The economy is not looking too bad

Reform-based stimulus amid the lockdown helped sustain supply. The need is to spur demand prudently, given the fiscal constraint

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Based on sharp falls during the lockdown and due to the widespread misconception that equated the fiscal stimulus to the promised new expenditure of about 10 per cent of GDP, market analysts and international agencies are forecasting negative growth rates for India in 2020-21. But the demand stimulus is the excess of expenditure over taxation. As revenues shrink, this will be much larger than a 0.5 per cent. The Central plus State fiscal deficit is widely expected to be in excess of 10 per cent of GDP—even as the RBI’s borrowing support allows expenditure to be made before revenue realisation.

Analysts also underestimate human resilience. Endogenous growth theories tell us a temporary real shock such as an earthquake or a war, after which human capital remains relatively intact, leads to a rapid recovery—people strive to make up for lost. Second, there is expenditure to rebuild capital. India, we have a war against a virus, with expenditure needed for building up medical facilities.

Of course, uncertainties on the evolution of COVID-19 are a question mark on a possible recovery. But building on the early lockdown that contributed to flattening the curve, increasing preparedness and awareness, the gradual unlock may be able to avoid a US-type second spike. Mega cities continue to be locked down, but the digital age enables much of their work to be done from home.

Absolute numbers of infections look high, but they are still low per million of population.

Positive growth

The data from June, the period of Unlock 1.0, gives good news. Manufacturing PMI rose to 47.2, after a low of 27.4 in April. CMSI unemployment averages around 2 per cent for June compared to 23.5 per cent in May. It reached the pre-lockdown 8.5 per cent in the week ending 26 June, although it was lower in rural and higher in urban areas. GST collections in June were sharply to ₹40,097 crore (97 per cent of the collections in June last year), imports rose to 78 per cent of last June. Forward-looking stock markets are booming in the thumbs-up-for-economy.

It is a source of national shame and sorrow that the absence of job insurance for migrant labour in cities led to their panic return under the extended lockdowns. But it was waiting for them at home. MNREGA was an institution that delivered—13 per cent higher job man-days were created in May. Even if tank trains have stopped, but returning trains are full, as urban jobs revive. Even so, there are longer-lasting rural initiatives that may allow a better distribution of labour, facilities, and wages.

Therefore, we may not see a sharp fall in the April-June quarter, as June makes up, or a negative growth for the year as widely forecast. The NIAJune Review, which correctly builds in the monetary fiscal stimulus, forecasts a 1.3 per cent growth for the year if supply constraints do not bite. The June data indicates this scenario is most likely to be right.

Reversal of policy tightening

India’s policy had not done well since the deep slowdown started in 2018 due to tightening of financial conditions after the IL&FS fiasco. A reversal of these conditions from mid-2019 led to a recovery in January-February 2020. Many high-frequency indicators showed this. PSB NPA were in single digit; they had gained from recoveries via the NCLT. But the credit infrastructure was insufficient in February and the lockdown in March brought in Q4 growth at 3.1 per cent, lower than the previous quarter, but still above market forecasts of about 1 per cent. In the absence of more granular monthly analysis, declining quarterly growth supported the general perception India was already in a bad condition when Covid-19 struck, and thus was likely to be badly hit.

But counter-cyclical monetary fiscal policy delivered. An over-large stimulus in 2008-09 actually led to overheating. Benign conditions are reducing interest rate spreads. Even SDFs are finally getting credit from a fine-tuned government partial credit guarantee programme. Covid-19 pushed the adjustment. Appropriate stimulus is delivering again during the unlock process. Limited fiscal room, however, makes caution important.

Large early demand boost in advanced economies did not deliver a recovery. There were sharp falls in growth rates. Indeed, transfers aimed at rescue, and are expected to be followed by more. Fiscal deficits are likely to go up to 20-25 per cent. Since households, firms and governments are all highly leveraged, adding to debt would make it unsustainable. It is argued low interest rates and inflation make the circumstances best for monetary financing, which is unlikely to create risks. There is even advocacy for helicopter money, where some central bank (CB) assets are written off to enable transfers to government.

But such policies quickly raise risk premiums for emerging markets (EMs) and discredit hard-won CB independence. There is a view that some of the money created should be given to CBs, but this is unlikely to happen. Fortunately, inflation is likely to remain low in importing EMs like India, and reversion liquidity tightening gives space to support government borrowing. Already, 10-year G-Sec yields have reached an 11-year low of 5.40 per cent.

Even so, India cannot afford universal unconditional transfers, especially given the large population and potentially unlimited demands. Fiscal expansion has to be controlled, reversible and avoid the over-reaction of 2008. Reform-based stimulus, as in the mid-May package, helps fiscal sustainability and may even improve private spending to the extent that forward-looking behaviour foressees lower future taxes and instability. It reassures rating agencies that have put India at the minimum investment grade. But growth is also important for ratings, it is the best way to reduce debt ratios.

Sequencing is essential to economise, and make expenditure effective. Under the lockdown, supply fell more than demand, and so initial government measures were rightly focused on survival transfers, delaying compliance, food and medical expenditure. But under Unlock, supply has recovered more than demand. As shops open, demand is the more immediate constraint. Businesses and consumers are fearful, each looking to the other to start; and so, this is the right time for a further fiscal boost from the government—the only one free of fee. This is similar to how governmenr credit warrantce overcame banks’ fear and risk aversion.

Strategic push

Inflation demand, further expenditure of about 2 per cent of GDP could be strategically distributed over a triennium to spend that expire in three months, since earlier transfers with go into precautionary savings temporary cuts in GST and house registration fees; a special, Centrally sponsored scheme to provide 100 days’ employment on demand in urban areas, to be used to help municipalities fight Covid-19 and make it safer for migrants to return; wage subsidies for GST registered positive turnover and viable MSMEs, since only about 10 per cent get bank loans. There are supplementary demand sources, such as agriculture (which is doing well); ‘reviving economy’ for building inventories; pick-up demand for consumer durables, which increased 45 per cent in June; retail housing; import substitution for Chinese goods; and the coming festival season.

These are testimony to India’s growing diversity thathelps absorb shocks. Some sectors are hurt, but others are doing well. The government only has to set the ball rolling.

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