NATIONAL COUNCIL OF APPLIED ECONOMIC RESEARCH

Quarterly Review of the Economy, Q2:2020-21

in Coronavirus Times

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NATIONAL COUNCIL OF APPLIED ECONOMIC RESEARCH

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Contributors:

Overview: Sudipto Mundle and Bornali Bhandari
Hysteresis and the Quarterly, Annual, and Medium-to-Long Term Growth Outlook: Sudipto Mundle and Rudrani Bhattacharya (NIPFP)
Agriculture: Anil Kumar Sharma
Industry: Saurabh Bandyopadhyay, Bornali Bhandari and Ajaya K Sahu
Services: Bornali Bhandari
External Sector: Bornali Bhandari
Prices: Ajaya K Sahu, Rudrani Bhattacharya (NIPFP) and Bornali Bhandari
Fiscal outlook, Q2: 2020-21: Sudipto Mundle, Ajaya K Sahu and Pallavi Choudhuri
Money and Financial Markets: Pallavi Choudhuri and Sudipto Mundle

Organisational Assistance: Sudesh Bala, Praveen Sachdeva, Shilpi Tripathi, Sangita Chaudhary, Sukriti Chauhan, Eman Rahman and Khusvinder Kaur

Project Leader: Sudipto Mundle
Coordinator: Bornali Bhandari

Published by
Published by
Professor Anil K. Sharma
Secretary and Operations Director
The National Council of Applied Economic Research (NCAER)
NCAER India Centre
11, Indraprastha Estate, New Delhi–110 002
Tel: +91-11-2345 2657, 6120 2698
Email: aksharma@ncaer.org
www.ncaer.org

Contents

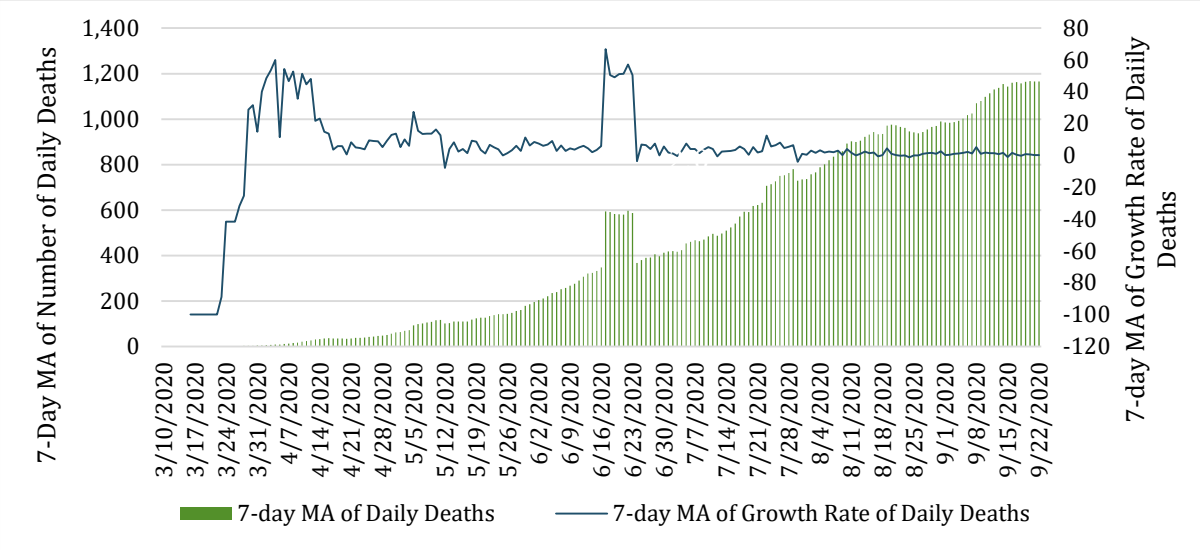
Chapter 1: Overview

Sudipto Mundle and Bornali Bhandari

Introduction

The coronavirus pandemic is still raging in India. It is now ranked second after the United States (US) in terms of the cumulative number of infections[1]. It is ranked third after US and Brazil in terms of total number of Covid-19 related deaths, which already exceeds 88,000 (September 21st, 2020) and is beginning to approach 100,000. Although the pandemic related death rate is still relatively low at 66 per million, it is a matter of little comfort. Well over 1,000 lives are lost every day due to the pandemic (Figure 1.1). The growth rate of daily deaths has remained stationary at close to 1 percent per day and that of cumulative deaths at 1.5 per cent through September. The curve of total pandemic deaths will completely flatten only when both these rates decline to zero.

Figure 1.1: 7-day Moving Averages (MA) of Number and Growth (% change) of Daily Deaths March 10, 2020 to September 22, 2020



Source: Authors' computations from Ministry of Health and Family Welfare.

Meanwhile, the economy is in an unprecedented crisis. The NCAER May 2020 and June 2020 QRE had assessed that the economy would contract by 26 per cent in Q1. Official estimates have now confirmed that GDP did decline by 24 per cent in Q1 (Table 1.1). At the same time retail inflation has remained elevated and sticky at over 6 per cent, i.e, above the Reserve Bank of India (RBI) target inflation band of 2 per cent-6 per

[1] John Hopkins University, Coronavirus Resource Centre website. https://coronavirus.jhu.edu/map.html.

cent. Elevated inflation along with the steep contraction of the economy requires macroeconomic policy to navigate its way between two competing goals of reviving the economy and containing inflation, a very challenging task.

Out of the three sectors, agriculture was the only exception that showed positive growth. Industry and services sectors showed double digit year-on-year (y-o-y) contraction in Q1:2020-21. On the demand-side, barring government final consumption expenditure, all other components, namely private consumption, investment, exports and imports contracted sharply (Table 1.1).

Table 1.1: GDP, GVA and its components, Q1: 2020-21(% change y-o-y)

Item	***(%y-o-y)***	***Item***	***(%y-o-y)***
Agriculture	3.4	*Private Final Consumption Expenditure*	(-) 26.7
Industry	(-) 38.1	*Government Final Consumption Expenditure*	16.4
Services	(-) 20.6	*Gross Fixed Capital Formation*	(-) 47.1
GVA	(-) 22.9	*Exports*	(-) 19.8
		Imports	(-) 40.4
		GDP	(-) 23.9

Source: MoSPI.

Thus, both supply and demand collapsed during 2020-21 Q1. However, inflation has remained elevated at 6.7 per cent in July and August 2020, breaching the RBI's inflation target band of 4 per cent ± 2 per cent despite the contraction in demand. This suggests that supply contraction has dominated macroeconomic dynamics. The nationwide lock down was gradually eased since June 2020 to enable the revival of economic activities. Some States have subsequently imposed local lockdowns to cope with the pandemic. As a consequence supply constraints have continued, albeit with some easing. The leading indicators for the second quarter suggest that while y-o-y growth is still negative the contraction is moderating. Going forward, much will depend on how the spread of the disease plays out and how Central and State governments respond to it. Both factors are major unknowns at this time. Hence, the outlook for the rest of 2020-21 and also 2021-22 remains highly uncertain.

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

We are now forecasting that y-o-y growth will remain negative through Q2, Q3 and Q4 at (-) 12.7 per cent, (-) 8.6 per cent and (-) 6.2 per cent respectively. For the year as a whole 2020-21 GDP will decline by (-) 12.6 per cent. The key question is how the economy will perform thereafter. References to V-shaped recovery etc. obfuscate more than they reveal. The fact is that economic hysteresis, the medium to long term footprint of a major economic shock, is indeed very long. Post 2020-21 annual growth of 7

per cent would imply a positive growth swing of 20 per cent not ever seen so far in India. Assuming very optimistically that 7 per cent growth is indeed achieved because of the base effect of a steep decline in 2020-21, combined with strong policy measures to revive growth, we would still reach the previous peak output level of 2019-20 only by the end of 2022-23. If that annual growth path of 7 per cent can be sustained over the long term, again a heroic assumption, the economy will catch up with its pre-pandemic growth path only by 2037-38. A more likely scenario is that after getting back to its previous peak output level by 2022-23 the economy will settle back to its pre-pandemic growth path of 5.8 per cent. To nudge the economy to any higher growth path would require ambitious economic reforms across a wide front like the 1991 reforms.

Agriculture

As mentioned before, despite the sharp decline in output in all other sectors agriculture grew by 3.4 per cent in real terms in the first quarter of 2020-21 (Table 1.1). This is mainly because of the excellent performance of production in all farm products except sugar cane during the agricultural year 2019-20, which includes the first quarter of financial year 2020-21, i.e., the months of April, May and June 2020. This in turn is largely because of the excellent performance of rains during the monsoon and post-monsoon period of the agricultural year. For the full financial year 2020-21 it is too early to predict with any certainty how agriculture will perform. However, if the good rainfall activity experienced until the end of August continues and predictions made by the India Meteorological Department turn out to be true for the entire year, then it is likely that the agricultural sector will record strong growth in 2020-21. The coverage of area under Kharif crops until the end of August 2020 is significantly higher compared to last year for several food-grain crops such as rice, pulses, and coarse grains. The same is true for most non-foodgrain crops such as oilseeds, cotton, and sugarcane. Water storage in major reservoirs of the country is also adequate. All this augurs well for the remaining kharif season and Rabi crops.

Industry

GVA in Industry contracted by an unprecedented 38.1 per cent in Q1: 2020-21 because of the stringent nation-wide lockdown that was imposed towards the end of March 2020 to deal with the novel coronavirus (Table 1.1). Growth of all the four sub-sectors namely mining, manufacturing, construction, electricity gas & water utilities, contracted in Q1: 2020-21. This massive contraction came at the end of a long period of declining industrial growth that started from Q4 of 2017-18, marking the fourth quarter of monotonic decline after Q1 of 2019-20. With gradual unlocking since June 2020 there has been some modest recovery. High frequency leading indicators such as IIP, electricity consumption, GST collection, number of e-way bills generated etc. indicate a gradual and sporadic recovery. Though the peak level of industrial output achieved in Q4: 2019-20 is yet to be reached, the extent of contraction, y-o-y, has moderated during Q2: 2020-21. The sporadic nature of the recovery is mainly attributable to the policy flip-flops of re-locking

and unlocking pursued by individual state governments in some of the most industrialised states in response to the resurgence of Covid-19 cases in these states.

Services

The services sector contracted in Q1: 2020-21 and is most likely to do so y-o-y also in Q2. Only one leading indicator from the second quarter, revenue earning railway goods traffic, showed some modest positive growth in August 2020. Other indicators suggest a y-o-y decline. Compared to Q1 the trends were somewhat mixed in Q2, depending on the operational status of the sector. While freight traffic across modes showed improvement in July and August 2020, the y-o-y contraction of passenger traffic has remained very high. The outlook remains uncertain for the rest of the year depending on our ability to control the spread of the virus.

External Sector

The narrowing of the trade balance in the first quarter and then in July-August is due to the faster recovery of exports as compared to imports. The merchandise and services trade balance has been in surplus since April 2020. Merchandise trade was contracting y-o-y since June 2019 with intermittent periods of positive growth. The novel coronavirus pandemic accelerated that decline. The contraction of merchandise exports and imports have both moderated since April, but contraction of exports has moderated more. While trends in India's merchandise trade since April 2020 have been similar to that of the rest of the world, India's service trade trends have been somewhat better. The uncertain nature of the pandemic implies that the outlook for trade going forward also remains highly uncertain.

Indian foreign currency reserves have grown at an accelerating pace since October 2019. In July and August 2020 foreign exchange reserves grew by 22.4 per cent and 25.8 per cent respectively. There has been a surge in NRI inflows in the first quarter of 2020-21. Foreign institutional investment (FII) inflows have also increased significantly through June, July and August 2020. Oil prices and oil exports & imports have all declined compared to a year ago. The exchange rate of the rupee was depreciating since March 2020 but then stabilised during July-August 2020, appreciating marginally compared to the first quarter. This helps to mitigate any external inflationary pressures but the trade-off is that exports have become relatively more expensive. The Real Effective Exchange Rate (36-country, trade weighted) has appreciated 1.4 per cent since June 2020. Faced with the classic policy trilemma of open economies, i.e. choosing any two of three alternatives among free capital mobility, exchange-rate management and monetary policy autonomy, the central bank currently appears to be leaning away from exchange rate management.

Prices

Elevated and sticky retail inflation has persisted during the first two months of the second quarter. Monthly retail food inflation remained high at 9.2 per cent during July-August 2020 on a y-o-y basis. Core CPI inflation (non-food, non-fuel) was also high at 5.8 per cent during the same period. Further, the WPI which had been deflating earlier showed positive inflation in August 2020. Going forward, our VAR model nowcasts 6.6 per cent retail inflation in Q2: 2020-21 and forecasts a moderating trend for the remaining quarters of 2020-21. The headline inflation for the financial 2020-21 is forecast at 6.5 per cent. This is well above the RBI inflation target band of 2-6 per cent. With one-year ahead inflation expectations already at double-digits, any further entrenchment of inflation expectations could push India into a high-inflation and low-growth spiral, with challenging macroeconomic policy implications.

Fiscal Outlook

Fiscal policy making has become very challenging with inflation rising alongside an unprecedented contraction of economic activity.

The stringent countrywide lock down that was imposed in the wake of the novel coronavirus pandemic has completely destabilised the fiscal situation which was already under considerable stress even before the lock down. With GDP growth slowing down to only 3.1 per cent in Q4 of 2019-20 and GDP then contracting by (-) 23.9 per cent in Q1 of 2020-21, there has been a steep slide in revenues.

Instead of passing this through as a contraction of expenditure, the Central Government has maintained expenditure at more or less budgeted levels, with additional borrowing to compensate for the shortfall in revenue. This will entail a large increase in the combined annual fiscal deficit. The Central and State Government's deficits will together add up to almost 13 per cent of GDP, with a total public sector borrowing requirement of 14 per cent to 15 per cent of GDP. Combined with liquidity infusion of nearly 9 per cent of GDP on the monetary policy side, this adds up to a very strong stimulus for aggregate demand. How much of this will translate to recovery of real economic activity and how much will spill over into inflation depends on the supply response following the unlocking of the economy since the end of June. The growth and inflation forecasts (discussed above) signal the need for caution in allowing the deficit to increase much further.

Monetary Policy and Financial Markets

Determining the appropriate monetary policy stance has become very challenging in the present context of unprecedented contraction of the economy along with elevated inflation.

One major challenge that the RBI is facing is to enable the financial market to absorb the massive borrowing program of the government without allowing interest rates to rise. It seems inevitable that at least a part of this borrowing will have to be monetised to avoid excessive pressure and crowding out in the financial markets. The RBI

held the policy repo rate steady at 4 per cent in its bi-monthly review meeting held on August 6, 2020, while maintaining an accommodative stance. Transmission of policy rate changes has also strengthened significantly since February 2020 and bank lending rates as well as short maturity bond yields have declined though the benchmark 10-year G-sec yield is still elevated. RBI has undertaken several interventions to moderate the benchmark yield. But RBI's expansionary monetary policy has had to be modified due to rising inflation.

Credit growth, especially for micro, small and medium enterprises (MSMEs) has unfortunately remained muted due to high and rising risk aversion. Banks prefer to invest in low return low risk sovereign debt. Several measures to stimulate credit flow to these enterprises have so far proved ineffective. Meanwhile, the long persisting challenge of non-performing assets has become greatly aggravated by the coronavirus crisis and country wide lockdown. The Gross non-performing assets ratio (GNPA) was 8.5 per March 2020. Stress tests suggest that the GNPA could spike to as much as 12.5 per cent or even 14.7 per cent of total loans by March 2021

Conventional fiscal and monetary policies alone will not be enough to get the economy out of its current crisis unprecedented of contraction combined with rising inflation. That will require wide ranging reforms no less ambitious than the reforms of 1991. The most urgent component of such a reform package is the set of reforms to ensure the stability of the financial sector in India. These should include much stronger supervision of banks as well as other financial institutions; resolution of existing NPAs, if necessary through the creation of a 'Bad' bank; at least partial disinvestment and governance reforms in state owned banks before they are recapitalised and more effective incentives and guarantees to induce growth of lending to MSMEs.

Chapter 2: Hysteresis and the Quarterly, Annual, and Medium-to-Long Term Growth Outlook

Sudipto Mundle and Rudrani Bhattacharya[1]

The coronavirus pandemic is still raging in India. Well over 1,000 lives are lost every day due to the pandemic and cumulative Covid-19 deaths are beginning to approach 100,000. Meanwhile, the economy is in an unprecedented crisis. The NCAER May 2020 and June 2020 QRE had indicated that the economy would contract by 26 per cent in Q1. Official estimates have now confirmed that the GDP did decline by 24 per cent in Q1. We are now forecasting that year-on-year growth will remain negative through Q2, Q3 and Q4 at (-) 12.7 per cent, (-) 8.6 per cent and (-) 6.2 per cent respectively. For the year as a whole 2020-21 GDP will decline by (-) 12.6 per cent. The key question is how the economy will perform thereafter. References to V-shaped recovery etc. obfuscate more than they reveal. The fact is that hysteresis, the long term footprint of a major economic shock, is indeed very long. Post 2020-21 an annual growth of even 7 per cent would imply a massive positive growth swing of 20 per cent within one year, something not ever seen before in India. Nevertheless, assuming very optimistically that 7 per cent growth is indeed achieved because of the base effect of a steep decline in 2020-21, combined with strong policy measures to revive growth, we would still reach the previous peak output level of 2019-20 only by the end of 2022-23. If that annual growth path of 7 per cent can be sustained over the long term, again a heroic assumption, the economy will catch up with its pre-pandemic growth path only by 2037-38. A more likely scenario is that after getting back to its previous peak output level by 2022-23 the economy will revert to its pre-pandemic growth path of 5.8 per cent. To nudge the economy to any higher growth path would require ambitious economic reforms across a wide front comparable to the reforms of 1991.

2.1 Introduction

The coronavirus pandemic is still raging in India. Well over 1,000 lives are lost every day due to the pandemic and cumulative Covid-19 deaths are beginning to approach 100,000. Meanwhile, the economy is in an unprecedented crisis. The NCAER May 2020 and June 2020 QRE had indicated that the economy would contract by 26 per cent in Q1. Official estimates have now confirmed that the GDP did decline by 24 per cent in Q1. This sharp contraction has come on top of several years of a gradual slowdown of the economy. The Gross Domestic Product (GDP) was declining during the past four years. It almost halved from 8.26 per cent in 2016-17 to 4.18 per cent in 2019-20. The growth rate of Gross Value Added (GVA) at basic prices follows similar trends. During the lockdown period of April to June, 2020, GVA contracted by (-) 22.8 per cent. In this background, we nowcast growth for Q2:2020-21 along with forecasts for Q2, Q3, Q4 and for the whole year 2020-21. Levels of GDP and GVA at constant basic prices differ but their growth rates are similar, showing the same pattern of turning points in them. Here we have used GVA growth as a proxy for GDP growth.

[1] Rudrani Bhattacharya is an Assistant Professor at the National Institute of Public Finance and Policy, New Delhi.

2.2 Nowcast GDP growth for Q2: 2020-21

The model has been estimated using a factor-augmented dynamic coefficient model. India, an emerging economy, is subject to frequent structural changes due to exogenous as well as policy shocks. This dynamic relationship needs to be captured quantitatively to facilitate nowcasting or forecasting of economic growth. Earlier research found that dynamic coefficient models can better capture the turning points of Indian GDP growth (Bhattacharya et al., 2019)[2]. We have therefore estimated a Factor-Augmented Time-Varying Coefficient regression model following Hamilton, 1994; and Kim and Nelson, 1999[3].

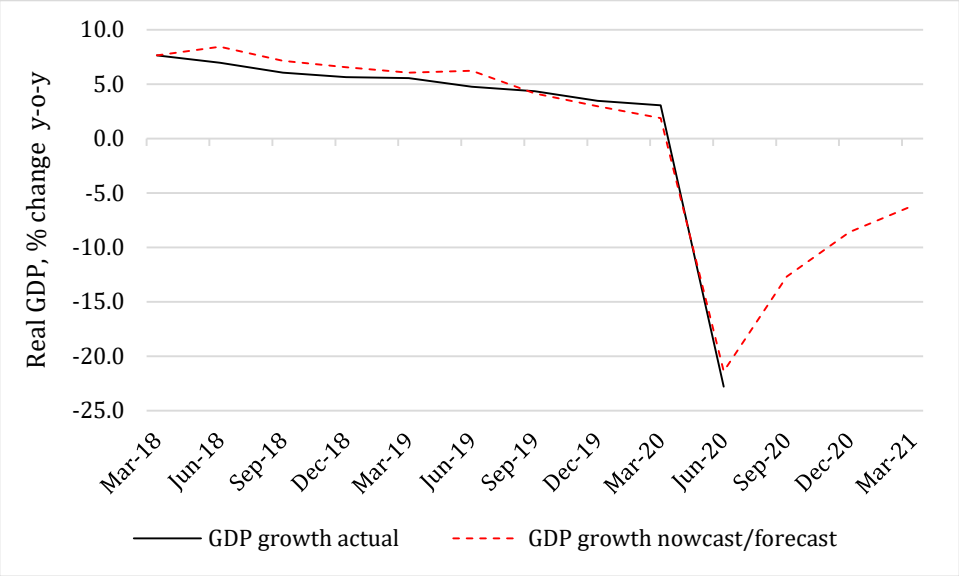
We have used the model to nowcast Q2: 2020-21 GDP growth two months ahead of the GDP data release. The set of monthly indicators used for the nowcast consists of indicators available at least from April, 2011 and till July, 2020. These include the following:

1. *Industrial variables*: Index of Industrial Production.
2. *Services variables*: Cargo handled at major ports.
3. *Monetary variables*: Food credit, non-food credit, aggregate deposits.
4. *External sector variables*: Exports, Non-oil imports.
5. *Price*: Consumer Price Index (CPI) for all India.
6. *Fiscal variables*: Net tax revenue, Revenue expenditure net of interest payment, Goods and Services Tax (GST) received by the Centre and the States.[4]
7. *Energy sector variables*: Electricity Consumption
8. *Weather variables:* Rainfall

Our model gives an in-sample prediction for Q1: 2020-21 GDP growth of (-) 21.4 per cent against the actual outcome of (-) 22.8 per cent (Figure 2.1). Based on our model, the nowcast of Q2: 2020-21 two months ahead of the GDP data release by the Central Statistics Office (CSO) is (-) 12.7 per cent[5].

[2] Bhattacharya, R., Chakravartti, P., Mundle, S., 2019. "Forecasting India's economic growth: a time varying parameter regression approach". *Macroeconomics and Finance in Emerging Market Economies*, 12(3).
[3] Hamilton, J. D., 1994. *Time Series Analysis*. Princeton University Press.
Kim, C.-J., Nelson, C.R., 1999. *State Space Models with Regime Switching: Classical and Gibbs Sampling Approaches with Applications.* MIT Press.
[4] The GST data sourced from the website of the GST council are available from August, 2017. For the purpose of our time series analysis, we backcast the growth in real GST received using growth rate in non-agricultural GVA in constant 2011-12 prices.
[5] With a range of between (-)14.3 per cent and (-) 11 per cent at the 95 per cent confidence interval.

Figure 2.1: GDP growth actual, nowcast and forecast
Q4: 2018-19 to Q4: 2020-21 (% change y-o-y)

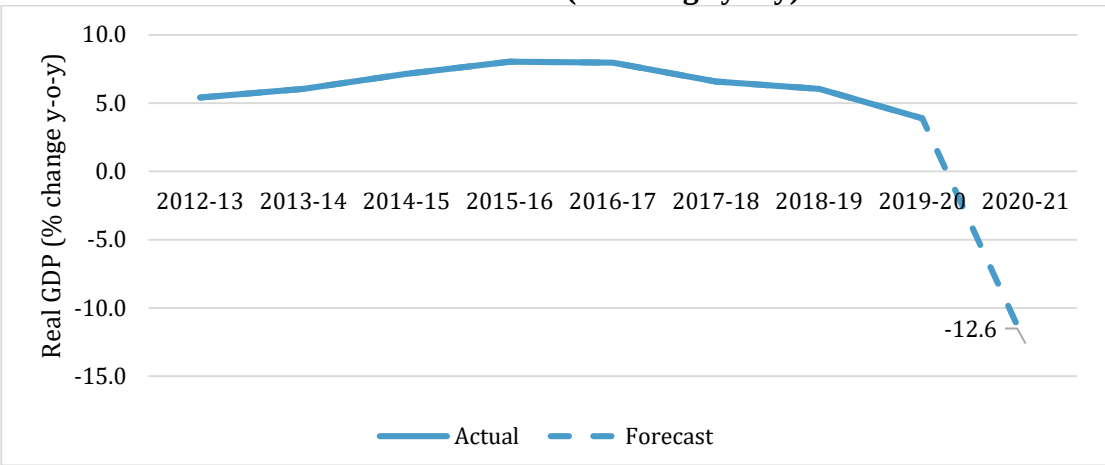


Source: MoSPI. Nowcast and forecast based on Factor-Augmented Time-Varying Coefficient regression model, Bhattacharya, R., Chakravartti, P., Mundle, S., 2019. "Forecasting India's economic growth: a time varying parameter regression approach". *Macroeconomics and Finance in Emerging Market Economies*, 12(3).

2.3 Forecasting Annual GDP Growth for the Financial Year 2020-21

Using the nowcast for Q2: 2020-21 (and the same model), we have forecast GDP growth for Q3: 2020-21 and then used the latter value to further forecast GDP growth for Q4: 2020-21. Our model forecasts (-) 8.6 per cent and (-) 6.2 per cent growth in Q3: 2020-21 and Q4: 2020-21 respectively. Averaging the GDP growth rates for the four quarters of 2020-21 gives us the estimated GDP growth rate of (-) 12.6 per cent for the financial year 2020-21.

Figure 2.2: Annual GDP Growth, actual and forecast 2012-13 to 2020-21 (% change y-o-y)



2.4 The Medium to Long Term Growth Outlook

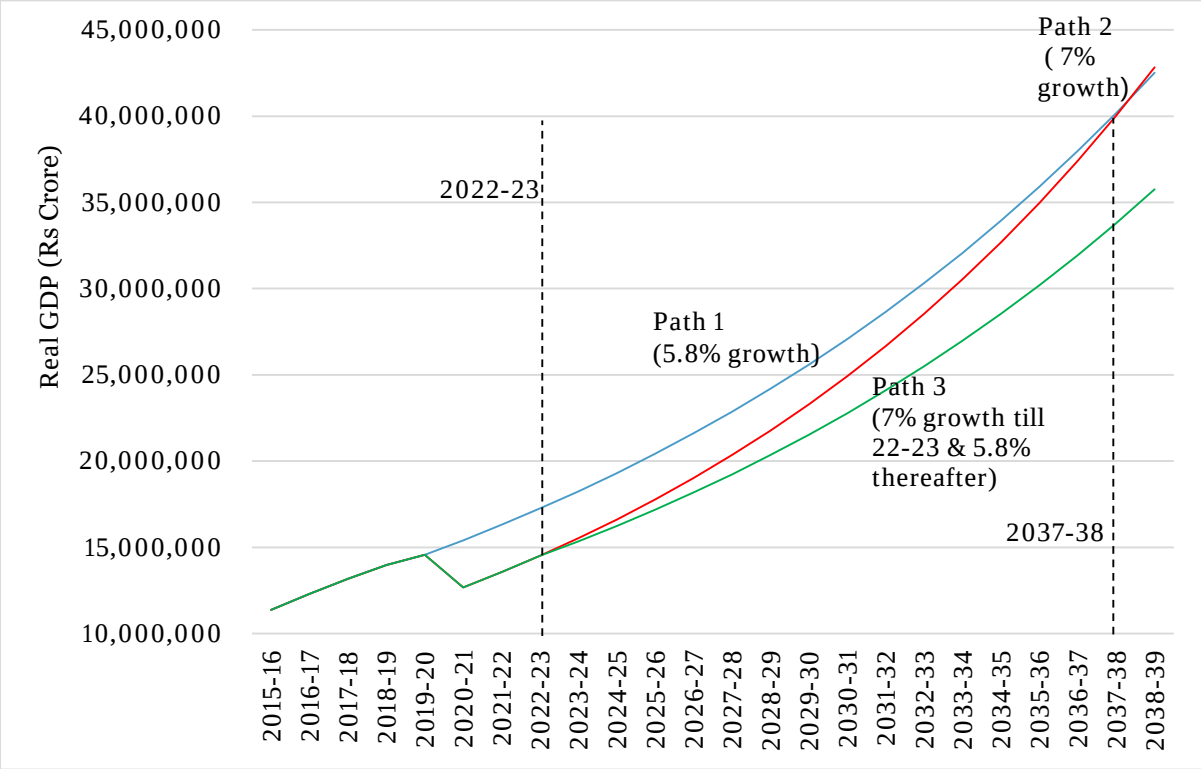
The key question from a longer term perspective is what will be the recovery path after 2020-21. References to V-shaped recovery etc. obfuscate more than they reveal. The fact is that hysteresis, the long term footprint of a major economic shock, is indeed very long. Within the current year our forecasts are indicating a short sharp recovery during Q2, Q3 and Q4, when the y-o-y change in output is still negative but the contraction is moderating, i.e., output in each quarter is higher than in the previous quarter (Figure 2.1), such that the year will end with an annual y-o-y contraction of 12.6% as compared to the Q1 y-o-y contraction of 23.9% (Figure 2.2) What will happen thereafter?

Post 2020-21 an annual growth of even 7 per cent would imply a massive positive growth swing of 20 per cent within one year, from (-) 12.6% to (+) 7%, something not ever seen before in India. Nevertheless, assuming very optimistically that 7 per cent growth is indeed achieved because of the base effect of a steep decline in 2020-21, combined with strong policy measures to revive growth, we would still reach the previous peak output level of 2019-20 only by the end of 2022-23.

To consider what could happen from that point on we have simulated three alternative growth paths. Path I is a counterfactual scenario of the growth path that the economy might have followed if the novel coronavirus pandemic had not struck, i.e., if the economy had continued to grow after 2019-20 at the same pace, a forward projection of the past trend growth rate of 5.8 per cent recorded till 2019-20 (Figure 2.3). Path II shows that if after catching up with the previous peak output (of 2019-20) in 2022-23 at 7 per cent annual growth, the same growth path of 7 per cent can be sustained over the long term, again a heroic assumption, then the economy will catch up with its counter-factual pre-pandemic growth path (Path I) only by 2037-38. A more likely scenario is that after getting back to its previous peak output level by 2022-23, the economy could revert to its pre-pandemic growth path of 5.8 per cent, shown as Path III in Figure 2.3. The actual long term growth path of the economy is likely to lie between Path II and Path III. To nudge the economy to a higher growth path than Path III would

require ambitious economic reforms across a wide front comparable to the reforms of 1991.

Figure 2.3: Simulated Paths of Medium to Long-term Growth



Source: NCAER Authors.

Chapter 3: Agriculture

Anil K Sharma

Despite the sharp decline in output in all other sectors of the economy, agricultural GVA grew by 3.4 per cent in real terms in the first quarter of financial year 2020-21. This is mainly because of the excellent performance of production in all farm products except sugar cane during the agricultural year 2019-20, which includes the first quarter of financial year 2020-21, i.e., the months of April, May and June 2020. This in turn is largely attributable to the excellent performance of rains during the monsoon and post-monsoon period of the agricultural year. For the full (word deleted) financial year 2020-21, it is too early to predict with any certainty how agriculture will perform. However, if the good rainfall activity experienced until the end of August continues and predictions made by the India Meteorological Department turn out to be true for the entire year, then it is likely that the agricultural sector will record strong growth in 2020-21. The coverage of area under Kharif crops until the end of August 2020 is significantly higher compared to last year for several food-grain crops such as rice, pulses, and coarse grains. The same is true for most non-foodgrain crops such as oilseeds, cotton, and sugarcane. Water storage in major reservoirs of the country is also adequate. All this augurs well for the remaining kharif season and Rabi crops. Barring the exceptions of pulses and condiments & spices, and to a lesser extent milk, wholesale prices of all food items have also remained muted in the first four months of the current financial year.

3.1 Progress of the South-west Monsoon

The South-west monsoon arrived in Kerala on June 1, 2020 exactly on the normal date of its arrival and advanced fairly rapidly covering entire Kerala, Tamil Nadu, and parts of North-eastern states of the country. This was followed by a rapid advancement of the monsoon into central and north-western parts of the country and before the end of June it had covered the entire country. Rainfall in the country as a whole was 32 per cent higher than normal. The excess rainfall is measured as a weighted average of the deviation of actual rainfall index from the normal index in different areas, weighted by the unirrigated area under foodgrains (Table 3.1).

All four main regions of the country – east, west, north and south received more than normal rainfall with deviations in monsoon rainfall indices ranging from 10 per cent in southern region to 41 per cent in the western region. Some parts of the country including Assam, Meghalaya, Sub-Himalayan, West Bengal, Sikkim, and parts of Madhya Pradesh, Maharashtra, Uttar Pradesh, and Chhattisgarh experienced flood like situations due to heavy to very heavy rainfall.

In July, however, the behaviour of the monsoon was very erratic. Some parts of the country such as the eastern and southern regions experienced extensive rainfall, whereas northern and western regions witnessed low rainfall activity. As a result the cumulative monsoon rainfall till July was just about 3 per cent above normal compared to an excess of 32 per cent in the month of June. As the season progressed, monsoon rainfall in the month of August was much better compared to July in most parts of the

country. Rainfall improved significantly in the eastern, western and southern regions as well as the country as a whole. Only the northern region ended up with a slightly lower than normal rainfall.

As of September 3, 2020 out of a total 36 sub-divisions in the country 33 sub-divisions (92%) had experienced normal to excess rainfall. There were only three sub-divisions – Western Uttar Pradesh, Jammu and Kashmir, and four smaller states of the eastern region (Nagaland, Manipur, Mizoram, and Tripura) that had deficient rainfall. Given these trends in the first three months of the monsoon season, it is likely that for the full monsoon season from June to September will India will have received normal rainfall, i.e., in the range of 96 per cent to 104 per cent of the long period average, as had been predicted by the India Meteorological Department in its early August forecast.

Table 3.1: Deviations in Actual Monsoon Rainfall Indices from the Normal during June, July, and August of 2020-21 (Per cent)

S. No.	Region	June	June-July	June – August*
1	Eastern Region	31.1	12.7	8.9
2	Western Region	40.8	(-)4.3	16.3
3	Northern Region	27.1	(-)7.9	(-)4.4
4	Southern Region	9.9	15.7	25.4
	All India	31.7	2.7	10.9

Source: *Computed using data from India Meteorological Department, Ministry of Earth Sciences. Government of India.*

* The data for June to August is up to 3rd of September 2020.

Notes:

1. These are deviations in regional level rainfall indices computed on the basis of un-irrigated area under foodgrains as weights.
2. The eastern region includes – Assam, Bihar, Jharkhand, Odisha, and West Bengal.
3. The western region includes – Chhattisgarh, Gujarat, Madhya Pradesh, Maharashtra, and Rajasthan.
4. The northern region includes - Haryana, Himachal Pradesh, Jammu and Kashmir, Punjab, Uttarakhand, and Uttar Pradesh.
5. The southern region includes Andhra Pradesh, Karnataka, Kerala and Tamil Nadu.

3.2 Agricultural performance in 2019-20 and prospects for 2020-21

Thanks to good rainfall during the monsoon and the post-monsoon seasons, the farm sector performed well in 2019-20. Foodgrain production registered a new record of 292 million tonnes, 2.3 per cent higher than the previous record output. Output of the two major foodgrains, rice and wheat also achieved new records at 117.5 million tonnes and 106.2 million tonnes, respectively (Table 3.2). Output of coarse cereals and pulses was also higher than in the previous year. The output of oilseeds in 2019-20, estimated at 34.2 million tonnes, was 8.6 per cent higher than the previous year, and the estimated

output of cotton in 2019-20 was also higher at 34.2 million compared to the previous year. The output of horticultural crops in 2019-20, estimated at 320.5 million tonnes, was 3.2 per cent higher compared to the 2018-19 level of output and the provisional estimate of milk output at 191 million tonnes was 1.8 per cent higher than in 2018-19. Only sugarcane output declined, falling by nearly 13 per cent in year-on-year (y-o-y).

Table 3.2: Output of Selected Agricultural Items in 2017-18, 2018-19, and 2019-20 (million tonnes)

Crops	2017-18	2018-19	2019-20
Rice	112.8	116.5	117.5
Wheat	99.9	103.6	106.2
Coarse Cereals	47.0	43.1	45.2
Pulses	25.4	22.1	23.0
Foodgrains	285.0	285.2	291.9
Oilseeds	32.8	28.0	34.9
Cotton#	379.9	405.4	353.8
Sugarcane	32.8	28.0	34.9
Horticulture crops	310.7	310.7	320.5
Milk Output	176.3	187.7	191.0 (p)

Source: *Directorate of Economics and Statistics, Ministry of Agriculture and Farmers Welfare, Government of India.*
Million bales of 170 kgs each.
p: provisional

In the current year, the year of the pandemic and the great decline, agriculture is the only sector which recorded positive growth in real terms during the first quarter of 2020-21. This is because of the excellent performance of agriculture during the agricultural year 2019-20 as described above.

It is too early to predict with certainty whether agriculture can sustain this high performance through the rest of the year. It will depend on how rainfall performs during the rest of the monsoon & post-monsoon period and its year-long impact. However, if the momentum of rainfall activity experienced until the end of August continues and predictions made by the India Meteorological Department (IMD) turn out to be true, then it is likely that the agricultural sector will be the only sector to register positive growth in 2020-21. Indications from the Ministry of Agriculture and Farmer's Welfare suggest that the coverage of area under Kharif crops until the end of August 2020 is significantly higher for several crops such as rice, pulses, and coarse grains compared to their level last year. The same is true for some non-foodgrain crops such as oilseeds, cotton, and sugarcane. Further, information from the Central Water Commission indicates that as of September 3, 2020 the live storage available in 123 reservoirs was 4 per cent higher than the live storage during the corresponding period last year and 120 per

cent higher than the average storage for the last ten years. This augurs well for the remaining kharif season and the Rabi crop.

Stocks of foodgrains with the Food Corporation of India are much higher than the minimum buffer stocking norms. As of July 1, 2020, stocks were reckoned at 83.3 million tonnes, 27.4 million tonnes of rice and 55.8 million tonnes of wheat. Such large quantities of stocks are handy for expanding supplies and meeting shortages during crises, especially in parts where food needs to be distributed for free. Further, a better outlook for 2020-21 indicates that the supply of essential items is expected to remain comfortable. These developments will keep price expectations under check during the financial year 2020-21 (Table 3.3). Some commodity groups like cereals; pulses; vegetables; and fruits have seen much lower rates of inflation during the first four months of the current financial year compared to the corresponding period in 2019-20.

However, there are two groups of food articles, pulses and condiments & spices, for which the prices have risen at double digit rates during these past four months. Also, while the rise in milk prices has been moderate at 5 per cent, it is more than three times the 1.5 per cent price increase recorded last year. This is partly the base effect of low rates of inflation last year. Also, the disruptions in supply chains logistics experienced during the lockdown period may have impacted these prices. There have been reports of transport and labour scarcity in the distribution network during this period.

Table 3.3: Changes in Wholesale Price Indices of Food Articles in 2019-20 and 2020-21 (April – July)

S. No.	Product	Increase in 2019-20 over 2018-19 (%)	Increase in 2020-21 over 2019-20 (%)
1	Food Articles	6.9	2.9
2	Cereals	8.2	2.7
3	Pulses	18.9	11.8
4	Vegetables	24.5	-2.4
5	Fruits	1.0	0.1
6	Milk	1.5	5.0
7	Eggs, meat and fish	5.7	3.5
8	Condiments and spices	2.7	10.1
9	Other food articles	2.1	0.7

Source: Computed using data from the Economic Advisor, Ministry of Commerce and Industry, Government of India.

Industry

Saurabh Bandyopadhyay, Bornali Bhandari and Ajaya K Sahu

GVA in Industry contracted by an unprecedented 38.1 per cent in Q1: 2020-21 because of the stringent nation-wide lockdown that was imposed towards the end of March 2020 to deal with the Coronavirus pandemic. Growth of all the four sub-sectors contracted in Q1: 2020-21. This massive contraction came at the end of a long period of declining industrial growth that started from the fourth quarter of 2017-18, marking the fourth quarter of monotonic decline since Q1 of 2019-20. With gradual unlocking since June 2020 there has been some modest recovery. High frequency leading indicators such as IIP, electricity consumption, GST collection, number of e-way bills generated etc. indicate a gradual and sporadic recovery. Though the peak level of industrial output achieved in 2019-20 Q4 is yet to be reached, the extent of contraction, y-o-y, reduced. The sporadic nature of the recovery is mainly attributable to the policy flip-flops of re-locking and unlocking pursued by individual state governments in response to the resurgence of Covid-19 cases in these states. Going forward, much will depend on how the spread of the disease plays out and how governments respond to it. Both factors are major unknowns at this time. Hence, the outlook for the rest of 2020-21 and also 2021-22 remains highly uncertain.

4.1 Introduction

Industrial growth in Q1:2020-21 exhibited a sharp negative growth. The fall in GVA in the first quarter when the entire country had remained under lockdown during April–May 2020 was predictable. Though economic activity was gradually unlocked from June 2020, industrial growth remained weak through June and July 2020, showing some positive signs of revival in August. However, the situation has differed across States and going forward on the strength of industrial recovery will depend on the course of the virus and the distinct patterns of locking down and unlocking economic activity being observed in different states. Therefore, the outlook remains highly uncertain at this stage.

4.2 Industry: Aggregative Trends

The latest estimates from the Central Statistics Office (CSO), dated 31st August, 2020) show that Gross Value Added (GVA) in Industry (at 2011-12 prices) contracted by 38 per cent on a year-on-year (y-o-y) basis (Figure 4.1). This was the fourth consecutive quarter of contraction for the sector after 2019-20 Q4, but in fact industrial production has been on a declining trend since 2017-18 Q4 (Figure 4.2). Barring Electricity, Gas & Water Supply, GVA in all the remaining sectors showed double-digit contraction in Q1with contraction being the sharpest in the construction sector. Even in nominal terms, all the four sub-sectors contracted.

Fig. 4.1: GVA Industry and its Components, Q1: 2020-21 (% change y-o-y)

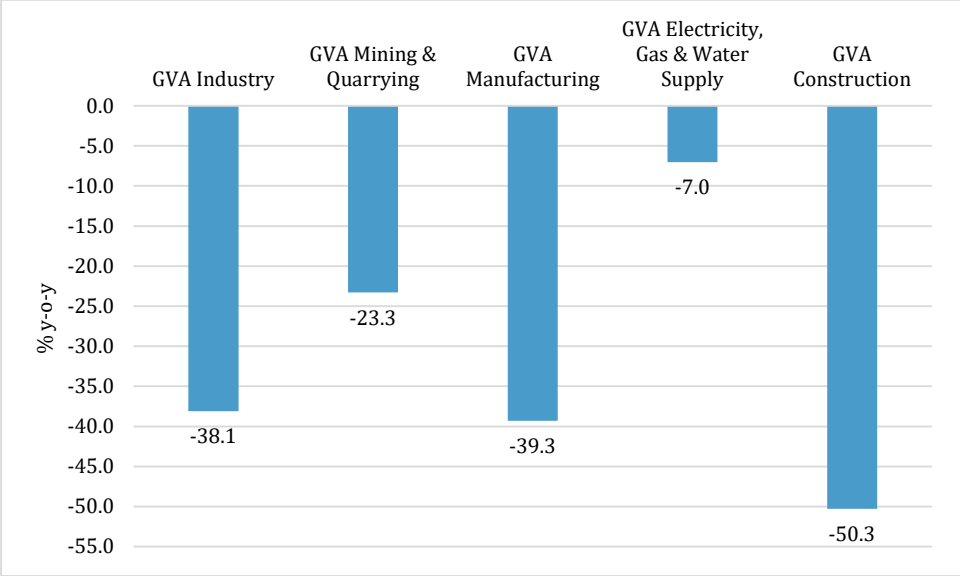
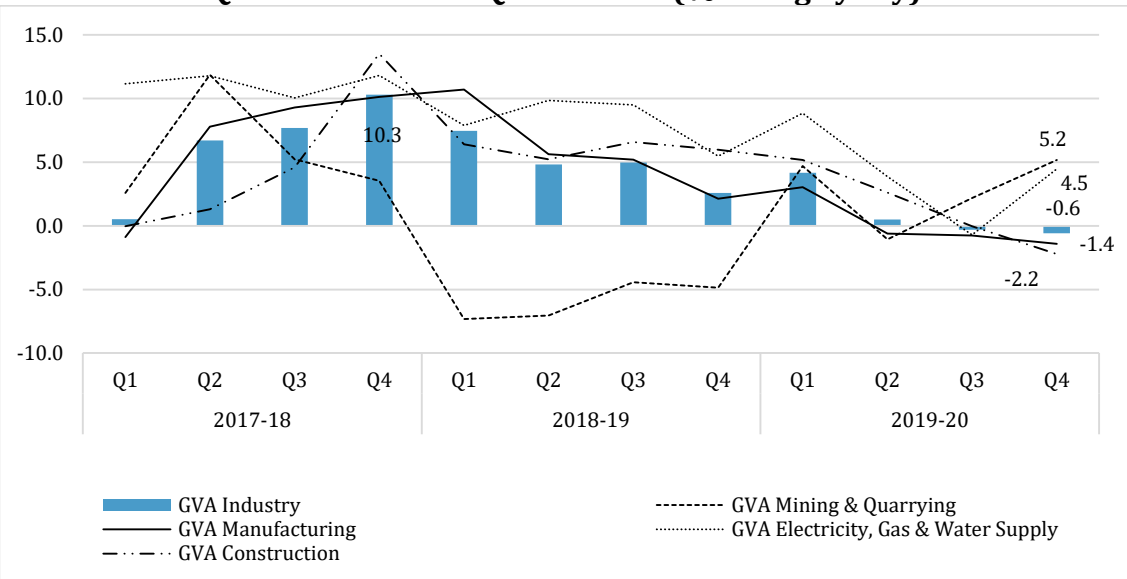


Fig. 4.2: GVA Industry and its Components Q1: 2017-18-21 to Q4: 2019-20 (% change y-o-y)



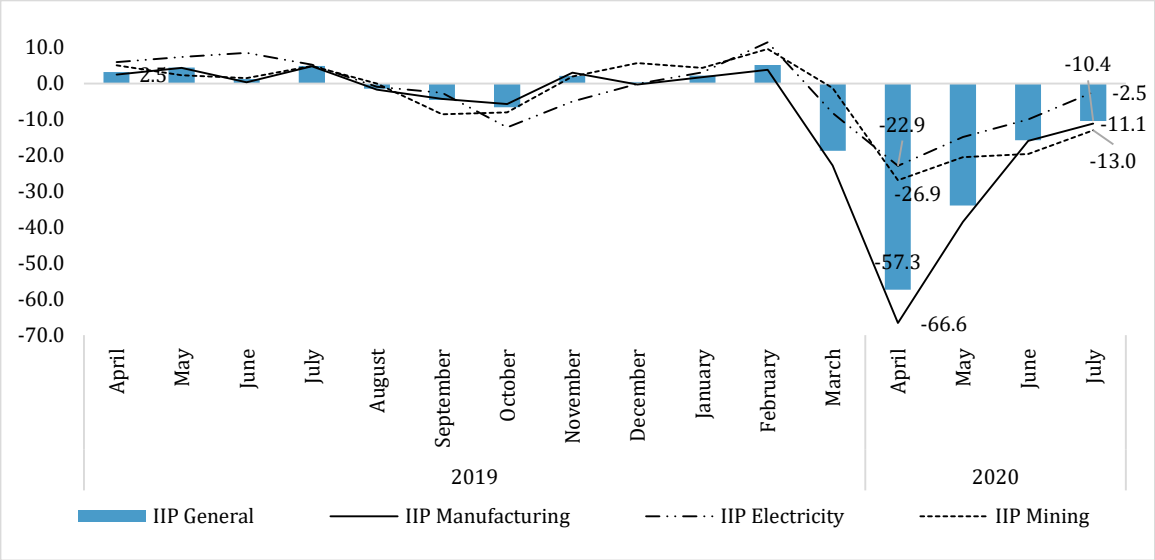
Source: NCAER Computations from MoSPI.

These results are not at all surprising given that the economy was in a lockdown for most of April and May 2020 and was gradually 'unlocked' only in June 2020. However, non-congruent State-imposed local lockdowns accompanied this.

4.3 Trends in Industrial Activity in Q2: 2020-21

The leading indicators from Q2: 2020-21 point to a sporadic recovery in July and August 2020, from the deep dive experienced in April and May. After the precipitous fall in Q1: 2020-21, the Index of Industrial Production (IIP), the indicator of the performance for organised sector industry, recovered in July 2020 i.e. showed lower rates of contraction. All the three sub-indices of IIP, Mining, Manufacturing and Electricity continued to contract in July 2020 on a y-o-y basis but the rate of contraction had decreased in July, compared to June 2020 (Figure 4.3).

Figure 4.3: Index of Industrial Production, General, Mining, Manufacturing and Electricity (% change y-o-y), April 2019 to July 2020



Source: NCAER Computations from the MoSPI data.

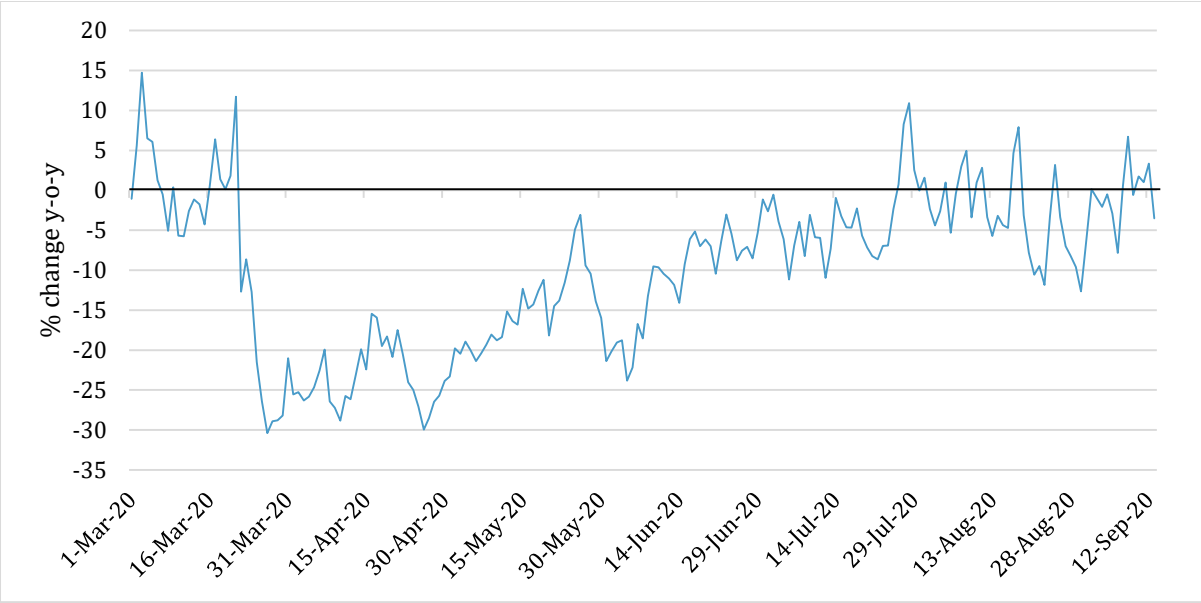
In the use-base classification barring consumer non-durables all categories of goods continued to register double-digit negative growth in July 2020. The IIP Consumer non-durables has shown positive growth for two consecutive months in June 2020 (14.7 per cent) and July (6.7 per cent) on a y-o-y basis. This was probably because of pent-up demand for necessities like food & beverages, clothes, shoes etc., after the strict lockdown in April and May 2020.

Core IIP, with a weight of 40.3 per cent in IIP contracted by 9.6 per cent in July 2020. Barring fertilisers, all the remaining industry sectors contracted. Using 2-digit based classification, 21 industries continued to contract in July 2020 and two showed expansion in July 2020. Manufacturing of tobacco products recovered in July 2020 to show positive y-o-y growth of 6.1 per cent. Manufacture of 'pharmaceuticals, medicinal chemical and botanical products' have been showing positive growth since May 2020. In July it grew by 22 per cent on a y-o-y basis. The spread of the coronavirus has raised a demand for products for this industry.

Several leading indicators show a gradual recovery of business sentiments and economic activity after the sharp decline in April. These include daily electricity demand, registration of new companies[1], GST returns and e-way bills[2].

But electricity demand and GST returns showed a tapering off of recovery during July or August. Using daily peak electricity demand from March 1, 2020 to August 30, 2020, the y-o-y growth shows steady recovery after the sharp initial dip in April 2020 (Figure 4.4). Demand growth tapered from the second half of August and continued to be volatile.

Figure 4.4: Peak Energy Demand Met, March 1, 2020 to 13th September, 2020 (% change y-o-y)



Source: Authors' computations Power System Operation Corporation Ltd. https://posoco.in/.

[1] Data on registration of new companies from the Ministry of Corporate Affairs Monthly Newsletter indicates that monthly registration of companies has increased after hitting lowest of 3,209 Companies in April 2020[1]. A total of 16,487 companies were registered in July, 2020 as compared to 10,699 in July 2019. An increase (50.51%) in registration of companies has been witnessed in July 2020 over the previous month.

[2] The number of e-way bills generated have shown negative y-o-y growth since March 2020[2]. After contracting at 83.6 per cent in April 2020, there has been a steady recovery and in August 2020, it showed growth of (-) 3.5 per cent. The e-ways bills generated for intra-state seems to have showed a more rapid recovery in August, having almost converged to the levels of August 2019. However, the recovery in inter-State has been relatively more tepid. This indicates that logistic issues continue to pose a problem and supply chains remain affected. The interpretation is that supply-side issues continues to pose a problem for India.

Similarly, after contracting by 71.7 per cent in April 2020 on a y-o-y basis, total GST collection showed recovery in May [(-) 38 per cent] and June 2020 [(-) 9 per cent]. However, this was not sustained in July [(-) 14.4 per cent] and August 2020 [(-) 12 per cent].

Other leading indicators from the second quarter show a moderate recovery. The IHS Markit PMI of the manufacturing sector increased to 52 in August 2020, having remained well below 50 during the previous four months.

4.4 Outlook

The recovery of industrial activity is likely to stretch through 2020-21 and most of 2021-22 before it reaches the previous peak output level of 2019-20. Available data on some of the leading indicators such as electricity consumption, industrial production, GST collections and PMI point in this direction. However, much will depend on how the Coronavirus pandemic plays out and the policies and the reform measures that the government pursues in response to the pandemic. Both these determinants are unknown at this stage, rendering the outlook going forward highly uncertain.

Chapter 5: Services

Bornali Bhandari

The services sector contracted in Q1: 2020-21 and is most likely to do so year-on-year also in Q2. Only one leading indicator from the second quarter, revenue earning railway goods traffic, showed some modest positive growth in August 2020. Other indicators suggest a y-o-y decline. Compared to Q1 the trends were somewhat mixed in Q2, depending on the operational status of the sector. While freight traffic across modes showed improvement in July and August 2020, the y-o-y contraction of passenger traffic has remained very high. The outlook remains uncertain for the rest of the year depending on our ability to control the spread of the virus.

5.1 Introduction

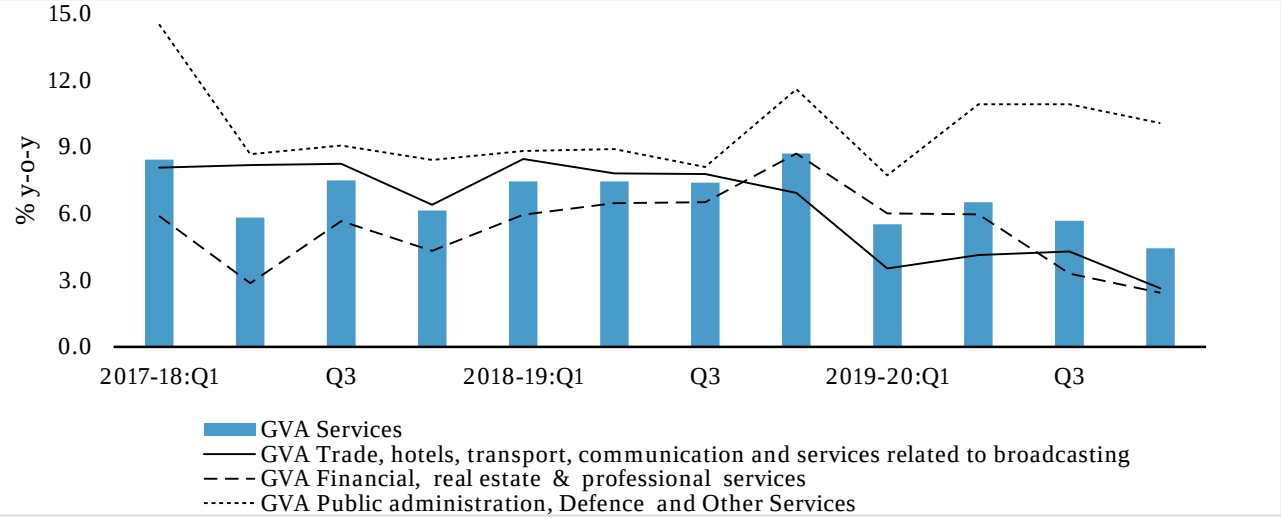
The service sector and its three sub-sectors all contracted in the first quarter of Q1: 2020-21. Leading indicators for the second quarter also indicate contraction, though the shortfall compared to the same period last year has moderated. The outlook remains gloomy and highly uncertain for the remaining part of the year.

5.2 Services sector in 2019-20

5.2.1 Gross Value Added of GVA Services and its Components

The Services sector recorded mixed growth patterns during the period Q1: 2017-18 to Q2: 2019-20 (Figure 5.1).

Figure 5.1: GVA Services and its Components
(% change y-o-y, Q1: 2017-18 to Q4: 2019-20)

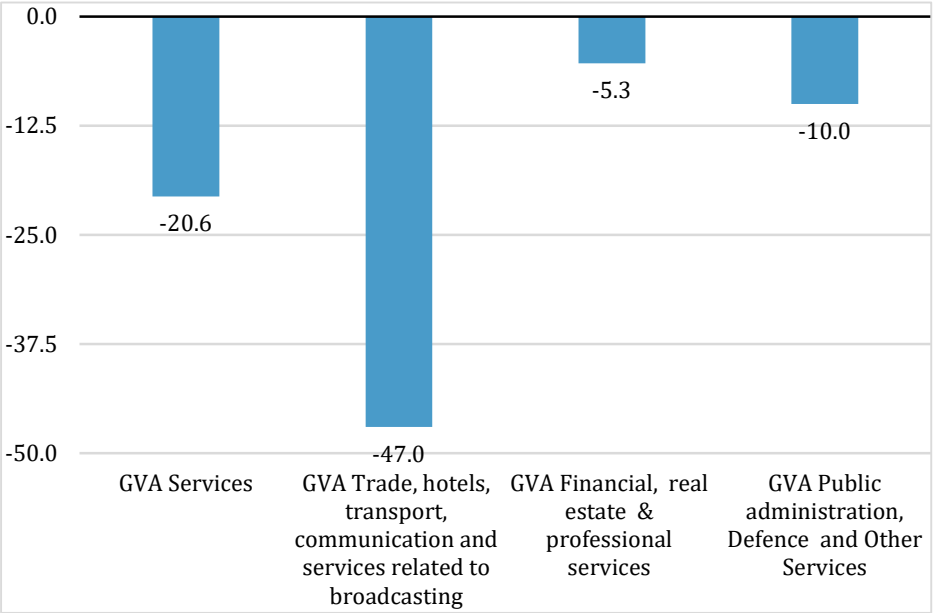


Source: NCAER Computations from MoSPI.

During the current year the services sector contracted by 20.6 per cent during Q1 on a year-on-year (y-o-y) basis, with a decline in all the three sub-sectors (Figure

5.2). Amongst the three sub-sectors, 'trade, hotels, transport, communication and services related to broadcasting' experienced the deepest contraction of 47 per cent in Q1: 2020-21 (Figure 5.2). The contraction was much less in 'public administration, defence and other services' (10 per cent) and 'financial, real estate and professional services' (5.3 per cent).

Figure 5.2: GVA Services and its Components (% change y-o-y, Q1: 2020-21)



Source: NCAER Computations from MoSPI.

5.2.2 Lead Indicators for July and August, 2020-21

Leading indicators from July and August showed some recovery compared to Q1 but continuing shortfalls compared to the same period last year. The extent of shortfall has of course varied across sub-sectors.

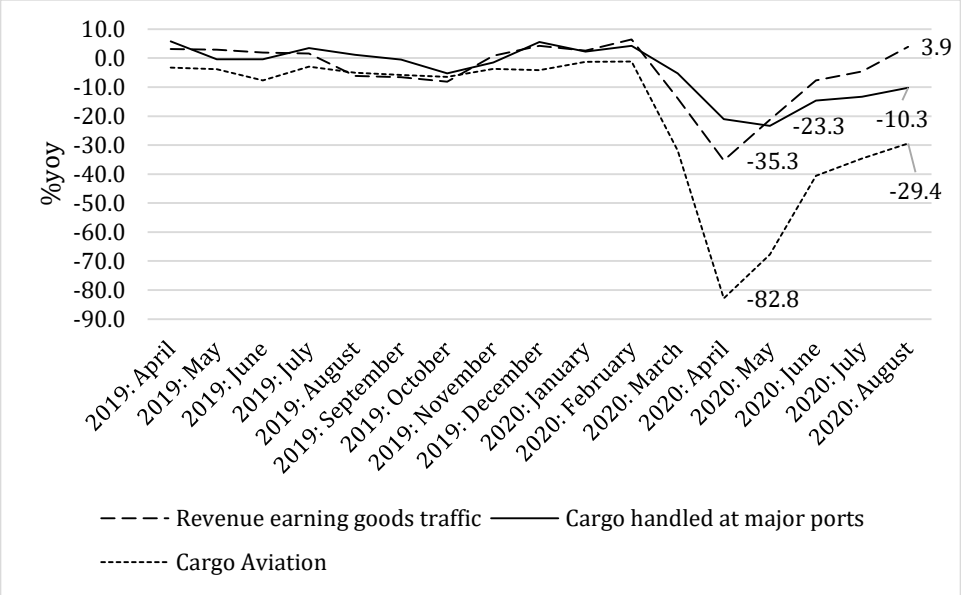
In the transport sector, the freight sector has performed relatively better than passenger traffic. After contracting for five straight months between March and June 2020, revenue earning goods traffic showed y-o-y growth of 3.9 per cent in August 2020 (Figure 6.2)[1]. Cargo handled at major ports contracted by 13.3 per cent and 10.3 per cent in July and August 2020 respectively. It had showed contraction of 19.7 per cent in the first quarter. Cargo aviation traffic showed contraction of 32 per cent in July-August 2020 on a y-o-y basis (Figure 6.2), a significant moderation of the rate of decline from the first quarter. It had contracted by 63.7 per cent in Q1: 2020-21.

[1] Roadways carry majority of freight traffic. The modest growth in railways freight traffic could also be due to substitution between modes of transport as roads transport face logistic issues across States.

Aviation passenger traffic shows similar trends but the contraction is deeper and the recovery slower. It contracted by 81.4 per cent during July-August 2020 on a y-o-y basis. Similarly, railways passenger traffic contracted by 100 per cent in Q1: 2020-21 and by 98.7 per cent in July-August 2020 over the corresponding period in the previous year[2]. The corresponding y-o-y growth rates in Q1: 2019-20 and July-August 2019 were (-) 0.6 per cent and (-) 2.2 per cent respectively. This is because only selected trains were running in July and August. This should improve September onwards if more passenger train services are restored.

After declining by 86 per cent in Q1: 2020-21, the production of commercial vehicles contracted by 45.3 per cent in July 2020 on a y-o-y basis. The number of new telephone connections has been in contraction between November 2019 and May 2020. The average y-o-y growth during this period has been (-) 1.6 per cent. Unfortunate, other data on communication services has remained patchy because of the pandemic.

Figure 5.3: Cargo Traffic carried by Air, Rail and Ports, April 2019 to August 2020 (% change y-o-y)



Source: Ministry of Railways, Airways Authority of India and India Ports Association.

Note : Revenue earning goods traffic is measured in million tonnes, aviation cargo & major ports traffic in thousand tonnes.

[2] There were 714.2 million and 690.4 million railway passengers in July and August 2019 respectively. It dropped to 14.6 and 22.3 million passengers in July and August 2020 respectively. http://www.indianrailways.gov.in/railwayboard/view_section.jsp?lang=0&id=0,1,304,366,554, 818,821.

Financial sector services are among the few sub-sectors for which indicators have registered positive y-o-y growth during the Q2 period, but the growth has been muted. In July 2020, bank credit to the commercial sector grew at a y-o-y rate of 6.4 per cent (Reserve Bank of India) as compared to y-o-y growth rate of 6.3 per cent during May-June 2020. Non-food credit grew by 6.2 per cent y-o-y in July 2020. Aggregate deposits grew by 12 per cent y-o-y in July 2020, marginally higher than 10 per cent and 11 per cent in May and June respectively.

The IHS Markit PMI Indices for July and August 2020 were 34.2 and 41.8 respectively, indicating that the large majority of production managers expected output to decline during July and August, though the proportion expecting a decline in August was somewhat less than in July.

5.3 Outlook for 2020-21

From the discussion above it is evident that the Services sector will continue to show negative growth during the second quarter compared to the corresponding period last year. Such contraction is likely to persist till the end of the current year and probably much of 2021-22, though the extent of contraction may get progressively moderated. However, much will depend on how the spread of the pandemic evolves and how central and state governments and the public respond to it. These are all unknown factors at present, making the outlook going forward highly uncertain.

Chapter 6: External Sector

Bornali Bhandari

The narrowing of the trade balance in the first quarter and then in July-August is due to the faster recovery of exports as compared to imports. The merchandise and services trade balance has been in surplus since April 2020. Merchandise trade was contracting y-o-y since June 2019 with intermittent periods of positive growth. The novel coronavirus pandemic accelerated that decline. The contraction of merchandise exports and imports have both moderated since April, but contraction of exports has moderated more. While trends in India's merchandise trade since April 2020 have been similar to that of the rest of the world, India's service trade trends have been somewhat better. The uncertain nature of the pandemic implies that the outlook for trade going forward also remains highly uncertain.

Indian foreign currency reserves have grown at an accelerating pace since October 2019. In July and August 2020 foreign exchange reserves grew by 22.4 per cent and 25.8 per cent respectively. There has been a surge in NRI inflows in the first quarter of 2020-21. Foreign institutional investment (FII) inflows have also increased significantly through June, July and August 2020. Oil prices and oil exports & imports have all declined compared to a year ago. The exchange rate of the rupee was depreciating since March 2020 but then stabilised during July-August 2020, appreciating marginally compared to the first quarter. This helps to mitigate any external inflationary pressures but the trade-off is that exports have become relatively more expensive. The Real Effective Exchange Rate (36-country, trade weighted) has appreciated 1.4 per cent since June 2020. Faced with the classic policy trilemma of open economies, i.e. choosing any two of three alternatives among free capital mobility, exchange-rate management and monetary policy autonomy, the central bank currently appears to be leaning away from exchange rate management.

6.1. Coronavirus Pandemic, World Economy & the Indian Economy

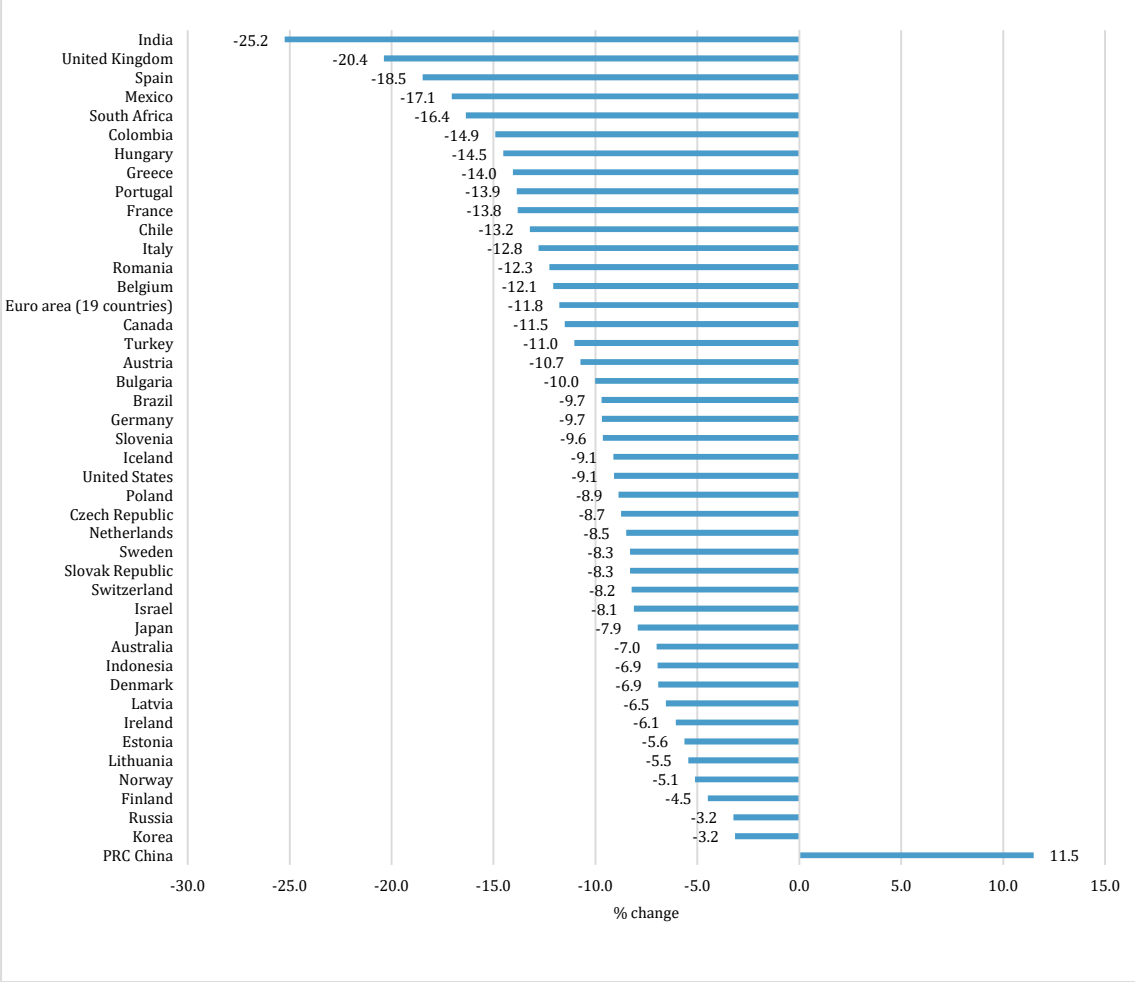
The novel coronavirus pandemic continues to take a huge toll in lives and also livelihoods in many countries across the globe. Several countries resorted to social distancing, quarantining, lockdowns and closures of all non-essential sectors/businesses, imposing a severe adverse shock on economic activity. Many countries have seen a flattening of the curve. But, unfortunately, some countries have experienced a subsequent resurgence in infections. The pandemic and the containment measures that followed delivered a severe negative shock to economic activity across the whole world. India imposed a nationwide lockdown through most of April and May, the most stringent in the world. Not surprisingly, it also experienced the sharpest GDP contraction, year-on year (y-o-y), among all countries in the April-June period in 2020 (Figure 6.1). Ironically, China where the pandemic originated was the only major country which recorded strong growth during this period. This is presumably because of the base effect after the pandemic spread was quickly contained and stringent lockdown measures reversed early in the year.

The OECD September 2020 Outlook forecasts that the global economy will contract by 4.5 per cent in 2020[1]. The forecast indicates that the US economy will contract

[1] OECD. 2020. "OECD Interim Economic Assessment Coronavirus: Living with uncertainty". https://www.oecd-ilibrary.org/economics/oecd-economic-outlook/volume-2020/issue-1_34ffc900-en. September 16.

by 3.8 per cent, Euro Area by 7.9 per cent and Japan by 5.8 per cent. In contrast, OECD forecasts that China will grow at a positive rate of 1.8 per cent. For India OECD is forecasting a contraction of 10.2 per cent in 2020-21 as compared to our NCAER forecast of 12.6 per cent contraction (see Chapter 2).

Figure 6.1: Quarterly Growth Rates of real GDP, percentage change over same quarter, previous year, Q2 (April-June): 2020



Source: OECD, https://stats.oecd.org/index.aspx?queryid=350.

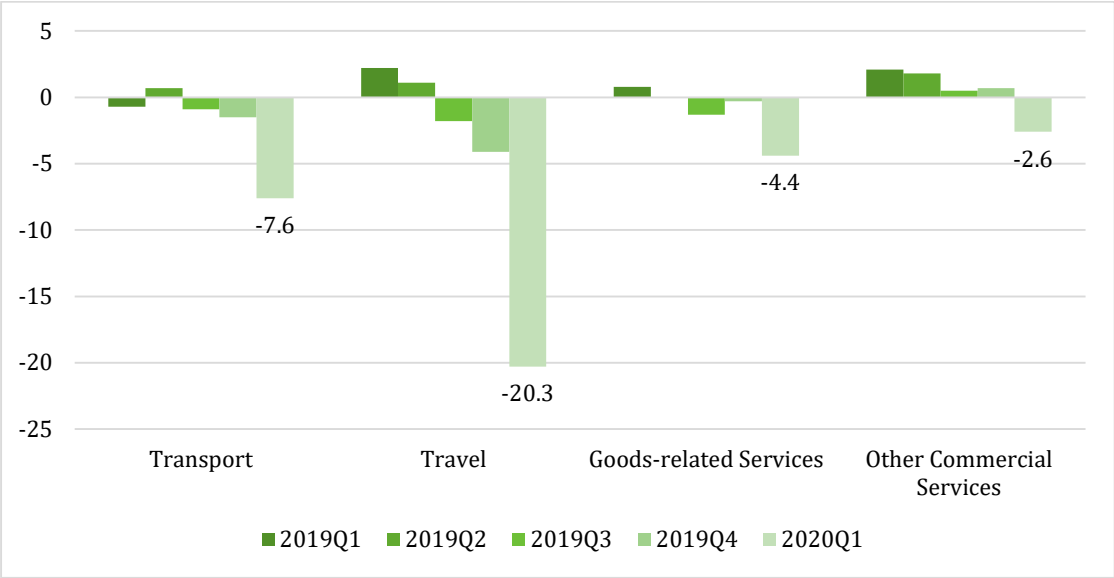
In India as in the rest of the world trade, merchandise exports and imports, all contracted sharply during the April-June period of 2020 in the wake of the pandemic[2]. The World Trade Organisation (WTO) Goods Trade Barometer[3] showed an index value

[2] The data in this paragraph are taken from the same source. https://www.wto.org/english/res_e/statis_e/latest_trends_e.htm.

[3] "The Goods Trade Barometer is designed to gauge momentum and identify turning points in world trade growth. Readings of 100 indicate growth in line with medium-term trends; readings greater than 100

of 84.5 in June 2020, which was lower than the baseline value of 100 and 18.6 points lower than the corresponding period in the previous year[4].China was the significant exception with a modest positive growth rate in June 2020. Trade in commercial services also contracted for all economies for the months April to June 2020. Passenger travel in particular declined very sharply because countries imposed pandemic related restrictions on entry and airlines cancelled flights (Figure 6.2). The outlook for international trade remains very uncertain.

Figure 6.2: Sectoral Performance of Trade in Commercial Services, 2019:Q1 to 2020 Q1 (% change q-o-q)



Source: Reproduced from https://www.wto.org/english/res_e/statis_e/latest_trends_e.htm.

Note: The years refer to calendar years, e.g. 2019: Q1 refers to January-March of that year. The growth rates are quarter-on-quarter changes of seasonally adjusted data.

6.2 India's Balance of Trade

India's merchandise and services trade deficit started narrowing since Q2: 2019-20 (Table 6.1). Since Q1: 2020-21, the combined (merchandise plus services) trade deficit has turned into a surplus.

The merchandise trade deficit narrowed through 2019-20 and first four months of 2020-21. The services trade balance was already in surplus during 2019-20 and the surplus increased further in 2020-21.

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suggest above-trend growth, while those below 100 indicate below-trend growth." It consists of five components – export orders, automotive products, container shipping, Air freight, electronic components and raw materials.
https://www.wto.org/english/news_e/news20_e/wtoi_19aug20_e.htm.

[4] World Trade Organisation. 2020.
https://www.wto.org/english/news_e/news20_e/wtoi_19aug20_e.htm. August 19.

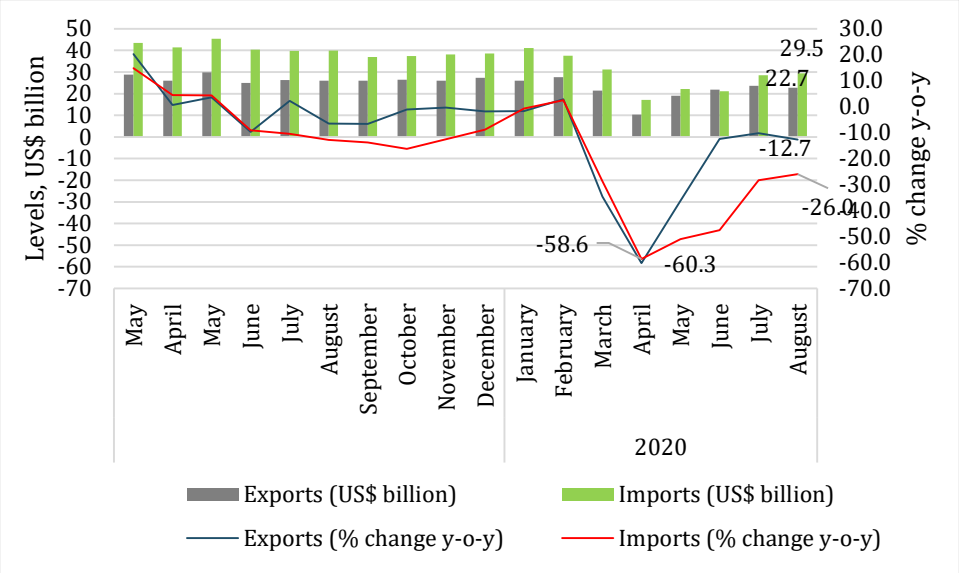
The emergence of a trade surplus is not an indicator of buoyant trade. Both merchandise & services exports and imports were declining through 2020-21, but imports declined more than exports hence the surplus (Table 6.1).

6.2.1 Merchandise trade

Merchandise exports have been contracting (y-o-y) since June 2019 barring two months when it recorded positive growth (July 2019 and February 2020). The novel-coronavirus accelerated the decline in April 2020 (Figure 6.3). Merchandise imports showed similar trends.

Figure 6.3: Merchandise Exports and Imports (% change y-o-y)

(April 2019 to August 2020)



Source: Computed from Ministry of Commerce.

Merchandise exports and imports are still well below their 2019-20 levels (Figure 6.3). However, the y-o-y contraction has moderated much more for exports compared to imports. This is because export demand is a function of incomes abroad whereas import demand is a function of domestic income. The latter has taken a much stronger hit compared to incomes of India's trade partners. This is because of the more stringent national lockdown in India during April-June and extended local lockdowns in some States in response to the spread of the virus. This negative income effect has been reinforced by the price effect of recent exchange rate appreciation and some higher import tariffs.

6.2.2 Services Trade

Services trade have contracted (y-o-y) for the period April-July 2020. Services exports had declined by 9.2 per cent in Q1: 2020-21 (financial year) and service imports by 24.8 per cent. By July 2020 monthly service exports had come down to US$ 17 billion as compared to US $19 billion in July 2019, Service imports were US$ 13 billion and US $10 billion respectively in July 2019 and July 2020.

6.3. Capital flows, Remittances, Foreign Currency Assets and Exchange Rate

This section briefly discusses different channels of foreign exchange flows, changes in the stock of foreign currency assets and exchange rate movements.

6.3.1 Foreign Investment Flows

Foreign investment inflows in India have been volatile during April-July 2020 (Table 6.2) on a month-on-month (m-o-m) basis but contracted on a y-o-y basis. This trend holds for both inward foreign direct investment (FDI) and net foreign portfolio investment. In July 2020 FDI inflows increased compared to June 2020 while foreign institutional investments (FIIs) declined. The volatility has continued during August 2020[5].

6.3.2 Remittances

There are three types of non-resident deposits: (i) FCNR (B)- foreign currency non-resident banks; (ii) NR(E)RA - non-resident external rupee account and; (iii) NRO-Non-resident ordinary. Total NRI deposits (outstanding) has increased on a m-o-m basis in US$ terms (Table 6.2).

6.3.3 Foreign Currency Assets

Foreign currency assets have increased quite rapidly since October 2019. It rose by 22.4 per cent y-o-y in July 2020 to a total of US$ 491 billion.

6.3.4 Exchange Rate

After sharply depreciating from Rs 71.5 per US$ in February 2020 to Rs 76.2 per US$ in March 2020, the rupee has gone back up to RS 74.6 Rs per US$ in August 2020. The nominal exchange rate of the rupee against the US$ depreciated by 8.6 per cent between March and August 2020. While this reduces the relative price of exports compared to imports in nominal terms, it also reduces the return on external portfolio investments, thereby discouraging foreign capital inflows. Further, for Indian investors who have borrowed in foreign exchange, often without hedging adequately, the currency depreciation is increasing their debt burden. Finally, though the exchange rate

5 foreign institutional investment (net) in rupee terms (not shown in Table 6.2) has gone down from Rs 26, 009 in June 2020 to Rs 3, 301 in July 2020 before going back up again to Rs 49,879.

has depreciated in nominal terms, the Real Effective Exchange Rate (36-country, trade weighted) has actually appreciated 1.4 per cent since June 2020, thereby tilting the relative prices against Indian exports.

Table 6.1: Summary of India's Trade Balance

Time Period	Merchandise Trade Balance		Services Trade Balance		Trade Balance Merchandise plus Services	
	US$ billion	***% change y-o-y***	***US$ billion***	***% change y-o-y***	***US$ billion***	***% change y-o-y***
2017-18	(-)160	-	111	-	(-)92	-
2018-19	(-)180	(-)12.7	123	10.5	(-)104	(-)12.8
2019-20	(-)154	14.4	132	7.3	(-)73	29.8
Q1: 2019-20	(-)46.1	(-) 2.5	19.6	2.4	(-)26.4	(-) 2.6
Q2: 2019-20	(-)38.2	25.9	18.9	(-)2.0	(-)19.2	40.3
Q3: 2019-20	(-)34.4	31.3	20.8	4.9	(-)13.6	55.0
Q4: 2019-20	(-)34.8	2.8	20.7	3.1	(-) 14.1	10.3
Q1: 2020-21	(-)9.1	80.2	21.0	7.0	11.9	145.1
July-August 2020	(-) 27.3	-	12.5	-	(-) 14.8	-
July-August 2020-21	(-)11.6	57.5	13.9	11.3	2.3	116.9

Source: Ministry of Commerce & RBI.
Notes: 1.An increase (decrease) in trade deficit has a minus (plus) sign in the percentage y-o-y change in trade balance.
2. Services trade for August 2020-21 has been estimated and reported by Ministry of Commerce.

Table 6.2: External flows, Foreign Currency Assets and Exchange Rates

Month	Net Foreign Direct Investment	Direct Investment to India	Equity Inflows	Net Portfolio Investment	Net Foreign Institutional Investment	Foreign Investment Inflows	Total NRI Deposits (Outstanding)	Foreign Currency Assets	(Rs per US$)	REER (36 country, trade weighted) 2004-05 base	NEER (36 country, trade weighted) 2004-05 base
	US$ million										
2019: Jul	3,482.4	4,681.4	4,588.1	457.0	299.9	3,939.4	133,124.7	401,091.3	68.8	117.7	74.9
Aug	1,850.7	2,762.0	2,668.7	(-) 363.1	(-) 520.3	1,487.6	130,514.6	396,005.0	71.1	115.7	73.3
Sep	1,981.3	2,949.7	2,856.4	2,382.5	2,225.4	4,363.9	132,893.3	401,615.0	71.4	116.2	73.2
Oct	2,646.2	4,064.0	3,330.5	2,580.1	2,681.5	5,226.3	133,719.9	410,453.0	71.0	117.3	73.4
Nov	2,770.5	3,657.5	2,924.0	5,860.5	5,961.9	8,630.9	132,699.0	419,367.0	71.5	117.4	72.7
Dec	4,326.4	5,512.0	4,778.4	(-) 611.4	(-) 510.0	3,715.0	133,137.7	422,732.0	71.2	119.1	72.8
2020: Jan	5,251.9	6,228.8	5,808.0	2,038.6	1,706.0	7,290.5	133,565.3	437,248.0	71.3	117.9	72.4
Feb	2,737.1	4,019.9	3,599.1	(-)1,148.3	(-) 1,480.9	1,588.8	132,510.7	445,823.0	71.5	117.5	72.9
Mar	3,974.2	4,936.7	4,515.9	(-)14,635.2	(-)14,967.8	(-) 10,661.0	130,580.5	439,663.0	74.6	114.6	71.2
Apr	2,249.6	3,269.3	2,883.9	83.5	(-)1,001.4	2,333.1	129,338.5	441,564.0	76.2	113.9	70.4
May	(-)1,992.1	(-)1,437.7	2,352.2	(-)1,325.0	(-)972.3	(-) 3,317.2	131,136.7	455,208.0	75.6	115.1	70.6
Jun	(-)838.2	(-)72.2	1,661.6	1,935.8	3,132.4	1,097.7	132,719.0	467,039.0	75.7	113.8	69.6
Jul	3,268.9	4,099.3	3,164.7	1,247.3	619.3	4,516.2	135,368.8	490,829.0	74.9	114.6	70.0
Aug	NA	NA	NA	NA	NA	NA	NA	498,094.0	74.6	115.4	70.0

Note: NA means Not Available.
Source: Reserve Bank of India.

Chapter 7: Prices

Ajaya Sahu, Rudrani Bhattacharya[1] and Bornali Bhandari

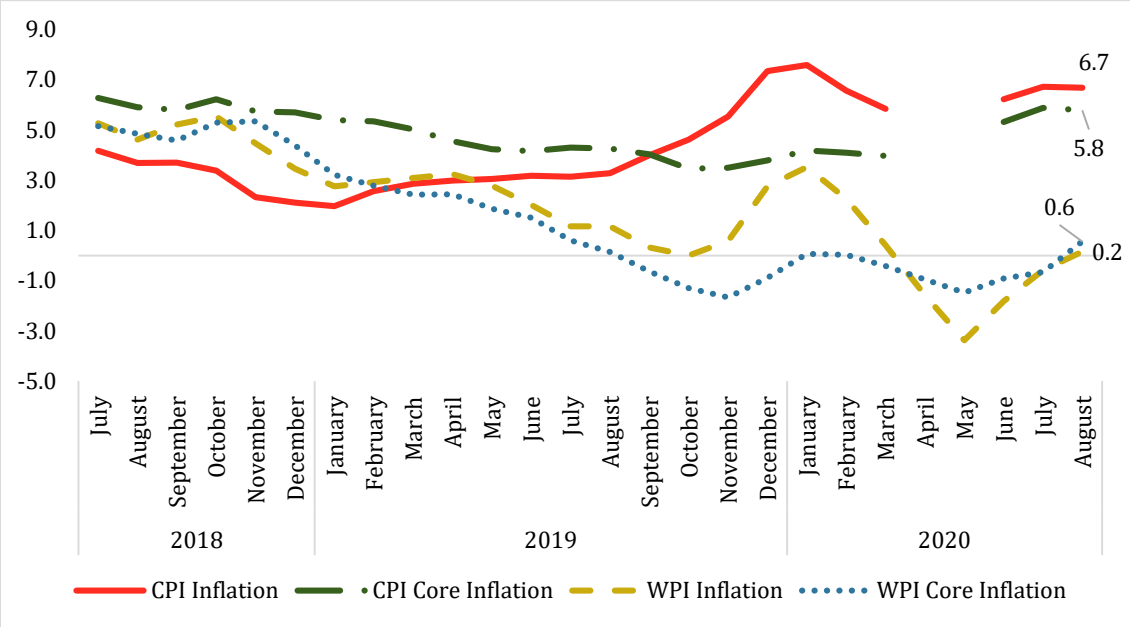
The first quarter showed negative GDP growth and high retail inflation. This stagflation was driven by negative supply factors dominating the negative demand ones. The divergence of CPI and WPI inflation in the first quarter was seen as a confirmatory evidence. The first two months of the second quarter has shown sticky and elevated retail inflation at 6.7 per cent. Retail food inflation has showed signs of moderation over time but remained high at 9.2 per cent in July-August 2020 on a y-o-y basis. Even (non-food and non-fuel) core CPI inflation also was high at 5.8 per cent in the same period. Further WPI showed inflation in August 2020 versus deflation. The VAR model forecasts 6.6 per cent retail inflation in Q2: 2020-21. The States imposed local lockdowns which have resulted in continuation of supply constraints, albeit with some easing since April 2020. This is also evident in the slow convergence between WPI and CPI inflation seen in July-August 2020. The VAR model forecasts a moderating trend for the remaining quarters of 2020-21. The headline inflation will be 6.5 per cent during the financial year 2020-21. Despite easing of supply constraints and weak demand, inflation is forecasted to remain well above the RBI inflation target band of 2-6 per cent this fiscal. With one-year ahead inflation expectations at double digits already, any further entrenchment of inflation expectations may push India in a high-inflationary and low-growth spiral that the country has fought hard to come out of.

7.1 Introduction

The Indian economy was characterized by stagflation in the first quarter of the current fiscal as (negative) aggregate supply factors dominated the (negative) aggregate demand ones. Factors such as supply constraints due to lockdowns, logistic issues and labour shortages would have negatively affected aggregate supply and contributed to higher headline retail inflation Q1: 2020-21 (Figure 7.1). In contrast, the Wholesale Price Index (WPI) experienced deflation in April and May 2020. The gap between retail and WPI inflation which had widened in Q1: 2020-21, has showed signs of narrowing in the second[2]. While retail inflation remained elevated and sticky at 6.7 per cent on a year-on-year (y-o-y) basis, WPI inflation increased and was positive in August 2020 at 0.2 per cent (Figure 7.1). The retail inflation has stayed outside the RBI inflation target band of 2-6 per cent for three months of June, July and August 2020. The States imposed local lockdowns has resulted in continuation of supply constraints with some easing from April 2020. The main area of concern is the core retail inflation, which has also remained elevated & sticky and averaged at 5.8 in July-August 2020 on a y-o-y basis. This is much higher than 4.3 per cent in July-August 2019. Even WPI core inflation was positive at 0.6 per cent in August 2020 on a y-o-y basis.

[1] Rudrani Bhattacharya is an Assistant Professor at the National Institute of Public Finance and Policy, New Delhi.
[2] The divergence between CPI and WPI inflation could be explained by factors like increase in trade margins and supply disruptions (particularly during the COVID period) affecting more the retail markets than the wholesale markets. The easing of supply disruptions could drive them closer as we see from the graph above.

Figure 7.1: CPI and WPI Inflation: Overall and Core July 2018– August 2020, (% change y-o-y)



Source: Authors' calculations from MoSPI and Office of Economic Advisor.

7.2 Retail Inflation

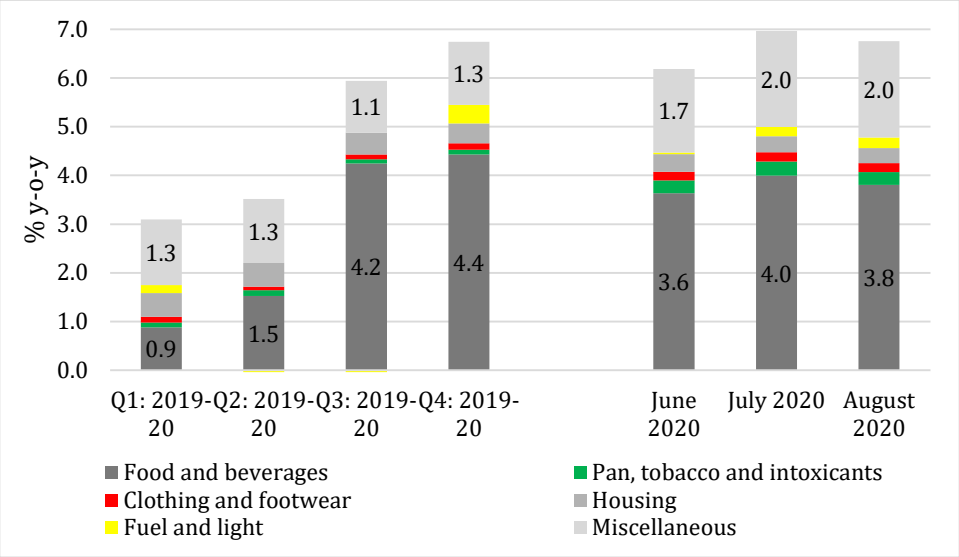
Retail inflation remained sticky and elevated at 6.7 per cent in July-August 2020 on a y-o-y basis. This average inflation rate of 6.7 per cent has persisted since Q4: 2019-20. To discount for base effects and incorporate more recent changes, we compute the inflation rate on month-on-month basis using seasonally adjusted CPI. It shows an upward trend in July (3.0 per cent) and August 2020 (5.6 per cent).

Even rural and urban retail inflation converged and averaged at 6.7 per cent in July-August 2020 on a y-o-y basis. In contrast, the average rural and urban retail inflation in July-August 2019 was 2.2 and 4.4 per cent respectively.

The current inflation dynamics are being mainly driven by supply-side factors (see Box 7.1 for an extensive discussion). 'Food and beverages' followed by 'miscellaneous' inflation have been the main drivers of overall inflation (Figure 7.2). Within 'food and beverages', vegetables was the major driver of inflation between August 2019 and March 2020. Since then, it has become more broad-based. Within vegetables, potatoes with 68.5 per cent and 79.5 per cent y-o-y inflation has occupied the headlines.

Overall, food inflation in the first two months of the second quarter showed a moderating trend. After peaking at 11.1 per cent in Q4: 2019-20, Consumer Food Price Inflation eased to 9.5 per cent in Q1: 2020-21. It showed signs of further easing to 9.3 per cent and 9.1 per cent in July 2020 and August 2020 respectively.

Figure 7.2: Contributors to overall CPI Inflation Q1: 2019–20 to Q2: 2019-20, June- August 2020 (% change y-o-y)

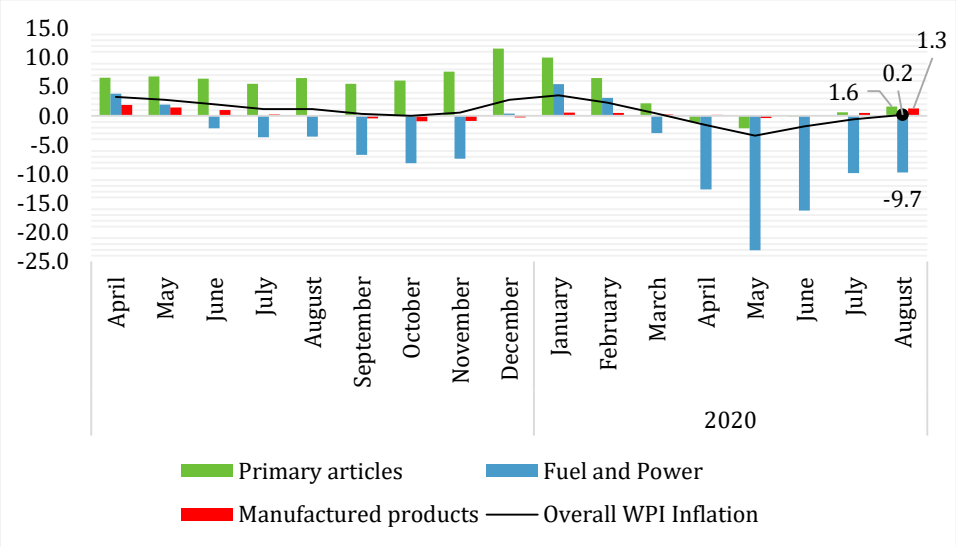


Source: Authors' calculations from MoSPI.

7.3 Wholesale Price Index (WPI)

After deflating since April 2020, WPI showed inflation of 0.2 per cent in August 2020 (Figure 7.3). Both primary articles and manufactured products showed rising inflation trends in July and August 2020. They both moved from deflation or no inflation in Q1: 2020-21 to one per cent or less than one per cent inflation during July-August 2020. WPI Fuel, power and light was in deflation since March 2020. It showed an average deflation rate of 9.8 per cent in July-August 2020 on a y-o-y basis.

Figure 7.3: WPI Inflation (% change y-o-y), April 2019 to August, 2020



Source: Authors' calculations from MoSPI.

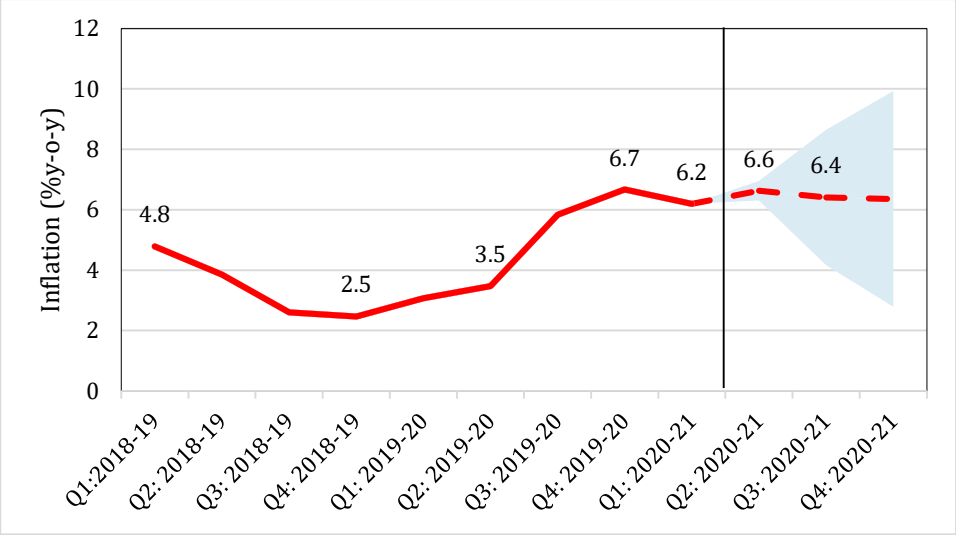
7.4 Commodity Price Inflation

The August numbers from the IMF Commodity Prices would indicate that global commodity prices seem to be gaining strength. The IMF Commodity Price shows that it is deflation but deflation rate has come down from 11.8 per cent in July 2020 to 2.6 per cent in August 2020 on a y-o-y basis. Brent Crude oil fell from US$63.6 per barrel in January 2020 to US$23.3 per barrel in April 2020 before rising up to US$44.3 per barrel. Precious metal has shown double digit inflation in July and August 2020 -29.7 per cent and 32.8 per cent respectively on a y-o-y basis. Inflation has edged up in August 2020 for base metals, food & beverages and industrial inputs.

7.5 Expected Behaviour of Inflation in 2020-21 Q2 and the rest of the financial year 2020-21

We forecast the inflation rate for Q2: 2020-21 and fiscal year 2020-21 using a Vector Auto Regression (VAR) model. Data from April, 2012 to August, 2020 are used consisting of monthly y-o-y inflation rates of CPI headline, CPI food and CPI core; WPI oil and WPI food; and changes in the exchange rate, non-food credit given by scheduled commercial banks as a proxy for the current level of economic activities and repo rate. The model forecasts that CPI headline inflation will moderately decline over the months of the current and next two quarters of the financial year 2020-21. The moderating trend of inflation indicates that the effects of negative supply shocks are weakening compared to the effects of negative demand shocks on prices (Figure 7.4). This is despite the rising trend of average inflation expectations reported by RBI Household Surveys of Inflation Expectations and reporting a double digit expected current inflation of the households. Our model further predicts that the CPI headline inflation will be 6.6 per cent in Q2: 2020-21, and marginally decline by March, 2021. The headline inflation will be 6.5 per cent during the financial year 2020-21.

Figure 7.4: Outlook for CPI inflation (% change y-o-y), Q1: 2018-19 to Q4: 2020-21



Source: Estimated by Rudrani Bhattacharya.
Note: The dashed line in shaded part shows the forecast inflation rate from Q2: 2020-21 to Q4: 2020-21 with 95% confidence interval.

Box 7.1 : Demand versus Supply factors fuelling Retail Inflation

The NCAER Business Expectations Survey June 2020 reported that demand side sentiments about new orders, domestic sales, exports and ex-factory output prices were muted (NCAER 2020a). However, a majority of firms said they had seen a rise in unit cost of raw materials, electricity and labour and more than 50 per cent of firms expected these costs to go up in the next three months. Further, firms had incurred additional costs (if and when they were operational between April-June 2020) on items like sanitisation, providing accommodation and transportation for their workers during the pandemic. Due to the novel coronavirus restrictions, firms were working below capacity and therefore were unable to optimise their production process. However, the IIM Ahmedabad Business Inflation Expectations Survey reported that business inflation expectations had moderated in July 2020.

The RBI in its recent Monetary Policy Committee (MPC) Report observed that recent inflation was fuelled by supply disruptions and there was no demand pressure on prices. Further, it found that the consumption pattern was shifting in favour of food and that food inflation was caused by recent floods and lockdown related supply disruptions.

The NCAER Delhi Coronavirus Telephone Survey Phase III also reported that farmers faced logistic issues in June 2020 (NCAER 2020b). As a thought experiment, we constructed WPI and CPI food articles inflation comprising of cereals, pulses, fruits & vegetables, milk, spices, eggs, meat & fish. WPI and CPI inflation, which was diverging earlier, started converging from June 2020. No CPI estimates are available for April and May. This pattern could be interpreted to indicate that supply constraints, which were more severe for retail trade, started easing in the second quarter of 2020-21.

Sources:

IIM Ahmedabad. 2020. Business Inflation Expectations Survey: July 2020. September.
NCAER. 2020a. The NCAER Business Expectations Survey for India: First Quarter 2020-21. August.
NCAER. 2020b. Delhi NCR Coronavirus Telephone Survey-Round 3.
https://www.ncaer.org/event_details.php?EID=285. July 4.
RBI. 2020. Minutes of the Monetary Policy Committee Meeting August 4 to 6, 2020.
https://www.rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=50240.

Chapter 8: Fiscal outlook, 2020-21:Q2[1]

Sudipto Mundle, Ajaya K Sahu and Pallavi Choudhuri

Fiscal policy making has become very challenging with inflation rising at the same time with an unprecedented contraction of economic activity.

The stringent countrywide lock down that was imposed in the wake of the novel coronavirus pandemic has completely destabilised the fiscal situation which was already under considerable stress even before it came. With GDP growth slowing down to only 3.1 per cent in Q4 of 2019-20 and GDP then contracting by (-) 23.9 per cent in Q1 of 2020-21, there has been a steep slide in revenues.

Instead of passing this through as a contraction of expenditure, the Central Government has maintained expenditure at more or less budgeted levels, with additional borrowing to compensate for the shortfall in revenue. This will entail a large increase in the combined annual fiscal deficit. The Central and State Government's deficits will together add up to almost 13 per cent of GDP, with a total public sector borrowing requirement of 14 per cent to 15 per cent of GDP. Combined with liquidity infusion of nearly 9 per cent of GDP on the monetary policy side, this adds up to a very strong stimulus for aggregate demand. How much of this will translate to recovery of real economic activity and how much will spill over into inflation depends on the supply response following the unlocking of the economy since the end of June. As the forecasts in chapter 2 indicate, the contraction of the economy is moderating and we may end the year with a decline of around (-) 13 per cent in real GDP year-on-year (y-o-y.) Meanwhile, the headline inflation rate has already risen to about 7 per cent, exceeding the RBIs tolerance band of 4 per cent +/- 2 per cent. This signals the need for caution in allowing the deficit to increase much further.

8.1 Introduction

The fiscal situation was already under considerable stress even before the novel coronavirus shock. With GDP growth slowing down to only 3.1 per cent in Q4 of 2019-20 and GDP then contracting by an unprecedented (-) 23.9 per cent in Q1 of 2020-21, there has been a steep slide in revenues. Instead of passing this through as a contraction of expenditure, the Central Government has maintained expenditure at more or less budgeted levels. This has entailed a large increase in the combined fiscal deficit of the Central and State Governments. Taken together with large doses of liquidity infusion, this adds up to a very strong stimulus for aggregate demand. How much of this translates to recovery of real economic activity and how much will spill over into inflation depends on the supply response. Rising inflation signals the need for caution in allowing the deficit to increase much further.

8.2 Revenues

On the revenue side recent budgets have made unduly optimistic assumptions. In 2019-20, for instance, the budget assumed total tax revenue of the order of Rs 24.61 trillion (12.1 per cent of GDP) while the actual realisation was only Rs 20.10 trillion (9.9 per cent of GDP) (Table 8.1). As against the implied growth of 18.3 per cent over 2018-19, tax revenue actually *declined* by (-) 3.4%. Despite this poor performance the 2020-21 budget assumed that tax revenue would grow by over 20 per cent during 2020-21. With the coronavirus lock down striking when the situation was already so grim, tax revenue plummeted by (-) 30 per cent

[1] We would like to acknowledge the very helpful comments of Shankar Acharya on an earlier draft of this chapter. However, the authors alone are responsible for the errors that remain.

during the period April-July 2020 compared to the same period the previous year. The Centre's share, net of transfers to states, fared even worse, declining by over (-) 40 per cent.

Indirect taxes which account for 48 per cent of total tax revenue declined by over 27 per cent y-o-y during the April-July period while direct taxes declined by about 33 per cent. Central GST, the largest single component of indirect taxes (51 per cent share) declined by 34 per cent. Non-tax revenues, which account for about 19 per cent of total revenue receipts, also fell nearly 44 per cent during April-July 2020. As a consequence total revenue receipts during this period fell by a nearly 30 per cent.

8.3 Expenditure

Despite this the level of Central Government expenditure during the period April-July 2020 grew by over 11 per cent y-o-y, only slightly lower than the budgeted level of expenditure growth during the full year (Tables 8.2 and 8.3). In other words, at the Central Government level the revenue decline has not been passed on to expenditure. It has been largely offset by additional borrowing. This is also confirmed by the fact that the proportion of budgeted annual expenditure spent during the April-July period is 35 per cent in 2020-21, which is virtually the same as the 34per cent of annual budgeted expenditure spent during the same period last year (Table 8.2). In other words there has been no expenditure compression during the lock down period despite the dramatic decline in tax revenue.

There are of course large variations around this average picture of expenditure growth. Because of the focus on providing relief to rural households during and after the lock down period, the share of annual expenditure of the Ministry of Agriculture and, especially, Ministry of Rural Development were much higher during the April-July period of 2020 compared to the same period in 2019 (Table 8.2). The same is true of the April-July expenditure share of the Ministry of Health and Family Welfare, which is higher this year because of efforts to deal with the coronavirus pandemic which was still spreading exponentially during this period, and the Ministry of Social Justice and Empowerment.

On the other hand, the April-July share of annual expenditure was lower this year compared to last year for several other ministries including the Ministry of Human Resource Development and the Ministry of Women and Child Development. On the infrastructure side the April-July share of annual expenditure in 2020 has been lower compared to 2019 for the Ministry of Power, transport ministries (Road Transport, Railways, Civil Aviation and Shipping) and Jal Shakti Ministry. It has also been lower for the Ministries of Heavy Industry and Micro, Small and Medium Enterprises. But it has been much higher for the Ministry of Power and also the Ministry of Communications.

8.4 Fiscal Deficit and Fiscal Stimulus

As might be expected, the maintenance of expenditure levels during the April-July period more or less in line with budget projections despite the sharp decline in revenues during this period implies that the revenue shortfall has been offset by additional borrowing, i.e., a massive increase in the fiscal deficit. The budget target was to reduce the Central Government fiscal deficit in 2020-21 to Rs 8 trillion or 3.5 per cent of GDP compared to the actual deficit of Rs 9.4 trillion (4.6 per cent of GDP) in 2019-20 (Table 8.3). This would entail a reduction of

the deficit by 14.9 per cent y-o-y. As against that the fiscal deficit during April-July 2000 has actually gone *up* by 50 per cent compared to the same period last year.

For the whole year 2020-21 the Central Government budget deficit works out to be 8 per cent of GDP (Table 8.4) when we add together the planned deficit in the budget (3.5 per cent of GDP) plus the additional post budget borrowing (2.1 per cent) plus the further borrowing to finance components of the Atma Nirbhar Bharat programme (2.4 per cent). Adding to this the budgeted fiscal deficit of the states, 2.8 per cent of GDP, takes the combined fiscal deficit of the Centre plus States to 10.8 per cent of GDP. The Centre has allowed the states to borrow an additional 2 per cent of GDP beyond their Fiscal Responsibility and Budget Management (FRBM) limits to meet their extra spending requirements to cope with the pandemic, which would take the combined fiscal deficit to 12.8 per cent of GDP. Allowing for off-budget borrowing of the Centre and States through public enterprises, amounting to over 1 per cent of GDP, the total public sector borrowing requirement (PSBR) would add up to a massive 14 per cent to 15 per cent of GDP.

In this context there is a view that the Central Government has done very little in terms of providing a fiscal stimulus to help revive the economy. This is mainly due to a miscommunication about the fiscal stimulus provided by the Centre. On 13 May the government announced the launch of Rs 20 trillion Atmanirbhar Bharat stimulus package (Table 8.5).[2] It was incorrectly assumed that this was the government's *fiscal* stimulus package. However, the fiscal component of this package was just over 1 per cent of GDP,[3] the bulk of it consisting of monetary policy and credit guarantee measures to infuse more liquidity into the system. This led to the view that the government had provided very little *fiscal* stimulus. However, as explained above, the fiscal component of the Atmanirbhar Bharat package is only a small component of the total fiscal stimulus (2.4 per cent), which adds up to around 14 per cent to 15 per cent of GDP.

As regards the additional borrowing headroom provided for the states, this is subject to conditions that may be difficult to fulfil. So it is not clear that the States will undertake such additional borrowing. On the other hand many states have demanded that the Centre should draw on the Compensation cess to pay them the full compensation due for the shortfall of their share of GST revenues compared to the projected norm. The norm is estimated on the basis of 14 per cent annual growth of base year revenues of state taxes subsumed under GST as mandated in the GST Compensation Act. Compared to the estimated shortfall of nearly Rs 3 trillion compared to this norm the amount collected by the Compensation cess is only Rs 65,000 crores[4]. There is an ongoing dispute about how this gap is to be financed. Whichever way the dispute gets resolved, it is quite clear that there will have to be additional borrowing to cover the gap, whether by the Centre or the States.

So for the year as a whole the total PSBR will indeed add up around 14 per cent-15 per cent of GDP. If we take only the fiscal impulse, i.e. the change in PSBR compared to last year, as the appropriate measure of a fiscal stimulus even that would add up to around 5 per cent to 6 per cent of GDP. There is a further monetary stimulus being provided though liquidity infusion amounting to 8.9 per cent of GDP[5]. So the government and RBI have together provided a

[2] The package has since been expanded to Rs 24.7 trillion or 12.4 per cent of GDP. see Table 8.5

[3] This has subsequently been increased to 2.4 per cent of GDP. See table 8.5.

[4] See Sudipto Mundle, Honourable Arun Jaitley's grand bargain in the GST Compensation Fund, *Mint,* 18 September, 2020

[5] See chapter 9 on Monetary Policy and Finance.

very large aggregate demand stimulus. How much of this will translate to recovery of growth and how much will lead to additional inflation depends on how supply constraints will respond to the gradual unlocking of the economy. The headline inflation rate has already risen above the RBI's tolerance band while GDP is still declining, implying that the Indian economy is now approaching a phase of stagflation. Our forecast suggests that this is likely to persist beyond 2020-21, spilling over to 2022-23.

Table 8.1: Receipts and Percentage Changes

		Rs crores						*%age changes*					*Share in Total**				
S.No.	**Items**	**2018-19 (actual)**	**2019-20 (BE)**	**2019-20 (PA)**	**2020-21 (BE)**	**2019-20 (April-July)**	**2020-21 (April-July)**	**2019-20 (PA) over 2018-19 (Actuals)**	**2019-20 (PA) over 2019-20 (BE)**	**2019-20 (BE) over 2018-19(Actuals)**	**2020-21 (BE) over 2019-20 (PA)**	**2020-21 (April-July) over 2019-20 (April-July)**	**2018-19 (actual)**	**2019-20 (PA)**	**2020-21 (BE)**	**2019-20 (April-July)**	**2020-21 (April-July)**
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17
1	Revenue receipts (3+10)	1553011 (8.2)	1962761 (9.6)	1682107 (8.3)	2020926 (9.0)	382610	227402	8.3	(-)14.3	26.4	20.1	(-)40.6	93.2	96.1	90.0	95.7	97.7
2	Tax revenue (gross)	2080465 (11.0)	2461195 (12.1)	2009882 (9.9)	2423020 (10.8)	539068	380000	(-)3.4	(-)18.3	18.3	20.6	(-)29.5					
3	Tax revenue (net to Centre)	1317211 (6.9)	1649582 (8.1)	1355886 (6.7)	1635909 (7.3)	338705	202788	2.9	(-)17.8	25.2	20.7	(-)40.1	84.8	80.6	80.9	88.5	89.2
4	Direct tax[2]	1125224 (5.9)	1335000 (6.6)	1037217 (5.1)	1319000 (5.9)	217133	144968	(-)7.8	(-)22.3	18.6	27.2	(-)33.2	54.1	51.6	54.4	40.3	38.1
5	Indirect tax[3]	955241 (5.0)	1126195 (5.5)	972665 (4.8)	1104020 (4.9)	321,935	235,032	1.8	(-)13.6	17.9	13.5	(-)27.0	45.9	48.4	45.6	59.7	61.9
6	Central GST	457534 (2.4)	526000 (2.6)	494070 (2.4)	580000 (2.6)	140900	92949	8.0	(-)6.1	15.0	17.4	(-)34.0	47.9	50.8	52.5	43.8	39.5
7	UT GST	2779 (0.0)	2768 (0.0)	2629 (0.0)	3000 (0.0)	710	519	(-)5.4	(-)5.0	(-)0.4	14.1	(-)26.9	0.3	0.3	0.3	0.2	0.2
8	Integrated GST	28944 (0.2)	28000 (0.1)	9204 (0.1)		35920	23038	(-)68.2	(-)67.1	(-)3.3		(-)35.9	3.0	0.9	0.0	11.2	9.8
9	GST compensation cess	95081 (0.5)	109343 (0.5)	95551 (0.5)	110500 (0.5)	32796	21298	0.5	(-)12.6	15.0	15.6	(-)35.1	10.0	9.8	10.0	10.2	9.1
10	Non-tax revenue	235800 (1.2)	313179 (1.5)	326221 (1.6)	385017 (1.7)	43905	24614	38.3	4.2	32.8	18.0	(-)43.9	15.2	19.4	19.1	11.5	10.8
11	Non-debt capital receipts	112684 (0.6)	119828 (0.6)	68620 (0.3)	224967 (1.0)	17063	5458	(-)39.1	(-)42.7	6.3	227.8	(-)68.0	6.8	3.9	10.0	4.3	2.3

Note: Figures in parenthesis denote percentage of GDP. *1. Shares of revenue receipts and non-debt capital receipts refer to percentage share of total receipts, 2. Shares of tax (net to centre) and non-tax revenue refer to percentage share of total revenue receipts, 3. Shares of direct and indirect tax refer to percentage share of gross tax revenue, 4. Shares of CGST, UTGST, IGST and GST compensation cess refer to percentage share of indirect tax. 2 Direct tax includes income, corporate and other minor direct taxes. 3 Indirect tax includes central GST, UT GST, integrated GST, GST compensation cess, customs, union excise duties and other minor indirect taxes of the central government. Direct and Indirect tax are gross figures inclusive of states' share. PA Provisional Actuals, BE Budget Estimates.

Source: Data for 2019-20 and 2020-21 (BE) are taken from Receipt Budget 2020-21. Rest are taken from CGA Monthly publications.

Table 8.2: Expenditure across Ministries and Departments (Rs. Crore)

S.No.	Ministry/Department	2020 - 2021		% of Actuals (April-July) to Budget Estimates		April-July 2020 over April-July 2019 (% change)
		Budget Estimates	*April-July 2020 (Actual)*	*2020-21*	*2019-20*	
	1	2	3	4	5	6
1	Ministry of Agriculture and Farmer's Welfare	142762 (4.7)	50528	35.4	25.8	41.2
2	Ministry of Rural Development	122398 (4.0)	102335	83.6	34.8	145.5
3	Ministry of Human Resource Development	99312 (3.3)	20243	20.4	24.4	(-)12.5
4	Ministry of Health And Family Welfare	67112 (2.2)	27056	40.3	31.2	34.2
5	Ministry of Jal Shakti	30478 (1.0)	6097	20.0	25.7	(-)15.9
6	Transport Ministries (Road Transport+ Railways+ Civil Aviation+ Shipping)	169637 (5.6)	51648	30.4	33.0	(-)0.6
7	Ministry of Power	15875 (0.5)	2957	18.6	38.3	(-)51.4
8	Department of Telecommunications	66432 (2.2)	17764	26.7	23.5	177.0
9	Ministry of Heavy Industries+ MSMEs	9086 (0.3)	1458	16.0	25.7	(-)32.4
10	Ministry of Social Justice & Empowerment	11429 (0.4)	2195	19.2	9.6	125.4
11	Ministry of Women And Child Development	30007 (1.0)	5563	18.5	25.4	(-)24.9
12	Ministry of Finance	1168937 (38.4)	378554	32.4	29.9	25.8
13	Total Expenditure	3042230 (100.0)	1054209	34.7	34.0	11.3

Note: Figures in the parenthesis denote share of each ministry/ department in total expenditure
Source: Controller General of Accounts.

Table 8.3: Receipts, Expenditure and Deficits

		Rs Crores						%age changes					Share in Total*				
S.No.	*Item*	*2018-19 (actual)*	*2019-20 (BE)*	*2019-20 (PA)*	*2020-21 (BE)*	*2019-20 (April-July)*	*2020-21 (April-July)*	*2019-20 (PA) over 2018-19 (Actuals)*	*2019-20 (PA) over 2019-20 (BE)*	*2019-20 (BE) over 2018-19(Actuals)*	*2020-21 (BE) over 2019-20 (PA)*	*2020-21 (April-July) over 2019-20 (April-July)*	*2018-19 (actual)*	*2019-20 (PA)*	*2020-21 (BE)*	*2019-20 (April-July)*	*2020-21 (April-July)*
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17
1	Revenue receipts	1553011 (8.2)	1962761 (9.6)	1682107 (8.3)	2020926 (9.0)	382610	227402	8.3	(-) 14.3	26.4	20.1	(-)40.6	93.2	96.1	90.0	95.7	97.7
2	Tax revenue (net to Centre)	1317211 (6.9)	1649582 (8.1)	1355886 (6.7)	1635909 (7.3)	338705	202788	2.9	(-) 17.8	25.2	20.7	(-)40.1	84.8	80.6	80.9	88.5	89.2
3	Non- tax revenue	235800 (1.2)	313179 (1.5)	326221 (1.6)	385017 (1.7)	43905	24614	38.3	4.2	32.8	18.0	(-)43.9	15.2	19.4	19.1	11.5	10.8
4	Non-debt capital receipts	112684 (0.6)	119828 (0.6)	68620 (0.3)	224967 (1.0)	17063	5458	(-)39.1	(-) 42.7	6.3	227.8	(-)68.0	6.8	3.9	10.0	4.3	2.3
5	Total receipts (1+4)	1665695 (8.8)	2082589 (10.2)	1750727 (8.6)	2245893 (10.0)	399673	232860	5.1	(-) 15.9	25.0	28.3	(-)41.7	100	100	100	100	100
6	Total Expenditure	2315113 (12.2)	2786349 (13.7)	2686362 (13.2)	3042230 (13.5)	947278	1054209	16.0	(-) 3.6	20.4	13.2	11.3					
7	Revenue expenditure	2008024 (10.6)	2447780 (12.0)	2349618 (11.6)	2630145 (11.7)	839673	942360	17.0	(-) 4.0	21.9	11.9	12.2	86.7	87.5	86.5	88.6	89.4
8	Revenue deficit	455013 (2.4)	485019 (2.4)	667511 (3.3)	609219 (2.7)	457063	714958	46.7	37.6	6.6	(-)8.7	56.4					
9	Fiscal deficit (6-5)	649418 (3.4)	703760 (3.5)	935635 (4.6)	796337 (3.5)	547605	821349	44.1	32.9	8.4	(-)14.9	50.0					
10	Primary deficits	66770 (0.4)	43289 (0.2)	324599 (1.6)	88134 (0.4)	364081	622765	386.1	649.8	-35.2	(-)72.8	71.1					

Notes: Figures in parenthesis denote percentage of GDP. *1. Shares of revenue receipts and non-debt capital receipts refer to percentage share of total receipts, 2. Shares of tax revenue (net to centre) and non-tax revenue refer to percentage share of total revenue receipts. PA Provisional Actuals, BE Budget Estimates

Sources: Data for 2019-20 and 2020-21 (BE) are taken from Receipt Budget 2020-21. Rest are taken from CGA Monthly publications.

Table 8.4. Fiscal Stimulus- Budget plus Post-Budget (2020-21)		
	Item	***GDP (%)***
	1	2
1	Central Government Budget Deficit	3.5
2	Post-Budget additional borrowing	2.1
3	Atma Nirbhar Bharat fiscal component	2.4
4	States' Budget	2.8
5	Additional borrowing headroom for States	2.0
6	Total	12.8

Source: NCAER Conceptualisation.

Table 8.5: AtmaNirbhar Economic Package

	Items	Total in (₹Crores)	Additional fiscal cost (post-budget)	Contingent liability (CL)/ fiscal outgo	Liquidity / support through financial institutions	Remarks
		I	II	III	IV	
	Economic Measures introduced prior to PM's AtmaNirbhar package					
26.03.20	Pradhan Mantri Garib Kalyan Yojana (PMGKY)	1,70,000 (0.85)	1,52,620 (0.76)			subtract PM-Kisan allocation (budgeted amount)
	Revenue loss due to tax concessions from March 22, 2020	7,800 (0.4)	7,800 (0.04)			Ref: Government of India
	PM's announcement for anti-Covid health facilities	15,000 (0.08)	15,000 (0.08)			Ref: PM's announcement, Government of India
February - July 2020	RBI's liquidity injection	9,57,000 (4.79)			9,57,000 (4.79)	Ref: RBI Monetary Policy Statement, dated Aug 06, 2020
	AtmaNirbhar package					
13.05.20	Tranche 1 of AtmaNirbhar package (₹5,94,550 crore)					
	Collateral free automatic loans to MSMEs	3,00,000 (1.50)		60,000 (0.30)	3,00,000 (1.50)	100% guaranteed by Govt.; assumed 20% contingent liability
	Subordinate Debt for stressed MSMEs*	20,000 (0.10)		4,000 (0.02)		Ref: Government of India; Government support extended to Credit Guarantee Trust for MSME (CGTMSE). CGTMSE to provide partial credit guarantee support to banks
	Fund of Funds for Equity infusion into MSMEs	50,000 (0.25)		10,000 (0.05)		Ref: Government of India
	Special liquidity scheme for NBFCs/ HFCs/ MFIs	30,000 (0.15)		6,000 (0.03)	30,000 (0.15)	securities fully guaranteed by govt.; assumed 20% contingent liability
	Partial Credit Guarantee Scheme 2.0 for NBFCs	45,000 (0.23)		9,000 (0.05)	45,000 (0.23)	first 20% loss to be borne by govt.; assumed 20% contingent liability
	Liquidity injection for Discoms by PFC & REC	90,000 (0.45)			90,000 (0.45)	guaranteed by States, liquidity infusion to be made by PFC/REC
	EPF support for business and workers for 3 months	2,800 (0.01)	2,800 (0.01)			
	EPF rates reduced for Employers and Employees for 3 months*	6,750 (0.03)				policy change - reduction in rate from 12% to 10%
	25% reduction in TDS/ TCS rate*	50,000 (0.25)				policy change
14.05.20	Tranche 2 of the Atmanirbhar package (₹3,10,000 crore)					
	Free food grain supply to migrants for two months	3,500 (0.02)	3,500 (0.02)			
	Interest subvention of 2% for prompt-payees of MUDRA-Shishu loans	1,500 (0.01)	1,500 (0.01)			

Table 8.5 contd.: ₹20 trillion AtmaNirbhar package (contd.)

	Items	Total (₹crores)	Addl. fiscal cost	(CL)/ fiscal outgo	Liquidity / financial support	Remarks
		I	II	III	IV	
	Special liquidity scheme to provide ₹10,000 working capital to 50 lakh street vendors	5,000 (0.03)	5,000 (0.03)			
	Housing for Middle Income Group (₹6-18 lakh a year) - Credit-linked subsidy scheme	70,000 (0.35)	6,000 (0.03)			Estimated based on targeted 2.5lakh households, using data from MHUA, Govt. of India
	Emergency working capital funding for farmers through Nabard	30,000 (0.15)			30,000 (0.15)	
	Concessional credit through Kisan Credit Cards	2,00,000 (1.00)			2,00,000 (1.00)	
15.05.20	Tranche 3 of Atmanirbhar package (₹1,50,000 crore)					
	Financing facility for Agri Infrastructure projects	1,00,000 (0.50)			1,00,000 (0.50)	
	Scheme for formalisation of Micro Food Enterprises	10,000 (0.05)	6,000 (0.03)			Ref: PIB - The expenditure will be shared by GOI and the States in ratio of 60:40.
	Funding for fishermen through PM Matsya Sampada Yojana	20,050 (0.10)	9,407 (0.05)			Ref: PIB - Central govt. share ₹9407 crore state's share: ₹4880 crore, beneficiaries contribution: ₹5763 crore
	Animal Husbandry Infrastructure Development Fund	15,000 (0.08)			15,000 (0.08)	Interest subvention scheme to be implemented through NABARD - Ref: Notes on Demands for Grants, 2020-2021 (Demand No. 40), Govt. of India
	Promotion of Herbal Cultivation*	4,000 (0.02)				Announced in budget - excess allocation for package not clear.
	Beekeeping initiatives*	500 (0.003)				Budgeted amount of ₹2400 crore (not clear whether ₹500 is subsumed under this)
	Operation Green to be extended to all vegetables	500 (0.003)	500 (0.003)			
16.05.20	Tranche 4 of Atmanirbhar package (₹8,100 crore)					
	Viability gap funding	8,100 (0.04)	8,100 (0.04)			
17.05.20	Tranche 5 of Atmanirbhar package (₹40,000 crore)					
	Increase in MGNREGA budgetary allocations	40,000 (0.20)	40,000 (0.20)			
	Additional Tranche (₹2,17,360 crore)					
22.06.20	Garib Kalyan Rojgar Abhiyan	50,000	50,000			rural public works scheme for migrants
08.07.20	Free foodgrain under PMGKAY	1,49,000 (0.75)	1,49,000 (0.75)			
	Free LPG under PM Ujjwala Yojana	13,500 (0.07)	13,500 (0.07)			
	Extension of EPF contribution of 24%	4,860 (0.02)	4,860 (0.02)			
	Grand Total	**24,70,463 (12.35)**	**4,75,587 (2.38)**	**89,000* (0.45)**	**17,67,603 (8.84)**	

Source: Mundle and Choudhuri (2020). *Quarterly Review of the Economy, 2020:1Q, In Coronavirus times, Ch. VIII. NCAER. New Delhi.*

Notes: (A) Data based on PIB, Govt. of India. ***(B)*** figures in parentheses reflect % of GDP, assuming GDP of 200 trillion rupees. ***(C)*** In addition to actual fiscal cost (col II), and financial support (col IV), Grand Total (col I) also includes government credit guarantee, of which only CL (col III) is shown, and also few items, which were already in the 2020-21 budget.

* These are not part of the fiscal/financial stimulus. Total stimulus amounts to ₹22,43,190 crores, which is 11.22% of GDP.

Money and Financial Markets

Pallavi Choudhuri and Sudipto Mundle

Determining the appropriate monetary policy stance has become very challenging in the present context of unprecedented contraction of the economy along with elevated inflation. The outlook for economic activity continued to be grim. GDP for Q1 of 2020-21 declined by 23.9% year-on-year (y. o. y) while retail inflation, measured by the Consumer Price Index, rose to 6.9% in June from 5.84% in March, breaching the RBI's inflation band of 4 percent +/-2%. RBI Governor has expressed concern particularly about elevated food inflation but prices of other items are also rising.

One major challenge RBI is facing is enable the financial market to absorb the massive borrowing program of the government without allowing interest rates to rise. It seems inevitable that at least a part of this borrowing will have to be monetised to avoid excessive pressure and crowding out in the financial markets. The Reserve Bank of India (RBI) held the policy repo rate steady at 4 percent in its bi-monthly review meeting held on August 6, 2020, while maintaining an accommodative stance. Transmission of policy rate changes has also strengthened significantly since February 2020 and bank lending rates as well as short maturity bond yields have declined though the benchmark 10-year G-sec yield is still elevated. RBI has undertaken several interventions to moderate this rate. But RBI's expansionary monetary policy has had to be modified due to rising inflation.

Credit growth, especially for MSMEs has unfortunately remained muted due to high and rising risk aversion. Banks prefer to invest in low return but low risk sovereign debt. Several measures to stimulate credit flow to these enterprises have so far proved ineffective. Meanwhile, the long persisting challenge of non-performing assets has become greatly aggravated by Coronavirus crisis and country wide lockdown. The Gross non-performing assets ratio (GNPA) was 8.5 per March 2020. Stress tests suggest that the GNPA could spike to as much as12.5 per cent or even 14.7 per cent of total loans by March 2021

Conventional fiscal and monetary policies alone will not be enough to get the economy out of its current crisis unprecedented of contraction combined with rising inflation. That will require wide ranging reforms no less ambitious than the reforms of 1991. The most urgent component of such a reform package is the set of reforms to ensure the stability of the financial sector in India. These should include much stronger supervision of banks as well as other financial institutions; resolution of existing NPAs, if necessary through the creation of a 'Bad' bank; at least partial disinvestment and governance reforms in state owned banks before they are recapitalized and more effective incentives and guarantees to induce growth of lending to MSMEs.

9.1 Policy Rate, Inflation, and Financial Markets

Rising inflation, combined with a sharp decline in output following the nationwide lockdown in late March, has made the determination of an appropriate monetary policy stance very challenging. The Reserve Bank of India (RBI) kept the policy repo rate unchanged at 4 per cent and the reverse repo rate at 3.35 per cent during its August bi-monthly meeting (see Figure 9.1). It had earlier reduced the repo rate by 75 and 40 basis points (bps) in March and May 2020, along with strong doses of liquidity injection. The RBI's liquidity injections since February 2020, , amounted to approximately

Rs.9.57 trillion or about 4.8 per cent of GDP as per the RBI Monetary Policy Statement, dated August 06, 2020 (see Chapter 8 Table 8.5)[1].

The yield on 3-month treasury bill (T-bill) have fallen by 103 bps between April 10, 2020 and August 14, 2020, settling at 3.27 per cent, pricing in the reduction in the policy repo rate. (See Figure 9.1). The yield on the 10-year benchmark government security (G-sec) had dropped to a low of 5.73 per cent in May, 2020, but it has started creeping back to 6 per cent (it was 5.97 per cent on August 14, 2020). The bond market started heating up especially after the RBI kept the policy repo rate unchanged at 4 per cent in its bi-monthly meeting in August. The RBI also refrained from making any announcement on measures to absorb the huge additional government borrowing that is required to finance the budgeted levels of spending despite the massive drop in revenue collection as a consequence of the steep decline in economic activity. But it should be noted that an inflation rate of 6.9% implies a negative real yield on G-secs.

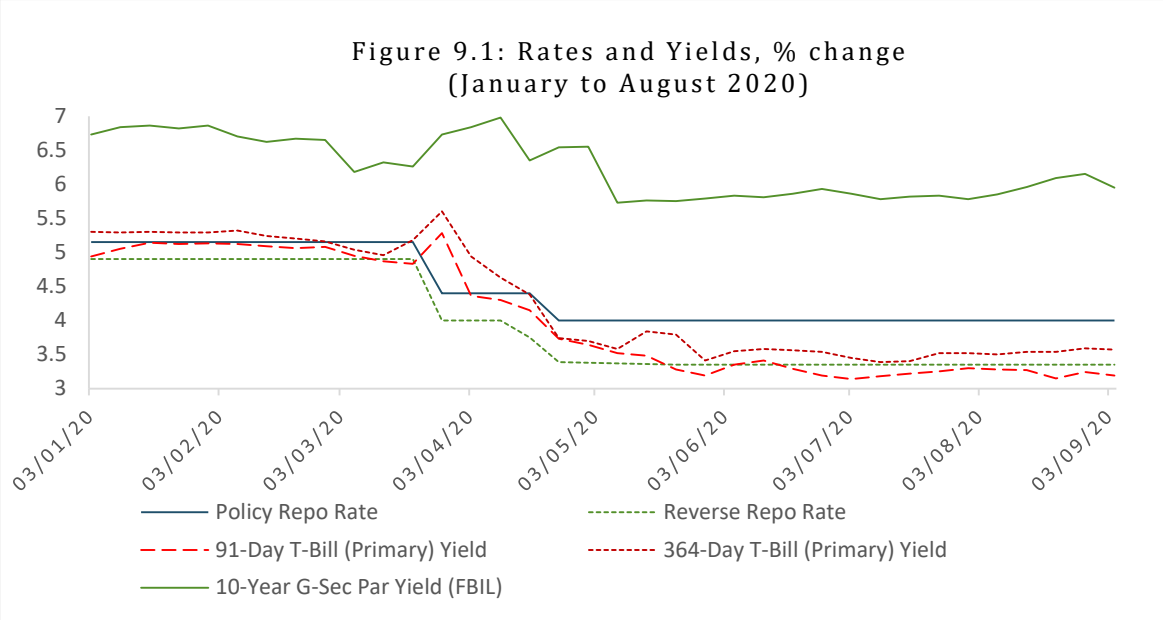
The RBI has undertaken another round of Operation Twist, a special bond-swapping programme under open market operations (OMOs) to purchase Rs. 10,000 crore rupees of 10-year G-secs, while selling an equivalent amount of shorter term debt on August 27 and September 3. The intention was to create additional demand for long-dated bonds, while simultaneously increasing the supply of the short term bonds, thereby raising short-term yields while moderating the long term yield, which serves as the benchmark for corporate bonds.

The RBI is slated to repeat Operation Twist in two additional tranches of Rs. 10,000 crores each, along with a long-term repo operations (LTRO) aggregating to rupees one trillion, in September to cool off bond yields. It has given banks the option of reversing funds taken under the LTRO to reduce their cost of funds. Banks can now decrease their interest liability by returning funds availed via LTRO at the earlier prevailing repo rate of 5.15 per cent and swap it for funds at the current repo rate of 4 per cent, thus effectively reducing their interest costs.

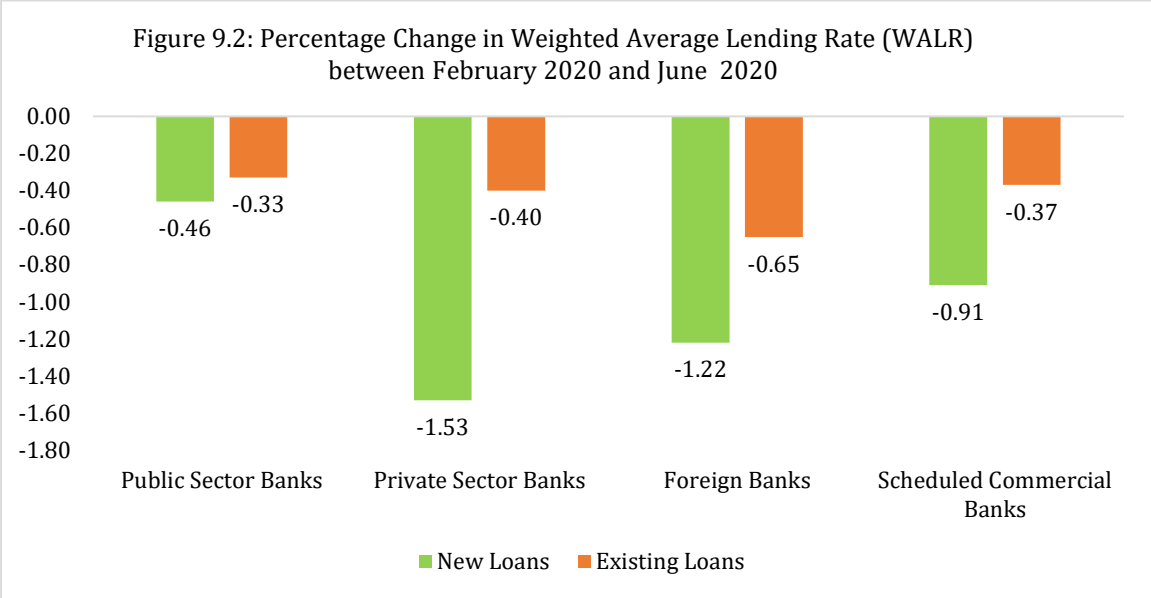
The Central Bank announced an additional set of liquidity measures and a relaxation in mark-to-market rules in the wake of the sudden spike in bond yields during the second half of August 2020. It raised the limit on Held-To-Maturity (HTM) bonds under the Statutory Liquidity Ratio (SLR) from 19.5 per cent to 22 per cent of Net Demand and Time Liabilities (NDTL), effective from September 1. The move is expected to encourage banks to park their funds in G-secs without having to cover for short term volatility in yields. HTM bond investments do not have to be marked current market rates, and thus, do not incur nominal losses. The RBI expects this will trigger a rally in the bond market, bringing down bond yields.

All these recent RBI initiatives are aimed at enabling the market to absorb the central government's massive Rs. 12 trillion borrowing programme for the current fiscal year without a large increase in yields.

[1] Refer to RBI's Monetary Policy Statement, dated Aug 06, 2020
https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=50175



Source: RBI.



Source: RBI

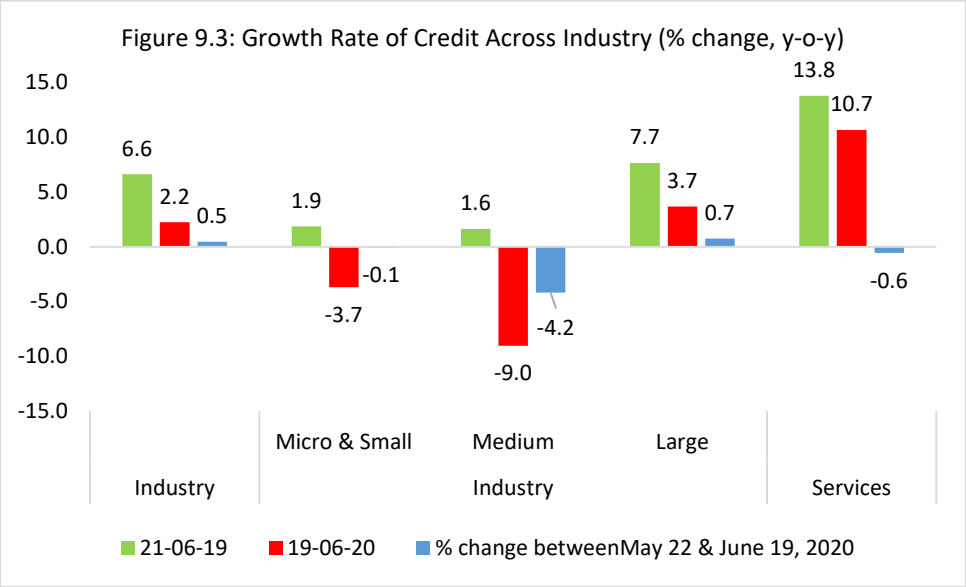
The weighted Average Lending Rate (WALR) on fresh rupee loans declined by 91 basis points(bps) on average by end June 2020. for all scheduled commercial banks. It declined by 46 bps for public sector banks (PSBs) and by 153 bps for private banks, settling at 8.18 per cent and 8.74 per cent respectively (figure 9.2). Thus, transmission of policy rate change has strengthened significantly since February 2020. However, RBI's expansionary monetary policy stance has had to be modified due to rising inflation. Headline inflation based on the consumer price index (CPI) rose to 6.9 per cent in July 2020 y-o-y compared to 6.2 per cent in June 2020. Food inflation in particular spiked to 9.6%, mainly due to supply-side disruptions (see chapter 7: Prices). The RBI governor has noted that the headline inflation is expected to remain elevated during the second

half of FY 2020-21. This allows less room for the RBI to carry out further rate cuts even while facing the sharpest economic contraction recorded since independence.

The Indian Rupee has appreciated by 1.4 per cent since April 3, 2020 in nominal terms. The spot rate fell to INR 74.77 against the US Dollar on August 14, 2020 as compared to INR 75.83 on April 3, 2020. This has happened mainly on account of the persistent inflow of foreign institutional investment (FII), especially into the domestic equity market. The net equity inflow from FIIs amounted to Rs. 84,160 crores between April and August 2020. However, foreign portfolio investors (FPIs) have pulled out a record sum from the Indian debt market – the net outflow between April to August 2020 has been Rs. 42,818 crores.

9.3 Bank lending

Credit to industry (comprising both MSMEs and large corporates) rose by only 2.2 per cent, y-o-y, as on June 21, 2020 compared to 6.6 per cent during the previous year (June 19, 2019). While growth of credit to large industries (3.7 per cent, y-o-y) was higher than for other industry segments, the growth of credit to micro and small industries and medium industries (MSME), y-o-y, was negative at (-) 3.7 per cent and (-) 9 per cent respectively (Figure 9.3). Growth of credit to services was much higher at 10.7 per cent, y-o-y, as on June 21, 2020, though this was than the 13.8 per cent growth of credit to services during the corresponding period of the previous year (Figure 9.3).



Source: RBI

Even before the Coronavirus pandemic struck banks were shying away from lending to the MSME sector because of risk aversion. They preferred to invest in low yield but safer government securities using the SLR (statutory liquidity ratio) window. Risk aversion greatly increased following the stringent nation-wide lockdown in late March. Responding to this challenge, on 13 May 2020, the Finance Minister(FM) announced a large credit guarantee arrangement for MSMEs totaling Rs.3 trillion as part of

the Rs.20 trillion AtmaNirbhar Bharat package announced on 12 May, 2020[2] [see chapter 8 Table 8.5]. Unfortunately, these credit guarantees have not been very successful so far in reviving lending to the MSME sector. In the period following the announcement of the credit guarantee package, credit extended to MSMEs continued to fall. Data from the RBI indicates that credit to micro and small industries fell by 0.07 per cent and that to medium industries fell by 4.8 per cent between May 22, 2020 and June 19, 2020.

As part of its Rs 20 trillion AtmaNirbhar package (see chapter 8, Figure 8.5), the central government also offered a partial credit guarantee scheme (PCGS 2.0) for small and medium non-bank financial companies (NBFCs), including micro-finance institutions (MFIs) and housing finance companies (HFCs). NBFCs are one of the primary sources of credit for the MSME sector. The credit guarantee package for NBFCs is thus also aimed at enhancing credit availability for MSMEs. The scheme has been extended till November 19, 2020; the government also increased the investment limit for banks in AA and AA- rated bonds from 25 to 50 per cent of their total investment in bonds or commercial papers to make this scheme a success. However, most small and mid-sized NBFCs face difficulties in tapping into the commercial paper/bond markets to raise capital because of higher levels of compliance and disclosure requirements mandated by the capital market regulator. Hence, the effectiveness of these new relaxations in enhancing liquidity for small and medium NBFCs remains to be seen.

9.4 Financial stability and financial sector reforms

To address the abnormal conditions resulting from the Covid-19 pandemic and stringent lockdown, the RBI appointed a committee chaired by K.V. Kamath to recommend what relief could be provided in debt repayment by stressed enterprises. The RBI has accepted the Kamath Committee recommendations. Among other things, the committee proposed a 'Resolution Framework for Covid 19 related Stress'. The report extends relief to 26 sectors affected by the Covid-19 pandemic factoring in parameters based on leverage, liquidity, and debt serviceability. The loan restructuring programme is expected to provide liquidity to borrowers who have been particularly affected by the pandemic. However, the loan recast recommendations will also result in banks postponing recognition of some stressed assets.

The RBI's July 2020 Financial Stability Report (FSR) noted that the Indian banking system is under severe pressure due to the Covid-19 induced lockdown. Stress tests conducted by the monetary authority, covering 53 scheduled commercial banks, indicate that the crisis could increase the GNPA ratio [3] to its highest level in nearly two decades. The gross non-performing assets (GNPA) ratio was already very high prior to the pandemic because of the 'twin balance sheet problem' that has been plaguing the banking sector for several years now. It stood at 8.5 per cent as of March 2020. As compared to that the GNPA could spike to as much as 14.7 per cent of total loans by March 2021 in

[2] The package subsequently eventually increased to Rs.24.7 trillion, with a total of Rs. 21.9 trllion as the stimulus component due to subsequent rounds of liquidity operations by the RBI and extension of the Central Government's economic relief package.
[3] GNPA ratio is the ratio of gross non-performing loans to total loans.

a 'very severe' stress scenario. Even in a more moderate baseline scenario the GNPA could increase to as much as 12.5 per cent.

On September 14, 2020, the RBI announced that by June 2021 banks will have to fully automate the recognition of non-performing assets, along with calculations for loan provisioning made against such advances. While such automatic classification has been operational since 2011, manual intervention of NPA identification and provisioning was carried out on a routine basis according to the RBI. It has introduced a tougher framework for the automation process, which is to be made effective without any exceptions and irrespective of the size of the account. Manual intervention shall be permitted only after supervisory assessment under special circumstances.

The FSR has noted that credit growth in the financial sector has failed to take off due to high risk aversion. In this context the RBI Governor observed on September 15, 2020 that commercial bank investment in bonds, commercial papers, debentures, and shares of corporate firms went up by Rs. 5,615 crores between April to August 2020, against a drop of Rs. 32,000 crores during the corresponding period last year. Risk aversion is likely to have increased further during the pandemic due to the moratorium introduced by RBI on March 27, 2020, wherein it announced that all commercial banks, housing finance companies (HFCs), and Non-banking financial companies (NBFCs) could provide a moratorium of 3 months on repayment of term loans outstanding on March 1, 2020. This was subsequently extended for another three months. The FSR reveals that 48.6 per cent of borrowers, accounting for 50.1 of total loans (by value) had opted for the moratorium till April 30. However, recent reports[4] suggest there is a declining trend in the number of borrowers opting for a moratorium. Evidently, with the gradual resumption of economic activity following since June 8, 2020, borrowers' ability to service their loans have improved.

This element of positive news notwithstanding, the financial sector clearly remains extremely fragile. The long standing problem of non-performing loans has persisted. Resulting from this, risk aversion has increased and the medium and small businesses in particular have been starved of credit. Banks have preferred to channel their loans towards low yielding but low risk channels. Confidence in the financial sector has also been undermined during the last couple of years due to major scams in commercial banks, cooperative banks, NBFCs and financing companies for the housing sector. This was the prevailing situation when the Coronavirus shock struck, rendering the already prevailing problems vastly more acute. The huge extra borrowing requirement of the central and state governments, arising from plummeting tax revenues in the wake of the lock down of economic activities cannot be met through market borrowing alone and will certainly require monetisation of at least a part of the additional government debt.

These challenges point to the urgency of thorough going financial sector reforms including much stronger supervision of banks as well as other financial institutions; resolution of existing NPAs, if necessary through the creation of a 'Bad' bank; at least partial disinvestment and governance reforms in state owned banks before they are recapitalised; more effective incentives and guarantees to induce growth of lending to MSMEs.

[4] Financial Express, July 25, 2020: "India heading for another NPA crisis? RBI predicts bad loans could be as high as 12.5% by March". Retrieved from https://www.financialexpress.com/industry/banking-finance/india-heading-for-another-npa-crisis-rbi-predicts-bad-loans-could-be-as-high-as-12-5-by-march/2034493/

This QRE has pointed out that conventional fiscal and monetary policies alone will not be enough to get the economy out of its current crisis unprecedented contraction combined with rising inflation. That will require wide ranging reforms no less ambitious than the reforms of 1991. The most urgent component of such a reform package is the set of reforms outlined above to ensure the stability of the financial sector in India.

NATIONAL COUNCIL OF APPLIED ECONOMIC RESEARCH
NCAER India Centre, 11 Indraprastha Estate, New Delhi 110002, India
Tel: +91-11-2345 2698/2699, Email: info@ncaer.org W: www.ncaer.org

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