Economy Watch

Monitoring India's macro-fiscal performance

October 2019

Building a better working world

Contents

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

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Highlights

1. IIP growth at (-)1.1% in August 2019 showed a contraction in industrial output for the first time in 26 months.
2. PMI also signaled a stagnation in manufacturing and a contraction in services in September 2019.
3. CPI inflation increased to 4.0% in September 2019 mainly due to rising vegetable prices.
4. WPI inflation fell to 0.3% in September 2019 from 1.1% in August 2019.
5. As per the CGA, center's gross taxes during April-August FY20 grew by 4.2%, the lowest growth observed since FY10.
6. After contracting until July 2019, growth in center's capital expenditure turned positive during the first five months of FY20. However, at 3% during April-August FY20, it remained much lower than 20.6% in the corresponding period of FY19.
7. Growth in bank credit fell to a 17-month low of 10.2% in August 2019 as compared to 12.2% in July 2019.
8. Merchandise exports contracted for the third time in four months by (-) 6.6% in September 2019 as compared to (-) 6.0% in August 2019.
9. Net FDI inflows were at a seven-month low of US$1.8 billion in August 2019 as compared to US$3.7 billion in July 2019.
10. CAD in 1QFY20 broadened to 2.0% from an eight-quarter low of 0.7% in 4QFY19.
11. The IMF has also revised down its global growth projections to 3% in 2019 and 3.4% in 2020.
12. Both OECD and IMF have revised downwards, India's growth forecast for FY20 to 5.9% and 6.1%, respectively.

Foreword

Waiting for recovery: two-sided policy push

Multiple multilateral agencies have revised down their global growth forecasts for 2019 and 2020. The latest in this series of revisions is the IMF which projected global growth at 3% in 2019 and 3.4% in 2020 and downward revisions of 0.2% points and 0.1% points, respectively. Earlier in September 2019, the OECD revised down the global growth forecast by 0.3% points and 0.4% points to 2.9% in 2019 and 3% in 2020, respectively. Most of these agencies cite weakening demand and ongoing trade conflicts between the US and other major economies as the reason for the sharp downward revisions.

Low demand is also the main driver behind the continued softening of global crude prices. Average global crude prices fell from US$65.1/bbl. in 1QFY20 to US$59.7/bbl. in 2QFY20. In spite of a short-term supply disruption due to an attack on Saudi Arabia's refineries, supply prospects have improved significantly since then. The strength of demand for oil will determine the short- to medium-term course of their prices. While this works in India's favor, the broad-based global and domestic demand slowdown also makes reversing India's economic slowdown more challenging.

India has experienced a continued slowdown since the previous growth peak of 8.2% in FY17. Growth fell to 7.2% in FY18, 6.8% in FY19 and is slated to fall to 6.1% in FY20, as per the RBI's October 2019 monetary policy review. The IMF also projected India's growth rate at 6.1% in 2019 (FY20) and 7% in 2020 (FY21), downward revisions of 0.9% points and 0.2% points, respectively, from their earlier estimates. Earlier, the OECD also revised down India's growth by 1.3% points and 1.1% points, respectively, to 5.9% in 2019 (FY20) and 6.3% in 2020 (FY21). Similarly, the World Bank (South Asia Economic Focus) forecasted India's GDP growth at 6% in 2019 (FY20) and 6.9% in 2020 (FY21). Although both monetary and fiscal policies have been used aggressively to reverse this economic slowdown, so far, an upturn has not become visible.
The government started its policy efforts in February 2019 with the RBI reducing the repo rate by 25 basis points from 6.5% to 6.25%. Since then, there have been four more repo rate reductions, providing a cumulative reduction of 135 basis points, bringing the repo rate down to 5.15%. However, according to RBI's own estimate, transmission has been limited to only about 29 basis points for fresh Rupee loans of commercial banks by August 2019* as compared to 75 basis points reduction in the policy rate over the same period.

The fiscal policy initiative started in earnest after the presentation of the central government's annual budget in July 2019. A series of stimulus measures were announced which included two major steps. The first related to export incentives introduced through a scheme of remission of duties/taxes on export products, replacing the Merchandise Exports from India Scheme (MEIS). After that, the corporate tax rates for domestic companies were sharply reduced whereby the basic rate was reduced to 22% and the effective rate was reduced to 25.17%. A number of analysts have estimated the impact of these fiscal stimuli measures on center's fiscal deficit. These estimates indicate a slippage in FY20 fiscal deficit, originally estimated at 3.3% of GDP, by margins ranging from 0.2% points of GDP (Bhattacharya, 2019) to 0.5% points of GDP (Barclays, 2019). Rangarajan and Srivastava's (2019) estimates discussed in the "In focus" section indicate a larger slippage of 0.7% points of GDP. Correspondingly, the states' fiscal deficit may also go up since the forgone revenues in center's taxes will need to be shared with the states. To the extent that the central and state governments attempt to reduce expenditure in order to keep slippage in fiscal deficit to a minimum, there would be a reduction in the net impact of the fiscal stimulus thereby delaying economic recovery.

High frequency data pertaining to IIP, PMI, bank credit and exports indicate a continued slowdown in 2QFY20. IIP contracted by (-) 1.1% in August 2019 from 4.6% in July 2019. PMI manufacturing remained unchanged from its August 2019 level at 51.4 while PMI services contracted to 48.7 in September 2019. Growth (y-o-y) in bank credit fell to a 17-month low of 10.2% in August 2019 as compared to 12.2% in July 2019. WPI inflation fell to 0.3% in September 2019 from 1.1% in August 2019. Both merchandise exports and imports contracted for the second successive month by (-) 6.6% and (-) 13.8%, respectively, in September 2019. There may be a seasonal upswing during October-November 2019 due to the festive season, but a sustained recovery may have to wait for a few more months.

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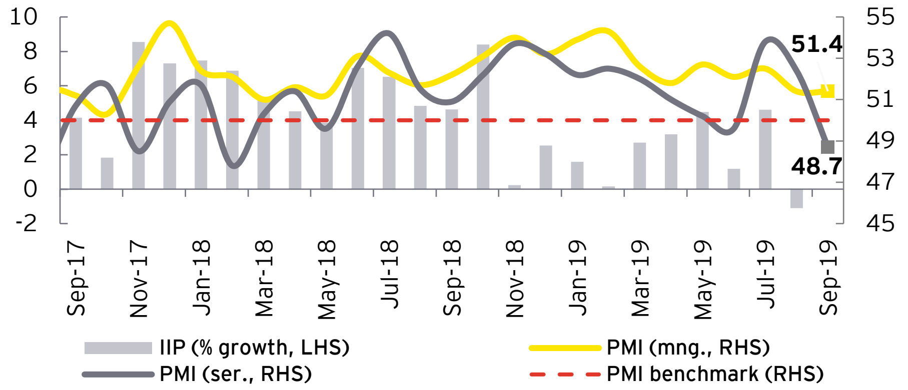
** October 2019 Monetary Policy Review Statement, RBI (released 4 October 2019)*

1. Growth: IIP contracted by (-) 1.1% in August 2019

A. IIP growth: contracted for the first time in 26-months

- Owing to underlying weakness across all sub-industries, IIP fell to its lowest level since November 2012, contracting by (-)1.1% in August 2019 as compared to a growth of 4.6% (revised) in July 2019 (**Chart 1**).
- Manufacturing sector output (accounting for 77.6% of overall IIP) contracted by (-)1.2% in August 2019 as compared to a growth of 4.5% (revised) in July 2019. Output of electricity declined for the first time since February 2013. It contracted by (-)0.9% in August 2019 as compared to a growth of 4.8% in July. Mining sector output's growth was at a five-month low of 0.1% in August 2019 (Table A1 in data appendix).
- Pointing to slackness in investment demand, output of capital goods industry contracted for the eighth consecutive month by (-) 21.0% in August 2019, its worst performance in the 2011-12 based IIP series. Output of consumer durables also contracted by (-)9.1% in August 2019 as compared to (-) 2.7% in July 2019.
- The output of eight core infrastructure industries contracted for the first time since April 2015 by (-) 0.5% (y-o-y) in August 2019 from 2.7% in July 2019 (revised). This was primarily due to a sharp contraction in the output of coal ((-) 8.6%), crude oil ((-) 5.4%), natural gas ((-) 3.9%), cement ((-) 4.9%) and electricity ((-) 2.9%) in August 2019.

Chart 1: IIP growth and PMI



IIP contracted for the first time in 26 months by (-)1.1% in August 2019 due to underlying weakness in all sub-industries.

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

B. PMI: signaled stagnation in manufacturing and contraction in services in September 2019

- Headline manufacturing PMI (seasonally adjusted (sa)) at 51.4 in September 2019, remained unchanged from August 2019 and at its joint-lowest reading since May 2018 (**Chart 1**). On a quarterly basis, PMI manufacturing averaged 51.8 in 2QFY20, its joint-weakest performance since 4QFY18.
- PMI services contracted to 48.7 in September 2019 from 52.4 in August 2019. This indicated the lowest reading since February 2018. On a quarterly basis, PMI services averaged 51.6 in 2QFY20 as compared to 50.3 in 1QFY20.

In September 2019, manufacturing PMI remained unchanged from the previous month at 51.4 while services PMI contracted to 48.7.

- Reflecting a contraction in services PMI and stagnation in manufacturing PMI, the composite PMI Output Index (sa) fell to a 19-month low of 49.8 in September 2019 from 52.6 in August 2019.

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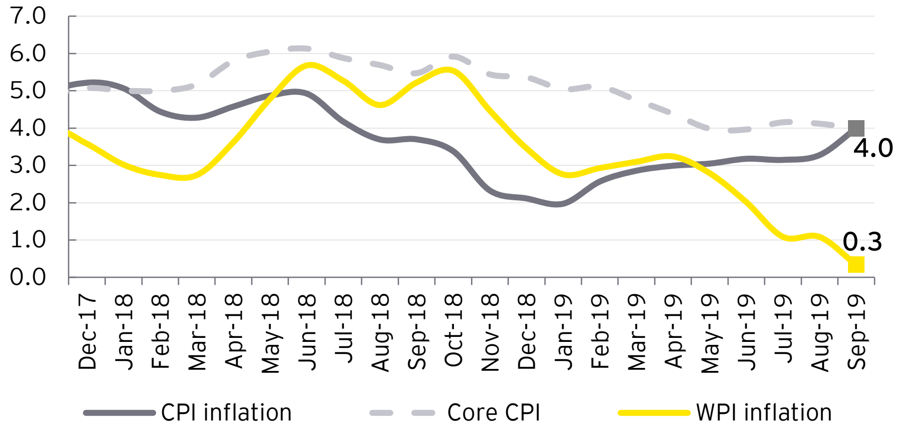
2. Inflation: CPI inflation increased to a 14-month high of 4.0% in September 2019

CPI inflation increased to 4.0% in September 2019 from 3.3% (y-o-y) in August 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.
- Fuel and light prices contracted for the third successive month, by (-) 2.2% in September as compared to (-) 1.7% in August 2019.
- Core CPI inflation[1] moderated to 4.0% in September, a 27-month low from 4.1% in August 2019.
- Inflation in transportation and communication services eased to a 47-month low of 0.1% in September 2019 from 1.2% in August 2019 due to a contraction in petrol prices by (-) 10.5% in September 2019. This was the tenth successive month of contraction in petrol prices.
- Inflation in clothing and footwear eased to an all-time low (2011-12 series) of 1.0% in September 2019, its fifteenth sequential fall, from 1.2% in August 2019.

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



CPI and WPI based inflation continued to diverge, increasing to 4.0% and dropping to 0.3%, respectively, in September 2019. This was mainly due to rising inflation in food (and beverages) which has a much larger weight in CPI (45.9%) than in WPI (15.3%).

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

WPI inflation fell to 0.3% in September 2019 from 1.1% in August 2019 (Chart 2)

- Contraction in prices of fuel and power accelerated to a 37-month high of (-) 7.1% in September 2019 from (-) 4.0% in August 2019. This was its fourth successive month of contraction. Contraction in prices of mineral oils increased to (-) 11.2% from (-) 6.9% over the same period.
- Contraction in prices of crude petroleum accelerated to a 43-month high of (-) 21.4% in September 2019 from (-) 14.6% in August 2019.
- Inflation in manufactured products fell for the 11th successive month to (-) 0.3% in September 2019 from 0% in August 2019 driven by contraction in prices of manufactured basic metals which increased to (-) 8.2% from (-) 6.1% over the same period.
- WPI core inflation fell to a 38-month low of (-) 1.1% in September 2019 from (-) 0.4% in August 2019.
- Food price index-based inflation increased to a three-year high of 6.0% in September 2019 from 5.8% in August 2019 as inflation in vegetables increased to 19.4% from 13.1% over the same period.

[1] 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.

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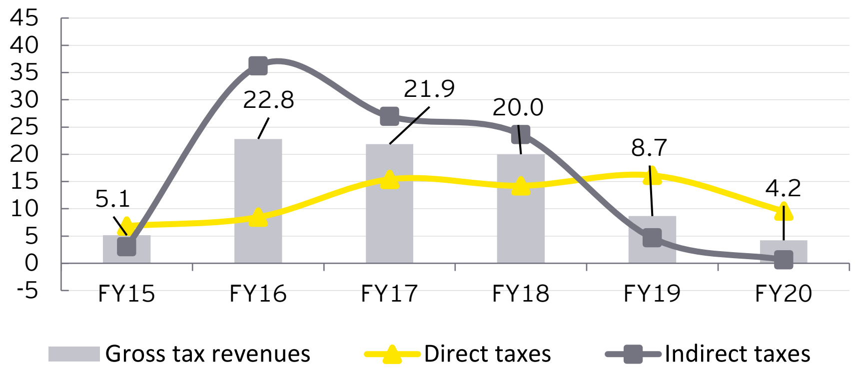
3. Fiscal performance: center's fiscal deficit during April-August FY20 stood at 78.7% of the budgeted target

A. Tax and non-tax revenues

- As per the Comptroller General of Accounts (CGA)[2], gross central taxes during April-August FY20 grew by 4.2% as compared to 8.7% during April-August FY19 (**Chart 3**). The cumulated growth in gross taxes during the first five 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.
- Gross central taxes during April-August FY20 stood at 26.8% of the annual budgeted target as compared to the corresponding figure of 27.9% in FY19.
- Direct tax revenues grew by 9.6% during April-August FY20, lower than 16.1% during the same period in FY19.
- Corporate tax revenues grew by 4.6% during the first five months of FY20 as compared to 14.3% during the corresponding period of FY19.
- Growth in income tax revenues during April-August FY20 was at 13.2% as compared to 17.5% during April-August FY19.
- Indirect taxes (comprising union excise duties, service tax, customs duty#, CGST, UTGST, IGST(2) and GST compensation cess) grew by only 0.6% during April-August FY20 which is the lowest in the last 10 years. Growth in the corresponding period of FY19 was 4.6%. The sharp fall in the growth of indirect taxes during the first five months of FY20 may be attributed to IGST refunds to the tune of INR46,098 crores in August 2019.

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



As per the CGA, center's gross taxes during April-August FY20 grew by 4.2% as compared to 8.7% during the corresponding period of FY19. The cumulated growth in gross taxes during the first five 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 center's gross tax revenues along with direct and indirect taxes; (4) Collections under customs for July 2017 also include INR21,377 crores on account of IGST on import/exports and compensation cess on imports/exports of INR609 crores for 2017-18.

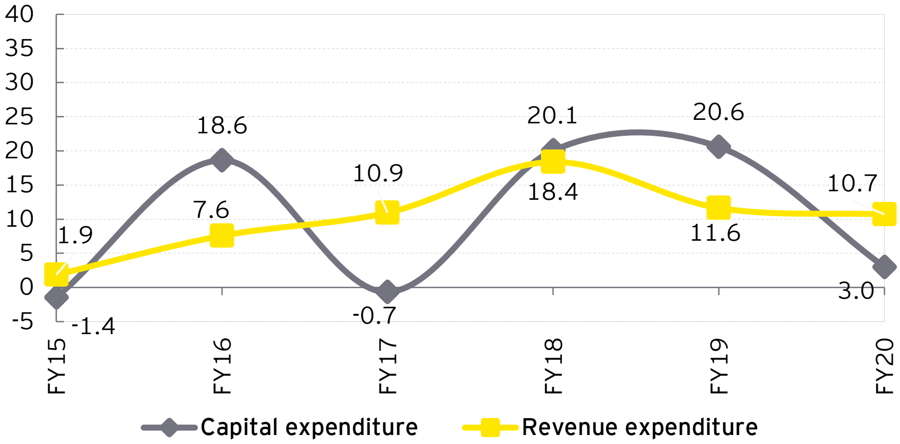
- The center's non-tax revenues showed a growth of 102% during April-August FY20 as compared to 42% during the corresponding period of FY19. This high growth during the first five months of FY20 is attributable to receipt of dividends and profits to the extent of INR1,49,859 crores in August 2019. This is largely on account of transfers by the RBI to the government based on the recommendations of the Bimal Jalan Committee.
- According to the latest data available as per the Department of Disinvestment, the disinvestment proceeds up to 23 July 2019 stood at INR12,357.49 crores, which is 11.7% of the FY20 target at INR105,000 crores.

[2] Monthly accounts for August 2019 released on 30 September 2019

B. Expenditures: revenue and capital

- Center's total expenditure during April-August FY20 grew by 9.8% as compared to 12.7% during April-August FY19 mainly due to subdued growth in capital expenditure during this period (**Chart 4**).
- Revenue expenditure during April-August FY20 grew by 10.7% as compared to 11.6% during the corresponding period of FY19. Revenue expenditure during April-August FY20 stood at 42.5% of the budgeted target as compared to 43.8% in the corresponding period of FY19.
- Center's capital expenditure during April-August FY20 witnessed a positive but low growth of 3%. Capex had shown a contraction of (-) 3.4% until July 2019. Growth in capital expenditure during April-August FY19 was much higher at 20.6%. As percentage of the FY20 budgeted target, capital expenditure during April-August FY20 stood at 40.2%, lower than the corresponding figure of 44% in FY19.

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



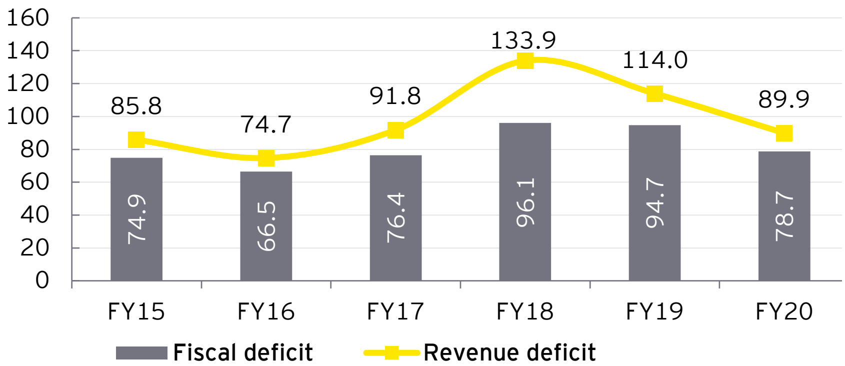
After contracting till July 2019, growth in center's capital expenditure turned positive during the first five months of FY20. However, at 3% during April-August FY20, it remained much lower than 20.6% in the corresponding period of FY19.

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

C. Fiscal imbalance

- Center's fiscal deficit during April-August FY20 stood at 78.7% of the annual budgeted target as compared to 94.7% in the corresponding period of FY19 **(Chart 5)**.
- Center's revenue deficit during the first five months of FY20 was at 89.9% of the annual budgeted target as compared to 114% during the corresponding period of FY19.

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



Center's fiscal deficit during April-August FY20 stood at 78.7% of the annual budgeted target while the corresponding ratio for revenue deficit stood at 89.9%.

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

4. India in a comparative perspective: status and prospects

Real GDP growth

Global growth at 3% in 2019 expected to be the weakest since 2009; broad-based weakening of growth in AEs with a more pronounced slowdown in EMDEs.

- Global growth is forecasted to fall to 3% in 2019, its weakest since 2009. This is attributable to weak trade and subdued industrial production. Growth is projected to pick up modestly to 3.4% in 2020 and 3.6% subsequently owing to continued policy support in AEs and projected stabilization in stressed EMEs.
- In the US, growth is projected at 2.4% in 2019 but moderate gradually thereafter reflecting an assumed shift in the fiscal stance from expansionary to neutral.
- Growth in the Euro area is projected at 1.2% in 2019 due to weaker growth in foreign demand and a drawdown of inventories. Growth is expected to pick up modestly thereafter as external demand recovers and temporary factors such as new emission standards which hit German car production, fade.
- Among the EMDEs, China's growth is projected to fall to 6.1% in 2019 and further to 5.8% in 2020 as escalating tariffs and weakening external demand are projected to accentuate the slowdown.
- India's growth was sharply revised down to 6.1% in 2019 reflecting a weak outlook for domestic demand. Growth is expected to recover to 7% in 2020 and 7.4% thereafter due to lagged effects of monetary policy easing, reduction in CIT rates, recent government measures to address corporate and environmental regulatory uncertainty and government programs to support rural consumption (Table 1).
- In Brazil, growth is projected to fall to 0.9% in 2019 due to mining supply disruptions, hurting economic activity. However, growth is projected to recover to 2.4% by 2021.

Table 1: Real GDP growth (% annual)

	2018	2019	2020	2021	2022	2023	2024
AEs	2.3	1.7	1.7	1.6	1.6	1.5	1.6
US	2.9	2.4	2.1	1.7	1.6	1.6	1.6
Euro area	1.9	1.2	1.4	1.4	1.4	1.3	1.3
Japan	0.8	0.9	0.5	0.5	0.5	0.5	0.5
EMDEs	4.5	3.9	4.6	4.8	4.8	4.8	4.8
Brazil	1.1	0.9	2.0	2.4	2.4	2.4	2.3
Russia	2.3	1.1	1.9	2.0	2.0	1.9	1.8
India*	6.8	6.1	7.0	7.4	7.4	7.4	7.3
China	6.6	6.1	5.8	5.9	5.7	5.6	5.5
World	3.6	3.0	3.4	3.6	3.6	3.6	3.6

Source (basic data): World Economic Outlook, IMF, October 2019
Note: forecasted for 2019 and beyond;
*data pertains to fiscal year. For example, data for 2019 pertains to the year FY20.

CPI inflation

Inflation in AEs is projected to gradually rise and stabilize at 2.0% by 2023; inflation in EMDEs is forecasted to gradually moderate from 2021 onwards and stabilize at 4.3%

- CPI-based inflation in AEs is forecasted to decline to 1.5% in 2019, consistent with softening of commodity prices and weakening growth. It is expected to gradually rise thereafter and stabilize at 2% by 2023 (Table 2).
- Inflation in the US is expected to remain within the medium-term target of 2% in 2019 but exceed thereafter.
- Inflation in EMDEs is expected to marginally fall in 2019.
- Inflation in the EMDEs is set to moderate to about 4.3% in 2023 and 2024 due to expected waning in pass-through from previous currency depreciations and moderation in inflation expectations which are projected to become better anchored around targets in some economies, including India.

Table 2: CPI inflation (%, annual)

	2018	2019	2020	2021	2022	2023	2024
AEs	2.0	1.5	1.8	1.8	1.9	2.0	2.0
US	2.4	1.8	2.3	2.4	2.3	2.3	2.3
Euro area	1.8	1.2	1.4	1.5	1.7	1.8	1.8
Japan	1.0	1.0	1.3	0.7	1.2	1.3	1.3
EMDEs	4.8	4.7	4.8	4.5	4.4	4.3	4.3
Brazil	3.7	3.8	3.5	3.8	3.6	3.5	3.5
Russia	2.9	4.7	3.5	3.9	4.0	4.0	4.0
India*	3.4	3.4	4.1	4.1	4.0	4.0	4.0
China	2.1	2.3	2.4	2.8	2.9	3.0	3.0
World	3.6	3.4	3.6	3.5	3.5	3.4	3.4

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

5. In focus - Landmark corporate income tax reforms: short-term revenue pain for long-term growth gain

Introduction

In order to fiscally stimulate the Indian economy, the central government adopted Corporate Income Tax (CIT) reforms announced on 20 September 2019 as its main vehicle. These reforms serve a twin purpose. First, by its very nature, it is a structural reform designed to increase productivity and profitability of companies in India by making them globally competitive. The CIT reforms were already initiated way back in FY16 Union Budget. Completion of these reforms was a medium-term objective. Second, these reforms also serve a short-term purpose since it puts additional purchasing power in the hands of domestic companies to stimulate the demand and reverse the economic slowdown.

These CIT reforms constitute a major milestone in India's long legacy of tax reforms aimed at lowering tax rates and broadening tax bases. The reforms relate to a reduction in the basic CIT rate applicable to domestic companies from 30% to 22% which translates into a reduction of nearly 10 basis points, when cesses and surcharges are included. For new investments in the manufacturing sector, the basic CIT rate was reduced from 25% to 15%, translating into a reduction of nearly 12 basis points taking into account the cesses and surcharges. Further, in order to provide relief to companies which continue to avail exemptions/incentives, the rate of Minimum Alternate Tax (MAT) was reduced from 18.5% to 15%. These rate reductions are effective from FY20[3]. While availing the option of reduced tax rates, the domestic companies will have to forego all other exemptions or incentives. A comparable rate reduction has not been provided for foreign companies operating in India.

Brief review of CIT reforms

Table 3 gives the statutory CIT rate inclusive of cesses and surcharges for domestic and foreign companies for the period AY91 to AY20. It can be observed that the CIT rate has broadly been brought down over time for both domestic and foreign companies. For domestic companies, the CIT statutory rate including cesses and surcharges peaked at 57.5% during AY92 to AY94. It was brought down to 46% in AY95 with a basic CIT rate of 40%. This was a result of the recommendations of the Chelliah Committee (early 90s) that suggested bringing down the statutory CIT rate from levels varying between 51.75%-57.5% to 45%. The statutory CIT rate was further reduced to 35% in AY98. Later, based on the recommendations by Shome Committee (2001) and Kelkar Committee (2002), the statutory CIT rate inclusive of cesses and surcharges was brought down to 33.7% with a basic rate of 30% in AY06. Since then, the basic CIT rate has remained at 30% and the center has varied the rates of cesses and surcharges leading to variations in the statutory CIT rate including cesses and surcharges. For foreign companies, the statutory CIT rate including cesses and surcharges was brought down from a high of 72.8% in AY94 to 41% in AY04. The basic CIT rate in AY04 was at 40% and it has remained at this level since. However, the volatility in the rates after AY04 has been due to varying rates of central cesses and surcharges.

Table 3: Statutory CIT rate inclusive of cesses and surcharges for domestic and foreign companies

Assessment year (AY)	CIT rate*: domestic companies	CIT rate*: foreign companies	Assessment year	CIT rate*: domestic companies	CIT rate*: foreign companies
AY91	40.00	65.00	AY06	33.66	41.82
AY92	57.50	65.00	AY07	33.66	41.82
AY93	57.50	65.00	AY08	33.99	42.23
AY94	57.50	72.80	AY09	33.99	42.23
AY95	46.00	55.00	AY10	33.99	42.23
AY96	46.00	55.00	AY11	33.22	42.23
AY97	46.00	55.00	AY12	32.45	42.23
AY98	35.00	48.00	AY13	32.45	42.02
AY99	35.00	48.00	AY14	33.99	42.02
AY00	38.50	48.00	AY15	33.99	43.26
AY01	38.50	48.00	AY16	33.99	43.26
AY02	35.70	48.00	AY17	34.61	43.26
AY03	36.75	42.00	AY18	34.61	43.26
AY04	35.88	41.00	AY19	34.94	43.26
AY05	36.59	41.82	AY20	25.17	43.26

Source (Basic data): Union budget documents, CBDT notifications, RBI; * Statutory rate inclusive of cesses and surcharges.

[3] https://pib.gov.in/PressReleseDetail.aspx?PRID=1585641

In FY16, the then finance minister announced that the basic CIT rate would be reduced to 25% as the rate of 30% was higher than those prevalent in other major Asian countries, making the Indian industry uncompetitive. However, this was attempted in incremental steps in the next four years. Table 4 shows the CIT rate reductions undertaken in a span of four years from FY17 to FY20. In FY20, when the turnover threshold for availing the lower CIT rate of 25% plus cesses and surcharges was enhanced to INR400 crores, it covered 99.3% of all companies in FY18. However, their cumulative share in income tax liability was estimated at close to 20%[4] (Table 5).

Table 4: Reform of corporate taxes

Union Budget	Reduced corporate tax rate	Turnover criteria for reduced CIT rate (in INR)
FY17	29% + surcharge and cess	Turnover < 5 crore
FY18	25% + surcharge and cess	Turnover < 50 crore
FY19	25% + surcharge and cess	Turnover < 250 crore
FY20	25% + surcharge and cess	Turnover < 400 crore

Source (Basic Data): Statement of Revenue Impact of Tax Incentives under the Central Tax System, Union Budge 2019-20; respective Union Budgets

Table 5: Income-wise share in tax liability

#	Level of profit before taxes (FY18) (in INR)	Cumulative share in total number of companies FY18 (%)	Cumulative share in income tax liability FY18 (%)	Effective tax rate FY18 (%)
1	Less than zero	43.1	1.3	0.0
2	zero	53.6	8.0	0.0
3	0-1 crore	94.6	10.4	26.4
4	1-10 crore	98.9	17.0	27.4
5.1	10-31.3 crore	99.3	22.0	29.1
5.2	31.3-50 crore	99.7	26.4	29.1
6	50-100 crore	99.8	31.6	28.4
7	100-500 crore	99.956	47.9	28.6
8	Greater than 500 crores	100.0	100.0	26.3
	All companies			29.5

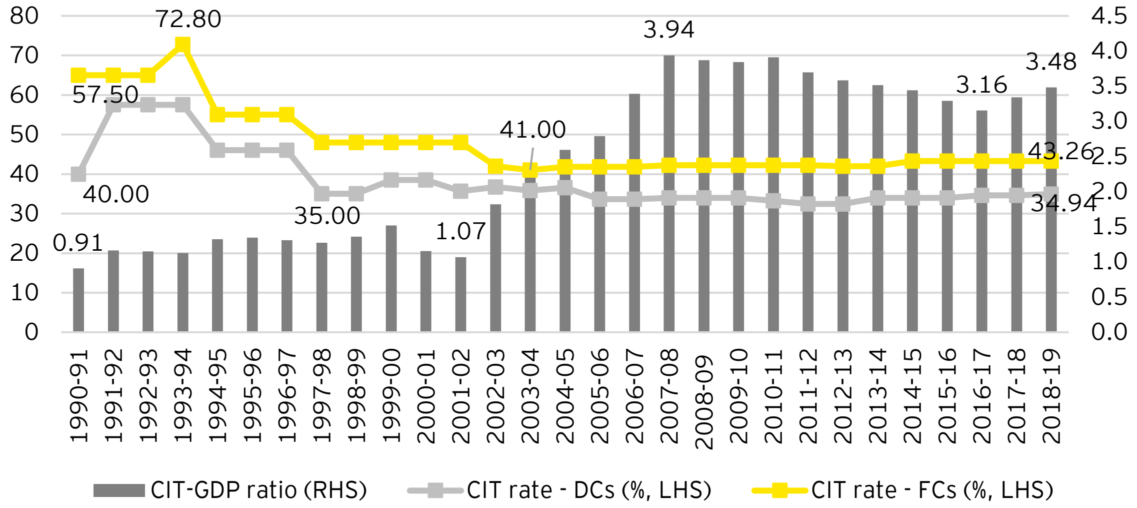
Source (Basic Data): Statement of Revenue Impact of Tax Incentives under the Central Tax System, Union Budge 2019-20; respective Union Budgets; EY estimates
Note: Based upon the assumption that profit before taxes are proportional to the turnover

In FY17 budget speech, the then finance minister had also announced a phasing out of various exemptions as the corporate tax was proposed to be lowered. These included an option for new manufacturing companies to be taxed at 25% plus surcharges and cesses, provided they did not claim profit-linked or investment-linked deductions, limiting the accelerated depreciation from 100% to 40% from April 2017 onward, and limiting the benefit of deductions for research from 200% to 150% from April 2017 onward and 100% from April 2020 onward. During this period, the center's revenue forgone as a proportion of CIT revenues also witnessed a decline from 17.8% in FY17 to 16.4% in FY18 and FY19.

While broadly analyzing the movement of CIT revenues relative to GDP and the statutory CIT rate inclusive of cesses and surcharges, it is evident that during the period FY91 to FY02, when the CIT rates for both domestic and foreign companies were relatively high, the CIT to GDP ratio averaged only 1.2% (Chart 6). Subsequently, as the rates were gradually brought down, starting with the reduction in statutory rate including cesses and surcharges on foreign companies to 42% in FY03 from 48% in FY02, the CIT revenues relative to GDP improved, reaching a peak of 3.9% in FY08. This was also the period when the Indian economy witnessed high GDP growth rates. It remained close to this level until FY11. However, post FY11, there was a gradual decline in the CIT to GDP ratio which reached a trough of 3.2% in FY17. This phase, showing a fall in CIT revenues relative to GDP, was accompanied by some increases in the CIT rate especially if we consider the changes in the rates of surcharge. Over a long period therefore, there is a broad indication of an inverse relationship between CIT rate and CIT revenues relative to the GDP. The fall in CIT revenues relative to GDP post FY11 is quite sharp. Noticeably during this period, the nominal GDP growth fell, which may have led to reduced profitability of companies. We examined the trend in nominal growth rate and the share of loss making and zero profit companies in total companies and found an inverse relationship between the two.

[4] Based upon the assumption that profit before taxes are proportional to the turnover

Chart 6: CIT revenue to GDP ratio and CIT rates



Source (Basic data): MoSPI, Union Budget documents, CBDT notifications, RBI; * CIT rate implies statutory rate inclusive of cesses and surcharges; DCs refer to domestic companies and FCs refer to foreign companies.

Analyzing the impact of FY20 CIT reforms

1. Identifying beneficiary vs. status quo companies

In order to assess the revenue impact of the CIT reforms, we need to distinguish between three broad groups of companies pertaining to domestic companies that are expected to gain from these reforms, domestic companies that continue with the existing rates, and foreign companies which also continue with the existing rates. In a recent analysis, *Rangarajan and Srivastava (2019)*[5] have called these three groups as beneficiary domestic companies (Group A), status quo domestic companies (Group B) and status quo foreign companies (Group C). Based on the available information from the revenue forgone statement for FY18 (FY20 Union Budget) covering 8,41,687 companies, Group A companies are those with an effective tax rate (ETR) above 25.17%. These companies are likely to take advantage of the lower rate. Group B companies have an ETR below 25.17%. They may prefer to continue with the existing rates while availing tax exemptions and/or deductions. Since there is no change in the tax rates applicable on foreign companies, they will continue to maintain status quo. Table 6 shows Group A companies have a relatively larger share in the total number of companies, total profit before tax and total tax revenue. Group B companies, on the other hand, account for only 2.6% in terms of number of companies. But their share in the tax base at 17.5% and tax paid at 12.4% is relatively larger.

Table 6: Beneficiary and status quo companies: share in tax and tax base

Group	Group's name	Share in number of companies (%)	Share in profit before tax (%)	Share in total tax revenues (%)	Effective tax rate (%)
A	Beneficiary domestic companies	93.2	74.3	76.7	30.4
B	Status quo domestic companies	2.6	17.5	12.4	20.9
C	Status quo foreign companies	4.2	8.3	11.0	39.1
		Number	INR crores	INR crores	%
	Total	8,41,687	15,18,224	4,47,744	29.5

Source: Statement of Revenue Impact of Tax Incentives under the Central Tax System: Financial Years 2017-18 and 2018-19 (Union Budget 2019-20)

Table 7 shows the composition of each company group in terms of the major sectors, their shares in group level profits, tax paid and their respective ETRs. In group A, manufacturing including pharmaceuticals, motor vehicles and engines have the highest share in total tax paid at 39.7% followed by financial intermediation activities

[5] "*The macro arithmetic of corporate tax cuts*", C. Rangarajan and D.K. Srivastava (published in Hindu Business Line on 4 October 2019); https://www.thehindubusinessline.com/opinion/the-macro-arithmetic-of-corporate-tax-cuts/article29586882.ece

including commercial loan activities at 18.0%. In Group B, manufacturing activities such as those of refined petroleum products together contribute 51.2% of the total tax paid with an ETR of 21.7%. Their share in the number of companies is however much smaller at 4.4%. In Group C, consisting mainly of foreign-owned companies, 66.4% of the total tax is contributed by commercial banks, saving banks and discount houses (financial intermediation sector).

Table 7: Group-wise shares of major sectors in total tax paid and effective tax rate

#	Major sectors	Share in group total			Effective tax rate
		No. of companies	Profit before tax	Total tax paid	
Group A					
1	Other services	24.4	7.7	8.8	34.7
2	Financial intermediation services	6.2	16.8	18.0	32.6
3	Manufacturing	16.5	40.8	39.7	29.6
4	Computer and related services	2.4	10.9	9.6	26.7
5	Residual	50.5	23.8	24.0	30.7
	Total	100.0	100.0	100.0	30.4
Group B					
1	Manufacturing	4.4	49.4	51.2	21.7
2	Electricity, gas and water	21.4	22.5	23.0	21.3
3	Mining and quarrying	0.9	22.4	19.9	18.6
4	Residual	73.3	5.7	5.9	21.5
	Total	100.0	100.0	100.0	20.9
Group C					
1	Financial intermediation services	0.6	64.5	66.4	40.3
2	Mining and quarrying	1.2	22.3	20.9	36.7
3	Residual	98.2	13.3	12.7	37.5
	Total	100.0	100.0	100.0	39.1

Source (Basic Data): Revenue impact of Tax Incentives under the Central Tax system, Receipts Budget, Union Budget 2019-20

2. *Impact on CIT revenues*

Rangarajan and Srivastava (2019) estimated the cost of this reform in terms of revenue foregone in FY20 using the distinction between the beneficiary and status quo groups. They reassessed the FY20 budget estimate of CIT revenues given at INR7,66,000 crore by using FY19 CGA actuals instead of revised estimates. The budgeted growth rate over CGA actuals at 15.4% (14.2% with respect to FY19 RE) also requires a downward adjustment due to the economic slowdown. Budget estimates for FY20 were based on a nominal GDP growth assumption of 12%. CIT revenues grew only by 4.6% in the first five months of FY20. CIT revenues have been reassessed assuming a nominal GDP growth at 10% and using a buoyancy of 1.2. The assumed buoyancy in FY20 (BE) with respect to FY19 (RE) was a little less than 1.2. The reassessed CIT revenue is estimated at INR7,43,201 crore (Table 8). This may be used to derive the revenue impact of the CIT reforms.

Using the proportion of tax revenues in FY18 for companies in Groups A, B, and C, the corresponding revenues may be estimated for FY20 at the old rates. Tax revenues divided by the ETR gives an estimate of its tax base. On this tax base for Group A companies, the new lower CIT rate of 25.17% is applied. For groups B and C, there is no change since their ETR continue at the earlier rates of 20.9%[6] and 39.1%, respectively.

[6] The estimated tax revenue would be somewhat lower than the amount indicated for Group B companies because this group includes some of the companies who may be currently paying MAT at 18.5%. The MAT rate has now been reduced to 15%. Based on MAT revenue assessed for FY19 at INR30,700.7 crores, we estimate the effect of a reduction of MAT rate from 18.5% to 15% at INR5,808.2 for FY19.

Table 8: Estimated revenue impact of new CIT rates (INR crore)

Group	Pre-reform reassessed tax revenue	Estimated profit before tax (tax base)	Post-reform estimated tax revenue	Revenue loss
Group A	5,69,830	18,72,270	4,71,250	98,579
Group B	91,948	4,39,795	91,948	0
Group C	81,423	2,08,001	81,423	0
Total	**7,43,201**	**25,20,067**	**6,44,621**	**98,579**

Source (basic data): Statement of Revenue Impact of Tax Incentives under the Central Tax System: Financial Years 2017-18 and 2018-19 (Union Budget 2019-20) and authors' estimates

The estimated revenue loss is thus, INR98,579 crore (Table 8), which is lower than the revenue foregone estimate given by the government at INR1,45, 000 crore. Recent analysis by Barclays and Nomura[7] also stated that the government's estimate of revenue loss due to the CIT rate reduction is an overestimate.

3. *Impact on fiscal deficit*

Rangarajan and Srivastava (2019) also extend their analysis to estimate the impact of the CIT reform on the fiscal deficit. This would depend on a broader set of factors. Relative to the budget estimates, downward adjustments are required for all central taxes since the base year (FY19) figures, as well as the nominal growth and assumed buoyancy numbers appear to be out of alignment. Second, the revenue cost of the CIT reforms and the earlier announcement relating to the export incentives (INR50,000 crore) should be provided for. On the positive side, the effect of RBI additional dividends needs to be considered. There would be positive effects of the stimulus through the CIT reforms and export incentives, but these may take time to work themselves out. From the RBI transfer of INR1,76,051 crore, after deducting INR90,000 crore which has already been provided for in the budget, INR86,051 crore is included. This assumes that like last year when an interim dividend of INR28,000 crore was paid by the RBI, the central government may again ask for an interim dividend of a similar amount in FY20[8].

In their assessment, a set of positive and negative effects of CIT reforms supplemented by a reassessment of budgetary revenue estimates gives a broad idea of the likely fiscal slippage (Table 9).

Table 9: Adjustments relative to budget estimates for FY20 (INR crore)

Item	Total	Center	States
Revenue cost of CIT reform	98,579	62,463	36,116
Revenue cost of export subsidy	50,000	31,682	18,318
Revenue cost of downward revision of BE	2,14,006	1,35,602	78,404
Total revenue cost	**3,62,585**	**2,29,747**	**1,32,838**
Less: additional dividends from RBI	86,051	86,051	
Net revenue loss	**2,76,534**	**1,43,696**	**1,32,838**
Net revenue loss as % of GDP - S1 (at 10% growth)	1.32	0.69	0.64
Net revenue loss as % of GDP - S2 (at 9.5% growth)	1.37	0.72	0.65
Net revenue loss as % of GDP - S3 (at 9% growth)	1.42	0.75	0.67

Source (basic data): "*The macro arithmetic of corporate tax cuts*", C. Rangarajan and D.K. Srivastava (published in Hindu Business Line on 4 October 2019); https://www.thehindubusinessline.com/opinion/the-macro-arithmetic-of-corporate-tax-cuts/article29586882.ece, Statement of Revenue Impact of Tax Incentives under the Central Tax System: Financial Years 2017-18 and 2018-19 (Union Budget 2019-20) and; *reassessed GDP for 2019-20

It is thus shown that lower the nominal GDP growth, the higher is the slippage in fiscal deficit relative to GDP. It is also a matter of concern that a substantial part of the slippage in fiscal deficit is to be borne by the state governments.

The central government may attempt to reduce the extent of slippage in fiscal deficit by enhancing their efforts to garner additional non-tax revenues and disinvestment proceeds over and above the budget estimates. To some extent, public sector companies would also gain from the lower CIT rate. As a result, additional profits would accrue to them which can be accessed by the government in the form of higher dividends. This might also serve

[7] Emerging Market Research document (dated 26 September 2019) - "India: deconstructing the tax cut math", Barclays, Asia Insights (dated 20 September 2019) – "India: government blinks on fiscal and announces corporate tax cuts", Nomura

[8] It may be noted that the Jalan Committee had recommended that payment of such interim dividends "*may…be restricted to extraordinary circumstances*". This point was brought out by Dr. Rakesh Mohan in the correspondence with Dr. Rangarajan (*op.cit*)

to reduce center's fiscal deficit. However, this gain would largely accrue only to the central public sector enterprises and only marginally to state public sector enterprises since they have a very limited number of profit-making public enterprises[9]. However, any contraction in expenditure may be avoided since that would only delay economic recovery by neutralizing the effect of the fiscal stimulus.

Some other estimates of the potential impact CIT reform may have on fiscal deficit of the center are summarized in Table 10.

Table 10: Potential slippage from center's budgeted fiscal deficit for FY20: selected estimates

#	Institution	Slippage from the budgeted fiscal deficit target (estimated fiscal deficit to GDP ratio)	Comments
1	Barclays	0.5% points (3.8% of GDP)	The analysis accounts for reduced state transfers and other sources of revenue such as RBI dividends and petroleum taxes; takes into account a normal revenue shortfall (due to weaker growth)
2	Nomura	0.3% points (3.6% of GDP)	The analysis takes into account weak nominal GDP growth estimated at 9.5%, higher RBI dividends and potentially large expenditure savings
3	Survey of seven economists (median) - Standard Chartered, Edelweiss Securities Ltd., Nirmal Bang Equities Pvt, Oxford Economics, TS Lombard, Yes Bank, Morgan Stanley	0.6% points (3.9% of GDP)	NA
4	Moody's	0.4% points (3.7% of GDP)	NA
5	A.K. Bhattacharya	0.2% points (3.5% of GDP)	Based on the assumption that government saves the entire expenditure on tax exemptions (INR1.08 trillion)

Source: Emerging Market Research document (dated 26 September 2019) - "India: deconstructing the tax cut math" (http://www.cogencis.com/newssection/analysis-govt-bets-the-house-with-corporate-tax-cut-to-boost-growth/), Asia Insights (dated 20 September 2019) - India: government blinks on fiscal and announces corporate tax cuts (https://www.business-standard.com/article/pti-stories/corporate-tax-cut-carries-fiscal-slippage-risks-experts-119092100860_1.html), Financial Express (https://www.financialexpress.com/economy/indias-fiscal-deficit-may-rise-highest-in-four-year-after-nirmala-sitharaman-gives-tax-gifts/1712373/), Economic Times (https://economictimes.indiatimes.com/news/economy/indicators/moodys-cuts-indias-fy20-growth-forecast-to-5-8/articleshow/71515759.cms?from=mdr), Business standard (https://www.business-standard.com/article/economy-policy/underestimates-overreactions-the-math-behind-fm-s-corporation-tax-cuts-119092301355_1.html)

4. Short-term effects

Companies may use the benefit of the CIT rate revision in a variety of ways. These are briefly discussed as follows:

1. **Investment effect:** in the case of companies which switch to the lower CIT rate and have a tax benefit, if additional profits are utilized to increase capital expenditure, corporate investment may go up and spur production in the future years.
2. **Dividend distribution effect:** if tax benefits are converted into additional dividends, it might have a demand-side effect. There may be a pick-up in consumption demand and this may have a more immediate effect.
3. **Price reduction effect:** if the beneficiary companies pass on their benefits partially/fully to the consumers through lower product prices, it would have a positive demand-side impact, possibly in the short-run.
4. **Reduction in corporate debt:** tax benefits could be used by the corporates for deleveraging thereby reducing their borrowings and future interest liability.
5. **Buyback effect:** additional profits of the beneficiary companies could be used by them for sharing buybacks, reducing their liabilities and increasing income in the hands of individuals holding these shares. This could have an effect of augmenting demand in the system.

[9] This point was made by Dr. Rakesh Mohan who was a member of the Expert Committee to Review the Extant Economic Capital Framework (Bimal Jalan Committee) in a letter that he wrote to Dr. C. Rangarajan with reference to the article by Rangarajan and Srivastava (2019)

6. **Additional government dividend effect:** since some of the beneficiary companies within Group A would be public-sector companies, they may gain in terms of additional profit due to the lower CIT rate which can be accessed by the government in the form of higher dividends. Most of this benefit is likely to accrue to the central government because profit making state level public enterprises are limited in number.

Individual circumstances of companies would determine their decisions as to which option or combination of options would be adopted. In all likelihood, the effects will be diffused across different options and the positive impact of CIT reforms on investment may take some time to materialize.

5. Long-term effects

Essentially, the CIT reforms are supply side reforms aimed at increasing the profitability and productivity of investment. India's CIT rates have now become globally competitive as shown in Table 11. There is intra-sectoral neutrality across industry and services except for new manufacturing companies which has got an additional boost. Supply side reforms take time to work themselves out. Fiscal space for demand expansion stands squeezed out in the current year. The expected increase in investment will take time to work out. Economic theory suggests that the value of autonomous expenditure multiplier[10] increases when the tax rate is lowered. This multiplier would then result into increased GDP levels based on the extent of the increase in autonomous expenditures which include government expenditures. Thus, the long-term benefit would be the result of the combination of higher multiplier and higher government expenditures. It may therefore be recommended that to take full advantage of the CIT reforms, the government should increase its capital expenditures.

Table 11: CIT rates: a cross-country comparison

S. no.	Country	CIT rate (%)	S. no.	Country	CIT rate (%)
1	Brazil	15	9	South Korea	25
2	China	25	10	US	21
3	Russia	0, 15.5, 20	11	UK	19
4	South Africa	28	12	Japan	23.2
5	Indonesia	25	13	Italy	24
6	Malaysia	24	14	Germany	15.83
7	Thailand	20	15	France	32.02
8	Singapore	17	16	Canada	15

Source: OECD. Stat, 2019 worldwide corporate tax guide, EY (https://www.ey.com/gl/en/services/tax/worldwide-corporate-tax-guide---country-list)

However, there are still issues of alignment that need to be addressed in due course. First, the difference in effective rates between foreign and domestic companies has increased after the CIT reforms. As such, instead of increasing their investment, foreign companies may be discouraged for further investment in India, given their relatively higher tax burden compared to domestic companies. Secondly, there is a significant difference between the tax treatment of new manufacturing companies and existing manufacturing companies. This implies an inducement to set up new companies rather than expand investment in existing companies which would have added more quickly to higher profits and higher tax revenues. Thirdly, the broad parity between the highest PIT rate and the average CIT rate would also require reforms in the PIT rate structure.

[10] This refers to increase in GDP following a 1% increase in government expenditure when it is not financed by a corresponding increase in taxation.

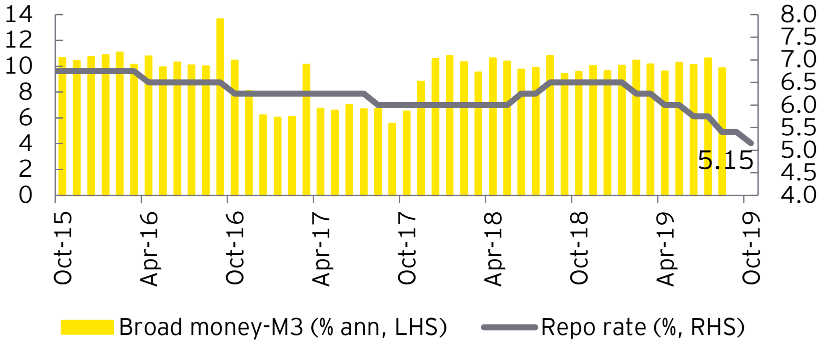
6. Money and finance: RBI lowered the repo rate to 5.15% in October 2019 from 5.40% in August 2019

A. Monetary sector

Monetary policy

- The RBI lowered its policy repo rate by 25 basis points to 5.15% during its October 2019 monetary policy review (Chart 7). This is the fifth consecutive rate reduction since January 2019 thereby taking the cumulated rate reduction to 135 basis points during this calendar year.
- While projecting inflation to average in the range of 3.5% to 3.7% during 2HFY20, the RBI indicated that these projections were based on the following broad assumptions (a) price pressure on food items and pulses is expected to be limited; (b) vegetable prices are likely to moderate in the coming months; (c) output prices are projected to remain soft due to persistent weak demand conditions. However, volatility in crude oil prices owing to geo-political uncertainties and financial markets, particularly in the currency markets of emerging economies, may pose some uncertainties to the CPI inflation outlook.

Chart 7: Growth in broad money and movements in repo rate



Source: Database on Indian Economy, RBI

The RBI lowered the repo rate by 25 basis points to 5.15% during its fourth bi-monthly monetary policy review held in October 2019.

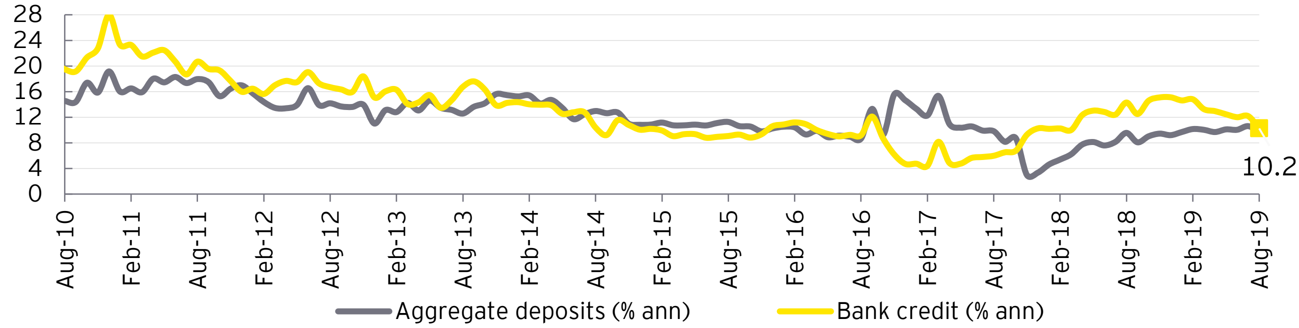
Money stock

- Growth in broad money stock (M3) fell to a four-month low of 9.9% in August 2019 from 10.6% in July 2019 (**Chart 7**). Growth in time deposits, accounting for nearly 76% of M3, fell to 9.3% in August 2019 from 9.9% in July 2019.
- Narrow money (M1) grew at a slower pace of 11.9% in August 2019 as compared to 13.2% in July 2019. This was due to a lower growth in demand deposits at 10.3% in August 2019 as compared to 12.8% in July 2019. Growth of currency in circulation was marginally lower at 12.9% in August 2019 as compared to 13.0% in July 2019.

Aggregate credit and deposits

- Growth in bank credit fell to a 17-month low of 10.2% in August 2019 as compared to 12.2% in July 2019 (**Chart 8**). There was a broad-based slowdown in the growth of credit to major sectors of the economy in August 2019 which is reflective of weakness in demand conditions.

Chart 8: Growth in credit and deposits



Source: Database on Indian Economy, RBI

- Growth in non-food credit also fell to 9.8% in August 2019, its lowest growth since March 2018, as compared to 11.4% in July 2019 owing to a fall in credit to industries and services sectors.
- Growth in credit to services fell to 13.3% in August 2019 from 15.2% in July 2019 while credit to industries fell to a 10-month low of 3.9% in August 2019 from 6.1% in July 2019. Growth in credit to agricultural sector was at 6.8% in August 2019, similar to the level seen in July 2019.
- Housing sector credit also grew at a slower pace of 16.6% in August 2019 as compared to 19.2% in July 2019.
- Growth in aggregate bank deposits fell to 9.7% in August 2019 as compared to 10.6% in July 2019.

B. Financial sector

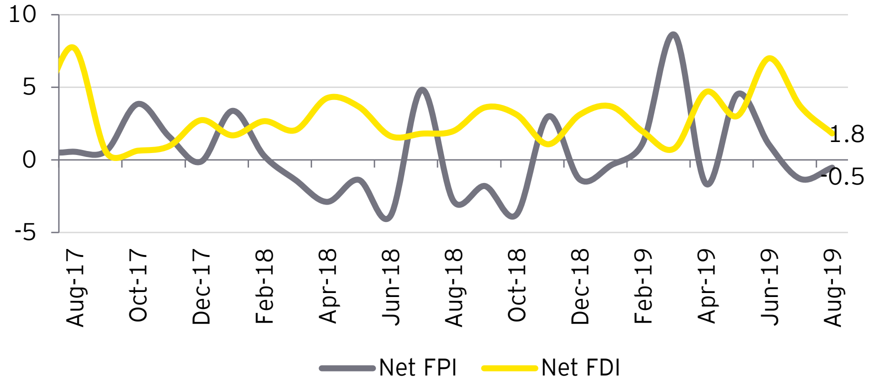
Interest rates

- Interest rates offered by commercial banks on term deposits with a maturity of more than one year was lowered for the fourth consecutive month to average at 6.68% in September 2019, (ranging between 6.25% and 7.10%), as compared to 6.76% in August 2019.
- Commercial banks lowered the marginal cost of lending rate (MCLR) for the third successive month to 8.08% in September 2019 as compared to 8.15% (average) in August 2019.
- The average yield on 10-year government securities increased for the second subsequent month to 6.75% in September 2019 from 6.62% in August 2019. Government bond yields were influenced by factors including: (a) lower GDP growth outturn in 1QFY20, (b) uncertainties surrounding global crude oil prices and (c) increased prospects of a fiscal slippage on account of the recently announced CIT rate reduction.

FDI and FPI

- As per the provisional data released by the RBI on 14 October 2019, the overall foreign investment inflows (FIIs) fell further to US$1.3 billion in August 2019 as compared to US$2.4 billion (revised) in July 2019 due to lower net FDI inflows and continued net outflow of FPIs during the month.

Chart 9: Net FDI and FPI inflows (US$ billion)



Net FDI inflows were at a seven-month low of US$1.8 billion in August 2019 as compared to US$3.7 billion in July 2019.

Source: Database on Indian Economy, RBI

- Net FDI inflows were at a seven-month low of US$1.8 billion in August 2019 as compared to US$3.7 billion (revised) in July 2019 (**Chart 9**). Gross FDI inflows were also lower at US$4.1 billion in August 2019 as compared to US$5.9 billion (revised) in July 2019.
- Net portfolio investment outflows were lower at US$0.5 billion in August 2019 as compared to outflows of US$1.3 billion in July 2019.

7. Trade and CAB: merchandise exports contracted at (-) 6.6% in September 2019

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

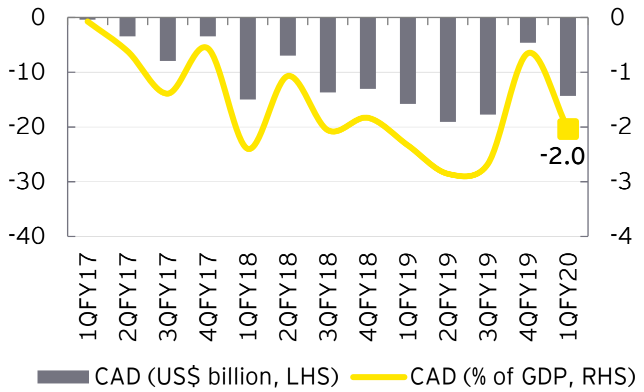
- CAD in 1QFY20 broadened to 2.0% from an eight-quarter low of 0.7% in 4QFY19 as merchandise trade deficit widened to 6.6% of GDP (**Table 12**) from 4.9% during the same period. Merchandise imports increased to 18.3% of GDP in 1QFY20 from 17.2% in 4QFY19 while merchandise exports fell to 11.8% of GDP 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 12: 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 10: CAD



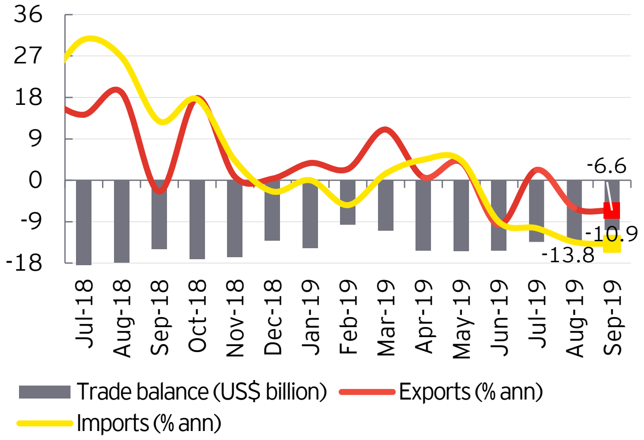
Source: Database on Indian Economy, RBI

B. Merchandise trade and exchange rate

Both merchandise exports and imports contracted for the second successive month by (-) 6.6% and (-) 13.8%, respectively, in September 2019.

- Merchandise exports contracted for the third time in four months by (-) 6.6% in September 2019 as compared to (-) 6.0% in August 2019 (**Chart 11**), led by a fall in exports of oil and engineering goods.

Chart 11: Developments in merchandise trade



Source: Ministry of Commerce and Industry, GoI

- The pace of contraction in oil exports increased to (-) 18.6% in September 2019 from (-) 10.7% in August 2019. Engineering goods exports contracted by (-) 6.2% in September 2019 as compared to (-) 9.4% in August 2019.
- The pace of contraction in imports accelerated to a 37-month high of (-) 13.8% in September 2019 from (-) 13.4% in August 2019, driven primarily by a sustained fall in imports of petroleum products, transport equipment and gold.
- The pace of contraction in oil imports increased to (-) 18.3% in September from (-) 8.9% in August 2019.
- Out of the 30 broad sectors for which exports and imports data is provided, 22 and 25 sectors, respectively, experienced a contraction in September 2019.
- Exports and imports excluding oil, gold and jewelry continued to contract by (-) 4.2% and (-) 8.0%, respectively, in September 2019 as compared to (-) 5.6% and (-) 8.6%, respectively, in August 2019.
- Merchandise trade deficit fell to a six-month low of US$10.9 billion in September 2019 from US$13.5 billion in August 2019 due to a sharper contraction in imports.
- The Indian Rupee depreciated marginally to INR71.3 per US$ in September 2019 from INR71.1 per US$ in August 2019.

8. Global growth projections revised down to 2.9% in 2019 and 3% in 2020

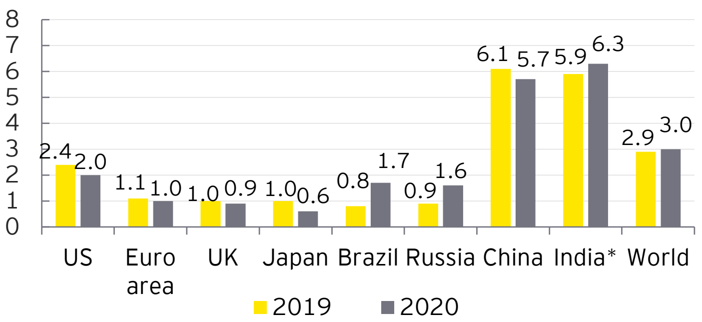
A. Global growth outlook

- The OECD (Interim Economic Outlook, September 2019) projected global growth to slow down from 3.6% in 2018 to 2.9% in 2019 (downward revision of 0.3% points) and 3% in 2020 (downward revision of 0.4% points). These would be the weakest annual global growth rates since the financial crisis.
- Growth in the US is projected at 2.4% in 2019 (downward revision of 0.4% points) and 2% in 2020 (downward revision of 0.3% points). Higher tariffs are expected to increase business costs and business investment and exports are projected to moderate.
- In the Euro area, growth is projected to be low at 1.1% in 2019 and 1% in 2020. Growth is expected to be weaker in Germany and Italy relative to the rest of the Euro area.
- Growth in Japan is forecasted at 1% in 2019 due to stronger social spending supporting demand following the increase in the consumption tax rate in October 2019. However, growth is projected to moderate to 0.6% in 2020 when fiscal consolidation efforts resume.

The OECD projected global growth at 2.9% in 2019 and 3% in 2020 (Chart 12), the weakest annual growth rates since the financial crisis. There was a downward revision in the growth forecasts of almost all G20 countries and major EMEs.

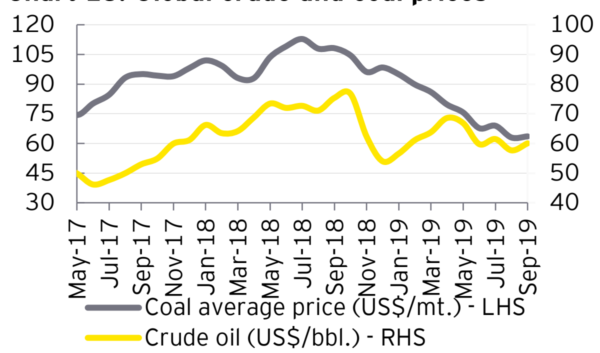
- Growth in China was revised downwards to 6.1% in 2019 and 5.7% in 2020 due to a negative impact of trade tensions on investment. However, new fiscal/quasi-fiscal stimulus measures and easing of monetary policy is expected to cushion credit growth and demand in 2019.
- Growth in India was revised down by 1.3% points to 5.9% in 2019 and by 1.1% points to 6.3% in 2020 due to a sharp fall in growth during the recent quarters. India is no longer projected to be the fastest growing economy in 2019 as growth in China is expected to surpass that in India.
- Growth in Brazil is projected at 0.8% in 2019 and is expected to pick up to 1.7% in 2020 supported by lower real interest rates boosting private consumption and progress made towards implementation of reforms boosting investment.

Chart 12: Global growth projections



Source: OECD Interim Economic Outlook, September 2019
*data pertains to fiscal year

Chart 13: Global crude and coal prices



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

B. Global energy prices: Global crude prices rose in September 2019 as Saudi Arabia's crude production fell

- Average global crude prices[11] increased to US$60/bbl. in September 2019 from US$57.7/bbl. in August 2019 (**Chart 13**) reflecting a disruption of Saudi Arabia's oil production facilities. It is estimated that Saudi Arabia's crude oil production fell to 8.5 million bbl/day on an average in September 2019 from 9.9 million bbl/day in August 2019[12]. However, latest information indicated that supply was largely restored by drawing down on inventories.
- Average global coal price[13] increased marginally to US$63.6/mt. in September 2019 from US$63/mt. in August 2019. On a quarterly basis, coal price averaged US$56.2/mt. in 2QFY20, a 13-quarter low.

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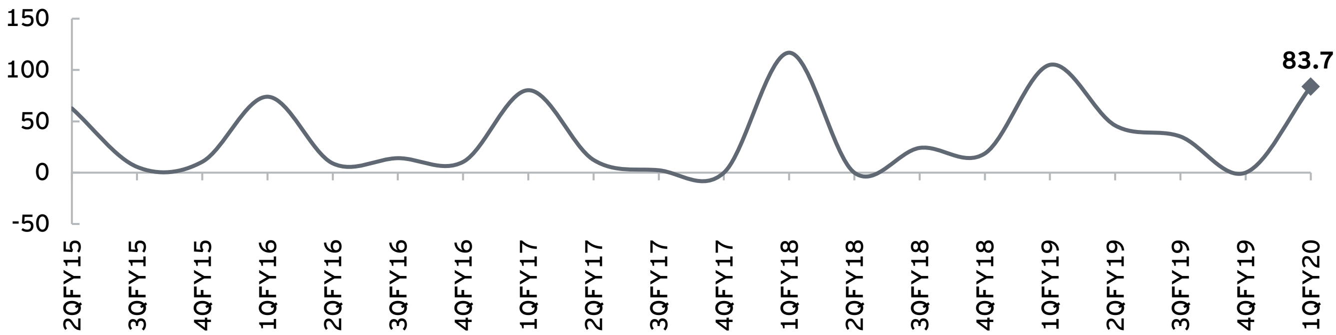
[11] Simple average of three spot prices, namely, Dated Brent, West Texas Intermediate and Dubai Fateh
[12] Short-term Energy Outlook, EIA (released 8 October 2019)
[13] Simple average of Australian and South African coal prices

9. Index of Macro Imbalance (IMI): pointed to a deterioration in the macro balance in 1QFY20

IMI pointed at worsening of macro-balance in 1QFY20

- The IMI is obtained by adding the percentage deviation of inflation rate (based on new CPI 2011−12=100), fiscal deficit (as a percentage of GDP) and current account deficit (as a percentage of GDP) from their respective benchmarks of 4%, 3% and 1.3% of GDP[14]. All three components of IMI have been given equal weightage (33.33%). The state of "balance" is judged by a value of "0".
- An index value greater than zero indicates the presence of an imbalance in the economy. While considering the percentage deviation of each of the indicators from its selected norm, only the positive deviations are taken. Negative deviations are equated to zero to ensure that the negative and positive deviations across indices are not canceled out.
- Reflective of a deterioration in the macro balance, the IMI increased to 83.7 in 1QFY20 as compared to a near-full macro balance in 4QFY19 (**Chart 14**). Two of the three components of IMI namely, center's fiscal deficit (8.8% of GDP) and current account deficit (2.0%) were above their respective benchmark levels in 1QFY20.

Chart 14: IMI (quarterly)



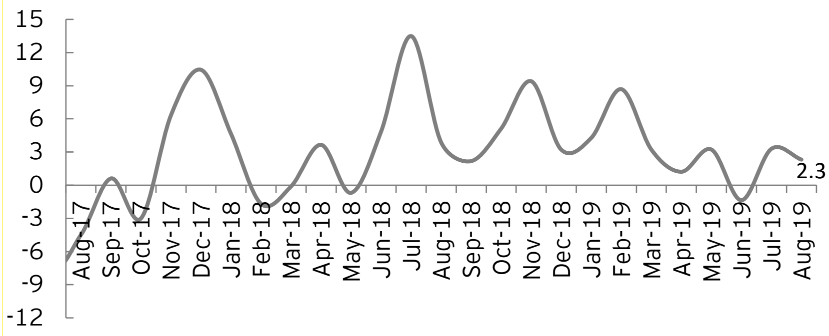
Source (Basic data): RBI, MoSPI and EY estimate

10. Index of Aggregate Demand (IAD): indicated sustained weakness in demand conditions in August 2019

Growth in IAD continues to remain subdued at 2.3% in August 2019

- The y-o-y growth in the index of aggregate demand fell to 2.3% in August 2019 from 3.3% in July 2019 and it continued to stay below the FY19 annual average growth of 5.1% (**Chart 15**).
- Subdued demand conditions continued to prevail in both manufacturing and services sector in August 2019. Demand conditions in the agricultural sector are indicated by growth in credit to agricultural sector which stood at 6.8% in August 2019, similar to what it was in July 2019.

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



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

[14] Rangarajan, C (2016): "Can India grow at 8 to 9 per cent?" The Hindu, http://www.thehindu.com/opinion/lead/can-india-grow-at-8-to-9-per-cent/article8596824.ece, Accessed on 17 May 2016.

11. 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
2Q FY19	5.3	0.9	5.6	7.5	5.4	3Q FY19	53.4	53.0
3Q FY19	3.7	2.8	3.4	6.9	3.4	4Q FY19	53.6	52.2
4Q FY19	1.5	2.2	1.4	1.5	3.3	1Q FY20	52.2	50.3
1Q FY20	3.0	3.0	2.4	7.2	3.5	2Q FY20	51.8	51.6
May-19	4.5	2.3	4.4	7.4	3.8	Jun-19	52.1	49.6
Jun-19	1.2	1.5	0.2	8.2	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	-1.1	0.1	-1.2	-0.9	-0.5	Sep-19	51.4	48.7

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

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

Fiscal year/quarter/month	CPI	Food Price Index	Fuel and light	Core CPI	WPI	Food Price Index	Mfg. products	Fuel and power	Core WPI
	% change y-o-y				% change y-o-y				
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	5.0	1.4	1.1	1.4
2Q FY20	3.5	3.5	-1.4	4.1	0.8	5.4	0.0	-4.9	-0.5
Jun-19	3.2	2.2	2.2	4.0	2.0	5.4	1.0	-2.1	0.9
Jul-19	3.1	2.4	-0.3	4.2	1.1	4.5	0.3	-3.6	0.1
Aug-19	3.3	3.0	-1.7	4.1	1.1	5.8	0.0	-4.0	-0.4
Sep-19	4.0	5.1	-2.2	4.0	0.3	6.0	-0.3	-7.1	-1.1

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

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

Fiscal year/month	Gross tax revenue	Corporate tax	Income tax	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	
Jan-19	7.3	16.7	14.3	15.7	1.5	121.5	143.7
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

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)					
Jan-19	35,066	126	9,511	8,435	53,138
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

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	10-year govt. bond yield	Net FDI	Net FPI	Fiscal year/quarter/month	FX reserves US$ billion
	%		% change y-o-y				%	US$ billion			US$ billion
Nov-18	6.50	FY16	13.5	10.1	9.7	10.5	7.7	36.0	-4.1	FY16	360.2
Dec-18	6.50	FY17	3.1	10.1	7.9	11.6	7.0	35.6	7.6	FY17	370.0
Jan-19	6.50	FY18	22.1	9.5	7.5	7.5	7.0	30.3	22.1	FY18	424.5
Feb-19	6.25	FY19	13.3	10.1	13.8	8.9	7.7	30.7	-0.6	FY19	412.9
Mar-19	6.25	2Q FY19	14.6	9.4	13.1	8.6	7.9	7.4	0.2	3Q FY19	395.6
Apr-19	6.00	3Q FY19	12.7	9.6	14.9	9.2	7.7	7.3	-2.1	4Q FY19	412.9
May-19	6.00	4Q FY19	13.3	10.1	14.2	10.0	7.4	6.4	9.4	1Q FY20	429.8
Jun-19	5.75	1Q FY20	11.3	10.1	12.5	9.9	7.2	14.7	3.9	2Q FY20	433.7
Jul-19	5.75	May-19	12.9	10.3	12.5	10.1	7.3	3.0	4.5	Jun-19	429.8
Aug-19	5.40	Jun-19	11.3	10.1	12.0	10.0	7.0	7.0	1.1	Jul-19	428.8
Sep-19	5.40	Jul-19	13.2	10.6	12.2	10.6	6.6	3.7	-1.3	Aug-19	428.3
Oct-19	5.15	Aug-19	11.9	9.9	10.2	9.7	6.6	1.8	-0.5	Sep-19	433.7

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	-14.5	65.5	46.0	54.7	2013	3.5	1.4	5.1
FY17	5.1	0.9	-8.1	67.1	47.9	73.0	2014	3.6	2.1	4.7
FY18	10.6	20.9	47.0	64.5	55.7	90.8	2015	3.4	2.3	4.3
FY19	8.7	9.9	12.3	69.9	67.3	100.4	2016	3.4	1.7	4.6
3Q FY19	5.7	6.1	6.8	72.1	64.3	99.7	2017	3.8	2.5	4.8
4Q FY19	6.0	-1.2	-15.1	70.5	60.5	90.2	2018	3.6	2.3	4.5
1Q FY20	-1.7	-0.3	2.3	69.5	65.1	74.3	2019*	3.0	1.7	3.9
2Q FY20	-3.6	-12.6	-26.7	70.4	59.7	65.2	2020*	3.4	1.7	4.7
Jun-19	-9.7	-9.1	-15.3	69.4	59.8	67.7	2021*	3.6	1.6	4.6
Jul-19	2.2	-10.4	-13.4	68.8	61.5	68.9	2022*	3.6	1.6	4.8
Aug-19	-6.0	-13.4	-13.5	71.1	57.7	63.0	2023*	3.6	1.5	4.8
Sep-19	-6.6	-13.8	-10.9	71.3	60.0	63.6	2024*	3.6	1.6	4.8

Source: Database on Indian Economy - RBI, Pink Sheet - World Bank and IMF World Economic Outlook Update, 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	ETR	effective tax rate
22	EXP	exports
23	FAE	first advanced estimates
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	MCLR	marginal cost of funds-based lending rate
47	Ming.	mining and quarrying
48	Mfg.	manufacturing
49	m-o-m	month-on-month
50	mt	metric ton
51	MoSPI	Ministry of Statistics and Programme Implementation
52	MPC	Monetary Policy Committee
53	NEXP	net exports (exports minus imports of goods and services)
54	NPA	non-performing assets
55	NCLT	National Company Law Tribunal
56	OECD	Organisation for Economic Co-operation and Development
57	ONGC	Oil and Natural Gas Corporation Limited
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	SLR	Statutory Liquidity Ratio
65	Trans.	trade, hotels, transport, communication and services related to broadcasting
66	US$	US Dollar
67	UTGST	Union Territory Goods and Services Tax
68	UT	union territory
69	WPI	Wholesale Price Index
70	y-o-y	year-on-year
71	2HFY19	second half of fiscal year 2018-19, i.e., September 2018-March 2019
72	1HFY18	first half of fiscal year 2017-18, i.e., April 2018-September 2018

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EYIN1910-015
ED None

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