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Helping Indian economy down the road to recovery

 Lekha Chakraborty, Harikrishnan S write: An accommodative stance on public spending in budget holds key to economic revival

Written by [Lekha Chakraborty](#) , [Harikrishnan S](#) |

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People wear face mask as a precaution in a market in Jammu on January 21, 2022. (AP Photo Anand)

As per the recent GDP estimates, the Indian economy will grow at 9.2 per cent in 2021-22. However, this is lower than the Reserve Bank of India's estimate of 10.1 per cent made in December last year. The nominal GDP is estimated to grow at 10.1 per cent. These GDP estimates published ahead of the Union budget 2022-23 are significant as they will be used for fiscal projections. The economy is expected to recover to its pre-Covid level by the end of this fiscal year. The country's growth trajectory will, however, largely depend on the government's fiscal policy that takes into account the limitations of the monetary policy in triggering a recovery.

The central bank has adopted a "whatever it takes" stance to deal with the pandemic. The status quo has been maintained on key policy rates over several [monetary policy committee](#) (MPC) decisions. Though the RBI has not yet "formally announced any "normalisation procedure", it is absorbing excess liquidity through raising the cut-off yield rate of VRRR (Variable Rate Reverse Repo) and curtailing the G-sec acquisition programme. As Joseph Stiglitz and Hamid Rashid have j



related policies alone cannot lead a country out of the macroeconomic crisis. However, absorbing the excess liquidity that was injected as part of the pandemic response to stimulate the economy is necessary as there is the possibility of an increase in non-performing assets (NPAs).

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There is mounting pressure on the RBI/MPC to increase the interest rates against the backdrop of taper tantrum and the possible interest rate hikes by the US to prevent a capital flight. Globally, central banks have started increasing interest rates. However, no firm decision has been taken in India as an increase in the rates can affect the recovery.

Inflationary pressures are also mounting. The [Wholesale Price Index \(WPI\) inflation](#) has risen to a record high of 13.56 per cent in December 2021 as per the Ministry of Commerce and Industry's data. At 5.59 per cent in December 2021, the Consumer Price Index inflation, though within the comfort zone of the inflation targeting framework of 4 per cent with a band of plus/minus 2 per cent, is close to the framework's upper threshold.

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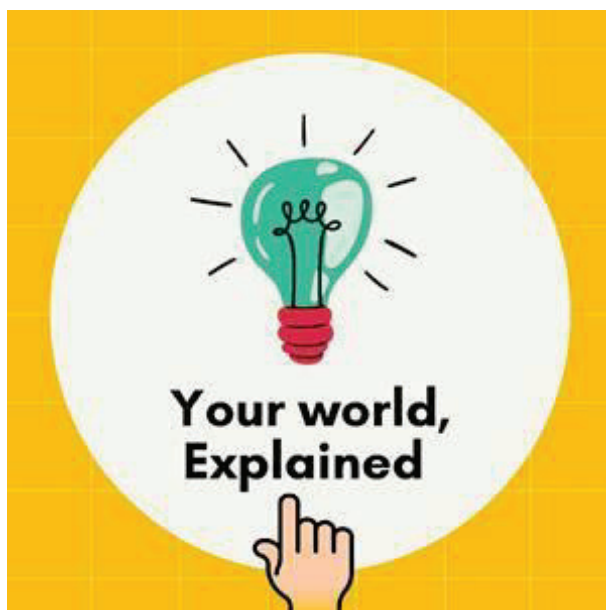
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Given these macroeconomic uncertainties, maintaining an accommodative fiscal posture in the upcoming Union budget is crucial for a sustainable recovery. The deficit as a percentage of GDP is expected to decline from 9.5 per cent in 2020-21 to 79 per cent in 2021-22. The RBI's estimates suggest that revenue deficit pre-empted about 76 per cent of the gross fiscal deficit during the

period 2018-19 to 2019-20, which increased further to 79 per cent in 2020-21 and 76 per cent in 2021-22 (BE). Thus, any attempt at fiscal consolidation at this juncture through compression in capital expenditure can adversely affect economic growth.

Public investment in infrastructure is a major growth driver. Bringing down fiscal deficit to threshold levels can be detrimental to the recovery. The plausible "fiscal risks" arising from mounting public debt and deficits need to be tackled through a medium-term roadmap of fiscal consolidation, as an immediate deficit reduction can affect the recovery process. Considering that the impact of a credit-linked stimulus on the economy is limited, the significance of fiscal dominance cannot



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This column first appeared in the print edition on January 25, 2022 under the title 'Nurturing the recovery'. Chakraborty is professor at NIPFP and Harikrishnan is an independent analyst.

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