

# Monthly Economic Review

*March 2023*



सत्यमेव जयते

आर्थिक कार्य विभाग  
DEPARTMENT OF  
ECONOMIC AFFAIRS

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### Indian economy: growing with stability

*Global economic prospects continue to be uncertain and the latest developments in the financial markets, especially in the advanced economies, have added to this uncertainty. In its April 2023 update of the World Economic Outlook (WEO), the IMF has attempted to clear the path of uncertainty. It has projected global growth to decline from 3.4 per cent in 2022 to 2.8 per cent in 2023. Growth is forecasted to marginally improve to 3.0 per cent in 2024, but not enough to beat the growth rate of 2022 while falling significantly short of the 6.4 per cent mark attained in 2021. Elevated inflation and financial tightening, which have weakened the growth process, are thus expected to weigh on economic activity for at least three years since the armed conflict broke out between Russia and Ukraine in February 2022. The slowing of global growth, accompanied by pressures from deglobalisation and supply chain disruptions, has also moderated global trade. IMF projects the increase in global trade volume to fall from 5.1 per cent in 2022 to 2.4 per cent in 2023 before slightly improving to 3.5 per cent in 2024.*

*Even within 2022, global trade volume weakened from the first to the second half. Consequently, India's merchandise exports declined in the last quarter of 2022 (Q3 of FY23). However, India's merchandise imports fell more sharply with the easing of international commodity prices. This led to a smaller merchandise trade deficit, significantly narrowing India's current account deficit (CAD) from 3.7 per cent of GDP in Q2 to 2.2 per cent in Q3 of FY23. Sustained growth in net services exports and a strong inflow of remittances by Indians employed overseas also contributed to the improvement of CAD. The narrowing of the CAD, accompanied by a rising inflow of foreign portfolio investment (FPI) resulted in an increase in foreign exchange reserves by the end of Q3. With forex reserves further increasing by the end of FY23, prospects of a still narrower CAD in Q4 are bright.*

*Even as external stability strengthened, factors contributing to internal stability also improved. Fiscal parameters for the centre and the states in FY23 have been robust, as seen in solid revenue generation and improvement in the quality of expenditure. The improvement in expenditure quality is driven by significant capex by the centre and the rationalisation of revenue expenditure. Consequently, the ratio of revenue expenditure to capital outlay is lower for Apr-Feb 2023 compared to the corresponding period of the previous year. The centre's emphasis on capex has also encouraged the states to announce an increase in their capex*

*allocation in the budget of FY24. Broad-based economic activity and robust revenue buoyancy have further led to a consolidation in states' fiscal deficit target, with most states projecting a fiscal deficit for FY24 in the range of 3-3.5 per cent of the GSDP, in line with the borrowing limit announced by the central government.*

*Internal macroeconomic stability has further strengthened with easing inflationary pressures in March 2023, driven by the softening of food and core inflation, which fell to a 16-month low. The sequential growth of CPI-core in March 2023 is the weakest since June 2022 and can be attributed to the beginning of the pass-through of declining WPI inflation in consumer goods prices. Although CPI for the full year rose from 5.5 per cent in FY22 to 6.7 per cent in FY23, it was much lower in the second half of FY23 at 6.1 per cent compared to 7.2 per cent in the first half. The easing of international commodity prices, the promptness of measures taken by the government, and monetary tightening by the RBI have helped to rein in domestic inflation. Inflationary expectations also appear to be anchoring, as witnessed in various surveys for households and businesses.*

*Core inflation, however, in many major economies continues to be sticky, prompting faster-than-expected policy rate hikes by central banks. The recent collapses of a few banks in the US and Europe on the back of this tightening cycle have posed pertinent questions to policy makers on the vulnerability of their financial systems, particularly in emerging market economies (EMEs). Banking supervision in India, however, is robust with the RBI's overarching coverage of institutions, regardless of asset size, in its bi-annual assessment of financial stability. Macro stress tests are also performed from time to time on individual banks. Investment in held-to-maturity (HTM) securities is limited to 23 per cent of deposits, reflecting an effective insulation of asset value from adverse market developments. For the assets exposed to the securities market (mostly G-secs whose value has also fallen with an increase in their yield), the investment fluctuation fund (IFR) maintained by banks provides a suitable buffer. Loans constitute more than 50 per cent of the total assets of the top 10 Indian banks, thereby making them relatively immune to yield spikes. Finally, rapid withdrawal of deposits is unlikely as 63 per cent of the deposits contributed by the households, are considered sticky. Further, as more than 60 per cent of deposits are held by public sector banks, depositors in India are reassured about the safety of their savings.*

*FY23 has been strong for India's economy despite the tailwind of the pandemic and the headwind of the geo-political conflict intertwining to escalate global economic uncertainty. The economy is estimated to grow at 7 per cent, higher than the trend rate and the growth of the other major economies. Growing macroeconomic stability, as seen in the improved current account deficit, easing inflation pressure, and a banking system strong enough to survive the increase in policy rates, has made the growth rate further sustainable. With the April 2023 update of the WEO projecting India to be the fastest-growing economy in FY24, it is likely to be underpinned by even more robust stability in the macroeconomic variables. The Economic Survey 2022-23 and RBI also project Indian economy to register a real GDP growth rate of 6.5 per cent in 2023-24. The estimates are in line with the World Bank estimate of 6.3 per cent and ADB estimate of 6.4 per cent for 2023-24.*

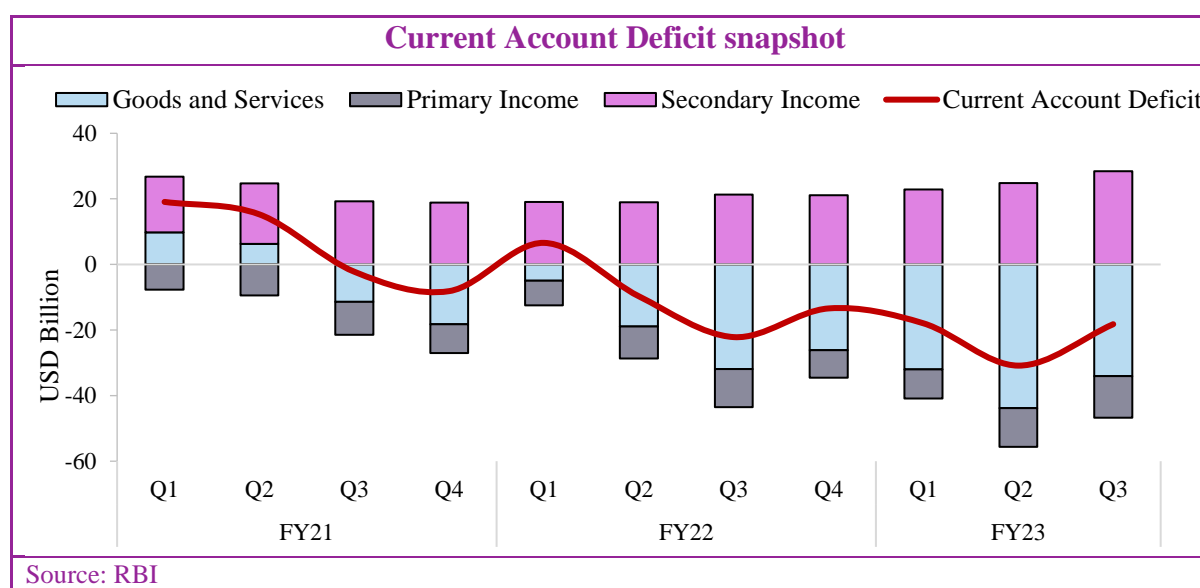
*However, we reiterate that downside risks to our official forecast of 6.5 per cent for real GDP growth in FY24 dominate upside risks. OPEC's surprise production cut has seen oil prices rise in April, off their lows of low-Seventies per barrel in March. Further troubles in the financial sector in advanced nations can increase risk aversion in financial markets and impede capital flows. Forecasts of El Nino, at the margin, have elevated the risks to Indian monsoon rains.*

## External Sector

### *India's Current Account Deficit (CAD) narrowed in Q3 of FY23, set to decline further in Q4*

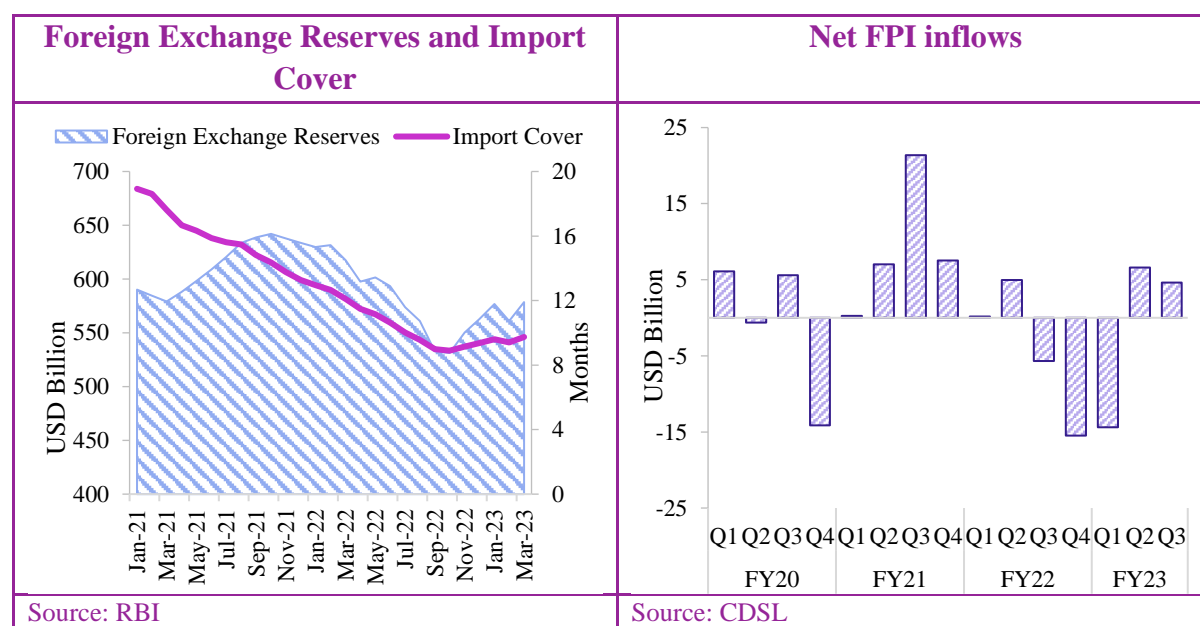
1. International Monetary Fund (IMF), in its April 2023 update of the World Economic Outlook (WEO), has forecast world output growth to slow from 3.4 per cent in 2022 to 2.8 per cent in 2023. The growth estimate marginally improves to 3.0 per cent in 2024 but still lower than that of 2022 while falling significantly short of the 6.4 per cent attained in 2021. Elevated inflation and financial tightening will thus weigh on economic activity for at least three years since the armed conflict between Russia and Ukraine broke out in February 2022. Pressures from deglobalisation and supply chain disruptions will further add to the slowing of global growth and moderate global trade. The weakening of global growth and trade is expected to both weaken and strengthen the stability of India's external sector. On the one hand, it may lower India's exports and widen the Current Account Deficit (CAD). On the other hand, it may reduce the value of imports by easing commodity prices and narrowing the CAD. So far, the net impact of the two opposing effects has been positive in narrowing the CAD. This has strengthened the stability of India's external sector.

2. Data released by the RBI show that the CAD narrowed to 2.2 per cent of the GDP in Q3 of FY23, compared to 3.7 per cent in Q2 and 2.7 per cent in the corresponding quarter of the previous year. This was driven by a moderation in merchandise trade deficit caused by lower growth in imports relative to exports, a jump in net services exports propped up by a surge in IT and business services exports, and a resilient inflow of remittances by Indians employed overseas that has already reached record levels for any year.



3. Narrowing CAD strengthens the external sector stability by lowering pressure on foreign exchange reserves to finance CAD. If, at the same time, forex reserves were also to

increase, external sector stability is further reinforced. These twin benefits were experienced by the Indian economy in Q3. As the CAD narrowed in Q3, the forex reserves started rising from their lowest level on 21<sup>st</sup> October 2022, growing 7.3 per cent by the end of December 2022. While the narrowing of the CAD itself explains part of the increase in the forex reserves, the balance originated from a record inflow of net Foreign Portfolio Investment (FPI) in Q2 and Q3, which had witnessed an outflow in Q1. Portfolio inflows in Q3 can be partly attributed to market expectation of a moderation in the pace of rate hikes by major central banks and partly by India's growth momentum that did not let up even as the world output slowed.



4. Forex reserves have grown by 2.8 per cent by the end of March 2023 compared to December 2022 despite FPI outflows in Q4 of FY23. While a renewed perception of major central banks increasing policy rates further than earlier anticipated has changed the direction of FPI flows, continuing improvement in the trade account is likely to drive the further narrowing of CAD. This is seen in the relative movements of exports and imports on the merchandise account. Merchandise exports in Q4 of FY23 are lower than the previous year's corresponding quarter. However, year on year, merchandise imports have contracted by 4.7 per cent in the same quarter, thereby improving the merchandise trade account. Overall trade balance has further improved as net services exports are estimated to increase by 19.4 per cent in the last quarter of FY23.

5. With forex reserves now providing an import cover of 9.7 months and the CAD narrowing to a manageable level, FY 23 has closed with stronger stability in India's external sector. Larger reserves and narrower CAD will further stabilise the rupee as well. Going forward, India's trade deficit may further fall as PLI schemes deepen their impact and reduce the country's import dependence. At the same time, India's recent engagements with the UAE,



the UK, and Australia and the launch of a new Foreign Trade Policy will increase the global market share of the country's exports.

### **Box 1: Foreign Trade Policy (FTP) 2023**

The new FTP aims to increase the country's exports to US\$ 2 trillion by 2030. The policy marks a shift from an incentives-based regime to a remission and entitlement-based regime to achieve this goal. Under the remission-based regime, taxes and duties paid in the process of exports are refunded to the exporter. This will be fully compatible with WTO provisions. The FTP 2023 focuses on process re-engineering and automation to facilitate ease of doing business for exporters. The Key Approach to the FTP is based on four pillars: - (i) Shift from Incentive to Remission, (ii) Export promotion through collaboration-Exporters, States, Districts, and Indian Missions, (iii) Ease of doing business, reduction in transaction cost and e-initiatives and (iv) Emerging Areas such as facilitating e-Commerce exports, Developing Districts as Export Hubs, access to dual-use high-end technology items under SCOMET (Special Chemicals, Organisms, Materials, Equipment and Technologies) policy.

#### **Process Re-Engineering and Automation**

The FTP emphasises export promotion and development, moving away from an incentive regime to a regime which is facilitating, based on technology interface and principles of collaboration. FTP 2023 codifies implementation mechanisms in a paperless, online environment, building on earlier 'ease-of-doing-business' initiatives. Reduction in fee structures and IT-based schemes will make it easier for MSMEs and others to access export benefits. During FY24, all processes under the Advance and Export Promotion Capital Goods (EPCG) Schemes, including issue, re-validation, and Export Obligation (EO) period extension, will be covered in a phased manner. Cases identified under the risk management framework will be scrutinised manually, while most applicants are expected to be covered under the 'automatic' route initially.

#### **Towns of Export Excellence**

Four new towns, namely Faridabad, Mirzapur, Moradabad, and Varanasi, have been designated as Towns of Export Excellence (TEE) in addition to the existing 39 towns. The TEEs will have priority access to export promotion funds under the Market Access Initiative (MAI) scheme and will be able to avail of Common Service Provider (CSP) benefits for export fulfilment under the EPCG Scheme. This addition is expected to boost the exports of handlooms, handicrafts, and carpets.

#### **Recognition of Exporters**



Exporter firms recognised with 'status' based on export performance will now be partners in capacity-building initiatives on a best-endeavour basis. Similar to the 'each one teach one' initiative, 2-star and above status holders would be encouraged to provide trade-related training based on a model curriculum to interested individuals. This will help India build a skilled manpower pool capable of servicing a \$5 trillion economy before 2030. Status recognition norms have been re-calibrated to enable more exporting firms to achieve 4 and 5-star ratings, leading to better branding opportunities in export markets.

### **Promoting export from the districts**

The FTP provides for building partnerships with State governments and taking forward the Districts as Export Hubs (DEH) initiative to promote exports at the district level and accelerate the development of the grassroots trade ecosystem. Efforts to identify export-worthy products & services and resolve concerns at the district level will be made through an institutional mechanism—State Export Promotion Committee and District Export Promotion Committee at the State and District level, respectively. District-specific export action plans to be prepared for each district outlining the district-specific strategy to promote the export of identified products and services.

### **Streamlining SCOMET Policy**

India is emphasising the "export control" regime as its integration with export control regime countries strengthens. There is a broader outreach and understanding of SCOMET (Special Chemicals, Organisms, Materials, Equipment and Technologies) among stakeholders, and the policy regime is being made more robust to implement international treaties and agreements entered into by India. A robust export control system in India would provide access to dual-use high-end goods and technologies to Indian exporters while facilitating exports of controlled items/technologies under SCOMET from India.

### **Facilitating E-Commerce Exports**

FTP 2023 outlines the intent and roadmap for establishing e-commerce hubs and related elements such as payment reconciliation, bookkeeping, returns policy, and export entitlements. As a starting point, the consignment-wise cap on E-Commerce exports through courier has been raised from ₹5 Lakh to ₹10 Lakh in the FTP 2023. Integration of Courier and Postal exports with Indian Customs EDI Gateway (ICEGATE) will enable exporters to claim benefits under FTP.

### **Merchanting trade**

To develop India into a merchanting trade hub, the FTP 2023 has introduced provisions for merchanting trade. Merchanting trade of restricted and prohibited items under the export policy would now be possible. Merchanting trade involves the shipment of goods from one foreign country to another foreign country without touching Indian ports, involving an Indian

intermediary. Over time, this will allow Indian entrepreneurs to convert certain places, like GIFT City etc., into major merchanting hubs.

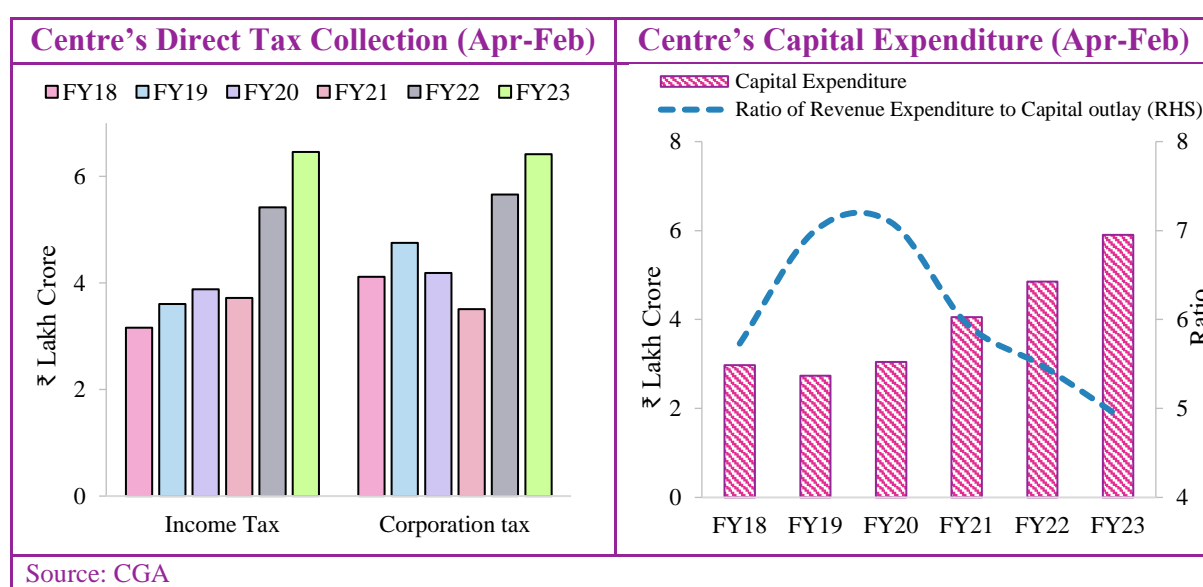
### Amnesty Scheme

The Government is firmly committed to reducing litigation and fostering trust-based relationships to help alleviate the issues faced by exporters. In line with the "Vivaad se Vishwaas" initiative, which sought to settle tax disputes amicably, the government is introducing a special one-time Amnesty Scheme under the FTP 2023 to address default on Export Obligations. This scheme is intended to provide relief to exporters who have been unable to meet their obligations under EPCG and Advance Authorizations and who are burdened by high duty and interest costs associated with pending cases.

## Fiscal Sector

*Central and States likely to meet their Fiscal Deficit Targets in FY23, supported by strong revenue growth*

6. Despite the announcement of several fiscal measures, such as fuel tax cuts and an extension of the food subsidy program to offset the impact of rising inflation, the central government is likely to meet its fiscal deficit target of 6.4 per cent of the GDP in FY23. The Gross Fiscal Deficit of the Central Government for April-February 2023 stands at 82.8 per cent of the Revised estimates, slightly higher than last year's level but lower than the past 5 years' average. The improvement in budgetary indicators of the Centre has been supported by strong revenue growth. The Gross Tax Revenues registered an increase of 12 per cent during Apr-Feb 2023 compared to the corresponding period of the previous year, with a robust expansion under all major taxes except Excise Duties.



7. The emphasis on capital expenditure has been the highlight of the fiscal policy strategy of the Government. The capital expenditure during Apr-Feb 2023 was 21.7 per cent higher compared to the corresponding period of the previous year. This has led to an improvement in spending quality, which is reflected in the declining Revenue Expenditure to Capital Outlay ratio over the past years. The momentum in Central Government's capital expenditure is envisaged to continue in FY24 to sustain economic growth when the global economy is adversely affected by monetary policy tightening, rising inflation and supply chain disruption. The budgeted capital expenditure for FY24 stands 33 per cent higher than the previous year (3.3 per cent of the GDP). The Centre has also announced continuing the 50-year interest-free loan to State governments under 'The Scheme for Special Assistance to States for Capital Investment' with an enhanced outlay of ₹1.3 lakh crore. This is likely to spur investment in infrastructure and incentivise States for complementary policy actions.

8. Central Government's emphasis on capex has also encouraged States to increase their capital expenditure. The States' Monthly Fiscal Accounts data released by O/o CAG shows that during Apr-Feb 2023, the Capital expenditure by States was 11.9 per cent higher compared to the previous year. This increase is attributable to strong revenue generation and support provided by the Centre in terms of advance release of payment to states. The states have spent around 54.7 per cent of their budgeted capital expenditure during this period, in line with past trends.

9. The 24 major states, which have presented their Budgets as of March 23, have cumulatively announced a 17.7 per cent increase in capital expenditure in FY24 compared to the previous year's Budget estimates. States have also announced various measures to facilitate capital formation and support infrastructure growth. These include Gujarat's announcement to develop a road network for connecting with border areas, Mizoram's Socio-Economic Development programme to provide families with capital to support ongoing economic activities or start new ventures, Odisha's Mukhyamantri Janajati Jeebika Mission to improve critical infrastructural needs incidental to livelihood promotion and support for tribal livelihood promotion, among others. Recently, the National Planning Group (NPG) under PM Gati Shakti scheme has approved infrastructure projects related to railways in Rajasthan, Odisha and Uttar Pradesh to develop an integrated and planned infrastructure and reduce logistics costs.

#### **Growth in State's Actual Capital Expenditure (April-February) [per cent]**

	<b>FY21</b>	<b>FY22</b>	<b>FY23</b>
Andhra Pradesh	124.8	-33.5	-36.3
Arunachal Pradesh	87.8	-7.8	12.1
Assam	-2.7	21.9	1.4
Bihar	1.5	27.2	19.5
Chhattisgarh	-0.6	22.9	13.3
Gujarat	-17.8	18.8	28.8

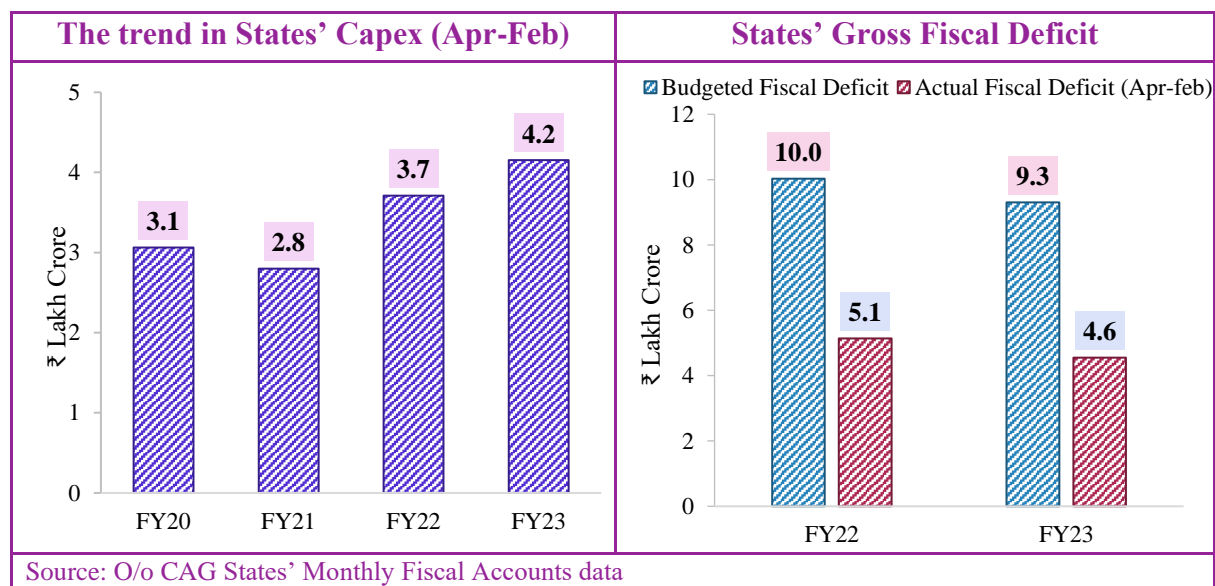
Haryana	-73.6	103.2	17.3
Himachal Pradesh	-19.3	22.4	2.1
Jharkhand	-51.3	18.9	73.2
Karnataka	0.2	3.6	39.6
Kerala	31.7	11.3	0.9
Madhya Pradesh	-13.7	50.7	8.3
Maharashtra	-27.3	42.9	33.3
Manipur	86.5	103.4	3.5
Meghalaya	49.3	74.7	-27.9
Mizoram	-33.7	-21.4	61.6
Nagaland	867.3	3.3	-22.8
Odisha	-25.8	21.4	79.8
Punjab	37.8	179.7	-38.5
Rajasthan	-11.3	81.6	-4.0
Sikkim	75.2	-11.1	34.8
Tamil Nadu	26.8	22.2	-1.9
Tripura	-20.0	38.0	85.1
Uttar Pradesh	-29.1	59.2	19.6
Uttarakhand	-9.4	38.2	5.6
West Bengal	-32.9	47.5	25.7
Telangana	-2.8	89.6	-40.2
<b>Total</b>	<b>-8.6</b>	<b>32.7</b>	<b>11.9</b>

Source: O/o CAG States' Monthly Fiscal Accounts data

10. Increased spending on Capex by States is being supported by strong revenue generation. States have witnessed robust revenue growth in FY23, with Total revenue receipts witnessing a growth of 14.1 per cent during Apr-Feb 2023, driven by robust growth in tax and non-tax revenues. Actual revenue receipts during the same period were 80.1 per cent of the budgeted estimates. Apart from the robust economic activity, the revenue collection in States has been strengthened by various measures taken by the State Governments in this direction. These include Assam's liquidation scheme for payment of arrears, Haryana's one-time scheme for settlement of old VAT dues, Assam and Kerala's Green tax, and Uttar Pradesh's new liquor policy with increased fees. Some states like Tamil Nadu, Andhra Pradesh, Telangana, Karnataka, Madhya Pradesh, Haryana, Kerala, Assam, and UT of Puducherry have considered revising their power tariffs during FY23. States like Tamil Nadu, Telangana and Kerala have revised the property taxes to support their revenues.

11. Increased focus on capex coupled with strong revenue generation has improved States' Budgetary indicators. States' Gross Fiscal Deficit as a per cent of Budget Estimates during April-February 2023 was 51 per cent, slightly higher than the previous year's level but lower than the pandemic years. Consolidation in the Fiscal Deficit can be attributed to broad-based economic recovery and strong revenue generation. The majority of the States witnessed a surplus in their revenue account during the same period. The States that announced their

Budgets for FY24 have projected a consolidation in the fiscal deficit compared to the previous year, driven by faster growth in receipts than in expenditure. Most states are projecting a fiscal deficit in the range of 3-3.5 per cent of the GSDP, in line with the borrowing limit announced by the Central Government (3.5 per cent of the GSDP).



12. An analysis of the Ratio of Actual Gross Fiscal Deficit to Revenue Receipts indicates that 12 out of 27 States have moved towards fiscal consolidation in Apr-Feb FY23 (compared to FY22), reflecting lower leverage.

#### The ratio of States' Actual Fiscal Deficit to Revenue Receipts (April-February)

	FY22	FY23	Difference
Andhra Pradesh	0.39	0.43	0.04
Arunachal Pradesh	-0.17	-0.16	0.01
Assam	0.20	0.24	0.04
Bihar	0.54	0.61	0.07
Chhattisgarh	0.05	0.01	-0.04
Gujarat	0.04	0.02	-0.02
Haryana	0.41	0.34	-0.07
Himachal Pradesh	0.08	0.28	0.21
Jharkhand	-0.07	0.05	0.11
Karnataka	0.10	0.09	-0.02
Kerala	0.43	0.22	-0.21
Madhya Pradesh	0.23	0.19	-0.04
Maharashtra	0.06	-0.01	-0.07
Manipur	0.38	0.07	-0.31
Meghalaya	0.14	0.12	-0.01
Mizoram	0.11	0.37	0.26
Nagaland	0.58	0.51	-0.06
Odisha	-0.16	0.07	0.23

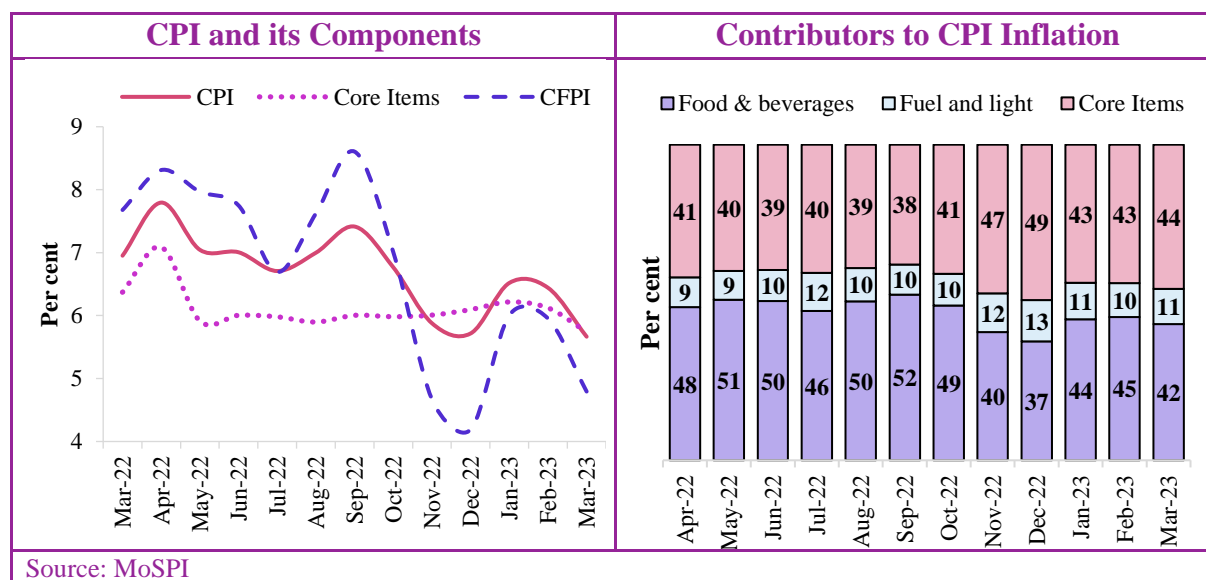
Punjab	0.29	0.32	0.03
Rajasthan	0.22	0.27	0.04
Sikkim	0.09	0.13	0.04
Tamil Nadu	0.27	0.29	0.02
Telangana	-0.01	0.01	0.01
Tripura	1.34	1.98	0.64
Uttar Pradesh	0.01	0.00	-0.01
Uttarakhand	1.09	0.94	-0.15
West Bengal	0.29	0.24	-0.05

Source: O/o CAG States' Monthly Fiscal Accounts data

## Inflation

*CPI Inflation eased to a 15-month low in March, driven by the softening of food and core inflation*

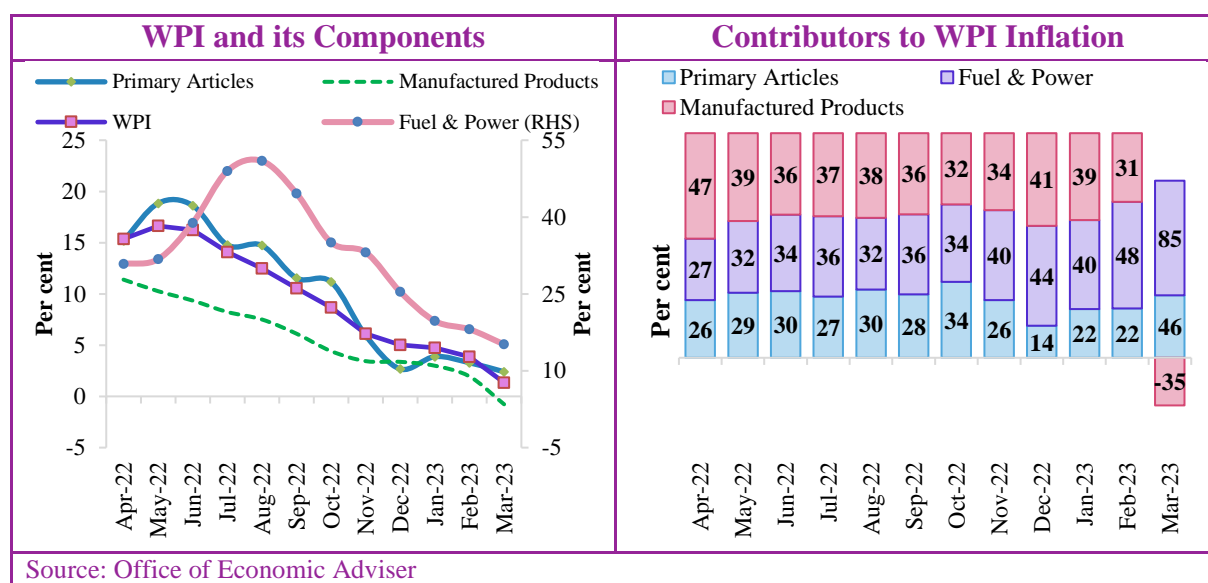
13. Inflationary pressures have begun to ease, with CPI inflation in March 2023 declining to a 15-month low at 5.7 per cent. A softening of food and core inflation contributed to the moderation in inflation. A drop in the prices of 'vegetables', 'oil and fats' and 'cereal and products' reduced food inflation from 5.9 per cent in February to 4.8 per cent in March. At the same time, core inflation dipped to a 23-month low of 5.7 per cent. The sequential growth of CPI-core in March 2023 is the weakest since June 2022 and can be attributed to the beginning of the pass-through of declining WPI inflation in consumer goods prices. This is, for example, seen in declining inflation in 'personal care and effects', signalling a pass-through of lower input costs by Fast Moving Consumer Goods (FMCG) companies to consumers.



14. Although CPI for the entire year rose from 5.5 per cent in FY22 to 6.7 per cent in FY23, it was much lower in the second half of FY23 at 6.1 per cent compared to 7.2 per cent in the first half. The drop of more than 100 basis points in inflation from the first to the second half

of FY23 reflects the easing of international commodity prices, the impact of the prompt of measures taken by the government and monetary policy tightening rein in inflation.

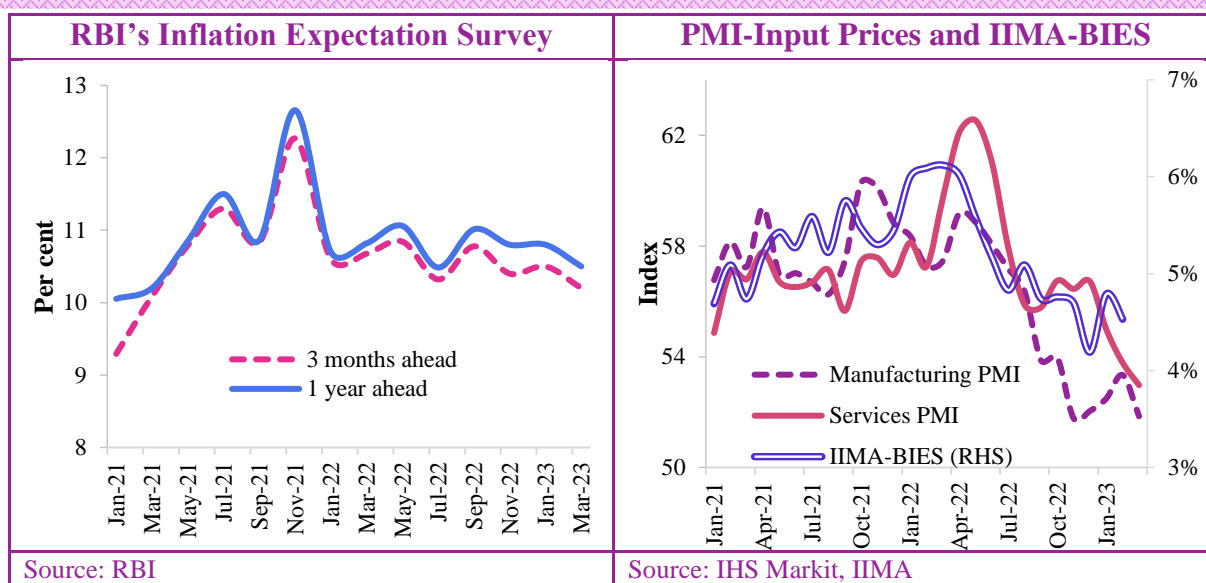
15. WPI inflation in March 2023 has further eased to 1.3 per cent due to lower prices of manufactured goods, fuel, and power. The decline in manufactured goods inflation is contributed by basic metals, food products, and chemical and chemical products while declining prices of mineral oils and electricity have eased fuel and power inflation. For the full year, WPI inflation has fallen from 13.0 per cent in FY22 to 9.4 per cent in FY23. The fall, however, is sharper in the second half at 4.9 per cent as compared to 14.2 per cent in the first half of FY23, by and large tracking the declining value of imports into the country.



16. With the softening of inflationary pressures, inflation expectations of households and businesses have been anchoring. In the March 2023 round of RBI's survey of households, inflation expectations have moderated by 30 bps for both three months and one year ahead. Business Inflation Expectations Survey (BIES) conducted by IIM Ahmedabad, covering mainly manufacturing firms, also witnessed a decline in the one-year ahead 'business inflation' expectation in February 2023. This is further corroborated by manufacturing firms polled by PMI experiencing a softening of the input price inflation in March 2023, which is at its second-lowest mark in two and half years. Services firms have also recorded a decline in the rate of input price inflation, which is at its lowest since September 2020.

17. In addition to the factors stated in the February 2023 release of the *Monthly Economic Review*, there are additional factors, going forward, that may influence the inflation trajectory in India's economy. These include the volatile international crude oil market and constrained supplies of milk and wheat.





18. The volatility in crude oil markets continues, with OPEC+ countries deciding to cut crude oil production from May 2023. This has already led to a spike in crude oil prices in April 2023. However, the upside risk to prices appears to be short-term, as oil demand is expected to remain weak amid the global slowdown. Further, a built-up in inventories and a possible increase in US oil output will continue to put downward pressure on prices.

19. Milk inflation has remained elevated for several months due to a growing supply-demand mismatch. Milk production has been impacted by a Lumpy Skin Disease (LSD) infecting millions of cattle in late 2022. Even as this reduced milk supply, the price of milk further rose with high fodder and transportation costs. In December 2022, the government initiated the production of the vaccine Lumpi-ProVac for controlling and eradicating LSD in animals. The vaccination drive is expected to curb the spread and immune the cattle against the skin disease. While this would increase milk supply, a general drop in inflation will moderate the fodder and transport costs, thereby lowering milk inflation.

20. Although the second advance estimate has projected a record foodgrain production, the crop damage caused by unseasonal rains and hailstorms in some parts of the country since mid-March may constrain wheat production, besides perishable items such as fruits and vegetables.

21. To counter inflationary pressures along with supporting growth, RBI has been engaged in necessary actions. In its recent meeting, however, the RBI's Monetary Policy Committee (MPC) has kept the policy rate unchanged as it closely observes the outcome of its past actions. Notably, the RBI sees CPI inflation declining to 5.2 per cent in the full year of FY24, lower than the 5.5 per cent attained in FY22, which was mostly free of the impact of the Russia-Ukraine conflict.

## Financial Stability

### *Banking system stability and RBI regulations render an SVB-like incident improbable*

22. Even as the global economy was reeling under the pressure of unceasing inflationary pressures and the consequent monetary tightening, financial vulnerabilities emerged at the forefront. The collapse of a few regional banks in the United States and the takeover of the crisis-hit Credit Suisse Bank by the Union Bank of Switzerland (UBS) have sent ripples across the global banking industry and posed fears of a contagion effect across economies. The event has also raised the pertinent question among policymakers on the vulnerability of their financial system to such a collapse, especially in Emerging Market Economies (EMEs) that may lack the fiscal space to calm financial markets with fiscal packages. A discussion of what caused the collapses overseas is beyond our remit but we will confine to restating the factors that make the Indian banking system considerably less prone to such developments in the near-to-medium term future.

23. While incidents like those mentioned above are bound to happen in a rapid tightening cycle amid an uncertain economic environment, an analysis of the Indian banking system reveals that Indian banks appear well-placed to handle any stress emanating from the current tightening cycle. The importance accorded to system-wide financial stability has its origins in the aftermath of the 2007-08 global financial crisis. The macro-and micro-prudential measures in recent years by RBI and the government have culminated in the enhancement of risk absorption capacity, thereby improving the banking system's stability.

24. Various measures have been taken, including the creation of an investment fluctuation reserve (IFR) to create a buffer to shield banks from adverse yield movements, uniform application of capital and liquidity requirements to all banks, irrespective of their asset size and exposure, provision of guidelines on governance in commercial banks etc. with the focus on dealing with the root cause of vulnerabilities. The IFR acts as a countercyclical macroprudential tool that is created by transferring the gains realised on the sale of investments during an easing interest rate cycle and acts as a shock absorber in a tightening phase. As per the RBI's Financial Stability Report (FSR) of December 2022, the system-wide IFR of scheduled commercial banks (SCBs) stood at 2.2 per cent of the available-for-sale (AFS)<sup>1</sup> plus held-for-trading (HFT) investment portfolio. It helped banks to absorb the losses associated with the rise in G-sec yields in Q1 FY23 and resultant treasury losses to the tune of 4.9 per cent of their operating profit. Additionally, macro stress tests reveal that for an increase of 250 basis points (bps) in yields of banks' HTM portfolios, no commercial bank would fall short of its regulatory Capital to Risk-

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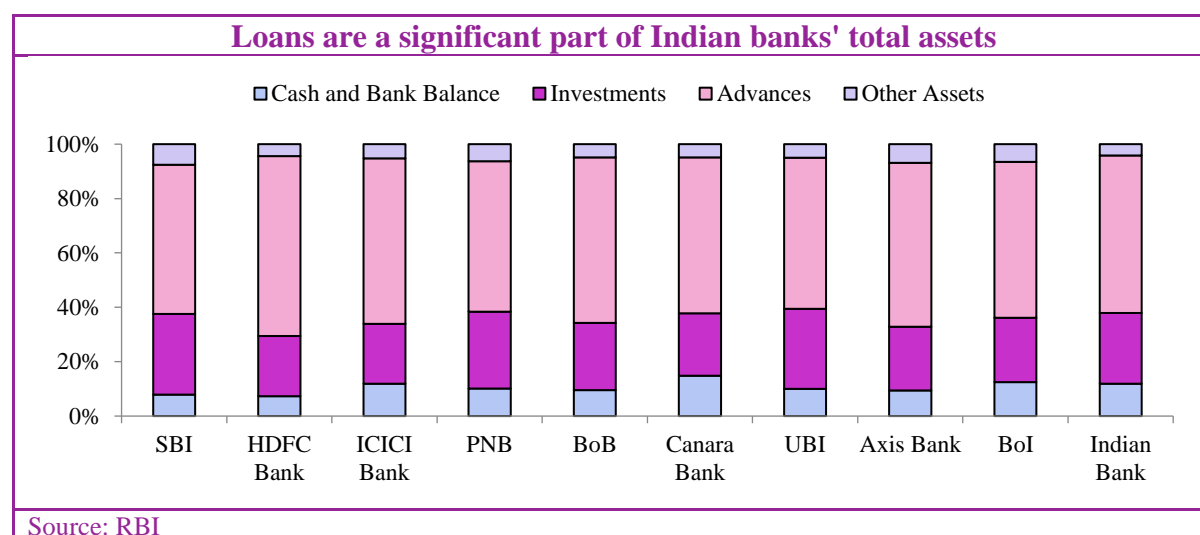
<sup>1</sup> Held for Trading (HFT) Securities are the securities acquired by the banks with the intention to trade by taking advantage of the short-term price / interest rate movements. These securities are to be sold within 90 days. Held to maturity (HTM) Securities are the securities acquired by the banks with the intention to hold them up to maturity. Available for Sale (AFS) Securities are securities not classified under HFT and HTM. For both AFS and HFT, profit or loss on sale of investments will be taken to the Profit & Loss Account.

weighted assets Ratio (CRAR). The RBI has also stipulated that banks cannot place more than 23 per cent of their deposit liabilities in their HTM portfolios. This implies that a 10 per cent loss sustained in banks' HTM portfolios will have only a deposit impact of 2.3 per cent.

25. Furthermore, the RBI remains meticulous in its bi-annual assessment of not just SCBs but also NBFCs and cooperative banks. This frequent assessment of financial institutions, regardless of balance sheet size ensures that vulnerabilities are identified even in smaller institutions, which may be impacted relatively more by monetary tightening and yield spikes. The relaxation in the coverage of such assessments can lead to financial accidents, as had happened in the case of the regional US Banks. The US government in 2018 exempted multiple US banks under a US\$ 250 billion asset threshold from the Dodd-Frank Act's regulations which meant these banks were subject to lower scrutiny as compared to larger US banks.

26. Apart from these regulatory requirements and actions, certain characteristics of the banking system will help reduce the probability of an SVB-like incident occurring in India. First, the RBI's Basic Statistical Returns reveal that as of March 2022, 60.1 per cent of India's deposits are with Public Sector Banks (PSBs). 63 per cent of total deposits are owned by households considered sticky retail customers; therefore, deposit withdrawals in this category will remain limited.

27. Second, Indian banks don't hold a majority of their assets in the form of bonds. Instead, for the top ten banks in terms of asset size, loans constitute more than 50 per cent of their total assets, making banks more immune to the rising interest rate cycle.



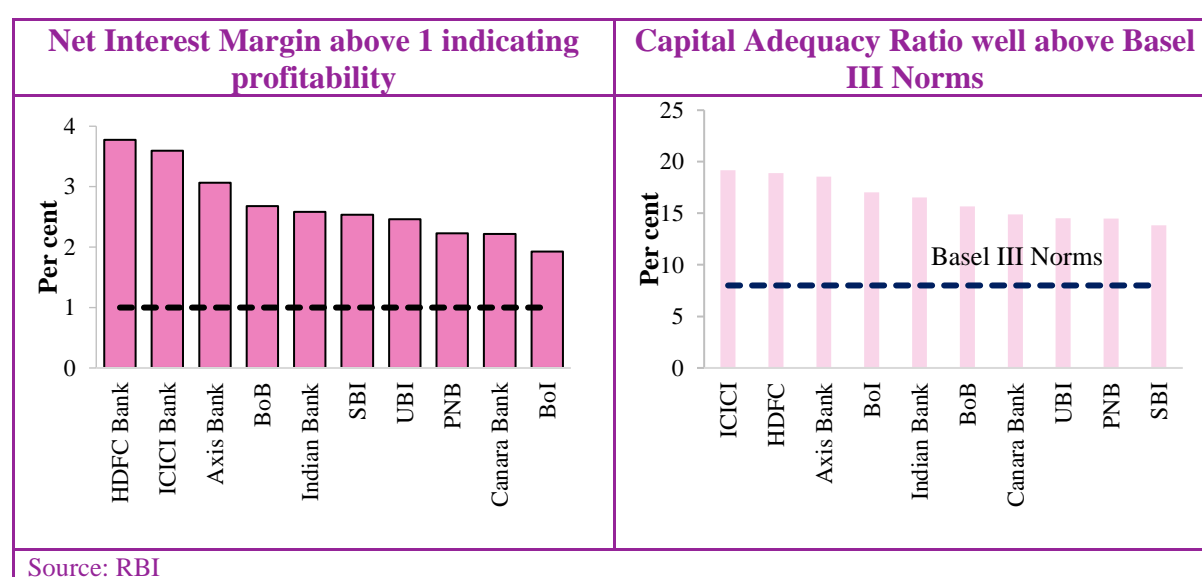
28. Third, Asset-Liability Mismatch (ALM) is another threat that emerges as policy rates are hiked. ALM in banks is not an anomaly but is embedded in the revenue models of financial institutions to earn margin and hence is prevalent in the banking system of all countries. However, the extent of ALM and the regulatory and supervisory framework to manage the vulnerability arising out of it is crucial as it may expose banks to risks if short-term interest

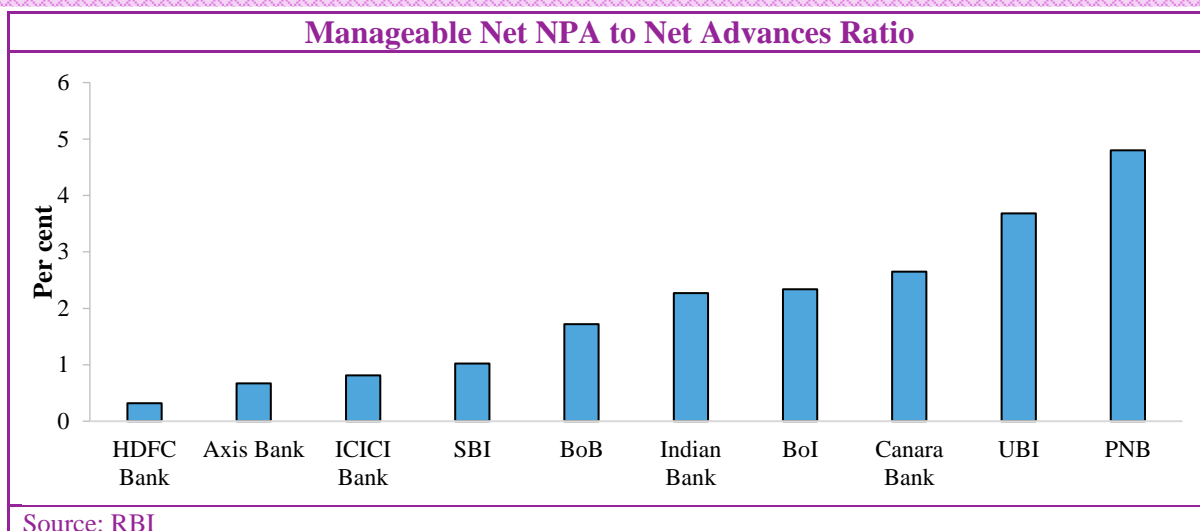
rates rise or if there is a sudden demand for liquidity. ALM build-up is not an onerous issue in the Indian banking system.

Asset and liability profile of major banks (Figures in per cent)									
	up to 1 year			1-5 years			over 5 years		
	Depo sits	Investm ents	Advan ces	Depo sits	Investm ents	Advan ces	Depo sits	Investm ents	Advan ces
State Bank of India	37.5	13.3	22.3	32.9	43.4	48.3	29.7	43.3	29.3
HDFC Bank	27.9	45.2	28.8	43.9	37.7	54.5	28.2	17.0	16.7
Punjab National Bank	23.4	6.5	29.0	46.2	21.6	54.8	30.4	71.9	16.2
Canara Bank	39.3	10.0	37.1	43.8	22.4	37.2	16.9	67.6	25.7
ICICI Bank	24.8	51.2	32.1	43.6	27.7	46.2	31.6	21.1	21.7
Bank of Baroda	35.4	51.6	16.6	37.1	25.1	66.1	27.6	23.3	17.3
Union Bank of India	35.4	70.6	25.4	20.1	9.8	55.9	44.5	19.6	18.6
Axis bank	36.8	51.8	24.3	3.3	15.8	32.3	59.8	32.4	43.4
Bank of India	28.6	19.1	18.9	40.0	17.4	53.0	31.4	63.5	28.1
Indian Bank	30.6	46.3	30.3	21.2	15.6	54.5	48.1	38.1	15.2

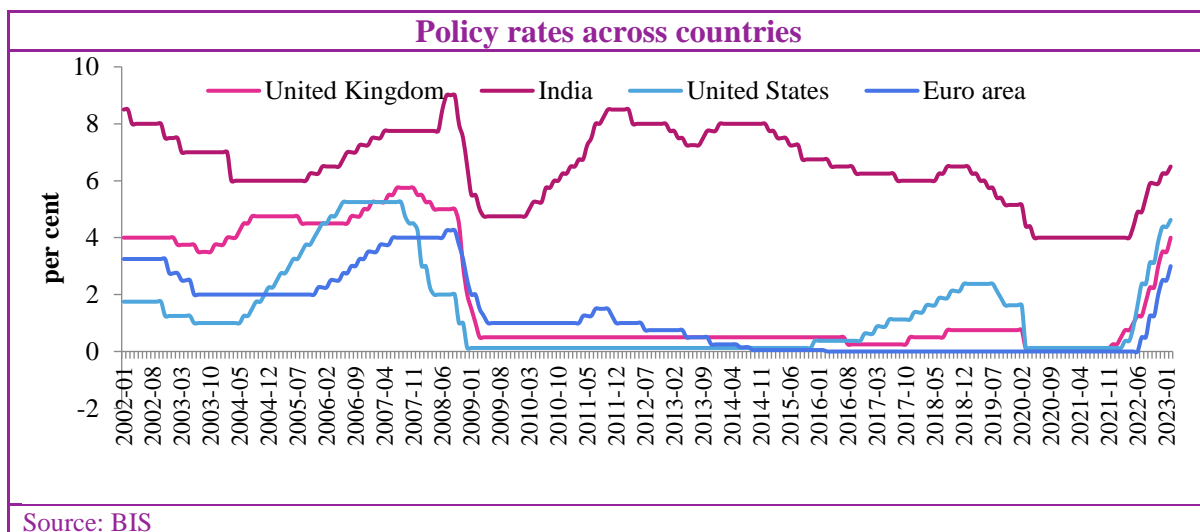
Source: RBI  
Note: Deposits, Investments and Advances across tenure add to 100.

29. Fourthly, after a phase of recapitalisation and cleaning up of bank balance sheets during the past years, there is a visible improvement in various banking indicators. Despite having major proportion of loans in the asset basket, Net Interest Margin, an indicator of a bank's profitability and growth for all major banks, is high, implying efficient investment by banks. The ratio of net NPA to net advances has been low and witnessed a declining trend driven by lower slippages and the reduction in outstanding GNPA's through recoveries, upgrades and write-offs. The capital adequacy ratio for top 10 major banks (based on asset size) has been well above Basel III Norms.



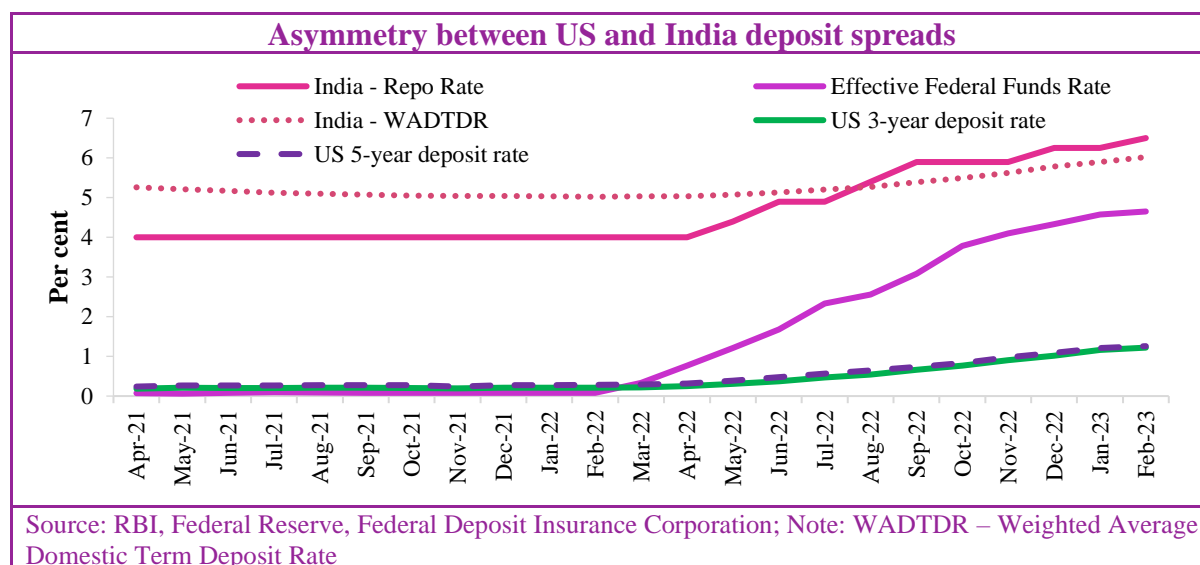


30. Fifth, interest rate cycles have been quite prominent in India, aligning with RBI's financial conditions and goal to maintain financial stability and manage inflationary pressures. The exposure and attunement to regular interest rate cycles have made Indian banks well-equipped to handle the cycles. This is unlike the case in Advanced Economies (AEs) where long-term interest rates have been close to zero for an extended period of time. Therefore, financial participants expected the rates to remain at low levels. So, when rates went up sharply within a short time to curb inflationary pressures, vulnerabilities in the financial markets come to the fore.



31. Finally, the spread between deposit rates and the policy rate in India is much lower compared to that in the US. This is because of the ultra-low policy rate that has prevailed since the GFC. The graph below reveals that while the deposit rates in the US and India have risen at a broadly similar pace, the rapid rise in policy rates in the US has generated a large spread between deposit rates in the US and the effective federal funds rates. The slow transmission of rate hikes to deposit rates has meant that depositors will look for instruments that yield better returns such as money market funds and treasury bills. Since the spread is not as large in India's case, withdrawal of deposits en masse remains an improbable event. The April 2023 RBI

Monetary Policy Report also notes that the transmission of policy rates to retail deposit rates gained momentum in the second half of FY23 as banks intensified their efforts to garner retail deposits to fund robust domestic credit growth.



32. The multifaceted nature of RBI’s regulatory actions, the improved bank balance sheets and the attunement of the Indian banking system to frequent interest rate cycles augur well for India’s financial stability and significantly reduce the probability of an SVB-like event occurring in India. These factors will also help support the medium-term growth trajectory to remain on course. However, rising uncertainty leaves no space for complacency and dynamic risk identification and management will be critical, especially in the current credit upcycle.

## Outlook

33. FY23 has been strong for India’s economy despite the headwinds from the geo-political conflict escalating global economic uncertainty. The economy is estimated to grow at 7 per cent, higher than the trend rate and the growth of the other major economies. Growing macroeconomic stability as seen in the improved current account deficit, easing inflation pressure, and a banking system strong enough to survive the increase in policy rates, has made the growth rate further sustainable. With the April 2023 update of the WEO projecting India to be the fastest-growing economy in FY24, it is likely to be underpinned by even more robust stability in the macroeconomic variables. The Economic Survey 2022-23 and RBI also project Indian economy to register a real GDP growth rate of 6.5 per cent in 2023-24. The estimates are in line with World Bank estimate of 6.3 per cent and ADB estimate of 6.4 per cent for 2023-24. It is important, however, to be vigilant against potential risks such as El Nino conditions creating drought conditions and lowering agricultural output and elevating prices, adverse geopolitical developments and rising global financial instability. All these three could affect the favourable combination of growth and inflation outcomes currently anticipated.

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### Performance of High-Frequency Indicators

Data Title	Unit	YTD Period/As at the end of	Year to Date			Year to Date (YoY Growth)		
			2019-20	2021-22	2022-23	2019-20	2021-22	2022-23
Agriculture								
Fertiliser Sales	Mn Tonnes	Apr-Feb	55.8	55.0	63.2	6.4	-12.2	14.9
Domestic Tractor Sales	Lakhs	Apr-Mar	7.1	8.4	9.5	-10.3	-6.4	12.2
Rabi Production	Mn Hectare	2nd AE	149.6	162.5	170.1	7.5	4.6	4.7
Kharif Production	Mn Tonnes	2nd AE	142.4	153.5	153.4	0.1	3.8	-0.1
Reservoir Level	Bn Cu. Metres	20-Apr	44.5	68.6	66.9	14	10.9	-2.5
Wheat Procurement (RMS)	LMT	NA	NA	NA	187.9	NA	NA	NA
Rice Procurement (KMS)	LMT	2nd April	NA	NA	492.3	NA	NA	NA
Rainfall	Millimetres	June-Sep	968	874.6	925	20.4	-8.7	5.8
Industry								
8-Core Industries	Index	Apr-Feb	131.4	134.1	144.6	1.27	11.0	7.9
IIP	Index	Apr-Feb	130.1	130.0	137.1	0.97	12.5	5.5
Domestic Auto sales	Lakh	Apr-Mar	207.1	164.2	196.8	-26.5	-7.9	19.8
PMI Manufacturing	Index	Apr-Mar	52.3	54.0	55.6	-0.8	7.5	3.0
Power consumption	Billion kWh	Apr-Mar	1,290.3	1,380.1	1,506.5	1.2	8.2	9.2
Natural gas production	Bn Cu. Metres	Apr-Mar	31.2	34	34.5	-5.1	18.7	1.3
Cement production	Index	Apr-Feb	147.1	153.1	168.1	1.8	22.3	9.7
Steel consumption	Mn Tonnes	Apr-Mar	100.5	105.8	118.2	11.7	5.2	11.8

Data Title		YTD Period/As at the end of	Year to Date			Year to Date (YoY Growth)		
			2019-20	2021-22	2022-23	2019-20	2021-22	2022-23
Inflation								
CPI-C	Index	Apr-Mar	146.3	163.8	174.7	4.8	5.5	6.7
WPI	Index	Apr-Mar	121.8	139.4	152.5	1.7	13.0	9.4
CFPI	Index	Apr-Mar	146.5	163.7	174.6	6.7	3.8	6.6
CPI-Core	Index	Apr-Mar	145.7	162.9	172.8	4.0	6.0	6.1
Services								
Average Daily ETC Collection	₹ Crore	Apr-Mar	NA	104.5	148.4	NA	64.2	42.0
Domestic Air Passenger Traffic	Lakh	Apr-Mar	2745.1	1668	2703.4	-0.26	58.5	62.1
Port Cargo Traffic	Million tonnes	Apr-Feb	642.1	650.2	712.4	1.45	7.7	9.6
Rail Freight Traffic	Million tonnes	Apr-Mar	1210.2	1418.1	1512.1	-1.06	15.0	6.6
PMI Services	Index	Apr-Mar	51.9	52.3	57.3	-0.4	25.5	9.5
Fuel consumption	Million tonnes	Apr-Mar	214.1	201.7	222.3	0.4	3.8	10.2
UPI (Value)	₹ Lakh crore	Apr-Mar	21.3	84.2	139.2	143.1	105.1	65.4
UPI (Volume)	Crore	Apr-Mar	1251.9	4596.8	8375.3	132.2	105.8	82.2
E-way Bill Volume	Crore	Apr-Mar	62.9	77.4	96.1	12.8	25.5	24.2
Fiscal Indicators								
Gross tax revenue (Central Govt)	₹ Lakh crore	Apr-Feb	16.8	22.7	25.4	-0.8	36.6	12.0
Revenue Expenditure	₹ Lakh crore	Apr-Feb	21.6	26.6	29	12.8	10.2	9.2
Capital Expenditure	₹ Lakh crore	Apr-Feb	3	4.8	5.9	11.4	19.7	21.7
Total Expenditure	₹ Lakh crore	Apr-Feb	24.7	31.4	34.9	12.6	11.5	11.1
Fiscal Deficit	₹ Lakh crore	Apr-Feb	10.4	13.2	14.5	21.7	-6.3	10.4
Revenue Deficit	₹ Lakh crore	Apr-Feb	7.8	8.7	9.2	20.5	-16.8	6.3
Primary Deficit	₹ Lakh crore	Apr-Feb	5.2	6.4	6.5	49.4	-23.8	1.6
GST Collection	₹ Lakh crore	Apr-Mar	12.2	14.8	18.1	3.8	30.4	21.9

Data Title		YTD Period/As at the end of	Year to Date			Year to Date (YoY Growth)		
			2019-20	2021-22	2022-23	2019-20	2021-22	2022-23
External Sector								
Merchandise exports	USD Billion	Apr-Mar	313.2	422.3	446.9	-5.2	45.1	5.8
Non-oil exports	USD Billion	Apr-Mar	271.9	354.7	352.5	-4.1	33.7	-0.6
Merchandise imports	USD Billion	Apr-Mar	474.2	613.6	713.5	-7.8	56.2	16.3
Non-oil non-gold imports	USD Billion	Apr-Mar	312.8	402.1	463.9	-7.1	45.9	15.4
Net FDI	USD Billion	Apr-Jan	36.3	30.9	26.5	29.6	-27.8	-14.2
Net FPI	USD Billion	Apr-Mar	-3.0	-16.0	-5.5	-	-	-
Exchange Rate	INR/USD	Mar	74.4	76.2	82.3	7.1	4.7	8.0
Foreign Exchange Reserves	USD Billion	14th Apr	479.6	603.7	586.4	15.8	3.6	-2.9
Import Cover	Months	31st Mar	12.0	11.9	9.7	-	-	-
Monetary and Financial								
Total Bank Credit	₹ Lakh crore	Mar	97.7	109.5	136.8	6.1	8.6	15.0
Non-Food Credit	₹ Lakh crore	Mar	97.3	108.9	136.6	6.1	8.7	15.4
10-Year Bond Yields	Per cent	Mar	6.70	6.33	7.33	-1.0	0.3	1.0
Repo Rate	Per cent	8th April 2023	4.4	4	6.5	-1.9	0.0	2.5
Currency in Circulation	₹ Lakh crore	24 <sup>th</sup> March 2023	24.5	31.3	33.8	14.5	9.8	7.9
M0	₹ Lakh crore	24 <sup>th</sup> March 2023	30.3	40.7	43.1	9.4	13.0	5.9
Employment								
Net payroll additions under EPFO	Lakh	Apr-Feb	72.9	107	131	22.6	62.5	22.4
Number of person demanded employment under MGNREGA	Crore	Apr-Mar	30.1	40.2	33.2	-0.6	-10.0	-17.4
Urban Unemployment Rate	Per cent	Dec	7.9	8.8	7.2	-2	-1.5	-1.6
Subscriber Additions: National Pension Scheme	Lakh	Apr-Jan	5.9	6.4	6.2	2.1	40.0	-2.4