A limited window

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Writer - Saugata Bhattacharya (Executive Vice President and Chief Economist, Axis Bank)

Policy support is needed to nurture the drivers of growth and sustain recovery process.

The April-June quarter GDP numbers were slightly weaker than the consensus estimates, with growth coming in at 20.1 per cent. The more representative measure of economic activity, gross value added (GVA), grew by 18.8 per cent. As a technical aside, GDP is derived by adding indirect tax collections, net of subsidy payouts, to GVA. The higher GDP growth was driven by high indirect tax collections, largely GST. Note that while interpreting the growth prints, one must be mindful that they are over a base quarter that had contracted sharply due to the lockdowns during the first Covid wave last year.

In terms of sectoral activity, the revival of manufacturing GVA was the most robust, with mining and electricity growth somewhat moderate. Agriculture grew at 4.5 per cent, with cereals, pulses and oilseeds output at all-time highs. As could be expected, the services sector remained vulnerable, with activity even softer than expected. The weakest was the composite print of "trade, hotels, transport and communications", though even the construction revival was weaker than expected, given analysts' reports of strong residential demand. Steel and cement output growth — proxies for construction activity — were also quite robust in the quarter.

From the demand and expenditure side — a mirror to the above output description — private consumption was up 19.3 per cent (vs a 26.2 per cent contraction) while investment was at 55.3 per cent. Government consumption was lower by 4.8 per cent. Net exports (exports minus imports) are typically in deficit, but the gap was much lower in the first quarter — almost a quarter of the deficit observed in the last year. This reflects both high exports and subdued imports (mainly a reflection of weak domestic demand, particularly of lower crude imports).

The overall and sector-specific activity levels need to be evaluated vis-à-vis the corresponding thresholds of (the pre-pandemic) first quarter of 2019-20. This provides a perspective of how much lower activity levels remain at present, and the quantum of recovery required to regain the levels. The deepest gaps, understandably, persist in the services segments, most starkly in the construction and "trade+" groups, which are still significantly below the thresholds. In aggregate, GVA remains 8 per cent below, despite the pace of recovery rising.

Looking beyond the first quarter, the set of high-frequency economic signals we track suggest a strong recovery in July and August. Axis Bank's Composite Leading Indicator shows August activity above pre-pandemic levels, and would have been even higher if poor tractor sales in July had not pulled the Index reading lower. Mobility indicators — electricity consumption, e-Way bills, etc — suggest continuing strong activity in August. Rains, still deficient in most geographies, seem to have recovered recently. Jobs and hiring indicators, though, present mixed signals.

We expect India's 2021-22 GDP growth around 9.5-10 per cent, with some upside, as the pace of vaccinations increase, and if concerns of even a moderate third wave begin to wane. But, how can this recovery over the rest of the year and beyond be sustained, and even accelerated? The three distinct potential growth drivers — consumption, investment and exports — will need to be effectively sustained by policy initiatives over the next couple of years.

The most direct support is likely to be higher government spending. The prints of the Centre's revenues and expenditures during April-July this year suggest that it has significant room to increase spending.

In addition to revenues from planned disinvestments, speedy and effective implementation of the National Monetisation Plan will open up further fiscal space to increase spending, in particular, on capex. These initiatives are well placed for bridging demand gaps in the near term.

There have been significant improvements in corporate balance sheets over the course of the pandemic. The debt overhang has been reduced, operations have become more efficient, and the surviving enterprises are more competitive and resilient. However, the large universe of mid-and small-sized enterprises will take some time to restore their pre-pandemic operational levels. An increase in the flow of credit, from banks, NBFCs and markets, particularly to these stressed segments, is a priority, as a supplement to state spending. Bank credit off-take has remained modest during April-July, growing at an average of 6.1 per cent. This will need to increase.

The external environment provides another opportunity for India to scale up. Global inventories are low and depending on the progression of the pandemic relaxations across geographies, are likely to provide opportunities for Indian exports to fill some of these gaps. While some of the supply dislocations might transitory, this is an opportunity to increase and embed market shares. Yet, offshore risks are also rising.

Global central banks' are signalling the imminent normalisation of ultra-loose monetary policy, and the resulting increase in financial sector volatility will have spillover effects on emerging markets, including India. While our economic fundamentals are now far better, the RBI will also shift to a neutral monetary policy stance sooner or later, with a gradual increase in interest rates. To keep the process smooth, it is crucial to raise India's potential growth so that the economic recovery does not rapidly close the output gap, thereby preventing a surge in inflationary pressures.

There is a limited window of opportunity for India to leverage the current ongoing realignment of global supply chains and progressively onboard both manufacturing and services entities. Multiple reform initiatives, tax and other incentives are in the process of implementation. These need to be accelerated in coordination with states, and using the massive amounts of data now available, to enable an environment of steady, high growth in the medium term.

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