India Outlook

Bad debts continue to choke lending and investment growth in India

Prime Minister Narendra Modi's main challenge as the 2019 elections approach is economic rather than political. His BJP has enough support in parliament to pass laws, the opposition Congress Party is in disarray with a weak leader and the BJP is well placed for the year-end contests in the Himachal Pradesh and Gujarat state elections. Instead, the main threat is a slump in growth to 5.7 per centyoy in Q2'17 from a 7.4 per cent average for the decade to 2016. That has undermined employment growth, which will hurt Mr Modi with the younger Indians who voted him into office. The introduction of the GST from July contributed to the slump but the biggest factor is a banking system choked with bad debt and a related slump in lending and business investment.

To help lift bank lending the Government has announced a massive recapitalisation of state-owned banks, which Morgan Stanley has characterised as India's TARP (referring to the $700bn scheme that helped rescue the US economy from 2008). India's proposed Rs 2.1 trillion (US$ 32bn) recapitalisation over two years is certainly large enough to revive lending by state-owned banks, which account for 75 per cent of all loans. The key issues are whether companies want to borrow and whether state-owned banks have the skill to clean-up their books and make better new loans.

While India's consumer demand is strong, industrial growth remains in a slump

GST remains a painful process for small firms. However, constant fine-tuning is underway and by mid-2018 its negative impact should have faded. GST collections appear to be stable near the Rs 921bn reported for September. Total gross tax collected for the September quarter was Rs 3.6 trillion, up 25 per cent yoy, so the GST hasn't hurt public finances.

India's economy has split into two parts: a consumer-led sector that is doing quite well; and an industrial-led sector that is stuck in a slump and is pulling down GDP growth. It is mostly problems in the industrial sector that have cut bank credit growth to 6.9 per cent yoy for September from an average annual rate of 16.6 per cent for the decade to 2016. We expect slightly better growth in 2H FY18 which should lift full year growth to around 6.5 per cent and perhaps 7 per cent by FY19. In its October forecast, the IMF puts FY2017/18 growth at 6.7 per cent (in April it had forecast 7.2 per cent) and FY 2018/19 at 7.4 per cent (previously 7.7 per cent).

The industrial production measure captures the industrial slump. Growth for July and August was just 1.4 per cent yoy from 1.9 per cent yoy in 1H'17 and 5.1 per cent in 2016. The Dun & Bradstreet business optimism index was down 33 per cent yoy to 55.2 in September, which is below the lowest score during the 2008-09 global financial crisis (57.1 recorded in June 2009). We expect 2017 growth for industrial production at 1.7 per cent lifting to 3.6 per cent in 2018, which is still below the decade average to 2016 of 5.4 per cent.

Vehicle sales capture the consumer picture. Total vehicle sales rose 12 per cent yoy in the September quarter after 4 per centyoy growth in January-June 2017. Passenger vehicle growth of 7.9 per cent yoy in the July-September quarter was roughly in line with the 8.9 per cent yoy reported for 1H'17. As expected, commercial vehicle sales rebounded by 14.3 per cent yoy in the quarter after falling 3.7 per cent yoy in 1H'17, as firms put off purchases in the two months prior to GST introduction. Three wheelers saw a similar rebound to 8.1 per cent yoy growth after a 16.6 per cent fall in 1H'17. Finally, two-wheeler sales growth lifted to 12.7 per cent yoy in in the September quarter from 3.9 per cent yoy in 1H'17.

CPI inflation edged up to 3.3 per cent yoy in September, which is the low end of the RBI's 2-6 per cent target range, suggesting one more cut is possible from the current 6 per cent policy rate. After climbing against a weakening US$ in the first half of the year, the Rupee is expected to slip against a strong US$ into 2018, as the US Fed lifts its policy rate. ■

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	6.5
Inflation - CPI, yr avg (FY12 series), %	9.0	6.0	4.9	4.5	3.5
RBI lending (repo) rate, year end, %	8.0	7.5	6.75	6.25	5.75
Rupee to US$1, RBI Ref Rate, yr end	60.1	62.5	66.2	64.8	66.5

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