INDIA

Economic growth will slow somewhat but remain robust, at close to 7½ per cent in 2019 and 2020. Higher oil prices and the rupee depreciation are putting pressure on demand, inflation, the current account and public finances. However, business investment and exports will be strong, as past structural reforms – including the new Insolvency and Bankruptcy Code, smoother implementation of the Goods and Services Tax (GST), better roads and electricity and bank recapitalisation – are paying off.

Monetary policy will need to be tightened as inflation expectations are trending up and there are several upside risks to inflation. Containing the relatively high public debt-to-GDP ratio would require controlling contingent liabilities, such as those stemming from public enterprises and banks. Further subsidy reform would help make social spending more effective. Improving public banks' governance is also key to avoid a new wave of non-performing loans and to support the investment recovery.

Investment and exports are key growth engines

Investment is growing steadily, driven by the gradual increase in capacity utilisation, large infrastructure programmes and recent structural reforms which are supporting investors' confidence, in particular the new Insolvency and Bankruptcy Code and public bank recapitalisation. The rebound in exports is supported by a weaker rupee and an easier-to-comply-with Goods and Services Tax. Private consumption remains strong, in particular in rural areas where incomes are benefitting from the good monsoon and steady government spending on rural roads, housing and employment programmes.

Consumer price inflation remains within the target band, partly reflecting one-off factors, such as a good monsoon, lower excise taxes on oil products and the government's request to public-sector oil marketing companies to lower their margins. However, pressures on inflation are rising from the rupee depreciation and recent increases in wages and housing allowances for public employees. Core inflation and inflation expectations are edging up.

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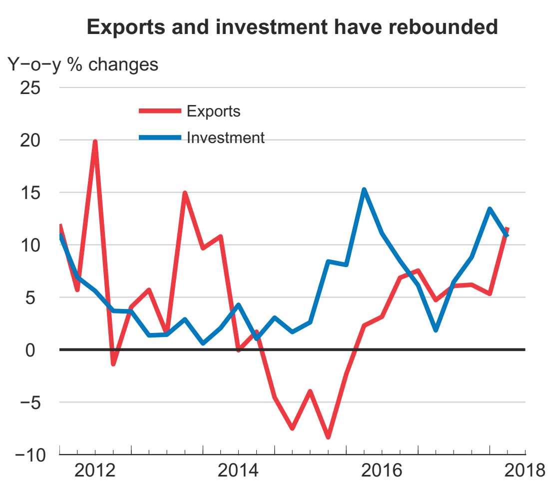

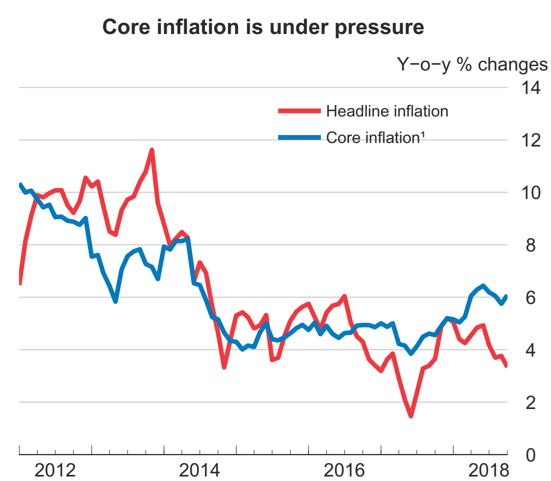

1. Core inflation excludes food, beverages and fuel.
Source: OECD Economic Outlook 104 database; and Central Statistics Office.

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India: **Demand, output and prices**

	2015	2016	2017	2018	2019	2020
	Current prices INR trillion	Percentage changes, volume (2012/2013 prices)				
GDP at market prices	137.6	7.1	6.7	7.5	7.3	7.4
Private consumption	80.9	7.3	6.6	7.2	7.4	7.4
Government consumption	14.3	12.2	10.9	7.0	7.3	5.3
Gross fixed capital formation	39.2	10.1	7.6	6.2	6.0	8.6
Final domestic demand	134.4	8.6	7.3	6.9	7.0	7.5
Stockbuilding[1]	6.4	-1.2	0.0	0.1	0.0	0.0
Total domestic demand	140.8	6.9	8.1	8.3	6.9	7.5
Exports of goods and services	27.3	5.0	5.6	8.9	4.5	6.3
Imports of goods and services	30.4	4.0	12.4	12.0	3.4	6.9
Net exports[1]	- 3.2	0.1	-1.5	-0.9	0.1	-0.3
Memorandum items						
GDP deflator	_	3.5	3.1	4.9	4.7	4.3
Consumer price index	_	4.5	3.6	4.5	5.0	4.5
Wholesale price index[2]	_	1.7	2.9	4.8	4.6	4.3
General government financial balance[3] (% of GDP)	_	-7.0	-6.6	-6.4	-6.2	-6.0
Current account balance (% of GDP)	_	-0.6	-1.9	-2.1	-2.8	-3.0

Note: Data refer to fiscal years starting in April.
1. Contributions to changes in real GDP, actual amount in the first column.
2. WPI, all commodities index.
3. Gross fiscal balance for central and state governments.
Source: OECD Economic Outlook 104 database.

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The current account deficit is increasing, driven by India's growth differential with other economies and higher oil prices. Financing the deficit is becoming more challenging as foreign direct investment inflows are sluggish and portfolio capital is being pulled out by higher yields in advanced economies. The government has hiked import duties to limit the current account deficit and lessened constraints on firms' external borrowing. The

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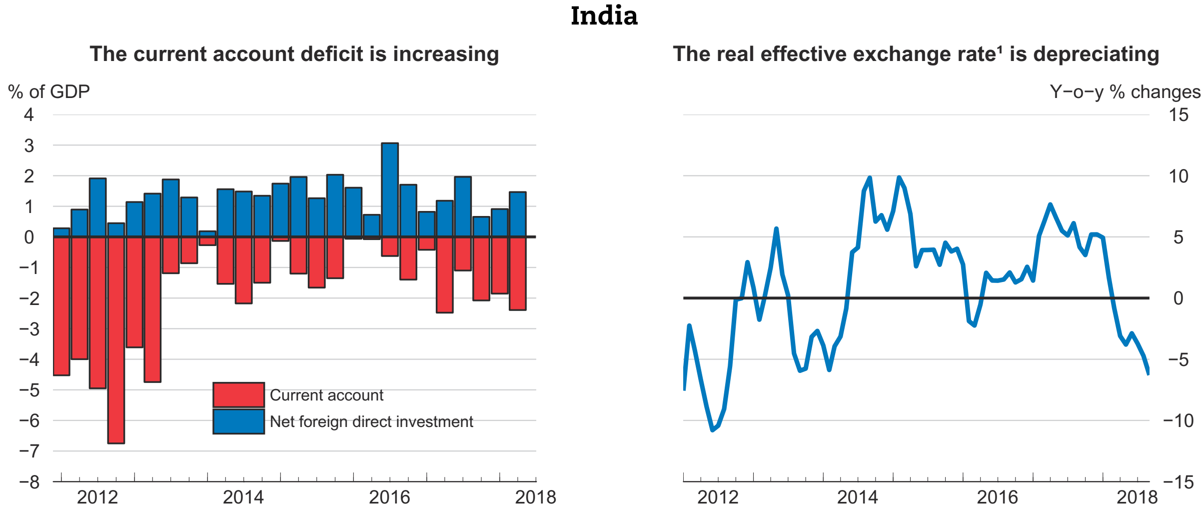

1. Real effective exchange rate calculated using a basket of 36 currencies (trade weighted).
Source: Reserve Bank of India.

StatLink http://dx.doi.org/10.1787/888933876803 depreciation of the real effective exchange rate remains moderate. External vulnerability is now less of a concern than in previous episodes of financial turmoil as macroeconomic fundamentals have improved and foreign exchange reserves have been replenished.

Further structural reforms are key to improving living standards for all

India has little fiscal and monetary space. Ratios of public deficit and debt to GDP remain high. Demonetisation, GST and tax amnesties have spurred the formalisation of the economy and resulted in an increase in the number of taxpayers. However, the hike in public wages and pensions, stress in corporate and bank balance sheets, debt waivers for farmers and cuts in excise taxes are putting pressure on fiscal outcomes. As a result, there is little scope to finance better infrastructure and social services. To maintain inflation within the target range and anchor inflation expectations, the projections incorporate marginal increases in monetary policy rates.

Structural reforms are vital for sustaining growth and rising living standards. The ongoing subsidy reform – replacing price subsidies by direct cash transfers to households *via* their bank account and using a unique identification number – makes household support more equitable and efficient. It also improves financial inclusion, reduces market distortions and generates public savings. Successful local experiments in reforming food and fertiliser subsidies should be extended. The new Insolvency and Bankruptcy Code (IBC) helps resolve non-performing loans and gradually changes debtors' behaviour. Reaping the full benefits of the IBC would require increasing judicial resources. Getting the financial sector back to health would require that the planned recapitalisation of public banks be accompanied by governance reforms and better systems to avoid bank fraud.

Creating more and better jobs is a priority to raise living standards and reduce informality and income disparities. Adjusting training programmes to meet employers' needs is essential to support job creation in the formal sector, productivity and export performance. Labour regulation reforms at the state level should be assessed and replicated if successful. This would require up-to-date data on employment and the quality of jobs. There is also scope to boost India's participation in global value chains, productivity, and incomes by further improving the ease of doing business and opening India more to trade and investment.

Growth is projected to remain strong in 2019 and 2020

Tighter financial conditions, higher oil prices, adverse terms of trade, lower growth in partner countries, and rising political uncertainties in India and abroad will tend to reduce growth somewhat. Even so, economic activity is projected to slow only marginally from a high level. Recent improvements in the GST administration, enabling exporters to get faster tax refunds, and the depreciation of the rupee will boost exports. Corporate investment will remain vigorous, supported by recent structural reforms and better infrastructure (in particular road and energy provision). Inflation pressures will be reinforced by the decision to raise minimum support prices and government purchases of some agricultural products. The Reserve Bank's credibility in targeting inflation and the projected marginal increases in policy rates will help anchor inflation. Confidence and investment would suffer from unexpected difficulties in non-bank financial institutions and delays in reducing non-performing loans. A further increase in oil prices and contagion from turbulence in other emerging-market economies are the major external risks. On the other hand, the hike in US tariffs on Chinese imports could benefit India's exports, in particular in the textile sector.