

Overview of the indian economy



The Indian economy has shown a remarkable growth after the adoption of liberalization policy. The opening up of the Indian economy in the early 1990s led to increase in industrial output and simultaneously raised the inflation rate in India. There was an immense pressure on the inflation rate due to the stupendous growth rate of employment and industrial output. The main concern of the Reserve Bank of India (the central bank) and the Ministry of Finance, Government of India was the prevalent and intermittent rise of the inflation rate. Increasing inflation rate could be detrimental to the projected growth of Indian economy. Thus, the Reserve Bank of India was putting checks and measures in various policies so as to put a stop to the rising inflation. The Indian business community and the general public were assured by the central bank that the inflationary rise was harmless but still certain apprehensions existed among them. The pricing disparity of agricultural products between the producer and end-consumer was contributing to the increasing Inflation Rate. Apart from this the steep rise of prices of food products, manufacturing products, and necessities had also catapulted the Inflation Rate. As a result of all this, the Wholesale Prices Index (WPI) of India reached 6.1% and the Cash Reserve Ratio touched 5.5% on 6th January, 2007. The Reserve Bank of India gave top priority to price stability in its recently drafted monetary policy so as to arrest the panic and discomfort amongst the Indian business circles. It also aims to sustain the stupendous rate of economic growth of India. The Reserve Bank of India raised the Cash Reserve Ratio and used it as a tool to arrest the increasing Inflation Rate. Rationalizing the pricing disparity between the producer and the consumer is the only solution to this problem. Only this will ensure inflation stabilization and thus sustainable economic growth of India.

From the beginning of FY2008 the Indian economy faced a rise in the prices of vegetables, pulses and other basic food stuffs. All this was accompanied with sharp rise in the prices when the annual policy statement for 2008-09 was unveiled on April 29. Inflation increased steadily during the year, reaching 8.75% by the end of May and in June when this figure jumped to 11% then there was an alarming increase in the prices. There were many reasons for it but one of the main driving forces was reduction in government fuel subsidies, which lifted gasoline prices by an average 10%. Indeed, by July 2008, the key Indian Inflation Rate i. e. the Wholesale Price Index touched the mark of 12.6%, highest rate in past 16 years of the Indian history. This was almost three times the RBI's target of 4.1% and almost doubled as compared to last year. This continuous rise slipped back to 12.4% by mid-August.

Since the beginning of 2008 combination of various internal and external factors led to steep domestic inflation and the resultant steps taken to control it in were slowing the pace of expansion. These factors included the marked rise in the international prices of oil, food, and metals, moderating the rate of capital inflows, worsening current and fiscal account deficits, increasing cost of funds, minor depreciation of the Indian rupee against the dollar, and slow growth in industrial economies. The Indian economy was at a critical juncture where policies to contain inflation and ensure macroeconomic stabilization have taken center stage. In the first quarter of FY2008 (i. e. April -June), growth rate of GDP slowed down to 7.9% from 9.2% in the corresponding prior-year quarter, for the slowest expansion in three and a half years. The most remarkable decline was in industry where

growth rate fell to 6.9% this was mainly because of cutting in the manufacturing growth rate to 5.6%. The slowdown was widened when agriculture and services sector showed a negligible growth of 1.4% and 0.9% points, below their performances of the year-earlier quarter. Over the medium term, the main objective of the government was to bring down inflation to 3%. The Repo and Reverse Repo Rates remained unchanged whereas Cash Reserve Ratio (CRR) was increased by 0.25 percentage points.

A survey of manufacturing companies was conducted by the Reserve Bank of India in June 2008 which indicated a moderation in business optimism. This was corroborated by the composite business optimism index for July - September 2008 that was prepared by Dun and Bradstreet, which shows a decline of 11.2% as compared to the previous quarter. In July, the BBB-rating on foreign currency debt was confirmed but downgraded the view for India's long-term local currency debt from stable to negative, with a noticeable deterioration in the fiscal position. Growth of the broad money supply (M3) had to be moderated in the range of 16.5 to 17 per cent. While deposits were scheduled to rise by 17% and non-food credit disbursements by banks will grow at a slow rate of 20% as compared to 22.5% in 2007-08. Credit disbursed by banks last year was less as compared to the previous period. Bank credit had grown by a scorching 30% every year for consecutively three years beginning in 2004-05.

The combined budget deficits of the central and state governments have been substantially reduced over the past 5 years. This reflected sincere efforts by the government to adhere to fiscal responsibility legislation. For <https://assignbuster.com/overview-of-the-indian-economy/>

FY2008, the central Government's deficit is budgeted at 2.5% of GDP and the states' at 2.1% (4.6% of GDP on a consolidated basis). The major factors that strengthen the appreciable fiscal consolidation from the base were a wider tax base supported by a buoyant economy and improved compliance. Two main situations that must be overcome before achieving the deficit targets for the FY2008 are: a slowing economy that may limit the revenue buoyancy seen in recent years and continuous pressure by the Central Government to raise the salaries of its employees by 21% (about 0.3% of GDP) in response to recommendations of the Sixth Central Pay Commission. Similar wage increases were announced immediately by half a dozen states and others were following the suit. On the other hand provision for these salary increases was not budgeted.

EFFECTS

Inflationary pressures in any economy leads to depreciation of its domestic currency. This is what our Indian economy was facing due to the running inflation and as a result Indian rupee depreciated by about 20% since April 2008. Inflation affects- 1. Common man: Inflation effects a common man in different roles such as a consumer: Products such as crude oil, fertilizers, pharmaceutical products, ores and metals, or use imported components such as Personal Computers and laptops are directly imported. Due to depreciation of the Indian Rupee all these goods became very expensive. Components in computers such as processor, hard disk drive and motherboard are also imported. Products such as mouse, keyboard and monitor also witnessed an impact on their prices due to Rupee depreciation. Inflation may rise in an economy when the input costs increase.

As an investor:

Depreciation of rupee makes imports of various components, capital goods and raw materials more expensive. As inputs and other equipment that are imported get costlier and reducing the profit margins. Companies that import goods in bulk and those with heavy foreign currency borrowings may be marked down in the stock market as the rupee depreciates.

As a Wage-earner:

During inflation this class of common man suffered a lot because of two reasons-

1. Increase in wages and salaries failed to keep pace with the rising prices.
2. Wages increased during inflation but there is always a time lag between the rise in price and increase in wages. As a result common man loses during the intervening period.

Export companies:

Due to depreciation of domestic currency exporters receive better prices for their goods and services when sold in foreign markets.

Foreign Investors:

Depreciation of Indian Rupee reduced the returns that foreign investors used to earn by investing in Indian companies. Depreciation of a currency triggered FII outflows. NRI investors, who previously invested their money in

India under various deposit schemes due to high interest rates, started finding those schemes less attractive on account of rupee depreciation.

Country's Balance of Payments:

One of the drawbacks of depreciation of Rupee is that exports become cheap in terms of foreign currency and imports become costlier. Current account deficit widened because Indian imports basically constitutes essentials such as crude oil, natural resources and many capital goods. Depreciation of Indian Rupee made the exports more competitive globally and as a result higher exports covered up the trade deficit.

Farmers:

The prices of the primary commodities such as minerals, diesel oil and fuel, power light and lubricants went up significantly. This disparity affected the agricultural sector in two ways-

1. It had a restrictive effect on investments in farming and affected the production efficiency.
2. On one hand the agricultural commodity prices were falling or stagnant and on the other hand increasing prices of agriculture inputs and other daily life commodities led to deterioration in the living standard of the farmers.

Prices paid by the consumer have impacted by the cost of living of the entire value chain, which grows on the inefficient markets and this adds to the final cost of the material. For example, high energy cost itself has contributed to

the increase in the cost of inputs required for agriculture besides pushing up the marketing costs of farm products.

IT companies:

The IT sector is amongst the highest recruiters in the Indian economy and a depreciating rupee spells good news for the sector. Bills for Information Technology companies are basically prepared in dollars or in other foreign currencies. Depreciation of the rupee increased their realizations and bodes well for their margins. The main reason for the good performance in the second quarter of Infosys Technologies and Satyam Computers was the depreciation of the Indian Rupee. An estimate suggests that a 1 per cent depreciation in the rupee expands an IT company's margins by 0.30-0.40 per cent.

CONCLUSION

Majority of India's population lies close to the poverty line and inflation acts as a 'Poor Man's Tax'. More than half of the income of this group is spent on food and this effect is amplified when food prices rise. The dramatic increase in inflation will have economic as well as political implications for the Congress Government, with an election due within a year. Economic growth rate in the emerging markets have slowed down but is far from over. The BRIC countries i. e. Brazil, Russia, India and China alone account for more than 3 billion people and with consumption rate increasing every year. It is expected that the high inflation rates will be there for a long period of time which is worrying news for the Indian Government. Direct regulatory measures such as the reduction in import tariffs were adopted in order relax

the supply-side pressures on various agricultural commodities. While adopting the direct measures, the Government realized that the relaxation of supply-side pressures would dampen inflationary expectations by increasing supplies in the commodities market.

The RBI's attempt to control excess liquidity in the market by raising the interest rates pushed up real-estate prices as well as the commodity prices, thus fuelling inflation. A closer look at certain commodities would reveal that the prices of sugar and wheat were managed by the Government through various market intervention mechanisms. As a result the physical market's role in effective price discovery was affected. Trade in the commodities market operated in an asymmetrical information situation from both the supply and demand sides. Hence, market operations could only benefit segments that were privy to the available information. The existing agricultural market ecosystem revolves around the traders and to some extent the producers with no say from side of consumers. Hence, at the end both consumers and producers are often at a loss. Generally, traders keep a heavy margin to compensate for the physical and financial risk involved in carrying the commodity for short as well as long term.