

APEX CAPEX

How is govt capital expenditure driving India's growth? Will RBI's suggested provisioning affect it?

INDIVIAL DHASMANA
New Delhi, 12 May

The International Monetary Fund (IMF) recently attributed India's robust economic growth to strong public investments supported by a resilient domestic demand.

Krishna Srinivasan, Director of the Asia and Pacific Department, International Monetary Fund said in a blog post: "...India, where public investment remains an important driver, making it the world's fastest-growing major economy."

But there are layers to this. The government capital expenditure (capex), both of the Centre and states, steadily rose in recent years, aggregating more than Rs 10 trillion since 2021-22 (FY22). It is projected to rise to ₹19.07 trillion (revised estimates of the Centre and budget estimates of the states) during FY24, 34 per cent higher than the previous year. This comprised 6.5 per cent of the country's gross domestic product (GDP) during FY24 against 5.3 per cent in the previous year and 5.6 per cent in FY22.

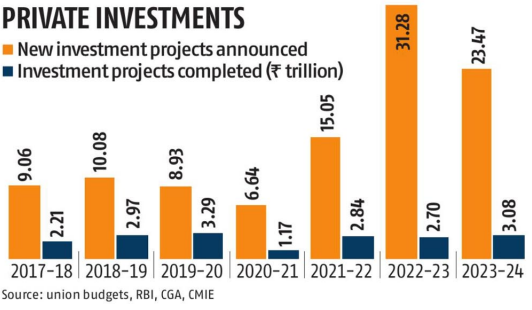
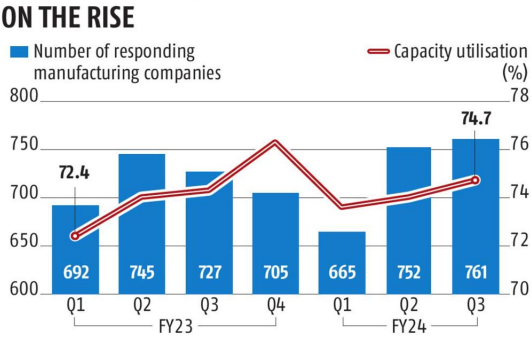
Govt capex drives growth
Most of this capex push, particularly the Centre's, has gone to infrastructure, mainly to railways, and roads and highways. The two accounted for more than 45 per cent of the Centre's capex since FY21 and more than 40 per cent since FY20, when the economy started slowing down with lockdowns being announced at the fag end of the year.

Madan Sabnavis, Chief Economist at Bank of Baroda, says governments have a role to play in infrastructure, where the private sector normally plays a secondary role. "Our government has been focussing on roads and railways for this reason," he says.

Ranen Banerjee, Partner at PwC India, believes the economic growth is being pump primed by government expenditure, which is needed. The government can afford it, given the high tax buoyancy. The government capex is skewed towards roads and railways because these are two sectors that are able to absorb the allocations, he says.

Recently, the Reserve Bank of India (RBI) came out with draft norms, suggesting higher asset provisioning for infrastructure lending.

Some public sector entities have said that the proposed provisioning norms will not impact their cost for infrastructure projects since there is government guarantee on them, but some experts say the proposed norms are much higher than the current



ones and, if enforced, will hit profitability and affect capex growth because lenders will tighten their lending.

Rajeshwar Burla, senior vice-president at ICRA, the rating agency, says the new provisioning norms, if effected, are not going to affect government projects directly, but public private partnership bidders will have to price these increases in project costs.

He says the impact will be 15 to 50 basis points on the cost of these projects, depending on whether there is a revision in the date of commencement of commercial operation.

"Now lenders can become cautious after their due diligence. Bid participation in Tier 2 and Tier 3 projects could be affected," Burla says.

Manushree Sagar, Senior Vice President at ICRA, says the draft norms are silent on loans raised by public sector entities versus others as of now. "There

is no clarity as of now. One has to wait for the final guidelines," she says.

Private sector projects

The value of new projects announced by the private sector rose substantially in FY23 to ₹31.28 trillion, double of the ₹15.05 trillion in the previous year.

However, it came down by almost a fourth to ₹23.47 trillion in FY24, according to data by the Centre for Monitoring Indian Economy, though even at the reduced level it was higher than the pre-FY23 level.

These are not inflation-adjusted figures.

The decline in the value of projects announced by the private sector during FY24 could be attributed to the decline in growth of private final consumption expenditure, denoting domestic demand, to 3 per cent during FY24 (second advance estimates) from 6.8 per cent in

the previous year even as the IMF pinned its hopes on resilient domestic demand.

Besides, projects, particularly in the infrastructure sector, take years to complete. The value of completed projects never crossed ₹3 trillion in any of the past seven years till FY24.

This could be due to the excess capacity with companies. For instance, capacity utilisation in the manufacturing sector remained below 75 per cent for the past seven quarters till the third quarter of FY24 (barring Q4, FY23), according to RBI data.

Consumption demand

"Private investment, which is related to industries in infra, such as metals, cement, engineering, and chemicals, is increasing for sure. However, investment in non-infra industries is lagging because of lower demand, which means excess capacity," says Sabnavis.

Consumption demand is low, he says, adding, "I would differ with the IMF that consumption demand is resilient as it has been affected by high inflation and lower incomes due to the limited growth in high-income jobs," says Sabnavis.

According to Aditi Nayar, chief Economist at ICRA, the private sector capex cycle is likely to be measured and not be excessively exuberant over the next few years. She says urban consumption demand is projected to remain upbeat, albeit uneven, in FY25.

"The high-income households and new entrants into the formal labour markets, which have a relatively high propensity to consume, would continue to drive urban demand in FY25," Nayar points out.

The consumption of low-income and middle-age middle-income households, which is assessed to have been tepid lately, may improve modestly, aided by expectations of a cooling in the inflation in essential food items, she says.

However, the recent tightening of norms for personal loans and credit cards by the RBI could affect credit growth for these segments, which may weigh on the discretionary consumption of urban households. Besides, the ongoing weakness in rural sentiments and consumption on account of the uneven monsoon and lower crop output in FY24 is likely to spill over into the first half of FY25, until there is some visibility around the farm cash flows from rabi procurement and outcomes for the next kharif crop, says Nayar.

Banerjee, however, says private consumption expenditure is resilient and growing, although at a slower rate than the overall growth.