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PRADEEP GAUR/MINT

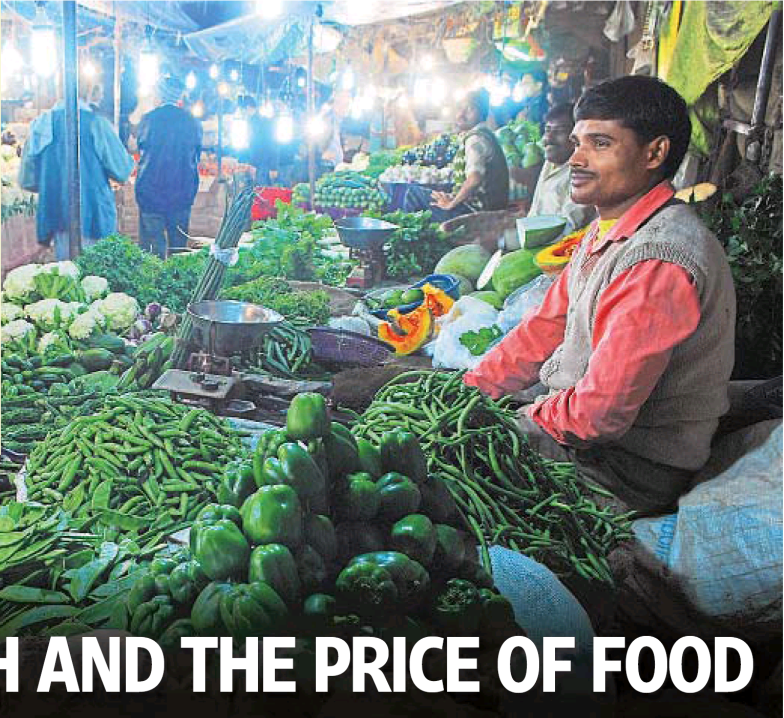
FEEDING GROWTH

TABLE 1: Growth of expenditure on GDP
(2011-12 market prices)
(in %)

	Weight	2014-15 H1	2015-16 H1
Private final consumption expenditure	57.3	5.6	7.1
Government final consumption expenditure	12.2	5.3	3.3
Gross fixed capital formation	29.9	6.2	5.8
Exports	21.2	8.1	-6.2
Imports	23.2	3.3	-4.2

TABLE 2: Growth of gross value added
(2011-12 basic prices)
(in %)

	2014-15 H1	2015-16 H1
Total gross value added	7.9	7.2
Trade, hotels, transport and communication	10.5	11.7
Agriculture	2.4	2



ORGANIC LINK

HIGH GROWTH AND THE PRICE OF FOOD

EXPERT VIEW

SUDIPTO MUNDLE
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We have started the year on a high note. India is now the fastest growing major economy in the world. But it is a high note in a very sombre musical score. India is at the top in the growth league tables, but the global economy itself is at the edge of a very steep decline. If it goes down that path, then it will take all the world's economies along with it, India included.

Besides, India is the fastest growing not because its growth has accelerated, but because growth has declined in other fast growing economies, especially China. International Monetary Fund (IMF) data indicates China grew about 6% in 2015, less than half the peak growth of 14.2% it achieved in 2007. Since then China's growth has declined precipitously. Estimates based on alternative indicators suggest that actual growth could be even lower. Some would argue that this is a managed deceleration, designed to switch China from an export- and investment-led growth path to one led by domestic consumption. But most observers believe the Chinese economy is spiralling out of the control of its managers. Capital is flowing out of China at the rate of around $100 billion a month, cumulatively amounting to over $1.5 trillion over the past year-and-a-half, according to some estimates. The stock market has been plunging almost every week.

The China Shock is the latest in a series of repeated shocks that has left the global economy in turmoil. First came the US sub-prime lending crisis of 2007, that morphed into the Great Recession of 2008-09. Before the world could recover, there came the European sovereign debt crisis of 2011, led by the insolvency of Greece, a crisis which is not over yet. Then came the war against ISIS in Syria and Iraq, which is still continuing. Now we have the China Shock.

The tapering of Chinese demand combined with the tapering of quantitative easing in the US has led to the collapse of global commodity prices, especially the price of oil. The latter has been further pushed on the supply side by the emergence of shale gas as an alternative to Middle East oil, and the return of Iran to the global oil market following the lifting of sanctions.

The shock waves from the series of crises culminating in the China slowdown is impacting not just commodity markets but also, and inevitably, the emerging market economies including India. These economies too have experienced the flight of capital and the consequent collapse of asset prices. Here in India, the benchmark Sensex has fallen below 25,000 points and the Nifty below 7,500 points, levels that last prevailed before the Narendra Modi government came to power in May 2014. China already seems to be on the path of regression to mean global growth as had been anticipated three years ago by Pritchett and Summers in a widely cited paper. What is the outlook for India?

In the long run, different factors will determine the outcome. But to assess our prospects in the near term it is necessary unravel a peculiar macroeconomic phenomenon that has puzzled most observers, including the Reserve Bank of India (RBI) governor and the chief economic adviser. Central Statistics Organisation (CSO) estimates, based on the new series since 2011-12, indicate that GDP, measured at constant market prices, grew at a healthy pace of 7.3% in 2014-15 and 7.2% in the first half of 2015-16. This is the highest growth rate recorded by any major economy in the world in this period, as we noted at the outset. Yet, most other collateral indicators would suggest that growth is much lower.

> India's current high growth is not necessarily a flawed estimate, but is organically linked to food price inflation

Initial results of corporate performance now coming in for the third quarter of 2015-16 suggest overall net profits have declined. The Purchasing Managers Index shows demand is depressed. Not surprising, considering that the wholesale price index for manufactures, the nearest we have to a producer price index in India, is now declining while base rates of commercial banks are in the 9.5% to 9.7% range. That implies real interest rates faced by manufacturers are very high, around 10% or more. Manufacturing output actually declined by 4.4% compared with a year ago in November, the last month for which Index of Industrial Production data is available, and rose by only 3.9% for the April-November period. Agricultural growth for the first half of the year 2015-16 was only 2%, thanks to a weak monsoon. Central bank data available up to September indicates that bank credit has only grown by 8.9%, down to about half the credit growth rate of 15.1% for the corresponding period of 2013.

Export growth has been decelerating for the past three years, and has been negative for the past 13 months, reflecting the slowdown in destination markets (*Table 1*). In any case, since imports exceed exports in India, the net balance of merchandise trade has a negative impact on aggregate demand.

The other major source of autonomous demand is investment. During the first half of 2015-16, gross fixed capital formation, which accounts for 29.9% of final demand, grew by only 5.2%. Government final consumption expenditure, with a share of 12.2% in final demand, grew by only 3.3% during the same period. The main source of demand growth has been private final consumption expenditure, which grew 7.1% during this period. This component accounts for about 57% of aggregate demand.

Moreover, in a relatively low-income country like India, consumption expenditure is largely a function of income and not an autonomous source of demand. So what is driving the 7% plus growth?

It would be easy to simply dismiss the new 2011 gross domestic product (GDP) series as flawed since the picture does not seem to add up. However, while the numbers are puzzling, no one has explained why the new series is flawed. After all, it draws on a more robust data base than the earlier series. Also, conceptually it incorporates changes that are better aligned with global best practice in national income estimation. So, is there another narrative embedded in the data? Are there factors at work that could account for growth of over 7%?

To answer that question, it is necessary to look at a more granular picture that goes beyond the aggregates, starting with inflation. As widely reported, the food consumer price index is inflating at 6.3% though the wholesale price index for food items is inflating at only 0.6% as of January 2016.

Since food prices are fairly stable at the wholesale point, but rising 10 times as fast at the retail point, incomes from the trade in food must be rising rapidly. If this is true, we should expect to see a sharp increase in income from domestic trade in the national accounts.

That is indeed what we see. The disaggregated picture of growth of gross value added during the first half of 2015-16 indicates that the group Trade, Hotels, Transport and Communications is the fastest growing sector in the economy, galloping along at a breathtaking pace of 11.7% (*Table 2*). It is helping to pull along the rest of the economy at a smart clip of 7.3%, while agriculture, the sector producing the food, is growing at a mere 2% (see CSO press release, 30 November 2015). Within this group, hotels is a relatively small component and a large segment of transport and communications reflects derived demand. Hence, trade is the component that is leading this sector.

It is noted in this context that private consumption expenditure accounts for over 57% of aggregate demand. Since food accounts for 54% of total consumption spending (the weight of food in the consumption basket), it accounts for about 31%, or nearly a third of aggregate demand. This is the base on which food traders operate. Hence, rising margins and incomes from the trade in food have become strategic variables in the dynamics of both inflation and growth. This interpretation needs to be verified with more disaggregated data.

Meanwhile, we have some independent, though indirect, confirmation from disaggregated RBI data on bank credit flows. Data available up to September shows the fastest growth in credit at 13.7% was recorded in semi-urban areas, which is presumably where the large bulk of food traders are based. This compares with credit growth of 10.2% and 10.5% in rural and urban areas, respectively, and only 7.5% in metropolitan areas.

The main takeaway from this analysis is that India's current high growth is not necessarily a flawed estimate, but that it is organically linked to food price inflation, and the rising margin between the wholesale and retail price of food. There is an interesting political choice to be made here. Should we continue to celebrate India's status as the fastest growing economy in the world, while leaving it to consumers to cope with rising food prices as best as they can? Or should we look for ways to contain the rise in retail food prices, and collaterally settle for a lower rate of growth that is more in line with the rest of the world?

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