‘Govt needs to focus on improving investment climate’

S&P Global Ratings expects the fading economic reopening momentum in India and tight monetary policy to restrain domestic demand growth this year. However, it is more optimistic about the next financial year as it expects the rate cut cycle by the central bank to begin early in 2024. In an email interview with **Asit Ranjan Mishra**, Asia-Pacific Chief Economist of S&P Global Ratings, **LOUIS KUIJS**, charts the key reforms India needs ahead of the general elections next year. Edited excerpts:

Q&A

LOUIS KUIJS

Chief Economist, Asia-Pacific, S&P Global Ratings

Many agencies have raised their growth forecast for India to above 6 per cent for FY24, after the more-than-expected growth rate of 7.2 per cent in FY23. Why did S&P stick to six per cent for FY24?

We expect slower global growth to weigh on external demand this fiscal year. In addition, fading economic reopening momentum and tight monetary policy will restrain domestic demand growth this year. In this environment, we expect about 6 per cent growth for India in this fiscal year. We project acceleration to 6.9 per cent growth in FY25 on the back of recovering external demand, controlled inflation, and improved domestic demand.

WE EXPECT INFLATION MOMENTUM TO EASE THROUGH THE YEAR AND INFLATION EXPECTATIONS ARE LIKELY TO REMAIN ANCHORED. THAT WILL ALLOW THE CENTRAL BANK TO BEGIN REDUCING INTEREST RATES GRADUALLY TOWARDS OUR PROJECTED TERMINAL POLICY RATE OF 5%

What gives S&P the confidence that the rate cut cycle will begin in early 2024 despite a 5 per cent CPI inflation projection?

We forecast average inflation of 5 per cent in FY24. We expect inflation momentum to ease through the year and inflation expectations are likely to remain anchored. That will allow the central bank to begin reducing interest rates gradually towards our projected terminal policy rate of 5 per cent. Our inflation projections assume normal monsoons, which will be important in containing food inflation.

What are the key economic reforms that the government needs to focus on from now till the general elections?

The most important reforms are measures to improve the investment climate and the quality of public services. Investment in manufacturing would benefit from reforms of land acquisition and labour legislation. Investment in education and judiciary infrastructure remains a key priority, as is improving accountability in public education. Further progress on privatisation to reduce the public sector footprint is another potential reform area.

Do you expect a fiscal slippage in FY24 ahead of general elections next year when governments usually spend more than usual?

The government has charted a gradual fiscal consolidation path following stimulus from the pandemic. The pace of fiscal consolidation is slower than among most regional peers. Spending on capex is a key priority and is unlikely to be dialed back. Public capex spending is set to grow strongly again in FY24. Revenue performance has been improving over the past two fiscal years, which can partially offset spending.

India's services exports have been robust in FY23. Do you see them getting impacted by global uncertainties in FY24?

Services exports are likely to remain resilient this year as tourism and travel improve. However, weaker global growth is likely to restrain growth in overall trade and sections of service exports such as technology.

How does S&P see consumer and investment demand to pan out in FY24?

Private consumption growth was a weak 2.8 per cent YoY in the January-March quarter compared with GDP growth of 6.1 per cent. Investment growth in the same period was 8.9 per cent.

We expect fading reopening momentum and moderately tight monetary policy to weigh on consumption demand in FY24. Meanwhile, public infrastructure spending and greater resilience in financial and corporate sector balance sheets should support investment growth.

Will schemes like the production-linked incentive scheme (PLI) help improve India's competitiveness?

The production-linked incentive scheme may be beneficial in attracting manufacturing activity and establishing manufacturing supply chains. This can help competitiveness. Over a longer horizon, production incentives will need to be supplemented by the ongoing structural reform efforts to increase competitiveness.

Do you think India will benefit from efforts like friend-shoring and Western firms de-risking their investments from China? What does India need to do to attract more foreign investment?

Foreign direct investment (FDI) inflows have been mixed with a sharp decline over FY2023 amid rising global interest rates. This followed strong FDI inflow growth over FY20 and FY21, and flat growth in FY22. Broad economic conditions and competitiveness will be important drivers of the foreign direct investment outlook.