

South Asia

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Sheen wearing off Indian growth

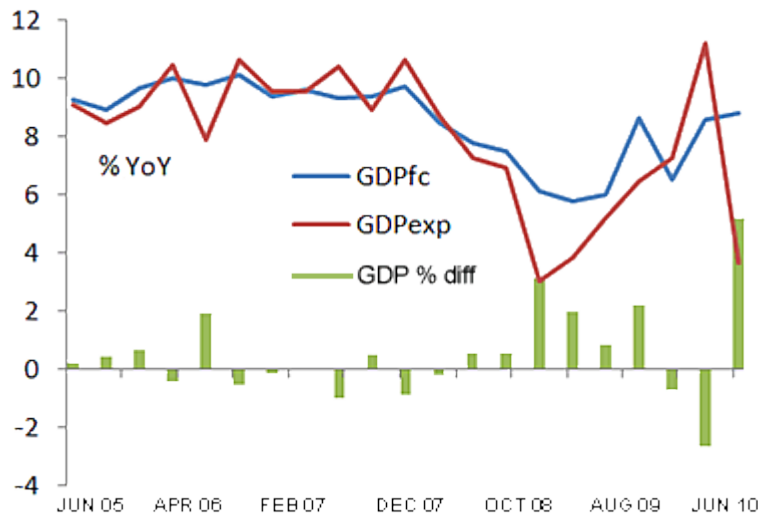
By Kunal Kumar Kundu

BANGALORE - India's 8.8% economic growth in the three months through June stands out like a beacon in a world clouded by pessimism. Not surprisingly, the government and policymakers in New Delhi are smiling from ear to ear while anticipating growth of close to 9% by the end of the fiscal year.

A time to rejoice? Not so fast. While India is definitely one of the growth stories, and will act as an inspiration, there is a definite tendency to go overboard at the slightest hint of positive numbers. More production, much less demand - that in a nutshell sums up the recently released gross domestic product (GDP) numbers for the first quarter of the fiscal year that started on April 1. Before we dwell on the numbers in general, it is important to note that the high growth number is, in itself, questionable.

An 8.82% growth in GDP at factor cost compares highly unfavorably with a 3.66% growth in GDP from the expenditure side. A difference of 5.16% in GDP calculation from two different angles makes the quality of the data suspect.

It is also clear that inequality in the Indian society has gone up manifold. The best way to understand this is by looking at India's Gini coefficient. The coefficient, a widely used measure of a country's inequality of income or wealth, ranges between 0 and 1, where 0 implies perfect equality and 1 connotes total inequality.



Source: Ministry of Statistics & Programme implementation, author's calculation. Note: fc - factor cost; exp - expenditure

There are two important observations here.

- The latest difference in growth rates (depicted by the green bars) between the two methods of GDP calculation is the highest in the data set;

- While the GDP growth rate calculated at factor cost is the highest over the past 10 quarters, the growth rate from the expenditure side is the second-lowest, and the current growth rate has dipped considerably compared with the previous quarter

Clearly there is a big mismatch between production and demand data. I have always maintained that domestic demand will fall as the effect of economic stimulus wanes. This is clearly showing now. During the previous quarter, the growth rate of consumer demand, or private final consumption expenditure, plummeted to 2.65% from 5.28%. During the first quarter, it barely budged (0.3%). More worrying, though not surprising, is that the government is failing to fill the vacuum left by the consumers. Government demand, or government final consumption expenditure, actually receded (minus 0.6%).

The only saving grace has been the government's ability to continue to spend on the social sector, although the growth rate was lower at 6.7% vis-a-vis 7.6% during the same period in the previous year.

Given the humungous (albeit one-off) revenue generated by the recent 3G spectrum auction, the government should be in a position to carry out the politically desired social sector spending without worrying much about the deficit. However, the situation would change next year. Not surprisingly, the new Direct Tax Code has not only been watered down significantly compared with what was initially proposed (given the likely impact of revenue), its introduction has been deferred by a year.

The biggest boost to the growth rate during the quarter under study has been the manufacturing sector, which grew by 12.4% (3.8% in the previous quarter). However, the Index of Industrial Production data is now showing clear signs of slowdown.

A bigger challenge to growth during the next few quarters will come from potential supply-side constraints, as capital formation, or gross fixed capital formation, is showing signs of stagnation. The average growth rate during the past 10 quarters has been only 5.87% (only 3.66% during the quarter through June), while the average for the previous 10 quarters has been as high as 15.52%.

Even external demand (read exports) is showing clear signs of a slowdown. Given that the United States is poised for a double dip and that Europe is expected to see a troubled time next year as austerity measures kick in, one can't be too optimistic on that front.

Additionally, the monsoon can again play spoilsport. In fact, the concept of a normal monsoon is a misnomer. While India could end up having a "normal" monsoon this year, several parts of the country are witnessing extreme situations. For example, states like Bihar, Orissa and West Bengal are facing severe drought. Elsewhere there is flood. The average - a "normal" monsoon. It is, therefore, a possibility that agriculture might suffer. If that happens, rural demand will taper off.

India, therefore can expect lower growth in the next few quarters, and full year GDP expansion could be somewhere close to 8% and not the 8.5% to 9% that many analysts (in government or outside) would want us to believe.

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His other articles are available at <http://kunalsthoughts.weebly.com>