Growth's New Normal: 7.5%

For over two decades India's growth rates have been mostly underestimated. External shocks such as financial crises interrupted high growth phases earlier. But not anymore. The national balance sheet is more resilient, setting the stage for a new era

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When the real GDP data for July-September quarter of 2023-24 was released, the 7.6% growth rate was almost universally greeted as a 'pleasant surprise'. So was the 7.2% growth reported for 2022-23.

To me, a veteran forecaster of Asia's economies over the past 33 years, the only surprise is that the consensus for India's growth each year seems to cluster around the 6.5% mark. Subsequently there are 'surprise' upgrades after the year is over, and when the 'final' estimate is released almost three years after the end of the fiscal year.

Trajectory changed two decades ago | India has moved to a higher-growth trajectory that most economists seem reluctant to acknowledge. Between 2003-04 and 2007-08, real GDP grew at an average annual pace of 7.9%. The global slowdown in 2008-09 brought the average growth during Manmohan Singh's first term down to 6.9%. Average annual growth slowed further to 6.7% during his second term.

And persisted since 2014 | During Narendra Modi's first term as prime minister, India's real GDP grew at an average annual pace of 7.4%, comfortably the fastest pace of any prime ministerial term.

Reforms will keep growth going | Economic reforms under Modi – creating a single national market with the GST, strengthening creditor rights with the Insolvency and Bankruptcy Code (IBC), direct benefit transfer through the JAM (JanDhan-Aadhar-Mobile) trinity, and rapid infrastructure improvement – clearly did pay off.

In the 15 years to 2018-19, India's average annual real GDP growth thus averaged exactly 7%. And in the 21 years from 1998-99 to 2018-19, India's real GDP growth averaged 6.7% per year.

Pandemic shock hasn't changed the story | The onset of Covid-19 in January 2020, coming at a time when global growth was already slowing, caused India's real GDP to decelerate to 3.9% growth in 2019-20. A global pandemic is a once-in-a-century economic calamity, and it should surely be excluded from any analysis of the economy's longer-term potential growth.

The bounce back is proof | In the subsequent two-and-a-half years, April 2021 to September 2023, India's real GDP has grown at an average annual pace of 8.1%. Shouldn't we then acknowledge that this – or at least the 7.5% average annual growth during seven-and-a-half of the last nine-and-a-half years is India's new trend or potential growth rate?

Reforms will lead to more investment | Additional economic reforms, including the successful rollout of the world's leading digital stack, and the vast improvement in India's transportation infrastructure – with double the pace of highway construction relative to the previous decade, a doubling in the number of airports and urban rapid transit systems, and a vast enhancement of port efficiency – are necessarily boosting productivity. And those reforms, coupled with cuts in corporate tax rates to globally competitive levels, plus production-linked incentives (PLI) are bolstering the incentives to invest.

Last 18 months are proof | India's real gross fixed capital formation has consistently grown at 8% or more year-over-year in each of the past six quarters. When more capital is deployed, it naturally boosts productivity. So it is time for us to accept 7.5% growth as the new normal in Modi's India.

There were 7%+ phases earlier | There have been other periods of over 7% growth in the past. India's real GDP grew 7.3% annually in April 1994 and March 1997. Then the Asian Financial Crisis intervened. Growth inevitably slowed.

The Vajpayee years were devoted to strengthening India's external resilience, and bolstering a financial system weakened by breakneck credit growth. Vajpayee delivered three years of current account surpluses (i.e., exports of goods and services exceeding imports) in 2001-02 to 2003-04, and average annual real GDP growth of 5.9% during his six years in office – the fastest growth delivered by any Indian PM until then.

The 6.8% annual average growth of the Manmohan Singh years was marred by classic signs of overheating in his second five-year term. Having inherited three years of current account surplus from Vajpayee, Singh allowed the current account deficit (CAD) to widen to 4.3% of GDP in 2011-12 and 4.8% of GDP 2012-13, while CPI inflation averaged over 10% in each of the five years of his second term. Like in all previous episodes of faster growth, external constraints eventually derailed the growth momentum.

This time it's different | Under Modi, however, the CAD has never exceeded 2.1% of GDP in any year, and is likely to be less than 1% of GDP this year. Consequently, external debt is now less than 18% of GDP. CPI inflation has averaged 5% annually between June 2014 and October 2023, and has not exceeded 7.6% in any month. The financial sector, beset by a 'twin balance-sheet crisis' in May 2014, has been cleaned up and strengthened.

Macroeconomic and financial stability therefore mean that the new normal of 7.5% growth in the Modi era is the harbinger of faster growth to come. It is time economic forecasters acknowledged the reality that is staring them in the face.

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