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

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
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)
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

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<tbody>
<tr>
<td>Ann. POP of SA (per cent)</td>
<td>12.04</td>
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Jul–Sep 2013; 12.04
Margins may have started improving

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

Jul–Sep 2013; 0.07
The P/E ratio of the broad market has gently declined

P/E ratio of CMIE Cospi index

![Graph showing the P/E ratio of the CMIE Cospi index from 2009 to 2014. The graph indicates a gentle decline in the P/E ratio over the years. The peak value is around November 2013, with a value of 18.64.](image-url)
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

Sep 2013; 9.47
Monetary policy was hijacked by exchange rate considerations

91-day tbill rate

[Graph showing 91-day tbill rate fluctuations from 2011 to 2013.]
Growth of bank credit (in real terms)

Sep 2013; 4.45
Part IV

Net exports
REER for India and China
BIS REER index levels

Aug 2013
REER−China
REER−India
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

Jul–Sep 2013; 0.34
Change in infrastructure ‘under implementation’

Percentage points of GDP

Jul–Sep 2013; 1.06
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
- 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.
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

<table>
<thead>
<tr>
<th>Year</th>
<th>US Inflation</th>
<th>US - Short term interest rates</th>
<th>US- GDP growth rate</th>
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<tr>
<td>2014</td>
<td>1.5</td>
<td>0.092</td>
<td>2.58</td>
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<td>2015</td>
<td>1.77</td>
<td>0.16</td>
<td>3.35</td>
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<tr>
<td>2016</td>
<td>1.94</td>
<td>0.925</td>
<td>3.47</td>
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<td>2017</td>
<td>2.1</td>
<td>2.07</td>
<td>3.36</td>
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Baseline model forecast

With 50% and 95% confidence interval

Source: Author’s calculation
Thank you.