Moving towards an investment revival

Is corporate investment finally stirring to life? There are now a few silver linings in what continues to be a dark sky. These rays of hope deserve more attention than they are getting right now.

In its latest monetary policy statement released in early February, the monetary policy committee of the Indian central bank said, as part of its comments on the outlook for the Indian economy, that there are early signs of “a revival in investment activity”. The panel that sets interest rates believes the revival in global demand should help strengthen domestic investment. Earlier, the World Bank had said in its June update on the global economy that gross domestic capital formation—or investment—would overtake private consumer spending in fiscal year 2019 as the main driver of Indian economic growth. The International Monetary Fund (IMF) has also been expecting a private sector investment recovery in the next fiscal year.

Much of this seems to fly in the face of an overwhelming fact: Indian industry is still struggling with the problem of overcapacity. The production facilities frenetically built during the previous economic boom have run into the problem of weak domestic demand. However, the first synchronized recovery in the global economy since the financial crisis could provide the export demand needed for Indian companies struggling with excess capacity.

The industrial outlook surveys conducted every quarter by the Reserve Bank of India (RBI) continue to show capacity utilization at a little over 70%. This number needs to increase by at least 10 percentage points before companies get back into investment mode. It is also widely known that the twin balance sheet problem, or the mirror images of excess corporate leverage and a mountain of soured bank loans, is a huge obstacle for private investment. Companies are more focused on using cash flows from operations as well as asset sales to reduce debt rather than invest in new capacity.

However, the global data is more reassuring. Many large economies have seen a strong revival in corporate investment over the past few months, and it would be unusual if Indian corporate investment did not pick up, though a lot depends on what happens to the structural overcapacity in China as a result of its investment bubble. The big policy gamble taken by the Donald Trump administration in the US—of a large fiscal stimulus despite tight labour markets—could blow another global bubble unless monetary policy is tightened rapidly. But for now it will fuel strong global demand.

Much of the early data in India suggests that the game right now is capacity expansion rather than building new facilities. The Mark To Market column published in this newspaper cited the order trends in capital goods companies such as ABB India, Siemens and Thermax to argue that brownfield investments are seeing a recovery. There is less action as far as greenfield investments go. The index of industrial production also suggests that capital goods production is growing at a healthy clip, though it must be reiterated that this segment of the factory output data is notoriously volatile.

There is widespread agreement that India cannot have sustainable growth acceleration unless private sector investment picks up. The economy has till recently been very heavily dependent on consumer spending plus public investment by the government. The two other drivers of aggregate demand—corporate investment and exports—have struggled. It is for this reason that the recent green shoots are important.

A bit of recent economic history would help clarify why a recovery in private sector investment matters for India. The two important economic booms in the 26 years since the 1991 economic reforms tell us an important story. Be it the 1994-97 acceleration or the one between 2004-08, it is clear that a combination of a strong global economy plus a private sector investment boom is needed to lift the underlying trend economic growth on a sustainable basis. Consumer spending and government expenditure alone can take economic growth so far—but no further.

Strong export growth to complement the recovery in domestic demand could help companies deal with excess capacity. The deleveraging of corporate balance sheets as well as the recapitalization of public sector banks can create space for the financing of new industrial capacity. The battle against the investment slump is far from over—but there is now reason to hope that the worst is over.

Will the global economic recovery revive investments in India ? Tell us at views@livemint.com

END