Syllabus subtopic: Indian Economy and issues relating to planning, mobilization of resources, growth, development and employment.

Prelims and Mains focus: About the economic slowdown and its impact on this year’s budget; measures to be taken to address it; About PMI

Context: Finance Minister Nirmala Sitharaman will present her second budget at a time when the economy has hit rock bottom, with growth plummeting to a six-and-a-half-year low and dismal revenue growth, besides ongoing tensions in West Asia threatening to set oil price soaring to unsustainable limits.

• Therefore, the FM will have to walk a tight rope in boosting demand without allowing fiscal deficit to go off-track.

Background

• The Indian economy had decelerated for the sixth consecutive quarter to 4.5% in the three months ended September, on the back of sagging domestic and overseas demand, while investment recovery remained tepid.

• The latest data by the statistics ministry shows that economic growth may have revived marginally in the second half to help achieve 5% gross domestic product (GDP) growth for 2019-20.

Performance of various indicators

• Recently, there have been some signs of bottoming out of the economy. The manufacturing Purchasing Managers’ Index (PMI) for India shot up in December—the highest since February—after recording a two-year low in October.

• With improvements in a number of leading indicators, including goods and services tax (GST) collections, infrastructure sector growth, automobile sales and non-oil merchandise exports, experts expect factory output to turn positive in November after contracting in September.
What has been the approach of the govt. so far?

- The National Democratic Alliance (NDA) government’s approach so far has been to take incremental sector-specific, supply-side measures.
- The big supply push though came in the form of a cut in corporate tax rates to attract investments by technology companies looking for avenues outside China, amid Beijing’s ongoing trade war with Washington. While it expected to see a big shift in investment activity, the numbers are yet to show up.

Performance on the fiscal front?

- While the fiscal deficit for 2019-20 has been set at 3.3% of GDP, the Centre had already exceeded the full-year target by around 15% in just eight months. Low direct and indirect tax collections, and the tardy pace of the government’s strategic disinvestments, are likely to miss its over-optimistic revenue collection targets in budget 2020 by a fair margin.
- In fact, the corporate tax rate cuts will further dent direct tax collections. The underperformance of the Centre’s tax revenues will also affect the capacity of the state governments to spend.
- However, non-tax revenue receipts, excluding the transfers from the central bank, may look a lot better next fiscal year if the government manages to successfully privatize Bharat Petroleum Corp. Ltd (BPCL), Container Corp. of India Ltd (Concor) and Air India.

Leveraging the FFC

- The government may heave a sigh of relief that the tenure of the 15th Finance Commission, which will submit a fresh fiscal consolidation road map for both the Centre and states, has been extended by a year.
- This may allow the finance minister to digress from the fiscal consolidation path one last time, while committing to the fresh road map. However, what could complicate matters is rising crude prices.

Concerns for India’s GDP

- The rising oil prices is a cause for concern. It will adversely impact inflation, fiscal deficit and current account deficit, as well as GDP growth. In such a scenario, the government’s capacity to intervene will remain constrained.
• **Low nominal GDP growth** will weaken the government’s capacity to introduce strong fiscal stimulus measures, because it constraints growth in tax revenues.

• Thus, in spite of the low growth, **countercyclical policy**, both in the form of monetary or fiscal stimulus, remains constrained. There is thus a likelihood of the current economic slowdown stretching itself for a few more quarters, reflecting in a U-shapes, rather than a V-shaped recovery.

• **Lower real GDP growth** and **subdued inflation** in most part of the current fiscal year has led to the **nominal GDP growing at 6.1%** in the third quarter. For FY20, the statistics ministry has estimated it at 7.5%.

**What should the govt. do?**

• Under the current circumstance of weak growth impulses, the government needs to **boost consumption demand**. Consumption demand has been a casualty during the economic downturn and government needs to support that.
• The govt. should **direct resources towards spending**, which increases consumer demand through **PM-KISAN, NREGA** or construction activity.
• It should take some more measures in the **residential real estate sector**, which has been doing badly. It has announced a **subvention scheme**, but it needs to provide support for purchase of houses.

**About Purchasing Managers’ Index**

PMI or a Purchasing Managers’ Index (PMI) is an indicator of business activity — both in the manufacturing and services sectors. It is a survey-based measure that asks the respondents about changes in their perception of some key business variables from the month before. It is **calculated separately** for the manufacturing and services sectors and then a composite index is constructed.

**How is the PMI derived?**
The PMI is derived from a series of qualitative questions. Executives from a reasonably big sample, running into hundreds of firms, are asked whether key indicators such as output, new orders, business expectations and employment were stronger than the month before and are asked to rate them.

**How does one read the PMI?**

A figure above 50 denotes expansion in business activity. Anything below 50 denotes contraction. Higher the difference from this mid-point greater the expansion or contraction. The rate of expansion can also be judged by comparing the PMI with that of the previous month data. If the figure is higher than the previous month’s then the economy is expanding at a faster rate. If it is lower than the previous month then it is growing at a lower rate.

**What are its implications for the economy?**

The PMI is usually released at the start of the month, much before most of the official data on industrial output, manufacturing and GDP growth becomes available. It is, therefore, considered a good leading indicator of economic activity. Economists consider the manufacturing growth measured by the PMI as a good indicator of industrial output, for which official statistics are released later. Central banks of many countries also use the index to help make decisions on interest rates.

**What does it mean for financial markets?**

The PMI also gives an indication of corporate earnings and is closely watched by investors as well as the bond markets. A good reading enhances the attractiveness of an economy vis-a-vis another competing economy.