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Where are we in the growth cycle?

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THE WORLD ECONOMY could be witnessing a steep revival in the current year and next, after a decline of 3.1% in GDP in 2020. World GDP is likely to expand by 5.9% in 2021, followed by a further 4.9% next year. The two consecutive years of above-trend growth will likely take the level of output much above the pre-Covid trajectory.

This is after a slight downward revision to global growth estimates by the IMF, on the back of supply constraints and spread of the delta variant. The average time a freight ship stays in the ocean has increased to 70 days now from 40 days before the pandemic. Delays at ports are just one factor as there is acute shortage of semi-conductor chips used in cars, mobile phones, computers and tablets. To add to the problem, consumers have been buying more of these, and the trend is visible in India. You can expect producers to respond to the situation and supply will catch-up—only with a lag. For instance, the Taiwan Semiconductor Manufacturing Corporation (TSMC), the world's largest chip-manufacturer, is investing $100 billion over three years to reduce demand-supply imbalance in the global chip industry while other manufacturers are also investing to ramp-up capacity.

For now, commodities have turned expensive. For instance, copper now costs approximately $10,000/mt. Such high prices were last seen in 2011; prices had almost halved by 2016. Aluminium now costs in excess of $2,800/mt. Again such price levels were seen in 2011. Same is the case for nickel, lead and zinc. Only iron ore prices have seen a large dip this year, on the back of slowdown in China's property market, a large consumer of steel. Notably, home sales and prices are on the mend in China.

A similar build-up is seen in energy markets. Oil prices have touched a 7-year high this year and there is room for further upside if winter is colder than usual. Not enough natural gas is available in Europe for meeting heating and industrial demand. Coal-fired plants are again seeing an increase in utilisation to meet demand. Coal prices have risen by 113.9% this year. All of this has implications for India's current account and inflation.

A resurgent world economy has also helped Indian exporters—both merchandise goods and services. India's merchandise goods are likely to touch $400 billion this year, up from $296 billion in FY2021. Net services exports too are rising by 18.6% and will exceed $100 bn this year. More firms are looking at digitising operations and the Indian IT sector is best placed to offer solutions. Indian IT firms are competing with each other for talent and salaries are seeing an upward momentum not seen since Dot-Com era.

> **The near-term risk is rising oil prices that will expand India's current account deficit. Higher demand for USD to purchase oil implies lower value for INR, all else being equal**

Indian start-ups are also benefitting from global investment upcycle in digital ecosystems which in turn is leading to improvement in job creation. Recent EPFO data shows that India added 1.5 million jobs which was 12% higher over the previous month. Formal job additions are also visible in income tax collections which are up by 69.3% over the last year. Even over a two-year period, income tax collections are higher by 20.5%.

But, it is the corporate sector where recovery is most visible. Early results of 250 firms for the quarter ending September 2021 show that revenue is up 27% and PAT is higher by 24% over the last year. The difference in the two is explained by 425 bps drop in operating margins. This is more to do with rising commodity prices. Corporates are gradually increasing prices to consumers so as not to derail underlying growth. However, this will have some impact on volume growth going forward.

More importantly, this will have a repercussion on inflation. After seeing a sharp uptick in the beginning of the year, headline inflation has been falling on the back of lower food inflation. Within food, it is the perishable segment led by vegetables which explains the downward momentum. This year, price build-up in vegetables is a third of what is typically seen. And now vegetable prices are rising on the back of higher than usual rainfall in September and continuing rains in October while there is upward pressure building from higher global commodity prices and pass-through into domestic prices.

As the global economy starts to witness a tapering of peak growth and higher inflation, in India's case, we should see higher inflation and higher growth as well. RBI expects inflation at 5.3% in FY2022 and in the range of 4.5-5.2% in FY2023. It expects growth at 9.5% and 7.8% in FY2022 and FY2023, respectively.

After a long time, India has many levers to push for higher growth. The government has tweaked policies to favor investment led revival over a consumption led one with higher capex increasingly financed by buoyant tax collections. Banks themselves are flushed with liquidity since accretion to deposits is far more than credit disbursals, have cleaner balance sheets and are adequately capitalised. The stage is set for financing this infrastructure growth led by the spending from the government.

Indian corporate sector is deleveraged and generating enough cash which can be invested back. RoEs of Indian corporate sector continue to see upward momentum. A competitive corporate tax rate is a plus. The only risk to the corporate recovery cycle is rising commodity prices which may hit margins if demand does not sustain. For now, there are all indications that start-up and digital ecosystem along with IT services should generate enough jobs to ensure demand momentum sustains in the medium-term. Real estate sales have picked up, particularly in cities where IT services and startups are concentrated. The PLI scheme is ushering in manufacturing jobs and investments, which will give a boost to demand as well.

The near-term risk is rising oil prices that will expand India's current account deficit. Higher demand for USD to purchase oil implies lower value for INR, all else being equal. This again will add some upside pressure on inflation. However, India's forex reserves are more than enough to ensure minimal financial volatility. As long as increase in inflation and interest rates is gradual and represents a normal reversal in economic cycle, there are more than enough levers aiding India to achieve a higher growth trajectory than what has been seen in the last few years.