India Outlook

The GST: so far so good

Prime Minister Narendra Modi's position has improved in 2017 with a major win in the Uttar Pradesh state election in March (India's most populous state) and the July defection of Bihar chief minister Nitish Kumar from the Congress-led opposition to re-join Mr Modi's BJP. In the 245-seat upper house, where the BJP-led coalition lacks a majority, these factors should deliver 47 extra seats within a few years, as its members are re-appointed. Political momentum is now clearly with Mr Modi as the Congress Party dwindles, and that will help him negotiate for support for his reform bills in the upper house and with state governments. It also puts him firmly on track to win a second five-year term in the 2019 elections.

While it is early days, the GST implementation has been relatively smooth so far. Most businesses (apart from some small traders) have adapted well, while the removal of border checkpoints has slashed the time and cost involved in moving goods across states. Still, confusion could grow next month, when the first batch of businesses will have to file tax returns. Most businesses will have to file returns in September, which is when we will find out if the new GST network can effectively match vendor and buyer invoices, administer tax collections and refunds, and identify evaders.

> Political momentum is now clearly with Mr Modi as the Congress Party dwindles, and that will help him negotiate for support for his reform bills in the upper house and with state governments.

Cleaning up USD180bn in bad debts in the banks (17 per cent of all loans) is a big challenge. Bad debts in the construction, metals and mining, transport, and engineering sectors have crimped bank lending and undermined economic growth. New powers given to the Reserve Bank of India (RBI) to resolve non-performing loans should help.

Fiscal year starting 1 April	2013-14	2014-15	2015-16	2016-17	2017-18
GDP mp (FY12 series), real growth, %	6.6	7.2	7.9	7.1	7.0
Inflation - CPI, yr avg (FY12 series), %	9.0	6.0	4.9	4.5	4.5
RBI lending (repo) rate, year end, %	8.0	7.5	6.75	6.25	6.00
Rupee to US$1, RBI Ref Rate, yr end	60.1	62.5	66.2	65.0	66.0

Sources: 2013-2016 data from the government (NCI, RBI) and CEIC. 2017-2018 forecasts.

Previously, we reduced our India GDP growth forecasts as we expect GST complications and continued weakness in bank lending to slow growth. These headwinds should ease by late 2018, allowing growth to return to 7-8 per cent from 2019. We may lift our near-term forecast in Q4'17 if GST implementation runs smoother than we expect.

A key development to watch is whether fixed investment can recover. Capex growth has averaged just 3.5 per cent pa in the last five years, from 10.6 per cent pa expansion in 2007-11. Commercial vehicle sales fell 3.7 per cent yoy in 1H'17 from a 16.2 per cent yoy lift in 1H'16, with medium & heavy vehicle sales slumping 9.6 per cent yoy in 1H'17 from a 23.6 per cent surge the same time last year. This likely reflects weakness in the construction sector and uncertainty surrounding the GST, which may have caused some firms to delay purchases.

How quickly consumers rebound from the disruption of demonetisation is also critical for the outlook. Real growth of consumer spending surprisingly surged 11 per cent yoy in Q4'16 before easing to 7.3 per cent yoy in Q1'17. Two-wheeler sales have recovered modestly, up about 4 per cent yoy from a 7.5 per cent lift in full 2016, while sales of three-wheelers remain weak, down 16.6 per cent yoy in H1'17 from an 11 per cent fall in full 2016. Meanwhile, car sales have stayed resilient and rose 7.8 per cent yoy in 1H'17 from a 6.9 per cent yoy increase in 2H'16, suggesting demonetisation has had negligible impact on urban consumers. ■