

**High-level Regional Policy Dialogue on
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challenges for building resilience, and issues for global reform"**

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Presentation

**India: Lessons Learnt and Current Challenges after Global
Financial Crisis**

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Contents of the Presentation

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- What are the lessons learnt from the crisis?
- What are the reasons for resilience ? The roles of monetary, fiscal, prudential financial regulations and capital flows management?
- What are the current Challenges?
- Inflation trends and policy measures for containing inflation.
- Growth vs. Inflation
- What is the impact of slowdown in US?
- What are the medium term challenges?

Impact of the Crisis

- Compared East Asian Crisis period, India is more integrated with the world during the recent crisis.
- Trade integration: India's two way trade (merchandise exports plus imports) as a proportion of GDP more than doubled.
- It increased from 19.6% in 1998-99, the year of Asian crisis to 40.7% in 2008-09.
- If our trade integration is deep our financial integration was even deeper.
- Ratio of external transactions (gross current account flows plus gross capital account flows) to GDP had more than doubled from 44% in 1998-99 to 112% in 2008-09.

Impact of the Crisis

- Crisis transmitted through three principal channels
 - Direct effect on financial institutions
 - Liquidity problem and choking of credit
 - Impact on real sector
- India has largely escaped the first transmission
- Impact on real economy: GDP, manufacturing, services, private consumption
- Impact on balance of payments: Exports, Current account and capital account
- India is affected through low confidence channel

Impact of the Crisis

- Output growth which averaged 9.5% per annum during 2005-08 dropped to 6.8 % in the crisis year 2008-09.
- Exports which grew at 25% during 2005-08 decelerated to 13.6% in 2008-09 and showed negative growth of -3.5 2009-10.
- Capital flows also got affected and put pressure on exchange rate.
- The exchange rate depreciated from Rs.39.4 per dollar in Jan2008 to Rs.51.2 per dollar in March 2009.

Response to the Crisis

- India's counter-cyclical fiscal stimulus started much before the start of the crisis. It started in Feb.2008
- Farm loan waiver (debt relief package), higher salaries to govt. employees following Sixth Pay Commission Report, higher expenditure on national rural employment guarantee scheme (NREGS), increase in minimum support prices for farmers. Fiscal deficit increased.
- Although they were not intended as fiscal stimulus, the measures became handy during the crisis. They created rural demand. It generated demand for particular industrial products.

Response to the Crisis

- Three fiscal stimulus packages were announced during December 2008 to Feb.2009. Overall fiscal stimulus of 3.5% of GDP.
- Monetary Policy: RBI's action comprised monetary accommodation and counter cyclical regulatory measures
- RBI's successive policy announcements reduced repo and reverse repo rates.
- Repo rate declined from 9% in July 2008 to 4.75% in April 2009. Cash Reserve ratio declined from 9 to 5%.
- Govt. also announced specific measures to address the impact of global slowdown on exports.
- Govt. did not intervene in foreign exchange market

Main factors responsible for Resilience

- India's growth rate increased significantly from 6.8% in 2008-09 to 8% in 2009-10.
- Exports growth in 2010-11 was 37.5%.
- What are the reasons for a quick rebound and resilience of Indian economy?
- Monetary policy, fiscal policy, export policies and some of structural advantages including calibrated approach to capital convertibility etc. helped for quick recovery and resilience.
- The details of monetary policy indicates that RBI targeted three objectives: (a) to maintain comfortable rupee liquidity (b) augment foreign exchange liquidity; (c) a policy that would keep credit delivery on track.

Response to the challenge

- Like any central bank, RBI used both conventional and unconventional measures.
- Taken together, the measures put in place since mid-September 2008 have ensured that the Indian financial markets continue to function in an orderly manner. About 7% of GDP as liquidity.
- There are also several structural factors that have come to India's aid. (RBI, 2009)
 - First, In spite of adverse shocks, India's financial markets have shown admirable resilience.
 - This is in large part because India's banking system remains sound, healthy, well capitalized and **prudently regulated**.

Reasons for Resilience

- Second, our comfortable reserve position provided confidence to overseas investors.
- Third, majority of Indians do not participate in equity and asset markets, the negative impact of wealth loss effect is muted. Consumption demand not affected.
- Fourth, because of India's mandatory priority sector lending, institutional credit for agriculture has remained unaffected.
- Fifth, India has many safety net programmes including the Mahatma Gandhi National Rural Employment Guarantee Scheme (MGNREGS).
- These uniquely Indian version of automatic stabilizers have also protected the poor from the extreme impact of the global crisis.

Lessons of the Crisis for India and other Emerging Economies (D.Subbarao, 2011).

- 1. In a globalizing world, decoupling does not work
- 2. Global imbalances need to be redressed for the sake of global stability
- 3. global problems require global co-ordination
- 4. price stability and macro economic stability do not guarantee financial stability
- 5. Microprudential regulation and supervision need to be supplemented by macroprudential oversight.
- 6. Capital controls are not unavoidable but advisable in certain circumstances
- 7. Economics is not Physics
- 8. Having a sense of economic history is important to prevent and resolve financial crisis

Current Challenges

- **Inflation:** It is major source of concern in India. Headline inflation increased from negative levels in mid-2009 to double digits during March-July 2010. It averaged 9.6% in 2010-11.
- Inflation for food articles was 15.3% and 15.6% respectively in 2009-10 and 2010-11.
- In the second half of 2010-11, high consumption demand, it spread to manufactured products.
- Domestic supply problem, increase in demand and increase in crude oil prices are responsible.
- India responded with tightening of monetary policy: RBI increased ten times from 4.75% in April 2009 to 8.00% in July 2011.
- Protein inflation as consumption patterns changed. Supply problems in agriculture

Inflation

Commodities	2006-07	2007-08	2008-09	2009-10	2010-11
All	5.42	4.66	8.1	3.8	9.6
Primary	7.85	7.61	11.0	12.7	17.7
Food Articles	7.78	7.78	9.1	15.3	15.6
Fuel and Power	5.61	0.93	11.6	-2.1	12.3
Manufacture	4.43	4.97	6.2	2.2	5.7
--Food products	3.22	4.27	8.7	13.5	3.7

Inflation and Economic Growth

- There is a debate in India on the instruments needed for controlling inflation. According to some, Monetary policy may not be the right one.
- Fiscal policy and supply side are important.
- Due to monetary tightening, investment demand got affected although consumption demand is less affected. It has adverse impact on growth.
- The first quarter GDP growth 2011-12 is 7.7% compared to 8.8% last year same quarter.
- Rising interest rates, high inflation and global uncertainty has affected growth.
- But RBI's view: Short term there would be trade-off between growth and inflation. In the medium term, there would be low inflation with high growth.

Economic Growth

Sector	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
GDP	9.6	9.3	6.8	8.0	8.5	<u>8.2</u>
Agri-	4.2	5.8	-0.1	0.4	6.6	<u>3.0</u>
Industr y	12.2	9.7	4.4	8.0	7.9	<u>7.1</u>
Manuf actur	14.3	10.3	4.2	8.8	8.3	<u>7.0</u>
Servic es	10.1	10.3	10.1	10.1	9.4	<u>10.0</u>

Balance of Payments

- Current Account Deficit: Improved to 2.6% in 2010-11 from 2.8 in 2009-10.
- This improvement came about by cyclical upswing in global trade and turn around in invisibles.
- Export growth was 37.4% in 2010-11 and 46% in the first quarter of 2011-12.
- Diversification of trade in terms of composition as well as destination helped in achieving strong export performance. The share of exports to US and Europe declined over time.
- FDI flows are also reasonably good for India. In this fiscal, they are expected to be higher than portfolio investment.
- Capital account balance is positive 3.6% of GDP

What is the Impact of Downgrading of US

- More than downgrade, what is important is the slow pace of recovery in the US and Europe.
- It will have implications for trade and capital flows
- India's growth rate is predicated more on domestic strengths (domestic demand and consumption)
- There could be some impact on exports if slowdown in global growth is sharp.
- Regarding capital flows, the impact is more difficult to predict.
- It depends on the degree of risk aversion among several other factors. On the other hand, capital flows to India could still increase in spell as relative returns in EMEs could be high.

Balance of Payments (in US \$ billion)

Items	2007-08	2008-09	2009-10	2010-11	2011-12proj
Exports	166.2	189.0	182.2	250.5	330.2
Imports	257.6	307.7	300.6	380.9	484.2
Trade Balance	-91.5	-118.7	-118.4	-130.5	-154.0
TB% GDP	-7.4%	-9.7%	-8.5%	-7.5%	-7.7%
CA balance	-15.7	-28.7	-38.4	-44.3	-54.0
CA as% of GDP	-1.3	-2.3	-2.8	-2.6	-2.7
Private remitta.	41.7	44.6	53.5	53.4	55.5
inbound FDI	34.2	35.0	33.1	23.4	35.0
Portfolio capit	29.6	-14.0	32.4	30.4	14.0
CapA.Balan ce as % of GDP	8.7%	0.7%	3.9%	3.6%	3.6%

Fiscal Deficit Problem

- The Centre's fiscal deficit which was 2.6% in 2007-08 increased to 6% in 2008-09 and to 6.4% in 2009-10 and declined to 5.1% in 2010-11.
- The combined (centre+states) in 2010-11 was 7.7%.
- On current assessment, the fiscal deficit in 2011-12 is likely to overshoot the budget projections of 4.6% for the Centre.
- Fiscal space to support any counter-cyclical policies is limited.
- More enduring fiscal consolidation strategy required: restraining subsidies, implementation of Direct Tax Code(DTC) and Goods and Services Tax (GST) need to be put in place.

Fiscal Deficit and Outstanding Liabilities

Year	Gross Fiscal Deficit			Outstanding Liabilities		
	centre	state	combined	centre	states	combined
2007-08	2.6	1.5	4.1	56.9	26.6	71.4
2008-09	6.0	2.4	8.5	56.6	26.3	72.1
2009-10	6.4	2.9	9.3	53.7	25.0	69.2
2010-11 (Revised)	5.1	2.6	7.7	49.9	23.0	64.3
2011-12 (budget)	4.6	2.2	6.8	48.5	22.4	63.0

Medium Term Challenges

- Lowering Inflation and Inflation Level Expectations.
- Harnessing technology for agriculture productivity investment
- Maintaining right balance between consumption and investment
- Facilitating Energy Security
- Facilitating Infrastructure Finance
- Fiscal consolidation
- Promoting Financial Inclusion and inclusive growth

THANK YOU