



ourview

The Indian economy is gathering momentum

*But there are also mounting pressures on
inflation and the trade deficit*



JAYACHANDRAN/MINT

The latest economic data released last week by the bean counters in New Delhi should be a relief for the Narendra Modi government, especially since it was followed a few days later by historic political wins in North East India. These tailwinds cannot harm the incumbent regime in the months leading to the next general election—even though political outcomes are never simple extrapolations of economic trends.

The numbers for the third quarter show that the Indian economy is well on the recovery track, after the twin shocks from demonetization and the messy transition to the new goods and services tax (GST). At 7.2%, gross domestic product (GDP) at constant prices clocked its best rate of expansion in five quarters—and a full 1.5 percentage points higher than the bottom hit during the first quarter of the current fiscal year. GDP growth has been rising for three consecutive quarters now.

A look at the gross value added (GVA) trends provide a more mixed picture. GVA growth in the third quarter was lower than the GDP growth rate—6.7% versus 7.2%, in all probability because of high indirect tax collections during the three months to December. This wedge between the two main measures of economic growth should reduce once the GST stabilizes. This newspaper believes that policy makers should look at GVA rather than GDP in such situations, so the case for an early interest rate hike is less compelling if the Reserve Bank of India looks at GVA rather than GDP.

However, even while GVA growth has lagged GDP growth in the third quarter, the trend in core GVA—once agriculture and public administration are taken away from the calculations—shows that the underlying private sector economy is doing very well. Core GVA grew at 7.4% in the third quarter, and the recovery in the industrial sector is especially welcome. The farm economy continues to struggle because of the collapse in many food prices, but there is little doubt that the rest of the private sector is gaining momentum.

The data on aggregate demand is also worth highlighting, because it reveals an important switch in importance between domestic consumption and domestic investment. The Indian

economy has been kept on track for several years by consumer spending.

It is well known that investment activity was bogged down by excess capacity on the one hand and balance sheet stress on the other. The data for the third quarter shows that consumer spending is losing momentum while investment spending is gathering pace. Is the long investment drought finally over? It is too early to say, but some recent signals are encouraging, though it is likely that what we are seeing now is brownfield rather than greenfield investments. The prospect of an investment revival featured in these columns on 19 February (bit.ly/2F9cG5g). However, the slowing down of consumer spending needs more attention.

What lies ahead? The Indian economy should continue to accelerate this year, especially since the global economy is in the midst of the first synchronized expansion after the North Atlantic financial crisis. Global trade is recovering rapidly while the investment cycle has also turned in most developed economies. These should help India as well.

However, not everything is so benign. Inflation is rearing its head again, and the sharp recovery in the nominal growth numbers show that price pressures are building up in the Indian economy. The trade deficit has been growing rapidly, and the capital inflows needed to fund it could get disrupted in case US monetary policy gets tightened more than expected. The conservative macroeconomic framework that has served India so well since the rupee scare in the middle of 2013 could get severely tested in the months ahead.

It is good to see economic growth back on track. However, it is easier to initiate growth but more difficult to sustain it. There has been a lot of celebration that India is once again the fastest growing major economy, but the task of pushing the potential growth rate higher should not be lost sight of. It is also useful to remember that economic growth is around one percentage point lower than what should be possible in a strong global economy.

Is the Indian economy on a sustainable recovery path? Tell us at views@livemint.com