

India in the global economic downturn

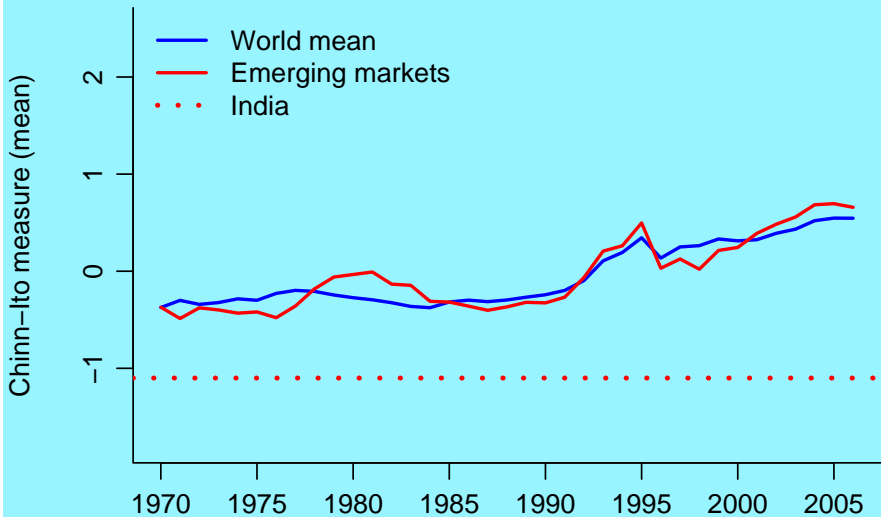
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Part I

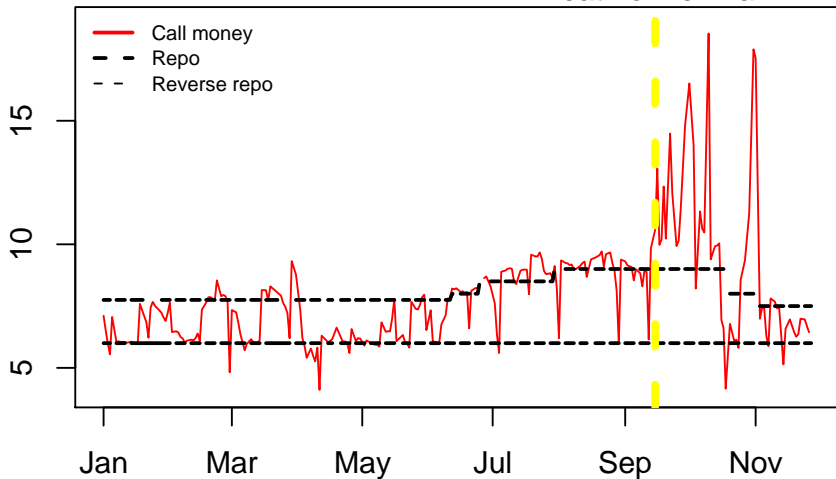
How isolated is India?

India's *de jure* capital controls



What happened when Lehman died

Death of Lehman



Action on 15th September itself

Date	TED Spread	Call money rate	RBI repo (Bln. Rs.)
(Monday) 8 Sep	1.13	8.83	10.25
9 Sep	1.19	8.30	30.25
10 Sep	1.20	8.94	129.85
11 Sep	1.24	8.88	151.95
12 Sep	1.36	6.15	144.00
(Monday) 15 Sep	1.79	9.84	518.15
16 Sep	2.04	10.59	575.65
17 Sep	3.03	13.07	594.80

Roughly \$10 billion of additional borrowing from RBI.

What happened?

- Many Indian firms (financial and non-financial) were using the London money market
- From mid-Sep 2008 onwards, they were short of dollar liquidity
- Borrowed in the rupee money market, convert to USD, and meet obligations there

Part II

Most important channel of transmission

Profitability of tradeables

- Tariffs have dropped dramatically
- Infrastructure of transportation and communications has improved
- For tradeables, there is now no 'Indian price'; there is only the world price.
- The drop in world prices of tradeables has dented profitability of Indian firms producing tradeables.

Shock to investment

- Investment \approx 40% of GDP
- Of this, investment by private corporations \approx 16% of GDP (and this is volatile)
- Private corporate investment adversely affected by:
 - Lower prices of tradeables
 - Lowered Q
 - Financing constraints.
- The biggest question today: What will happen to private corporate investment in 2009 and 2010?

Part III

Standard macroeconomic policy is ineffective

Fiscal policy and monetary policy?

Fiscal policy

- The fiscal space is lacking

Monetary policy

- Lack of monetary policy framework
- Lack of monetary policy transmission.

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 - ① Deepening *de facto* convertibility
 - ② Large investment/GDP ratio; decline can setoff a big downturn
- Private corporate investment now holds the key.

Summary: a daunting situation

- Low trade/GDP ratio + steep wall of *de jure* controls.
- But:
 - ① Deepening *de facto* convertibility
 - ② Large investment/GDP ratio; decline can setoff a big downturn
- Private corporate investment now holds the key.
- Lack of institutional capability owing to lack of work in fiscal, financial and monetary institution building.

Thank you.
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