

Whither India's Economy Post-COVID-19?[§]

ABSTRACT India's economy was weak in 2019 but appeared to be near a trough. A protracted slide in growth had continued since 2016. The continued challenges in implementation of the 2017 national Goods and Services Tax and credit stresses in the domestic financial sector beginning in 2018 weighed on growth and sentiment. Sectors such as construction, housing, and autos reflected extremely low levels of activity. The RBI eased monetary policy and pledged to stabilize the financial sector, and the government introduced a large corporate tax cut to attract manufacturing activity, among other measures. While we did not believe that any of these measures represented a forceful cyclical policy stimulus that would result in a sharp rebound, we thought that, together, they would help put a floor under the deceleration in growth, and combined with better external conditions, we would see India's growth climbing back toward its long-term trend. However, just as the Indian economy was starting to look up in the beginning of 2020, the rising tide gave way to the COVID-19 shock. Against this backdrop, this paper presents a synthesis of our research on the macroeconomic and fiscal implications of the COVID-19 crisis for India and lays out the challenges in setting and implementing policy.

Keywords: *Indian Economy, COVID-19, Macroeconomics, Fiscal Policy, Monetary Policy*

JEL Classification: *E0, E5, E6*

1. Introduction

The year 2019 was a difficult year for the Indian economy, which slowed significantly and sharply, with some market participants worried about India being on an inescapable path to a hard landing. Just

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when the Indian economy was starting to look up after a continued and significant slowdown, the rising tide gave way to the COVID-19 shock (Mishra and Tilton 2020a). In India, the spread of the virus, announcements on the shutdown of important sectors, social distancing measures, and fears among consumers and businesses have all escalated sharply since early March 2020.

There were five pillars supporting our relatively optimistic view on growth in late 2019—improvement in global growth, easing of domestic financial conditions, fiscal support, positive sentiment, and high-frequency indicators turning favorable. In fact, all five pillars dramatically turned around after early March 2020. The Goldman Sachs global team sharply downgraded its 2020 global growth forecasts and was forecasting a global recession (Hatzius, Struyven, and Walker 2020). The softening of domestic financial conditions since early 2018 had reversed by March end 2020. Although policies are clearly evolving, the fiscal impulse so far is at best moderate and has fallen short of market expectations. The uplift in sentiment that was beginning to play out early in 2020 also reversed, driven by both domestic and global factors. Finally, the early signs of economic stabilization that had been evident from late 2019 also turned around.

Against this setting, this paper provides an overview of the evolving macroeconomic situation in India. Section 2 discusses the global backdrop, Section 3 presents facts on the spread of the virus, Section 4 analyzes the economic impact, Section 5 goes over the fiscal implications, and Section 6 discusses some of the challenges with the economy's restart underway. We finally conclude with some policy implications.

2. World in Recession: Global Recovery Has Begun but Risks Remain

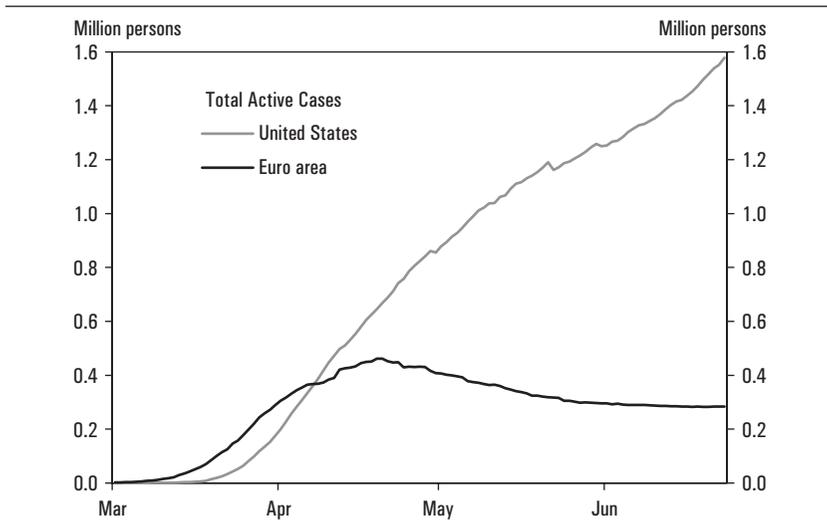
Back in March 2020, the Goldman Sachs global team sharply downgraded its growth forecasts across most of the world's major economies. The global team estimated that global real GDP had fallen 16 percent (not annualized) in the three months from mid-January to mid-April 2020, and by July was forecasting global GDP growth to be at -3.4 percent in 2020, with risks remaining on the downside. This is almost certainly the deepest recession since at least World War II.

Global recovery has now begun, and global GDP is rising (Hatzius 2020). The most striking piece of evidence that the global recovery has

begun was the 2.5 million US payroll employment gain in May 2020 and the drop in the US unemployment rate from 14.7 percent to 13.3 percent. Europe has seen active virus cases decline consistently since mid-April 2020, despite a gradual loosening of restrictions. The policy support, especially in advanced economies, has been massive, leading to stabilization in disposable incomes.

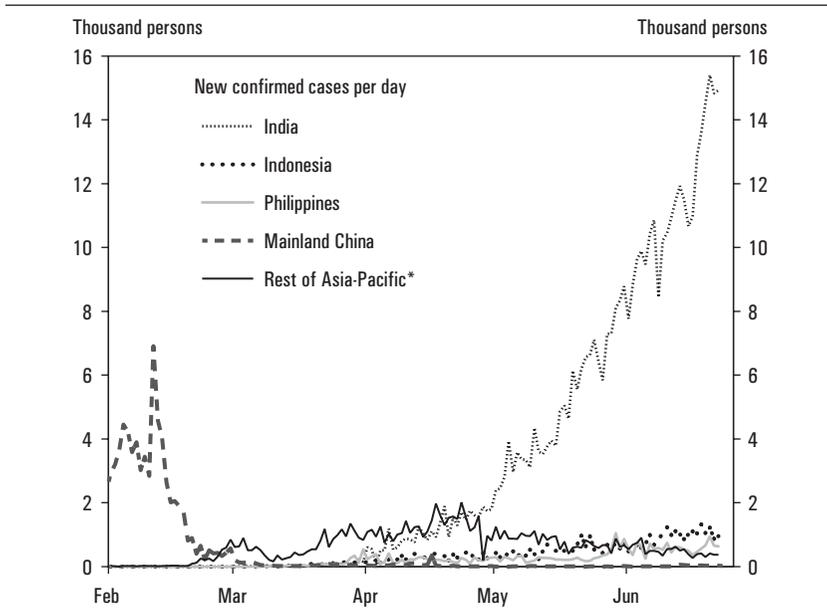
The key risk to the global sequential recovery is the fact that the virus has not been brought under control in the United States, and several emerging economies. The US has not managed to control the virus as effectively as the Euro area (Figure 1a). Compared to the rest of Asia, the situation is also strikingly worse in India (Figure 1b), where new cases have accelerated, especially since the reopening started, and now stand at 16,000 per day. This compares with less than 1,000 new daily additions on average in the rest of the Asia region (Tilton 2020). The situation in India and the US, along with localized outbreaks in several parts of the world, raises the risk of a rise in infections as economies open up further, which might trigger renewed government restrictions or individual changes in behavior that could weigh on growth.

FIGURE 1 a. US Underperforms in Virus Control



Source: Johns Hopkins University Center for System Science & Engineering, CEIC Data, Goldman Sachs Global Investment Research.

FIGURE 1 b. India an Exception in Virus Control in Asia



Source: Johns Hopkins University Center for System Science & Engineering, CEIC Data, Goldman Sachs Global Investment Research.
 Note: *Economies in Goldman Sachs coverage.

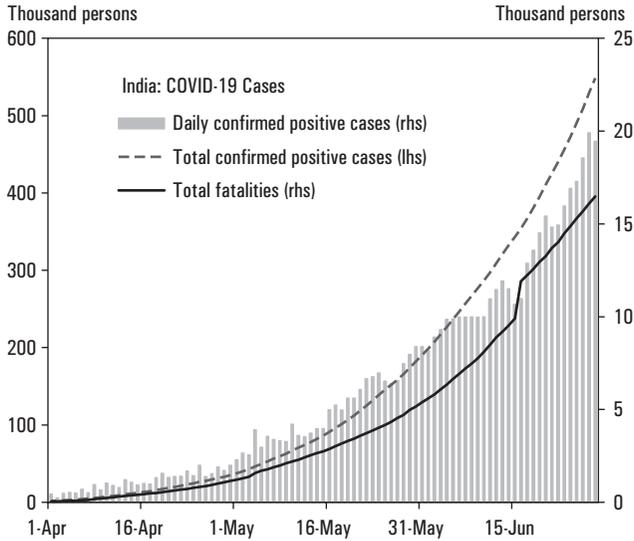
3. The Spread of COVID-19 Has Accelerated in India

The total number of COVID-19 cases in India crossed the 500,000 mark on June 26, 2020. As of June 28, 2020, daily new positive cases also continued to increase, with a record of approximately 20,000 cases added on June 27 (Figure 2).

The silver lining may be that the cases appear to be concentrated in certain states. Maharashtra continues to be the most impacted state, with total confirmed cases above 160,000, followed by Tamil Nadu, Delhi, and Gujarat. Together, these four states still account for nearly 65 percent of the total cases in the country. In total, 80 percent of the cases are concentrated in only eight states (Figure 3).

Next, we look at the total number of “active” cases (i.e., subtracting recoveries and deaths from total positive cases). While these reported a declining trend at the nationwide level in the first week of June 2020, driven by higher recoveries (Figure 4a), they have begun to rise once again. The number of active cases in Maharashtra, particularly in Mumbai, was a key

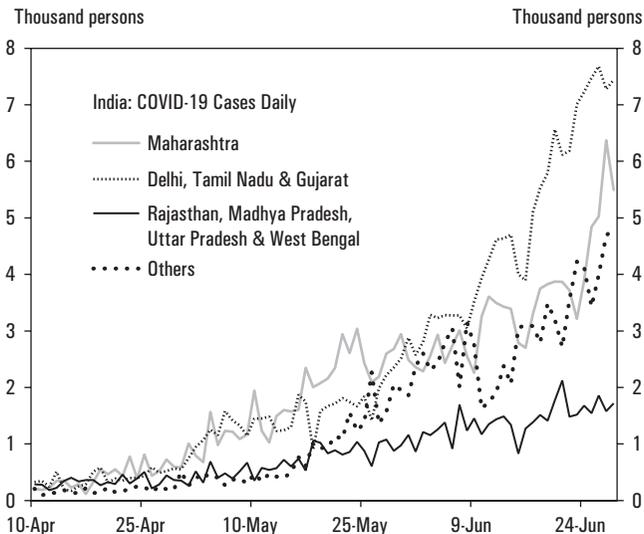
FIGURE 2. India Added about 20,000 Confirmed Cases on June 27, 2020, with Total Number Nearing the 550,000 Mark



Source: Ministry of Health and Family Welfare.

Note: Data as of June 28, 2020; "lhs" is left-hand-side axis; "rhs" is right-hand-side axis.

FIGURE 3. Eight Indian States Account for 80 percent of Total Cases



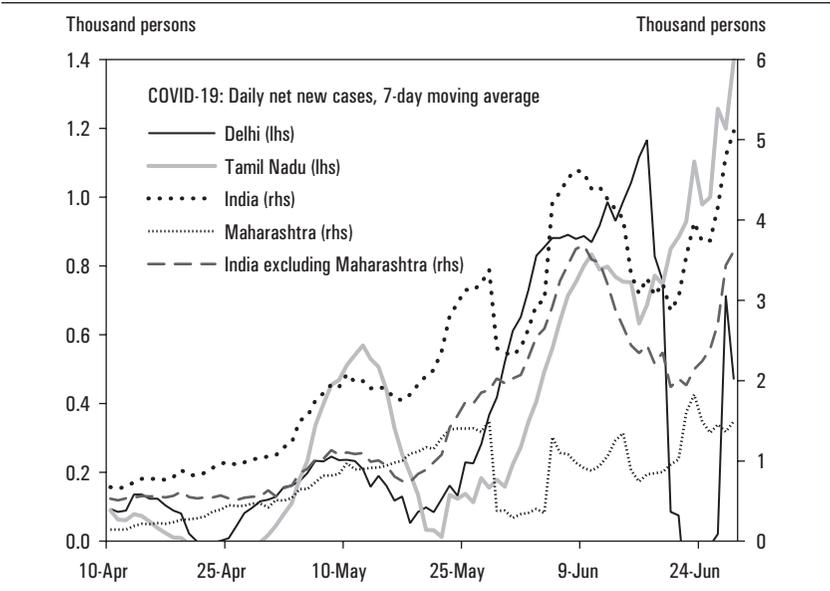
Source: Ministry of Health and Family Welfare.

Note: Data as of June 28, 2020.

driver of nationwide trends until May 2020. Reported cases in Tamil Nadu and Delhi have risen rapidly since then and now appear to be leading India-level trends in active cases.

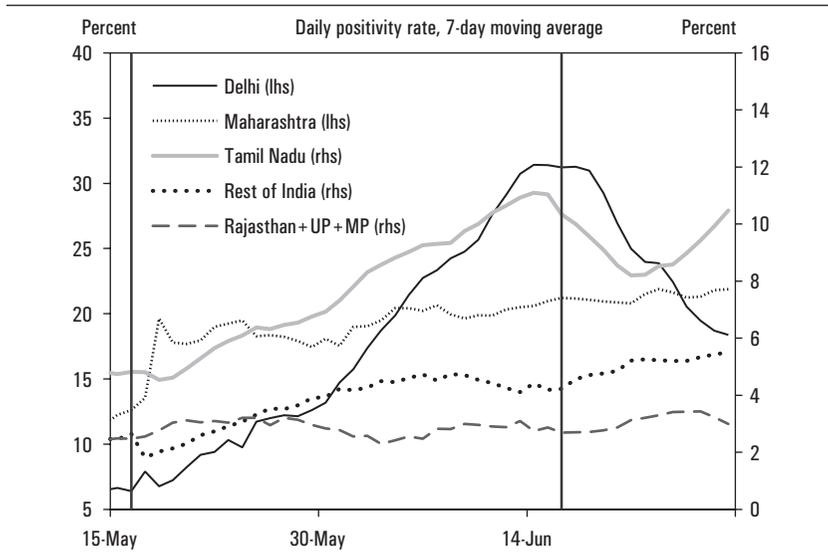
As the virus spread accelerated, testing for COVID-19 has been ramped up sharply. Therefore, we also look at cases adjusted for testing, that is, the positivity rate, defined as the number of confirmed positive cases as a percentage of total tests. Except for certain states such as Rajasthan, Uttar Pradesh, and Madhya Pradesh, the positivity rate has increased since mid-May 2020. In particular, we note that for Delhi and Tamil Nadu, the positivity rate rose sharply from mid-May to mid-June 2020, even though there was no change in testing strategy during this period (Figure 4b). This could be attributed to the relaxation of lockdown restrictions since May 18, 2020, as also confirmed by the increased mobility in these states measured by Google mobility indices (see more on this below). Testing, on the other hand, was ramped up only after June 17, 2020, after which the positivity rate declined as tests rose at a faster pace than reported cases (the period between May 18 and June 17 is marked by vertical lines in Figure 4b). For

FIGURE 4 a. The Number of Active Cases was Driven by Maharashtra till May 2020, then Led by Delhi and Tamil Nadu



Source: Ministry of Health and Family Welfare, COVID19India.org.
 Note: Data as of June 28, 2020; "lhs" is left-hand-side axis; "rhs" is right-hand-side axis.

FIGURE 4 b. The Positivity Rate Rose Sharply in mid-May, though Testing Numbers Remained Unchanged



Source: Ministry of Health and Family Welfare, COVID19India.org.

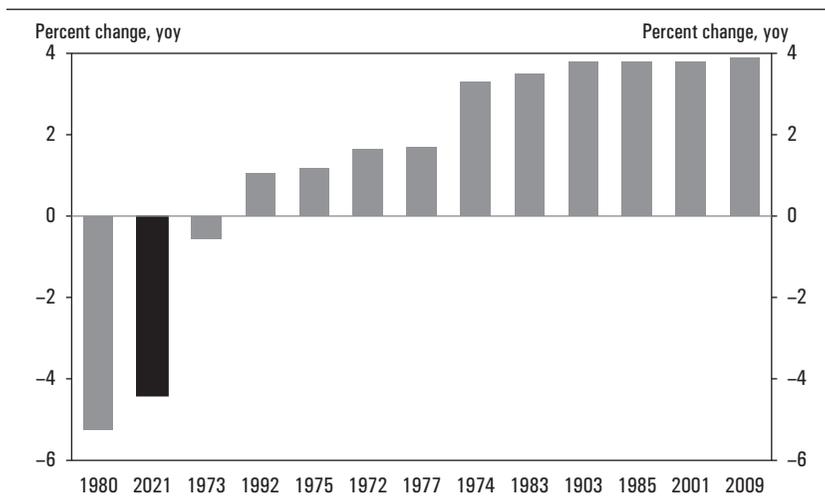
Note: Daily positivity rate = Daily confirmed cases/Daily number of tests; Data as of June 28, 2020; “lhs” is left-hand-side axis; “rhs” is right-hand-side axis; the vertical lines indicate the time between when lockdown restrictions were first relaxed (May 18, 2020) and when testing was ramped up (June 17, 2020).

Tamil Nadu, however, the positivity rate has started to rise once again, which has been followed by a reimposition of lockdown restrictions in the four hardest-hit districts, including Chennai.

4. Severe Early Economic Impact of COVID-19 in India: Expect Sequential Recovery, but Risks Remain

Our baseline assumption is that after the deep contraction in Q2 of calendar year 2020 (–45 percent QoQ annualized rate), activity will rebound sharply, and mechanically in Q3. For Q4 of 2020 and Q1 of calendar 2021, we expect a step-down to a more normal and lower sequential growth pace. The main reason for this is that different parts of the economy are likely to recover from the virus hit at different speeds. By the end of Q3, industrial activity could possibly normalize, especially in manufacturing, where virus control might be easier, with limited room for big further gains. In contrast, industries in which virus control is harder—for example, travel

FIGURE 5. Our Forecast of -4.4 percent Growth in FY21 is Very Close to the Deepest Recession between 1972 and 2021 that India Witnessed in 1980



Source: Haver Analytics, Goldman Sachs Global Investment Research.

Note: The x-axis shows growth rates for selected fiscal years between 1972 and 2021 for comparison with 2021, shown according to increasing annual GDP growth rates.

or entertainment—will still be in a gradual normalization process, and probably will not rebound fully until a vaccine or another comprehensive medical solution is available.

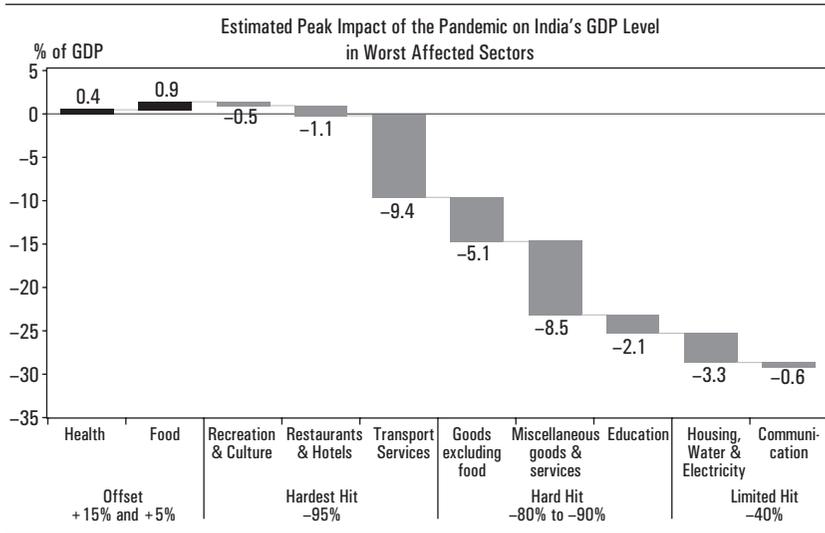
Our quarterly estimates imply that real GDP would contract by -4.4 percent in FY21. This forecasted -4.4 percent decline in FY21 would be close to the deepest recession India has witnessed, which was in 1980 (Figure 5).

4.1. Comparing Projected FY21 Growth with the Pre-pandemic Baseline

Next, we dig into the components of the sharp drop in growth compared to our pre-pandemic baseline. We expect the impact of the pandemic to work through three channels: decline in India's exports from a slowdown in global demand, and domestic supply chain bottlenecks; a hit to services consumption arising from the shutdowns, virus fears, and social distancing measures; and a slowdown in investment from factory closures, the dip in demand, and supply chain disruptions.

Let us start with our estimates of the effect of the virus on consumption. Figure 6 provides illustrative estimates of how large the GDP impact of these consumption cutbacks could be for India. The bottom of the chart shows

FIGURE 6. Estimated Peak Impact of –30 percent on Monthly GDP through Consumption Spillovers



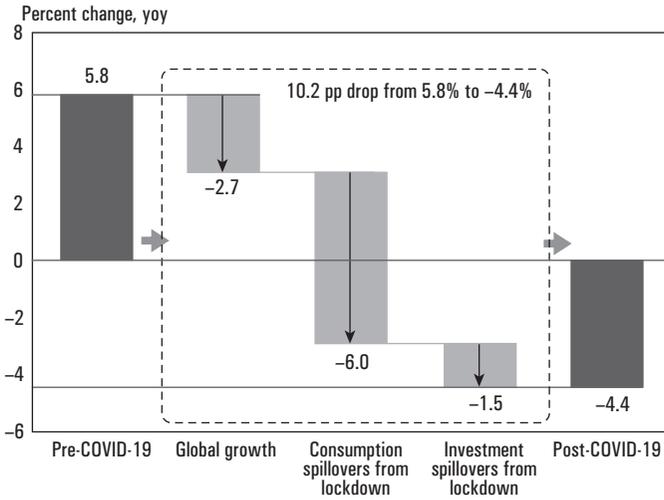
Source: Haver Analytics, Goldman Sachs Global Investment Research.

our assumptions about the peak magnitude of cutbacks—for example, we assume a 95 percent decline in spending on “recreation and culture,” and in “restaurants and hotels,” and an 80–90 percent decline in “education” services. Overall, consumption contributes 60 percent to Indian GDP. The bars in the chart multiply these assumed cutbacks by the GDP share of each category to estimate the annualized impact on the level of GDP (relative to a no-pandemic counterfactual). In total, our assumptions about consumption cutbacks imply a peak hit of about –30 percent to the monthly GDP level through consumption spillovers.

We assume that these peak consumption effects would last for more than half of Q2. Even if we assume that everything had become fully normalized by mid-May 2020, that would still imply that Q2 GDP would be roughly 15 percent below the norm (half of the quarter would be 30 percent below the norm). Against our pre-COVID-19 trend growth assumption of roughly 6 percent, 15 percent below the norm for the quarter would imply Q2 growth of –9 percent on a year-on-year (YoY) basis. This is with an assumption of immediate and total recovery, which obviously would not happen; therefore, we expect Q2 to report a decline of more than –9 percent in YoY terms.

We assume roughly two months of peak shutdown, and translate the monthly hit to consumption in annualized terms, which would be about –6.0

FIGURE 7. Lower Global Growth, Hit to Consumption from the Lockdown, and Investment Spillovers Explain the Roughly 10.2 Percentage Points Lower GDP Growth at -4.4 percent Compared to the Pre-virus Situation



Source: Haver Analytics, Goldman Sachs Global Investment Research.

percent. To the consumption hit, we add the impact on India’s exports (-2.7 percent) and investment (-1.5 percent). Figure 7 summarizes the components of the downgrade in growth compared to our pre-pandemic baseline.

4.2. Stronger Mechanical Rebound in Q3, but Gradual Recovery Thereafter

We do not believe that the later half of the fiscal year will see any more rapid sequential growth than we thought previously. While macroeconomic policies have clearly eased, and we expect them to ease further, we believe that policy support, in particular discretionary fiscal policy support (defined as direct support to households and businesses) that can minimize second-round effects of the pandemic and make any economy quickly rebound in times of an unprecedented shock, has been tepid so far. Our calculations suggest that in aggregate, the discretionary component of fiscal support across the seven phases of announcements by the Finance Ministry, including a ₹1.7 trillion package announced in March 2020, five rounds of announcements from May 13–17, and an extension of the free provision of food grains announced on June 30, 2020, stands at 1.8 percent of GDP (₹3.6 trillion; Table 1), which is much smaller than the aggregate figure of 10 percent of GDP (₹20 trillion) costing of the economic package announced by the government.

TABLE 1. Total Discretionary Spending Stood at 1.8 percent of GDP during March–June 2020

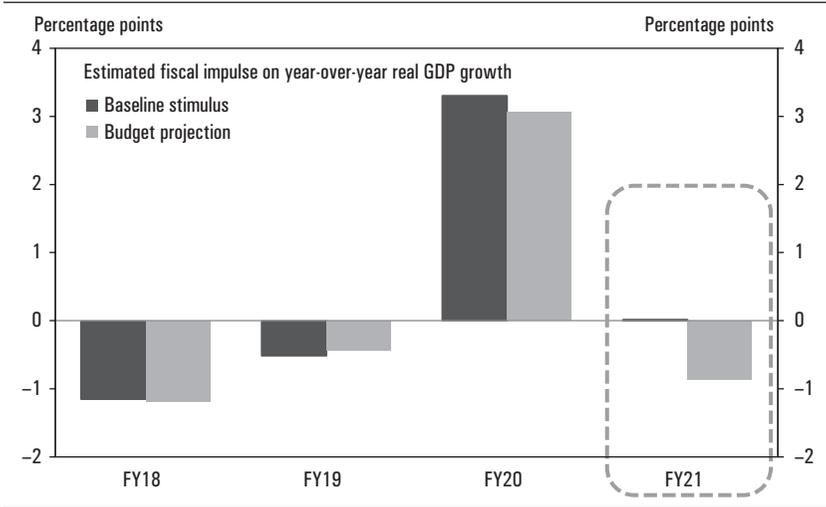
	<i>Relief Amount (₹ billion)</i>	<i>Relief Amount (% of GDP)</i>
<i>Stimulus Package until June 30, 2020</i>		
Revenue loss due to tax concessions since March 22, 2020	78	0.04
Health infrastructure fund announced on March 24, 2020	150	0.07
Stimulus amount announced in:		
Phase 1, March 26, 2020	1,700	0.84
Phase 2, May 13, 2020	5,946	2.95
Phase 3, May 14, 2020	3,100	1.54
Phase 4, May 15, 2020	1,500	0.74
Phase 5, May 16, 2020	81	0.04
Phase 6, May 17, 2020	400	0.20
Phase 7, June 30, 2020	900	0.45
Total fiscal and monetary stimulus announced until June 30, 2020	13,855	6.87
Amount infused by RBI between February and April 2020	7,985	3.96
Total fiscal and monetary stimulus announced until June 30, 2020	21,840	10.83
Health infrastructure	150	0.07
Discretionary spending in:		
Phase 1	980	0.49
Phase 2	596	0.30
Phase 3	50	0.02
Phase 4	500	0.25
Phase 5	0	0.00
Phase 6	400	0.20
Phase 7	900	6.45
Total discretionary spending until June 30, 2020	3,576	1.77

Source: Ministry of Finance, Goldman Sachs Global Investment Research.

Further, our “fiscal impulse” calculation (see Mishra and Tilton 2020b), which captures a complete set of seasonally adjusted quarterly tax and spending flows at the Central and state levels, combined with our assumption on multipliers that vary across different tax and spending items, estimates only a neutral fiscal impulse (of +1.1bp, Figure 8), even after including the Central Government’s stimulus package announced so far.

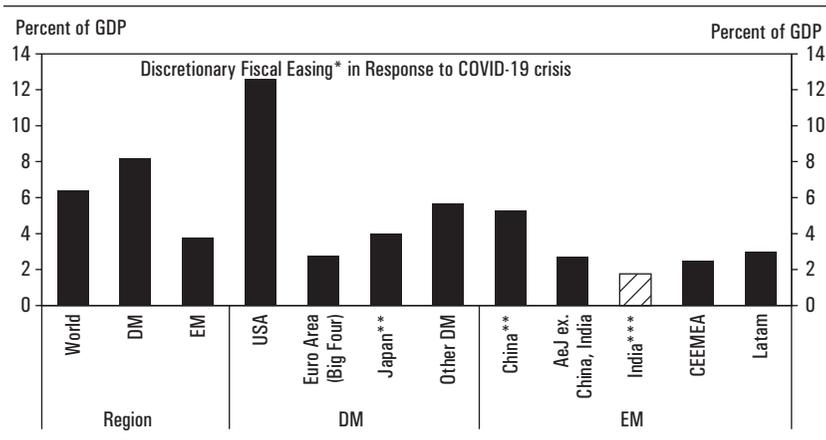
Importantly, the discretionary component of India’s fiscal policy support remains small compared with other emerging economies, and far less compared with advanced economies (Figure 9).

FIGURE 8. Discretionary Spending of 1.8 percent GDP Would Lead to a Fiscal Impulse of Only 1.1 bps



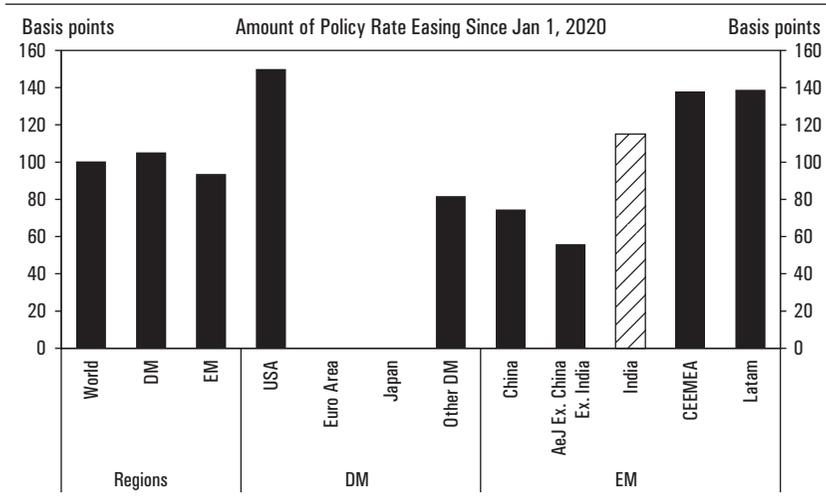
Source: Union Budget FY21, Ministry of Finance, Goldman Sachs Global Investment Research.

FIGURE 9. India’s Discretionary Fiscal Stimulus of 1.8 percent GDP is Much Lower as Compared with Other Emerging Market (EM) and Developed Market (DM) Economies



Source: Ministry of Finance, Goldman Sachs Global Investment Research.

Note: *Discretionary policy actions taken since the outbreak that lead to higher government expenditures or lower tax receipts. **Goldman Sachs expected easing. ***Does not include stimulus announced by various states. “AeJ ex. China, India” refers to Asia excluding Japan and China and India; CEEMEA refers to Central and Eastern Europe Middle East and Africa; Latam refers to Latin America.

FIGURE 10. RBI has Cut Policy Rate by 115 bps since March 2020

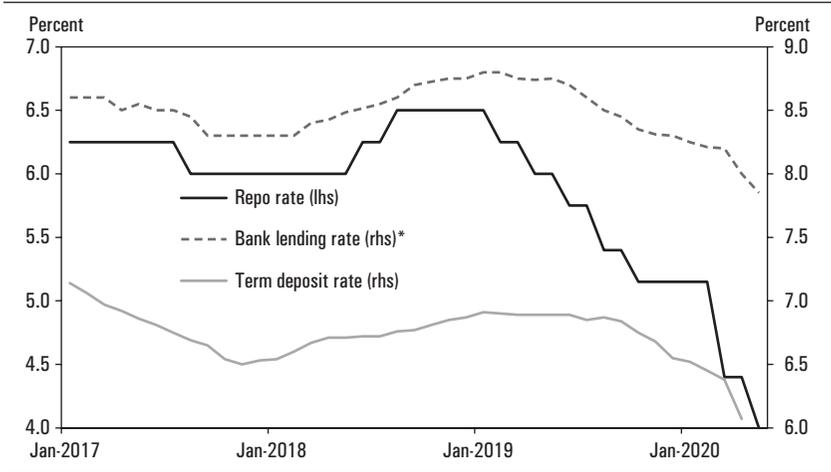
Source: RBI, Goldman Sachs Global Investment Research.

Note: Data as of end-June 2020. RBI cuts are since March 2020. "AeJ ex. China, India" refers to Asia excluding Japan and China and India; CEEMEA refers to Central and Eastern Europe Middle East and Africa; Latam refers to Latin America; DM and EM refer to Developed Market and Emerging Market Economies, respectively. Euro Area and Japan showed negligible cuts as of end-June 2020.

On the monetary side, markets have perceived the Indian central bank as the main game in town. The RBI has reduced policy rates by 115 bps since the COVID-19 crisis hit and combined policy rate changes with other tools such as liquidity injection, long-term repo operations, and regulatory measures. India's policy rate easing, in fact, remains comparable with the average conventional monetary policy support we have seen across emerging and advanced economies (though lower than CEEMEA and Latam; Figure 10).

Transmission of conventional monetary policy, however, remains a challenge. Indian banks have transmitted RBI's prior policy actions, but only to a limited extent (based on RBI data for scheduled commercial banks, since January, the average pass-through of policy rates into bank lending rates and deposit rates is around 40 bps; Figure 11). The transmission of policy rate cuts has been a long-standing issue, and it continues to be delayed and muted in magnitude. Banks have essentially not been willing to cut rates as deposits and household financial savings are at historical lows. Even while policy rates are down, the rates paid by the government on small savings are significantly higher than bank deposit rates. Transmission has continued to be weak, despite the nudges by the RBI in moving from a base rate to a marginal cost of lending rate (MCLR) to more accurately reflect the

FIGURE 11. Bank Lending Rates Declined Only by 40 bps between January 2020 and May 2020



Source: RBI, Goldman Sachs Global Investment Research.

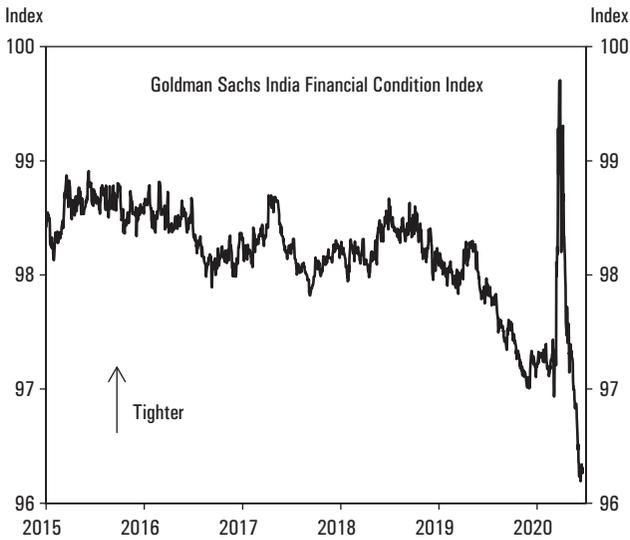
Note: *Marginal cost of funds-based Lending Rate (1-yr) for scheduled banks; "lhs" is left-hand-side axis; "rhs" is right-hand-side axis.

marginal costs of funds, and more recently to the introduction of external benchmarks on the asset side.

Domestic financial conditions have softened considerably following the measures taken by the central bank since the end of March 2020. Figure 12a shows the Goldman Sachs India Financial Conditions Index (FCI), which is a weighted average of short-term and long-term interest rates, equity prices, credit spreads, and the trade-weighted exchange rate. The FCI has eased by roughly 200 bps since early April 2020. The spreads for NBFCs have declined too by about 100 bps from mid-May 2020, but still remain elevated compared to previous years (Figure 12b).

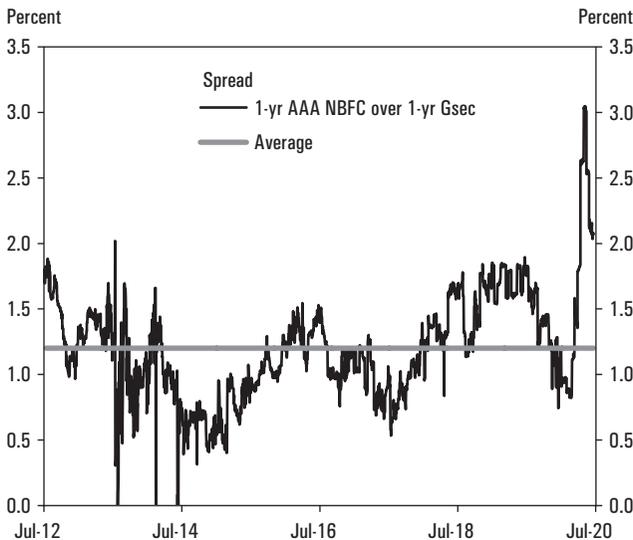
Despite the easing of financial conditions, our overall sense so far is of a less aggressive policy stimulus by Indian policymakers even when compared to 2009, for example, where the shock was different in nature and less severe, but when monetary and discretionary fiscal policies were each eased by more than 400 bps. Despite stronger initial conditions and positive output gaps pre-Global Financial Crisis and a liquid and well-capitalized domestic financial sector, the direct policy support was larger in magnitude. This time around, the initial conditions were weaker in India—a negative output gap and a weak financial sector—when the COVID-19 crisis hit the economy. Yet the direct support from macro policies so far has been strikingly smaller in magnitude (Table 2).

FIGURE 12 a . Financial Conditions have Eased by 200 bps since Early April 2020



Source: Goldman Sachs Global Investment Research.

FIGURE 12 b . NBFC Spreads have Fallen by 100 bps since Mid-May 2020, but Remain Historically High



Source: Bloomberg.

TABLE 2. Current Slowdown has been Very Deep, yet the Monetary Response has been Relatively Modest

<i>Recent Episodes of Slowdown</i>	<i>Period</i>	<i>Duration (No. of Months)</i>	<i>Decline in CAI (pp)</i>	<i>Policy Response</i>		
				<i>Monetary</i>	<i>Fiscal</i>	<i>FX</i>
Global Financial Crisis (GFC)	Jun-08 to Jan-09	8	-7.0	-425 bps	+4.3 pp	Unchanged
Post GFC	Feb-11 to Oct-11	9	-3.3	+200 bps	+1 pp	-3.3%
	Feb-12 to Sep-12	8	-2.6	-50 bps	-1 pp	-4.3%
Demonetisation	Oct-16 to Jan-17	4	-2.0	No Action	No Action	-0.7%
Pre-covid slowdown	Jan-18 to Dec-19	24	-2.6	+50 bps followed by -135 bps	No Action	-2.1%
COVID outbreak	Mar-20 onwards	4	-11.7	-115 bps	+1.8pp*	-4.1%

Source: CEIC, Haver Analytics, Goldman Sachs Global Investment Research.

Note: CAI refers to the Goldman Sachs Current Activity Indicator. Monetary policy response is measured by the change in repo rate during the episode; fiscal policy response is measured by the change in general government fiscal deficit (as a percentage of GDP); FX policy response is measured by change in Real Effective Exchange Rate (REER). *Based on our calculation of discretionary fiscal spending.

5. Fiscal Uncertainty at a High; FY21 Budget Framework Loses Relevance in Light of COVID-19 Shock

We expect nominal GDP to contract in FY21 (vis-à-vis government budget expectations of 10 percent growth). This would obviously have dramatic implications for the fiscal outlook for 2020 and 2021. On the tax side, even assuming similar buoyancy in tax collections as originally budgeted for, we expect a sharp shortfall in total receipts. While some shortfall in direct tax collections and Goods and Services Tax would be offset by the recently announced higher excise duties on petrol and diesel, it would at best be partial. On top of the risk to tax revenue collections, the execution of the privatization program—the key linchpin of the government’s budget framework—would also pose serious challenges this year. The execution of privatization plans was weak in FY20, as has historically been so, with the government resorting to sales within public sector entities in order to achieve budget targets rather than to private buyers. Asset sales underperformed significantly in FY20 in comparison with what was originally envisaged, yet

were pegged at even more ambitious levels for FY21 (0.9 percent of GDP). While the intent to undertake privatization is clear, and we think the plan to sell part of the government's holding in the Life Insurance Corporation is a welcome move, the COVID-19 crisis, as well as weak global and domestic market sentiments, would obviously make it even harder to achieve progress on implementation. On the spending side, the usual strategies to achieve budget targets—lower spending on subsidies, lower transfers to states, and squeezing capital spending—would, and perhaps should, be limited this year, given the contraction in economic activity and the need for fiscal policy support.

We form our baseline scenario where we build in the impact of the COVID-19 shock on tax, non-tax, and privatization receipts, and a discretionary fiscal stimulus of 1.8 percent of GDP. With revenue collections falling short, and the government unable to squeeze spending by as much, we project a Central Government deficit of 7.1 percent of GDP in this scenario (Table 3), 360 bps above the original budget projections.

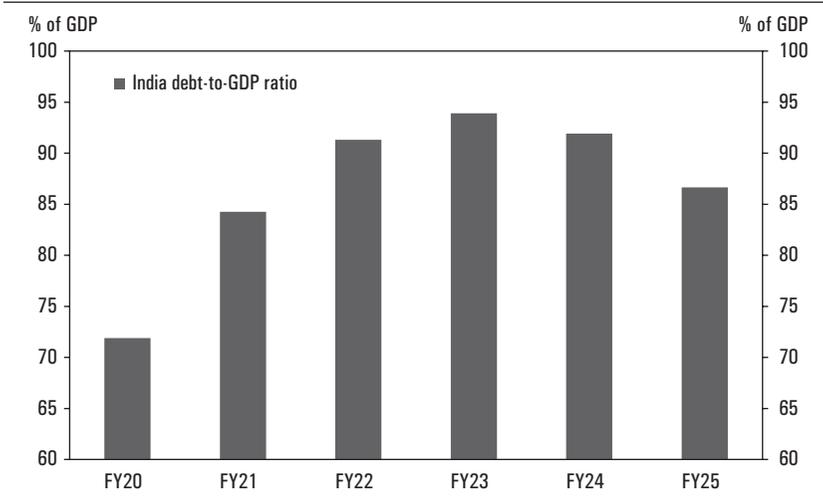
Assuming that state governments use their enhanced borrowing limits recently allowed by the Central Government, and net borrowing of public sector enterprises follows historical patterns, we forecast that the consolidated deficit for FY21 could reach close to about 15 percent of GDP. This

TABLE 3. Fiscal Budget Targets for FY21 Seem Unrealistic Post COVID-19 Outbreak

% of GDP	FY20	FY21BE	FY21F
			<i>Fiscal Response Equal to 1.8% of GDP</i>
Fiscal deficit	4.6	3.5	7.1
Expenditure	13.2	13.5	16.1
Capital	1.7	1.8	1.6
Revenue	11.6	11.7	14.5
Revenue	8.3	9.0	8.3
Tax	6.7	10.8	7.2
Non-tax	1.6	1.7	1.0
Recovery of loans	0.1	0.1	0.1
Privatization receipts	0.2	0.9	0.7

Source: Union Budget FY21, Haver Analytics, Goldman Sachs Global Investment Research.

Note: FY21F refers to Goldman Sachs forecasts and FY21BE refers to Budget Estimates for financial year 2020-21; FY20 is actual data from financial year 2019-20; Total discretionary spending, as per our calculations, is 1.8 percent of GDP or ₹3.6 trillion. Assumed ₹600 billion is spent in FY20, rest will be spent in FY21. Nominal GDP levels in FY21BE and FY21F are different.

FIGURE 13. Debt-to-GDP Ratio Might Increase to 85 percent in FY21

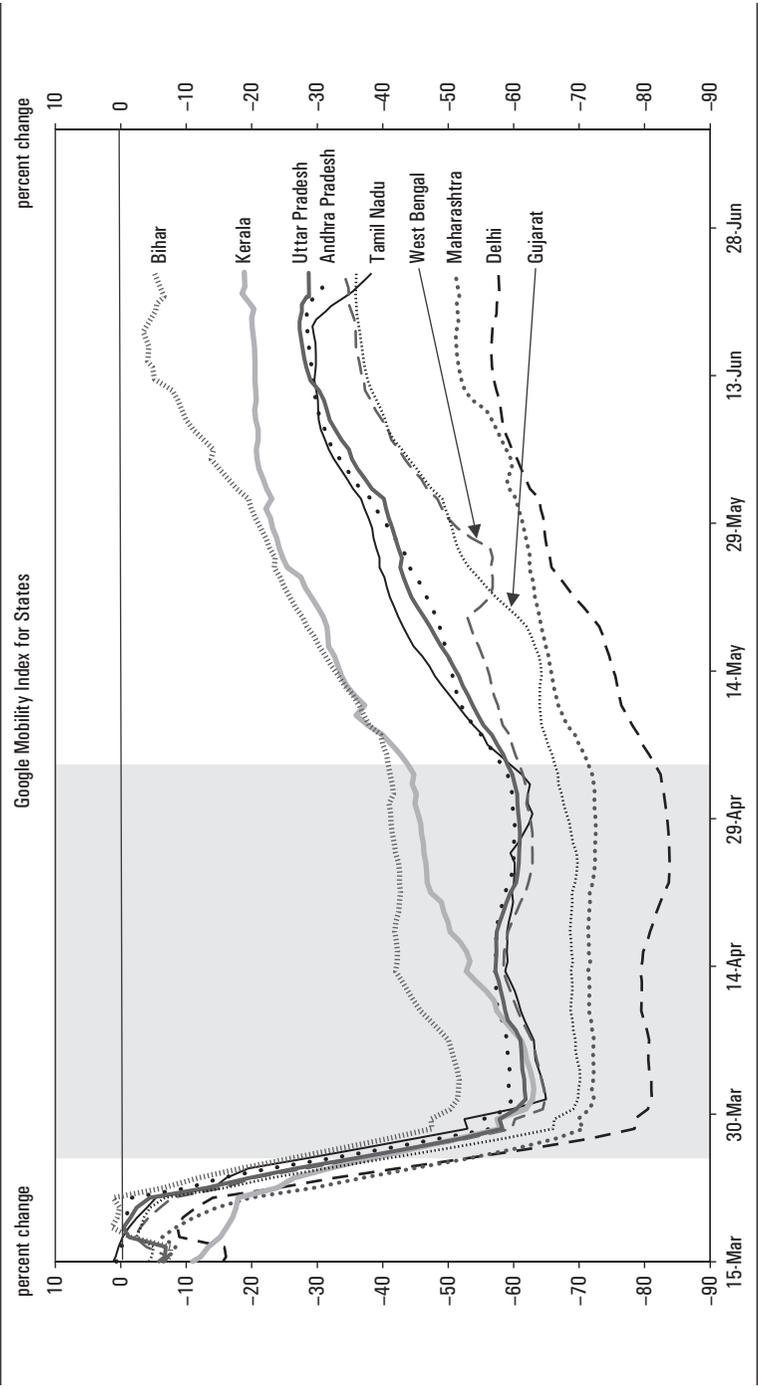
Source: Goldman Sachs Global Investment Research.

would lead to a sharp increase in the government's debt to GDP from an estimated 72 percent of GDP in FY20 to as high as 85 percent of GDP. Going forward, how the debt dynamics evolve will depend on the evolution of real and nominal GDP growth, and the government's fiscal plan. Under a scenario of gradual economic recovery, even with a sharp consolidation in the primary deficit, the interest-growth differential would remain positive, and debt as a share of GDP would continue on an upward path for the next few years. The debt-to-GDP ratio could start to decline from FY24, assuming that the interest-growth differential turns negative, putting downward pressure on debt dynamics, and with continued consolidation of the primary deficit by the government (Figure 13). Moreover, even when debt starts to decline, it would likely be at significantly higher levels than it is currently.

6. The Restart and the Challenges

The restart of the Indian economy is underway. In this section, we explore how mobility is normalizing, how the virus is spreading, and how economic outcomes are evolving across states with different degrees of reopening. Based on Google mobility data, mobility has picked up nationwide since early May 2020, but has remained significantly below normal levels in all states through June 23, 2020 (Figure 14).

FIGURE 14. Mobility has Improved in All Major States since Early May 2020, but Remains Significantly below Normal



Source: Google LLC "Google COVID-19 Community Mobility Reports."

Note: The Google Mobility Index compares mobility on various days of the week with median day-values from the 5-week period between January 3 and February 6, 2020. The mobility index reported in the figure above is the average of grocery/pharmacy, parks, retail and recreation, transit, and workplace mobility. 7-day moving averages are shown in the figure. The shaded portion highlights the lockdown period (from March 25 to May 4, 2020). Data as of June 23, 2020.

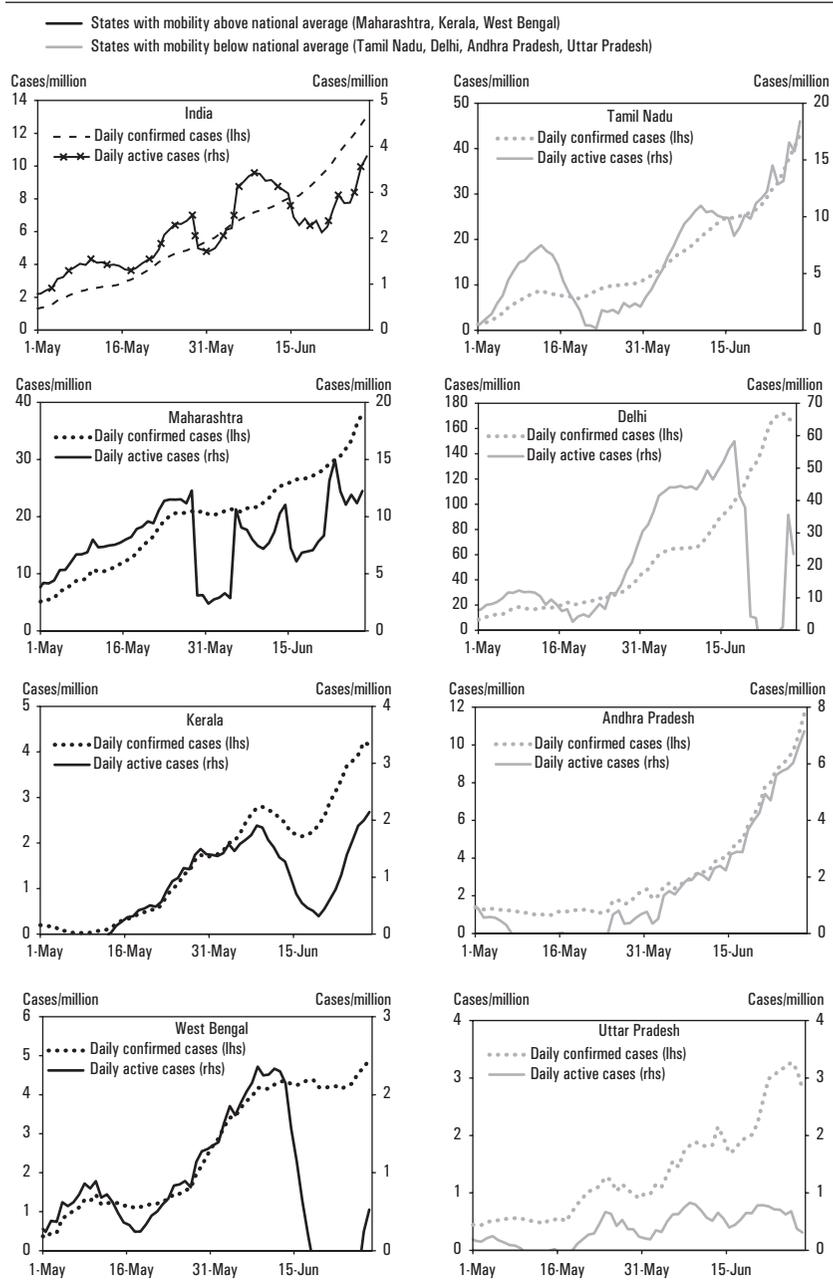
The “de facto” restart of the economy exhibits significant variation across states and also sectors. Across states, Maharashtra reopened the least within a month of relaxation of restrictions since early to mid-May 2020. Mobility, however, plateaued nationwide more recently as cases rose, and in certain states like Tamil Nadu, due to the reimposition of lockdown restrictions. While visits to grocery stores have increased the most, those to parks have risen the least (Google mobility data by activity type not shown here).

But is the increase in mobility causing the virus to spread? In order to explore this, we define the degree of restart (or reopening) at the state-sector level by measuring the change (percentage point difference) in the five mobility sub-indices and the aggregate mobility index between two points in time. These two points are (a) the peak of the lockdown, just before the lockdown rules started to be relaxed: we take a 7-day moving average ending May 3, 2020 (the first wave of lockdown relaxations started on May 4) and (b) mobility data as of June 12, 2020 (the last week before lockdown restrictions were reimposed in several states and mobility began to decrease).

Unlike in several advanced economies, we find net new cases to have risen sharply immediately following the relaxation of restrictions in states that reopened the most (Figure 15). Notably, even after adjusting for testing, the positivity rate rose sharply for Delhi and Tamil Nadu between mid-May and mid-June 2020, coincident with the relaxation of lockdown rules in these two states (Figure 4b). Testing was ramped up only after June 17, 2020, post which we did observe a further spike in cases, especially in Delhi. Delhi also exhibited a sharp fall in active cases after mid-June 2020 due to a large number of recoveries (likely cumulated over a short period of time), but active cases were once again on a rising trajectory in Delhi.

Finally, we fit a model for the daily growth rate in the number of active cases, drawing from the cross-country analysis by the Goldman Sachs global team (see Hatzius, Struyven, and Rosenberg 2020). The model includes the change in the mobility index, in addition to lags in the growth rate of cases and the age of the virus. Table 4 shows the regression results. Our model can explain 66 percent of the variation in new active cases. The results further strengthen our finding that states that reopened to a greater extent show higher growth in active COVID-19 cases. The magnitude of the estimated coefficient on the mobility index suggests that every 1 percent increase in aggregate mobility increases the growth rate of daily active cases by 0.4 pp, which is economically and statistically significant. For example, mobility in Maharashtra increased by 3.84 percent on June 10, which is estimated to have lifted the growth rate of new active cases by 1.45 pp on June 12. This is also evident from the spike in active cases on June 12 for Maharashtra before they declined (Figure 15).

FIGURE 15. Net New COVID-19 Cases are on a Rising Trend in States That have Reopened the Most



Source: Data as of June 28, 2020. Ministry of Health and Family Welfare, COVID19India.org.

Note: "lhs" is left-hand-side axis; "rhs" is right-hand-side axis.

TABLE 4. Every 1 percent Increase in Aggregate Mobility Increased the Growth Rate of Active COVID-19 Cases by 0.4 Percentage Points

	<i>Daily Growth Rate of Active Cases per Million[^]</i>
1-day lagged growth rate	0.209*** [3.838]
2-day lagged growth rate	0.182*** [3.321]
Average 3–7-day lagged growth rates	0.187** [2.514]
Days since start of outbreak	–0.061** [–2.194]
2-day lagged growth rate in aggregate mobility (7-day moving average)	0.378*** [2.717]
Number of states	12
Observations	316
R-squared	0.663

Source: Goldman Sachs Global Investment Research, Google LLC “Google COVID-19 Community Mobility Reports,” COVID19India.org.

Note: Model built on data from May 17 to June 12, 2020; *t*-statistics in brackets; [^]natural log difference of active cases per million, multiplied by 100; states fixed effects have been included in this regression; **p* < 0.1, ***p* < 0.05, ****p* < 0.01.

7. Conclusion and Policy Implications

Policymakers are usually focused on short-run economic management issues. But the short-run has to be a bridge to the medium and long run. The central medium-run questions facing India are as follows: Where will growth come from? What will be the key macroeconomic drivers of growth going forward? Discretionary fiscal policy support—defined as targeted support to households and businesses, the kind of policy support that can revive any economy quickly in times of an unprecedented shock like we have seen—is tepid in our view. Monetary policy has been the main game in town; however, the transmission of conventional monetary policy continues to pose challenges; the exchange rate has remained remarkably stable in this crisis, and the RBI’s real effective exchange rate has, in fact, strengthened by 4 percent since pre-COVID-19 and would actually be a drag on growth. Therefore, while pent-up demand, favorable base effects, and massive policy support in advanced economies driving the global recovery could lift India’s economy in 2021, we struggle to see any domestic fundamental forces to drive India’s growth forward in the medium-run.

That said, the uncertainty around the medium-term outlook continues to be very high. There are several unknowns—how the virus will evolve globally and domestically? How successful will government actions be in limiting the spread of the virus? How quickly potential vaccines will develop globally? How strongly and for how long people will choose to cautiously avoid normal activities? And how effective will macroeconomic policies be in supporting the economy?

Overall, we see three key risks to the medium-term outlook. The first key risk to sequential recovery is that of the pandemic not being brought under control over the next few months, leading to another round of shut-downs. The second key risk to watch out for would be domestic financial sector risks. There was a high degree of risk aversion in the financial sector even before the pandemic. State-owned banks, which form 60–70 percent of India's banking system assets, reported no YoY growth in credit pre-COVID-19; nonbanking financial companies were struggling with their own problems after the failure of ILFS in September 2018, and growing loans at low single digits; private banks were supporting credit growth, but ever since the crisis in a domestic Indian bank even private sector bankers went risk averse (see Jain and Verma 2020a, 2020b). Post the COVID-19 outbreak, the government has announced a series of credit guarantee schemes and several regulatory measures with moratoriums around principal and interest payments. All these pose a host of implementation challenges—this is true not only in India but also across the world. The key risk we see is the lack of a significant credit offtake from these programs and, at the same time the building up of a host of medium-term risks in the system with regulatory forbearance, leading to moral hazard, higher non-performing loans in the future, and risks related to fraudulent practices.

Finally, the third risk to watch for is the fiscal risk. As discussed above, with nominal GDP contracting, revenues will likely contract, and that would put sharp upward pressure on the government's fiscal and debt positions. With the interest rate–growth differential turning positive, debt dynamics are likely to turn adverse. Market participants and credit rating agencies appear to be less worried about the worsening of fiscal and debt positions in the short-term—in fact, the opposite. They appear to be more concerned about the fact that India may not have the administrative and fiscal capacity to implement a large fiscal support, and that would be a headwind to growth. What would reassure markets and avoid further credit rating downgrades is not lower fiscal spending in the short-run, as many perceive, but most importantly a strategy to revive growth, combined with a credible fiscal plan for the medium-term.

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Comments and Discussion*

Chair: **Duvvuri Subbarao**
Former Governor, RBI

Shankar Acharya
ICRIER

A topic like “Whither the Indian Economy” tempts one to talk for at least an hour, but Subbarao chairing this session has squeezed that down to 10 minutes. So I will make my points in a somewhat more staccato way than perhaps I might have otherwise done. I will not try to cover all the territory that Prachi could because in 30 minutes she could do a lot more. Let me focus on a few points on growth projections in FY 2020–21 (henceforth FY21) and beyond, and some related issues. Let me also say that I think Prachi has been remarkably optimistic. I would not be quite so optimistic.

First, let me say a few words about the evolution of growth projections for the year FY21. Around February 2020 at Budget time, most observers hoped or expected growth to be around 5–6 percent in FY21. After the lockdown began, sometime in April, “institutional” projections from the World Bank, the IMF, various investment banks, credit rating agencies, and others, certainly through April and at least the first half of May 2020, were still looking at GDP expansion, with some positive rate between 0 and 2 percent. I found that quite incredible because, by mid-May, one had seen some awful high-frequency numbers on the economy, and I could see no reason for growth to be in positive territory at all.

So, in mid-May, I published (*Business Standard*, May 14, 2020) a couple of scenarios. I am mentioning them because they are pertinent for comparing Prachi’s with mine and those by others. I presented a quarter-by-quarter “guestimation” of what might happen to growth during FY21. In the more optimistic scenario, GDP went down by about 11 percent YoY, and by about 14 percent in the other. By the way, I was not the only one doing this. Pronab Sen expressed similar expectations, as far as I recall, of about 11–12 percent

* To preserve the sense of the discussions at the India Policy Forum, these discussants’ comments reflect the views expressed at the IPF and do not necessarily take into account revisions to the conference version of the paper in response to these and other comments in preparing the final, revised version published in this volume. The original conference version of the paper is available on NCAER’s website at the links provided at the end of this section.

negative growth for the full financial year. NCAER, in the first version of its *Quarterly Review of the Economy*, had a number of scenarios, one of which depicted a 12 percent decline and the others were much more optimistic, based on various kinds of assumed policy interventions.

In the subsequent three weeks after May 14, I think we saw a lot of downward revisions in these institutional projections from the IMF, the World Bank, investment banks, credit rating agencies, and others. They came down, broadly speaking, to the -4 to -7 percent range for growth in FY21. I think Prachi and Goldman Sachs came down to -4, but others like the State Bank of India had around -7.

To my mind, what is interesting is that a subset of these projections were actually for Q1 YoY of FY21. That included Prachi and Goldman, of course. She is perhaps the most pessimistic, I think at -45 percent for Q1, if I remember correctly. CRISIL was -25 percent for Q1, NCAER in its revised paper was -26 percent, my mid-May projections were -25 and -33 percent, and Pronab Sen's, as far as I can recall from his paper, was -37 percent. So note that Prachi's was actually the worst, comparing quarter-to-quarter, year-on-year, whereas her full-year projection was much more in the standard, moderate range, not in double digits, as some of us are.

I would be willing to make a bet with Prachi: if Q1 FY21 GDP goes down by 45 percent YoY, as she seems to expect, there is no chance of getting any full-year decline below 10 percent. Basically, my view is that if we get knocked down by the lockdown to the extent of about -25 to -30 percent YoY for Q1, then, scrambling our way up quarter by quarter—and I agree that what is going on is now a sequential improvement each quarter—it will be quite challenging to get down to a single-digit number for GDP decline in the full year FY21.

When we talk about growth during this year and the next, we should be looking not just at growth rates but also at the level of GDP by quarter. This is what I did in my June 11 article in the *Business Standard*. I agree that we will probably see some version of a modified V, and we are already seeing that: a very sharp downturn in Q1, and then a substantial improvement in Q2, which has just begun, of course. But, in level terms, it will be a fairly miserable story. Throughout the year, we may be well below the average quarterly level for 2019–20 in real terms.

The key question is: what will be the point in time when we recover to, say, the average quarterly level of 2019–20? At present, I do not see that happening till the second half of 2021–22, and that is assuming that the un-lockdown proceeds relatively smoothly, for which the current evidence is not wholly reassuring. So I think it is going to be significantly grimmer

than the picture that Prachi painted. My expectation is, if we are lucky, that we will get to 2019–20 GDP levels in the second half of 2021–22.

What about beyond 2021–22? This will depend, I think pretty obviously, on what is happening to the global economic environment, what is happening to the pandemic, and our own policies this year and the next. Speculating about post 2021–22 on present trends and policies, it is possible that average growth in the medium term (say five years after 2021–22) in India could be in the 3–5 percent range.

Another point, which arose more from the author's presentation than my initial reading of her paper, is that I disagree with her strongly on the characterization of the fiscal situation. If we use the standard definitions of fiscal deficit and fiscal impulse, FY21 will see a massive fiscal deficit. The combined (Centre plus states) deficit would be, in my view, 12 percent plus, essentially because of huge revenue shortfalls. And as for impulse, comparing to the previous year, we will see perhaps plus 5 percent. Now, the point is that it is not going to matter a whole lot from the GDP point of view since I think the dominant factor is likely to be the supply side during most of the year, that is, the binding constraint is going to be coming from aggregate supply rather than aggregate demand.

When we come to the policies and key concerns, I think we are in much closer agreement. First, I think the key challenge going forward will be how to manage localized lockdowns better than we are doing, because otherwise public policy is hitting supply more than it should. It will not be easy and I do not have any silver bullets because this requires enormous medical knowledge. Second, I agree with the author that the issues of debt sustainability will emerge, with government debt up to 85 percent of GDP in nominal terms by the end of FY21. We will also face major challenges in grappling with the renewed stress on our financial sector, which has been under continuous pressure for quite a few years. Things looked to be improving until COVID-19 hit, and now, of course, because of the lockdowns, there is enormous stress on the financial sector. It will be a huge challenge for whoever is making policy to deal with that.

Finally, let me point out a couple of things that the author did not mention, and which I would emphasize on the policy side as we look to the future. First, I think we need to try to keep a strong commitment to open trade policies. It is not happening; indeed, it has not been happening for the past three years. But it is something that we must try to do because otherwise we gain less from the updraft in the global economy as it recovers. I see all sorts of problems here, particularly now that it is complicated by the unpleasant events on the northern frontier of our country.

We must also seriously try to live by the slogan, “Ease of Doing Business.” Business has become difficult as a consequence of COVID-19 and associated policy responses such as lockdowns and continued mini-lockdowns. These have temporarily conferred massive discretionary authority to different layers of government, which is often implemented in an uncoordinated, sometimes unjustified, manner. I am not saying any of this is easy, but as far as economic agents are concerned, particularly producers, the situation is sometimes reminiscent of the bad days of the Licence-Permit Raj. So, we must fight to not let that become a permanent state of affairs.

Vijay Joshi

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This is a very nice, interesting, and valuable paper. My main comment is that it would become even more of a valuable paper if it discussed policy options in greater detail.

I begin with a couple of minor points about the early parts of the paper. I wish that there had been more detail about the employment and unemployment situation because that is important from both a macroeconomic and a welfare point of view. I also think there could have been more detail about the destruction of supply chains since the pandemic is partly a supply shock and partly a demand shock.

I now turn to my main points. The paper contends that (a) the government’s discretionary fiscal support is only 1.8 percent of GDP and (b) the fiscal impulse is around zero. These are very important claims. The paper’s fiscal impulse figure of approximately zero means that there has been hardly any genuine fiscal expansion at all. However, the concepts of “discretionary fiscal support” and “fiscal impulse” are not very commonly understood by non-macroeconomists, so I think the author should explain them clearly and show with their help why the government’s figure of 10 percent of GDP as the fiscal stimulus is highly exaggerated.

The main gap in the paper is that it does not include an extended discussion of policy options at the current juncture. The paper uses the word “tepid” to describe the policy response, and I would certainly agree with that description. But there is a crying need to examine the issues in much greater depth than I am about to do. As I see it, the task before the government is twofold—the first one is the recovery objective, which is to get the economy back to normal working, and the second is the growth objective, which is to correct the drift which has been happening in the last few years

and return the economy to rapid and inclusive growth. As the author correctly observes, capital markets are not much concerned right now about overruns in fiscal deficits and debts, rather the reverse. But what they are looking for is a strategy to revive growth that also contains a credible plan for medium-run fiscal consolidation.

On the recovery objective, given the severity of the slump, it is vital to support incomes and consumption across the board. This is so on humanitarian grounds. But, happily, this does not conflict with sensible macro-economic policy at this point because, with the easing of the lockdown, an expansion of demand is necessary not only to bring about greater capacity utilization but also to encourage the rebuilding of supply chains and, thereby, the return of workers and jobs to cities. Conventional monetary policy has its limits because of transmission problems, so the main action has to be in fiscal policy. In my view, there should be an immediate universal cash transfer of at least 1 percent of GDP, possibly 2 percent of GDP. I say “universal” in order to avoid any problems of identifying beneficiaries, which would massively slow down the process. How would this stimulus be financed? In my view, half of it should be financed in the normal way and half of it should be financed by printing money. You can call the latter helicopter money if you wish, you can call it selling bonds to the RBI if you wish, but basically it is printing money. If the fiscal expansion was 1 percent of GDP and it was monetized to the extent of 0.5 percent of GDP, there would be a one-off increase in money supply of around 2 or 3 percent of GDP.

The usual objection to such a move is that it would be inflationary. But note that oil prices and commodity prices are low, and food stocks are high. Current inflation is running at 6 percent a year because of the destruction of supply chains. However, given the slump, there is a lot of disinflation in the pipeline, and it is important at this point to crank up demand if supply chains are going to be revived. Imports would increase under this scenario, but that is not a worry because we are starting from a current account surplus and the reserves position is very comfortable. The second objection is that printing money could become a habit. But I do not find that plausible, since we now have a credible inflation targeting regime. The third objection is that markets will take fright, but I do not think that is correct. What they are looking for is a revival plan (which also includes a medium-run fiscal consolidation plan).

Now I turn to the inclusive growth objective. We want to have a step-up in growth, and this objective can be pursued either sequentially or simultaneously with the recovery objective. The elements of the unfinished reform agenda are well known. Many people, including myself, have written about

it. Of course, any reform program would require not merely greater liberalization but also more public investment, and more social expenditures on health and education, along with fiscal consolidation. How can that be achieved? Note that there is a huge amount of fiscal space that could be available once the economy returns to normal. If we undertake a program for winding up dysfunctional subsidies and tax exemptions, for more extensive privatization, for some taxation of agricultural incomes, and for winding up ineffective social welfare schemes (while retaining the effective ones), all these things put together could potentially yield up to 10 percent of GDP. There is thus no shortage of potential fiscal space. In addition, I would say that it would probably be quite safe to conduct some extra borrowing externally from either official sources or from commercial sources.

In conclusion, there are two paths that the government could take at this point. One path is to play it very safe but that, I think, is actually likely to hinder recovery and continue the drift. The second path is more ambitious: take some risks and use the occasion for some immediate expansion, as well as a complete reset of the economy. My vote is for the ambitious path.

General Discussion

Participants in the General Discussion included **Rajeswari Sengupta, Raghuram Rajan, Sudipto Mundle, Karthik Muralidharan, Govinda Rao, and Gunajit Kalita.**

To get a sense of the richness of this discussion, we invite you to view the video of the General Discussion segment of this IPF session. Please use the appropriate hyperlink on the IPF 2020 Program available at the links below.

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