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FY 2023-24: Year End Macroeconomic Review

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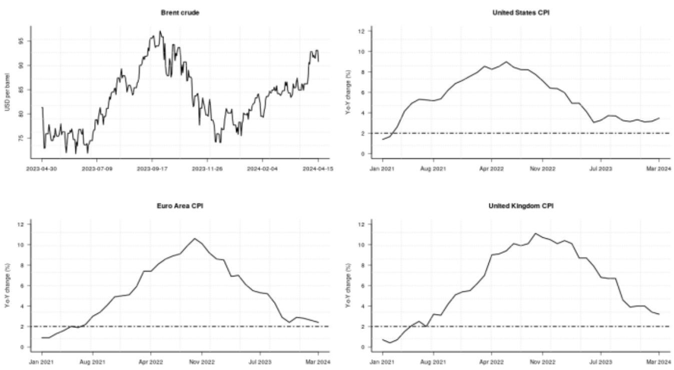
Global macroeconomic outlook: Slow but steady growth recovery with moderating inflation.

Against a background of multiple geo-political disruptions, global growth is expected to maintain a pace of slow but steady recovery. Estimated to have grown at 2.3 percent in 2023, the global economy is projected to grow at the same rate in 2024 and 2025. Growth in advanced economies is expected to rise marginally from 1.6 percent in 2023 to 1.7 percent in 2024 and 1.8 percent in 2025, while emerging and developing economies are projected to grow at 4.2 percent in 2024 and 2025. There are of course considerable variations in growth across countries around these global and group averages. In the United States, growth is projected to rise to 2.7 percent in 2024 before moderating to 1.9 percent in 2025. Growth in the Euro area is expected to pick up from 0.4 percent in 2023 to 0.8 percent in 2024 and 1.5 percent in 2025. Growth in China is expected to slow down to 4.6 percent in 2024 and 4.1 percent in 2025, mainly due to the protracted crisis in the property sector.

Figure 1: Global inflation moderating but slightly elevated owing to rising oil prices



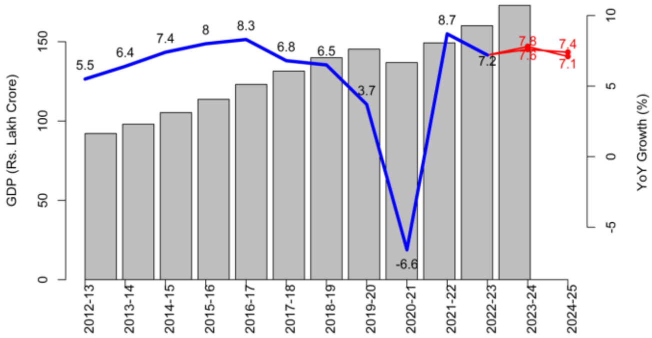
Source: US Energy Information Administration; US Bureau of Labor Statistics; Eurostat; and Office for National Statistics UK.

Global inflation has eased from the peaks seen around the middle of 2022, but remains above target levels. Commodity prices have rebounded in recent months after moderating in 2023. Oil prices in particular have risen with ongoing wars in Ukraine and Gaza. It is likely that the recent hardening of commodity prices will delay the rate cut cycles in many economies.

India: Robust growth, moderating inflation & shrinking current account deficit

Real GDP growth in India was a robust 7.6 per cent in FY 2023-24 (Second Advanced Estimate, Central Statistical Organisation), up from 7 per cent in FY 2022-23. The growth spurt in FY 2023-24 was driven by double digit growth of 10 per cent in capital formation (Capex) which, in turn, was led by high public sector capex. At the sectoral level, high non-agricultural growth was broad based with 9 per cent growth in industry and 7.5 per cent growth in services. However, agriculture performed poorly, recording a growth of only 0.7 per cent. This is mainly due to uneven rainfall, volatile weather conditions, and reduction in wheat acreage in response to softening of wheat prices with the easing of Black Sea supply disruption.

Figure 2: Growth forecast at 7.1-7.4 for FY 2024-25



Source: MOSPI; Bhattacharya, Chakravartti and Mundle

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(2019)[1]; Bhattacharya, Bhandari and Mundle (2023)[2].

Our growth projections are derived from two alternative forecasting models, one based on high frequency indicators (NIPFPhf) and the other based on annual indicators (NIPFPaf). The models had forecast annual growth rates of 7.8 per cent and 7.6 per cent respectively compared to the actual outcome of 7.6 per cent. The forecasts for FY 2024-25 based on the high frequency indicators model and annual frequency indicators model are, respectively, 7.1 per cent and 7.4 per cent (Figure 2). These are marginally higher than projections from the World Bank, IMF and RBI (Table 1). Our high frequency indicators model growth forecasts for the four quarters of FY 2024-25 are the same as or marginally higher than the RBI quarterly forecasts (Table 1).

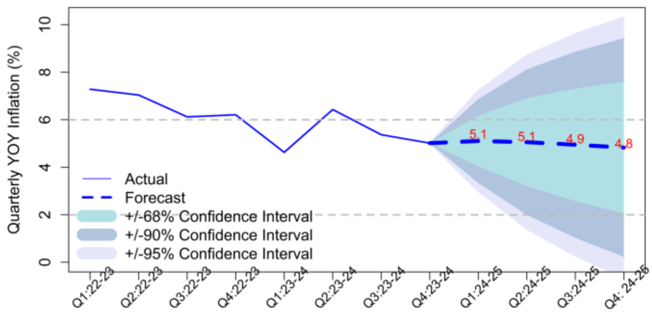
Table 1: Comparable forecasts by other organisations

	FY 23-24	Q1 2024-25	Q2 2024-25	Q3 2024-25	Q4 2024-25	FY 24-25
NIPFP hf	**7.8**	**7.2**	**6.9**	**7.3**	**7.1**	**7.1**
NIPFPaf	**7.6**					**7.4**
RBI	7	7.2	6.8	7	6.9	7
Actual (MOSPI, SAE)	7.6					
IMF	7.8					6.8
World Bank	7.5					6.6

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

Inflation remained at 5.4 per cent in FY 2023-24, within the 6% upper limit of RBI's tolerance band. It had exceeded the upper limit in July and August, 2023-24 due to high inflation in prices of vegetables, pulses, and milk & milk products. Food price inflation remained elevated at 7.5 per cent in FY 2023-24, while energy declined from September 2023. Core inflation was declining in FY 2023-24 but rebounded in the last two months, mainly on account of services.

Figure 3: FY 24-25 inflation forecast of NIPFP at 5 per cent, still above 4 per cent target



Source: Bhattacharya & Kapoor, 2020

For FY 2024-25 we forecast an annual inflation rate of 5 per cent, still above the 4 per cent RBI target, but within the tolerance band (Figure 3). However, the forecast is subject to upside risks on account of persisting high food price inflation and the rebound of global crude oil prices. Our quarterly inflation forecasts for Q1, Q2, Q3 and Q4 are respectively 5.1 per cent, 5.1 per cent, 4.9 per cent and 4.8 per cent. The corresponding forecasts by RBI are 4.5 per cent, 4.9 per cent, 3.8 per cent and 4.6 per cent respectively.

In the **external sector**, India's merchandise exports for FY 2023-24 were USD 437.06 Billion as against USD 450.5 Billion during FY 2022-23 (April-March), a decline of 3 percent (Figure 4). Merchandise exports fell for the first time in four years (since 2020-21) owing to geo-political tensions and export curbs on food items such as rice, wheat and sugar. However, merchandise imports declined by a steeper 5.5 percent. This helped narrow the merchandise trade deficit to USD 238.4 billion as compared to USD 265 billion in FY 2022-23. However, the overall trade deficit improved by 35 percent to USD 78 billion due to the buoyant services export (Figure 4). The

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

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

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services trade surplus at USD 162 billion in FY 2023-24 was more than USD 143 billion recorded in 2022-23

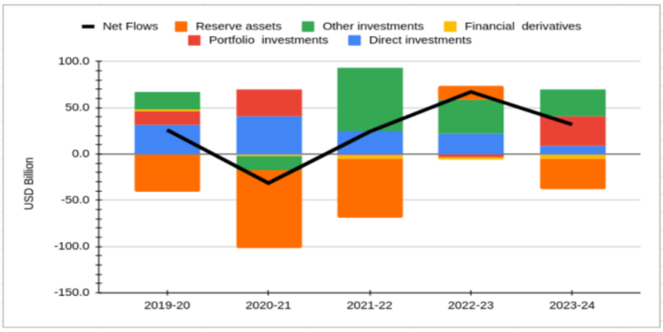
Figure 4: External Sector: Current account

Source: Ministry of Commerce and Industry, CMIE Economic Outlook

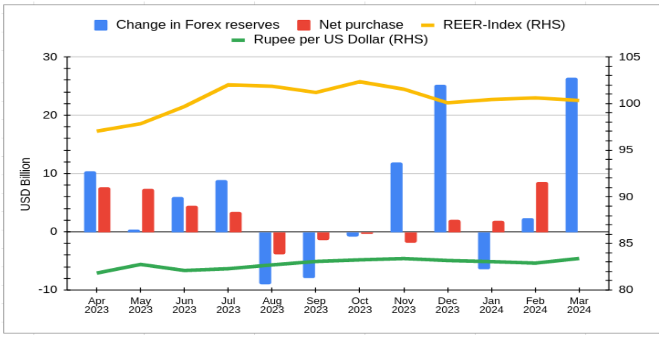
As an outcome of the higher services exports, India's current account deficit narrowed to USD 10.5 billion or 1.2 percent of the GDP in the October-December quarter 2023-24 from USD 11.4 billion in the previous three months. For the first nine months of 2023-24 as well, the current account deficit narrowed to USD 31 billion as against USD 65.6 billion recorded in the corresponding period of 2022-23. However, recent trade data suggests that this decline may have now been reversed.

Net flows on the financial account declined to USD 31.8 billion in April-December 2023-24 from USD 67.19 billion in the same period of 2022-23 (Figure 5). This decline reflected a sharp decline in net direct investment flows from USD 21.6 billion in April-December 2022-23 to only USD 8.4 billion in April-December of 2023-24. This is mainly attributable to a large increase in repatriation. High interest rates in advanced economies, monetary tightening and geo-political uncertainties led to a rise in repatriation in April-December of 2023-24. In contrast, net flows under portfolio investments rose sharply to USD 32.6 billion in April-December 2023-24 as compared to a net outflow of USD 3.5 billion in the same period of 2022-23. Correspondingly, foreign portfolio investors were net buyers in Indian markets during the first 9 months of FY 2023-24. In particular, there was a revival in FPI buying activity in 2023-24 in the debt segment.

Figure 5: Composition of Financial account flows, change in reserves and exchange rate movements



Source: RBI, CMIE Economic Outlook



Source: RBI, CMIE Economic Outlook

Despite variations in the US dollar index, the rupee was relatively stable. It depreciated by 2.9 percent against the dollar in FY 2023-24 as compared to a depreciation of more than 7 percent in the previous year. The RBI intervened in the market to prevent undue fluctuations in the rupee dollar rate. Notably, from September to January, the RBI undertook both purchase and sale of dollars at varying periods to prevent appreciation and depreciation pressure on the rupee. Overall, the rupee exchange rate movement was contained in a narrow range despite major headwinds. The foreign exchange reserves of the RBI rose from USD 578.4 billion in 2022-

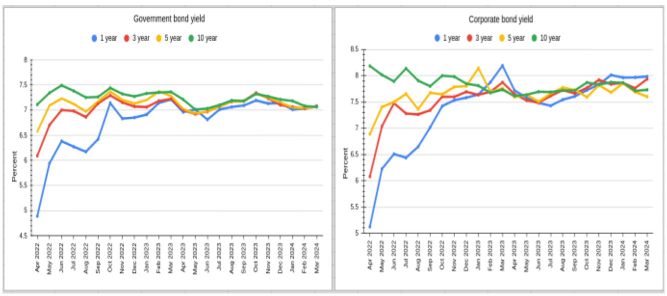
23 to USD 645.5 billion in 2023-24, a rise of USD 67 million (Figure 5).

Monetary policy and financial sector developments

Call rate persisted above the repo rate: Since April 2023, the RBI has maintained a status quo on the policy rate. The stance has also been maintained at withdrawal of accommodation. During the second half of FY 2023-24, the call money rate persisted above the repo rate, indicating tightness in liquidity. Liquidity was in deficit during September to March of FY 2023-24. Typically, towards the end of the financial year, money market liquidity tightens due to outflows on account of Goods and Services tax payments. This time RBI conducted Variable Rate Repo auctions to ease the liquidity position.

Convergence of short-term and long term bond yields: In the dated securities market, short-term bond yields rose due to the RBI's 'withdrawal of accommodation' stance. However, long-term rates broadly held steady due to decline in domestic inflation, moderation in planned government borrowing during FY 2024-25 and, importantly, the announced inclusion of the Indian government's securities in the emerging market global bond indices. As a consequence, yields on short and long dated government securities converged, with the yield curve even inverting at times (Figure. 6). This convergence between short and long dated sovereign bonds was also mirrored in the convergence of short and long dated corporate bonds. It reflects a maturity mismatch between high demand for long dated bonds and large supply of short term corporate bonds.

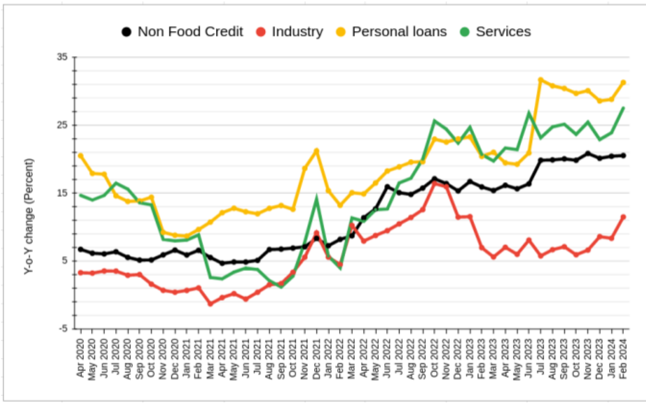
Figure 6: Government and corporate bond yields



Source: CMIE

Credit growth remains robust: Credit growth remained robust, with non-food bank credit registering a growth of 16.5 percent in February, 2024. Personal loans (18.1 percent) and loans to services (21.2 percent), which includes credit to NBFCs, have been the major components of growth in non-food credit as of February 2024 (Figure 7). Our assessment is that this has been primarily driven by rising investment in real estate. However, credit to industry also seems to have bottomed out and is showing signs of revival in recent months.

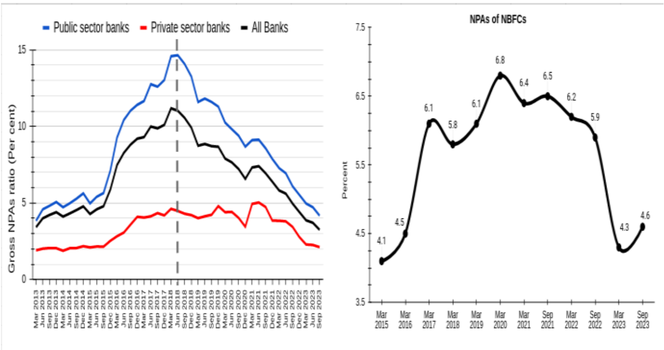
Figure 7: Robust credit growth



Source: CMIE

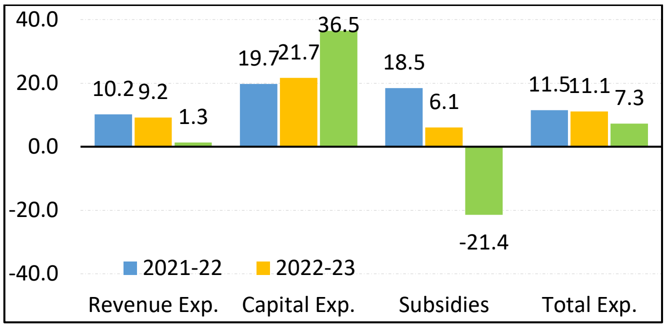
Sustained improvement in asset quality of banks and NBFCs: During the last financial year, there was also continuing improvement in the asset quality of banks and non-bank financial companies (NBFCs). Gross non-performing assets ratio of banks declined to 3.25 percent in September 2023, lowest since March 2013, with a welcome convergence of NPA ratios of public and private sector banks (Figure.8). Better regulatory compliance and transparent norms governing the recognition of bad loans has led to this continuing improvement in the asset quality of banks and NBFCs.

Figure 8: Declining ratio of non-performing assets



Source: Financial stability report, RBI

Figure 9: Expenditure growth (Y-o-Y Apr-Feb; %)



Fiscal performance of Central and State Governments

Central government: A massive thrust on capital expenditure (Capex) has been the hallmark of the central government's fiscal policy in recent years. Capex increased by over 36 per cent in 2023-24 (Apr-Feb) on top of very large increases during the last few years (Figure 9). In 2024-25 (BE) it is budgeted to increase by 17 per cent. This has been made possible largely due to buoyant growth of revenues from all taxes, except excise and customs duties (Table 2). The push to capital expenditure has been combined with restrained revenue spending, including strong compression in major subsidies (food, fertilizer and petroleum), and fiscal consolidation. The central government achieved its fiscal deficit (FD) target of 5.9 per cent of GDP in 2023-24. In 2024-25, revenue expenditure is budgeted to increase by a mere 3 per cent while major subsidies are budgeted to decline by 7.8 per cent. The FD target for 2024-25 is set at 5.1 per cent. The budgeted 0.8 per cent reduction in FD 2024-25 to reach the 2025-26 target of 4.5 per cent looks ambitious. But it is achievable if revenue buoyancy and expenditure growth moderation is sustained.

Table 2: Revenues of the Central Government: Apr-Feb (% change)

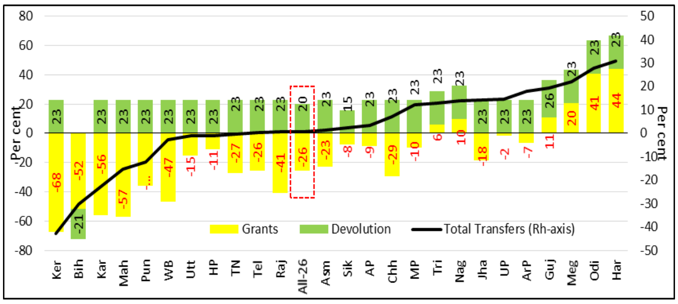
Indicators	Y-o-Y growth (%)		2024-25BE over
	2022-23	2023-24	2023-24RE
Nominal GDP	14.2	9.1	10.5
Centre's Net Revenue*	10.6	11.6	11.2
Gross Tax Revenue (GTR)	12	13.5	11.5
Corporation Tax	13.5	17.3	13
Income tax	19.1	25.8	13.1
Union Excise duties	-18.6	-5.8	5
CGST	24.5	13.7	13.1
Customs duty	14.4	3.9	5.8
Non-Tax Revenue (NTR)	-19.8	44.9	6.4

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

The States: Setting aside large inter-state variations, 'all state governments' as a group have also performed well in own tax revenue mobilization. Own revenues account for 65 per cent of total revenue of the states and their own tax revenue accounts for 88 per cent of their total own revenue. This key component of states' revenue has registered a growth of 11 per cent during 2023-24. In 2024-25, the combined all-states OTR has been budgeted to grow by 14 percent, the implied buoyancy being greater than 1 if nominal GDP grows by 12 per cent.

The growth in central transfers, the other component of states' revenues, has been negligible at 0.7 per cent in 2023-24 with several states (9 states) reporting a decline (Figure 10). Devolution increased by 20 per cent on average. However, this was mostly off-set by a 26 per cent decline in grants. With the GST compensation period ending in June 2022, the decline in grants is largely on account of discontinuation of GST compensation. For 2024-25, the all-states combined budget indicates a 10 percent decline in grants.

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

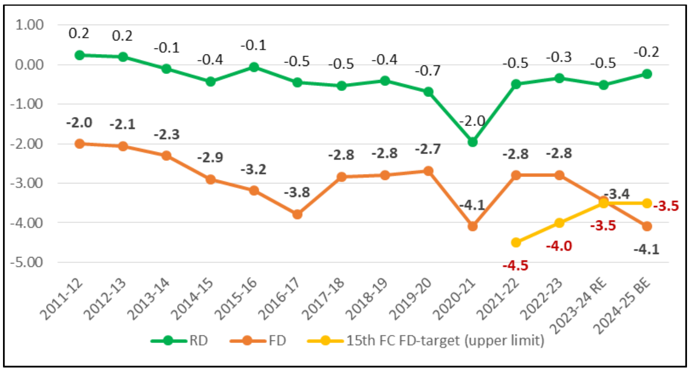


Source: Comptroller and Auditor General of India (C&AG)

On the expenditure side, total spending aggregated across all states increased by 12.6 percent in 2023-24 (Apr-Jan). It entailed an increase in both revenue and capital expenditure, with capital expenditure rising by about 36 percent on average. To incentivise more capital expenditure by states, the Union government introduced a scheme for Special Assistance to States for Capital Investment wherein it provided 50-years interest free capital expenditure loans to states. In 2022-23 the provision for loans under this scheme was Rs 1 trillion, which was increased to Rs. 1.3 trillion in 2023-24. Till February 2024, Rs. 95,225.77 crore (or 73 per cent of the budgeted amount) had been released to states. For 2024-25, the scheme has been continued with an allocation of Rs. 1.3 trillion. Despite this, capex is budgeted to increase by only 9 per cent in the all states combined budget, with 9 states budgeting for a decline. The states appear to be substituting their own revenue by the central Government capex grant in financing capex.

The States resumed their post-pandemic fiscal consolidation in 2022-23. The FY 2022-23 combined fiscal deficit (FD) of all-states of 2.8 per cent of GSDP was well within the 15th Finance Commission recommended fiscal consolidation path. However, the latest budget numbers indicate a reversal. In 2023-24 (RE), the combine fiscal deficit of all-states (as % of GSDP) is estimated to increase to 3.4 per cent in 2023-24 (RE) and further to 4.1 per cent in 2024-25 (BE). This is a serious cause for concern. The States' in aggregate need to make a stronger effort towards fiscal consolidation. The apparent fiscal complacence could be due to the sharp fall in all-states outstanding liabilities relative to GDP. The all-state combined liabilities are projected at 28.1 per cent of GSDP in 2024-25, well below the 15th FC recommended level of 32.8 per cent.

Figure 11: Deficits - States (% of GSDP)



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

To Conclude A challenging global environment notwithstanding, the economy continues to grow at a robust pace of around 7 per cent along with moderating inflation, despite high food price inflation. Moreover, growth has been broad based across industry and services though subdued in agriculture due to weather and market conditions. The main challenge for macroeconomic management is on the employment front. Modest but positive trends such as the transfer of workers from agriculture to the non-agricultural sector, the rising employment share of the formal sector, improvement in real wages etc. of the pre- pandemic period were all reversed during the pandemic and this situation has not changed. Positive indicators such as increase in labour force participation rates and employment in recent PLFS surveys mainly reflect the increase in self-employment of unpaid workers, especially women, in the unorganised sector.

In the external sector, the surplus in service exports has helped to offset the large deficit in merchandise trade, so the trade deficit has remained modest. Moreover, exports have declined but imports have declined more, hence the current account deficit has been manageable at under 2 per cent of GDP, though the position may have altered in recent weeks. The deficit has been largely financed by net FPI flows and other assets, with FDI experiencing a sharp decline.

On the monetary policy front, status quo on the Repo rate and the RBI's 'withdrawal of accommodation' stance has tightened liquidity. Consequently, the call rate has persisted above the Repo rate. Yields on short term government securities have also risen as a consequence, while yields on long dated securities have held steady due to several market conditions, leading to a convergence of yields and sometimes even an inversion of the yield curve. Moderation of inflation and sustained robust growth, supported by buoyant credit flow, despite monetary tightening is a measure of the successful conduct of monetary policy. Effective regulation of the financial sector has also led to a sustained improvement in asset quality and NPA reduction for banks as well as NBFCs.

On the fiscal front revenue, especially tax revenue, has been very buoyant for both the Central Government and the States. The Centre has used this fiscal space to continue its massive thrust to capex alongside fiscal consolidation. The capex boost includes a 50 year zero interest capex loan to States of Rs 1 trillion in FY 2022-3, which was increased to an allocation of Rs 1.3 trillion in 2023-24 and has been continued in 2024-25. However, the states are using this loan to substitute for their own revenues in capex, so overall capex growth in the states budgeted for FY 2024-25 is modest. Moreover, as a group the states now appear complacent regarding fiscal consolidation, which had been resumed in FY 2022-23 following the pandemic. This is a cause for concern.