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The economy is turning the corner

Private sector investment, a dominant driver of economic growth, is showing signs of revival

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Amid the glum headlines about another year of slowing economic growth, there is a silver lining in the first official forecast, released last week, of national income in the fiscal year ending March 2018.

It is widely known that the Indian economy has continued to lose momentum because of the lingering impact of demonetisation as well as the messy transition to the new goods and services tax (GST). However, there are signs that the Indian economy is turning the corner — although it is far from a done deal.

Finance minister Arun Jaitley should pay attention to the silver lining as he finalises the last full budget before the next general elections. The national income estimates show that nearly a quarter of the expansion in domestic demand during fiscal year 2018 come from investment activity. It accounted for less than a tenth of the increase in domestic demand in the previous fiscal year.

Why is this important? Any economy is powered by four engines — consumer spending, government spending, investment in new equipment and the trade balance with the rest of the world. The first three are sources of domestic demand while the fourth measures net foreign demand for Indian products.

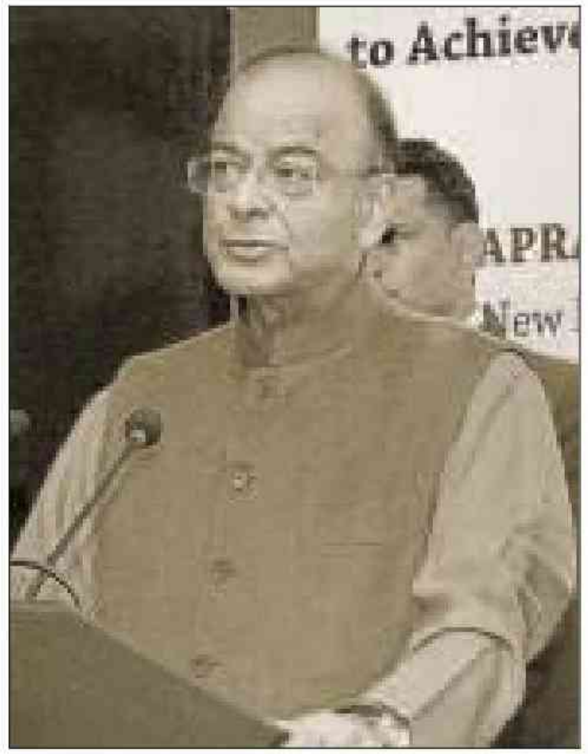
Only two of these four engines have been firing in recent years. Indian consumers have continued to buy, aided by a rise in household debt. The government had to spend to absorb the shock to private sector demand because of demonetisation.

The other two engines of aggregate demand have only sputtered. Private sector investment has been held back because of excess capacity on the one hand as well as weak company finances on the other. (Note: The official capital formation numbers include investment by enterprises and households.)

The quarterly capacity utilisation surveys by the Reserve Bank of India continue to show excess industrial capacity. So companies can increase production without investing in new factories. Companies have also used their free cash flow to reduce debt rather than create new production capacity.

The first government forecast of economic growth in the current fiscal year offers a glimmer of hope that investment activity is perhaps finally picking up after more than six years of inertia.

A look at national savings data also shows that corporate savings have been going up as a percentage of gross domestic product, though the latest available data is only for the fiscal year ended March 2016.



■ **As he finalises the Union Budget, finance minister Arun Jaitley should keep the silver lining in mind** PTI

It is in this context that the recent synchronised recovery in the global economy is important — led by a revival in private investment. Global trade is gaining momentum. Many Asian countries have reported robust exports growth in recent months. India has not yet been able to join the party. Expert opinion is divided on whether this is because of an overvalued exchange rate that prices Indian products out of the global market or the disruptions to domestic supply chains following the twin policy shocks over the past 15 months.

An export revival will provide the extra foreign demand that could gradually help close the excess capacity gaps in several industries, making investments in new factories more attractive.

What happened during the economic boom that ended in 2008 is instructive. Private sector investment became the dominant driver of economic growth. Much of this investment came from registered manufacturing firms that were producing for exports. This investment surge was financed by higher domestic savings as well as a deluge of foreign capital that came in as part of the global financial bubble.

Is India due for a repeat? It is hard to say, though the World Bank said in its June update on the Indian economy that it expects private sector investment to become an important driver of economic growth in fiscal year 2019. The cold fact is that national savings and investment rates are nearly 10 percentage points down from a decade ago.

A lot thus depends on an investment revival. The past 25 years tell us that the Indian economy grows rapidly only when private sector investments as well as exports are strong.

Think of the economic boom in the three years to 1997 and then the spectacular advance in the four years to 2008. In other words, India has had high levels of sustainable growth whenever all four engines of demand are whirring efficiently.

The first tentative signs of a revival in private sector investment combined with the recovery in the global economy point to an overdue rebalancing that the government needs to build on. Or else the silver lining will be just that — a hope

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