NCAER’s Quarterly Review of the Economy, Q2:2020-21
in Coronavirus times

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with Ashima Goyal and Pranjul Bhandari
in conversation with
Shekhar Shah

Webinar, Friday, September 25, 2020, 6:30 pm IST
QRE Team

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Outline

I. Hysteresis and the Quarterly, Annual, and Medium-to-Long Term Growth Outlook

II. Performance of the Real Economy and Trade
   A. Domestic Real Sector Trends
   B. External Sector
   C. Price Trends

III. Macroeconomic Policies
   A. Grim Fiscal Outlook 2020-21
   B. Monetary Policy Challenges
Coronavirus Pandemic still raging

- Over 1,000 daily deaths, growing at 1% daily
- Total deaths now over 90,000

Source: MoHFW.
Economy in an unprecedented crisis

- GDP in Q1: 2020-21 contracted by 23.9% year-on-year (y-o-y).
- Contraction moderating but y-o-y growth still negative

![Graph showing GDP growth actual, nowcast, and forecast from Q4: 2018-19 to Q4: 2020-21 (% change y-o-y).]
Economy in an unprecedented crisis

- Growth forecast for 2020-21: (-) 12.6%
- Unfortunately, projected annual inflation also elevated at 6.5%, above RBI target band
- Competing goals of reviving growth vs containing inflation, macroeconomic policy challenging
Hysteresis: medium to long-term impact of shock

- **Path I**: Counterfactual trend growth path (5.8%) with no shock
- **Path II**: Assumed optimistic 7% growth path post 2021
  - Previous peak output (2019-20) will be reached only in 2022-23
  - Catch-up with counterfactual 5.8% growth path only by 2037-38
- **Path III**: Trend growth path (5.8%) after reaching peak output in 2022-23
  - 1991-type wide ranging reforms necessary to nudge economy to higher growth path
Sustained decline in GDP Growth since Q3: 2017-18 before coronavirus crisis

Real GDP Growth

<table>
<thead>
<tr>
<th>Year/Period</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015-16</td>
<td>8.3</td>
</tr>
<tr>
<td>2016-17</td>
<td>8.3</td>
</tr>
<tr>
<td>2017-18</td>
<td>4.2</td>
</tr>
<tr>
<td>2018-19 Q1</td>
<td>8.7</td>
</tr>
<tr>
<td>2018-19 Q2</td>
<td>8.7</td>
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<tr>
<td>2018-19 Q3</td>
<td>8.7</td>
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<tr>
<td>2018-19 Q4</td>
<td>8.7</td>
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<tr>
<td>2018-19 Q1</td>
<td>8.7</td>
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<tr>
<td>2018-19 Q2</td>
<td>8.7</td>
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<tr>
<td>2018-19 Q3</td>
<td>8.7</td>
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<td>2018-19 Q4</td>
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<tr>
<td>2018-19 Q1</td>
<td>8.7</td>
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<tr>
<td>2018-19 Q2</td>
<td>8.7</td>
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<tr>
<td>2018-19 Q3</td>
<td>8.7</td>
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<tr>
<td>2018-19 Q4</td>
<td>8.7</td>
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<tr>
<td>2019-20 Q1</td>
<td>8.7</td>
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<tr>
<td>2019-20 Q2</td>
<td>8.7</td>
</tr>
<tr>
<td>2019-20 Q3</td>
<td>8.7</td>
</tr>
<tr>
<td>2019-20 Q4</td>
<td>8.7</td>
</tr>
<tr>
<td>2020-21 Q1</td>
<td>3.1</td>
</tr>
</tbody>
</table>

Legend: ▢ Annual; ▶ Quarterly.
Source: MoSPI and NCAER Estimates.
Forecast of normal South-west monsoon augurs well for Indian agriculture

Sub-division wise Rainfall Distribution
(June 1, 2020 to 23rd September, 2020)

Source: IMD
Steep Decline in Industrial Growth since Q4: 2017-18

Growth in Industry GVA

Legend: Annual, Quarterly.
Source: MoSPI and NCAER Estimates.
IIP confirms moderating contraction in July 2020

IIP General and IIP Manufacturing (%y-o-y)

Source: MoSPI
Sharp decline in services growth projected for 2020-21

Growth in GVA Services

Legend:  Annual;  Quarterly

Source: MoSPI and NCAER Estimates
Cargo traffic has shown relatively lower rates of contraction compared to passenger traffic.

**Revenue Earning Goods Traffic, Cargo Handled at Major Ports and Cargo Aviation Traffic**

- **Revenue earning goods traffic**
- **Cargo handled at major ports**
- **Cargo Aviation**

**Air Passenger and Railways Passenger Traffic**

- **Air Passengers**
- **Railways Passengers**

**Source:** Ministry of Railways, Indian Ports Association and Airports Authority of India.
Exports and imports growth declining since Q2: 2018-19, now negative

Growth of Exports and Imports of Goods & Services
(US$ terms, %y-o-y)

Source: Ministry of Commerce and RBI.
Increase in foreign currency assets & exchange rate movements

[Graph showing foreign currency assets and exchange rates]
Inflation trends and forecast

Source: Contributed by Rudrani Bhattacharya
Unrealistic revenue projections

- 2019-20 BE assumed 18.3% tax revenue growth
- Actual 2019-20 tax receipts (provisional) was (-) 18.3% compared to 2019-20 BE
- Despite this 2020-21 BE assumed 20.6% tax revenue growth
Sharp slide in tax revenue following lockdown

- Lockdown has led to a sharp contraction in economic activities.

- This in turn has led to a large reduction in tax revenues of about 30% in April-July 2020 year-on-year.

- Direct taxes, indirect taxes & its largest single component, GST, have all declined significantly.
Revenue decline has not been passed on as expenditure compression

- Central government revenue receipts declined by 42% during April-July 2020 (y-o-y).
- Revenue decline has not been passed on as expenditure contraction.
- Expenditure increased by 11.3% during April-July 2020 (y-o-y).
- Revenue decline has been absorbed by a 50% increase (y-o-y) in the fiscal deficit during April-July 2020.
Fiscal Stimulus and Fiscal Impulse (2020-21)

- Low fiscal component of Atmanirbhar Bharat (2.4% of GDP) was misleading
- Expected fiscal deficit in 2020-21 is 12.8% of GDP, up from 6.3% last year
- The public sector borrowing requirement is expected to be around 14%-15% of GDP (2020-21).
- This amounts to a large fiscal stimulus
- Even the fiscal impulse will be large at 6.5% of GDP for 2020-21.

<table>
<thead>
<tr>
<th>Item</th>
<th>GDP (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Central Government Budget Deficit</td>
<td>3.5</td>
</tr>
<tr>
<td>2 Post-Budget additional borrowing</td>
<td>2.1</td>
</tr>
<tr>
<td>3 Atmanirbhar Bharat fiscal component</td>
<td>2.4</td>
</tr>
<tr>
<td>4 States’ Budget Deficit</td>
<td>2.8</td>
</tr>
<tr>
<td>5 Additional borrowing headroom for States</td>
<td>2.0</td>
</tr>
<tr>
<td>6 Combined fiscal deficit 2020-21</td>
<td>12.8</td>
</tr>
</tbody>
</table>
Challenging monetary policy task

• Competing policy goals of reviving economy & containing inflation while pandemic still raging

• Reviving economic activity is the priority since GDP contracted by 23.9% in Q1

• However, headline inflation at 6.7% now above RBI’s target band

• Given this context, liquidity infusion of 4.8% of GDP provided by RBI in addition to fiscal stimulus

• Repo rate also reduced from 5.2% in February 2020 to 4% in May 2020.

• Repo rate reduction subsequently paused because of elevated inflation

• Inflation containment will mainly require strengthening of supply responses
Improved transmission of Repo rate changes

- The transmission of reduction in Repo rate has improved
- Weighted average lending rate of commercial banks has declined by 0.9% since February
- Transmission has been strongest for foreign banks (-1.4%), followed by private sector banks (-1.1%)
- Transmission has been weaker for public sector banks at only 0.7%

### Weighted average lending rate for fresh loans, January and July 2020

<table>
<thead>
<tr>
<th></th>
<th>Jan-20</th>
<th>Jul-20</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scheduled Commercial Banks</td>
<td>9.4</td>
<td>8.5</td>
</tr>
<tr>
<td>Private Sector Banks</td>
<td>10.2</td>
<td>9.1</td>
</tr>
<tr>
<td>Foreign Banks</td>
<td>8.6</td>
<td>7.2</td>
</tr>
<tr>
<td>Public Sector Banks</td>
<td>8.9</td>
<td>8.2</td>
</tr>
</tbody>
</table>

**Source:** RBI
Improved transmission of Repo rate changes

• Yield on short maturity government bonds have also followed Repo rate reductions

• However, yield on the benchmark 10-year G-sec has remained elevated.

• RBI has taken several steps to moderate the G-sec yield such as TLTRO, Twist Operations etc.

• However, these have not proved very effective so far

• This is mainly attributable to crowding out by massive government borrowing following economic contraction

Rates and Yields, % (January to August 2020)

Policy Repo Rate
Reverse Repo Rate
91-Day T-Bill (Primary) Yield
364-Day T-Bill (Primary) Yield
10-Year G-Sec Par Yield (FBIL)

Source: RBI
Credit growth has declined further in 2020

- Credit growth has declined for all sectors in 2020, turned negative for micro, small and medium industries.
- This is despite several credit guarantee schemes provided under Atmanirbhar Bharat programme to reduce risk aversion.
- Lenders prefer low return but also low risk government sovereign debt, MSME businesses also reluctant to borrow
- Situation may not improve so long as crowding out by large government borrowing persists

**Growth Rate of Credit Across Industry (% y-o-y)**

<table>
<thead>
<tr>
<th>Industry Type</th>
<th>21-06-19</th>
<th>19-06-20</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ag &amp; Allied</td>
<td>8.4</td>
<td>2.4</td>
</tr>
<tr>
<td>Industry</td>
<td>6.6</td>
<td>2.2</td>
</tr>
<tr>
<td>Micro &amp; Small</td>
<td>1.9</td>
<td>-3.7</td>
</tr>
<tr>
<td>Medium Industry</td>
<td>1.6</td>
<td>-9.0</td>
</tr>
<tr>
<td>Large</td>
<td>7.7</td>
<td>3.7</td>
</tr>
<tr>
<td>Services</td>
<td>13.8</td>
<td>10.7</td>
</tr>
<tr>
<td>Personal</td>
<td>15.9</td>
<td>10.5</td>
</tr>
<tr>
<td>Priority</td>
<td>8.7</td>
<td>1.9</td>
</tr>
</tbody>
</table>

Source: RBI
Financial Sector Stability and Reforms

• Financial sector already under stress prior to lockdown, with Gross Non-performing Assets (GNPA) 8.5% in March 2020

• Financial Stability Report indicates stress levels have considerably aggravated since the lockdown

• Stress tests covering 53 commercial banks indicate
  – GNPA could spike to 14.7% under ‘very severe’ stress
  – GNPA could spike to 12.5% under ‘moderate’ stress

• In the short-term monetization of at least a part of massive government borrowing could reduce crowding out and enhance credit flow to the private sector

• However, urgent reforms are required to strengthen financial stability and the health of the financial sector in the long-term. Key reform measures would include:
  – Strengthened supervision of banks
  – Establishment of a ‘bad bank’ to acquire NPAs and clean up bank balance sheets
  – Governance reform in public sector banks, reduction of government ownership to less than fifty per cent before recapitalization of these banks
Thank You!