When Will Growth Revive?
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When will growth be restored? A frequently asked question for which nobody really has the answer. Though economic fundamentals assert themselves in the medium to long term, short term economic trends are often driven by whimsical stock market expectations that can become self fulfilling. As Keynes pointed out in the *General Theory*, stock prices are driven by nothing more tangible than the guesses of millions of investors about how everyone else is guessing. Of course, the expectations of investors are shaped by real economic conditions. However, these conditions are read differently by different investors, ranging from 'bearish' pessimists at one end to 'bullish' optimists at the other. Expectations also vary about which way the market will turn. When bearish sentiments prevail, the market goes down and tends to pull the real economy down. As market goes lower and lower, more and more investors expect an upturn, bullish sentiments gather momentum and after a point the market actually begins to recover, with rising asset prices giving a fillip to the real economy. Where that tipping point lies is anybody's guess, but we can make an informed guess based on objective economic conditions.

With growth having decelerated to 5.3% in the third quarter of 2008-2009, after 7.9% and 7.6% in the first two quarters, we will probably end the year on 31 March with overall growth of around 6.5%, give or take a few percentage points. Not bad at all, considering that the developed world is actually shrinking. Against this base line, what is the outlook going forward? The economic crisis hit us only in September 2008, following the collapse of Lehman Brothers, when half the financial year was over. The full year effect of the negative factors that triggered the crisis will only be felt in 2009-2010. Hence 2009-2010 could be worse than 2008- 2009 unless there are other mitigating developments, whether internal or external.

On the internal front anecdotal evidence suggests that the slew of credit promoting measure taken by the RBI, the reduction in various duties, and the pump priming impact of a huge fiscal deficit in 2008-2009 are beginning to take effect. Prime lending rates are coming down, as are consumer loan rates. Construction activity and the demand for cement has picked up. Car sales rose by 22% in February 2009 over February 2008, and that for scooters, motorcycles etc. by over 15%. New cell phone connections grew by over 20 million in the last two months, an annualized growth rate of over 60%. A significant component of this demand is rural despite indifferent crop production and continuing farmer distress in several states. Evidently, off-farm employment and rural services are now major drivers of rural income. Given the large demand priming deficit budgeted for 2009-2010, the recovery of consumer demand should gather momentum through the coming year if there is a normal monsoon. This will help turn around overall industrial growth, which remains depressed. Low inflation is a major facilitating factor here. It enables amendment of the FRBM act and deficit financing by printing money instead of crowding out private investment. The main challenge here will be the quick resumption of fiscal prudence once growth has been revived.

These domestic factors may yield growth of 6% or so through 2009-2010. Anything more will require positive developments in the external sector, which now accounts for more than a quarter of the Indian economy. Exports have grown during the current quarter compared to the same period last year, thanks to rupee depreciation. However, the IMF and the World Bank are both forecasting that the world economy will shrink this year—global recession. This will dominate the rupee depreciation effect. Hence, export demand will remain flat or grow very moderately in 2009-2010 and full recovery cannot get underway in India till we see the beginnings of global recovery. This trade effect will be reinforced by external effects via capital flows. The FII's flight to safety that drained the stock market, the main channel through which the global crisis was first transmitted to India, will not be reversed till recession is turned around in the developed countries, especially the United States. Unfortunately, despite billions of dollars worth of bailouts and many fiscal stimulus packages, the flow of negative economic news from the developed countries continues unabated and they continue to spook the markets. While assessments vary, the modal view is that recovery in the US and the global economy may not appear till the end of 2010, i.e., the latter half of fiscal 2010-2011 in India. Thus, all things considered, India is likely to grow at around 6% or so through 2009-2010, and the early months of the following year. Return to a higher growth path of around 8 % may not occur till the latter half of 2010-2011.

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