PHD Chamber of Commerce and Industry

Global Economic Turmoil, Impact on Indian Economy

Look Ahead

March, 2016

Global Economic Turmoil, Impact on Indian economy: Look ahead

Abstract

The global macroeconomic landscape is currently going through a slowdown and turmoil characterized by weak growth of world output. The situation has been aggravated by; (i) declining prices of a number of commodities, with reduction in crude oil prices being the most visible of them; (ii) turbulent financial markets and (iii) volatile exchange rates. Nonetheless, India has registered a robust and steady pace of economic growth in 2015-16. Additionally, its other macroeconomic parameters like inflation, fiscal deficit and current account balance are improving. Wholesale price inflation has been in negative territory for more than a year and the all-important consumer prices inflation has declined to nearly half compared to previous years.

1. Global Economic Scenario

The global economic activity has remained subdued in 2015 with global growth forecast revised down to 3.4% from 3.6% in 2016 and 3.6% from 3.8% in 2017. Growth in emerging markets and developing economies which account for over 70% of global growth, declined for the fifth consecutive year, while a modest recovery continued in advanced economies.

It has been pointed out that there are some key transitions which continue to influence the global outlook. These include the gradual slowdown and rebalancing of economic activity in China away from investment and manufacturing toward consumption and services, lower prices for energy and other commodities, and a gradual tightening in monetary policy in the United States in the context of a resilient U.S. recovery as several other major advanced economy central banks continue to ease monetary policy.

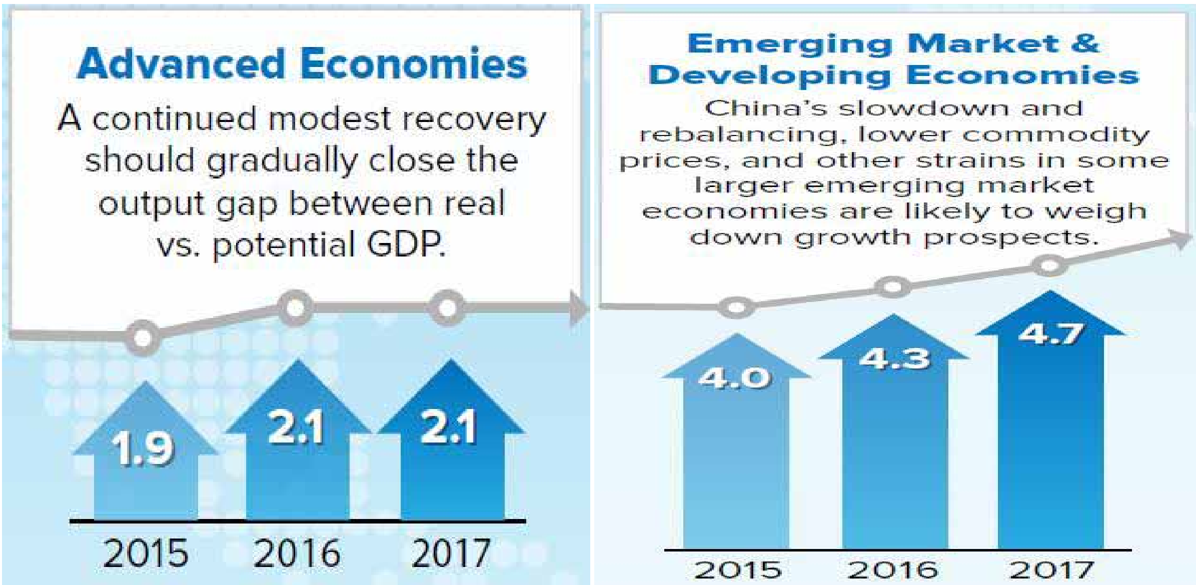
Oil prices have further declined markedly, reflecting subdued global demand and expectations of sustained increases in production by OPEC members. With renewed declines in commodity prices and weakness in global manufacturing, headline inflation is set to soften again in most countries. Core inflation rates remain generally stable and well below inflation objectives in advanced economies.

Financial market volatility has risen amid declining asset prices. Persistent financial market turbulence and the associated asset price declines could perpetuate tighter financial conditions in advanced economies, increasing the cost of capital as well as risk premiums and interest rates. Triggered by developments in financial markets in advanced economies, a more significant and lasting rise in global risk aversion accompanied by a stronger pullback of capital flows to emerging markets may generate even tighter financial conditions in these economies.

Various international organizations have pointed that achieving strong growth in the global economy remains elusive, with only a modest recovery in advanced economies and slower activity in emerging markets. Further, there is need to deploy broad-based reform plans that incorporate monetary, fiscal, and structural policies to stimulate persistently weak demand, re-launch productivity growth, create jobs and build a more inclusive global economy.

According to the IMF, growth in advanced economies is projected to rise by 0.2 percentage points in 2016 to 2.1%, and hold steady in 2017. Overall activity remains resilient in the United States, supported by still-easy financial conditions and strengthening housing and labour markets. The US will grow by 2% in 2016 and by 2.2% in 2017, while the UK is projected to grow at 2.1% in 2016 and 2% in 2017. Canadian growth is projected at 1.4% this year and 2.2% in 2017, while Japan is projected to grow by 0.8% in 2016 and 0.6% in 2017. Growth in Japan is also expected to firm in 2016, on the back of fiscal support, lower oil prices, accommodative financial conditions, and rising incomes.

The IMF has projected that the euro area is projected to grow at a 1.4% rate in 2016 and a 1.7% pace in 2017. In the euro area, stronger private consumption supported by lower oil prices and easy financial conditions is outweighing a weakening in net exports. Germany is forecast to grow by 1.3% in 2016 and 1.7% in 2017, France by 1.2% in 2016 and 1.5% in 2017, while Italy will see a 1% rate in 2016 and 1.4% rate in 2017.

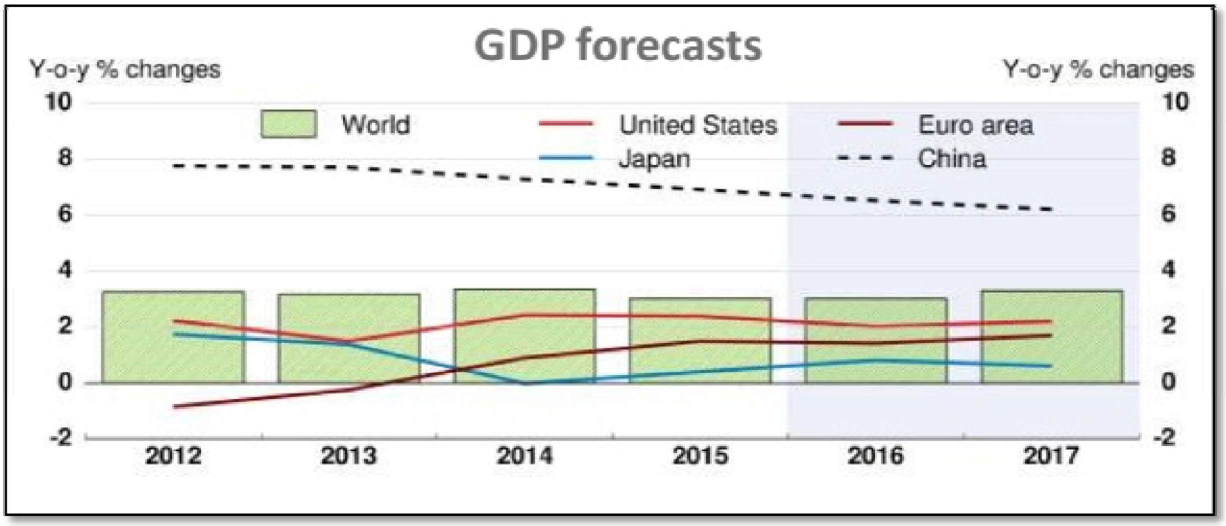


Source: PHD Research Bureau, compiled from IMF

As reported by the IMF, while, growth in emerging market and developing economies is projected to increase from 4% in 2015, the lowest since the 2008–09 financial crisis to 4.3% and 4.7 % in 2016 and 2017, respectively. Growth in China is expected to slow to 6.3% in 2016 and 6.0% in 2017, primarily reflecting weaker investment growth as the economy continues to rebalance.

India will continue to grow robustly, by 7.4% in 2016 and 7.3% in 2017, according to the IMF. 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. By contrast, Brazil's economy is experiencing a deep recession and is expected to shrink by 4% this year and only to begin to emerge from the downturn next year.

With the projected pickup in growth being once again weaker than previously expected and the balance of risks remaining tilted to the downside, raising actual and potential output through a mix of demand support and structural reforms is even more urgent. Additionally, in advanced economies, where inflation rates are still well below central banks' targets, accommodative monetary policy remains essential.



Source: PHD Research Bureau, compiled from OECD

Policymakers in emerging market and developing economies need to press on with structural reforms to alleviate infrastructure bottlenecks, facilitate a dynamic and innovation-friendly business environment, and bolster human capital. Thus, it has been observed that unless the key transitions in the world economy are successfully navigated, global growth could be derailed.

2. Impact on Indian Economy

Growth- India's economic growth is amongst the highest in the world, helped by a reorientation of government spending towards the much needed public infrastructure. These achievements are remarkable because they have been accomplished in the face of global headwinds and a second successive season of poor rainfall. Its macro-economy is robust, and it is likely to be the fastest growing major economy in the world in 2016.

The Indian economy has continued to consolidate the gains achieved in restoring macroeconomic stability in the previous year. Inflation, the fiscal deficit, and the current account deficit have all declined, rendering India a relative haven of macro-stability in these turbulent times. Economic growth appears to be recovering, albeit at varying speeds across sectors.

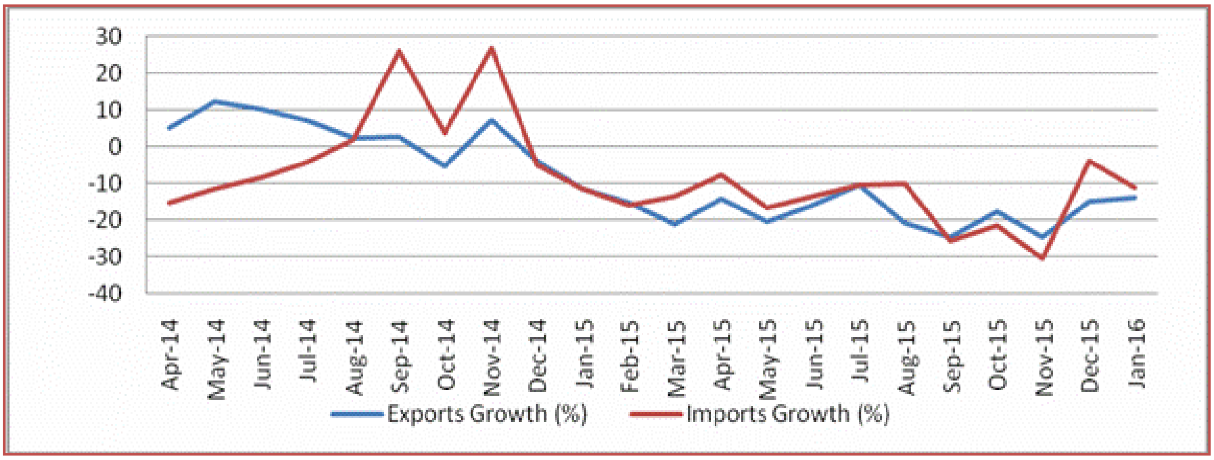
Foreign trade- During the current financial year India's exports declined year-on-year by 17.6 % to US$ 217.7 billion and this decline was broad-based. In keeping with the global trends of slow growth, imports have declined by 15.5 % in 2015-16 (April-January) to US $ 324.5 billion. Lower imports of petroleum, oil and lubricants (POL) are major reasons for the decline in total imports this year so far. The rupee depreciated vis-à-vis the US dollar but appreciated against a number of other major currencies.

Trend in Exports and imports (US$ Billions)

Sl. No.	Components	2012-13	2013-14	2014-15	2015-16 (April-Dec)
1	Exports Volume	300.40	312.36	310.33	196.09
2	Imports Volume	490.74	450.95	448.03	294.94

Source: PHD Research Bureau, Compiled from Ministry of Commerce

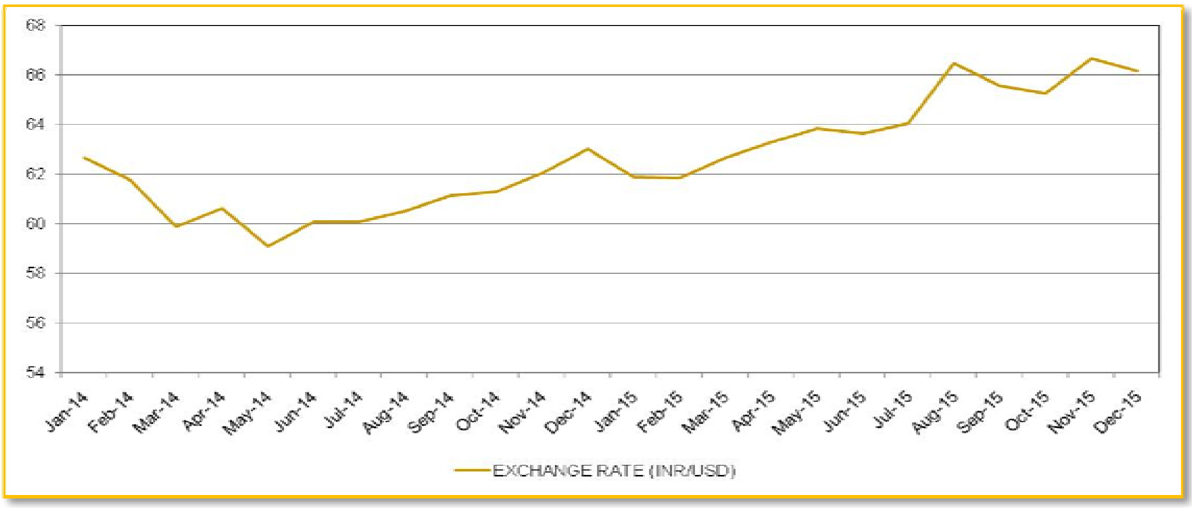
Trend in Exports and imports (%)



Source: PHD Research Bureau, compiled from Ministry of Commerce and Industry, Govt of India

Rupee Outlook- Notwithstanding the beneficial impact on rupee from lower Brent Crude, gold, and FDI/ECB inflows, the headwinds force is severe. The downside risk from USD strength against major currencies will add to the pressure on the rupee. Indian exporters which are already not in a comfortable zone will remain vulnerable to the developments in Chinese Yuan and other major emerging market currencies. Large foreign holdings of Indian equities, shifts in global investor sentiment and portfolio rebalancing moves will continue to impact rupee. Near term outlook for rupee is likely to remain clouded by risk perceptions.

Exchange rate (INR/USD)

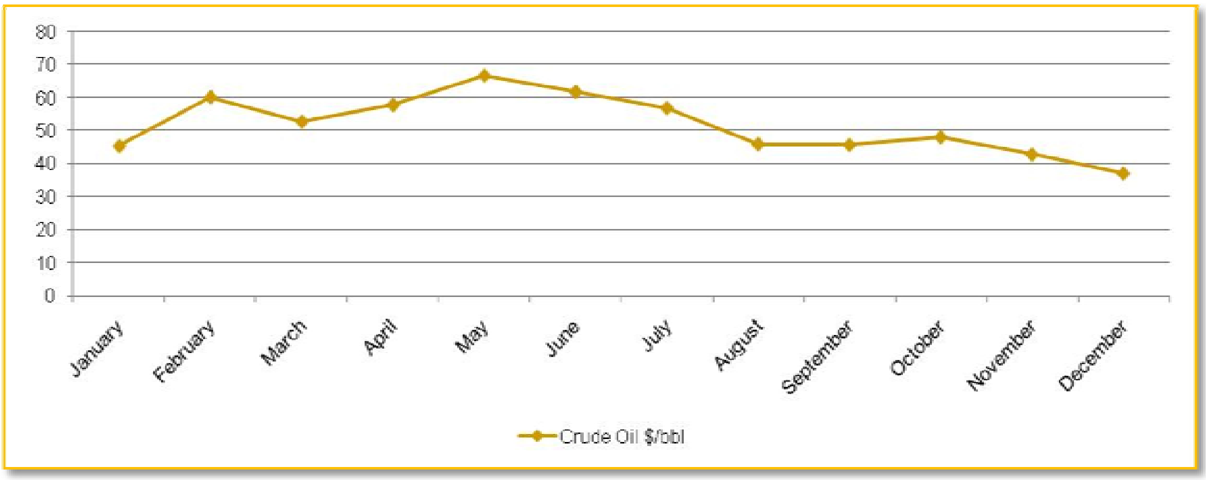


Source: PHD Research Bureau, compiled from Bloomberg

Commodity Prices- Though the pressure on commodities and specifically on oil prices will likely continue but the pace of fall may not be as steep as has been witnessed in the past two years. Hence any significant weakness in the oil prices beyond the current levels looks limited. Further, with India being a net importer of oil and commodities, it should really focus on taking advantage of the lower global commodity prices and falling oil prices. Low crude oil prices will help India keep its fiscal deficit in control and lower oil prices will imply smaller oil, petroleum and fuel based subsidies.

Importantly, a lower import bill will also have positive effects on inflation and inflation expectations. Commodity prices continued to fall in the fourth quarter of 2015, reflecting abundant supplies, weaker growth prospects in emerging economies, and a strong U.S. Dollar. One of the largest declines was in crude oil, which fell from $51 per barrel (bbl) in early October to less than $30/bbl.

Fluctuating Commodity Prices – 2015



Source: PHD Research Bureau, compiled from Bloomberg Markets

Monetary Policy Stance- Fiscal deficit target of 3.9% of the GDP for this year and pegging it at 3.5% for the next has boosted investor hopes that the central bank can no longer postpone an interest rate reduction. Also with the global economic slowdown, inflation is safe from any risks. In light of this 25 basis points cut can be expected in the next bi monthly policy of RBI. However, the amount of interest rate cuts could be limited since inflation continues to be a concern given the erratic monsoons, which have pushed up food prices.

The RBI has already cut rates by 125 bps since January 2015. Existing rigidities in the banking sector have allowed only about half of those rate cuts to get passed on. Bank base rate have adjusted about 60-75 bps over this rate reduction cycle. On top of that, hopes of any further reduction had been dashed as bond yields started to rise. Rate cut will provide a much needed mood lift to markets that have been sulking since the turn of the year.

Nonetheless, careful economic management as regards monetary and liquidity policy, inflation, growth outlook, and fiscal consolidation is essential for sustaining India's growth. As the global prospects and policy challenges point towards a weak global recovery, the task is to sustain India's achievements in a more difficult global environment as the correlation between global and Indian growth has been growing significantly.

3. Look Ahead

If the world economy remains weak, India's growth will face considerable headwinds. For example, if the world continues to grow at close to 3% over the next few years rather than returning to the buoyant 4%-4.5% recorded during 2003-2011, India's medium-term growth trajectory could well remain closer to 7%-7%. In the current global environment, there needs to be a recalibration of growth expectations and consequently of the standards of assessment.

The government needs to examine exports, consumption, and private investment as there are possibilities for exogenous developments, from a rebound in agriculture to a full-fledged international crisis, uncertainty arising from the divergence between growth in nominal and real aggregates of economic activity.

To sum up, India is bright spot in the global economic system, projected to grow at a robust pace in the times to come. India stands out as a haven of stability and an outpost of opportunity. Its macro-economy is stable, founded on the government's commitment to fiscal consolidation and low inflation.

For a sustained growth over the next few decades requires timely implementation of the reforms agenda even though continuing sensitivity to shocks can derail growth, given that the world environment is far from conducive to sustained high growth. If the reforms agenda is implemented effectively at the grass root level, we should expect to see India progressing rapidly with increased presence in the world economic system in the coming times.

Given the fact that the government is committed to carrying the reform process forward, aided by the prevailing macroeconomic stability, India has every potential to raise the economy's growth momentum and achieve growth rates of 8% or higher in the coming years. The GDP growth rate in India has shown encouraging trends thereby confirming that India will comfortably retain its position as the world's fastest-growing major economy.

Further, sustaining high rates of GDP growth over a longer period will require a recovery of export growth along with reforms in infrastructure sector, especially power and roads. On account of India being a significant, resilient and sustainable economy there is hope for a transformed India to emerge, where the economy will be in double digit growth trajectory, moving forward.

Overview of Global Economy (percent change)

Latest IMF projections

Global economy still growing, but at a slower pace.
(percent change)

	Estimates	Projections		Difference from October 2015 WEO projections[1]	
	2015	2016	2017	2016	2017
World Ouput	3.1	3.4	3.6	-0.2	-0.2
Advanced Economies	1.9	2.1	2.1	-0.1	-0.1
United States	2.5	2.6	2.6	-0.2	-0.2
Euro Area	1.5	1.7	1.7	0.1	0.0
Germany	1.5	1.7	1.7	0.1	0.2
France	1.1	1.3	1.5	-0.2	-0.1
Italy	0.8	1.3	1.2	0.0	0.0
Spain	3.2	2.7	2.3	0.2	0.1
Japan	0.6	1.0	0.3	0.0	-0.1
United Kingdom	2.2	2.2	2.2	0.0	0.0
Canada	1.2	1.7	2.1	0.0	-0.3
Other Advanced Economies	2.1	2.4	2.8	-0.3	-0.1
Emerging Market and Developing Economies	4.0	4.3	4.7	-0.2	-0.2
Commonwealth of Independent States	-2.8	0.0	1.7	-0.5	-0.3
Russia	-3.7	-1.0	1.0	-0.4	0.0
Excluding Russia	-0.7	2.3	3.2	-0.5	-0.8
Emerging and Developing Asia	6.6	6.3	6.2	-0.1	-0.1
China	6.9	6.3	6.0	0.0	0.0
India	7.3	7.5	7.5	0.0	0.0
ASEAN-5[2]	4.7	4.8	5.1	-0.1	-0.2
Emerging and Developing Europe	3.4	3.1	3.4	0.1	0.0
Latin America and the Caribbean	-0.3	-0.3	1.6	-1.1	-0.7
Brazil	-3.8	-3.5	0.0	-2.5	-2.3
Mexico	2.5	2.6	2.9	-0.2	-0.2
Middle East, North Africa, Afghanistan, and Pakistan	2.5	3.6	3.6	-0.3	-0.5
Saudi Arabia	3.4	1.2	1.9	-1.0	-1.0
Sub-Saharan Africa	3.5	4.0	4.7	-0.3	-0.2
Nigeria	3.0	4.1	4.2	-0.2	-0.3
South Africa	1.3	0.7	1.8	-0.6	-0.3
Low-Income Developing Countries	4.6	5.6	5.9	-0.2	-0.2

Source: IMF, *World Economic Outlook Update*, January 2016.
[1]Difference based on rounded figures for both the current and October 2015 *WEO* forecasts.
[2]Indonesia, Malaysia, Philippines, Thailand, and Vietnam.

Source: PHD Research Bureau, compiled from IMF

India: Statistical snapshot

Indicators	FY10	FY11	FY12	FY13	FY14	FY15	FY16
GDP at FC - Constant prices Rs Bn	45161	49185	52475	54821	91698	9827089*'	2579701*''
GDP at FC - Constant prices growth YOY (%)	8.6	8.9	6.7	4.5	6.6	7.2*'	7.3*''
GDP at MP-current prices Rs. Bn	64778	77841	90097	101133	113550	11550240*'	2640568**''
Agriculture growth	0.8	8.6	5	1.4	3.7	0.2*	(-)1.1*''
Industry growth	10.2	8.3	6.7	0.8	1.2	6.6*	11.1*''
Services growth	8	7.5	4.9	7	4.6	10.2*	9.3*''
Consumption (% YOY)	8.4	8.2	8.9	5.2	4.7	-	-
Private consumption (% YOY)	7.4	8.7	9.3	5.5	6.2	6.3	-
Gross domestic savings as % of GDP	33.7	34	31.4	30.1	30.5	30.6"'	-
Gross Fixed Capital Formation as % of GDP	31.7	30.9	31.8	30.4	28.3	30.0**	30.4*''
Gross fiscal deficit of the Centre as a % GDP	6.5	4.8	5.7	4.9	4.5	4.1''	3.9
Gross fiscal deficit of the states as a % GDP	2.9	2.1	1.9	1.9	2.5	2.3''	-
Gross fiscal deficit of Centre & states as a % GDP	9.3	6.9	8.1	7.2	6.7	6.6''	-
Merchandise exports (US$Bn)	178.3	250.8	305.7	300.2	312.35	310.5	21.1^^^
Growth in exports	-2.6	40.6	21.9	-1.8	3.98	(-)1.2	(-)13.6^^^
Imports (US$Bn)	287.6	369.4	489.1	490.3	450.94	447.5	28.7^^^
Growth in imports (YOY)	-3.9	28.5	32.4	0.2	-8.1	-0.59	(-)11^^^
Trade deficit (US$Bn)	109.3	118.6	183.4	190.1	138.6	137	7.6^^^
Net invisibles US$Bn	80	79.3	111.6	107.5	115	-	-
Current account deficit US$Bn	38.4	48.1	78.2	88.2	32.4	10.1	6.2
Current account deficit as % of GDP	3.2	2.6	4.2	4.8	1.7	1.3~~	1.6^^
Net capital account US$Bn	53.4	60	67.8	94.2	33.3^^	11.8	-
Overall balance of payments US$Bn	-13.4	-13.1	12.8	3.8	15.5^^	6.9	-
Foreign exchange reserves US$Bn	279.1	304.8	294.9	292.04	304.22	316.2 ~	350.37 ~~~
External debt - Short term US$Bn	52.3	65	78.2	96.7	89.2``	86.4```	84.7&&&
External debt - Long term US$Bn	208.7	240.9	267.5	293.4	351.4``	376.4```	
External debt - US$Bn	260.9	305.9	345.8	392.1	441``	462```	-
Money supply growth	16.9	16.1	13.5	13.6	13.2	11.1&&	12&
Bank credit growth	17.1	21.2	16.8	13.5	14	8.6	-
WPI inflation	3.8	9.6	8.9	7.4	5.7#	2.1	(-)0.9^^^
CPI inflation	12.4	10.4	6	10.2	9.8	6.4	5.69^^^
Exchange rate Rs/US$ annual average	47.4	45.6	47.9	54.4	60.68	61.14	68.16@@

Source: PHD Research Bureau compiled from various sources, *Data pertains to Provisional Estimates of National Income 2014-15 from MOSPI, " Handbook of Statistics of Indian Economy 2014-15 from RBI, "' Data pertains to Annual Report of RBI 2013-14, *' Data pertains to GVA at Basic prices in 2014-15 from Provisional Estimates of National Income of MOSPI, based on the new methodology of the Government, *'' Data pertains to GVA at Basic Prices at constant prices for Q3 2015-16, **'' Data pertains to GVA at Basic Prices at constant prices for Q3 2015-16, "'Data pertains to the new Series Estimates from economic survey 2014-15, ** Data pertains to Provisional estimates of National income, 2014-15, MOSPI, ***Data pertains to Q2 2014-15. ^^Data pertains to India's Balance of payment Q2 2015-16 from RBI, ^^^Data pertains to January 2016, ``India's external debt end Dec 2013 from RBI, ``` Data pertains to end Dec 2014 from RBI, , # Data pertains to Mar 2013, ~ Data as on week ending 27th March, 2015 from RBI, ~~ Data pertains to 2014-15 from the Economic Survey, ~~~Data as on week ending 19th February 2016 from RBI, & Projections from RBI for FY2016 from October 2015 RBI Bulletin, && Data pertains to March 2015, &&& External debt at end March 2015, @@ Data pertains to 1st March 2016 from RBI, @@@Data pertains to February 2015, #Data pertains to November 2014.

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At a Global level we have been working with the Embassies and High Commissions in India to bring in the International Best Practices and Business Opportunities.

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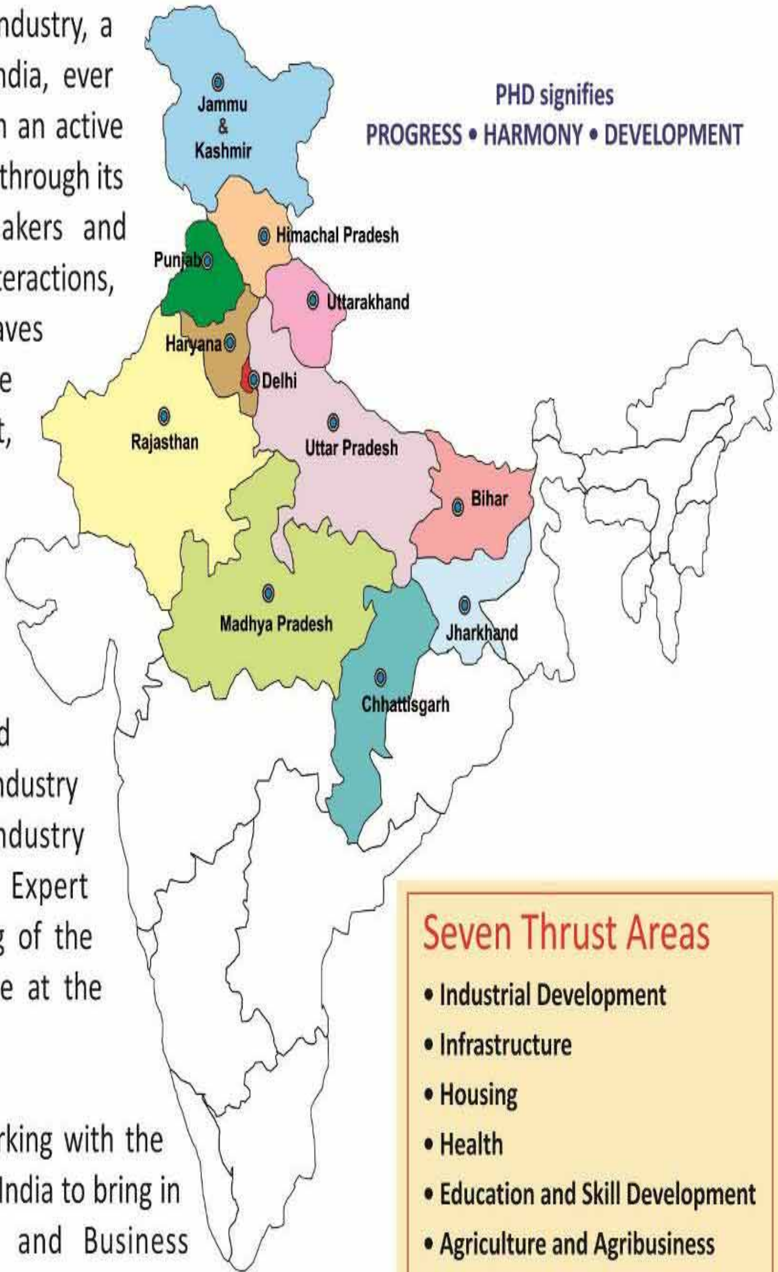

Seven Thrust Areas

- Industrial Development
- Infrastructure
- Housing
- Health
- Education and Skill Development
- Agriculture and Agribusiness
- Digital India