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‘Next big consumption trigger will be govt employees’ pay hike’

A DITI Nayar, chief economist & head of research & outreach at the second-largest domestic agency Icria Ratings, in an interaction with TNIE’s **Benn Kochuveedan** tells the real consumption trigger will happen next year when the new pay commission award for central government employees kicks in, adding on to the income tax and GST cuts, along with 100 bps interest rate cuts, which may boost consumption of small to mid-ticket items. Edited excerpts:

The government is selling GST rate cuts as silver-bullet for all ills plaguing the economy, especially missing consumption side of growth. Even at 80% capacity utilisation, why companies aren’t investing? Why income tax cut has failed to boost consumption, if the latest sales numbers are any indication... Can these two tax breaks work for the economy the way government wants us to believe? Overall capacity utilisation has been averaging at 75% for the past a few years. When a little bit of capacity gets added, demand picks up to that extent. Typically in the past, 75% utilisation was seen as a good trigger for expansion, but in the past couple of years what we’ve noticed is capacity expansion is happening in a modest fashion, and not loudly. It’s not an exuberant capex cycle but a more realistic, what-is-needed-is-added-type-of-capacity-addition. So it isn’t making the same kind of macro noises that we saw in the past two big private sector capex cycles. From a macro point of view, this is more sustainable as it’s more realistic so not creating same kind of feel-good factor.

Now over the past three quarters we’ve had some positives for boosting consumption and capex, as well as some negatives. So the positives are income tax cuts, 100 bps repo rate cuts, and lower GST rates, while negatives are increasing external uncertainties, mainly for export-oriented sectors. Balancing all this out, my sense is you may end up with slightly accelerated capacity expansion in domestically-focused sectors and the GST cuts should speed up this.

That means these so-called reforms are not going to give leg-up to overall growth? Do you mean to say growth impact will be segmented? Can these steps cushion US tariff impacts?

In a macro-sense, yes. Why I am saying so is because we started the year with a GDP forecast of 6.5% for FY26. With the tariff-related negative shocks, we had reduced that in two tranches to 6%. But after GST rate cut and first quarter GDP printing in much higher than expected, we’ve gone back to our initial projection of 6.5%. Yes, I agree that Q1 had a lot of front-loading of government capex and exports to the US and this won’t happen in Q2 for sure.

We’re hopeful GST cuts will lead to a pickup in consumption of small to mid-ticket items and services. In fact, the kind of gains that consumers from GST cuts is bigger than the income tax cut. Taken together, plus the interest rate cuts, these add to a broader feel-good factor. Obviously, there will be segments that are still going to feel the pain, especially those households that are deriving their income from export-oriented and labour-intensive sectors like textiles and gems & jewelry. But broadly, GST cut is something that will put more money into the pockets of consumers.

You’ve inflation forecast of 2.6% for this fiscal. For a faster growth clip, economy needs higher inflation, right?

No, I don’t think so; a 2.6% headline inflation can support a 6% plus growth. In any case, inflation this year is subdued as base effect and food inflation has been better. Looking ahead, on food side, we’ve had good monsoons. Of course, there has been crop damages in the past few weeks, which will have an impact on yields.

Companies are saying they want clearly visible demand drive to add capacity. So tell me what are two-three things that would lead to better demand?

In the medium-term, I think the next big consumption trigger will be the pay revision which will come in from next year. We should see mid to higher consumer durables possibly getting pick-up in demand after that.

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