Article:

India's GDP expected to grow at 7.3% in 2018-19

China's economic growth is projected to slow down to 6.2 each in 2019 and 2020 and 6 per cent in 2021, according to the January 2019 Global Economic Prospects report released by the World Bank.

India's GDP is expected to grow at 7.3 per cent in the fiscal year 2018-19, and 7.5 per cent in the following two years, the World Bank has forecast, attributing it to an upswing in consumption and investment.

The bank said India will continue to be the fastest growing major economy in the world.

China's economic growth is projected to slow down to 6.2 each in 2019 and 2020 and 6 per cent in 2021, according to the January 2019 Global Economic Prospects report released by the World Bank on Tuesday.

In 2018, the Chinese economy is estimated to have grown by 6.5 per cent as against India's 7.3 per cent. In 2017, China with 6.9 per cent growth was marginally ahead of India's 6.7 per cent, mainly because the slowdown in the Indian economy due to demonetisation and implementation of the Goods and Services Tax (GST), the report said.

"India's growth outlook is still robust. India is still the fastest growing major economy," World Bank Prospects Group Director Ayhan Kose told PTI in an interview.

"With investment picking up and consumption remaining strong, we expect India to grow 7.3 per cent in the fiscal year 2018-2019, and average 7.5 per cent in 2019 and 2020. India registered quite a bit of pick up in doing business ranking. The growth momentum is there (in India)," Kose told PTI.

In India, the growth has accelerated, driven by an upswing in consumption, and investment growth has firmed as the effects of temporary factors wane, the World Bank said in its latest report.

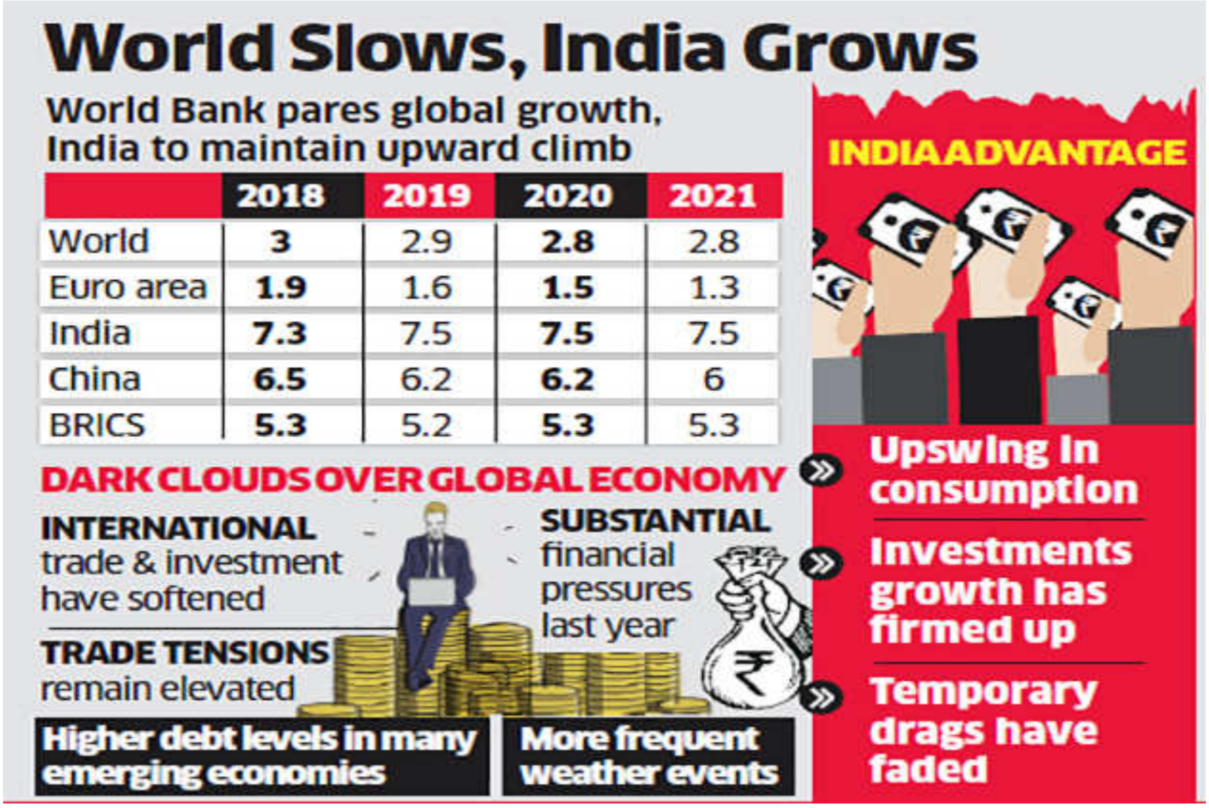
Domestic demand has strengthened as the benefits of structural reforms such as the Goods and Services Tax (GST) harmonisation and bank recapitalisation take effect.

"India's growth accelerated to an estimated 7.3 per cent in FY2018/19 (April to March) as economic activity continued to recover with strong domestic demand. While investment continued to strengthen amid the GST harmonisation and a rebound of credit growth, consumption remained the major contributor to growth," the World Bank said.

According to the report, India's GDP is forecast to grow by 7.3 per cent in FY2018/19 and 7.5 per cent thereafter, in line with June forecasts. Private consumption is projected to remain robust and investment growth is expected to continue as the benefits of recent policy reforms begin to materialise and credit rebounds.

Strong domestic demand is envisioned to widen the current account deficit to 2.6 per cent of GDP next year. Inflation is projected to rise somewhat above the midpoint of the Reserve Bank of India's target range of 2 to 6 per cent, mainly owing to energy and food prices, the bank said.

Others



It said in India the recent introduction of the GST and steps toward demonetisation are expected to encourage a shift from the informal to the formal sector.

"India's recent growth numbers suggest that the economy remains robust despite temporary setbacks (due top demonetisation and GST)," Kose said.

The World Bank's estimate suggest that India's potential growth rate is around seven per cent, and is expected to remain around seven per cent, he said in response to a question.

"The fact is that Indian economy is being able to deliver growth slightly above its potential is a very good sign," he added.

Refraining from commenting on the economic performance of the Modi Government that too in an election year, the World Bank official said growth performance of India as compared to other emerging markets has been quite impressive.

"India's growth performance has been quite impressive. Year after year it has delivered strong numbers around its potential growth," he said.

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Commentary:

The article outlines the growth in real GDP of India, despite several policy reforms within the country, and compares it with China.

India's growth rate is attributed to strong consumption and investment, which shows that there is an increase in aggregate demand that has led to an increase in the real GDP.

Figure 1: Business cycle diagram

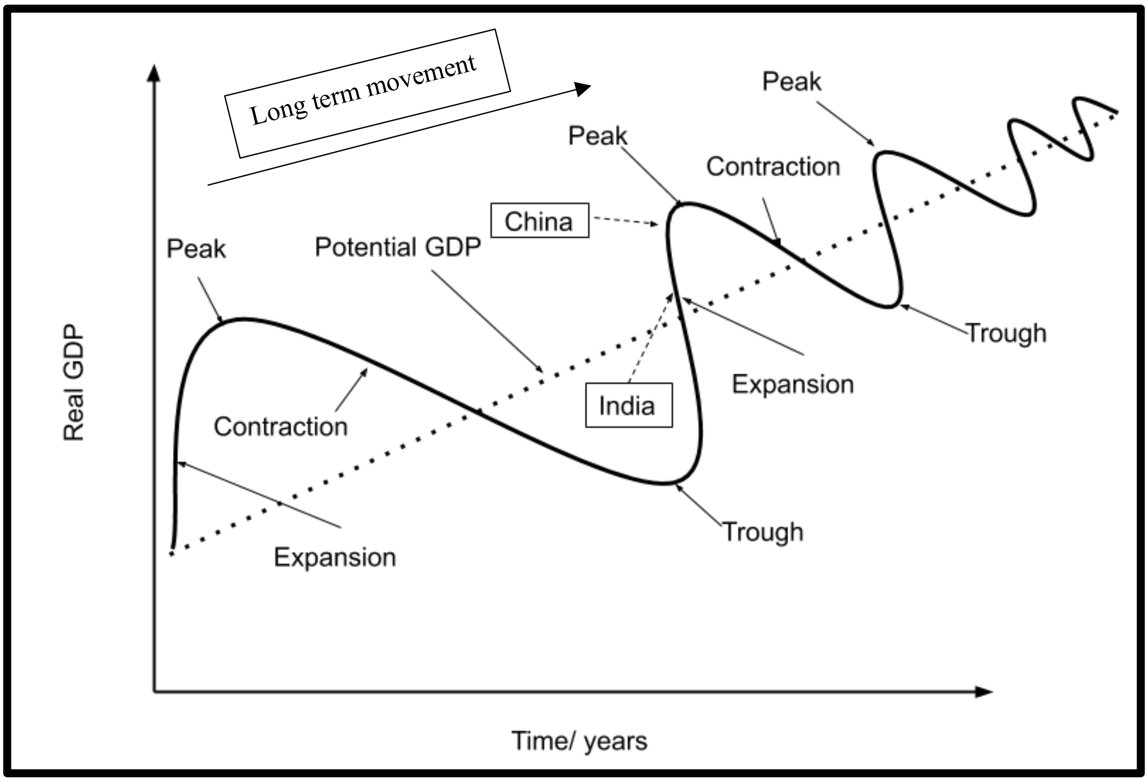

Figure 1 shows the business cycle diagram. The economy passes through 4 stages in the business cycle diagram: Expansion (period of rising real GDP), peak (period of overheating in the economy), contraction (period of decline in the real GDP), and trough (period of low real GDP). Despite the short run fluctuations in the economic growth rate, due to demonetization and the implementation of GST (Goods and service tax), an indirect tax system, there was a rise in potential GDP, average growth over time, shown by the dotted line with positive upward slope, in the long term. Moreover, the fluctuations in the GDP get milder as time goes on as the economy stabilizes in the long term, due to government intervention.

The rise in consumption and investment has led to Keynesian multiplier effect. This occurs when a change in investment will lead to a larger change in the real GDP.

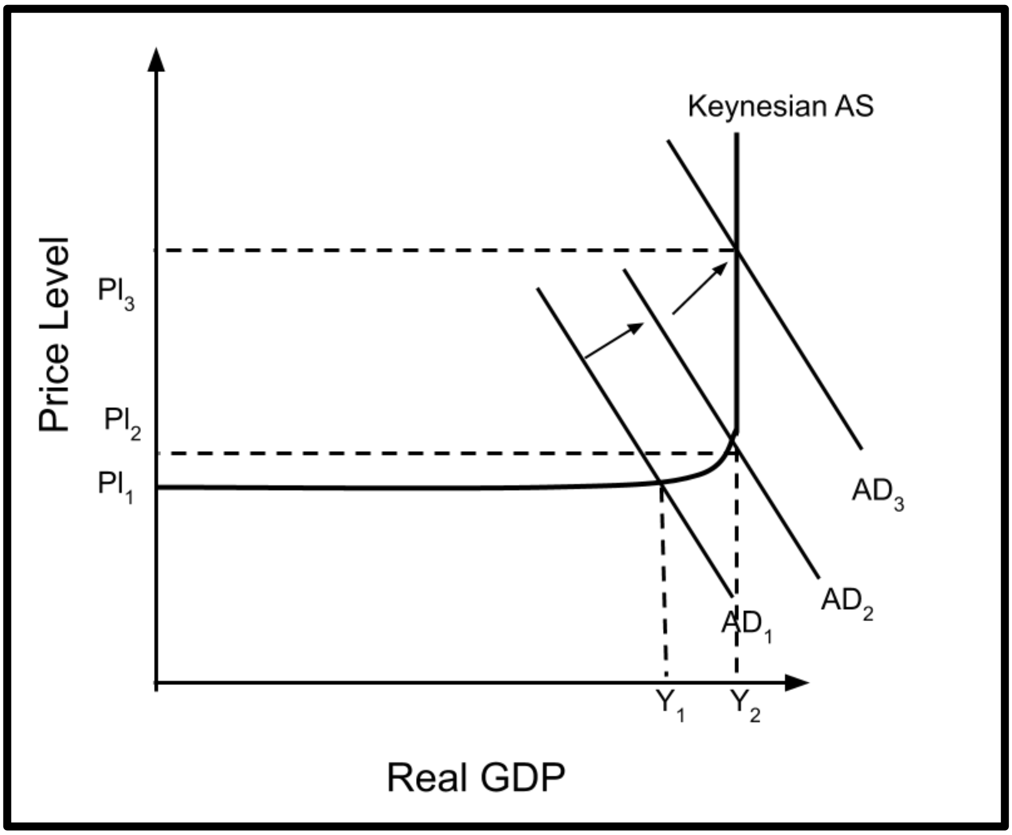

Figure 2: Keynesian Multiplier

The above diagram illustrates the "Keynesian Multiplier effect". Due to increase in investment expenditure, a shift in the aggregate demand arises, due to autonomous spending (increase in spending without increase in income) shown by the shift from AD_1 to AD_2. This shift causes a larger percentage change in GDP, shown by increase in Y_1 to Y_2, than percentage change in price level, shown by shift from Pl_1 to Pl_2. At this point, India is producing at the potential GDP, and achieves full employment. However, due to the expenditure, an increase in income occurs for suppliers. The suppliers will further spend this income on goods and services, and consumption expenditure will increase, due to induced spending (increase in spending on domestic goods and services due to an increase in income increasing the GDP), and is shown by the shift from AD_2 to AD_3. The shift has a large change in price level, shown by shift from Pl_2 to Pl_3, whereas, the change in real GDP is negligible. A shift in AD beyond this point, due to induced spending, only increases the price level, and has no effect on GDP, creating an Inflationary Gap. Rising inflation leads to a fall in real GDP and India has to suffer due to higher prices.

The extent to which the multiplier effect can affect the Indian economy will depend on the MPC, fraction of additional income spent by households on consuming domestic goods and services. Due to economic growth, an influx of imports occurs in the economy. If the MPM, additional income spent by households on consuming imports, is greater than the MPC, the size of the induced spending becomes smaller and the multiplier effect does not occur. This is because greater proportion of the rise in income is spent on imported goods, which reduces the X-M component of AD and controls the multiplier effect. This will help India avoid the rising inflation that accompanies the increase in expenditure. However, this may also cause imported inflation in India.

The rise in real GDP is bound to improve the living standards of the population of India. As a result, increased imports will offer more choice to consumers and make domestic firms more competitive and efficient. However, increased spending on imports leads to a larger current account deficit. Increased demand for imports results in imported inflation for inelastic goods such as food and energy. On top of that, demand pull inflation occurs as the economy overheats due to the high economic growth. The rising prices reduce the disposable income of the households and incentivize further consumption as real value of savings fall. This leads to further inflation.

The shift of employment from the informal to the formal economy, due to GST and demonetization, increases the government tax revenue provides information about the demographics of the working population. Moreover, this shift ensures that health and safety regulations are followed, credit is made available, and training, education opportunities are available for employees.

Although major policy reforms occurred in the country, households and firms have shown sustained confidence in the economy. The degree of benefit or damage derived from the multiplier effect will depend on the time lags occurring in between the induced and autonomous spending.

Word Count: 749 words

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