered on term deposits, with a maturity of more than one year, between 6.00% and 6.75% for the third consecutive month in January 2018.
- The marginal cost of fund-based lending rate (MCLR) was kept in the range of 7.65%-8.05% in January 2018. The average MCLR was at 7.85% in January 2018, a tad lower than the rate of 7.86% in December 2017.
- The average yield on 10-year government securities eased marginally but remained high at 7.22% (weekly average) in January 2018 as compared to 7.35% in December 2017. Bond yields were influenced by concerns over fiscal slippage, excess borrowing through G-Sec and increased expectations of a rate hike as CPI inflation hit a 16-month high in December.

FPI and stock market

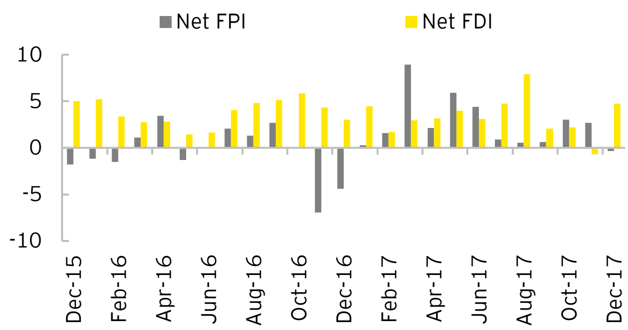
- The benchmark S&P NIFTY index ended higher in January 2018 increasing to 10,771 points (average) from 10,322 points in December 2017 (Chart 20). Market sentiments were largely driven by a positive global growth outlook, strong FII inflows and expected recovery in India's GDP growth in 2HFY18.
- As per provisional data, overall foreign investment inflows increased to US$4.0 billion in December 2017 from US$1.3 billion in November 2017 led by higher FDI inflows.
- Net FDI inflows reached a four-month high of US$4.3 billion in December 2017 (Chart 21). In November 2017, FDIs registered a net outflow of US$1.3 billion. Gross FDI inflows totaled US$48.2 billion during April-December 2017 as compared to US$47.9 billion during the corresponding period of previous fiscal year.

Chart 20: Stock market movement



Source: Database on Indian Economy, RBI.

Chart 21: Gross FDI and FPI inflows



Source: Database on Indian Economy, RBI.

- FPIs recorded a net outflow of US$0.4 billion in December 2017 as compared to US$2.7 billion net inflows in November 2017.

7. Trade and CAB: Continued moderation in export growth

A. Current account balance (CAB): Significant improvement over 1QFY18

CAB as a percentage of GDP improved to (-) 1.2% in 2QFY18 from a four-year low of (-) 2.4% in 1QFY18. It is expected to deteriorate in 3QFY18 due to high levels of merchandise trade deficit.

The improvement in CAB over 1QFY18 was primarily due to the combined effect of a slowdown in merchandise imports and pickup in merchandise exports along with faster growth in net transfers. Merchandise trade deficit moderated substantially to (-) US$32.8 billion from a four-year peak (Table 7). However, despite net service exports rising to a 10-quarter high in 2QFY18, the Economic Survey 2017-18 has forecasted CAB at (-) 1.5-2.0% for FY18 due to high trade deficit in 2HFY18.

Table 7: CAB

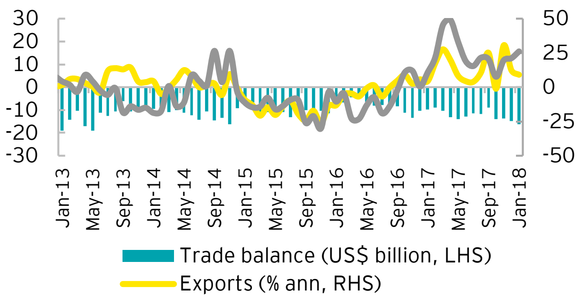
	CAB (- deficit/ +surplus) (US$ billion)	CAB as a % of nominal GDP	Goods account net (US$ billion)	Services account net (US$ billion)	Income account net (US$ billion)	Transfers net (US$ billion)
FY14	-32.4	-1.7	-147.6	73.0	-23.0	65.3
FY15	-26.8	-1.3	-144.9	76.6	-24.1	65.7
FY16	-22.2	-1.0	-130.1	69.7	-24.4	63.0
FY17	-15.3	-0.7	-112.4	67.5	-26.3	56.6
3QFY17	-8.0	-1.4	-33.3	17.8	-6.4	13.9
4QFY17	-3.5	-0.6	-29.7	17.6	-5.6	14.2
1QFY18	-15.0	-2.5	-42.0	18.3	-5.8	14.5
2QFY18	-7.2	-1.2	-32.8	18.4	-8.5	15.6

Source: Database on Indian Economy, RBI.

B. Merchandise trade and exchange rate

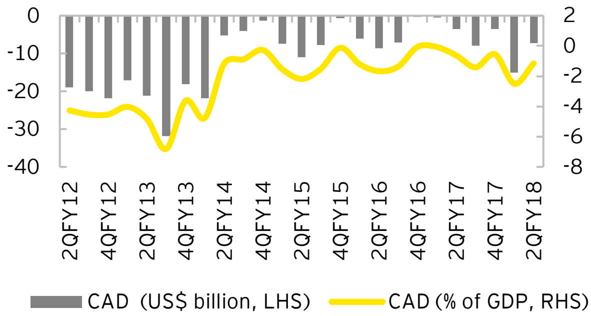
- Growth in merchandise exports in January 2018 dipped further to 9.1%, from 12.4% in December 2017 – the third successive month of decline from a six-year high of 30.5% in November 2017 (Chart 22).
- Growth in engineering goods exports declined substantially to 15.8% in January from 25.3% in December 2017 contributing 70% to the fall in overall growth of exports. Growth in oil exports rose to 39.5% from 25.1% in December.
- Import growth rose for the fourth successive month to an eight-month high of 26.1% from 21.1% in December aided by an increase in the growth of imports of petroleum goods, transport equipment and machinery besides industrial inputs.
- Oil imports, which have been growing at 25%+ rates since October 2017, increased by 42.6% in January, a 10-month high growth rate, from 34.9% in the previous month. Growth in the import of transport equipment turned positive after 3 months of contraction while that of machinery reached a 9-month high of 29.1% in January from 11.2% in December.
- Trade deficit widened to a 56-month high of US$16.3 billion in January from US$14.9 billion in December. 3QFY18 trade deficit widened to an 18-quarter high of US$42.7 billion from US$32.1 billion in 2QFY18.
- The Indian rupee appreciated marginally to INR63.6 per US dollar in January from INR64.2 per US dollar in December.

Chart 22: Developments in merchandise trade



Source: Ministry of Commerce and Industry.

Chart 23: CAD



Source: Database on Indian Economy, RBI.

Home

8. Global growth: IMF projects a broad-based strengthening of global growth

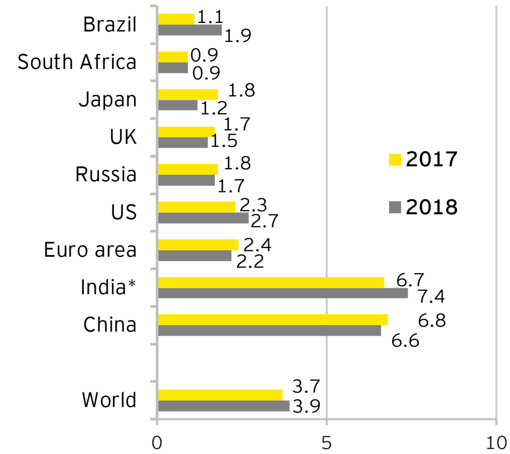
A. Global growth outlook

- As per the IMF (World Economic Outlook Update, January 2018), global growth is estimated to strengthen from 3.2% in 2016 to 3.7% in 2017 (Chart 24). In their assessment, the recovery in global growth is broad-based and is supported by a pickup in investment particularly in advanced economies and increased manufacturing output in Asia.
- Global growth is projected to strengthen further in 2018 and 2019 as favorable global financial conditions and strong sentiment would help maintain the recent acceleration in demand, particularly investment. Additionally, the recently approved tax policy changes in the US are expected to positively contribute to growth in the US with spillover effects.
- For the US, growth forecasts have been revised up for 2017 due to stronger-than-expected growth in the first three quarters. Growth has also been revised up for 2018, 2019 and 2020 due to higher projected external demand and the expected positive impact of a reduction in corporate tax rates on investment. The US Fed maintained the federal funds rate in the range of 1.25% to 1.5% in its January 2018 monetary policy review as inflation continued to remain below 2%.
- For the Euro area, growth has been revised up for countries such as Germany, Italy and the Netherlands, reflecting stronger domestic and external demand. However, growth in Spain has been revised down for 2018, reflecting the effects of increased political uncertainty on confidence and demand. For the region as a whole, growth is estimated at 2.4% in 2017 and 2.2% in 2018.

The IMF, in its January 2018 update of the World Economic Outlook, has projected global growth to strengthen to 3.7% in 2017 and 3.9% in 2018. The IMF indicates that there is a need to raise potential output growth through structural reforms in order to raise productivity, particularly in advanced economies with aging populations.

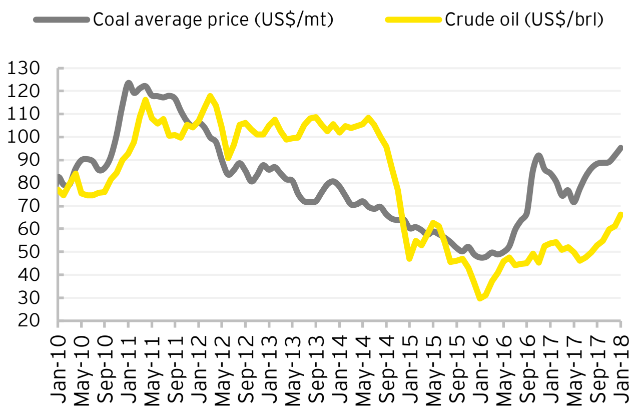
- GDP growth in Japan has also been revised up for 2018 and 2019, reflecting upward revisions to external demand, the supplementary Budget for 2018 and stronger-than-expected growth outcome in the first three quarters of 2017.
- GDP growth in emerging market and developing economies (EMDEs), which account for more than half of the world growth, is projected at 4.7% in 2017, strengthening to 4.9% in 2018.
- Growth in China is estimated at 6.8% in 2017, moderating to 6.6% in 2018. It is expected to fall further to 6.4% in 2019. However, in the case of India, after dipping to 6.7% in 2017, GDP growth is expected to improve to 7.4% in 2018 and further to 7.8% in 2019 as the effects of demonetization and GST wane.

Chart 24: Global growth projections



Source: IMF World Economic Outlook Update, January 2018.
*Forecast pertains to fiscal year FY18 and FY19 accordingly.

Chart 25: Global crude and coal prices

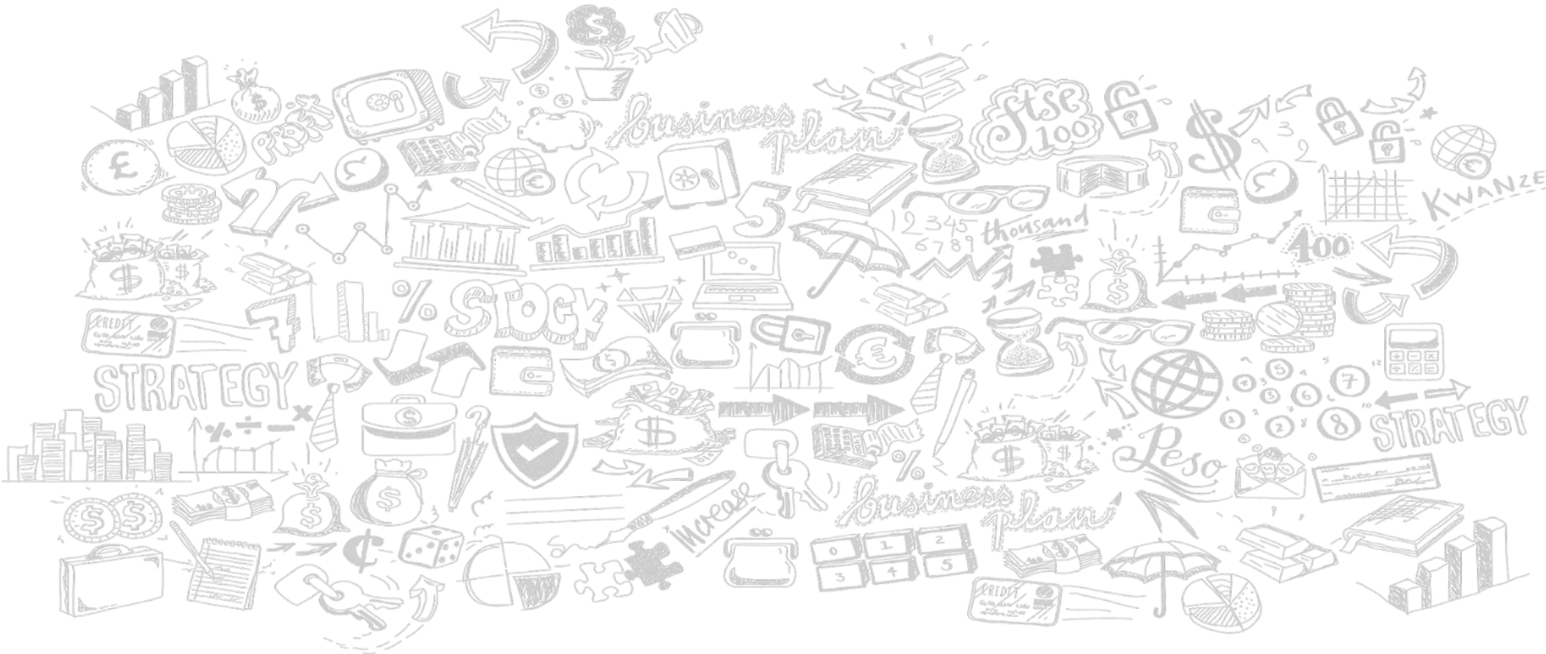


Souce: World Bank, Pinksheet.

B. Global energy prices

Average global crude price increased to US$66.2/bbl. in January 2018, the highest since November 2014, on account of reduced output from North Sea and Venezuela. Average coal price also increased to US$95.3/mt., the highest since April 2012.

- Average global crude prices[1] increased further to US$66.2/bbl. in January 2018, the highest since November 2014 (US$61.2/bbl. in December 2017) (Chart 25). This is attributable to reduced supply from North Sea and Venezuela. The International Energy Agency (IEA) has, in its January 2018 issue of the Oil Market Report, projected a slowdown in demand growth in 2018 mainly due to higher crude oil prices, changing patterns of oil use in China, recent weakness in OECD demand and switch to natural gas in several non-OECD countries.
- Average global coal prices increased for the eighth successive month to US$95.3/mt. in January 2018 (US$92.0/mt. in December 2017), the highest since April 2012.



[1] Simple average of three spot prices, namely, Dated Brent, West Texas Intermediate and Dubai Fateh.

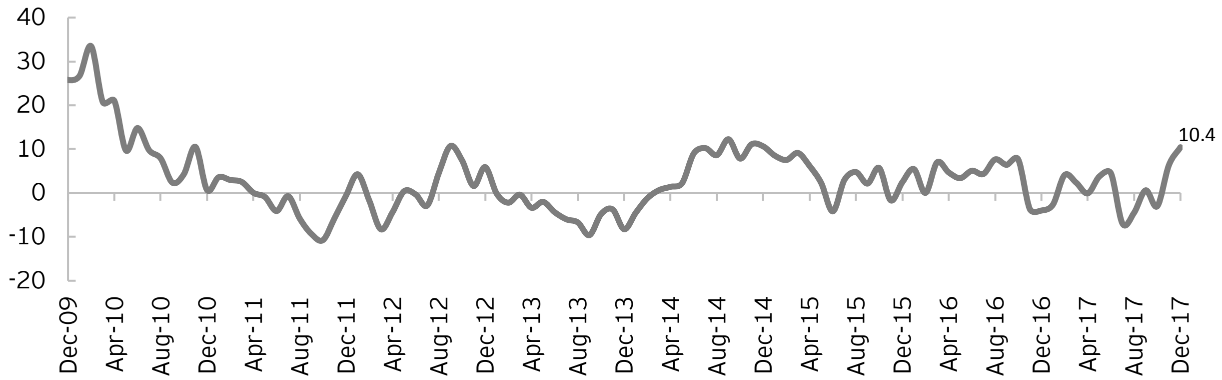
Home

9. Index of aggregate demand (IAD): Aggregate demand strengthened in December 2017

Robust growth in agriculture and manufacturing sectors coupled with modest recovery in the services sector pushed the growth in IAD to a three-year high in December 2017.

- 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, 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 index of aggregate demand accelerated further, reaching a three-year peak of 10.4% in December 2017 as compared to 6.3% in November 2017, partly due to base effect (Chart 26). Demand conditions remained robust in both agricultural and manufacturing sectors, while demand conditions in services sector recovered marginally during the month.

Chart 26: Growth in IAD (y-o-y)



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

Table 8: IAD

Month	Apr-17	May-17	Jun-17	Jul-17	Aug-17	Sep-17	Oct-17	Nov-17	Dec-17
IAD	120.8	123.0	122.9	110.7	117.3	122.9	122.5	117.2	123.9
Growth (% y-o-y)	-0.1	3.8	4.5	-7.0	-4.5	0.6	-3.0	6.3	10.4

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							
FY14	3.3	-0.2	3.6	6.0	2.6	**FY14**	50.5	48.5
FY15	4.0	-1.3	3.8	14.8	4.9	**FY15**	52.2	51.7
FY16	3.3	4.3	2.9	5.7	3.0	**FY16**	51.3	51.7
FY17	4.6	5.3	4.3	5.8	4.8	**FY17**	51.6	51.0
4QFY17	3.1	7.9	2.2	4.3	3.1	**4QFY17**	51.2	50.2
1QFY18	1.9	1.1	1.6	5.3	2.5	**1QFY18**	51.7	51.8
2QFY18	3.3	7.1	2.5	6.1	4.0	**2QFY18**	50.1	48.0
3QFY18	5.9	0.8	7.1	3.8	5.4	**3QFY18**	52.5	50.4
Sep-17	4.1	7.6	3.8	3.4	4.7	**Oct-17**	50.3	51.7
Oct-17	2.0	-0.1	2.2	3.2	5.0	**Nov-17**	52.6	48.5
Nov-17	8.8	1.1	10.7	3.9	6.8	**Dec-17**	54.7	50.9
Dec-17	7.1	1.2	8.4	4.4	4.0	**Jan-18**	52.4	51.7

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				
FY14	9.4	12.1	7.7	7.2	5.2	9.6	3.0	7.1	2.7
FY15	5.9	6.4	4.2	5.6	1.3	4.3	2.6	-6.1	2.7
FY16	4.9	4.9	5.3	4.6	-3.7	1.2	-1.8	-19.7	-1.8
FY17	4.5	4.2	3.3	4.8	1.7	5.9	1.3	-0.3	-0.1
4QFY17	3.6	1.5	4.2	5.0	5.0	4.7	3.3	21.3	2.1
1QFY18	2.2	-0.9	5.3	4.2	2.3	0.5	2.7	11.2	2.3
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	2.6	9.5	3.1
Oct-17	3.6	1.9	6.4	4.5	3.7	3.2	2.6	10.9	2.9
Nov-17	4.9	4.4	8.2	4.9	4.0	4.4	2.7	8.4	3.1
Dec-17	5.2	5.0	7.9	5.1	3.6	3.0	2.6	9.2	3.2
Jan-17	5.1	4.7	7.7	5.0	2.8	1.6	2.8	4.1	3.5

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 BE)	13.4	16.3	21.0	18.3	8.6	3.5	2.6
	Cumulated growth (%, y-o-y)					% of budgeted target	
Jul-17	17.1	24.2	18.8	21.1	13.9	92.4	131.5
Aug-17	20.0	15.5	13.3	14.2	23.6	96.1	133.9
Sep-17	19.9	11.3	16.4	13.5	23.0	91.3	118
Oct-17	18.9	11.8	16.2	13.8	21.1	96.1	124.7
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	104.4 (RE)	102.2 (RE)

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.

Fiscal Year/ Month	CGST	UTGST	IGST	GST compensation cess	Total GST
	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)				
Jul-17	-	-	34	-	34
Aug-17	15, 253	-	70,918	7,749	93,920
Sep-17	15, 135	-	30, 395	8024	53, 554
Oct-17	31, 187	21	18, 370	8031	57, 609
Nov-17	23, 839	75	18, 627	7103	49, 644
Dec-17	24, 215	216	17, 142	7899	49, 472

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
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
FY17	6.25	**FY17**	3.6	10.6	8.0	11.7	7.0	35.6	7.6	370.0
Jul-17	6.25	**4QFY17**	3.1	10.1	5.8	13.6	7.0	5.0	10.8	370.0
Aug-17	6.00	**1QFY18**	1.3	7.0	5.1	10.6	7.0	7.2	12.5	386.5
Sep-17	6.00	**2QFY18**	1.6	5.6	6.1	9.3	6.6	12.4	2.1	399.7
Oct-17	6.00	**3QFY18**	45.8	10.6	9.0	5.3	7.1	4.6	5.3	409.4
Nov-17	6.00	**Sep-17**	1.6	5.6	6.5	8.2	6.7	0.6	0.6	399.7
Dec-17	6.00	**Oct-17**	2.7	6.5	7.1	9.2	6.9	1.6	3.0	398.8
Jan-18	6.00	**Nov-17**	35.0	8.8	9.3	3.0	7.1	-1.3	2.7	400.7
Feb-18	6.00	**Dec-17**	45.8	10.6	10.6	4.0	7.4	4.3	-0.4	409.4

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)						Calendar year	Global growth (annual)		
	Exports	Imports	Trade balance	Ex. rate (avg.)	Crude prices (avg.)	Coal prices (avg.)		World GDP	Adv. econ.	Emer. econ.
	% change y-o-y		US$ billion	INR/US$	US$/bbl	US$/mt		% change y-o-y		
FY14	4.7	-8.3	-135.8	60.5	103.7	76.1	2011	4.2	1.7	6.3
FY15	-1.3	-0.5	-137.7	61.1	83.2	65.9	2012	3.5	1.2	5.3
FY16	-15.5	-15.0	-117.7	65.5	46.0	52.7	2013	3.3	1.2	5.0
FY17	5.0	0.0	-105.6	67.1	47.9	70.4	2014	3.4	1.9	4.6
4QFY17	16.8	25.6	-29.2	67.0	52.9	79.8	2015	3.4	2.1	4.3
1QFY18	10.6	32.8	-40.1	64.5	49.4	75.3	2016	3.2	1.7	4.3
2QFY18	13.4	19.1	-32.1	64.3	50.2	85.9	2017**	3.7	2.3	4.7
3QFY18	13.1	16.1	-42.7	64.7	58.7	90.0	2018**	3.9	2.3	4.9
Oct-17	-1.1	7.6	-14.0	65.1	54.9	88.8	2019**	3.9	2.2	5.0
Nov-17	30.5	19.6	-13.8	64.9	59.9	89.1	2020*	3.7	1.7	5.0
Dec-17	12.4	21.1	-14.9	64.2	61.2	92.0	2021*	3.8	1.7	5.1
Jan-18	9.1	26.1	-16.3	63.6	66.2	95.3	2022*	3.8	1.7	5.0

Source: Database on Indian Economy- RBI, Pink Sheet-World Bank and IMF World Economic Outlook October 2017, IMF World Economic Outlook Update January 2018; *forecasted data as according to October 2017 issue of WEO, **forecasted data as according to January 2018 update of WEO.

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 (AE)	5.5	0.9	-8.4	3.1	5.6	5.6	9.0	6.9	10.7	2.0
2QFY16	8.2	2.3	12.2	9.3	5.7	1.6	8.3	13.0	7.2	-1.4
3QFY16	7.3	-2.1	11.7	13.2	4.0	6.0	10.1	10.5	7.5	0.9
4QFY16	8.7	1.5	10.5	12.7	7.6	6.0	12.8	9.0	6.7	1.6
1QFY17	7.6	2.5	-0.9	10.7	10.3	3.1	8.9	9.4	8.6	1.1
2QFY17	6.8	4.1	-1.3	7.7	5.1	4.3	7.7	7.0	9.5	2.4
3QFY17	6.7	6.9	1.9	8.2	7.4	3.4	8.3	3.3	10.3	2.6
4QFY17	5.6	5.2	6.4	5.3	6.1	-3.7	6.5	2.2	17.0	5.4
1QFY18	5.6	2.3	-0.7	1.2	7.0	2.0	11.1	6.4	9.5	2.2
2QFY18	6.1	1.7	5.5	7.0	7.6	2.6	9.9	5.7	6.0	2.4

	Expenditure components						IPD inflation
Fiscal year/quarter	GDP	PCE	GCE	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 (AE)	6.5	6.3	15.2	-0.9	4.4	8.2	2.4
2QFY16	8.4	3.9	4.1	5.0	-4.4	-3.7	1.0
3QFY16	7.4	5.9	5.1	7.0	-8.7	-10.0	1.2
4QFY16	9.0	11.8	2.4	3.9	-1.6	-3.7	1.6
1QFY17	7.9	8.4	16.6	7.4	2.0	-0.5	2.3
2QFY17	7.5	7.9	16.5	3.0	1.5	-3.8	2.8
3QFY17	7.0	11.1	21.0	1.7	4.0	2.1	3.2
4QFY17	6.1	7.3	31.9	-2.1	10.3	11.9	6.0
1QFY18	5.7	6.7	17.2	1.6	1.2	13.4	3.3
2QFY18	6.3	6.5	4.1	4.7	1.2	7.5	3.0

Source: National Accounts Statistics, MOSPI.

List of abbreviations

Sr. no.	Abbreviations	Description
1	AD	Aggregate demand
2	bbl.	Barrel
3	CAB	Current account balance
4	CGA	Comptroller General of Accounts
5	CGST	Central Goods and Services Tax
6	CPI	Consumer Price Index
7	CSO	Central Statistical Organization
8	Disc.	Discrepancies
9	EMDEs	Emerging market and developing economies
10	EXP	Exports
11	FII	Foreign investment inflows
12	FPI	Foreign portfolio investment
13	FY	Fiscal year (April–March)
14	GDP	Gross domestic product
15	GFCE	Government final consumption expenditure
16	GFCF	Gross fixed capital formation
17	GoI	Government of India
18	GST	Goods and Services Tax
19	GVA	Gross value added
20	IAD	Index of Aggregate Demand
21	IEA	International Energy Agency
22	IGST	Integrated Goods and Services Tax
23	IIP	Index of Industrial Production
24	IMI	Index of Macro Imbalance
25	IMF	International Monetary Fund
26	IMP	Imports
27	IPD	Implicit price deflator
28	LAF	Liquidity adjustment facility
29	MCLR	Marginal cost of funds based lending rate
30	m-o-m	Month-on-month
31	mt	Metric tonne
32	MPC	Monetary Policy Committee
33	NDU	Non-departmental undertaking
34	NEXP	Net exports (exports minus imports of goods and services)
35	PFCE	Private final consumption expenditure
36	PMI	Purchasing Managers' Index (reference value = 50)
37	PSU	Public sector undertaking
38	RE	Revised estimate
39	UTGST	Union territory goods and services tax
40	WEO	World Economic Outlook
41	WPI	Wholesale Price Index
42	y-o-y	Year on year

Our offices

Ahmedabad
2nd floor, Shivalik Ishaan
Near C.N. Vidhyalaya
Ambawadi
Ahmedabad - 380 015
Tel: + 91 79 6608 3800
Fax: + 91 79 6608 3900

Bengaluru
6th, 12th & 13th floor
"UB City," Canberra Block
No. 24 Vittal Mallya Road
Bengaluru - 560 001
Tel: + 91 80 4027 5000
+ 91 80 6727 5000
+ 91 80 2224 0696
Fax: + 91 80 2210 6000

Ground Floor, 'A' wing
Divyasree Chambers
11, O'Shaughnessy Road
Langford Gardens
Bengaluru - 560 025
Tel: +91 80 6727 5000
Fax: +91 80 2222 9914

Chandigarh
1st Floor, SCO: 166-167
Sector 9-C, Madhya Marg
Chandigarh - 160 009
Tel: +91 172 331 7800
Fax: +91 172 331 7888

Chennai
Tidel Park, 6th & 7th Floor
A Block, No. 4, Rajiv Gandhi Salai
Taramani, Chennai - 600 113
Tel: + 91 44 6654 8100
Fax: + 91 44 2254 0120

Delhi NCR
Golf View Corporate Tower B
Sector 42, Sector Road
Gurgaon - 122 002
Tel: + 91 124 464 4000
Fax: + 91 124 464 4050

3rd & 6th Floor, Worldmark-1
IGI Airport Hospitality District
Aerocity, New Delhi - 110 037
Tel: + 91 11 6671 8000
Fax + 91 11 6671 9999

4th & 5th Floor, Plot No 2B
Tower 2, Sector 126
NOIDA - 201 304
Gautam Budh Nagar, U.P.
Tel: + 91 120 671 7000
Fax: + 91 120 671 7171

Hyderabad
Oval Office, 18, iLabs Centre
Hitech City, Madhapur
Hyderabad - 500 081
Tel: + 91 40 6736 2000
Fax: + 91 40 6736 2200

Jamshedpur
1st Floor, Shantiniketan Building
Holding No. 1, SB Shop Area
Bistupur, Jamshedpur – 831 001
Tel: +91 657 663 1000
BSNL: +91 657 223 0441

Kochi
9th Floor, ABAD Nucleus
NH-49, Maradu PO
Kochi - 682 304
Tel: + 91 484 304 4000
Fax: + 91 484 270 5393

Kolkata
22 Camac Street
3rd Floor, Block 'C'
Kolkata - 700 016
Tel: + 91 33 6615 3400
Fax: + 91 33 2281 7750

Mumbai
14th Floor, The Ruby
29 Senapati Bapat Marg
Dadar (W), Mumbai - 400 028
Tel: + 91 22 6192 0000
Fax: + 91 22 6192 1000

5th Floor, Block B-2
Nirlon Knowledge Park
Off. Western Express Highway
Goregaon (E)
Mumbai - 400 063
Tel: + 91 22 6192 0000
Fax: + 91 22 6192 3000

Pune
C-401, 4th floor
Panchshil Tech Park
Yerwada
(Near Don Bosco School)
Pune - 411 006
Tel: + 91 20 6603 6000
Fax: + 91 20 6601 5900

Ernst & Young LLP

EY | Assurance | Tax | Transactions | Advisory

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

Ernst & Young LLP is one of the Indian client serving member firms of EYGM Limited. For more information about our organization, please visit www.ey.com/in.

Ernst & Young LLP is a Limited Liability Partnership, registered under the Limited Liability Partnership Act, 2008 in India, having its registered office at 22 Camac Street, 3rd Floor, Block C, Kolkata - 700016

EYIN1802-009

ED None

ey.com/in
@EY_India EY|LinkedIn EY India EY India careers ey_indiacareers