

## INDIA

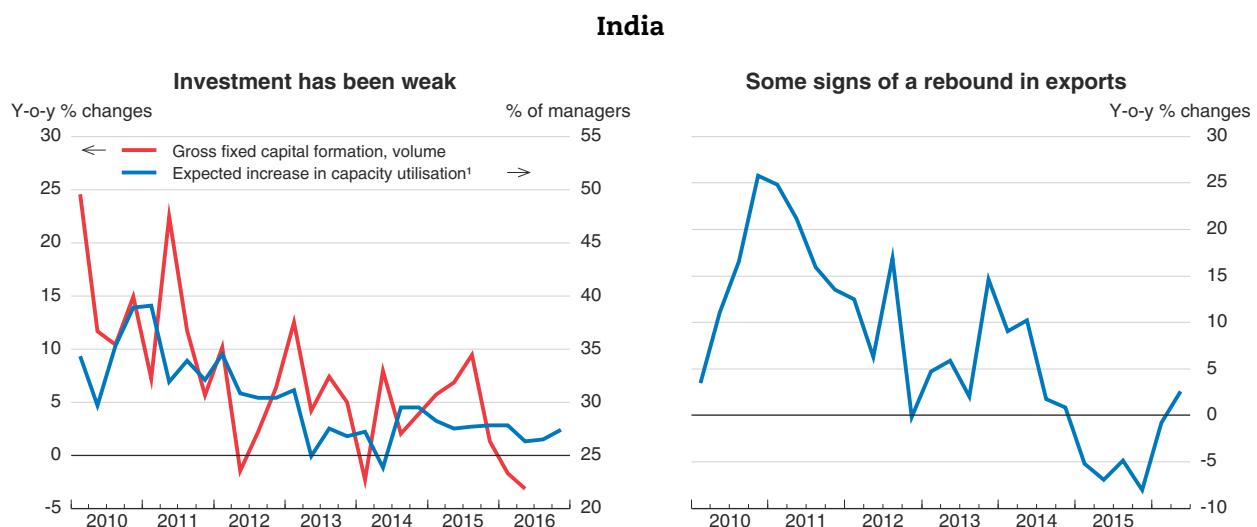
**With projected annual growth of 7.5% in 2017-18, India will remain the fastest growing G20 economy. Private consumption will be supported by the hike in public wages and pensions and by higher agricultural production, on the back of a return to normal rain fall. Private investment will revive gradually as excess capacity in some sectors diminishes, infrastructure projects mature, corporates deleverage, banks clean their loan portfolios, and the Goods and Service Tax (GST) is implemented.**

Despite commendable fiscal consolidation efforts at the central government level, the combined debt of states and central government remains high compared with other emerging economies. Inflation expectations are adjusting down only slowly. Overall there is little room for accommodative policies, although some monetary impulse is still to come, as recent cuts in policy rates are yet to be reflected fully in lower lending rates. Repairing public banks' balance sheets and improving their governance would support the revival in investment. Creating more and better jobs will require policies to improve the ease of doing business further, in particular faster and more predictable land acquisition, and upgrading social and physical infrastructure.

Despite the high public deficit compared with other emerging economies, there is room to make public finance more growth-friendly and inclusive. The ongoing landmark GST and subsidy reforms are promising. The government plan to cut the corporate income tax rate while broadening the base is also welcome. More revenue could be raised from the personal income tax, and its redistributive impact enhanced, to finance higher spending on health, education, housing, transport and water infrastructure and make growth more inclusive.

### **Steady private and public consumption growth**

India has become the fastest-growing G20 economy, with growth rates hovering around 7.5%. Private consumption in urban areas is buoyed by an increase in public wages



1. Percentage of managers interviewed expecting an increase in capacity utilisation.

Source: Central Statistical Office; and Reserve Bank of India.

## India: Demand, output and prices

	2013	2014	2015	2016	2017	2018
	Current prices INR trillion	Percentage changes, volume (2012/2013 prices)				
<b>GDP at market prices</b>	112.7	7.2	7.6	7.4	7.6	7.7
Private consumption	65.1	6.2	7.4	7.6	8.1	7.5
Government consumption	11.5	12.8	2.2	8.3	4.9	6.8
Gross fixed capital formation	35.6	4.9	3.9	0.7	4.7	7.3
Final domestic demand	112.3	6.5	5.8	5.7	6.8	7.4
Stockbuilding <sup>1</sup>	3.8	0.1	0.0	0.0	0.0	0.0
Total domestic demand	116.1	6.9	8.0	5.9	7.7	7.9
Exports of goods and services	28.5	1.7	-5.2	4.5	4.6	5.2
Imports of goods and services	31.9	0.8	-2.8	-2.3	5.4	6.3
Net exports <sup>1</sup>	-3.4	0.2	-0.5	1.5	-0.2	-0.2
<i>Memorandum items</i>						
GDP deflator	—	3.3	1.1	3.8	4.4	4.3
Consumer price index	—	5.9	4.9	5.2	5.2	4.6
Wholesale price index (WPI) <sup>2</sup>	—	2.0	-2.5	3.2	4.0	4.2
General government financial balance <sup>3,4</sup>	—	-6.5	-7.2	-7.0	-6.6	-6.4
Current account balance <sup>3</sup>	—	-1.3	-1.1	-0.8	-0.9	-0.9

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.

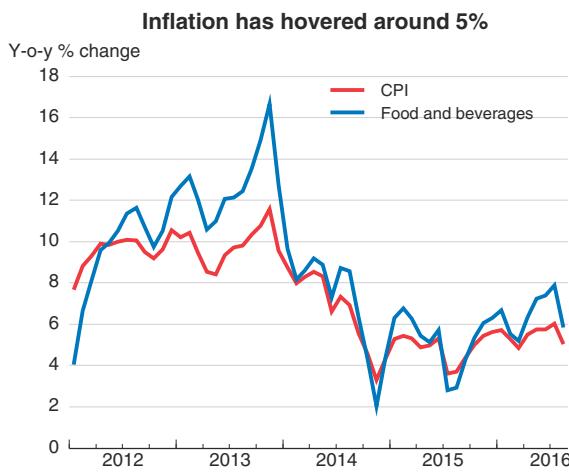
4. Gross fiscal balance for central and state governments.

Source: OECD Economic Outlook 100 database.

StatLink  <http://dx.doi.org/10.1787/888933439263>

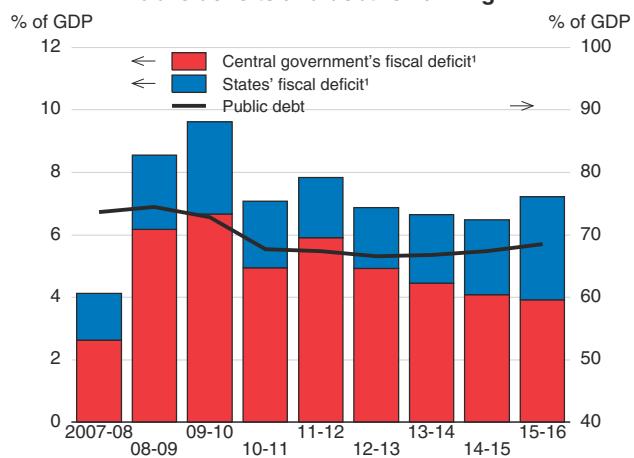
and pensions by over 20% in 2016 and 2017. The return to normal weather conditions, after two years of a poor monsoon, is raising agricultural production and consumption in rural areas. Exports bounced back early in 2016 and export orders are growing. However, private investment has remained weak, dragged down by low capacity utilisation and the weak

## India



1. Data for the fiscal year 2015-16 are provisional.  
 Source: Reserve Bank of India; and Controller General of Accounts.

## Public deficits and debt remain high



StatLink  <http://dx.doi.org/10.1787/888933437695>

financial position of some corporations. Job creation in the organised sector has also remained subdued.

Robust growth has been accompanied by a decline in inflation and the current account deficit. The disinflation process has been supported by the change in the monetary policy framework aimed at anchoring inflation expectations, the government's active management of food stocks to minimise spikes in food prices and lower commodity prices. The decline in merchandise imports, driven by weak (import-intensive) business investment, and lower gold imports have kept the current account deficit to below 1.5% of GDP.

***Little room for expansionary macroeconomic policies but a role to play for structural reforms***

The combined deficit and debt of the central government and states are high compared with other emerging market economies. The ongoing subsidy reform improves the targeting and effectiveness of social programmes and should be extended to other products, in particular food, fertiliser, water and electricity. The increase in public wages and pensions, combined with the need to recapitalise public banks, will leave little room in this and next year's budgets for higher public investment. In the longer term, the government should aim to raise public spending on education, health, water, energy and transport infrastructure to improve access for all to core basic services and to reduce bottlenecks to investment. Higher revenue from property and the personal income tax could finance additional spending.

The Reserve Bank of India has cut policy rates by 175 basis points since December 2014. Going forward, there is little room for significant further cuts since the rise in public sector wages, still high inflation expectations and firmer commodity prices will make reaching the 4% mid-range inflation target challenging. However, even in the absence of more cuts, some monetary impulse is still to come as monetary policy transmission has been slow and incomplete so far.

The government's success in passing key structural reforms is boosting growth prospects but effective implementation is key. The Goods and Services Tax (GST) should replace a myriad of consumption and sales taxes. By reducing tax cascading, the GST will boost competitiveness, investment and economic activity in the medium term. The government aims to implement the GST from April 2017, which is ambitious given the number of key parameters still to be agreed upon, the still complex legislative process involved and the required IT infrastructure to be developed. However, the projections assume that this objective will be met.

The new Bankruptcy Code should facilitate time-bound closure of businesses and the reallocation of resources to more productive firms and prevent the build-up of non-performing loans. Implementing the Code and reducing delays will require improving judicial institutions. Recent cuts in administrative requirements for hiring are most welcome. They should be accompanied by efforts to modernise labour laws, including at the state level, to boost quality job creation. Recent efforts to raise power generation capacity, including the focus on renewable energy, are promising. Adjusting utility prices to ensure they cover costs would make supply more responsive to demand conditions.

***Growth is projected to remain strong and investment to revive***

Buoyant private consumption will revive investment as excess capacity diminishes, deleveraging by corporates and banks continues and infrastructure projects mature. The implementation of the GST from April 2017 should lower the price of capital goods and lift investment although it may have short-term adverse effects on prices and demand for services which will likely be subject to a higher rate of tax. The revival of (import-intensive) corporate investment and lower remittance flows will weigh on the current account deficit. Robust FDI inflows should, however, mitigate India's external vulnerability.

Further structural reform is a clear upside risk for growth. Some states have taken the lead in reforming land and labour market regulations but it is still unclear whether others will follow suit. There are also downside risks to the projections. Rolling out the GST later than projected may delay the investment recovery. Slower efforts to clean up banks' balance sheets and to recapitalise public banks would raise uncertainties and hurt investment. An increase in commodity prices would raise inflation, dampen private consumption and weigh on both the current account and fiscal deficits. Weak demand in major trading partners will affect exporting sectors. Geopolitical risks could escalate, affecting business sentiment and creating pressures on public (military) spending.