Macroeconomic Indicators

24 January 2020

Agenda

- Diversification
- Asset Allocation
- Active Investment Strategies
- Rebalancing & Review

Session Contours

- Introduction to macro economics
- National Income
  - GDP
  - GNP
- Macro Economic Terminology
  - Fiscal policy
  - Monetary Policy
    - Weapons of credit control
- Economic growth
  - Inflation
    - Deflation
    - Stagflation
  - Balance of Payments

Introduction to macro economics

- Macroeconomics is focused on the movement and trends in the economy as a whole.
- It is the analysis of a nation's economy as a whole, examining aggregate data, such as inflation, industrial production, price levels, and unemployment.
- Study of the entire economy in terms of the total amount of goods and services produced, total income earned, level of employment of productive resources, and general behaviour of prices

Definition of macro economics

Macro economic is the study of the overall aspects and workings of a national economy, such as income, output, and the interrelationship among diverse economic sectors.

It is basically determined by two variable factors

- GDP/ GDI
- GNP

GDP / GDI

GDP refers to the gross domestic produce of a country . Alternatively is also known as GDI .ie. gross domestic income of a country.

It refers to the market value of all goods and services produced within an economy in a year.

GDP = C+I+G+(X-M) where

C= Consumption

I = Investment

G = Government Expenditure

X = Exports

M = Import

GNP

GNP refers to the Gross National Produce of a country .

- Gross National Product. GNP is the total value of all final goods and services produced within a nation in a particular year, plus income earned by its citizens (including income of those located abroad), minus income of non-residents located in that country.
- GNP is one measure of the economic condition of a country, under the assumption that a higher GNP leads to a higher quality of living, all other things being equal.

GNP = GDP + Net factor Income abroad (Receipts remitted – Payments made)

Facts about GNP

- Since World War II, GNP has been generally regarded as the most important indicator of the status of an economy.
- In the United States, the economy is considered to be in recession if there are two consecutive quarters of decrease in GNP.
- Despite the fact that GNP does not allow for inflation, overall value of production, and other factors, it is nevertheless a significant measurement of economic health.

Macro Economic Terminology

- It is necessary that one should be familiar with the terminology that are important in understanding modern macroeconomic issues and its applications.

- The next few slides will broadly cover some of the basic concepts of macroeconomics and explain their importance to business.

Fiscal Policy

Instruments of Fiscal Policy:

1. Public expenditure
2. Taxes
3. Public debt

The above mentioned instruments are used by the public authorities to achieve desirable level of production, consumption and National Income.

Fiscal Policy features

A fiscal policy can be either expansionary or contractionary .

A contractionary fiscal policy focuses focuses on increasing taxes,increasing public debt and cutting planned expenditure.

An expansionary fiscal policy focuses on focuses on cutting taxes,decreasing Public debt and increasing planned expenditure.

INDIAN INSTITUTE FOR FINANCIAL CERTIFICATIONS

Impact of fiscal policy

- During inflation more and more taxes are levied on the community. This decreases the purchasing power of the people and desirable price level is achieved. During inflation public expenditure is decreased so that all in production may decrease high prices and increase the value of money.
- During deflationary period taxes are reduced and public expenditure is increased. In this way incentives to invest are increased and national income begins to rise. For economic development public debts are necessary.

Monetary Policy

Monetary policy is the process by which the government, central bank, or monetary authority of a country controls

(i) the supply of money,

(ii) availability of money,

(iii) cost of money or rate of interest,

This control is exercised to attain a set of objectives oriented towards the growth and stability of the economy

INDIAN INSTITUTE FOR FINANCIAL CERTIFICATIONS

Monetary policy

- Money supply is measured by M3
  - M3 = Currency,notes and coins with the public + Demand deposits with banks + Fixed Deposit with banks.
- Expansionary policy focuses on injection of liquidity into the system. Expansionary policy is traditionally used to combat unemployment in a recession by lowering interest rates
- Contractionary policy focuses on absorption of liquidity from the system. contractionary policy involves raising interest rates in order to combat inflation.

Weapons of Credit Control

Monetary policy rests on the relationship between the rates of interest in an economy, that is the price at which money can be borrowed, and the total supply of money. Monetary policy uses a variety of tools to control one or both of these

We are going to discuss in brief about the various tools available for credit control .

IIFC INDIAN INSTITUTE FOR FINANCIAL CERTIFICATIONS

Cash Reserve Ratio

- The Cash Reserve Ratio (CRR) refers to the liquid cash that banks have to maintain with the Reserve Bank of India (RBI) as a certain percentage of their demand and time liabilities.
- For example if the CRR is 10% then a bank with net demand and time deposits of Rs 1,00,000 will have to deposit Rs 10,000 with the RBI as liquid cash.
- If RBI decides to increase the percent of this, the available amount with the banks comes down.
- Hence the total money available with the banks for lending comes down leading to an increase in the interest rates

INDIAN INSTITUTE FOR FINANCIAL CERTIFICATIONS

Cash Reserve Ratio

- The increase in interest rates leads to a decrease in demand for money , hence helps in controlling the inflow of money in the economy.
- RBI is using this method (increase of CRR rate), to drain out the excessive money from the banks.

Rising interest rates have several implications in the stock market .

High interest rates lead to adverse demand for goods and services and investment activity for short term traders

For long term investment traders the change in CRR does not make any significant difference

INDIAN INSTITUTE FOR FINANCIAL CERTIFICATIONS

Bank Rate

- Interest rate that is charged by central bank on advances to other banks.
- This is done to control inflation and stabilize the country’s exchange rates
- Any increase in bank rate makes borrowing more expensive. This leads to less business spending which can slow down the growth of a company
- If a company is seen as cutting back on its growth spending or is making less profit then the estimated future cash flow will drop which leads to lowering the price of the company's stock.

INDIAN INSTITUTE FOR FINANCIAL CERTIFICATIONS

Effect on stock and bonds market

- If enough companies experience a decline in their stock prices, the whole market, or the indexes that many people equate with the market, will go down.
- For many investors, a declining market or stock price is not a desirable outcome. Investors wish to see their invested money increase in value
- However it must be noted that “interest rates affect the market but do not determine it “.
- Hence any changes in the interest rates leads to volumes in terms if transaction on stock and bonds market.

INDIAN INSTITUTE FOR FINANCIAL CERTIFICATIONS

Statutory Liquidity Ratio

It refers to the amount that all banks require to maintain in cash or in the form of Gold or approved securities with the central bank.

It mainly entails :

- Cash
- Gold valued at a price not exceeding the current market price,
- Unencumbered approved securities (Government securities or Gilts come under this) valued at a price as specified by the RBI from time to time.

It is commonly used to contain inflation and fuel growth, by increasing or decreasing it respectively.

INDIAN INSTITUTE FOR FINANCIAL CERTIFICATIONS

Repo Rate

- It is the transaction whereby central bank purchases government securities from the banks with an agreement that the securities will be bought back by the banks at a later date at specified rate.
- RBI aims to maintain the country's money supply by controlling the repo rate
- A reduction in the repo rate will help banks to get money at a cheaper rate.
- When the repo rate increases borrowing from RBI becomes more expensive.

Reverse Repo Rate

- It is the transaction whereby banks purchases government securities from the central bank with an agreement that the securities will be bought back by the banks at a later date at specified rate.
- The Reverse repo Rate is the exact opposite side of a repo rate wherein the borrower and the lender switch sides

INDIAN INSTITUTE FOR FINANCIAL CERTIFICATIONS

Inflation

- Inflation is defined as an increase in the price of bunch of Goods and services that projects the Indian economy.
- An increase in inflation figures occurs when there is an increase in the average level of prices in Goods and services.
- Inflation happens when there are less Goods and more buyers, this will result in increase in the price of Goods, since there is more demand and less supply of the goods.

It should be noted that some % of inflation is necessary for an economy to grow.

Implications of inflation

- Inflation leads to high energy price, rising labour costs and pressure on supply of raw materials which adds upto the cost of the company.
- Due to inflation , interest rates are high and the value of money also declines and hence goods and services become more expensive.
- High interest rates and companies raising prices of stock don’t add up to attractive investment.
- Inflation robs investors by raising prices with no corresponding increase in value. You pay more for less.
- Fixed income securities take the bigger hit during inflation.

INDIAN INSTITUTE FOR FINANCIAL CERTIFICATIONS

Deflation

- A decline in general price levels, often caused by a reduction in the supply of money or credit.
- Deflation can also be brought about by direct contractions in spending, either in the form of a reduction in government spending, personal spending or investment spending.
- Deflation has often had the side effect of increasing unemployment in an economy, since the process often leads to a lower level of demand in the economy

Implications of deflation

- It leads to low interest rates , lowering wages which leads to less spending power.
- In deflationary times, most companies cannot raise their prices without losing business: then they have to cut their costs. Cutting costs also means cutting jobs and reducing salaries.
- It discourages investment and spending, because there is no reason to risk on future profits when the expectation of profits may be negative and the expectation of future prices is lower.
- It favors those who hold currency over those who do not.

Stagflation

- This was a term coined in the 1970s for the twin economic problems of stagnation and inflation
- It is a period of slow economic growth and high unemployment (stagnation) while prices rise (inflation) .
- It is also defined as Inflation accompanied by stagnant growth, unemployment or recession
- **Note that both inflation and deflation have certain positive aspects however ; stagflation is the only economic which only has negative impact on the economy.**

INDIAN INSTITUTE FOR FINANCIAL CERTIFICATIONS

Balance of Payments

- It measures the payments that flow between any individual country and all other countries.
- It is used to summarize all international economic transactions for that country during a specific time period, usually a year.

INDIAN INSTITUTE FOR FINANCIAL CERTIFICATIONS

Thank You

INDIAN INSTITUTE FOR
FINANCIAL CERTIFICATIONS