1 Economy in Recovery Mode

> "Be ever active in the management of the economy because the root of wealth is economic activity; inactivity brings material distress. Without an active policy, both current prosperity and future gains are destroyed."
>
> —Arthashashtra

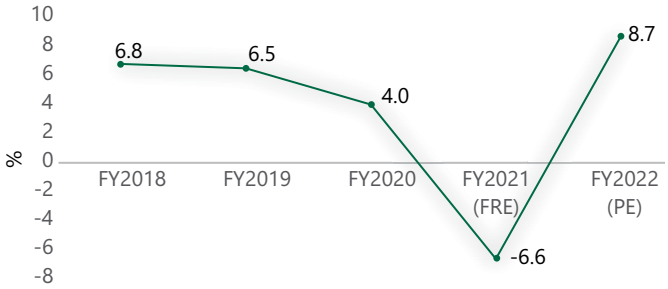
NABARD operated in an extremely uncertain economic situation during the current fiscal. The pace of growth recovery, fiscal and monetary policies, money and debt market conditions (which turned volatile during the second half of FY2022 with global inflationary pressures and elicited monetary policy action from central banks of advanced economies and Euro areas and major emerging market economies) have all had implications for our business and finances.

1.1 The recovery path

After two years and three waves of COVID-19 pandemic, the Indian economy started recovering from the second quarter of FY2022 even as a few sectors struggled to regain pre-pandemic momentum. Several high frequency indicators, growth figures, and sectoral indicators signalled recovery.

India registered 8.7% growth in gross domestic product (GDP) in FY2022, which surpassed the pre-pandemic level (Figure 1.1) thus reviving our hopes to become third-largest economy in the world by mid 2030s. Expansionary fiscal measures and monetary, regulatory, and liquidity initiatives that prioritised growth over other objectives helped the GDP bounce back through Q2–Q3 FY2022 though it lost some pace in Q4 FY2022 due to COVID-19 Omicron infections and global geopolitical conflicts. The growth pace was relatively high due to more localised (as opposed to full) lockdowns, adaptability of COVID protocols, and vaccination drives. Business expectations and consumer confidence improved as did the investment climate, reflected in higher gross fixed capital formation to GDP ratio of 32.5% as compared to FY2021 (30.5%).[1]

Figure 1.1: Growth trend of India's gross domestic product at 2011–12 prices (FY2018–FY2022)



Note: FRE = First Revised Estimates; PE = Provisional Estimates.

Source: National Statistical Office, Ministry of Statistics and Programme Implementation, Government of India.

In FY2022, all sectors experienced steady growth in gross value added (GVA) (at 2011–12 prices),[2] which was an improvement over FY2021 when all sectors (barring agriculture, financial, real estate, and professional services) showed a decline.[3] Agriculture in FY2022 slowed down compared to the 3.3% growth during FY2021 though it remained the saviour through the pandemic (the agriculture sector is discussed in detail in Chapter 2). Provisional estimates indicate that the industry sector[4] is likely to recover to 9.8% in FY2022 from negative growth of –1.8% and –2.4% in the two previous fiscals. Manufacturing, which stagnated during the pandemic, is set to grow at 9.9% in FY2022, expecting to touch ₹24.7 lakh crore.[5] The services sector,[6] accounting for 53.8% of the economy, which contracted by 7.8% in FY2021, is likely to grow at 8.2% in FY2022.[7]

Government packages and spending along with accommodative fiscal and monetary policies have spurred economic activity (Box 1.1). As a strategy, investments in infrastructure have been stepped up and capital expenditure, prioritised to sustain growth. Further, credit by scheduled commercial banks (SCBs) grew briskly by 9.6% in FY2022 (as on 25 March 2022), as compared to 5.6% in FY2021.[8] Growth in credit deployed by SCBs was the highest for agriculture and allied activities (9.9%), followed by services (8.9%) and industry (7.1%) in FY2022.[9]

However, recovery slowed down in the second half of the year owing to geopolitical conflicts; excess inflation over the tolerance limits across major economies; consequent rate hikes and supply chain disruptions;

Box 1.1: Policy announcements to support economic recovery

Pradhan Mantri (PM) Gati Shakti National Master Plan (NMP): Approved in October 2021, PM Gati Shakti NMP aims to provide multimodal connectivity to various economic zones and integrate the infrastructure linkages holistically for seamless movement of people, goods, and services to improve logistics efficiency.

National Monetisation Pipeline: Aggregate monetisation potential of ₹6 lakh crore through core assets of the central government over a 4-year period between FY2022 and FY2025.

Stimulus package during FY2022: A total package of ₹6.3 lakh crore including Loan Guarantee Scheme for pandemic-affected sectors; Emergency Credit Line Guarantee Scheme; extension of PM Garib Kalyan Anna Yojana till September 2022; new scheme for public health (₹15,000 crore); revival of North Eastern Regional Agricultural Marketing Corporation, etc.

Response to COVID-19 pandemic: Strengthening health infrastructure, speedy implementation of the vaccination programme, and the nationwide resilient response to the pandemic.

Production-Linked Incentive Scheme: Government of India committed to an outlay of ₹2 lakh crore for 14 sectors, over a period of 5 years starting from FY2022.

Mega Investment Textiles Parks (MITRA): The scheme was launched in FY2022 to create world-class infrastructure with plug-and-play facilities to create global champions in exports.

Redefining micro, small, and medium-sized enterprises (MSMEs): Removal of distinction between manufacturing and service MSMEs; upward revised definition of MSMEs in industry and service sector.

Accommodative monetary policy: The repo rate was maintained at 4% in FY2022 by the Monetary Policy Committee of the Reserve Bank of India (RBI), while continuing with an accommodative stance to revive and sustain growth on a durable basis and to mitigate the impact of the pandemic on the economy, and also ensuring that inflation remained within the target going forward.

Microfinance policy: The RBI has reviewed the microfinance policy to harmonise the regulation of microfinance loans provided by entities such as commercial banks, NBFCs and NBFC-MFIs. The RBI has directed the financing entities to put in place policies for assessment of household income, limits on loan repayment obligations of a household as a percentage of household income, and pricing of microfinance loans.

Note: MFI = Microfinance Institution; NBFC = Non-Banking Financial Company.

Box 1.2: Growth-oriented Union Budget FY2023

- Significantly higher allocation of 35.4% to capital expenditure of ₹7.5 lakh crore compared to ₹5.5 lakh crore in the previous year's budget
- *Amrit Kaal*, a 25-year blueprint for the vision of India@100 complementing the growth focus at the macro-level with an all-inclusive welfare focus at the micro-level
- Four priorities for achieving the vision for India@100:
  - PM Gati Shakti
  - inclusive development
  - productivity enhancement and investment, sunrise opportunities, energy transition, and climate action
  - financing of investments
- Promoting digital economy and fintech, technology-enabled development, energy transition, and climate action
- Relying on a virtuous cycle of private investment being crowded in by complementary public capital investment
- Replacement of the Special Economic Zones Act with a new legislation that will enable the states to become partners in "Development of Enterprise and Service Hubs"

Source: Government of India, Budget 2022-23, Speech of Minister of Finance, 1 February 2022.

continued accommodative fiscal and monetary policies introduced to recover the economy post-pandemic; and the Delta and Omicron COVID waves. Geopolitical conflict has disrupted the supply of energy and commodities, causing sharp rise in the prices of crude oil, minerals, metals, and wheat, affecting global economic recovery and worsening inflation.

The growth story is likely to continue through FY2023 as the Union Budget FY2023 has several growth-oriented and futuristic proposals with a focus on investment in infrastructure (Box 1.2).

1.2 Transforming into an export-led economy

India has never been in the league of export-led economies such as South Korea, Taiwan, Hong Kong, and Singapore. However, Chatterjee and Subramanian (2020) have asserted that contrary to perception, India has been an exemplar of the export-led growth model. But export growth has stagnated over the years due to lack of comprehensive reforms in the export sector.[10]

It is therefore heartening to note that India's merchandise exports recovered strongly from the pandemic-induced collapse and registered a growth of 44.6% to reach a record $421 billion in FY2022.[11] The growth was led by a surge in export of engineering and electronic goods and agricultural products. Going forward, the implementation of the Pradhan Mantri Gati Shakti National Master Plan (see Box 1.1) would facilitate and sustain high growth of exports.

India is negotiating 16 new and expanding 7 existing free trade agreements (FTAs) / comprehensive economic partnership agreements (CEPAs), including those with the United Kingdom, the European Union, the United States (US), and Canada. India entered into a CEPA with the United Arab Emirates in FY2022, which is expected to enhance bilateral trade from $60 billion to $100 billion in 5 years.[12] Before signing a CEPA, India and Australia have entered into an Economic Cooperation and Trade Agreement to expedite trade between them.

The Product-Linked Incentive Scheme, which focuses on exportability of sectors as well as their global scale and competitiveness, would boost India's exports and also create employment opportunities. Further, according to NITI Aayog's Export Preparedness Index 2021, India has tremendous potential to transform into an export-based super economy.[13] The index could facilitate the formulation of export policies by all states and union territories to promote 'one district one product' and other state-specific products and services for export.

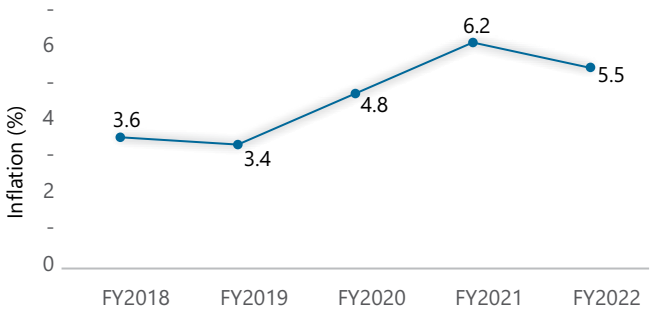
Therefore, the right policy initiatives, signing of CEPAs, and creation of export infrastructure would transform India into an export-led economy. These would stimulate the economy to grow at a sustainable annual rate of 7%-8% over the next 25 years.

1.3 Inflationary pressures

India's average retail inflation (consumer price index), which was 3.4% in FY2019 and 4.8% in FY2020, shot up to 6.2% FY2021 before dropping to 5.5% in FY2022 (Figure 1.2). The pandemic-induced supply chain disruptions, stalled economic activities, and rising food prices resulted in high inflation.

FY2022 witnessed a sharp rise in inflation from 4.2% in April to 6.3% in May and June due to rising food and commodity prices (Figure 1.3). However, the subsequent

FIGURE 1.2: Trend in average consumer price index trend in India



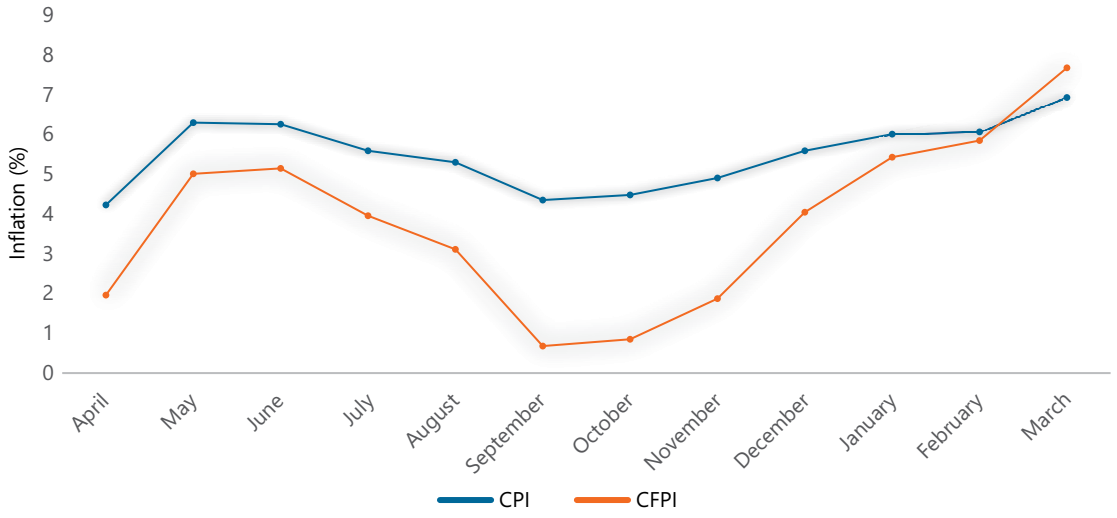
Source: Ministry of Statistics and Programme Implementation, Government of India.

months, July (5.6%) to September (4.4%), witnessed decline in inflation on account of continuous easing of food prices, especially vegetables, reflected in food inflation at 0.7% (September), although fuel inflation remained high. The period October 2021 to March 2022 witnessed a steady elevation in inflation from 4.5% to 6.7%, crossing the RBI's tolerance limit of 6% (Figure 1.3). This was on account of sharp rise in food inflation from 0.9% to 7.7%. The RBI has projected 6.7% retail inflation for FY2023.[14] However, global inflation could worsen India's inflationary expectations.

Further, quantitative tightening and series of rate hikes by the US amidst highest inflation, unprecedented in 4 decades that broke the target rate by over four times, forced the RBI not to be behind the curve as inflation breached targets and remained untameable. Reverse flight of capital, depreciation in the Indian Rupee value, worsening current account deficit, imported inflation, and volatility in the financial markets are some of the problems India was forced to deal with. India's foreign exchange reserves had to be drawn on, reducing them to $596 billion,[15] though the level is still comfortable.

The money and debt market developments have been a result of fiscal and monetary policies and priorities. During the pandemic, growth and liquidity in the system were prioritised and the RBI kept the repo rate low at 4% for almost 2 years till May 2022.[16] Money markets were flush with liquidity; short-term interest rates (aligned to the floor of the RBI's liquidity adjustment facility) firmed up in the second half of the year due to rebalancing of liquidity. Yields hardened in

FIGURE 1.3: Consumer price index (FY2022)



Note: CPI = Consumer Price Index; CFPI = Consumer Food Price Index

Source: Ministry of Statistics and Programme Implementation, Government of India.

the debt markets in the second half of the year due to large issuances of bonds and securities by governments and diverse monetary policy stances across the world.[17]

1.4 Poised for faster growth

India aspires for a $5 trillion economy by FY2026, and $10 trillion by mid-2030s. But, the prevailing global and domestic economic situations as mentioned in this chapter, muted the prospects.

After 2 years of policy priority to growth and accommodative monetary policy, driven by global inflationary pressures and rate hikes by central banks in major economies, the RBI chose to hike the repo rate in the off-cycle monetary policy announcement in May 2022 and regular hike in June 2022 by total 90 basis points.

The resultant debt and money market dynamics would influence NABARD's finances and costs as also its business in the coming fiscal. We would be operating in a high and increasing interest regime as inflation projections are at 6.7% for FY2023 amidst ever-downgrading of India's growth prospects by various agencies. For instance, the RBI projected economic growth of 7.2% for FY2023 in its April resolution, which is 60 basis points down from the pre-war projection.[18]

Despite these developments, the growth aspirations can still be fulfilled with comprehensive reforms and liberalisation in industry (with a focus on manufacturing), services, agriculture, and export sectors, coupled with an emerging start-up ecosystem. NABARD too is poised to achieve its developmental and business goals set for the FY2023 as it performed through last 2 difficult years.

Notes

1. GOI (2022a), Press Note on Provisional Estimates of Annual National Income 2021-22 and Quarterly Estimates of Gross Domestic Product for the Fourth Quarter (Q4) of 2021-22, National Statistical Office, Ministry of Statistics & Programme Implementation, Government of India, 31 May. https://mospi.gov.in/documents/213904/416359/Press%20Note_PE%20FY22m1653998874449.pdf.
2. GOI (2022b), Provisional Estimates of National Income 2021–22, National Statistical Office, Ministry of Statistics and Programme Implementation, Government of India.
3. GOI (2022b), Note 2.
4. Industry sector consists of mining and quarrying, manufacturing, electricity, gas, water supply, and other utility services.
5. Growth in industry sector is calculated using data from GOI (2022b), Note 2.
6. The services sector consists of construction, trade, hotels, transport, communication & services related to broadcasting, financial, real estate & professional services, and public administration, defence, & other services ('public administration, defence, & other services' category includes education, health, recreation, and other personal services).
7. Growth in service sector is calculated using data from GOI (2022b), Note 2.
8. RBI (2022a), *RBI Bulletin Weekly Statistical Supplement*, Vol. 37, No. 14, 8 April 2022.
9. RBI (2022b), Sectoral Deployment of Bank Credit March 2022. https://rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=53631.
10. Shoumitro Chatterjee and Arvind Subramanian (2020), 'India's Export-Led Growth: Exemplar and Exception', Working Paper No. 1, October 2020, Ashoka University.
11. Ministry of Commerce and Industry. https://dashboard.commerce.gov.in/commercedashboard.aspx.
12. PIB (2022), Cabinet approves Memorandum of Understanding between India and United Arab Emirates (UAE) on Cooperation in the field of Industries and Advanced Technologies, posted on 08 June, Press Information Bureau, New Delhi. https://pib.gov.in/PressReleasePage.aspx?PRID=1832176#:~:text=India%20and%20the%20UAE%20have,in%20the%20next%20five%20years.
13. NITI Aayog (2022), *Export Preparedness Index 2021*, Government of India.
14. RBI (2022c). Monetary Policy Statement, 2022–23. Resolution of the Monetary Policy Committee (MPC) April 6–8, 2022.
15. RBI (2022d). *RBI Bulletin Weekly Statistical Supplement*, Vol. 37, No. 19, 13 May 2022.
16. The repo rate was increased to 4.4% in the off-cycle MPC meeting in May 2022 and further to 4.9% in June 2022 MPC meeting.
17. RBI has changed its longstanding accommodative stance in June 2022 MPC meeting and inflation targeting is given top priority.
18. The Russia–Ukraine War | RBI (2022e), *RBI Annual Report 2021-22*. https://www.rbi.org.in/Scripts/AnnualReportPublications.aspx?year=2022.