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Disseminating the India Story

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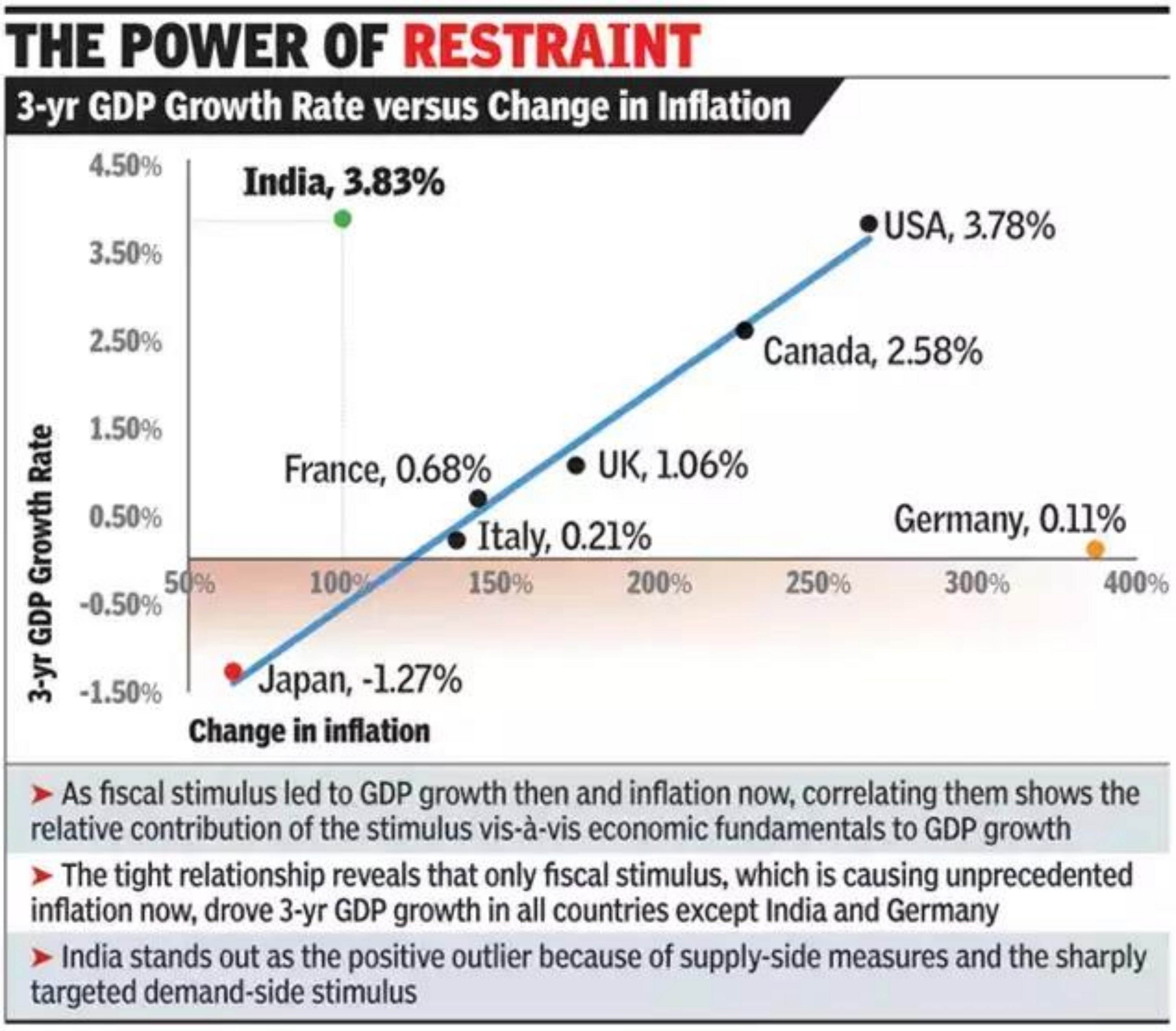

Subramanian, Times of India, 7th Sep 2022

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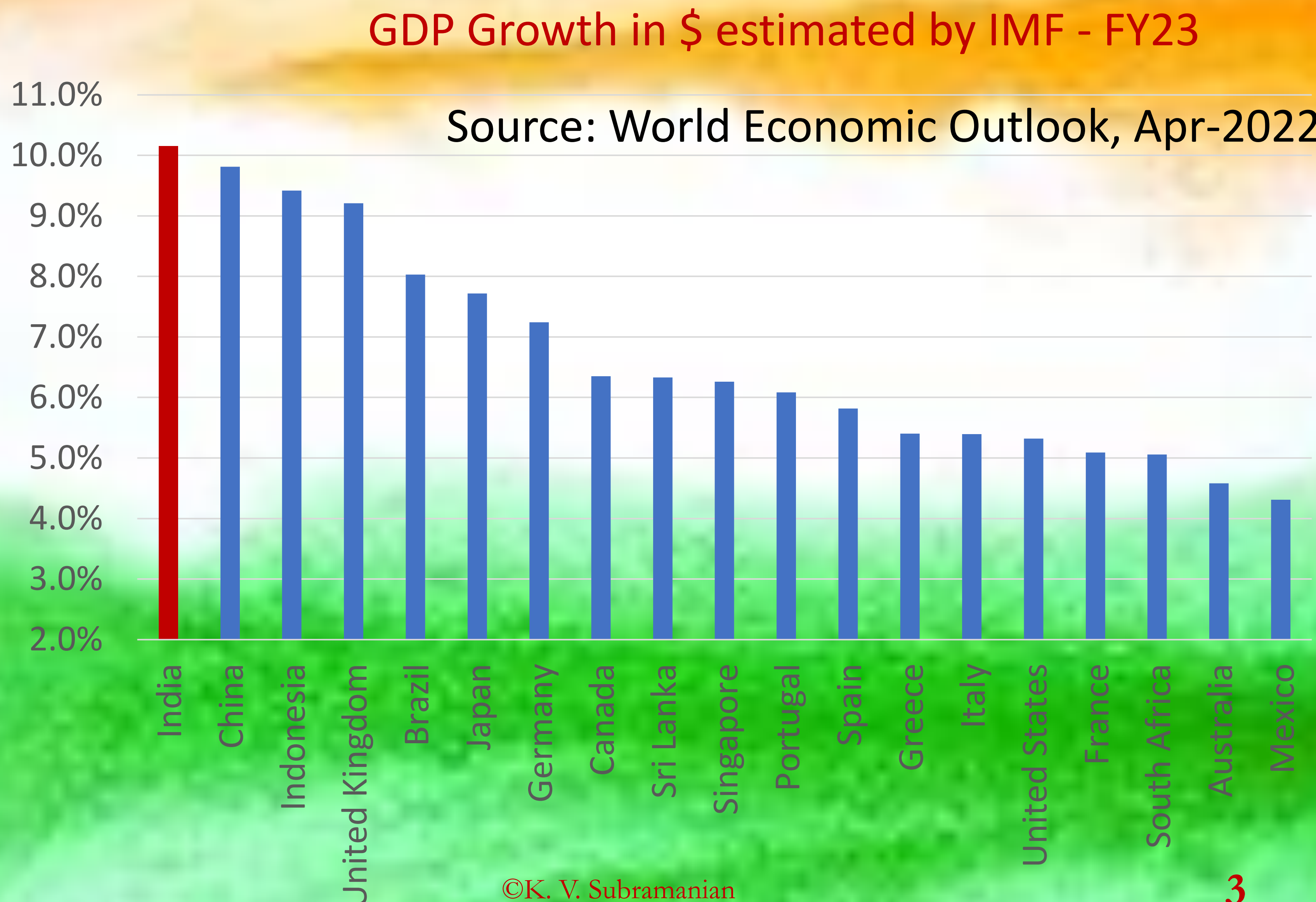
India offers foreign investors highest opportunity in FY23 as GDP growth in USD projected to be highest



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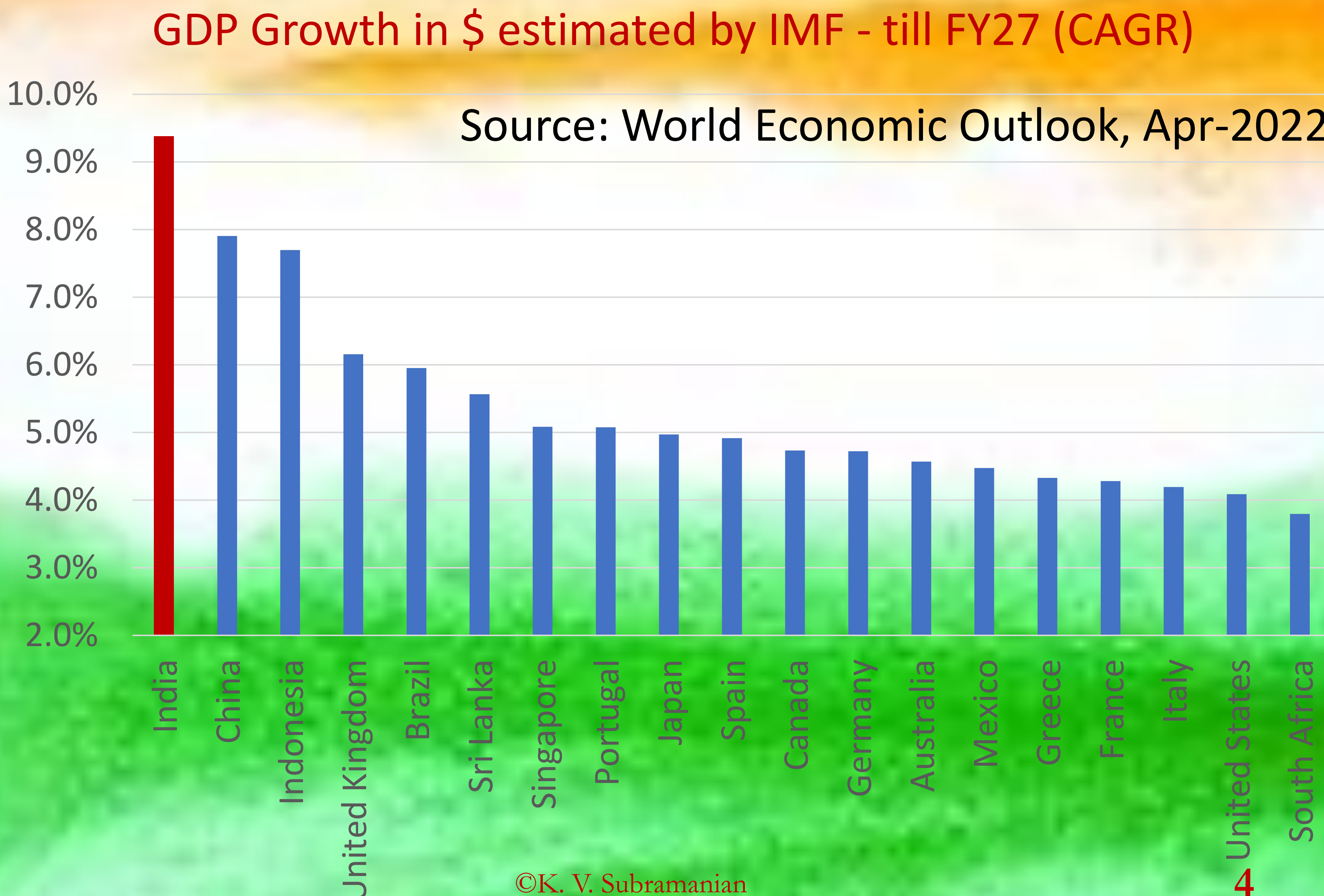
India offers foreign investors highest opportunity till FY27 as GDP growth in USD projected to be highest



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Indian economy this decade: Key Narratives

- India will be the fastest growing economy in the world this decade with 7-8% growth (in real terms) per annum.
- Four questions key to understand this prognosis
  - Impact of Covid on India's economic fundamentals?
  - What is the economic vision that India is pursuing? Which sectors/ areas is India emphasizing?
  - Was the growth decline before the pandemic structural?
  - What are the risks and challenges?
- To separate facts from narratives, this presentation draws on rigorous research published in GoI's Economic Surveys:
  - 2018-19: Strategic blueprint for $5 trillion economy
  - 2019-20: Ethical wealth creation, which has been India's DNA, key to India's future economic progress
  - 2020-21: Post-Covid Economic Path

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India’s macro-economic performance during Covid

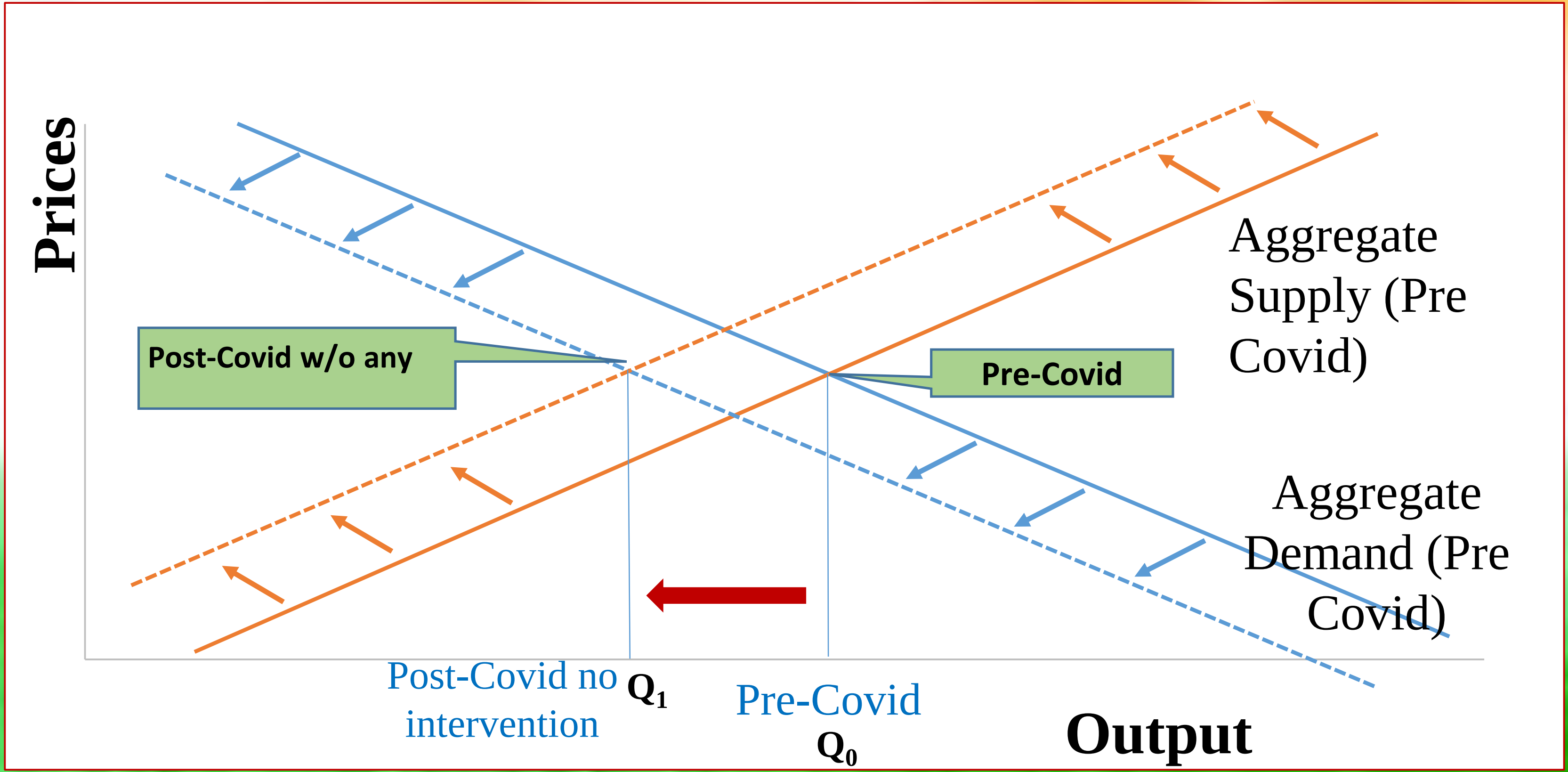
Macroeconomic fundamentals more resilient in once-in-a-century COVID-19 crisis than in GFC (2008)

Macroeconomic Indicators	2009-10 GFC	2020-21 Covid
CPI inflation (%)	11.5	5.6
Fiscal Deficit as % of peer economies*	331	138
Current Account Balance as % of GDP	-4.8	0.9
ΔRevenue Expenditure (Central Govt.)	27%	5.9%
ΔCapital Expenditure (Central Govt.)	-4.8%	13.1%
ΔGross Fixed Capital Formation (% of GDP)	-4.5%	2.4%
INR Depreciation	56%	0.06%
External Debt as % of GDP	20.7	21.1
Forex Reserves (USD billion)	252	579
ΔGovt Bond Yields 10-year	4.0%	0.9%
FDI ($ billion)	8.3	80.1
FPI ($ billion)	-9.9	36.2

* Emerging & developing Asia as defined in World Economic Outlook

As every country expands fiscally in a crisis, India's Fiscal deficit must be compared to peers

To understand impact of Covid-19 on GDP and prices, consider case of laissez faire, i.e. no policy intervention



Absent any intervention, GDP ↓ much greater ($Q_1 << Q_0$).
But inflation not much ($P_1 \approx P_0$) as both demand & supply ↓

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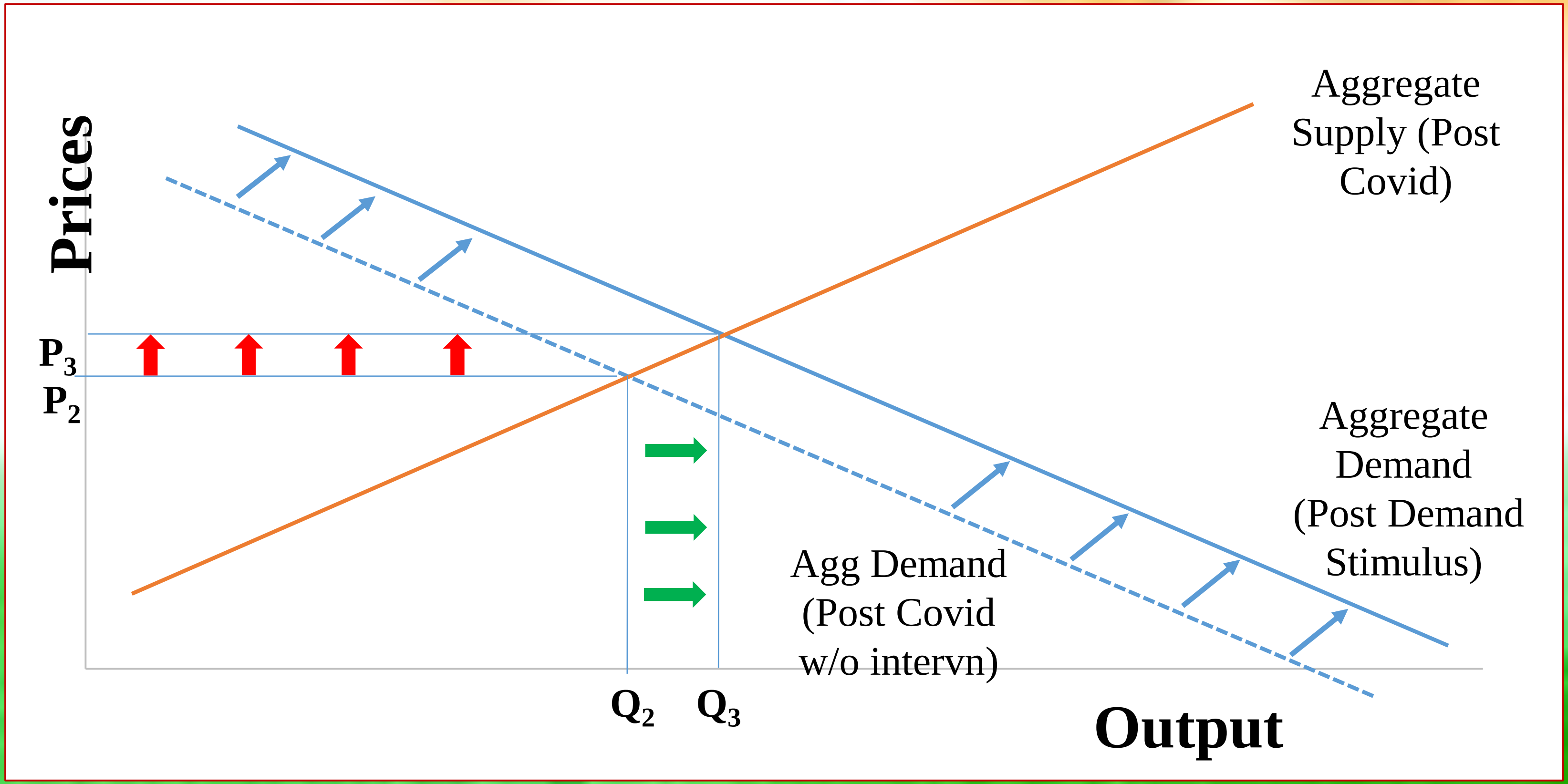
Only demand-side intervention => inflation ↑ sharply, as is happening in other countries (400% ↑ in US vs. 4% in India vis-à-vis average) & in India during GFC (2-digit inflation for 1.5 yrs)



Only demand stimulus => GDP ↓ is lower (Post-covid is Q_3 not Q_2). But inflation ↑ (P_3 >> P_2) as demand ↑ but supply does not.

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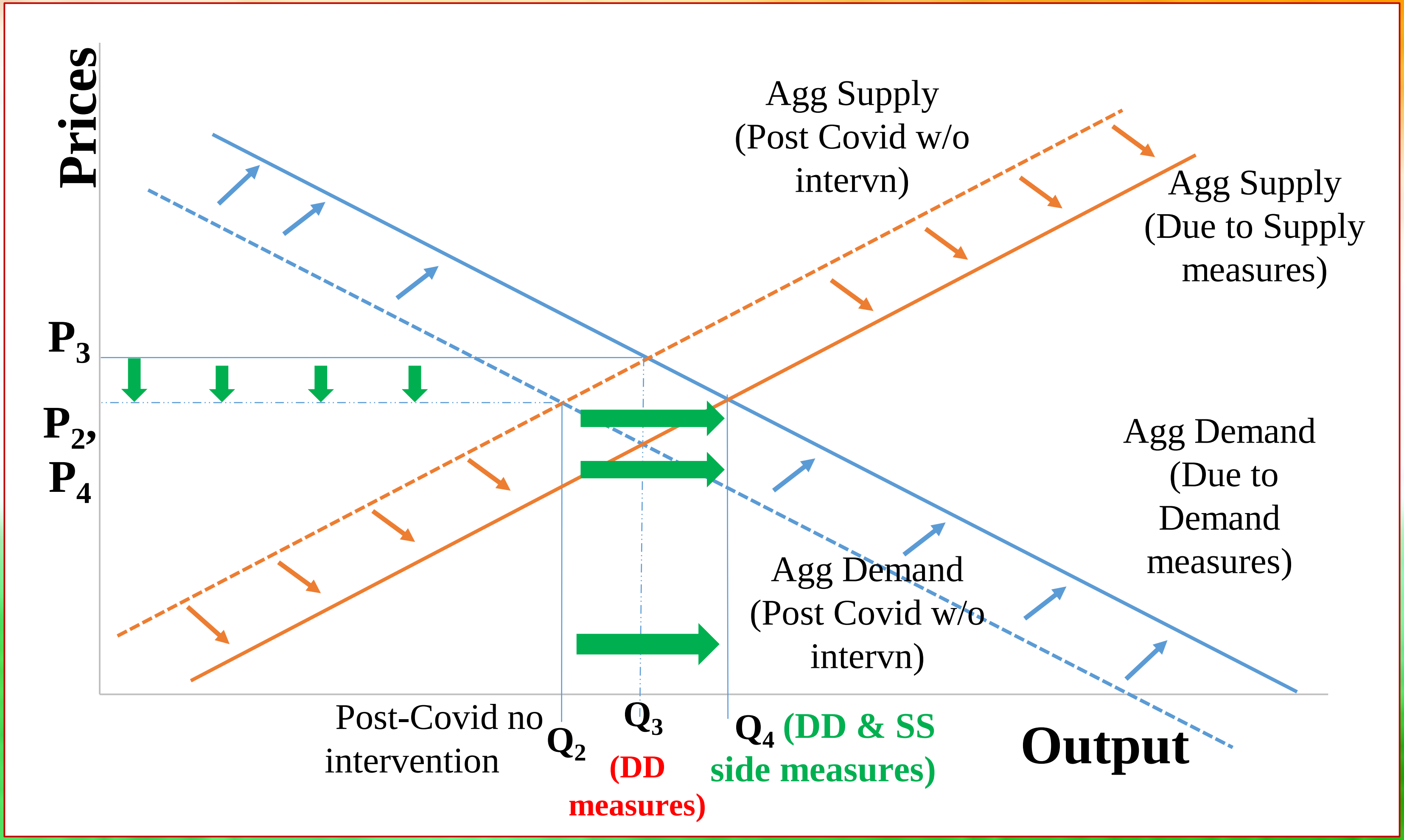
India's COVID-19 policy response included both demand & supply-side measures to boost output & control inflation



Demand+supply measures => GDP ↓ much lower (Post-covid is Q_4 not Q_3 or Q_2). And inflation ↑ lower ($P_4 < P_3 >> P_2$).

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India's better macroeconomic fundamentals in COVID-19 due to clarity of policy and courage of conviction to be different from the rest

- Covid-19 was a huge shock to supply
  - Supply chain disruptions
  - When engines of the economy are shut via lockdowns, they do not rev back to full speed immediately => supply shortage
- Advanced economies primarily undertook Demand-side measures and are facing 4x inflation
  - Emerging economies, where supply-side frictions are far more salient than in advanced economies, are facing 60-70% inflation in some cases
- If India had followed the same policy as in GFC or as other economies did in Covid, India would have had 18-20% inflation
- India is not facing this eventuality because of India's policy

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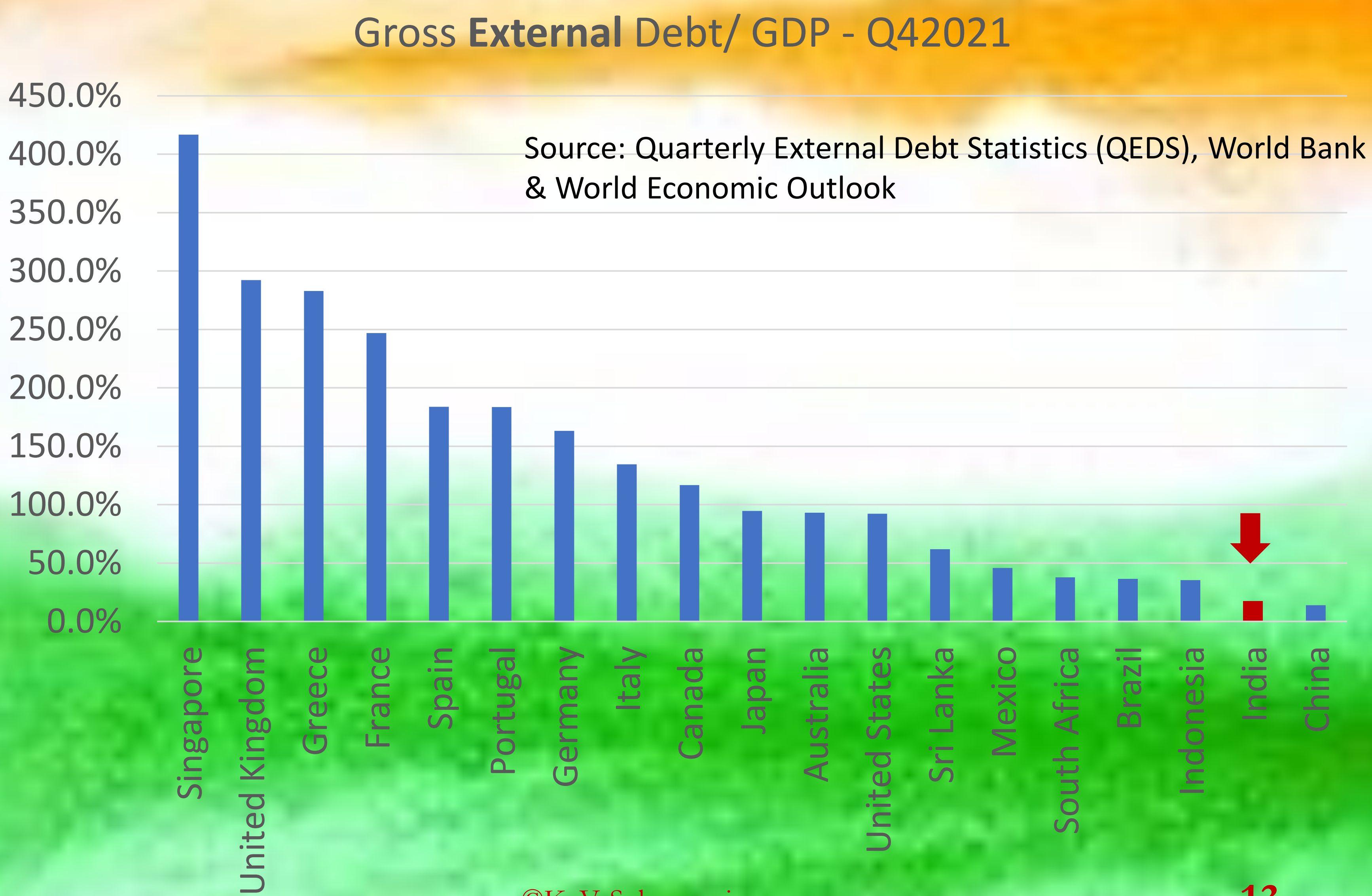
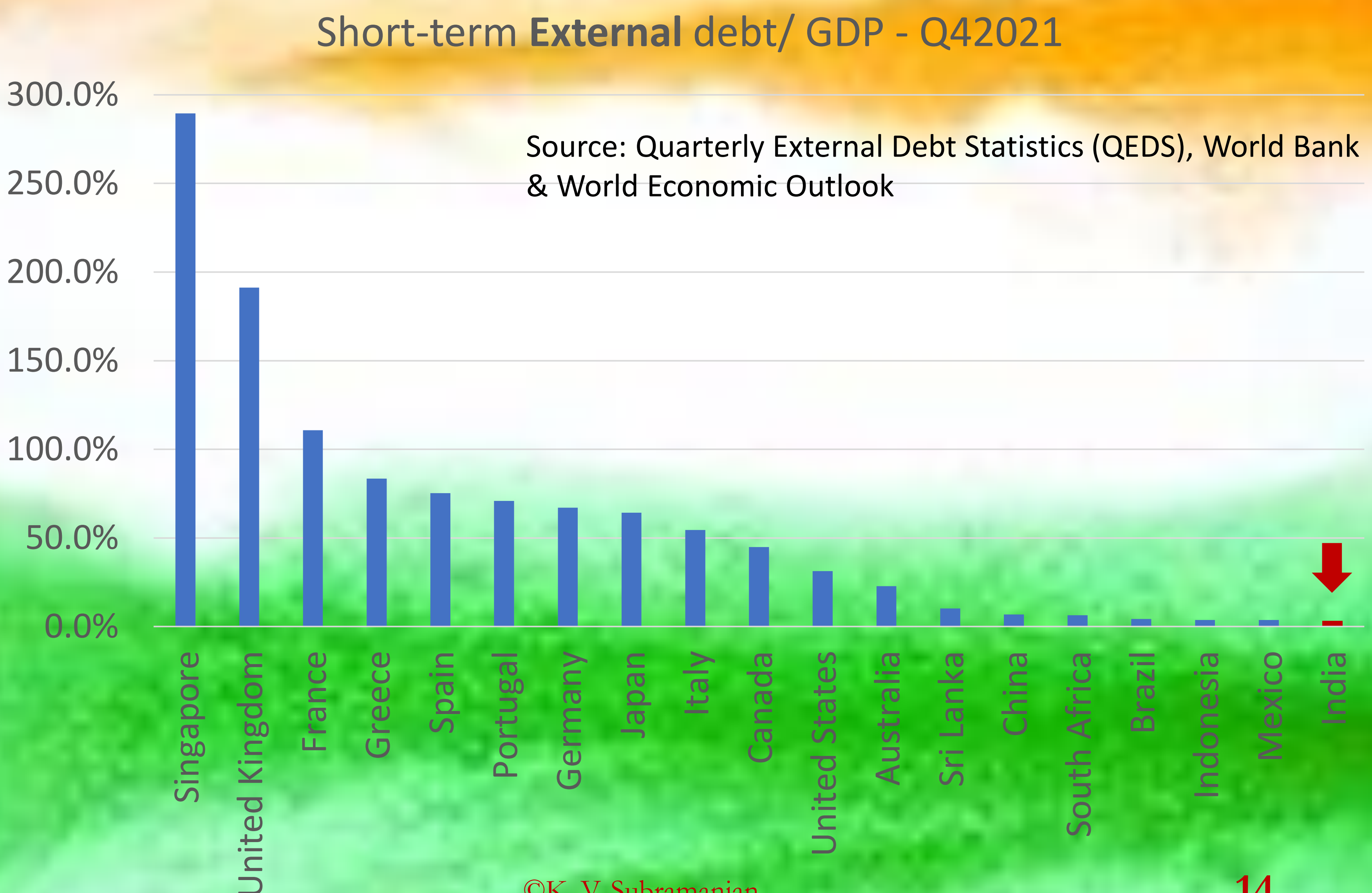
Core Principles that drove India's Policy Response

- Principle 1: Impact of macro policy on economic outcomes is felt with a lag
- Principle 2: Macro policy that ↑demand only delivers a short-term growth and long-term high inflation while macro policy that ↑ both demand & supply deliver long-term growth without high inflation
- Principle 3: ↑Revenue expenditure only is myopic policymaking while ↑capital expenditure is far-sighted policymaking
- Principle 4: Capital expenditure increases both demand and supply while revenue expenditure only increases demand
- Principle 5: Capital expenditure "crowds in" private investment while revenue expenditure "crowds out" private investment
- Principle 6: As private investment always collapses during economic crises, to keep the investment rate from falling precipitously, thereby impacting growth, government should increase its capital expenditure

India's external debt as a % of GDP is among the lowest



India's short-term external debt as a % of GDP is the lowest



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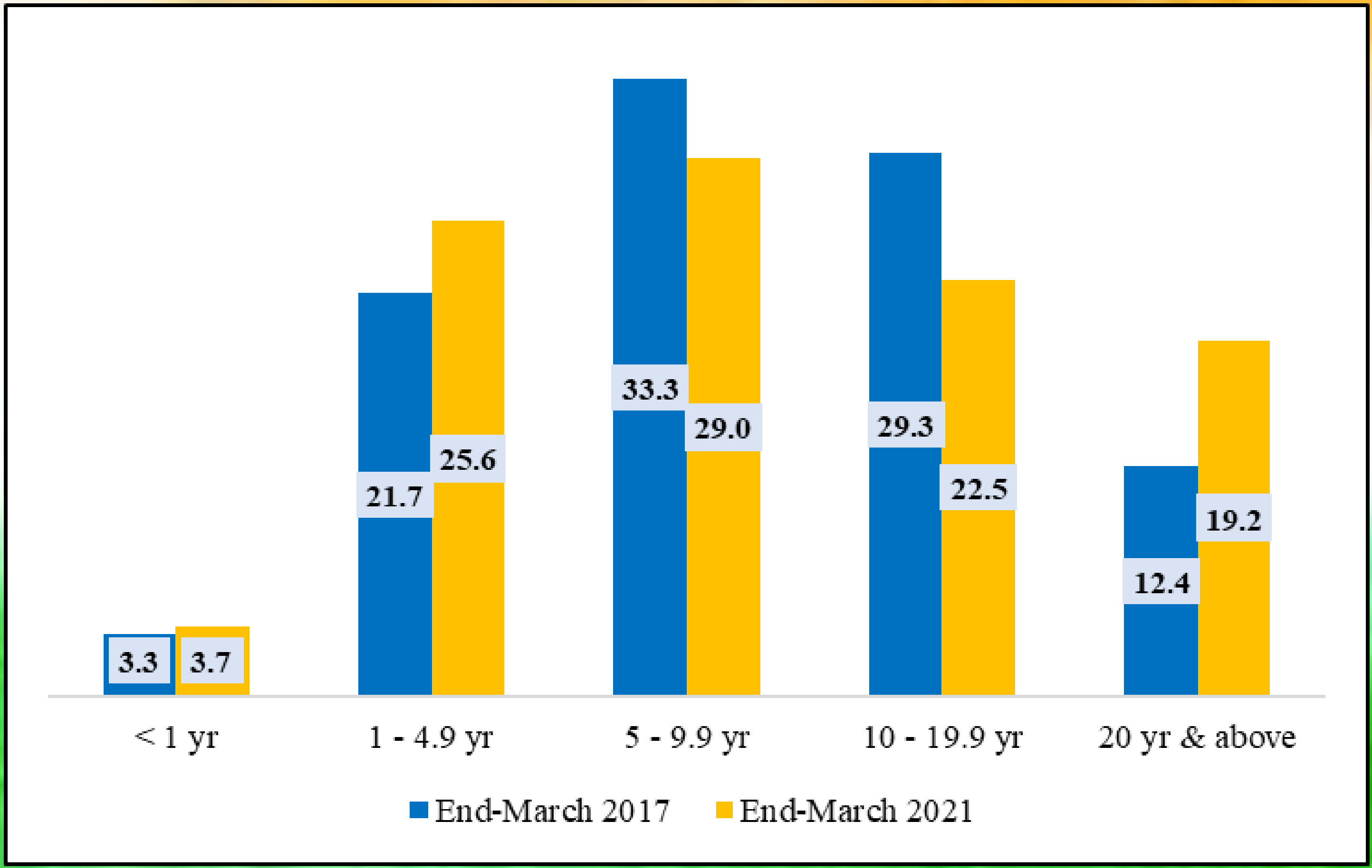
India's short-term external debt as a % of GDP being lowest among other countries is consistent with proportion of short-term debt being v low



Source: Status paper on Public Debt, Ministry of Finance (April 2022)

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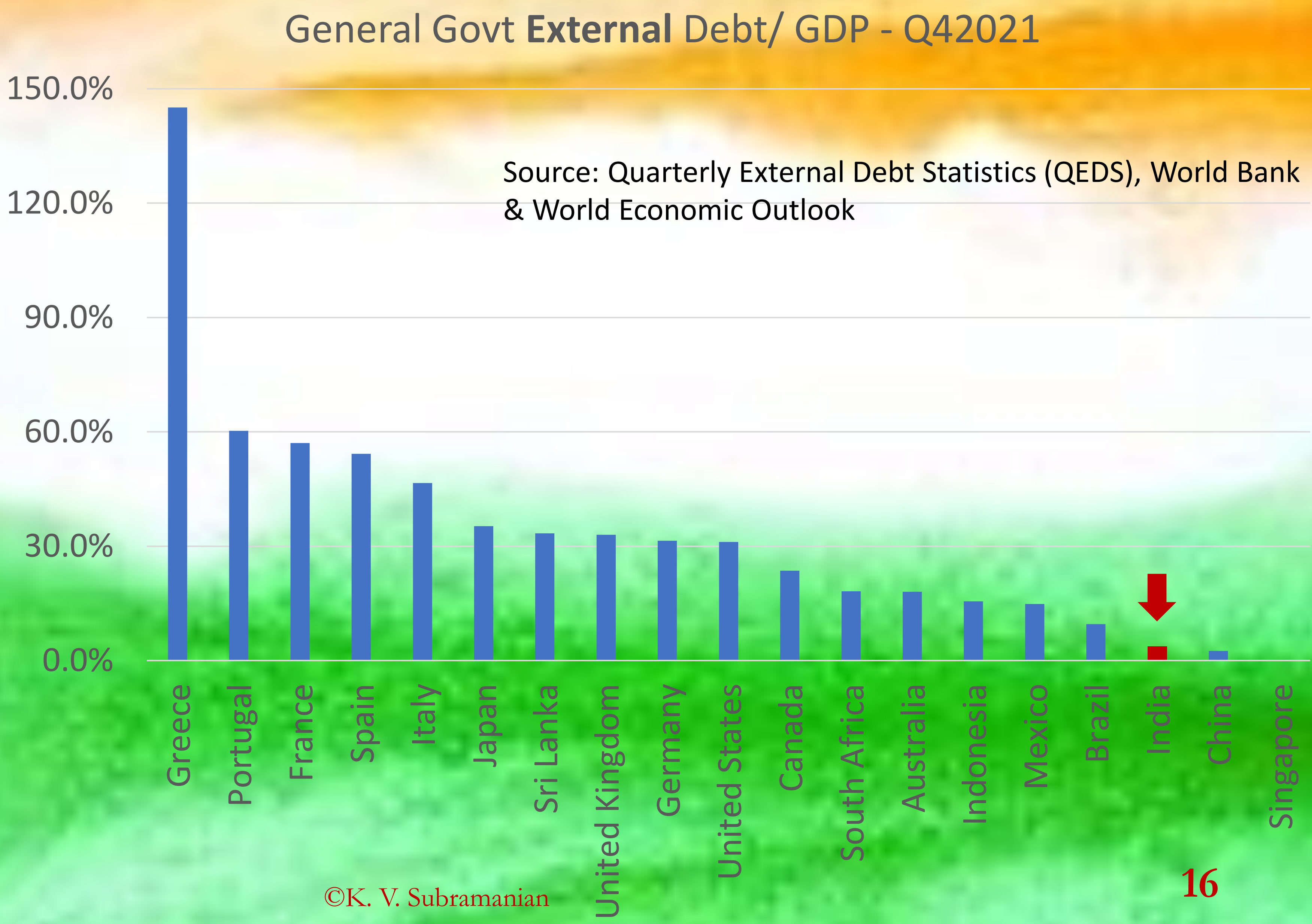
Indian General Government's external debt as a % of GDP is among the lowest



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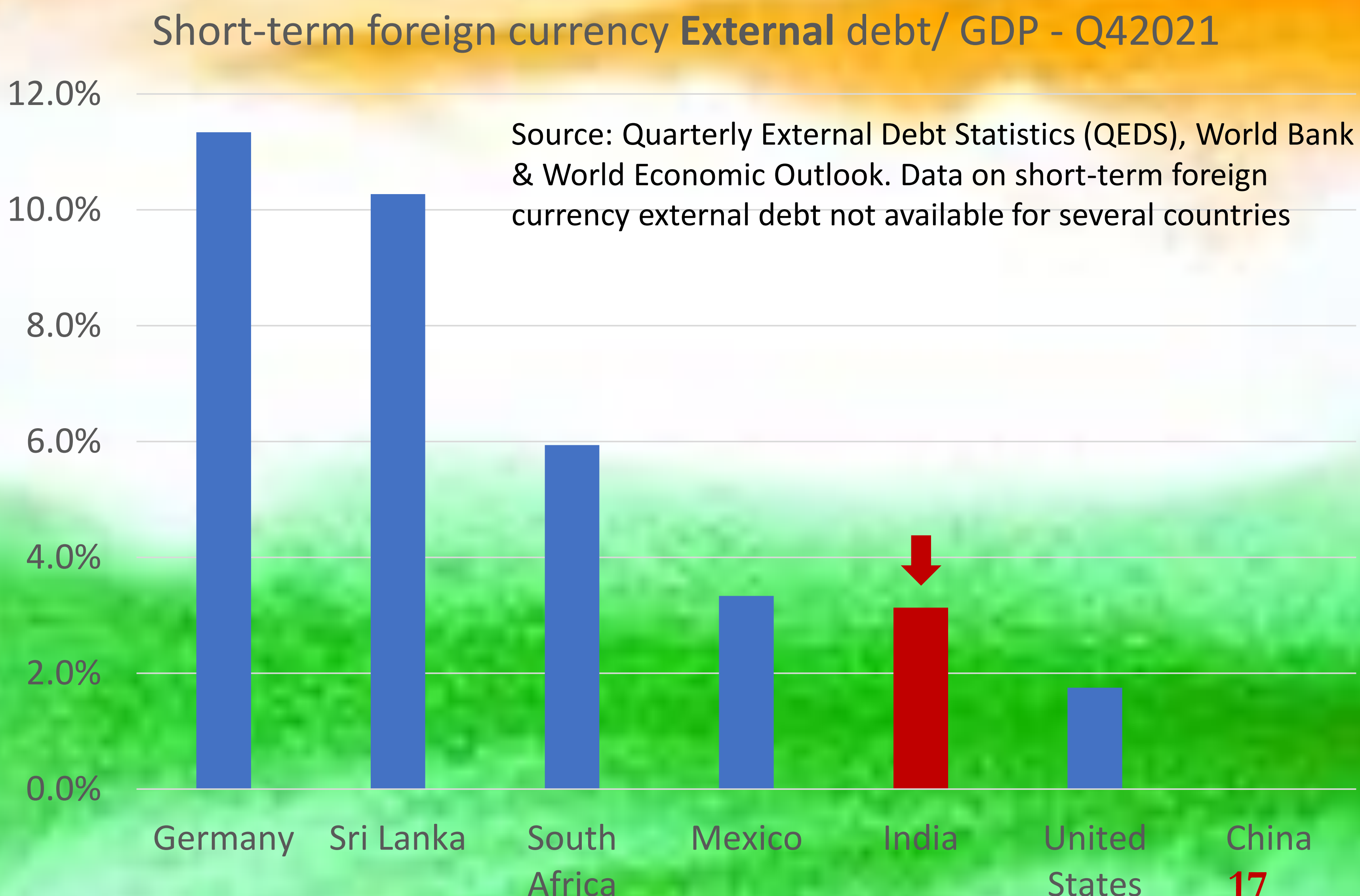
India’s short-term external debt denominated in foreign currency as a % of GDP is low



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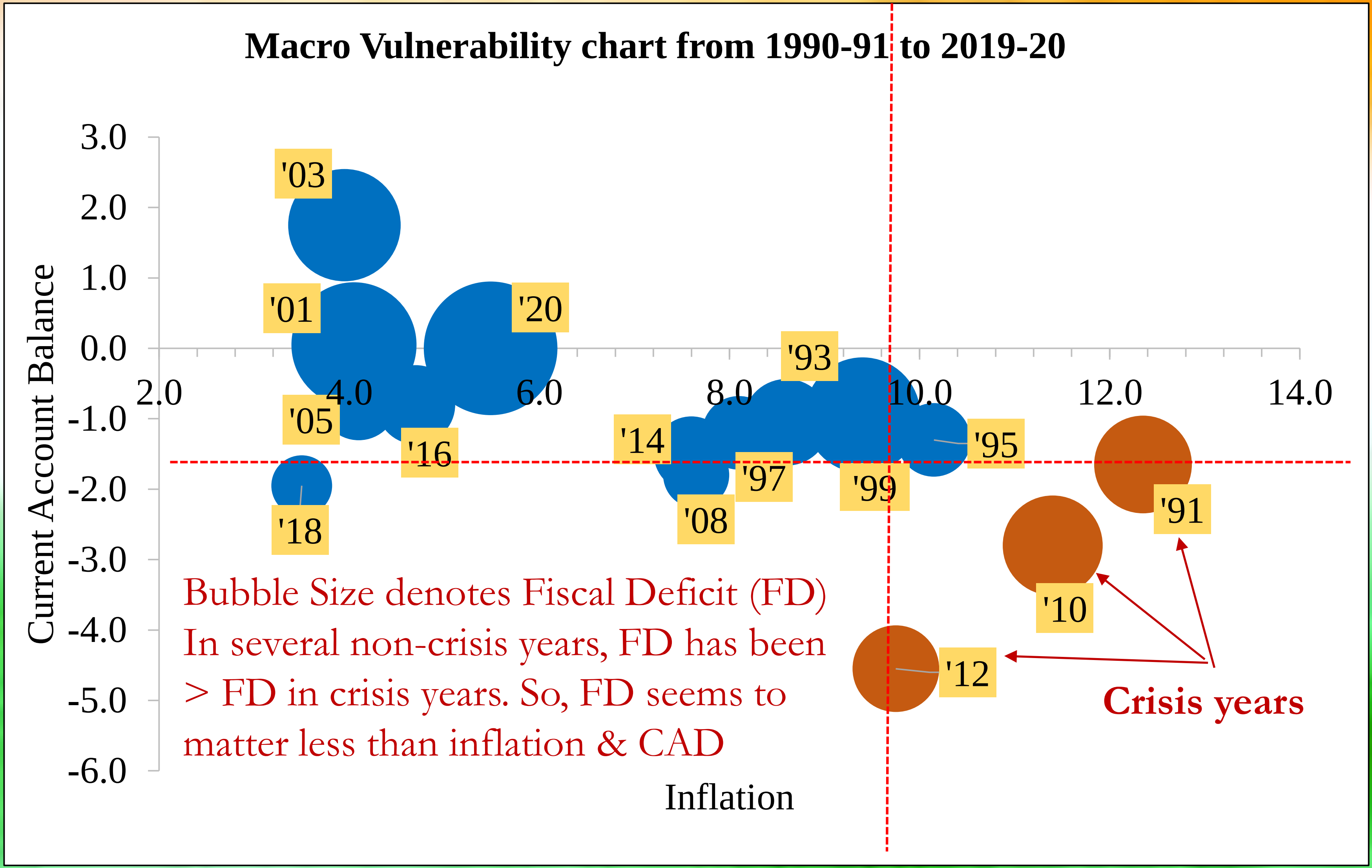
Historically, only double-digit inflation AND CAD > 1.8% of GDP makes India's macro vulnerable… that's not the case now



Source: IMF, RBI

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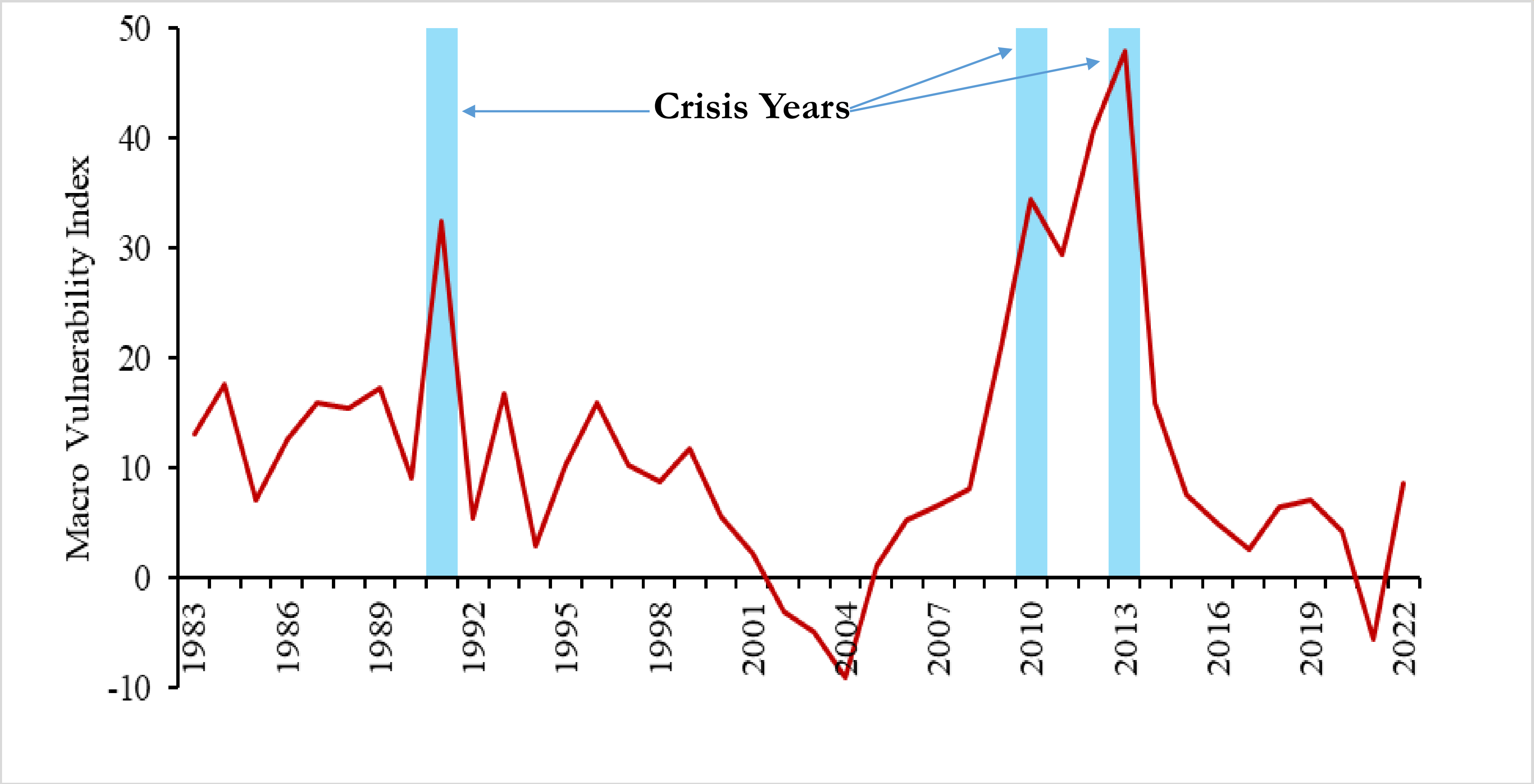
Macro-vulnerability indicator = FD*CAD tracks crises in India very well. Based on this indicator, likelihood of crisis very low for India now



Source: IMF, RBI

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Looking forward

Source: Economic Surveys of 2018-19, 2019-20, 2020-21

India's New Economic Vision

1.Growth + Efficient Welfare

- Exclusive focus on growth to generate resource for welfare
- Efficient welfare to not only reduce inequality but also to enhance aggregate demand
- Separation enables comparative advantage & enhances efficiency

2.Ethical Wealth Creation

- Wealth as boon not bane
- Enabling & empowering of private sector (deliberate emphasis on privatization & asset monetization)

3.Virtuous Cycle

- Virtuous cycle originating from private investment
- Public capex to "crowd in" private investment
- Supply-side reforms to accelerate private investment

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Looking forward:

1. Financial Sector Healthier (Recall financial sector contributed to slowdown before Covid)

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Financial sector reforms strengthening Banking Sector

- Profitability: Public sector banks have returned back to profitability and their asset quality has improved.
- Bad bank to become operational from this month (Jun-2022). Will free up management bandwidth for new credit.
- Privatization of public sector banks a major move

Looking forward:
2. Growth in Manufacturing

Emphasis on Manufacturing for job creation & aggregate demand

- ❑Jobs in the formal sector => increases aggregate consumption
- ❑Manufacturing crucial for jobs in formal sector
- ❑PLI scheme for 13 sectors (winner picking + incentive for growth)
- ❑Changes in MSME definitions to enable economies of scale & avoid problem of dwarfism that hinders job creation
- ❑Labour law reforms to enable job creation in manufacturing
- ❑Infrastructure investment in Railways & Roads => ↓ logistics costs
- ❑Infrastructure investment in power => cost of production ↓ in mfg
- ❑Fin sector reforms to enable capital (DFI, ARC, privatisation of PSBs, 74% insurance FDI)
- ❑Move people from agriculture to manufacturing

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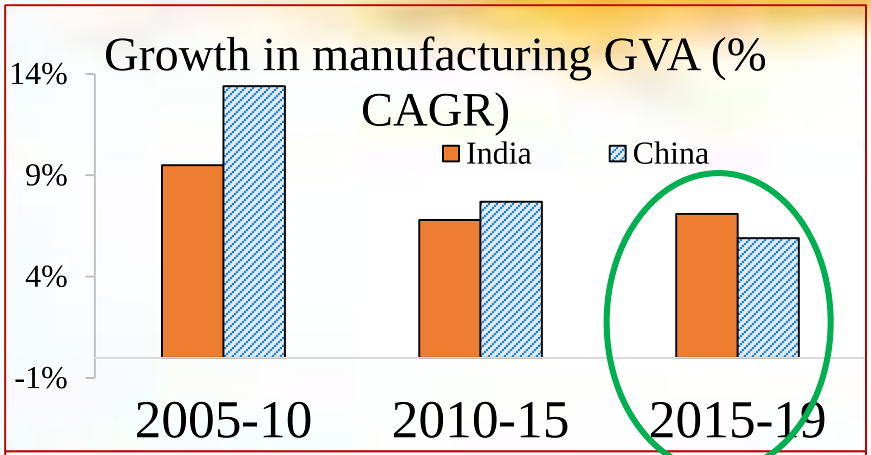
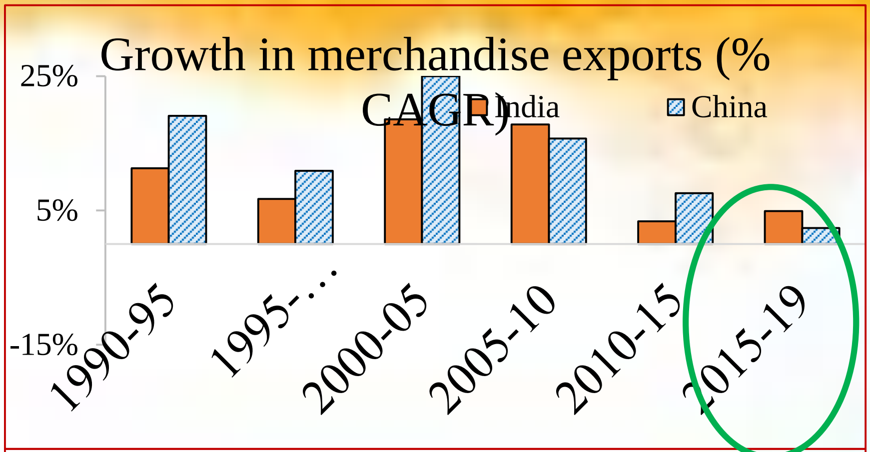
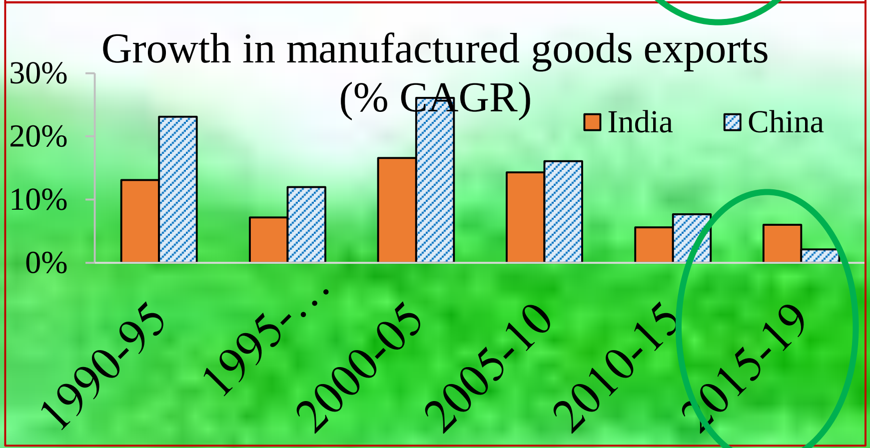
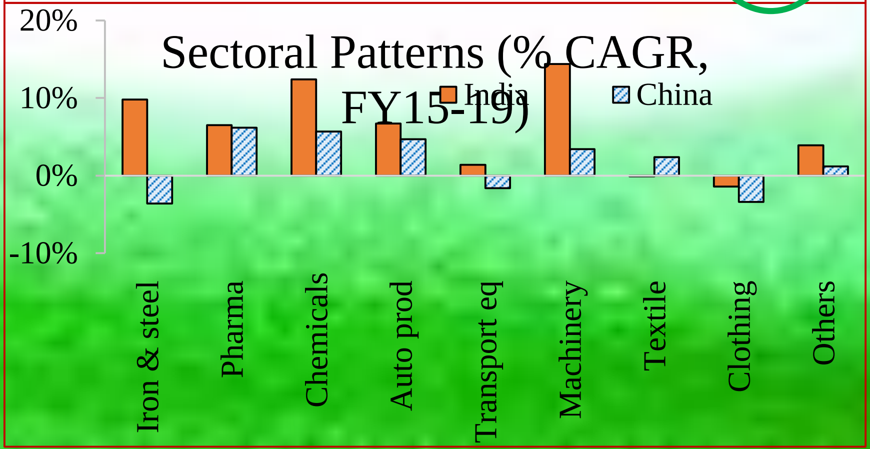
India's manufacturing GVA growth showing encouraging signs



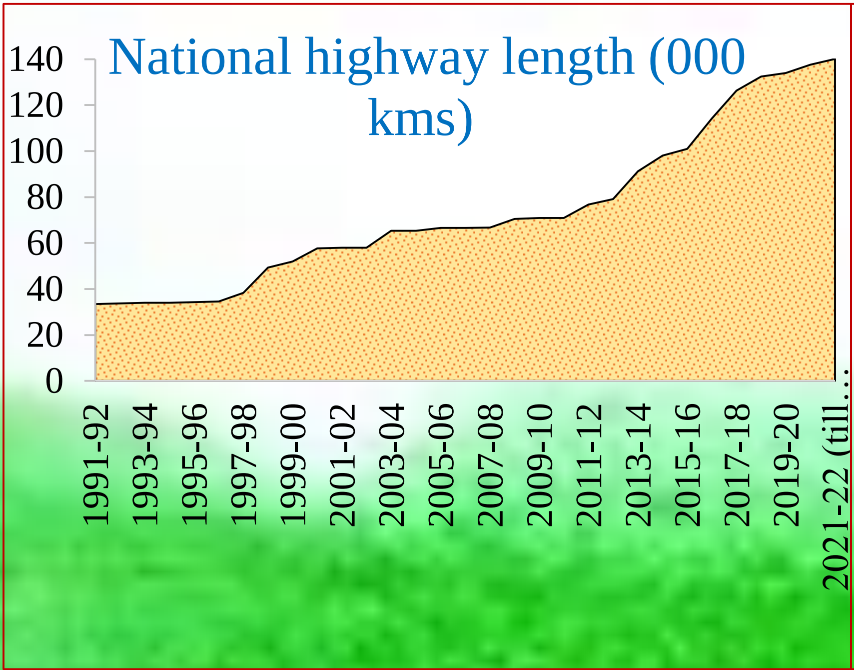


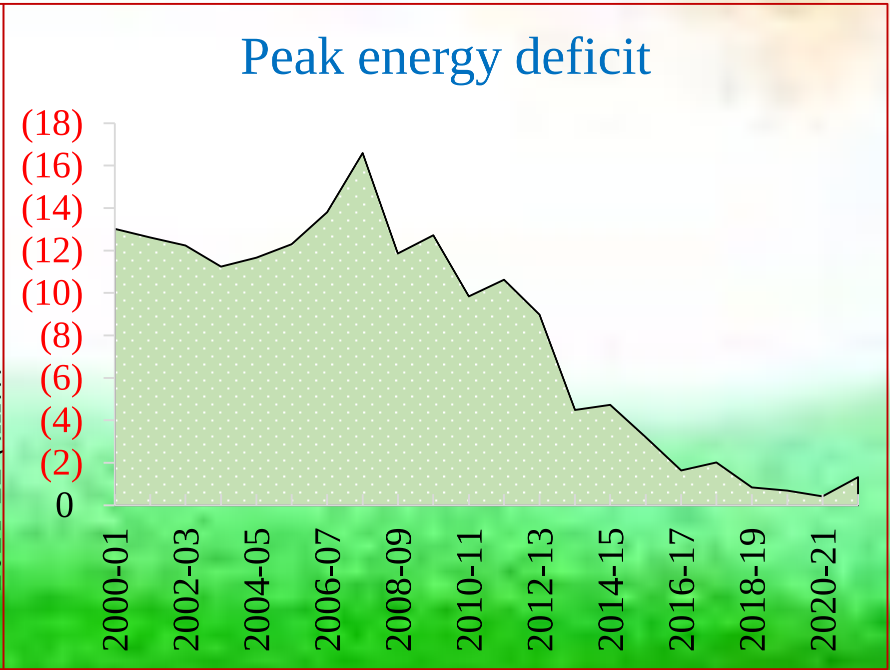




Source: UNSTATS, WTO, Axis Capital Research

Improvement in Manufacturing stemming from addressing systemic problems: 1. Strengthening of physical infrastructure





Source: MoRTH, NHAI

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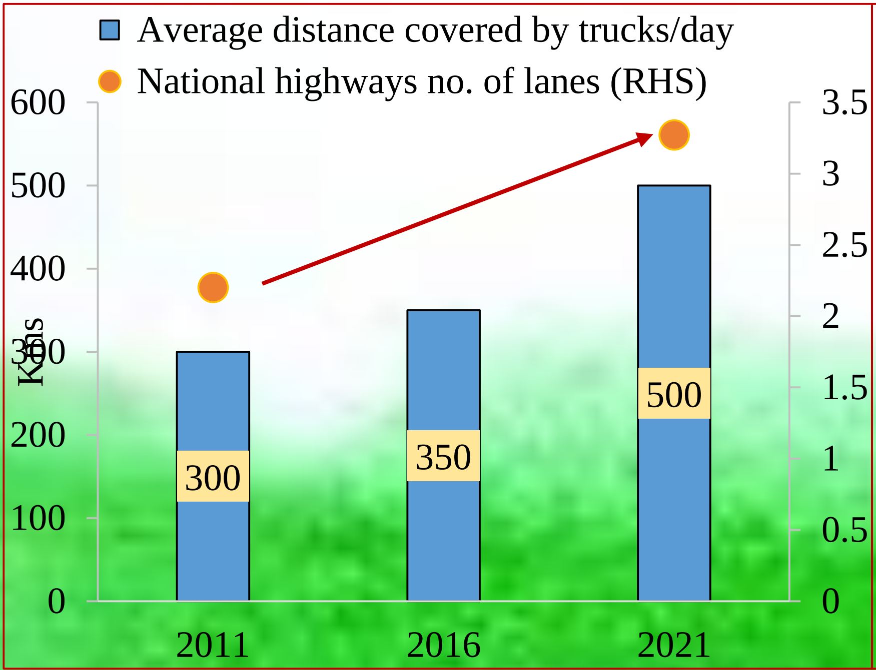
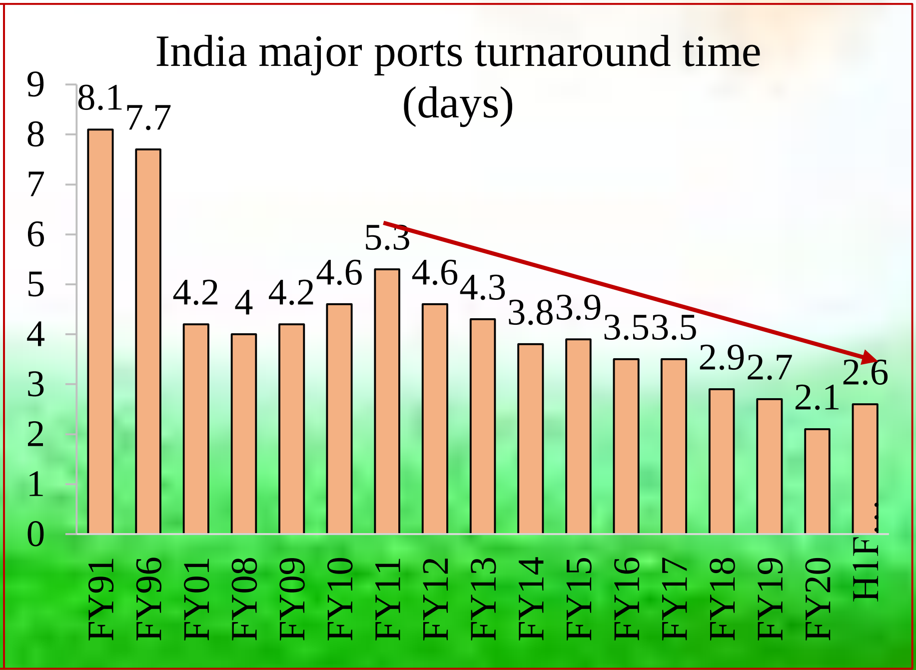
Improvement in Manufacturing stemming from addressing systemic problems:
2. Significant improvement in logistics efficiency





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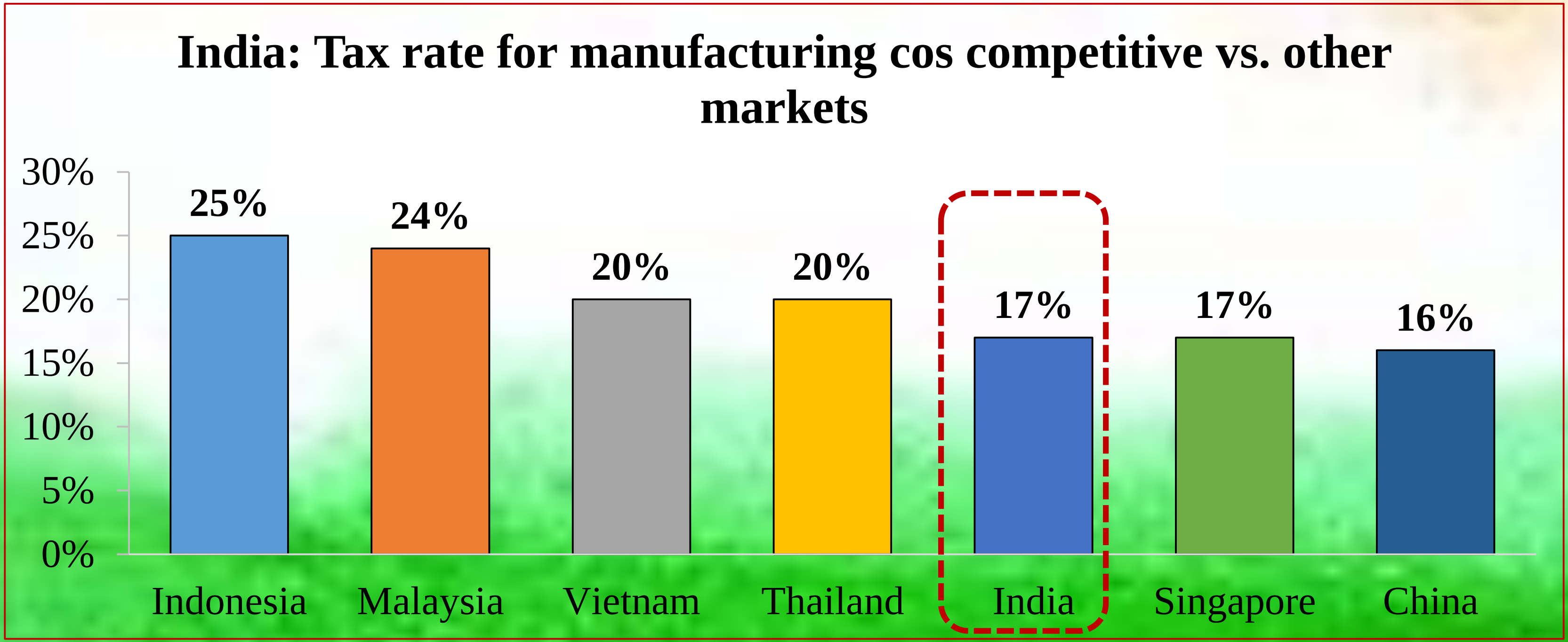
Improvement in Manufacturing stemming from addressing systemic problems:
3. Competitive tax rates



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Thank You

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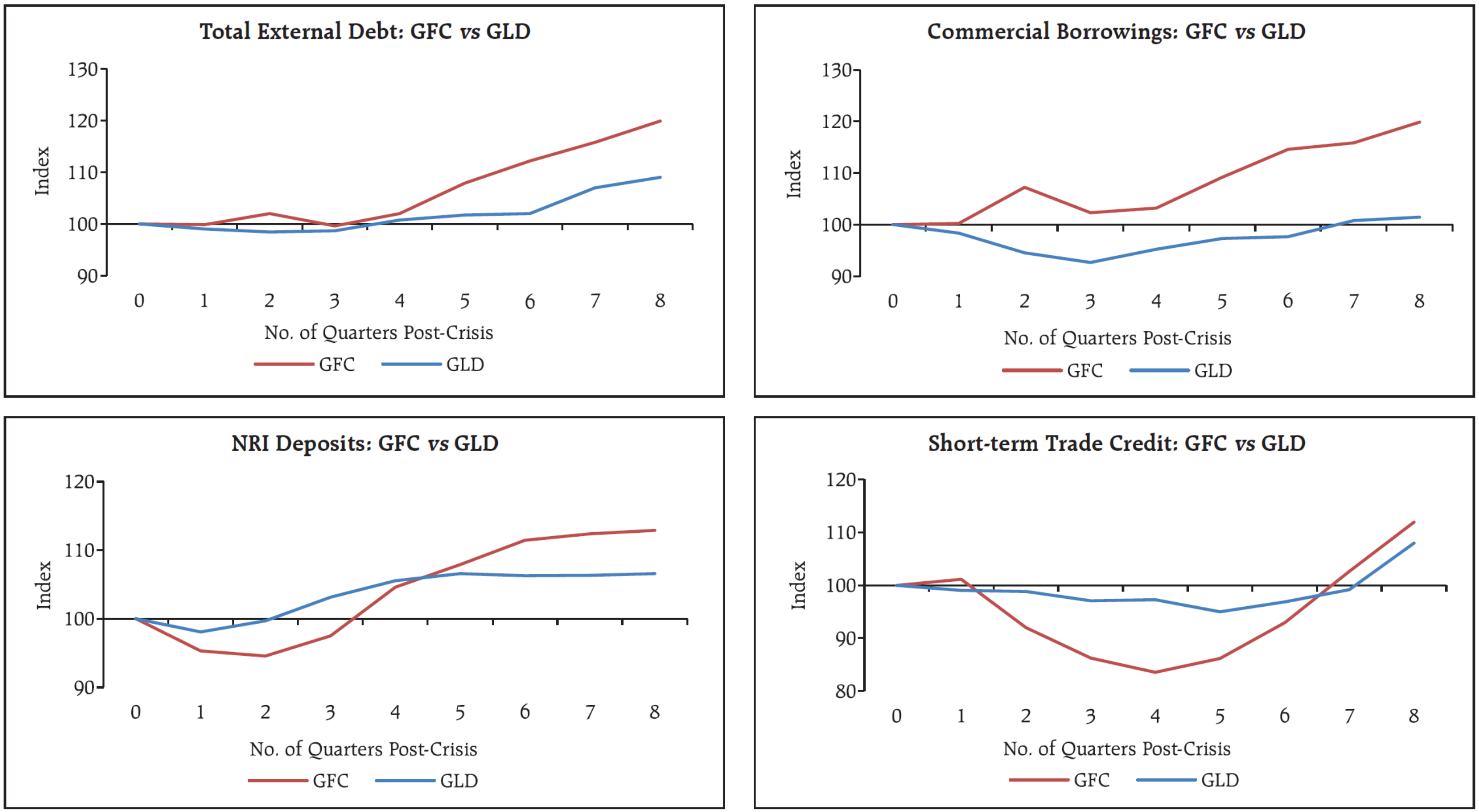
RBI Bulletin May 2022 shows India's external debt performance much better during Great Lockdown (GLD) in Covid than in Global Financial Crisis (GFC)

Figure 5: Performance of India's External Debt: GFC vs GLD
(GFC, 2008:Q2=100; GLD, 2019:Q4=100)



Source: RBI, Ministry of Finance and authors' calculations.

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Pre-pandemic Economy: Why did India's growth decline before Covid?

Why do you need to understand the reason for India's growth decline before Covid?

- If investors think that the growth decline was "structural", i.e. due to economic fundamentals being weak, they will doubt the prognosis for the future

- Only if investors believe that the reason for the growth decline before Covid was not structural, will they believe that India has moved on from those problems.

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Why did Growth decline before Covid?

Overhang from problems originating in the financial sector is much longer than when problems originate in real sector

→

Overhang from Crony lending till 2013 led to sharp deceleration in growth of credit: 9% p.a. during 2015-21 vs. 21.9% p.a. from 2005-14.

→

First Investment got impacted. Lower investment impacted growth, which in turn impacted consumption. Virtuous cycle slowed down sharply.

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Why did Growth decline before Covid?

- Reference: Pages 20-27, Vol-II, Eco Survey 2019-20
- Key point #1: When problems originate in the financial sector, the overhang is much longer than when problems originate in the real sector
    - Point made by academic research (Mian and Sufi, *Journal of Economic Perspectives*, 2018) and
    - Policy research (International Monetary Fund, 2017, "Household Debt And Financial Stability", Ch. 2 in Global Financial Stability Report)
    - As an example, compare impact of Global Financial Crisis (GFC) vs. Covid crisis. Growth bounced back immediately after Covid but the overhang lasted several years after GFC.
- Key point #2: Huge crony lending till 2013 => credit growth declined from 2014 (credit growth of 9% p.a. during 2015-21 vs. 21.9% p.a. from 2005-14) => private investment declined sharply slowing down "virtuous cycle"
- Evidence in following slides

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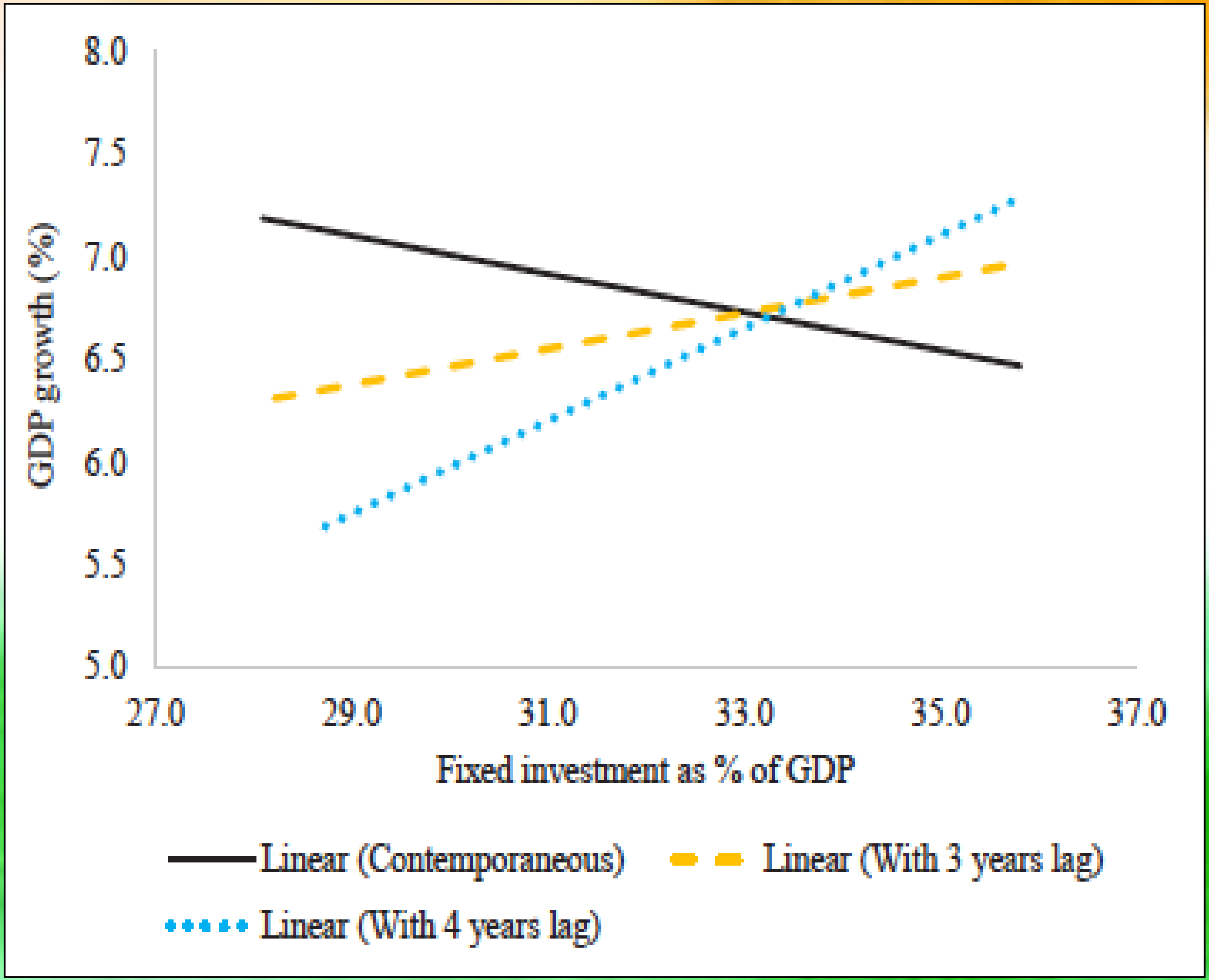
Investment in year t has maximum impact on GDP growth four years later (see blue line)



Source: Economic Survey 2019-20

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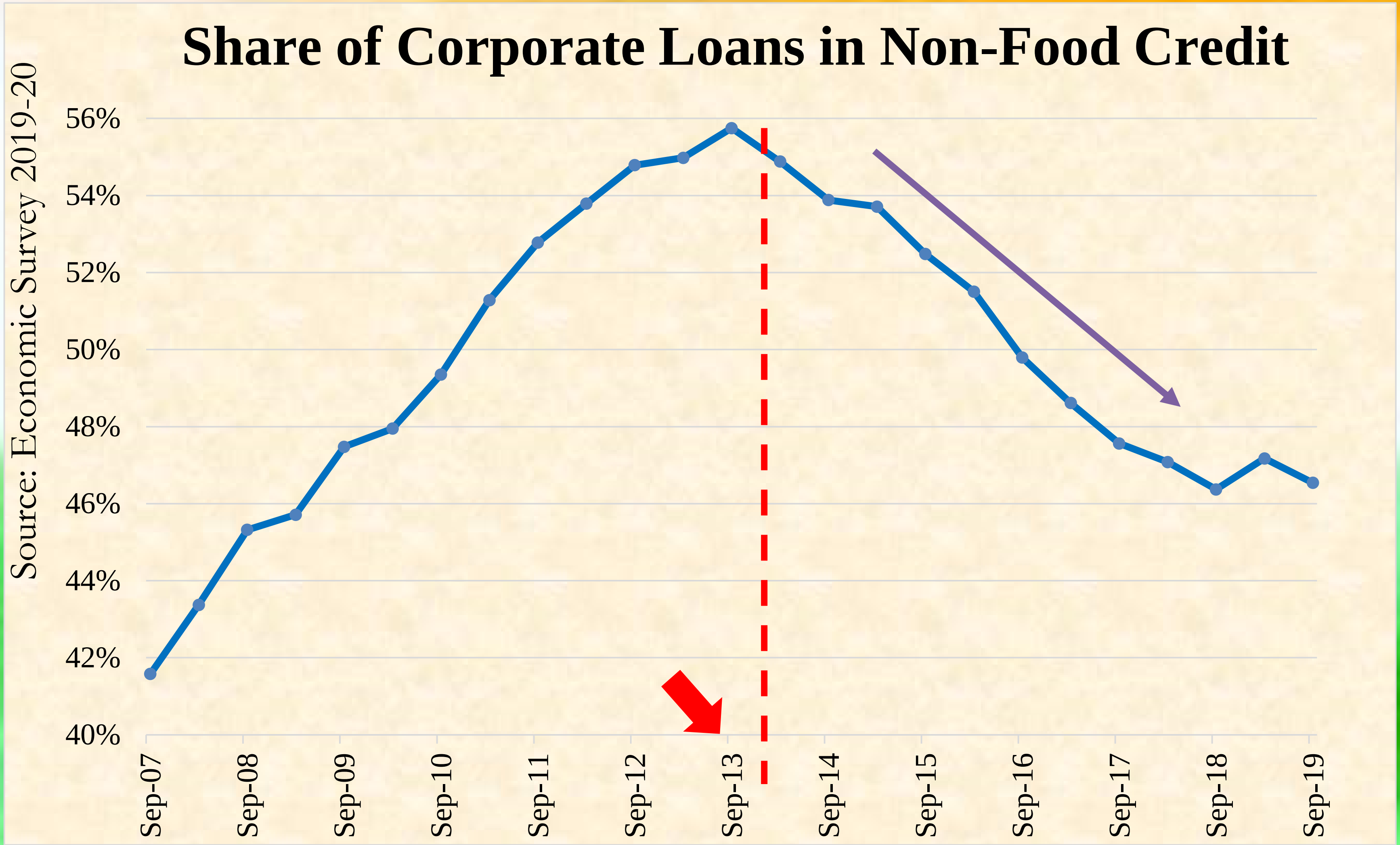
Boom & bust in Corporate Credit: 2013 is focal point



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Private Investment affected by sharp decline in Credit

Credit growth: 2015-21: 9% p.a.
2005-14: 21.9% p.a.

Source: Economic Survey 2019-20

Firm Year	Corporate Credit (↑ or ↓ in debt/assets): (1)	Investment (↑ or ↓ in Fixed Assets): (2)	Relationship between (1) & (2)
2011	2006-10	2011-15	Not Significant
2012	2007-11	2012-16	Not Significant
2013	**2008-12**	**2013-17**	**Significant & -ve**
2014	2009-13	2014-18	Not Significant
2015	2010-14	2015-19	Not Significant

Fact shown in Table : ↑ in Corporate Credit from 2008-12 correlates –vely with corporate investment from 2013-17. No correlation for change in corporate credit in any of the other 5-year periods.
Inference: The boom-bust in corporate credit – with 2013 as the focal point – led to the sharp decline in private investment.

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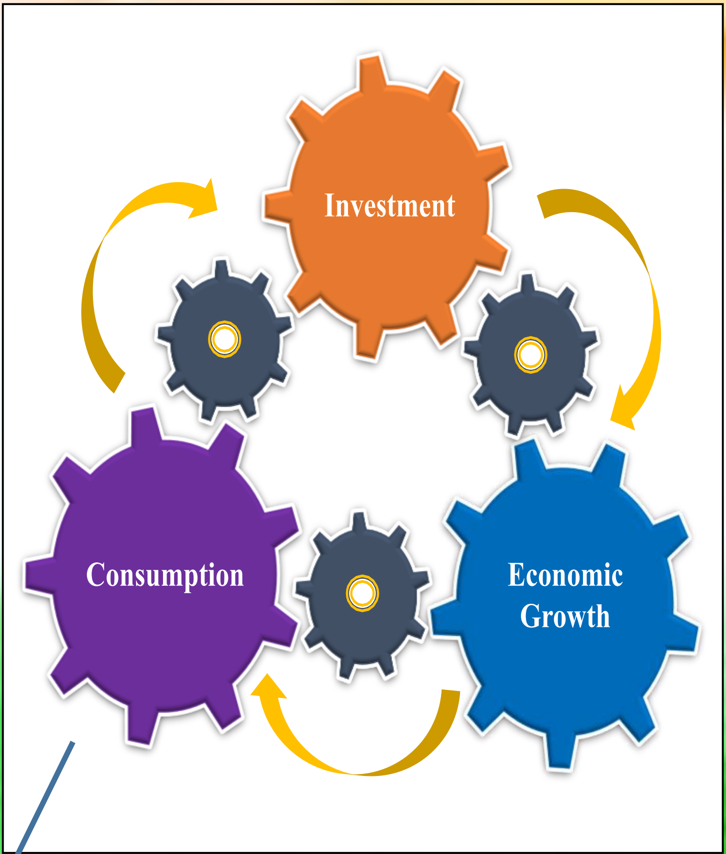
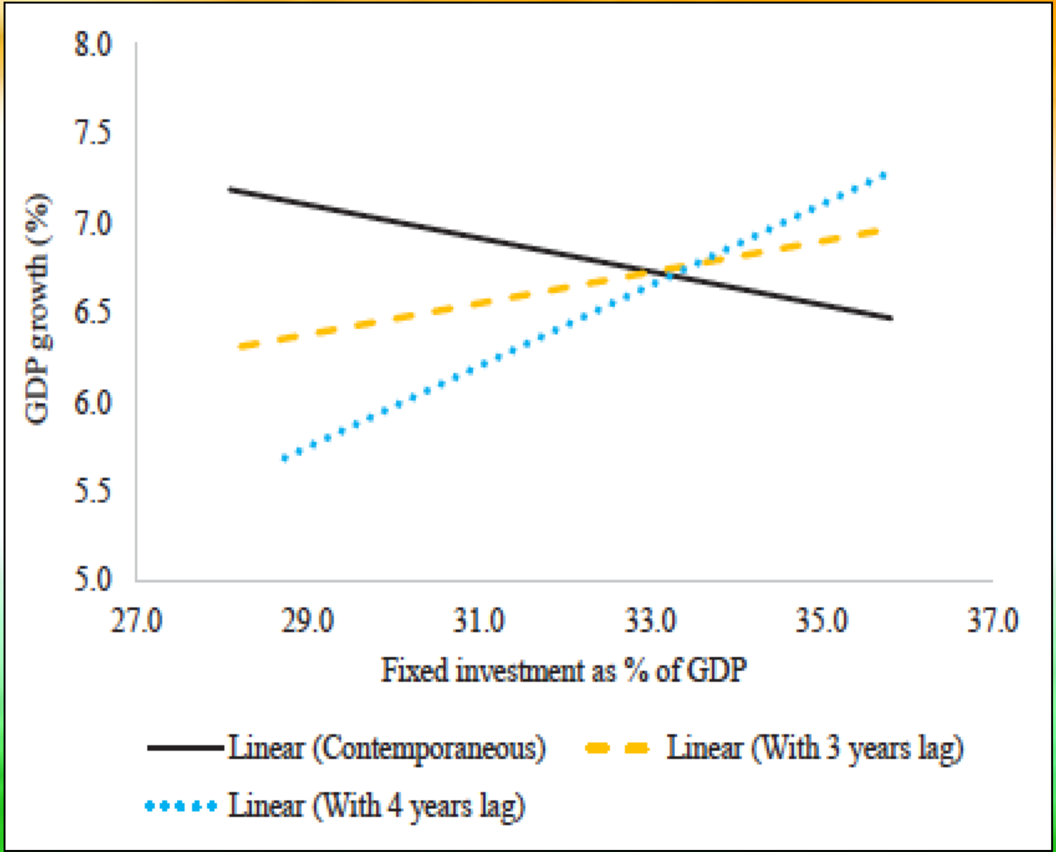
Lagged effect of declining investment on GDP growth

Source: Economic Survey 2019-20





Recall that investment has sharpest effect on growth 4 years later.
So, decline in investment from 2013 had impact on growth from 2017.
Cascading effects on consumption then through the "virtuous cycle."

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Pre-pandemic Economy: India’s employment situation before Covid?

Why am I providing the employment numbers?

- Employment is an area where the uninformed/ misinformed narratives have been endemic.

- Data – from Periodic Labour Force Survey conducted by NSSO – clearly separates the facts from the narrative

- Employment data clearly reveal that quality of jobs has improved
  - ↑ in Salaried/ regular wage workers by 40 mn in 2019-20 vs 2011-12, especially among females
  - ↑ in formal employment by 20.6 mn

- Side-point: NSSO Survey data is trustworthy, CMIE is not. See:
  - https://www.epw.in/journal/2021/52/commentary/how-reliable-labour-market-data-india.html
  - https://economictimes.indiatimes.com/jobs/a-tale-of-two-methodologies-which-dataset-captures-the-real-picture-of-the-labour-market/articleshow/81234857.cms
  - https://economictimes.indiatimes.com/opinion/et-commentary/view-its-time-for-cmie-to-rethink-how-they-determine-labour-market-data/articleshow/83554205.cms

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Regular wage/ salaried employees ↑ 46.9% (= 41 mn) in 2019-20 vis-à-vis 2011-12, 82% ↑ among females

	Regular Wage/Salaried Employee (millions)			
	2011-12	2019-20	2019-20 vs 2011-12	2019-20 vs 2011-12 (%)
Total	88.3	129.7	41.4	46.9%
Urban	59.1	84.3	25.2	42.6%
Rural	29.3	45.4	16.1	54.9%
Male	71.0	98.0	27.0	38.0%
Female	17.4	31.7	14.3	82.1%

Source: Periodic Labour Force Survey

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Self-employed ↑ by 36.5 mn in 2019-20 vis-à-vis 2011-12 = growth of 14.9%

	Self-employed (millions)			
	2011-12	2019-20	2019-20 vs 2011-12	2019-20 vs 2011-12 (%)
Total	245.4	281.9	36.5	14.9%
Urban	57.3	65.2	7.9	13.8%
Rural	188.1	216.6	28.5	15.2%
Male	173.3	200.2	26.9	15.5%
Female	72.0	81.7	9.7	13.4%

Source: Periodic Labour Force Survey

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Casual labour ↓ by 15.5 mn in 2019-20 vis-à-vis 2011-12 with ↓ by 18.6 mn in rural areas contributing most

	Casual labourer (millions)			
	2011-12	**2019-20**	**2019-20 vs 2011-12**	**2019-20 vs 2011-12 (%)**
Total	139.2	123.7	**-15.5**	**-11.2%**
Urban	20.2	23.2	3.0	14.7%
Rural	119.1	100.5	**-18.6**	**-15.6%**
Male	99.5	89.5	**-10.0**	**-10.0%**
Female	39.7	34.1	**-5.6**	**-14.1%**

Source: Periodic Labour Force Survey

Formal Employment ↑ by 20.6 mn in 2019-20 vis-à-vis 2011-12 = growth of 53.8%

Organized & Unorganized (in millions)				
	2011-12	2019-20	2019-20 vs 2011-12	2019-20 vs 2011-12 (%)
Formal	38.30	58.90	**20.60**	**53.8%**
Informal	434.60	476.45	41.85	9.6%
Total	472.90	535.34	62.44	13.2%

Source: Periodic Labour Force Survey

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Formal Employment in organized sector ↑ by 13.8 mn in 2019-20 vis-à-vis 2011-12 = growth of 37.2%

Organized sector (in millions)				
	2011-12	2019-20	2019-20 vs 2011-12	2019-20 vs 2011-12 (%)
Formal	37.10	50.90	**13.80**	**37.2%**
Informal	44.70	44.57	-0.13	-0.3%
Total	81.80	95.47	13.67	16.7%

Source: Periodic Labour Force Survey

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Formal employment in unorganized sector ↑ by 6.4 mn in 2019-20 vis-à-vis 2011-12 = growth of 400%

Unorganized sector (in millions)				
	2011-12	2019-20	2019-20 vs 2011-12	2019-20 vs 2011-12 (%)
Formal	1.60	8.00	**6.40**	**400.1%**
Informal	389.50	431.87	42.37	10.9%
Total	391.10	439.87	48.77	12.5%

Source: Periodic Labour Force Survey

Labour Force Participation Rate (LFPR), Worker Participation Rate (WPR) have ↑ and Unemployment Rate (UR) ↓ over last 4 years

Years	LFPR (%)	WPR (%)	UR (%)
2017-18	49.8	46.8	6.0
2018-19	50.2	47.3	5.8
2019-20	53.5	50.9	4.8
2020-21	54.9	52.6	4.2

Above data is from Annual PLFS data by NSSO.

Quarterly PLFS report by NSSO, which only tracks urban areas, showed sharp ↑ in unemployment rate due to Covid lockdown (20.8% in Apr – Jun, 2020 quarter).

NSSO's Survey methodology is thus quite robust and results reliable.

Note NSSO data is not administrative data

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Potential Challenges & Risk factors

Is quality of macro-data a challenge? No… See Economic Survey 2019-20

- No! See https://www.indiabudget.gov.in/budget2020-21/economicsurvey/doc/vol1chapter/echap10_Vol1.pdf
- Using careful statistical and econometric analysis, this chapter finds no evidence of mis-estimation of India's GDP growth. The models that incorrectly over-estimate GDP growth by 2.8% for India post-2011 also mis-estimate GDP growth over the same time period for 51/95 other countries in the sample. The magnitude of mis-estimation in the incorrectly specified model is anywhere between +4% to -4.6%, including UK by +1.6%, Germany by +1.0%, Singapore by -2.3%, South Africa by -1.2% and Belgium by -1.3%. However, when the models are estimated correctly by accounting for all unobserved differences among countries as well as the differential trends in GDP growth across countries, GDP growth for most of these 52 countries (including India) is neither over- or underestimated. In sum, concerns of over-estimation of India's GDP are unfounded.

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Real Challenges and Risk Factors

- Global economy, especially supply-side problems stemming from the Ukraine war

- Inflation becoming systematically embedded through inflation expectations, which then may lead to monetary policy being unsupportive of growth

- Implementation of several initiatives and reforms announced post Covid