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# CEA: OVERALL, ECONOMIC GROWTH IS MOVING IN THE RIGHT DIRECTION, ALTHOUGH ITS PACE IS STILL BELOW WHAT THE ECONOMY NEEDS BUT A PACE THAT IS EXPECTED TO PICK UP IN RESPONSE TO THE ONGOING REFORMS; SAYS AS PER THE RECENTLY RELEASED FIRST QUARTER GDP DATA OF THE CURRENT FINANCIAL YEAR 2015-16, PRICE-WISE, THE ECONOMY APPEARS TO BE IN OR CLOSE TO DEFLATION TERRITORY

**New Delhi, September 2, 2015**
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The Chief Economic Adviser Dr Arvind Subramanian in a Statement with regard to recently released First Quarter GDP Data of the Current Financial Year 2015-16 said here today that

"At a time of sharp declines in the price of oil, which led to sharp changes in Indirect Tax Collections and subsidy payments, national income data have to be interpreted with care.

There are two measures of aggregate economic activity: gross value added at basic prices (GVA) and gross domestic product at market prices (GDP). Essentially, GDP at market prices is the value of goods and services that are paid for by consumers which is allocated between: (i) the factors of production (measured by GVA); and (ii) government. Hence the basic national income identity: GDP = GVA + net indirect taxes (NIT), which is equal to indirect taxes less subsidies.

The issue that arises is how to derive estimates of NIT at constant prices given that the data are collected at current prices. The procedure followed by the Central Statistics Office (CSO), which is entirely consistent with recommended international practice for quarterly estimates, can be intuitively understood as follows. Under this procedure, indirect taxes are assumed to grow in line with the relevant tax base, which consists of the value of imports, manufacturing, and services. (In the case of subsidies, the CSO uses the GDP deflator to arrive at constant price estimates.)

Normally, this procedure would appropriately capture the reality. However, these are unusual times because indirect taxes have been increasing sharply and subsidies have been declining dramatically. During such times, the recommended international practice, by construction, will lead to tax increases in excess of the growth in the tax base—for example, due to increases in tax rates or improvements in collection efficiency—not being fully captured in measured GDP. Since NIT increased substantially—by 40 percent in nominal terms in the latest quarter—the GDP estimates will have to be interpreted with particular caution because of the commensurate potential for understating GDP growth.

With this as background, we can turn to the highlights of the latest GDP estimates.

- The most striking implication of the latest GDP estimates relates to prices. Prices, measured by the deflator for GVA, grew at 0.1 percent. And prices, measured by the deflator for GDP, grew at 1.7 percent according to the latest estimates. Even this estimate for growth of the GDP deflator could be over-stated if real GDP growth is potentially under-stated for reasons noted above. Price-wise, the economy appears to be in or close to deflation territory.

- Second, in the light of the above explanation, GVA estimates, at this stage, are perhaps a more reliable indicator of underlying economic activity. Measured by GVA, growth increased to 7.1 % in Q1 FY2016 from 6.1 percent in Q4 FY2015. Directionally, the latest data suggest that economy is recovering which is consistent with other more high-frequency indicators such as revenue collections, real credit growth, etc.

- Third, this directional change i.e, an improvement in growth from Q4 FY 2015 to Q1 FY 2016—could also be indicated by the GDP estimates if they are adjusted for the reasons noted above in line with the practices used for annual estimates. This is in contrast to current estimates that suggest a decline from 7.5% in Q4 FY2015 to 7.0% in Q1 FY2016. In other words, the headline GDP growth number could also be indicating that the economy is recovering not slowing down.

- Fourth, growth has been spread between manufacturing (7.2% in Q1 FY2016) and services (8.9% in Q1 FY2016). On the demand side, growth is being driven by private consumption (7.4% in Q1 FY2016), but fixed capital formation has also shown signs of improvement, increasing from 4.1 percent in the Q4 FY2015 to 4.9 per cent in Q1 FY2016.

Overall, economic growth is moving in the right direction, although its pace is still below what the economy needs but a pace that is expected to pick up in response to the ongoing reforms. And one real challenge that looms ahead appears not to be price inflation but possibly price deflation".

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