STATE OF THE ECONOMY

Quarterly Assessment and Growth Outlook:
April-June, 2022

JULY 1, 2022

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

NATIONAL INSTITUTE OF PUBLIC FINANCE
AND POLICY | NEW DELHI

MAJOR HIGHLIGHTS

- As on 20th June 2022, the total number of confirmed cases of Covid-19 infections reported was around 43.3 million and the number of registered deaths were around 5.25 lakh. As of 20th June 2022, around 2 billion doses of vaccine had been administered in India. In addition, more than 41.9 million people were vaccinated for precaution doses.

- The GDP estimates as provided by the National Statistical Office (NSO) record an increase of 8.7 percent in 2021-22. A decomposition of the aggregate and sectoral annual growth into (i) effect of change in 2021-22 compared to the level of the pre-pandemic year 2019-20 and (ii) the base year growth effect of 2020-21, shows that the 8.7 percent growth in 2021-22 is mainly driven by low base year growth effect of 2020-21, whereas the level of economic activities in 2021-22 is just 1.6 percent higher than the level of the pre-pandemic year 2019-20.

- In 2021-22, Agriculture, Manufacturing, Financial Services and Public Administration services register robust rate of expansion compared to the level of the pre-pandemic year 2019-20. The double digit growth recorded in Mining and Quarrying and Construction is mainly on account of low base growth effect of 2020-21. Moderate expansion of activities in Utilities sector in 2021-22, compared to the pre-pandemic level of 2019-20, as well as low base effect of 2020-21 have contributed to the double digit growth in this sector in 2021-22. Trade, Hotels and Transport services in 2021-22 remained lower than the pre-pandemic level of 2019-20. However, the negative base growth effect of higher magnitude has raised the overall growth of this sector in 2021-22 to a double digit number.

- The growth (YoY) estimates of quarterly gross domestic product (GDP) for the period January-March 2022 is 4.1 percent**,** substantially lower than the growth of 20.1 percent experienced in the quarter of April-June 2021, that of 8.3 percent recorded in the quarter of July-September, 2021, and the growth rate of October-December, 2021 of 5.4 percent. In this quarter, all sectors, except for manufacturing, record expansion compared to the same quarter previous financial year. The slowdown in the pace of growth is on account of decline of base effect driven by recoveries over the quarters of 2020-21. The spread of omicron variant of Covid-19 has further moderated the economic activities in this quarter.

- All expenditure side components of GDP, except for Govt. Final Consumption Expenditure (GFCE), record substantially high growth during the FY 2021-22 compared to their respective levels in 2020-21. A decomposition of growth rates in these components into the change relative to pre-pandemic level of 2019-20 and the base growth effect of 2020-21reveals sign of broad based demand revival in 2021-22 compared to the pre-pandemic levels of 2019-20.

- On the inflation front, CPI headline inflation crossed the 6 percent mark in January 2022 and continuously increased to 7.8 percent in April 2022, on account of rising food inflation along with sticky core and energy inflation. Cost-push factors such as agricultural wage inflation and MSP hike, adverse weather shocks and rising global edible oil inflation have mainly driven wholesale and retail food inflation up. A broad-based rise in inflation in core items can be observed since the beginning of FY 2021-22. High rate of oil inflation, along with demand revival in the face of pandemic-induced supply disruptions causing core inflation to remain high. The headline inflation is expected to be at 7.3 percent, above the upper limit of RBI's band in 2022-23.

- India's current account balance (CAB) recorded a deficit of 1.2 per cent of GDP in FY 2021-22 after a surplus of 0.9 per cent in 2020-21 as the trade deficit widened. The current account deficit (CAD) recorded a decline in Q4 2021-22 from Q3 2021-22. The decline in CAD was mainly on account of a moderation in trade deficit and lower net outgo of primary income. In the financial account, total capital flows to India is more than three and half times lower than the capital inflows recorded during the same period of 2020-21. This fall in capital flows to India is driven by decline in FII inflows in the backdrop of rising global uncertainties caused by the Ukraine war and the expectations of increase in interest rate by the Fed in USA. However, FDI inflow has increased by 23% post-Covid in comparison to FDI inflow reported pre-Covid in India. It is mostly attributed due to the liberal and transparent policy for FDI, wherein most of the sectors are open to FDI under the automatic route.

- Monetary Policy Committee (MPC) of the Reserve Bank of India Act, 1934, increased the policy repo rate from 4 to 4.40 percent in May 2022 and further by 50 basis points to 4.90 per cent in June, 2022. The standing deposit facility (SDF) rate was revised to 4.65 per cent and the marginal standing facility (MSF) rate and the Bank Rate to 5.15 per cent. The RBI remains focused on "withdrawal of accommodation" to support economic growth recovery, while ensuring that inflation remains within the medium-term target for Consumer Price Index (CPI) inflation of 4 per cent within a band of +/- 2 per cent.

- Under the non-food category, credit flows recorded substantial growth in all sectors in the beginning of Q1 2022-23 compared to the same period in 2021-22. However credit flows to medium industries have grown at a much higher rate, followed by micro and small industries, while large industries registered contraction. Even though there is risk of rise in the share of gross non-performing assets of the Scheduled Commercial Banks, they are expected to have sufficient capital, both at the aggregate and individual levels, even under stress conditions.

- Gross tax revenues of the Union government in 2021-22 as well as GST revenue collection have grown at double digit rates in 2021-22 compared to the levels of 2020-21. With the exception of Union Excise duties, all central taxes contributed to the increase in gross tax revenues of the Union in 2021-22, on account of the low base effect of 2020-21 when most central taxes contracted, and due to growth in revenues driven by revival of economic activities in 2021-22. Total expenditure was higher by 8.1 percent over the actuals of 2020-21, driven by an increase in the capital expenditure. Fiscal deficit as a share of GDP in FY 2021-22 has moderated from 2020-21 on account of higher revenues and fiscal consolidation.

- Both tax and non-tax revenues of the states have increased in FY 2021-22 compared to the levels in 2020-21. However in Q4 2021-22 own tax revenues registered a decline compared to that in Q4 2020-21 on account of lowering of excise duty on fuel by several state governments to stabilise inflation.

- Total expenditure of the states has also increased in the FY 2021-22 compared to FY 2020-21. Capital expenditure has increased at a higher rate than the revenue expenditure, and is expected to boost further under PM Gati Shakti and other productive capital investments. The revenue and fiscal deficits as a percent of GDP aggregated across all the 25 states have improved considerably in 2021-22 compared to the numbers in 2020-21.

- As a result of revenue position and calibrated expenditure by the states during 2021-22, the aggregate market borrowings of state governments have been less than that indicated in the market borrowing calendar by 23.5 percent.

- Going forward the states are faced with fiscal risks. Apart from macro-economic shocks arising from uncertainties surrounding the evolving COVID situation, impact of spill-overs from the Russia-Ukraine war operating through high global food and commodity prices, and the synchronized monetary tightening by central banks across the world, the other potential sources of risks to states' finances are realisation of contingent liabilities, reverting to old pension scheme by some states, increased expenditure on non-merit goods and realisation of government guarantees extended to state-owned enterprises and rising overdues of loss making power DISCOMS.

- Overall, in the background of mounting commodity inflation and rising global uncertainties due to the Ukraine war, Indian economy is expected to grow at a moderate rate in FY 2022-23, possibly lower than the rate achieved in the FY 2021-22. Decline in the growth momentum, high and sticky food inflation and depreciating pressure on rupee are the three major macroeconomic challenges India has to address in 2022-23.

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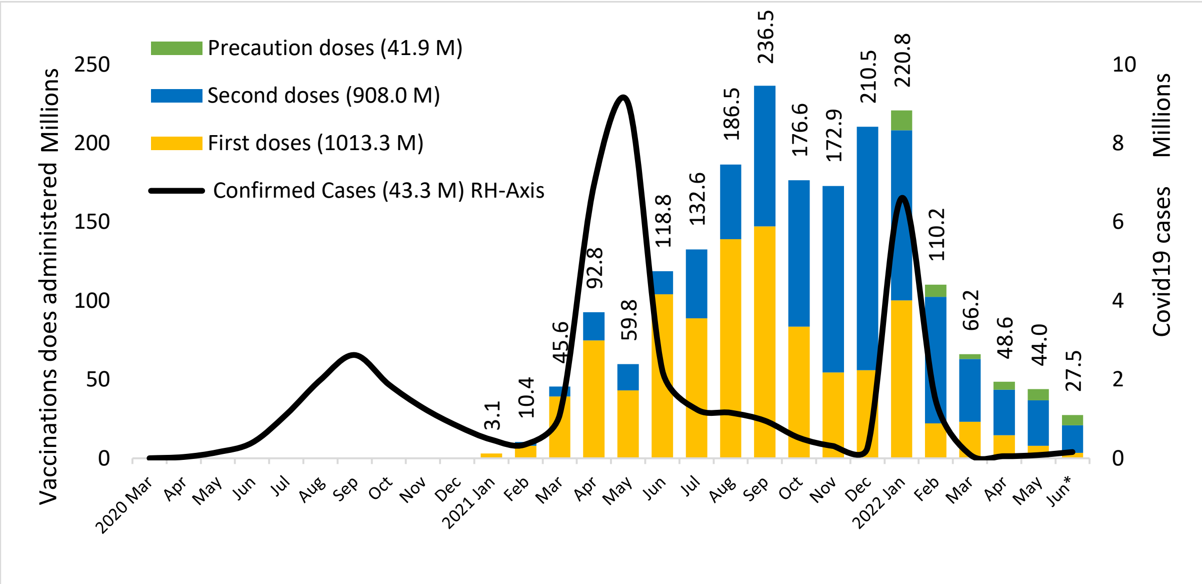
I GROWTH OUTLOOK

- As on 20th June 2022, the total number of confirmed cases of covid infections reported is around 43.3 million and the number of registered deaths were around 5.25 lakh. As of 20th June 2022, a total number of around 2 billion doses of vaccine had been administered in India (1013.3 mn 1st dose and 908.0 mn 2nd dose). In addition, more than 41.9 million people were vaccinated for precaution doses (Figure 1.1).

Figure 1.1 Monthly Covid-19 cases and vaccinations doses administered in India



* Till dated June 20, 2022
Source: State bulletins, and Ministry of Health and Family Welfare (MoHFW), GoI

Recent trends in growth

- **The GDP estimates as provided by the National Statistical Office (NSO) record an increase by 8.7 percent in 2021-22 from the level in 2020-21.** Thus, GDP in 2021-22 shows an expansion compared to a contraction by (-) 6.6 percent in 2020-21 (Table 1.1). **Table A.1 in Appendix A presents decomposition of aggregate and sectoral annual growth into (i) effect from change in 2021-22 compared to level of pre-pandemic year 2019-20 and (ii) the base year growth effect of 2020-21.** A negative base growth effect contributes positively to the current growth rate, while a positive base effect reduces it. [1] Table A.1 in Appendix A shows that **the 8.7 percent growth in 2021-22 is mainly driven by low base effect of 2020-21, whereas the level of economic activities in 2021-22 is just 1.6 percent higher than the level in the pre-pandemic year of 2019-20.**

- **In 2021-22, Agriculture, Manufacturing, Financial Services and Public Administration services register robust rate of expansion (by 6-9 percent) compared to the level in the pre-pandemic year 2019-20 (Table A.1 in Appendix A).** The double-digit growth recorded in Mining and Quarrying, and Construction is mainly on account of low base effect of 2020-21. Moderate expansion of activities in Utilities sector in 2021-22, compared to the pre-pandemic level of 2019-20, as well as low base

[1] The formula for the decomposition of growth rate into rate of changes relative to pre-pandemic level and the base effect is given in Appendix A.

effect of 2020-21 have contributed to the growth in this sector. Trade, Hotels and Transport services registers a double-digit growth of 11.1 percent in the last financial year. The decomposition in Table A.1 shows that this sector has registers a contraction in activities by (-) 14.2 percent in 2021-22 compared to the pre-pandemic level of 2019-20. However, the negative base effect of (-) 25.2 raised the overall growth of this sector in 2021-22 to a double-digit number.

- **The growth (YoY) estimates of quarterly gross domestic product (GDP) for the period January-March 2022 is 4.1 percent,** substantially lower than the growth rate of 20.1 percent experienced in the quarter of April-June 2021, that of 8.3 percent recorded in the quarter of July-September, 2021, and the growth rate of October-December, 2021 of 5.4 percent (Table 1.1).

- The double-digit growth in Q1 2021-22 has been on account of the low base in the same quarter when real GDP growth rate had registered a (-) 24.4 percent contraction. Real GDP growth in Q2 of 2020-21 (YoY) showed signs of initial recovery as the growth rate improved significantly to (-) 7.4 percent. With improving base growth rate, the real GDP growth (YoY) in Q2 2021-22 becomes lower than the growth rate experienced in the previous quarter of FY 2021-22. Similarly, the growth rates in Q3 and Q4 of 2021-22 have further tapered off due to improving base effect. Additionally **the spread of omicron variant of covid-19, along with adverse weather condition in the beginning of Q4 2021-22 have further moderated the economic activities in this quarter.**

Table 1.1 Quarterly Growth Rates (%, constant prices) of GDP, 2011-12 Series

Sectors	Annual 2020-21	Annual 2021-22	Q1 2021-22 Apr-Jun YoY	Q2 2021-22 Jul-Sep YoY	Q3 2021-22 Oct-Dec YoY	Q4 2021-22 Jan-Mar YoY
GDP	**-6.6**	**8.7**	**20.1**	**8.3**	**5.4**	**4.1**
Agriculture, Fishing, etc.	3.3	3.0	2.2	3.2	2.5	4.1
Mining & Quarrying	-8.6	11.5	18.0	14.5	9.2	6.7
Manufacturing	-0.6	9.9	49.0	5.6	0.3	-0.2
Electricity, Gas, Water etc.	-3.6	7.5	13.8	8.5	3.7	4.5
Construction	-7.3	11.5	71.3	8.1	-2.8	2.0
Trade, hotels, Trans., etc	-20.2	11.1	34.3	9.6	6.3	5.3
Financial & Prof. Serv.	2.2	4.2	2.3	6.1	4.2	4.3
Public Admin, defence, etc	-5.5	12.6	6.2	19.4	16.7	7.7

Source: National Statistical Office (NSO)

- **In Q4, 2021-22, Agriculture, Mining and Quarrying, and all categories of Services record growth (YoY) in the range of 4-8 percent from their respective levels of Q4 2020-21 (Table 1.1)** Construction shows a moderate growth of 2 percent**. Manufacturing,** which acted as the main engine of growth during the first two quarters of 2021-22, **registered a mild contraction by (-) 0.2 percent in the last quarter of 2021-22.** The manufacturing growth in the beginning of 2021-22 was mainly driven by the **surge in automobile demand as the public transport services were disrupted during the periods of second wave of the pandemic.** However this **pandemic driven growth was not sustained** over the later half of 2021-22.

- All expenditure side components of GDP, except for Govt. Final Consumption Expenditure (GFCE), recorded substantially high growth during the FY 2021-22 from their respective levels in 2020-21. **Private Final Consumption Expenditure (PFCE) recorded 7.9 percent growth in 2021-22.** However, a decomposition of this growth rate into the change relative to pre-pandemic level of 2019-20 and the base growth effect of 2020-21shows, that **PFCE had actually grown by 1.5 percent in 2021-22 compared to the pre-pandemic level of 2019-20 (see Table A.2 in Appendix A). The high growth**

rate of this component in 2021-22 was mainly driven by the large negative base growth effect of 2020-21. Hence a mild revival of private consumption demand was observed.

- **Investment demand (GFCF) recorded 15.8 percent annual growth during the FY 2021-22.** The decomposition in Table A.2 shows **it had grown by 4.1 percent in this year compared to the level of the pre-pandemic year of 2019-20. The double digit growth in 2021-22 is mainly on account of the large negative base growth effect of 2020-21.**

- **Government Final Consumption Demand (GFCE) showed a mild 2.6 percent growth in 2021-22.** However, the decomposition in Table A.2 shows that **it had grown by 6 percent in 2021-22, compared to the pre-pandemic level of 2019-20, owing to government's efforts to revive the economy.** The decomposition also shows a **positive base growth effect of 3.5 percent in 2020-21, owing to various stimulus packages implemented in this year. The positive growth in the base year partly offset the expansionary effects of 2021-22.**

- **Real exports and imports record robust growth rates of 24.3 percent and 35.5 percent** respectively. The decomposition in Table A.2 shows that both these components recorded **robust expansions in 2021-22 by double digit rates, compared to the respective levels at the pre-pandemic year of 2019-20. Again large negative base year growth effects further added to the annual growth** rates of these two components in 2021-22.

- In Q4 2021-22, all major components of the expenditure side GDP recorded positive growth rate (YoY), with imports of goods and services recording the highest growth, followed by exports (Table 1.2). Both the components showed double digit growth in the range of 17-18 percent in this quarter. However, private consumption expenditure recorded the lowest growth rate of only 1.8 percent in Q4 2021-22.

Table 1.2 Expenditure-side Growth Rates of GDP (%, constant prices), 2011-12 series

Components	Annual 2020-21	Annual 2021-22	Q1 2021-22 Apr-Jun YoY	Q2 2021-22 Jul-Sep YoY	Q3 2021-22 Oct-Dec YoY	Q4 2021-22 Jan-Mar YoY
GDP	**-6.6**	**8.7**	**20.1**	**8.3**	**5.4**	**4.1**
Private Final Consumption Exp. (PFCE)	-6.0	7.9	14.4	10.5	7.4	1.8
Govt. Final Consumption Exp. (GFCE)	3.6	2.6	-4.8	8.9	3.0	4.8
Gross Fixed Capital Formation (GFCF)	-10.4	15.8	62.5	14.6	2.1	5.1
Exports of Goods and Services	-9.2	24.3	40.8	20.7	23.1	16.9
Imports of Goods and Services	-13.8	35.5	61.1	41.0	33.6	18.0

Source: National Statistical Office (NSO) & NIPFP estimates

High frequency indicators predict resilience in economic activities in Q1 2022-23

Agriculture

- Agriculture remained resilient in Q4 2021-22 recording a 4.1 percent YoY growth. The actual area sown for kharif foodgrain is more than the normal area sown till the beginning of February, 2022 and rainfall being at the normal level in April-May, 2022, **agricultural activities are expected to remain resilient in Q1 2022-23.** However the **performance of this sector** in the first quarter of 2022-23 **is subject to downward risks on account of volatile weather conditions in January and in March 2022.** In January 2022, the rainfall was 128 percent higher than the normal level, while it fell less by 70 percent from the normal level in March 2022. This volatile weather condition has adversely affected wheat production. High temperature in North India is also expected to adversely affect productivity of crops such as wheat. Consequently, Govt. estimates of wheat production for the crop year 2021-22 (July 2021 to June 2022) has been adjusted downward from 111.3 million tonnes to 105 million tonnes. **Agricultural sector may reflect the effects of the adverse weather shocks on its activities in Q1 2022-23.**

Industry

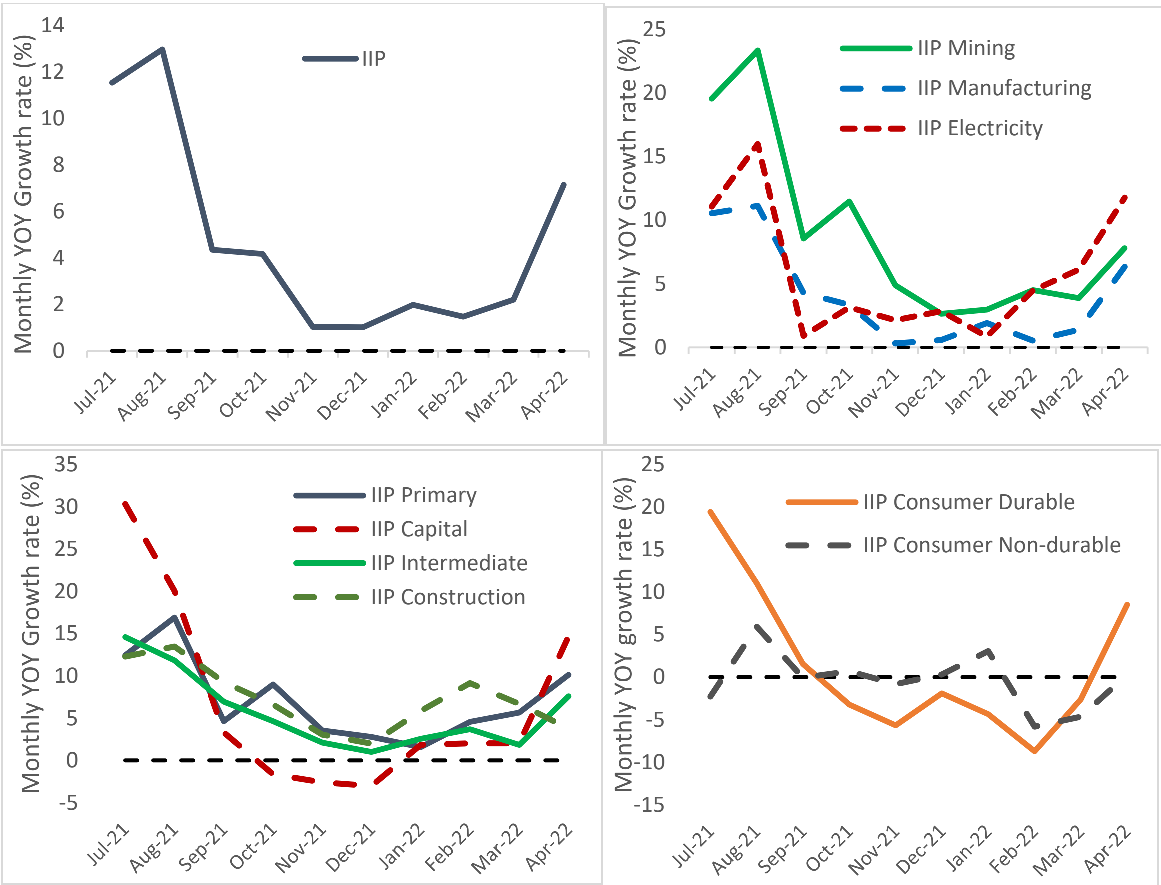
- **IIP growth showed a significant rebound after a long period of muted growth:** IIP growth was muted at 2.3 percent during the entire period of September 2021 to March, 2022. **In April 2022, general IIP recorded 7 percent growth rate,** showing a significant rebound in the beginning of the first quarter of FY 2022-23. **The sharp rise in IIP growth was broad based** across all the activity based and use based components, except for IIP infrastructure (Figure 1.2).
- IIP capital goods recorded the highest rate of growth of 14.7 percent followed by IIP electricity (11.8 percent) and IIP primary goods (10.1 percent) in April 2022. IIP consumer durables and non-durables recorded continuous contraction during the second half of 2021-22. IIP consumer durables showed 8 percent growth in April 2022, while IIP consumer non-durables recorded to a mild positive rate of growth in this month.
- Muted performance in manufacturing and consumer durable goods industries in Q4:2021-22 was driven by contraction in production of two wheelers, commercial vehicles and the sales of passenger cars (Table 1.3). **During the pandemic year of 2020-21, the restrictions on public transport services caused sharp rise in the production and sale of private vehicles. However, this pandemic driven growth in the automobile sector had subsided, and eventually recorded a contraction in** Q3 2021-22, compared its performance in Q3, 2020-21 and that trend continued till Q4, 2021-22.
- After recording contraction in the months of Q4, 2021-22, production of two wheelers rebounds to a positive growth rate in April 2022, while production of commercial vehicles and passenger car sales record strong growth in the months of Q1, 2022-23 (Table 1.3). Electricity generation and steel consumption also show strong double-digit growth in May 2022. Production of coal also records a double-digit growth in April 2022. **The current trends in the high frequency indicators of industrial activities indicate robust industrial growth in Q1, 2022-23.**

Table 1.3 Recent Trends in Selected Indicators of Industrial Sector

Indicator	Jan 2022 YoY growth	Feb 2022 YoY growth	Mar 2022 YoY growth	Apr 2022 YoY growth	May 2022 YoY growth
Production of coal (million tonnes)	7.7	6.4	0.3	**28.4**	
Production of crude oil (‘000 tonnes)	-2.4	-2.2	-3.3	-1.0	
Production of two wheelers (‘000 numbers)	-19.4	-23.7	-20.0	**0.8**	
Production of commercial vehicle (‘000 numbers)	8.7	21.5	14.3	**39.5**	
Passenger car sales	-6.0	-0.8	2.9	-1.8	**157.0**
Production of cement (‘000 tonnes)	14.1	5.0	8.9	7.9	
Consumption of steel (‘000 tonnes)	0.5	-5.3	0.7	1.2	20.2
Electricity generation (million Kwh)	-0.6	2.8	4.3	10.0	20.4

Source: NSO, CMIE

Figure 1.2 Recent trend in components of IIP



Source: NSO

Table 1.4 Recent Trends in Selected Indicators of Services Sector

Indicator	Jan 2022 YoY growth	Feb 2022 YoY growth	Mar 2022 YoY growth	Apr 2022 YoY growth	May 2022 YoY growth
Cargo Port ('000 tonnes)	-2.8	-4.5	1.2	**5.5**	**8.9**
Cargo Air ('000 tonnes)	0.5	-2.8	0.3	**2.4**	
Cargo Rail ('000 tonnes) (SA)	7.8	6.6	6.7	**9.4**	
Passenger Air ('000 numbers)	-8.7	4.7	44.2	**95.4**	
Passenger Rail (million numbers)	44.4	44.8	53.0	**116.2**	
Tourists arrival	140.4	141.8	177.9	**465.8**	
Tele Subscribers (million numbers)	-0.9	-1.8	-2.8		
NSE Turnover (Rs Crore)	**-11.4**	**-28.2**	-1.0	**-2.9**	**-26.5**

Source: CMIE

Services

- After slowing down in the beginning of Q4 2021-22 during the spread of Omicron, **indicators of all modes of trade showed strong growth in the months of Q1, 2022-23 (Table 1.4).** Indicators of transport services also recorded strong growth in the beginning of Q1 2022-23. Number of tourists arrival in India, an indicator of tourism services also registered strong growth in Q4 2021-22 and in the beginning of Q1 2022-23. However, growth in NSE stock index, an indicator of financial services recorded volatile performance in the last and the current quarter. **Overall, the services sector performance is expected to remain strong in Q1 2022-23.**

Demand

- On the demand side, CMIE's Index of Consumer Sentiments growth recorded steady positive growth over the months of Q4 2021-22 and Q1 2022-23. Again, the data on new investments from CMIE Capex database showed 127.7 and 139.5 percent YoY growth respectively in non-financial sector in Q3 and Q4 of 2021-22. However, growth in investments under implementation remained moderate at 2-4 percent in these quarters. Cost of completed projects shows a contraction by 14 percent in Q4 2021-22 from the level in the same quarter of FY 2020-21. **The slow pace of project implementation may cause moderate revival of investment demand in FY 2022-23.**

Growth outlook for near future

- **Overall, in Q1 2022-23, the economy is expected to record strong growth** on account of favourable base year effect and sustained revival of activities in the post pandemic years. According to the **projections by IMF and World Bank, the Indian economy is expected to grow at 7.5-8.2 percent in 2022-23. The Reserve Bank of India has projected the real GDP to grow of 7.2 per cent 2022-23,** with a **growth of 16.2 per cent in Q1:2022-23;** 6.2 percent in Q2; 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 rise in commodity inflation, fresh spread of Covid-19 infections in India, and increase in policy rate, along with withdrawal of its accommodative stance by the Reserve Bank of India (RBI).**

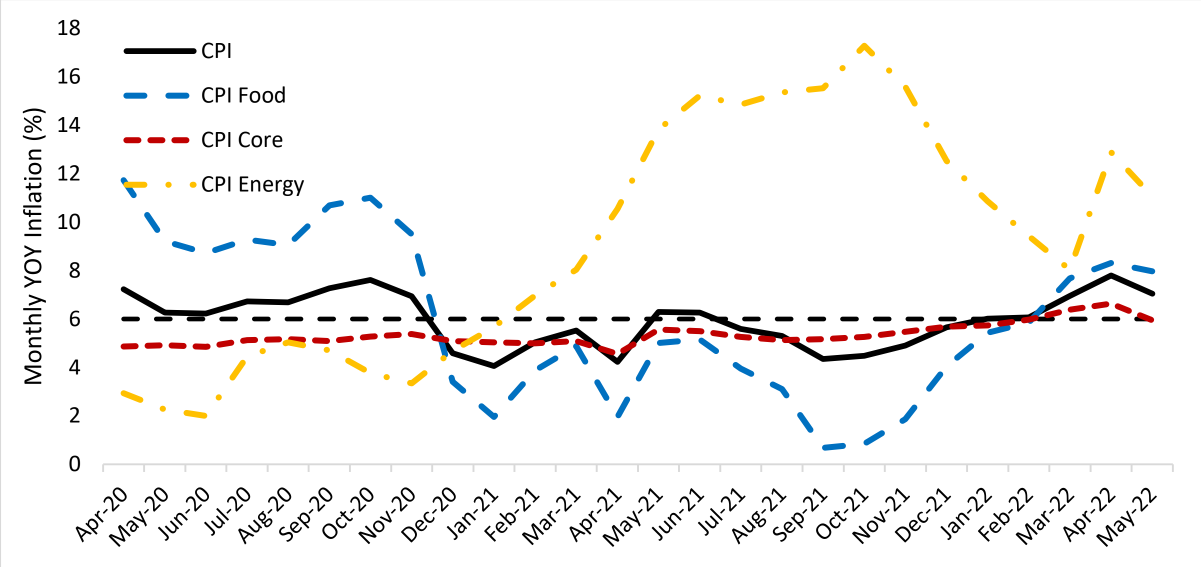
II INFLATION ASSESSMENT AND OUTLOOK

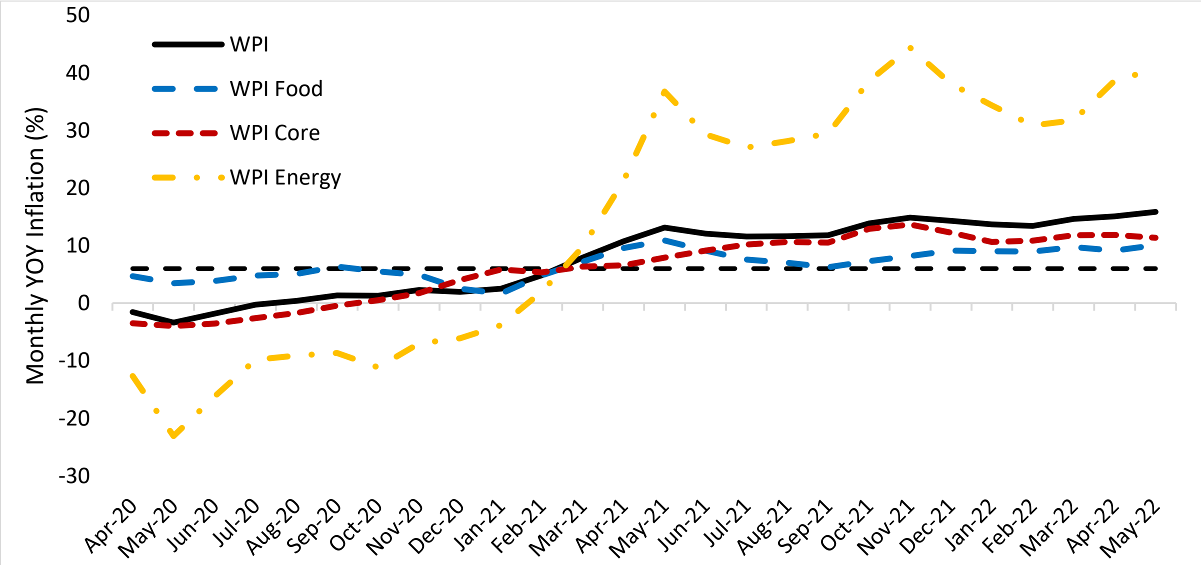
Recent trend in inflation

- During the FY 2021-22 , the average Consumer Price Index (CPI) inflation (monthly Year-on-Year) was 5.5 percent, within the Reserve Bank of India's (RBI) tolerance band of 2–6 percent. The moderate headline inflation (YoY) was on account of easing of food inflation from July 2021. However, food inflation rebounded since October 2021 and the headline inflation crossed the 6 percent mark in January 2022 (See Figure 2.1). The average 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. **CPI food inflation continued to increase and reached at 8.3 percent in April, 2022, causing a 7.8 percent headline inflation in the same month. The food inflation had moderated marginally to 8 percent in May, 2022, with headline inflation moderating to 7 percent in the same month.**

- CPI core inflation remained sticky at 5.5 percent in the FY 2021-22. **CPI core inflation** had been continuously rising since October 2021 and **reached 6.6 percent in April 2022. It had moderated marginally to 6 percent in May, 2022.** CPI energy inflation had been rising continuously since January 2021 on account of the transmission of surging global crude oil prices (Figure 2.2). During this period, CPI energy inflation remained high at 13.3 percent. It showed a declining trend from November 2021 and declined to 8 percent in March 2022. However, **CPI energy inflation rebounded and reached 12.9 percent in April 2022 and to 11.1 percent, owing to a rebound in the global crude oil inflation.**

Figure 2.1 Recent Trends in CPI and WPI





Source: NSO, Office of the Economic Adviser, Department for Promotion of Industry and Internal Trade

- During FY 2020-21, overall WPI inflation was low at 1.3 percent due to deflation in world crude oil prices. During the FY 2021-22, the average WPI inflation went up to 13 percent on account of low base effects of 2020-21, high energy (32.5 percent), core (10.6 percent) and food inflation (8.6 percent). **All the components of WPI continued to show a rising trend, with overall WPI inflation at 15.9 percent, WPI food inflation at 10.1 percent, WPI energy at 40.1 percent in May 2022, while WPI core moderated to 11.3 percent in this month from 11.8 percent in April 2022.**

- WPI food articles inflation was moderate at 4.2 percent during the FY 2021-22. However, it increased from 0.1 percent in October 2021 to 4.8 percent in November 2021 and further to 9.6 percent in January 2021. **The WPI food inflation became double digit in January 2022 at 10.3 percent.** After moderating to around 8 percent during February-April, 2022, **it went up again to 12.3 percent in May 2022. Cost-push factors such as agricultural wage inflation and MSP hike, and adverse weather shocks have contributed to raising WPI food articles inflation.**

- **Manufactured food products inflation remained high at 11.8 percent during the FY 2021-22 on account of production and supply disruptions driven by the pandemic. However, we observe a declining trend in it from October 2021.** In January 2022, the manufactured food products inflation was at 8.1 percent, but showed a rebound to 9.5 percent in February 2022 and 10.6 percent in March, 2022. **It was at 8.6 percent in May 2022.**

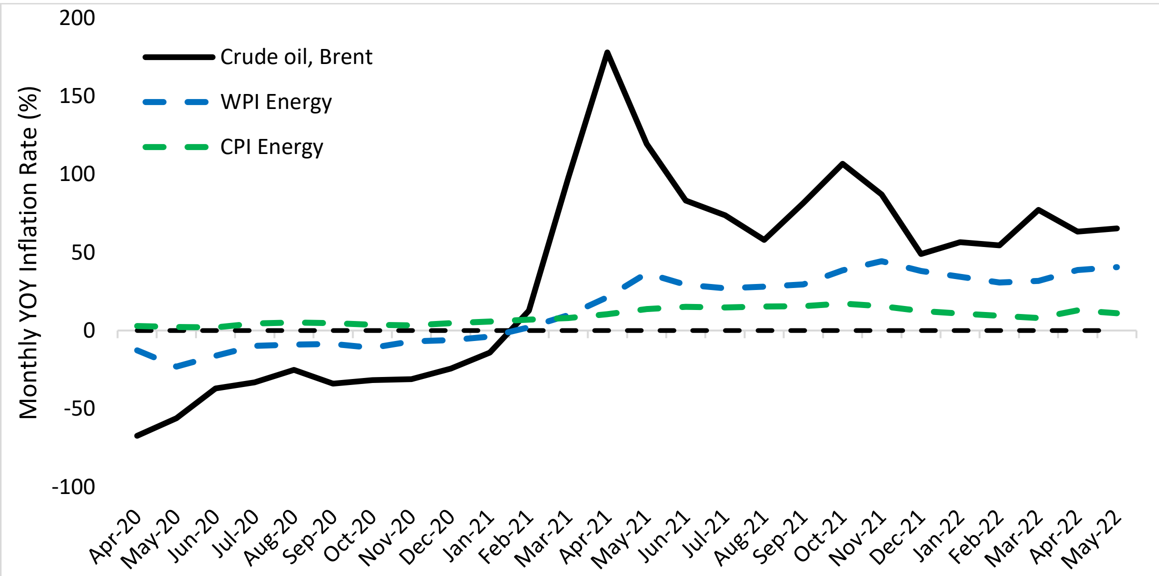
Contributors to retail and wholesale inflation

- During April-December 2021, **CPI food inflation** was mainly driven by Edible oil, Egg, Meat and Fish (EFM), and pulses inflation. Since January 2022, inflation in **Pulses (9.3 percent) and Fruits (5.8 percent) started contributing to CPI food inflation. Edible oil inflation (26 percent) and EFM inflation (7.8) continued to be the major contributors to it.** Spices inflation also emerged as one of the major contributors to retail food inflation since March, 2022.

- Since November 2022, high inflation in **Fruits and Vegetables (20.7 percent), Egg, Meat & Fish (8 percent) and foodgrains (5.4 percent), particularly Cereals** were the major contributors to WPI food articles inflation.

- **CPI Core inflation,** since April 2021, **was mainly driven by inflation in Clothing and Footware, (7.5 percent) and non-oil Miscellaneous items (5.9 percent)** comprised of Health, Non-oil Transport and Communications, Recreations and Amusements and Personal care and effects prices. During this period, **WPI core inflation was driven by high inflation in Textiles, Chemicals, Paper and Paper products, Rubber and Plastic products, Metals and Furniture.**

Figure 2.2 Recent Trends in Crude oil and Energy Inflation



Source: NSO, Office of the Economic Adviser, Department for Promotion of Industry and Internal Trade, World Bank.

Supply and demand shocks contributing to rising wholesale and retail inflation

- **In the supply side, crop wastage due to excessive rainfall** relative to the normal level during November 2021to January 2022 (77.5 percent on average) and high and **sticky agricultural wage rate** (5.6 percent on average in the months of August-December, 2021) driven by **hike in MGNREGA wage rate, and supply constraints of migrant labourers due to the pandemic, caused upward pressure on WPI cereals and vegetables prices since November 2021**. The rainfall in

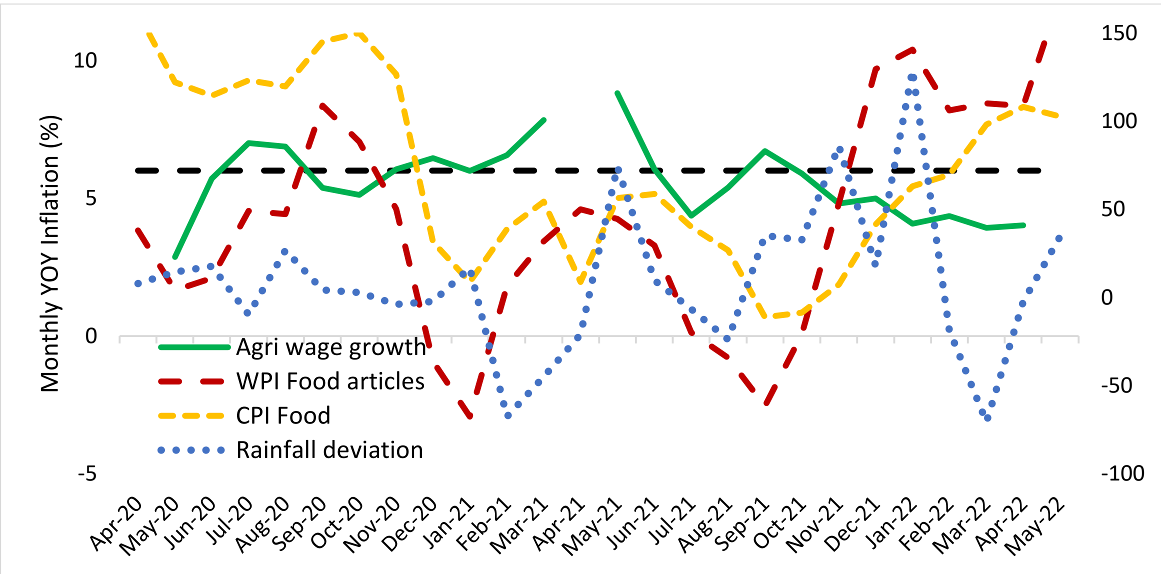
November 2021 was 86 percent higher than the normal level, while the rainfall in January 2022 was the highest for this month in five years at 128.9 percent higher than the normal level. The excessive rainfall led to crop damages and drove WPI food inflation up (Figure 2.3).

- The agricultural wage growth was 6.7 percent in September 2021 (Figure 2.3). It moderated marginally in the subsequent months. The average agricultural wage growth was sticky at 5.6 percent during September-December 2021, adding to the production cost of food commodities. Again, in March, rainfall was 70 percent below the normal level possibly affecting vegetables and fruits production. Also, **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, is transmitting to the retail market, causing high inflation rate in these food commodities in the CPI basket. Supply shortage due to the war between Russia and Ukraine, as well as adverse weather condition raised global edible oil price inflation to 62 percent since April 2021**, driving up the CPI Edible oil price inflation in India.

- 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 component of the CPI inflation. Supply chain disruption, caused by the pandemic, is another supply side factor driving up the retail inflation.

- On the demand side, the economy showed **signs of demand revival post the third wave**. This was captured by a continuous rise in the YoY change in the **CMIE consumer sentiments from 8.3 percent in December 2021 to 40.3 percent in May 2022. Non-agricultural rural wages** had also grown from **4.1 percent in January 2022 to 24.3 percent in March 2022 and to 22.6 percent in April 2022, driving up demand for food commodities and consequently CPI food inflation as food consists of 47.25 percent in the rural CPI basket.** Finally, the substantial liquidity in the economy via accommodative monetary policy reflected in low market rate of interest (3.2 percent in FY 2021-22) was conducive for boosting aggregate demand.

Figure 2.3 Factors Driving Inflation



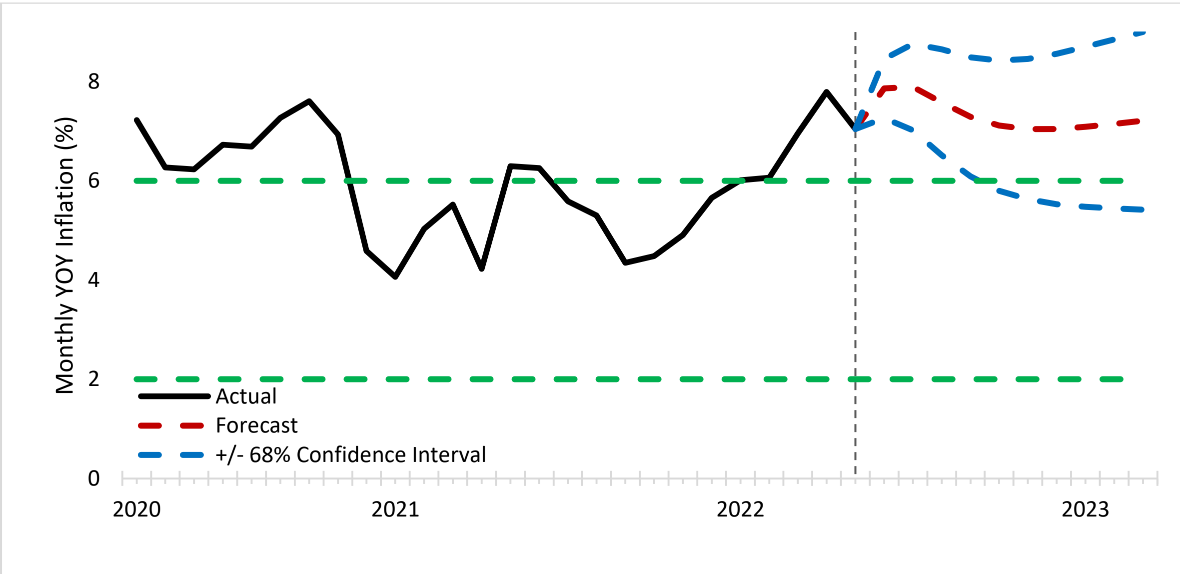
Source: NSO, Office of the Economic Adviser and CMIE

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

- Headline inflation outlook is based on past trends and underlying drivers of inflation, including inflationary expectations, wholesale food inflation, demand conditions, interest rate and oil prices. **Overall, the headline inflation in June 2022 is expected to increase to 7.9 percent from the rate of 7.0 percent in May 2022. Further, it is expected to be at 7.3 percent, higher than RBI's upper limit of the tolerance range in the FY 2022-23 (Figure 2.4).**

- The high inflation is expected to be on account of the following upward risks: i) high and sticky crude oil inflation due to Russia-Ukraine face off; (ii) increase in wholesale inflation in cereals, pulses, vegetables and fruits on account of MSP hike and adverse weather shock in Q4, 2022-23 (iii) sticky core inflation near the upper level of the band, which is a **direct fallout of the pandemic** (for example, supply chain disruptions in the face of demand revival) (iv) rural demand revival. However, a **few factors can work in favor of moderating** the pace of inflation. These are: (i) moderation of global edible inflation reducing pressure from CPI food inflation; (ii) Withdrawal of accommodative monetary policy stance and interest rate hike by RBI moderating core inflation.

Figure 2.4 Inflation Projections for June 2022 to March 2023



Source: NIPFP

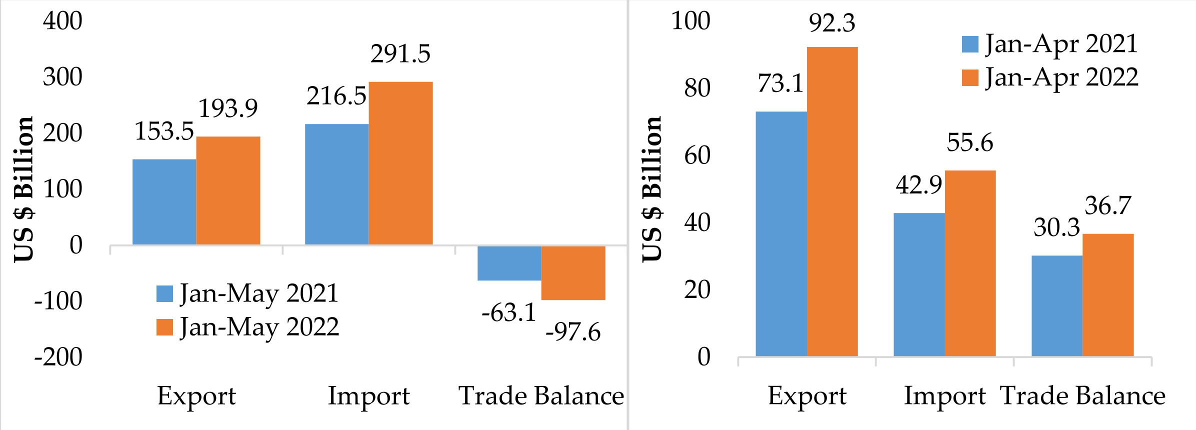
III EXTERNAL SECTOR

Performance of merchandise trade

- India's merchandise trade deficit widened to USD 97.6 billion during January to May 2022, from USD 63.1 billion in comparison to the year-ago level (figure 3.1 Left Panel). Total exports during January to May 2022 amounted to USD 193.9 billion, increased by 26.3 per cent as compared with 46.9 per cent increase during the same period of the previous year. This fall in export growth may be possibly attributed to spread of omicron in the beginning of 2022.

- The rise in imports outweighed that in exports. Total imports during January-May 2022 amounted to USD 291.5 billion, an increase of 34.6 per cent over the same period of last year.

Figure 3.1 Merchandise Trade Performance [LEFT] and Services Trade Performance [RIGHT]



Source: DGCI&S, and Reserve Bank of India

- Oil imports in January to May 2022 record positive YoY growth. The high growth in oil imports in January to March 2022 are partly on account of low base effects of the same months in 2021 (Table 3.1). Non-Oil imports from March to May 2022 saw a steady increase.

Table 3.1 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
Jan 22	-17.0	35.2	4.6	30.6	52.2	12.4	3.0	36.9
Feb 22	-18.5	37.1	6.9	30.3	55.7	15.5	5.3	34.9
Mar 22	-18.3	44.4	9.8	34.7	62.8	21.1	1.2	40.5
Apr 22	-20.4	39.8	7.9	31.9	60.2	20.1	1.8	38.2
May 22	-23.3	37.3	8.1	29.2	60.6	18.1		

Source: DGCI&S

Top 10 Commodity groups: Export and Import

- During January to April 2022, the highest export of USD 37.4 billion was recorded in Engineering goods which constitute the largest share of 23.9 percent in India's total export basket (Table 3.2). Among the top ten principal commodity groups, the rate of growth of Petroleum: crude and products at 145.9 percent has been the highest followed by electronic goods (33.9 per cent). Ores and minerals which cover 1.5 per cent share in total exports during January to April 2022, has contracted by 35.4 per cent. The import of this commodity, with an import share of 7.9 percent, grew at 104.9 per cent in this period. On the imports side, among the top 10 commodity groups, petroleum and crude oil products with the highest share in total imports of 29.9 percent, grew at 75.1 percent during January-April 2022 (Table 3.3).

Invisible trade

- During January to April 2022, services exports stood at USD 92.3 billion registering a growth of 26.2 per cent over the same period of calendar year 2021 (Figure 3.1 Right Panel). India's services imports stood at USD 55.6 billion in this period, showing an increase of 29.6 per cent compared to the same period of 2021. Net invisible receipts were higher in FY 2021-22 due to increase in net exports of services and net private transfer receipts, while net income outgo was marginally higher than a year ago (Table 3.4).

- In FY 2021-22, net inflows of all services categories show expansion at the YoY growth rate of 21.4 percent compared to FY 2020-21 (4.3 percent). In Q4 2021-22, net exports in Transport, Construction, and Financial Services, constituting 5.7 percent of the services basket recorded negative YoY growth, mainly due to Omicron which affected transport services the most. Telecommunications, computer, and information; other business services; and insurance and pension services are major drivers of trade in services in terms of compositional share in Q4 2021-22 and registered positive growth rate respectively of 25%, 521%, and 484.3% (Table 3.5).

Table 3.2 Top 10 Major Commodity groups of Export (Value in US $ Billion)

Rank	Commodity	Jan-Apr 2021	Jan-Apr 2022	Growth(%)	% Share
1	Engineering goods	30.0	37.4	24.7	23.9
2	Petroleum: crude and products	11.8	29.1	145.9	18.6
3	Chemicals & related products	17.5	20.1	15.0	12.9
4	Agricultural and allied products	16.9	18.8	11.2	12.0
5	Textiles (excluding RMGs)	6.8	8.1	19.5	5.2
6	Electronic goods	5.1	6.8	33.9	4.3
7	Readymade garments	5.4	6.5	20.4	4.1
8	Ores & minerals	3.5	2.3	-35.4	1.5
9	Leather & leather manufactures	1.3	1.7	28.6	1.1
10	Other commodities	1.2	1.7	46.0	1.1

Source: DGCI&S

Table Error! No text of specified style in document.**3.3 Top 10 Major Commodity groups of Import (Value in US $ Billion)**

Rank	Commodity	Jan-Apr 2021	Jan-Apr 2022	Growth(%)	% Share
1	Petroleum: crude and products	39.5	69.1	75.1	29.9
2	Engineering goods	32.7	35.9	9.7	15.5
3	Electronic goods	22.0	29.8	35.6	12.9
4	Chemicals & related products	16.9	25.3	50.4	11.0
5	Ores & minerals	8.9	18.1	104.9	7.9
6	Agricultural and allied products	8.0	11.1	39.1	4.8
7	Textiles (excluding RMG)	1.8	1.9	5.9	0.8
8	Readymade garments	0.3	0.5	52.2	0.2
9	Leather & leather manufactures	0.3	0.3	36.0	0.1
10	Other commodities	1.6	2.1	28.7	0.9

Source: DGCI&S

Current Account Balance

- The current account balance (CAB) recorded a deficit of 1.2 per cent of GDP in FY 2021-22 after a surplus of 0.9 per cent in 2020-21 as the trade deficit widened to US$ 189.5 billion from US$ 102.2 billion a year ago (Table 3.4). Trade in goods; and primary income account, experienced persistent deficit in all the quarters of FY 2021-22. Secondary income is persistently positive and increased in FY 2021-22 compared to 2020-21.

- India's current account deficit (CAD) decreased to US$ 13.4 billion (1.5 per cent of GDP) in Q4:2021-22 from US$ 22.2 billion (2.6 per cent of GDP) in Q3:2021-22. The sequential decline in CAD in Q4:2021-22 was mainly on account of a moderation in trade deficit and lower net outgo of primary income.

Table 3.4 Summary of Current Account (US $ Billion)

	2020-21 Annual	2021-22 Annual	2020-21 Q4	2021-22 Q1	2020-21 Q2	2021-22 Q3	2021-22 Q4
I. Goods and Services (Net)	-13.6	-81.9	-18.3	-4.9	-18.9	-31.9	-26.2
I.a. Goods	-102.2	-189.5	-41.7	-30.7	-44.5	-59.8	-54.5
I.b. Services	88.6	107.5	23.5	25.8	25.6	27.8	28.3
II. Primary Income (Net)	-36.0	-37.3	-8.7	-7.5	-9.8	-11.5	-8.4
III. Secondary Income (Net)	73.6	80.5	18.9	19.0	19.0	21.3	21.2
Current Account Balance (CAB)	24.0	-38.7	-8.1	6.6	-9.7	-22.2	-13.4
CAB as a % of GDP	0.9	-1.2	-1.0	0.9	-1.3	-2.6	-1.5

Source: Reserve Bank of India

Table 3.5 Services: Sectoral Performance comparison

Sl.No.	Items	YoY Growth in 2020-21	YoY Growth in 2021-22	YoY Growth in Q4:2020-21	YoY Growth in Q4:2021-22	% Share to Services in 2021-22	% Share to Services in Q4:2021-22
1	Manufacturing services on physical inputs owned by others	63.6	62.0	65.7	98.5	0.4	0.7
2	Maintenance and repair services n.i.e.	-31.7	68.5	-41.6	152.9	-1.1	-1.4
3	Transport	-163.7	-251.4	-160.0	-459.3	-3.0	-5.7
4	Travel	-137.9	137.2	-131.4	185.0	-6.7	-8.4
5	Construction	-96.1	-2084.6	-82.6	-420.3	-0.3	-0.4
6	Insurance and pension services	-54.1	290.4	-58.8	484.3	1.2	1.7
7	Financial services	-123.4	-65.3	-37.8	-176.7	-0.1	0.4
8	Charges for the use of intellectual property n.i.e.	-5.5	28.5	28.1	24.4	-7.6	-8.2
9	Telecommunications, computer, and information services	5.7	22.3	11.0	25.2	103.3	104.6
10	Other business services	-69.0	-2117.9	-205.2	521.1	6.8	10.5
11	Personal, cultural, and recreational services	-48.7	176.6	-34.7	68.5	-1.2	-0.9
12	Government goods and services n.i.e.	-12.5	-57.8	-19.5	34.5	-0.2	-0.4
13	Others n.i.e.	323.8	33.1	81.0	12.0	8.4	7.6
	Services (1 to 13)	**4.3**	**21.4**	**6.6**	**20.6**	**100.0**	**100.0**

Source: RBI

Financial Account

FDI and FPI

- In the financial account, during FY 2021-22, total capital flows in India is 22.1 USD billion, more than three and half times lower than the capital inflows recorded during the same period of 2020-21. This decline is mainly on account of decline in FIIs by 2.7 times due to rising global uncertainties caused by the Ukraine war and expectations of increase in Fed rate in USA.

- The net foreign direct investment (FDI) inflows at US$ 38.6 billion in FY 2021-22 were lower than US$ 44.0 billion in 2020-21. However, net FDI at US$ 13.8 billion in Q4 2021-22 was higher than US$ 2.7 billion in Q4:2020-21.

- In terms of FDI inflows, India is emerging as a preferred investment destination among global investors. FDI inflows to India has increased by 23% post-Covid (March, 2020 to March 2022: USD 171.84 billion) in comparison to FDI inflow reported pre-Covid (February, 2018 to February, 2020: USD 141.10 billion) due to a liberal and transparent FDI policy. Reforms across sectors such as Coal Mining, Contract Manufacturing, Digital Media, Single Brand Retail Trading, Civil Aviation, Defence, Insurance and Telecom have been undertaken recently.[2] It is expected that a further liberal and simplified FDI policy is to be adopted for providing Ease of doing business and attract investments.

- In terms of top investor countries of FDI Equity inflow, Singapore is at the apex with 27%, followed by U.S.A (18%) and Mauritius (16%) for the FY 2021-22. Under sectors, Computer Software & Hardware has emerged as the top recipient of FDI Equity inflow during FY 2021-22 with around 25% share followed by Services Sector (12%) and Automobile Industry (12%) respectively. Among the States/UTs Karnataka is the top recipient state with 38% share of the total FDI Equity inflow reported during the FY 2021-22 followed by Maharashtra (26%) and Delhi (14%).

- Net foreign portfolio investment (FPI) recorded an outflow of US$ 16.8 billion in FY:2021-22 as against an inflow of US$ 36.1 billion a year ago. Net FPI recorded an outflow of US$ 15.2 billion – mainly from the equity market.

Foreign Exchange Reserve

- India's foreign exchange reserves stands at USD 601.4 billion in May 2022, while in April 2022 it was USD 597.7 billion, providing an import cover of 8.7 months. Of the components of foreign exchange reserves, share of Foreign Currency Assets (FCA) have declined from 89.9 percent in January 2022 to 89.1 percent in April 2022 with a marginal increase in share in May 2022 (89.3). The component of Gold records an increase in share from 6.3 percent to 7.0 percent from January to April 2022, and it is now 6.8 per cent in May 2022. The share of Special Drawing Rights (SDR) has increased from 3 percent to 3.1 percent from January to May 2022. Whereas the share of reserve tranche position (RTP) remains at same level of 0.8 percent.

- There has been a secular decline in the growth rate of foreign currency reserves during this period mainly driven by continuous decline in growth rates in FCA and Reserve Tranche Position. The trade balance turning to deficits, along with outflows in foreign investments have weakened India's foreign exchange reserve position during the FY:2021-22.

Exchange Rate

- Nominal exchange rate (Indian rupee vis-a-vis US dollar) remained in the range of INR 73-77 per US dollar during January 2021 to May 2022. The INR remained under depreciating pressure on account of uncertainties related to the third wave of the pandemic, interest rate hike by developed countries, and the Russia-Ukraine war. The capital outflows due to rapid sell off of short-term Indian equities by foreign investors seen during Q3 and Q4: 2021-22 has also contributed to this depreciating pressure.

[2] Source: Ministry of Commerce and Industry (Press release, 20 May 2022) https://pib.gov.in/PressReleasePage.aspx?PRID=1826946

India’s trade outlook for 2022-23

- India’s trading prospects in 2022-23 will depend on its major trading partners’ economic prospects. India’s top ten export destinations include USA, the largest market for India’s exports with 17.5 percent share in total exports, followed by UAE (6.9 percent), China (3.6 percent), Bangladesh (4.2 percent) as other major export destinations. These ten countries together are the home of 47.9 percent of India’s exports. According to the data from Ministry of Industry and Commerce, Government of India, India’s exports to all these major destinations except China recorded significant and positive growth during January to April 2022, over the same period in 2021. In 2022, India’s exports growth to its developing economy trade partners remained significantly higher compared to developed economy trade partners.

Table 3.6 Growth and Inflation in major countries of export and import

	Real GDP Growth			CPI Inflation		
	2021	2022 (P)	2023 (P)	2021	2022 (P)	2023 (P)
U S A	5.7	3.7	2.3	4.7	7.7	2.9
U A E	2.3	4.2	3.8	0.2	3.7	2.8
China	8.1	4.4	5.1	0.9	2.1	1.8
Bangladesh	5.0	6.4	6.7	5.6	6.0	6.2
Netherlands	5.0	3.0	2.0	2.8	5.2	2.3
Hong Kong	6.4	0.5	4.9	1.6	1.9	2.1
Singapore	7.6	4.0	2.9	2.3	3.5	2.0
U K	7.4	3.7	1.2	2.6	7.4	5.3
Germany	2.8	2.1	2.7	3.2	5.5	2.9
Nepal	2.7	4.1	6.1	3.6	5.8	5.8

Source: IMF World Economic Outlook (Apr 2022)

- Overall, World economic outlook by IMF projected positive growth for all the major export destinations of India for the year of 2022. GDP at constant price of these trading partners has recovered in 2021 from 2020 contraction, recording strong positive growth in 2021 (Table 3.6). According to the World Bank’s Commodity Market Outlook, the heightening of commodity inflation caused by Ukraine war is going to persist till the end of 2024. The energy prices are projected to grow at 42 percent and non-energy commodity prices at 20 percent in 2022, compared to their levels in 2021. In this background the International Monetary Fund (IMF), in its January 2022 update of the World Economic Outlook, has lowered global output and trade growth projections for 2022 to 4.4 per cent and 6.0 per cent from its earlier forecasts of 4.9 per cent and 6.7 per cent, respectively.

- The growth rate of the major trade partners of India, namely, U.S., Netherlands, Singapore and UK, are projected to decline over 2022 and 2023 compared to 2021. This may adversely affect the export prospects of India into these countries in 2022-23. However, the Ukraine war has opened up new opportunities for Indian agricultural exports of wheat, maize, millet, pulses, fruits and processed food. Particularly, exports of wheat from Ukraine and Russia constitute 25 percent share of the global wheat trade. The disruptions in wheat supply from Ukraine have led the world to look for alternative suppliers of wheat such as India. However, lack of rain and high temperature in India in the beginning of 2022 has adversely affected production of wheat in the country. Consequently the Indian government imposed a ban on wheat exports on 13th May, 2022.

IV MONETARY POLICY

MPC decisions

- The Monetary Policy Committee (MPC) increased the policy repo rate under the liquidity adjustment facility (LAF) by 40 basis points from 4 to 4.40 percent on May 4, 2022. The committee further increased the policy rate at its meeting on June 8, 2022 by 50 basis points to 4.90 percent. With regard to the monetary policy corridor, the standing deposit facility (SDF) rate was revised to 4.65 per cent and the marginal standing facility (MSF) rate and the Bank Rate to 5.15 per cent.

- The RBI remain focused on "withdrawal of accommodation" to support economic growth recovery, while ensuring that inflation remains within the medium-term target for consumer price index (CPI) inflation of 4 per cent within a band of +/- 2 per cent.

- Globally, in the background of mounting commodity inflation and uncertainties caused by the Ukraine war, central banks have started "earlier than expected" rise in the policy rates. As part of monetary policy "normalisation", central banks also engaged in reducing their balance sheets by ending asset purchases. The volatility in the global financial markets due to mounting uncertainty on the potential rate hikes by US Federal Reserve may exacerbate capital flight from emerging economies.

- Against the backdrop of these uncertainties, the real GDP growth for 2022-23 was projected by MPC at 7.2 per cent 2022-23, with a growth of 16.2 per cent in Q1 2022-23; 6.2 percent in Q2 4.1 per cent in Q3 and 4.0 per cent in Q4 2022-23.

- Due to geopolitical tensions and global growth risks and uncertainties, inflationary trajectory will be uncertain and RBI projections indicate that inflation will be above the upper tolerance of 6 per cent through the first three quarters of 2022-23. Based on the assumption of a normal monsoon in 2022 and average crude oil price (Indian basket) of US$ 105 per barrel, inflation is projected by MPC at 6.7 per cent in 2022-23, with Q1 at 7.5 per cent; Q2 at 7.4 per cent; Q3 at 6.2 per cent; and Q4 at 5.8 per cent[3].

Credit

- Based on the data on sectoral deployment of bank credit for the month of April 2022 collected from select 40 scheduled commercial banks (accounted for about 93 per cent of the total non-food credit deployed by all scheduled commercial banks), on a YoY basis, non-food bank credit registered a growth of 11.3 per cent in April 2022 as compared with 4.7 per cent a year ago.

- The sectoral credit growth (YoY) revealed that agriculture and allied activities grew at 10.6 per cent in April 2022 (10.7 per cent in April 2021); industry accelerated to 8.1 per cent in April 2022 (0.4 per cent in April 2021); services sector picked up to 11.1 per cent in April 2022 (2.4 per cent in April 2021) and personal loans segment grew to 14.7 per cent in April 2022 (12.1 per cent in April 2021).

- Within the industrial sector, credit to medium industries grew by 53.5 per cent in April 2022 (44.8 per cent in 2021), micro and small industries by 29.0 per cent (8.7 per cent in 2021), while large industries contracted by (-) 1.6 per cent (3.6 per cent in 2021).

[3] RBI (2022a): MPC Meeting Minutes June 2022- https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=53832

- Within industry, credit growth to 'all engineering', 'beverage & tobacco', 'chemicals & chemical products', 'food processing', 'gems & jewellery', 'infrastructure', 'leather & leather products', 'mining and quarrying', 'petroleum, coal products & nuclear fuels', 'rubber, plastic & their products' and 'vehicles, vehicle parts & transport equipment' accelerated in April 2022 as compared with the corresponding month of the previous year. However, credit growth to 'basic metal & metal products', 'cement & cement products', 'construction', 'glass & glassware', 'paper & paper products', 'textiles' and 'wood & wood products' decelerated/contracted[4].

- Within service sector, the credit growth picked up mainly due to 'NBFCs', 'trade', 'tourism, hotels & restaurants' and 'transport operators'. Credit growth in personal loans segment was primarily driven by 'housing' and 'vehicle loans' segments.

Money Supply and FOREX

- Reserve money (excluding the first-round impact of the CRR increase by 50 bps to 4.5 per cent effective May 21, 2022) grew by 8.0 per cent on a YoY basis as on June 3, 2022 (12.2 per cent in June 2021). Money supply (M3) grew at 8.8 per cent as on May 20, 2022 (10.3 per cent in May 2021), predominantly by the growth in aggregate deposits with banks (85 per cent of total M3) at 8.7 per cent (9.7 per cent in May 2021). On the sources side, bank credit to the commercial sector – the major constituent – led the expansion in M3. Scheduled commercial banks' (SCBs') credit growth accelerated to 12.1 per cent YoY as on May 20, 2022, more than double that of 6.0 per cent recorded a year ago[5]. As on June 3, 2022, India's foreign exchange reserves were of the order of US$ 601.1 billion, of which the major component is net forward assets of the RBI.

Financial Stability - Gross Non-Performing Assets (NPA)

- The estimates from RBI's December 2021 Financial Stability Report shows that macro stress tests for credit risk indicate that the gross non-performing asset (GNPA) ratio of Scheduled Commercial Banks may increase from 6.9 per cent in September 2021 to 8.1 per cent by September 2022 under the baseline scenario and to 9.5 per cent under a severe stress scenario. The Report further stated that the SCBs would, however, have sufficient capital, both at the aggregate and individual levels, even under stress conditions[6].

Interest rates

- The Treasury-Bill cut off price of 91days, 182 days and 364 days was 5.00 per cent, 5.63 per cent and 6.12 per cent respectively, as per June 10th, 2022. The average yield on 10-year government bond increased to 7.55 percent on June 10th, 2022. The weighted average call money rate is 4.34 percent. The rate of interest provided by commercial banks on 'term deposits' with a maturity of more than one year is 5.0/5.75 percent, as per the data released by the RBI on June 10th, 2022[7].

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[4] [4] https://rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=53783
[5]https://rbidocs.rbi.org.in/rdocs/Bulletin/PDFs/RBIJUNEBULLETIN2022BC3DC495560D430E9D6E7A0122FF225E.PDF
[6] RBI (2021): Financial Stability Report, Reserve Bank of India, December 2021. https://www.rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=1190
[7] RBI Ratios and Rates as per June 10, 2022. https://rbi.org.in/scripts/WSSView.aspx?Id=25387

V FISCAL ISSUES

Union government

Revenues

- As per the provisional accounts (PA) released by the Controller General of Accounts (CGA), the gross tax revenues of the Union government in 2021-22 show an increase of around 33.6 percent over 2020-21 actuals and 7.6 percent over the revised estimates for 2021-22. With the exception of Union Excise duties, all central taxes contributed to the increase in gross tax revenues of the Union in 2021-22 (Table 5.1). This increase could be attributed to (a) low base effect as the economy was adversely affected due to covid-19 pandemic which resulted in the contraction of real GDP by about 6.6 percent and revenues from most central taxes also contracted[8] and (b) growth in revenues driven by revival of economic activities in 2021-22.
- In order to raise resources, the government in 2020-21 increased excise duty on petrol and diesel. This resulted in an increase in revenues from union excise duties by 62.81 percent over 2019-20. However, in November 2020-21, in order to provide relief to the citizens from rising oil prices the government cut the excise duty on petrol and diesel. This explains the marginal decline in revenues from union excise duties as per the provisional estimates for 2021-21 over 2020-21.
- As per 2022-23 BE, the government has budgeted its gross tax revenue to increase by 9.61 percent, the non-tax revenues are budgeted to be lower by 14 percent over 2021-22RE. The union excise duties in 2022-23BE as also budgeted to be lower by about 15 percent.

Table 5.1 Overview of Revenues

Indicators	2022-23 BE **Rs. Cr.**	2021-22 PA **Rs. Cr.**	2020-21 RE **Rs. Cr.**	2020-21 Accounts **Rs. Cr.**	Change in 2021-22 PA over 2020-21 **(%)**	Change in 2021-22 PA over 2021-22 RE **(%)**	Change in 2022-23 BE over 2021-22 RE **(%)**
Revenue Receipt@	22,04,422	21,68,426	20,78,936	16,33,920	32.71	4.30	6.04
Gross Tax Revenue	27,57,820	27,08,291	25,16,059	20,27,104	33.60	7.64	9.61
- Corporation Tax	7,20,000	7,12,037	6,35,000	4,57,719	55.56	12.13	13.39
- Income Tax	7,00,000	6,73,410	6,15,000	4,87,144	38.24	9.50	13.82
- Union Excise Duties	3,35,000	3,90,807	3,94,000	3,91,749	-0.24	-0.81	-14.97
- CGST	6,60,000	5,91,224	5,70,000	4,56,334	29.56	3.72	15.79
Tax Revenue@	19,34,771	18,20,382	17,65,145	14,26,287	27.63	3.13	9.61
Non-tax Revenue	2,69,651	3,48,044	3,13,791	2,07,633	67.62	10.92	-14.07

Note: @ net of states' share in central taxes and collections under NCCD to be transferred to NDRF.
Source: CGA and Union Budget

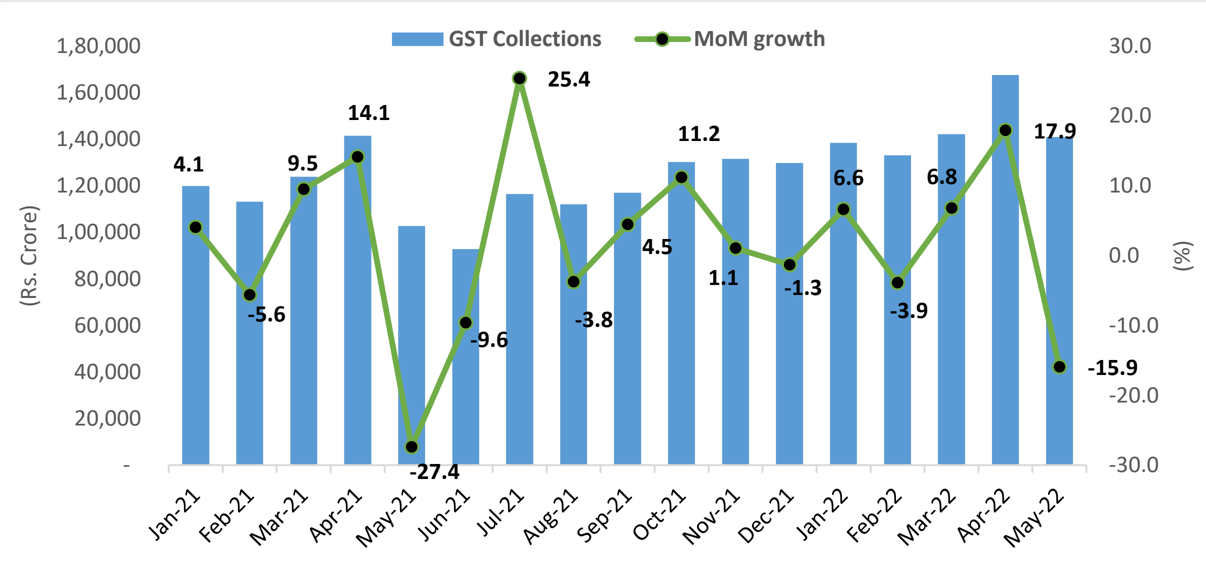
- On the indirect taxes front, GST collections have remained buoyant throughout 2021-22. The gross collections remained above Rs. 1 lakh crore in all the months of 2021-22 except in May and June 2021 due to the second wave of Covid-19 pandemic. The third wave of the pandemic did not seem to have much impact on GST collections. In April 2022, GST collection at Rs. 1.67 lakh crore was all-time highest monthly collection since its implementation (Figure 5.1).

[8] Exception being revenues from Union Excise Duties.

Expenditure

- On the expenditure front, as per the provisional actuals for 2021-22, total expenditure was higher by 8.1 percent over the actuals of 2020-21 (Table 5.2). Total expenditure is budgeted to increase by about 4.64 percent in 2022-23BE. The increase in total expenditure is largely due to the increase in capital expenditure which as per 2021-22(PA) was higher by 39 percent over the actuals of 2020-21. This trend of higher spending on capital expenditure continued in 2022-23 with the government budgeting for an increase in capital expenditure by 24.5 percent in 2022-23BE.

Figure 5.1 GST collections and month-on-month growth



Source: CMIE Economic Outlook

- Capital expenditure has a high multiplier effect, enhances the future productive capacity of the economy, and results in a higher rate of economic growth. In 2020-21 the union government launched a "Scheme for Special Assistance to States for Capital Expenditure" wherein financial assistance was provided to states in the form of a 50-year interest free loan for undertaking capital investments. In 2020-21 out of the allocated amount of Rs.12,000 crore, Rs.11,830.29 crore was released under this scheme to the states. The Scheme was continued in the year 2021-22 and its allocations increased to Rs.15,000 crore. In 2022-23, the government increased the allocations under this scheme to Rs. 1 lakh crore.[9]

Table 5.2 Overview of Expenditure

Indicators	2022-23 BE	2021-22 PA	2020-21 RE	2020-21 Accounts	Change in 2021-22 PA over 2020-21	Change in 2021-22 PA over 2021-22 RE	Change in 2021-22 RE over BE	Change in 2022-23 BE over 2021-22 RE
	Rs. Cr.	**Rs. Cr.**	**Rs. Cr.**	**Rs. Cr.**	**(%)**	**(%)**	**(%)**	**(%)**
Revenue Exp.	31,94,663	32,01,373	31,67,289	30,83,519	3.82	1.08	8.14	0.86
Capital Exp.	7,50,246	5,92,798	6,02,711	4,26,317	39.05	-1.64	8.75	24.48
Total Exp.	39,44,909	37,94,171	37,70,000	35,09,836	8.10	0.64	8.23	4.64

Source: CGA and Union Budget

[9] The scheme was redesigned and renamed as "Special Assistance to States for Capital Investment 2022-23".

- In 2020-21, fiscal deficit at 9.2 percent of GDP was much higher than what the government had budgeted. This increase in the deficit was on account of the pandemic and increased fiscal transparency. Fiscal deficit in 2021-22RE improved to 6.9 percent of GDP on account of higher revenues and fiscal consolidation and is budgeted to be around 6.4 percent of GDP in 2022-23BE.
- The fiscal deficit of the Union government during the first two months of 2022-23 (i.e., April-May 2022) stood at 12.3 percent of the budget estimates. It was 8.2 percent during the same period last year. The higher fiscal deficit during April-May 2022 vis-à-vis 2021-22 is primarily due to higher capital expenditure. Government's capital expenditure at the end of May was 14.3 percent the budget estimates for 2022-23 as compared to 13.7 percent of the budget estimates during the same period in 2021-22.

Debt

- The Union Government has budgeted for a gross market borrowing of Rs. 14.31 lakh crore for 2022-23. Out of this, the Government plans to borrow Rs. 8.45 lakh crore or 59 percent of its planned borrowings in the first half of 2022-23.[10] The gross borrowing for the fiscal 2021-22 was Rs 12,05,500 crore.

State governments

- Finances of state governments in aggregate show an improvement in 2021-22 as compared to 2020-21 on account of (a) economic recovery facilitated by widespread coverage of vaccination and (b) low base effect. As per the provisional estimates of 2021-22, own revenues aggregated across 25 states show an improvement of 21.87 percent over 2020-21. Both own-tax and non-tax revenues contributed to the increase (Table 5.3). However, the 2021-22 provisional actuals of own revenues were lower than the 2021-22 budget estimates.
- SGST, Sales tax and State Excise which together account for more than two-thirds of states' own tax revenues increase by 21.05 percent, 16.56 percent and 7.63 percent respectively 2021-22 PA as compared to that in 2020-21 due to revival of economic activity and rising commodity prices in the post-pandemic period.
- Own revenues aggregated over 25 states in Q4-2021-22 show a decline of 2.57 percent as compared to the same period in 2020-21. While own tax revenues declined by 6.45 percent, non-tax revenues registered a growth of 21.28 percent during this period. Revenues from SGST, Sales Tax and State Excise Duties declined by 6.63 percent, 20.86 percent and 20.21 percent respectively in Q4-2021-22 as compared to Q4-2020-21. In order to address high inflation in the economy, several state governments reduced excise duties on fuel in line with the reduction in excise duty by the union government during November 2021, thereby impacting the revenues from such taxes.
- As per the Provisional Actuals of 2021-22, tax devolution to states was 47.42 percent higher as compared to that during 2020-21. In fact tax devolution was 120.8 percent of the budget estimates of 2021-22. The increase was due to the revival of economic activity facilitated by the rapid pace of vaccination, one of the fastest across the world, which ensured that the impact of subsequent Covid waves was muted. Central grants aggregated across 25 states in 2021-22(PA) were, however, lower by about 12.74 percent as compared to that during 2020-21. Central grants were around 65.5 percent

[10] As per Union Budget 2022-23, the budgeted gross market borrowing through dated securities for 2022-23 is Rs 14,95,000 crore. Taking into account the switch operations conducted on Jan 28, 2022, the gross market borrowing through dated securities for the FY 2022-23 is expected at Rs 14,31,352 crore. https://pib.gov.in/PressReleaseIframePage.aspx?PRID=1812085

of the budget estimates for 2021-22. The net effect of the increase in tax devolution and reduction in grants being an increase in total central transfers to states. Central transfers in 2021-22(PA) were higher by about 15.73 percent vis-à-vis 2020-21.

Table 5.3 Percent change in key fiscal indicators of States (25 states)

25 States	% Change 2021-22 PA and 2020-21	2021-22 PA as % of 2021-22 BE	% Change during Jan-Mar 2021-22 over 2020-21
1. Total revenue receipt	19.17	89.34	14.53
2. Own revenue receipt	21.87	88.54	-2.57
3. Own tax revenue	19.50	88.86	-6.45
a) SGST	21.05	82.59	-6.63
b) Sales tax	16.56	94.05	-20.86
c) State excise	7.63	85.40	-20.21
4. Non-tax revenue	39.64	86.56	21.28
5. Central transfer	15.73	90.43	35.82
6. Tax devolution	47.42	120.82	90.49
7. Grants-in-aid	-12.74	65.45	-20.46
8. Revenue expenditure	6.36	88.04	-6.41
9. Capital expenditure	25.01	80.94	1.21
10. Total expenditure	8.68	86.86	-5.07
a) General services	4.42	87.78	-13.05
b) Social services	10.75	86.78	-3.85
c) Economic services	10.52	83.84	0.02

Source: Comptroller and Auditor General of India

- As a result the total revenue receipts, aggregated across 25 states, were higher by about 19.71 percent in 2021-22(PA) over 2020-21. However it was around 89.34 percent of the budget estimate for 2021-22.
- On the expenditure front, total expenditure in 2021-22(PA) fell short of the budgeted numbers by 13.14 percent. However, as compared to 2020-21, total expenditure was higher by about 8.68 percent. The increase on account of the increase in both revenue and capital expenditures. While revenue expenditure in 2021-22(PA) were higher by 6.36 percent over 202-21, capital expenditure was higher by about 25 percent. The higher capital spending is likely to lend support to the process of economic recovery in the post-pandemic period. The state governments however missed the target for capital spending in the FY 2021-22 by 19 percent.
- The union government provided an additional amount of up to 15000 crore to states as 50-year interest free loans for spending on capital projects for the fiscal 2021-22 under the Scheme of Financial Assistance to States for Capital Expenditure. In 2022-23, the union government increased the outlay for the same to 1 lakh crore. This has been done with the objective of incentivising states to undertake greater capital expenditure on infrastructure projects under PM Gati Shakti and other productive capital investments, thereby generating remunerative employment and spurring economic growth.

- The aggregate market borrowings of state governments in financial year 2021-22 have been 14.6 percent less compared to the corresponding period of 2020-21. Twenty-seven states and two UTs have borrowed an aggregate of Rs 6.49 lakh crore in 2021-22 as compared to Rs 7.60 lakh crore in the corresponding period of the previous year (by twenty eight states and two UTs). The aggregate market borrowings in the year 2021-22 have been less than that indicated in the market borrowing calendar of states by 23.5 percent. This was enabled by an improved revenue position and calibrated expenditure by the states during the current financial year. Also, states with the aim of fiscal consolidation may also be limiting their borrowings after having borrowed heavily in FY21 (around Rs 8 lakh crore).
- Examining market borrowings by individual states we find that 22 states have undertaken lower borrowing in the current financial year compared to what was budgeted. Odisha did not undertake any market borrowing in FY22. Improvement in the fiscal position of several states may have contributed to the lower market borrowings.
- The revenue and fiscal deficits as a percent of GDP aggregated across all the 25 states stood at 0.02 percent and 2.53 percent respectively in 2021-22. They have improved considerably from 1.87 percent and 3.97 percent of GDP respectively in 2020-21. This can be attributed to revival of economic activities which improved the growth momentum and also due to fiscal consolidation measures undertaken by state governments.

Future Outlook

- With the revival of economic activities, growth picked up resulting in an increase in revenues of both the union as and the state governments. For 2022-23BE, states in aggregate have budgeted the own tax revenues to grow at 29.61 percent which translates into a tax buoyancy on 2.26. However, between 2015-16 and 2021-22RE the own-tax buoyancy was 0.89[11]. Own tax revenues aggregated across states as percent of GSDP has been falling since 2012-13. This is an area of concern. With GST compensation regime ending in June 2020, the states will be further stretched to meet their expenditure needs.
- A recent report by RBI highlighted some of the fiscal risks confronting state governments in India.[12] Apart from macro-economic shocks arising from uncertainties surrounding the evolving COVID situation, impact of spill-overs from the Russia-Ukraine war operating through high global food and commodity prices, and the synchronized monetary tightening by central banks across the world, the other potential sources of risks to states' finances are realisation of contingent liabilities, reverting to old pension scheme by some states, increased expenditure on non-merit goods and realisation of government guarantees extended to state-owned enterprises and rising overdues of loss making power DISCOMS.
- All these warrant corrective measures such as restricting revenue expenditure, power sector reforms and improving expenditure quality to prevent debt GSDP ratios of states from deteriorating further.

[11] OTR buoyancy between 2017-18 and 2021-22RE was 0.92.

[12] RBI (2022), Reserve Bank of India Bulletin, Volume LXXXVI, Number 6, June 2022. Available at https://www.rbi.org.in/Scripts/BS_ViewBulletin.aspx

Appendix A

Formula for decomposing annual growth rate into changes from the pre-pandemic level and the base year growth effect:

$$g_t = \frac{Y_t - Y_{t-1}}{Y_{t-1}} \times 100$$

$$= \frac{Y_t - Y_{t-1} + Y_{t-2} - Y_{t-1}}{Y_{t-1}} \times 100$$

$$= \left[\left(\frac{Y_{t-2}}{Y_{t-1}}\right)\left(\frac{Y_t - Y_{t-2}}{Y_{t-2}}\right) \times 100\right] - \left[\left(\frac{Y_{t-2}}{Y_{t-1}}\right)\left(\frac{Y_{t-1} - Y_{t-2}}{Y_{t-2}}\right) \times 100\right]$$

$$= A - B$$

Here, A = Change in current year from pre-pandemic level

B = Base year growth effect; and t = 2021-22; t-1 = 2020-21; t-2 = 2019-20

Table A.1 Decomposing Annual growth rates into current changes and base growth effect: Aggregate and sectoral GDP

Sectors	Annual growth 2021-22	Current changes relative to pre-pandemic year 2019-20	Base growth effect of 2020-21
GDP	**8.7**	**1.6**	**-7.1**
Agriculture, Fishing, etc.	3.0	6.2	3.2
Mining & Quarrying	11.5	2.1	-9.4
Manufacturing	9.9	9.3	-0.6
Electricity, Gas, Water etc.	7.5	3.8	-3.8
Construction	11.5	3.6	-7.9
Trade, hotels, Trans., etc	11.1	-14.2	-25.2
Financial & Prof. Serv.	4.2	6.4	2.2
Public Admin, defence, etc	12.6	6.8	-5.8

Source: National Statistical Office (NSO) & NIPFP estimates

Table A.2 Decomposing Annual growth rates into current changes and base growth effect: Expenditure-side components of GDP

Components	Annual growth 2021-22	Current changes relative to pre-pandemic year 2019-20	Base growth effect of 2020-21
GDP	**8.7**	**1.6**	**-7.1**
Private Final Consumption Exp. (PFCE)	7.9	1.5	-6.4
Govt. Final Consumption Exp. (GFCE)	2.6	6.0	3.5
Gross Fixed Capital Formation (GFCF)	16.8	4.2	-11.6
Exports of Goods and Services	24.3	14.1	-10.2
Imports of Goods and Services	35.5	19.5	-16.0

Source: National Statistical Office (NSO) & NIPFP estimates

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