

The Indian Economy

94th Foundation Course for AIS and CCS Officers
Dr Marri Channa Reddy HRD Institute, Hyderabad,
Telengana
September 17, 2019

Dr Alok Sheel
RBI Chair Professor in Macroeconomics
Indian Council for Research in International Economic
Relations
New Delhi

Contents

- **The World Economy and Outlook**
- **Drivers of Growth**
- **Macroeconomic Fundamentals**
- **Macroeconomic Policies and Structural Reform**
- **India's Economic Growth**

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

IMF World Economic Outlook October 2018

GDP per capita 2018, Atlas method (WB)

Ranking	Economy	(US dollars)	
CHE	1	Switzerland	83,580
USA	6	United States	62,850
GBR	22	United Kingdom	41,330
KOR	30	Korea, Rep.	30,600
MYS	67	Malaysia	10,460
TUR	68	Turkey	10,380
RUS	69	Russian Federation	10,230
CHN	71	China	9,470
MDV	73	Maldives	9,310
MEX	74	Mexico	9,180
BRA	75	Brazil	9,140
THA	87	Thailand	6,610
ZAF	94	South Africa	5,720
IRN	98	Iran, Islamic Rep.	5,470
IRQ	102	Iraq	5,030
LKA	116	Sri Lanka	4,060
IDN	120	Indonesia	3,840
PHL	121	Philippines	3,830
PSE	123	West Bank and Gaza	3,710
BTN	132	Bhutan	3,080
VNM	139	Vietnam	2,400
GHA	142	Ghana	2,130
IND	144	India	2,020
BGD	151	Bangladesh	1,750
PAK	155	Pakistan	1,580
KHM	160	Cambodia	1,380
MMR	163	Myanmar	1,310
NPL	168	Nepal	960
AFG	183	Afghanistan	550

IMF: World Economic Outlook July 2019 Update

Table 1. Overview of the *World Economic Outlook* Projections
(Percent change, unless noted otherwise)

	Year over Year			
	2017	2018	Projections	
			2019	2020
World Output	3.8	3.6	3.2	3.5
Advanced Economies	2.4	2.2	1.9	1.7
United States	2.2	2.9	2.6	1.9
Euro Area	2.4	1.9	1.3	1.6
Germany 3/	2.2	1.4	0.7	1.7
France	2.3	1.7	1.3	1.4
Italy	1.7	0.9	0.1	0.8
Spain	3.0	2.6	2.3	1.9
Japan	1.9	0.8	0.9	0.4
United Kingdom	1.8	1.4	1.3	1.4
Canada	3.0	1.9	1.5	1.9
Other Advanced Economies 4/	2.9	2.6	2.1	2.4
Emerging Market and Developing Economies	4.8	4.5	4.1	4.7
Commonwealth of Independent States	2.2	2.7	1.9	2.4
Russia	1.6	2.3	1.2	1.9
Excluding Russia	3.5	3.9	3.5	3.7
Emerging and Developing Asia	6.6	6.4	6.2	6.2
China	6.8	6.6	6.2	6.0
India 5/	7.2	6.8	7.0	7.2
ASEAN-5 6/	5.3	5.2	5.0	5.1
Emerging and Developing Europe	6.1	3.6	1.0	2.3
Latin America and the Caribbean	1.2	1.0	0.6	2.3
Brazil	1.1	1.1	0.8	2.4
Mexico	2.1	2.0	0.9	1.9
Middle East, North Africa, Afghanistan, and Pakistan	2.1	1.6	1.0	3.0
Saudi Arabia	-0.7	2.2	1.9	3.0
Sub-Saharan Africa	2.9	3.1	3.4	3.6
Nigeria	0.8	1.9	2.3	2.6
South Africa	1.4	0.8	0.7	1.1
<i>Memorandum</i>				
Low-Income Developing Countries	4.7	4.9	4.9	5.1
World Growth Based on Market Exchange Rates	3.2	3.0	2.7	2.9
World Trade Volume (goods and services) 7/	5.5	3.7	2.5	3.7
Advanced Economies	4.4	3.1	2.2	3.1
Emerging Market and Developing Economies	7.4	4.7	2.9	4.8

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.

Drivers of growth country specific

Relative weights of Engines

- The relative importance of the three engines vary from country to country, reflecting structural differences in their economies.

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

Recent shifts in India's growth drivers

From three engines to single?

Average annual nominal growth

	<i>Consumption</i>	<i>Investment</i>	<i>Exports</i>
2004/05 - 2010/11	15%	17%	21%
2011/12 - 2018/19	13%	9%	9%

- Exports of Goods and Services have declined from 25% of GDP in 2013-14 to less than 20% presently.

- Gross Domestic Capital Formation has declined from 36% of GDP in 2007/08 to below 30% presently

- Consumption has increased from 66% of GDP in 2010/11 to over 70% presently

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%

External Deficits and Capital Stops in 2008 and 2013

Country	Depreciation		Depreciation	
	7/8/08 -10/8/08	CAB/GDP 2008	22/7/13 -30/8/13	CAB/GDP 2013
Australia	45.5%	-4.5%	9.2%	-3.7%
Brazil	50.0%	-1.7%	15.6%	-2.3%
China	3.0%	9.3%	-0.3%	2.6%
India	19.0%	-2.4%	19.8%	-5.1%
Indonesia	28.7%	0.1%	11.9%	-2.8%
Mexico	35.0%	-1.7%	8.4%	-0.8%
South Africa	58.1%	-7.2%	3.7%	-6.3%

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	5.8%				

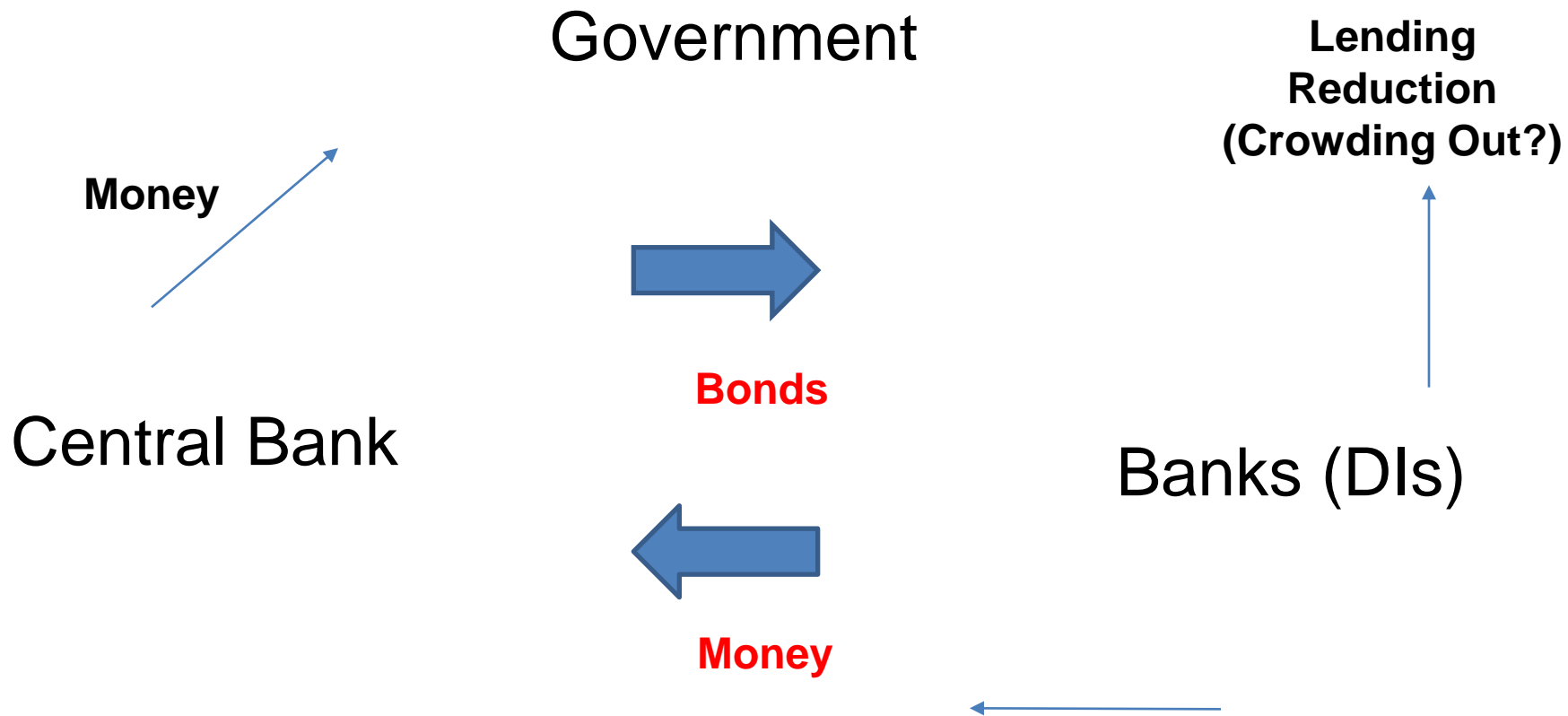
Macroeconomic Policies for stabilizing growth

- 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, as protracted use a source of instability on its own.
- Fiscal Policy
 - Government's tax and expenditure policies, since government is the single biggest consumer and investor. Instrument: fiscal deficit.
- Monetary Policy
 - The domain of the central bank that sets the price of money. Instrument: repo rate.

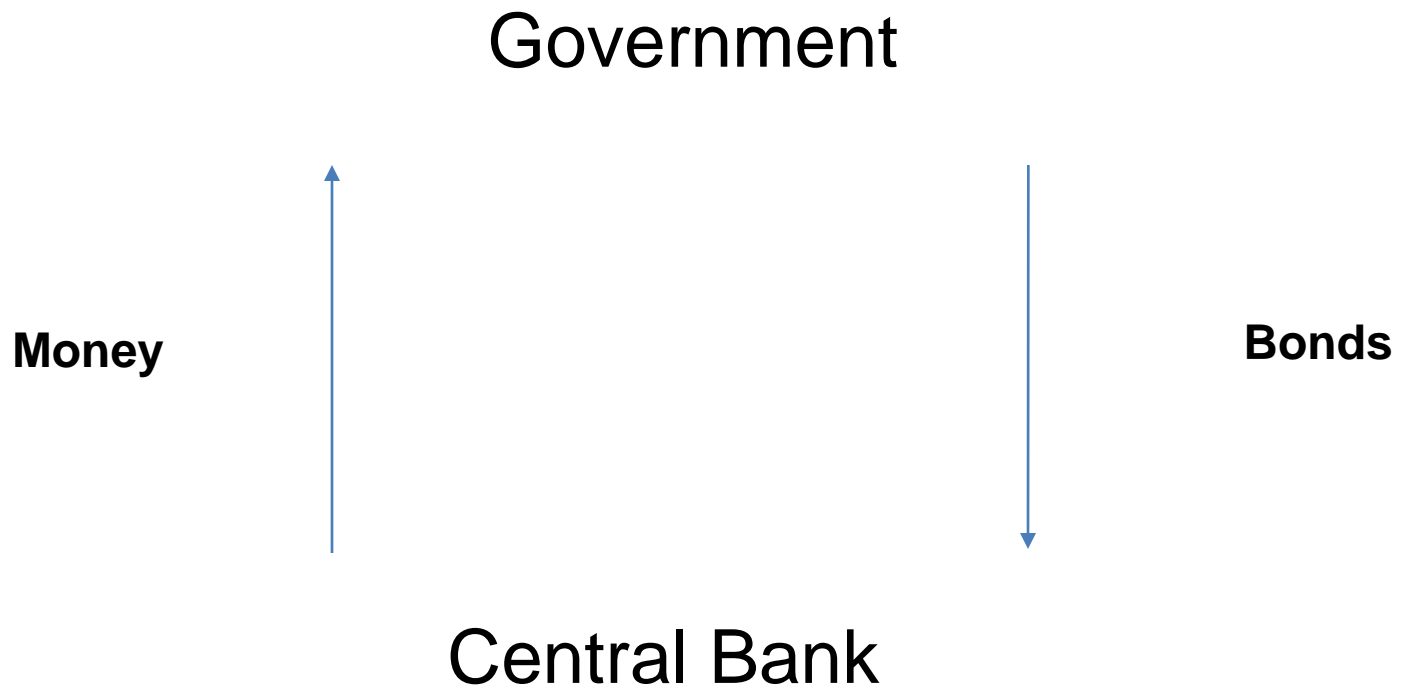
Fiscal and Monetary Policy

- Rise and dominance of **fiscal policy** traced to the **Keynesian Revolution** in the aftermath of the Great Depression of the 1930s.
- Dominance of **monetary policy** traced to the **Stagflation** of the 1980s.
- **Fiscal policy an eminently political tool** (within the executive domain) making for easy entry and difficult exit.
- The consensus in advanced economies is for **monetary policy** as the **first line of defence**, with fiscal policy moving from discretionary to automatic stabilizers.
 - Monetary policy **constrained by ZLB**, at which point fiscal policy takes over?
- **Developing countries more dependent on fiscal policy** on account of weak transmission channels of monetary policy on account of less developed financial markets.
- **Central bank independence:**
 - **Critical for market economies** dependent on pvt investment
 - **Formal:** Executive not giving policy direction to central banks
 - **Effective:** Unpleasant arithmetic and fiscal dominance

Fiscal Policy (Debt Financed)



Fiscal Policy (Money Financed)



Structural Policies for raising growth potential

- Illustrative List:
 - Macroeconomic policies are temporary and
 - Demonetization
 - Tax reforms, such as GST, permanently lowering rates
 - Insolvency and Bankruptcy Code, 2016.
 - Bank Mergers
 - Labour reforms
 - Making trade and investment more open and free

India's Economic Growth

Global Growth

Adv

World Econs EMDEs India

1980-01	3.2	2.9	3.7	
2002-07	4.5	2.5	7.1	
2003	3.7	1.9	6.3	
2004	4.9	3.1	7.5	
2005	4.6	2.6	7.3	
2006	5.3	3	8.2	
2007	5.4	2.8	8.7	
2008	2.8	0.1	6.1	
2009	-0.6	-3.5	2.7	
2010	5.4	3.1	7.4	
2011	4.3	1.7	6.4	
2012	3.5	1.2	5.3	
2013	3.5	1.4	5.1	
2014	3.6	2.1	4.7	
2015	3.5	2.3	4.3	
2016	3.4	1.7	4.6	
2017	3.8	2.4	4.8	
2018	3.6	2.2	4.5	
2019	3.2	1.9	4.1	
2004-07	5.1	2.9	7.9	9.1/7.9
2011-13	3.8	1.4	5.6	5.3/5.7
2014-18	3.6	2.1	4.6	7.5

IMF, WEOs

2019 WEO July Update

Table I: Three Growth Narratives

	Original	2015-2018	2019
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%	5.5%	5.6%
2013-14	4.7%	6.4%	6.4%
2014-15		7.4%	7.4%
2015-16		8.2%	8.0%
2016-17		7.1%	8.2%
2017-18			7.2%
2018-19			6.8%

CSO, Ministry of Statistics and

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	

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
- Consensus on economic slowdown
 - 5 successive quarters of declining growth
- Debate over causes of slowdown:
 - Cyclical?
 - Structural?

GDP vs Other Indicators

	2003/04-2007/08	2014/15-2018/19
Real GDP growth	7.8%	7.5%
Avg_WPI-CPI	5.1%	3.1%
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 Kwh) - Ex. Domestic	8.3%	6.2%
Rail Freight Growth (Bn Ton Km)	6.9%	0.8%
Road Freight Growth (Bn Ton Km)	10.2%	11.0%
Air cargo growth (Tons)	10.5%	8.5%
Coal Lignite production growth (Tons)	5.6%	2.0%
IAP growth	6.4%	0.3%
IT Market Growth (\$)	26.2%	8%
FDI Net Growth (\$)	56.20%	9.10%

Target of \$ 5 Trillion Economy by 2024-25

Aggregate GDP

- Size of the Indian economy \$ 2.47 trillion in 2018-19
- The economy grew at an annual average nominal rate of 11.1% between 2014-15 and 2019-20, while the rupee depreciated @ 2.8% annually against US\$, yielding an annual average growth rate of 8.3% in dollar terms.
- \$ 5 Trillion economy:
 - 8.3 % growth: 2026-27
 - 7% growth: 2027-28
 - 6% growth: 2029-30
 - 5% growth: 2031-32
 - **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:
 - 2067-27: \$ 3157 (UMI 2029-30)
 - 2027-28: \$ 3027 (UMI 2032-33)
 - 2029-30: \$3055
 - 2031-32 : \$2978
 - **2024-25: \$3188 (UMI 2026-27)**