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Looking back: Was 2017 the year of disruption or of consolidation?

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By-VP Singh

A new day brings new hope. A new year brings even greater hope. Such hope is wont to get even more significant if the year preceding was one that had bore a jolt like demonetisation. The past year, 2017, began with a population impacted by the DeMo decision debating what the future holds—some in angst, some in anticipation. The Uttar Pradesh (UP) Assembly elections, in February, was to provide the verdict on this debate and Modinomics. The Opposition hoped to consolidate votes by stitching another mahagathbandhan, but that was not to be. Not only did the mahagathbandhan not happen, on the contrary, the voters saw disruption—the ruling Samajwadi Party (SP) split. Eventually, the Bharatiya Janata Party and allies won, securing more than 80% seats. The BJP celebrated it as an endorsement of the Centre's DeMo decision, while the victory, in reality, could also have been because of any combination of the following factors—the consolidation of Hindu votes, split in the SP, new LPG connections, good governance, or sops announced in the Union budget.

The beginning of 2017 also marked the beginning of the second half of Modi's term. Thus, from the ruling dispensation's perspective, also held strategic importance as the public yearned for achhe din. Demonetisation intensified that yearning. The aam aadmi transformed into self-proclaimed economist. Gains in terms of improvements on inflation, current account and interest rate didn't seem to impress the public. Private investment was sluggish. Promises of creating 10 million jobs, doubling of farmers' income, and reining-in price increases seemed like tall promises. For the government, 2017 had to be the year for shifting the gear. Big government spending and sops for the industry needed to be announced. But, a string of elections were in line—UP, Uttarakhand, Manipur, Goa, Punjab, Himachal Pradesh and, most important, Gujarat. This constrained the government in making any big-bang announcements. Another disruption— advancing of the Union Budget to February 1—came as the solution. This brought the budget exercise in greater alignment with the financial year. Earlier, the budget exercise used to get completed by first week of May after getting the Presidential consent, but, that meant losing one month of the financial year. With the Budget advanced, speculations about a highly populist budget were rife. But, the budget exhibited astute fiscal discipline. The fiscal deficit target of 3.9% for 2016-17 was achieved, and the target of 3.2%, for FY18, was maintained. The Plan and Non-Plan categorisation was done away with, and a whopping 25.4% increase in capital expenditure was seen.

Very rarely have governments in India stuck to fiscal discipline. Perils of sustained fiscal deficits largely remained ignored. The skewed distribution of the tax burden on the salaried class, the debt-ridden private sector, weak banks, mounting NPAs, farm loan waivers, the impending social sector spend, the economic shock of demonetisation, and then dithering global growth required the government to spend a lot in 2017-19. This could happen only through increased government income, which required another disruption—disruption of the tax system via the implementation of GST. It got implemented on July 1, after a long wait of 17 years, yet many accuse the government for premature delivery. It has been disruptive.

The clamour for growth intensified as GDP growth reached just 5.7% in Q1 FY18, the lowest growth in the last three years. A bumper yield, after two consecutive monsoon failures, ironically, led to farmers' incomes plummeting as prices crashed. Good news kept evading the Indian economy. Modinomics seemed to be failing as the lingering impact of DeMo and a complex GST took its toll. The production cost increased due to global recovery, but investment remained stuck despite lower interest rates. Rising commodity prices pushed the CPI to 3-4%, discouraging further interest rate cuts. Surging imports of gold and electronics wiped out the previously achieved gains of controlling the current account deficit (CAD). CAD increased to a four-year high of 2.4% of the GDP. Achhe din remained elusive. The economy needed investment, but who would finance that?

Commercial banks couldn't match RBI's repo rate cut that had been gradually lowered from 8%, in January 2014, to 6%. The economy was facing the twin balance-sheet problem. Bad loans piled up to more than `10 trillion. Industry borrowers were not in a position to repay due to poor demand conditions. Demand would have improved if jobs got created, but that required investment, which wasn't coming easy. This resulted in a stalemate. The flush of liquidity from DeMo could not be used by the banks as it was treated as 'incremental cash' for maintaining the 'incremental cash reserve ratio'. The treatment as 'incremental CRR' was necessary, otherwise, the demand for government securities would shoot up to maintain the banks' statutory liquidity ratio requirements. There weren't as many government securities in the market. Stalemate continued.

Recapitalisation came as an ingenious solution. With fresh equity of `2.11 trillion, the banks' lending capability enhanced significantly. Banks are to use the money under 'incremental CRR' to buy bonds from the government. Bankers, industry, domestic and foreign institutional investors—all cheered the news, thus uplifting the mood in the economy.

Moody's upgraded India's sovereign rating from the lowest investment grade of Baa3 to Baa2. It is the first upgrade of India's rating in 14 years. Sticking to deficit targets, 30 ranks jump in the 'ease of doing business' and continuance of reforms like Insolvency and Bankruptcy Code and GST—all of this seemed to be getting rewarded. The upgrade implied more foreign investments and cheaper cost of funds for Indian companies. The industry mood largely looked buoyant, and it expected that the economic recovery was near.

Q2 saw the economy grow by 6.3%. Industry seemed to have come out of the disruptions caused by DeMo and GST. Apprehensions are still there about the sustainability of this recovery, though, BJP wins in Gujarat and Himachal Pradesh have seen stock markets soaring to new heights. Apprehensions will always be there, and so will hope. The new year 2018 has brought a fresh set of hopes about this recovery being a sustained one, though, the debate continues whether 2017 has been year of disruption or consolidation.

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