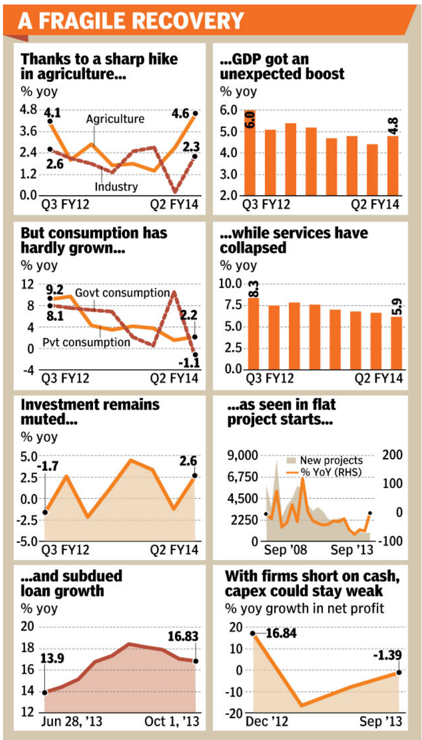
Slowing govt-spend will drag future GDP growth

Apart from the surprising agricultural growth of 4.6% in Q2FY14—a number last seen nine quarters ago—which is what ensured a slightly respectable GDP growth of 4.8% even in the face of contracting government-spend, a few other numbers stand out. The first, obvious from the imports data even earlier, is the collapse in ‘valuables’ or the amounts that households save by way of gold and silver is down from 4% of GDP at market prices in Q1FY14 to a moderate 2.5% in Q2FY14. Two, and more worrying from the point of view of the full year’s GDP, private consumption has hardly moved. It grew 2.2% in Q2FY14 which is better than Q1’s 1.6%, but worse than Q4FY13’s 3.8% and a far cry from the 9% growth levels even six quarters ago. Three, while government expenditure has been slowing for some months now, since the government has already used up 84% of the full year’s fiscal deficit target in just the first seven months, the next few quarters will see further slowing in government expenditure which will drag growth further. If the economy still did well despite this, it was thanks to agriculture and a 10% hike in growth in the financing sector, largely a factor of interest rates going up as well as NRI deposits looking up. Given the buoyancy in RBI’s swap-based inflows, we can expect more buoyancy under this head in the third quarter as well.



What of the future? While agriculture will still give some more of a kick to growth, the surprise is services slowing despite the relatively good growth of software exports. Services growth slowed to 5.9% in Q2FY14 after remaining steady at 6.6% for the previous two quarters—once again, a far cry from the 10-11% levels of FY11. One reason could be that, based on a Crisil analysis, while one unit of industrial output required 0.36 units of services in 1998-99, this rose to 0.44 units in 2007-08 —in other words, a sustained industrial slowdown will result in a services slowdown, albeit with a lag. The other imponderable, of course, is what happens to investment levels. Anecdotal evidence does not suggest any pick up in investment levels and growth contracted 1.2% in Q1FY14 before rising a bit to 2.6% in Q2FY14. Logically, serious investment growth will have to await a new government, but if the projects cleared by CCI—R3.7 lakh crore at last count—start coming on stream soon, this will boost investment levels. And in areas like petroleum and telecom, as this newspaper has pointed out before, considerable steps have been taken to boost the investment horizon. All optimism, however, has to be tempered with the knowledge that India Inc’s balance sheets continue to be stressed—34% of total debt in Credit Suisse sample of all listed firms excluding finance firms and oil marketing firms is held by those with an interest cover of under 1. So it will take time for India Inc to be able to respond to investment opportunities. So far there is little to suggest the year’s growth will be much over last year’s 5%, it could even be a little lower.