India Outlook

Of GST, cash squeeze and more

India has five state elections underway, with the most important contest in the northern state of Uttar Pradesh (UP is India's most populous state with 222m people, 140m voters, and 80 MPs in the national parliament). The results will not be announced till March 11, but higher turnouts are being reported. While local turf battles will be paramount, voters will also be passing judgement on PM Narendra Modi's controversial demonetisation of November 8. That continues to hurt the poorer and rural households that dominate in UP. Mr Modi, who led his BJP coalition to a landside win in the 2014 general elections, has had a patchy record in state polls since then. Yet his drive to reform India depends on strong popular support for change and a big loss in UP would weaken his position going forward.

The dominant policy issue for 2017 is GST introduction, which has moved back from the start of the new fiscal year on April 1 to July 1. There is limited scope to delay after that, as the constitutional authority for states to raise some key local taxes will expire in September. Central and state officials are racing to negotiate key details, while corporates and industry associations are trying to figure out who wins and who loses. The broad promise is of a triple win: government revenues will rise; corporates will find it easier to address a national market; and consumers should gain products and services of better quality and value. Yet poor implementation could undermine all three potential wins.

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Finance Minister Arun Jaitley announced a "steady-as-she-goes" budget in February with a deficit target of 3.2 per cent for FY2017-18 based on projected revenue growth of 9 per cent and spending growth of 6.6 per cent. Welfare schemes for poor and rural households gained support, but that might not be the vote winner Mr Modi hoped for. The budget assumes GDP growth in the current FY of 7.6 per cent with 7-7.5 per cent forecast for FY2017/18.

The cash squeeze created by the withdrawal on November 8 of India's two largest notes (the 500 and 1,000 rupee notes, accounting for 86 per cent of the value of currency in circulation) is set to continue until mid-2017, cutting a percentage point or more off growth. India is overwhelmingly a cash transaction economy and by January 20, currency with the public was still 40 per cent below year-ago levels. Hardest hit are poor and rural households and the many industries that rely on cash payments to workers and suppliers. The result was a 2 per cent yoy fall for industrial production in December led by falls of 10.3 per cent yoy for durables and 5 per cent yoy for non-durables. We think current GDP growth is much weaker than implied by the government's budget forecast, with the annual rate slowing to 6.7 per cent by the December quarter from 7.4 per cent for the year to Q3'16. GDP growth in the first two quarters of 2017 is likely to remain in a 6.0-6.5 per cent range before lifting in the next two to 7 per cent. The following year should see a return to 7.5 per cent growth provided the economy isn't derailed by GST introduction.

December's falls in industrial production for consumer goods hint at a sharp drop in growth for consumer demand, which we estimate at 5.5 per cent in Q4'16 from an average of 7 per cent for the prior 10 quarters. Real consumer demand growth should lift towards 6 per cent by 2H'17. Vehicle sales for January capture the divergent community impact: hardest hit were 3-wheeler sales, down 27 per cent yoy, followed by 2-wheeler sales (-8 per cent yoy), and commercial vehicles (-2 per cent yoy). By contrast, car sales jumped 13 per cent yoy and the number of domestic air passengers continued to grow strongly at 24 per cent yoy in December. ■

Fiscal year starting 1 April	2013-14	2014-15	2015-16	2016-17	2017-18
GDP mp (2011-12 base year), real growth, %	6.6	7.2	7.9	6.0	7.0
Inflation - CPI, yr avg, %	9.0	6.0	4.9	5.0	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	68.5	71.5

Sources: 2013-2015 data from the government (NCI, RBI) and CEIC.