

The Indian Economy: ***Prognosis and Path Forward***

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Overview

- **India in the Global Economy**
- **Macroeconomic Fundamentals**
- **Engines of Growth**
- **Debates on Recent Economic Trends**
- **Macroeconomic Policies for stabilizing Growth**
- **Structural Reforms for Raising Growth Potential**
- **The \$ 5 Trillion Economy**

Major trends in the Global Economy

Short-term

- Global economy has slowed sharply since 2017
- Downturn both in AEs and EMDEs
- Low income countries have bucked the trend
- India's growth projection for 2019-20 slashed from 7.3% in April 2019 to 6.1% in October 2019. This still leaves it as the fastest growing major economy ?
- India Q1 growth at 5%, and SBI forecast for Q2 at 4.2%, and 2019-20 at 5%

Medium to Long-Term

- Declining growth in AEs since 1980
- 2002-07 boom basically an EMDE phenomenon
- Post GFC sharp decline in EMDE growth – still to bottom out – but still higher than 1980-2001
- Geopolitical implications: Rising share of EMDEs in the global economy from around 20% to 40% at market exchange rates, and from 35% to 60% at PPP
- EMDE fortunes linked to vicissitudes of global trade?
- India's good growth potential undeniable: demographic sweetspot with declining dependency ratios, abundance of cheap and young labour force, known strength in the sunrise services and IT sectors, – big domestic demand in a world of shrinking trade

IMF: World Economic Outlook October 2019

	2017	2018	Projections	
			2019	2020
World Output	3.8	3.6	3.0	3.4
Advanced Economies	2.5	2.3	1.7	1.7
United States	2.4	2.9	2.4	2.1
Euro Area	2.5	1.9	1.2	1.4
Germany ²	2.5	1.5	0.5	1.2
France	2.3	1.7	1.2	1.3
Italy	1.7	0.9	0.0	0.5
Spain	3.0	2.6	2.2	1.8
Japan	1.9	0.8	0.9	0.5
United Kingdom	1.8	1.4	1.2	1.4
Canada	3.0	1.9	1.5	1.8
Other Advanced Economies ³	2.9	2.6	1.6	2.0
Emerging Market and Developing Economies	4.8	4.5	3.9	4.6
Emerging and Developing Asia	6.6	6.4	5.9	6.0
China	6.8	6.6	6.1	5.8
India ⁴	7.2	6.8	6.1	7.0
ASEAN-5 ⁵	5.3	5.2	4.8	4.9
Emerging and Developing Europe	3.9	3.1	1.8	2.5
Russia	1.6	2.3	1.1	1.9
Latin America and the Caribbean	1.2	1.0	0.2	1.8
Brazil	1.1	1.1	0.9	2.0
Mexico	2.1	2.0	0.4	1.3
Middle East and Central Asia	2.3	1.9	0.9	2.9
Saudi Arabia	-0.7	2.4	0.2	2.2
Sub-Saharan Africa	3.0	3.2	3.2	3.6
Nigeria	0.8	1.9	2.3	2.5
South Africa	1.4	0.8	0.7	1.1
<i>Memorandum</i>				
European Union	2.8	2.2	1.5	1.6
Low-Income Developing Countries	4.7	5.0	5.0	5.1
Middle East and North Africa	1.8	1.1	0.1	2.7
World Growth Based on Market Exchange Rates	3.2	3.1	2.5	2.7
World Trade Volume (goods and services)	5.7	3.6	1.1	3.2

Global Growth 1980-2019

<i>Period</i>	World	AEs	EMDEs	US	Euro area	China	India	Trade
1980-2001	3.2	2.9	3.5	3.1		9.7	5.5	5.7
2002-07	4.8	2.6	7.2	2.8	2.0	11.3	8.0	7.7
2011-19	3.6	1.9	4.8	2.2	1.3	7.3	6.9	3.7

Year	World	AEs	EMDEs	China	India
2012	3.5	1.2	5.4	7.9	5.5
2013	3.5	1.4	5.1	7.8	6.4
2014	3.6	2.1	4.7	7.3	7.4
2015	3.5	2.3	4.3	6.9	8.0
2016	3.4	1.7	4.6	6.7	8.2
2017	3.8	2.5	4.8	6.8	7.2
2018	3.6	2.3	4.5	6.6	6.8
2019	3.0	1.7	3.9	6.1	6.1

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Enigmas of the Indian Economy

Positives

- The fastest growing major economy globally
- Macroeconomic fundamentals within target
- Decoupled from EMDE growth in the post GFC period?
- Ranking in World Bank's 2019 'Ease of Doing Business' improved from 134 in 2014 to 63 in 2020.

Negatives

- Medium term headline growth rates out of synch with global and EMDE trends.
- High frequency indicators not aligned with headline GDP growth. Former CEA has estimated that Indian growth overestimated by 2.5%
- Five (six?) successive quarters of declining growth.
- Exports, investment and savings have been declining since the GFC. India never really recovered from the GFC?
- Moody's ratings outlook for India downgraded from stable to negative

EMDE Growth: 5 YrMA

Year	World	AEs	EMDEs	China	India
2012	3.2	0.6	5.5	9.4	6.9
2013	3.3	0.8	5.4	9.0	7.4
2014	4.1	1.9	5.8	8.6	7.2
2015	3.7	1.8	5.2	7.9	6.8
2016	3.5	1.7	4.8	7.3	7.1
2017	3.5	2.0	4.7	7.1	7.4
2018	3.6	2.2	4.6	6.9	7.5
2019	3.5	2.1	4.4	6.6	7.3

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Macro-economic fundamentals

- Macroeconomic fundamentals
 - Inflation, fiscal deficit, current account deficit, Rupee value
- Potential growth and business cycles.
- Gold standard: growth at potential rate with stable macroeconomic parameters. For India:
 - Fiscal deficit of Centre & States below 6%
 - Inflation at around 4%
 - CAD below 2%
 - Stable REER

India's Macroeconomic Fundamentals

	Real Growth	CPI	CAD	CFD	REER (6 currency)	Av. Repo	Asset Infl (Sensex)
2004-05	7.3%	4.0%	0.5%	7.2%	100	6.00%	-1.7%
2005-06	7.9%	4.2%	-0.4%	6.5%	104.45	6.15%	44.2%
2006-07	8.1%	4.6%	-0.8%	5.4%	103.82	6.98%	48.3%
2007-08	7.7%	6.4%	-1.1%	4.0%	113.4	7.75%	34.9%
2008-09	3.1%	9.0%	-2.2%	8.3%	103.94	7.33%	-25.4%
2009-10	7.9%	12.4%	-2.2%	9.3%	110.73	4.77%	26.0%
2010-11	8.5%	10.3%	-2.9%	6.9%	124.5	5.88%	19.4%
2011-12	5.2%	8.4%	-4.3%	7.8%	121.17	7.98%	-6.4%
2012-13	5.6%	10.4%	-4.8%	6.9%	117.15	8.00%	4.5%
2013-14	6.4%	9.7%	-1.7%	6.7%	112.8	7.54%	10.5%
2014-15	7.4%	6.3%	-1.3%	6.7%	119.92	7.92%	32.0%
2015-16	8.0%	5.6%	-1.1%	6.9%	122.71	7.04%	-0.9%
2016-17	8.2%	4.1%	-0.7%	7.0%	125.17	6.38%	3.9%
2017-18	7.2%	2.9%	-1.8%	6.6%	129.19	6.08%	18.5%
2018-19	6.8%	5.6%	-2.2%	5.9%	121.7	6.33%	11.0%

Engines of Growth

- Three basic engines:
 - Consumption
 - Investment
 - Exports
- $\text{GDP} = \text{National Income} = \text{Investment} + \text{Consumption} + (\text{Exports} - \text{Imports})$
 - The imported content of Investment and Consumption excluded from National Income.

Structure of the Indian Economy

Relative weights of Engines

- The relative importance of the three engines vary from country to country, reflecting structural differences in their economies.
- These weights may rebalance over time.

Economic Structure 2017/18

Country	Cons/GDP	Inv/GDP	Exports GS/GDP
China	54.2	44.4	19.5
India	67.5	30.6	19.7
Germany	72.0	20.1	47.0
Japan	72.0	24.0	17.8
United Kingdom	86.4	17.4	29.9
United States	81.7	20.6	12.1

IMF WEO Database and World bank database

Composition of Growth: 3 YMA

	PFCE	GFCE	Cons	GFCF	Xports of G&S	GDP
Years	Contribution to Growth at 2011-12 Prices					
2005-08	48%	9%	58%	54%	39%	7.9%
2006-09	46%	8%	54%	50%	50%	6.3%
2007-10	48%	9%	58%	54%	39%	6.2%
2008-11	57%	18%	75%	47%	54%	6.5%
2009-12	58%	23%	80%	42%	34%	7.2%
2010-13	54%	21%	75%	35%	44%	6.4%
2011-14	53%	13%	66%	49%	33%	5.7%
2012-15	60%	7%	67%	49%	48%	6.4%
2013-16	66%	5%	71%	38%	42%	7.3%
2014-17	57%	4%	61%	17%	22%	7.9%
2015-18	55%	6%	61%	13%	7%	7.8%
2017-19	54%	9%	62%	23%	1%	7.3%
Years	Growth Rate at 2011-12 Prices					
2005-08	6.6%	7.4%	6.7%	15.5%	17.4%	7.9%
2006-09	5.6%	8.3%	6.0%	11.1%	13.7%	6.3%
2007-10	5.6%	11.7%	6.5%	9.1%	5.3%	6.2%
2008-11	5.4%	10.3%	6.1%	7.3%	9.8%	6.5%
2009-12	6.4%	8.6%	6.7%	10.3%	10.0%	7.2%
2010-13	6.5%	4.1%	6.1%	9.4%	13.9%	6.4%
2011-14	6.7%	2.6%	6.1%	6.2%	10.0%	5.7%
2012-15	6.4%	2.9%	5.8%	3.0%	5.5%	6.4%
2013-16	7.0%	5.0%	6.7%	3.1%	1.3%	7.3%
2014-17	7.5%	7.0%	7.4%	5.8%	0.4%	7.9%
2015-18	7.9%	9.4%	8.1%	8.1%	1.4%	7.8%
2017-19	8.1%	10.3%	8.4%	9.7%	7.4%	7.3%

Debate over the Indian Economy

- The growth narrative debate
 - Revision of base year to 2011-12
- The Growth numbers debate
 - Various kinds of economic data inconsistent with GDP growth
 - 2/3 engines of growth sputtering since 2012-13
 - Consensus on economic slowdown is recent
 - 5 successive quarters of declining growth since Q1 2018-19
 - The third engine – consumption – also sputtering
- Debate over causes of slowdown:
 - Global factors? Cyclical? Structural?

Why the Debates Matters

- If the slowdown is cyclical/temporary, macroeconomic policies should get growth back on track.
- If the slowdown is structural, the decline becomes permanent through ‘hysteresis’, and structural reforms are required to raise growth potential.
- If the decline is attributed to decline in external demand, rebalancing the economy is required – what China is attempting to do.
- If growth is wrongly estimated, policy missteps are likely.

India's Economic Growth

Two Growth Narratives		
	<i>Original</i>	<i>2019</i>
2003-04	7.9%	
2004-05	7.9%	
2005-06	9.3%	7.9%
2006-07	9.3%	8.1%
2007-08	9.8%	7.7%
2008-09	3.9%	3.1%
2009-10	8.5%	7.9%
2010-11	10.3%	8.5%
2011-12	6.6%	5.2%
2012-13	4.5%	5.6%
2013-14	4.7%	6.4%
2014-15		7.4%
2015-16		8.2%
2016-17		8.0%
2017-18		7.2%
2018-19		6.8%
CSO, Ministry of Statistics and Programme Implementation, GOI		

Quarterly GDP Growth

	Q1	6.0%
	Q2	6.8%
	Q3	7.7%
2017-18	Q4	8.1%
	Q1	8.0%
	Q2	7.0%
	Q3	6.6%
2018-19	Q4	5.8%
	Q1	5%
	Q2	
	Q3	
2019-20	Q4	

External Factors?: Export Performance

Recent Export Performance (Goods and Services)								
Country	2012	2013	2014	2015	2016	2017	2018	Total
Vietnam	15.6	16.9	11	9.8	10.7	17	12.2	93.2
Bangladesh	6.1	14.9	8.1	9.2	10.7	4.1	6.8	59.9
China	5.9	8.8	4.3	-2.2	1.1	9.1	4	31
India	0.82	5.3	3.9	-5.3	6.7	9.9	4.7	26.0
<i>IMF WEO Database October 2019</i>								

Cyclical?: High Frequency Indicators

	2003/04-2007/08	2014/15-2018/19
Real GDP growth	7.8%	7.5%
Real GDP growth_wpi_cpi	9.0%	8.0%
Real Bank Credit growth	21.6%	7.5%
Real Tax Revenue Growth	13.1%	8.2%
IIP Growth	10.1%	3.8%
Export growth(US\$)	27.0%	3.3%
Electricity Growth (Bn Kw)	8.3%	6.2%
Rail Freight	6.9%	0.8%
Road Freight	10.2%	11.0%
Air cargo	10.5%	8.5%
Coal production	5.6%	2.0%
IAP growth	6.4%	0.3%
IT Market	26.2%	8%
Sensex inflation	25.9%	10.5%
FDI Net growth (\$)	56.2%	9.1%
Employment Growth	0.80%	-1%

Structural?: Shift in India's growth drivers

From Investment and Exports to Consumption

	Consumption	GFCF	Exports
Years	Average Annual Growth at 2011-12		
2005/06-2010/11	6.4%	11.4%	13.6%
2011/12-2018/19	7.2%	6.9%	6.1%

- Exports of Goods and Services have declined from 25% of GDP in 2011-12 to 21% in 2018-19.
- Gross Fixed Capital Formation has declined from 34% (GDCF 40%) of GDP in 2010/11 to 32% (GDCF 35%) in 2018-19.
- Consumption has increased from 66% of GDP in 2010/11 to 68 % in 2018/19
- Savings, especially household savings, have declined from 34.6 % of GDP in 2011-12 to 30.5% in 2018 (household from 23.6% to 17.2%)
- Bottomline: Single engine economic growth unsustainable over the medium to long run

Macroeconomic Policies for stabilizing growth

- Two basic tools
 - Fiscal policy and monetary policy
 - Can be stimulative, contractionary or neutral
 - Temporary in nature. Rolled back when the underlying instability is gone. Protracted use can be a source of instability (public debt/asset inflation).
- Fiscal Policy
 - Government's tax and expenditure policies, since government is the biggest consumer, investor and income transferor. Instrument: fiscal balance
- Monetary Policy
 - The domain of the central bank that sets the price of money. Instrument: repo rate.

Macroeconomic Policy Response

Policies remained tight till the first half of 2019 as both the central bank and the treasury were slow in recognizing, and therefore in addressing, the downturn:

Monetary Policy

- Five successive rate cuts by RBI since February 2019, bringing down the repo rate from 6.5% to 5.15% presently. Despite this, lending growth by banks halved from the beginning of the year to 8.8% by September end.
- Transmission channels weak because of frictions arising from Bank NPAs and administered Interest rates.
- More aggressive rate cuts can be expected in the near future: Assuming potential GDP growth to be 7%, current GDP to be 5%, target inflation at 4% and current inflation rate at 3.5%, the predicted policy rate according to the 'Taylor Rule' is 2.75%.

Fiscal Policy

- Keynes: "The boom, not the slump, is the right time for austerity at the Treasury." - John Maynard Keynes (1937) Collected Writings.
- Fiscal policy in tightening mode at the time of the union budget in June 2019. Several tax measures rolled back in end August 2019 as fiscal policy entered stimulative mode.
- Fiscal policy to stimulate consumption, and structural policies to revive investment, as fiscal space limited: headline FD numbers misleading because of
 - Off budget expenditure items
 - Structural and cyclical balances
- Timely exit (when private investment revives) to avoid 'crowding out'.

Recent Monetary Policy Trends

	Average repo rate	Average of WPI- CPI	Real repo rate	GDP old	GDP New
2003-04	7.0%	4.6%	2.4%	7.9%	
2004-05	6.0%	5.2%	0.8%	7.9%	
2005-06	6.1%	4.4%	1.8%	9.3%	7.9%
2006-07	7.0%	5.6%	1.4%	9.3%	8.1%
2007-08	7.8%	5.5%	2.2%	9.8%	7.7%
2008-09	7.3%	8.5%	-1.2%	3.9%	3.1%
2009-10	4.8%	8.1%	-3.3%	8.5%	7.9%
2010-11	5.9%	9.9%	-4.0%	10.3%	8.5%
2011-12	8.0%	8.7%	-0.7%	6.6%	5.2%
2012-13	8.0%	8.7%	-0.7%	4.5%	5.6%
2013-14	7.5%	7.5%	0.1%	4.7%	6.4%
2014-15	7.9%	3.8%	4.2%		7.4%
2015-16	7.0%	1.0%	6.1%		8.0%
2016-17	6.4%	2.9%	3.4%		8.2%
2017-18	6.1%	2.9%	3.1%		7.2%
2018-19	6.3%	4.9%	1.4%		6.8%
2019-20	5.6%				

Recent Fiscal Policy Trends

Exhibit 5: Adjusted deficit of the combined government was at a seven-year high of 8.8% of GDP in FY19...

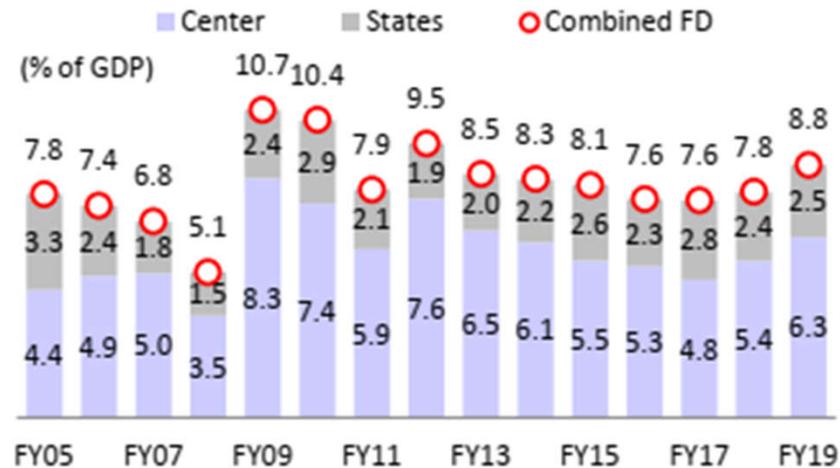
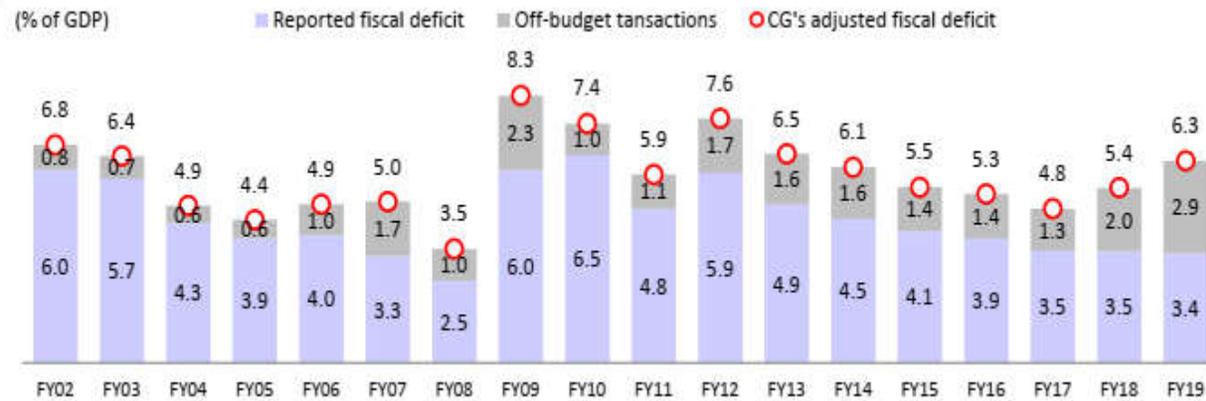


Exhibit 4: Adjusted fiscal deficit of the central government vis-à-vis reported fiscal deficit



Source: Union Budget documents, CGA, CAG, MOFSL

Structural Policies for raising growth potential

Illustrative 'laundry' List:

- Demonetization ?
- Tax reforms, such as GST and tax administration
- Improving hard and soft infrastructure
- Financial sector reform: Insolvency and Bankruptcy Code, 2016, Bank Mergers, cleaning up balance sheets, Improving the transmission channels of monetary policy, privatization of banks.
- Labour market reform and improving human capital
- Making the Indian economy regionally and globally competitive by making product, trade, agricultural trade, and land markets more open and free. Privatization of non-strategic public assets and companies.
- Institutional independence and data integrity
- Predictable policies in line with a pre-declared roadmap
- An economy driven by markets and private investment needs social harmony, light touch economic governance and arms length between Government and Corporates to fire animal spirits.

\$ 5 Trillion Economy by 2024-25?

Aggregate GDP

- Size of the Indian economy \$ 2.75 trillion in 2018-19 at Mkt exchange rates
- The economy grew at an annual average nominal rate of 11.1% between 2014-15 and 2019-20, with an average deflator of 3.6% (i.e 7.5% real growth), while the rupee depreciated @ 2.8% annually against US\$.
- Spreadsheet projections on the above assumptions indicate the following timelines for a \$ 5 Trillion economy :
 - 8 % (real) growth: March 2027
 - 7% growth: March 2028
 - 6% growth: March 2029-30
 - 5% growth: 2030-32
 - **10-10.8 % growth: 2024-25**

Per Capita GDP

- UN 2019 population projections
- WB definition of Low Middle Income of \$996-3895 annual per capita income, and Upper Middle Income of \$3896-12055 per capita.
- India's per capita income \$ 2020 in 2018
- Even if the \$5 Trillion GDP target of 2024-25 is achieved, Indian per capita income will remain in the low middle income range.
- Projected per capita income:
 - 2027-27: \$ 3157 (UMI 2029-30)
 - 2027-28: \$ 3027 (UMI 2032-33)
 - 2029-30: \$3055
 - 2031-32 : \$2978
 - **2024-25: \$3188 (UMI 2026-27)**

India: A large poor country

GDP Per Capita the single best measure of relative well-being of Nations

Economic Size 2019		
GDP at Market Exchange Rates		
Rank Market	US\$ Bn	Rank GDP per Capita
1 US	21482	8
2 China	14172	72
3 Japan	5221	26
4 Germany	4117	18
3 India	2958	145
GDP at Purchasing Power Parity (PPP)		
Rank PPP	US\$Bn	Rank GDP per Capita
1 China	27449	75
2 US	21482	12
3 India	11413	126

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Philippines
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Bhutan
Vietnam
Ghana
India
Bangladesh
Pakistan
Cambodia
Myanmar
Nepal
Afghanistan

(US dollars)

83,580
62,850
41,330
30,600
10,460
10,380
10,230
9,470
9,310
9,180
9,140
6,610
5,720
5,470
5,030
4,060
3,840
3,830
3,710
3,080
2,400
2,130
2,020
1,750
1,580
1,380
1,310
960
550