How to deal with the GDP growth variations in forecasts

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THE SHARP UPWARD revision in the GDP growth number from 7.6% to 8.2% raises a few pertinent issues relating to data availability and quality of forecasts.The practice is to have the first advance estimate in January followed by a second one in February. There are provisional estimates provided in May, which show that the economy has done very well last year (as per the table). And over time, there are final estimates, which are captured in subsequent releases. These final numbers can be seen when the second advance estimates are brought out in February and hence the FY22 growth numberwould be anchored at this point of time.

The table *(seeright)gives* three of these estimates starting from the first advance estimates to the final numbers which come after two years.There are interesting observations to be made from the table.There appearto be substantial differences between the first advance estimates, which come well before the year ends,and the final numbers, that arrive after some iterations. The provisional numbers lie somewhere between the ones that are released in the month ofMayjust afterthe financial year endsAs can be seen,there is no definite pattern and the waves vary across years. In FY20, the final numberwas much lower than the initial estimates while in FY21 there was improvement in growth. FY22 was different as afterbeing revised downwards in May 2022, it went up sharply in the final estimates. Hence, the sharp revision in the upward direction between January, May and final forecasts can beverysignificant,which can be 1% higher.

The first issue here is whether there is any merit in having an estimate in January even before the financial year has ended. This is important because data used would be available generally up to November (industry, inflation) or December (GST) and is based on several extrapolations. Hence pushing up numbers for 8-9 months to 12 months runs the risk of seasonal factors which can overstate or understate the true picture. Presently, the only discernible use of this number is in the Budget where revenue numbers are based on how the economy has grown in the preceding year and the projection made for the coming year. This is necessary as there is need for some basis for making these projections. Here, the first advance estimates has use.

In the absence of such data, the ministry of finance would have to make independent forecasts of both the previous year as well as the coming year. The call on the year gone by would then be even more subjective and hence the NSO's estimate is required.This could run the risk of skewing budgetary numbers, but there is no alternative. For example, when the Union Budget for FY25 was presented, the GDP for FY24 was assumed to be at a certain level based on real growth of 7.3%. Now, with growth being 8.2%, there is an upward movement which in turn will provide a higher base for making a projection for FY25. But in FY20 and FY22, there would have been a downward bias. And the final numbers would increase the denominator for the fiscal deficit ratio (in nominal terms), thus lowering it. The opposite would hold when denominator comes down.

INTERESTING OBSERVATIONS

	First advance	Provisional	Final
FY20	5.0	4.2	3.9
FY21	-7.7	-7.3	-5.8
FY22	9.2	8.7	9.7
FY23	7.0	7.2	7.0
FY24	7.3	8.2	

Source: MoSPI

The next issue is whether there should be second advance estimates. Here the number is a little more updated but still comes before the year comes to an end.This forecast can be dispensed with as these numbers would not be used in any of the major policies of the government. This would mean that after the first advance estimates, there would be only provisional estimate in the month of May.

The divergence between the final and provisional numbers is a concern.This is so because for all purposes, the provisional number is used to explain what has happened in the economy which is then used for policy formulation. But once the final growth numbers vary by as much as 1% from the provisional estimates,there are questions of comparability that come in. Ideally, the final numbers should be published within three months by August to reduce ambiguity.

The problem is that since data has been volatile and subject to base effects, most explanations would be erroneous if the final numbers deviate to this extent. The challenges for NSO are known and hard to solve immediately given that the flow of data is uneven.As a large part of the economy is unorganised, getting authentic data is a challenge. Under these circumstances, it would be prudent for policy makers and corporates to workwith GDPgrowth numbers with a range of up to 25 bps on both sides. Meanwhile, efforts must be on to narrow down the time period before the final numbers are out.

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