INDIAN ECONOMY

CRISIL Insights

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Through the monthly CRISIL Insights Indian Economy series, we offer incisive analysis of macroeconomic parameters of the country. In this issue, we offer a panoramic view of the central government's finances over the past 15 years and take a look at the implications of the interim budget in the short run

Fisking the fiscal math

The past couple of years have seen the central government veer off their fiscal targets. This was mainly due to transitory disruptions from demonetisation, glitches in implementation of the goods and services tax, and more recently, the income support scheme for farmers. An analysis of the central government's finances over the past 15 years - the period spanning the rule of the United Progressive Alliance (UPA) I, II, and the present National Democratic Alliance (NDA) governments – reveals the following:

- The fiscal deficit of the central government has come down from over 6% of GDP in the post-crisis period of fiscal 2010 to around 3.4% in fiscal 2019. However, after a phase of consolidation, the government's finances are once again under stress
- The medium-term objective of the fiscal policy has been to bring down the deficit to 3% of GDP on a sustained basis, as prescribed by the Fiscal Responsibility and Budget Management (FRBM) Act. However, this target has been met only once since 1991 – in 2008, on the back of strong growth and changes in tax rates leading to healthy tax collections. Meeting this target has been an exception rather than the norm
- Historically, the gap between actual fiscal deficit and the budget target has been quite wide and increases with the time horizon of the target. What is encouraging is that despite a high error rate, the gap has been narrowing over time in the base year as well as first- and second-year ahead rolling forecasts
- Final budgets do not differ much from interims in terms of overall fiscal targets and broad expenditure and revenue trends as the wiggle room remains more or less the same due to commitments under the FRBM Act. After it took over in May 2014, the NDA government had retained the fiscal targets set in the interim budget of the UPA II government. The wiggle room for fiscal 2020 does not exist as fiscal deficit has been targeted 30 basis points higher than originally envisaged under FRBM

Part of the recent slippage is due to transitory factors that will correct over a period, but a good part is also due to factors that could persist. There is a need to check populist measures such as farm loan waivers and accelerate attempts to mobilise revenue to regain fiscal health.

Global Research & Analytics

Money and Banking	Industrial Production	Inflation
Focus shifts to growth	Y-O-Y uptick, sequential slip	On the descent

MONEY AND BANKING

- Stumping status quo-ists and going for growth, the Reserve Bank of India (RBI)'s Monetary Policy Committee (MPC) slashed the policy rate by 25 basis points and unanimously moved to ease its policy stance to neutral from calibrated tightening
- Repo rate now stands at 6.25%, and the reverse repo and marginal standing facility (MSF) rates at 6.00% and 6.50%, respectively. Short-term interest rates such as that on commercial paper and certificate of deposit continued to soften
- Systemic liquidity remained tight, but eased compared with December. To support liquidity, the RBI continued open market operations
- Banking credit continued to post double-digit growth, registering 14.2% on-year as of January 18, 2019. However, growth was still not broad-based as industrial credit growth remained anemic
- CRISIL Research expects banking credit to grow at ~13% on-year this fiscal compared with 7.4% in fiscal 2018, driven by strong retail credit growth, higher disbursement to non-banks, and resolution of big ticket-sized stressed assets

INDUSTRIAL PRODUCTION

- IIP grew at 2.4% in December, compared with 0.3% in November, led by manufacturing. Despite the uptick, Q3 growth sulked at 3.6% compared with 5.3% in Q2, led by sluggish growth in manufacturing
- According to the end-use classification, the sharpest pick-up was in infrastructure and construction goods, where growth doubled to 10.1% compared with November. This segment continues to display strength backed by government-supported construction activity
- For the year so far (April to December) IIP growth is higher at 4.6%, compared with 3.7% in the last fiscal
- For fiscal 2020, growth impetus will be mostly domestic, driven by private consumption and investment. While the government's investment spending is gradually taking a backseat, given the push to consumption, capacity utilisation can improve and private sector investments should start looking up

INFLATION

- Consumer price index (CPI) inflation fell to a 19-month low of 2.05% in January on continued negative food inflation and a sharp drop in fuel inflation
- CPI inflation has declined for the fifth consecutive month and reached close to the lowest inflation reading (1.5% in June 2017) in this series
- Food inflation was negative for the fourth straight month and led the fall in headline inflation. Fuel inflation, which had reached double digits a few months back, has also been easing. It declined for the fourth straight month, reaching a low of 1.3% in January, largely on account of negative petrol and diesel inflation
- Wholesale Price Index (WPI)-based inflation too slowed down in January. Falling for the third consecutive month, WPI inflation reached 2.8% in January 2019, a ten-month low. The slowdown in fuel and manufacturing inflation pulled down headline WPI inflation
- For fiscal 2019, CRISIL forecasts CPI inflation at 3.7%, compared with 3.6% recorded in fiscal 2018. In fiscal 2020, however, inflation may see some upside

Interest Rate	Rupee	Trade
Fiscal fret	Rise from fall	A claw back, a flat line

INTEREST RATE

- Yield on the 10-year government security (G-sec) averaged 7.50% in January, 10 basis points (bps) higher on-month
- Fiscal concerns ahead of interim budget and rising oil prices weighed on sentiment
- The dovish monetary policy delivered by the Federal Reserve helped cool domestic yields towards the month-end
- State governments are expected to borrow Rs 2.19-2.26 trillion from the bond market in the January-March quarter, sharply higher than Rs 1.23-1.28 trillion in the previous quarter, raising concerns of crowding out in the bond market
- We expect bond yields to soften slightly in fiscal 2020, driven by an easing monetary policy, benign crude prices, and slowing global growth. The latest cut in the repo rate, coupled with the change in the monetary policy stance from calibrated tightening to neutral, should reduce some pressure on bond yields
- CRISIL expects the 10-year G-sec yield to average 7.5% by March 2020 from an estimated 7.6% average in March 2019

RUPEE

- Rupee posted modest gains in January as the greenback slid for the first time in 11 months, hit by political and economic exigencies in the United States (US)
- The rupee averaged 70.7 per US dollar ($) in January, gaining marginally 0.1% on-month (losing 11.1% on-year). This marks the third successive month of gains for the rupee
- The US dollar index[1] depreciated on-month for the first time since January 2018 on concerns of slowing US growth amid the prolonged government shutdown and the Federal Reserve's dovish stance
- Further gains were capped as foreign portfolio investors (FPIs) net-withdrew $0.8 billion from the Indian market, predominantly from equities
- A pick-up in crude oil prices, after two consecutive months of decline, also kept the investors cautious. Brent crude oil price averaged $59.4 per barrel in January, 5.1% higher on-month

TRADE

- Merchandise exports[2] recovered slightly in January, growing 3.7% on-year compared with 0.3% in December 2018. Meanwhile, imports flatlined, growing 0.02% compared with -2.4%
- Trade deficit stood at $14.7 billion, $1.7 billion higher on-month but $0.9 billion lower on-year. Trade deficit was mainly brought down by non-oil goods
- In January, oil imports slipped for the first time in two-and-a-half years. Due to a 14% decline in crude oil prices, oil imports declined 3.6% in January, compared with 3.2% growth in the previous month
- Services exports grew 12% on-year in December compared with 8.3% in the previous month

[1] Dollar index (broad) is the weighted average of the foreign exchange value of the US$ against the currencies of a broad group of 26 major US trading partners
[2] All trade figures are in US$ terms

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