ENTER

Economy Watch

Monitoring India's macro-fiscal performance

July 2022

Building a better working world

Contents

Prepared by Macro-fiscal Unit, Tax and Economic Policy Group, EY India

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Highlights

1. In June 2022, PMI indicated an easing pace of growth in manufacturing and a strong expansion in services with their respective levels at 53.9 and 59.2.

2. IIP posted a double-digit growth of 19.6% in May 2022 as compared to 6.7% in April 2022 due to a significant favorable base effect.

3. CPI inflation remained high at 7.0% in June 2022, the same level as seen in May 2022. WPI inflation remained above 15% for the third successive month in June 2022 with its level at 15.2%.

4. Center's gross tax revenues (GTR) grew by 29.1% during April-May FY23 with growth in direct taxes at 61.2% and that in indirect taxes at 9.0%.

5. During April-May FY23, Center's total expenditure grew by 22.6% with growth in revenue expenditure at 15.3% and that in capital expenditure at 70.1%.

6. During April-May FY23, the ratio of Center's fiscal and revenue deficits to their respective annual budgeted targets stood at 12.3% in each case, the lowest levels considering the period FY01 to FY21.

7. Bank credit grew by 12.1% in May 2022, its fastest pace since July 2019.

8. Merchandise exports growth increased marginally to 23.5% in June 2022 from 20.6% in May 2022 whereas merchandise imports growth remained elevated, although easing slightly to 57.5% from 62.8% over this period.

9. Merchandise trade deficit widened to an unprecedented high of US$(-)26.2 billion in June 2022.

10. Net FDI inflows fell marginally to US$4.9 billion in May 2022 while FPI's registered outflows for the eighth successive month at US$(-)4.2 billion in May 2022.

11. In June 2022, global crude and coal prices remained elevated at US$116.8/bbl. and US$284.9/mt. respectively.

12. The OECD has projected global growth at 3.0% in 2022 with India's FY23 growth forecasted at 6.9%.

Foreword

Inflation continues to dominate policy discourse

With CPI inflation at 7% in June 2022, the 1QFY23 CPI inflation has averaged 7.3%, slightly lower than the RBI's forecast at 7.5%. There is not much relief for the low-income consumer budgets with inflation in clothing and footwear at higher levels of 9.2% and 11.9% respectively in June 2022. Fuel and light inflation has also increased to 10.4% in June 2022 as compared to 9.5% in May 2022.

WPI inflation at 15.2% in June 2022 remained above 15% for the third successive month due to inflationary pressures emanating from high global crude and commodity prices. Fuel and power inflation was at an elevated level of 40.4% in June 2022, close to its six-month high level of 40.6% in May 2022 as inflation in electricity accelerated to an all-time high (2011-12 series) of 24.4%. Inflation in mineral oils remained elevated at 57.5% in June 2022 as compared to 61.9% in May 2022. Inflation in wholesale food prices was at a nearly nine-year high (2011-12 series) of 12.4% in June 2022 led by higher inflation in vegetables which increased to 56.7%. Inflation in tomatoes was at a historic high of 281.1% in June 2022.

With WPI inflation leading CPI inflation by a margin of 8.2% points on average in 1QFY23, we anticipate that the implicit price deflator (IPD)-based inflation would continue to remain high. This implies that the 1QFY23 nominal GDP growth would continue to exceed the corresponding real GDP growth. In 1QFY23, the RBI has estimated the real GDP growth at 16.2%. Adding to this, an anticipated IPD-based inflation in excess of 11%, nominal GDP may show a growth of about 28% in 1QFY23.

Linked to these trends, the buoyancy of tax revenues is expected to be high, as discussed in detail in the 'In-focus' section of the June 2022 issue of the EY Economy Watch. This is confirmed by data pertaining to Center's gross tax revenues (GTR) as given by the CGA for FY22 and the first two months of FY23. In FY22, Center's GTR grew by 33.8%. During April-May FY23, Center's GTR showed a growth of 29.1%.

High frequency indicators for May and June 2022 point to continuing recovery in economic activities. Headline manufacturing PMI at 53.9 in June 2022 expanded for the twelfth successive month, although falling from 54.6 in May 2022 due to inflationary pressures. PMI services increased to 59.2 in June 2022, its highest level since April 2011. These numbers confirm an ongoing recovery in the industrial and services sectors. Gross GST collections in June 2022 remained high at INR1.45 lakh crore, increasing from INR1.41 lakh crore in May 2022. Growth in power consumption remained elevated at 19.1% in June 2022 as compared to 22.9% in May 2022. All-India vehicle retail sales showed a y-o-y growth of 27.2% in June 2022 with a robust growth of 40.2% in passenger vehicle sales. Merchandise exports growth increased marginally to 23.5% in June 2022 from 20.6% in May 2022 led by high growth in exports of petroleum products, gems and jewelry and readymade garments. IIP posted a double-digit growth of 19.6% in May 2022 as compared to 6.7% in April 2022 due to a significant favorable base effect coupled with broad-based improvement in the growth of all the key sectors constituting the IIP. Bank credit grew by 12.1% in May 2022, its fastest pace since July 2019.

Some risks however to the ongoing recovery process emanate from a high merchandise trade deficit at US$(-)26.2 billion in June 2022, and continuing depreciation of the Indian rupee vis à vis the USD which reached the level of INR78.1 per US$ (average) in June 2022. An important RBI initiative relates to taking first steps towards internationalization of the Indian Rupee by announcing an arrangement for Indian exporters and importers to settle their trade transactions in the Indian Rupee through the mechanism of 'Special Vostro Accounts'[1].

While short-term inflation related concerns continue to dominate the ongoing policy discourse, some important data points have emerged, with significant long-term implications. One important information based on the UN World Population Prospects 2022 released on 11 July 2022[2] indicates that India would have the largest total population in the world at 142 crore by 2023, i.e., within one year, overtaking the population of China. These population data also confirm that by 2025, in terms of absolute numbers, the working age persons in India would exceed those of China. By 2030, the share of India's working age population in the age group of 14 to 65 years at 68.9%, would peak

[1] https://rbi.org.in/Scripts/NotificationUser.aspx?Id=12358&Mode=0
[2] https://population.un.org/wpp/

delivering nearly 104.3 crore working age persons. The productive employment of such a large working age population is critical for ensuring that India maintains a robust GDP growth. For this purpose, higher government expenditure on education, skilling and training must become a policy priority. Based on World Bank data, India's combined government expenditure of central and state governments on education amounted to 4.4% of GDP in 2018. This needs to be raised to nearly 6% of GDP by the end of the present decade. Augmentation of health expenditure is also required where the combined government expenditure has languished at 1% of GDP in 2019. However, education may be accorded a higher priority since India's young dependency ratio is forecasted to exceed its old dependency ratio until 2056. In the 'In-focus' section of the current issue of the EY Economy Watch, we have conducted a detailed examination of the size and sectoral allocation of government expenditures to explore possibilities for augmenting education and health spending. Priority needs to be accorded to the government's overall strategy for generating employment given the prospects of a growing share of working age population in the medium to long term.

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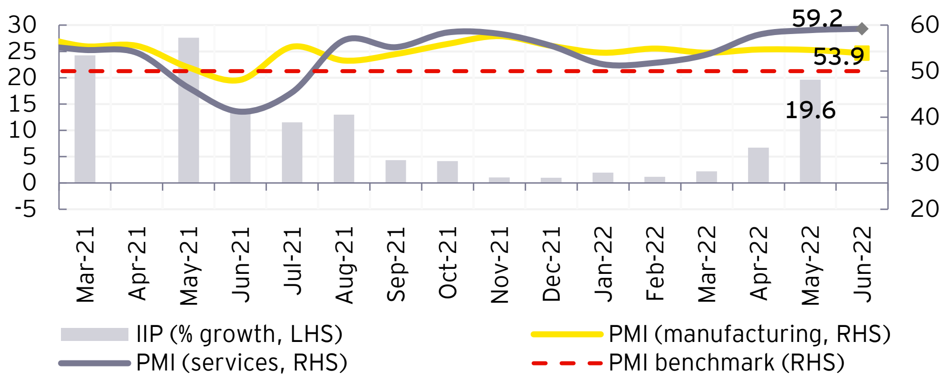
1. Growth: PMI signaled a strong pace of expansion in services in June 2022

A. PMI: signaled an easing pace of growth in manufacturing and a strong expansion in services in June 2022

- Headline manufacturing PMI (seasonally adjusted (sa)) at 53.9 in June 2022 expanded for the twelfth successive month, although falling from 54.6 in May 2022 due to inflationary pressures **(Chart 1)**. On a quarterly basis, PMI manufacturing averaged 54.4 in 1QFY23, close to the 4QFY22 level of 54.3.
- PMI services increased to 59.2 in June 2022, its highest level since April 2011, as compared to 58.9 in May 2022. Alongside, output prices increased at the fastest rate since July 2017. On a quarterly basis, PMI services averaged 58.7 in 1QFY23, rising sharply from 52.3 in 4QFY22.
- With the expansion in services offset by an easing pace of growth in manufacturing, the composite PMI Output Index (sa) at 58.2 in June 2022 was little changed from 58.3 in May 2022. On a quarterly basis, composite PMI averaged 58.0 in 1QFY23 as compared to 53.6 in 4QFY22.

Chart 1: PMI and IIP growth



In June 2022, PMI indicated an easing pace of growth in manufacturing and a strong expansion in services with their respective levels at 53.9 and 59.2.

Source: MoSPI and S&P Global.
Note: IIP growth for April 2021 is not shown in the chart as it was inordinately high at 133.5% due to a favorable base effect.

B. IIP: showed a double-digit growth of 19.6% in May 2022

- As per the quick estimates of IIP released by the MoSPI on 12 July 2022, IIP posted a double-digit growth of 19.6% in May 2022, improving from 6.7% (revised) in April 2022 **(Chart 2)**. This was due to a significant favorable base effect coupled with broad-based improvement in the growth of all the key sectors constituting the IIP.
- Among the sub industries, output of electricity showed the highest growth of 23.5% in May 2022, increasing from 11.8% in April 2022. This was followed by manufacturing output showing a growth of 20.6% in May 2022 as compared to 5.8% in April 2022.
- Output of mining sector grew by 10.9% in May 2022 as compared to 8.0% (revised) in April 2022.

IIP posted a double-digit growth of 19.6% in May 2022 as compared to 6.7% in April 2022, led by a significant favorable base effect.

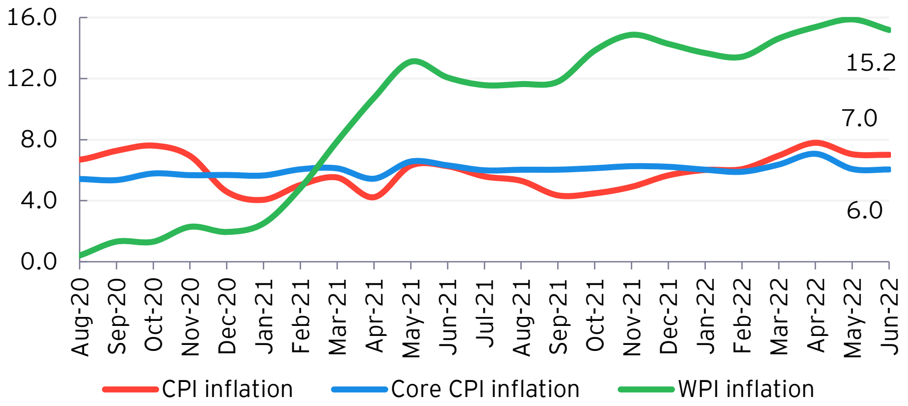
- As per the use-based classification of industries, growth in the output of consumer durables was at 58.5% in May 2022, largely due to base effect. Similarly, high growth of 54.0% and 18.2% respectively was observed in the output of capital goods and infrastructure/ construction goods industry in May 2022. Output of consumer non-durables, however, posted a low growth of 0.9% in May 2022, although emerging from a contraction of (-)0.6% in April 2022.
- According to provisional estimates, growth in the output of eight core infrastructure industries (core IIP) accelerated to 18.1% in May 2022 from 9.3% (revised) in April 2022. This was largely due to a favorable base effect. Growth in all the eight subsectors turned positive in May 2022, with the output of cement (26.3%), coal (25.1%), fertilizers (22.8%), electricity (22.0%), petroleum refineries (16.7%), and steel (15.0%) posting double digit growth rates.

2. Inflation: CPI inflation remained elevated at 7.0% in June 2022

CPI inflation remained high at 7.0% in June 2022, the same level as seen in May 2022 (Chart 2).

- Consumer food inflation eased marginally to 7.7% in June 2022 from 8.0% in May 2022 as inflation in edible oils and fats fell to a 27-month low of 9.4% in June 2022. This was mainly the result of the reduction by the Center in import duties on selected edible oils, including palm oil, soyabean oil and sunflower oil.
- Fuel and light-based inflation rose to 10.4% in June 2022 from 9.5% in May 2022 as inflation in LPG increased to a 5-month high of 21.2% and that in kerosene to an unprecedented high of 95.7% in June 2022 owing to high global crude prices.
- Inflation in clothing and footwear increased to 9.2% and 11.9% respectively in June 2022 from 8.5% and 10.7% respectively in May 2022 with adverse implications for low-income consumer budgets.
- Within transportation and communication services subgroup, inflation in petrol and diesel used for conveyance eased to 22-month low levels of 5.4% and 0.7% respectively in June 2022 partly reflecting the impact of the recent sharp reduction in excise duties on fuel.
- Core CPI inflation[3] eased to a 9-month low of 6.0% in June 2022.

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



Source: MoSPI, Office of the Economic Adviser, Government of India (GoI)

In 1QFY23, CPI inflation averaged 7.3%, up from 6.3% in 4QFY22. With this, the CPI inflation remained above the RBI's upper tolerance limit of 6% for the second successive quarter.

WPI inflation remained above 15% for the third successive month in June 2022, due to inflationary pressures emanating from high global crude and commodity prices.

- Fuel and power inflation was at an elevated level of 40.4% in June 2022, close to its six-month high level of 40.6% in May 2022, as inflation in electricity accelerated to an all-time high (2011-12 series) of 24.4% reflecting the upward revisions in electricity tariffs by selected state governments. Inflation in mineral oils remained elevated at 57.5% in June 2022 as compared to 61.9% in May 2022.
- Inflation in wholesale food prices was at a 103-month high (2011-12 series) of 12.4% in June 2022 led by higher inflation in vegetables which increased to 56.7%. Inflation in tomatoes was at a historic high of 281.1% in June 2022.
- Inflation in manufactured basic metals moderated to 12.1% in June 2022 from 18.9% in May 2022 aided partly by a favorable base effect. Consequently, core WPI inflation eased to a 14-month low of 9.3% in June 2022.

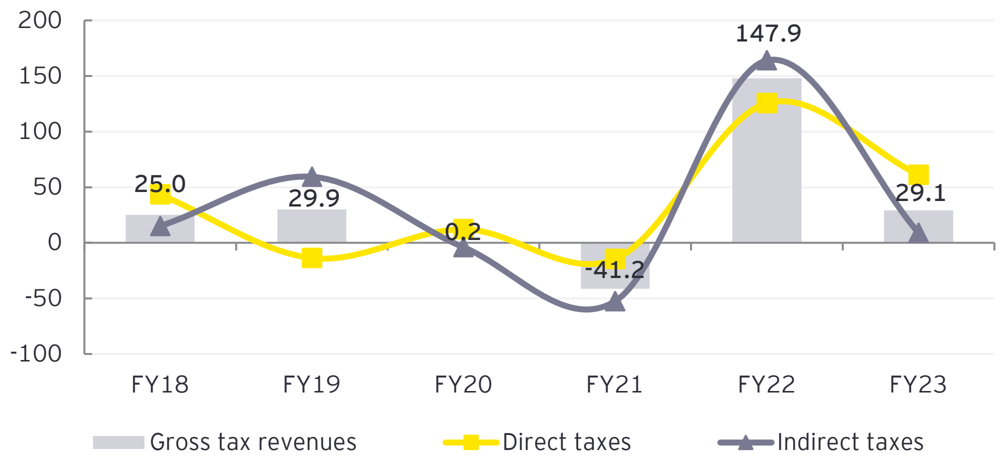
[3] Core CPI inflation is measured in different ways by different organizations/agencies. Here, it has been calculated by excluding food, and fuel and light from the overall index.

3. Fiscal performance: Center's gross tax revenues grew by 29.1% during April-May FY23

A. Tax and non-tax revenues

- As per the Controller General of Accounts (CGA), Center's GTR[b] grew by 29.1% during the first two months of FY23. GTR showed a high growth of 147.9% during the corresponding period of FY22 due to a favorable base effect as there was a sharp contraction of (-)41.2% during April-May FY21 reflecting the impact of the pandemic **(Chart 3)**.
- Center's GTR during April-May FY23 stood at 14.6% of the annual budget estimate (BE). In comparison, the corresponding ratio in FY22 stood at 14.1%. GTR during the first two months of the fiscal year relative to BE has averaged 7.4% during FY01 to FY21.
- During April-May FY23, direct taxes[a] showed a growth of 61.2% while indirect taxes[a] grew by 9.0%. Owing to considerable base effects, growth in direct and indirect taxes during the corresponding period of FY22 was high at 125.5% and 164% respectively.
- Corporate income tax (CIT) revenues showed a strong growth of 80.7% during April-May FY23 and personal income tax (PIT) collections grew by 49.9% during this period.
- Among indirect taxes, GST revenues[c] showed a growth of 23.6% during April-May FY23.
- There was a contraction in both customs duties and union excise duties (UED) during the first two months of FY23. Customs duties contracted by (-)18.8% and UED revenues by (-)16.6% reflecting the impact of the recent reduction in customs duties on certain raw materials[4] as also a reduction in UED rates on petroleum products.

Chart 3: Growth in central gross tax revenues during April-May (%, y-o-y)



Center's GTR grew by 29.1% during April-May FY23 with growth in direct taxes at 61.2% and that in indirect taxes at 9.0%.

Source: Monthly Accounts, CGA, Government of India

Notes: (a) Direct taxes include personal income tax and corporation tax, and indirect taxes include union excise duties, arrears of service tax, customs duty, and GST (comprising CGST, UTGST, IGST and GST compensation cess) (b) Other taxes (securities transaction tax, wealth tax, fringe benefit tax, banking cash transaction tax, etc.) are included in the center's GTR along with direct and indirect taxes, (c) IGST revenues are subject to final settlement.

- Center's non-tax revenues showed a contraction of (-)57.7% during April-May FY23. Center's non-tax revenues during the first two months of FY23 stood at 18.3% of the annual budgeted target.
- Non-debt capital receipts of the Center during April-May FY23 stood at 31.5% of the annual budgeted target largely driven by receipts from disinvestment, particularly that of the Life Insurance Corporation (LIC).
- As per DIPAM[5], disinvestment receipts up to 21 July 2022 stood at INR24,543.7 crore, that is 37.7% of the FY23 BE at INR65,000 crore.

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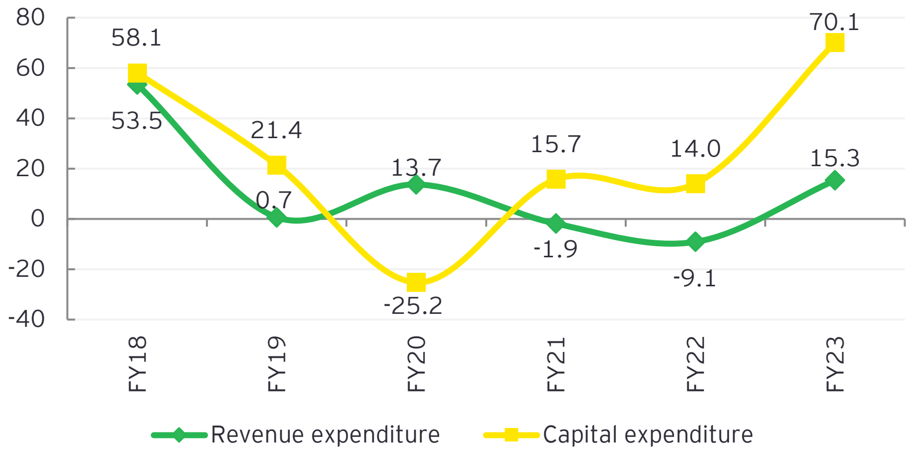
[4] shorturl.at/imoZ1
[5] https://dipam.gov.in/

B. Expenditures: revenue and capital

- Center's total expenditure grew by 22.6% during April-May FY23 as compared to a contraction of (-)6.6% during the corresponding period of FY22.
- Revenue expenditure grew by 15.3% during April-May FY23 as compared to a contraction of (-)9.1% during April-May FY22 **(Chart 4)**.
- Capital expenditures were frontloaded during April-May FY23, showing a growth of 70.1% during this period, significantly higher than 14.0% during the corresponding period of FY22.

Chart 4: Growth in central expenditures during April-May (%, y-o-y)



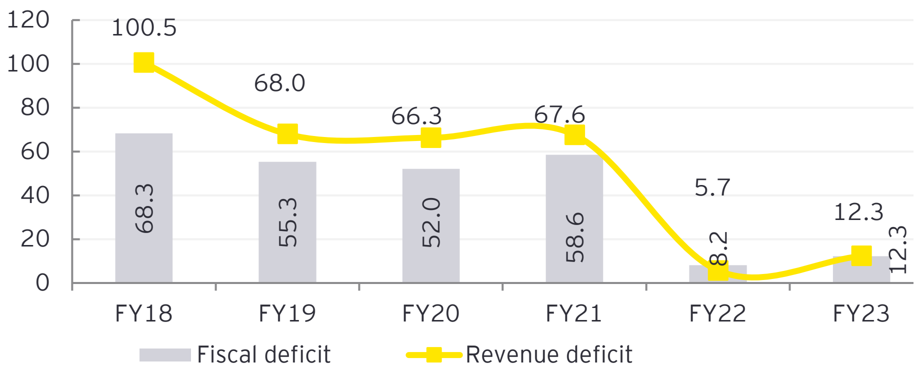
During April-May FY23, Center's total expenditure grew by 22.6% with growth in revenue expenditure at 15.3% and that in capital expenditure at 70.1%.

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

C. Fiscal imbalance

- Center's fiscal deficit during April-May FY23 stood at 12.3% of the annual budgeted target, the lowest level considering the period from FY01 to FY21. Buoyant revenues of the center largely enabled a low level of fiscal deficit during the first two months of FY23 relative to the BE (**Chart 5**).
- Center's revenue deficit during April-May FY23 at 12.3% of the annual budgeted target also stood at the lowest level considering the corresponding ratios during FY01 to FY21.

Chart 5: Fiscal and revenue deficit during April-May as percentage of BE



During April-May FY23, the ratio of the Center's fiscal and revenue deficits to their respective annual budgeted targets stood at 12.3% in each case, the lowest levels considering the period FY01 to FY21.

Source: Monthly Accounts, CGA, Government of India and MoSPI.

4. Comparative global perspective: India's FY23 general government fiscal balance projected at (-)8.3% of GDP

General government financial balance

- Although there was a reduction in fiscal deficit levels in 2021, these have largely remained above the pre-pandemic levels **(Table 1)**.
- In the US, fiscal deficit to GDP ratio is expected to fall to (-)6.7% in 2022 with expiration of pandemic related fiscal programs. This may have a strong contractionary impact on growth.
- In the UK and the Euro area, fiscal deficit relative to GDP is projected to fall in 2022 and 2023. The UK has committed to a gradual medium-term fiscal consolidation plan, implying that the fiscal stance would be contractionary. In the Euro area, fiscal stance is projected to be broadly neutral in 2022, with a moderate consolidation in 2023.
- In Japan, fiscal deficit relative to GDP is expected to increase to (-)6.9% in 2022 as fiscal policy is expected to remain supportive for addressing the high energy prices due to the ongoing geopolitical conflict.
- In Brazil, fiscal deficit is expected to increase in 2022 as public expenditure is expected to increase driven by higher social transfers with the new Auxilio Brasil program, adjustments in civil service wages, and higher discretionary expenses.
- India's fiscal deficit to GDP ratio is expected to decline to (-)8.3% in FY23 from (-)9.4% in FY22 despite a planned increase in capital expenditure. It is projected to fall further in FY24, although remaining higher than the FRBM target of 6%.
- In China, fiscal policy is expected to provide support in the form of cuts in taxes and spending of reserve funds. In South Africa, fiscal deficit is expected to decline in 2022 and 2023 as fiscal policy is expected to be more targeted, providing support to vulnerable households.

Table 1: General government financial balance (% to GDP)

Country	2020	2021	2022	2023
US	-15.4	-11.8	-6.7	-5.3
UK	-12.8	-8.3	-5.3	-4.1
Euro area	-7.1	-5.1	-4.1	-3.0
Japan	-9.0	-5.7	-6.9	-4.6
Brazil	-13.6	-4.0	-6.4	-5.9
India*	-13.3	-9.4	-8.3	-7.6
China	-6.9	-6.6	-6.5	-6.6
South Africa	-11.6	-6.4	-5.2	-4.3

Source: OECD Economic Outlook Database, June 2022
Note: (1) Actuals for 2020 and 2021 for forecasts for 2022 and 2023
(2) +ve indicates surplus and -ve indicates deficit
*data pertains to fiscal year

Current account balance

- The current account effects of the commodity price shock depend on countries' net export positions and the size of the price shocks for individual commodities.
- Current account deficit relative to GDP is expected to widen in 2022 for the US and the UK, and the current account surplus is projected to fall for Euro area and Japan.
- High energy prices are expected to adversely affect current account balances in the UK, Euro area and the US. Further, Japan's current account balance is expected to deteriorate due to its high dependence on Russia for coal and non-ferrous metals **(Table 2)**.
- Brazil's current account deficit is expected to narrow in 2022 and 2023, helped by higher commodity prices. For the same reason, South Africa is expected to post a surplus on its current account in 2022, although lower than that in 2021.
- India's current account deficit is expected to widen in FY23 due to the surge in energy import costs.
- In China, the current account surplus is expected to increase in 2022 and 2023 aided by China's large oil and grain reserves that would help mitigate the impact of rising global energy and food prices.

Table 2: Current account balance (% to GDP)

Country	2020	2021	2022	2023
US	-2.9	-3.6	-4.2	-4.3
UK	-2.5	-2.6	-7.2	-7.6
Euro area	2.8	3.6	2.2	2.0
Japan	2.9	2.8	1.5	1.2
Brazil	-1.6	-1.8	-1.0	-0.9
India*	1.0	-1.2	-2.2	-1.8
China	1.7	1.8	3.0	3.1
South Africa	2.0	3.7	2.8	1.7

Source: OECD Economic Outlook Database, June 2022
Note: (1) Actuals for 2020 and 2021 for forecasts for 2022 and 2023
(2) +ve indicates surplus and -ve indicates deficit
*data pertains to fiscal year

5. In focus: Managing India's government finances: re-strategizing for the 21st century

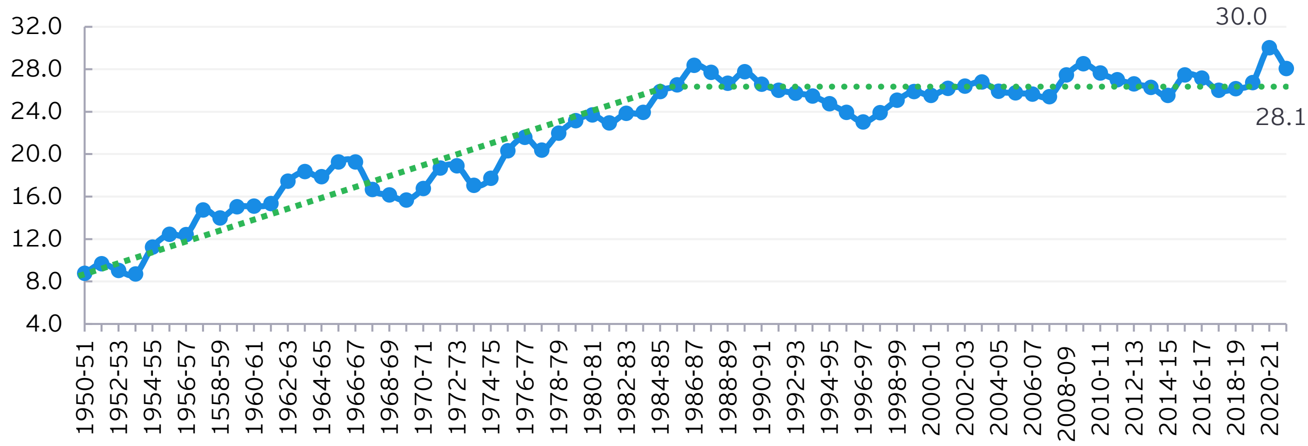
1. Introduction

Recently released UN World Population Prospects 2022 (11 July 2022)[6] indicate that India is to emerge as the largest country in terms of size of total population by 2023, i.e., within a span of one year, overtaking the population of China. These population data also confirm that by 2025, in terms of absolute numbers, working age persons in India would exceed those of China. By 2030, the share of India's working age population in the age group of 14 to 65 years at 68.9%, would peak, delivering nearly 104.3 crore working age persons. The productive employment of such a large working age population is critical for ensuring that India maintains a robust GDP growth. For this purpose, higher government expenditure on education, skilling and training must become a policy priority. In this context, we examine issues relating to the size of government in India as measured by the combined government expenditure relative to GDP and its sectoral allocation. This would help explore feasible ways of expanding government expenditure on education and health to take advantage of India's unfolding demographic dividend.

2. Size of government expenditure in India

The combined expenditure of central and state governments relative to GDP was at a low level of 8% of GDP in FY51. It increased on a trend basis, to about 26% of GDP by the mid-1980s. After that, this ratio has remained relatively stationary at an average of 26.4% during FY85 to FY22 with some inter-year volatility (Chart 6). In FY21 and FY22, this ratio increased to 30% and 28.1% respectively, reflecting increased COVID-related spending. As government expenditure reflects intervention of the government sector in the economy through purchases of goods and services and transfer payments, the government is clearly the most important economic agent. However, compared to a group of peer countries, the size of government in India has remained relatively small, as summarized in Table 3.

Chart 6: India's total expenditure to GDP ratio (%)



Source (basic data): IPFS, MoSPI, CAG, CGA, RBI, Union Budget documents

Considering countries included in Table 3, the highest share of government expenditure relative to GDP pertains to France at 55.3% (2019). India's share at 27.4% in 2019 (FY20) is the lowest. The share of the US at nearly 36% exceeds India's share by a margin of nearly 9% points. A small size of the government implies relative under-provision of public goods and merit services. In order to increase the sectoral allocation for merit services, such as education and health, it is critical that the overall size of government expenditure relative to GDP be increased in a sustained way.

[6] https://population.un.org/wpp/

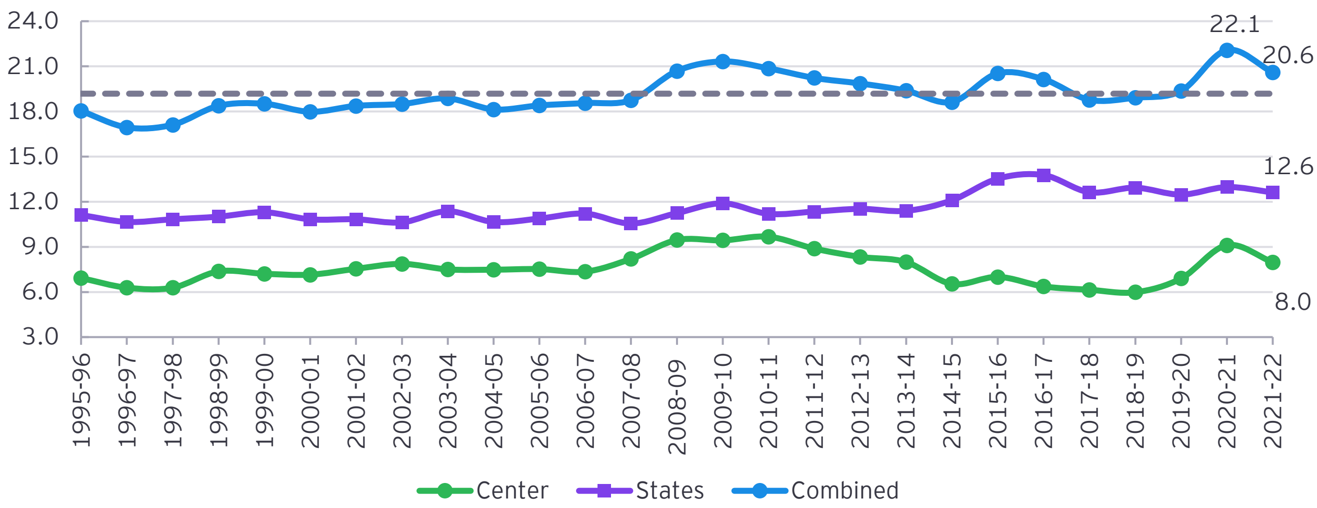
Table 3: General government expenditure relative to GDP (%): selected countries

Countries	2001	2010	2015	2017	2018	2019
France	51.7	56.9	56.8	56.5	55.6	55.3
Italy	47.3	49.9	50.3	48.8	48.4	48.5
Germany	47.4	48.1	44.1	44.2	44.3	45.0
Canada	41.1	43.1	40.0	40.5	40.7	40.7
Brazil	36.2	39.9	38.5	38.3	37.7	37.4
UK	34.7	44.6	40.0	38.8	38.4	38.2
Japan	35.2	37.7	37.3	36.7	36.8	37.2
Australia	35.7	37.0	37.4	36.9	37.0	39.0
US	32.8	39.8	35.2	35.5	35.6	35.8
India*	27.8	27.4	27.1	26.2	26.3	27.4

Source (basic data): IMF
*For India, data is with reference to fiscal year

As discussed earlier, government expenditure pertains to the purchases of goods and services as well as transfer payments. Two important heads of transfer payments relate to interest payments and pensions. These heads reflect committed expenditures where current expenditures depend on past decisions. Thus, government expenditure net of interest payments and pensions would largely reflect government purchases of goods and services and the available discretionary fiscal space. The share of combined expenditures net of interest payments and pensions relative to GDP has ranged between 18%-22% during FY96 to FY22, with an average of 19.2% (Chart 7). This discretionary fiscal space requires to be uplifted. Since not much can be done towards reducing committed expenditures, at least in the short to medium term, greater emphasis should be placed on increasing the revenue to GDP ratio pertaining both to tax and non-tax revenues for increasing discretionary government expenditures relative to GDP.

Chart 7: India's combined expenditure net of interest payments and pensions relative to GDP (%)

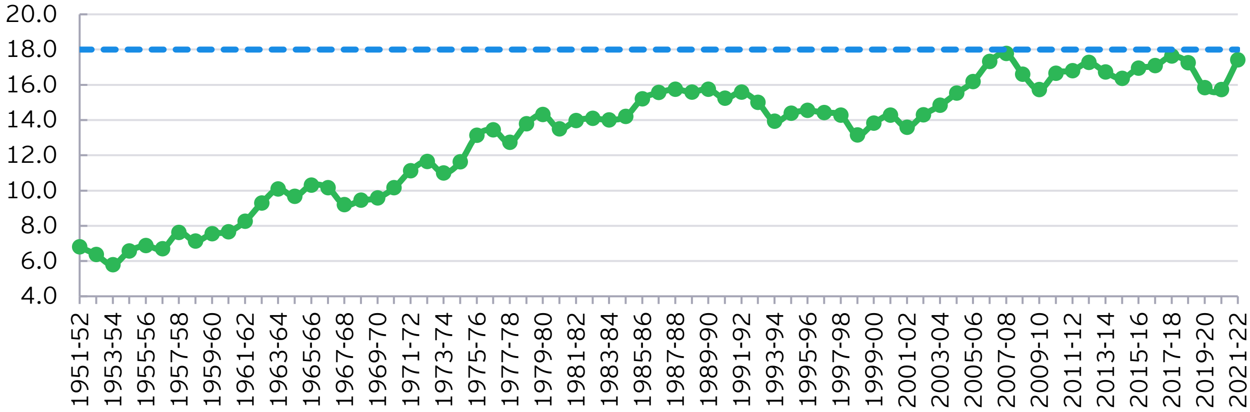


Source (basic data): IPFS, MoSPI, CAG, CGA, RBI, Union Budget documents

3. India's tax-GDP ratio: subdued performance

Since tax revenues have financed 59% of government's total expenditure on average during FY85 to FY22, it is clear that the primary reason for the stagnation in India's expenditure to GDP ratio over this period is the stagnation in its tax-GDP ratio. This ratio has languished over a period of more than 30 years in the range of 16-17%, reaching a peak of 17.8% in FY08 (Chart 8). In recent past, having reached a peak of 17.6% in FY18, it fell to 15.7% in FY21, the year of the COVID crisis. In FY22, it recovered to 17.4%. It is imperative that the combined tax-GDP ratio be increased closer to corresponding ratios amongst the peer countries.

Chart 8: India's combined tax-GDP ratio (%)



Source (basic data): IPFS, MoSPI, CAG, CGA, RBI, Union Budget documents

India may endeavor to increase the combined tax-GDP ratio to at least close to the level of the US of about 25% (Table 4). This would require maintaining a combined tax buoyancy of higher than 1 for a number of years. Greater reliance may be placed on a higher buoyancy in direct taxes. Simulations indicate that even if a direct tax buoyancy of 1.2 and indirect tax buoyancy of 1.1 is sustained, India's combined tax-GDP ratio reaches a level of 25% by the mid-2040s. This task may be expedited and facilitated by the service sector focused evolution of the structure of output in India as discussed in detail in Section 5. As the share of agriculture falls, the relative share of the tax base pertaining to non-agricultural sectors namely, industry and services, would increase.

Table 4: General government tax-GDP ratio (%): selected countries

Countries	2000	2010	2015	2017	2018	2019
France	43.4	42.1	45.3	46.1	45.9	45.4
Italy	40.5	41.7	43.0	41.9	41.9	42.4
Germany	36.4	35.5	37.3	37.8	38.5	38.8
Canada	34.7	31.0	32.8	33.1	33.2	33.5
Brazil	29.4	33.2	32.0	32.3	33.2	33.1
UK	32.8	32.1	32.4	32.8	32.9	33.0
Japan	25.8	26.5	30.7	31.4	32.0	--
Australia	30.5	25.3	27.9	28.5	28.7	--
US	28.3	23.5	26.2	26.7	24.4	24.5
India*	14.3	16.7	16.9	17.6	17.2	15.8

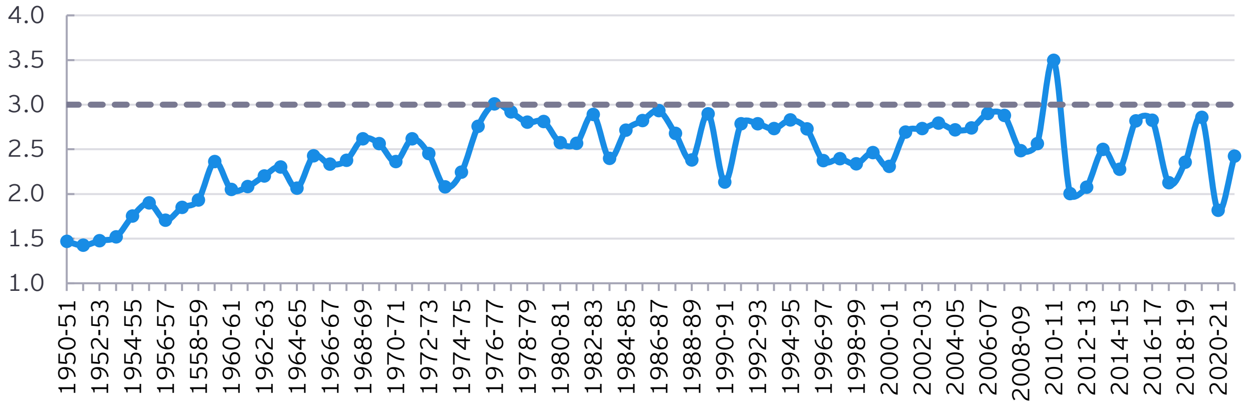
Source (basic data): OECD (https://data.oecd.org/tax/tax-revenue.htm), IPFS-Government of India and Union and States' Budget documents

*For India, data is with reference to fiscal year

4. India's non-tax-GDP ratio: relative stagnation

The stagnation in India's non-tax to GDP ratio at less than 3% has been one of the key factors constraining the growth of its revenues relative to GDP. Chart 9 shows that after increasing from a low level of 1.5% in FY51 to about 3% by the late 1970s, the non-tax to GDP ratio has stagnated at below 3% except for one year, that is FY11. In that year, the central government was able to garner significant non-tax revenues through spectrum auctions pertaining to 3G and 4G.

Chart 9: India's combined non-tax GDP ratio (%)



Source (basic data): IPFS, MoSPI, CAG, CGA, RBI, Union Budget documents

In Table 5, we compare non-tax revenues and non-debt capital receipts together relative to GDP for India and a selected set of countries. It is notable that this ratio is the lowest for India at 2.9% in 2019 (FY20). Other BRICS economies namely, Russia, Brazil, China, and South Africa have a relatively higher ratio ranging from 3.6% to 12.1%. For advanced economies like Germany, France and Japan, this ratio has exceeded 15%.

Table 5: Non-tax revenue and non-debt capital receipts as % to GDP: selected countries

Country	2000	2005	2010	2015	2019
Germany	24.0	22.7	22.0	21.9	22.5
France	22.5	22.8	24.0	24.6	22.2
Japan	12.3	12.8	13.2	15.3	15.7
China	0.8	1.5	6.8	11.0	12.1
US	NA	11.1	11.5	11.6	11.2
UK	8.0	8.7	9.4	9.6	9.8
Russia	8.7	7.4	7.6	9.0	9.8
Brazil	10.0	12.5	14.0	6.8	7.8
Australia	6.1	6.4	6.7	6.9	7.0
South Africa	1.6	1.0	3.0	-0.6	3.6
India	3.3	3.4	2.7	3.1	2.9

Source: IMF
Note: derived by reducing tax revenue from total revenues.

Non-tax revenues depend on a variety of untapped or under-exploited sources. One important non-tax revenue source relates to the return on government investment in the public sector. Many public sector enterprises, both relating to the central and state governments, have remained loss-making entities. The average rate of return on even the profit-making enterprises, once a select list of public sector enterprises where monopoly advantages may be available is taken out, is also quite low. The rate at which the government is able to disinvest public sector owned assets has been rather low. One notable area where additional non-tax revenues can be generated pertains to land owned by the government and the public sector enterprises where a significant increase in the market value of such land has occurred but has not been accounted for. An extended discussion on this subject is available in the 'In-focus' section of the February 2021 issue of the EY Economy Watch[7]. Another potential area where non-tax revenues may be increased relates to user fees and charges levied by the central and state governments on various public and merit services. This includes court fees, fees in educational institutions, charges in government-run hospitals, etc. In most cases of such public provision of critical services, unit costs have been increasing as they are generally linked to the overall inflation while the fees and user charges have remained stagnant in nominal terms. This has led to an inordinate increase in the implicit or indirect budgetary subsidies. There is considerable rigidity in increasing nominal

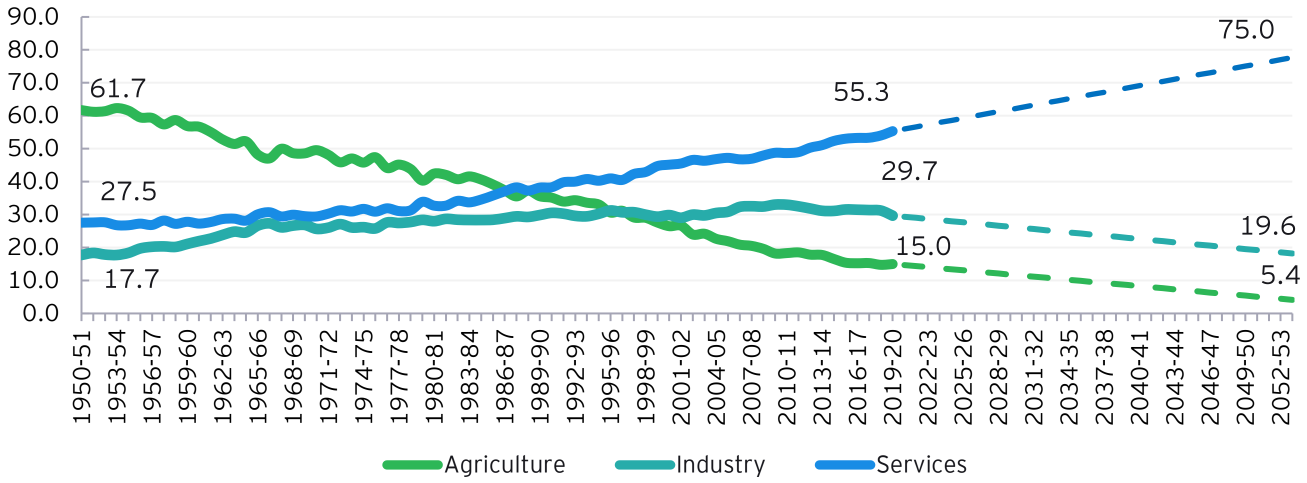
[7] https://assets.ey.com/content/dam/ey-sites/ey-com/en_in/topics/tax/economy-watch/2021/02/economy-watch-february-2021.pdf

levels of fees and charges since these are administered or regulated. An appropriate strategy is needed to determine a suitable level of implicit subsidy and to ensure that a link between unit cost of service provision and recovery rates is maintained. For a detailed discussion of the concepts and some of the estimates involved, reference may be made to Srivastava and Rao (2004)[8] and Mundle and Rao (1991)[9].

5. Evolving structure of the Indian economy: implications for government tax revenues

Chart 10 shows the dynamic nature of the evolution of the Indian economy in the context of its output structure. As a percentage of GVA at constant prices, the share of agriculture has been falling on a trend basis. In the early 1950s, it was higher than 60%. This share steadily fell over the decades to close to 15% by the early 2020s. The reason for this fall is the fact that the growth in agricultural GVA has averaged at about 3% over a long period of time although it has also been quite volatile around this average. In comparison, the share of services in overall GVA has increased on a trend basis, from a level of about 27% in the mid-1950s to about 54% by FY22. If these trends are extrapolated as shown in Table 5, the share of agriculture may fall to a little above 5% by 2049-50 while the share of services may be close to 75%.

Chart 10: Structure of GVA (%)



Source (basic data): MoSPI
Note: Dotted lines indicate estimates.

The share of the industrial sector has increased to about 30% by FY20 from a level of about 18% in the early 1950s. However, this share may follow a mildly inverted-U shape and may fall to about 20% by 2049-50. Such an evolving structure of output in India has significant implications for the sectoral employment potential as well as for the tax-GDP ratio.

Table 6: Per year reduction in sectoral shares (% points)

Year	Agriculture	Industry	Services
1991-2000	-0.80	-0.05	0.65
2001-10	-0.94	0.37	0.40
2011-20	-0.32	-0.34	0.66
Expected change in 1 decade (% points)			
	-3.2	-3.4	6.6
Expected change in 3 decades (% points)			
	-9.6	-10.1	19.7
Share in total GVA			
2019-20	15.0%	29.7%	55.3%
2049-50	5.4%	19.6%	75.0%

Source (basic data): MoSPI

[8] Srivastava, D. K., and Rao, C. B (2004). Government Subsidies in India: Issues and approach, in Favaro, E.M. and A.K. Lahiri (eds.) Fiscal Policies and Sustainable Growth in India, Oxford University Press, 2004 (with C. Bhujanga Rao as co-author)
[9] Mundle, S., & Rao, M. G. (1991). Volume and composition of government subsidies in India, 1987-88. Economic and Political Weekly, 1157-1172.

6. India's expenditure priorities: under provision of education, health, and infrastructure

India has under-prioritized government expenditure for health and education. As shown in Table 7, based on World Bank data, India's combined government expenditure of central and state governments on education amounted to 4.4% of GDP in 2018. In the case of health, this share has languished at less than 1% of GDP (2019) as shown in Table 8.

Table 7: General government expenditure on education relative to GDP: selected countries

No.	Country Name	2000	2005	2010	2015	2016	2017	2018
1	Brazil	3.9	4.5	5.6	6.2	6.3	6.3	6.1
2	South Africa	4.9	4.5	5.1	5.5	5.4	5.6	5.6
3	France	--	--	--	--	--	5.5	5.4
4	UK	4.0	4.9	5.7	5.5	5.4	5.4	5.2
5	Germany	--	--	4.9	4.9	4.8	4.9	5.0
6	US	--	--	--	5.0	4.8	5.1	4.9
7	Euro area	4.6	5.0	5.5	4.9	4.8	4.9	4.8
8	Russia	2.9	3.8	--	3.8	3.8	4.7	4.7
9	India	4.3	3.2	3.4	4.1	4.3	4.3	4.4
10	China	--	2.4	3.8	3.8	3.8	3.7	3.5
11	Japan	3.5	3.3	3.6	--	3.1	3.1	3.1
12	*High income*	*4.6*	*4.9*	*5.1*	*4.9*	*4.8*	*4.8*	*4.8*
13	*Middle income*	*3.5*	*3.8*	*4.0*	*4.2*	*4.3*	*4.4*	*4.3*
14	*World*	*3.9*	*4.0*	*4.3*	*4.4*	*4.3*	*4.3*	*4.3*

Source (Basic data): World Bank
*Includes expenditure on current, capital, and transfers

In order to ensure that India takes full advantage of its emerging population trends, particularly with respect to the age structure of the population, the government may re-strategize its sectoral priorities in favor of education and health. Any increase in the revenue to GDP ratio should be earmarked for an increase in the shares of education and health expenditures. As the young dependency ratio is expected to remain higher than the old dependency ratio until 2056, education may be prioritized above health so that the available working age persons are educated, trained and skilled for productive employment. This is discussed further in Section 8.

Table 8: General government expenditure on health relative to GDP: selected countries

No.	Country Name	2000	2005	2010	2015	2016	2017	2018	2019
1	Germany	7.7	7.8	8.4	8.6	8.7	8.8	8.9	9.1
2	Japan	5.7	6.2	7.4	9.0	9.0	9.0	9.0	9.0
3	US	5.5	6.6	7.9	8.5	8.6	8.5	8.5	8.5
4	France	7.0	7.4	7.9	8.3	8.6	8.6	8.5	8.3
5	UK	5.5	6.9	8.1	7.9	7.9	7.8	7.9	8.1
6	Euro area	6.4	6.9	7.5	7.5	7.6	7.5	7.5	7.6
7	South Africa	3.0	3.1	4.4	5.0	5.0	5.0	5.1	5.4
8	Brazil	3.5	3.3	3.6	3.9	3.9	4.0	3.9	3.9
9	Russia	3.0	2.9	3.1	3.1	3.0	3.1	3.2	3.5
10	China	1.0	1.4	2.2	3.0	2.9	2.9	2.9	3.0
11	India	0.8	0.8	0.9	0.9	0.9	1.0	0.9	1.0
12	*High income*	*5.6*	*6.3*	*7.2*	*7.6*	*7.7*	*7.6*	*7.6*	*7.7*
13	*Middle income*	*2.0*	*2.1*	*2.5*	*2.8*	*2.8*	*2.8*	*2.7*	*2.8*
14	*World*	*5.0*	*5.5*	*5.7*	*5.9*	*5.9*	*5.8*	*5.8*	*5.9*

Source (Basic data): World Bank

Another area where adequate emphasis needs to be placed in the reorganization of government expenditure pertains to government capital expenditure. In this case, it would be appropriate to manage government finances such that the 'Golden Rule' is adhered to. This implies that balance should be maintained on government's revenue account and the entire sustainable level of fiscal deficit and non-debt capital receipts should be utilized fully for asset creation which may pertain to defence and non-defence capital assets. In terms of the Fiscal Responsibility Legislations (FRL), the sustainable level of combined fiscal deficit is 6% of GDP. To this, an additional 0.5 to 1.0% may be added for non-debt capital receipts, implying that the combined government expenditure on infrastructure may be raised from the present level of 4.7% in FY22 (Table 9) to about 7% of GDP.

Table 9: Capital expenditure relative to GDP (%): Center, states and combined

Year	Center		States	Combined
	Total	*of which Defence*		
FY09	1.4	0.7	2.6	4.0
FY10	1.7	0.8	2.6	4.3
FY11	2.0	0.8	2.3	4.3
FY12	1.6	0.8	2.3	3.9
FY13	1.5	0.7	2.2	3.8
FY14	1.6	0.7	2.2	3.8
FY15	1.5	0.7	2.3	3.8
FY16	2.1	0.6	3.0	5.1
FY17	1.8	0.6	3.3	5.1
FY18	1.5	0.5	2.5	4.0
FY19	1.6	0.5	2.5	4.1
FY20	1.6	0.6	2.2	3.9
FY21	1.7	0.7	2.2	3.9
FY22	2.3	--	2.4	4.7

Source (basic data): IPFS, MoSPI, CAG, CGA, RBI, Union Budget documents

7. India's fiscal discipline: persistent erosion

In this section, we have reviewed the relevant trends in the revenue deficit to GDP ratio, the fiscal deficit to GDP ratio and the government debt to GDP ratio since FY92. Chart 11 shows the profiles of revenue deficit to GDP ratio of the central and state governments. Throughout the period after the 1990s, the central budget has remained in revenue deficit. In comparison, the aggregate account of states shows a deficit profile which is lower than that of the central government throughout the period from FY92 to FY22. In fact, there are some years of revenue surplus in the mid-2000s and a near-balance situation in many years in the 2010s. Considering the combined government, except for FY08, there has been a deficit on the revenue account relative to GDP. This had peaked at 6.8% in FY02 considering the pre-COVID years, and at 8.9% in FY21 which was the COVID-affected year (Chart 12)[10].

Chart 11: Revenue deficit to GDP ratio (%) - Center and states

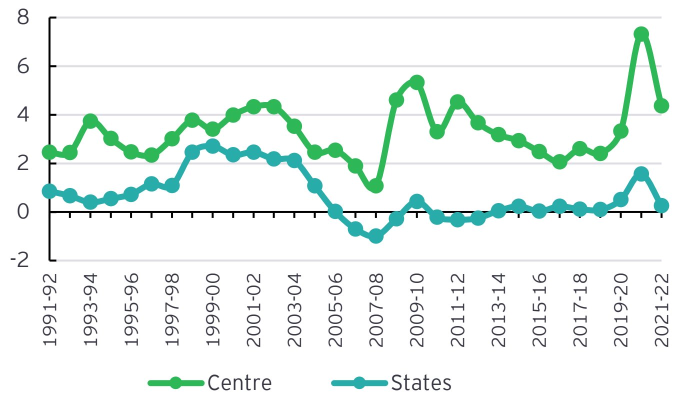
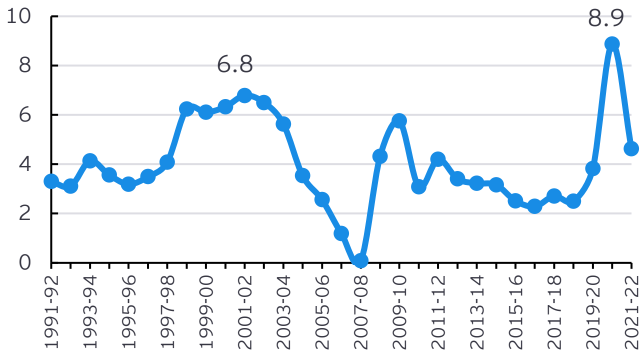


Chart 12: Combined general government revenue deficit to GDP ratio (%)



Source (basic data): CAG, CGA, Union Budget documents, MoSPI, RBI, IPFS

[10] The addition of revenue account balance across states implies that revenue surpluses of some states are adjusted against the revenue deficits of other states. Similarly, for the combined account, revenue surplus of states as a whole is adjusted against revenue deficit of the Center.

Charts 13 and 14 provide the corresponding trends for the fiscal deficit to GDP ratio of the central and state governments separately and on their combined account. A major landmark occurred in the 2000s when the central government and most of the state governments enacted their FRLs. However, the pattern of fiscal deficit in the ensuing years indicates that except for FY07 and FY08, the threshold of 6% of GDP has been breached in most years. In recent past, combined fiscal deficit relative to GDP remained close to 6% in FY18 and FY19.

Chart 13: Fiscal deficit to GDP ratio (%) - Center and States

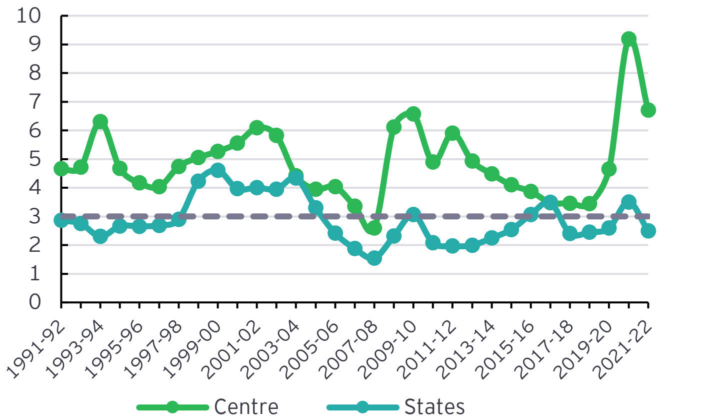
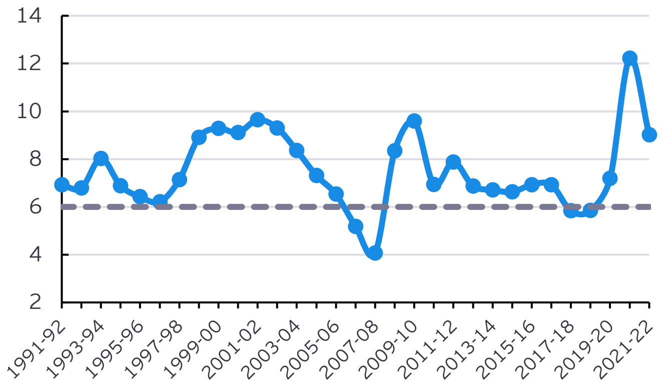


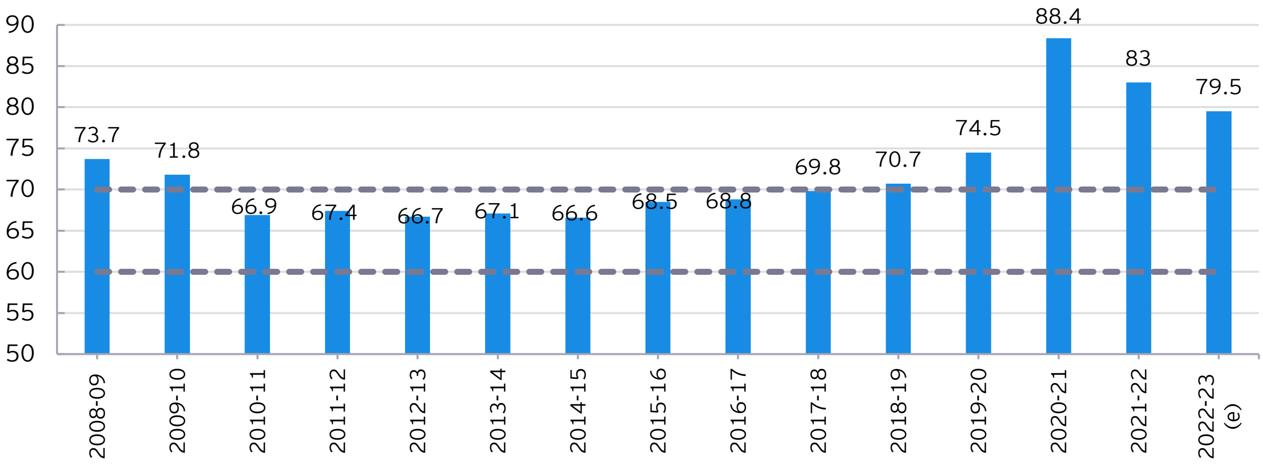
Chart 14: Combined general government fiscal deficit to GDP ratio (%)



Source (basic data): CAG, CGA, Union Budget documents, MoSPI, RBI, IPFS

The accumulation of fiscal deficit over time results into debt. The profile of government debt to GDP ratio depends on accumulated primary deficits, effective interest rate and nominal growth rate. According to the Center's Fiscal Responsibility and Budget Management Act (FRBMA) 2018, the sustainable threshold of the combined debt to GDP ratio is 60%. This target has been missed in all post-FRL years. The situation has considerably worsened due to COVID's deleterious impact in recent years. In FY21, the combined debt-GDP ratio rose to an estimated level of 88.4%, exceeding the FRBM threshold by 28.4% points (Chart 15). Restoring government debt-GDP ratio to levels closer to 60% is a pre-requisite for re-strategizing government finances to create adequate fiscal space for reprioritization of education, health, and capital expenditure. This would facilitate India to become the largest economy, in terms of size of GDP measured in purchasing power parity (PPP) terms, in the next three decades or so after having become the largest economy in terms of population in 2023.

Chart 15: India's combined debt-GDP ratio (%)



Source (basic data): CAG, CGA, Union Budget documents, MoSPI, RBI, IPFS
(e): estimated

8. Concluding observations

Recently released data on World Population Prospects by the UN, forecasts that India would become the largest economy in terms of total population by 2023. The next task is to also become the largest economy in terms of size of output as measured by GDP in PPP terms. One pre-requisite for achieving this target is re-strategizing government intervention in the economy to accord higher priorities to education, health, and physical infrastructure. For this, restoration of FRBM targets of fiscal deficit and government debt relative to GDP and achieving balance on the revenue account are critical so that adequate fiscal space can be created. The changing age structure of India's population is slated to keep on increasing the share of working age persons in the total population. If these persons are productively employed, a virtuous cycle of growth, employment, saving and investment can be created. To achieve this objective, India will have to increase its revenue to GDP ratio and steadily increase the share of education, health and infrastructure in total government expenditure.

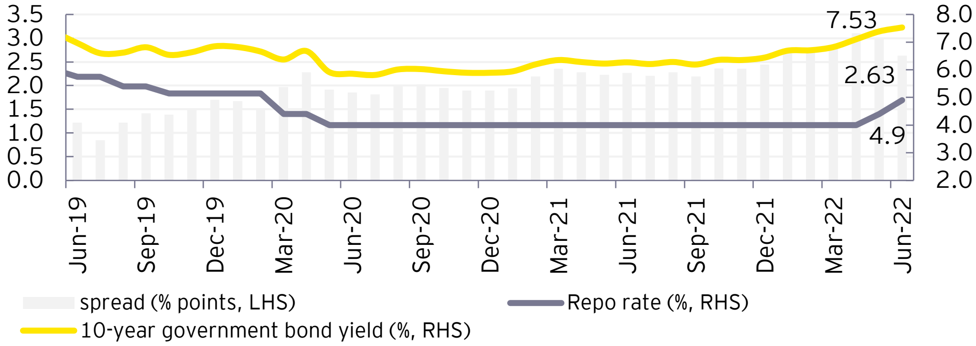
6. Money and finance: growth in bank credit accelerated to a 34-month high of 12.1% in May 2022

A. Monetary sector

Monetary policy

- After retaining the repo rate at 4.0% for 24 months, the RBI increased it in two steps of 40 and 50 basis points respectively in two consecutive monetary policy reviews held in May and June 2022, thereby taking the repo rate to 4.9% **(Chart 16)**. Further, the stance of monetary policy was changed to gradual withdrawal of accommodation.
- While projecting the CPI inflation at 6.7% for FY23, the RBI assessed that the uncertainty surrounding the domestic inflation has exacerbated due to the ongoing global geopolitical situation and the consequent elevated global commodity prices. Further, the RBI also noted that inflation pressures may emanate from: (a) shortfall in rabi production due to heat wave, (b) adverse global supply conditions in edible oils, (c) upward revision in electricity tariffs by state governments and (d) elevated global crude oil prices over a prolonged period.

Chart 16: Movements in the repo rate and 10-year government bond



Bank credit by scheduled commercial banks (SCBs) grew by 12.1% in May 2022, its fastest pace since July 2019.

Source: Database on Indian Economy, RBI

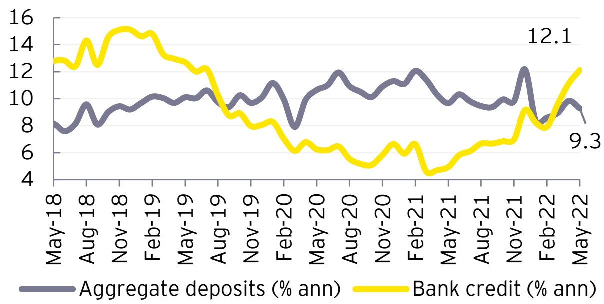
Money stock

- Growth in broad money stock (M3) fell to 7.8% in June 2022, its lowest level since October 2017, due to a slowdown in the growth of narrow money (M1) and time deposits.
- Growth in M1 moderated sharply to 8.7% in June 2022 from 11.7% in May 2022 led by a slowdown in the growth of currency with the public and demand deposits. Growth in currency with the public moderated to 8.0% in June 2022 from 8.9% in May 2022 while growth in demand deposits fell sharply to 10.6% in June 2022 from 16.1% in May 2022.
- Time deposits, accounting for about 76% of M3 on average (last three years) grew by 7.5% in June 2022, marginally lower than 7.8% in May 2022.

Aggregate credit and deposits

- Outstanding bank credit by SCBs grew by 12.1% in May 2022 **(Chart 17)**, its fastest pace since July 2019, led by higher credit growth across all the key sectors of the economy.
- Growth in non-food credit was at a three-year high of 12.6% in May 2022 as compared to 11.3% in April 2022.
- Sectoral bank credit data indicate that growth in credit to services was the highest at 12.9% in May 2022, improving from 11.1% in April 2022 indicating sustained recovery in services sector demand.

Chart 17: Growth in credit and deposits



Source: Database on Indian Economy, RBI

- Growth in credit to the agricultural sector also improved to a five-month high of 11.8% in May 2022 from 10.6% in April 2022.
- Growth in outstanding credit to industries increased further to 8.7% in May 2022 from 8.1% in April 2022. Within the industrial sector, credit to drugs and pharmaceuticals showed the highest growth of 17.5% in May 2022 as compared to 15.4% in April 2022. Growth in credit to infrastructure, although remained strong at 9.5% in May 2022, was marginally lower than 10.2% in April 2022.
- Personal loans, accounting for about 30% of total non-food credit, grew at a robust pace of 16.4% in May 2022 as compared to 14.7% in April 2022.
- Growth in aggregate deposits of residents slowed marginally to 9.3% in May 2022 from 9.8% in April 2022.

B. Financial sector

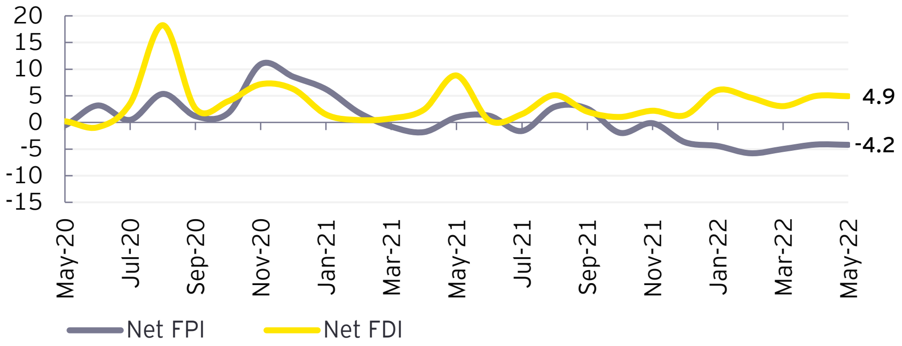
Interest rates

- As per the data released by the RBI on 1 July 2022, the average interest rate on term deposits with a maturity period of more than one year was increased to 5.38% in June 2022 from 5.32% in May 2022, with the actual rate ranging from 5.00% to 5.75%.
- The average MCLR was increased for the third successive month to 6.98% in June 2022, from 6.79% in May 2022. In June 2022, actual MCLR ranged between 6.65% and 7.30%.
- The average yield on 10-year government bonds increased by about 14 basis points to 7.53% in June 2022, its highest level since November 2018, as compared to 7.39% in May 2022 **(Chart 16)**. In 1QFY23, the benchmark bond yields averaged relatively higher at 7.34% as compared to 6.74% in 4QFY22.
- WALR on fresh rupee loans by SCBs increased by 35 basis points to 7.86% in May 2022 from 7.51% in April 2022.

FDI and FPI

- As per the provisional data released by the RBI on 15 July 2022, overall foreign investment[11] (FIs) inflows were marginally lower at US$0.7 billion in May 2022 as compared to US$0.8 billion (revised) in April 2022. This was due to a fall in the net FDI inflows.

Chart 18: Net FDI and FPI inflows (US$ billion)



Net FDI inflows fell marginally to US$4.9 billion in May 2022, while FPIs registered outflows for the eighth successive month at US$(-)4.2 billion in May 2022.

Source: Database on Indian Economy, RBI

- Net FDI inflows were marginally lower at US$4.9 billion in May 2022 as compared to US$5.0 billion in April 2022 **(Chart 18)** reflecting lower gross FDI inflows at US$8.1 billion in May 2022 as compared to US$8.4 billion in April 2022.
- FPIs registered outflows for the eighth consecutive month with net outflows continuing to be high at US$(-)4.2 billion in May 2022, similar to the outflows seen in April 2022. With this, the cumulative net FPI outflows amounted to US$(-)29.4 billion during October 2021 to May 2022.

[11] Foreign Investment (FI) = net FDI plus net FPI

7. Trade and CAB: merchandise trade deficit was at a historic high of US$(-)26.2 billion in June 2022

A. CAB: current account deficit eased to (-)1.5% of GDP in 4QFY22

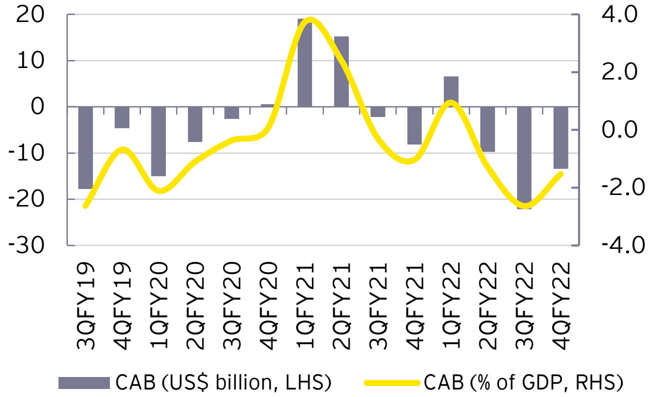
- Current account deficit narrowed to (-)1.5% of GDP in 4QFY22 from (-)2.6% of GDP in 3QFY22 **(Chart 19, Table 10)** reflecting an improvement in exports to 13.4% of GDP from 13.0% and a decline in imports to 19.6% of GDP from 20.1% over this period.
- On an annual basis, current account posted a deficit of (-)1.2% relative to GDP in FY22 as compared to a surplus of 0.9% in FY21. Merchandise trade deficit increased to a three-year high of (-)6.0% of GDP in FY22 largely reflecting rising global crude and commodity prices. Net transfer receipts fell to a four-year low of 2.5% of GDP in FY22 although net service receipts surged to a seven-year high of 3.4% of GDP.

Table 10: Components of CAB in US$ billion

Fiscal year	CAB as % of nominal GDP	CAB	Goods account net	Invisibles* net
FY19	-2.1	-57.3	-180.3	123.0
FY20	-0.9	-24.7	-157.5	132.8
FY21	0.9	23.9	-102.2	126.1
FY22	-1.2	-38.8	-189.5	150.7
1QFY22	0.9	6.6	-30.7	37.3
2QFY22	-1.3	-9.7	-44.5	34.8
3QFY22	-2.6	-22.2	-59.7	37.6
4QFY22	-1.5	-13.4	-54.5	41.1

Source: Database on Indian Economy, RBI
Note: (-) deficit; (+) surplus; *invisibles include services, current transfers and income components

Chart 19: CAB



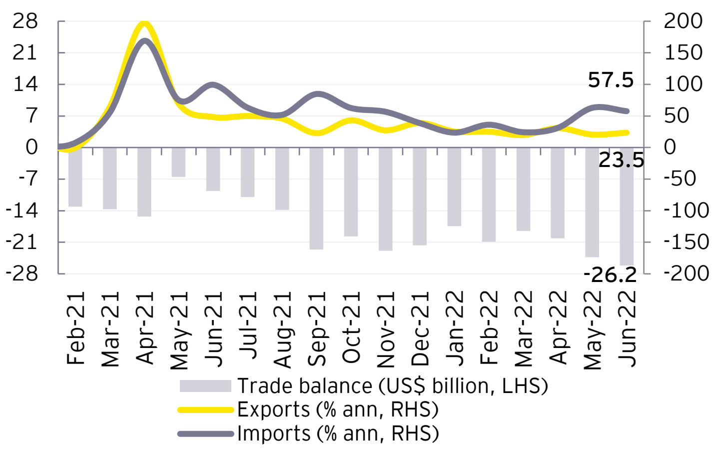
Source: Database on Indian Economy, RBI

B. Merchandise trade and exchange rate

Merchandise exports growth increased marginally to 23.5% in June 2022 from 20.6% in May 2022, whereas merchandise imports growth remained elevated, although easing to 57.5% from 62.8% during this period.

- The higher growth in merchandise exports was led by higher growth in exports of petroleum products, gems and jewelry and readymade garments which grew by 119.0%, 25.3%, and 49.8% respectively in June 2022 as compared to 60.9%, 8.7% and 27.8% in May 2022.
- Merchandise imports growth moderated but remained elevated at 57.5% in June 2022 due to high growth in imports of oil, coal, electronic goods and gold which increased to 99.5%, 260.6% (75-month high), 32.8% and 182.8% respectively in June 2022 as compared to 102.7%, 172.1%, 34.0% and 789.2% in May 2022.
- Y-o-y growth in exports excluding oil, gold and jewelry fell to a 16-month low of 8.7% in June 2022 whereas growth in imports of this segment rose to a 7-month high of 41.1% taking the trade deficit of this category to a record high level of US$(-)11.4 billion in June 2022.
- Merchandise trade deficit widened to an unprecedented high of US$(-)26.2 billion in June 2022 **(Chart 20).**
- Services trade surplus fell to a six-month low of US$8.4 billion in May 2022.
- The rupee depreciated to an unprecedented low level of INR78.1 per US$ (average) in June 2022 from INR77.3 per US$ (average) in May 2022 on account of pressures arising from a) geopolitical uncertainties, b) high FPI outflows, c) rising crude prices, d) widening trade deficit, and e) faster pace of monetary policy tightening in the US.

Chart 20: Developments in merchandise trade



Source: Ministry of Commerce and Industry, GoI

8. Global growth: OECD projected global growth at 3.0% in 2022 and 2.8% in 2023

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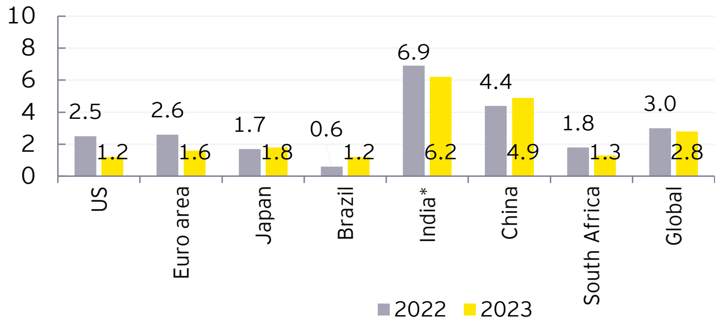
A. Global growth

> The OECD has projected global growth at 3.0% in 2022 with India's FY23 growth forecasted at 6.9%.

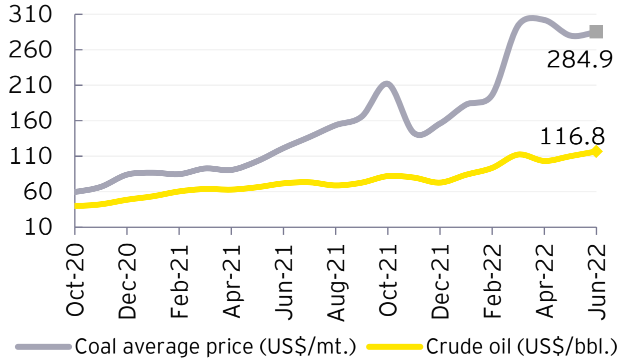
- As per the OECD, global growth is forecasted at 3.0% in 2022, a downward revision of 1.5% points from the December 2021 forecast (**Chart 21**). Global growth is expected to remain subdued in 2023 as well. This is attributable to sharp downturns in Russia and Ukraine, and considerably weaker than expected growth in most economies particularly in Europe.
- Growth in the US is projected to fall from 5.7% in 2021 to 2.5% in 2022 and further to 1.2% in 2023 due to supply shortages resulting from the geopolitical conflict and COVID-related lockdowns in China, monetary policy tightening and expiry of pandemic-related fiscal measures.
- In the Euro area, growth is projected to slow from 5.3% in 2021 to 2.6% in 2022 and 1.6% in 2023 as severe supply side bottlenecks are expected to lead to rising inflationary pressures and further dent real household incomes and business sentiment.
- Growth in Japan, forecasted at 1.7% in 2022, would remain unchanged from 2021. In 2023 also, growth is expected to remain subdued at 1.8%. Growth prospects have been dented by the Omicron wave as well as weak external demand and increase in prices of key commodity exports.
- China's growth is projected at 4.4% in 2022, falling from 8.1% in 2021. In OECD's assessment, this partly reflects the continuation of stringent measures for curbing the spread of COVID as well as weak real estate investment due to tighter regulations and failure of some major developers. Growth is projected to improve to 4.9% in 2023.
- Brazil's GDP growth is projected to fall sharply to 0.6% in 2022 before picking up to 1.2% in 2023. A range of factors, including rising inflation, global geopolitical conflict, weather conditions, political uncertainty and the spread of Omicron variant in early 2022, have adversely affected growth prospects in Brazil.
- While India has recorded the fastest rebound from the COVID-related downturn among all G-20 countries, growth momentum is expected to ease in 2022 (FY23) owing to weaker external conditions, rising global food and energy prices, and tightening of monetary policy. Nonetheless, India's growth, forecasted at 6.9% in FY23, remains the highest among major economies of the world, supported by strong government spending.

Chart 21: Global growth projections (%)



Source: OECD Economic Outlook (June 2022)
*Data pertains to fiscal years FY23 and FY24 respectively.

Chart 22: Global crude and coal prices



Source (basic data): World Bank, Pink Sheet, July 2022

B. Global energy prices: Global crude price averaged US$110.1/bbl. in 1QFY23

- Average global crude price[12] increased to US$116.8/bbl. in June 2022 from 110.1/bbl. in May 2022 due to continuing disruptions resulting from the ongoing geopolitical conflict, supply outages in Libya and expected shutdowns in Norwegian oil and gas plants[13] (**Chart 22**). On a quarterly basis, the global crude price averaged US$110.1/bbl. in 1QFY23, up from US$96.6/bbl. in 4QFY22.
- Average global coal price[14] continued to rise, increasing to US$284.9/mt. in June 2022 from US$280.0/mt. in May 2022. In 1QFY23, the global coal price averaged US$289.0/mt., its highest level since the inception of the price series in 1970.

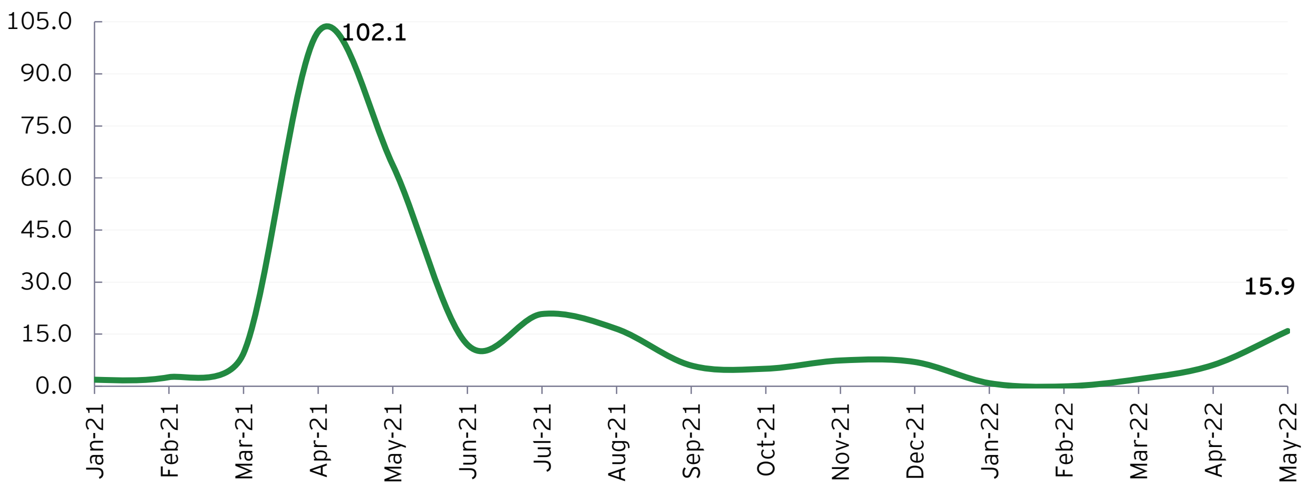
[12] Simple average of three spot prices, namely, Dated Brent, West Texas Intermediate and Dubai Fateh
[13] https://www.cnbc.com/2022/07/01/oil-markets-opec-output-russia-global-economy.html
[14] Simple average of Australian and South African coal prices

9. Index of Aggregate Demand (IAD): grew by 15.9% in May 2022

Growth in IAD accelerated to a nine-month high of 15.9% in May 2022 from 6.1% in April 2022

- EY has developed an IAD to reflect the monthly combined demand conditions in the agriculture, manufacturing and services sectors. It considers the movements in PMI for manufacturing and services, both measured in seasonally adjusted (sa) terms, tracing the demand conditions in these sectors. Demand conditions in the agricultural sector have been captured by movements in monthly agricultural credit off-take (sa)[15].
- Growth in IAD accelerated to 15.9% in May 2022 from 6.1% in April 2022, partly due to a favorable base effect and partly due to a broad-based pickup in demand conditions across all the three key sectors of the economy during the month **(Chart 23 and Table 11)**.
- Demand conditions in the services sector remained robust for the second successive month while those in manufacturing appeared broadly stable with a marginal dip in May 2022 over that in April 2022.
- Demand conditions in the agricultural sector, as indicated by growth in credit off-take, also showed an improvement in May 2022.

Chart 23: Growth in IAD (y-o-y)



Source (Basic data): IHS Markit PMI, RBI and EY estimates
Note: From this issue onwards, we will be using seasonally adjusted data for constructing the IAD.

Table 11: IAD

Month	Sep-21	Oct-21	Nov-21	Dec-21	Jan-22	Feb-22	Mar-22	Apr-22	May-22
IAD	140.8	145.9	147.3	145.8	139.7	141.1	142.7	148.1	149.9
Growth (% y-o-y)	6.0	5.1	7.4	7.0	0.9	0.0	2.1	6.1	15.9
Growth in agr. credit	10.2	10.2	10.6	14.6	10.1	10.2	9.5	10.5	11.7
Mfg. PMI**	3.7	5.9	7.6	5.5	4.0	4.9	4.0	4.7	4.6
Ser. PMI**	5.2	8.4	8.1	5.5	1.5	1.8	3.6	7.9	8.9

**Values here indicate deviation from the benchmark value of 50. A positive value indicates expansion in demand while a negative value implies contraction in demand; PMI for Mfg. and Serv. are seasonally adjusted.

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

[15] We have constructed a seasonally adjusted series for agricultural credit using Census X-13 technique in E-views (version 12).

10. Capturing macro-fiscal trends: data appendix

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

Fiscal year/ quarter/ month	IIP	Mining	Manufacturing	Electricity	Core IIP	Fiscal year/ quarter /month	PMI mfg.	PMI ser.
	% change y-o-y							
FY19	3.8	2.8	3.8	5.2	4.4	FY19	52.8	52.2
FY20	-0.8	1.6	-1.4	0.9	0.4	FY20	52.3	51.9
FY21	-8.5	-7.8	-9.6	-0.5	-6.4	FY21	50.2	41.7
FY22	11.4	12.2	11.8	8.0	10.4	FY22	54.0	52.3
1QFY22	44.4	27.5	53.0	16.8	26.0	2QFY22	53.8	52.4
2QFY22	9.5	17.1	8.6	9.3	9.2	3QFY22	56.3	57.3
3QFY22	2.1	6.1	1.4	2.7	5.3	4QFY22	54.3	52.3
4QFY22	1.8	3.8	1.2	3.9	4.9	1QFY23	54.4	58.7
Feb-22	1.2	4.6	0.2	4.5	5.9	Mar-22	54.0	53.6
Mar-22	2.2	3.9	1.4	6.1	4.9	Apr-22	54.7	57.9
Apr-22	6.7	8.0	5.8	11.8	9.3	May-22	54.6	58.9
May-22	19.6	10.9	20.6	23.5	18.1	Jun-22	53.9	59.2

Source: MoSPI, Office of the Economic Adviser, Ministry of Commerce and Industry and S&P Global

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				
FY19	3.4	0.1	5.7	5.5	4.3	0.6	3.7	11.5	4.2
FY20	4.8	6.7	1.3	3.8	1.7	6.9	0.3	-1.8	-0.4
FY21	6.2	7.7	2.7	5.5	1.3	4.0	2.8	-8.0	2.2
FY22	5.5	3.8	11.3	6.1	13.0	6.7	11.0	32.9	10.9
2QFY22	5.1	2.6	13.0	6.0	11.7	3.6	11.5	28.2	11.3
3QFY22	5.0	2.2	12.9	6.2	14.3	6.8	12.0	40.4	12.2
4QFY22	6.3	6.3	8.5	6.1	13.9	9.2	10.3	32.3	10.5
1QFY23	7.3	8.0	10.2	6.4	15.5	10.8	10.2	40.0	10.4
Mar-22	7.0	7.7	7.5	6.4	14.6	9.3	11.3	31.8	11.4
Apr-22	7.8	8.3	10.7	7.1	15.4	9.1	11.4	38.8	11.6
May-22	7.0	8.0	9.5	6.1	15.9	10.9	10.1	40.6	10.4
Jun-22	7.0	7.7	10.4	6.0	15.2	12.4	9.2	40.4	9.3

Source: Office of the Economic Adviser, Ministry of Commerce and Industry and MoSPI
* The CPI for April and May 2020 has been imputed

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 % of GDP	Revenue deficit % of GDP
FY19 (CGA)	8.4	16.2	13.1	14.9	3.0	3.4	2.4
FY20 (CGA)	-3.4	-16.1	4.0	-7.8	1.7	4.7	3.3
FY21 (CGA)	0.7	-17.9	-2.3	-10.7	12.7	9.2	7.3
FY22 (CGA)	33.8	55.7	43.5	49.6	20.0	6.7	4.4
FY23 (BE over FY 22 RE)	9.6	13.4	13.8	13.6	5.7	6.4	3.8
Cumulated growth (%, y-o-y)						% of budgeted target	
Oct-21	55.8	91.6	53.3	70.9	44.0	36.3	27.5
Nov-21	50.3	90.4	47.2	66.3	38.6	46.2	38.8
Dec-21	44.2	66.5	50.5	58.7	31.5	47.7	36.4$
Jan-22	38.5	63.8	48.3	56.1	24.1	58.9	48.6$
Feb-22	36.6	61.3	45.7	53.3	23.3	82.7	79.7$
Mar-22	33.8	55.7	43.5	49.6	20.0	99.7	94.9$
Apr-22	36.5	75.2	59.6	65.9	10.1	4.5	-0.1
May-22	29.1	80.7	49.9	61.2	9.0	12.3	12.3

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.
$as a proportion of revised estimate

Fiscal year/month	CGST	UTGST	IGST	GST compensation cess	Total GST (Center)
	INR crore				
FY 2022 (RE)	5,70,000	-	-	1,05,000	6,75,000
FY 2023 (BE)	6,60,000	-	-	1,20,000	7,80,000
Monthly tax collection (INR crore)					
Oct-21	48,546	140	8,970	8,221	65,877
Nov-21	49,238	118	7,238	9,442	66,036
Dec-21	46,227	254	14,635	9,141	70,257
Jan-22	69,662	432	-27,918	9,456	51,632
Feb-22	48,169	159	7,903	10,100	66,331
Mar-22	63,330	1,230	-14,480	9,092	59,172
Apr-22	64,093	162	11,345	10,435	86,035
May-22	49,876	244	4,741	10,199	65,060

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

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

Fiscal year/ month	Repo rate (end of period)	Fiscal year/ quarter/ month	Bank credit	Agg. deposits	Net FDI	Net FPI	Fiscal year/ quarter/ month	M1	M3	10-year govt. bond yield	FX reserves
	%		% change y-o-y		US$ billion			% change y-o-y		%	US$ billion
Aug-21	4.00	FY19	13.7	8.9	30.7	-0.6	FY19	13.6	10.5	7.69	411.9
Sep-21	4.00	FY20	9.5	9.9	43.0	1.4	FY20	11.2	8.9	6.83	475.6
Oct-21	4.00	FY21	5.9	11.0	44.0	36.1	FY21	16.2	12.2	6.05	579.3
Nov-21	4.00	FY22	7.0	9.7	38.6	-16.8	FY22	10.6	8.7	6.40	617.6
Dec-21	4.00	1QFY22	5.2	10.1	11.6	0.4	2QFY22	11.4	9.3	6.23	638.6
Jan-22	4.00	2QFY22	6.5	9.5	8.7	3.9	3QFY22	11.5	9.3	6.38	633.6
Feb-22	4.00	3QFY22	7.7	10.6	4.6	-5.8	4QFY22	10.6	8.7	6.74	617.6
Mar-22	4.00	4QFY22	8.6	8.6	13.8	-15.2	1QFY23	8.7	7.8	7.34	593.3
Apr-22	4.00	Feb-22	7.9	8.6	4.7	-5.8	Mar-22	10.6	8.7	6.82	617.6
Apr-22	4.00	Mar-22	9.6	8.9	3.1	-5.0	Apr-22	13.2	10.2	7.11	597.7
May-22	4.40	Apr-22	11.1	9.8	5.0	-4.2	May-22	11.7	8.8	7.39	601.4
Jun-22	4.90	May-22	12.1	9.3	4.9	-4.2	Jun-22	8.7	7.8	7.53	593.3

Source: Database on Indian Economy - RBI

Table A5: External trade and global growth

External trade indicators (annual, quarterly and monthly growth rates)							Global growth (annual)			
Fiscal year/ quarter/ month	Exports	Imports	Trade balance	Ex. rate (avg.)	Crude prices (avg.)	Coal prices (avg.)	Calendar year	World GDP	Adv. econ.	Emer. econ.
	% change y-o-y		US$ billion	INR/US$	US$/bbl.	US$/mt		% change y-o-y		
FY19	8.7	10.4	-182.3	69.9	67.3	100.4	2012	3.5	1.2	5.4
FY20	-5.1	-7.7	-161.4	70.9	58.5	70.4	2013	3.5	1.4	5.1
FY21	-6.9	-16.9	-102.6	74.2	43.8	67.2	2014	3.5	2.1	4.7
FY22	43.8	55.1	-192.2	74.5	78.4	163.0	2015	3.4	2.4	4.3
2QFY22	38.5	66.5	-47.4	74.1	71.7	152.3	2016	3.3	1.8	4.5
3QFY22	36.6	51.4	-64.3	74.9	78.3	170.3	2017	3.8	2.5	4.8
4QFY22	23.1	27.7	-56.8	75.2	96.6	224.5	2018	3.5	2.2	4.5
1QFY23	24.8	49.5	-70.6	77.2	110.1	289.0	2019	2.8	1.6	3.7
Mar-22	19.8	24.2	-18.5	76.2	112.4	294.4	2020	-3.1	-4.5	-2.0
Apr-22	30.7	31.0	-20.1	76.2	103.4	302.0	2021	6.1	5.2	6.8
May-22	20.6	62.8	-24.3	77.3	110.1	280.0	2022	3.6	3.3	3.8
Jun-22	23.5	57.5	-26.2	78.1	116.8	284.9	2023	3.6	2.4	4.4

Source: Database on Indian Economy - RBI, Pink Sheet - World Bank and IMF World Economic Outlook April 2022.

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

Fiscal year/quarter	Output: major sectors									IPD inflation
	GVA	Agr.	Ming.	Mfg.	Elec.	Cons.	Trans.	Fin.	Publ.	GVA
FY19 (3rd RE)	5.8	2.1	-0.8	5.4	7.9	6.5	7.2	7.0	7.5	4.7
FY20 (2nd RE) $	3.8	5.5	-1.5	-2.9	2.2	1.2	5.9	6.7	6.3	2.9
FY21(1st RE) $	-4.8	3.3	-8.6	-0.6	-3.6	-7.3	-20.2	2.2	-5.5	3.3
FY22(PE)*	8.1	3.0	11.6	9.9	7.5	11.5	11.1	4.2	12.6	9.4
4QFY20	3.3	7.5	-1.3	-4.6	2.7	1.8	5.1	4.2	7.6	3.0
1QFY21	-21.4	3.0	-17.8	-31.5	-14.8	-49.4	-49.9	-1.1	-11.4	2.3
2QFY21	-5.9	3.2	-7.9	5.2	-3.2	-6.6	-18.8	-5.2	-10.2	1.7
3QFY21	2.1	4.1	-5.3	8.4	1.5	6.6	-10.1	10.3	-2.9	3.4
4QFY21	5.7	2.8	-3.9	15.2	3.2	18.3	-3.4	8.8	1.7	5.2
1QFY22	18.1	2.2	18.0	49.0	13.8	71.3	34.3	2.3	6.2	7.0
2QFY22	8.3	3.2	14.5	5.6	8.5	8.1	9.6	6.1	19.4	8.8
3QFY22	4.7	2.5	9.2	0.3	3.7	-2.8	6.3	4.2	16.7	10.4
4QFY22	3.9	4.1	6.7	-0.2	4.5	2.0	5.3	4.3	7.7	10.9

Source: National Accounts Statistics, MoSPI
$ Growth numbers for FY21 are based on the first revised estimates (RE) of NAS released by the MoSPI on 31 January 2022 over the second RE of NAS for FY20, *FY22 growth numbers are based on the Provisional Estimates (PE) of National Accounts released on 31 May 2022 over the first revised estimates for 2021 released on 31 January 2022.

Fiscal year/quarter	Expenditure components						IPD inflation
	GDP	PFCE	GFCE	GFCF	EX	IM	GDP
FY19 (3rd RE)	6.5	7.1	6.7	11.2	11.9	8.8	3.9
FY20 (2nd RE) $	3.7	5.2	3.4	1.6	-3.4	-0.8	2.4
FY21(1st RE) $	-6.6	-6.0	3.6	-10.4	-9.2	-13.8	5.6
FY22(PE)*	8.7	7.9	2.6	15.8	24.3	35.5	10.0
4QFY20	2.7	1.2	8.0	0.6	-9.1	-2.4	4.3
1QFY21	-23.8	-23.7	13.6	-45.3	-25.5	-41.1	2.9
2QFY21	-6.6	-8.3	-22.9	-4.5	-6.4	-17.9	4.0
3QFY21	0.7	0.6	-0.3	-0.6	-8.6	-5.2	5.4
4QFY21	2.5	6.5	29.0	10.1	3.7	11.7	9.2
1QFY22	20.1	14.4	-4.8	62.5	40.8	61.1	10.2
2QFY22	8.4	10.5	8.9	14.6	20.7	41.0	9.8
3QFY22	5.4	7.4	3.0	2.1	23.1	33.6	9.8
4QFY22	4.1	1.8	4.8	5.1	16.9	18.0	10.4

Source: National Accounts Statistics, MoSPI
$ Growth numbers for FY21 are based on the first revised estimates (RE) of NAS released by the MoSPI on 31 January 2022 over the second RE of NAS for FY20, *FY22 growth numbers are based on the Provisional Estimates (PE) of National Accounts released on 31 May 2022 over the first revised estimates for 2021 released on 31 January 2022.

List of abbreviations

Sr. no.	Abbreviations	Description
1	AD	aggregate demand
2	AEs	advanced economies
3	Agr.	agriculture, forestry and fishing
4	AY	assessment year
5	Bcm	billion cubic meters
6	bbl.	barrel
7	BE	budget estimate
8	CAB	current account balance
9	CGA	Comptroller General of Accounts
10	CGST	Central Goods and Services Tax
11	CIT	corporate income tax
12	Cons.	construction
13	CPI	Consumer Price Index
14	COVID-19	Coronavirus disease 2019
15	CPSE	central public-sector enterprise
16	CRAR	Credit to Risk- weighted Assets Ratio
17	CSO	Central Statistical Organization
18	Disc.	discrepancies
19	ECBs	external commercial borrowings
20	EIA	US Energy Information Administration
21	Elec.	electricity, gas, water supply and other utility services
22	EMDEs	Emerging Market and Developing Economies
23	EXP	exports
24	FAE	first advance estimates
25	FC	Finance Commission
26	FII	foreign investment inflows
27	Fin.	financial, real estate and professional services
28	FPI	foreign portfolio investment
29	FRBMA	Fiscal Responsibility and Budget Management Act
30	FRL	Fiscal Responsibility Legislation
31	FY	fiscal year (April–March)
32	GDP	Gross Domestic Product
33	GFCE	government final consumption expenditure
34	GFCF	gross fixed capital formation
35	GoI	Government of India
36	G-secs	government securities
37	GST	Goods and Services Tax
38	GVA	gross value added
39	IAD	Index of Aggregate Demand

Sr. no.	Abbreviations	Description
40	IBE	interim budget estimates
41	ICRIER	Indian Council for Research on International Economic Relations
42	IEA	International Energy Agency
43	IGST	Integrated Goods and Services Tax
44	IIP	Index of Industrial Production
45	IMF	International Monetary Fund
46	IMI	Index of Macro Imbalance
47	IMP	imports
48	INR	Indian Rupee
49	IPD	implicit price deflator
50	MCLR	marginal cost of funds-based lending rate
51	Ming.	mining and quarrying
52	Mfg.	manufacturing
53	m-o-m	month-on-month
54	Mt	metric ton
55	MoSPI	Ministry of Statistics and Programme Implementation
56	MPC	Monetary Policy Committee
57	MPF	Monetary Policy Framework
58	NEXP	net exports (exports minus imports of goods and services)
59	NPA	non-performing assets
60	NCLT	National Company Law Tribunal
61	OECD	Organization for Economic Co-operation and Development
62	OPEC	Organization of the Petroleum Exporting Countries
63	PFCE	private final consumption expenditure
64	PIT	personal income tax
65	PMI	Purchasing Managers' Index (reference value = 50)
66	PoL	petroleum oil and lubricants
67	PPP	Purchasing power parity
68	PSBR	public sector borrowing requirement
69	PSU/PSE	public sector undertaking/public sector enterprises
70	RE	revised estimates
71	RBI	Reserve Bank of India
72	SLR	Statutory Liquidity Ratio
73	Trans.	trade, hotels, transport, communication and services related to broadcasting
74	US$	US Dollar
75	UTGST	Union Territory Goods and Services Tax
76	WALR	weighted average lending rate
77	WHO	World Health Organization
78	WPI	Wholesale Price Index
79	y-o-y	year-on-year
80	1HFY20	first half of fiscal year 2019-20, i.e., April 2019-September 2019

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