NATIONAL INSTITUTE of Public Finance and Policy

NIPFP Policy brief

No. 45

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FY 2024-25: Mid-Year Macroeconomic Review

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Globally, growth recovering gradually while inflation is easing, but oil price volatility still poses an inflation risk

Global growth is projected to post a slow recovery in the near term. The International Monetary Fund's World Economic Outlook (WEO) projects global growth to grow at 3.2 percent in 2024 and 2025. Advanced economies are projected to grow at 1.8 percent in 2024 and 2025, led by faster than expected growth in the US. Emerging Markets and Developing Economies (EMDEs) are projected to grow at a stable pace of 4.2 percent.

Alongside slow growth recovery, inflation in advanced economies has eased from the highs of 2022, prompting central banks to start the rate cut cycle. The European Central Bank (ECB) has cut its benchmark policy rate thrice this year. The US Federal Reserve cut its benchmark borrowing rate by 50 basis points in September and 25 basis points in November in response to softer inflation and weak labour market conditions. However, volatility in global crude oil prices due to the conflict in the Middle East poses an upside risk to global inflation.

India: Growth moderated, inflation rose and the current account balance turned negative again in Q1 2024-25

Real GDP growth in India was high at 8.2 per cent in FY 2023-24 (Central Statistical Organisation), mainly due to the strong multiplier effect of high public sector capex. However, growth moderated to 6.6 per cent in Q1 2024-25. This was despite accelerated private consumption growth, and a reduction in the real trade deficit (**Table 1**).[1] The moderation in growth is mainly attributable to contraction in government consumption expenditure following announcement of the Model Code of Conduct for the elections. Also investment, which slowed down sharply towards the end of 2023-24 showed some recovery in Q1 2024-25 but was still muted compared to the first three quarters of FY 2023-24.

On the production side, at the sectoral level growth was tepid in tourism, travel & communications (5.7 per cent) and financial services (7.1 per cent). However, growth was robust in industry (8.3 per cent), and 'public administration, defence and other services' (9.5 per cent). Within the industrial sector, construction recorded the highest growth (10.5 per cent), followed by 'electricity, gas, water & other utilities'.

Table 1: Year-on-Year growth rates in aggregate demand and components

Demand components	2023-24 YoY (%)	2023-24 Q1 YoY (%)	2023-24 Q2 YoY (%)	2023-24 Q3 YoY (%)	2023-24 Q4 YoY (%)	2024-25 Q1 YoY (%)
Aggregate demand (GDP)	8.2	8.2	8.1	8.6	7.8	6.6
Govt. Final Consumption Exp. GFCE	2.5	-0.1	14.0	-3.2	0.9	-0.2
Private Final Consumption Exp. PFCE	4.0	5.5	2.6	4.0	4.0	7.4
Gross Fixed Capital Formation GFCF	9.0	8.5	11.6	9.7	6.5	7.5
Net Exports	459.7	888.0	88.8	183.6	6.0	-11.8

Source: CSO, MOSPI

Agricultural performance improved in Q1 2 024-25 compared to the second half of FY 2023-24. Significant increase in kharif area sown under foodgrains in 2024-25

[1] Since real trade balance i.e., real net exports is a negative number, a positive growth in this variable means widening of trade deficit; while a negative growth implies narrowing of trade deficit.

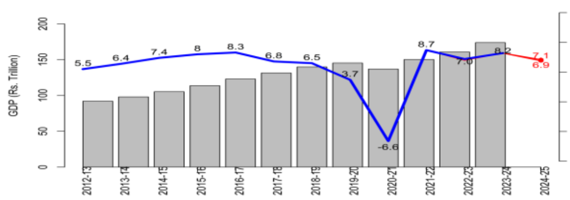
compared to the previous year and above average rainfall in August-September 2024 are expected to boost rice production in the current financial year, but pulses yield may be adversely affected due to excess moisture.

In Q2 2024-25, industrial growth was moderate at 4.1 per cent during April-September 2024-25, with a significant slowdown in IIP growth for mining and electricity. Manufacturing IIP growth also moderated in this quarter with a slowdown in IIP growth for construction and consumer goods. Performance in services was mixed, with growth moderate in tourism and credit growth moderate while trade services growth was buoyant and assets managed under mutual funds grew at a high and rising rate.

Forecast for FY 2024-25

The NIPFP growth projections are derived from two alternative forecasting models, one based on high frequency indicators (NIPFPhf) and the other based on annual indicators (NIPFPaf). The models forecast annual growth rates of 6.9 per cent and 7.1 per cent respectively for FY 2024-25 (**Figure 1**). These are similar to projections from World Bank, IMF and RBI (**Table 2**).

Figure 1: Growth forecast at 6.9-7.1 for FY 2024-25



Source: MOSPI; Bhattacharya, Chakravartti and Mundle (2019)[2]; Bhattacharya, Bhandari and Mundle (2023)[3]

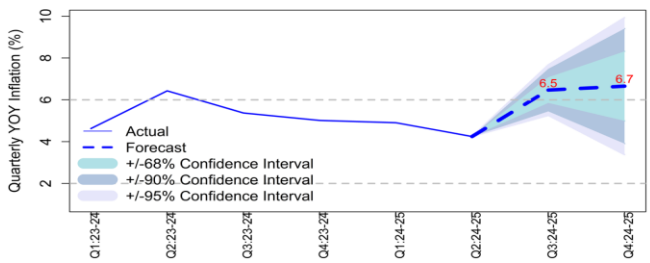
Table 2: Comparable forecasts by other organisations

	FY 23-24	Q1 24-25	Q2 24-25	Q3 24-25	Q4 24-25	FY 24-25
Actual	8.2	6.6				
NIPFP hf	7.8	7.2	6.6	6.9	7.3	6.9
NIPFPaf	7.6					7.1
RBI		7.1	7.2	7.3	7.2	7.2
IMF						7.0
World Bank						7.0

Source: NIPFP; MOSPI; RBI; IMF; World Bank

During the first half of FY 2024-25, **headline (CPI) inflation** was at 5.2 per cent, well within RBI's tolerance band of 2 to 6 per cent. It fell below the target of 4 per cent in July and August, 2024 on account of moderate food and core price inflation and energy price deflation. But broad based rebound in all components of CPI drove it up to 5.5 per cent in September 2024 and to 6.2 per cent, above the upper limit of the tolerance band in October 2024. During September-October 2024, food inflation spiked to 9.2-10.9 per cent due to soaring vegetables, fruits and edible oil prices and high and sticky price inflation for cereals and pulses. Declining core inflation also inverted due to rising gold and silver price inflation.

Figure 2: FY 2024-25 inflation forecast of NIPFP at 5.6 per cent, well above 4 per cent target



Source: Bhattacharya & Kapoor, 2020[4]

[2] Rudrani Bhattacharya, Parma Chakravartti and Sudipto Mundle (2019), "Forecasting India's Economic Growth: A Time-Varying Parameter Regression Model," *Macroeconomics and Finance in Emerging Market Economies,* Volume 12, Number 3.

[3] Rudrani Bhattacharya, Bornali Bhandari and Sudipto Mundle (2023), "Nowcasting India's Quarterly GDP Growth: A Factor-Augmented Time-Varying Coefficient Regression Model (FA_TVCRM)," *Journal of Quantitative Economics*, Volume 21.

[4] Rudrani Bhattacharya and Mrikankshi Kapoor, (2020) "Forecasting Consumer Price Inflation in India: Vector Error Correction Mechanism vs. Dynamic Factor Model Approach for Non-Stationary Time Series." NIPFP Working Paper No. 323.

For FY 2024-25, we forecast an annual inflation rate of 5.6 per cent, well above the 4 per cent RBI target, but within the tolerance band (**Figure 2**). However, our inflation forecasts for Q3 and Q4 2024-25 are 6.5 and 6.7 respectively, implying headline inflation will exceed the upper limit of the tolerance band during the second half of FY 2024-25. This is likely to be driven by food price inflation, and also in core and energy price inflation. In comparison, RBI has forecast inflation for Q3 and Q4 FY 2024-25 at moderate rates of 4.8 per cent and 4.2 per cent respectively and at 4.2 per cent for FY 2024-25, assuming that the food price shock is transitory.

Gradual improvement in labour market indicators observed

According to the Period Labour Force Survey (PLFS) data of NSSO, Labour Force Participation Rate (LFPR) for males rose from 75.1 per cent to 77.5 per cent between FY 2017-18 and FY 2023-24, while that for females rose from 21.1 per cent to 35.6 per cent. The male employment rate (WPR) improved from 68.6 per cent to 73.8 per cent during this period and the female employment rate rose from 19.2 to 33.8 per cent. The quarterly urban LFPR has remained fairly stable, with a marginal increase for males and marginal decline for females between January-March 2024 and April-June 2024.

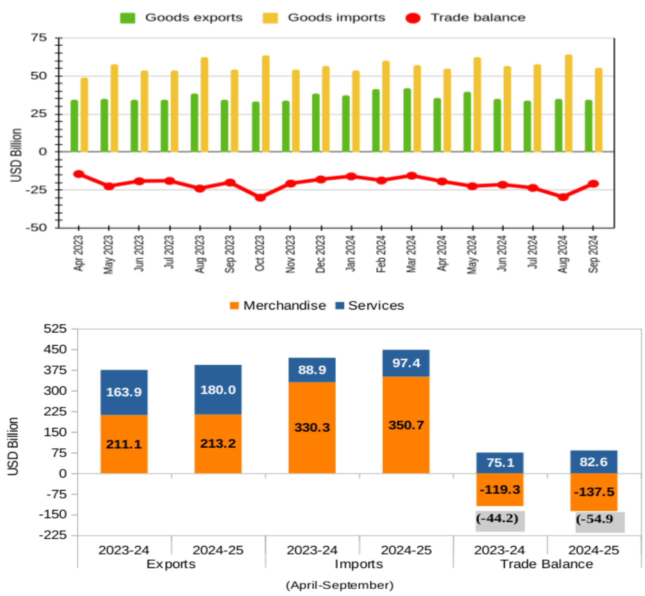
The conflict in West Asia and the continuing Russia-Ukraine war adversely impacted performance of India's external sector

In the first half of the current year, merchandise export growth remained weak due to geo-political tensions and disruptions in global demand. After two months of contraction, merchandise exports rose by 0.5 % in September to USD 34.6 billion. The tepid growth in merchandise exports was mainly on account of a sharp contraction in oil exports in September. In contrast, the non-oil exports grew by a healthy 6.8 percent. For the period April-September 2024, India's merchandise exports grew by just 0.95 percent. However, this was better than the contraction of 8.9 percent during the same period last year.

Merchandise imports grew by only 1.6 % in September, mainly due to a contraction in oil imports. For the first half of the current year, India's merchandise imports grew by 6 percent, led by growth of almost 30 percent in gold imports.

For April-September, India's total exports (goods and services) posted a growth of 4.9 % while total imports registered a growth of 6.9 %. The deficit in merchandise trade more than offset services trade surplus, leading to rise in overall trade deficit to USD 54.9 billion in the first half of the current year as compared to USD 44.2 billion in the same period of last year (**Figure 3**).

Figure 3: Merchandise trade more than offset services trade surplus, leading to rise in overall trade deficit in the first half of FY 2024-25



Source: DGCI&S, RBI, Ministry of Commerce and Industry, and CMIE Economic Outlook

India's current account balance inverted to a deficit at 1.1 percent of GDP in Q1 of FY 2024-25, from a surplus of 0.5 percent of GDP in Q4 of FY 2024-25. The widening of the current account deficit was on account of an increase in the merchandise trade deficit to USD 65.1 billion in Q1 from USD 56.7 billion in Q1 of the previous year (**Figure**

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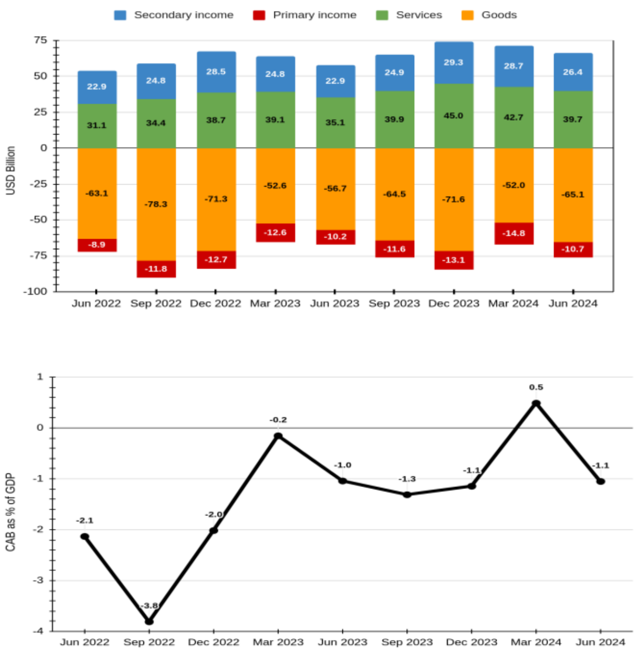
4). The trade deficit increased due to higher oil imports in Q1. However, it is encouraging that the surplus on services trade improved to USD 39.7 billion in Q1 of FY 2024-25 as compared to USD 35.1 billion in Q1 of FY 2023-24. Secondary income also improved from USD 22.9 billion in Q1 FY 2023-24 to USD 26.4 billion in Q1 FY 2024-25 due to higher remittances by Indians employed overseas.

Figure 4: Current account balance turned negative due to merchandised trade deficit in the beginning of FY 2024-25



Source: RBI and CMIE Economic Outlook

In financial accounts there was a slowdown in portfolio flows but a rise in FDI flows in Q1 FY 2024-25

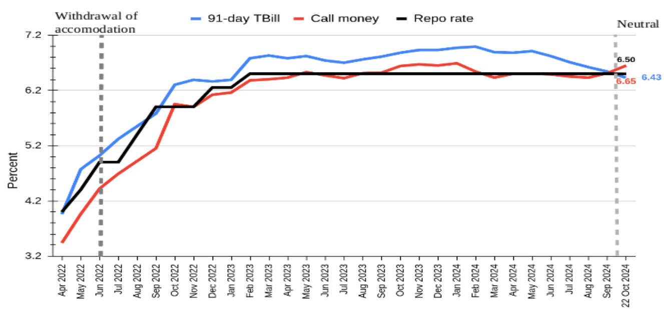
Net flows on the financial account amounted to USD 9.1 billion. This was marginally lower than the net flows in the same quarter of last year, but better than the contraction during Q4 of FY 2023-24. The weakness in the net flows were due to a sharp decline in portfolio flows on account of heightened global risks and election related uncertainty. However, direct investment saw an improvement compared to the previous quarter as well as corresponding quarter of FY 2023-24. There was an accretion of only USD 5.2 billion to the foreign exchange reserves in Q1 of FY 2024-25 as compared the accretion of USD 24.4 billion in Q1 of FY 2023-24.

In the first half of the current financial year, the rupee-dollar rate remained stationary within the narrow range of Rs 83.1 to Rs 84.1 to a dollar. Consequently, the annualised volatility of the rupee-dollar rate saw a decline during this period. The reduced volatility is attributable to active intervention by the Reserve Bank of India (RBI) to manage the exchange rate. By September end, India’s foreign exchange reserve crossed USD 700 billion, a sharp increase from USD 638 billion in April. While the narrower fiscal and current account deficits and foreign portfolio flows in debt securities boosted reserves, RBI’s active exchange rate intervention also helped in bolstering foreign exchange reserves.

Monetary policy and financial sector developments

After a 250 basis points increase in the policy rate between May 2022 and February 2023, the RBI’s Monetary Policy Committee (MPC) has left the policy rate unchanged since February 2023. The monetary policy stance was also maintained at withdrawal of accommodation. In the October MPC meeting, the RBI kept the policy rate unchanged but changed the stance from withdrawal of accommodation to neutral. A neutral stance gives flexibility in adjusting policy rates in response to the prevailing economic conditions.

Figure 5: Status quo on policy rate and switch of monetary policy stance to neutral, short-term rates converged towards the repo rate



Source: RBI, and CMIE Economic Outlook

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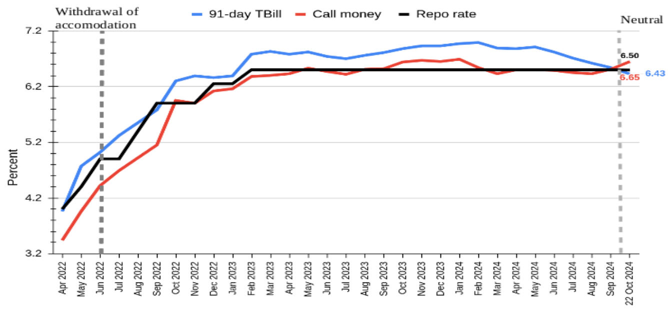

Source: RBI, and CMIE Economic Outlook

The RBI has been managing liquidity in the banking system by conducting variable rate repo and variable rate reverse repo auctions to inject or absorb liquidity so that the weighted average call rate (WACR) remains aligned with the repo rate. In the first half of the current financial year, the WACR has been hovering around the repo rate (**Figure 5**). In June, July and August, the call rate was lower than the repo rate owing to surplus liquidity. In September, the weighted average call rate inched slightly higher than the repo rate.

Yields on the government bonds have trended downwards due to easing of inflation and anticipation of monetary policy easing (**Figure 6**). Indian sovereign bond inclusion in the JP Morgan bond index also led to a greater demand for sovereign bonds and softening of yields. The yields across maturities have converged to around 6.8-7 percent. However, rising crude oil prices, geo-political uncertainties and the strengthening of the dollar could put upward pressure on government bond yields. A similar trend is visible across corporate bond yields. The yields across maturities (excluding the one year bond) are seen to be converging around 7.5-8 percent in the first half of the current year.

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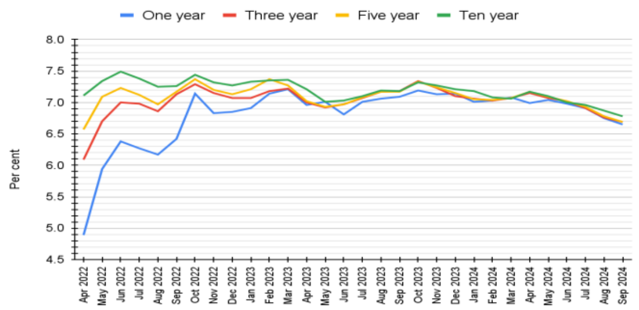
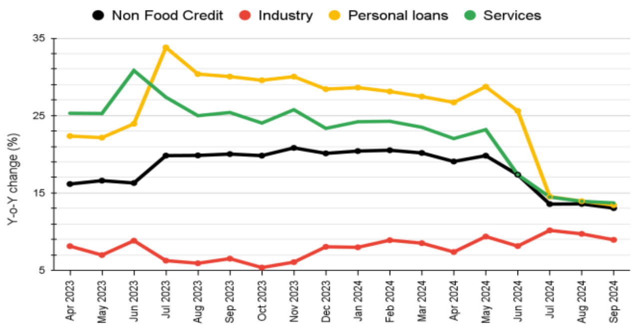
Figure 6: Converging and declining government bond yields across maturities



Source: CMIE Economic Outlook

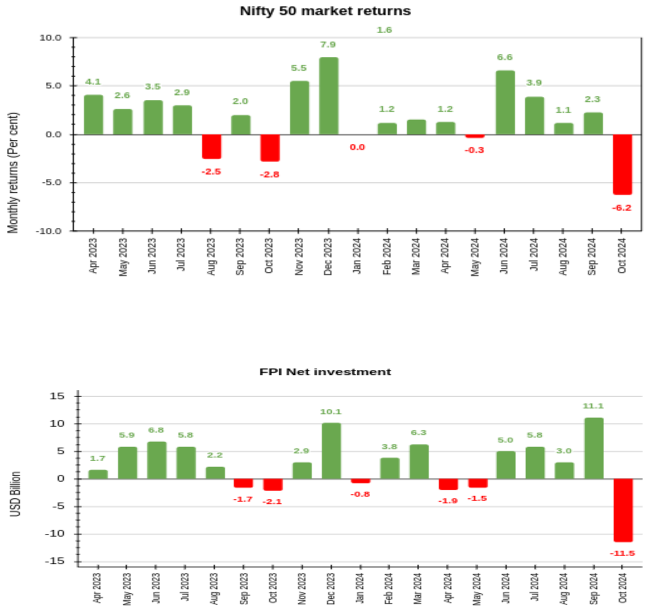
Non-food bank credit growth has moderated in recent months (**Figure 7**). In August and September 2024 non-food credit grew by 13.6 percent and 13 percent, respectively, a sharp slide from the 20 percent growth seen in August and September of last year. Two important constituents of bank credit, personal loans and loans to services, which drove bank credit growth to 20 percent last year, have visibly slowed since June this year. Late last year, the RBI had imposed higher risk weights to curb exuberance in retail lending. Despite this, bank credit reported strong growth in the initial months of the current year. However, some private sector banks have reported emergence of stress in the typically higher-yielding segments of unsecured retail loans, such as credit cards. This has led to a more cautious approach towards retail lending and consequently a moderation of credit growth.

Figure 7: Sharp decline in growth of non-food credit and its constituents in Q2 FY 2024-25



Source: RBI, and CMIE Economic Outlook

Figure 8: After being net buyers in the first half of FY 2024-25, FPI became net sellers in October 2024 and stock market returns became negative



Source: NSE, CMIE Economic Outlook and NSDL

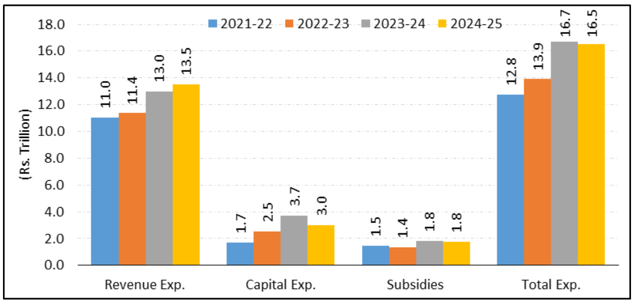
NSE Nifty 50 registered positive returns consecutively for four months (June-September) of the current year. Concerns over weaker corporate earnings led to the under-performance of the stock market in October. Uncertainty regarding US election results also contributed to nervousness in the stock markets.

Foreign Portfolio Investors (FPIs) became net buyers from June to September after the election-related uncertainty faded. September 2024 was a particularly strong month for FPI inflows. The surge in FPI investments driven by the US Federal Reserve's aggressive interest rate cut, which made Indian assets more attractive. However, the strong FPI flows reversed in October owing to the escalating geo-political conflict, rising crude oil prices and strong performance of the Chinese markets after the announcement of stimulus measures by China. Relentless FPI selling has continued in November as well. Weaker Q2 earnings, the slowdown in India's high-frequency indicators and uncertainty over the potential implications of a Trump presidency for emerging markets has affected investor sentiments in October and November.

Fiscal performance of Central and State Governments

Central government: The massive thrust on capital expenditure (Capex) which has been the hallmark of central government's fiscal policy in recent years continued in 2024-25. The capex was budgeted to increase by over 17 percent in 2024-25 (BE). However, during Apr-Aug 2024, there was a sharp 19.5 percent compression in capex as compared to Apr-Aug 2023 due to announcement of the election code of conduct (Figure 9). The growth in revenue expenditure during this period has been modest at 4.1 percent with no significant change in major subsidies (food, fertiliser and petroleum). Total expenditure growth during this period was negative due to sharp contraction in capex and modest growth in revenue expenditure. In H2-2024-25, capex is likely to pick-up, but meeting the 2024-25 budget estimates of capex will require a massive effort by the government. Tax revenues, however, were buoyant during Apr-Aug 2024, except corporation tax and excise duties (Table 3). Non-tax revenue growth has been very high at 59.6 percent due to enhanced dividends from RBI. Central government's fiscal deficit (FD) at 5.6 percent of GDP in 2023-24 was lower than the target of 5.9 percent. For 2024-25, the FD target is set at 4.9 percent of GDP for 2024-25. The budgeted 0.7 percent reduction in FD in 2024-25 to reach the 2025-26 target of 4.5 percent is likely to be met given the buoyancy in revenues and moderation in expenditure.

Figure 9: Trends in Expenditure (Apr-Aug; Rs trillion)



Source: Controller General of Accounts (CGA); Union Budget

Table 3: Central Government Revenue Collection: Apr-Feb (% change)

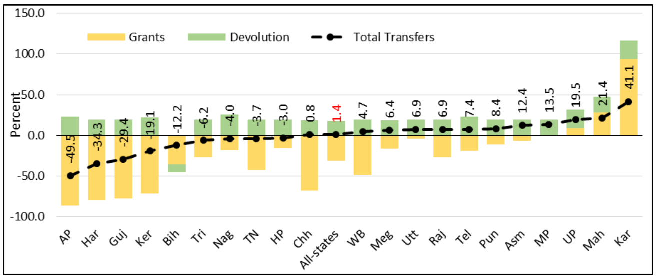
Indicators	Y-o-Y growth (%)		2024-25BE over 2023-24RE
	2022-23	2023-24	
Centre's Net Revenue*	21.6	19.2	15.9
Gross Tax Revenue (GTR)	14.3	12.1	11.7
Corporation Tax	4.0	-6.0	10.5
Income tax	30.5	25.5	16.1
Union Excise duties	-4.5	4.2	5.1
CGST	13.8	10.4	12.2
Customs duty	20.2	12.9	8.7
Non-Tax Revenue (NTR)	69.2	59.6	45.2

Note: * net of states' share in central taxes and collections under NCCD to be transferred to NDRF.
Source: Controller General of Accounts (CGA); Union Budget

The States: Setting aside large inter-state variations, 'all state governments' as a group have also performed well in own tax revenue mobilization. On average own revenues accounted for 68 percent of total revenue of states and their own tax revenue (OTR) accounted for 91 percent of total own revenues. This key component of states' revenue registered a growth of 9 percent during Apr-Aug 2024. In 2024-25, the combined all-states OTR has been budgeted to grow by 14.5 percent, the implied buoyancy being greater than 1 if nominal GDP grows by 10.5 percent.

The growth in central transfers, the other component of states' revenues, has been negligible at 1.4 percent during Apr-Aug 2024 with 9 states reporting a decline (Figure 10). Devolution increased by 18 percent on average. However, this was mostly off-set by a 31 percent decline in grants. Grants declined in all the states except Uttar Pradesh, Maharashtra and Karnataka. For 2024-25, the all-states combined budget indicates a 11 percent increase in devolution but a 6 percent decline in grants.

Figure 10: State-wise growth in central transfers: Y-o-Y (%) Apr-Jan 2023-24



Source: Comptroller and Auditor General of India (C&AG)

On the expenditure side, during Apr-Aug 2024 the combined capex of all states contracted by 6.7 percent. Large variations notwithstanding, capex contracted in most states during this period. The combined revenue expenditure of all states, which account for about 89.5 percent of states' total expenditure, grew by 11 percent. As a result the total expenditure of all states grew by 9 percent on average during Apr-Aug 2024. The Union government has been incentivising states to increase their capex through a scheme for Special Assistance to States for Capital Investment wherein it provided 50-years interest free capital expenditure loans to states. In 2022-23 the provision for loans under this scheme was Rs 1 trillion, which was increased to Rs. 1.3 trillion in 2023-24 and further to Rs. 1.5 trillion in 2024-25. Despite this, capex is budgeted to increase by a modest 5.6 percent in the all states combined budget.

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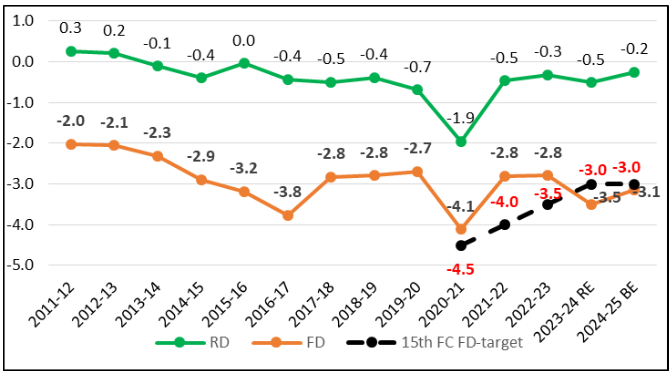
States' fiscal consolidation has been resumed post-pandemic. Although the all-state combined fiscal deficit as percent of GDP increased to 3.5 percent in 2023-24RE from 2.8 percent in 2022-23 (Figure 11), in 2024-25 it is budgeted to improve to 3.1 percent, close to the 15th FC target of 3 percent. The all-state combined liabilities are projected at 28.3 percent of GSDP in 2024-25, which is well below the 15th FC recommended level of 32.8 percent.

Figure 11: Deficits - States (% of GSDP)



Source: Finance Accounts and Budget documents of states; MoSPI; Report of 15th Finance Commission

While the all-states liabilities, centre's liabilities and combine liabilities of centre and states are all within the 15th FC recommended levels, the budgeted combined fiscal deficit of centre and states in 2024-25 at 8 percent of GDP is higher than the 15th FC prescribed limit of 7.3 percent.

A summary of key takeaways

Real GDP is projected to grow at 7 per cent in FY 2024-25 on top of 7 per cent and 8.2 per cent in FY 2022-23 and FY 2023-24 respectively. This implies that despite adverse global conditions, the economy is back to the high growth path of 7-8 per cent achieved before 2017-18.

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Some growth moderation is observed in Q1 2024-25 due to contraction in Govt. consumption (Model Code of Conduct). This is despite the pick-up in private consumption growth and narrowing of the trade deficits. Looking at components of production on the supply side, growth has been moderate in tourism, travel and financial services as well as industrial growth in the first half of FY 2024-25.

Headline inflation exceeded the upper limit of RBI's tolerance band in October 2024 owing to soaring food price inflation and a rebound in core and energy price inflation. Our annual inflation forecast of 5.6 per cent for FY 2024-25 is well above the 4 per cent policy target. Key risk factors are high food inflation and rebound in core and energy price inflation

During the first half of FY 2024-25, merchandise export growth was subdued due to geo-political disruption and reduced global demand. The merchandise trade deficit more than offset the services trade surplus, leading to a rise in the overall trade deficit. In Q1 FY 2024-25, the external financial account experienced a slowdown in portfolio flows due to global risks and election related uncertainty, but a rise in FDI flows. The sustained increase in forex reserves to over $ 700 billion by September 2024 was followed by a decline in October. The rupee-dollar exchange rate remained stable with REER depreciating mildly in September along with a decline in volatility. These trends are attributable to RBI interventions.

In monetary policy, the policy rate has been unchanged at 6.5 per cent since February 2023, while the stance was changed to neutral in the October meeting of MPC. The weighted average call rate has remained aligned to the policy rate while the yields on government bonds have converged and trended downwards across maturities. Bank credit growth has moderated in recent months due to deceleration of growth in personal loans and growth of credit to services. Foreign Portfolio Investors were net buyers in the Indian markets from June to September but turned net sellers in October.

On the fiscal front, central government's tax revenue has been very buoyant. The Centre has used this fiscal space to continue its massive thrust to capex alongside fiscal consolidation. The capex boost includes a 50 year zero interest capex loan to States which was raised to Rs. 1.5 trillion in 2024-25 from Rs. 1.3 trillion in 2023-24. There are large variations across states in fiscal performance. Notwithstanding this, growth in revenues of states is largely driven by own tax revenue. On average, the growth in central transfers to states has been modest with a large increase in devolution being mostly offset by reduction in central grants. Despite central government's push to increase states' capex, all-state capex contracted. Growth in states' total expenditure is mainly attributable to the increase in revenue expenditure, which accounts for about 90 percent of total expenditure. States' post-pandemic fiscal consolidation has been resumed. The budgeted all states fiscal deficit of 3.1 percent in 2024-25 is close to the 3 percent target set by 15th FC while debt to GSDP ratio is well below 15th FC target.