

India in a Globalizing World

Some Policy Dilemmas

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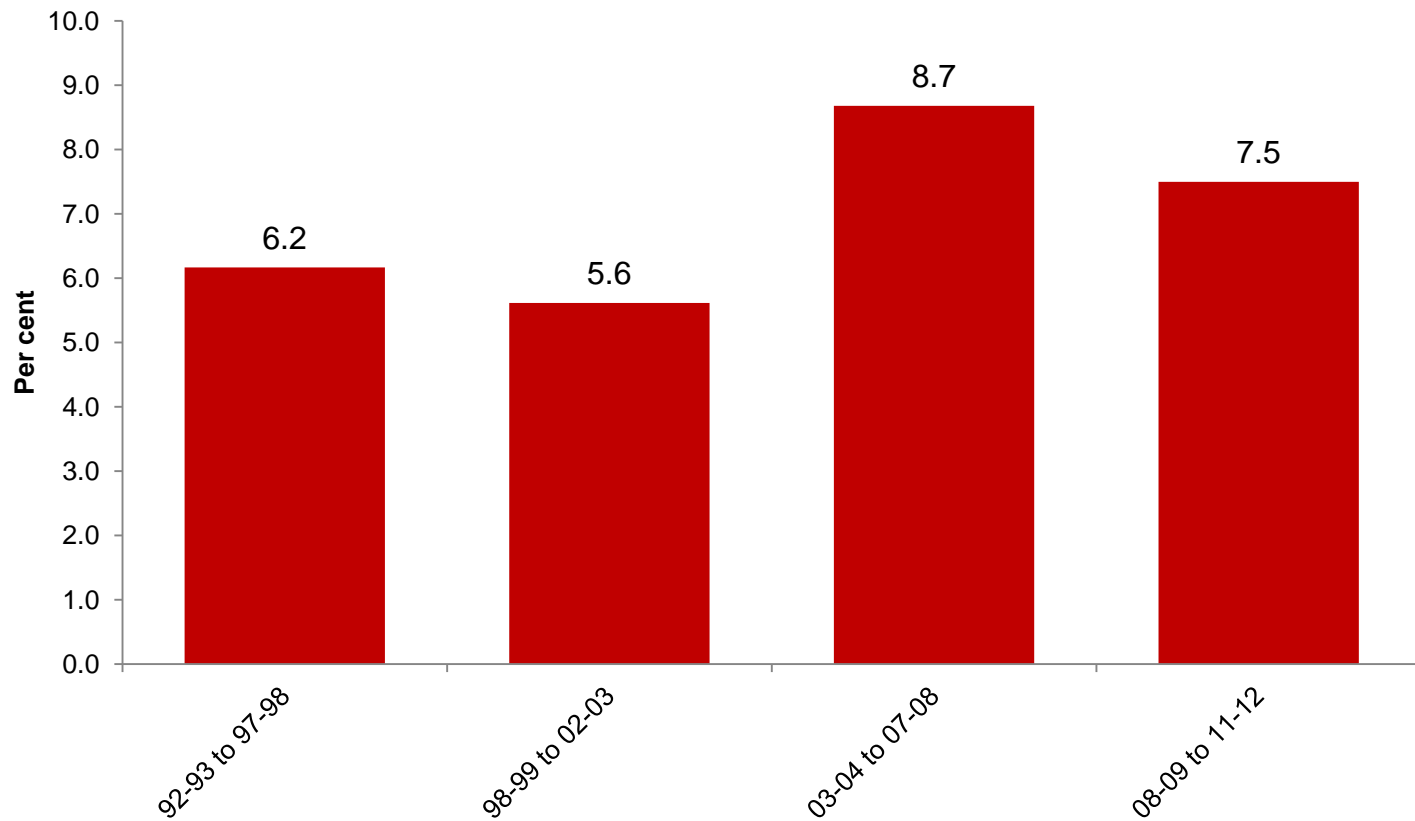
India

Macroeconomic Situation

Cause for Concern?

India - Macroeconomic Situation

Long Term Trends in Growth Rate



India Growth Story

What drove India's growth in the pre-crisis period?

India Growth Story

Started fraying, beginning
with the global financial
crisis of 2008/09

From One Crisis to Another

- Just as we were recovering from 2008/09 crisis, the eurozone crisis hit us.
- Policy space to respond to the crisis is much less now than in 2008/09.

India

Current Macroeconomic Situation

- Growth has moderated
- Inflation is high and persistent
- Balance of Payments under stress
- Twin deficits (fiscal deficit, current account deficit)
- Investment has decelerated
- No policy space for stimulus

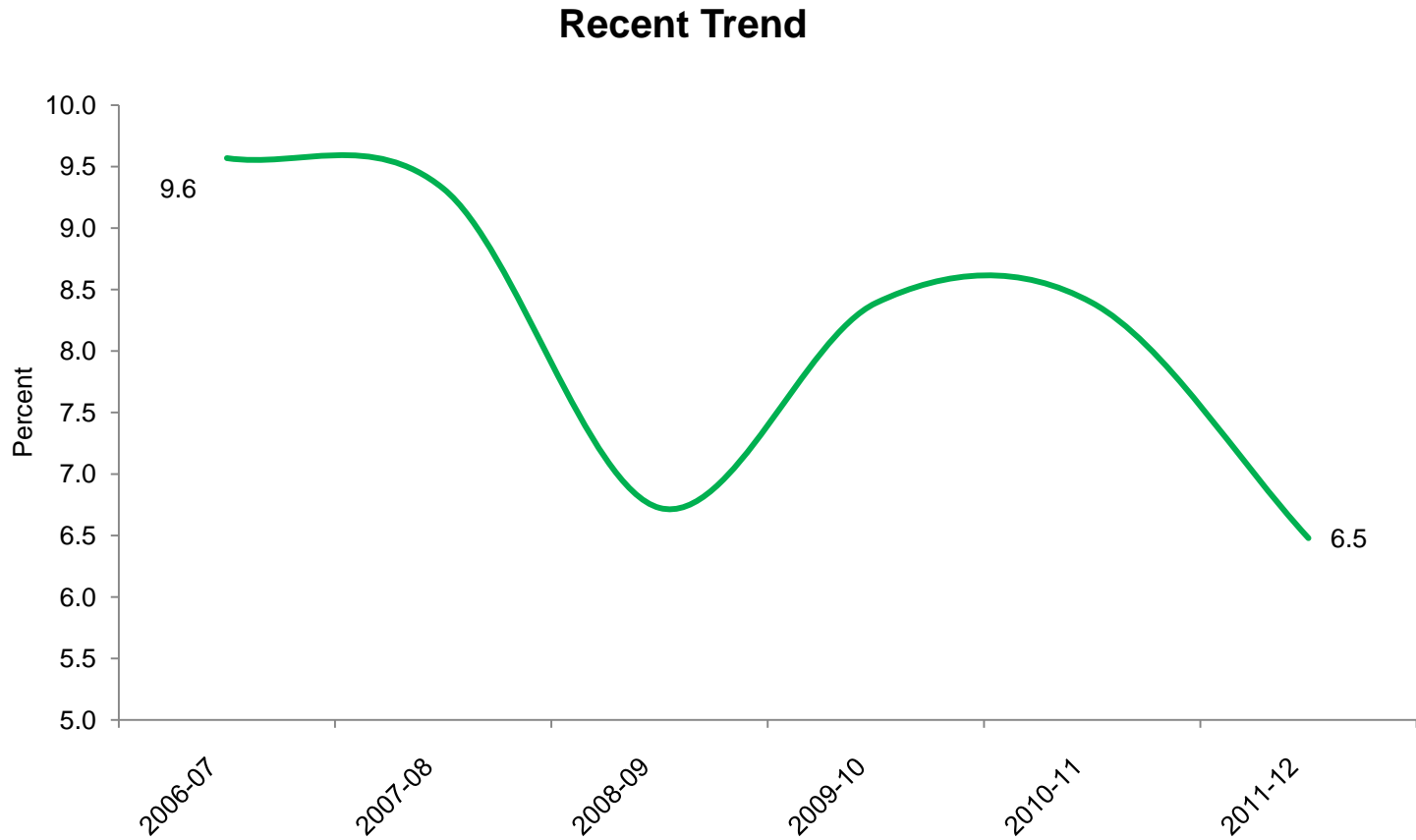
Three Policy Dilemmas

1. How do we manage the growth-inflation dynamics?
2. External Sector - how do we manage the short-term trade-offs without compromising long-term sustainability?
3. Fiscal Consolidation - how to manage the political economy constraints?

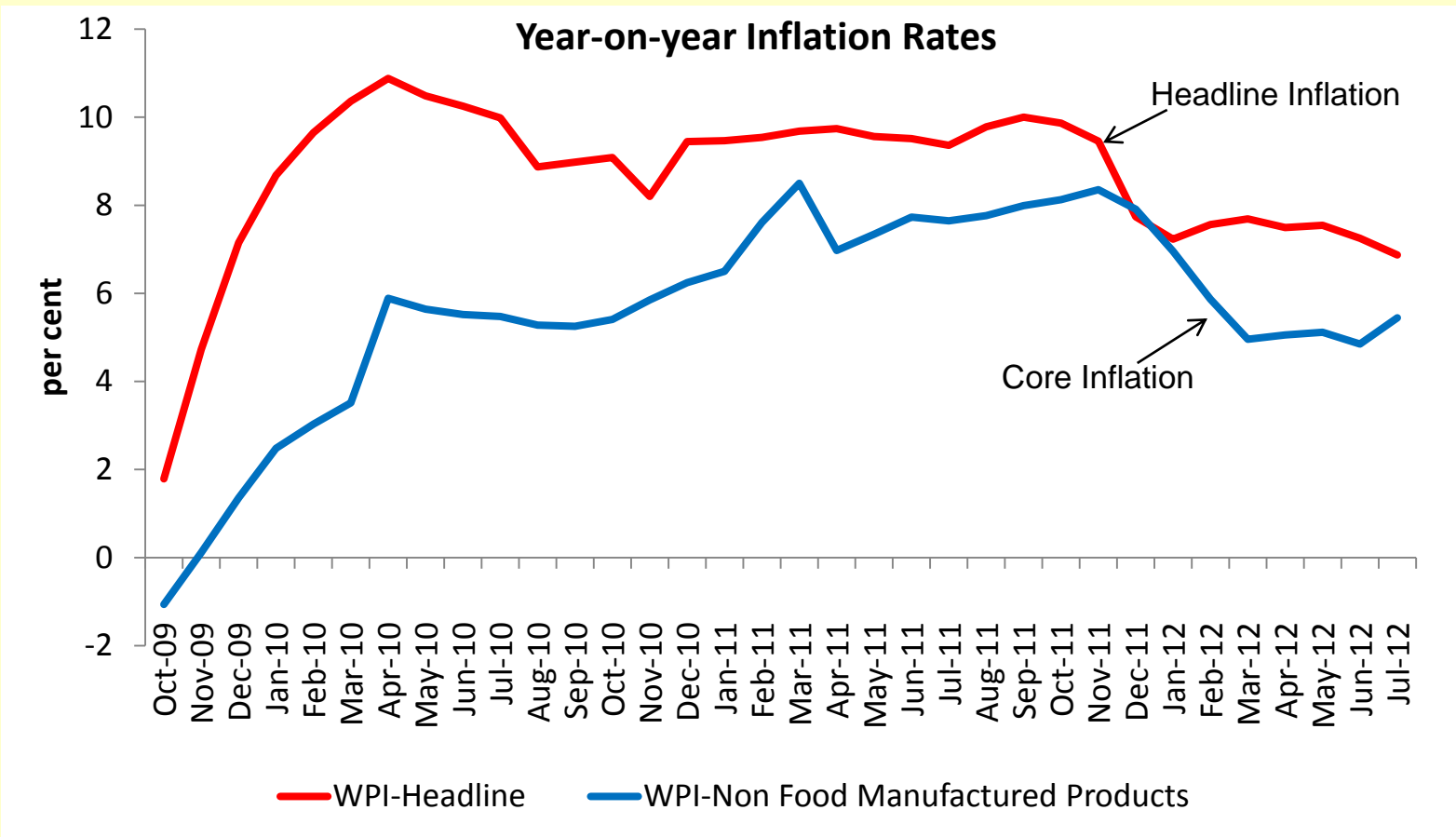
Dilemma - 1

How do we manage the growth-inflation dynamics?

Why has growth slowed?



What is the inflation story?



What is driving Inflation?

- Food (cyclical + structural)
- Global commodity prices + depreciation
- Fiscal deficit
- Demand pressures

Inflation and RBI

- What has RBI done to control inflation?
- Has RBI succeeded in controlling inflation?

Growth - Inflation Risks

- Global Uncertainty
- Commodity Prices
- Fiscal Deficit
- Monsoon Performance
- Supply Response

Dilemma - 1

How do we manage the growth-inflation dynamics?

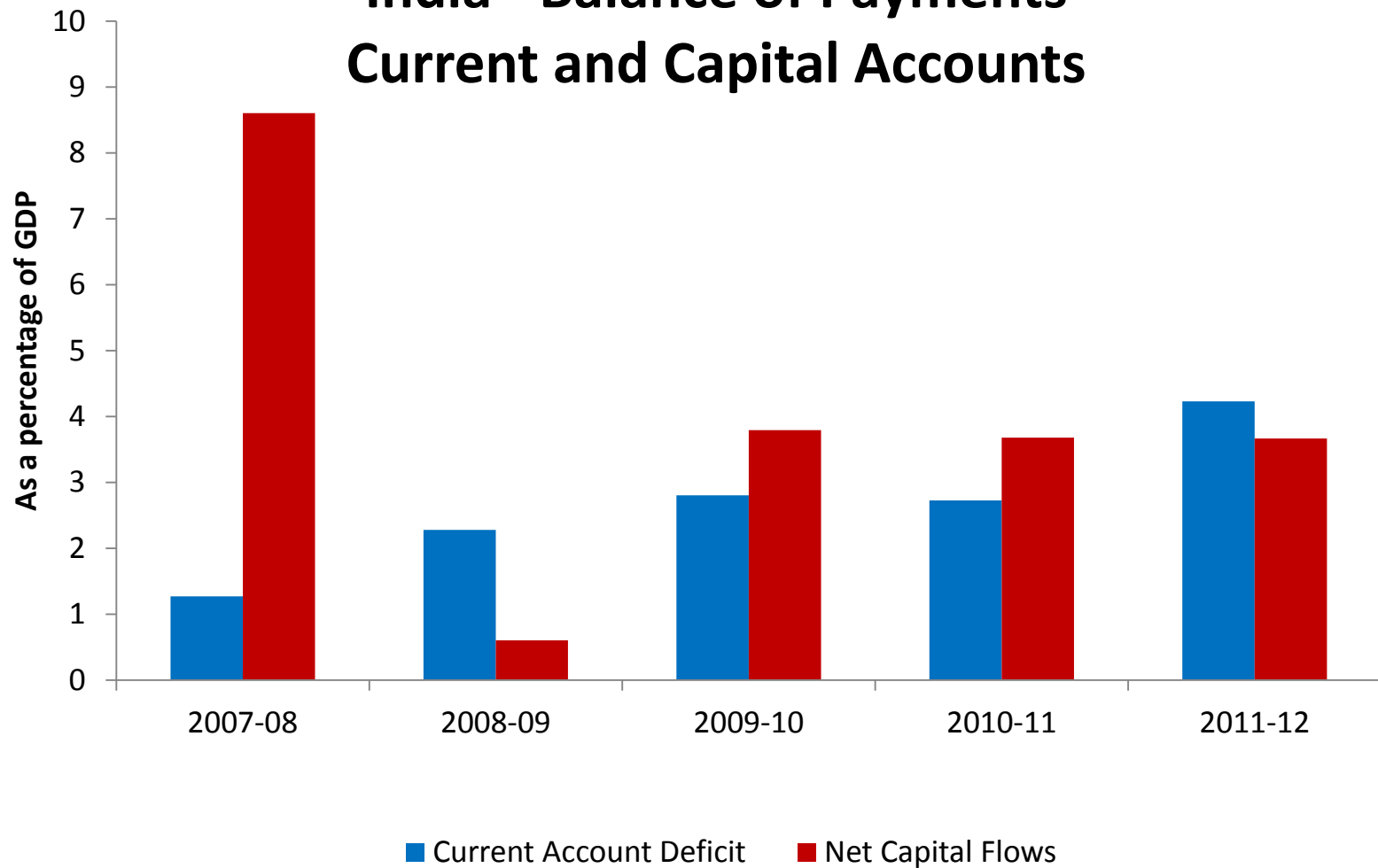
Dilemma - 2

External Sector - how do we manage the short-term trade-offs without compromising long term sustainability?

What is the external sector problem?

- Large current account deficit (CAD)
- Financing the CAD with stable flows

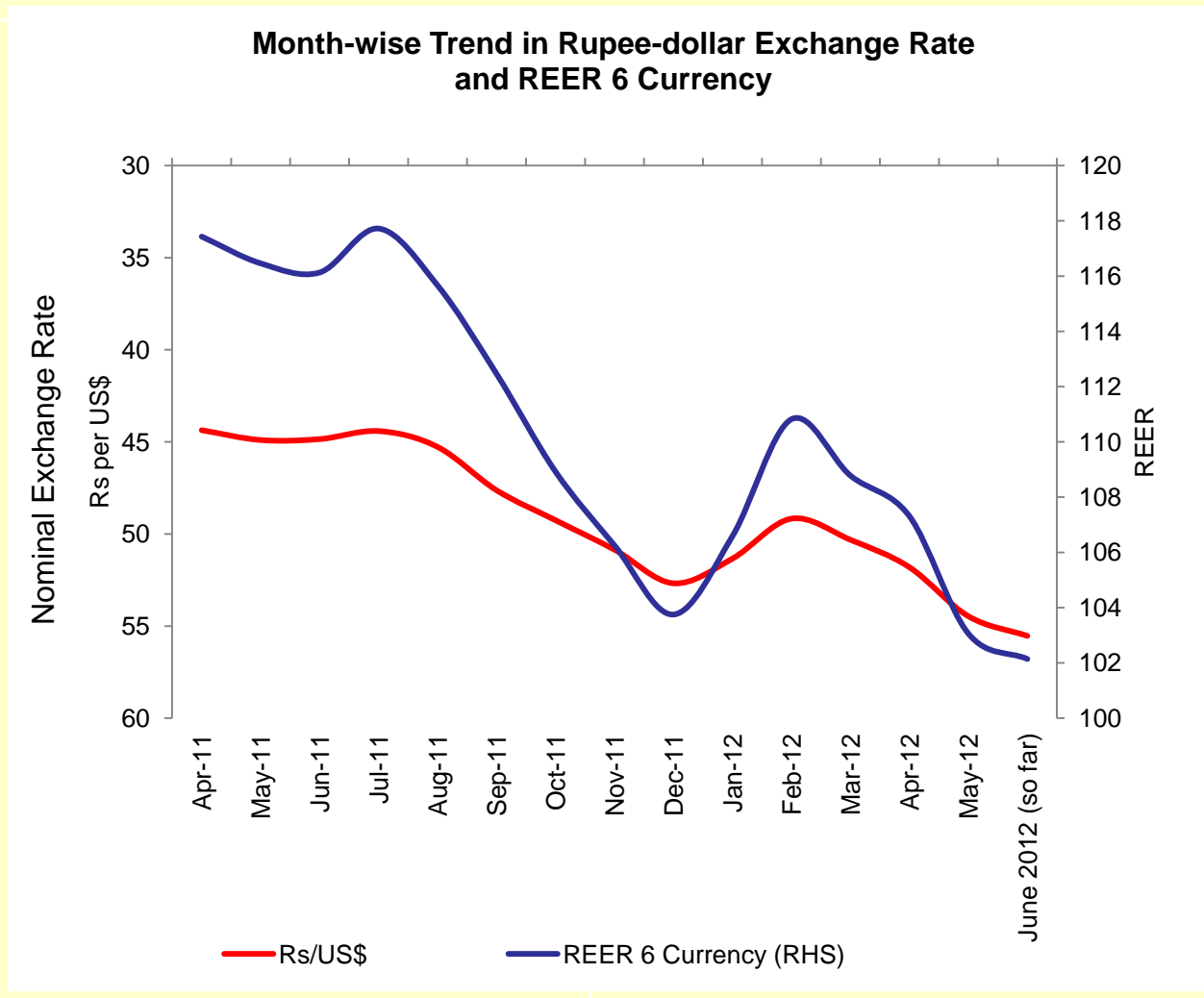
India - Balance of Payments Current and Capital Accounts



External Sector Problem

- Why has current account deficit (CAD) increased?
- Why have capital flows thinned?
- What has been the result of this?

How much has the rupee depreciated and why?



Rupee Depreciation?

What is the impact of rupee depreciation?

**What has RBI done to
contain volatility in the
exchange rate?**

What is the 'Capital Flows' problem?

- We want capital flows just equal to CAD
- But they are invariably either too much or too little
- And they are volatile

Capital Flows - How volatile? Quickly Reversing Trends

Pre-Crisis (2005/08) - Great Moderation - Volatile Inflows

Crisis (2008/09) - Safe Haven - Outflows - Sudden exit

Post-Crisis (2010/11) - Volatile inflows - 'Currency Wars'

Eurozone Crisis (2011)- Confidence Effect - Outflows

Managing Capital Flows

Change in world view on
capital controls from pre-
crisis to post-crisis

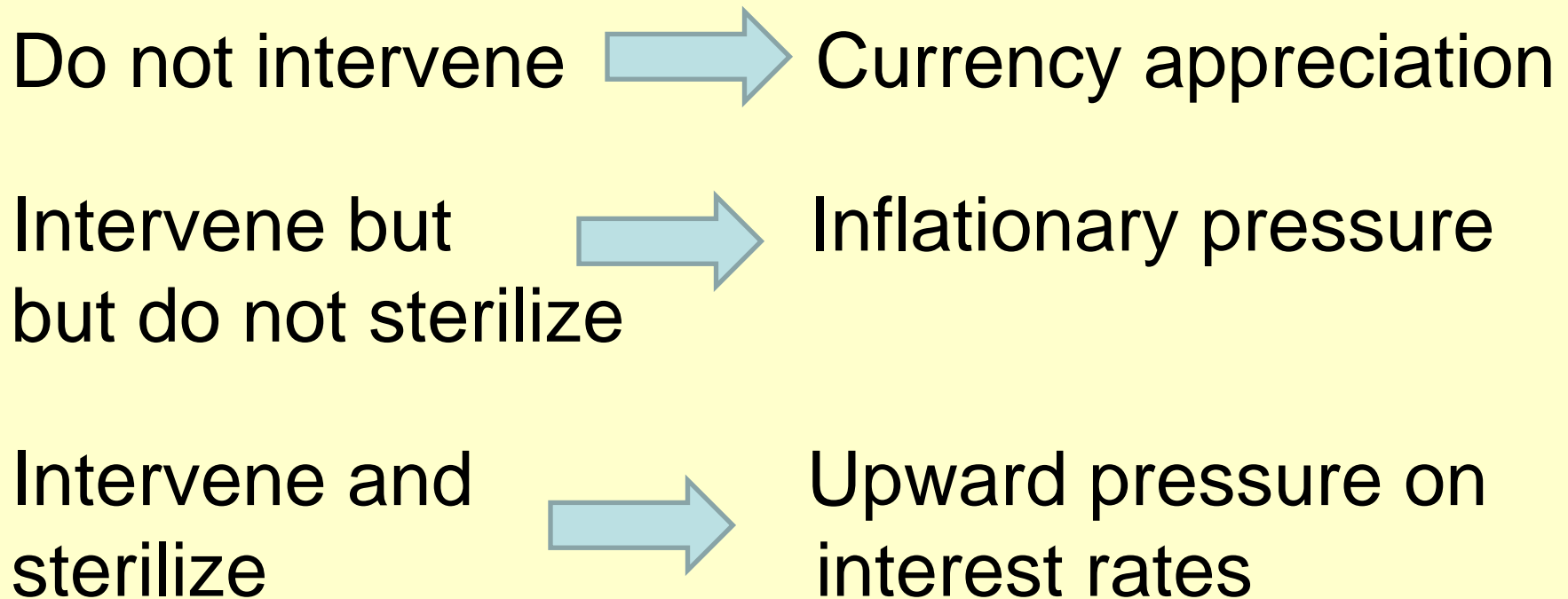
Managing Capital Flows

- Two options
 - Capital Controls
 - Exchange Rate Management
- No option is totally benign

Managing Capital Flows

No Benign Options

Capital inflows



External Sector Management

What is RBI's policy

- on capital account?
- on exchange rate?

External Sector Management

Sustainable Solution

- Reducing CAD in the medium term
- Financing CAD in the short-term

Policy Dilemma - 3

How to manage the political economy of fiscal consolidation?

Fiscal Deficit

Why is fiscal deficit a problem?

India's Fiscal Deficit

- What is India's fiscal deficit problem?
- What are the challenges in fiscal consolidation?

Why 2012 is not 1991?

India and China

Is the “India Growth Story” still credible?