Economy Watch

Monitoring India's macro-fiscal performance

November 2019

Building a better working world

Contents

Prepared by Macro-fiscal Unit, Policy Advisory Group, EY India

D.K. Srivastava, Chief Policy Advisor, EY: dk.srivastava@in.ey.com
Muralikrishna Bhardwaj, Senior Manager, EY: muralikrishna.b@in.ey.com
Tarrung Kapur, Manager, EY: tarrung.kapur@in.ey.com
Ragini Trehan, Manager, EY: ragini.trehan@in.ey.com

Highlights

1. Reflecting slackness in the performance of industrial sector, IIP declined by (-) 0.4% in 2QFY20, its lowest level under the 2011-12 base series, as compared to a growth of 3.0% in 1QFY20.
2. PMI signaled a near-stagnation in manufacturing and continued contraction in services in October 2019.
3. CPI inflation increased to 4.6% in October 2019 from 4.0% in September 2019 mainly due to rising vegetable prices.
4. WPI inflation fell further to 0.2% in October 2019 from 0.3% in September 2019 due to continued contraction in prices of fuel and non-food manufactured products.
5. As per the CGA, gross central taxes during 1HFY20 grew by 1.5% as compared to 8.6% during 1HFY19, the lowest growth observed since FY10.
6. Growth in center's capital expenditure picked up to 15.3% during April-September FY20 as compared to 11.1% during April-September FY19.
7. Center's fiscal deficit during 1HFY20 stood at 92.6% of the annual budgeted target while the corresponding ratio for revenue deficit stood at 99.9%.
8. Growth in bank credit fell to a 23-month low of 8.7% in September 2019 from 10.2% in August 2019.
9. Confirming a demand slowdown, there was a broad-based contraction in merchandise imports for the fifth successive month at (-) 16.3% in October 2019.
10. Net FDI inflows were lower at US$7.0 billion in 2QFY20 as compared to US$13.9 billion in 1QFY20.
11. The IMF has revised down its global growth projections to 3% in 2019, its weakest level since 2009.

Foreword

Reversing India's economic slowdown: what more can be done?

In spite of multiple fiscal and monetary policy initiatives, the Indian economy has continued to slow down. With IIP growth contracting further to (-)4.3% in September 2019, its lowest level under the 2011-12 based IIP series, many analysts have revised their FY20 growth forecast downwards ranging from 4.9% (Nomura and NCAER) to 5.6% (Moody's). The September 2019 core sector IIP data shows a contraction of (-) 5.2% which is the worst in the new IIP series. Manufacturing PMI fell to a two-year low of 50.6 and services PMI fell to 49.2 in October 2019. The automobile sector remained in deep contraction. Motor vehicle sales showed a sharp contraction of (-) 23.3% in September 2019 which however, slowed to (-) 5.5% in October 2019 mainly due to seasonal factors. According to the RBI's capacity utilization data, the capacity utilization is at a seven-quarter low of 73.6 in 1QFY20, which is the lowest since 3QFY18. These trends indicate that the recent fiscal measures announced by the government, including the sharp reduction in the CIT rates and incentives for automobile, housing and export sectors, have not yielded much result as yet. The repo rate reduction of 135 basis points during February 2019 to October 2019 has also not elicited any significant positive response. The key question is whether it is only a matter of time before the growth starts to pick up or are there still some tools available for the government which may be used to accelerate the recovery process.

One clear policy option to hasten the recovery process could be a direct and strong demand push injected into the economy through the augmentation of government's expenditure. India's policymakers have been constrained by a sharp reduction of tax revenue growth accompanied by FRBMA limits on government borrowing. Center's tax revenue during 1HFY20 has shown a growth of only 1.5%. This situation is likely to worsen further as the revenue depleting effect of the CIT rate reduction manifests itself. Various estimates of the impact of CIT rate reforms on fiscal deficit, which we had reviewed in the October 2019 issue of Economy Watch, indicated that the slippage in fiscal deficit for center could be in the range of 0.5% to 0.7% points of GDP for FY20. There will also be an impact on state's fiscal deficit, which may be about 0.6% points of GDP. Furthermore, states will also be at the receiving end of the lower growth of center's gross tax revenues. Together this means that neither the center nor the states may be able to inject additional purchasing power into the system through a direct demand stimulus in the near future. The government may be able to increase its expenditure only if it is willing to permit a large slippage in the fiscal deficit target prescribed by the FRBM. To reach a size of US$5 trillion by FY25, there is a need to add more countercyclical and structural policy initiatives to the long list of policy initiatives already undertaken to uplift the current and potential growth. A large investment is particularly needed in India's infrastructure sector. The FY20 Union Budget had envisaged an annual investment of about 10% of GDP for the next five years. However, the method of financing such a large investment has not yet been specified.

India slipped 10 ranks from 58 to 68 from 2018 to 2019, respectively, in the Global Competitiveness Index prepared by the World Economic Forum released in September 2019. India has decided not to join the RCEP at least for the time being as its substantive concerns have not been met. India is particularly concerned in regard to RCEP's impact on sectors such as textiles, milk, steel and more broadly, small- and medium-sized industries. On its own part, there is a need for India to substantively increase its competitiveness while RCEP has to make specific provisions addressing India's concerns.

There is some positive news as well. India has shown an improvement in the Ease of Doing Business ranking by climbing 14 ranks in this index to 63, making it the one of world's top 10 most improved countries for the third consecutive time. With the push given by the sharp CIT rate reduction, investment is likely to pick up in due course. The longer-term prospects for India's economic growth remain intact.

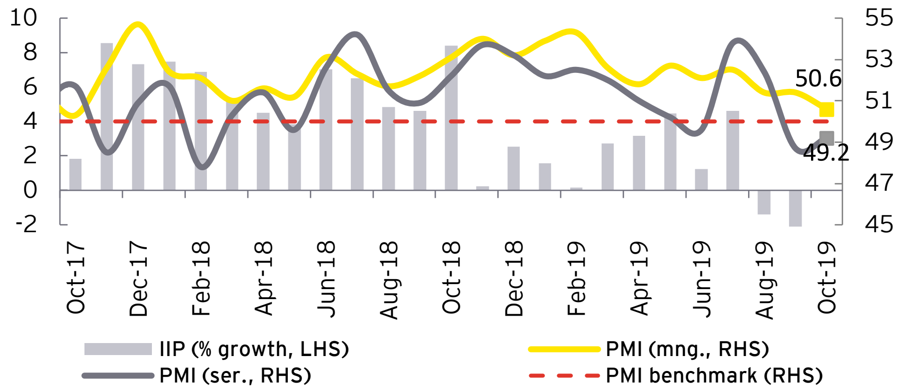
D.K. Srivastava
Chief Policy Advisor, EY India

1. Growth: IIP contracted by (-) 4.3% in September 2019

A. IIP: growth contracted for the second consecutive month in September 2019

- IIP's growth contracted by (-) 4.3% in September 2019, its lowest level under the 2011-12 based IIP series, as compared to a decline of (-) 1.4% (revised) in August 2019 due to a broad-based contraction across all sub-sectors (**Chart 1**).
- Manufacturing sector's output (accounting for 77.6% of overall IIP) contracted by (-) 3.9% in September 2019 as compared to a contraction of (-) 1.6% (revised) in August 2019. Output of electricity declined further by (-) 2.6% in September 2019 from (-) 0.9% in August 2019. Mining sector's output sharply contracted by (-) 8.5% in September 2019 as compared to a flat growth (0%) in August 2019 (Table A1 in data appendix).
- Reflective of a sustained weakness in the investment demand, output of capital goods industry contracted by (-) 20.7% in September 2019 for the ninth consecutive month, marginally lower than (-) 21.4% in August 2019. Output of both consumer durables and non-durables contracted by (-) 9.9% and (-) 0.4%, respectively, in September 2019.
- The output of eight core infrastructure industries contracted for the second month in a row by (-) 5.2% in September as compared to (-) 0.5% in August 2019. This was primarily on account of a broad-based contraction in the output of coal ((-) 20.6%), petroleum refinery products ((-) 6.7%), crude oil ((-) 5.4%), natural gas ((-) 4.9%), cement ((-) 2.9%), electricity ((-) 3.7%) and steel ((-)0.3%) in September 2019.

Chart 1: IIP growth and PMI



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

IIP declined by (-) 0.4% in 2QFY20, its lowest level under the 2011-12 base series, as compared to a growth of 3.0% in 1QFY20. This is reflective of slackness in the performance of the industrial sector.

B. PMI: signaled a near-stagnation in manufacturing and continued contraction in services in October 2019

- Headline manufacturing PMI (seasonally adjusted (sa)) fell to a two-year low of 50.6 in October 2019 from 51.4 in September 2019 (**Chart 1**). The growth softened in the consumer goods category and an increase in contraction was witnessed in the intermediate goods segment.
- PMI services contracted for the second straight month to 49.2 in October 2019 as compared to 48.7 in September 2019. This is attributable to weakness in domestic demand and only a modest upturn in external demand.

In October 2019, manufacturing PMI was at a two-year low of 50.6 while services PMI continued to contract at 49.2.

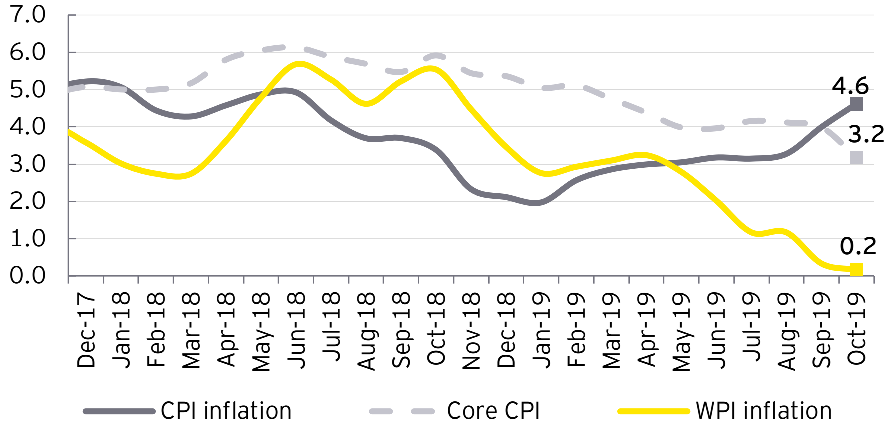
- Reflecting a near stagnation in manufacturing PMI and a continued contraction in services PMI, the composite PMI Output Index (sa) fell to 49.6 in October 2019 from 49.8 in September 2019.

2. Inflation: CPI inflation increased to a 16-month high of 4.6% in October 2019

CPI inflation increased to 4.6% in October 2019, its fifth sequential rise, from 4.0% (y-o-y) in September 2019 (Chart 2) mainly due to rising vegetable prices.

- Inflation in vegetables increased to a 19-month high of 15.4% in September 2019 from 6.9% in August 2019, driven by inflation in onions which rose to 66.4% from 6.4% over the same period. As a result, consumer food price based inflation increased to a 21-month high of 5.1% in September 2019 from 3.0% in August 2019.
- Core CPI inflation moderated to an all-time low (2011-12 series) of 3.2% in October 2019 from 4.0% in September 2019, thus reflecting the ongoing demand slowdown.
- Fuel and light prices continued to contract for the fourth successive month, by (-) 2.0% in October 2019 as compared to (-) 2.2% in September 2019.
- Prices of transportation and communication services contracted for the first time in four years by (-) 0.5% in October 2019 as compared to a growth of 0.1% in September 2019.
- Inflation in health services eased to an 18-month low of 5.6% in October 2019 from 7.7% in September 2019.

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



CPI-based inflation increased to 4.6% in October 2019 due to rising vegetable prices, even as core CPI and WPI based inflation fell significantly to 3.2% and 0.2%, respectively, reflecting the ongoing demand slowdown.

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

WPI inflation fell further to a 40-month low of 0.2% in October 2019 from 0.3% in September 2019 (Chart 2) due to continued contraction in prices of fuel and non-food manufactured products.

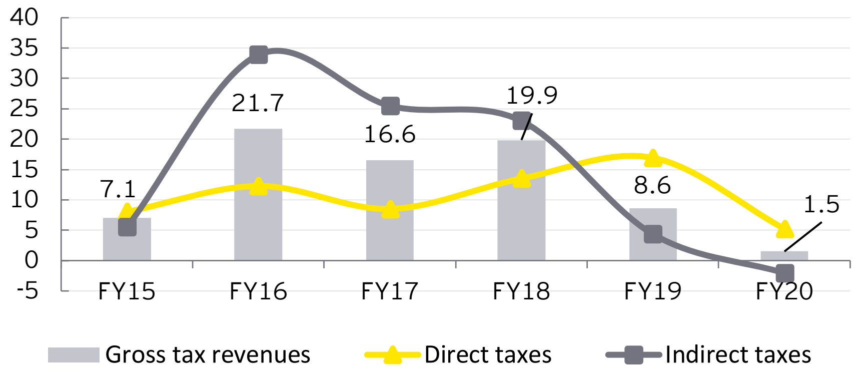
- WPI core inflation (non-food manufactured products) fell for the third successive month to a 40-month low of (-) 1.7% in October 2019 from (-) 1.1% in September 2019.
- The contraction was broad-based but particularly prominent in prices of manufactured basic metals which fell by (-) 9.8% in October 2019 as compared to (-) 8.2% in September 2019.
- Contraction in prices of fuel and power increased to a 39-month high of (-) 8.3% in October 2019 from (-) 7.1% in September 2019. This was its fifth successive month of contraction. Contraction in prices of petrol and diesel increased to (-) 10.5% and (-) 9.4%, respectively, in October 2019.
- Contraction in prices of crude petroleum and natural gas accelerated to a 41-month high of (-) 17.6% in October 2019 from (-) 13.4% in September 2019.
- Food price index-based inflation increased to a 39-month high of 7.6% in October 2019 from 6.0% in September 2019 as inflation in vegetables increased to 38.9% from 19.4% over the same period.

3. Fiscal performance: center's fiscal deficit during 1HFY20 stood at 92.6% of the budgeted target

A. Tax and non-tax revenues

- As per the Comptroller General of Accounts (CGA)[1], gross central taxes during 1HFY20 grew by 1.5% as compared to 8.6% during 1HFY19 (**Chart 3**). The cumulated growth in gross taxes during the first six months of FY20 was the lowest since FY10. Growth in both direct and indirect taxes fell during this period as compared to the corresponding period of the previous fiscal year with a contraction in the indirect tax growth.
- Direct tax revenues grew by 5.2% during April-September FY20, lower than 16.9% during the same period in FY19.
- Corporate tax revenues grew by 2.3% during the first six months of FY20 as compared to 17.2% during the corresponding period of FY19.
- Growth in income tax revenues during April-September FY20 was at 8.9% as compared to 16.5% during April-September FY19.
- Indirect taxes (comprising of union excise duties, service tax, customs duty, CGST, UTGST, IGST(2) and GST compensation cess) contracted by (-) 2% during April-September FY20 which is the lowest in the last 10 years. Growth in the corresponding period of FY19 was 4.4%. The sharp fall in the growth of indirect taxes during the first six months of FY20 may be attributed to IGST refunds to the tune of INR13, 828 crore in this period.

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



As per the CGA, center's gross taxes during 1HFY20 grew by 1.5% as compared to 8.6% during the corresponding period of FY19. The cumulated growth in gross taxes during the first six months of FY20 was the lowest since FY10.

Source: Monthly Accounts, Controller General of Accounts (CGA), Government of India
Notes: (1) Direct taxes include personal income tax and corporation tax, and indirect taxes include union excise duties, service tax, customs duty, CGST, UTGST, IGST and GST compensation cess from July 2017 onwards; (2) IGST revenues are subject to final settlement; (3) other taxes (securities transaction tax, wealth tax, fringe benefit tax, banking cash transaction tax, etc.) are included in the center's gross tax revenues along with direct and indirect taxes.

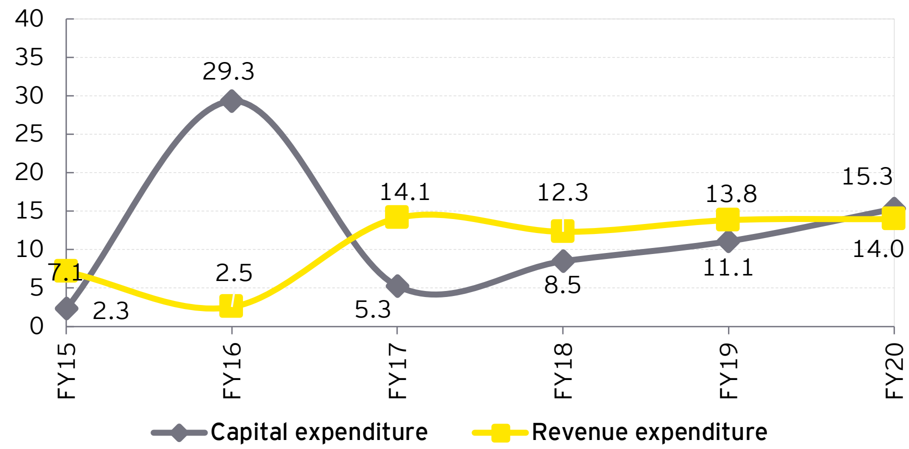
- The center's non-tax revenues showed a growth of 91.8% during April-September FY20 as compared to 34.8% during the corresponding period of FY19. This high growth during the first six months of FY20 may be attributable to receipt of high dividends and profits in August 2019.
- According to the latest data available as per the Department of Disinvestment, the disinvestment proceeds up to 11 November 2019 stood at INR17, 364.26 crore, which was 16.53% of the FY20 target of INR105,000 crore. The central government has recently[2] given an "in-principle" for strategic disinvestment of 28 CPSEs including subsidiary units and joint ventures with sale of majority stake of the government and transfer of management control.

[1] Monthly accounts for September 2019 released on 31 October 2019
[2] https://pib.gov.in/newsite/PrintRelease.aspx?relid=194643

B. Expenditures: revenue and capital

- Center's total expenditure during April-September FY20 grew by 14.1%, higher than 13.5% during April-September FY19 mainly due to a rise in capital expenditure in September 2019 (**Chart 4**).
- Revenue expenditure during April-September FY20 grew by 14% as compared to 13.8% during the corresponding period of FY19.
- Growth in center's capital expenditure, which remained subdued at 3% until August 2019, picked up to 15.3% during April-September FY20. Growth in capital expenditure during April-September FY19 was at 11.1%.

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



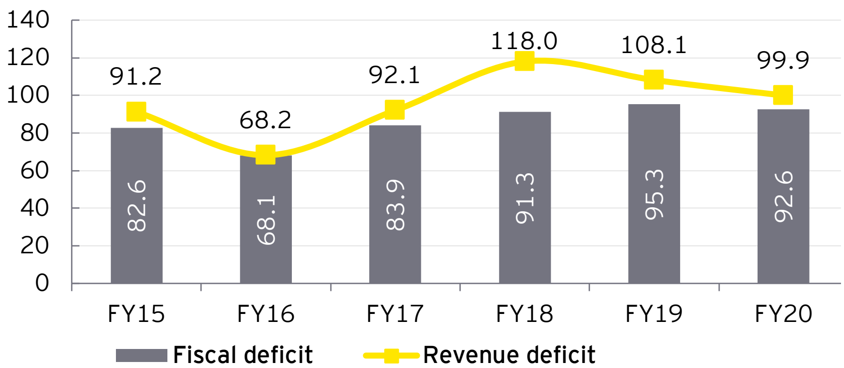
After posting a subdued growth of 3% until August 2019, growth in center's capital expenditure picked up to 15.3% during the first six months of FY20. This was higher than 11.1% during the corresponding period of FY19.

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

C. Fiscal imbalance

- Center's fiscal deficit during 1HFY20 stood at 92.6% of the annual budgeted target mainly due to a pickup in the center's expenditures and a sluggish growth in revenues during this period. The corresponding figure for FY19 stood at 95.3% **(Chart 5)**.
- Center's revenue deficit during the first six months of FY20 was at 99.9% of the annual budgeted target as compared to 108.1% during the corresponding period of FY19.

Chart 5: Fiscal and revenue deficit during April-September as percentage of annual budgeted target



Centre's fiscal deficit during 1HFY20 stood at 92.6% of the annual budgeted target while the corresponding ratio for revenue deficit stood at 99.9%.

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

4. India in a comparative perspective: status and prospects

General government net lending/borrowing as percentage of GDP

Reflecting an expansionary fiscal stance, general government fiscal deficit as percentage of GDP is expected to remain high in 2019 and 2020 as compared to their levels in 2018 for selected major economies.

- Among AEs, general government fiscal deficit as percentage of GDP in the US is projected to fall to 5.6% in 2019 and 5.5% in 2020 as a result of an assumed shift in the fiscal stance from accommodative to broadly neutral (Table 1).
- Among EMDEs, China's fiscal deficit relative to GDP is expected to increase from 4.8% of GDP in 2018 to 6.1% in 2019 and further to 6.3% in 2020 due to continued policy stimulus supporting activity in the face of adverse external shocks.
- In Russia, fiscal surplus relative to GDP is projected to fall in 2019 and 2020 and a fiscal deficit is forecasted from 2021 onwards. This may be attributable to a subdued outlook for global crude prices.
- India's fiscal deficit to GDP ratio is projected to increase from 6.4% in 2018 to 7.5% in 2019 owing to the recent fiscal initiatives undertaken to counter the economic slowdown. These include a reduction in the CIT rate and export incentives. Fiscal deficit is expected to remain above 6% of GDP throughout the forecast period.

Table 1: General government net lending/borrowing (% of GDP)#

	2018	2019	2020	2021	2022	2023	2024
AEs	-2.6	-2.9	-2.8	-2.8	-2.8	-2.6	-2.5
US	-5.7	-5.6	-5.5	-5.5	-5.6	-5.3	-5.1
Euro area	-0.5	-0.9	-0.9	-0.9	-0.9	-0.9	-0.8
Japan	-3.2	-3.0	-2.2	-1.9	-1.8	-1.8	-2.0
EMDEs	-3.8	-4.8	-4.9	-4.9	-4.8	-4.8	-4.7
Brazil	-7.2	-7.5	-6.9	-6.6	-6.4	-6.1	-5.7
Russia	2.9	1.0	0.1	-0.3	-0.6	-0.7	-0.8
India*	-6.4	-7.5	-7.2	-7.0	-6.9	-6.9	-6.8
China	-4.8	-6.1	-6.3	-6.2	-6.2	-6.2	-6.1
South Africa	-4.4	-6.2	-6.7	-6.4	-6.4	-6.5	-6.6

Source (basic data): World Economic Outlook, IMF, October 2019
Note: forecasted for 2019 and beyond; # surplus (+) and deficit (-)
*data pertains to fiscal year. For e.g., data for 2019 pertains to the year FY20.

Current account balance as *percentage* of GDP

Current account surplus in AEs is expected to narrow while current account deficit in EMDEs is projected to widen during the forecast period

- For AEs as a group, current account surplus relative to GDP is projected to fall to 0.6% in 2019, 0.5% in 2020 and further to 0.4% by 2023.
- In the US, current account deficit as % of GDP is expected to increase to 2.5% in 2019 and 2.6% in 2020, driven by an expansionary fiscal policy and strengthening of dollar. Current account deficit is expected to gradually decline from 2021 onwards.
- Current account surplus in Euro area and Japan are forecasted to fall during the forecast period.
- Among EMDEs, current account surplus relative to GDP is expected to fall from 6.8% in 2018 to 5.7% in 2019 and further to 3.2% by 2023 largely as the crude oil prices are forecasted to remain low in the medium-term owing to global demand slowdown.
- The modest widening of China's current account surplus in 2019 is expected to be reversed in the subsequent years as the rebalancing process continues. Current account deficit as percentage of GDP is expected to broadly widen in Brazil, India and South Africa, particularly from 2021 onwards.

Table 2: Current account balance (% of GDP)#

	2018	2019	2020	2021	2022	2023	2024
AEs	0.7	0.6	0.5	0.5	0.5	0.4	0.4
US	-2.4	-2.5	-2.6	-2.5	-2.4	-2.4	-2.3
Euro area	2.9	2.8	2.7	2.6	2.4	2.2	2.2
Japan	3.5	3.3	3.3	3.3	3.4	3.5	3.7
EMDEs	0.01	-0.04	-0.4	-0.5	-0.6	-0.7	-0.8
Brazil	-0.8	-1.2	-1.0	-1.1	-1.2	-1.4	-1.6
Russia	6.8	5.7	3.9	3.4	3.3	3.2	3.2
India*	-2.1	-2.0	-2.3	-2.3	-2.4	-2.4	-2.5
China	0.4	1.0	0.9	0.8	0.6	0.5	0.4
South Africa	-3.5	-3.1	-3.6	-3.6	-3.8	-4.2	-4.7

Source (basic data): World Economic Outlook, IMF, October 2019
Note: forecasted for 2019 and beyond; # surplus (+) and deficit (-)
*data pertains to fiscal year. For e.g., data for 2019 pertains to the year FY20.

5. In focus: Resource transfer to states - Finance Commission to consider J&K's new status, and defence and internal security

Introduction

The Finance Commission (FC) is a constitutional body in India which examines the mechanism of resource transfers from the center to states normally every five years. The Fifteenth Finance Commission (FFC) is presently deliberating on its Terms of Reference (ToR), which have been recently supplemented by some additional ToRs. The first one was issued on 29 July 2019 that relates to the need for recommending a funding mechanism for defence and internal security. Another ToR is linked to the Jammu and Kashmir Re-organization Act, 2019 (J&KRA) which has resulted in the formation of the erstwhile state of Jammu and Kashmir as a union territory (UT) with legislature and the formation of Ladakh as a UT without legislature. Consequently, India will have 28 states instead of 29 and three UTs with legislature instead of two and six UTs without legislature.

Along with the additional ToR issued on 29 July 2019, the FFC's term was extended by one month from 30 October 2019 to 30 November 2019. It has now been extended to 30 October 2020 and the period of award has also been extended by one year[3]. In both cases, critical issues are involved affecting center-state fiscal transfers. States would be looking forward to the FFC's award in the light of the original and the additional ToRs. We note that the additional ToRs may have significant implications for the states in terms of their share in transfers and the distribution of these transfers across the states.

I. Funding defence and internal security

With regards to defence and internal security, the additional ToR states the following:

"*9A. The Commission shall also examine whether a separate mechanism for funding of defence and internal security ought to be set up, and if so, how such a mechanism could be operationalised.*"

If a separate fund earmarked for defence and internal security is to be financed by a cess, it would lead to a reduction in the divisible pool of center's tax revenues since cesses and surcharges are not sharable with states. Defence is mentioned under items 1 and 7 in the Union List of the Seventh Schedule as follows:

"1. *Defence of India and every part thereof including preparation for defence and all such acts as may be conducive in times of war to its prosecution and after its termination to effective demobilisation.*

7. Industries declared by Parliament by law to be necessary for the purpose of defence or for the prosecution of war."

Internal security, on the other hand, does not appear anywhere in the three lists. Its wider interpretation may have a linkage with entries 1 and 2 of the State List as follows:

"*1. Public order (but not including the use of any naval, military or air force or any other armed force of the Union or of any other force subject to the control of the Union or of any contingent or unit thereof in aid of the civil power).*

2. Police (including railway and village police) subject to the provisions of entry 2A of List I."

However, since it is not mentioned anywhere in the lists, internal security can be considered as belonging to the union government as a residual item under Clause 97 of the Union List.

Further, under Article 355 relating to emergency provisions it is mentioned, "*it shall be the duty of the Union to protect every state against external aggression and internal disturbance and to ensure that the government of every state is carried on in accordance with the provisions of this Constitution*".

Thus, in terms of constitutional provisions, the subject of defence and internal security together may be considered as pertaining to the unUJHion government. However, internal security is a matter where the cooperation of states may be frequently required.

Defence and internal security as pure public good

From the viewpoint of economic theory, defence and internal security can be considered as examples of pure public good, satisfying the criteria of non-excludability and non-rivalry in consumption or use. As such, individual consumers cannot be excluded from the benefit of the service of defence and internal security provided by the government. The property of non-rivalry means that the consumption of the concerned good or service by one

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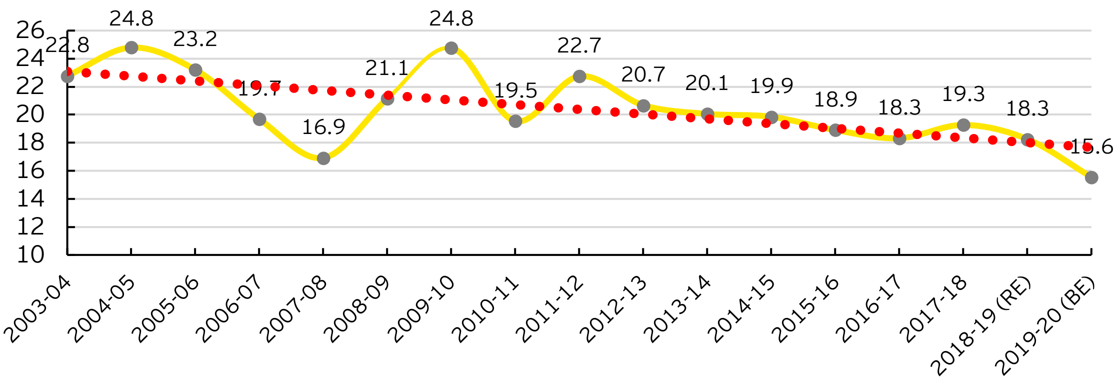
[33] As per PIB press release dated 27 November 2019 the Union Cabinet approved a) submission of the first report for year FY21 and b) extension of the tenure of the FFC to 30th October 2020 to submit the final report with recommendations covering the award period FY22 to FY26

individual does not reduce its availability for another. This happens for jointly consumed goods or services. Such services should be financed by taxation. If it is a subject belonging to the union government alone, then it should be financed by a tax listed under the Union List. However, after the 80th amendment to the Constitution, there is no union tax except the taxes listed under articles 268, 269 and 269A that are not sharable with the states. The relevant share(s) of the shareable taxes are required to be decided on the basis of recommendations of the FC. The main exception to this rule is cesses and surcharges. Surcharges can be levied as an additional levy on a mother tax. Cesses can also be so levied. However, they should be earmarked for a specific purpose. Proceeds of cesses and surcharges are not sharable with the states and the divisible pool is determined after excluding the proceeds from cesses and surcharges.

Since defence and internal security expenditure is a large expenditure, financing it through a cess would imply excluding a large amount from the divisible pool. Further, the additional ToR number 9A does not mention financing of these expenditures. Rather, it talks about a funding mechanism implying that the Commission may consider whether a 'Defence and Internal Security Fund' should be created and if so, whether it should be permanent and non-lapsable or for a finite period. Once a fund is created, the Commission may also consider whether it should be financed through a distinct cess or directly from the divisible pool by earmarking a proportion of the pool for such expenditure. In the discussions preceding the issuance of the ToR, the term "Rashtriya Suraksha Nidhi" has been referred to in various places[4]. It is also possible that the proposed fund may not necessarily cover all defence expenditures but only a portion of it, covering certain specified purposes.

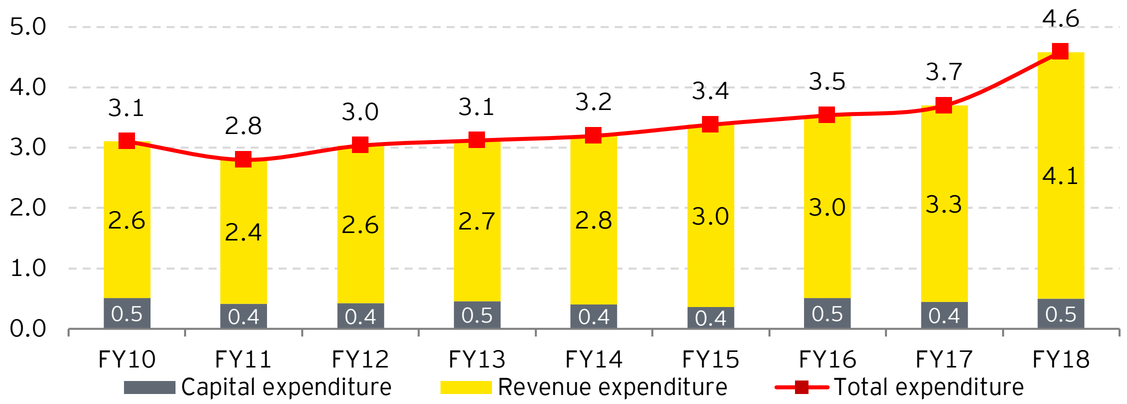
Chart 6: Center's defence expenditure relative to revenue receipts (net)



Source (basic data): Union budget documents of various years

We note that in the case of defence and internal security, historically, expenditure on defence relative to center's revenue receipts has been falling since 2004-05. As shown in Chart 6, from a peak of nearly 25% in 2004-05 and 2009-10, it has fallen to about 15.6% in 2019-20 (BE).

Chart 7: Center's expenditure on internal security (Police) relative to its total expenditure



Source (basic data): Union budget documents of various years

[4] Article titled '*Central funds to states may be cut to create internal security fund*', published on 23 September 2019 in The Economic Times; https://economictimes.indiatimes.com/news/defence/nk-singh-headed-finance-commission-working-on-proposal-cabinet-cleared-enabling-approvals-on-july-17/articleshow/70384389.cms

On the other hand, the share of centre's expenditure on internal security, particularly revenue expenditure, has been steadily increasing (Chart 7).

Precedence of National Calamity Contingency Fund

In the history of FC recommendation-based funding mechanisms, there is only one instance that is comparable. This relates to the funding of expenditure relating to natural calamities. This fund is called National Calamity Contingency Fund (NCCF), which was created on the basis of the recommendations of the Eleventh FC. The commission had also recommended its financing mechanism in the form of a cess, called as National Calamity Contingency Cess. However, the union and state governments can spend on natural calamities beyond the finances that becomes available through this fund. The considerations that led to the creation of the fund include:

1. **Inadequacy of normal budgetary allocation:** such a fund may be justified for expenditure heads where normal budgetary allocation turns out to be much lesser than the needed expenditures. Historically, it has been seen that neither the union government nor the state governments have been able to allocate reasonable expenditures for preventing, dealing with and mitigating the consequences of natural calamities.
2. **Unanticipated shocks subject to expenditure shocks:** the relevant expenditure head may be subject to unanticipated shocks due to external or sudden turn of events such as natural calamities like earthquakes, floods, droughts, etc. In situations like these, large expenditure requirements arise.
3. **Shared responsibility of center and states:** the introduction of a cess to finance specified expenditures levied over a union tax necessarily means reduction of the divisible pool for the states under the present constitutional arrangements. Such cesses can be better justified if in order to deal with the unexpected events, both central and the sub-national governments are involved, which is the case with natural calamities.
4. **Constant replenishment of funds:** the expenditure head should be such that there should be an immediate replenishment of funds as soon as they get withdrawn. This is the nature of contingency funds.
5. **Non-lapsable nature of need:** a cess is an appropriate mechanism for keeping a fund to ensure that the allocated amounts do not lapse and cannot be redistributed to other expenditure heads at the time of the closure of financial year. In case of natural calamities, it was considered justified to create a non-lapsable fund as the effects of a calamity may last for several years and the related expenditures may need to be incurred for an existing need without the requirement of annual parliamentary approvals, year after year.

In the case of defence and internal security, it is easily seen that these conditions are met to different degrees. In the case of defence, there are unanticipated shocks that arise from time to time due to the imposition of wars and conflicts arising from external sources. It is also difficult to anticipate the expenditure requirements when such shocks arise.

In terms of internal security, joint involvement of center and states may be of considerable practical value and therefore, some of the spending from the proposed fund may be through the state governments.

Lapsability is also a significant issue in the case of defence expenditures, particularly for defence capital expenditure, where due to various procedural rigidities the allocated budgeted expenditures remain unspent and eventually may be released for other ministries. There may thus be a case for creating a non-lapsable funding mechanism for expenditure on defence and internal security. However, there is no need for such a fund to meet all the requirements of defence and internal security. Some expenditures can easily be kept out, such as defence pensions and possibly defence salaries. Such fund may be most relevant for purchase and maintenance of defence goods, particularly the defence capital goods, and for development, research and innovation. Table 3 shows that it is mostly defence capital expenditure, where actuals tend to be lower than the budgeted amount.

Table 3: Defence capital and revenue expenditure: BE viz.-à-viz. actuals

Fiscal year	Defence capital expenditure			Defence revenue expenditure		
	Actual (INR crore)	BE (INR crore)	Actual to BE (%)	Actual (INR crore)	BE (INR crore)	Actual to BE (in %)
FY04	16863	20953	80.5	43203	44347	97.4
FY05	31994	33483	95.6	43862	43517	100.8
FY06	32338	34375	94.1	48211	48625	99.1
FY07	33828	37458	90.3	51682	51542	100.3
FY08	37462	41922	89.4	54219	54078	100.3
FY09	40918	48007	85.2	73305	57593	127.3

Fiscal year	Defence capital expenditure			Defence revenue expenditure		
	Actual (INR crore)	BE (INR crore)	Actual to BE (%)	Actual (INR crore)	BE (INR crore)	Actual to BE (in %)
FY10	51112	54824	93.2	90669	86879	104.4
FY11	62056	60000	103.4	92061	87344	105.4
FY12	67902	69199	98.1	103011	95216	108.2
FY13	70499	79579	88.6	111277	113828	97.8
FY14	79125	86741	91.2	124374	116931	106.4
FY15	81887	94588	86.6	136807	134412	101.8
FY16	79958	94588	84.5	145937	152139	95.9
FY17	86371	86340	100.0	165410	162759	101.6
FY18	90445	86529	104.5	186129	175861	105.8

Source (basic data): Union budget documents of various years

As Table 4 shows, most capital expenditure is incurred on machinery and equipment including aircrafts that are mainly imported. Their purchases are made from external providers and the purchase process is characterized by various constraints and rigidities. A non-lapsable fund might be quite useful in this context.

Table 4: Structure of defence capital expenditure

Components of defence capex	2016-17	2017-18	2016-17	2017-18
	INR crore		Share in total (%)	
Land	394	727	0.5	0.8
Construction	8,264	7,571	9.6	8.4
Aircrafts and aeroengines	23,892	29,924	27.7	33.1
Heavy and medium vehicles	2,538	2,376	2.9	2.6
Other equipment	29,794	28,383	34.5	31.4
Other capital expenditure*	21,476	21,458	24.9	23.7
Total	**86,357**	**90,438**	100.0	100.0

Source: Union budget documents, *including naval fleet, naval dockyard/projects, research and development

Separate treatment of defence and internal security to overcome issues of asymmetry

Carving out one expenditure head from the items listed in the Union List of the Seventh Schedule for special treatment does create issues of asymmetry in relation to other central government responsibilities as well as the states. The allocation of funds for any expenditure head is the responsibility of the central government who can make the necessary allocation from within its share of the divisible pool and other non-sharable resources such as non-tax revenues. Center's expenditures are also financed by borrowing and non-debt capital receipts. The central government can also create any fund for defence and internal security from within its own resources without asking the Finance Commission's consideration of the matter. If the Finance Commission considers the matter where a direct or indirect reduction of resources allocated to the states is involved, the Finance Commission should ask for supplementary memoranda from the states on this matter.

II. Reorganization of Jammu and Kashmir

The J&KRA 2019, which was enacted on 9 August 2019[5] has significant implications for the vertical and horizontal dimensions of fiscal transfers. Pursuant to the act, J&K has been made a UT with legislature and Ladakh as a UT without legislature. This reduced the number of Indian states from 29 to 28 and increased the UTs in India from seven to nine. The number of UTs with legislature will now have J&K in addition to Delhi and Puducherry. UTs without legislatures will increase from the existing five to six by the addition of Ladakh. One of the additional ToR is related to J&KRA, 2019.

Historically, in per capita terms, J&K has been the recipient of relatively large per capita transfers. As shown in Table 5, during the period FY16 to FY18, larger transfers were given to J&K through the grants channel.

Table 5: Per capital transfers (INR) of actual devolution and statutory grants under 14 FC period: J&K, Bihar and UP

Fiscal year	J&K	Bihar	UP	Ratio of Bihar's per capita transfer to J&K's per capita transfer (%)	Ratio of UP's per capita transfer to J&K's per capita transfer (%)
Per capita actual devolution (INR)					
FY16	6,093	4,574	4,439	75.1	72.9

[5] The bill was passed in Rajya Sabha on 5 August 2019 and passed in Lok Sabha on 6 August 2019 and assented to by the President of India on 9 August 2019

Fiscal year	J&K	Bihar	UP	Ratio of Bihar's per capita transfer to J&K's per capita transfer (%)	Ratio of UP's per capita transfer to J&K's per capita transfer (%)
FY17	7,005	5,233	5,081	74.7	72.5
FY18	8,655	5,679	5,516	65.6	63.7
FY19	9,665	6,074	5,903	62.8	61.1
FY20	10,505	6,565	6,383	62.5	60.8
Per capita actual statutory grants (INR)					
FY16	7,633	257	203	3.4	2.7
FY17	7,986	317	354	4.0	4.4
FY18	8,575	351	401	4.1	4.7
FY19	1,149	458	463	39.9	40.3
FY20	1,392	603	642	43.4	46.1
Per capita fiscal transfers (INR)					
FY16	13,727	4,831	4,642	35.2	33.8
FY17	14,991	5,549	5,435	37.0	36.3
FY18	17,230	6,030	5,917	35.0	34.3
FY19	10,814	6,532	6,366	60.4	58.9
FY20	11,897	7,168	7,025	60.3	59.0

Source (basic data): Union budget documents, various years, 14 FC Report

The FFC according to the J&KRA, 2019 will be given an additional ToR as per Clause 83 which is detailed below.

"83. (1) The award made by the Fourteenth Finance Commission to the existing State of Jammu and Kashmir shall be apportioned between the successor Union territory of Jammu and Kashmir; and Union territory of Ladakh by the Central Government on the basis of population ratio and other parameters:

Provided that on the appointed day, the President shall make a reference to the Union Territories Finance Commission to take into account the resources available to the successor Union territory of Ladakh and make separate award for the successor Union territory of Ladakh:

Provided that on the appointed day, the President shall make a reference to the Fifteenth Finance Commission to include Union territory of Jammu and Kashmir in its Terms of Reference and make award for the successor Union territory of Jammu and Kashmir.

(2) Notwithstanding anything in sub-section (1), the Central Government may, having regard to the resources available to the successor Union territory of Ladakh make appropriate grants and also ensure that adequate benefits and incentives in the form of special development package are given to the backward areas of this region."

In view of these changes, the vertical dimension of fiscal transfers will require a reconsideration since aggregate needs of states would now pertain to 28 states. So far, the requirements of UTs have been considered as part of the center's requirements and an assessment of their needs should be a part of the center's memorandum to the FFC. However, depending upon the language of the additional ToR given to the FFC, the FC can determine the way in which J&K's fiscal needs may be considered. In the case of horizontal dimension of fiscal transfers, fiscal needs and requirements of inter-se equity across states may have to be considered for 28 states and the central government may take a view on the special needs of J&K as well as Ladakh.

Treatment of UTs as states: constitutional and legal considerations

The constitutional and legal basis for treating the UTs at par with the states for the purpose of Article 280 of the Constitution was well-summarized in the communication from the member-secretary of the 11 FC to the Ministry of Home Affairs. The salient points of this communication are reiterated below.

Article 1 of the Constitution deals with the name and territory of the union. The states and the territories are as specified in the First Schedule. The First Schedule of the Constitution of India relating to the states includes both states as well as UTs.

Under Article 367, the General Clauses Act, 1897, apply for interpretation of the Constitution. Section 3(58) of the General Clauses Act, 1897 defines a State as follows:

"3(58) State - as respects any period before the commencement of the Constitution (Seventh Amendment) Act, 1956, shall mean a Part A State, a Part B State or a Part C State; and as respects any period after

*such commencement, shall mean a State specified in the First Schedule to the Constitution and **shall include a Union territory**";*

The term "states" includes "union territories" has been confirmed in the Supreme Court's judgements AIR 1970 SC 1126 and AIR 1976 SC 1856. The Supreme Court has held that the President adopted the General Clauses Act, 1897, by giving a new definition of the state. The new definition appropriate to the purpose applied to the interpretation of the Constitution.

As per the Supreme Court's decision as reported in 1254 SC 586, **union territories are not part of the central government nor do they get merged with it**. They are separate entities and are governed under Part VIII of the Constitution (Articles 239 to 241).

The principle of equality under Article 14 of every citizen whether he is living in the territory of a state or a union territory shall be applicable, in such circumstances.

Under Article 239, Parliament is entitled to make laws in respect of UTs. (Even local legislatures therein cannot be created by Parliament under Article 240). In an area where law is not made by the Parliament, President administers through an administrator. For the purpose of grants under Article 275, authority is given to the Parliament, but until a provision is made by Parliament, the President exercises that power. However, the rider is that if FC is constituted, President shall make the order, after considering its recommendations. Thus, Finance Commission's note for devolution Under Article 275 with respect to union territories cannot be obviated. Here union territories would mean "states" as per Section 3(58) of the General Clauses Act,1897[6].

Application of 73rd and 74th amendments to the Constitution

While considering transfers from the states to local bodies within the state, the Constitution treats UTs at par with states.

Para IX of the Constitution of India dealing with the panchayats and Para IX(A) of the Constitution of India dealing with the municipalities have been made applicable to the UTs distinctly under Article 243L and Article 243ZB of the Constitution. As per para 3(c) and 3(d) of the ToR, the FC is duty bound to deal with the panchayats and municipalities, respectively, of the UTs also in view of the special provisions made in Article 243 L and 243 ZB.

Part IX: The Panchayats

243L. Application to Union territories*: The provisions of this Part shall apply to the Union territories and shall, in their application to a Union territory, have effect as if the references to the Governor of a State were references to the Administrator of the Union territory appointed under article 239 and references to the Legislature or the legislative Assembly of a State were references, in relation to a Union territory having a Legislative Assembly, to that Legislative Assembly:*

Provided that the President may, by public notification, direct that the provisions of this Part shall apply to any Union territory or part thereof subject to such exceptions and modifications as he may specify in the notification.

PART IXA-THE MUNICIPALITIES

243ZB. Application to Union territories*—The provisions of this Part shall apply to the Union territories and shall, in their application to a Union territory, have effect as if the references to the Governor of a State were references to the Administrator of the Union territory appointed under article 239 and references to the Legislature or the Legislative Assembly of a State were references in relation to a Union territory having a Legislative Assembly, to that Legislative Assembly:*

[6] https://indiacode.nic.in/handle/123456789/2328?locale=en accessed on 15 November 2019

Provided that the President may, by public notification, direct that the provisions of this Part shall apply to any Union territory or part thereof subject to such exceptions and modifications as he may specify in the notification.

GST and the UTs with legislatures

While implementing the Goods and Services Tax (GST), the Constitution has treated UTs with legislature at par with the states. Article 246A (1) of the Constitution (One Hundred and First Amendment) Act, 2016 states that *notwithstanding anything contained in articles 246 and 254, Parliament, and, subject to clause (2), the Legislature of every* ***State****, have power to make laws with respect to goods and services tax imposed by the Union or by such State*. Further in Article 366, Clause 26B is inserted. This clause states that ***"State" with reference to articles 246A, 268, 269, 269A and article 279A*** *(GST-related Articles)* ***includes a Union territory with Legislature***. Thus, UTs with legislature, including J&K, are to be treated at par with other states of India with respect to the GST, specifically in terms of transfer of IGST revenues and the GST compensation cess.

Asymmetry between J&K, Ladakh, Puducherry and Delhi

J&K, as a UT with legislature becomes comparable with Delhi and Puducherry which are also UTs with legislature. The J&KRA, 2019 provides that the FFC should include the union territory of J&K in its ToR and make an award for it. This would be asymmetric if a similar award is not made to Delhi and Puducherry. It may be important to ensure a symmetric treatment of the states within the group of states and the UTs with legislature within the group of UTs with legislature. There may be a justification for treating UTs with legislature on par with the states in the matter of distribution of center's tax revenues among states both on constitutional grounds and the needs of the citizens of these UTs with legislature. However, this matter may be further examined by the concerned central ministries including home and finance.

Summary

Both the subjects of defence and internal security funding mechanism and the formation of J&K and Ladakh as UTs have significant implications for the vertical and horizontal dimensions of fiscal transfers. In summary, we may note the following points:

1. Expenditure on defense and internal security is potentially subject to unanticipated expenditure requirements. Normal budgetary allocations for defence has fallen over time relative to center's revenue receipts. Further, there is a need to ensure that budgetary allocation for defence, particularly to meet its capital expenditure needs may not lapse. For these purposes, it may be useful to create a separate defence and internal security fund. However, in doing so, it may be ensured that the allocation of center's resources for the states are not reduced.
2. With the reorganization of J&K under the J&KRA, 2019 the FFC will have to recast its methodology for determining vertical and horizontal dimensions of resource transfers to the subnational governments in view of the fact that the total number of states has been reduced to 28. However, UTs with legislature, for all practical purposes including transfers to local bodies and the implementation of GST, have been treated on par with states. Further, J&K's status as a UT may only be temporary. At the same time, there is a need to ensure symmetry of treatment for all UTs with legislature.

The report of the FFC is keenly awaited in view of these salient changes as also because of the revenue trends of central taxes for FY20 which have shown a growth rate of only 1.5% in 1HFY20. Earlier, the FFC's term was extended by one month from 30 October 2019 to 30 November 2019[7]. It has now been extended to 30 October 2020 and the period of award has also been extended by one year[8]. The first report of the Commission may become available shortly since its recommendations will provide salient inputs for the formulation of the FY21 budgets of the union, state as well as the UT governments.

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[7]https://fincomindia.nic.in/writereaddata/html_en_files/fincom15/others/Notification%20dated%2029.07.2019.pdf

[8] As per the press release dated 27 November 2019 the Union Cabinet approved a) submission of the first report for the first fiscal year FY21 and b) extension of the tenure of the FFC to 30th October 2020 to submit the final report with recommendations covering the award period FY22 to FY26; https://pib.gov.in/PressReleseDetail.aspx?PRID=1593654

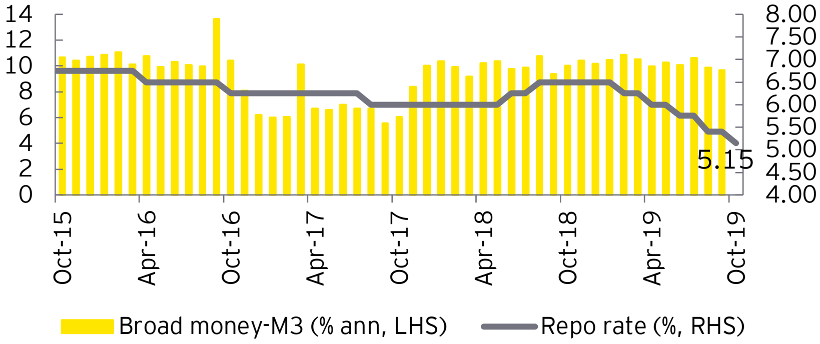
6. Money and finance: credit growth fell to a 23-month low in September 2019

A. Monetary sector

Monetary policy

- Earlier, in its October 2019 monetary policy review, the RBI for the fifth consecutive time lowered its policy repo rate to 5.15%, thereby taking the cumulated rate reduction to 135 basis points during this calendar year.
- However, the transmission of lower repo rate to lending rates continued to remain staggered and incomplete. In its October 2019 policy statement, the RBI noted that "as against the cumulative policy repo rate reduction of 110 basis points during February-August 2019, the weighted average lending rate (WALR) on fresh rupee loans of commercial banks declined by only 29 basis points. However, the WALR on outstanding rupee loans increased by 7 bps during the same period".

Chart 8: Growth in broad money and movements in repo rate



Source: Database on Indian Economy, RBI

Transmission of lower repo rate to lending rates continued to remain fractional.

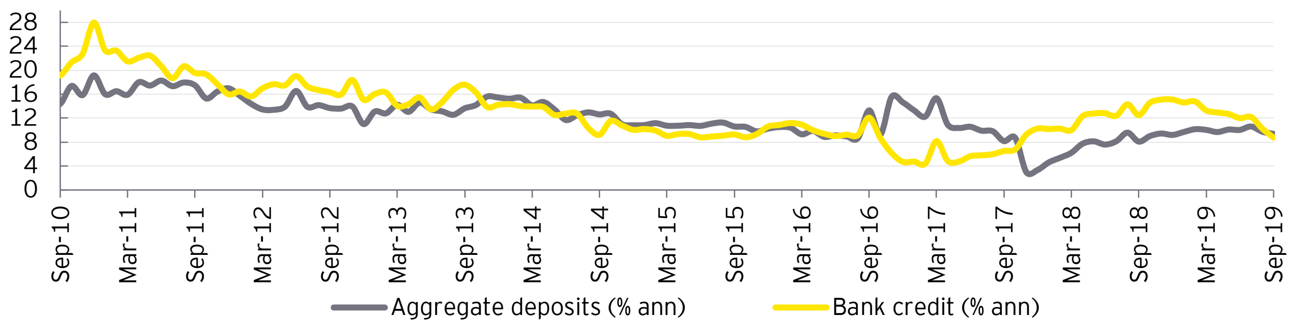
Money stock

- Growth in broad money stock (M3) fell to a 12-month low of 9.6% in September 2019 from 9.8% in August 2019 (**Chart 8**). Growth in time deposits, accounting for nearly 76% of M3, remained at 9.3% in September 2019, as seen in August 2019.
- Narrow money (M1) growth slowed for the second consecutive month to 10.8% in September 2019 from 11.8% in August 2019. This was due to a lower growth in demand deposits which fell to a nine-month low of 7.2% in September 2019 as compared to 10.3% in August 2019. Growth of currency in circulation increased to 13.6% in September 2019 from 12.9% in August 2019.

Aggregate credit and deposits

- Growth in bank credit fell to a 23-month low of 8.7% in September 2019 from 10.2% in August 2019 (**Chart 9**). From its recent peak of 14.9% in 3QFY19, growth in bank credit fell every subsequent quarter to a six-quarter low of 10.4% in 2QFY20 as compared 12.6% in 1QFY20. This is indicative of the weakening demand in the economy.

Chart 9: Growth in credit and deposits



Source: Database on Indian Economy, RBI

- Growth in non-food credit also fell for the second consecutive month to 8.1% in September 2019, its lowest level since October 2017, as compared to 9.8% in August 2019 owing to a sharp fall in credit to industries and services sectors.
- Growth in credit to services fell sharply to a two-year low of 7.3% in September 2019 from 13.3% in August 2019 while credit to industries fell to a 13-month low of 2.7% in September 2019 from 3.9% in August 2019. Growth in credit to agricultural sector increased marginally to 7.0% in September 2019 from 6.8% in August 2019.
- Growth in housing sector credit increased to 19.9% in September 2019 from 16.6% in August 2019.
- Growth in aggregate bank deposits fell further to 9.4% in September 2019 from 9.7% in August 2019.

B. Financial sector

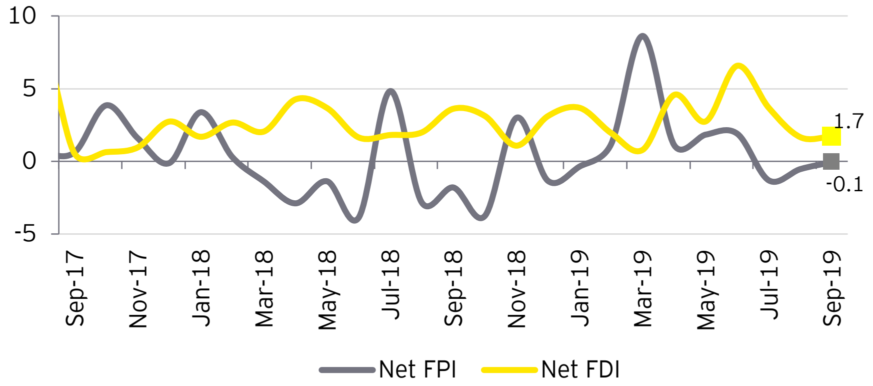
Interest rates

- Interest rates offered by commercial banks on term deposits with a maturity of more than one year was lowered for the fifth consecutive month to average at 6.61% in October 2019, (ranging between 6.25% and 6.96%), as compared to 6.65% in September 2019.
- Commercial banks lowered the marginal cost of lending rate (MCLR) for the fourth successive month to 7.96% (average) in October 2019 as compared to 8.08% in September 2019.
- The average yield on 10-year government securities fell by 28 basis points to 6.54% in October 2019 from 6.82% in September 2019. This was partly due to a reduction in the policy repo rate by the RBI and partly owing to a sustained surplus liquidity in the banking system. However, heightened concerns over the center's finances, particularly the likelihood of a short fall in revenues together with the possibility of additional market borrowing by the center in the remaining part of the fiscal year may have limited the fall in yields.

FDI and FPI

- As per the provisional data released by the RBI on 11 November 2019, the overall foreign investment inflows (FIIs) increased to US$1.6 billion in September 2019 from US$1.1 billion (revised) in August 2019 due to the sustained level of net FDI inflows and lower net FPI outflows during the month.

Chart 10: Net FDI and FPI inflows (US$ billion)



Net FDI inflows stood at US$1.7 billion in September 2019, similar to the level seen in August 2019. However, in 2QFY20 net FDI inflows were lower at US$7.0 billion as compared to US$13.9 billion in 1QFY20.

Source: Database on Indian Economy, RBI

- Net FDI inflows were low but stable at US$1.7 billion in September 2019, similar to the level seen in August 2019. (**Chart 10**). Gross FDI inflows were, however, higher at US$4.2 billion in September 2019 as compared to US$3.9 billion (revised) in August 2019.
- Net portfolio investment outflows were lower for the third consecutive month at US$0.1 billion as compared to US$0.5 billion in August 2019.

7. Trade and CAB: merchandise imports contracted sharply by (-) 16.3% in October 2019

A. CAB: Current account deficit (CAD) expanded to 2.0% of GDP in 1QFY20

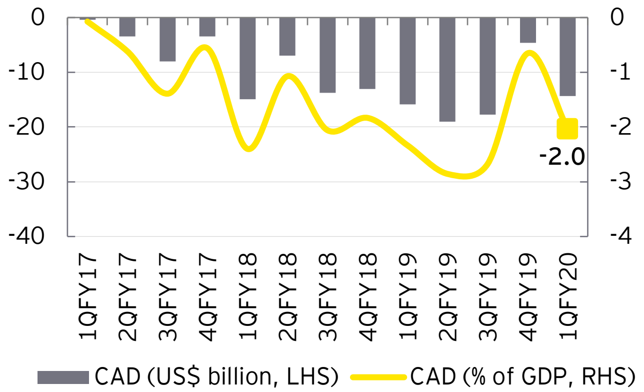
- CAD in 1QFY20 broadened to 2.0% from an eight-quarter low of 0.7% in 4QFY19 as merchandise trade deficit widened to 6.6% of GDP from 4.9% during the same period (**Table 6**). Merchandise imports increased to 18.3% of GDP in 1QFY20 from 17.2% in 4QFY19 while merchandise exports fell to 11.8% of GDP from 12.3% over the same period. Net service exports also fell to a four-quarter low of 2.8% of GDP in 1QFY20 from 3.0% in 4QFY19. Net transfers, however, improved to 2.6% of GDP from 2.3% over this period.

Table 6: Components of CAB in US$ billion

	CAB	CAB as a % of nominal GDP	Goods account net	Services account net
FY16	-22.2	-1.1	-130.1	69.7
FY17	-15.3	-0.7	-112.4	67.5
FY18	-48.7	-1.8	-160.0	77.6
FY19	-57.3	-2.1	-180.3	81.9
2QFY19	-19.1	-2.9	-50.0	20.3
3QFY19	-17.8	-2.7	-49.3	21.7
4QFY19	-4.6	-0.7	-35.2	21.3
1QFY20	**-14.3**	**-2.0**	**-46.2**	**20.0**

Source: Database on Indian Economy, RBI;
Note: (-) deficit; (+) surplus

Chart 11: CAD



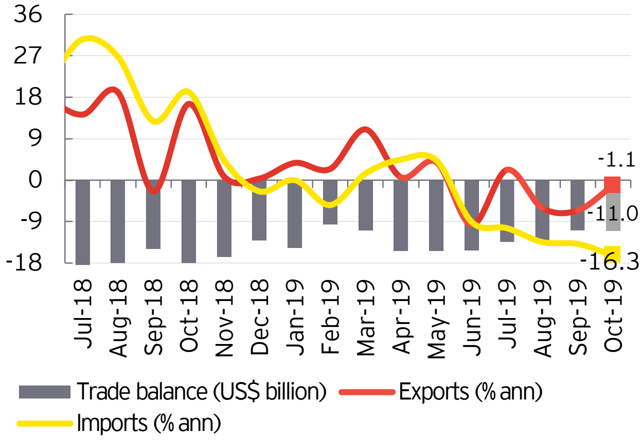
Source: Database on Indian Economy, RBI

B. Merchandise trade and exchange rate

Merchandise imports contracted for the fifth successive month by (-) 16.3% while merchandise exports contracted for the third successive month by (-) 1.1% in October 2019.

- Merchandise exports contracted for the third consecutive month by (-) 1.1% in October 2019, but at a lesser pace as compared to (-) 6.6% in September 2019 (**Chart 12**), led by a sustained fall in oil exports.

Chart 12: Developments in merchandise trade



Source: Ministry of Commerce and Industry, GoI

- The pace of contraction in oil exports remained high at (-) 14.6% in October 2019 as compared to (-) 18.6% in September 2019. Growth in engineering goods exports turned positive at 1.2% in October 2019 from a contraction of (-) 6.2% in September 2019.
- The pace of contraction in imports accelerated to a 39-month high of (-) 16.3% in October 2019 from (-) 13.8% in September 2019, driven primarily by a fall in imports of petroleum products, electrical and non-electrical machinery, and electronic goods.
- The pace of contraction in oil imports increased to (-) 31.7% in October from (-) 18.3% in September 2019.
- Imports excluding oil, gold and jewelry contracted for the third successive month by (-) 9.5% in October 2019 as compared to (-) 8.0% in September 2019, thus confirming a slowdown in demand.
- Out of the 30 broad sectors for which exports and imports data is provided, 18 and 22 sectors, respectively, experienced a contraction in October 2019.
- Merchandise trade deficit remained low at US$11 billion in October as compared to US$10.9 billion in September 2019 due to a sharper and sustained contraction in imports.
- The Indian Rupee appreciated marginally to INR71.1 per US$ (average) in October 2019 from INR71.3 per US$ in September 2019.

Home

8. Global growth: projected at 3% in 2019 to be the weakest since 2009

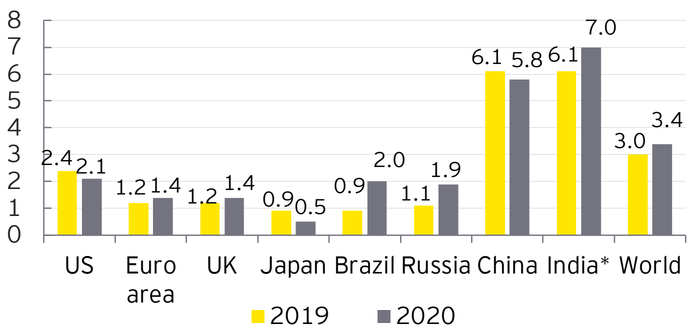
A. Global growth outlook

- The IMF (World Economic Outlook, October 2019) projected global growth at 3% in 2019, weakest since 2009, owing to weak trade and industrial production. Growth is projected to pick up to 3.4% in 2020 due to continued macroeconomic support in advanced economies (AEs) and projected stabilization in some stressed emerging market and developing economies (EMDEs).
- In AEs, growth is forecasted to ease to 1.7% in both 2019 and 2020, a downward revision of 0.1% points for 2019. Growth in EMDEs was also revised down by 0.5% points and 0.2% points to 3.9% and 4.6% in 2019 and 2020, respectively.
- Growth in the US is projected at 2.4% in 2019, moderating to 2.1% in 2020. Stimulus from recently adopted two-year budget deal is expected to offset the fading effects of the 2017 Tax Cuts and Jobs Act.
- In the Euro area, growth is projected to be low at 1.2% in 2019 and improve to 1.4% in 2020. External demand is projected to recover in 2020 and temporary factors such as new emission standards that had adversely impacted the German car production are expected to fade.

The IMF projected global growth at 3% in 2019, weakest since 2009. It is expected to recover to 3% in 2020.

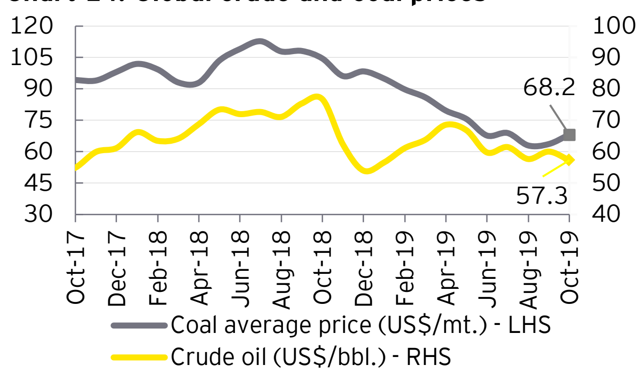
- Growth in Japan is forecasted at 0.9% in 2019, moderating to 0.5% in 2020 due to continued weakness in the external sector and anticipated decline in private consumption which was as a result of the recent increase in the consumption tax rate.
- Growth in China was revised downwards by 0.2% points and 0.3% points to 6.1% and 5.8% in 2019 and 2020, respectively. Escalating tariffs and weak external demands are expected to exacerbate the slowdown.
- Growth in India was revised down by 1.2% points to 6.1% in 2019 due to weaker than expected outlook for domestic demand. Growth is expected to increase to 7% in 2020 supported largely by lagged effects of monetary policy easing and a recent reduction in CIT rates.

Chart 13: Global growth projections



Source: IMF World Economic Outlook, October 2019
*data pertains to fiscal year

Chart 14: Global crude and coal prices



Source (basic data): World Bank, Pink Sheet, November 2019

B. Global energy prices: World Bank revised down its global crude price projection in 2019 and 2020, reflecting a global growth slowdown

- Average global crude price[9] fell to a five-month low of US$57.3/bbl. in October 2019 from US$60/ bbl. in September 2019 as Saudi Arabia's supply was fully restored post the disruption in October 2019. The World Bank, in its October 2019 issue of the Commodity Markets Outlook, revised down its projection of global crude oil prices to US$60/bbl. in 2019 and US$58/bbl. in 2020, reflecting a global growth slowdown.
- Average global coal price[10] increased to US$ 68.2/mt. in October 2019 from US$63.7/mt. in September 2019. The World Bank lowered its projection for global coal price to US$79/mt. in 2019 and US$71/mt. in 2020 due to a reduced consumption as a result of an ongoing shift to reduce emissions and industrial slowdown.

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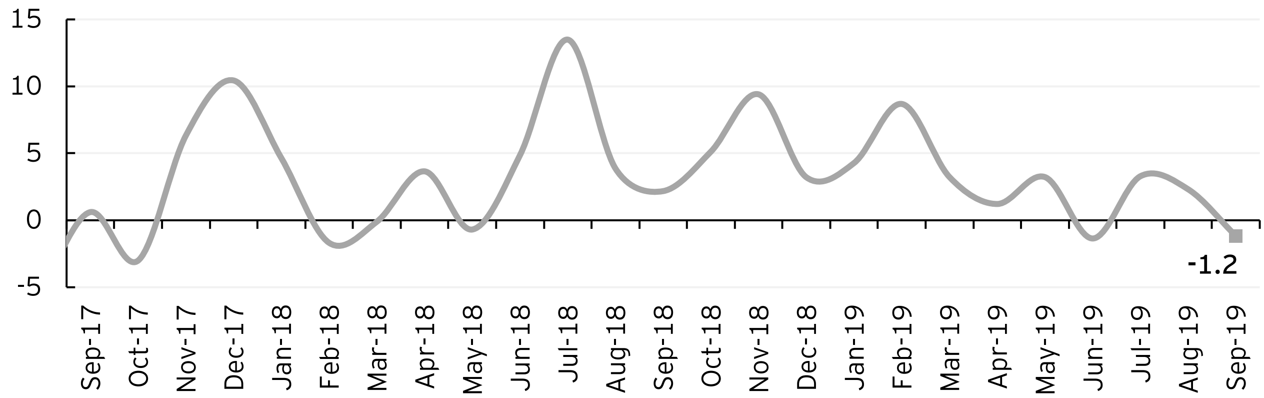
[9] Simple average of three spot prices, namely, Dated Brent, West Texas Intermediate and Dubai Fateh
[10] Simple average of Australian and South African coal prices

9. Index of aggregate demand (IAD): contracted for the second time during this fiscal year

Pointing to weaker demand conditions, IAD contracted by (-) 1.2% in September 2019

- An IAD has been developed by EY 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 non-seasonally adjusted terms, tracing the demand conditions in these sectors. Demand conditions in the agricultural sector have been captured by movements in monthly agricultural credit off-take.
- On an y-o-y basis, the index of aggregate demand contracted by (-) 1.2% in September 2019 as compared to a growth of 2.3% in August 2019 **(**Error! Reference source not found.**)**, owing to a sharp contraction in the demand conditions in services sector.
- Demand conditions in manufacturing sector continued to remain subdued while that in agricultural sector improved marginally in September 2019.

Chart 15: Growth in IAD (y-o-y)



Source (Basic data): RBI, MoSPI and EY estimate

Table 7: IAD

Month	Jan-19	Feb-19	Mar-19	Apr-19	May-19	Jun-19	Jul-19	Aug-19	Sep-19
IAD	126.9	129.3	128.1	126.7	126.1	127.1	129.8	124.6	124.1
Growth (% y-o-y)	4.3	8.7	3.2	1.2	3.2	-1.4	3.3	2.3	-1.2
Growth in agr. credit	7.6	7.5	7.9	7.9	7.8	8.7	6.8	6.8	7.0
Mfg. PMI**	2.7	4.4	2.2	1.7	3.1	1.7	1.8	1.3	1.4
Ser. PMI**	1.9	2.8	2.3	1.4	-0.3	1.1	4.4	-0.7	-1.9

**Values here indicate deviation from 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 non-seasonally adjusted.
Source (Basic data): IHS Markit PMI, RBI and EY estimates.

10. Capturing macro-fiscal trends: data appendix

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

Fiscal year/quarter/ month	IIP	Mining	Manufacturing	Electricity	Core IIP	Fiscal year/quarter/ month	PMI mfg.	PMI ser.
	% change y-o-y							
FY 16	3.3	4.3	2.9	5.7	3.0	FY 16	51.3	51.7
FY 17	4.6	5.3	4.3	5.8	4.8	FY 17	51.6	51.0
FY 18	4.4	2.3	4.7	5.3	4.3	FY 18	51.5	50.0
FY 19	3.8	2.8	3.8	5.2	4.4	FY 19	52.8	52.2
3Q FY19	3.7	2.8	3.4	6.9	3.4	3Q FY19	53.4	53.0
4Q FY19	1.5	2.2	1.4	1.5	3.3	4Q FY19	53.6	52.2
1Q FY20	3.0	3.0	2.4	7.3	3.2	1Q FY20	52.2	50.3
2Q FY20	-0.4	-1.2	-0.4	0.4	-1.0	2Q FY20	51.8	51.6
Jun-19	1.3	1.5	0.3	8.6	0.7	Jul-19	52.5	53.8
Jul-19	4.6	4.8	4.5	4.8	2.7	Aug-19	51.4	52.4
Aug-19	-1.4	0.0	-1.6	-0.9	-0.5	Sep-19	51.4	48.7
Sep-19	-4.3	-8.5	-3.9	-2.6	-5.2	Oct-19	50.6	49.2

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

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

Fiscal year/quarter/month	CPI	Food Price Index	Fuel and light	Core CPI	WPI	Food Price Index	Mfg. products	Fuel and power	Core WPI
	% change y-o-y				% change y-o-y				
FY16	4.9	4.9	5.3	4.9	-3.7	1.2	-1.8	-19.7	-1.8
FY17	4.5	4.2	3.3	4.9	1.7	5.9	1.3	-0.3	-0.1
FY18	3.6	1.8	6.2	4.6	2.9	1.9	2.7	8.2	3.0
FY19	3.4	0.1	5.7	5.5	4.3	0.6	3.7	11.5	4.2
3Q FY19	2.6	-2.0	6.7	5.6	4.5	-0.9	4.1	13.9	4.8
4Q FY19	2.5	-0.9	1.9	5.0	2.9	3.0	2.4	2.7	2.7
1Q FY20	3.1	1.7	2.4	4.1	2.7	5.1	1.5	1.2	1.4
2Q FY20	3.5	3.5	-1.4	4.1	0.9	5.6	-0.1	-4.8	-0.5
Jul-19	3.1	2.4	-0.3	4.2	1.2	4.9	0.3	-3.6	0.0
Aug-19	3.3	3.0	-1.7	4.1	1.2	5.9	0.0	-3.5	-0.4
Sep-19	4.0	5.1	-2.2	4.0	0.3	6.0	-0.4	-7.1	-1.1
Oct-19	4.6	7.9	-2.0	3.2	0.2	7.6	-0.8	-8.3	-1.7

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

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

Fiscal year/month	Gross tax revenue	Corporate tax	Income tax	Direct taxes*	Indirect taxes**	Fiscal deficit	Revenue deficit
						% of GDP	% of GDP
FY16	17.0	6.0	8.5	6.9	30.1	3.9	2.5
FY 17	17.9	6.7	21.5	12.3	21.6	3.5	2.1
FY 18	11.8	17.8	19.9	18.6	6.0	3.5	2.6
FY19 (CGA actuals over FY18 actuals)	8.4	16.2	7.2	12.3	2.5	3.4	2.3
FY20 (BE over CGA actuals)	18.3	15.4	23.3	18.6	19.8	3.3	2.2
	Cumulated growth (%, y-o-y)					% of budgeted target	
Feb-19	7.9	15.4	14.2	14.9	3.3	134.2	158.1
Mar-19	8.4	16.2	13.1	14.9	2.9	101.7	108.4
Apr-19	6.9	59.3	16.3	24.3	-3.4	22.3	26.6
May-19	0.2	-51.6	15.0	12.1	-4.0	52.0	66.3
Jun-19	1.4	6.3	12.3	9.7	-4.0	61.4	77.1
Jul-19	6.6	5.5	6.0	5.8	7.3	77.8	94.2
Aug-19	4.2	4.6	13.2	9.6	0.6	78.7	89.9
Sep-19	1.5	2.3	8.9	5.2	-2.0	92.6	99.9

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 estimates FY20

Fiscal year/month	CGST	UTGST	IGST	GST compensation cess	Total GST (center)
	INR crore				
FY 2019 (RE)	5,03,900	-	50,000	90,000	6,43,900
FY 2020 (BE)	5,26,000	-	28,000	1,09,343	6,63,343
Monthly tax collection (INR crore)					
Feb-19	35,908	105	4,453	8,173	48,639
Mar-19	46,191	584	2,340	8,175	57,290
Apr-19	46,848	171	-564	8,874	55,329
May-19	34,557	154	7,195	7,713	49,619
Jun-19	35,400	188	4,039	8,026	47,653
Jul-19	24,095	197	25,250	8,183	57,725
Aug-19	68,545	117	-46,098	6,822	29,386
Sep-19	38,132	482	-3,650	7,148	42,112

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

Note: IGST revenues are subject to final settlement.

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

Fiscal year/month	Repo rate (end of period)	Fiscal year/ quarter/ month	M1	M3	Bank credit	Agg. deposits	Net FDI	Net FPI	Fiscal year/quarter/month	10-year govt. bond yield	FX reserves
	%		% change y-o-y				US$ billion			%	US$ billion
Nov-18	6.50	FY16	13.5	10.1	9.7	10.5	36.0	-4.1	FY16	7.7	355.6
Dec-18	6.50	FY17	3.1	10.1	7.9	11.6	35.6	7.6	FY17	7.0	370.0
Jan-19	6.50	FY18	21.8	9.2	7.5	7.5	30.3	22.1	FY18	7.0	424.4
Feb-19	6.25	FY19	13.6	10.5	13.7	8.9	30.7	-0.6	FY19	7.7	411.9
Mar-19	6.25	3Q FY19	13.6	10.2	14.9	9.2	7.3	-2.1	3Q FY19	7.7	393.4
Apr-19	6.00	4Q FY19	13.6	10.5	14.2	10.0	6.4	9.4	4Q FY19	7.4	411.9
May-19	6.00	1Q FY20	11.3	10.1	12.6	9.9	13.9	4.8	1Q FY20	7.2	427.7
Jun-19	5.75	2Q FY20	10.8	9.6	10.4	9.9	7.0	-1.9	2Q FY20	6.7	433.6
Jul-19	5.75	Jun-19	11.3	10.1	12.0	10.0	6.6	1.9	Jul-19	6.6	429.6
Aug-19	5.40	Jul-19	13.2	10.6	12.2	10.6	3.7	-1.3	Aug-19	6.6	428.6
Sep-19	5.40	Aug-19	11.8	9.8	10.2	9.7	1.7	-0.5	Sep-19	6.8	433.6
Oct-19	5.15	Sep-19	10.8	9.6	8.7	9.4	1.7	-0.1	Oct-19	6.5	442.6

Source: Database on Indian Economy - RBI

Table A5: External trade and global growth

External trade indicators (annual, quarterly and monthly growth rates)							Global growth (annual)			
Fiscal year/quarter/month	Exports	Imports	Trade balance	Ex. rate (avg.)	Crude prices (avg.)	Coal prices (avg.)	Calendar year	World GDP	Adv. econ.	Emer. econ.
	% change y-o-y		US$ billion	INR/US$	US$/bbl.	US$/mt		% change y-o-y		
FY16	-15.6	-15.2	-117.7	65.5	46.0	54.7	2013	3.5	1.4	5.1
FY17	5.1	0.9	-108.2	67.1	47.9	73.0	2014	3.6	2.1	4.7
FY18	10.6	20.9	-159.0	64.5	55.7	90.8	2015	3.4	2.3	4.3
FY19	8.6	10.0	-179.4	69.9	67.3	100.4	2016	3.4	1.7	4.6
3Q FY19	5.3	6.6	-47.8	72.1	64.3	99.7	2017	3.8	2.5	4.8
4Q FY19	6.0	-1.2	-35.2	70.5	60.5	90.2	2018	3.6	2.3	4.5
1Q FY20	-1.7	-0.3	-46.0	69.5	65.1	74.3	2019*	3.0	1.7	3.9
2Q FY20	-3.6	-12.6	-37.7	70.4	59.7	65.2	2020*	3.4	1.7	4.7
Jul-19	2.2	-10.4	-13.4	68.8	61.5	68.9	2021*	3.6	1.6	4.6
Aug-19	-6.0	-13.4	-13.5	71.1	57.7	63.0	2022*	3.6	1.6	4.8
Sep-19	-6.6	-13.8	-10.9	71.3	60.0	63.7	2023*	3.6	1.5	4.8
Oct-19	-1.1	-16.3	-11.0	71.0	57.3	68.2	2024*	3.6	1.6	4.8

Source: Database on Indian Economy - RBI, Pink Sheet - World Bank and IMF World Economic Outlook, October 2019; *Indicates projections as per October 2019 database.

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
FY16#	8.0	0.6	10.1	13.1	4.7	3.6	10.2	10.7	6.1	1.2
FY17	7.9	6.3	9.5	7.9	10.0	6.1	7.7	8.7	9.2	2.7
FY18	6.9	5.0	5.1	5.9	8.6	5.6	7.8	6.2	11.9	3.9
FY19 (PE)*	6.6	2.9	1.3	6.9	7.0	8.7	6.9	7.4	8.6	4.2
1QFY18	5.9	4.2	2.9	-1.7	8.6	3.3	8.3	7.8	14.8	3.2
2QFY18	6.6	4.5	10.8	7.1	9.2	4.8	8.3	4.8	8.8	3.8
3QFY18	7.3	4.6	4.5	8.6	7.5	8.0	8.3	6.8	9.2	4.7
4QFY18	7.9	6.5	3.8	9.5	9.2	6.4	6.4	5.5	15.2	3.8
1QFY19	7.7	5.1	0.4	12.1	6.7	9.6	7.8	6.5	7.5	4.6
2QFY19	6.9	4.9	-2.2	6.9	8.7	8.5	6.9	7.0	8.6	4.8
3QFY19	6.3	2.8	1.8	6.4	8.3	9.7	6.9	7.2	7.5	3.8
4QFY19	5.7	0.5	4.5	2.6	4.3	7.1	6.0	9.5	10.7	3.6
1QFY20	4.9	2.0	2.7	0.6	8.6	5.7	7.1	5.9	8.5	2.9

Source: National Accounts Statistics, MoSPI
*Growth numbers for FY19 (PE) are calculated over the revised estimates for FY18 as per the NAS released by MoSPI on 31 May 2019
Growth numbers are based on the revised estimates of NAS released by MoSPI on 31 January 2019

Fiscal year/quarter	Expenditure components						IPD inflation
	GDP	PFCE	GFCE	GFCF	EX	IM	GDP
FY16	8.0	7.9	7.5	6.5	-5.6	-5.9	2.3
FY17	8.2	8.2	5.8	8.3	5.1	4.4	3.1
FY18	7.2	7.4	15.0	9.3	4.7	17.6	3.8
FY19 (PE)*	6.8	8.1	9.2	10.0	12.5	15.4	4.1
1QFY18	6.0	10.1	21.9	3.9	4.9	23.9	4.4
2QFY18	6.8	6.0	7.6	9.3	5.8	15.0	4.3
3QFY18	7.7	5.0	10.8	12.2	5.3	15.8	3.6
4QFY18	8.1	8.8	21.1	11.8	2.8	16.2	3.1
1QFY19	8.0	7.3	6.6	13.3	10.2	11.0	4.3
2QFY19	7.0	9.8	10.9	11.8	12.7	22.9	4.7
3QFY19	6.6	8.1	6.5	11.7	16.7	14.5	4.1
4QFY19	5.8	7.2	13.1	3.6	10.6	13.3	3.4
1QFY20	5.0	3.1	8.8	4.0	5.7	4.2	2.8

Source: National Accounts Statistics, MoSPI
*Growth numbers for FY19 (PE) are calculated over the revised estimates for FY18 as per the NAS released by MoSPI on 31 May 2019
Growth numbers are based on the revised estimates of NAS released by MoSPI on 31 January 2019

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	CPSE	central public-sector enterprise
15	CSO	Central Statistical Organization
16	Disc.	Discrepancies
17	ECBs	external commercial borrowings
18	EIA	US Energy Information Administration
19	Elec.	electricity, gas, water supply and other utility services
20	EMDEs	Emerging Market and Developing Economies
21	EXP	Exports
22	FAE	first advanced estimates
23	FC	Finance Commission
24	FII	foreign investment inflows
25	Fin.	financial, real estate and professional services
26	FPI	foreign portfolio investment
27	FRBMA	Fiscal Responsibility and Budget Management Act
28	FY	fiscal year (April–March)
29	GDP	Gross Domestic Product
30	GFCE	government final consumption expenditure
31	GFCF	gross fixed capital formation
32	GoI	Government of India
33	GST	Goods and Services Tax
34	GVA	gross value added
35	IAD	Index of Aggregate Demand

36	IBE	interim budget estimates
37	ICRIER	Indian Council for Research on International Economic Relations
38	IEA	International Energy Agency
39	IGST	Integrated Goods and Services Tax
40	IIP	Index of Industrial Production
41	IMF	International Monetary Fund
42	IMI	Index of Macro Imbalance
43	IMP	Imports
44	INR	Indian Rupee
45	IPD	implicit price deflator
46	J&KRA	Jammu and Kashmir Reorganization Act
47	MCLR	marginal cost of funds-based lending rate
48	Ming.	mining and quarrying
49	Mfg.	manufacturing
50	m-o-m	month-on-month
51	mt	metric ton
52	MoSPI	Ministry of Statistics and Programme Implementation
53	MPC	Monetary Policy Committee
54	NEXP	net exports (exports minus imports of goods and services)
55	NPA	Non-performing assets
56	NCLT	National company law tribunal
57	OECD	Organisation for Economic Co-operation and Development
58	OPEC	Organization of the Petroleum Exporting Countries
59	PFCE	private final consumption expenditure
60	PIT	personal income tax
61	PMI	Purchasing Managers' Index (reference value = 50)
62	RE	revised estimates
63	RBI	Reserve Bank of India
64	RCEP	Regional comprehensive economic partnership
65	SLR	Statutory Liquidity Ratio
66	Trans.	trade, hotels, transport, communication and services related to broadcasting
67	US$	US Dollar
68	UTGST	Union Territory Goods and Services Tax
69	UT	union territory
70	WPI	Wholesale Price Index
71	y-o-y	year-on-year
72	1HFY20	first half of fiscal year 2019-20, i.e., April 2019-September 2019

Our offices

Ahmedabad
22nd Floor, B Wing, Privilon,
Ambli BRT Road, Behind Iskcon
Temple, Off SG Highway,
Ahmedabad - 380 015
Tel: + 91 79 6608 3800

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

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

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

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

Delhi NCR
Golf View Corporate Tower B
Sector 42, Sector Road
Gurgaon - 122 002
Tel: + 91 124 443 4000

3rd & 6th Floor, Worldmark-1
IGI Airport Hospitality District
Aerocity, New Delhi - 110 037
Tel: + 91 11 4731 8000

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

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

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

Kochi
9th Floor, ABAD Nucleus
NH-49, Maradu PO
Kochi - 682 304
Tel: + 91 484 433 4000

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

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

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

Pune
C-401, 4th floor
Panchshil Tech Park
Yerwada
(Near Don Bosco School)
Pune - 411 006
Tel: + 91 20 4912 6000

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