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Dealing with the macroeconomic uncertainties

The Union Budget needs to maintain an accommodative fiscal stance to support the sustainability of economic growth

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Macroeconomic uncertainties are mounting. Against the backdrop of possible interest rate hikes by the U.S. Federal Reserve and the taper tantrum, there is pressure on the Reserve Bank of India (RBI) to increase its interest rates to prevent capital outflows. The monetary policy corridor is still "accommodative" to support the growth recovery. Globally, central banks have started increasing the interest rates. However, we need to wait for the Monetary Policy Committee meeting in February 2022 to understand the RBI's decisions regarding policy rates.

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Inflationary pressures

Inflationary pressures are also high. In India, the wholesale price index (WPI) inflation rose to a record high of 14.32% in November 2021 as per the data released by the Ministry of Commerce and Industry. The WPI decreased slightly to 13.56% in December 2021. The consumer price index (CPI) inflation now is 5.03%, though that is still within the comfort zone of the inflation targeting framework envisaged in

India's new monetary framework. The official nominal inflation anchor in India is 4%, with a band of variations of +/- 2. It has been argued that the inflation we are currently experiencing is transitory in nature due to supply chain disruptions and volatile energy and food prices.

Absorbing the excess liquidity that was injected to stimulate growth as part of the pandemic response is crucial to reversing trends in non performing assets (NPAs). The RBI Financial Stability Report, published on December 29, 2021, revealed a possible worsening of the gross non performing asset (GNPA) ratio of scheduled commercial banks — from 6.9% in September 2021 to 9.5% by September 2022 — under a "severe stress scenario" estimates.

The RBI has not yet formally announced any "normalization" procedure, though absorption of excess liquidity was attempted by increasing the cut-off yield rate of variable rate reverse repo (VRRR) to 3.99%, and curtailing the government securities acquisition programme.

Interest rates structure

The structure of interest rates is also a matter of concern. The call money market rates are below the repo rate. The bond yields are increasing ahead of the Union Budget 2022-23. The cut off yield rate of 10-year benchmark bond is as high as 6.63%. The rise in bond yields will result in higher borrowing costs for the Government.

Given these macroeconomic uncertainties, maintaining an accommodative fiscal policy stance in the upcoming Union Budget for FY23 is crucial for a sustainable recovery. The fiscal deficit as a percentage of GDP rose to 9.5% in 2021–22 (revised estimates). The RBI estimates suggest that revenue deficit pre-empted about 70% of the gross fiscal deficit during the period 2018-19 to 2019-20 and increased further to 79% in 2020-21 (revised estimates) and 76% in 2021-22 (Budget estimates).

Any attempt at fiscal consolidation at this juncture employing capital expenditure compression rather than a tax buoyancy path can adversely affect economic growth. Public investment — infrastructure investment in particular — is a major growth driver through "crowding-in" of private corporate investment.

Omicron is a reminder that the COVID-19 pandemic is still not over. Public spending on healthby the Union government is still below 1% of GDP, though the estimate has increased from 0.2% of GDP in 2020–21 (revised estimates) to 0.4% of GDP in 2021-22 (Budget estimates). Strengthening investments in the health-care sector is crucial at this juncture as a prolonged lockdown can accentuate the current humanitarian crisis and deepen economic disruptions.

Bringing down the fiscal deficit now can be detrimental to economic growth recovery. The plausible "fiscal risks" arising from the mounting public debt and deficits need to be tackled with a medium-term road map of fiscal consolidation, as instantaneous deficit reduction can affect the sustainable growth recovery process.

When credit-linked economic stimulus has an uneven impact on growth recovery, the significance of fiscal dominance cannot be undermined. We argue that the upcoming Union Budget for 2022-23 should maintain an accommodative fiscal stance in order to support the sustainability of the economic

growth process and also for financing human development, which is crucial in the time of a pandemic.

Address unemployment

Rising unemployment needs to be addressed through an urgent policy response that strengthens job guarantee programmes. The welfare models of the Government in providing food security to poor households and designing gender budgeting in energy infrastructure are also welcome. However, we need to go further to strengthen social sector policies in the time of a pandemic. To deal with these issues and more, maintaining an accommodative fiscal policy stance in the upcoming Union Budget for 2022-23 is crucial.

The advance GDP estimates released by the National Statistical Office on January 7, 2022, revealed that India's GDP growth rate will be 9.2% in FY22. In FY21 it was 7.3%. However, this growth estimate is lower than that published by the RBI in December 2021, which was 9.5%. The growth in nominal GDP is estimated to be 17.6%. These GDP estimates published ahead of the announcement of the Union Budget 2022-23 are significant as they will be used for projections — including those for the fiscal deficit — in the upcoming Budget. How India emerges from the pandemic to meet these estimates will depend largely on an accommodative fiscal policy stance when monetary policy has limitations in triggering the growth recovery.

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