

# Rising Govt Debt, High Oil Prices Just can't Shackle India's Bull Run

## Expert Take



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As the world struggles with growth deficit due to higher leverage and unattractive demographic profile of the developed world, emerging economies are reporting much stronger structural as well as cyclical rebound in growth.

China and India being the fastest-growing economies in the world (in that order) accounted for 11% of the nominal world GDP in 2010; as per the International Monetary Fund (IMF), this figure is expected to rise to 34% by 2030.

India posted a GDP growth of 8%+ CAGR between the years 2003 and 2010 and is poised for a much stronger structural progress as it boasts of an under-leveraged consumer and a productive demographic profile that adds over 1 crore people to the earning population every year. The one-billion plus population of India, with an average age of 25 relative to China's 30, is at present massively under-penetrated for the demand it generates. The per-capita spend on home, personal-care products, energy and variety of consumables in India is steeply lower than that of the developed world. Further, the economy continues to largely run on cash; where the use of credit cards as an indication of households' leverage for consumption is minuscule. Household debt

as proportion of the GDP stood at 10% for India relative to around 90% for the United States in 2010. This makes a case for a massive potential demand in the second-fastest growing economy.

The supply side of the growth story looks favourably placed from the perspective of inputs of production. Domestic savings rate of 34% of the GDP can address the requirement for capital input for production. The abundance of capital and labour is finally backed by quality institutional framework—physical and intellectual property rights, along with an effective judiciary—would enable higher input productivity.

There are obvious challenges that India needs to overcome to ensure that abundant labour and sufficient capital are put to use optimally. Some of them are infrastructure deficit, poor education and health-care facilities and rigid labour laws.

The more recent global headwinds caused by sovereign debt and global commodities inflation, however, have created suspicion about India's growth advantage. Two issues about India have really bothered domestic and international investors—government debt and exposure to global oil shocks. I would like to express the view that on both counts India fares much better than the widely held negative view.

Before we look deeper into government debt, we also need to evaluate India from a total financial debt standpoint. By total financial debt, I mean an amalgamation of all debts—government debt, corporate bonds and bank loans. The total financial debt of the US and Europe as a percentage of the GDP is about 330-340%. Even China has a total debt/GDP of 180%. India on the other hand has only 116%. The key point is that the Indian economy is significantly (almost by a factor of 3 to 1) under-leveraged when compared with the western economies. Thus, the debt deleveraging concerns plaguing the west are not applicable to India.



Even on government debt, India's public debt/GDP was 44% at the end of 2010, as against 220% for Japan, 75% for the US and 72% for Europe. More importantly, India is growing at 17% nominal rate while the western world is struggling to grow at 3-4% nominal rate. Essentially, our government can grow its spending 17% year on year and still have a constant debt/GDP. The problem with the western world is that their nominal GDP is growing too slowly (3-4%) for them to afford the 7-8% fiscal deficits.

Another factor that should soothe concern regarding government debt in India is our low tax/GDP. The US has a tax/GDP of 27%, while most European countries have tax/GDP of 35-45%. India, on the other hand, has a tax/GDP of about 17%. Thus, as our country develops further and the tax collection regime becomes more robust, our government should be able to increase revenues as a percentage of the GDP.

Bottom-line: the fiscal concerns facing the west versus the fiscal issues in India are fundamentally different.

Now, on the impact of high oil prices on India, three points need to be made. Firstly, India's oil consumption as a percentage of GDP is 6.5% and we import 72% of our oil. Therefore, ev-

ery 10% increase in oil prices reduces our GDP growth by 0.47 bps. Thus, if an oil shock occurs due to QE3 and oil prices shoot up by 25-30%, the resultant impact will be a 1.4% drop in GDP. This is hardly catastrophic in an economy growing at 7.7%.

Secondly, India has shown significant elasticity of petrol consumption versus petrol prices. So, impacts of sustained high periods of oil prices should be somewhat self-correcting.

Finally, we have seen significant oil efficiency gains in the western world, especially in the US, over the last 25 years. While the US's nominal GDP has increased five times since 1980, the barrels of oil consumed are largely constant. Over the long run, it's not unreasonable to expect some of the same efficiency gains in India. In fact, since 2007, India's oil consumption has increased only 17% while our nominal GDP has grown by 40%. Our oil consumption as a percentage of GDP was 8% in 2007, and fell to 6.4% in 2010.

In an nutshell, every correction in the markets is an opportunity to systematically participate and build wealth, as whether you participate or not, this bull called India will be definitely un-caged with no looking back.