Flagging uncertainty

Nothing can better capture the state of uncertainty in the minds of policymakers ahead of the Union Budget than the observation that "economic management will be challenging in the coming year". This telling statement in the Economic Survey comes even as the Union Finance Ministry's customary pre-budget document expects India's GDP growth for 2017-18 to be "close to" 6.75 per cent — better than the Central Statistics Office's forecast of 6.5 per cent — further picking up to "between 7 and 7.5 per cent" in the coming fiscal. Given that the worst from the twin shocks of demonetisation and GST is over, exports are growing at a healthy clip on the back of a synchronised global economic recovery, and an insolvency resolution framework-cum-recapitalisation package to deal with the banking system's bad loans problem is finally in place, there is enough cause for cautious optimism today. Yet, the overall sense from the Survey is one of ambivalence.

There are three main sources of uncertainty facing the economy that the Survey has flagged. The first is, of course, oil. A $10-per barrel increase in global crude prices is estimated to reduce India's growth by 0.2-0.3 percentage points, increase wholesale inflation by about 1.7 percentage points and worsen the current account deficit by $9-10 billion. In 2015-16 and 2016-17, the cost of crude imported by Indian refiners averaged $46-47 per barrel, which is now over $65. That, apart from crimping spending power of households, could also force the RBI to raise interest rates to contain inflationary pressures. The second risk factor is fiscal. While the number of tax filers has gone up significantly after demonetisation and GST, the revenue buoyancy from it would, however, take time to accrue. In the interim, the pressure to cut excise duties on petroleum products — and extending of other sops in a year of state elections leading to the big one in 2019 — may engender a "pause" in fiscal consolidation, as the Survey admits. The third eventuality to guard against is a sharp correction to elevated stock prices. The danger here is not just the dent to sentiment from investors losing money, but of capital outflows happening and the RBI responding again by tightening monetary policy, thereby choking off a nascent recovery.

There's nothing that the current government can do about oil prices. Nor should it bother overly about stock valuations; much of it represents a healthy reallocation of savings from physical to financial assets. What the government can do is not to indulge in fiscal adventurism. At a time when global central banks are in the process of withdrawing monetary stimulus, the risk of capital outflows can be real. We saw this during May-August 2013. India paid the price of macroeconomic instability then. It shouldn't pay that price again.

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