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A special series by the Centre for New Economics Studies's InfoSphere team aims to closely study and understand the macro-state of the Indian economy in a lead up to the next Union Budget.

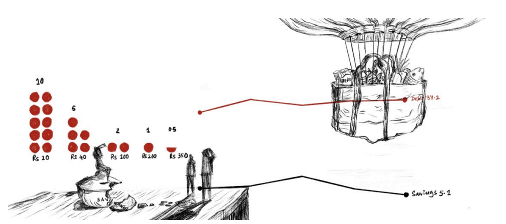
This first part of the series focuses on the intertwined aspects of consumption and investment, which have been a central topic of discussion amongst economists, policymakers for the past year.

On the surface, headlines trumpet India's robust GDP growth.

However, beneath this veneer lies a more troubling economic reality. Stagnant incomes and consumption paint a worrying picture. People simply aren't spending more, indicating a lack of growth in purchasing power.

This weakness in consumer demand is further amplified by a sharp decline in household savings. With everyday expenses likely rising due to inflation, many households are forced to spend a larger portion of their income, leaving less room to save for future needs or investments.

Compounding this consumer sluggishness is a decade-long slump in private investment, the lifeblood of job creation and economic expansion. Despite a strong push for government spending (capex), a key indicator of investment demand — Gross Fixed Capital Formation (GFCF), which is defined as the acquisition of produced assets (including purchases of second-hand assets) — has exhibited a concerning decline.



Recent data shows a deceleration to a four-quarter low of 6.46% in the last quarter (January-March), compared to 9.7% just three months prior. This follows a subdued growth of 3.75% recorded in the previous fiscal year. This decline in GFCF suggests businesses are hesitant to invest in new ventures, potentially due to a lack of consumer demand or uncertainty about the overall economic climate.

Furthermore, preliminary signs suggest a moderation in private final consumption expenditure (PFCE), which serves as a proxy for consumer demand within the economy. PFCE growth witnessed a marginal decline from 4.03% in the December quarter to 3.98% in the final quarter. While less pronounced than the GFCF slowdown, this trend nevertheless presents a significant challenge for the upcoming budget. This data paints a picture of a sluggish economic cycle, where both consumer spending and business investment are showing signs of slowing down.

Investment & Consumption’s Percentage Share in GDP (Source : InfoSphere)

When we take a closer look at the spending patterns across India, the 2022-23 Household Consumer Expenditure Survey offers a mixed bag of insights. On the positive side, the gap between urban and rural spending is narrowing.

Urban residents still spend significantly more (Rs 6,459) compared to their rural counterparts (Rs 3,773), but this disparity has shrunk considerably from the wider gap exceeding 90% observed in 2004-05. This suggests a potential improvement in living standards for rural households, likely due to factors like government initiatives and increased rural-urban migration.

However, beneath this headline improvement lies a cause for serious concern: persistent inequality within both rural and urban areas. The top 5% of earners in urban areas spend a staggering 10.4 times more than the poorest 5%, highlighting a vast wealth gap. While the rural disparity of 7.6 times is slightly lower, it’s still a significant difference. This inequality becomes even more alarming when looking at the lowest consumption brackets. The gap between rural and urban spending for the bottom 10% has actually widened over the past decade, increasing from 34% to 46%. This suggests that the poorest households, both rural and urban, are struggling to keep pace with even basic necessities.

A single glimmer of hope emerges when examining the spending habits of wealthier groups. The significant gap between the top urban and rural spenders has shrunk from 109% to 79% since 2011-12.

This convergence in spending patterns at the higher end could indicate a potential future decrease in overall inequality, but much work needs to be done to bridge the wider chasm at the lower income levels. Overall, the macro consumption data paints a complex picture — a national consumption gap that appears to be closing alongside a widening divide within both rural and urban populations. This highlights the need for the upcoming budget to address not just overall economic growth, but also undertake different fiscal policy interventions that promote a higher disposable income in the hands of low income groups for a more equitable distribution of wealth.

Rural-Urban Inequality in the Households MPCE across Fractile Classes (Source: InfoSphere)

India’s upcoming budget, as discussed earlier by the author, walks a tightrope around issues of inflation, debt and employment related challenges. It must reignite sluggish consumption and investment while tackling persistent inequality. The data presents a fascinating challenge — the national consumption gap is narrowing, but the divide within both rural and urban populations is widening.

To address this, the budget should target specific areas. To boost consumption, especially among those most affected by the slowdown, tax relief for lower income brackets can put more money in their pockets and encourage spending. Additionally, rural development initiatives and policies promoting wage growth-social safety net (within programmes like MGNREGA) can help improve living standards of the more vulnerable while creating economic opportunities across the board.

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On the investment side, streamlining the tax system through measures like reducing the macro-indirect and direct tax burden on middle-income households, phasing out unnecessary exemptions can also incentivise small and medium scale businesses to invest (which have been worst impacted since the 2016 demonetisation shock). Broadening the tax base, while ensuring fairness for lower income/business brackets, can create a more sustainable revenue stream for the government, without creating restrictions in spending-investment.

By implementing a multi-pronged approach that tackles both consumption and investment while promoting inclusivity, the budget has the potential to not only stimulate economic growth but also bridge the gap between rich and poor, propelling India on a path towards a more sustainable and equitable future.

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