***Growth and Fiscal Consolidation: Can both go together?***

The Budget 2017 reinforced the message that India will continue to remain in the path of bespoke conservative fiscal approach, as dictated by orthodox economics. To the extent policy uncertainty is reduced , bond and currency markets which tend to pay a premium for policy and economic predictability is likely to view this budget favourably , at least in the immediate short term. Given the low-key recovery the Indian economy has exhibited over the last couple of years, this article will discuss scenarios under which the fiscal deficit target may be breached not only for the current year but also for the next year. And the culprit could be the unresolved issues of GDP calculation as per the new 2011-12 base and arguably optimistic nominal GDP estimates for FY2016 and FY2017.

***Upward Bias in GDP estimates:*** On 31st January 2017, while the release of Economic Survey grabbed eyeballs with its erudition and freshness of perspective, the release of another macroeconomic number went largely unnoticed-The first revised estimate of GDP for the year 2015-16. As the press release from Ministry of Statistics and Program Implementation (MOSPI) states “*The estimates of GDP and other aggregates for the years 2012-13 to 2014-15 have also undergone revision due to use of latest available data on agricultural production; industrial production especially those based on the provisional results of Annual Survey of Industries (ASI): 2014-15 and final results of ASI: 2013-14*”. The point to note is that the GDP estimates of period as far as 2011-12 got re-estimated. As Table 1.1 shows for the years FY2012-13 to FY2014-15 the Nominal GDP estimates have been marginally but steadily revised downward. For FY2015-16 the absolute value of nominal GDP got adjusted upwards. As table 1.2 shows the nominal GDP growth rate has been falling steadily since FY2012-13 and as per estimates nominal GDP is expected to change trend and grow by 11.9% in FY16-17.

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|  | **Table 1.1:Nominal GDP( INR Lakh Crore)(Base:2011-12)** | | | | | |
|  | **2011-12** | **2012-13** | **2013-14** | **2014-15** | **2015-16** | **2016-17** |
| 30/1/2015(New Series Launch with Base 2011-12) | 88.3 | 99.9 | 113.45 |  |  |  |
| 29/5/2015(Provisional Estimate for 2014-15) |  |  |  | 125.4 |  |  |
| 29/1/2016 (First Revised Estimate of 2014-15) | 87.36 | 99.51 | 112.73 | 124.88 |  |  |
| 8/2/2016 (Advanced Estimate for 2015-16) |  |  |  |  | 135.67 |  |
| 6/1/2017(First Advance Estimate for 2016-17) |  |  |  |  |  | 151.93 |
| 31/1/2017(First Revised Estimate of 2015-16) | 88.87 | 99.47 | 112.37 | 124.34 | 136.75 |  |

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|  | **Table 1.2:Nominal GDP(Growth)(Base:2011-12)** | | | | |  |
|  | **2011-12** | **2012-13** | **2013-14** | **2014-15** | **2015-16** | **2016-17** |
| 30/1/2015(New Series Launch with Base 2011-12) |  | 13.1% | 13.6% |  |  |  |
| 29/5/2015(Provisional Estimate for 2014-15) |  |  |  | 10.5% |  |  |
| 29/1/2016 (First Revised Estimate of 2014-15) |  | 13.9% | 13.3% | 10.8% |  |  |
| 8/2/2016 (Advanced Estimate for 2015-16) |  |  |  |  | 8.6% |  |
| 6/1/2017(First Advance Estimate for 2016-17) |  |  |  |  |  | 11.9% |
| 31/1/2017(First Revised Estimate of 2015-16) |  | 13.9% | 13% | 10.7% | 10% |  |
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***Can we Actually Meet the Fiscal Deficit target this Year***? In a year where the mandated currency exchange , called demonetisation in popular parlance, is expected to affect the GDP growth downward, the official estimates suggest that the economy will turnaround. As per the official calculation, which explicitly did not consider the impact of demonetisation, FY16-17 is expected to show the best nominal GDP growth in three years. Of course the Economic Survey estimates the nominal GDP of the current fiscal year to be 100 basis point (bp) to 25 bp lower but this may also turn out to be a tad too optimistic. To the extent the fiscal deficit is calculated as a percentage of nominal GDP a downward adjustment of the same will breach the fiscal deficit target. As such the previous budget (for the year Fy2016-17) estimated a nominal GDP growth rate of 11% so as to restrict the fiscal deficit at 3.5% of GDP.

The 3.2% fiscal deficit target of FY2017-18 is based on a nominal GDP growth rate of 11.75%. An economy of nominal GDP of INR 136.75 lakh crore as of March 31,2016 is expected to grow to an estimated 169.7 Lakh crore by 31 March , 2018 and support a fiscal deficit of INR 5.4 lakh crore ie; hit the fiscal deficit target of 3.2% for FY2017-18. Whew!

Given that GDP estimates gets re-estimated even three years into the future, we may figure out two or three years down the line that India may have missed the fiscal deficit target in FY2016-17.

***Past Tango of fiscal deficit and Nominal GDP:*** Fiscal deficit target overshooting in the first half of a fiscal and thereby forcing government to curtail spending in the second half is not a new phenomenon. Even now by December 2016, around 94 % of the fiscal deficit has already been used up. The need to keep fiscal deficit in check forces government to sharply curtail spending in the last quarter if not the entire second half of the fiscal. In the absence of meaningful private investment this tends to further damp down the economy during the second half.

The nominal GDP growth in H1FY15 was above 13%. However by H1FY15(ie; 30 September 2014) the government had already exhausted 86% of its projected full year Fiscal Deficit(FD) of FY15(INR4.39 trillion). The H2FY15 nominal GDP growth nose-dived to 7% level and thus the full year(FY15) nominal GDP growth was 10.8%. One of the contributing factors has possibly been the sharp curtailment of government spending, which allowed Government to meet a FD target of 4.1% (of nominal GDP) in FY15.

When Mr. Jaitley presented FY2015-16 budget on 28th February 2015, he projected a fiscal deficit of INR 5.55 trillion (1 trillion is 1 Lakh crore). This was expected to be 3.9% of the then (as of Feb, 2015) expected FY16 nominal GDP of INR 141 trillion. This is because the budget expected an 11.5% nominal GDP growth in 2015-16 over the then projected 2014-15 nominal GDP of INR126.5 trillion. Subsequently, the FY15 nominal GDP was re-estimated at a marginally lower amount of INR 124.9 trillion. Since the nominal GDP for FY16 was scaled down from original budget expectations, in order to remain within fiscal deficit target of 3.9% for FY16, the FY16 fiscal deficit of INR 5.55 lakh crore has been reduced to INR5.35 trillion.

***The Moment of truth:*** Thus, the nominal growth rates anticipated in the budget often get revised downward significantly and likewise the government reduces spending to keep the ratio of fiscal deficit in line with budgetary expectations. What is different this year is that the degree of downward revision in nominal GDP estimates may be much higher than has been the case in the past few years. If the spending is reduced by that commensurate amount to keep the fiscal deficit target ratio in check then it may affect the growth of the economy further. Ironically , an approach of fiscal consolidation which is considered conservative may cause larger instability if the growth scenario does not play out.