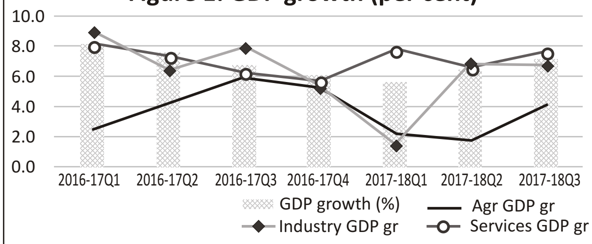
Indian Economic Scenario*

Introduction

As pointed out by the Ministry of Finance[1] Indian economy is poised for slower growth (less than 7 per cent) during 2017-18, but it is still among the fastest growing major economies of the world. According to ADB (2018)[2], despite growth easing in 2017, Indian economy is projected to bounce back to 7.3 per cent in 2018 and to 7.6 per cent in 2019 as the country's new tax regime is supposed to improve productivity. World Bank[3] projected that the economy will grow at 7.3 per cent in 2018-19 making it again the fastest growing economy of the world. IMF also remains bullish on India with a forecasted growth rate of 7.4 per cent[4] in 2018-19. The RBI, in its recent Monetary Policy Report expressed optimism about economic revival and pegged GDP growth at 7.4 per cent for 2018-19. Apart from the continuing reforms like recapitalization of public sector banks, resolution of distressed assets under the Insolvency and Bankruptcy Code, lower inflation, improved current account balance and notable reduction in the fiscal deficit to GDP ratio are contributing positively to economic growth. However, rising global oil price and growing protectionist tendencies in some countries, rising external debt, stagnating agricultural sector remain to be causes for concern towards achieving a higher growth rate. After adjusting with the twin impacts of demonetization and implementation of GST, Indian economy is expected to register a growth rate of around 6.5 per cent[5] in 2017-18 [Figure 1].

Figure 1: GDP growth (per cent)



Source: MOSPI and RBI

Scenario in the Real Sector

The sectoral GDP growth indicates that the agricultural sector has been exhibiting the lowest growth rate during the FY 2017-18 with a revival in the last quarter. The industry maintained a growth of over 6 per cent during the last two financial years with a slump to 1.5 per cent in the first quarter of 2017-18 but registered a steady revival in the second quarter. The steady growth of industry continued in the third quarter also. Compared to these sectors, service sector which accounts for more than 55 per cent of Indian economy, was quite consistent in the last two years. With an exception of 5.7 per cent in last quarter of 2016-17, the sector maintained a growth rate between 6.3 per cent and 8.2 per cent in the recent past [Figure 1]. The GDP growth in first quarter of 2016-17 was 8.1 per cent, which declined steadily to 5.7 per cent during first quarter of 2017-18; however, GDP revived and growth rate

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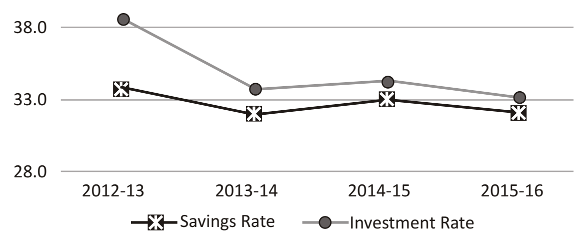
[1] *The Economic Survey,* 2017-18
[2] *Asian Development Outlook,* ADB, 2018
[3] *Global Economic Prospects-South Asia,* World Bank, January 2018
[4] *IMF World Economic Outlook,* April 2018
[5] *The Economic Survey,* 2017-18

increased to 7.2 per cent in the third quarter. The decline was mainly attributed to the undesirable effects of demonetization undertaken in November 2016 and the GST implementation in July 2017.

The savings rate and investment rate[6] were range bound during the last few years, hovering between 32 per cent and 34 per cent and between 33 per cent and 39 per cent, respectively [Figure 2]. Interestingly, throughout all these years, investment rate was higher than savings rate owing to the foreign investment inflows.

Figure 2: Savings and Investment Rate (per cent)



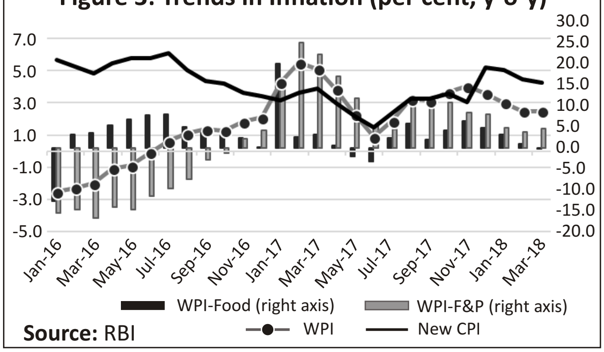
Source: CSO

Recent Trends in Inflation

After the adoption of inflation targeting by the Reserve Bank of India (RBI), the Consumer Price Index (CPI) is being tracked as the benchmark of change in prices in the economy[7]. The new CPI monthly inflation (y-o-y) continued to moderate during 2016-17 and 2017-18; it ranged between 1.5 per cent and 3.6 per cent between April 2017 and November 2017, but then started to record a rise since December 2017. In January 2016, CPI inflation stood at 5.7 per cent and did not rise beyond 6 per cent till August. From September onwards, it eased and settled in a comfortable zone on account of favourable monsoon and falling food prices and reached the low of 1.5 per cent in June'17, in line with sharp plunge in Wholesale Price Index (WPI). CPI increased from next month and again crossed the mark of 5 per cent in December 2017 on the back of higher government expenditure due to higher HRA and concomitant higher consumption expenditure [Figure 3].

The WPI inflation remained subdued for several months during 2016, then surged during January and March 2017 owing to sudden increase in global crude oil prices. However, with the moderation in the global crude prices, inflation also came down to 0.9 per cent in June 2017. But, with renewed rise in global oil prices in the successive months, coupled with rising food prices owing to the waning of positive supply shocks, inflation rose and reached the level of 3.6 per cent in December 2017. However, food prices eased and in March 2018, WPI inflation remained at 2.5 per cent [Figure 3]. With continuous surge of global oil prices, WPI-fuel and power rose steadily since January 2016 month on month and reached a record high of 25.17 per cent in February 2017. With fall in global crude

Figure 3: Trends in Inflation (per cent, y-o-y)



Source: RBI

[6]Savings rate is gross domestic savings as a proportion of GDP and Investment Rate is Gross Capital Formation as a proportion of GDP.

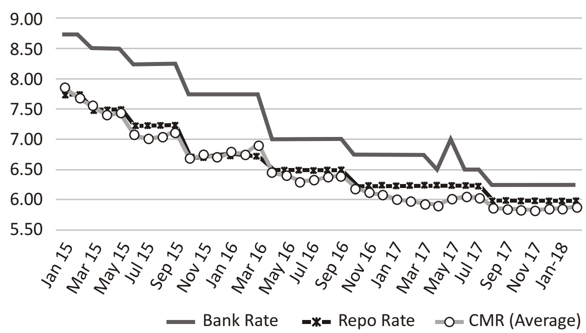
[7]From January 2015, the base year of CPI has been changed from 2010 to 2012 and to keep parity with changing consumption habits of Indian consumers with rising per capita disposable income, the weightages of sub-components have also been revised. This new CPI inflation is referred here as new CPI or CPI.

oil price, it touched 4.7 per cent in March 2018.

Movement of Key Interest Rates

Over the last few years, Reserve Bank of India has cut down the policy rates to ensure smooth liquidity supply and support growth on the face of sluggish GDP growth and stable inflation. During January 2015 to February 2018, SLR has been slashed from 22 per cent to 19.5 per cent in phases. The CRR was kept stable at 4 per cent during the same period. The downward movement of market determined weighted average call money rate (CMR) also indicated easy liquidity in the system. The Bank Rate was 8.75 per cent in January 2015 which was reduced to 6.25 per cent in August 2017. As of February, 2018, the rate remained the same. Similarly, the Repo Rate which was at 7.75 per cent in January and February 2015, was reduced to 6 per cent in August 2017 and the rate remained unchanged upto February 2018. The movement of call money rate representing the short term money market was quite in synchronization with the Repo Rate. With slight hardening at times depending on market liquidity conditions, during the period of January 2015 to February 2018, CMR also showed a steady decline from 7.9 per cent to lower than 6 per cent [Figure 4].

Figure 4: Key Interest Rates (per cent)

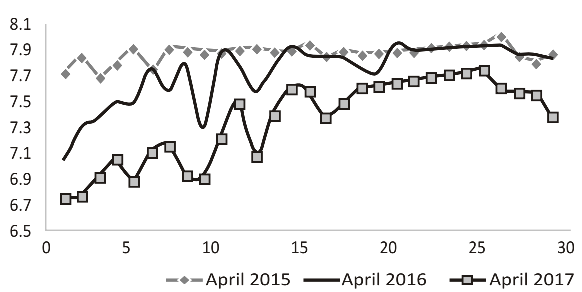


Source: RBI

As a positive indication for the Indian industrial sector, bank credit to the commercial sector has risen during the period from July 2016 to July 2017. In March 2017, the credit disbursal was at its high with ₹91018 billion disbursed to the commercial sector by the banks. The upsurge reflects the increasing business activity and overall vibrancy of the Indian economy.

The monthly yield curves for the Indian economy for last three years are shown in Figure 5. In order to compare the movement of yields across maturities (in years), yield curves for the month of April for 2015 to 2017 have been presented here. The yield curve was quite flat in 2015 implying a very small spread across maturities. But, in 2016 and 2017 yields on maturities in the short and medium run have fallen significantly, while those on the longer run have recorded a fall much less sharper. For example, the yield on a 5-year maturity government bond was at 7.9 per cent in 2015 and it fell to 6.9 per cent in 2017, whereas the yield on a 25-year maturity government bond fell to only 7.7 per cent from 7.95 per cent during the same period. The movement of yield curve in the short run has some peculiarity in the sense that yields on 5-year maturity is less than that of 3-year and 4-year maturity government bonds implying uncertainty in the short to medium run.

Figure 5: Yield Curve in India (maturity in years)

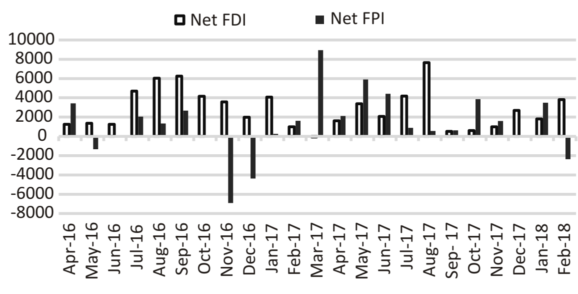


Source: RBI

Recent Trends in Financial Markets

India continued to be an attractive destination of foreign institutional investors in the last two years [Figure 6]. Net FPI investments[8] started to recover since calendar year 2017, backed by expectations of an economic recovery, falling interest rates and improving earnings outlook. After a net outflow of investments in 2016, a sharper turnaround was observed in 2017, particularly in terms of FII inflows into debt markets. In February 2018, FPI again hit the negative zone after December 2016, following the global trend where institutional investors are withdrawing money from emerging markets to invest in US after US bond yields touched record high. On the other hand, FDI inflows have been quite steady during the last two years.

Figure 6: Foreign Investments into India (US$Mn)



Source: RBI

The recovery of Indian economy also set the favourable mood for the stock exchange with turnover in National Stock Exchange (NSE) showing overall upward trend with slight fluctuations during the FY 2016-17. In April 2016, the turnover was ₹3094.8 billion which registered month on month growth in an uninterrupted manner only with a slight fall for the months of October and December 2016. The stock exchange continued with this optimism and the turnover rallied further in the following months to touch ₹5439 billion in July 2017. Turnover in Bombay Stock Exchange (BSE), although quite smaller in size compared to NSE, clocked positive growth during the period of April 2016 to March 2017 with moderate volatility and downward movement in the months of October and December 2016 and also in April 2017. The turnover increased sharply from ₹491 billion in April 2016 to ₹2891 billion in March 2017.

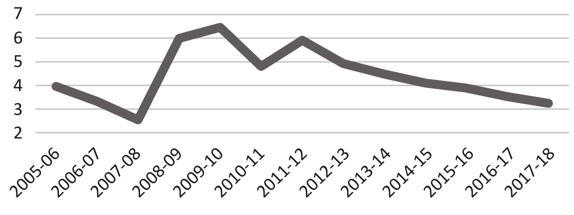
Government Budget

As mentioned in this year's budget, the central government has been able to contain the fiscal deficit (FD) as proportion to GDP at a level below 4 per cent since 2015-16. Fiscal deficit as percentage of GDP stood at 3.96 per cent in 2005-06 which surged sharply to 5.99 per cent in 2008-09 and then further to an 11 year high of 6.46 per cent in 2009-10. The worsening of fiscal deficit was driven by increased government expenditure and tax cuts to promote growth. In 2010-11, strict fiscal consolidation by the government could contain fiscal deficit to a much lower level. From 2012-13 onwards, the FD to GDP ratio declined steadily thanks to stringent policy measures like reduction in subsidy bill and higher tax revenue and non-tax revenue collection. In FY 2017-18, the fiscal deficit stood at reasonably low of 3.24 per cent [Figure 7].

In the context of implementation of GST in July 2017, it would be really interesting to note the changes in the collection of revenue on account of indirect taxes. It has been observed that in 2016-17 the central government has been able to generate an

[8]Net FPI consists of American Depository Receipt/Global Depository Receipt, Foreign Institutional Investment, Offshore funds and others, net of Portfolio investment by India.

Figure 7: Fiscal Deficit/GDP (per cent)



Source: RBI

indirect tax revenue of ₹5.6 lakh crore and the state governments have collected a revenue of ₹15 lakh crore[9]. During 2017-18, total revenue collected under GST in the period between August 2017 and March 2018 has been ₹7.19 lakh crore. This includes ₹1.19 lakh crore of CGST, ₹1.72 lakh crore of SGST, ₹3.66 lakh crore of IGST and ₹62,021 crore of cess. For this eight months, the average monthly collection has been ₹89,885 crore. Including the collection of July 2017, the total GST collection during the financial year 2017-18 stands provisionally at ₹7.41 lakh crore. Also, there has been a progressive improvement in the compliance level observed during the course of the year; compliance level has reached an average of 65 per cent by the end of financial year from around 55-57 per cent observed during initial months. The SGST collection during the year, including the settlement of IGST has been ₹2.91 lakh crore and the total compensation released to the states for a period of eight months during the last financial year was ₹41,147 crore to ensure that the revenue of the states is protected at the level of 14 per cent over the base year tax collection in 2015-16.[10]

However, since many goods are outside the purview of GST, some discussions are on the offing whether and how to incorporate them into this system. The GST council's meeting took place on May 4, 2018. The discussions relate to the imposition of sugar cess to benefit the farmers - in clearing their dues, de-privatization of GSTN, simplification of GST filing, incentivizing digital payments through concessional GST rates, the E-Way bill and inclusion of real estate/property transfer under the GST regime.

Performance of the External Sector

The balance of payment situation in India continued to be comfortable during the period 2006-07 to 2016-17. The current account deficit to GDP ratio (CAD/GDP) hovered between 0.7 per cent and 4.8 per cent during 2006-07 and 2016-17. Owing to a sharp rise in gold imports and increase in oil prices, CAD/GDP ratio crossed 4 per cent mark in 2011-12 and 2012-13. However, improved invisibles balance along with net capital inflows dominated by foreign investment and banking capital was more than sufficient to reduce the CAD/GDP ratio substantially. Increased foreign investment led to a significant rise in foreign exchange reserves to the tune of US$ 350369 million in January 2016 to US$ 359155 million in January 2017. FY 2017-18 also started with a good note and at the end of July 2017, the forex reserve amounted to US$ 392868 million. This led to a comfortable import cover for India of more than 11 months during 2016-17 [Table 1].

The INR has been quite stable against US Dollar and Euro during the last few years. Despite occasional depreciation against US Dollar during 2015-16 and 2016-17, the fluctuations have been limited. During 2017-18, the movement of rupee showed an appreciating bias against the US Dollar,

[9] RBI Handbook of Statistics on Indian Economy, latest issue.

[10] PIB Press Release, April 27, 2018, Ministry of Finance, GOI.

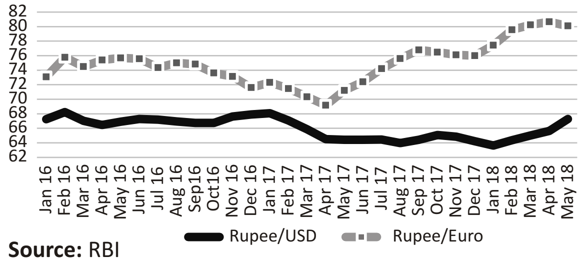
Table 1: BoP Situation in India

	Current Account Deficit/GDP (%)	Import Cover of Reserves (months)
2006-07	1.0	12.5
2007-08	1.3	14.4
2008-09	2.3	9.8
2009-10	2.8	11.1
2010-11	2.8	9.5
2011-12	4.2	7.1
2012-13	4.8	7.0
2013-14	1.7	7.8
2014-15	1.3	8.9
2015-16	1.1	10.9
2016-17	0.7	11.3

Source: RBI

barring intermittent depreciation in September and October 2017 [Figure 8].Three major factors triggered the appreciation of Indian Rupee. First, the large volume of FPI inflow in Indian debt market, which increased steadily on account of relatively higher yield on debt, pushed up the value of Indian Rupee. Second, the continued weakness of US Dollar throughout 2017 has been a major contributor; the Dollar Index[11] tumbled over 12 per cent from around 104 in January 2017 to 91 in September 2017.Third, the newly found optimism of business fraternity in Indian economy possibly based on recent developments in political scenario also provided a boost to Indian exchange rate. However, the strong performing Rupee seemed a bit volatile since the beginning of 2018. Widening current account deficit on account of increasing merchandise deficit, rising crude and gold prices, steadily rising external debt and over-valued Real Effective Exchange Rate (REER)[12] can further add to the woes of Rupee.

Figure 8: Movement of Rupee against USD and Euro



Source: RBI

Although the European Union is still suffering from the aftermath of Brexit, European Economy is recovering and the Euro is going strong which is vividly reflected in the India-Euro exchange rate movement [Figure 8]. Indian rupee depreciated steadily since April 2017 against Euro, barring a few months.

Challenges Related to Rising International Crude Prices

Petroleum prices are skyrocketing with the crude benchmark climbing to US$75 per barrel. Many of the South-east Asian countries import more than 80 per cent of the oil it consumes and are facing widening trade deficits triggered by this petroleum price rise. India is also heavily dependent on crude oil import; the recent depreciation of rupee to the mark of ₹67 per US$ relates largely to the rising crude prices. Over and above this base price of petroleum, hefty excise and sales taxes are imposed by the centre and the states respectively. There are wide ranging variations in the petrol prices across Indian states, almost 6 per cent-40 per cent, primarily triggered by the varied ranges of

[11]Dollar Index is an weighted Geometric Mean of Dollar's value against currencies of six major trading partner of Dollar namely Euro, Japanese Yen, Pound Sterling, Canadian Dollar, Swedish krona and Swiss Franc.

[12]Real Effective Exchange Rate is the weighted average of exchange rates adjusted for relative price differential between the domestic and foreign currency. Generally, 6 currency trade weighted REER and 36 currency trade weighted REER for India are available.

(effective) sales taxes imposed and collected by the states. The centre's duty on petroleum is 'specific' while that of the states is ad valorem (based on value). Obviously, rising prices lead to huge revenue collection for the states, though the gains vary quite a bit across states. So far, petroleum has been kept out of GST. Though there are discussions to bring it under this integrated tax network, it is yet to materialize with the full consent of the states. To find a common rate which is both RNR (revenue neutral) and same across states is a real challenge for the GST council; the RNR might be as high as 100 per cent. From the centre's point of view, the excise duty cut and integrating petroleum under the common tax platform viz. GST, might disrupt the fiscal consolidation efforts towards meeting Fiscal Deficit targets.