

Investment: The Next Big Story

India's post-Covid economic recovery has been about investing for the future. It makes the country an outlier

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In economic parlance, investment holds a special place in assessing the quality of overall economic growth. At an aggregate level, investment is nothing but spending by economic agents (households, private corporations and government) on creation of capital assets. It can take the form of dwellings, machinery and equipment, and intellectual property products.

In the short run, investment influences GDP via the transactional impact of generation of capital assets. More importantly, in the longer run, it boosts the productive capacity of the economy and increases overall efficiency.

India's investment story

In case of Indian economy, the share of investments in GDP (in nominal terms), also referred to as the investment rate, peaked at 35.8% in 2007-08, before plummeting to 27.3% in 2020-21 – the year that saw an unprecedented air of despondency unleashed by the Covid-led global recession. However, the long winter of investments is now showing conclusive signs of thawing. Investment rate has recovered to 29.2% in 2022-23. More importantly:

- It attained a level of 31.7% on standalone basis during January-March 2023, the highest in the last 35 quarters.

- It accounted for a little over half of the 6.1% headline GDP growth (in inflation-adjusted terms) seen in the January-March 2023 quarter.

So, what is responsible for the investment pivot in the last two years, besides the pandemic morphing into an endemic state? We believe that a multitude of domestic enablers have been providing a nurturing environment for investments to revive in the last two years.

Policy shift towards investment

The foremost is the policy environment. Despite fiscal challenges associated with the post-Covid period the government took two bold policy calls.

- First, was to infuse confidence by prioritising countercyclical fiscal policy, and take on the baton of supporting investments in the economy when the private sector understandably withdrew due to the fear of the unknown.

Indeed, the government's budgetary capital spending has jumped from its pre-Covid level of 3.6% of GDP in 2019-20 to 4.9% of GDP in 2022-23, the highest since the Global Financial Crisis in 2008. Out of this, majority turnaround can be attributed to central government, with states playing a minor supportive role.

- Second, was to retain focus on long term



INDIA'S INVESTMENT BOOM

	Change in Investment-GDP Ratio (in % points)	
	2022 over 2019 (Estimates)	2028 over 2022 (Forecasts)
World	1.0	0.0
Developed Countries	0.6	-0.7
Developing Countries	1.2	0.1
India	1.5	3.4

Source: IMF, QuantEco Research

macro-stability while announcing structural measures to revive investments. With targeted programmes like the National Infrastructure Pipeline, National Monetisation Programme, Gati Shakti, Performance Linked Incentives etc the government has depicted a strong policy intent for improving business climate.

Private sector clean-up is over

Besides government's active role in nurturing investments, the scourge of the 'twin balance sheet syndrome' that weighed upon corporate sector's

capability for expanding capacity and banking sector's risk appetite has now turned around after a mending and healing period of about four years that involved calibrated regulatory and supervisory interventions from RBI.

- As per CMIE data, the non-financial sector's debt has declined sharply from 16.8% in 2020-21 to an estimated level of 10.7% in 2022-23. This has helped boost profitability, with RBI data on private corporate sector's profitability pointing towards improvement in net profit after tax to an average of 1.7% of GDP in the post-Covid phase (barring Q1 FY21 that faced the brunt of the nationwide lockdown) compared to an average of 1.2% seen during the twin balance sheet syndrome phase (Q4 FY16 to Q4 FY20).

- This has reflected in improvement in asset quality of the banking sector – as per RBI data, the gross NPA ratio of all scheduled commercial banks reduced from 11.2% in FY18 to 5.0% in September 2022.

In addition to these underlying megatrends, the investment climate is also finding support from:

- Normalisation of economic activity post complete re-opening of the economy (four-quarter moving average of industrial capacity utilisation data from RBI shows improvement to 74% as of December 2022 from its pre-Covid level of 71.9% as of December 2019).

- Geopolitical preference of 'China Plus One' strategy in a bid to diversify dependence of global supply chains beyond China. This is benefiting countries like India, Vietnam and Bangladesh.

- Moderation in input price inflation amidst concerns over global economic slowdown. Brent crude oil price has fallen to \$75/bbl currently from an average level of \$95/bbl in 2021-22. It's reassuring that the core WPI inflation is now negative and is likely to buoy operating performance for Indian manufacturers.

Going forward, we continue to expect the investment rate to increase further. Improvement in order books and project announcements corroborate this belief.

Having said so, we do acknowledge the emergence of near-term cyclical headwinds in the form of the anticipated global economic slowdown and significant tightening of interest rates over the course of last year. While this could potentially slow down the rate of progress on investment revival in the near term, the long-term outlook remains constructive for India.

As a matter of validation, IMF data (see table) suggests that India has not just seen one of the best improvements in investment rate in the post-Covid phase, but more importantly, it is expected to significantly outperform peer groups in the longer run.

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