Paper — IV — Economy And Development Of India And Andhra Pradesh

Major Challenges of Indian Economy – Inconsistent growth rate, Low growth rates of agriculture and manufacturing sectors

Current trends and challenges in the Indian Economy

Good news is underway for India as its economy is poised to win back its tag of the fastest growing economy in the world. The recent upgrade of India's rating by the US based credit rating agency Moody's (Baa2 from Baa3) in recognition of the reforms agenda pursued by the Government is a major boost to investor confidence. Further, as the short term disruptions caused by major reforms such as the Goods and Services Tax (GST) and demonetization recede, the economy is on the rebound and is likely to achieve higher growth targets in the New Year.

Growth

Gross Domestic Product (GDP) is on a recovery path after slowdown in the first quarter of 2017-18, and real GDP growth for the second quarter (2QFY18) increased to 6.3% from 5.7% in the previous quarter, a likely fallout of the introduction of GST. The second half of 2017-18 will witness a higher growth rate, and this is further expected to consolidate in the coming New Year, as the benefits of GST and other reforms gain traction.

The agricultural sector registered moderate growth as erratic monsoon in several parts and flooding in some states impacted performance.

Industrial growth accelerated sharply during the second quarter of FY 2018 and jumped to 6.9% from 1.5% in the previous quarter, on account of a sharp increase in manufacturing and electricity, gas, water supply and utility services. Manufacturing registered an impressive growth at 7% in 2QFY18 as compared to 1.2% posted in the first quarter. Services sector grew only marginally at 6.6% in the second quarter as compared to 7.8% in the previous quarter.

Inflation

The economy saw high inflation during October 2017 owing to elevated food prices. Going forward, this is likely to be contained on account of a good harvest and favourable monsoons. The impact of GST on prices is likely to become clearer in the coming year as the teething problems related to its implementation ease out. Further, the GST Council's decision to cut tax rates on 177 items is also expected to partially ease the inflationary pressure, as the companies start passing the benefits of lower prices to consumers.

External Sector

Healthy foreign fund inflows caused the rupee to strengthen during the latter half of the year. The recent Moody's upgrade is likely to encourage further inflows and the rupee could appreciate further. On the other hand, the impact of the decision in the US to raise interest rates and introduce tax cuts may work the other way. In any case, India's consumer markets are expected to remain a strong incentive to FDI. A contraction in export growth pushed the merchandise trade

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deficit to a near 3-year high in October 2017, which was forcefully reversed in November with a positive growth rate of over 30%. With the streamlining of GST related issues and some changes in GST rules by the Government as well as firming of global recovery, export growth will emerge as a powerful growth driver in 2018.

Monetary Policy

The Reserve Bank of India (RBI) kept policy rates unchanged in its fifth bi-monthly monetary policy meeting on 6th December, 2017. However, industry is hopeful that going forward, RBI would lower interest rates to boost broad-based investment and consumption activity which in turn would promote economic growth.

Credit Growth

Credit growth to the non-food sector shows encouraging signs of pick-up in the last few months. Recapitalization of Public Sector Banks may bolster credit flows further and ease their stressed assets situation.

CII Business Confidence Index

The Business Confidence Index (BCI) by Confederation of Indian Industry (CII), climbed up to 59.7 during October-December 2017 as against 58.3 in the previous quarter. This increase was a result of improvement in the perception regarding overall economic conditions and expectations of improved business situation post the recent disruptions which prompted companies to be optimistic about favourable economic growth in the future. The findings are part of CII's 101st edition of quarterly Business Outlook Survey, based on around 200 responses from large, medium, small and micro firms, covering all regions of the country. The recovery recorded in the index coupled with India's sharp improvement in the Ease of Doing Business rankings (India jumped 30 places to 100) this year reinforces company perception that demand pick up is underway. Most of the respondents in the survey also believe that GST payments would become hassle-free by Q1 2018-19.

Challenges

Firms rated low domestic demand followed by high commodity prices as main concerns in CII's Business Outlook Survey. Stepping up private investment remains a major macroeconomic challenge in the next year.

Inflationary pressures also remain a concern. Though food prices are likely to be contained on account of favourable monsoons, caution must be exercised as upside risks still remain in the form of implementation of farm loan waiver and 7th Pay Commission hand-outs.

India's share in world exports is currently at 1.8%. Efforts to increase this figure by way of providing export credit to manufacturers, increasing the capital base of Export Credit Guarantee Scheme (ECGC), increasing subvention to 4% etc. must be undertaken.

The economy benefitted from increased foreign inflows during the latter half of 2017. While this is good news, efforts to contain further appreciation of the rupee should be in place as further strengthening may affect exports and job creation.

Bank credit growth hit a 20 year low in 2016-17 with Non-Performing Assets (NPAs) at 9.9%. India has been ranked fifth on the list of countries with highest NPAs. Though bank recapitalization efforts are underway, the economy needs to recover from the bad loan problem quickly for

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favourable economic growth in the future. The infrastructure deficit is a major concern and infrastructure investment needs to be stepped up as currently it is not in par with the needs of the economy.

Other challenges for the economy include addressing infrastructural bottlenecks in the agricultural sector, investment in human resources to leverage the demographic dividend, increasing expenditure on education and healthcare sectors, and social security provision for the unorganized sector. With on-going reforms that are beginning to positively impact the economy, CII is optimistic about Indian growth prospects in 2018. At the same time, policymakers need to be watchful and address the current macroeconomic challenges for a sustainable and fruitful recovery.

Inflation and oil prices

Inflation & Control Mechanism

Inflation is a sustained increase in the general price level of goods and services in an economy over a period of time. When the price level rises, each unit of currency buys fewer goods and services.It is the percentage change in the value of the Wholesale Price Index (WPI) on a year-on year basis. It effectively measures the change in the prices of a basket of goods and services in a year. In India, inflation is calculated by taking the WPI as base.

Formula for calculating Inflation=

(WPI in month of current year-WPI in same month of previous year)

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——————————— X 100

WPI in same month of previous year

Inflation occurs due to an imbalance between demand and supply of money, changes in production and distribution cost or increase in taxes on products. When economy experiences inflation, i.e. when the price level of goods and services rises, the value of currency reduces. This means now each unit of currency buys fewer goods and services.

It has its worst impact on consumers. High prices of day-to-day goods make it difficult for consumers to afford even the basic commodities in life. This leaves them with no choice but to ask for higher incomes. Hence the government tries to keep inflation under control.

Contrary to its negative effects, a moderate level of inflation characterizes a good economy. An inflation rate of 2 or 3% is beneficial for an economy as it encourages people to buy more and borrow more, because during times of lower inflation, the level of interest rate also remains low. Hence the government as well as the central bank always strive to achieve a limited level of inflation.

Various measures of Inflation are:-

- GDP Deflator
- Cost of Living Index
- Producer Price Index(PPI)
- Wholesale Price Index(WPI)
- Consumer Price Index(CPI)

There are following types on Inflation based on their causes:-

- Demand pull inflation
- cost push inflation
- structural inflation
- speculation
- cartelization
- hoarding

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Various control measures to curb rising inflation are:-

- Fiscal measures like reduction in indirect taxes
- Dual pricing
- Monetary measures
- Supply side measures like importing the shortage goods to meet the demand
- Administrative measures to curb hoarding, Cratelization.

Monetary Measures to curb rising inflation
The most important and commonly used method to control inflation is monetary policy of the Central Bank. Most central banks use high interest rates as the traditional way to fight or prevent inflation. Monetary measures used to control inflation include:
(i) Bank rate policy :-When the central bank raises the bank rate, it is said to have adopted a dear money policy. The increase in bank rate increases the cost of borrowing which reduces commercial banks borrowing from the central bank. Consequently, the flow of money from the commercial banks to the public gets reduced. Therefore, inflation is controlled to the extent it is caused by the bank credit.
(ii) Cash reserve ratio :-the central bank raises the CRR which reduces the lending capacity of the commercial banks. Consequently, flow of money from commercial banks to public decreases.
(iii) Open market operations:-Open market operations refer to sale and purchase of government securities and bonds by the central bank. To control inflation, central bank sells the government securities to the public through the banks. This result in transfer of a part of bank deposits to central bank account and reduces credit creation capacity of the commercial banks.

Fiscal Measures to curb rising inflation

The government may raise both direct and indirect taxes to wipe out excess aggregate spending. Once a tax on income and/or wealth is imposed, disposable income gets reduced. This will greatly reduce private aggregate spending.

Direct control on prices and rationing of scarce goods are the two such regulatory measures.

1. Direct Controls on Prices:

The purpose of price control is to fix an upper limit beyond which the price of particular commodity is not allowed and to that extent inflation is suppressed.

2. Rationing:

When the government fixes the quota of certain goods so that each person gets only a limited quantity of the goods, it is called rationing. Rationing becomes necessary when the essential consumer goods are relatively scarce.

The purpose of rationing is to divert consumption from those goods whose supply needs to be restricted for some special reason, e.g., to make such commodities available to a large number of people.

Brent Crude is a major trading classification of sweet light crude oil that serves as a major benchmark price for purchases of oil worldwide. This grade is described as light because of its relatively low density, and sweet because of its low sulphur content. Brent Crude is extracted from the North Sea and comprises Brent Blend, Forties Blend, Oseberg and Ekofisk crudes (also known as the BFOE Quotation). The Brent Crude oil

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marker is also known as Brent Blend, London Brent and Brent petroleum.

Effect of oil prices :

1. Will adversely affect the twin deficit and current deficit of the economy which will have spillover impact.
2. Oil prices are highly vulnerable due to the geopolitical factors and hence they affect our monetary and fiscal policies.
3. Rampant change in oil prices affect our economy by bringing inflation in our economy and hence growth.

Current Account Deficit

The current account deficit is a measurement of a country's trade where the value of the goods and services it imports exceeds the value of the products it exports. The current account includes net income, such as interest and dividends, and transfers, such as foreign aid, although these components make up only a small percentage of the total current account. The current account represents a country's foreign transactions and, like the capital account, is a component of a country's balance of payments (BOP).

The current account balance seems to be an abstruse economic concept. But in countries that are spending a lot more abroad than they are taking in, the current account is the point at which international economics collides with political reality. When countries run large deficits, businesses, trade unions, and parliamentarians are often quick to point accusing fingers at trading partners and make charges about unfair practices. Tension between the United States and China about which country is primarily responsible for the trade imbalance between the two has thrown the spotlight on the broader consequences for the international financial system when some countries run large and persistent current account deficits and others accumulate big surpluses.

- A current account deficit indicates that a country is importing more than it is exporting.
- Emerging economies often run surpluses, and developed countries tend to run deficits.
- A current account deficit is not always detrimental to a nation's economy—external debt may be used to finance lucrative investments.

Managing a Current Account Deficit

A country can reduce its existing debt by increasing the value of its exports relative to the value of imports. It can place restrictions on imports, such as tariffs or quotas, or it can emphasize policies that promote export, such as import substitution, industrialization, or policies that improve domestic companies' global competitiveness. The country can also use monetary policy to improve the domestic currency's valuation relative to other currencies through devaluation, which reduces the country's export costs.

While an existing deficit can imply that a country is spending beyond its means, having a current account deficit is not inherently disadvantageous. If a country uses external debt to finance investments that have higher returns than the interest rate on the debt, the country can remain solvent while running a current account deficit. If a country is unlikely to cover current debt

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