NOTE FOR THE
ECONOMIC ADVISORY COUNCIL
TO THE PRIME MINISTER (EAC–PM)

# STATE OF THE ECONOMY

*Quarterly Assessment and Outlook*
*October-December, 2022*

**National Institute of Public Finance and Policy**
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# 1 MAJOR HIGHLIGHTS

## Monetary policy developments

- Non-food bank credit growth has been strong so far despite rise in interest rates, indicating revival in demand. The composition of non-food credit has turned more broad-based. While credit in 2021 was primarily driven by the personal loans segment and services segment, credit to industry has seen a pick up in the first two quarters of the current year. Particularly, the pick up in bank credit to large industries bodes well for investment revival in the economy.

- The RBI has undertaken a process of monetary policy normalisation since the beginning of FY 2022-23; increasing rates and withdrawing surplus liquidity through variable rate reverse repo auctions (VRRR). The RBI has raised the policy repo rate by 225 basis points. The repo rate is presently at 6.25 percent and is at its highest level since 2019. Short-term yields have hardened in response to the monetary policy tightening. The benchmark 10 year also rose but not at the same pace as the short-term yields. The recent moderation in the domestic wholesale and retail inflation has led to softening of yields. However, the hawkish tone of Federal Reserve officials caused an across the board marginal hardening of yields towards the latter part of November. Going forward, yields are likely to fluctuate within a narrow band.

- Foreign Portfolio Investors were net sellers in Q1. They turned net buyers in the second quarter (Q2), with a net investment of USD 6909 million. The recent softening of inflation, along with the prospect of slower rate hikes have improved foreign investor sentiment. However the recent resurgence of Covid cases in China may make them cautious.

- Banks continue to witness improvement in asset quality. According to the Financial Stability Report, December 2022, the gross non-performing assets (GNPAs) of scheduled commercial banks fell to a seven-year low of 5.0 per cent and net non-performing assets (NNPA) have dropped to ten-year low of 1.3 per cent in September 2022. Net NPAs of private banks have fallen to 0.8 percent, as against 1.8 percent for public sector banks in September, 2022.

- According to the Financial Stability Report, December 2022, while the GNPA ratio of the NBFC sector fell from 6.9 per cent in June 2021 to 5.1 per cent in September 2022, stress is observed in some segments of the NBFC sector such as NBFC Investment and Credit Companies and NBFC-Factor. The recent regulatory refinements on NBFCs are also likely to impact the sector's assessment of asset quality in the near term.

## Fiscal policy developments

- Own revenues aggregated across 26 states during Apr-Oct 2022 show an increase of around 26.73 percent as compared to that during the same period in 2021-22. Own revenues were about 44 percent higher than that during April-Oct 2019. The robust growth in own revenues is due to the growth in own tax revenues (which increased by 26.81 percent Apr-Oct 2022 vis-à-vis Apr-Oct 2021) and own non-tax revenues (which were higher by about 26.17 percent).
- Central transfers aggregated across 26 states show an increase of about 21.77 percent during Apr-Oct 2022 vis-à-vis 2021. Growth in central transfers was driven largely by tax devolution which grew by about 40.30 percent during Apr-Oct 2022 as compared to that in 2021. Central grants to states, however, show a modest increase of about 4.15 percent during this period.
- In the 2022-23 budget, the Union government provided Rs. 1 lakh crore to states for capital expenditure under the scheme "Special Assistance to States for Capital Investment 2022-23". Despite capex push from the Union government, states have been tardy in their expenditure on capital account. Capital expenditure aggregated across 26 states during Apr-Oct 2022 was lower by about 0.43 percent vis-à-vis Apr-Oct 2021. Several states report a fall in capital expenditure during Apr-Oct 2022 vis-à-vis April-Oct 2021.
- States are seen to be consolidating fiscally. However, states' fiscal consolidation is driven by robust own tax revenues and tax devolution as also by compression in capital expenditure.
- Market borrowings by states during Apr-October 2022-23 was lower by about 5.1 percent as compared to that during Apr-Oct 2021-22. In addition to the comfortable cash flow position of the state governments due to higher tax devolution to states by the Union government and robust growth in own tax revenues the Lower offtake can also be attributed to the uncertainty regarding inclusion of off-budget borrowings of state governments in deciding their annual borrowing limits.
- The gross tax revenue of the Union government during Apr-Oct of the current fiscal is higher by 18 percent as compared to the same period in 2021. All central taxes contributed to the increase with the exception of Union Excise Duties. Collections from Union Excise duties were lower by about 18.8 percent.
- Robust direct tax collections can be attributed to improved economic activity and higher corporate profitability. Duty cuts in petrol and diesel by the Union government to cool inflation led to lower collections under union excise duties during this period.
- GST collections have continued to remain buoyant. High inflation, stronger enforcement and improved economic activity are the key drivers of higher GST revenues.
- Capital expenditure of the Union government was higher by about 61.5 percent as compared that that during 2021. In contrast, the revenue expenditure was higher by about 10.25 percent.
- On account of buoyant revenues, revenue deficit during the first four months of 2022-23 was 16.39 percent of the 2022-23 budgeted estimates while fiscal deficit was 20.52

percent of 2022-23BE. The Union government in order to give push to capital spending had budgeted for a higher capital expenditure in 2022-23BE.

- Fiscal deficit was 38.6 percent higher than that in 2021. In December, the government has sought an additional amount of Rs.3.6 trillion as supplementary demands for grants for 2022-23, primarily to fund a higher subsidy bill on items such as fertilizers, food and LPG. Although this might increase the fiscal deficit in absolute terms but the FD-GDP ratio is likely to remain within the target of 6.4 percent.

## Optional simplified corporate and personal income tax rate systems

- In a recent innovative policy reform, India's corporate income tax system was overhauled with optional lower rates in lieu of giving up complex deductions. The lower rates of 25 percent for domestic manufacturing companies, 22 percent for all companies and 15 percent for domestic manufacturing startups involve giving up ever larger sets of deductions.
- However, official data reveals a puzzle wherein larger companies have opted more for the lower optional rates while smaller ones appear reluctant in switching to the optional regime.
- The use of tax deductions and other provisions to create low or zero tax companies led to introduction of minimum alternate tax. This further complicated the tax code.
- This provides the rationale for a simpler tax regime with lower rates but fewer deductions. Some of the optional schemes also do not impose minimum alternate tax.
- Our analysis finds that the absence of accelerated deductions and carry forward of loss in some of the the new optional schemes such as the one for startups may be a major deterrent to adoption by smaller firms which are unlikely to have positive profits in initial years. On the other hand, for larger mature firms, absence of MAT may be a major attraction.
- In light of the analysis, policy options are suggested to improve the scheme so as to achieve the laudable objective of implementing a simple tax regime with lower rates and minimal deductions.

## External trade and domestic sector specific policy developments: June-December, FY 2022-23

- During June-December 2022-23, India has taken various efforts related to trade and development through negotiations, agreements & MoUs; and promotion and facilitation through launching e-portals. Some of the prominent bi-lateral trade agreements taken place during this period are (i) India-UK FTA negotiations, (ii) Comprehensive Economic Cooperation and Partnership Agreement (CECPA) Forum 2022 in collaboration with Economic Development Board, Government of Mauritius, and (iii) India-Gulf Cooperation Council (GCC). These initiatives are expected to create new jobs, raise living standards, and provide wider social and economic opportunities in the country.

- In order to curb rising prices of wheat flour, the Cabinet Committee on Economic Affairs, has approved the proposal for amendment of the policy on exemption for Wheat or Meslin Flour (HS Code 1101) from export restrictions/ ban. In order to ensure food security of 1.4 billion people of the country, the decision was taken to put a prohibition on export of wheat in May 2022 in the back drop of rising domestic wheat prices as a consequence of the Ukraine war. The approval will now allow to put a restriction on the export of Wheat Flour.
- To bring ease in international trade transactions, the Government of India has made suitable amendments in the Foreign Trade Policy and Handbook of Procedures to allow for International Trade Settlement in Indian Rupees (INR) i.e., invoicing, payment, and settlement of exports / imports in Indian Rupees.
- To build a strong and inclusive ecosystem for innovation and entrepreneurship in India, Start-up India has launched a call for startup applications for registration on the Mentorship, Advisory, Assistance, Resilience and Growth (MAARG) portal, as the National Mentorship Platform. The MAARG portal claims to be an one stop platform to facilitate mentorship for startups across diverse sectors, functions, stages, geographies, and backgrounds.

## Growth assessment and outlook

- The GDP estimates for the quarter Q2 (July-December) 2022-23 as provided by the National Statistical Office (NSO) record an increase by 6.3 percent from the level in Q2 2021-22. The slowdown of growth in Q2 2022-23 reflected base effect normalisation, along with contraction in mining and manufacturing.
- Trade, hotels & transport services recorded double digit growth in Q2 2022-23. The output in the Trade, hotels & transport services finally exceeded the output of the pre-pandemic level in this quarter. Agriculture, Utilities, Construction, Financial services, real estate and professional services, and Public administration, defense and other services recorded robust growth in this quarter.
- All expenditure side components of GDP, except for Govt. Final Consumption Expenditure (GFCE), recorded robust growth in Q2 2022-23 from their respective levels in Q2 2021-22 In this quarter, private consumption expenditure finally exceeded the pre-pandemic level, indicating private demand revival.
- Overall, we expect mixed performances across sectors/sub-sectors in Q3 2022-23, with agriculture and services showing resilience, while industrial activities may show some improvement as private demand revives. However, the yearly growth rate will be moderate on account of normalisation of the base effect, fiscal consolidation at the state level, monetary tightening and slow down in the global demand.
- According to the projections by IMF and World Bank and RBI, the Indian economy is expected to grow at 6.8-6.9 percent in 2022-23 and at 6.1-6.5 percent in 2023-25. According to NIPFP estimates, India is projected to grow at a robust rate of **7.2 percent per year over the period 2022-23 to 2026-27.** The medium term growth projections for India by IMF and RBI are **6 percent** and **6.5–8.5 percent** respectively. World

Bank predicts India to grow on average at a rate of **7 percent** during the three-year period of 2022-24.

## Inflation assessment and outlook

- The average headline inflation remained elevated during April-November 2022 at 6.95 percent on account of high and sticky inflation in all its components, e.g, CPI food, CPI energy and CPI core inflation. However in November 2022, headline inflation was recorded at 5.9 percent, below the upper band of RBI's tolerance level for the first time in FY 2022-23.
- Cost-push factors such as agricultural wage inflation and MSP hike, adverse weather shocks and rising global edible oil and crude oil inflation have mainly driven wholesale and retail food inflation up during April-October 2022. Food inflation significantly moderated in November 2022 with the arrival of the winter crop.
- A broad-based rise in inflation in core items is observed in the first half of FY 2022-23. High rate of oil inflation, along with demand revival in the face of pandemic-induced supply constraints caused core inflation to remain high.
- Overall, the headline inflation in December 2022 is expected to decline further to 5.3 percent and continue the trend for the rest of the FY 22-23. It is expected to be at 6.3 percent, higher than RBI's upper limit of the tolerance range the FY 2022-23. However, upward risks are as follows:
    1. Increasing trend in rural wage inflation, including agricultural wage inflation as a consequence of wage-price spiral and robust agricultural activities, may induce upward pressure on food and overall inflation from both supply and demand side.
    2. High and sticky cereal inflation driven by domestic wheat price inflation as a consequence of the Ukraine war.
    3. Core inflation is expected to rise in near future despite monetary tightening by RBI, as a consequence of lagged and week transmission mechanism.
    4. Sticky domestic retail energy inflation due to the lagged transmission process of moderating global oil inflation.

## Balance of payments situation

- During April-November of FY 2022-23 India's overall trade (merchandise and services) deficit widened to USD 111.0 billion from USD 47.3 billion in the previous corresponding period. Gross inward foreign direct investment (FDI) moderated to US$ 44.2 billion during April-October 2022 from US$ 48.6 billion a year ago. Net FDI, however, increased to US$ 22.7 billion during this period from US$ 21.3 billion a year ago, mainly due to a decline in outward FDI by India.
- The majority of FDI equity inflows was received by manufacturing, retail and wholesale trade, financial services, computer services and communication services during April-October 2022. Singapore, Mauritius, and the US were major source countries of FDI during this period.

- India-Australia Economic Cooperation and Trade Agreement which will come into effect from 29th December 2022 expected to have a positive aspect in this uncertain trade outlook.

# 2 MONETARY POLICY DEVELOPMENTS

**Radhika Pandey and Lekha Chakraborty**

## 1 Monetary Policy Developments

In the current financial year, the RBI has raised the policy repo rate by 225 basis points. The repo rate is presently at 6.25 percent and is at its highest level since 2019. September and October saw an increase in the short-term interest rates such as the call rate and the 91-day t-bill rate. The benchmark ten year bond yield also rose, but the movement was comparatively range-bound. Increase in interest rates by the US Federal Reserve (four consecutive 75 basis points hike), and the consequent strengthening of the U.S dollar resulted in lowering of the interest rate differential between the Indian and US bonds. The recent moderation in the US inflation prompted expectations of a slower pace of rate hikes.

## 2 MPC Decisions

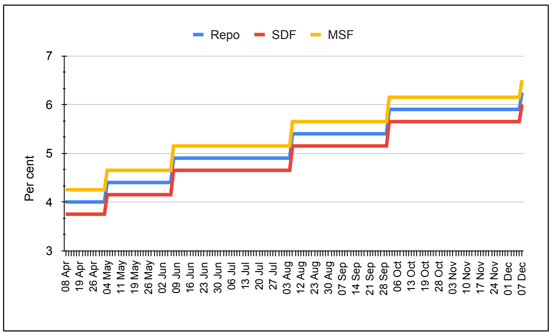
- In its meeting held during 28th-30th September, 2022, the Monetary Policy Committee decided to raise the policy repo rate by 50 basis points to 5.90 per cent. The corresponding upper-bound (MSF) and lower-bound (SDF) rates of the LAF were increased to 6.15% and 5.65% respectively. **The MPC decided to focus on withdrawal of accommodation to ensure that inflation remains within the target band.**

- An additional meeting of the MPC was scheduled on November 3, 2022. The meeting was scheduled under the provisions of Section 45ZN of the Reserve Bank of India Act, 1934 to inform the central government of the reasons for failure to achieve the inflation target, the remedial actions it proposes to take, and an estimate of the time within which the inflation target shall be achieved after the implementation of the remedial actions. The meeting on 3 November was scheduled to formulate a response to the government. A letter was sent to the Government after the deliberations at the meeting.

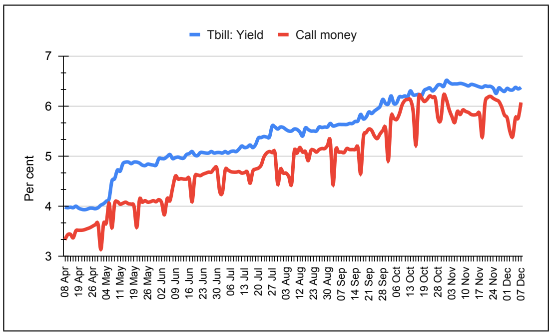
- In its monetary policy meeting held between 5th December and 7th December, the MPC decided to **raise the policy repo rate by 35 basis points to 6.25 percent.** The LAF corridor was kept symmetric with the Marginal Standing facility (MSF) at 6.5 percent and Standing Deposit Facility (SDF) at 6 percent.

  The moderation in inflation prompted the RBI's MPC to reduce the quantum of rate hike. The MPC noted that while the worst of inflation was behind us, the persistence of the core inflation continues to be a cause of concern. The projection for inflation was retained at 6.7 percent. The projection for growth was revised downwards from 7 percent to 6.8 percent for the current financial year. (See panel 1 of Figure 2.1, for the evolution of the RBI LAF corridor in FY 2022-23).

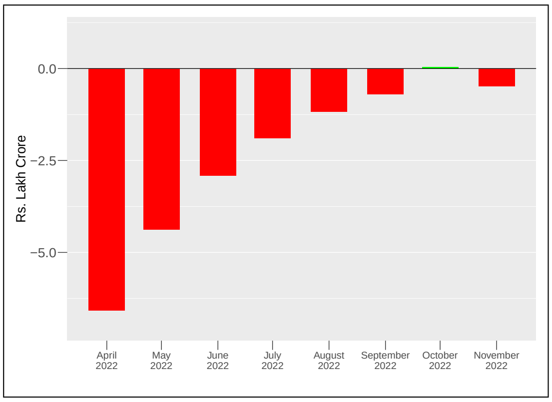
RBI LAF corridor, all rates in percent




91-day TBill yield & Call Rate, in percent




Net liquidity injection/absorption by the RBI




G-Sec yields (1, 5, and 10 year maturities)

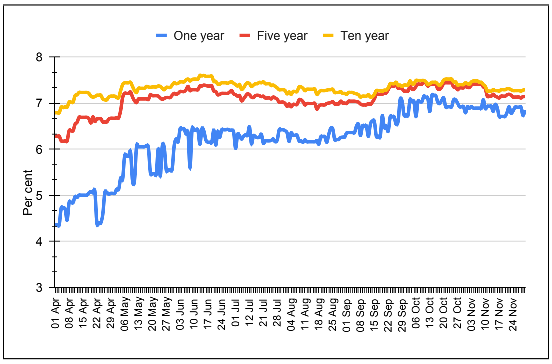



Figure 2.1: Interest rates and liquidity

# 3 Structure of Interest Rates

The RBI has undertaken a process of monetary policy normalisation since the beginning of FY 2022-23; increasing rates and withdrawing surplus liquidity through variable rate reverse repo auctions (VRRR). Consequently, the call rate has continued to inch up.

- Call rate (Panel 2, Figure 2.1): Call rate hovered between 5.10 to 5.15 percent till the middle of September. In the second half of the month, the call rate breached the then repo rate (5.4 percent). **In October, the call rate had been above the then repo rate of 5.9 percent owing to tight liquidity conditions. Increased demand for cash during the festive season, tax outflows, RBI's spot market intervention to stem the rupee slide led to drying up of banking system liquidity in October.** For most of November, the call rate was below 6 percent except for a few days from November 21 to November 28.

- 91 day treasury bill rate (Panel 2, Figure 2.1): Similar to the call rate, the 91-day treasury bill rate also hardened in September, particularly during the last week of September. The rate hike by the US Federal Reserve along with indications of more rate hikes, tightening of systemic liquidity due to advance tax flows and higher auction cut-offs led to hardening of the t-bill rates. October also saw hardening of the t-bill yield. The first week of November saw hardening of yields owing to higher weekly auction cut-offs, the second week saw a moderation in yields owing to better than expected U.S inflation print and decline in crude oil prices. Moderation in the domestic wholesale and retail inflation also led to softening of yields. The hawkish tone of Federal Reserve officials caused an across the board marginal hardening of yields towards the latter part of November.

- Liquidity position (Panel 3, Figure 2.1): On account of rising interest rates, system-wide liquidity, though in surplus, has been decreasing. This is reflected in moderation in the pace of liquidity absorption by the RBI. Average daily liquidity absorption in April 2022 was Rs. 6.59 lakh crore, which came down to Rs. 0.71 lakh crore by September 2022, which came down to Rs 0.48 lakh crore in November, 2022. **Liquidity turned into deficit in the middle of December due to outflows on account of advance tax payments and possible intervention by the RBI.**

- Yields on government bonds (Panel 4, Figure 2.1): **Yields on government bonds were influenced by the US Fed and the RBI's interest rate decisions, global crude oil prices, inflation trajectory in India and the US, trajectory of the US bond yields and the discussion around the future course of interest rates by central banks across the globe.** The yield on the 10 year government bond saw a moderation in the first week of September owing to the buzz around India's bond inclusion in global bond indices. From the second week onwards, yields on government bonds hardened on concerns that the US Federal Reserve will persist with aggressive rate hike path. Post the monetary policy announcement on 30th September, the 10 year bond yield hardened while yields on bonds at the shorter end (1 year and 5 year bonds) eased.

  In October, bond yields rose during the first half of the month as Indian government bonds were not included in global indices. Fall in global crude oil prices in the middle of October led to easing of yields. Optimism over possibility of limited rate hikes by the US Fed resulted in decline in bond yields towards the end of the month.

Indian Government bond yields slid in November, with the *10 year bond yield posting its steepest monthly decline in more than 2 years.* Easing domestic and U.S inflation raised hopes that rate hikes will moderate in the coming months. The fall in bond yields was also aided by buying of government bonds by foreign investors and rupee appreciation. However, the commentary by the US Fed Chair suggested more hawkish outlook. Hence rates hardened towards end November.

# 4 Credit Deployment and Money Supply

## 4.1 Credit Deployment

Despite RBI's rate hikes since May 2022, demand for credit has remained strong, indicating revival in the overall demand.

- Non food bank credit registered a growth of 15.73 percent in Q2 of FY 2022-23 compared to 6.75 percent in the corresponding period of the previous year. This momentum was maintained in October with non-food credit posting a growth of 18.3 percent on a year-on-year basis. *On an incremental basis, non-food bank credit increased by Rs.2.6 trillion in October 2022. The increase in non-food bank credit in October is the highest since April.*
- Credit to industry which was muted in 2021 saw a revival in the first two quarters of FY 2022-23. It grew by 9.47 percent in the first quarter and further by 12.56 percent in the second quarter. While credit to micro and small, and medium industries continued to register double digit growth, credit to large industries jumped from 3.30 percent in Q1 of FY 2022-23 to 7.93 percent in Q2. Credit to industry continued to grow at a strong pace in October. *Credit to large industry registered a double-digit growth of 10.9 percent against a contraction of 0.4 per cent a year ago.*
- Credit to services posted a growth of 20 percent in Q2 as compared to 12.82 percent in the previous quarter. This was led by credit to NBFCs, trade and transport operators. In October, credit to services surged to 22.5 percent.
- Personal loans category also witnessed strong growth in Q2. Credit grew at 19.6 percent as compared to 18 percent in the June quarter. Credit for consumer durables, vehicle loans and housing were the prime drivers of credit growth in this segment. In October too, personal loans continued to witness strong growth.

## 4.2 Money Supply

- Broad money (M3) was Rs 210.72 trillion at the end of the second quarter (Jul-Sep), registering a growth of 8.6 percent over the corresponding quarter of the last year. As per the latest available data, M3 stood at Rs 216.16 trillion as on December 2.[1]
- Currency with public was Rs 30.8 trillion as on December 2. The biggest component of M3 is time deposits with banks, amounting to Rs 162.3 trillion. Time deposits with banks have been growing at a rate of 8.5-8.6 percent since August, 2022. Narrow money or M1 was Rs 53.8 trillion as on December 2. Narrow money registered a growth of 8.4 percent in September, 10.5 percent in October and 9.7 percent in November.

[1] See, https://www.rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=54880

# 5 Foreign Portfolio Investment (FPI) and Foreign Direct Investment (FDI)

Net Flows FPI (USD Billion) Net FPI - Debt and Equity Breakdown (USD Billion)

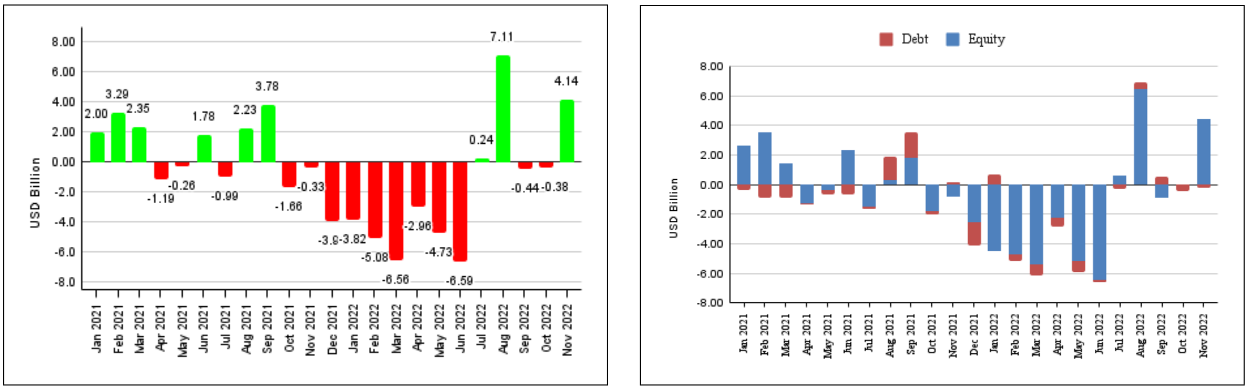



Figure 2.2: FPI - Net Investments

- Foreign Portfolio Investors were net sellers in Q1. They turned net buyers in the second quarter, with a net investment of USD 6909 million. On a monthly basis, FPIs were net buyers in July and August but turned net sellers in September and October (Panel 1, Figure 2.2). **While September was dominated by net outflows from the equity segment, October saw FPIs turning net sellers in the debt segment.** Aggressive monetary policy tightening by the U.S Fed and the consequent narrowing of the yield differential led to outflows of FPIs from the debt segment (Panel 2, Figure 2.2).

- FPIs were net buyers in November and registered net investment of USD 4138 million. Till December 16, FPIs were net buyers to the tune of USD 1058 million.[2]

- After recording strong inflows in Q1 FY 2022-23 (USD 22.3 Billion), Foreign Direct Inflows moderated in Q2 FY 2022-23, at USD 16.6 Billion. This was lower than the corresponding figure of USD 19.8 Billion for same period of the previous year (Q2 FY 2021-22).[3]

# 6 Financial Stability

- Banks continue to witness improvement in asset quality. According to the Financial Stability Report, December 2022, the gross non-performing assets (GNPAs) of scheduled commercial banks fell to a seven-year low of 5.0 per cent and net non-performing assets (NNPA) have dropped to ten-year low of 1.3 per cent in September 2022. Net NPAs of private banks have fallen to 0.8 percent, as against 1.8 percent for public sector banks in September, 2022.

- According to the Financial Stability Report, December 2022, while the GNPA ratio of the NBFC sector fell from 6.9 per cent in June 2021 to 5.1 per cent in September 2022, stress is observed in some segments of the NBFC sector such as NBFC Investment and

[2] https://www.fpi.nsdl.co.in/web/Reports/Yearwise.aspx?RptType=6
[3] A detailed discussion on the trend of FDI and FPI flows follows in Chapter 8.

Credit Companies and NBFC-Factor. The recent regulatory refinements on NBFCs are also likely to impact the sector's assessment of asset quality in the near term.

## 7 Looking forward

- Non-food credit growth has been strong so far in Q2 FY 23, outpacing deposit growth. Going forward, credit growth is likely to slow down with rate hikes, particularly in the rate sensitive sectors. Moreover, banks are also seeking to increase deposit rates, which may provide impetus to deposit growth. As credit growth moderates, the wide gap between credit and deposit growth is likely to narrow.
- For money/bond markets, short-term yields (T-Bills) have increased faster than longer-term yields (GSecs) since the beginning of FY 2022-23. On back of (i) easing inflation, both domestically (5.88% YoY for November 2022), and for the US (7.1% YoY for November 2022), (ii) expectations around a slower pace of central bank rate hikes, (iii) a weakening USD Index, and (iv) possibility of crude oil price remaining subdued, long-term bond yields are expected to remain range bound in the next few months.
- For capital markets, the softening of inflation, (especially US CPI, along with the prospect of slower rate hikes) have improved foreign investment sentiment, as FPIs have turned back to constituting net-buyers in Indian markets[4]. However, hawkish commentary by the US Fed Chair - especially around the terminal policy rate being higher than expected may imply that FPI inflows will continue to remain volatile in the upcoming months. However Domestic Institutional Investors (DIIs) have been providing support to the market.

[4]Both: (i) for November 2022, (ii) till the third week of December 2022.

# 3 FISCAL POLICY DEVELOPMENTS

**Manish Gupta**

## 1 Fiscal Issues: State Governments

- Own tax revenue aggregated across 26 states during April-October 2022 showed an increase of around 26.81 percent as compared to that during the same period in 2021-22. It accounted for about 54 percent of the own-tax revenue budgeted by these states during 2022-23. SGST, Sales tax and State Excise (23.3 percent) which together account for about 80 percent of states' own tax revenues also show considerable increase. **Growth of own taxes aggregated across states has been robust even when compared to that during 2019-20, the last pre-covid normal year** (Table 3.1).
- The own non-tax revenues were also higher during April-October 2022 vis-à-vis April-October 2021. As a result, **own revenue receipts comprising own tax and own non-tax revenues, aggregated across 26 states were higher by about 26.73 percent over April-October 2021. Own revenues were about 44 percent higher than that during April-October 2019.**

Table 3.1: **Percent change in key fiscal indicators of States (26 states)**

| | | **Apr-Oct2022 (as % of 2022-23 BE)** | **% change during Apr-Oct 2022 over same period of** | |
|---|---|---|---|---|
| | | | **2021-22** | **2019-20** |
| 1 | Revenue Receipts | 48.20 | 24.90 | 30.68 |
| 2 | Own Revenue Receipts | 52.71 | 26.73 | 44.35 |
| 3 | Own tax Revenue | 54.51 | 26.81 | 43.24 |
| | a) GST | 54.12 | 30.44 | 38.91 |
| | b) Sales Tax | 56.56 | 18.81 | 44.34 |
| | c) State Excise | 52.51 | 23.30 | 44.75 |
| 4 | Non-tax Revenue | 42.04 | 26.17 | 53.51 |
| 5 | Central Transfers | 42.24 | 21.77 | 11.87 |
| 6 | Tax Devolution | 49.84 | 40.30 | 16.96 |
| 7 | Grants-in-aid | 35.33 | 4.15 | 5.97 |
| 8 | Revenue Expenditure | 48.47 | 13.97 | 28.69 |
| 9 | Capital Expenditure | 30.30 | -0.43 | 20.25 |
| 10 | Total Expenditure | 44.53 | 9.59 | 24.71 |
| | Of which, | | | |
| | a) General Services | 48.23 | 12.07 | 24.52 |
| | b) Social Services | 43.35 | 7.67 | 27.24 |
| | c) Economic Services | 37.16 | 1.92 | 6.96 |

[1]

[1] Source: Comptroller and Auditor General of India

- Central transfers aggregated across 26 states show an increase of about 21.77 percent during April-October 2022 vis-à-vis 2021. However, as compared to the similar period in 2019 (i.e., the last pre-covid normal year), the increase in central transfers was around 11.87 percent. **Growth in central transfers was driven largely by tax devolution which grew by about 40.30 percent during April-October 2022 as compared to that in 2021.** Central grants to states, however, show a modest increase of about 4.15 percent during this period. Central grants during April-October 2022 stood at 35.33 percent of 2022-23 budget estimates (Table 3.1).

- While revenue expenditures aggregated across 26 states during April-October 2022 show an increase of about 14 percent over April-October 2021, capital expenditure was lower by about 0.43 percent. **Several states report a fall in capital expenditure during April-October 2022 vis-à-vis April-October 2021. Capital expenditure accounted for about 30.30 percent of the 2022-23 budget estimates.**

- In the 2022-23 budget, the Union government provided Rs. 1 lakh crore to states for capital expenditure under the scheme "Special Assistance to States for Capital Investment 2022-23". **As per the monthly summary report of Department of Expenditure, Rs.73,880.41 crore have been approved by the Union government for 26 states till November 2022 of which Rs.36,656 crore (i.e., 49.6 percent of the approved amount) has been released to states as 1st instalment.** Despite the capex push from the Union government, states have been tardy in their expenditure on capital account.

- **Combined fiscal deficit of 26 states is lower during April-October 2022 both as percent of 2022-23 budget estimates and also as percent of H1-GDP as compared to that during 2021, 2020 and 2019** as evident from Table 3.2.

- **States are seen to be consolidating fiscally. States' fiscal consolidation is driven by robust own tax revenues and tax devolution as also by compression in capital expenditure.**

Table 3.2: **Fiscal Deficit (26 states)**

| | **April-October** | | | |
|---|---|---|---|---|
| | 2022 | 2021 | 2020 | 2019 |
| As % of H1 GDP | 2.32 | 3.77 | 4.76 | 2.64 |
| As % of 2022-23 BE | 35.31 | 51.44 | 72.72 | 44.68 |

Source: Controller and Auditor General of India; MoSPI.

- As per the tentative borrowing calendar, the State Governments/Union Territories (UTs) were to raise Rs. 4.02 lakh crore during the first two quarters of 2022-23 (Rs. 1.90 lakh crore in Q1 and Rs. 2.12 lakh crore in Q2). States in Q1 of 2022-23 have borrowed 1.10 lakh crores (or 58 percent of the indicative borrowing) and Rs. 1.66 lakh crore (or 78 percent of the indicative amount) in Q2. In Q3, market borrowings by the State Governments/Union Territories (UTs) is expected to be around Rs. 2.53 lakh crores.

- In March, the Union Government in order to bring in transparency in the finances of state governments informed the states that their off-budget borrowings are to be equated with their own debt and any such fund raised by them in 2020-21 and 2021-22 would need to be adjusted out of their borrowing ceiling in 2022-23. With many states facing difficulties due to the borrowing restriction in current fiscal year because of the magnitude of such loans, the Union government relaxed the norms. As per the new norms, off-budget borrowing done by states up to 2020-21 may not be adjusted and only those done in 2021-22 can be adjusted over up to 4 years till March 2026. Lower borrowings by states in Q1-2022 could be on account of the uncertainty associated with the inclusion of off-budget borrowings while fixing the annual borrowing limits of states. Relaxation of these norms in July resulted in relatively higher borrowing by states in Q2-2022. States are expected to perform better in Q3.

- Market borrowings by states during April-October 2022-23 was lower by about 5.1 percent as compared to that during April-October 2021-22. In addition to the comfortable cash flow position of the state governments due to higher tax devolution to states by the Union government and robust growth in own tax revenues the **lower offtake can also be attributed to the uncertainty regarding inclusion of off-budget borrowings of state governments in deciding their annual borrowing limits.**

# 2 Fiscal Issues: Union Government

## 2.1 Revenues

- The gross tax revenue of the Union government during April-October of the current fiscal is higher by 18 percent as compared to the same period in 2021 and it accounts for about 58.4 percent of the budget estimates for 2022-23. All central taxes contributed to the increase in gross tax revenue with the exception of Union Excise Duties (Table 3.3).
- While revenues from Personal Income tax during April-October 2022 was higher by about 27.7 percent, CGST by 31.5 percent, Corporation tax by 24.1 percent and Customs by 9.5 percent as compared to that during April-October 2021, collections from Union Excise duties were lower by about 18.8 percent. Collections from Union Excise duties during April-October 2022 accounted for about 49.45 percent of the budget estimates for 2022-23 (Table 3.3).
- **The Buoyant direct tax collections can be attributed to improved economic activity and higher corporate profitability. Duty cuts in petrol and diesel by the Union government to cool inflation led to lower collections under union excise duties during this period.**
- The GST collections have continued to remain buoyant. Since March 2022, monthly GST collections have been above Rs. 1.4 trillion (Figure 3.1). High inflation, stronger enforcement and improved economic activity are the key drivers of higher GST revenues. In November 2022, GST collection was Rs.1.46 trillion.
- **From July 1, 2022 India imposed tax on windfall gains accruing to oil companies from soaring energy prices due to the Russia-Ukraine conflict.** It joined a select league of nations globally that have taxed windfall gains accruing to oil companies from rising energy prices. **The government imposed Rs.6 per litre tax on the export of petrol and jet fuel (ATF) and Rs.13 per litre on the export of diesel.** Additionally, Rs.23,250 per tonne tax was levied on crude oil produced domestically.

[2]Note: * net of states' share in central taxes and collections under NCCD to be transferred to NDRF.

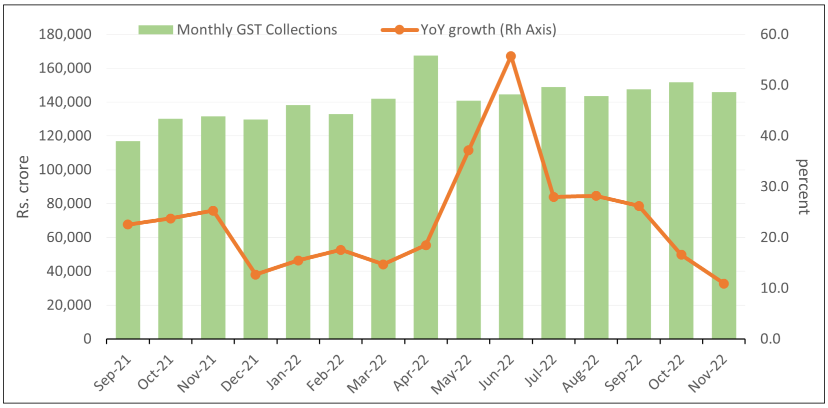
Table 3.3: **Overview of Revenues**

| **Indicators** | **Apr-Oct 2022** *(Rs. Crore)* | **2022-23 BE** *(Rs. Crore)* | **Apr-Oct 2022** *(% of 22-23BE)* | **% change Apr-Oct 2022 & Apr-Oct 2021** | **% change Apr-Oct 2022 & Apr-Oct 2019** |
|---|---|---|---|---|---|
| Revenue Receipt* | 1349882 | 2204422 | 61.24 | 7.14 | 48.73 |
| Gross Tax Revenue | 1609605 | 2757820 | 58.37 | 18.00 | 53.03 |
| Corporation Tax | 410587 | 720000 | 57.03 | 24.09 | 50.53 |
| Income tax | 397605 | 700000 | 56.80 | 27.73 | 62.69 |
| Union Excise duties | 165652 | 335000 | 49.45 | **-18.82** | 45.37 |
| CGST | 413568 | 660000 | 62.66 | 31.46 | 45.26 |
| Customs | 122926 | 213000 | 57.71 | 9.48 | 90.70 |
| Tax Revenue* | 1171103 | 1934771 | 60.53 | 11.20 | 71.34 |
| Non-Tax Revenue | 178779 | 269651 | 66.30 | **-13.57** | **-20.24** |

2

Source: CGA, Union Budget

These rates are to be revised every fortnight. **It is expected that the windfall tax on oil produced within India and fuel exported overseas recoup some of the central revenues lost due to the reduction in excise duty on fuel.**




Source: PIB releases

Figure 3.1: **Monthly GST collections and year-on-year growth**

- Non-tax revenues of the union government during April-October 2022 was 13.6 percent lower as compared to that during April-October 2021. As compared to April-October 2019, the last pre-covid normal year, non-taxes revenue were lower by 20.2 percent. **The fall in non-tax revenues is attributable to monetary compression, lower profits and reduced surplus transfers from RBI and reduced dividends by public sector banks.**

## 2.2 Expenditure

- **On the expenditure side, during April-October 2022, capital expenditure by the Union government was higher by about 61.5 percent as compared that that during 2021.** In contrast, the revenue expenditure was higher by about 10.25 percent.
- The Union government in order to give push to capital spending had budgeted for a

higher capital expenditure in 2022-23BE. During the first seven months of the fiscal 2022-23 (i.e., April-October 2022) (Table 3.4).

Table 3.4: **Overview of Expenditures**

| **Indicators** | **Apr-Oct 2022** *(Rs. Crore)* | **2022-23 BE** *(Rs. Crore)* | **Apr-Oct 2022** *(% of 22-23 BE)* | **% change Apr-Oct 2022 & Apr-Oct 2021** | **% change Apr-Oct 2022 & Apr-Oct 2019** |
|---|---|---|---|---|---|
| Revenue Exp. | 1734697 | 3194663 | 54.30 | 10.25 | 19.34 |
| Capital Exp. | 409014 | 750246 | 54.52 | 61.49 | 103.21 |
| Total Exp. | 2143711 | 3944909 | 54.34 | 17.35 | 29.54 |
| Revenue Deficit | 384815 | 990241 | 38.86 | 22.76 | -29.52 |
| Fiscal Deficit | 758137 | 1661196 | 45.64 | 38.59 | 5.23 |

Source: CGA, Union Budget

- Fiscal deficit during April-October 2022 was about 45.6 percent of the budget estimates for 2022-23 and was around 38.6 percent higher than that in 2021. In December, the government has sought an additional amount of Rs.3.6 trillion as supplementary demands for grants for 2022-23, primarily to fund a higher subsidy bill on items such as fertilizers, food and LPG. Although this might increase the fiscal deficit in absolute terms but the FD-GDP ratio is likely to remain within the target of 6.4 percent.
- For the second half (H2) of 2022-23, the union government in consultation with the Reserve Bank of India has finalised its borrowing plan. During H2-2022-23 it plans to borrow Rs. 5.92 trillion.[3]. Thus, for the entire fiscal year 2022-23, the government now plans to borrow Rs. 14.21 trillion instead of Rs.14.31 trillion. As per the latest available information, till November, the government borrowed Rs. 9.95 trillion (or about 70 percent of its planned borrowing during the current fiscal).

## 3 Future Outlook

- Robust recovery in tax collections augurs well for the Government to provide the required budgeted support to the economy. The investment activity will get boost from government's capex push and improvement in bank credit which will contribute to the economic recovery process.

[3] https://www.pib.gov.in/PressReleasePage.aspx?PRID=1863433

# 4 OPTIONAL SIMPLIFIED CORPORATE AND PERSONAL INCOME TAX RATE SYSTEMS

**Supriyo De**

## 1 Rationale, adoption rates and possible reforms

- India's corporate and personal income tax systems were recently overhauled with optional lower rates in lieu of giving up complex deductions. For corporate income tax, with effect from assessment year (AY) 2017-18 (corresponding to income arising in the previous year or fiscal year (FY) 2016-17), per section 115BA, domestic manufacturing companies were given the option of switching to a lower basic tax rate of 25% instead of the prevailing basic rate of 30%. For this they had to forego certain deductions and incentives. For AY 2020-21 two further lower rate options were introduced. Section 115BAA applicable to all domestic companies offered a lower rate of 22% for foregoing certain deductions. Section 115BAB offered domestic manufacturing start-up companies an even lower rate of 15% for foregoing a wider set of deductions. Section 115BAC came into effect from AY 2021-22 for individuals and HUFs. It offers lower and more graduated tax slabs in lieu of giving up certain deductions and the ability to carry forward and set off losses and claim depreciation in relation to the non-permissible deductions. As with corporate tax rates, the special scheme gives a choice to taxpayers whereby they can opt for lower tax rates and a simpler tax regime instead of higher rates with complex deductions and allowances.

Table 4.1: **Comparison of companies opting for the concessional tax regime and those under earlier tax regime (Financial Year 2019-20)**

| **S. No.** | **Slabs of Total Income (in crores)** | **No. of Companies (under 115BAA)** | **No. of Companies (under 115BAB)** | **No. of Companies (under earlier tax rate of 30% plus surcharge & cess)** | **Total Income (under 115BAA)** | **Total Income under 115BAB) (in crores)** | **Total Income (under earlier tax rate of 30% plus surcharge & cess) (in crores)** |
|---|---|---|---|---|---|---|---|
| **1** | $<0$ & 0 | 44067 | 981 | 483002 | - | - | - |
| **2** | 0-1 | 74948 | 256 | 248934 | 13792.48 | 24.69 | 28561.38 |
| **3** | 1-10 | 19642 | 7 | 19400 | 63106.44 | 10.44 | 57498.13 |
| **4** | 10-50 | 4742 | - | 3060 | 104060.15 | - | 64506.88 |
| **5** | 50-100 | 849 | - | 463 | 59812.06 | - | 32727.46 |
| **6** | 100-500 | 954 | - | 440 | 201569.09 | - | 92647.91 |
| **7** | $>$500 | 246 | - | 130 | 491089.68 | - | 295778.13 |
| | **Total** | **14544** | **1244** | **755429** | **933429.91** | **35.13** | **571719.89** |

Source: Receipts Budget 2022-23

- At first glance, the new regime with lower rate options seems very attractive and should have seen many companies opting for them. However, data from the government reveals a puzzle wherein larger companies have opted more for the lower optional rates while smaller ones appear hesitant in switching to the optional lower tax regime (Table 1).

According to the receipt budget document for 2022-23, in FY2019-20, only 15.85% of companies opted for 22% tax without exemptions/incentives (S. 115BAA) and only 0.14% of companies for 15% tax meant for new manufacturing units (s.115BAB). Of the companies with total income Rs. 0-1 crore, 74,948 opted for s. 115BAA, 256 for s. 115BAB while the vast majority, 2,48,934 remained with the 30% rate. On the other hand, for companies with total income over Rs. 500 crore, 246 opted for s.115BAA and only 130 remained with the 30% tax rate.

- Before delving into the possible reasons for this conundrum, it is useful to highlight the circumstances underlying the move towards a simplified optional tax regime. In 1989-90, there were five rates of corporate tax for: 1) closely held domestic companies engaged in trading or investment, 2) other closely held domestic companies, 3) widely held domestic companies, 4) foreign companies' income from certain fees and royalties, 5) other incomes of foreign companies. A process of rationalization and simplification followed. In 1991-92, the distinction between closely held trading and investment companies and other closely held companies was removed leaving only 4 rates. In 1995-96, the distinction between widely held and closely held companies was also removed leaving one rate for all domestic companies. This simplified structure continued till 2016-17 when a lower tax rate was brought for smaller domestic companies (with taxable income below Rs. 5 crore) bringing the number of rates up to 4 (2 for domestic companies and 2 for foreign companies). From FY 2019-20 this norm was modified to make the small size category being domestic companies with turnover less than Rs. 400 crores in the preceding year. For FY 2020-21, a new set of special rates were instituted for an alternative simplified regime for companies willing to opt for giving up complex tax incentives, deductions and MAT credits for lower upfront rates of tax. This brings the number of rates to 6 (7 if the rate of 25% for small companies is considered different from the 25% special rate for s. 115BA).

- The provisions and reporting of direct taxes in the corporate accounting system when compared with direct tax law need some clarifications. Most tax systems account for incomes in a manner that result in taxable profit being different from profit before tax (PBT) per corporate accounts. These differences arise from differences in depreciation calculations for various assets, additional allowances and incentives given by the tax system and allowances or disallowances of certain expenses. Tax laws also allow for amortization of preliminary expenses (s. 35D of Income Tax Act) and carry forward and set-off of losses that may make corporate accounts and tax accounts dissimilar. Besides divergences in the computation of profits, this could also lead to the rather peculiar situation where a company with positive profits as per corporate accounts would have no or very low taxable income per tax law. Creative accounting and tax planning allowed some companies to deliberately pay low or no tax. To address this, many tax systems put in place alternative minimum tax or minimum alternate tax rules. With minimum alternate tax (MAT) provisions in place, there is an additional layer of complication. Per Indian tax laws, if the corporate income tax calculated is less than a certain threshold, an additional liability arises that requires payment up to that threshold. This additional liability can be accumulated for a specified period of time for adjusting against future tax liabilities. MAT added another layer of complexity to an already complex tax system. Moreover, it seeks to take away from the right hand (through additional taxes) what was earlier given by the left hand (in form of deductions, allowances and incentives).

The original sin, in this case, is excessive deductions, allowances and incentives. In the long run, this issue needed to be addressed.

- Recent reforms in the corporate tax rates and structures can be analysed in light of the above discussion. The concessional tax rates are specified in sections 115 BA, 115BAA and 115 BAB. These sections are discussed below in layman terms though the actual provisions are quite complex.

## 1.1 Section 115BA

- The section 115BA addresses the applicable tax rates only for manufacturing businesses in India under specific circumstances. The tax rate is 25% (plus surcharge and cess) for manufacturing enterprises that adhere to all Chapter XII requirements (apart from Sections 115BAA & 115 BAB).
- There is no time limit granted to domestic manufacturing enterprises for selecting a reduced income tax, according to one of Section 115BA's subsections. Once they have adjusted the brought forward losses, they can utilise the Section 115 BA benefits whenever they want. There are multiple requirements that must be met in order to guarantee that the tax rate stays at 25%.

## 1.2 Section 115BAA

- Section 115BAA provides lower corporate tax rate for all domestic businesses. Domestic enterprises have an alternative tax rate of 22% plus surcharge of 10% and a cess of 4% with effective tax rate 25.17%. This section is effective from FY 2019–20 (AY 2020–21) after fulfilling the requirements described under it. Moreover, if the corporation chooses Section 115BAA, it is not required to pay MAT.
- The following requirements must be met in order for all domestic businesses and manufacturing firms to elect to pay income tax at the rate of 22% (plus any surcharge and cess). Such businesses should not take advantage of any exclusions or incentives provided by various income tax regulations. As a result, the company's total income shall be calculated by not allowing various deductions. Moreover, if the company chooses to be taxed under section 115BAA, the opportunity to claim set off is permanently lost. Such companies will have to exercise this option to be taxed under the section 115BAA on or before the due date of filing income tax returns mentioned under section 139, which is typically 30th September of the assessment year. The aforementioned losses shall be deemed to have been allowed and shall not be eligible for carry forward and set off in subsequent years.

## 1.3 Section 115BAB

- A domestic corporation may avail section 115BAB if it satisfies the requirements listed in section 115 BAB (The benefit is accessible beginning with the 2019–20 fiscal year (AY 2020-21). A new manufacturing business might choose to be taxed in accordance with section 115BAB at the rate of 15%. The deadline for filing income tax returns, which is typically September 30 of the assessment year, unless otherwise extended, is when the corporation must exercise the option. Once the corporation selects section 115BAB for a certain fiscal year, it cannot change its mind later.

- Unfortunately, the majority of the incentive deductions and exemptions in the Income Tax Act of 1961 are extremely complicated rules due to the strict restrictions. For section 115BAB, there are a web of conditions that new manufacturing firms must meet the following conditions in order to qualify for the benefit under the section. For example, a manufacturing firm should not use any plant and machinery that was previously used in any of their businesses; such machinery or plant was not, at any time prior to the date of the installation, used in India; such machinery or plant is imported into India as these assets have already availed the benefit of depreciation before.

Table 4.2: **Major provisions of sections 115 BA, 115BAA and 115 BAB**

| **Particulars** | **Section 115 BA** | **Section 115 BAA** | **Section 115 BAB** |
|---|---|---|---|
| Effective date | A.Y.2017-18 | A.Y.2020-21 | A.Y.2020-21 |
| Eligible entities | All domestic companies engaged in the manufacturing and production of articles | All domestic companies | All domestic companies engaged in the manufacturing and production of articles |
| Date of introduction | Incorporated and commenced on and after first march 2016 | No specific requirement | Incorporated on and after 1st October 2019 and commenced on and before 31st march 2023 |
| Allowance for specified deductions | Not allowed | Not allowed | Not allowed |
| Basic rate of tax | 25% | 22% | 15% |
| Surcharge | 7% if income above Rs 1 crore up to Rs 10 crores 12% for income above Rs 10 crores | 10% | 10% |
| Cess | 4% | 4% | 4% |
| MAT applicability | Applicable@15% | Not applicable | Not applicable |
| Provision for specified domestic transactions (arm's length price section 92B) | Not applicable | Not applicable | Applicable |
| Restriction on use of second-hand plant & machinery or building used as a hotel or convention centre | No such restriction | No such restriction | Restriction is applicable |

## 2 Factors driving companies' adoption of the concessional tax regime

- As noted in above, companies seeking to avail sections 115 BA, 115BAA and 115 BAB have some opportunity costs and some benefits:

1. **Foregone set off of losses and unabsorbed depreciation:** The main opportunity cost for sections 115BAA and 115 BAB is not claiming set off of losses and unabsorbed depreciation carry forward from any earlier years. These sections are supposed to incentivize new companies. However, in general start-ups are unable to earn profits in the initial stage. Since they are unable to carry forward losses, start-ups and new incorporations are reluctant to avail these sections. The benefits are then availed by those companies whose income is positive, which tend to be larger and older.
2. **Restrictions on the use of second-hand machinery etc.:** Section 115BAB has restrictions on use of second-hand machinery. For new start-ups that are short on finances, this can be a major deterrent in adoption of the section.
3. **Irreversibility and complexity of choices:** Sections 115 BA, 115BAA and 115 BAB are irreversible in nature and involve ensuring commercial certainty about the business. For new and smaller companies this is very difficult to ascertain. Moreover, the complexity of the provisions would require serious professional accounting support to determine which to choose. That only increases the cost of compliance disproportionately for small and new businesses and deters adoption of the new schemes. Consequently, vast majority of small companies do not opt for these new schemes and remain with the default option of the normal tax rate of 30 percent plus surcharge and cess.
4. **Benefit of MAT exemption:** The incidence of MAT generally falls on companies with large divergences between their tax profits per Income Tax law and book profits per Company Law and general accounting principles. Small and new companies are unlikely to have major MAT incidence. In the circumstances, this benefit is more likely to accrue to larger established companies than smaller and newer ones.

Table 4.3: **Percentages of companies opting for the concessional tax regime and those under earlier tax regime (Financial Year 2019-20)**

| **S. No.** | **Slabs of Total Income (in crores)** | **Availing 115BAA** | **Availing 115BAB** | **Availing earlier tax rate of 30% (plus surcharge and cess)** | **Total Income (under 115BAA)** | **Total Income (under 115BAB)** | **Total Income (under earlier tax rate of 30% plus surcharge and cess)** |
|---|---|---|---|---|---|---|---|
| **1** | $<0$ & 0 | 8.35% | 0.19% | 91.47% | 0.00% | 0.00% | 0.00% |
| **2** | 0-1 | 23.12% | 0.08% | 76.80% | 32.55% | 0.06% | 67.40% |
| **3** | 1-10 | 50.30% | 0.02% | 49.68% | 52.32% | 0.01% | 47.67% |
| **4** | 10-50 | 60.78% | 0.00% | 39.22% | 61.73% | 0.00% | 38.27% |
| **5** | 50-100 | 64.71% | 0.00% | 35.29% | 64.63% | 0.00% | 35.37% |
| **6** | 100-500 | 68.44% | 0.00% | 31.56% | 68.51% | 0.00% | 31.49% |
| **7** | $>500$ | 65.43% | 0.00% | 34.57% | 62.41% | 0.00% | 37.59% |

*Source*: Author's calculation based on Receipt Budget, 2022-2023

- In effect, the optional tax provisions intended to simplify the tax regime for small firms and startups inadvertently became a set of complex provisions that resulted in a tax cut for larger and more established firms. Probably for the larger more profitable companies, the lack of various deductions was more than compensated by the non-imposition of MAT. Moreover, since for companies with turnover below Rs. 400 crore the basic tax rate is 25%, section 115BA is essentially superfluous for them. That only leaves sections 115BAA (22%) and 115BAB relevant for smaller firms (15%). Even they have very limited adoption among smaller entities. Moreover, due to its irreversible nature and inability to carry forward losses, start-ups and small companies may be hesitant in committing to the scheme. To make matters worse, the complexity of the provisions may also be deterring adoption. In light of the analysis, certain policy options are suggested to improve the scheme so as to achieve the laudable objective of implementing a simple tax regime with lower rates and minimal deductions:

1. To make the scheme simple, there should be just one optional lower tax rate say at 20% applicable to both manufacturing and non-manufacturing entities. The diverse lower rates of 25%, 22% and 15% could be merged into this.

2. Inability to claim accelerated depreciation allowances and loss carry forward is a major disincentive especially for younger and smaller companies like start-ups. At least carry forward of losses should be re-instituted in the simplified scheme.

3. The tax system should be made simple and not overburdened with multiple policy objectives. Policymakers should take steps to provide comprehensive incentives for innovative start-ups outside the tax system. Such measures could include productivity linked incentive (PLI) schemes, provision of seed-finance and appropriate incubation facilities.

- Very little data is available on adoption of the new personal income tax optional rate. However, lessons from the corporate income tax rate analysis may be useful for those rates also.

# 5 EXTERNAL TRADE AND DOMESTIC SECTOR SPECIFIC POLICIES: JUNE-DECEMBER, 2022

**Dinesh Kumar Nayak**

## 1 Negotiations, Agreements and MoUs

- During June-December 2022-23, India has taken various efforts related to trade and development through negotiations, agreements & MoUs; and promotion and facilitation through launching e-portals.
- The 20th Session of India-Finland Joint Commission (JC) was held from 2nd-3rd June 2022. Both sides agreed for the Action Plan for 2022-23 in the field of Digitisation, Education, Development of 5G & 6G, Energy, Start-ups etc.
- During 13th to 24th June 2022, India-UK FTA negotiations was held in Brussels. Negotiation for Investment Protection Agreement & Geographical Indication Agreement was formally launched. There have been negotiations in ten policy areas, namely, Trade and Gender, Trade and Development, SMEs, Innovation, SPS, GRP, Transparency, Anti-Corruption, Competition, and CPTF. The 5th round of negotiations took place from 18th to 29th July 2022, in fifteen policy areas, namely Goods (GMA), Intellectual Property, Financial Services, Telecoms., Trade Remedies, Subsidies/SOEs, Procurement, Services, Core Text, Investment, Rules of Origin, Disputes, TBT, Intellectual Property and Procurement.
- The twelfth World Trade Organization (WTO) Ministerial Conference (MC-12) was held in Geneva, during 12-17 June, 2022. India participated constructively in negotiations in agriculture, fisheries, WTO response to pandemic, TRIPS, E-Commerce and WTO reform.
- A major outcome of WTO MC-12 was agreement on new global rules for Fisheries Subsidies to curb harmful subsidies and protect global fish stocks, at the same time recognizing the needs of fishers in developing and least-developed countries (LDCs). The agreement prohibits support for Illegal, Unreported and Unregulated (IUU) fishing and the fishing in overfished stocks.[1]
- The Economic Development Board, Government of Mauritius, in collaboration with the High Commission of India organized the launching of the Comprehensive Economic Cooperation and Partnership Agreement (CECPA) Forum 2022. The official opening of the CECPA Forum was held in Mauritius on 13th September, 2022.
- The first meeting of the India-Mauritius High-Powered Joint Trade Committee was held on 1st August 2022 in New Delhi to discuss various outstanding issues, including Mutual Recognition Agreements (MRAs) on qualifications by professional bodies, as under India- Mauritius CECPA.

[1] https://commerce.gov.in/wp-content/uploads/2022/07/Major-Achievements-of-DoC-for-June-2022.pdf

- On 21st December 2022, India-Gulf Cooperation Council (GCC) agreed to expedite conclusion of the requisite legal and technical requirements for formal resumption of the FTA negotiations. Both sides emphasized that the FTA will create new jobs, raise living standards, and provide wider social and economic opportunities in India and all the GCC countries. GCC countries contribute almost 35% of India's oil imports and 70% of gas imports. Investments from the GCC in India are currently valued at over USD 18 billion.

## 2 Facilitation, Promotions, and e-Portals

- Prime Minister of India launched a portal named National Import-Export for Yearly Analysis of Trade (NIRYAT) along with the inauguration Vanjiya Bhawan on 23rd June 2022. This portal will provide real time data to all stakeholders. From this portal, important information related to more than 30 commodity groups exported to more than 200 countries of the world will be available. In the coming time, information related to district-wise exports will also be available on this. This will also strengthen the efforts to develop the districts as important centers of exports.

- In order to curb rising prices of wheat flour, the Cabinet Committee on Economic Affairs, has approved the proposal for amendment of the policy on exemption for Wheat or Meslin Flour (HS Code 1101) from export restrictions/ ban. The conflict between Russia and Ukraine, accounting for around 1/4th of the global wheat trade, led to the global wheat supply chain disruptions. This caused increase in demand of Indian wheat, raising price of wheat in the domestic market. In order to ensure food security of 1.4 billion people of the country, the decision was taken to put a prohibition on export of wheat in May 2022. The approval will now allow to put a restriction on the export of Wheat Flour.

- India launched the National Logistics Policy on 17th September 2022 in order to bring the logistic cost from 13% to single digit. In this direction drone technology is expected to emerge as important aspect of transport and logistics sector, especially for remote areas. In this context the Unified Logistics Interface Platform (ULIP) has been prepared as an integrated portal in which information about the location of goods can be obtained on a real-time basis with considerable ease.

- **Logistics efficiency is a function of infrastructure, services (digital systems / processes / regulatory framework) and human resource**. PM GatiShakti National Master Plan (NMP) has been launched for providing multi-modal connectivity infrastructure to various economic zones. It is a transformative approach for improving logistics efficiency and reducing logistics cost, with focus on integrating existing and proposed infrastructure development initiatives to ensure first and last mile connectivity, for seamless movement of people and goods.

- The Policy is planned to be implemented through a Comprehensive Logistics Action Plan (CLAP). The interventions proposed under the CLAP are divided into eight key action areas:(i) Integrated Digital Logistics Systems (ii) Standardisation of physical assets and benchmarking service quality standards (iii) Logistics Human Resources Development and Capacity Building (iv) State Engagement (v) EXIM (Export-Import) Logistics (vi) Service Improvement framework (vii) Sectoral Plan for Efficient Logistics

(viii) Facilitation of Development of Logistics Parks.

- To ensure technologically enabled, integrated, cost-efficient, resilient, and sustainable logistics ecosystem for accelerated and inclusive growth, the policy introduces Unified Logistics Interface Platform (ULIP), Standardization, Monitoring framework and skill development for greater efficiency in logistics services.
- To bring ease in international trade transactions, the Government of India has made suitable amendments in the Foreign Trade Policy and Handbook of Procedures to allow for International Trade Settlement in Indian Rupees (INR) i.e., invoicing, payment, and settlement of exports / imports in Indian Rupees.[2]
- On 23rd November 2022, Start-up India has launched a call for startup applications for registration on the Mentorship, Advisory, Assistance, Resilience and Growth (MAARG) portal, as the National Mentorship Platform. To build a strong and inclusive ecosystem for innovation and entrepreneurship in India, MAARG portal claims to be an one stop platform to facilitate mentorship for startups across diverse sectors, functions, stages, geographies, and backgrounds.

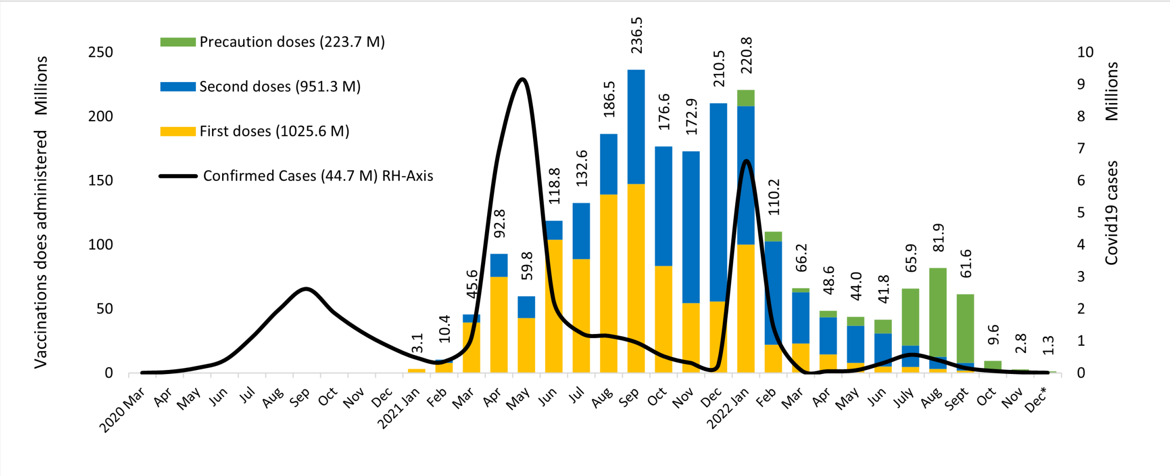
# 3 Expectations from the trade and domestic sector-specific policy initiatives

- The bi-lateral trade agreements are expected to soften the impacts of global recession on India's external trade in near future, while in the long run, these initiatives are expected to create new jobs, raise living standards, and provide wider social and economic opportunities in the country.
- Domestically, the policy initiatives on Unified Logistics Interface Platform (ULIP), standardization, monitoring framework, unified start-up platform to support innovation and entrepreneurship, and skill development for greater efficiency are expected to develop a technologically enabled, integrated, cost-efficient, resilient, and sustainable logistics ecosystem for accelerated and inclusive growth.

[2] The Directorate General of Foreign Trade (DGFT) had earlier introduced Para 2.52(d) vide Notification No. 33/2015-20 dated 16.09.2022 to permit invoicing, payment and settlements exports and imports in INR in sync with RBI's A.P. (DIR Series) Circular No.10 dated 11th July 2022.

# 6 GROWTH OUTLOOK

**Rudrani Bhattacharya**




* Till dated December 25, 2022
Source: State bulletins, and Ministry of Health and Family Welfare (MoHFW), GoI

Figure 6.1: **Monthly Covid-19 cases and vaccinations doses administered in India**

- As on 25th December 2022, the total number of confirmed cases of covid infections reported around 44.7 million and the number of registered deaths were around 5.31 lakh. As of 25th September 2022, a total number of around 2.20 billion doses of vaccine had been administered in India (1025.6 mn 1st dose and 951.3 mn 2nd dose). In addition, around 223.7 million people were vaccinated for precaution doses (Figure 6.1)

## 1 Recent Trends in Growth

Table 6.1: **Quarterly Growth Rates (%, constant prices) of GDP, 2011-12 Series**

| **Sectors** | **Annual 2020-21 YoY** | **Annual 2021-22 YoY** | **Q1 2022-23 Apr-Jun YoY** | **Q2 2022-23 Jul-Sep YoY** |
|---|---|---|---|---|
| **GDP** | -6.6 | 8.7 | 13.5 | 6.3 |
| **Agriculture, Fishing, etc.** | 3.3 | 3.0 | 4.5 | 4.6 |
| **Mining & Quarrying** | -8.6 | 11.5 | 6.5 | -2.8 |
| **Manufacturing** | -0.6 | 9.9 | 4.8 | -4.3 |
| **Electricity, Gas, Water etc.** | -3.6 | 7.5 | 14.7 | 5.6 |
| **Construction** | -7.3 | 11.5 | 16.8 | 6.6 |
| **Trade, hotels, Trans., etc** | -20.2 | 11.1 | 25.7 | 14.7 |
| **Financial & Prof. Serv.** | 2.2 | 4.2 | 9.2 | 7.2 |
| **Public Admin, defence, et.** | -5.5 | 12.6 | 26.3 | 6.5 |

Source: National Statistical Office (NSO)

- **The GDP estimates for the quarter Q2 (July-September) 2022-23 as provided by the National Statistical Office (NSO) record an increase by 6.3 percent from the level in Q2 2021-22 (Table 6.1).** The high growth rate of 13.5 percent recorded at Q1 2022-23 reflected the low base effect caused by slow down of economic activities in April-June 2021 due to the second wave of the pandemic.
- **The slowdown of growth in Q2 2022-23 reflected base effect normalisation, along with contraction in mining and manufacturing, although, Trade, hotels & transport services recorded double digit growth in Q2 2022-23.** In Q2 2022-23, the output in the Trade, hotels & transport services (Rs trillion 6.5) finally exceeded the output of the pre-pandemic level (Rs. trillion 6.4).
- Manufacturing output contracted in this quarter (Rs trillion 6.0) compared to the same quarter in 2020-21 (Rs. trillion 5.9) and 2021-22 (Rs trillion 6.2). However, manufacturing output in Q2 of the two post-pandemic years were higher than the level of Rs. trillion 5.6 in the same quarter of 2019-20, the pre-pandemic year. **The contraction was on account of receding pandemic-induced domestic automobile demand, slowdown in exports and high commodity inflation.**
- In Q2 2022-23, the mining output also contracted (Rs. trillion 6.7), after recovering in 2021-22 (Rs. trillion 6.9) from the pandemic period contraction. **The contraction is mainly driven by rise in cost of raw materials, power and fuel.**
- Agriculture remained resilient through out the pandemic years owing to good monsoon, better availability of credit to farmers ensured via fiscal stimulus packages, and rise in income on account of increased MSPs. Despite actual area sown for kharif foodgrain was 2.3 percent lower than the normal area sown till the end of September 2022, due to normal rainfall, agricultural output was robust in Q2 2022-23.
- Utilities, Construction, Financial services, real estate and professional services, and Public administration, defense and other services recorded robust growth in the range of 5.6–7.2 percent in Q2 2022-23. These sectors showed expansion in this quarter compared to the pre-pandemic output of the same quarter.

Table 6.2: **Expenditure-side Growth Rates of GDP (%, constant prices), 2011-12 series**

| **Sectors** | **Annual 2020-21 YoY** | **Annual 2021-22 YoY** | **Q1 2022-23 Apr-Jun YoY** | **Q2 2022-23 Jul-Sep YoY** |
|---|---|---|---|---|
| **GDP** | -6.6 | 8.7 | 13.5 | 6.3 |
| **Private Final Consumption Exp. (PFCE)** | -6.0 | 7.9 | 25.9 | 9.7 |
| **Govt. Final Consumption Exp. (GFCE)** | 3.6 | 2.6 | 1.3 | -4.4 |
| **Gross Fixed Capital Formation (GFCF)** | -10.4 | 15.8 | 20.2 | 10.4 |
| **Exports of Goods and Services** | -9.2 | 24.3 | 14.7 | 11.5 |
| **Imports of Goods and Services** | -13.8 | 35.5 | 37.2 | 25.4 |

Source: National Statistical Office (NSO)

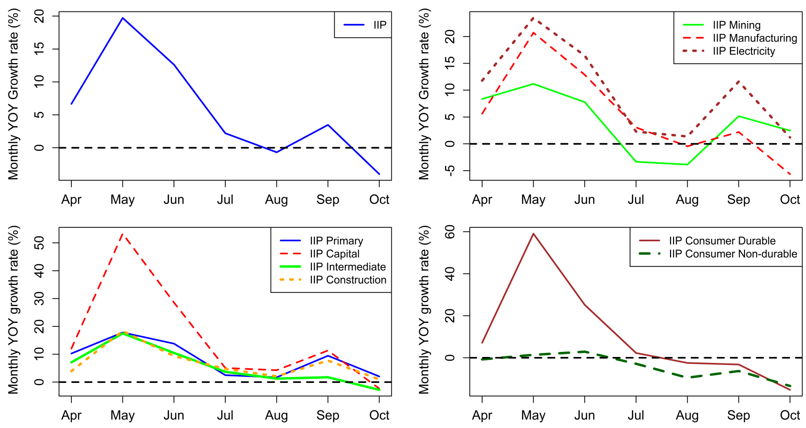
- All expenditure side components of GDP, except for Govt. Final Consumption Expenditure (GFCE), recorded robust growth in Q2 2022-23 from their respective levels in Q2 2021-22 (Table 6.2). In this quarter, private consumption expenditure finally exceeded the pre-pandemic level. Government final consumption expenditure recorded contraction by 4.4 percent in Q2 2022-23 compared to the same quarter previous year (Chapter 3).

# 2 High frequency indicators predict mixed performance of sectors/sub-sectors in Q2 2022-23

## 2.1 Agriculture

- Agriculture remained resilient in Q1 2022-23 recording a 4.6 percent YoY growth. Minimum Support Prices (MSP) of Paddy, Jowar, Moong and Soyabean were increased by 1.3, 2, 6 and 5 times respectively in the beginning of 2022-23 compared to the level of 2021-22 contributing to rise in prices of paddy, wheat and pulses in the second half of the FY22-23. Domestic wheat price was also rising as a fall out of the Ukraine war. Consequently, as on 23rd December 2022, the actual area sown for foodgrains under Rabi crop is 3.6 percent higher compared to the area sown during the same period in 2021. Robust growth in domestic sales of tractors at 6.5 percent in October-November 2022 also reflected resilience in agricultural activities in the third quarter of 2022-23. During October-December 2022, the rainfall is merely 8 percent below the normal level on average. Consequently, **agricultural activities are expected to remain resilient in Q3 2022-23 as well.**

## 2.2 Industry




Source: NSO

Figure 6.2: **Recent trend in components of IIP**

- General IIP recorded a contraction by 4 percent in the beginning of Q3 2022-23. This has been driven by a broad-based contraction in most of activity-based and use-based components except for IIP Mining, IIP Electricity and IIP Primary goods (Figure 6.2). Contraction in IIP Manufacturing and IIP Consumer durables again reflected the receding pandemic-induced domestic automobile, slowdown in exports (Chapter 8), and high commodity inflation.

- High frequency indicators for industrial sector showed mixed performance across sectors

Table 6.3: **Recent Trend in Growth (%) of Selected Indicators of Industrial Sector**

| **Indicator** | **Jul 2022 YoY growth** | **Aug 2022 YoY growth** | **Sep 2022 YoY growth** | **Oct 2022 YoY growth** | **Nov 2022 YoY growth** |
|---|---|---|---|---|---|
| **Production of coal** (million tonnes) | 10.9 | 9.3 | 13.5 | 3.1 | |
| **Production of crude oil** ('000 tonnes) | -3.8 | -3.4 | -2.4 | -2.2 | |
| **Production of two wheelers** ('000 numbers) | 3.7 | 11.6 | 8.0 | -6.4 | 17.6 |
| **Production of commercial vehicle** ('000 numbers) | 34.6 | 36.5 | 39.8 | 31.8 | |
| **Passenger car sales** (number) | 11.1 | 21.1 | 91.9 | 28.6 | 28.1 |
| **Production of cement** ('000 tonnes) | 0.7 | 1.8 | 12.4 | -4.3 | |
| **Consumption of steel** ('000 tonnes) | 13.0 | 14.3 | 11.7 | 11.0 | 12.3 |
| **Electricity generation** (million Kwh) | 2.5 | 0.4 | 10.9 | -1.4 | 11.9 |

Source: NSO, Office of Economic Adviser, CMIE

and in the beginning of Q3 2022-23 (Table 6.3, columns 4 and 5). For instance, production of two and three wheelers, one of the major indicators of manufacturing sector register sober double digit growth in November 2022, after showing a contraction in October 2022. Production of commercial vehicles and sales of passenger cars record robust growth in the months of Q3 2022, indicating a **possible rebound of automobile sector growth after muted performance in Q2 2022 on account of the revival of demand.**

- Similarly **Utilities sector indicates sign of improvement** in Q3 2022-23 as **electricity generation records 11.9 percent growth in November 2022, vis a vis contraction by 1.4 percent in October 2022.** Increase in the demand for electricity due to cold waves in the Northern part of India will work as catalyst to this sector's performance.

- Production of coal recorded a muted growth of 3.1 percent while production of crude oil contracted in October 2022, compared to the level in October 2021, indicating **a possible slowdown of the mining sub-sectors in Q3 2022.** Decrease in crude oil production was a consequence of the tax imposed on the production of domestic crude oil (Chapter 3). Again a **mixed performance is observed for the indicators of infrastructure sector,** namely production of cement and consumption of finished steel. **Mixed performance of infrastructure indicators along with contraction in IIP Construction in October 2022 indicate possibility of volatile performance of the construction sector in Q3 2022.**

- PMI for the manufacturing sector stagnating at 55.5 in October-November is also indicative of muted producer sentiments in this sector. This is despite the robust YoY growth in industrial credit deployment in the beginning of Q3 2022, even though transmission of higher policy rate to the lending rate is observed (Chapter 2).

## 2.3 Services

Table 6.4: **Recent Trend in Growth (%) of Selected Indicators of Services Sector**

| Indicator | Jul 2022 YoY growth | Aug 2022 YoY growth | Sep 2022 YoY growth | Oct 2022 YoY growth | Nov 2022 YoY growth |
|---|---|---|---|---|---|
| **Cargo Port** ('000 tonnes) | 15.1 | 8.0 | 14.9 | 3.6 | 1.9 |
| **Cargo Air** ('000 tonnes) | 6.1 | -1.2 | -0.5 | -15.0 | |
| **Cargo Rail** ('000 tonnes) | 8.3 | 7.9 | 9.1 | 1.3 | |
| **Passenger Air** ('000 numbers) | 127.4 | 73.1 | 61.6 | 39.8 | |
| **Passenger Rail** (million numbers) | 168.6 | 113.6 | 87.6 | 62.2 | |
| **Tourists arrival** | 783.9 | 437.3 | | | |
| **Tele Subscribers** (million numbers) | -3.0 | -2.9 | -1.4 | | |
| **NSE Turnover** (Rs Crore) | -25.6 | -7.9 | -10.2 | -41.0 | -14.6 |

Source: Ministry of Ports, Shipping and Waterways, Ministry of Tourism Press Release, Telephone Regulatory Authority of India, NSE, CMIE

- Goods trade via all modes of transport showed decline in YoY growth rates during September-November 2022-23 (Table 6.4). **Transport sector is expected to record moderate growth in Q3 2022-23 as fading of the base effect is observed in Q2 2022-23.** Adverse market sentiment and lower liquidity, reflected in the negative growth in NSE turnover since the beginning of FY 2022-23 **may moderate the financial sector performance in Q3 2022-23.**

## 2.4 Demand

- On the demand side, CMIE's Index of Consumer Sentiments show steady improvement from 74.5 in Q2 2022-23 to 81.3 in the months of Q3 2022-23, **reflecting the sign of private consumption demand revival**. Significant improvement in employment rate is not observed since June 2022. **Stagnation in employment reflects stagnation of IIP consumer non-durables that largely belong to MSME sector.**

# 3 Growth outlook for near future

- **Overall, we expect mixed performance across sectors/sub-sectors in Q3 2022-23,** with agriculture and services showing resilience, while industrial activities may remain muted in this quarter. There is a possibility of manufacturing sector growth to improve on the back of automobile industry.
- According to the projections by IMF and World Bank, the Indian economy is expected to grow at 6.8-6.9 percent in 2022-23. The Reserve Bank of India has reduced its projection of real GDP growth at 6.8 per cent in 2022-23, with a growth of 4.1 per cent in Q3 and 4.0 per cent in Q4 2022-23. **The growth prospect for the FY 2022-23 is subject to downward risk on account of the (i) high and sticky**

**commodity inflation, (ii) transmission of higher policy rate to market rate and lending rate, (iii) recession in China already affecting India's exports to this country, with possibility to be further aggravated by the expected global recession, (iv) decline in imports of intermediate commodities as a consequence of recession in China, (v) spread .of the new Covid-19 variant adversely affecting tourism, hotels and transport services**

- The slowdown of the economy is expected to continue in 2023-24 as RBI projects 6.5 percent growth for the FY 23-24. The projections by IMF and World Bank indicate a growth rate of 6.1-6.2 percent in this financial year.

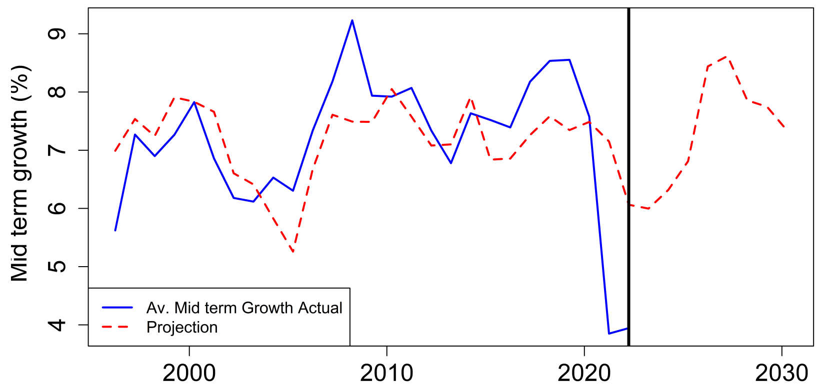
# 4 Medium term growth projection for India

Medium term growth rate of is defined as the average growth rate for five years for an economy. The medium term growth rate for India is estimated following Aromi (2019), where the expected cumulative five-year GDP growth is a function of previous growth outcomes in two preceding non-overlapping five-year periods and the one year lagged value of current account balance to GDP ratio.[1] This framework provides a simple method of filtering the short run fluctuations in growth.

The model estimated is the following:

$$g_{[t+1,t+5]} = \alpha + \sum_{k \in [5,10]} \beta_k g_{[t-k,t-k+4]} + \beta_{cab} cab_{t-1} + u_{t-1} \tag{6.1}$$

Here $g_{[t+s+1,t+s+4]}$ denotes the cumulative GDP growth during the five-year period $[t+s+1, t+s+5]$, and $cab_{t-1}$ is the current account balance of the previous year, expressed as a fraction of GDP, capturing the external shocks.




Source: NIPFP

Figure 6.3: **Projection of average growth for five years**

Figure 6.3 depicts the projected path of average growth for five years till 2029-30. India is projected to grow at a robust rate of **7.2 percent per year over the period 2022-23 to**

[1] J. Daniel Aromi, 2019, "Medium term growth forecasts: Experts vs. simple models," *International Journal of Forecasting*, Volume 35, Issue 3, July–September 2019, Pages 1085-1099.

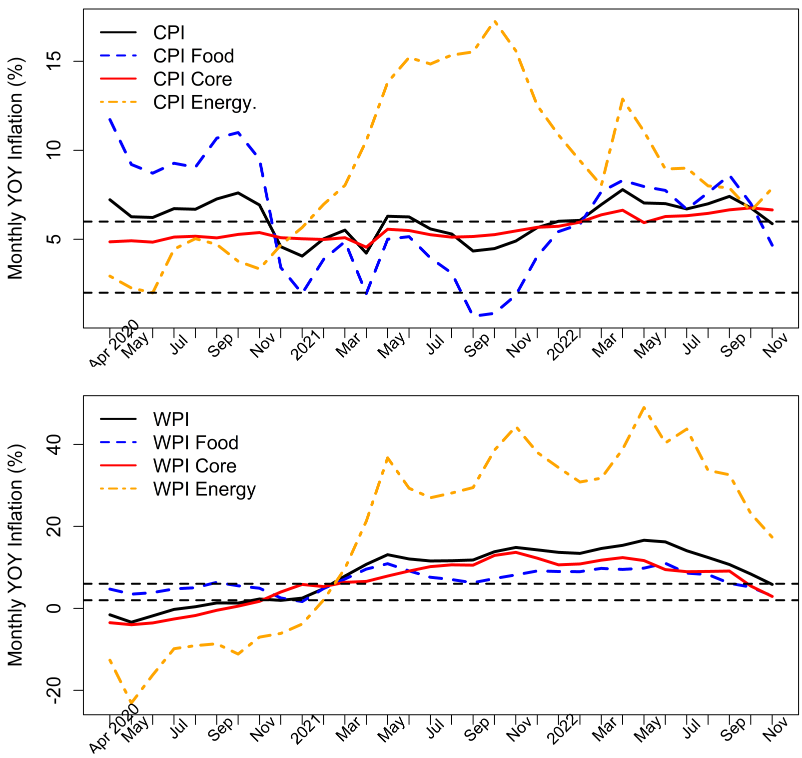
**2026-27.** The medium term growth projections for India by IMF and RBI are **6 percent** and **6.5–8.5 percent** respectively. World Bank predicts India to grow on average at a rate of **7 percent** during the three-year period of 2022-24.[2]

[2]https://www.worldbank.org/en/publication/global-economic-prospects#data

# 7 INFLATION ASSESSMENT AND OUTLOOK

**Rudrani Bhattacharya**

## 1 Recent trend in inflation

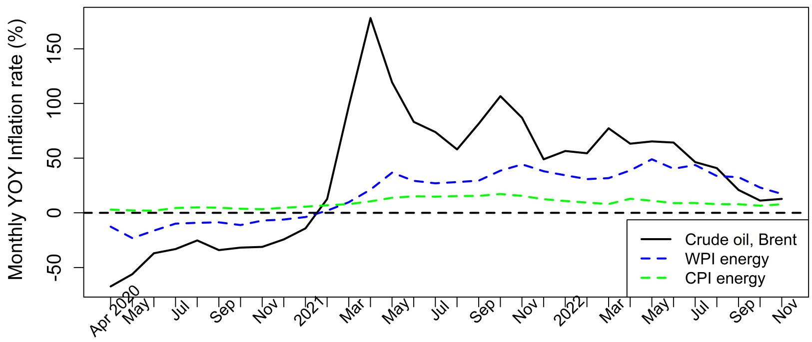



Source: NSO, Office of the Economic Adviser

Figure 7.1: **Recent Trends in CPI and WPI**

- **The average headline inflation remained elevated during April-November 2022 at 6.95 percent** on account of high and sticky inflation in all its components, e.g, CPI food (7.3 percent), CPI energy (9 percent) and CPI core (6.5 percent, Figure 7.1). **However in November 2022, headline inflation was recorded at 5.9 percent, below the upper band of RBI's tolerance level for the first time in FY 2022-23.**

- **Inflation in CPI food** remained moderate at 3.8 percent during the FY 2021-22. However, it increased from 1.9 percent in November 2021 to 4.1 percent in December 2021. It continued to increase and reached 8.3 percent in April, 2022, causing a 7.8 percent headline inflation in the same month. The food inflation had moderated marginally afterwards for a short period before rising to 8.6 percent in September, 2022. Finally it significantly moderated to **4.7** percent in November 2022 with arrival of the winter




Source: Office of the Economic Adviser, World Bank

Figure 7.2: **Recent Trends in Crude oil and Energy Inflation**

crops.

- **CPI core inflation** remained sticky at a range of 5-6 percent during the covid years as health and transport services became expensive during that period. CPI core inflation had been continuously rising since October 2021. **With the revival of demand and muted performance of the consumer nondurables (Chapter 6), a broad-based rise in core inflation is observed since the end of 2021.**

- CPI energy inflation had been rising continuously since January 2021 on account of the transmission of surging global crude oil prices (Figure 7.2). It surged to 17.3 percent in October, 2021. Since then **CPI energy inflation showing declining trend with some volatility, following the trend in global oil inflation at a lag.** The average inflation rate in CPI energy was at 9 percent during April-November, 2022.

- **Overall WPI inflation was elevated at 12.5 percent during April-November 2022. It substantially moderated to 5.8 percent in November 2022** on account of softening WPI food articles and WPI manufactured food products inflation, and WPI core inflation. WPI energy inflation also reduced to 17.8 percent in November 2022 from the rate prevailing in April-October 2022 (37.3 percent). This lowering of WPI inflation rate is also on account of base effect normalisation.

- WPI food inflation became double digit in Jun 2022 at 11 percent. It reflected declining trend since then and registered a modest 3 percent inflation rate in November 2022, on account of low inflation rate in both WPI food articles and manufactured food products.

- WPI food articles inflation remained elevated at 11 percent during the April-October 2022. **Cost-push factors such as agricultural wage inflation and MSP hike, and adverse weather shocks have contributed to raising WPI food articles inflation during this period.** WPI food articles inflation softened to 1.1 percent with arrival of the winter crop.

- Manufactured food products inflation remained high during the FY 2021-22 on account of production and supply disruptions driven by the pandemic. **It showed a declining trend since the beginning of FY 2022-23 and substantially declined to 3.1 percent in October 2022, before showing a rebound to 4.4 percent in**

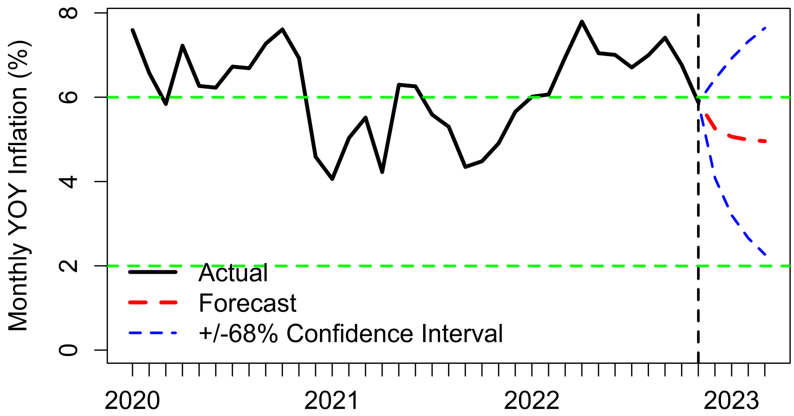
**November 2022.**

## 2 Contributors to retail and wholesale inflation

- During April-November 2022-23, major drivers of CPI food inflation (7.3) are Cereals (2.1 percent); vegetables (1.8 percent); Milk (1.1 percent) and Spices (0.9 percent).
- During April-November 2022-23, Fruits and Vegetables (5 percent), Foodgrains (1.8 percent), Milk (1.6 percent), Egg, Meat & Fish (0.8 percent) and Spices (0.7 percent) were the major contributors to WPI food articles inflation.
- **During April-November 2022-23, CPI core inflation (5.6) was driven by inflation in non-oil Miscellaneous items (3.6 percent), and Clothing and Footware (1.1 percent).** Health, Non-oil transport and communication, Household goods and services, and Personal care, contributing in the range of 0.7–1.7 percent of the non-oil miscellaneous inflation, were the major drivers of this component of CPI.

## 3 Supply shocks, MSP hike and demand revival contributed to high and persistent wholesale and retail inflation

- On the supply side **crop failure due to adverse weather condition, and sticky agricultural wages due to hike in MGNREGA wage rate was driving WPI vegetables and fruit prices up** since November, 2021. Minimum Support Prices (MSP) of Paddy, Jowar, Moong and Soyabean were increased by 1.3, 2, 6 and 5 times respectively in the beginning of 2022-23 compared to the level of 2021-22 contributing to cereals and pulses inflation. Rising cereals and vegetable prices in the wholesale market on the other hand, was transmitted to the retail market with a lag, causing high inflation rate in these food commodities in the first half of FY 2022-23. Rising transport costs were responsible for driving inflation rate in Milk and EMF. **However, with the arrival of the winter crop, a sharp decline in WPI food articles was observed in November 2022, lowering CPI food and the headline inflation substantially in this month.**
- High and sticky oil price inflation, apart from adding to production cost of core items and to the transport cost of core and food items, also directly increased the inflation in energy components of the CPI and WPI inflation. Supply chain disruption, caused by the pandemic affecting transport and logistics as well as human mobility, is another supply side factor driving up the retail inflation. **The broad-based increase in inflation rate of the core CPI is a consequence of the demand revival observed in FY 2022-23 (Chapter 6). Rural demand also remained buoyant in this period as captured by rise in rural wage inflation from 4.4 percent in April 2022 to 5.8 percent in October 2022.**




Source: NIPFP

Figure 7.3: **Inflation Projections for December 2022 to March 2023**

## 4 Headline Inflation is expected to remain slightly above the upper limit of RBI's tolerance band in FY 2022-23

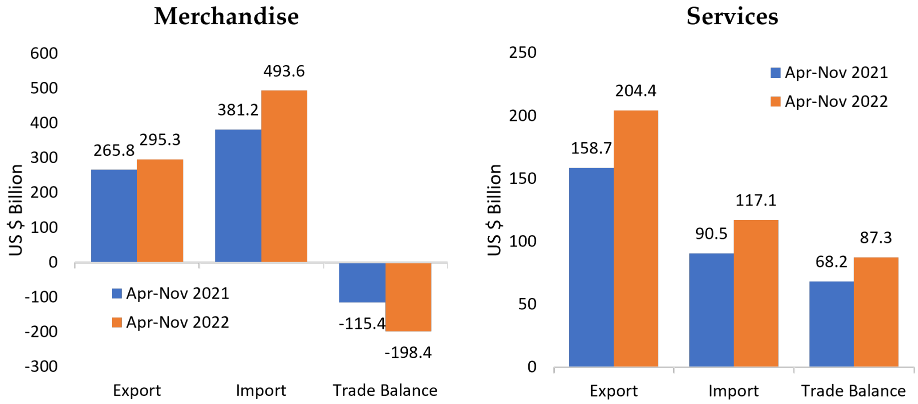
- Overall, the headline inflation in December 2022 is expected to decline further to 5.3 percent and continue the trend for the rest of the FY 22-23. It is expected to be at 6.3 percent, higher than RBI's upper limit of the tolerance range the FY 2022-23 (Figure 7.3).
- FY 2022-23 being a normal rainfall year, WPI food articles inflation and hence CPI food and headline CPI inflation substantially declined with the arrival of the winter crop in November, 2022. This positive supply shock is expected to reduce food inflation further during the rest of the FY22-23 and the beginning of FY 23-24.
- **However, upward risks are as follows** (i) increasing trend in rural wage inflation, including agricultural wage inflation as a consequence of wage-price spiral and robust agricultural activities, may induce upward pressure on food and overall inflation from both supply and demand side; (ii) high and sticky cereal inflation driven by domestic wheat price inflation as a consequence of the Ukraine war; (iii) core inflation is expected to rise in near future despite monetary tightening by RBI, as a consequence of lagged and weak transmission mechanism, (iv) sticky domestic retail energy inflation due to the lagged transmission process of moderating global oil inflation.

# 8 BALANCE OF PAYMENTS SITUATION

**Dinesh Kumar Nayak and Rudrani Bhattacharya**

## 1 External Sector

### 1.1 Performance of Merchandise Trade




Source: DGCI&S, and Reserve Bank of India

Figure 8.1: **Merchandise Trade Performance [LEFT] and Services Trade Performance [RIGHT]**

- India's merchandise trade deficit widened to USD 198.4 billion during April to November 2022, from USD 115.4 billion in comparison to the year-ago level (Figure 8.1 Left Panel). Total exports during April to November 2022 amounted to USD 295.3 billion, increased by 11.1 per cent as compared with 52.9 per cent increase during the same period of the previous year. This decline in export growth is attributed to the global recession.

- The rise in imports outweighed that in exports. Total imports during April to November 2022 amounted to USD 493.6 billion, an increase of 29.5 per cent over the same period of last year.

- India's trade in merchandise deficit during Q1 and Q2 FY 22-23 were respectively, at USD 62.71 Billion, and USD 81.69 Billion. For the first two months Oct-Nov of Q3 FY 22-23, the trade balance in merchandise is estimated at USD 55.77 billion.

- Merchandise exports exhibited a positive growth of 26.76 percent and 7.87 percent for Q1, and Q2 of FY 22-23 over the same period of last year. Imports exhibited a growth of 44.53 per cent and 30.55 per cent respectively for Q1, and Q2 FY 22-23. This reflects steady revival of India's domestic demand amidst the global slump.

- Oil import in April to November 2022 recorded positive YoY growth. Oil exports in November 2022 contracted by 1.8 percent (Table 8.1) as a consequence of contraction in domestic crude oil production. The YoY growth in Non-Oil imports from April to November 2022 increased compared to same period of 2021.

Table 8.1: **Merchandise Exports, Imports and Trade Balance (USD Billion)**

| | | Exports | | | Imports | | | |
|---|---|---|---|---|---|---|---|---|
| | Trade Balance | Total | POL | Non-POL | Total | Crude & POL | Gold & Silver | Non-POL & Non-Gold & Silver |
| Jul 21 | -10.6 | 35.5 | 5.8 | 29.7 | 46.1 | 12.4 | 4.2 | 29.5 |
| Aug 21 | -11.7 | 33.3 | 4.7 | 28.7 | 45.1 | 9.4 | 6.7 | 29.0 |
| Sep 21 | -22.5 | 33.8 | 5.2 | 28.6 | 56.3 | 16.8 | 5.7 | 33.8 |
| Oct 21 | -17.9 | 35.7 | 5.3 | 30.3 | 53.6 | 12.3 | 6.0 | 35.3 |
| Nov 21 | -21.2 | 31.8 | 5.5 | 26.3 | 53.0 | 14.2 | 4.5 | 34.3 |
| Jul 22 | -28.0 | 38.4 | 8.2 | 30.2 | 66.4 | 21.1 | 3.5 | 41.8 |
| Aug 22 | -26.9 | 37.0 | 8.5 | 28.5 | 63.9 | 19.3 | 4.3 | 40.3 |
| Sep 22 | -29.2 | 35.4 | 7.3 | 28.1 | 64.7 | 18.8 | 4.9 | 41.0 |
| Oct 22 | -27.6 | 31.4 | 6.3 | 25.1 | 59.0 | 18.2 | 4.3 | 36.5 |
| Nov 22 | -23.9 | 32.0 | 5.4 | 26.6 | 55.9 | 15.7 | 3.4 | 36.7 |

Source: DGCI&S

**Top 10 Commodities: Export and Import**

- During April to November 2022, the highest export of USD 70.6 billion was recorded in Engineering goods which constitute the largest share of 23.9 percent in India's total exports (Table 8.2). Among the top ten commodities for export, the rate of growth of Petroleum crude and products at 58.9 percent has been the highest followed by electronic goods (54.2 per cent). Handloom products, Plastic & Linoleum and engineering goods have contracted respectively, by 25.8 per cent, 9.7 and 2.0 per cent.
- On the imports side among the top ten commodities, petroleum and crude oil products with the highest share in total imports of 29.7 percent, grew at 52.6 percent during April-November 2022 (Table 8.3). Except import of gold which contracted at 18.1 percent, all other items have recorded positive growth for April to November period.

## 1.2 Invisible Trade

- During April to November 2022, services exports stood at USD 204.4 billion registering a growth of 28.8 per cent over the same period of calendar year 2021 (Figure 8.1, right Panel). India's services imports stood at USD 117.1 billion in this period, showing an increase of 29.4 per cent compared to the same period of 2021. Net invisible receipts recorded higher in FY 2022-23 till November. Till the end of Q2, 2022-23, Transport, and Telecom., computer and IT sectors registered highest growth in net services exports (Figure 8.2). However, fifty percent of services basket registered contraction in net exports in this period.

Table 8.2: **Top 10 Major Commodity of Export (Value in US $ Billion)**

| Rank | Commodity | Apr-Nov 2021 | Apr-Nov 2022 | Growth (%) | % Share |
|---|---|---|---|---|---|
| 1 | Engineering Goods | 72.0 | 70.6 | -2.0 | 23.9 |
| 2 | Petroleum Products | 39.4 | 62.7 | 58.9 | 21.2 |
| 3 | Gems & Jewellery | 25.9 | 26.4 | 2.1 | 9.0 |
| 4 | Chemicals | 18.8 | 20.4 | 8.4 | 6.9 |
| 5 | Drugs & Pharmaceuticals | 15.9 | 16.6 | 4.4 | 5.6 |
| 6 | Electronic Goods | 9.3 | 14.4 | 54.2 | 4.9 |
| 7 | RMG of all Textiles | 9.7 | 10.4 | 7.2 | 3.5 |
| 8 | Handloom Products etc. | 9.9 | 7.3 | -25.8 | 2.5 |
| 9 | Rice | 6.0 | 7.0 | 16.5 | 2.4 |
| 10 | Plastic & Linoleum | 6.4 | 5.8 | -9.7 | 2.0 |

Source: DGCI&S

Table 8.3: **Top 10 Major Commodity of Import (Value in US $ Billion)**

| Rank | Commodity | Apr-Nov 2021 | Apr-Nov 2022 | Growth (%) | % Share |
|---|---|---|---|---|---|
| 1 | Petroleum products | 96.1 | 146.6 | 52.6 | 29.7 |
| 2 | Electronic goods | 44.6 | 51.9 | 16.4 | 10.5 |
| 3 | Coal, Coke & Briquettes | 18.8 | 37.3 | 97.7 | 7.5 |
| 4 | Machinery, etc. | 24.9 | 29.4 | 17.8 | 6.0 |
| 5 | Gold | 33.2 | 27.2 | -18.1 | 5.5 |
| 6 | Chemicals | 19.2 | 23.7 | 23.7 | 4.8 |
| 7 | Stones | 19.2 | 21.1 | 9.7 | 4.3 |
| 8 | Transport equipment | 12.9 | 17.3 | 33.9 | 3.5 |
| 9 | Artificial resins, plastic | 12.8 | 16.0 | 24.8 | 3.2 |
| 10 | Vegetable Oil | 12.2 | 14.3 | 16.7 | 2.9 |

Source: DGCI&S

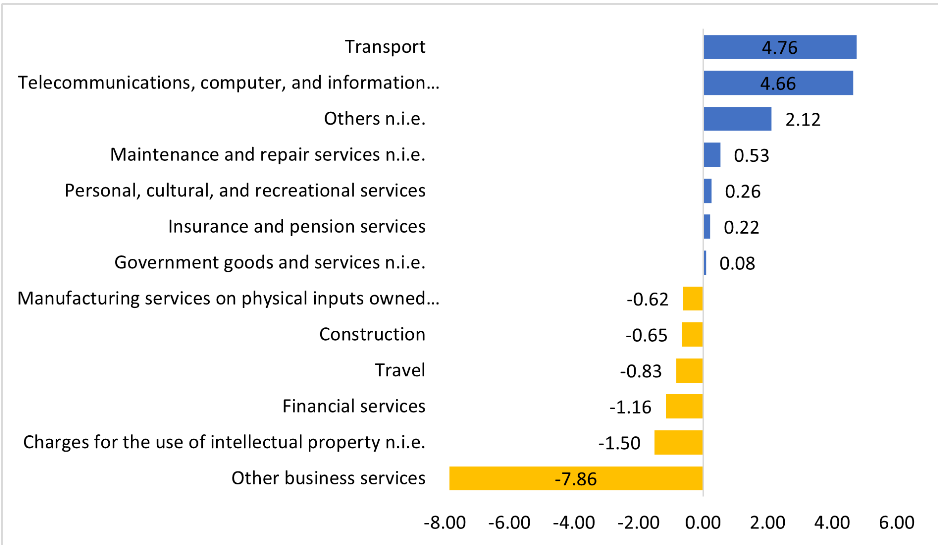
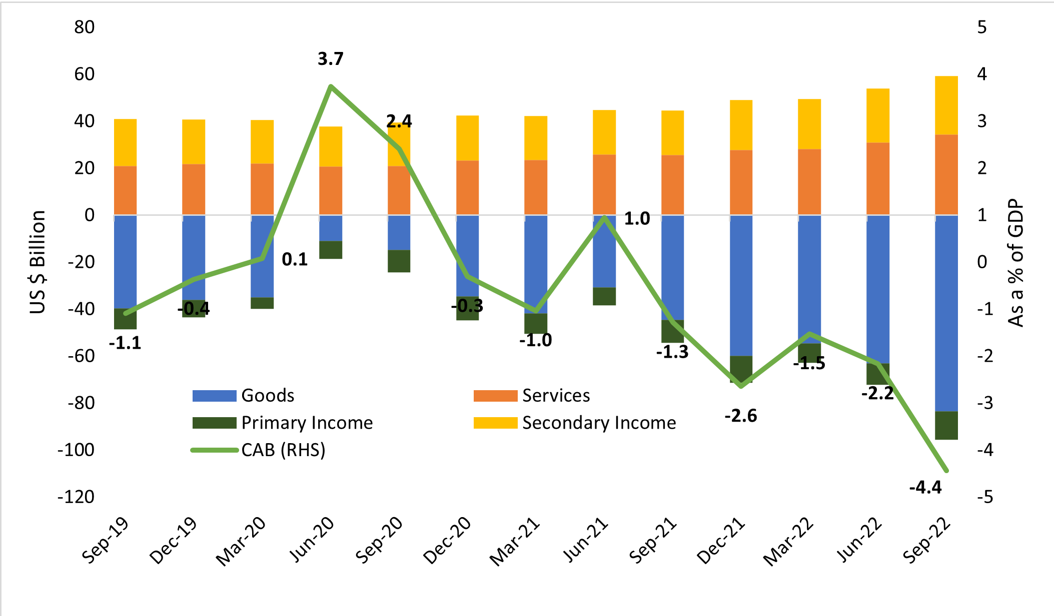



Figure 8.2: **Growth in net exports of the services basket (%)**

### 1.3 Current Account Balance

- The current account balance (CAB) approached to deficit of 4.4 per cent of GDP in Q2 FY 2022-23 after a surplus of 0.9 per cent in Q1 2021-22 due to widening merchandise trade deficit (Figure 8.3). Trade in goods; and primary income account, experienced persistent deficit in all quarters, whereas the net services and secondary income registered surplus in these quarters.




Source: DGCI&S, and Reserve Bank of India

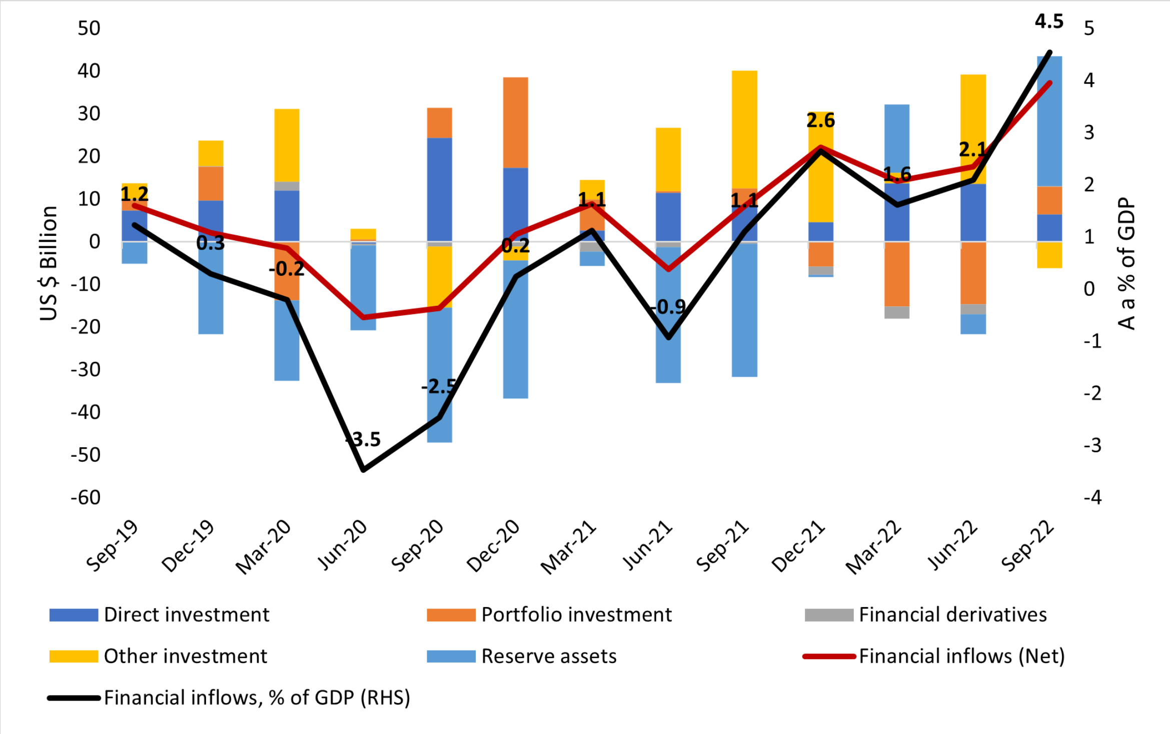
Figure 8.3: **Quarterly composition and trend of Current account balance (CAB)**

## 2 Financial Account

Financial account surplus largely financed current account deficit in April-October 2022-23. This period showed net financial account inflows despite FPI outflows because of net inflows of FDI, ECBs, and trade credit (Figure 8.4).

### 2.1 FDI and FPI

- Gross inward foreign direct investment (FDI) moderated to US$ 44.2 billion during April-October 2022 from US$ 48.6 billion a year ago. Net FDI, however, increased to US$ 22.7 billion during this period from US$ 21.3 billion a year ago, mainly due to a decline in outward FDI by India.
- The majority of FDI equity inflows was received by manufacturing, retail and wholesale trade, financial services, computer services and communication services during April-October 2022. Singapore, Mauritius, and the US were the major investors to India.
- Net FPI flows to India were to the tune of US$ 4.7 billion in November 2022, mainly in the equity market. However, according to RBI in December 2022 (as on 13th December, 2022), Indian markets witnessed FPI outflow of US$ 0.3 billion. During November




Source: DGCI&S, and Reserve Bank of India

Figure 8.4: **Quarterly composition and trend of financial account balance**

2022, financial services, oil, gas and consumable fuels, and information technology sectors attracted the bulk of FPI investment in equity market. According to Institute of International Finance (IIF), Indian markets received more FPI investment than other emerging market economies (EMEs), except China and Taiwan, in November 2022.

- External commercial borrowing (ECBs) registrations during April-October 2022 stood at US$ 12.4 billion. Net ECB inflows, however, were negative as principal repayments (US$ 14.3 billion) exceeded gross disbursements (US$ 12.3 billion). The rise in overall cost of ECB loans, however, was relatively less as the weighted average interest rate spread of ECBs over the benchmark interest rate was limited to 170 basis points during April-October 2022 (193 bps during April-October 2021).

- Major global benchmark rates, viz., the London interbank offer rate (LIBOR) and the secured overnight financing rate (SOFR) have increased by 301 bps and 277 basis points, respectively during April-October 2022.

## 3 Foreign Exchange Reserve

- India's foreign exchange reserves stood at US$ 564.1 billion as on December 9, 2022 and covered 9.2 months of imports projected for 2022-23. The reserves have increased by US$ 31.4 billion since end September 2022.

# 4 Exchange rate

- In the foreign exchange market, the Indian rupee (INR) showed appreciation by 0.6 per cent in November 2022, amidst weakening of the US dollar, softening crude oil prices and net FPI inflows. The INR appreciation was modest compared to most of the other EME currencies. In terms of the 40-currency real effective exchange rate (REER), the INR depreciated by 0.6 per cent in November 2022 (month-on-month).

# 5 India's trade outlook

- The growth rate of the world economy in 2023 is projected at a modest rate of 2.7 percent by IMF, 1.9 percent by the World Bank, and 0.9 percent by OECD. The latest 'below trend' reading on the Goods Trade Barometer of the World Trade Organisation (WTO) for September 2022 projects a worsening of the global trade outlook.
- Slowing down of the global growth rate, along with worsening of trade outlook predicts further slowdown in exports by India, contributing to rising trade deficit in the coming quarters of FY 22-23 and FY 23-24. Apart from crude oil, rising prices of vegetable oil, coal and fertilisers contributed to ballooning of the trade deficit in India.
- India's bilateral cooperation and trade agreements with Australia, Canada, Finland, Mauritius, and Gulf region (Chapter 5) are the efforts to improve trade prospect of the country in medium to long term.