

The Lessons of China: Implications for India

Stephen S. Roach

Yale University

Morgan Stanley

Centre for Advanced Financial Research and Learning (CAFRAL)

Reserve Bank of India

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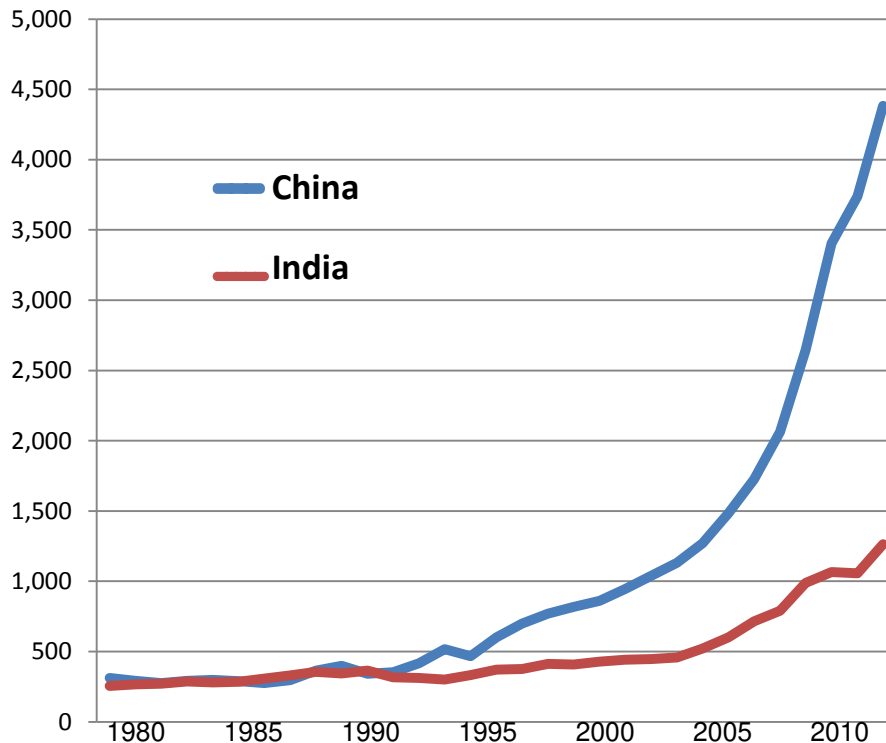
One Way to Put It



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Two Different Development Strategies

GDP Per Capita



Source: IMF

China: **Macro**

- High investment and saving
- Urbanization and infrastructure
- Foreign direct investment

India: **Micro**

- World-class companies
- High quality workforce
- Rule of law
- Democracy
- Financial deepening

Per Capita Caveats

	<u>1992 to 2001</u>	<u>2002-11</u>
Per capita real GDP growth		
China	9.3%	9.6%
India	3.8%	6.2%
Real GDP growth		
China	10.3%	9.9%
India	5.8%	7.2%
Population Growth		
China	1.0%	0.5%
India	1.9%	1.5%

Source: IMF

India vs. China: Macro Comparisons

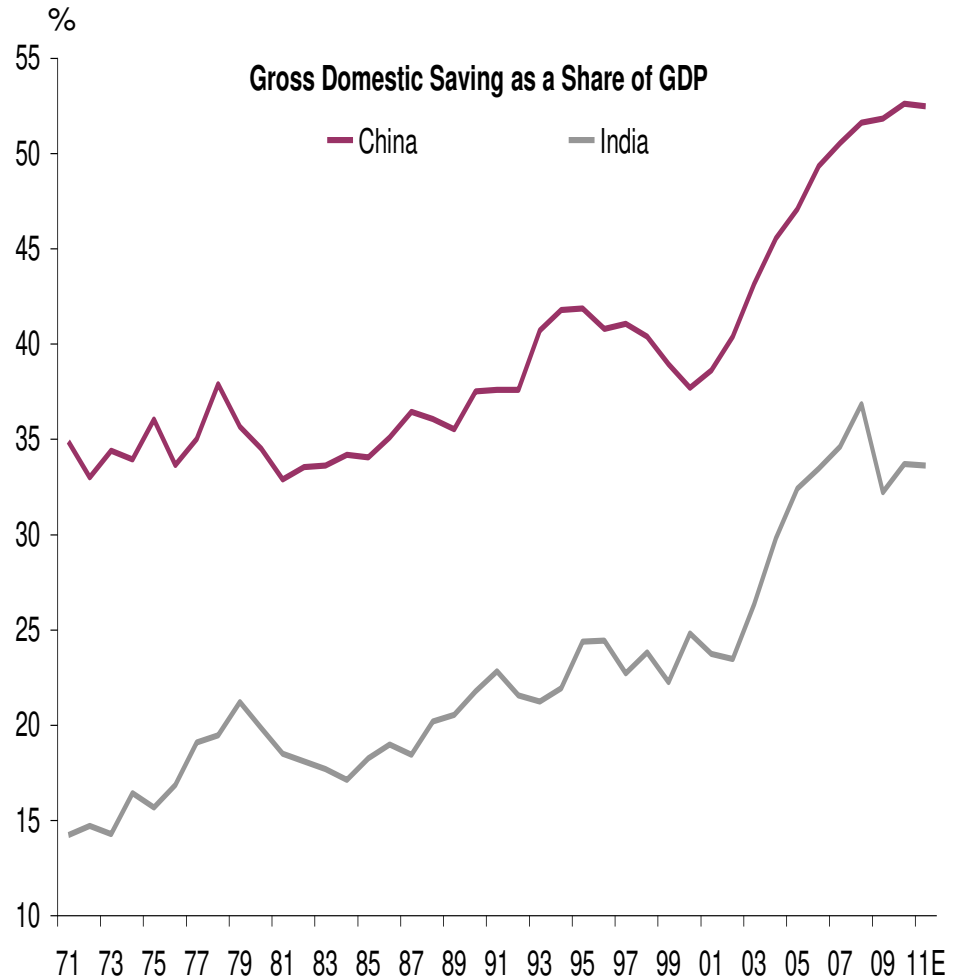
	India		China	
	<u>2000</u>	<u>2010</u>	<u>2000</u>	<u>2010</u>
<u>As % of GDP:</u>				
Domestic Saving	23.7%	33.6%	37.7%	52.6%
Current Account	-1.0	-3.2	1.7	5.2
Fiscal Balance	-9.5	-7.2	-2.5	-1.7
<u>Shares of GDP:</u>				
Investment	24.1%	37.6%	35.3%	48.6%
Consumption	63.9	58.3	46.4	33.8
Exports	13.2	21.9	20.9	25.6
<u>In Dollars (billions):</u>				
FX Reserves	40	297	166	2,847
FDI Inflows	4	25	41	106

Source: National and IMF data

Saving Holds the Key

Saving and *early-stage* development

- Funds capacity expansion
- Enables export-led growth
- Fuels infrastructure spending
- Facilitates massive urbanization

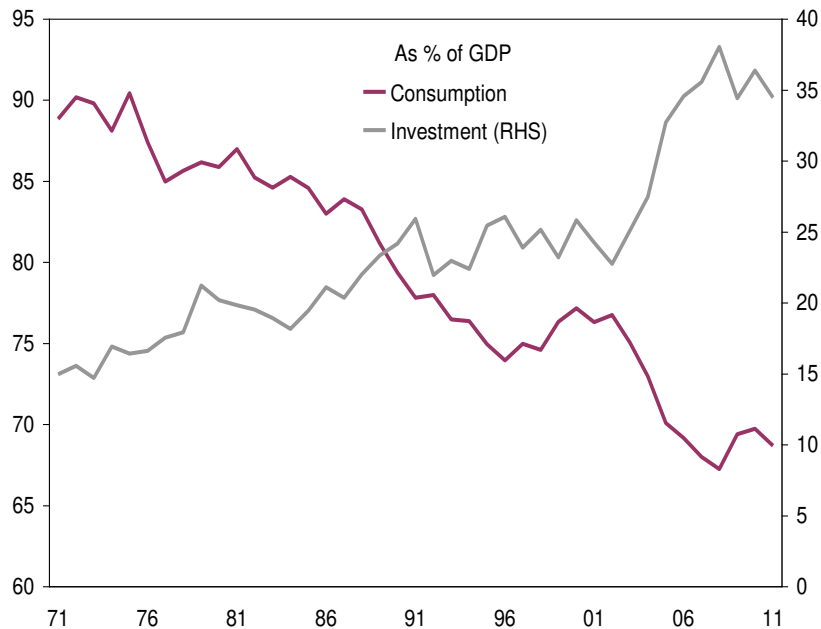


Source: CEIC, Morgan Stanley Research

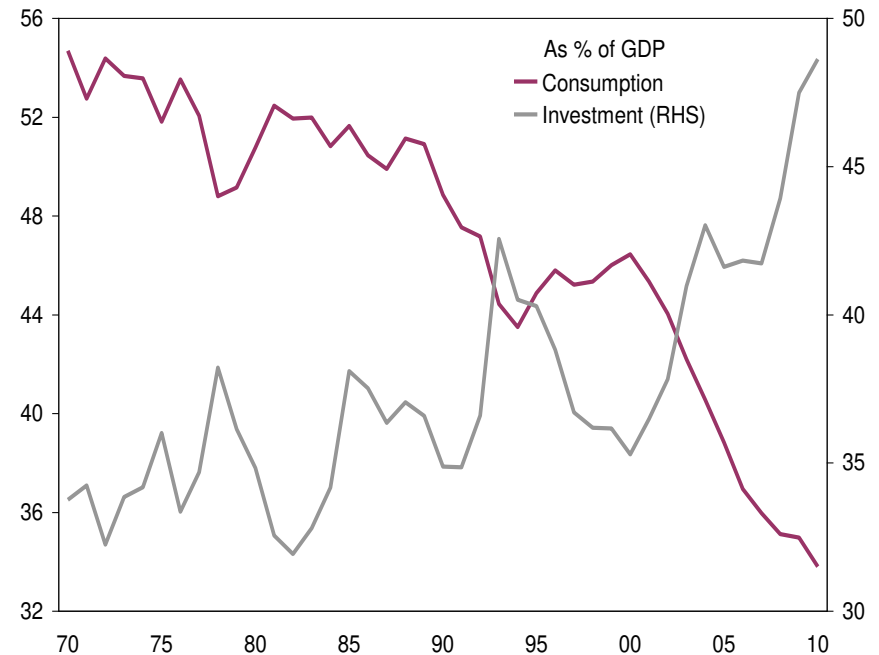
Saving and Macro Imbalances

Consumption vs. Investment

India: Low Saver



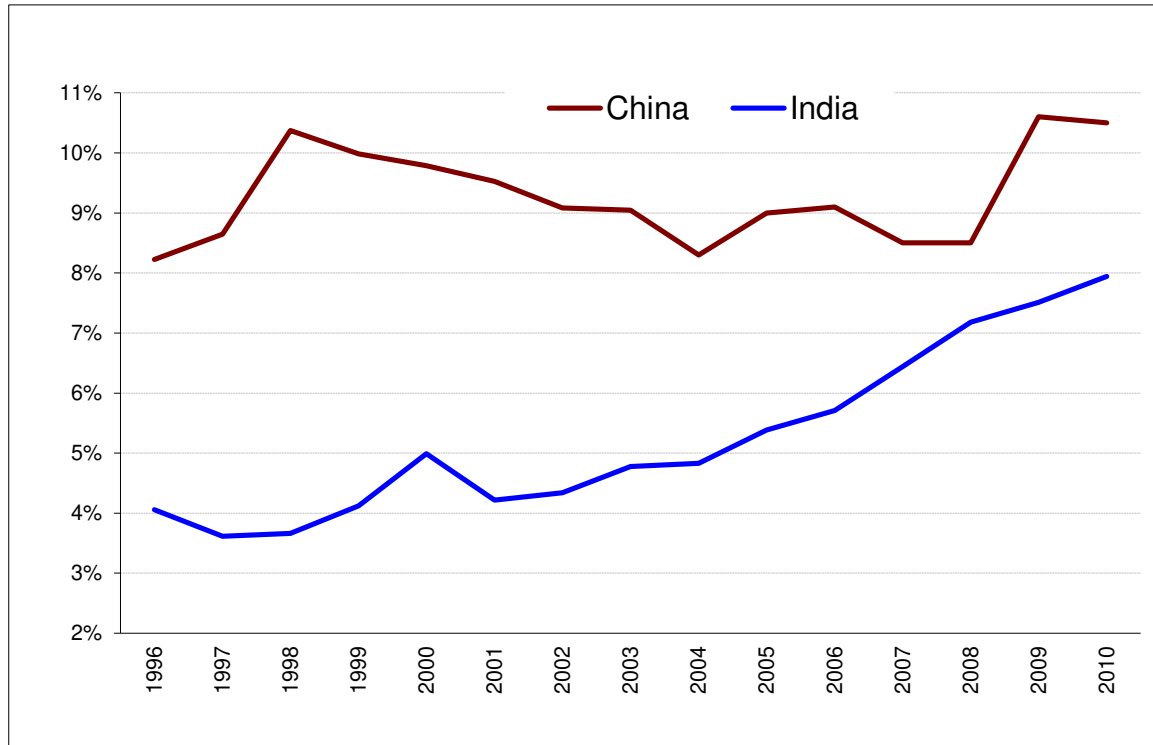
China: High Saver



Source: CEIC, Morgan Stanley Research

Infrastructure Imperatives

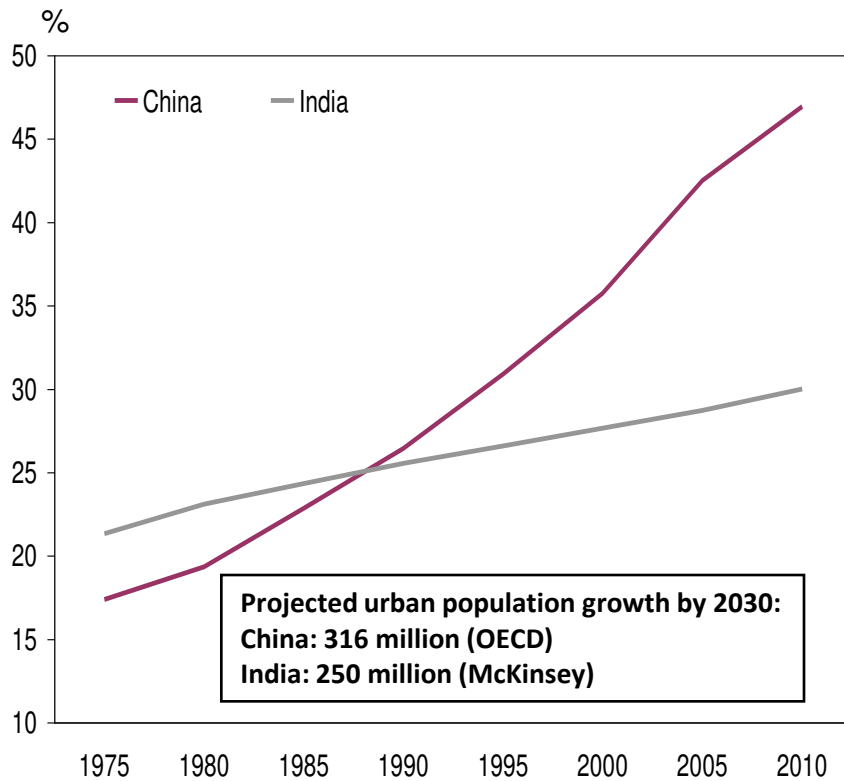
Infrastructure Spending (% of GDP)



Source: CEIC, Morgan Stanley Research

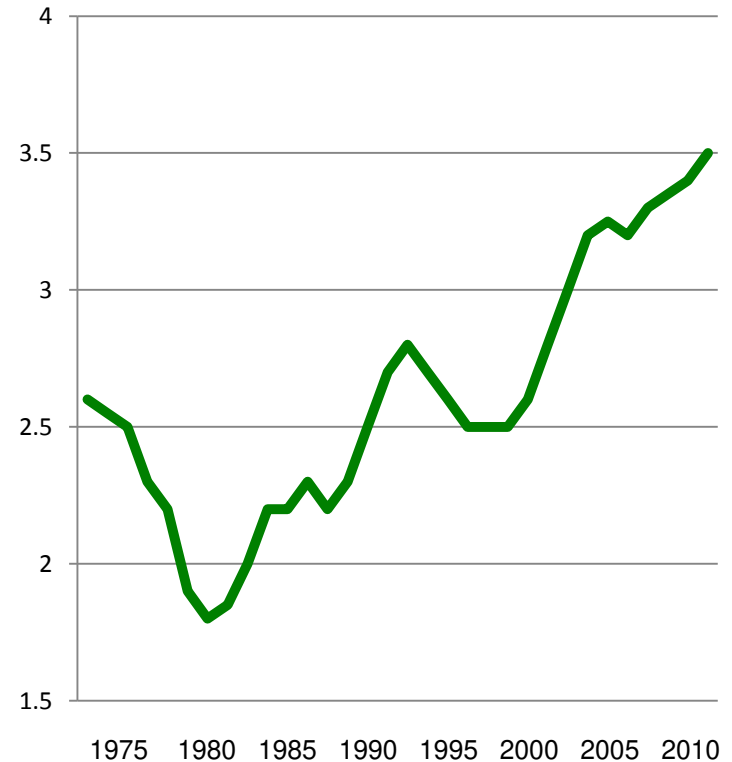
Urbanization Drives Domestic Demand

Urban Share of Total Population

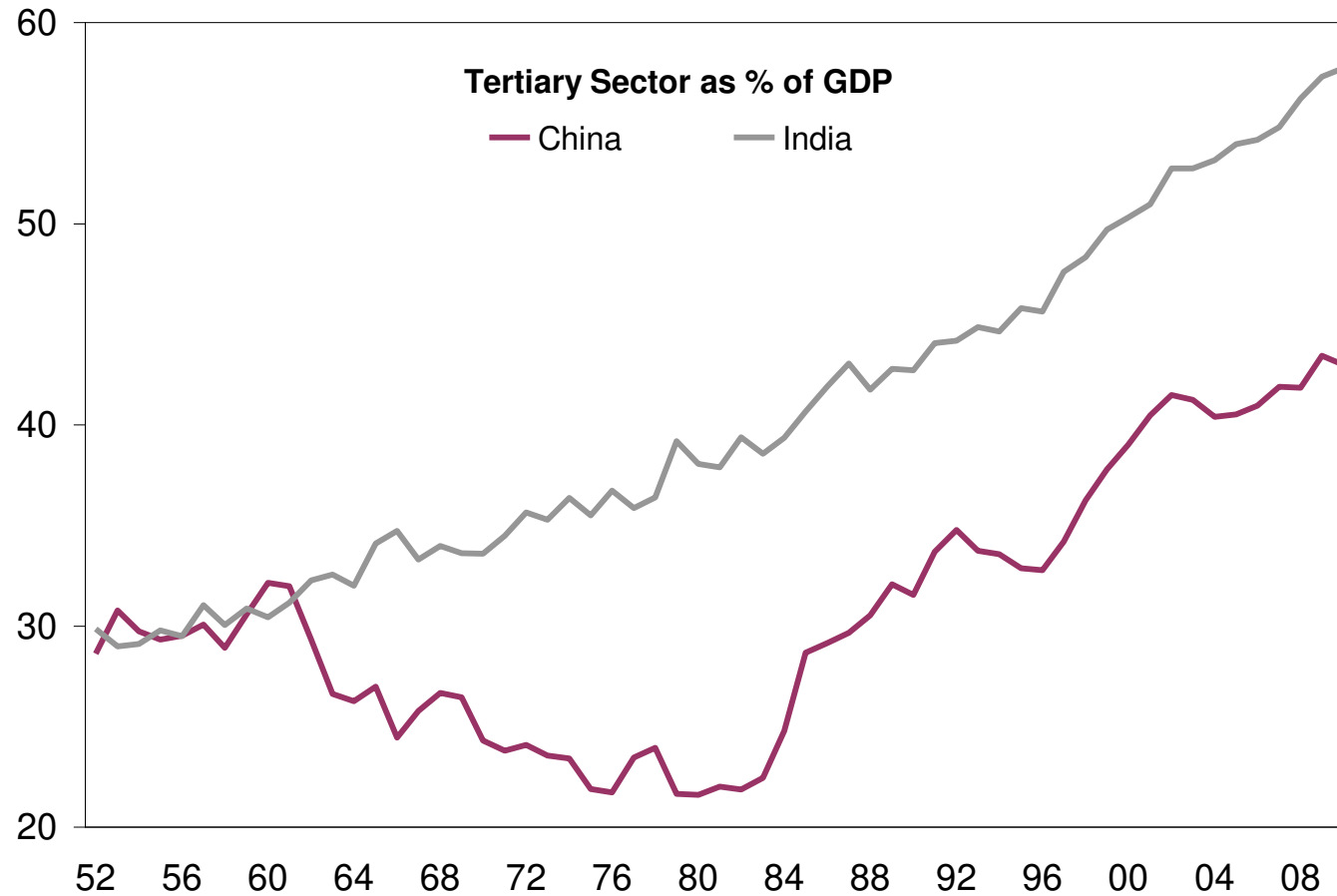


Source: UN, OECD, Morgan Stanley Research

China: Ratio of Urban to Rural Income



Labor-Intensive Services



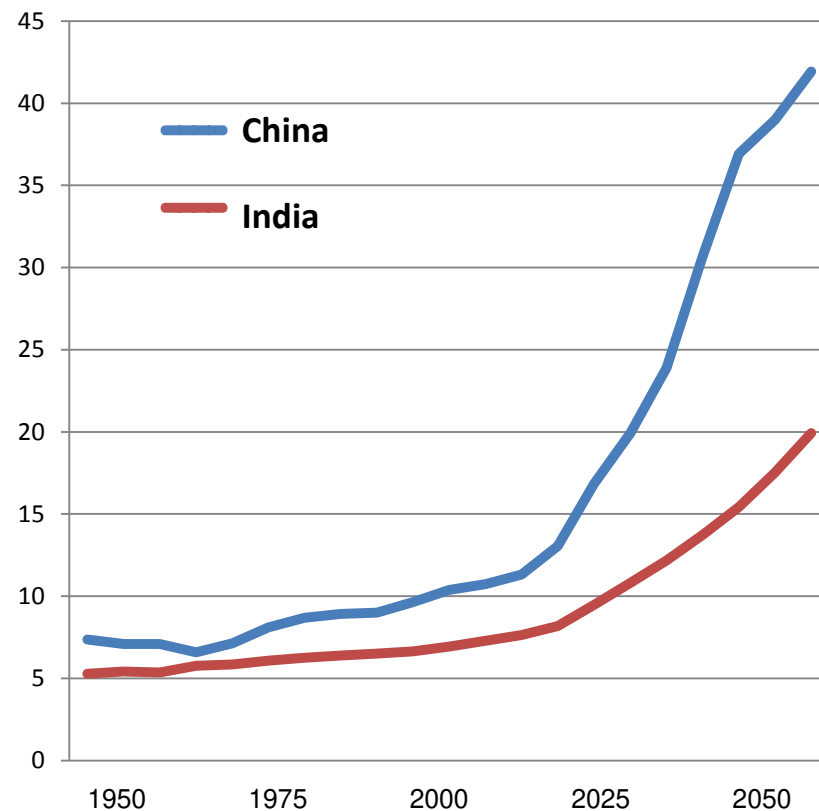
Source: CEIC, Morgan Stanley Research

Saving and Sustainable Development

Saving and *later-stage* development

- Saving absorption unlocks consumption
- Sustains balanced development
- Facilitates retirement funding
- Shock absorber

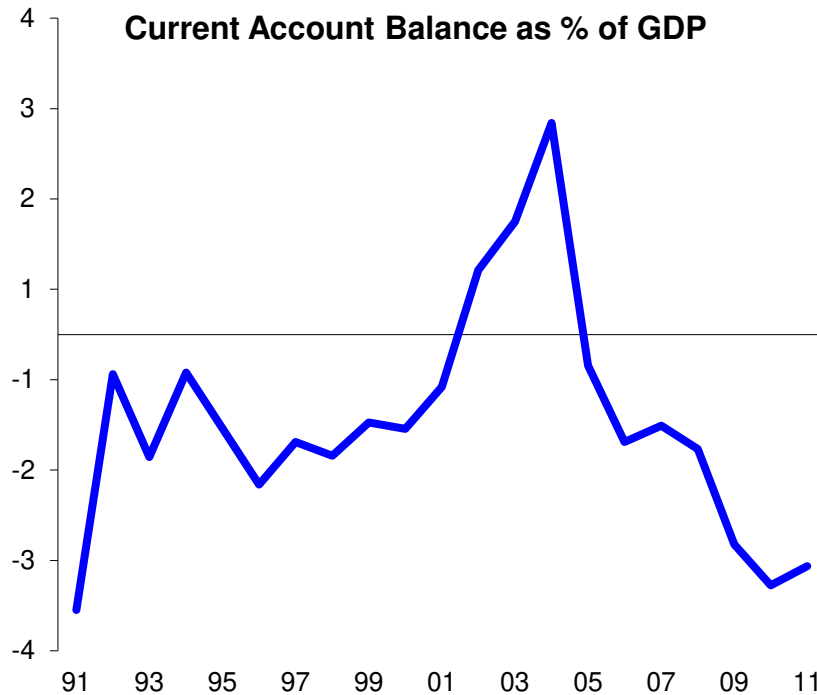
Old-Age Dependency Ratio



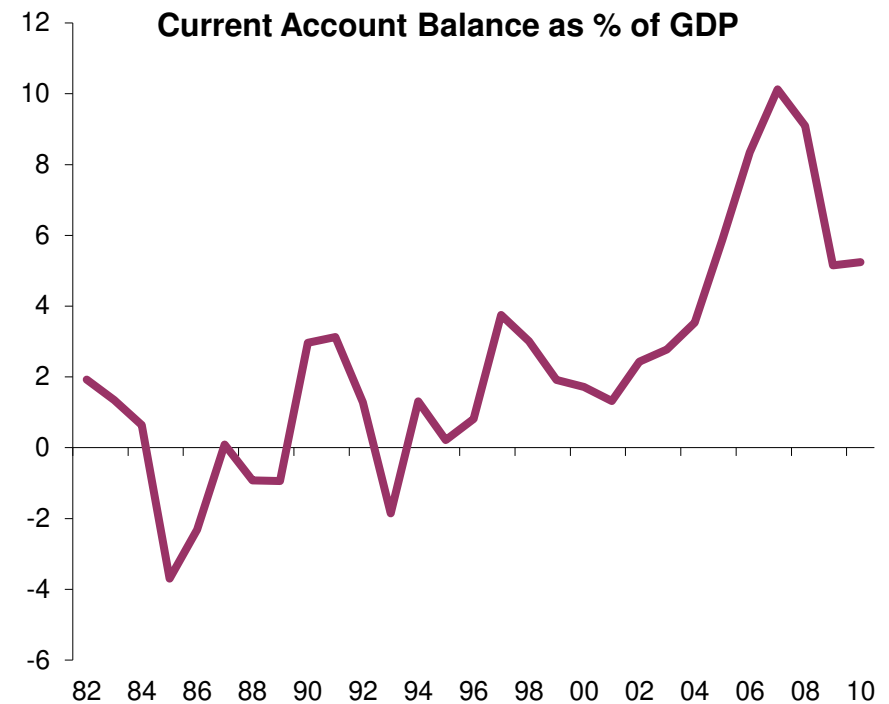
Source: United Nations World Population Prospects: The 2010 Revision: medium variant
Note: Old-age dependency ratio is 65 and older relative to working age (15 to 64) population

Saving and Current Account Disparities

India: Deficit Saver



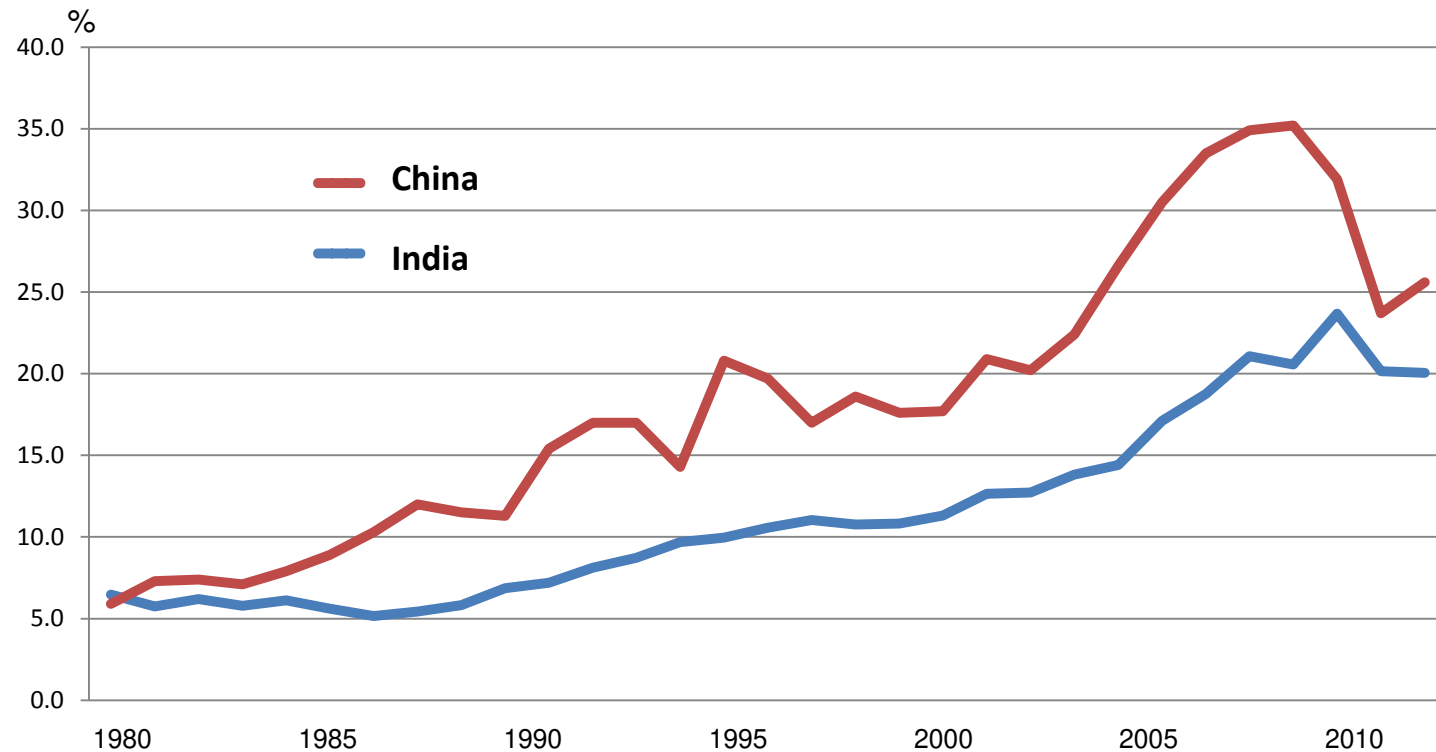
China: Surplus Saver



Source: CEIC, Morgan Stanley Research

Export-Led Growth

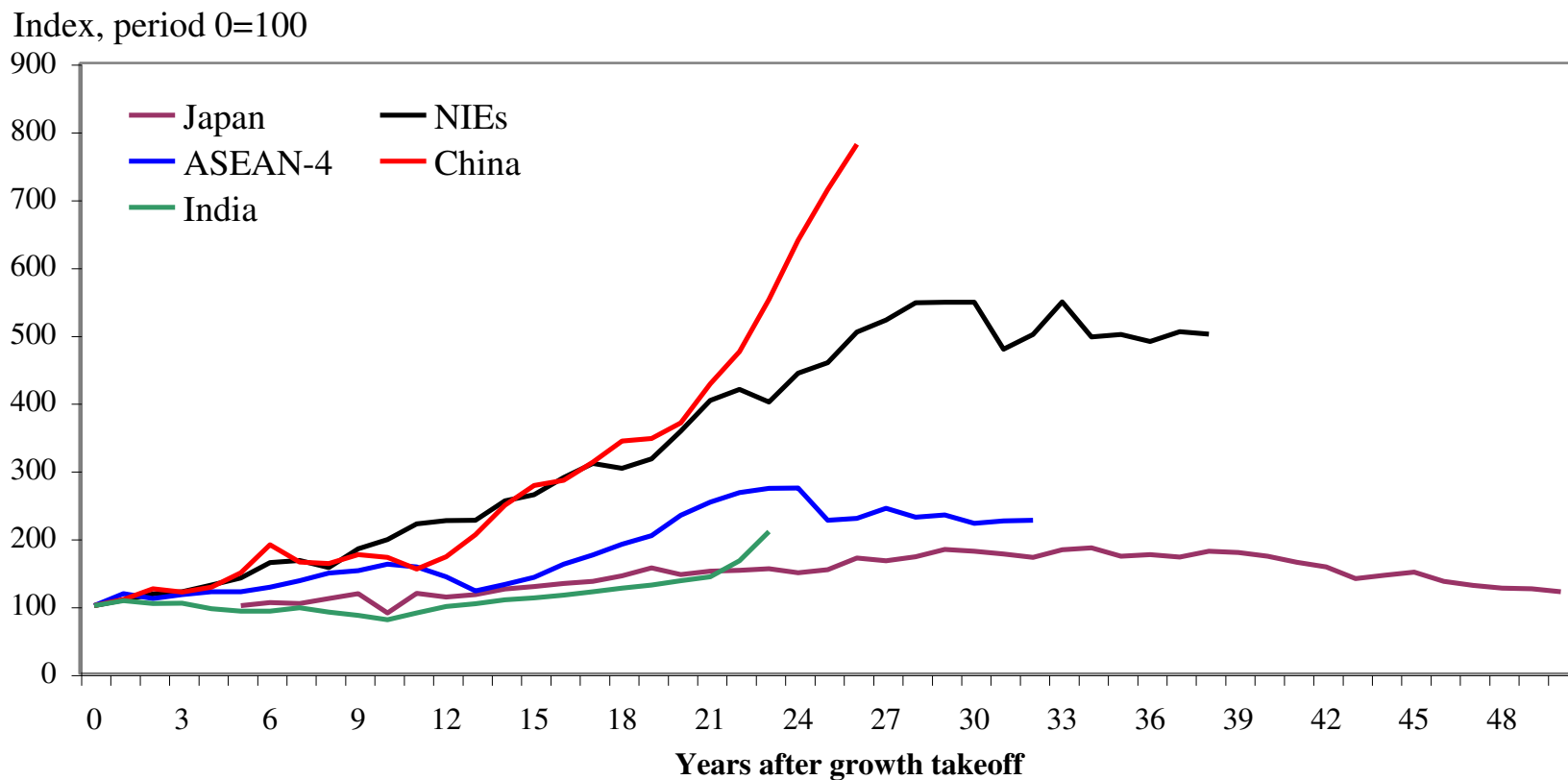
Export Shares of GDP



Source: CEIC, Morgan Stanley Research

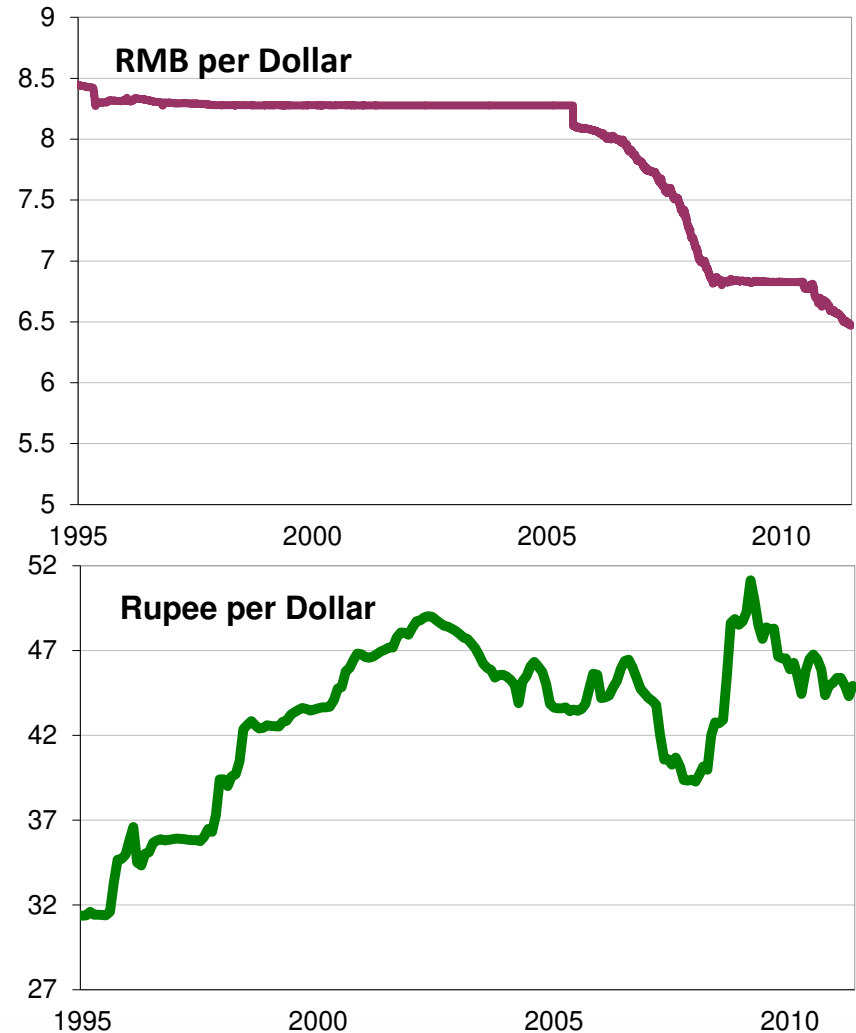
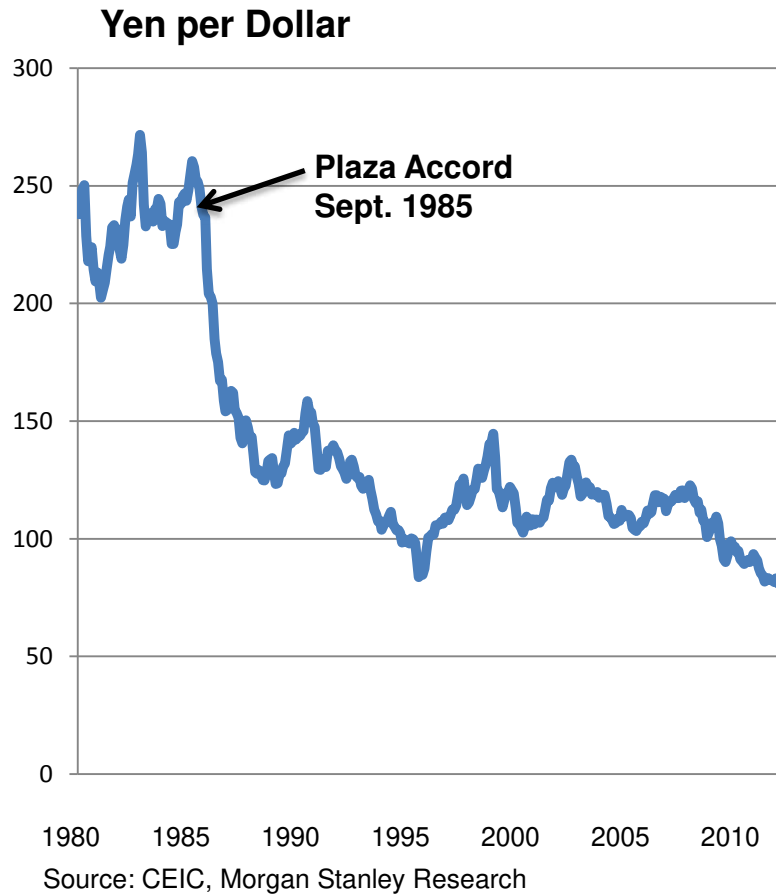
Export-Led Asian Development

Shares of World Trade Indexed at “Takeoff”



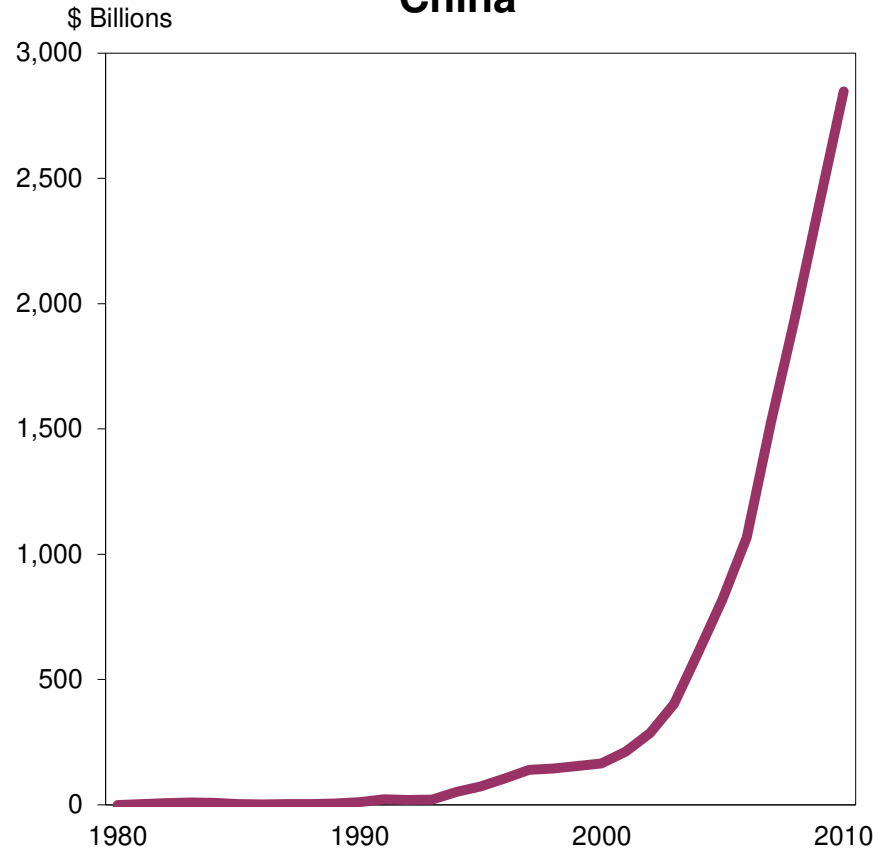
Source: International Monetary Fund

The Currency Bogey

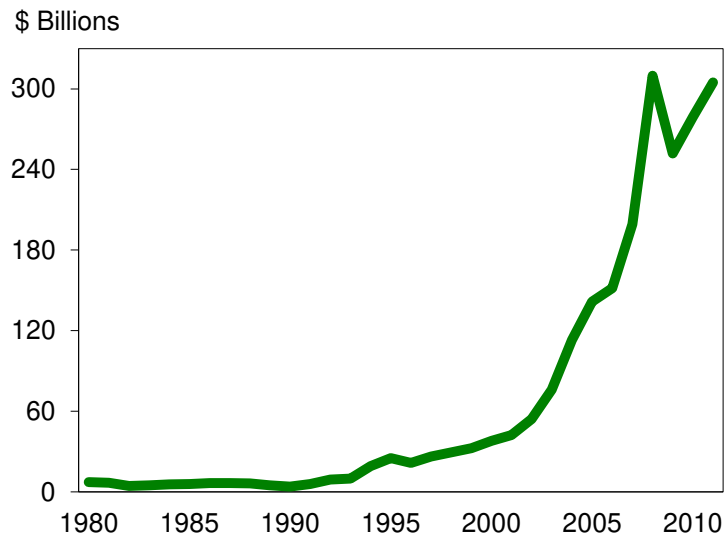


FX Reserve Accumulation

China



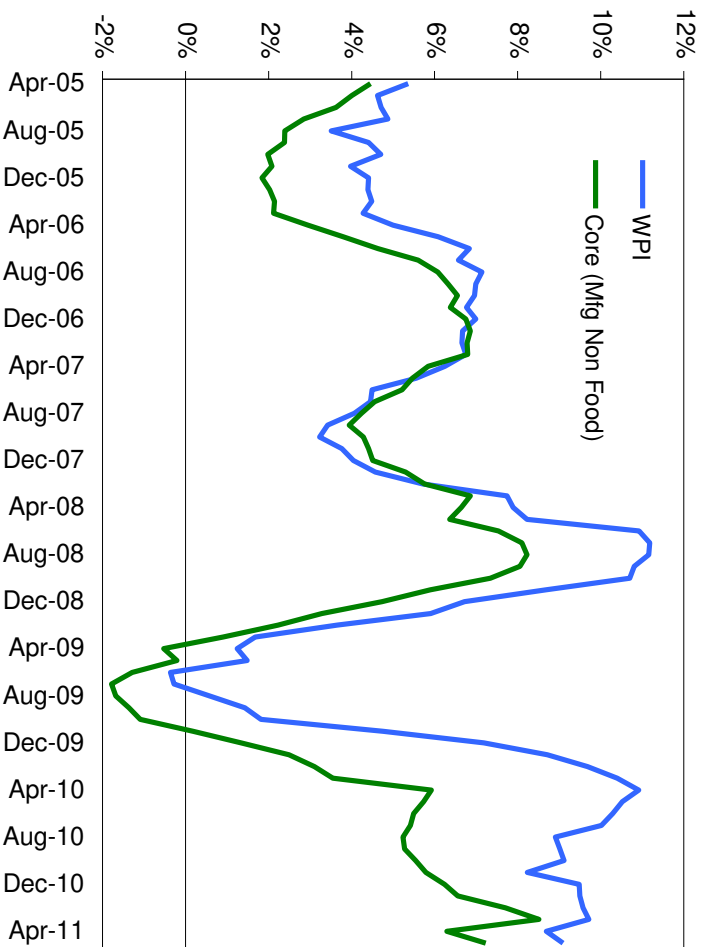
India



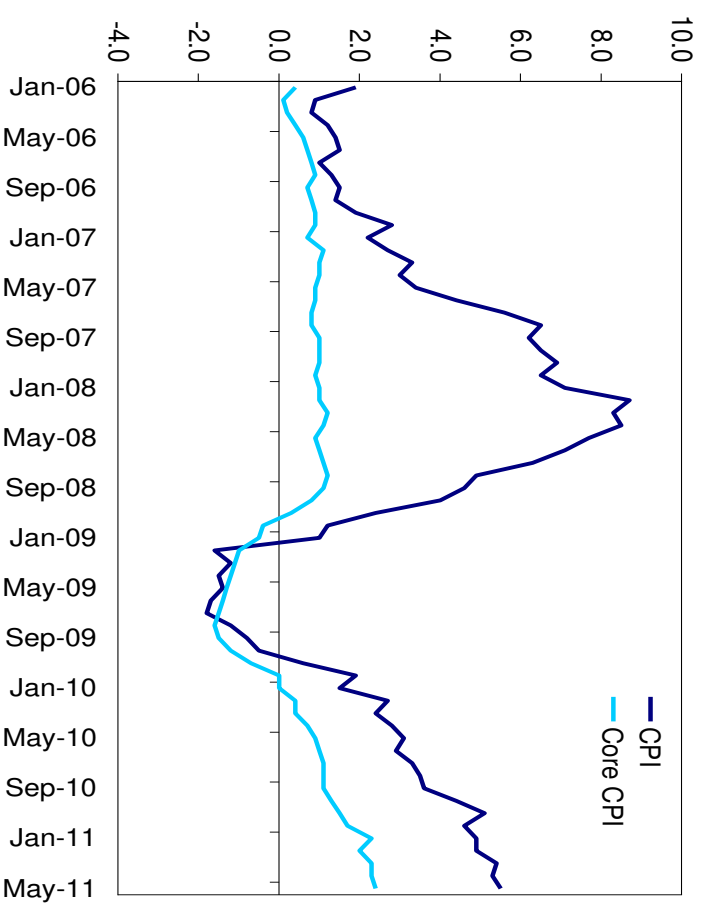
Source: CEIC, Morgan Stanley Research

Inflationary Consequences

India



China



Source: CEIC, Morgan Stanley Research

Finance and Economic Development

- **Passive vs. Active Financial Sector**
- **Compensation for Saving Shortfall?**
- **Macro-Prudential Regulatory Focus**
- **Role of Monetary Policy**
- **Crisis Management Imperatives**

The Litany of Crises: 10 in the Past 30 Years

- **1982: Latin American Debt Crisis**
- **1987: Stock Market Crash**
- **1990: US Saving and Loan Crisis**
- **1995: Mexico**
- **1997: Asia**
- **1998: LTCM**
- **2000: Dotcom**
- **2001: Enron-led Accounting Scandals**
- **2007: Subprime**
- **2010: Europe**

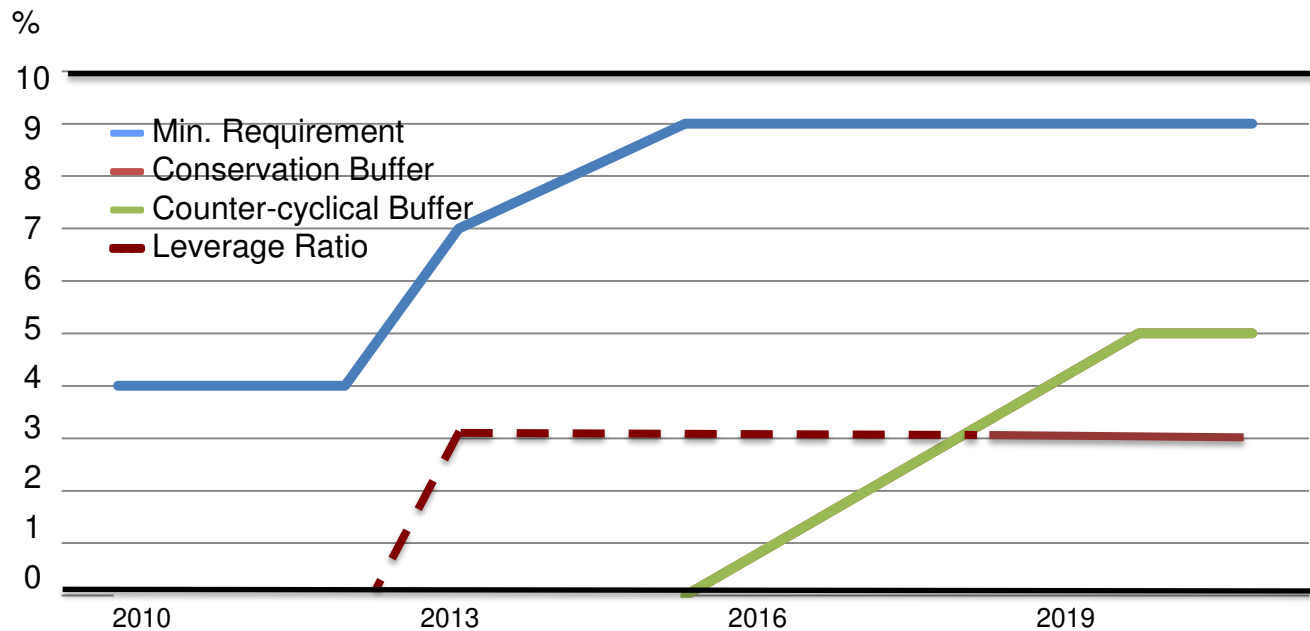
Post-Crisis Regulatory Agenda

Focus on Systemic Risks

- **Micro- vs Macro-Prudential Regulations**
- **The Regulatory Perimeter**
- **Banks and Shadow Banks**
- **Incentive-Compatible Rules**
- **Global Architecture for Global Risks**

Basel III

Phase-in Schedule for Regulatory Increases in Bank Capital



Source: Bank for International Settlements

Scaling the Banking Systems: China vs. India

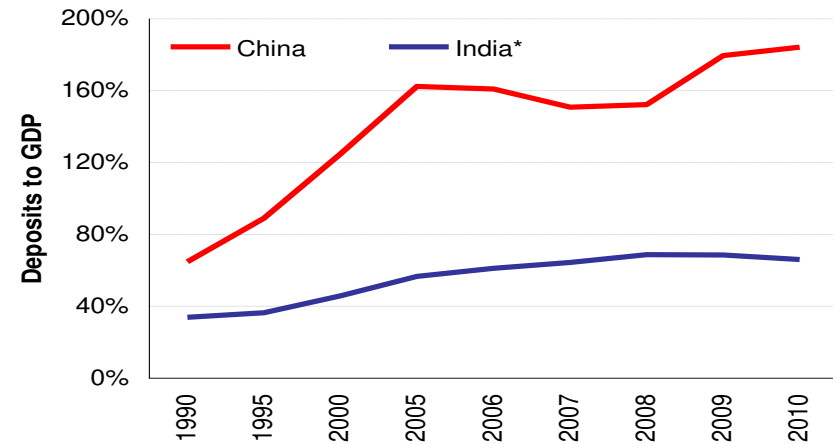
Financial System Snapshot

- Bank-centric credit intermediation
- China: Over-capitalized
- India: Adequately-capitalized SCBs
- Passive utility-like functionality
- NPLs well contained

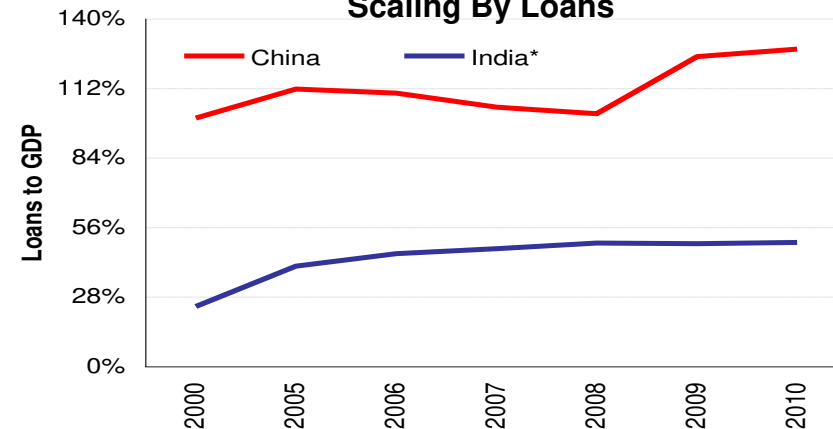
Source: CEIC, Morgan Stanley Research

* India data shown on a fiscal year basis

Scaling By Deposits

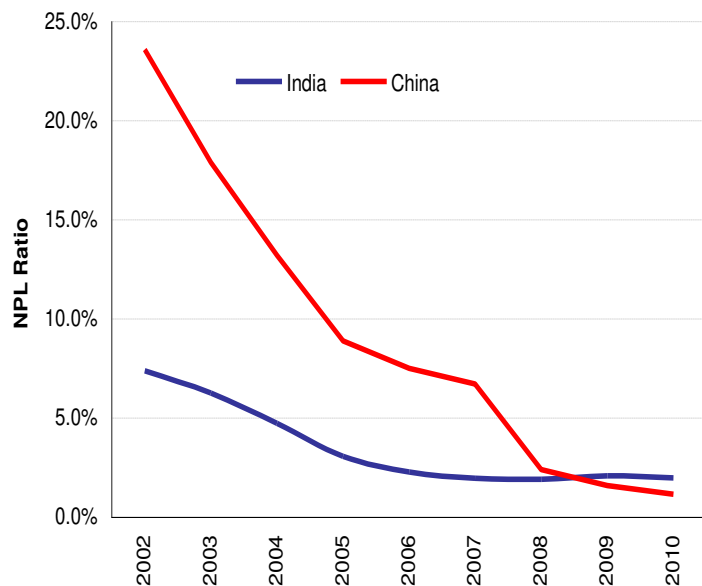


Scaling By Loans



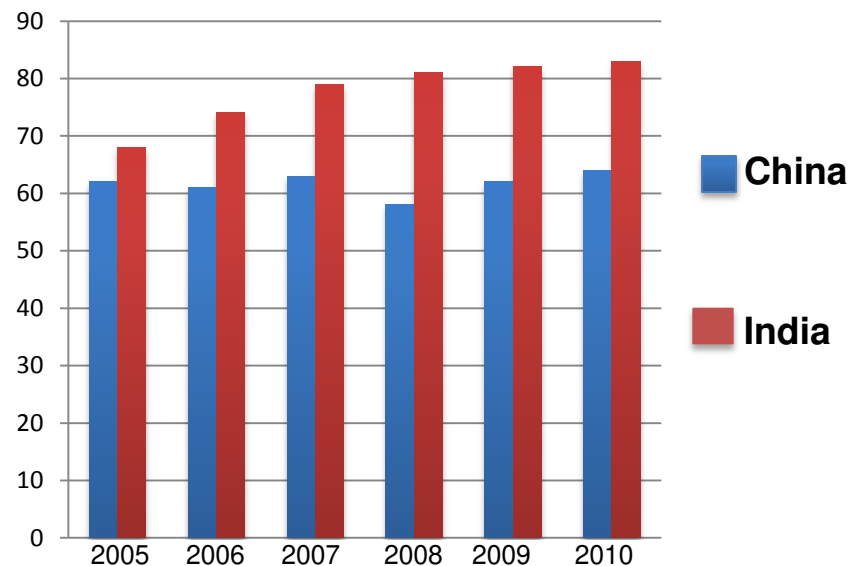
Prudent Lending Practices

Non-Performing Loans



Source: CEIC, Morgan Stanley Research

Loan to Deposit Ratios: Large Banks



Source: IIF and BankScope

Re-Regulation and International Competitiveness

- **The Volcker Rule**
- **Derivatives Regulations**
- **Capital Requirements**
- **Systemically Important Financial Institutions (SIFIs)**
- **Resolution Authority**

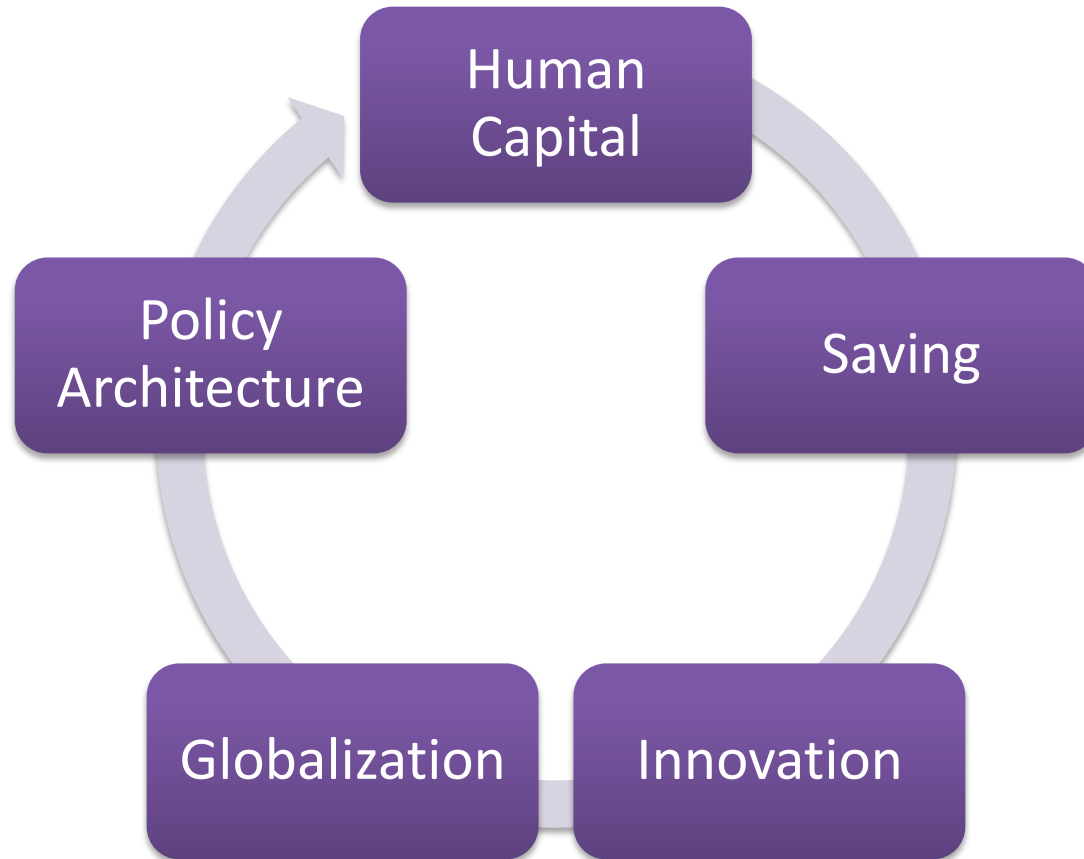
The Role of Monetary Policy

- **Re-Regulation – Necessary but Not Sufficient**
- **The Price of Risk**
- **Asset and Credit Bubbles**
- **Distortions to Real Economy**
- **Financial Stability Mandates**

An Optimal Policy Architecture

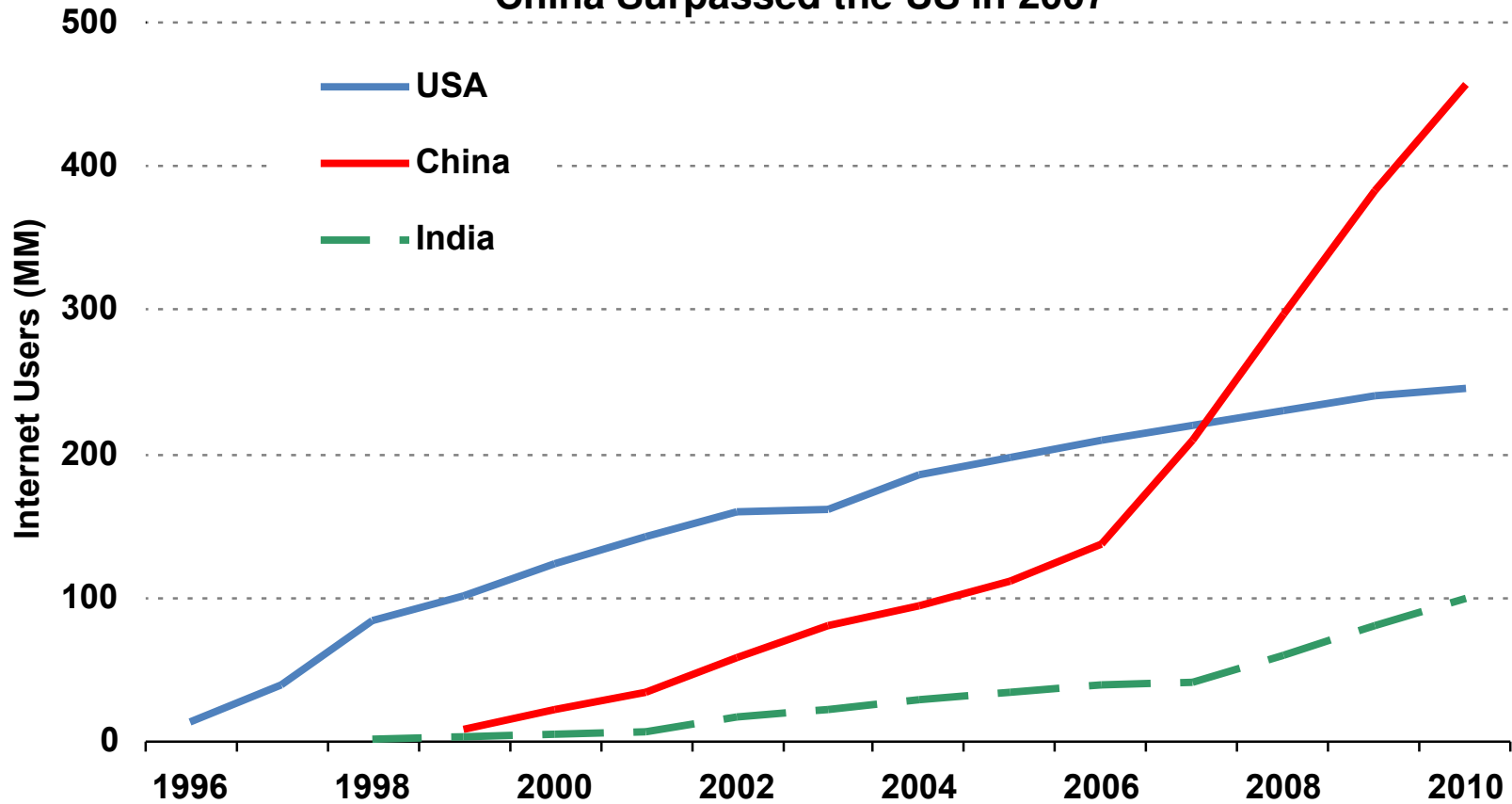
- **First Line of Defense: Monetary stability and fiscal sustainability**
- **Second Line of Defense: Macro-prudential safeguards**
- **Last Line of Defense: Capital controls?**
- **The Inevitability of the Next Crisis**

Shifting Development Paradigm



Innovation and the New Connectivity

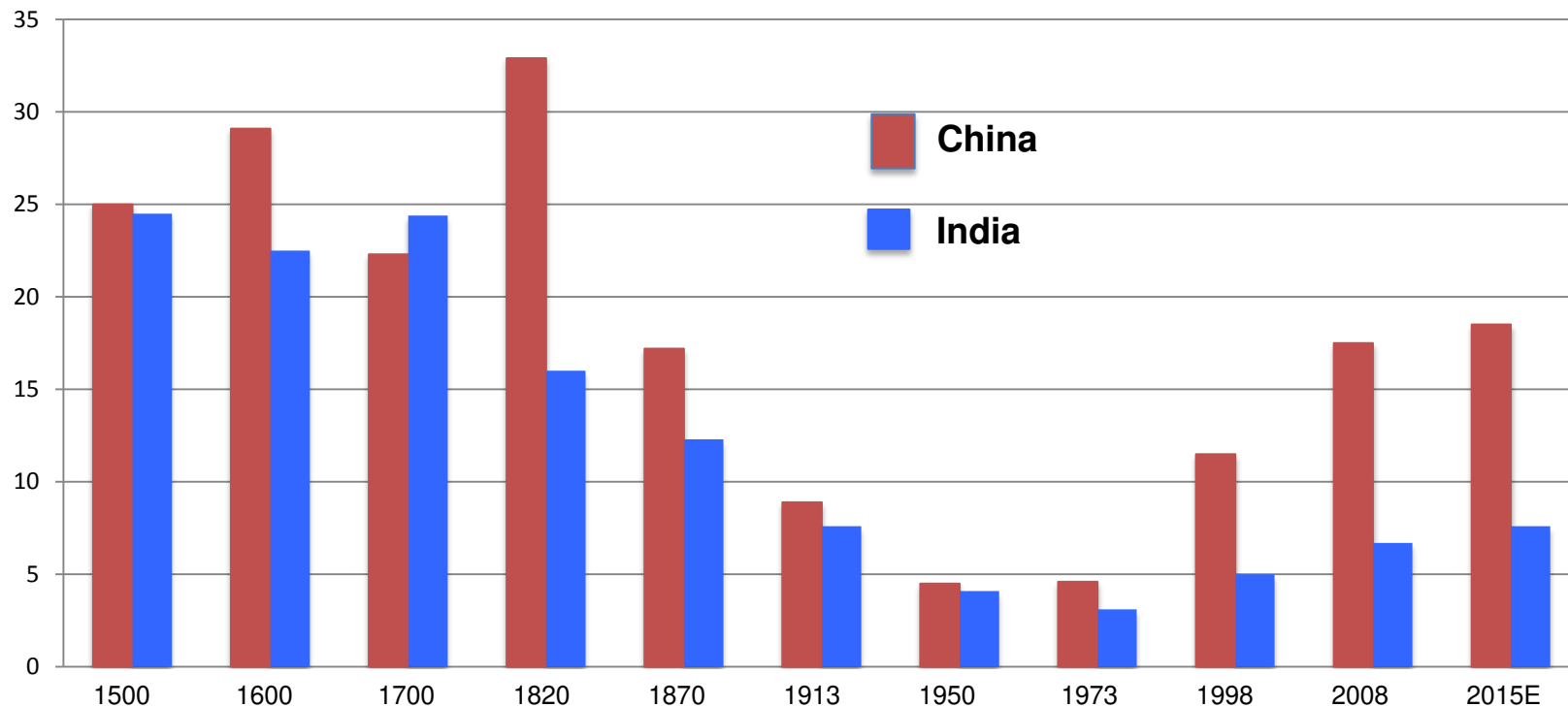
**Internet Users:
China Surpassed the US in 2007**



Source: Morgan Stanley Research, Internetworldstats.com

Will History Repeat Itself?

Shares of World GDP: 1500 to 2015



Source: Angus Maddison, *The World Economy: A Millennial Perspective*, OECD (2001); IMF, Morgan Stanley