Quickonomics

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Undoing the consumption shock

Household consumption demand, according to the latest National Statistical Office estimates on India's gross domestic product (GDP) for this fiscal, is lagging fiscal 2020 levels by 3%. That makes it the worst performer among the expenditure-side components of GDP post-pandemic.

This note looks at reasons why consumption, which makes up ~55% of the GDP, has gone missing, and recommends ways in which the Budget could bring some of it back.

The consumption cycle badly needs a lift

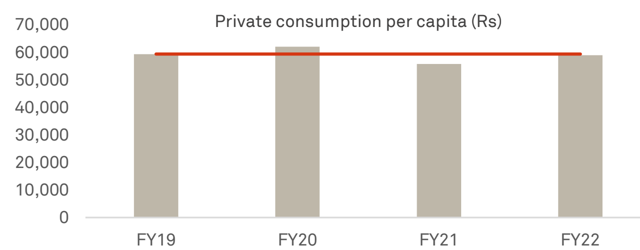
Private consumption was slowing even before the pandemic. On a per capita basis, consumption growth slipped from 6.8% in fiscal 2017 to 4.4% in fiscal 2020. It contracted sharply by 10.1% in fiscal 2021. Beyond that, the catch-up has been slower than for other demand components of GDP. By the end of this fiscal, it would not even have sighted fiscal 2019 levels.

Income growth slows: It's a similar story with household incomes. Per capita GDP growth — a proxy for household income growth — was 6.9% in fiscal 2017. It slowed to 3% in fiscal 2020 before contracting 8.2% in fiscal 2021. Beyond that, the catch-up has been so slow that by this fiscal-end, it would not even have caught up with fiscal 2020 levels.

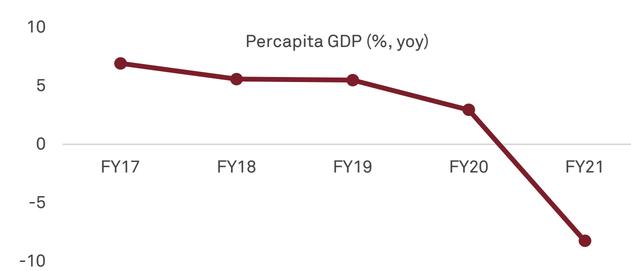
Rural wage growth remains tepid. With reduced budgetary allocation to rural employment schemes in fiscal 2022, and weakness in economic activity, wage growth has slowed of late, in the farm and non-farm sectors. The Reserve Bank of India data shows, farm wage growth in nominal terms slowed to 5.7% in fiscal 2022 (April-November average), from an average of 6.6% in fiscal 2021. Non-farm wage growth halved to 3.2% from 6.4%. In fact, discounting for the high inflation, non-farm wages in real terms show negative growth (or decline) on-year.

Consumer sentiment weakening due to a lower savings cushion: Household financial savings in India averaged 13% of GDP for nearly a decade through fiscal 2015. This ratio gradually slipped to 11% by fiscal 2020, as income growth slowed and households dipped into their savings. As the pandemic hit, it shot up to 21% of GDP in the June 2020 quarter, led by a forced reduction in consumption on account of the lockdowns. But savings dropped to a low of 8.2% in the December 2020 quarter. Job losses and lower earnings over recurrent waves, and the pressure on medical expenditure during the pandemic, have taken a toll on household savings, which might have shrivelled further since. Those suffering income loss are clearly consuming less and those who used up their savings are prioritising rebuilding buffers.

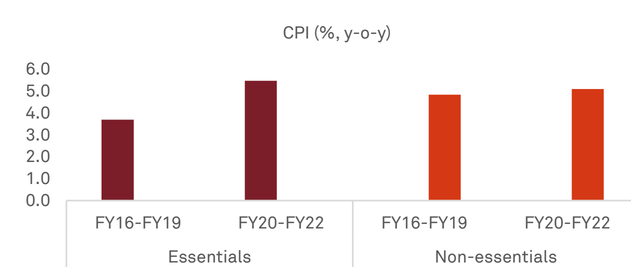
Private consumption lagging



Income slowing from pre-pandemic days



Inflation eroding purchasing power



Note: Essential inflation category includes food, fuel, rent, clothing and health
Source: National Statistical Office, CEIC, CRISIL

High inflation is eroding purchasing power: Inflation in the essentials category (food, fuel, rent, clothing and health) for the three years through this fiscal was, on average, 180 basis points higher than for the three years ended fiscal 2019. In contrast, inflation in the discretionary categories was only 30 basis points higher.

Income inequality is rising: The current consumption slowdown is also a consequence of the income inequality spawned by the pandemic. Lower income segments, especially those employed in the small and medium enterprises, unorganised sectors and contact-based services, were most affected in terms of purchasing power because of repeated Covid waves, continuing restrictions, social distancing norms and the fear factor. GDP in construction, a 'low-skill' labour-intensive segment, is estimated to be only 1.3% above its pre-pandemic level.

Support to rural employment schemes fell, impacting consumption in rural areas. For fiscal 2021, the government announced a higher allocation under the Mahatma Gandhi National Rural Employment Guarantee Scheme (MGNREGS) and rural construction works, providing succour to workers in the hinterlands. But that was short-lived. In the Union Budget 2022, these allocations were downsized as Covid cases were contained. However, data suggests that in the absence of employment opportunities in urban areas, demand for rural works stayed high even this fiscal, a large part of which remained unmet.

What can the Budget do?

The past few budgets have emphasised the government's intent to drive potential growth by leaning on a mix of capex and reforms. But with the pandemic affecting low income segments the most, near-term measures to support incomes and private consumption are crucial to strengthen the bridge to the medium-term growth path.

Delaying a sharp fiscal correction to make room for boosting employment and infrastructure spending is probably the best bet at this juncture.

Our back-of-the-envelope calculations show that the government could create an additional fiscal space of Rs 35 lakh crore over fiscals 2022-2026, by postponing the fiscal deficit milestone of 3%.

Moreover, though nominal GDP growth is estimated to decline from 17.6% in fiscal 2022 to 12-13% in fiscal 2023, it remains strong. A broad-based recovery and improved compliance should also benefit tax collections. This, together with a gradual path of deficit reduction, can provide room to accommodate spending on supporting rural and urban employment generation — near-term consumption-supporting measures as outlined below — and to fund capex over the next four fiscals.

Generate employment that also supports asset creation: Policy support focus on incomes must continue for longer, till growth becomes broad-based and demand conditions show sustained improvement.

- The MGNREGS remains the only lifeline for the vast section of landless, informal sector and migrant workers, who have borne the brunt of repeated pandemic waves and lack of employment opportunities in urban areas. A higher allocation for the MGNREGS must be prioritised this fiscal
- There is also merit in introducing similar employment generation schemes in urban areas, given how swathes of workers such as in urban construction and contact-based services remain un/underemployed, even if lockdowns have become less restrictive. The case for a national urban employment guarantee scheme has repeatedly been put forth by experts as well as the Parliamentary Standing Committee on Labour in its August 2021 report. The time is ripe for its realisation
- Such spending could be frontloaded towards the first half of the next fiscal

This does not mean a steroidal lift is advocated. Any support measures will have to be designed carefully after weighing their impact on consumer price inflation, which remains high with risks tilted upwards.

Ease pressure on inflation: Inflation takes away from all. Fiscal policy can help control inflation by further bringing down excise duty on fuels. The reduction of excise on petrol and diesel by Rs 5 and Rs 10 per litre, respectively, in November 2021 was welcome, but consumers could do with more relief now.

Easing the fuel tax burden will augment disposable income while simultaneously trimming the input cost burden for producers.

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