General Studies-3; Indian Economy – Growth and Development

IMF's Annual Assessment of India's Economy

1) Introduction

- The International Monetary Fund has released the results of its annual assessment of the Indian economy, with predictions for 2018-19 and 2019-20.
- India's growth trajectory has recovered from the disruptions caused by demonetisation and the teething troubles after the introduction of GST.

2) IMF's Predictions

- There's no change in the forecast for India GDP growth—it remains 7.3% for the current fiscal year and 7.5% for 2019-20.
- Gross investment as a percentage of GDP is projected to jump from 30.6% in FY18 to 32.2% this year.
- Consumption will continue to be a driver of growth.
- IMF predicts that growth in merchandise exports will be a strong 13.2% this fiscal year.
- This increase in growth is expected to lead to a rise in consumer price inflation to an average of 5.2% this fiscal.
- That is well above the RBI's target of 4% and monetary policy can therefore be expected to be tight.
- Economic growth will lead to a rise in money supply, which is expected to go up by 11.4% this fiscal.
- A revival in bank credit to the private sector is expected.
- Savings as a percentage of GDP is forecast to increase, but not to the same extent as investment.
- This imbalance between domestic savings and investment will result in a higher current account deficit, which the IMF estimates at 2.6% of GDP this fiscal year.

3) Highlights

- India now contributes, in purchasing power parity measures, 15% of the growth in the global economy.
- Some of the recent structural reforms, such as the implementation of GST and Insolvency and Bankruptcy Code (IBC), along with liberalization of FDI and improvement in the ease of doing business will help improve economic activity.
- The IMF has also highlighted several external and internal risks.

4) Positives

- IMF's mission chief for India siad that India is a source of growth for the global economy for the next few decades and it could be what China was for the world economy.
- IMF said the near-term macroeconomic outlook for India is "broadly favourable."
- IMF described the GST as a "milestone reform" in India's tax policy.
- RBI has sufficient reserves to smoothen volatility in the currency market.
- The RBI has done well by pre-emptively hiking rates to anchor inflationary expectations, which will also help reduce volatility in the currency market.

5) External Risks

- On the external front, there are risks such as high crude prices and the tightening of global financial conditions.
- Spillover risks from a global trade conflict, and rising regional geopolitical tensions.

- The widening of the current account deficit is getting reflected in the depreciation of the rupee.
- The US Federal Reserve is reducing the size of its balance sheet at a predetermined pace and is also raising policy rates.
- Higher bond issuance by the US government to fund its budget deficit is affecting dollar liquidity in global markets.
- It could escalate volatility in global financial markets and increase the risk for emerging market economies like India.
- The rising interest rate has also put pressure on capital flows.
- Indian markets witnessed capital outflows in excess of $11 billion between April and June.

6) **<u>Internal Risks</u>**
- Delay in addressing the twin balance sheet issue.
- Possible revenue shortfall owing to GST implementation issues.
- Even though India now has a bankruptcy code in place, these are still early days and the structure will take time to stabilize.
- Resolution or liquidation of distressed assets could result in large haircuts for banks.
- This will possibly increase the capital requirement of public sector banks and the government, with fiscal constraints, may find it difficult to spare resources.
- While the collection from GST is improving, it is still running below the desired rate of ₹1 trillion per month.
- A shortfall in revenue will affect Central government finances as it is bound to compensate state governments.
- Any compression in capital expenditure as a result of revenue shortfall will affect growth.

7) **<u>Concerns / Challenges</u>**
- The resolution of the twin balance sheet problem is a real challenge.
- Tightening of monetary policy will make it more challenging to revive the credit cycle.
- High household inflation expectations and large general government fiscal deficits and debt remain key macroeconomic challenges.
- The multiple rate structure and other features of India's GST environment could give rise to high compliance and administrative costs.

8) **<u>Way Forward</u>**
- The government must not allow the fiscal deficit to cross the budgeted mark of 3.3% of GDP.
- IMF has highlighted that even as important reforms have been implemented, more will be needed in areas like land and labour.
- IMF pushed for a simplified GST structure.
- Labour market reforms could complement the GST in terms of promoting the formal economy and creating fiscal space for needed social and infrastructure spending.
- Market reforms and greater formalization of the economy will push growth and generate higher tax revenue.
- A strong fiscal position will also help reduce external vulnerabilities.
- While important steps have been taken to improve the recognition of NPAs and recapitalise Public Sector Banks (PSBs), more needs to be done.
- The government should work on smoothening the IBC and GST and not allow electoral compulsions to affect fiscal management.