Will India's Modi manage to stabilize the country's currency and economy?

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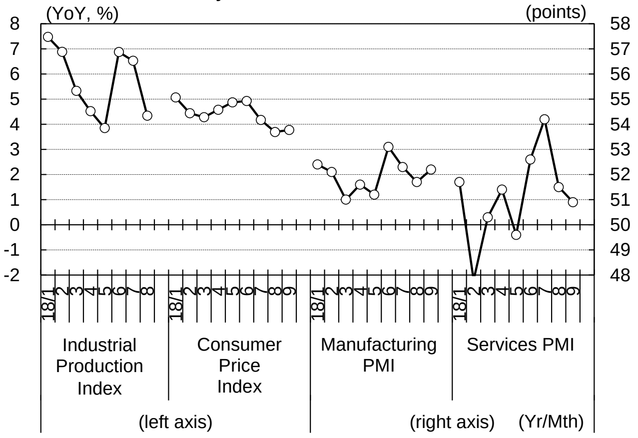
India's Narendra Modi administration is facing a crucial moment in implementing economic policy management. On the economic growth front, the country's real GDP growth accelerated to +8.2% YoY in Apr-Jun and the monthly economic indicators such as production and business sentiment suggest that the economy remains resilient (see chart 1). On another front, there have been growing concerns from abroad towards the economy as it is running high current account deficits amid increasing downward pressure on currencies in emerging markets in general associated with intensifying US-China trade conflict and rising interest rates in the US, and the rupee has lost over 10% against the dollar so far this year, the biggest decline among the major Asian currencies (see chart 2). In reaction to weakening rupee, the government announced in mid-September the measures to encourage capital inflows such as easing overseas borrowing norms for corporates and relaxing rules on issuing bonds for overseas investors, and to curb imports (by raising import duties on non-essential items).

The consistency of Modi administration's overall economic policy, however, needs to be watched. First of all, the items subject to the previously cited hike in import duty make up only around 3% of total imports. Meanwhile, the government decided in July to implement measures to stimulate domestic demand such as reducing goods and services tax (GST), which are not consistent with the measure to curb imports aiming to stabilize its currency. Furthermore, the government decided in July to substantially raise the crop purchase price which could stoke inflation that currently remains around median value of the target band (around +4% YoY), and accelerate the currency depreciation. The acceleration of inflation rate could discourage an expansion of solid domestic demand through accelerating the pace of rate hike by the Reserve Bank of India (RBI) going forward. It could also go against banks' resolution of non-performing assets (NPAs) which is one of the government's top priority issues. The gross NPA ratio of the Indian banks was 11.6% in March 2018, remaining high level. There are a large amount of NPAs remaining mainly in infrastructure (transportation and power) and steel sectors on the back of delay in land seizure and obtaining licenses, in addition to deceleration of growth, after the investment boom in the mid-2000s (see note). Ahead of a general election in April 2019, it will be important to keep an eye on Modi administration's ability to implement the policy management in number of areas such as stabilizing currency value, maintaining solid economic expansion, and clearing away NPAs.

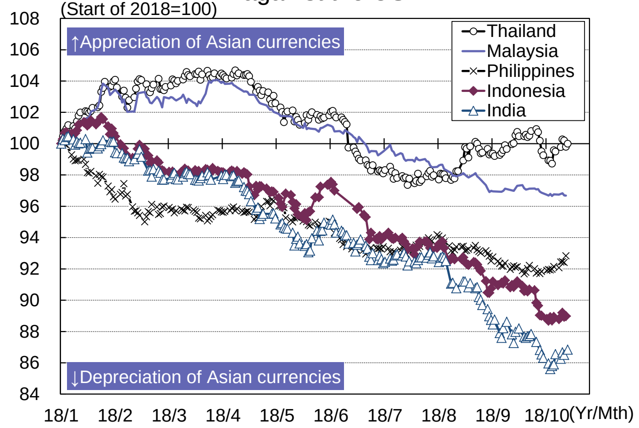
Note: the government aims to speed up the procedures for failure resolution based on The Insolvency and Bankruptcy Code, 2016 and promote the recapitalization of public sector banks (PSBs).

Chart 1: Major economic indicators in India



Source: Reserve Bank of India (RBI), Bloomberg, MUFG Bank Economic Research Office

Chart 2: Exchange rate of major Asian currencies against the USD



Source: Bloomberg, MUFG Bank Economic Research Office

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