



# *Quarterly Review of the Economy, 2020:1Q* *in Coronavirus times*

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# QRE Team

## **Team Members**

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# Outline

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

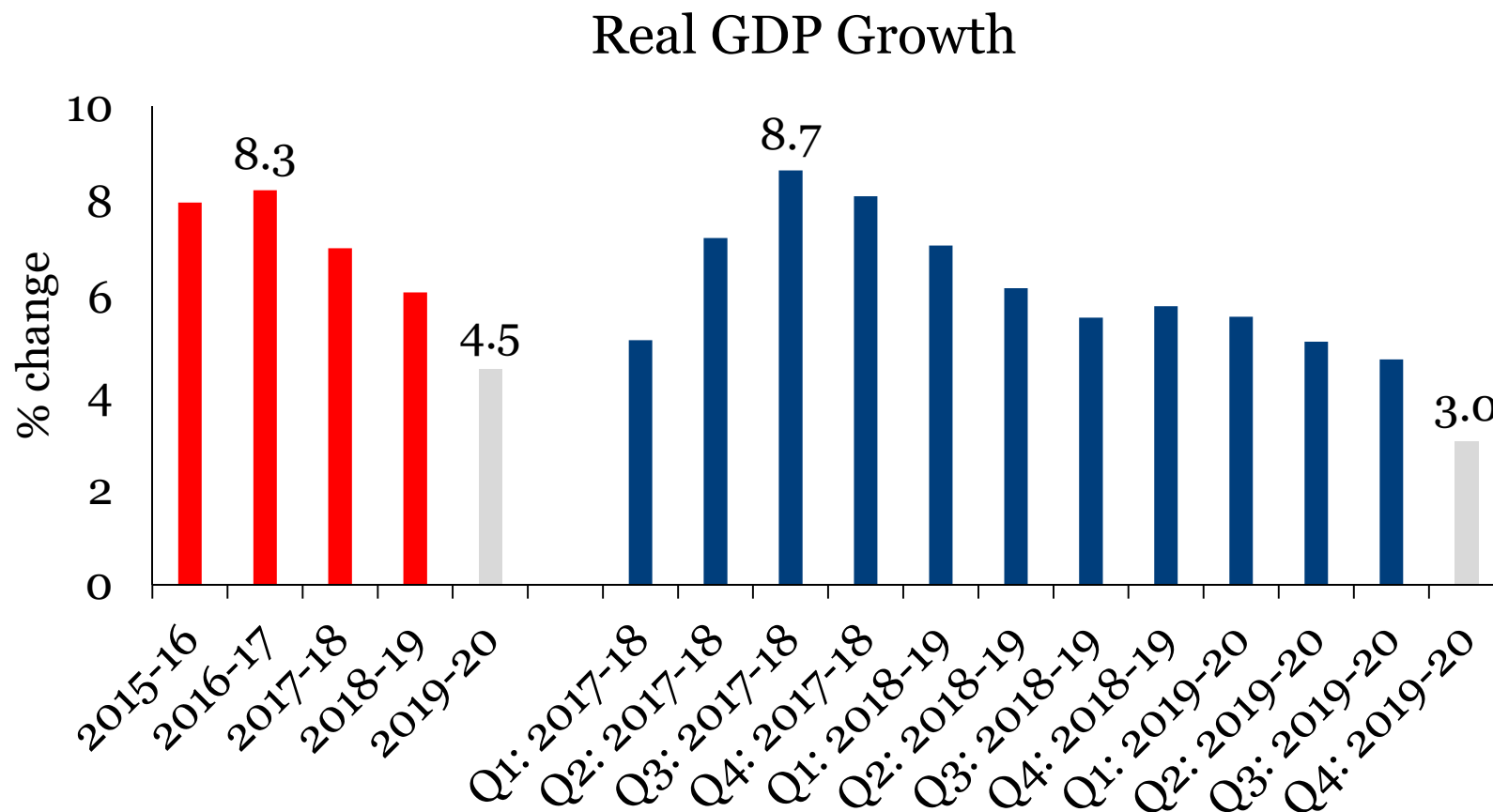
- A. Real Sector Trends
- B. Demand-side Trends
- C. Business Sentiments
- D. Price Trends

## **II. Policy Simulations**

## **III. Macroeconomic Policies**

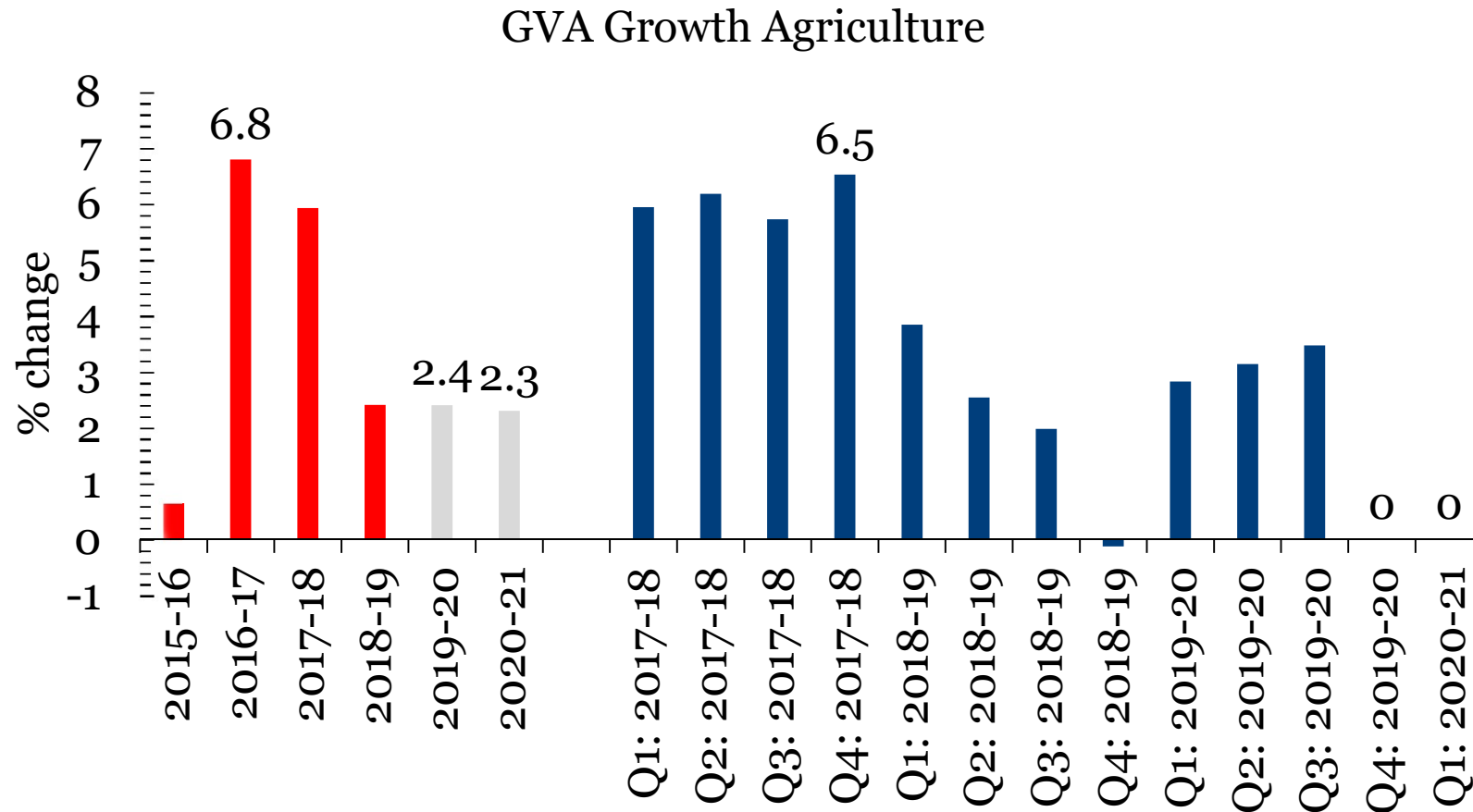
- A. Fiscal Policy
- B. Monetary Policy and Credit

# Sustained decline in GDP Growth since 2016-17 before coronavirus crisis



Legend: \_ Annual; \_ Quarterly and \_ projections.  
Source: MoSPI and NCAER Estimates.

# Sharp decline in agricultural growth since Q4: 2017-18



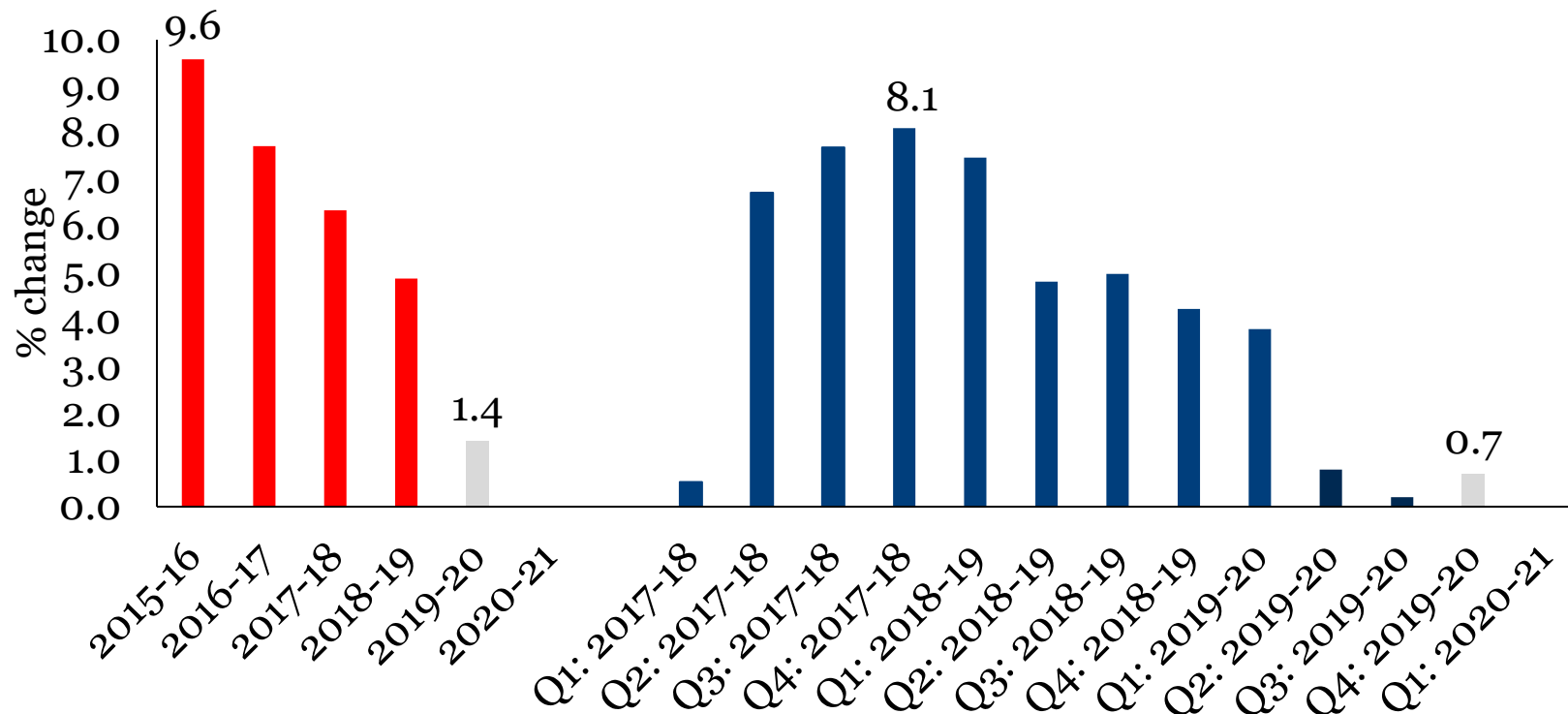
Legend: █ Annual; █ Quarterly and █ projections.

Source: MoSPI and NCAER Estimates

# Steep Decline in Industrial Growth since Q1: 2018-19

Expected decline of (-)27% in 2020-21 and (-)54% in Q1: 2020-21

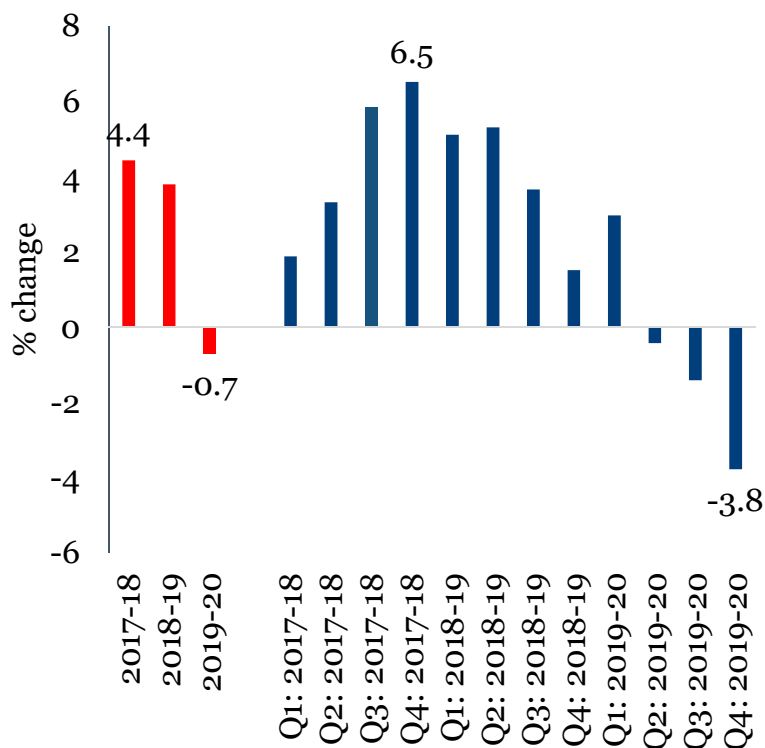
Growth in Industry GVA



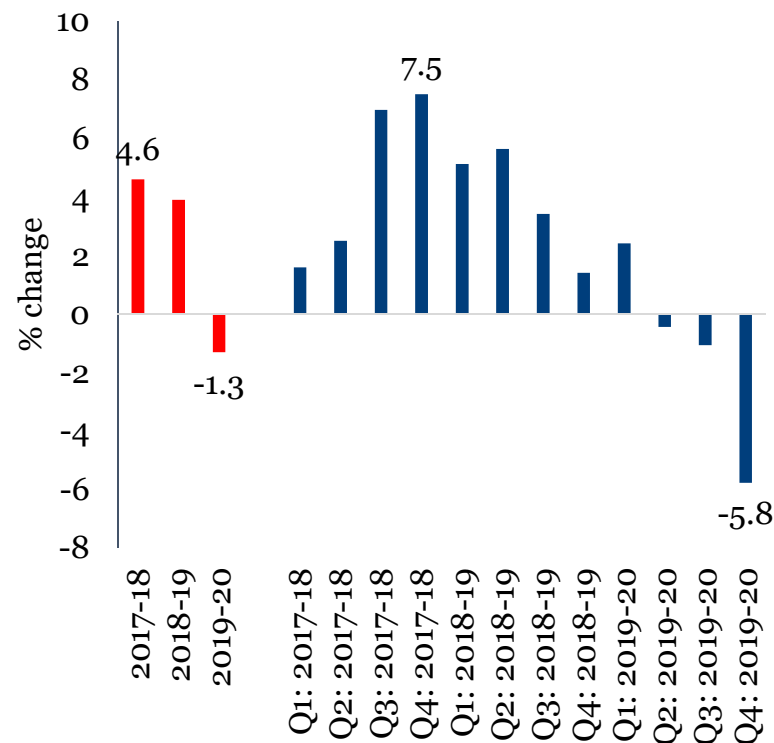
Legend: \_ Annual; \_ Quarterly and \_ projections.  
Source: MoSPI and NCAER Estimates

# IIP confirms continuing industrial slowdown

Growth (%) in IIP General

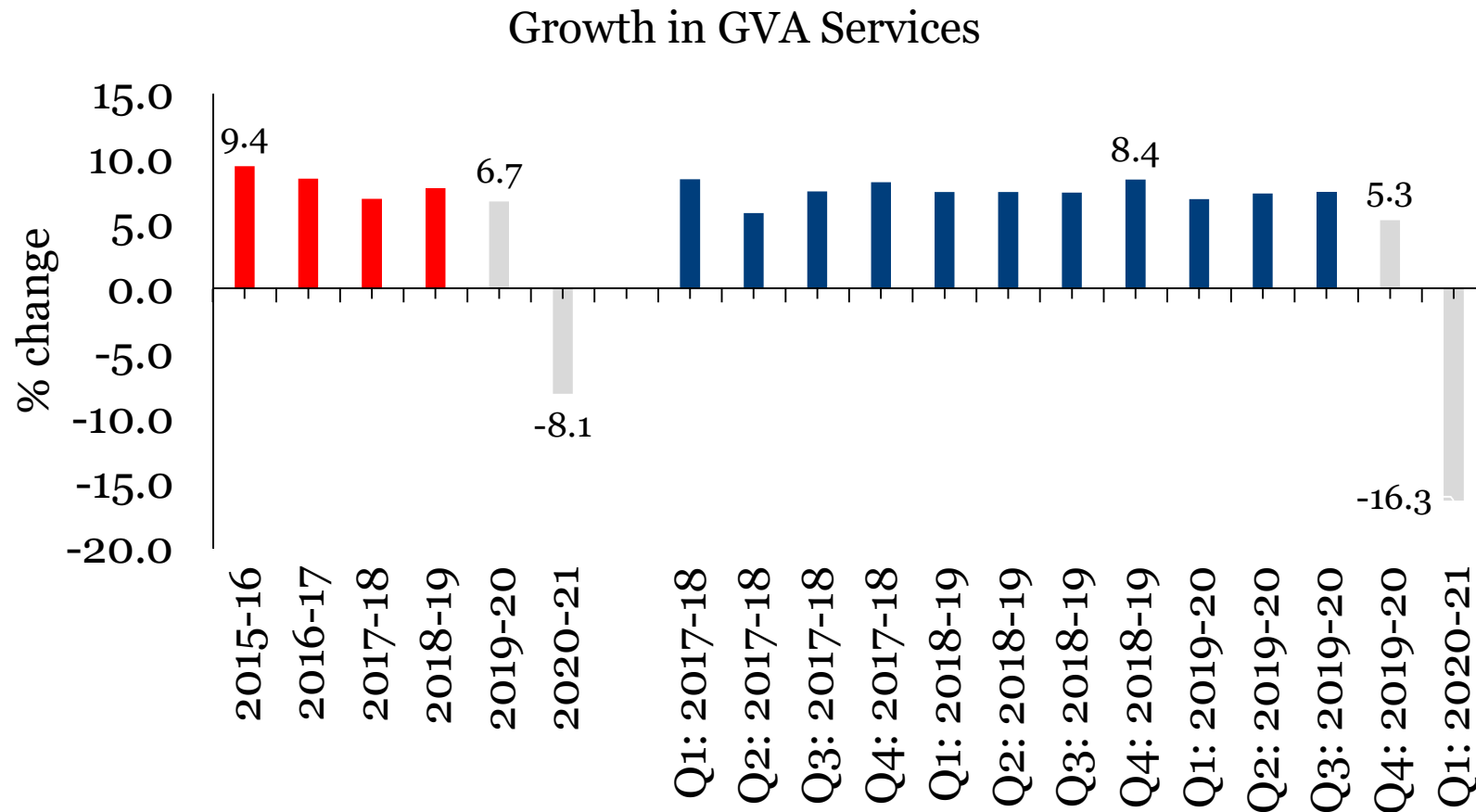


Growth (%) in IIP Manufacturing



Legend: \_ Annual; \_ Quarterly and \_ projections.  
Source: MoSPI and NCAER Estimates

# Sharp decline in services growth projected for 2020-21

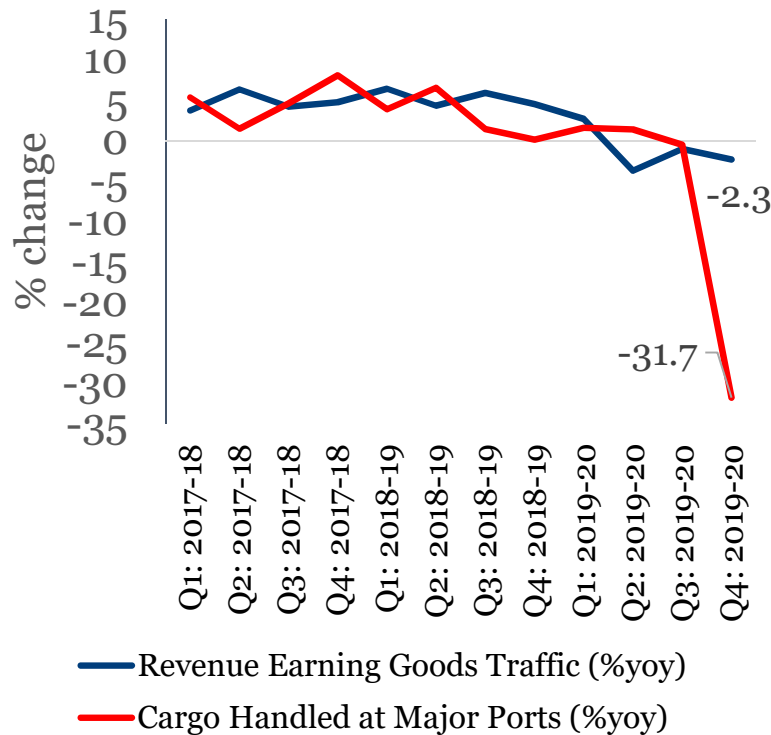


Legend: \_ Annual; \_ Quarterly and \_ projections.

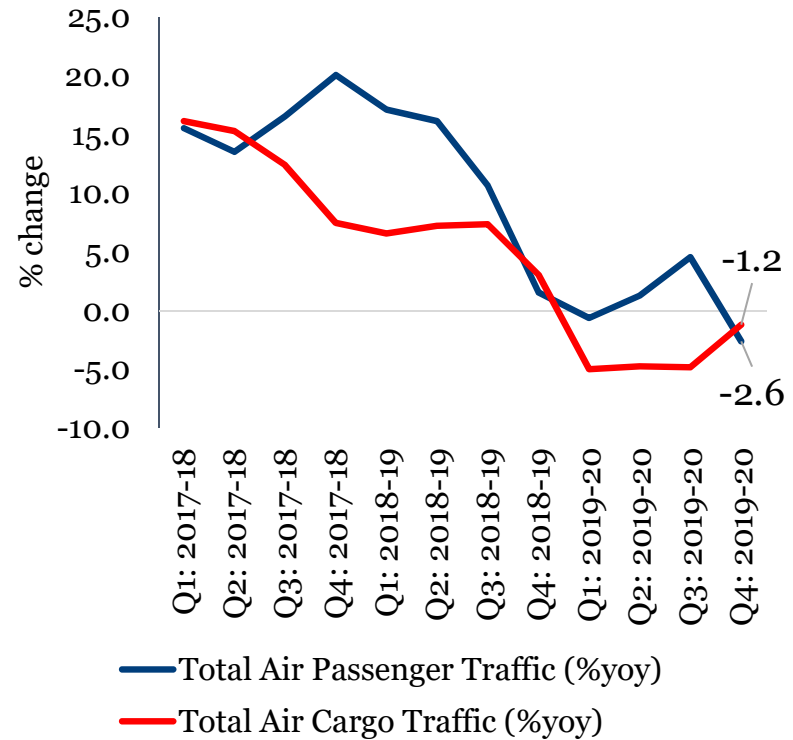
Source: MoSPI and NCAER Estimates

# Cargo and passenger traffic continue to decline

Revenue Earning Goods Traffic and Cargo Handled at Major Ports



Air Passenger and Cargo Traffic



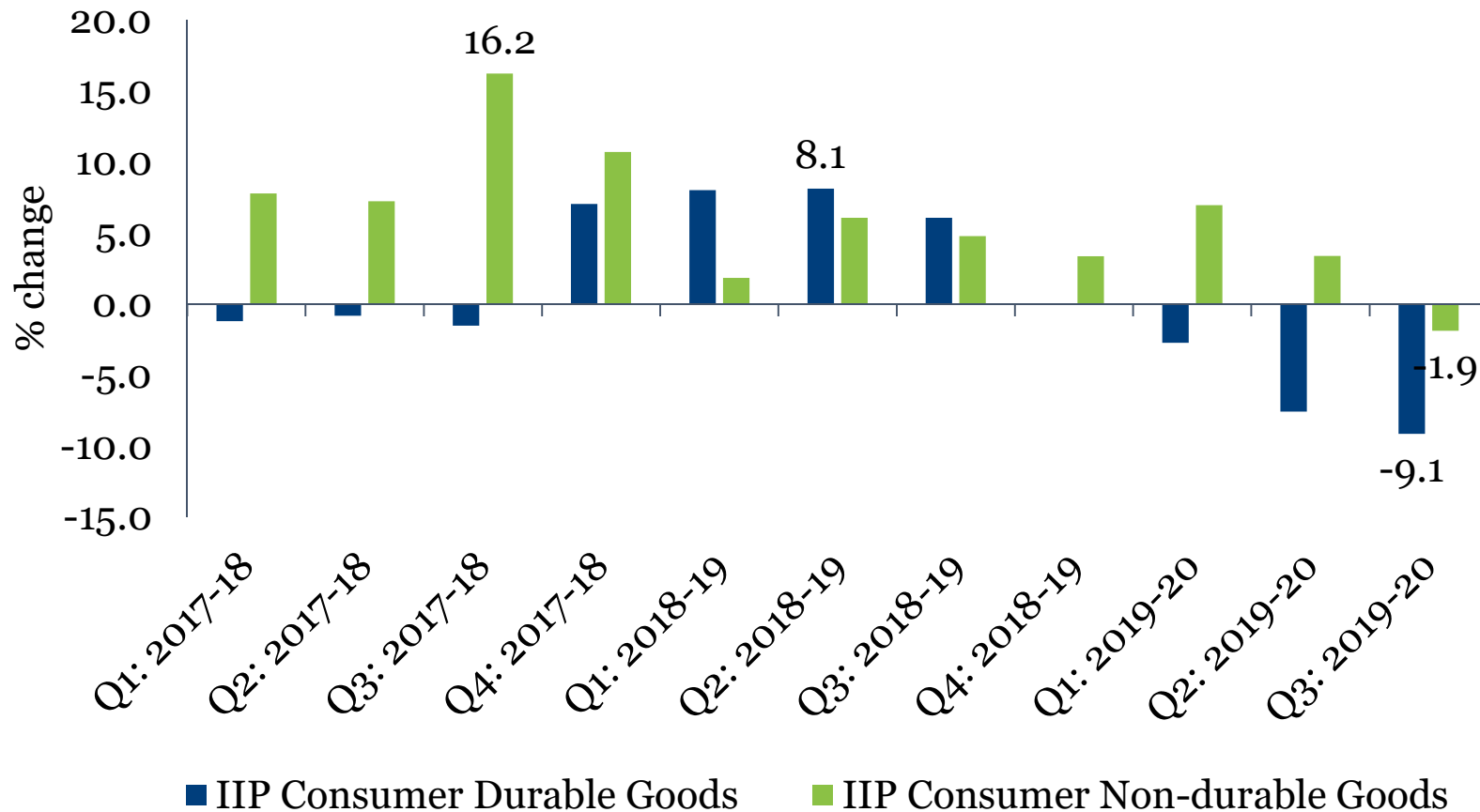
Legend: \_ Annual and \_ Quarterly

Note: The data for Air traffic are from January-February 2020.

Source: CMIE and Airports Authority of India.

# Consumption demand declining sharply

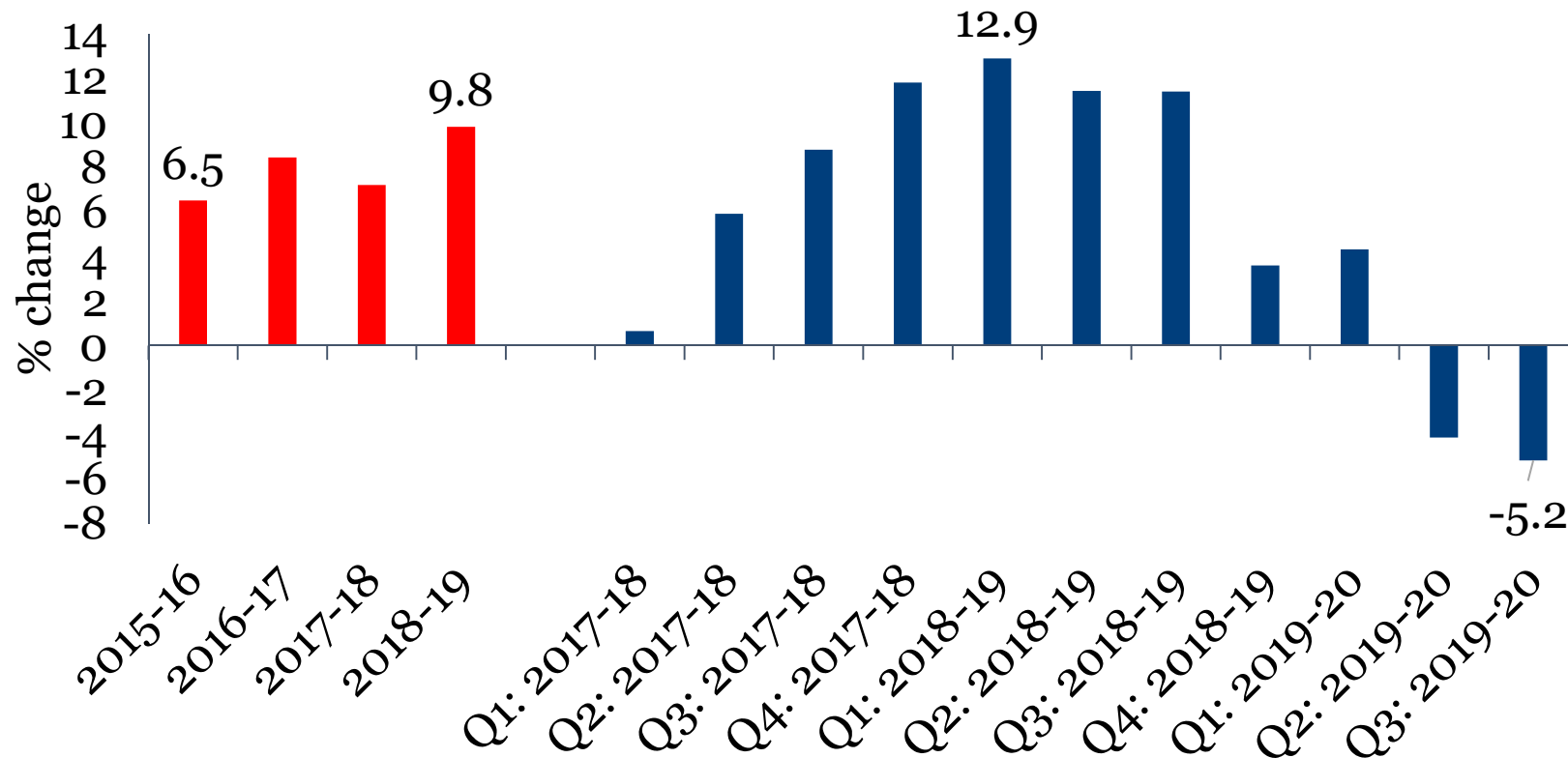
Growth in IIP Consumer Durable and Non-durable Goods



Source: MoSPI

# Investment demand falling sharply

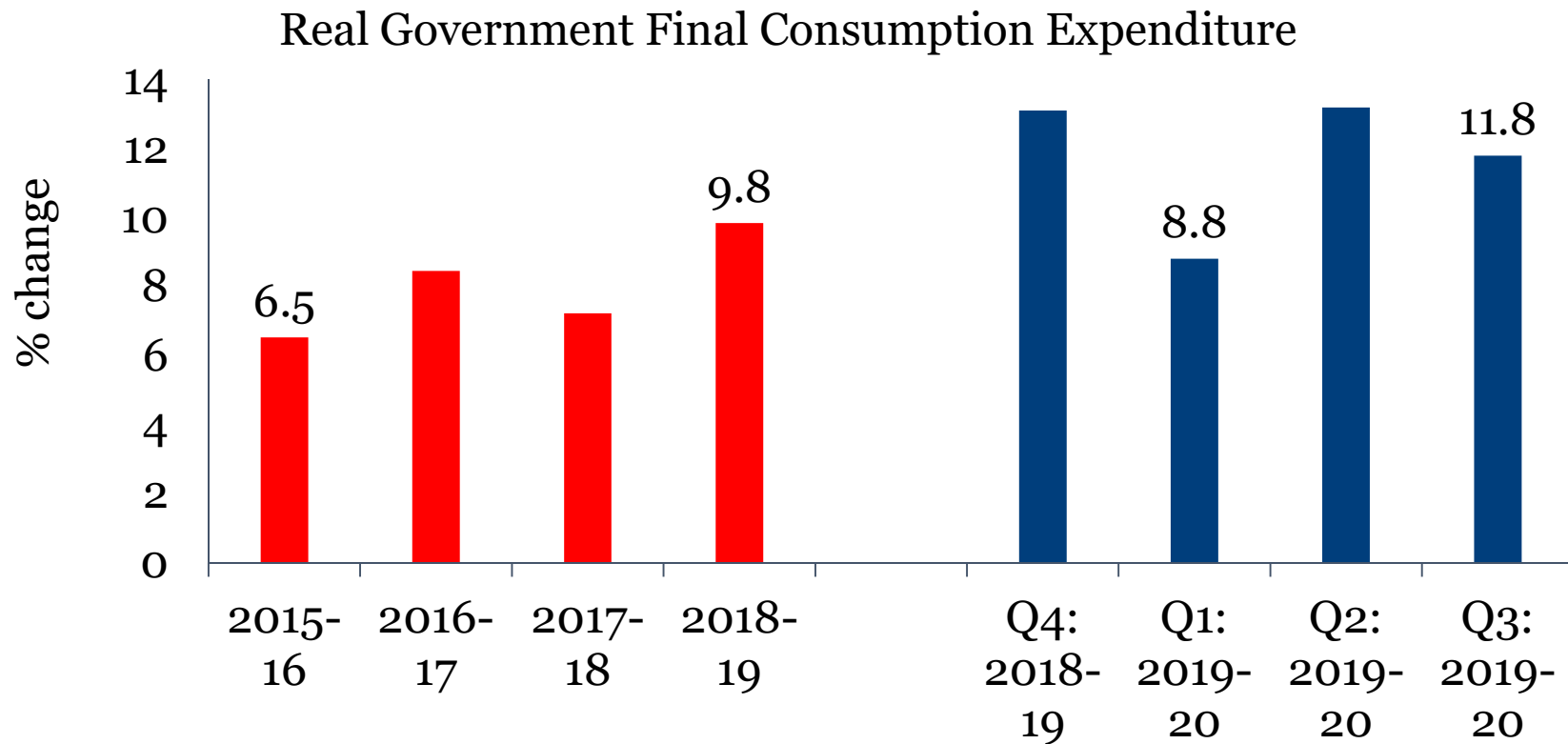
## Growth in Real Government Fixed Capital Formation



Legend: \_ Annual and \_ Quarterly

Source: MoSPI

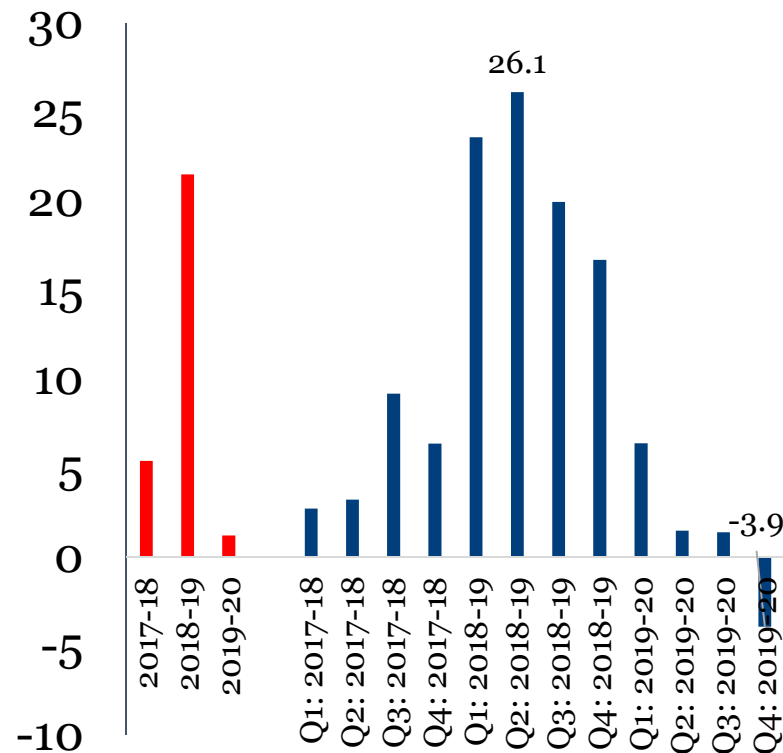
# Government Expenditure compression reversed after Q1: 2019-20



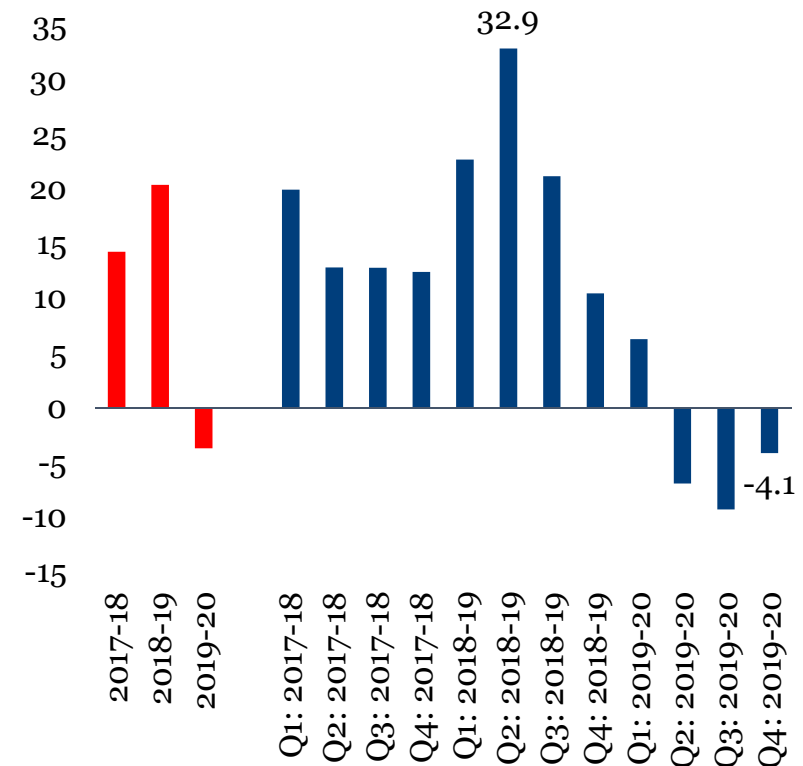
Legend: \_ Annual and \_ Quarterly.  
Source: MoSPI.

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

Growth of Exports of Goods and Services (Rs terms, %yoy)



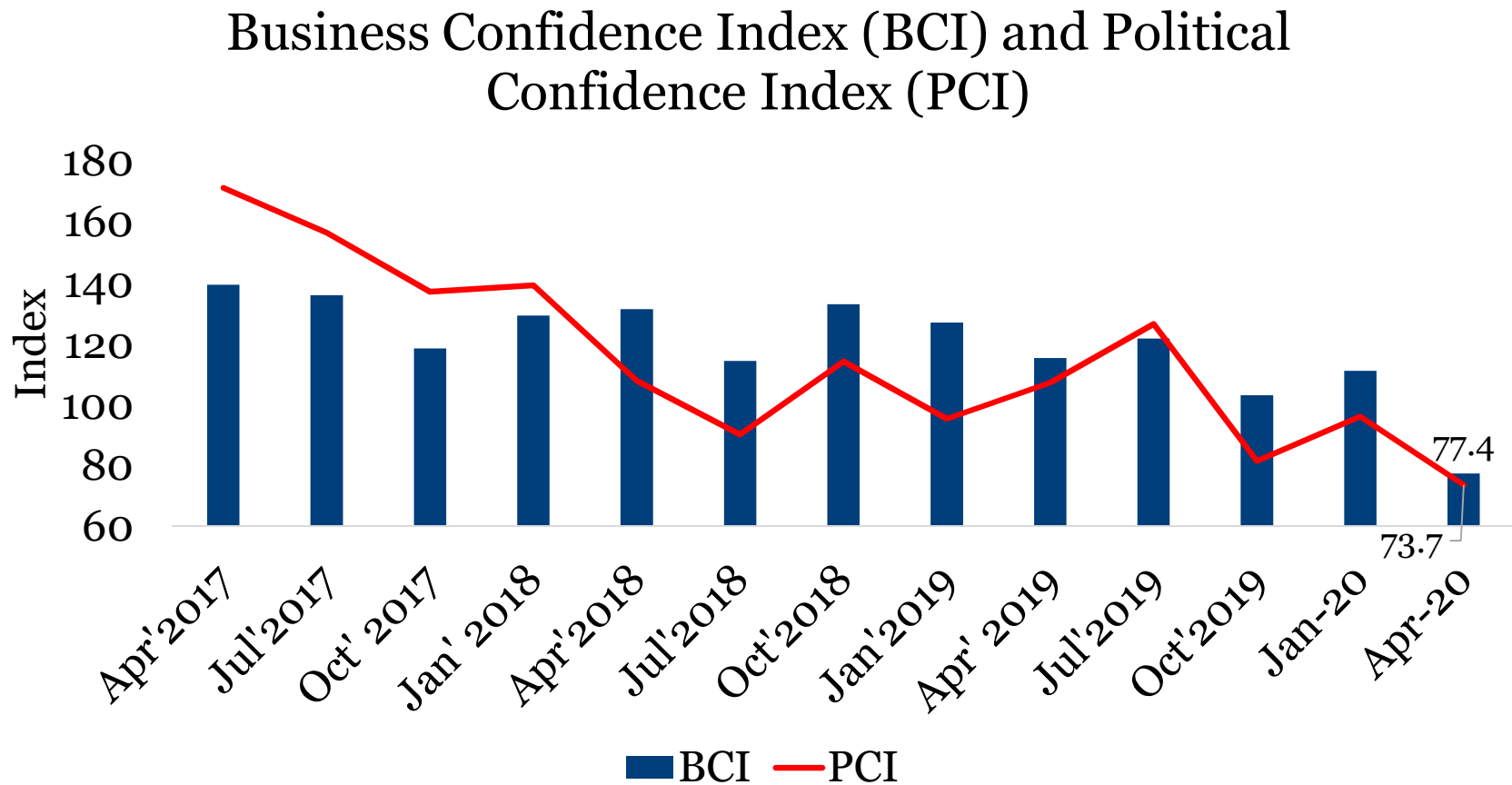
Growth of Imports of Goods and Services (Rs terms, %yoy)



Legend: \_ Annual and \_ Quarterly

Source: Ministry of Commerce and RBI.

# Business and Political Confidence Indices (NCAER) continue declining in April 2020

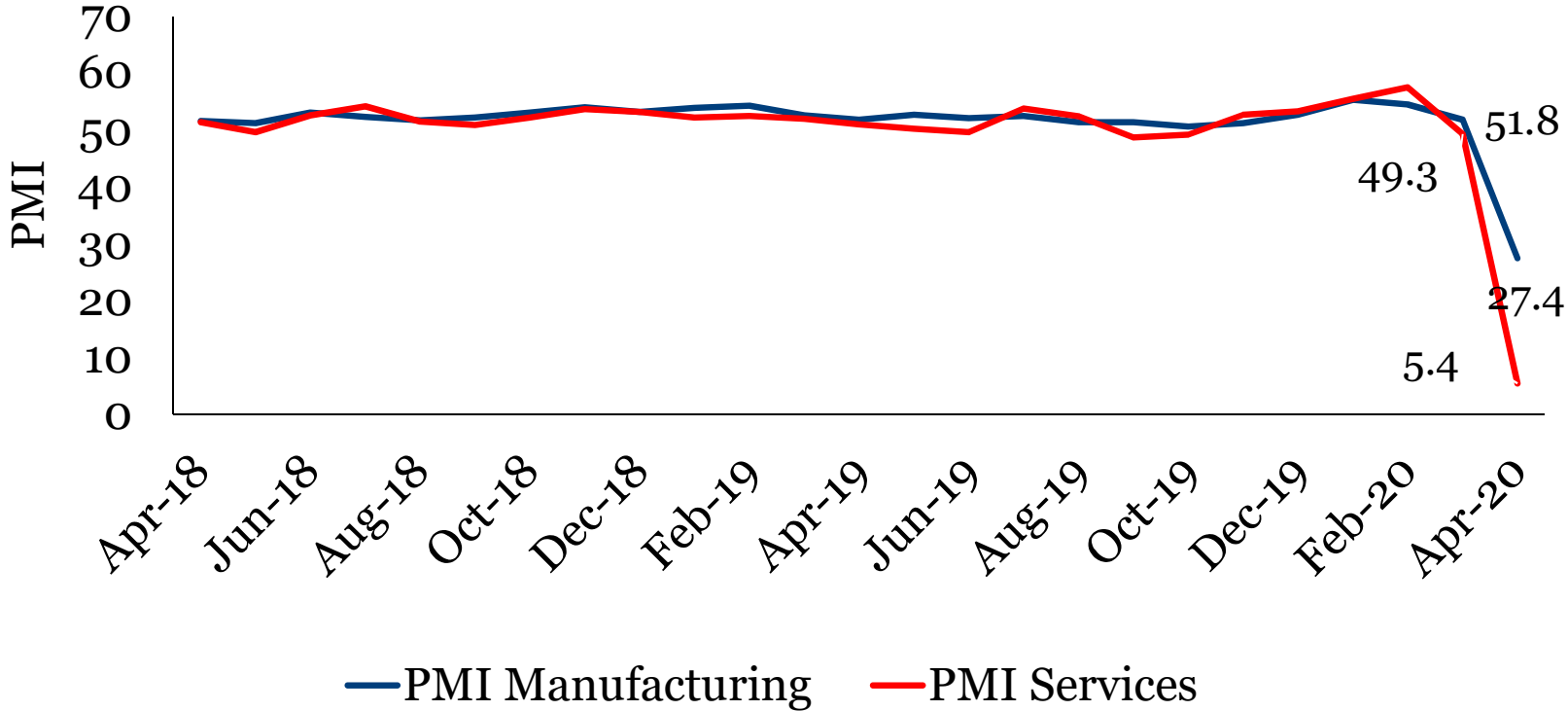


Source: NCAER

# Nikkei PMI dropped sharply in April 2020

## 2020

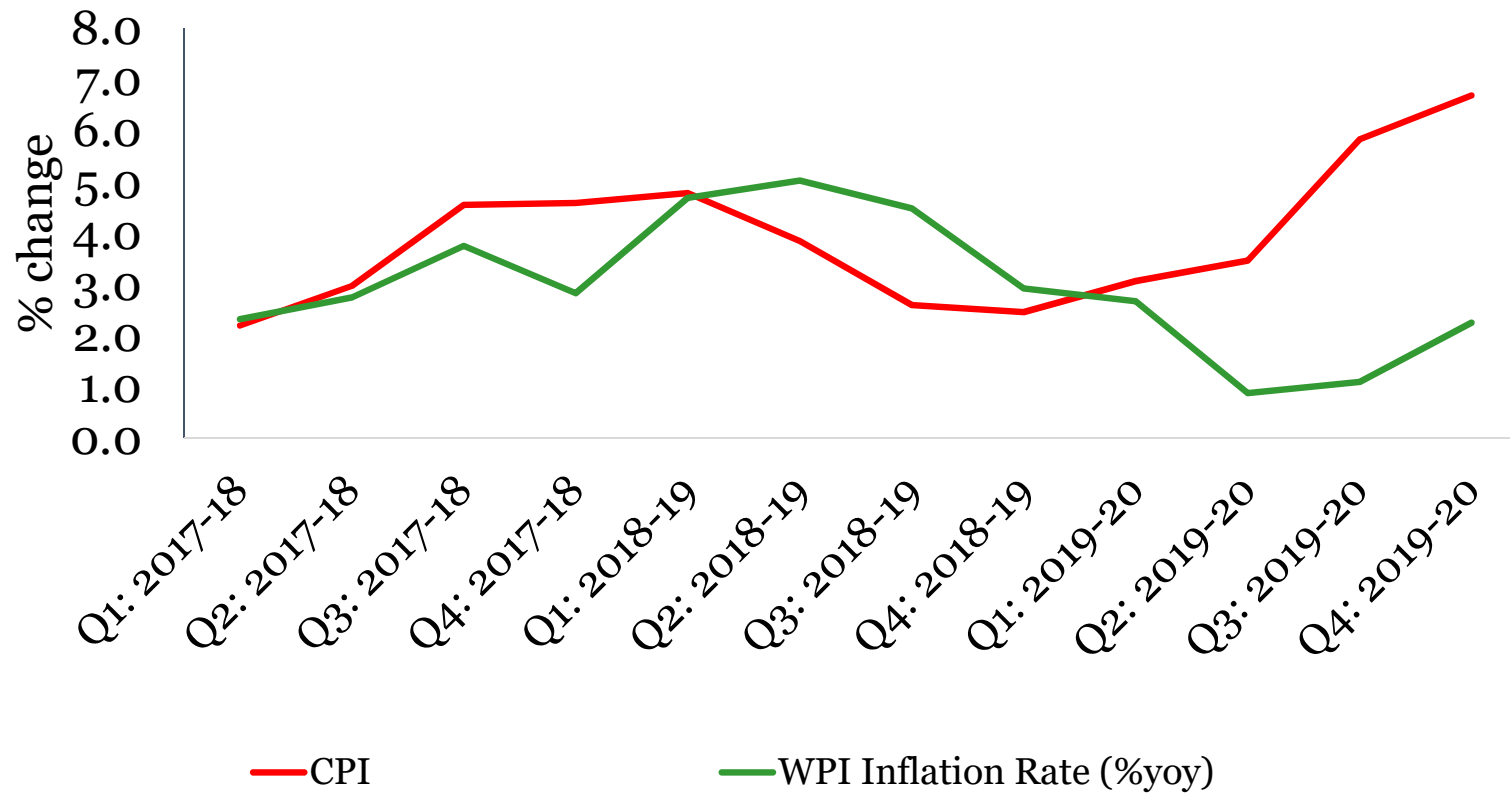
Indices April 2018 to April 2020



Source: Nikkei PMI

# Inflation trends

CPI and WPI



Source: MoSPI and Office of Economic Advisor

# Baseline Assumptions about Disruptions in Key Sectors

Sector	2019-20:Q4	2020-21:Q1	2020-21:Q2	2020-21:Q3	2020-21:Q4	2019-20	2020-21
Agriculture	0.0	0	3.0	3.0	3.0	2.4	<b>2.3</b>
Industry	0.7	-54.2	-27.0	-27.0	0	1.4	<b>-27.1</b>
Services	5.3	-16.3	-8.0	-8.0	0	5.8	<b>-8.1</b>
<b>GVA</b>	<b>3.0</b>	<b>-25.7</b>	<b>-12.3</b>	<b>-12.3</b>	<b>0.5</b>	<b>4.4</b>	<b>-12.5</b>

- Negative growth to continue until Q3: 2020-21 and recover modestly to 0.5% in Q4
- For the whole year, GDP growth expected to be (-)12.5%
- These are based on assumption of no policy stimulus (either monetary or fiscal)
- What could be the impact of various stimulus measures undertaken till now?
- Alternative fiscal policy simulations and their impact are assessed using policy simulations model

# About the policy simulation model

- Core model has 31 equations
  - 21 behavioral equations and 10 identities
- Simple model, cause effect relationships are transparent
- It is a demand side model with four major blocks: Income, fiscal, monetary and external
- Follows eclectic approach
- Flexible, easily adaptable to address different questions
- Present version is used for working out macro-fiscal relationships for the 15<sup>th</sup> FC
- A negative growth of -12.5% for 2020-21 is imposed on the model to derive deficit conditions for the base case
- In addition, four possible policy scenarios are simulated to derive GDP growth, FD, Inflation and CAD

# Policy Simulations: Four Scenarios

## Scenario 1

- Starting with the base case, revenue and capital expenditures are increased as per the 2020-21 (Budget Estimates).

## Scenario 2

- Increase public expenditure by 1% of GDP
- Reduce Repo Rate

## Scenario 3

- Increase public expenditure by 3% of GDP

## Scenario 4

- Increase public expenditure by 5% of GDP

# Policy Simulation Results

Scenarios	GDP growth (%)	Inflation (%)	Fiscal Deficit (as % of GDP)	CAD (as % of GDP)
Base case	-12.5	4.5	6.4	1.4
Scenario-1	-4.1	6.6	7.4	2.3
Scenario-2	-1.9	7.4	7.7	2.5
Scenario-3	1.2	8.9	8.8	3.0
Scenario-4	3.6	10.1	9.4	3.6

# Key Takeaways: Facing Stark Choices

- Fiscal stimulus of 3% (Scenario 3) is enough to generate positive GDP growth
- 5% fiscal stimulus (Scenario 4) generates 3.6% growth
  - ❖ This is closest to Government stimulus package.
  - ❖ However, there are trade-offs: this results in double-digit inflation with unsustainable CAD of 3.6%.
- The model suggests aggregate demand responds faster to stimulus than aggregate supply, hence, the rise in inflation
- Any improvement in supply side could moderate inflationary pressures, but this needs broader policy interventions.

# Fiscal Outlook

- Great deal of uncertainty about economic activity, revenue, expenditure, deficits etc. in 2020-21
- Budgets of Central and State governments now mostly of academic interest, will need revision through supplementary budgets
- Assessments of fiscal outlook have to be largely based on judgments and assumptions
- Our assessment of fiscal outlook draws on the model based simulations presented earlier

# Fiscal Outlook

## Scenario 1

- Assumes expenditure levels as in Central and State budgets
- GDP still declines by 4%
- With extra borrowing to compensate for the consequent revenue shortfall Fiscal Deficit rises to 6.6%

## Scenario 4

- Assumes a high expenditure stimulus of 5% of GDP over and above the budgeted levels for 2020-21
- Generate 3.6% GDP growth
- However, this comes along with a large Fiscal deficit (9.4%), double digit inflation (10.1%) and an unsustainable Current Account Deficit (3.6% of GDP)

## Scenario 3

- Assumes a smaller expenditure stimulus of 3% of GDP additional spending over budgeted levels for 2020-21
- Positive GDP growth of 1.2%
- A lower inflation (8.9%), a smaller Fiscal deficit (8.8% of GDP) and smaller current account deficit (3% of GDP) as compared to Scenario 4
- **Preferred Scenario**

# Fiscal Outlook

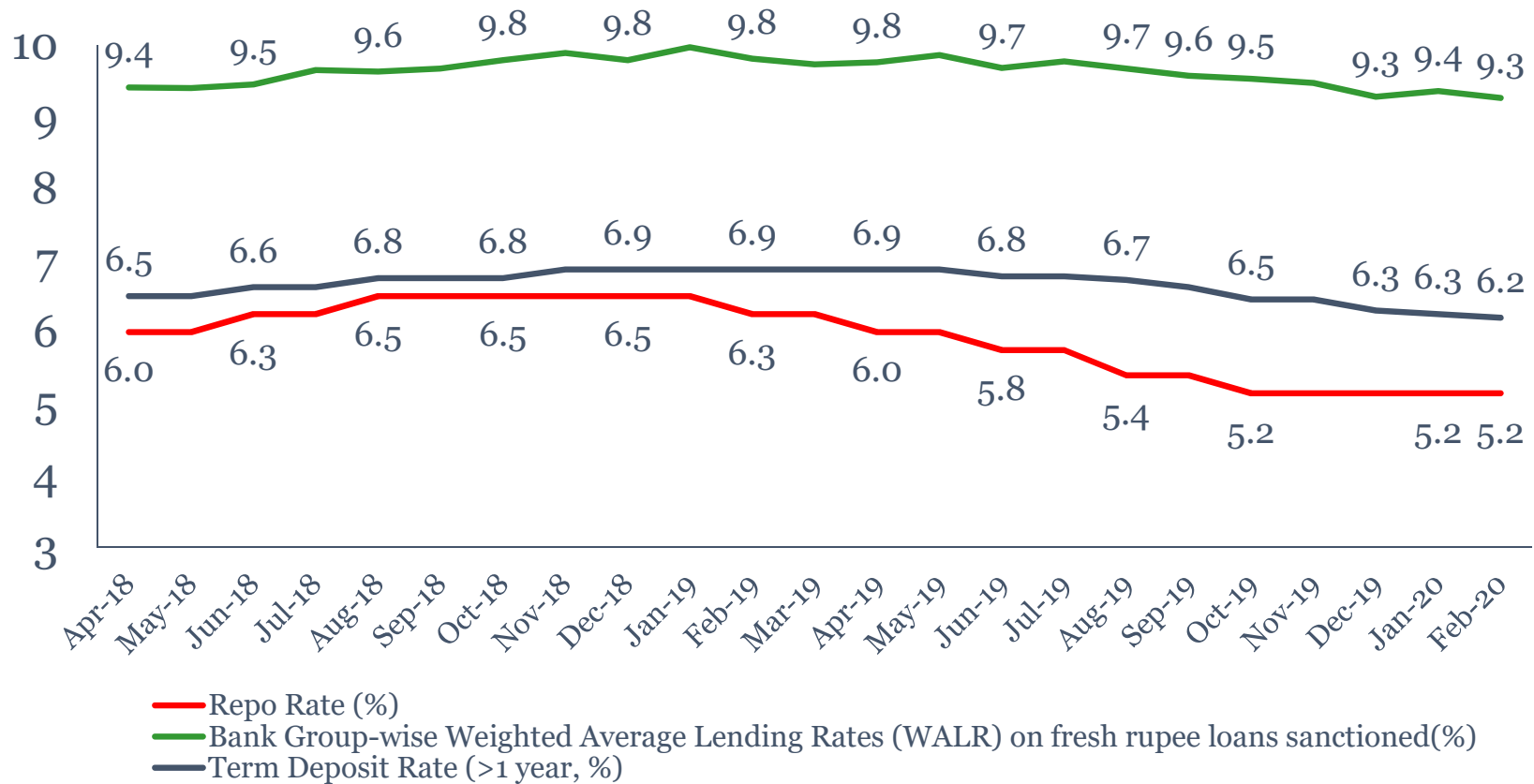
- On 12 May the Prime Minister announced a massive stimulus package of Rs 20 trillion (10% of GDP)
- This includes both monetary and fiscal stimulus measures
  - ❖ RBI liquidity infusion of Rs 8 trillion (4% of GDP)
- Netting out the liquidity component, the remaining headroom for additional borrowing to finance Covid19 related expenditure out of the Rs 20 trillion envelope is Rs 12 trillion (6% of GDP)
  - ❖ This includes the additional borrowing of Rs 5.9 trillion (3 % of GDP) already announced before 12 May

# Fiscal Outlook

- This huge expenditure stimulus even exceeds the expenditure stimulus of 5% of GDP in our Scenario-4
- This would lead to even higher growth but also higher inflation and a larger Fiscal Deficit and Current Account Deficit than in Scenario-4, where these were already too high
- It is therefore suggested that this stimulus package be spread over two years: 2020-21 and 2021-22.
- Options for financing this massive additional borrowing on top of the earlier budgeted borrowing are discussed in the next section on monetary policy.

# Weak Transmission

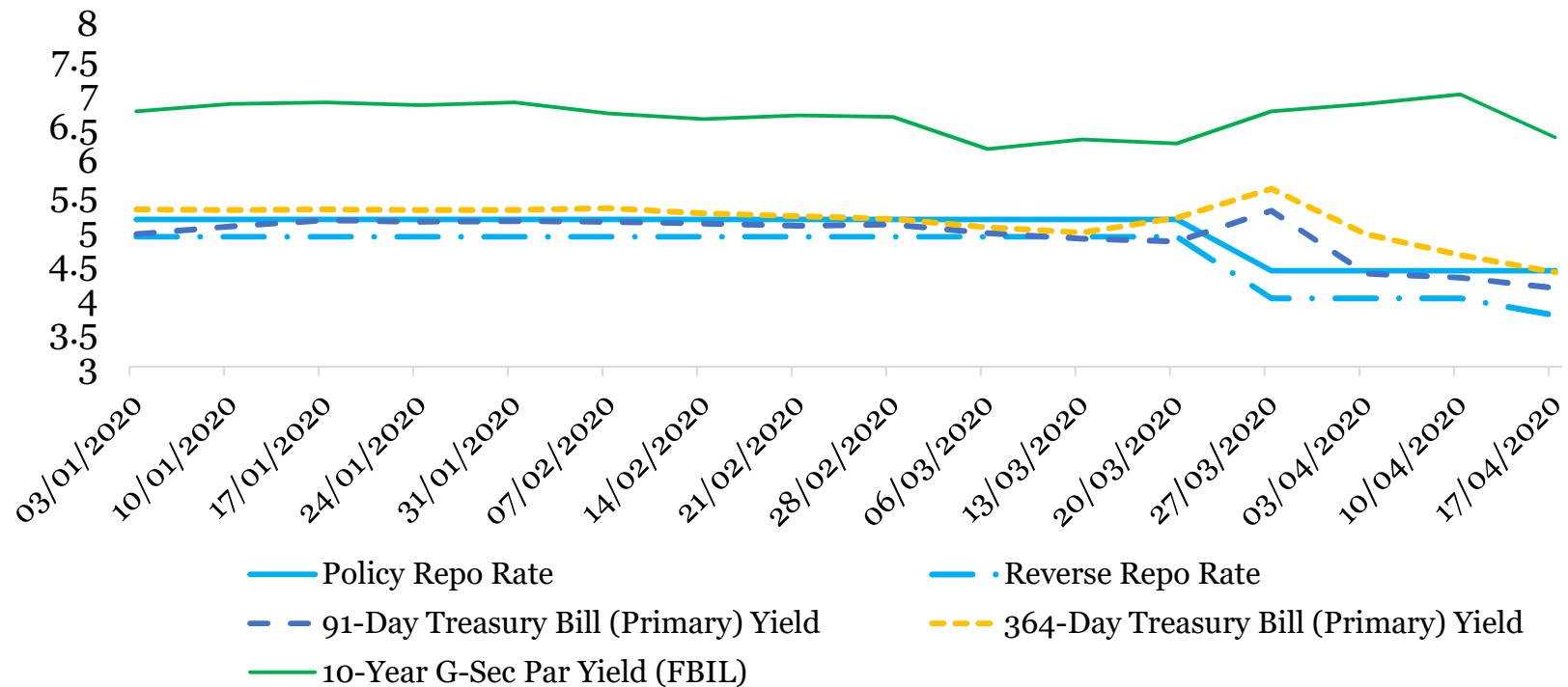
Repo Rate, WALR and Term Deposit Rate  
April 2018 to February 2020



Source: RBI

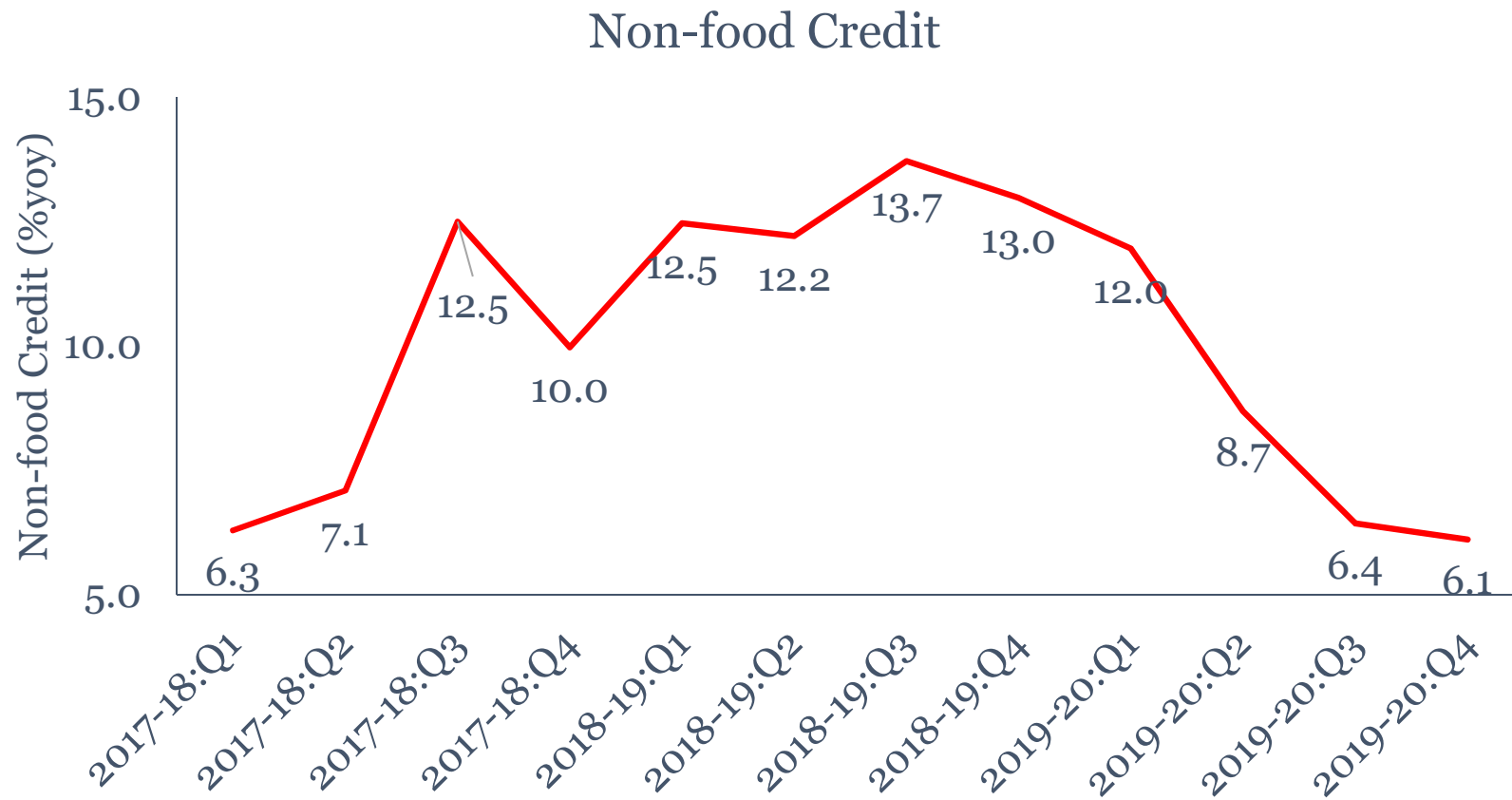
# Transmission still weak for 10 year G-secs but strong for shorter maturity govt. bonds

Repo Rate and yield on Domestic bonds of various maturities (%), (April 2019 to April 2020)



Source: RBI

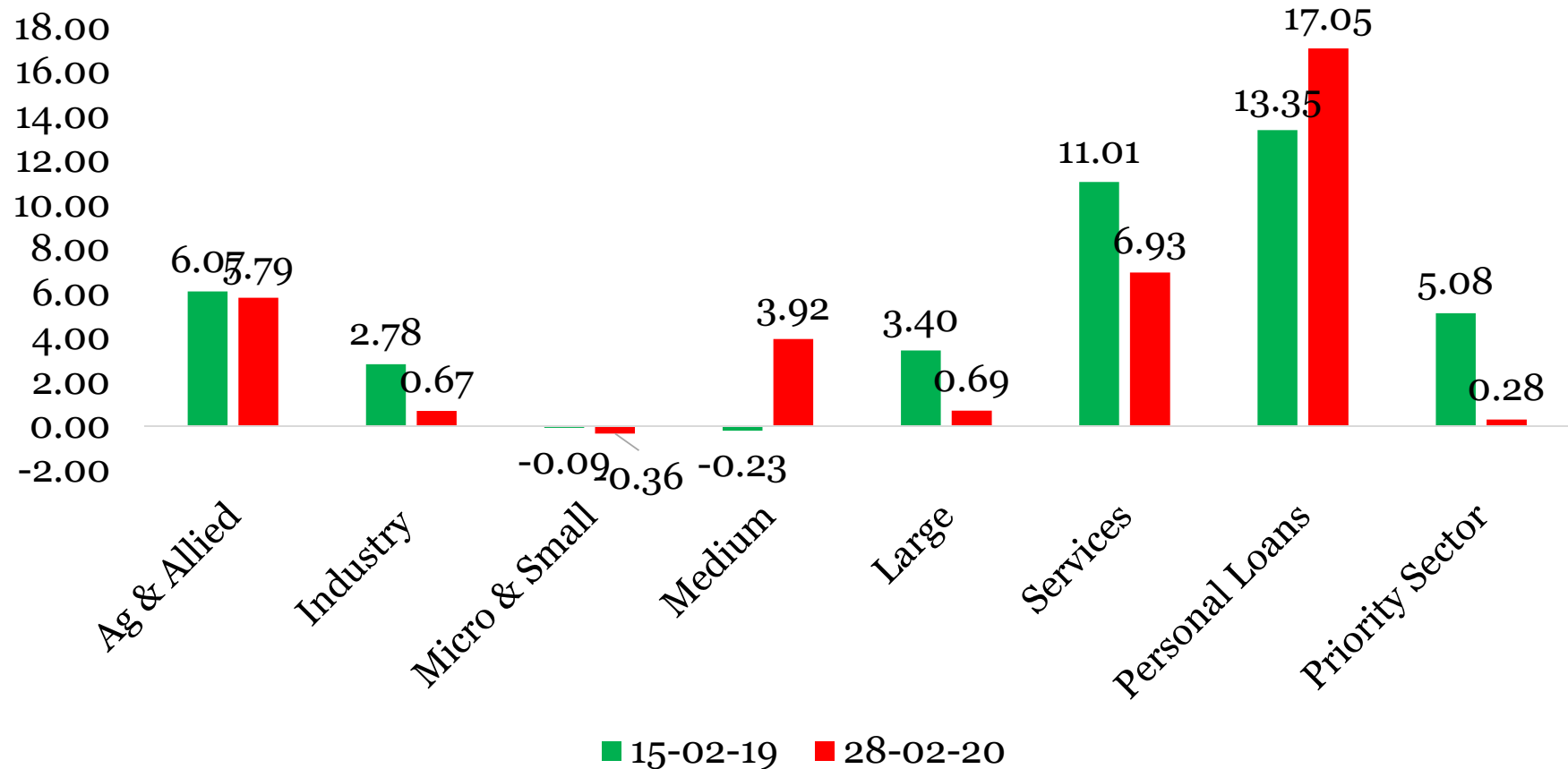
# Non-food credit growth very weak



Source: RBI.

# Credit growth depressed for all segments except personal loans

Growth Rate of Bank Credit by Sectors (% , y-o-y)



Source: RBI

# Rising Risk Aversion and Stalled Bank lending

- Rising risk aversion against lending to NBFCs even prior to Covid19 crisis due to several scams like IL&FS
  - ❖ but NBFCs main source of credit for MSMEs
  - ❖ TLTRO 2 of ₹25,000 crores, intended for directing credit to NBFCs remained only half subscribed.
- Similar rising risk aversion to lend to MSMEs.
- Such risk aversion likely to increase under Covid19 crisis
  - ❖ MSME borrowers also averse to borrowing under present conditions
  - ❖ Credit flow to MSMEs has virtually dried up
  - ❖ Need credit guarantees or partial credit risk guarantees
- Measures just announced on 13 May do include these provisions
  - ❖ Government credit guarantee for MSMEs
  - ❖ RBI Partial credit guarantee

# Challenge of Massive Government Borrowing post Rs 20 trillion stimulus package

- Including ₹12 trillion additional borrowing to finance fiscal component of ₹20 trillion stimulus package, total government borrowing program of over ₹17 trillion ( 8.5-9.5 of GDP)
- Government borrowing on such a scale unprecedented in India, not clear if financial system can cope
- Multiple channels need to be used to face this massive demand for sovereign loans

# Challenge of Massive Government Borrowing post Rs 20 trillion stimulus package

- Possible channels for financing government borrowing
  - ❖ Commercial bank lending, beyond a point will raise yields and crowd out private borrowers
  - ❖ Re-purposing and further liberalisation of 'Ways and Means' advances, allowing much larger advances for up to 1 year, then converting advances to dated securities
  - ❖ Direct monetisation of residual deficit by RBI, lender of last resort, through private placements
- Finally, it would be more prudent to spread this borrowing over two years, 2020-21 & 2021-22
  - ❖ This would help to revive the economy while maintaining financial stability.

**Thank You!**

