STATE OF THE ECONOMY

PART 1

ECONOMIC SURVEY VOL. 2 CHAPTER 1

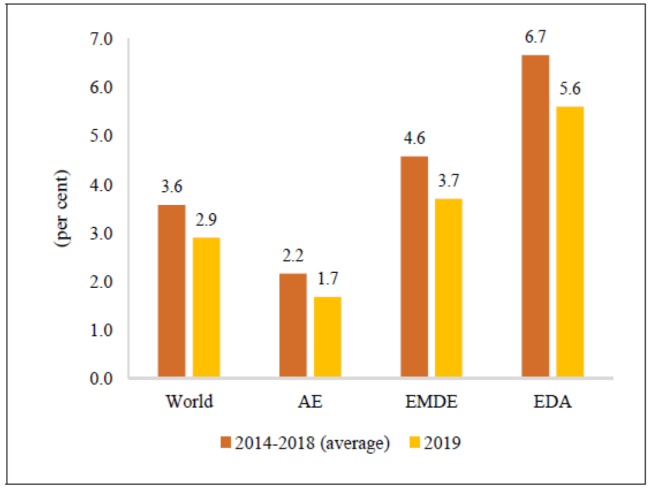
CHAPTER AT A GLANCE

- The year 2019 was a difficult year for the global economy with world output growth estimated to grow at its slowest pace of 2.9 per cent since the global financial crisis of 2009, declining from a subdued 3.6 per cent in 2018 and 3.8 per cent in 2017.
- Amidst a weak environment for global manufacturing, trade and demand, the Indian economy slowed down with GDP growth moderating to 4.8 per cent in H1 of 2019-20, lower than 6.2 per cent in H2 of 2018-19.
- A sharp decline in real fixed investment induced by a sluggish growth of real consumption has weighed down GDP growth from H2 of 2018-19 to H1 of 2019-20. Real consumption growth, however, has recovered in Q2 of 2019-20, cushioned by a significant growth in government final consumption.
- On the supply side, the deceleration in GVA growth has been contributed generally by all sectors save 'Agriculture and allied activities' and 'Public administration, defence, and other services', whose growth in H1 of 2019-20 was higher than in H2 of 2018-19.
- India's external sector gained further stability in H1 of 2019-20, with a narrowing of current account deficit (CAD) as percentage of GDP from 2.1 in 2018-19 to 1.5 in H1 of 2019-20, impressive foreign direct investment (FDI), rebounding of portfolio flows and accretion of foreign exchange reserves. Imports have contracted more sharply than exports in H1 of 2019-20, with easing of crude prices, which has mainly driven the narrowing of CAD.
- Headline inflation rose from 3.3 per cent in H1 of 2019-20 to 7.35 per cent in December 2019-20 on the back of temporary increase in food inflation, which is expected to decline by year end. Rise in CPI-core and WPI inflation in December 2019-20 suggests building of demand pressure.
- The deceleration in GDP growth can be understood within the framework of a slowing cycle of growth. The financial sector acted as a drag on the real sector: investment-growth-consumption, as described in the Economic Survey of 2018-19.
- In an attempt to boost investment, consumption and exports, the government in 2019-20 has taken important reforms towards speeding up the insolvency resolution process under Insolvency and Bankruptcy Code (IBC), easing of credit, particularly for the stressed real estate and NBFC sectors, and announcing the National Infrastructure Pipeline 2019-2025 amongst other measures.
- Based on CSO's first Advance Estimates of India's GDP growth for 2019-20 at 5 per cent, an uptick in GDP growth is expected in H2 of 2019-20. The government must use its strong mandate to deliver expeditiously on reforms, which will enable the economy to strongly rebound in 2020-21.

INTRODUCTION (BACKGROUND)

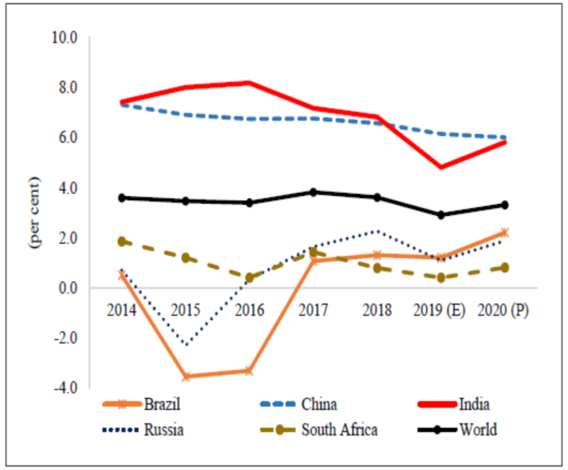
- 2019 was a difficult year for the global economy
- World output growth estimated to grow at its slowest pace of 2.9 per cent since the global financial crisis of 2009
- Uncertainties, although declining, are still elevated due to protectionist tendencies of China and USA and rising USA-Iran geo-political tensions.

Figure 1: Growth of global output



Data Source: World Economic Outlook, October 2019 database and January 2020 update
Note: AE – Advanced Economies, EMDE – Emerging Market and Developing Economies, EDA – Emerging and Developing Asia.

Figure 2: Growth of individual BRICS countries

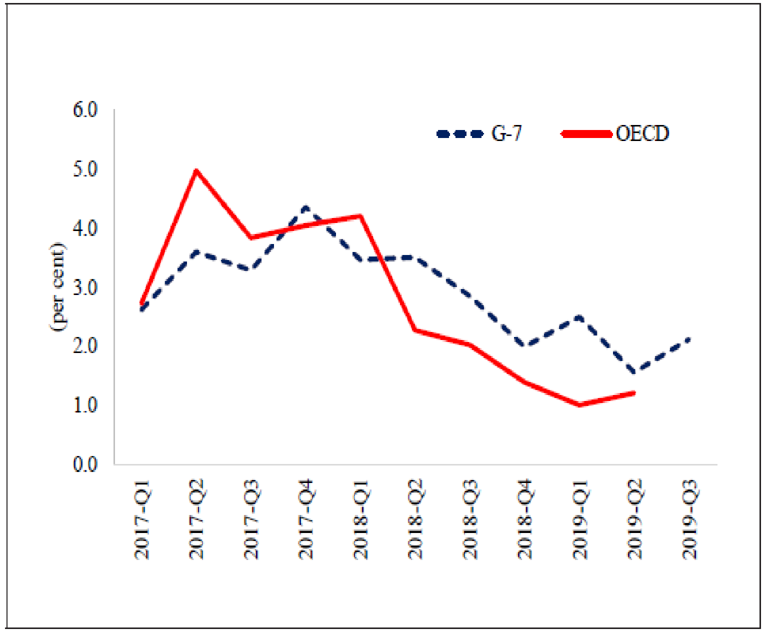


Data Source: World Economic Outlook, October 2019 database and January 2020 update
Note: E – Estimates of IMF, P – Projections of IMF

- Amidst a weak environment for global manufacturing, trade and demand, the Indian economy slowed down with GDP growth moderating to 4.8 per cent in the first quarter of 2019-20.
- A sharp decline in real fixed investment induced by a sluggish growth of real consumption has weighed down GDP growth.
- The deceleration in GDP growth can be understood within the framework of a slowing cycle of growth with the financial sector acting as a drag on the real sector.
- In an attempt to boost demand, 2019-20 has witnessed significant easing of monetary policy with the repo rate having been cut by RBI by 110 basis points.
- Speeding up the insolvency resolution process under Insolvency and Bankruptcy Code (IBC) and easing of credit, particularly for the stressed real estate and Non-Banking Financial Companies (NBFCs) sectors.
- Measures taken to boost investment, particularly under the National Infrastructure Pipeline.
- It is imperative that the Government deliver expeditiously on reforms, which will enable the economy to strongly rebound in 2020-21.

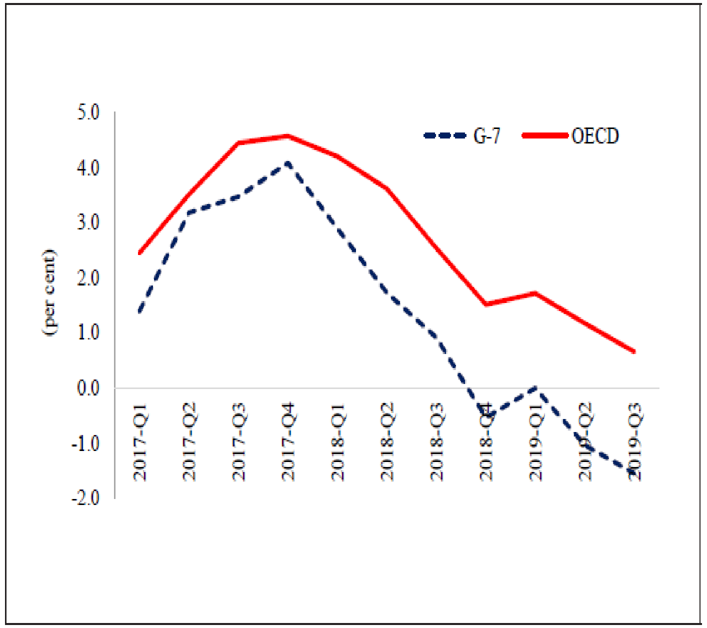
- Along with the weakening of global economic activity, inflation the world over also remained muted in 2019 reflecting a slack in consumer demand.
- From the supply side, lower energy prices in 2019 also contributed to softening of inflation.
- The global slack in consumer demand affected industrial activity, which slumped in most of the major economies in 2019.
- As global industrial activity slowed down, there was a drop in growth of manufacturing exports from major economies.
- Increasing trade barriers as well as trade uncertainty stemming from growing trade tensions also weakened business confidence and further limited trade. India’s manufacturing exports also fell.

Figure 4: Growth of fixed investment



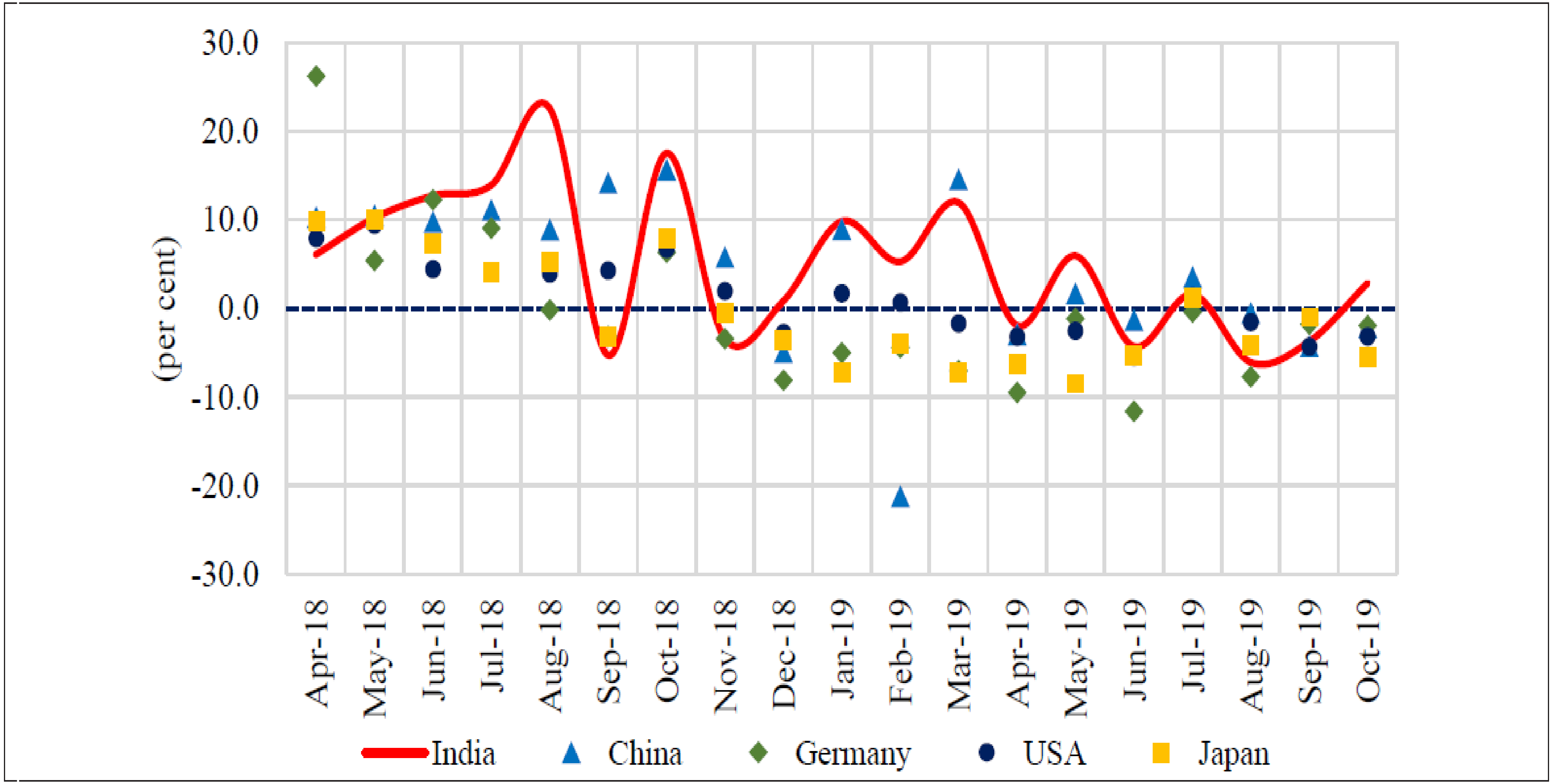
Data Source: OECD database
Note: Quarters are on calendar year basis.
G-7 refers to the group of seven large advanced economies in the world; namely Canada, France, Germany, Italy, Japan, the United Kingdom and the United States

Figure 5: Growth of index of manufacturing production



Data Source: OECD database
Note: Quarters are on calendar year basis.
OECD is the Organisation for Economic Co-operation and Development with 36 member countries.

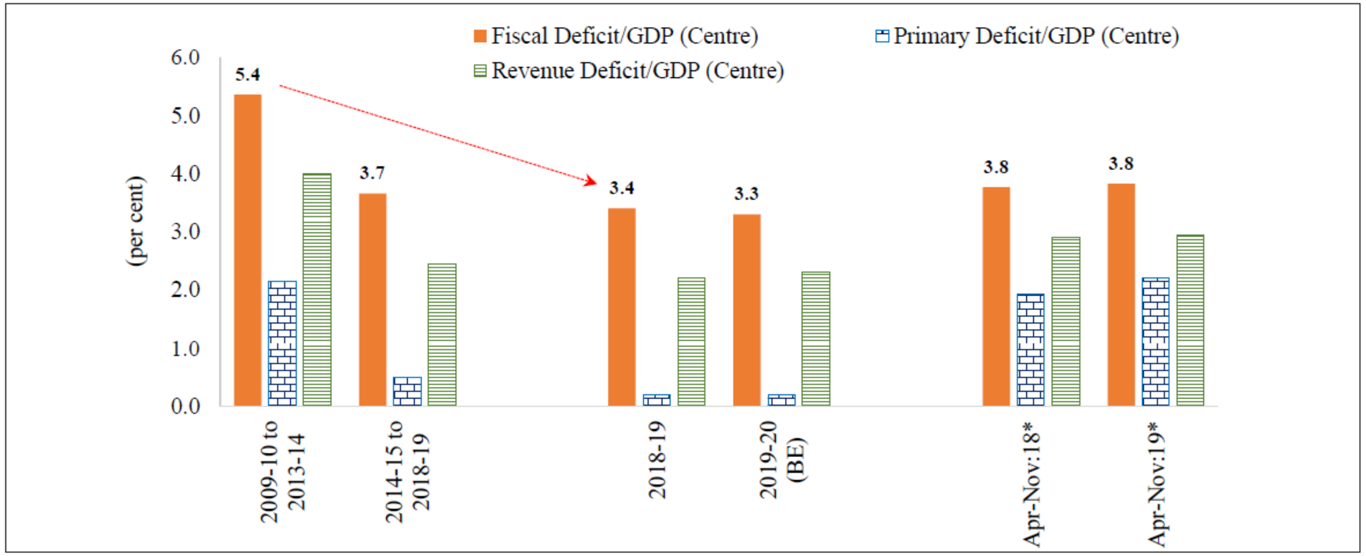
Figure 6: Non-agriculture, non-fuel merchandise export[1] growth



Data Source: Trade Map Database

- **Fiscal Situation**
- In 2019-20, Centre's fiscal deficit was budgeted at 3.3 per cent of GDP as compared to 3.4 per cent of GDP in 2018-19
- In the first eight months of 2019-20, fiscal deficit stood at 114.8 per cent of the budgeted level .
- Net Tax revenue to the Centre, which was envisaged to grow at more than 25 per cent in 2019-20 relative to 2018-19, grew at 2.6 per cent during April to November 2019, which was nearly half its' growth rate for the corresponding period last year.
- On the expenditure side, the budgeted expenditure of the Central government grew at 12.8 per cent in April-November 2019 over the corresponding period of the previous year, expending almost 60 per cent of the budget.

Figure 12: Gross Fiscal Deficit (Centre) as percentage of GDP



Data Source: Union Budget and CGA
Note: * : The figures for 2018 are with respect to GDP (PE) data for 2018-19 and figures for 2019 are provisional and with respect to budgeted GDP for 2019-20.

- The National Statistical Office (NSO) has estimated India's GDP to have grown at 4.8 per cent in the first half (H1) (April-September) of 2019-20, the deceleration in GDP growth has been contributed generally by all sectors save 'Agriculture and allied activities' and 'Public administration, defence, and other services',

- On the demand side, the deceleration in GDP growth was caused by a decline in the growth of real fixed investment in H1 of 2019-20 when compared to 2018-19 induced in part by a sluggish growth of real consumption.

- However, growth of real consumption started picking up in Q2 of 2019-20, mostly driven by a significant jump in government final consumption.

- Growth of private final consumption expenditure also picked up in the same quarter.

Table 2: Quarter wise growth of real Gross Value Added (GVA) and GDP (per cent)

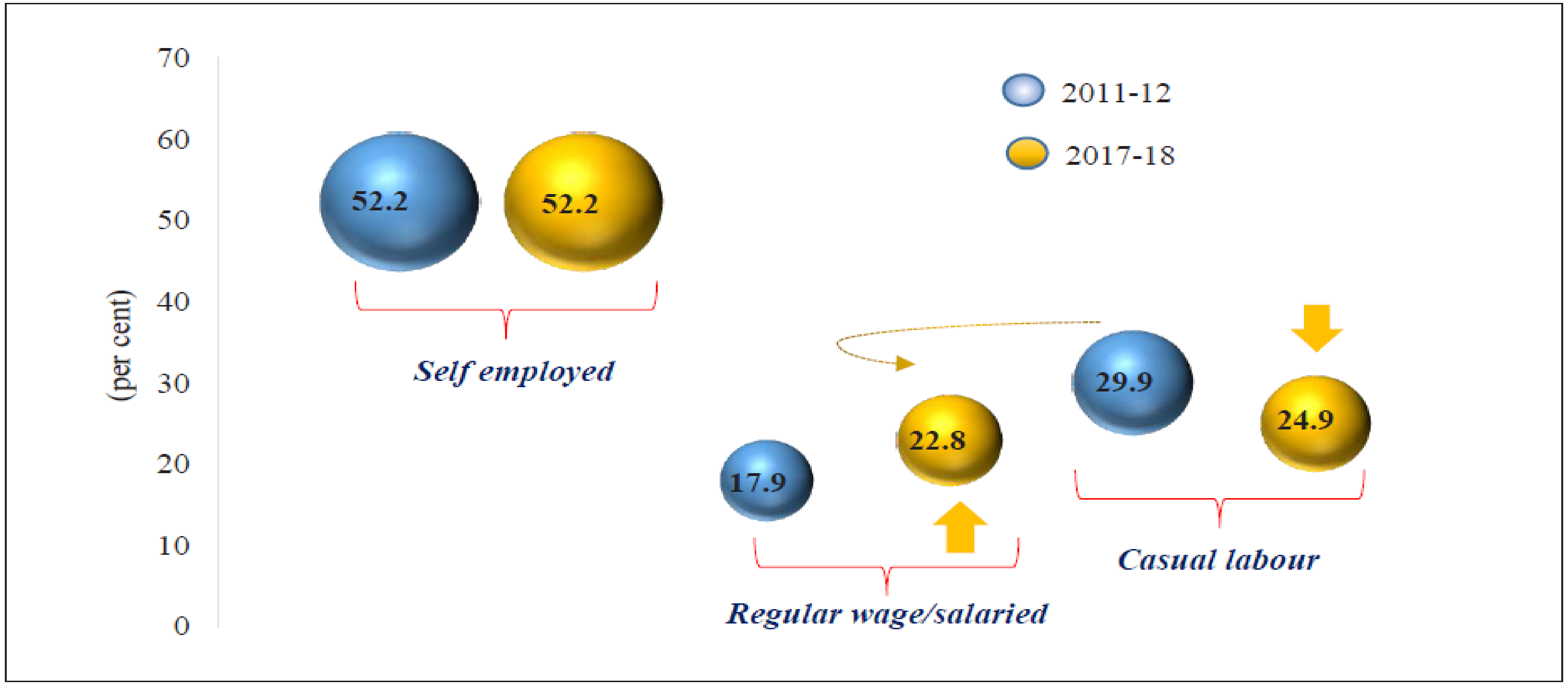
	2018-19				2019-20	
	Q1	Q2	Q3	Q4	Q1	Q2
GVA at basic prices	7.7	6.9	6.3	5.7	4.9	4.3
Agriculture, forestry & fishing	5.1	4.9	2.8	–0.1	2.0	2.1
Industry	9.8	6.7	7.0	4.2	2.7	0.5
Services	7.1	7.3	7.2	8.4	6.9	6.8
GDP at market prices	8.0	7.0	6.6	5.8	5.0	4.5

Data Source: National Statistical Office

- **Inflation**
- In H1 of 2019-20, CPI (Headline) inflation was estimated at 3.3 per cent, slightly higher than that in H2 of the previous year.; Contributed mainly by supply-side factors.
- The food prices spiked following unseasonal rainfall and a flood-like situation in many parts of the country, which affected agricultural crop production.
- Core inflation (headline less food and fuel inflation) further reflects the state of demand in the economy.
- There has been a secular moderation in CPI-core inflation which also reflects a weakening of demand pressure in the economy.
- **Employment: Formal vs Informal**
- There has been an increase in the share of formal employment, as captured by ‘Regular wage/salaried’, from 17.9 per cent in 2011-12 to 22.8 per cent in 2017-18 (Figure 11).
- This 5 percentage points increase in the share of ‘Regular wage/salaried’ group has been on account of 5 percentage points decrease in the share of casual workers, which reflects formalization in the economy.
- As a result, in absolute terms, there was a significant jump of around 2.62 crore new jobs over this period in the usual status category with 1.21 crore in rural areas and 1.39 crore in urban areas.

- The proportion of women workers in 'Regular wage/salaried' employees' category has increased by 8 percentage points (from 13 percent in 2011- 12 to 21 per cent in 2017-18) with addition of 0.7 crore new jobs for female workers in this category.
- The drop in casual labour has mainly originated from the rural sector where rural labourers have shifted from agricultural to industrial and services activity.
- In urban region, there has been a shift of employment from self-employed to salaried jobs

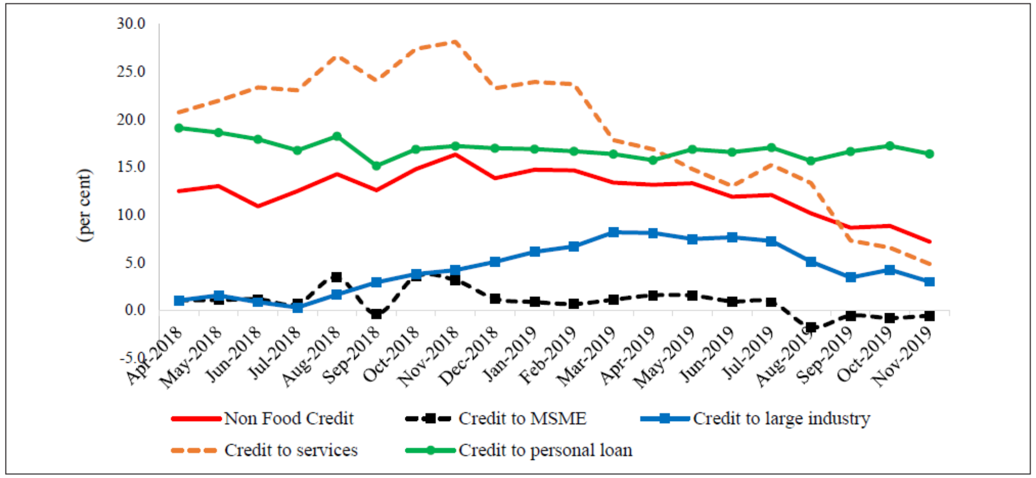
Figure 11: Distribution of workers by all ages in usual status (PS+SS) by statuses in employment



Data Source: Periodic Labour Force Survey 2017-18, Ministry of Statistics & Programme Implementation
Note: PS- Principal Status, SS- Subsidiary Status.

- **Monetary Policy and Credit Growth**
- The stance of the Monetary Policy Committee of Reserve Bank of India continued to be accommodative as it reduced the policy repo rate by 135 basis points since February 2019.
- The rate cut along with excess liquidity in banks was expected to transmit well into lowering interest rates.
- However, the transmission has varied across different market segments (Figure 13)
- The deceleration in credit growth was witnessed across all major segments of non-food credit, save personal loans which continued to grow at a steady and robust pace.
- The deceleration in credit growth was most in the services sector.
- Credit growth to industry also witnessed a significant decline in recent months, both for MSME sector as well as large industries.
- Agriculture and allied activities benefited from a higher growth of credit (Figure 14).
- Decline in credit growth has been attributed to growing risk aversion of banks that continue to apprehend the build-up of Non-Performing Assets (NPAs).
- This is despite the admission of more than 2000 corporate insolvency resolution processes between December 2016 and June 2019.
- The IBC process contributed to reducing the NPAs from 11.2 per cent of gross advances in March 2018 to 9.3 per cent in March 2019.
- However, the NPA ratio remains the same six months forward, at 9.3 per cent, in end September 2019.

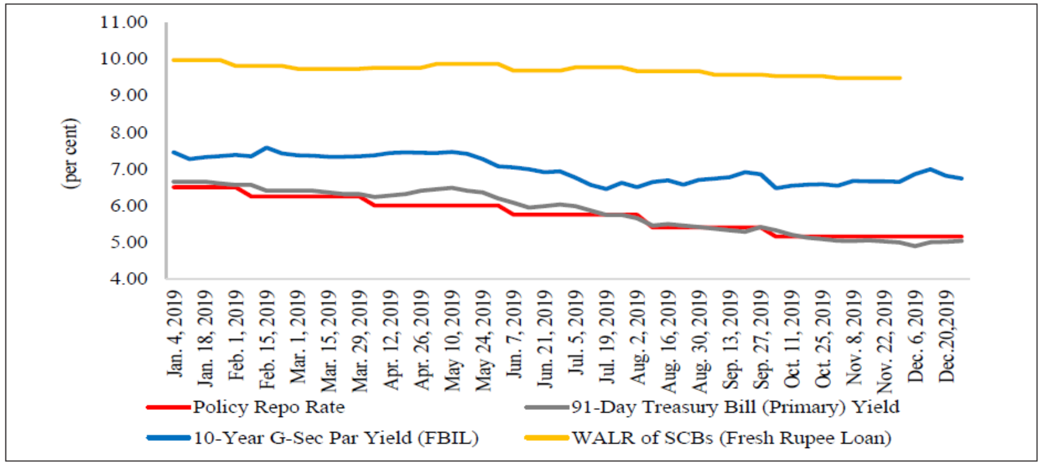
Figure 14: Growth of non-food bank credit



Data Source: RBI

Note: Growth of sectoral credit corresponds to select 41 Scheduled Commercial Banks.

Figure 13: Policy rate, yield and lending rate



Data Source: RBI

Note: WALR refers to Weighted Average Lending Rate

- The prospects of easy investment in G-secs is possibly due to the risk aversion being displayed by SCBs.
- During the first eight months of 2019-20, scheduled commercial banks mobilized the same amount of deposits as in the corresponding period of the previous year.
- Yet, the SCBs chose to invest thrice the amount in G-secs in the current year, as compared to the previous year while reducing their credit off-take by more than four-fifths.
- It appears that risk aversion towards lending to the private sector has increased in 2019 (Table 4).

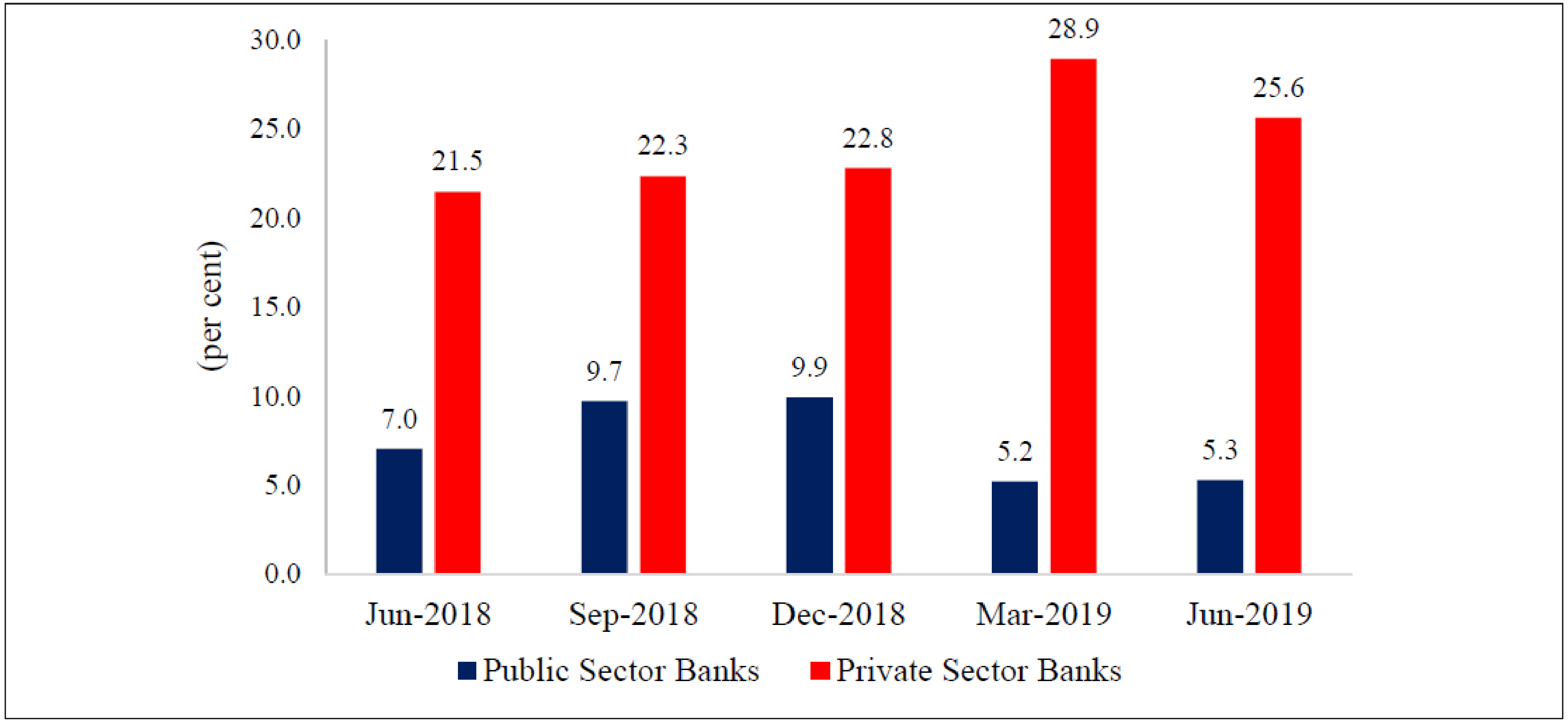
Table 4: Net Scheduled Commercial Bank Credit (in ₹ lakh crore)

	April-November	
	2018-19	2019-20
Net Credit of Scheduled Commercial Banks	5.07	0.89
Net Aggregate Deposits of Scheduled Commercial Banks	3.87	3.85
Incremental Credit-Deposit Ratio (per cent)	131.0	23.1
Investment in Government Securities	1.07	3.37

Data Source: RBI

- The risk aversion to lending to the private sector appears to be relatively more in respect of Public Sector Banks (PSBs).
- As Figure 15 shows, growth of credit from the PSBs was not only much lower than that of private sector banks but credit growth of PSBs also dipped sharply from December 2018 onwards.

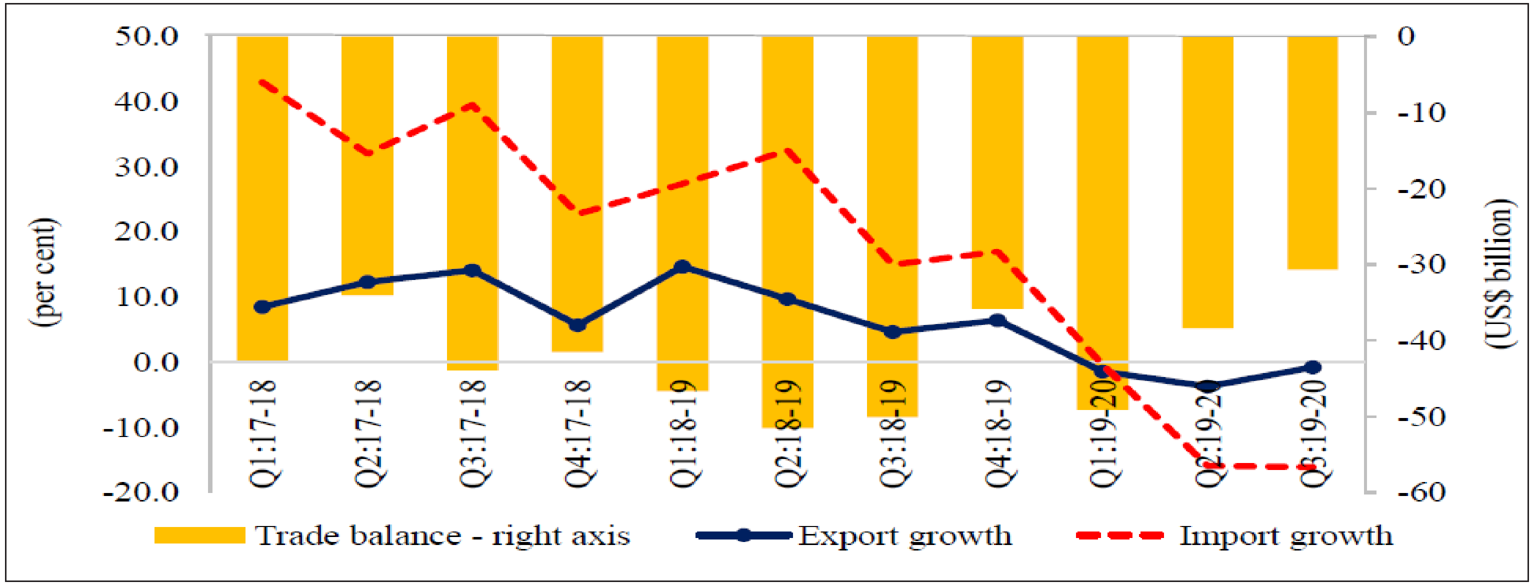
Figure 15: Growth in credit of Public & Private Sector Banks



Data Source: RBI

- **External Sector Performance**
- Contraction in import bill, partly contributed by a decline in oil prices
- Slower contraction of exports from a pick-up in global activity.
- The depreciation of real exchange rate since July 2019 may have been supportive of resurgence in India's exports (Figure 18), though the evidence for exchange rate depreciation contributing to exports seems tenuous (Volume 1, Chapter 5).
- Despite muted growth of services exports, the trade balance on the services account continued to be positive in 2019-20.

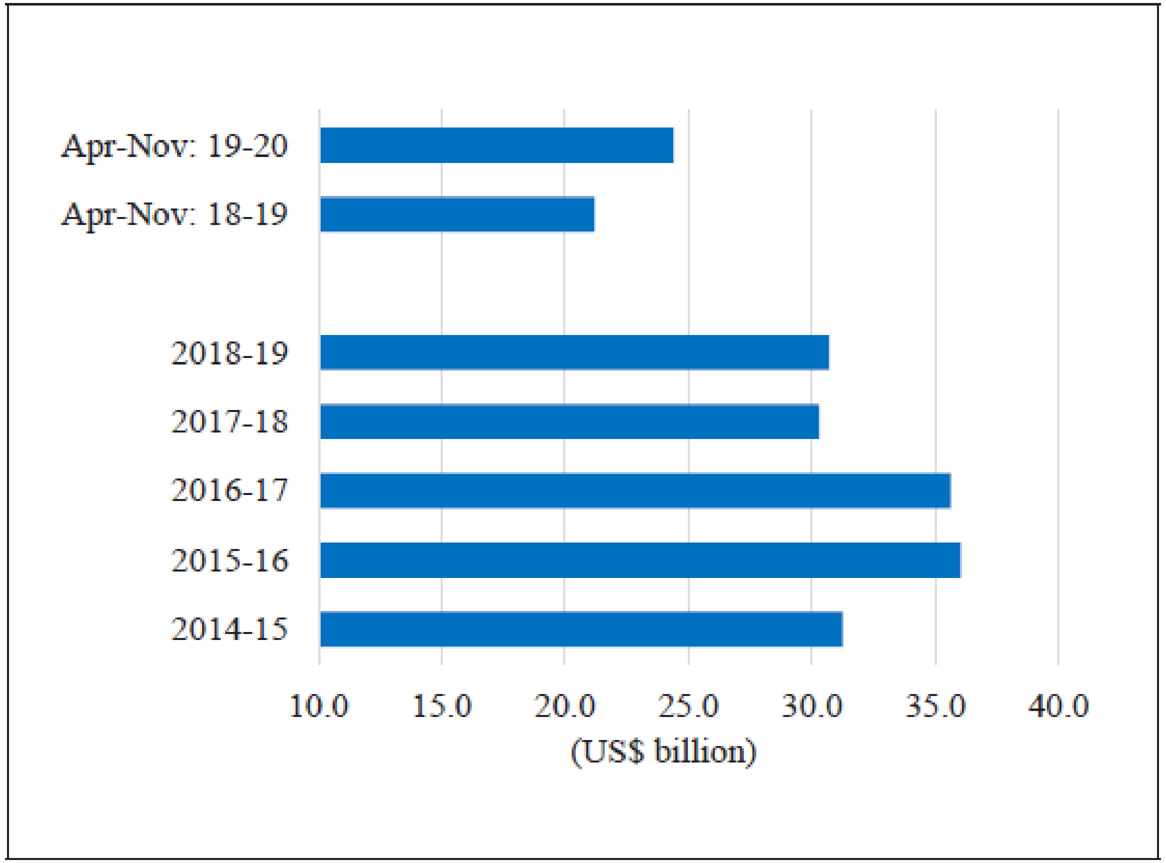
Figure 16: Growth of merchandise exports and imports



Data Source: Department of Commerce, Ministry of Commerce and Industry

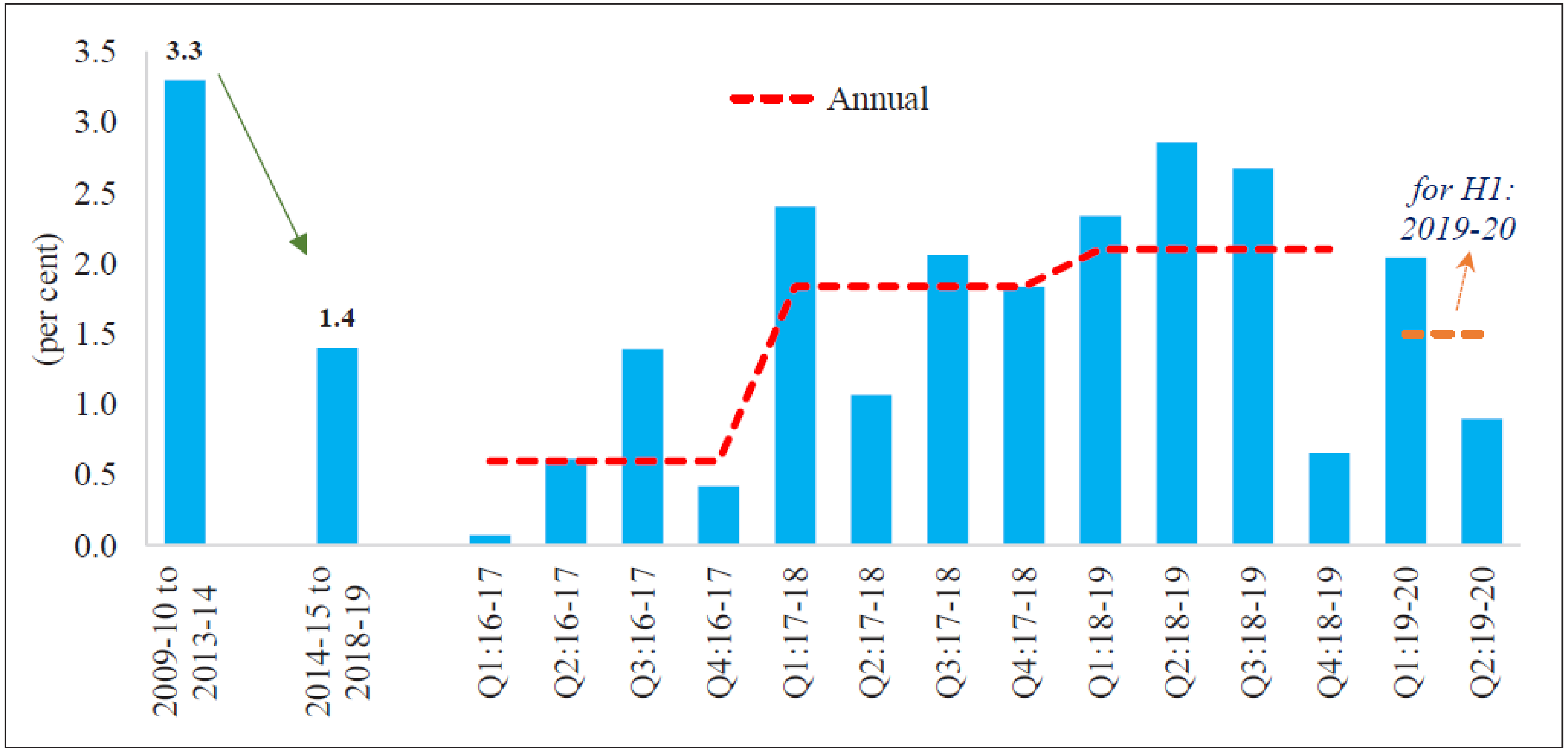
- Lower Current Account Deficit (CAD) reflects reduced external indebtedness of the country making domestic economic policy increasingly independent of external influence.
- The CAD, which was 2.1 per cent of GDP in 2018-19, has improved to 1.5 per cent in H1 of 2019-20 on the back of significant reduction in trade deficit (Figure 20).
- Foreign Direct Investment (FDI) provides a more stable source of financing the CAD as compared to external borrowings.
- During 2014-19, gross FDI to India has been robust as compared to the previous five years; the trend has continued in 2019-20 as well (Figure 21)
- Consequent to the improvement in current account and higher capital flows into the country, the Balance of Payments (BoP) position of the country has improved

Figure 21: Net annual FDI inflows



Data Source: RBI's monthly bulletins

Figure 20: Current Account Deficit as percentage of GDP



Data Source: RBI

- **Sectoral developments**
- Share of agriculture and allied sectors in the total GVA of the country has declined from 2009-14 to 2014-19 mainly on account of relatively higher growth performance of tertiary sectors.
- This is a natural outcome of the development process that leads to faster growth of non-agricultural sectors.
- The contribution of industrial activities to GVA has also declined from 2009-14 to 2014-19.
- Manufacturing sector, which contributes more than 50 per cent of industrial GVA, has driven the decline while the share of construction sector has also moderated.
- Services sector has moved ahead faster, distancing itself further from agriculture and industry.
- Financial, real estate and professional services has driven the increase in the contribution of service sector followed by public administration.
- Even globally, the services sector has supported global growth partly offsetting the decline in manufacturing activity.

Table 5: Sectoral shares in GVA (per cent)

	2009-10 to 2013-14	2014-15 to 2018-19	2018-19	H1: 2019-20
Agriculture, forestry & fishing	18.3	17.4	16.1	13.9
Industry	32.3	29.6	29.6	28.3
Mining & Quarrying	3.2	2.4	2.4	2.1
Manufacturing	17.5	16.6	16.4	15.4
Electricity, Gas, Water supply & other utility services	2.4	2.6	2.8	2.9
Construction	9.2	8.0	8.0	8.0
Services	49.4	52.9	54.3	57.8

Part 2: Projections and Outlook

Next PPT (Pages 16-35 of the Economic Survey, Vol 2, Chapter 1)

THANK YOU

-Anushruti