

# The macroeconomic situation

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# The problems

1. Inappropriate monetary policy from 2002 onwards has given a sustained inflation crisis from 2/2006 onwards.
2. Strong recovery after 2008/2009
3. Monetary and fiscal stimulus was overdone
4. Pranab Mukherjee's period (1/2009 to 6/2012)
5. Corruption scandals → collapse of investments linked to government
6. Collapse of confidence
7. Balance sheet effects also hamper investment
8. Collapse of private investment
9. Capital flows faltered + inappropriate rupee defence: made things worse.

The outcome: A pronounced business cycle downturn.

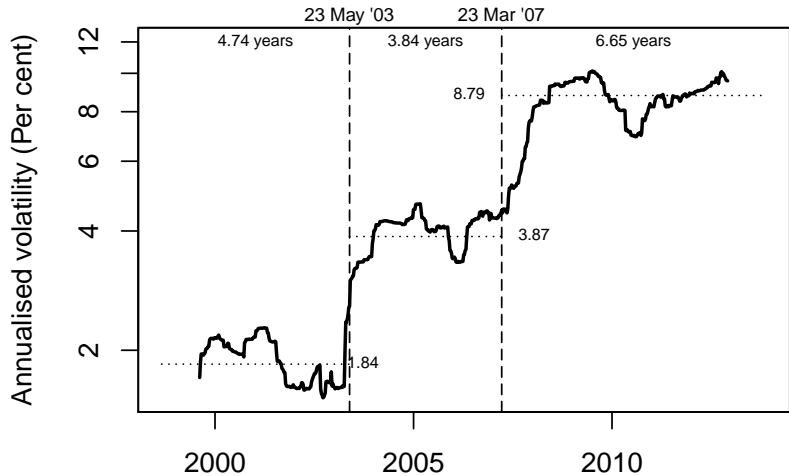
# Part I

## The rupee defence

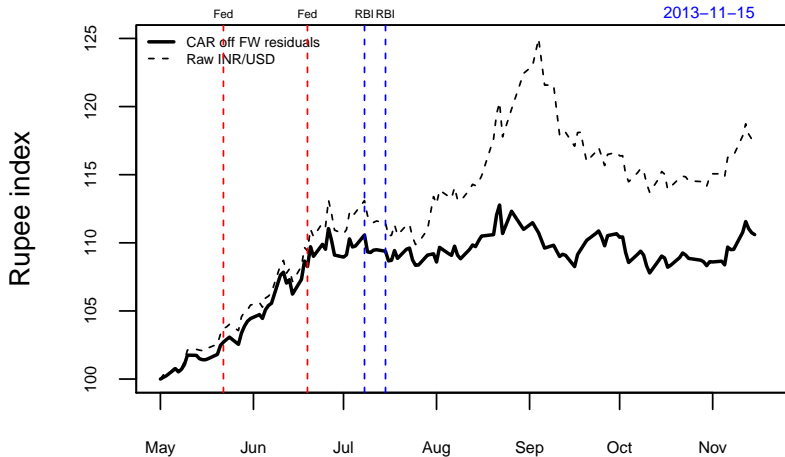
# Strong depreciation of the rupee in recent years



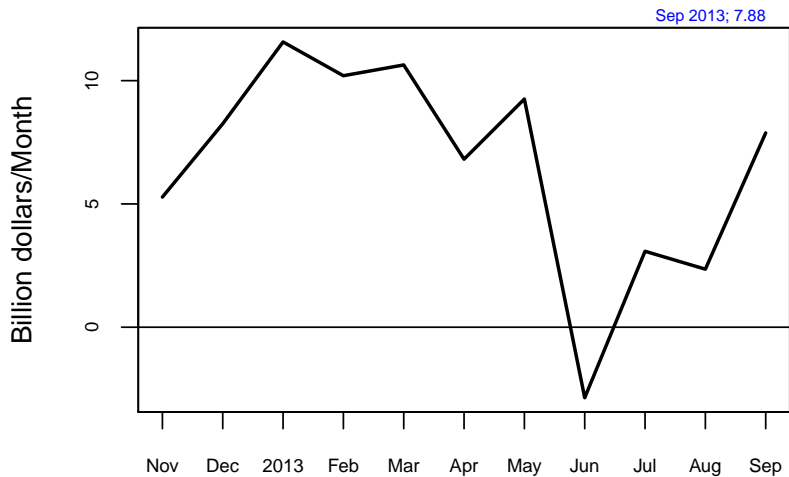
# The context: transition into a floating exchange rate



# Most of the India-specific depreciation was *after* RBI actions



## Capital flows have improved



## Part II

# Business cycle downturn



# Measurement

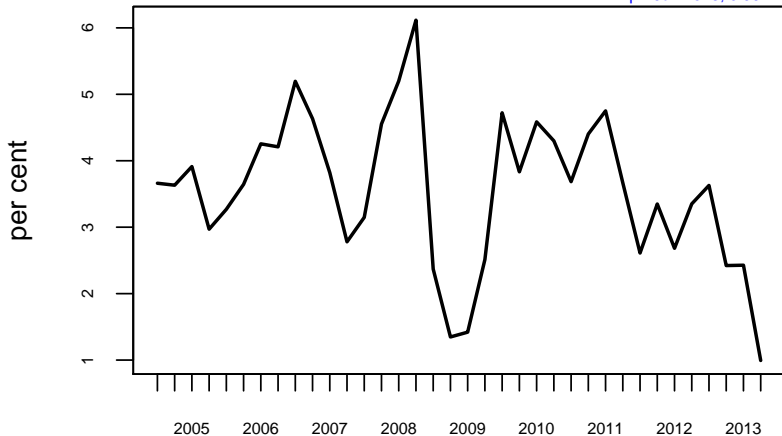
- ▶ GDP non-agriculture non-government is a good measure of what's going on in Indian capitalism.  
Observed till Apr-May-Jun quarter.
- ▶ Nominal measure – for large firms only – using performance of listed firms where quarterly results are available.  
Non-finance non-oil firms only.

Incomplete results for Jul-Aug-Sep quarter visible. Upward bias?

# Real GDP growth has done very badly

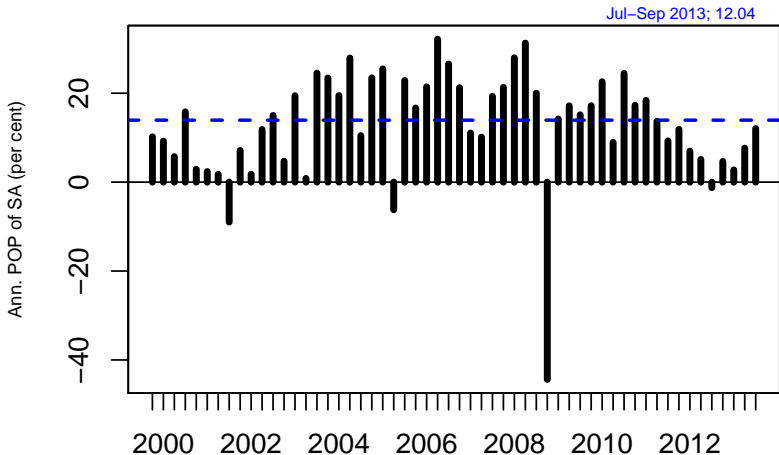
Q-o-q of SA real GDP (non-agri non-government)

Apr-Jun 2013; 0.99



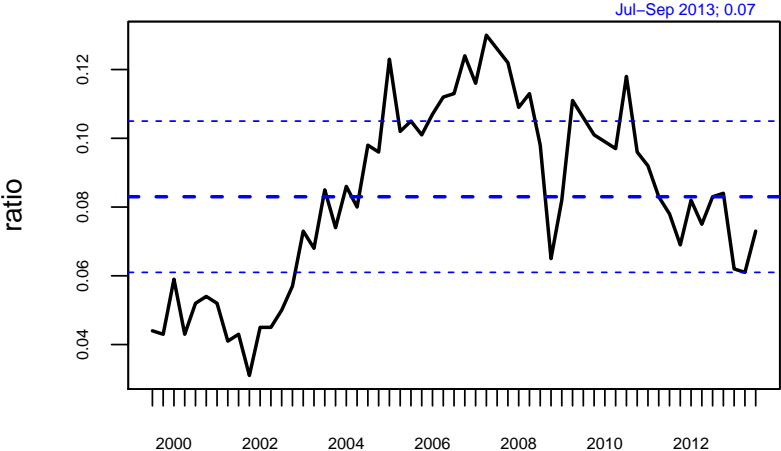
# The growth of the sales of big firms looks better

Q-o-q of SA index of nominal net sales of non-oil non-finance listed firms



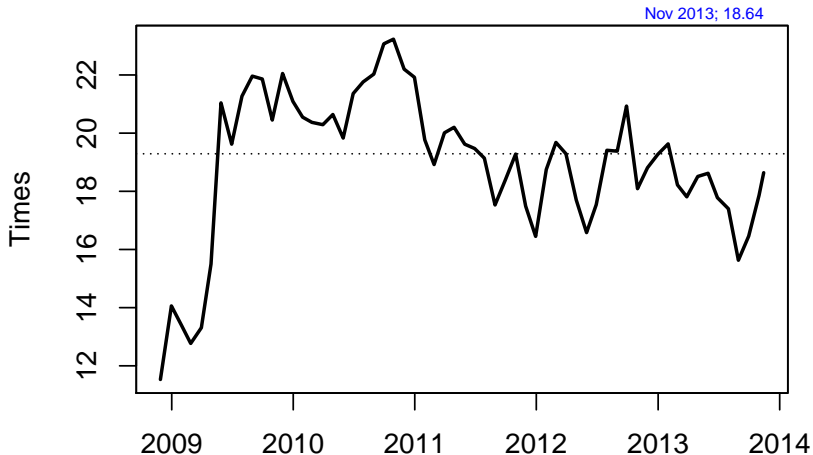
# Margins may have started improving

Net profit (after tax) as a ratio of net sales of non-oil non-finance listed firms



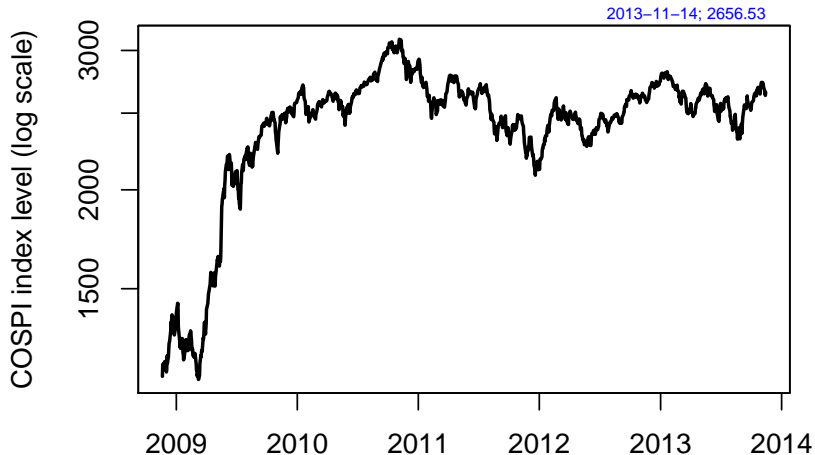
# The P/E ratio of the broad market has gently declined

P/E ratio of CMIE Cospi index



# The broad market has held up well

CMIE Cospi index level

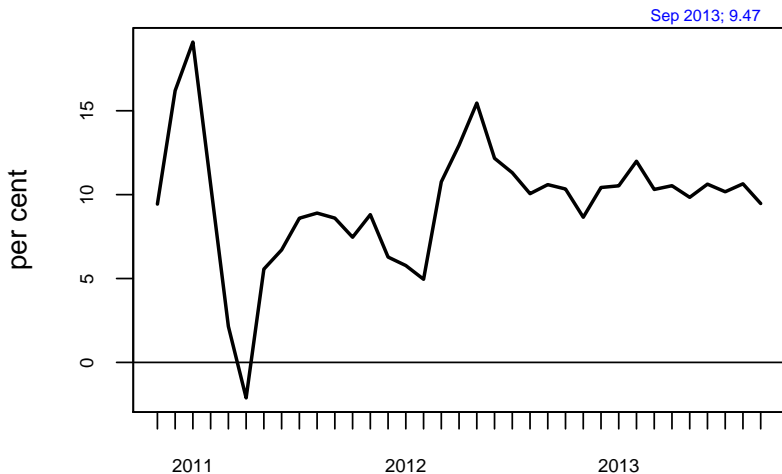


# Part III

## The inflation crisis

# Sustained inflation crisis

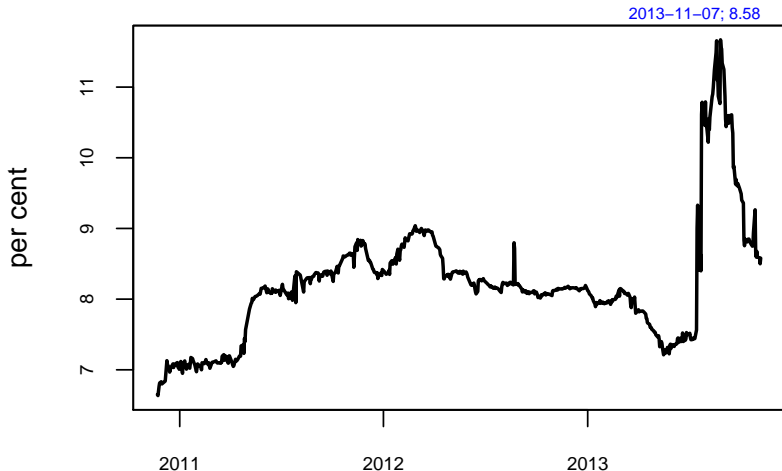
3mma of annualised M-o-m SA CPI inflation



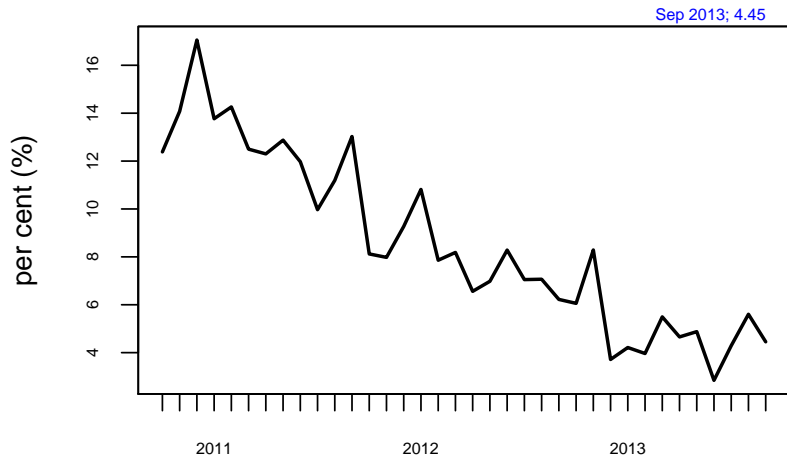


# Monetary policy was hijacked by exchange rate considerations

91-day tbill rate



# Growth of bank credit (in real terms)

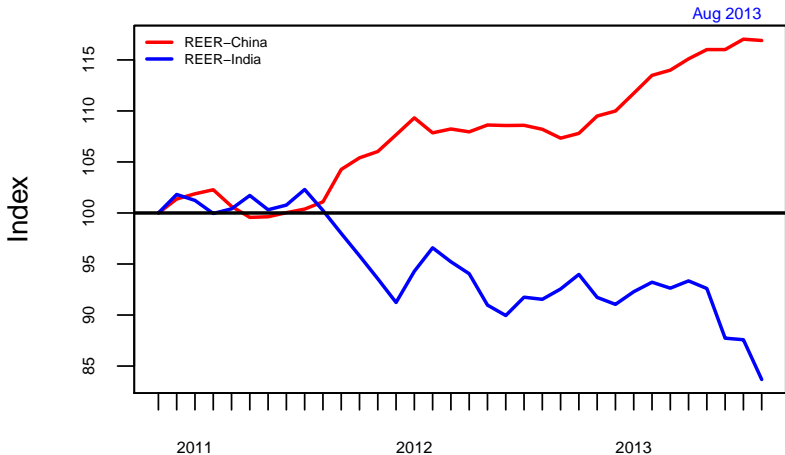


# Part IV

## Net exports

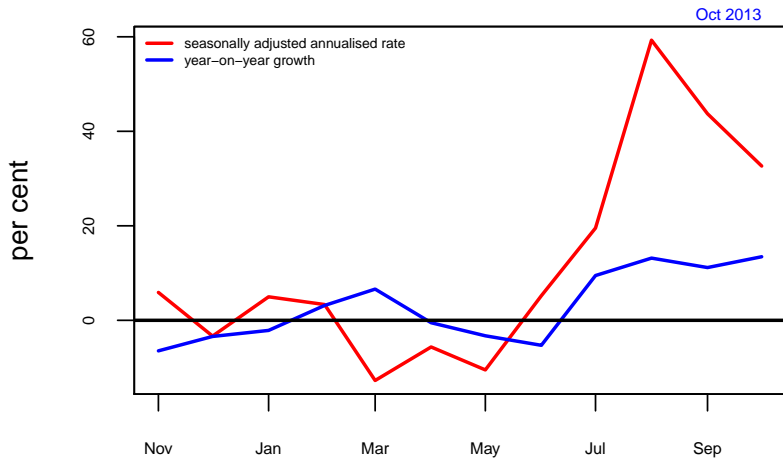
# REER for India and China

BIS REER index levels



# Some impact on exports is visible

3mma of annualised M-o-m change in SA merchandise exports



## Part V

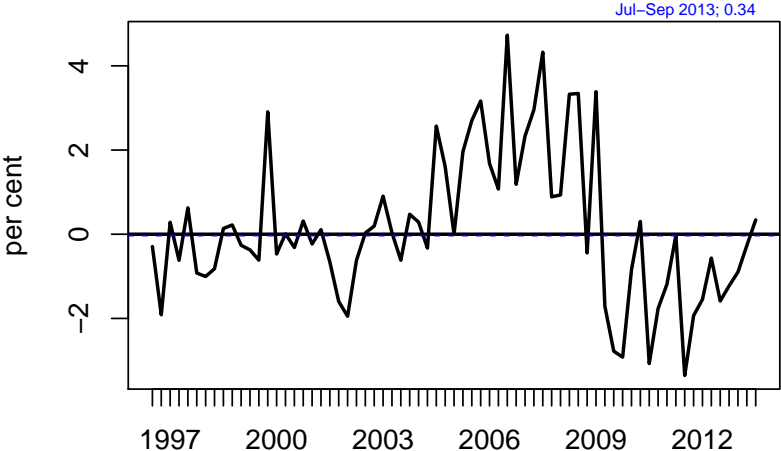
### Early positive signs on investment

# Measurement

- ▶ CMIE Capex database observes all projects
- ▶ Classifies them as 'announced' or 'under implementation'
- ▶ Private 'announced' are important as a measure of confidence
- ▶ Infrastructure 'under implementation' are important as a measure of solving the policy constraints.
- ▶ We focus on first differences in the quarterly data (per cent to GDP)

# Change in private 'announced'

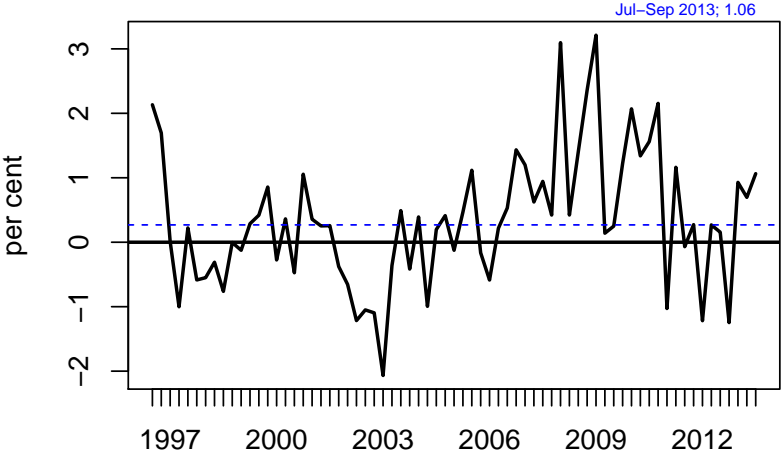
Percentage points of GDP





# Change in infrastructure 'under implementation'

Percentage points of GDP



# Part VI

## Short term outlook

# Trend and cycle

- ▶ Let us not lose sight of the basics – business cycle fluctuations are around trend growth.
- ▶ Trend growth is driven by :
  1. The size of the labour force
  2. The human capital per person of the labour force
  3. Capital accumulation
  4. Productivity gains.
- ▶ These are deep micro-economic features of the economy and do not change on business cycle horizons.

# Inflation

- ▶ In the short term, tradeables inflation is going to get worse
- ▶ Monetary policy is finally taking inflation seriously
- ▶ Bank credit is now restrictive
- ▶ The monetary policy transmission is weak
- ▶ Structure of expectations is improving
- ▶ Inflation is likely to subside in 2014 but slowly.
- ▶ From 2006-2013 bad inflation hampered growth; now reduced inflation and then reduced interest rates will help growth from 2015 onwards.

## International aspects

- ▶ The US and the world economy are healing, which is good for export demand
- ▶ Rupee depreciation, and the Chinese appreciation, are good for India.
- ▶ A gradual process of solving frictions on the capital account is underway.
- ▶ It is likely that capital flows will finance the CAD without requiring a big depreciation, other than a scenario of a terrible mess after the 2014 elections.

# Investment

- ▶ There are early signs that the investment bust is healing.
- ▶ Government processes were frozen after the corruption crises. Gradually, improved processes are falling into place.
- ▶ Early signs of recovery of infrastructure investment.
- ▶ Balance sheet problems + low profitability hampers the private sector.

## The firm data perspective

- ▶ High interest payments in the Jul-Aug-Sep 2013 quarter will subside in the Oct-Nov-Dec 2013 quarter.
- ▶ Tradeables profitability helped by INR depreciation.
- ▶ Revival of investment helping demand conditions.

# Part VII

## Medium term outlook



## Policy process

- ▶ MOF and RBI are gradually getting better.
- ▶ RBI last month: delicensing of bank branches, opening up to foreign banks.
- ▶ MOF last month: voluntary adoption of regulatory governance from the draft Indian Financial Code by all financial agencies, and start four projects on new agencies (FSAT, PDMA, RC, FDMC).
- ▶ Uneven implementations and slow movement on the big transformative projects:
  1. Goods and services tax (GST)
  2. Unique identity authority (UIDAI)
  3. Indian Financial Code (IFC)
  4. Delhi-Mumbai Industrial Corridor (DMIC)
  5. Direct tax code (DTC)
- ▶ These things matter for long term growth. They also matter for the confidence of the financial system.

## Medium term forecasts from the FPAS model

- ▶ What can we say about adjustment on business cycle horizons?

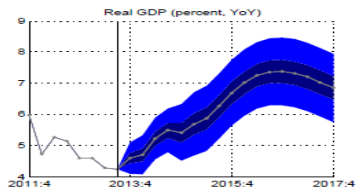
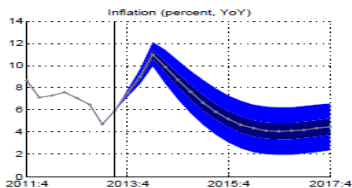
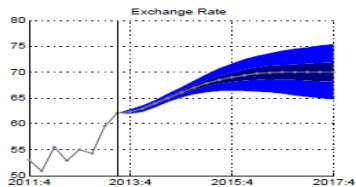
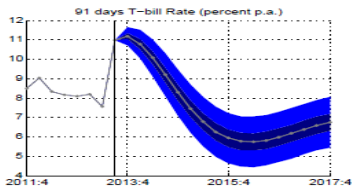
# Forecasting

## ***Assumptions for baseline scenario:***

1. US Fed interest rate forecast : WEO, IMF
2. US Inflation forecast : WEO, IMF
3. US GDP forecast : WEO, IMF
4. Structural constraints

Year	US Inflation	US - Short term interest rates	US- GDP growth rate
2014	1.5	0.092	2.58
2015	1.77	0.16	3.35
2016	1.94	0.925	3.47
2017	2.1	2.07	3.36

# Baseline model forecast



With 50% and 95% confidence interval

Source: Author's calculation

Thank you.