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WHAT ARE INDIA’S IMMEDIATE GROWTH PROSPECTS?

Relevant for: Indian Economy | Topic: Issues relating to Mobilization of resources incl. Savings, Borrowings & External Resources

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Construction work along the river Brahmaputra in Guwahati. | Photo Credit: AP

The National Statistical Office (NSO), on February 28, 2023, released a set of new numbers pertaining to annual and quarterly national income for 2020-21, 2021-22, and 2022-23. This new dataset provides an opportunity to make a final assessment of COVID-19’s adverse impact on India’s GDP growth.

As per NSO’s second advance estimate (SAE), India suffered a contraction of (-) 5.7% in 2020-21 which is much lower than its first advance estimate (FAE) at (-) 7.7%. In this revision, the three sectors which benefited the most were manufacturing, construction, and financial, real estate et al. Real GDP during this COVID-19 year amounted to 136.9 lakh crore, higher than the 134.4 lakh crore assessed earlier. Since then, GDP grew by 9.1% in 2021-22 and 7% in 2022-23. Comparing the current real GDP level at 159.7 lakh crore, the compound annual average growth rate between 2019-20 and 2022-23 was 3.2%. It may be noted that some countries including China, Bangladesh and Vietnam had a positive growth even in the COVID-19-affected year of 2020.

Sector-wise, while overall GVA in 2022-23 is higher by 11.3% as compared to 2019-20, one sector — mining and quarrying — still shows a contraction at (-) 0.3%. Trade, hotels, transport et al also show a weak growth of 4.3%. Sectors showing a higher-than-average increase include construction at 18.6%, manufacturing at 14.8%, financial, real estate et al at 14.3% and agriculture at 12%. From the viewpoint of aggregate expenditure, overall increase in real GDP is 10% with government final consumption expenditure (GFCE) growing at 7.4%. Gross fixed capital formation and private final consumption expenditure (PFCE) show an increase of 17.7% and 13.1%, respectively.

The gross fixed capital formation to GDP ratio in nominal terms is 29.2% in 2022-23 as compared to 28.6% in 2019-20. The corresponding real investment rates are 34% and 31.8%, respectively. The difference in real and nominal rates is due to the differential inflation rates of capital goods vis-à-vis overall GDP. Thus, in real terms, there is more improvement in the investment rate. Accordingly, the estimated incremental capital output ratio (ICOR) was at 8.5 in 2019-20 as compared to 4.9 in 2022-23. This is because the 2019-20 GDP growth rate was rather low at 3.7% reflecting considerable unutilised capacity. The average capacity utilisation ratio in the manufacturing sector was only 70.3% in 2019-20, having fallen from 75.2% in 2018-19. In the first half of 2022-23, the capacity utilisation ratio is higher at 73.5%. While the gross fixed capital formation rate has picked up whether measured in real or nominal terms, the subdued growth implies a lower capacity utilisation and a higher ICOR.

In Q3 of 2022-23, real GDP growth was at 4.4%, falling from 6.3% in Q2 and 13.2% in Q1. However, this decline in growth rate is in line with the projections made by the Reserve Bank of India earlier. It would now require a growth of 5.1% in Q4 to enable reaching an annual growth of 7% in 2022-23. This appears feasible as most high frequency indicators point towards an improved economic activity. PMI manufacturing in January and February 2023 at 55.4 and 55.3, respectively, remained above its long-term average at 53.7. PMI services increased from 57.2 in January 2023 to a near 12-year high of 59.4 in February 2023. Core IIP showed a growth of 7.8% in January 2023, increasing from 7% in December 2022. Credit growth was also high at 16.1% in the week ending February 10, 2023. Monthly credit data, however, indicate a high credit growth only with respect to personal loans. Industrial credit growth was at a seven-month low. A higher quarterly growth in Q4 appears feasible because of a favourable base effect since growth was subdued in the corresponding quarter of the previous year at 4%.

Sector-wise, in Q3 of 2022-23, manufacturing showed a contraction at (-) 1.1% while public administration, defence et al showed a weak growth at 2%. On the expenditure side, GFCE contracted by (-) 0.8% while PFCE showed a weak growth at 2.1%. The contribution of net exports to real GDP growth was (-) 0.2% points, improving from (-) 3.4% points and (-) 3.1% points, respectively, in the previous two quarters. Thus, the growth rate in Q3 and the expected growth rate in Q4 are quite decidedly low. From a normal base, growth is yet to pick up to the desired level.

Given the anticipated global economic slowdown, India's 2023-24 growth is likely to remain lower than the growth rate of its preceding year of 7%. The RBI has projected a growth of 6.4% for 2023-24. The International Monetary Fund, on the other hand, has projected a lower growth of 6.1%. NSO's data revisions indicate a lowering of the negative contribution of net exports in 2022-23 to (-) 1.9% points as per the SAE from (-)2.8% points in the FAE. If fiscal stimulus is continued, injected largely through capital expenditures as envisaged in the 2023-24 Union budget, we may come closer to the RBI's growth estimate. However, with elections round the corner, there may be pressure to increase revenue expenditures. This might lead to a growth rate closer to 6%. Any stimulus for growth should be undertaken while adhering to the fiscal consolidation road map so as to keep India's medium-term story intact. A steady growth of 6% to 7% can be ensured over the medium term, only if the fixed capital formation rate is raised by another 2 percentage points. This is notwithstanding the global factors that are not encouraging.

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