

January 2017

# **Economy Watch**

Monitoring India's macro-fiscal performance

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List of abbreviations:

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

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## Foreword: Union Budget FY18 provides cautious support to growth



GDP growth in India has fallen well below its potential level, estimated to be in the range of 8%–10% by the Economic Survey 2016–17 (Survey), because of a continuing investment slowdown, accentuated by a demonetization-linked consumption slowdown. Given the weak export demand and global policy uncertainties, India will have to largely rely on domestic policy initiatives to uplift growth to its potential level.

Ground for a strong fiscal stimulus was prepared by the FRBM Review Committee, which submitted its report immediately preceding the Budget presentation. This Committee recommended relaxation of the fiscal deficit target up to a margin of 0.5% points of GDP in the presence of “far-reaching structural reforms with unanticipated fiscal implications.” Demonetization clearly constitutes such a structural reform. The Survey berated the rating agencies (Refer to Box 1, page 4, Economic Survey 2016-17, ‘Poor Standards? The Rating Agencies, China & India’) and argued that the comparators used for assessing India are not appropriate. India has a strong growth trajectory and has shown commitment to fiscal discipline. In fact, India might be able to carry much more debt than other countries. Thus, the Finance Minister could have taken the benefit of larger borrowing to stimulate the economy by retaining the fiscal deficit target of 3.5% of GDP for FY18.

However, the Finance Minister chose to remain cautious by limiting the revision in the fiscal deficit target from its earlier announced path to only 3.2%. This does not provide an adequate push to capital expenditure in FY18 which is budgeted to fall from 1.9% to 1.8% of GDP. We also note that the monetary policy stimulus would not be effective until inventories are exhausted by a strong fiscal stimulus. Additional borrowing by the public sector to finance the fiscal stimulus at the present juncture would not crowd out private investment because of an increase in financial savings linked to the surge in bank deposits as a result of demonetization.

The global situation does not warrant much optimism, as the policies of economies such as the US and other advanced countries are becoming more inward-oriented. The global growth slowdown, fall in the growth rate of the global population as also fall in overall productivity imply that high export growth phases may be few and far between from now on. The global crude prices and the prices of primary articles are also firming up. Under these circumstances, in order to take the maximum advantage of India’s unfolding demographic dividend, reliance has to be placed largely on domestic policy initiatives. This is why India needs to provide a stronger fiscal stimulus than what is proposed in the Budget. We consider the following options to be useful: first, the Center’s fiscal deficit may be kept at 3.5% of GDP in FY18; second, states should also be allowed to go up to 3.5% of GDP as far as their consolidated fiscal deficit is concerned; and, third, departmental and non-departmental public sector enterprises should be induced to undertake their expansion plans by investing to the extent of at least 0.75% points of GDP. These initiatives may be supplemented by a progressive increase in the tax-GDP ratio, which should become feasible with the implementation of GST and demonetization-linked digitization.

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

## Highlights of January

1. **Budget FY18 and the Survey recognize the demonetization-linked growth slowdown.** This could be in the range of 1.15%–1.4% points of GDP.
2. As per the CSO’s latest GDP advance estimates for FY17, **growth in PFCE has slowed down to 5.5% and investment growth, as measured by GFCF, has become stagnant at 0%.** On the output side, GVA growth in FY17 has fallen to 6.5%.
3. **Annual CPI inflation declined to a 25-month low of 3.4% in December 2016** because of a sharp fall in food prices. CPI inflation has fallen sharply from its previous peak of 6.1% (y-o-y) in July 2016.
4. **WPI inflation marginally increased to 3.4% in December 2016** to converge with CPI inflation after a long gap.
5. Cumulated fiscal deficit stood at 94% of the annual revised estimate up till December 2016. According to Budget FY18, the target of 3.5% of GDP for FY17 is expected to be met. However, **a small moderation in the FY18 fiscal deficit target at 3.2% of GDP has been budgeted.**
6. **The FRBM Review Committee, which submitted its report immediately preceding the Budget presentation, recommended anchoring fiscal discipline to debt rather than fiscal deficit relative to GDP and suggested flexibility in the fiscal deficit target to the extent of 0.5% points of GDP** in case of “far-reaching structural reform in the economy with unanticipated fiscal implications.”
7. **Growth in bank credit fell to 5.1% in December 2016,** reflecting demonetization-linked contraction.
8. **The IMF projected global growth at 3.1% in 2016** and an increase to 3.4% in 2017 due to improved growth outlook for both advanced and emerging economies, particularly China. However, a major challenge relates to the uncertainty regarding US policies and their global ramifications

# 1 Growth: significant upward revision to FY16 GDP growth as investment growth accelerates

## A. GDP growth

- ▶ As per the CSO's First Revised Estimates of National Income Accounts, India's real GDP is estimated to have grown by 7.9% in FY16 as compared to the earlier provisional estimate of 7.6% released in May 2016.
- ▶ GFCF was estimated to have grown by 6.1% in FY16 relative to the earlier estimate of just 3.9%. A significant upward revision in the growth of GFCF (by 2.2% points) was largely responsible for driving the overall growth upward in FY16. In addition, growth in GCE was also revised upward to 2.9% as compared to 2.2%.
- ▶ Both exports and imports contracted in FY16. However, growth in imports at (-) 5.9% contracted at a faster rate. As a result, the contribution of net exports (exports less imports) was marginally positive at 0.2% points.
- ▶ On the production side, growth in industrial and services sector for FY16 was revised upward. Accordingly, the GVA growth in the industrial and services sectors are 8.2% and 9.8%, respectively, in FY16 (Table A6). The overall GVA growth has been revised upward to 7.8%.
- ▶ As per the RBI's February 2017 monetary policy statement, GVA growth for FY17 is projected at 6.9% and at 7.4% for FY18.

**Table 1: real GDP growth (%)**

AD component	FY13	FY14	FY15	FY16	FY17
PFCE	5.3	7.4	6.8	7.3	5.5
GCE	0.7	0.6	9.4	2.9	26.5
GFCF	4.8	1.8	4.1	6.1	0.0
EXP	6.8	7.8	1.7	-5.4	2.2
IMP	6.0	-8.1	0.8	-5.9	-0.8
<b>GDP</b>	<b>5.5</b>	<b>6.5</b>	<b>7.2</b>	<b>7.9</b>	<b>7.0</b>
<i>Of which</i>					
% contribution of discrepancies	1.0	-1.1	-0.5	1.3	1.7

Source: (Basic data) MOSPI

**Table 2: sectoral real GVA growth (%)**

Sector	FY13	FY14	FY15	FY16	FY17
Agr	1.5	5.6	-0.3	0.8	3.3
Ming.	-0.6	3.1	14.7	12.3	-9.4
Mfg.	5.9	5.1	7.5	10.6	5.0
Elec.	2.5	4.0	7.2	5.1	9.7
Cons.	0.6	3.0	3.0	2.8	7.2
Trans.	9.7	6.8	8.6	10.7	6.5
Fin.	9.7	11.0	11.1	10.8	6.8
Publ.	4.3	3.8	8.1	6.9	15.6
<b>GVA</b>	<b>5.4</b>	<b>6.2</b>	<b>6.9</b>	<b>7.8</b>	<b>6.5</b>

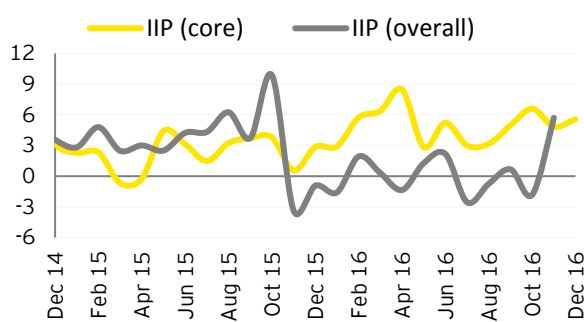
Source: (Basic data) MOSPI

- ▶ Using the latest revised GDP and GVA estimates for FY16 as given by the CSO release on 31 January 2017, in conjunction with the advanced estimates for FY17 released earlier, which did not account for the impact of demonetization, GDP and GVA growth rates for FY17 have been re-estimated at 7.0% and 6.5%, respectively (Table 1).
- ▶ Growth in PFCE has slowed to 5.5% in FY17 and investment growth, as measured by GFCF, has become stagnant at 0%. GCE is expected to be the second-largest driver of domestic demand in FY17, with estimated growth of 26.5%.
- ▶ A number of key sectors account for the growth slowdown. These include manufacturing (5.0%), transport and communication services (6.5%), financial services (6.8%) and mining ((-) 9.4%). The main driver of growth in FY17 is public administration, which is estimated to grow by 15.6%, largely due to the upward revision in the salaries for government employees.

## B. Industrial growth: core sector output shows signs of recovery in December

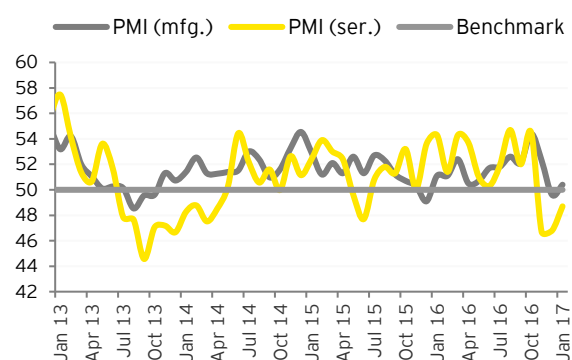
- ▶ Growth in IIP turned positive in November 2016 (Chart 1) as it recovered to 5.7% (y-o-y) from (-) 1.8% in October 2016, driven by a favorable base effect. However, the m-o-m growth numbers indicate that IIP contracted for two successive months in October ((-) 0.7%) and November ((-) 1.3%).
- ▶ On an m-o-m basis, the manufacturing sector continued to contract at (-) 1.3% in November 2016. In October it had contracted by (-) 2.6%. The electricity sector also contracted by (-) 6.2% in November 2016 as compared to a growth of 1.7% in October 2016.
- ▶ As per use-based industrial classification, the capital goods industry grew by 15.0% (y-o-y) in November 2016, reversing its contractionary trend since November 2015, partly owing to a favorable base effect. The consumer goods industry grew by 5.6% in November as compared to a decline of (-) 1.6% (y-o-y) in October 2016.
- ▶ Growth in the output of eight core infrastructure industries recovered to 5.6% (y-o-y) in December 2016 from 4.9% in November 2016. This improvement was driven by higher growth in the output of steel (14.9%) and petroleum refinery (6.4%). However, growth in the output of crude oil ((-) 0.8%) and cement ((-) 8.7%) contracted in December.

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 improved to 5.6% in December. In November 2016, the IIP growth had turned positive at 5.7% owing to a favorable base effect.

## C. PMI: signals a recovery in manufacturing and easing contraction in services in January 2017

PMI signals marginal recovery in the manufacturing sector in January 2017, while the services sector continued to contract.

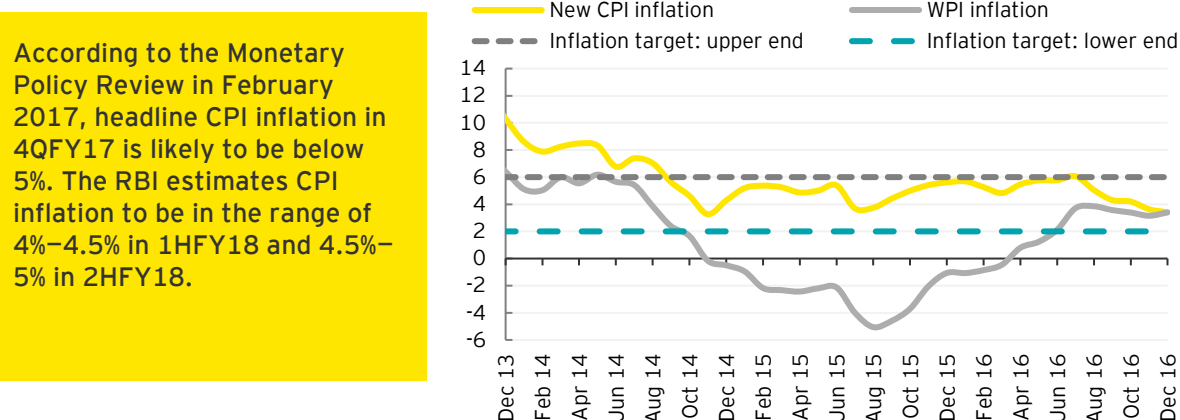
- ▶ After contracting in December for the first time in the year, the headline manufacturing PMI (sa) recovered from 49.6 to 50.4 in January 2017 (Chart 2). There was a modest growth in both new orders and output as compared to the steep contraction observed during the last month.
- ▶ Headline services PMI (sa) remained in the contraction territory at 48.7 in January 2017 (46.8 in December 2016) as new orders and activity fell for the third straight month. However, the rate of contraction was the slowest in the current three months sequence of reduction.
- ▶ Composite PMI Output Index (sa) increased from December's 38-month low of 47.6 to 49.4 in January 2017, pointing to a weaker contraction in private sector activity. The easing pace of contraction was supported by a rebound in factory production.

## 2 Inflation: declining food prices push CPI inflation to a 25-month low

Annual CPI inflation declined to a 25-month low of 3.4% in December 2016 due to a sharp fall in food prices. CPI inflation has fallen from its previous peak of 6.1% (y-o-y) in July 2016.

- ▶ CPI-based inflation (Chart 3) declined to 3.4% in December 2016 as compared to 3.6% in November 2016.
- ▶ Core CPI inflation (excluding food and fuel) declined marginally to 4.9% after rising to 5.0% in November 2016 (y-o-y).
- ▶ 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 1.4% in December 2016.
- ▶ Fuel and lighting inflation reached a 10-month high of 3.8% as compared to 2.8% in the previous month.
- ▶ According to the RBI, the contraction in demand as a result of demonetization was partly responsible for the decline in the prices of vegetables.

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



Source: Ministry Of Statistics and Programme Implementation (MOSPI)

**WPI inflation increased for the first time in six months, rising marginally to 3.4% in December 2016 from 3.2% (y-o-y) in November 2016 because of a decline in the prices of primary articles.**

- ▶ WPI inflation for primary articles reached a 14-month low of 0.3% in December 2016 from 1.2% in November 2016. Within primary articles, WPI inflation in food articles turned negative for the first time in 16 months, reaching (-) 0.7% in December. The persistent decline in the inflation in non-food articles was marginally arrested as it increased to 0.6% in December 2016 from (-) 0.1% in the previous month.
- ▶ Inflation in fuel and power climbed to a 29-month high of 8.7% in December 2016 as compared to 7.1% in November 2016. Inflation in diesel prices reached a 40-month high of 20.3% in December 2016.
- ▶ After contracting for 16 successive months till June 2016, WPI core inflation turned positive and increased for the fifth successive month at 2.2% in December as compared to 1.6% in November 2016.
- ▶ Inflation in minerals and basic metals and alloys was at four-year high levels of 12.9% and 5.4%, respectively.
- ▶ WPI and CPI based inflation rates started to diverge after February 2012. This divergence reached a peak of 9% points in September 2015, after which the rates started to converge gradually. In December 2016, they again converged after a gap of four years.

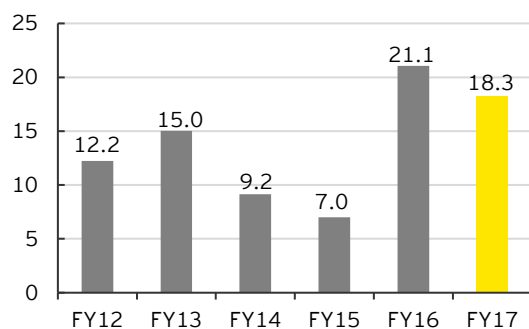
### 3 Fiscal performance: cumulated fiscal deficit at 94% of annual revised target by December 2016

#### A. Tax and non-tax revenues

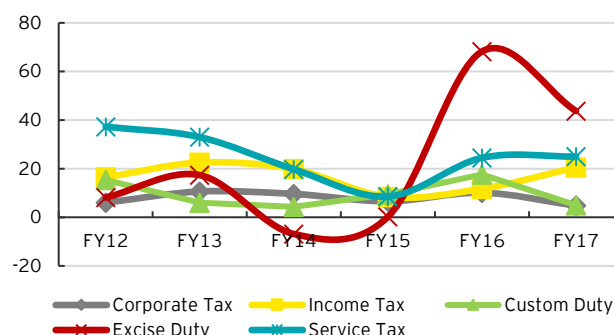
The Center's gross tax revenues grew by 18.3% during April–December FY17, driven by robust growth in revenues from income tax, union excise duties and service tax. Growth in non-tax revenues during this period was negligible at 0.5%.

- ▶ The Center's revenue receipts during April–December FY17 were 65.6% of the annual revised target as compared to 66.6% during the same period of FY16.
- ▶ Growth in cumulated gross tax revenues was lower at 18.3% during April–December FY17, compared to 21.1% during the corresponding period of FY16 (Chart 4). This was led by a higher growth in indirect taxes at 25.5%. Growth in direct taxes was at 10.7% during April–December FY17.
- ▶ Within direct taxes, income tax revenues grew by 20.5% during April–December FY17 (Chart5) as compared to 11.7% during the same period of FY16. This included the effect of IDS1 and IDS2 linked to the income disclosures under the Pradhan Mantri Garib Kalyan Yojana (PMGKY) Deposit Scheme. On the other hand, growth in corporation tax revenues remained sluggish at 4.8% during April–December FY17 as compared to the corresponding value of 10.1% in FY16.
- ▶ Among indirect taxes, Union excise duties witnessed a strong growth of 43.7% during April–December FY17 due to the additional duties levied on petroleum products which contributed almost 70% to the total excise collections in 1HFY17. Growth in service tax revenues was also high at 25% during April–December FY17.
- ▶ Growth in customs duties remained subdued at 4.9% during April–December FY17 because of contraction in imports, particularly gold imports.

**Chart 4: growth in cumulated gross tax revenues up to December 2016**



**Chart 5: growth in cumulated tax revenues up to December 2016**



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

- ▶ Growth in non-tax revenues was at 0.5% during April–December FY17 as compared to 22.6% in the corresponding period of FY16. This implies that for realizing the revised estimates for non-tax revenue growth for FY17 given in Budget FY18, non-tax revenues are required to grow by 118.5% (y-o-y) in the last quarter of FY17.
- ▶ 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.

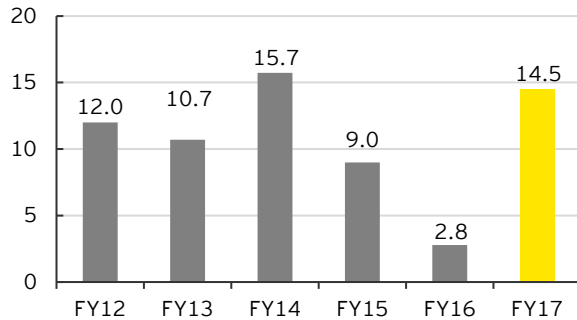
#### B. Expenditures: revenue and capital

- ▶ Total expenditure grew by 11.9% during April–December FY17 as compared to the corresponding value of 6.3% in FY16.

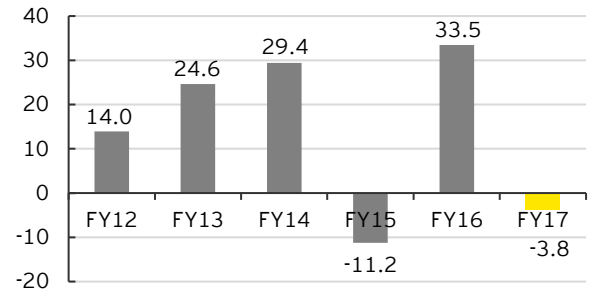
- ▶ Growth in revenue expenditure was 14.5% during April–December FY17 as compared to 2.8% during the same period in FY16 (Chart 6). This largely reflects the impact of salary and pension revisions based on the recommendations of the 7th Pay Commission.
- ▶ The Center’s capital expenditure contracted by (-) 3.8% during April–December as compared to a growth of 33.5% in the corresponding period of FY16 (Chart 7).

The Center’s revenue expenditure grew by 14.5% during April–December FY17, while capital expenditure contracted by (-) 3.8%.

**Chart 6: growth in cumulated revenue expenditure up to December 2016**



**Chart 7: growth in cumulated capital expenditure up to December 2016**



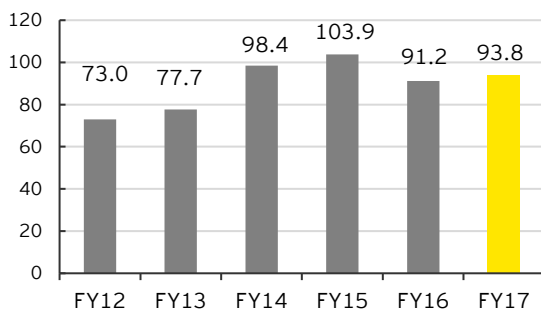
Source: Monthly Accounts, Controller General of Accounts, Government of India

### C. Fiscal imbalance

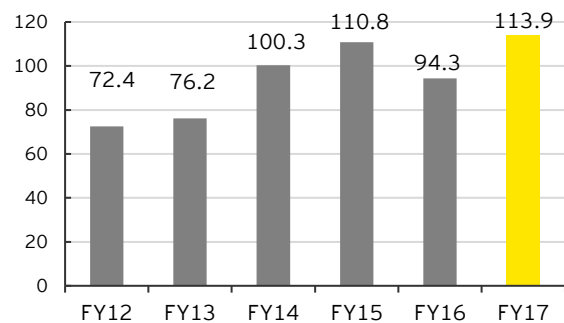
- ▶ The Center’s fiscal deficit stood at 93.8% of the annual revised target during April–December FY17 as compared to 91.2% in the corresponding period of FY16. As per revised estimates for FY17 given in Budget FY18, the fiscal deficit target of 3.5% of GDP is to be met (Chart 8).
- ▶ The Center’s revenue deficit increased to 113.9% of the annual revised target during April–December FY17 as compared to 94.3% during the same period in FY16 (Chart 9).

As per revised estimates for FY17 given in Budget FY18, the fiscal deficit target of 3.5% of GDP is to be met. On the other hand, since revenue deficit during April–December 2016 is already at 113.9% of the annual revised estimate, it is likely to miss its FY17 target.

**Chart 8: cumulated fiscal deficit up to December 2016 as a % of annual revised estimates for FY17**



**Chart 9: cumulated revenue deficit up to December 2016 as a % of annual revised estimates for FY17**



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



## 4 In focus: Union Budget takes a cautious approach to supporting growth

India's November 8 demonetization of high-denomination currency amounting to INR15.44 trillion, i.e., 86.1% of the currency in circulation at that time, was by all accounts a disruptive economic move. The Survey estimates the extent of demonetization-linked erosion in GDP growth in FY17 to be in the range of 0.25%–0.50% points. This implies that the real GDP growth in FY17 would be in the range of 6.50%–6.75%, given the growth rate of 7% for FY17 as estimated by the CSO without taking into account the effect of demonetization. Taken together, these imply a reduction in FY17 GDP growth in the range of 1.15%–1.40% points as compared to the growth of 7.9% achieved in FY16 as per the latest CSO release (31 January 2017). This "demonetization dip" in the growth rate, as shown in Chart 10 can clearly qualify as a "far-reaching structural reform in the economy with unanticipated fiscal implications." The FRBM Review Committee has recommended that in the presence of such a structural reform, there would be a case for deviating from the fiscal deficit target of 3% of GDP. The Committee recommended a flexibility of up to 0.5% points. This flexibility should be invoked if recommended by a "fiscal council." It also suggested that fiscal discipline be anchored to debt rather than the fiscal deficit relative to GDP. For the medium term, it suggested that the desired target should be a consolidated debt-GDP ratio of 60%, of which 40% could be central debt and 20% could be consolidated state debt. Both these provisions provided enough justification for taking up a strong fiscal stimulus in Budget FY18 for uplifting India's economic growth closer to its potential, which the Survey quantifies to be in the range of 8%–10%.

### Constraints to India's growth

Apart from demonetization, which would have a short-term impact, there are longer-term constraints emanating from a slowing down of investment demand and a weakening of global demand for India's exports. With the changed political situation in the US as also Brexit, the world economy is entering into an era of "de-globalization," which could adversely affect India's growth prospects. First, there might be a possibility of eruption of trade tensions among major countries, impacting India's exports. Second, there could be competition among major players in lowering corporate tax rates to attract capital. Third, with the US incrementally uplifting the Fed rate, there would be steady pressure on the Indian rupee.

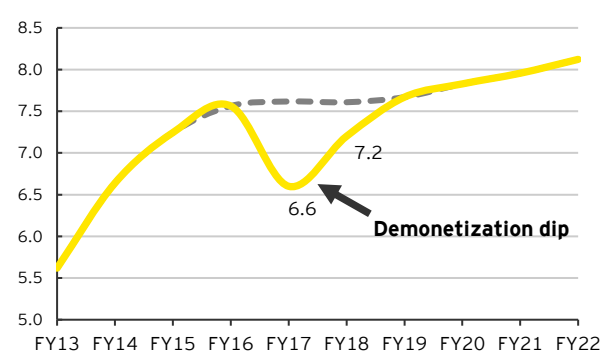
As Table 3 shows, gross fixed capital formation had started to contract in the last quarter of FY16. The magnitude of this contraction increased in the first and second quarters of FY17. Furthermore, the CSO's latest release shows that even private final consumption expenditure slowed down considerably with an annual growth of 5.5% in FY17 compared to 7.3% in FY16. There were other indicators of the post-demonetization slowdown in terms of a sharp fall in bank credit growth and PMI for manufacturing and services, which fell below the threshold of 50 in December 2016, indicating contraction.

Table 3: Real GDP growth (%)

AD component	2Q FY16	3Q FY16	4Q FY16	1Q FY17	2Q FY17	FY16	FY17
PFCE	6.3	8.2	8.3	6.7	7.6	7.3	5.5
GCE	3.3	3	2.9	18.8	15.2	2.9	26.5
GFCF	9.7	1.2	-1.9	-3.1	-5.6	6.1	0
EXP	-4.3	-8.9	-1.9	3.2	0.3	-5.4	2.2
IMP	-0.6	-6.4	-1.6	-5.8	-9	-5.9	-0.8
GDP	7.6	7.2	7.9	7.1	7.3	7.9	7
Of which % contribution of disc.	1.2	2.1	4.1	0.9	1.5	1.3	1.7

Source (Basic Data): MOSPI, Annual data has been taken from the CSO Release dated 31 January 2017

Chart 10: Annual GDP growth (%) up till FY22



Source (Basic Data): IMF

### Financing fiscal stimulus

The Survey also berated the rating agencies (Refer to Box 1, page 4, Economic Survey 2016-17, 'Poor Standards? The Rating Agencies, China & India'). The Survey argues that India is very different from the comparators used by the rating agencies. India has a strong growth trajectory and has shown commitment to fiscal discipline. In fact, India might be able to carry much more debt than other countries. In other words, both the FRBM Review Committee and the observations of the Survey on the rating agencies created ground for the Finance Minister to retain fiscal deficit at 3.5% of GDP in FY18, the same as in FY17, to support demand. However, he chose to allow for a minor increase by retaining fiscal deficit at 3.2% of GDP, which could enable a growth of 10.7% in capital expenditure in FY18 (Table 4). Demand can also be additionally supported through various other channels. First, the Government can access a one-time fiscal windfall linked to currency extinguishment, which has not been factored in Budget FY18. The extent of this gain could be as much as 0.5% of GDP. Second, many states that are asking for a relaxation of their borrowing norms due to revenue erosion as

a result of the slowdown can together be allowed an additional borrowing up to 0.5% of GDP. Borrowing 0.5% points above the FY18 target of 3% of GDP would be justifiable noting that the consolidated Government's debt-GDP ratio fell to 69% in 2015 from its peak of 84% in 2003. However, the Survey recognizes that state finances are under stress with their consolidated fiscal deficit going up from 2.5% of GDP in 2014–15 to 3.6% of GDP in 2015–16, partly because of the UDAY scheme.

Third, departmental enterprises such as Posts and Railways and non-departmental public enterprises can be persuaded to take up their expansion plans given the prevailing low prices of investment goods. Their borrowing, largely off budget, can add another 0.5% of GDP to the fiscal stimulus. Together, these channels could provide a stimulus amounting to 2.0% of GDP. Most of this stimulus should be directed toward augmenting infrastructure. Qualitatively, some push to construction, housing and manufacturing, particularly the automobile sector, through sector-specific incentives should help these demonetization-afflicted sectors.

### Sequencing fiscal and monetary policy

As long as private investment demand remains weak, any interest rate reduction may not prove to be effective. Investment demand would pick up only after existing inventories are exhausted. At that point, monetary stimulus would become effective. The surge in bank deposits implying augmented financial savings would enable the Government to borrow the extra amount without putting pressure on the interest rate. Fiscal stimulus, therefore, has to come first and it is best introduced by augmenting the Government's capital expenditure, which would increase consumption demand in the economy. But, as indicated in Table 4, capital expenditure as a percentage of GDP is slated to fall in FY18.

**Table 4: Expenditure performance and prospects**

#	Expenditure head	INR lakh crore			Growth (%)		As a % of GDP	
		FY16 (Actuals)	FY17 (RE)	FY18 (BE)	FY17 (RE) over FY16 (Actuals)	FY18 (BE) over FY17 (RE)	FY17 (RE)	FY18 (BE)
1	Revenue expenditure <i>of which</i>	15.4	17.3	18.4	12.8	5.9	11.5	10.9
	Interest payments	4.4	4.8	5.2	9.4	8.3	3.2	3.1
	Pensions	1.0	1.3	1.3	32.4	2.4	0.9	0.8
	<b>Total subsidies</b> <i>of which</i>	2.6	2.6	2.7	-1.4	4.5	1.7	1.6
	Fertilizer subsidy	0.7	0.7	0.7	-3.3	0.0	0.5	0.4
	Food subsidy	1.4	1.4	1.5	-3.0	7.5	0.9	0.9
	Petroleum subsidy	0.3	0.3	0.3	-8.2	-9.2	0.2	0.1
2	Capital expenditure	2.5	2.8	3.1	10.6	10.7	1.9	1.8
3	Total expenditure	17.9	20.1	21.5	12.5	6.6	13.4	12.7

Source (Basic Data): Union Budget FY18

The Finance Minister, however, has left room for introducing additional fiscal stimulus as part of a mid-term revision during the course of FY18 by observing that a final call on the matter will be taken after the recommendations of the FRBM Review Committee are examined in depth. In the context of monetary stimulus, the Survey observes that the room for it may be limited because domestic prices are expected to come under pressure due to increased prices of global crude and other primary articles. This has also been indicated by the RBI in its Monetary Policy Review in February 2017.

### Realizing revised estimates for FY17

On the face of it, the Budget does not make excessively optimistic assumptions about tax revenue growth with an assumed buoyancy of just a little more than 1. In the case of non-tax revenues, the assumed growth is negative considering that the one-time surge in non-tax revenues due to spectrum sales would not be available in FY18. These growth rates must, however, be examined relative to the feasibility of their base numbers, which are the revised estimates for FY17, which are based on data for 8 to 9 months of FY17. If we compare the full-year magnitude of the revised estimates with the April–December cumulated magnitudes, the balance that is required to be realized is unduly large for some key variables. For instance, while in the first 9 months, corporate tax revenues showed a growth of 4.8% over the corresponding period of the previous year, the growth required in the last quarter of FY17 is 17.7%. Similarly, in case of non-tax revenues, the achieved growth was only 0.5% and the required growth in the last quarter is 118.5% if the revised estimates are expected to be realized. In case of disinvestments, realized revenue in the first 10 months was INR31,014 crore and the balance to be achieved in the remaining 2 months of FY17 is INR14,486 crore, which is nearly 50% of what has been realized in 10 months. There is thus reason to believe that there may be slippage in the revised estimates of revenue and non-debt capital receipts for FY17.

With respect to capital expenditure, considerable distance is to be covered in the last quarter of FY17 if the revised estimates are to be met. During April–December FY17, capital expenditure contracted by 3.8%. To realize the revised estimates, growth in 4QFY17 will have to be 52.1%.

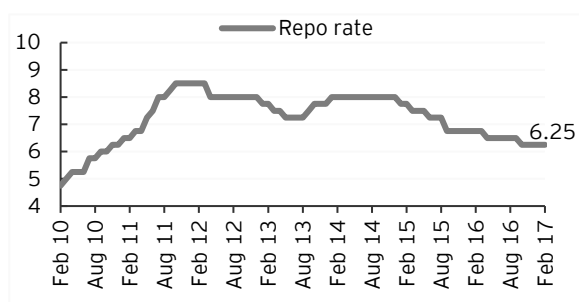
## 5 Money and finance: growth in bank credit fell to 5.1% in December 2016

### A. Monetary sector

#### i. Monetary policy

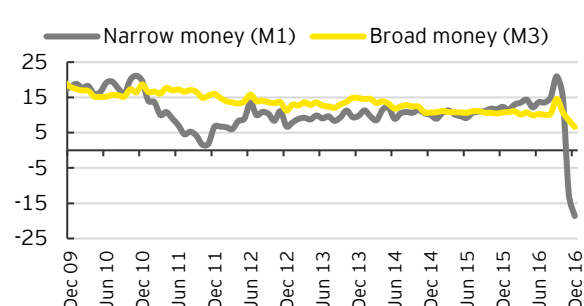
- ▶ All members of the RBI's Monetary Policy Committee unanimously voted in favor of retaining the policy repo rate at 6.25% (Chart 11) in its Monetary Policy Review held on 8 February 2017 as underlying risks to inflation persisted. The policy statement indicated that core CPI inflation, which excludes food and fuel components, has been sticky at 4.9% since September 2016.
- ▶ The RBI assesses upward risks to inflation as arising from (a) hardening of international crude prices, (b) increased volatility in exchange rate and (c) fuller effects of the house rent allowance on CPI inflation.

Chart 11: movements in repo rate



Source: Data Base on Indian Economy, RBI

Chart 12: growth in narrow and broad money



The RBI kept the policy repo rate unchanged at 6.25% in February 2017. The decision was based on the premise that risks to inflation are on the rise and the underlying core CPI inflation had remained at 4.9% since September 2016 despite a fall in the headline CPI inflation.

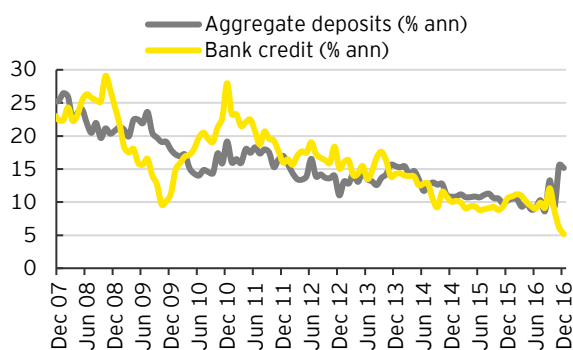
#### ii. Money stock

- ▶ Growth in broad money ( $M_3$ ) plummeted further to 6.6% (y-o-y) in December 2016 from 8.5% (y-o-y) in November 2016 (Table A4). Growth in time deposits, accounting for over 76% of the broad money stock, slowed to 13.6% from its 31-month peak of 14.3% in November 2016.
- ▶ Narrow money ( $M_1$ ) contracted further to (-) 18.6% in December 2016 as compared to (-) 12.3% in November 2016 (Chart 12). Growth in currency in circulation declined further to (-) 39.9% in December 2016 from (-) 23.6% in November 2016. Cash withdrawal limits imposed by the RBI coupled with a slow re-monetization process were responsible for this contraction.

#### iii. Aggregate credit and deposits

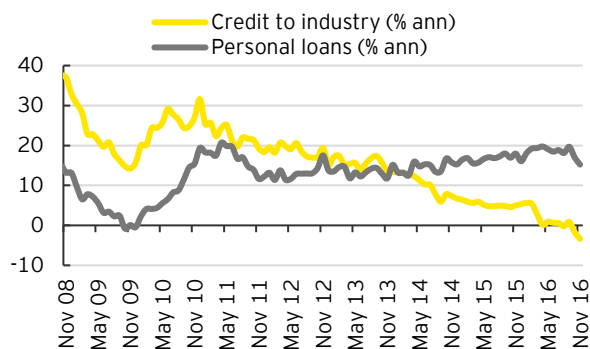
- ▶ Growth in bank credit fell to a historic low of 5.1% (y-o-y) in December 2016 from 6.2% (revised) in November 2016 (Chart 13). Growth in non-food credit fell to 5.3% in December 2016 from 6.5% (revised) in November 2016, while food credit contracted at a slower pace of (-) 5.4% during the month. Even though the lending rates are lowered, continued weakness in demand is likely to constrain the growth of credit.
- ▶ The y-o-y growth of personal loans, a key driver of non-food credit growth, fell to a 27-month low of 13.5% in December 2016 (Chart 14) as compared to 15.2% in November. Credit to industries contracted at an increasing magnitude of (-) 4.3% in December 2016 as compared to (-) 3.4% in November. The Survey observed that growth in credit offtake has been constrained as the corporate and banking sector balance sheets remained under stress during this year.
- ▶ Growth in aggregate bank deposits marginally slowed to 15.2% (y-o-y) in December 2016 as compared to 15.6% (revised) in November 2016. With the re-monetization process expected to be completed early in the next fiscal year, the trend of increasing bank deposits is likely to be reversed.

**Chart 13: growth in credit and deposits**



Source: Data Base on Indian Economy, RBI

**Chart 14: growth in industrial and personal loans**



Source: Data Base on Indian Economy, RBI

## B. Financial sector

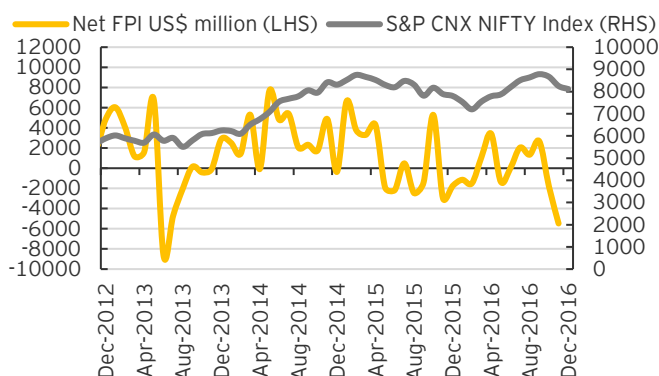
### i. Interest rates

- ▶ The MCLR was maintained at 8.65% in December 2016. Since its introduction in April 2016, the MCLR rate has been cut down by a total of 30 basis points.
- ▶ Banks lowered the interest rates on term deposits (>1 year) to 6.79% in December 2016 from 6.88% (mid-point) in November 2016.
- ▶ The average yield on 10-year Government bonds fell further to 6.53% in December 2016 from 6.61% in November 2016. Demonetization of high-denominated currency has led to huge buildup of liquidity in the banking system, pushing down the bond yields.

### ii. FPI and stock market

- ▶ The benchmark S&P NIFTY index fell further to 8,114 points in December 2016 (average) losing nearly 137 points as compared to the average index value of 8251 points in November 2016 (Chart 15). Markets responded negatively to the RBI's decision to withhold its policy rate leading to an increased outflow of foreign portfolio investments.

**Chart 15: Stock market movement**



- ▶ As per provisional data, overall FIIs continued to remain negative for the second consecutive month, registering a net outflow of US\$1.0 billion in December 2016 similar to the level of outflows seen in November 2016. Net FPI outflows moderated to US\$ 4.0 billion in December 2016 from US\$5.5 billion in November 2016. Sustained outflows of FPIs dented the stock market performance during December 2016. Moreover, net FDI inflows slowed to US\$3.1 billion in December as compared to US\$4.5 billion November 2016.

## 6 External sector: growth in exports remain positive but imports slow down

### A. Current account balance

The CAB as a percentage of GDP deteriorated to (-) 0.6% in 2QFY17 (Table 5, Chart 17) from (-) 0.1% in the previous quarter. Merchandise trade balance deteriorated to (-) US\$25.6 billion in 2QFY17 from a seven-year low of (-) US\$23.8 billion in 1QFY17.

**Table 5: current account balance (US\$ billion)**

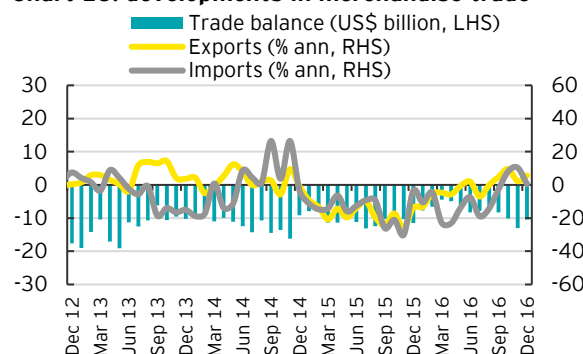
	CAB (- deficit/+surplus) (US\$ billion)	CAB as a % of nominal GDP	Goods account net (US\$ billion)	Services account net (US\$ billion)	Income account net (US\$ billion)	Transfers net (US\$ billion)
FY13	-88.2	-4.8	-195.7	64.9	-21.5	64.0
FY14	-32.4	-1.7	-147.6	73.0	-23.0	65.3
FY15	-26.8	-1.3	-144.9	76.6	-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

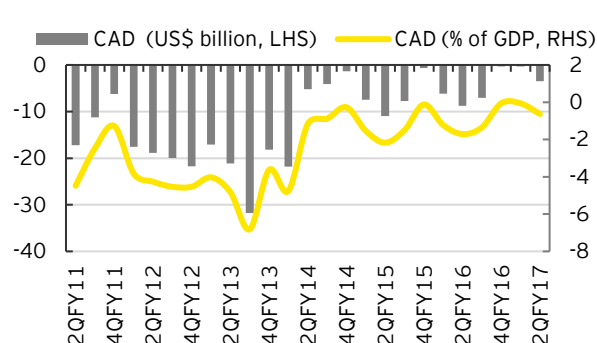
- ▶ Growth in merchandise exports increased to 5.7% in December 2016 from 2.3% in November 2016. (Chart 16).
- ▶ There was a sharp increase in the growth of exports of gems and jewelry, which was at 27.9% in December 2016, as compared to a contraction of 12.8% in November 2016. Growth in exports of Drugs and pharmaceuticals increased to 12.5%, the highest clocked in this fiscal so far.
- ▶ Growth in oil exports reached a 30-month peak of 8.2% in December 2016 from 3.4% in November 2016.
- ▶ Growth in overall imports declined to 0.5% in December 2016 from 3.5% in November, when it turned positive for the first time after 22 successive months of contraction.
- ▶ Growth in oil imports reached a 33-month peak of 14.6% in December 2016 as compared to 5.9% in the previous month.
- ▶ India's merchandise trade deficit declined to US\$10.4 billion in December 2016 as compared to US\$13.0 billion in November 2016.
- ▶ The Indian rupee weakened to INR68.1 per US dollar in January 2017 from INR67.9 per US dollar in December 2016 as a result of lower demand for Indian rupee in the aftermath of demonetization.

**Chart 16: developments in merchandise trade**



Source: Ministry of Commerce and Industry

**Chart 17: CAD**



Source: Data Base on Indian Economy, RBI

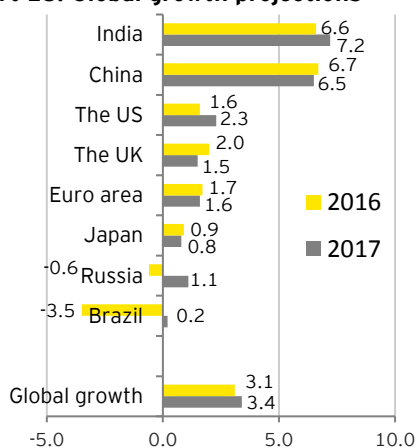
## 7 Global economy: Fed kept the policy rate steady in January 2017

### A. Global growth outlook

- ▶ The IMF, in its January update of World Economic Outlook, projected global growth at 3.1% in 2016. It is expected to pick up pace to 3.4% in 2017 and 3.6% in 2018 (Chart 18).
- ▶ Growth projections for advanced economies have been revised up to 1.9% for 2017 and 2% in 2018 due to stronger activity in the second half of 2016 and a projected fiscal stimulus in the US.
- ▶ The growth projections for the US have been revised significantly upward to 2.3% in 2017 and 2.5% in 2018. The US Fed, in its January 2017 Policy Meet, left the benchmark interest rate in the range of 0.5%–0.75% unaltered, although there was an improvement in the employment and inflation outlook.
- ▶ Growth in the Euro area is projected at 1.7% in 2016 and 1.6% in 2017. In the UK, GDP is projected to grow by 2% in 2016 due to better-than expected growth in 3Q of 2016. The IMF has revised up its growth forecast for the UK by 0.4% points to 1.5% in 2017. There has been an upward revision in the growth forecast for Japan as well for 2017.
- ▶ The IMF has projected a substantial improvement in the growth outlook of EMDEs, which are projected to grow by 4.1% in 2016 and 4.5% in 2017, reflecting a gradual normalization of conditions in a number of large economies that are currently experiencing macroeconomic strains.
- ▶ Notably, growth in China has been revised up by 0.3% points to 6.5% in 2017 on expectations of continued policy support. Growth forecasts for 2017 have been revised downward for Brazil and Mexico following weaker-than-expected growth outcomes in the second half of 2016 and US-related uncertainty in Mexico.

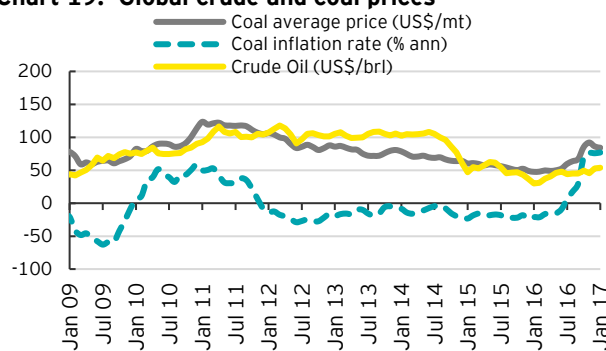
The IMF projected global growth at 3.1% in 2016 and an increase to 3.4% in 2017 due to an improved growth outlook for both advanced and emerging economies, particularly China. However, a major challenge relates to the uncertainty regarding US policies and their global ramifications.

Chart 18: Global growth projections



Source: World Economic Outlook Update, IMF (January 2017)

Chart 19: Global crude and coal prices



Source: World Bank, Pinksheet

### B. Global energy prices

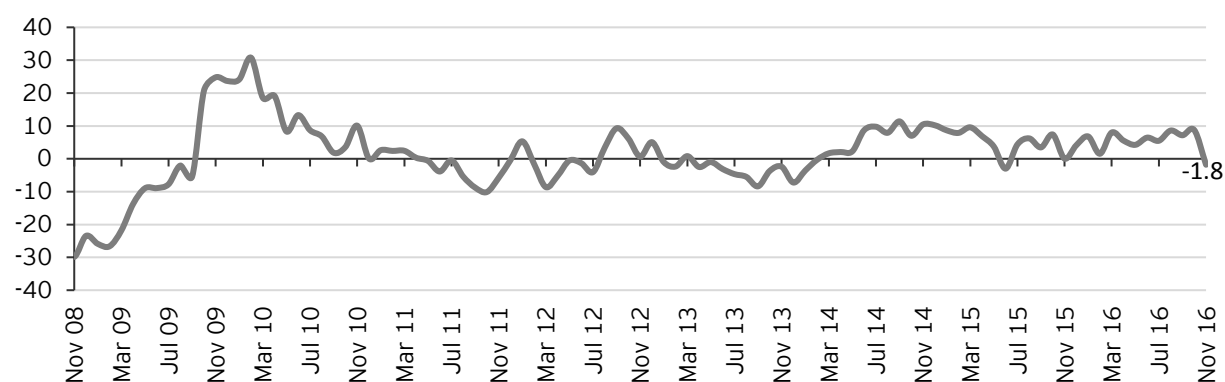
- ▶ Global crude prices marginally increased to US\$ 53.6/bbl in January 2017 from US\$52.6/bbl in December 2016 (Chart 19) as the production cuts commenced, but market participants awaited confirmation on reductions in output. The World Bank has projected crude prices to average \$55/bbl in 2017, an increase of 26% over 2016, reflecting expected rising oil demand and tightening supply under the assumption of partial compliance to the OPEC/ non-OPEC agreement. Prices are expected to average US\$60/bbl in 2018.
- ▶ After peaking at US\$92/mt in November 2016, average global coal prices declined to US\$ 84.2/mt in January 2017 from US\$86.0/mt in December 2016 as the Chinese Government relaxed rules to allow for higher production. 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 prices.

## 8 Index of aggregate demand: contracts in November 2016

The demonetization-linked demand contraction is reflected in the IAD as it contracted by (-) 1.8% in November 2016 after having posted a robust growth of 8.8% in October 2016.

- ▶ 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 by (-) 1.8% in November 2016 from 8.8% in October 2016. (Chart 20). Growth in credit to the agricultural sector, a proxy for demand conditions in the farm sector, fell to a 26-month low of 15.6% in November 2016. Cash crunch due to demonetization took a toll on demand in the industrial and services sectors, too, during November, leading to a contraction in overall demand.

Chart 20: growth in IAD (y-o-y)



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

Table 6: IAD

Month	Mar-16	Apr-16	May-16	Jun-16	July-16	Aug-16	Sep-16	Oct-16	Nov-16
IAD	123.4	122.8	121.0	120.2	121.7	125.5	124.8	129.7	114.6
Growth (% y-o-y)	8.0	5.5	4.2	6.4	5.5	8.6	7.2	8.8	-1.8

## 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	3.0	FY16	51.3	51.7
3QFY16	1.7	3.2	1.1	4.4	1.7	4QFY16	51.5	53.3
4QFY16	0.2	2.2	-1.1	9.3	5.0	1QFY17	51.0	51.7
1QFY17	0.7	2.5	-0.6	9.0	5.4	2QFY17	52.2	52.9
2QFY17	-0.8	-2.7	-0.9	1.4	3.7	3QFY17	52.1	49.3
Aug-16	-0.7	-5.9	-0.3	0.1	3.2	Oct-16	54.4	54.5
Sep-16	0.7	-3.2	0.9	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	3.9	5.5	8.9	4.9	Jan-17	50.4	48.7

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
Sep-16	4.3	4.1	3.1	3.6	5.7	2.5	5.6
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

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	
May-16	38.3	-165.4	42.8	22.5	94.6	30.1	42.9	56.2
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)

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	9.9	-11.3	360.3
Nov-16	6.25	Sep-16	21.0	14.6	12.1	13.3	6.9	6.3	2.7	372.0
Dec-16	6.25	Oct-16	15.2	10.9	8.7	9.2	6.8	2.3	-1.8	367.2
Jan-17	6.25	Nov-16	-12.3	8.5	6.2	15.6	6.6	4.5	-5.5	365.3
Feb-17	6.25	Dec-16	-18.6	6.6	5.1	15.2	6.5	3.1	-4.0	360.3

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\$/brl	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	87.8	2015	3.2	2.1	4.0
Sep-16	4.8	-2.5	-8.3	66.7	45.0	67.1	2016*	3.1	1.6	4.1
Oct-16	9.6	8.1	-10.2	66.7	49.3	85.2	2017*	3.4	1.9	4.5
Nov-16	2.3	10.4	-13.0	67.6	45.3	92.0	2018*	3.6	2.0	4.8
Dec-16	5.7	0.5	-10.4	67.9	52.6	86.2	2019*	-	-	-

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)**

Fiscal year/quarter	Expenditure components						Output: aggregate and selected sectors			
	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 (AE)	7.0	5.5	26.5	0.0	2.2	-0.8	6.5	3.3	4.4	8.7
2QFY15	8.3	9.2	15.4	2.2	1.1	4.6	8.1	2.8	5.9	10.7
3QFY15	6.6	1.5	33.2	3.7	2.0	5.7	6.7	-2.4	3.8	12.9
4QFY15	6.7	6.6	-3.3	5.4	-6.3	-6.1	6.2	-1.7	5.7	9.3
1QFY16	7.5	6.9	-0.2	7.1	-5.7	-2.4	7.2	2.5	6.7	8.8
2QFY16	7.6	6.3	3.3	9.7	-4.3	-0.6	7.3	2.0	6.3	9.0
3QFY16	7.2	8.2	3.0	1.2	-8.9	-6.4	6.9	-1.0	8.6	9.1
4QFY16	7.9	8.3	2.9	-1.9	-1.9	-1.6	7.4	2.3	7.9	8.7
1QFY17	7.1	6.7	18.8	-3.1	3.2	-5.8	7.3	1.8	6.0	9.6
2QFY17	7.3	7.6	15.2	-5.6	0.3	-9.0	7.1	3.3	5.2	8.9

Source: National Accounts Statistics, MOSPI

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