Covid-19 Crisis: India's Macroeconomic Policy Response and Future Challenges

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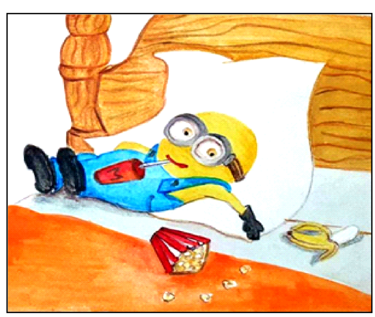
Background

Indian economy was ranked as the 5th largest economy in 2019 (Myers, 2020). The country overtook France and Germany to secure the ranks of top five largest economies of the world. On an optimistic note, it has been growing steadily at a growth rate above 5 per cent in 2009-2019 time period. However, the world ranking is expected to change owing to the external shocks imposed by the Novel Coronavirus to all economies of the world. Coronaviruses are a large family of viruses that are known to cause illness ranging from the common cold to more severe diseases such as Middle East Respiratory Syndrome (MERS) and Severe Acute Respiratory Syndrome (SARS). A novel coronavirus (CoV) is a new strain of coronavirus that has not been previously identified in humans (WHO, 2020). The real impact of this disease has been studied by various scientists after it was declared as a pandemic in January 2020 by World Health Organization. Being a fast spreading infectious disease, COVID-19 has taken a serious toll on the human health with countries reporting alarming number of positive cases and consequent deaths within a short-period of time. Ruling Governments of all the affected countries face a serious challenge of saving lives and economy side by side. As majority of the affected countries imposed lockdown and work-from-home options (except the essential services and industries), the economic activities



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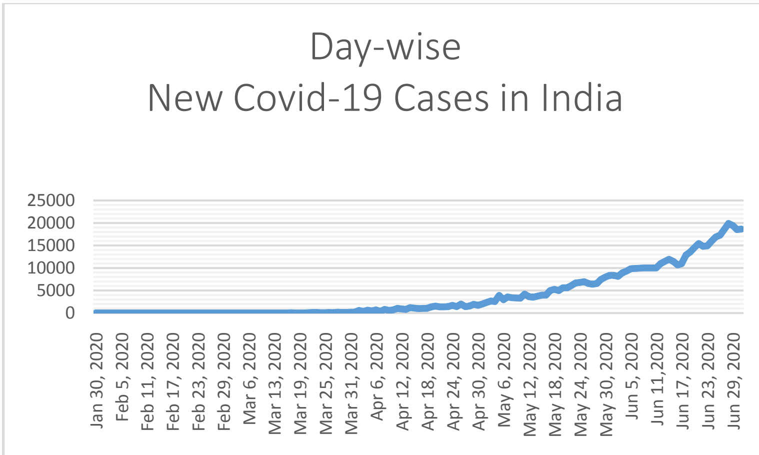
have been seriously affected. Rating agencies paint a gloomy future for the world economy cautioning against grim depression in store for the countries battling the disease.

Economic revival packages are being announced by various countries in order to restart economic activity and stimulate consumer demand. The global economy is projected to contract sharply in the financial year 2020-21 (nearly 3 per cent), worse than what was experienced during the times of 2008-09 financial crisis. The prime pull factors for the economic recession are: extent of globalisation and dependence of a country on imports, pre-crisis sectoral contribution of agriculture & manufacturing to GDP (as WFH options couldn't be substituted here), pre-crisis macroeconomic health of a country and post-crisis expansion of Government expenditure, quantum of foreign exchange reserves, foreign-aid recipient, extent of tax-base and revenue collections, etc. Detailed studies on these factors can potentially reveal the macroeconomic strength of a country in absorbing recessionary shocks. With the global and country-wide forecasts, the central banks of various countries have announced monetary stimulus measures to liquidate the economy and policy makers have adopted fiscal measures.

This research examines the macroeconomic constraints behind the fiscal and monetary stimulus packages announced by the Indian Government and reviews the challenges that pose to the economy in mitigating the present and future crisis. The paper discusses the Covid-19 crisis situation in the World and India in terms of economic indicators and examines the state of Indian economy before and during the COVID-19 crisis. The primary focus of the paper is to understand and explain the macroeconomic constraints/challenges linked to the fiscal and monetary stimulus announced by the current government. In doing so, the paper briefly discusses the broad elements of the fiscal and monetary package. It also critically discusses the growth forecasts and analyses the growth prospects of India for the forthcoming years. The paper concludes with a discussion on the key policy challenges for India with the COVID-19 crisis.

Covid-19 Crisis in India

Covid-19 has given rise to two concurrent global crisis: health crisis and economic crisis (UNDP, 2020). The first positive case of COVID-19 was detected on 30th January 2020 in Kerala where a student of Wuhan was spending vacation in the home state, Kerala in India (Rawat, 2020). India has seen an exponential curve in terms of rising cases since then. The total detected cases have crossed 5 lakh (5,87092 on 01 July 2020) since then and there have been growing debates about the community transmission of the disease by different groups.

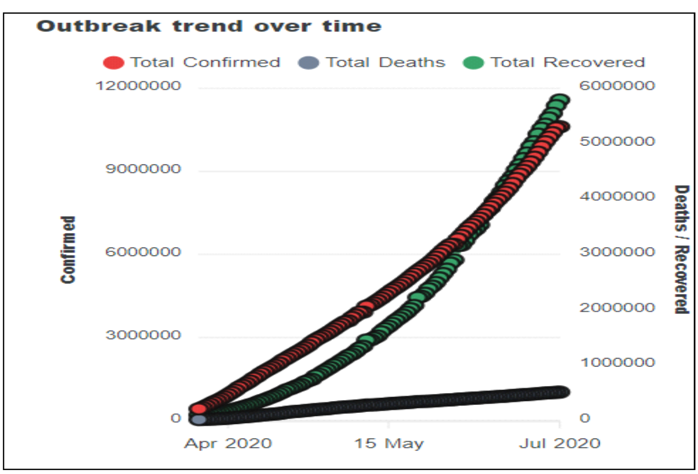


Source: Compilation of data from Web as on 01 July 2020.

Graph I: Total Covid-19 Cases in India

It can be observed that India has experienced a steadily rising trend from January till June 2020 and the positive impact in slowing the growth rate of this contagious disease can be observed giving time to the local and state governments to build the required health infrastructure and design policies to stimulate economic activity.

The number of positive cases by mid-June 2020 had already crossed 3,00,000 and the fatality rate has been 2.8 per cent which is relatively low given the large population density of the country. The Indian Government has been able to control time taken to multiply cases by imposing nation-wide lockdown for



Source: (Corona Tracker, 2020)

Graph II: Rising Trend of Covid-19 Cases in India (as on 01 July 2020)

68 days for March 25th to May 31st in the year 2020. However post-lockdown, India continued to report record-breaking numbers of positive cases as well as deaths, though it has been debated that the peak of Corona graph would be reached in August-September 2020 owing to the resumption of economic activity in different parts of the country and consequent risk of spread through close contacts at workplace or outside home.

Unlike China, India has experienced a distributed spread of COVID-19 Cases across states with not a single state/Union territory reporting zero case. Table 1.1 depicts the state-wise numbers ranked in the descending order highlighting the concentration of higher cases in urban clusters particularly around metropolitan cities.

STATE ⇕	CASES ▾	ACTIVE ⇕	RECOVERED ⇕	DEATHS ⇕
Maharashtra	1,74,761 ▲ 4,878	75,995 ▲ 2,682	90,911 ▲ 1,951	7,855 ▲ 245
Tamil Nadu	90,167 ▲ 3,943	38,892 ▲ 1,558	50,074 ▲ 2,325	1,201 ▲ 60
Delhi	87,360 ▲ 2,199	26,270 ▲ 24	58,348 ▲ 2,113	2,742 ▲ 62
Gujarat	32,557 ▲ 619	7,049 ▲ 178	23,662 ▲ 422	1,846 ▲ 19
Uttar Pradesh	23,492 ▲ 664	6,711 ▲ 61	16,084 ▲ 578	697 ▲ 25
West Bengal	18,559 ▲ 652	5,761 ▲ 226	12,130 ▲ 411	668 ▲ 15
Rajasthan	18,014 ▲ 354	3,381 ▼ 256	14,220 ▲ 602	413 ▲ 8
Telangana	16,339 ▲ 945	8,785 ▼ 774	7,294 ▲ 1,712	260 ▲ 7
Karnataka	15,242 ▲ 947	7,078 ▲ 692	7,918 ▲ 235	246 ▲ 20
Andhra Pradesh	14,595 ▲ 704	7,897 ▲ 418	6,511 ▲ 279	187 ▲ 7
Haryana	14,548 ▲ 338	4,340 ▼ 136	9,972 ▲ 470	236 ▲ 4
Madhya Pradesh	13,593 ▲ 223	2,626 ▲ 19	10,395 ▲ 196	572 ▲ 8
Bihar	10,043 ▲ 403	2,289 ▲ 101	7,687 ▲ 297	67 ▲ 5
Assam	8,227 ▲ 475	2,568 ▲ 160	5,647 ▲ 314	12 ▲ 1

Source: (COVID 19 Tracker, 2020)

Graph III: State-wise Distribution of COVID-19 Cases in India

Maharashtra has reported the highest number of cases leading with nearly the 1/3rd of the country count vis-à-vis other states. This was followed by the state of Tamil Nadu and capital Delhi whereas the highest fatality rate has been reported in the state of Gujarat and the steepest steady rise in cases is being accounted by Delhi and Mumbai regions in the early June period. Multiple reasons account for the spread of COVID-19 in India ranging from relaxed approach to religious gatherings to the return of migrant labour as well as Indian citizens from overseas to various states during the lockdown period. Given the large population base, high number of migrant persons in different parts of

India and the re-opening of the economic activities , there have been growing concerns about need for further lockdowns in near future.

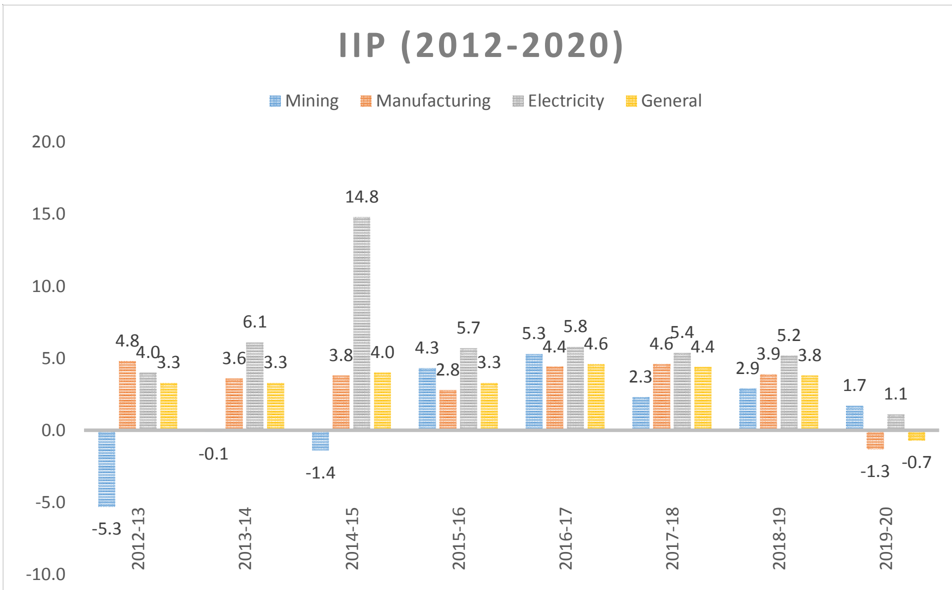
State of Indian Economy at the Onset of Covid-19 Crisis

Despite being the 5th largest economy in the world, the slow pace of growth in the year 2019-20 had been a cause of concern for the Indian policy-makers. Slowdown in the industrial activity coupled with financial issues in the airline industry marked the beginning of financial year 2019-20. The GDP growth rate for the year 2019-20 fell to 11 year low of 4.2% amidst the end of the financial year during nation-wide lockdown. World output growth also grew at a slow rate of 2.9 per cent reflecting upon the slowing consumer demand worldwide coupled with uncertainties due to the US-China trade conflict and rising geo-political tensions between US and Iran. This led to a weak environment for international trade, consumer demand and global manufacturing.

Source: Author's Compilation

Graph IV: GDP Growth Trends 2019-20

The Index of Industrial Production (IIP) data reflects that manufacturing activity contracted to -1.3 per cent in 2019-20 compared to 3.9 per cent in 2018-19. This was pertinent owing to the nationwide lockdown. It can be observed that electricity sector grew at the slowest rate (1.1. per cent in 2019-20) in the last eight years while manufacturing sector reported negative growth rate for the first time in this period at annual basis. Development theories account the linkage of high unemployment rate in developing economies to slow growth of manufacturing sector. Slowdown in the year 2019-20 was coupled with one of the highest unemployment rates India has witnessed in the last 2 decades (6 per cent approximately). It can also be observed that mining sector continue to grow at a positive rate (1.7 per cent) in the year 2019-20, mainly owing to key reforms in the mining sector.



Source: Author's own Compilation

Graph V: Trends in Index of Industrial Production

State of Indian Economy and Policy Announcements during Lockdown (2020-21)

Social distancing measures in the physical markets have brought in a sharp drop in consumer demand. Disrupted supply chains during the period of country-wide lockdown has also affected the inventory stock and business revenues across different sectors. Reduction in demand can have a vicious impact on further industrial activity plunging the economy into recession until the crisis is completely over. Government of India announced plethora of measures during the lockdown so as to prevent the economy from turning into an economic crisis from health crisis.

Monetary Stimulus Package: In order to arrest the impact of Covid-19 crisis and consequent lockdown on liquidity, India's Central Bank has announced stimulus package for the common man, commercial enterprises, non-banking financial companies as well as banks. The policy aimed to mitigate the ill-effects of virus, revive growth and ensure financial stability. The repo rate has been reduced to 4 per cent and the fixed reverse repo rate has been reduced to 3.35 percent. The Marginal Standing Facility rate has been reduced to 4.25 per cent. The accommodative stance has been taken mainly to revive growth. This measure has been taken to discourage surplus bank deposits with RBI and encourage their flow into productive channels of the economy. It also aimed to expand the bank's credit growth which vital to revive the economy from slowdown. Reduction in Cash Reserve Ratio by 100 basis points to 3 per cent. Moreover, the Central bank also reduced the requirement of minimum daily CRR Balance to 80 per cent from 90 per cent effective from 28 March 2020 till 26 June 2020. Marginal facility rate has been increased from 2 per cent of statutory liquidity ratio to 3 per cent. Banks will be able to withdraw more money through this measure in times of stress. Targeted Long-term repo auctions of 3 years tenure to be conducted for a total amount of 1,50,000 crore at floating rate. This measure has been introduced to retain the liquidity in the banking system. Moratorium on term loans for the period of 6 months has been extended. This measure is aimed at stabilising liquidity at household level and to ensure sustained increase in consumer demand post-lockdown.

Refinance facility has been provided to financial institutions like National Bank for Agriculture and Rural Development (NABARD), Small industrial Development Bank of India (SIDBI) and National Housing Bank (NHB) to enable them to meet sector-specific needs. Advances under this facility to be charged at the RBI's policy repo rate at the time of availing it. Changes also introduced for the asset classification in the banking system. The 90-day NPA period will not include the moratorium period. Non-Banking Financial Companies (NBFCs) have been given flexibility to consider similar relief to their borrowers. Scheduled commercial banks and cooperative banks to not provide dividends to their shareholders from profits pertaining to the financial year 2019-20 till further instructions of RBI. This measure has been taken with a view to conserving bank capital. Liquidity coverage ratio has been brought down from 100 per cent to 80 per cent temporarily. It shall be restored back to 90 per cent by the end of 01 October 2020 and 100 per cent by the end of 01 April 2021.

Some other measures were announced by the Central bank for NBFC loans for commercial projects, resolution timeline, etc. which can be directly accessed on central bank's webpage. To sum up, the monetary stimulus package of RBI has been aimed to easing liquidity at not just banks, but also non-banks and financial institutions. RBI has estimated that inflation has been on a declining trajectory and is expected to fall below its target rate of 4 per cent at the end of the second quarter of 2020-21 (RBI, 2020).

It has also been found that in the production sectors, industrial production shrank by close to 17 per cent in March 2020, with manufacturing activity down by 21 per cent. The output of core industries, which constitutes about 40 per cent of overall industrial production, reduced to 6.5 per cent. The manufacturing PMI for April recorded its sharpest deterioration to 27.4, spread across all sectors. The services PMI plunged to an all all-time low of 5.4 in April 2020 (RBI, 2020)

Fiscal Stimulus Package: Alongside the monetary stimulus package, the Ministry of Finance also announced a fiscal stimulus package on 12th May 2020. Together, a whopping 20 lakh crore rupees have been injected in the Indian economy to enable it to recover from the external shock of Covid-19 crisis. Measures have been taken to boost employment, stabilise business investments and encourage self-reliant economy. The key highlights and their expected impact on Indian economy can be discussed:

(i) Injection of additional Rs.40,000 crore to MGNREGA Scheme (Mahatma Gandhi National Rural Employment Guarantee Act). This step is expected to boost rural employment and is hailed as an important step towards absorption of rural migrant labour that has returned from urban areas owing to nationwide lockdown.

(ii) Rs.15,000 crores have been committed for health related measures for containment of Covid-19.

(iii) Borrowing limits of the states have been increased from 3 to 5 per cent of gross state domestic product (GSDP).

(iv) Structural reforms to be introduced in eight sectors: Coal, Mineral, Defence, Airports and airspace, Maintenance: Repairs and operations (MRO), power sector, social infrastructure projects, space and atomic energy

(v) Upgradation of farm infrastructure (cold chains & harvest storage), animal husbandry (Rs. 5000 crore infusion to dairy farmers) and fishery (development of marine and in-land fisheries)

(vi) Collateral free automatic loans for businesses and MSMEs and Rs.30,000 crore liquidity has been injected into NBFCs.

(vii) Free food grains to be distributed to migrant labour for two months and affordable rental housing complex to be provided for Migrant workers or urban poor. Street vendors to be provided credit facility and Rs. 6000 crore employment boost using CAMPA Funds (Compensatory Afforestation Fund Management and Planning Authority)

(viii) Rs.90,000 crore financial support to power discoms and Rs.3 lakh crore emergency working capital facility has been provided to the small businesses.

Key Challenges at Policy Level

(a) Slow Growth Forecast

With GDP growth slowing down to 3.1 per cent in the last quarter of 2019-20 and the consequent lockdown of more than 68 days, the growth forecasts of Indian economy have been revised from time to time. India's growth rate was 4.2 per cent for the year 2019-20. However, it is expected to contract below zero in the current fiscal year 2020-21. India's central bank has forecasted the annual GDP growth rate to contact in the range of 1 to 6 per cent while IMF has predicted that Indian economy will shrink by 4.5 per cent in the current fiscal year.

Table I: Growth Forecasts for India

Name of the Institution	*Annual GDP Growth forecast (In percent) in 2020-21*	*Annual GDP Growth forecast (In percent) in 2021-22*
FITCH	-5	8
World Bank	-3.2	5.8
RBI	-6 to 1	NA
Moody	0	6.6
IMF	-4.5	NA

Source: Author's Compilation.

Moreover, the merchandise exports have reduced by 60.3 per cent in April 2020 and imports have contracted by 58.6 percent. Incidentally, the net foreign direct investment as well as net portfolio investment has picked up in May 2020. The foreign exchange reserves of India have been US $487 billion which are sufficient for a year's imports. Government of India has announced fiscal and monetary stimulus package with the objective of accelerating the economic growth rate from the second quarter of FY 2020-21. Moreover, in the post-lockdown period, majority of the workplaces have opened up which has begun the process of economic revival. It has been estimated that the unemployment rate in India fell to its pre-lockdown level of 8.5 per cent in the week that ended on 21 June from the peak rate of 23.5 per cent in April and May owing to job-losses to workers due to nationwide lockdown. However, urban unemployment continues to be higher than rural unemployment (CMIE, 2020).

(b) Migrant Labour

Nationwide lockdown initiated by the Government has impacted the migrant labour the most who form the larger percentage of India's informal sector. The migrant labour not only lost their temporary jobs and incomes accruing from it, they also faced cash and food crunch leading to voluntary return to their hometowns. Nearly 40 million internal migrants have been affected directly or indirectly by the travel bans, lockdown and social distancing measures preventing them to return neither to their workplace nor to their hometowns (World Bank, 2020). This led to the beginning of journey of thousands of migrants on foot covering long distances (greater than 1000 kms) from their workplace locations to their home-states. This led to the Government starting special ‘Shramik’ trains for inter-state transport of migrant labour and also set-up of camps with basic provisions to provide shelter to stranded migrants in various districts. Government also began special air services ‘Vande Bharat’ to transport stranded Indian citizens/workers in other countries back to India.

The dual challenge of the State Governments has been to monitor the health status of the migrants who have returned from cities having high Covid-19 cases and also provide employment opportunities for their sustainable livelihoods. Skill mapping has been done by many states including Uttarakhand, Rajasthan, Uttar Pradesh and Madhya Pradesh for the returned internal migrants and also been undertaken for skilled workers returning from foreign countries under the Vande Bharat Mission through the SWADES scheme (Sharma, 2020).

(c) FRBM Challenge

The economic shock induced by the Covid-19 crisis has further scaled up the Fiscal challenges of the Indian Government. The fiscal deficit in February 2020 (much before the crisis) was higher than the target rate and was proposed to be relaxed from 3.3 per cent to 3.8 per cent in the Union Budget announcements by the Ministry of Finance owing to the slowdown in the economic growth rate. However, the Covid-19 crisis coupled with the nationwide lockdown of nearly two months pushed the Government to announce economic stimulus package of nearly 10 per cent of GDP amidst the high fiscal deficit numbers further aggravating the gap between Government expenditures and revenues. This is expected to further deepen India’s fiscal deficit and rolling targets for the next two years.

Under the Fiscal Responsibility and Budget Management Act (2004), the Government has the challenge of reducing its fiscal deficit to 3 per cent of GDP using plethora of suggested measures to ensure the country’s financial stability. Government borrowings are expected to increase to the tune of 6 to 7 per cent of GDP which is again higher than the FRBM limit and will reduce public savings temporarily. Currency printing better known as deficit financing is another alternative in the hands of the Government. It is also being debated whether FRBM targets themselves need a practical revision as the Government has not been able to achieve them. There have been reports estimating fiscal deficit target being revised to 7.9 per cent for the FY 2020-21 (PTI, 2020). Fiscal stability is the next big challenge for the Government post economic and health revival in India.

(d) Health Expenditure

It has been estimated that public health systems in countries have a chance to respond to the Covid-19 crisis without getting burdened if they are able to successfully 'flatten the curve' of new cases and resulting fatalities. It is equally important to not only reduce the caseload but also do so within the existing health system capacities of different regions (UNDP, 2020). In the Indian scenario, arresting the growth of Covid-19 cases has not only been a medical & administrative challenge but also a socio-economic challenge. 100% implementation of almost all the WHO recommendations for the individuals has been a serious challenge not only in rural areas but also urban areas leading to a spike in the number of cases after the country went in its first and second stage of 'Unlock'.

Despite of an increase in the health expenditure by the Government focused on containment of Covid-19 virus and boosting research and development for its treatment & prevention, positive results are still awaiting with the country grappling hard to control the spread of virus from the stage of local to community transmission. Effective health strategies and social outreach of Covid-19 related awareness programmes are the need of the hour to arrest the magnitude and spread of virus in the densely populated country.

Discussion and Conclusion

World Trade Organization has predicted that the global merchandise trade is expected to contract by 13-32 per cent in the year 2020. Capital outflows are expected to continue in the emerging market economies and global financial markets have been volatile. In the case of India, a consensus exists among the various forecasters for the sharp-turnaround of GDP growth similar to V or U shape expected from the third quarter of 2020-21. Preliminary data suggests that Indian economy has already resumed its economic activity and is currently on the road to recovery.

The biggest fiscal challenge amidst Covid-19 crisis for India is to effectively revive and accelerate the economic growth rate to above six per cent in the next two financial years and this calls for a comprehensive strategy of reviving all the industries in the primary, secondary and tertiary sector. However there are twin constraints to this challenge currently: less than full-capacity workforce at workplaces and worsening health status of few states in India. This is preventing utilisation of productive capacity in optimum manner and is leading to slow revival in manufacturing industries.

Achievement of monetary targets of India's central bank is also a cumbersome challenge. Effective transmission of monetary policy changes in increasing household demand for goods and services is likely to be an important factor in stimulating economic activity in the country. However, this requires fine-tuning of demand-supply logistic chain which is possible only when the physical and e-markets resume manufacturing and delivery to the pre-lockdown levels. While RBI has infused seemingly sufficient liquidity in banks, non-banks, and other developmental and financial institutions, & also relaxed the moratorium period and other NPA measures, the transmission of the benefits of these policy measures to the common man in reviving aggregate demand is expected to take some time. Therefore, Indian economy is expected to grow at a slow rate till the end of second quarter of FY 2020-21.

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