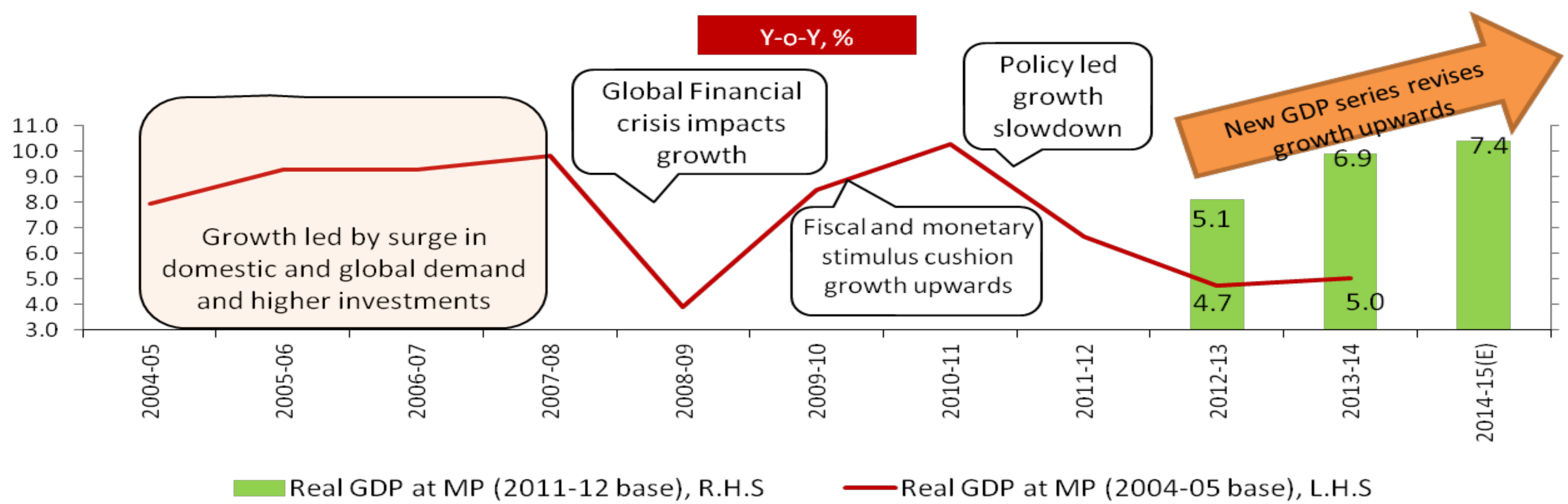
India
Macroeconomic Scenario

ICRIER

Indian Council for Research on International Economic Relations

The turnaround of India's growth story

- As per the new series of national accounts India's GDP grew at 6.9% in fiscal 2014, compared to 5.0% as per the old series.
- The Central Statistical Office (CSO) expects GDP growth for fiscal 2015 to rise to 7.4 % in fiscal 2015- putting India at par with china.
- Economic survey 2013-14 expects India to grow around 8.1- 8.5% in 2015-16 boosted by declining oil prices and increasing monetary easing.



Note: CSO's estimate for 2014-15

Source: Central Statistical Office

The new GDP math

- CSO has released the new series national accounts. The major change in the new series are:
  - Revision in the base year from 2004-05 to 2011-12
  - Revisions in the methodology of compilation, adoption of latest classification systems, and, inclusion of new and recent data sources.
  - GDP at factor cost will replaced by Gross Value Added (GVA) at basic prices, which is the practice in OECD countries and will facilitate international comparability of data
  - GVA at basic prices will be used to calculate the *'GDP at Market Prices'* which will henceforth be referred to as 'GDP'.
  - Comprehensive coverage of Corporate Sector both in manufacturing and services and partnership firms covered under Limited Liability Partnership Act have also been covered.

GVA at basic prices= [Compensation to employees] + [Operating surplus/mixed income] + [Consumption of fixed capital] + [Production taxes] – [Production subsidies]

GDP = GDP at MP= ΣGVA at basic prices + Product taxes - Product subsidies

Implications of the revised GDP series

- Growth has been revised upwards boosted by higher growth in industrial sector on the supply side and an uptick in government and private consumption and investments on the demand side.
- **Changing structure of the economy**- The share of agriculture and industry in GDP has risen, while that of services has fallen.
- Nominal GDP for 2013-14 is marginally lower than the old series implying no impact on significant ratios such as CAD, fiscal deficit.

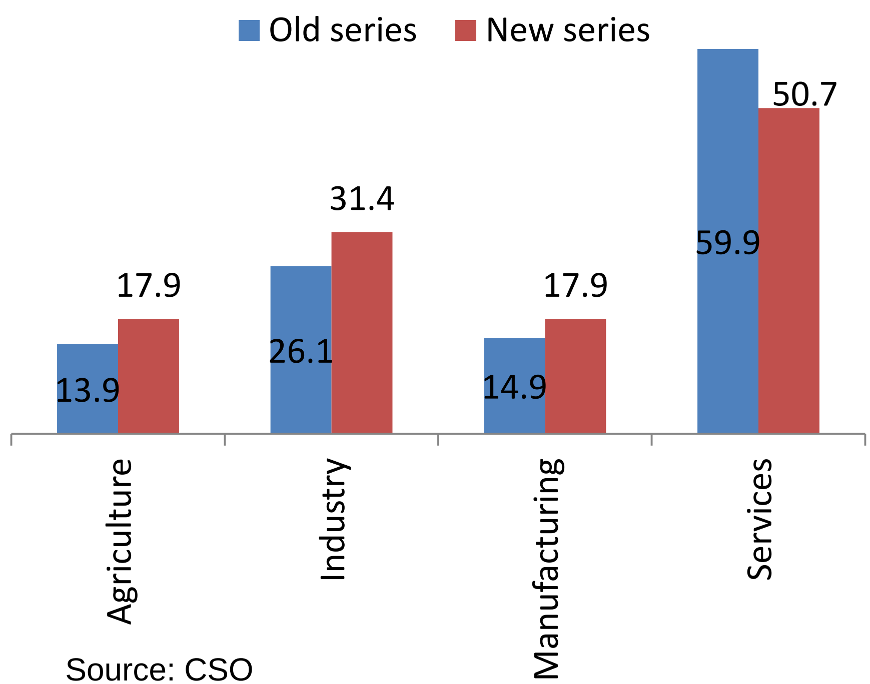
Growth rates in new and old series, % y-o-y

	GVA at basic prices	GVA at factor cost	GDP at Market Prices= GDP	Private Final Consumption Expenditure	Gross Fixed Capital Formation
New series: 2011-12 base					
2012-13	4.9	4.9	5.1	5.5	-0.3
2013-14	6.6	6.6	6.9	6.2	3
Old series: 2004-05 base					
2012-13	-	4.5	4.7	5	0.8
2013-14	-	4.7	5	4.8	-0.1

Increase	Decline

Source: CSO

% share in total GVA Factor cost, 2013-14

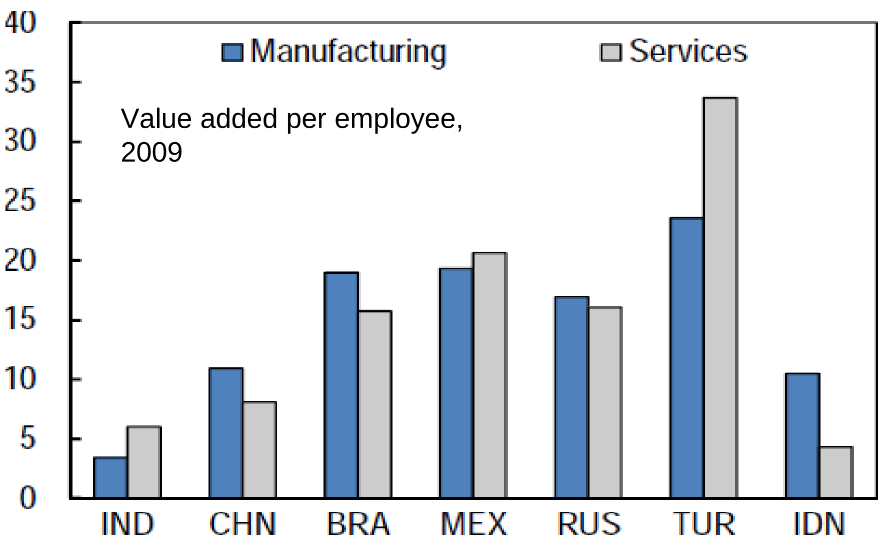


Source: CSO

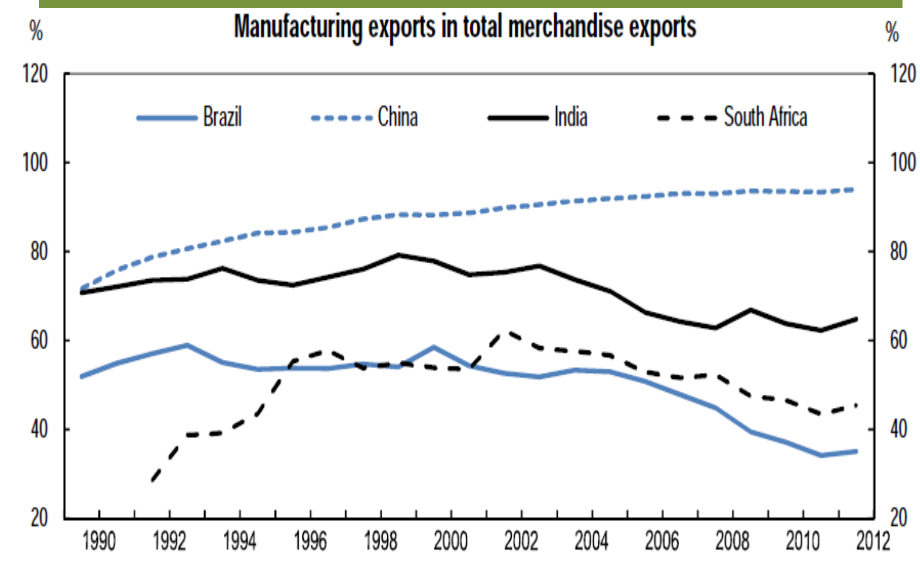
Manufacturing holds the key for future growth

- A recent OECD paper[1] highlighted that :
  - Manufacturing sector in India has contributed little to income, export and employment growth[2].
  - India's manufacturing productivity is low in international comparison.
  - It has created few and low quality jobs. Most manufacturing jobs were created in informal sector.
  - Manufacturing growth is constrained by a complex business environment, stringent labor regulations, infrastructure bottlenecks and tax system. Policies are needed to address them.
  - Structural changes like movement to higher technological sectors are needed.

Manufacturing Productivity is low in International Comparison



Share of manufacturing exports in total exports has declined

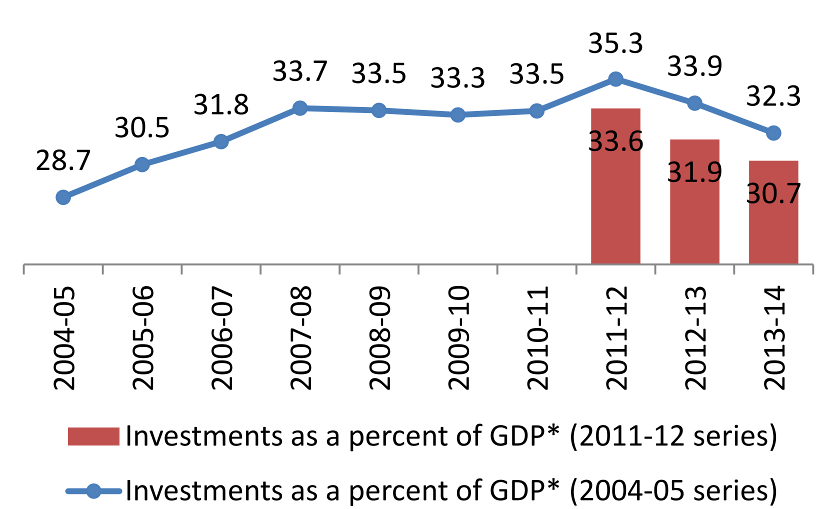


[1]Challenges and Opportunities of India's Manufacturing Sector", Joumard, I., U. Sila and H. Morgavi (2015), *OECD*

Investments remain muted, efficiency increases

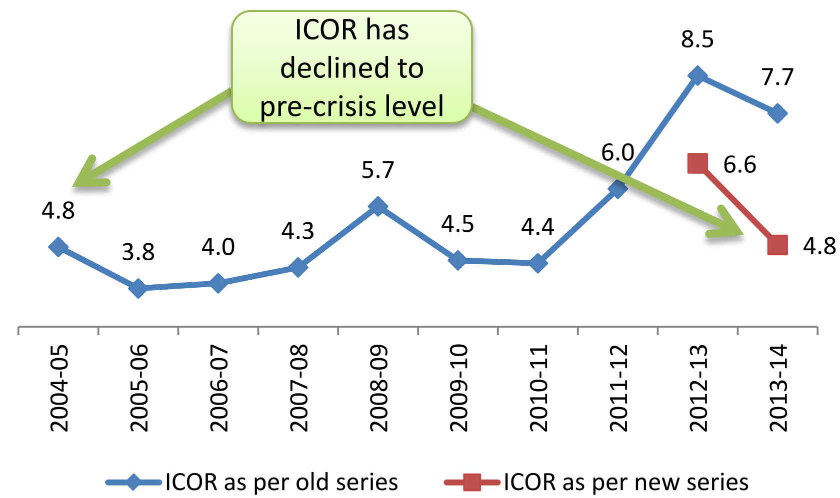
- Investment (GFCF) as a proportion to GDP have declined post 2011-12. This was accompanied by lower capital efficiency (rising Incremental Capital Output Ratio) .
- Slowdown was driven by rising policy uncertainty, delayed project approvals and supply bottlenecks (particularly in power and mining), partially due to higher interest rates (IMF, 2014 and Tokuoka, 2012) and other structural constraints .
- Efficiency of capital has risen in the last one year due to better business environment, speedier clearances etc.

Decline in Investments...



Source: CSO

...but higher capital efficiency



Note: Capital efficiency has been measured by ICOR which is calculated as the ratio of GFCF to incremental GDP at MP
Source: CSO

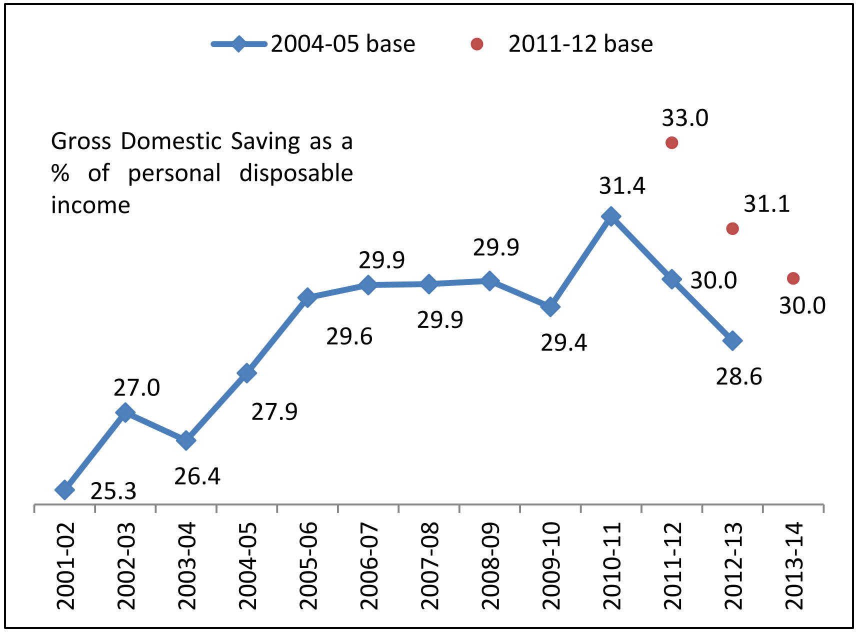
What are the structural constraints in India?

- Some of the structural constraints as indicated by some studies are the following:
  - **Delayed project Approvals**: Difficulties in taking quick decisions on project proposals have affected the ease of doing business resulting in considerable project delays and insufficient complementary investments.
  - **Ill-targeted subsidies** cramp the fiscal space for public investment and distort allocation of resources.
  - **Low manufacturing base**, especially of capital goods, and low value addition in manufacturing. Manufacturing growth and exports could be facilitated with simplified procedures, easy credit, and reduced transaction cost.
  - Presence of a **large informal sector** and inadequate labour absorption in the formal sector. Absence of required skills is considered an important reason.
  - **Low agricultural productivity-** Sustaining high economic growth is difficult without robust agricultural growth.
    - Structural factors engendering continued high food inflation need to be tackled.
    - Issues related to significant **presence of intermediaries** in the different tiers of marketing, **shortage of storage** and **processing infrastructure**, inter-state movement of agricultural produce, etc. need to be addressed.

Source: Economic Survey 2013-14, Ministry of Finance, Government of India

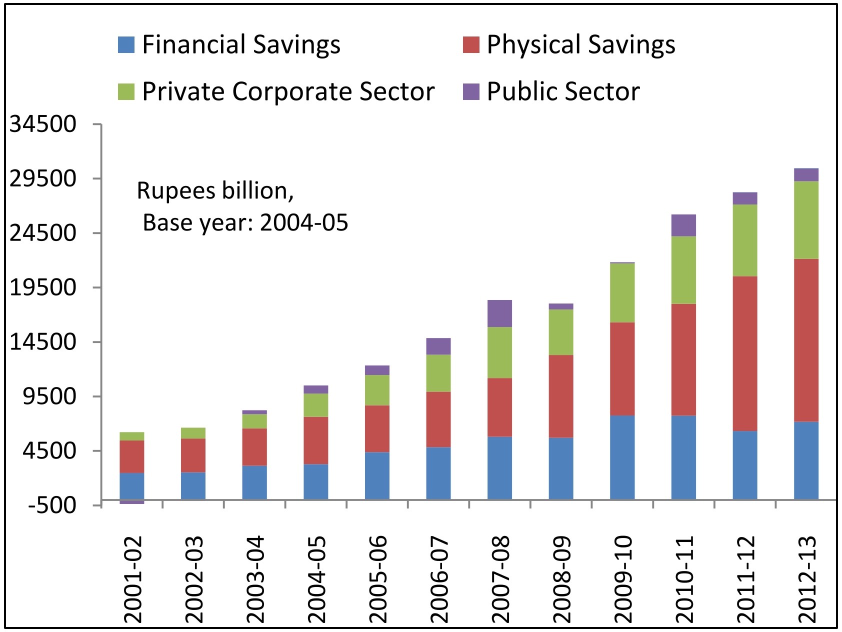
Savings have declined and shifted to less productive assets

Decline in savings since 2010-11



Source: CEIC database

Private and financial savings witness a decline

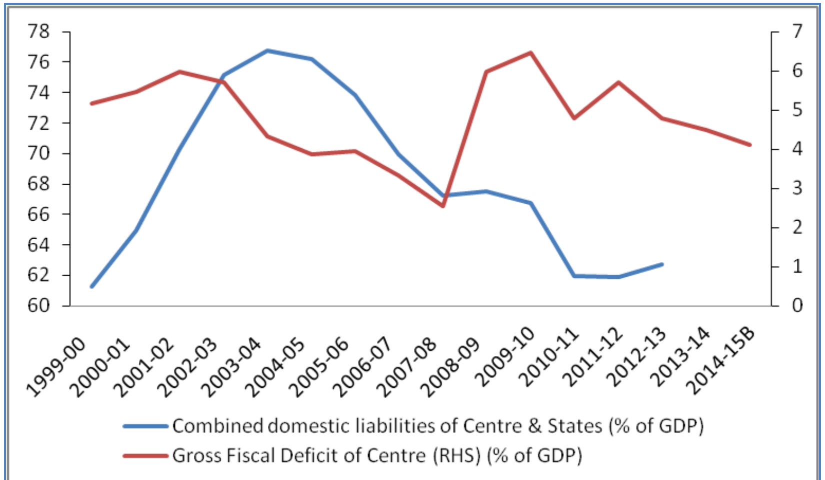


Source: RBI database

- Gross national saving rate is over 30% of GDP, higher that OECD and BRICs standards.
- Rate of saving as a % of Gross National disposable income fell to 30% in 2013-14 from 33% in 2011-12 as per the CSO.
- High inflation and negative real interest rates on bank deposit have distorted household behaviour.
- Gold and real estate have been preferred to bank deposits (OECD Economic Survey of India, 2014)

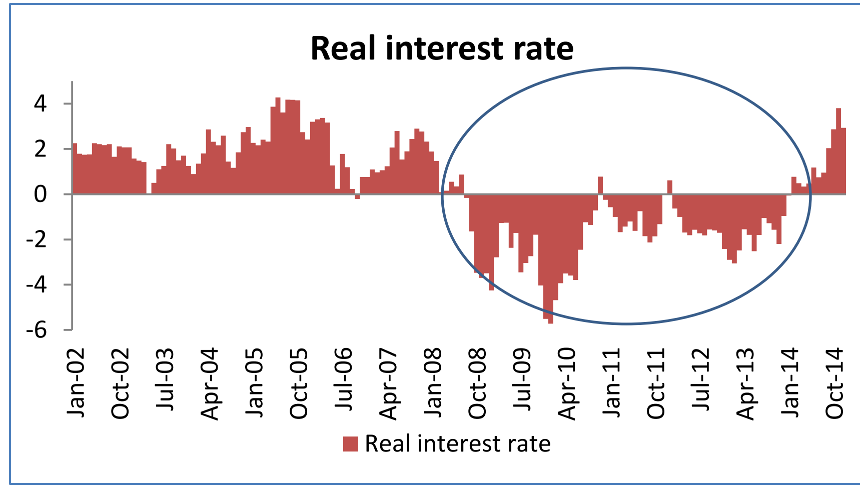
Worsening fiscal situation

Ballooning deficits but overall debt under control



Source: RBI, Economic survey

Inflation has played and important role in stabilizing the debt; resulting in negative interest rate in last few years



Adversely affecting the financial savings

Source: Economic survey

Budget 2015-16:

- Acceleration of economic growth is likely to boost the revenue
- Low international energy prices will significantly reduce the energy subsidy burden
- Significant increase in the surplus profit transfer by the RBI to the government.
- Cuts in the capital expenditure to curb fiscal deficit is worrisome.

Fiscal Indicators (% of GDP)

(Red denotes increase from previous year while grey denotes decline)

	Gross Fiscal Deficit	Gross Primary Deficit	Revenue Deficit	Subsidies
2007-08	2.5	-0.9	1.1	1.4
2008-09	6	2.6	4.5	2.3
2009-10	6.5	3.2	5.2	2.2
2010-11	4.8	1.8	3.2	2.2
2011-12	5.7	2.7	4.4	2.5
2012-13	4.8	1.8	3.6	2.6
2013-14	4.5	1.1	3.1	2.2
2014-15RE	4.1	0.8	2.9	2.1
2015-16B	3.9	0.7	2.8	1.8

Source: RBI, Economic survey

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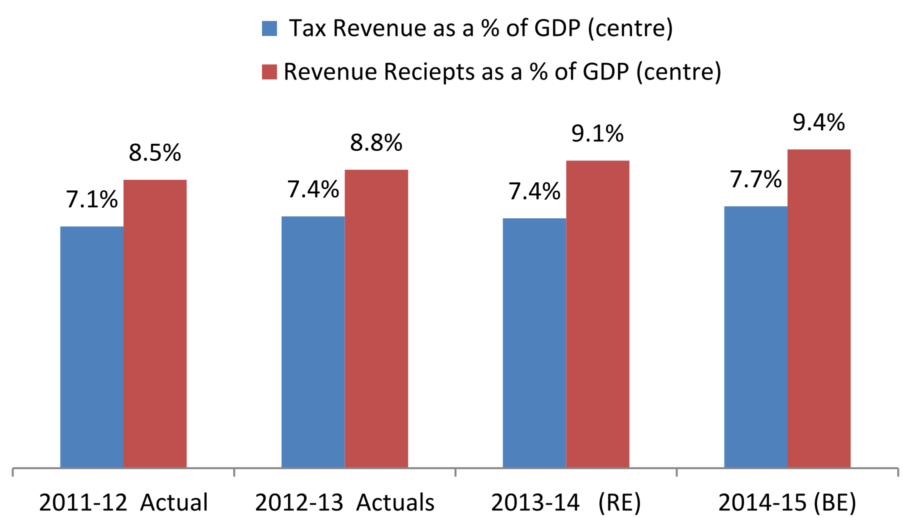
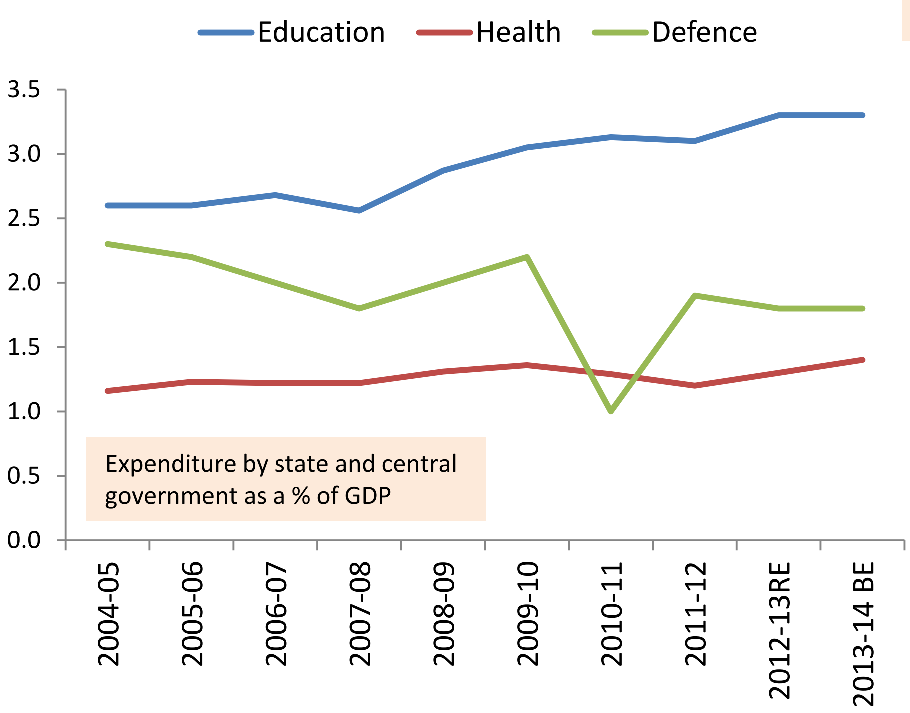


Note- BE= Budget estimate, RE= Revised Estimate, GDP at Market prices (2004-05 base used)
Source: Union Budget, CSO

- Tax to GDP ration has stagnated in the last 4 years.
- Even with higher growth predicted for FY15 (7.4%), the rise in tax to GDP ratio is only marginally higher .
- As per the World bank database, India's tax revenue as a % of GDP for 2013 at 10.7% was much lower than the world average of 14. 3%.
- Implementation of the Goods and Services Tax (GST) will be instrumental in raising the tax to GDP ratio.

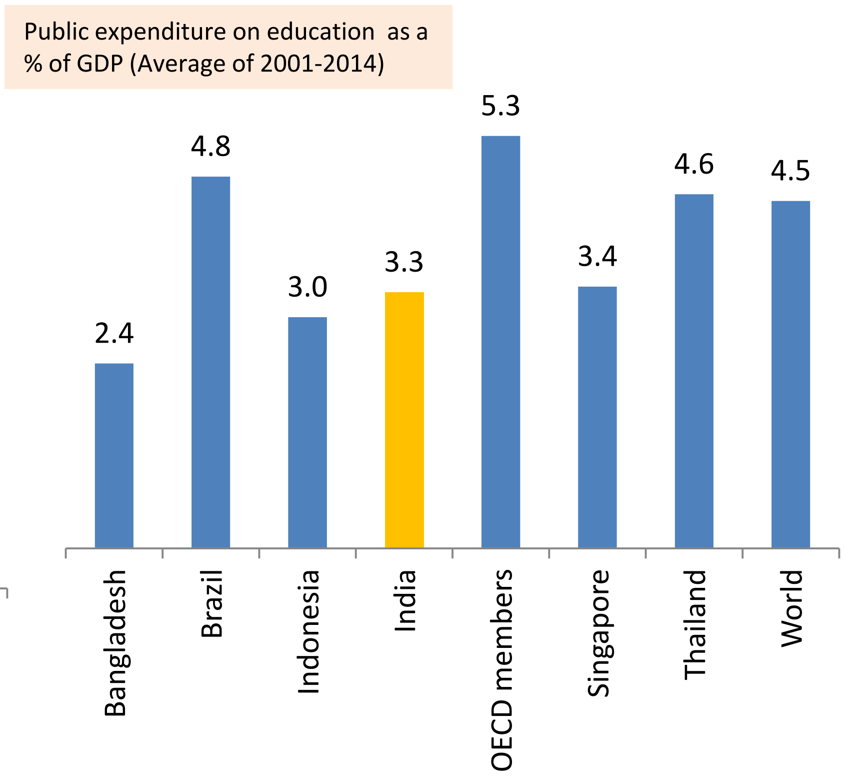
Higher spending on social services is needed

Spending on health has been really low



Source: Economic survey of various years, Ministry of finance, Government of India

Spending on education is much lower than world



Source: World bank database

14th Finance Commission Report: New dimension to centre- state relations

Major Recommendations
Increase the share of states in centre's divisible tax pool to 42% from current 32%
Reduce fiscal deficit to 3.6% and 3% of GDP by 2015-16 and 2016-17 respectively and revenue deficit to zero by 2019-2020
An independent fiscal council to be established to undertake fiscal policy implications of budget proposals.
Compensate states fully (100%) for 3 years in case of revenue loss due to GST
Do away with plan and non- plan distinction in revenue expenditure of state governments
FRBM act to be replaced with a Debt ceiling and Fiscal Responsibility legislation

Source: 14th Finance Commission Report

- The union government on 24th February, 2014 accepted the recommendations of 14th Finance Commission.
- The commission was headed by former RBI governor Dr. Y.V. Reddy.
- The commission has assumed a nominal gross domestic product (GDP) growth rate of 13.5% during the five-year period.
- The increased share of tax devolution from the centre to the states will provide greater fiscal policy space to states, even at the cost of leaving less revenue for its own schemes and programs
- Increase in the flow of unconditional transfers to states and would leave enough fiscal space for the centre to carry out specific purpose transfers to states
- The report adhered to the recommendation of the Kelkar committee on the fiscal consolidation road map assuming improvement in the macro-economic conditions and improvement in total tax revenues due to tax reforms

Deteriorating health of the banking system

Asset quality of commercial banks in India has deteriorated due to downturn in the economy in recent years

- Strains on a number of companies/projects has resulted in sharp rise in NPAs

- Return on equity has declined sharply on account of lower profitability; however, fresh infusion of capital post the implementation of Basel III capital norms since April 1, 2013 is also responsible for the decline (RBI Annual Report, 2014)

Select Financial Indicators of SCBs (Red denotes increase from previous year while grey denotes decline)

	1998	2008	2009	2010	2011	2012	2013	2014
CRAR (per cent)	11.5	13.0	13.2	14.5	14.2	14.2	13.9	13.0
Gross NPA (per cent)	14.8	2.4	2.4	2.5	2.3	2.9	3.4	4.1
Net NPA (per cent)	7.6	1.1	1.1	1.1	0.9	1.2	1.7	2.2
Return on Equity (per cent)	14.6	12.5	13.3	13.3	13.7	13.4	12.9	9.5
Interest Spread (per cent)	3.1	2.4	2.4	2.7	3.1	3.1	3.0	-

Gross NPAs Across Sectors (% of gross advances to the sector)				
	2011	2012	2013	2014
Agriculture	3.3	4.3	4.7	4.4
Medium & Small Enterprises	3.6	4.0	5.1	5.2
Other Priority Sector	4.0	4.4	3.0	3.0
Total Priority Sector	3.6	4.2	4.4	4.4
Non Priority Sector	1.8	2.3	3.0	4.0
Total	2.4	2.9	3.4	4.1

Financial Inclusion in India

- Mandate to transfer MNREGA wages through bank accounts and accounts opened under PMJY scheme has ensured that nearly all Indian households have bank accounts.
- Improvement in banking infrastructure and significant increase in accounts have not translated in operations in terms of transactions (RBI Annual Report 2014)
- A large number of bank accounts remain dormant, resulting in costs incurred for banks and no benefits to the beneficiaries (GoI, 2014)
- **Suggested measures to increase the transactions**
  - Reinvention of microfinance scheme to improve the borrowing from low income group. Instead of relying on private player who charge high rate of interest, government should focus on public sector banks. Overdraft facility under PMJY step in the right direction, however, implementation will be the key
  - Proposed Post Bank of India should also have focus on small loans for people with little or no collateral and no credit history
  - Linking ADHAR number with bank account for Direct Benefit Transfers (DBT)
  - Improving the financial literacy

Pradhan Mantri Jan-Dhan Yojana

	No Of Accounts			No Of Rupay Debit Cards	Balance In Accounts	No Of Accounts With Zero Balance
	(In Lacs)			(In Lacs)	(In Lacs)	(In Lacs)
	Rural	Urban	Total			
Public Sector Banks	533	451.47	984.48	912.32	817463.04	655.41
Regional Rural Banks	184.89	32.98	217.87	149.68	159948.08	159.35
Private Banks	32.26	20.12	52.38	45.93	72551.5	29.97
Total	750.15	504.57	1254.7	1107.9	1049962.62	844.73

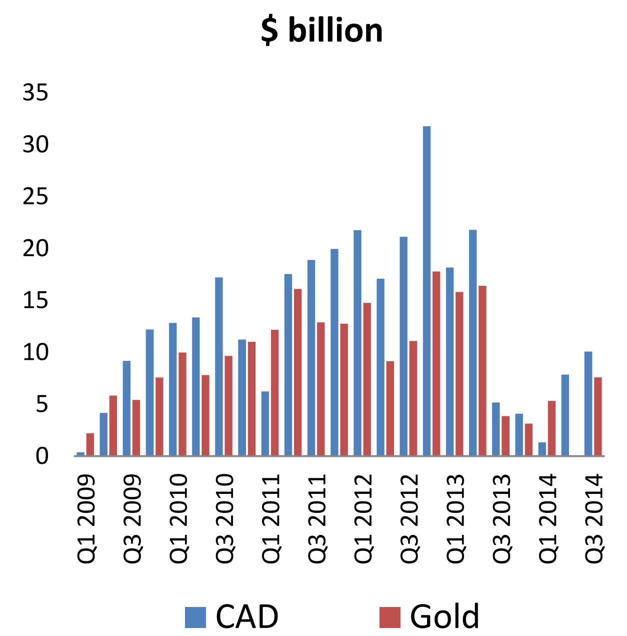
Improvement in CAD, but external sector vulnerable

- Moderation in gold imports and international crude oil prices has pulled CAD down. Gold has been a key driver of the CAD in recent years
- Despite improvement in CAD, the external position remains vulnerable
- Export growth remains subdued
- Reserves cover less than eight months of import
- The quality of reserve has also declined; potentially volatile component of our liability has increased from 42 % of reserve in 2010 to 66 % of reserve in 2014

Balance of Payments	Avg.2004-2008	Avg.2010 -2014	2010-11	2011-12	2012-13	2013-14
Merchandise Exports (% change)	25.3	12.2	40.4	20.9	-1	3.9
Merchandise Imports (% change)	32.3	9.7	27.6	30.3	0.5	-7.2
Trade Balance/GDP (%)	-5.4	-8.9	-7.5	-10.1	-10.5	-7.9
Invisible Balance/GDP (%)	5.1	5.7	4.6	5.9	5.8	6.1
Current Account Balance/GDP (%)	-0.3	-3.2	-2.8	-4.2	-4.7	-1.7
Net Capital Flows /GDP(%)	4.6	3.7	3.7	3.6	4.8	2.6

(Red denotes increase from previous period while grey denotes decline)

External Debt Indicators						
External Debt Stock (US$ billion)	156.5	357.9	317.9	360.8	409.4	440.6
Debt-GDP Ratio (%)	17.7	20.4	18.2	20.5	22	23.3
Import cover of Reserves (in Months)	**13.9**	**8.5**	**9.5**	**7.1**	**7**	**7.8**
Short-term Debt to Total Debt (%)	13.6	21.2	20.4	21.7	23.6	20.3
Reserves to Debt (%)	**113.7**	**85**	**95.9**	**81.6**	**71.3**	**69**

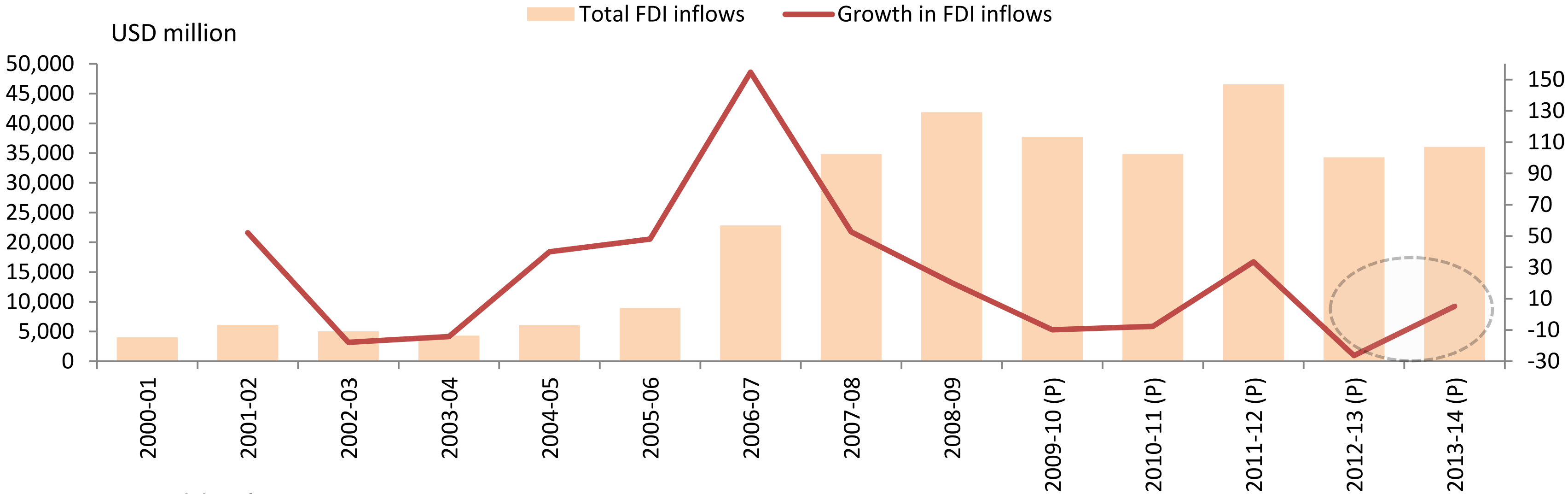


Source: Thomson Reuter Datastream, RBI

Exchange rate misalignment

- Free fall of the Rupee value in recent years has raised the question of fair/equilibrium value of the currency
- Overvaluation/undervaluation creates distortions in the market; these episodes are followed by painful corrections
- Despite sharp depreciation in recent years, studies show that Rupee is still overalued
  - Bhagwati & Barua (2014) show that Rupee is overvalued by 7 – 8 % at the exchange rate of 63.6 Rs./$
  - Rajwade (2014) showed that due to high remittances and capital inflows India is suffering a variety of the Dutch Disease
  - Rajwade (2014) said that exchange rate needs to be around 70 Rs./$

Mild uptick in FDI inflows



Note: P- Provisional
Source: Department of industrial Policy and Promotion

- The uptick in FDI inflows was on account of higher inflows in telecommunications (300%), computer software(130%), chemicals (200%) and power (100%) sector.
- Services sector, metallurgical industries, Hotel & Tourism are the sectors which witnessed maximum decline in last 2 years.
- Japan continues to be among the top 5 countries investing in India.

Share of top investing countries FDI equity inflows

USD million	Country	2010-11	2011-12	2012-13	2013-14	2014-15 (April-November)
1	MAURITIUS	6987	9942	9,497	4859	5205
2	SINGAPORE	1705	5257	2308	5985	3747
3	JAPAN	1562	2972	2237	1718	1289
4	U.K.	755	7874	1080	3215	998
5	NETHERLANDS	1170	1115	1856	2270	2429

Source: Department of industrial Policy and Promotion

MEA'S Annual Budget

(In crores)

Year	2012-13	2013-14	2014-15	2015-16
MEA (RE)	10,062.00	11,793.65	12,620.00	14,966.83*
MEA(A)	10,114.77	11,794.94	NA	NA
GTB (RE)	14,30,825	15,90,434	16,81,158	17,77,477*
% of GTB (RE)	**0.70**	**0.74**	**0.75**	**0.84****

Source: Ministry of External Affairs and Expenditure budget, Union Budget.

Abbreviations:

BE: Budgeted Estimate
RE: Revised Estimate
MEA: Ministry of External Affairs
A: Actual
NA: Not available
GTB: Government's Total Budget

* Budgeted Estimates figure due to unavailability of Revised Estimates figures for the respective years
** Calculated using Budgeted Expenditure due to unavailability of Revised Estimates for the respective years

Annual Budget MEA- Components

(In crores)

Year	2012-13	2013-14	2014-15
ITEC (RE)	3,633.93	5,411.65	6,268.81*
A&L to countries (RE)	5,471.93	7,038.15	9,434.82*
ITEC (% of MEA RE**)**	36.12	45.89	49.67***
A&L to countries (% of MEA RE**)**	**54.38**	**59.68**	**64.05****

Source: Ministry of External Affairs and Union Expenditure budget

Abbreviations:

RE: Revised Estimate

MEA: Ministry of External Affairs

A&L: Aid and Loans

NA: Not available

ITEC: India Technical and Economic Cooperation

* Budgeted Estimates figure due to unavailability of Revised Estimates figures for the respective years

** Calculated using Budgeted Expenditure due to unavailability of Revised Estimates for the respective years

** *Calculated as percentage of ITEC (budgeted) to MEA (revised) due to unavailability of ITEC Revised Estimates for year 2014-15.

Aid and Loan advanced to the following countries: Bhutan, Afghanistan, Nepal, African Countries, Mongolia, Sri Lanka, Myanmar, Eurasia, Bangladesh, Maldives, Latin American Countries and Others.

Annual Budget MEA- A&L Top 5 recipients

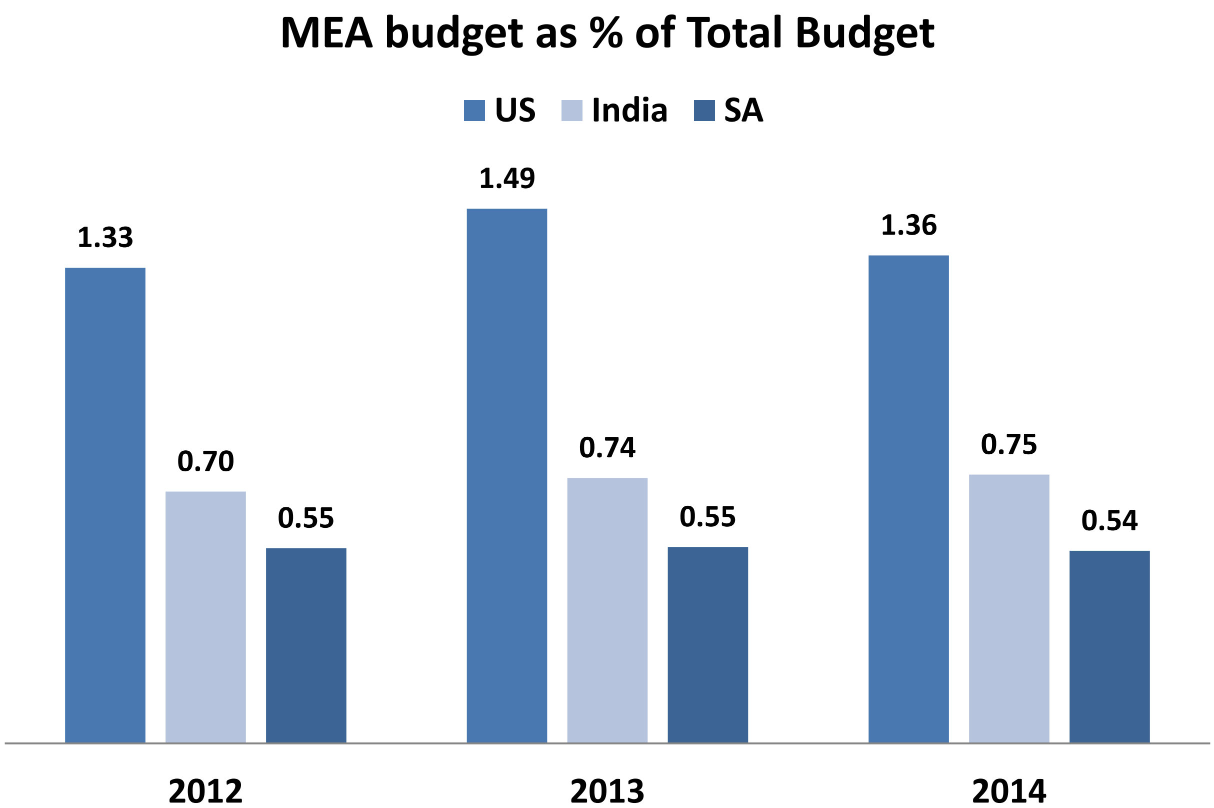
(In crores)

Year	2012-13	2013-14	2014-15 *
Bhutan	3,409	4,190	6,074
Afghanistan	491	525	676
Sri Lanka	290	410	500
Bangladesh	280	580	350
Nepal	270	380	450

Source: Outcome Budget, Ministry of External Affairs.

Aid and Loans advanced to the other countries include, African countries, Mongolia, Myanmar, Eurasia, Maldives, Latin American countries and Others.

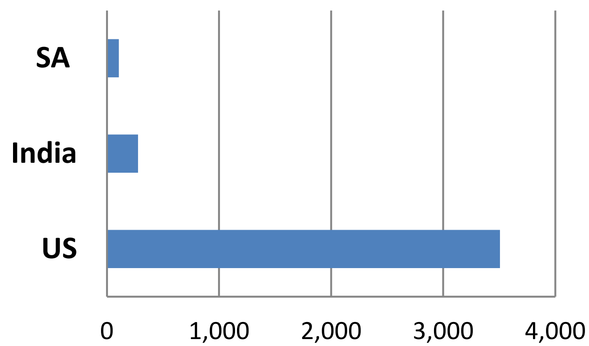
Annual Budget MEA- India, US, SA



Note: SA denotes Republic of South Africa.
SA equivalent of MEA, India is Department of International Relations and Cooperation.
USA equivalent of MEA, India is Department of States.
Source: US- U.S Department of State and The White House
India- Ministry of External Affairs and Expenditure budget, Union Budget
Republic of South Africa- National Treasury, Ministry of Finance, Republic of South Africa

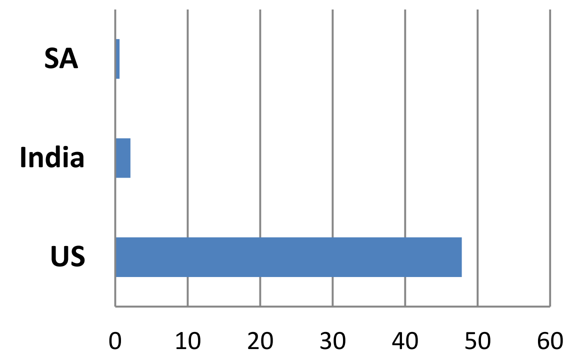
Comparison of Annual Budgets

Total Budget (In $ Billion)



	US	India	SA
Total Budget	3,506	276.8	106.1

MEA Budget (In $ Billion)



	US	India	SA
MEA Budget	47.8	2.1	0.6

- India's 2014 Union Budget is around **7.9%** of US Federal Budget.
- India's 2014 MEA budget was around **4.3 %** of US Department of State Budget.
- Republic of South Africa's budget for the same was around **1.19 %** of US Department of State Budget.

Note: SA denotes Republic of South Africa.
SA equivalent of MEA, India is Department of International Relations and Cooperation.
USA equivalent of MEA, India is Department of State.
Source: US- U.S Department of State and The White House
India- Ministry of External Affairs and Expenditure budget, Union Budget
Republic of South Africa- National Treasury, Ministry of Finance, Republic of South Africa