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Economy on the Revival Path:

Need for a Calibrated View

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The third quarter estimate of GDP for the year and the second advance estimate of National Income for 2017-18 released on February 28 shows that the economy, after the two major disruptions is in the recovery mode. There has been a steady acceleration in the growth of GDP from 5.7 per cent in the first quarter to 6.5 per cent in the second and further to 7.2 per cent in the third quarter. The estimated growth of GDP for the year has been marginally increased to 6.6 per cent from 6.5 per cent estimated in the first estimate released in January this year. The Economic Survey estimated the growth for the year at 6.75 per cent and the RBI too was close at 6.7 per cent. However, the CSO's estimate of 6.6 per cent seems to be more likely as the coming quarters will see the GST refunds given as the technology stabilises and the difference between the gross value added (GVA) and GDP will become narrower. The acceleration in GDP to 7.2 per cent in the third quarter has led some people to declare that India has become the fastest growing large economy beating China. While it is clear that the economy seems to have recovered from the disruptions, a careful analysis of the numbers advises a more sobering view. Sustained increase in investment and growth requires addressing the structural factors impinging on growth.

While it is true that there has been a steady acceleration in the growth of GDP as well as GVA in the three successive quarters, they are still well below the growth rates for the corresponding quarters in 2016-17. The GDP growth rates in the first three quarters of 2016-17 were 8.1%, 7.7% and 6.8% as compared to current year's at 5.7%, 6.5%, 7.2%. The estimated annual growth for the current year at 6.6 per cent is lower than the previous year's growth of 7.1 per cent. Similar trend is seen in the case of GVA which in the three quarters of 2016-17 registered growth rates of 8.3%, 7.2% and 6.9% as compared to the current year's rates at 5.6%, 6.2% and 6.7%. Curiously, in the third quarter, the GDP in the current year (7.2%) is higher than the previous year's (6.8%) even though the GVA is lower and the difference seems to be mainly due to the failure to provide GST refunds to the exporters due to the technology hitch and the inability to finalise GST returns. Thus, the GDP numbers will correspondingly be reduced as and when the refunds are given. Thus, even as the economy is seen in the recovery mode, the growth is still below that of the last year.

The sectoral growth analysis brings out some interesting features. First, the two sectors that suffered the most due to demonetisation have shown recovery. The construction sector and finance, real estate and professional services both grew at 2.8 per cent in the third quarter last year and the growth in the third quarter this year is estimated at 6.8 and 6.7 per cent. While this shows the recovery from the disruptions, it also shows that the growth is not very robust as it is over the low base last year. The annual growth for the current year in construction is estimated at 4.3 per cent as compared to 1.3 per cent last year and finance and real estate sector is expected to grow at 7.2 per cent as compared to 6 per cent last year. Second, in five of the eight sectors, the growth rate for the current year is lower than last year's and these include Agriculture and allied (from 6.3 to 3 per cent), manufacturing (7.9 to 5.1 per cent) mining and quarrying (13 to 3 per cent), electricity, gas and water supply (9.2 t 7.3 per cent) and public administration (10.7 to 10.1 per cent). Of course, the manufacturing sector has recovered steadily from (-)1.8 per cent in the first quarter to creditable 8.1 per cent in the third but further acceleration will require solution to structural problems. These number pot toward s the need to immediately undertake measures to alleviate farm distress and revive the investment climate in the country. Third, Even as output of agriculture has shown an increase, the price of farm products have lagged as shown by the difference between current and constant price growth rates. The numbers show that the growth of prices is just about 1.2 per cent for agriculture and allied sector (difference between current and constant price growth rates), as compared to over 10 per cent for mining and quarrying and 2,7 per cent in manufacturing. The slow increase in prices of farm products signifies the changing terms of trade.

The growth in gross fixed capital formation (GFCF) at 12 per cent in the quarter is impressive and this possibly signifies the pickup in investment activity. The increase in the growth of the core sector for January at 6.7 per cent also signifies a strong performance. However, the PMI for the services sector has contracted in February to 47.8 from 51.7 in the previous month and this is a matter of concern. The short point is that the recovery is still not steady nor is it uniform. The last month with a series of scams uncovered in the commercial banks casts worrying shadow and raise questions about the ability of the banking sector to finance investments. Of course, financing long term capital requirements of the manufacturing sector through short term deposits collected by the commercial banks is a misalignment and much of the requirements will have to be financed through long term sources such as bonds. In any case the ability of the investors to borrow and the commercial banks to lend will depend on how fast and effectively the NCLT will resolve the cases referred to it.

In addition, there are a number of exogenous factors threatening recovery. The Federal Reserve is expected to hike interest rates at least three times this year and it remains to be seen how much and haw fast this will happen. There is the devil of rising protectionism. The upward movement in oil prices too is threatening to spoil the party. The overshooting the fiscal deficit numbers will constrain the RBI's monetary policy and if the prices show an upward trend the RBI too may take a hawkish stance. Let us hold the breath and see how we will muddle through.

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