Deloitte Touche Tohmatsu India LLP
7th Floor, Building 10, Tower B
DLF Cyber City Complex
DLF City Phase-II
Gurgaon– 122 002,
Haryana, India

Tel: +91 (124) 679 2000
Fax: +91 (124) 679 2012

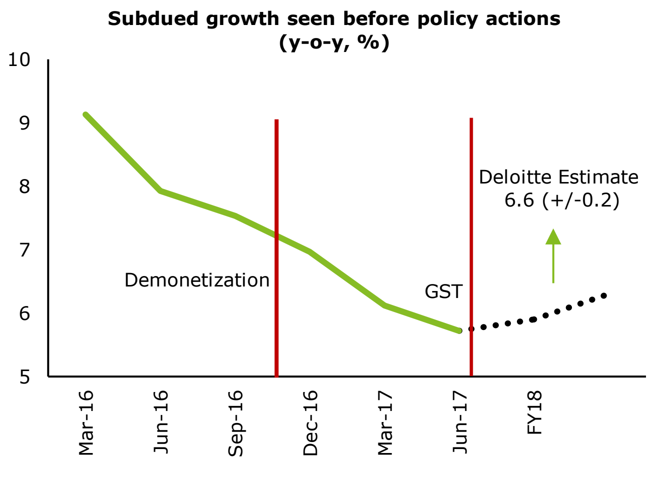
India’s growth story expected to continue despite short-term disruptions

India’s growth narrative over the last year can be defined by significant structural changes which may be regarded as partially responsible for the ongoing market uncertainty and short-term growth pains. These reforms, by their very nature, are targeted to have long-term growth impact and recovery under this scenario will predictably take time. The weakness in India’s growth over the last six quarters has been on account of an agriculture slowdown despite normal monsoon, subdued manufacturing activity, low capacity utilization and a general pushback in investments among other things. However, on the flip side are other factors which indicate an otherwise healthy side including high liquidity, healthy capital inflows, strong government revenues, and improving foreign exchange reserves.

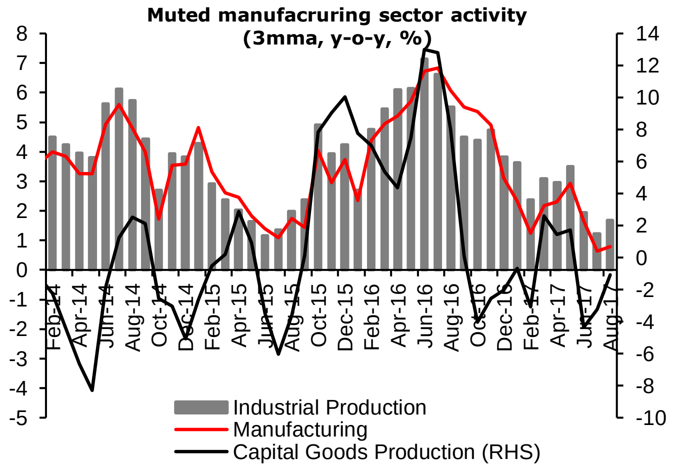
In its latest bi-monthly monetary policy statement, the Reserve Bank of India (RBI) lowered its gross value added projections for FY18 from 7.3% to 6.7%. Most of the estimates from other institutions also seem to suggest that the chances of achieving a growth number above 7% seems unlikely in FY18. There are clearly pain points for the economy, the most prominent of them being the concerns in the banking system, especially stressed balance sheets in the public sector banks. As such, non-performing loans (NPLs) – where payments have not been made for at least 90 days – have grown by a significant 90% in 2016 after growing by 22.8% in 2015. Importantly, close to 88% of INR 6 trillion worth of NPLs are accounted for by the public sector banks as of Dec’16. This corresponds to the weak investment demand which can partly be attributed to an already highly leveraged corporate sector.

At the same time, pace of new loans to industry have remained in the negative territory at 0.4% y-o-y as of Sep’17 – pointing to a continued weak investment sentiment – which is also reflected in the below optimal manufacturing and production activity. While the recently announced policy recourse in terms of INR 2.11 trillion bank recapitalization plan may address capacity scarcity issue and improve lending capacity, this will at best be a slow process and will likely add to budgetary pressure. Farm loan waivers and housing allowance may further stretch the resources of the states thereby limiting capital expenditure. These issues are a clear indication that the recovery process may take longer time than anticipated.

Fig 1. The stress areas in the Indian growth story

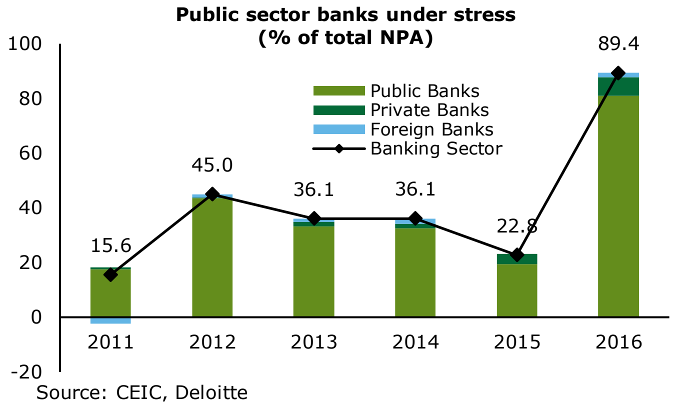


Source: CEIC, Deloitte

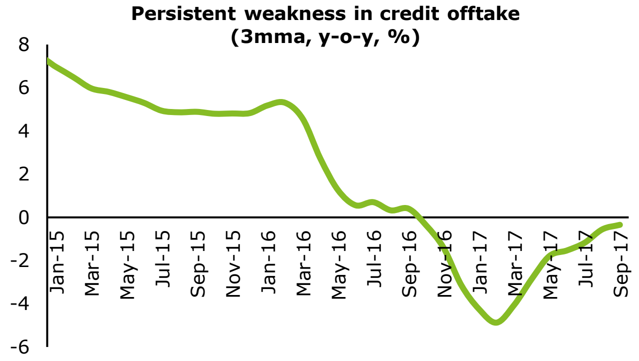


Source: CEIC, Deloitte

Deloitte.



Source: CEIC, Deloitte

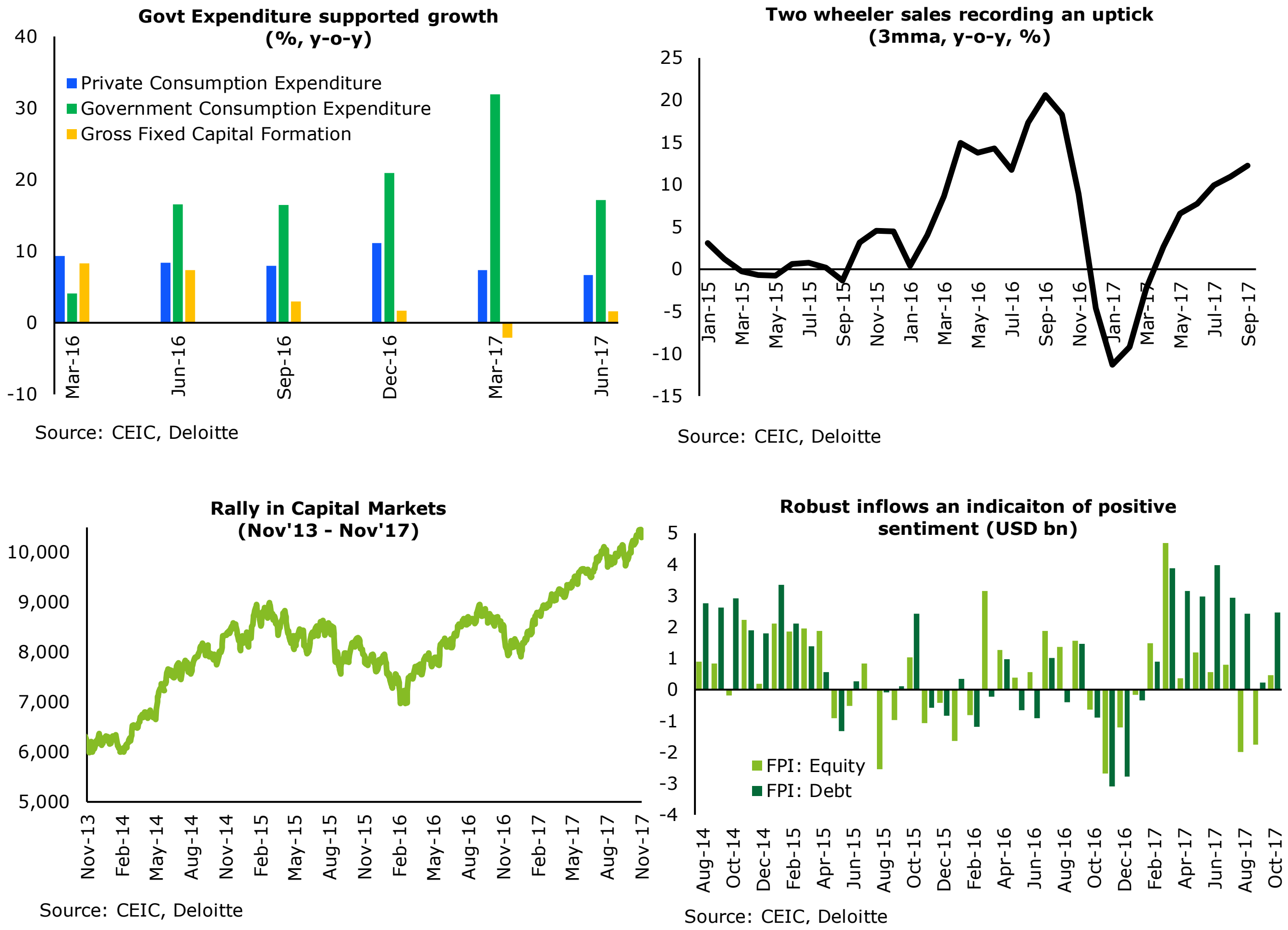


Source: CEIC, Deloitte

Policymakers and other key stakeholders have been actively working on measures to boost growth and to try and reverse the persistent economic weakness. For instance, there has been an increase in government expenditure over the past few quarters (as seen in Fig 2), which has contributed to economic growth, thereby preventing a sharper decline in the growth rate. In the coming quarters it is expected that apart from government expenditure, it is private rural consumption that is likely to drive growth. This in part is reflected in a revival of two and three wheeler sales growth — a proxy for rural consumption — in recent months. Expansion in rural demand may additionally be derived from farm income growth through increases in minimum support prices (MSP), farm loan waivers and some increase in employment through the recently announced Bharatmala project. An upswing in rural consumption may further be supported by an expanding access to financial products and services. This expansion of financial inclusion net is an offshoot of increasing policy push toward digitization.

We also expect that investment demand might see a major turnaround in the quarters to come as market adjust to disruptions and risk appetite improves. This in part is likely to be augmented through ramped-up public sector infrastructure spending. The positive growth view is further cemented through operations of the stock market which have provided optimistic readings of corporate earnings growth. While capital markets have rallied over the last year (Nifty50) gaining close to 20% at the end of Oct'17, reflecting increased participation and confidence shown by foreign portfolio investors (FPIs; investments in stock and bonds market), cumulative foreign direct investment (FDI; international capital flows into businesses) flows also reached record highs. On the external front, export growth has continued to grow markedly in recent months to 25.8% as of Sep'17 and positive predictions for global growth for 2017 and 2018 should help provide a further boost to exports. The expected upswing in domestic environment is likely to be supplemented by a stable outlook on crude oil prices which might help in keeping the economy strongly set on fiscal deficit target while a 30 pace gain in World Bank "ease of doing business" ranking is likely to stimulate muted investment sentiment. This should be more than favorable in bringing buoyancy in equity markets and setting India's place as a compelling investment destination.

Fig 2. The healers of economic downturn



Even with these measures and policy intitiatives, one should be careful in expecting a rapid increase in economic growth. The effect of the recently announced economic package as well as the other structural reforms, aimed at long-term sustainability, may trickle down to growth in productivity and revival of private investment in the next fiscal, only at a less than rapid pace. The real risk and challenge will be to make the right short term decisions about the composition of fiscal expenditure so as to ensure that short term successes do not have long-term costs. We are positive that these plans will help accelerate growth, however, in order to realize gains from structural changes, there is a need to implement policy reforms efficiently and in a time bound manner.

*Note * Figures and statistics through CEIC data and Deloitte analysis*

Information for the editor for reference purposes only

The authors are Anis Chakravarty, Lead Economist and Partner, Deloitte India and Umang Aggarwal, Economist, Deloitte India