In 9 Charts: India's Growing Debt Problem Has 'Crisis-Like Symptoms'

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'High debt accompanied by low employment and high food inflation (or more volatile headline inflation) is the worst possible scenario for an emerging market.' Photo: Charles Pieters/Flickr (CC BY-NC-ND 2.0 DEED)

analysis

Economy

'Crisis' needs to be viewed not in terms of present debt volume but in the larger trend and macroeconomic connection observable between rising government debt and other macro aggregates.

Deepanshu Mohan

Economy

27/Dec/2023

The IMF recently concluded its Article IV consultation with India and published its executive board's report. The team notes: "India's economy showed robust growth over the past year. Headline inflation has, on average, moderated although it remains volatile. Employment has surpassed the pre-pandemic level and, while the informal sector continues to dominate, formalisation has progressed".

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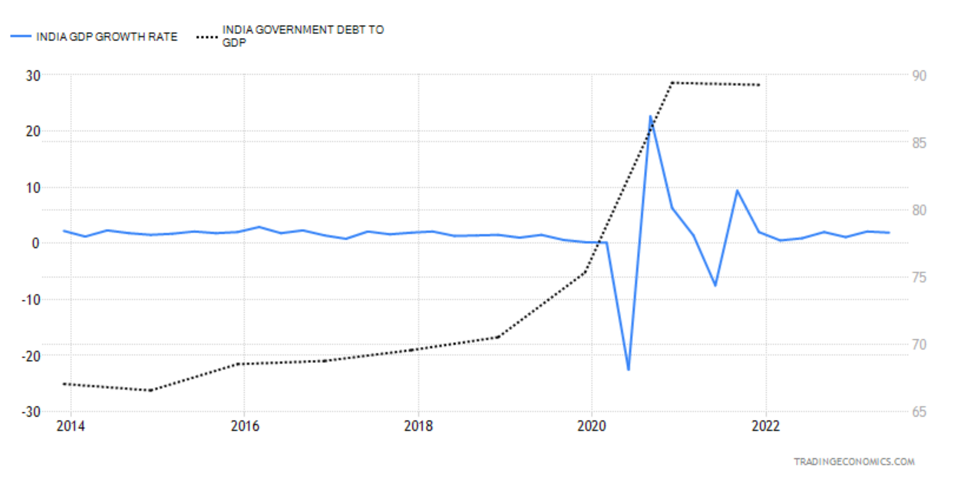
The report further highlights growing debt, accompanied by a "volatile inflation" spell, lower employment (dominated by the informal sector), and a potential disruption of global supply chain resulting in "increasing fiscal pressures for India".

The Indian government's response to the IMF report, particularly concerns about debt, was unsurprisingly aimed at refuting the institution's word of caution. While the IMF highlighted a need for substantial investment — especially from India's private sector — to enhance the nation's capacity to withstand climate stresses and natural disasters, the GOI's own response stressed that its sovereign debt risks are limited as it is primarily denominated in domestic currency.

KV Subramanian, India's executive director at the IMF, challenged its claim, stating that despite historical shocks, India's public debt-to-GDP ratio has shown minimal fluctuations. The disagreement centres on the IMF's reclassification of India's exchange rate regime to a "stabilised arrangement".

Let's review the debt numbers in context to other macroeconomic trends.

Government debt, GDP growth rate



(Source: Author's calculations, Trading Economics)

Growth has remained relatively weak in India's 2016-2020 timeline. The macro growth rate crashed during the lockdown of 2020 and then rose nominally after Covid restrictions were lifted. On average, the real growth rate remains suboptimal. However, the macro government debt to GDP levels, already rising from 2015, have ballooned since 2018. With a lower denominator (GDP level), one can expect the net debt effect to rise even if borrowings remained the same, which isn't the case. The IMF data (see Table 1 below) indicates how government debt has increased to alarming levels of 82.4% (anything over 80% of GDP is a red risk marker, in economic crisis terminology)

Table 1. India: Selected Social and Economic Indicators, 2019/20-2024/25 1/

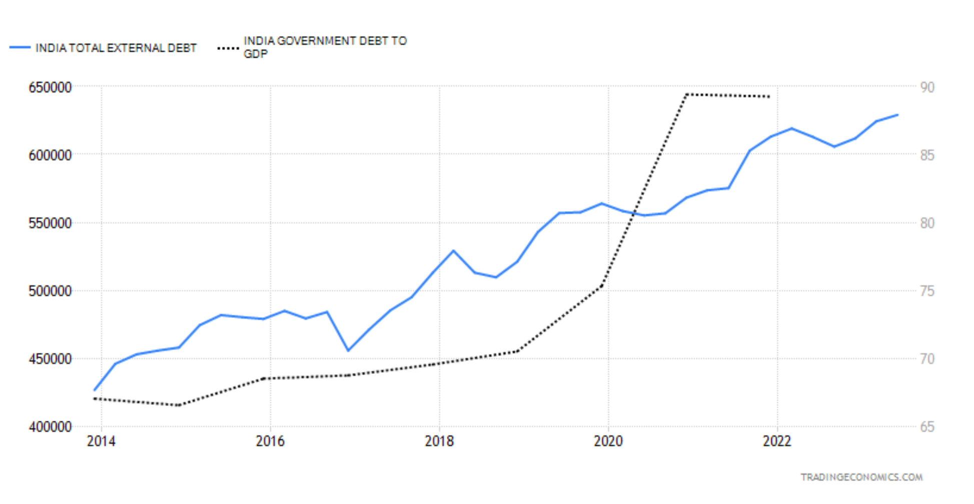
	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
				Est.	Projections	
Growth (in percent)						
Real GDP (at market prices)	3.9	-5.8	9.1	7.2	6.3	6.3
Prices (percent change, period average)						
Consumer prices - Combined	4.8	6.2	5.5	6.7	5.4	4.6
Saving and investment (percent of GDP)						
Gross saving 2/	29.2	29.7	30.0	29.1	29.9	30.0
Gross investment 2/	30.1	28.8	31.2	31.0	31.7	31.9
Fiscal position (percent of GDP) 3/						
Central government overall balance	-4.8	-8.6	-6.8	-6.5	-6.0	-5.8
General government overall balance	-7.7	-12.9	-9.6	-9.2	-8.8	-8.5
General government debt 4/	75.0	88.5	83.8	81.0	82.0	82.4
Cyclically adjusted balance (% of potential GDP)	-7.6	-9.1	-8.7	-9.3	-8.8	-8.5
Cyclically adjusted primary balance (% of potential GDP)	-2.9	-3.8	-3.6	-4.1	-3.4	-2.8
Money and credit (y/y percent change, end-period)						
Broad money	8.9	12.2	8.8	9.0	10.8	7.8
Domestic Credit	8.3	9.5	9.0	13.1	12.9	9.8
Financial indicators (percent, end-period)						
91-day treasury bill yield (end-period)	4.2	3.3	3.8	6.9	…	…
10-year government bond yield (end-period)	6.1	6.2	6.8	7.3	…	…
Stock market (y/y percent change, end-period)	-23.8	68.0	18.3	0.7	…	…
External trade (on balance of payments basis)						
Merchandise exports (in billions of U.S. dollars)	320.4	296.3	429.2	456.1	436.1	460.6
(Annual percent change)	-5.0	-7.5	44.8	6.3	-4.4	5.6

(Source: IMF Article IV Report on India)

These numbers of course rely upon data sourced by the IMF from India's government (and they have remained in question, as India's statistical infrastructure reels under the current government). There is always the possibility of 'hidden debt' arising from fiscal deficit that's 'silently hidden' and 'not accounted for' in official data. In times of crisis, 'hidden debt' numbers can wreck an economy. India isn't there yet, but a large enough shock to the economy, amidst alarming government debt numbers, could take it there.

Government debt, external debt, household debt

Apart from rising general government debt in the last 10 year period, there is a sustained rise in external debt, too (contradicting what KV Subramanian was saying), as seen below, along with a gradual but persistent rise in household debt levels, at a time when real incomes/wages have been regressively stagnant and consumer prices/inflation has remained high (which accrues higher indebtedness particularly among lower/middle income earners).



(Source: Author's calculations, Trading Economics)

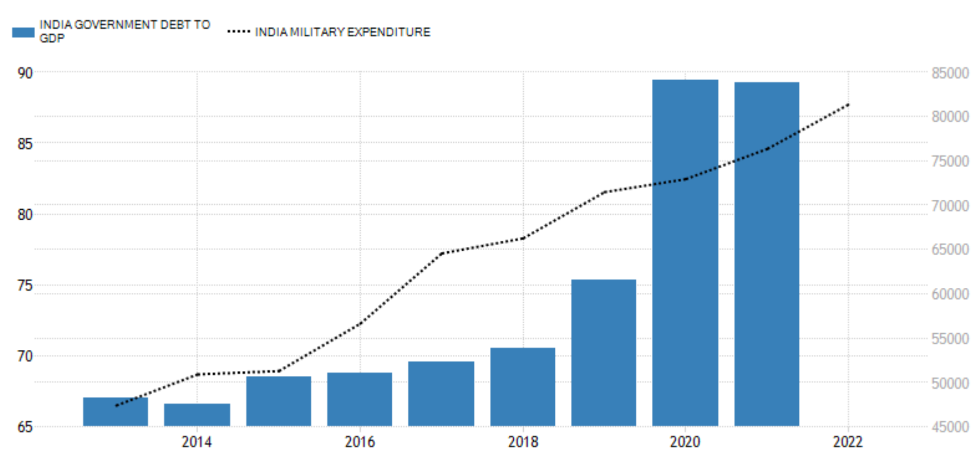
Rising external debt requires a greater robustness of dollar/reserve currency balance for a given country, which has been a concern for India's balance of payment position in recent times. The RBI has done everything possible to exercise dollar selloffs for maintaining exchange rate stability in the currency market for a depreciating rupee, and if one looks at the incoming flow mechanism of forex into the country, macro-FDI levels have remained (as per IMF's own Table 1) more or less the same, even though foreign portfolio numbers have remained extremely volatile for India (signalling a rise in hot money inflow/outflow and a loss in credibility of an emerging market to attract long term stable investment via FDI). See below.

External trade (on balance of payments basis)						
Merchandise exports (in billions of U.S. dollars)	320.4	296.3	429.2	456.1	436.1	460.6
(Annual percent change)	-5.0	-7.5	44.8	6.3	-4.4	5.6
Merchandise imports (in billions of U.S. dollars)	477.9	398.5	618.6	721.4	701.1	751.7
(Annual percent change)	-7.6	-16.6	55.3	16.6	-2.8	7.2
Terms of trade (G&S, annual percent change)	2.1	2.0	-8.1	-2.8	3.1	0.3
Balance of payments (in billions of U.S. dollars)						
Current account balance	-24.6	24.0	-38.7	-67.0	-65.5	-73.0
(In percent of GDP)	-0.9	0.9	-1.2	-2.0	-1.8	-1.8
Foreign direct investment, net ("-" signifies inflow)	-43.0	-44.0	-38.6	-28.0	-32.8	-44.4
Portfolio investment, net (equity and debt, "-" = inflow)	-1.4	-36.1	16.8	5.2	-30.6	-33.9
Overall balance ("+" signifies balance of payments surplus)	59.5	87.3	47.5	-9.1	40.8	54.7
External indicators						
Gross reserves (in billions of U.S. dollars, end-period)	477.8	577.0	607.3	578.4	619.2	673.9
(In months of next year's imports (goods and services))	11.1	9.0	8.1	7.8	7.7	7.9
External debt (in billions of U.S. dollars, end-period)	558.4	573.4	619.1	624.3	681.1	748.3
External debt (percent of GDP, end-period)	19.7	21.5	19.7	18.4	18.7	18.5
Of which: Short-term debt	8.3	9.5	8.5	8.1	8.1	8.1
Ratio of gross reserves to short-term debt (end-period)	2.0	2.3	2.3	2.1	2.1	2.1
Real effective exchange rate (annual avg. percent change)	3.1	-0.8	0.3	-0.4	...	...
Memorandum item (in percent of GDP)						
Fiscal balance under authorities' definition	-4.6	-9.2	-6.8	-6.4	-5.9	-5.6

(Source: IMF Article IV Report on India)

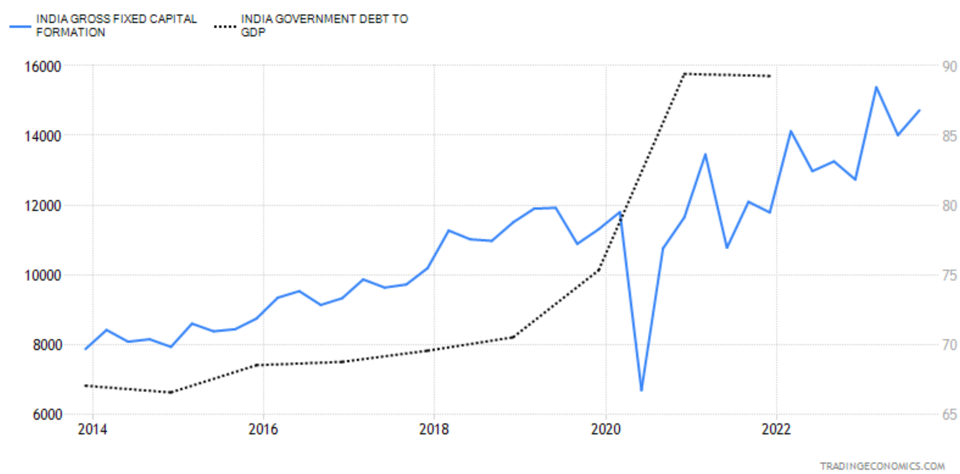
Government debt, government spending, higher military expenditure

Further, the correlative mapping of trends (over the last 10 years) in rising government debt levels with macro-government spending shows two things: a) a rising government spending level justified for ‘capital formation’ (which will now be inhibited by constrained borrowing power as debt continues to rise), and b) how much of the (rising) spending is proportionately linked to persistently growing military expenditure (one sees this trend in parallel and being common to any given country where there is higher centralisation of power and rise in militarised authoritarianism). The problem is all of this rising spending is actually leading to higher growth and is coming at the cost of essential social/welfare expenditure for human capital development.



(Source: Author’s calculations Trading Economics)

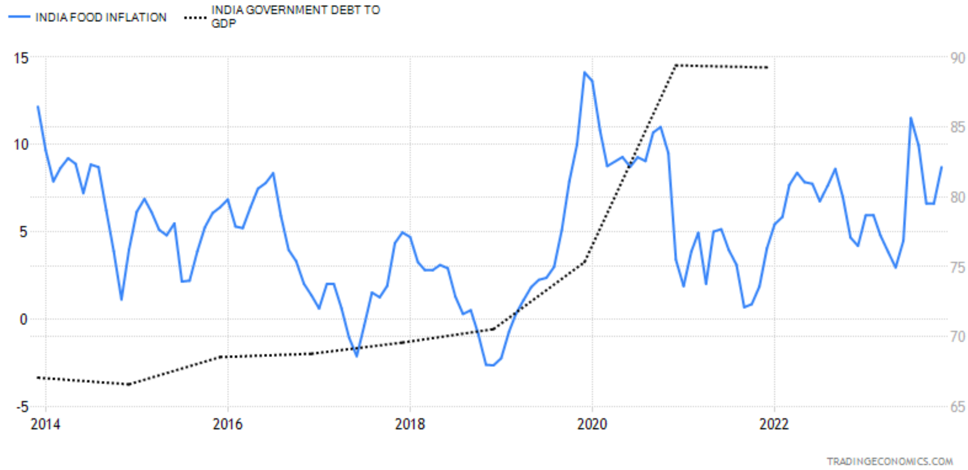
The capex-fuelled government spending spree in the last three years hasn't allowed for greater capital formation (to attract private capital investment for growth). The weak Gross Fixed Capital Formation numbers reflect this. For me, that's an even bigger concern. If the government is spending big and doing so by borrowing more to attract/progressively push for growth via private investment, and none of that is happening (private investment remains woefully weak), the government is basically accruing more debt at the cost of spending to waste and endangering the possibility of future usefully borrowing for crisis or large-scale credit needs.



(Source: Author's calculations Trading Economics)

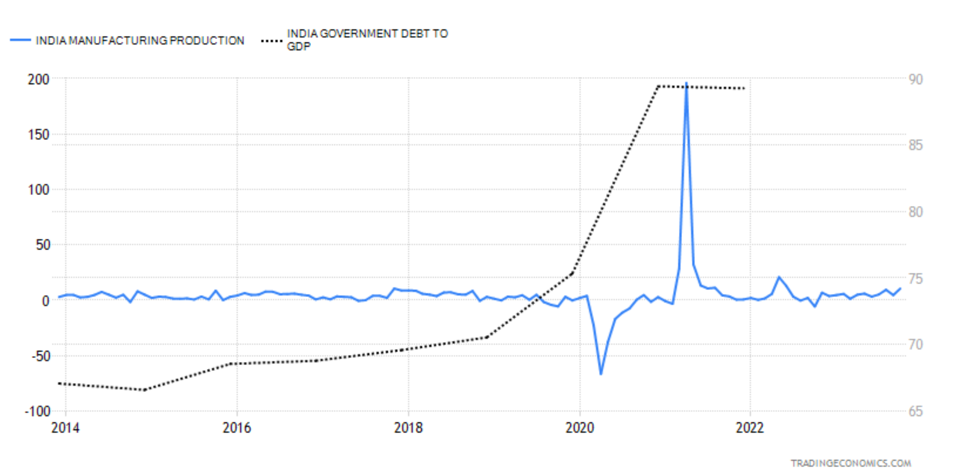
Government debt, employment and inflation woes

High debt accompanied by low employment and high food inflation (or more volatile headline inflation) is the worst possible scenario for an emerging market, particularly one that boasts of a demographic dividend in its working age population composition. India's growth story is one of jobless growth anchored by higher informalisation and casualisation of work, in absence of 'good jobs'.



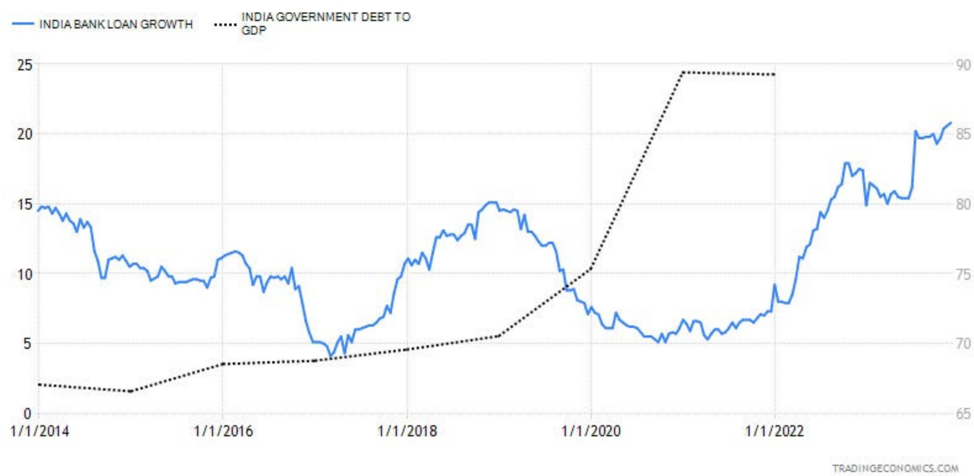
(Source: Author's calculations, Trading Economics)

Manufacturing production is still weak and where the potential for jobs is higher, in services, the nature of competitiveness (in a worker surplus economy) does not yield higher wages. Workers are settling for low-value service work, much of it at the intersection of 'informal' and 'formal' work.



(Source: Author's calculations, Trading Economics)

How is this related to rising government (or macro) debt? Learning from the higher growth episodes of China from the 1980s, it is evident that for any large emerging market to progress and aspire to higher growth while drawing people out of poverty, having a larger credit expansion plan in its financial sector is vital, along with a larger borrowing space for crisis/exogenous shocks/disruptive responses. If we look into the bank credit trend accompanying the rise in government debt level, one sees that even as credit is growing in India's financial sector (which is vital for growth prospects) a higher debt level, amidst a lower growth cycle, will leave less space for both long-term credit expansion or borrowing to happen. One is quite sure that the RBI would be aware of this, but I am not sure if in the given compromised nature of institutional independence and a lack of public institutional autonomy, there is much the RBI can do or say to the government on the matter.



(Source: Author's calculations, Trading Economics)

Looking at these numbers, one thing is clear: India is experiencing a 'debt crisis problem'. 'Crisis' needs to be viewed not in terms of present debt volume but in the larger trend and macroeconomic connection observable between rising government (household, external and corporate) debt and other macro aggregates (from growth, employment, inflation, to financial credit expansion). The government would need to take serious fiscal consolidation measures to address these challenges, rather than living in denial and refuting what the IMF has cautioned against.

Deepanshu Mohan is professor of economics and director, Centre for New Economics Studies, Jindal School of Liberal Arts and Humanities, OP Jindal Global University.