THE BROOKINGS INSTITUTION

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Inaugural Global Agenda Forum

The Rising Powers: Navigating the BRICs Century

Featuring:

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MR. LINN: Turning next to Urjit, from the outside there has been, going back a bit in India's history, this perception of a “Hindu rate of growth,” which was maybe 2 to 3 percent or thereabouts, which turned out to be a mistaken extrapolation of India's future. We have now had a decade or more of very rapid growth. Where is it leading? Are we wrong again in projecting this one out more or less indefinitely? What are the risks to sustainability especially, given your background? Can you talk a bit about infrastructure but also pick up on some of Mr. Murthy's points this morning?

MR. PATEL: Actually, India left the Hindu rate of growth behind since the 1980s. I think the Indian elephant is surging ahead. India is no longer at the takeoff stage. Since fiscal 2003-2004, it is actually flying high at rapid cruising speed. Just to give you a perspective, since the second quarter of 2003, there has been only one quarter of economic growth which has been less than 7 percent. The last 4 years of average annual GDP growth, including this fiscal, is 8.3 percent, and the last two fiscal years it has been 9 percent plus. Its recent performance comes very close to rivaling that of China.

To provide a perspective that was first brought forward by Arvind Panagariya, in the last four fiscal years India's GDP in current dollars has increased by over $350 billion, and 1990-1991 (which was the year of the balance of payments crisis) the GDP was $317 billion. Sometime in this calendar year, India's GDP will cross or will come very close to a trillion dollars. The growth momentum has exhibited great traction and it has been broad-based, except for agriculture. Manufacturing, which has been lagging until relatively recently, has been growing in double digits.

One of the things that have caught the economic debate in India is whether this is sustainable, and whether the recent performance is structural or is it cyclical. There are a couple of compelling reasons which would suggest that it could be structural. The most important is that the savings and investment ratios as percentage of GDP have increased from about 25 percent of GDP in 2001, to over 32 percent of GDP in 2005-2006, which is usually an indicator of a cycle that is set in motion.

India's use of capital is also more efficient than that of China. China has savings and investment ratios in excess of 40 percent and GDP growth rates of 9 to 10 percent. India achieves that with considerably less savings and investment. There is rapid integration with the global economy and, therefore, India does benefit from the global upswing, which is a cyclical factor. India's international trade -- exports plus imports of goods and services as a percent of GDP -- is now over 45 percent. India is not waiting for the world to come to it. It is assimilating fast through trade and even output investment. There has been a couple of marquee FDIs this calendar year -- the Tata takeover of Corus for over $11 billion, and the Novelis Aluminum Company in Canada for about $7 billion. It is ironic, but if both of these transactions actually take place this fiscal year, then I think there will be a net outward flow of FDI. I am not positive of that, but it is very likely, so it is an interesting bit that is taking place.

I think the reason is that Indian management is being supported by international capital. These are leveraged buyouts. A fair amount of money is going to be borrowed on the strengths of businesses based in India and takeovers abroad.

The growth has been propelled by well-known competitive advantages, so I am not going to spend much time, but India is gradually emerging as a preferred location for even manufacturing and R&D. India is home to about 25 percent of the suitable talent available across all global sourcing locations for services. It produces the second-largest number of engineering graduates in the world, second only to China, and this is about 300,000.

The other thing that has underpinned India's recent growth performance is broad macroeconomic stability which has mitigated uncertainty, and a successive pro-reform and market-friendly government that has kept the broad thrust of reforms and liberal tendencies going forward.

Over the last 3 years, the most important cyclical factor is that we have had is domestic credit growth in excess of 30 percent increasing annually, which is on the back of low interest rates, very liberal doses of international liquidity, and domestic -- growth, which has been in excess of 20 percent per annum over the last 2 years. This has had a multiplier effect on account of an unprecedented housing and consumer boom. That has the potential for headwind which would suggest that the 9 percent plus growth over the last 2 years may decline.

The increase in portfolio flows from abroad has been on the back of a larger international appetite for risk, which means that the international liquidity spillover could turn back and, therefore, the pursuit of relatively loose fiscal and monetary policies which has been the case over the last few years would have to be reined in.

The credit cycle is actually now already in reverse phase because the inflationary trends, which Narayana Murthy this morning described, has become politically uncomfortable now. The headline inflation rate is now at 7 percent, which is beyond the 5 to 5-1/2 percent preferred rate by the Reserve Bank of India which is in charge of the monetary policy. However, if you look at the consumer price index, the overall price index is in excess of 8 percent. Primary articles, which include foods like fruits and vegetables, are in excess of 12 percent; steel inflation is 15 percent; cement is 16 percent. The primary source of protein in India comes under the heading of -- the price increase there has been 25 percent. So there is going to be a fair bit of tightening which has already started. The risk rates on commercial real estate by the central bank have increased -- rates have been hiked by 170 basis points over the past 2 years, and -- instrument of the –– ratio, which is the fractional reserve requirement of banks vis-à-vis the central bank, has been increased by a full percentage point in the space of 3 months. Banks' exposure to the capital markets has also been pared down.

The Indian equity market is trading at a premium in excess of 45 percent to the emerging markets, and about 20 percent globally based on forward earnings. However, it is ironic that the current return on equity is sustainable, as the market trading is at 5.2 percent on the earnings book. The global risk appetite is crucial to whether India can sustain this growth going forward because it is running a current account deficit and, therefore, a spike in interest rates abroad would have deflationary consequences. I think they have lacked the growth rate of about 6-1/2 percent, which was behind about a decade, from 1992 to 2002. However, 9 percent going forward is doubtful, but it is a higher growth rate that we are looking for with as we move on. I will stop there.

MR. LINN: Thanks very much, Urjit.