NATIONAL COUNCIL OF APPLIED ECONOMIC RESEARCH

Quarterly Review of the Economy, 2021-22:Q1

in Coronavirus Times

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Chapter 1: Overview

Sudipto Mundle and Bornali Bhandari

1.1 Introduction

The second Covid–19 wave, four times greater in ferocity compared to the first wave in terms of number of cases and deaths, has further disrupted the growth process which had already been severely damaged by the first wave. Paradoxically, we estimate that Gross Domestic Product (GDP) will grow by 11.5 per cent in Q1 and 8.4 per cent–10.1 per cent for the whole year 2021–22[1]. However, these high growth rates are quite misleading since 2021–22:Q1 follows the very steep decline in 2020–21:Q1 and mainly reflects strong base effect. At the end of 2021–22 GDP still be about the same as Rs 146 trillion as in 2019–20 - two lost years.

High frequency indicators show a sharp decline in economic activity during April, May 2021- the peak of the second Covid–19 wave. There are some indicators of recovery in June as unlocking proceeds. Export growth is projected to remain buoyant with recovery in the global economy. This, combined with expansionary macroeconomic policies could help accelerate growth recovery.

Unfortunately, an inexplicably contractionary fiscal policy in 2021–22, sharply reducing the deficit, will delay recovery. An accommodating expansionary monetary policy has also become challenging because of rising inflationary pressures, but growth recovery is still the priority for RBI.

We now present a brief overview of the performance within individual segments of the economy, developments on the prices front and the outlook for fiscal and monetary policy.

1.2 Agriculture

The agricultural sector grew at 3 per cent in 2020–21 on top of 4.3 per cent growth recorded in 2019–20. This was mainly thanks to a good monsoon which was 12.5 per cent above normal with only the northern region experiencing a slight deficit. It is too early to predict how the sector will perform in 2021–22, but all indications, such as progress of monsoon so far, suggest that agriculture will again register normal

[1] Since conventional forecasting techniques do not work well when there are large shocks, we have used an alternative methodology of assessing the strength of economic activities at a highly granular level, going down in some cases to National Industrial Classification 5-digit level, based on such information as was available and taking account of factors like period of lockdown in a geography where the relevant activity is important. These micro level assessments were then aggregated up step by step to generate sectoral and national level Gross Value Added (GVA). The growth rate of GVA marked up by 0.1 per cent, the average difference between growth of GVA and GDP has been used as a proxy for estimating GDP growth. This approach successfully estimated GDP growth for 2020-21 at (–) 25.7 per cent, close to the actual growth rate of (–)24.4 per cent.

growth in 2021–22. This is notwithstanding temporary disruptions created by the second Covid–19 wave and a potential third wave.

1.3 Industry

The 2nd wave of the pandemic has completely disrupted the recovery of industrial growth. Indicators like the Index of Industrial Production, electricity demand, GST collections indicate a decline in industrial activity in 2021–22:Q1 compared to 2020–21:Q4. However, this is still much higher than in 2020–21 Q1. It is assessed that Industry will grow by 26.7 year on year (y-o-y) to Rs 8 trillion. Performance of the sector for the rest of the year will depend on the pace of progress with vaccinations and the intensity of the third Covid–19 wave. For the full year, it is assumed that industry will grow between 13.7 per cent and 15.7 per cent, reaching GVA of around Rs 41.1–41.9 trillion. This is only slightly higher than GVA of Rs 39.3 million achieved two years ago in 2019–20.

1.4 Services

Services output is estimated to have declined in 2021–22:Q1, compared to 2020–21:Q4, as the second Covid wave peaked. But y-o-y growth is still estimated to be positive because of the much sharper contraction of output in 2020–21:Q1. With the second wave having subsided and phased unlocking, services output is expected to recover from Q2 onwards. However, there may again be a dip in output in Q3 because of the risk of a third wave. We assess that GVA in Services will reach Rs 72.2–Rs 73.6 trillion in 2021–22. Though this will amount to a positive y-o-y growth of 6.7 per cent–8.7 per cent compared to the even lower output of Rs 67.6 trillion in 2020–21, it will still be lower than GVA of Rs 73.8 trillion) achieved two years ago in 2019–20.

1.5 Trade

Merchandise exports have continued to recover since the nation-wide lockdown in March 2020, however there was a dip during the 2nd Covid wave in April 2021. Merchandise imports followed a similar recovery path but has declined through April and May 2021 due to the second wave. Much of this growth was in goods trade since services exports & imports have remained flat since March 2020. The trade balance which was in surplus in the first half of 2020–21 and in deficit during the second half has again turned positive in May 2021. Going forward the outlook for goods exports remains buoyant because of strong growth in some of India's major trading partners. Capital inflows have been highly volatile, rising from a net outflow of USD 10.7 billion in March 2020 to a peak inflow of USD 23.5 billon in August 2020, then declining to USD 0.9 billion in April 2021. Foreign exchange reserves have been rising significantly since March 2020 barring a small dip in February & March 2021. Reflecting this reserve accumulation, the exchange rate has been appreciating since April 2020, barring a small depreciation during April 2021.

1.6 Prices

CPI headline inflation has risen from 4.3 per cent in April, 2021 to 6.3 per cent in May. While inflation was driven by food price inflation in 2020, it is now being driven by the rise in energy prices. CPI Core inflation (excluding food & fuel) remained sticky at around 6 per cent since July 2020 and has since risen to 6.6 per cent in May 2020. Clearly, rising inflation is now more broad-based than just for energy products. WPI inflation is now at double digit levels, partly because of the base effect of very low inflation last year but also because of genuine pricing pressure, and it is also fairly broad based. Headline CPI inflation breached the 6 per cent upper limit of the RBI's target band, rising to 6.3 per cent in May 2021 from 4.3 per cent in April, 2021. However, our forecasts indicate that headline inflation will moderate from 6.3 per cent in May, 2021 to 3.3 per cent in August, 2021, followed by a rebound in September, 2021.

1.7 Fiscal policy outlook

The economic growth process which was completely disrupted by the first Covid–19 wave, and the stringent nation-wide lockdown, will remain disrupted in FY 2021–22 because of the second wave and risks of a potential third wave. To recover from this unprecedented disruption for two consecutive years, the growth process now needs a strong expansionary macroeconomic policy push. The required fiscal policy stance in this context is high expenditure growth. Large deficit financing will be required for a second year. Revenues are likely to fall short of expectations because of the depressed level of economic activity. Unfortunately, instead of the required high expenditure growth, expenditure in the 2021–22 budget was actually reduced to Rs 34.8 trillion in 2021–22, down from Rs 35.1 trillion in 2020–21, a significant reduction in real terms. Even after factoring in the post-budget increase in allocations for larger procurement of Covid–19 vaccines, extension of the additional food subsidy program till November 2021, planned expenditure in 2021–22 at 16.3 per cent of GDP is still significantly lower than 17.8 per cent in 2020–21. The fiscal deficit is being reduced sharply from 9.2 per cent of GDP in 2020–21 to 7.2 per cent in 2021–22. This premature fiscal compression is quite inexplicable since there is little risk of elevated level of sovereign debt, which is mostly domestic anyway, becoming unsustainable[2]. This unfortunate premature fiscal compression will further extend the period of disruption before the economy can return to normal growth.

1.8 Monetary Policy

Since the beginning of the pandemic in early 2020 the main policy challenge the RBI has had to address is to provide enough liquidity to finance the huge increase in government borrowing without allowing interest rates and bond yields to rise. It

[2] In an interesting article Chenoy and Jain have demonstrated that at prevailing interest rates, there is a knife edge at around 9 per cent growth. At growth rates above this level even the present high debt:GDP level would be sustainable, though it would become unsustainable if growth fell below 9 per cent.
See S. Chenoy and A. Jain, Fiscal Policy and Growth in a Post-Covid World, Economic & Political Weekly, 27 February, 2021.

continues to face the same challenge in FY 2021–22. To deal with this challenge the RBI has held the policy repo rate and the reverse repo rate steady at 4 per cent and 3.35 per cent since May 2020. It has at the same time conducted complex interventions in the sovereign bond market, including most recently a combination of Twist Operations and Open Market Operations. Transmission of the policy rate to bank lending rates has strengthened significantly. The weighted average lending rate fell by 116 basis points for a fall in 115 bps points in the policy repo rate from February 2020 till April 2021. Yields on short maturity sovereign bonds have also closely tracked the repo-reverse repo rate band. The benchmark 10–year G-Sec yield has also been range bound. However, going forward rising inflationary pressures and the U.S. Federal Reserve announcement of an earlier than expected increase in the Federal funds rate will make it increasingly difficult for the RBI to continue maintaining its accommodative monetary policy stance. It is also a major concern that despite the reduction in interest rates and adequate liquidity infusion the growth of credit has continued to decline.

Chapter 2: Agriculture

Anil K Sharma

The agricultural sector grew at 3 per cent in 2020–21 on top of 4.3 per cent growth recorded in 2019–20. This was mainly thanks to a good monsoon which was 12.5 per cent above normal with only the northern region experiencing a slight deficit. It is too early to predict how the sector will perform in 2021–22, but all indications, such as progress of monsoon so far, suggest that agriculture will again register normal growth in 2021–22. This is notwithstanding temporary disruptions created by the second Covid–19 wave and a potential third wave.

2.1 Introduction

Notwithstanding the pandemic, which has impacted overall performance of the economy in a significant way, agricultural sector is estimated to witness a growth of 3 per cent in 2020–21 on top of 4.3 per cent growth recorded in 2019–20. Even though there have been disruptions in the food supply chain and considerable challenges have been experienced in terms of logistics, but the saving grace has been the monsoon rainfall the onset of which was precisely on the normal date of its arrival, June 1, 2020. And, the advancement of monsoon rainfall during the first month of the monsoon season was fairly rapid and covered the entire southern and North-eastern states of the country in the first two weeks of its arrival and then by the end of June rainfall had covered almost the entire country. As the season progressed, the behavior of monsoon rainfall activity turned very erratic as there were some parts of the country such as eastern and southern regions, which experienced extensive rainfall, but northern and western regions witnessed low rainfall activity.

During the third month of August three main regions (east, west, and south) barring the exception of northern region received normal or excess rainfall due to significant improvement in rainfall activity. In the final month of September, barring the exception of some parts of the northern region, monsoon rainfall again remained very active in other three major regions of the country, that is, east, west and north. Thus, on the whole cumulative monsoon rainfall for the season as a whole turned out to be 12.5 per cent above normal for the country with only northern region experiencing a slightly below normal rainfall activity, though it was still normal in the broad normal limits of 19 per cent below or above normal.

The spatial distribution of overall seasonal rainfall during the year was also comparatively better than last year's rainfall. Of the total 36 agro-meteorological sub-divisions, 31 subdivisions of the country received excess to normal seasonal rainfall.

The post monsoon season also experienced a similar outcome as only northern region witnessed below normal rainfall (Table 2.1). Nonetheless, a considerable amount of rainfall received in the monsoon season has not only been of immense help during the critical stages but has also improved the storage of water in major reservoirs of the country. The current year's storage of water in major reservoirs of the country was 122 per cent of last ten year's average storage as on March 25, 2021. This led to the above

normal coverage of area sown under both food grains as well as non-food grains and record output of many agricultural commodities as reflected in the second advance estimates of crop production, which have been recently released by the Ministry of Agriculture in the month of February 2020–21.

The third advance estimates for 2020–21 indicate that output of rice (both kharif and rabi) is likely to be of the order of 121.5 million tonnes, about 3.2 per cent above last year's record output (Table 2.2). Likewise, production of wheat is estimated to touch 108.8 million tonnes, marginally higher than last year's record. The total output of coarse cereals (kharif and rabi) is also expected to be about 3.9 per cent higher than previous year's output. And, production of pulses is likely to witness an increase of about 11.3 per cent from 23 million tonnes in 2019–20 to 25.6 million tonnes in 2020–21. As a result, the overall output of foodgrains in the country in 2020–21 is expected to touch a new record of 305.4 million tonnes.

Among non-food grains, oilseed output is also likely to be about 10.2 per cent higher than last year's output and is expected to touch a new record of 36.6 million tonnes. In the case of cotton, the second advance estimates have placed output at about 36.5 million bales in 2020–21, which is 1.1 per cent higher compared to the 2019–20 output level. Sugarcane and horticultural crops have also experienced an increase in output and so has milk production.

As a consequence of record output in 2020–21, prices of food articles have remained low in 2020–21. The rate of inflation of food articles during the period from April to March in 2020–21 has been 3.1 per cent as compared to 8.4 per cent during the same period last year (Table 2.3). There are only two commodity groups, which have witnessed higher rates of inflation in 2020–21 – milk and other food articles. All other remaining groups of commodities have recorded much lower rates of inflation compared to the similar period last year. Though the volatility in prices of food articles (standard deviation) was higher in April to March 2020–21 compared to the corresponding period in the previous year.

2.2 Prospects for 2021–22

The prospects for output of the agricultural sector in 2021–22 depend largely on progress of south-west monsoon rainfall during June to September period of monsoon season. The forecast as well as progress so far in the first three weeks of June indicate that monsoon rainfall for the country as a whole is likely to be normal. The India Meteorological Department's updated forecast at the start of season on June 1 was that the seasonal rainfall (June to September) for the country as a whole is likely to be 101% of the Long Period Average (LPA) with a model error of ± 4%. And, early pointers for the period from June 1 to 22 so far suggest that rainfall has been normal in 28 of the 36 sub-divisions of the country. It is too early to predict, but all indications at this stage are that agricultural sector is set to witness normal growth in 2021–22 notwithstanding temporary disruptions created by the second wave of Covid-19 pandemic during the first quarter of 2021–22.

Food Articles inflation in the first two months of the current fiscal is higher than

the corresponding period of the previous year (Table 2.4). It is mainly driven by the rise in prices of fruits; eggs, meat & fish, and other food articles.

Table 2.1: Deviations of Actual Rainfall Indices from the Normal (2020–21)

Region	***Monsoon Season (June – September)***	***Post Monsoon Season (October – December)***
East	6.1	(–)13.1
West	21.8	7.4
North	(–)5.1	(–)62.6
South	35.6	(–)15.0
All India	**12.5**	**(–)3.1**

Source: Computed.

Notes:

1. These are regional level rainfall indices computed on the basis of un-irrigated area under foodgrains as weights.
2. The eastern region includes – Assam, Bihar, Jharkhand, Odisha, and West Bengal
3. The western region includes – Chhattisgarh, Gujarat, Madhya Pradesh, Maharashtra, and Rajasthan
4. The northern region includes – Haryana, Himachal Pradesh, Jammu and Kashmir, Punjab, Uttarakhand, and Uttar Pradesh
5. The southern region includes Andhra Pradesh, Karnataka, Kerala, and Tamil Nadu

Table 2.2: Output of Selected Crops during 2019–20 and estimates for 2020–21 (million tonnes)

Crop	*Output in 2019–20*	*Estimated Output in 2020–21*
Rice		
Kharif	103.3	104.3
Rabi	16.6	17.2
Wheat	107.9	108.8
Coarse cereals		
Kharif	33.6	35.6
Rabi	14.1	14.1
Pulses		
Kharif	7.9	8.5
Rabi	15.1	17.1
Foodgrains		
Kharif	**143.8**	**148.4**
Rabi	**153.7**	**157.1**
Oilseeds		
Kharif	**23.2**	**24.6**
Rabi	**10.8**	**12.0**
Cotton#	**36.1**	**36.5**
Sugarcane	**370.5**	**392.8**
Horticulture crops	**320.8**	**326.6**
Milk	**198.4**	**208.0**

Source: Government of India, Ministry of Agriculture and Farmers Welfare.
Note: # units in lakh bales.

Table 2.3: Changes in Wholesale Price Indices of Food Articles in 2019–20 and 2020–21 (April – March)

S. No.	*Product*	*Increase in 2019–20 over 2018–19*	*Increase in 2020–21 over 2019–20*
1	Food Articles	8.4	3.1
2	Cereals	7.5	(–) 2.6
3	Pulses	15.9	11.6
4	Vegetables	31.2	3.4
5	Fruits	3.2	1.5
6	Milk	2.5	4.6
7	Eggs, meat and fish	6.5	2.7
8	Condiments and spices	11.0	3.9
9	Other food articles	(–) 0.3	12.0

Source: Computed.

Table 2.4: Changes in Wholesale Price Indices of Food Articles in Apr–May 2021–22

S. No.	*Product*	*Increase in 2020–21 over 2019–20*	*Increase in 2021–22 over 2020–21*
1	Food Articles	2.7	4.6
2	Cereals	3.6	(–) 2.9
3	Pulses	13.6	11.4
4	Vegetables	(–) 4.8	(–) 9.0
5	Fruits	0.6	23.8
6	Milk	5.7	2.3
7	Eggs, meat and fish	2.2	10.8
8	Condiments and spices	13.4	2.0
9	Other food articles	(–) 3.2	17.3

Source: Computed.

Chapter 3: Industry

Saurabh Bandyopadhyay, Bornali Bhandari and Ajaya K Sahu

The 2nd wave of the pandemic has completely disrupted the recovery of industrial growth. Indicators like the Index of Industrial Production, electricity demand, GST collections indicate a decline in industrial activity in 2021–22:Q1 compared to 2020–21:Q4. However, this is still much higher than in 2020–21 Q1. It is assessed that because of the strong base effect that industry will grow by as much as 26.7 year on year (y-o-y) to Rs 8 trillion. Performance of the sector for the rest of the year will depend on the pace of progress with vaccinations and the intensity of the third Covid–19 wave. For the full year, it is assumed that industry will grow between 13.7 per cent and 15.7 per cent, reaching Gross Value Added (GVA) of around Rs 41.1–41.9 trillion. This is only slightly higher than GVA of Rs 39.3 trillion achieved two years ago in 2019–20.

3.1 Introduction

The growth rate of Index of Industrial Production (IIP) and other high frequency indicators indicate that the year-on-year (y-o-y) growth in 2020–21:Q3 and 2020–21:Q4 have displayed noticeable revival. However, though the April 2021–22 numbers looks promising on the back of a very low base, the emergence of second wave of Coronavirus infections, with sporadic time-bound lockdown in several of the major states makes uncertain the spell of recovery in industrial production for the entire April–June quarter of the ongoing fiscal.

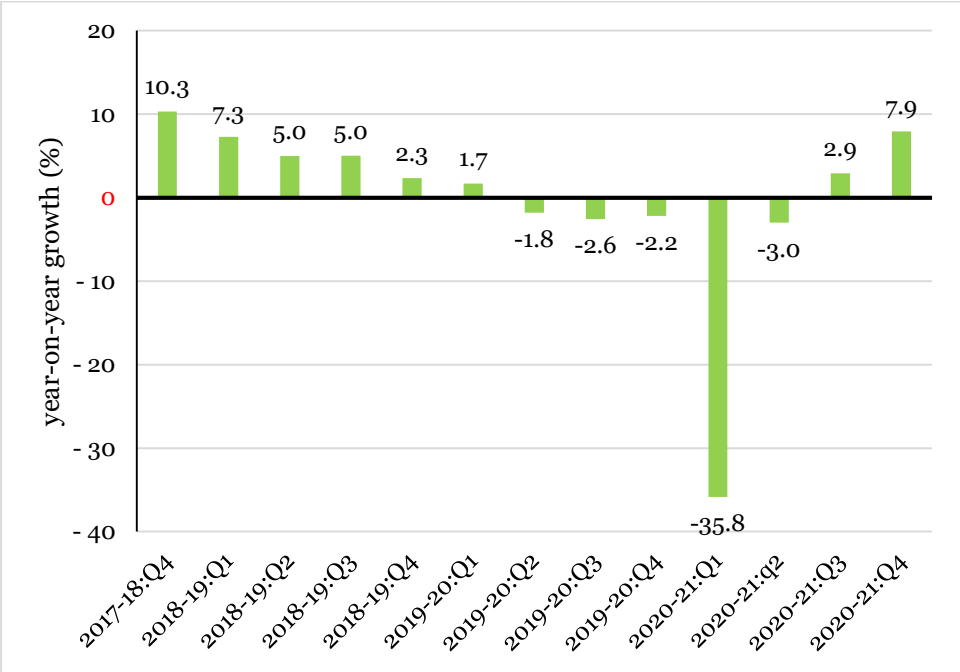
3.2 Industry: Aggregative Trends

The Gross Value Added (GVA) of Industry segments, consists of Mining & Quarrying, Manufacturing, Electricity, Gas & Water Supply (EGW) and Construction had been steadily declining since Q4: 2017–18 (Figure 3.1). After contracting for five consecutive quarters (three of them pre-Coronavirus pandemic), the real GVA Industry recorded positive growth of 2.9 per cent on a y-o-y basis in 2020–21:Q3. It gained momentum in 2020–21:Q4 with 7.9 per cent growth (Figure 3.1), recording its highest level at Rs 11.2 trillion (Annex 3.1).

Three out of four sub-sectors recorded positive growth in the third and four quarters. The significant exception was 'mining and quarrying', which contracted for both third and fourth quarters (Annex 3.1). After contracting for five consecutive quarters (three of them pre-Coronavirus pandemic), the GVA Manufacturing recorded 1.7 per cent y-o-y growth in 2020–21:Q3 and 7 per cent in 2020–21:Q4. EGW has been consistently growth since 2020–21: Q2 onwards and notched over 9 per cent growth rate in 2020–2021:Q4. The construction sector was one of the worst affected during lockdown but reflected a sharp revival since Q3 and recorded over 14 per cent growth rate in Q4: 2020–21.

For the entire year, GVA Industry growth contracted by (–) 7.0 per cent in 2020–21, driven by contraction in manufacturing, mining and construction. EGW is the only sector which showed positive growth in 2020–21 but it is slower than the previous year (Annex 3.1).

Figure 3.1: GVA Industry Segments, 2017–18:Q4 to 2020–21:Q4 (% y-o-y)



Source: Ministry of Statistics and Programme Implementation (MoSPI).

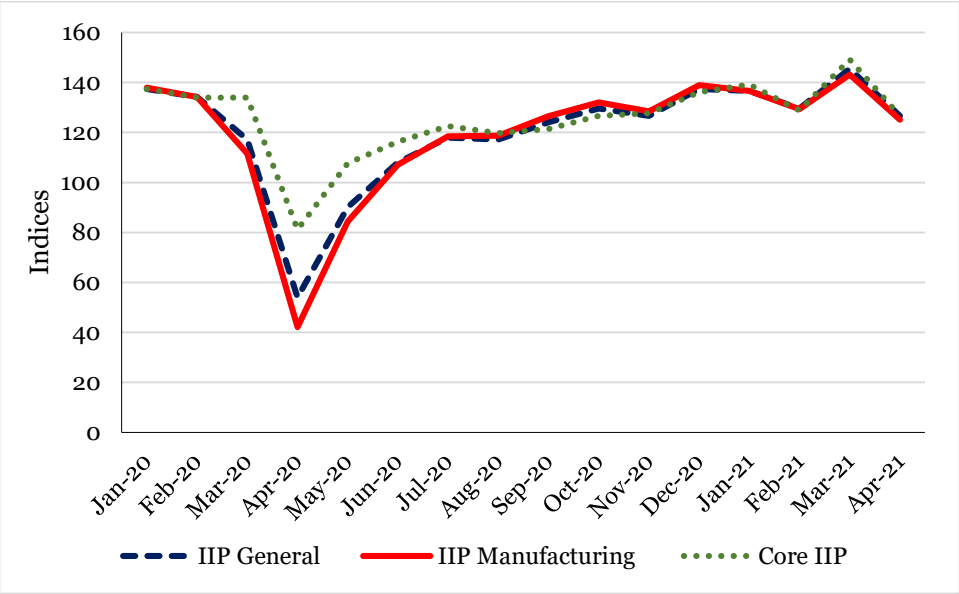
3.3 Trends in Industrial Activity: 2021–22

The Index of Industrial Production (IIP) is a measure of industrial activity in the economy. After the sudden announcement of the nation-wide lockdown on 25th March 2020, IIP movements exhibited a V-shaped pattern during March to June 2020. Thereafter IIP improved but at a moderating pace (Figure 3.2). There was a significant surge in activity in March 2021 but it did not sustain in April 2021 as some States had started imposing lockdowns due to the 2nd wave of the Coronavirus pandemic (Chapter 2). While industrial activity was higher on a y-o-y basis in April 2021, it was lower on a month-on-month basis.

IIP manufacturing with a weight of 77.6 per cent in IIP and core IIP with a weight of 40.3 per cent in IIP also conform to the broad trends described above (Figure 3.2)[1]. Disaggregated data from use-based (Annex 3.2) and 2–digit National Industrial Classification (NIC) codes (Annex 3.3) also confirm these broad trends. The one significant exception is the pharmaceutical industry which has maintained robust growth throughout the pandemic (Annex 3.3).

[1] The core index comprises of eight core/infrastructure industries namely coal, crude oil, natural gas, petroleum refinery products, fertilisers, steel, cement and electricity.

Figure 3.2: IIP General, IIP Manufacturing and Core IIP, January 2020 to April 2021



Source: Ministry of Statistics and Programme Implementation.

3.4 Outlook

As mentioned in Chapter 2 any attempt to forecast industrial performance through conventional techniques under present conditions would be futile. Our assessment of industrial performance in the first quarter of 2021–22 is based on inputs from domain experts and such data as has been available about likely performance of individual subsectors in the first quarter. The assumed impact of Covid–19 on overall industrial performance in Q1 is a weighted aggregation of these sub-sector level assessments.

There are four key differences between the 2020 nation lockdown imposed at March–end and 2021 state-wise lockdown for which the timeline starts in mid–April. Chhattisgarh, Delhi, Jharkhand, Kerala and Maharashtra were the earliest States to impose lockdowns in mid–April 2021. By June 7th, many States had started unlocking in a phase-wise manner. It has been assumed that the sub-sectors would be worst affected during April & May with activity gradually recovering thereafter as the lockdown is phased out through June in various States (Annex 3.4).

Second, some States like Tamil Nadu, Maharashtra allowed export units to remain open so that they could continue to fulfill export orders. The third difference is that many sectors were affected as industrial oxygen was diverted due to the pandemic[2]. The fourth difference is freight moving transport did not shut down. Railways freight continued to be operational. While States did not shut down intra-State movement of roads traffic, inter-State movement may have been affected due to pandemic related issues. The evidence for that is provided in Chapter 5 in the Services chapter

[2] Oxygen is used in diverse applications covering many industries, including steel manufacturing, chemical processing, pulp and paper, metal production, metal fabrication, glass manufacturing, petroleum recovery and refining.
Oxygen SicgilSol India Private Limited, Industrial, Oxygen, Nitrogen, Argon, High Purity Gases

where rail freight, e-way bills etc. all showed moderate levels of traffic in April–May 2021.

The sub-sectors of the industrial sector are discussed below:

1. Mining and Quarrying: The 'mining and quarrying' sub-sector has a 9.1 per cent share in industrial GVA. Maharashtra (20.1 per cent), Rajasthan (14.3 per cent), Gujarat (12.9 per cent) and Odisha (12.4 per cent) form almost 60 per cent of the Indian GVA in this sector[3].

   As mentioned earlier, the mining sector contracted throughout all the four quarters in 2020–21. Due to base effects, it is assumed that GVA in Mining will grow by 11 per cent in 2021–22:Q1 to reach Rs 0.8 trillion in the first quarter. The GVA Mining was Rs 0.7 trillion in 2020–21:Q1 and Rs 0.9 trillion in 2020–21:Q4. It is assumed that the mining sector was partially affected due to state-wise lockdowns due to logistics issues etc. IIP Mining index showed continued production in April. Revenue earning freight traffic showed continued movement of coal and iron ore.

2. Manufacturing: The manufacturing sub-sector accounts for 56.7 per cent of industrial GVA. Four States comprising of Maharashtra (18 per cent), Gujarat (16 per cent), Tamil Nadu (12 per cent) and Karnataka (8 per cent) comprise 54 per cent of Indian manufacturing. Any shut down in these States would disproportionately affect the sector.

   The impact of Covid–19 on the manufacturing sector depends on what enterprises could stay open for producing 'essential items' under the Disaster Management Act since work-from-home is not an option for manufacturing. Further, supply chain disruption affected both input and output flows. In 2021, the supply chains would be affected to a lesser degree as many States allowed goods carrying traffic free movement. Even in plants allowed to be open, worker absenteeism and adoption of social distancing would imply operation at sub-optimal capacity. The assessment for manufacturing sub-sectors using highly granular level, going down in some cases to National Industrial Classification 5-digit level is as follows:

   a. Food Products, Beverages and Tobacco: Production of food products falls under the Disaster Management Act and would therefore continue to operate. This sub-sector accounts for 12.7 per cent of the manufacturing sector. It is assumed that the GVA will grow by 27 per cent in 2021–22:Q1 on a y-o-y basis. The IIP data from April 2021 shows that the IIP indices for food products, beverages and tobacco were higher than April 2020 but lower than March 2021.

   b. Textiles, Apparel and Leather Products: This sub-sector accounts for 14.9 per cent of the manufacturing sector. Within this sub-sector, the sub-sector of textiles and ginning forms the largest share. The sector would largely be closed barring export units and some enterprises producing

[3] The shares of States are 5-year moving averages between 2015-16 and 2019-20.

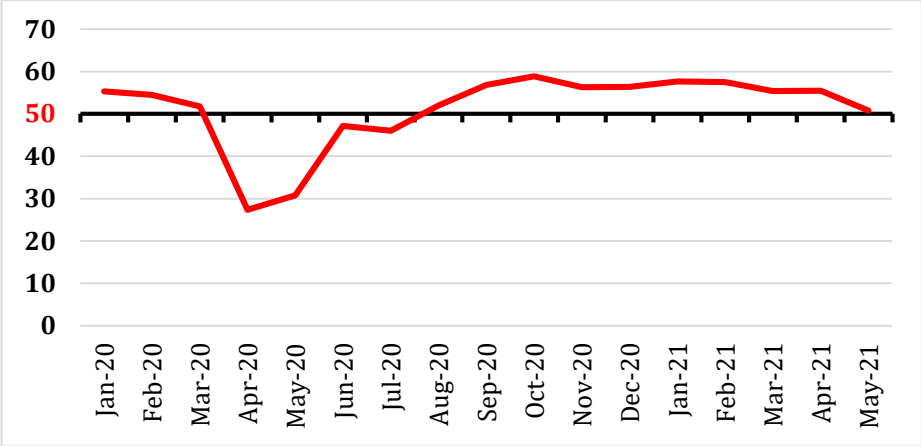
cloth masks, Personal Protection Equipment etc[4]. The IIP April 2021 for each sub-sector are lower than that of March 2021 but higher than that of April 2020. Therefore, it is assumed that the sector will grow at 58 per cent on a y-o-y basis.

- Metal Products: This sub-sector accounts for 15 per cent of the manufacturing sector. This sub-sector would be negatively affected by both localized lockdowns and diversion of industrial oxygen. Here it is assumed that real GVA will grow by 23 per cent in 2021–22:Q1 on a y-o-y basis.
- Machinery and Equipment: This sub-sector accounts for 20.2 per cent of the manufacturing sector and includes production of computers, electronics, communication, optical products etc. and repair of computers, personal & household goods. It would be affected negatively by the lockdown. Therefore it is assumed that the real GVA will grow by 35 per cent in 2021–22:Q2 on y-o-y basis.
- Other Manufactured Goods: This sub-sector accounts for 37.2 per cent of the manufacturing sector. It is assumed that the real GVA will grow by 27.1 per cent in 2021–22:Q1 compared to the corresponding period last year. This sub-sector includes enterprises in manufacturing of pharmaceuticals, chemicals, rubber, plastic, coke and refined petroleum products, many of which have continued to operate during the lockdown. However, some may have been affected by the diversion of industrial oxygen. The pharmaceutical industry has shown consistent growth as mentioned earlier (Annex 3.3).

Annex 3.3 shows that all sectors were operational in April 2021 compared to April 2020. Taking a weighted average, it is assumed that GVA of the manufacturing sector would have grown by 26.7 per cent in 2021–22:Q1 on a y-o-y basis. The IHS PMI for manufacturing remained above 50 (Figure 3.3) indicating continued expansion in May 2021 though at lower levels. Base effects account for the double-digit growth. GVA manufacturing will reach Rs 4.8 trillion in 2021–22:Q1, much lower than Rs 5.7 trillion in 2019–20:Q1.

[4] Anecdotal evidence suggests that demand for shroud cloth and funeral related textiles like 'gamcha' went up and benefitted those particular industries.
COVID-19: Mounting Deaths Stir Powerlooms Back to Life in UP, Bihar as Demand for Shrouds Rises | NewsClick

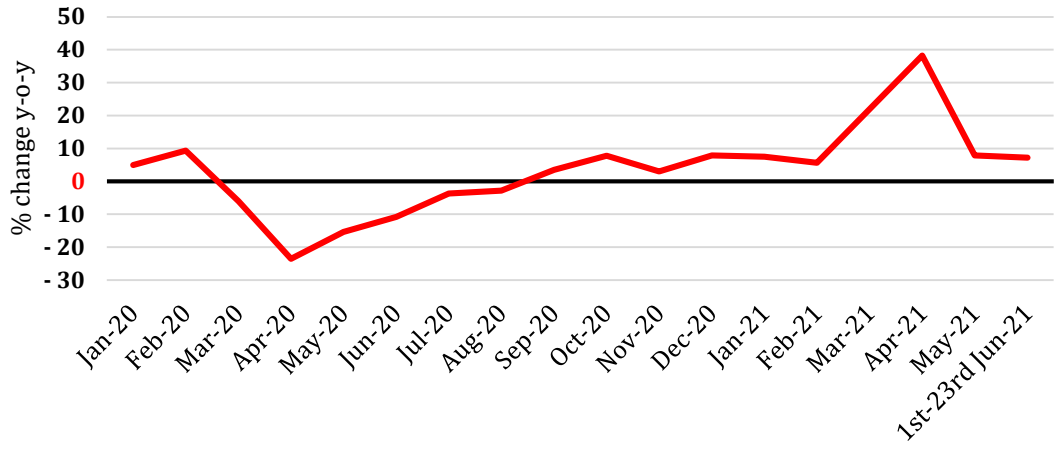
Figure 3.3: PMI Manufacturing, January 2020 to May 2021



Source: IHS.

3. Electricity, Gas and Water Supply: This sub-sector accounts for 7.3 per cent of the industry sector. Maharashtra (13.8 per cent) and Gujarat (12.2 per cent) contribute 26 per cent to the GVA of this sector. IIP Electricity grew in double digits in April 2021 on a y-o-y basis. The electricity demand (Figure 3.4) grew moderately in May and June 2021. It is assumed that the sector will grow by 10 per cent on a y-o-y basis in 2021–22:Q1.

Figure 3.4: Maximum Electricity Demand January 2020 to 23rd June 2021

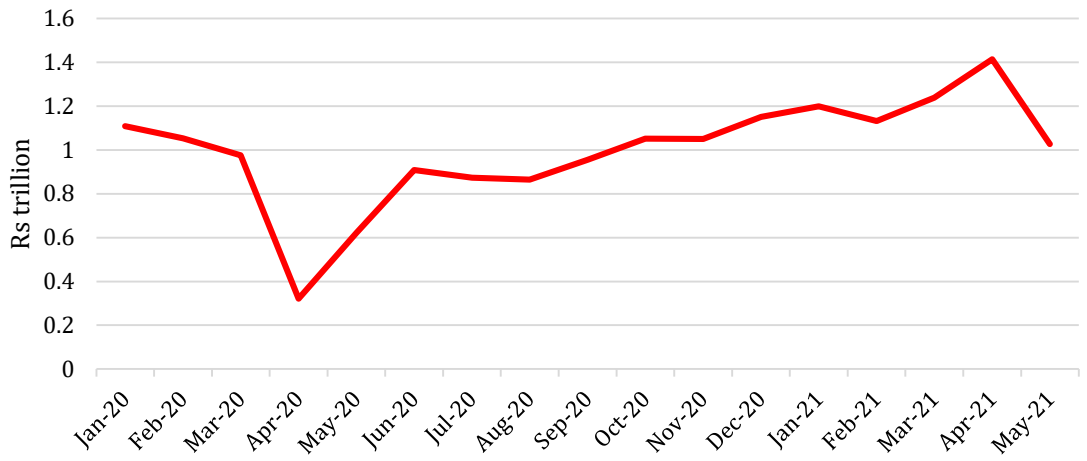


Source: Power System Operation Corporation Ltd. https://posoco.in/.

4. Construction: This sub-sector accounts for 27 per cent of industry. It was the worst affected in Q1 of last fiscal. Tamil Nadu (13 per cent), Uttar Pradesh (11.5 per cent) and Maharashtra (9.8 per cent) together contribute 34.3 per cent to the total Indian GVA in this sector.

In April 2021, IIP steel and cement indices were lower than March 2021 but higher than April 2020 indicating positively growth. Rural construction was also affected as MGNREGA data showed negative growth in both demand and supply of jobs compared to last year in May 2021. It is assumed that the construction sector grew at 25 per cent in 2021–22:Q1 on a y-o-y basis.

Figure 3.5: GST Collections Jan 2020 to May 2021 (Rs trillion)



Source: Goods & Services Tax Network

Aggregating across subsectors on a weighted average basis indicates that industry GVA will grow by 26.7 per cent in 2021–22:Q1 to reach Rs 8 trillion (Table 3.1). This is substantially higher than Rs 6.4 trillion in 2020–21:Q1 but lower than Rs 11.2 trillion in 2020–21:Q4. The GST collections data from April and May indicate robust growth (Figure 3.5). We assume that the sector will be gradually recovering through the subsequent quarters. However, the 3rd wave of the pandemic may affect the growth prospects.

Performance of the sector for the rest of the year will depend on the pace of progress with vaccinations and the intensity of the third Covid–19 wave, if and when it occurs. Therefore, it is assumed that industry will grow between 13.7 per cent and 15.7 per cent, reaching GVA of around Rs 41.1–41.9 trillion. This is only slightly higher than GVA of Rs 39.3 trillion achieved two years ago in 2019–20.

Table 3.1: Quarterly Assumptions about Disruptions in GVA and Key Sectors, Rs trillion (Figures in brackets are % y-o-y)

Sector	2021–22:Q1	2021–22:Q2	2021–22:Q3	2021–22:Q4	2021–22
Industry *Baseline*	8 (26.7)	10.1 (10.0)	10.6 (8.0)	12.3 (10.0)	
Industry *Optimistic*	8 (26.7)	10.3 (12.0)	11.0 (12.0)	12.5 (12.0)	
Mining	0.8 (11.0)	Left Blank intentionally			
Manufacturing	4.8 (32.1)				
Electricity, Gas & Water Supply	0.8 (10				
Construction	1.6 (25.0)				

Source: NCAER QRE Team.

Annex 3.1 Real GVA Industry and its Components (Rs trillion)

Year: Quarter	Industry	Mining	Manufacturing	EGW	Construction
2019–20:Q1	9.9	0.8	5.7	0.8	2.6
2019–20:Q2	9.5	0.6	5.6	0.8	2.4
2019–20:Q3	9.5	0.8	5.5	0.7	2.6
2019–20:Q4	10.4	1.0	5.9	0.7	2.8
2020–21:Q1	6.4	0.7	3.6	0.7	1.3
2020–21:Q2	9.2	0.6	5.6	0.8	2.2
2020–21:Q3	9.8	0.7	5.6	0.8	2.7
2020–21:Q4	11.2	0.9	6.3	0.8	4.2
2019–20	**39.3 (–1.2)**	**4.2 (–2.5)**	**22.7 (–2.4)**	**3.0 (2.1)**	**10.4 (1.0)**
2020–21	**36.5 (–7.0)**	**2.9 (–8.5)**	**21.1 (–7.2)**	**4.1 (1.9)**	**9.5 (–8.6)**

Source: Ministry of Statistics & Programme Implementation, May 31, 2021.
Notes: EGW stands for Electricity, Gas, Water Supply & other Utilities
Figures in brackets indicate year-on-year growth

Annex 3.2 Use-based classification of manufacturing

	Indices					
	Primary goods	**Capital goods**	**Intermediate goods**	**Infrastructure/ construction goods**	**Consumer durables**	**Consumer non–durables**
Jan–20	133	102	147	147	124	158
Feb–20	131	97	146	145	117	153
Mar–20	134	73	126	118	83	122
Apr–20	92	7	45	20	6	73
May–20	106	35	84	88	40	135
Jun–20	109	64	108	115	78	148
Jul–20	114	71	125	129	99	149
Aug–20	109	76	129	131	110	140
Sep–20	112	90	134	133	129	147
Oct–20	118	91	141	144	134	149
Nov–20	122	84	138	137	113	149
Dec–20	130	96	150	151	125	161
Jan–21	134	93	150	150	124	150
Feb–21	125	94	138	139	125	147
Mar–21	145	108	155	159	129	160
Apr–21	127	82	138	135	112	142
2019–20	**126 (0.7)**	**108 (–14.0)**	**126 (9.1)**	**142 (–3.6)**	**130 (–8.8)**	**145 (–0.1)**
2020–21	**127 (–7.0)**	**93 (–18.8)**	**138 (–9.4)**	**137 (–8.7)**	**119 (–15.2)**	**145 (–2.1)**

Source: Ministry of Statistics & Programme Implementation
Note: Figures in brackets indicate year-on-year growth.

Annex 3.3: 2-digit Industry Classification

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NIC 2008	Description	Jan-20	Feb-20	Mar-20	Apr-20	May-20	Jun-20	Jul-20	Aug-20	Sep-20	Oct-20	Nov-20	Dec-20	Jan-21	Feb-21	Mar-21	Apr-21
10	Manufacture of food products	151.8	137.1	118.1	94.3	98.0	102.7	111.0	107.1	110.9	113.9	133.9	149.1	149.0	135.2	151.7	128.1
11	Manufacture of beverages	103.2	108.7	87.5	7.2	54.9	83.9	78.9	76.8	84.6	82.7	86.3	90.1	95.4	94.8	108.5	92.0
12	Manufacture of tobacco products	108.4	85.9	91.5	0.3	40.7	91.6	102.0	84.2	88.3	86.5	92.9	98.1	103.7	79.2	87.3	85.2
13	Manufacture of textiles	122.2	116.7	100.3	11.0	40.2	63.1	93.9	96.6	105.4	110.7	108.9	114.9	115.3	111.2	117.0	113.2
14	Manufacture of wearing apparel	162.3	164.6	115.6	9.7	62.6	105.9	112.5	113.8	121.4	119.9	101.7	140.0	129.4	141.2	144.6	136.1
15	Manufacture of leather and related products	130.6	131.6	100.8	1.7	52.4	99.7	110.7	106.0	123.3	116.4	105.0	121.9	124.9	121.4	124.4	106.8
16	Manufacture of wood and products of wood and cork, except furniture; manufacture of articles of straw and plaiting materials	104.2	117.9	85.1	4.7	39.6	74.0	83.0	85.5	116.8	111.8	108.7	126.6	112.0	111.6	121.2	107.0
17	Manufacture of paper and paper products	91.8	89.0	69.2	21.7	50.3	82.9	67.0	79.0	64.2	71.7	71.6	78.1	80.2	79.5	90.1	87.9
18	Printing and reproduction of recorded media	93.8	94.6	74.2	23.1	52.6	70.2	68.5	65.4	68.3	69.0	70.5	83.0	70.0	67.7	74.7	66.2
19	Manufacture of coke and refined petroleum products	129.9	125.5	132.3	87.7	95.9	104.5	109.4	100.6	103.2	109.3	124.8	125.0	129.3	113.6	130.9	118.5
20	Manufacture of chemicals and chemical products	124.9	121.7	101.1	53.0	95.9	117.3	122.2	118.9	125.5	128.0	120.4	131.8	131.6	119.3	131.6	120.2
21	Manufacture of pharmaceuticals, medicinal chemical and botanical products	225.3	228.1	168.6	93.6	234.3	237.1	243.1	221.9	236.0	239.6	226.0	239.9	205.4	214.7	229.1	206.2
22	Manufacture of rubber and plastics products	102.4	103.3	77.9	29.4	69.5	91.6	100.6	98.8	107.8	111.5	104.7	112.8	108.5	105.7	114.5	106.5
23	Manufacture of other non-metallic mineral products	135.4	133.5	107.2	16.9	91.2	110.4	105.4	96.2	103.8	117.1	112.7	122.6	127.2	124.2	139.8	120.1
24	Manufacture of basic metals	168.7	169.5	143.0	40.3	103.2	131.5	153.1	162.9	160.5	170.6	165.4	181.7	179.8	162.8	184.7	158.2
25	Manufacture of fabricated metal products, except machinery and equipment	94.6	94.6	73.1	3.7	44.2	67.3	82.0	83.9	92.1	95.7	81.8	99.0	93.7	93.2	100.9	80.0
26	Manufacture of computer, electronic and optical products	158.3	137.7	100.6	12.6	64.5	114.8	144.9	146.3	167.2	151.1	115.0	138.8	155.6	166.7	171.7	139.7
27	Manufacture of electrical equipment	113.0	102.8	71.4	5.6	31.6	61.7	82.6	94.4	126.5	132.4	114.4	131.8	109.7	106.0	108.6	86.0
28	Manufacture of machinery and equipment n.e.c.	118.5	113.6	86.9	9.1	44.6	80.2	85.6	92.6	108.9	113.2	105.4	118.5	110.0	112.0	129.0	98.7
29	Manufacture of motor vehicles, trailers and semi-trailers	108.4	100.0	64.2	0.7	20.7	53.7	73.5	85.0	99.5	109.9	99.2	103.2	107.8	105.6	114.9	103.6
30	Manufacture of other transport equipment	128.7	131.0	107.8	0.2	22.8	72.3	108.4	133.5	162.4	167.2	139.3	121.1	136.4	135.6	146.2	114.0
31	Manufacture of furniture	202.5	201.5	168.9	1.4	60.5	144.8	157.0	181.1	168.3	167.7	144.7	183.9	163.4	165.7	174.1	153.4
32	Other manufacturing	87.9	82.8	62.0	10.7	28.6	51.7	50.0	56.2	67.4	83.4	65.5	76.7	85.0	85.3	93.3	95.0

Source: MoSPI

Annex 3.4 Timeline of 2nd Wave Lockdowns in Major States

Dates	*Full Lockdown*
April 13	Chhattisgarh
April 19-22	Delhi, Jharkhand, Kerala, Maharashtra
April 29-30	Gujarat (partial), Uttar Pradesh, West Bengal
May 3-5	Andhra Pradesh, Bihar, Haryana, Karnataka, Madhya Pradesh, Punjab
May 10-13	Tamil Nadu, Telangana, Assam
	Phase-wise unlocking
June 4	Gujarat
June 7-10	Andhra Pradesh, Assam, Bihar, Delhi, Haryana, Kerala, Maharashtra, Punjab, Rajasthan, Telangana, Uttar Pradesh

Chapter 4: Services

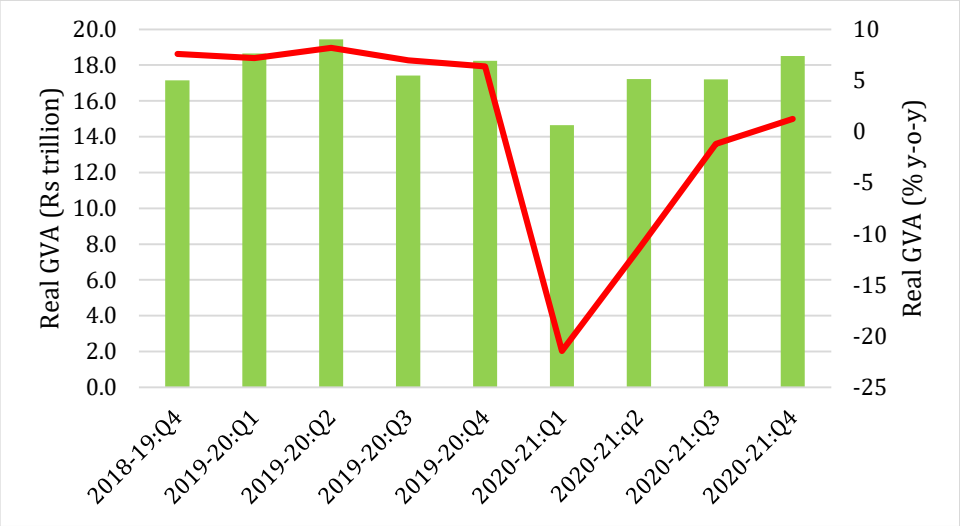
Bornali Bhandari

Services output is estimated to have declined in 2021–22:Q1, compared to 2020–21:Q4, as the second Covid wave peaked. But y-o-y growth is still estimated to be positive because of the much sharper contraction of output in 2020–21:Q1. With the second wave having subsided and phased unlocking, services output is expected to recover from Q2 onwards. However, there may again be a dip in output in Q3 because of the risk of a third wave. We assess that GVA in Services will reach Rs 72.2–Rs 73.6 trillion in 2021–22. Though this will amount to a positive y-o-y growth of 6.7 per cent–8.7 per cent compared to the even lower output of Rs 67.6 trillion in 2020–21, it will still be lower than GVA of Rs 73.8 trillion) achieved two years ago in 2019–20.

4.1 Past Trends in Services Sector

The services sector contracted by (–) 8.4 per cent in 2020–21. The year-on-year (y-o-y) growth of the Gross Value Added (GVA) of the Services sector had been slowing down since Q4: 2018–19 but the outbreak of unprecedented Coronavirus pandemic virtually brought the economy to a standstill (Figure 4.1). The Services sector has contracted for three consecutive quarters in 2020–21, albeit at a moderating pace. It was only in the fourth quarter that the Services sector grew positively at 1.3 per cent.

Figure 4.1: Real GVA (Rs trillion and % change y-o-y)



***Source**:* Ministry of Statistics and Programme Implementation.

Within services sector, there were sub-sectoral differences (Annex 4.1). Services growth which majorly is driven by Trade, hotels, restaurants & communications (THRC), carried the burden of the pandemic being dominated by contact-intensive services. Its annual growth contracted by (–) 18.4 per cent in 2020–21 and the quarterly patterns show that the sector contracted for all four quarters in the last fiscal (see

Annex 4.1) though at a moderating pace. In contrast, the other two sectors recovered to show moderate but positive growth in the fourth quarter of last fiscal.

4.2 Outlook

Growth of the sub-sectors within the services sector for 2021–22:Q1 have been assessed based on such indicative information as are available as of now and inputs from domain experts. These were then aggregated on a weighted average basis to estimate the impact of Covid-19 on the Services sector as a whole. Annex 3.4 shows the timeline of the State lockdowns. Some sectors like rail and air traffic are managed by the Centre and therefore the impact would be relatively more homogenous in those sectors. The sub-sectors are discussed in further detail below:

1. 'Trade, hotels, transport, communication and services related to broadcasting': The share of this sector in the services sector is about 35.7 per cent. Our assessment for this sub-sector is that the GVA in this sub-sector would grow by 13.2 per cent (Table 4.1). Further details are as follows:
    a. Trade and repair services: Unlike the experience of 2020, wholesale and retail shops were allowed to be opened for a limited time in each State. Essential services were open through the lockdown. Shopping malls were closed. Given the based effects and partial lockdown, it is assumed that the sub-sector would grow by 10 per cent in 2021–22:Q1 on a y-o-y basis.
    b. Hotels & Restaurants: As discussed in Box 4.1, it is assumed that this sector would contract by (–) 44 per cent on a y-o-y basis.

Box 4.1. Impact of 2nd wave of COVID-19 on Tourism Sector

Tourism activities, which had started picking up from the Q3 of 2020-21, are expected to have seen a halt again in Q1 this year. It is assumed that the contraction in the hotels & restaurants sub-sector will be similar to last year, at (–)44.5 per cent. The slight uptick (y-o-y) may be attributed to the fact that there was no forced restriction on movement, unlike last year when almost all states were under lockdown. This year, the inter-state movement is relatively easier, even with lockdown. While no leisure/holiday are expected but some trips related to medical and social purpose may be taking place. Even social ceremonies, like weddings etc., were taking place with limited gathering.

Source: Contributed by Poonam Munjal, Senior Fellow, NCAER.

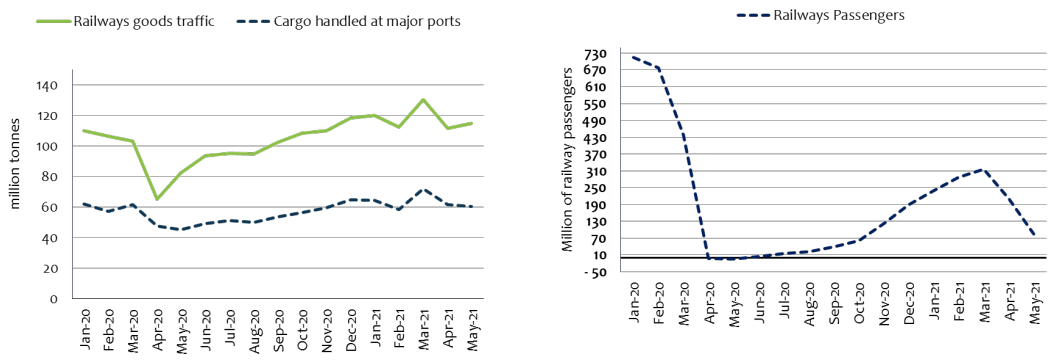
    c. Transport, storage, communication & services related to broadcasting: There would be sub-sectoral differences. Within the transport sector, cargo traffic would fare better compared to passenger traffic as movement of goods was allowed. The lead indicators from the transport sectors confirm that (Figures 4.2, 4.3 and 4.4). Air cargo traffic slowed down in April 2021 but to a lesser degree than passenger traffic. On a y-o-y basis, they show triple-digit growth[1]. Google mobility data shows recovery in

[1] Maharashtra alone contributes 40 per cent to air transport in India.

mobility in June 2021 after the slowdown in April and May 2021.

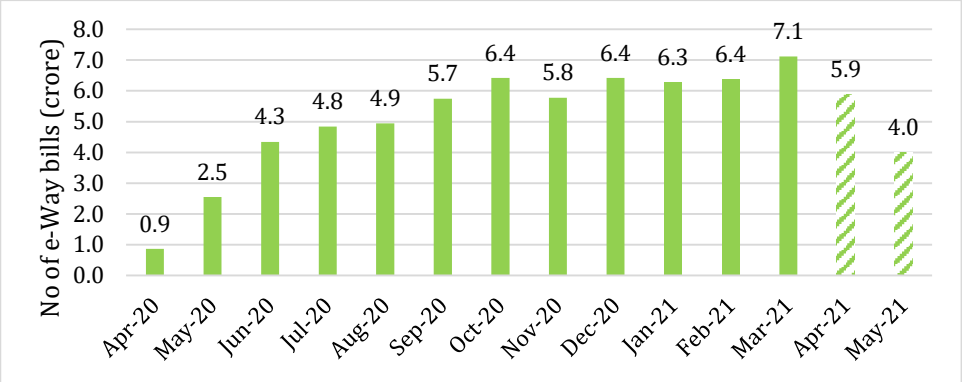
Warehousing would also continue to function as e-Commerce continued to be operational in almost all the States throughout the lockdown period. Communication and Services related to broadcasting: The telecom sector continue to show robust growth due to behavioural changes.

Figure 4.2: Moderation in cargo traffic lower than passenger traffic within the transport sub-sector



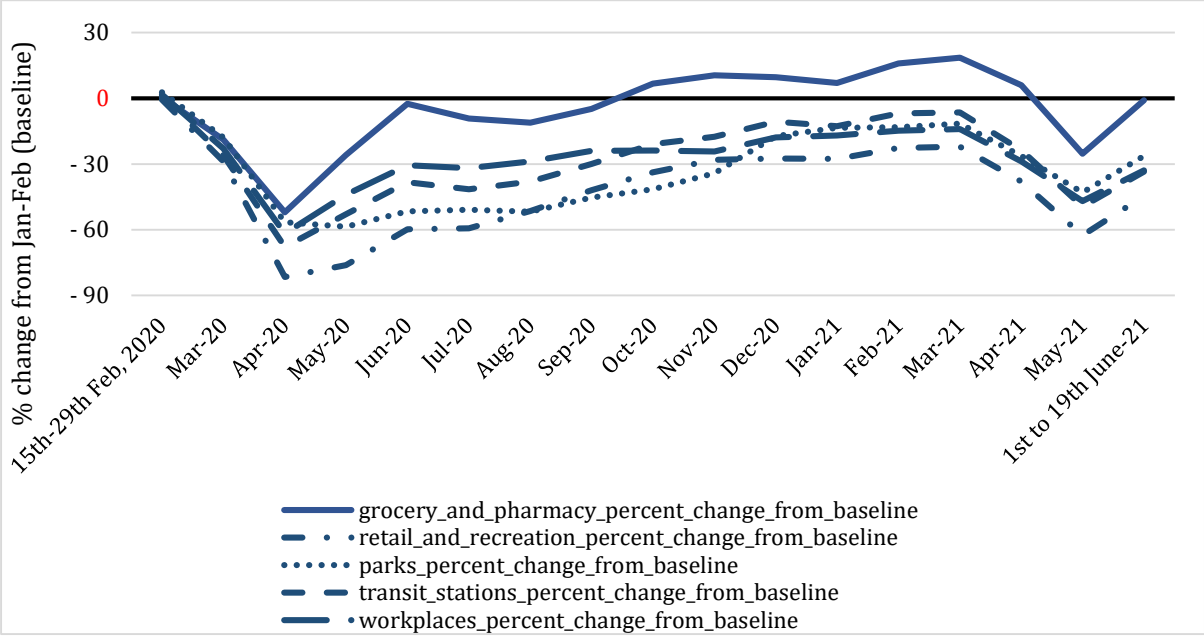
Sources: Ministry of Railways and Indian Ports Association.

Figure 4.3: No. of e-way bills (crore)



Source: Goods & Services Tax Network.

Figure 4.4: Google Mobility: Slowdown in mobility in April and May 2021 with an improvement in June 2021



Source: Goods & Services Tax Network & Google LLC "Google COVID-19 Community Mobility Reports". https://www.google.com/covid19/mobility/ Accessed: December 5, 2020.
Note: Graph on the RHS show deviations from the baseline, which is the median value, for the corresponding day of the week, during the 5-week period Jan 3–Feb 6, 2020

2. Financial, real estate & professional services: Overall the GVA of this sub-sector is expected rise by 5.0 per cent in 2021–22:Q1 on a y-o-y basis. The average share of this sub-sector in overall services sector is 40.2 per cent. Financial services is assumed to register positive growth as banks and other financial outreach activities have remained open[2]. Real estate activities remained closed. Business services are assumed to have remained open as there was a shift to work from home. Professional, scientific and technical services have continued and some administrative and support service activities have also continued. Legal activities have continued, though at a reduced pace, as courts carried out activities via e-Courts. Accounting and book keeping activities have also continued. However, rental and leasing service activities seem to have come to a stop.

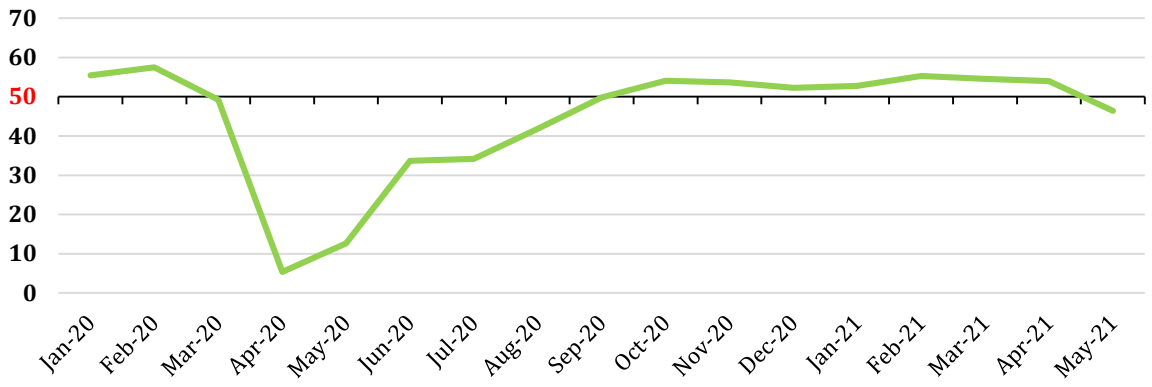
3. Public Administration, Defence & Other Services: On average, this group accounts for 24.0 per cent of the services sector. We expect 10 per cent y-o-y growth in this sector. The sheer nature of the COVID-19 related lockdown means that there would be a higher demand for public administration. Defence, of course, remained operational. Education services remained operational, but at a reduced pace, while other personal services mostly remain closed. We are assuming that the GVA of the health sub-sector has experienced a positive shock because of the much higher level of activity in response to the COVID-19 crisis, mainly in public health services.

[2] Maharashtra alone forms 25% of GVA of financial services.

Overall for the services sector, the IHS Purchasers' Managers Index indicates slowdown in the first two months and contraction in May 2021 (Figure 4.5).

Using shares as weights, the GVA for the services sector is estimated. For 2021-22:Q1, we estimate the y-o-y growth for the services sector to be 4.8 per cent. The GVA for the Services sector for first quarter is estimated to be Rs 15.4 trillion. This is higher than 2020–21:Q1 (Rs 14.7 trillion) but lower than 2020–21:Q4 (Rs 18.5 trillion). We assume growth rates for the remaining quarters factoring in the possible third wave to estimate the annual GVA both in levels form and y-o-y growth rates (Table 4.5).

Figure 4.5: PMI Services, January 2020 to May 2021



Source: IHS Markit Purchasing Managers' Index.
Note: A value above 50 indicates expansion and lower shoes contraction.

Table 4.**1: Quarterly Assumptions about Disruptions in GVA and Key Sectors, Rs trillion**
Figures in brackets indicate % change y-o-y

Sector	***2021–22:Q1***	***2021–22:Q2***	***2021–22:Q3***	***2021–22:Q4***	***2021–22***
Services *Baseline*	15.4 (4.8)	18.6 (8.0)	18.2 (6.0)	20.0 (8.0)	72.2 (6.7)
Services *Optimistic*	15.4 (4.8)	18.9 (10)	18.9 (10)	20.4 (10)	73.6 (8.7)
Trade, hotels, transport, communication and services related to broadcasting	3.9 (13.2)	Left intentionally blank			
Financial, real estate & professional services	8.0 (5.0)				
Public administration, Defence and Other Services	3.9 (10.0)				

Source: NCAER QRE Team.

Annex 4.1: Real GVA Services and its Components

Year: Quarter	*Services*	*Trade, Hotels, Transport, Communication & broadcasting*	*Finance, real estate and professional services*	*Public administration, defence & other services*
2019-20:Q1	18.7	6.6	8.0	4.0
2019-20:Q2	19.4	6.4	8.6	4.4
2019-20:Q3	17.4	6.6	6.2	4.6
2019-20:Q4	18.2	7.3	6.3	4.6
2020-21:Q1	14.7	3.5	7.6	3.6
2020-21:Q2	17.2	5.4	7.8	4.0
2020-21:Q3	17.2	6.1	6.6	4.5
2020-21:Q4	18.5	7.2	6.6	4.7
2019-20	**73.8 (7.2)**	**27.0 (6.4)**	**29.2 (7.3)**	**17.6 (8.3)**
2020-21	**67.6 (–8.4)**	**22.1 (–18.2)**	**28.7 (–1.5)**	**16.8 (–4.6)**

Source: Ministry of Statistics & Programme Implementation.

Chapter 5: External Sector

Prerna Prabhakar and Bornali Bhandari

Merchandise exports have continued to recover since the nation-wide lockdown in March 2020, however there was a dip during the 2nd Covid wave in April 2021. Merchandise imports followed a similar recovery path but has declined through April and May 2021 due to the second wave. Much of this growth was in goods trade since services exports & imports have remained flat since March 2020. The trade balance which was in surplus in the first half of 2020–21 and in deficit during the second half has again turned positive in May 2021. Going forward the outlook for goods exports remains buoyant because of strong growth in some of India's major trading partners. Capital inflows have been highly volatile, rising from a net outflow of USD 10.7 billion in March 2020 to a peak inflow of USD 23.5 billon in August 2020, then declining to USD 0.9 billion in April 2021. Foreign exchange reserves have been rising significantly since March 2020 barring a small dip in February & March 2021. Reflecting this reserve accumulation, the exchange rate has been appreciating since April 2020, barring a small depreciation during April 2021.

5.1 Coronavirus Pandemic, World Economy & the Indian Economy

Global economic outlook has improved since December 2020. As per the International Monetary Fund World Economic Outlook of April 2021[1] the world economy is projected to grow at 6 per cent in 2021 and 4.4 per cent in 2022. The OECD Economic Outlook[2] May 2021 forecasts that global GDP growth will grow by 5.8 per cent in 2021 and 4.4 per cent in 2022. This is driven by vaccine rollout and massive fiscal support by the United States.

The OECD Economic Outlook points out that the global recovery is uneven. This is driven by the unevenness in vaccination rollout and trade patterns. Countries dependent on service sectors like tourism are finding it harder to recover compared to ones which are involved in merchandise trade like supply chains, particularly pharmaceuticals, medical supplies and IT material.

For India, the NCAER assessment is that the economy will grow by 8.4-10.0 per cent 2021–22 (Chapter 2).

5.2 India's Balance of Trade

India has experienced two consecutive years of contraction in international trade. Exports of goods & services (in US$ terms) contracted in 2019–20 and 2020–21 by (–) 54.5 and (–) 6.6 per cent respectively. The corresponding numbers for imports were (–) 4.3 per cent and (–) 16.6 per cent respectively.

Exports of goods & services exhibited a V-shaped pattern of contraction and recovery in 2020–21:Q1. Thereafter, exports growth levelled off. Imports exhibited a

[1] https://www.imf.org/en/Publications/WEO/Issues/2021/03/23/world-economic-outlook-april-2021
[2] https://www.oecd.org/economic-outlook/

slower recovery. Consequently, India had a trade surplus in 2020–21:H1. This turned into a deficit in 2020–21:H2 as imports surged. There has been a slowdown in trade in April and May 2021 compared to March 2021 but they are higher than April and May 2020. The imposition of State-wide lockdowns has led to a decline in economic activity and therefore imports, resulting in a small trade surplus in May 2021. The dynamics of trade are being driven by merchandise trade as services trade levels have remained flat since April 2020 (Annex 5.1).

Figure 5.1: Exports and Imports of Goods & Services (US$ billion), January 2020 to May 2021

Sources: Ministry of Commerce and RBI.
Note: Services data for May are estimated.

Merchandise Trade

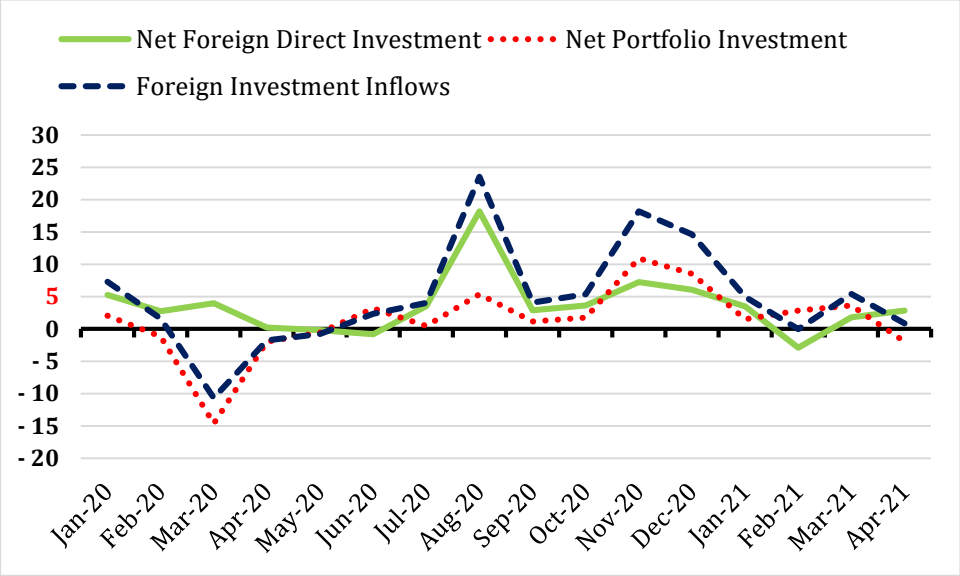
Cumulative exports for the period April–May 2021 exhibited an increase at 113.8 per cent on y-o-y basis (at USD 62.89 Billion). All major export categories registered a positive growth for April–May 2021 –engineering and electronic goods exhibiting a y-o-y growth of 107.5 per cent and 173.5 per cent respectively-implying positive prospects for India's role in Global Value Chains. Non-petroleum and non-gems and jewellery exports amounted to USD 47.6 billion in April–May 2021, exhibiting a y-o-y growth of 87.1 per cent.

India's merchandise imports increased by 114.3 per cent in April–May 2021 to USD 84.27 billion. Imports for major commodity groups witnessed a growth for April–May 201 on a y-o-y basis. Non-oil, non-gold imports was USD 57 billion in April–May 2021, a positive growth of 83.4 per cent on a y-o-y basis.

5.3. Foreign Investment Flows

Foreign investment inflows (FII) have shown a highly volatile trend since 2020 - rising from a net outflow of USD 10.7 billion in March 2020 to a peak inflow of USD 23.5 billon in August 2020 and then declining to only USD 0.9 billion in April 2021. Mirroring the overall trend, both components of FII, i.e., foreign direct investment (FDI) and portfolio inflows, were quite volatile too (Figure 5.2). Net FDI inflows have declined from a peak of USD 18.2 billion in August 2020 to USD (–) 3.0 billion in February 2021. It has since risen to USD 2.8 billion in April 2021. There has been a net portfolio outflow of USD 2.0 billion in April 2021. However, latest data by NSDL shows that FPI turned positive again, rising to USD 1.9 billion in June 2021 (data upto 24th June).

Figure 5.2: Foreign Investment Flows, January 2020 to April 2021



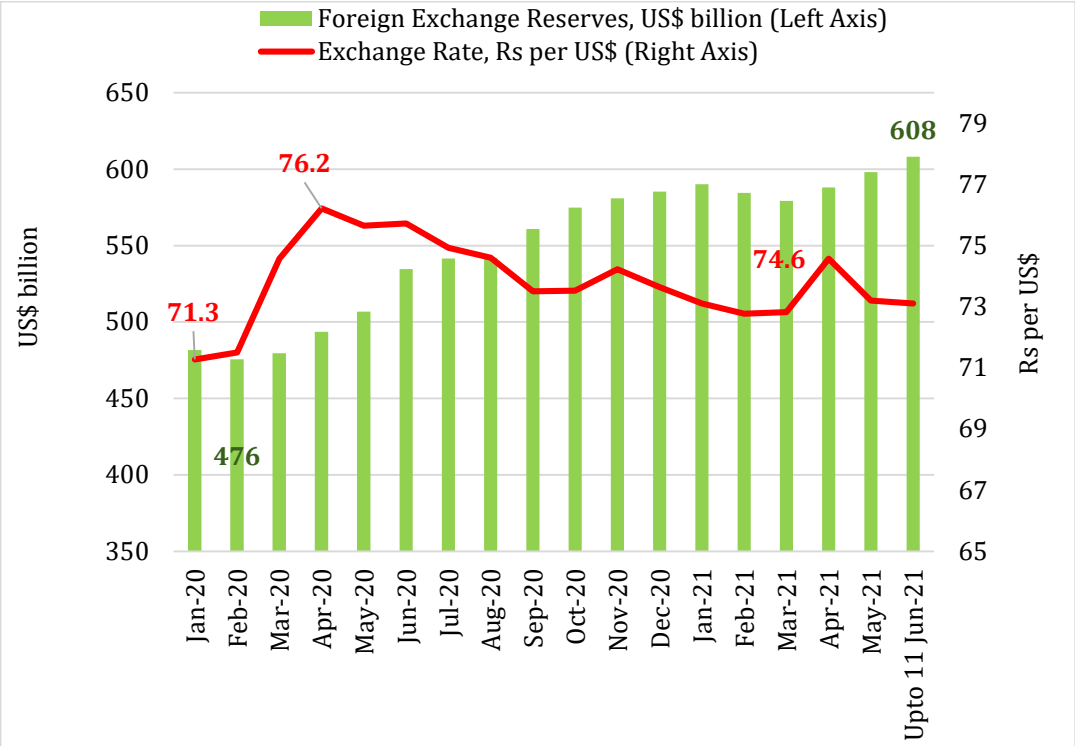
Source: Reserve Bank of India.

5.4 Foreign Exchange Reserves and Exchange Rate

Foreign exchange reserves have continued to rise since April 2020 (Figure 5.3). After a slight moderation in February and March, 2021 (as compared to January 2021), the foreign exchange reserves picked up in April and May, 2021 on account of foreign capital inflow (Annex 5.2). However, the Reserve Bank of India (RBI) has said that even these large reserves may not be adequate if a recovery of economic activity leads to a large trade deficit along with a small negative capital inflow.

Reflecting this reserve accumulation, the exchange rate has been appreciating April 2020, barring a small depreciation in April 2021. Adjusting for India's high inflation rate relative to its trade partners, the real effective exchange rate (REER) has appreciated even more. (Figure 5.4).

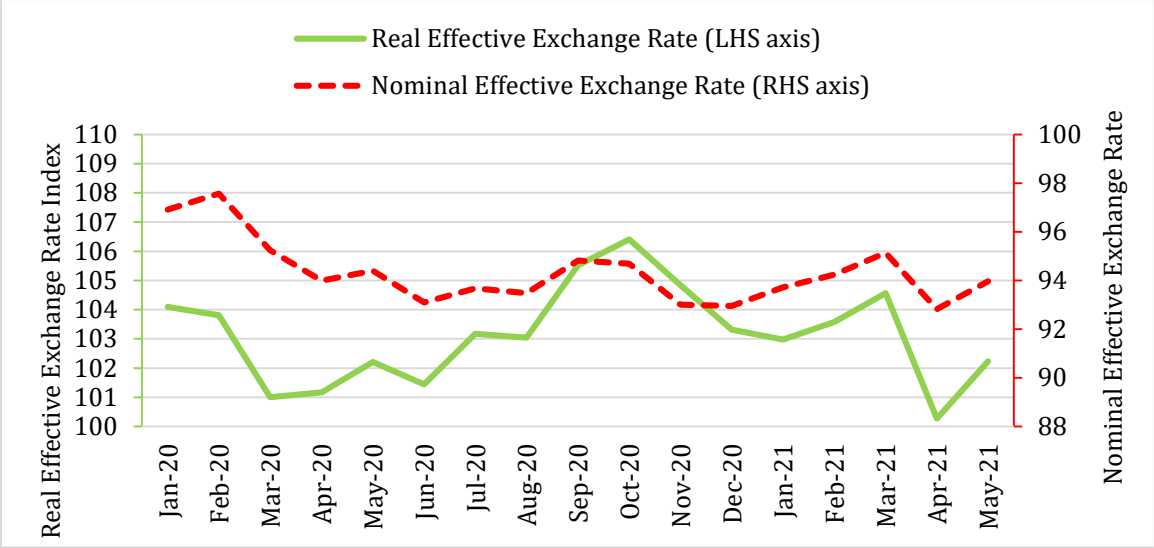
Figure 5.3: Exchange rate appreciation driven by rising foreign exchange reserves, January 2020 to 11th June, 2021



Source: Reserve Bank of India.

Figure 5.4: Appreciation of the real and nominal effective exchange rates

Trade-weighted 40-currency basket, Base: 2015–16=100



Source: Reserve Bank of India.
Note: Rising (falling) REER & falling (rising) NEER implies appreciation (depreciation).

5.5 Outlook

The World Trade Organisation forecasts 8 per cent increase in world merchandise trade volume.[3] The prospects for merchandise trade is optimistic for the case of India. This is due to improvement in growth prospects of US and other advanced economies. Plus, India has a comparative advantage in key areas like pharmaceuticals, which play to its advantage. The spread of vaccination helps to improve the trade outlook.

The downside risks includes the uneven spread of the vaccine rollout combined with future waves of the pandemic due to evolution of different mutants. Any sudden spike in crude oil prices can also affect the trade balance in India. Another related issue is the shortage of containers that might get stuck at a country's port and cannot be sent back to due shortage of staff or due to movement restrictions, hence creating a shortage. As has been witnessed in the past, this shortage has adverse implications for trade flows. This also drives up input prices.

The prospects for services trade remains muted with a number of economies imposing travel restrictions like border closures or banning entry from high risk region. There seems to a wave of optimism with respect to the foreign investment flows as FPI flows to India have started showing signs of recovery. According to UNCTAD World Investment Report[4], India was the fifth largest recipient of FDI inflows in the world in 2020. Though, Indian economy has been exposed to production disruption and investment delays due to second wave of COVID-19, its strong fundamentals provide optimism for the medium term.

[3] WTO | 2021 Press Releases - World trade primed for strong but uneven recovery after COVID 19 pandemic shock - Press/876.
[4] https://unctad.org/webflyer/world-investment-report-2021

Annex 5.1: Summary of India's Trade Balance

Time Period	*Exports, US$ billion*			*Imports, US$ billion*			*Trade Balance US$ billion (% change y-o-y)*
	Goods	*Services*	*Total*	*Goods*	*Ser-vices*	*Total*	
Apr–20	10	16	27	17	9	26	0
May–20	19	17	36	22	10	32	4
Jun–20	22	17	39	21	10	31	8
Jul–20	24	17	41	28	10	39	2
Aug–20	23	16	39	29	10	39	0
Sep–20	28	17	45	30	10	40	4
Oct–20	25	17	41	34	10	43	(–)2
Nov–20	24	17	41	33	10	43	(–)3
Dec-20	27	19	46	43	12	54	(–)8
Jan-21	27	17	44	42	10	52	(–)8
Feb-21	28	18	45	40	11	51[1]	(–)6
Mar-21	34	18	52	48	13	61	(–)9
Apr-21	31	17	48	46	10	56	(–)8
May-21	32	18[1]	50[1]	39	10[1]	49[1]	2[1]
2020–21:Q1	**51 (–37)[2]**	**50 (–9)[2]**	**102 (–26)[2]**	**60 (–52)[2]**	**29 (–18)[2]**	**90 (–45)[2]**	**12 (145)[2]**
2020–21:Q2	**74 (–6)[2]**	**51 (–8)[2]**	**125 (–6)[2]**	**88 (–25)[2]**	**30 (–17)[2]**	**118 (–23)[2]**	**7 (133)[2]**
2020–21:Q3	**76 (–4)[2]**	**52 (–6)[2]**	**128 (–5)[2]**	**110 (–6)[2]**	**31 (–11)[2]**	**141 (–7)[2]**	**-13 (–21)[2]**
2020–21:Q4	**90 (19.6)[2]**	**55 (0.4)[2]**	**145 (11.5)[2]**	**131 (18.4)[2]**	**33 (–2.7)[2]**	**164 (13.4)[2]**	**(–)19 (–30.6)[2]**

Sources: Ministry of Commerce (MoC) for goods trade and Reserve Bank of India (RBI) for services trade.
Notes: 1. Not RBI actuals but preliminary estimates from MoC; 2. Figures in parentheses indicate % change year-on-year; 3. NA stands for Not Available.

Annex 5.2 Current account and capital account balance, 2019-20:Q1 to 2020-21:Q3

(US$ billion)	*2019-20:Q1*	*2019-20:Q2 (P)*	*2019-20:Q3 (P)*	*2019-20:Q4 (P)*	*2020-21:Q1 (P)*	*2020-21:Q2 (P)*	*2020-21:Q3 (P)*
Overall Balance of Payments (1+2+3)	**14**	**5**	**22**	**19**	**20**	**31**	**32**
1. Current Account (1.1+1.2)	**(–)15**	**(–)6**	**(–)1**	**1**	**20**	**(–)15**	**(–)2**
1.1 Merchandise Trade	(–)47	(–)38	(–)35	(–)35	(–)10	(–)15	(–)35
1.2 Invisibles Trade	32	32	33	36	30	30	33
2. Capital Account (2.1+2.2+2.3+2.4+2.5)	**29**	**12**	**22**	**17**	**1**	**15**	**33**
2.1 Foreign Investment	19	10	18	(–)2	0	31	38
2.2 Loans	10	3	3	10	2	(–)4	0
2.3 Banking Capital	3	(–)2	(–)2	(–)5	2	(–)11	-8
2.4 Rupee Debt Service	0	0	0	0	0	0	0
2.5 Other Capital	(–)3	1	4	14	(–)4	(–)1	3
3.0 Errors & Omissions	**0**	(–)1	**1**	**1**	**(–)1**	**1**	**1**
4.0 Monetary Movements (4.1+4.2)	**(–)14**	**(–)5**	**(–)22**	**(–)19**	**(–)20**	**(–)32**	**(–)32**
4.1 I.M.F.	0	0	0	0	0	0	0
4.2 Foreign Exchange Reserves	(–)14	(–)5	(–)22	(–)19	(–)20	(–)32	(–)32

Source: Reserve Bank of India.
Note: P stands for Preliminary

Chapter 6: Prices

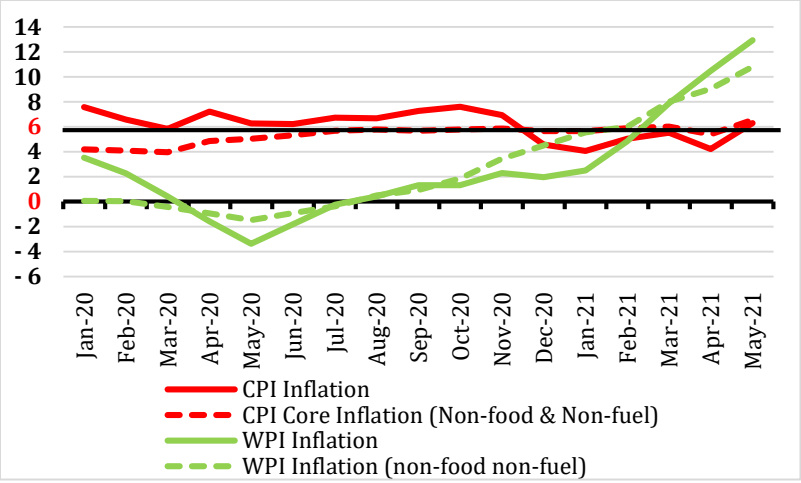
Rudrani Bhattacharya[1] and Ajaya K Sahu

CPI headline inflation has risen from 4.3 per cent in April, 2021 to 6.3 per cent in May. While inflation was driven by food price inflation in 2020, it is now being driven by the rise in energy prices. CPI Core inflation (excluding food & fuel) remained sticky at around 6 per cent since July 2020 and has since risen to 6.6 per cent in May 2020. Clearly, rising inflation is now more broad-based than just for energy products. WPI inflation is now at double digit levels, partly because of the base effect of very low inflation last year but also because of genuine pricing pressure, and it is also fairly broad based. Headline CPI inflation breached the 6 per cent upper limit of the RBI's target band, rising to 6.3 per cent in May 2021 from 4.3 per cent in April, 2021. However, our forecasts indicate that headline inflation will moderate from 6.3 per cent in May, 2021 to 3.3 per cent in August, 2021, followed by a rebound in September, 2021.

6.1 Introduction

Both retail and wholesale inflation have edged up since March 2021. While wholesale inflation is in double digits, headline inflation has also breached the 6 per cent upper limit of the Reserve Bank of India (RBI's) target band, rising to 6.3 per cent in May 20201 from 4.3 per cent in April 2021. Interestingly, while inflation was high at 6.3 per cent in May 2020 and May 2021, core inflation in May 2020 was much lower at 5 per cent compared to 6.6 per cent in May 2021. That is because inflation is more broad-based now rather than just confined to food inflation. This is true for both wholesale and retail inflation.

Figure 6.1: CPI and WPI Inflation: Overall and Core Inflation, October 2019– May 2021, (per cent change y-o-y)



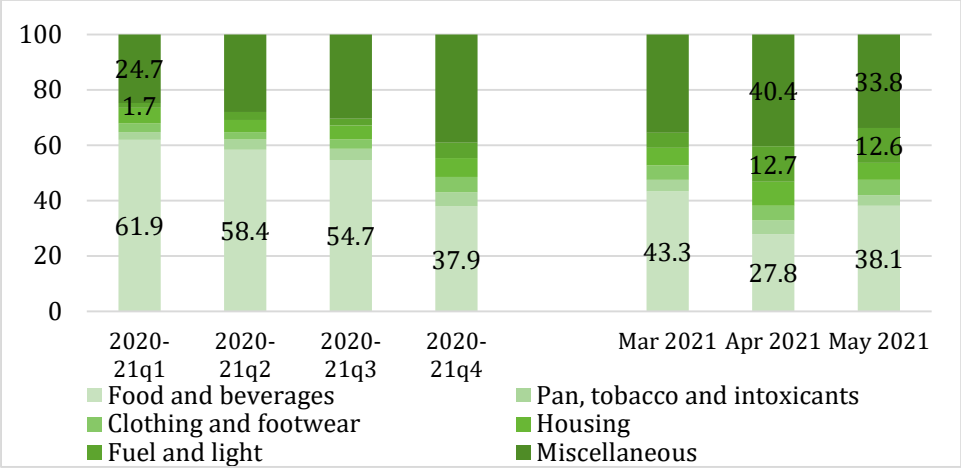
Sources: Ministry of Statistics and Programme Implementation and Office of Economic Advisor.

[1] Rudrani Bhattacharya is an Assistant Professor at NIPFP.

6.2 Retail Inflation

CPI headline inflation has risen to 6.3 per cent in May, 2021 from 4.3 per cent in April, 2021. CPI Inflation is more broad-based in April and May 2021 (Figure 6.2). The contribution of food inflation to overall inflation has come down from the highs of 2020–21:Q1 when it was 62 per cent. The contribution fuel inflation has increased from 1.7 per cent in in 2020–21:Q1 to 12.6 per cent in May 2021. The contribution of miscellaneous inflation has also increased between the first quarter of last fiscal and the first two months of the current fiscal. Within 'miscellaneous items', transport and communication (which includes petrol and diesel for vehicles, bus/train fares, and mobile telephone charges), and health inflations were the major drivers of miscellaneous inflation.

Figure 6.2: Contribution of various sub-groups to CPI Inflation (%)



Source: Ministry of Statistics and Programme Implementation.

Core inflation (non-food non-fuel inflation) has reached 6.6 per cent in May 2021. However, the core-core inflation (non-food non-fuel non-gold and non-petroleum products) gold and petroleum products (petrol and diesel) has remained below 6 per cent during the said period.

6.3 Wholesale Price Inflation

Aggregate WPI (base year 2011–12) registered an all-time high inflation rate of 11.7 per cent in April–May, 2021, since its release in April, 2012. Double-digit WPI inflation during March–May, 2021 is on low base of 2020 as well as intensifying pressure in all components—food (double digit inflation in manufactured food products), core and energy during second wave of the pandemic.

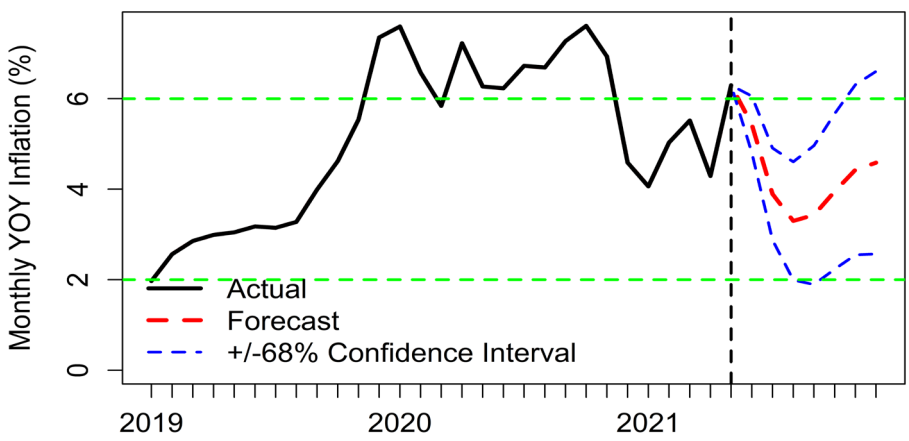
Manufactured products were the major driver of WPI inflation contributing to more than 80 per cent of WPI inflation in 2020–21:Q4. However, post March 2021,

percentage share of fuel and power increased substantially to 25.4 per cent and 35.1 per cent respectively in April and May 2021. The surge in WPI inflation during April–May 2021 was primarily fuelled by fuel & power inflation (20.9 per cent and 37.6 per cent in April and May 2021 respectively), and within manufacturing sector basic metal (19.3 per cent and 27.6 per cent), textiles (9.7 per cent and 11.4 per cent), and food products (12.6 per cent and 15.2 per cent). Primary articles, that had seen inflation of (–) 1.6 per cent in January 2021, had inflation rate increased to 7.3 per cent, 10.2 per cent and 9.6 percentage respectively in March, April and May 2021. This hike is mainly due to rise in prices of crude petroleum and natural gas. Primary food article inflation, however, had remained below 5 per cent during this period.

6.4 Commodity Price Inflation

The IMF Commodity Price that showed deflationary trend since April 2020 (inflation rate of (–) 32 per cent y-o-y) up to November 2020 (inflation rate of (-) 1.6 per cent). However, it showed inflationary trends since then and inflation rate increased to 50.8 per cent, 72.5 per cent and 70.1 per cent respectively in March, April and May 2021. Though some the big rise may be attributed to low base, yet the data shows rise in global commodity prices since December 2020. Food price index inflation which was negative since March 2020 till July 2020, showed positive movement since August 2020 (1.0 per cent) and rose to 39.9 per cent in May 2021. Basic metal prices which showed deflationary trend up to July 2020, showed inflationary trend since then and registered inflation rate of more than 80 per cent in April and May 2021. Brent Crude oil fell from US$63.6 per barrel in January 2020 to US$23.3 per barrel in April 2020 before rising up to US$64.8 and US$68 per barrel in April and May 2021 respectively. Precious metal continued to show double digit inflation during April 2020–May 2021.

Figure 6.3: Outlook for CPI inflation (per cent change y-o-y), June to December: 2021



Source: Estimated by Rudrani Bhattacharya.
Note: The dashed line in shaded part shows the forecast inflation rate from June-December, 2021 with 68 per cent confidence interval.

6.5 Expected Behaviour of Inflation in 2021-22 Q1 and Till December, 2021

- **The inflation forecast for Q1: 2021–22 is 5.3 and that of Q1–Q3: 2021–22 is 4.4.**
- **Overall, the headline inflation is expected to retreat inside RBI's band in June, 2021 and continue to moderate till August, but will register a rebound after that.** The initial moderation will be on account of moderation in crude oil inflation from 178 percent in April, 2021 to 119 percent in May, 2021. 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 (iii) sticky core inflation near the upper level of the band which is a **direct fallout of the pandemic such as** supply chain disruptions on the face of demand revival.

Chapter 7: Fiscal Policy Outlook

Sudipto Mundle and Ajaya K Sahu

The economic growth process which was completely disrupted by the first Covid-19 wave, and the stringent nation-wide lockdown, will remain disrupted in FY 2021–22 because of the second wave and risks of a potential third wave. To recover from this unprecedented disruption for two consecutive years, the growth process now needs a strong expansionary macroeconomic policy push. The required fiscal policy stance in this context is high expenditure growth. Large deficit financing will be required for a second year since revenues are likely to fall short of expectations because of the depressed level of economic activity. Unfortunately, instead of the required high expenditure growth, expenditure in the 2021–22 budget was actually reduced to Rs 34.8 trillion in 2021–22, down from Rs 35.1 trillion in 2020–21, a significant reduction in real terms. Even after factoring in the post-budget increase in allocations for larger procurement of Covid-19 vaccines and extension of the additional food subsidy program till November, planned expenditure in 2021–22 at 16.3 per cent of GDP is still significantly lower than 17.8 per cent in 2020–21. The fiscal deficit is being reduced sharply from 9.2 per cent of GDP in 2020–21 to 7.2 per cent in 2021–22. This premature fiscal compression is quite inexplicable since there is little risk of the high level of sovereign debt, which is mostly domestic anyway, becoming unsustainable. This unfortunate premature fiscal compression will further extend the period of disruption before the economy can return to normal growth.

7.1 Introduction

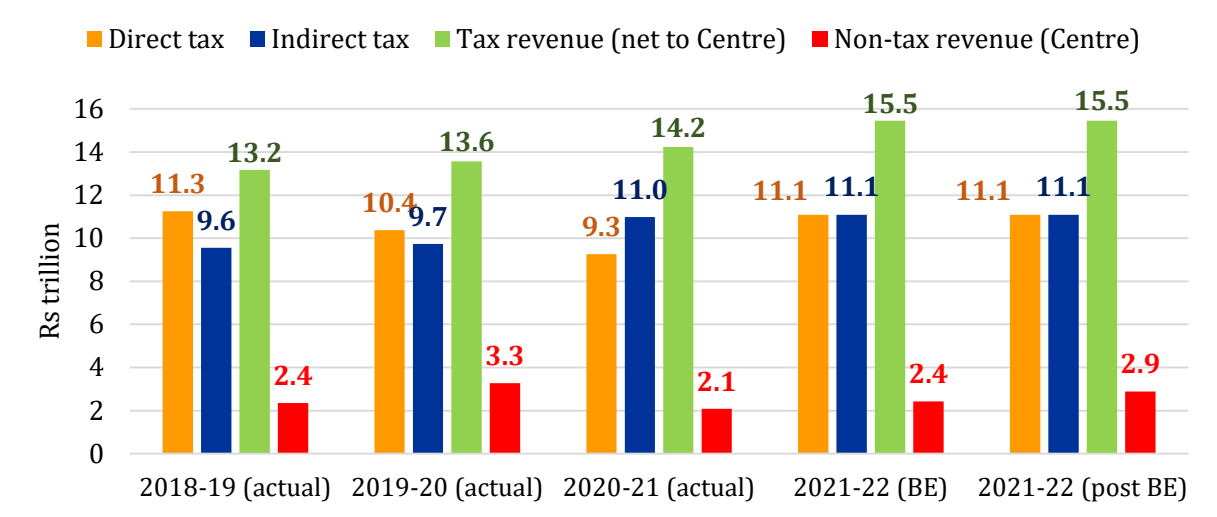
The unprecedented disruption of the economic growth, following the Covid–19 pandemic and stringent national economic lockdown in 2020–21, exacerbated by the second wave and potential third wave, can only be moderated by a strong macroeconomic policy shock. The required fiscal policy stance in this context is a rapid expansion in public expenditure to revive demand. Instead, the level of expenditure relative to GDP and the fiscal deficit are being sharply reduced. This inexplicable premature fiscal compression will further exacerbate the disruption of the normal growth process.

7.2 Revenues

Fiscal marksmanship in projecting revenues has deteriorated significantly in recent years. Direct tax revenue declined from Rs 11.3 trillion in 2018–19 to Rs 10.4 trillion in 2019–20 and further to Rs 9.3 trillion in 2020–21. Despite this the 2021–22 budget assumes that direct tax collections will rise to Rs 11.2 trillion though economic activity remains subdued and lower than in the last normal year 2019–20. Fortunately, indirect tax revenues have been buoyant and rose even in 2020–21 to Rs 11.1 trillion when there was a sharp contraction in economic activity. This is mainly on account of rising GST collections, much of the teething problems of earlier years having been ironed out. Total tax revenue of the central government, net of states share, was

estimated at Rs15.5 trillion in the 2021–22 budget or 6.9 per cent of GDP (Figure 7.1). There could be some shortfall in this if direct tax collections fall short of the budget target. However, non-tax revenue projections post budget have risen from Rs 2.4 trillion to Rs 2.9 trillion, because of the higher than budgeted transfer of surpluses from the Reserve Bank of India (RBI). Total revenues are now being estimated at Rs 18.3 trillion or 8.2 per cent of GDP.

Figure 7.1: Tax Revenues



Source: Controller General of Accounts.

7.3 Expenditure

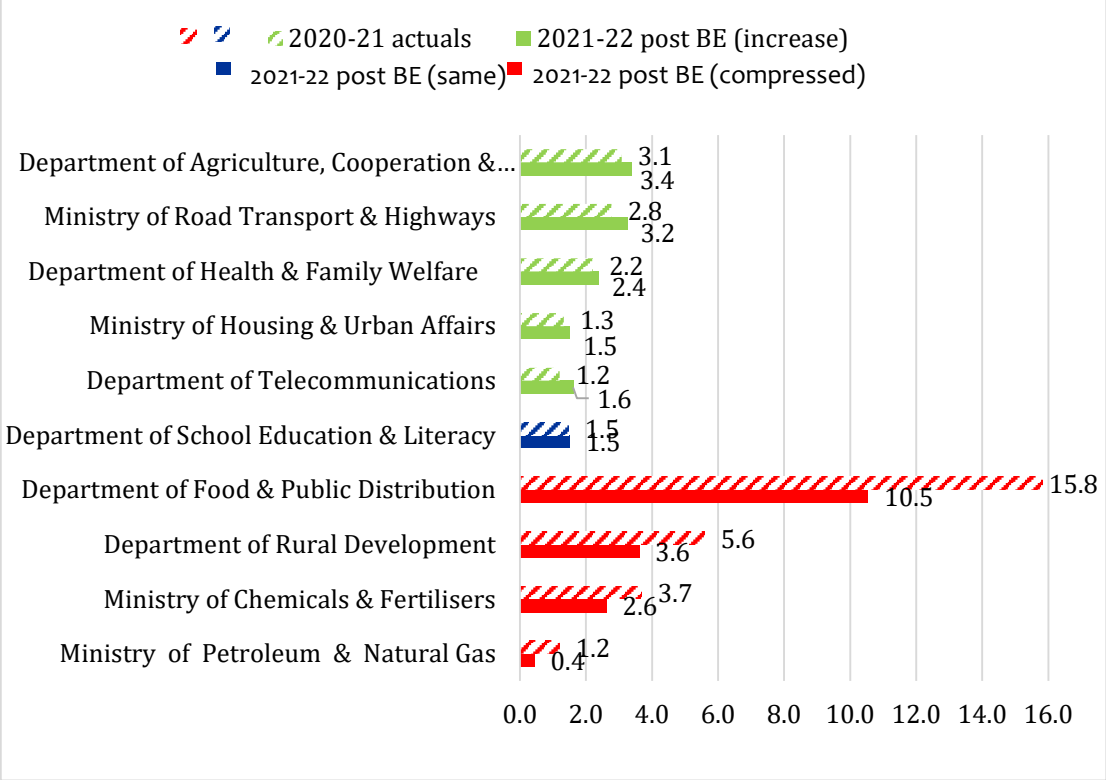
The expenditure budget for 2021–22 has large variations in the allocation shares of different departments. While the shares of some departments have increased that of other departments has declined (Figure 7.2 and Table 7.1). But while the increase are marginal, the reduction in allocations for some departments is significant, reflecting the compression of overall expenditure (Figure 7.2).

The apparent large reduction in allocation for 'food and public distribution' is misleading. The very large allocation for this department in the 2020–21 budget included the transfer of outstanding liabilities of the Food Corporation of India to the National Small Savings Fund in addition to the current food subsidy, which was brought back to the budget (Table 7.2). In 2021–22 the allocation for food subsidy was increased from Rs 1.3 trillion in the budget to Rs 1.45 trillion post budget on account of the extension of the additional food subsidy scheme to November 2021. The initial budget allocation for 'health and family welfare' was actually lower in 2021–22 compared to 2020–21. It was raised by Rs 15,000 crores post budget for additional procurement of vaccines, taking the allocation for the sector to Rs 86,269 crores or over Rs 8,700 crores in excess of the 2020–21 allocation.

The reduction in allocation for 'rural development' is mainly on account of the reduction of allocation for Mahatma Gandhi National Rural Employment Guarantee Act (MNREGA). The reduction in allocation for ' chemicals and fertilisers' is mainly on

account of the reduction in the fertiliser subsidy and the reduction in allocation for 'petroleum and natural gas' is mainly on account of the reduction of fuel subsidies.

Figure 7.2: Changes in the Expenditure Shares of Major Central Government Departments

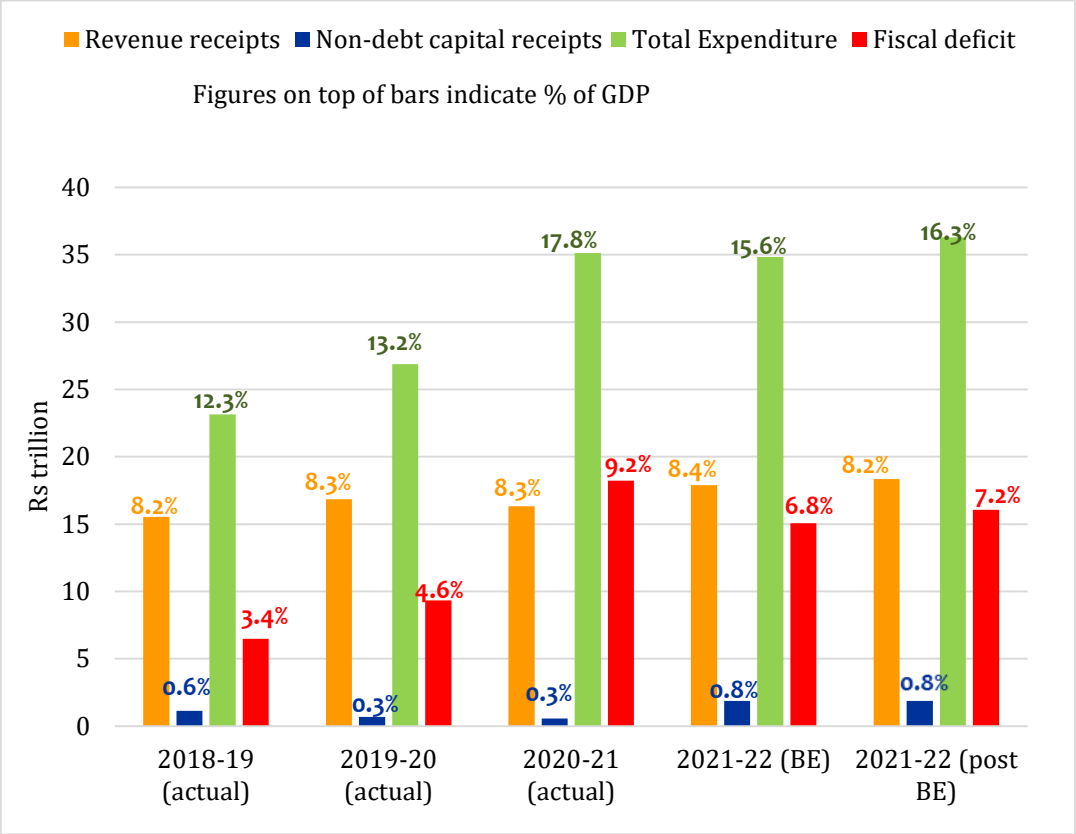


Sources: Controller General of Accounts, Union Budget and Government of India announcements

7.4 Fiscal Compression

To recover from the unprecedented negative shock for two consecutive years, the growth process now needs to be kick-started by a very strong positive macroeconomic policy shock. The required fiscal policy stance in this context is very rapid expenditure growth. This will require large deficit financing since revenues are likely to fall well short of expectations on account of the depressed level of economic activity. Unfortunately, instead of the required rapid increase, expenditure in in the 2021–22 budget was actually reduced to Rs 34.8 trillion in 2021–22compared to Rs 35.1 trillion in 2020–21, a very significant reduction in real terms (Figure 7.3).

Figure 7.3: Fiscal Compression



Sources: Controller General of Accounts, Union Budget and Government of India announcements

Even after factoring in the post-budget increase in allocations for larger procurement of Covid–19 vaccines and extension of the additional food subsidy program till November, planned expenditure in 2021–22 at 16.3 per cent of GDP is significantly lower than 17.8 per cent in 2020–21 The fiscal deficit is being reduced from 9.2 per cent of GDP in 2020–21 to 7.2 per cent in 2021–22. This premature fiscal compression is completely inexplicable since there is little risk of the high level of sovereign debt, which is mostly domestic anyway, becoming unsustainable[1]. This unfortunate premature fiscal compression will further extend the period of disruption before the economy can return to normal growth.

[1] See the discussion in in Chapter 1 footnote no. 2.

Table 7.1: Changes in the Expenditure Shares of Major Central Government Ministries/Departments

Ministries/Departments	*Rs trillion*				*Share in total expenditure (%)*		
	2020-21 actual	*2021-22 BE*	*Announcements post 2021-22 BE*	*2021-22 post BE*	*2020-21 actual*	*2021-22 BE*	*2021-22 post BE*
Share of expenditure increased between 2020-21 actual and 2021-22 post BE							
Capital expenditure under all departments	4.2	5.5		5.5	12.1	15.9	15.2
Department of Agriculture, Cooperation & Farmers Welfare	1.1	1.2		1.2	3.1	3.5	3.4
Ministry of Road Transport & Highways	1.0	1.2		1.2	2.8	3.4	3.2
Department of Health & Family Welfare	0.8	0.7	0.2	0.9	2.2	2.0	2.4
Ministry of Jal Shakti	0.2	0.7		0.7	0.7	2.0	1.9
Department of Telecommunications	0.4	0.6		0.6	1.2	1.7	1.6
Ministry of Housing & Urban Affairs	0.5	0.5		0.5	1.3	1.6	1.5
Share of expenditure stayed same between 2020-21 actual and 2021-22 post BE							
Department of School Education and Literacy	0.5	0.5		0.5	1.5	1.6	1.5
Share of expenditure decreased between 2020-21 actual and 2021-22 post BE							
Department of Food & Public Distribution	5.6	2.5	1.3	3.8	15.8	7.3	10.5
Department of Rural Development	2.0	1.3		1.3	5.6	3.8	3.6
Ministry of Chemicals and Fertilisers	1.3	0.8	0.1	1.0	3.7	2.3	2.6
Ministry of Petroleum and Natural Gas	0.4	0.2		0.2	1.2	0.5	0.4
Total Expenditure	35.1	34.8	1.6	36.4	100.0	100.0	100.0

Note: Those Ministries/Departments are taken whose share in total expenditure were more than 1%.
Sources: Controller General of Accounts, Union Budget and GoI announcements

Table 7.2: Change in subsidy and expenditure (Rs trillion)

	2020-21 (RE)	*2021-22 (post BE)*	*% Change*
MGNREGA	1.1	0.7	-35
Petroleum Subsidy	0.4	0.1	-64
Fertiliser Subsidy	1.3	0.9	-30
Food subsidy	4.2	3.7	-12
NSSF loan amount outstanding with FCI as on 31 March 2020	2.5		
Financial support extended to FCI through loans from NSSF	0.8		
Effective food subsidy	2.5	3.7	48

Sources: Union Budget and GoI announcements.

Chapter 8: Monetary Policy Challenges

Pallavi Choudhuri and Sudipto Mundle

Since the beginning of the pandemic in early 2020 the main policy challenge the RBI has had to address is to provide enough liquidity to finance the huge increase in government borrowing without allowing interest rates and bond yields to rise. It continues to face the same challenge in FY 2021–22. To deal with this challenge the RBI has held the policy repo rate and the reverse repo rate steady at 4 per cent and 3.35 per cent since May 2020. It has at the same time conducted complex interventions in the sovereign bond market, including most recently a combination of Twist Operations and Open Market Operations. Transmission of the policy rate to bank lending rates has strengthened significantly. The weighted average lending rate fell by 116 basis points for a fall in 115 bps points in the policy repo rate from February 2020 till April 2021. Yields on short maturity sovereign bonds have also closely tracked the repo-reverse repo rate band. The benchmark 10–year G-Sec yield has also been range bound. However, going forward rising inflationary pressures and the U.S. Federal Reserve announcement of an earlier than expected increase in the Federal funds rate will make it increasingly difficult for the RBI to continue maintaining its accommodative monetary policy stance. It is also a major concern that despite the reduction in interest rates and adequate liquidity infusion the growth of credit has continued to decline.

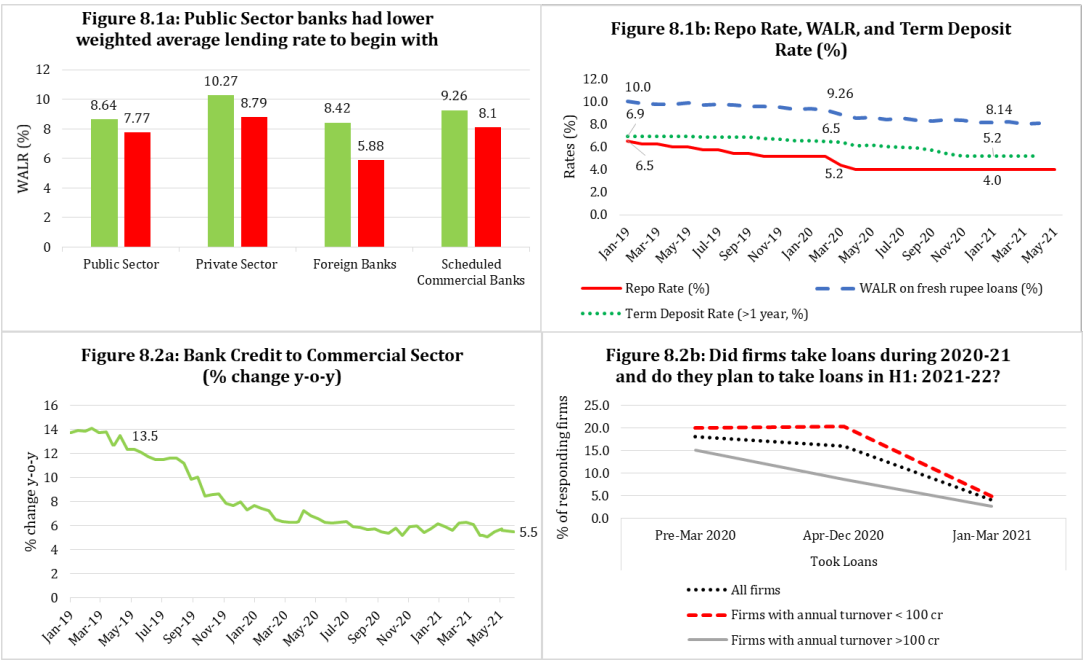
8.1 Introduction

Since the beginning of the pandemic in early 2020 the main policy challenge the RBI has faced is to provide enough liquidity to finance the huge increase in government borrowing without allowing interest rates and bond yields to rise. The Monetary Policy Committee (MPC) has held the policy repo rate and the reverse repo rate unchanged at 4 per cent and 3.35 per cent respectively under the liquidity adjustment facility (LAF), since May last year, while at the same time conducting complex monetary policy interventions in the sovereign bond market, including most recently a combination of Twist Operations and Open Market Operations to prevent an increase in rates and yields. However, maintaining this accommodative monetary policy stance is likely to be more challenging going forward.

On the one hand, the growth process in the economy remains completely disrupted due to the pandemic and related lockdown measures, requiring a continuation of the low interest rate regime. On the other hand, the headline inflation has now risen 6.3 per cent (May 2021) exceeding the RBI's target range of 4(+/–)2%. Further, core inflation has also risen to 6.3 per cent, indicating that there is an inflation spike, even after excluding food and fuel price inflation. Also, externally the U.S. Federal Reserve has announced of an earlier than expected increase in the Federal funds rate. Both developments are likely to put an upward pressure on interest rates. Addressing the situation, in the latest MPC report, the RBI has announced that it will continue to maintain an accommodative monetary policy stance as long as necessary in order to revive growth on a durable basis, making it clear that reviving growth is still its policy priority as compared to containing inflation.

8.2 Interest rate policy and growth of bank credit

Monetary policy transmission to lending and deposit rates have improved substantially backed by surplus liquidity in the banking system and mandated external benchmarking of interest rates for loans. The Weighted Average Lending Rate (WALR) on fresh rupee loans declined by 116 basis points(bps) on average between February 2020 and April 2021 for all scheduled commercial banks. It declined by 87 bps for public sector banks (PSBs) and by 148 bps for private banks, settling at 7.8 per cent and 8.8 per cent respectively (see figures 8.1a and 8.1b). Thus, transmission of policy rate change has strengthened significantly since February 2020.



***Sources**:* Reserve Bank of India and NCAER Business Expectations Survey Round 116.

Despite better rate transmission in the banking sector, the growth of bank credit to the commercial sector has continued to decline sharply (Figure 8.2a). On the one hand, banks have become more risk averse to lending because of continuing uncertainties exacerbated by the second Covid–19 wave and a potential for a third wave, on the other hand, most firms are unwilling to borrow despite low interest rates due to the same uncertainties and slackening of consumer demand. Data from the NCAER Business Expectations Survey (BES) indicate that the share of firms borrowing has steadily gone down from 18 per cent before March 2020 to 16 per cent between April and December 2020. This fell further in Q4 of 2020–21, falling to 4 per cent (January to March 2021) of responding firms (Figure 8.2b). Further, only 6 per cent of responding firms have expressed their willingness to borrow during the first half of the current fiscal year[1].

In order to boost lending to the MSME sector, the RBI opened an on-tap liquidity

[1] Bhandari, B., Gupta, S., Sahu, A.K. and Urs, K.S. (2021). "Why are firms not taking credit?" *Qrius*. https://qrius.com/why-are-firms-not-taking-credit/ . May 17.

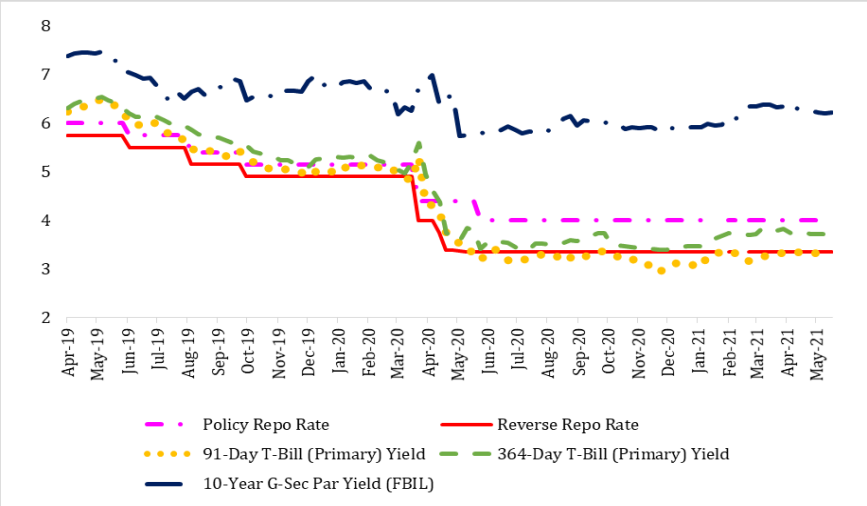
window to the tune of Rs. 15,000 crore, especially those in contact-intensive sectors. Banks can borrow using this window for a tenor of 3 years at the policy repo rate for onward lending. Additionally, they can invest their surplus liquidity with the RBI at a mark-up of 40 bps above the reverse repo rate. Another special liquidity facility of Rs. 16,000 crore has been extended to the Small Industries Development Bank of India (SIDBI) to support the funding requirements of MSMEs in credit deficient and aspirational districts. The RBI also announced Resolution Framework 2.0 for MSMEs, to avail a one-time restructuring of loans till September 30, 2021. This is expected to support MSMEs, particularly those that had not availed the facility previously announced in August 2020.

8.3 Liquidity Management

The Central Bank is slated to carry out the third tranche of G-SAP (government securities acquisition program), buying G-Secs for Rs 40,000 crore on June 17, 2021, of which Rs 10,000 crore will comprise purchasing state development loans (SDLs). The RBI aims to carry out G-SAP 2.0 in the Q2 of 2021–22, along with secondary market operations of Rs 1.2 lakh crore in a bid to support government's borrowing program and keep interest rates low.

The RBI has, so far, injected liquidity to the tune of Rs 60,000 crore under the first G-SAP, in addition to regular open market operations (OMOs). The RBI have also been working towards ensuring that the yield on government bonds do not over shoot and carried out a bond purchase and sale auction under operation twist on May 6, 2021 to smoothen the yield curve. The weighted average yields between April 2020 and end of May 2021 was around 6.06 per cent as against 6.74 per cent during the corresponding period of the previous year (figure 8.3).

Figure 8.3: Rates and Yields (%)



Source: Reserve Bank of India.

8.4 External Markets

Foreign institutional investors (FIIs) have pumped Rs. 58,441 crore into Indian equities so far this year (till 19 June, 2021). The FIIs were net buyers in June purchasing assets worth Rs 15,312 crore, although they were net sellers in April, selling Rs 2,594 worth of equity. Investments in debt have been negative, with the FIIs pulling out Rs 19,792 crore during the calendar year till 19 June, 2021. The U.S. Federal Reserve has recently announced that it might raise interest rates earlier than expected moving their first projected interest rate hike from 2024 to an year earlier. This indicates that the U.S. economy's recovery is expected to be on track, and the Fed may raise interest rates to contain a possible increase in U.S. inflation. The Federal Reserve has maintained its target for the federal funds rate at a range of 0.00–0.25 per cent since March 2020. The Fed interest rate hike might lead to FIIs pulling out of riskier Emerging Markets, including India. The influx of dollar resulting from FII investments in equities, along with high inflow of Foreign Direct Investments and improvement in trade balance (see Chapter V) led to the possibility of a weaker rupee. In order to accommodate the large inflow of foreign capital without allowing it to impact domestic liquidity, the RBI has been operating in the foreign exchange forwards market.

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