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INDIA DEVELOPMENT UPDATE

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Preface

The India Development Update (IDU) reports on recent developments in India's economy and places these in a global context. Based on these developments and on policy changes over the period, the IDU updates the outlook for India's economy.

The report is prepared by a team from the Macroeconomics, Trade and Investment (MTI) Global Practice, under the guidance of Auguste Tano Kouame (Country Director), Mathew A. Verghis (Regional Director), and Hoon Sahib Soh (Practice Manager). The team is led by Dhruv Sharma (Senior Economist) and comprises Kanika Bhatnagar, Tanvir Malik, Emilia Skrok, Mohini Gupta, Nayantara Sarma, Nandini Krishnan, Naresh Kumar, Rishabh Choudhary and Kavya Singh.

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1. Executive Summary

India's growth continued to be resilient, despite some signs of a moderation in the second half of FY22/23

Global economic activity slowed in the second half of 2022 on the back of synchronized monetary policy tightening, deteriorating financial conditions and ongoing inflationary pressures. However, the reopening of China's economy and stronger than expected growth outcomes in the United States and euro area at the end of 2022 are providing some tailwinds to growth in 2023. Although significant challenges remain in the global environment, India was one of the fastest growing economies in the world with real GDP growing 7.7 percent year-on-year during Q1-Q3 fiscal year 2022/23 (April-March, FY22/23). Growth was underpinned by robust domestic demand – strong investment activity bolstered by the government's capex push and buoyant private consumption, particularly among higher income earners. While the overall growth momentum remains robust and real GDP growth for FY22/23 is estimated to be 6.9 percent, there were signs of moderation in Q3 as growth slowed to 4.4 percent year-on-year (y-o-y). There was also a change in the composition of domestic demand in Q3 FY22/23 with a lower share from government consumption as fiscal consolidation efforts continued. Estimates suggest that the pandemic induced a spike in extreme poverty ($2.15), of up to 4 percentage points, moderated in FY21/22.[1] Facilitated by widespread access to vaccines, extreme poverty rates are estimated to have declined to 13.8 percent in FY21/22, although not as low as pre-pandemic levels. Continued poverty reduction in FY22/23 will depend on how the economic rebound translates into productive jobs for the bottom half of the population and the welfare implications of fiscal consolidation efforts.

Inflation moderated in the second half of 2022 but remains above the upper threshold of the central bank's target range…

Headline inflation averaged around 6.6 percent in FY22/23. Average inflation in H2 FY22/23 was almost 1 percentage point lower than the first half as inflationary pressures began to taper and the combination of supply side measures (such as export restrictions) and monetary policy tightening began to take effect. Notwithstanding the moderation, headline inflation remains above the Reserve Bank of India's (RBI) target range of 2–6 percent. The gradual moderation in price pressures was led by a decline in food inflation (the single largest component of headline inflation) and easing fuel prices on the back of softening in global oil prices. However, the core inflation remained elevated in FY22/23, averaging around 6.1 percent over the fiscal year. While there was some tapering in domestic demand growth in Q3, it remained the main reason for the stickiness in core inflation. An improving traditional market services sector (trade, hospitality, transport and storage and, communication) also played a role in propping up core inflation.

… and the RBI has been raising rates

Elevated inflationary pressures continued to drive monetary policy decision making despite growing headwinds against growth prospects. Since May 2022 the RBI's Monetary Policy Committee (MPC) has hiked the repo rate (its main policy rate) by 250 basis points. The nominal policy rate is 6.5 percent while the real rate is now heading closer to positive territory after being negative for most of FY22/23.

The current account deficit narrowed in Q3 FY22/23 as commodity prices eased

The current account deficit narrowed from 3.3 percent of GDP in H1 FY22/23 to 2.2 percent in Q3 FY22/23. While service exports remained robust, softening global demand weighed particularly on merchandise goods exports, which limited overall export growth. Robust domestic demand supported strong capital goods imports, but signs of weakness emerged in Q4 as private consumption activity began to moderate. Easing global commodity prices also played a critical role in reducing pressure on import growth. The

[1]Estimates are based on the methodology documented in a World Bank Policy Research Working paper by Roy and van der Weide (2022), which relies on imputed consumption from the Consumer Pyramid Household Surveys (CPHS) implemented by the Centre for Monitoring the Indian Economy, a private data company. The CPHS sample is re-weighted to make it more nationally representative. The series has been revised to incorporate recent survey years.

current account balance remains adequately financed by robust net capital inflows and foreign direct investment inflows. The rupee has depreciated by 9.1 percent since April 2022, but the pace of depreciation showed signs of slowing in H2.

The government remains on track to meet its fiscal deficit target for FY22/23 thanks to strong revenue growth

Robust nominal GDP growth bolstered revenue collection during Q1-Q3 FY22/23. The highlight continued to be the performance of the Goods and Services Tax (GST) with average growth of over 20 percent year-on-year. According to the government's revised estimates, tax revenues were about 8 percent higher than budgeted and 15.6 percent higher than the previous year. On the expenditure side, the announcement of several support measures to offset the impact of inflationary pressure caused current spending to exceed budget estimates by 8 percent, largely due to increased allocation for income support measures like the food subsidy, fertilizer subsidies and Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA). Capital spending was only 3 percent lower than budgeted but 22 percent higher than the previous year and reached an all-time high level of 2.7 percent of GDP. Overall, the central government is likely to meet its fiscal deficit target of 6.4 percent in FY22/23. The general government fiscal deficit – the combined deficit of the Centre and States – is estimated to have declined further to 9.4 percent in FY22/23 from 13.3 percent of GDP in FY20/21. Public debt is also estimated to decline to 84.3 percent of GDP in FY22/23, from a peak of 87.6 percent in FY20/21.

Growth is projected to moderate to 6.3 percent in FY23/24, constrained by slower consumption growth, fiscal consolidation and challenging external conditions

Although India's economy has been relatively resilient to challenging external conditions, real GDP growth is likely to moderate to 6.3 percent in FY23/24 from the estimated 6.9 percent in FY22/23. Domestic demand is likely to remain robust despite an expected tempering of consumption growth. Consumption is expected to be constrained by rising borrowing costs, slower income growth and continued fiscal consolidation. Investment activity is expected to be supported by the government's sustained capex-push and improved corporate and banking sector balance sheets due to healthy corporate profits and a reduction in non-performing loans (NPLs), respectively. Moderating consumption growth, easing global commodity prices and the lagged effect of monetary policy tightening is expected to bring headline inflation within the RBI's target range despite core inflation remaining elevated. On the external front, the negative contribution of net exports will be smaller due to the strong performance of service exports and a gradual decline in the import bill. The narrowing trade deficit will contribute to the current account deficit reducing to 2.1 percent from around 3 percent in FY 22/23. The general government deficit will likely consolidate by 0.7 percentage points to 8.7 percent in FY23/24 due to continued, albeit slower, revenue growth and lower current spending, reflecting the withdrawal of pandemic-related support programs. The lower projected fiscal deficit will stabilize the debt-to-GDP ratio at around 83 percent.

There are some downside risks to India's growth in FY23/24

Despite resilience amid slowing global growth, there are headwinds to India's growth in FY23/24. Recent financial sector turmoil in the US and Europe could reduce appetite for emerging market assets, trigger another bout of capital flight and put pressure on the Indian rupee. Tighter global financial conditions could also weigh on the risk appetite for private investment in India. Notwithstanding external pressures, Indian banks are well capitalized, and the impact of policy tightening on bank balance sheets has been less severe in India due to the relatively modest pace of tightening. Moreover, faster-than-expected inflation due to higher food or fuel prices may also weigh on domestic demand. These downside risks to growth could affect fiscal consolidation plans. The debt path is highly sensitive to variation in nominal growth rates and further moderation in economic growth could lead to an increase in the already high public debt-to-GDP ratio.

2. Recent Economic Developments

a. Real sector and inflation

Growth & labor market

Slower growth in the second half of 2022 clouded the global outlook for 2023…

Coming into 2023, the outlook for the world economy was clouded by aggressive monetary policy tightening, deteriorating financial conditions, and declining confidence. Global trade growth slowed in the second half of 2022, mirroring the slowdown in industrial production and economic activity across advanced economies. Economic activity also deteriorated significantly in China, to its slowest pace since the mid-1970s, due to COVID-19 related restrictions, droughts, and ongoing property sector stress.

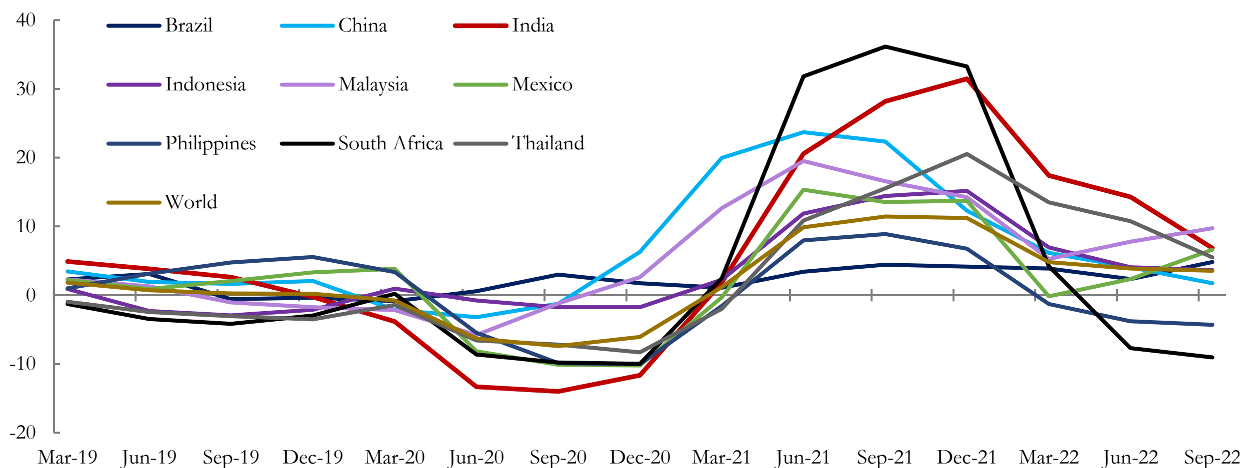
…but high frequency indicators stabilized in early 2023

High frequency indicators improved in January and February, aided by the reopening of the Chinese economy. Services activity showed signs of improvement, but the manufacturing sector continued to show signs of declining activity. Growth outcomes for the United States and the euro area in the fourth quarter of calendar year 2022 were also better than expected. Financial conditions eased in January-February 2023 with an increase in financial flows to emerging Markets and Developing Economies (EMDEs), particularly China, due to improved market sentiment.

Growth in India has been resilient in the face of a challenging global economic environment

Global economic activity has softened, and financial conditions have hardened on the back of a synchronized global monetary policy tightening to manage elevated inflation. Despite these challenging external economic conditions, India was one of the fastest growing major economies in the world in 2022. In the first three quarters of FY22/23, India's real GDP expanded by 7.7 percent y-o-y on the back of robust growth in domestic demand, primarily bolstered by strong investment activity and buoyant private consumption. Net exports, however, were a drag on growth amid slowing global growth weighing on India's merchandise exports and resilient domestic demand pushing up imports. Even so, India's exports, in terms of volume, have performed better than most emerging market economies (EMEs), underscoring the limited impact of global spillovers on the Indian economy (Figure 2.1).

Figure 2.1: The global growth slowdown has had a limited impact on India's exports vis-à-vis other EMEs
(3 quarter moving average, year-on-year change in volume of merchandise exports, percent)



Source: UNCTAD and World Bank staff calculations.
Note: The graph refers to quarters in calendar year terms.

Real GDP growth slowed in Q3 FY22/23 (October-December)

Real GDP grew 4.4 percent year-on-year (y-o-y) in Q3 FY22/23, slower than the 6.3 percent growth in Q2, due to weaker growth in private consumption and contraction in government consumption. Growth in private consumption was lower than the previous two quarters but the contraction in government consumption was even greater, reflecting the withdrawal of pandemic-related stimulus. However, investment grew strongly, despite elevated global commodity prices and rising borrowing costs (Figure 2.2), bolstered by the central government's capex push through infrastructure development projects. Unfavorable global conditions weighed on India's merchandise export growth, but services export growth remained relatively robust. Import growth slowed due to the more modest growth in private consumption. As a result, net exports narrowed from the large deficit in H1 of FY22/23, thus reducing the drag net exports places on growth.

Despite the slowdown in Q3, fiscal year-to-date growth remains strong

In terms of fiscal year-to-date (April-December), real GDP growth was bolstered by a favorable base effect and remained robust at 7.7 percent y-o-y. Strong domestic demand, underpinned by robust consumer spending by higher-income groups and higher public investment, was the main growth driver. However, consumer spending by low-income groups was weak due to slow income growth. On the supply side, contact-intensive services finally exceeded their pre-pandemic level and construction activity increased as well.

The relative importance of private consumption has increased as a share of GDP

The components of robust domestic demand have steadily changed (Figure 2.3) since Q1 FY22/23. The share of government consumption in GDP declined below the long-term average (FY16-FY20) of 10.1 percent over Q2 and Q3 of FY22/23. By contrast, the share of private consumption increased by almost 5 percentage points over its long-term average. While the share of investment in GDP declined in Q3, it was still slightly higher than the FY16-FY20 average. Therefore, the robust domestic demand growth during the first three quarters of FY22/23 was driven by expanding private consumption and investment as government consumption growth lost momentum. This reflects the government's commitment to reduce the share of current spending and pivot to greater capital expenditure. On the external front, the GDP share of exports of goods and services has increased by almost 2ppts above the long-term average and that of imports has increased by about 3ppts. The relatively robust performance of India's exports amid softening global growth was due to buoyant services exports and resilient exports of resource-based and medium and high-technology goods[2].

[2] Resource-based manufacturers include chemicals and related products and, petroleum crude and products. Medium and High-technology products include medical and surgical instruments, electronics items, machinery, office equipment, transport equipment and project goods.

Figure 2.2: Growth was bolstered by investment in Q3 FY22/23

(Contribution to GDP growth, percentage points, y-o-y)

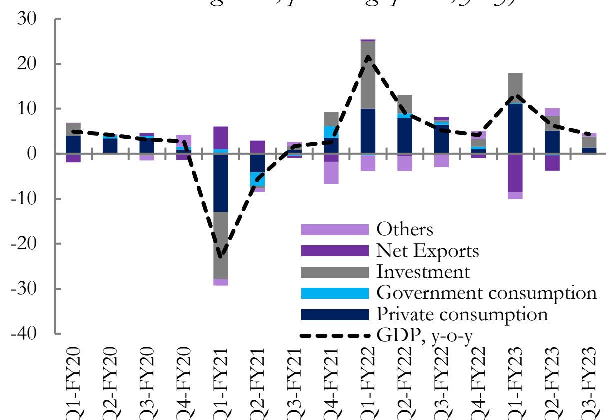
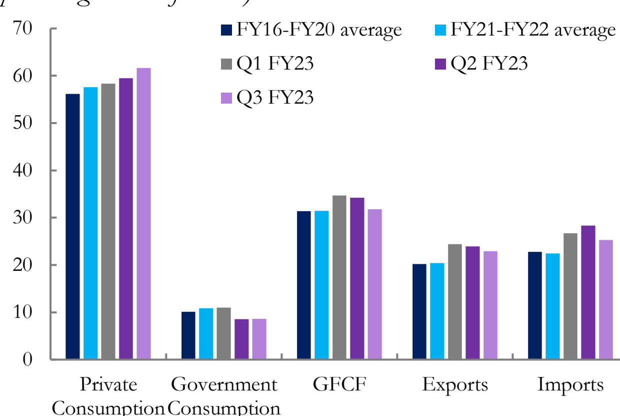


Figure 2.3: The share of government consumption in GDP has fallen below its long-term average

(percentage share of GDP)



Source: NSO, CEIC and World Bank staff calculations.
Note: The fiscal years have been abbreviated. For instance, FY23 stands for FY22/23.

On the supply side, growth was driven by fast expansion in services…

Real Gross Value Added (GVA, which excludes subsidies and taxes on commodities) grew by 4.6 percent y-o-y in Q3 FY22/23 compared to 5.5 percent in Q2 FY22/23 (Figure 2.4). The services sector, accounting for 53 percent of GVA, was the major growth driver. Robust discretionary consumer spending and global demand for India's services exports buoyed the services sector. Another important growth driver was the construction sector, which grew 8.4 percent in Q3 on the back of the government's capex push. However, the manufacturing sector registered a contraction for the second consecutive quarter. Soft global demand, elevated input costs and a shift in consumer spending from goods to services weighed on the manufacturing sector. Growth in the agriculture sector accelerated to 3.7 percent despite the erratic monsoon season, which delayed the sowing of Rabi (winter) crops and export restrictions on wheat and rice products. High input costs hurt margins in most sub-sectors of manufacturing, resulting in a 4.3 percent y-o-y contraction in output.

…which translated into a recovery in traditional market services to pre-pandemic levels

The services sector has now fully recovered from the lingering weakness of pandemic years FY20/21 and FY21/22. Within services, modern market services – financial and business services – and public administration, defense and other services [3] have consistently outperformed the traditional market services – trade, transport and storage, hospitality, and post and communication – since FY20/21 (Figure 2.5). Modern market services grew through the pandemic years and other services recovered by Q3 FY21/22 to the pre-pandemic level. In contrast, traditional market services, which account for about 18 percent of GVA, fully recovered only in Q3 FY22/23; finally expanding above their pre-pandemic FY19/20 level. This growth came on the back of increased spending by higher-income groups on air travel, hotels and restaurants and also the roll-out of 5G telecom services.

[3] Other services include education, health, recreation and other personal services

Figure 2.4: Growth in services has boosted GVA growth…
(Contribution to GDP growth, percentage points, year-on-year)

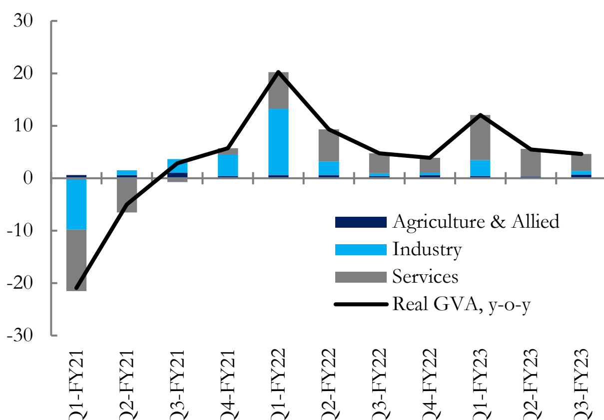
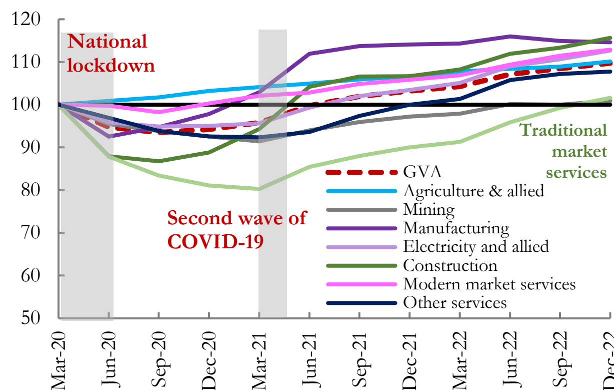


Figure 2.5: …especially with the full recovery of traditional market services in Q3 FY22/23
(4 quarter rolling sum: Index FY19/20=100)

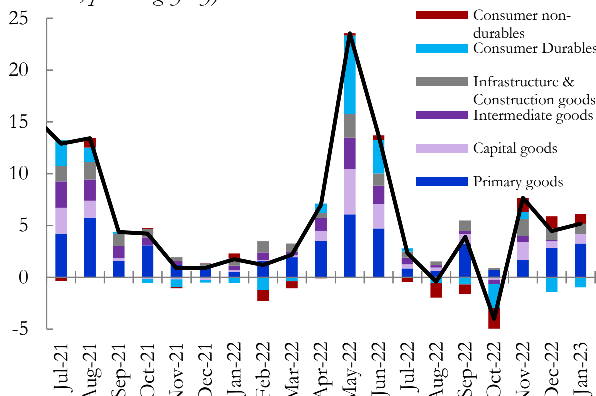


Source: NSO, CEIC and World Bank staff calculations.
Note: Services have been decomposed into Modern market services (Business and Financial services), Traditional market services (Trade, Transport and Storage, Hospitality, and Post and Communication), and Other services.

Most high frequency indicators showed improvement at the start of Q4 FY22/23

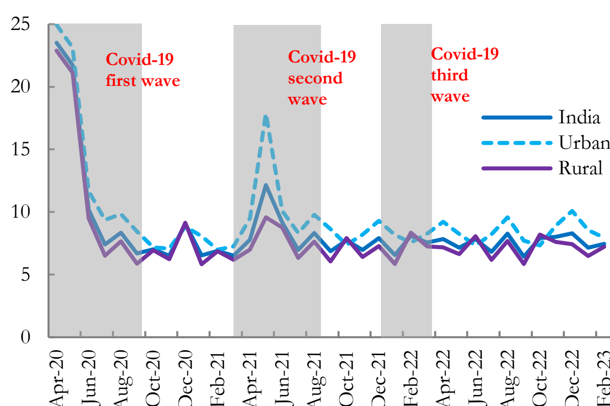
High frequency indicators showed that private consumption and investment continued to expand in January-February 2023. Some proxies for industrial output, such as electricity generation and passenger car sales, expanded consistently while others such as two-wheeler sales remained weak and slipped below their pre-pandemic level after a brief uptick in August-October 2022. Although industrial activity continued to expand, growth in the sector has decelerated since the first quarter, due to supply-chain disruptions, elevated input prices, weaker domestic demand for consumer durables and slowing global growth (particularly in the euro area and China). The Index of Industrial Production (IIP, a proxy for industrial activity, Figure 2.6) grew 5.2 percent y-o-y in January. High-frequency proxies for services output remained firmly on an upward trajectory. The services Purchasing Managers' Index (PMI), increased to a 12-year high of 59.4 in February (an index reading above 50 indicates expansion) on the back of strong demand for consumer services and robust export growth. This trend in consumption was mirrored in a 20 percent y-o-y increase in GST E-way bills —which record the inter and intra-state movement of goods worth more than INR 50,000. Air passenger traffic also grew sharply but remained below pre-pandemic levels. Bank credit continued to grow firmly, with growth of over 20 percent y-o-y in credit to services and personal loans in January 2023. In the same month, total outstanding credit grew 16.3 percent y-o-y.

Figure 2.6: Industrial production has been sluggish due to weaker growth in consumer durables
(contribution, percentage y-o-y)



Source: NSO and World Bank staff calculations.

Figure 2.7: The unemployment rate moderated in Q3
(unemployment rate, percentage)



Source: CMIE and World Bank staff calculations

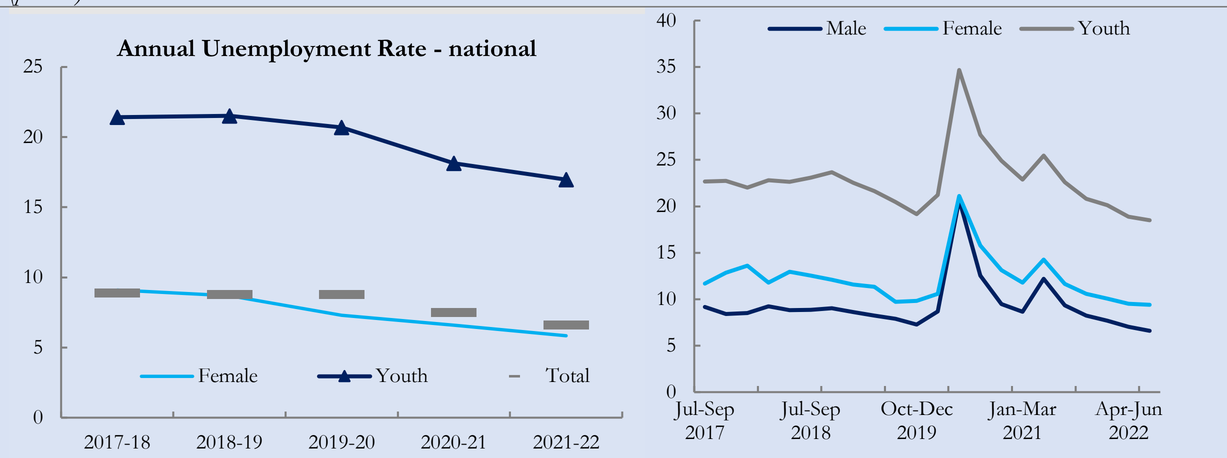
The labor market has recovered unevenly

On the labor market front, improvements have been uneven. Enrollments to the employment provident fund—a proxy for formal employment—moderated in Q3 FY22/23 (following an increase in Q2), driven by firms in the services sector. The number of new subscribers to the employee provident fund remained below one million through October-December 2022. However, the unemployment rate dipped from the year's peak of 8.1 percent in August 2022 to 7.5 percent in February 2023, driven by a sustained fall in urban unemployment (Figure 2.7). Unemployment in rural areas fell below 7 percent in January but increased slightly in February. Demand for work under the Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA) also moderated from December to January and remains around pre-pandemic levels.

Box 2.1: An update on labor market developments in India

The urban unemployment rate has fallen from its peak of 20.8 percent in 2020 to below pre-pandemic level. Since 2017-18, when comparable data is available from the Periodic Labor Force Survey (PLFS), national unemployment rates (current weekly status, CWS) have hovered around 8 percent (Figure 2.1.1). These stable annual rates mask an increase in urban and adult male unemployment rates since 2019-20. On the other hand, female and youth unemployment rates have been falling. The COVID-19 pandemic marked a sharp divergence in urban unemployment, which spiked from 9.1 percent to 20.8 percent (April-June PLFS 2020, urban sample). This recovered to 7.2 percent in the latest available quarter (July-September, 2022), below the pre-pandemic level.

Figure 2.1.1: Unemployment rate (CWS) for urban, females, youth, and entire population
(percent)

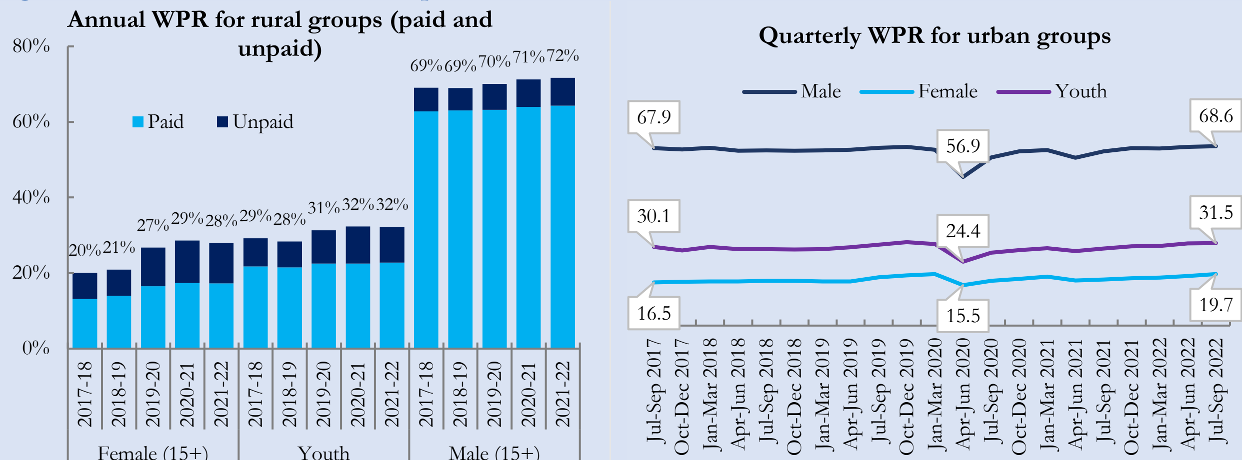


Source: Periodic Labor force Survey using current weekly status (multiple years)

The urban labor market in 2020 was characterized by job transitions into more vulnerable employment, which subsided in subsequent years. In the immediate aftermath of the pandemic, there was substantial churn in the urban labor market into more vulnerable employment types and out of the workforce. In Q2 2020, many urban workers switched to casual wage work due to the pandemic and over 35 percent of urban self-employed workers transitioned to casual wage work, with males being affected more (39 percent) than females (25 percent). Among salaried workers, about 40 percent had to switch to casual wage work, with both males and females being equally impacted. Thereafter, fewer distress-induced job transitions occurred; in Q2 2021 around 20 percent of salaried and self-employed workers transitioned either into casual-wage work or exited the labor force (downward transitions), with females slightly more impacted than males. By Q2 2022, upward job transitions became more common i.e., workers transitioned from being unemployed to casual wage workers – 10 percent of male unemployed workers in Q1 2022 became casual wage workers in Q2 2022. Urban women faced both upward and downward transitions. Around 25 percent of female casual-wage workers moved upwards into self-employment and salaried work while a similar share also moved out of the workforce.

Since 2020, the female worker population ratio (FWPR) has increased but has been driven by women engaged in unpaid work in rural areas. FWPR in rural areas increased from 20 percent in 20117-18 to 28 percent in 2021-22, but this improvement has been largely due to an increased number of unpaid workers. In contrast, the increase in FWPR in urban areas was more modest; from 16.5 percent in 2017 to 19.7 percent in 2022 (Figure 2.1.2).

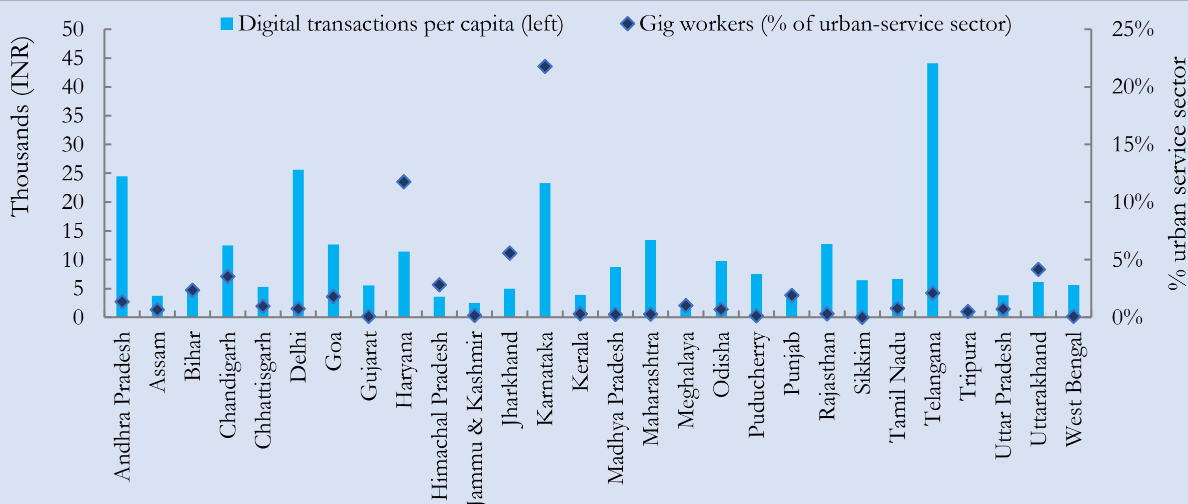
Figure 2.1.2: Trends in Worker-Participation Ratios



Source: Estimated using PLFS unit level data of urban re-visit samples and rural annual samples using current-weekly status

India's labor market has returned to stability since the pandemic, but it is still unclear how good-quality job growth can be promoted and sustained over time. India's economic growth has been led by services and the digital economy has gained momentum since demonetization and the pandemic. Going forward, the rise of "gig-workers" (workers on a digital platform) and the contractual nature of their employment will be important indicators to track. Gig-workers are a new category of workers captured by the Consumer Pyramids Household Survey (May-December 2022) as self-employed or salaried workers on a digital platform. Figure 2.1.3 presents the share of "gig-workers" as a percent of urban, service sector workers and the per capita transactions on a popular digital payments platform. States such as Karnataka and Haryana have high shares of gig-workers and higher per-capita transactions, but the relationship varies across states.

Figure 2.1.3. Gig workers and digital transactions per capita



Source: Consumer Pyramids Household Survey (May-December 2022), Digital transactions per-capita from the PhonePe Pulse Dataset (2022-Q1); population projections from the National Commission on Population 2020 (Ministry of Health & Family Welfare).

Note: The measure of "Gig-workers" is a new addition to the Consumer Pyramids Household Survey and it may take some survey rounds of iteration before stabilizing. The state-level shares are only indicative at present and will be tracked in future to gain reliable insights on the gig-economy.

Inflation

Headline inflation averaged 6.3 percent over Oct 2022 – Feb 2023

Headline CPI inflation averaged 6.3 percent in October 2022-February 2023, a percentage lower than that in the first half of FY 22/23 (Figure 2.8). Inflation settled within the Reserve Bank of India's (RBI) target range (2 – 6 percent) for the first time in 2022 in November and again in December. The moderation in prices was driven by a decline in food inflation, which accounts for almost 40 percent of the national CPI basket. Food prices softened the most for vegetables and fruits, while prices edged up for cereals, spices and protein-based food items (Figure 2.9). The upward pressure on cereals and spices contributed to headline inflation once again rising to above the RBI's tolerance band in January and February 2023. Fuel inflation remained moderate over this period, with kerosene prices registering a decline in response to softening international prices. Over the past year, the government implemented several supply-side measures to control inflation – prohibiting wheat exports, imposing export duty on rice and continuing increased entitlements under the food subsidy program to protect vulnerable sections of the population from rising food inflation.

Figure 2.8: Headline inflation is elevated but easing as food and fuel prices moderate

(percentage, y-o-y)

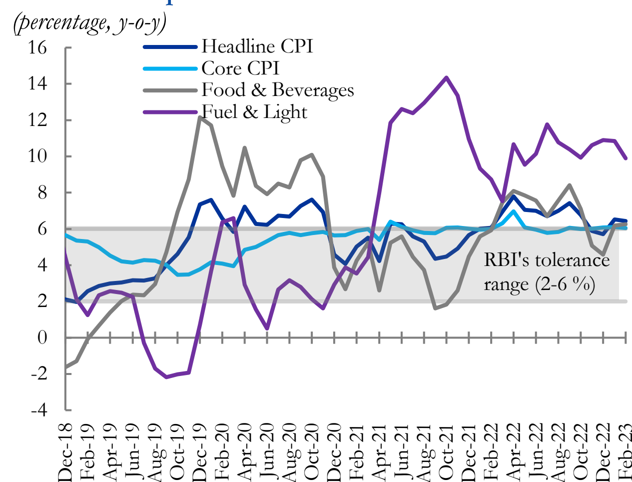
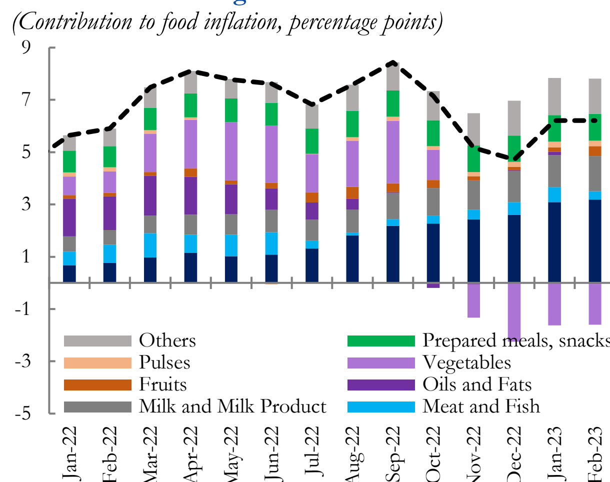


Figure 2.9: Food inflation has moderated driven by lower inflation in vegetables

(Contribution to food inflation, percentage points)



Core inflation remains elevated

Core inflation, which excludes food and fuel prices, remained elevated and sticky, averaging over 6 percent during October 2022-February 2023 (Figure 2.10). It has been above 5 percent y-o-y since 2020. The transmission of high input costs to retail prices of household goods and increasing demand-pull price pressures in some of the traditional market services (trade and hospitality) kept core inflation high. Elevated fuel prices have also had a second-order impact on transport costs.

Wholesale price inflation has declined to a two-year low

WPI inflation, which tracks prices at which businesses sell to each other, has been declining consistently since October 2022 (Figure 2.11). It fell to a two year low of 3.9 percent in February 2023, after having been in double digits since April 2021. Easing price pressures of commodities such as fuel and manufactured goods considering the global slowdown, as well as a high base effect helped pull WPI inflation down.

Figure 2.10: Core inflation remains elevated and sticky
(Contribution, percentage, y-o-y)

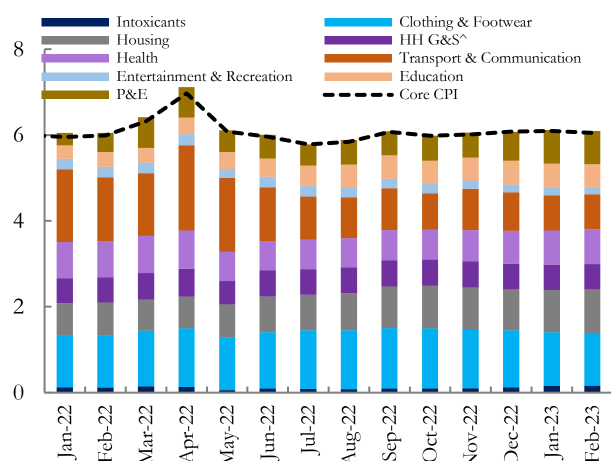
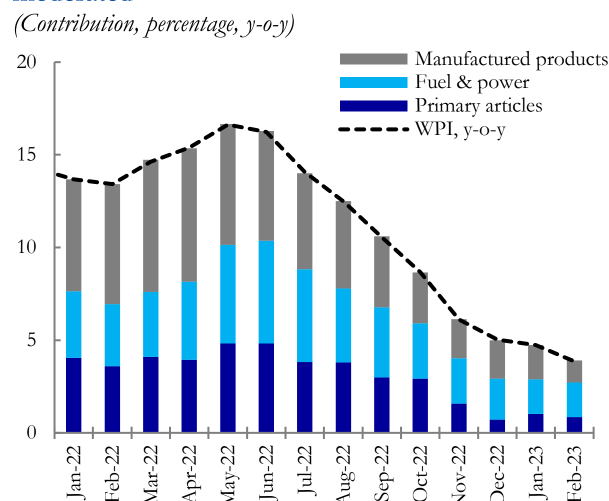


Figure 2.11: Wholesale price pressures have moderated
(Contribution, percentage, y-o-y)



Source: NSO, Ministry of Commerce, CEIC and World Bank staff calculations.

b. Monetary and financial sector

The RBI has continued to hike interest rates in response to inflationary pressures …

As inflation remained around the upper threshold of the RBI's inflation target through the second half of FY22/23, exceeding the 6-percent mark in January, the central bank's Monetary Policy Committee (MPC) continued to hike the policy interest rate (repo rate). Since May 2022, the MPC has hiked the repo rate by 250 basis points in six successive meetings from 4 percent to 6.5 percent. However, as price pressures eased on some fronts and global growth slowed, the pace of tightening also slowed, with the RBI only increasing the repo rate by 25 basis points in February, compared with four successive hikes of 40-50 basis points in the first half of 2022. The Standing Deposit Facility (SDF), for overnight deposits of commercial banks with the RBI, has effectively replaced the fixed rate reverse repo rate as the floor of the liquidity adjustment facility and remains 25 basis points below the repo rate (Figure 2.12). The RBI has continuously highlighted the need to bring inflation back to its threshold range to prevent inflation expectations from getting unanchored. Inflation expectations increased after the pandemic and peaked at over 12 percent in November 2021 but have moderated since then and remain well below their average level in 2010-14.

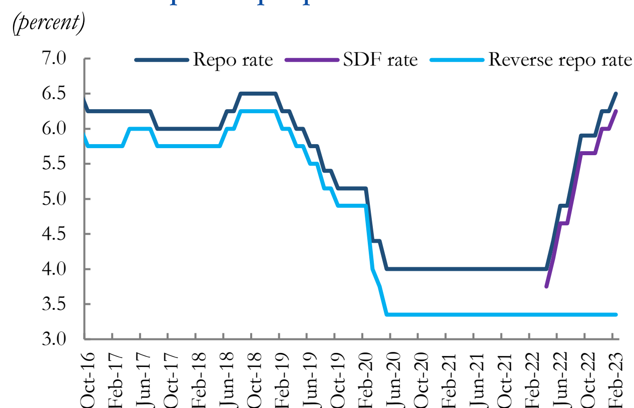
… but real interest rates remain close to zero

Despite the sizeable increase in the nominal policy interest rate, the real interest rate has only increased to just over 0 percent and remains below the 1-1.5 percent level that the RBI considers to be the neutral rate. Central banks in advanced economies have also rapidly increased rates in response to inflationary pressures in recent months.

As the recovery has been strengthening, money supply growth has slowed

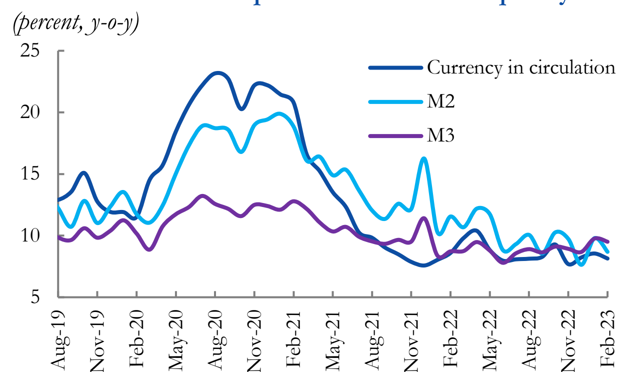
Along with the policy rate hikes, the RBI has used several measures since April 2022, to reduce liquidity in the system, leading to a moderation in money supply growth (Figure 2.13). While overall system liquidity, as measured by total average absorption under the liquidity adjustment facility, remains in surplus, it has fallen from an average of INR 2.2 trillion in August-September 2022 to INR 1.6 trillion in January 2023.

Figure 2.12: After six successive rate hikes, the repo rate has increased past its pre-pandemic level
(percent)



Source: CEIC and RBI

Figure 2.13: Money supply growth has moderated as the RBI has taken steps to reduce excess liquidity
(percent, y-o-y)



Source: CEIC,RBI and World Bank staff calculations

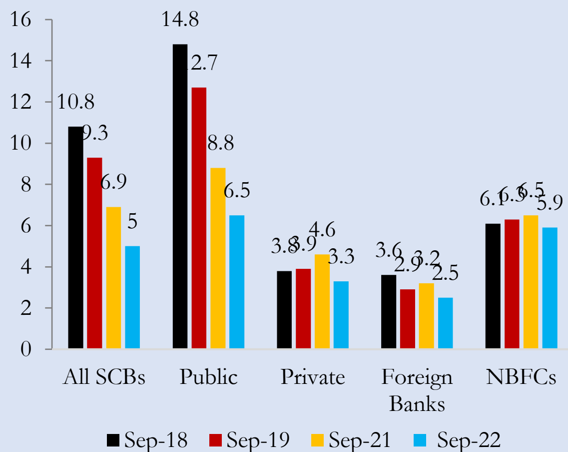
Box 2.2: India's financial sector remains strong with healthier balance sheets and recovering credit growth

Asset quality of commercial banks continues to improve over the first half of FY22/23 and capital adequacy remains well above regulatory requirements. Asset quality continued to improve through the first half of FY22/23 with non-performing loans (NPLs) having fallen from 6.9 percent of total commercial bank assets in September 2021 to 5 percent in September 2022 (Figure 2.2.1). A drop in the slippage ratio which indicates additional non-performing assets (NPAs) in a year, along with increased write offs of bad loans helped drive the decline. The improvement was broad based, with non-performing assets declining across banks and financial institutions. The decline also continued across most sectors, with the ratio falling in the agriculture, industry, services and personal loans categories. However, despite declining, the GNPA ratio remained high for some subsectors such as gems and jewelry and construction. The micro, small and medium enterprise (MSME) sector also showed some signs of distress, with one sixth of accounts availing funds under the Emergency Credit Line Guarantee Scheme (ECLGS) turning into non-performing assets, of which the micro enterprises segment forms the largest share. Capital adequacy (the capital to risk weighted assets ratio) declined to 16 percent in September 2022 from 16.6 percent in September 2021 but remains well above regulatory requirements.

Credit growth accelerated on the back of economic recovery, picking up across industry and services. Credit growth accelerated to 17.5 per cent in September 2022 compared to 6.7 percent in September 2021, mainly driven by retail credit. The increase was in comparison to a low base of the previous couple of years, the accumulation of deposits in the last few years, and banks drawing on their high-quality liquid assets (HQLAs). Across nonfood credit, personal credit continued to remain high, and the contribution of industry and services has been increasing in the last year (Figure 2.2.2). Within industry, credit growth was boosted by credit extended under the ECLGS Scheme to the MSME sector, broad based recovery of domestic demand, high working capital requirements and regulatory modifications on the definition of MSMEs. Across services, credit growth to the non-banking financial corporations (NBFCs) has grown by 30.6 percent in September 2022 due to a favorable base effect.

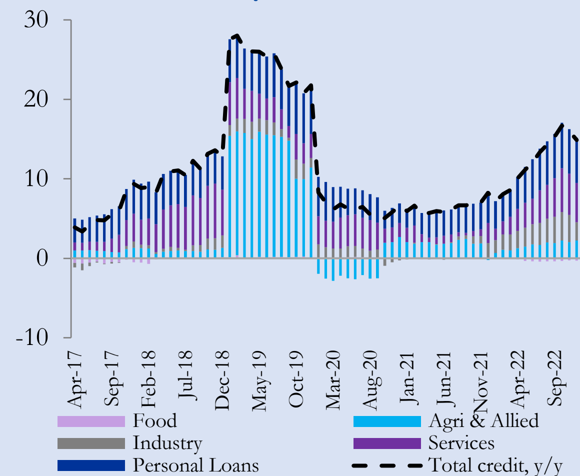
Regulatory initiatives emphasized improving the resilience of financial intermediaries, increasing digital lending and integrating climate and cyber risks into existing frameworks. The RBI amended the regulatory framework for Asset Reconstruction Companies (ARCs), which help manage distressed financial assets of banks and financial institutions. The new framework aims to strengthen governance norms, increase transparency, improve prudential requirements, and increase the efficacy of ARCs. The central bank also issued guidelines on digital lending, applicable to all banks and non-banking companies, to improve transparency and privacy. Other sector regulations focused on strengthening and addressing vulnerabilities in the financial sector by improving resilience, easing compliance, and reducing the cost of financial intermediaries. The central bank also issued guidelines on managing risks to the financial sector from cyber risks and climate change.

Figure 2.2.1: Gross NPAs have fallen across all banks and in NBFCs



Source: Financial Stability Report, RBI

Figure 2.2.2: Credit growth accelerated, with increased contribution of industry and services

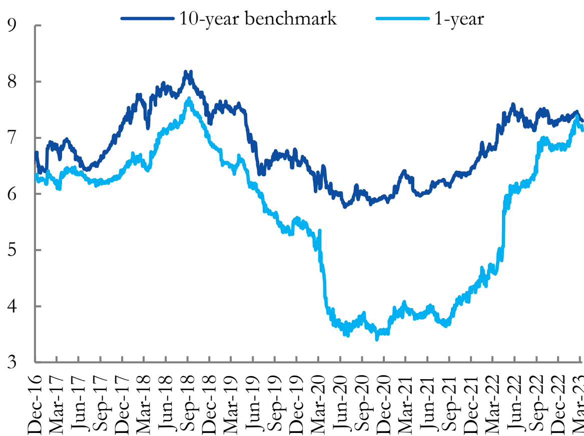


Source: CEIC, RBI and World Bank staff calculations

The 10-year benchmark yield increased by over 65 basis points in FY22/23 and the yield curve is flattening

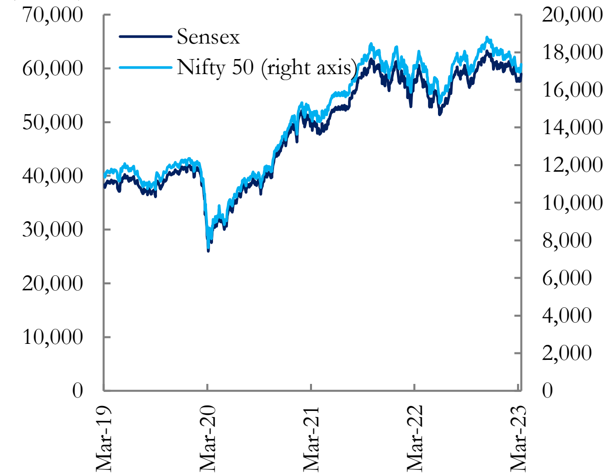
The benchmark yield on 10-year sovereign bonds has been increasing since May 2022 and peaked at around 7.6 percent in June (Figure 2.14). However, since then it has largely remained stable around 7.4 percent. It has increased by 66 basis points in fiscal year-to-date terms and 170 basis point compared to its lowest mark in October 2020. The yield curve, which measures the difference in yields of securities with different maturities has flattened significantly, indicating market expectations that the RBI is likely to pause interest rate hikes and even cut rates later in 2023 as inflationary pressures recede.

Figure 2.14: Both the benchmark yield and short-term interest rates have trended upwards since October 2021
(percent)



Source: CEIC and CDSL

Figure 2.15: Financial markets have fallen from historic highs in recent months
(index)



Source: CEIC, Exchange Data International Limited and BSE Limited

India's financial markets reached new highs in January

Since September 2022, stock markets bounced back, driven by better-than-expected corporate earnings in the first half of FY22/23, moderation in domestic inflation and easing global commodity prices, and a reversal in foreign portfolio flows back into India. As a result, markets hit a new all-time high in January 2023 but have been marked by volatility since then due to surprises in inflation data for advanced economies and uncertainty with respect to the monetary policy response (Figure 2.15).

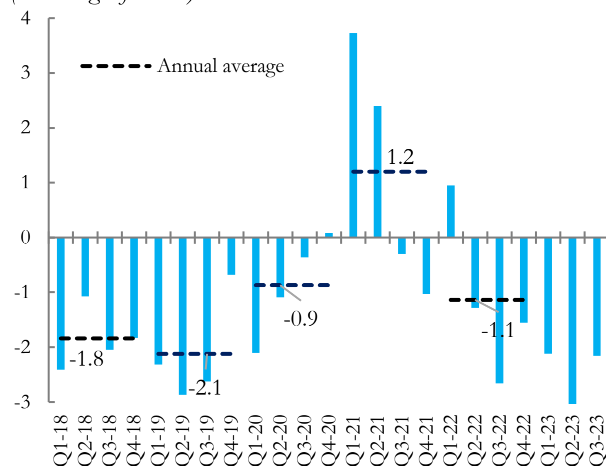
c. External sector

The current account deficit narrowed in Q3 FY22/23

The current account deficit narrowed from 3.3 percent of GDP in H1 FY22/23 to 2.2 percent of GDP in Q3 FY22/23 (Figure 2.16). This was due to a narrowing of the merchandise trade deficit, compared with the second quarter, on the back of easing commodity prices that caused a faster deceleration in import growth than export growth (Figure 2.17). Robust demand for information technology and financial services increased the services trade surplus to a record 4.6 percent of GDP. Resilient inflows of workers' remittances from abroad also boosted secondary income receipts.

Figure 2.16: The current account deficit narrowed in Q3 FY22/23…

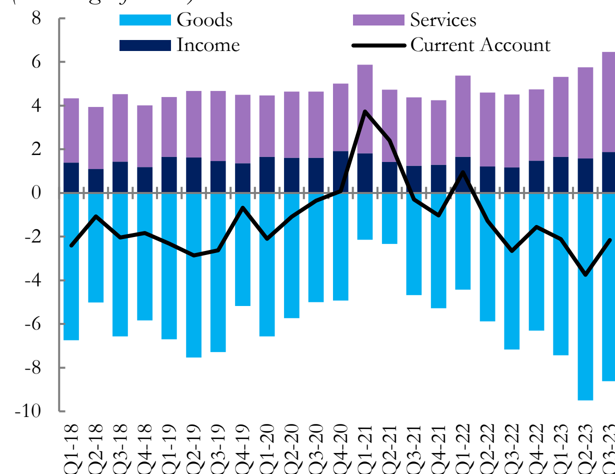
(Percentage of GDP)



Note: Dashed lines represent averages for the full fiscal years.
Source: CEIC, RBI, World Bank staff calculations

Figure 2.17: …primarily due to a narrowing merchandise trade deficit

(Percentage of GDP)



Source: CEIC, RBI, World Bank staff calculations

Weak external demand caused the trade deficit to narrow in Q3 FY22/23

The merchandise trade deficit narrowed in Q3 FY22/23 in comparison with the first half of FY22/23. While merchandise imports continued to grow in y-o-y terms, (albeit at a much slower pace than in the year-earlier period), driven by resilient domestic economic activity, they declined in comparison with the first half of FY22/23 as commodity prices eased and the decline in imports outweighed the contraction in exports. Non-oil imports contracted 0.4 percent y-o-y, reflecting a contraction in manufacturing activity (India is a net importer of capital intermediate goods) amid slower global growth and tightening financial conditions (Figure 2.19). Over the same period, overall exports contracted by 2.1 percent, of which non-oil exports[4] contracted by 8.3 percent y-o-y (Figure 2.18).

4 India is a net importer of crude oil but some of these oil imports are re-exported as refined petroleum products. Oil exports amounted to 22 percent of total merchandise exports in Q1 FY22/23, up from around 16 percent in FY21/22.

Figure 2.18: Merchandise exports contracted…
(contribution to growth y-o-y, percentage points)

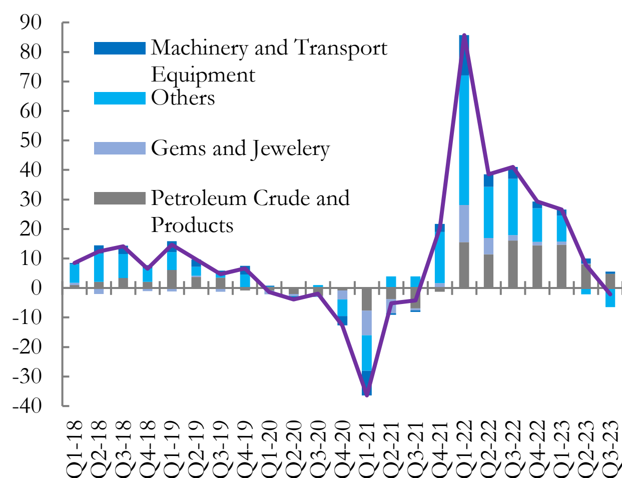
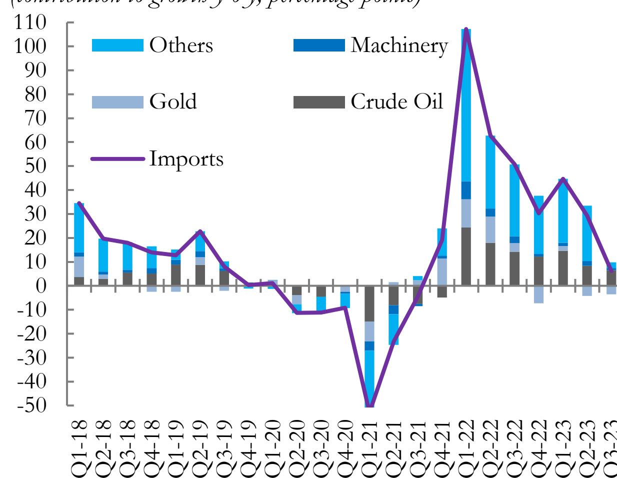


Figure 2.19: …but merchandise imports growth continued on the back of still-high global oil prices
(contribution to growth y-o-y, percentage points)

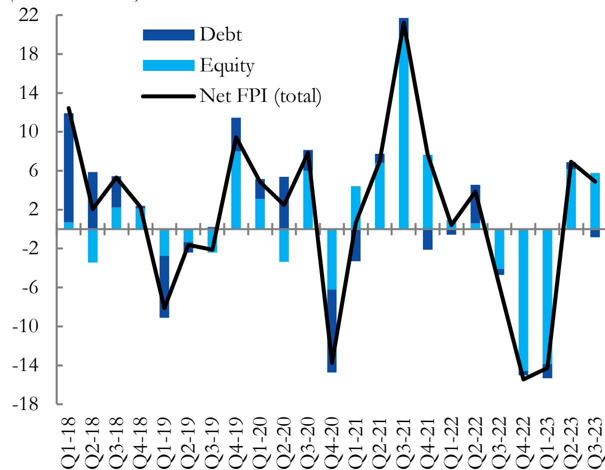


Source: CEIC, Ministry of Commerce and Industry, World Bank staff calculations

Foreign portfolio flows have remained resilient while foreign direct investment inflows moderated

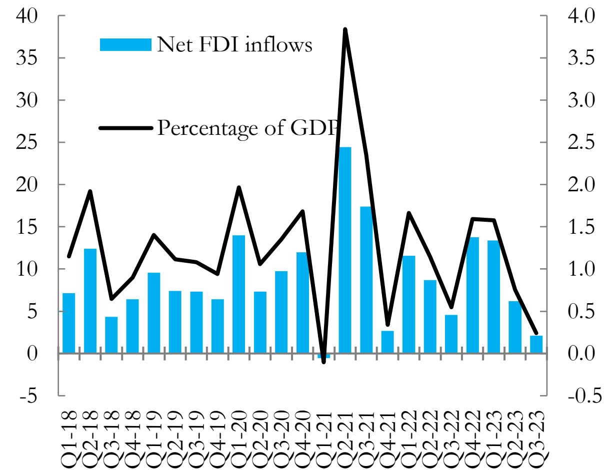
Net portfolio investment flows from equity markets remained positive in Q3 FY21/22 as the RBI hiked the policy rate and the growth differential widened vis-à-vis the US (Figure 2.20). Equity inflows continued to grow in January-February, particularly in the capital goods, services, information technology and healthcare sectors, offsetting debt outflows. Meanwhile, net FDI inflows fell sharply in Q3 FY22/23 (Figure 2.21). While gross FDI investments were positive and stable at around USD 7.3 billion, FDI by India abroad spiked to USD 5.2 billion, bringing down net FDI flows.

Figure 2.20: FPI inflows moderated but remained positive in Q3 FY22/23
(USD billions)



Source: CEIC, RBI, NSDL World Bank staff calculations

Figure 2.21: Net FDI flows moderated in Q3
(USD billions, left axis); (Percentage of GDP, right axis)



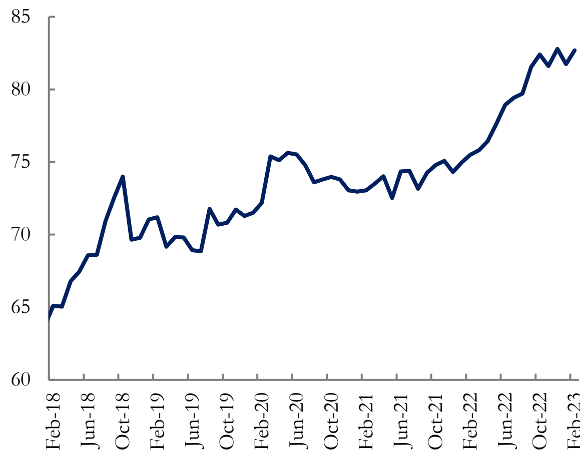
Source: CEIC, RBI, World Bank staff calculations

The rupee depreciated steadily in Q1-Q3 FY21/22, but stabilized in January-February

The rupee depreciated 9.2 percent in the first three quarters of FY22/23, but its value stabilized in the first two months of 2023, with the rupee appreciating 0.1 percent at end-February compared with December 2022. The depreciation momentum was arrested by the narrowing of the merchandise trade deficit and relatively higher capital inflows (Figure 2.22). The real effective exchange rate (REER), which compares a currency's value against a weighted average of major trading partners' currencies, appreciated slightly in calendar year-to-date terms in February 2023. This was largely

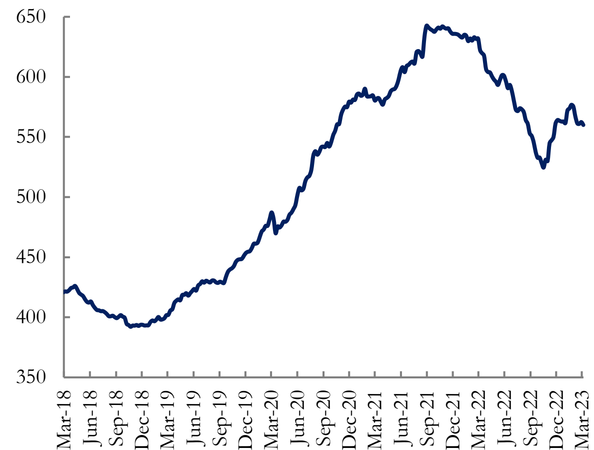
driven by higher inflation than its major trade partners (such as the US and UK). In addition, the RBI's intervention in the foreign exchange market helped to mitigate volatility. Nevertheless, foreign exchange reserves have increased since August 2022 to around 560 billion at end-February 2023 (Figure 2.23)—equivalent to around seven months of import cover[5].

Figure 2.22: The Indian rupee appreciated marginally in February on the back of capital inflows
(INR/USD)



Source: Haver, IMF, World Bank staff calculations

Figure 2.23: Foreign exchange reserves have declined from their peak in 2021 but remained adequate
(USD billion)



Source: CEIC, RBI, World Bank staff calculations

d. Fiscal sector and debt sustainability

The central government is on track to meet its fiscal deficit target of 6.4 percent of GDP in FY22/23…

Despite the announcement of several fiscal measures (such as fuel tax cuts and extension of the food subsidy program) to offset the impact of rising inflation, the central government is likely to meet its fiscal deficit target of 6.4 percent in FY22/23. According to the government's revised estimates, tax revenues were about 8 percent higher than budgeted and 15.6 percent higher than the previous year, with strong growth in revenues from the goods and services tax and direct taxes compared with FY21/22. The overall increase in receipts was offset by higher spending. Current spending was 8 percent higher than budgeted, largely due to increased allocation for income support measures like the food subsidy, fertilizer subsidies and Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA). Capital spending was only 3 percent lower than budgeted but 22 percent higher than the previous year and reached an all-time high level of 2.7 percent of GDP.

… and is projecting a fiscal deficit target of 5.9 percent in FY23/24

The consolidation in FY23/24 is mainly expected to be driven by a reduction in welfare spending and stable revenue growth. The underlying nominal GDP growth estimates are realistic at 10.5 percent. Overall, tax revenues are projected to increase by about 11.7 percent in budget estimates, with the expectation that the buoyant growth in corporate and personal income taxes as well as GST would continue. At the same time, current spending is only projected to increase marginally, by 1.2 percent, reflecting withdrawal of pandemic support measures in terms of lower spending on the food

[5] Based on World Bank staff projections of FY23/24 imports of goods and services

subsidy and welfare programs like the Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA).

Strong revenue growth will keep the deficit target within reach

In the first eleven months of FY22/23 (April-February), for which data are available, the central government's gross tax revenues increased by 12.0 percent y-o-y. This was driven by 19 percent y-o-y growth in personal income tax collection, 13.5 percent growth in corporate income tax and 24.5 percent growth in GST collections (Figure 2.24). The government had achieved 83.9 percent of its revised estimate for tax revenues, compared with 83.4 percent of the revised estimate on the expenditure side. As a result, the fiscal deficit had reached 82.8 percent of the revised estimate or 5.3 percent of GDP (Figure 2.25).

Figure 2.24: Robust revenue growth has kept the fiscal deficit in check

(fiscal deficit, percent of FY22/23 budget estimates)

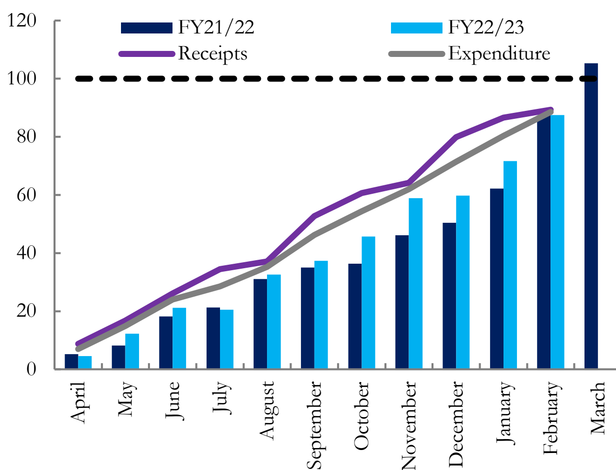
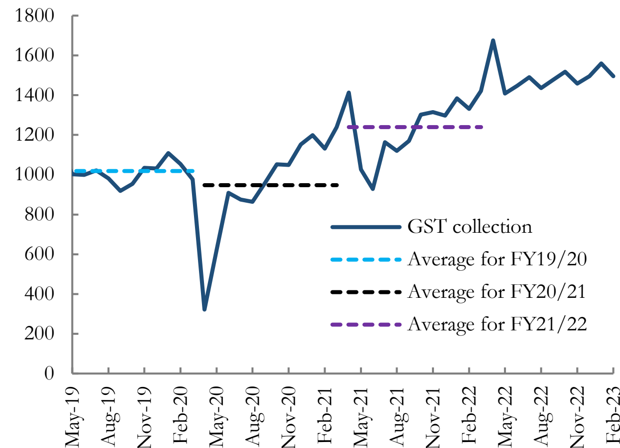


Figure 2.25: GST collection has increased sharply compared with the past three years

(GST collection, INR billion)



Source: CEIC, Ministry of Finance, and WB staff calculations

State governments are estimated to have a smaller fiscal deficit of 3.0 percent in FY22/23 due to high revenue growth

According to provisional monthly data until December 2022, the combined fiscal deficit for the states is estimated to be 1.7 percent of GDP, well below the 3.5 percent of GSDP borrowing limit proposed by the central government (not including the additional 0.5 percent borrowing that is conditional on adoption of power sector reforms). Although many states were adversely affected by the end of the GST compensation period in June 2022[6], revenue growth has been robust, around 21.7 percent y-o-y, due to the strong growth in GST collections and the taxes that contribute to the divisible pool of funds. Expenditure growth has been slower at around 12 percent, driven by a moderation in spending on pandemic-related health and welfare programs, while capital spending growth has slowed to 6 percent.

State budgets for FY23/24 indicate further consolidation

As of end-March, over twenty states had announced their Budgets for FY23/24 and most of them projected a consolidation in the fiscal deficit compared with the previous year, driven by faster growth in receipts than in expenditure. Most states are projecting a fiscal deficit in the 3-3.5 percent range, in line with the borrowing limit announced by the central government. Receipts are projected to grow by about 12 percent on average, compared with revised estimates for FY22/23, while spending growth is projected at around 9 percent. Capital spending is projected to increase sharply across most states by over 20 percent.

[6] When the Goods and Services Tax was adopted in 2017, the states were promised compensation for a period of 5 years if revenue growth was below 14 percent. After the COVID-19 pandemic, the compensation was reduced and a part of it was given to the states in the form of back-to-back loans. While the loans will be serviced by the GST compensation cess, compensation ended in June 2022.

Both the general government deficit and public debt have declined

The general government fiscal deficit – the combined deficit of the Center and States – declined from 13.3 percent of GDP in FY20/21 to 10.5 percent in FY21/22 (of which the central government deficit was 6.8 percent and the states deficit was 3.7 percent) and is estimated to have declined further to 9.4 percent in FY22/23 (of which the central government deficit is estimated to be 6.4 percent and the states' deficit 3.0 percent) (Figure 2.26) as tax revenues largely increased in line with nominal GDP growth and expenditures declined as a share of GDP (Figure 2.27). Public debt also declined from 87.5 percent of GDP in FY20/21 to 85.4 percent in FY21/22 as the primary deficit narrowed and the growth-interest rate dynamics turned favorable again with the revival in economic activity. The debt-to-GDP ratio is estimated to have fallen further to 83.0 percent in FY22/23, driven by fiscal consolidation and faster nominal GDP growth.

Figure 2.26: The general government fiscal deficit declined in FY22/23 and so did the debt/GDP ratio
(percent of GDP)

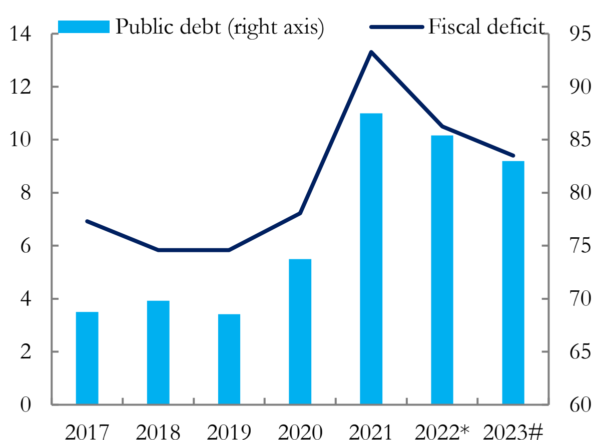
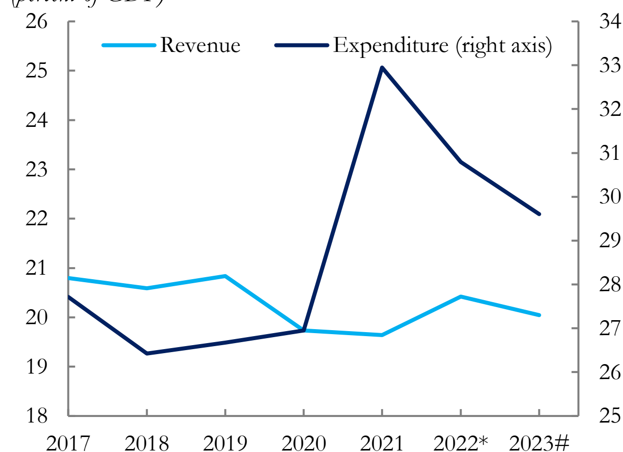


Figure 2.27: Revenues remained stable around 20 percent of GDP and expenditures declined
(percent of GDP)



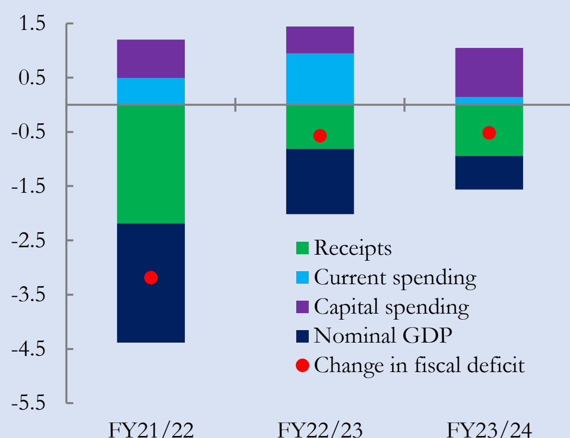
Note: #Based on revised estimates for the central government and budget estimates for the states *Based on actuals for the central government and provisional accounts for the states.
Source: CEIC, RBI, NSO, State budgets and WB staff calculations

Box 2.3: A closer look at the Union Budget for FY23/24

The Budget of the central government for FY24 reflects continuity and a calibrated approach to fiscal policy. Ahead of the next national elections in May 2024, the government stayed course on its medium-term fiscal consolidation path, targeting a deficit of 5.9 percent in FY24, while increasing public investment.

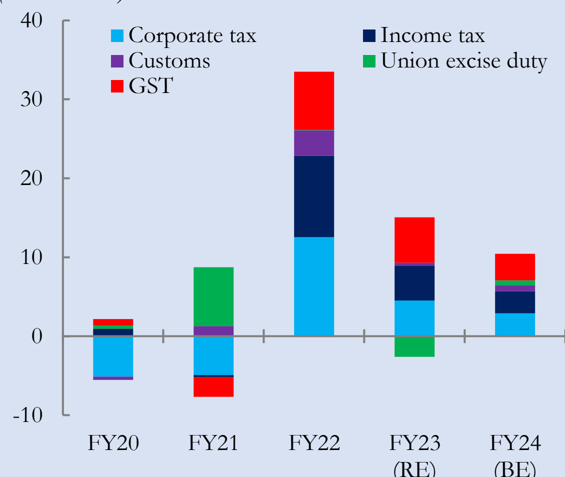
The consolidation is projected to be achieved due to an increase in revenues and a decline in current spending as a share of GDP (Figure 2.3.1). Total receipts are projected to increase by about 12 percent, mainly on the back of an 11.7 percent increase in tax revenues (Figure 2.3.2) and a 15 percent increase in non-tax revenues. Total expenditures are projected to increase, from a high base, by about 7.5 percent. Current spending is expected to increase only marginally by 1.2 percent, while capital spending is expected to increase more significantly by 37 percent.

Figure 2.3.1: The fiscal deficit is projected to decline due to higher revenues and modest growth in spending
(Contribution to change in fiscal deficit as a share of GDP)



Note: An increase in revenues and nominal GDP has a negative contribution to change in the fiscal deficit while an increase in spending has a positive contribution.
Source: CEIC, Ministry of Finance and World Bank staff calculations

Figure 2.3.2: Revenues are projected to increase across all sources
(USD billion)



Source: CEIC, Ministry of Finance and World Bank staff calculations

The underlying growth estimates and targets are realistic, but subject to downside risks. Nominal GDP is projected to increase by 10.5 percent in FY24. Given that inflation is likely to be in the 5-5.5 percent range, real GDP growth would be 6.5 percent, compared with the World Bank forecast of 6.3 percent and consensus growth forecasts of 5.8 percent. Overall, gross tax revenues are projected to increase by 11.7 percent, with the expectation that the buoyant growth in corporate and personal income taxes as well as GST will continue as the economy recovers.

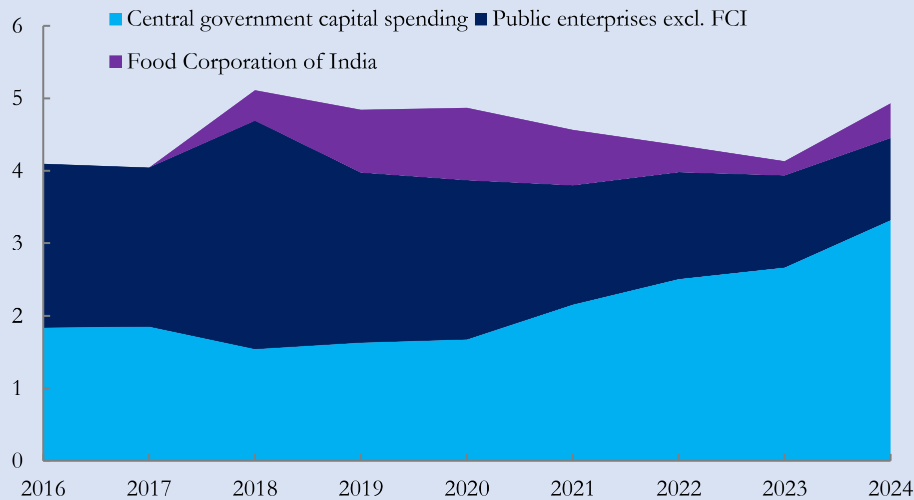
On the expenditure side, budget allocations for the Mahatma Gandhi National Rural Employment Guarantee Scheme (MNREGA) and for food subsidies have been cut by around 30 percent in FY24, with potential welfare implications. The withdrawal of the additional food grains provided during the pandemic prevents converting the relief measure into an entitlement, while at the same time providing support to Priority and Antyodaya households via a new integrated food security program launched in January 2023 that would provide free food grains under the National Food Security Act (NFSA) for the year 2023.[7] MGNREGA allocations may increase later in the year as the scheme is demand driven, but delayed payments could pose a threat to the welfare of rural workers. At the same time, the allocation for the Jal Jeevan Mission (safe drinking water in rural areas) and the PM Awas Yojna (housing for urban poor) increased significantly compared to the budget allocation in FY22/23, which could cushion the impact on vulnerable households. However, taken together, the reduced allocations may have negative welfare and distributional impacts, if food prices increase further and in case of agricultural shocks during the year.

Capital spending (such as on railways, roads, highways and defense) is budgeted to increase considerably, but this partly reflects budgetary support for investment by public sector enterprises. Capital spending is projected to increase by 37 percent year-on-year, from an already high base. In addition, the allocation for 50-year interest-free loans to states (over and above their normal borrowings) for capital expenditure has been increased by 30 percent to INR 1.3 trillion. However, the combined investments by the central government and public sector enterprises have not increased significantly as a share of GDP compared to the pre-pandemic period even though the central government's capital spending has increased (Figure 2.3.3). The main public sector enterprises whose source of financing has shifted towards budget support and away from

[7] The NFSA covers 75 percent of the rural population and 50 percent of the urban population and households are broadly divided into two categories: a) Antyodaya Anna Yojna (AAY) designed for the poorest of the poor wherein the household gets 35kg of food grains per family per month at subsidized prices, and b) Priority Households (PHH) comprising poor households who are not covered in AAY and receive 5kg food grains per person per month at subsidized prices.

market financing are the National Highways Authority of India (NHAI) and the Indian Railways. One possible reason for the shift from market financing to budget support is that the government can borrow from the market at more favorable terms. The share of resources raised by the Food Corporation of India, which was mainly used to cover arrears in food procurement and covering the cost of the food subsidy also declined in FY22/23, compared with the pre-pandemic period. These borrowings were brought on budget in FY20/21 and repaid by the central government. The government has clarified that the increased borrowing by FCI in FY23/24 does not represent off-budget borrowing.

Figure 2.3.3: The share of central government spending has increased but overall spending, including central public enterprises has not increased.
(percent share of GSDP)



Source: CEIC, Ministry of Finance and World Bank Staff calculations

2. Outlook

Real GDP growth is expected to moderate in FY23/24 due to global spillovers, monetary policy tightening and slower consumption growth

Real GDP growth is expected to moderate from 6.9 percent in FY22/23 to 6.3 percent in FY23/24, because of continued global growth spillovers, the lagged impact of the monetary policy tightening and slower consumption growth (Figure 3.2). Global growth is expected to slow down significantly in 2023 to 1.8 percent (compared to 2.8 percent in 2022), with the pace of growth likely to be the third weakest in nearly three decades and overshadowed only by the global recessions caused by the pandemic in 2020 and the global financial crisis in 2009 (Global Economic Prospects, January 2023). Economic activity has softened amid deteriorating financial conditions on the back of synchronized global monetary policy tightening. While inflation is expected to ease this year following subsiding global supply disruptions, softer demand, and moderating prices of critical commodities like metals and oil, it is likely that inflationary pressures will be persistent for a longer period (Global Economic Prospects, January 2023). In India, while the central bank hiked its policy rate multiple times since May 2022 to keep elevated household inflation expectations anchored, headline inflation remains elevated. The lagged impact of monetary policy tightening, heightened growth uncertainty, and reduced current spending of the government are expected to constrain domestic demand in India in FY23/24. Merchandise export growth will slow down as global demand softens and import growth will also be muted due to moderating domestic demand. The trade deficit is expected to narrow which would lower the drag net exports places on growth compared to FY22/23.

Figure 3.1: GDP share of government consumption is on a downward trajectory…

(share of GDP)

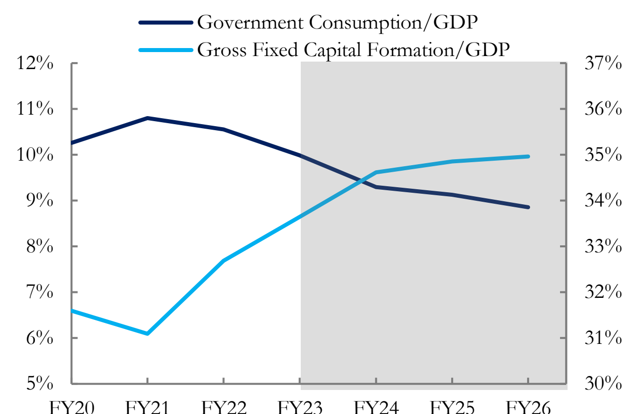
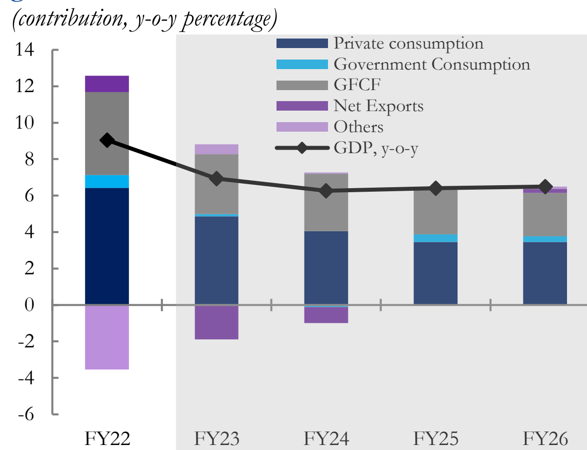


Figure 3.2: …contributing to a moderating GDP growth in FY23/24

(contribution, y-o-y percentage)



Source: CEIC and World Bank Staff calculations

Note: The shaded portion reflects the World Bank projections

Domestic demand will be tempered by higher borrowing costs, lower share of current spending by the government and heightened growth uncertainty

Although private consumption growth was robust in FY22/23, growth momentum is expected to be modest in FY23/24. Weaker global growth prospects and rising borrowing costs are likely to weigh on discretionary spending. Consumer spending by lower-income groups is expected to be hit, weaker than the tepid FY22/23 outcomes, due to slower growth in their incomes. This is consistent with labor market data indicating that over the past two years jobs and earnings losses were higher among informal workers like those in casual-wage work, those with below-tertiary level education, and those in low-paying sectors most affected by the pandemic, such as retail and hospitality services, and construction. While some of these workers and sectors have bounced back to or even surpassed pre-pandemic levels, the weak points of the recovery have shifted as migrants moved back to rural areas and the share of agricultural workers, who are also in vulnerable employment and are among the lowest earners, increased.

Domestic demand is also likely to be curtailed by a slower increase in government consumption as the Union Budget reaffirmed the government's commitment to reducing the share of current spending to 11.6 percent of GDP from 15.6 percent in FY20/21. Overall, government consumption as share of GDP is projected to decline from 10 percent in FY22/23 to 9.3 percent in FY23/24 (Figure 3.1). In contrast, investment activity will continue to be buoyed by higher public capex. The Union Budget has allocated 3.3 percent of total spending to capital expenditure, the bulk of which will be spent on infrastructure development. However, investment by private corporations will be constrained by limited risk appetite on the back of tight financial conditions, heightened growth uncertainty and elevated input prices. Nonetheless, conditions remain conducive for increased investment by private corporations: (a) increased profitability, especially of the services sector, (b) improved balance sheets of corporations and banks, (c) higher capacity utilization rate in the manufacturing sector, (d) the government's measures to facilitate business activity –production linked incentives (PLI) schemes, masterplan for logistics development, simplifying business regulations, and increased public infrastructure development, which can crowd-in private investment. Therefore, the investment cycle is projected to pick up in the second half of FY23/24, contingent on global growth recovery in 2024 and lower borrowing costs. This will translate into higher GDP share of investment.

Headline and core inflation will be on a downward trajectory, but some upside risks persist

Headline inflation is expected to average 5.2 percent in FY23/24, falling within the RBI's target range (2-6 percent) and 1.1 ppts less than average inflation in FY22/23. The key factors driving down inflation will be moderating global oil prices, lower food prices and easing core inflation. Global crude oil prices have fallen from a peak of USD 120 per barrel mid-2022 to around USD 83 per barrel (as of February 2023) and are projected to fall further by about 12 percent in 2023. This would translate into lower domestic fuel inflation, which will lower headline inflation directly and through second-order effects. The other significant component is food with a weight of 39 percent, which averaged around 6.9 percent y-o-y in FY22/23. Prices of cereals (weight of 9.7 percent in the CPI basket) surged over global and domestic supply concerns last year but are expected to ease on the back of an abundant winter crop harvest in Q1 FY23/24. Nonetheless, an extreme weather event, like last year's unprecedented heat wave which affected the wheat crop, poses a risk to cereal inflation. Furthermore, core inflation is expected to remain elevated but on a downward trajectory as the impact of monetary policy tightening starts to materialize from mid-FY23/24. Moderating global oil prices will push transportation costs down, and inflation in other services is also expected to ease on the back of a modest growth in consumer spending. Furthermore, an expected fall in prices of inputs such cotton and synthetic fibers over FY23/24 will further push down core inflation.

The CAD will narrow as the merchandise trade deficit declines

The current account deficit is expected to narrow to 2.1 percent of GDP from 3 percent in FY22/23 due to a substantial decline in the merchandise trade deficit. Moderating domestic demand and easing commodity prices will weigh on merchandise import growth. The overall merchandise export growth is also likely to be muted due to soft global demand, but export growth will be supported by a recovering China and resilient global demand for India's medium and high-technology goods. India's exports of medium and high-technology goods are expected to perform relatively better, extending the growth momentum achieved in FY22/23 to FY23/24. The central government has taken several initiatives (rationalizing customs duty on intermediate inputs, PLI scheme, National Electronics Policy) to encourage investment in such sectors, particularly in the case of electronics, the exports of which have increased in the post-pandemic period. At the same time, export of IT and Professional services will remain robust due to their critical nature to business operations. The narrowed current account deficit will be financed by stable FDI inflows and net portfolio capital inflows, driven by the strong

macroeconomic fundamentals of India and a favorable growth differential with the US. India's large foreign exchange reserves provide an additional buffer against external macroeconomic shocks. As of February 2023, these reserves provided about seven months of import cover, in terms of an estimated FY23/24 imports.

Fiscal consolidation will likely be slower; driven by moderate revenue growth and reduced current spending

The central government will continue to support growth through targeted fiscal support while safeguarding fiscal sustainability. Given the underutilization of borrowing space by the states and realistic assumptions in the FY23/24 Union Budget, the general government deficit is projected to decline to 8.7 percent of GDP in FY23/24 from 9.4 percent in FY22/23. The FY23/24 Union Budget provides continued impetus to capital spending and increased allocations to various programs that aim to support India's decarbonization agenda. As per the Budget, the consolidation will be driven by robust revenue growth in both direct and indirect taxes and lower current spending, mainly attributable to a withdrawal of additional food subsidy entitlements and lower costs for fertilizer and fuel subsidies. Nevertheless, risk of fiscal slippage remains amid the moderation in domestic demand growth and easing inflation; all of which might weigh on revenue and nominal GDP growth.

The debt-to-GDP ratio will stabilize around 84 percent but remains sustainable with low rollover risk

The elevated public debt-to-GDP ratio is stable but subject to risks arising from macroeconomic uncertainty. The projected level of the fiscal deficit stabilizes the debt-to-GDP ratio around 84 percent but if nominal GDP growth were to moderate more than currently projected, faster consolidation would be needed to reduce the debt burden over the medium-term. Notwithstanding these risks, the debt position remains sustainable. India's public debt is mostly domestic (only around 3 percent of public debt is external), of medium- or long-term maturity, and held by residents.

There are some downside risks to India's growth in FY23/24

Despite the overall resilience of the economy, there are significant headwinds to growth in FY23/24. The recent turmoil in the financial sector in the US and Europe may have adverse spill overs for the global financial markets through increased volatility and reduced risk appetite for emerging market assets. This could lead to another round of portfolio capital outflows, which in turn could contribute to depreciation pressures on the Indian rupee. External pressures notwithstanding, Indian banks are well capitalized, and the pace of interest rate hikes has been modest compared with advanced economies so the impact of policy tightening on bank balance sheets has been less severe. There are upside risks to food prices due to potentially extreme weather events during the summer and monsoon months. As a result, higher headline inflation could dampen domestic demand. Rural household incomes could also be affected by lower-than-expected agricultural output from the winter harvest due to unseasonal rainfall. Lastly, the expected fiscal consolidation and stabilization of the public debt ratio at around 83 percent are predicated on nominal GDP growth remaining in double digits through the forecast period. Given the high nominal effective rate of interest on public debt (at over 7 percent) a faster than expected moderation in economic growth would cause the public debt-to-GDP ratio to increase further instead of stabilizing at current levels.

Table 3.1: Macroeconomic outlook indicators

Indicator (percent y-o-y, unless otherwise indicated)	FY19/20	FY20/21	FY21/22	FY22/23	FY23/24
Real GDP Growth, at constant market prices	3.9	-5.8	9.1	6.9	6.3
Private Consumption	5.2	-5.2	11.2	8.3	6.9
Government Consumption	3.9	-0.9	6.6	1.2	-1.1
Gross Fixed Capital Formation	1.1	-7.3	14.6	10.1	9.3
Exports, Goods and Services	-3.4	-9.1	29.3	11.5	9.2
Imports, Goods and Services	-0.8	-13.7	21.8	19.0	11.6
Real GDP Growth, at constant factor prices	3.9	-4.2	8.8	6.6	6.3
Agriculture	6.2	4.1	3.5	3.2	3.4
Industry	-1.4	-0.9	11.6	3.6	6.8
Services	6.4	-8.2	8.8	9.5	6.7
Inflation (Consumer Price Index)	4.8	6.2	5.5	6.6	5.2
Current Account Balance (percent of GDP)	-0.9	0.9	-1.2	-3.0	-2.1
Fiscal Balance (percent of GDP)	-7.2	-13.3	-10.5	-9.4	-8.7
Debt (percent of GDP)	73.6	87.5	85.4	83.0	83.4
Primary Balance (percent of GDP)	-2.5	-7.8	-5.2	-4.2	-3.3

Source: CEIC and World Bank Staff calculations
Note: Shaded columns are WB forecasts

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