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# Getting back on track

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**The GDP numbers are good but for growth to pick up further, we need to push private investment**

The national income numbers for the second quarter of 2017-18 has come as a relief. Gross Domestic Product (GDP) has grown at 6.3% year-on-year compared to 5.7% in the first quarter. The trend of declining growth rate quarter after quarter, which was seen in the last one year, has been reversed. This is a welcome sign. However, doubts and concerns persist for some.

## Signs of revival?

Is this a flash in the pan or is it a sign of a revival? Can we expect a further rise in the growth rate in the rest of the year? Some people are disturbed by the excessive focus on GDP and its growth rate. It is true that development has many dimensions and for a balanced view, one must look at all of them. Nevertheless, GDP is an important indicator of the performance of the economy, and a faster rate of growth is most often a prerequisite for rapid social development.

What are the encouraging signs flowing out of the data on GDP for the July-September quarter? For this, we need to look at sectoral growth rates. The most encouraging sign is the performance of the manufacturing sector which grew at 7% against 1.2% in the previous quarter. This is really a turnaround, if we don't dispute the number. In the corresponding quarter in the previous year, the growth rate was 7.7%. It appears that the manufacturing sector has come out of the disruptions caused by demonetisation and more particularly, the implementation of the goods and services tax (GST).

Three other sectors which have grown strongly are the two subsectors under services — trade, hotels, etc., and public administration — besides electricity and other utility services. The trade sector grew by 9.9% and there is some indication by the Chief Statistician, T.C.A. Anant, that there could be some underestimation here.

Public administration grew at 6%, much lower than the previous quarters but still reasonably high. In fact, it is a good sign that despite a lower growth of government expenditure, overall growth rate picked up. Some calculations show that excluding agriculture and public administration, the GDP growth rate in Q2 was 6.8% compared to 3.8% in Q1. The electricity sector has done well with a growth rate of 7.6% compared to 7.0% in Q1.

The growth rate in agriculture was low at 1.7%. This was to be expected because the growth rate in agriculture was very strong the previous year. Even though the monsoon has been good, one should not expect a much stronger growth over a good year. The construction sector grew at 2.6% only. It is yet to recover from the impact of demonetisation. But that should not come as a surprise as demonetisation was directly meant to hurt the way business was being done in this sector.

## Discouraging signals

The most discouraging sign is the behaviour of the Gross Fixed Capital Formation (GFCF). It is true that GFCF at current prices grew at 6.3% in Q2 against 2.9% in the corresponding period last fiscal. This shows an improvement in terms of sentiment. However, as the growth rate of GFCF fell below the growth rate of GDP, the ratio of GFCF to GDP has fallen from 27.1% to 26.4%. This is truly disturbing. The fall must be due to a decline in private investment, as public investment during this period has done reasonably well. Without a rise in the private investment rate, sustained high growth cannot be maintained.

There are some doubts about the high growth in manufacturing. In this context, analysts draw attention to the disparities between the rate of growth in the index of industrial production (IIP) and national income statistics. For example, in Q2 of 2017-18, manufacturing under IIP grew at 2.2%. There is, of course, a difference between the national income and IIP figures, the former dealing with value added and the latter with total production. Nevertheless, such sharp differences raise some concerns. In the new methodology in estimating value added in the manufacturing sector, corporate data play a major role. This approach is not incorrect. Though many committees, including the one headed by me, on savings have recommended the use of corporate sector data, some cross-checking is needed. The government has set up the National Statistical Commission to give credibility to the Indian Statistical System. It must make effective use of it. Perhaps a clear statement from the National Statistical Commission will help to put the doubts at rest.

## The road ahead

What do the numbers say about the future? After staying at the same level for two quarters, gross value added (GVA) has moved up. This may be broadly taken to mean that the decline in growth rate has bottomed out. Perhaps the glitches caused by GST have been overcome. That only amounts to the removal of a negative factor. Therefore, the immediate prospect is some improvement in the growth rate in the next two quarters. In the next two quarters, there is not much space for public administration to push the economy. Last year, a reasonable rate of growth was achieved because of the strong growth of government expenditure in all quarters. This year, at the end of the third quarter, fiscal deficit has almost reached the budgeted level. Even after allowing for some slippage, it is unlikely that government expenditure can act as a driver of growth. Thus, while one can expect the growth rate to pick up in the second half, any substantial increase depends on the behaviour of private investment which remains intractable.

Yet another factor influencing growth is exports. India's export performance has picked up in the current year. In terms of growth rate, it was doing reasonably well. During April-September, exports grew by 11.52%. But there was a setback in October with the export growth rate turning negative. However, the world economy is generally looking better this year. World trade in 2017 is expected to grow at 1.7% compared to 0.8% in 2016. Improvement in the external environment may help to raise our

exports. This may be another positive factor influencing growth, even though it is difficult to say how strong it will be. All in all, it appears that the GDP growth for the year as a whole may be around 6.5%.

For growth to pick up in a strong way, policymakers need to address the issue of declining investment rate. As pointed out already, the GFCF ratio has fallen to 26.4%. As late as 2014-15, the GFCF rate was 30.8%. Only when the reversal of this trend happens can we be assured of a sustained high growth of 7% plus. The excess capacity built up during the boom period must have been used up by now. A complex set of factors is keeping down the private investment rate. These factors need to be addressed in order to push up private investment, even as the pace of public capital expenditures, which have shown a pick up recently, is maintained.

## Sectoral Growth Rates

(% real growth, y-o-y)

| | Q1 FY17 | Q2 FY17 | Q3 FY17 | Q4 FY17 | Q1 FY18 | Q2 FY18 |
|---|---|---|---|---|---|---|
| Farm and allied sectors | 2.5 | 4.1 | 6.9 | 5.2 | 2.3 | 1.7 |
| Mining & quarrying | -0.9 | -1.3 | 1.9 | 6.4 | -0.7 | 5.5 |
| Manufacturing | 10.7 | 7.7 | 8.2 | 5.3 | 1.2 | 7.0 |
| Electricity, utility services etc. | 10.3 | 5.1 | 7.4 | 6.1 | 7.0 | 7.6 |
| Construction | 3.1 | 4.3 | 3.4 | -3.7 | 2.0 | 2.6 |
| Trade, hotels etc. | 8.9 | 7.7 | 8.3 | 6.5 | 11.1 | 9.9 |
| Financial Services etc. | 9.4 | 7 | 3.3 | 2.2 | 6.4 | 5.7 |
| Public administration and others | 8.6 | 9.5 | 10.3 | 17 | 9.5 | 6.0 |
| Overall GVA | 7.6 | 6.8 | 6.7 | 5.6 | 5.6 | 6.1 |

Source MoSPI

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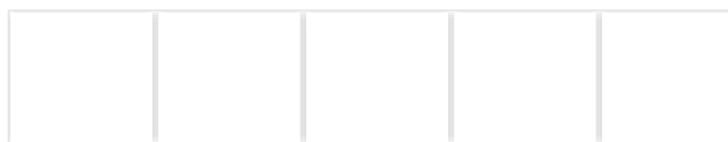

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