Time for Catching Up With The Global Economic Reality

A recent report from the Paris based International Energy Agency (IEA) includes its revised forecasts for world oil demand in 2009. It comes with up with the shocking estimate that compared with 2008, global demand for oil in 2009 will decline by half a million barrels per day (bpd)! This is based on the IEA's estimates that global economic growth will be a mere 1.2% for all economies after being revised downwards from nearly 3% forecast earlier. This must necessarily imply that OECD economies will collectively post a negative growth rate in 2009 and emerging economies are also likely to achieve only moderate GDP growth. China is expected to grow only at 6.5%, the lowest rate in eight years, despite the massive stimulus that the authorities announced at the end of last year. Given the weakness in Chinese and US demand¸ global oil prices are likely to remain soft this year.

What are the implications for us in India? Let me discuss three that I consider most important. First, the reality of an unprecedented global economic downturn and absence of any recovery in 2009 should now be recognized. The impact on India's economic prospects for this year and the next should be carefully and urgently worked out. There is currently a lack of real appreciation amongst Indian policy and opinion makers of the severity of the global economic downturn. Not surprisingly therefore, some like Surjit Bhalla continue to insist that India's economic performance in 2009 will be better than in 2008. This is dangerous because it prevents from focusing attention on measures that should be taken to try and mitigate the impact of the global downturn and prevent domestic demand plummeting. Thus, we should now be putting the implementation of public sector infrastructure projects on a mission mode. At the least it should be ensured that funds allocated in the budget and in the stimulus packages are utilized. If the previous home minister could have been held accountable for the Mumbai debacle, those in charge of infrastructure and economic ministries should also be held accountable for their poor performance and consequently compromising the country's economic security Better to take action now, rather than wait for the young, educated and unemployed taking to the streets. It does not take long for demographic dividend to be converted to a demographic crisis.

The second implication is for the government to use this window of low global oil prices to take the much needed step of decontrolling the prices of petroleum products. This will remove, once for all, this vexed issue from the realm of partisan politics. There is a cabinet decision of May 2003 to dismantle the administered oil price mechanism. This was held in abeyance first by the NDA government and then so far by the present government. It is disingenuous to argue that dismantling oil price controls will harm the poor. Deserving beneficiaries, which must not by any stretch of imagination include the motorcycle and car owners, can be easily protected by properly targeting the subsidy through either cash transfers or a system of smart ration cards. These will permit them to secure their supplies of kerosene and perhaps LPG at lower prices from all designated outlets that would be directly subsidized by the government. The price decontrol along with the assurance that it will never be brought back, will attract domestic and foreign investment in all the segments of the petroleum sector. Getting rid of oil price controls will contribute to improving the investment climate directly and also boost business confidence in general. So this should be announced now along with a further price cut.

The third implication is to closely monitor the economy and try and take advance action rather than react to worsening conditions as they emerge. In the unfortunate absence of a full time finance minister, a mechanism should be established under the Prime Minister to monitor the implementation of the stimulus package and also to undertake some much needed reforms. Such monitoring would for example have revealed that non-food credit has actually contracted both in November and December. The contraction has been of the order of Rs30000 crore compared to October levels. On Friday 16 January, commercial banks parked nearly Rs 39 000, under the reverse repo window, which is more than seven times the amount (Rs 5035 crore) borrowed from the RBI at repo rates. This amply demonstrates commercial banks inability or unwillingness to advance credit. It is important at this stage for the RBI and the government to discuss with the banks the reasons which are preventing banks from advancing credit despite the liquidity that is now at their disposal. Simply ordering the banks to lend more will only increase the share of directed lending which inevitably results in rising levels of non performing assets. RBI should consider and also explain to all of us the reasons for which it still pays a 4% percent interest on funds parked with it when it wants the banks to lend more. And the government should immediately consider lowering the guaranteed returns on small savings and employees provident fund