An elusive recovery: explaining the economic slowdown

A view of the BSE building in Mumbai. | Photo Credit: Shashi Ashiwal

Growth in industrial output, according to the Index of Industrial Production released by the Central Statistics Office on Tuesday, has slumped to 1.2% in July as against a much higher rate of 4.5% recorded during the same month last year. July's industrial output growth is still higher than the growth rate of -0.2% witnessed in June. Retail price inflation, as measured by the Consumer Price Index, rose to a five-month high of 3.36% in August as compared to 2.36% in July. These numbers follow the slowdown reported earlier this month in the growth of gross domestic product (GDP) during the first quarter of 2017-18.

The implementation of the goods and services tax (GST) has caused significant uncertainty among businesses about the tax rates and other rules to be followed under the new tax regime. This has led to a drop in business activity across the value chain, which in turn is reflected in the lacklustre industrial output numbers. In addition, the economy has been contracting for the last five consecutive quarters, starting well before the implementation of GST or the demonetisation of high-value rupee notes in November last year, before growth in the latest quarter hit a three-year low. Many have attributed this to the drought in private investment which has lasted for years now. The current slowdown is thus very likely the result of both short-term disturbances caused by GST as well as other secular influences.

The slump in economic growth in recent years has led to increasing pressure on the Reserve Bank of India to provide a boost to the economy by cutting interest rates aggressively. The underlying belief is that printing money can grow the economy. The rise in retail inflation in August, however, probably rules out any form of aggressive monetary stimulus by the RBI in its next policy meeting due to be held in October. Even so, at least some part of the lost growth may be recovered over the next few quarters as the economy adapts to GST and other related short-term disturbances. A sustained recovery that puts India on the high-growth trajectory for years, as recommended by former RBI Governor Raghuram Rajan, however, may be possible only after the government implements structural reforms in the labour and land market.

The new U.S. Fed Chairman is unlikely to opt for policies that might upset the President's plan

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