

Indian Economy

Current challenges and why the best is yet to come

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The Transformation

From Hindu to Sardar rate of growth !

Average growth rate:

- just 3.5%
in the 25-year period prior to 1980-81
(the Hindu rate of growth)
- Increased to about 6%
in the next 25 yrs
ie in the period since 1980-81

Post Reforms: The Watershed Years

Break from trend growth rate

- Since 1990s per capita income has been growing at about 4% pa implying a person's income will double in 18 yrs
- With life expectancy of about 72 yrs Indians could see their income double at least thrice in adult years & five times if economy grows at 9%

The Inflection Point: A Quantum Jump

- Particularly sharp increase in growth rate since 2003-04: Average growth over past five years 8.5%, past four years 8.9%.
- Per capita income grew 7.8% in 2007-08 (April – March) as against 0.6% in 1970s.
- Suddenly India became the flavour of the season

Brought with it worldwide attention

Goldman Sachs Report (2003):

Dreaming with Brics: The path to 2050

- India could potentially be a bigger growth story than China and one of the world's three largest economies in less than 30 years
- It is the only BRIC economy likely to sustain above - 5% growth throughout the next 45yrs
- The only BRIC country whose population would grow throughout the period with its population overtaking that of China in 2034

India played to BRICs Script

(till 2007-08)

India on eve of crisis

- Growing strongly at above 8% for 5 years
- Service sector engine of growth, manufacturing revival
- Savings and investment rising smartly
- Financial sector in good shape
 - Banks well-capitalised, NPA levels low
 - Leverage levels not excessive, Insignificant exposure to opaque, illiquid asset backed securities.
 - Conservatively managed; calibrated opening up

Before muffing up lines in '08-09

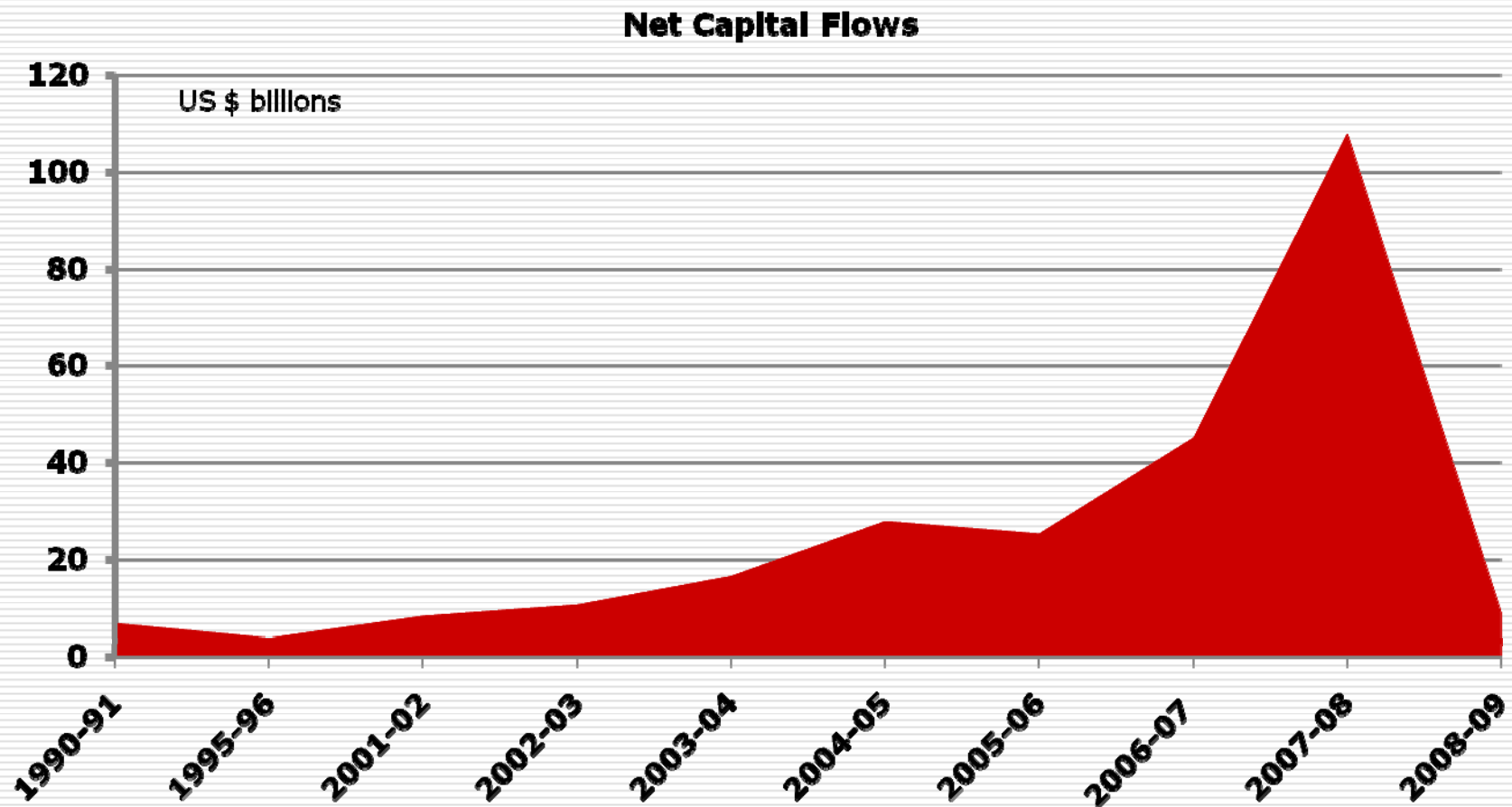
When

- Global risk aversion increased:
 - Foreign investors sold off Indian equities & debt
 - Banks cut credit lines to Indian banks
 - Banks refused to roll over fx debts of Indian corporates (including trade credit)
- Corporates turned to domestic banks
- Dollar as well as rupee liquidity became tight
- Export demand fell as export markets collapsed

Impact of global crisis on India

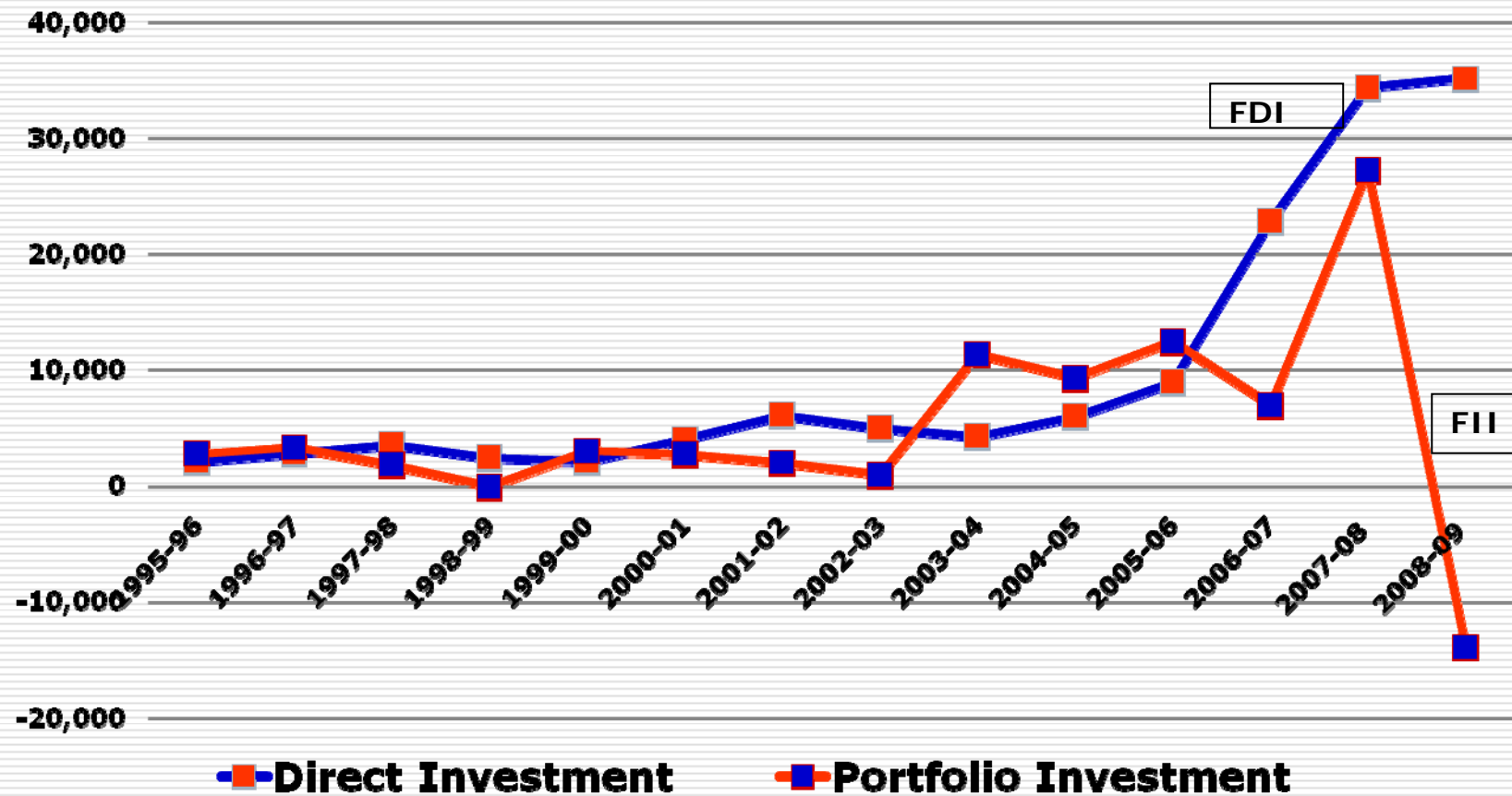
- **Capital Flows declined**
 - surplus on capital account, used to balance the deficit on the current account, declined sharply– from \$108 bn in 2007-08 to \$ 9.1 bn in 2008-09.
- **Foreign Currency Reserves fell:**
 - From \$ 310bn in March 2008 to \$278 billion as of 4 Sept 2009 down (up from \$257bn in March 2009)

Globalisation means India now borrows in global markets

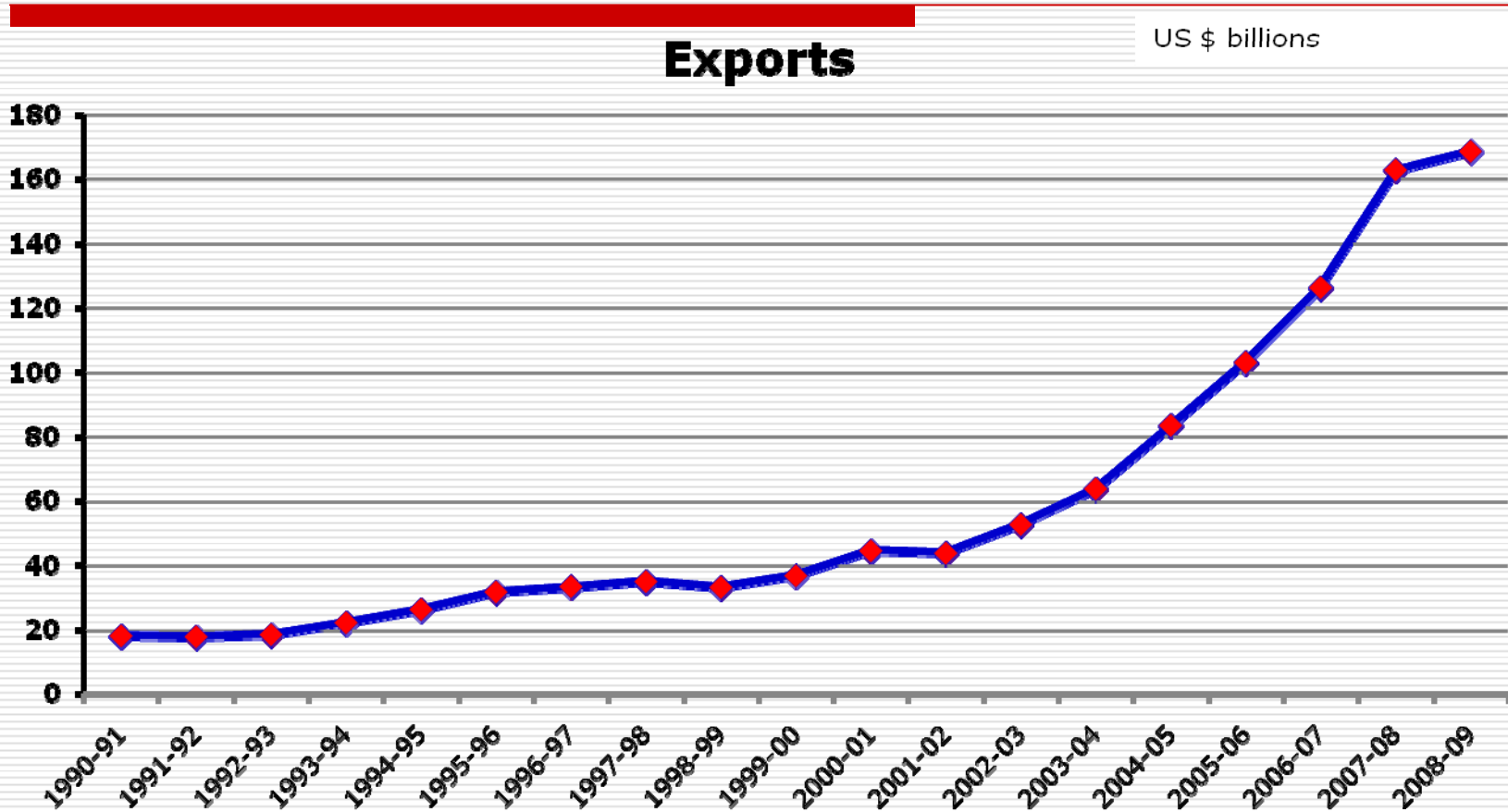


Source : RBI Annual Report 2008-09

...and foreigners invest in India

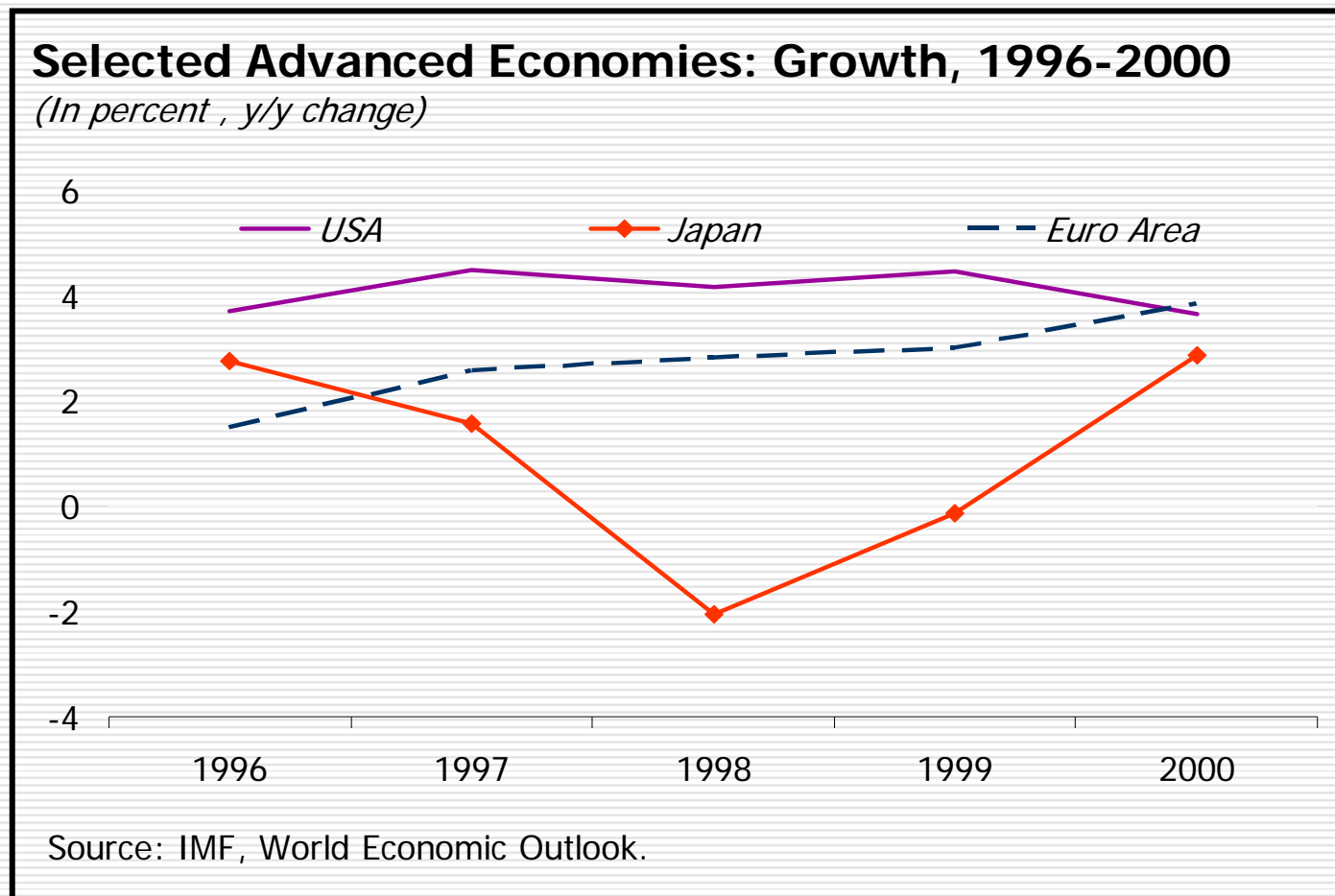


India is much more reliant on exports...

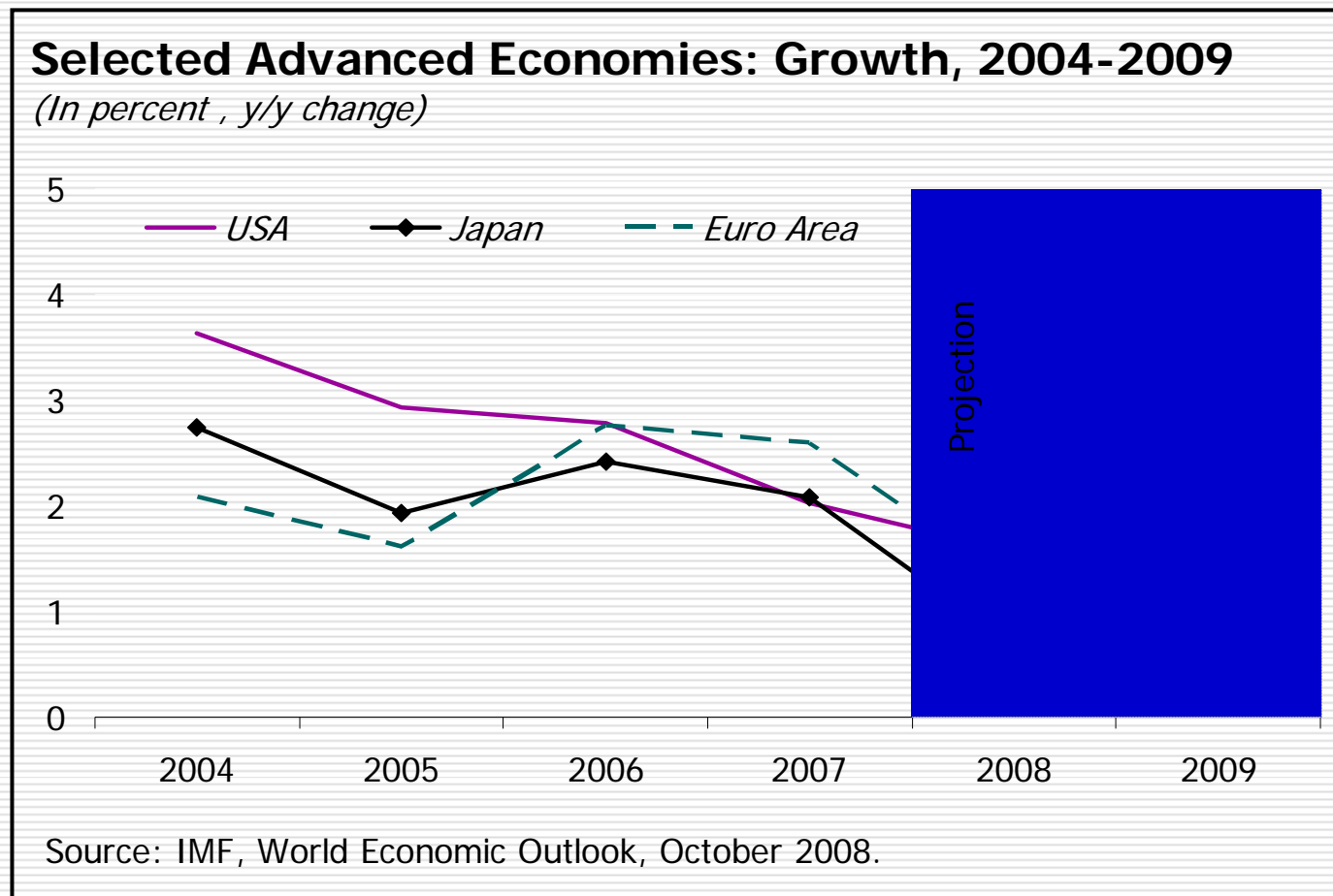


Source: RBI Monthly Bulletin

In 1999, Asia exported its way out of recession



...but now the export outlook is dire



Net Result

- **Economy slowdown** from 3rd qtr 08-09
 - GDP growth dipped to 6.7% in 08-09
 - Growth in Q 1 09-10 down to 6.1%
 - **Industrial growth** dipped sharply
 - **Exports fell** – Aug 2009 saw 11th consecutive month decline in exports in dollar terms, imports (inclgd non-oil imports) also fell

So India had to look to its large domestic market to spur growth

- What did government do?
Like all govts, resorted to fiscal stimulus measures
- What did the Reserve Bank of India do?
- Once again like all central banks eased liquidity in a bid to meet demands from corporates/retail borrowers

Fiscal Response

- **Three stimulus packages** – Dec 2008, Jan 09, Feb 09 combining tax cuts and increased expenditure upwards of **\$ 30 billion**
- **July budget was fourth stimulus** package: projected an increase in govt's fiscal deficit to 6.8% of GDP up from 2.7% in 2007-08 and 6.0% in 2008-09
- **Key difference between India & ROW:** Fiscal stimuli in the form of higher govt expenditure began well before crisis hit India as 2008-09 was a pre-election year

Monetary Response

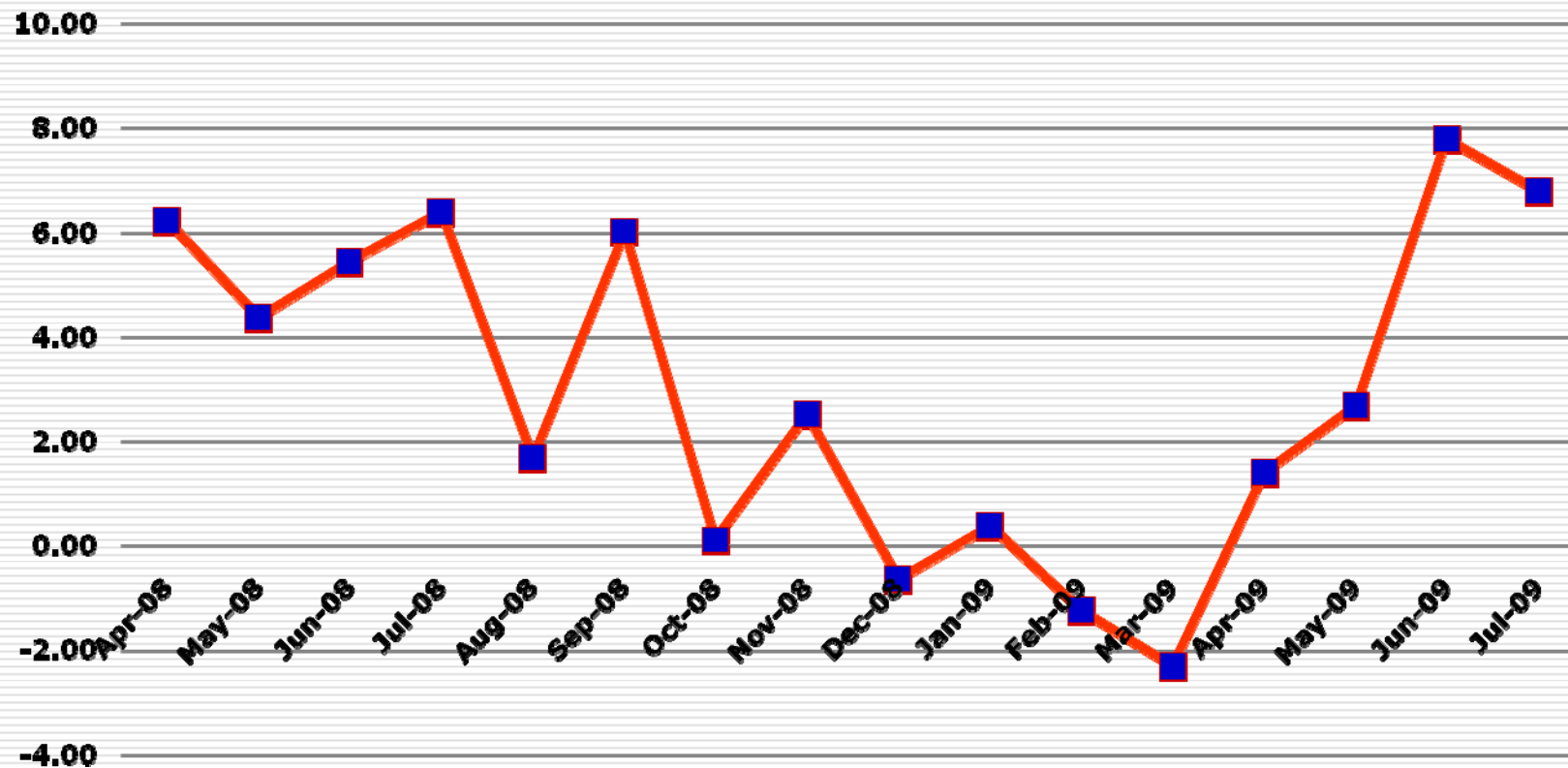
- Monetary
 - benchmark overnight **lending rate (repo rate) cut** 425 basis points from 9% to 4.75% between Sept 2008 & July 2009.
 - **Cash reserve ratio cut** 150 basis points
 - **Liquidity injection of Rs 5,617 bn or about 10%** of GDP through these and other refinance facilities.

Impact :

- Monetary policy ensured adequate liquidity
- Fiscal policy shored up demand
- For now we seem to be managing well
Index of Industrial Prod looking up
- Stock market revival
- Q1 2009-10 corporate results robust

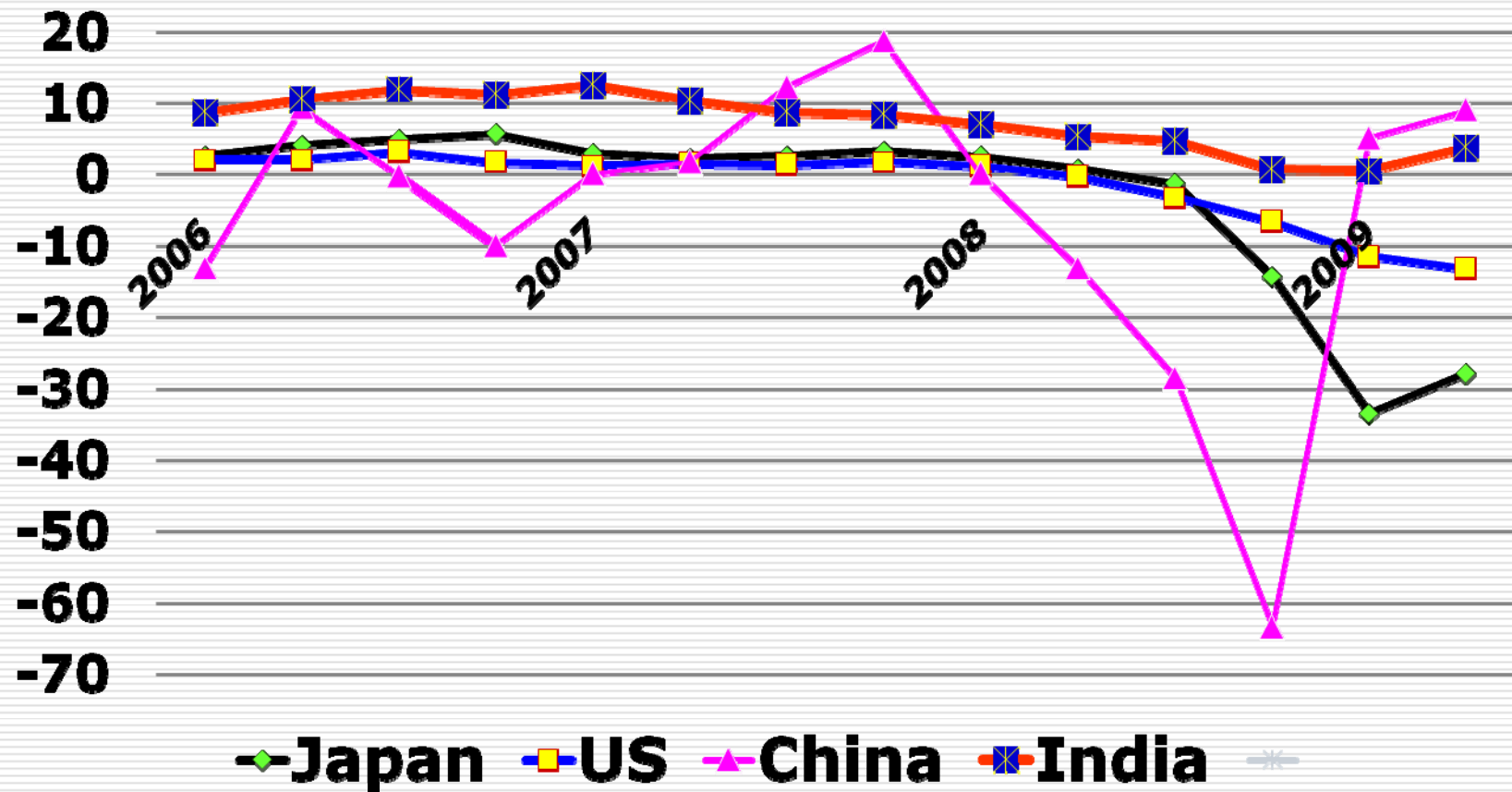
Signs of optimism in Industry

Y-o-Y change in Industrial Growth

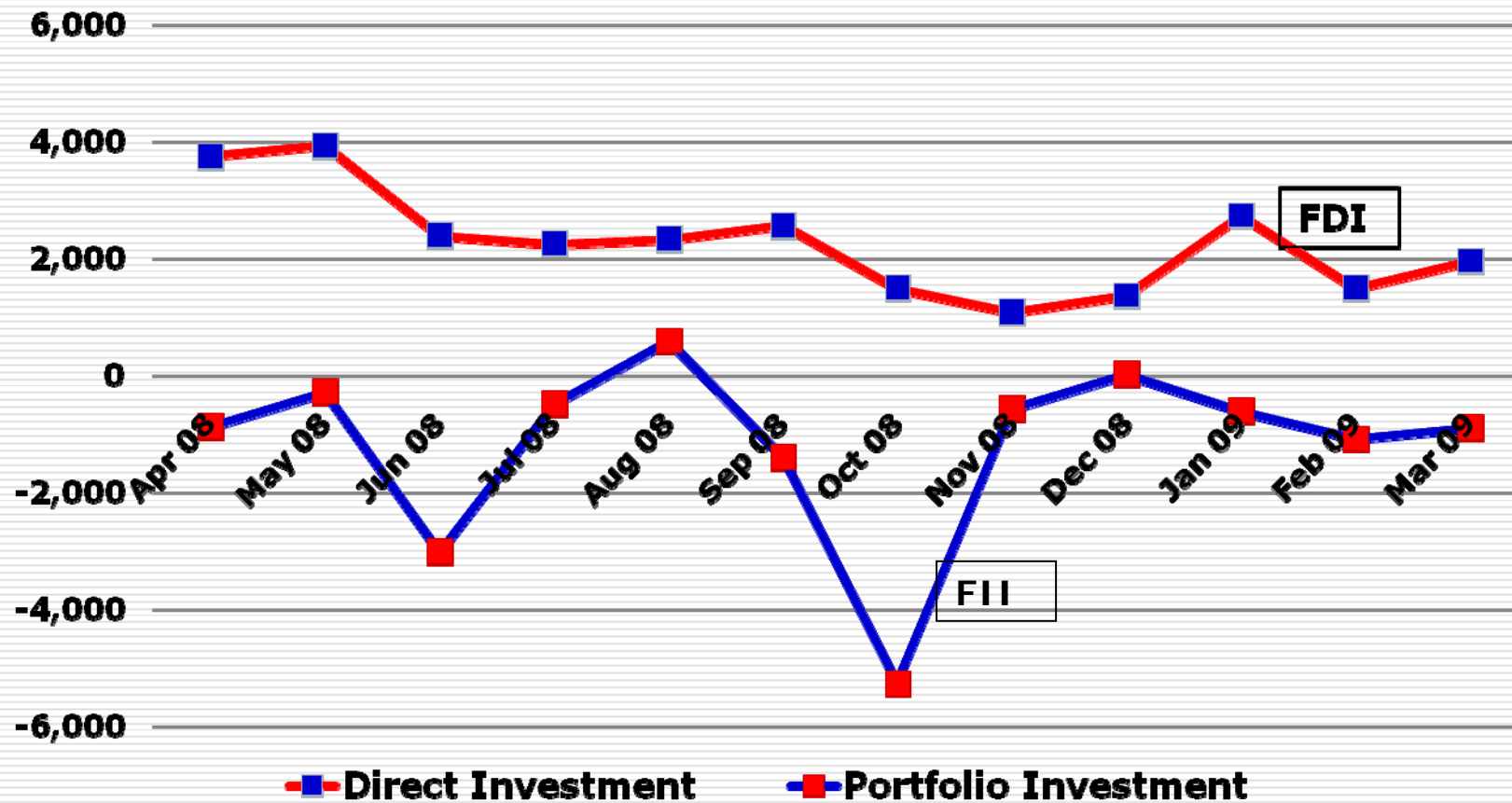


Industrial Production

– a comparative picture



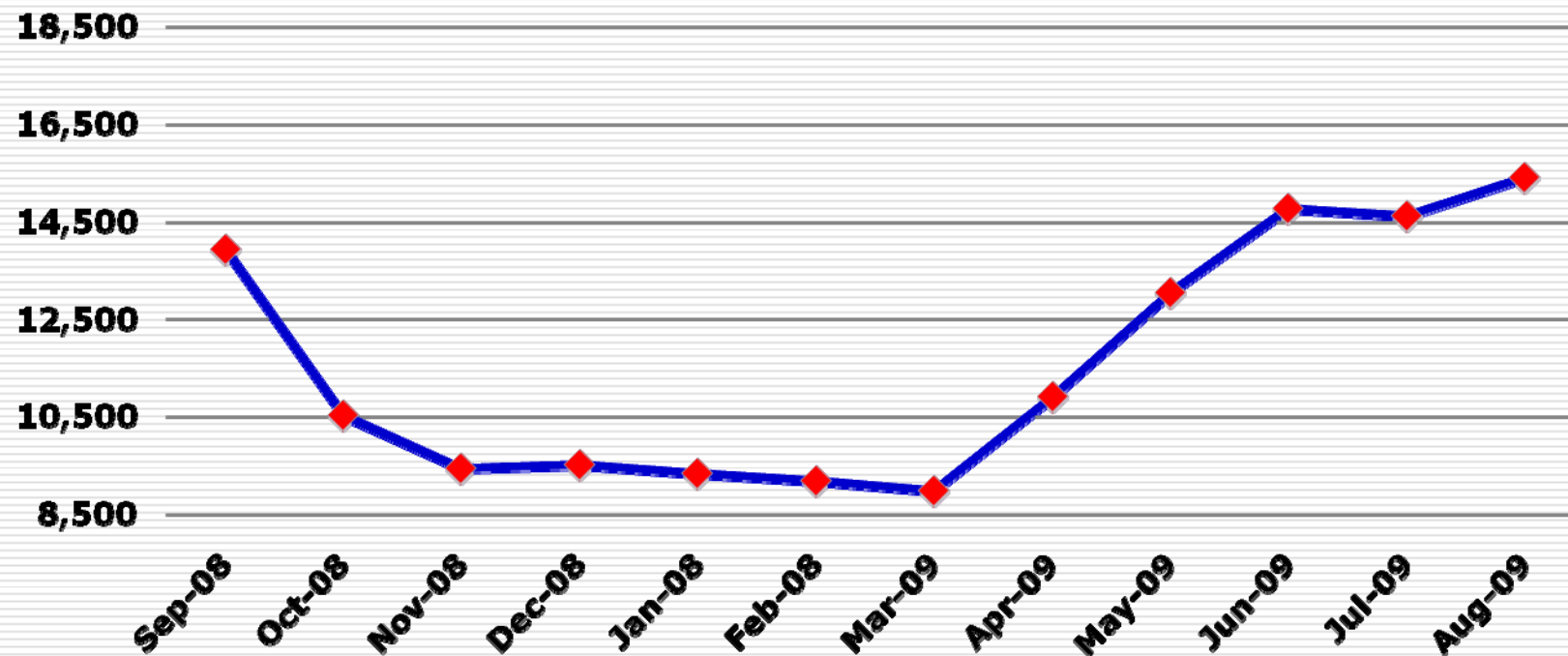
Foreign investment returns



Stock markets begin to look up

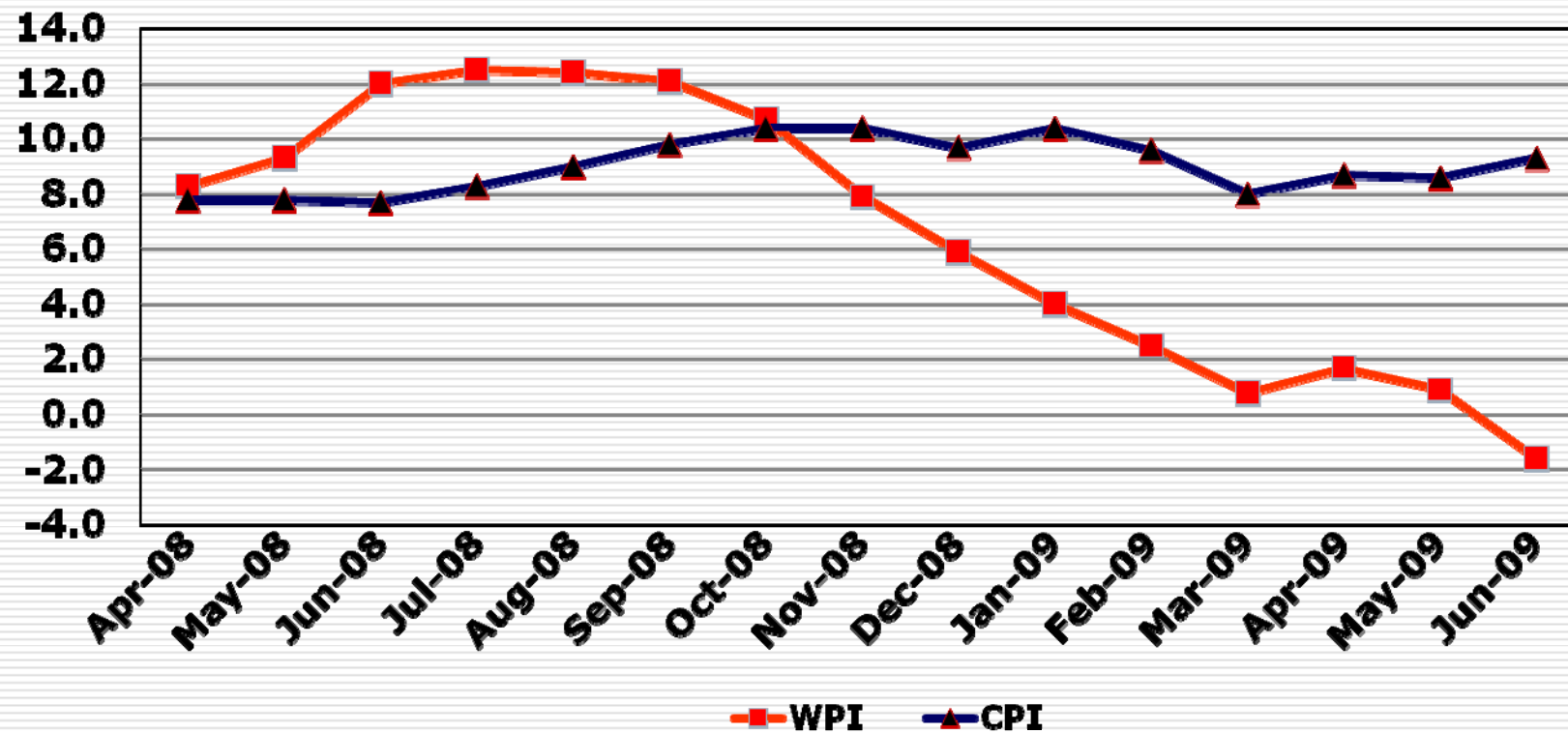
Peak 19827
in Dec 07

BSE Sensex

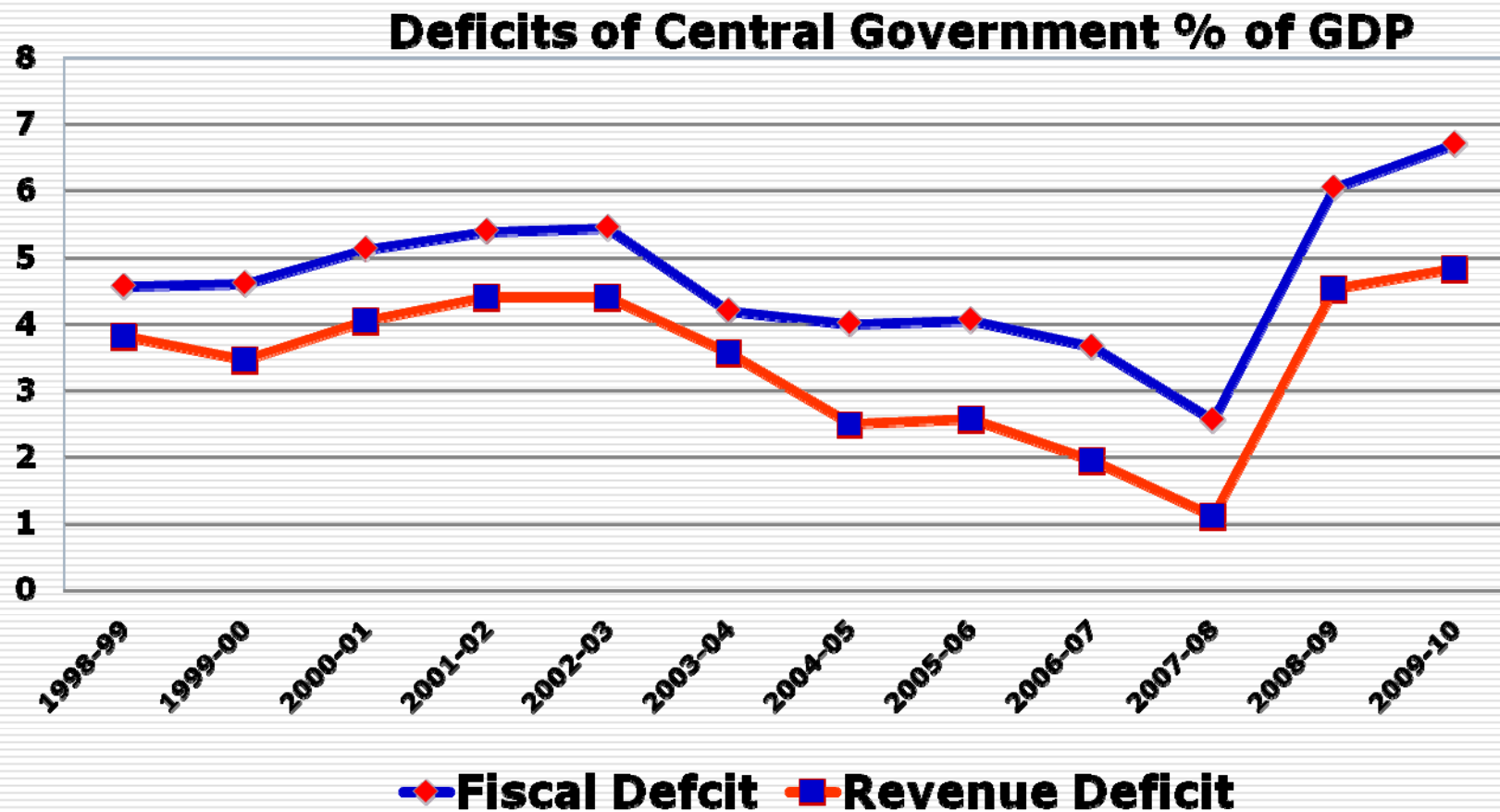


But prices play hookey

Variations in Price Indices



Fiscal discipline goes for a six



What's the flip side?

- Excess liquidity – banks parking over Rs 1 trillion daily with RBI thru reverse repo window
- Huge deficit – 6.8% of GDP, reversing gains of previous period of fiscal consolidation
- High debt/GDP ratio : 80%, add the borrowings of public sector enterprises and figure could cross 100% of GDP

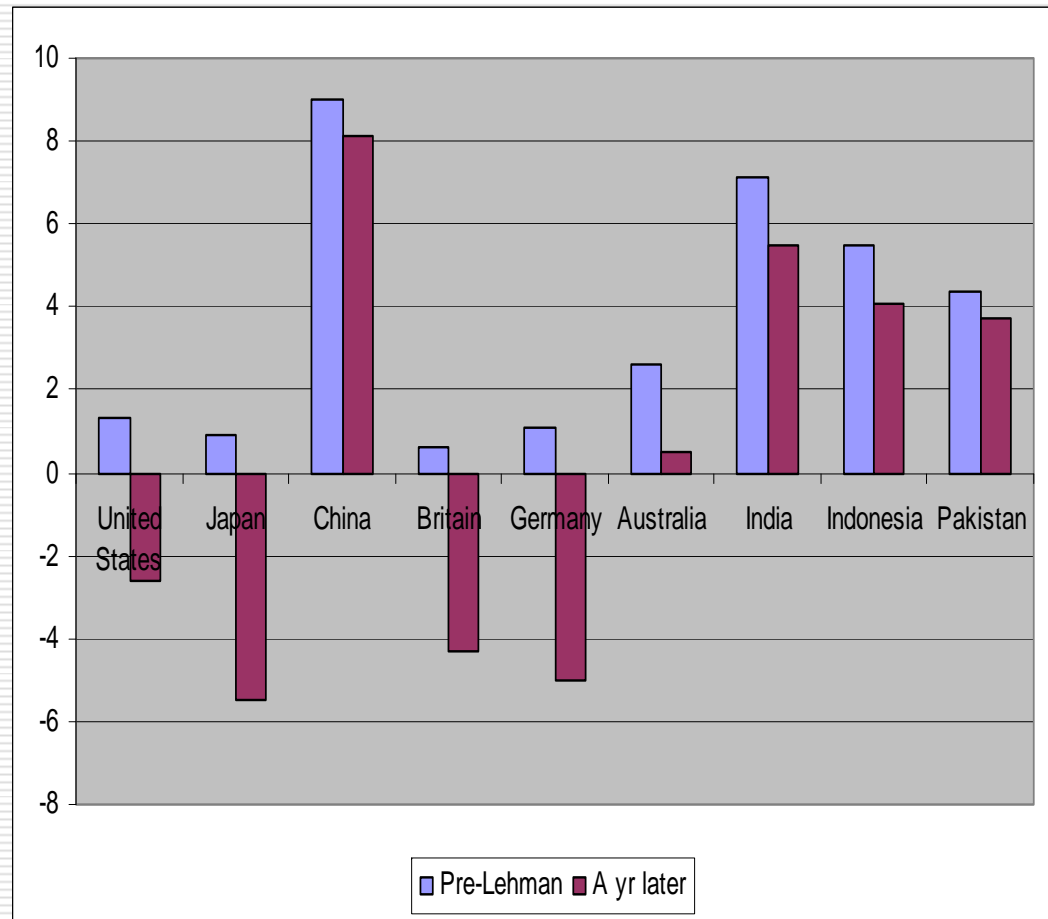
But overall picture remains robust

**Overall growth at 6.7% in
2008-09 still amongst fastest
globally**

mainly because services sector
and agriculture continued to do
well

The Global Picture

Country	Pre-Lehman	A year later
United States	1.3	-2.6
Japan	0.9	-5.5
China	9	8.1
Britain	0.6	-4.3
Germany	1.1	-5.0
Australia	2.6	0.5
India	7.1	5.5
Indonesia	5.5	4.1
Pakistan	4.4	3.7



Key Question

Was the previous high growth phase a flash in the pan? Is 6 -7% GDP growth the best India can do?

OR

Will India return to 9% GDP growth?

To answer this question ...

- Ability of Indian economy to ride out the global crisis
- What has Globalization meant?
- Has it made Indian economy more vulnerable?

It's been a Goldilocks globalisation so far but ...

Openness offers a number of benefits but it also increases the risk from external demand and capital flows. Swings in capital flows and sudden stops can have a significant impact on exchange rates, domestic monetary and liquidity conditions and overall macroeconomic and financial stability

Is growth sustainable?

- Yes! Why?
- Till recently growth was consumption led
- Now growing evidence it is investment-led
 - gross capital formation was 39% of GDP in 2007-08 as against 24.2% in 2001-02
- Domestic savings rate is up :
 - 37.7% of GDP as against 23.5% in 2001-02

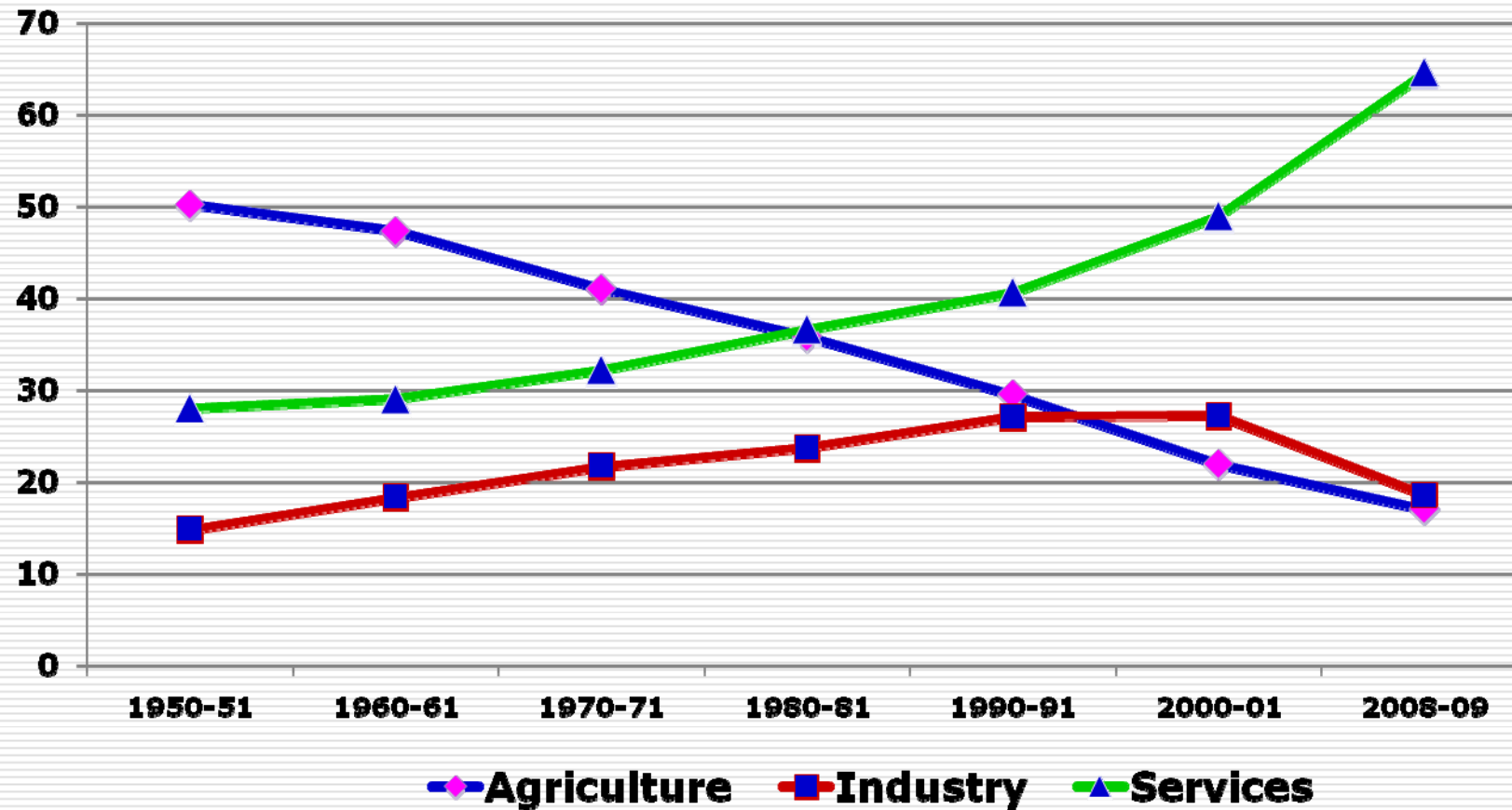
Capital inflows are up too

- In 2007-08 inward FDI was \$34 bn, up from \$22 billion in 06-07 and \$ 4-5 bn few years earlier. Between April –July 2009 FDI \$ 10.5bn (\$12.3bn in 08-09)
- Portfolio flows up from \$7 bn in 2006-07 to \$30bn in 2007-08. Between April-Sept \$ 8.7 bn compared to outflow of \$ 8.6bn in the previous year

What has changed?

- Composition of GDP changed
- Services now about 63% of GDP, Industry 20% and agriculture 18% of GDP as against 41%, 27% & 32% resp in 1990-91
- Services has been growing at double digits
11.2% in 2006-07, 10.7% in 2007-08
& 9.6% in 2008-09

GDP composition has changed



Source: National Accounts Statistics, CSO

Manufacturing looking up but...

- Manufacturing has staged a strong revival – grew 12% in 2006-07 and 9.1% in 2007-08, slowed down in 2008-09 to 2.4%
- Achilles heel is agriculture where growth has lagged behind 3.8% (2006-07), 4.5% (2007-08) & 1.6% (2008-09) – growth rate is not just low but hugely dependant on monsoon
- But low share in GDP means less impact on overall GDP growth

Net Result

- Unlike earlier times when the Indian economy showed flashes of brilliance only to disappoint, this time round the higher growth seems to have deeper moorings – there is a structural change
- But globalisation is both a plus and a minus – so as India gained from opening up it is now suffering the pangs of global slowdown

Outlook for the year

- RBI Survey of Professional Forecasters
 - GDP growth 09-10: 41% probability of growth between 6.0 – 6.4%
 - 09-10: 43% probability of gr 7.0-7.4%
 - Long-term GDP forecast next 5 yrs 7.5%
 - Long-term GDP forecast next 10 yrs 8%
 - Is this possible? Wishful thinking?
-

What are the positives?

- **Financial sector** robust, low leverage,
Commercial banks healthy B/Sheets
- **Less dependence on export** sector
- Robust **farm sector** and growth in rural incomes
- **Competitive** domestic cos thanks to trade reforms
- **External payments** situation comfortable
- Softening **commodity prices**, benign inflation

...and the negatives

- Negative **external environment**:
 - reduction in demand and increasing protectionism, both capital and current account negative
- Business **confidence levels** low Bank credit unable to **make up for decline** in equity investment, NBFC credit & foreign capital
- Limited **fiscal space**, Decline in **private investment going forward**
- **Monsoon** uncertainties.

Near-term challenges

- Biggest challenge is to deal with the combination of subdued growth with latent inflation risk. Withdrawal of monetary and fiscal accommodation risks endangering recovery impulses while continued accommodation increases risk of inflation.
 - Large govt borrowing programme and accompanying high fiscal deficit raises inflationary expectations and puts upward pressure on interest rates.
-

The challenges going forward

- Dealing with the drought
- Shifting people out of agriculture into productive non-farm employment
- Increasing employment opportunities
- Improving infrastructure, physical & social
- Legal & labour reforms
- Reducing inequalities & Governance

What's the outlook

- Growth will recover to 7-8% but 9% is unlikely till global economy recovers.
- Should we worry? Yes! because India is home to a third of world's poor
- Because democracy means their voices (rightly) cannot be ignored
- Because growth will not be sustainable unless it is inclusive

Why the best is yet to come

- **No going back on reform**
- **FM** - Economic reform is a continuous process and not a flurry of announcements
- **Large domestic market** open to external competition
- **Political stability**, rule of law

Reforms on anvil

- **Reform of direct tax code** and shift to a GST (goods and services tax)
- **National Skill Development Corporation**
- **IIFCL for funding infrastructure**, one of the biggest bottlenecks
- **PPP in infra projects** – Urban renewal mission, Bharat Nirman for rural areas
- **Bankruptcy code**
- **Disinvestment**
- **Increased outlay on health and education**

Large domestic market

Efficient and open to external competition

Large and growing middle class: estimated at anywhere between 300-400 million, though middle class in India very different from middle class in developed countries - households with annual incomes of Rs 0.2mn - Rs 1 mn (at 2001-02 prices) NCAER definition

Political stability

- Rule of law
- Govt elected for 5 year term in May 2009, less unwieldy a coalition than before, no Left backing
- Right to information, right to education

India – SWOT

- Strengths
- Big domestic mkt
- High rate of S & I
- Demographic div
- Robust externals
- Democracy
- Skilled labour

- Weaknesses
- Fiscal deficit
- Poor Infra
- Demo liability
- Labor mkt rigidity
- Democracy
- Poor governance

To sum up:

The **India story** is best explained by Padma Desai's response to Jeff Sachs' critique of slow pace of India's reforms: 'You can't cross a chasm in two leaps' (Jeff Sachs)

- 'You can't cross it in one leap either unless you are Indiana Jones so you drop a bridge instead.' (Padma Desai)
- 'The future ain't what it used to be' (Yogi Berra)



धन्यवाद

THANK YOU