India – The New Age Bright Spot In The Global Scenario

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ABSTRACT:

India's growth story has created a buzz as it enters 2016 on the cusp of a critical growth recovery, which offers opportunities that may not be available to many of its emerging market peers that are more dependent on exports and commodities.

This research paper seeks to explore –

1. How India is projected as the fastest growing major economy.
2. Whether emerging markets are in crisis.
3. Lessons for China in the aftermath of the slowdown.
4. Important themes that are likely to shape Indian economy in 2016.

Key Words:

Emerging economies, policy trade – offs; economic rebalancing; micro-economic fundamentals; structural reform, financial volatility, fiscal consolidation; Index of Industrial Production (IIP); Purchasing Manager's Index (PMI); bumpy road.

Introduction:

Modest growth will be seen in the advanced economies in 2016 with the US performing relatively better, and a continued growth slowdown in the emerging economies, with commodities exporters being under particular pressure. Emerging Asia will remain the fastest growing segment of the global economy, with India continuing to register 7% plus growth. However, risks are weighted to the downside, with the possibility that a prolonged period of financial market volatility could impact confidence.

India enters 2016 on the cusp of a cyclical growth recovery with inflation within the Central bank's target and the economy benefitting from lower commodity prices. This offers India opportunities more than that of many emerging peers. On the other hand, Indian corporate and bank balance sheets, hit by the previous slowdown, are still being repaired and until this process of repair is complete, the ongoing economic recovery will likely to be muted.

Objectives:

The slowdown and rebalancing of the Chinese economy, lower commodity prices, and strains in some large emerging market economies will continue to weigh on growth prospects in 2016-17. Also added is the gradual exit from an accommodative monetary policy by the US – all downside risks. Global growth could be derailed on account of the spillover effect of China's rebalancing on other economies through trade, weaker commodity prices and increasing volatility in financial markets.

The objective of this research paper is to examine how India has created a buzz and it stands tall as the fastest growing major economy. In the process India has to go slow and steady in dealing with potential economic and policy threats such as inadequate infrastructure, exchange rate volatility and over-regulation. It has to prove that despite fear which clouds the streets, strong macroeconomic fundamentals will finally win.

Research Methodology:

This is a research paper which draws on secondary data of IMF, World Bank, UN Report and Central Statistical Organisation (CSO). The analysis examines the fact that India is an exception in the global scene with improved macroeconomic foundations and economic reforms. The Indian economy has shown a lot of resilience in maintaining growth during a time of ebbing global demand, falling commodity prices and weakening growth in emerging economies. A stimulating fiscal policy and fiscal consolidation is the need of the hour and should not hold back much needed capital spending at this point of time.

Main Paper:

The IMF has retained India's growth projections at 7.5% for 2016-17 and 2017-18 each, even as it cut its forecast for the global economy to 3.4% in 2016 and 3.6% in 2017. Growth in China is expected to slow to 6.3% in 2016 and 6% in 2017, primarily reflecting weaker investment growth as the economy continues to rebalance. India and the rest of emerging Asia are generally projected to continue growing at a robust pace, although with some countries facing strong headwinds from China's economic rebalancing and global manufacturing weakness. Emerging markets and developing economies account for over 70% of the global growth.

Even as IMF retained growth projections for India's economy for the current financial year, it should be noted that it represents stagnation in growth compared to 2014-15. Besides, it also implied that growth would be only bit higher in the second half of the current financial year, since the first half yielded expansion at 7.2%.

Data provided by IMF also showed that India will have to diversify its exports to developing countries since they would see increase in their imports in 2016 and 2017 compared to 2015.

India is expected to be the fastest growing large economy in 2016-17, the World Economic Prospects 2016 Report by UN has pointed out. India's average GDP growth has been estimated to grow by 7.3% in 2016 and 7.5% in 2017, up from 7.2% in 2015. China will be increasing its GDP by 6.9% and 6.5% for next 2 years.

In comparison, GDP in S. Asia (India, Bangladesh, Pakistan, Nepal, Bhutan, Sri Lanka, Maldives and Afghanistan) is expected to grow by 6.7% in 2016 and 7% in 2017. India's economy accounts for over 70% of the GDP in S. Asia.

The major challenges to the economy in unlocking growth is the lack of suitable infrastructure, including energy and transport, delay in big ticket economic reforms like GST and a wide gender gap in employment. Falling crude prices is an important driver behind the country's falling import figures and a balancing current account deficit. But 20% of India's exports are in the category of refined petroleum products which have also suffered from falling crude rates.

Are Emerging Markets in Crisis?

The BRIC countries are no longer the darlings of the investment world; Russia has economically succumbed to falling oil prices and the effects of international sanctions. China had grown too fast, based on excessive debt, and has created bubbles in real estate and in the stock market. After decades of over 20% export growth, China's exports saw negative growth in November2015. Brazil's economy has slumped with fall in crude oil and other commodity prices.

Global factors are thus indicating a bumpy road in 2016. The Chinese economy which was just 9% the size of the American economy in 1993, is now 59%.

The volatility in China's financial markets have limited direct effects on other emerging economies. It speaks of the difficulties inherent in the process of reform and rebalancing on which the Chinese authorities embarked in Nov 2013 and the difficult policy trade-offs that the authorities may be finding increasingly difficult to keep in balance. For eg, a significant weakening of the yuan will undoubtedly have negative consequences for the global economy as a whole as it will result in even stronger deflationary pressures.

IMF has called for demand support and structural reforms to contain the risks. For advanced economies, where inflation is still below the target rate, it suggests accommodative monetary policy continues and fiscal stimulus programmes should be provided as needed and fiscal consolidation, where required should be growth friendly and equitable.

Prospects of a gradual increase in US interest rates coupled with financial market volatility have led to tighter external financial conditions, declining capital flows and further currency depreciations in many emerging economies.

China's topsy turvy stock market and deteriorating currency are roiling global markets. Brazil and Russia have entered deep recessions. However, a financial crisis in emerging economies is less likely than the scary headlines and global market turmoil suggest. The fact is that most developing countries are in much sounder shape than they appear at first. In recent years, most emerging economies have not added enough debt, relative to the size of their economies. Over the past decade, Malaysia's private debt-to-GDP ratio has risen by 18.5% points, Indonesia by 12.5, India by 17, and S Africa by 11, according to data provided by Capital Economics. By comparison, before the 1997 financial crisis, that ratio had surged by nearly 100% points in Thailand and well over 50 in Malaysia.

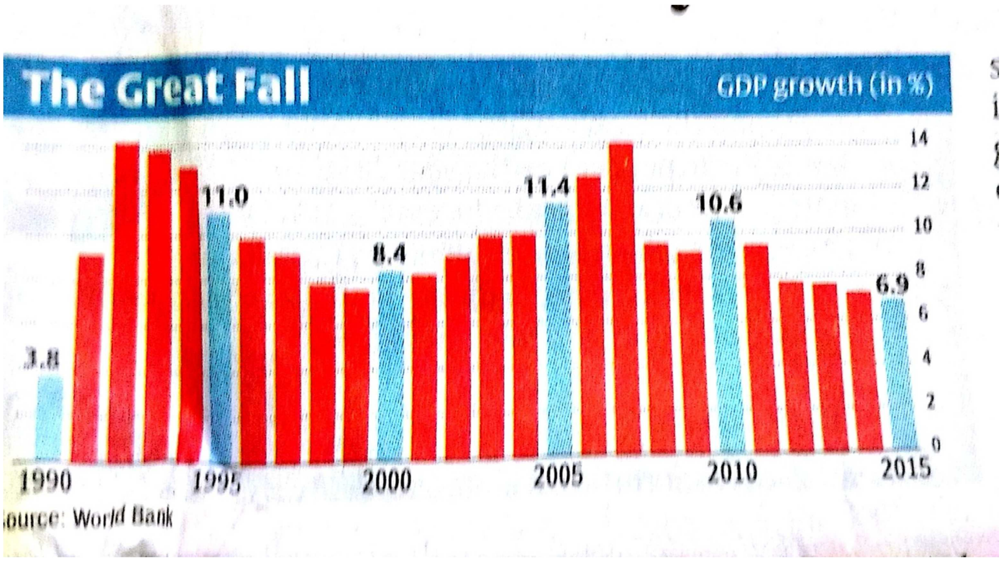
Many developing economies are much better prepared for external shocks as well. In many key emerging markets, most of the new debt is denominated in local, not foreign currency; that makes them less vulnerable to weakening currency and capital outflows. Foreign exchange reserves also beefed up substantially. According to World Bank data, Indonesia had accumulated $112 billion in reserves by the end of 2014 – six times higher than in 1996, before the Asian financial crisis. Thailand's pile at $157 billion, was four times bigger. In India, the reserves stood at only $5.6 billion in 1990, ahead of its near-debt crisis; by 2014, they had grown to $325 billion.

Of course, there is always a chance that a blow-up in one country could spread throughout emerging markets, as happened in the late 1990s. in such panicked circumstances, the differentiated conditions of individual economies cease to matter very much.

Still emerging economies have proven remarkably resilient amid the traumas of the past 3 years. Concerns over the impact of Federal Reserve tightening have led to a stampede of capital out of emerging markets at different periods since mid-2013. In the last quarter, outflows hit an all-time record of $270 billion – larger than the amount that fled during the depths of the 2008 financial crisis. Currencies across emerging markets have tanked as a result. Indian rupee has lost about a fifth of its value against the dollar since mid 2013, and Indonesia's rupiah a third. The Russian ruble is worth less than half what it was only 18 months ago. Yet, despite these stresses, no major emerging economy has tumbled into a full blown crisis.

The negative reaction in India's markets is borne out of fear. Fear about China slowdown, currency and policy mistakes in China and fall in oil prices are making investors nervous. It is not justified by the fundamentals. Oil below $30 increases the risk of credit defaults, posing a threat to the global economy. By itself low oil prices will not lead to recession. India has done better than other emerging market currencies. The Indian currency is down 7.8% but not the same as in other emerging markets. Russia's fell 55-60%. Macro fundamentals in India are good and we have a good Central Bank. Even if there is some weakness it will be limited compared to other currencies.

Lessons for China:



China's slowdown along with the slump in commodity prices, prompted the IMF to cut its global forecasts. A slowing economy and shift to consumer-led growth is hurting industry in China. China will experience a "bumpy landing" in the coming year.

China's main stock index fell nearly 10%. This is a dramatic warning that it is time to make fundamental changes in the way they manage the economy. The Chinese economy is growing nearly 7%, down from 10.6% in 2010, but still a healthy pace. The boom was fuelled by lavish investment and spending as well as profligate borrowing. China's Central Govt orchestrated that binge by pumping billions of dollars into the economy in the aftermath of the 2008 global financial crisis and by failing to to enact reforms that would make it easier for private and foreign companies to compete with inefficient state owned enterprises. Chinese officials also used state-owned media to encourage individual investors to pour their savings and borrowed money into the stock market, leading to a massive bubble. When market started to tumble over the summer, the Government blamed rumourmongers and speculators, and ordered firms and state-owned companies to keep buying which simply disguised the underlying problems.

Instead of trying to micro manage stock prices, China should be strengthening the economy foremost by shifting its emphasis from **investment to consumer spending and services.** China can no longer grow by taking people off the farm and putting them to work in factories. It needs to move people into white-collared jobs. It should help create more such jobs and make the economy more competitive by easing the way for private companies to get into industries like telecommunications and insurance currently dominated by state owned corporations.

China also has to clean up its **financial system.** Many businesses and local Governments have borrowed billions of dollars to build high speed rail lines, real estate developments and other projects. The Government should encourage lenders and borrowers to quickly **restructure loans** that paid for those projects so that banks are not crippled by bad debts.

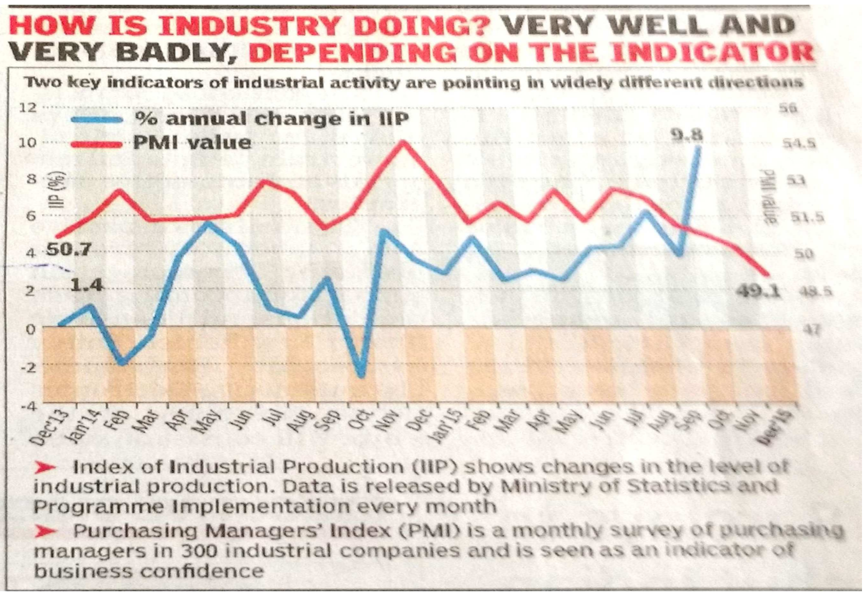
China's dealing with its problems has far-reaching implications because it has become such a big part of the world economy. It is one of the biggest consumers of oil, soyabean and iron ore and when demand falters, economies in Brazil, Saudi Arabia and S. Africa suffer. Even industrialized economies like Germany, Japan and US are vulnerable, because they sell manufactured goods to China and many MNCs have invested a lot of money in the country. Devaluing the currency, the renminbi will aid the domestic economy by raising China's exports and reducing its imports, but at the expense of the rest of the global economy. A Command and Control approach to economic management will not produce the results of the past.

The Themes that will drive the Indian Economy:

Concerns over the US rate cycle and China growth have hurt flows into emerging markets. Following are some of the themes that are likely to slowly and steadily shape the Indian economy in 2016.

1. **Gradual Growth Recovery :**

Growth will be driven by a faster rise in **Consumption**, rather than **Capital expenditure.** Higher real disposable incomes, lower borrowing costs and the income boost from the Pay Commission hike will further boost urban demand. Rural demand should improve, if monsoon is normal. Government's thrust on infrastructure investments may be constrained given the added burden of Seventh Pay Commission, while under unutilized capacity in the manufacturing sector is likely to prevent a substantial acceleration in private sector capital expenditure.



The **Diwali Effect** regularly impacts Oct and November data. Consumption rises during the Dussehra-Diwali period due to bonuses, the traditional annual buying and with holidays, manufacturing falls. It is hard to deseasonalise this effect, since festive season wanders across 2 months. By clubbing Oct and Nov 2015, we can average the Index of Industrial Production (IIP) values and compare those to similarly averaged period of Oct-Nov 2014. The averaging leads to a small positive change in IIP in Oct-Nov 2015 combined. This indicates growth in manufacturing slowed but it was still growing in Oct-Nov 2015. There are further worries in that the Manufacturing PMI (Purchasing Managers' Index) for Dec has a negative value, under 50. This suggests contraction in December 2015.

Thus **investment recovery** will be mainly led by implementation of stalled projects and FDI inflow. At the margin, consumption demand will outpace capital expenditure demand.

2. **Stable Inflation Outlook:**

After falling sharply in 2015, CPI inflation is expected to average 5.4% in 2016 from 4.9% in 2015.However lower oil prices, weak wage growth and ample manufacturing spare capacity offset the upside risk from rising discretionary demand. RBI is expected to deliver a final 25 basis point repo rate cut in Q2 2016. Beyond this, with inflation expectations still elevated and little headway in farm reforms, it will be challenging to lower inflation to RBI's medium-term inflation target of 4% (March 2018), particularly with the output gap likely to close gradually.

Low inflation indicates a greater balance between domestic demand and supply conditions and would help India's private sector remain internationally competitive. And because Corporate profits are an important source of Government revenues, stronger corporate profits will support the Government's **fiscal consolidation** efforts. Corporate taxes at 17% contributes to a significant portion of Centre's revenues. However, while the pay revision for central Government employees and pensioners is likely to boost demand, it also poses a challenge to fiscal and inflation management.

3. **Quality of Fiscal Consolidation:**

The Government's objective of fiscal consolidation without compromising the **quality of consolidation** looks challenging. The once-a-decade hike in government employee salaries and pensions and the "one-rank-one-pension scheme will cost the Government 0.5% and 0.4% of GDP respectively Add to that

the 0.4% of GDP fiscal consolidation envisaged (from 3.9% in FY 16 to 3.5% in FY17) and it becomes clear that the Government needs to create savings and additional revenues of almost 1% of GDP.
Higher tax collections from excise duties on petroleum products, a hike in the service tax rate and significantly higher asset sales can partly plug the gap, but the fiscal deficit target of 3.5% of GDP cannot be achieved without a slight cutback in capital expenditure. The Government will have to increase its dependence on off-balance-sheet sources of financing of infrastructure projects.

4. **Problem of Plenty:**

   Low commodity prices remain a positive for India's external sector. Despite the divergence between domestic(faster) and global(slower) growth, India's current account deficit is expected to narrow to 0.5% of GDP in 2016 from 0.7% in 2015. Moreover financing the current account deficit should be even easier. Net FDI inflows are expected to rise to 1.6% of GDP in 2016 due to strong **pull factors** such as relaxation of FDI norms, emerging new growth avenues like e-commerce, Railways and renewable, improving domestic growth and **push factors** like slowing China.

5. **Legislative Reforms:**

   Among legislative reforms, the **GST Bill** remains the litmus test. Strategic disinvestments from loss-making PSUs, the Bankruptcy Code and the amendment to the RBI Act are other key reforms that could help. Overall we cannot expect any fireworks, but a gradual growth recovery and benefits from lower commodity prices may support the **slow and steady cycle in 2016.**

Conclusion:
There is a need for policy makers in emerging markets and developing countries to redirect activity to **new sources of growth.** These economies also need to press on with **structural reforms** to remove infrastructure bottlenecks, facilitate a dynamic and innovation friendly business environment and bolster human capital through reforms in education, labour and product markets.

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