



Photo: Vijay Pandey

Coronavirus Briefing

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

Sudipto Mundle, Bornali Bhandari, Rudrani Bhattacharya  
with Ashima Goyal and Pranjul Bhandari  
in conversation with  
Shekhar Shah

**Webinar, Friday, September 25, 2020, 6:30 pm IST**

# QRE Team

## Team Members

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# Outline

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

## **II. Performance of the Real Economy and Trade**

A. Domestic Real Sector Trends

B. External Sector

C. Price Trends

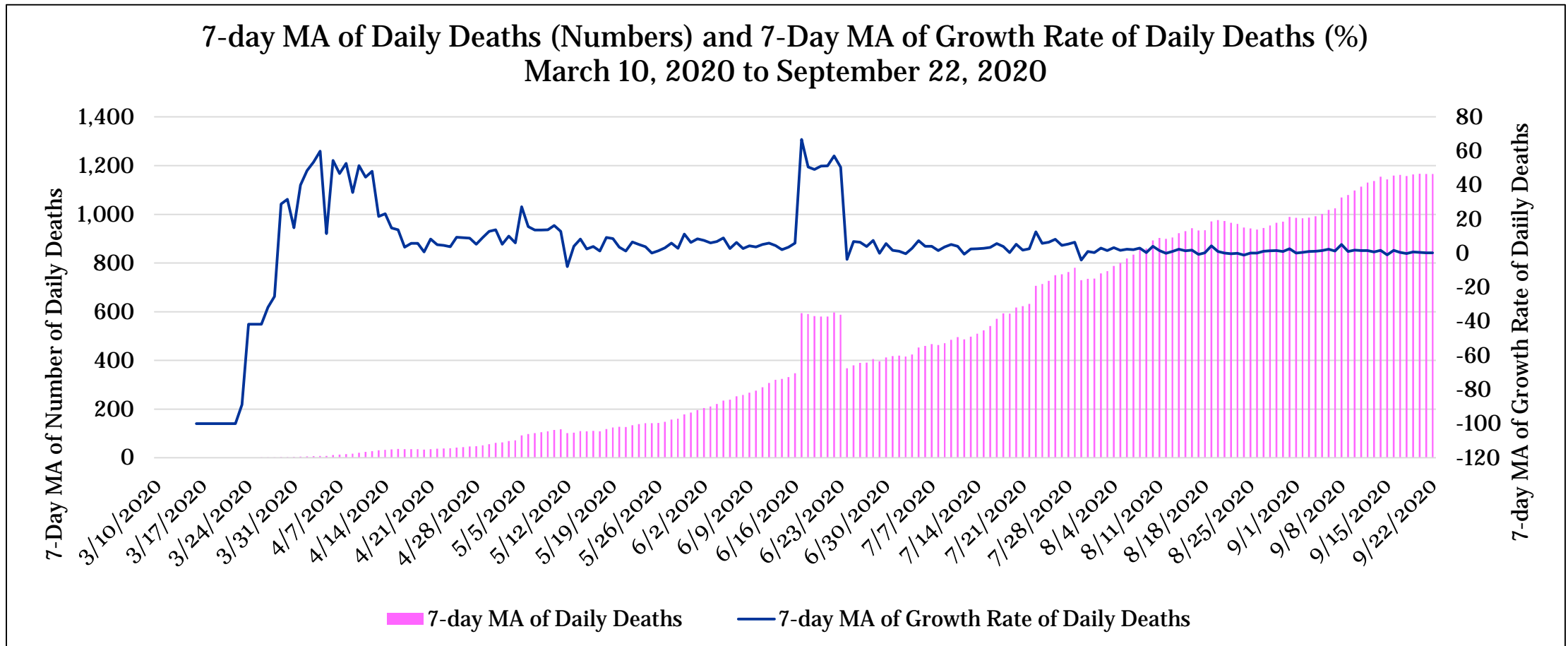
## **III. Macroeconomic Policies**

A. Grim Fiscal Outlook 2020-21

B. Monetary Policy Challenges

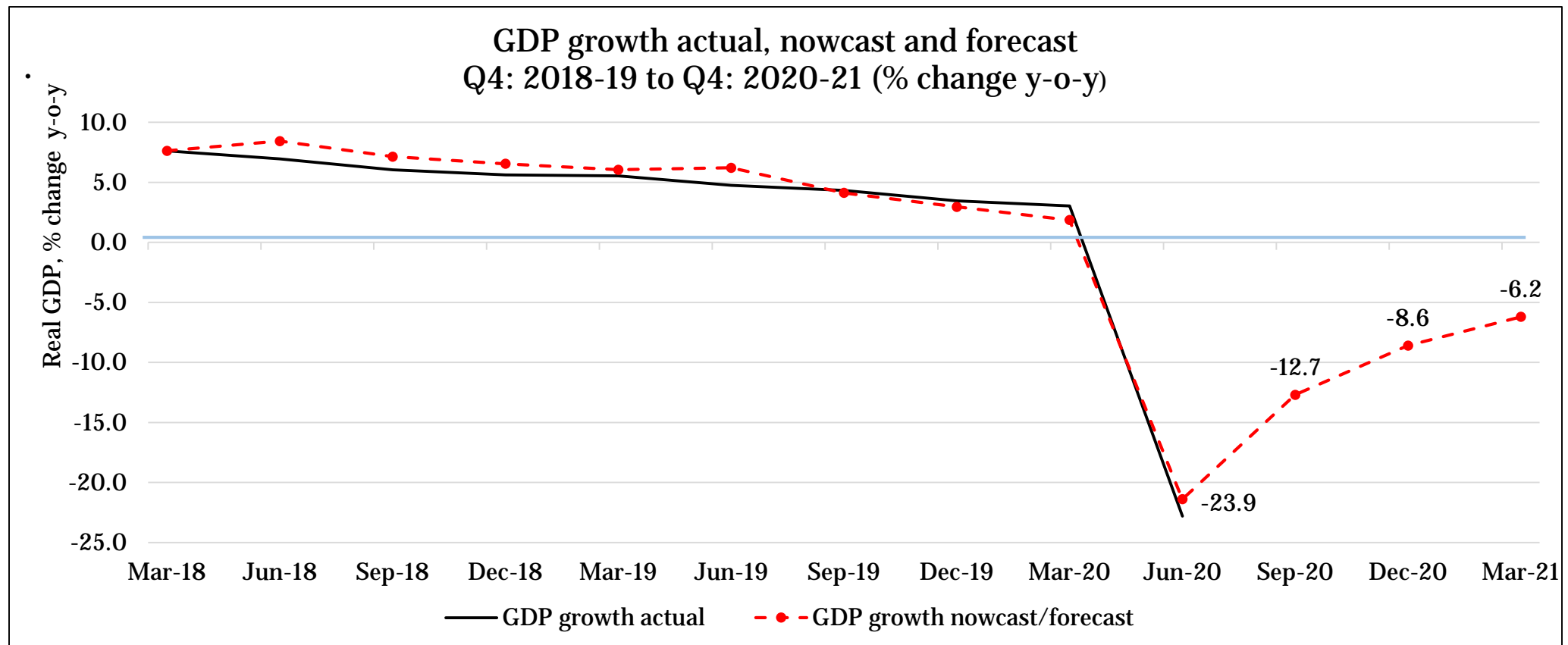
# Coronavirus Pandemic still raging

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



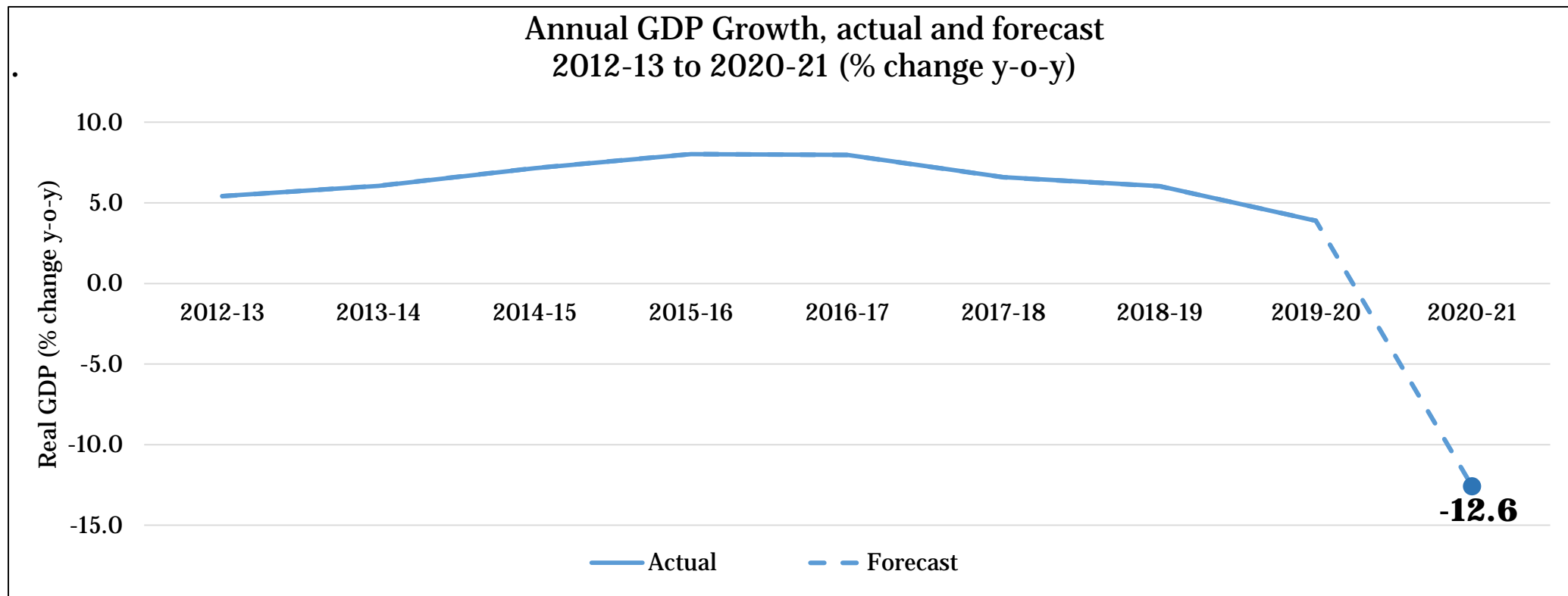
# Economy in an unprecedented crisis

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



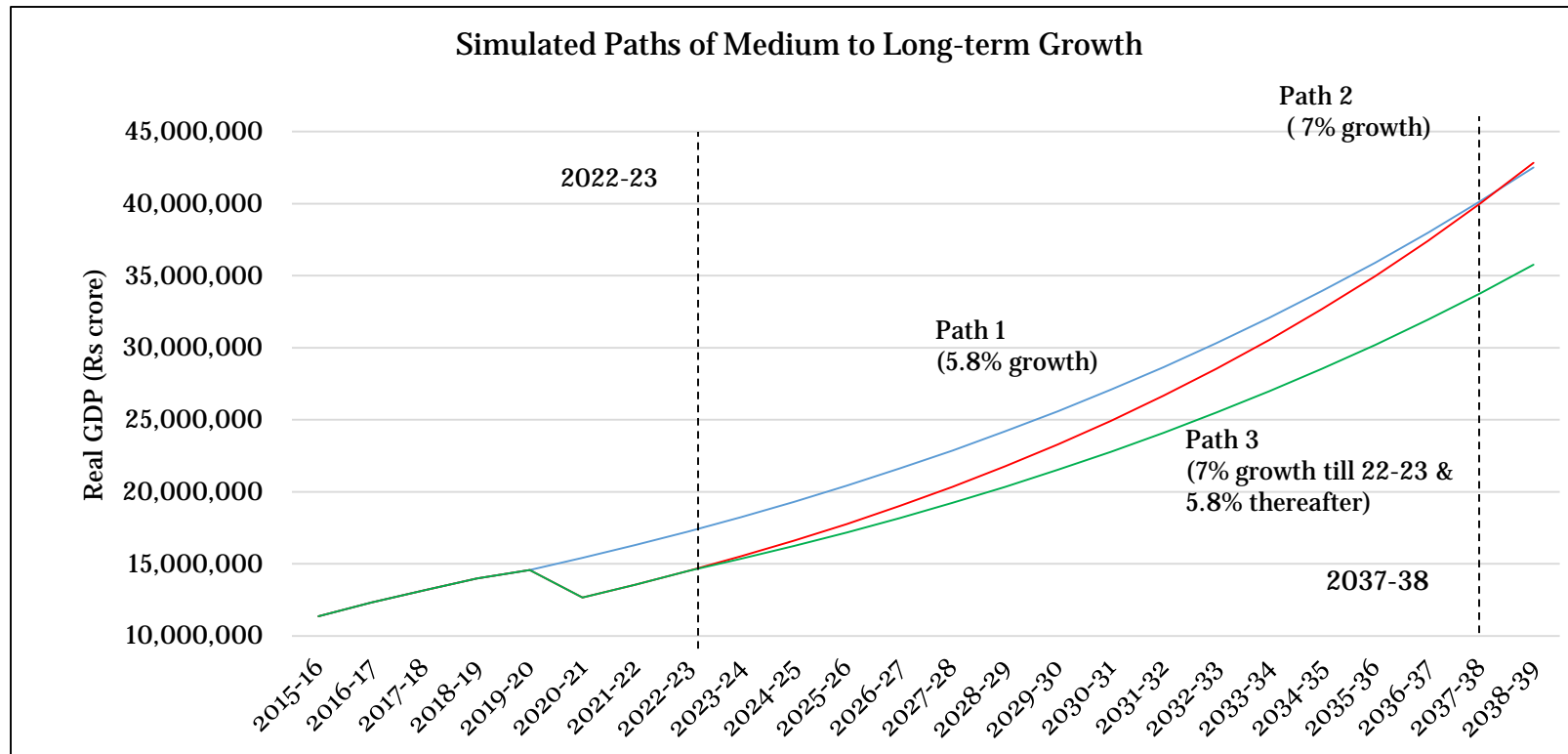
# Economy in an unprecedented crisis

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

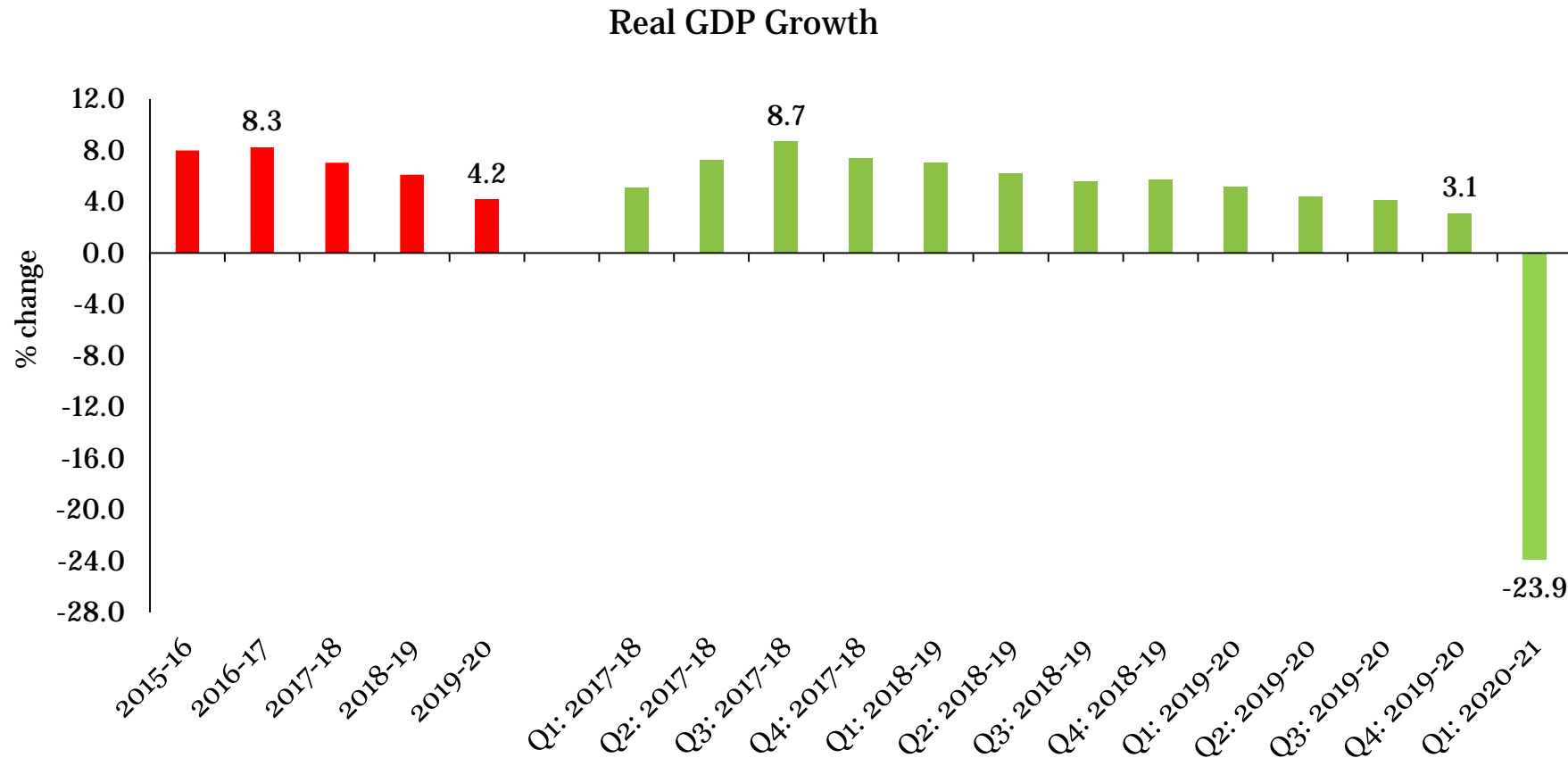


# Hysteresis: medium to long-term impact of shock

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



# Sustained decline in GDP Growth since Q3: 2017-18 before coronavirus crisis



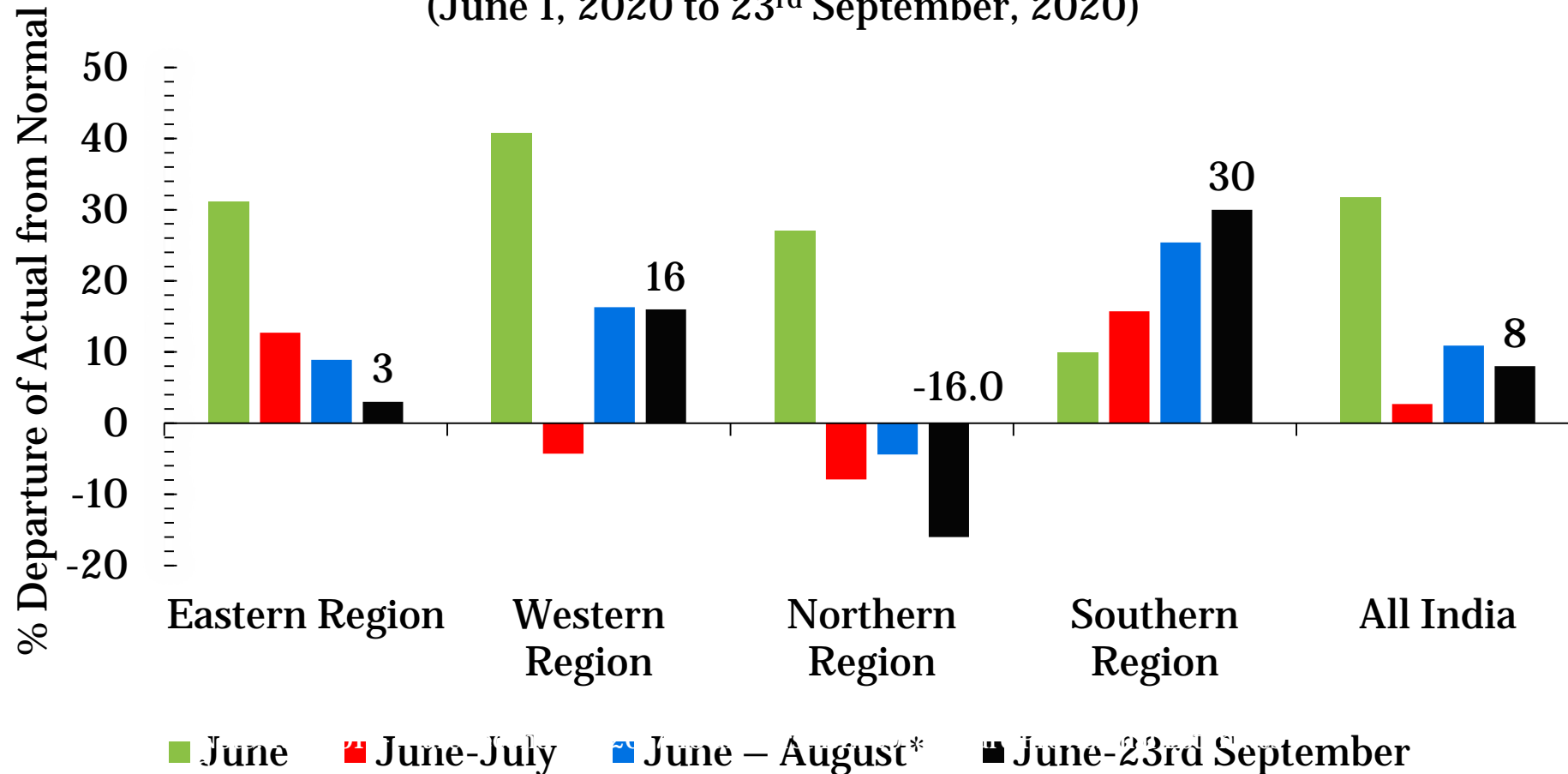
Legend: ■ Annual; ■ Quarterly.

Source: MoSPI and NCAER Estimates.



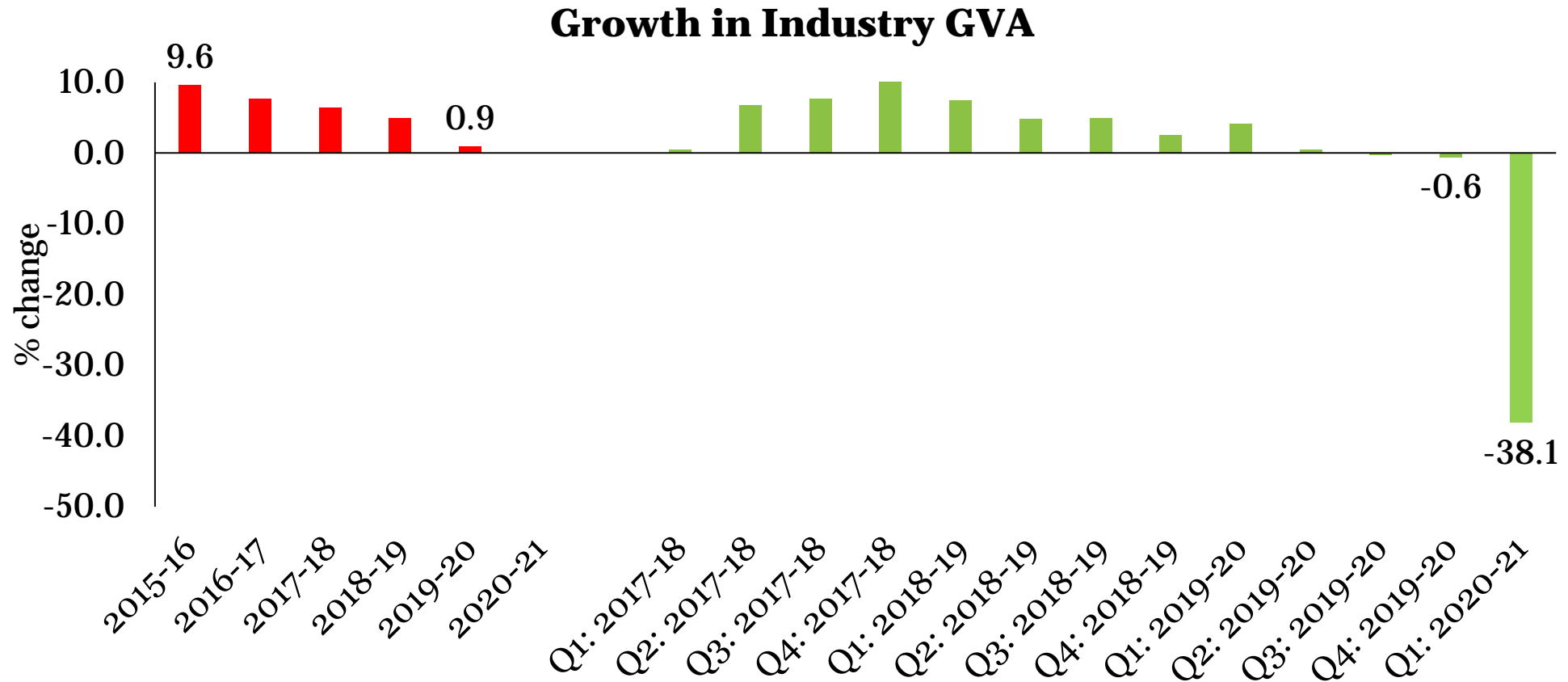
# Forecast of normal South-west monsoon augurs well for Indian agriculture

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



Source: IMD

# Steep Decline in Industrial Growth since Q4: 2017-18

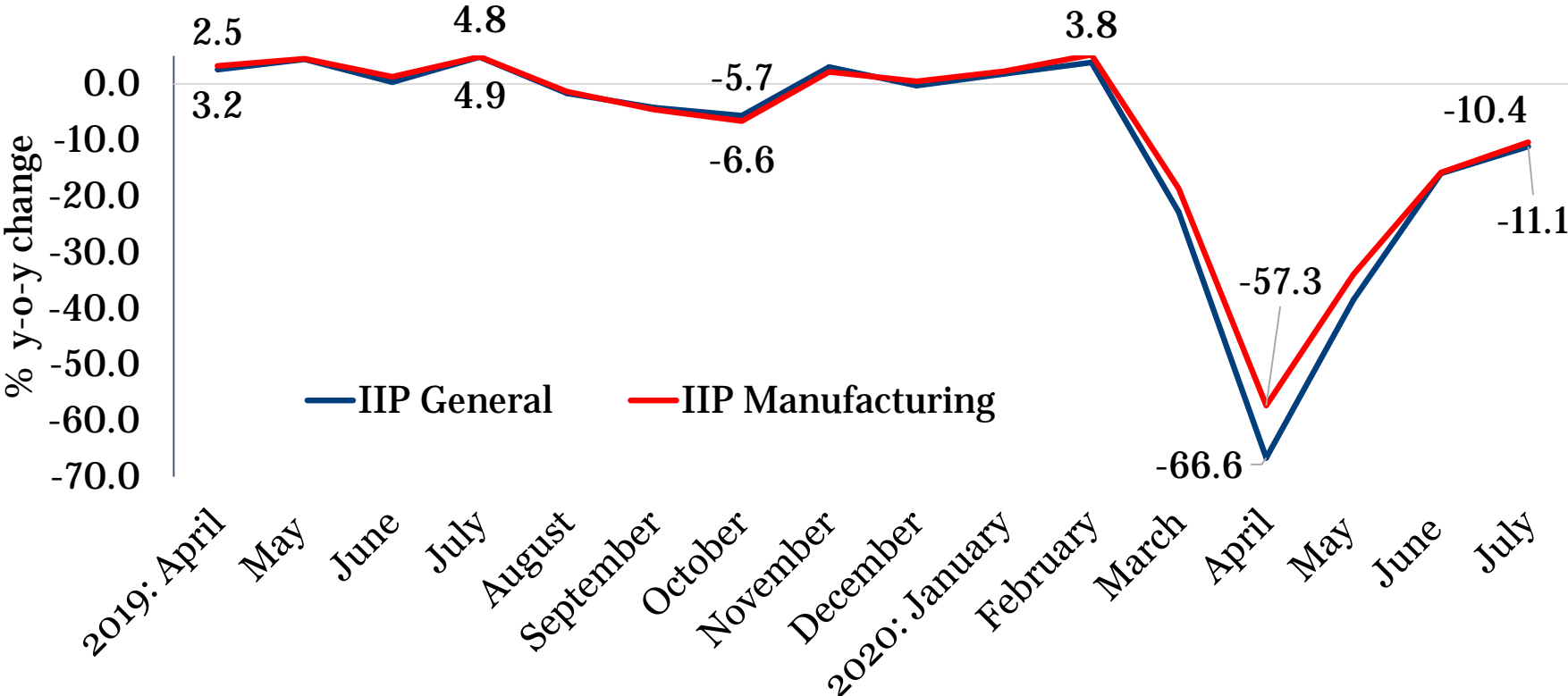


Legend: ■ Annual ■ Quarterly.

Source: MoSPI and NCAER Estimates.

# IIP confirms moderating contraction in July 2020

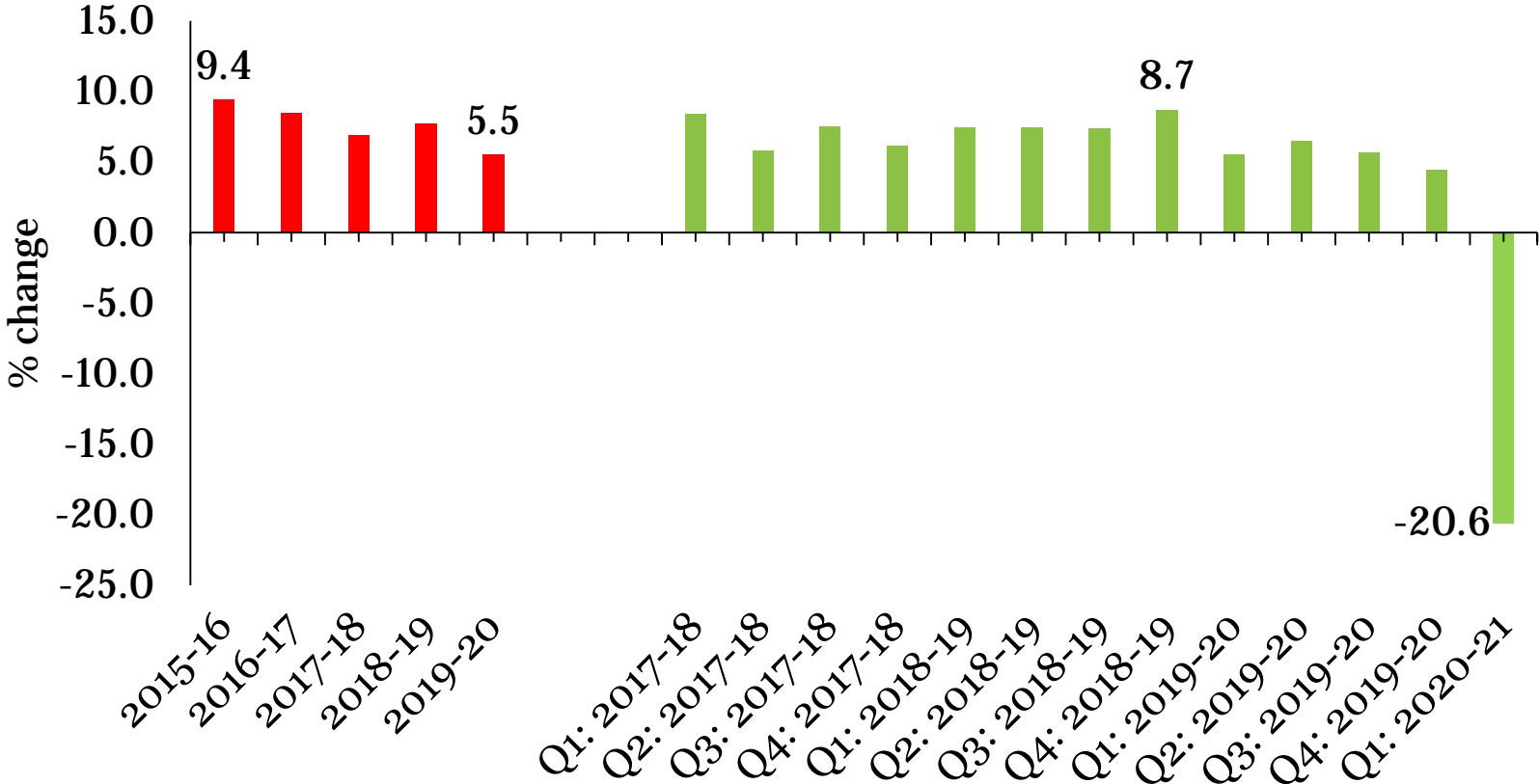
IIP General and IIP Manufacturing (%y-o-y)



Source: MoSPI

# Sharp decline in services growth projected for 2020-21

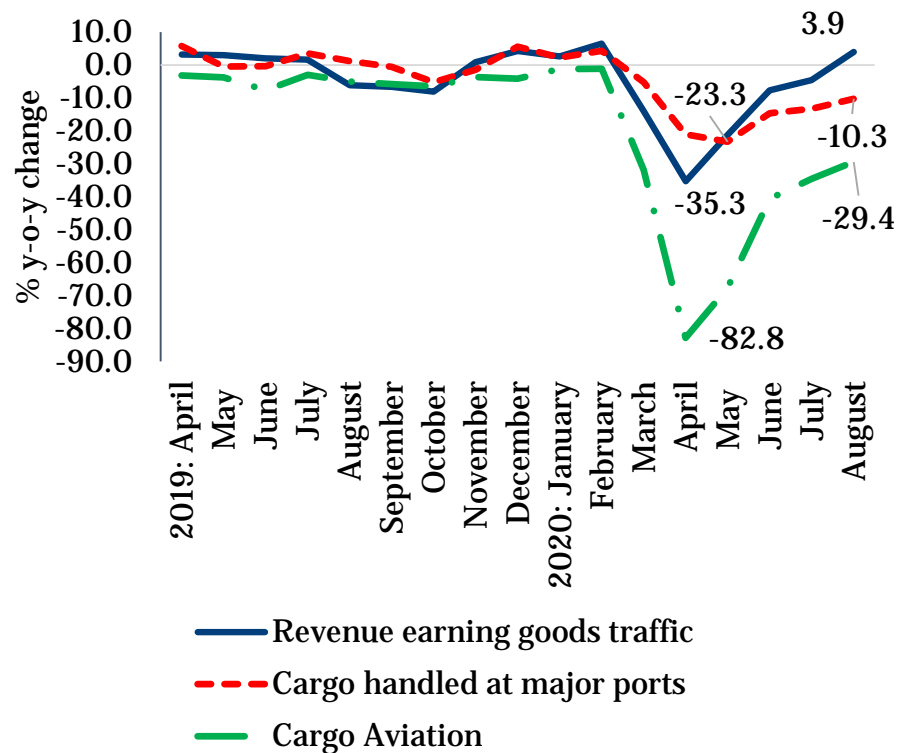
**Growth in GVA Services**



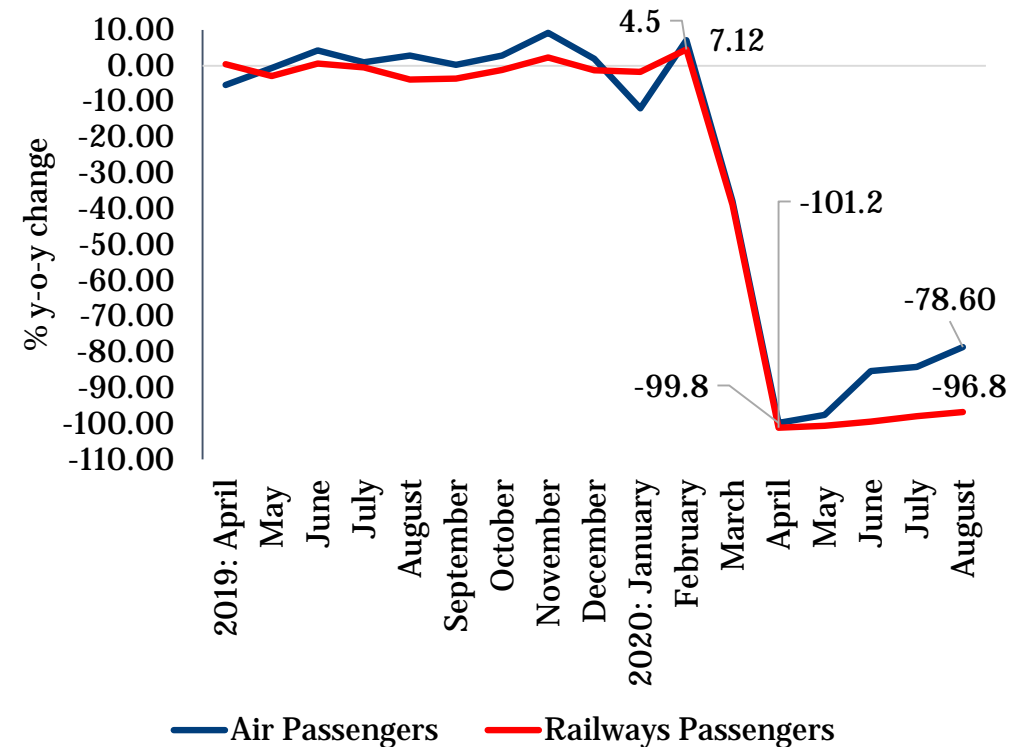
Legend: ■ Annual; ■ Quarterly  
**Source:** MoSPI and NCAER Estimates

# Cargo traffic has shown relatively lower rates of contraction compared to passenger traffic

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



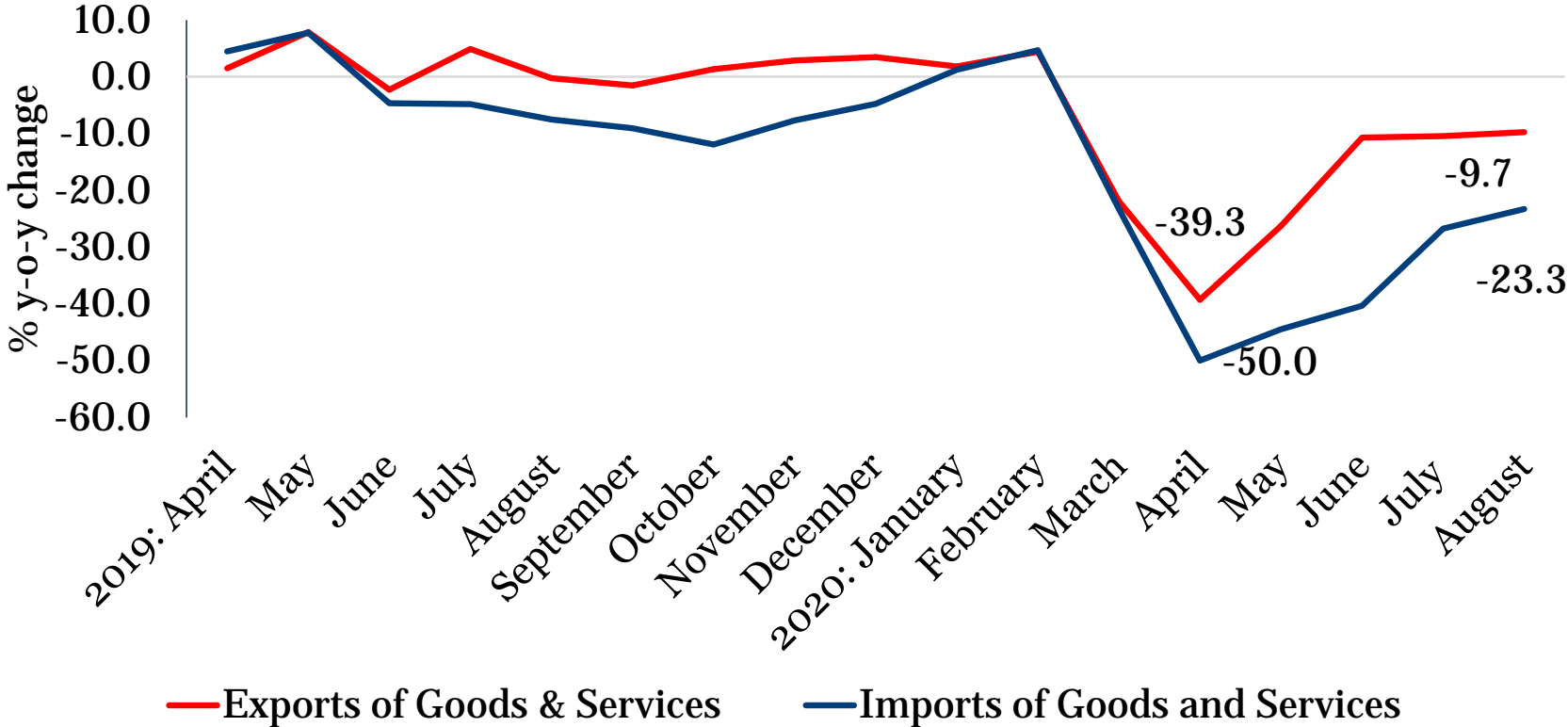
**Air Passenger and Railways Passenger Traffic**



**Source:** Ministry of Railways, Indian Ports Association and Airports Authority of India.

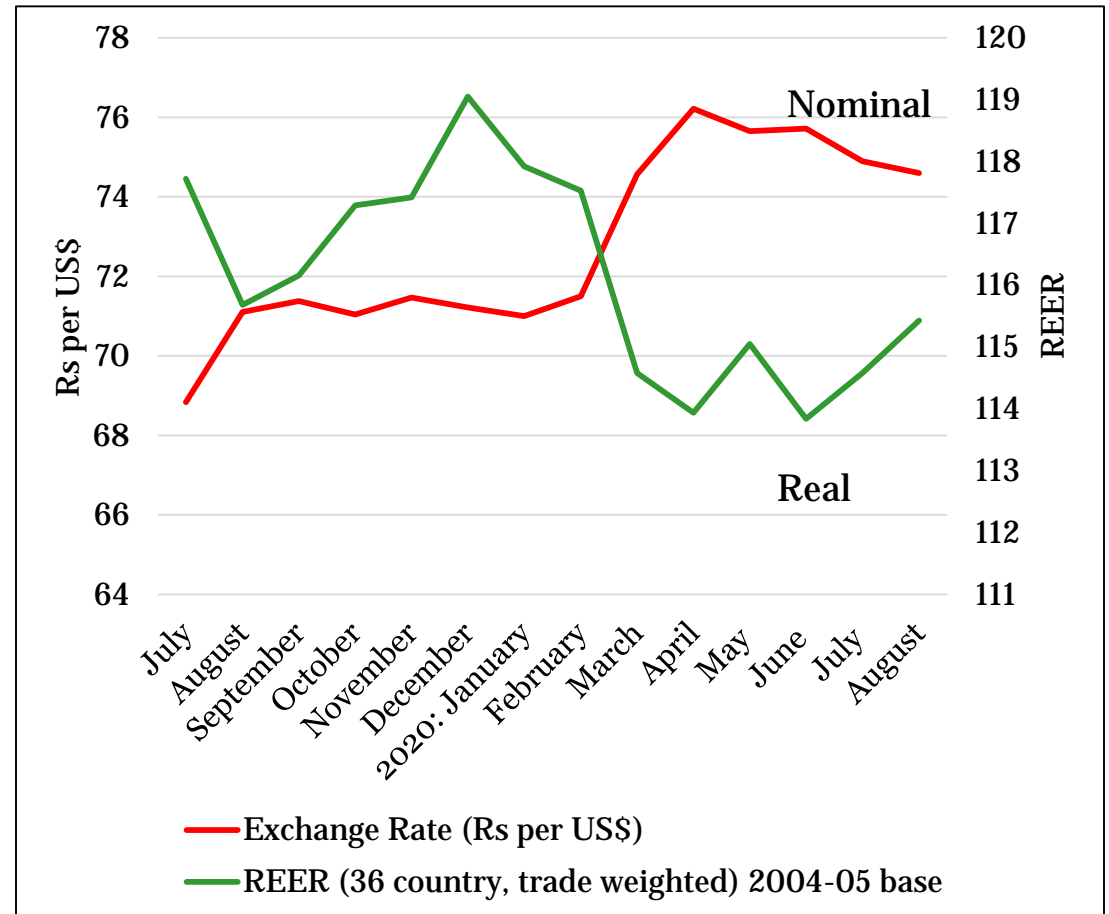
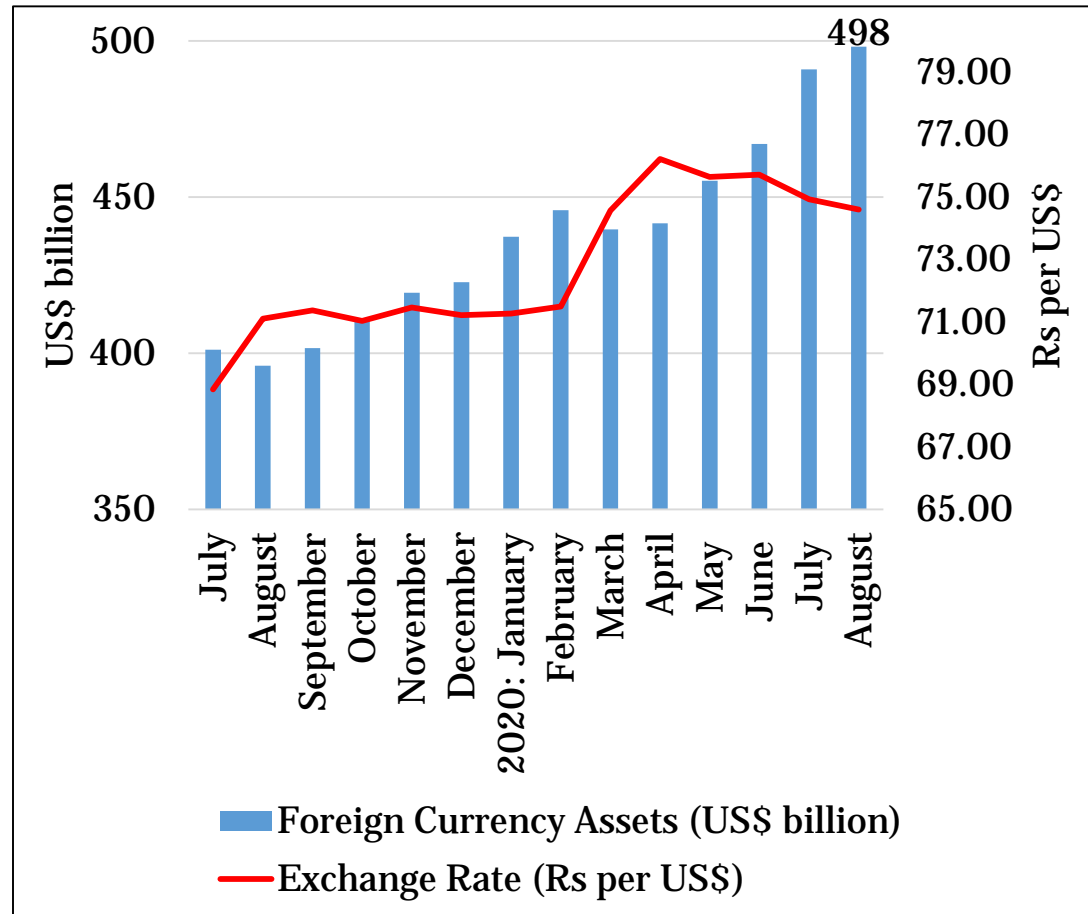
# Exports and imports growth declining since Q2: 2018-19, now negative

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

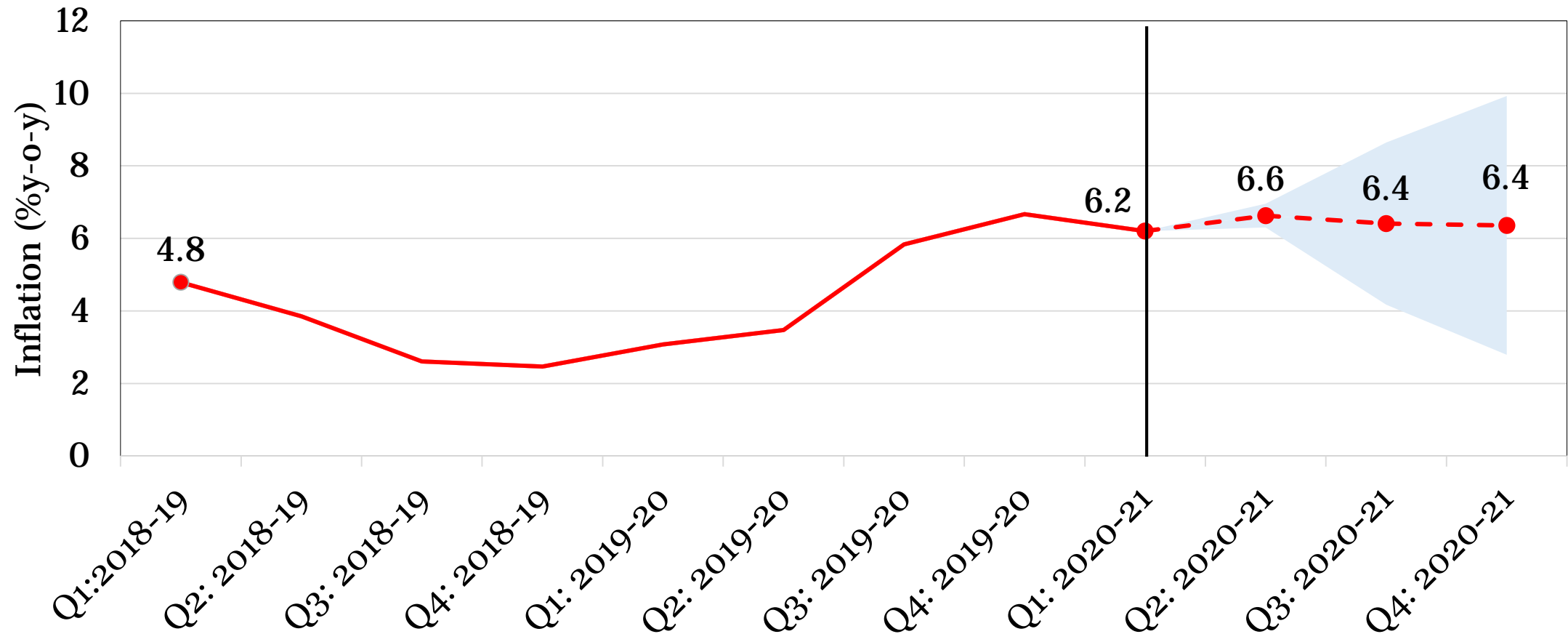


Source: Ministry of Commerce and RBI.

# Increase in foreign currency assets & exchange rate movements



# Inflation trends and forecast

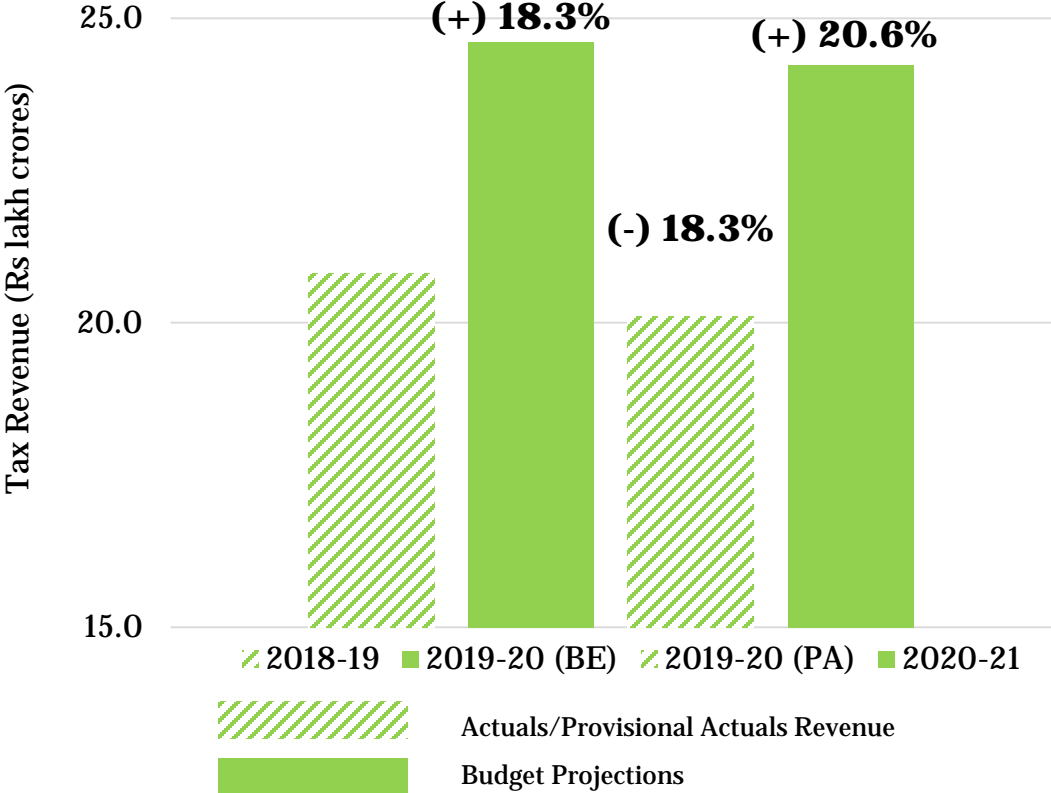


**Source:** Contributed by Rudrani Bhattacharya



# Unrealistic revenue projections

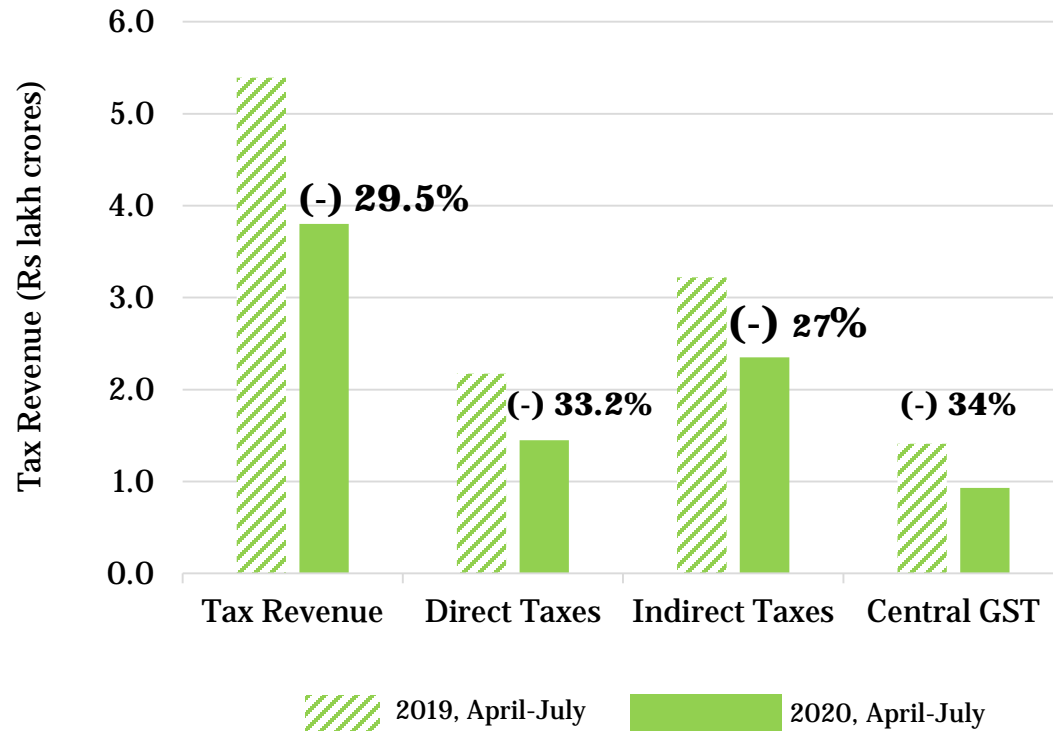
Tax Revenue Actuals and Projections



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

# Sharp slide in tax revenue following lockdown

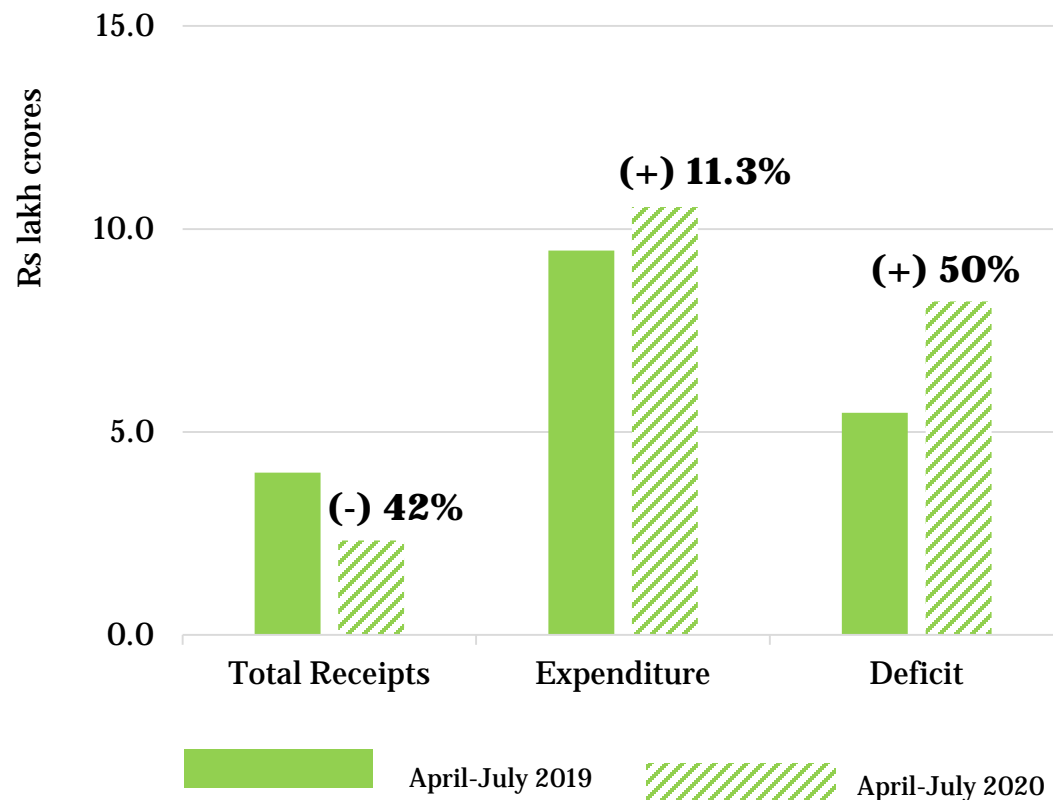
Tax Revenue, April-July (2019 and 2020)



- Lockdown has led to a sharp contraction in economic activities.
- This in turn has led to a large reduction in tax revenues of about 30% in April-July 2020 year-on-year.
- Direct taxes, indirect taxes & its largest single component, GST, have all declined significantly.

# Revenue decline has not been passed on as expenditure compression

Receipts, Expenditure and Deficits



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

# Fiscal Stimulus and Fiscal Impulse (2020-21)

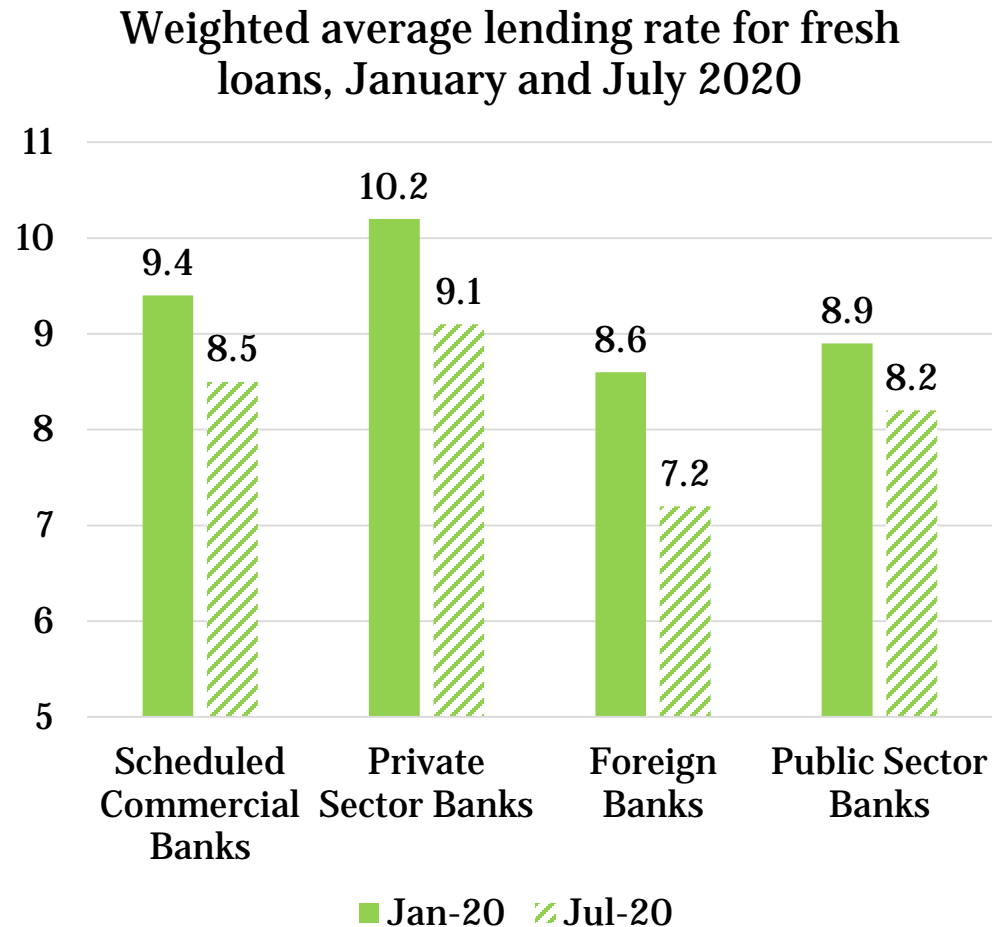
	Item	GDP (%)
	1	2
1	Central Government Budget Deficit	3.5
2	Post-Budget additional borrowing	2.1
3	Atmanirbhar Bharat fiscal component	2.4
4	States' Budget Deficit	2.8
5	Additional borrowing headroom for States	2.0
6	Combined fiscal deficit 2020-21	12.8

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

# Challenging monetary policy task

- Competing policy goals of reviving economy & containing inflation while pandemic still raging
- Reviving economic activity is the priority since GDP contracted by 23.9% in Q1
- However, headline inflation at 6.7% now above RBI's target band
- Given this context, liquidity infusion of 4.8% of GDP provided by RBI in addition to fiscal stimulus
- Repo rate also reduced from 5.2% in February 2020 to 4% in May 2020.
- Repo rate reduction subsequently paused because of elevated inflation
- Inflation containment will mainly require strengthening of supply responses

# Improved transmission of Repo rate changes

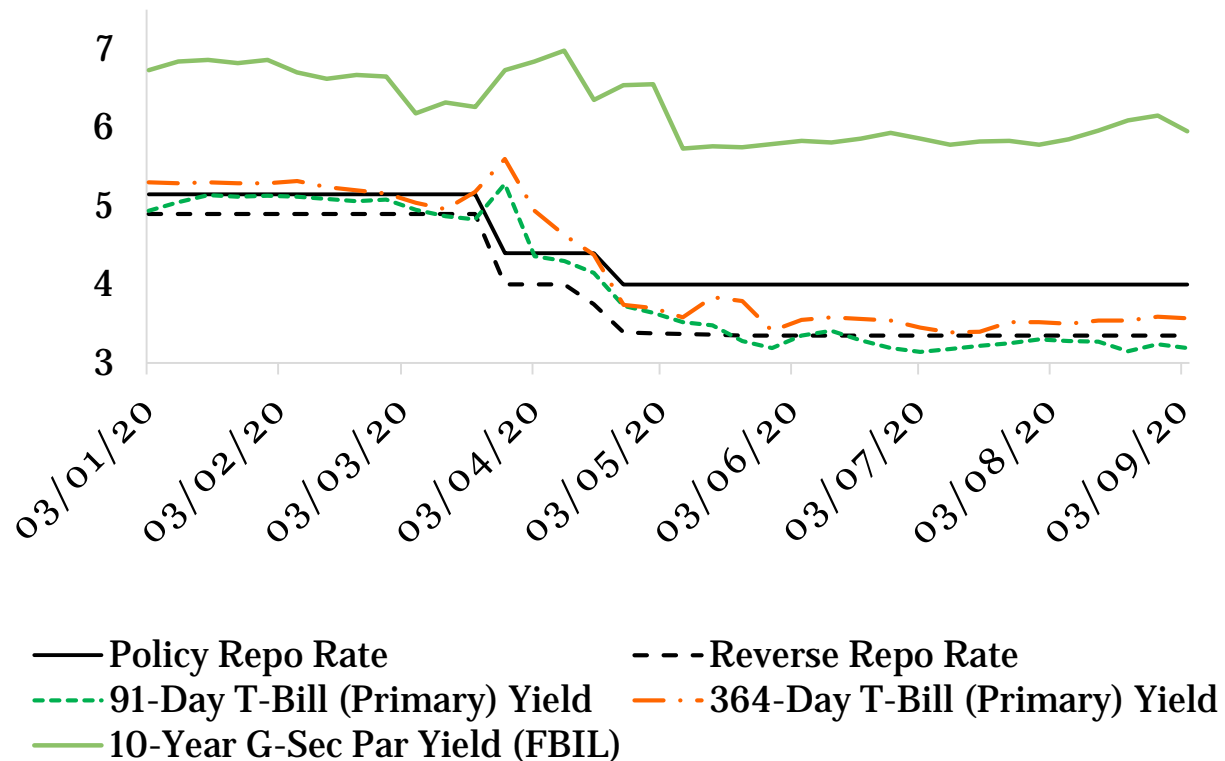


Source: RBI

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

# Improved transmission of Repo rate changes

**Rates and Yields, % (January to August 2020)**

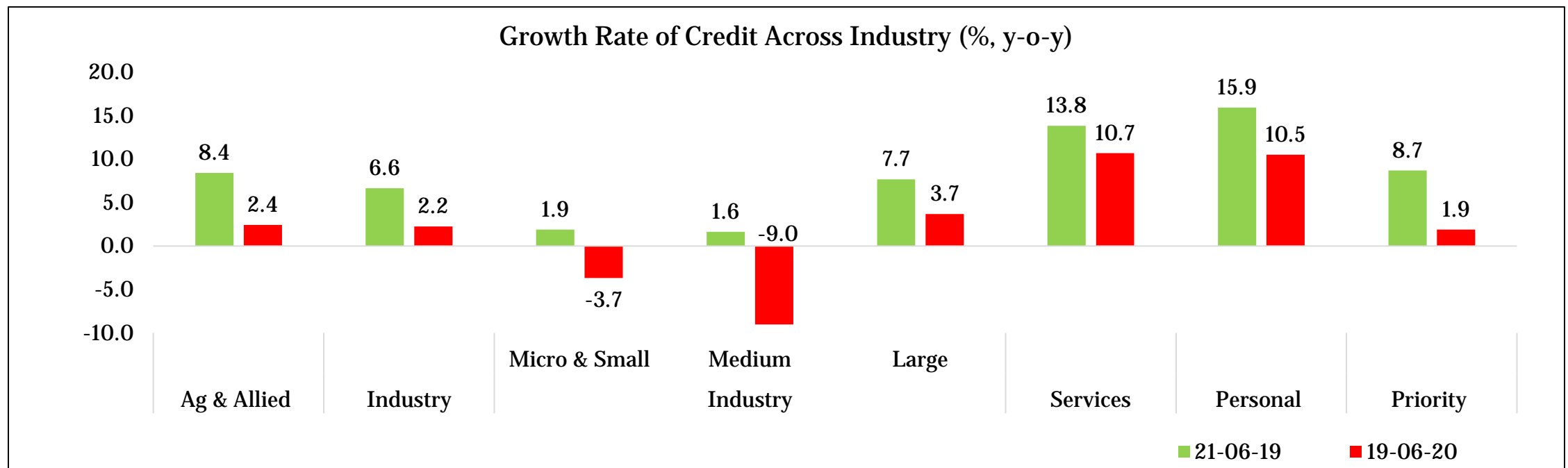


- Yield on short maturity government bonds have also followed Repo rate reductions
- However, yield on the benchmark 10-year G-sec has remained elevated.
- RBI has taken several steps to moderate the G-sec yield such as TLTRO, Twist Operations etc.
- However, these have not proved very effective so far
- This is mainly attributable to crowding out by massive government borrowing following economic contraction

**Source:** RBI

# Credit growth has declined further in 2020

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



Source: RBI



# Financial Sector Stability and Reforms

- Financial sector already under stress prior to lockdown, with Gross Non-performing Assets (GNPA) 8.5% in March 2020
- Financial Stability Report indicates stress levels have considerably aggravated since the lockdown
- Stress tests covering 53 commercial banks indicate
  - GNPA could spike to 14.7% under 'very severe' stress
  - GNPA could spike to 12.5% under 'moderate' stress
- In the short-term monetization of at least a part of massive government borrowing could reduce crowding out and enhance credit flow to the private sector
- However, urgent reforms are required to strengthen financial stability and the health of the financial sector in the long-term. Key reform measures would include:
  - Strengthened supervision of banks
  - Establishment of a 'bad bank' to acquire NPAs and clean up bank balance sheets
  - Governance reform in public sector banks, reduction of government ownership to less than fifty per cent before recapitalization of these banks

**Thank You!**