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Growth in the Indian Economy- Some Thoughts

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The poor performance of the markets last week has again underlined global concerns over the developments in the United States and the European Union. In terms of the impact on the Indian economy, the media have been articulating both points of view - that it would have no effect, and that it would have a considerable impact.

It is true that the last decade has witnessed considerable integration of the Indian economy with the rest of the world. Trade GDP (gross domestic product) ratios were only around 12 per cent in 2000 but are close to 36 per cent now, in an economy that has doubled in size in real terms during this period. Exports are no longer of traditional products like gems and jewellery and handicraft; now a significant proportion of exports is accounted for by refined petroleum products (of the order of 40 per cent) and manufactured goods, including light engineering goods, plastics and pharmaceuticals. Indian companies have invested overseas in manufacturing facilities, coal mines, oil exploration and even in infrastructure construction, and corporate results reflect the performance of overseas subsidiaries in a significant way. There is greater exposure to external debt, with external commercial borrowings of the corporate sector close to US\$250 billion, an increase of 18 per cent during the first six months of 2011. Finally, the equity markets are closely integrated with the rest of the world, and investments by foreign institutional investors significantly affect market volumes and prices.

It is therefore possible to argue that the impact of the slowdown in the developed markets would be felt significantly in India.

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The planning commission as well as the prime minister's economic advisory council have scaled down GDP growth forecasts for FY 2010/11 from 8.5 per cent to 8 per cent, and some academics are pitching it even lower, at around 7.5 per cent. This has been based on several indicators. First, there is a slowing down in the index in industrial production growth figures, and in the growth of bank credit for the non-farm sectors. Though data is scarce, there is a reported slowdown in fresh capital investments. With the stock markets choppy, equity-raising activity has slowed down, and is currently only around 40 per cent of the amount up to July 2010. Several IPOs have been postponed. Government has been unable to come up with a road map for dilution of shares in public-sector undertakings, which have been budgeted for in the current year's government revenues. Second, the monsoon has not been up to expectation in all regions, and growth in agricultural production is expected to be only of the order of 2 per cent in the current year. Third, there is no sign of inflation abating, and food inflation has been in excess of 9.2 per cent so far in 2011. The Reserve Bank of India (RBI) has been tightening monetary policy for the last seven quarters, and the recent increase of 50 basis points in the July review indicates the concern that the RBI has over inflation. Monetary tightening has affected credit flow to industry as well as to the real estate sector, and home loans are now at 13 per cent or more, compared with 9.5 per cent only two years ago. Finally, there is also concern that the budgetary expectations of fiscal management may not be realised. Expenditure on subsidies and flagship programmes like the National Rural Employment Guarantee scheme continue to eat away revenues, and there is not very much to cheer from the revenue side.

In short, both from the external front as well as internal macroeconomic concerns, it does appear that there is likely to be a significant slowdown in the Indian economy over the next 18 months.

Interestingly, there are clear signals that this gloom is not quite justified. First, it is clear that even the most pessimistic analysts expect at least a 7 per cent or 7.5 per cent rate of growth in real terms for the economy over the next decade, representing a threefold increase in GDP by 2025. Since agriculture growth, based on long-term trend lines, has been only between 2 per cent and 3 per cent, and industry averages appear to be no greater than 6 per cent, it is clear that the services sector is likely to witness a greater than 9 per cent rate of growth. Currently, this sector accounts for more than 55 per cent of the GDP.

Disaggregating this further, there are sectors that are witnessing growth rates of 15 per cent and above. These include education, health care, hospitality (hotels, restaurants), travel and fast moving consumer goods (FMCG), to name a few. In the tertiary-education sector, for example, admissions this year demonstrated the woeful shortage of good tertiary institutions. In colleges like the Shri Ram College of Commerce in New Delhi and several state-run engineering colleges of repute, the cut-off rates for admission were a full 200 out of 200. This means that all seats were filled with students scoring 100 per cent in their school leaving examinations. Private colleges that charge capitation and management fees for admission

have had a field day. Even distance learning institutions, like the Indira Gandhi Open University, have seen admissions growing by more than 20 per cent. On the one hand, this shows up a serious supply gap in tertiary institutions; on the other, this points to the large numbers of school leavers who are now able to afford tertiary education.

The picture is similar in healthcare as well. Existing hospital chains like Apollo hospitals and Fortis are expanding fast, even in tier two and tier three cities, followed by compound growth in the pharmaceutical industry. Tourism, hotels and restaurants are growing at a compound annual growth rate of 18 per cent and the FMCG sector is not far behind. In short, consumption sectors, including mobile phones and electronics, leisure and travel, and self care, are growing at more than 15 per cent. This has been in part fuelled by healthy employment growth in the services sector in the last year. The banking sector has recruited more than 100,000 new employees, of which State Bank of India alone has recruited 25,000. The IT and other services sectors have accounted for around 500,000 in the last year. Total employment creation in the organised sectors in services has exceeded a million in the last 12 months. This immediately leads to a spurt in consumption, as FMCG, textiles and electronics grow. The next phase comes with a little extra savings— for two- or four-wheelers and then, after a couple of years, a flat.

Extrapolating this forward, it is easy to see that the consumption sectors will grow far faster than the rest of the economy, and will account for a significant contribution to growth. Taking a projection up to 2025, it is easy to predict a tripling of the GDP in nominal terms, even with slow growth in the manufacturing and agriculture sectors. Growth in the consumption sectors would be at least three times this figure, and consumption expenditure would be up by eight to nine times current levels.

This would be the bulwark of the projected 7 per cent + growth for the next decade. It also follows that given slow increases in agriculture and only gradual increases in manufacture, the pressure on consumption would lead to considerable price pressures. Consumer prices will continue to go up in view of the supply-demand mismatch. Commodity price increases will only exacerbate the pricing pressures.

India is in for a decade of good growth and high inflation. Infrastructure will probably remain what it is today.

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