India
With GDP growth weakening considerably in the first quarter (Q1) of fiscal year 2019 (FY2019, ending 31 March 2020), slower growth at 6.5% is now forecast for this year. Proactive policy interventions should foster recovery into FY2020, with growth expected to rise to 7.2%, only marginally lower than forecast in ADO/2019. A slowing economy, benign food inflation, and declining oil prices motivate reductions to inflation forecasts, even as monetary policy loosens. The current account forecast is revised for a narrower deficit in FY2019 than projected in April, reflecting weaker aggregate demand and lower oil prices, but, with GDP growth expected to revive, the forecast is retained for a wider deficit in FY2020.

Updated assessment
GDP growth declined from 5.8% year on year in Q4 of FY2018 to 5.0% in Q1 of FY2019, the lowest in 6 years (Figure 3.3.15). Moderation in growth was widespread as consumption, investment, manufacturing, and services suffered slowdowns. Although agriculture grew by 2.0% in Q1 of FY2019, reversing contraction in the previous quarter, it remained below the sector’s 5-year average growth of 2.9%.

Industry growth declined from 4.2% year on year in Q4 of FY2018 to 2.7% in Q1 of FY2019, as manufacturing grew by a disappointing 0.6%. Weakness in manufacturing is corroborated by a growth slowdown indicated in the volume-based index of industrial production from 5.1% in Q1 of FY2018 to 3.0% a year later. While capital goods and consumer durables contracted, intermediate goods and consumer nondurables grew at a healthy pace. The automobile industry, which makes up a large share of manufacturing, suffered in Q1 of FY2019 a 10.5% sales slump year on year. This was its worst such downturn since December 2008—until August 2019, which recorded a decline of 19.7% caused by reduced lending, consumer confusion over a coming transition to new emission standards, and deferred purchases. Construction also slowed, to 5.7%, as indicated by weak sales of cement and steel, while mining and quarrying grew by 2.7%.

Growth in services decelerated to 6.9%, the sector’s slowest rate in 7 quarters. The slowdown reflected weak 5.9% expansion in financial, real estate, and professional services. It was indicative of disruption caused by the foundering and rescue of a major nonbanking financial company (NBFC) and how this situation had substantially reduced the availability of funds for NBFCs to lend in FY2018 and Q1 of FY2019. Trade, hotels, and transport and communication services grew by 7.1%, and public administration, defense and others expanded by 8.5%, as they were less affected by weakness in industry.

Private consumption, which has been a strong driver of growth in recent years, grew by only 3.1% in Q1 of FY2019,
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its lowest rate in more than 4 years (Figure 3.3.16). Urban consumption was likely affected by subdued wage growth and a credit crunch, while continued rural stress constrained rural consumption. Government consumption remained healthy, however, growing by 8.8%.

Gross fixed capital formation grew by 4.0% in Q1 of FY2019, marginally up from 3.6% in the previous quarter but well below 13.3% in the same quarter of FY2018. With general elections held during the quarter, muted private investment was deepened by the usual postponement of investment until after elections. Moreover, capital expenditure by the central government contracted, which further slowed growth. Even as export growth deteriorated because of the fragile global environment, previous drag on growth from net exports fell to nil in the quarter as weak domestic demand markedly pulled down import growth.

After remaining below 3% in the second half of FY2018, inflation inched up a little in the first 5 months of FY2019 to average 3.1%, as food prices previously depressed by a supply glut, especially for vegetables and pulses, started rising in FY2019. Core inflation remained at 4.3% (Figure 3.3.17).

With headline inflation staying below 4.0%, which is the midpoint of the target range, the Reserve Bank of India, the central bank, has cut policy rates by a cumulative 110 basis points since February 2019 and, in its most recent policy statements, indicated further scope for monetary easing (Figure 3.3.18). Recapitalization by the government and loan-resolution procedures helped ease stress on banks as the share of nonperforming loans declined from 11.5% in March 2018 to 9.3% a year later (Figure 3.3.19). This decline was broadly based, with the ratio declining for all major industries, including infrastructure, metals and metal products, textiles and food processing.

Growth in bank credit excluding lending by banks to Food Corporation of India for procuring food slowed somewhat from an average of 12.1% year on year in FY2018 to 11.0% in the first 5 months of FY2019. (Figure 3.3.20). Growth in credit for infrastructure, engineering goods, cement, and chemical products experienced an uptick, but growth in credit for textiles, metals and metal products, and food processing moderated from the previous year. Within the service sector, credit growth to software services declined significantly to become negative, while credit growth increased markedly for real estate, tourism, and hotels and restaurants.

In contrast, NBFCs experienced worsening stress from rising nonperforming loans, slower profit growth, and declining capital adequacy. Net flow of financial resources from systematically important NBFCs to commercial borrowers reversed from $42.6 billion in FY2017 to contraction by $5.6 billion in FY2018, reflecting severe stress in the sector.
The central government fiscal deficit for FY2019 is budgeted at the equivalent of 3.3% of GDP, but in the fiscal year to July this target was already 77.8% met. Tax revenue collection in the first 4 months of FY2019 remained subdued, growing by only 6.6%, about two-thirds of annual targeted growth of 9.5%. Despite measures to improve compliance, growth in income tax collection was slow. Sluggish corporate tax collection likely reflected lower tax rates set in the budget for most domestic corporations and subdued economic growth. Collection of goods and services tax (GST) increased by only 6.4% in the first 5 months of FY2019, implying continued implementation issues. Nontax revenue received a boost as the central bank transferred to the government a record $25 billion, equal to 0.9% of GDP and well above the budgeted 0.7% of GDP. In addition to a dividend that is transferred every year, the central bank transferred part of its excess capital, in line with a recommendation from an expert committee.

Expenditure grew at a similarly muted rate, rising by 6.5% in the first 4 months of FY2019. Current expenditure increased by 7.9% in the period, mainly on higher outlays for fertilizer and fuel subsidies. Capital expenditure contracted by 3.4%, possibly because general elections curbed public investment.

After recording double-digit growth in most of FY2018, imports fell by 5.6% in the first 5 months of FY2019 from the year earlier (Figure 3.3.21). Muted oil prices meant oil imports shrank by 6.1% in US dollar terms despite an increase in volume. Imports aside from oil and gold contracted by 5.7%, highlighting weak growth in aggregate demand. Rising gold prices and monetary stress may explain a 3.4% decline in gold imports.

Exports also contracted in the first 5 months of FY2019, by 1.4%, reflecting worsening global trade tensions, rising protectionism, and a growth slowdown in the advanced economies. Exports to major destinations grew in April–July 2019—to the US by 4.5% and to the People’s Republic of China (PRC) by 8.5%—but other export markets contracted, notably Germany; Hong Kong, China; the United Arab Emirates; and the United Kingdom. Lower oil prices caused petroleum exports to fall by 6.4%.

Net foreign direct investment (FDI) inflows grew by a strong 61% to $18.3 billion in the first 4 months of FY2019, a result of continued liberalization of guidelines and improvement in the ease of investment (Figure 3.3.22). Portfolio investment by foreign institutional investors provided net inflow during April–August 2019 (Figure 3.3.23). While debt inflows have been strong, outflow in the equity segment in July–August added to domestic pressures on the stock market, which saw prices fall by 4.0% in the first 5 months of FY2019 (Figure 3.3.24). This primarily reflects rising trade tensions, which typically induce capital flight to safe havens. Consequently, the Indian
rupee depreciated by 3.2% against the US dollar from the beginning of FY2019 to the end of August 2019 (Figure 3.3.25). In the first 5 months of FY2019, strong FDI inflows and a lower trade deficit helped international reserves climb by $17 billion to $429 billion (Figure 3.3.26).

**Prospects**

Following weak growth in Q1, expansion in the remaining quarters of FY2019 will depend on how much domestic demand grows, but the result will certainly be less than forecast in ADO 2019. Government initiatives—including those in a revised budget for FY2019 and measures announced in August and September—promise to boost confidence and foster a rapid recovery. Direct income support for smallholder and marginal farmers is expected to boost rural consumption and compensate to some degree for losses from an uneven monsoon. Urban consumption is expected to improve as cuts in monetary policy rates lower the cost of borrowing and as disposal income improves following tax relief included in the budget for low-income taxpayers.

The latest corporate tax cuts, announced on 20 September, are a large fiscal stimulus equal to 0.7% of GDP. The average effective corporate tax rate including all surcharges will fall from 30% to 25% and, for new manufacturing companies, to 17%. This will place India among the emerging economies with the lowest corporate tax rates, promising to boost investment and growth and make India more competitive internationally.

The recapitalization of state-owned banks and mergers of 10 public banks into 4 will improve the health of the banking sector, as will governance reform announced in August. This action, recent policy rate cuts, and likely further easing will reduce the cost of borrowing and improve the flow of credit to industry and infrastructure projects, while supporting higher business investment as the growth outlook improves. The government’s decision to provide additional liquidity to housing finance companies and partial credit guarantees for purchasing the pooled assets of NBFCs will help NBFCs to repair their balance sheets and restore lending.

The automobile industry, which has seen sharply declining sales, is expected to revive on account of steps taken to improve bank and NBFC credit flows, as well as on such demand-boosting measures as deferring a hike in registration fees, clearing up uncertainty over emission standards, and renewing the government automotive fleet. Policy action to ensure the fast-tracking of GST refunds should provide an important boost to small and medium-sized firms that have been constrained by a crunch on working capital. The Nikkei purchasing managers’ index for manufacturing had shown strength in recent months before declining a bit in August, as did the index for services (Figure 3.3.27).
On balance, growth is expected to slow to 6.5% in FY2019, not accelerate to 7.2% as forecast in ADO 2019. Recovery from a 6-year low of 5.0% growth in Q1 of FY2019 depends on there being proactive policy interventions. Such measures should continue to aid recovery in FY2020, with the growth rate in the first half benefiting as well from a low base set in early FY2019. Growth is expected to reaccelerate to 7.2% in FY2020, albeit marginally less than 7.3% forecast in ADO 2019.

Risks to the growth outlook tilt primarily to the downside as the lag between growth-enhancing policy measures and impact on aggregate demand may extend longer than anticipated. A revenue shortfall because of weak economic activity would constrain government spending and further dampen aggregate demand.

Food inflation is expected to accelerate in FY2019 as an uneven monsoon spells a somewhat weaker harvest and as higher procurement prices are instituted to better compensate farmers. Moderation in global oil prices is expected to apply downward pressure on retail prices for petroleum products, albeit less than expected in ADO 2019 and partly offset by surcharges on petroleum products announced in the budget. However, as this Update went to press, a recent drone attack on Saudi Arabia’s oil-producing infrastructure could reverse the trend of global oil prices. Domestic fuel inflation is expected to be only modestly lower than in FY2018. Core inflation is expected to remain stable, though higher than headline inflation as aggregate demand improves during the year. In sum, inflation will likely accelerate less than previously anticipated owing to growth and food inflation being lower than projected. The forecast for inflation is lowered from 4.3% to 3.5% for FY2019 and from 4.6% to 4.0% for FY2020, in both years staying within the central bank target range.

In its first budget, the reelected government has prioritized fiscal prudence over populism. The fiscal deficit for FY2019 is budgeted at 3.3% of GDP, down from the actual deficit of 3.4% in FY2018. Central government revenue is targeted to grow by 14.3% in FY2019, aided by strong growth in nontax revenue. Tax revenue growth is expected to remain sluggish on account of only modest growth in collections of income tax and GST. The target for personal income tax collection is nonetheless ambitious and may be difficult to achieve with a GDP growth slowdown, despite government efforts to widen and deepen the tax net and impose higher taxes on individuals with high net worth. Lower forecast GST collection has been offset by raising excise duty and taxes on petroleum products. Nontax revenue has been budgeted higher on larger dividends and profits from public enterprises, including the central bank, and higher proceeds from disinvestment.
Current expenditure is set to grow by 14.3% and capital expenditure by 6.9%. Thus, while current expenditure is set to increase from the equivalent of 11.4% of GDP to 11.6%, capital expenditure will decline from 1.7% to 1.6%. Higher current expenditure will go mainly to higher outlays for committed expenditure, mainly subsidies and interest payments. Capital expenditure on defense, railways, roads, urban infrastructure, electric power, and roads is projected to increase at a healthy rate. As in the previous years, a large part of capital expenditure is shifted off-budget to state-owned entities.

Exports are likely to take a hit from subdued global demand and rising trade tensions. Petroleum exports are expected to contract in FY2019 and underperform projections in ADO 2019. Non-oil exports will also moderate with rising trade tensions and weak global demand, though recent weakness in the Indian rupee could provide some impetus. In sum, exports in FY2019 are expected to grow by 5.0%, revised down from 8.0% forecast in ADO 2019. The surplus in services is likely to shrink as global demand weakens.

A weakening currency and oil prices slightly higher than previously anticipated are likely to take oil imports higher, though the pace of expansion will be slower than in FY2018. Growth in imports other than oil and gold will fall short of the forecast in ADO 2019 in tandem with disappointing GDP growth. On balance, overall imports are now expected to grow by 4.0%, revised down from 8.0% forecast in ADO 2019, but remittances above earlier expectations may cushion the trade deficit. The current account deficit is expected to equal 2.2% of GDP in FY2019, slightly smaller than forecast in ADO 2019. However, if higher oil prices from the drone attack are sustained, the current account deficit could widen further.

In FY2020, export growth will likely remain muted at 6.5% as growth in the advanced economies and the PRC slows further. Stable oil prices will moderate import growth, though a pickup in aggregate demand should expand imports excluding oil and gold. All imports are expected to grow by 8.0%, and the current account deficit is expected to widen to the equivalent of 2.5% of GDP in FY2020, as forecast in ADO 2019. However, if higher oil prices from the drone attack are sustained, the current account deficit could widen further.

Capital inflows are expected to remain healthy in FY2019 and FY2020. With rising trade tensions between the US and the PRC, some firms may move part of their operations to India, thereby enhancing FDI inflows. However, for this to materialize, the government will have to continue its effort to improve the ease of doing business and further liberalize FDI regulations. Global monetary easing could also bolster portfolio inflows. Capital flows are expected to be sufficient to finance the current account deficit, though a shortfall is possible and may require a modest drawdown of reserves.

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<th>Table 3.3.2 Selected economic indicators, India (%)</th>
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Note: Years are fiscal year ending on 31 March of the next year.
Source: ADB estimates.