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Session 1 – Stimulating and Sustaining Growth, Building Resilience: the Role of Macroeconomic Policies

Stimulating Growth, Inclusiveness and Resilience: Lessons from India's experience

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Stimulating Growth, Inclusiveness and Resilience: Lessons from India's experience

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- Impact of the crisis and lessons learnt
- What are the reasons for resilience during and 2009-10 and 2010-11? The roles of monetary, fiscal, prudential financial regulations and capital flows management?
- What are the current Challenges since 2010-11?
- How India wants to come out of the current challenges and stimulate growth?
- Inclusive growth policies.
- Impact of high food inflation and policies
- Energy challenges and policies

Impact of the Crisis

- Compared to East Asian Crisis period, India is more integrated with world during the recent crisis.
- Trade integration: Merchandise exports plus imports as a proportion of GDP more than doubled. From 19.6% in 98-99 to 40.7% in 2008-09
- 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.
- Output growth which averaged 9.5% during 2005-08 dropped to 6.7% in the crisis year 2008-09. Adverse impact on exports and exchange rate.

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. But, 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: Central Bank, Reserve Bank of India (RBI) 's action comprised monetary accommodation and counter cyclical regulatory measures
- RBI's successive policy announcements reduced repo and reverse repo interest 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.

Main factors responsible for Resilience

- India's growth rate increased significantly from 6.8% in 2008-09 to 8.4% 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, Inspite 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, India's 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 affe.
- Fouth, 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.

Current challenges: Growth, Inflation, Twin Deficits

- After showing resilience, growth moderated, increase in inflation, current account deficit and fiscal deficit in 2011-12 and 2012-13 due to global (Eurozone problem) and domestic factors
- **Growth Story**:
- India's growth rate during 5 year period 2003 to 2008 was more than 8% per annum
- What drove India's growth in the pre-crisis period?
- Massive increase investment . Gross domestic capital formation increased from 25% in 2002-3 to 39% in 2007-08. Rise in productivity also.

Macro challenges

- Exports grew from 15% of GDP in 2003 to 23% in 2008.
- As mentioned above, with financial crisis, growth declined to 6.7% in 2008-09 before showing resilience in 2009-10 and 2010-11 (8.4% growth)
- External and domestic factors led to lower growth in 2011-12 (6.5%) and expected to be between 6.5% in 2012-13. Independent estimates put 6 or below 6%.
- Apart from global factors, it was viewed, policy paralysis at the Centre due to coalition politics and governance problems led to decline.
- Investment rate declined. Private consumption also moderated. Tightening of monetary policy was partly responsible for the decline.

GDP growth

Annual Rates	2005-6 to 2007-8 (average)	2008-09	2009-10	2010-11	2011-12	2012-13 (projections)
GDP	**9.5**	**6.7**	**8.4**	**8.4**	**6.5**	**6.7**
Agri.	5.0	0.1	1.0	7.0	2.8	0.5
Manuf.	11.6	4.3	9.7	7.6	2.5	4.5
Industr.	10.5	4.4	8.4	7.2	3.4	5.3
Servic.	10.4	10.0	10.5	9.3	8.9	8.9

Macro challenges

- Inflation increased significantly.
- Reasons for inflation: Food inflation, fiscal deficit, demand increase, oil prices
- Food inflation (also structural problem; protein inflation).
- Fiscal deficit increased since the financial crisis.
- Current account deficit also increased significantly to 4.2% of GDP due to decline in exports and increase in imports (increase in oil prices and increase in gold imports).
- Depreciation of rupee by 19% between June 2011 to June 2012

Table 2. Inflation for Commodity groups

Commodities	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012 August
All	5.42	4.66	8.1	3.8	9.6	8.9	7.56
Primary	7.85	7.61	11.0	12.7	17.7	9.8	10.1
Food Articles	7.78	7.78	9.1	15.3	15.6	7.3	9.1
Fuel and power	5.61	0.93	11.6	-2.1	12.3	14.0	8.3
Manufacture	4.43	4.97	6.2	2.2	5.7	7.3	6.1
Manu. Food products	3.22	4.27	8.7	13.5	3.7	7.1	9.0

Year	Gross Fiscal Deficit		
	Centre	States	Combined
2007-08	2.5	1.5	4.0
2008-09	6.0	2.4	8.5