[COVER STORY]

THE ECONOMIC CRISIS

THE FINANCIAL SQUEEZE

A host of issues—both global and domestic—threaten to derail the economy, posing fresh challenges to the Narendra Modi government a few months months before the next general election. Can the country fend them off?

By M.G. Arun and Shweta Punj

Illustration by Nilanjan Das

Back in the last general election, in 2014, nothing helped the then prime ministerial candidate Narendra Modi more than his promise to root out corruption and bring a troubled economy, derailed by the 'policy paralysis' in the second edition of the UPA government, back on track. With just months to go before the next general elections, the economy, ironically, is occupying centre stage again, navigating a precarious patch, brought on by a host of global and a few homegrown factors. The little gloss it achieved after growth bounced back to 8.3 per cent in the first quarter of the current fiscal is all but gone. Rising oil prices and a widening current account deficit, or CAD, where the value of imports is higher than that of exports, have weakened the Indian rupee by14 per cent this calendar year, and it's being pushed down further. High fuel prices are threatening to stoke inflation, forcing a wary central bank to resort to a 'calibrated tightening' of the monetary policy. State-owned banks are struggling to address the mountain of over Rs 9 lakh crore bad loans, even as litigation delays the sale of stressed assets of companies under a revamped bankruptcy code. Meanwhile, the non-banking financial company or NBFC space, also ominously called shadow banking, is reeling under the impact of the fallen giant Infrastructure Leasing & Financial Services (IL&FS), which has piled up Rs 91,000 crore in debt, as delayed or shelved projects felled any profit. Even the private banking sector faced a crisis of confidence as the top boss at the second largest bank—ICICI Bank—resigned over charges of nepotism, while the regulator cracked the whip on two others—Axis Bank and Yes Bank—disallowing extended terms to their CEOs over alleged irregularities. Agriculture continues to be in the doldrums, despite the government's promise to double farmers' incomes and prop up crop prices. A recent Reserve Bank of India (RBI) survey said consumer confidence—reflecting households' perceptions and expectations on the general economic situation, the employment scenario and the overall price situation—slipped to 94.8 points, down from 98.3 in June this year. To add to the government's embarrassment, efforts to bring back fugitive businessmen Vijay Mallya, Nirav Modi and Mehul Choksi have yielded nothing, gnawing at Modi's image as an anti-corruption crusader. Stock market indices, quick to react to news, good or bad, have been on a losing streak, as foreign investors pull out of Indian stocks, with global worries and a weak rupee hitting local returns.

This is definitely not a scenario the ruling Bharatiya Janata Party and the Modi government had hoped for the economy on the eve of five state assembly elections and the general election next year. The sense of economic stability witnessed in the government's early years has given way to uncertainty and fear. Businessmen, once said to be a favoured lot under the government, are now wary of investing or embarking on risky projects. The Mood of the Nation poll INDIA TODAY conducted in August gave a whiff of the sentiment of the man on the street. To the question whether one's economic status (income, saving and spending power) had changed in the past four years, only 42 per cent believed it had, a fall of four percentage points from the previous survey in January, while the majority either thought it had remained the same (28 per cent) or become worse (25 per cent). Lack of jobs and price rise were deemed the biggest concerns.

FUEL DISCONTENT
Rising fuel prices have sent the government's finances in a tizzy

YASIR IQBAL

CRUDE MOOD

So, what has changed between the early days of the Modi government and now, and how alarming is it? Are just external factors, largely not in the country's control, to blame or are policy missteps too responsible for the fragile economy? For starters, on the global front, it is fair to say that the economy is grappling with three major shocks: the rising global oil prices, rising interest rates in the US (the 10-year government bond yields have risen to over 3 per cent) and the rising trend of trade protectionism around the world, resulting in trade wars. Crude oil prices have been surging after the Organisation of Petroleum Exporting Countries, or OPEC, decided to cut production levels. Since April 1 this year, Brent crude oil prices have surged by 24 per cent, from $68 per barrel to $84 as on October 5. High oil prices spike the country's import bill as it buys most of its oil from overseas, widening the CAD to 2.4 per cent of the GDP in the first quarter. In 2017-18, India imported 219 million tonnes of crude oil worth around $88 billion (Rs 6.5 lakh crore), as per oil ministry data. Every dollar per barrel change in crude oil prices impacts the import bill by Rs 823 crore.

₹10,500 CRORE

LOSS IN CENTRAL REVENUE THIS FISCAL DUE TO THE Rs 1.50 CUT IN EXCISE DUTY ON FUEL

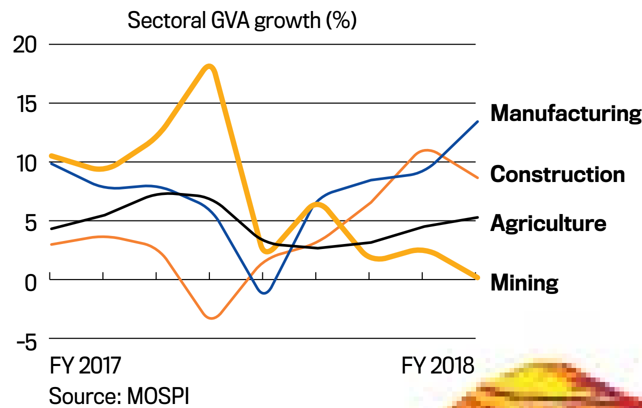
As fuel prices rose and the public clamoured for a price cut (the Congress observed a nationwide *bandh* on September 10), the Centre, on October 4, cut excise duty on fuel by Rs 1.50, and asked oil marketing companies to cut retail prices by another Re 1. However, this will dent government revenues by Rs 10,500 crore this fiscal, making it more challenging for finance minister Arun Jaitley to stick to the fiscal discipline he has maintained so far. Certain BJP-ruled states, including Gujarat and Maharashtra, also reduced fuel prices. Economists say the move was a bad one, since it will cost oil marketing companies Rs 1,40,000 crore and the government nearly Rs 70,000-80,000 crore since it is a shareholder. And while the government might end up paying through its nose for the excise cut, its impact on household expenditure would be about Rs 900, equivalent to two coffees from Starbucks, says a research note by Citibank. Despite these cuts, petrol cost Rs 87.50 a litre and diesel Rs 77.37 on October 8 in Mumbai. "The government is in defensive mode. Rather than framing policies, it is reacting to events. Once you get into that mould, it's difficult to come out of it," says an economist. Escalating oil prices have put consumption under stress. Household expenses have gone up and, as is evident from passenger vehicle data, households are cutting back on spending. The slowdown in growth of sales of passenger vehicles continued for the third consecutive month in September. Sale of cars dropped by 5.6 per cent in September while that of SUVs went down by 8.3 per cent over September last year. This was the steepest decline in a month since

THE INDIA STORY

Though the situation is not alarming in terms of GDP growth and inflation yet, the slowdown in various sectors, rising fuel prices, the fallign rupee and the crisis in banking have left the economy precariously perched and in dire need of government intervention

IN A LIMBO

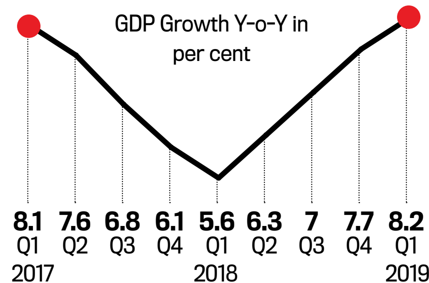
Sectors such as mining, agriculture, are performing much below capacity and a lot of the pain here is due to domestic policy inaction



Source: MOSPI

V-SHAPED RECOVERY

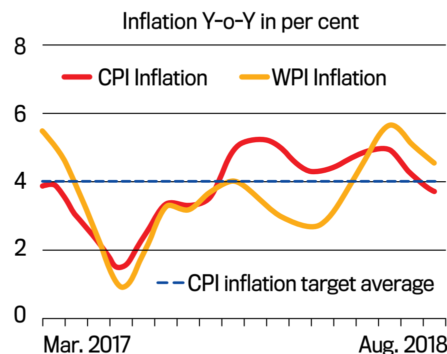
India's GDP growth hit a sharp low before staging a comeback. But 8.2% growth is not sustainable



Source: MOSPI

PRICE WISE

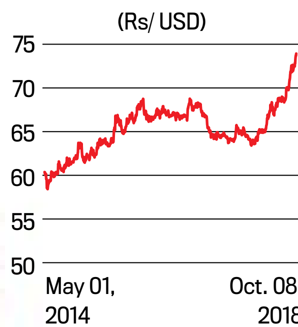
A tight monetary policy has kept inflation under control



Graphic by TANMOY CHAKRABORTY

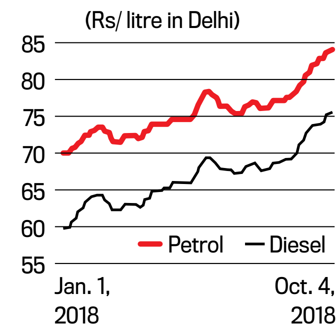
DOLLAR DOLDRUMS

The rupee has weakened 14 per cent this calendar year and is yet to recover from the free fall



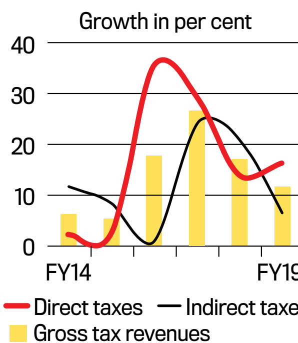
FUELLING DISCOMFORT

Rise in international prices of crude has affected oil-importing countries such as India



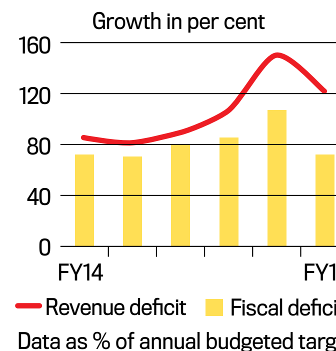
SHRINKING EARNINGS

After peaking in the middle of the Modi government's term, government revenue is beginning to see a decline



FISCAL IMBALANCE

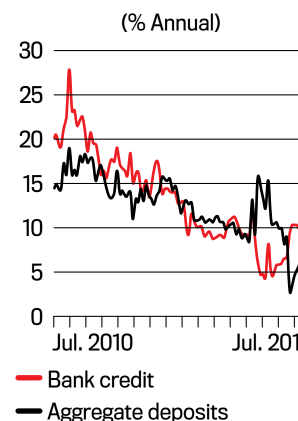
Both external and internal factors have played havoc with the government's fiscal discipline



Data as % of annual budgeted target

NO CREDIT TO ANYONE

Credit growth's recovering; deposit growth at 8.1 per cent is just marginally higher than a 10-yr low of about 3% in Jan



FOREX REVERSES

From a healthy peak in 2007-08, India's forex situation has begun to slip in the past decade

Source: Database on Indian Economy, RBI; (Basic Data: RBI; MOSPI

June 2017, said industry body Society of Indian Automobile Manufacturers.

The other big global factor hurting India and other emerging economies is the China-US trade war. The tit-for-tat tariffs the two countries imposed on each other's goods impacted crude and base metal prices, as well as investment across borders. The US has imposed new tariffs of $200 billion on Chinese goods arriving on its shores this September, even as China said it would retaliate with tariffs on another $60 billion of US goods. Although the US move to clamp tariffs on steel and aluminum imports in March this year may not hurt India in a major way, India needs to tread carefully, says Ajai Sahai, director general and CEO of the Federation of Indian Export Organisations, or FIEO, as it will be caught in the crossfire.

RUPEE IN A TAILSPIN

If rising oil prices rattled the consumer, the falling rupee shook up financial markets. 'The rise in crude prices has exerted pressure on the CAD of oil importing countries such as India, which has further led to depreciation of the currencies,' says a report from Crisil. From 65.1 to a dollar on April 2 this year, to 71 on August 31, the rupee depreciated 9 per cent, which Crisil attributes to the RBI move to increase the repo rate twice by 25 basis points. The rupee weakened further (74.4 to a dollar on October 9) after the US Fed raised interest rates a third time this calendar year. This led to foreign capital outflow of $11.223 billion (Rs 8,300 crore) by September-end, further stressing Indian currency, adds the report.

Sahai busts the myth that a weak rupee alone can aid exports. He acknowledges rupee depreciation as one of the factors in making exports competitive but not the only one. "We're losing labour competitiveness because our workers are not as skilled. We have to improve productivity through skilling," he had said in an earlier interview. The higher rupee also singes corporates with large borrowings from foreign markets in the form of external commercial borrowings (ECBs), as it increases their interest outgo.

On the other hand, the high cost of

imports can have a spiralling effect. "India is a much poorer country (its per capita income in 2018 was $2,000 or Rs 148,000; lower than Argentina's $14,300 and Turkey's $10,500). As prices of imported goods rise, a much larger proportion of Indians will bear the pain," says Professor R. Nagaraj of the Indira Gandhi Institute of Development Research in Mumbai.

The government had announced five measures on September 14 to shore up the rupee and rein in the widening CAD. These included curbing non-essential imports and increasing exports, reviewing the mandatory hedging condition for infrastructure loans borrowed under the ECB route, permitting the manufacturing sector to access ECBs up to $50 million with residual maturity of a year instead of three, exempting masala bonds (bonds issued outside India but denominated in Indian currency instead of the local one) from withholding tax this financial year and bringing foreign portfolio investors into the corporate debt market by removing restrictions on their investments. Customs duties were hiked on 19 items, including refrigerators and air conditioners, from 10 per cent to 20. But these measures did not have any substantial impact in stabilising the rupee. Many expected the RBI to intervene and raise key rates to keep the rupee in check, but it kept the rates unchanged in its October 5 announcement, saying it would rather stick to its mandate of 'inflation targeting'.

INVESTMENT SLUMP

One of the biggest hopes from the Modi government was that it would instil confidence in investors in manufacturing and infrastructure, two sectors that were key to more employment and growth. However, that has not happened, as new data from the Centre of Monitoring Indian Economy (CMIE) shows. According to the data, new investment announcements have declined in the July-September period for the second quarter in a row. Private and public sector companies together announced new projects worth Rs 1.49 lakh crore in the quarter which ended in September, 41 per cent lower than the preceding quarter. On a year-on-year basis, the decline was less pronounced at 12 per cent. Fresh private investments plunged 64 per cent in the quarter ended September, on a sequential basis. For the first time, the value of new projects announced by private players during the quarter was lower compared to those announced by the public sector, reports said.

FOR THE FIRST TIME, THE VALUE OF NEW PROJECTS ANNOUNCED BY PRIVATE PLAYERS THIS QUARTER WAS LOWER COMPARED TO PUBLIC SECTOR PROJECTS

The share of stalled proj-

HOW PRECARIOUS IS THE INDIAN ECONOMY AT THIS POINT?

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N.R. BHANUMURTHY
Professor, National Institute of Public Finance and Policy

Currently, the Indian economy is facing downside pressures on various counts. Although it has registered a surprise growth of 8.2% in the first quarter of FY19, going forward, it would be tougher to achieve such high growth. Most of the analysts as well as RBI suggest that the growth in the second half of FY19 could be much lower. But most importantly, there are risks building up across all the growth drivers. In addition to this, given the multiple elections this year, one is not sure how the government will navigate the economy from here on.

R. NAGARAJ
Indira Gandhi Institute of Development Research, Mumbai

The situation looks pretty grim, in the short term. The problem is capital flight, as foreign institutional investors (FIIs) are withdrawing their money, leading to a fall in the rupee value, and plummeting stock prices. Rising oil prices, increase in the US interest rates and deepening bad debts of domestic financial firms are the principal causes of the grim economic situation. Taking solace in the grimmer situation of other Emerging Market Economies (EMEs) does not make us look any better. India is a much poorer country (with India's per capita income in 2018 at $2000, Argentina's $14,300, and Turkey's $10,500). As prices of imported goods rise, the pain will be borne by a much larger proportion of Indians.

PRONAB SEN
Country Director, International Growth Centre, India

The Indian economy is indeed in a precarious position where it is facing the prospect of the main drivers of growth during the last few years coming to an abrupt halt.

MAITREESH GHATAK
Professor of Economics, London School of Economics

The outlook certainly doesn't look very bright. As far as GDP growth is concerned, it slowed to a four-year low of 6.7% in 2017-18. In fact, excluding the last two years of the UPA II government, the so-called period of policy paralysis, this is a 15-year low. The IMF in its World Economic Outlook (WEO) has downgraded India's projected growth for 2018 from 7.7% in its April 2017 report to 7.4% in its July 2018 update to the WEO. The talk of 8.2% growth in the first quarter of the new financial year is misleading—as the economy recovers from the twin shocks of demonetisation and messy implementation of GST, there are bound to be quarters where growth will appear high as the economy catches up with trend growth, from which it went on a downward swing in 2016-2017. Investment rates are down, exports are down, the rupee is in a free fall, and inflation is creeping up. Naturally, job creation has slowed down too—a recent CMIE report shows there was in fact a marginal decline in formal sector employment in FY 2017-18. Another recent report from the Centre for Sustainable Employment points out that there has been an absolute decline in employment post 2015, a trend that started earlier.

D.K. JOSHI
Chief Economist, Crisil

It's a mixed picture with divergent movements in the real and financial sectors. While growth is on the mend and inflation is within RBI's target, the financial sector, particularly the banking sector, is going through a clean-up phase. We expect growth at 7.5% and inflation at 4.8% in the current fiscal. Also, current account deficit has been steadily rising, which makes India vulnerable to tightening global financial conditions and emerging market sell-off. This has resulted in a sharper-than-expected weakening of the rupee against the dollar. That said, the situation is not as precarious as in 2013 when CAD was over 4% of the GDP, inflation was touching 10%, and fiscal deficit was over 4.5% of GDP. Just a mention of a likely tapering of bond purchases by the US Federal Reserve had sent the rupee on a tailspin, sending more than 25% down in a matter of months.

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DO YOU ATTRIBUTE THIS MAINLY TO THE GLOBAL HEADWINDS OR DO DOMESTIC POLICIES HAVE A ROLE TO PLAY?

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PRONAB SEN
Country Director, IGC, India

The problem has unquestionably been precipitated by global developments, but the conditions which have led to our present state of vulnerability are the outcome of our past policies. Unfortunately, the discourse has focused excessively on oil price increases and flight of portfolio capital with resulting stress on the current account deficit and the exchange rate. The real threat comes from the fact that our recent growth has been largely urban and organised sector led. The rural and informal sectors have languished. Farmers' agitations are a symptom of this. This skewed pattern appears to have led to distributional changes which makes us far more dependent on imports and external financing than would have been the case if our growth pattern had been more balanced. This pattern is almost entirely domestic policy driven.

N.R. BHANUMURTHY
Professor, NIPFP

After a stable external environment for the past three years, there are many global headwinds that emerging markets such as India are facing. International oil prices, unwinding of Quantitative Easing, protectionist policies, etc., are indeed posing downside risks to the Indian economy. However, there are also some domestic policies that are exacerbating the risks. One of most important ones, apart from NPAs and banking issues, is the misguided fiscal consolidation policy of the government. Conveniently, the government has adopted the fiscal deficit target of the FRBM while ignoring the sub-target of reducing revenue deficits. Hence, the current policy that leads to compression of public capital expenditure, in my view, would not be expansionary while at the same time could be inflationary. Given all the global headwinds, any macro framework would suggest that one should compromise on the growth targets if one has to contain the twin deficits. But what we see is contrary–targeting higher growth than what was specified in the 2018-19 Union Budget. This could widen both CAD and fiscal deficit even to unsustainable levels or could adversely affect the future growth. However, there are other policy measures such as building of rural infrastructure and various reform measures that could dampen down the risks emanating from global economy to some extent.

MAITREESH GHATAK
Professor, LSE

Global headwinds are part of the game. The current government also benefited from falling oil prices until recently. Crude oil prices hit a record of $160 a barrel in 2008, with the average price being $93 per barrel during the UPA II years, with the corresponding figure being $53 during the Modi years. I think the government in its zeal for the so-called war on corruption took its eyes off pro-growth reforms or pro-poor welfare policies. The biggest casualty has been investment. Another way to see why domestic policies played a role in the economic slowdown is to compare India's growth rate with the world growth rate. If we take the difference between India's growth rate and the average growth rate in the world, the margin was 4.48 percentage points under the current government, which is good but if we compare with the previous government, it was 5.26 percentage points under UPA II, even taking into account the so-called policy paralysis in its last two years.

R. NAGARAJ
IGIDR

Both. Rising global interest rates and oil price increases are the principal international reasons affecting India's economic outlook. Trump's trade war is causing considerable uncertainty in global trade, affecting India as well. Domestic problems in financial firms like the IL&FS groups' defaults on loan repayments, and corporate governance issues with the ICICI Bank a few months ago have also contributed to the fragility in the financial markets. Government's action appears far too little and hesitant

D.K. JOSHI
Chief Economist, Crisil

The stress in the economy is both due to global and domestic factors. The rise in NPAs of public sector banks can be traced to domestic factors such as aggressive bidding and overinvestment in sectors such as infrastructure, falling metal prices and also the regulatory push to recognise the weak assets in the banking system with an objective to clean up the system. Global headwinds are largely responsible for rising external vulnerability and weakening of currency. The shocks are now much bigger in quantum and complexity. As India imports over 80% of its crude oil requirement, a sharp pick-up in oil prices has bloated CAD and made India more vulnerable to a global risk off scenario.

ects also increased marginally during the July-September quarter. As much as 24 per cent of all private projects remained stalled in the quarter under review. The power sector was hit the hardest, with the highest share of stalled projects at 35.5 per cent, followed by manufacturing where 29.5 per cent projects were stalled.

This has happened mainly due to lack of funds and fuel, shortages of raw material and unfavourable market conditions. "The biggest casualty has been investment—India's investment accounted for 30.8 per cent of its nominal GDP in March 2018, a little higher than 30.1 per cent in the previous quarter," says Maitreesh Ghatak, professor of economics at the London School of Economics. In contrast, from June 2004 to March 2018, it averaged 35.1 per cent, with an all-time high of 41.2 per cent in September 2011. It reached a record low of 29.6 per cent in March 2017, post-demonetisation.

₹823 CRORE

IMPACT ON INDIA'S IMPORT BILL WITH EVERY DOLLAR PER BARREL CHANGE IN CRUDE OIL PRICES

The latest Business Today Business Confidence Index survey conducted in the July-September quarter showed a drop in confidence levels of business leaders. On a scale of 100, the index for the quarter stood at 48.7, lower than 49.3 in the previous quarter. It was also a lower 51.4 in January-March 2014, just before the Modi government came to power.

SINKING BANKS

Banking woes continue as the mountain of bad loans keeps growing. Recent RBI data shows that between April 2014 and April 2018, the country's 21 state-owned banks ended up writing off Rs 3,16,500 crore of loans even as they recovered Rs 44,900 crore written off on a cumulative basis.

One of the government's remedies for the banking sector has been consolidation. Recently, three public sector banks—Bank of Baroda, Vijaya Bank and Dena Bank—were merged to create India's third largest bank with total business worth Rs 14.82 lakh crore. Dena Bank is one of the 11 PSBs that have been put under RBI's prompt corrective action (PCA) framework. Banks are put under PCA when they breach key regulatory requirements relating to the capital adequacy ratio (a measure of a bank's available capital as a percentage of its credit exposures), return on assets and amount of non-performing assets (NPAs). The concern some experts have is that post a merger, nothing—the capital, net worth or the assets of the banks— really changes. Though the combined numbers look impressive, they do precious little to improve the overall performance of these banks.

The private banking sector has its own share of troubles. Earlier this month, ICICI Bank chief Chanda Kochhar, mired in conflict-of-interest controversy for months, resigned after seeking early retirement. Kochhar is alleged to have favoured Venugopal Dhoot's Videocon in the bank's lending practices. Videocon's founders had an investment in a renewable energy company founded by Kochhar's husband, Deepak.

But the biggest shock in recent months has come from shadow banking firm IL&FS, a company with annual revenues of close to Rs 19,000 crore, and acknowledged as the pioneer in public private partnerships (PPPs)in India. That financial edifice looked impenetrable, till cracks appeared in the form of huge debt the firm could hardly repay, threatening its survival and rattling the stock markets.

In a surprise move on October 1, the Centre replaced all board members of the beleaguered infrastructure funding firm by moving the National Company Law Tribunal (NCLT), as it attempted to assuage the concerns of financial markets after the firm defaulted on its loans and threatened to shake up the entire NBFC segment. The government appointed a six-member board, led by Uday Kotak, chairman of Kotak Mahindra Bank, ringing in memories of the rescue of Satyam Computers in 2009. "IL&FS is part of the shadow banking system, representing loosely regulated and opaque institutions whose lending has grown considerably in the present decade," says Nagaraj. Hence, IL&FS's collapse could reverberate in the credit markets with kneejerk reactions adversely affecting

AD.

credit flow (which, in fact, has been decelerating for years now) to productive sectors.

The worry is there might be more skeletons in the closet. The RBI, too, has raised a red flag on the working of NBFCs, saying credit growth in shadow banking is much higher than nominal GDP and that regulations need to be tightened further for credit growth to come down to nominal GDP levels. This will aggravate the credit squeeze in the economy.

RURAL DISTRESS

In Kushalpura village, just over an hour's drive from Rajasthan capital Jaipur, a group of women lament the perilous state of their finances. Among them is Kamla Devi, 60, whose hands, bruised and coarse from decades of working in the fields, move emphatically as she says "*Main bas haath pe haath rakh kar baithi rahti hoon* (I just sit idle all day)." She has a little less than an acre of land but is unable to cultivate it for lack of water. Selling milk fetches her a mere Rs 20 a kilo. In the harvest season, she earns Rs 200 a day for cutting bajra from the fields. It's a familiar story in these parts. There isn't enough work, farming is no longer lucrative and opportunities in and around the village are few.

The three kharif crop-growing states—Gujarat, West Bengal and Bihar—are affected by weak rainfall. According to a Crisil analysis, several states such as Rajasthan, Madhya Pradesh, Uttar Pradesh, Andhra Pradesh, Karnataka and Maharashtra had pockets of severe monsoon deficiency in the crucial months of July and August which impacted sowing. The report points out that 2018 is turning out to be another year where farmer incomes have remained low; in fact, mandi prices have been trailing minimum support prices announced in July.

VEGETATIVE STATE
Escalating fuel prices have had a cascading effect on food prices

NILADRI DAS

For Kishor Patil, 37, a cotton and jowar farmer in Parola in the Jalgaon district of Maharashtra, the main challenge is to get better prices for his farm produce. The government purchases cotton at Rs 5,600 per quintal; the price goes up to Rs 6,000 per quintal in the open market. "These are the rates for the best quality cotton. I never get this rate as my cotton is never adjudged the best neither by government agencies nor private traders," he says.

An economist, highlighting the urgency to lift farm incomes, says the government has to get prices up to MSP levels. If food prices don't go up in the next few days, the government and economy will have a big problem on their hands because festive spending will be lower, depressing the mood further.

TRIPPING BUSINESSES

When the Modi government accorded a big push to manufacturing through its 'Make in India' campaign, it also said the move would be supported by an equally big push to the ease of doing business. India, went the government's narrative, needed to shake itself out of its traditional image of being a slow-moving giant, shackled by archaic labour laws, delays in land acquisition, corruption and red tape that threatened to delay projects and drive out investors. The jet-setting PM and his business delegations were wooing investments from everywhere. States were made to compete with each other on ease of business rankings, that would then be publicly displayed. FDI was encouraged in certain sectors through policy reforms, and the Goods and Services Tax (GST) was launched, subsuming dozens of state and local levies, which ought to have made transactions more transparent and simpler. However, despite all these, manufacturing has failed to make an impact, hovering around 17 per cent of the GDP, with minuscule job creation. Exports have been struggling, and start-ups are still complaining of difficulties to get their enterprises off the ground. Meanwhile, GST got off to a bumpy start, dogged by poor implementation, technical glitches in the launch stages and frequent tweaks in rates.

Manjit Singh, 47, of Dashmesh Engineering in Bengaluru, says profits for his business are low despite better demand. "Customers expect European quality at Chinese pricing," he says, referring to cheaper goods from the latter. Singh, who has an annual revenue of Rs 1.3 crore, wants GST to be reduced to 5-6 per cent from 18 per cent and interest rates on industrial borrowing lowered from 12-13 per cent to 4-6 per cent.

A policy paralysis is also bogging down the coal mining sector. India is the world's second largest coal importer while state-run Coal India Ltd (which produces more than 80 per cent of India's coal) continues to miss its production targets. Coal blocks were reallocated after irregularities were found in the auction of coal blocks under UPA. But, of the 163 blocks allocated, just over a dozen have reached their desired production level. The rest have either not secured environmental clearance or failed to submit acceptable mining plans. The government needs to move on this with urgency, either by reallocating the blocks or prodding the allottees into action.

NO QUICK FIXES

Despite the over 8 per cent growth in the June quarter, the country may find it difficult to sustain it. Various estimates suggest that India will close the year at about 7.3 per cent. "India cannot sustain 8 per cent growth.

WITH STRESS ON MULTIPLE FRONTS–CAD, FISCAL DEFICIT, A WEAK RUPEE, HIGH OIL PRICES, FLIGHT OF CAPITAL, TRADE WARS ETC.–IS RBI'S SINGLE-MINDED FOCUS ON INFLATION WARRANTED?

PRONAB SEN
Country Director, IGC, India

There is nothing inherently wrong with inflation targeting, but the RBI appears to have interpreted its mandate much more rigidly than the 'flexible targeting' objective requires. It is really a pity it has consistently allowed the terms of trade to shift against agriculture in the name of inflation targeting.

N.R. BHANUMURTHY
Professor, NIPFP

The RBI, and the MPC, under the monetary policy framework agreement, has been mandated, mainly to maintain the price stability (in other words, contain inflation) although there are some vaguely worded '..while keeping in mind the objective of growth'. In a sense, maintaining price stability is expected to ensure targeted growth. I also feel inflation is a byproduct of stability in the external accounts as well as output gap. The recent hikes by the MPC were aimed at addressing the CAD, weak rupee, and capital flight issues, on the assumption that these could lead to higher inflation in the medium term. Although I expected a rate hike in the recent review, the decision of the MPC to adopt a calibrated tightening is a step in the right direction that could ensure stability on both external account as well as prices. But it is not clear if that means the RBI could change the interest rates between the policy reviews.

MAITREESH GHATAK
Professor, LSE

I do think the RBI's main focus should be on inflation control. Having too many objectives with a limited set of instruments can make things worse. The recent increase in growth is largely consumer demand driven which is largely driven by a rise in personal loans. This, together with rise in oil prices does point to a risk of inflation.

R. NAGARAJ
IGIDR

Probably not. Monetary policy has also to focus on output growth and employment situation, as in most countries. Further, in a globalised market, monetary authorities cannot take their eyes off from financial stability. This is a painful lesson learned during the global financial crisis of 2008. Apparently, the monetary authorities seem much too focused on domestic concerns, or, largely operating within a closed economy framework.

D.K. JOSHI
Chief Economist, Crisil

The RBI is taking a considered stance, in my opinion. A status quo in the October policy is in sync with the monetary policy's primary objective of 'maintaining price stability, while keeping in mind the objective of growth'. It is important to keep in mind that the monetary policy decision was presented in the backdrop of tightening liquidity after some adverse developments in the domestic financial market. To be sure, the RBI has raised the repo rate twice by 25 bps each this year in response to inflation threat. RBI targets inflation, not the rupee, as it made clear recently. Pursuing multiple targets sends confusing signals.

AD.

GIVEN THE NPA CRISIS, AND NOW THE PRESSURES ON THE SHADOW BANKING SECTOR IN THE WAKE OF IL&FS, DO YOU FORESEE A BIG CREDIT SQUEEZE?

PRONAB SEN
Country Director, IGC, India

A distinction needs to be drawn between credit and long-term loans. It is almost certain that term loans will be under pressure for some time to come, but if that leads to an increase in working capital and consumer credit, I would welcome it.

N.R. BHANUMURTHY
Professor, NIPFP

While there are some positive signs in terms of the credit off-take in the recent period, the worsening NPA situation as well as the crisis in the private banking industry, it would be difficult to see substantial increase in the credit growth in the near future. However, with IBC getting into action, one should expect speedy solution to the NPA issue. One also needs to be wary of further increase in NPAs due to MUDRA loans, as alerted by Raghuram Rajan.

MAITREESH GHATAK
Professor, LSE

The credit squeeze has already started as reflected in the sharp fall in the investment rate. As mentioned by Raghu Rajan in a recent note to the Parliamentary Committee on NPAs, these reflect loans that originated in 2006-2008 when economic growth was strong. As Rajan says, while corruption undoubtedly played a part, banker overconfidence and lack of due diligence played big roles, and in this environment, unless there are global tailwinds, I don't see how a credit squeeze can be avoided.

R. NAGARAJ
IGIDR

Yes, I do. IL&FS is part of the shadow banking system, representing loosely regulated and opaque institutions whose lending has apparently grown considerably in the present decade. Hence, IL&FS's collapse could reverberate in the credit markets with a lot of kneejerk reactions, adversely affecting credit flow (which in fact has been decelerating for years now) for productive sectors.

D.K. JOSHI
Chief Economist, Crisil

No comment

HOW SOON MIGHT WE TIDE OVER THE DOMESTIC ECONOMIC CRISIS? WHAT WILL IT TAKE?

PRONAB SEN
Country Director, IGC, India

The depreciation of the rupee is an important corrective in itself. However, it would be well to remember that while oil price increase and FPI flight impact almost immediately, adjustments in exports and imports in response to the rupee depreciation take time. New customers and sources have to be identified, fresh contracts drawn up, production has to be ramped up, supplies have to begin. Three to four months is the minimum. Nevertheless, there is evidence that speculators are 'shorting' the rupee, leading to excessive depreciation. This needs to be put down with a firm hand. The government and the RBI have instruments to do so, but the recent marginal tinkering with duties and external borrowings is unhelpful.

N.R. BHANUMURTHY
Professor, NIPFP

One easy way to cope up with the current situation is by targeting lower growth, although it may be politically not appealing. My own analysis shows the GDP growth in FY19 would be less than 7% provided if we do not want to run a CAD of more than 2.5% while stick to a fiscal deficit target of 3.3%. Going forward, it largely depends on how we address the banking sector issues. However, the risks from the global economy are expected to continue for two more years, which could affect domestic growth.

MAITREESH GHATAK
Professor, LSE

It's only eight months till the next elections, which constrains the government's hands. So I am not sure how much course correction is possible since the problems have no quick fixes.

R. NAGARAJ
IGIDR

Not very soon, in my view. The problem may persist for at least a year. With elections round the corner, badly needed tough policy decisions to tide over the crisis may be hard to come by. There seems to be a dire need for a medium-term action plan. Moreover, policymakers need to clearly communicate their actions to reduce uncertainty among decision makers. To do these, the government must first admit the seriousness of the problem, whichit has not done. Its complacency seems to partly stem from unrealistic official estimates of GDP and employment growth rates, which are seriously questionable. Specific actions required: one, currency stabilisation.Two, curbing domestic demand in the short term and steps to boost output and employment by improving domestic fixed investment rate to in the medium term.

D.K. JOSHI
Chief Economist, Crisil

Global pain is not going away in a hurry. It will transmit into the domestic economy and continue to challenge us in the foreseeable future. We expect NPA levels to rise somewhat from the March 2018 level of 11.6%, peak during the current fiscal, then start coming down from there. CRISIL's analysis of the liquidity position of the large non-banks—both non-banking financial companies (NBFCs) and housing finance companies (HFCs)—that it rates, shows they are maintaining adequate liquidity buffer to manage mismatches, if any, in their asset-liability maturity profiles. But continued market disruption can constrain access to funding, and will be a key sensitivity factor for the prospects of non-banks. India's GDP growth is expected to rebound to 7.5% in fiscal 2019, supported by the third straight year of normal monsoons, reductions in GST-related problems, fading of demonetisation impact, budgetary support to the roads and rural economy, and a low-base effect. But improving growth outlook will not lift all boats, and sectors such as thermal power, telecom, capital goods and real estate will remain under stress.To tide over the situation, the government will need to maintain fiscal rectitude, generate resources to recapitalise public sector banks and continue reforms. It also needs to address issues in the minerals/ coal sector where domestic hurdles have led to rising imports in an environment of rising global coal prices.

Productive capacity of the economy is not there. When India grew at 8 per cent in the past, there were global tailwinds," says an economist. Part of the reason why the country saw strong growth in the last quarter was because it emerged from the bottom after GST and demonetisation, he adds.

There are obviously no quick fixes for problems in the economy. To restore confidence, the government must take measures to stem speculative dollar demand. Since private investment has stalled again, public sector investment will have to keep pace. India will have to work aggressively on its long-term strategy to reduce dependency on imported crude and push forward a slew of initiatives towards solar, renewable sources.

Those targets will have to be revised and the pace, quickened. The move to renewable energy will have to be supplemented by shale gas and current utilisation of coal-based energy. D.K. Shrivastava, chief policy advisor, EY, also adds that it is critical at this point for the government to bring down the CAD and fiscal deficit to sustainable levels (2.4 per cent and 6 per cent, respectively). "Shaky macros adversely affect India's image. It drives investors away and the fight is about the perception of the Indian economy,"he says.

To aid businesses, experts say that just as GST supposedly simplified the country's tax laws (the implementation glitches and frequent changes notwithstanding), you need a similar initiative to prune the various modalities in establishing a new business. Some say an online single-window clearance regimen would be best in increasing transparency and helping corporates expand or establish their business. The other issues that need to be addressed are simplifying land acquisition laws, which remain cumbersome; reducing the time and processes required in receiving construction permits; improving investor protection and enforcement of contracts; and simplifying taxation processes, among others.

On October 6, Jaitley said there are some more steps on the anvil to narrow CAD and bolster foreign exchange inflows. Enunciating some of the steps taken recently, he said the government cut the borrowing target for the current fiscal by Rs 70,000 crore and allowed oil companies to raise $10 billion in one year. On October 11, import duties on 15 more items were hiked to 20 per cent to rein in the CAD and shore up the rupee, after stock markets crashed 1,000 points in intraday trade amid a sell-off in global markets. A possible issue of bonds to non-resident Indians is also on the cards. Meanwhile, SBI has said it will buy loans worth Rs 45,000 crore from NBFCs as a measure to inject more liquidity into the cash-starved sector.

While its intentions may be earnest, the government does not have enough time to chart out a revival of the economy in time for a good report for May 2019. ■

AD.