Consumption share in GDP to take a knock after demonetisation

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Demonetisation could lead to a notable dip in the share of private consumption in India's gross domestic product (GDP), pulling down economic growth during the second half of FY17 and beyond. In FY16, private final consumption expenditure (PFCE) accounted for 55.6 per cent of India's GDP at constant prices down from 56.1 in FY14 and the 10-year high of 60 per cent in FY09.

Economists expect the PFCE share to decline further in FY17 putting downward pressure on economic growth unless balanced by either higher government expenditure, investments or net exports (exports or goods and services minus imports). In the past three years, growth got a kick from a sharp rise in net exports that improved from -6.4 per cent of GDP in FY13 to -1.3 per cent of GDP in the last financial year.

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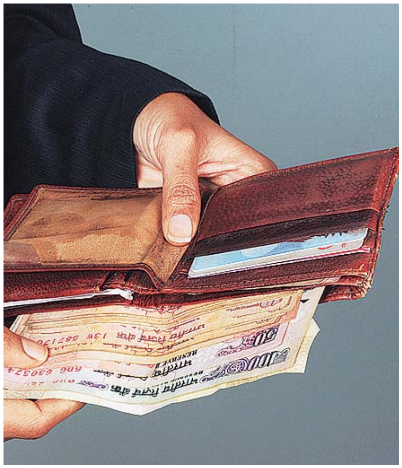
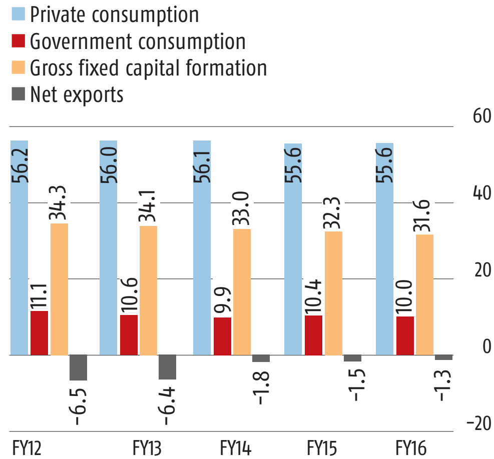
(Figures as % of GDP)





Note: Private final consumption expenditure; government final consumption expenditure
All variables are as per cent of GDP at constant prices
Source: Central Statistical Organisation

"Going by the numbers from November and December, we have seen a decline in demand across consumer industries. So intuitively, one can conjecture from the data that private expenditure will decline in FY17," says Madan Sabnavis, chief economist at CARE Ratings. "GDP growth is heading for a slowdown in FY17, maybe from earlier projection of 7.6 per cent to 7 per cent."

Government final consumption expenditure (GFCE) and investments (gross fixed capital formation) did not contribute to economic growth in the past three years either. Investment share in GDP declined from 33 per cent in FY14 to 31.6 per cent of GDP in FY16. During the same period, government consumption was stable at around 10 per cent.

The outlook for government consumption and investment is not bright either. "The government has a limited fiscal space right now. They are committed to keeping the fiscal deficit at 3.5 per cent of GDP. The revenue from spectrum sales has been lower than expected, and additional revenue generation from income disclosure scheme in the current financial period is low," Sabnavis adds.

According to Devendra Pant of India Ratings, even if the government was able to substantially increase expenditure, it may not result in drastic changes. "The government has a very limited role in boosting the overall growth by stepping up public expenditure in the near term. For example, the government can increase demand for steel, cement and labour by stepping up road construction. But, the whole process may take years to materialise," he said.

Economists don't see any immediate uptick in investments or capex given the surplus capacity across sectors. "Companies are seeing decreasing growth across sectors. They will not be in the mood to invest," says Sabnavis.

Pant agrees. "If you look at what is happening with e-commerce companies, they have stopped building inventories. Roughly 30 per cent of e-tailer sales were cash-on-delivery. Now, cash-on-delivery has come to a grinding halt leading to a sharp decline in sales and demand. So, going forward, what will be of utmost importance is how quickly this liquidity crisis is resolved."

This has thrown the ball in the foreign trade court. Because of a sharp decline in crude oil prices beginning 2014, net exports have been a saviour for the Indian economy boosting GDP growth and corporate profitability despite stagnation in overall production of goods and services. Economists, however, rule out incremental gains from net exports in the forthcoming quarters.

"With global demand remaining weak and few cash-intensive export sectors like gems & jewellery and textiles already slowing down, we expect that export growth could temporarily take a hit. However, with demonetisation expected to hit discretionary spending, import growth could also slow down, thereby offsetting the downside to exports. We see limited scope for net exports being able to lessen the impact of decreasing consumption," says Upasana Bhardwaj, senior economist at Kotak Mahindra Bank.