STATE OF THE ECONOMY

Quarterly Assessment and Growth Outlook:
October-December, 2020
January-March, 2021

APRIL, 2021

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

NATIONAL INSTITUTE OF PUBLIC FINANCE
AND POLICY | NEW DELHI

MAJOR HIGHLIGHTS

- GDP growth rate for Q1, 2020-21 (YoY) registered a -23.9 percent decline. The rate of contraction declined to -7.5 percent in Q2. With the broad based resumption of economic activity, the third quarter estimate (Q3: Oct – Dec, 2020) of the growth rate has improved to 0.4 percent.

- Sector wise growth has been primarily led by rising profits (17-19 percent YoY) of major listed Nifty 50/500 companies. The recovery in profits of companies in financial sector, consumer durables and communication services has signalled the revival of consumer confidence and pickup in discretionary spending of households.

- There are signs of strong recovery of the construction activities in Q3 2020-21. However, given the volatile performance of production and use of raw materials, the sustainability of construction sector growth in Q4 remains unpredictable. Services sectors like tourism and transport continue to face disruptions in reaching their potential. However, sustained positive growth in cargo movements by railways and ship during the months of Q3 2020-21 indicates revival of trading activities in the economy.

- Average CPI inflation during the three quarters of the financial year 2020-21 was 6.6 percent, which was largely driven by rising food, miscellaneous and core inflation. CPI inflation retracted within the target band of the RBI in December, 2020 (4.6 percent), owing to a decline in food inflation. However, inflation in miscellaneous items (28 percent of CPI basket) remained persistently higher than the 6 percent mark since June, 2020. This level is due to the rise in expenditure on health, particularly in urban sector and transport systems.

- Finances of State governments have shown improvement in the third quarter of the fiscal year 2020-21 with the revival of economic activities. While Q1 of 2020-21 was characterised by sharp contraction in own revenues on account of Covid-19 induced lockdown, Q2 saw revenue contraction moderating with the phased opening of the economy. Q3 was characterised by growth in own revenue of States moving into the positive territory.

- SGST and Sales tax, which together account for about two-thirds of States' own tax revenues increased by 4.5 percent and 20.20 percent respectively in Q3 as compared to 2019-20. Several state governments increased duties on petrol, diesel and alcohol. This increase resulted in revenues from state excise by about 17.08 percent in Q2 and 26.73 percent in Q3.

- Central transfers aggregated across 23 states show a decline of 6.14 percent during Q3 of 2020-21 vis-à-vis 2019-20 largely due to decline in tax devolution. Tax devolution to States was lower by 33.62 percent as compared to Q3 of 2019-20. However, central grants to States show an increase of about 22.67 percent during Q3 of 2020-21.

- The proposals made in Budget 2021 represent stability in structure of income tax, a much-needed position for the government to take, if it seeks to bring more taxpayers into the tax net. The two measures which could contribute positively to revenues are the changes in customs duties and the tax on interest earned through Provident Fund contributions above a prescribed threshold. Revenue gains from the former would depend on pickup of imports and those from the latter will manifest only a year from now and will flow in only from FY 2022-23.

- Fiscal stability between the Union and States, sectoral grants focused on outcome, and strengthening finances and service delivery at the local level are some of the key highlights of Fifteenth Finance Commission's recommendations.

- Contraction in revenues due to Covid-19 and associated fiscal uncertainties in 2021-22 were addressed by the FC-XV by increasing the untied revenue deficit grants by 59.34 percent as compared to 2020-21. Seventeen states are eligible for this grant in the FY 2021-22. With the vertical shares remaining unchanged at 41 percent and with the significant increase in various grants recommended by the Commission, the share of grants in total transfers has increased to 19.65 percent. This is much higher than the shares of grants recommended by successive Finance Commissions since the Sixth Finance Commission.

- The Covid-19 pandemic highlighted long-pending challenges in the health sector. Unconditional grants-in-aid support to the health sector to the tune of Rs.1,06,606 crore is 10.3 percent of the total grants recommended by the Commission.

- On the monetary policy front, the Report on Currency and Finance (RCF) reviewed the New Monetary Policy Framework (NMF) in the context of the inflation targeting mandate. The report highlighted that the primary focus of flexible inflation targeting is on price stability and that augurs well for further opening of capital account and eventual internationalization of Indian rupee. The report also stated that the present inflation anchor of 4 percent with +/- 2 percent band is appropriate for next five years.

- On macroeconomic assessment, the MPC in April 2021 highlighted that Monetary Policy will continue to 'support and nurture' the economic recovery and that its stand will remain 'accommodative', till the recovery is well secured. The growth outlook projected by MPC remains at 10.5 percent for FY 2021-22, but has also warned of downside risks in the wake of recent waves of Covid infections.

****

I MACROECONOMIC ASSESSMENT AND GROWTH OUTLOOK

Trends in Growth

- The onset of the pandemic and lockdowns beginning March, 2020 had presented a unique set of challenges for policy interventions. As the economy emerges from a combination of shocks, the trends of the past three quarters (April to Dec., 2020) suggest a gradual recovery in most sectors of the economy as captured by a variety of economic indicators.

- The growth estimates of quarterly GDP for the period October – December, 2020 as provided by the NSO show a rebound in GDP growth from negative to a positive territory. Real GDP growth rate for Q1, 2020-21 (YoY) had registered a -23.9 percent decline, while Q2, 2020-21 (YoY) showed signs of initial recovery and the fall in economic growth moderated to -7.5 percent. With the broad based resumption of economic activity, the third quarter estimates (Q3: Oct – Dec, 2020) the growth rate has significantly improved to 0.4 percent.

Table 1: Quarterly Growth rates (percent, Constant prices) of GDP, 2011-12 Series

Sectors	Annual 2019-20	Q1 2020-21 Apr – Jun	Q2 2020-21 Jul – Sep	Q3 2020-21 Oct - Dec
		YoY	YoY	YoY
GDP	**4.2**	**-23.9**	**-7.5**	**0.4**
Agriculture, Fishing, etc.	4.0	3.3	3.0	3.9
Mining & Quarrying	3.1	-18	-7.6	-5.9
Manufacturing	0.0	-35.9	-1.5	1.6
Electricity, Gas, Water etc.	4.1	-9.9	2.3	7.3
Construction	1.3	-49.4	-7.2	6.2
Trade, hotels, Trans., etc	3.6	-47.6	-15.3	-7.7
Financial & Prof. Serv.	4.6	-5.4	-9.5	6.6
Public Admin, defence, etc	10.0	-9.7	-9.3	-1.5

Source: National Statistical Office (NSO), Press Release, February, 26th, 2021

- The emerging trends of growth are indicative of three key aspects (a) ease of restrictions have led to spurt in economic activity, (b) improvement in consumer demand and confidence, especially in the festival period and (c) revival of business confidence in the private corporate sector.

- The sectoral growth experience of Q3 in comparison to Q1 and Q2 has shown that part of the growth pickup has been led by the strong recovery in the private corporate sector. Sector wise growth has been primarily led by rising profits (17-19 percent YoY) of major listed Nifty 50/500 companies[1]. The recovery in profits of companies in financial sector, consumer durables and communication services has signalled the revival of consumer confidence and pickup in discretionary spending of households.

- **Negligible to moderate contraction**: Agricultural sector remains on a positive growth trajectory and continues to be unaffected by the pandemic and has shown improvement in growth in the last quarter. After moderate contraction in Q1, Electricity, Gas and Water, construction and financial services have shown a rebound to a positive growth.

[1] NSE Corporate Performance Review, March, 2021

- **Large contraction, but limited recovery**: Trade, Hotels, Transport and Communication as well as Mining and Quarrying sectors contracted significantly in the last two quarters and continue to remain affected by the measures imposed to contain the pandemic.

- On the expenditure side, Q3 estimates show a sharp decline in all expenditure-side components except for government expenditure in Q1 2020-21. While growth (YoY) in investment rebound to positive domain in Q3, exports growth deteriorated in Q3 as compared to Q2. After a drastic contraction in Q1, imports growth has steadily improved in both Q2 and Q3.

- Following a double digit growth in government expenditure in Q1 2020-21 owing to the Fiscal Stimulus Package, a sharp contraction was observed in Q2. The Q3 estimates show a moderate increase, which may be attributed to stimulus package by the Government in the month of Diwali.

Table 2: Expenditure side Growth Rates of GDP (%, Constant Prices), 2011-12 series

Sectors	Annual Growth 2019-20	Q1 2020-21 Apr-Jun	Q2 2020-21 Jul-Sep	Q3 2020-21 Oct-Dec
		YoY	YoY	YoY
GDP	4.2	-23.9	-7.5	0.4
Private Final Consumption Exp (PFCE)	5.3	-29.9	-11.3	-2.4
Govt. Final Consumption Exp. (GFCE)	11.8	12.8	-24.0	-1.1
Gross Fixed Capital Formation (GFCF)	-2.84	-46.4	-6.8	2.6
Exports of Goods and Services	-3.6	-22	-2.1	-4.6
Imports of Goods and Services	-6.8	-41.1	-18.2	-4.6

Source: National Statistical Office (NSO), Press Release, February, 26th, 2021

Growth outlook for the near future

Growth outlook is based on past trends and recent high frequency growth indicators.

I Agriculture

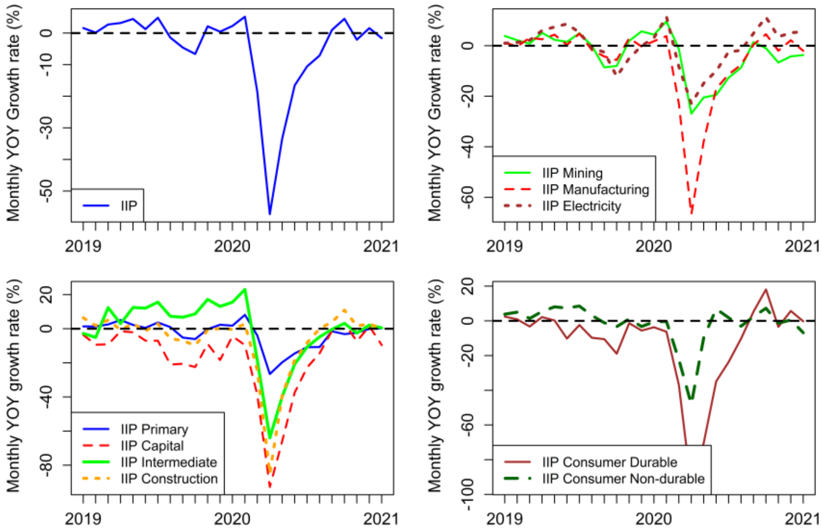
- Given past trends, the outlook for the agricultural sector reflects a positive growth in Q4 2020-21, owing to a normal rainfall and positive growth in domestic sale of tractors (around 40 percent during October 2020 to January 2021).

II Industry

- As per the activity based and use-based classifications of IIP, in the beginning of Q3, 2020-21, IIP showed an increase largely due to the base effect. Future trend would depend on the increase in the levels of economic activity.

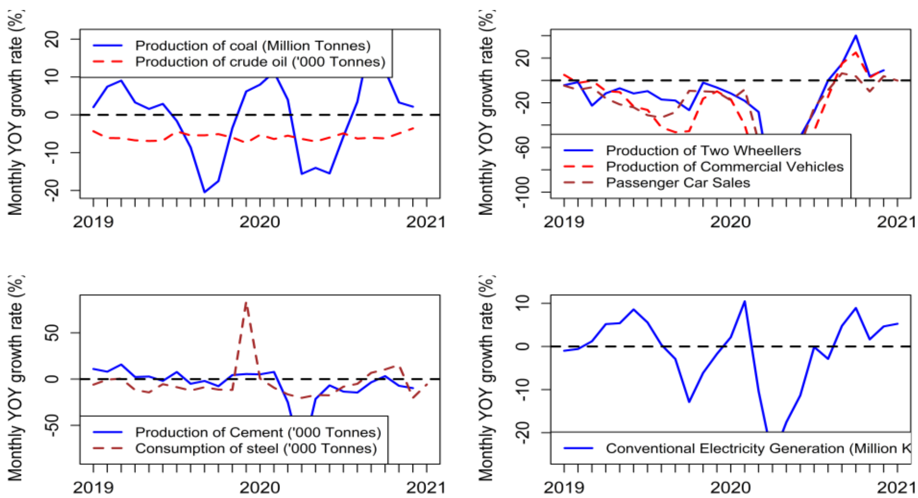
- After an increase in production of coal in October, 2020 by 11.5 percent compared to October, 2019, the YoY growth declined to 3 percent and 2 percent respectively in November and December, 2020 (Figure 1). Sectors related to consumer durables (e.g., two-wheelers and commercial vehicles, Figure 2) has recovered strongly in the beginning of Q3 2020-21, driven largely by lifestyle changes enforced by the pandemic. The production of two wheelers and commercial vehicles recorded 40 and 24 percent YoY growth in October, 2020 compared to October, 2019. However, growth in these two sub-sectors declined to single digit in the next two months of the quarter. The YoY growth rate in the passenger car sales remains volatile showing negative growth in the last quarter.

Figure 1: Recent trend in components of IIP



Source: NSO

Figure 2: Recent trends in selected high frequency indicators for industrial sector



Source: CMIE

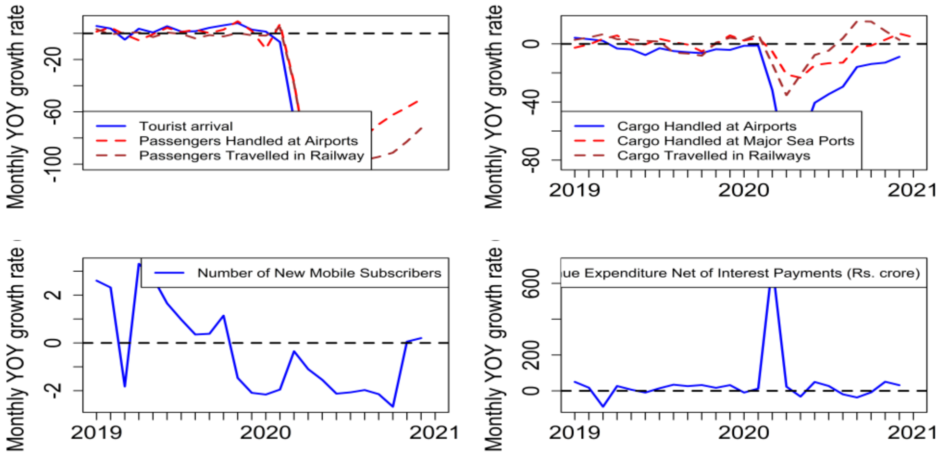
- A steady positive monthly YoY growth in electricity supply from October, 2020 to January, 2021 has driven a sustained positive growth in Electricity, Gas and Water Supply in Q3 2020-21. This trend is expected to continue in Q4, 2020-21.

- Sectors related to raw materials (e.g., steel and cement, Figure 2) have recovered from a deep contraction, but have stagnated in the recent months. The strong recovery of the construction activities in Q3 2020-21 possibly boosted consumption and industrial demand for raw materials in the beginning of this quarter. However given a volatile performance of production and use of raw materials, the sustainability of construction sector growth in Q4 remains unpredictable.

III Services

- Sectors related to services like tourism and transport (proxied by railway and airport traffic), where social distancing norms are difficult to implement continue to face disruptions in reaching their potential. However, sustained positive growth in cargo movements by railways and ship during the months of Q3 2020-21 and the beginning of Q4 2020-21 indicates revival of trading activities in the economy (Figure 3). A positive growth in new subscriptions of mobile connections till January, 2021 has generated expectation for revival of the telecommunication services.

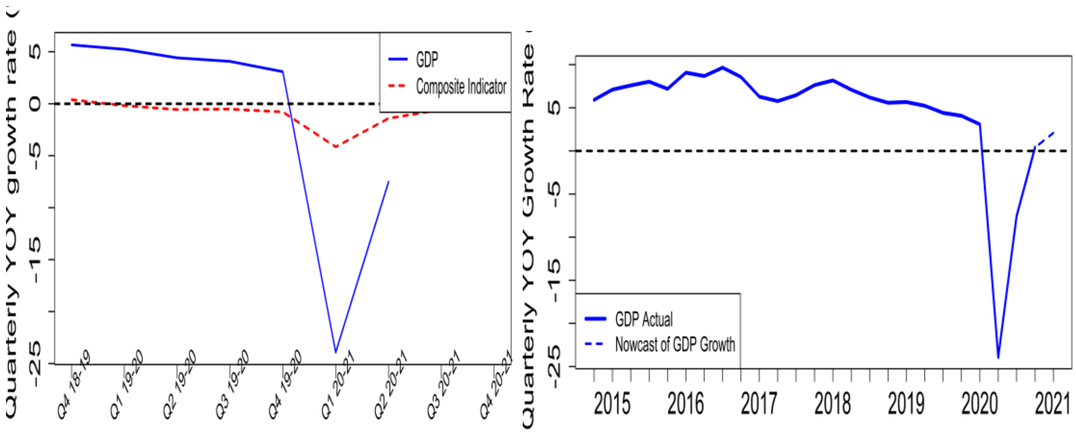
Figure 3: Recent trend in selected high frequency indicators for service sector



Source: CMIE, TRI, CGA

- **Overall, GDP growth rate (NowCast) in Q4, 2020-21 is expected to improve.** The composite indicator constructed from 28 high frequency indicators predicts Q4 2020-21 GDP growth to be 2 percent (Figure 4). India's real GDP growth as projected by RBI for the year 2021-22 is 10.5 percent.

Figure 4: GDP growth outlook for Q3 and Q4, 2020-21



3. Inflation outlook for the near future

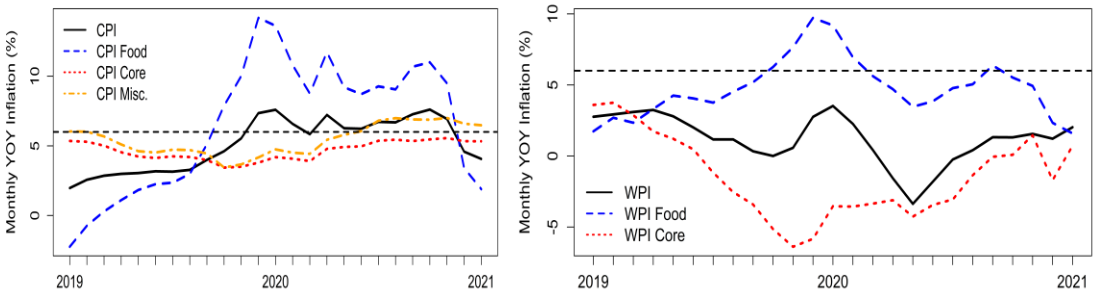
- **During the three quarters of the financial year 2020-21, the average CPI inflation was 6.6 percent,** thus breaching the target band of the RBI. The deviation has been largely driven by rising food, miscellaneous and core inflation (Figure 5, left panel). However, the CPI inflation retracted within the band in December, 2020 and January, 2021 (4.6 percent and 4 percent respectively), owing to the decline in food inflation.

- The average inflation in CPI food was 11 percent from October, 2019 to October, 2020. This elevated level was a result of crop damages due to prolonged abnormal rainfall in onion producing states since August, 2019 (Figure 5, right panel). The price pressure intensified and spread across other food commodities, especially during and post lockdown period due to supply chain disruptions. This period also witnessed a gradual rise in agricultural labour cost on account of demand for sowing and harvesting of kharif crops (Figure 6, left panel). With the rainfall coming to the normal level and arrival of the winter crops, the pressure on food inflation released, thereby gradually reducing it to 3.4 percent in December, 2020.

- The core (non-food, non-fuel) CPI inflation was affected largely by supply shocks caused by disruption than by negative demand shocks, causing it to rise over 4 percent persistently since the initial lockdown period. The inflation rate in miscellaneous items (28 percent of CPI basket) remains persistently higher than the 6 percent mark since June, 2020. This level is due to rise in expenditure on health, particularly in urban sector and transport systems caused by the pandemic.

- **WPI exhibited deflation in April-July, 2020, but have risen thereafter.** The deflation was caused by deflation in crude oil prices (Figure 6, right panel). WPI food (food articles and manufactured food products) inflation experienced a transitory effect of abnormal rainfall in Q3 and Q4 of 2019-20. WPI core (non-food, non-oil) recorded deflation of around -1.7 to -1.4 percent since the beginning of the financial year 2020-21.

Figure 5: Recent Trends in CPI and WPI



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

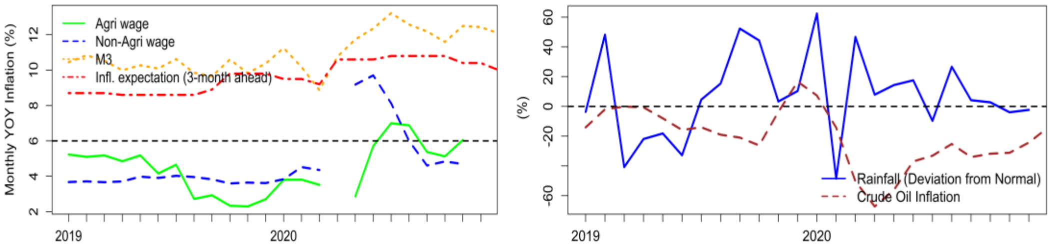
I Inflation outlook for the future

Inflation outlook is based on past trends and underlying drivers of inflation including inflationary expectation, labour (wage) cost, money supply and oil prices.

- **Inflationary expectation**: RBI's household inflation expectation (3 month ahead) was at a high of 9 percent in the pre-Covid period (January, 2019, to March, 2020, (Figure 6, left panel). During April to October, 2020, it rose higher to 11 percent. However it declined marginally to 10 percent in January, 2021. This indicates monetary policy's limited ability in anchoring inflation expectation on a sustained basis.

- Labour cost: The non-agricultural wage growth jumped to 9 percent in May, 2020 and further to 9.7 percent in June 2020. While both the wages growth moderated afterwards around 5 percent, the agricultural wage showed a rebound in November, 2020. (Figure 6, left panel)

Figure 6: Factors driving Inflation



Source: CMIE, World Bank

- **Overall, the headline inflation is expected to remain within RBI's tolerance band during Q4, 2020-21 and the first half of 2021-22.** However, there are a few upward risks on inflation. These are (i) rise in agricultural wages with the onset of kharif activities, (ii) rebound of crude oil inflation (iii) sticky core inflation near the upper level of the band which is a **direct fallout of the pandemic such as** supply chain disruptions and limitations owing due to financial stress in small and medium enterprises.

II FISCAL ISSUES: UNION GOVERNMENT

Tax Revenues

- The total revenue receipts of the Union Government at Rs. 15,55,153 crore in 2020-21RE are lower by about 23 percent as compared the 2020-21 budget estimates of Rs. 20,20,926 crore. This is mainly due to the slowdown caused by Covid-19 and the ensuing lockdown. Tax revenues of the Union net of states' share in shareable taxes decreased from Rs. 16,35,909 crore to Rs 13,44,501 crore during this period, a fall of about 17.8 percent. All central taxes show a fall during this period with the exception of Union Excise duties. The receipts from Union excise duties increased by 35.2 percent in 2020-21RE as compared to 2020-21BE on account of increase in duties on petroleum.

- The non-debt capital receipts show a sharp decline from Rs. 2,24,967 crore to Rs. 46,497 crore, a decline of nearly 79 percent due to shortfall in disinvestment proceeds in FY 2020-21. In contrast, the revenue receipts of the Union government comprising tax revenue (net of states' share) and non-tax revenues in Q3 of 2020-21 were higher by 62.76 percent as compared Q3 of 2019-20. Overall, for the period from April to December 2020 (i.e., first three quarters of 2020-21), revenue receipts show a fall of about 5.08 percent as compared to 2019. This fall was due to the decline in receipts from non-tax revenues which were lower by 47.85 percent. Tax revenues, on the other hand show an increase of 6.35 percent during this period.

- Tax revenues during April-December 2020 account for about 58.8 percent of the budget estimates for 2020-21. During April-December 2019 they accounted for about 54.9 percent of the budget estimates for 2019-20. As of January, 2021, the revenue collection from GST touched an all-time high of nearly Rs 1.2 lakh crore. This figure was 8 percent higher than the collections made in Jan 2020[2]. CGST collections increased from Rs 43,040 crore in December 2020 to Rs 44,666 crore in January 2021, an increase of about 3.8 percent.[3]

- The fiscal deficit stood at Rs 11,58,469 crore at the end of December 2020, which is about 145.5 percent of the 2020-21 BE. The revenue deficit was 144.9 percent of the 2020-21BE. The FD for the

[2] PIB Press Release on 31-01-21: GST Revenue collection for January 2021 almost touches ₹1.20 lakh crore

[3] CGA Monthly Accounts

year 2020-21RE is estimated at 9.5 percent of the GDP. At the end of December, market borrowings by the Union Government stood at Rs. 12,32,637.38 crore, which were 230 percent higher as compared to the 2020-21 BE of Rs. 5,35,869.62 crore. The market borrowings were subsequently revised to Rs. 12,73,788.17 crore as per the revised estimates of 2020-21.

Trends in Expenditure

- Union government's total expenditure during Q3 of 2020-21 was about 28.9 percent higher than the corresponding period of 2019-20. While the revenue expenditure was higher by about 18.9 percent, the capital expenditure increased by 110.5 percent. However, total expenditure, revenue expenditure and capital expenditure during April-December 2020 (i.e., first 9 months of 2020-21) were higher by about 8.1 percent, 6.3 percent and 20.9 percent respectively as compared to April-December 2019.

- The revised estimates for total expenditure for 2020-21 at Rs 34,50,305 crore show an increase of 13.4 percent over the budget estimates. While the capital expenditure increase is expected to increase from Rs. 4,12,085 crore to Rs 4,39,163 crore an increase of about 6.6 percent. The revenue expenditure is expected to increase from Rs. 26,30,145 crore in 2020-21 BE to Rs. 30,11,142 crore in 2020-21RE-an increase of 14.5 percent.

Economic recovery and future outlook: An assessment

- Revival of economic activities in the coming months is likely to strengthen the finances of union and state governments. It is crucial at the same time to strike a balance between short term resource requirements and long term debt sustainability. The additional borrowing may not have full impact on fiscal deficit as the capacity to borrow and avail flexibility offered by the central government will vary across states.

- **Revenue Performance:** The budget presented by the Finance Minister puts on record the potential shortfall in revenue generation in the current fiscal year. The Revised Estimates for 2020-21 have been adjusted downward to reflect the impact of a shock due to Covid-19 pandemic to growth to the economy in the first three quarters of 2020-21.

- Budget Estimates for 2021-22 propose a growth of about 22 percent over the Revised Estimates of 2020-21. The growth rate of GDP at current prices assumed for the budget estimates is 14.4 percent. With this growth rate the buoyancy expected is about 1.5 which is considerably on a higher side.

- The context for the next fiscal year is set in an economy that has experienced a decline in nominal incomes. In this context, the data on Income Tax filing provides a precursor for the likely impact that can be anticipated for the next fiscal year. The Income Tax E-filing data provides some information on the number of returns filed till January 2021 for the Assessment Year 2020-21. The returns filed correspond to incomes earned in Financial Year 2019-20. Table 3 shows that the number of returns filed has declined overall by about 6.5 percent, with the sharpest reduction in ITR 6, i.e., the returns filed by Companies. It is important to note that these returns correspond to pre-Covid period and have been filed during the Covid year.

Table 3: Compliance in the form of returns filed by January

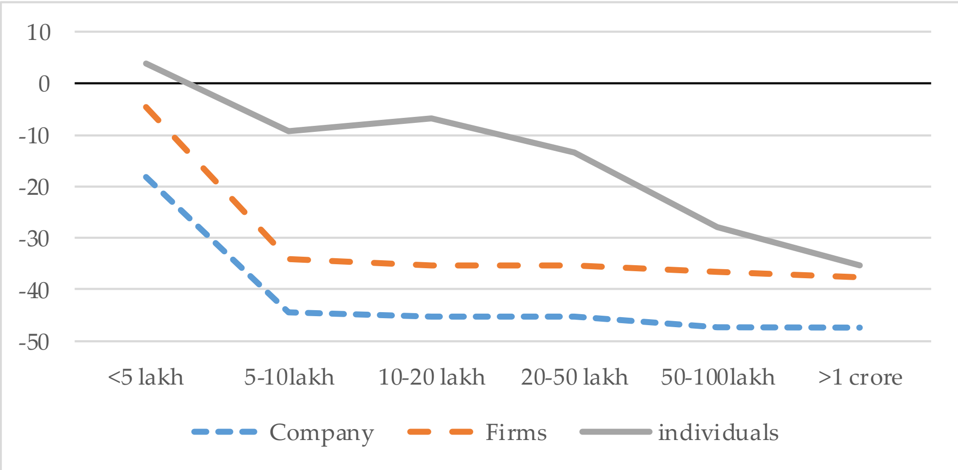
	2019-20	2020-21	Increase (%)
ITR-1 Sub Total	**3,24,26,929**	**3,02,91,643**	**-6.58%**
ITR-2	48,34,539	46,66,884	-3.47%
ITR-3	1,10,37,264	90,15,677	-18.32%

ITR 4 Sub Total	**1,46,20,705**	**1,52,22,267**	**4.11%**
ITR-5	14,32,613	12,23,532	-14.59%
ITR-6	8,50,589	5,89,661	-30.68%
ITR-7	2,18,059	1,72,806	-20.75%
Total	6,54,20,698	6,11,82,470	-6.47842

Source: Income Tax Filing statistics, CBDT (website)

- Another statistic worth flagging is the distribution of incomes. Since the returns filed during any financial year includes returns for the relevant assessment years as well as revised returns for earlier year, it would be incorrect to attribute the income to AY2020-21 alone. However, the trends are indicative since the same caveat holds for information regarding FY 2019-20. Figure 7 shows the percentage change in the number of returns with income in the different classes. *There is a consistent decline in incomes returned across all classes*. The decline is the smallest in the lowest income group which could suggest a downward shift of taxpayers from higher to lower income groups.

Figure 7: Distribution of growth in income returned
(returns filed in FY 2020-21 versus FY 2019-20)



- The returns corresponding to FY 2020-21 might see a larger decline, thus raising concerns about the revenue projections for 2021-22, especially since a significant part of the self-assessment tax for 2020-21 would be paid in 2021-22.

- Improvement in GST collection is being attributed partly to compliance and partly to administrative efforts. The focus of revenue generation is likely to shift more to administration. The GST Council is expected to undertake an exercise to rationalise the rates of tax, which especially in a year of recovery from the pandemic, would be an important step for improving the revenue performance of GST.

- **Budget Proposals and the impact on Revenue:** The proposals made in Budget 2021 are remarkable in that they represent stability in structure in income tax, a much-needed position for the government to take, if it seeks to bring more taxpayers into the tax net. The few measures that were incorporated into Finance Bill, 2021 are more in the nature of an incentive to some segments, rather than revenue augmenting. The only two measures which could contribute positively to revenues are the changes in customs duties and the tax on interest earned through Provident Fund contributions above a prescribed threshold. Revenue gains from the former would depend on pickup imports and those from the latter will manifest only a year from now and those from the latter will flow in only from FY 2022-23.

III FISCAL ISSUES: STATE GOVERNMENTS

- Finances of State governments have shown a gradual improvement in the third quarter of the fiscal year 2020-21 with the revival of economic activities. While Q1 of 2020-21 was characterised by sharp contraction in own revenues on account of Covid-19 induced lockdown, Q2 saw revenue contraction moderating with the phased opening of the economy. In contrast, Q3 was characterised by growth in own revenue of states moving into the positive territory. Despite gradual revival, revenue generation and public spending in last three quarters of FY 2020-21 remained lower than the corresponding period of 2019-20.

- Decline in own revenue receipts seems to have been arrested in Q3 as States managed to improve revenue performance considerably. The decline in own tax revenues aggregated across 23 States moderated from -43.38 percent in Q1 to -7.33 percent in Q2 and in Q3 it increased by about 10.94 percent as compared to the corresponding period in 2019-20 (Table 4).

- As far as the non-tax revenues are concerned, Q3 results show moderation in decline as compared to the previous two quarters of 2020-21. However, own revenue receipt of States aggregated over the first three quarters i.e., April to December 2020, remained lower by 13.28 percent as compared to that in 2019-20.

Table 4: Percentage change in key fiscal indicators of States in 2020-21 over 2019-20 (23 states)

		Q1 (Apr-Jun)	Q2 (Jul-Sep)	Q3 (Oct-Dec)	Q1+Q2+Q3 (Apr-Dec)
Revenues					
1	Total Revenue Receipt (2+5)	-19.07	-16.09	2.49	-10.78
2	Own Revenue Receipt (3+4)	-40.79	-9.19	8.85	-13.28
3	Own Tax revenue	-43.38	-7.33	10.94	-12.87
	Of which				
	(i) SGST	-40.56	-13.12	4.50	-16.24
	(ii) Sales Tax	-39.12	-5.63	20.20	-7.84
	(iii) State Excise	-37.07	17.08	26.73	1.39
4	Non-tax Revenue	-18.58	-23.69	-7.56	-16.61
5	Central transfer (6+7)	20.07	-24.90	-6.14	-7.16
6	Devolution	-5.82	-23.98	-33.62	-22.43
7	Grants	56.02	-25.79	22.67	9.49
Expenditure					
8	Revenue expenditure	13.27	-9.88	2.24	0.66
9	Capital expenditure	-41.96	-24.29	7.23	-19.04
10	Total expenditure (8+9)	7.27	-11.51	2.83	-1.60
	Of which				
	(i) Expenditure on General Services	5.10	-4.81	8.44	2.18
	(ii) Expenditure on Social Services	16.10	-7.23	-1.07	1.10
	(iii) Expenditure on Econ. Services	-16.84	-18.45	2.06	-10.71
11	Revenue Deficit (% of GDP)	-3.98	-1.65	-0.68	-1.92
12	Fiscal Deficit (% of GDP)	-4.76	-3.15	-2.36	-3.26

Notes: Negative values indicate decrease and positive values increase; Negative value for deficits indicate deficit. Source: Comptroller and Auditor General of India (CAG).

- SGST and Sales tax, which together account for about two-thirds of States' own tax revenues increased by 4.5 percent and 20.20 percent respectively in Q3 as compared to 2019-20. To generate additional revenues, several state governments increased duties on petrol, diesel and alcohol. This resulted in an increase in revenues from state excise by about 17.08 percent in Q2 and 26.73 percent in Q3. The revenues from state excise show an increase of about 1.39 percent during April-Dec 2020 vis-à-vis 2019-20.

- **Central transfers** aggregated across 23 states show a decline of 6.14 percent during Q3 of 2020-21 vis-à-vis 2019-20 largely due to fall in tax devolution by the Union government. Tax devolution to states was lower by 33.62 percent as compared to Q3 of 2019-20. However, central grants to states show an increase of about 22.67 percent during Q3 of 2020-21. Central grants to states also includes GST compensation.

- The revenue expenditure in Q3 of 2020-21, improved by 2.24 percent with a commensurate rise in revenue receipts. The turnaround in capital expenditure by the state governments has been significant, as it turned positive in Q3. Capital expenditure was higher by 7.23 percent as compared to a considerable fall in Q1 and Q2 over corresponding period in 2019-20.

- Service-wise break-up of expenditure show that the expenditures on general and economic services increased by 8.44 percent and 2.06 percent respectively in Q3. The expenditures of social services, which include expenditures on medical & public health, water supply & sanitation, labour & employment, social security & welfare etc., declined by 1.07 percent. However, the period from April-December 2020 showed an increase in expenditure on general services and social services by 2.18 percent and 1.10 percent respectively. In contrast, expenditure on economic services contracted by 10.71 percent as compared to 2019-20.

- States had budgeted Rs. 6.96 lakh crore as market borrowing for the fiscal year 2020-21 out of the total internal-debt of Rs. 8.99 lakh crore. The additional borrowing facility of 2 percent of GSDP, beyond the 3 percent borrowing limit, provided under Aatma Nirbhar Package in May 2020 amounted to about Rs. 4.28 lakh crore. While states have to incur higher market borrowing due to shortfall in revenue receipts, the actual borrowing is expected to remain less than the enhanced limit. The actual borrowing will, however, depend upon the capacity of the states to access market borrowing and their ability to meet the conditions to be eligible for additional borrowings.

- In last three quarters, states gross market borrowing has been Rs. 5.56 lakh crore, which accounts for about 80 percent of budgeted market borrowing. In Q3 (Oct –Dec 2020-21), the states' gross borrowing was Rs. 2.02 lakh crore, which was about 36 percent of gross bowing incurred by the states in last three quarters. (RBI Bulletin, February 2021)

- The back-to-back loans provided to the states to meet the estimated shortfall of Rs. 1.10 lakh crore in revenue arising due to implementation of GST was being accounted for under loans from centre in state budgets. Up to January 2021, about 65 percent of the total estimated GST compensation shortfall has been released to the States.

- *Despite improved performance in Q3, the fiscal position aggregated across 23 states for the period April-December 2020 (i.e., first three quarters of 2020-21) show decline in both own-tax and non-tax revenues as compared to 2019-20. Central transfers are lower by 7.16 percent largely due to the fall in tax devolution to states which show a fall of about 22.43 percent as compared to 2019-20. While revenue expenditures increased by 0.66 percent, there was a contraction of capital expenditure by 19.04 percent. Total expenditures aggregated across 23 states fell by 1.60 percent.*

- The impact of the pandemic on the finances of states can further be assessed from the examination of annual budgets of states for FY 2021-22. Aggregating budget numbers of 22 states that have so far presented their budget, the 2020-21 revised estimates of own-tax revenues are lower by 14.86 percent as compared to the 2020-21 budget estimates. Estimates of SGST were lower by 18.31 percent, sales tax by 11.17 percent and non-tax revenue by 22.77 percent. Central transfers to states were also estimated to be lower by 15.89 percent with tax devolution falling by about 30.33 percent. Central Grants to states, however, are higher by 4 percent in 2020-21RE as compared to 2020-21BE (Table 4)

- The GSDP aggregated across 22 states is projected to fall by 8.9 percent in 2020-21RE as compared to what was budgeted by these states for 2020-21BE. However, in 2021-22, the GSDP is projected to grow at 11.61 percent in nominal terms.

- In 2021-22BE, the States have budgeted their own tax revenue to grow by 28.4 percent, which translates into an aggregate buoyancy factor of 2.44. The revenue deficit and fiscal deficit aggregated across 22 states as percent of GSDP is estimated to be around 1.86 percent and 4.23 percent respectively in 2020-21RE as compared to 0.08 percent and 2.64 percent in 2020-21BE. As of 2021-22BE these States in aggregate have budgeted for a revenue surplus of 0.52 percent of GSDP and a Fiscal Deficit of 3.35 percent. The outstanding liabilities as percent of GSDP are budgeted to increase from 24.8 percent in 2019-20 to 28.64 percent in 2021-22BE.

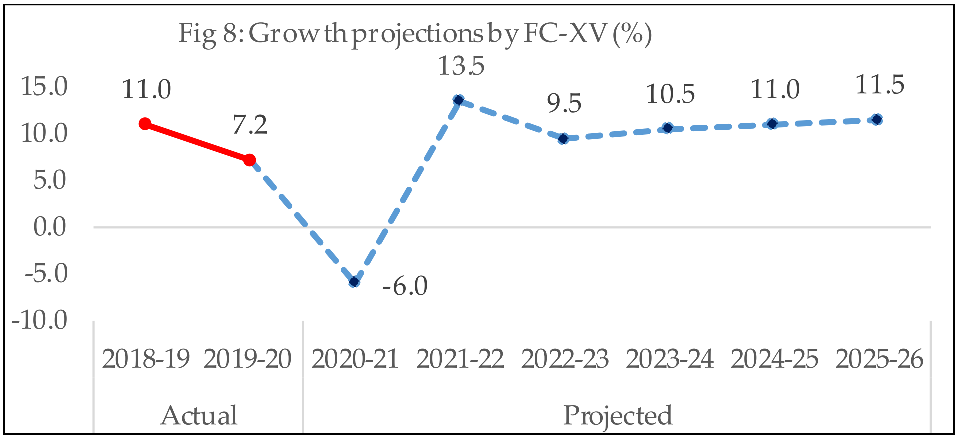
Table 5: Percent change in key fiscal indicators of States (22 states)

		% Change between	
		2020-21RE & 2020-21BE	**2021-22BE & 2020-21RE**
1	**Total Revenue Receipt (2+5)**	**-16.01**	**24.14**
2	**Own Revenue Receipt (3+4)**	**-16.11**	**29.03**
3	Own Tax Revenue	-14.86	28.40
4	Own Non-Tax Revenue	-22.77	32.77
5	**Central Transfers (6+7)**	**-15.89**	**18.37**
6	Share in Central Taxes	-30.33	24.05
7	Grants-in-aid	4.00	13.14
8	Revenue Expenditure	-4.37	12.35
9	Capital Expenditure	-16.87	34.95
10	**Total Expenditure (8+9)**	**-13.04**	**16.82**
11	Outstanding Liabilities	4.71	12.30
12	**GSDP**	**-8.88**	**11.61**

Notes: Negative values indicate decrease and positive values increase;
Source: 2021-22 Budget documents of 22 states.

IV 15TH FINANCE COMMISSION: KEY HIGHLIGHTS

FC-XV was constituted at a time when the economic growth was slowing down and then in early 2020, the Covid-19 pandemic struck which had a disastrous impact on the economy and on finances of both the Union and the State governments. In the wake of the pandemic the Commission was of the view that there would be uncertainties in GDP growth. Accordingly it assumed a differentiated growth path (Fig 8). The economy is assumed to contract by 6 percent in nominal terms in 2020-21. For 2021-22 the Commission projected the nominal GDP to grow by 13.5 percent in 2021-22. High growth assumption in 2021-22 is primarily due to the low base in 2020-21. The GDP is projected to grow in nominal terms by 9.5 percent in 2022-23; 10.5 percent in 2023-24; 11 percent in 2024-25 and 11.5 percent in 2025-26.



Note: Actuals till 2019-20 and projections thereafter

Addressing Vertical and Horizontal Imbalance

A) ***Vertical Imbalance***: FC-XV considered stability and predictability of resources as an essential component of long-term fiscal management both at the Union and the State level. In its final report for 2021-26 the Commission kept the vertical sharing at 41 percent of the divisible pool of taxes with the state governments (28 states). In its view "this level of vertical transfers will allow appropriate fiscal space for the Union to meet its demands as well as maintain an adequate level of unconditional resources for the States."

B) ***Horizontal Imbalance***: There exists considerable heterogeneity among states in terms of their size, population, per capita incomes etc. These differences affect fiscal capacities as well as needs of the states thus leading to differences in both level and cost of basic service provisioning. Finance Commissions have used a number of criteria for distribution of shareable central tax revenue among states. The criteria and weights used by FC-XV to determine the inter se share of states are presented in Table 6.

Table 6: Criteria and Weights assigned for Horizontal Devolution

Criteria	**Weights (%)**
Population (2011)	15.0
Area	15.0
Forest and ecology	10.0
Income distance	45.0
Tax and fiscal efforts	2.5
Demographic Performance	12.5

Source: 15th FC report.

Examining the inter se shares recommended by Finance Commissions starting from FC-XI to FC-XV(II) we see that the inter se shares of the richest 6 states[4] fell from 10.004 percent recommended by FC-XI to 9.003 percent during FC-XIII period and further to 8.269 percent during the award period of FC-XV(II), although there was an increase in the inter se shares of these states during the award period of FC-XIV (Table 7). The inter se shares of the middle income states show an increase from 28.308 percent during FC-XI to 32.508 percent recommended by FC-XV(II). The inter se shares of the bottom 10 states declined from 60.398 percent recommended by FC-XI to 57.926 percent recommended by FC-XIV. However, we see an increase in the shares of these states as recommended by FC-XV.

[4] Based on the per-capita GSDP provided by the Fifteenth Finance Commission

Table 7: Inter se Shares of States recommended by FC-XI to FC-XV (%)

States	11 FC Shares	12 FC Shares	13 FC Shares	14 FC Shares	15 FC Shares (I)	15 FC Shares (II)
Goa	0.206	0.259	0.266	0.378	0.386	0.386
Sikkim	0.184	0.227	0.239	0.367	0.388	0.388
Haryana	0.944	1.075	1.048	1.084	1.082	1.093
Kerala	3.057	2.665	2.341	2.500	1.943	1.925
Karnataka	4.930	4.459	4.328	4.713	3.646	3.647
Himachal Pradesh	0.683	0.522	0.781	0.713	0.799	0.830
Top 6 States	**10.004**	**9.207**	**9.003**	**9.755**	**8.244**	**8.269**
Telangana	--	--	--	2.437	2.133	2.102
Uttarakhand	--	0.939	1.120	1.052	1.104	1.118
Tamil Nadu	5.385	5.305	4.969	4.023	4.189	4.079
Maharashtra	4.632	4.997	5.199	5.521	6.135	6.317
Gujarat	2.821	3.569	3.041	3.084	3.398	3.478
Mizoram	0.198	0.239	0.269	0.460	0.506	0.500
Punjab	1.147	1.299	1.389	1.577	1.788	1.807
Andhra Pradesh	7.701	7.356	6.937	4.305	4.111	4.047
Arunachal Pradesh	0.244	0.288	0.328	1.370	1.760	1.757
Nagaland	0.220	0.263	0.314	0.498	0.573	0.569
Rajasthan	5.473	5.609	5.853	5.495	5.979	6.026
Tripura	0.487	0.428	0.511	0.642	0.709	0.708
Middle 12 states	**28.308**	**30.292**	**29.930**	**30.464**	**32.385**	**32.508**
Orissa	5.056	5.161	4.779	4.642	4.629	4.528
Chhattisgarh	--	2.654	2.470	3.080	3.418	3.407
West Bengal	8.116	7.057	7.264	7.324	7.519	7.523
Madhya Pradesh	8.838	6.711	7.120	7.548	7.886	7.850
Meghalaya	0.342	0.371	0.408	0.642	0.765	0.767
Assam	3.285	3.235	3.628	3.311	3.131	3.128
Manipur	0.366	0.362	0.451	0.617	0.718	0.716
Jharkhand	--	3.361	2.802	3.139	3.313	3.307
Uttar Pradesh	19.798	19.264	19.677	17.959	17.931	17.939
Bihar	14.597	11.028	10.917	9.665	10.061	10.058
Bottom 10 states	**60.398**	**59.204**	**59.516**	**57.926**	**59.371**	**59.223**

Note: States are ranked based in the comparable PCGSDP average over 2016-18 given in the FC-XV Report; The total of these states do not add up to 100 percent as inter se shares of J&K is not included.
Source: Reports of Finance Commissions (FC-XI to FC-XV)

Grants Recommended by 15th FC

FC-XV was of the view that grants-in-aid can make corrections for cost disabilities and other redistributive requirements which can be addressed only to a limited extent in any devolution formula. Besides, grants are more directly targeted and used to equalise the standards of basic social services. The Commission recommended grants amounting to Rs.10,33,062 crore for its award period 2021-26. The grants recommended by FC-XV account for about 19.65 percent of the total transfers recommended by it. Table 8 summarises the various grants recommended by FC-XV.

Table 8: Grants Recommended by FC-XV (in Rs crore)

FC-XV Grants		2021-22	2022-23	2023-24	2024-25	2025 -26	2021-26
1	Revenue Deficit grant	118,452	86,201	51,673	24,483	13,705	294,514
2	Local Body grant	80,297	84,703	87,181	92,087	92,093	436,361
3	Grants for Disaster Management	22,184	23,294	24,466	25,688	26,969	122,601
4	Sector-specific grants	12,346	23,729	24,773	33,062	36,077	129,987
i	*Health*	*4,767*	*6,211*	*6,368*	*6,527*	*7,882*	*31,755*
ii	*School Education*	*0*	*1,200*	*1,200*	*1,200*	*1,200*	*4,800*
iii	*Higher Education*	*1,133*	*1,177*	*1,259*	*1,303*	*1,271*	*6,143*
iv	*Implementation of agricultural reforms*	*0*	*7,500*	*7,500*	*15,000*	*15,000*	*45,000*
v	*Maintenance of PMGSY roads*	*3,731*	*4,249*	*5,565*	*6,151*	*7,843*	*27,539*
vi	*Judiciary*	*2,085*	*2,085*	*2,085*	*2,085*	*2,085*	*10,425*
vii	*Statistics*	*0*	*677*	*166*	*166*	*166*	*1,175*
viii	*Aspirational districts and blocks*	*630*	*630*	*630*	*630*	*630*	*3,150*
5	State-specific grants	0	9,919	9,919	14,883	14,878	49,599
Total Grants		**2,33,279**	**2,27,846**	**1,98,012**	**1,90,203**	**1,83,722**	**10,33,062**

Source: 15th FC report.

Fiscal Consolidation Roadmap Recommended by FC-XV

Given the past performance of both the levels of government and the current pressures on the finances, FC-XV adopted normative principles with the objective of creating fiscal space for health and other important expenditure requirements while maintaining medium term fiscal sustainability. The Commission maintained that the Union government must support state and local government budgets to maintain the macro-fiscal balance. However, the responsibility of balancing the budgets of state governments lies primarily with those governments themselves.

Fiscal Consolidation path for the Union Government: The indicative debt-deficit path for the Union recommended by the Commission is presented in Table 9. The Commission has estimated a sharp rise in debt to GDP ratio in 2020-21 owing to the contraction in nominal GDP by 6 percent[5] along with the fall in revenues and increase in expenditure needs. There is a declining trend in deficit and debt going forward, as the economic growth picks up. The Commission recognised that it is impossible to pursue the current FRBM path. The revenue deficit cannot be eliminated and as per the Commission's analysis, and 3 percent FD will be insufficient to cover the revenue account imbalances till 2024-25 and will barely cover it in 2025-26.

Table 9: Indicative debt-deficit path for the Union Governments (% of GDP)

Indicators	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Revenue Deficit	5.9	4.9	4.5	3.9	3.3	2.8
Fiscal Deficit	7.4	6.0	5.5	5.0	4.5	4.0
Total Liabilities	62.9	61.0	61.0	60.1	58.6	56.6

Notes: * (-) surplus/ (+) deficit. Source: 15th FC report.

[5] The contraction in nominal GDP estimated by the NSO as per the 2nd advances estimates for 2020-21 is 3.8 per cent which is lower than that projected by FC-XV.

A major component of revenue account of the Union government is the schematically tied transfers to state governments primarily through the Centrally Sponsored Schemes (CSS). The Commission recommended rationalisation of such schemes through an independent evaluation of CSS. The Union Budget 2020-21 shows that fifteen of the thirty umbrella CSS account for about 90 percent of the total allocation under CSS. Many umbrella schemes have, within them, several smaller schemes with negligible allocations. The Commission recommended that there should be a threshold amount of annual appropriation below which the funding for a CSS may be stopped and the administrating department should justify the need for the continuity of the scheme.

Fiscal Consolidation path for the State Governments: The debt-deficit path for the states as derived by the Commission is presented in Table 10. FC-XV pointed out that if a state is unable to utilise its sanctioned borrowing limit during the first four years of the award period of FC-XV (i.e., 2020-21 to 2024-25), then it has an option of availing the unutilised borrowing amount (calculated in rupees) in any of the subsequent years within its award period.

Table 10: Indicative debt-deficit path for the State Governments (% of GSDP)

Indicators	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Revenue Deficit	-0.1	-0.5	-0.8	-1.2	-1.7	-2.5
Fiscal Deficit	4.5	4.0	3.5	3.0	3.0	3.0
Total Liabilities	33.1	32.6	33.3	33.1	32.8	32.5

Notes: * (-) surplus/(+) deficit. Source: 15th FC Report;

The debt-deficit path recommended by the Commission for the ***General government*** is presented in Table 11. The combined liabilities also show a similar trend as the states and Union's debt, increasing sharply in 2020-21 and reducing in the last three fiscal years.

Table 11 Indicative Deficit and Debt Path for the General Government (% of GDP)

	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
RD-Union	5.9	4.9	4.5	3.9	3.3	2.8
FD-Union	7.4	6.0	5.5	5.0	4.5	4.0
Total Liabilities-Union	62.9	61	61	60.1	58.6	56.6
RD-States	-0.1	-0.4	-0.8	-1.1	-1.6	-2.4
FD-States	4.2	3.3	3.3	2.8	2.8	2.8
Total Liabilities-States	31.1	30.7	31.3	31.1	30.9	30.5
RD-Combined	5.8	4.5	3.7	2.8	1.7	0.4
FD-Combined	11.6	9.3	8.8	7.8	7.3	6.8
Netting*	4.2	3.4	2.7	2.1	1.7	1.4
Total Liabilities-Combined	89.8	88.3	89.6	89.1	87.8	85.7

Note: * The items netted include the stock of Union Government loans to the States, the stock of NSSF securities and Treasury Bills held by the State Governments; FC-XV termed the recommended debt path as ''indicative'' given the uncertainties and challenges that prevailed at the time of analysis; (-) surplus/(+) deficit. Source: FC-XV Report

FC-XV also recommended incentive based extra borrowing space for states. Considering the impact of the pandemic on the power sector and on State finances the Commission considered various options that would provide States with a liquidity cushion to implement structural improvements in the finances of DISCOMs and simultaneously introduce governance improvements. Accordingly, it recommended extra annual borrowing space for the States, of the magnitude of 0.50 percent of their GSDP for each of the first four years of the award covering the period (2021-22 to 2024-25), based on certain performance criteria in the power sector.

In the commission's view, the current FRBM framework needs major restructuring and recommended that the time-table for defining and achieving debt sustainability may be examined by a ***High-powered Inter-governmental Group***. This High-powered Group can craft the new FRBM framework and oversee its implementation. It is important that the Union and State Governments amend their FRBM Acts, based on the recommendations of the Group, so as to ensure that their legislations are consistent with the fiscal sustainability framework put in place.

***Fiscal Institution*:** The Commission observed that there is absence of an independent fiscal institution to evaluate the fiscal plans and performance of governments which lowers the capacity to monitor the compliance to the fiscal rules. Review of international experience also suggest that there is high correlation between establishing fiscal rules and setting up independent fiscal councils as adequate external and independent scrutiny makes for better compliance with fiscal rules.

In India, successive finance commissions have made recommendation in this regard but there is not much progress. FC-XV recommended establishment of an independent Fiscal Council with powers to assess records as required from the Union as well as the states for continuing ex-ante monitoring and assessment of the internal consistency of revenue, expenditure, and deficit targets, under the fiscal responsibility legislations. The fiscal council would have only an advisory role clearly separated from enforcement.

V MONETARY POLICY

Review of New Monetary Framework

- On February 26th 2021, Report of Currency and Finance (RCF) was released by the RBI which reviews the New Monetary Policy Framework (NMF) in the context of the inflation targeting mandate[6]. The report highlighted that the primary focus of flexible inflation targeting is on price stability and that augurs well for further opening of capital account and eventual internationalization of Indian rupee. The report also stated that the present inflation anchor of 4 percent with +/- 2 percent band is appropriate for next five years. While the Monetary Policy Committee (MPC) was constituted under NMF, the report highlights that the operational aspects of MPC need a review, regarding the processes of onboarding of MPC members, timings relate to release of MPC minutes, among others.

MPC Decisions

- The RBI retained the status quo on Repo Rate at 4 percent in its meetings on February 5, 2021 and 6th April, 2021[7]. The reverse repo rate also remained at its status quo rate of 3.35 percent. The marginal standing facility (MSF) rate and the Bank Rate stood at 4.25 percent. Since the last quarter, there has been a resurgence in fuel inflation due to a surge in international crude prices and high taxation on petroleum by central and state governments. In February, the MPC had decided to retain the 'accommodative stance' into the next financial year – to revive economic growth on a sustained manner and mitigate the impact of Covid-19 on the macro economy. These decisions are in consonance with the objective of achieving the medium-term target for consumer price index (CPI) inflation of 4 percent within a band of +/- 2 percent, while supporting the growth momentum.

[6] RBI (2021) Report of Currency and Finance, Reserve Bank of India

[7] RBI (2021a) Monetary Policy Committee Statement, 2020-21, No. 7 and RBI (2021b) Resolution of the MPC, April 7th, 2021, No. 2021-22/16

- In its macroeconomic assessment, the MPC in April 2021 highlighted that Monetary Policy will continue to 'support and nurture' the economic recovery and that its stand will remain 'accommodative', till the recovery is well secured. The growth outlook projected by MPC remains at 10.5 percent for FY 2021-22, but has also warned of downside risks in the wake of recent waves of Covid infections.

Credit

- The non-food bank credit growth stood at 5.7 percent in January 2021 as compared to 8.5 percent in January 2020, on a year-on-year (YoY) basis. The credit growth (by the end of Q3) to agriculture and allied activities grew to 9.9 percent in January 2021 as compared to 6.5 percent in January 2020. The credit to industry contracted by 1.3 percent in January 2021 as compared to 2.5 percent growth in January 2020. This change was because of the contraction in bank credit to large industries by 2.5 percent in 2021 January, as compared to 2.8 percent growth in January 2020.

- The credit deployed to medium industries registered a robust growth of 19.1 percent in January 2021 as compared to 2.8 percent in January 2020, whereas the credit to micro and small industries registered a growth of 0.9 percent in January 2021 as compared to 0.5 percent in January 2020. The acceleration in growth of bank credit in January 2021 compared to the growth in January 2020 was registered for the industrial sectors including mining & quarrying, food processing, textile, 'gems & jewellery, petroleum, coal products & nuclear fuels, 'paper and paper products, leather and leather products, and vehicles, vehicle parts and transport equipment.

Money Supply

- The growth in M3 (Broad Money) decreased to a three-month low of 12.1 percent in January 2021, due to a decline in the growth of time deposits to 9.7 percent in January 2021. The growth in M1 (Narrow Money) increased from 19.6 percent in December 2020 to 19.9 percent in January 2021.

Financial Stability - Gross Non-Performing Assets (NPA)

- The estimates from RBI's January 2021 Financial Stability Report shows that commercial banks' Gross Non-Performing Assets (GNPA) would increase to 13.5 percent by September 2021 under the 'base case scenario' and to 14.8 percent under the 'severe stress scenario'[8]. Public infrastructure sector excluding electricity had a GNPA ratio of 12.6 percent while electricity sector had a GNPA ratio of 11.2 percent in September 2020. In the case of agriculture, GNPA ratio was at 9.6 percent while that in services was at 6.9 percent in September 2020. The GNPA in the retail sector had the lowest ratio at 1.7 percent in September 2020.

Interest rates

- The rate of interest provided by commercial banks on 'term deposits' with a maturity of more than one year averaged 5.20 percent, as per the data released by the RBI on 15 February 2021. The average yield on 10-year government bond increased slightly to 5.94 percent in January 2021 (after retained at 5.89 percent in November and December 2020). The MPC noted that financial markets remain buoyant, supported by accommodative monetary conditions, abundant liquidity and optimism from the vaccine rollout.

---

[8] RBI (2021): Financial Stability Report, Reserve Bank of India,

VI EXTERNAL SECTOR OUTLOOK

Current Account

- During 2020-21 Q1 India's exports (-36 percent YoY) and imports (-52 percent YoY) saw a sharp contraction in line with the movement in global trade. Despite a gradual revival of the merchandise trade, Q3 of 2020-21 recorded -5 percent and -8.3 percent YoY growth rate of exports and imports respectively. The **trade deficit** during the April-December, 2020-21 was USD 57.5 billion as compared to USD 125.9 billion in the corresponding period of the last year.

- **Total exports** during April-December, 2020-21 amounted to USD 200.8 billion, having contracted by -15.7 percent as compared to -2.4 percent during the same period of the previous year. Commodities such as Petroleum, Oil and Lubricants (POL), organic and inorganic chemicals, electronic goods, textiles & allied products, engineering products, gems and jewellery pulled export growth downwards.

- **Total imports** during April-December, 2020-21 amounted to USD 258.3 billion, having contracted by -29.1 percent in comparison to -7.2 percent during the same period last year. The sharp decline in POL imports that constitute about a quarter of total merchandise imports pulled the overall import growth downwards. Other sectors which contracted include capital goods, ores and minerals, precious and semi-precious stones.

- **Current account balance** turned into surplus (0.1 percent of GDP) in Q4: FY 2019-20 on the back of a lower trade deficit and a sharp rise in net invisible receipts. Data shows a persistent outgo from the **primary income** account, of which nearly 93 percent is attributable to investment income payments/ receivables--dividends, interest. While **services trade** showed robust a YoY growth in 2019-20 Q1 and Q2, growth rate in 2020-21 Q1 declined to -10.3 percent for export and -18.1 percent for imports and for Q2 it was -5.4 percent and -9.7 percent respectively, dragged down by three sectors transport, travel and financial services.

Exchange Rate

- After depreciating to its lowest level of 76.86 **Rupees to 1 USD** on April 16, 2020, the Rupee subsequently appreciated (3.5 percent between Dec and April) owing to FPI flows to the domestic equity market and the weakening of the USD. In terms of 36-currency **NEER** (trade based weights), Rupee depreciated by 2.9 percent in December 2020 over March 2020; however, it appreciated by 2.2 percent in terms of **REER**.

- While current account surplus (which, in turn, is largely due to contraction in imports rather than increase in competitiveness of exports) in first half of 2020-21 has been a key factor for reserve accretion, robust capital inflows (both FDI and FPI), in subsequent months drove **foreign exchange reserves** to an all-time high of US$ 586.1 billion as on January 8, 2021, covering about 18 months of imports.

****

National Institute of Public Finance and Policy, New Delhi

Report prepared by

Dr. Pinaki Chakraborty,
Director
With contributions from NIPFP Faculty:
R. Kavita Rao, Lekha Chakraborty,
Pratap R. Jena, Manish Gupta,
Rudrani Bhattacharya, Amey Sapre,
Dinesh Kumar Nayak

Correspondence:
Dr. Pinaki Chakraborty,
Director
National Institute of Public Finance and Policy, 18/2, Satsang Vihar Marg,
Special Institutional Area,
New Delhi – 110 067
director@nipfp.org.in