MACRO ECONOMICS

BY:
CA VAIBHAV JAIN
FCA, ACS, LL.B, MBF (ICAI), FAFD (ICAI),
Registered Valuer (S&FA) - IBBI
Phone: +91 9711310004
E-mail id: vaibhavjain@inmacs.com

Since 1963
MEHRA GOEL & CO. Chartered Accountants

NATIONAL INCOME ACCOUNTING

WHAT IS NATIONAL INCOME ?

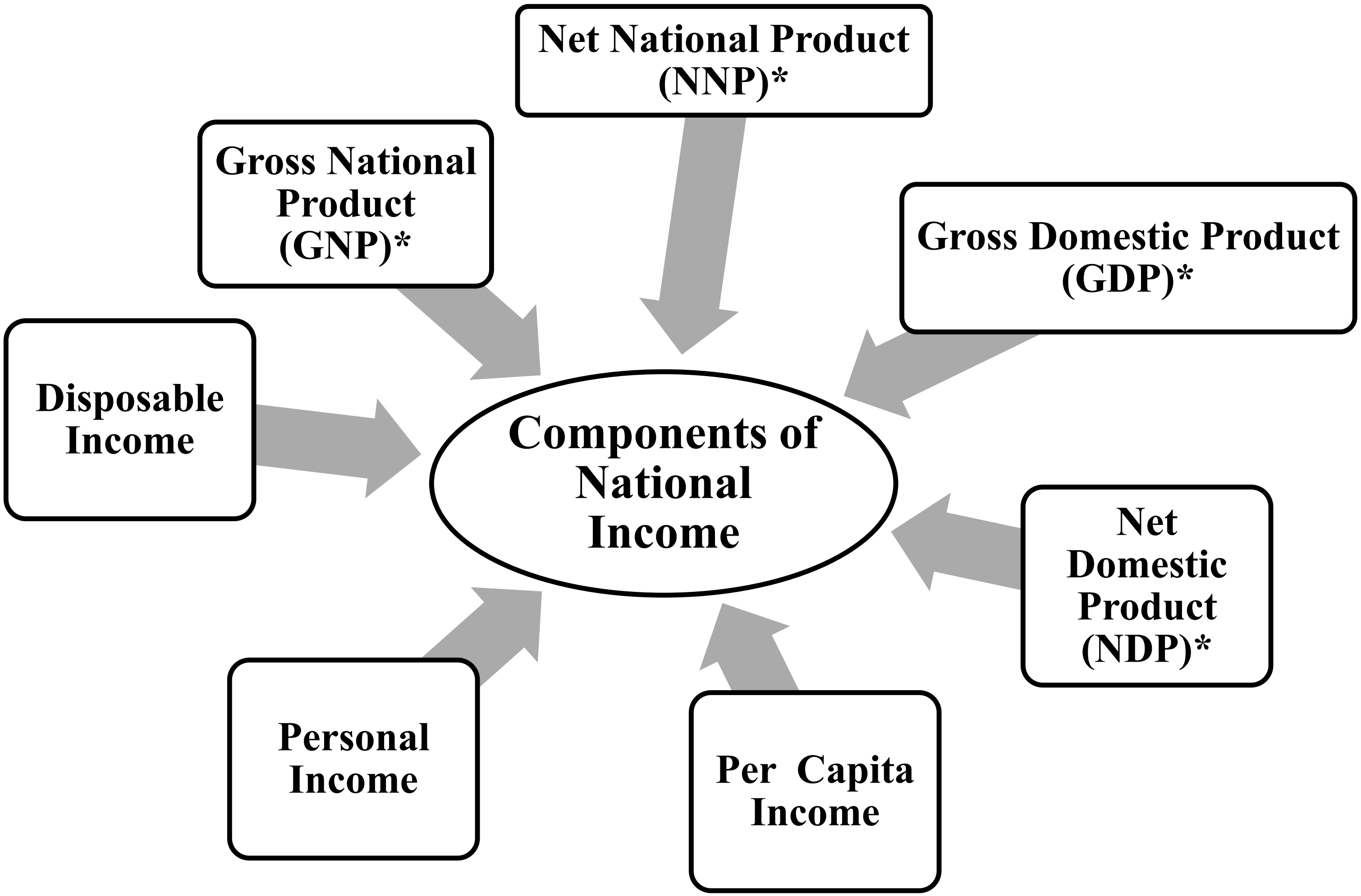
- National income is used interchangeably with national dividend, national output and national expenditure. On this basis, national income has been defined in a number of ways.
- In common parlance, national income means Net value of all goods and services produced within the domestic territory of a country in an accounting year plus net factor income abroad.

BENEFITS OF NATIONAL INCOME ACCOUNTS

National income Accounts

- Helps in analyzing and evaluating the performance of an economy.
- Helps in understanding the composition and structure of the national income.
- Helps in understanding Income distribution, economic forecasting and choosing economic policies and evaluating them.

COMPONENTS OF NATIONAL INCOME



* GNP/NNP/GDP/NDP are calculated either at Market Prices or at Factor Cost.

METHODS OF MEASURING NATIONAL INCOME

- National income can be measured using three aproaches viz;

Approach 1
- Expenditure Approach

Approach 2
- Income Approach

Approach 3
- Product Approach

MEASUREMENT OF NATIONAL INCOME

Expenditure Approach:

- Personal Consumption: Purchase of goods and services produced by firms, individuals or household.
- Investment: Purchase of capital goods by firms for use in production and in changes in the firm inventory.
- Government Spending: Expenditure incurred by federal, state and local government for final goods and services.
- Net Exports (X-M): Difference between the value of exports and the value of imports.

MEASUREMENT OF NATIONAL INCOME

Income Approach:

- Wages and Salaries: Income received by labour from firm for services rendered to them.

- Net Interest: Difference between total interest payment received and total interest payments made by households.

- Rental Income: Payment for rented inputs.

- Profit: Corporate profit earned by business corporations or payment of dividend to shareholders.

Product Approach:

- Also known as Output Approach or Value Added Approach is measured by net value of all final goods and services produced by nation during a year.

BASICS OF FISCAL POLICY

Definition:

- Fiscal Policy refers to a policy under which government uses its expenditure and revenue programs to produce desirable effects on national income, production and employment.

AIM of Fiscal Policy:

- The main aim of Fiscal Policy is to see that the three facets of financial system are healthy.
- The three facets of financial system are:

  1) Public Debt

  2) Public Revenue

  3) Public Expenditure.

The Main Objectives of Fiscal Policy is to attain:

- ✓ Economic growth
- ✓ Full Employment
- ✓ Reducing inequalities of income and wealth
- ✓ Controlling Inflation
- ✓ Price Stability.

There are two types of Fiscal Policy:

1) Expansionary Fiscal Policy
2) Contractionary Fiscal Policy

TYPES OF FISCAL POLICY

1) ***Expansionary fiscal policy:***

An expansionary fiscal policy is used to address recession and the problem of general unemployment on account of business cycles. This is achieved through:

- An increase in government expenditure for goods and services.
- A decrease in taxes.
- A combination of the above two measures.

2) Contractionary fiscal policy:

- A decrease in government expenditure for goods and services.
- An increase in taxes.
- A combination of the above two measures.

Which Factors affect Fiscal Policy?

- Tax Policies
- Government subsidies
- Government borrowings, lending's and investment.

What is Fiscal Deficit?

- Fiscal deficit is the difference between what the government spends and what it earns.
- It is expressed as a percentage of GDP.

Through the use of budgetary instruments such as public revenue, public expenditure, public debt and deficit financing, government intends to favourably influence the level of economic activity of a country.

LIMITATIONS OF FISCAL POLICY

1) __Time Lag:__

- Recognition Lag
- Decision Lag
- Implementation Lag
- Impact Lag

2) __Political Considerations:__

- Tax increases are unpopular with voters.
- Cutting down government spending is difficult where programs are popular with citizens.
- Spending/Taxation promises made by government up for re-election are difficult to maintain.

3) __Different levels of government:__

- Federal Government and provincial government fiscal policy may differ.

CONTD…

4) __Regional Variations:__

- If one region is doing well while another region is suffering, then what policy should be used is the biggest challenge.

5) __Size of national Debt:__

- Since expansionary policy require more borrowing/deficit spending, it results in an increase in national debt, debt to GDP ratio etc. which places increased burden on future generations.

6) __Crowding Out:__

- Government borrowing to fund stimulus programs increases competion for fund resulting in higher interest rates.
- Small private borrowers cant affort such high interest rates and results in crowding out, viz, less investment in capital goods, less production & employment, slower economic growth.

BASICS OF MONETARY POLICY

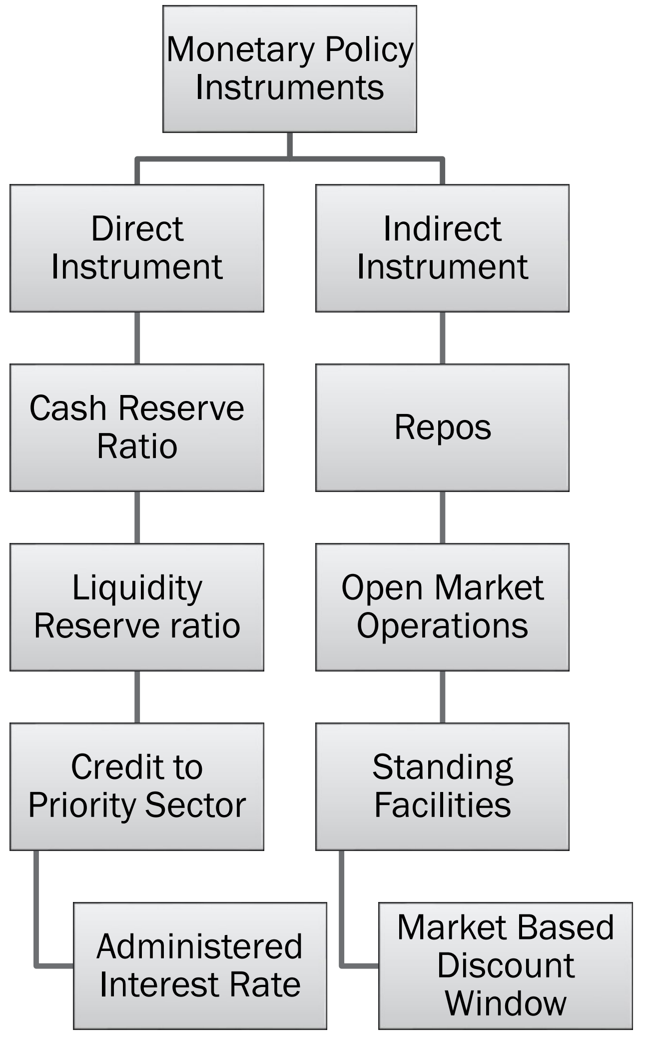
What is Monetary Policy ?

- Monetary policy refers to the use of monetary policy instruments which are at the disposal of the central bank to regulate the availability, cost and use of money and credit.

Why is Monetary Policy Required ?

- The basic purpose for drafting monetary policy is to:
  - Promote economic growth
  - Price stability
  - Optimum levels of output and employment
  - Balance of payments equilibrium
  - Stable currency
  - Any other goal of government's economic policy.

MONETARY POLICY INSTRUMENTS



DIRECT INSTRUMENTS

Cash Reserve Ratio:

- The Cash Reserve Ratio (CRR) refers to the fraction of the total net demand and time liabilities (NDTL) of a scheduled commercial bank in India which it should maintain as cash deposit with the Reserve Bank irrespective of its size or financial position.

Statutory Liquidity ratio:

- The Statutory Liquidity Ratio (SLR) is what the scheduled commercial banks in India are required to maintain as a stipulated percentage of their total Demand and Time Liabilities (DTL) / Net DTL (NDTL) in Cash, Gold or approved investments in securities.

INDIRECT INSTRUMENTS

Repo or repurchase option:

- Repo or repurchase option is a collaterised lending because banks borrow money from Reserve bank of India to fulfill their short term monetary requirements by selling securities to RBI with an explicit agreement to repurchase the same at predetermined date and at a fixed rate. The rate charged by RBI for this transaction is called the 'repo rate'.

Reverse Repo:

- Reverse Repo is defined as an instrument for lending funds by purchasing securities with an agreement to resell the securities on a mutually agreed future date at an agreed price which includes interest for the funds lent .

TYPES OF REPO MARKETS

➢ Following are the types of Repo Markets:

Type 1
- Repo on sovereign securities

Type 2
- Repo on Corporate debt securities

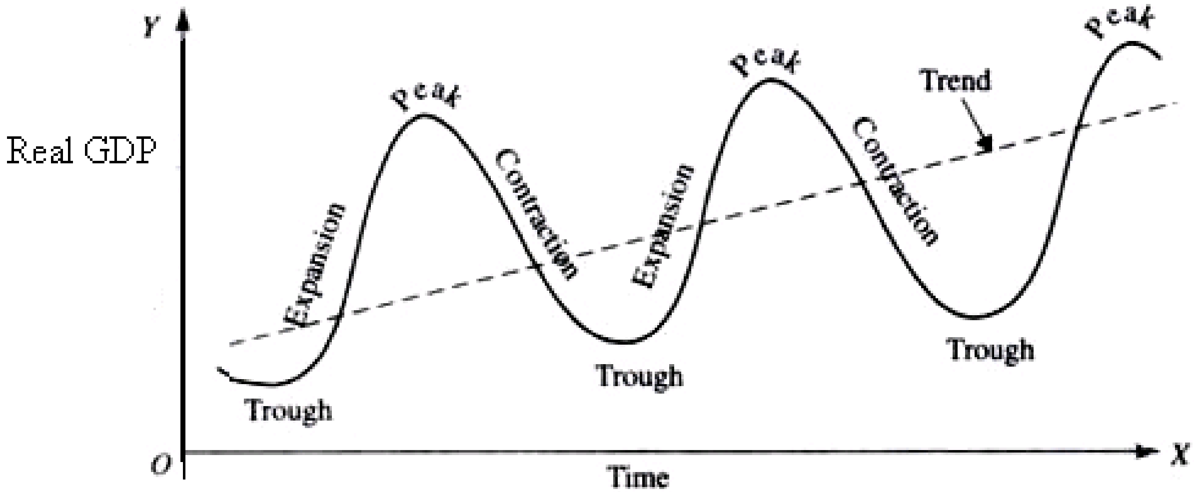
Type 3
- Other Repos

UNDERSTANDING BUSINESS CYCLES

What is Business Cycles:

- Economic activities measured in terms of production, employment and income move in a cyclical manner over a period of time.
- These Cyclical movement is characterized by alternative waves of expansion and contraction which depicts periodic up and down movement in economic activities.
- Alternative waves are associated with alternate periods of prosperity and depression.

PHASES OF BUSINESS CYCLES



<u>Business Cycle comprises of four phases, viz:</u>

- Expansion phase
- Peak phase
- Contraction/Recession phase
- Trough phase

CONTD….

Expansion phase:

- Expansion is the phase when all macro economic variables like output, employment, income and consumption increases.
- Under this phase, prices go up, money supply increases, self reinforcing features of business cycle pushes the economy upwards.

Peak phase:

- Peak is the phase where the highest point of growth; referred to as *boom* is faces. Beyond the phase of peak, no further expansion is possible and which sees the downward turning point.

CONTD….

Contraction/Recession phase:

- Contraction/Recession is a phase where slowing down process of all economic activities starts taking place.

Trough phase:

- Trough is the phase where there is the lowest ebb of economic cycle which is followed by the next turning point in the cycle, when new growth process starts afresh.
- phase starts highest point of growth; referred to as *boom* is faces. Beyond the phase of peak, no further expansion is possible and which sees the downward turning point.

THANK YOU!

BY:
CA VAIBHAV JAIN
FCA, ACS, LL.B, MBF (ICAI), FAFD (ICAI),
Registered Valuer (S&FA) - IBBI
Phone: +91 9711310004
E-mail id: vaibhavjain@inmacs.com

Since 1963
MEHRA GOEL & CO. Chartered Accountants

New Delhi:
505, Chiranjiv Tower
43, Nehru Place,
New Delhi -110019
India
+91- 11 26430349,
26419527

Gurgaon:
101, Global Business Square,
Building No. 32, Sector 44,
Institutional Area,
Gurgaon - 122003
India
+91-124-4786200

Mumbai:
201, Madhava Building,
Bandra Kurla Complex,
Bandra East,
Mumbai - 400051
Indoa
+91-22-4974-6258

Chandigarh:
SCO-705, 1st Floor,
NAC Manimajra,
Chandigarh, 160101,
India
+91-97113-10004

Noida:
Ground Floor,
GF 001, Trustone City,
Tower 2, Plot No 21,
TechZone IV, Noida Extension,
Greater Noida, 201 308, India
+91-97113-10004

- Integrity
- Excellence
- Independence
- Confidentiality
- Competence