THE RECENT RECESSION IN INDIAN ECONOMY

Principle of Economics

DECEMBER 23, 2020

DHRUV MAHESHWARI
2019A7PS0020U

Acknowledgements

I would like to express my sincere gratitude to Sartaj Sir, my professor for giving me this wonderful project. I learnt a lot about the various economic recessions India faced, their consequences and about the current recession in the economy.

Section I: Introduction, highlighting the issue and the related concerns

Recession is defined as a fall in the overall economic activity for two consecutive quarters (six months) accompanied by a decline in income, sales and employment.

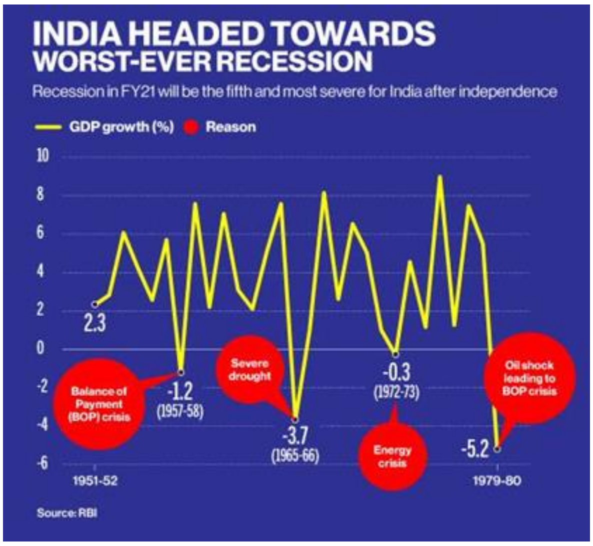
The economic impact of the 2020 coronavirus pandemic in India has been largely disruptive. India's growth in the fourth quarter of the fiscal year 2020 went down to 3.1% according to the Ministry of Statistics.

According to Nomura India Business Resumption Index economic activity fell from 82.9 on 22 March to 44.7 on 26 April. Unemployment rose from 6.7% on 15 March to 26% on 19 April and then back down to pre-lockdown levels by mid-June. During the lockdown, an estimated 14 crore (140 million) people lost employment while salaries were cut for many others.

The current recession staring at India brings a new set of challenges. The crisis has emerged out of the blue as the country is in a lockdown, severely hampering economic activity. For India this is estimated to be the worst ever contraction of GDP growth. RBI in its MPC meet acknowledged that this year's GDP will be in negative territory but refrained from giving any numbers. However other agencies predict a sharp contraction in the range of 5%-6.8% in FY21, with the bulk of the fall estimated to be in Q1 of FY21 when quarterly GDP may contract by nearly half.

Section II: A historical review of such issues faced/discussed previously

In independent India's history, four such years of negative GDP growth were registered. They saw contraction of -1.2% (FY58), -3.66% (FY66), -0.32% (FY73) and -5.2% (FY80). The recession looming now is different from previous recessions as it comes with a fresh set of challenges.



FY58 - Balance of Payment (BoP) crisis

The year 1957 was a difficult period for agriculture sector. Weak monsoon adversely affected agricultural production, which led to increase in prices. The government which had already imported 20 lakh tonnes of food grains in the previous fiscal had to further import 40 lakh tonnes. During 1957-58, India encountered its first drop in economic growth when a negative GDP growth of 1.2 per cent was recorded. The reason behind it was a ballooning import bill which swelled by more than 50 per cent between 1955 and 1957. During the same time exports registered a sluggish growth. India's trade deficit widened by over 9 times from $0.1 billion in 1955 to almost $0.9 billion in 1957 while gold stock and foreign reserves were reduced to half.

FY66 - Severe Drought

India which had fought wars with China in 1962 and more recently with Pakistan in 1965 was in a recovery stage. The very next year, two severe droughts affected Indian economy (during 1966 & 1967). During that time India had heavy reliance on foreign aid especially from the US. In FY1966, due to drought, food grain production fell 20 per cent. Foreign food aid came to the rescue of the starving population. India received 70 lakh tonnes of food aid in fiscal 1965, equivalent to 10 per cent of domestic production.

In fiscal 1966 India received 1 crore tons of food aid. In 1965-66 India registered an economic contraction of -3.66%.

FY73 - Energy Crisis

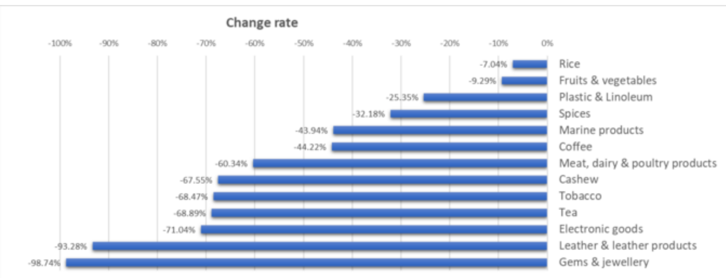
In 1973, world witnessed its first energy crisis as the Organisation of Arab Petroleum Exporting Countries (OAPEC) proclaimed an oil embargo (an embargo is an official ban on an activity or trade with a particular country). It targeted nations that were supporting Israel during the ongoing "yom kippur" war. As a result, in a short while, oil prices shot up 400 per cent from $3 to $12. Consequently, India's oil import bill rose from $414 million in 1972-73 to $900 million till 1973-74. This was twice the amount of foreign exchange reserves present at that time. Since then energy became a top most priority for India. In 1972-73, India's economy contracted by 0.32%.

FY80 - Oil Shock leading to BoP crisis

The world witnessed a second oil shock during 1979-80. It occurred due to a decrease in oil production in the wake of Iranian revolution and led to increase in oil prices. This was followed by Iran-Iraq war which further curtailed production and escalated prices. This led to a serious crisis as the cost of India's imports almost doubled between 1978-79 to 1981-82. During this time, India's exports also took a hit as it contracted by 8%, which led to a balance of payment crisis.

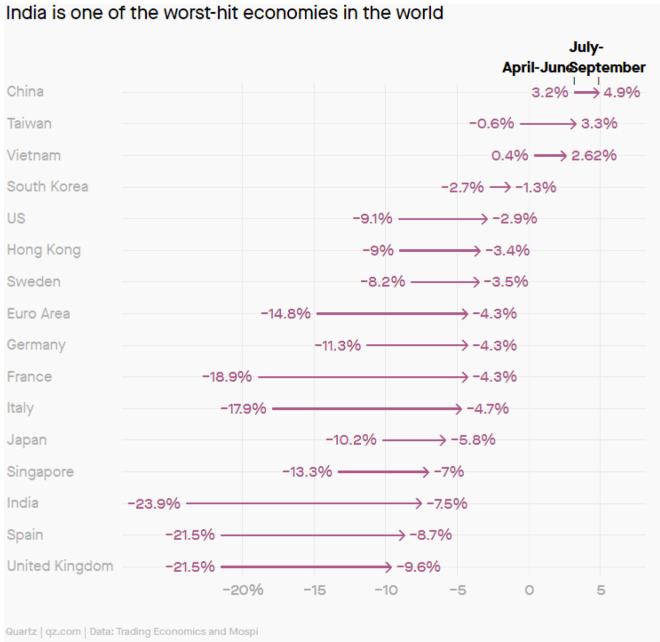
Section III: The present ongoing discussions / perspectives on consequences and implications

The Covid-19 lockdowns between March and June hurt the Indian economy pretty badly. But even after the lockdowns were lifted, things haven't changed for the country much as India continued to be one of the worst-hit major economies during the July-September period.



India's exports in April 2020 fell by -36.65% year-on-year, while imports in April 2020 fell by -47.36% as compared to April 2019.

In the September quarter, India's economy contracted by 7.5% year-on-year. Among the major economies of the world, only the UK and Spain shrunk sharper than India.



In Delhi, night light radiance fell 37.2% compared to 1–31 March 2019. This was the biggest fall for any metro in India. Bangalore fell 32% while Mumbai dropped by 29%. India's fuel demand in April 2020 as compared to the previous year fell nearly 46%. Consumption of fuel was the lowest since 2007. Cooking gas (LPG) sales rose ~12%. By the first half of June 2020, India's fuel demand was 80-85% of what it was before the lockdown. Oil prices dropped sharply in 2020 following the COVID-19 pandemic. Demand also fell sharply.

A study found that "10% of farmers could not harvest their crop in the past month and 60% of those who did harvest reported a yield loss" and that a majority of farmers are facing difficulty for the next season. Due to logistical problems following the lockdown tea estates were unable to harvest the first flush. The entire Darjeeling tea-based tea industry will see significant fall in revenue as tea exports could see a yearly drop up to 8%. In March 2020, tea exports from India fell 33% in March as compared to March 2019. During the lockdown, food wastage increased due to affected supply chains, affecting small farmers.

Manufacturing sector also took a toll as many MNCs had to shut their factories.

The economic downturn in September was led by the service sector with trade, hotel, and transport segments witnessing the sharpest fall. Other parts of the service industry such as finance, real estate, professional services, public administration, and defence were also in negative territory.

Section IV: Different policy measures taken by various authorities

On April 15, with a view to supporting economic activities, the government announced several relaxation measures in geographical areas designated as non-hotspot, with effect from April 20, 2020.

On April 29, the government permitted inter-state movement of stranded people, including migrant workers, managed by the nodal authorities who are designated by the states. Some graded relaxations in economic activities have been allowed in geographic areas designated as orange and green zones on May 4 and domestic air travel restarted on May 25.

On May 12, the PM announced a relief package of around 10 percent of GDP (Rs 20 lakh crore), including previously announced monetary and fiscal measures. The economic package consisted of a mix of reforms, infrastructure building, support to stressed businesses and a certain amount of direct cash support. The "collateral-free loans" that the package provided aimed to "resume business activity and safeguard jobs". Changes in FDI policy, privatization of the power sector, provident fund contribution and ease of doing business measures were also announced.

On July 29, the central government issued 'Unlock 3.0' guidelines further paving the way for a phased re-opening of activities across the country and limiting the lockdown only to containment zones till August 31.

On August 29, the government issued ('Unlock 4.0') to further re-open the economy in September, removing restrictions on metro rail in a graded manner from 7 September, and allowing for social, academic, sports, entertainment, and other congregations of up to 100 people.

On September 30, the central government issued "Unlock 5.0" guidelines to allow state/union territory governments to decide on reopening schools and coaching institutions after October 15 in a graded manner. Cinemas/theatres/multiplexes will be permitted to open with up to 50% of their seating capacity and entertainment parks will be permitted to open from October 15. The ceiling on congregations has been extended to 200 people.

On 12 October 2020, the finance minister announced another economic stimulus package. This package has been launched keeping in mind the upcoming festive season. The package includes perks for central govt. employees to spend more on consumer durables during the festive season and a much higher capital expenditure for both the centre and states.

Fiscal Policies

India's fiscal support measures can be divided into two broad categories:

(i) above-the-line measures which include government spending (about 3.2 percent of GDP, of which about 2.2 percent of GDP is expected to fall in the current fiscal year), foregone or deferred revenues (about 0.3 percent of GDP falling due within the current year) and expedited spending (about 0.3 percent of GDP falling due within the current year).

(ii) (ii) below-the-line measures designed to support businesses and shore up credit provision to several sectors (about 5.2 percent of GDP).

In the early stages of the pandemic response, above-the-line expenditure measures focused primarily on social protection and healthcare.

These include

- in-kind (food, cooking gas) and cash transfers to lower-income households (1 percent of GDP);
- wage support and employment provision to low-wage workers (0.5 percent of GDP);
- insurance coverage for workers in the healthcare sector;
- healthcare infrastructure (0.1 percent of GDP).

The more recent measures that were announced in October and November include additional public investment (higher capital expenditure by the central government and interest-free loans to states, of about 0.2 percent of GDP) and support schemes targeting certain sectors. The latter includes a Production Linked Incentive scheme targeting 13 priority sectors and is expected to cost about 0.8

percent of GDP over 5 years, a higher fertilizer subsidy allocation benefiting the agriculture sector (0.3 percent of GDP) and support for urban housing construction (0.1 percent of GDP).

Several measures to ease the tax compliance burden across a range of sectors have also been announced, including postponing some tax-filing and other compliance deadlines, and a reduction in the penalty interest rate for overdue GST filings. Measures without an immediate direct bearing on the government's deficit position aim to provide credit support to businesses (1.9 percent of GDP), poor households, especially migrants and farmers (1.6 percent of GDP), distressed electricity distribution companies (0.4 percent of GDP), and targeted support for the agricultural sector (0.7 percent of GDP), as well as some miscellaneous support measures (about 0.3 percent of GDP). Key elements of the business-support package are various financial sector measures for micro, small, and medium-sized enterprises and non-bank financial companies, whereas additional support to farmers will mainly be in the form of providing concessional credit to farmers, as well as a credit facility for street vendors. Agricultural sector support is mainly for infrastructure development.

Monetary and Macro-financial

Since March 2020, the Reserve Bank of India (RBI) reduced the repo and reverse repo rates by 115 and 155 basis points (bps) to 4.0 and 3.35 percent, respectively, and announced liquidity measures across three measures comprising Long Term Repo Operations (LTROs), a cash reserve ratio (CRR) cut of 100 bps, and an increase in marginal standing facility (MSF) to 3 percent of the Statutory Liquidity Ratio (SLR), now extended till March 2021 and open market operations (including simultaneous purchases and sales of government securities), resulting in cumulative liquidity injections of 5.9 percent of GDP through September.

The RBI has provided relief to both borrowers and lenders (through end-August) and the Securities and Exchange Board of India (SEBI) temporarily relaxed the norms related to debt default on rated instruments and reduced the required average market capitalization of public shareholding and minimum period of listing. On April 1, the RBI created a facility to help with state government's short-term liquidity needs, and relaxed export repatriation limits.

Earlier, the RBI introduced regulatory measures to promote credit flows to the retail sector and micro, small, and medium enterprises (MSMEs) and provided regulatory forbearance on asset classification of loans to MSMEs and real estate developers (later extended to loans from NBFCs). CRR maintenance for all additional retail loans has been exempted, and the priority sector classification for bank loans to NBFCs has been extended for on-lending for FY 2020/21.

During April 17-20, the RBI, along with additional monetary easing, announced:

(a) a TLTRO-2.0 (funds to be invested in investment grade bonds, commercial paper, and non-convertible debentures of NBFCs);
(b) special refinance facilities for rural banks, housing finance companies, and small and medium-sized enterprises;
(c) a temporary reduction of the Liquidity Coverage Ratio (LCR) and restriction on banks from making dividend payouts;
(d) a standstill on asset classifications during the loan moratorium period with 10 percent provisioning requirement, and an extension of the time period for resolution timeline of large accounts under default by 90 days. Furthermore, state's Ways and Means Advance (WMA) limits have been increased by 60 percent and now extended till March 2021.

On May 13, the government announced measures targeting businesses:

(i) a collateral-free lending program with 100 percent guarantee,
(ii) subordinate debt for stressed MSMEs with partial guarantee,
(iii) partial credit guarantee scheme for public sector banks on borrowings of non-bank financial companies, housing finance companies (HFCs), and micro finance institutions.

The government also announced

(i) a Fund of Funds for equity infusion in MSMEs,
(ii) a special purpose vehicle (SPV) to purchase short-term debt of the eligible non-bank financial companies and housing finance companies, fully guaranteed by the government and managed by a public sector bank.

On May 22, the RBI undertook further regulatory easing, including the increase in the large exposure limit, relaxation of some of the norms for state government financing, credit support to the exporters and importers and extension of the tenor of the small business refinancing facilities. On June 4, the RBI extended the benefit under interest subvention and prompt repayment incentive schemes for short-term agricultural loans until August 31, 2020.

On June 12, the GST council announced that it would halve the interest rate charged on overdue filings of small businesses. Banks are required to maintain additional provision of five percent over and above the provision already held by them for accounts restructured. The RBI also announced a resolution plan for corporate and personal loans that were classified as 'standard' as of March 1, 2020 but were stressed due to COVID-19. Resolution needs to be invoked by end-December 2020 and the eligible loans continue to be classified as 'standard' until the implementation of the resolution plan. Ten percent provisioning is required following the implementation of the resolution plan. On August 31, banks are allowed to hold fresh acquisitions of SLR securities acquired from September 1, 2020 under held-to-maturity up to an overall limit of 22 per cent through March 31, 2021.

On September 22, the Parliament adopted the amendment to the Indian Bankruptcy Code, with no insolvency cases until December 25,2020. On October 9, the RBI announced that the risk weights for new housing loans sanctioned until March 31, 2022 will not be linked to the size of the loan, while they will remain linked to the LTV ratios; the maximum single counterparty exposure limit for retail loans by banks was eased from 5 to 7.5 crore. The RBI announced OMOs of state government securities on October 16. On-tap TLTROs up to three years tenor for a total amount of up to INR1,00,000 crore at a floating rate linked to the policy repo rate were announced on October 21. The Government extended the Emergency Credit Line Guarantee Scheme (ECLGS) for MSMEs first till November 30th, 2020, and then till March 31, 2021, while at the same time relaxing the eligibility criteria.

Section V: Critical evaluation of these various measures

With the onset of Covid-19, a developing country like India was taken on backfoot. The government's first response was to curb the spread of virus in our densely populated country. Hence, a complete lockdown was imposed which impacted the livelihood of many people and hence the country's GDP was badly affected.

The initial expenditure by the government was to develop infrastructure so as to accommodate the rising cases in India. Secondly, the government was trying to ensure that poverty struck people had food, shelter and other basic amenities to survive. On 20 June the Garib Kalyan Rojgar Abhiyaan was launched to provide livelihood and tackle the impact of COVID-19 on migrant workers in India. It is a rural public works scheme with an initial funding of ₹50,000 crore covering 116 districts in 6 states.

As unemployment started looming, the government eased out loan system, extended the due date for tax and GST filings and gave waivers too. India focussed on giving importance to agriculture sector to ensure that there is sufficient stock of grain and there should be no need to import food, which would have added worry to the already burdened economy.

The institutions also focussed on giving assistance to small scale industries. Interest rates charged on overdue filings were halved.

As the months of October, November and December are marked with festivals and considered to be auspicious, India saw a revival of small businesses. Also, with growing anti-China sentiments and FDIs, the demand for commodities rose in festival season giving employment opportunities to many semi-skilled workers in the industry. The sentiments of "Make in India" and "Aatm Nirbhar Bharat" further helped local goods to be more accessible in the market than the imported ones.

The hospitality sector also saw a recovery phase as people ventured out to celebrate the festivals with family. The restaurants also saw a ray of hope as people started flocking after June 1.

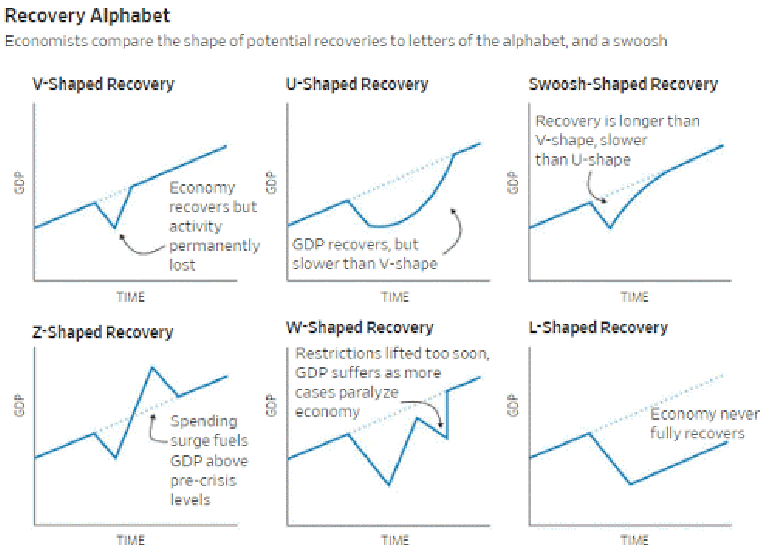
"We anticipate the overall Indian hospitality sector (including organised, unorganised and semi-organised operators) to incur an estimated total revenue loss of Rs 90,000 crore in 2020. Occupancy and average daily rate (ADR) are expected to reach pre-Covid levels only by 2022 and 2023, respectively—assuming that a vaccine is in place by early 2021 and becomes widely available before the end of the year," said Mandeep Lamba, President (South Asia) HVS ANAROCK.

Section VI: Conclusion and your take

As of December 2020, the threat of Covid-19 still looms. Although the country is trying to revive its economy, things won't improve until we have a vaccine ready for commercial use.

The fear of virus still looms in the minds of people and that is why many middle-aged and elderly people are not willing to step out. This has made a dent on the sales of many shops, revenues of various firms which are therefore looking for cost cutting measures such as removal of extra employees. Lower wage rates and salaries have plagued the expected future demand. This viscous cycle would be controlled only when people come out with a happy mind and feel secure.

Economists believe that India's economy is not out of the woods yet. Factors such as the rise of Covid-19 infections, re-imposition of lockdowns in certain parts of the country, and discounting of festive demand, will give a clearer picture in upcoming quarters. Various economists suggest different possible paths for the rise of Indian economy in the upcoming quarters. The same has been shown in the figure below.



References

- https://economictimes.indiatimes.com/markets/coronavirus-impact-on-economy
- https://en.wikipedia.org/wiki/Economic_impact_of_the_COVID-19_pandemic_in_India
- https://edition.cnn.com/2020/11/27/economy/india-recession/index.html
- https://www.businesstoday.in/current/economy-politics/india-stares-at-5th-recession-how-is-it-different-from-the-past-downturns/story/406518.html