

## Shobhana's edit

### *Few other drivers of growth in medium-term*

Ratings agencies and bond markets will hate it, but finance minister [Arun Jaitley](#) needs to take a call on whether he wants to relook his deficit target—the alternative is to settle for lower GDP since there are few growth drivers as strong as government expenditure at the moment; and when spent in areas like roads and railways, the impact on jobs creation is even greater. Even though GDP growth is overstated due to the change in methodology, this fell to 7.1% in Q1FY16 from 7.5% in Q4FY15, and more recent data—the Purchasing Managers Index (PMI) is at a 22-month low—suggests a sluggish recovery. High frequency data such as auto sales and loan growth are giving contradictory signals while management commentary from corporates like capital goods manufacturer L&T—the company's management has lowered its order inflow targets this year to 5-7% as compared to the 15% indicated earlier—is alarming. While there has been an increase in the growth of consumption in Q1FY16, this has not been so dramatic as to make up for the fall in growth of investment and government expenditure—while consumption growth rose from 6.2% in Q1FY15 to 7.4% in Q1FY16, that in government expenditure fell from 1.6% to 1.2% and from 8.7% to 4.9% in the case of gross fixed capital formation. Given the stressed nature of corporate balance sheets, it is difficult to see India Inc's investment levels rising for quite a while.

In such a situation, with the government hinting at overall tax collections falling short by Rs 50,000 crore and divestment receipts by another Rs 30,000 crore, containing the deficit at 3.9% of GDP implies a sharp containing of expenditure, though it is true more dividends from [RBI](#) could alleviate the cuts a bit, as will selling the SUUTI stakes in companies like ITC, Axis Bank and L&T; in any case, at 5.7%, the proposed increase in overall government spending in FY16 wasn't too high to begin with.

There are many who believe that, this time around, it is an increase in consumption that will drive growth—and the rise in consumption is predicated on falling interest rates, savings from significantly lower inflation and, next year, from the implementation of the Pay Commission award. How much this will impact consumption remains to be seen since there are several imponderables. Without seeing healthy jobs creation—labour bureau data makes it clear this is not happening—household savings from inflation may not be spent but could just as well get channelised into savings. It is also not clear that the government will implement the Pay Commission award next year—the report will be out next month—since government finances won't get the boost they got this year from the increase in tax rates; the boost to household

## **Time to relax the deficit?**

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budgets will also get muted as the fall in inflation rates stabilises. If the government is to make clear that the deficit will be breached only to spend more on infrastructure, it is possible the bond markets will not react as harshly to the increased capital expenditure by the government.