Measures to incentivise credit will mitigate pain in the MSME sector

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As the second wave of the Covid-19 pandemic evolves, 2021-22 GDP growth is likely to fall, depending on the severity and duration of lockdowns. Economists' consensus forecasts are in the range of 9 to 11% now, and all cite downside risks. In comparison, the Union Budget, had, in early February, based its fiscal projections on a 14.4 per cent nominal GDP growth, implying a real growth of 10-10.5 per cent.

Obviously, these forecasts are likely to undergo changes, due to the uncertainty inherent in statewide infection curves and the consequent series of expanding public healthcare responses involving lockdowns, restrictions and other measures. A crucial input into the changing forecasts will be vaccine availability because of the confidence imparted for the progressive opening up of economic activities, and for boosting both sentiment and demand, especially for services. Note that a 1 per cent slowdown in growth shaves off almost Rs 2 lakh crore from potential income.

There are two aspects of these forecasts which are worth emphasizing. One, the first advance estimates of growth will be based on extrapolations from a limited data set, available till October and November. A substantial part of the extrapolation exercise involves the financial results of corporates which are declared quarterly. Broadly, a proxy for the nominal Gross Value Added (GVA) for the industry and services segments can be derived from the sum of operating profits and employee costs. Operating profits growth of large and mid size companies have been quite robust in 2020-21. It is only the later sequence of revisions which incorporate trends from larger databases which capture the performance of smaller enterprises.

Growth forecasts for the April-June quarter of 2021-22 were earlier very high, due to the 24% contraction of the first quarter last year following the total lockdown. However, this now needs to be significantly lowered. This is largely inferred from signals of multiple indicators of economic activity, which are indicative of the current economic momentum and recovery. These are inter alia a set of manufacturing, services, fiscal, financial, mobility, and employment metrics. Axis Bank's Composite Leading Indicator had shown a strong uptick in March 2021. The FY21 fourth quarter results are beginning to trickle in, and based on a small set of 250 non-financial companies, sales had increased significantly. Obviously, there is the base effect, but there were signs of recovering momentum. However, on the basis of the limited signals available thus far for April and the first week of May '21, there has been a sharp drop in economic activity, back to levels now tentatively consistent with economic activity around May 2020, when we were exiting the first lockdown. The May signals are led by the sharp drop in Google mobility indicators related to commerce, but a slowdown is also seen in FasTAG payments and other mobility signals, and a steep drop in vehicle registrations in early May. There's also a sharp drop in e-Way bills, as well as electricity consumption. Channel checks suggest that sales of diesel and petrol have fallen sharply, and petroleum refineries have reportedly cut their throughputs. CMIE data shows that the urban unemployment rate has risen to close to 15% in last two weeks. Even rural employment, which had been holding up in April, some part at least due to the then ongoing harvesting season, has now risen above 14%. Although the Manufacturing and Services Purchasing Managers Index (PMIs) had printed as high in April as in March, this probably largely reflected conditions in the first half of April, when the lockdowns were just beginning. Having said this, indications are that manufacturing still remains active, despite some dislocations in labour supply.

The trends are likely to mildly deteriorate and then stabilise over the next months. Till recently, the renewed lockdowns and restrictions had been impacting dominantly the large urban agglomerations in economically important states. For instance, of the five states that account for almost 50 per cent of India's GDP, three (Maharashtra, UP and Karnataka) are severely affected, with varying degrees of lockdowns. Within Maharashtra, the share of districts housing the five largest cities and urban agglomerations in 2019-20 was 56 per cent. Although Maharashtra is one of the most urbanised states, the lockdowns in the agglomerations of Bengaluru and the National Capital Regions will also have large effects. But there is now concern of the effects of the spreading infections to smaller towns and rural areas.

Second, there is only anecdotal evidence now of disruptions in economic activity of smaller enterprises which form the vast majority of enterprises in India, let alone the informal sector. Channels checks and reports of industry associations support this narrative. Various surveys have also indicated the large impact on lower income families. Note that the lockdowns will be the second hit on the incomes of many of these households, amplifying the effects on demand revival of their already depleted savings. In other words, the economic loss is likely to be larger than the initial formal GDP numbers will convey.

Increasing the flow of bank credit to the stressed sectors, those most impacted by the restrictions on movement, will be key to preserving their cash flows and hence solvency. The micro and small business segments of MSMEs are reportedly the most badly affected. A template based on last year's ECLGS, where a portion of loans to MSMEs is guaranteed by the Govt is likely to incentivise cash flows to smaller businesses. In addition to the multiple refinancing lines provided by RBI, some very judiciously selective extensions of regulatory forbearance and relaxations of prudential norms might also help.

Once the infections surge tapers, and the lockdowns ease, the pace of recovery will also depend on the ability of the Centre and state governments to spend. The loss of incomes this time will hopefully have a more muted impact on tax revenues. And finally, an accelerated rollout of vaccines will be crucial in boosting consumer confidence, and will help to boost economic recovery in the second half of FY22. The structural reforms undertaken by the Union Govt and many states will help to push up India's potential growth thereafter.

Chart 1: Change in travel for Retail and Recreation

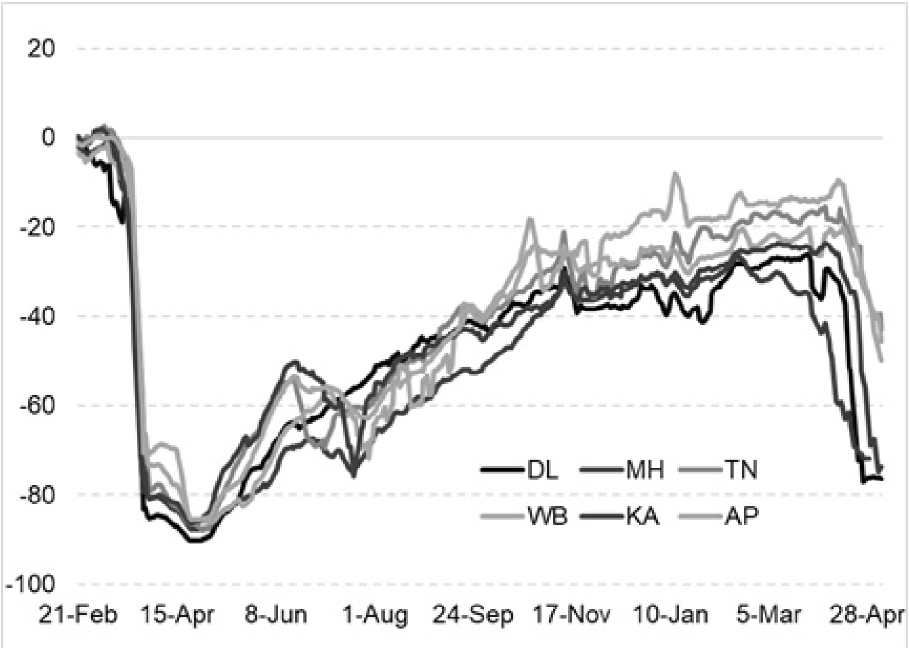
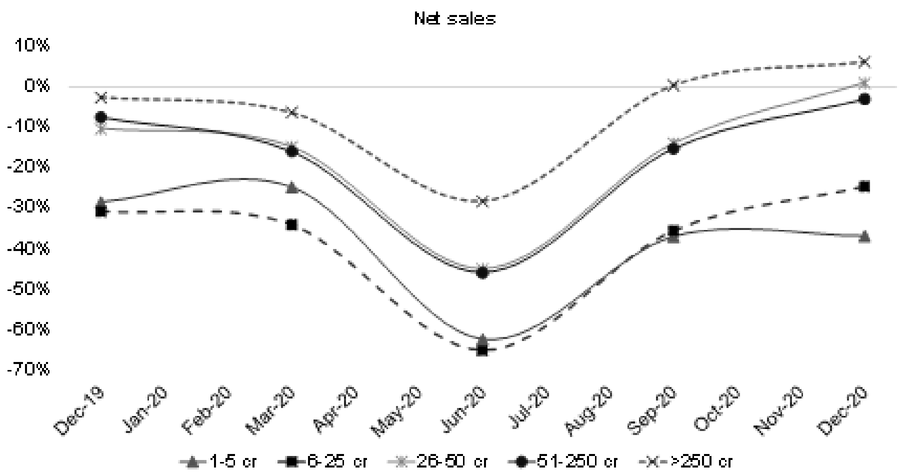


Chart 2: Performance of companies by size of sales



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