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Private investment to lead India's growth in FY19, says World Bank

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Although private investment growth in India will remain challenging in the short term, it will eventually pick up in 2018-19 to overtake private consumption as the main driver of economic growth, the World Bank said in its latest 'India Economic Update' released on Monday.

Gross fixed capital formation (GFCF), which indicates investment demand in the economy, is forecast to grow by 3.3% in FY17, jump to 6.8% in FY18 and overtake private consumption (7.4%) in FY19 with 8.8% growth to become the major growth driver.

This is due to the key reform steps taken by the government such as implementation of bankruptcy law and goods and services tax, higher infrastructure push and continued inflow of foreign direct investment, the Bank said. "Abolition of Foreign Investment Promotion Board will further support investment growth. Moreover, RBI efforts to reform banking sector in addition to a higher steady state of banking sector deposits post-demonetization will eventually allow credit growth to recover robustly and sustainably," it added.

Gross fixed capital formation is forecast to grow by 8.8% in FY19 and be the main growth driver. HEMANT MISHRA/MINT

Private investment continues to face impediments in the form of corporate debt overhang, stress in the financial sector with rising bad loans, excess industrial capacity, and regulatory and policy challenges, putting downside pressures on India's potential growth.

In February, the industrial production index for capital goods contracted 3.4%, while credit to industry contracted 5.2%, suggesting a meaningful recovery in private investments is unlikely until later in FY18.

"On the positive side, consumption will remain robust, given declining inflation and solid household credit growth, and pick-up in trade is likely to endure at least through the first half of the fiscal year, helping lift investment," the Bank said.

Private investment, which accounts for three quarters of total GFCF, has not been forthcoming despite the promise of crowding-in by public sector investments and government efforts to improve the business environment and facilitate foreign direct investment (FDI). GFCF contracted by 2.1% in the fourth quarter and GFCF as a percent of gross domestic product (GDP) stood at 28.5% during the same quarter compared to a medium-term average (5 year) of 32.4% of GDP. "This weakness in private investment has been attributed to local and global excess-capacity, leveraged corporate and bank balance sheets, and remaining domestic bottlenecks," the Bank said.

Supporting the view of an incipient pick-up, production of capital goods expanded by 6.8% in January 2017 after 13 consecutive months of negative growth, imports of machinery rose by 13.5% in March, and FDI expanded by 10.9% in Q3 FY17 driven primarily by investments in the telecommunications sector.

At a time of weakness in investment growth, private consumption remains a stable growth driver, expected to range between 7.2% and 7.5% between FY17 and FY20. The minor deceleration in FY17 is offset by higher rural incomes from favourable agricultural growth, revisions to civil servants' pay by an average of 24%, and declining inflationary expectations.

Sunil Kant Munjal, chairman, Hero Enterprise agreed with the World Bank's assessment that next year could see a revival in private investments. "Companies do not invest because they see little scope for return. Now capacity is getting absorbed and consumption is increasing, companies are looking at investing in the months to come," he added.

The Bank expects government to maintain its momentum in public infrastructure spending, with government capital expenditure budgeted at 3% of GDP in FY18, flat from previous year. "Private investment is expected to pick up, but only gradually as recovery may be protracted, in part due to relatively longer-term effects of demonetization on cash-reliant construction activities (household investment, largely housing, accounts for approximately 1/3 of total investment), corporate leverage and the persistent weakness in credit growth, which suggest that the financial sector may require more time to adjust," it said.

Amrit Raj contributed to this story.