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Growth remains fragile

Spending boost needs big rate cuts which may not happen, so need to look at relaxing fiscal constraint

Though the new GDP series remains a mystery considering that most macro-demand datasets are at multi-year lows—growth in loan disbursements from banks is at a 22-year low and deposits growth is at a 51-year low—the provisional GDP estimates put out by the CSO for FY15 are worse than they appear on the surface. Though GDP growth at 7.3% is just marginally lower than the 7.4% projected in the Advance Estimates in February, the slippage is greater when you look at the gross value added (GVA) where, compared to the Advance Estimate of 7.5%, the Provisional Estimate is 7.2%—essentially this suggests the fall in input prices and reduction in oil subsidies gave GDP an extra cushion in FY15. The Advance Estimates of a 7.5% rise in GVA required GVA in Q4FY15 to rise 7.7% while the actual was just 6.1%—and the collapse cannot be explained in terms of just agriculture.

In terms of the demand-side, private final consumption was projected to grow at 7.1 in FY15 but grew just 6.3%, and government expenditure rose just 6.6% as compared to the projected 10%. Rural demand has performed worse than urban demand, and this got exacerbated as the year went by—in Q4FY15, while passenger vehicle sales grew 3.95%, two-wheeler sales which have a higher rural component contracted 0.25%. Investment growth, not surprisingly given the local and global demand situation as well as the high excess capacity—cement capacity utilisation is at 71% and automobile at 63% according to Crisil—continues to remain poor. As compared to 33.6% of GDP in FY12 according to the new GDP series, gross fixed capital formation was 30.7% in FY14 and fell to 30% in FY15.

The question then is what this augurs for the current year where, going by the budget numbers, nominal GDP is expected to grow at 11.5% since the boost to GVA from lower input prices and lower oil subsidies will no longer be available. And, as National Statistical Commission chairman Pronab Sen said after the GDP data was out, the efficiency gains that boosted manufacturing growth over the last 2 years may have run their course. In which case, boosting private consumption is critical, as is the role of RBI—most analysts are penciling in a 25bps rate cut on Tuesday. Certainly, as chief economic advisor (CEA) Arvind Subramanian has argued, there is enough comfort on the inflation front even if there is a deficient monsoon. With cereals accounting for nearly a tenth of the entire CPI basket—and more than a fifth of the foods and beverages component—as compared to under 7% for fruits and vegetables whose prices tend to rise the most in a poor monsoon year, the government can dump grain to dampen inflation. While pulses inflation will rise—indeed, it has been rising, to 12.5% in April—inflation in oil and fats continues to fall in line with global prices. Whether a 25bps will move the needle, of course, remains a question—BRICS Bank chairman-designate KV Kamath's view is nothing short of 200bps will do the trick. This may be a bit extreme, and Crisil reckons a combination of lower inflation, oil prices and normal growth will impart an extra ₹1.4 lakh crore of consumption power in FY16, or a 2% hike in normal spending—but if consumers don't see an improvement in jobs prospects or see inflation trending up, the money could well get channelised into savings instead.

A 25bps rate cut means ₹17,500 cr of savings each year, but a 25bps relaxation in the deficit will mean ₹35,000 cr more in the year for new infrastructure—the latter's short-term impact will be much higher

A 25bps rate cut, assuming it takes place and banks pass this on, may not do much for spurring investment demand in the current circumstances—Crisil is looking at private investment picking up only in FY17 given how over-leveraged India Inc is, particularly in the case of infrastructure firms, and the CEA is also looking at only consumption and public investment as short-term growth-drivers. What a rate cut will do, however, is to provide a big relief to stressed corporate balance sheets—going by the outstanding loans of banks today, to all sectors, a 25bps rate cut translates into savings of ₹17,500 crore a year. While this gain is a recurring one each year, it is worth keeping in mind that a 25bps rise in the deficit will lead to a ₹35,000 crore increase in government investment—breaching the deficit makes sense only if the money is spent on investment—which is a far bigger short-term growth driver; indeed, as *FE* has argued before, if the FM were to reduce the wheat/rice stocks in FCI's buffers to even the expanded norms or sell his SUUTI shares, this money can be got without breaching the deficit.

Whether banks will pass on the repo cut, assuming it is made, is another story. Of the 50bps cut by RBI since January 2014, only 15bps have been passed on, and that too after a visibly annoyed RBI Governor said he wouldn't cut rates till this was done. The problem, however, is that with bank deposits growth at a 51-year low of 11.42%, banks are in danger of seeing a further fall in this with a cut in deposit rates. Most small savings schemes run by the government offer higher rates than banks do, and they even have a tax advantage—PPF offers 8.7% while Sukanya Samriddhi offers 9.2%. So banks are unlikely to be able to pass on all the rate cuts. While higher public sector investment and slowly limping back private consumption remains this year's only hope—a full-fledged investment recovery cannot take place till banks force promoters to deleverage by selling assets—the monsoon is the other imponderable. Crisil's 7.9% projection for FY16 gets reduced to 7.4% in the case of a poor monsoon—heavy pre-monsoon showers will certainly lower soaring temperatures, but they will also lower the monsoon's intensity, and GDP growth.

APPORTUNITY

What if an app could direct a person with no access to sanitation facilities to a clean public toilet?

Often enough, to demonstrate the scale of India's mobile revolution, a comparison with the state of sanitation in the country is drawn—more Indians indeed have mobile subscriptions than access to a toilet. However, in that, lies an opportunity. Chennai-based Akara Research and Technologies holds the other revolution in Indian telecom—the growing adoption of cheap smartphones—can help relieve India of its sanitation shame to a great degree. What if an easy-to-use app points you at nearest public toilet, using GIS technology? Drawing from its study in Shimla and Tirupati, Akara says a person, say, a slum-dweller, can be taught to use an app on a cheap smartphone and locate a toilet nearby—the app would not just indicate distance, it could give real time information on availability of water, whether there are separate toilets for women and men, and whether they are clean or not. If the interface is made easy enough for a semi-literate or illiterate person to use, it could indeed spur a behavioural change, and empower women—the public sanitation infrastructure, Akara notes, is skewed against the latter. Such an app can thus facilitate increased usage of public toilets—the government and corporates (under CSR) are building many in the earnest of the Swachh Bharat Abhiyan—and their monitoring.

Speaking of apps for monitoring, the government has come up with Bhuvan Ganga, an app that the public can use to monitor the progress of clean-up of the Ganga under the Namami Gange project. One can upload real-time images, clicked on one's smartphone, of any river-surface pollution. Once the central server receives and processes the image, the contractor in charge of the clean-up in that stretch of the river can be hauled up for any laxity. Indeed, the true potential of India's mobile revolution may lie in low-cost smartphones and mobile data services reaching all corners of the country.

What lies ahead?

It is premature to judge the Modi govt for results. What it is to be tested for is policy vision—and it scores high there

SUDIPTO MUNDLE

With investment and growth yet to pick up, the wild expectations from the Modi govt, when it came to power, have moderated. Nevertheless, the mood remains positive, in sharp contrast to the despondency that prevailed earlier

To assess the performance of the Modi government at the end of its first year is, in many ways, premature—at least in terms of economic management. The macroeconomic outcomes seen during the year, whether positive or negative, can mostly be traced back to events and actions that originated much earlier, or to conditions in the global economy, not acts of commission or omission of the government. Moreover, the translation of a policy or reform agenda into legislative or executive action is a drawn-out process, and the transmission from those actions to actual outcomes is an even longer process. It took several years before the 'big-bang' reforms of 1991 led to a sustained rise in India's growth rate. The same was true of similar reforms that were launched in China from the late 1970s.

So, the most we could expect at the end of the Modi government's first year is not results or even a long list of policy actions taken, but a vision, an approach and a clear programme of action for the next four years. Looking beyond the catchy slogans, we find the government has indeed laid out an ambitious action programme, and in some areas significant action has already been taken. What are the government's strengths and weaknesses in implementing the programme, going forward? What are the opportunities and risks? What lies ahead?

Infrastructure development is the government's top priority. In the absence of a revival of the private investment cycle, the government has adopted a strategy of public investment-led growth, with investment in infrastructure at its core. The assumption is that public investment in infrastructure will catalyse private investment and high growth. In the power sector, enactment of the new Coal Mines (Special Provisions) Act, enabling auctioning of coal mines, and the linking of domestic gas prices to international market prices will together eliminate the feedstock bottleneck for coal- and gas-based power supply. Additionally, several ultra-mega solar power projects under implementation will significantly increase the flow of clean energy. In other infrastructure, a huge step-up has been programmed for investment in railways, roads, ports, airports, inland waterways and urban infrastructure. Swachh Bharat and cleaning of the Ganga are part of this programme. Plans are also in place to supplement budgetary resources for financing these investments, e.g., an infrastructure investment fund and tax-free bonds, along with supporting institutional reform such as the 3P India (public-private partnership) model.

In social inclusion, the government has opted for direct benefit transfers as an approach to minimise the large leakages that occur. Under the Pradhan Mantri Jan Dhan Yojana, over 125 million accounts have already been opened for transfer of various direct benefits to disadvantaged target groups. These accounts will be linked to the Aadhaar database, under which over 1 billion persons have already been registered, to serve as the platform for transfer of all direct benefits, including assistance under MGNREGA, food security, etc.

In the area of monetary policy and financial systems reform, the signing of the monetary policy framework agreement is a landmark. It unambiguously defines the authority and responsibility of RBI vis-a-vis the government for inflation control. A new law to curb black money has also been passed. Together with RBI, the government has also rationalised the regulation of non-bank finance companies as well as the system of financial sector regulation itself.

The main initiative in fiscal policy is the goods and services tax (GST) that will bring a sea change in domestic market integration, giving a boost to both growth as well as revenue. Unfortunately, the required bill is still winding its way through Parliament. The proposed roll-back of tax exemptions and concessions is important. It could enhance revenues by upto 4% of GDP. However, it is yet to be implemented. So, is the decision to establish an independent public debt agency. On the expenditure side, subsidies on petroleum, diesel and gas have been compressed by linking their domestic prices to international prices. However, neither the Expenditure Management Commission nor its interim report find any mention in the current budget.

The fifth thrust area is the 'ease of doing business' in India, which is linked to the Make-in-India agenda. Allowing FDI upto 100% in railways and upto 49% in defence are significant measures. Other measures include the postponement of GAAR for two years and simplification of procedures for FDI and other businesses, e.g., the G2B portal eBiz for registration and commencement of business. A skills mission is being launched, and the Mudra Bank is being set up to refinance loans to micro units under the Pradhan Mantri Mudra Yojana.

In implementing the large agenda described above, the Modi government enjoys several advantages, especially the mood of positive expectations. The exuberance drummed up during the Modi election campaign and following his awesome victory, had led to wild expectations that somehow economic trends would be immediately turned around. With investment and growth yet to pick up, there has been a suitable moderation of such expectations, reflected in a stock market that remains where it was a year ago. Nevertheless, the mood remains positive, in sharp contrast to the despondency that prevailed earlier. This is an important opportunity the government can leverage to revive investment and growth with quick policy action in priority areas.

A related psychological asset is the absence of mega scams that hobbled the UPA government in its second innings. However, an important lesson from the UPA experience is that these assets can quickly turn into liabilities if some skeletons start tumbling out of the cupboard. Adverse reports of the CAG and other watchdog institutions should not be treated lightly.

Another strength is the profile of the council of ministers. A few seasoned and experienced political leaders have been joined by a large group of young, intelligent and, by all accounts, extremely hard working ministers hungry for results. Led by an equally energetic prime minister, there is a strong likelihood that this team will indeed get things done.

Offsetting these strengths are also some risks. Two controversial reform proposals could carry a heavy political cost. A market-distorting land acquisition Bill that would forcibly transfer land from farmers to business interests, and labour market reform based on the Rajasthan model, that eases doing business for employers but offers little protection to workers. These two reforms, that paint the government as being pro-business at the cost of other stakeholders, are facing resistance not only from opposition parties but also the BJPs own sister organisations. The prime minister has also been cautioned by his allies, the leaders of corporate India, his well-known admirers like professor Jagdish Bhagwati, and his friend US president Barack Obama that his economic agenda could be derailed if he is not more pro-active in curbing the fanning of divisive politics. Another potential risk is a deficit in capacity and depth of talent in the Union government bureaucracy to carry through the ambitious economic agenda. Finally, is it possible that a PMO-centric style of decision making, which has clearly driven the agenda so far, could become a constraint when implementation gathers momentum?

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A mixed bag for agri-trade

The first year of the Modi govt saw some hits, like the offloading of FCI stock in the open market, and some misses

TEJINDER NARANG

A SCAN of Indian agro-trade in the first year of the Modi government reveals a blend of significant positives and negatives. The momentum of the past built a legacy and the proactive steps taken in the past year augur well for reforms. However, some policies have remained static and continue to complicate the supply-demand mismatch and threaten export realisation. With the steep fall in crude-oil prices, demand for biofuels stands compressed. This has perhaps led to a retreat in global agro-commodity values and has also dented India's export competitiveness in wheat, sugar, corn, oil and soymeals. Lower exports also diminish domestic demand pressure. That may keep inflation down, but provides poor realisation to producers.

Ironically, India, in FY16, could become a net importer of superior-quality wheat (estimated at 1 million tonnes) from being a consistent exporter since 2011—0.5 million tonnes have already been contracted at landed prices which is cheaper than local cost. Imports from Australia, Russia, Ukraine and France are foreseen.

Wheat and rice

The Modi government wisely raised MSP of wheat and paddy by 4%, a departure from the high MSP increases of the past, and shunned the extra bonuses given to farmers earlier by both the Centre and the states. Credit is due to the food ministry for reducing public stock-holding of grains by efficiently managing procurement of wheat and paddy and offloading some of it in the market—from a peak of 60 mt in FY13, it has been brought down to 34 mt in FY15. This implies lower commitment of public funds for procuring stocks in surplus, increased availability of grains in the open market and a sharp drop in inflation. There are two factors behind the reduction—first, the abolition of the levy-rice policy and second, the evacuation of 4 mt of FCI wheat through exports in the last two years.

Eliminating levy rice policy has ensured substantial availability of non-basmati rice in market at lower prices, thereby enabling exports competitiveness. India registered the world's largest rice exports in FY15 (at 12 mt), in the overall rice traded worldwide (42 mt).

The wheat stockpile could have been reduced by another 2-3 mt had the government not dithered in making marginal adjustments in contracting at when global prices were \$290-\$299 per tonne fob, and later, \$260-\$270 fob—the fall in the rupee's value in the last two years would have earned significant gains. Niche opportunities were missed by sheer inflexibility in decision-making.

There is no possibility of exporting low-quality Indian wheat in FY16 as world prices are set to fall below \$185-\$195/mt fob. Another difficult decision that the government now faces is whether to distribute low-quality wheat under the PDS or to explore other alternatives for its disposal.

Sugar

The over-supply of sugar (27-28 mt) as compared to the demand (23 mt), bulging carry-in stocks of 10 mt and lower prices (down by 9% from a year ago) have further complicated an already tricky situation that involves about ₹21,000 crore of arrears due to farmers and 550 millers having suffered crushing losses. The poor financial health of the sugar industry has meant that banks, which lent to millers, are now burdened with loans that could soon turn bad. Exports are down to 0.5 mt while the expectation was of at least 2.5-3 mt being shipped out by Indian traders. Neither the states nor the Centre have shown enough willingness to correct the existing situation of pricing of cane, which is now a political issue for cane-growing states with the cane-farmers votebank in mind. Granting WTO non-compatible export subisidies to sugar , proposing public procurement of sugar (to create a 3 mt-buffer) or chasing mills for payments to farmers—all of these are solutions like the ostrich burying its head in the sand. The issue of the state-advised price for cane has to be taken by the horns and dealt with once and for all. The policy perspective behind such action is to be prioritised rather than hollow polemics.

Oilseeds

India imports about 12-13 mt of edible oil per annum—palm oil constitutes 80% while the balance 20% is soy, sunflower, canola, etc. The global prices of edible oils are declining in tandem with the fall in global agro-commodity prices. The wholesale prices are also reflecting the same trend. But domestic manufacturers demand high import duties to in order to nullify competition from lower-cost imported oil. High seed prices, due to low production or speculation in future exchanges or hoarding by the farmers, is behind the high-priced locally crushed oil.

Why should the consumer should pay high prices for edible oil and why should the government be an accomplice in this? World prices will continue to plunge down with higher yields due to adoption of GM technology. If our production remains inconsistent with the global adoption of GM technology, the local industry is bound to remain sick.

Pulses

Inflation in pulses, at 15.38 %, is the only black mark while milk, fruits and vegetables are reflecting marginal deflation. The import intensity of pulses will be significantly move up if predictions of a deficient monsoon this year come true. Nearly 70% of pulses are rabi crops where gross area of cultivation competes with wheat—another rabi crop. The predominance of wheat in sowing area—due to the MSP and public procurement support from the government—comes at the cost of pulses. Four to five million tonnes of import is foreseen, with substantive price escalation.

For full marks in agri-trade, the government needs to figure out how to dispose the low-quality wheat stocks and display the courage to prod states out of populist cane-pricing. It also must take a well-considered view on adopting GM technology for oilseeds and should not mess up imports of pulses through subsidies.

The author is a grains-trade analyst

LETTERS TO THE EDITOR

Shed no tears for Salman Khan

Apropos of the edit 'Unjust cause' (May 8), the message that 'no one is above law' should finally pour into the ears of those Salman Khan-admirers who did not hesitate even to taunt the court that awarded the actor his punishment for the hit-and-run case he was involved in, which is a clear contempt of the court. In India, influential persons, be they industrialists, film personalities or politicians, treat the judiciary as something that exists to be subverted; they try to influence the judicial process by the dint of their money or muscle power and are allowed VIP treatment at jail. So, the maudlin sentimental support for Khan should take back-seat (pun intended) and the judiciary should be allowed to perform its duty without pressure/hindrance from any quarter. The helpless victims should be adequately compensated by the perpetrator for his grievous misdeed. The court should explain the reason behind the inordinate delay in delivering the final verdict, which frustrates the basic concept of natural justice.

Debabrata Sengupta
Howrah

Private banks outperform PSBs

It is shocking that PSU banks have fallen behind their private sector counterparts in terms of profits. The government is entirely to blame for this. One one hand, it doesn't recapitalise banks at the time of their need. On the other, the nationalised banks must further the inclusion agenda of the government and must heed political "requests" regarding loan grants. Not surprising then that they are outclassed by the private banks.

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