Covid Pandemic And Indian Industries:

An Effort To Rebound Amid Surmounting Challenges

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The Indian economy has grown by 8.7 per cent in FY22, whereas the growth in the fourth-quarter of 2022 is a moderate 4.1 per cent. Nevertheless, the credit off-take has shown notable growth in recent times. The credit demand is used both to cover increasing costs, as well as for demand and capacity expansion. In particular, housing, vehicle loans, and certain personal loans in 'other' categories are experiencing their growth momentum. During the financial year 2022(FY22), the construction sector (including steel, cement and others) has exhibited impressive growth in terms of revenue in comparison to previous year.

Despite such signs of recovery, the Indian economy is still not completely out of the woods, in fact, it is facing looming challenges. For instance, in the first five months of 2022, foreign investors (Foreign Institutional Investors or FIIs) have sold USD 23.4 billion from the equity segment. While the Indian government's decision of imposing export duty on iron ore and certain steel products would be helpful in increasing domestic availability of raw materials, as well as to control domestic inflationary trends to some extent, but on the other hand, the steel industry is facing some hiccups as a fallout of this policy.

The global market sentiment is also weak amid inflationary challenges, geopolitical tensions and forthcoming Fed rate hike. The World Bank has also revised growth forecast for 2022 downwards to 2.9 per cent from 5.7 per cent. The External Commercial Bank (ECB) will end net purchases of asset purchase programme by July 2022, as well as intends to increase interest rates by 0.25 per cent in July'22 and likely to increase them again in September'2022. In India, The assumption of crude oil remaining at $105/barrel is a bit conservative, given the current pace of rate hike, if crude rises further, rates would be further front loaded at faster pace, which would hurt growth. In this backdrop, this paper throws an analytical perspective on future growth momentum of Indian industries as well as current challenges that some of the industries are facing.

Keywords: Capacity expansion, credit demand, Foreign Institutional Investors, export duty, steel, construction, inflation, crude oil, economic growth.

JEL Code: L52,L61,L62,L64, L67, L74, L78.

Introduction

Though it is well-known and much deliberated to us, still It is useful to pick-up certain lines from Martin Wolf's piece from the FT, published recently in "Disease and war are shaping our economy". To sum up in a phrase "It was not familiar economic forces that caused the upheavals of recent years, but Covid and the war in Ukraine. These huge surprises have also reminded us that it is impossible to forecast the economy." An argument can be made that economic policies we need that will try minimizing such adverse impacts caused by external factors, and we have to frame policies since such external factors are impacting our economies.

The first tinker is that sharp appreciation of the dollar is potentially devastating for borrowers with large dollar-denominated liabilities. The strong US dollar index and treasury yields have reversed to certain extent the movement of capital flows, especially fixed income products from EM markets to US. There may not be a general debt crisis, but debt crises in vulnerable countries are certain. Some (or many?) pundits yelled at the time of the so-called quantitative easing (QE), that basically US policymakers are creating a bubble that is surely going to burst in future, which will have repercussion effects for the global economy.

To reiterate the phrase from Buffet and Bryan Rich ("Pro Perspectives") "only when the tide goes out, do you discover who's been swimming naked." The "tide" in this case, is the easy money, low inflation era. Well, policymakers can counteract by saying "all of your crises (global financial crisis 2008, Covid, war etc; are human-made or nature-made, not due to economic reasons, what else we could have done except for such optimal policies to support the broken producers and other economic agents?" Fair enough. We can try to learn lessons from the past, so that we can avoid same mistakes in the future, and we know catching up with human psychology of certain sections causing such disruptions is impossible, hence often not possible to pre-empt.

As expected, Fed minutes meeting has indicated at their last meeting that they expect higher interest rates to remain in place until prices come down. They stick to 2% to indicate their strict attitude in reducing inflation and providing clear message to the market so as to anchor inflation expectations as much as correctly they can. At the current juncture, it seems even if that goal can be achieved at all, it will be a dream-distant, as CNBC1 reported that Fed's preferred inflation gauge of consumer price expenditures rose 6.2% from a year ago.

Consumer survey from participants indicate that recent inflation data generally had come in above expectations and that, correspondingly, inflation was declining more slowly than they had previously been anticipating. Inflation is especially taking its toll on lower-income Americans. This is also highlighted by Wolf, who stressed the need to protect the vulnerable. The "cost of living" crisis is the worst possible time to slash spending on the weakest sections of the society.

In Indian context, the YOY retail inflation is very high during September'22 among states like West Bengal (9.44%), Telangana (8.67%), Madhya Pradesh (8.65%), Andhra Pradesh (8.06%), Odisha (8.06%), Maharashtra (8.03%) [benchmarking states having yoy CPI inflation above 8%]. Highest product-level inflation is observed in Cereals (11.53%), vegetables (18.05%), Spices (16.88%). The monthly rural inflation has increased from Aug'22 to Sept'22 from 7.15% to 7.56%, and urban inflation has increased from 6.72% to 7.27. The decline in rupee possibly would not be able to take much benefits of export competitiveness, since it takes time for diversifications of markets and product sophistications (India needs time to catch up), and also due to weak global demand.

Producing new products, demand for which might have been generated in the Covid-era instantly will be difficult, and obviously we have certain disadvantages in this regard compared to countries like China. India has lost substantial foreign exchange reserves in an attempt to protect rupee, i.e. the nominal exchange rate, and an argument is often made that the real effective exchange rate or REER is overvalued, so let the rupee decline a bit to correctly reflect its true REER, and let's not waste our precious forex reserves. In an attempt to balance between the two, i.e. maintain a stable exchange rate as well as to save forex reserves, the RBI has resorted towards certain market measures like buy and sell swap options.

However, the RBI's earlier attempt to enhance forex reserves by incentivizing foreign inflows and from NRI sources was not very successful. And, selling dollars at spot market will help to stabilize rupee, but if it is tried to be balanced by buying at forward markets, not sure how would be the impact on the forward premium. A step has been taken by the RBI to prevent local banks not to build additional positions in the non deliverable forward (NDF) market, to prevent the spillovers of offshore volatility in the domestic market.

On the other hand, the pitfall is that importers are getting affected, and many small and medium players might not be able to opt for costly financial hedge (except for the natural benefit of the natural hedge). Couple of years back, many market players were blamed they were not hedging (even if they could possibly) just because they thought that the RBI would not allow to depreciate rupee beyond a certain level of exchange rate, a typical case of the 'moral hazard' problem.

The Global Scenario

Global uncertainty surrounding the course of geopolitical conditions weighs heavily on the inflation outlook and recession risks in advanced economies (AEs) are rising. In India, the domestic reservoir levels are comfortable though the risk of crop damage from excessive/unseasonal rains, however, remains. Elevated imported inflation pressures remain an upside risk for the future trajectory of inflation, amplified by the continuing appreciation of the US dollar. The outlook for crude oil prices is highly uncertain and tethered to geopolitical developments. The Reserve Bank's enterprise surveys point the pass-through of input costs to prices remains incomplete.[1]

Significant risks have build-up due to Russia-Ukraine military conflict that escalated an acute energy crisis in Europe and recession for certain developed economies seems prominent. If the Fed raise the federal funds rate by 5% during mid2023, growth will be significantly affected. Further rate hike could dampen the US stock market as well as capital outflows will spendthrift from the emerging market economies, as well as increasing liabilities in dollar denominated debt. In the first half of 2022, US real GDP declined outright, overall real consumer spending grew at just one-fourth of its 2021 pace, and residential investment declined by 8%.1 High inflation, especially in food and gas prices has restrained consumer spending by reducing real purchasing power. Price increase in food and energy are especially hard on low-income families, who spend ¾ th of their income on necessary items like- food, gas, shelter. Food price pressures continue to worsen due to Russia-Ukraine war and extreme weather in US, EU, China. The PCE index for food and beverages has increased each month in 2022 by an average of 1.2%, resulting in an 8.5% cumulative increase in the index year-to-date through July. Core inflation (excluding volatile food and energy prices) moderated in July, but it is necessary to observe whether the trend continues in subsequent months as well. The time that will take towards inflation back to 2% will depend on the following:

- Continued easing in supply constraints
- Slower demand growth
- Lower mark-ups
- Delivery times and supply of some goods show some improvement

Labour force participation shows a welcome increase in the August employment data particularly women in the age 25-54 years have increased. According to some leading Economists, measuring labour demand by adding aggregate employment by job vacancies and then compares that with the labour force, shows while demand still exceeds supply, the gap has started to narrow down. The unemployment rate has declined (net) from 4% in Jan to 3.7% in August. Hourly wage growth slows marginally in August showing some easing. Excluding volatile energy and food prices from Price index 6.3% in July, the Core inflation remains at 4.6%, and easing of supply disruptions, such as used cars, will further lower core inflation.

There is a need to focus on the ratio of job openings/unemployment and median inflation since this will assess the tightness of labour market and underlying inflation. If inflation expectations can be controlled, probably with "tough talk" of 75 basis points in the next meeting, the actual

[1] "Minutes of the Monetary Policy Committee Meeting, September 28-30, 2022"(14 October 2022)[https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=54541]

inflation can show downward trend. Finally, it needs to be observed if the inflation shows a moderation trend, even at 3% would be fine instead of 2%, given the societal cost or unemployment trade off. So, for instance, the economy probably can accept a 3% r.o.i at 5% unemployment rate, rather than a 2% r.o.i with a 6.5% unemployment rate or more.

Mark-up reduction will be a significant contributor towards reduced pricing pressures, as data shows at the sectoral level that margins remain high in areas such as motor vehicles and retail. Divergence between retail and wholesale prices suggested an unusually large retail auto margin. Overall retail margins (the difference between the price retailers charge for a good and paid for that good) have increased significantly, and more interestingly, this has increased substantially more than the average hourly wage that retailers pay workers to stock shelves, suggesting there is scope for a reduction in such retail margins. With Gross Retail Margins (GRM) amounting to about 30% of sales, a reduction in currently elevated margins could make an important contribution to reduced inflation pressures in consumer goods.

Nevertheless, inflation in US remains still a major challenge, which is reflected from the Fed (7 September 2022) “The Biege Book”, to quote “Price levels remained highly elevated, but nine Districts (out of twelve) reported some degree of moderation in their rate of increase. Substantial price increases were reported across all Districts, particularly for food, rent, utilities, and hospitality services. While manufacturing and construction input costs remained elevated, lower fuel prices and cooling overall demand alleviated cost pressures, especially freight shipping rates. Several Districts reported some tapering in prices for steel, lumber, and copper. Most contacts expected price pressures to persist at least through the end of the year.”

An important takeaway is that the effect of the increased policy rate and pace of balance sheet shrinkage should put downward pressure on aggregate demand, particularly in interest-sensitive sectors like housing. Expending an entire paragraph on housing, Governor C. J. Waller stated, “the housing market is a significant channel for monetary policy, and I will be watching this sector carefully.” 2Very importantly, quote unquote, “Following a lengthy sequence of adverse supply shocks to goods, labour and commodities that, in combination with strong demand, drove inflation to multidecade highs, we must maintain a risk management posture to defend the inflation expectations anchor. While we have no control over the supply shocks to food, energy, labor or semiconductors we have both the capacity and the responsibility to maintain anchored inflation expectations and price stability.”

Governor C. J. Waller is also of the opinion that forward guidance is becoming less useful at this stage of the tightening cycle. Future decisions on the size of additional rate increases and the destination for the policy rate in this cycle should be solely determined by the incoming data and their implications for economic activity, employment, and inflation. Further, he has made certain strong and credible arguments as follows:

"*While I welcome promising news about inflation, I don't yet see convincing evidence that it is moving meaningfully and persistently down along a trajectory to reach our 2 percent target. I keep in mind that a year ago we saw similarly promising evidence of inflation moderating for several months before it jumped up to a high and then very high level. Those earlier inflation readings probably delayed our pivot to tightening monetary policy by a few months. The consequences of being fooled by a temporary softening in inflation could be even greater now if another misjudgment damages the Fed's credibility. So, until I see a meaningful and persistent moderation of the rise in core prices, I will support taking significant further steps to tighten monetary policy*."

The European Central Bank (ECB) on 8 September 2022, raised the three major interest rates by 75 basis points. The interest rate on the main refinancing operations is increased to 1.25%, interest rate on marginal lending facility is increased to 1.50%, interest rate on deposit facility is increased to 0.75%. Since the deposit facility rate is raised above zero, the two-tier system for the remuneration of excess reserves is not required; hence it is suspended by setting the multiplier to zero.

According to Eurostat's flash estimate, inflation reached 9.1% in August 2022. Some of the major driving factors are as follows:

• Elevated energy and food prices.

• Demand pressures in some sectors due to the re-opening of the economy.

• Supply bottlenecks ECB have revised their inflation projections as follows:

(a) 8.1% in 2022

(b) 5.5% in 2023

(c) 2.3% in 2024

Economic Growth projections are as under:

(i) 3.1% in 2022
(ii) 0.9% in 2023
(iii) 1.9% in 2024

German angst felt at their worst energy crisis, and the German Chancellor Olaf Scholz blamed its previous government for failing advancement towards renewable energy and higher dependency on Russian gas. A new relief measure of 65 billion euro has been announced to be funded partly through windfall profits from energy companies.4 European Union (EU) is also considering plans to redistribute some electricity producers' windfall revenues to households and companies facing high energy prices.

GDP growth projections: Select Advanced Economies (AEs) and EMEs)

Countries	Oct'2022	July'2022
US	1.6	2.3
UK	3.6	3.2
Euro Area	3.1	2.6
Japan	1.7	1.7
Brazil	2.8	1.7
Russia	-3.4	-6.0
India	6.8	7.4
China	3.2	3.3
South Africa	2.1	2.3

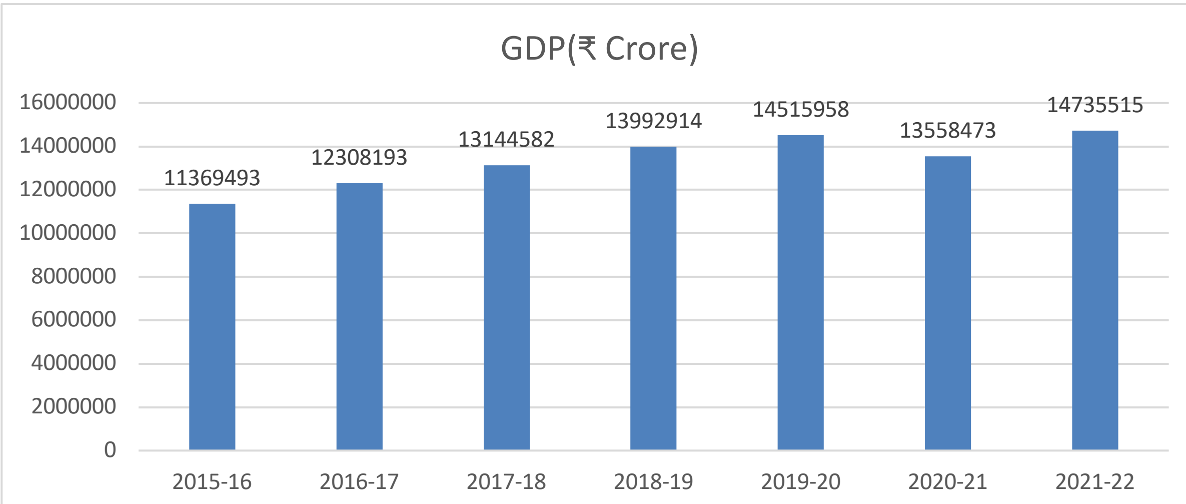
Source: IMF, RBI Bulletin October 2022

The Indian Scenario

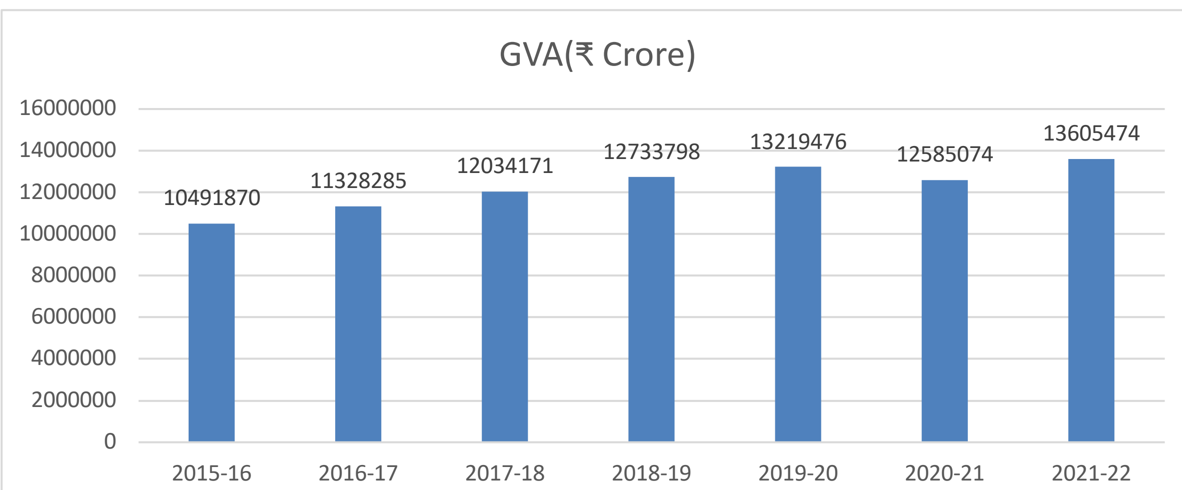
According to the Monetary Policy Committee (MPC) of the RBI, inflation is likely to be above the upper tolerance level of 6 per cent through the first three quarters of 2022-23, with core inflation remaining high. The outlook is fraught with considerable uncertainty, given the volatile geopolitical situation, global financial market volatility and supply disruptions. Food & Beverages and fuel & light sub-groups of the CPI registered YOY rates above 7 per cent throughout this period from March to August, except for a rate of 6.7 per cent in the case of food & beverages in July. Only in the case of housing and pan, tobacco and intoxicants, among the major categories of CPI, with a combined weight of 12.45 per cent in the CPI, the inflation rate was below 4 per cent during the period, except for housing price index which rose by 4.1 per cent in August. Among the other remaining sub-categories, clothing, and footwear registered inflation rate of about 9 per cent and the other remaining consumption items constituting 'miscellaneous' sub-category registered inflation rate of above 7 per cent in March and April.

As highlighted by Prof. Shashank Bhide in 14 October 2022 monetary policy minutes,

"*The RBI survey of households conducted in September 2022 on price expectations indicates expectations of continued high rate of inflation, with the average expected inflation rate being higher than in the survey conducted in July 2022. Inflation rate is also expected to be higher 3-months ahead and one-year ahead compared to the prevailing situation. The expectations of future price readings appear to be affected more by the present conditions than the likely impact of the decline in the commodity prices in the international markets. The survey of enterprises (Industrial Outlook Survey) conducted by RBI in September 2022 reflects some relief on selling prices in H2:FY2022-23 as the proportion of respondents who expect selling prices to rise drops compared to Q2: FY 2022-23. Although financing costs are expected to increase, other input cost pressures are expected to decline. The Wholesale Price Index, reflecting the price conditions at the producer level, has registered double digit rate of increase YOY basis in July* *and August. While there is a variation in the price changes across the broad range of commodities, in a few major categories of commodities, the price rise is significant. In the case of vegetables, fruits, crude petroleum, petrol, diesel, LPG and electricity, the WPI increased at double digit rates in July and August. In the case of cereals, the increase was 9.8 per cent in July and 11.8 per cent in August. The impact of decline in international market prices on domestic prices is yet to pass through to the domestic consumer prices*."[2]



Source: The RBI "HANDBOOK OF STATISTICS ON INDIAN ECONOMY"(15 September 2022).



Source: The RBI "HANDBOOK OF STATISTICS ON INDIAN ECONOMY"(15 September 2022).

[2] "Minutes of the Monetary Policy Committee Meeting, September 28-30, 2022"(14 October 2022)[https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=54541]

While the Covid and subsequent geopolitical tensions manifested in Russia-Ukraine war ravaged the global economy, and as India has also been impacted, certain economic indicators have shown positive rebounds. For instance, GST collections (Centre plus states) recorded a robust year-on-year (y-o-y) growth of 26.2 per cent and stood at INR 1.48 lakh crore in September 2022. E-way bills generation recorded 84 million in September, on the back of increased economic and trading activity in the economy induced by festive season. According to the Federation of Automobile Dealers Association (FADA) [10th Ocober'2022], compared to Navratri'19 (which was prior to covid), total retails increased by 16%. Here too, all categories showed positive momentum with 2W, 3W, CV, PV and Tractors growing by 4%, 31%, 37%, 59% and 90% respectively.[3]

Commercial vehicle sales registrations also increased in September, led by an increase in sales of heavy commercial vehicles due to bulk fleet purchases. As highlighted by the RBI October 2022 bulletin,[4] sales of fast-moving consumer goods (FMCG) products increased by 12 per cent (y-o-y), driven by double digit growth in commodities and packaged food. Price corrections led to a sequential decline in value growth in September 2022, even as volume growth sustained in both urban and rural areas. In rural areas, demand for work under the Mahatma Gandhi National Rural Employment Act (MGNREGA) increased marginally in September. India's merchandise exports at US$ 35.4 billion recorded growth of 4.8 per cent on y-o-y basis, despite a sequential decline of 3.8 per cent in September. There are certain impact of the export tax imposed on iron and steel products.

Top ten export commodities of India (September 2022)

Commodities	**Share(%)**	**USD Billion**	**YOY Growth(%)**	**MOM Growth(%)**
Engineering Goods	24	8.4	-10.9	1.2
Petroleum Products	18	7.4	43	-12.5
Gems and Jewellery	11	3.8	17.3	13.9
Organic and Inorganic chemicals	**7**	2.4	3.0	-6.1
Drugs and Pharmaceuticals	6	2.2	6.9	2.4
Electronic goods	6	2.0	72.0	16.7
RMG of all Textiles	3	1.1	-18.1	-13.6
Cotton	2	0.8	-39.0	-9.5

[3] https://fada.in/images/press-release/16343da04dd6efFADA%20Releases%20Navratri%E2%80%9922%20Vehicle%20Retail%20Data.pdf

[4] https://rbidocs.rbi.org.in/rdocs/Bulletin/PDFs/1STATEOFTHEECONOMY33D23E6FAEC747C18FA8595A5AA81091.PDF

Yarn/Fabs./Madeups, Handloom products etc.				
Rice	2	0.8	1.6	-23.9
Marine Products	2	0.7	6.3	8.7

Source: Ministry of Commerce & Industry, RBI October Bulletin.

As per the Reserve Bank's annual survey on exports of computer software and information technology enabled services (ITES) 2021-22, North America accounts for more than a half of total software exports, followed by Europe.[5]

India's merchandise imports remained above US$ 60 billion for the fifth consecutive month in September 2022, however import growth moderated to 8.7 per cent on a y-o-y basis and declined sequentially by 3.8 per cent. During H1:2022-23, imports were US$ 380.3 billion, growing by 38.6 per cent. An analysis of the top 10 major commodity groups reveals that items such as crude products, electronic goods, machinery and chemicals witnessed contraction on a sequential basis in September'2022.

Concluding Remarks:

The Covid pandemic has changed the entire global economic situation, after which the Russia-Ukraine war has further complicated the situation. Putin continues its threat dominance, while adding earlier that to it curtailing grain export from Ukraine and he would retaliate if a price cap were imposed by the Western countries on Russian crude exports. He has highlighted that Russia has contractual obligations on energy deliveries but might alter their strategy and plan if a price cap is imposed.

On the other hand, China is facing both the NPA issues and weakening loan demand. There are substantial overdue amounts from property loans that the top Chinese lenders like Bank of China, China Construction Bank, the Industrial and Commercial Bank of China, Agricultural Bank of China are facing. China is also facing issues in its exports, and a part explanation is its factory production is disrupted due to power shortages caused by severe drought and heat wave in Central China. Widespread lockdowns in China in an attempt towards zero Covid policy has also played a role.

The UK prime Minister Liz Truss apologized on the "Mini Budget" mistakes that crashed the country's currency, unnerved financial markets and led to her firing her finance minister and closest political ally. Truss replaced Chancellor of the Exchequer Kwasi Kwarteng with Jeremy Hunt, a former cabinet minister would reverse "almost all" tax

[5] "Census on Foreign Liabilities and Assets of Indian Direct Investment Entities for 2021-22 - Data release"(22 September 2022) RBI Press Release; https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=54408

measures announced three weeks ago by his predecessor. The stunning reversal would raise £32 billion ($36 billion), he said.[6]

It seems, the tide for India is likely to be tilted as directed by the storm coming from the developed economies like US, UK and developments of the Russia-Ukraine war impact having large global repercussions impact. The current challenge in today's world is that the global politics has taken a grimy shape. The implication of this statement is that the scope of choice for internal policies would be less for India to influence its own economy, instead it needs to balance with the global tempest.

[6] "UK Prime Minister Liz Truss apologizes for mini-budget 'mistakes'"(17 October 2022), CNN Business[https://edition.cnn.com/2022/10/17/uk/liz-truss-mini-budget-apology-bbc-intl-hnk/index.html[https://edition.cnn.com/2022/10/17/uk/liz-truss-mini-budget-apology-bbc-intl-hnk/index.html]

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