The Inquisitive Meridian
Multidisciplinary Journal

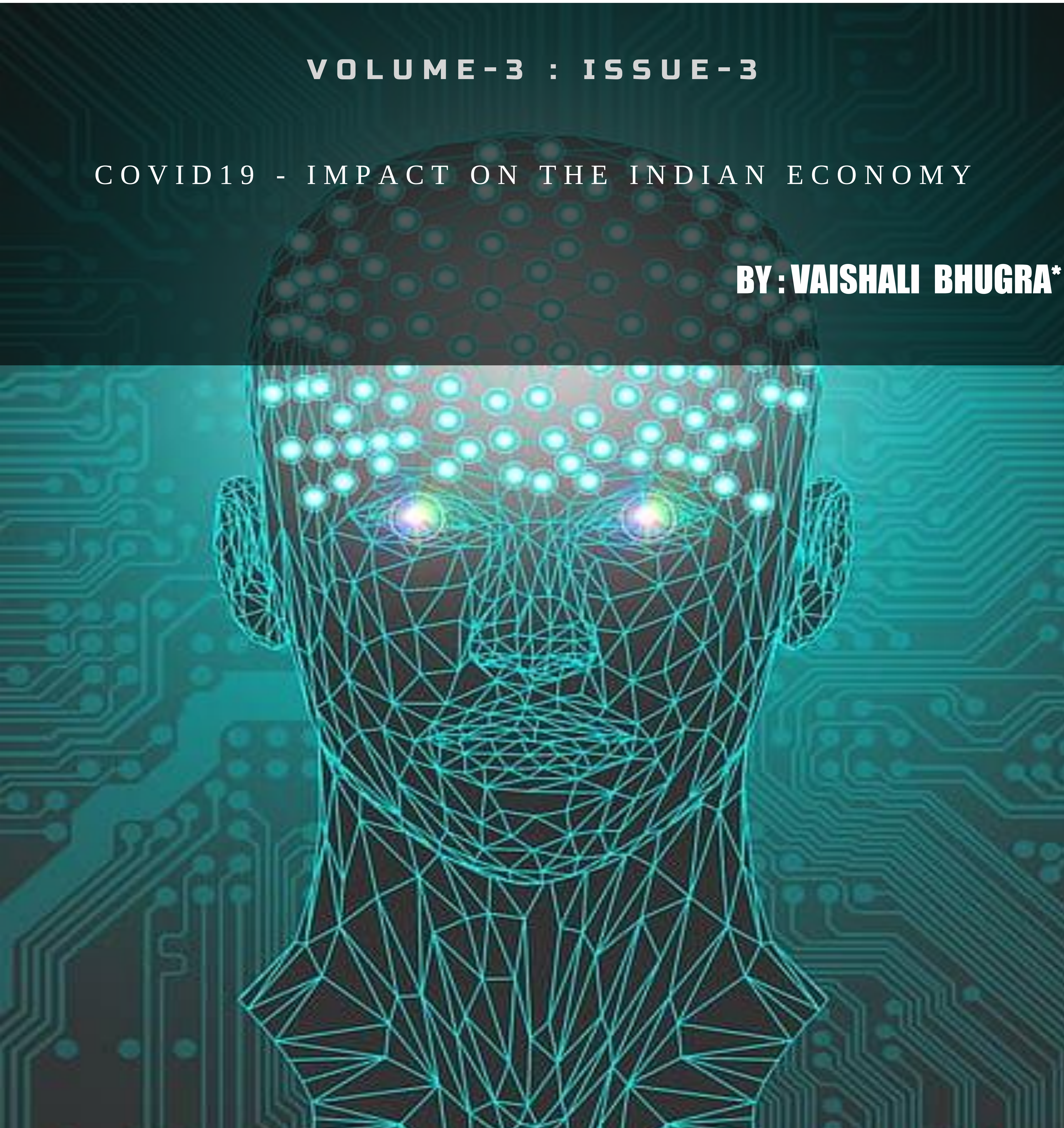
Received: August, 2020

Published: October, 2020

VOLUME-3 : ISSUE-3

COVID19 - IMPACT ON THE INDIAN ECONOMY

BY : VAISHALI BHUGRA*



The Inquisitive Meridian
Online ISSN:
ISSN-2347-6257

Abstract:

The outbreak of the covid-19 pandemic is an unprecedented shock to Indian economy. The economy was already in a parlous state before Covid-19 struck. With the prolonged country-wide lockdown, global economic downturn and associated disruption of demand and supply chains, the economy is likely to face a protracted period of slowdown. The magnitude of the economic impact will depend upon the duration and severity of the health crisis, the duration of the lockdown and the manner in which the situation upfolds once the lockdown is lifted. The state of the Indian economy in the pre covid-19 period, assess the potential impact of the shock on various segments of the economy, analyse the policies that have been announced so far by the central government and The Reserve Bank of India to ameliorate the economic shock and put forward a set of policy recommendations for specific sectors.

Keywords: COVID-19, Indian economy, Health crisis, economic impact.

Author : Vaishali Bhugra*[1]

[1] The author is currently pursuing B.COM LL.B 2nd year at University of Petroleum and Energy Studies (U.K).
Contact no.- 6261454466 , Email - bhugravaishali01@gmail.com

Introduction

The whole world is in the middle of a global Covid-19 pandemic, Which is inflicting two kinds of shocks on countries: a health shock and an economic shock. Given the nature of the disease which is highly contagious, the ways to contain the spread include policy actions such as imposition of social distancing, self-isolation at home, closure of institutions, and public facilities, restrictions on mobility and even lock down of an entire country. These actions can potentially lead to dire consequences for economies around the world. In other words, the effective containment of the disease requires the economy of a country to stop its normal functioning. This has triggered fear of a deep and prolonged global recession. On April 9, the chief of International Monetary Fund, Kristalina Georgieva said that the year 2020 could see the worst global economic fallout since the Great depression in the 1930 with over 170 countries likely to experience negative per capita GDP growth due to the raging coronavirus pandemic. The world has witnessed several epidemics such as the Spanish flu, outbreak of HIV/AIDS, SARS, MERS and Ebola. In the past, India has to deal with diseases such as small pox, plague and polio. All of these individually have been severe episodes. However, the covid-19 which originated in china in December 2019 and over the next few months rapidly spread to almost all countries of the world can potentially turn out to be the biggest health crisis in our history. Many experts already called this is a Black Swan event for the global economy. India recorded the first case of the disease on January 30,2020. Since, then the cases have increased steadily and significantly. India has recorded the third highest covid-19 caseload in the world after the united states and Russia with more than a million confirmed cases and more than 25000 deaths. The doubling rate has steadily gone up to around 18-22 days and the daily confirmed cases are 28000-30000. Globally there have been more than 13 million confirmed cases and close to 6 lakhs deaths in the whole world according to world health organization.

In order to curb the spread of virus, the government of India announced a nationwide lock-down starting March 25,2020 which continued for about two months. All non- essential services and businesses, including retail establishments, educational institutions, places of religious worship, across the country stayed closed during this period and all the means of travel were stopped aside from inter-state transport permitted toward end April and early may to let migrant workers, stranded pilgrims, tourists and students return to their native places. At the time this was the most far- reaching measure undertaken by any government in response to the pandemic and till date remains the world’s biggest lock-down in context of this disease. Subsequently, from end may early June onward the lock-down was gradually relaxed in a phased manner but contained in high-risk zones or containment areas. This was required given the uneven spread of the pandemic across the country with some states like Delhi, Gujarat, Maharashtra, Tamil Nadu, West Bengal etc. reporting higher than average confirmed cases and given the tremendous hardship that the nationwide lock-down had begun imposing on the overall economy with the continued surge cases, after an initial phase of relaxation in June, the nationwide lock-down was extended till July 31 albeit in a less strict manner compared to the lockdown of March 24. Measured relaxations have been permitted in areas outside the containment or high-risk zones including opening of non-essential establishments and businesses. Domestic flights have been allowed subject to the guidelines issued by the government to ensure safe travel of the passengers amidst the pandemic. However, restrictions on educational institutions, places of public gathering, such as shopping malls, gyms, swimming pools, cinemas theatres, entertainment parks, places of religious worship, operation of metro trains services etc. while vehicular movements within states is allowed there remains in place a night curfew period in almost all states. The re-imposition of the lockdown has delayed any chance of economic recovery that was anticipated once the first phase of unlocking had begun in June. The lockdown was primarily intended to buy time to prepare the health system and to put together a plan of how to deal with the outbreak once the case-load started accelerating. India's public health system is relatively weaker than other countries. The government spends only 1.5% of the total GDP on public health as a result of which the system remains grossly under- prepared to deal with a health crisis. The lockdown period was used to ramp up testing, contact-tracing. Isolating confirmed patients in designated quarantine centers and setting up treatment facilities including makeshift hospitals. However, the health care system continues to be overwhelmed by the rising number of patients every day especially in the worst affected states.

The unprecedented lockdown has had a significant effect on the economy. Millions of jobs and livelihoods are now at stake. As activity around the country came to a halt, with no job or income, more than 50 million migrant workers either returned to their native villages or shifted to camps inside the cities because state borders were sealed. While there are reports of some of them returning back to the cities now in search of jobs and livelihoods majority have not yet come back thereby imposing a massive strain on labour supply in the urban areas. Transportation of raw materials and finished goods across state was also severely constrained. Countries have closed national borders bringing international trade and commerce to an abrupt halt. All these are severely disrupting supply mechanisms and distribution chains in almost all sectors. At the same time, there has been a complete collapse Of consumption demand as millions of people stay home and postpone their non-essential expenditures. The overall magnitude of the impact of the pandemic will depend upon the duration and severity of the health crisis, the extent to which intermittent lock-downs are required in different regions of the country and the manner in which the situation unfolds as and when the nationwide lock-down is finally lifted and normal economic activity is permitted. The loss to the economy has already been substantial.

This crisis comes at a time when India's GDP growth was slowing down and unemployment was on the rise owing to poor economic performance over the last several years. The precarious situation that the economy was in before getting hit by this stock will potentially worsen the effect of the stock. This is especially because the financial sector which is the brain of the economy has not been functioning properly and the macroeconomic policy space to respond to such a crisis is severely limited. Earlier, Indian economy was primarily experiencing a demand slowdown whereas now both demand and supply have been disrupted. There are four channels through which the impact is getting transmitted to output growth. These are external supply and demand constraints due to global recession and disruption of global supply chains, domestic supply disruptions, and decline in domestic demand. The economic shock is impacting both formal and informal sectors. It may take a long time for the economy to recover from this shock even if the lock-down is fully lifted by August or September 2020. To the large extent the recovery will depend on the policy responses of the government and The Reserve Bank of India (RBI) during the crisis period. The policymakers have already announced an initial round of actions. Much more needs to be done to minimize the impact of the shock on the economy.

INDIAN ECONOMY IN PRE - COVID 19 PERIOD

The shock is playing out in almost a similar manner in all countries of the world in terms of demand and supply disruptions and the consequent economic slowdown. In case of India however the problem might be more acute and longer lasting owing to the state the economy was in, in the pre-covid-19 period. By the time the first covid-19 case was reported in India, the economy had deteriorated significantly after years of feeble performance.Among the indicators of rural consumption, motorcycle sales and the consumer non-durable segment remained in contraction in February 2020, reflecting weak rural demand. The lock down would have dampened any chance of revival of consumption demand and private investment. A few specific factors make India's position particularly vulnerable as it tries to deal with the ongoing economic crisis.

THE BANKING AND CORPORATE SECTORS

During crisis time, one sector of the economy that is required to play a crucial role in terms of alleviating the pressures on the real economy is the financial sector. The need of the hour is to keep credit flowing to all categories of economic agents: firms, households etc. to help them tide over this crisis.

In a bank dominated economy, particularly at a time when the stock market is touching new lows every day. The financial intermediaries that most firms will turn to are the banks. Actions taken by banks would be crucial in addressing this economic challenge. Banks also plays a vital role as institutional participants in the debt market. However, the banking sector in India is badly broken. Banks, especially the public sector banks, have been struggling to deal with mounting losses from non-performing assets on their balance sheets. The problems in the banking sector have been adversely affecting credit growth and by the time the pandemic hit India. These problems had begun to hurt the debt market as well which also play an important role in the context of financial intermediation. This could rapidly become a serious choke point as the Indian economy struggles to come to terms with this un precedented shock. The government and the banking regulator (RBI) took a series of steps to address the crisis. These included putting the weakest ten banks under a prompt corrective action framework which prevented them from expanding their books, initiating investigations by the Central Vigilance Commission (CVC), Central Bureau of Investigation (CBI) Etc. against senior officials of the banks, and directing banks to trigger the insolvency and bankruptcy code, against defaulting firms and accept large haircuts even when capital to provide for the losses was not sufficient. The single step is likely to deter bank officers from taking commercial decisions. While part of the fall in commercial credit growth may have been due to lack of demand given the balance sheet crisis in the private corporate sector, as admitted by the RBI governor himself in recent times " In view of subdued profitability and deleveraging by certain corporates, risk adverse banks have shifted their focus away from large infrastructure and industrial loans towards retail loans.

The consequences of heightened risk aversion in the banking system have begun hurting the debt market. In a situation where bank credit growth has been at a multi decade low, debt market especially the short-term debt market plays a vital role in financing terms. Credit spread on all these ATI bonds shot up and several planned issuances were cancelled. It is unlikely that any bank will be able to issue these bonds in the near future making it difficult for banks, especially private sector banks to raise capital. This is going to become a serious constraint as banks to raise capital. This is going to become a serious constraint as banks struggle to deal with the impact of the Covid-19 shock on their already fragile balance sheets.

LIMITED POLICY SPACE

Given the state of the economy and especially the state of the financial institutions, the policy levers available to the government to deal with the economic crisis are limited. Global Financial crisis (GFC)was felt in India, the domestic economy was in a better shape having experienced a credit boom and a high growth rate for the preceding year and the government was also in a position to implement both monetary and fiscal stimulus measures. More importantly, the financial institutions were not so badly damaged. This shows that the government now has very little fiscal room. As the crisis unfolds, falling tax collections, declining revenues of public sectors enterprises and rise in health sector expenses will further hamper the ability of the government to support the economy. Even without any additional expenditure, the deficit would go up substantially because of the decline in tax revenues and disinvestment receipts.

Monetary policy has its limitations too which had become apparent in the run-up to the crisis. In response to the growth slowdown, the Reserve Bank of India (RBI) embarked on a path of monetary expansion. Monetary policy transmission in India has been weak owing to structural deficiencies such as illiquid bond market, large sections of the population left out of the formal financial system etc. In addition, an impaired banking system and lackluster investment demand for the private corporate sector, will further hamper the transmission of a policy rate cut to aggregate demand and hence growth. In other words, the combination of demand and supply shocks are hitting the Indian economy at a time when the tools to deal with the crisis are most ineffective namely fiscal, monetary and financial. The external sector of the economy has been weakening as well. The nominal value of exports of goods and services.

IMPACT OF THE CRISIS

The countrywide lockdown has brought nearly all economic activities to an abrupt halt. The disruption of demand and supply forces are likely to continue even after the lockdown is lifted. It will take time for the economy to return to a normal state and even then social distancing measures will continue for as long as the health shocks plays out. Hence, demand is unlikely to get restored in the next several months, especially demand for non-essential goods and services. Three major components of aggregate demand- consumption, investment and exports are likely to stay subdued for a prolonged period of time. In addition to the unprecedented collapse in demand, widespread supply chain disruptions will continue for a while due to the unavailability of raw materials, exodus of millions of migrant workers from urban areas, slowing global trade, and shipment and travel related restrictions imposed by nearly all affected countries. The supply chains are unlikely to normalise for some time to come. Already several industries are struggling owing to complete disruption of supply chains from china. The longer the crisis lasts, the more difficult it will be for firms to stay afloat. This will negatively affect production in almost all domestic industries. This in turn will have further spill over effects on investment, employment, income and consumption, pulling down the aggregate growth rate of the economy. At this stage, the possible duration of the underlying health crisis remains uncertain. In addition, there are multiple unknown factors such as the true extent of impairment suffered by the different sectors of the economy, the magnitude of deterioration of the balance sheets of economic agents such as firms and households, the ability of both the formal and informal sectors to bounce back to normalcy once the lockdown is fully relaxed and most importantly, the potential destruction of the productive capacity of the economy. Therefore, it is difficult to fully comprehend the extent of the damage that the Indian economy is currently incurring. Some of the statistics available now already highlight the severity and duration of the slowdown the economy may experience going forward. After some amount of recovery in economic activity in June 2020 it appears that the slowdown has resumed once again in most of the sectors. The improvement seen in most high frequency indicators after the collapse in the April-May period has begun to wane since mid-June. This is presumably due to the renewed lockdowns all over the country and damage to consumer sentiment and overall economic productivity. Since, June end there has been no further moderation in the pace of declaration in electricity demand. Vehicle registration related transactions declined dramatically in end March and April, began improving since May but have begun falling again in the first week of July. There will be large scale effects for the hospitality and tourism industries. Hotels and restaurant chains across the country are closed right now. They are unlikely to witness a pick-up in demand even when the lockdown is relaxed. Their businesses will suffer for several months, sparking worries of large-scale layoffs. The world travel and tourism council has projected that travel could fall by 25% in 2020 putting to risk 12-14% of the jobs in the sector. Hotels and restaurants account for another 4 million jobs. With all non-essential businesses closed, most industries have been witnessing a drastic decline in sales. Revenue losses will force businesses to either close down or opt for wholesale retrenchment of workers. Operations of a large number of companies in specific sectors will not see business getting back to normal even after the lockdown ends, as the labour has moved out. Even capital-intensive sectors such as real estate, consumer durables and jewellery may not see a demand revival for several month or quarters. The labour participation rate recovered faster than the unemployment rate but in July this too has been slowing down indicating some sort of a plateauing out. A large number of firms will however struggle to survive they have to pay rents, salaries, debts etc. even as their revenues will steadily keep falling as people change lifestyles and cut back on expenditures.

Many of the firms will end up defaulting on their loans due to persistent fall in revenues. The firms that were near insolvency will end up in the bankruptcy process. Several large business houses have already invoked the provisions of force majeure to stall the payment of license fees, rents etc. and to restrain the invocation of penalties. The Indian economy will also continue to get affected by the global recession that may last for a while. This is bound to have spill over effects through financial and trade linkages of India with the rest of the world. Already foreign investors have been pulling money out of the Indian financial markets and are fleeing to safe assets as stock markets have crashed.

AGRICULTURE AND RURAL ACTIVITIES

The agriculture sector is critical as large numbers of workers and the entire country's population are dependent on this sector. The performance of the agriculture is also key to the state of rural demand. There were very fluctuations in the agriculture activities. However, the terms of trade have moved against agriculture due to bumper crop and horticulture production which caused a decline in food prices. Growth in rural wages was subdued in the pre-covid19 period, particularly for agriculture labour in both nominal and real terms, partly due to the slowdown in the construction sector. The adverse impact of covid-19 on agriculture has been much less as compared to manufacturing and services. However, the initial lockdown did affect agricultural activities and the necessary supply chains through several channels: input distributions, harvesting, procurement, transport hurdles, marketing and processing. Closure of restaurants, transport bottlenecks etc. reduced the demand for fresh produce, poultry and fisheries products, affecting producers and suppliers. A study of Narayanan (2020) indicates that when the initial lockdown was imposed in March, farmers were stuck with harvest as Agriculture product market committee (APMC) mandis closed in several states thereby disrupting food supply distribution from the production to the consumption centers. The study indicates that the government should focus on post-harvest activities, wholesale and retail marketing and initiate procurement operations. Some state governments have already taken initiatives.

Since, supply chains have not been working properly, vast amount of food started getting wasted leading to massive losses for Indian farmers. Media reports show that the closure of hotels, restaurants, sweet shops and tea shops during the lockdown affected the milk producers adversely. Due to lack of demand, the dairy farmers dumped the milks in the drains. Unable to export their produce many farmers are also dumped their seasonal products such as grapes etc. Poultry farmers have been badly hit due to misinformation particularly on social media at one stage, that chickens are the carriers of covid-19. Millions of small poultry farmers across the country particularly in the states of Maharashtra, Karnataka, Orissa and Andhra Pradesh were struggling after sales have crashed 80% over these false claims. Some of these developments have since got reversed. There is evidence that despite being considered an essential service, agriculture and food supply chains were impacted in the initial days of the lockdown. However, over the last two months, activity seems to have been recovering to some extent as agriculture markets adapted to the lockdown. Accordingly, the prices of cereal and vegetables which had initially gone up have been reversing. On the health risk in rural areas, it is true that presently the problem is much more serious in urban areas because of high density. But it can spread to 70% of India's population who live in rural areas. Many migrant workers have gone back to rural areas. There is a risk of covid-19 spreading to the farmers, agricultural labourers, workers and other working throughout the food supply chains. The agriculture and rural population have to be protected as social distance will be practiced relatively less in rural areas.

INFORMAL SECTOR

India has a very high share of informal employment in total employment. The informal workers were already facing problems with low wages and income in the pre-covid19 period. The pandemic has affected all levels of the society but it is the informal workers including migrants are the worst affected. With almost no economic activity particularly in urban area, the lockdown has led to large scale losses of jobs and incomes for these workers. Thus, livelihood of millions of workers was affected and it would take longer time for them to recover from this economic shock. There are about 40 to 50 million seasonal migrant workers in India. They help in the construction of urban buildings, roads, factory production and participate in several service activities. Soon after the lockdown was announced, one could see the images of hundreds of thousands of migrant workers from several states walking on foot for several hundred miles to go back to their respective village in search of safety. This exodus was triggered by the march 24 lockdown which was announced rather abruptly without giving the people of the country any time to prepare for it. Most of the migrants continue to be out of work as businesses and establishments have shut down or because it is not easy for them to return back to the urban areas having through one round of extreme hardship. In the absence of money, jobs, and any food, savings or shelter in large cities, they had been desperate to reach their villages but had allegedly received little support. Few migrant even died on the way due to exertion and lack of food. These workers feel villages are better for them as they can stay with their families. However, it is questionable whether they will be able to support themselves and their families by staying in the villages where the income earning opportunities might be significantly worse than in the cities, the very reason why they had migrated out to their native places in the first place.

Some of the migrants have returned to urban areas after relaxation of the lockdown but many of them are still in rural areas. These workers are looking for jobs in rural areas. Even the skilled and semi-skilled are working in the works MGNREGA. It will take some time for the economy to pick up in the post-covid19 period and this will further aggravate the future uncertainty for informal workers in general and migrant workers in particular. In the formal sector to the extent the firms do not close down, employees will still have their jobs and receive their salaries. The informal sector works differently. It depends crucially on people’s daily demand. With a large chunk of the potential customers of the informal sector staying at home right now and withdrawing from non-essential expenditures, the survival of informal sectors units will become questionable with every passing day, especially as the health crisis and the associated lockdown drags on. Many firms in the informal sector will be forced to shut down.

FINANCIAL MARKETS

Since the outbreak of covid19, there has once again been turbulence in the debt market. Credits spreads of corporate debt papers have risen sharply to levels higher than what was witnessed in the aftermath of the crisis. Debt mutual funds, even those that invest at the short end of maturity liquid funds, ultra-short duration funds etc. have taken serious hits to their net value assets making investors nervous.

These factors along with the general risk aversion triggered by the covid19 outbreak and the associated business disruption are likely to push firms to redeem their investments in debt funds and stocks pile cash. This has already created extra ordinary redemption pressures on mutual funds. Ideally mutual funds would respond to these redemption pressures by selling the debt securities that they have been holding to interested buyers in the secondary market. Although the sell-off was witnessed across-the-board, it was more severe for industries that are hit the hardest by the covid19 pandemic and the consequent lockdown such as tourism and hotels, real estate, asset financing services, banks, metal industry, automobile and ancillaries, textiles, electricity, mining and food product companies.

ANALYSIS OF POLICIES ANNOUNCED

On march 26,2020 the finance minister announced a Rs 1.7 lakhs crore package largely aimed at providing a safety net for those who have been worse affected by covid-19 lockdown i.e., the unorganized sector workers, especially daily wage workers and urban and rural poor. The “Pradhan Mantri Garib Kalyan Yojana” contains the following components:

1. Free additional 5kg wheat or rice per person for 3 months.
2. 1kg free pulses per household for 3 months.
3. Free LPG for Ujjwala beneficiaries for 3 months.
4. Rs 2000to 87 million farmers under PM Kisan yojana in 10 days.
5. Increase in MGNREGA wages Rs 202from Rs. 182.
6. Rs 500 per month to 200 million female for jan dhan account holders for next 3 months.
7. State to use district mineral fund for medical activities.

ATAMNIRBHAR PACKAGE:

In May 2nd week the Finance Minister announced a comprehensive economic relief package called the atamnirbhar (self-sufficient) package. Which had three components:

i. Monetary actions.
ii. Fiscal actions.
iii. Economic reforms.

POLICY CHALLENGES

While some policy actions have already been announced by the government and the RBI, they are mostly interim measures and are not going to be adequate to support the economy. Given the current macroeconomics and financial environment in India, there are significant challenges is fiscal, monetary and financial policies which have to be taken into consideration by the policymakers. Even more important, there are some policy traps that must be avoided in order to prevent a long term eco nomic disaster. The objective must be to ensure a V-shaped economic recovery once the health crisis abates. In case of fiscal policy, even assuming a conservative scenario where the government does not incur any additional expenses due to covid-19, the deficit will be greater than the projected value in the budget. During the two months long lockdown, almost all economic activities had been suspended and most of these are unlikely to resume in near future given the nature of the health shock. As a result, government revenues will fall drastically.

POLICY RECOMMENDATIONS

Within the constraint discussed above, there are a few actions that the policymakers can consider as they gear up to deal with the economic crisis. A joint effort from both the state and central governments is critical.

1. AGRICULTURE:

- Safety of farm population
- Supply chains.
- Procurements measures.
- Food security for farm families and agricultural workers.
- Avoid exports bans.

- Agricultural reforms.

2. INFORMAL SECTOR:

- Food and nutritional security.
- Cash transfers.
- Mahatma Gandhi National Rural Employment Guarantee Act scheme.
- Migrant workers.
- MSME And MFI
- State levels programmes.

3. BANKING SECTOR

- Resolving firms.
- Reviving credit growth.

4. MONETARY POLICY

5. FISCAL POLICY

CONCLUSION

Covid-19 has posed an unprecedented challenge for India. Given the large size of the population, the precarious situation of the economy, especially for the financial sector in the pre-covid19 period, and the economy's dependence on informal labour, lockdown and other social distancing measures are turning out to be hugely disruptive. The central and state government have recognized the challenge and have responded but this response should be just the beginning. The eventual damage to the economy is likely to be significantly worse than the current estimates. On the demand side the government needs to balance the income support required with the need to ensure the fiscal situation does not spin out of control. The balance struck so far seems to be a reasonable one but the government needs to find a greater scope for supporting the incomes of the poor. Involvement of the state and the local governments may also be crucial in the effective implementation of further fiscal incentives. Policy makers need to be prepared to scale up the response as the events unfold so as to minimize the impact of the shock on both the formal and informal sectors and pave the way for a sustained recovery. At the same time they must ensure that the responses remain enshrined in a rules-based framework and limit the exercise of discretion in order to avoid long term damage to the economy.