FINANCIAL TIMES

May 31, 2012 3:57 pm

Slump in growth alarms New Delhi

By James Fontanella-Khan in New Delhi, James Crabtree in Mumbai and Kanupriya Kapoor in Nashik

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Safety blankets such as agricultural subsidies need to be reformed if India is to avert disaster, say analysts

The dramatic drop in Indian economic growth isn't bothering the likes of Mahendra Saraf.

A farmer, he works in a sector that has seen growth shrink to 1.7 per cent in the first three months of 2012 against 7.5 per cent in the same period last year. But Mr Saraf, 26, is confident the blow to his profits will be cushioned by government agricultural subsidies. "Global and domestic demand has not been very strong," he says, "but the government buys excess grain at a fixed price, so we will get that money anyway."

Such safety blankets – the size of which vary from state to state and industry to industry – are among the targets of those who say the government of Manmohan Singh needs to take radical measures to restore growth in the Indian economy.

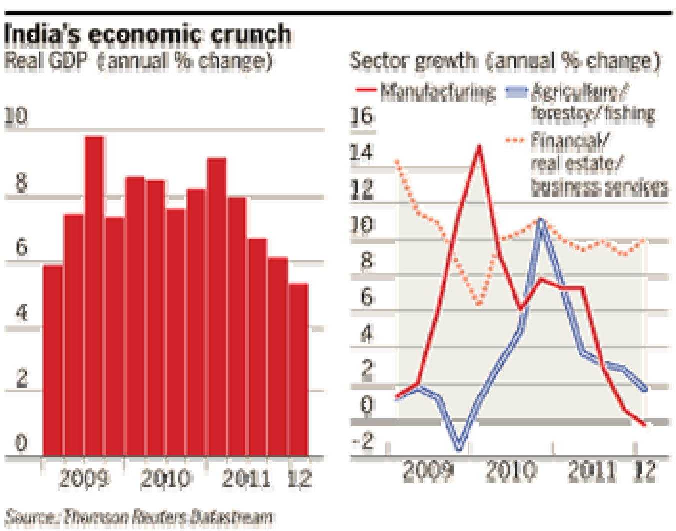
With growth in the first quarter of 2012 rising at 5.3 per cent, the slowest rate in nine years, policy makers are panicking about how to turn things around.

“It’s an absolute disaster,” says Omkar Goswami, head of the Corporate and Economic Research Group in New Delhi. “We went from nearly growing at 10 per cent to 5 per cent in less than two years... it’s very, very concerning.”

Although Delhi often blames the eurozone sovereign debt crisis for India’s woes, domestic economists argue that the country’s difficulties are self-inflicted, blaming the political paralysis that has set in over the past two years as the Congress party-lead coalition has stumbled from one crisis to another.

“The Indian economy is losing its shine and the policy response so far has ranged from nonexistent to ineffectual,” said Eswar Prasad, senior fellow at the Brookings Institution. “Fiscal policy is adrift and the reform process has lost momentum, compounding the effects of a weak external environment.”

The slump in growth took even the government by surprise.



“I had expected that the rise in the agricultural growth rate will perhaps compensate, to some extent, the decline in the industrial production. But that does not seem to happen,” said Chakravarthy Rangarajan, chairman of the Prime Minister’s Economic Advisory Council. “Therefore, the overall growth rate remains somewhat subdued. It is very disappointing.”

Agriculture was not the biggest loser in the first quarter of 2012. Manufacturing, which 12 months earlier had been growing at 7.3 per cent contracted by 0.3 per cent between January and March. However, financial services, the largest component of Indian GDP, continued to expand, growing 10 per cent.

The sharp drop in quarterly growth was primarily owing to a slowdown in investment. This “is partly a result of higher interest rates, which have caused credit growth to slow. But in addition, many large projects have been postponed or cancelled due to lack of approval for land acquisition, particularly in the steel and power sectors," says Andrew Kenningham at Capital Economics.

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Business figures say this fall-off in investment is visible across sectors, although some – such as telecoms and infrastructure – have been especially badly hit. "Renewables are a little insulated, but in the power sector in general things are not good at all," says Sumant Sinha, chief executive of Renew Power, a wind farm developer. "Banks have got a bit burned lending to this sector, so we have to work a lot harder to get financing, while interest rates are still high, and this constrains our ability to get projects off the ground."

The Reserve Bank of India cut rates by 50 basis points in April, more than most analysts expected, but still not enough to make many capital intensive investments viable, according to Leif Lybecker Eskesen, chief India economist at HSBC.

"Manufacturing in India really is a terrible story," says Ajit Ranade, chief economist at the Aditya Birla Group, one of the country's largest conglomerates. "Clearly the biggest priority is reviving investor spending, and in especially the private sector, where the growth rate is nearly zero now."

But inflation of 7.23 per cent means the central bank is not in a position to cut rates again. "The slowdown in growth is deepening and the downside risks to the outlook have increased. However, the lingering inflation pressures suggest that monetary policy cannot be eased aggressively," says Mr Eskesen.

Back at his farm Mr Saraf discusses the expansion to his family's farm and pesticides shop, but others have not been so fortunate. Local media reported suicides among Maharashthran farmers who, after a recent drought, were unable to produce enough grain to repay debts.

The stories highlight the dilemma that the Singh government faces. If it wants to revive growth it will have to pass unpopular reforms that will hurt the likes of Mr Saraf but, if it fails to do so, it risks dragging the economy into the worst crisis for more than 20 years.