



The fundamentals of the  
**Indian Economy**  
continue to be strong

## THE global economic slowdown has impacted India, but thanks to a strong regulatory regime, high savings rate and a growing consuming class, the country has been able to effectively grapple the crisis. India's Union Minister of Commerce & Industry, Kamal Nath, talks about the impact of the crisis and the measures being taken by the government in an interview with *India Now*.

India's articulate and affable Union Minister of Commerce & Industry, Kamal Nath, is a bundle of energy, who is equally at ease addressing constituents at Chhindwara, his parliamentary constituency in Madhya Pradesh, attending a breakfast meeting with counterparts from around the globe in Geneva, or engaging in tough trade talks involving mind-boggling minutiae and technical details in distant international capitals.

Ministry officials speak in awe of his ability to pack multiple tasks and assignments in a 24-hour span, his phenomenal grasp of complex issues, his negotiating skills and the capability to put in long hours of work daily. He can hold forth on India's positions in trade talks, reel out figures relating to exports and imports, foreign direct investment (FDI), special economic zones (SEZs), travel thousands of kilometres across continents, and then address a huge gathering of dignitaries or an international news conference.

How does he manage all these tasks and yet appear refreshing at the end of a busy working day? "For me, the satisfaction lies in fulfillment of a goal, of achieving the given objective," the minister told *India Now*, in an exclusive interview at his Udyog Bhavan office in New Delhi. "When you pursue a goal and are keen to fulfill your commitments, you get the necessary energy to carry out the tasks," he adds.

### **Excerpts from the interview with Minister Kamal Nath:**

#### **What are the crucial lessons to be learnt by the developed world from the ongoing financial turmoil?**

The present global financial crisis is of unprecedented dimensions and has highlighted some major weaknesses in the regulation and supervision of the

global financial system. The following lessons can be drawn from the crisis:

- Financial supervision has drawn widespread critique: The stereotype perception is that risk management and supervisory practices lagged behind financial innovations and emerging new business models. The present crisis underscores the need for regulation staying ahead of the curve, and for continually upgrading the skills and instruments for financial regulation and supervision.
- Inter-agency coordination: The origins of the current crisis can be traced to both the build up of macro-global imbalances and the mispricing of risks in the financial system, which in turn, was facilitated by prolonged easy monetary policy and excess liquidity in advanced economies. The respective roles of central banks, regulators, supervisors and fiscal authorities regarding financial stability need to be revisited for ensuring close co-operation among all the agencies entrusted with the task of maintaining financial stability.
- Weaknesses of structured products and derivatives: Unfolding of crisis has revealed the weaknesses of structured products and derivatives in the credit markets. This throws up questions about the appropriateness of various structured products such as credit derivatives and their financial stability implications.
- Finally, the near meltdown of the US financial sector is seen by some as evidence that markets do not work. This may be the wrong lesson to draw. The right lesson is that markets and institutions do succumb occasionally to excesses, which is why regulators have to be vigilant, constantly finding the right balance between attenuating risk-taking and moderating volatility.

#### **How long do you think the present crisis will continue? What are the major steps to be taken to revive global economic growth?**

Till six months ago, there was a view that the fallout of the crisis will remain confined to the financial sector and that, at the most, there would only be a shallow recession in the advanced economies. These expectations have now been belied. The contagion has traversed from the financial to the real sector. The recession is likely to be deeper and the recovery may be longer than earlier anticipated.

#### **The IMF projection for growth of world output and imports by advanced economies:**

- Growth of world output, trade volume and imports by advanced economies has been further revised downward by IMF in its November, 2008, projection, as compared with October, 2008, projection.
- The most important aspect of November 2008 forecast is that while there has been some downward revision of world output, trade volume and imports by advanced economies during 2008, the downward revision for 2009 has been significantly on the higher side. The implication is that the situation in 2009 would be still more difficult as compared to 2008.
- As per IMF November 2008 forecast, world output will increase by 3.7 per cent in 2008 (down by 0.2 per cent from October 2008 forecast) and 2.2 per cent in 2009 (down by 0.8 per cent from October 2008 forecast) as compared with 5.0 per cent in 2007.
- World trade volume (both goods and services) will increase by 4.6 per cent in 2008 (down by 0.3 per cent from the October forecast) as compared to robust growth of 7.2 per cent and 9.4 per cent in 2007 and 2006 respec-



tively. Projection for 2009 is 2.1 per cent.

- As per the forecast, imports by advanced economies would grow only by a meagre 1.8 per cent in 2008 and (-) 0.1 per cent in 2009 as compared with 4.5 per cent in 2007.
- Lower imports by the developed countries are bound to impact exports from the developing countries including India.

In the context of slowdown of global growth, central banks in several countries have resorted to coordinated liquidity injections and downward revision of interest rates. Besides, governments have also undertaken strong fiscal stimulus initiatives in an effort to revive the growth.

In India, the Reserve Bank of India (RBI) has taken a series of measures for countering the impact of the global recession on India's economic growth. On the monetary side, the RBI has sought to pump sufficient liquidity into the banking system to enable bank credit to meet the expanded requirements of the economy.

Banks have been provided adequate liquidity through a series of reductions in the cash reserve ratio (CRR) and additional flexibility in meeting the statutory liquidity ratio (SLR) requirement. Interest rate reductions have also been signaled by reductions in the repo and reverse repo rates. Access to external commercial borrowings has also been liberalised so that borrowers capable of accessing funds from abroad are allowed to do so.

Separately, the Government of India has taken a number of fiscal measures to stimulate the economy. These measures, inter alia, include: across-the-board reduction in Cenvat, support to the export, housing, micro, small and medium enterprises (MSME), textiles, infrastructure and finance sectors.

### **Will India emerge stronger from this global crisis?**

To answer whether India will emerge stronger from the global crisis has to be assessed by considering positive and negative factors that the Indian economy has to reckon with against the background of its strengths.

#### **On the positive side:**

- India continues to retain its position as

preferred destination for investments (latest World Investment Report places India as second-most preferred destination). Foreign direct investment (FDI) inflows accelerated in the first half of 2008-2009 and are likely to remain strong, even if there is further moderation in growth rate.

- Prospects on remittances also seem favourable. NRI deposits, which are rupee denominated, are unlikely to be affected by the global financial meltdown. NRI deposits, which are US\$/foreign exchange denominated, may find India's public sector banking system a safe haven at a time of unprecedented global turmoil and uncertainty. This is supported by the fact that net inflows have turned positive in 2008-2009 (so far) from negative in 2007-2008.
- From a macro-economic perspective, the contribution of foreign capital to gross domestic investment (of 37.5 per cent of GDP) was only 1.5 per cent of GDP.
- India has a relatively high share of services in GDP than many other emerging economies and developing countries. Historically across countries, services tend to be less affected by cyclical downturns than manufacturing. This factor is likely to moderate the negative affect on overall GDP growth.
- Five years of nearly 4 per cent agriculture growth, followed by a projected 2.5 to 3 per cent growth, along with scaling up of the National Rural Employment Guarantee Act (NREGA) programme, means that rural income and consumption are strong and likely to remain so. This is also reflected by the rise in Wholesale Price Index (WPI) food inflation and faster rise in Consumer Price Index (CPI) for agriculture/rural labour despite favourable agricultural growth.
- Like other high growth Asian economies, India's domestic saving rate remains high and has risen sharply with higher growth during the last five years. Also, the increase in gross domestic saving during the last five years was greater than the increase in gross domestic investment rate over the same period.
- Having run a tight monetary policy



## STIMULATING DEMAND

### When do you expect growth to pick up steam?

In a globalised economic system India cannot remain unaffected by the ongoing international economic meltdown and the financial crisis. The crisis has already impacted, albeit moderately, on economic and industrial growth in the country.

The government is committed to taking steps to minimise the impact of the global financial crisis on the Indian economy. It has taken a number of steps recently. These include:

- An across-the-board cut of 4 per cent in ad-valorem Cenvat rate except for petroleum products.
- Several other measures to support exports, housing, Micro, Small & Medium Enterprises (MSME) and textile sectors.
- Authorising India Infrastructure Finance Co Ltd (IIFCL) to raise over US\$2 billion to refinance bank lending for infrastructure projects. This will enable the funding of highways and port projects on hand of about US\$5 billion. To fund additional projects of about US\$15 billion at competitive rates over the next 18 months, IIFCL is being enabled to access in tranches an additional US\$6.15 billion by way of tax free bonds, once funds raised in the current year are effectively utilised.

Exporters are especially hit by recessionary conditions globally. To support exports a number of steps have been taken. As a further measure:

- Taking into account the fact that the rupee has appreciated nearly 4 per cent against the US dollar since November 2008, it has been decided to restore the Duty Entitlement Passbook Scheme (DEPB) rates to those prevailing prior to November 2008. In order to provide predictability and stability of regime in the short-term for future contracts, the DEPB Scheme would be extended till December 31, 2009.
- Duty drawback benefits on certain items including knitted fabrics, bicycles, agricultural hand tools and specified categories of yarn are being enhanced. These changes will take effect retrospectively from

September 1, 2008.

- Exporters have raised a number of procedural issues where modification of procedures could reduce delays faced by them. To consider these and similar problems, the government has decided to constitute a committee under the chairmanship of the finance secretary and including secretaries of the departments of revenue and commerce to look into and resolve these issues on a fast-track basis.
- EXIM Bank has obtained from the RBI a line of credit of over US\$1 billion and will provide pre-shipment and post-shipment credit, in rupees or dollars, to Indian exporters at competitive rates.

The government is closely monitoring its spending to expedite the pace of expenditure for all schemes and programmes. It will set up a fast track monitoring committee to ensure expeditious approval and implementation of central projects. The measures outlined above, together with steps taken earlier, constitute a substantial counter-cyclical stimulus in the current year.



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during the first half of 2008-2009, there is considerable scope for monetary policy easing over the next 6 to 12 months to offset the global increase in demand for money that is being transmitted to India.

#### On the negative side:

- For global capital markets, developments in the US financial markets have been very critical. The freezing of US monetary markets has affected normal, routine trade credits and suppliers' credit, which is very seldom affected in normal cyclical downturns. This is one of the reasons that make current prices unprecedented. These are likely to be reversed when markets unfreeze.
- Equity disinvestment and repatriation has reduced availability of risk capital for the corporate sector worldwide.
- Medium to long term flows are likely to be lower as long as the deleveraging process goes on in the US.
- A major concern is the slowdown

in the OECD countries with growth estimates for the US, EU and Japan being revised downwards virtually every month since September 2008. This will have negative effect on imports of these countries and consequently on exports of emerging economies. Further, specific export intensive manufacturing sectors (eg gems and jewellery) could be strongly affected.

On the whole, the general outlook in the short run and for 2008-2009, continues to be one of cautious optimism. There is evidence of a slowdown in economic activity. The real GDP growth is likely to moderate in the second half of 2008-2009. Industrial activity, particularly in the manufacturing and infrastructure sectors, has decelerated. The services sector too, which has been India's prime growth engine for the last five years, has slowed, mainly in the construction, transport and communication, trade and hotels and restaurants sub-sectors.

For the first time in seven years, exports declined in absolute terms in October and November 2008. Recent data indicate that the demand for bank credit has slackened despite comfortable liquidity in the system. Higher input costs and dampened demand have dented corporate margins, while the uncertainty surrounding the crisis has affected business confidence. Going forward, developments in the real economy, financial markets and global commodity prices, point to a period of moderation in growth, with declining inflation.

However, as indicated earlier, the fundamentals of the Indian economy continue to be strong. The RBI has estimated that GDP growth during 2008-2009 would be between 7.5 and 8.0 per cent. Mid-year review of the Government of India has put it between 7 to 8 per cent.

Once calm and confidence are restored in the global markets, it is expected that economic activity in India will recover sharply. But a period of painful adjustment is inevitable. ↗