



# Understanding Economic and Business Environment

## EPITM 5

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### Macroeconomy as a **Set of Institutions**



- All those *institutions* that mediate & support the basic economic processes of *production*, *exchange*, *distribution* & *accumulation*
- history, culture, structure & functioning of institutions governing these processes defines the *texture* of an economy
- It is institutions that distinguish one economy from another & key to understand *why nations grow or fail*

## Capitalism



*refers to a class of economic systems where the institutions of (i) private property, (ii) markets, & (iii) firms, combine each other & interact with families, governments & other institutions*

- they may differ greatly across countries
- provided incentives and opportunities for:
  - (i) technological innovations
  - (ii) gains from specialisation
- but growth also has come with costs of depleting resources and climate change

## What Explains **Success** or **Failure** of Nation States/Economies



### 👉 **Crony Capitalism Fails!**

- if private property is not secure
  - markets won't be competitive
- firms survive because of personal network
  - rent seeking class
  - oligarchic power structure
  - crony capitalism

### 👉 **Dynamic Capitalism Succeeds**

1. private incentives for cost reduction innovation
2. firms managed efficient managers (lessen cost)
3. supportive public policy/stable society

## Sustaining High Growth Lessons from International Experiences



- Commission's Report reflects a broader intellectual shift in our understanding of the process of development.
- Focus is not just on **growth strategies** but also on **health, education, science and** technology and other **social policies**.
- Commission also emphasizes the need to ensure the availability of basic **social** and **physical amenities** country.

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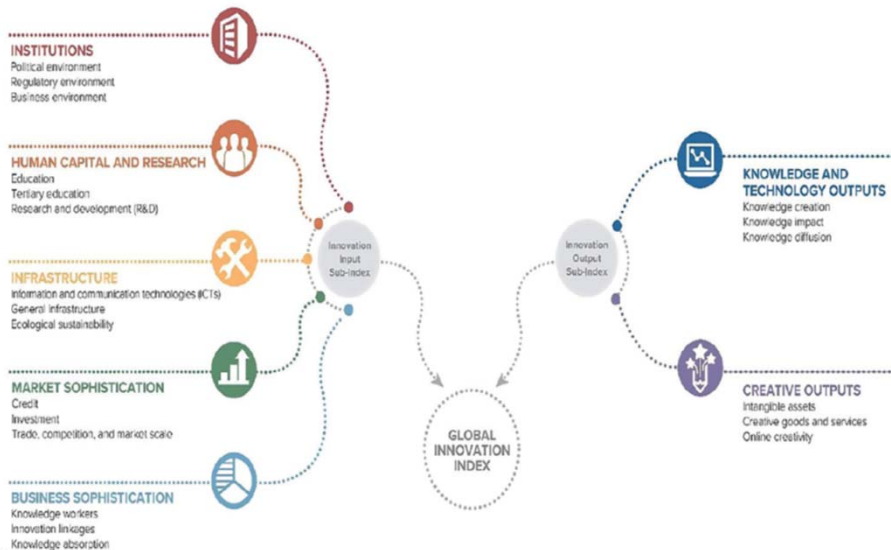
## Only 4.5% (23) Countries are Full Democracy India (R#53): Flawed Democracy!!



## Why Institutions Matter?



Framework of the Global Innovation Index 2020



## Competitiveness Index



**2: COMPONENTS OF THE COMPETITIVENESS INDEX**  
Index 4.0 2018

### ENABLING ENVIRONMENT

- Pillar 1**  
Institutions
- Pillar 2**  
Infrastructure
- Pillar 3**  
ICT adoption
- Pillar 4**  
Macroeconomic stability

### HUMAN CAPITAL

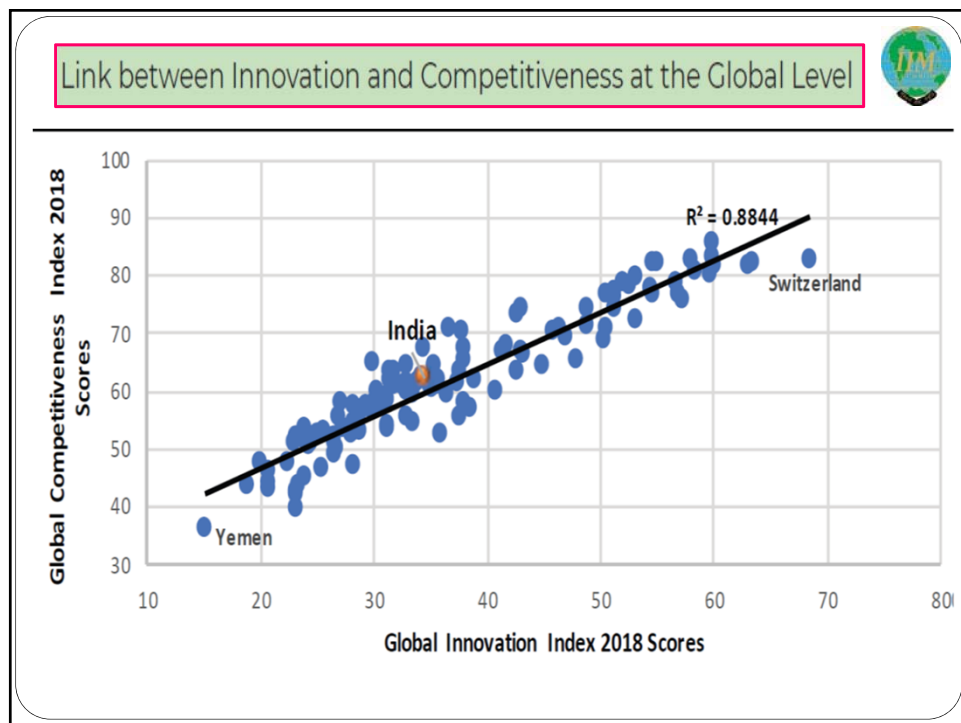
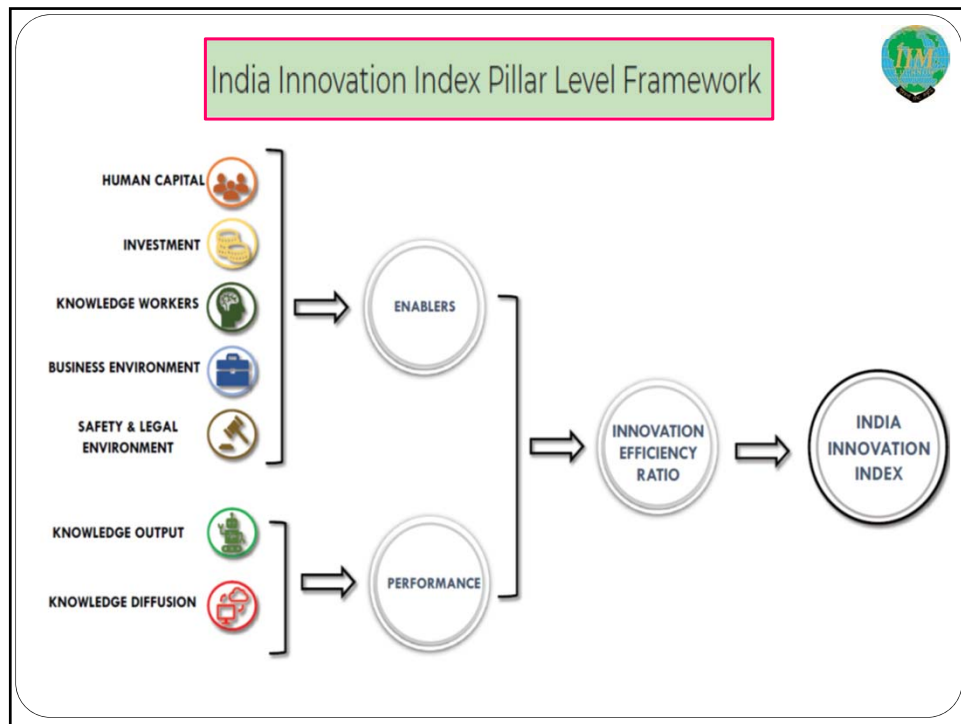
- Pillar 5**  
Health
- Pillar 6**  
Skills

### MARKETS

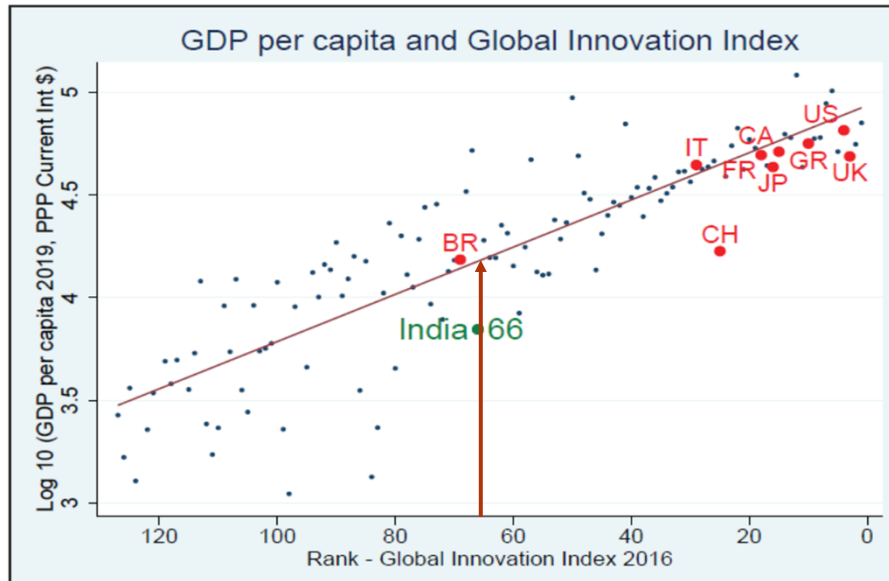
- Pillar 7**  
Product market
- Pillar 8**  
Labour market
- Pillar 9**  
Financial system
- Pillar 10**  
Market size

### INNOVATION ECOSYSTEM

- Pillar 11**  
Business dynamism
- Pillar 12**  
Innovation capability



## Why Institutions Matter?



## Bureaucratic Efficiency

Country	No. of days to start business	No. of days to enforce a contract	No. of years to resolve insolvency	Border compliance for exports (hours)	Border compliance for imports (hours)
India	30	1,445	4.3	106.1	264.5
China	23	496	1.7	25.9	92.3
Vietnam	22	400	5	55	56
Bangladesh	20	1,442	4	99.7	183
Malaysia	18	425	1	45	69
Pakistan	18	1,071	2.6	75	129.3
Thailand	5	420	1.5	51	50
South Korea	4	290	1.5	13	6
Singapore	3	164	0.8	10	33

Source: Author's construction, using World Bank data (World Bank 2018).

## India's Ranking



### Improvements

- ↳ 27 Knowledge and Technology, and 10 Knowledge Diffusion
- ↳ 31 Market and 55 Business Sophistication
- ↳ 60 Human Capital and Research
- ↳ 61 Institutions and Infrastructure
- ↳ 01 ICT Services Exports

### Worse

- ↳ 107 Education
- ↳ 115 in New Businesses
- ↳ 108 & 105 in ICT Access and Use
- ↳ 105 Starting a New Business
- ↳ 101 Female with Advanced Degrees

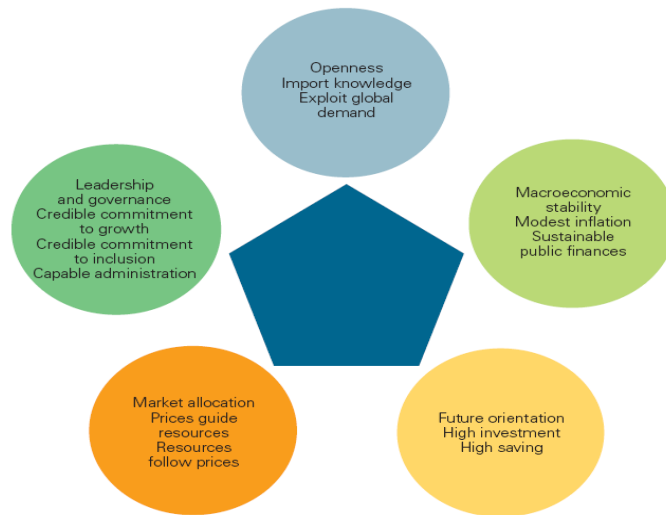
## Ease of Doing Business Ranking



<u>Metric</u>	<u>Rank</u>
<b>Starting a Business</b>	<b>136</b>
Dealing with construction permits	27
Getting Electricity	22
<b>Registering property</b>	<b>154</b>
Getting credit	25
Protecting minority investors	13
<b>Paying Taxes</b>	<b>115</b>
Trading across Borders	68
<b>Enforcing contracts</b>	<b>163</b>
Resolving Insolvency	52

<https://www.doingbusiness.org/en/rankings>

## Sustaining High Growth Lessons from International Experiences



Source: Commission on Growth and Development (2008)

## Economic Growth (& Welfare) is Driven by?



- 👍 **I**nvestment in (Physical) Capital
  - 👍 Saving & Investment
- 👍 **I**nvestment in Human Capital
  - 👍 Education (skill up gradation), Health & Social Security
- 👍 **A**doption of New Technology
  - 👍 R & D
  - 👍 Infrastructure
  - 👍 Private Investment
  - 👍 FDI



## Business Coincident Economic Indicator



### 👍 Main Aggregates

- ➡ GDP Growth, Unemployment Rate & Inflation
- ➡ C, S & I (as a % of GDP)

### 👍 6 CEII

1. Production of consumer goods
2. Non-oil non-gold imports
3. Auto sales
4. Rail freight
5. Air cargo
6. Government receipts

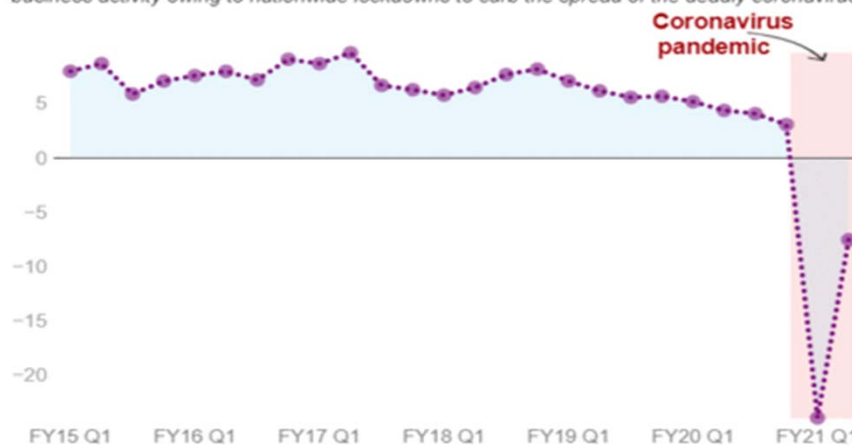
### 👍 9 CEII, in addition:

1. IIP-core
2. Exports
3. Foreign tourist inflows

## Quarterly GDP growth since 2014-15



India's GDP had witnessed worst quarterly slump of 23.9% in Q1 of FY21 due to closure of business activity owing to nationwide lockdowns to curb the spread of the deadly coronavirus.



Source: Ministry of Statistics and Programme Implementation

## AD Side: Underlying Drivers of Growth



Components	Growth (per cent)					Contribution to Growth (per cent)				
	2008-09	2009-11	2011-14	2014-18	2018-20	2008-09	2009-11	2011-14	2014-18	2018-20
1	2	3	4	5	6	7	8	9	10	11
<b>I. Total Consumption Expenditure</b>	<b>5.5</b>	<b>6.5</b>	<b>6.1</b>	<b>7.5</b>	<b>7.0</b>	<b>118.2</b>	<b>53.5</b>	<b>71.5</b>	<b>64.6</b>	<b>91.8</b>
Private	4.5	5.9	6.7	7.4	6.2	81.9	40.4	66.2	53.8	68.5
Government	11.4	9.7	2.6	8.2	10.9	36.3	13.1	5.3	10.8	23.3
<b>II. Gross Capital Formation</b>	<b>-2.6</b>	<b>14.5</b>	<b>2.0</b>	<b>6.5</b>	<b>3.7</b>	<b>-31.3</b>	<b>64.1</b>	<b>16.6</b>	<b>30.1</b>	<b>17.9</b>
Fixed investment	3.2	9.4	6.2	6.2	3.5	32.6	35.9	37.9	25.0	13.9
Change in stocks	-51.4	56.2	-27.4	31.5	12.2	-75.4	17.9	-16.7	3.5	3.4
Valuables	26.9	45.0	-11.1	8.5	0.8	11.4	10.3	-4.6	1.6	0.5
<b>III. Net exports</b>						<b>-72.4</b>	<b>-4.1</b>	<b>8.9</b>	<b>-8.5</b>	<b>14.0</b>
Exports	14.8	7.3	10.0	1.4	4.4	99.0	16.2	42.3	3.7	10.9
Imports	22.4	6.9	6.1	4.2	0.9	171.4	20.3	33.4	12.3	-3.0
<b>IV. GDP</b>	<b>3.1</b>	<b>8.2</b>	<b>5.7</b>	<b>7.7</b>	<b>5.2</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

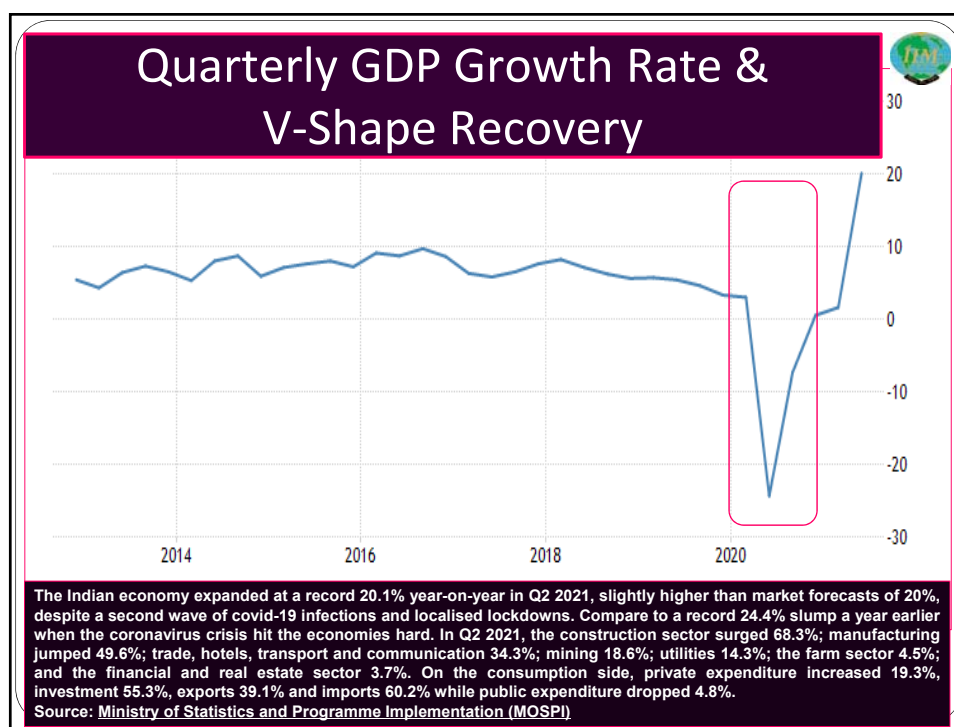
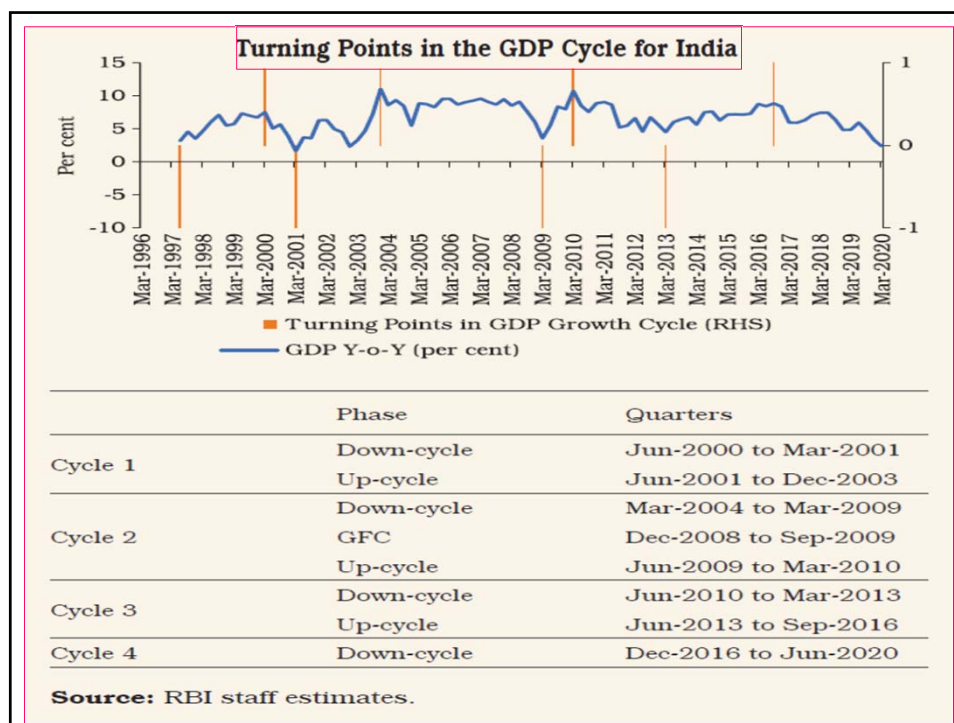
Source: NSO and RBI staff calculations.

## AS Side: Real GVA Growth



Sectors	Growth (per cent)					Contribution to Growth (per cent)				
	2008-09	2009-11	2011-14	2014-18	2018-20	2008-09	2009-11	2011-14	2014-18	2018-20
1	2	3	4	5	6	7	8	9	10	11
<b>I. Agriculture, Forestry and Fishing</b>	<b>-0.2</b>	<b>4.0</b>	<b>4.5</b>	<b>3.3</b>	<b>3.2</b>	<b>-1.2</b>	<b>8.7</b>	<b>14.6</b>	<b>6.9</b>	<b>10.6</b>
<b>II. Industry</b>	<b>3.4</b>	<b>9.1</b>	<b>2.9</b>	<b>8.8</b>	<b>2.6</b>	<b>18.6</b>	<b>29.2</b>	<b>11.8</b>	<b>26.8</b>	<b>11.1</b>
2. Mining and Quarrying	-2.5	9.7	-5.6	8.7	-1.4	-2.4	5.0	-4.4	3.4	-0.4
3. Manufacturing	4.7	9.3	4.5	8.9	2.9	18.5	22.2	14.1	20.9	8.7
4. Electricity, Gas, Water Supply and Other Utility Services	4.9	6.5	5.1	8.3	6.2	2.5	2.0	2.1	2.5	2.8
<b>III. Services</b>	<b>6.4</b>	<b>8.0</b>	<b>7.0</b>	<b>8.1</b>	<b>6.3</b>	<b>82.6</b>	<b>62.1</b>	<b>73.6</b>	<b>66.3</b>	<b>78.3</b>
5. Construction	5.6	6.4	5.4	4.7	3.7	11.6	7.9	9.0	5.3	5.3
6. Trade, Hotels, Transport, Communication and Services related to Broadcasting	2.4	9.0	7.5	8.7	5.7	9.6	19.8	24.0	22.0	21.3
7. Financial, Real Estate and Professional Services	5.2	5.6	8.5	8.7	5.7	23.5	15.0	28.8	24.9	25.1
8. Public Administration, Defence and Other Services	15.8	11.8	5.1	8.4	9.7	37.8	19.4	11.7	14.1	26.6
<b>IV. GVA at basic prices</b>	<b>4.3</b>	<b>7.4</b>	<b>5.6</b>	<b>7.4</b>	<b>5.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Source: NSO and RBI staff calculations.



## Consumer & Business Confidence Survey



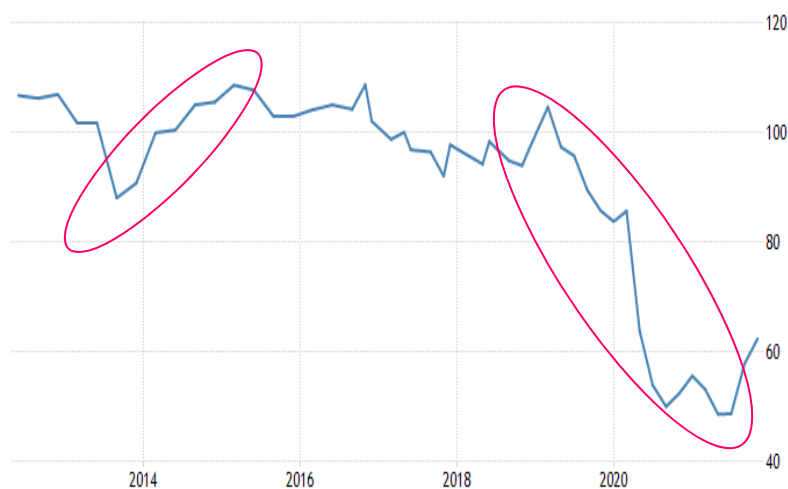
### 1. Current Situation Index (CSI)

- ☛ consumers' perceptions & expectations
- ☛ covering 6 metropolitan cities & 5000 households
  1. employment scenario; 2. price situation; & 3. their own income & spending

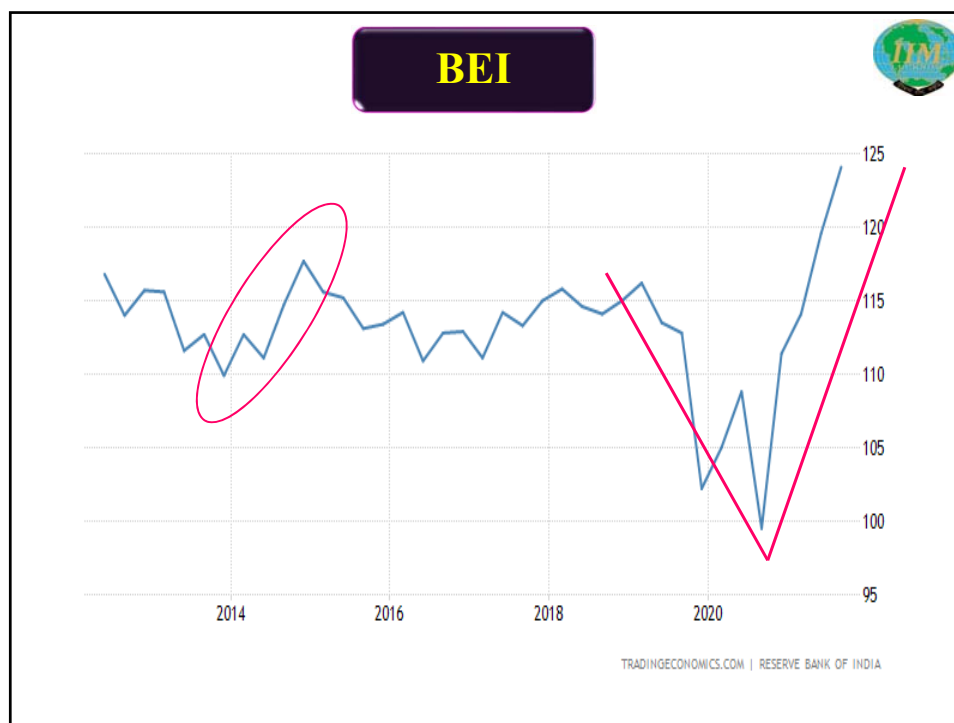
### 2. Business Expectations Index (BEI)

- ☛ weighted (share of GVA of different industry group) net response of nine business indicators:
  - ☛ (1) overall business situation; (2) production; (3) order books; (4) inventory of raw material; (5) inventory of finished goods; (6) profit margins; (7) employment; (8) exports; and (9) capacity utilisation.

## Current Situation Index (Consumer confidence)



TRADINGECONOMICS.COM | RESERVE BANK OF INDIA

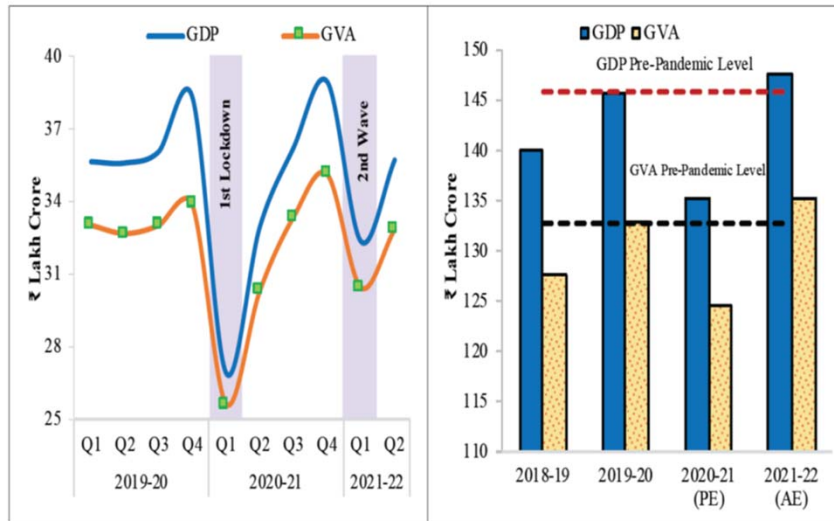


**CSI**

Summary based on Net Responses						
Main Variables	Current Perception compared with one-year ago			One year ahead Expectations compared with current situation		
	Jan-21	Mar-21	Change	Jan-21	Mar-21	Change
Economic Situation	-57.9	-63.9	↓	21.3	5.3	↓
Employment	-62.3	-62.4	↓	26.7	10.7	↓
Price Level	-86.9	-92.6	↓	-63.5	-64.4	↓
Income	-51.0	-53.7	↓	41.4	33.4	↓
Spending	35.5	38.2	↑	59.6	59.3	↓
<b>Consumer Confidence Index</b>	<b>55.5</b>	<b>53.1</b>	<b>↓</b>	<b>117.1</b>	<b>108.8</b>	<b>↓</b>
↑ Positive Sentiments with sign of improvement compared to last round				↑ Negative Sentiments with sign of improvement compared to last round		
↓ Positive Sentiments with sign of deterioration compared to last round				↓ Negative Sentiments with sign of deterioration compared to last round		
↔ Positive Sentiments with no change compared to last round				↔ Negative Sentiments with no change compared to last round		



Figure 1: Gross Domestic Output (Constant Prices, Base Year:2011-12)



Source: National Accounts Statistics (NSO), MoSPI

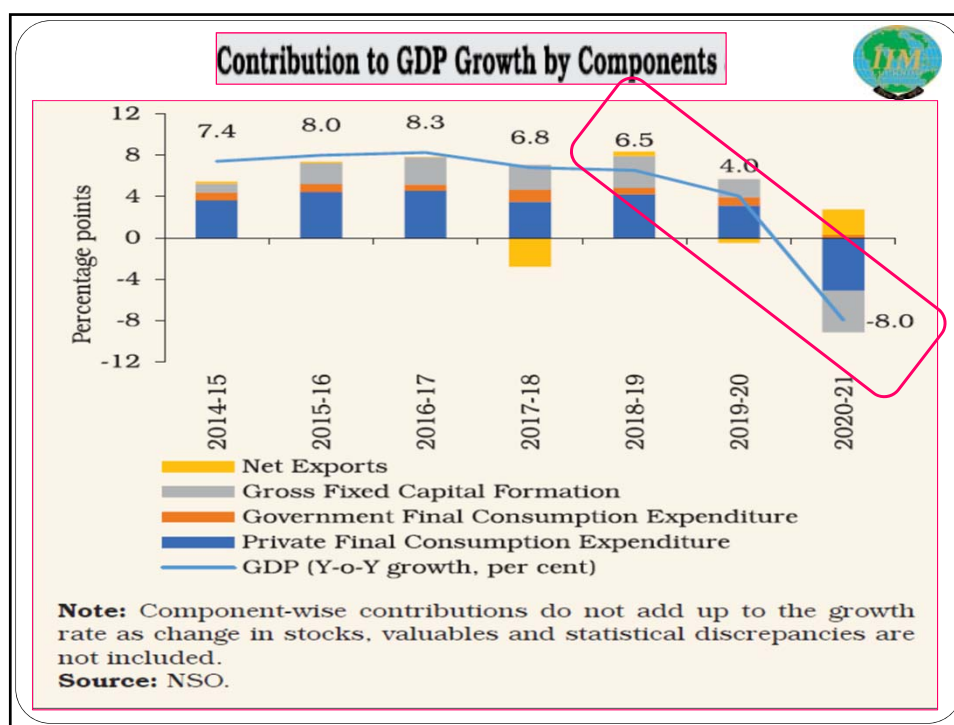
## AD Side: Underlying Drivers of Growth



(Per cent)

Component	2016-17	2017-18	2018-19	2019-20	2020-21
1	2	3	4	5	6
<b>I. Total Consumption Expenditure</b>	<b>7.8</b>	<b>7.1</b>	<b>7.4</b>	<b>5.9</b>	<b>-7.1</b>
Private	8.1	6.2	7.6	5.5	-9.0
Government	6.1	11.9	6.3	7.9	2.9
<b>II. Gross Capital Formation</b>	<b>3.7</b>	<b>10.8</b>	<b>9.7</b>	<b>2.3</b>	<b>-12.9</b>
Fixed Investment	8.5	7.8	9.9	5.4	-12.4
Change in Stocks	-48.8	68.3	27.2	-39.7	-3.5
Valuables	-18.6	40.2	-9.7	-14.2	-38.0
<b>III. Net Exports</b>					
Exports	5.0	4.6	12.3	-3.3	-8.1
Imports	4.4	17.4	8.6	-0.8	-17.6
<b>IV. GDP</b>	<b>8.3</b>	<b>6.8</b>	<b>6.5</b>	<b>4.0</b>	<b>-8.0</b>

Source: NSO.



### AS Side: Real GVA Growth

**Table 1: Annual Growth of GVA at constant (2011-12) prices (per cent)**

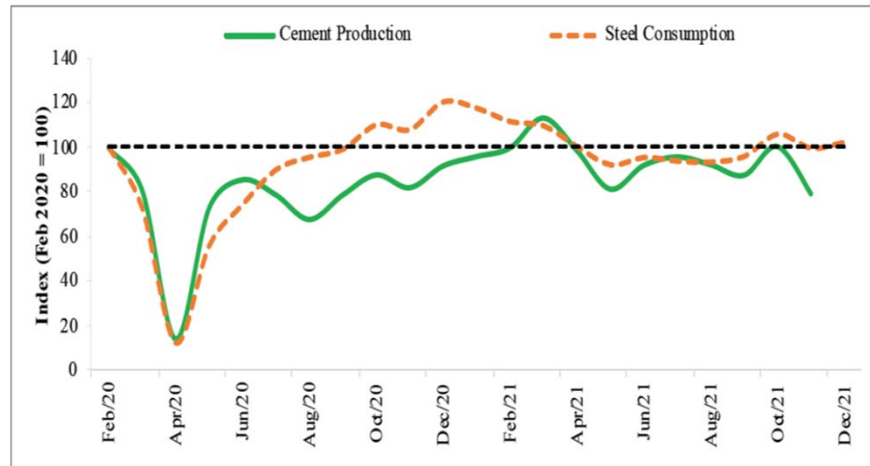
Sectors	2019-20 (1st RE)	2020-21 (PE)	2021-22 (1st AE)	Recovery over 2019-20
Agriculture & Allied Sectors	4.3	3.6	3.9	107.7
Industry	-1.2	-7.0	11.8	104.1
Mining & quarrying	-2.5	-8.5	14.3	104.6
Manufacturing	-2.4	-7.2	12.5	104.4
Electricity, gas, water supply & other utility services	2.1	1.9	8.5	110.5
Construction	1.0	8.6	10.7	101.2
<b>Services</b>	<b>7.2</b>	<b>-8.4</b>	<b>8.2</b>	<b>99.2</b>
Trade, hotels, transport, communication and services related to broadcasting	6.4	-18.2	11.9	91.5
Financial, real estate & professional services	7.3	-1.5	4.0	102.5
Public administration, defence and Other Services	8.3	-4.6	10.7	105.6
<b>GVA at basic price</b>	<b>4.1</b>	<b>-6.2</b>	<b>8.6</b>	<b>101.9</b>

Source: NSO  
Note: RE - Revised Estimates, PE - Provisional Estimates, AE - Advance Estimates

## Indicators of Demand

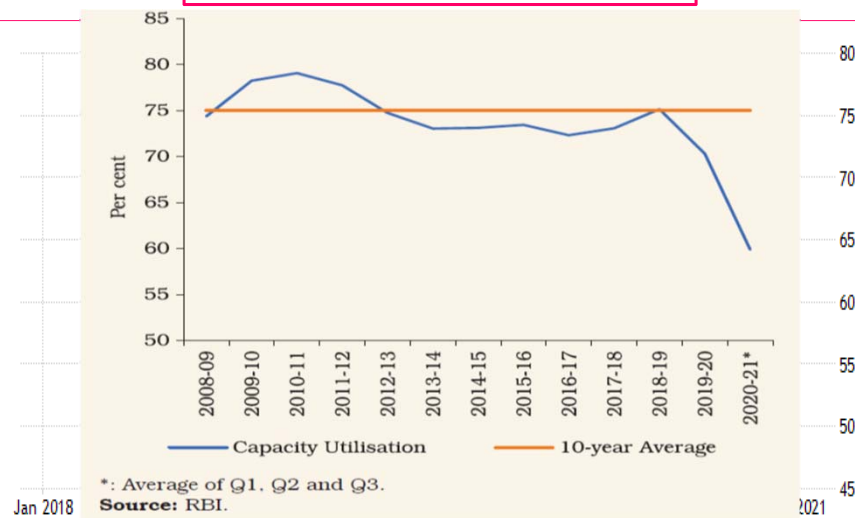


Figure 9: Construction Sector Indicators



Source: Joint Plant Committee; and O/o Economic Advisor, DPIIT

## Capacity Utilisation



SOURCE: TRADINGECONOMICS.COM | RESERVE BANK OF INDIA



## Indian Economic Slowdown



### ☛ Is it a Cyclical or Structural Slowdown?

- structural downturn: decline in potential ( $Y^*$ ) growth
- average output gap ( $Y - Y^*$ ): -0.24% for 2012-19
- “Equilibrium Growth” Recession!

### ☛ Is it a AD-led or AS-led Slowdown?

- Demand-led GDP growth slowdown from 8.2% to 4.7% between Q4 2017/18 to Q3 2019/20
- Fall in PFCE (C) from 8.1% to 5.8%
- Fall in GFCF (I) from 13.5% to -5.15%
- Manufacturing: 10.1% to -0.2%
- Construction: 13.7% to 0.3%
- Unemployment increased 3.37% to 7.6% (2017-19)
- For last 7 quarters, economy is operating below  $Y^*$
- GoI position was: Supplied-led & Cyclical!!

## Analyzing COVID 19 Impact



1. A Survey of Indian Economy
  - Aggregate Demand-led Secular Slowdown
2. COVID 19:
  - Transmission Mechanism & Disruption
  - Supply Chain, Production & Consumption
  - Lockdown & Near-Term Impact
  - MSME: Growth & Income Distribution
3. Monetary and Fiscal Stimulus Packages
  - **Content, Usefulness & Critique**
4. Covid 19 Crisis
  - An Opportunity to Reinvent or Missed Opportunity!
  - Can India Benefit from FDI Moving Away from China
  - Impending Uncertainty and Road Ahead

## Why the AD Curve Might Shift??



1. **Changes in Consumption (C)  $\Rightarrow$  ( $Y^D$ )**
  - confidence/sentiment/ tax policies
2. **Changes in Investment (I)**
  - money supply (credit) & price of credit (i)
  - tax policies
  - macroeconomic uncertainty
    - growth expectations
3. **Changes in Government Expenditure (G)**
  - policy decision/policy environment
4. **Changes in Net Exports (NX)**
  - world economy business cycles

## COVID 19 Disruption



- ☛ **Money or Income loss**
  - we use Money from producing what we individually produce to exchange for what we need
  - Income is earned from work that is done outside our home – Economic Activity
  - payment to housemaid:
    - exchange our labour for their labour
- ☛ **Lockdown**
  - only essential prodn. is allowed
  - geographically dispersed prodn. needs movement to serve consumers
  - needs finance, trade & transportation
    1. Global Supply Chains affected country's X & M
    2. Global Prodn. affected

## COVID 19 Disruption



### ☛ Manufacturing

- JIT inventory management – working capital (WC) (borrowings) – holding minimum inventories
- supply disruptions stall prodn. in entire supply chain

### ☛ Lockdown Effect

- workers & capital exist but prodn. stops
- WC: to pay for raw materials/inputs/wages to workers
- sales stop – revenue loss - default payments – NPAs
- big businesses recourse to “retained savings”
- MSMEs: savings used for consumption
- WC a form of investment required for prodn./restart
- so, if I & prodn. goes down – Y, C & S goes down
- since sales decline – W & P goes down
- Hence, AD

## COVID 19 Disruption

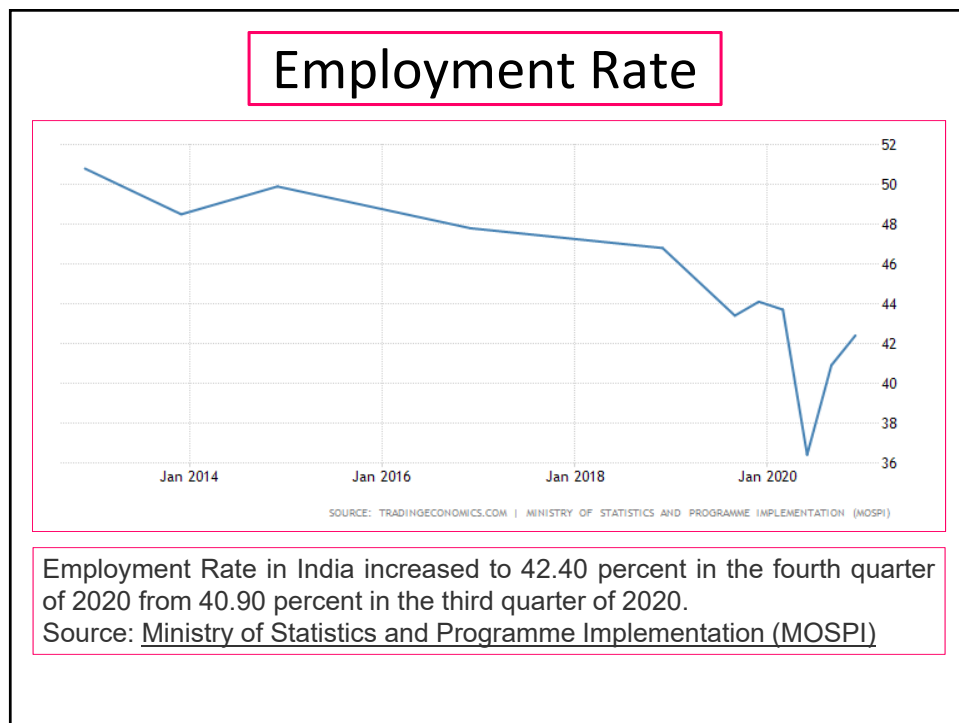
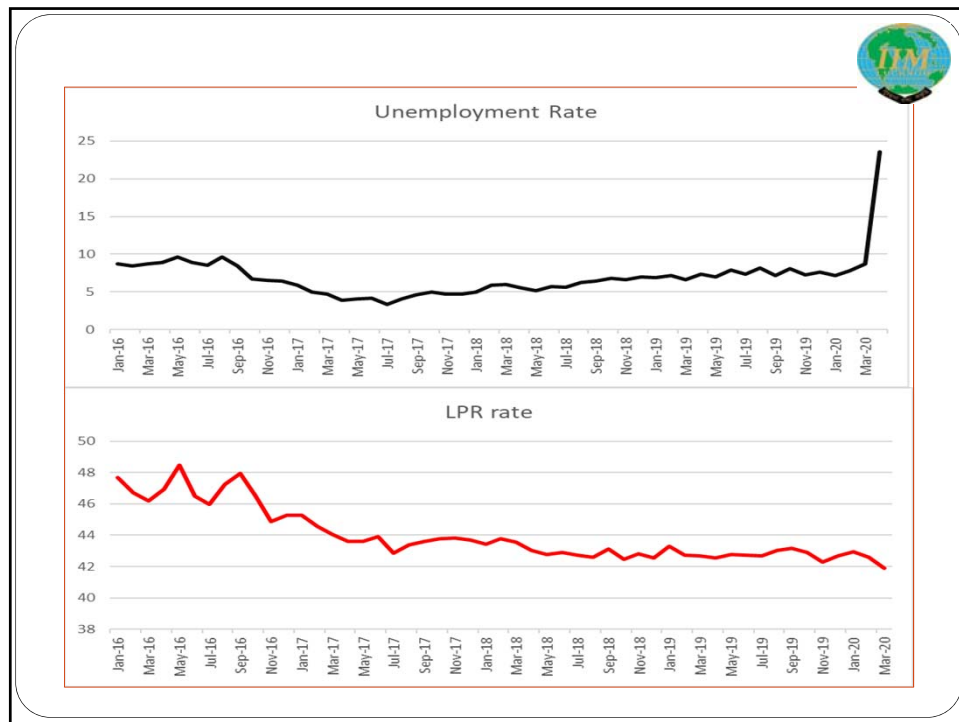


### ☛ MSME

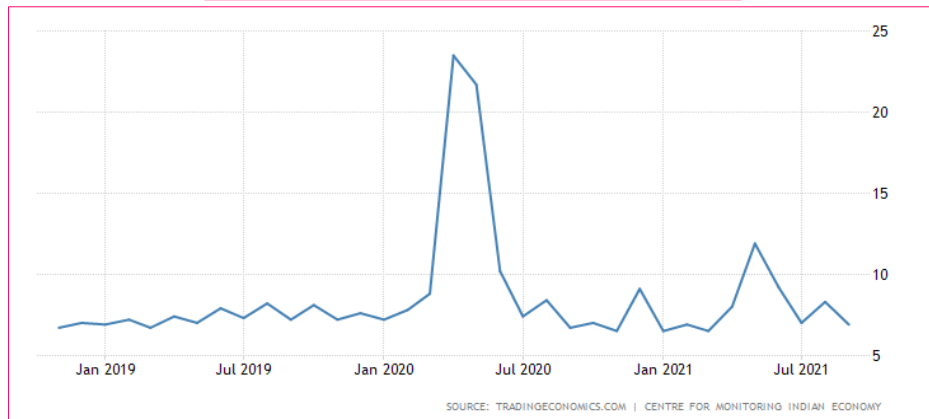
- use S for C in lockdown, Bank Deposits falls
- since prodn. & I declines – Credit Demand falls
- RBI (CB) effort to boost economy through monetary stimulus – Repo cut alone is unsuccessful
- Banks are parking funds with RBI at low Rev-Repo
- informal/migrant workers lost livelihoods - Y & C falls

### ☛ Business Failures

- highly leveraged firms debt default
- financial firms/NBFCs first ones to fail
- 3 month moratorium on interest payment may not be sufficient for prodn. revival due to uncertainty
- firmers may sell at distress P but traders profit from consumers

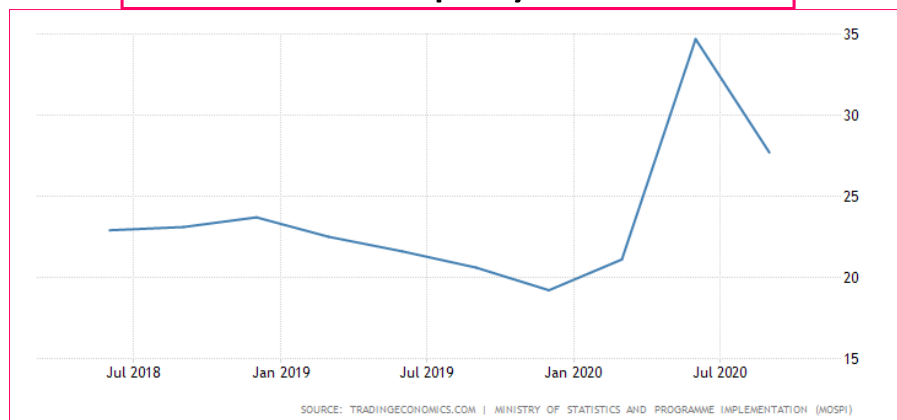


## Unemployment Rate



Unemployment Rate in India decreased to 6.90 percent in September from 8.30 percent in August of 2021. In India, the unemployment rate is estimated by directly interviewing a large sample of randomly selected households. Centre for Monitoring Indian Economy Consumer Pyramids panel of households includes over 174,405 households including over 522,000 members who are over 15 years old.

## Youth Unemployment Rate



Youth Unemployment Rate in India decreased to 27.70 percent in the third quarter of 2020 from 34.70 percent in the second quarter of 2020. Source: [MOSPI](#)

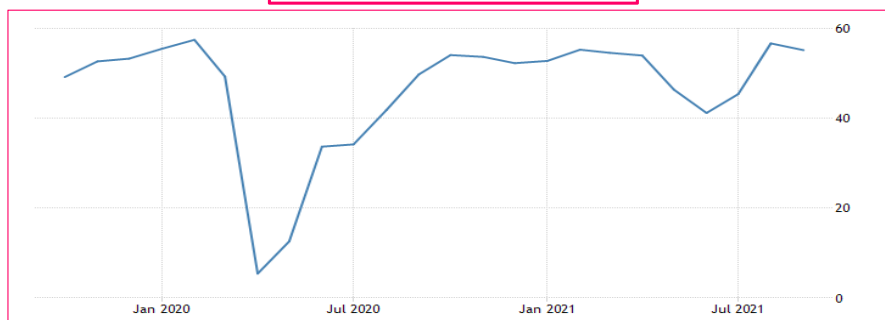
Youth unemployment rate in India refers to unemployment rate for persons ages 15 to 29 in urban areas.

## Manufacturing PMI



**India Manufacturing Growth Beats Forecasts:** The IHS Markit India Manufacturing PMI increased to 53.7 in September 2021 from 52.3 a month earlier and above market consensus of 51.8, indicating a stronger expansion in overall business conditions across the sector. Both output and new orders expanded at a faster rate, amid the easing of COVID-19 restrictions. Meanwhile, new export orders increased at a faster pace, though one that was modest overall. At the same time, employment little-changed, as many firms reported the compliance of government guidelines surrounding shift work. Prices data showed input cost inflation accelerated to a five-month high, due to a faster rise in fuel, raw material and transportation prices. Output prices, however, increased at a slower and only moderate rate. Lastly, business confidence improved.

## Services PMI



**The IHS Markit India Services PMI** declined to 55.2 in September of 2021 from August's 18-month high of 56.7, and below market expectations of 57. The reading pointed to the second straight of expansion in the sector, amid the easing of COVID-19 restrictions. Output continued to grow, while new orders expanded, with the rate of expansion was marked and the second-fastest since February 2020. Meanwhile, employment increased for the first time in 10 months, but was marginal overall, with the pace of backlog depletion eased and was only slight. On the price front, input price inflation eased to an eight-month low. As a result, output price inflation slowed and was negligible by historical standards. Looking ahead, business sentiment weakened amid worries inflationary pressures

The IHS Markit India Services PMI (Purchasing Managers' Index) is based on data compiled from monthly replies to questionnaires sent to purchasing executives in around 350 private service sector companies. The index tracks variables such as sales, employment, inventories and prices. A reading above 50 indicates that the services sector is generally expanding; below 50 indicates that it is generally declining.

## Indian Economy Slowdown



The investment rate declined in 2012-13 and 2019-20

- slackening corporate investment rate
- weak domestic and external demand

### 1. Structural Reasons:

- Jobless(ness) Growth
- Rural Wage Stagnation
- Weak Business Confidence

### 2. Global Turbulence

- Geopolitical Uncertainty
- Brexit & Trump's Protectionist Policy

### 3. Policy Disruptions: Demonetization, GST & Covid 19

## The EXCHANGE Rate



### 👍 Prices in Different Currencies

☞ Exchange Rate –  $e = D^C/F^C$

*units of domestic currency required to purchase  
one unit of foreign currency*

*or*

*domestic price of foreign currency*

### 👍 Forex Market

☞ Generic term for worldwide institutions for trading different currencies

## Exchange Rate in the Long Run



### ☞ Relative Purchasing Power of Currency (PPP)

- ☞ A unit of currency can buy same basket of goods

### ☞ Real Exchange Rate

- ☞  $R = e * P^f / p$
- ☞  $p^f$  = foreign price,  $p$  = domestic price
- ☞  $e$  = Rupee price of  $F^C$
- ☞  $R = 1 \Rightarrow$  currencies are at PPP
- ☞  $R$  = Trade Competitiveness Index
  - ☞ or Real Exchange Rate

## Four Most Important Lessons of Macroeconomics



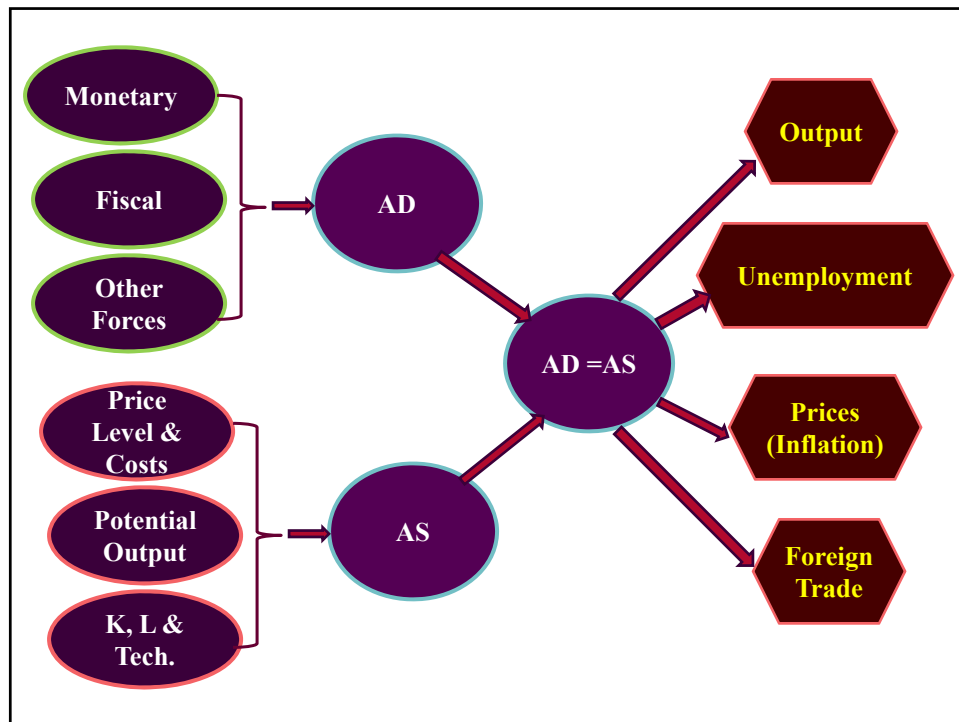
### ✓ **Long-Run Analysis**

- ✓ *Country's capacity to produce goods & services determines the standard of living of its citizens*
- ✓ *Rate of money growth determines the rate of inflation, but does not affect the rate of unemployment*

### ✓ **Short-Run Analysis**

- ✓ *Aggregate Demand influences the amount of goods & services that a country produces*
- ✓ *Policymakers who control monetary & fiscal policy face a tradeoff between inflation & unemployment*





## *Random Reflections* **LOGOTHERAPY**



*Man's Search For Meaning*  
*The Classic Tribute to Hope from the Holocaust*  
by VIKTOR FRANKL