

● SLOWING ECONOMY

THIS IS THE OPPORTUNE TIME FOR THE GOVERNMENT TO DIVEST MAJORITY OWNERSHIP OF MANY OF THE BANKS SO THAT BANKING IS CARRIED ON PROFESSIONAL LINES

Need to speed up structural reforms

DESPITE THE SHARP deceleration in the growth of GDP during the first quarter of the year, the government has continued to be in the denial mode. The Union finance minister has continued to talk about the strong macro fundamentals, and the deceleration in the growth of GDP in the first quarter of the year to 5.7% was simply described as a “little dip”. In fact, there is reluctance to admit that demonetisation has entailed a heavy cost on the economy even as economic indicators stare at the face. Hopefully, the stinging criticism by Yashwant Sinha, the former finance minister, will spur the government into some positive action rather than engaging in fruitless debates. There are reports about the measures to boost the economy and, hopefully, this will not be reduced to another round of “stimulus” though fiscal expansion which could delay the revival of the investment climate even further.

The slowing down of the economy is a matter for concern. The Gross Value Added (GVA) in the last quarter on FY17 sharply declined to 5.6%, compared with 6.7% in the previous quarter and 8.2% in the corresponding quarter in the previous year partly reflecting the impact of demonetisation. In fact, every sector of the economy, except agriculture and public administration, decelerated, and there was absolute decline in the growth of the construction sector by 3.6%. If the growth of public administration (17%) and agriculture are excluded, the growth rate falls to 3.8%. The trend has continued in the first quarter of the current fiscal with GVA growing at the unchanged 5.6%. In fact, these estimates do not fully take into account the impact of demonetisation on the informal sector, and when the GDP is revised, we are likely to see even a sharper deceleration as medium and small scale enterprises (MSMEs) which were severely impacted contribute to 38% of GDP and 42% of exports and employ over 81 million peo-

**M GOVINDA
RAO**

Emeritus professor, NIPFP, and chief economic adviser, Brickwork Ratings
Views are personal



ple. The first-quarter estimate of the GVA shows a sharp decline in the growth of manufacturing, to 1.2%, reflecting partly reflecting the impact of GST implementation. The situation is not likely to be better in the second quarter, and in this situation, we should be happy if the economy grows at 6.5% during FY18.

Unfortunately, the two disruptions of demonetisation and GST implementation have added to the already existing structural problem of declining Gross Domestic capital Formation (GDCF). The GDCF has shown a steadily declining trend over the years and is hovering at less than 29.5% (constant prices) in the first quarter of this year, compared with 31% in the corresponding period last year. According to the CMIE, the rate of increase of corporate investment by the top 1,000 companies is the slowest in 25 years—up just by 5.8%. The investment commitments during April-June this year, totalling ₹98,000 crore, are much lower than the ₹1.5 lakh crore average commitment in the last few years. Of this, 25% of the investments is in the aviation sector—Spicejet and IndiGO ordering new planes—and that will not have direct impact on domestic economic activity. Outward flow has started even in foreign portfolio investment and, in August, it was ₹12,770 crore. There is no worthwhile credit take off by the corporate sector because, corporates are unwilling to borrow and banks are unwilling to lend.

The solution lies in expeditiously resolving the twin balance-sheet problem. Despite the passing of Insolvency and Bankruptcy Code (IBC), corporate

debt restructuring and initiatives to deal with the stressed assets of the banks, the problem has continued to grow. The government does not have resources to recapitalise the banks to the required level to meet with Basel III norms, and the problem is not likely to be solved anytime soon. This is the opportune time for the government to divest majority ownership of many of the banks so that banking is carried on professional lines. Of course, attempt to resolve the issues by applying the IBC should continue. In addition, it is important to restart the stalled projects which are feasible on an urgent basis. The addition to stalled projects in the first quarter of the year is ₹2.4 lakh crore as compared with the ₹0.35 lakh crore in the last quarter of FY17. The Kelkar Committee report on PPP is yet to be acted upon. The stalled road projects must be revived expeditiously. The debt burden on power projects is heavy, partly because of the declining demand and the discoms which have been reluctant to enter into power purchase agreements in the wake of low prices of power in the spot market.

The government seems to be thinking about providing stimulus by relaxing the fiscal deficit target. The vice-chairman of NITI Aayog argues that what is relevant is the revenue deficit and government borrowing for investment should not be a constraint. Unfor-

tunately, household sector's financial saving is not unlimited and the rationale for fixing fiscal deficit target is to limit government borrowing to provide borrowing space for the private sector. As it is, meeting the fiscal deficit target of 3.2% of GDP at the Centre is going to be a major challenge. The advance tax collections of income tax have grown at 11% which is lower than 14% last year. It is unlikely that 15.5% growth of income tax assumed in the budget estimate will be realised. The GST blues are yet to be overcome and there is considerable uncertainty on its revenue productivity at least in the short run. The income declaration scheme will bring just about ₹8,000 crore in the third instalment. There is no way the disinvestment target of ₹72,000 crore will be reached. Demonetisation has caused a sharp reduction in the dividend from RBI. We are likely to witness a lot of action on the ₹3 lakh crore suspicious deposits in the wake of demonetisation, but to what extent they will result in revenue gains remains to be seen. The situation at the state level is equally precarious. Thus, all the attempts at consolidation will come to nought if any attempt to provide fiscal stimulus is made by breaching the targets. The rating agencies are not likely to take kindly to any such fiscal adventurism.

All the attempts at fiscal consolidation will come to nought if any attempt to provide fiscal stimulus is made by breaching the targets. The rating agencies are not likely to take kindly to any such fiscal adventurism

breaching the targets. The rating agencies are not likely to take kindly to any such fiscal adventurism.

In this environment, RBI is likely to adopt a wait-and-watch approach and hold the rates for the present. The reasoning would be the uncertainty around the fiscal situation and possible oil price increase. The manoeuvrability is limited also because the Federal Reserve has abandoned monetary easing and has already increased the rates twice. The ball is squarely in the government's court and hopefully, it will act before it is too late.

