Will the Indian economy go down the Sri Lankan way?

■ *Dr. T. K. Jayaraman*

There are widespread concerns and speculations about the immediate future of the Indian economy. There are also views, amounting to wishful thinking, freely circulated in social media.

The answer in one word to the question posed is "No"!

Let me deal with the concerns, speculations and wishful thinking, one by one in the reverse order.

Wishful thinking

The views being circulated in social media mainly hovers around some disgruntled politicians. The desire to oust the central government by any means continues to be strong - uniting the opposition at least on one point. The views are based on agitational politics, a term which became popular in the 1970s. The clarion call then was: "Sangarsh Karo, Hum Sath Hain!"

It was given a respectful name later in 1983: "People Power" in the Philippines resulting in the overthrow of Ferdinand Marcos, when people went to the streets. The latest in the Sri Lankan case proves it could be a success again! An economic crisis can be easily manipulated once it is brought to the streets.

Speculations

Speculations are based on fears about the current status of the world economy and their impact on India's growth and inflation for the last few months, especially the ongoing Ukraine and Russia conflict with consequences of falling supply and demand. The fears are genuine. The latest update of the *World Economy Outlook* (WEO) by the International Monetary Fund (IMF) released on July 26 makes a dismal reading. Global economic growth, which was already weakened by the Covid-19 pandemic in 2019 with periodical emergence of new variations of the virus in 2020 and 2021, contributed to further decline in growth in the two quarters of 2022 as well.

Several shocks, including inflation due to negative spillovers from the war in Ukraine, resulted in shortages of food grains and supply chain bottlenecks in major commodities. The updated July WEO gives the new, revised forecasts **(Table 1)**. The updated baseline forecast is growth would slow down from 6.1% last year to 3.2% in 2022, - 0.4% lower than the April 2022 WEO. The lower growth in early 2022, consequent fall in purchasing power and tighter monetary policy to fight inflation by the United States (US) Federal Reserve have all contributed to further downward revision of growth rate to 1.4% in the US. In China, the second largest economy, lockdowns and the deepening real estate crisis have led to reduction in growth rate forecast by 1.1%. In Europe, downgrades reflect spillovers from the war in Ukraine and overall anti-inflationary measures. India's growth rate is also revised downwards come down by 0.8% from 8.2% to 7.4%. The IMF notes that the downward revision in growth rate is "the result of less favourable external conditions and more rapid monetary policy tightening."

TABLE 1 — Revised Forecasts of Growth Projection for Major Countries and India : 2022 and 2023

	2022	2023
World	3.2	2.9
US	2.5	1.4
China	3.3	4.6
Eurozone	2.6	1.2
Brazil	1.7	1.1
Russia	-6.0	-3.5
South Africa	2.3	1.4
India	7.4	6.1

Source: IMF 2022 Updated July 2022 World Economic Outlook

The Sri Lankan situation was the result of a combination of several factors which included inadequate foreign reserves, the twin deficits comprising fiscal and trade deficit, record inflation, falling export earnings and poor performance by tourism sector, which in normal times accounts for 10% of GDP), since the Easter shooting of 2018 and above all bad economic mismanagement.

TABLE 2 — Major Countries and India : Increases in central bank policy rates in 2022

	Hikes by bps	Latest rate (%)
Hungary	835	9.75
Brazil	400	13.25
USA	225	2.5
Canada	225	2.5
Australia	125	1.35
South Korea	125	1.50
UK	100	1.25
India	90	4.9
Euro Area	50	0.5

Note: 100bps= one percentage point

Inflation is expected to touch in 2022, 6.6% in advanced economies and 9.5% in the emerging market and developing economies this year—upward revisions of 0.9 and 0.8%. In 2023, the, disinflationary monetary policy is expected to bite, with global output growing by just 2.9%. **Table 2** presents the hikes in interest rates in 2022 since January to date in major countries, including India.

The IMF has highlighted the need for taming inflation. That should be the first priority for policymakers. Although tighter monetary policy will inevitably have real economic costs, targeted fiscal support is recommended for cushioning the impact on the most vulnerable segments. Such policies will need to be offset by increased taxes or lower government spending. The IMF has not forgotten the pandemic. The governments have been reminded that vaccination rates must be stepped up. India, which has taken more intensive steps than any country in the world, has announced free booster doses to all.

In these circumstances, the speculations about India's future are influenced by recent happenings in the region. The Sri Lankan situation was the result of a combination of several factors which included inadequate foreign reserves, the twin deficits comprising fiscal and trade deficit, record inflation, falling export earnings and poor performance by tourism sector , which in normal times accounts for 10% of GDP), since the Easter shooting of 2018 and above all bad economic mismanagement. They led to the unprecedented economic crisis, finally ended in change of government as well.

TABLE 3 — India : Crude Price, Inflation and External Sector indicators : 2021 April to June 2022

Month	Petroleum Crude Price $/barrel	Inflation percent	Exchange Rate Rupees per dollar	Trade Balance $ billion	Net FPI flows (Equities) $ billion	Foreign Reserves $ billion
2021 April	65.9	4.2	70.78	-15.1	-1.29	588
May	68.9	6.3	72.52	-6.28	-0.39	598
June	75.6	6.26	74.36	-9.4	2.36	609
July	74.7	5.59	74.34	10.97	-1.51	601
August	74.3	5.3	73.09	-13.81	0.28	633
September	78.6	4.35	74.19	-22.59	1.79	639
October	84.4	4.48	74.19	-19.7	-1.81	640
November	71.4	4.91	75.03	-22.91	-0.79	637
December	77.2	5.66	74.46	-21.68	-2.53	634
2022 January	91.7	6.01	75.03	-17.42	-4.46	629
February	95.5	6.07	75.49	-20.88	-4.74	631
March	109.8	6.95	75.9	-18.51	-5.39	617
April	108.3	7.79	76.6	-24. 29	-5.24	606
May	117.2	7.04	77.29	-26.18	-6.4	593
June	122.71	7.01	78. 02	NA	-1.8	573

Source: Trading Economics; RBI Monthly Bulletin (Various issues)
NA= Not available

TABLE 4 — World Commodity Prices : May 2021 to July 2022

Commodities	2021 May	Peak Price	2022 May	2022 Early July
Aluminium/T	2500	3750	2796	2319
Zinc/T	2969	4500	3499	3150
Copper/lb	4.7	4.8	4.16	3.52
Palladium/t/oz.	2200	3000	1968	2168
Crude, Brent/barrel	65	128	108	108
Wheat/bu	700	1280	1265	893
Soybean/bu	14	17.69	16.14	15.16
Sugar/lbs	17	20.2	18.52	19.05
Cotton//lbs	80	160	145	93
Gold/t.oz	1800	2050	1823	1740
Silver/t.oz	28	28	20.7	19.2

Source: Times of India July 13, Wednesday, 2022

The economic mismanagement was the result of efforts to save foreign exchange, which landed the economy in distress. With only $2.31 billion of foreign reserves for debt repayment of over $4 billion, the government banned imports of all chemical fertilizers in 2021 to make agriculture 100% organic, which severely hit the country's farm production. Sri Lanka's high dependency on imports for essential items like sugar, pulses and cereals added fuel to the economic crisis. Sri Lanka could face a trade deficit of $10 billion this year. Foreign direct investment has been slowly declining. Available data show it was only $548 million in 2020 falling from $ 1.6 billion in 2018 and $793 million in 2019, reflecting the decline in international investor confidence in Sri Lanka.

Speculations are not themselves dangerous. Only wishful thinking expressed in social media degenerates into rumors and once repeated as "forwards", they become potential economic threats, aiming at destabilizing the economy.

Concerns

Concerns, expressed in the responsible mainstream media and social media, based on evaluation of facts and figures as well as on assessment of past experiences, are more meaningful. **Table 3** presents key economic indicators during the last 15 months. The trade balance has been worsening since September 2021contributing to deterioration in the current account balance. It is widening each month from January 2022. The reasons can be linked to rise in prices of minerals and energy prices, as imports valued in dollars are mounting, exceeding total earnings from exports of goods and services. Further, with the US Fed increasing its interest rate and uncertainty in the world economic situations, investors are pulling out their short-term capital from India. The latter makes the dollar stronger, depreciating the rupee more and more. On July 15 it touched nearly ₹80 per US dollar. The Reserve Bank has been intervening in the market downloading dollars and raising the value of the rupee. This would reduce the dollar holdings of RBI. The foreign reserves are low at $573 billion, as compared to the highest ever at $640 billion touched in October 2021.

The critics are raising a relevant point by questioning whether the RBI is doing the right thing as defense is useless when foreign investors are repatriating their funds following the US Fed's tightening, anti-inflationary stance. The fall in reserves is not by itself risky, as the purpose of accumulating reserves in good times, when short term foreign portfolio inflows are flooding the economy. The RBI Governor observed "After all, this is the very purpose for which we had accumulated reserves when the capital inflows were strong. And, may I add, you buy an umbrella to use when it rains!"

The objective of intervention is to manage an orderly movement in the currency. External debt of India is now $620.7 billion. Debt of the government and central bank is only 20% of the debt. The rest is in the private sector. The ratio of foreign reserves to external debt was 97.8%.

The RBI has indicated its readiness to continue the tightening stance, as the pressure on the rupee would be mounting. The US Fed raised its policy rate by 75 basis points (bps) to 2.5%. India has to keep the interest rate differential attractive for enticing short term flows. Leading economists feel that the RBI would raise the interest rate by at least 35 bps. The central government has done its due on the fiscal policy side by reducing the cess on petrol and diesel.

One major step.

One major step in reducing the impact of the rising value of dollar on India's imports is the latest RBI notification on July 11, known as 'International Trade Settlement in Indian Rupees (INR)'. It allows cross-border trade in Indian currency under the Foreign Exchange Management Act (FEMA) 1999. Countries, including Russia and Iran which have considerable trade with India can settle trade payments based on market determined bilateral exchange rate, instead of US dollar. If more countries join under this new arrangement, it would be well and good.

The latest news is that commodity prices would be falling with recession in advanced economies. **Table 4**. provides the trend.

The recession probability forecasts are also of interest **(Table 5)**. India has zero probability. Leading Indian economists are confident that world recession will not affect India. Madan Sabnavis, Chief Economist, Bank of Baroda is of the view that the overall impact of the recession on India will not be significant, as, among other factors, global commodity prices will also fall, which is positive. Sabnavis adds that the country's domestic economic factors are positive which will

TABLE 5 — Recession Probability Forecast for Asia and Pacific

Country	Forecast (%)
Sri Lanka	85
New Zealand	33
South Korea	25
Japan	25
China	20
Hong Kong	20
Taiwan	20
Pakistan	20
Malaysia	13
Vietnam	10
Thailand	10
Philippines	8
Indinesia	3
India	0

Source: Bloomsburg Survey

insulate India from any major negative impact. Latest data, as I write is the crude has already fallen to its 12-week level. Brent futures for the September delivery on Wednesday, July 27 fell $2.08, or 2.0%, to settle at $100.69 a barrel. Other commodity prices have also started cooling off, as global nickel prices recently declined 50.2% from its high of 2022, aluminium fell 36.4% lower than its high seen this year so far.

— Dr TK Jayaraman was a former Senior Economist, Asian Development Bank, Manila. Presently, he is a Honorary Adjunct Professor to Amrita School of Business, Bengaluru Campus. He is also a Visiting Research Professor, Faculty of Business, Accounting, Finance and Economics, University of Tunku Abdul Rahman , Kampar Campus, Perak State, Malaysia. His website: www.tkjayaraman.com.