# Covid-19

# Macroeconomic impact FAQs

April 27, 2020

Research

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# Problem nonpareil

Since there is no cure for Covid-19 yet, the only potent weapon to control its spread is social distancing, which necessitates lockdowns. But these containment measures have a huge trade-off in terms of livelihoods lost.

India started its fight against the pandemic with a stringent nationwide lockdown from March 24 midnight, and rightly so, given:

- Its high population density makes it more vulnerable (India's population density is thrice that of China)
- Its fragile state of health infrastructure cannot take the medical overload if the pandemic spins out of control
- It has limited fiscal space compared with advanced countries, to spend its way out of the hardship

But the more we rely on lockdown measures, the greater will be the need to cushion the economy via fiscal stimulus. And that may be constrained by limited fiscal room. Moreover, the large unorganised labour force may have little option but to return to work sooner than later, as the government may not have the fiscal muscle to support all of them beyond a point.

India has extended the initial 21-day lockdown by another 19 days, till May 3. The second phase (April 15-May 3) appears less stringent than the first -- there are attempts to balance the trade-offs and include relaxation clauses this time, particularly for rural areas. But the leeway would depend on the ability of zone/states to control further spread of the virus. Although this is expected to provide much needed relief to agriculture, rural employment schemes, construction and manufacturing, the coming days will pretty much remain, a case of crossing the river by feeling the stones.

For the economy, the lockdown has already had serious consequences. The impact will vary by sector, but services, which accounts for over 55% of India's gross domestic product (GDP), has been hit particularly hard.

There is also no escaping the global recession, with deep contraction in advanced countries. These developments will dwarf the gains from the sharp drop in crude oil prices, and the monetary and fiscal stimuli worldwide and at home.

What does the pandemic mean for India? Our economists have parsed every conceivable angle of the current cataclysm, to find answers to questions that simply won't go away.

# FAQs

Domestic shock of lockdown now more dominant

That the pandemic would push the global economy towards a recession is now loud and clear, with many global multilateral agencies marking down global growth expectations. Financial markets too are pricing in weaker growth ahead.

India, which has mostly averted major damages from all sorts of large global crises in the past, seems to be withstanding the latest burst of pandemic too, as it reports far fewer infections compared with major and emerging economies. The truth, of course, will be known only in hindsight.

But surely, the Indian economy is not completely insulated from the global economic shock. The effects of our own lockdown are also beginning to tell. While the pandemic has tested the nation's healthcare economy the most, the lockdown's broader impact could bring fresh challenges in the coming quarters.

## How has the macroeconomic outlook changed?

What initially was as an exogenous blow has rapidly transformed into a domestic shock, as the country sees a forced 40-day lockdown. Moreover, there are chances that parts of the economy might continue to face restrictions even after May 3.

The lockdown has already begun to take a toll on the economy. The automobile sector's sales contracted 44% on-year and exports fell 35% in March 2020. April promises to be worse.

Also, a global recession is now guaranteed with deep contraction in advanced countries. S&P Global has further marked down its growth forecasts. Global GDP is now forecast to contract 2.4% in 2020 compared with the earlier estimate of a 0.4% growth.

In view of these developments, we have revised our India growth outlook to 1.8% from 3.5% for fiscal 2021.

Our forecast is premised on:

- A normal monsoon. Indian Meteorological Department (IMD) expects the southwest monsoon in the range of 96-104% of the long-period average, considered the normal range. Yet, there could be some disruptions during the sowing activity because of labour shortage
- A sharp fall in oil prices cushioning the economy, while benefiting a few sectors
- The effect of the pandemic subsiding materially, if not wearing out, in the April-June quarter

### Assumption on stringency of the lockdown measures

| | Q1 | Q2 | Q3 | Q4 |
|---|---|---|---|---|
| Stringency of containment measures | | | | |

Note: Fading colour shows the effect of the pandemic on the economy subsiding over the quarters

*Source: CRISIL*

### Revised outlook on key macros

| Macro variable | FY19 | FY20 | FY21 F | Rationale for outlook |
|---|---|---|---|---|
| GDP (%, y-o-y) | 6.1 | 5.0* | 1.8 | An initial blow from the external front has rapidly transformed into a domestic shock, as the country reels under a forced lockdown. The impact of the domestic spread and forced lockdown for over a month is now dominant. |
| CPI inflation (%, y-o-y) | 3.4 | 4.8 | 4.4 | Inflation should soften, for three reasons: (1) the abnormal surge in food inflation in fiscal 2019 has started to correct; (2) core inflation will remain moderate with slowing growth; and (3) the sharp drop in crude oil prices will keep fuel inflation soft |
| 10-year G-sec yield (%, March-end) | 7.5 | 6.2 | 6.5 | Despite lower inflation and softer policy rates, higher market borrowings amid fiscal slippage should push up yields |
| CAD/GDP (%) | 2.1 | 1 | 0.2 | Current account deficit is likely to remain under check, because of low commodity and crude oil prices. Yet, the rupee will be volatile, because of the selloff by foreign portfolio investors (FPIs) and the risk-off scenario. |
| Re/US$ (March average) | 69.5 | 74.4 | 73 | |

Note: *Second advance estimate, **revised estimate and ***budgeted estimate in the Union Budget for 2020-21

*Source: National Statistical Office (NSO), Budget documents, Reserve Bank of India (RBI), CRISIL*

Risks to the outlook could come from three factors:

- A further mark-down in global growth, in case of uneven health recovery and premature austerity in the face of a large rise in public debt
- Continuing restrictions in India - cases are still rising and there are no initial signs of containment yet - in key parts of the economy that drive production/demand, extending the recovery path. Productive capacity of several sectors could get hit, constraining supply
- A second wave of cases emerging, which could further add to the uncertainty, breaking sentiments further

## What does this mean for industry and services sectors?

The lockdown is expected to have a serious impact on both the industrial and services sectors, which are facing a double whammy from a slump in export demand and hit to domestic demand. Initial data suggests services are taking the bigger blow, while industry is also facing headwinds. The Purchasing Managers Index (PMI) for manufacturing fell to 51.8 in March, from a peak of 54.5 in February. Services contracted, as PMI slipped below 50.0 to 49.3 from 57.5 in February.

The first quarter of fiscal 2021 is so far slated to go through 33-days of lockdown. Although some economic activity will resume after April 20, this will be in select areas and dependent on the spread of the pandemic. In areas where the spread is large, restrictions are expected to continue even after May 3. The worry is that large industrial states, such as Maharashtra, Gujrat, Tamil Nadu, and Andhra Pradesh, have continued to witness a rise in the number of cases and face the risk of an extended period of restrictions. Together, these states contribute over 50% to India's industrial gross value added (GVA) and over 40% to services GVA.

While demand in some subsectors could be postponed to subsequent quarters, some might face a permanent loss.

- In the industrial sector, subsectors such as food products, cement, steel, other items used in construction, export items such as gems and jewellery, and textiles, face the threat of permanent loss of demand, or a scenario where even pent-up demand may not compensate for the loss. In other subsectors, such as consumer durables, cars retailing and discretionary goods, there could be demand postponement

But the services sector could be hit harder because a larger part of it either support industrial activity or are discretionary in nature. Some of this, however, will be offset by growth in telecom revenue (due to higher usage of data) and higher media consumption

- Permanent demand loss is more likely in sectors such as retail trade, education, air, rail, road and water transport, logistics, real estate, entertainment, hotels and restaurants, and other personal discretionary services
- So far, the services sector – which accounts for 41% of total exports – has been resilient. But a recession in the advanced economies would dampen the prospects for information technology (IT)-IT-enabled services and tourism, and bring down service-exports growth
- Some domestically-led services could continue to bear the brunt for an extended period even after the lockdown is lifted, as consumers will be averse to public transport (including air transport), and places of entertainment business such as malls and cinema halls, hotels and restaurants, among others

Overall, even as the lockdown measures are gradually lifted, caution on part of households and businesses to spend could hit services more than the industrial sector. There is also the impact on incomes and a continued pain in the global economy is expected to keep activity weak.

## Is it a supply or a demand shock?

It is a rare event that has hurt both supply and demand across the globe, through various channels.

**Impact on supply chains**

| | |
|---|---|
| **Factory shutdowns** | • The lockdown has mandated factory shutdowns of all non-essential commodities<br>• Non-essential services activities, such as transport, hospitality and education, have also been halted |
| **Logistical bottlenecks** | • Restrictions on movement is creating bottlenecks in transport of goods from one part of the economy to another |
| **Disruption in availability of inputs** | • Lockdowns across the globe have disrupted global supply chains, affecting availability of inputs for several industries, especially auto, electronics and pharmaceuticals |
| **Labour shortage** | • Reverse migration in India could temporarily lead to a shortage of available workforce, especially in the informal sector |
| **Drying of cashflows** | • Loss of sales could crunch working capital for micro, small and medium enterprises (MSMEs), which could even lead to shutdowns<br>• The ability to raise capital might get more restricted amid tightening financial conditions |

**Impact on demand**

| | |
|---|---|
| **Cuts in consumer spending** | • The lockdown has severely restricted spending on non-essential goods and services<br>• Transport, durable goods, recreation, restaurants and hotels are most affected<br>• India's urban economy to see a larger dip (33% of total population) |
| **Lower global demand** | • Global GDP to decline 2.4% in 2020, worse than that during the Global Financial Crisis<br>• Lower external demand has begun to hurt India's exports, which fell 34% on-year in March. Exports comprise ~17% of India's GDP |
| **Loss of income/ employment** | • Falling company profits may result in pay cuts and layoffs<br>• Most vulnerable are workers in the informal sector – a dominant part of India's workforce, gig economy workers in the transport sector, and low-skilled workers who cannot 'work from home' |
| **Weaker sentiment** | • The pandemic-induced slowdown and uncertainty comes at a time when India's consumer and business sentiment was already weak<br>• Consumers could increase precautionary spending and postpone purchases such as automobiles and real estate<br>• Firms could postpone investment decisions further |

*Source: CRISIL*

These various supply and demand disruptions are influencing each other and dragging the Indian economy into a downward spiral. As noted by the Federal Reserve Bank of St. Louis[1], the pandemic first creates a supply shock, since disruptions in global supply chains and factory shutdowns affect an economy's contemporaneous ability to produce goods and services.

The impact on demand is more complicated. In the short run, the perceived supply shortage can induce consumers to hoard products, creating excess demand. However, as an MIT study[2] has observed for the US, factory shutdowns and resultant layoffs and income losses ultimately weigh on demand as well.

[1] Understanding supply and demand shocks amid Coronavirus. Federal Reserve Bank of St. Louis, March 2020

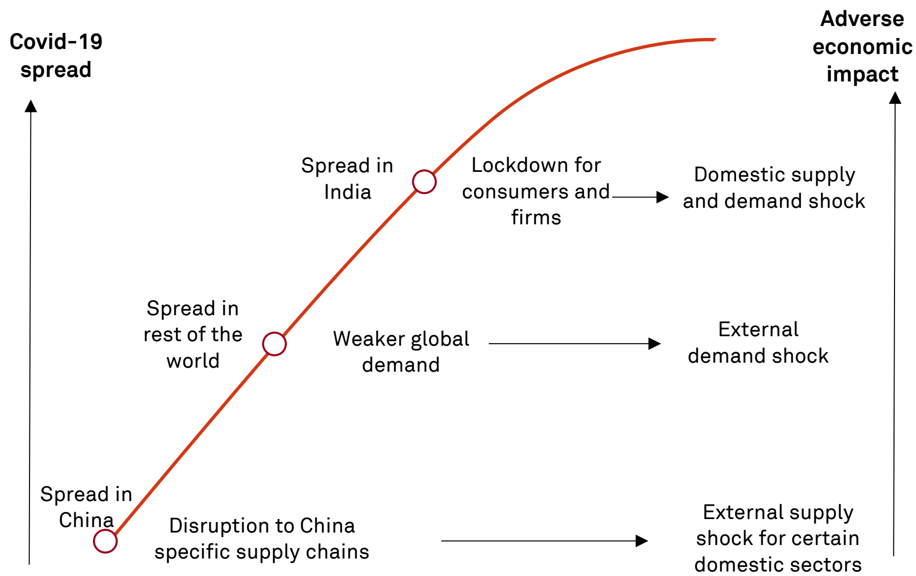
[2] Guerrieri, V Laurenzoni, G Straub, L (2020). Macroeconomic implications of Covid-19: can negative supply shocks cause demand shortages? MIT, April 2020

This would further aggravate stress on the supply side of the economy, reinforcing the loop of an economic downturn.

Covid-19 first caused a supply shock. Then, the demand shock followed

For India, the economic impact of the pandemic began as a supply shock, emanating from China. The impact on the country was initially limited to some sectors dependent on China-centred supply chains. Then, as the disease spread to rest of the world, it raised risks of weakening global demand. With the pandemic eventually spreading to India and triggering a lockdown, the impact has further magnified into a shock with similar supply and demand ramifications as seen in other affected economies.

**Economic costs rising with the steepening Covid-19 curve**




*Source: CRISIL*

Lockdowns are showing a disastrous impact on the economy and could lead to a permanent loss of GDP, unemployment and poverty, despite relief packages. Rough estimates on the economic impact so far can simply be seen in term of loss of GDP. For instance, CRISIL now expects the Indian economy to grow 1.8% in fiscal 2021, compared with an earlier estimate of 6% before the pandemic. **The loss of GDP in nominal terms is Rs 10 lakh crore or ~Rs 7,000 per capita.** This is the combined impact of global slump and domestic lockdown.

The dilemma for policymakers is between extending, lifting or partially easing lockdown measures, even as concerns remain around fighting the crisis, protecting health even after the virus spread is contained, and ensuring a smooth economic recovery. There is also worry that if officials lift social distancing prematurely, the virus could flare up, requiring re-imposition of distancing measures. Such a scenario could not only bring larger losses to incomes and overall economic activity, but would also infuse uncertainty on spending by household and businesses, even if the measures are eventually lifted.

Eventually, the containment of domestic spread, the duration of the domestic lockdown, the extent of global slump, and domestic policy support to recovery will decide the shape of the economic recovery.

## What is the impact on the financial sector?

The pandemic has roiled financial markets across the globe. Almost all asset classes have seen large volatility and witnessed significant decline in values.

**Tightening global financial conditions adversely affected domestic markets**

The sharpest fall was in crude oil prices, which slipped below the $30 per barrel mark. This was accompanied by significant tightening in financial conditions, especially in the US, as lower-rated instruments linked to shale companies witnessed selloffs. Redemptions led to a significant tightening in dollar liquidity globally, leading to a sharp depreciation of emerging market currencies, including the Indian rupee.

India has not been insulated from the financial market turmoil. In March, FPIs withdrew $15.9 billion, the largest monthly outflow till date, from the Indian markets. This resulted in over 4% depreciation in the rupee against the US dollar. The Sensex tumbled 23%, while sovereign bond yields exhibited high volatility, oscillating more than 30 basis points between the peak and trough of the month. Moreover, as seen in most crises, corporate bond spreads and term premiums widened significantly.

Such a shock has hit India's financial system when its health was already weak. The weakness has gradually transmitted from public sector banks (which are saddled with non-performing assets after the 2008 Global Financial Crisis) to non-banking financial companies (which are stung by defaults and crisis of confidence) and even private sector banks. Tighter financial conditions amid global risk aversion further limits the ability to support the economy through credit flows.

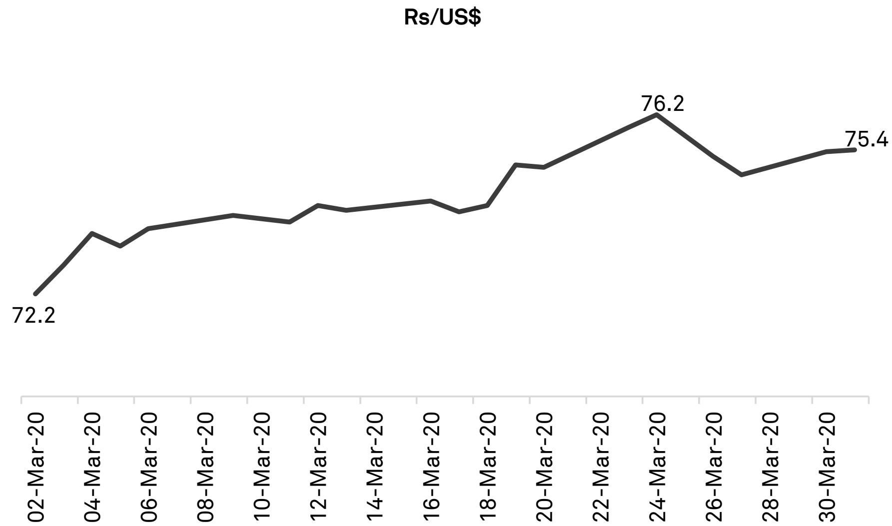
Major central banks have responded quickly. In particular, the US Federal Reserve cut its policy rate to 0% lower bound, launched a massive quantitative easing (QE) programme, including purchases of even corporate bonds, and opened dollar-swap lines to major central banks, including the RBI. This has helped stabilise the markets to some extent.

The RBI also announced a number of measures to ease the domestic financial conditions, including permitting banks to offer moratorium on loans, and introducing targeted long-term repo operations (TLTROs) to support corporates, specifically the small and medium enterprises. This should help mitigate stress to some extent. However, according to CRISIL Ratings, credit-quality trends will ultimately be determined by the pace of economic recovery, demand resilience in specific sectors, and normalisation of working capital cycles[3].

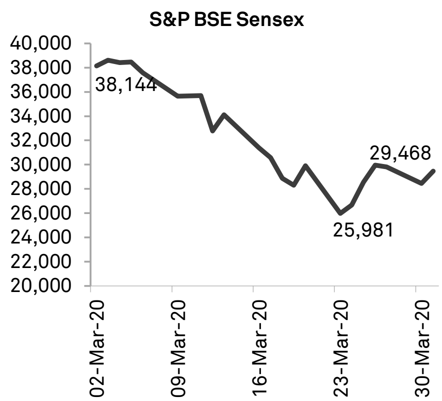
[3] CRISIL Ratings (April 2020). Pandemic to weigh in on credit quality

## Market turmoil after the pandemic

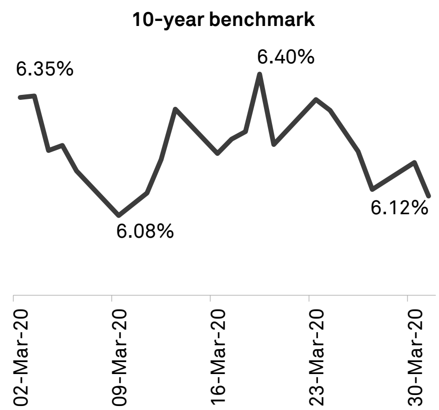
**The rupee depreciated sharply…**



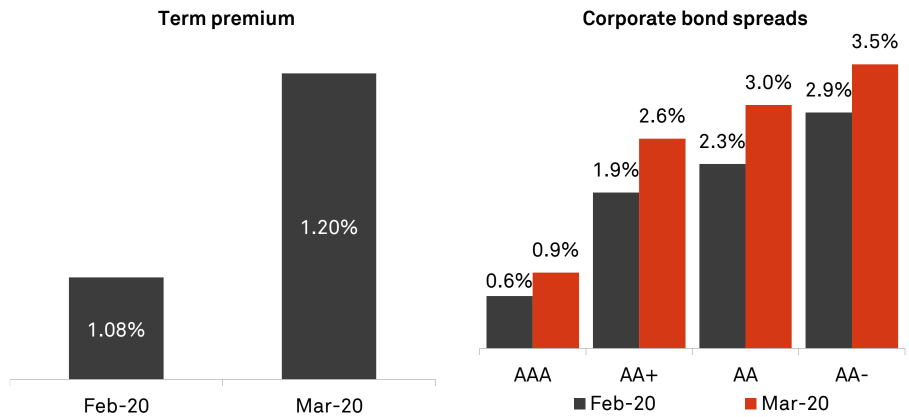

**…equities slumped…**




**…G-sec yields turned volatile…**



**...and bond spreads and term premiums have risen**




Note: G-sec refers to government security, term premium is the difference of 10 year G-sec over 1 year G-sec, corporate bond spreads are for 5-year securities over annualised G-sec yields

*Source: RBI, CEIC, CRISIL*

**Casual labourers and workers with little or no job security are the most vulnerable to an economy wide shutdown**

## How vulnerable is the Indian labour market?

A nationwide lockdown and social distancing across India has brought economic activity, barring essential services, to a grinding halt. Understandably, a large proportion of India's workforce, which comprises the informal sector, has taken a hit. The most affected are daily-wage earners and those with no job security. In India, casual labourers form ~25% of workforce. These labourers would take the first hit, due to the shutdowns and layoffs. The most-affected industries – construction, mining, a large section of manufacturing, and transport – have a sizeable proportion of casual labourers; for example, they form ~83% of the construction workforce. Even in the salaried category, ~38% do not have job security, implying that they do not have a valid job contract, are not eligible for paid leave and do not have social security benefits.

Thus, the continuation of lockdown would have serious consequences for the livelihoods of these categories of workforce, possibly leading to permanent job loss in some cases.

### Vulnerable workforce in India

**24.9%**
**Casual labour**

| 83% | 43% | 16% | 12% |
|---|---|---|---|
| Construction | Mining | Manufacturing | Transport |

**38%**
**Regular salaried with no job security**

| 71% | 54.2% | 49.6% |
|---|---|---|
| No job contract | Not eligible for paid leave | No social security |

*Source: Annual report of Periodic Labour Force Survey (PLFS), 2017-18, MOSPI*

An unintended consequence of this lockdown has been that daily-wage labourers, casual workers, or those with no regular jobs have migrated back to their home states, as they face the prospects of income loss and livelihood. This wave of reverse migration is problematic, as it undermines the purpose of social distancing, and could possibly allow the virus to transmit from urban areas, where cases have been largely reported, to rural areas and other less-affected states. The Census 2011 counts 1.72 crore persons as those who had migrated for work. Of this, 58 lakh were inter-state migrants. These numbers, though dated, point to the magnitude of the migrant workforce in India. The Economic Survey of India 2016-17 estimates migration in the range of 50-90 lakh persons annually. Reverse migration of such large swathes of population is likely to create additional pressure on the state governments' resources, particularly for the low-income ones, such as Bihar, Uttar Pradesh, Rajasthan, and West Bengal, which together account for roughly half of the inter-state migrant population. The pressure on the states' resources may be three fold:

### Unintended impact of lockdown

### Millions of migrants on the move

- Increased pressure on healthcare infrastructure (because of transmission of virus from urban to rural, and from more affected to the less affected states)
- Increased government expenditure on food, shelter and transport of displaced and homeless
- Hit to domestic remittances because of loss of incomes and livelihoods

*Source: CRISIL*

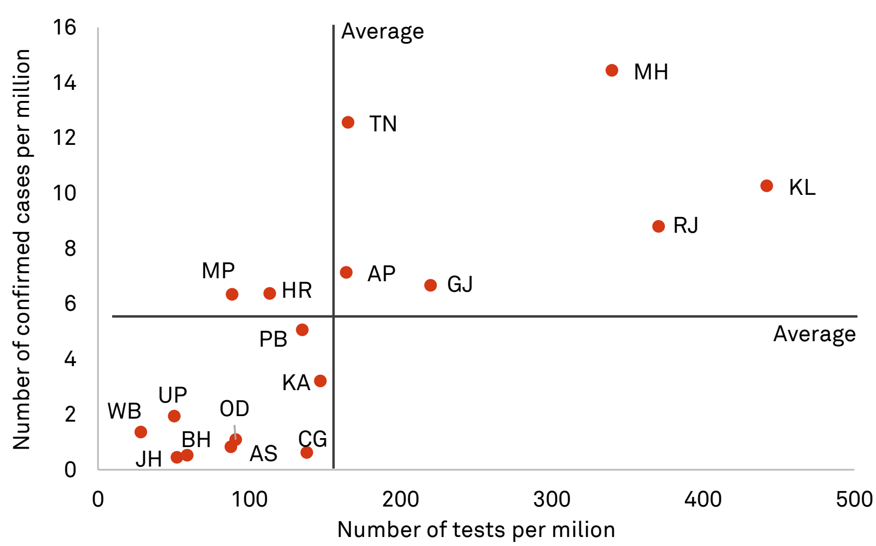
Given the large proportion of vulnerable workforce, states have announced financial assistance for the poor and issued advisories for establishments to ensure on-time payment of wages. However, with the extended lockdown, cash flow pressures of the firms, both big and small, may exacerbate and states may have to announce further relief measures.

## State of the states: How susceptible are they?

States that have tested more have seen more cases

States that are testing more have detected more cases. These include: Maharashtra, Rajasthan, Kerala and Tamil Nadu. Kerala, however, has managed to control the spread of the pandemic. This indicates that there is a risk of more cases emerging in the next few weeks, as India ramps up its testing capacity. At particular risk are states such as Madhya Pradesh, which have tested less, but still have relatively higher number of confirmed cases.

**Testing and confirmed cases are strongly correlated**




Note: Data on number of cases and tests as of April 12, 2020

*Source: Ministry of Health and Family Welfare (MoHFW), state health departments, CRISIL*

## Which states are vulnerable to the lockdown?

Even before the nationwide lockdown was announced, several states had imposed travel restrictions and curtailment of activity. In such a scenario, it is understood that certain sectors, such as construction, auto, and tourism, have been more affected than others. While states have announced interim relief measures to support incomes, the continuation of the lockdown will necessitate a higher fiscal stimulus.

States with lower health preparedness and fiscal capacity, higher share of industry and services will be worse off

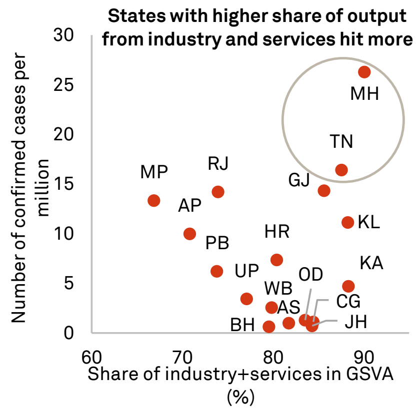
| State | Economic vulnerability | | | | | Fiscal capacity to push growth | |
|---|---|---|---|---|---|---|---|
| | 3-year average (FY16-FY18) | FY18 | FY18 | 2019 | FY18 | FY19 | FY20 RE |
| | Share of industry and services in GSVA | % of casual labour | % regular salaried with no valid job contract/social security | Doctor population ratio (1:x populatlon) | Hospital beds per 1000 persons | PCI (in '000 rupees) | Outstanding liabilities to GSDP (%) |
| Andhra Pradesh | 70.8 | 36.9 | 51.9 | 542 | 0.5 | 107 | 31.6 |
| Assam | 81.7 | 18.5 | 26.5 | 1650 | 0.5 | 60 | 17.6 |
| Bihar | 79.6 | 32.2 | 19.9 | 812 | 0.1 | 31 | 30.2 |
| Chhattisgarh | 84.4 | 19.6 | 45.3 | 2485 | 0.3 | 71 | 20.2 |
| Gujarat | 85.6 | 16.7 | 47.3 | 715 | 0.3 | 155 | 16.1 |
| Haryana | 80.4 | 20.6 | 41.6 | 1812 | 0.4 | 169 | 21.3 |
| Jharkhand | 84.3 | 23.6 | 41.5 | 6931 | 0.3 | 57 | 27.1 |
| Karnataka | 88.3 | 26.8 | 34.8 | 485 | 1.1 | 155 | 18.2 |
| Kerala | 88.3 | 29.3 | 30.8 | 446 | 1.1 | 148 | 30.3 |
| Madhya Pradesh | 66.9 | 28.2 | 39 | 977 | 0.4 | 59 | 25.4 |
| Maharashtra | 90.1 | 24.1 | 29.5 | 478 | 0.4 | 153 | 16.1 |
| Odisha | 83.5 | 27.2 | 42.9 | 1508 | 0.4 | 74 | 17.9 |
| Punjab | 73.8 | 20.4 | 52.2 | 584 | 0.6 | 116 | 39.8 |
| Rajasthan | 73.9 | 16 | 54.3 | 1551 | 0.6 | 79 | 33.4 |
| Tamil Nadu | 87.6 | 33.5 | 34.4 | 643 | 1 | 139 | 21.4 |
| Telangana | 88.4 | 24.4 | 40.5 | 1833 | 0.6 | 144 | 20.6 |
| Uttar Pradesh | 77.1 | 21.3 | 41.7 | 1756 | 0.4 | 44 | 28.2 |
| West Bengal | 79.8 | 31.8 | 41.7 | 1032 | 0.8 | 73 | 33.3 |

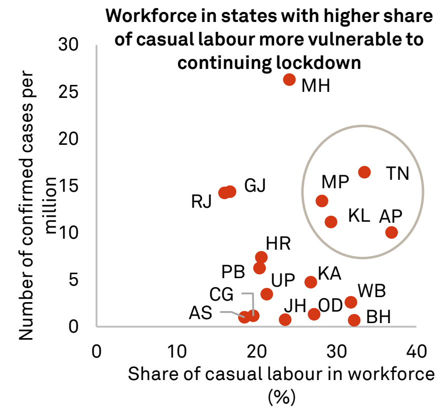
Note: Per capita income (PCI) of Maharashtra calculated based on average gross state domestic product (GSDP) growth of FY17 and FY18, applied on PCI of FY18. Outstanding liabilities of Andhra Pradesh, Assam and Madhya Pradesh of FY20 budget estimates; GSVA – gross state value added

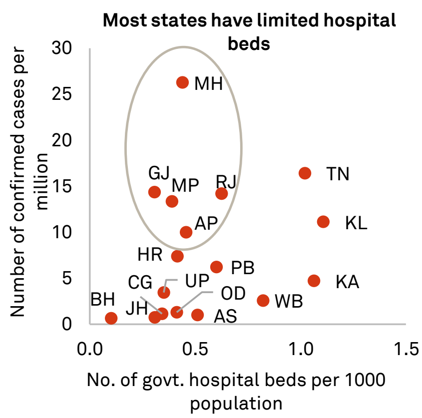
*Source: MOSPI, RBI, PLFS 2017-18, National Health Profile 2019, State Budget documents, CRISIL*

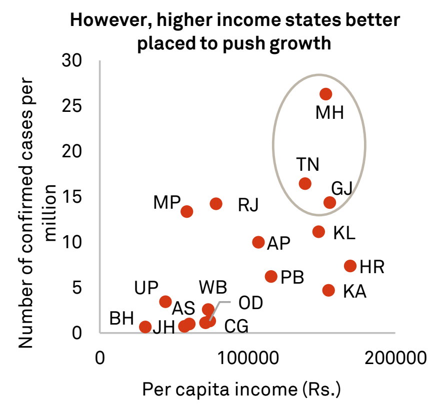
**Economic vulnerability:** States in which industrial and services sectors are predominant, such as Maharashtra, Tamil Nadu, Karnataka and Kerala, are more vulnerable to this economic shock. Of these, Kerala and Karnataka have managed to contain the spread. Further, states with a higher proportion of labour in the informal sector (casual labour or with no valid job contracts) would have to implement more income-supporting measures, due to possible job losses during the lockdown. States like Andhra Pradesh, Madhya Pradesh, Uttar Pradesh, Rajasthan and Chhattisgarh are particularly vulnerable.

**Both high- and low-income states have limited healthcare infrastructure**




Note: Data on number of cases as of 17 April 2020

*Source: MoHFW, MOSPI, RBI, PLFS 2017-18, National Health Profile 2019, budget document of states, CRISIL*

- **Healthcare preparedness:** Public healthcare facilities are sorely needed during a pandemic. Thus, the medical capacity of states to provide treatment, isolation wards and intensive care needs to be assessed to understand their preparedness. Healthcare infrastructure is likely to be overwhelmed, if the number of cases in states increase exponentially. In most states, there is only one doctor for more than 1,000 persons. Further, many states – including , Andhra Pradesh, Bihar, Jharkhand, Gujarat, Uttar Pradesh, Madhya Pradesh, Haryana, and Maharashtra – lie below the national average of 0.5 government hospital beds per 1,000 population. What is interesting to note is that both high- and low-income states have limited healthcare personnel and infrastructure, indicating lower healthcare expenditure across states.

- **Fiscal capacity:** The state governments' ability to tackle the pandemic will depend not just on their health infrastructure, but also their fiscal capacity. Income-support schemes and sector-specific relief measures imply government expenditure that is much more than budgeted. The states' fiscal deficits are already stretched, given the slowdown in economic growth seen before the spread of the pandemic. To deal with the shock, increased borrowing by states to finance expenditure in the coming fiscal is a *sine qua non*. In this situation, states that have managed to limit their debt or have high per-capita incomes would be able to push growth better. Lower debt implies states have the room to borrow more, while higher per-capita income implies a larger tax base. States such as Maharashtra – which has seen the highest number of Covid-19 cases – along with Tamil Nadu, Telangana, and Gujarat, seem to be relatively better placed in terms of fiscal position, with high per capita income and low debt ratios

## How have the states responded?

States have been at the forefront in dealing with the pandemic. Even before the central government had announced the Rs.1.7 lakh crore package, several states had announced relief packages, particularly for low-income groups and the needy, such as daily-wage labourers, construction workers, the old, and widows. These range from financial assistance in the form of monthly pay-outs, direct-benefit transfers, and increased allocation of food under the public distribution system (PDS). To support farmers, some states have announced the provision of agricultural inputs, such as seeds and farming equipment on rent. States have also issued advisories to factories and other establishments to ensure on-time payment of full wages for workers, including daily-wage workers and contractual staff. A summary of the measures announced is presented in the table below:

**Range of assistance delivered by states**

| Category | Agriculture: Support in rabi harvesting and procurement | Monthly financial assistance | Shelter and food | Free food and/or increased allocation under PDS | Advisory on no reduction/on time payment of wages |
|---|---|---|---|---|---|
| **Target beneficiary** | Farmers | BPL, low income groups like daily wage workers, construction workers | Migrants, construction workers, homeless, displaced | Ration card holders, old aged, needy | Labourers/ skilled/unskilled workers |
| Andhra Pradesh | ✓ | ✓ | ✓ | ✓ | |
| Bihar | ✓ | ✓ | ✓ | ✓ | |
| Chhattisgarh | | | ✓ | ✓ | ✓ |
| Gujarat | | | | ✓ | ✓ |
| Haryana | ✓ | ✓ | ✓ | ✓ | ✓ |
| Jharkhand | | ✓ | | ✓ | |
| Karnataka | | | ✓ | ✓ | |

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| Kerala | ✓ | ✓ | ✓ | ✓ | ✓ |
| Madhya Pradesh | ✓ | ✓ | | ✓ | |
| Maharashtra | | ✓ | ✓ | ✓ | ✓ |
| Odisha | | | ✓ | ✓ | ✓ |
| Punjab | ✓ | ✓ | ✓ | ✓ | |
| Rajasthan | ✓ | ✓ | ✓ | ✓ | ✓ |
| Tamil Nadu | | ✓ | ✓ | ✓ | |
| Telangana | | ✓ | ✓ | ✓ | ✓ |
| Uttar Pradesh | ✓ | ✓ | ✓ | ✓ | ✓ |
| West Bengal | | ✓ | ✓ | ✓ | ✓ |

*Source: State government notifications, as compiled by PRS Legislative Research, CRISIL*

## What should be the policy response?

Governments within their capacities are taking 'whatever it takes' approach and using all possible policy instruments – fiscal, monetary, macro prudential and regulatory – to contain the economic damage . Multilateral organisations are also proactively extending support to low-income countries by utilising and ramping up their lending capacity. But it is widely believed that fiscal policy will have to do the heavy-lifting, as:

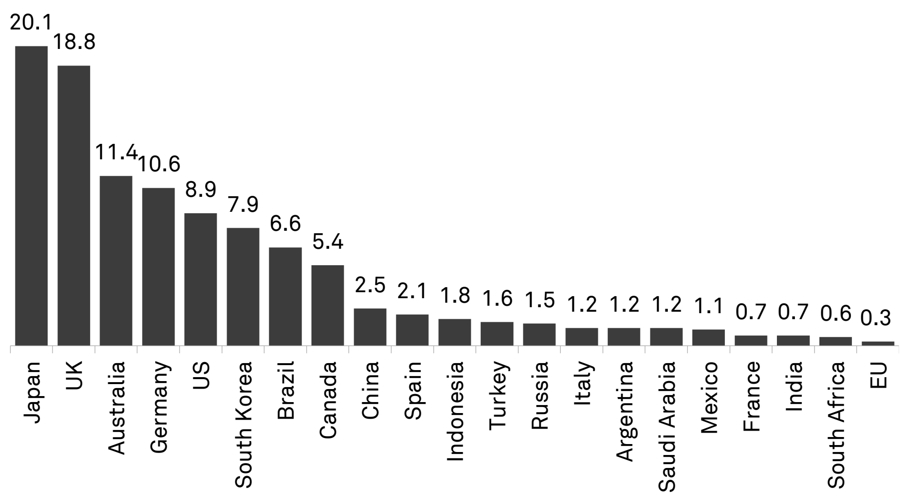
- This is primarily a health crisis and the first and foremost response from any government has to be to ramp up testing, production of masks, medical gear and hospital capacities, all of which require fiscal support
- Since containment/lockdown has widely been adopted as a means to flatten the curve of the virus spread, it becomes imperative for governments to support households and firms during this period, by providing them in cash/kind to avoid extreme suffering and prevent income loss, layoffs and bankruptcies
- Once the lockdowns are lifted, the focus should be on increasing aggregate demand to drive back the economy to operate close to its potential. This is, essentially, a role of fiscal policy
- As pointed out earlier, most advanced economies are operating at near zero or even negative interest rates, implying that they have pretty much exhausted the monetary space. As such, monetary policy actions take time to transmit, whereas fiscal policy can act much quicker, by getting money

into the peoples' hands. That said, the role of monetary policy is crucial in terms of maintaining financial markets stability

## What have global governments done so far?

Fiscal support by governments have come in the form of direct payments to households, temporary deferral of tax payments, extension of unemployment insurance, increase in guarantees, and loans to businesses. It has ranged between 0.3-20.1% of GDP among the G20 nations (see chart). According to the International Monetary Fund (IMF), countries have taken fiscal actions amounting to ~$8 trillion so far, of which close to $7 trillion has come from G20 nations.

**G-20 action to fight Covid-19 (support as % of GDP)**




Note: *Excluding guarantees

*Source: IMF*

As for monetary policy support, central banks have tried to enhance liquidity in their financial systems and sustain credit flows through a variety of measures, such as lowering interest rates, lowering capital buffers and reserve requirements, creating temporary lending facilities for banks and businesses, and easing loan terms. Major central banks have initiated bilateral swap lines with emerging market countries. In key advanced economies, QE[4] programmes have been ramped up.

Multilateral institutions have also announced economic packages. The IMF has created a rapid credit facility and has already disbursed emergency support to many low-income countries. The fund has committed to use all its $1 trillion

[4] The European Central Bank unveiled a new €750 billion bond-buying program in response to COVID-19 on 18 March (over and above its ongoing QE program) and later relaxed country wise bond purchase limits. Earlier the US Fed had announced a $700 billion QE program, which too was later made open-ended.

lending capacity. Likewise, the World Bank said it is ready with its first set of emergency-support operations for developing countries around the world, using a dedicated and fast-track facility to deploy up to $160 billion over the next 15 months.

## What has been India's policy response?

The Indian government too announced a slew of policy measures to address the economic fallout of the nationwide lockdown[5]. So far, monetary policy is playing a bigger role than fiscal stimulus, which seems rather minuscule at this juncture in relation to what has been happening in the developed world.

The monetary policy support from the RBI has largely been in the form of liquidity enhancement (reduction in policy rates and cash reserve ratio requirement), supporting financial market liquidity (through TLTRO for corporates, NBFCs, and mutual funds) and reducing debt-servicing burden (by providing moratorium on payment of term loans and interest on working capital facilities).

In view of the latter, the Securities and Exchange Board of India (SEBI), the capital markets regulator, temporarily relaxed the compliance norms by credit-rating agencies (CRAs) related to debt default on rated instruments. The SEBI also provided compliance relaxation to mutual funds in areas such as order execution, meeting sectoral exposure norms in debt schemes and increase in borrowing limits.

The fiscal policy response so far has focused on ramping up the health infrastructure (Rs 15,000 crore, or about 0.1% of GDP) package for testing facilities, personal protective equipment, ICU beds and ventilators, and in protecting the poor population (though the Pradhan Mantri Garib Kalyan Yojna, worth Rs 1.7 lakh crore, or about $23 billion). The latter primarily included cash transfers (through PM-KISAN, Jan Dhan accounts and pensions to senior citizens and widows), in-kind transfer (food and cooking gas), wages support (through Mahatma Gandhi National Rural Employment Guarantee Act, or MGNREGA) and insurance coverage for workers in the healthcare sector. Measures to ease the tax compliance burden across sectors, including postponing some tax-filing and other compliance deadlines, have also been announced.

While the above steps are a welcome relief, the government seems to be taking measured steps and not trying to front-load its response, unlike in many other nations. The Indian government, therefore, needs to step up its fiscal response drastically. The quantum of fiscal support announced so far is low, and the coverage is quite poor. For instance:

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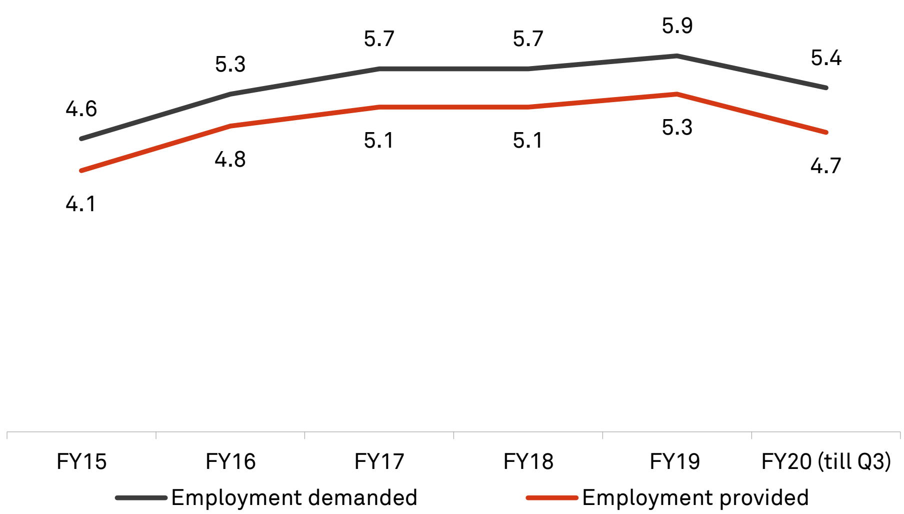
[5] First implemented for 21 days starting 25th March, 2020 and later on extended till 3rd May 2020, albeit with partial resumption of some economic activities

- **Fiscal space:** Relaxing the fiscal deficit target by 1.5% of GDP for fiscal 2021 can release Rs 3.5 lakh crore for a stimulus. It can be used for topping up income transfers and foodgrain support. It can also be used for facilitating business disruption loans by offering a guarantee to commercial banks, and containing the spill-over effects of the pandemic spread to services, such as restaurants, transport (including air and ground), entertainment, tours and travel, and retail.
- **Jan Dhan accounts:** The government has announced support for only 20.51 crore women account holders. But, as per the latest statistics, India has 38.08 crore Jan Dhan accounts. Other than that, there is still a huge unbanked[6] population in India that would remain outside the ambit of such a bank-transfer scheme.
- **MGNREGA:** The Act aims to provide at least 100 days of wage employment in a financial year to every household whose adult members volunteer to do unskilled manual work. However, past trend suggests work supplied under this scheme has always lagged that demanded (see chart below). So the scheme needs to be ramped up significantly, especially in light of reverse migration, for the benefits under this scheme to materialise fully.

**Number of households in crore**




*Source: MGNREGA website*

- **PM-Kisan:** Based on estimates of the Agriculture Census 2015-16, the central government targets to cover 14.49 crore farmer-families under this scheme, whereby Rs 6,000 per year is transferred in three instalments of Rs 2,000 each every four months, directly into the bank accounts of farmers, subject to certain exclusion criteria relating to higher-income status. The government has announced benefits for 8.89 crore farmer families under this

[6] According to the World Bank's Global Findex report, 2017, India's unbanked population stood at 190 million. Between then and now, around 120 million Jan Dhan accounts have been opened. That means, roughly, around 70 million people - mostly at the bottom of the pyramid – still may not have a bank account.

scheme. This means 5.6 crore farmer families, or ~39% of the target list, remain below the radar. Other than this, landless and tenant farmers would remain excluded in the current scheme of things.

- **Informal workforce:** The fiscal relief package announced by the government had some provisions for low-wage earners and construction workers in the organised sector, but India has a large informal workforce that is more vulnerable during the lockdown period and needs to be supported. Based on various estimates, 89-90% of India's estimated 465 million employed population can be termed informal[7]. This segment of the workforce is neither assured of job security nor social protection, and hence need a focused intervention. While the government is trying to provide food and shelter to them, some cash support would also be needed.
- **Informal firms:** While large corporates may have the capital buffer to sustain their businesses during some part of the lockdown period, smaller firms require immediate economic relief, as they need the capital to avoid closure, retain and pay their employees. This segment is pretty large. For instance, according to the Economic Census data, of the 5.85 crore establishments, ~94% were not registered with the government and ~95% employed less than five workers. Moreover, a large proportion (above 80%) of MSMEs are self-financed and only ~7% borrow from formal institutions. Thus, it is unlikely that these small firms would benefit from the government's steps, such as contribution to Employees' Provident Fund Organisation or credit market interventions (cheaper loans and increased limit on non-performing assets, or NPAs). Since most MSMEs primarily operate on cash, more direct measures of liquidity may be the need of the hour.

The government of India seems to be working on another stimulus package, which should hopefully address the above issues.

## What are the implications for global growth?

The pandemic has created an unprecedented health emergency, not seen in almost a century. It has spread to over 100 countries, with many even witnessing a second wave of infections. To arrest the spread, most countries have imposed lockdowns to prohibit movement of people and gatherings. This has led to a shock to the global economy.

The adverse economic impact has rapidly escalated in a short span of time, leading S&P Global to significantly revise down its growth projections for this calendar year. It expects global GDP to decline 2.4% in calendar 2020, compared with a 3.3% growth projected in December 2019 and a 0.4% growth on March 30, 2020. Most of the downside risks envisaged earlier have materialised, as reflected in the sharp declines in global PMIs and a record rise in US

[7] Casual labours, majority of self employed and a part of regular wage/salary workers in the organised sector whose work is contractual in nature constitute the base of informal workforce in India

unemployment claims. Moreover, lockdowns and social distancing measures are likely to remain longer than previously thought, aggravating the economic impact.

The downward revisions have mainly been driven by advanced economies and spillovers effects of that to the rest of the world. The US and Europe are expected to enter a recession. Markdowns have also been made for emerging markets, including India and China. However, a significant rebound is expected in calendar 2021 provided conditions normalise. The key assumption behind this is that the pandemic will peak by mid-year. However, S&P Global acknowledges an extraordinary level of uncertainty regarding the rate of spread and peak of the outbreak, and would keep updating its estimates according to the evolving situation.

**Growth forecasts for major global economies**

| | 2019 | 2020F | 2021F |
|---|---|---|---|
| **World** | **2.9** | **-2.4** | **5.9** |
| US | 2.3 | -5.2 | 6.2 |
| Eurozone | 1.2 | -7.3 | 5.6 |
| China | 6.1 | 1.2 | 7.4 |
| Japan | 0.8 | -3.6 | 3 |
| **India** | **5** | **1.8** | **7.5** |

Note: Forecasts as on April 17, 2020, India numbers are for corresponding fiscal years

*Source: S&P Global, CRISIL*

## How different is this from the Global Financial Crisis?

The current economic shock is bigger, much more uncertain, and emanates from an health emergency. The solution to the present crisis lies in science being able to find a vaccine for Covid-19, which could take 12-18 months. The intervening period will be one of extreme disruption. Some key aspects in which the current crisis differs from the 2008 one, are:

- **A supply shock, resulting in a demand shock**: The 2008 crisis originated in a crisis in the financial sector, which choked financial flows. This hit demand, but did not cause disruption in supply. Only long-term supply potential was affected because of postponement of investments. However, in the present case, social distancing measures to arrest the pandemic have led to an immediate disruption in supply, as factories shut down, accompanied by a reduction in demand for non-essential goods and services.
- **A more broad-based global crisis**: The 2008 crisis started in the US, with the impact on other countries dependent on how closely they were linked to the US and the associated global financial system. However, the Covid-19 crisis has proved an economic shock to every country. Not only is the impact coming from external channels, due to weakening global demand and trade flows, but also from domestic channels, amid weakening domestic demand.

- **Level of international cooperation is different:** It was of a much higher order earlier than what we are witnessing now. That can make the fight against Covid-19 a tad difficult.
- **Same policy tools cannot work:** The policy measures after the 2008 crisis majorly involved unprecedented monetary easing to stabilise the financial markets and revive demand. However, monetary easing at present cannot jumpstart demand, since people cannot go out to spend or re-start business activity till the lockdowns remain.

  Fiscal policy is set to do the heavy-lifting in the current crisis. The monetary policy space is limited, particularly in advanced economies, where rates are close to zero and central bank balance sheets are stretched. But central bank actions (asset purchases) and low interest rates will play a supporting role by making it less costly to deploy fiscal policies.

  Also, same policy tools cannot be used in advanced economies and emerging markets. As pointed out by Ricardo Hausmann[8], emerging markets lack the fiscal space that advanced economies have to provide for the stimulus. Borrowing costs are higher and access to international finance is more constrained among emerging markets.

- **This is a trade-off between health and economic costs:** Resurrecting the global economy is going to be no easy feat. Most economic activity remains constrained by lockdowns. But lifting the lockdowns could raise chances of a fresh wave in Coivd-19 cases, aggravating the health emergency. Indeed, policy makers are unenviably tasked with treading the tight rope between saving lives and making life liveable.

[8] Hausmann R. (March 2020). Flattening the Covid-19 curve in developed economies. Project Syndicate

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