Any delay in rolling out GST will take the shine off India

The chief executive of Centennial Asia Advisors on why the Modi-led government may not go in for a populist budget to counter criticism of its handling, execution of demonetisation

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SINGAPORE: The impact of demonetisation on the black economy is not really clear and this issue can be addressed only if the government rolls out other reforms such as getting rid of unnecessary regulations that give some bureaucrats the ability to demand bribes, a streamlined taxation system that is fairer and easier to comply with and, most critically, a more transparent way for political parties to fund their activities, Manu Bhaskaran, chief executive of Centennial Asia Advisors, said. The handling of the demonetisation process may lead global investors to conclude that the execution capacity of the Indian bureaucracy is poor, Bhaskaran said in an interview. Besides, if demonetisation were to lead to a delay in rolling out the goods and services tax (GST), it will take the shine off India as this is reform is a game-changer, he added. Bhaskaran was also of the view that the Modi-led government is unlikely to go in for a populist budget to counter criticism of its handling and execution of demonetisation. Edited excerpts:

India has been growing at more than 7%, and suddenly it has been hit by the demonetisation drive. What will the impact be on the economy in the near term, mid term and long term?

Even before demonetisation, some of the indicators, especially industrial production, were lacklustre. So, even before the demonetisation, there were pockets of weakness in the economy. There is considerable anecdotal evidence of disruption to economic activities and some hard data—the November PMI. Clearly, the last quarter of calendar 2016 and the first quarter of calendar 2017 will be weak. Thereafter, assuming as is likely that the cash shortage is resolved, economic activities will resume and there will also be some catch-up as well; so, second quarter of calendar 2017 onwards should see a bounce-back. Beyond that, it is not clear how much of a positive impact the attack on the black economy will really have. My suspicion is that if the black economy, corruption and all those evils are to be really overcome, other reforms are necessary—getting rid of unnecessary regulations that give some bureaucrats the ability to demand bribes, a streamlined taxation system that is fairer and easier to comply with and, most critically, a more transparent way for political parties to fund their activities. The fact is that politics is an expensive activity and political parties need huge amounts of money. In some democracies, such as in northern Europe, political parties get public funding; so there is less incentive to resort to illicit means of raising money.

With the government under heavy criticism over the way demonetisation has been executed, do you fear a populist budget this time?

There is still some time to go before the budget is announced. I don't think there should be such a connection between the demonetisation and the budget.

How do international investors look at India on the overall demonetisation process?

It is another example of a promising reform gone awry. Some may conclude that it reflects poorly on the execution capacity of the Indian bureaucracy.

Do you think that GST will be delayed? If that happens, how do you see markets and international investors reacting to the same?

GST is a very important game-changer for India. Any delay will take the shine off India. Or if the implementing regulations for GST and the details of the various tax rates, etc., are so complex that some of the benefits of GST are lost, there will be disappointment.

Capital expenditure in India's private sector has failed to take off. Will private capex continue to remain weak in 2017?

Large companies are struggling with excess capacity and too much debt, while banks are wary of lending until they get their bad loans under control. There should be some bounce-back from the weak levels of 2016, but these main impediments need to be resolved before there is a big rebound.

Will the rising oil prices turn out to be a headwind for India? In the past, the country has benefited immensely from lower oil prices and the slump in commodity prices. But crude appears to be steadily heading up.

I see oil prices in a tight range of $50-60 per barrel for most of 2017, with occasional spikes above and below that range. In that scenario, oil prices will not act as a headwind.

Assuming that we have a rate hike in December, how many more rate hikes can we expect from the Fed in 2017?

At least four (rate hikes) next year of 25 basis points each, in addition to the one that is likely in December. The Fed is behind the curve.

How do you see India being impacted by this rise in rates?

India is not so trade-dependent, so a weaker INR (rupee) versus USD (dollar) should not affect goods exports. Services exports should benefit; this is an argument for more outsourcing. However, it is not clear if the incoming Trump administration will place restrictions on outsourcing to India.

Apart from trade, the other impact is through the financial channel. A rising USD and rising US rates will prompt even more outflows from emerging markets such as India. There could be some financial stresses as a result—not just to INR and the balance of payments but also to companies that took on too much USD debt.

How do you rate India's efforts to improve the business environment and encouraging foreign investment under the Modi-led government?

There has been good progress, and we are confident that more good work will be done in this area. But India starts off very far behind its competitors, and has a long way to go to catch up.

Looking ahead, what are the key challenges that confront India? Is it jobless growth? Is it Increasing inequality?

The main challenge is to spur growth higher and to ensure it is well distributed and job-intensive. That means getting a lot of things right—infrastructure, improving education at many levels especially vocational, reforming labour laws…

How will South-East Asia be impacted now that it is very unlikely that the Trans-Pacific Partnership (TPP) will materialize?

The TPP is more a case of a foregone opportunity than an actual loss. It would have opened 40% of world GDP (gross domestic product) to companies based in the smaller economies of SE Asia, giving them the opportunity to gain scale in a way no other trade agreement can, not even the Regional Comprehensive Economic Partnership (RCEP). The TPP covered a lot more ground than any other trade agreement—intellectual property protection, investor-state dispute settlement, harmonization of standards, etc.

SE Asia will now turn to RCEP, but negotiations are slow as India is proving to be a difficult partner to negotiate with.

Even if RCEP happens, its impact will be quite limited. The other impact is geopolitical. The TPP gave an added economic dimension to President Obama's pivot to Asia, vastly strengthening America's soft power appeal. With the TPP gone, America's credibility is in shreds. China has been emboldened and is gaining substantial ground as a result.

Singapore is experiencing its slowest growth since the global financial crisis in 2009. What is the way forward for the city-state? What fiscal measures can be considered?

Singapore should benefit from the budding recovery in global demand; it is highly open with a trade to GDP ratio above 300%, so it wins big whenever the world economy speeds up.

There are already some early albeit tentative signs of a pick-up as seen in industrial production and exports. But the lead indicators for world trade are positive, and that suggests that these incipient signs of recovery should gather strength.

That should buy policymakers time to address domestic headwinds such as the real estate deflation and a loss of competitiveness due to high costs.

Companies in Singapore are also dealing with the government's more restrictive policies on hiring foreign workers.

As the economy remains weak and monetary policy has already been eased, fiscal support seems the more likely way forward. So, we are likely to see a more supportive budget when it is announced in February. There is scope to step up infrastructure spending by bringing forward projects that are already approved such as the fifth terminal for Changi Airport and the new port in Tuas as well as new MRT (mass rapid transit) lines. In addition, there could also be measures to extend support to the small and medium enterprise sector through loan guarantees or similar measures.

In addition, the government's Committee for the Future Economy is set to make its report on longer term plans for Singapore's economy. There are likely to be new initiatives to bolster

Singapore's ability to build commanding positions in new emerging areas such as big data, fintech and so on.

How worried should Southeast Asia be going into 2017 on account of the slowdown in China?

The main impact of the slowdown in China has already been absorbed—lower commodity prices and lower demand for resources and manufactured goods. However, China is stepping up its engagement with the region through many initiatives such as the One Belt One Road scheme. Some of the Chinese projects in the region are massive such as the projects in Malaysia, the Melaka Gateway and the Kuala Lumpur-Kuantan rail link. Chinese firms are making acquisitions in the region as well and some manufacturing activity is moving out of China into SE Asian countries such as Vietnam.

What does Donald Trump mean for Asia?

First, there is the risk of protectionism affecting both trade in goods as well as outsourcing. Trump's interventions to, for example, stop Carrier from relocating production outside the country provide a hint to Trump's America First-type policies. He may also demand a renegotiation of trade deals with Asia such as the US-Korea Free Trade Agreement (FTA) or the US-Singapore FTA.

Second, Trump's domestic policies should boost growth in the near term in the US, which should then lead to greater demand for Asian exports if trade protectionism is restrained.

He has vowed to cut restrictive regulations across the board, slash taxes and step up defence spending. It is unlikely that Congress will have the political will to cut spending in line with lower taxes so the budget will become highly expansionary by late 2017 or early 2018. Higher US growth will spill over to Europe and Japan as well, helping their nascent recoveries to gain strength. The net effect on global demand for Asian exports should be substantial.

Third, there is the geopolitical impact—if Trump picks a fight with China, then SE Asian countries might be caught in between. The telephone conversation he had with Taiwan's President Tsai (Tsai Ing-wen) and his comment that he did not feel bound by the One China policy, which is so important to China, point to difficulties ahead between the US and China.

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