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Don't blame GST and DeMo

The economic slowdown began much earlier, thanks to a punctured capex circle and feeble consumption demand

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The economy has been slipping due to transient factors such as demonetisation and GST. The root of the malaise is private investment; a punctured capex cycle that is the Achilles' heel of the economy.

The narrative has changed since the time the GDP and current account data points were released for the June quarter. Shocked by the sharp slowdown in growth numbers coupled with a surging deficit in current account, the business media and policy commentators had started to breathlessly comment on how India's macro had suddenly lost its magic as a fallout of demonetisation and the poor implementation of GST. Mainstream channels joined the chorus to magnify this quarter muddle into a mega trend of sharper slump.

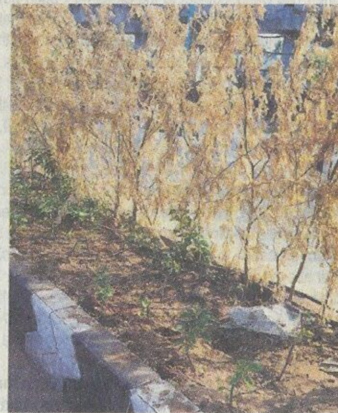
Yes, the GDP growth which came at 5.7 per cent for the June quarter was shockingly low and the CAD at 2.4 per cent belied even the most pessimistic projections. That said, putting the onus entirely on some transient factors such as GST and DeMo is akin to missing the woods for the trees.

A closer look

A closer look at the data points shows that the economy has been slipping steadily since March 2016, much before demonetisation. The core GVA peaked in March 2016 at 10 per cent plus and has been sliding since then to sub-5 per cent in March 2017, before marginally recovering to a 5 per cent plus level in the June quarter.

This, seen in the context of structurally falling numbers both in private investment growth and in Gross Fixed Capital Formation will make one understand that the root of the malaise is in the secular slowdown of investment demand. Of course, the sharp appreciation of the rupee over the past several months in real effective exchange rate basis has added to the woes. With the current account slipping, adjustment is on the cards with the rupee providing much needed relief to exporters.

That leaves us with the bigger challenge of how to stem the rot in the capex cycle. Without reviving the private capex cycle, it is near impossible for the economy to cross the 7-8 per cent hurdle, though it can recover to a high 6 per cent when the transient factors fade in a couple of quarters. This is because private capex constitutes over 30 per cent plus of GDP (over $600 billion) which, if it remains sluggish, can scuttle the India Story. The Government's ill-advised plan to splurge on public investment by relaxing fiscal norms (through fiscal stimulus), can barely move the needle on growth, while it could upset the portfolio flows and hence the rupee if bond investors start fleeing consequent to the prospect of rising market borrowings.



The rot set in Way back M KARUNAKARAN

Tough task

Reviving investment demand is not easy. The Government has been struggling with this for two years. It is not so much supply of credit than the demand for credit. Therefore, neither rate-cuts nor balance sheet clean-ups in PSBs can revive investments meaningfully, though they can help incrementally.

Given the surplus liquidity that is sloshing in the global monetary system, capital or the cost of it is the last thing that worries corporate chieftains. India Inc is not investing, not for lack of capital, but because of gross under-utilisation in many sectors. High capital intensive sectors such as energy, metals, and oil and gas suffer from serious surplus capacity globally too. Add to this the surge in buy-out opportunities for Indian corporates because of balance sheet stress in capital-intensive sectors. Why would any corporate invest in greenfield projects if ready capacities are available at distressed levels?

What is the solution? Growth in consumption, both private and public, holds the key to recovery in investment demand. Capacity utilisation in India was at 72.7 per cent for the quarter ended December 2016. One useful thumb-rule is that when capacity utilisation starts to move beyond 80 per cent plus, companies begin to invest in new capacity. Sustained rise in consumption over the next few quarters can improve utilisation to this desired level, which in turn can kick off recovery in private capex cycle. Buoyancy in global growth can help too. Greenshoots across global economies can go a long way in reducing spare global capacity. This, along with strengthening private consumption in India, will, over time, compel chieftains to open their purse strings on new capacity additions. Till then, it is going to be a sub-7 per cent reality, which the Government and investors have to make peace with.

The writer is founder-CEO and fund manager, TrustLine Holdings Pvt Ltd