INDIA

GROWTH SLOWS BUT PUBLIC FINANCES SHOW RESILIENCE

The Indian economy coped well with the external environment in 2022, but slowed down mainly because of inflationary pressures. Over the fiscal year which will end in March 2023, the budget deficit could exceed the initial target, but the overrun should be marginal and the debt-to-GDP ratio should continue to fall. The government's refinancing risks remain contained. On the other hand, the tensions on external accounts are likely to remain relatively strong, mainly as a result of the fall in exports in an unfavourable international context. Nonetheless, the central bank should be able to contain the depreciation of the rupee. While foreign exchange reserves have fallen significantly, they are still sufficient to cover the country's external financing needs.

EXPECTED SLOWDOWN IN GROWTH

In the second quarter of the 2022/2023 fiscal year which began on 1st April 2022, economic growth slowed to 6.3% year-on-year (YoY) after an exceptionally strong first quarter due to favourable base effects. Over the second half of the fiscal year, growth is not expected to exceed 5% compared to last year. Although domestic demand is expected to remain solid, it is likely to grow at a less sustained rate than in the first part of the year.

All the economic indicators confirm a slowdown since September-October 2022, although public investment should remain strong. In addition, while services sector activities remain dynamic, a contraction in industrial production was recorded last October, in conjunction with lower exports.

After reaching a high point in September 2022, at 7.4% YoY, inflation slowed to 5.9% YoY in November 2022, driven by a marked slowdown in food prices, while the increase in energy prices remained significant (+10.6% YoY). Therefore, although inflation stood below the target of 4% +/- 2 percentage points set by the monetary authorities, inflationary pressures remained strong, as evidenced by the rise in core inflation (prices excluding food and energy products), which stood at +6% YoY in November.

Although less exposed to the global economic environment than other Asian countries, India will not be spared by the expected recession in Europe and the US. Furthermore, monetary tightening (+225 basis points between April and December 2022) is likely to continue in the last quarter of the current fiscal year and weigh on the investment decisions of companies, even if their financial situation is much more solid than at the start of the Covid-19 pandemic. The government is expected to maintain an expansionary fiscal policy in order to develop infrastructure and support household purchasing power in a pre-electoral context (the general elections are scheduled for May 2024).

The risks to growth remain significant. The labour market has not returned to its pre-crisis levels. The unemployment rate remains high (8% in November) and the labour force participation rate, which measures the proportion of the population in work or seeking employment, remains structurally low (39.6% in November 2022), and lower than the pre-crisis level (42.7% at the end of 2019). A significant part of the population is not looking to enter the labour market. The situation is particularly concerning for youth. For example, the unemployment rate for young people aged 20–24 living in urban areas was 42% in October 2022.

At the present time the country has not been able to exploit its demographic advantage. According to the IMF, unless the government succeeds in significantly increasing job creation, particularly for young people and women, potential growth will be 6% by 2027, 0.5 percentage points lower than what was estimated before the Covid-19 outbreak. Conversely, if the participation rate rises, particularly in high-productivity sectors, and financial intermediation develops, then medium-term growth could reach 7%, according to the IMF.

FORECASTS

	2020	2021	2022e	2023e	2024e
Real GDP growth, % (1)	-6.6	8.7	6.9	6.1	6.3
Inflation, CPI, year average, % (1)	6.1	5.5	6.7	5.5	4.4
General Gov. Balance / GDP, % (1)	-13.9	-10.2	-10.0	-9.0	-8.1
General Gov. Debt / GDP, % (1)	89.4	84.1	83.5	83.6	83.6
Current account balance / GDP, % (1)	0.9	-1.2	-3.5	-2.6	-2.4
External debt / GDP, % (1)	21.5	19.5	19.6	19.8	19.9
Forex reserves, USD bn	579	618	545	560	575
Forex reserves, in months of imports	9.0	7.9	6.7	6.5	6.9

TABLE 1

(1) FISCAL YEAR FROM APRIL 1ST OF YEAR N TO MARCH 31ST OF YEAR N+1
e: ESTIMATE & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

INDIA: LABOUR MARKET

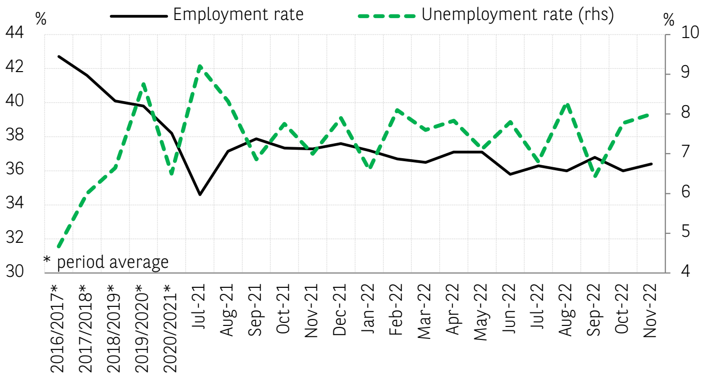

CHART 1

SOURCE: CMIE, BNP PARIBAS

ALTHOUGH FRAGILE, PUBLIC FINANCES SHOW RESILIENCE

In its budget drawn up around a year ago, the government forecast a reduction in the deficit from 6.7% of GDP to 6.4% of GDP for the fiscal year ending on 31 March 2023. As for the States, their objective was to reduce their consolidated deficit from 3.6% of GDP to 3.3% of GDP, which would have reduced the general government's deficit well below 10% of GDP (compared with 10.2% of GDP in 2021/2022).

The central government's budget deficit remained contained over the first seven months of the 2022/2023 fiscal year. Between April and October 2022, the fiscal deficit was only 45.6% of its annual target, a level well below previous years (over the past five years, on average the deficit was 70.9% of its annual target in the same period). It was therefore only 4.9% of GDP. The resilience of the public accounts over the first seven months can be explained by an increase in government revenues.

The increase in government revenues reflects a significant increase in levies on corporate profits (+27.7%) and taxes on goods and services (+31.5%), while revenues generated by international trade transactions fell (-18.8%) due to the drop in excise duties on imports of energy products; a decision taken by the government to contain the rise in prices caused by the conflict in Ukraine. Income from the tax on goods and services was the biggest source of income for the government (25.7%), reflecting the good performance of economic activity but also a significant improvement in the collection of taxes.

In terms of public expenditure, the government has adopted a policy of supporting growth, despite limited fiscal room for manoeuvre. In particular, it has been able to continue with its policy of developing infrastructure. Over the first seven months of the fiscal year this expenditure was around 55% of its annual target.

The central government's deficit target is likely to be exceeded given the slowdown in growth and the high level of investment expenditure over the rest of the fiscal year. This expenditure is therefore expected to be around 3% of GDP over the entire fiscal year compared to only 1.6% of GDP before the Covid-19 pandemic. Furthermore, in an attempt to limit the impact of the sharp rise in international commodity prices on households and farmers, the government has significantly increased the subsidies on food prices and fertilisers. The food aid programme was extended until the end of 2022. The additional cost brought about by the higher subsidies is estimated at more than 0.7% of GDP for the full fiscal year.

Interest payments on debt remained a major item of expenditure (22.4% of expenditure between April and October 2022 was spent on interest), up 22.4% over the first seven months of the current fiscal year compared to the same period last year. However, although still very high, the ratio of interest expenditure to revenue decreased slightly for the second consecutive year. Interest payments represented 34.7% of revenues in the first seven months of the year, compared to a high of 40.2% in the 2020/2021 fiscal year. Nonetheless, this positive trend could deteriorate over the short term given the rise in yields on government bonds against a backdrop of a tighter monetary policy. Over the first six months of the current fiscal year, the average rate of return on bonds issued by the government rose from 6.6% at the beginning of the year to 7.3%.

In the short and medium term, the consolidation of public finances is expected to continue. Despite the prospect of the general elections in May 2024, the government has reaffirmed its commitment to reduce its central deficit to 4.5% of GDP by the 2025/2026 fiscal year. Furthermore, although debt levels remain high, the refinancing risks are contained.

Over the first part of the fiscal year, the deficit was financed almost exclusively by the issue of debt securities on the domestic market. After reaching a high of 89.4% of GDP during 2020/2021 the debt ratio should fall for the second consecutive year, to 83.5% of GDP in March 2023. In the medium term the debt level is likely to remain consistently above the pre-crisis level. However, refinancing risks remain contained. Debt has a long maturity (11.9 years on average) and debt securities for one year or less make up only 7.9% of total debt. Furthermore, debt is almost exclusively denominated in local currency (only 6.1% of debt is denominated in foreign currency) and more than 93% is held by residents.

INDIA: RBI'S MONETARY POLICY

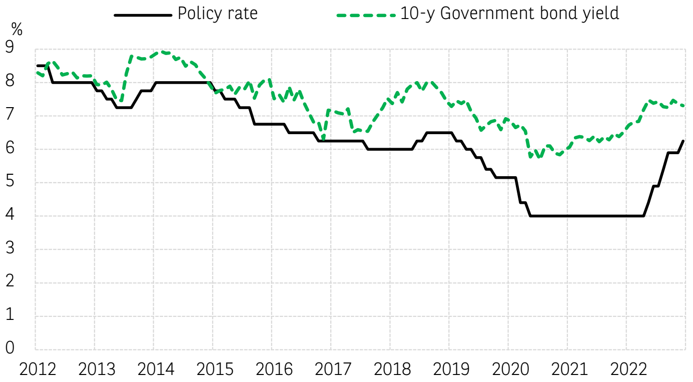

CHART 2

SOURCE: RBI, BNP PARIBAS

EXTERNAL ACCOUNTS STILL UNDER PRESSURE

External accounts have been under pressure since the start of the conflict in Ukraine. As a net importer of raw materials, India has seen its energy bill rise significantly, even though it very quickly substituted a large part of its oil imports from the Middle East with oil from Russia (the price per barrel of Urals oil has been on average USD 30 less than the price of Brent since March 2022). Between April and September 2022, the trade deficit reached 8.9% of GDP (compared to 5.1% of GDP a year earlier) and the current account deficit was 3.9% of GDP. The latter was only partially covered by foreign direct investment. The widening of the current account deficit could have been much greater without the good performance of the services sector, where the surplus increased by 0.5 GDP points (to 3.9% of GDP).

Pressures on external accounts are likely to remain strong at least in the first part of 2023, mainly because of the decline in exports to Europe and the United States. Therefore, over 2022/2023 as a whole, the current account deficit should reach 3.5% of GDP, compared with only 1.2% last year. In addition, capital inflows will not be sufficient to cover this, increasing the downward pressures on foreign exchange reserves and on the rupee.

Although pressures on the currency eased in October and November 2022, they remain strong, as evidenced by the downward movements since the beginning of December. Over the calendar year 2022 as a whole, the rupee depreciated by 10.3% against the dollar. This movement could have been larger without the currency sales by the central bank. The latter's room for manoeuvre remains comfortable, but it has reduced significantly with the contraction in foreign exchange reserves (-USD 70bn over one year). At the end of December, foreign exchange reserves covered the country's short-term financing needs by a factor of 1.4.

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