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Push for growth

Monetary accommodation continues, but it may not be enough to spur growth

It was an anxious Monetary Policy Committee (MPC) that reduced the repo rate for the fifth consecutive time and slashed growth projections for this year from 6.9 per cent earlier to 6.1 per cent now. Its retail inflation projection of below 4 per cent for the second half of this year and beyond explains the basis for an accommodative approach going forward. In his address on Friday, the RBI Governor clearly said that high frequency indicators were not encouraging, with the prospect of good farm output providing a silver lining. While the markets have not reacted well to a 25 basis point repo rate cut — they were probably expecting more — there is a limit to which the MPC can cut rates. At the back of their mind would be the spread between the Fed and domestic rates, and the prospect of bond outflows if that gets too narrow. Given the erosion of wealth that has already taken place after the July Budget, India could do with less volatility on the external account at this stage. As the Governor rightly observed in his media briefing, the effects of the cumulative rate cut of 135 basis points as well as the new norm of 'external benchmarking' of lending rates of banks may require time to take effect.

But above all, there are limits to the effectiveness of monetary policy in a demand-constrained economy with 'weak consumer sentiment' as conceded by the RBI. The MPC has done its bit by trying to push lending through the NBFCs to priority sector, and now to households 'at the bottom of the pyramid', but addressing weak sentiment calls for a multi-pronged approach. The Centre's fiscal thrust through tax cuts for the corporate sector are expected to encourage investment, but for that to happen demand needs to pick up. The responsiveness of investment to supply-side steps tax cuts or low interest rates cannot always be ascertained, more so when the economy is in deceleration mode. A counter-cyclical public spending push may be more effective in the short term, given the advantage of low inflation rates and a comfortable liquidity situation; with credit growth declining since September 2018, there is little chance of government spending crowding out private investment. Infrastructure spending must be prioritised. The lessons of 'austerity' in the West, after the GFC, should not be lost on India.

A recent edition of SBI's newsletter observes that lower interest rates might have increased 'household leverage' more than disposable incomes. Hence, the impact of further rate cuts on consumer spending too remains uncertain, more so if the economy is not generating jobs. Interest rates as a revival instrument are a fair-weather friend. It can work in conjunction with other forces.

SUKIYAKI

MANJULA PADMANABHAN

Monetary easing is fine, but not enough

Lower rates and fiscal stimulus alone will not spur growth. Structural constraints, economic and financial, need to be addressed

HIMADRI BHATTACHARYA

With a 25-basis point cut in the policy repo rate by the RBI's Monetary Policy Comittee in its fourth bi-monthly meeting this fiscal, the cumulative easing in 2019 so far stands at 135 basis points. Such deep and continuous rate cuts have not been witnessed in the recent decades. Also, with the new policy rate now at 5.15 per cent, a section of the market believes that a sub-5 per cent rate is clearly on the horizon, given the not-so-upbeat prospects of the Indian economy outlined in the MPC's statement. The accommodative stance of the policy continues.

The MPC took note of the further widening of the negative output gap since its last bi-monthly meeting in August. There is a view among analysts that the MPC should have reduced the rate by 40 basis points to reflect the urgency needed to aid growth recovery, especially because inflation has been behaving so well. Perhaps this was also the reason why one MPC member voted in support of a larger cut. The equity market responded negatively to the lowering of the growth projection for 2019-20 by MPC from 6.9 per cent to 6.1 per cent. However, the benchmark 10-year G-Sec yield rose marginally after the policy.

Macro economic scene

That the policy rate will be cut in this meeting was a foregone conclusion. The attention was significantly on the macro economic prospects for the remainder of the current fiscal and beyond. To its credit, the MPC has faithfully and succinctly provided its analysis and assessment of the current situation: underlying the growth deceleration for five consecutive quarters culminating in a dismal 5 per cent in the first quarter of 2019-20 from the demand perspective was a sharp slowdown in private consumption expenditure to an 18-quarter low, and a muted gross capital formation for the last two quarters. The supply-side situation was pulled down by manufacturing growth, moderating to 0.6 per cent in the first quarter of 2019-20.

While agriculture and allied activities were lifted by higher production of wheat and oilseeds during the last rabi season, growth in the services sector was stalled by construction activity. Indicators of rural and urban demands point towards the presence of significant headwinds.

The sales of commercial vehicles contracted by double digits in July-August, reflecting the extent of the crisis facing the road transportation sector. Of the two major indicators of construction activity, finished steel consumption decelerated sharply in August and cement production actually contracted. The services PMI moved into contraction in September 2019 as a result of a decline in new business inflows.

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Growth outlook

The MPC does not seem to expect any notable turnaround in the demand condition in the second and third quarters of 2019-20. While the growth rate for the second quarter has been estimated at 5.3 per cent, a jump has been projected in the second half to 6.6-7.2 per cent.

In its view, the prospects of agriculture have brightened considerably on the back of a good monsoon, positioning the sector favourably for regenerating employment and income, and the revival of domestic demand. It hopes that the impact of the monetary policy easing since February 2019 is feeding into the real economy and will boost demand. In its view, the fiscal and other measures announced by the government over the last two months will revive sentiment and spur domestic demand, especially private consumption. The outlook for the first half of 2020-21 — a return to a 7 per cent plus rate — looks shining bright in comparison to the present.


Better future The Monetary Policy Committee's growth rate estimate for the first half of 2020-21 is at over 7 per cent

Drivers of slowdown

Three factors can be highlighted as the main triggers of the cyclical slowdown: the disruptions caused by the demonetisation of 2016, introduction of the GST in 2017 and very high number of NPAs in banks. The combined effect of the three was compounded by strong cyclical downturn impulses from abroad powered by major trade friction, weak consumer sentiment and industrial outlook, that have been sought to be countered by the expansive fiscal and accommodative monetary stance there. There is also a strong likelihood that the forces unleashed by the IBC and other recent reforms are growth negative in the short run, as they cause a 'reset' in the way business is done in India. For instance, the construction sector is adjusting to the new rules of the game resulting from the RERA and tighter tax administration.

However, it has now become increasingly clear that there are several structural factors at play that are causing the current sharp fall in growth. In the absence of any reliable research in this regard, the identification of the structural factors will be heuristic and even tentative. But it is worth attempting: falling household savings rates, high cost of financial intermediation and its deficient supervision, inadequate and inefficient economic and social infrastructure, low-quality technical education and skill-development arrangements (except in a handful of national level institutions), an overburdened judicial system — to name only a few. As has always been the case in India, only crises provide the opportunity for big-ticket reforms by taking a hard look at the deep-seated structural bottlenecks, which are all too well-known.

However, unlike in the aftermath of the BoP crisis of 1990-91, there are no 'low-hanging fruits' to be plucked this time around. The upshot here is that monetary easing and fiscal stimulus alone will not catapult the growth rate to 7.5-8 per cent on a sustained basis.

As for the RBI, this painful phase of the economy should be taken advantage of by pushing thoroughgoing reforms in banks and NBFCs. There is a looming danger now that a fresh wave of NPAs may hit banks sooner rather than later, even as quite a few of them continue to struggle under the deadweight of their current high NPAs.

Through the Billion Press. The writer is a former central banker and consultant to the IMF

Here comes the Trump slump

Apart from the obvious damage from tariffs to agriculture and shipping, the US' manufacturing sector, too, is in a bad way

PAUL KRUGMAN

When he isn't raving about how the deep state is conspiring against him, Donald Trump loves to boast about the economy, claiming to have achieved unprecedented things. As it happens, none of his claims are true. While both GDP and employment have registered solid growth, the Trump economy simply seems to have continued a long expansion that began under Barack Obama. In fact, someone who looked only at the past 10 years of data would never guess that an election had taken place.

But now it's starting to look as if Trump really will achieve something unique: He may well be the first president of modern times to preside over a slump that can be directly attributed to his own policies, rather than bad luck.

There has always been a deep unfairness about the relationship between economics and politics: Presidents get both credit and blame for events that usually have little to do with their actions. Jimmy Carter didn't cause the stagflation that put Ronald Reagan in the White House; George HW Bush didn't cause the economic weakness that elected Bill Clinton; even George W Bush bears at most tangential responsibility for the 2008 financial crisis.

More recently, the "mini-recession" of 2015-16, a slump in manufacturing that may have tipped the scale to Trump, was caused mainly by a plunge in energy prices rather than any of Obama's policies.

Now the US economy is going through another partial slump. Once again, manufacturing is contracting. Agriculture is also taking a severe hit, as is shipping. Overall output and employment are still growing, but around a fifth of the economy is effectively in recession.

But unlike previous Presidents, Trump has done this to himself, largely by choosing to wage a trade war he insisted would be "good, and easy to win."

Across sectors

The link between the trade war and agriculture's woes is obvious: America's farmers are deeply dependent on export markets, China in particular. So they're hurting badly, despite a huge financial bailout that is already more than twice as big as the Obama administration's auto bailout.


US markets Supply chains disrupted

Shipping may also seem an obvious victim when tariffs reduce international trade, although it's not just an international issue; domestic trucking is also in recession.

The manufacturing slump is more surprising. After all, the US runs a large trade deficit in manufactured goods, so you might expect that tariffs, by forcing buyers to turn to domestic suppliers, would be good for the sector. That's surely what Trump and his advisers thought would happen. But that's not how it has worked out. Instead, the trade war has clearly hurt US manufacturing. Indeed, it has done considerably more damage than even Trump critics like yours truly expected.

The trade warriors, it turns out, missed two key points. First, many US manufacturers depend heavily on imported parts and other inputs; the trade war is disrupting their supply chains. Second, Trump's trade policy isn't just protectionist, it's erratic, creating vast uncertainty for businesses both here and abroad. And businesses are responding to that uncertainty by putting plans for investment and job creation on hold.

Political fallout

So the tweeter-in-chief has bungled his way into a Trump slump, even if it isn't a full-blown recession, at least so far. It's clearly going to hurt him politically, notably because of the contrast between his big talk and not-so-great reality. Also, the pain in manufacturing seems to be falling especially hard on those swing states Trump took by tiny margins in 2016.

And while many presidents have found themselves confronting politically damaging economic adversity, Trump is, as I said, unique in that he really did this to himself.

Of course, that doesn't mean that he will accept responsibility for his mistakes. For the past few months he has been trying to portray the Federal Reserve as the root of all economic evil, even though current interest rates are well below those his own officials predicted.

My guess, however, is that Fed-bashing will prove ineffective as a political strategy, not least because most Americans probably have at best a vague idea of what the Fed is and what it does.

So what will come next? Trump being Trump, it's a good bet that he'll soon be denouncing troubling economic data as fake news. And somehow or other this will turn out to be another deep-state conspiracy, probably orchestrated by George Soros.

The scary thing is that around 35 per cent of Americans will probably believe Trump. But that won't be enough to save him. NYT

LETTERS TO THE EDITOR

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Social media perils

This is with reference to the editorial 'The Internet and children' (October 4). One of the reasons for misuse of the Internet is that in big cities, especially in nuclear families, the children are given less time by the parents and tend to use social media networks at an early without realising its harmful effects. With increasing use of social media children will not be able to inculcate the benefits of value and literary education.

Second, once children get addicted to social media, no amount of persuasion will deter them, even if coercive measures are used. This may result in many psychological problems.

However, in the modern and tech-savvy society it is practically not possible to keep the children away from social media, especially when many parents themselves use it too. As such, parents should monitor the child's activities so that their children do not get addicted or use sites which are not advisable for children.

Veena Shenoy
Thane

Work in progress

Prime Minister Narendra Modi's declaration that the country has become open-defecation free (ODF) was excusable, but rather premature. Many people across the country are still to break the habit of open defecation. According to a study by the Research Institute for Compassionate Economics, 44 per cent of people living in rural areas of Uttar Pradesh, Bihar, Madhya Pradesh and Rajasthan still follow this practice. The situation cannot be very different in most of India's other parts.

Credit must be given to the Modi government for the Swacch Bharat mission and toilet-building to facilitate the elimination of open defecation. But all these low-cost toilets cannot be said to be conveniently located, accessible, self-contained with essentials like toilet seats and tapped water. It should not be forgotten that many people in our country are still homeless.

A lot more needs to be done on several fronts to make India fully free from open defecation. Behavioural change is of prime importance. An improvement in the overall economic condition of poor people that raises their standard of living is sure to go a long way. Making India fully free from open defecation is a 'work in progress' and it should continue till the attainment of the goal.

G David Milton
Maruthancode

Diplomatic route

Ever since US President Donald Trump pulled out his country from the Joint Comprehensive Plan of Action or Iran nuclear deal of 2018, there has been no dearth of tension on the ground. Imposition of punitive economic sanctions by the Trump administration with an intent to usher in a regime change in Iran now seems to have only strengthened the resolve of Tehran's leadership to strengthen its ambitious nuclear programme. Under these circumstances, Iranian President Rouhani had expressed his willingness to the talks with the US proposed by French President Emmanuel Macron. No doubt, it is a good diplomatic opening. Sustained dialogue and not the threats of military confrontation would help resolve the issues surrounding Iran nuclear programme.

M Jeyaram
Sholavandan

Growth story

After having gained a largely favourable international consensus on sensitive matters of national importance, it is time India prioritises the next steps for socio-economic growth and restore the partially lost momentum in key sectors. Instead of brainstorming on austerity measures to reduce the widening fiscal deficit, a quick revival in demand-driven sectors is needed. A spike in crude oil can lead to inflationary-pressures; it is thus important to channelise the welfare expenditures and leverage the global rate cuts, greater foreign fund influx and the political leadership to fast-track the investment cycle. Despite recent conditions, India's growth story appears to be decent and well-punctuated by fiscal discipline, consistent macro economic indicators and controlled inflation. As several business communities reciprocate the country's growth objective, stakeholder confidence and overall retail consumption could soon witness an uptick,.

Further, a lower corporate tax can boost earnings growth, enhance fund-inflows and control the debt, even though global cues remain turbulent.

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