India Flash

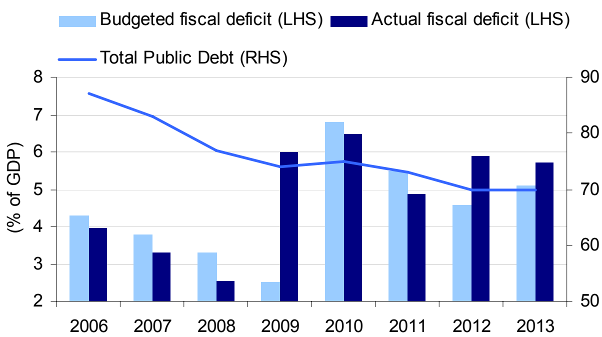
India's path to fiscal consolidation: are the targets achievable?

In its recent roadshows with overseas investors, Indian officials have reiterated their commitment to keep the fiscal deficit to within the 5.3% of GDP target for FY13 (year ending March 2013). Amid a higher than expected subsidy burden, the target was revised up in October 2012 from 5.1% initially, and compares to last year's outturn 5.9% which, in turn, was an overshooting of the 4.6% official target (Chart 1). The government's longer term fiscal plans are for consolidation to a deficit of 4.8% of GDP in FY14 to 3.0% in FY17. India's fiscal deficit, along with a gap in the external current account (Chart 2), are key concerns among investors and rating agencies. Furthermore, slowing real GDP growth (BBVA est.: 5.5% in FY13), elevated inflation and a weak rupee present significant macro headwinds. Therefore, the government's resolve in achieving its fiscal commitments will be closely watched. Persistent fiscal slippages have undermined efforts to narrow the current account deficit, and have reduced overall savings and private investment, and have kept public debt (general government) relatively high at 70% of GDP.

- **Is the government's commitment to fiscal consolidation credible?** In a word, yes. Reassuringly, over the last quarter the government has taken positive steps towards fiscal consolidation alongside efforts to regain the momentum of reforms. These include: 1) partial deregulation of administered fuel prices, particularly diesel (which accounts for 60% of total losses on fuel subsidies), 2) launching of a direct cash transfer scheme to enhance efficiency of subsidies, transfers and social welfare payments, 3) building of a consensus on implementation of a nationwide Goods and Services Tax (GST) to replace the existing VAT, excise duties and services tax, and improve tax buoyancy, 4) tighter curbs on spending and 5) reducing railway passenger subsidies.

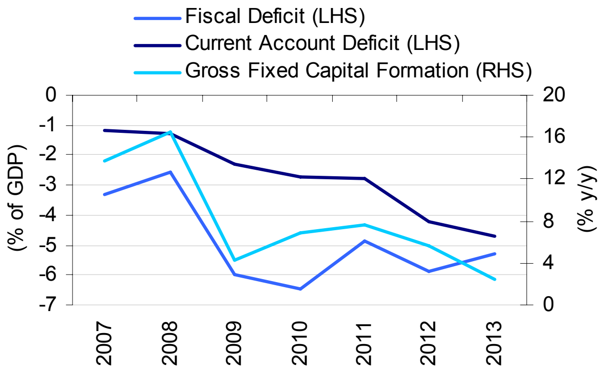
But are the numbers likely to add up? Probably not. The government's efforts have helped improve India's fiscal imbalances; for example, the monthly deficit in November was down by -2.9% y/y led by a slight improvement in gross tax collections and a deceleration in total expenditure growth. However, on a cumulative basis (April-November), fiscal trends continue to disappoint. Slower GDP growth, weak corporate profitability and lower divestment/telecom auction receipts have dragged on total receipts (up 12% y/y vs. 23% budgeted), while non-plan spending (includes interest and subsidies), has overshot target (16% y/y vs. 9%). Furthermore, the quality of fiscal adjustment remains questionable given curbs on capital spending. On current trends, we therefore project a modest overrun of the FY13 deficit, to reach 5.7% of GDP. To stay within its target, the government could resort to "creative accounting" by deferring subsidy payments or other big ticket expenditures.

Chart 1
A mixed record of meeting budget targets



* FY13 actual budgeted estimate is not available and is show n as BBVA's estimate of 5.7% of GDP

Chart 2
India's fiscal deficit is a headwind to macro stability



*Fiscal year 2013 includes figures for the first half of the year

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