In Conversation….

Roopa Kudva*

In this column, Roopa Kudva answers questions on the Indian economy posted by the Editor.

Editor: What are your views on medium to long term prospects for the Indian economy? Which are some of the major challenges India is likely to face? What are our major strengths that will take us forward?

Roopa Kudva: Though riddled with severe challenges, I feel that the India story can be rewritten and, in the medium to long run, we are likely to see India emerge as a major player in the global economy.Post general elections early this year, India stands on the most stable political ground in three decades. This has improved the confidence of both domestic and foreign players and opened up possibilities for reshaping the trajectory of the economy. We see severe inefficiencies and bottlenecks for businesses in India but we see many positive steps by the government to reduce these such as initiating a streamlined approach for monitoring clearances of large projects, faster permits, online environmental clearances, etc.India will soon have a bigger working-age population than any other country of the world. If jobs are created and youth are equipped with the required skill-sets, India's economic growth will

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accelerate. For this to happen, revival of the manufacturing sector and bridging the skill gap will be critical and that seems to be the key focus area for the new government.If supported by progress on reforms that have been directionally initiated like labour reforms, land acquisition reforms, and GST implementation, India can deliver 6.5 per cent per year growth over the next five years. The speed and success of these reforms can create an upside to our medium term outlook of 6.5 per cent, failure to do so can also trap the economy in low growth equilibrium. There is a 50 per cent chance of India achieving 6.5 per cent average GDP growth over the next five fiscals; 20 per cent chance of growth slipping below this, and 30 per cent chance of an upside.

In the context of sector performance, which sectors will drive India's growth and which sectors / industries will hold us back?

Consumer discretionary sectors like automobiles (cars and two wheelers) have started showing improvement in sales, albeit on a low base. Improved economic outlook, stable/declining fuel costs, and moderating inflation will support volume growth for these sectors going forward. Even commercial vehicle sales are seeing early signs of revival, more specifically in the medium and heavy commercial vehicle (MHCV) segment. With consumption growth picking up, non-discretionary sectors like FMCG are also likely to see better volume growth from the second half of 2014-15.On the other hand, late cyclical sectors linked to domestic investments such as capital goods, construction, etc. are expected to remain muted for some more quarters. Also other industrial sectors like cement and steel are likely to see only gradual improvement in demand and will continue to face weak utilization rates owing to overcapacity.

Going forward, can you list three policy initiatives which are crucial for the country in the next 2-3 years?

I think one of the important initiatives that the government should step up on is in reforming labour laws and formulating pro-job policies. A recent CRISIL study shows that by 2020, pro-job policies can deliver:

- 11 million more jobs in the manufacturing sector
- 36 million more jobs in labour-intensive services·
- 10 million less people dependent on farm income

Secondly, the economy will benefit greatly if GST is implemented. GST will lift tax revenues, lower the cost of doing business, and boost growth. It will be critical for meeting the fiscal deficit target of 3 per cent of GDP by 2016-17. Implementation of GST can lift GDP growth by 0.9-1.7 per cent in future years.Thirdly, having a single-window clearance for large steel, coal, and power projects will help large investment projects by reducing the time taken for clearances, and thus increase the expected project returns by lowering project costs.

What, in your opinion, are some of the challenges for the financial sector?

The role of the financial sector is critical for a sustainable and equitable growth of any economy and for the well-being of people. In the Indian context, the financial sector is expected to meet the following four diverse expectations:

- Access to basic financial services for a vast segment of underserved population
- Large investment needs of the economy, particularly in building the infrastructure assets
- Sophisticated projects required by the Indian corporate sector to compete effectively in the global economy
- Maintain stability and keep the faith and confidence of the stakeholders – including depositors, regulators, government, and customers

Let us look at each one of the above in a little more detail.

Financial Inclusion Ensuring that all Indians have access to basic financial services is a huge challenge. CRISIL's unique financial inclusion index (Inclusix), which measures the level of financial inclusion in India right down to the district level, shows that just one in two Indians has a bank savings account and one in seven has access to bank credit. Further, the bottom 50 districts (out of 630+ in India) have less than 2 per cent of the bank branches in the country. This problem is now well understood by the market participants, regulators, and the government and several steps are being taken to boost the financial inclusion levels. The recent launch of the Pradhan Mantri Jan Dhan Yojana coupled with regulatory initiatives to allow differentiated banks (like payment banks) in the country are steps being taken to address this challenge.

Funding India's Infrastructure The second major challenge that the financial sector faces is in ensuring that it meets the huge infrastructure financing requirements of the country. Our estimates show that Rs.26.4 lakh crore of investment is required to fund infrastructure from FY 2014 to FY 2018. Of this, Rs.18.3 lakh crore is expected to be raised through debt.Meeting this requirement will require several innovative instruments and structures. Some of these include infrastructure debt funds (IDFs), credit enhanced structures, specialized bond guarantee agency, future flow securitization, and infrastructure investment trusts (InVits).

Sophisticated Tools for Indian Corporates Third, there is a need to keep up the pace of financial innovation with the growing requirements of Indian corporates as they go global. The financial sector needs to ensure that sufficiently sophisticated products are available to meet the needs of these corporates, especially products to enable risk mitigation. These must again be balanced with the need to have adequate regulations aimed at making the markets transparent, reliable, and stable.

Maintaining Systemic Confidence Fourth, there is a need to ensure that stakeholders (like depositors and regulators) have adequate confidence in the financial sector.One of the key aspects to maintain stability and confidence in the financial system is to enhance the capital levels. Our estimates show that the capital requirement for banks will be Rs.4.7 lakh crore over the next five years up to March 2019, mainly to meet the Basel III norms. Developing Indian bond markets and expanding investor base for newer and riskier products (especially the Tier I non-equity instruments) will be critical towards this.The regulatory agenda will continue to evolve to reorient the financial system to meet the above objectives. The key focus will remain on balancing innovation with systemic stability in order to develop the financial system and markets.

Can you elaborate your views on the BRICS bank?

It is too early to have a definitive view on the BRICS Bank and its operationalization. However, the intent is clear and representative of the fact that the emerging economies in BRICS have come of age, and demand their say in global matters. The New Development Bank (NDB) is widely believed to be a political result of the long-standing demand of the emerging economies to have a larger voting power in the global financial institutions like IMF and the World Bank. The BRICS countries together account for a fifth of the world economy, but wield only about 10 per cent of the votes at the IMF. NDB will have two prime objectives. First, provide development finance to the member countries – so this opens up an additional source of funding for infrastructure development in these countries. The World Bank's estimates suggest a $1 trillion infrastructure investment gap in developing countries. There is also a growing thought that the needs of a developing country are different and a specialized entity in this area may be more tuned into the issues at hand. Second, NDB will also aim to protect the emerging economies from global financial crises, and provide support in times of financial difficulties. An interesting thing to watch for will be how the five emerging powers work out the operational framework for this new bank. China will be the largest contributor and it is likely that the bank will prefer renminbi over dollar as its base currency. The economic gap between the five nations is very wide – hence the principle of parity between the members will be a challenge. The members are also diverse from the geo-political perspective.