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## India: A light in a dimming global economy

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# INDIA: A LIGHT IN A DIMMING GLOBAL ECONOMY

Strong domestic consumption and investment is driving GDP growth in India and the outlook appears positive, despite slowing global growth. In this edition of *Infocus*, Sam Jochim and Amanda Cotti look at India's economy, its structural challenges and the opportunities that lie ahead.

## Growth and inflation

India's economy is the sixth largest in the world based on GDP at constant prices in 2015 US dollars.<sup>1</sup> The IMF projects it will grow around 6% per annum over the next five years, a faster pace than other BRIC nations (see Figure 1).

### 1. BRIC real GDP (% change, year-on-year)<sup>2</sup>



Following the pandemic-related contraction in fiscal year 20-21, India's GDP rose 9.1% and 7.2% in fiscal years 21-22 and 22-23 respectively. Almost 60% of this growth was accounted for by private consumption, with over a third coming from capital expenditures, around 10% from government spending and trade detracting slightly from growth.<sup>3</sup>

Given the strength of the services sector and the high level of consumer optimism in India, private consumption appears well placed to drive growth again in fiscal year 23-24 (see Figure 2).

Furthermore, the Reserve Bank of India (RBI) believes banks and private companies have healthy balance sheets, while supply chain normalisation, business optimism and robust government capital expenditures are additional factors supportive of a renewal of the capex cycle.<sup>5</sup>

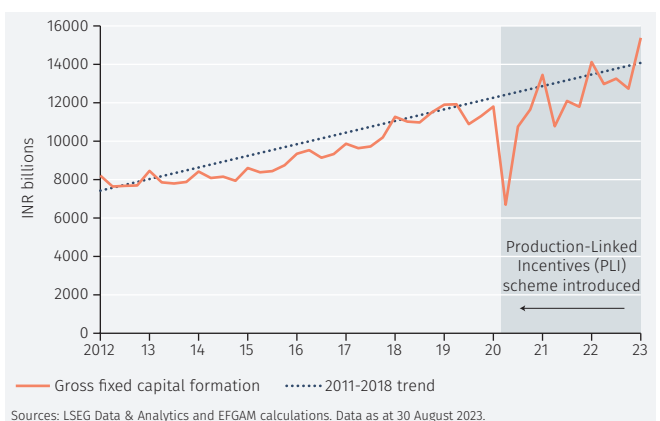
A further tailwind to growth comes from the government's Production-Linked Incentives (PLI) scheme which was

### 2. India services PMI, future consumer expectations and GDP growth<sup>4</sup>



introduced in 2020. This scheme proposes financial incentives over five years to boost domestic manufacturing across 14 key sectors.<sup>6</sup> Since the PLI's introduction, fixed capital formation in India accelerated beyond its 2011-2018 trend implied level (see Figure 3). Further acceleration is possible in 2024 as protectionist policies, such as the impending import restriction on laptops and tablets, are implemented to encourage domestic production.<sup>7</sup>

### 3. Gross fixed capital formation (constant prices in 2011 fiscal year)



<sup>1</sup> [https://data.worldbank.org/indicator/NY.GDP.MKTP.KD?most\\_recent\\_value\\_desc=true](https://data.worldbank.org/indicator/NY.GDP.MKTP.KD?most_recent_value_desc=true)

<sup>2</sup> Data and forecasts for India are presented on a fiscal year basis. In India, the fiscal year starts on 1 April and ends on 31 March.

<sup>3</sup> EFGAM calculations based on data from: <https://www.pib.gov.in/PressReleaseIframePage.aspx?PRID=1928682>

<sup>4</sup> Future consumer expectations range between 0 and 200 with any score above 100 indicating optimism. To fit the scale of the chart, all values have been divided by 2 so that values are rangebound between 0 and 100 and any number above 50 indicates optimism.

<sup>5</sup> 2023-24 Resolution of the Monetary Policy Committee (MPC) August 8-10, 2023: [https://www.rbi.org.in/Scripts/BS\\_PressReleaseDisplay.aspx?prid=56173](https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=56173)

<sup>6</sup> <https://www.investindia.gov.in/production-linked-incentives-schemes-india>

<sup>7</sup> <https://www.reuters.com/world/india/india-restricts-import-laptop-computers-govt-notice-2023-08-03/>

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However, while protectionist policies can raise demand for domestic products in the short run, in the longer run they are more likely to reduce aggregate demand due to market inefficiencies which increase costs for consumers.<sup>8,9</sup> The result could be a slower pace of GDP growth due to weaker aggregate demand.

Turning to monetary policy, India adopted a flexible inflation targeting framework in 2016, formalising price stability as the primary policy objective. The RBI targets CPI inflation at 4% with a 2% tolerance band either side of the target.

Food accounts for around 46% of the CPI basket in India, making it an important determinant of inflation. Since food prices are more vulnerable to supply shocks than other goods and services, having a credible inflation target to anchor both inflation and inflation expectations is important.<sup>10</sup>

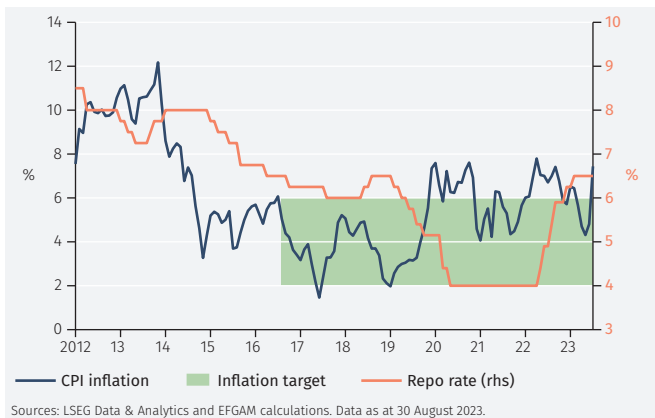
Without such a target, long-run inflation expectations can drift due to supply shocks, on which monetary policy has little impact. If long-run inflation expectations are stable, supply shocks are less likely to lead to second-round effects and more likely to manifest themselves as one-off changes to the rate of inflation, i.e. they become transitory.<sup>11</sup>

In May 2022, the RBI began raising interest rates with inflation above the upper end of its target range at 7.0% year-on-year. Having raised the repo rate by a cumulative 250 basis points to 6.5%, the central bank left rates unchanged at its last three meetings, while inflation fell to within its target range (see Figure 4).

Conditions were in place for interest rate cuts before the end of 2023. However, in July inflation increased once more above the RBI's target range. This was driven by an increase in vegetable prices, reflecting the impact of a late start to the Monsoon season and uneven rainfall distribution, highlighting the vulnerability of inflation in India to agricultural supply shocks.

The RBI expects price increases to peak in the second quarter of the fiscal year at 6.2% before falling towards the midpoint of the inflation target over the next year. Monetary policy is therefore likely to remain restrictive for the remainder of 2023

4. India's CPI inflation (% change, year-on-year)



to maintain the credibility of the inflation target. Interest rate cuts are possible in 2024 in the absence of further shocks.<sup>12</sup>

### Structural challenges, ambitions and reforms

Prime Minister Narendra Modi's government announced an array of reforms upon his re-election for a second term in 2019. These focus on deregulation, attracting foreign investment and simplifying processes. Modi's ambition is to achieve 'Atmanirbhar Bharat', a phrase which means self-reliant India. Though most reforms have not been started and many of those that have remain incomplete, they hold the potential to enhance the business landscape for private companies and facilitate foreign investor access to India's market. A non-exhaustive list of reforms is summarised in the Appendix.

A key aspect of achieving Atmanirbhar Bharat is Modi's 'Make in India' plan.<sup>13</sup> This plan was originally announced when Modi first took office in 2014. Many new policies have been announced during his second term aimed at boosting domestic production. The Production Linked Incentives scheme previously mentioned, for example, forms part of this.

While protectionist policies aimed at boosting domestic production may be popular among local producers, they often result in market inefficiencies which frustrate productivity gains. Furthermore, empirical studies have shown that the removal of trade barriers would significantly increase welfare in India.<sup>14</sup>

<sup>8</sup> Nowzad, B. (1978) 'Significance of Rise in Protectionism', in The Rise in Protectionism. International Monetary Fund. <https://doi.org/10.5089/9781451976632.054>

<sup>9</sup> Alessandro, B., Cacciatore, M. and Ghironi, F. (2018) 'Protectionism and the business cycle', *Journal of International Economics*. <https://www.nber.org/papers/w24353>

<sup>10</sup> *Inflation-Forecast Targeting for India: An Outline of the Analytical Framework* <http://tinyurl.com/mpkb8psh>

<sup>11</sup> Al-Mashat, R.A. (2018), 'India: Stabilizing Inflation', in *Advancing the Frontiers of Monetary Policy*. International Monetary Fund. <http://tinyurl.com/y4t2dmfy>

<sup>12</sup> See also: 2023-24 Resolution of the Monetary Policy Committee (MPC) 8-10 August, 2023.

<sup>13</sup> <https://www.makeinindia.com/index.php/policy/new-initiatives>

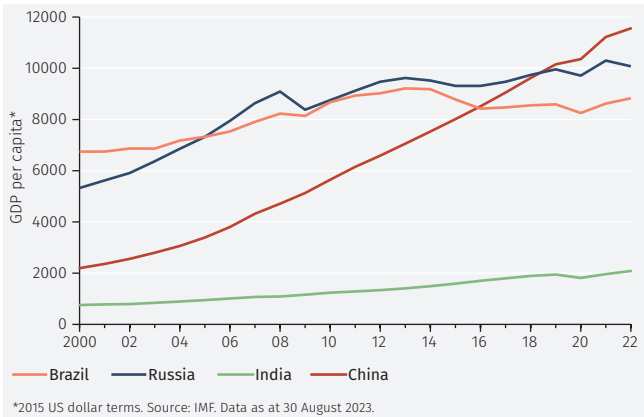
<sup>14</sup> Van Leemput, E. (2016) 'A Passage to India: Quantifying Internal and External Barriers to Trade', *International Finance Discussion Papers* <https://doi.org/10.17016/IFDP2016.1185>

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This highlights a key problem with Atmanirbhar Bharat: it fails to address some of the structural problems facing India such as poor living standards and inefficient labour. Despite being the world's sixth-largest economy, GDP per capita ranks one hundred and sixty-fifth. For context, India's GDP per capita in 2022 was USD 2085, below the global median of USD 6205.<sup>15</sup>

GDP per capita is a useful proxy for productivity. That India's GDP per capita is the lowest of all the BRIC countries and almost ten times less than that of the US therefore represents both a challenge and a significant opportunity for growth (see Figure 5).

## 5. GDP per capita



A key reform which could have a large impact in this area is the National Education Policy (NEP).<sup>16</sup> The NEP came into effect in the 2023-24 academic year and focuses on access, equity, quality and accountability.<sup>17</sup> Although this should help improve living standards and increase productivity, it will take time for India to reap the rewards. For those entering the new system in 2023, most will not enter the working population as high-skilled workers for at least another fifteen years.

## 2024 election & foreign policy

Despite a lack of progress with many important reforms, Modi benefits from an approval rating of almost 80%.<sup>18</sup> A general election will be held in India between April and May 2024 and he is likely to retain the premiership for another five years. However, Modi's victory is not a certainty. His ruling party, the Bharatiya Janata Party (BJP), lacks popularity.

If Modi retains power, India will likely maintain its current approach to foreign policy, which has been based on a closer alignment with Western countries and away from its strained relationship with China. A 58-point joint communique with the US was released following a meeting with Biden in June, reaffirming the commitment of the two countries to the US-India Comprehensive Global and Strategic Partnership.<sup>19</sup> The West appears determined to reduce its dependence on China, presenting India with a valuable opportunity to establish itself as a geopolitical powerhouse.

However, India's approach will likely be measured. Despite differing geopolitical stances, India and China are closely aligned when it comes to trade. China ranks top among India's import origins and third as an export destination, with over USD 100 billion of goods and services flowing between the two economies in 2021.<sup>20</sup>

## Conclusion

In summary, the outlook for India is positive. GDP growth is projected to be around 6% per annum for the next five years and despite the current surge, inflation is expected to return to its target range, opening the door for rate cuts in 2024.

However, average living standards in India are disappointingly low. Moreover, additional structural problems such as inefficient labour persist. Modi's reforms, intended to achieve 'Atmanirbhar Bharat', have not yet addressed these structural issues and may yet aggravate them. Nevertheless, groundwork is now being laid for India's future, with the National Education Policy having the potential to mitigate some of these problems.

This will take time and the challenge is not insignificant. Re-election for Modi in 2024 could see a fresh set of reforms introduced. In any case, India appears to be on the right path and has the potential for a prosperous future.

<sup>15</sup> All GDP per capita data in constant 2015 US dollar terms. <http://tinyurl.com/2nj4bvea>

<sup>16</sup> [https://www.education.gov.in/sites/upload\\_files/mhrd/files/NEP\\_Final\\_English\\_0.pdf](https://www.education.gov.in/sites/upload_files/mhrd/files/NEP_Final_English_0.pdf)

<sup>17</sup> <http://tinyurl.com/3pmkuz2t>

<sup>18</sup> *The Economist* (June 2023). <https://www.economist.com/asia/2023/06/15/narendra-modi-is-the-worlds-most-popular-leader>

<sup>19</sup> <https://www.whitehouse.gov/briefing-room/statements-releases/2023/06/22/joint-statement-from-the-united-states-and-india/>

<sup>20</sup> Based on OEC data. [https://oec.world/en/visualize/tree\\_map/hs92/export/ind/show/all/2021/](https://oec.world/en/visualize/tree_map/hs92/export/ind/show/all/2021/)

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## APPENDIX

### List of thirty reforms that the Modi government confronted when it took office in 2019

Area	Reform	Implementation	Date implemented	Status
Deregulation	Fully privatise Air India	Flagship airline privatized and sold to Tata Group.	January 2022	Completed
Foreign direct investment	Allow more than 50% foreign investment in insurance	The ceiling was raised from 50% to 75% for insurance FDI	March 2021	Completed
Foreign direct investment	Allow more than 50% foreign investment in defense	The ceiling was raised from 50% to 75% for defence FDI	September 2020	Completed
Process simplification	Pass the Major Port Authorities bill	Major Port Authorities Bill was passed meaning more autonomy.	February 2021	Completed
Process simplification	Reduce the corporate tax rate from 30% to 25%	Corporate tax decreased from 30% to 25%.	September 2019	Completed
Process simplification	End retrospective taxation of cross-border investment	Retrospective taxation of cross-border investments has been abolished.	August 2021	Completed
Deregulation	Allow companies to conduct layoffs without government permission	The parliament on 23 September 2020 passed the Industrial Relations Code 2019 giving firms with up to 300 employees flexibility in hiring and firing.	Ongoing since 2019	Incomplete
Process simplification	Create an outside restructuring process to ease the burden on the NCLT	The Reserve Bank of India gives Indian banks the discretion to refer defaulters to NCLT on a case-by-case basis.	Ongoing since 2019	Incomplete
Process simplification	Increase the number of NCLT benches and the case resolution deadline to 1 year	On August 5, 2019, the President signed the Insolvency and Bankruptcy Code (Amendment) Act, 2019, and increased the resolution deadline for NCLT cases to 330 days. The Central Government added five more benches between July 2018 and March 2019.	Ongoing since 2019	Incomplete
Process simplification	Create a bankruptcy resolution process for financial firms	The Ministry of Corporate Affairs notified the Insolvency and Bankruptcy Rules 2019, allowing an interim framework for Financial Service Providers (excluding banks), to file for insolvency proceedings on a case-by-case basis.	Ongoing since 2019	Incomplete
Process simplification	Offer one-stop shopping for central government clearances	A review of the National Single Window System on 5 December 2022 has onboarded 27 Central Departments and 19 states. The remaining 8 Ministries are expected to onboard by December 31, 2022, and the balance states/UTs by March 31, 2023.	Ongoing since 2019	Incomplete
Deregulation	Fill all judicial vacancies in India's courts	Nearly 26 percent of judgeships in India's subordinate courts remain vacant, while 36 percent of judgeships in India's high courts are vacant.	Ongoing since 2019	Not started
Deregulation	Stop forcing banks to lend to "priority sectors"	The Reserve Bank of India currently forces banks to allocate 40% of their credit to priority sectors	Ongoing since 2019	Not started
Deregulation	Deregulate Kerosene Pricing	The government maintains a price cap on public distribution system kerosene, and provides subsidies to compensate for the fixed price, thereby maintaining controls over kerosene pricing.	Ongoing since 2019	Not started
Deregulation	Deregulate Natural Gas Pricing	While the government has taken steps to introduce profit-sharing in natural gas production, the government has still implemented price ceilings on natural gas, maintaining control of pricing.	Ongoing since 2019	Not started

(Cont.)

## INDIA: A LIGHT IN A DIMMING GLOBAL ECONOMY

(cont)

Area	Reform	Implementation	Date implemented	Status
Deregulation	Establish a 10-year Plan to Privatize All Central Public Sector Enterprises (CPSEs)	The government continues a piecemeal approach to the privatization of CPSEs with no long-term deadline for completion.	Ongoing since 2019	Not started
Deregulation	Privatise public sector banks	The government continues to hold a majority stake in public sector banks.	Ongoing since 2019	Not started
Deregulation	Offer business owners central government permits in 10 days or less	According to the World Bank's Ease of Doing Business Report 2019, it takes 17 days to start a business in India, more than the average of 13.7 days in South Asia.	Ongoing since 2019	Not started
Foreign direct investment	Raise the ceiling on foreign institutional investment in government bonds	For FY 2019-2020, the Reserve Bank of India set the limit on foreign institutional investment in government bonds to 6 percent, far lower than its emerging market counterparts	Ongoing since 2019	Not started
Foreign direct investment	Release annual report detailing origins and destinations for all inbound FDI	India's FDI data currently shows only the last point of departure for FDI (usually Mauritius or Singapore), and the city foreign investment applications are filed in (Delhi or Mumbai).	Ongoing since 2019	Not started
Foreign direct investment	Reduce restrictions on foreign investment in multi-brand retail	Foreign direct investment in multi-brand retail is subject to minimum investment size, sourcing rules and location limitations.	Ongoing since 2019	Not started
Foreign direct investment	Allow more than 50 percent foreign investment in direct retail e-commerce	Foreign direct investment in direct business-to-consumer retail e-commerce is not allowed unless items are all being sold under a single brand, meet local content requirements, and the inventory is not owned or controlled by the foreign company.	Ongoing since 2019	Not started
Foreign direct investment	Raise ceiling on foreign institutional investment in Indian companies	The long-standing 10% limit on single institutional investors hinders investment in high-growth Indian companies.	Ongoing since 2019	Not started
Process simplification	Place pricing control of electrical power in the central government	State-level tariff-setting bodies have been unable to balance political interests and consumer requirements to deliver reasonably priced power.	Ongoing since 2019	Not started
Process simplification	Amend or replace the Land Acquisition Act, 2013	The Fair Compensation in Land Acquisition, Rehabilitation, and Resettlement Act, 2013 requires that states obtain approval from at least 80% of residents before buying land, making it difficult to find plots for industry and infrastructure.	Ongoing since 2019	Not started
Process simplification	Release proposed regulation with cost-benefit analyses & input from stakeholders	Regulations in India are implemented without a 30-day notice and comment period, and released without a cost-benefit analysis, which makes the operating environment difficult for businesses.	Ongoing since 2019	Not started
Process simplification	Simplify the Goods and Services Tax rates to three rates	The current rate structure of four rates, plus a separate tax rate for gold and a 0 percent rate, is overly complicated and should be simplified.	Ongoing since 2019	Not started
Process simplification	Include electricity, oil & gas, real estate, and alcohol in the ambit of the GST	While nearly 1300 goods and 500 services are covered by the GST, electricity, oil and gas, real estate, and alcohol are not currently in the ambit of the tax.	Ongoing since 2019	Not started
Process simplification	Establish the already-approved Rail Development Authority	The government takes no steps to institute the Rail Development Authority despite cabinet approval.	Ongoing since 2019	Not started
Process simplification	Establish a paperless court system to ensure speedy resolution of cases	The government announced the launch of the Integrated Case Management Information System to digitize India's courts but has so far been implemented only in the Supreme Court.	Ongoing since 2019	Not started

Source: Center for Strategic and International Studies. As at August 2023.

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