

The intriguing picture of investment

The household, and not corporate, sector is responsible for the decline in investment rate between 2011-12 and 2016-17



C RANGARAJAN

Growth in any year can occur either because of better utilisation of existing capacity or because of new investment. However, over the medium to long term, the key driver of growth is investment. Without a high investment rate, it is difficult to sustain a high growth rate.

An analysis of the recent trends on income and investment indicates two things. Over the last four years, the growth rate has been maintained at a reasonable level. The average growth rate of GDP has been 7.3 per cent. However, what is disturbing has been the declining trend. The growth rate of GDP in 2015-16 was 8.2 per cent. It came down to 7.1 per cent in the following year and for the year which has just ended the growth rate was 6.7 per cent.

Another disturbing trend has been the decline in investment rate. In 2011-12, the gross fixed capital formation rate was 34.31 per cent of GDP. By 2016-17, it had come down to 28.53 per cent. It is, therefore, necessary to take a close look at the behaviour of different components of fixed capital formation and this is the purpose of this article.

Behaviour of savings

Since the major source of funding investment is domestic savings, it is useful to first look at the trend in savings for the last six years. The details are provided in Table 1. The gross domestic savings rate has fallen from 34.65 per cent of GDP in

2011-12 to 29.98 per cent in 2016-17.

The breakup of the savings shows that the steepest decline has been with respect to the household sector where the total savings have fallen from 23.64 per cent of GDP in 2011-12 to 16.26 per cent in 2016-17. The private corporate sector savings as a proportion of GDP have actually increased by almost 2.5 percentage points. The savings rate of the public sector including general government shows no change.

In the case of households both financial savings and savings in physical assets have declined quite sharply over the six-year period. The data provided in the Annual Reports of the Reserve Bank of India show some difference in financial savings more particularly for 2016-17. However the trend is the same.

Behaviour of investment

Investment (gross capital formation) includes three elements, gross fixed capital formation, change in stocks and valuables (gold). The most important component is gross fixed capital formation which means capital expenditures on machinery and equipment and dwellings.

Table 2 provides the details relating to the three sectors—private corporate sector, public sector including general government and household sector. The gross fixed capital formation rate as already noted fell from 34.31 per cent in 2011-12 to 28.53 in 2016-17. Public sector including general government showed no change.

Gross fixed capital formation stayed at a little above 7 per cent of GDP. Private corporate sector investment showed in fact a rise from 11.23 per cent in 2011-12 to 12.29 per cent in 2016-17. Therefore, the only sector that appears to have been responsible for the decline in investment is households. Household sector's fixed capital formation rate has

Table 1

Domestic saving by type of institutions (at current prices as a % GDP)						
Item	2011-12	2012-13	2013-14	2014-15*	2015-16#	2016-17®
1 Household sector	23.64	22.48	20.34	19.56	17.79	16.26
Gross financial saving	10.68	10.7	10.6	10.08	11.05	9.21
Less financial liabilities	3.32	3.32	3.19	3.02	2.84	2.46
Saving in physical assets	15.90	14.73	12.61	12.14	9.24	9.17
Savings in the form of valuables	0.39	0.37	0.33	0.37	0.34	0.33
2 Private corporate sector	9.46	10.00	10.75	11.69	12.22	12.11
Financial corporations	1.18	1.27	1.16	1.36	0.82	0.86
Non-financial corporations	8.28	8.73	9.59	10.33	11.40	11.25
3 Public sector	3.35	3.00	2.58	2.40	2.34	2.36
Financial corporations	1.93	1.75	1.46	1.36	1.29	1.33
Non-financial corporations	1.42	1.25	1.12	1.04	1.05	1.03
4 General government	-1.81	-1.6	-1.55	-1.41	-1.09	-0.74
5 Gross domestic saving (1+2+3+4)	34.65	33.88	32.12	32.24	31.25	29.98

Table 2

Gross capital formation (at current prices as a % GDP)						
Item	2011-12	2012-13	2013-14	2014-15*	2015-16#	2016-17®
Gross fixed capital formation	34.31	33.44	31.3	30.08	28.47	28.53
Private corporate sector	11.23	11.79	11.68	11.02	12.01	12.29
Financial	0.26	0.24	0.23	0.23	0.3	0.25
Non-financial	10.97	11.55	11.45	10.79	11.71	12.05
Public sector	3.86	3.61	3.56	3.45	3.76	3.40
Financial	0.10	0.10	0.12	0.09	0.09	0.08
Non-financial	3.76	3.51	3.44	3.36	3.67	3.32
Household sector	15.75	14.63	12.52	12.06	9.13	9.09
General government	3.48	3.41	3.53	3.55	3.57	3.76
Change in stocks	2.38	2.16	1.29	2.51	1.85	0.66
Valuables+	2.90	2.75	1.44	1.68	1.47	1.16
Others	-0.64	0.34	-0.25	-0.74	0.48	0.28
Gross capital formation	38.95	38.69	33.78	33.52	32.28	30.62

Note: *Third Revised Estimates #Second Revised Estimates ®First Revised Estimates
Source: CSO (First RE of NI,CE, Savings and CF for 2016-17 released on January 31, 2018)

shown a steep decline from 15.75 per cent to 9.1 per cent over the six-year period.

Intriguing numbers

Why are these numbers intriguing? First of all, the investment ratios according to the new series with base 2011-12 show a much higher rate as compared to the old series with 2004-05 as base. For example, in 2007-08, when the Indian economy grew at 9.4 per cent, the gross fixed capital formation rate was only 32.9 per cent.

For 2011-12, data are available for the new as well as the old series. Ac-

ording to the older series, gross fixed capital formation rate for 2011-12 was 31.8 per cent. For the same year, according to the new series, it is 34.3 per cent. However, even according to the new series, the investment rate has been coming down since 2011-12.

The second intriguing factor is that the decline in the gross fixed capital formation rate between 2011-12 and 2016-17 has been caused by the household sector rather the corporate sector.

Much of the discussion on the slowdown in growth has centred around weak investment demand

by the corporate sector. Several analysts have drawn attention to the number of stalled projects.

Weakening of the investment sentiment has been interpreted as a failure of the corporate sector to make investment. But this does not appear to be so. It is true that the corporate investment rate in 2007-08, when we had the highest growth rate, was 14.3 per cent of GDP. There is certainly a decline from that level. But over the six-year period there is none. In fact, there is one percentage point increase.

How does one interpret the steep decline in the investment rate in the household sector? Household sector's savings in physical assets which is the same as investment is normally in the form of housing. It is difficult to attribute the sharp decline only to the reduction in investment in housing. Data do show that the reduction in investment rate in dwellings by households between 2011-12 and 2015-16 was 4 per cent.

Perhaps, part of the explanation also lies in the fact that the term 'households' includes not only individual households but also non-corporate business.

In fact, by definition what is not government and private corporate comes under the category of households. Households investment in machinery and equipment came down from 2.96 per cent of GDP in 2012-13 to 1.90 per cent in 2015-16. Therefore, in part small businesses have suffered more and invested less.

The fall in investment rate as an explanation for the slowdown in growth seems reasonable. However, it is perplexing that corporate investment did not show any decline. Within the business sector, the non-corporate business seems to have borne a higher burden.

The writer is former Chairman of the Economic Advisory Council to the Prime Minister, and former Governor, Reserve Bank of India.

Scan & share



<http://bit.ly/2J0qmnj>