"Emerging Issues on the Road Map for a 5 Trillion Economy in India"

T.P.KALAVATHY
B.COM (ACCOUNTING & FINANCE)
SHRI KRISHNASWAMY COLEGE FOR WOMEN
CHENNAI 40
kalawathykeshavan@gmail.com

ABSTRACT

Economic growth in India has been moderately high at 7.8% in recent past, now expected to grow at 8.75% (IMF estimates). For this growth to be sustainable, the demand for infrastructure needs to be adequately fulfilled. The importance of capital markets cannot be under-emphasised for a developing economy like India which needs significant amount of capital for development of strong infrastructure.

Capital markets in any country play a pivotal role in the growth of economy and meeting the country's socio-economic goals. They are an important constituent of the financial system given their role in the financial intermediation process and capital formation of the country. The report aims to provide an outline of global stock markets and its contribution to GDP

Currently, India spends only 6% of its GDP on provision of infrastructure, as compared to China which spends as much as 20% on infrastructure development, which would remain as key catalyst to this research

The report includes the recent trends of investments in Indian Stock Market detailing Domestic Institutional Investors, Foreign Institutional Investors, promoters and of course the common public and also suggest measures to ensure a more safer and secured base for investments, thereby mitigating frequent flight of capital. The report aims to assess the trends of Savings amongst Household and its potential to drive the Indian capital market

Conclusively, it is estimated that India will require capital flows of USD 500 billion merely for developing its infrastructure. The Indian economy's was sized at USD 1 trillion in 2009-2010 with the savings rate of Indian households of 33.4% in 2009 -2010. In the current decade or so, it is expected that the economy will grow at an average rate of 8%.

This report would broadly analyse the periodic changes in regulatory framework of current Indian Capital Markets, their constituents and the impetus required, to take the capital markets to the next level. This suggestive framework would remain as the key catalyst to India's USD 5Trillion roadmap.

Economic Growth and Savings Habit

Every modern economy is based on a sound financial system which helps in production, capital and economic growth by encouraging savings habits, mobilising savings from households and other segments and allocating savings into productive usage such as trade, commerce, manufacture etc.

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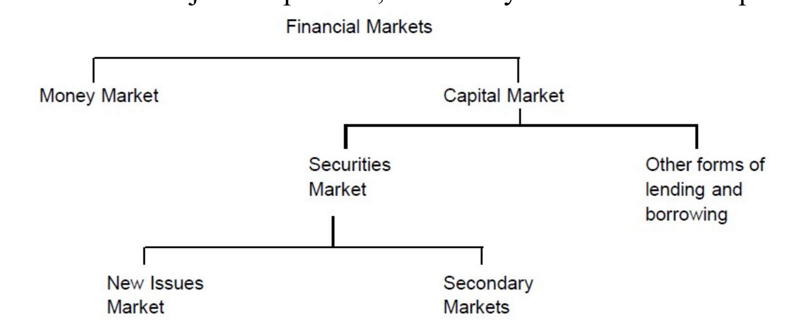
Private Investment as Driver of Growth

Investment, especially private investment, is the “key driver” that drives demand, creates capacity, increases labour productivity, introduces new technology, allows creative destruction, and generates jobs. Exports must form an integral part of the growth model because higher savings preclude domestic consumption as the driver of final demand. Similarly, job creation is driven by this virtuous cycle. While the claim is often made that investment displaces jobs, this remains true only when viewed within the silo of a specific activity. When examined across the entire value chain, capital investment fosters job creation as the production of capital goods, research & development and supply chains generate jobs.

Long term growth of financial system is ensured through:
(a) Education of investors
(b) Giving autonomy to FIs to become efficient under competition
(c) Consolidation through mergers
(d) Facilitating entry of new institutions to add depth to the market
(e) Minimising regulatory measures and market segmentation.

Capital Market as Component of Financial Markets

The financial markets have two major components; the money market and the capital market



The Capital Market comprises the complex of institutions and mechanisms through which intermediate term funds and long term funds are pooled and made available to business, government and individuals. The capital market and in particular the stock exchange is referred to as the barometer of the economy. Government’s policy is periodically reviewed so that creation of wealth through products and services is sustained and thereby surpluses and profits are channelised into productive uses through capital market operations. Reasonable opportunities and protection are afforded by the Government through special measures in the capital market to get new investments from the public and the Institutions and to ensure their liquidity.

The upsurge in performance of certain large companies and the astounding increase of their share prices boost the market sentiment to divert the savings more and more into equity investments in companies. This lead to growth of equity cult among investors to contribute resources not only for companies but even for financial institutions and banks.

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Compelled Need for Capital Market to Drive GDP

Capital market plays an extremely important role in promoting and sustaining the growth of an economy.

– It provides an effective source of investment in the economy.

– It plays a critical role in mobilizing savings for investment in productive assets, with a view to enhancing a country's long-term growth prospects, and thus acts as a major catalyst in transforming the economy into a more efficient, innovative and competitive marketplace within the global arena.

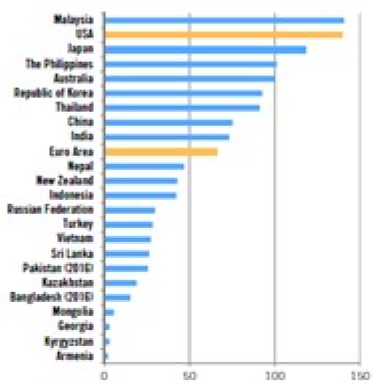
–liquid markets make it possible to obtain financing for capital-intensive projects with long gestation periods. This certainly held true during the industrial revolution in the 18th century and continues to apply even as we move towards the so-called "New Economy".

Table

: Stock Market Turnover Ratio (2015)

Countries	Stock Market Turnover Ratio (2015)
Kazakhstan	7.6
Sri Lanka	8.6
Philippines	16.1
Indonesia	21.2
Malaysia	29.1
Vietnam	36
India	50.9
Korea	149.8
Japan	113.8
World	162.9

Figure Stock market capitalization to GDP (% - 2015)



By issuing equity on capital markets, infrastructure companies tap financial resources and often use these resources in infrastructure projects. However, this is only possible if they have access to a developed stock market. Of the 53 countries in the Asia-Pacific region, 35 have a stock exchange though at different level of development.In addition, with the exceptions of a few countries, market capitalization is relatively limited in the region (see Figure).Furthermore the liquidity in the Asian equity markets tends to be low (see Table), which reduces their attractiveness for investors seeking the possibility of rapid exits at a stable price. Where stock markets are developed, infrastructure companies have typically been large issuers. For instance, it is estimated that listed infrastructure and utility companies represent around 5-6 per cent of the equity market universe globally.

Significance of Capital Markets in Indian Economy

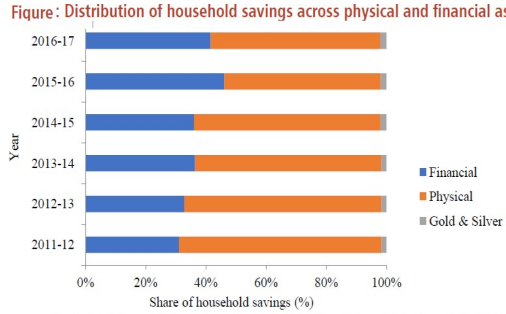
India is the largest democracy in the world and the second most populous nation, with nearly 1.35 billion people. It is the sixth-largest economy, with a GDP of $2.6 trillion in 2017. In purchasing power parity (PPP) terms, it ranks third behind the United States (US) and China. As one of the world's fastest-growing economies, with a current and projected annual GDP growth of nearly 7.5%, it is a critical engine of global economic growth.

India's economy has few unique structural strengths that enable robustness and allowed the economy to be relatively resilient to the vagaries of global economic patterns: – Domestic consumption driven economy: Nearly 60% of India's GDP is driven by domestic private consumption, as compared to 40% in China.

Hence Indian economy is fairly protected against external shocks and cyclic public investment. – Healthy savings: Compared to low personal saving rates in many developed countries in the west and east (6%-7% in the US, 9%-10% in Germany, 4% historically in UK, 2.5% in Japan), India's households have maintained a high savings share(Refer Figure) of their income at 22%. This is primarily due to lack of access to consumption or lack of social security nets.

As access to goods and essential services (e.g. healthcare) improves, these savings will continue to provide a buffer for further consumption. – Working age majority: With a median age of 28 years, India is a nation of young working-age persons who drive both income and consumption. It will continue to remain young up to 2030 with a median age of 31 years, compared to 40 years in the US and 42 years in China.

Figure: Distribution of household savings across physical and financial assets



Source: First Revised Estimates of National Income, Consumption Expenditure, Saving and Capital Formation for 2016-17, Central Statistics Office. January 2018

Size of Indian Stock Markets – 3rd Largest

Indian stock market is the world third largest stock market on the basis of investor base and has a collective pool of about 20 million investors. There are over 9,000 companies listed on the stock exchanges of the country. The Bombay Stock Exchange, established in 1875, is the oldest in Asia. National Stock Exchange is the largest and most advanced stock market in India is also the third biggest stock exchange in Asia in terms of transactions. It is among the 5 biggest stock exchanges in the world in terms of transactions volume.

Markets Capitalisation of Indian Capital Markets

Table Stock exchanges in the Asia region, as of end 2017

	Stock exchange	Legal status	Self-listing	Market capitalisation (USD billion)	Number of listed companies	Trading volume (USD billion)
Bangladesh	Dhaka SE	Private company	No	44	302	27
	Chittagong SE	Private company	No	42	270	2
China	Shanghai SE	State-owned	No	5 084	1 396	7 558
	Shenzhen SE	State-owned	No	3 618	2 089	9 167
Hong Kong (China)	Stock Exchange of Hong Kong	Joint Stock Company	Yes	4 351	2 118	1 959
India	National SE	Joint Stock Company	No	2 351	1 897	1 013
	Bombay SE	Joint Stock Company	No	2 332	5 616	149
Indonesia	Indonesia SE	Private company	No	521	566	94
Japan	Tokyo SE	Joint Stock Company	Yes	6 223	3 604	5 805
Korea	Korea Exchange	Joint Stock Company	No	1 772	2 134	1 601
Malaysia	Bursa Malaysia	Joint Stock Company	Yes	453	901	128
Mongolia	Mongolian SE	Self-regulatory organisation	No	1	218	0
Pakistan	Pakistan SE	Private company	Yes	78	559	12
Philippines	Philippine SE	Joint Stock Company	Yes	290	267	34
Singapore	Singapore Exchange	Joint Stock Company	Yes	787	750	213
Chinese Taipei	Taiwan SE	State-owned	No	1 073	924	773
	Taipei Exchange	State-owned	No	112	744	252
Thailand	Stock Exchange of Thailand	State-owned	No	549	688	326
Viet Nam	Ho Chi Minh SE	State-owned	No	115	344	38
	Hanoi SE	State-owned	No	10	385	7

Market capitalization is the measure of corporate size of a country. It shows the current stock price multiplied by the number of outstanding shares. It is commonly referred to as Market cap. It is calculated by multiplying the number of common shares with the current price of those shares. The table below shows the market capitalization of various stock markets in the world.

It can be observed that India occupies an important position in the world ranking of Market capitalization. This is in spite of having the third largest investor base, after Japan and USA and having the largest number of companies listed. United States leads the list of countries with the highest market capitalization. It is interesting to note that the

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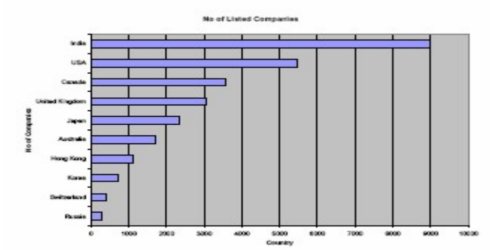
total market capitalization of all the companies listed on the New York Stock Exchange is greater than the amount of money in the United States.

Significance of Corporates in Indian Stock Markets

India has the highest number of companies listed in the stock market. After India, United States has the highest number of companies listed.



Market Regulation

It is important to ensure smooth working of capital market, as it is the arena for the players associated with the economic growth of the country. Various laws have been passed from time to time to meet this objective. The financial market in India was highly segmented until the initiation of reforms in 1992-93 on account of a variety of regulations and administered prices including barriers to entry. The reform process was initiated with the establishment of Securities and Exchange Board of India.

Stock Exchanges are Cross Border Centric

Exchanges are crossing national boundaries to extend their service areas and has led to cross-border integration. Exchanges offer cross-border trading to facilitate overseas investment options for investors. This not only increased the appeal of the exchange for investors but also attracts more volume. Exchanges regularly solicit companies outside their home territory and encourage them to list on their exchange and global competition has put pressure on corporations to seek capital outside their home country.

Risks Of Cross Border Linkages-Indian Stock Market

Presently, the fluctuations in the Indian market are attributed heavily to cross border capital flows in the form of FDI, FII and to reaction of Indian market to global market cues. In this context, understanding the relationship and influence of various exchanges on each other is very important. With the cross border movements of capital like never before in the form of FDI and FII, coupled with the easing of restrictions bringing various stock exchanges at par in terms of system and regulations, it can be assumed reasonably that a particular stock exchange will have some impact on other exchanges.

Relevance of IOSCO for Risk Mgt in Indian Capital Markets

IOSCO is recognized as the international standard setter for securities markets. Its membership regulates more than 95% of the world’s securities markets and it is the primary international cooperative forum for securities market regulatory agencies. IOSCO members are drawn from, and regulate, over 100 jurisdictions.

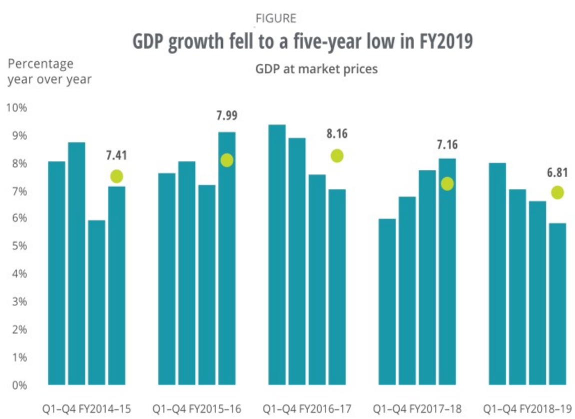
It facilitates cross-border cooperation, reducing global systemic risk, protecting investors and ensuring fair and efficient securities markets. The Securities and Exchange Board of India is also a signatory to IOSCO MMoU.

India's Economic Journey under New Ideology

During the last five years, India's economy has performed well. By opening up several pathways for trickle-down, the government has ensured that the benefits of growth and macroeconomic stability reach the bottom of the pyramid.

To achieve the objective of becoming a USD 5 trillion economy by 2024-25, as laid down by the Prime Minister, India needs to sustain a real GDP growth rate of 8%. International experience, especially from high-growth East Asian economies, suggests that such growth can only be sustained by a "virtuous cycle" of savings, investment and exports catalysed and supported by a favourable demographic phase.

As articulated by the Prime Minister, Shri. Narendra Modi, India aims to grow into a USD 5 trillion economy by 2024-25, making India the third-largest economy in the world. Given 4% inflation, as the Monetary Policy Framework specified by the Government for the Reserve Bank of India, real annual growth rate in GDP of 8 per cent is an immediate need.

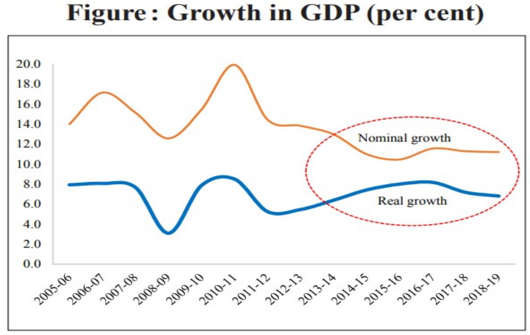


GDP growth for 2019-20 has been revised downwards from 7.0 per cent in the June policy to 6.9 per cent – in the range of 5.8-6.6 per cent for H1:2019-20 and 7.3-7.5 per cent for H2 – with some downside risks. GDP growth for Q1:2020-21 is projected at 7.4 per cent. The impact of monetary policy easing since February 2019 and favourable base effects are expected to support GDP growth, especially in the second half of the year.

India's Economic Trajectory – Quick Review

India will Steadily accelerate the gross domestic product (GDP) growth rate to achieve a target of about 8 per cent during 2018-23 (note that this target has been set to catalyse policy action and does not represent a forecast). This will raise the economy's size in real terms from USD 2.7 trillion in 2017-18 to nearly USD 4 trillion by 2022-23. Besides having rapid growth, which reaches 9-10 per cent by 2022-23, it

Figure : Growth in GDP (per cent)

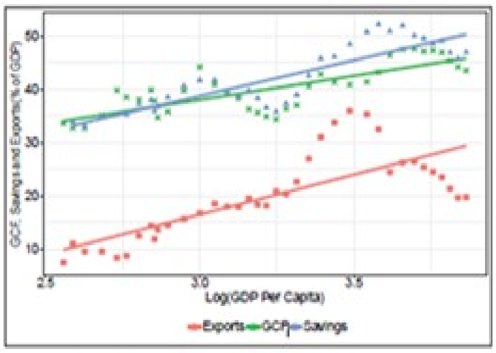


Data source: Central Statistics Office

is also necessary to ensure that growth is inclusive, sustained, clean and formalized. The investment rate should be raised from 29 per cent to 36 per cent of GDP which has been achieved in the past, by 2022-23

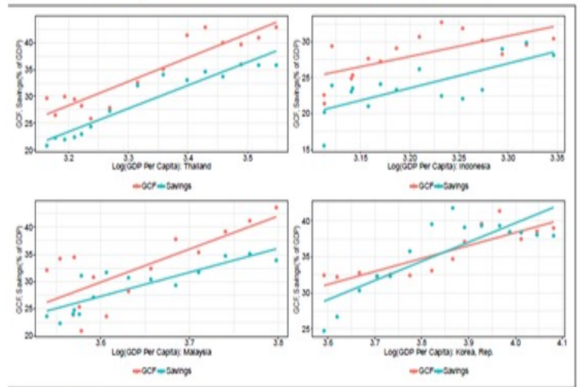
Figure belowshows how the share of GCF, savings and exports in GDP evolved for China

Figure : Share of GCF, Savings and Exports in GDP vs. log GDP Per Capita US$: China (1980-2017)



Source: World Bank

Figure : Share of GCF and Savings in GDP vs. log GDP Per Capita in constant 2010 US$: High Growth East Asian Economies ex-China (1980-1995)



Source: World Bank

As a function of the log of GDP per capita from 1980 to 2017. Crucially, we note that all the three macro-variables increased as the country became richer. Thus, as the economy started doing better, as measured by the rising GDP per capita, China's savings, investment and exports increased further.Figureshows the same relationships for saving and investment for four countries in East Asia (Thailand, Indonesia, Malaysia and South Korea), which witnessed high growth before the Asian Financial Crisis.

Ripple effect on India due to Sluggish Global Growth Outlook-IMF

Since the April 2019 World Economic Outlook (WEO), United States further increased tariffs on certain Chinese imports and China retaliated by raising tariffs on a subset of US imports. Global technology supply chains were threatened by the prospect of US sanctions, Brexit uncertainty continued, and geopolitical tensions roiled energy prices.

Against this backdrop, global growth is forecast at 3.2 percent in 2019, picking up to 3.5 percent in 2020 (0.1 percentage point lower than in the April WEO projections for both years). GDP releases so far this year, together with generally softening inflation, point to weaker-than anticipated global activity. Investment and demand for consumer durables have been subdued across advanced and emerging market economies as firms and households continue to hold back on long-term spending. Accordingly, global trade, which is intensive in machinery and consumer durables, remains sluggish. The projected growth pickup in 2020 is precarious, presuming stabilization in currently stressed emerging market and developing economies

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CONCLUSION

With rapidly growing assets under management marching towards a highly ambitious USD 5 Trillion Economy, India's institutional investors have the potential to play a critical role in infrastructure financing provided that governments develop viable pipelines of infrastructure projects. With Rural and urban Infrastructure constituting a pivotal role in the ambitious journey, animal spirit infusion into a mediocre Indian Capital Market is inevitable.

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