



Financial crisis

ECONOMIC RECOVERY

low risk, high gain

CREDIT CRUNCH

FURTHER GAINS

Confidence the key

CAPITAL INVESTMENT

STOCK MARKET SURGE

Future now secure says

Downturn

Money flow

slump

Profits down

Record returns

Economic disaster looming

Economic upturn

Crash!

Business world optimistic

Stocks tumble

Interest rates

Investment boom

RECESSION FORECAST

Bust!

reports progress

MONETARY POLICY

Banks gain investor trust

fear grows

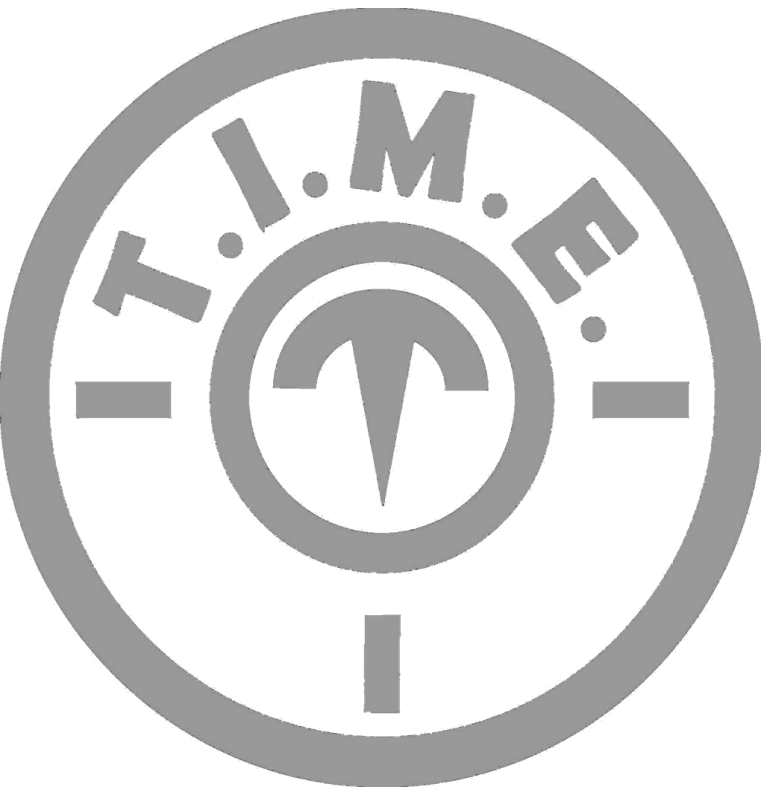
Govt. funds

Financial growth

risk

stability on horizon

MACROECONOMICS



Ankur Jain

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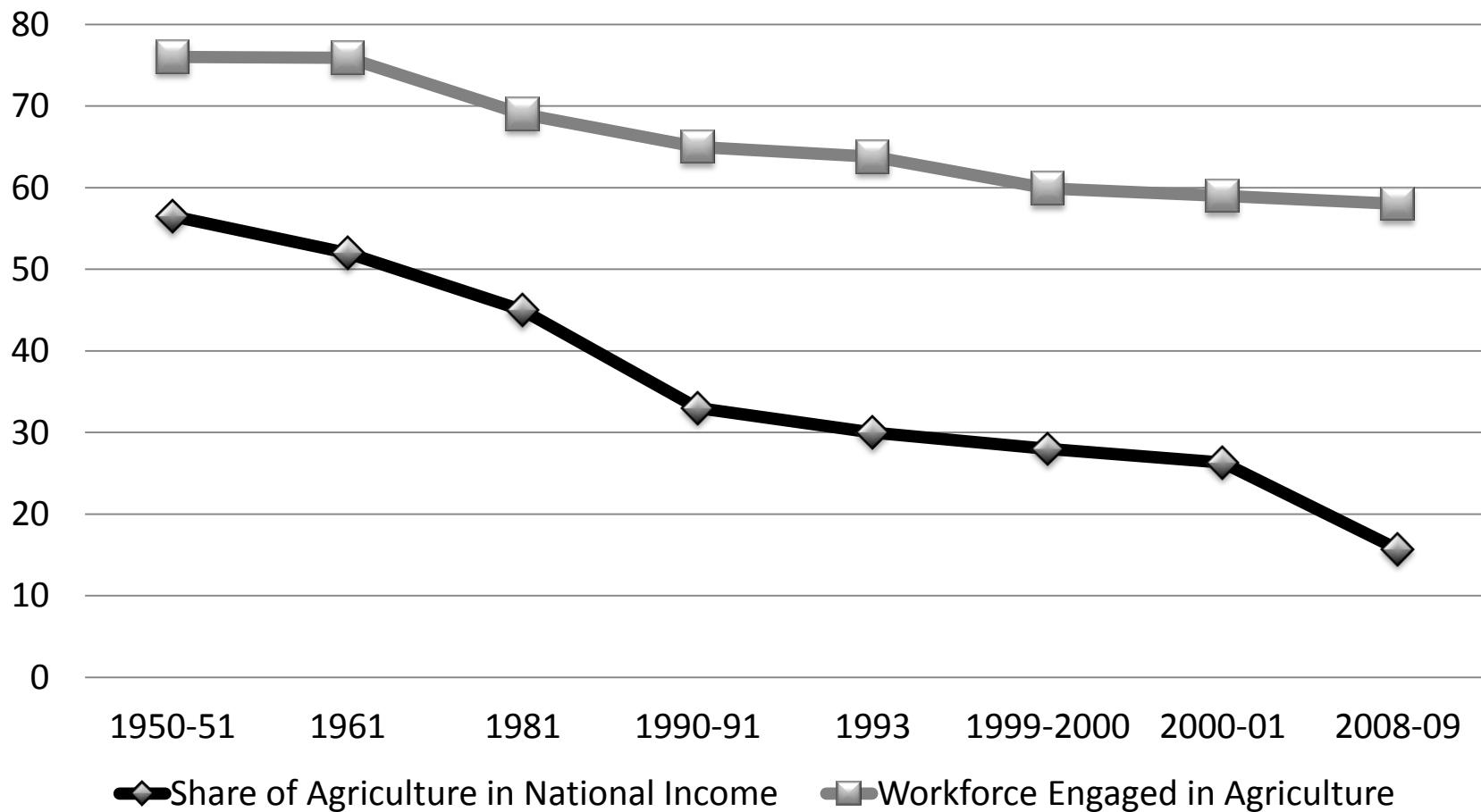
THE 3 SECTORS OF THE ECONOMY

- Primary – agriculture, forestry, fishery, animal husbandry
- Secondary— mineral, power, mining, manufacturing industries.
- Services— Education, transport, trade, communication, banking, other services

THE 3 SECTORS OF THE ECONOMY

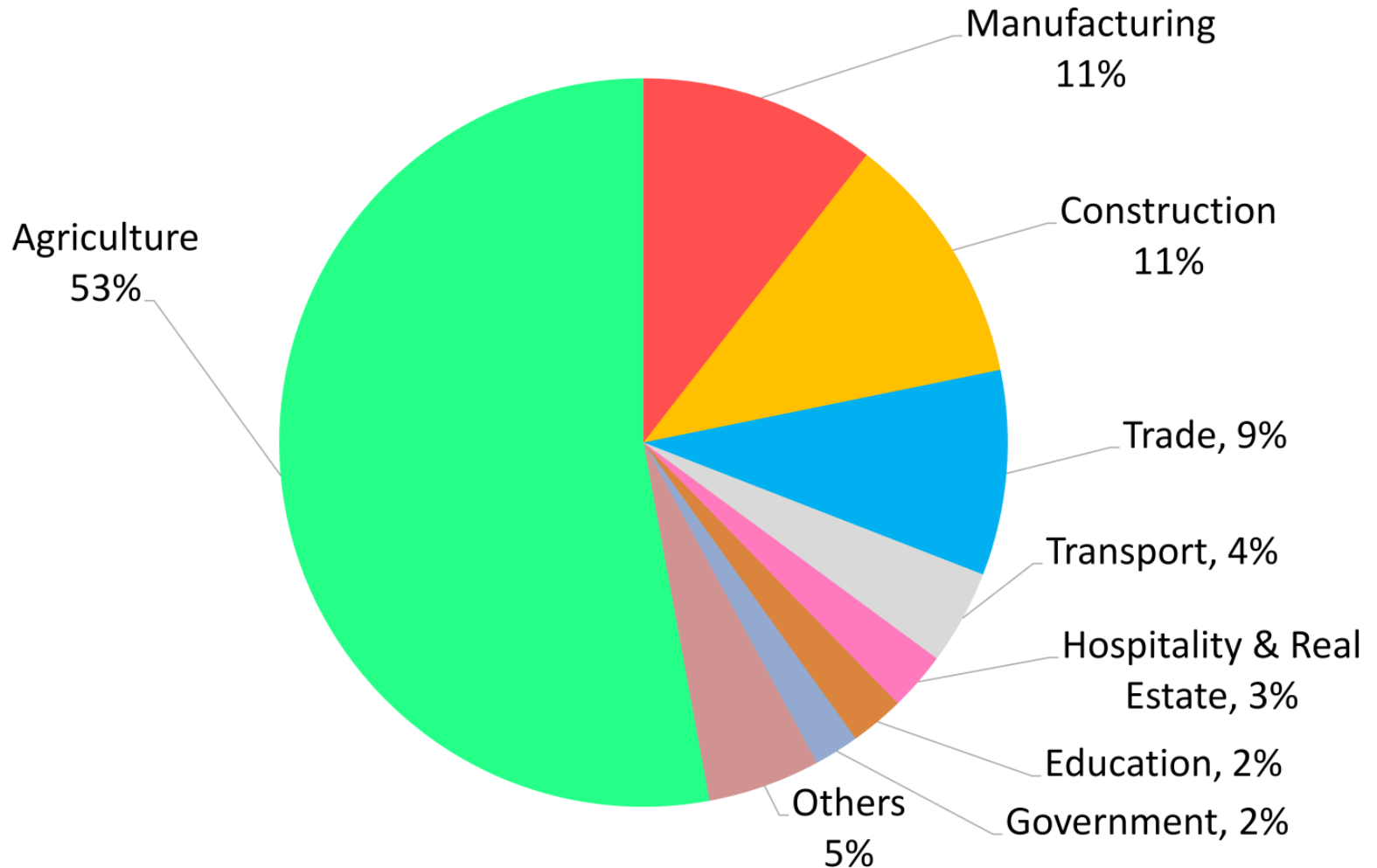
- What is “value chain” and what are its uses in determining level and spread of income?
 - Economic dominance of one sector indicates the level of income of an economy
 - Demographic dominance indicates the spread of income of an economy
- India has nearly 60% workforce engaged in agriculture, whereas France has 7%, Australia 6% and UK/USA have 2-3%.
- Why are incomes high in Services?
- Can this be replicated in Primary/Secondary sectors?
 - Yes !

Changing Economic and Demographic Profile of India

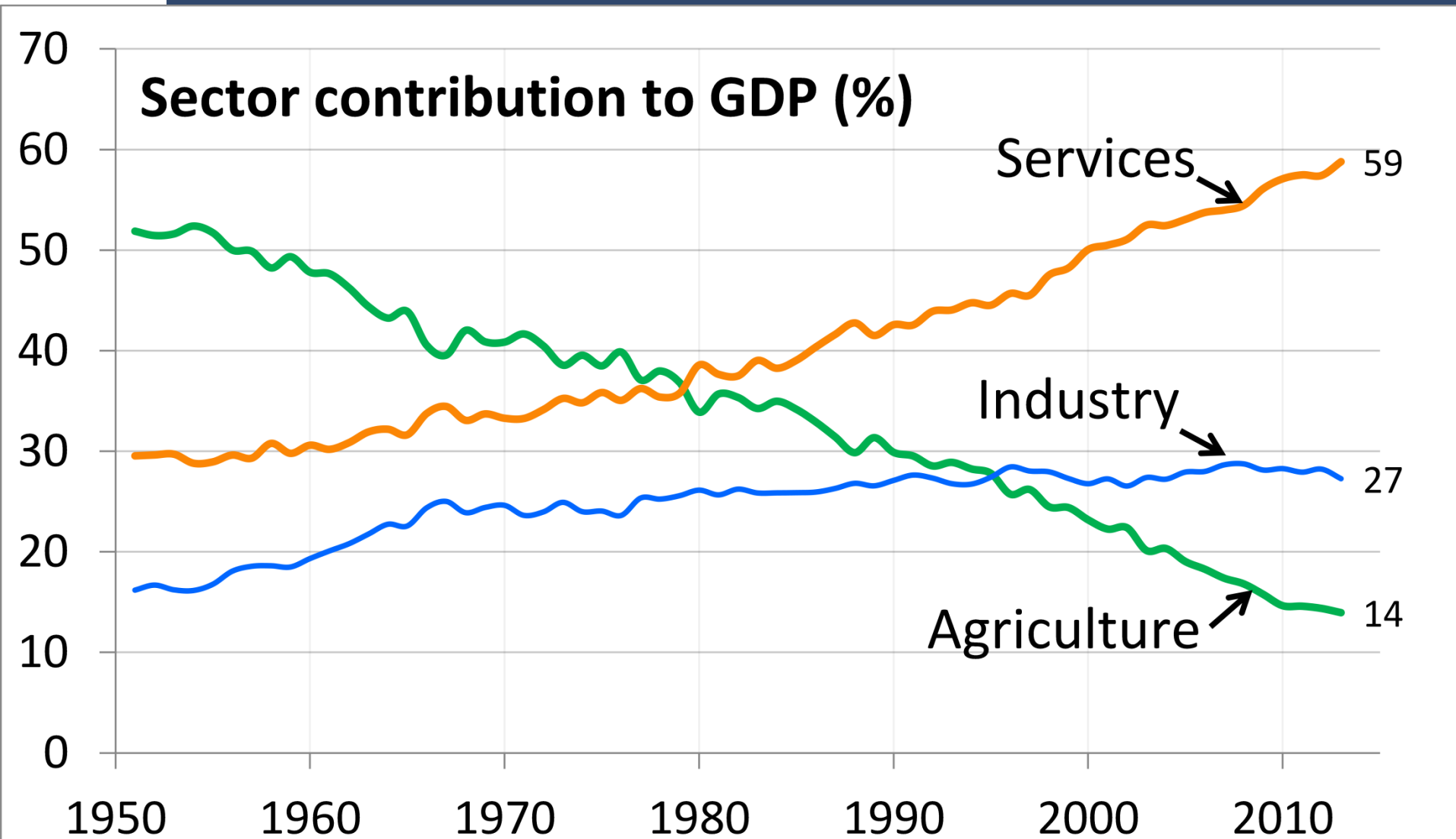


A study in contrast - I

Employment by Sector (%) 2009-10



A study in contrast - II



TYPES OF ECONOMY

- Market Economy
- Socialist Economy
- Mixed Economy

What is Communism?

Indicators of Economic Health

- GDP
- Per Capita Income
- Inflation
- Human Development Index
- Level of Employment
- B.P.L. Population

GDP

- GDP – total flow of goods and services produced in a country in one year.
- $GNP = GDP + \text{income from abroad}$
- $NDP / NNP = GDP / GNP - \text{depreciation}$
- $GDP\text{-PPP} = \text{GDP based on Purchasing Power Parity}$
- $PCI = \text{Per capita GDP}$

Indicators of Economic Health

- GDP
 - Nominal Basis – 6th rank in 2016 (2.384 trillion \$)
 - PPP basis – 3rd rank in 2016 - (8.727 trillion \$)
 - Thus, Conversion Factor $\rightarrow 8.727/2.384 = 3.66$ which means that if you want to do what you can do with 1 dollar in India, you need 3.66 dollars in the USA
- GDP Growth Rate 2013 – 4.7% (2013), 5.5% (2014), 7.3% (2015), 6.5-7% in 2016
- **Real growth, i.e. inflation adjusted**
- Per Capita Income –
 - 1718 \$ Nominal (140th in 2016, down from 129th rank in 2015)
 - 6658 \$ PPP (122nd rank in 2016, down from 118th rank in 2015)
- GDP by Expenses and GDP by income differs in India
- Which factor is the most important factor?

More (or Less) Brew for Your Buck

In countries where the currency is overvalued, a dollar doesn't go as far. That means **it would take more dollars to buy a Starbucks latte in a country with a strong currency, like Norway**, than in one with a currency that has less buying power, like India. This measure—known as purchasing-power parity—is a crude way to compare the relative strengths of currencies.

Price of a Starbucks grande latte, measuring approximately 16 oz. or 473 milliliters, converted to U.S. dollars using rates of Feb. 20; tax included when applicable.



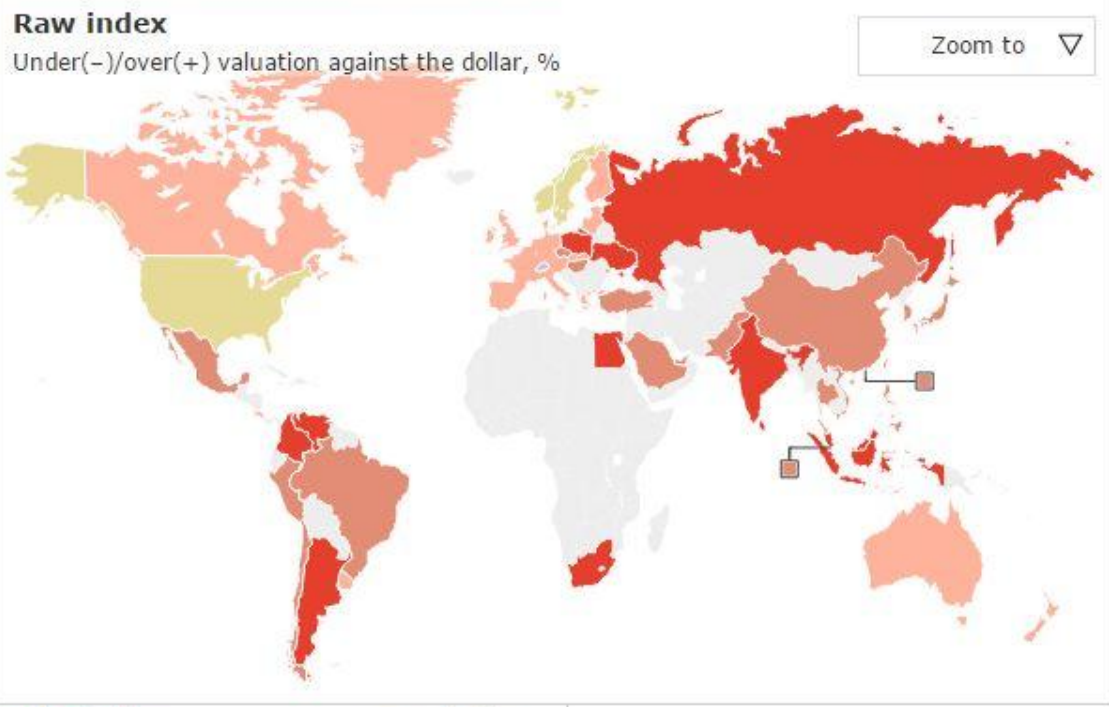
Another measure

Change in the strength of inflation-adjusted currencies against a basket of other countries'



The Big Mac index

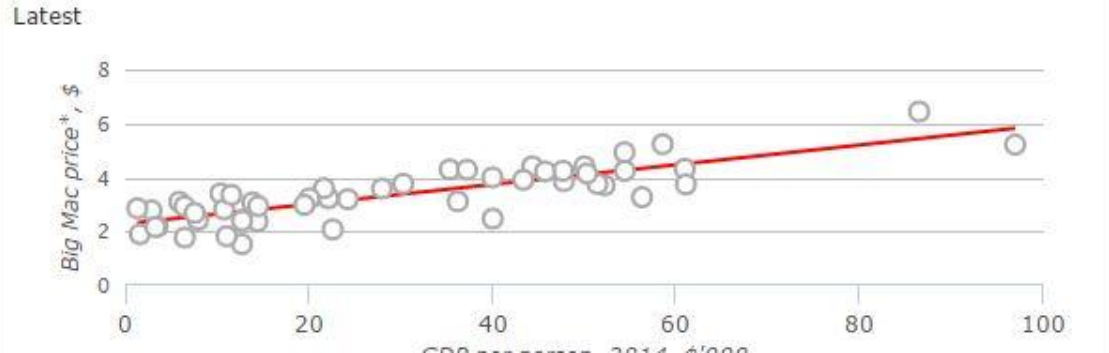
Select base currency: US dollar
Raw index Adjusted index



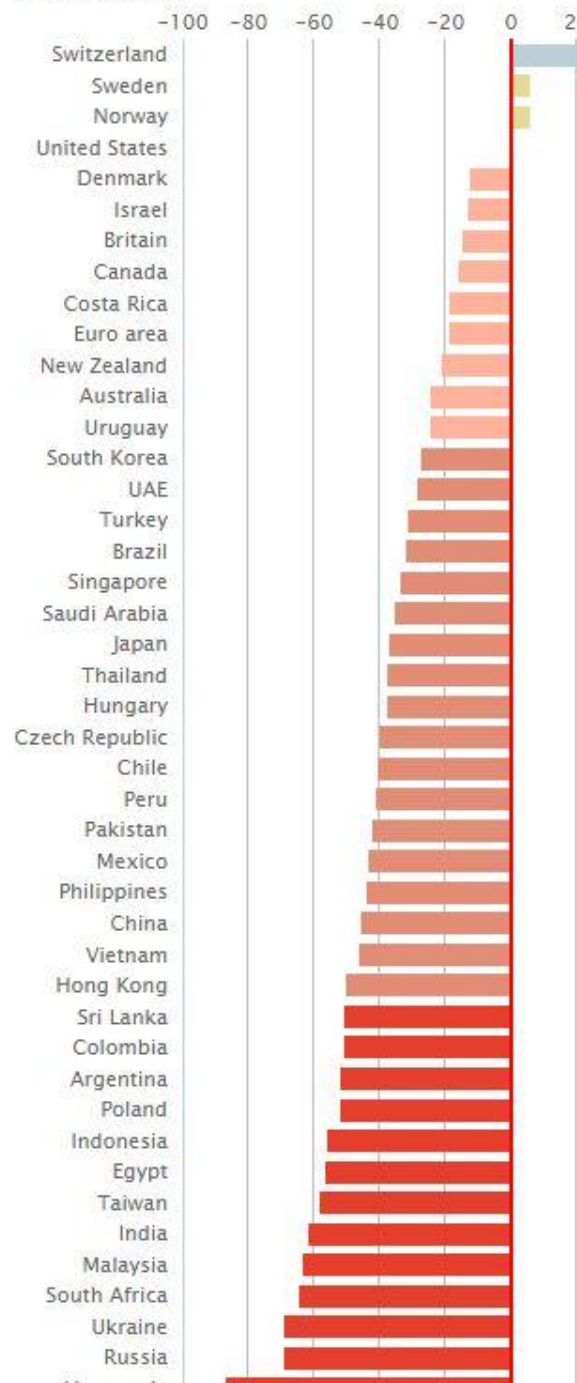
Undervalued by: ■ >50% ■ -/+ 10% ■ 10-50%

Overvalued by: ■ 25-50% ■ 50-100% ■ >100%

Big Mac prices v GDP per person



January 2016





Indicators of Economic Health

INFLATION

- Steady rise in prices, resulting in decline in purchasing power of the money.
- 2 types - cost push & demand pull.
- Measured on a Year on Year basis.
- Moderate inflation is good for economy.
 - WHY?



Indicators of Economic Health

WPI - WHOLESALE PRICE INDEX

- Measures increase / decrease in industrial, commercial prices of commodities under 3 broad categories.
 - Primary articles - 102 items – 20.12% weight
 - Fuel, power etc. - 19 items – 14.91% weight
 - Manufactured products - 555 items – 64.97% weight
- Total – 676 Articles
- Base year - 2004-05
- Was used for calculating INFLATION. From 1st April 2014, India has replaced this with CPI (Consumer Price Index) as the primary method to calculate inflation.

Indicators of Economic Health

CPI—CONSUMER PRICE INDEX

- Calculates increase / decrease in retail price, which have a direct bearing on consumers.
- Latest indices to have Services Component also.
- Different types of CPIs for various consumers (older method)
 - for agricultural laborers
 - for rural laborers
 - for industrial workers
 - for urban non-manual employee
- Newer method
 - Rural and Urban
 - 250 goods

Indicators of Economic Health

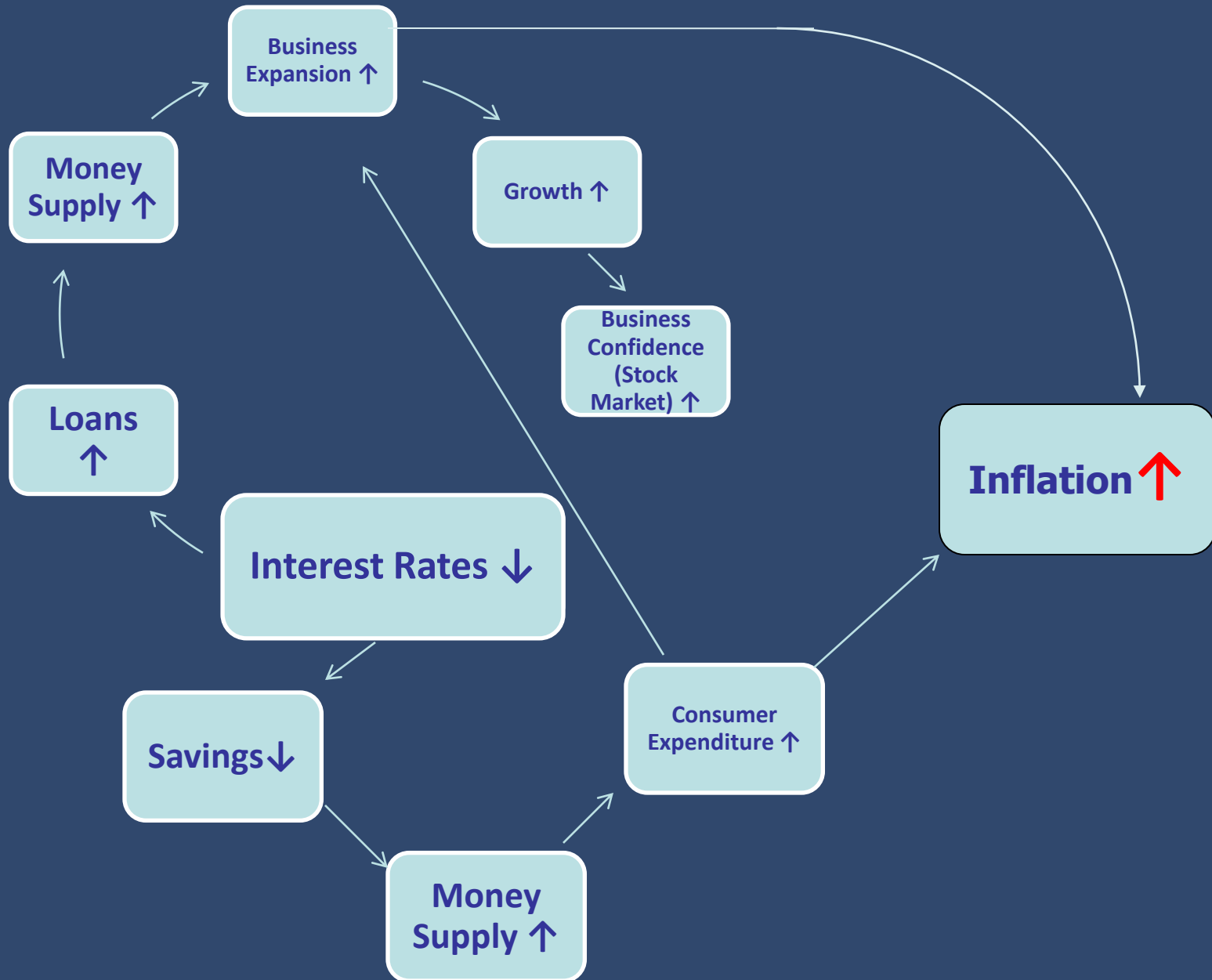
Producer Price Index

- Tracks the price of goods recorded at the first transaction.
- Measures changes in prices received by domestic producers of goods and services over time.
- Different from the retail prices, which include shipping costs, taxes and other levies.
- Gives an account of the economy's efficiency in transferring goods and services from the producer to the consumer, who could be the final consumer or another producer using it as an input.

Factors behind Inflation

- Passage of time and economic growth
- Fluctuation in agricultural output
- Increase in Money Supply
- Interest Rates
- Large parallel economy
- Heavy non-plan expenditure by Govt.
- High fiscal deficits and deficit financing
 - FRBM, 2003
- Govt.'s attempts to bridge deficits by higher indirect taxes → rise in costs.

The Interest in Interest Rates!





Hyperinflation !!!



Hyperinflation - <https://goo.gl/32NNpx>



What is Deficit Financing?



Human Development Index



सर्व शिक्षा अभियान



सब पढ़ें सब बढ़ें



Indicators of Economic Health

HDI - HUMAN DEVELOPMENT INDEX

- Developed by UNDP in 1996
- Measures **physical quality of life** in a country along 3 key parameters
 - ▶ Life expectancy at birth
 - ▶ No. of years in school
 - ▶ Per capita income
- India's Rank – 135 in 2014, 130 in 2015

What about **Gross National Happiness** ?

Poverty Line



REUTERS

Indicators of Economic Health

POVERTY LINE

- Consumption expenditure required for getting 2100 calories per person in urban area and 2400 calories in rural areas.
- Why was the line been pegged to Rs. 28, 32 or 47 /day?
- Key parameters
 - No. of people BPL (1/3 of the world's poor)
 - % of population BPL as per GOI estimates – Range from 22-29.5%
 - World Bank 2011 estimates – 21.2% living below \$1.90 per day

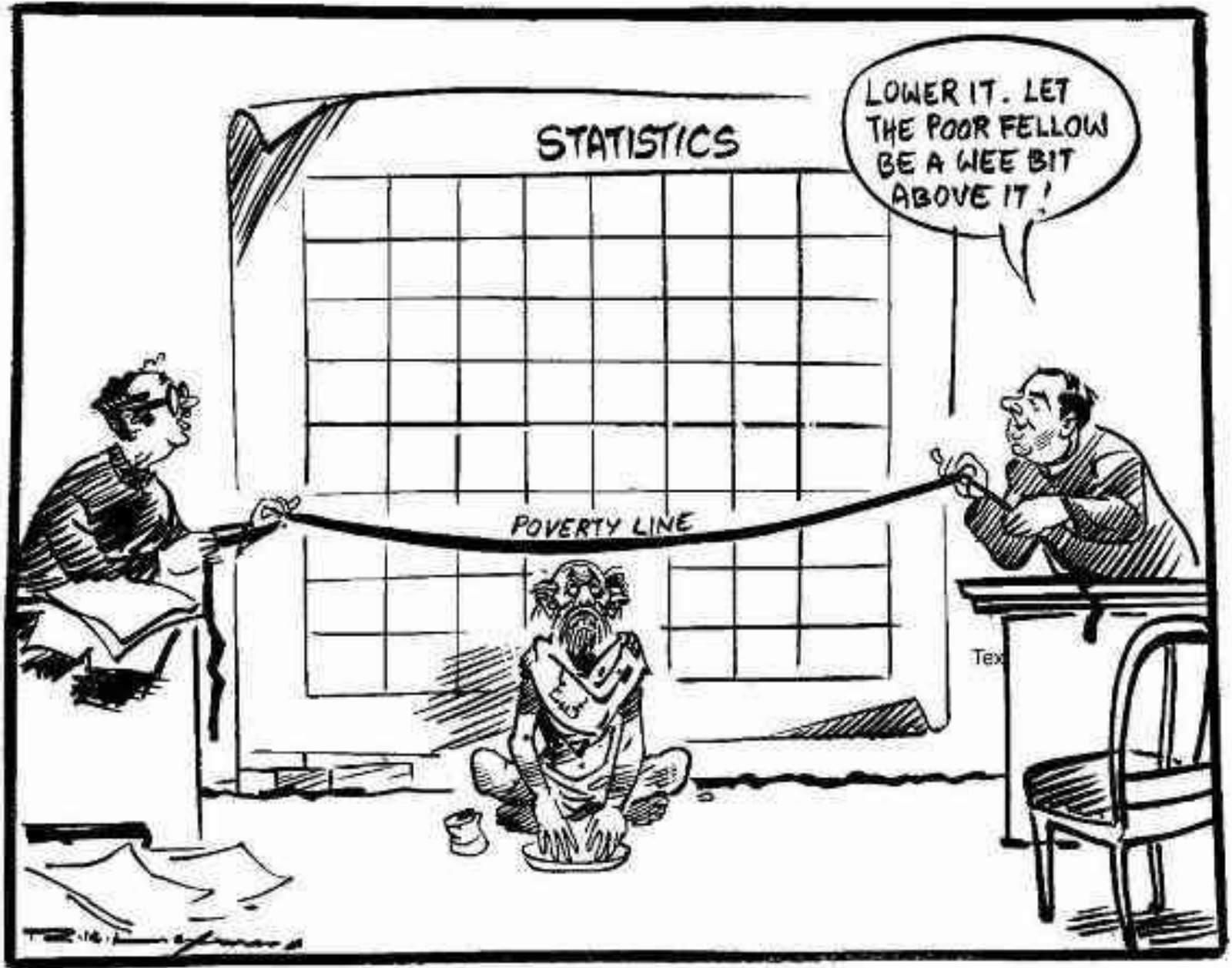


Image Courtesy: The Times of India



**CONGRATS! NOW
YOU ARE TALL
ENOUGH TO ENJOY
THE FRUITS OF OUR
ECONOMY...**

**POVERTY
WALL**

ECONOMY

~~TALL~~

TALL (NEW)

**POVERTY LEVEL
IN INDIA
DROPS TO 22%**

**SATISH
ACHARYA**

sify
.com

Unemployment



Indicators of Economic Health

EMPLOYMENT

- Standard person year of 273 days. Person working at least 4 hours a day is considered employed.
- Drop in employment growth rate in post-reform years, nearly 1% p.a.
- Manufacturing sector not keeping pace with population growth in the past.
- Mechanisation, computerisation.
- Seasonal and disguised unemployment in agri. sector.
- Stringent wage laws adding to involuntary unemployment.
- **Unemployment - 5.0% in 2016. 4.9% Urban, 5.1% Rural.**



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Monetary Policy



Monetary Policy

- Who decides this ?
 - Central Bank Of a Country
- What it aims to achieve?
 - Monetary policy regulates the money supply in an economy.

Tools of Monetary Policy

1. Bank Rate
2. Open market operations
3. CRR and SLR
4. Credit ceiling
5. Differential Interest Rates

Tools contd...

- Bank Rate - official rate of interest charged by RBI. Current rate – 6.75%
- Open market operations - RBI buying and selling securities to regulate money supply.
 - Repo rate – Rate at which RBI lends, in the short run, to banks, currently at 6.25%. Indicates rate at which liquidity is injected into the system. Decrease in Repo rate can lead to temporary expansion of money supply.
 - Reverse Repo – Rate at which RBI accepts deposits from banks, currently at 5.75%. Indicates rate at which liquidity is absorbed from the system. Decrease in Repo rate can also lead to temporary expansion of money supply.

MONETARY POLICY

A) CRR - every commercial bank to keep a certain percent of its demand and time deposits with the RBI. Currently at 4.00%.

B) SLR - commercial banks keep a fixed percentage of their demand and time deposits in liquid assets, viz. cash, securities, gold. Currently at 20.5%.

C) Differential Interest Rates

– Base Rate – 10.00 % – 10.25%

D) Priority sector lending



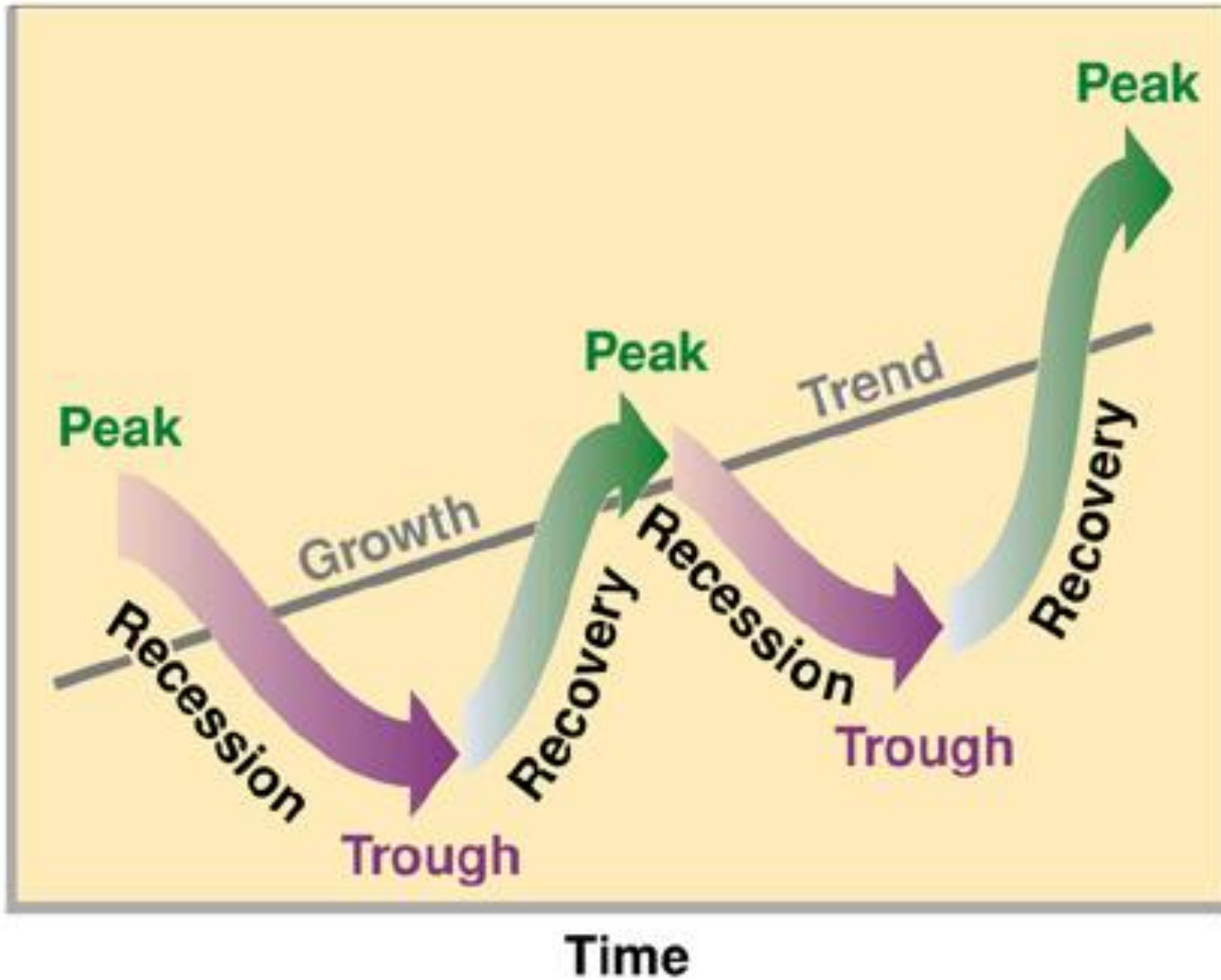
ROLE OF THE RBI



ROLE OF THE RBI

- Issue of bank notes of all denominations
 - All ?
- Regulates money supply
- Lender of last resort to banks
- Controls FOREX operations.

Level of real output



TRADE CYCLES

TRADE CYCLES

Refers to fluctuation in economic activity which forms a regular pattern.

- Expansionary phase characterized by increase in income, output, employment and inflation.
- Contraction phase is characterized by drop in income, output, employment and deflation (sustained fall in prices).

TRADE CYCLES

- **BOOM** - A particularly sharp upwards turn in demand and output. IT Boom, Realty Boom.
- **RECESSION** - Two consecutive quarters of falling GDP in an economy. Beginning of slump or depression. Occurs due to over production during earlier phase, rise in fuel and raw material prices etc.
- **SLUMP/CRASH/BUST** - Severe downturn phase. Opposite of boom, e.g., the great US slump

TRADE CYCLES

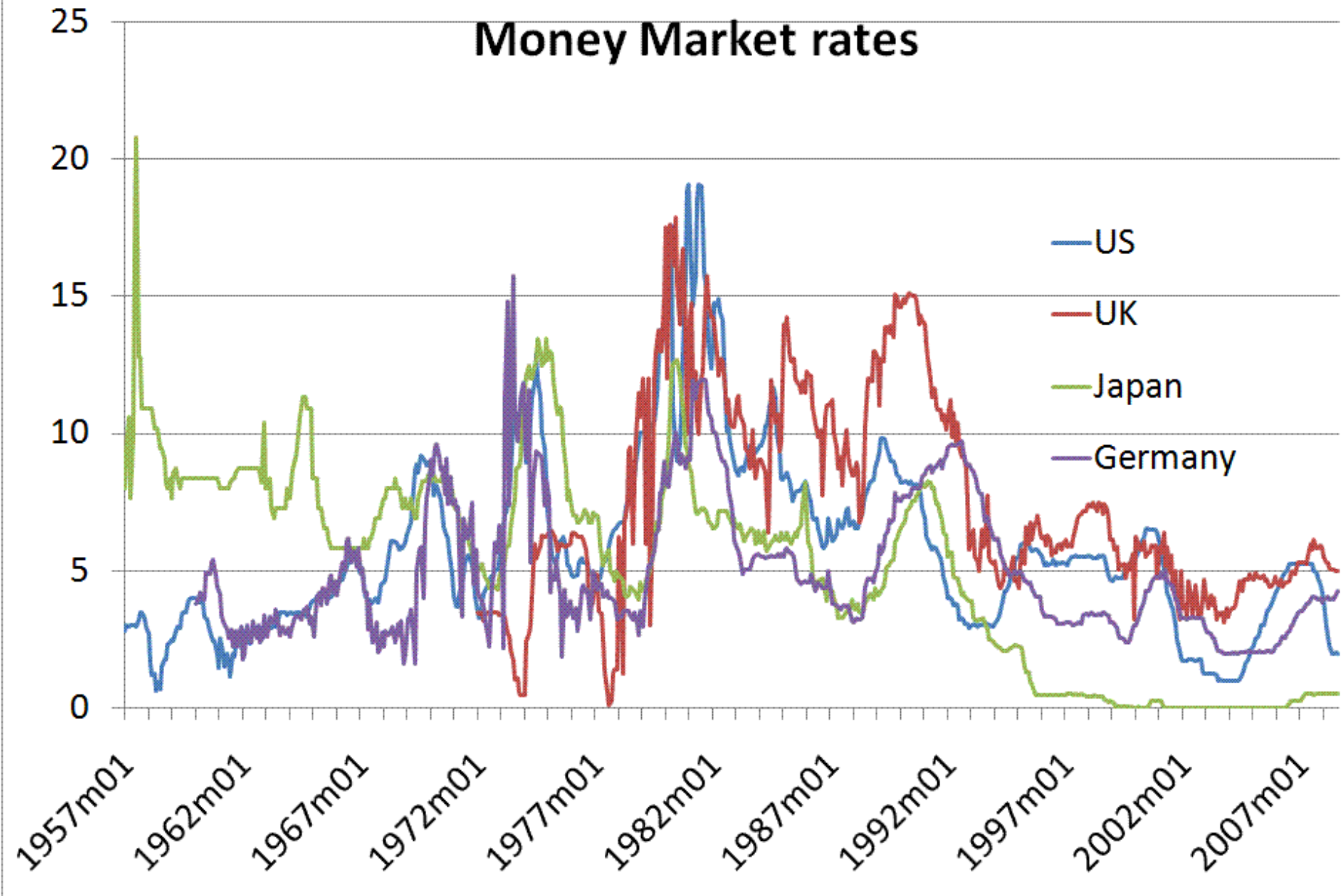
- **DIS-INFLATIONARY MEASURES**

Steps taken by govt. to bring down prices in face of chronic inflation.

- **STAGFLATION**

Decline in economic activity even in face of inflation. Production doesn't rise even with price rise, due to poor infrastructure or high raw material cost. Mostly seen in LDCs.

Money Market rates



MONEY MARKETS

MONEY MARKETS

- Market in short term securities, loans, gold and FOREX. Mainly commercial banks are involved.
- Inter-bank call money market, the most significant part. An over-the-phone market.
- Basic objectives
 - To even out short term surpluses and deficits
 - To provide easy access to short term money to meet commercial requirements at a realistic price.

Capital Markets



CAPITAL MARKET

- Market for long term loans.
- Consists of – a) Govt. securities
b) Industrial securities
- Govt. securities aimed at bridging fiscal deficit and financing public sector projects. Major holders are RBI, commercial banks, insurance cos. etc.; captive market for govt. securities.

Industrial securities

- Aimed at mobilizing long term funds for corporate to finance capital expenditures, e.g. new projects, acquisitions etc.
- Equities market consists of primary and secondary markets.
- Equity shares traded through stock exchanges by brokers in an online environment. BSE and NSE the two largest stock exchanges.

CAPITAL MARKET

- STOCK EXCHANGE - an organized market for trading of stocks and bonds. 23 in India. Facilitate financing for corporates.
- BSE- estd. 1875, it is the oldest in Asia. Getting overshadowed by newer NSE. 5749 listed companies. Sensex represents top 30 companies. 11th largest market capitalisation of 1.43 trillion \$.
- NSE - Also located in Mumbai. Nifty – top 50 companies on total market cap basis. 1696 companies. 12th largest market capitalisation of 1.41 trillion \$. 2nd largest trade in equities.
- SEBI- estd. 1992. Regulates working of stock exchanges, brokers and mutual funds. Registers FPI (foreign portfolio investment).



BANKING SECTOR IN INDIA

BANKING SECTOR IN INDIA

- RBI- guides, controls and regulates other commercial banks. Formulates monetary and credit policies.
- COMMERCIAL BANKS- mobilize savings and lend to borrowers ensuring maximum possible 'spread rate'. They keep demand deposits (current A/C), savings deposits and time deposits (FDs). Nationalised in 1969 & in 1980. These include
 - A) PSU banks (7 SBI group + 19 nationalized)
 - B) Pvt. Sector banks (Indian and foreign)

Current Account

1-(Import + Export) of goods and services and unilateral transfers.

2-Trade in goods.

3-Trade in Services.

Capital Account

- Private transactions
- Official transactions
- Direct investments
- Portfolio investments

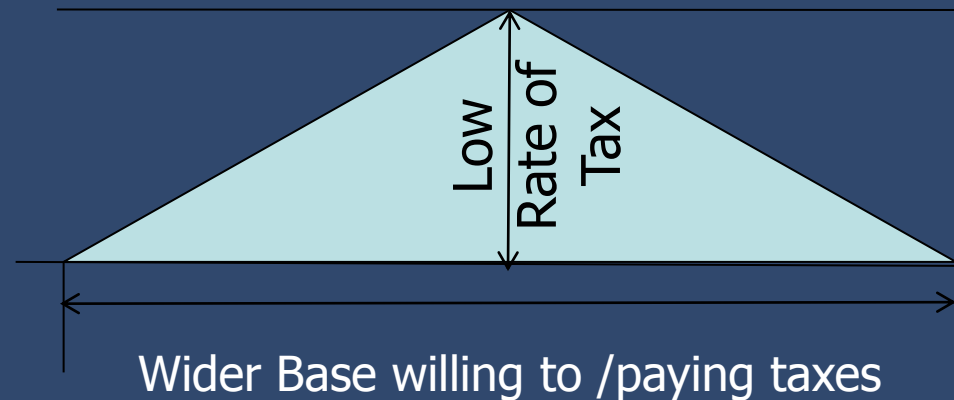
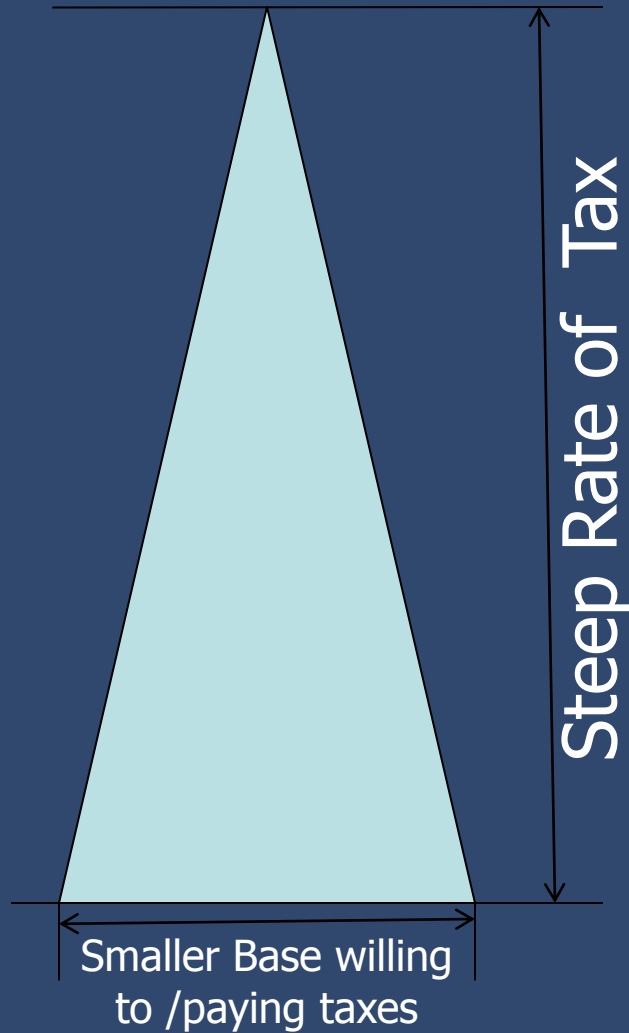
Fiscal Policy

- Who determines this?
 - Finance Ministry/ Budget office
- What exactly is this?
 - The part of govt. policy which is concerned with raising revenues through taxation and deciding on the level and patterns of expenditure (union budget).

Tools of Fiscal Policy

1. Level of taxation
2. Structure of taxation
3. Control of govt. expenditure
4. Subsidies and price controls
5. Export/ Import Restrictions

The Taxation Pyramid



Quiz TIME

- We had high taxes – how high were they? what was the highest rate of income tax in post-independence india?

97.75 %

ment with little scope for manoeuvrability for raising additional resources in times of emergency.

27. The maximum marginal rate of income tax, including surcharge, should be brought down from its present level of 97.75 per cent to 75 per cent. Some reduction in tax rates should also be given at the middle and lower levels. In order to create an impact, the reduction in the rates of taxation should be at one stroke.

28. The following rate schedule is recommended for

** Source Union Budget Document - 1974*

Union Budget



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STRUCTURE OF UNION BUDGET

REVENUE SIDE

1. Revenue receipts

A) 70% - tax revenue — central excise, customs duty, corporation tax, income tax, service tax, FBT, STT etc.

B) 20% - non-tax revenue — interest receipts on loans , profits from PSUs.

2. Capital receipts

10% - Principal repayment from debtors, disinvestment proceeds, market borrowings.

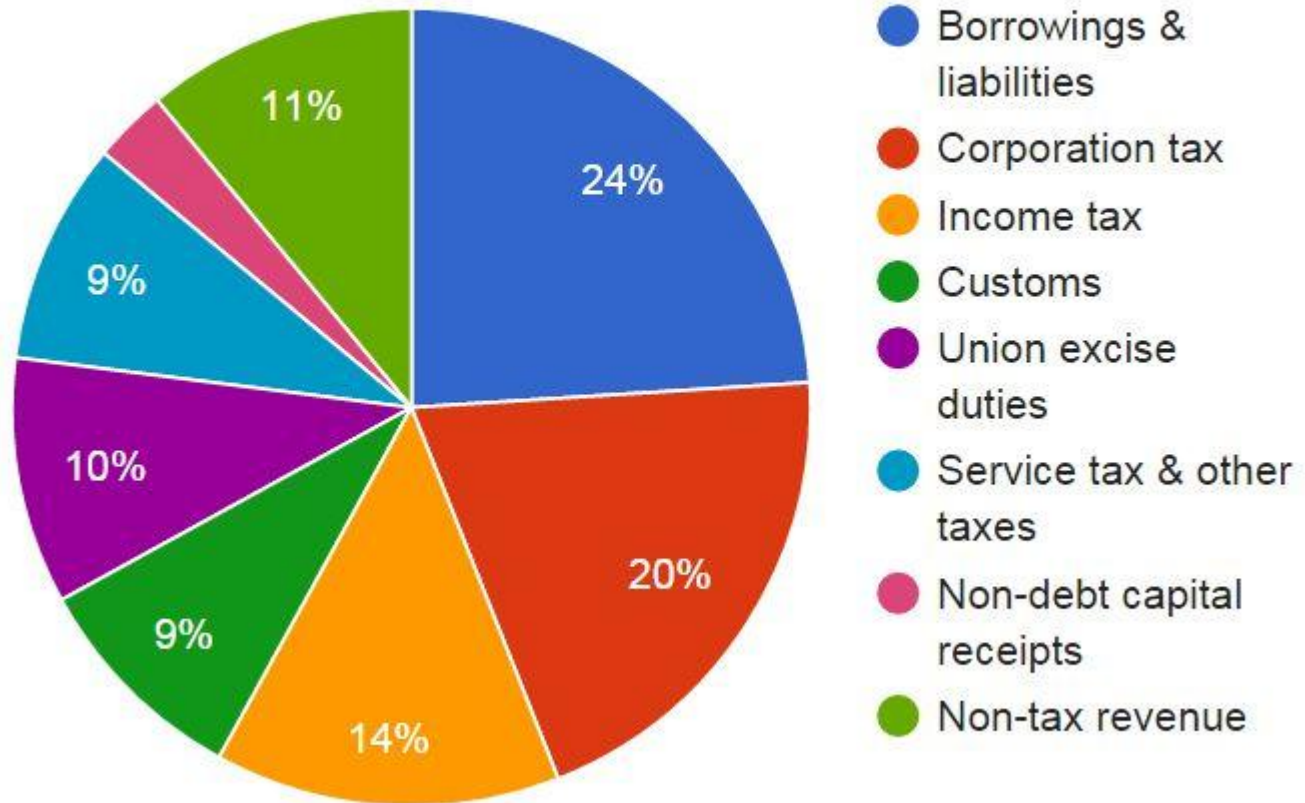
STRUCTURE OF UNION BUDGET

EXPENDITURE SIDE

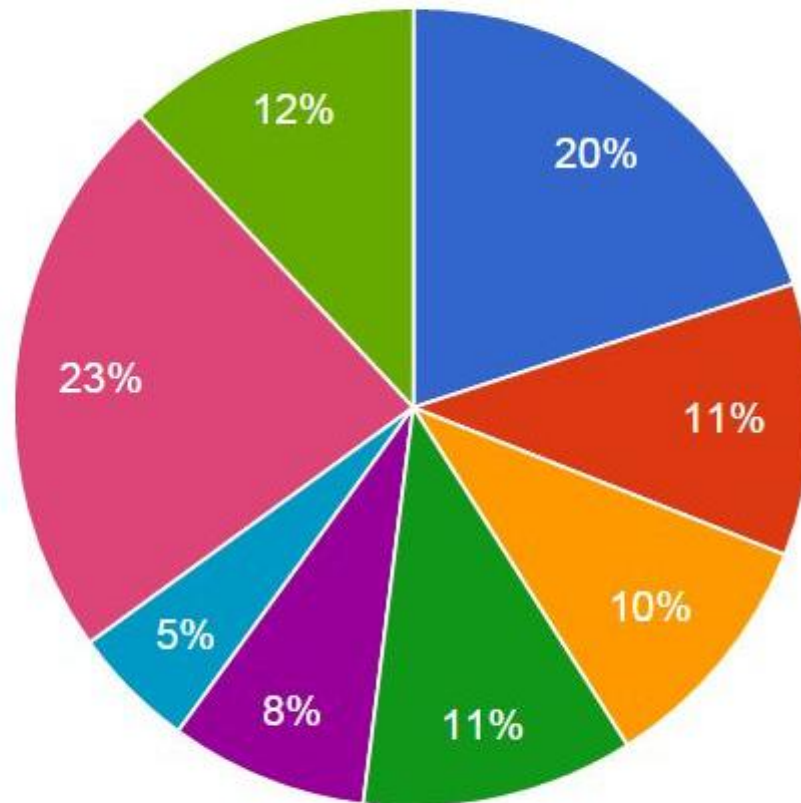
- Plan expenditure
 - incurred in central development schemes. Costs around 25% of total expenditure.
 - Revenue and Capital
- Non-plan expenditure
 - Interest payments, defence, subsidies, salary of govt. employees.
 - Accounts for approx. 75% of total expenditure.

Rupee Comes From

Rupee comes from

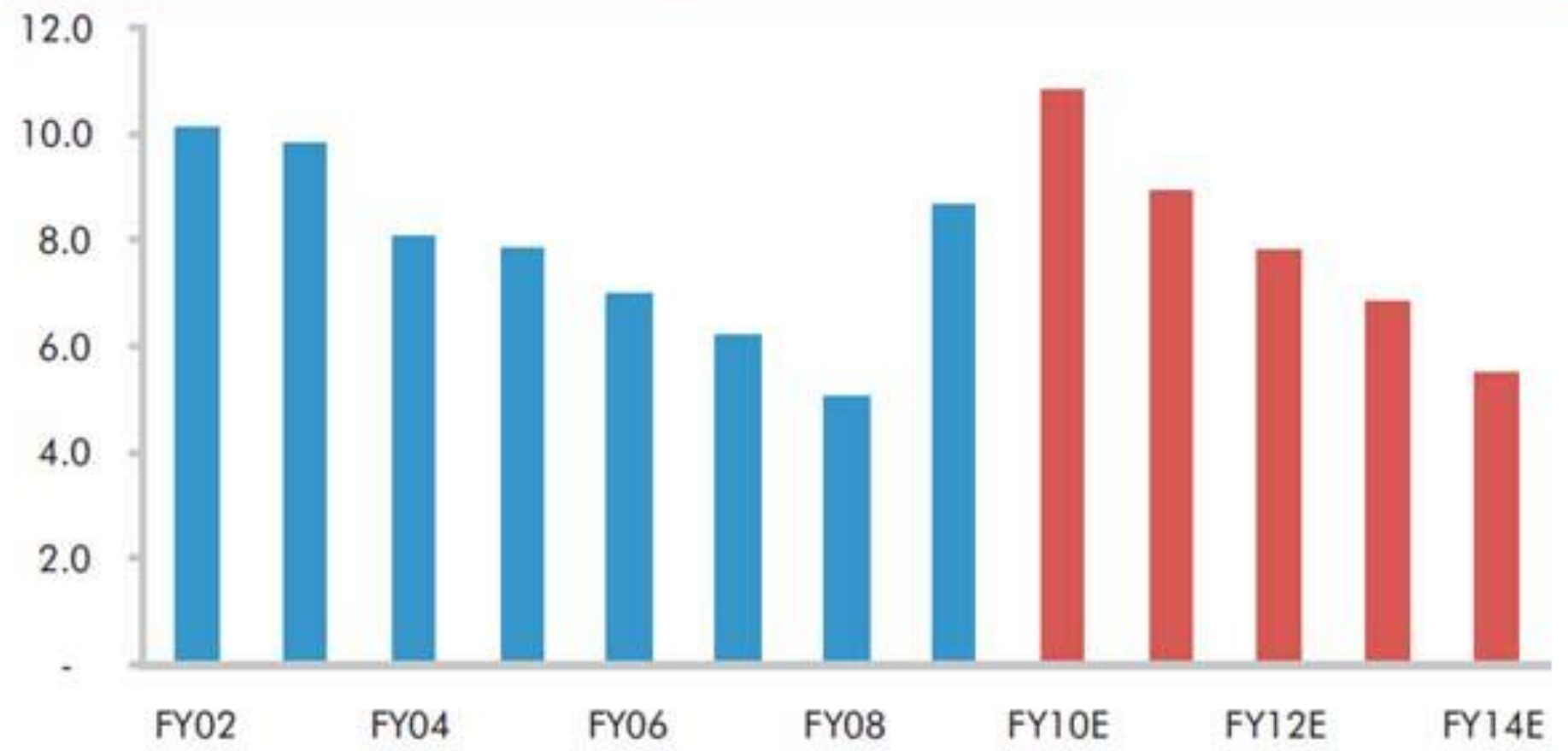


Rupee goes to



- Interest payments
- Defence
- Subsidies
- Central Plan
- Plan assistance to States & Uts
- Non-Plan assistance to States & Uts
- State's share of taxes & duties
- Other non-Plan expenditure

Exhibit 2: India Fiscal Deficit - On the mend



Source: Budget documents, Angel Research

DEFICITS AND DEFICIT FINANCING

DEFICITS

- **Revenue deficit**

Revenue expenditure (interest + subsidy + defense + law and order) — revenue receipts (tax + non tax)

- **Budget deficit**

Total expenditure - total receipts

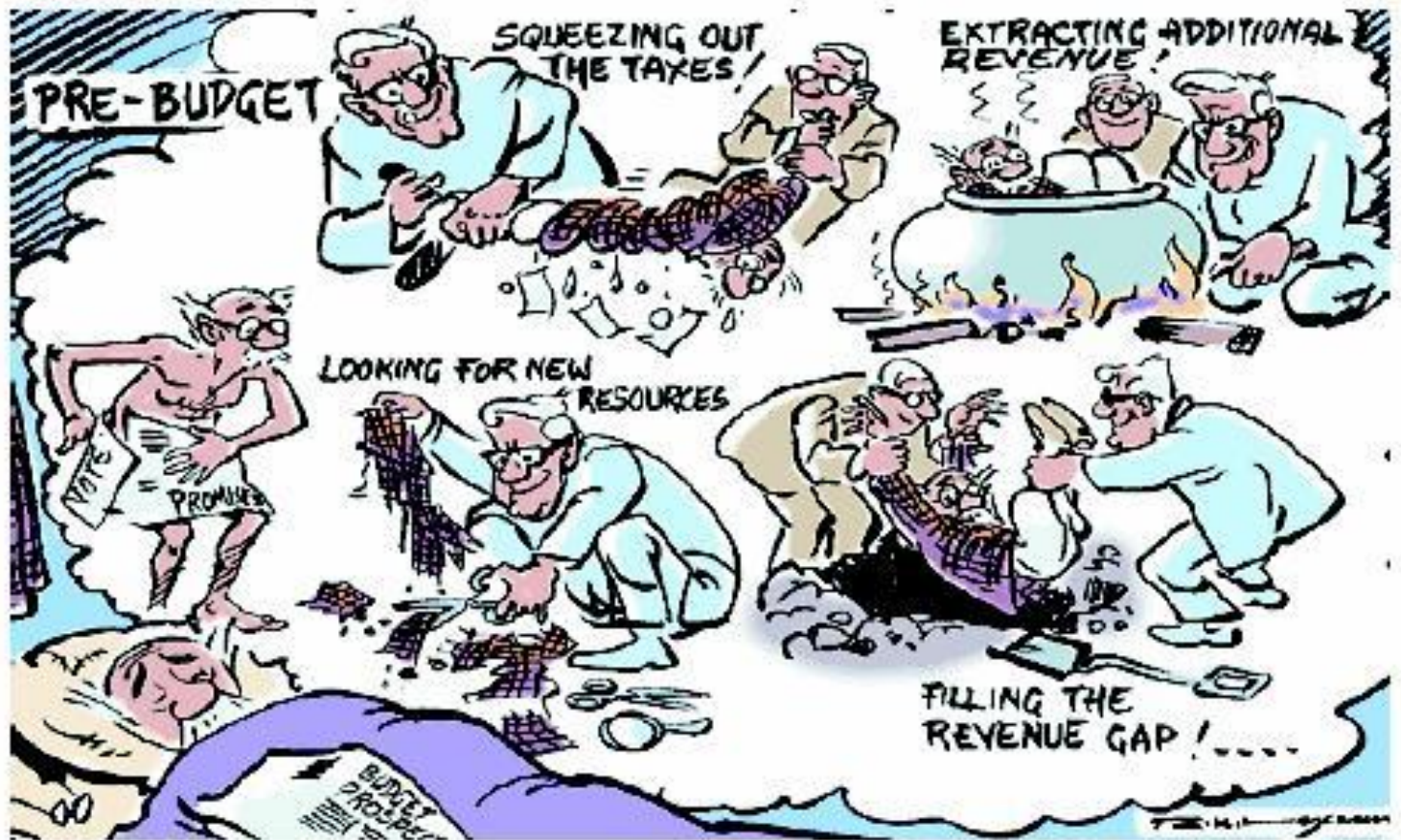
- **Fiscal deficit**

Budget deficit + borrowings from banks and public

DEFICIT FINANCING AND IMPACT

- Govt. borrows from RBI by transferring securities. RBI prints new currency and puts it into circulation on behalf of the govt.
 - increases money supply. Adds inflationary pressure in economy.
- In some countries, market borrowing is also termed as deficit financing.
 - evacuates funds available for pvt. investors. Also, Govt. ends up paying more interest in future. Development expenditure takes back seat.

TIMES OF YESTERDAY / R K LAXMAN FEBRUARY 27, 1981



TO THE LAST DROP: In order to raise more revenue, the government directed its efforts towards squeezing the common man more and more

TAXES !

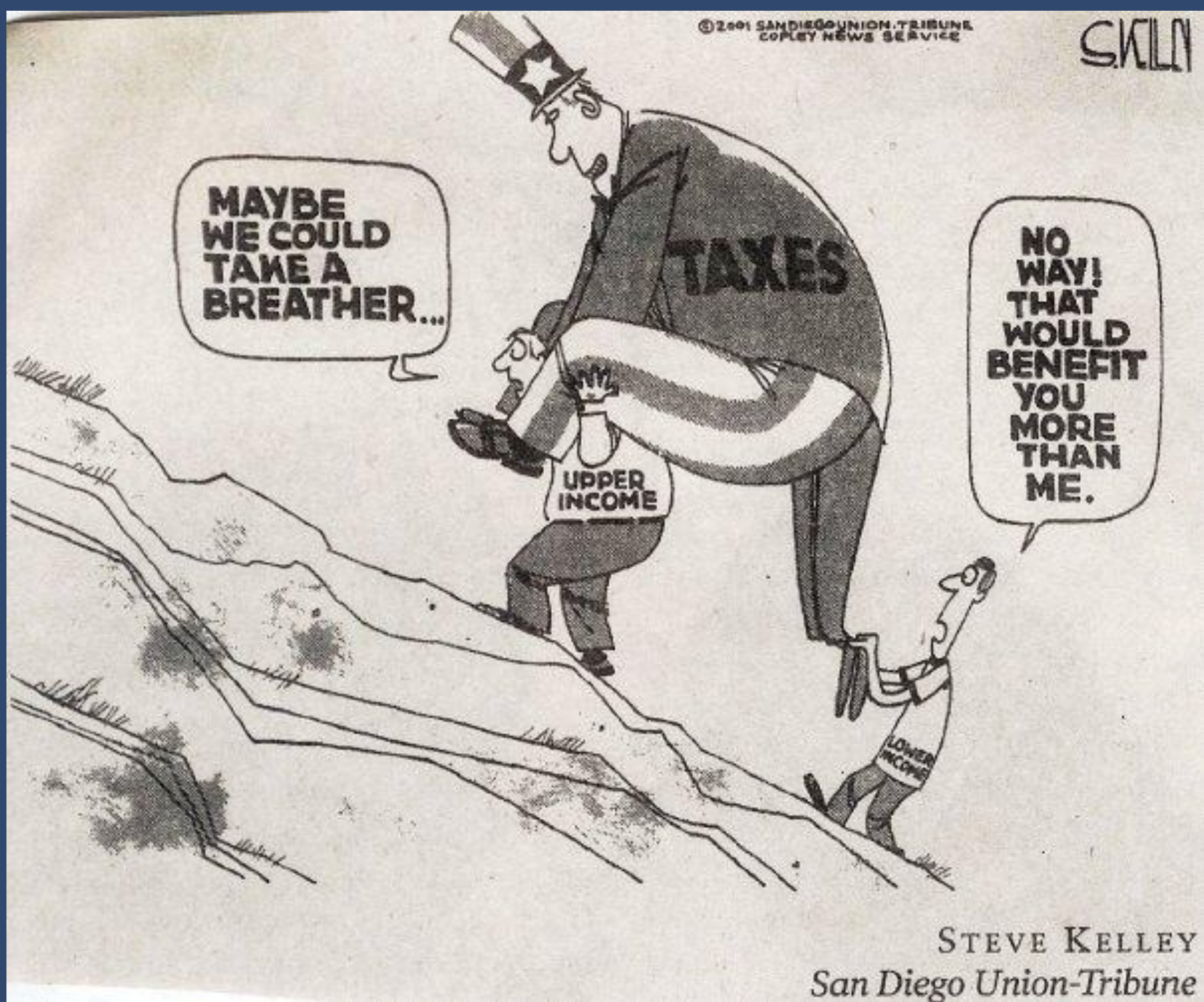
TAXES

- **DIRECT TAXES**

Direct incidence of tax on the person who pays the tax. liability to pay tax is NOT passed on to someone else. e.g. Income Tax, Corporation Tax, Wealth Tax, Land Revenue, Gift Tax etc. Known as progressive taxes.

- **INDIRECT TAXES**

Levied on goods and services. traders / producers pay it. Liability passed on to end customer. e.g. GST, VAT, Excise Tax, Customs Duty, Service Tax. Known as regressive taxes.





Thanks!
Questions?

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