Effect of Covid 19 on the Indian Economy

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Abstract

The Covid19 pandemic has been ongoing for approximately two years now. The last two years have been turbulent for everyone to say the least. This pandemic affected every aspect of life globally and there is scarcely a sector that was not impacted by it. India suffered heavy losses in terms of life and livelihood.

In this paper, I aim to analyse the effect Covid19 had on the Indian economy.

Methodology

The paper has been developed from various sources of secondary and primary research.

Sources for secondary research can be found below in the bibliography. Primary research includes an interview with an analyst at one of the MBB firms. Some of the questions asked are featured below.

Q1. In your opinion how did Covid19 effect India's economy?

Q2. What factor do you think had the biggest impact on the Covid economy?

Q3. Why in your opinion did inflation increase so much?

Q4. How do you think India's post Covid economy will fare?

Introduction

As relatively young economy, modern India has seen many ups and downs over the last seven decades. That said, the drop in GDP during the first year of the Covid19 pandemic is the sharpest drop it has ever seen historically (SWATI DHINGRA, 2021). What is even more jarring, is that this contraction was "much worse than the overall contraction in the world" (SWATI DHINGRA, 2021). But are things really as bleak as they seem to be? With the end of the pandemic in sight, India's economy looks to be bouncing back at a rate faster than the typical post-recession economy. This paper is an in-depth look at available data to understand what happened and what we can potentially expect for the coming financial year.

To truly understand the effect Covid19 had on the Indian economy, we must take into consideration the fact that there are two sides to it - the formal economy and the informal economy.

Let's first take a look at the formal economy.

Aspects of the formal economy considered

1. **India Real GDP Growth:** Real GDP growth rate, is a unit of measure that describes the increase or decrease of the total value of goods and services produced by an economy, after adjusting for inflation or deflation. Expressed in percentage, this figure is calculated to measure the growth rate of an economy over a period of time. It is used by policy makers when making decisions about enhancing economic growth or controlling inflation.

1. **CPI based Inflation:** The consumer price index (CPI), tracks the increase or decrease of the prices of common household goods and services at various levels. CPI based inflation/deflation is the rate of change in the prices of goods and services over a designated period of time. This percentage is crucial in understanding the maintenance of price stability in an economy and studying a country's economic health.

1. **Fiscal Deficit:** Fiscal deficit is the difference between government earnings and government spending and can be expressed as a percentage of the GDP. The size of the fiscal deficit needs to vary depending on the need of the hour. While a small fiscal deficit is often preferable, so as to increase the amount of government spending without incurring fiscal debt, a large fiscal deficit can be necessary in times of recession or crisis.

1. **Current Account Deficit:** The current account deficit is a measurement of a country's international trade where the value of the goods and services it imports exceeds the value of the products it exports.

1. **FDI:** Foreign Direct Investment, is when an individual or business purchases, a percentage/completely an asset (company, real estate etc.), in a different nation. FDIs are beneficial to both parties. Developing countries rely on FDI to help grow their emerging businesses with funding, technology, expertise and access to international markets. Individuals and companies from developed markets use FDI to expand their reach, diversify their holdings or reduce cost.

1. **Forex Reserves:** Foreign exchange reserves are assets held by a central bank. These assets include foreign currency and gold reserves. The main purpose of these reserves is to act as a

backup to the nation's currency, so they can be used in lieu if a currency suddenly faces selling pressure in the international markets.

Setting a baseline - Pre-Covid Era

1. **India Real GDP Growth:**

Aspect discussed	unit	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20
India Real GDP Growth	%	5.5	6.4	7.4	8.0	8.3	6.8	6.5	4.0

Source: (The World Bank, n.d.)

Pre Covid 19, India's GDP growth showed a healthy recovery after the lows of FY13. The BJP won the national election and enacted business friendly policies such as introducing the GST act, Mudra Loans for MSMEs and the insolvency and bankruptcy code. They introduced 'Make in India' to boost the manufacturing sector while inciting FDI by an increase in our ease of doing business rankings (Barman, 2018). As shown in the data above, this lead to sustained economic growth till FY18.
By 2019 however general consumption slowed down in the Indian economy. This was a results of various factors including a synchronised global slowdown, poor policy decisions such as demonetization, improper implementations of new policies like GST and a decline in investments in construction and infrastructure (Kapoor, 2019). This lead to a drop in GDP growth rate between FY18-20.

1. **CPI Inflation:**

Aspect discussed	unit	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20
CPI Inflation	%	9.3	11	6.7	4.9	4.9	3.3	4.0	3.7

Source: (World Bank, n.d.)

India struggled with high inflation due to a high fiscal deficit and loose monetary policy pre FY13. In September 2013, the Congress government appointed Raghuram Rajan, a globally respected economist, as the governor of the RBI. Rajan sharply increased interest rates and implemented measures- such as adopting the CPI as the primary indicator of inflation and increased Forex reserves (Goyal, 2016). Post these measures, inflation dropped and his successors have continued his good work in keeping inflation under control till FY21.

1. **Fiscal Deficit:**

Aspect discussed	unit	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20
Fiscal Deficit	% of GDP	4.9	4.5	4.1	3.9	3.5	3.5	3.4	4.6

Source: (Reserve Bank of India, n.d.)

A high fiscal deficit during the Congress government lead to a significant foreign outflow pre-2013. In 2014 the national government changed hands and the new ruling party introduced a roadmap to ~3% fiscal GDP deficit. Their plan was implemented successfully and the fiscal deficit came down to 3.4% of GDP in FY19. The government then loosened the fiscal deficit to 4.6% in FY20 to provide support to declining GDP.

1. **Current Account Deficit:**

Aspect discussed	**unit**	**FY13**	**FY14**	**FY15**	**FY16**	**FY17**	**FY18**	**FY19**	**FY20**
Current Account Deficit	% of GDP	5.0	2.65	1.35	1.1	0.5	1.4	2.4	1.0

Source: (The World Bank, n.d.)

Pre FY13, due to high gold and oil imports, India had a high current account deficit. To reduce these imports, the Indian government introduced tariffs on gold and other goods. Furthermore, a devaluation of the rupee in the foreign currency markets, made Indian goods and services cheaper for foreign countries, resulting in an increase of exports. As a result, the CAD is bought in check by FY15 and remains stable from there on.

1. **FDI:**

Aspect discussed	**unit**	**FY13**	**FY14**	**FY15**	**FY16**	**FY17**	**FY18**	**FY19**	**FY20**
FDI	USD bn	28	34.5	44	44.5	40	42	50.6	59.6

Source: (The World Bank, n.d.)

When the BJP government came into power in 2014, it was perceived by investors as a business friendly government with a clear majority in parliament. This set the stage for investor friendly policy implementations. Numerous business friendly practices such as a relaxing of investment norms in the coal mining, contract manufacturing and retail trading sectors were enacted by the Government, resulting in India's ranking on the World Bank's 'ease of doing business' list improving significantly. This lead to rising investments from foreign investors with India sees a spike in FDI which doubles between FY13 and FY20. The sectors that saw maximum inflow were tech(software and hardware, telecommunications, automobile and retail. (PTI, 2020)

1. **Forex Reserves:**

1. **Aspect discussed**	**unit**	**FY13**	**FY14**	**FY15**	**FY16**	**FY17**	**FY18**	**FY19**	**FY20**
Forex Reserves	USD bn	288.5	304	341	360	370	425	413	478

Sources: (Ministry of Finance, 2021)

While India's foreign reserves were high compared to other nations even pre FY13, there was concern among economists that the value was still low in the event of an economic crisis similar to the one faced by east Asian nations during the 1990s. When Raghuram Rajan was appointed governor of the RBI in 2013, he began increasing the forex reserves (Goyal, 2016). This he did by taking advantage of FPI inflows and buying dollars at every dip (Goyal, 2016). This progress was continued by his successors and by FY20, the forex reserves stood at nearly double of what they were when Rajan started.

As is evident from the data above, India's economy was already in decline before the pandemic started; leaving the government in a tough position with reduced resources for when it actually struck. Furthermore, without complete information about the then new disease, the panic stricken world took harsh measures to prevent it's spread. None however took more stringent measures than the Indian government. What followed was confusion and chaos, feeding negative sentiment into the financial markets, resource hoarding by individuals and the second largest migration this country had seen since independence, all driven by a loss of jobs and revenue by a significant portion of the population. Without adequate social support and Medicaid spending, the Indian economy was primed to suffer huge losses.

The impact during Covid 19

When asked, "**In your opinion how did Covid19 effect India's economy?**" – an MBB analyst said,

"India definitely witnessed a Covid induced recession in FY21 and FY22. The numbers tell you a lot of the story. GDP fell drastically, inflation shot up, businesses suffered and many shut shop leading to an immense number of layoffs. Fear and unemployment rose dramatically prompting a massive reverse migration leading to labour shortages for the little unskilled work that was still being done. All the panic and uncertainty lead to negative sentiments in the financial markets. In my opinion Covid 19 had a strong impact on the Indian economy and most of it was negative. Playing devil's advocate there where a few (very few) positive impacts too. The pandemic forced innovation and we did saw some breakthroughs in the fields of ecommerce, logistics and research. EdTech platforms and fintech platforms also flourished like never before."

1. **India Real GDP Growth:**

Aspect discussed	**Unit**	**FY21**	**FY22**
India Real GDP Growth	%	-7.3	8.3

Source: (The World Bank, n.d.)

In March 2020 India introduced one of the harshest lockdowns globally to curb the pandemic. This complete lockdown was imposed for a full quarter. Limited support measures via government sponsored loans were announced for the majority of stakeholders in India (MONEYCONTROL NEWS, 2020). These measures were significantly less supportive than those enacted by western governments, due to a desire to keep the fiscal deficit in check. This lead to a dramatic fall in all economic activity with the exception of essential services. The economy showed a rebound post the initial lock downs but was hampered again due to additional lockdowns across major economic centres during the second wave in Q1 FY22.

1. **CPI Inflation:**

Aspect discussed	**Unit**	**FY21**	**FY22**
CPI Inflation	%	6.6	5.3

Source: (World Bank, n.d.)

Inflation saw a sharp increase to 6.6% during the pandemic despite record low demand. This was primarily due to supply side issues during domestic and international lockdowns and their restriction on movement. A shortage of semi-conductors for example lead to a major increase in the price of electronics and a shortage of shipping containers impacted the cost of shipping goods, leading to an inflation of both raw materials and commodities alike (Hollenhorst, 2021). Inflation remained sticky through FY22 due to continued supply chain problems globally. India, however, controlled inflation better than most western democracies (i.e. US).

1. **Fiscal Deficit:**

Aspect discussed	Unit	FY21	FY22
Fiscal Deficit	% of GDP	9.4	6.9

Source: (Reserve Bank of India, n.d.)

The drastic drop in GDP significantly impacted government tax revenue, especially since a high share of tax revenue in India is via indirect taxes (GST). This resulted in a ballooning of the fiscal deficit to 9.4% and reduced the ability of the Indian government to enact any policy to support GDP growth (and so government measures were restricted to provisions of loans and significantly less drastic than those taken by major western economies) (MONEYCONTROL NEWS, 2020).

1. **Current Account Deficit:**

Aspect discussed	Unit	FY21	FY22
Current Account Deficit	% of GDP	-1.2	1.4

Source: (The World Bank, n.d.)

During the pandemic, India witnessed a current account surplus, meaning that the exports from India exceeded imports to India. While the numbers looked good on paper, the surplus was not a good indicatior for the Indian economy since it also showed falling imports due to a reduction in the income of the Indian consumer (SWATI DHINGRA, 2021). With a heavy lockdown, steep rise in inflation and a falling GDP; the income and consuming capacity of the average Indian fell leading to the above stated lack of imports. Falling exports exacerbated the issue of falling incomes by leading to closers and layoffs.

1. **FDI:**

Aspect discussed	Unit	FY21	FY22
FDI	USD bn	81	64.8

Source: (The World Bank, n.d.)

Foreign Direct Investment inflow increased substantially during the pandemic. As counter-intuitive as this is, there are valid reasons for the same. A very accommodative stance by the US federal reserve coupled with a lower interest rate lead to a substantial increase in the supply of money, permitting investors to acquire cash more easily to invest in businesses.

Additionally low interest rates in almost all western countries meant that investors started looking aboard to get higher yields on their investment. India became a prime target. This resulted in a strong rebound of the Indian financial markets during H2 of FY21 (correspondent, 2021).

1. **Forex Reserves:**

1. **Aspect discussed**	**Unit**	**FY21**	**FY22**
Forex Reserves	USD bn	577	630

Source: (Ministry of Finance, 2021)

Significant growth was also seen in India's forex reserves during the pandemic. This was largely due to high foreign direct investment (FDI) witnessed by India. This was forex directly being converted to INR for investment into India. Additionally, the Indian economy witnessed a current account surplus due to drop in imports. Due to these reasons, there was a surplus of dollars in the Indian forex market that were bought up by the RBI in exchange for INR.

From the above data, we can infer that the majority of damage to the Indian economy occurred due to supply chain issues which came into play because of Covid lockdowns, global shortages and inadequate social support spending. Though there was a surplus Current Account and increased FDI, any revenue generated was seen by citizens in top positions or citizens that invested in the financial markets. Due to the restriction of movement, limited government spending and drop in consumption, economic benefits where not reaped by the poor. Additionally with border tensions at the LAC and the banning of certain imports from China put further strain on MSMEs and logistic companies alike.

The lifting of lockdowns between the first and second wave lead to people going back to work and we saw a dramatic increase in GDP

In my interview with the MBB analyst I asked, **"What factor do you think had the biggest impact on the Covid economy?**". He said, "I think the biggest impact was created by international lockdowns and global shortages. One example of this is in the shortage of shipping containers. This shortage effected the price of everything. Even though imports were down due loss of incomes, exports also fell as for some the cost of shipping was just too high. Distribution channels were effected not just internationally but domestically too and the high cost of freight contributed significantly to the lack of both supply and demand."

Recovery post Covid 19

1. **India Real GDP Growth:**

Aspects discussed	**Unit**	**FY23**
India Real GDP Growth	%	8.7

Source: (NEWS, MONEYCONTROL, 2022)

The Indian economy posted sharp recovery after the lifting of the 2nd lockdown. Consumer spending rose drastically across categories. Despite the lockdowns in Q1 FY22, GDP still is estimated to record over 8% growth. Corporate profits saw a drastic rise during this phase and there has been an increase in investments by industry. e.g. the private equity industry invests USD 61 bn in FY22 (NEWS, MONEYCONTROL, 2022).

1. **CPI Inflation:**

Aspects discussed	**Unit**	**FY23**
CPI Inflation	%	4.5

Source: (FORTUNE INDIA, 2022)

Inflation is estimated to drop as supply side issues ease in the global supply chain from FY23 and beyond.

This was also corroborated in my interview with an MBB analyst when I asked, **“Why in your opinion did inflation increase so much?**” to which he said, “As I mentioned before, one of the main reasons for inflation was shortages, both domestic and global. Interrupted supply chains are a big problem for business and consumers alike. Once supply chains start returning to the norm or adjust circumvent covid related issues we should see a drop in inflation.”

1. **Fiscal Deficit:**

Aspects discussed	Unit	FY23
Fiscal Deficit	% of GDP	6.4

Sources: (Singh, 2022)

The government of India announced plans to keep an accommodate stance and maintain a high fiscal deficit till FY23. Post FY23, the deficit will gradually be bought back down to ~3% of GDP.

1. **Current Account Deficit:** As growth and income bounced back post the pandemic, so did imports. Rising imports led India back to a 1.4% CAD by FY22 (Lele, 2022), which as per economics, seems to be a healthy and stable long term rate for India.

1. **FDI:** FDIs are estimated to continue to remain high due to the growth story of India. India has been rated by investors as the no 1 destination to invest in Asia and no 2 globally (after the US) (correspondent, 2021). Financial markets remain significantly higher than the lows of H1 FY21 and 20+% higher than their peak in FY20 (correspondent, 2021).

1. **Forex Reserves:** Reserves are considered by economist to be at a very healthy level (20% of GDP). The expectation is for the forex reserves to continue to increase, however this increase is estimated to happen at a slower pace due to the large base of USD 630 bn.

Eventual spending by the private sector combined with a resurgence of hope in the markets and a resumption of infrastructure and construction activity even during the second wave, lead to stark economic recoveries. As global supply chains opened up, inflation dropped and the general population went back to work again, driving up public spending and tax revenue alike.

When asked, “**How do you think India’s post Covid economy will fare?**”, the MBB analyst said, “There has been promising recovery since the pandemic has slowed down and by the look of it this recovery will continue if there are no further extenuating circumstances. Will things on the ground stay the same? Probably not but with spending almost back to normal I think we are well on the way to a return of normalcy.“

Other considerations

The informal economy: The world’s informal economy or gig economy was arguably hit hardest by the Covid19 pandemic. In India, a significant portion of the population is employed in the informal economy. So while the statistics above paint a -not quite dire- picture, what they don’t take into account is that wealth and income inequality are on the rise. A study by the Pew Research centre suggests that one third of the pre-pandemic middle class have fallen into poverty and that the number of poor in the country has doubled (KOCHHAR, 2021). With the unemployment rate skyrocketing and average household income falling. The worst hit of course was the lowest income bracket -the daily wagers, the domestic workers, factory workers and micro vendors (SWATI DHINGRA, 2021). Without more exact statistics (as is in the nature of the nature if the informal economy) it is difficult to ascertain the actual extent of damage incurred.

Change in consumer behaviour: One of the biggest side effects of India's Covid19 policies was a forced change in consumer behaviour. Or perhaps it would be more accurate to say a fast tracked change. During and post the pandemic, consumer spending has noticeably shifted focus from physical to digital platforms in every aspect including how they work, entertain, learn, communicate, or shop. This is only natural given the combination of the virus and the lockdowns. In some cases these behavioural changes are temporary. Industries such as entertainment have already started bouncing back. Other changes will perhaps stay. The rise of ecommerce in every imaginable sector be it household goods to medication and even services is here to stay while a focus on remote working, learning and exercising might evolve further into a combination of the old and new (Sajal Kohli, n.d.).

Conclusion

In conclusion I would like to observe that the Covid19 pandemic did send the Indian economy into a temporary recession. However since the end of the pandemic, we have seen a V shaped recovery take place in the economy. Multiple factors such as GDP growth, forex reserves, FDI and CAD show healthy signs. Economists expect this recovery to continue and pertaining issues such as inflation are estimated to reduce overtime as the economy (India's and globally) move back to normalcy.

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