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INDUSTRY OUTLOOK

GROWTH PROSPECTS POST COVID-19
ISSUES AND CONCERNS

23 June 2020

I. INRODUCTION

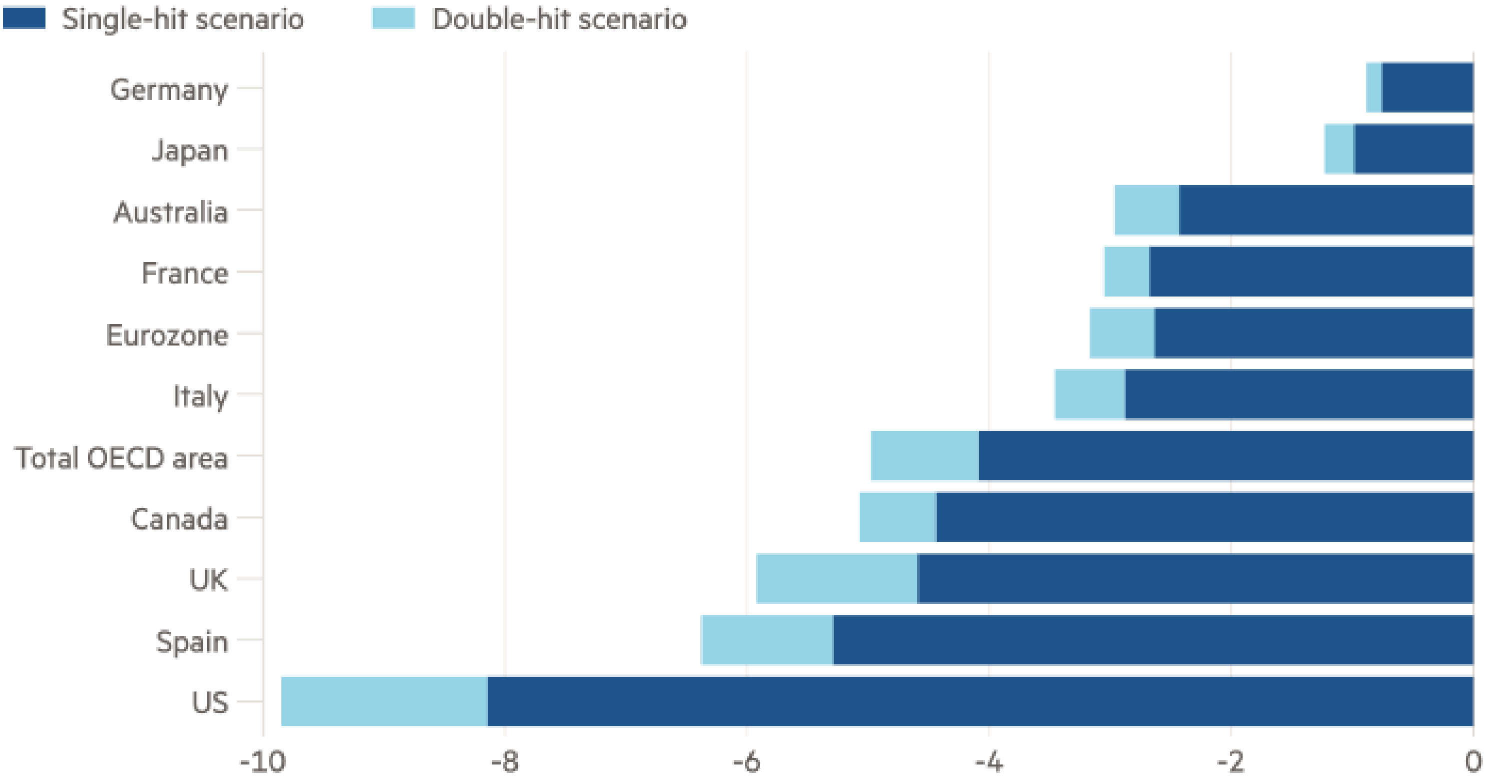
The global economy has been completely devastated in terms of all parameters, viz., income, output and employment by the COVID 19 pandemic. On the basis of a baseline scenario, in which the pandemic fades in the second half of 2020 and containment efforts are gradually unwound, the International Monetary Fund (IMF) in its biannual World Economic Outlook (WEO) projected the global economy to contract sharply by 3 per cent in 2020, much worse than during the 2008-09 financial crisis. The IMF projected 5.8 per cent recovery for global economy in 2021. But the recovery could be weaker than expected after the spread of the virus has slowed for various reasons. The IMF candidly admitted “these include lingering uncertainty about contagion, confidence failing to improve, and establishment closures and structural shifts in firm and household behaviour, leading to more lasting supply chain disruptions and weakness in aggregate demand”.

There is extreme uncertainty around the IMF’s global growth forecast. Hence, the IMF in its outlook said many countries face a multi-layered crisis comprising a health shock, domestic economic disruptions, plummeting external demand, capital flow reversals, and a collapse in commodity prices. The IMF stressed that the economic fallout reflects particularly acute shocks in specific sectors. The policymakers will, therefore, need to implement substantial targeted fiscal, monetary, and financial market measures to support affected households and businesses. In view thereof, the IMF cogently argued “fiscal measures will need to be scaled up if the stoppages to economic activity are persistent, or the pickup in activity as restrictions are lifted is too weak. Broad-based fiscal stimulus can preempt a steeper decline in confidence, lift aggregate demand, and avert an even deeper downturn. But it would most likely be more effective once the outbreak fades and people are able to move about freely”.

Similarly, the World Bank's global economic outlook (June 08, 2020) examined the impact of COVID-19 on the world economy and stressed that the global economy may contract by ~5.2 per cent, similar to the time of recession during Second World War, with the largest fraction of economies experiencing declines in per capita output since 1870. The World Bank predicted that the economic activity among advanced economies is expected to dip by ~7 per cent this year while the emerging market and developing economies are estimated to dip by ~2.5 per cent.

Policy differences explain the huge divergence in employment declines

Forecast employment growth in 2020 (%)



Source: Martin Wolf. "How Covid-19 will change the world". Financial Times, London. June 17, 2020.

II. FALSE DILEMMA OF A CHOICE BETWEEN SAVING LIVES AND SAVING LIVELIHOODS

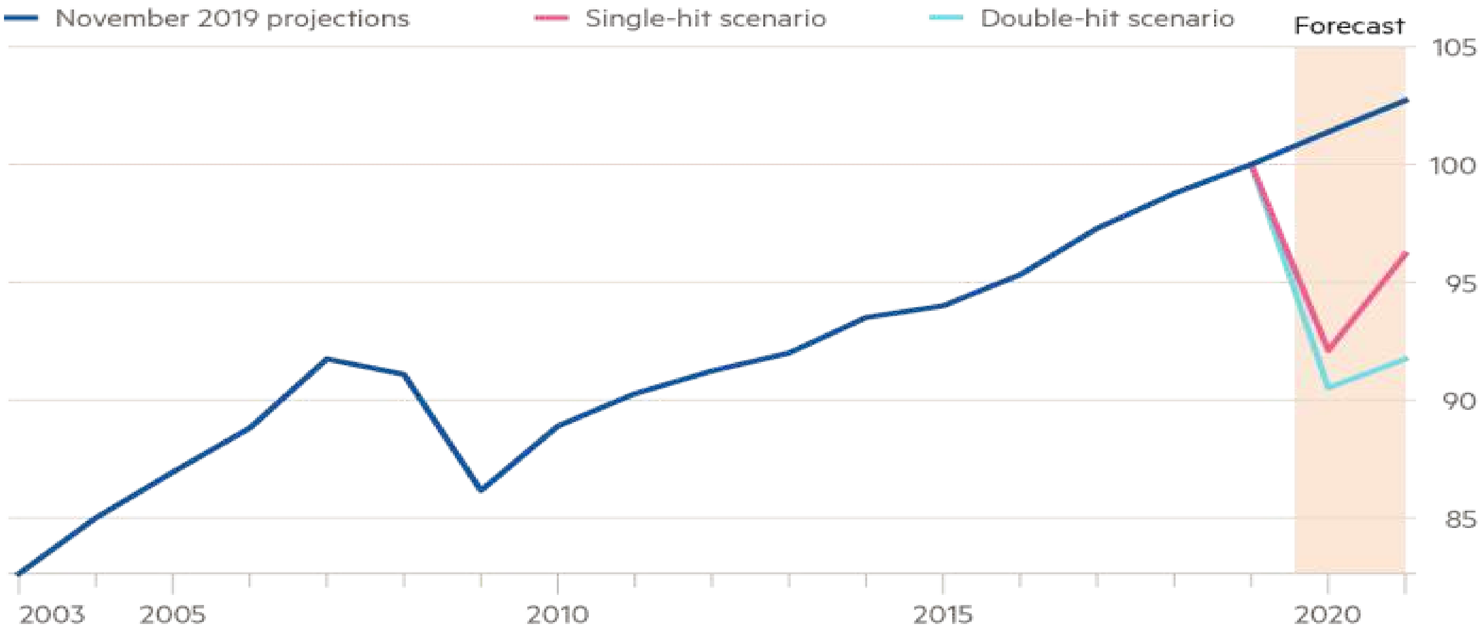
The rapidly evolving process and pattern of development is certain to lead to widespread economic devastation reflected in the severe hit to income, output, and employment. Given the magnitude of the funds required and the stimulus package announced, adhering to the mandated fiscal deficit level is ruled out now. This thesis can be substantiated by the fact that the IMF's Managing Director Kristalina Georgieva and WHO Director-General Dr. Tedros Adhanom Ghebreyesus have inconvertibly demonstrated an effective mechanism of tackling the pandemic. Towards this end, they have demolished the false dilemma of a choice between saving lives and saving livelihoods. To quote Georgieva and Dr. Ghebreyesus, "getting the virus under control is, if anything, a prerequisite to saving livelihoods". "Paying salaries to doctors and nurses, supporting hospitals and emergency rooms, establishing make-shift field clinics, buying protective gear and essential medical equipment, and carrying out public awareness campaigns about simple measures like hand washing are critical investments to protect people against the pandemic".

Further, IMF published a new World Pandemic Uncertainty Index for 143 countries, which clearly brings out the unprecedented level of uncertainty triggered by the coronavirus. As of March 31, it is three times the size of the uncertainty during the 2002–03 SARS epidemic and about 20 times the size during the Ebola outbreak. As the problem gets worse, the stakes rise higher necessitating boosting confidence and providing stability to the global economy in these tumultuous times.

The IMF is also regularly updating the global policy tracker to sensitize the member countries of the global experiences in addressing the challenge of COVID-19. The tracker now covers 193 economies and focuses on discretionary actions that supplement existing social safety nets and insurance mechanisms, and summarizes key economic responses governments are taking to limit the impact of the pandemic. Given this overarching environment, the concerns of prudence in fiscal management can be addressed at a later stage when things get back on rails.

Covid-19 will cause another massive hit to real incomes per head

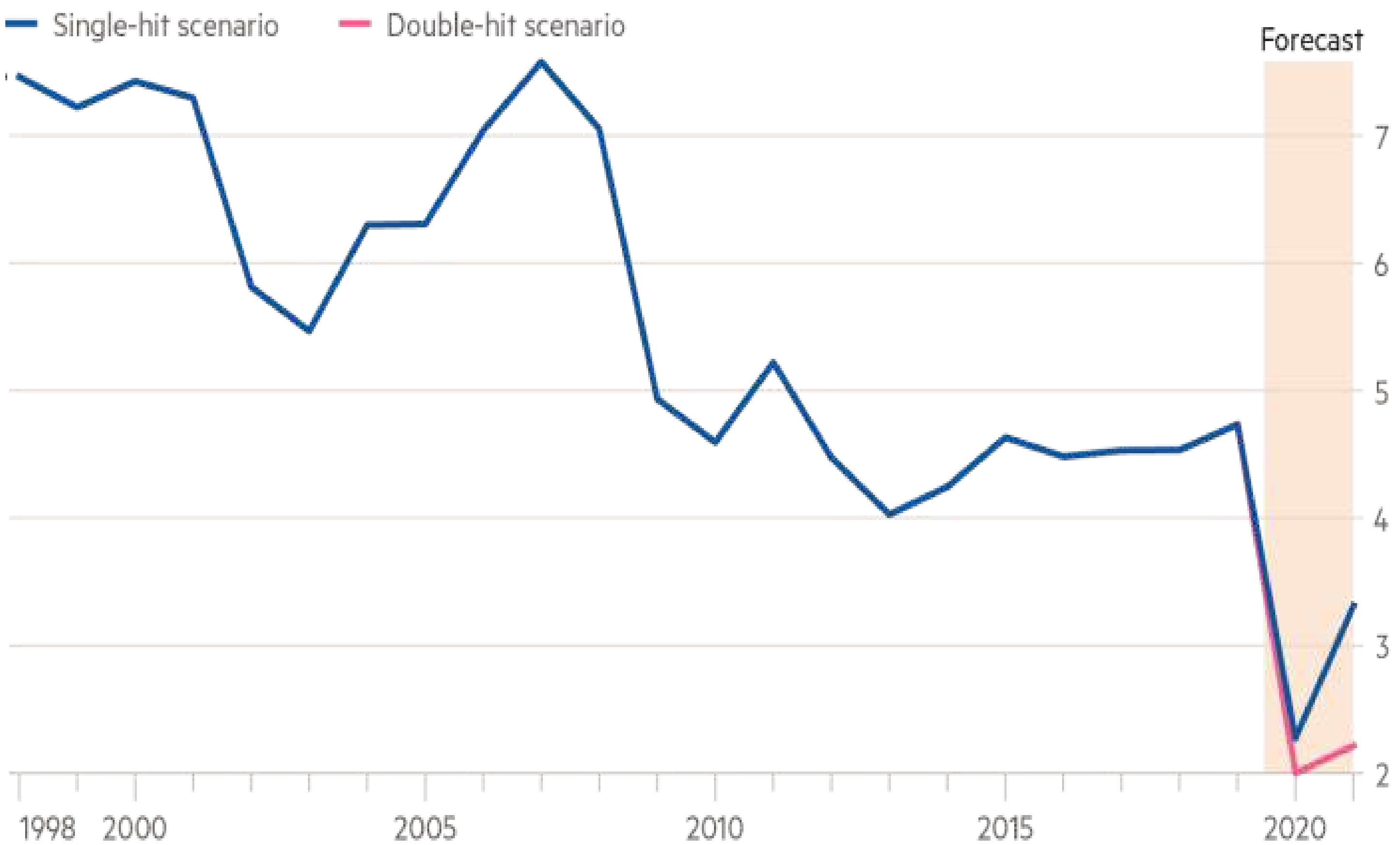
Real income per head in the median OECD economy (2019 = 100)



Source: Martin Wolf. "How Covid-19 will change the world". Financial Times, London. June 17, 2020.

The fall is likely to lower the investment rate, again

Real net productive investment in the median OECD economy (% of GDP)



Source: Martin Wolf. "How Covid-19 will change the world". Financial Times, London. June 17, 2020.

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III. SHRINKING INDIAN ECONOMIC GROWTH-FIRST TIME IN 41 YEARS

There is consensus across the development spectrum that the Indian growth prospects during the financial year 2020-21 are bleak because of supply and demand side disruptions and falling demand, particularly private consumption, in the aftermath of COVID-19. Agriculture is certainly expected to do well. However, growth in agriculture alone would be grossly inadequate to keep GDP growth positive. In case of agriculture in India, there is an asymmetry: while it accounts for about 56 per cent of employment, it only contributes 15 per cent to the GDP. Hence 3 per cent growth in agriculture would only contribute 0.45 per cent to GDP growth. Evidently, this is a very small figure.

Annual per cent change in real GDP

Region	2019	2020 (Projection)	2021 (Projection)
India	4.2	1.9	7.4
Brazil	1.1	-5.3	2.9
Canada	1.6	-6.2	4.2
China	6.1	1.2	9.2
France	1.3	-7.2	4.5
Germany	0.5	-7.0	5.2
Italy	0.3	-9.1	4.8
Japan	0.7	-5.2	3.0
Russia	1.3	-5.5	3.5
Spain	2.0	-8.0	4.3
UK	1.4	-6.5	4.0
USA	2.3	-5.9	4.7

Source: IMF World Economic Outlook (April 2020)

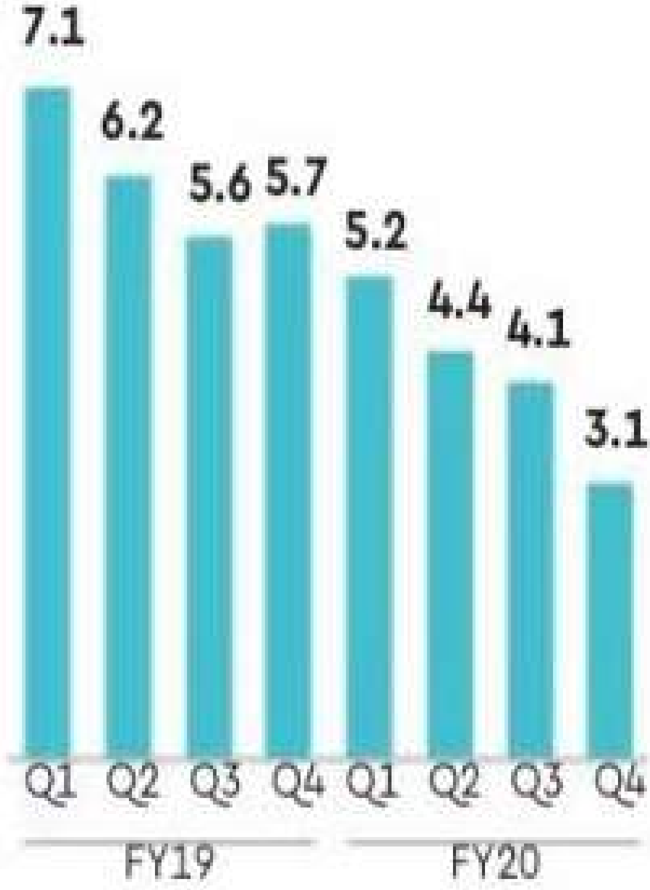
The IMF slashed its FY21 growth projection for India to 1.9 per cent from 5.8per cent projected in January, holding that the 'Great Lockdown' to combat the covid-19 outbreak will trigger the worst recession since the Great Depression in 1930s. In the case of the Indian economy, there was already a prolonged macro-economic slowdown prior to the onset of the coronavirus pandemic came because of persistent quadrupled balance-sheet problems, viz., weak financial position of banks, leveraged company balance-sheets, stressed NBFCs and seemingly intractable problems of the real estate sector. The severe disruption of economic activities caused by COVID-19, banks, both through demand and supply shocks, has overtaken the incipient recovery in the Indian economy leading to massive job losses.

Growth collapses...

(GDP, %, y-o-y)

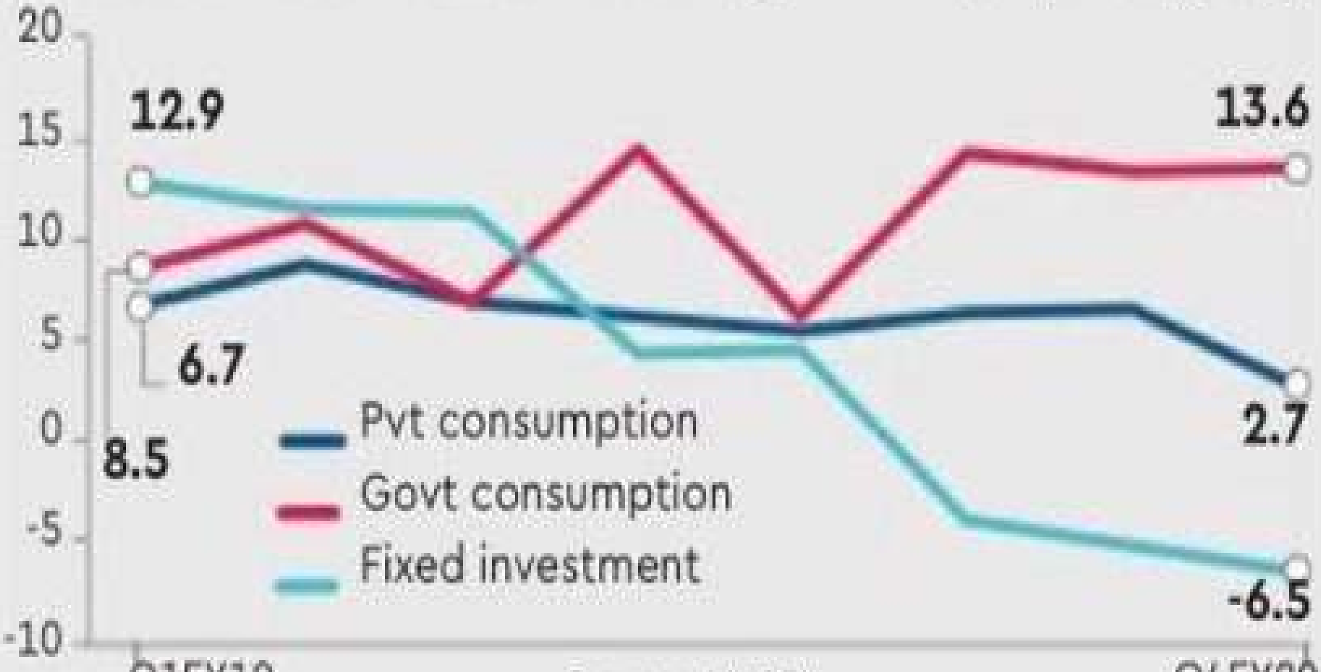
...as Covid-19 strikes

(GDP growth, %, y-o-y)



Investment falls headlong

(% growth, y-o-y)



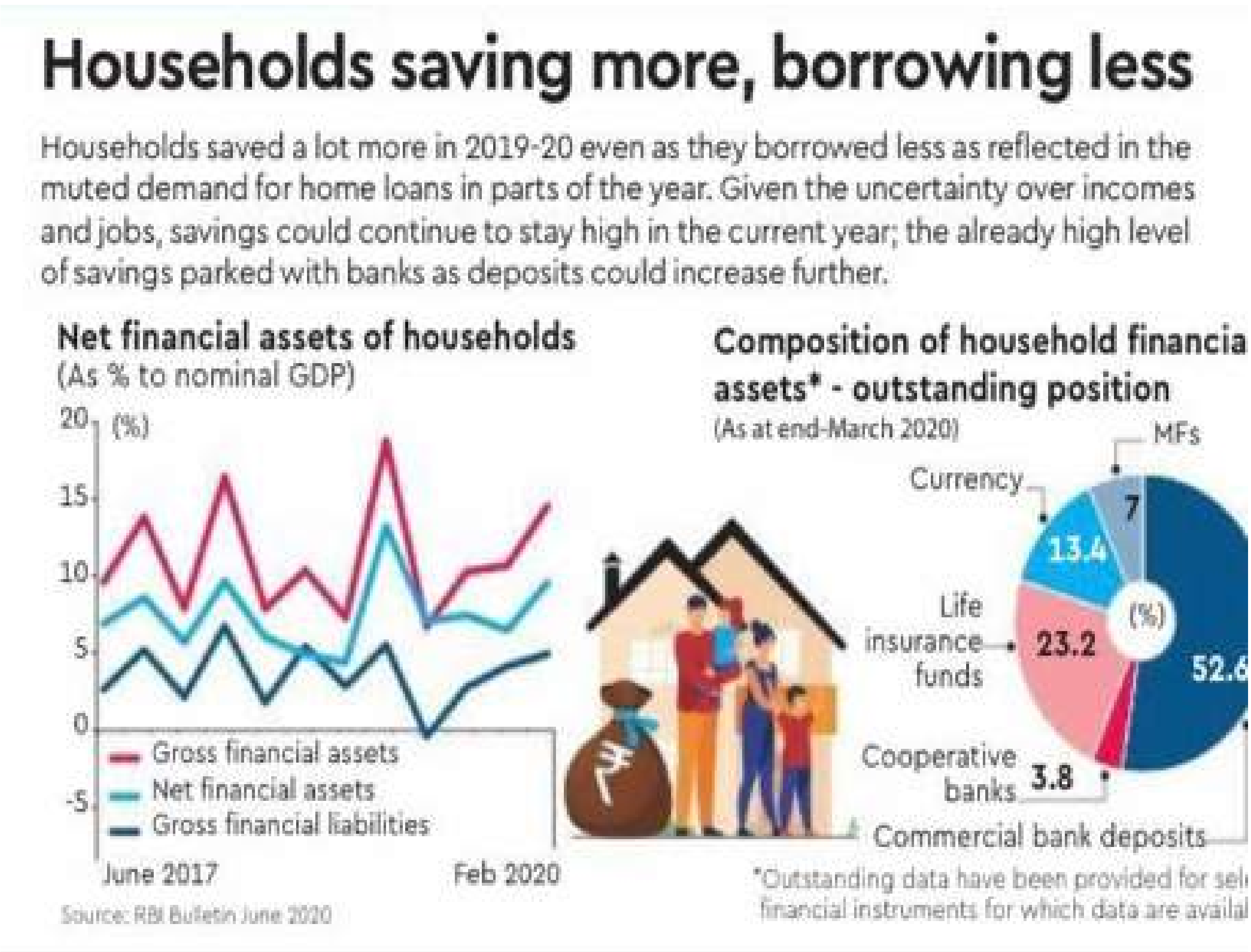
Source: MoSPI

The COVID 19 and the consequent aftermath of economic asphyxiation overshadowed the prolonged macro-economic slowdown and its discernible impact on unemployment and sectoral slumps. The IMF expects FY20 growth in India at 4.2 per cent as against 5 per cent estimated by India's Central Statistics Office (CSO). The World Bank forecasts that the Indian economy too is expected to contract by 3.2 per cent in the ongoing fiscal year (2020-21). "In India, growth is estimated to have slowed to 4.2 per cent in the fiscal year 2019/20 (the year ending in March-2020) and output is projected to contract by 3.2 per cent in fiscal year 2020/21, when the impact of COVID-19 will largely materialise". In view of the uncertainty and unfolding of the dynamic situation because of the prevalent pandemic, our sense is that GDP may decline by ~ 3 to 5 per cent this year.

Fitch Ratings on June 18, 2020 revised India's outlook to 'negative' from 'stable', stating that the coronavirus pandemic has significantly weakened the country's growth prospects for the year and exposed the challenges associated with a high public-debt burden. The move came after another rating agency Moody's earlier this month downgraded India's sovereign rating by a notch to lowest investment grade of 'Baa2' for the first time in 22 years. "Fitch Ratings has revised the outlook on India's long-term foreign-currency issuer default rating (IDR) to negative from stable and affirmed the rating at 'BBB-", the rating agency said.

Fitch expected economic activity to contract by 5 per cent in the fiscal year ending March 2021 (FY21) due to the strict lockdown measures imposed since March 25, before rebounding by 9.5 per cent in FY22. Fitch Ratings justifiably maintained, "the coronavirus pandemic has significantly weakened India's growth outlook for this year and exposed the challenges associated with a high public-debt burden. The rebound will mainly be driven by a low-base effect".

Overall credit conditions continue to be grim reflecting a global and domestic recession and a slower recovery. Sectors impacted most are aviation, travel, hotel, multiplexes, retail, small and medium enterprises and if there is leverage in these companies, there will be double whammy for them. High-ticket consumer durables are also certain to see deferred demand.

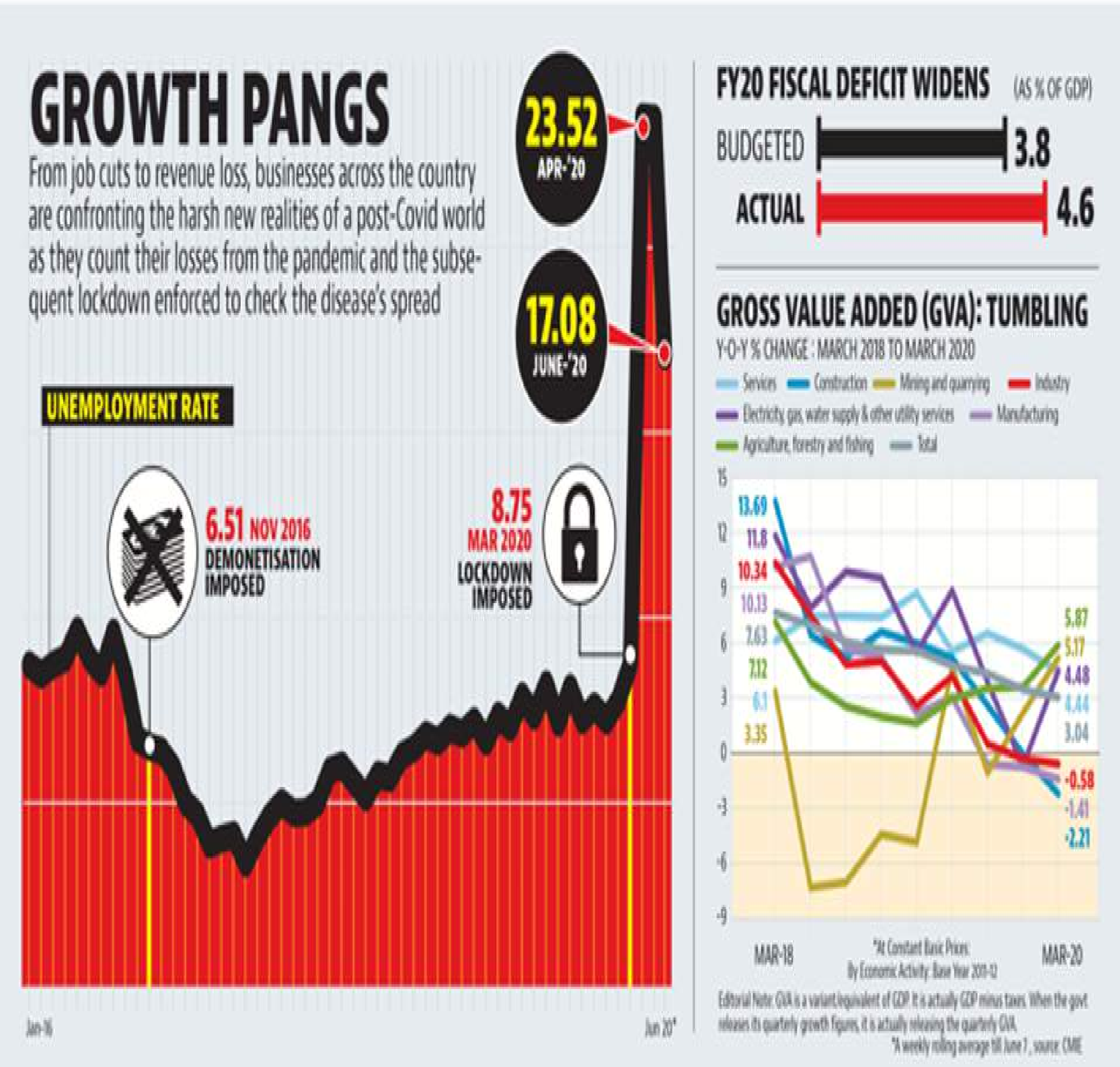


IV. OPTIONS AND CHOICES

Banks, which lack diversified exposure across sectors, are likely to face deteriorated financial position, e.g., micro-financing companies have been hit hard as they have not been able to collect payments. Companies into commercial vehicle finance are impacted, too, with 90 per cent of the trucks currently parked due to the lock-down.

The choppy global economic waters have become a defining characteristic with the whole world, advanced, emerging and low-income countries simultaneously closed down. Seeking foreign support is difficult because all other countries are passing through a similar process of fiscal stress and loose and accommodative monetary policy. The overarching macro-economic scenario is characterized by short cash, frayed supply lines, collapsed export markets and vanished workers necessitating a renewed thrust on the domestic economy. Although it included just one week of the lockdown, economic growth in the quarter ended March slumped to 3.1 per cent, despite the extremely limited impact of the lockdown in this quarter.

Despite considerable discourse, dialogue, debate and disagreement, there seems to be a consensus among the rating agencies that the GDP is likely to shrunk by more than 5% during FY 2021. Growth could, however, quickly gain traction next year to register a growth of 4 to 6 per cent next year, partly on a negative base.



V. CONCLUDING OBSERVATIONS

The RBI has been purchasing government bonds to further ease the financial conditions. The Indian government has also increased its spending on healthcare to bolster the COVID-19 response, wage support, in-kind and cash transfers to lower-income households, deferral of tax payments, as well as loan and liquidity support for small businesses and financial institutions.

The greatest threat to the economy during lockdown is the asymmetric financial obligations created by it. Producers and sellers of goods and services are required to shut down under the disaster management act without any concomitant change their legal obligations to pay rents & interest, repay debt, and for companies with more than 100 employees to keep employees on payroll and pay full wages. Some Governments worsened this asymmetry by ordering SMEs with less than 100 workers, to pay full wages. This could make things difficult.

The RBI could remove the asymmetry with respect to interest payments and debt repayments and the Govt. should remove all other asymmetric legal obligations which are likely to push firms into bankruptcy. The RBI's extension of moratoriums and conversion of accumulated interest into term loans are welcome steps in this direction.

The RBI needs to focus on sectors which have been NPAs since the global financial crisis, those which bore the brunt of the 2019 growth slowdown and those which will continue to suffer from the pandemic. These will need a comprehensive loan restructuring package, once the lockdown is phased out nationally. The RBI and the Government should devise a comprehensive framework, which will also deal with the Public Sector Banks (PSBs) confronted with the issue of mounting NPAs.

The MPC took the right call to revive growth and mitigate the pandemic's adverse impact while checking inflation. While in the medium term, both the monetary and fiscal policy must move in tandem, the fiscal policy has to play a more active role.

There is a compelling need for synchronized efforts by all stake-holders, viz., the Central and State governments, doctors, nurses, planners and policy-makers and even those at the helm of affairs in the government and various tiers of administration. All stake-holders must play their part in meeting this challenge.

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