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Managing Risks: Key to setting the stage for a brighter 2018

The last year can be thought of as a year of transition wherein we had some major reforms with an ongoing attempt to affect consumer behavior. Growth in the country is likely to have slowed down but it still remained one of the fastest growing nations in the world. That said, while the domestic economy is in recovery mode, the current year will possibly put the focus back on structural issues such as inflation and the external account.

Two key initiatives that changed the playing field were the implementation of demonetization, and the goods and services tax (GST) in quick succession and these may be regarded as partially responsible for market uncertainty and short-term growth pains. Enactment of these reforms was followed by muted economic activity over the last six quarters and the weakness has been characterized by an agriculture slowdown, subdued manufacturing activity, substantial NPAs with the banks, and continuing sluggishness in private investment. In fact, NPAs have grown by a massive 90% in 2016 from 22.8% in 2015[1].

For 2018, for growth to reach 7-7.5% range, both rural and urban parts have to do well. The rural economy has faced some stress over the last few years and we are likely to see some measures in the upcoming budget to alleviate the stress that has been built up. Apart from this, the government will need to consider measures to crowd in private investment, which continues to be tepid. The government investment currently is focused on developing infrastrucuture. A key initiative in this regard is the expansive "Bharatmala" project aimed at developing close to 35,000 km of roads at an investment of INR 5.4 trillion in the next five years, which should improve both the employment capacity and induce capital investments.

Private investment can be encouraged if the constraints to credit supply are managed. A key step here is the bank recapitalization plan. This plan, as it is implemented, can help the banks get over the hangover of the NPLs and restart the muted credit cycle.

One of the most awaited policy announcements pertain to the government's plan for fiscal deficit targeting. There are concerns that as the government spends to uplift the farm and the banking sector as well as to boost infrastructure development, it may be at the cost of fiscal consolidation. While the tax revenues are falling, the news on the external front is also mixed with the uncertainty about both FPI and FDI as US economy rebounds and US introduces tax reforms to funnel investment back in the country. The rising commodity prices, especially crude also pose a risk to managing growth and inflationary expectations.

In effect, the real challenge will be in effectively managing any short-term disruptions whilst making well-planned and effectively administered policy decisions to guide the recovery process. The right short term decisions must be taken keeping in mind the composition of fiscal expenditure so as to ensure that short term successes do not have long-term costs. Ultimately, as much as vigorous public investment in infrastructure remains a factor for propelling overall growth, addressing existing inequalities and institutional obstacles to development while implementing policy reforms in an effective and time-bound manner remains key.

[1] CEIC Data and Deloitte Analysis

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