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Five key trends that will affect India's economy in 2023

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After two tumultuous years, finally we will be ending 2022 with some optimism. The pandemic is behind us and while the Ukraine-Russia war lingers, its reverberations have subsided as the world learns to survive with it. The Indian economy is projected to record relatively healthy gross domestic product (GDP) growth of 6.9% in 2022-23 and inflation has started moderating. Corporate balance sheets are in good shape, with deleveraging over the last few years and banking sector non-performing assets having fallen. However, all is still not okay. Our problem of twin deficits has raised its ugly head again, with the current account deficit estimated at 3.6% of GDP and fiscal deficit budgeted at 6.4% of GDP in 2022-23. India is feeling the pinch of a global slowdown, with exports showing weakness. Hence, as we enter 2023, the big question is how India will weather the global slowdown. Here are five themes that are likely to have a significant bearing.

Inflation concerns to abate: While consumer and wholesale inflation have fallen in the last two months, the critical aspect now is how much time it will take to get sticky core inflation down. Core inflation tends to get more ingrained in the system, making it difficult to reverse the trend. With the recent sharp fall in food price inflation (5.1% in November from 8.4% in September), household inflationary expectations are likely to moderate, and that, along with a moderation in global commodity prices, should help contain core inflation to some extent. While goods inflation has been falling, services inflation has been inching up. But it is also likely to moderate in 2023 as pent-up demand fizzles out. We expect the consumer price index-based inflation to average 5.2% in 2023-24, which will still be above the Reserve Bank of India's (RBI) 4% target. Moderation of inflation will be supportive of a consumption revival in 2023. With inflation coming within the target band, RBI will get a breather. However, with stubborn core inflation, we cannot rule out one more rate hike in the beginning of 2023.

Capital expenditure to pick up but at a gradual pace: The government will continue to focus on a capital expenditure-based recovery in 2023. Specifically, the transport sector, including roads and railways, will benefit from it. With corporate deleveraging in the last few years and rising capacity utilization levels, the ground is favourable for a private capital expenditure revival. The share of private players in new investment proposals data from the Centre for Monitoring Indian Economy has increased to 85-90% from 65-70% a year ago, indicating a stronger private-sector intent to invest. Government initiatives like the production-linked incentive scheme are also supportive of a pick up in private capital expenditure. However, its pace will be gradual in the midst of the global slowdown and tightening financing conditions.

India will gain from China-plus-one strategies: Our increase in foreign direct investment (FDI) over the past decade has been quite gradual (5% compounded annual growth rate). In the next few years, we can expect a pick-up in FDI, given India's stable macro-economic environment and improved rank on the Ease of Doing Business index (No. 62 in 2019 from No. 77 in 2018). However, the pace of increase will also be gradual. For a big FDI jump, India will have to make the country's business environment and policies more conducive. Better access to global markets through trade agreements can give FDI a push.

Trade negotiations will gain prominence: India recently signed trade agreements with the UAE and Australia. Next year will be busy for trade negotiations, as India evaluates free-trade agreements with the UK, EU, Gulf Cooperation Council and Canada. India's share in global merchandise trade in the last decade has increased by a tiny 0.2 percentage point to 1.8% (China's share went up by 3.5 percentage points). New trade agreements are expected to help India gain greater share. Of course, the terms of these trade pacts would be critical for India to benefit on a net basis and that is where caution is needed.

There is no shying away from globalization and 2023 will re-emphasize this for the Indian economy. The global slowdown and tightening of finance conditions will impact India's economy through various channels. The critical aspect will be how India navigates its way ahead. This includes how cautiously trade pacts with key economies are evaluated as the country further embraces globalization and its G20 presidency provides a special opportunity to influence the global landscape at a turbulent juncture.

Rajani Sinha is chief economist, CareEdge.