INSIGHT

The IMF's growth downgrade math

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The IMF's January 2020 World Economic Outlook (WEO) update created a stir among global policy makers, Indian political circles and in the Indian media, on account of the sharp downward revision of its estimate for Indian growth in 2019-20 over its earlier October 2019 estimate. The estimate for 2019-20 was lowered by 1.3 per cent, from 6.1 per cent to 4.8 per cent. The projection for 2020-21 was lowered by 1.2 per cent, from 7 per cent to 5.8 per cent, and for 2021-22 by 0.9 per cent, from 7.4 per cent to 6.5 per cent. This was by far the sharpest growth downgrade for any major economy.

The furore was amplified following an interview by the Indian journalist Rahul Kanwal with Gita Gopinath, chief economist at the IMF, where she reportedly said that over 80 per cent of the downgrade in global growth relative to the October 2019 WEO numbers was on account of India. It appeared that India was currently the major drag on the global economy.

There is an associated debate on the line of causation, whether India pulled down the global economy or, since India accounts for only a very small share of the global economy, whether India's growth itself was affected by the global downturn. The Economic Survey for the year 2019-20 and the Union Budget for 2020-21 appears to be of this view.

Where do matters stand? What is the underlying math?

The WEO numbers can be a bit confusing for non-specialists. First, the IMF makes country specific estimates and projections (forecasts) for economic growth, including overall global growth, twice each year in April and October, through its iconic World Economic Outlook. The estimates are for the current year, and are based on observed data available to date. The projections are for the following years, and not nearly as reliable as the estimates. The estimates and projections for major countries, as well as for the world as a whole, are updated twice a year, in July and January.

Second, the WEO has separate calculations for GDP at Market Exchange Rates, and at Purchasing Power Parity. The former is done by converting the national income, calculated in local currency, into US dollars at market rates of exchange. The latter is based on the assumption that ₹70 (the approximate current valued of one US dollar) has more purchasing power in India than one dollar in the US. In its statistical appendix to the WEO the GDP calculations are at market prices, whereas the growth rates are real. So GDP deflators also come into play.

The growth rates being debated are those at Purchasing Power Parity. The accompanying table has therefore taken the GDP figures at PPP for both India and the World for the year 2017-18, available in the October 2019 IMF WEO database, as the base, and used the growth rates contained in the October 2019 WEO and the January 2020 update for the calculations.

GROWTH RATES AT PURCHASING POWER PARITY

	Actual	Estimate 2019		Projection 2020		Projection 2021	
	2018	Oct 19	Jan 20	Oct 19	Jan 20	Oct 19	Jan 20
India	6.8 %	6.1 %	4.8 %	7.0 %	5.8 %	7.4 %	6.5 %
World	3.6 %	3 %	2.9 %	3.4 %	3.3 %	3.6 %	3.4 %
GDP at PPP (US $)							
India	10,485	11,125	10,989	11,904	11,626	12,784	12,382
World	135,436	139,499	139,364	144,242	143,963	149,435	148,857
Change in growth in WEO January over October 2019							
India			-1.3 %		-1.2 %		-0.9 %
World			-0.1 %		-0.1 %		-0.2 %
Change in GDP in WEO January over October 2019 (US $ bn)							
India			-136		-278		-403
World			-135		-279		-577
Aggregate change in WEO January over October 2019 (US $ bn)							
India	-817	World	-992	India's share			82 %

Based on IMF World Economic Outlook

India comprises just 3.2 per cent of the global economy at Market Exchange Rates, and a 1 per cent or so downgrade in its growth may appear too insignificant to impact global growth. However its share of the global economy is significantly higher at PPP, amounting to 7.7 per cent in 2017-18. If one were to factor in the debate relating to the discrepancy between high frequency data and recent Indian GDP estimates, the impact on global growth would be even higher. The IMF, it may be noted, relies on the country's own statistical system for National Income numbers.

The calculations in the table (*Growth rates at purchasing power parity*) indicate that the downgrades in India's estimated growth in 2019-20, and projected growth in 2020-21 are exactly equal to the aggregate global downgrades. India's contribution to the near-term global growth downturn is therefore 100 per cent. It is when the estimate for 2019-20, and projections for 2020-21 and 2021-22, are taken together that India's share in the global downturn comes to 82. This matches the number given by IMF's Gopinath, who is quoted as having said "simple calculation says it would be over 80 per cent".

India's contribution to the current worsening global economic outlook is therefore very substantial when measured at PPP.

IMF's projections show the Indian economy recovering relatively well from 2020-21: "The growth markdown largely reflects a downward revision to India's projection, where domestic demand has slowed more sharply than expected amid stress in the non-bank financial sector and a decline in credit growth. India's growth is estimated at 4.8 per cent in 2019, projected to improve to 5.8 per cent in 2020 and 6.5 per cent in 2021 (1.2 and 0.9 percentage point lower than in the October WEO), supported by monetary and fiscal stimulus as well as subdued oil prices."

This conclusion is puzzling, since it points to structural problems (stresses in the financial system) as the primary cause of the slowdown, and yet it expects macroeconomic (fiscal and monetary) policies to put the economy on the path to recovery. Macroeconomic policies can however address only cyclical problems. Five reductions in the benchmark repo interest rate over a short period by the RBI have done little to lower lending rates or revive the credit cycle. With fiscal space constrained because of low growth and problems with the tax system, the 2020-21 Union Budget also has little stimulus on offer.

Structural problems need structural solutions, such as smoothening frictions in the financial and taxation systems. These were not on offer in the 2020-21 Budget. Moreover, a market economy is dependent on the animal spirits of private investors, and not on command and control, for growth. For this a clear roadmap and assurance of stability in economic policy going forward, the perception that crucial institutions of governance are at arm's length from the state, and continued social harmony, are sine qua non. Macroeconomic policies on their own are unlikely to revive growth to anywhere near former levels as India's growth potential itself has possibly declined on account of lingering structural problems.

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