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PRESS RELEASE

JUNE UPDATE

NCAER's Quarterly Review of the Economy 2020-21:Q1

in Coronavirus times

New Delhi (Thursday, June 25, 2020): The National Council of Applied Economic Research (NCAER) released its latest **June 2020 update on the *Quarterly Review of the Economy* (QRE)** for the first quarter of FY2020-21 today. NCAER's latest macroeconomic results were reported by NCAER Distinguished Fellow **Sudipto Mundle**, NCAER Senior Fellow **Bornali Bhandari**, and NIPFP Professor (and now Vice Chancellor, BASE in Bengaluru) **N R Bhanumurthy**. The webinar featured two of India's most prominent macroeconomists, the QRE guests **Shankar Acharya**, Honorary Professor, ICRIER, and former Chief Economic Adviser to the Government of India and **Pronab Sen**, Programme Director, IGC India, and former Chief Statistician of India. The webinar was moderated by NCAER Director General **Shekhar Shah.**

The **June QRE 2020 Update** revises the **NCAER 2020-21: Q1 QRE** that NCAER released on May 15, 2020, in its Coronavirus Briefing webinar. India's economy is in tremendous flux, with the aftereffects of its four near total lockdowns, and the priority in June that the Centre and States have given to reopening and accepting the risks of surging Coronavirus infections, including in the capital city of Delhi with its highest infection rate in India of 384 cases and 12 deaths per 100,000 population. The Central Government had just announced its main stimulus package when NCAER released its May 15 QRE. The June Update to the QRE 2020-21:Q1 brings all this into focus along with more recent policy developments.

The updated QRE provides a detailed, revised sector-by-sector assessment of the impact on GDP of the pandemic, the four national lockdowns, and now the phased reopening. The policy simulations presented by the QRE Team suggest that the fiscal and monetary stimulus undertaken by the Central Government and RBI could have resulted in positive annual GDP growth of 1.3 percent had the Indian economy at all levels not suffered the deep and wide, lockdown-related, supply disruptions. Unfortunately, these unprecedented supply disruptions are evident everywhere, particularly in manufacturing, in services, with firms and businesses closing down, especially MSMEs, the large-scale disruption of supply chains, and the intolerable plight of urban migrant workers desperate to get home and possibly unwilling to return quickly.

In the face of such grave uncertainty and a rapidly changing situation, with businesses and offices opening (and then closing again), the healthcare infrastructure under tremendous strain, and people lowering their guard despite widespread fear, making forecasts is itself a risky business. Rather than offer traditional macro forecasts, this June Update, as did the May 15 QRE, provides growth policy simulations based on our modelling work taking into account varying levels of GDP loss due to supply disruptions. Assuming no impact of supply disruptions, the model scenario shows very modest positive GDP growth of 1.3 percent. Assuming that supply disruptions will hold back GDP growth resulting in zero or negative growth, our model simulations show the impact on major macroeconomic indicators, in particular, moderately rising inflation, as detailed below.

QRE June 2020 Policy Simulations

The detailed sectoral and sub-sectoral assessments of supply disruptions are based on the views of domain experts and available industry and government data. The QRE's early assessment released on May 15 about 2019:Q4 (the QRE estimate was 3 percent) and overall 2019-20 GVA growth (QRE was 4 percent) matches closely with the provisional GVA figures released by CSO and MoSPI on May 29, 2020. As a hypothetical counterfactual, it is our assessment now that GDP growth would decline by (-) 12.4 percent for the year as a whole **in the absence of any specific Coronavirus recovery stimulus** (Table 1).

Table 1: "No-Stimulus" Quarterly GVA Growth Assumptions, (%year-on-year)

Sectors	Provisional CSO*		Base-case, QRE expert assumptions				
	2019-20:Q4*	2019-20*	2020-21:Q1	2020-21:Q2	2020-21:Q3	2020-21:Q4	2020-21
Agriculture	5.9	4.0	3.0	3.0	3.0	3.0	3.0
Industry	(-)0.6	0.9	(-)54.2	(-)36.0	(-)18.0	0	(-)27.1
Services	4.4	5.6	(-)16.3	(-)10.9	(-)5.4	0	(-)8.2
GVA	3.1	3.9	(-)25.7	(-)16.7	(-)8.1	0.5	(-)12.4

***Notes*: ***Provisional Estimates released on May 29, 2020 by MoSPI.
***Source*:** NCAER QRE Team and data from MoSPI; GVA=gross value added.

The counterfactual assumptions do not, of course, take into account the Government's and RBI's fiscal and monetary stimulus measures. Using this counterfactual, in our QRE base case scenario, these stimulus measures are allowed to work through our model assuming there are no pandemic or lockdown-related supply disruptions, resulting in positive GVA growth of 1.3 percent.

Building on this base case, we provide four alternative scenarios where we assume that supply disruptions will limit GDP growth to 0%, and then more stringently to -2, -5, and -10 percent growth in FY20-21 (Table 2). Our model-based policy simulations explore the impact of the fiscal and monetary policy measures on major macroeconomic aggregates that have been announced so far, including the *Atmanirbhar Bharat* package. The results suggest that while a decline in GDP could be significantly contained by these measures, the actual outcomes will depend on the strength of the supply response and the extent to which the lockdown-related supply disruptions are overcome. The simulations suggest that inflation would rise moderately to 6-8 percent and the current account deficit would remain below 3 percent of GDP. The combined fiscal deficit would be contained below 8 percent of GDP,

implying a total public sector borrowing requirement of probably around 9-10 percent of GDP. In sum, the results suggest that while a decline in GDP could be significantly contained by the stimulus measures already announced, the actual outcome will depend on the strength of the supply recovery.

Table 2: QRE 2020-21:Q1 June Update, GDP policy simulation results with alternative supply response assumptions

Growth scenarios (GDP growth assumption due to supply disruptions)	**Assumed GDP growth (%)**	**Model simulations**		
		Inflation (%)	Fiscal deficit (as % of GDP)	Current account (as % of GDP)
Counterfactual scenario (no policy stimulus, expert judgments)	(-) 12.4[1]	4.5	6.4	1.4
Base case (stimulus + assuming no impact of supply disruptions)	1.33	5.46	7.6	2.8
Scenario 1 (stimulus, but supply disruptions limit GDP growth to 0%)	0	6.03	7.8	2.6
Scenario 2 (stimulus, but supply disruptions limit GDP growth to -2%)	-2.0	6.44	7.8	2.3
Scenario 3 (stimulus, but supply disruptions limit GDP growth to -5%)	-5.0	6.71	7.6	1.8
Scenario 4 (stimulus, but supply disruptions limit GDP growth to -10%)	-10.0	7.78	7.4	1.1

[1]Minor differences between growth rates for GVA and GDP are being ignored.
***Source*:** Estimates using model from Bhanumurthy N R, S. Bose, and S. Satija, 2019. "Fiscal Policy, Devolution, and the Indian Economy". *NIPFP Working Paper* No. 287, https://nipfp.org.in/publications/working-papers/1883/. New Delhi, December.

The May 15 QRE release focused a lot on policy helping to build aggregate demand back into the economy after India's extreme lockdowns. Our work now shows even after we factor in the impact of the stimulus measures that have been announced by the Central Government and RBI, much may still remain undone if measures are not designed and implemented to overcome Coronavirus related supply disruptions, including in labour, logistics, trade, transport, and other sectors, all of them impinging on the ability of industry and trade to recover.

Outlook for Domestic Sector Performance

The outlook for **agriculture** looks positive. It is the only sector where we expect positive growth even in the absence of significant stimulus. This is because the availability of the main inputs is reportedly comfortable, the South-West monsoon is expected to be normal, and the incidence of pests and diseases is expected to remain below the economic threshold level. Our assessment is that GVA in agriculture will grow at 3.0 percent in 2020-21.

In the **industrial sector,** growth measured by the Index of Industrial Production (IIP) declined by (-) 55.5 percent in April 2020. Electricity demand also declined by nearly (-) 24 percent in April 2020, with a more moderate decline of (-) 17 percent in May 2020 and the first week of June 2020. Not surprisingly, the IHS Markit Purchasers Managers' Index indicated a contraction during both April and May. The NCAER assessment is that **industrial real GVA** may have declined by (-) 54.2 per cent in Q1: 2020-21. We further expect it to gradually recover to zero percent growth by the fourth quarter, implying an annual decline of (-) 27.1 per cent for 2020-21, but this does not take into account the impact of fiscal and monetary stimulus measures. The actual outcome will depend on the demand-

stimulating impact of these measures and the strength of the supply response. It is likely that the net impact will be a decline in industrial output for the year as a whole.

The IHS Markit Purchasers Managers' Index for the **services sector** also indicates a contraction during April and May. Other available lead indicators from April and May 2020 suggest mixed trends in line with our expectations. The GVA in the services sector is estimated to have declined by (-) 16 per cent in Q1: 2020-21, and is likely to register negative growth for the entire year 2020-21.

Outlook for the External Sector

Weak external demand and supply chain disruption triggered by the Coronavirus have severely hit Indian exports, which are estimated to have contracted by (-) 33.7 percent y-o-y in dollar terms during April-May 2020. However, imports have contracted even more, at (-) 48.3 percent cumulatively during April-May 2020 in dollar terms. This is partly because of weak domestic demand but also because of the global oil price crash. The sharper decline in imports as compared to exports has moderated the trade deficit. The pandemic has also had a severe adverse impact on remittance flows and triggered a large outflow of portfolio investments while slowing down the inflow of FDI. These developments have led to depreciation of the Indian rupee, which in turn, has encouraged the flight of capital.

Fiscal and Monetary Policy Outlook: Dealing with the Coronavirus Shock

The expected revenue shortfall combined with the required increase in expenditure will entail a large increase in the combined fiscal deficit of the Central and State governments. The fiscal stimulus already announced amounts to a substantial 9.7 percent of GDP, including 6.3 percent budgeted deficits (Centre plus States), 2.1 percent additional post-budget Central borrowing to offset the expected revenue shortfall, and 1.3 percent additional fiscal spending under the *Atmanirbhar Bharat* package. If we also count the 2 percent additional borrowing headroom now provided for States, which they may or may not use because of the stringent conditionality, the fiscal stimulus would add up to 11.7 percent of GDP, or over ₹23 trillion. Together with the liquidity infusion amounting to about 8 percent of GDP on the monetary side, this could lead to a very significant recovery of aggregate demand if there is sufficient uptake of the stimulus beyond direct income support. How that impacts GDP growth and inflation will depend on how aggregate supply responds to the restoration of demand. Optimally managing such a large, unprecedented, borrowing program is also a challenge for RBI and a financial sector that is already facing considerable stress. We recommend the use of multiple funding channels, including market borrowings, indirect monetisation, further easing of the 'ways and means' advances, and direct monetisation of a part of the fiscal deficit.

The ***Quarterly Review of the Economy*** **(QRE)** aims to meet the needs of policymakers, corporates, and others interested in tracking the latest developments in the Indian economy. It provides a data-driven, independent analysis of current policies and tracks sector-by-sector developments in India and globally. It contains special sections on external developments, prices, and monetary policy and capital markets. NCAER's quarterly and annual growth forecasts are widely quoted in the Indian and international media. Each QRE is released by NCAER at a quarterly State of the Economy seminar that brings together policymakers, industry leaders, and researchers. QREs are available by subscription, but during these extraordinary Coronavirus times, they are being released at NCAER webinars and available for free downloads from NCAER's website, www.ncaer.org.

As with this June Update to the 2020-21: Q1 QRE, NCAER is looking into issuing QRE updates during each quarter to track the Indian macro economy more closely and

assess the impact of policy changes and recovery assistance in these unprecedented Coronavirus times.

About NCAER | The National Council of Applied Economic Research

Established in 1956, NCAER is India's oldest and largest independent, non-profit, economic policy research institute. NCAER's work cuts across many sectors, including growth, macro, trade, infrastructure, logistics, labour, urban, agriculture and rural development, human development, poverty, and consumers. The focus of NCAER's work is on generating and analysing empirical evidence to support and inform policy choices. It is also one of a handful of think tanks globally that combine rigorous analytical and modelling capacity with deep data collection capabilities, especially for household surveys. More on NCAER is available on www.ncaer.org.

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