PRIME 30 YEARS

Path for India's Economic Recovery – Protect, Revive, Sustain

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Global Scenario

The devastation that Covid-19 is leaving behind is unfathomable. We are all hoping that the pandemic will soon come to an end and eagerly looking forward to a post pandemic era. One silver lining amongst these dark clouds is that we are in a much better place than we thought we would be a year ago. Globally, consumer spending in major economies came back strongly in the second half of last year, global goods trade is at pre-pandemic levels and several highly effective vaccines are being administered.

Positively, we are not going to witness a sluggish global recovery as we did during the aftermath of the global financial crisis of 2007-08. Importantly, corporate bankruptcies are at multi-decade lows and both US and China are expanding rapidly. According to World Bank, global growth is expected to rise by 5.6% in 2021 which is the strongest post-recession pace in eighty years.

However, the recovery is uneven and incomplete. The pandemic is far from over and the access to the vaccine has been unequal, especially in some of the emerging market economies. Many emerging countries have experienced multiple infection waves and the progress of the vaccination is slow as these countries have received only a fraction of the vaccines distributed to advanced economies.

In several emerging economies, rising inflation has been a worry and some of the central banks of these countries have already raised interest rates to tackle inflationary pressures. It will be difficult for central banks to maintain an accommodative policy stance if inflation continues to persist. Conversely, a tighter monetary policy will make economic recovery more difficult.

Indian Economy

As regards India, we experienced a second wave of the virus in April and May this year, while several European countries had already witnessed their third wave of infections. However, there is still fear in Europe about how the delta variant will impact its economic recovery.

The second wave has been extremely devastating for India from the health point of view but the economic impact has been less severe than during the first wave. The lockdowns were localised with micro containment zones and not as strict as last year with many sectors allowed to operate. Further, after the initial hurdles, the vaccination drive is gathering momentum. As more people get vaccinated, there are good chances that virus resistance will increase in the coming months. The pace of the vaccination drive combined with the gradual lifting of restrictions by states will see demand and consumer confidence coming back sharply.

If last September to March is any indication (wherein we saw a spike in the growth in different sectors), then one can be reasonably confident that our economy will bounce back once either more people are vaccinated or there is a significant reduction in the number of new Covid-19 cases.

From a policy perspective, the RBI has indicated that they will continue with an accommodative stance as long as it takes to revive and sustain growth. The impact of the second wave has tilted RBI's preference for growth over inflation. According to current projects, GDP is expected to be 9% to 10% for the year. The forecast has been lowered by 1 1/2% to 2% by most economists and other agencies.

The inflationary trend in the economy is a little bit of a concern with the CPI being over 6% in both May and June 2021. The inflationary pressure is mostly a reflection of higher commodity prices and supply chain bottlenecks. Given the circumstances, the RBI is likely to continue with an easy monetary policy for the next few months.

Since the onset of Covid-19, RBI has been proactive with monetary easing and liquidity support. The RBI needs to be commended for the host of measures it introduced. The central bank reduced the repo rate twice since March by 115 basis points to 4%. Overall, the total liquidity support announced by RBI from February 6, 2020, to March 31, 2021, amounted to Rs. 13.6 lac crore. To augment liquidity in the system, the RBI reduced the reverse repo rate, cut the cash reserve ratio, conducted targeted long-term repo operations (TLTRO 1.0 and 2.0), special liquidity facility for mutual funds, introduced refinancing facilities to NABARD, NHB, EXIM Bank and SIDBI, and simultaneous purchase and sale of securities under special open market operations to better manage the yield curve.

As the number of Covid-19 cases are coming down, we are witnessing the easing of restrictions in several states. Many Indian cities are buzzing with activity and traffic levels are close to pre-pandemic times. High frequency indicators such as e-way bills, railway freight and GST collections have recovered strongly in June after a steep fall in May 2021. There are other positives which augur well for the Indian economy such as (i) sales in rural and small towns, (ii) performance of the agricultural sector and digital and contactless services and (iii) less severe impact on manufacturing and exports as compared to 2020.

Opportunities

I do believe that India's pace of reforms will continue. Steps such as allowing the privatisation of public sector banks and increasing the FDI limits in the insurance sector to 74% shows the positive intent of the government. Sound regulatory policies and implementing structural reforms will help India attain a swift economic recovery.

Some of the positive signs are as follows:

1) India's Foreign Exchange Reserves are at a very comfortable level of USD 610 billion as of early July 2021 - which covers 18 months of imports.

   India is now the 4th largest holder of reserves after China, Japan and Switzerland.

   RBI has also been constantly intervening in the forex market and buying dollars.

2) Consequently, we have seen very little dip in the rupee during the course of the quarter from 73.45 on 31st March to 74.54 as of 14th July. The general consensus seems to be that the rupee will probably stabilise at broadly these levels for some time.

   In fact, the rupee has performed well and has depreciated only by 2% against the US dollar since January 2020. In this regard, India is much better off than other emerging countries such as Brazil, Russia, Turkey and South Africa, whose currencies had depreciated upwards of 20% against the dollar;

3) India's current account deficit is steadily falling over the years. During FY21, India achieved a current account surplus of 0.9%. However, the trajectory of the oil prices needs to be watched as India imports 80% of its oil requirements;

4) In FY21, India received FDI equity flows of USD 59.64 billion, a 19% growth over the previous year. This shows that foreign investors are confident of India's fundamentals.

5) Financial penetration in India is extremely low which implies a huge potential for growth. The mortgage to GDP ratio in India is 10-11%; in UK it is 68% and, in the US, the ratio is 52%. Other indicators include:
   - ☞Insurance penetration in India is at 3.8% of GDP. Malaysia, Thailand and China have ratios closer to 5% of GDP.
   - ☞India's mutual fund penetration is 16% of GDP compared to 114% in the US and 73% in the UK; And

6) Also, importantly, India has favourable demographics. India accounts for 17% of the world's population or 1 out of every 6th person in the world is an Indian. And 66% of this population is under the age of 35 years.

   India's middle-class is estimated to rise from 250 million individuals currently to 800 million by 2030. India is a domestic consumption-based economy. Private consumption forms 60% of the economy.

Conclusion

In conclusion, I do expect our economy to exceed growth projections this year. The macro fundamentals remain strong, consumption trends will sustain, India will continue to leverage its strength in technology, the stock markets are reflecting optimism with several IPOs being lined up and most of the financial sector players are well-capitalised.

In a post Covid-19 world, India will be able to climb back up the growth ladder. The main reason for my optimism is that India is a strong domestic consumption-based economy. And penetration levels are so low in India that the scope to grow remains immense.

The only real risk to sustained economic growth is the possibility of a third wave of Covid and the uncertainty surrounding the impact that it will have.

When this is all over, we will look back and not be able to believe that such a scenario happened. It is often said that India performs best in a crisis. The pandemic may just become a catalyst to bring in further reforms to ensure India's sustained long term growth.