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Home is where growth is

CRISIL Outlook | Fiscal 2017

Economy to grow at 7.9% in fiscal 2017

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Recovery needs another dose of good luck

Indeed, 2016 has begun on an ominous note. Both the International Monetary Fund and the World Bank have pared their global growth outlook for the year amid increasing signs of debility in the emerging markets. And once again, China has emerged as the epicentre of global risk and volatility.

For India, such a predicament cuts both ways. While a slowing world implies prices of crude oil and the commodity complex will remain battered, which will bolster the fiscal math, sluggishness in global demand will prolong the agony for exporters. That means the trigger for growth in fiscal 2017 will come from within -- or the domestic economy -- and, as in the current fiscal, another dose of good luck through low crude oil prices will be handy.

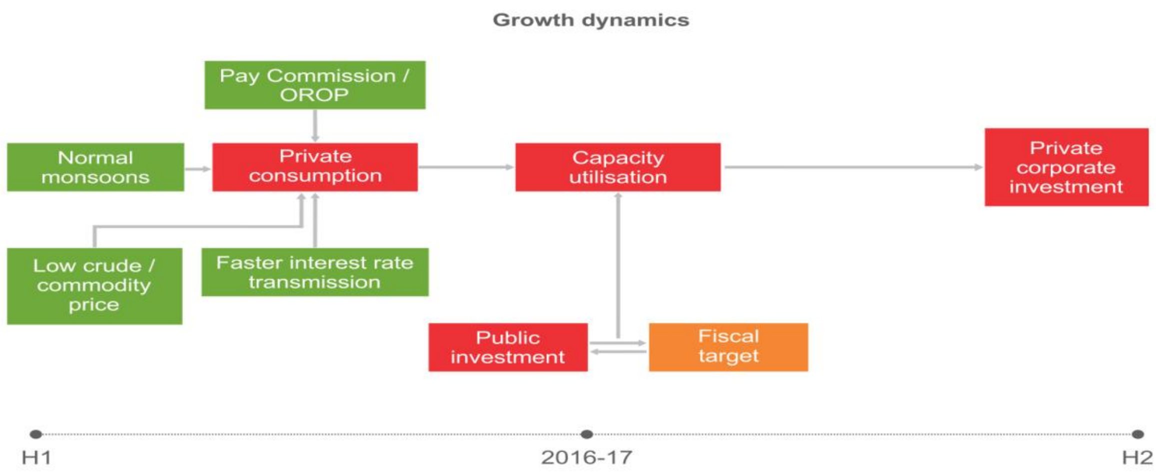
We see India's GDP growth at 7.9% in fiscal 2017

The Indian economy has weathered two successive monsoon failures plus damage from unseasonal rains in early 2015 with no deleterious repercussion on inflation and growth. A normal monsoon in fiscal 2017 will give agriculture a one-time growth kicker because of the low-base effect of the last two years. This should lift sagging rural demand and, by extension, overall GDP growth. The good part is, weather experts presage a La Nina event this year that lavishes rains.

Growth in the next fiscal will also find mild support from improved transmission of the Reserve Bank of India's policy-rate cuts and the implementation of the salary and pension revisions recommended by the One Rank One Pension Scheme and the Seventh Pay Commission. On its part, and to pump the prime, the government has tried to frontload investments in roads, railways and defence. We expect this approach to continue in the next fiscal, too. These factors will, in turn, raise capacity utilisation and create conditions for new investment by the private sector, especially in manufacturing. But if there is a third consecutive monsoon failure, consumption and private investment recovery will be delayed anew.

To slot sustainably into a higher growth trajectory, the country will have to address issues plaguing private investment and clean up bank balance sheets. India's investment to GDP ratio has fallen for five straight fiscals. Companies in infrastructure and other asset-heavy sectors will also need to deleverage materially. At the moment, progress on this front is tardy.

Read on for our detailed outlook for fiscal 2017.



Outlook for fiscal 2017

Our estimates show that India's economy will grow at 7.9% next fiscal from 7.6% expected in the current one, if supported by a normal monsoon. So far, the economy's modest recovery has been shaped by good luck on crude oil and commodities, and a supportive policy environment. While this is expected to continue, India cannot afford to be third-time unlucky with rains. We have revised downwards our growth forecast for next fiscal from 8.1% earlier due to intensifying global headwinds. Both the International Monetary Fund and the World Bank have already lowered their global growth forecasts for 2016 by 20 and 40 basis points (bps), respectively.

Next fiscal, we expect consumer price inflation (CPI) to stay soft at 5% and unchanged from fiscal 2016. This is assuming a normal monsoon, lesser decline in global oil and commodity prices, and sticky services sector-led components of consumer prices.

As for current account deficit (CAD), we expect mild upward pressure because imports are likely increase on a revival in investments and consumption. Exports, on the other hand, are expected to stay in the bog. The upshot is that we see CAD inching up to 1.6% of GDP next fiscal from an expected 1.3% in the current fiscal.

The rupee will be supported by improving growth-inflation mix, sufficient foreign exchange reserves, and low inflation and CAD. We also expect the government to improve the ease of doing business even more, and pass important reforms such as the Goods and Services Tax (GST), which can improve investor appetite. We expect the rupee to settle around 65 per US$ by March 31, 2017.

Indeed, the next fiscal will be closely watched for more reforms and implementation of executive action already announced. It will also be a year to spruce up bank balance sheets, reduce leverage in infrastructure and other asset-heavy sectors, and pull electricity distribution companies out of their financial quagmire. And expeditious legislation of GST and bankruptcy code will materially raise India's potential-growth rate.

Our key projections at a glance:

	FY14	FY15	FY16F	FY17F
GDP (%)	**6.9**	**7.3**	**7.6***	**7.9**
CPI (%, average)	9.2	6.0	5.0	5.0
CAD (% GDP)	-1.7	-1.3	-1.3	-1.6
Fiscal deficit (% GDP)	4.4	4.0	3.9	3.5
Exchange rate (March-end)	60.1	62.6	66.0	65.0
G-sec yield (%, March-end)	8.8	7.7	7.6	7.5

*Source: CEIC, CRISIL Research, Note: * Advance Estimates*

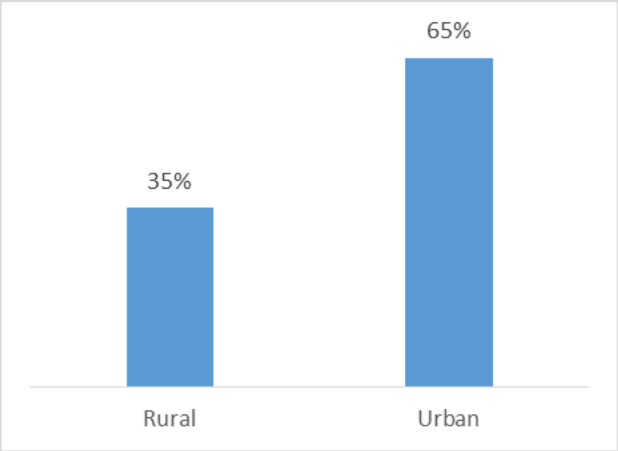
Monsoon will be a major factor next fiscal, and will impact:

a) ***The pace and quantum of consumption revival and thereby improvement in capacity utilisation:*** Household consumption data show 35% of the total consumption demand in India is from hinterland. Also, in the rural areas, 24% of consumption is towards discretionary items. A normal monsoon will mean this part of overall demand will be stoked as incomes rise.

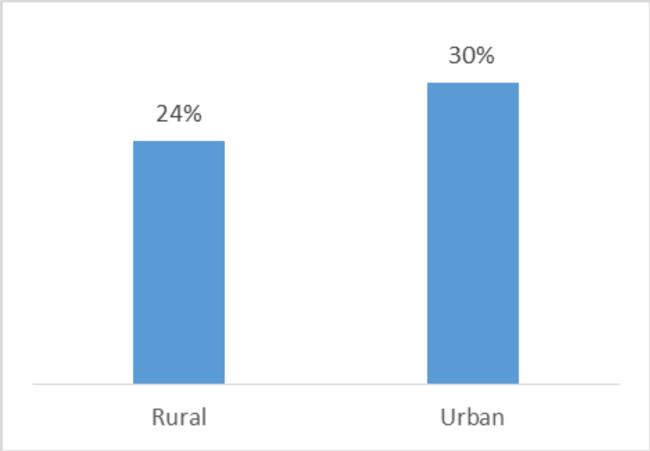
b) ***The performance of non-agriculture sector linked to agriculture:*** Improved outlook for rural economy will positively impact non-agriculture sectors such as manufacturing and services. The rural economy has a 51% share in manufacturing, and 26% share in services.

c) ***Inflation pressure in the economy:*** Despite the overall decline, inflation in rural areas has softened to a lesser extent and also remains higher than urban inflation. In the first 9 months of the current fiscal, rural inflation has fallen only by 100 bps compared with a 200 bps fall in urban inflation. This, coupled with the hit to rural incomes has eroded purchasing power.

Rural/urban consumption split

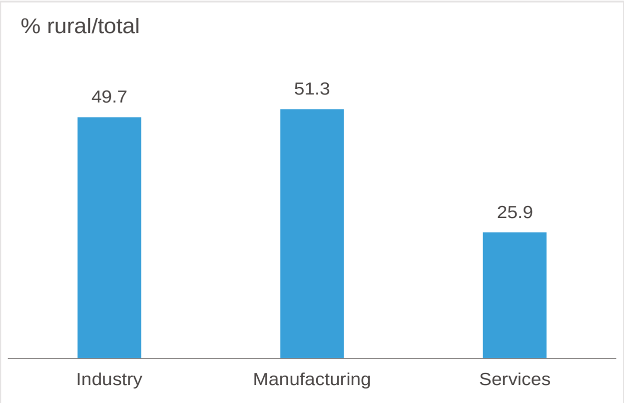


Discretionary spending out of total spending

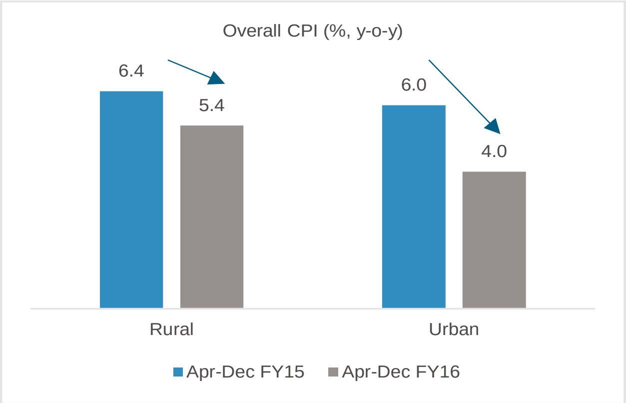


Source: NSSO, CRISIL Research

Share of rural economy in non-agriculture sectors



Inflationary pressure higher in hinterland



Source: CSO, CEIC, CRISIL Research

Base-case scenario: A normal monsoon

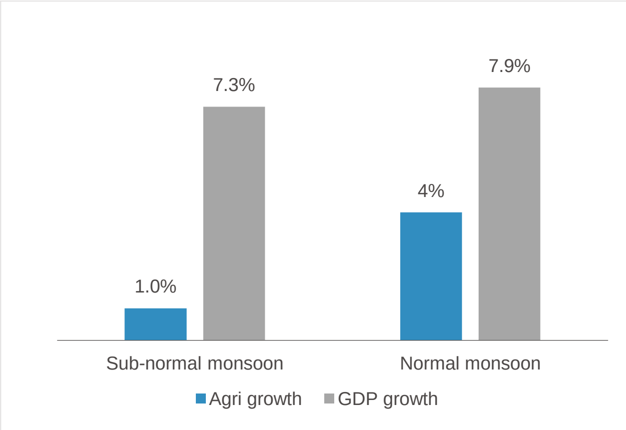
Our base case assumes a normal southwest monsoon accompanied by favourable temporal and regional distribution. Recent weather developments support this assumption. Weather experts have said El Niňo conditions will decline in the coming months and things will return to normal by the first quarter of next fiscal. Based on 26 El Niňo events since 1990, half of the incidents have been followed by a neutral year, while 40% have been followed by a La Niňa event --- where sea-surface temperatures cool and there's higher rainfall. The Australian Metrological Bureau estimates that a neutral or La Nina condition is equally likely in the second half of calendar 2016, while a repeat occurrence of El Niňo is least likely.

Given this, agriculture will grow at an above-trend level of 4% on a weak base caused by two consecutive poor monsoons. Therefore, in the base case, we expect GDP to grow 7.9% in fiscal 2017. The major impetus will come from the farm as non-agriculture growth picks up 10 bps over the previous fiscal to 8.6%.

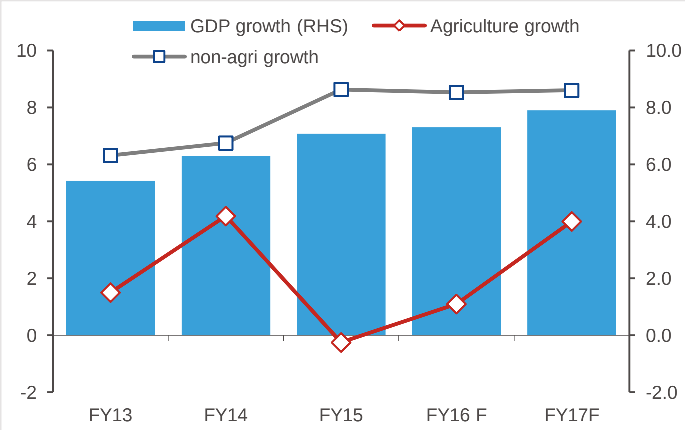
Bear-case scenario: A sub-normal monsoon

If there is a hat-trick of sub-normal monsoons, agriculture growth will stagnate around 1%, amplify farm stress, crunch rural demand and ultimately drag down non-agriculture growth. In fiscal 2016, a sub-normal monsoon and muted rural demand weighed on industry (e.g. lower sales of tractor and two-wheelers, etc.) and pushed back revival in private consumption. Given that the rural economy accounts for 50% of the industrial output and 26% of services sector GDP, a poor monsoon can lower GDP growth to 7.3% next fiscal.

GDP equations, fiscal 2017



Agriculture will provide the impetus



Source: CSO, CEIC, CRISIL Research

Dissecting the recovery

Ground indicators such as credit growth, capacity utilisation and investments indicate the recovery is nascent and this is reflected in low nominal GDP growth. Growth is expected to gain momentum as the government continues to undertake structural reforms, the steps taken in the last 18 months seep through, and the recommendations of the Seventh Pay Commission and OROP are implemented.

That said, the quantum and sustainability of the pick-up in growth will depend a lot on the munificence of the rain god. Private consumption recovery, so critical to stoking private corporate investment, has been firing on one cylinder so far -- urban demand – even as rural distress remains at elevated levels. A normal monsoon will thus be critical to the pace of recovery. Beyond farms, we see the recovery to be moderate, driven mainly by a rise in manufacturing growth.

Next fiscal, assuming a normal monsoon, the lagged impact of interest rate reductions will also start filtering through in the first half. Crude oil prices are expected to remain low and have been assumed at an average of $42.5 per barrel. In addition, we expect Pay Commission payouts, low inflation and easy monetary conditions to support overall demand.

On its part, the government has tried to frontload productive investments in roads, railways and defence this fiscal – with major success in road building – and we expect this trend to continue in the next. Execution under the National Highways Authority of India has increased by 43% year-on-year in terms of number of kilometres constructed till November 2015. CRISIL Research expects road investments to increase 2.9 times in the next five years compared with the last five years.

Growth drivers and drags

Fiscal 2016	Growth drivers / drags	Fiscal 2017
Weak, dented farm incomes	Monsoon	Assumed to be normal, propping up farm incomes and demand after 2 years
No hike	Pay Commission hikes	The sharper rise in wage bill will support consumption especially in sectors like auto, consumer durables, housing, tourism, retail. This will in turn lift utilisation rates and manufacturing investments in some of these sectors
High and at their peak	Bank NPAs	NPAs yet to bottom out
Dented	Private investment sentiments	A modest revival
Slow transmission	Interest rates	Improved transmission + lagged effect could see further push to retail lending. Also supportive of investment activity in some sectors where bank funding is available
Some pick-up	Public sector spending	Continued, albeit moderately higher public spending will support investments. Declining oil prices to create fiscal room
Collapsing	Exports	Some improvement expected as some of the trade partners see growth improve, but trade pick-up to be anaemic
Picked-up	Foreign investment (FDI)	Pick-up to continue as macros are relatively better, improved ranking on competitiveness, GST adopted etc
Remained low	Commodity prices	Expected to remain low and support

Unsupportive to growth · limited improvement · Improvement

Source: CRISIL Research

In turn, these factors will raise capacity utilisation rates and pave the path for new investment. We expect the private capex cycle to pick up by the second half of next fiscal. Among emerging markets, India will continue to remain in a sweet spot given the rise in the number of factors favourable to its growth.

The nuances of GDP growth

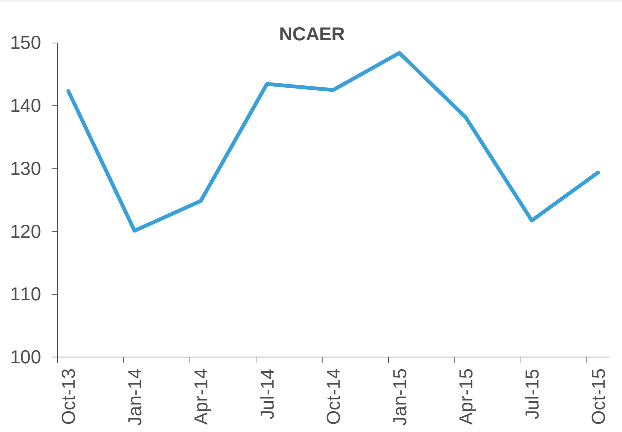
At basic prices	FY14	FY15	FY16*	FY17F
Agriculture	4.2	-0.2	1.1	4.0
Industry	5.0	5.9	7.3	7.6
Manufacturing	5.6	5.5	9.5	9.0
Mining & quarrying	3.0	10.8	6.9	7.0
Services	7.8	10.3	9.2	9.1

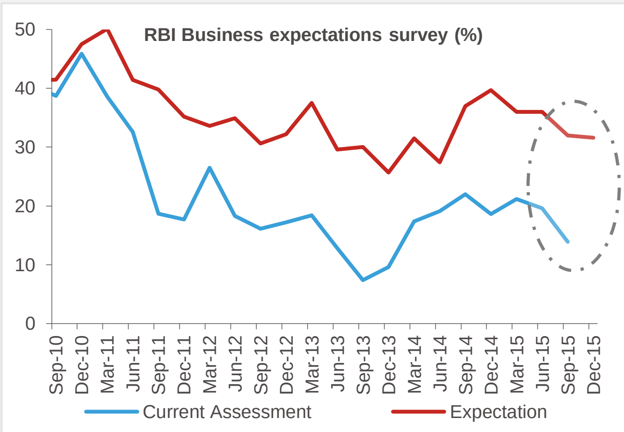
At market prices	FY14	FY15	FY16*	FY17F
GDP	6.6	7.2	7.6	7.9
Private consumption	6.8	6.2	7.6	8.0
Govt consumption	0.4	12.8	3.3	8.2
Fixed investment	3.4	4.9	5.3	8.1
Exports	7.8	1.7	-6.3	5.0
Imports	-8.2	0.8	-6.3	5.2

*Source: CSO, CEIC, CRISIL Research, Note: * Advance estimates, F=CRISIL Forecasts*

Box: Business sentiment corrects after dropping, but remains below the post-election peak

Surveys by the National Council for Applied Economic Research and the RBI show that business sentiment has started to improve after falling earlier in 2015. This has to do with recent government initiatives to push the pedal of reforms, especially FDI, and to improve the ease of doing business.



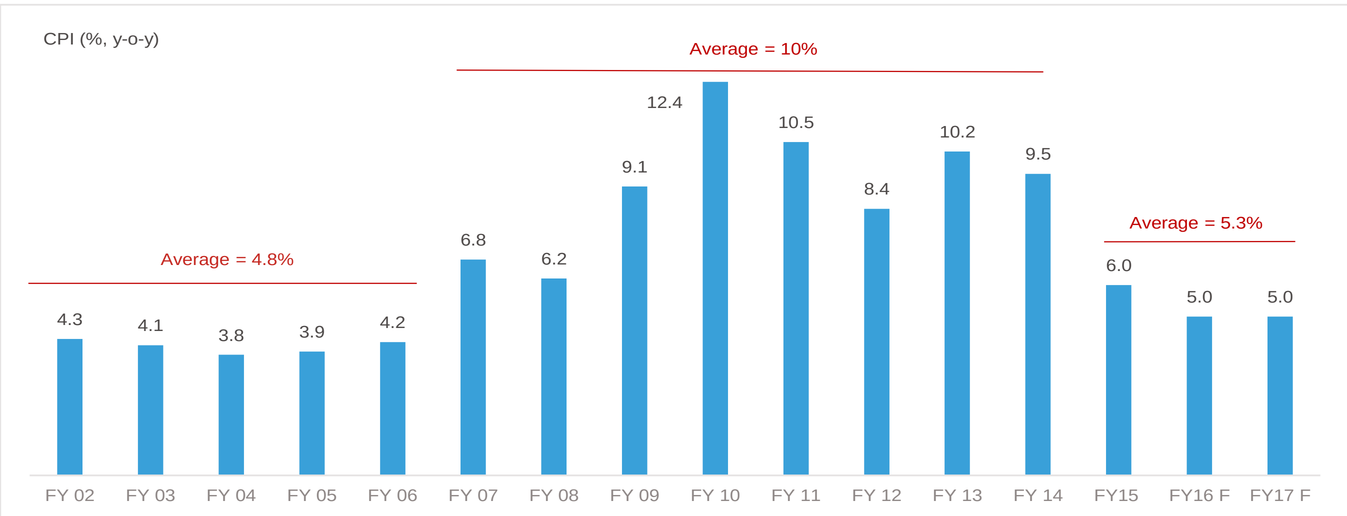


Source: CSO, CEIC, CRISIL Research

Why inflation will remain soft in fiscal 2017

Next fiscal, we expect CPI to stay soft at 5%, or unchanged from fiscal 2016. This assumes a normal monsoon, lesser decline in global oil and commodity prices, and sticky services sector-led components of consumer prices. Last fiscal saw the CPI fall 100 bps 5% from 6% in fiscal 2015, supported by (i) a sharp decline in food inflation despite the weak impact of monsoon; (ii) depressed global prices of oil and commodities, and, (iii) slack domestic demand and excess capacities that eroded the pricing power of manufacturers.

Inflation eases after staying elevated for long



Note: F=CRISIL Forecast, Source: CSO, CRISIL Research

If it tamps as presaged, average inflation between fiscals 2015 and 2017 will come down to around 5.3%, nearly halving from the 10% recorded between fiscals 2008 and 2014. But going forward, for inflation to ease further and stay within the RBI bound of 4% ± 2%, the government will have to undertake structural reforms to fix chronic supply-side constraints. This is especially critical in sectors such as agriculture where weather-related shocks are frequently causing large price spikes, and also in sectors such as health and education where inadequacy of good quality supply has kept inflation high and sticky (*see box*).

Three assumptions drive our outlook on CPI inflation for the next fiscal:

Assumption 1: Food inflation to stay benign

1. **No further weather-related shocks**

   This means we assume a normal southwest monsoon in the next fiscal, a pick-up in 2015-2016 rabi sowing followed by a healthy crop, and active food-supply management by the government. The last two years have seen a sharp fall in food stocks, especially rice and wheat, while procurement has been more or less constant. But even at these levels, stocks remain above the required norm and can be used in case of an adverse shock to production. (*see figure*).

2. **Only a mild pick-up in global food prices**

   The benefit from falling global food prices could diminish somewhat next fiscal. And for the first time in four years, global food prices are expected to rise in 2016. But this will be a mild 1.5% in 2016 as per World Bank estimates, after the 15% drop seen in 2015. So that’s unlikely to drive food inflation up.

3. **Moderate increases in minimum support price**

   Assuming the monsoon is normal and global food prices remain low, we expect the government to announce lower increases in minimum support price (MSP) next year. In the past, sharp increases in MSP – over 10% per year average for paddy and 15-20% for pulses between fiscals 2010 and 2013 – had a huge role to play in keeping food inflation persistently high. Fiscal 2014 onwards, moderate hikes in MSP – at 4% for paddy and 3-6% for pulses – have helped tame food inflation. In fiscal 2017, the MSP for pulses and oilseeds could see moderate hikes so as to incentivise production, while that for rice and wheat could be much lower.

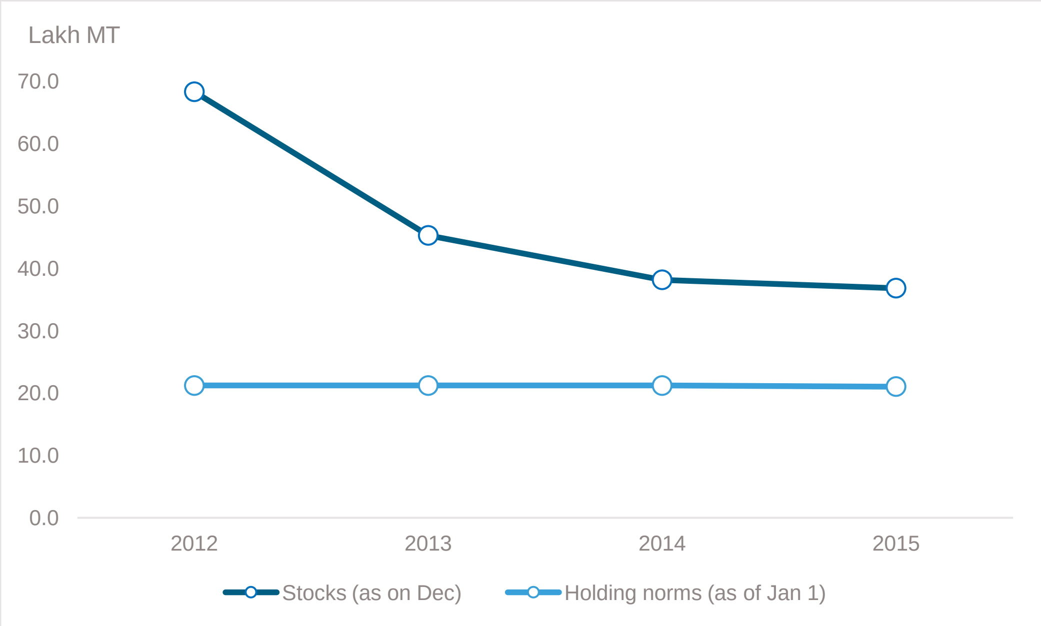
4. **Better pulses supply management**

   In fiscal 2016, pulses were the only food category where inflation had spiralled due to domestic production shortfall and relatively firm global prices[1]. From next year, the government is setting up of buffer stocks of pulses by procuring tur and urad. The government can also use the price stabilisation fund to procure stocks that are to be allotted to states based on demand and the rest is sold through designated outlets to consumers within a year of procurement. In the event of any price spike in pulses, the government can liquidate stocks to tame domestic prices.

This fiscal, a mix of factors brought down food inflation, such as better food-supply management by the government, higher production (especially cereals), declining global prices, moderate MSP hikes and utilisation of the price stabilisation fund to subsidise the cost of imported pulses. To top it all, dented rural demand came in handy. Most of these factors are expected to remain supportive next fiscal, too. The jury remains out on rural demand, though. To reiterate, the critical assumption is that monsoon will be favourable failing which the declining trajectory in food inflation will alter.

[1] November 2015, CRISIL Opinion: Every third year, pulses catch price-fire

Figure: Foodgrain actual stock versus holding norm



Source: Ministry of Agriculture, CRISIL Research

Assumption 2: Slow pick-up in domestic demand conditions

Next fiscal, lower inflation, especially in food and fuel items, and the impact of lower interest rate will improve the purchasing power of consumers. Empirical studies show that policy-rate changes by central banks impact the economy with a lag. In India, this is estimated at about three quarters – if banks pass it on, that is. In response to the 125 bps policy-rate cuts from the RBI starting January 2015, bank lending rates have come down only by ~60 bps. A cut of another 25 bps in the next fiscal, along with improved transmission of past reductions, will ease bank lending rates further and support consumption demand. The bigger push, however, would come from increased payouts due to the upward revision in the salaries of government employees and military pension, which could cause a transitory bump up in inflation.

However, we believe overall demand conditions will improve only gradually. Also, given large unutilised capacities, pricing power of manufacturers will remain weak. As a result, the pick-up in inflation will be modest and may manifest only towards the latter half of next fiscal. Additionally, shrinking rural income will hamper demand revival. The government is expected to broadly stick to the fiscal consolidation roadmap, while the RBI keeps a hawk's eye on inflation.

Assumption 3: Benign energy-driven inflation

Fuel and metal inflation is expected to remain benign. Barring geopolitical risks, global crude oil prices will tend to gravitate lower, albeit less ferociously than in this fiscal. Prices have fallen 36% so far this fiscal, and are expected to slip another 20% in the next. It should an average $42.5 per barrel next fiscal. The government has raised excise duty four times this fiscal, by a cumulative Rs 3.02 and Rs 5.57 per litre on petrol and diesel, respectively, to offset lower tax collection. Next fiscal, too, and despite a further fall in oil prices, the government may resort to fresh excise duty hikes if the fiscal consolidation goal is stretched. This will mitigate the pushdown to fuel inflation from lower global prices.

Table: Excise duty hikes this fiscal

Date	Excise on petrol (Rs/litre)	Excise on diesel (Rs/litre)
Dec 16, 2015	19.06	10.26
Dec 17, 2015	19.36	11.83
Jan 2, 2016	19.73	13.83
Jan 19, 2016	20.48	15.83
Total hike till date	3.02	5.57

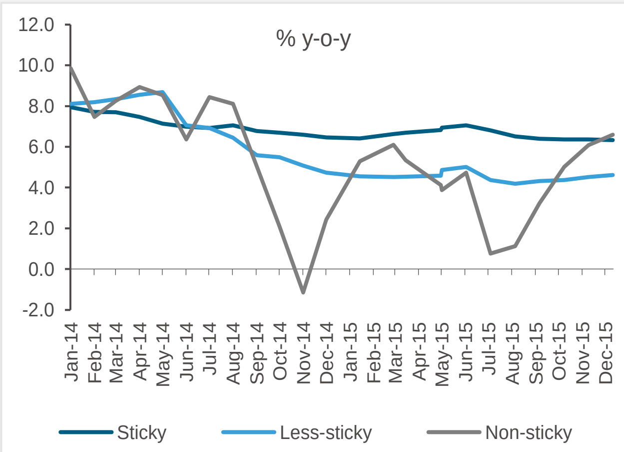
Source: CRISIL Research

However, and for the first time in five fiscals, metal prices are expected to remain relatively flat and this could stall the fall in inflation, especially captured in the wholesale price index.

What can go wrong with inflation next year?

- Yet another year of inadequate monsoon will fire up food inflation and crimp rural demand. In such a scenario, even if demand is sluggish, the supply shock will manifest in food inflation.
- Worry beads are already forming on the prospects of rabi crop, which usually enters the market in the first quarter of the fiscal. Rabi sowing so far has lagged considerably – it was 3% below last year's level as of January 28, 2016, with the worst-affected crops being rice (sowing down 7%), wheat (down 4.4%), and pulses and oilseeds (each down 2.7%). With the rabi crop contributing 50% of total foodgrain production and almost 100% for some crops, the pressure on inflation could mount if production remains low.
- The central and state governments are yet to accept the recommendations of the Seventh Pay Commission. Any sharper-than-expected hike in these payouts could prove inflationary.
- Services inflation has remained more or less unchanged from last year. Most of this rigidity comes from sub-categories such as health, education, recreation and amusement, and pan, tobacco and intoxicants where supply remains short and/ or demand tends to be relatively inelastic in the short run. This sector could see inflation remain stubborn or even rise as demand conditions improve.

Box: Breaking down the inflation components



Component index	Weight in CPI	FY15 (Apr-Dec)	FY16 (Apr-Dec)	Items included
Sticky	20%	7%	6.70%	Prepared meals, Pan/tobacco/intoxicants, Health, recreation & amusement, education
Less-sticky	50.10%	6.70%	4.50%	Milk and products, spices, non-alcoholic beverages, clothing & footwear, housing, fuel & light, household services and goods, personal care and effects, transport and communication
Non-sticky	29.90%	5.80%	3.60%	Cereals, eggs, meat and fish, pulses, oils and fats, fruits & vegetables, sugar

Note: Standard deviation for sticky items is in the range of 0 to 2, for less-sticky items is 2 to 3 and non-sticky is more 3

Source: CSO, RBI, CEIC, CRISIL Research

CAD to crawl up

Even as exports have been declining, the fall in imports on account of weak international commodity prices and subdued domestic demand has kept India's CAD under check. Accordingly, CAD for this fiscal is estimated to be flat at 1.3% of GDP.

Going ahead, however, we expect mild upward pressure on CAD because imports will increase as consumption and investment tick up. While oil imports will remain subdued in value terms owing to benign prices (CRISIL's forecast for Brent crude is $52.5 per barrel average in fiscal 2016 and $42.5 per barrel in fiscal 2017), non-oil imports due to growth in domestic investment and consumption will inflate India's import bill.

Exports, on the other hand, are seen in the rut. Not only petroleum exports, but non-oil exports are also expected to be subdued because of global weakness.

The IMF, in its latest World Economic Outlook released in January 2016, projected world GDP growth to improve only marginally from an estimated 3.1% in 2015 to 3.4% in 2016. That's 20 bps lower than its previous forecast in October 2015. And the World Trade Organisation had lowered world trade growth forecast for 2016 to 3.9% from 4.0% earlier. That means world trade will remain below 5%, which is the average for the last 20 years.

Box: India's declining exports

India's target of doubling exports to $900 billion by fiscal 2020 from $470 billion in fiscal 2015 might prove too ambitious if the current cyclical slowdown continues and structural issues are not sorted out. Merchandise exports, which are almost two-thirds of India's total exports, have been declining in the last eleven months. Cumulatively, they have fallen 17.9% in dollar terms in the first nine months of this fiscal, after seeing a 1.5% decline in fiscal 2015.

Global growth recovery has been slow and uneven. The World Trade Organisation has predicted world trade growth at 3.9% in 2016, which is much below the 7% growth achieved in the pre-financial crisis period. The recent cut in profit outlook by Maersk, the world's biggest shipping container operator, regarded as a bellwether of global trade, underscores the pervasive decline.

Small wonder India's export performance has suffered. Export destinations are not doing well, prices of many export items have fallen, and the rupee has appreciated in real terms against a basket of 36 currencies. But our analysis shows the decline in exports is more than that warranted by these factors. For instance, while world real GDP growth improved from 3.2% between 2009 and 2011 to 3.4% between 2012 and 2014, India's real growth of exports plunged from 11.1% to 3.1%. Latest data show, real growth in exports of goods and services from India stood at -6.3%, which suggests this is not a mere cyclical phenomenon -- there are structural elements at play as well.

Barring the United States and the United Arab Emirates, growth prospects in most of India's key export destinations in Asia and Europe remain fragile (*see table below*).

Growth forecast in India's top 10 export destinations (%)

	2014	2015E	2016P	Share in India's total exports (%)
United States	2.4	2.4*	2.7	13.7
United Arab Emirates	4.6	3.0	3.1**	10.6
Hong Kong SAR	2.5	2.5	2.6	4.4
China	7.3	6.9*	6.3	3.8
Saudi Arabia	3.5	3.4	2.2**	3.6
Singapore	2.9	2.2	2.0	3.2
United Kingdom	2.9	2.2*	2.4	3.0
Germany	1.6	1.5	2.0	2.4
Sri Lanka	7.4	6.5	6.5**	2.2
Bangladesh	6.3	6.5	6.8**	2.1

*Source: S&P forecasts, IMF. Note: *Actual data from respective countries, ** IMF forecasts, E=estimates, P=projections*

Personal transfers may see some slowdown

Besides goods and services trade, personal transfers (closely mirroring remittances from abroad, according to the old methodology of calculating GDP) form a substantial part of the current account. Along with income from services exports, they play an important role in compensating for the deficit in the goods trade account. According to the RBI, India received personal transfers worth $67.3 billion in fiscal 2015 and $33 billion in the first half of fiscal 2016.

Top 10 countries by remittance to India

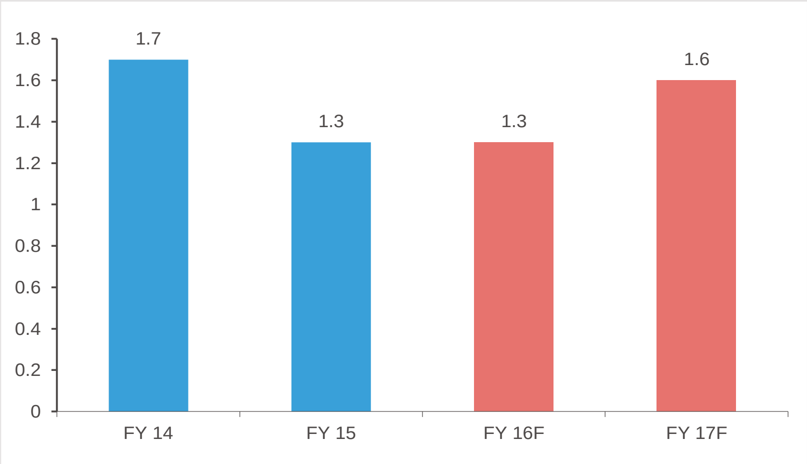
	2014	Real GDP growth (%)		Fiscal Deficit (% of GDP)	
Country	Remittances ($ billion)	2013-15 avg.	2016	2013-15 avg.	2016
United Arab Emirates	12.64	4.0	3.1	3.3	-4.0
United States	11.18	2.1	2.8	-4.2	-3.6
Saudi Arabia	10.84	3.2	2.2	-6.4	-19.4
Kuwait	4.74	0.7	2.5	20.6	0.1
Pakistan	4.70	4.0	4.5	-6.2	-4.2
Qatar	4.02	4.4	4.9	13.3	-1.5
United Kingdom	3.64	2.3	2.2	-5.2	-2.8
Oman	3.47	4.0	2.8	-5.3	-19.9
Canada	2.77	1.8	1.7	-2.0	-1.3
Nepal	2.73	4.3	4.4	1.9	-2.2

Source: World Bank, IMF, CRISIL Research

These ten countries account for roughly 85% of all the remittance India receives. Almost half of this comes from Middle East, especially the UAE and Saudi Arabia, for which oil exports are a major source of revenues. With oil prices hammered and expected to fall even more, both the GDP growth and the budgets (and therefore, government expenditure) in these countries will be strained. The table above shows a clear deterioration in the fiscal situation in Middle East. This will have an adverse impact on employment conditions in these geographies that, in turn, could taper remittances.

Overall, **therefore, we expect CAD to inch up to 1.6% of GDP in fiscal 2017 from 1.3% in fiscal 2016**.

CAD as percentage of GDP



Source: RBI, CRISIL Research

Fiscal consolidation to be a challenge next fiscal

While the government is on course to meet its fiscal deficit target of 3.9% of GDP as revenue remains fairly buoyant, two scenarios emerge for the next fiscal in the backdrop of recent recommendations of the Seventh Pay Commission, which accords a 23.5% rise in wages, allowance and pension to central government employees. This would translate to an additional expenditure of Rs 1.021 lakh crore – or 0.65% of GDP – next fiscal. However, the impact on central government budget would be limited to 0.45% of GDP as the rest will be borne by the railway Budget.

Scenario 1: The government accepts the recommendations *in toto*

The 23.5% salary hike is more than the general expectation of close to 15%. If the government accepts this hike, it would be a strain on the finances and will alter the roadmap of fiscal consolidation. If the government sets for itself a fiscal deficit target of 3.5% of GDP next fiscal (as recommended by the Fourteenth Finance Commission), productive spending would have to be cut to accommodate the extra burden from salary hikes. That's because the incremental benefit from lower oil prices (in terms of lower oil subsidies) will be smaller next fiscal. But the hike in excise duty on petrol and diesel is expected to fetch an additional Rs 274.6 billion compared with this fiscal.

On GST, there is no clarity yet on when and in what form it would be implemented. Even if implemented next fiscal, the benefits in terms of impetus to growth and revenue would be visible only in the medium-to-long run.

The other avenues that the government may try to increase its revenues through could be:

- Higher divestments
- Spectrum sales
- Further hike in service tax rate
- Further hike in excise duty on petrol and diesel

Scenario 2: The government dilutes Pay Commission recommendations

To continue public spending while staying on the fiscal consolidation path, the government may offer lesser hikes than what the Pay Commission has recommended. This will help achieve the fiscal deficit target of 3.5% of GDP next financial year without having to cut down on public investments.

Outlook: With private investment activity weak, we expect the government to crank up spending, which means it could use some wiggle room and adopt a less restrictive fiscal policy for the coming year. That would mean relaxing the fiscal deficit target somewhere above the 3.5% of GDP mark.

What about the risks for fiscal 2017?

The outlook for next fiscal is not without downside risks. How they pan out will determine whether India will see a recovery by foot or motor to a higher sustainable growth path.

1) **Hat-trick of monsoon failures will lower growth by 60 bps:** This fiscal, the impact of the second monsoon failure was partially mitigated by proactive government measures to control inflation, use buffer stocks, resort to imports and apply restrictions on export credit lines. Lower inflation, in turn, has contained the decline in purchasing demand. However, amid rising rural distress, we foresee a third straight year of inadequate rains fracturing the consumption story further and lowering GDP growth by 60 bps.
2) **Failure to continue structural reforms by the government:** Failure to pass important Bills such as GST, bankruptcy code and implement public sector bank and power sector reforms will hurt sentiment and slow the pace of recovery.
3) **S&P expects Fed to stand pat in March; sees only 2 rate hikes in 2016:** The expectation till a few weeks back was four hikes by the Fed in 2016. Faster pace of hikes by the Fed will result in greater capital outflows from emerging markets, including India, and a weakening of the rupee.
4) **A sharper-than-expected slowdown in China:** This can accentuate the trade imbalance with China and hurt metal and commodity-based sectors in India.

On the global front, too, many risks have reared in recent months. The table below details current global risks and their impact on India.

Global risks			
Issue	**Forecast/outlook for 2016**	**Impact on India**	**Positive/negative**
Weak global growth	IMF's world GDP growth forecast down to 3.4% from 3.6%. Likewise, World Bank reduced its forecast to 2.9% from 3.3%	Exports from India and foreign capital inflows may get hit	
Falling trade intensity	Growth in world trade volume revised down 70 basis points to 3.4% by IMF	Export revival may take longer	
Falling oil prices	CRISIL lowered its crude oil (Brent) forecast to an average $42.5 per barrel from $49.5 per barrel for fiscal 2016	Since India is a net oil importer, it stands to benefit by way of lower oil import bill, lower fuel subsidies and inflation	
Slowdown in Middle East	Economic growth in key oil-producing nations such as the UAE and Saudi Arabia is expected to slow down	Exports to these countries and remittances coming from there would be hit putting pressure on CAD	
Falling metal prices	Prices of most metals such as aluminium, copper and iron ore are expected to remain subdued	India being a net exporter of these, is going to be affected negatively. However, industries which use these as raw material would benefit from lower input cost	
Falling agri-commodity prices	Prices of wheat, rice and beef are expected to be lower in 2016	Since these are key export agri commodities from India, the impact would be negative. India's agri exports stood at $30 billion in fiscal 2015 with these 3 commodities having a share of 45%	
Slowdown in China	S&P forecasts Chinese growth to slow down to 6.3% from 6.9% in 2015	Lower commodity exports from India and capital market volatility. Also, higher trade imbalance with China	
Divergent monetary policies	While US is expected to increase interest rates further, European Union and Japan are expected to further ease their monetary policies	Volatile capital flows and currency fluctuation	
Corporate debt in emerging markets	Corporate borrowers with large foreign currency debt and weakening currencies to face increased burden to service their debt	Corporate defaults, especially amongst the highly leveraged ones, may rise. Increased foreign capital outflow	

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