Responding to Economic Developments

What is the issue?

\n\n

The economic indicators of the recent period call for shifts in policy response to boost the economy.

\n\n

What do the economic indicators show?

\n\n

\n

- **Growth** - The recently released quarterly estimates showed lower-than-expected July-September growth number for GDP.
\n
- With this, most analysts have lowered their full-year growth forecasts, with some projecting second-half growth at under 7%.
\n
- The encouraging sign is a pick-up in investment which was depressed so far.
\n
- But even this is overshadowed by declining consumer spending.
\n
- The Reserve Bank recognises this, but continues to project full-year growth at 7.4%.
\n
- Even that implies a second-half growth rate of only 7.2% which is no better than the unsatisfactory trend rate from 2014.
\n
- **Inflation** - Inflation has dipped more sharply than expected.
\n
- The current rate has been below RBI's target of 4% for the past three months.
\n
- Agricultural price inflation is lower still.
\n
- The quarterly GDP numbers record a sharp deterioration in terms of trade for agriculture.
\n

- This explains farmers' distress in many states, even as depressed rural wages have contributed to poor rural demand.
\n
- **Fiscal deficit** - The full year’s fiscal deficit target was crossed by October-end (in seven months).
\n
- The government insists that it will stay within the full-year target of 3.3% of GDP (down from 3.5% in the last two years).
\n
- But there is the growing possibility that it will be able to do so only by withholding payments that are due on various counts.
\n

\n\n

Is the response appropriate?

\n\n

\n
- **Government** - The first two indicators (economic growth and inflation) point to the need for an economic stimulus.
\n
- This is especially needed when demand growth is slowing.
\n
- But the policy response is far from it and the government continues to insist on sticking to fiscal contraction.
\n
- **Banks** - RBI on its part argues that it needs more time to understand price trends, and therefore has not lowered its policy rate of 6.5%.
\n

\n\n

\n
- Loan rates in the market are too high. Most banks have a lending rate of over 9% for their best customers.
\n
- E.g. HDFC’s home loan rates range from 8.8% to 9.5%, at a time when house prices are falling. Naturally, housing demand is low.
\n
- Small and medium enterprises borrow at much higher rates of interest.
\n
- The effective borrowing rate for majority of companies is more than their return on capital employed which make it “unaffordable”.
\n

\n\n

What should be done?

\n\n

\n
- Both the government and the RBI should re-examine their positions.
  \n
- Interest rates need to drop if there is to be broad-based economic revival.
  \n
- The fiscal stance should be less rigid as inflation is below target and the danger of runaway oil prices has also passed.
  \n
- There is thus a legitimate case for government to allow deficit level to inch up to a more realistic 3.5% of GDP, the same level as in the last two years.
  \n
- That will be a neutral, not expansionary, stance, easily justified in the current situation, and realistic.
  \n
- Besides this, there has to be a policy package to shore up agricultural prices, especially for crops with greater price volatility.
  \n
- The target to double agricultural exports is a start, but more needs to be done swiftly.
  \n

\n\n

\n\n

Source: Business Standard

\n