Global uncertainties, India's growth prospects

Normalisation of the economy has been disturbed and the growth objective would be served by apt fiscal policy moves

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On February 28, 2022, the National Statistical Office (NSO) released India's GDP data for Q3 of 2021-22 along with Second Advance Estimates (SAE) for 2021-22. Post COVID-19, the normalisation of the Indian economy has now been disturbed by the ongoing geopolitical uncertainties.

Growth performance

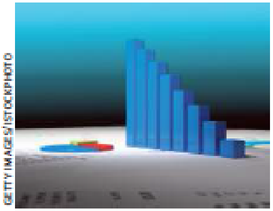
In the COVID-19 year of 2020-21, both real GDP and GVA contracted by minus 6.6% and minus 4.8%, respectively. The NSO's SAE show that real GDP and GVA growth are estimated to recover to 8.9% and 8.3%, respectively, in 2021-22. Despite this improvement, the magnitude of real GDP at ₹147.7 lakh crore in 2021-22 is only marginally higher than the corresponding level of ₹145.2 lakh crore in 2019-20. The NSO's GDP data highlights that in 2021-22, the nominal GDP growth at 19.4% is significantly higher than the real GDP growth due to an inordinately high implicit price deflator (IPD)-based inflation rate of 9.6%. Monetary policy authorities need to take note of this.

The magnitudes of all demand components in 2021-22 have surpassed their corresponding levels in 2019-20. However, the growth of consumption and investment demand – as measured by private final consumption expenditure (PFCE) and gross fixed capital formation (GFCF) in 2021-22 over 2019-20 is only 1.2% and 2.6%, respectively, suggesting sluggish revival in domestic demand. On the output side, the 2021-22 magnitude of the trade, transport *et.al* sector, which has many contact-intensive segments, has remained below its corresponding level in 2019-20 by ₹2.9 lakh crore. Growth in the construction sector in 2021-22 was at only 1.9% over 2019-20.

On a quarterly basis, both GDP and GVA show normalising growth with waning base effects. Real GDP growth moderated from 20.3% in Q1 to 5.4% in Q3 of 2021-22. Similarly, real GVA growth also fell from 18.4% to 4.7% over this period. The implied Q4 GDP and GVA growth rates are estimated to be even lower at 4.8% and 4.1%, respectively. Thus, without a base effect, quarterly growth performance appears to be averaging at less than 5%. Assuming some base effects to continue in the first two quarters, the annual growth in 2022-23 may not be more than 7%. Even this may not be realised due to the ongoing geopolitical conflict.

Crude upsurge impact

It is difficult to arrive at precise estimates of the impact of the increase in global crude prices, but some idea can be provided using the Reserve Bank of India (RBI)'s recent estimates (2021) of the growth and inflation effects of an increase of U.S.$10/bbl., *ceteris paribus*. The estimated impact is a reduction in real GDP growth by 27 basis points and an increase in CPI inflation by 40 basis points. This is based on using the baseline global crude price level of U.S.$75/bbl. For the full year of 2022-23, we may consider an average global



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crude price of U.S.$100/bbl. as a benchmark, although in the short run, it has already surged to U.S.$123.21/bbl. (average Brent crude price for the week ending March 7, 2022). An increase of U.S.$25/bbl. from the baseline price of U.S.$75/bbl. would lead to an estimated reduction in growth of 0.7% points and an increase in inflation of nearly 1% point. With reference to baseline growth for 2022-23 at 7% and CPI inflation at 5%, the revised levels of these may be put at 6.3% and 6%, respectively, due to the impact of crude price upsurge by an assumed margin of U.S.$25/bbl. through the year. The impact would be much larger if the margin of increase is enhanced. If the prices of other imported commodities also increase, the inflation impact will be higher.

Other challenges

In regard to fiscal implications, reference may be made to the budgeted nominal GDP growth forecast for 2022-23 at 11.1%. Assuming a revised real growth component of 6.3% and an IPD-based inflation component of 6.5%, which may be slightly higher than the corresponding CPI inflation, we may have a revised nominal GDP growth close to 13.0%. Applying on this, a tax buoyancy of 1, the resultant Centre's gross tax revenues (GTR) would be higher than the budgeted magnitude of ₹27.6 lakh crore by a margin of about ₹3.2 lakh crore. Alongside, there would also be increases in some components of expenditures linked to prices of petroleum products, including petroleum and fertilizer subsidies. The Government should attempt to keep the fiscal deficit at the budgeted level.

Other economic challenges emanating from global uncertainties may include a worsening of the current account balance due to higher import bills with a depreciating rupee. A study by the RBI in 2019 had estimated an increase in the current account deficit (CAD) following a U.S.$10/bbl. increase in global crude price, to be nearly 0.4% points of GDP. Thus, for an increase of U.S.$25/bbl. in global crude prices, the CAD may increase by 1% point of GDP. The RBI Professional Forecasters Survey's median estimate of CAD at 1.9% of GDP for 2022-23 may have to be revised upwards to 2.9%.

There would also be some sectoral supply-side bottlenecks and cost escalation. Sectors that draw heavily on petroleum products, such as fertilizers, iron and steel foundries, transportation, construction and coal, would be adversely affected. Due to the discontinuation of transactions through SWIFT, there would be some disruption in trade to and from Russia and Ukraine. However, the respective shares of imports and exports from these countries relative to India's overall imports and exports are limited. There would also be some adverse effects with regard to financial flows. Net foreign portfolio investment (FPI) outflows during October to December 2021 increased to U.S.$6.3 billion. Net foreign direct investment (FDI) inflows have also been falling during this period although they have remained positive.

Policymakers may have to exercise a critical choice regarding who bears the burden of higher prices of petroleum products in India among consumers and industrial users, oil marketing companies and the Government. If the oil marketing companies are not allowed to raise prices of petroleum products, the bill for oil sector-linked subsidies would go up. If the central and State governments reduce excise duty and value-added tax (VAT) on petroleum products, their tax revenues would be adversely affected. If, on the other hand, the burden of higher prices is largely passed on to the consumers and industrial users, the already weak investment and private consumption would suffer further. If growth is to be revived, maximum attention should be paid to supporting consumption growth and reducing the cost of industrial inputs with a view to improving capacity utilisation. The Government may have to strike an appropriate balance among these options.

As developed countries are being forced to raise their interest rates and inflationary pressures continue to mount in India and abroad, the RBI may find it advisable to raise the policy rate with a view to stemming inflationary pressures and outward flow of the U.S. dollar even as the growth objective would be served by fiscal policy initiatives.

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