India Outlook

The road ahead with GST

The switchover to the GST on July 1 will be a crucial test for the administration. The new tax is expected to bring in substantial revenue benefits to the government, lower prices for consumers through the elimination of cascading taxes and provide a single market environment for industry. Through the reduction of tax evasion, it is also expected to bring India's large unorganised sector into the formal, tax-paying fold. However, these are longer term benefits. In the short term, industry is gearing up for a difficult transition period. The multiplicity of tax rates (there are five tax slabs); increase in the compliance burden (an average business will have to file 36-60 returns a year against 12-18 currently); and a general lack of preparedness on the part of most of India's SME sector are a few of its major concerns. The government appears open to providing leeway wherever possible but supply disruptions and cash flow problems are nevertheless likely. Businesses are also likely to postpone major capex decisions until there is greater clarity on how the new tax will work.

So far, 81 per cent of firms registered under the old tax systems have completed GST Network (GSTN) registration, with small and medium firms (SMEs) given leeway to finish registration and to lodge their first returns. Registration for firms not previously covered started on June 25, and will likely take several months. When completed, it will shift the competitive framework in favour of larger firms that have always paid tax. Overall, taxes are expected to fall for manufacturers and rise for services firms.

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Apart from the GST, a second policy thrust with a significant impact in the coming 12-18 months is the government's recent direction to the Reserve Bank of India (RBI) to clear a logjam of bad loans, mostly held by state-owned banks. In the first six months, the focus will be on just 12 large bad loans, while banks prepare action plans for another 35-40 accounts. This process looks like working and should open the way to a gradual revival in bank lending and industrial growth from 2018.

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	66.5

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

GDP growth in the January-March 2017 quarter reflected the hangover from demonetisation with growth in manufacturing falling to 5.3 per cent yoy after two years at 9.8 per cent, while construction fell by 3.7 per cent yoy after two years at 4.2 per cent. Growth was supported by a 7.2 per cent yoy lift in services and a strong 5.2 per cent yoy rise in agriculture. Private consumption growth fell from 11 per cent to 7.3 per cent yoy but a 32 per cent yoy increase in government spending helped compensate for this. The recovery in demand spending has been quick in both urban and rural India. Passenger vehicle sales growth surged to 11.7 per cent in the April-May 2017 period compared to 1.8 per cent during the October-December quarter when demonetisation took place. Two-wheeler sales growth similarly jumped from -4.6 per cent to 9.6 per cent. Industrial growth however, has yet to recover. Growth on the new IIP series was 3.1 per cent yoy in April against 6.5 per cent yoy last year with the capex segment reporting a 1.3 per cent decline against 11.5 per cent growth last year.

Despite this, the markets remain strong with benchmark indices hitting record highs in the last few weeks. The BSE Sensex scaled the 30,000 marks to reach 31,300 while the Nifty cross the 9,700 level. Although some of this exuberance is likely to taper as the realities of the GST transition sink in, it does indicate underlying optimism vis-à-vis longer term economic prospects.

With bank lending growing sluggishly companies are compensating by borrowing from the markets. Based on data on outstanding value of corporate bonds, companies raised Rs 3.8 trillion in FY17 from the markets, a 43 per cent jump over last year. In comparison, net bank borrowing stood at Rs 5.8 trillion implying that bonds contribute 40 per cent of total new credit, up from 20 per cent five years ago. ■