INDIA

Economic growth is projected to remain strong and India will remain the fastest-growing G20 economy. The increase in public wages and pensions will support consumption. Private investment will recover gradually as excess capacity diminishes, and the landmark Goods and Services Tax and other measures to improve the ease of doing business are being implemented. However, large non-performing loans and high leverage of some companies are holding back investment.

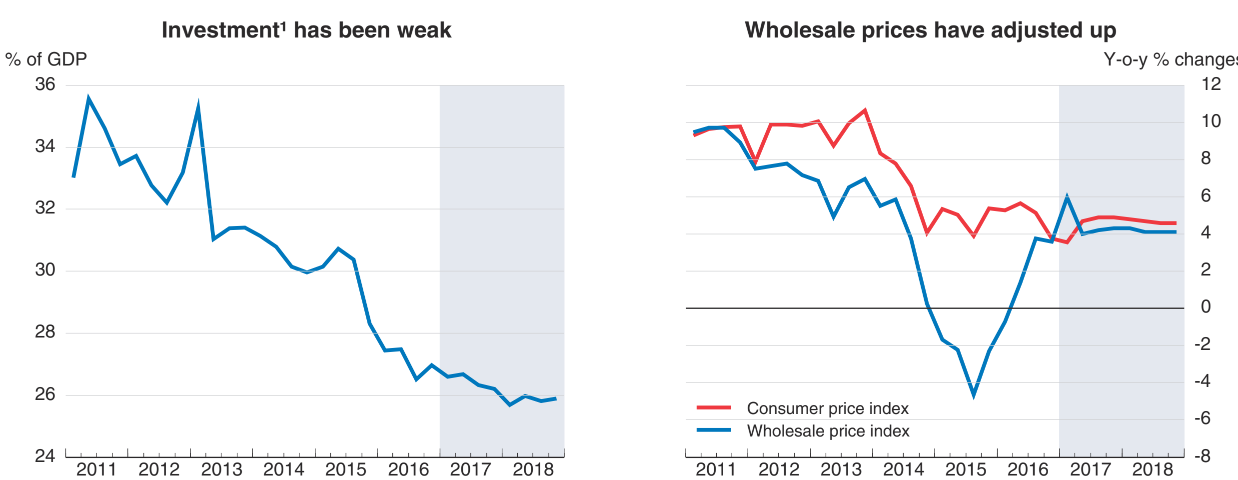
Monetary policy is projected to remain tight as inflation expectations have still not fully adjusted down. The need to reduce the relatively high public-debt-to-GDP ratio leaves little room for fiscal stimulus. However, investing more in physical and social infrastructure is critical to raising living standards for all. This should be financed by a comprehensive reform of income and property taxes. Restoring credit discipline and cleaning up banks' balance sheets will be instrumental to support the credit growth needed to finance more business investment.

Trade openness has increased, partly driven by a competitive service sector. Manufacturing has lagged behind, with limited contribution to exports and job creation, leaving many workers in low-paid jobs. Promoting quality job creation in manufacturing would require reducing further restrictions on FDI and trade, modernising labour regulations and providing better education and skills. Better infrastructure, transport and logistic services would facilitate manufacturing firms' access to global markets, particularly from remote and poorer regions.

Robust consumption and a rebound in exports are boosting growth

Growth remains strong. Private consumption has been buoyant, boosted by the increase in public wages and pensions and by higher agricultural and rural incomes. The costs of the withdrawal of high denomination notes – demonetisation – in November 2016 are wearing off, and sales of cars and two-wheelers have bounced back. Investment has so

India



1. Gross fixed capital formation.

Source: Central Statistical Office; Reserve Bank of India; and OECD Economic Outlook 101 database.

StatLink http://dx.doi.org/10.1787/888933503244

India: **Demand, output and prices**

	2013	2014	2015	2016	2017	2018
	Current prices INR trillion	Percentage changes, volume (2012/2013 prices)				
GDP at market prices	112.4	7.2	7.9	7.1	7.3	7.7
Private consumption	65.4	6.8	7.3	7.2	7.7	8.2
Government consumption	11.6	9.4	2.9	17.0	10.3	9.2
Gross fixed capital formation	35.1	4.1	6.1	0.6	4.7	5.9
Final domestic demand	112.1	6.2	6.5	6.3	7.2	7.7
Stockbuilding[1]	3.7	0.3	0.0	0.4	0.0	0.0
Total domestic demand	115.7	6.9	7.6	6.3	6.6	7.4
Exports of goods and services	28.6	1.7	-5.4	2.3	5.5	6.1
Imports of goods and services	31.9	0.8	-5.9	-1.2	2.0	4.9
Net exports[1]	- 3.4	0.2	0.2	0.7	0.7	0.2
Memorandum items						
GDP deflator	_	3.2	1.9	4.1	4.3	4.3
Consumer price index	_	5.9	4.9	4.5	4.8	4.6
Wholesale price index (WPI)[2]	_	2.0	-2.5	3.7	4.2	4.1
General government financial balance[3,4]	_	-6.5	-7.5	-7.0	-6.7	-6.4
Current account balance[3]	_	-1.3	-1.1	-0.7	-0.9	-1.2

Note: Data refer to fiscal years starting in April.
1. Contributions to changes in real GDP, actual amount in the first column.
2. All commodities index.
3. As a percentage of GDP.
4. Gross fiscal balance for central and state governments.

Source: OECD Economic Outlook 101 database.

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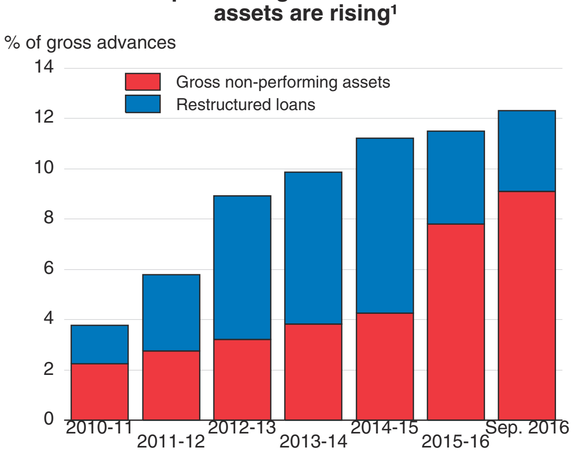
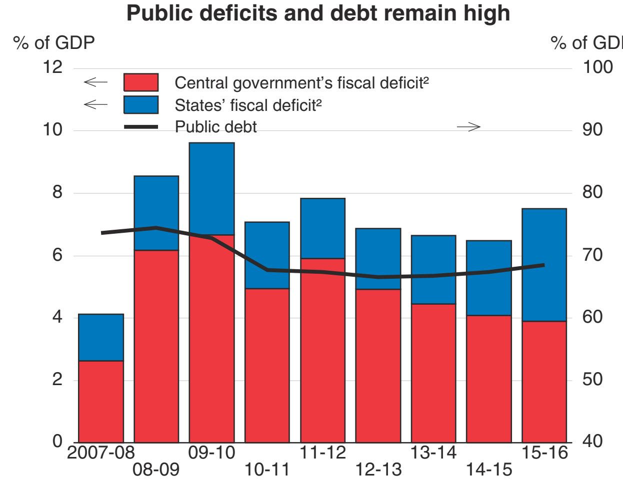
India

Non-performing loans and stressed assets are rising¹



Public deficits and debt remain high



1. A restructured asset is an asset whose terms have been modified, including alteration of the repayment period, repayable amount, instalments and rate of interest.
2. Data for the fiscal year 2015-16 are provisional.

Source: Reserve Bank of India; and Controller General of Accounts.

StatLink http://dx.doi.org/10.1787/888933503225

far failed to rebound, despite government efforts to develop rail, road and energy infrastructure and to improve the ease of doing business. Excess capacity (e.g. in the steel sector) and the weak financial position of some corporations, combined with large non-performing loans for most public sector banks, have restrained business investment.

Exports have picked up, driven by strong demand from Asia and the euro area. Higher oil prices and gold imports, coupled with a decline in remittances inflows, are reflected in some deterioration in the current account deficit. However, the deficit remains well below its longer-term average. FDI net inflows have been rising steadily since 2014 and are fully financing the current account deficit.

Structural reforms are key to promoting inclusive growth

The acceleration of structural reforms is bringing a new growth impetus. The Goods and Services Tax (GST), to be implemented from July 2017, should help make India more of a single market and thus spur productivity, investment, competitiveness, job creation and incomes. The abolition of the Foreign Investment Promotion Board, which reviewed foreign investment programmes, should promote FDI inflows. The central government's initiative to rank individual states on the ease of doing business is opening a new era of structural reforms. Many states have already modernised regulations and administrative procedures and some are experimenting with reforms of land acquisition and labour regulations.

There is little room for further cuts in interest rates. Consumer price inflation hovered below 4% at the end of 2016 and in early 2017, reflecting partly demonetisation, but also the success of the flexible inflation targeting framework. Ongoing structural reforms, including efforts to reduce the fragmentation of agricultural markets and land plots, and to develop the irrigation network, should help avoid inflation spikes in the future. In the short term, however, keeping inflation around 4% – the mid-point official inflation target – will be challenging given the roll-out of the GST and the upward adjustment in house rent allowance and in wages for state government employees.

The combined deficit and debt of the central government and states are relatively high. The central government has committed to reduce its deficit further in FY 2017/18 by better targeting fertiliser, petroleum and food subsidies. At the state level, current spending has tended to rise while investment targets have not always been met. The recent write-off of bank loans to farmers in the largest state will push up public debt, especially if other states follow suit. It could also undermine credit discipline and exacerbate income inequality since it will not benefit the poorest farmers, who rely predominantly on informal money lenders rather than banks.

Making growth more inclusive would require raising more revenue from property and personal income taxes to finance better social and physical infrastructure. Recent initiatives to benchmark states' social policies and outcomes, including health, sanitation and education, will strengthen incentives to improve the quality of public services. However, providing quality services to all would require raising public spending. Doubling public spending on health to 2.5% of GDP by 2025, as envisaged in the latest National Health Policy, and developing affordable housing for the poor would be welcome. It could be financed by removing the tax expenditures that benefit the rich most, freezing the personal income thresholds from which rates apply, reducing tax evasion and implementing fairer property taxation.

Growth increases will rest on the revival of investment

Growth is projected to increase further. Private consumption will remain steady as increases in wages and pensions for central government employees are followed by similar adjustments in the states. The recent increase in capacity utilisation, coupled with the rebound in industrial production for capital goods and manufacturing indices, bodes well for a gradual revival of private investment. The implementation of the GST, by lowering the price of capital goods, and the cut in the corporate income tax rate should also support investment. Inflation will likely increase from the low levels in early 2017, but will remain within the authorities' target band. The revival of (import-intensive) corporate investment, higher oil prices and lower remittance flows will be reflected in a larger current account deficit.

The prospect of further structural reform is a clear positive risk for growth. The deterioration in the quality of banks' portfolios, as shown by the increase in non-performing loans and stressed assets, risks damping investment and growth. India, as a net commodity importer, would suffer from higher commodity prices. Protectionist measures could restrict exports of goods and services and thus harm the economy's potential to create quality jobs.