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Is India the only hope for the global economy?

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In May 2014, the British magazine "The Economist" ran its story on the new Indian Prime Minister Narendra Modi and his major victory in the parliamentary elections under the headline "Strongman". The article claimed that he would give the subcontinent the best chance ever of prosperity and explained that he also promised fundamental changes for India's politics and economy ("Strongman - How Modi can unleash India", Economist, 24th May 2014). Now, in early 2016, the situation is looking somewhat different in many areas. Although India hopes to maintain its high growth at a level above seven per cent despite the turbulence in the global economy, whether or not it can sustain this development depends not least on whether Modi can implement the promised economic reforms in a more convincing manner than in the past.

Strong growth

During 2015, China and other emerging countries such as Brazil and Russia in particular ran into some serious difficulties. Compared with these countries, India is in a very good position. Prime Minister Modi even claims that India is the only economy which has not been affected by the global economic crisis ("India only economy not affected by global economic crisis: PM", Hindustan Times, 17th February 2016, www.hindustantimes.com). In fact, the overall economic figures recorded by the government are impressive. In the first half of the 2015/2016 fiscal year (1st April to 30th September 2015), it is estimated that the gross domestic product (GDP) increased by 7.2 per cent (adjusted for prices) (Ministry of Finance, Mid-Year Economic Analysis 2015-2016, p. 5). Between October and December 2015, economic output in real terms grew by 7.3 per cent, based on which the government is expecting a 7.6 per cent rise in the GDP for the entire fiscal year (Central Statistics Office, Ministry of Statistics & Programme Implementation, "Press Note on Advance Estimates of National Income 2015-16 and Quarterly Estimates of Gross Domestic Product for the Third Quarter (Q3) of 2015-16", http://mospi.nic.in/Mospi_New/upload/nad_PR_8feb16.pdf). The World Bank is slightly more conservative, anticipating an increase of 7.3 per cent (World Bank, "Global Economic Prospects: South Asia", January 2016).

Various factors have contributed to this growth (International Monetary Fund, India, Country Report 16/75, 2nd March 2016). India has benefited primarily from the drop in international oil prices since the end of 2014. During 2015, this helped private consumption in particular, which accounted for around 56 per cent of the real GDP: Between October and December 2015, this sector experienced an increase of 6 per cent compared with the previous quarter and was 6.4 per cent up on the same period in 2014 – it was therefore the strongest driving force behind the growth. Furthermore, favourable oil prices helped to reduce deficits in current accounts and in public households and to bring about a further drop in the rate of inflation. In January 2016, this figure stood at 5.7 per cent

(Central Statistics Office, "Consumer price index numbers on base 2012 = 100 for rural, urban and combined for the month of January 2016", Press Release, 12th February 2016), compared to a figure of over 7 per cent the previous year (Inflation India 2015, www.inflation.eu).

But not everything has gone smoothly. For example, in 2015 the ratio of investment to GDP dropped by three points to the most recent figure of 27.8 per cent since private companies in particular cut back significantly on their purchases of new plants and equipment, partly due to the poor earnings situation ("Corporate earnings to grow only 2% in December quarter: Crisil", Daily News and Analysis, 5th January 2016, www.dnaindia.com). Although the government increased its expenditure on infrastructure, this was not enough to compensate for the drop in private investments ("Infrastructure development top priority; Rs. 4 lakh crore stuck projects rolled: PM Modi", Daily News and Analysis, 5th November 2015, www.dnaindia.com).

The picture for the Index of Industrial Production (including the mining industry and electricity generation) is varied. On the one hand, in December 2015, this figure – at 1.3 per cent and in the manufacturing industry even 2.4 per cent – was lower than in the same month of the previous year (Central Statistics Office, "Quick estimates of index of industrial production and use-based index for the month of December, 2015", Press Release, 12th February 2016); whilst on the other, the average index for the period from April to December 2015 rose 3.1 per cent compared with the same period in 2014.

Ultimately, in light of the weak global economy in 2015, exports – which had made a solid contribution to the GDP throughout the preceding years – only moved in one direction – downwards. In January 2016, India recorded a monthly decline for the 14th month in a row. Overall, between April 2015 and January 2016, exports fell by 17.7 per cent compared with the same period in the previous year, to 217.7 billion U.S. dollars (Directorate General of Commercial Intelligence and Statistics, "Quick estimates for selected major commodities", www.dgciskol.nic.in). This means that export revenues in the 2015/2016 fiscal year are expected to remain significantly below 300 billion dollars, whereby this would be the worst result since 2010/2011. In the third quarter of the 2015/2016 fiscal year, exports accounted for just 20.2 per cent of the real GDP, whereas this figure was still at 23.9 per cent in the same quarter of the previous year (Central Statistics Office, "Press Note on Advance Estimates of National Income 2015-16", Ibid.).

Based on this and other negative factors, a significant number of observers believe that the official figures published on economic growth are too optimistic. For example, the investment bank Ambit Capital from Mumbai believes that the GDP in the third quarter of the 2015/2016 fiscal year only rose between five and six per cent ("Doubting India's 'fastest-growing' GDP stats, economists devise their own", Reuters, 5th February 2016, http://in.reuters.com).

Outlook for 2016 is slightly gloomy

Despite all this, the forecasts by the government and by the international organisations for the 2016 fiscal year are entirely positive. According to the latest "Economic Survey", the government has set itself a target of 7 to 7.75 per cent growth; the forecasts of the International Monetary Fund (+7.5 per cent) and the Asian Development Bank (+7.8 per cent) are roughly the same as the official ones.

However, there are no signs of euphoria in the Indian media. For example, the Indian business newspaper "Business Standard", published in New Delhi, used the quote "It is possible that we will do better this year, and possible that we won't" as the title for an interview with the government's Chief Economic Advisor, Subramanian ("It is possible that we will do better this year, and possible that we won't: Arvind Subramanian", Business Standard, 27th February 2016). Another report claimed that the "Economic Survey" has destroyed any hope for higher growth since the growth drivers are too weak despite monetary and fiscal stimuli ("Economic Survey accepts that GDP growth won't pick up", Business Standard, 26th February 2016).

The "Economic Survey", which is published every year, is a key document produced by the Indian government. It analyses the economic trends in the previous fiscal year according to the Ministry of Finance and presents the short and medium-term forecasts as well as planned measures (full text available under Ministry of Finance, "Union Budget - Economic Survey 2015-2016", http://indiabudget.nic.in). This "Survey" is presented to India's two Houses of Parliament together with the budget.

There are in fact a number of uncertainties and risks which could strongly influence India's economy. Firstly, how the global economy will develop in 2016 is extremely uncertain. Probably not in a positive direction, according to the government in Delhi, which refers to "a challenging global environment" ("India needs to sustain growth amid global slowdown: Arun Jaitley", Business Standard, 1st March 2016). According to the International Monetary Fund, shake-ups in the world finance system in particular could have a negative impact: By contrast, it claims that India can handle the economic slowdown in China better as it is less influenced by exports to China compared with other countries (IMF, Country Report, Ibid., p. 28).

This uncertainty about external trends is joined by numerous domestic problems. A number of very large companies are already heavily in debt. The same applies to companies in the infrastructure sector and metal industry in particular – areas which received a great many loans between 2008/09 and 2012/13. The public banks in particular are affected by these now non-performing loans and this, in turn, is having an impact on the entire banking sector, the granting of loans and the investment climate (IMF Country Report, Ibid., p. 7; IMF, India: Selected Issues, 2nd March 2016, p. 6). Against this background, government-funded investment projects will play an important part in stabilising growth again in 2016.

Due to the instability of the global economy, the budget for the 2016/2017 fiscal year presented by the Minister of Finance Jaitley at the end of February 2016 primarily contains measures to strengthen domestic demand. The government wants to do this in two ways (A. Suyash, "Budget 2016 walks on two legs of growth, inclusion", The Times of India, 2nd March 2016). On the one hand, it intends to stimulate economic growth, with a focus on agriculture, which has suffered from the absence of the monsoon rains for two years in a row. This sector is to receive twice as much money as it did the previous year, with the target of generating higher income and more employment for farmers. The state also wishes to further increase its investments in infrastructure, with a focus on railway and road construction ("Budget 2016: With public sector push, Jaitley hopes to boost private investment", Business Standard, 1st March 2016).

On the other hand, the government wants to maintain its course in relation to financial consolidation, with the aim of reducing the budget deficit to 3.5 per cent of the GDP. According to the Fitch rating agency, this would also mean increasing government revenue ("Budget 2016: Credit positive, uncertainties on few fronts, says Fitch", Business Standard, 1st March 2016). If this strategy succeeds, the Reserve Bank of India would also have more freedom to ease monetary policy. In addition, the budget also incorporates measures for strengthening the public banks.

High potential but reforms still necessary

Despite all the uncertainties and risks, India's potential is high. For example, the country's retail sector could achieve a volume of 1.1 to 1.2 trillion dollars by 2020 according to a study by the Confederation of Indian Industry and the Boston Consulting Group, compared to a figure of 630 billion dollars in 2015 (India Brand Equity Foundation, "Indian retail seen doubling by 2020: CII-BCG study", www.ibef.org/research/reports, 19th January 2016). This study claims that growth will be driven by an increase in per capita income and rapid urbanisation. E-commerce in particular will see a significant rise since in the next 15 years, more people will go online in India than anywhere else in the world (Economist, "The great race - Online retailing in India", Briefing, 5th March 2016).

However, how this potential unfolds depends largely on whether India can decide on how to tackle and solve existing structural problems in a resolute manner. This includes procuring land, greater flexibility on the labour market, a rise in female employment, greater efficiency in agriculture and more competition between federal states in order to attract investors (IMF Survey Magazine, "India Can Lock in Good Fortune with Private Investment, Structural Reforms, 2nd March 2016).

One of the most important reform projects is the introduction of the "Goods and Services Tax" (GST) – a national value added tax. It was approved by the Indian lower house of Parliament back in May 2015. However, since the upper house of Parliament controlled by the opposition Congress party has not yet approved the tax, it could not be put into force on the scheduled date – 1st April 2016 (www.gstindia.com).

The dispute between the government party and the opposition regarding the GST is even harder to comprehend given that it is largely undisputed that with a standardised value added tax, India would be able to exploit its potential growth much more effectively than in the past ("India Opposition Says Won't Block GST Bill If Three Demands Met", Bloomberg News, 4th March 2016, quoted from www.gstindia, 5th March 2016). This figure stands at up to ten per cent (Subramanian, Business Standard, 27th February 2016).

The resolute implementation of the necessary reforms is likely to give momentum to the many projects initiated by Modi's government since he came into office but which have not yet been met with widespread unanimous approval ("Investors want fewer Modi slogans, more substance", Nikkei Asian Review, 3rd March 2016). "Make in India" is the plan which is likely to have attracted the most attention at an international level. It was started in September 2014 and was aimed at making India into one of the world's most important locations for foreign direct investment, innovation and manufacturing. This involved fully or partially opening up 25 industry sectors for foreign investments (www.makeinindia.com).

According to figures from the Department of Industrial Policy & Promotion (DIPP), attempts to gain more foreign capital have so far been a noticeable success. A total of 39.3 billion dollars were invested in India in the 2015 calendar year – 37 per cent more than in 2014 (www.dipp.nic.in). The government is hoping this figure will rise to between 40 and 45 per cent in 2016 ("FDI inflows to rise by 40-45% in 2016: Amitabh Kant", The Statesman, 29th December 2015).

However, there is still a risk that the gap could widen between the intentions and objectives of the plan and its implementation ("Modi urged to make reality match 'Make in India' hype", Reuters, 14th February 2016, www.reuters.com). Thus, for example, foreign companies are complaining that there are still significant obstacles in relation to the legal framework and taxes, including in sectors that are in fact "open" ("India's Modi in foreign investment push", Financial Times, 10th November 2015). Modi's government also remains responsible in many respects for the creation of new jobs in industry. The Prime Minister announced its intention to create around 100 million jobs in industry by 2020 with the help of the "Make in India" campaign. However, observers outside the government think this target will be missed by a significant margin. One reason for this being that the foreign investors would use more and more robots and other labour-saving production processes (V. Mansharamani, "Modi's Manufacturing Mantar Means Malaise for Millions", www.mansharamani.com, 17th February 2016). Furthermore, a better infrastructure, smart cities and start-up initiatives have not been enough – despite the effects of creating employment – to combat youth unemployment and give these young people hope for the future; forcing the government to allocate far more of the budget to tackling this issue than previously (S. Datta-Ray, "How Jaitley let the youth down", Business Standard, 4th March 2016).

These examples show that charm alone, with which Modi is attempting to attract foreign countries to India, will not result in the necessary changes within the country. If the subcontinent wants to become a driver of the global economy in difficult times as well, attractive announcements need to be converted into credible measures. Prime Minister Modi still has a great deal to do.

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