NCAER SINCE 1956 QUALITY. RELEVANCE. IMPACT

For more information, please contact:
Bornali Bhandari at +91-9871825027, bbhandari@ncaer.org
Shilpi Tripathi at +91-9953779905, stripathi@ncaer.org
Sudesh Bala at +91-9899262692, sbala@ncaer.org

PRESS RELEASE

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

in Coronavirus times

New Delhi (Saturday, May 16, 2020): The National Council of Applied Economic Research (NCAER) released its first Coronavirus ***Quarterly Review of the Economy*** **(QRE)** for the first quarter of FY2020-21 in the evening of May 15th, just days after the Indian Government announced its Rs 20 trillion ($264 billion, roughly 10% of GDP) second recovery package on May 12th. The results were presented at a NCAER `webinar moderated by NCAER Director General **Shekhar Shah,** guest speaker and former RBI Deputy Governor, **Usha Thorat**, NCAER Distinguished Fellow **Sudipto Mundle** and Senior Fellow **Bornali Bhandari**, and NIPFP Professor **N R Bhanumurthy.**

The **NCAER Q1-2020 QRE** provides the first, detailed, sector-by-sector assessment of the GDP impact of the pandemic and of the three national lockdowns as India continues to haemorrhage jobs and migrants from its cities. The policy simulations done by the QRE Team suggest that something like 3% to 5% of additional public expenditure will be needed to return to modest but positive GDP growth in 2020-21.

Policy Simulations

Based on detailed judgement calls for agriculture, industry, and services, made by domain experts at NCAER, the QRE starts with a **hypothetical, "no stimulus" base case for each FY2020-21 quarter and the fiscal year**. This base case also assumes that industry and services GVA will stop shrinking by the end of December 2020 and show zero growth in the last quarter of FY20-21 (Table 1).

Table 1: "No-stimulus" quarterly, base-case GVA growth assumptions, (% y-o-y)

Sectors	Base-case, expert assumptions						
	2019-20 Q4	2020-21 Q1	2020-21 Q2	2020-21 Q3	2020-21 Q4	2019-20	2020-21
Agriculture	0	0	3	3	3	2	2
Industry	1	-54	-27	-27	0	1	-27
Services	5	-16	-8	-8	0	6	-8
GVA	3	-26	-12	-12	1	4	-13

Source: NCAER and NIPFP. AE=advance estimate

This base-case, hypothetical scenario then suggests that aggregate GVA would shrink by some 26% in Q1-2020 and by 13% overall for the fiscal year in the absence of any specific Coronavirus recovery assistance.

Building on this no-stimulus, hypothetical base case, QRE research done jointly with NIPFP provides **four, policy-based growth scenarios** for government fiscal expenditures of 0%, 1%, 3%, and 5% over the FY20-21 budget presented in February 2020 (Table 2).

Table 2: QRE Q1:2020 GDP policy simulation results on base case

Scenarios (public expenditure increase, % of GDP)	**GDP growth** %	**Inflation** %	**Fiscal deficit** (% of GDP)	**Current account** (% of GDP)
No-stimulus base case	-12.5	4.5	6.4	1.4
Scenario 1 (Budget 2020-21)	-4.1	6.6	7.4	2.3
Scenario 2 (1%)	-1.9	7.4	7.7	2.5
Scenario 3 (3%)	1.2	8.9	8.8	3.0
Scenario 4 (5%)	3.6	10.1	9.4	3.6

Source: Estimates using model from Bhanumurthy N R, Bose, S. and Satija, S. 2019. "Fiscal Policy, Devolution, and the Indian Economy". *NIPFP Working Paper* No. 287, https://nipfp.org.in/publications/working-papers/1883/. New Delhi, December 2019

In **Budget Policy Scenario 1**, it is assumed that central government expenditures is maintained as proposed in the Union Budget 2020-21[1]. In this scenario GDP declines by (-) 4.1%. The fiscal deficit still increases to 7.4% of GDP while inflation goes up to 6.6%.

The **1% Policy Scenario 2** incorporates the recovery measures taken by government and the Reserve Bank of India (RBI) prior to 12 May, 2020. Public expenditure is increased by 1%[2] of GDP while the assumed policy interest rate is reduced. In this scenario, the decline in GDP is limited to (-) 1.9%, while the fiscal deficit at 7.7% of GDP is similar to that in Scenario 1. The inflation rate now rises to 7.4%.

In the **3% Policy Scenario 3** public expenditure is increased by 3% of GDP. In this case GDP growth for 2020-21 is positive at 1.2%. But the fiscal deficit now goes up to 8.8% and inflation rises to nearly 9%.

In the **5% Policy Scenario 4** the fiscal stimulus is raised to 5% of GDP, as suggested by several analysts. In this case, GDP grows by 3.6% for 2020-21, but the fiscal deficit goes up further to 9.4% and inflation hits double digits at over 10%. The current account deficit also rises to an unsustainable 3.6% of GDP.

The rise in inflation with every simulated increase in public expenditure happens because aggregate demand responds faster than aggregate supply. This is possibly a

[1] In the case of States as there are no aggregate budget estimates available. so government expenditures for 2020-21 are assumed to be as per the estimates made prior to the COVID 19 in Scenario 1.
[2] In Scenarios 1 to 4, additional increase in public expenditure is distributed between capital and revenue expenditure at 10 per cent and 90 per cent, respectively.

correct reflection of the ground reality in which supply chains have been disrupted and cannot be easily restored because of the high mortality of small and medium enterprises in the lockdowns. If actual supply constraints turn out to be more binding than assumed in the simulation, fiscal stimulus packages could lead to even higher inflation and lower growth. This strongly suggests that to avoid the dangers of stagflation, we may need much broader policy interventions than just an increase in public expenditures. Alternatively, if there is an improved supply response later in the year, this could moderate inflationary pressures, also possible to the extent that some of the announced recovery package will only kick in over time, possibly beyond FY2020-21.

Outlook for domestic sector performance

The outlook for **agriculture** looks positive, the only sector showing positive growth. The availability of the main inputs is reportedly comfortable, the South-West Monsoon as forecast on April 15, 2020 is expected to be normal, and the incidence of pests and diseases is expected to remain below the economic threshold level at which the value of the crop destroyed exceeds the cost of controlling the pests.

The QRE team believes that the recession in **industrial growth** will deepen, expecting a base-case, no-stimulation decline of 54% in GDP growth in Q1-2020. After coming to a virtual standstill in the third quarter of 2019-20, industrial growth, led by manufacturing, improved in January and February 2020. But the Coronavirus pandemic wiped out those green shoots in March 2020.

The QRE team also believes that the recession in **the service sector** will deepen, expecting a base-case, no-stimulation decline of -16% in GDP growth in Q1-2020 and -8% overall. Within the Services sector the Coronavirus first impacted the trade, tourism, hotels and restaurants sub-sector. After the lockdown starting 25 March, 2020, transport was also adversely affected with road, rail and aviation cargo traffic dropping sharply. Tourist arrivals fell by -22.2% in Q4:2019-20.

Outlook for the external sector

Weak external demand and the pandemic triggered supply chain disruption has severely hit Indian exports, which contracted by 34% in March 2020 on a y-o-y basis. However imports have contracted even more because of weak domestic demand and the global oil price fall, thereby moderating the trade deficit. The pandemic has also had a severe adverse impact on remittance flows and triggered a large outflow of portfolio investments, while slowing down the inflow of FDI. These developments have depreciated the Indian rupee, which in turn has exacerbated the flight of portfolio capital.

Outlook for monetary policy and financial markets

With the economy under great strain, the RBI rolled out relief measures to stimulate credit flows to industry and services. Though well intended, monetary transmission has been quite ineffective, with the banking already under strain. If banks will remain unwilling to extend credit to MSMEs, it will be necessary that either the RBI or the government to provide credit guarantee, in addition to offering partial guarantee for investing in NBFCs, one of the primary credit providers to MSMEs. Support to both MSMEs and NBFCs have announced by the Finance Minister on 13 May, 2020, though details are still awaited. But, so far there is no evidence of enhanced spending on the public healthcare system, additional food support, or additional income support for the poorest.

In addition to RBI's liquidity measures amount to some Rs 8 trillion, the stimulus package will entail an unprecedented annual sovereign borrowing program of around of around 8.7% of GDP (this includes the budgeted net market borrowing of 2.7% of GDP along with 6% of GDP to support the balance Rs 12 trillion of the Rs 20 trillion economic package). No single approach can cope with such a massive demand for loans. Multiple channels will have to be combined, ideally spread over more than a year. These would include lending by commercial banks, re-purposing and further liberalisation of ways and means advances with much larger advance limits and longer period of advance and, finally, direct monetisation of a part of the deficit through direct RBI acquisition of government debt through private placement.

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

About NCAER | The National Council of Applied Economic Research

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

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

NCAER | Quality . Relevance . Impact