India Outlook

India faces issues with GST implementation, and in pushing through important structural reforms

With GDP growth slowing to a low of 5.7 per cent yoy in Q2'17, concern is growing that Prime Minister Narendra Modi's drive to reform India and lift its growth – as he did for Gujarat as its Chief Minister over 2001-14 – has stalled. There are two problems. First, problems with GST implementation may have been under-estimated and they may undermine growth. Secondly, little is being done to fix fundamental problems that have led to a collapse in domestic investment (such as bad bank debts, arcane labour laws and problems with acquiring land). At present, popular support for Mr Modi remains strong but the pain of GST implementation could cost him his crucial support base in the massive small business and trading community. Six state elections over the next year, including Gujarat and Karnataka, will show whether the Modi bandwagon has stalled.

Implementation of a goods and services tax (GST) is essential to creating a national market and to providing government with stable income to fund public investment. The main risk with GST implementation is that its complexity will have a negative impact on corporate cash flow in two areas: by slowing invoicing and payments and by delayed refunds from the tax office to companies (like exporters). Part of the latter problem appears to be that the government is itself low on funds. It front-loaded this year's budget, with over 90 per cent of FY2017-18 spending in the first four months (to July). It could turn to markets for funding, yet rating agencies have indicated concerns that may lead them to downgrade India. As it already sits on the lowest investment grade rating, a downgrade would cost India a lot and would undermine business confidence. The game isn't over yet, as vehicle sales to August (see below) suggests a positive outlook. But a difficult first year for the GST has started and gridlock on cash flow is a key risk.

> Automobile sales recovered in August after a GST-induced slump in June

As always, India's vehicle sales provide a snapshot of recent demand. After a weak 2015, mostly due to drought across rural India, two-wheeler sales, a good measure of demand from the massive low-income market, accelerated through 2016 reaching 15 per cent yoy growth in Q3 (Sept quarter). After demonetisation in November, sales fell for two quarters before a recovery in Q2'17. Passenger vehicle sales, reflecting middle class India, came through demonetisation with little disruption. Commercial vehicle sales also survived demonetisation, but then plunged 12.5 per cent yoy in Q2'17. That plunge – reported by clients in many other sectors – reflected a strategy of many local firms of running down stocks and holding back on big purchases in the pre-GST quarter, as such purchases lacked a deductable GST. Fortunately, August vehicle sales data suggests a return to normalcy. Passenger vehicle sales rose by 9.3 per cent yoy for the first two months of Q3 from 6.1 per cent growth in Q2'17, commercial vehicle sales swung to 10.4 per cent yoy growth after the Q2 fall of 12.5 per cent yoy, and two-wheeler sales rose 14 per cent yoy after 8.6 per cent yoy growth in Q2.

Provided the government gets tax refunds running and fixes glitches with its GST portal, India should scramble into 2018 without a GST-driven crisis. A bigger issue is the slump in bank (non-food) credit growth into a 5-6 per cent yoy range through 2017. That reflects – and undoubtedly contributes to – a slump in fixed investment growth to 1 per cent over the year to Q2'17. The central bank has announced a scheme to help banks resolve their bad debts, but progress has been slow so far. Although the April-June quarter was not representative due to the GST destocking phenomenon, GDP growth in FY18 is likely to be lower than the previous year.

The central bank may bow to pressure for rate cuts in the next few months. Along with rising risk concerns, that will see the Rupee fall by 1-2 per cent pa against the US$ in the next few months. ■

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	6.7
Inflation - CPI, yr avg (FY12 series), %	9.0	6.0	4.9	4.5	3.2
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.