CAN INDIA RECOVER?

With Covid serving a harsh blow to India's already beleaguered economy, the country is staring a recession squarely in the face. The Board of India Today Economists (BITE) weighs in on how long this will likely last and what they would prescribe to cure the ailing economy

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Q. Is the Indian economy going through a recession? By when do you estimate this might end?

● MAITREESH GHATAK

Yes, by all indications, it is. According to the International Monetary Fund's World Economic Outlook report, India's economy is expected to contract by 4.5 per cent during the fiscal year 2020-21, while the National Council of Applied Economic Research (NCAER) predicts a contraction of 12.5 per cent unless there is a huge stimulus. The Central Statistics Office (CSO) figures for the growth rate for the first quarter of 2020-21 are due soon and are expected to be negative. By all accounts, the contraction of GDP in the first quarter of 2020-21 has been significant. This is confirmed by other economic indicators, including satellite images of electricity consumption, according to a World Bank study. It is hard to see how the second quarter's growth rate can be positive, and two successive quarters of contraction is considered a recession. It is hard to tell when this might end. Unless the pandemic is brought under control globally and in India, it is hard to see how the economy can recover.

● D.K. SRIVASTAVA

India's growth is expected to contract in the first and second quarters of 2020-21. For the year as a whole, many multilateral institutions and rating agencies are predicting a contraction ranging from 3.2 per cent to 9.5 per cent, according to the World Bank and ICRA, respectively. This, in fact, may imply that all the four quarters in this fiscal year may show a contraction. However, I expect that the Indian economy would show a positive growth, at least by the fourth quarter of 2020-21.

● PRONAB SEN

The Indian economy is certainly going through a recession. The first quarter of FY21 will certainly show a contraction upwards of 20 per cent, and the second quarter, too, will register a contraction of 5 to 10 per cent. The recession will last at least one more quarter, as I expect the third quarter to also register negative growth. In the fourth quarter, we may see a small positive growth because of the base effect, but even this may change if the pandemic drags on for longer.

> **"Though the economy has rebounded from the lows of April, it is still well below business as usual...outlook remains bleak till a vaccine is found**
>
> **– D.K. JOSHI**

● D.K. JOSHI

Recessions are a rarity in a developing country like India. Since Independence, we have seen just five, when the GDP for an entire fiscal contracted. If we define recession as de-growth in GDP in a given fiscal, we are certain to see one now—CRISIL expects GDP to contract 5 per cent this fiscal over the last fiscal.

The task of forecasting is made difficult by the fact that economic data has become unreliable since response rates to data collection have been erratic after the lockdown. But we can connect the dots with what we have. Though the economy has significantly opened up since the very stringent lockdown in April, Google Mobility indicators point towards a plateauing below pre-Covid-19 levels since June-July. Just as we thought economic activity was starting to look up, reintroduction of containment measures, particularly in Tier II and III cities, continuing restrictions on some services (airlines, sports, recreation, hospitality), and the risk-averse behaviour of consumers have converged.

The Purchasing Managers' Index (PMI) for manufacturing and services is staying below 50, the threshold below which contraction is indicated. Air quality and traffic congestion data indicate sub-normal economic activity. Petroleum product consumption, GST collections and vehicle registrations also mirror the trend. So, though the economy has rebounded from the lows of April, it is still well below business as usual. Moreover, the downside risks to our outlook remain elevated until a Covid-19 vaccine is found and mass-produced.

All we can say for now is: If the pandemic were to peak out in the latter part of this quarter (July-September), GDP growth could move into mildly positive territory by the fourth quarter.

● SOUMYA KANTI GHOSH

Yes, the economy has entered a recession and this phase may last for some time. We can only hope for some continued recovery in the fourth quarter. The exact time is still difficult to model. Pandemics have long history, ranging from a few years to 100 years with multiple waves.

Q. Does the slowdown in India have any unique features vis-à-vis the global downtrend?

● MAITREESH GHATAK
India has a large informal sector, and it is a matter of guesswork as to how badly it has been hit. In general, there is a positive correlation between the extent of the public health crisis and the economic downturn with Brazil, Mexico, and South Africa—some of the countries hit worse than India—but the signs are not positive for India given the worsening public health scenario. Moreover, India was already on a path of economic slowdown when the crisis hit, which makes the prospects for recovery even more daunting.

● D.K. SRIVASTAVA
India's economic slowdown was visible prior to the onslaught of the pandemic. In fact, India's growth experience has been characterised by structural as well as cyclical problems. This was due to a persistent decline in the savings and investment rates, a fall in the real and nominal GDP growth rates in recent years and a sharp fall in the growth of central tax revenues. These are pre-Covid characteristics. The impact of the pandemic has forced policy-makers to increase borrowing-based stimulus well above the Fiscal Responsibility and Budget Management (FRBM) Act norms. The combined debt-to-GDP ratio by the end of 2020-21 may exceed the FRBM threshold of 60 per cent by nearly 20 percentage points. India's policy challenges are likely to continue well beyond the time Covid-19 is brought under control.

● PRONAB SEN
The nature of the Covid-19-induced recession is more or less the same all over the world since the reason is exactly the same—nationwide lockdowns in which all production except of essential goods and services is closed. India is slightly different in that it is at once a very large country and a federal state. As a result of these two characteristics, the pandemic has affected different parts of the country at different times, which has prompted state governments to impose localised lockdowns. This has two effects: first, the duration of lockdown effects is longer in India; and second, although production has resumed in most places, supply chains are still fragmented leading to relatively slower recovery. But India is not unique. The US is facing the same issues with the same consequences.

> **"India's growth experience has been characterised by structural as well as cyclical problems**
> —D.K. SRIVASTAVA

● D.K. JOSHI
This time, India is likely to be hit much harder compared to many other Asian economies and the global economy. Even during the global financial crisis in fiscal 2009, India's GDP grew 3.1 per cent on-year even as the world economy contracted. Importantly, India grew around 300 basis points faster than the global economy. Now we are expecting a contraction of 5 per cent this fiscal, well below the 3.9 per cent global contraction projected by S&P Global for 2020.

While S&P Global expects, on average, a permanent loss of 3 per cent to GDP in Asia-Pacific economies (excluding China and India) over the medium run, for India, we estimate that number at 10 per cent. That's because India faced the present crisis on a weak wicket and had low buffers. The pandemic magnified the headwinds and added misery and fears around personal safety.

Also, India's rural economy, which accounts for half the GDP, is better placed than its urban economy.

● SOUMYA KANTI GHOSH
The markers are similar to the rest of the world as the mode of containment is the same. But we must remember that we were in a slowdown mode even before Covid, when the world economy was moving up. The only difference is that we have a young population, so we have a higher probability of recovering faster.

Q. In your view, has the Rs 20 lakh crore package mitigated the crisis?

● **MAITREESH GHATAK**
As is well known by now, the quoted number of Rs 20 lakh crore, or 10 per cent of the GDP in 2019-20, clearly overstates the effective size of the economic package. The immediate (excluding measures that would lead to future increases in liabilities, like through loan guarantees), additional (not budgeted before the crisis hit), fiscal (excluding monetary policy measures) resources put on the table by the central government are far less than the stated stimulus amount and are to the tune of 1-2 per cent of GDP. Now, some package is better than no package, and without this package the impact of the crisis would have been worse. But could we have done more in terms of the amount of resources put on the table as well as a different portfolio of policies, one that paid greater attention to the demand side, like direct income support to compensate for the loss of incomes, jobs and livelihoods? The answer is yes.

● **D.K. SRIVASTAVA**
This package consisted of both monetary and fiscal measures. Its impact has, so far, been limited since a good part of the economy has been constrained by a variety of bottlenecks due to continued lockdowns. The additional spending, over and above the budgeted amounts, from the fiscal stimulus has been limited in magnitude measured as percentage of GDP. Compared to many other countries, India's fiscal stimulus has been rather low.

● **PRONAB SEN**
The Rs 20 lakh crore package is appropriate for the survival and revival phases, but has serious weaknesses due to the high degree of stress and risk-aversion in the financial sector, which is where most of these funds are supposed to come from. Furthermore, it is completely inadequate and, indeed, inappropriate for the recovery phase, where the real need is for a proper fiscal stimulus to demand.

> **"The package is appropriate for the survival and revival phase, but completely inadequate for the recovery phase**
> –PRONAB SEN

● **D.K. JOSHI**
To be sure, no amount of stimulus can offset what's wrought by the pandemic. It can only help reduce the pain. The Rs 20 lakh crore economic package (a mix of monetary and fiscal measures) has helped somewhat. The central bank measures have helped ease financial conditions and fiscal support has been directed towards vulnerable sections. As pointed out earlier, more needs to be done, the extent of which will be dictated by the willingness and ability of the government to stretch itself fiscally.

● **SOUMYA KANTI GHOSH**
Of the Rs 20 lakh crore, 40 per cent is liquidity injection through RBI. The rest is guarantees and reforms in agriculture that allow banks to lend to stressed entities in the MSME sectors. While this is absolutely fine, we need to ensure that supply constraints do not turn into a full-fledged demand problem and, in this respect, it is essential to unleash a direct fiscal support in unison.

Q. Given the grim economic forecasts all round, do you think the government needs a radical rethink on ways to stimulate the economy? What's your prescription?

● **MAITREESH GHATAK**
Yes, India's response has focused largely on the supply side (e.g., loan guarantees), but with a crisis like this, which has hit income, employment and demand across the board, policies to prop up the supply side are not sufficient. Demand-creating measures, such as direct income transfers and tax cuts are needed to regenerate the economy. India's steps in this regard have been quite meagre, compared to other emerging and developing countries. I would say three immediate steps should be taken:
1. Allocating more resources to direct income transfer and to MGNREGA;
2. Speeding up transfer of revenues that are due to the states; and
3. Pumping up spending on infrastructure with a focus on public health.

● **D.K. SRIVASTAVA**
The government should take this

opportunity to recast its fiscal and monetary policy frameworks so as to make them far more growth-oriented. In fact, real and nominal GDP growth rates have come down because of excessive control of consumer price index (CPI) inflation under the existing monetary policy framework in recent years and erosion of tax revenue growth, which has squeezed the available fiscal space. Specific policy prescriptions for the next few years are listed below:

1. Centre's fiscal deficit target should be uplifted to 4 per cent as compared to the present level of 3 per cent of GDP, and the FRBMA should be revised accordingly. States' debt-GDP targets should be increased to 30 per cent as against the current target of 20 per cent.

2. Monetary authorities should target a CPI inflation of 5 per cent on average rather than 4 per cent, while continuing with the tolerance range of +/- 2 percentage points. A fiscal and monetary policy council may be set up to coordinate between the fiscal and monetary authorities.

3. For 2020-21 and 2021-22, focus should be on government capital expenditure according to the schedule of the National Infrastructure Pipeline, so as to generate highest employment and output multipliers.

● PRONAB SEN

The ways to stimulate the economy are well known and nothing new needs to be added. The only 'new' thing is that notions regarding the importance of fiscal discipline need to be put on hold for the time being. The three immediate steps I would recommend are:

1. Step up direct income transfers, including free rations, significantly;

2. Announce a major fiscal stimulus for both this year and the next; and

3. Initiate credible movement on ramping up public investment.

Financing the fiscal deficit should not be a concern.

> **Demand-creating measures are needed to regenerate the economy. India's steps in this regard have been quite meagre**
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> —MAITREESH GHATAK

● D.K. JOSHI

The government will have to play a key role in supporting and reviving the economy. Put simply, it needs to spend more, a lot more.

The good news is that agriculture, which directly and indirectly supports over 40 per cent of the workforce, is expected to do well this year. In a way, this would take care of the resources to address food security challenges.

But given the deep hit to the non-agricultural economy, direct fiscal support at 1.2 per cent of GDP—which is what the various packages announced by the Centre till now sums up to—is acutely short of an effective stimulus. The quantum of support to the economy will depend on how long Covid-19 continues. Here's what needs to be done:

> **Policy-makers are convinced that 'targeted government interventions' work way better**
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> —SOUMYA KANTI GHOSH

1. Given that the affliction curve is showing no signs yet of flattening and then dipping, the government must loosen the purse strings and provide both an income lift to needy households (cash support) and financial support to vulnerable businesses, to create a strong bridge from crisis to recovery. I would suggest additional direct fiscal spending of at least 1 per cent of GDP over what has been envisaged so far.

2. Steps will need to be taken to address the working capital stretch hurting small enterprises because of payment delays by large companies. This can be done via low-cost lending support to big companies to enable them to release payments.

3. Additional spending to revive the post-pandemic demand will also be needed. At that stage, the government should rely more on infrastructure spending and start preparations for that (identification of projects and funding, among other things) to plant the economy firmly back on the growth trajectory.

● SOUMYA KANTI GHOSH

Yes, we need a radical rethink in policy-making. There are now serious doubts about the theory that economy functions best with an "invisible hand". Policy-makers are now convinced that "targeted government interventions" work much better. I believe a rethink of economic theory is an opportunity in the current scenario. We need:

1. A large counter-cyclical fiscal policy that supports both the Centre and states;

2. An increase in wages as a percentage of GDP through support to MSMEs, tweaking of MGNREGA and a policy for unorganised labour; and

3. To create an enabling atmosphere for private investment to come back vigorously via reforms in sectors like power, telecom, and a policy for coastal economic zones. ■