Is private investment expected to rise? | Explained

Will the tax incentives and other measures announced in the Budget help spur consumer demand?

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The story so far: With the government providing a tax stimulus through income tax breaks to boost consumer spending and the RBI cutting interest rates for the first time in nearly five years, Finance Minister Nirmala Sitharaman on Saturday said she was quite optimistic of the tide turning on private investments in the months to come. Addressing the media, she said, “anecdotal evidence suggests a pick-up in investment activity.” Ms. Sitharaman said that she had heard from different sources that orders for Fast Moving Consumer Goods (FMCG) for the period April to June were already getting booked, and that “industry is clearly seeing the signs of a possible recovery of consumption.”

Why was there a concern?

Private investment in India, which has been on a downward trajectory for more than a decade, showed further signs of weakening in the latest quarter. Private investment plans dropped by 1.4% in the December 2024-2025 quarter even though investments overall increased by 9.9% due to a significant rise in public investments by the Centre and State governments, which grew by 11.8% and 34.6%, respectively.

Private investment matters because it helps build physical, human, and other forms of capital that ultimately help increase the amount of goods and services produced in an economy. It should also be noted that private investment is generally considered to be more efficient than public investment, which is undertaken by the government. This is because private investors are subject to the discipline of profits and losses in the marketplace, which ensures that capital is allocated towards the most urgent needs of consumers. Public investments are not subject to the same degree of market discipline. But notably, public investment is viewed as a major reason behind the high growth numbers reported by India in recent years.

What determines private investment?

It is generally believed that money deposited as savings in banks by ordinary citizens is loaned out to fund large-scale investments. But in reality, private investment depends not on savings levels in the economy but on the pace at which loans are created by the banking system. This is because banks can create loans electronically through simple accounting entries that deposit money in borrowers' accounts even without savings to back these loans. So, there is a strong positive relationship between bank credit growth and the level of private investment, with heathy bank credit growth driving private sector investment higher. In fact, bank credit growth averaged about 22% between 2005 and 2014 when economic growth was high, before dropping precipitously to just around 9% between 2014 and 2021 when the economy began to slow down.

Why has private investment been sluggish?

Many economists have blamed the lack of sufficient consumer demand for the lack of strong private investment in the country. They argue that unless the government does something to increase the amount of money that consumers have in their hands to spend, investors would be unwilling to take the risk of investing in business projects. Given this backdrop, making incomes up to ₹12 lakh tax-free is seen as an attempt to put more money in the hands of individuals to boost consumer spending and spur private investment. However, over the decades, there has been an inverse or negative relationship between private investment and consumer spending.

Private final consumption expenditure stood at a high of 90% of GDP way back in 1950-51, from where it dropped gradually over the decades to hit a low of 54.7% of GDP in 2010-11. At the same time, private investment as a percentage of GDP rose from around 10% in the decades between independence and economic liberalisation to around 27% in 2007-08. Interestingly, from around the time when private investment hit a peak in 2011-12, private consumer spending has actually risen, not fallen. In other words, over the last decade or so, consumer spending has actually risen at the same time that private investment has dropped from its peak. This suggests that the negative relationship between private investment and consumer spending could simply be due to the fact that the money in an economy that is not invested is spent on consumption, and vice-versa. Given this, policy uncertainty and unfriendly government policies are cited as the major reasons behind the slowdown in private investment. Many analysts have pointed to the drop in the pace of economic reforms as discouraging private investors from undertaking long-term capital-intensive investment projects.

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