How much effect will the note ban have on growth?

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Although the real growth number this year will be lower than the advance estimate, there is no need to lose heart as the next year may be better, members at a panel discussion said. Sharmila Whelan, deputy chief economist at Asianomics, expects GDP growth at 6.9% with a downward bias considering the government's final consumption expenditure. Deepali Bhargava, Asia economist at Credit Suisse, says consumption will be largely in line with what CSO's expectations. Whelan does not see an outright collapse, nor does former chief economic advisor Arvind Virmani. According to M. Govinda Rao, emeritus professor, National Institute of Public Finance and Policy, there will be significant deceleration in growth. Edited excerpts:

The Central Statistical Organisation expects the economy to grow at 7.1% in this financial year, the GDP, that is. But there is a big catch in this advanced estimate. The impact of the demonetization has not been accounted for. The Central Statistics Organisation's head, DR TCA Anant, released the full year projection taking into account data from April to October. This puts the government in a bit of a bind ahead of the upcoming Union budget. How much would you rely on this data if it has not taken anything after November?

Virmani: Let me make a couple of general points. The most important and obvious one is that this story is not just about demonetization, but also the shift in the budget by 1.5 months which has necessitated this new estimate. So, it cannot be compared with the estimates or forecasts from last year which are based on three quarters because these are based on two quarters.

Now, this is an obvious, but it has the following implication and that is that the protocols that they have developed were for a particular period. That is they depended on what happened till the end of the calendar year. Now, notionally, they are applying the same protocol, but they may not be the best protocols if you are going to do every year in future this kind of one month accelerated thing. That confuses things more than usual. That, as I said, it is kind of obvious, but it needs to be said.

The second point of course, it is clear to everybody now that this does not explicitly take account of the data emerging after the demonetization. But I am not sure that some of these effects, particularly, what made me sit up and notice was the trade, hotels and transport where you have a significant decline in the growth rate.

That, as you may recall in my last discussion with you, I had said that the immediate effect of demonetization would be on retail trade and goods services and daily labour. So, I am not convinced that there is no effect at all because for the reason that the protocol is not clear and they may have had some flexibility in measuring that.

What are you working with now as GDP number for the full year and do the CSO numbers influence you?

Whelan: We don't really do GDP forecast, we more look at countries and in this case India in terms of where it is in terms of the business cycle and how the timing of the demonetization has impacted that. The main driver of GDP growth over the last couple of quarters has been consumption because the investment cycle is still to show signs of decisively turning up because of the ongoing problems in the corporate sector particularly the large private sector infrastructure companies as well as the public sector banks.

So, the private investment cycle has been very weak. Some of it has been supplemented by public investment spending but that is not enough. So, with that being as it is, the export story being weak and consumption being the main driver, the demonetization in that sense couldn't have come at a worse time because of implications it has for consumption given that 86% of consumer transactions are in cash. So, what we are looking at is a very sharp slowdown in consumption spending over the next 2-3 quarters and on the back of that, GDP growth. We wouldn't put it beyond the realms of possibility that you actually get a quarter on quarter contraction in GDP.

What would you work with as likely GDP number for the full year?

Whelan: As I said, it is about where we see India in the business cycle. So, the short term outlook - the next 2-3 quarters we have gone a lot more cautious and that could bring down any estimate of overall GDP growth for the full fiscal year. Having said that, we are very positive about the Indian growth story in general in medium to long term and demonetization is a positive from medium to long term point of view particularly for the budget and for cyclical tax revenues.


(From left) Deepali Bhargava, Asia economist, Credit Suisse; M. Govinda Rao, emeritus professor, National Institute of Public Finance and Policy; and Arvind Virmani, former chief economic advisor.

What are your thoughts? The important take away from the CSO's numbers is that even without taking into account any of the demonetization months since they were extrapolating from October, we still see the GDP advance estimate coming down to 7.1% from 7.6% last year. If demonetization is seen as a structural break at least for the short term then what may be the actual number?

Rao: It is very difficult to predict what the actual numbers will be but the fact of the matter is as you mentioned earlier, so far even this 7.1% was sustained by growth of public consumption expenditure and private consumption expenditure. Public consumption expenditure is not going to be as much as it was in the last six months for the reason that public sector wage increase that has happened is not going to play out in the next six months.

So, everything will have to depend upon the private sector consumption and that is the one which has been affected substantially if you look from the consumption side. There is virtually no investment, so there would be a significant deceleration in growth. My own feeling is that since they have repeatedly said that they have not taken into account the impact of withdrawal of selected bank notes, the actual growth will be much lower but possibly this is the growth rate they will basically base for their budget calculations but in many ways this is going to be very unrealistic.

I guess you had a good look at the press release. Even without demonetization we are seeing half a percentage point cut in the GDP growth. What was the number you are working with and are you likely to revise it?

Bhargava: We were working with 6.9% for the full year and the number that we have from the CSO does not factor in any impact on demonetization. So, clearly there is a downside risk even to our number. Clearly, coming from what we are seeing from a high frequency data available so far, what that suggests is there is a growth slowdown both in consumption and investment, but it is not an outright collapse as some of the market participants were expecting. So, that is a bit of good news. But having said that, a downward revision in the full-year numbers just by itself could mean that the actual numbers are much lower than what the street is expecting.

We have some final consumption expenditure numbers from the CSO. The advanced estimates for the government final consumption expenditure is a growth of 24%, obviously because of the Seventh Pay Commission and the one-rank one pension inclusion. The gross fixed capital formation falls by 0.2% and the private final consumption expenditure is up by 6.5%. Is this in line or will all this get revised?

Bhargava: Private consumption for us is pretty much in line. Even we are working with a number of 6.5% and primarily because the big correction in discretionary consumption that we were expecting is not yet getting reflected in the numbers. So, for example if you look at the numbers for November and December, just on the passenger car sales and commercial vehicles sales, they have been much better than what we were expecting on volume term. So, that surprised on the upside. Even some bit of other discretionary items like passenger traffic, etc. they have not really collapsed. In fact, the growth has been pretty much in line with what we see in the previous few months. Staples is one segment where the correction is being much sharper, but discretionary has held up pretty much on a stronger side. So, consumption will be pretty much in line with what our CSO is talking about.

What is your sense? We are going to see the impact of demonetization in the November, December and the subsequent months. Even without that, if the GDP number is 7.1%, what is your best estimate of the full year GDP growth?

Virmani: On the basis of data available, at the beginning of last month, I had adjusted my forecast to about 7.2%, plus-minus 0.2 %. Based on whatever the impact of the cash withdrawal was and in the general acceleration in inflation and global situation, etc. Given that, I do not know if you recall, but I think I said it to you only that the key issue is going to be remonetization in terms of the transaction demand for cash which really cannot be replaced by cheques and digital money so quickly in the period in which we are talking.

And the only thing I would add to that is that I would expand my range because the evidence available for the last 30 days does not indicate that enough small denomination cash has been injected so that the effects are going to continue and deepen in the third month after the demonetization.

So, it is possible that I would have to revise my estimate by another 0.5%, but I would not go below that as many of your discussions I have been watching, your earlier programmes, indicate. So at most, it would be a revision downwards of about 0.5%, but I would still wait for a couple of weeks to get a little more data on the cash. That is one point. The second point related to the budget is that when you look at this general government final consumption expenditure (GFCE) which you correctly noted is expansion because of the Pay Commission recommendation being implemented. This has not played out into the demand that quickly.

So, you will pay out the money into the accounts of the government servants and mostly by cheque. So, this is all going to be number one. It is not going to be number two economy. And this will play out over the next several months. So, your discussant who just commented before me is quite right that I do not anticipate that strong negative effect on the private consumption as many other people who have commented on your show have said.

What would you go with? We will probably get a slightly exaggerated fiscal deficit number of actual fiscal expenditure, both in the current year and next year because the government could be working with a higher number, you think?

Rao: As far as fiscal 2016-2017 is concerned, I do not really see a great deal of a problem because to the extent that the demonetized money does not go back to the banking system, there will be some, either in terms of the dividend from the RBI or in terms of the lower interest payment because of the cancellation of the government securities, there will be some adjustment. And I do not see 2016-2017 as a major problem for fiscal deficit numbers and the problem will happen in 2017-2018 budget numbers.

My point is that as it is for the current year the government was working with Rs150 lakh crore, advance estimates are saying Rs152 lakh crore. On this, if the government estimates a further growth, next year it might give itself a decent amount of room for fiscal spending?

Rao: Next year what will happen is that in the budget they will show that they are going to have a much larger borrowing space but then there is one other unknown element still, we do not know what is going to be the N.K. Singh's committee recommendations.

How exactly is he going to fix the fiscal target is as yet not known. So, that is an unknown thing. So, possibly we will have to wait until the report is presented. Whatever be the case the numbers that they are going to do based on this growth rate, that is 7% growth rate, will be an exaggerated number.

It will be exaggerated for revenues, it will be exaggerated for expenditures and deficits as well.

You said that you may have to revise your GDP number lower, how much lower might it be and what are your first comments on the next year FY18 in terms of growth?

Bhargava: For FY18 we do have an acceleration because we do expect some bit of government spending pickup to happen. Monetary conditions have improved and should improve significantly with the fall in MCLR that we have already seen. So, both these factors should mean that GDP growth accelerates and that will be most important for next year. The number we have for next year is 7.4% which is about 50 basis points acceleration.

There is a downside but key would be if it accelerates or decelerates and our view is that it should accelerate. In terms of this year I think we still have scope for government to spend in the last quarter given what we have on capex till November. So, for now I think we are going to stick with our 6.9% which is anyways lower than what the government is talking about. So, pretty much comfortable on 6.9%.