DEPUTY GOVERNOR OF THE RESERVE BANK OF INDIA ON THE CURRENT STATE OF THE ECONOMY

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On the eve of the implementation of India's national goods and services tax (GST), we had the pleasure of speaking with Viral Acharya, Deputy Governor of the Reserve Bank of India (RBI), and Ridham Desai, who oversees equity research at Morgan Stanley India. The conversation touched on a broad cross section of the Indian banking system and issues the RBI is focused on, and then on an investment angle of why Desai has a bullish outlook for India over the coming years: he thinks the market has the potential to triple within the next five years. In a future blog post, I will focus on the market implications, but below we focus on the first half of the conversation with Acharya.

Acharya touched on how his research has focused on banking, and how he is receiving the ultimate lessons and challenges in trying to apply the theory of his studies to practical implementation at the central bank.

The Current State of the Indian Economy

Today is an interesting stage in the development of India's economy, with a number of structural changes taking shape. The new GST is one big change for taxation; the solvency and bankruptcy code reforms should help develop the corporate bond market and alleviate stresses from banks' troubled loan books.

There is an overhang on the banking side of troubled loans that limit credit growth—and private investment has been disappointing for much of the last year. Reducing non-performing assets is a key goal for banks, particularly public-sector banks.

Acharya commented that reducing the debt levels of extended companies is an important piece to focus on. What we learned from the financial crisis was that providing liquidity and support to banks is not enough—these measures must come with markdowns on debt for the borrowers. He believes the new bankruptcy code will help this process, with the government also needing to do more work in this area.

Acharya wants to see structural and regulatory reforms continue so that when economic growth comes around, India is well-positioned to capitalize on it. He believes it is better to accept slower growth in the short run if it is going to lead to better long-run outcomes, and that temporary band-aid solutions are sub-optimal.

Acharya has studied a number of banking crises and believes that both the RBI and the Modi government are correct to focus on long-term structural reforms.

Global Pressures

India is tightly integrated with the global economy on trade and capital markets. The growth pickup in the developed world has supported India as its exports have increased with global trade. India has focused on the global nature of the economy with a combination of macroprudential constraints on capital flows. As a result, Acharya thinks India is well-positioned from inflation, growth and balance-sheet perspectives.

Bold Structural Reforms Come with Short-Term Hiccups

Acharya closed out the discussion by reminding everyone that if the GST was easy to implement, it would have been done a decade ago. If there are short-term disruptions, we should look past them with an understanding that it could take between six months and a year to adapt the system. He thinks this will help lead to better national brands in both goods and services—and that it will lead to better economic conditions for both consumers and businesses in the long run.

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Corporate Bonds : a debt security issued by a corporation.

Liquidity : The degree to which an asset or security can be bought or sold in the market without affecting the asset's price. Liquidity is characterized by a high level of trading activity. Assets that can be easily bought or sold are known as liquid asset.

Macroprudential Policy : an approach to financial regulation that is aimed at reducing the systemic risk to the financial system as a whole with a focus on elements such as capital and liquidity requirements. .