Foreign & Commonwealth Office

India Monthly Economic Report
Budget Edition 2017
British High Commission, New Delhi

SUMMARY:

- India's GDP – 7% growth in Q3 FY17
- India's Budget 2017 : focus on quality fiscal consolidation
- Divergent inflation : wholesale and consumer prices diverge on the back of rising crude oil prices
- GST Update

India's GDP – 7% growth in Q3 FY17

On 28 February, India's Central Statistics Office (CSO) released the first official estimate of economic growth post demonetisation. According to them, India's GDP grew at 7% (y/y) in Q3 FY17 as against 7.4% in Q2, despite the decision to make all Rs 500 and Rs 1000 notes invalid last November. Also, The CSO retains the 7.1% growth forecast of FY17.

This figure is contrasted by IMF's forecast. The IMF had forecast growth to slow to 6.6% in 2016-17, down from 7.6% in 2015-16, which would have led to India temporarily losing its crown as the fastest growing economy in the G20 to China. Similarly The Reserve Bank of India had forecast GDP to fall to a three year low of 6.9%. Also the Economic Survey had forecast growth of between 6.5% and 6.75% in advance of the Indian Budget. The Survey also referred to demonetisation as having short-term costs and long-term benefits.

Underlying the CSO's overall growth estimate was the following:

- The CSO showed manufacturing growth of 8.3% in Q3. However, this contrasted with short term manufacturing indicators such as Purchasing Managers Index and Index of Industrial Production which showed a contraction in Q3 FY16.
- The de-mo impact was visible in financial, real estate and professional services which grew at 3.1% in Q3 as compared to 7.6% in Q2. The construction sector grew at 2.7% in Q3 from 3.4% in Q2.
- The agriculture sector which grew at 6% in Q3 from 3.8% in the previous quarter and Public administrative services grew at 12% as compared to 11% in Q2.

A more clear view on impact of demonetisation on growth remains to be seen in the last quarter of FY17.

CSO: anticipated GDP year on year comparison –

Final Expenditures	Second Advance Estimates		First Advance Estimates	
	FY-17 (post De-mo)	GDP FY-16 (Revised)	GDP FY-17 (pre De-mo)	GDP FY-16
Private Final Consumption Expenditure (Demand)	7.2%	7.3%	6.5%	7.4%
Government Final Consumption Expenditure (Government Expense)	17%	2.9%	23.8%	2.2%
Gross Fixed Capital Formation (Investment)	0.6%	6.1%	-0.2%	3.9%
Inventory (Change in Stock)	17.2%	7.9%	5.2%	5.5%
Exports	2.3%	-5.4%	2.2%	-5.2%
(less) Imports	-1.2%	-5.9%	-3.8%	-2.8%
GDP at constant prices	**7.1%**	**7.9%**	**7.1%**	**7.6%**

India's Budget 2017: Focus on quality fiscal consolidation

Finance Minister Arun Jaitley presented the Union Budget 2017-18 – a fiscally conservative one, though it included some giveaways for low earners, focus on agriculture and rural sector and increased infrastructure spending.

Focus on fiscal discipline and FRBM Report

Before the budget, an independent panel headed by N K Singh, former Revenue Secretary, submitted a report to the Finance Minister on modifying the 13-year old Fiscal Responsibility and Budget Management (FRBM) Act. The panel's report provided the government with reasons to step up spending on key sectors without compromising on overall need for fiscal consolidation. It recommended a Fiscal Deficit target of 3% for the next three years – and the Government adopted a target of 3.2% for FY18, (Fiscal target for existing year is 3.5%) with the milestone 3% to be achieved in FY19. The revenue deficit (excess of revenue expenditure over revenue income) for FY18 was brought down from 2.3% to 1.9% while capital expenditure increased from 1.2% to 1.3% – a policy intended to boost public spending and revive growth.

Abolition of FIPB, automatic route for foreign investors

The Foreign Investment Promotion Board (FIPB) is an inter-ministerial body, responsible for processing approvals on some FDI proposals. In his Budget speech, Finance Minister Jaitley announced the abolition of the FIPB in 2017-18, describing it as an FDI liberalisation move. Based on Government's view of sector sensitivity to domestic and strategic priorities, currently 90% of investments are in the automatic route (do not require approval from this board) – which indicates that the move appeared logical since the government's intent to reduce intervention except where absolutely necessary and level the playing field as far as possible between Indian and foreign investors. The minister in his Budget Speech however added that a road map for the abolition would be introduced over the next few months. In November 2015, 15 sectors were liberalised for FDI, by increasing the percentage of foreign investment allowed in the various sectors. Then in June 2016, the government made amendments to the FDI policy in seven sectors, most importantly in defence, civil aviation and pharmaceuticals.

In the long run the Government of India has said that it expects demonetisation – the decision to make all Rs 500 and Rs 1000 notes invalid overnight last November - to increase the tax base and tax revenue as the share of the formal economy increases. The Budget also announced a 5% reduction in the tax for lower earners, to encourage them to pay income tax which will widen the tax base and as a result, we may expect an increase in the (income) tax-to-GDP ratio (17.5% currently). This reduction in personal income taxes and increase in exemption limits may increase liquidity with households and will boost consumption spending. The Budget also proposed a ban on cash transactions beyond £3,500, with the receiver paying an amount equivalent to the cash received as penalty. Jaitley also announced further anti-corruption reforms, including initiatives such as limit on cash donations to trusts/political parties to £25 per person, per donation, and funding political parties through new 'Electoral bonds'.

GST Update – Implementation in July?

In the 10th GST Council meeting, the draft law for compensating states for loss of revenue from GST implementation was cleared. With the next meeting scheduled for March 4, the agenda is set to seek approvals on the three pieces of legislation - and classification of goods and services under different tax slabs. The government is keen to roll out the new regime from July 1 but for that, it will have to get two laws – the Central GST (CGST) Act and Integrated GST (IGST) Act – approved by Parliament and each of the state legislatives have to pass the State GST (SGST) Act , before being ratified by the president.

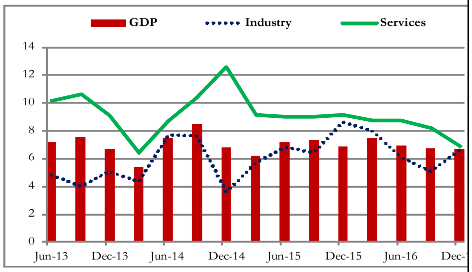
Divergent Inflation: wholesale and consumer prices diverge on the back of rising crude oil prices

WPI (wholesale price index) rose at a faster-than-expected pace, reaching a 30-month high of 5.25% in January due to rising global crude oil prices, even as food prices moderated. At the same time, CPI (consumer price index) inflation slowed to 3.2% in the same month – reflecting weak demand following demonetisation. CPI inflation is typically higher than the WPI – the last time the reverse was true was in 2011, when crude oil prices hit a high of $113. WPI is a producer price index including fuel and power, manufactured products and primary articles, while CPI includes more consumer centric items like food and beverages, housing, clothing etc.

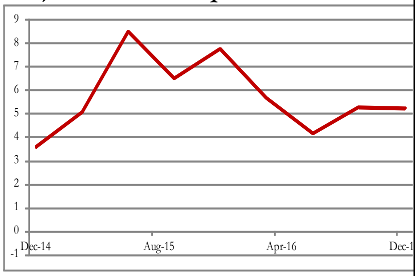
End of loosening cycle? – The Reserve Bank of India kept the policy repo rate on hold at 6.25% and shifted the monetary policy stance from 'accommodative' (more prepared to reduce interest rates), to 'neutral' (unlikely to cut rates, seeing upside inflation risks). The bi-monthly meeting of monetary policy on February 8 indicated transitory effects of demonetisation and expectation of rebound growth in next year. The RBI Governor Urjit Patel and the MPC committee also highlighted the risk of rise in global crude oil prices, volatility in the exchange rate and impact of the year's payout on 7th Central Pay Commission. However the RBI has targeted to keep inflation below the 5% mark until March 2017.

GROWTH: *IIP and PMI show contraction, while Q3 GDP growth is 7%.*

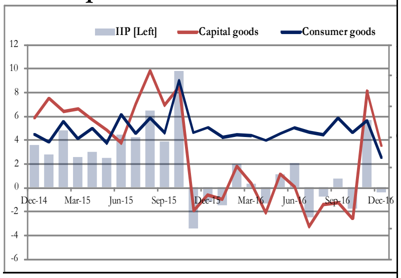
GDP



Projects Under Implementation

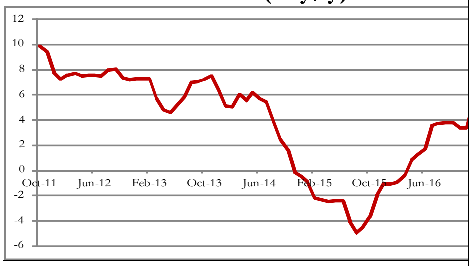


IIP/Capital/Consumer Goods

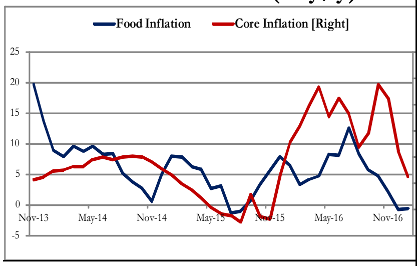


INFLATION: *Wholesale inflation grew at 5.25% , Retail inflation grew at 3.2%*

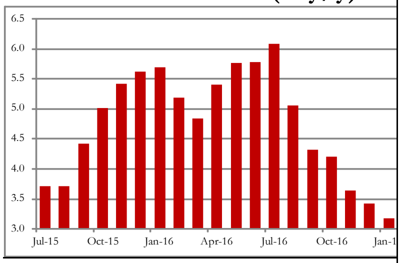
Wholesale Price Index (% y/y)



Food vs. Core Inflation (% y/y)

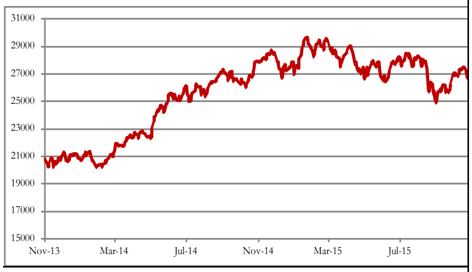


Consumer Price Index (% y/y)

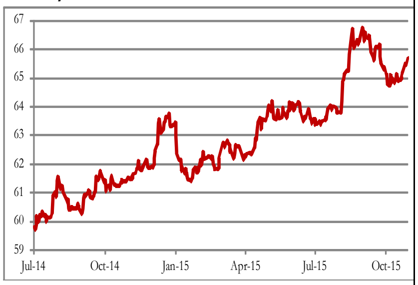


MARKETS: *Financial Markets remain volatile*

SENSEX



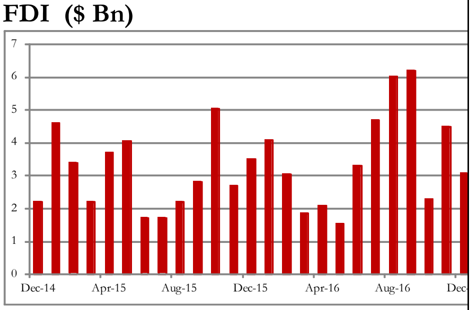
USD/INR



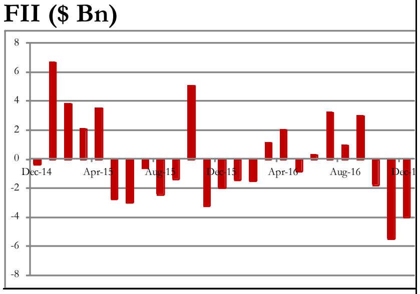
10yr Govt. Securities yield (%)

EXTERNAL: *FIIs trim exposure*

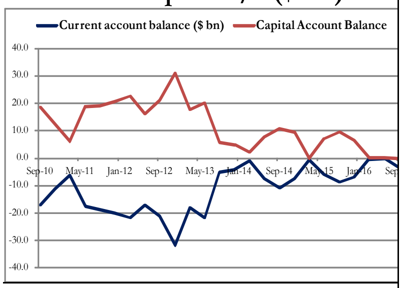
FDI ($ Bn)



FII ($ Bn)

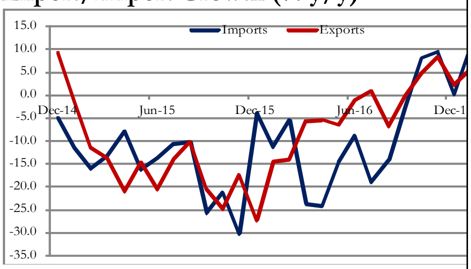


Current vs. Capital A/c ($ Bn)

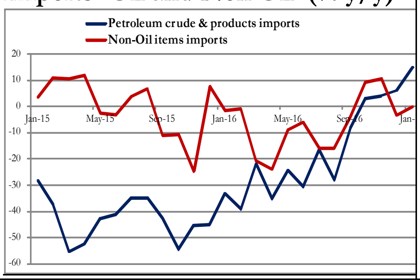


TRADE: *Increase in oil prices affect Export and Import*

Export/Import Growth (% y/y)



Imports- Oil and Non Oil (% y/y)



Trade Balance ($ Bn)