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India's Modi at three years earns mixed scorecard

Despite apparent success, trouble spots range from growing corporate debt to sluggish job creation

Indian Prime Minister Narendra Modi waves to people as he leaves after inaugurating the annual meeting of the African Development Bank in Gandhinagar, India on May 23. © AP

As Prime Minister Narendra Modi celebrates his third anniversary in power on May 26, India's economy seems to be firing on all cylinders. The country's stock markets rose to record highs earlier in May. Exports have been growing steadily, despite the Indian rupee's 4.5% rise against the dollar so far this year. The introduction of a goods and services tax, the world's biggest indirect tax reform program in the last 30 years, is scheduled for July 1. Consumer price inflation fell to just below 3% in April, the lowest rate in five years and below the central bank's target of 4%. Foreign direct investment rose to a record $60 billion in fiscal 2017 through March 31.

Politically, Modi enjoys unchallenged power and is India's most popular leader since Indira Gandhi, who was prime minister during most of the period between 1966 and 1984. His audacious demonetization of high-denomination banknotes last November, which sucked 67% of cash out of the economy, triggered widespread economic disruption for several months, but the gamble does not appear to have hurt his political fortunes. Modi's Bharatiya Janata Party won local elections in Uttar Pradesh, the country's most populous state, by a landslide in March.

The question is whether Modi will go for high growth and rapid job creation in the remaining two years of his term. That is unlikely, according to key analysts. Most predict that growth in gross domestic product is likely to trend just below 8% annually in the run-up to the 2019 general election. The BJP, which has vowed to expel its main rival, the Congress party, from power in the remaining small number of states it rules, is likely to focus on winning the six state elections scheduled for 2018. Among those contests will be one in Modi's home state of Gujarat where he was chief minister from 2001 to 2014 and where his BJP successors have proved less successful. "When Modi won power the popular wisdom was that you can only win elections by promising high growth and lots of jobs," one senior economist told the Nikkei Asian Review. "Now it is clear you don't need to do that, and Modi is likely to stick to populist and 'pro-poor' measures."

On May 23, Modi told the annual meeting of the African Development Bank, which was held in Gujarat, that by paying subsidies directly to the poor his government had saved $4 billion in three years. Three million poor households had been given free cooking-gas connections. He also noted that over 286 million Jan Dhan (People's Wealth) bank accounts had been opened for the poor.

Modi has been skilful in pushing a development message that wins him votes. Earlier this year he proclaimed he would lead the country toward a "New India" -- which includes a pledge to double farming incomes -- by 2022, the 75th anniversary of independence. Early on, he began to push a "Make in India" campaign, although that has not prevented him from loosening foreign investment rules. On May 24, his cabinet abolished a bureaucratic anachronism, the Foreign Investment Promotion Board, which used to have to approve every foreign direct investment proposal. The same day, Arun Jaitley, India's finance and defense minister, announced the government would select a few private-sector strategic partners to collaborate with foreign arms companies to manufacture fighter jets, helicopters, submarines and battle tanks in India, which currently is one of the world's biggest arms importers.

Glass half full?

Politically, Modi managed to avoid damaging fallout from the demonetization measure since there were no mass protests despite tough criticism from opposition parties. But the economic impact is less clear. The International Monetary Fund recently estimated that GDP will grow by 7.2% in fiscal 2017. But it noted that its effect on the informal and cash-based sectors of the economy is likely to be understated.

There has been a surge in the use of digital payment instruments, debit cards and e-wallets after the withdrawal of large-denominated banknotes from circulation. Around 75% of the cash removed from the system under the demonetization measure was replaced with new banknotes by the end of March, according to an estimate by the Reserve Bank of India, and this has contributed to increased economic activity.

The RBI noted that the cash crunch had a deflationary effect. "Food inflation declined from 3.7% (year-on-year) in October 2016 to 2.6% in November, to 2.0% in December and further to 1.3% in January 2017," it stated. But the RBI warned that inflation was likely to pick up again. Contrary to expectations that the central bank would cut interest rates to boost economic growth, it held its benchmark repo rate steady in both February and April and signaled its intention to keep a firm grip on money supply.

Bank coffers swelled as a result of unaccounted cash being deposited in accounts by harried citizens. But bank lending to businesses is now at a very low ebb. Both banks and businesses are groaning under a huge "twin balance sheet" problem of non-performing assets. A recent report from Credit Suisse, an investment bank, estimated that Indian banks need 860 billion rupees ($13.3 billion) in provisioning for NPAs over the next year. This amount may rise after the government decided in early May to grant power to the RBI to order banks to put bad loans in the NPA category. But there is still no sign of creating a "bad bank" that would assume a significant chunk of the $108 billion in NPAs, particularly in the steel, power, construction and telecom sectors.

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Troubled companies are not investing in new projects and stalled projects are being abandoned. The independent Centre for Monitoring Indian Economy said there were 1.4 trillion rupees ($21.65 billion) worth of investments in seven abandoned projects in April. This includes a $12 billion large steel project proposed by South Korea's POSCO that has been stuck since its inception in 2005 in environmental and land rights controversies.

Meanwhile, the government's ambitious sovereign wealth fund, the National Investment and Infrastructure Fund that was announced two years ago to finance both greenfield and stalled projects, has yet to get off the ground. Even so, Indian officials have been on roadshows around the world. NIIF aims to raise a total of $6 billion as its principal, with half coming from the Indian government and the rest from foreign investors, including sovereign funds.

Major hurdles lie ahead for Modi. The GST has been trumpeted as finally turning India into a single marketplace and as a triumph of "cooperative federalism." But its four tax brackets -- 5%, 12%, 18% and 28% -- plus a "sin surcharge" for superluxury items, will be levied on hundreds of goods and services. Many tax experts have urged the government to postpone the long-awaited tax to Sept. 1, but the Modi government seems determined to launch it on July 1. A vast technical system will be needed to match invoices, calculate input credits and keep tabs on millions of business entities, but there are bound to be glitches.

Jobs, jobs, jobs

The biggest worry for Modi concerns job creation. Rural wages, which grew by 18% per year between 2007 and 2012, have slowed to an annual growth rate of about 5% since then. The CMIE estimates that millions of rural workers left the labor force because they could not find jobs after demonetization.

There is hope of a turnaround with the monsoon predicted to be normal this year after a good rainfall in 2016 followed two years of drought. One positive factor could be benefits from the country's steadily improving rural infrastructure. A total of 47,350 km of rural roads were built in fiscal 2017, averaging 130 km per day, up from 73 km per day between 2011 and 2014, and increasing to about 100 km per day in the first two years of Modi's rule.

Critics accuse the Modi government of announcing too many infrastructure projects and other initiatives, and not focusing enough on job creation through concentrating on manufacturing and services. The once booming information technology sector, which employs four million people, is now staring at tighter visa rules in the U.S. and is threatened by automation and artificial intelligence. The government estimates that 12.8 million young Indians enter the workforce every year.

But there is no shortage of breezy optimism. A senior government official recently declared that India would be the world's third biggest auto manufacturer by 2026 and the industry would account for 12% of GDP and create 65 million jobs. Whether that assertion is correct will take nearly one more decade to prove.

Chaitanya Kalbag is a former Reuters Asia editor and former editor-in-chief of the Hindustan Times

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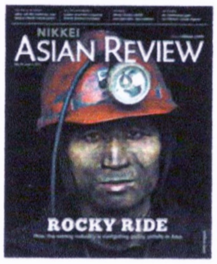

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