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New challenges emerge with growth on the mend

Over last year, the domestic growth momentum has remained muted due to internal challenges even as the global economy rebounded. This year the narrative has changed and the domestic economy will face a broader mix of headwinds that will need to be tackled effectively to maintain growth momentum.

Before delving into the set of challenges, some perspective is necessary of where we are in the growth cycle. The last year can be seen as a year of transition wherein we had some major reforms that were aimed at bringing structural changes in the economy. Growth is likely to have slowed down but India still remained one of the fastest growing nations in the world. As such, there seem to be signs of a pick-up in the growth momentum. The latest monthly indicators are hinting at a gradual but broad recovery. The industrial production print was driven higher by consumer non-durables while capital goods production accelerated for the fourth month in a row. On the sectoral front, manufacturing recorded double digit growth even as mining and electricity output remained stable. These numbers along with data on auto sales, gains in the Purchasing Managers Index (PMIs) and exports show that the situation on the ground is possibly changing.

However, there are risks to the outlook and managing inflation is one of the major challenges for the current calendar year. It must be noted that India was in the proverbial sweet spot as a global commodity price decline helped manage inflationary pressures while at the same time gave enough maneuverability to policy makers to reduce rates while keeping spending levels stable. But, the situation going forward is likely to be markedly different with global commodity prices on the rise in line with a recovery in global growth. On the other hand, India's largest import, crude oil is currently hovering at around USD 70 for a barrel, posing a risk to inflation and management of the fiscal situation. This also puts the RBI in a tough spot as it deals with giving the economy a push at a time when inflation is moving up.

Another concern is of maintaining financial stability as a build-up in non-performing loans (NPAs) over the last several years has possibly led to a loss in investment growth. The financial system remained resilient during the 2008-09 financial crisis; however there were financial excesses in its aftermath. Globally, India ranks fifth in terms of highest NPAs and highest among the BRIC nations[1]. Total NPAs of scheduled commercial banks have been on a persistent rise and have reached close to INR 8 trillion in FY17, about 86% of which are centered in public sector banks. Credit growth to industry has remained low and stood at 0.1% YoY growth as of Nov'17, pointing to a weakened investment sentiment.

Acknowledging this stress, a bank recapitalization plan was announced in Oct'17. The first phase of infusion was recently unveiled and showed that attention was being given to the smaller and weaker banks, which bodes well for credit flow in the economy. That said, it is believed that policy recourse of injecting INR 2.11 trillion in the banking system can address capacity constraints, this may not be sufficient to build long-term resilience. This policy is also expected to increase overall government debt. But the impact on fiscal deficit may be limited to interest payments. The scheme is expected to revive loan growth, and restart private investment activity. Much will depend on how soon bankers are ready to increase credit provisions. However, a fast reversal in credit cycle should not be expected as this will at best be a gradual process and will build up depending upon the strength of other macro fundamentals. The upcoming Budget might unveil some finer details and a longer term direction for state owned banks.

[1] http://www.businesstoday.in/current/policy/npa-problem-india-ranking-bad-loans-economies-with-huge-npa-bank-recapitalisation/story/266898.html

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Looking beyond the near term, shifting demographics has opened a window of opportunity and the chance is now to restructure business processes and realign policy focus for sustained growth. However, a major concern is that with increasing digitization and automation, many of the existing jobs may become redundant. Therefore, both the government and the industry has to create a long term focus on both skilling the new recurits as well as reskilling the existing workforce to overcome this challenge. In this context, creating new job opportunities together with restructuring business processes to include skill development as an important factor may ensure economic success. Automation and robotics are also likely to open new business avenues, increase scope of specialization, and reduce mismanagement while also allowing for transfer of human capacities into more productive uses. There are important takeaways from economies like Singapore, Japan, and Australia where gains from digitization have already played out[2]. That said, effective skilling is likely to allow the Indian workforce to specialize in services that will become a necessary requirement in an ageing environment, especially as sectors such as healthcare, nursing, housing, financial services, child care services, consumer goods segment among others will take precedence.

Overall, the Indian economy seems to be poised towards taking its rightful position on the global stage. The challenge essentially seems to be of making sure that the economy grows to its potential and that this growth process fosters equity. However, this can only be done if there are efficient and durable policy solutions administered to address both near term and longer term challenges possibly making the growth process sustainable.

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[2] https://www2.deloitte.com/content/dam/Deloitte/in/Documents/about-deloitte/in-deloitte-voice-of-asia-ed2-may17-noexp.pdf