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Interest rate certainty in lost high hopes on growth projection

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Abstract: For the last 5 years the government was quiet comfortable with Flexible Inflation Targeting instead of using discretion of targeting inflation in previous days when Inflation print was available still gives RBI much headroom to keep the interest rate under control. Most of the time in the last five years though real interest rates were positive but the way government has convinced RBI means that it is the Government which has to lead the economic growth. Private sector has to crowd in is the thinking prevailing as of now. Since the private consumption has stopped rising further for many years due to weaker push which could be given to people in the base of the pyramid as a result of which there is perceptible fall in the service demand and manufactured goods. Business opportunities are curtailed because of the States after 2014 are trying to see which way these are politically stable. Economics narratives are disturbed when there is change in the government. It is almost sure that interest rates could not swing too far beyond 6 percent and right earnestly the growth rate optimism is not hyped. Even 6 percent growth in these circumstances can give better complacency.

Keywords: Interest rate, growth projection, Flexible Inflation Targeting

I. INTRODUCTION:

Two times in the last one decade the global economies have gone through downward spiral which made the macro-economic situation such that central banks and sovereign government had to adopt measures to tackle the situation for all. Developing countries like India which is very huge in terms of population and complexities though has no record since independence to have done something satisfactory for all but definitely it is tied to global economic development in terms of trade and investment. The two mega episodes one in 2008 called global financial crisis in which crisis was felt to overcome the need of financing because the capital went missing in the stock market crash. The second is due to Covid which is a pandemic affecting lives and livelihoods. No doubt the performance of developing countries in putting the economy back to track through public health system and vaccination cannot be as laudable as these are in the developed countries after first wave but the government and enterprises came under acute stress during the first wave were expected to be dealt with monetary and fiscal stimulus. The government under exceptional situation had a first call to give necessary relief to the affected parts of the economy. The stress points were identified by the government and measures were announced to give relief as much as possible. Generally in India the first shock came from disruption in supply chain as the lockdown which were felt too necessary resulted in fall of the output and at the same time employment was also acutely disturbed. In India roughly 90 percent is unsecured unemployment out of which almost 50 percent dependent on agriculture though is unsecured but remained protected as the Covid was not expected to have its deleterious effect on the output though some freight problems were seen. The workers who work on unsecured basis in urban areas in variety of centers and also they belonged to different States had to go back to their villages as someone would have not given them shelter without paying for living here. The short term measures like providing free ration, training and increasing the outgo on MNREGA were being considered as common sense. The loss of employment and cut on the salaries of the employees had profound impact on the demand which had negative impact on inflation and inflation was brought under control. To run the budget for the year the government was expected to borrow additionally from the market and with the inflation remaining unexpectedly on the lower side the yield of borrowing could be kept as low as it was naturally possible. However after lockdown was lifted the economy was expected to be given boost by pump priming acting mostly on the supply side but government lacking the fiscal stimulus to keep the workers going with cheerful mood was not possible as the government in the last three decades since the economy was liberalized had to contend with the fiscal deficit capped by compulsion. Borrowing in any country has to be capped in case the growth is the point under consideration. The demand beaten down severely but well off unable to remain contented with what they could not do during lock down was shown up during the festival season and the overshooting of inflation was the obvious outcome of the pent up demand. The government for the last four years has been trying to transfer the resources from rich to poor by way of charging much more than normal excise duties but it did not show up in the inflation reason being employment scenario since 2006 is lackluster. It was only after December when workers came back to work to still less in number, the headline inflation was above

7 but again when the sign of Covid second wave appeared to be surging once again the inflation touched new low of 5.2. Across the shores the situation was different. At the first sign of economy going through trouble time, the Fed reserve in US had to cut the interest rates across the board and bond selling increased to give the chance to industries to keep rebuilding the output as much as they can. The money flooded in the US reached on Indian bourses and climbing of indices started immediately and it has the simple logic reflected in commitment of Indian economy as it has the span to go up and up. When the government has presented the budget heavy borrowing was expected but still challenge before the central bank was to keep interest rate as low as possible so that growth rate could be accelerated as much as possible. It is simple rule that so long as g>r the borrowing in the medium term should not be causing difficulty in gradually repaying the loan the government has been taking. But how much g can be greater r is also to be stated implicitly. In case g increases with increase in export and consumption which means the employment generation should also keep pace then the acceleration would be capable of bringing down the debt. The European economies since 2008 have found themselves in grave trouble because they exceeded the debt beyond the prudent limit. In case of US which is the largest economy the debt is found to have increased significantly but the readjustment which has been taking place is not found to have been affecting the debt as worrisome as it would have been for small economies like in the Europe but in India the situation of high debt can be alarming for the reason of social and cultural rigidities. It is the reason that though FRBM is breached but there is conscious thought it should not be increased astonishingly. This time was an extraordinary as output which does not get created someone cannot recoup the losses, following the same processes it has be regenerated and hence the limit of debt has increased significantly. In our earlier paper we have clearly mentioned that growth cannot leap frog but it has to creep due to structural deficiencies in the human development. The human resources are difficult to be harnessed with full potential because technology, training and potential do not move with the same pace in coherent manner. Even if the change is slow and structural reformation does not seem to be working fast, the lost output during the pandemic, expected interest rates, inflation and exchange rate are being reexamined. Since the projection of 90 percent Debt to GDP ratio in another 4 years has been assumed, whether a priori it can be presumed that inflation will not cross 6 percent with a view to soften the yield as low as possible so that limit itself does not start causing the brake to debt. Food inflation remains under control so long as workers wages are under control. Core inflation which arises from extra demand more than supply is difficult to come through because there is no sudden burst in employment generation. The government has tried to control the import by increasing the tariff and the export though has receded but it has come close to import. It indicates that government knowing the internal constraints on export is expected to keep import under control so that exchange rate does not go out of range unnecessarily when growth projections are modest at most. There is one aspect which left in suspense by the government. Government has enacted farms laws but left these unimplemented and every aspect is unclear. Basically structural reforms in India are at the cost of politics and there deepening is dependent on the political muscles built at the time of reforms. Same is the case of farms laws. What the government does is that it gets the idea as to how much the parliament for it is strong for at least 15 years. Once it is sure about it then farm laws can be started implementing most probably by October, 2021. As it begins to take place the government can see the outgo on fertilizer and food shrinking and going in the market mode completely. As the agriculture brought under market the export not immediately up to 4 years but after that it will begin to increase but inflation is bound to increase because wages across the rural sector will firm up. The question is how much would be the productivity gain in the given scenario the land is likely to be vacated from agriculture and to be used for infrastructure and manufacturing and this appeared to be objective of reforming the agriculture laws.

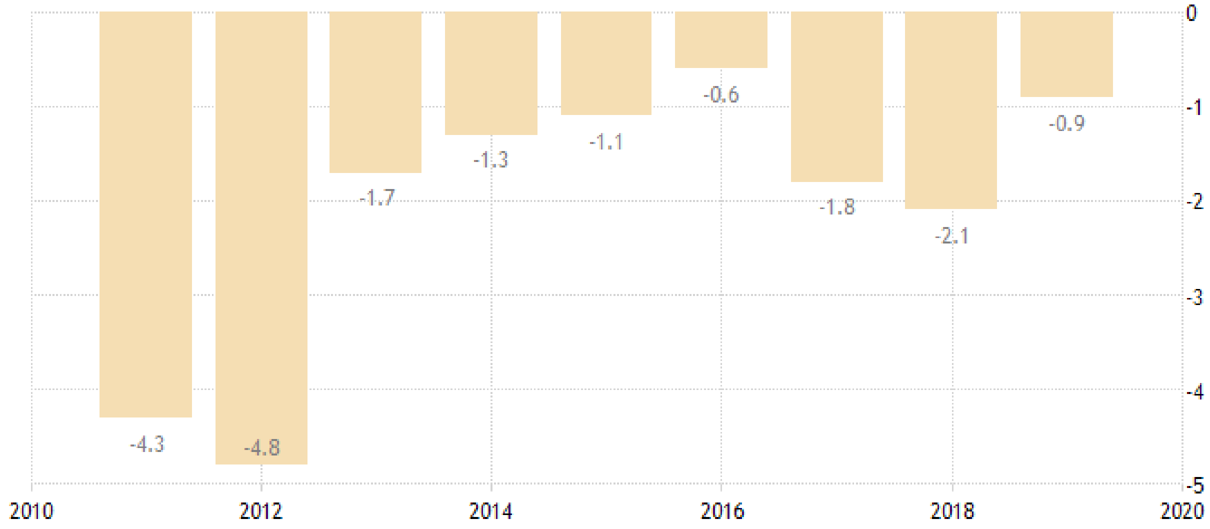
Indian Economic growth in the last 10 years.

India GDP Growth Rate - Historical Data		
Year	**GDP Growth (%)**	**Annual Change**

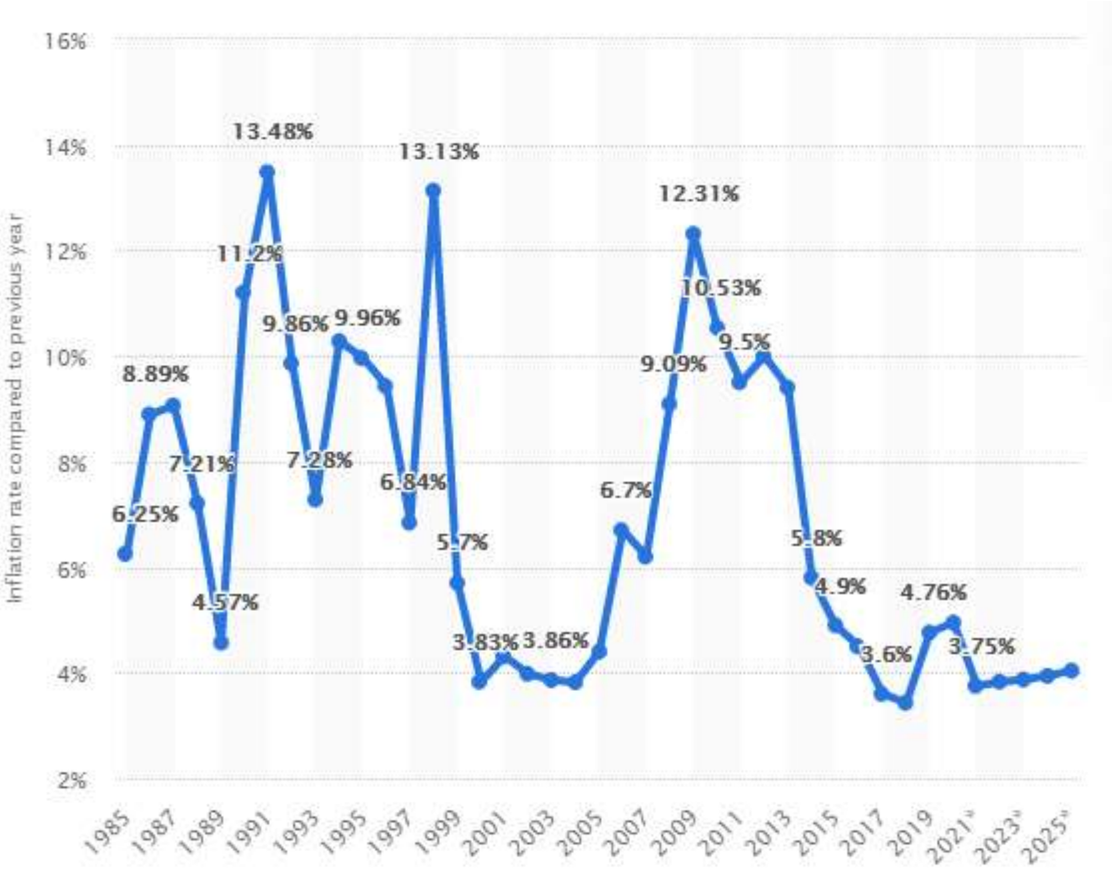
India GDP Growth Rate - Historical Data		
Year	**GDP Growth (%)**	**Annual Change**
2019	4.18%	-1.94%
2018	6.12%	-0.92%
2017	7.04%	-1.21%
2016	8.26%	0.26%
2015	8.00%	0.59%
2014	7.41%	1.02%
2013	6.39%	0.93%
2012	5.46%	0.22%
2011	5.24%	-3.26%
2010	8.50%	0.64%
2009	7.86%	4.78%
2008	3.09%	-4.57%
2007	7.66%	-0.40%

India GDP Growth Rate - Historical Data		
Year	**GDP Growth (%)**	**Annual Change**
2006	8.06%	0.14%
2005	7.92%	0.00%
2004	7.92%	0.06%
2003	7.86%	4.06%
2002	3.80%	-1.02%
2001	4.82%	0.98%

India’s Current account deficit in the last 10 years



India's CPI based inflation rate during the last 10 years.



In the past situation was entirely different. Indian policy makers were interested in pushing up the growth as much as possible but most of the time it was inflationary and it is evident from the current account deficit which was also significant and fiscal deficit was also out of the range both of which are indication of inflation. The people were expected to be pulled out of poverty and revenue spending was important to achieve that objective. It has been seen when poverty and unemployment stakes are high the government tends to go overdrive with fiscal deficit and current account deficit. Since 2008 the situation is entirely different. No new employment generating scheme has been added which could be due to two reasons one that hope to keep increasing the export has diminished particularly India is not firm on any Free Trade Agreement. The change of command in 2014 has also brought new ways to manage the economy in which de-facto concern for employment is not kept in the middle of decision making. While employment was not given too serious importance, the government has erratically conducted demonetization and implemented GST which ironically has eaten away significant GDP. Pandemic in 2020 has again shackled the system drastically where positive GDP was not expected and it has been recorded negative. In the previous decades service sector was the predominant sector to contribute in the GDP as it did not need any special focus to develop. It was by chance that it kept growing. Employment was expected to be generated in the manufacturing sector and rural economy. It was too late when the government turned its focus to Atamnirbhar Bharat in which import would be reduced to as minimum as possible but scale of 13 sectors will be built with liberal investment to be incentivized with PLI. As the process has already been started, in the last two years current account deficit has become narrower. But the support from the government is badly needed there is too much pressure on fiscal side and astonishingly has crossed 12 lacs crores for the first time. The question is of debt sustainability in case the growth does not consolidated, excess borrowing and that too what way inflation would go the controlling interest rate can make the debt unsustainable. It is therefore the government for the first time the government is making efforts on human development so that human beings become more capable to consume the goods and revenue generation along with GDP can take care of the interest payment out of the borrowing.

Government has expanded the scope of FDI in coal sector as well as insurance which means the use of these two products would show up in the GDP.

Exchange rate during the last 10 years

2009–10	73.7333	68.5335	47.4166	45.1350	75.8861	68.0188	67.0843	60.5913	51.1261	48.4338
2010–11	69.7228	70.7930	45.5768	44.6450	70.8853	71.9163	60.2181	63.2350	53.2963	54.0175
2011–12	75.3132	79.2512	47.9229	51.1600	76.3912	81.7975	65.8939	68.3550	60.7484	62.4250
2012–13	83.0262	81.4764	53.2112	54.2323	85.9713	82.3209	70.0693	69.5438	65.8530	57.7600
2013–14	92.2602	92.7790	60.5019	60.0998	98.3058	99.8498	60.4026	58.8300	81.1745	82.5765
2014–15	90.7955	86.3431	61.1436	62.5908	98.5731	92.4591	55.8266	52.1100	77.5209	67.5104
2015–16	91.3452	93.4510	65.4685	66.3329	98.7260	95.0882	54.5934	59.0600	72.2894	75.0955
2016–17	92.6156	87.9763	67.0720	64.8386	87.6897	80.8797	62.0350	57.9600	73.6087	69.2476
2017–18	90.8989	94.8065	64.4549	65.0441	85.5129	92.2846	58.1822	61.5400	75.4378	80.6222
2018–19	108.0361	96.0273	69.9229	69.1713	91.7865	90.4756	63.0468	65.5200	80.9580	77.7024

Sensex during the last 10 years

Year	Open	High	Low	Close
2010	17,473.45	21,108.64	15,651.99	20,509.09
2011	20,621.61	20,664.80	15,135.86	15,454.92
2012	15,534.67	19,612.18	15,358.02	19,426.71
2013	19,513.45	21,483.74	17,448.71	21,170.68
2014	21,222.19	28,822.37	19,963.12	27,499.42
2015	27,485.77	30,024.74	24,833.54	26,117.54
2016	26,101.50	29,077.28	22,494.61	26,626.46
2017	26,711.15	34,137.97	26,447.06	34,056.83

Year	Open	High	Low	Close
2018	34,059.99	38,989.65	32,483.84	36,068.33
2019	36,161.80	41,809.96	35,287.16	41,253.74
2020	41,349.36	47,896.97	25,638.90	47,751.33
2021	47,785.28	52,516.76	46,160.46	49,591.32

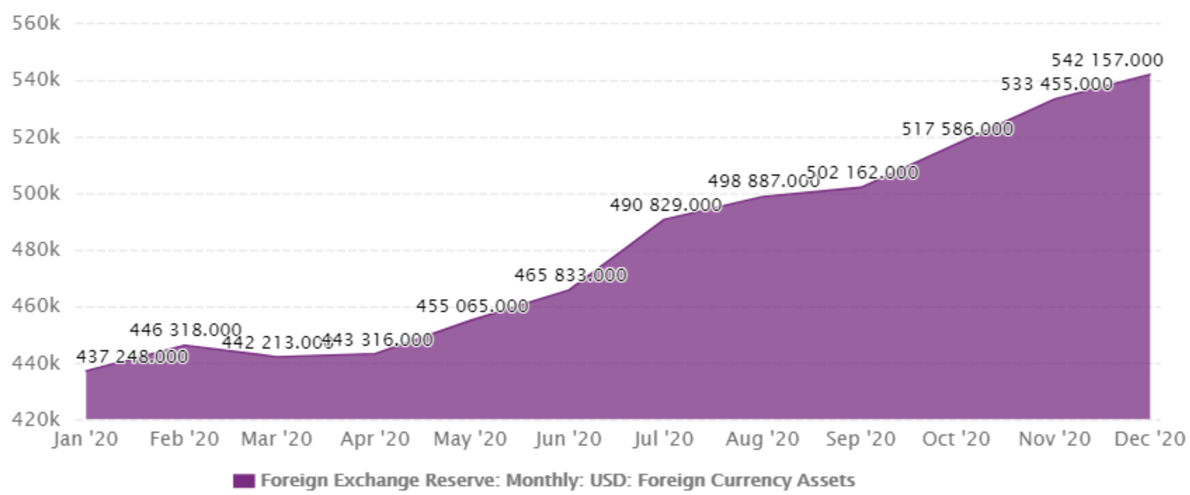
Quarterly repo rate during the last 10 years

Effective Date	Repo Rate	%Change
09 Oct 2020	4.00%	0.00%
06 Aug 2020	4.00%	0.00%
22 May 2020	4.00%	0.40%
27 March 2020	4.40%	0.75%
6 February 2020	5.15%	0.25%
07 August, 2019	5.40%	0.35%
06 June, 2019	5.75%	0.25%
04 April, 2019	6.00%	0.25%
07 February, 2019	6.25%	0.25%
01 August, 2018	6.50%	0.25%
06 June, 2018	6.25%	0.25%
02 August, 2017	6.00%	0.25%
04 October, 2016	6.25%	0.25%

05 April, 2016	6.50%	0.25%
29 September, 2015	6.75%	0.50%
02 June, 2015	7.25%	0.25%
04 March, 2015	7.50%	0.25%
15 January, 2015	7.75%	0.25%
28 January, 2014	8.00%	-0.25%
29 October, 2013	7.75%	-0.25%
20 September, 2013	7.50%	-0.25%
03 May, 2013	7.25%	-0.50%
17 March, 2011	6.75%	-0.25%
25 January, 2011	6.50%	-0.25%
02 November, 2010	6.25%	-0.25%
16 September, 2010	6.00%	-0.25%
27 July, 2010	5.75%	-0.25%
02 July, 2010	5.50%	-0.25%
20 April, 2010	5.25%	-0.25%
19 March, 2010	5.00%	-0.25%
21 April, 2009	4.75%	0.25%

05 March, 2009	5.00%	0.50%
05 January, 2009	5.50%	1.00%
08 December, 2008	6.50%	1.00%
03 November, 2008	7.50%	0.50%
20 October, 2008	8.00%	1.00%
30 July, 2008	9.00%	-0.50%
25 June, 2008	8.50%	-0.50%
12 June, 2008	8.00%	-0.25%
30 March, 2007	7.75%	-0.25%
31 January, 2007	7.50%	-0.25%
30 October, 2006	7.25%	-0.25%
25 July, 2006	7.00%	-0.50%
24 January, 2006	6.50%	-0.25%
26 October, 2005	6.25%	00.00

Foreign exchange reserve during the last 10 years



From the data given above it is pretty clear the sensex is zooming means more than debt receipt due to which interest rate differential is almost narrowed but foreign investment is coming to make gains from the stock market or signs of growth are visible. But back at home inflation was correlated with growth which is coming due to high demand but no certainty of employment mostly in the MSMEs. Repo rate cannot be rated as so low to incentivize the MSME has been keeping a check on the production by MSME and therefore employment is not very encouraging. Employment creation hinges on the courage to introduce worthwhile MSMEs so that further growth potential can be accessed. Export is not helping the growth to pick up some points and it is due to numerous reasons major among them is the high interest rates or any incentive by the government to scale up the production of the competitive products. For example India is not faring better in textile sector the reason attributed are the labor laws and high running cost of money. As the interest rates remain moderate to high small industries which are not covered by the banks need to access loan from NDFC which normally charge 4-5% interest higher than the banks. While growth rate and interest rate are related inversely therefore Sensex which has zoomed has not added much flavor to growth but it is the money parked in the stocks which are overvalued and accretion to foreign exchange is also very fast. But this time US is determined to go with all energy to step up growth rate up to 6 percent while expecting the increase in inflation, the interest rates in India are expected to touch higher even while the projection of growth on the back of high debt to GDP ratio is 90 percent. The government is expected significant foreign debts. Secondly when the gap between import and export is narrowed the chances of exchange rate not moving away from the central exchange rate the prices of international oil import are likely to remain unaffected for quite some time but as it is becoming almost clear that economic growth across the globe is to pick up after vaccination, the villain could be the oil prices and the fear about inflation is becoming true from the other side indirectly. The second wave of Covid which is more ferocious is the cause of concern for the health infrastructure and economy, some disruptions are visible to predicted growth rate. But this time no farsightedness is the point under consideration small damage to an extent of 0.5% is visualized. Definitely this time financial institutions will have less money to give credit as the past dues are yet to be cleared, the unorganized sector is still under stress and supply side was not perfected and hence contraction in industrial sector has been published by the department. Not so optimistic employment scenario in the next one or two years, wage reduction is also the norm saving and demand are going to have down side. Private sector miss to play its needed role, it is the government which will continue to borrow from the secondary market of course some primary securities will also be used. Inflation might be there due to supply side constraint but demand effect appears to be somewhat stronger on the negative side inflation is likely to stay within agreed range below 6percent. RBI will make every best efforts to keep control on the yield therefore even though borrowing is huge by the government inflation cannot fear the RBI to raise the interest rates otherwise the situation would be completely out of control so far as the needed growth rate is concerned.

Conclusions: The data presented above is very well convincing the economy has taken a downward shift in the business cycle and no additional stimulus is visible that it would suddenly cover the distance of fall and regain the original position. In slow motion and foreign exchange reserve being built up without any extra effort to boost export, somehow efforts will be made to control the imported inflation by keeping a check on the exchange rate.

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