

ADB



ADB Regional Forum

on the Impact of Global Economic and Financial Crisis

14–15 January 2010 • ADB Headquarters, Manila, Philippines

Report 3

Impact and Policy Responses India

Asian Development Bank

ADB

This paper was prepared by the Centennial Group as discussion materials for the "Regional Forum on the Impact of Global Economic and Financial Crisis" a regional technical assistance (RETA No. 6508), funded by the Asian Development Bank (ADB).

The views expressed in this publication are those of the consultants and do not necessarily reflect the views and policies of the Asian Development Bank (ADB) or its Board of Governors or the governments they represent.

ADB does not guarantee the accuracy of the data included in this publication and accepts no responsibility for any consequence of their use.

By making any designation of or reference to a particular territory or geographic area, or by using the term "country" in this document, ADB does not intend to make any judgments as to the legal or other status of any territory or area.

Impact and Policy Responses India

Prepared for ADB By
Manu Bhaskaran and Ritwick Ghosh

Centennial Asia Advisors

A member of
Centennial Group International

4 January 2010

CONTENTS

Introduction and Summary	3
1.1 Where does the economy stand?	4
1.2 The outlook: accelerating recovery but still subject to vagaries of global economy	7
1.3 What explains India's resilience?.....	9
1.4 Policy suggestions to build resilience	14

Introduction and Summary

- India's economy has performed extraordinarily well in the face of the most severe global recession in recent decades, and it now looks poised to recover smartly despite some headwinds to growth such as the weak monsoon and rising oil prices.
- India's good performance is not only due to it being less vulnerable to the global crisis, because of its lower exposure to trade. India has become more resilient to shocks of various kinds as a result of reforms, especially with the strengthening of the banking sector.
- Nevertheless, India was also fortunate in escaping a potentially more severe impact from the global crisis. A powerful series of counter-measures by the major economies arrested the financial panic, and allowed for a quick reflation of global demand; India may not have been as resilient if global financial markets and global demand had not steadied so quickly in response. India also benefited from domestic policies that happened to have been put in place well before the crisis.
- Given our view of the fragility of global economic recovery and the still-high risk of financial and other shocks in the global environment, India needs to address the policy towards further strengthening economic resilience. In particular, it needs to address its fiscal position.

Table 1.1: India GDP

% y/y	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09
Gross Domestic Product (GDP)	7.8	5.8	5.8	6.1	7.9
Supply aggregates					
Agriculture, Forestry and Fishing	2.7	-0.8	2.7	2.4	0.9
Mining and Quarrying	3.7	4.9	1.6	7.9	9.6
Manufacturing	5.1	0.9	-1.4	3.5	9.2
Electricity, Gas and Water Supply	3.8	3.5	3.6	6.2	7.5
Construction	9.6	4.2	6.8	7.1	6.5
Trade, Hotels, Transport and Communication	12.1	5.9	6.3	8.1	8.5
Financing, Insurance, Real Estate & Business Services	6.4	8.3	9.5	8.1	7.7
Community, Social and Personal Services	9.0	22.5	12.6	6.8	12.7
Demand aggregates					
Private Consumption Expenditure	2.1	2.3	2.7	1.6	5.6
Government Consumption Expenditure	2.2	56.6	21.5	10.2	26.9
Gross Fixed Capital Formation	12.5	5.1	6.4	4.2	7.3
Exports	24.3	7.1	-0.8	-10.9	-15.0
<i>Less Imports</i>	35.3	21.7	-5.7	-21.2	-29.8

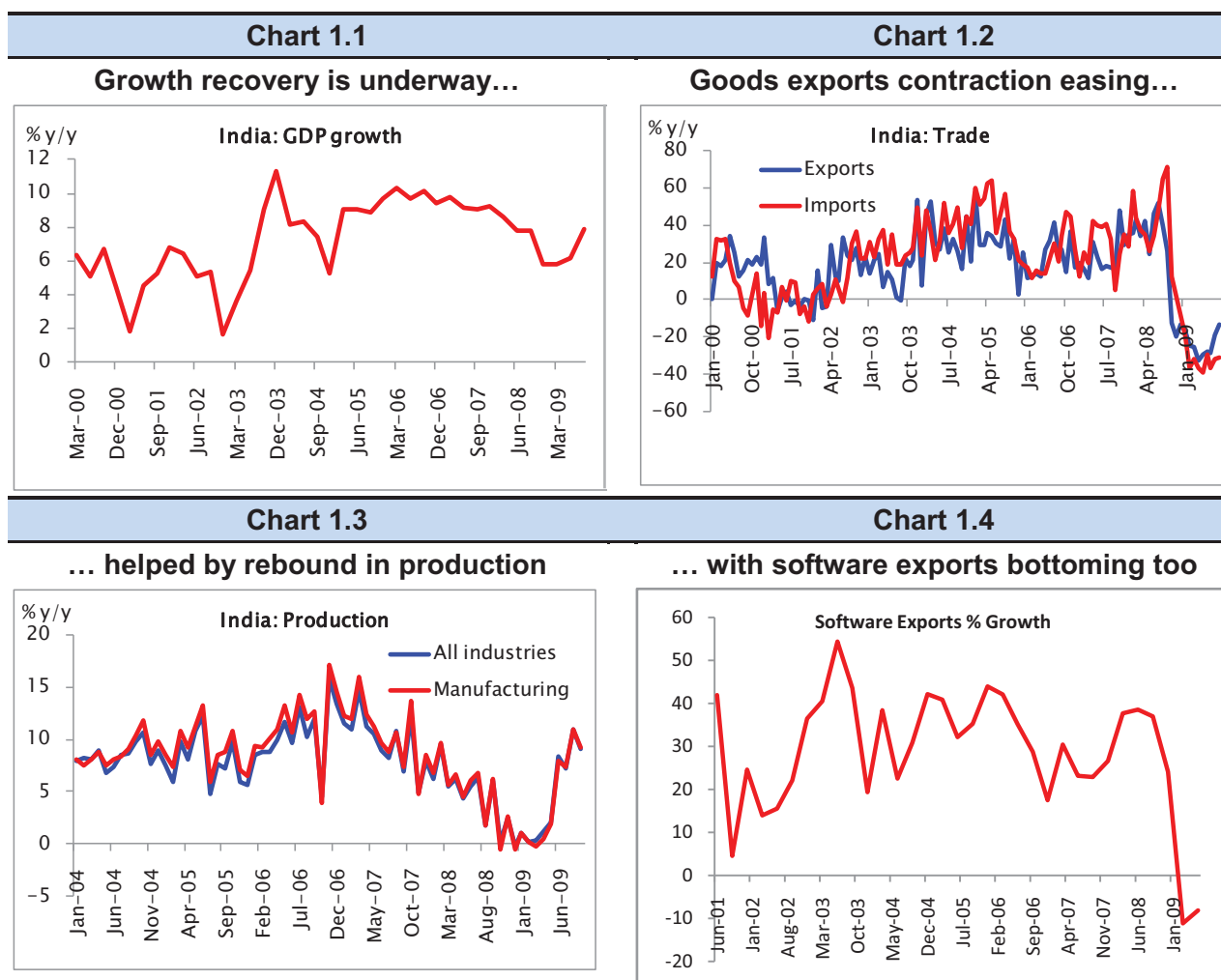
Source: Collated by Centennial Group using CEIC Database.

1.1 Where does the economy stand?

Economic activity – resilient and poised to recover

Chart 1.1 and Table 1.1 show that India's economy weathered the global recession reasonably well.

- GDP growth in the July-September 2009 quarter was surprisingly strong on the upside, rising 7.9% y/y (Chart 1.1). As Chart 1.2 shows, external demand for Indian merchandise exports is improving, which has helped the industrial sector to begin bottoming out (Chart 1.3). Software exports are also showing signs of a recovery (Chart 1.4).

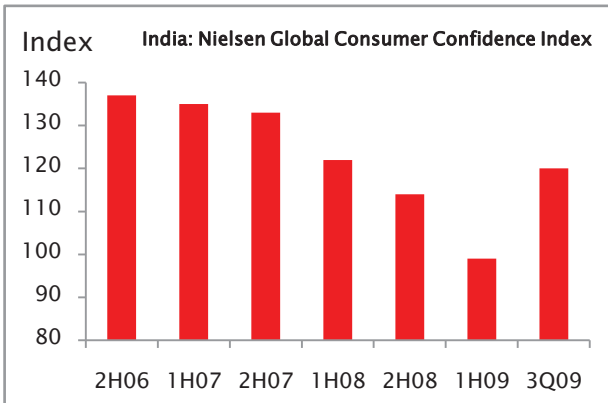


Source: Collated by Centennial Group using CEIC Database.

- The Indian consumer has also contributed to this resilience. As Chart 1.5 shows, consumer confidence has rebounded very strongly in the third quarter of this calendar year. This helps explain the sharp recovery in auto sales (Chart 1.6) – the willingness to spend on big ticket items underlines the robust state of the household sector in India. One reason for this could be the strength of remittance inflows (Chart 1.7) – after falling for several quarters, the March-June 2009 quarter saw a strong recovery.

Chart 1.5

Consumer confidence recovering smartly



Source: Collated by Centennial Group using CEIC Database.

Chart 1.6

... helping boost domestic sales

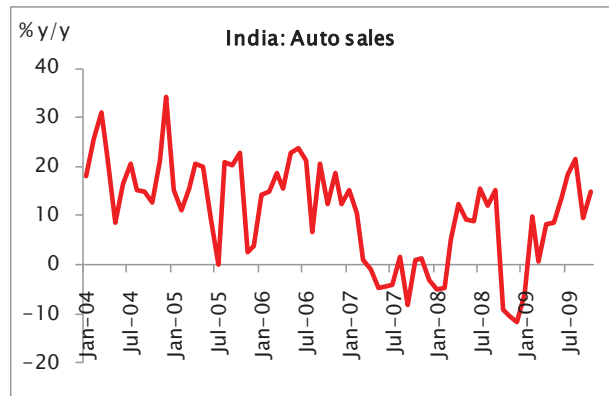
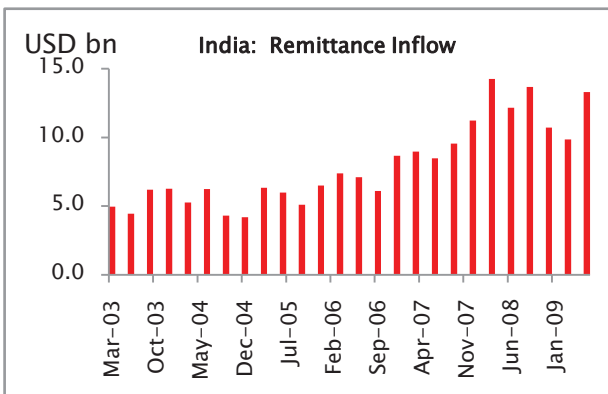


Chart 1.7

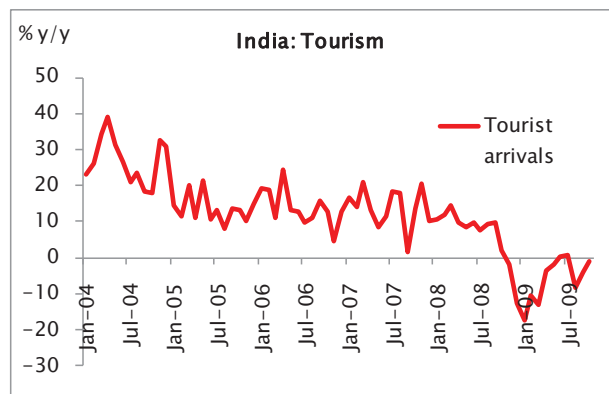
Remittances have helped support growth



Source: Collated by Centennial Group using CEIC Database.

Chart 1.8

Tentative recovery in tourism



A range of other indicators – tourist arrivals (Chart 1.8) and port traffic for example – point in the same direction of a much faster than expected revival in economic activity.

Stability indicators show a more mixed picture

While activity indicators have performed well, stability indicators, while signalling no major risks, have shown a more mixed picture.

- Inflation fell sharply as oil prices fell, and also as the economy slowed. However, as domestic demand recovered and oil prices rebounded, inflation as measured by the wholesale price index has moved up again (Chart 1.9). Looking more closely at consumer prices, we find that non-tradable inflation has risen materially (Chart 1.10), suggesting that there are underlying demand pressures in the system.

Chart 1.9

Inflation dived until early 2009, now rising

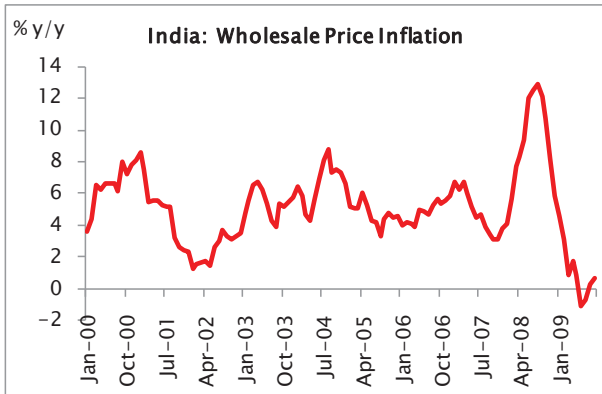
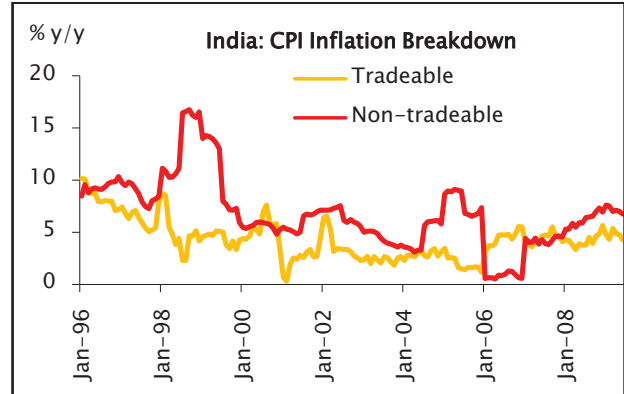


Chart 1.10

... with non-tradeables leading the way



Source: Collated by Centennial Group using CEIC Database.

- The external accounts have also shown some weakening. The trade balance improved significantly as slower domestic demand reduced imports, but as soon as domestic demand recovered, the trade deficit worsened again (Chart 1.11). This kept the current account balance weak (Chart 1.12).

Chart 1.11

Improvement in trade account reversing

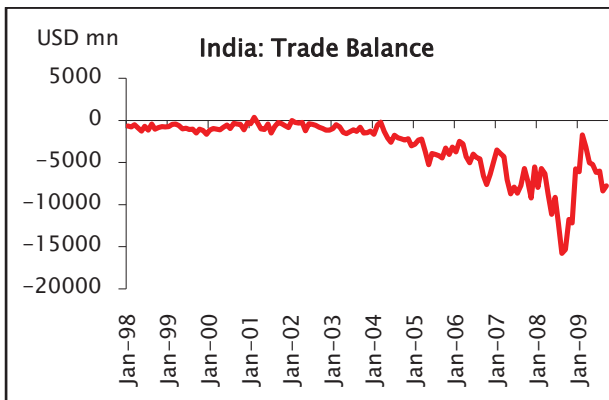
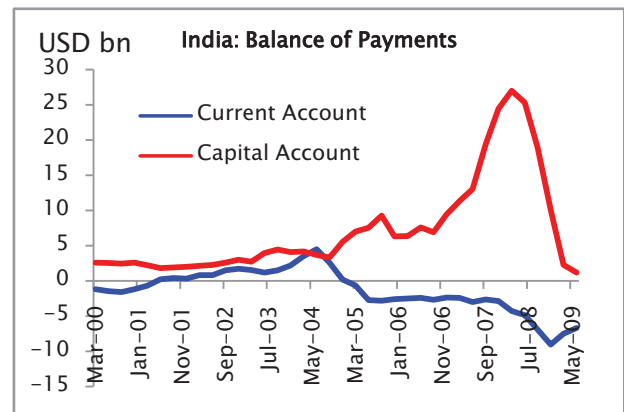


Chart 1.12

Worsening current/capital account deficit...



Source: Collated by Centennial Group using CEIC Database.

- Monetary aggregates appear well behaved. Credit growth (Chart 1.13) was maintained despite some deceleration, keeping broad money growing at an appropriate rate (Chart 1.14). Our estimate (Chart 1.15) shows India's monetary conditions at a well-balanced level, is supportive of growth, but not excessively so.
- At the same time, the domestic banking sector demonstrated robustness. At least in the early stages of the crisis for which the data is better, there was no sign that domestic banks' non-performing assets were deteriorating materially.

Chart 1.13

Credit growth eased a tad...

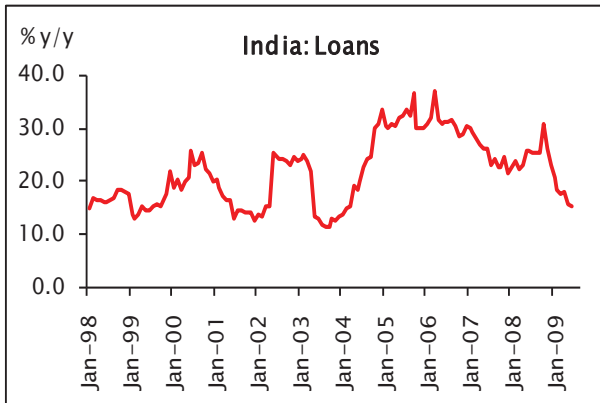
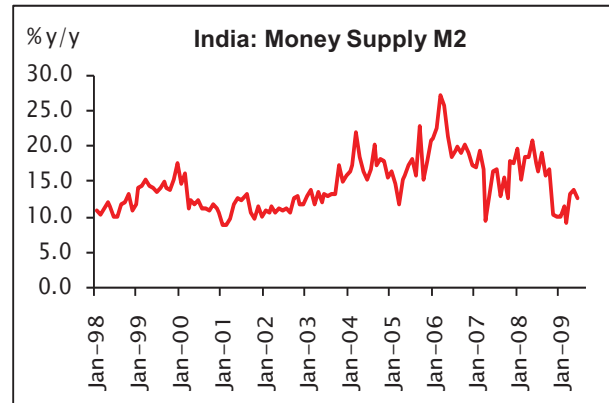


Chart 1.14

... with monetary aggregates well behaved



Source: Collated by Centennial Group using CEIC Database.

Chart 1.15

Monetary policy well calibrated

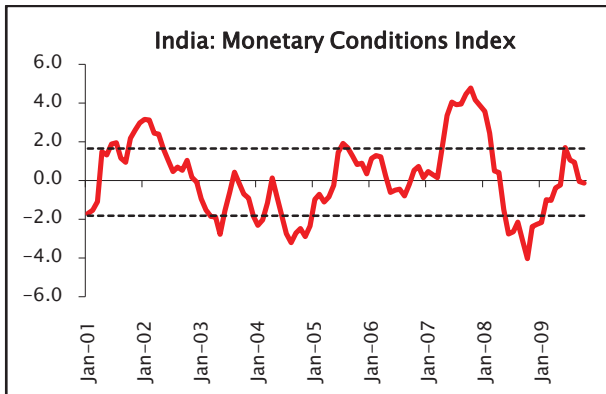
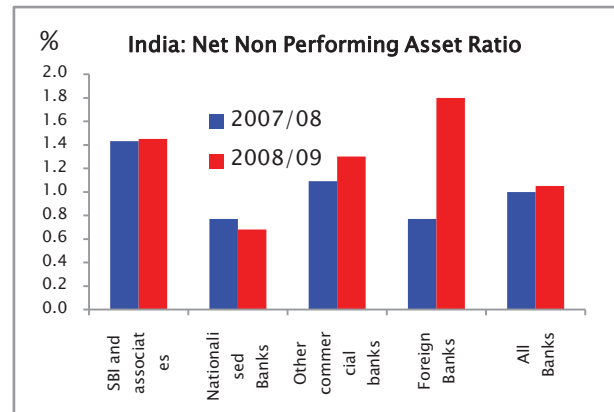


Chart 1.16

... domestic banks' loan book quality stable



Source: Collated by Centennial Group using CEIC Database.

1.2 The outlook: accelerating recovery but still subject to vagaries of global economy

We track four lead indicators for India, all of which are pointing to a sustainable rebound.

- The **OECD Lead Indicator** for India indicates a sharp rebound in Indian GDP growth, following an equally sharp downturn (Chart 1.17).
- The **Dun and Bradstreet Business Optimism Index** for India also shows that the September 2009 index has rebounded to September 2008 levels, after having improved over 2Q09 and 3Q09 (Chart 1.18).
- HSBC Market **Purchase Managers' Index** for India has been consistently over the 50 point mark since April 2009. A reading over 50 signals expansion in industrial activity. The index hit its lowest in December 2008 when it recorded 44.4.
- This better outlook is also supported by the **UBS lead economic indicator**, which has gone up from its record low of -2.1% in December 2008 to 2.5% in April 2009. This indicator is a useful forecast of production six-eight months ahead.

Chart 1.17

OECD indicators rebounded sharply...

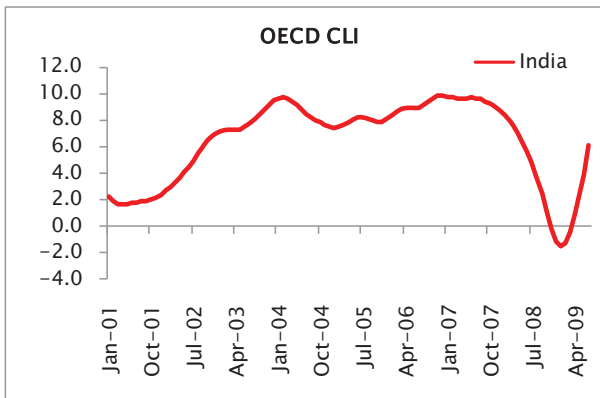
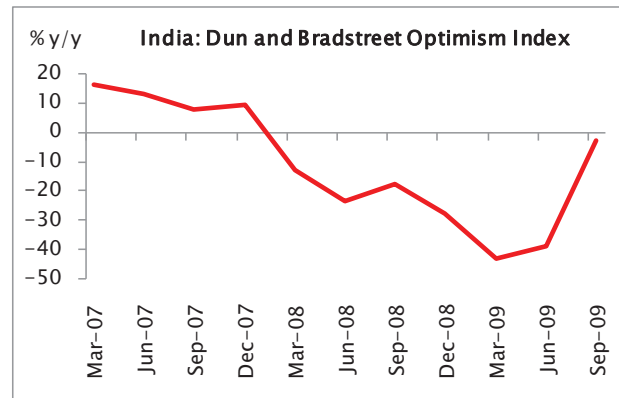


Chart 1.18

...so are other lead indicators



Source: Collated by Centennial Group using OECD and Dun and Bradstreet reports.

Breaking down the residual effects of the various transmission mechanisms, we have collated their effect in Table 1.2.

Table 1.2: Transmission Mechanisms

Mechanism	Baseline Scenario for 2009/10	Risks/Upsides to Baseline Scenario
Portfolio Capital flows	<ul style="list-style-type: none"> Capital inflows are highly linked to the volume of global liquidity, risk appetites of global investors and the perception of risk-adjusted returns in India relative to elsewhere. Our Overview argued that there would probably be massive inflows of largely speculative capital into Asia. We believe that India will be a major target of such funds. 	<p>Risks</p> <ul style="list-style-type: none"> An increase in interest rates in India relative to other economies because of higher inflation risks in India would aggravate the risks of destabilising inflows of speculative capital.
Trade	<ul style="list-style-type: none"> Export growth is set to shift from contraction to expansion before the end of 2009. However, once the initial rebound from a low base is over, the lack of robust improvement in G3 consumer spending will keep export growth subdued for the next few years. The weak monsoon will hurt agricultural exports, which form about 10% of the total. 	<p>Risks</p> <ul style="list-style-type: none"> Protectionism is a clear threat.
Remittances	<ul style="list-style-type: none"> Dubai's travails may cause the return of Indians working there. However, the impact will be localised to states, such as Kerala, those that are the main labour exporters to Dubai. Higher oil prices in 2010 could mean that other oil exporters in the Gulf continue to demand Indian workers. Recovery in G3 would allow remittances of professional workers there to rise. 	<p>Risks</p> <ul style="list-style-type: none"> Several countries are considering the introduction of restrictions on imports of foreign labour which will hurt India.

Mechanism	Baseline Scenario for 2009/10	Risks/Upsides to Baseline Scenario
Tourism	<ul style="list-style-type: none"> Recovery in 2010 will be slow, given perceived political risks, currency movements and slow recovery in the household sectors of G3 economies. The Commonwealth Games planned for October 2010 could help to some extent. 	<p>Upside</p> <ul style="list-style-type: none"> While G-3 tourist arrivals will remain low, India could be a prime tourist destination among short haul travels within Asia. The key market here would be ASEAN countries and the PRC.
FDI	<ul style="list-style-type: none"> A significant recovery is not expected until 2010. However, India would be among the leaders during the rebound phase post 2010. 	
Commodity Prices	<ul style="list-style-type: none"> The oil import bill will also increase in the coming months, but the impact will be softened by further appreciation of the Rupee. 	

The outlook raises questions about India's resilience and its policy response, both of which we will address in the next two sections.

1.3 What explains India's resilience?

India is less vulnerable and was helped by swifter than expected global recovery

One reason for India's relatively good performance during the global crisis is that it is simply less vulnerable because it is less exposed to the global economy:

- It has a lower export-to-GDP ratio than most East Asian economies;
- Financial linkages to the outside world were also less in some aspects than in other countries. Indian banks were generally not exposed to the troubled portions of the global financial system and remained substantially unaffected by problems such as write-offs of bad assets.

India was also helped by the rapid recovery in the global economy and in global finance. The unprecedented scale and co-ordinated nature of policy interventions by the major economies ended the financial panic, and put in place, the foundations for a recovery in trade and normal activity. As a result, the risks for India remained potential rather than being realised:

- Revival of foreign institutional investors.** A major weakness in India's resilience structure is the high ratio of financially mobile capital to foreign exchange reserves which, at 67.6%, is higher than most Asian economies. The swift return of confidence to global portfolio investors after March 2009 helped bring funds back to India, and allowed a recovery in domestic liquidity and in domestic asset prices, which in turn helped Indian businesses and investors regain confidence.
- Lagged adverse impacts were avoided by swift recovery:** The quicker than expected external recovery meant that: (a) Demand for Indian manufactured exports and services stabilized relatively quickly; (b) The shock to loan growth did not reverberate long enough for a contraction in credit; (c) Remittances did not fall as much as expected. Thus, potential shock amplifiers were dampened before they could do much damage to India's economy.

- **Lack of fiscal capacity not tested:** A protracted crisis would have required the government to continue providing fiscal support to limit the damage to India's economy. Given the restricted space for fiscal stimulus (see below), this would have put India in a dilemma – too small a response would not help the economy but a large stimulus may have tested financial markets' confidence in longer term fiscal sustainability, compromising efforts to boost the economy.

But the main reason is India's improved economic resilience

But the more important reason for India's resilience is that the reforms of the past 18 years have produced a more durable economy despite the increased exposure to the global economy. Table 1.3 outlines the key components of our resilience index (featured in the Overview section), showing a breakdown of India's resilience framework.

Table 1.3: Analysis of India's economic resilience

Component/Indicator	2000	2008	Comments
Export Diversity			
Avg. coefficient of variation for top 10 exports and destinations	0.9	0.6	<i>The more diversified your export base, the more resilient the economy is.</i> Export diversity has improved tremendously over the last 9 years. Number of principal trade partners is much higher.
Demand Diversity			
C + I + G (% of GDP)	99.3	100.8	<i>The greater the dependence on exports and less exposure to domestic demand, the less resilient the economy is likely to be.</i> Domestic demand is large enough to compensate for some loss of external demand.
Automatic Stabilisers			
10 yr. avg. of change in tax revenue/change in GDP	2.7	2.2	<i>Tax revenues automatically adjust as economy accelerates or decelerates, providing a natural automatic stabiliser or shock absorber in the economy.</i> Absence of efficient automatic stabilizers leaves society vulnerable.
Capacity for swift and effective policy response			
Fiscal - Public Debt (% of GDP)	60.0	55.6	<i>Higher public debt imposes a constraint on use of fiscal tools.</i> Poor fiscal management puts a cap on the government's ability to respond. A relatively low multiplier effect increases the inefficiency.
Monetary - G7-Country Inflation over 8 yrs (%/y)	-6.7	-2.9	<i>The greater the credibility the central bank has built up by controlling inflation not too different from major countries' inflation, the more latitude central bank has to ease monetary conditions in a slowdown.</i> Long periods of high inflation have created a less credible monetary policy.
External Financial Vulnerability			
Financially mobile capital (%age of foreign exchange reserve)	76.4	67.6	<i>High financially mobile capital in relation to FX reserves and high current account deficit/GDP signify reduced resilience.</i> Moderately large amounts of financially mobile capital.

Component/Indicator	2000	2008	Comments
Domestic Financial Vulnerability			
NPL Ratio	12.8	2.3	<i>A stronger banking sector with low non-performing loans is less likely to amplify an external shock by cutting lending drastically.</i> NPL ratio has been considerably reduced.
Vulnerability to oil prices			
Avg. excess production of energy (% of GDP)	-2.9	-0.1	<i>Country is more resilient if it is a net producer of energy.</i> High oil import bill, though it has fallen over the years.
Political Stability			
Index of Stability	5.9	6.3	<i>Country with political stability is more resilient.</i> Political conditions are stable.

Source: Centennial Asia Advisors.

Note: The values for 2000 and 2008 indicate the index number for the country less the regional average for that specific parameter

Second, the timing of the crisis fell coincidental to the election year. An election year is typically accompanied by generous government transfers to people to help improve popularity. Schemes such as the rural loan guarantee and the implementation of the pay commission recommendations were already underway and helped bolster the low and middle income tiers. Thus pre-election spending temporarily provided an automatic stabilizer mechanism which supported rural incomes. As the rural economy is sizable, once rural consumption weathered the shock, the economy was relatively safe from a deep rooted crisis.

The weakness in Indian structure of resilience is its endurance. It has ample shock absorbers which come into operation in the event of a shock. However, India's resilience only extends so far because these shock absorbers cannot be sustained if the downturn is prolonged. In addition, India also has some shock amplifiers which tend to kick in with a lag so that India's resilience to a prolonged global shock is in question.

The reasons for our more cautious view on Indian resilience are explained below:

Lack of fiscal space

Fiscal weakness was a primary reason for Fitch to downgrade India's credit rating in July 2009 by. The Fiscal Responsibility and Budget Management Act (FRBMA) enacted in 2003, had offered India a route to a more prudent fiscal position, but well before the global crisis forced the government to abandon FRBMA goals, adherence to the FRMBA was wavering¹. Deficit targets were repeatedly postponed and off-budget activities increased. For example, the issuance of oil-related bonds to compensate state-owned oil marketing companies for subsidy-related losses is filed as an off-balance sheet item and not included in the deficit. The adjusted overall and current balance for the government of India shows a different story (Table 1.4). What improvement there had been in the fiscal balance prior to 2008 was at least partly due to the economic boom in this period when a flourishing private sector provided the government with a bounty of tax revenues.

¹ 'India's Experience with Fiscal Rules: An Evaluation and The Way Forward', Alejandro Sergio Simone and Petia Topalova, IMF, Aug 2009.

Table 1.4: Adjustment in Central Government Finances, 2003/2004–2008/2009

% of GDP	2003/04	2004/05	2005/06	2006/07	2008/08	Cumulative chg 2003/04 to 2007–2008	2008/09
Total revenue and grants	10.2	10.2	10.1	10.9	11.8	1.6	11.0
Net tax revenue	6.8	7.2	7.6	8.5	9.3	2.5	8.9
Non-tax revenue	3.3	2.9	2.4	2.3	2.4	-0.9	2.0
Total expenditure and net lending	15.3	14.3	14.3	14.3	14.5	-0.8	16.8
Current expenditure	13.8	12.7	12.7	12.8	13	-0.8	14.9
Capital expenditure and net lending	1.5	1.6	1.6	1.5	1.6	0	1.9
Overall fiscal balance	-5.1	-4.1	-4.1	-3.4	-2.8	2.3	-5.8
Overall fiscal balance (augmented)	-5.2	-4.1	-4.6	-4.4	-3.4	1.9	-7.1
Current balance	-3.6	-2.5	-2.6	-1.9	-1.2	2.4	-4.0
Current balance (augmented)	-3.7	-2.5	-3.1	-2.5	-1.8	1.9	-4.2
Subsidy-related bonds	0.1	0.0	0.5	1.0	0.6	0.5	1.3
Central Government Debt	68.4	67.9	66.1	64.2	64.1	-4.4	-

Source: 'India's Experience with Fiscal Rules: An Evaluation and The Way Forward', Alejandro Sergio Simone and Petia Topalova, IMF, Aug 2009. Note: The current balance refers to the balance of a government's tax revenues, plus any proceeds from asset sales, minus government spending.

Lack of sufficient automatic stabilizers

The resilience index above focuses on revenue side stabilizers, as expenditure side stabilizers in Asia are negligible. However, India does have its own unique automatic stabilizers². Schemes such as the National Rural Employment Guarantee Act (NREGA) provide a legal guarantee for a hundred days of employment each financial year to any rural household willing to undertake unskilled manual labour at the specified wage. While this is a welcome addition to India's resilience, the efficacy of these schemes as automatic stabilizers may be overstated:

- **The NREGA suffers serious delays, reducing its ability to act in a timely fashion.** There have been delays in registration for employment and opening of new worksites. About 80% of applicants did not get employment within the stipulated period of time. Neither did they get the stipulated employment allowance during the period³. The lag in the implementation process reduces the effectiveness of the NREGA as a mechanism to bolster consumption and welfare.
- **Information about the NREGA is still not widespread.** Awareness of the existence of the NREGA is under process which currently excludes a large portion of the prospective scheme members. In time, as publicity improves, there should be a larger number of applicants to the scheme, but as of now the reach of the scheme is only partial.

² 'India - Managing the Impact of the Global Financial Crisis', Speech delivered at the Confederation of Indian Industry's National Conference and Annual Session 2009 in New Delhi on Mar 26, 2009.

³ National Rural Employment Guarantee Act: A Survey of Twenty Districts, Prepared with Financial Support and Research Inputs from Programme Evaluation Organisation (PEO), Planning Commission, Dec 2008.

- **The NREGA does not help urban workers.** The targeted segment for the NREGA is agricultural labourers and rural workers. Understandably, it cannot offer wages to match urban living costs and thus excludes the rural unemployed. This is a major concern for India since an externally motivated crisis first affects the major cities and causes urban unemployment.

The NREGA is probably more effective as a tool to alleviate poverty in the medium term than as an automatic stabilizer during a crisis. Besides the NREGA, India does not have any other scheme which can act as an automatic stabilizer. This means that another and more prolonged global downturn might require India to prepare a large fiscal stimulus package which could strain its fiscal resources.

Poorly targeted subsidies constrain fiscal resources

India's government expenditure is heavily drained by subsidies as the following data show⁴.

- During 2003–04, 16 large states covered under the study were issued 14 million tonnes of food from the central pool for distribution to poor families⁵. Of this, less than 6 million tonnes (or only about 40%) were delivered to the families below the poverty line, and the rest never reached them;
- This translates into the following sobering statistic - for every 1kg of food grain delivered to the poor, the government issues 2.4kg of subsidized grain;
- Out of an estimated budgetary consumer subsidy of INR72 billion for sixteen states in 2003-04, as much as 60% did not reach BPL households; and
- The Government spent INR36.5 billion through budgetary food subsidies to transfer INR1 to the poor. There could not be a more serious indictment of the governance system in India than in the findings above.

Monetary policy constraints

The Reserve Bank of India (RBI) has emerged as one of the strongest and most credible central banks in Asia. However, there continues to exist two technical problems with the monetary policy - persistently high inflation, and ambiguous price gauges.

Balancing the output-inflation choice: finding the right anchor.

In the high growth period in the last five years, the RBI has been unable to keep prices adequately under control. The last time consumer price inflation was below 5% was in January 2006 - a span of 42 months with inflation over 5%. The wholesale price index has generally been lower, except in 2008 when the WPI inflation averaged 9.1%. This has often raised the concern that the RBI might be biased in its trade-off of risks towards prioritising the growth objective rather than the inflation objective. Without a clear anchor for monetary policy, there is a lack of consistency in the long term.

No clear inflation measure.

The RBI has two primary measures of inflation- the wholesale price index (WPI) and the consumer price index (CPI). Even among the various CPIs, there are four sub-categories for the various groups of workers. It is understandable for a diverse country like India to have more than one measure of inflation, but the inconsistencies in the two measures does seem peculiar. The correlation between the two indices is 0.22.

⁴ 'India 2039: An affluent society in one generation', Prepared for the Emerging Markets Forum, ADB, 2009.

⁵ Poor families are defined by their household income being below the poverty line.

As of October 2009, the CPI based yearly read 11.5% while the WPI inflation read 4.8%. The CPI rate has been rising since March 2009 while the WPI rate had been decreasing until July 2009. The pith of the issue is the difference in the index makeup. While food is a majority category for the CPI, it has only a 15% weight in the WPI.

1.4 Policy suggestions to build resilience.

Highlighted below are some suggestions to policy makers. These suggestions are in four areas – fiscal management, developing social infrastructure, monetary policy and dependence on imported oil.

Fiscal policy

Disciplined fiscal management is an essential step needed, to allow space for the government to react appropriately.

- **Subsidies need to be streamlined or replaced by more targeted measures.** For example, Indonesia has begun to replace subsidies which often favour middle or higher income citizens (such as fuel subsidies) with more targeted cash transfers that focus on the poorest segments of the population.
- **New fiscal management framework should rectify shortcomings of the FRMBA.** As mentioned earlier, a new fiscal management framework will replace the now-abandoned FRBMA. This new framework should allow greater flexibility while also being explicit in the accounting principles it uses so as to limit the use of off-budget expedients. The rules should allow for anomalies such as a crisis where fiscal easing becomes necessary. A broader definition of the deficit should be undertaken which includes non-balance sheet items.
- **Set longer term objectives.** The government needs to set a fiscal discipline plan for a longer term with 5–10 years in mind. The maturity date of the previous plans encourages short term planning without considering a fiscal planning with a longer term picture.

Social infrastructure

To prepare for future crises India needs to ensure the presence of basic social infrastructure.

- **Create faster-acting automatic stabilizers:** India, like other emerging markets, needs to create basic automatic stabilizers, at both the urban and rural level. These should include plans to buffer workers rendered unemployed by a recession. An external crisis is more likely to hurt skilled labour, as the underdevelopment of the manufacturing sector in India prevents large job losses in the same sector. However, the business process outsourcing and information technology industries are more vulnerable and a different set of stabilizers should be applied there.
- **Increase labour mobility:** Easier mobility of workers across sectors and industries can be a critical shock absorber. The freer mobility of workers can be established by (i) improved education standards, (ii) spread of healthcare infrastructure, and (iii) better road infrastructure to reduce travel times to work.

Monetary policy

India's inflation is hard to manage as the factors are often exogenous and not simply a consequence of a domestic demand-supply function. Prices are affected by import prices,

trade channels, capital flows, monsoon, and commodity prices. Thus keeping inflation under control requires efficient monitoring of data and the ability to react swiftly.

We have two main suggestions for monetary policy changes:

- **Make the CPI the main policy measure:** Instead of two primary indicators of inflation, the RBI should shift to a single and more comprehensive index which measures the actual price consumers pay. An updated version of the CPI should be used as the measure of inflation.
- **More balance towards inflation control:** Beside the difficulties in measurement, the RBI should not compromise inflation in favour of higher output. While a multi-objective policy in India is probably better than inflation targeting, the policy should put more emphasis on inflation control. A clear transmission channel should also be established to ensure effective pass-through of RBI policies.

Oil dependency

Another vital shock amplifier has been the sizable oil import bill. While oil imports are unavoidable, the size of it needs to be less vulnerable to sudden oil spikes. The recent discoveries of oil reserves will probably cut India's oil imports by about 7%⁶. This can be done in many ways: (i) incentives to private corporations to invest in green projects; (ii) investments in other conventional fuel sources such as natural gas; and (iii) alternate fuel sources like nuclear, solar, and wind have been only superficially exploited and there is tremendous scope in this area.

⁶ This refers to calculation based on oil findings in Barmer, Rajasthan.

Report 3

Impact and Policy Responses India

About the Asian Development Bank

ADB's vision is an Asia and Pacific region free of poverty. Its mission is to help its developing member countries substantially reduce poverty and improve the quality of life of their people. Despite the region's many successes, it remains home to two-thirds of the world's poor: 1.8 billion people who live on less than \$2 a day, with 903 million struggling on less than \$1.25 a day. ADB is committed to reducing poverty through inclusive economic growth, environmentally sustainable growth, and regional integration.

Based in Manila, ADB is owned by 67 members, including 48 from the region. Its main instruments for helping its developing member countries are policy dialogue, loans, equity investments, guarantees, grants, and technical assistance.

