The challenge of achieving 9.5% growth rate

The key lies in the government's ongoing emphasis on infrastructure spending as reflected in its capital expenditure

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The National Statistical Office (NSO) released the second quarter gross value added (GVA) and gross domestic product (GDP) numbers on November 30, 2021, indicating the pace of economic recovery in India after the two COVID-19 waves. The contraction was highest in the first quarter of 2020-21, gradually easing off in the subsequent quarters. The resultant base effect was the strongest in the first quarter of 2021-22 as reflected in real GDP and GVA growth rates of 20.1% and 18.8%, respectively. The base effect weakened in the second quarter with GDP and GVA growth rates at 8.4% and 8.5%, respectively. Considering these two quarters together, the real GVA for the first half of 2021-22 at ₹63.4 lakh crore has remained below the level in the first half of 2019-20 at ₹65.8 lakh crore by (-)3.7%. This difference is even larger for GDP which at the end of first half of 2021-22 stood at ₹68.1 lakh crore, which is (-) 4.4% below the corresponding level of GDP at ₹71.3 lakh crore in 2019-20. As the base effect weakens in the third and fourth quarters of 2021-22, a strong growth momentum would be needed to ensure that at the end of this fiscal year, in terms of magnitude, GVA and GDP in real terms exceed their corresponding pre-COVID-19 levels of 2019-20.

Sectors that improved

In the first half of 2021-22, on the output side, only four of the eight GVA sectors have exceeded their corresponding 2019-20 levels. These are agriculture; electricity, gas, et al.; mining and quarrying; and public administration, defence and other services. Of these, the first and second quarter growth of public administration, defence and other services was at 5.8% and 17.4%, respectively. The upsurge in the growth of this sector in the second quarter of 2021-22 reflects the Central government's emphasis on capital expenditure which started gathering momentum in recent months. The Central government capital expenditure grew by 38.3% during the first half of 2021-22. This emphasis on government investment expenditure, supplemented by recovery of private investment expenditure, resulted in gross fixed capital formation (GFCF) showing a positive growth of 1.5% in the second quarter of 2021-22 over its corresponding level in 2019-20. However, even in this case, the level of GFCF in the first half of 2021-22 has remained below its corresponding level in 2019-20 by a margin of ₹1.93 lakh crore. Overall, domestic demand including private final consumption expenditure (PFCE) in the first half of 2021-22 remains below its corresponding level in 2019-20 by nearly ₹5.5 lakh crore. This indicates that investment as well as consumption demand have to pick up strongly in the remaining two quarters to ensure that the economy emerges on the positive side at the end of 2021-22 as compared to its pre-COVID-19 level. Private consumption demand would pick up with employment and income growth, especially in the small and medium sectors, which is linked to the recovery in

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the services sectors, particularly the trade, hotels et al. sector. This may happen in the second half of 2021-22 provided economic activities are not beset again by COVID-19's new strain, Omicron.

Annual growth prospects

To realise the projected annual growth at 9.5% for 2021-22 given both by the Reserve Bank of India (RBI) and the International Monetary Fund (IMF), we require a growth of 6.2% in the second half of 2021-22. This will have to be achieved even as the base effect weakens in the third and fourth quarters since GDP growth rate in these quarters of 2020-21 was at 0.5% and 1.6%, respectively. Thus, achieving the projected growth rate of 9.5% is going to be a big challenge. Had the growth rate of the second quarter been higher, the task would have been easier. If, in fact, we achieve the growth rate 9.5% in 2021-22, we can be confident that 2022-23 will see a growth rate of 6% to 7%.

The policy instrument for achieving a higher growth may have to be a strong fiscal support in the form of government capital expenditure. This is currently being facilitated by the buoyant Centre's gross tax revenues. The Centre's gross tax revenues have shown an unprecedented growth rate of 64.2% and a buoyancy of 2.7 in the first half of 2021-22. The nominal GDP growth at 23.9% and the implicit price deflator-based inflation at 9.0% in H1FY22 is the key reason for the buoyant tax revenues. The fiscal deficit target of 6.8% may come under pressure because of upward revisions in some expenditure items such as food and fertilizer subsidies, MGNREGA and extension of the Pradhan Mantri Garib Kalyan Anna Yojana along with some shortfall in non-tax and non-debt capital receipts. In spite of these pressures, it would be advisable for the Centre to continue infrastructure spending. The Centre's incentivisation of state capital expenditure through additional borrowing limits would also help in this regard. According to available information, 11 States in the first quarter and seven States in the second quarter qualified for the release of the additional tranche under this window. Even as Central and State capital expenditures gather momentum, high frequency indicators reflect an ongoing pick-up in private sector economic activities.

High frequency indicators

PMI manufacturing increased to a 10-month high of 57.6 in November 2021, increasing from 55.9 in October 2021. PMI services remained high at 58.1 in November 2021, its second-highest level since July 2011. Gross GST collections at ₹1.31 lakh crore remained above the benchmark of ₹1 lakh crore for the fifth consecutive month in November 2021. Core IIP growth increased to 7.5% in October 2021 from 4.4% in September 2021. Compared to its October 2019 value, core IIP showed a growth of 7.0% in October 2021. Merchandise exports growth was at 26.5% in November 2021 and 43.0% in October 2021 as compared to the corresponding month of the previous year. When compared to 2019 levels, exports grew by 35.9% in October and 15.9% in November 2021, reflecting robust external demand.

An important difference between 2019-20 and 2021-22 arises from the performance of the Centre's gross tax revenues (GTR). The growth in the Centre's GTR in the first half of 2019-20 was at 1.5% and there was a contraction of (-)3.4% for the year as a whole. In the face of such weak revenues, the Central government could not mount a meaningful fiscal stimulus in 2019-20 even as real GDP growth fell to 4.0%. In contrast, the government is in a significantly stronger position in 2021-22 since the growth in GTR in the first half is 64.2% and the full year growth is expected to be quite robust. Thus, the key to attaining a 9.5% real GDP annual growth in 2021-22 lies in the government's ongoing emphasis on infrastructure spending as reflected in government's capital expenditure. This is also seen in the high real growth in public administration, defence and other services of 17.4% in the second quarter of 2021-22. It is imperative that this momentum is sustained in the remaining part of the fiscal year.

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