STATE OF THE ECONOMY

Quarterly Assessment and Growth Outlook: April - June, 2021

JULY, 2021

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

NATIONAL INSTITUTE OF PUBLIC FINANCE AND POLICY | NEW DELHI

MAJOR HIGHLIGHTS

- The estimate of growth in the fourth quarter (Q4) of 2020-21 shows a moderate revival of real GDP growth of 1.6 percent.

- The onset of the second wave of Covid-19 during the March–May 2021 period led to a moderation in the recent growth momentum of the economy. The second wave, unlike the initial onset of Covid-19, was different in terms of its intensity as well as geographic spread. Geographically, the states of Maharashtra, Andhra Pradesh, Kerala, Uttar Pradesh, West Bengal and Delhi experienced a severe impact of the second wave.

- The second wave also saw the spread of infections to the rural areas. Most State Governments had implemented a graded or partial lockdown between March and May, and a gradual re-opening was announced beginning June 2021.However, these measures were different from the steps taken during the first wave in July–September 2020 on a few counts: (i) strict lockdowns were not implemented; (ii) industries, construction activities and public transport (including air, railways) were operational and (iii) the vaccination drive started in January 2021 and was ongoing through the second wave. In June, the Union Government announced that the immunisation exercise would revert to the central procurement and distribution of vaccines, and that vaccines would be provided to states at no additional cost.

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

- A possible adverse impact on agriculture is expected in the first half of FY 2021-22 on account of adverse weather conditions and spread of Covid infections to the rural areas. Recent episodes of cyclones in India adversely affected the cultivation of horticulture crops and vegetables in the March–May period. Rabi harvesting and kharif cultivation activities are also likely to be affected by the spread of Covid infections to rural areas and may retard agricultural performance in the first half of FY 2021-22.

- During FY 2020-21, the average CPI inflation was 6.2 percent, which breached the RBI's tolerance band of 2–6 percent**.** The high headline inflation has been on account of food, health expenditure and fuel-transport inflation.

- Tax revenues of the Union Government (net of states' share) in 2020-21 show an increase of 5 percent over 2019-20 accounts and 5.9 percent over 2020-21 RE, as per the provisional accounts (PA) released by the Controller General of Accounts (CGA). However, non-tax revenue registered a sharp fall of about 36.4 percent over 2019-20 accounts. As a result the total revenue receipts of the Union show a decline of about 3.1 percent in 2020-21 as compared to that in 2019-20.

- There has been a considerable increase in the expenditure of the Union Government in 2020-21 (PA) as compared to 2019-20 accounts, owing to higher spending on healthcare and livelihood support. The subsidy bill for the Union went up by 202 percent during 2020-21 (PA) over 2019-20 on account of higher requirement of food and fertiliser subsidies due to the pandemic.

- As per 2020-21 (PA), the fiscal deficit stood at 9.2 percent of GDP. The budgeted gross market borrowings for FY 2020-21 was Rs. 7.8 lakh crore. As on 26 March 2021, the Union

Government's gross market borrowings for FY 2020-21 stood at Rs. 13.7 lakh crore, an increase of 93 percent over the corresponding period in 2019-20.

- Finances of State Governments continue to show improvement in the fourth quarter of FY 2020-21 with the revival of economic activities. The total revenues aggregated across 23 states in Q4 was higher by 9.07% as compared to the corresponding period in 2019-20. Aggregating across the four quarters, we find the total revenues of states to be lower by 4.65% in 2020-21 vis-à-vis 2019-20. However, public spending in 2020-21 was higher than that in 2019-20.

- The decline in own tax revenues aggregated across 23 states moderated from -43.38 percent in Q1 of 2020-21 to -7.33 percent in Q2 and then increased by 10.94 percent in Q3. Own tax revenues show a considerable improvement in Q4, increasing by 16.47 percent as compared to the corresponding period in 2019-20.

- Central transfers aggregated across 23 states show an increase of 29.52% in Q4 of 2020-21 vis-à-vis 2019-20 due to the increase in both tax devolution (27.62%) and grants to states (31.67%). However, tax devolution to states aggregated across the four quarters of 2020-21 was lower by 8.44% as compared to that in 2019-20, due to fall in Central transfers in the first three quarters on 2020-21 on account of the Covid induced lockdown. Central grants to states (inclusive of GST compensation) was higher by about 15.43 vis-à-vis 2019-20.

- Aggregating 2021-22 Budget numbers of 28 States we observe 2020-21 revised estimates of own-tax revenues to be lower by 15.1 percent as compared to 2020-21 budget estimates. Central transfers to states were also estimated to be lower by 15.7 percent, with tax devolution falling by about 28.9 percent. Expenditures, both revenue and capital, are also lower by 4.35 percent and 16.6 percent respectively in 2020-21RE as compared to BE. GSDP aggregated across 28 states is projected to be lower by 8.5 percent in 2020-21RE as compared to what was budgeted by these States for 2020-21. However, in 2021-22, the GSDP is projected to grow at 10.9 percent in nominal terms.

- On the external front, against the backdrop of slowdown in world trade, India's merchandise exports and imports contracted by 7.3 percent and 18.0 percent, respectively, during 2020-21. Pharmaceuticals, agricultural products, engineering goods and iron ore were some of the sectors that recorded positive growth. During April-December 2020-21, the current account recorded a surplus of 1.7 percent of GDP as against a deficit of 1.2 percent a year ago.

- As on 21 May 2021, on a yearly basis, money supply continued to grow by 9.9 percent (YoY), driven by growth in aggregate deposits. Growth in currency-in-circulation had begun to moderate in the second half of FY 20-21 but saw a rising trend in April and May 2021, indicating a rise in precautionary demand for cash during the second wave of Covid-19.

- The RBI has further announced new measures to mitigate the impact of the second wave. Some of the measures include: (i) on-tap liquidity window of Rs. 15,000 crore for contact-intensive sectors; (ii), special liquidity facility of Rs. 16,000 crore to SIDBI; (iii) enhancement of the exposure thresholds under Resolution Framework 2.0 from Rs. 25 crore to Rs. 50 crore for MSMEs, non-MSME small businesses and loans to individuals for business purposes.

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1. Macroeconomic Assessment and Growth Outlook

I. Trends in Growth

- The growth estimates of quarterly gross domestic product (GDP) for the period January-March, 2021 as provided by the National Statistical Office (NSO), show that GDP at constant (2011-12) prices in Q4 of 2020-21 was estimated at Rs. 38.96 lakh crore, as against Rs. 38.33 lakh crore in Q4 of 2019-20, showing a growth of 1.6 percent. Real GDP growth rate for Q1, 2020-21 (YoY) had registered a -24.4 percent decline, while Q2 of 2020-21 (YoY) showed signs of initial recovery as the growth rate improved significantly to -7.4 percent. The Q4 estimate shows a moderate revival of the real GDP growth at a rate of 1.6 percent.

Table 1: Quarterly Growth Rates (%, constant prices) of GDP, 2011-12 Series

Sectors	Annual 2019-20	Annual 2020-21	Q1 2020-21 Apr – Jun	Q2 2020-21 Jul – Sep	Q3 2020-21 Oct - Dec	Q4 2020-21 Jan-Mar
			YoY	YoY	YoY	YoY
GDP	**4.2**	**-7.3**	**-24.4**	**-7.4**	**0.5**	**1.6**
Agriculture, Fishing, etc.	4.0	3.6	3.3	3.0	3.9	3.1
Mining & Quarrying	3.1	-8.5	-18	-7.6	-5.9	-5.7
Manufacturing	0.0	-7.2	-35.9	-1.5	1.6	6.9
Electricity, Gas, Water etc.	4.1	1.9	-9.9	2.3	7.3	9.1
Construction	1.3	-8.6	-49.4	-7.2	6.2	14.5
Trade, hotels, Trans., etc	3.6	-18.2	-47.6	-15.3	-7.7	-2.3
Financial & Prof. Serv.	4.6	-1.5	-5.4	-9.5	6.6	5.4
Public Admin, defence, etc	10.0	-4.6	-9.7	-9.3	-1.5	2.3

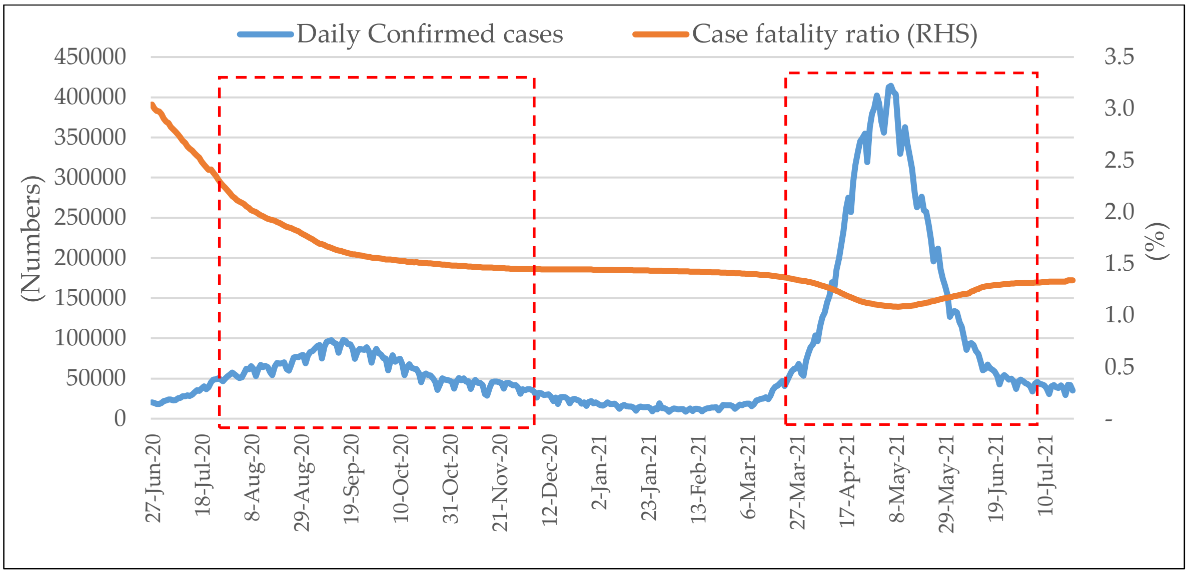
Source: National Statistical Office (NSO), Press Release, May, 31st, 2021

Economic recovery and the Second Covid Wave – March-May 2021

- The onset of the second wave of Covid-19 in March-May 2021 led to a moderation in the recent growth momentum of the economy. The second wave of infections, unlike the initial onset of Covid in 2020, was different in terms of both intensity and geographic spread. During 2020, the first peak of number of cases was reached in 220 days, whereas during the second wave, the peak was reached in 79 days. Geographically, the states of Maharashtra, Andhra Pradesh, Kerala, Uttar Pradesh, West Bengal and Delhi experienced a severe impact during the second wave.

- The second wave also led to spread of infections to rural areas. The newer variant of Covid infections was much more severe and a large number of cases required hospitalisation and critical health care. The policy response on containment was similar to earlier lockdowns, but was implemented by State Governments in a staggered manner. Most states had implemented a graded or partial lockdown between March and May and a gradual re-opening was announced beginning June. As evident from the Figure 1, new cases of infection are on the decline.

Figure 1: Trend of Covid Cases

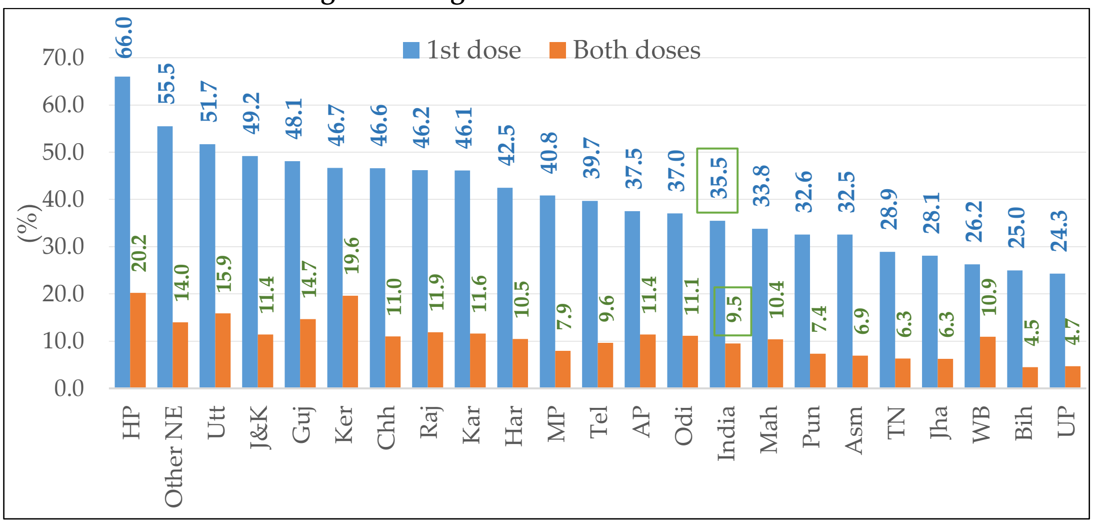


Note: As on 23 July 2021. Source: Covid19india.org

- At the start of the second wave in early March, the economy was on the track of revival with most sectors resuming their operations. Beginning March, the daily case load reached a peak of 4,00,000 cases, leading State Governments to re-impose lockdowns. However, this lockdown was different from the measures implemented during the first wave in July–September 2020 in a few ways: (i) strict lockdowns were not implemented; (ii) industries, construction activities and public transport (including air, railways) were operational; and (iii) the vaccination drive started in January 2021 and was ongoing through the second wave. In June, the Union Government announced that the immunisation exercise would revert to central procurement and distribution of vaccines, and that vaccines would be provided to states at no additional cost. While private hospitals would continue to procure up to 25 percent of the requirement, a price ceiling of Rs.150 per dose would be fixed.

- As of 23 July 2021. 35.5% of the population had received the first dose of vaccination and 9.5% were fully vaccinated. State-wise progress of vaccination is presented in Figure 2.

Figure 2: Progress of Vaccination in India



Note: As on 23 July 2021. Source: MoHFW; Population projection (NHM)

- The re-imposition of state-wise lockdown restrictions during between March and May is expected to retard the pace of revival in the beginning of financial year (FY) 2021-22.

- **Large contraction, but limited recovery**: Trade, Hotels, Transport and Communication as well as Mining and Quarrying sectors contracted significantly in the last two quarters of FY 2020-21 and continue to remain affected by the measures imposed to contain the pandemic.

- In Q4 of 2020-21, private final consumption expenditure (PFCE) recorded a modest positive growth (2.7 percent) over Q4 of 2019-20. This modest recovery indicates the slow pace of revival in consumer confidence. The high growth was registered by government final consumption expenditure (GFCE) owing to increase in expenditure on account of announcements in the Union Budget of 2021-22.

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

Sectors	Annual 2019-20	Annual 2020-21	Q1 2020-21 Apr-Jun	Q2 2020-21 Jul-Sep	Q3 2020-21 Oct-Dec	Q4 2020-21 Jan-Mar
			YoY	YoY	YoY	YoY
GDP	**4.2**	**-7.3**	**-24.4**	**-7.4**	**0.5**	**1.6**
Private Final Consumption Exp. (PFCE)	5.3	-9.1	-26.2	-11.2	-2.8	2.7
Govt. Final Consumption Exp. (GFCE)	11.8	2.9	12.7	-23.5	-1.0	28.3
Gross Fixed Capital Formation (GFCF)	-2.84	-10.8	-46.6	-8.6	2.6	10.9
Exports of Goods and Services	-3.6	-4.7	-22	-2.0	-3.6	8.8
Imports of Goods and Services	-6.8	-13.6	-40.9	-17.9	-5.0	12.3

Source: National Statistical Office (NSO), Press Release, May, 31st, 2021

II Growth outlook for the near future

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

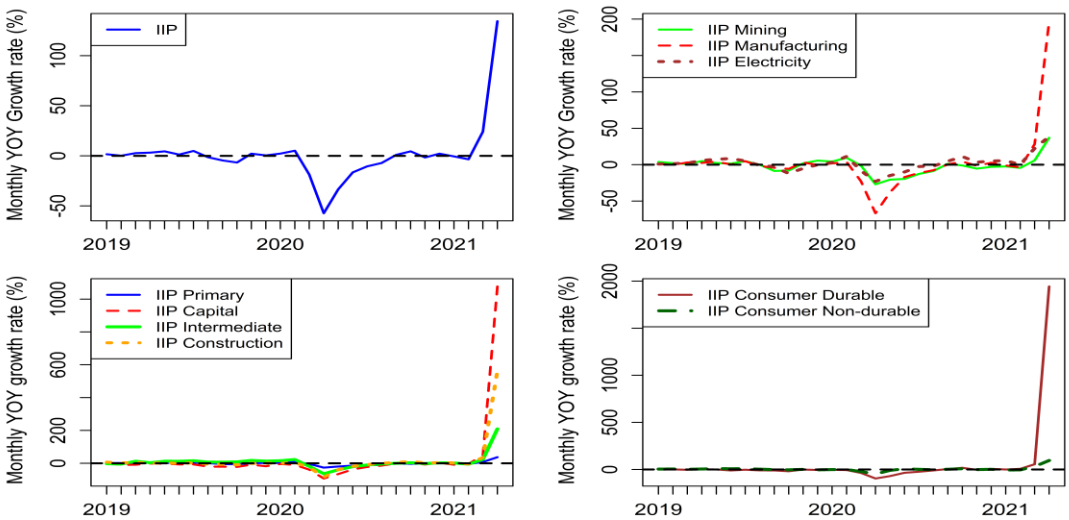
1. Agriculture

- Agricultural performance during 2020-21 has remained insulated from a negative shock on account of a good monsoon that kept rabi and kharif activities unaffected. However, there is a possibility of an unfavourable impact on agriculture in the first half of FY 2021-22 on account of delayed monsoon during June-July and the spread of Covid infections to the rural areas. The recent episodes of cyclones in some states (coinciding with the second wave) adversely affected cultivation of horticulture crops and vegetables. Rabi harvesting and kharif cultivation activities are also likely to be affected by spread of Covid infections to rural areas and may retard agricultural performance in the first half of FY 2021-22.

2. Industry

- In April2021, all components of the index of industrial production (IIP) recorded a positive growth rate, primarily on account of a low base in April 2020 (Figure 3).

Figure 3: Recent Trend in Components of IIP



Source: NSO

- Figure 2 shows that aggregate IIP and most of its components show a mild recovery after a subdued performance in Q3 of 2020.The re-imposition of lockdowns in major states moderated the pickup in industrial output and is likely to delay the revival of economic activities to pre-pandemic levels.

- Despite the slowdown, IIP Capital Goods registered a positive growth in March and April 2021. Capital goods such as plant, machinery and equipment are important inputs in the production process and this segment is also a major engine of recovery of growth. IIP Infrastructure/Construction also grew positively in March and April 2021. The activities in this sector received a boost from the National Infrastructure Pipeline Plan during 2020-21. The push for infrastructure development in the Union Budget of 2021-22 provided further boost to the sector for it to remain resilient during the spread of the pandemic.

Table 3: Pattern of Recovery in Selected High Frequency Indicators for Industrial Sector

Indicator	April 2019	April 2020	April 2021	May 2019	May 2020	May 2021
Production of coal (million tonnes)	56.4	47.6	52.2	58.5	50.3	
Production of crude oil ('000 tonnes)	2718.5	2545.8	2493.3	2800.0	2602.4	
Production of two wheelers ('000 numbers)	1867.0	0.0	1505.0	2029.0	284.0	632.0
Production of commercial vehicle ('000 numbers)	82.0	0.0	61.0	81.0	6.0	63.0
Passenger car sales	199090.0	2753.0	165944.0	191864.0	25702.0	61209.0
Production of cement ('000 tonnes)	29160.0	4305.0	27932.0	28562.0	22443.0	
Consumption of steel ('000 tonnes)	7691.0	1091.0	7341.0	8850.0	4789.0	7280.0
Electricity generation (million Kwh)	109263.4	81045.2	115473.3	117047.0	96501.4	103964.6

Source: NSO, CMIE

- Production in sectors related to consumer durables (e.g., two-wheelers and commercial vehicles) came to a complete halt in April 2020 (Table 3). The onset of the second Covid-19 wave in March 2021brought similar economic uncertainties, leading to large variations in production levels. However, the pandemic-induced lifestyle changes may also lead to conservative consumer spending and lower consumer confidence. Thus, consumer sentiments are more likely to remain subdued and growth in consumer durables is expected to slow down at least during the first half of 2021.

3. Services

- Passenger travel by air in April 2021 recovered only up to 46 percent over April 2019. Similarly, travel by rail in February 2021recovered up to 33 percent of the level in April 2019. The trends in these sectors indicates that **travel services are yet to recover from the impact of lockdowns and the second wave of the pandemic in the beginning of 2021.**

Table 4: Pattern of Recovery in Selected High Frequency Indicators for Services Sector

Indicator	April 2019	April 2020	February 2021	April 2021	May 2019	May 2020	May 2021
Passenger Air ('000 num.)	267.0	0.6		124.6	289.1	7.1	
Passenger Rail (million num.)	684.2	0.0	288.1		678.6	0.0	
Cargo Air ('000 tonnes)	275.16	47.24		263.0	293.9	94.92	
Cargo Rail ('000 tonnes)	100940	65300	112100		104730	82460	
Cargo Port ('000 ton)	60074.0	47432		61528	59184	45389	60448
Tele Subscribers (million num.)	1183.8	1169.44	1187.9		1183.2	1163.7	

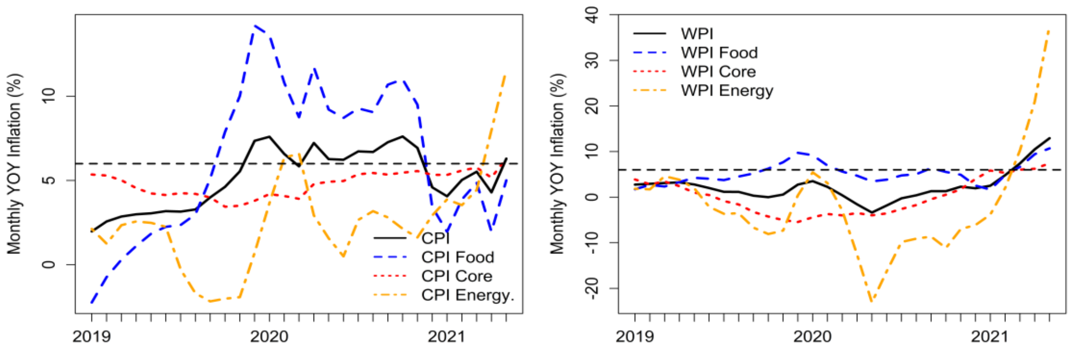
Source: CMIE, TRAI

- With the re-imposition of lockdowns in the beginning of 2021, cargo movement contracted by 7.4 percent in April and by 1.2 percent in May. The cargo movement by railways grew at 19.7 percent in March 2020 and 15.4 percent in April 2020 on month on month basis (after seasonal adjustment) basis on account of several measures taken by Indian Railways to keep the supply of essential commodities unaffected. However, the pace of activities stalled afterwards and became volatile during the October 2020-February 2021 period. **Overall, the momentum of recovery in the service sector activities got stalled due to the resurgence of the pandemic during Q1 of 2021-22.**

2. Inflation Assessment and Outlook

- **During FY 2020-21, the average consumer price index (CPI) inflation was 6.2 percent,** which breached the Reserve Bank of India's (RBI) tolerance band of 2–6 percent**.** The high headline inflation has been on account of food inflation resulting from crop damages by excess rainfall in the second half of FY 2019-20 and from core (non-food, non-fuel) inflation, driven mainly by health and fuel-transport inflation. (Figure 4, left panel). However, the CPI inflation retracted within the band in December 2020 and January 2021 (4.6 percent and 4 percent respectively), owing to the decline in food inflation with the arrival of winter crops.

Figure 4: Recent Trends in CPI and WPI



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

- The average inflation in CPI food was 11 percent from October 2019 to October 2020. This elevated level was a result of crop damages due to prolonged abnormal rainfall in the onion producing states since August 2019 (Figure 5, right panel). The price pressure intensified and spread across other food commodities, especially during and after the lockdown period, due to supply chain disruptions. This period also witnessed a gradual rise in the cost of agricultural labor, which was driven by the boost in agricultural activities on account of good monsoon, and the rise in easy retail financing provided in the stimulus package). With the rainfall returning to normal levels and the arrival of the winter crops in 2020, the pressure on food inflation eased, and it gradually came down to 3.4 percent in December 2020. The food inflation during Q4 of 2020-21 was 4.9 percent.

- The core CPI inflation was affected largely by supply shocks (caused by production and transport disruption) than by negative demand shocks, and was at 5.3 percent during FY 2020-21.The inflation rate in miscellaneous items (28 percent of the CPI basket) remained persistently higher than 6 percent in FY 2020-21. This high level was due to the rise in expenditure on health, particularly in the urban sector, and transport as a result of the pandemic.

- **The beginning of FY 2021-22 saw the economy experiencing a resurgence of inflationary pressures, driven by the upward trend in inflation in all the major components of the CPI:**

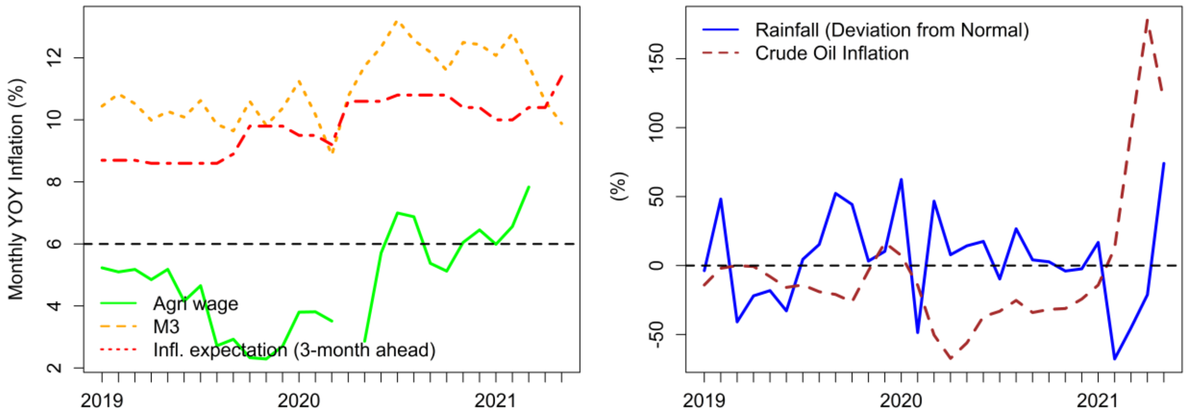
  - Crude oil inflation saw a rebound from February 2021 and recorded an inflation rate of 148.7 percent in April-May 2021 (Figure 5, right panel). Consequently, CPI energy inflation rose to 9.8 percent during the same period. Oil inflation transmitted to the core CPI inflation, which also crossed the 6 percent mark in May 2021.

  - The boost in agricultural activities in the post lockdown period pushed up the agricultural wage growth from 5 percent in October 2020 to 8 percent in March 2021.RBI's household inflation expectation (three month ahead) increased from 10 percent in February 2021 to 11.4 percent in May 2021 (Figure 5, left panel).

- **Wholesale Price Index (WPI) exhibited deflation in April-July 2020, but rose thereafter.** The deflation was caused by reduction in crude oil prices (Figure 5, right panel).During FY 2020-21, overall WPI inflation was low at 1.3 percent.

- WPI food articles inflation experienced a transitory effect of the abnormal rainfall in Q3 and Q4 of 2019-20 and was at 9.7 percent during that period. Normalisation of wholesale agricultural supply on account of good monsoon in FY 2020-21 helped in relaxing the pressure on wholesale prices of food articles. WPI food articles has been at 3.1 percent in FY 2020-21. However, manufactured food products inflation remained high at 5.5 percent, on account of production and supply disruptions driven by the pandemic. Consequently, WPI food (food articles and manufactured food products) inflation was at 4.5 percent during FY 2020-21.

Figure 5: Factors Driving Inflation



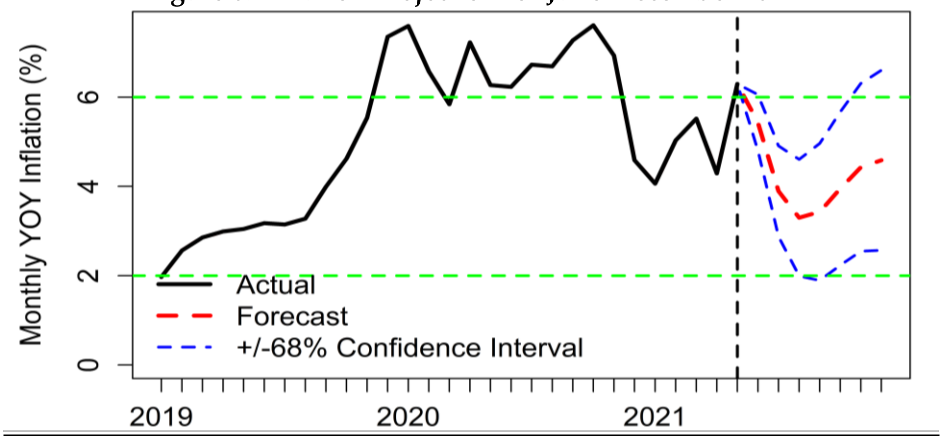
Source: CMIE, World Bank

Inflation outlook for the future

Headline inflation outlook is based on past trends and underlying drivers of inflation, including inflationary expectations, wholesale food inflation, demand conditions, money supply and oil prices.

- **Overall, the headline inflation in FY 2021-22 is expected to retreat within the RBI's band in June and continue to moderate till August, but is likely to register a rebound after that.** The initial retreat will be on account of moderation in crude oil inflation from 178 percent in April to 119 percent in May. However, the headline inflation may start rising again on account of a few upward risks on inflation. These are: (i) rise in agricultural wages with the onset of kharif activities; (ii) further rise in crude oil inflation; and (iii) sticky core inflation near the upper level of the band, which is a **direct fallout of the pandemic** (for example, supply chain disruptions in the face of demand revival).

Figure 6: Inflation Projection for June-December 2021



Source: NIPFP

3. FISCAL ISSUES: UNION GOVERNMENT

I Revenues

- Despite lockdowns across states, the tax revenues of the Union Government (net of states' share) in 2020-21 show an increase of 5 percent over 2019-20 accounts and 5.9 percent over 2020-21 RE, as per the provisional accounts (PA) released by the Controller General of Accounts (CGA) (Table 5). However, non-tax revenue registered a sharp fall of about 36.4 percent over 2019-20 accounts. As a result, the total revenue receipts of the Union show a decline of about 3.1 percent in 2020-21 as compared to that in 2019-20.

Table 5: Overview of Revenues

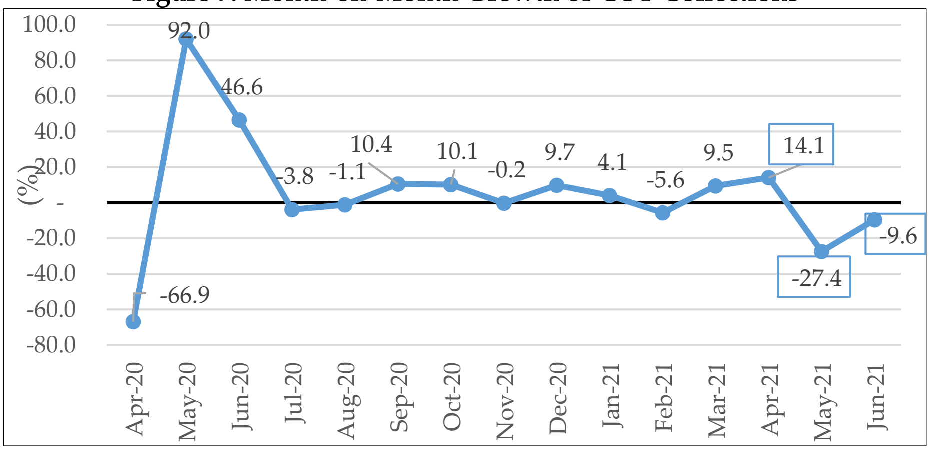
Indicators	Apr-May 2021		2020-21 PA Rs. Cr.	2020-21 RE Rs. Cr.	2019-20 Accounts Rs. Cr.	Change in 2020-21 PA over 2019-20 (%)	Change in 2020-21 PA over 2020-21 RE (%)
	Rs. Cr.	% of BE					
Revenue Receipt	3,49,977	19.6	16,32,094	15,55,153	16,84,059	-3.09	4.95
Tax Revenue	2,33,565	15.1	14,24,035	13,44,501	13,56,902	4.95	5.92
Non-Tax revenue	1,16,412	47.9	2,08,059	2,10,653	3,27,157	-36.40	-1.23

Source: CGA, Union Budget

- The revenue receipts for the first two months of FY 2021-22 amounted to Rs. 3.49 lakh crore, which was 19.6 percent of the budget estimate. Tax revenue (net of state's share) for April-May 2021 stood at around Rs. 2.33 lakh crore (15.1 percent of the 2021-22 BE). The corresponding figure for 2019-20 was 6.8 percent of the budget estimates of 2019-20.

- Among indirect taxes, growth in GST collections has been volatile during 2020-21 (Figure 7). The overall collections for the period FY 2020-21show a fall of about 7 percent over the corresponding period in 2019-20. However, the monthly GST collections have remained above Rs. 1 lakh crore for eight consecutive months since October 2020. The decline in GST collections in the months of May and June 2021 can be attributed to the slowdown in economic activity due to localised lockdowns imposed by State Governments to control the second wave of the pandemic. With the second wave of Covid cases declining and states easing lockdown restrictions, along with the increase in the pace of vaccination, we expect GST collections to improve in the coming months.

Figure 7: Month-on-Month Growth of GST Collections



Source: CMIE Economic Outlook

- Non-tax revenue receipts rose significantly during the first two months of FY2021-22 (47.9 percent of BE) due to dividends and profits amounting to Rs. 99,122 crore transferred by RBI to the government in May 2021.[1]

II Expenditure

- There has been a considerable increase in the expenditure of the Union Government in 2020-21 as compared to 2019-20 accounts, owing to higher spending on healthcare and livelihood support. The subsidy bill for the Union went up by 202 percent during 2020-21 PA over 2019-20 on account of higher requirement of food and fertiliser subsidies due to the pandemic. (Monthly Economic Report, Ministry of Finance, May 2021).

- The Union Government expenditure was low for April-May 2021 relative to the corresponding period in the previous two years. Revenue expenditure stood at 14.2 percent of BE for the first two months of FY2021-22 against 17.4 percent and 19.0 percent of BE in 2020-21 and 2019-20 respectively. Capital expenditure stood at 11.4 percent of BE in April-May 2021, lower than in the same period of 2020-21 (13.4 percent) and 2019-20 (14.2 percent).

Table 6: Overview of Expenditures

Indicators	Apr-May 2021		2020-21 PA Rs. Cr.	2020-21 RE Rs. Cr.	2019-20 Accounts Rs. Cr.	Change in 2020-21 PA over 2019-20 (%)	Change in 2020-21 PA over 2020-21 RE (%)
	Rs. Cr.	% of BE					
Revenue Exp.	4,15,000	14.2	3,086,360	3,011,142	2,350,604	31.30	2.50
Capital Exp.	62,961	11.4	424,821	439,163	335,726	26.54	3.27
Total Exp.	4,77,961	13.7	3,511,181	3,450,305	2,686,330	30.71	1.76

Source: CGA, Union Budget

- Fiscal deficit for 2019-20was 4.6 percent of GDP. For 2020-21, the budgeted fiscal deficit was 3.5 percent of GDP, which went up to 9.5 percent of GDP in the revised estimates due to the pandemic and increased fiscal transparency (inclusion of loans to the Food Corporation of India (FCI) in the budget). As per the 2020-21 (PA), fiscal deficit is at 9.2 percent of GDP. The marginal improvement over the 2020-21 RE was on account of improvement in revenue collections. The fiscal deficit is budgeted at 6.8 percent of GDP for 2021-22.

III Debt

- The budgeted gross market borrowings for FY 2020-21 was Rs. 7.8 lakh crore. As on 26 March 2021, the Union Government's gross market borrowings for that financial year 2020-21 stood at Rs. 13.7 lakh crore, an increase of 93 percent over the corresponding period in 2019-20 and around 176 percent of the budgeted number.

- The Union Government has budgeted for a borrowing of Rs. 12.05 lakh crore for FY 2021-22. The Government plans to borrow Rs. 7.24 lakh crore in the first half of the current fiscal as per its borrowing calendar, which is 60 percent of its budgeted borrowings. As of 28 May 2021, gross borrowings by the Union Government stood at Rs. 1.84 lakh crore – 25.4 percent of its gross borrowings slated for the first half of the year.

IV Economic recovery and future outlook: An assessment

- The RBI has cut its forecast of real GDP growth for the current fiscal from 10.5 percent to 9.5 percent. The economic recovery is critically dependent on the evolving path of future waves of

[1]https://rbidocs.rbi.org.in/rdocs/PressRelease/PDFs/PR2527C1530F79B78477E8FCE6B22E6C46C68.PDF

the pandemic and the containment measures that may be adopted. The localised lockdowns during the second wave had a moderate impact on economic activity. The pace of vaccination will be pivotal in determining the severity of future waves of the pandemic and the extent of its spread in urban and rural areas.

4. FISCAL ISSUES: STATE GOVERNMENTS

- Finances of State Governments continue to show improvement in Q4 of FY 2020-21, with the revival of economic activities. While Q1 of 2020-21 was characterised by contraction in total revenue receipts on account of lockdowns, Q2 saw some improvement following the phased opening of the economy. In contrast, Q3 was characterised by the growth in total revenue of states moving into the positive territory. The trend continued in Q4, with total revenues increasing by 9.07 percent as compared to Q4 of 2019-20. Aggregating across the four quarters, we find the total revenues of states to be lower by 4.65 percent in 2020-21 vis-à-vis 2019-20. However, public spending in 2020-21 was higher than in 2019-20.

Table 7: Percentage Change in Key Fiscal Indicators of States in 2020-21 Over 2019-20 (23 states)

		Q1 (Apr-Jun)	Q2 (Jul-Sep)	Q3 (Oct-Dec)	Q4 (Dec-Mar)	Q1toQ4 (Apr-Mar)
Revenues						
1	Total Rev. Rec. (2+5)	-19.07	-16.09	2.49	9.07	-4.65
2	Own Rev. Rec. (3+4)	-40.79	-9.19	8.85	-2.43	-9.55
3	Own Tax revenue	-43.38	-7.33	10.94	16.47	-4.48
	Of which					
	(i) SGST	-40.56	-13.12	4.50	9.93	-8.39
	(ii) Sales Tax	-39.12	-5.63	20.20	13.42	-1.58
	(iii) State Excise	-37.07	17.08	26.73	23.22	7.72
4	Non-tax Revenue	-18.58	-23.69	-7.56	-52.81	-36.35
5	Central transfer (6+7)	20.07	-24.90	-6.14	29.52	2.80
6	Devolution	-5.82	-23.98	-33.62	27.62	-8.44
7	Grants	56.02	-25.79	22.67	31.67	15.43
Expenditure						
8	Revenue expenditure	13.27	-9.88	2.24	16.61	5.71
9	Capital expenditure	-41.96	-24.29	7.23	40.29	5.01
10	Total expenditure (8+9)	7.27	-11.51	2.83	20.25	5.62
	Of which					
	(i) Exp. on Gen Services	5.10	-4.81	8.44	11.96	5.47
	(ii) Exp. on Soc Services	16.10	-7.23	-1.07	18.05	6.68
	(iii) Exp. on Econ. Services	-16.84	-18.45	2.06	35.09	5.10
11	Rev. Deficit (% of GDP)	**-3.98**	**-1.65**	**-0.68**	**-1.39**	**-1.88**
12	Fiscal Deficit (% of GDP)	**-4.76**	**-3.15**	**-2.36**	**-5.01**	**-3.91**

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

- The decline in own tax revenues in 2020-21 aggregated across 23 states moderated from -43.38 percent in Q1 to -7.33 percent in Q2, and then increased by 10.94 percent in Q3. Own tax revenues how a considerable improvement in Q4, increasing by 16.47 percent as compared to the corresponding period in 2019-20 (Table 7). In the case of non-tax revenues, there is a sharp fall in Q4of 2020-21 – 52.81 percent–over Q4 of 2019-20. As a result, own revenues were lower by 2.43

percent in Q4 in 2020-21 as compared to 2019-20. Own revenues of states, aggregated over the four quarters of 2020-21, remained lower by 9.55 percent as compared to that in 2019-20; own taxes remained lower by 4.48 percent and non-tax revenues by 36.35 percent.

- States Goods and Service Tax (SGST) and sales tax (which together account for about two-thirds of states' own tax revenues) increased by 9.93 percent and 13.42 percent respectively in Q4of 2020-21 as compared to Q4 of 2019-20. To generate additional revenues, several State Governments increased duties on petrol, diesel and alcohol. This resulted in an increase in revenues from state excise by about 17.08 percent in Q2, 26.73 percentin Q3 and 23.22 percent in Q4. While revenues from state excise show an increase of about 7.72 percent during the whole of FY 2020-21 vis-à-vis 2019-20, revenues from SGST and sales tax were lower by 8.39 percent and 1.58 percent respectively.

- **Central transfers** aggregated across 23 states show an increase of 29.52 percent during Q4 of 2020-21 vis-à-vis 2019-20, due to the increase in both tax devolution by the Union Government (27.62 percent) and Central grants to states (31.67 percent).

- Examining the Central transfers for the FY 2020-21 we observe that tax devolution to States, aggregated across the four quarters of 2020-21, was lower by 8.44 percent as compared to that in 2019-20. Central grants to states (inclusive of GST compensation), on the other hand, was higher by about 15.43 percent vis-à-vis 2019-20. The net effect of higher grants and lower tax devolution in 2020-21 as compared to 2019-20 is that Central transfers to states in aggregate were higher by about 2.80 percent.

- The revenue expenditure of states in Q4 of 2020-21 improved by 16.61 percent, with a commensurate rise in total revenue receipts. The capital expenditure, which turned positive in Q3 after a considerable fall in Q1 and Q2 over the corresponding periods in 2019-20, was higher by 40.29 percent in Q4. Aggregating over all the four quarters of 2020-21, we find capital expenditure to be higher by 5.01 percent vis-à-vis 2019-20.

- Service-wise break-up of expenditure in states show that the expenditures on general and social services increased by 11.96 percent and 18.05 percent respectively in Q4 of 2020-21. The expenditures on economic services, which fell during Q1 and Q2, turned positive since Q3 and show an increase of 35.09 percent in Q4. The period April 2020-March 2021 showed an increase in expenditure on all the three services as compared to the corresponding period in 2019-20 (Table7).

- The revenue and fiscal deficits as percent of GDP aggregated across 23 states for FY 2020-21 is 1.88 percent and 3.91 percent respectively. The Fifteenth Finance Commission, in its final report, has estimated a revenue surplus for all states at around 0.1 percent of GDP and fiscal deficit of 4.2 percent of GDP for FY 2020-21.

- States had budgeted Rs. 6.96 lakh crore as market borrowing for FY 2020-21 out of the total internal debt of Rs. 8.99 lakh crore. The additional borrowing facility of 2 percent of gross state domestic product (GSDP) – beyond the 3 percent borrowing limit – provided under Atma Nirbhar Package of May 2020 amounted to about Rs. 4.28 lakh crore. While states have to incur higher market borrowing due to shortfall in revenue receipts, the actual borrowing is expected to remain less than the enhanced limit, depending on the capacity of individual states to access market borrowing and their ability to meet the conditions to be eligible for additional borrowings.

- During 2020-21, up to 26 March 2021, State Governments have raised Rs. 7.8 lakh crore as gross market borrowings, which is 27.9 per cent higher what they did in 2019-20.As per the indicative calendar of market borrowings by State Governments/Union Territories for April-June 2021 (Q1 of

2021-22), the quantum of total market borrowings by State Governments/Union Territories is expected to be Rs. 1.78 lakh crore.

- The back-to-back loans provided to states to meet the estimated shortfall in revenue of Rs. 1.10 lakh crore due to the implementation of GST was being accounted for under loans from the Union in state budgets. In FY 2020-21, the Union Government has borrowed Rs. 1,10,208 crore at a weighted average interest rate of 4.8473 percent and passed it on to the State Governments (Rs. 101,329 crore) and Union Territories with Legislature (Rs. 8,879 crore). Furthermore, under the scheme 'Special Assistance to States for Capital Expenditure' announced as a part of the Atma Nirbhar Bharat Abhiyan, Rs. 11,830 crore has been released for capital expenditure to 27 states.

- The impact of the pandemic on the finances of states can further be assessed from the examination of annual budgets for FY 2021-22. Aggregating budget numbers of 27 states, the 2020-21 revised estimates of own tax revenues are lower by 15 percent as compared to the 2020-21 budget estimates. Estimates of non-tax revenue were lower by 23.8 percent. Central transfers to states were also estimated to be lower by 16.7 percent, with tax devolution falling by about 29.8 percent (Table 8).

- The GSDP aggregated across 28 states is projected to be lower by 8.50 percent in 2020-21 (RE) as compared to the BE figures. However, in 2021-22, the GSDP is projected to grow at 10.90 percent in nominal terms. In 2021-22BE, State Governments have budgeted their own tax revenue to grow by 28.82 percent, which translates into an aggregate buoyancy factor of 2.65. The revenue deficit and fiscal deficit as percent of GSDP, aggregated across 28 states, is estimated to be around 1.99 percent and 4.40 percent respectively in 2020-21RE, as compared to a revenue surplus of 0.14 percent and fiscal deficit of 2.74 percent in the BE for the same year. As of 2021-22BE, these states, in aggregate, have budgeted for a revenue deficit of 0.51 percent of GSDP and a fiscal deficit of 3.40 percent. The 15th FC had recommended a borrowing limit of 4 percent of GSDP for the states for 2021-22. State-wise FD budgeted for 2021-22 is presented in Figure 8. The outstanding liabilities, as percent of GSDP are budgeted to increase from 25.54 percent in 2019-20 to 29.50 percent in 2021-22BE.

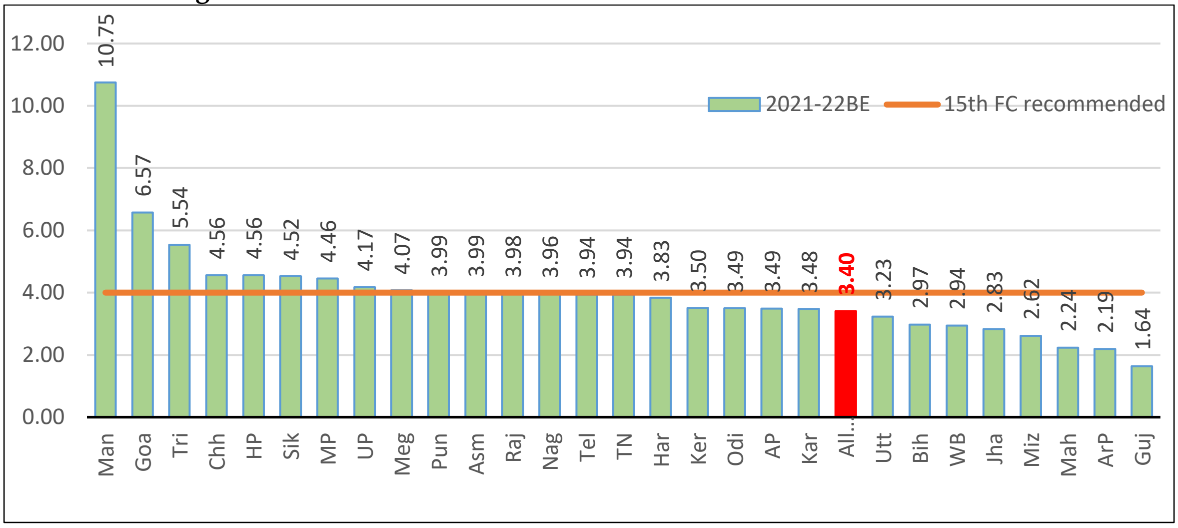
Table 8: Percentage Change in Key Fiscal Indicators of States (28 states)

		% change between	
		2020-21RE & 2020-21BE	**2021-22BE & 2020-21RE**
1	**Total Revenue Receipt (2+5)**	**-16.15**	**24.60**
2	**Own Revenue Receipt (3+4)**	**-16.52**	**29.62**
3	Own Tax Revenue	-15.12	28.82
4	Own Non-Tax Revenue	-24.10	34.45
5	**Central Transfers (6+7)**	**-15.73**	**19.08**
6	Share in Central Taxes	-28.88	20.23
7	Grants-in-aid	0.44	18.07
8	Revenue Expenditure	-4.35	11.93
9	Capital Expenditure	-16.59	34.31
10	**Total Expenditure (8+9)**	**-6.15**	**14.86**
11	Outstanding Liabilities	4.56	12.13
12	**GSDP**	**-8.50**	**10.90**

Notes: Negative values indicate decrease and positive values increase;
Source: 2021-22 Budget documents of 28 states.

- **Implications of high revenue projections:** The finances of State Governments for 2021-22 has been projected with an optimism on the revenue front and a cautious approach on the expenditure side. However, given the second wave of Covid-19 infections and uncertainly over the third wave, GSDP growth and the revenue realisation as per budgeted estimates seems a challenge and may well project an unrealistic picture of revenue collection. Since expenditures may not consolidate beyond a certain level, the implication is that the resulting fiscal deficit for 2021-22 could be higher than what has been budgeted for.

Figure 8: State-wise Fiscal Deficit for the Fiscal 2021-22 BE (% of GSDP)



Source: 2021-22 Budget documents of 28 States.

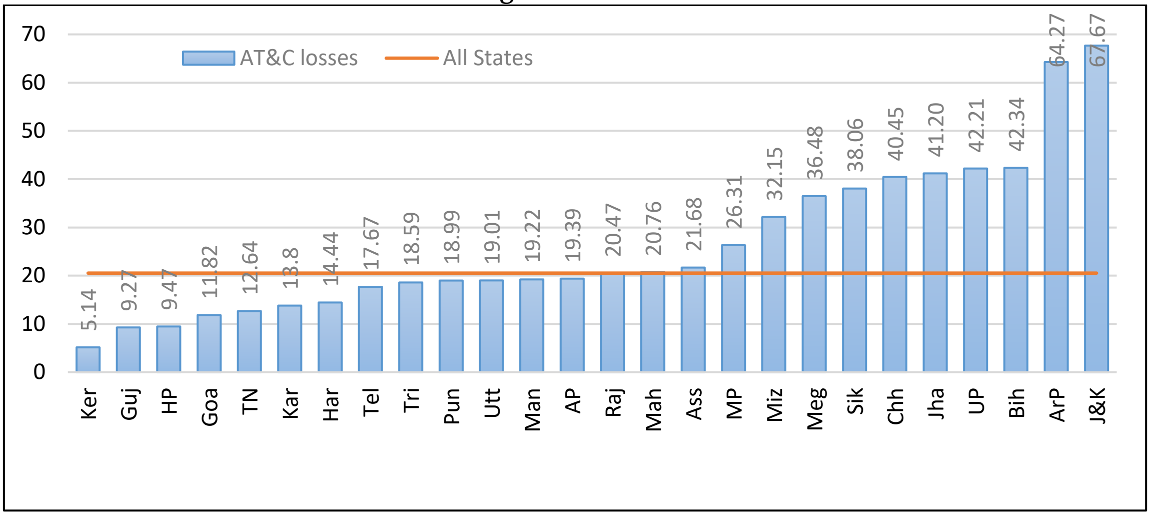
Power Sector Reforms

- Despite several initiatives to reform the power sector, the functioning of DISCOMs has remained a source of strain on State Finances. In order to provide liquidity cushion to States to implement structural improvements in the finances of DISCOMs and simultaneously introduce governance improvements the 15th FC recommended extra annual borrowing space for States of the magnitude of 0.50% of their GSDP for the period 2021-22 to 2024-25 based on some performance criteria.

- The performance criteria for availing extra 0.5% borrowing space 15th FC includes (a) timely submission of audited statements, including consolidated financial statements, (b) sustained increase in electricity consumption, (c) reduction in AT&C losses, (d) reduction in ACS-ARR gap and (e) reduction of cash subsidy and overall reduction of subsidy.

- In 2021-22 budget the Union Government announced a new scheme for revival of the power distribution sector in India. It would have an outlay of Rs 3 trillion for five years to FY26 with a gross budgetary support of Rs 97,631 crore. Most of the UDAY target earlier slated to be met by 2020 have now been extended for another 5 years. In the new schemes AT&C losses have to be brought down to 15%, cost-revenue gap to be down to zero and improvement in services of the discoms by 2024-25. Figure 9 shows state-wise AT&C losses as on 19 July 2021 as per the UDAY portal.

Figure 9: AT&C losses



Source: UDAY portal (https://www.uday.gov.in/home.php#)

5. MONETARY AND EXTERNAL SECTOR OUTLOOK

MONETARY POLICY

MPC Decisions

- The Monetary Policy Committee (MPC) of the RBI retained the repo rate at 4 percent in its meeting on 4 June 2021.[2] The reverse repo rate under the Liquidity Adjustment Facility (LAF) also remained at its status quo rate of 3.35 percent. The marginal standing facility (MSF) rate and the Bank Rate stood at 4.25 percent.

- The MPC had decided to retain the 'accommodative stance' to revive economic growth in a sustained manner and mitigate the impact of Covid-19 on the macro economy. This decision is in consonance with the objective of achieving the medium-term target for CPI inflation of 4 percent within a band of +/- 2 percent, while supporting the growth momentum.

- The MPC has projected real GDP growth for FY 2020-21 at 9.5 percent, but has highlighted that the vaccination process is expected to gather momentum and should lead to the normalisation of economic activity.

Credit

- The non-food bank credit growth stood at 5.9 percent in May 2021 as compared to 6.1 percent in May 2020, on a YoY basis. The credit to agriculture and allied activities grew to 10.3 percent in May 2021 as compared to 5.2 percent in May 2020. Credit to industry contracted by 0.8 percent in May 2021 as compared to 1.7 percent growth in May 2020. Credit to medium industries showed an impressive growth rate of 45.8 per cent in May 2021, as compared to a contraction of 5.3 per cent in May 2020. However, credit to large industries contracted by 1.7 per cent in May 2021 as compared to a growth of 2.8 per cent in May 2020.

- Acceleration in growth of bank credit in May 2021 compared to the growth in May 2020 was registered for the industrial sectors including infrastructure, mining & quarrying, food

[2] RBI (2021)Monetary Policy Committee Statement, June 4, 2021

processing, textiles, gems & jewellery, wood and wood products, paper and paper products, glass and glassware, leather and leather products, and rubber, plastic and their product and transport equipment.

- A deceleration in growth of credit was noted for construction, beverages and tobacco, petroleum, coal products and nuclear fuels, vehicles, vehicle parts and transport equipment, basic metal and metal products, cement and cement products, all engineering, chemicals and chemical products. Credit growth to the services sector decelerated to 1.9 per cent in May 2021, as compared to 10.3 per cent in May 2020. Personal loans registered an increase in growth of 12.4 percent in May 2021, as compared to 10.6 percent in May 2020.

Money Supply and FOREX

- Money supply (M3) and bank credit grew by 9.9 percent and 6.0 percent, respectively, as on 21 May 2021 compared with growth of 11.7 percent and 6.2 percent, respectively, a year earlier. India's foreign exchange reserves increased by US$ 21.2 billion in 2021-22 (up to May 28) to US$ 598.2 billion.[3]Reserve money rose by 12.4 per cent (Y-o-Y) as on 28 May 2021 and bank credit grew by 6.0 per cent (Y-o-Y) (as on 21 May 2021).[4]

- As of June 2021, the RBI has further announced new measures to mitigate the impact of the second wave. These include: (i) on-tap liquidity window of Rs. 15,000 crore for contact-intensive sectors; (ii) special liquidity facility of Rs. 16,000 crore to SIDBI; (iii) enhancement of the exposure thresholds under Resolution Framework 2.0 from Rs. 25 crore to Rs. 50 crore for MSMEs, non-MSME small businesses and loans to individuals for business purposes. These measures are aimed at providing credit and financial support for financially stressed sectors and to revive business conditions in the short to medium run.

Financial Stability - Gross Non-Performing Assets (NPA)

- The estimates from the RBI's July 2021 Financial Stability Report shows that scheduled commercial banks' Gross Non-Performing Assets (GNPA) would increase from 7.48 percent in March 2021 to 9.80 per cent by March 2022 under the 'base case scenario', and to 11.22 percent under the 'severe stress scenario'.[5] The capital to risk-weighted assets ratio (CRAR) has increased to 16.03 percent in scheduled commercial banks (as per Basel III stipulated the norm of CRAR at 8 per cent. CRAR is also called Capital Adequacy Ratio (CAR), which is a bank's capital by its risk-weighted assets).The provisioning coverage ratio (PCR) (the percentage of funds that a bank sets aside for losses due to bad debts) was 68.86 per cent in March 2021.

Interest rates

- The Treasury-Bill cut off price of 91days, 182 days and 364 days was 3.44 percent, 3.62 percent and 3.84 percent respectively, as of 7 July 2021. The average yield on 10-year government bond increased to 6.75 percent in July 2021.[6]According to July 2021 data, the weighted average call money rate is 3.5 percent,[7] which is below the repo rate. The rate of interest provided by commercial banks on 'term

[3]RBI (2021): MPC Resolution, June 4 2021
[4]RBI (2021): Governor's Statement, June 16, 2021
[5] RBI (2021): Financial Stability Report, Reserve Bank of India, July 2021.
[6] RBI Press Release: 2021-2022/504
[7] RBI Press Release: 2021-2022/495

deposits' with a maturity of more than one year is 4.90/5.50percent, as per the data released by the RBI on 2 July 2021.[8]

- India's foreign exchange reserves increased by US$ 63.32 billion in FY 2020-21 over FY 2019-20. RBI's net purchase of dollars increased to US$ 103.72 billion in FY 2020-21 as compared to US$ 45.10 billion in FY 2019-20.

- Rupee depreciated from US$/INR 72.8 in March 2021 to US$/INR 74.5 in April 2021.

Merchandise Trade

- Against the backdrop of slowdown in world trade, India's merchandise exports and imports contracted by 7.3 percent and 18.0 percent, respectively, during 2020-21. Pharmaceuticals, agricultural products, engineering goods and iron ore were some of the sectors that experienced positive growth. During April 2021, gold imports rose significantly as compared to April 2020, thus leading to a major spike in total imports.

Table 9: Merchandise Exports, Imports and Trade Balance (USD Billion)

		Exports			Imports			
	Trade Balance (%)	Total	POL	Non-POL	Total	Crude & POL	Gold	Non-POL & Non-Gold
Jan-21	-14.4	27.5	2.1	25.4	42.0	9.4	4.0	28.5
Feb-21	-13.0	27.5	2.4	25.1	40.5	9.0	5.3	26.2
Mar-21	-13.9	34.5	3.4	31.0	48.4	10.3	8.5	29.6
Apr-21	-15.1	30.6	3.6	27.0	45.7	10.9	6.2	28.6
May-21	-6.3	32.3	5.3	26.9	38.5	9.5	0.7	28.4
Year on Year Growth rate								
Jan-21		6.4	-33.1	12.0	2.0	-27.6	154.7	8.2
Feb-21		-0.8	-29.1	3.2	7.0	-16.2	123.9	6.3
Mar-21		60.3	35.5	63.6	53.8	2.2	591.8	47.4
Apr-21		201.1	192.3	202.3	167.6	133.9	219969.2	132.0
May-21		69.4	227.2	54.6	73.6	171.1	790.0	55.2

Source: DGCI&S

- With the onset of FY 2021-22, foreign direct investment (FDI) saw a positive net inflow of US$ 2.8 billionand foreign portfolio investment (FPI) experienced a net outflow of US$ 2 billion.

[8] RBI Ratios and Rates as per July 2021. https://rbi.org.in/scripts/WSSView.aspx?Id=24637

Figure 10a: Foreign Direct Investment (net)

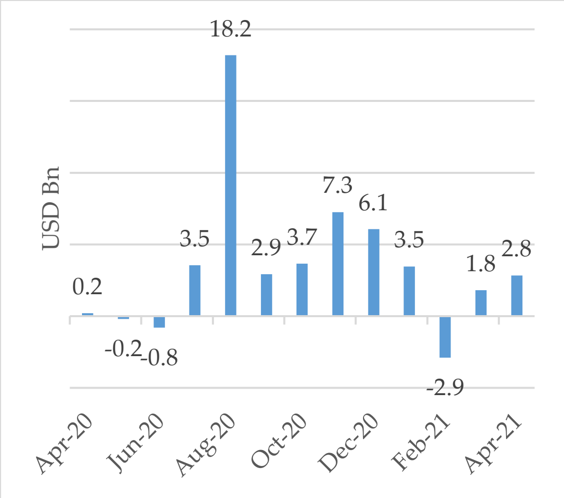
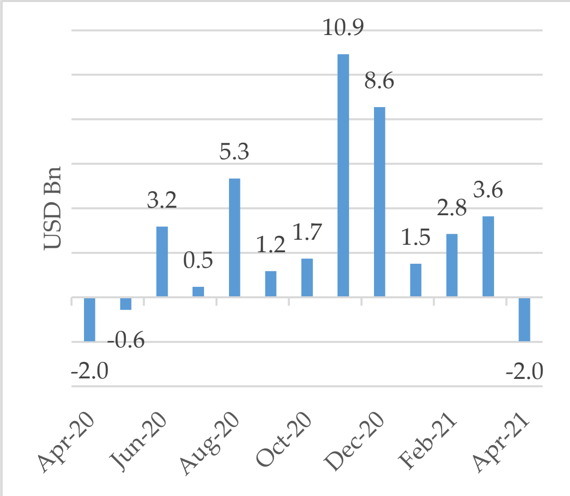


Figure 10b: Foreign portfolio investment (net)



Source: RBI

II Services Trade

- India's services exports remained relatively resilient and showed signs of gradual recovery, primarily on the back of robust software exports earnings. Despite global headwinds, software services accounted for more than 40 percent of India's total services exports. Travel and transportation services were severely hit by the imposition of lockdowns and travel restrictions world-wide.

- Overall, during April-December 2020-21, the current account recorded a surplus of 1.7 percent of GDP as against a deficit of 1.2 percent in 2019-20. After registering a record surplus in Q1 of 2020-21, the current account surplus narrowed in Q2 and turned negative in Q3, as the pace of contraction eased for both merchandise exports and imports and the trade deficit widened. Positive net terms of trade owing to modest crude oil prices and a decline in import volumes contributed to the surplus in April-December 2020 (Q1 to Q3 of 2020-21).

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