What does the COVID 19 experience tell us about Indian growth drivers?

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Overview

- Preconceptions, predictions and the Indian economy during Covid-19
  - ✓ **Natural experiment, abduction**
  - ✓ **Evidence on predictions and outcomes: growth, financial sector**
  - ✓ **To build a case for re-examining our understanding of India's growth drivers**
  - ✓ **And implications for monetary-fiscal coordination in Indian conditions**
- Causes of the 2010s slowdown and the turnaround
- Feasible reforms are those that build on current opportunities and trends
- These can sustain growth and employment as macro contsraints soften

Preconceptions and performance

Covid-19

- India: Congestion, poverty, inadequate health facilities
  - ✓ **First wave predictions:**
  - ✓ **Led to the lockdown**
- Economic cost high but human cost low
  - ✓ **Mortality rates**
  - ✓ **Rapid economic recovery**
- The delta variant and the second wave
  - ✓ **High human cost but low economic cost**
  - ✓ **First hit but passed in a few months, many countries prolonged struggle**
- Successful vaccination program
  - ✓ **Billion plus population size**
  - ✓ **Considerable medical, industrial and administrative abilities**

Output growth

- Perception: India was already doing badly
  - **Therefore needed medium-run structural changes; but recoveries surprised on upside**
- Pessimistic growth forecasts; had to be continually revised upwards after Covid-19 peaks
  - **Professional forecasters (30): Sept to March FY20: -9.1 to -7.5; FY21 7.4 to 11**
  - **Individuals, IMF, OECD, ADB**
- Actual growth rapid recovery after peaks
  - **Consumption, Investment, some recovery; G uneven; exports did better than 2019**
  - **Contact industries suffered but some substitution and innovation. Digitization benefitted outsourcing**
- But if fundamental constraints above a puzzle; major reforms take time
- High frequency data showed a turnaround in end 2019-early 2020 before Covid-19 hit in March
- Softening of monetary-financial conditions since 2019; further after Covid-19
  - **Delivered despite fiscal conservatism**
  - **Against views that fisc more effective since m transmission clogged, financial sector choked**
  - **How did the financial sector perform against predictions?**

Table 1: Forecast revisions

Changing GDP growth forecasts

Date of survey	May-20	Jul-20	Sep-20	Nov-20	Jan-21	Mar-21
For 2020-21	-1.5	-5.8	**-9.1**	**-8.5**	**-7.6**	**-7.5**
For 2021-22	11.7	7.2	**7.4**	**8.2**	**9.5**	**11**

RBI Survey of Professional Forecasters, various rounds

The survey is bimonthly and covers 45 professionals, more than 30 respond normally.

2020-21 actual GDP growth was -7.3. It was low because of a large subsidy imputation. GVA growth was less negative at -6.2

Table 2: Growth in the year of Covid-19

	Y-o-y growth (over last year quarter)					Q-o-Q growth (over last quarter)				
2020-21	Q1	Q2	Q3	Q4	Q1:FY22	Q1	Q2	Q3	Q4	Q1:FY22
Private Final Consumption Expenditure	-26.2	-11.2	-2.8	2.7	19.3	-29.0	20.0	17.7	2.3	-17.4
Government Final Consumption Expenditure	12.7	-23.5	-1.0	28.3	-4.8	24.5	-24.9	6.9	28.3	-7.6
Gross Fixed Capital Formation	-46.6	-8.6	**2.6**	**10.9**	55.3	-45.5	56.4	**16.0**	**12.1**	-23.6
Export	-21.8	-2.0	-3.5	**8.8**	**39.1**	-21.2	26.0	-1.9	11.7	0.8
GDP at market Price	**-24.4**	-7.4	0.5	1.6	**20.1**	-29.7	**22.3**	**9.9**	**7.5**	**-16.9**

Figure 1a: High frequency indicators for the pre Covid-19 period

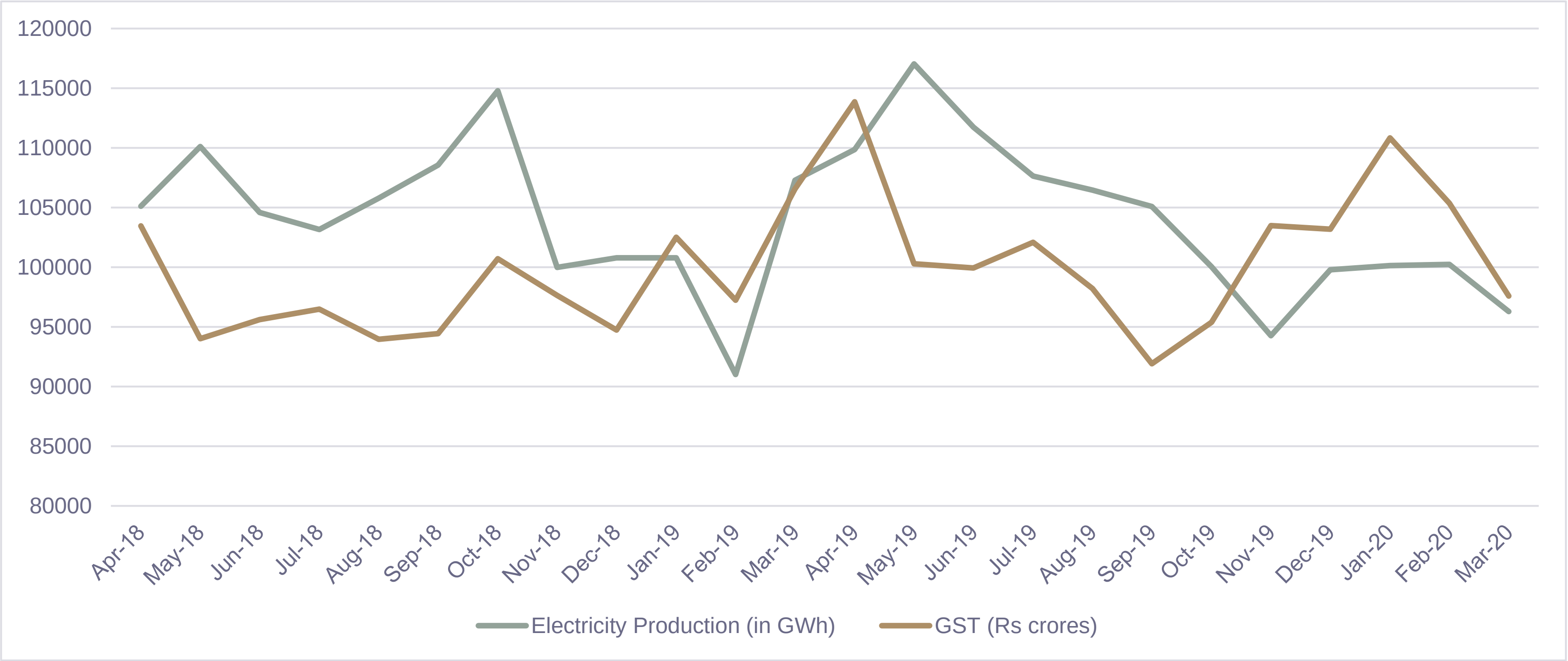


Figure 1b: High frequency indicators for the pre Covid-19 period: Coal (Thousand Tonnes)

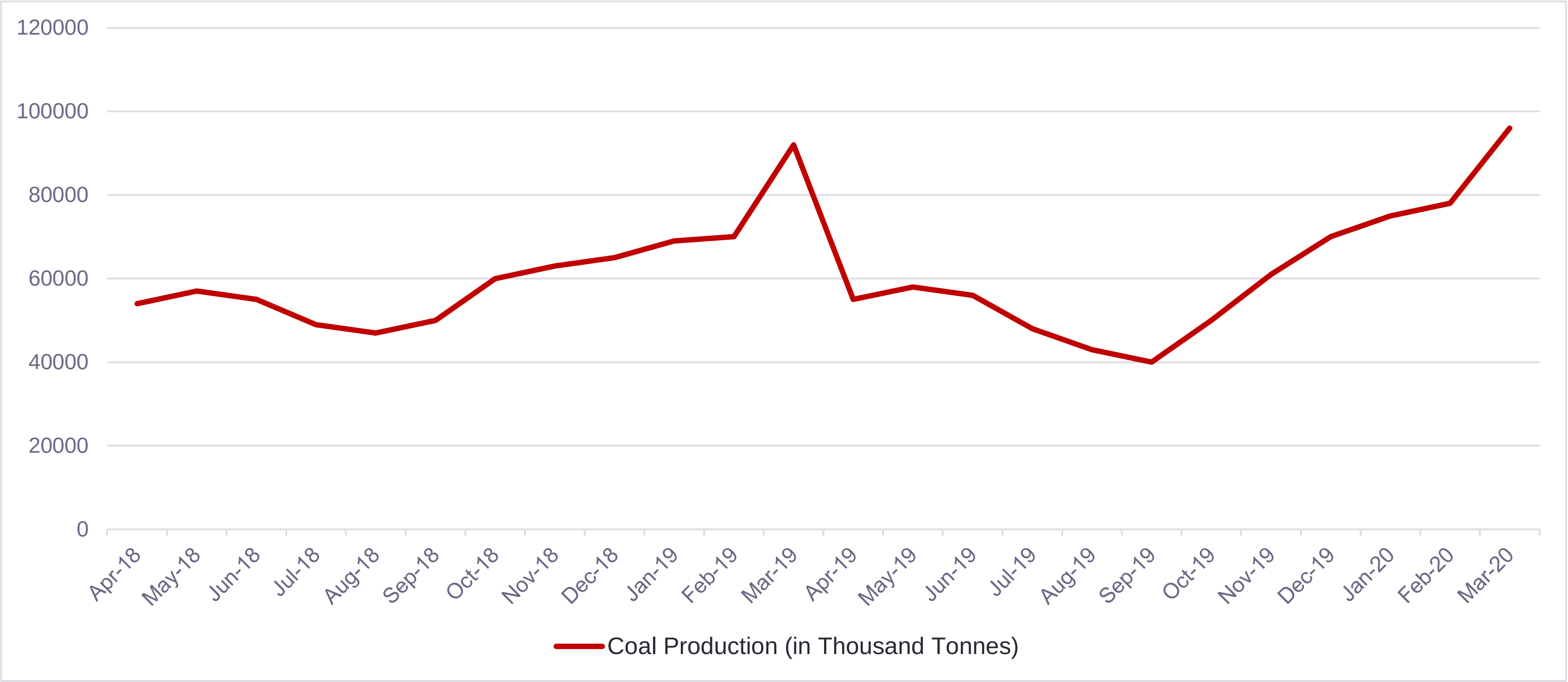
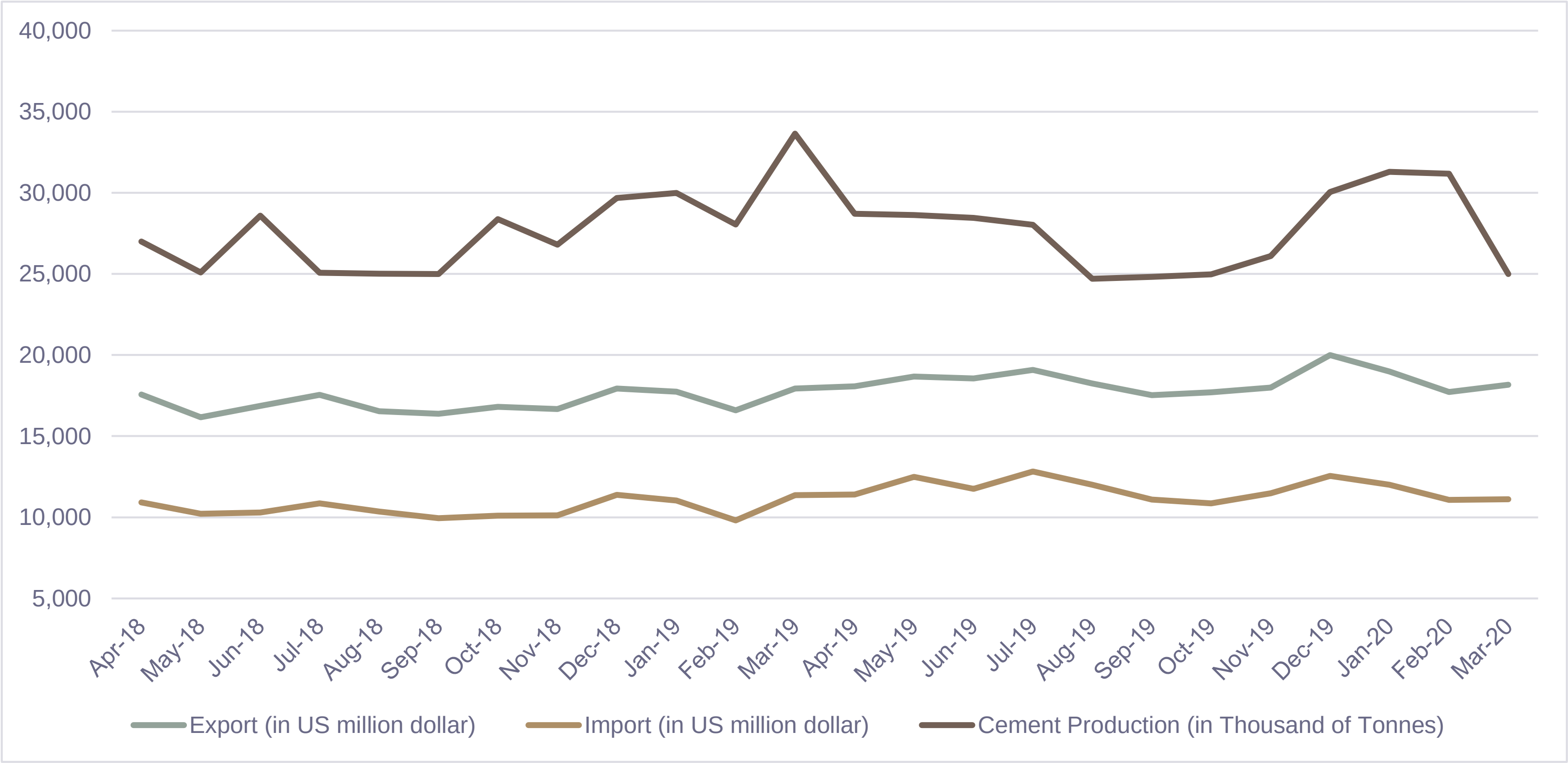


Figure 1c: High frequency indicators for the pre Covid-19 period



Financial sector

- Seen as fragile: GNPAs expected to rise
  - ✓ **But ratios improved instead of deteriorating**
  - ✓ **Collection efficiencies rose**
  - ✓ **Take up of restructuring was limited**
    - **March 21: Restructured advances 0.9% of funding**
    - **Buffers built; Capital adequacy rose**
  - ✓ **Moody's upgrade in October 2021: Said financial sector had surprised them on the upside**

- Regulatory relief time barred in line with reforms
  - ✓ **Corporate governance**
  - ✓ **Risk-based lending**
  - ✓ **Limits on exposures: retail, SMEs**

- Government credit warranties for SMEs
  - ✓ **Healthier: Not on books of banks**

- Diversity, stability; developmental and private financing
  - ✓ **Share of non-bank financing rose 64.4% (20-21) 59.3 (19-20) due to surplus liquidity**
  - ✓ **Financial flows to com sector Covid-19 year 68.2 (as % 18-19) exceeded 60.8 (19-20)**

Table 3a: Summary for PSBs

Public sector banks

	March 20	March 21	
		Forecast	Actual
GNPAs	**11.3**	**15.6**	**9.54**
CRAR	14.6	13.3	15.8
Provisions	64.2	-	68.4
NNPA	**4.0**	**-**	**3.1**

Table 3b: Predictions of non-performing loans compared to actual

July 2020 FSR (Projection of GNPA)

	Mar-20	Mar-21 (Actual Values)		Mar-21 (Projected Values)							
	Actual	Observed Value	% Change	Baseline	% Change	Medium Stress	% Change	Severe Stress	% Change	Very Severe Stress	% Change
Public Sector Banks	**11.3**	**9.54**	-15.6	**15.2**	34.5	15.5	37.2	15.9	40.7	16.3	44.2
Private Sector Banks	**4.2**	**4.78**	13.8	7.3	73.8	7.7	83.3	8.3	97.6	8.7	107.1
Foreign Banks	**2.3**	**2.43**	5.7	3.9	69.6	4.5	95.7	5.1	121.7	5.8	152.2
Scheduled Commercial Banks	8.5	7.48	**-12.0**	12.5	47.1	13.5	58.8	14.2	67.1	14.7	72.9

Source: Compiled from Financial Stability Report Issue no. 23, July 2021, RBI

Table 4: Projections of capital adequacy compared to actual values

	Mar-20	Mar-21 (Actual Values)	Mar-21 (Projected Values)			
	Actual	Observed	Baseline	Medium Stress	Severe Stress	Very Severe Stress
CRAR	**14.6**	**15.84**	**13.3**	12.7	12.1	11.8
CET-1	**11.7**	**12.78**	**10.7**	10.2	9.6	9.4

Source: Compiled from Financial Stability Report Issue no. 23, July 2021, RBI

Table 5: The evolution of select asset quality indicators

	September-19	March-20	September-20	March-21
GNPA Ratio				
PSBs	**12.3**	**10.8**	**9.7**	**9.5**
PVBs	5.1	5.1	4.8	4.8
FBs	2.9	2.3	2.5	2.4
All SCBs	9.3	8.4	7.5	7.5
NNPA Ratio				
PSBs	**5.1**	**4.0**	**2.9**	**3.1**
PVBs	1.8	1.4	1.0	1.5
FBs	0.5	0.5	0.4	0.6
All SCBs	3.7	2.9	2.1	2.4
Provisioning Coverage Ratio				
PSBs	60.1	64.2	70.5	**68.4**
PVBs	66.0	72.6	78.3	**70.0**
FBs	83.2	79.6	82.9	**75.2**
All SCBs	61.6	66.2	72.4	**68.9**
Capital to Risk weighted Assets Ratio				
PSBs	13.5	12.9	13.5	13.8
PVBs	16.4	16.5	18.2	18.4
FBs	17.5	17.7	18.7	18.5
All SCBs	15.0	14.7	15.8	16.0

Source: Compiled from Financial Stability Report, July 2021, RBI.
Note: The Provisioning Coverage Ratio gives the provisions held for NPAs as a percentage of GNPAs

Table 6: Composition of financial flows to the commercial sector (% of annual total)

Source	2018-19	2019-20	2020-21
A. Adjusted Non-food Bank Credit	**52.3**	**40.7**	**35.6**
i) Non-Food Credit	48.7	41.2	35.6
Petroleum and Fertilizers Credit	0.3	1.5	-1.3
ii) Non-SLR Investment by SCBs	3.5	-0.5	0.0
B. Flow from Non-banks (B1+B2)	47.7	59.3	64.4
B1. Domestic Sources	31.3	21.3	**40.8**
Public & rights issued by non-financial entities	0.4	4.5	2.4
Gross private placements by non-financial entities	6.6	16.6	17.4
Net issuance of CPs subscribed by non-banks	5.8	**-10.7**	**2.6**
Net credit by housing finance companies	7.1	2.0	2.9
Total accommodation by four RBI-regulated AIFIs – NABARD, NHB, SIDBI & EXIM Bank	4.8	5.7	8.4
Systematically important non-deposit taking NBFCs and Deposit taking NBFCs (net of bank credit)	5.4	**-1.6**	**4.9**
LIC's net investment in corporate debt, infrastructure and social sector	1.3	4.8	2.2
B2. Foreign Sources	16.4	**38.0**	**23.5**
External Commercial Borrowings/FCCB	3.0	10.8	0.1
Short-term credit from abroad	0.6	-0.5	-1.9
Foreign Direct Investment to India	12.8	**27.7**	**25.4**
Total Flow of Resources (A+B) as percent of 2018-19 values		**60.8**	**68.2**

Source: Calculated from RBI reports

Long-term scarring?

- Contact industries
  - ✓ **Difficult situation but faster than expected recovery, pent up demand, substitution**

- MSMEs
  - ✓ **Little government support but alleviating factors**
  - ✓ **No zombies: Substitution towards opportunity; learning; faster adoption of digital**
  - ✓ **Warranties for bank loans 7%; Informal finance; gold loan boom**
  - ✓ **NSSO (2016) 96% owned by one household**
    - **WFH feasible**
  - ✓ **Rating CMR 68% stayed in first category (ICRA, CARE); but RBI 2021 survey: confidence still low**

- Women
  - ✓ **First to loose jobs**
  - ✓ **But greater acceptability of WFH may induce long-term rise in Indian women's low work participation**

- Education, employment
  - ✓ **Remedial programs for the digitally excluded; BMC guidelines**
  - ✓ **Employment recovery after first wave, second less impact**

- Alleviating factors
  - ✓ **But wait for more data**
  - ✓ **Measures to sustain growth**

Employment: Structural changes

- Lockdown unemployment peak transient; signs of structural change
  - **Rural urban migration; non-agricultural employment**
  - **Women education and services**
    - **2011-2019 about 30m jobs lost for pre-secondary education**
    - **Similar no. gained for post-secondary**
    - **PLFS 2017-18: Share of services in regular female employment: 81.4 rural, 86.7 urban**
  - **Aspirational unemployment**
    - **Unemployment rates higher for youth—search period**
    - **Expand education, health, urban services; 3 tier towns**
    - **Web based employment; entrepreneurship; Indian unicorns**

- Jobs for the less skilled
  - **Quality ladders—retail, delivery, urban services**
  - **Labour intensive manufacturing-PLI; supply chains**

- Entrepreneurship
  - **Unicorns; digital innovations**

Reasons for 2010s slowdown

Global and domestic policy shocks

- India not alone in the slowdown
  - **Ten major EMs: IIP growth 4.3 pre-GFC (2000-08); 1.3 post-GFC (2009-17)**
  - **2011, 2013, 2015 larger shocks for EMs than 2008**
  - **Not enough done to moderate spillovers on EMs, market overreactions**
  - **Relative size of EMDEs higher: AEs share of global GDP in PPP terms: 2004--54%; 2021--42.18%**
  - **So necessary to protect EDEs; else negative spillovers to AEs**
- India: Collapse of credit in 2010s, while QE in rest of the world
  - **PSBs pushed to lend for infrastructure since 2000; ALM mismatches, global shocks, NPAs**
  - **Delays: Waiting for IBC before recap; AQR before recap**
  - **Credit fell sharply, firms, highly geared NBFCs with no liquidity support**
  - **Regulatory policies also strict as a reaction to 2000s corruption allegations and scams**
  - **GFC 2008: Over-stimulus as part of G-20 coordinated macro action**
  - **Double deficits and vulnerabilities to global QE and risk-on and –offs**
  - **Overreaction: Monetary, fiscal and regulatory tightening**

Feasible reforms to sustain growth

What type of reform is required?

- Reversal of macroeconomic, regulatory tightening in 2019
  - ✓ **Move to more balance, monetary-fiscal coordination**
  - ✓ **Countercyclical; smooth external shocks—FX reserves adequate, no full CAC**
    - **Support domestic cycle if outflows during Fed exit**

- Essential reforms done
  - ✓ **Finance: Diversity, more institutions: Government and markets**
  - ✓ **Corporate governance; anti-corruption measures—corporate bond markets**
  - ✓ **More to be done, but focus on feasible reforms that improve the supply-side**

- Land, labour pre-requisite?
  - ✓ **Foreign advice, IMF-WB**
  - ✓ **But political resistance when large groups are affected**
  - ✓ **Avoid large domestic shocks**

Complementary supply-side reforms to sustain growth

- Feasible reforms: Political economy
  - ✓ **Intensify trends at the margin, build on enormous opportunities: Technology, innovation and youth**
    - **Post Covid-19, WFH, outsourcing, supply chain diversification**
    - **Education, skilling, infrastructure, institutions, empowerment—many initiatives taken in these areas**
  - ✓ Land and labour: reform by stealth, quietly
    - **Competition among states**
  - ✓ States: Convergence to best practices (not indices), awareness, last man standing
    - **3rd tier capacity, uniform services linked to taxes, user charges, PPP in distribution with regulation**
    - **Small towns classified as urban, services provided—rural development funds**
    - **Vaccination centres: Expanding health infrastructure**
    - **Online land records (collateral), underutilized industrial parks, SMEs plug in facilities**
  - ✓ Governance: Focus point—Cost of doing business; human capacity
    - **CSS rationalized; States also—more than a thousand schemes, no scheme is ever shut**
    - **Tech- e-gov, e-metering, accounting systems, automatic payments with no delay**
    - **Courts, police, environment…**
  - ✓ Productivity growth 2011-2016 (NSS 73rd round): Unorganized sector (7.2), organized (3.2)
    - **Formalization taking place, GST, UPI**

Monetary-Fiscal strategy

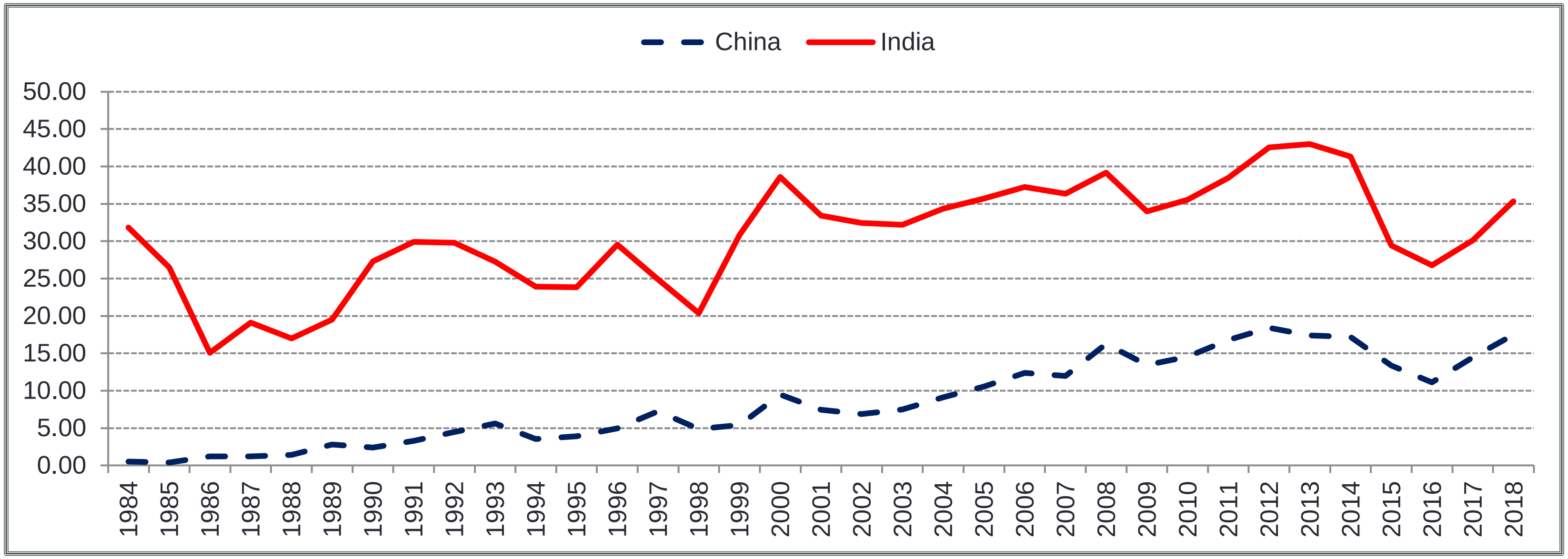
- Structure of past growth: Plans plus populism
  - ✓ **Low returns from government spending, debt 70%**
  - ✓ **Low or no user charges, cost shocks but fixed prices, cross subsidies, distortions**
  - ✓ **Large wealth: Can leverage inherited poorly monetized assets; attract climate change finance**
  - ✓ **Tax reform and data to increase tax base**
  - ✓ **Restructure towards supporting human capital formation: maximum spillovers**
  - ✓ **For the really poor income support through DBT now possible, leakages reduced**

- Using the financial sector: Below the line
  - ✓ **Credit warranties: remove fear of lending, risk aversion, spreads fell**
  - ✓ **Recap bonds affect debt only, do not raise deficits**
  - ✓ **Deepen institutions; DFI and net zero climate finance; leverage govt exp**

- Monetary fiscal coordination
  - ✓ **If continuing improvement in supply conditions reduces costs, inflation**
  - ✓ **Then monetary policy can keep r<g; reduce volatility, snowball effect would reduce debt**
  - ✓ **M transmission r aligned with liquidity affects output, while fiscal spending constrained by debt**
  - ✓ **World: Post Covid-19 supply shocks and high G debt: M-F coordination required; India this is the normal case**
  - ✓ **Keep demand only a step ahead of supply: Gradual sustainable rise in spending**
  - ✓ **Covid-19 period supply-demand mismatches: Continuous supply-side action: If exports and pent-up demand vanes, boost demand; if overheating, reduce it**

Macroeconomic constraints and growth volatility

Figure 2: Fuel imports (% of merchandise imports) (USD bn)



Commodity price and other shocks

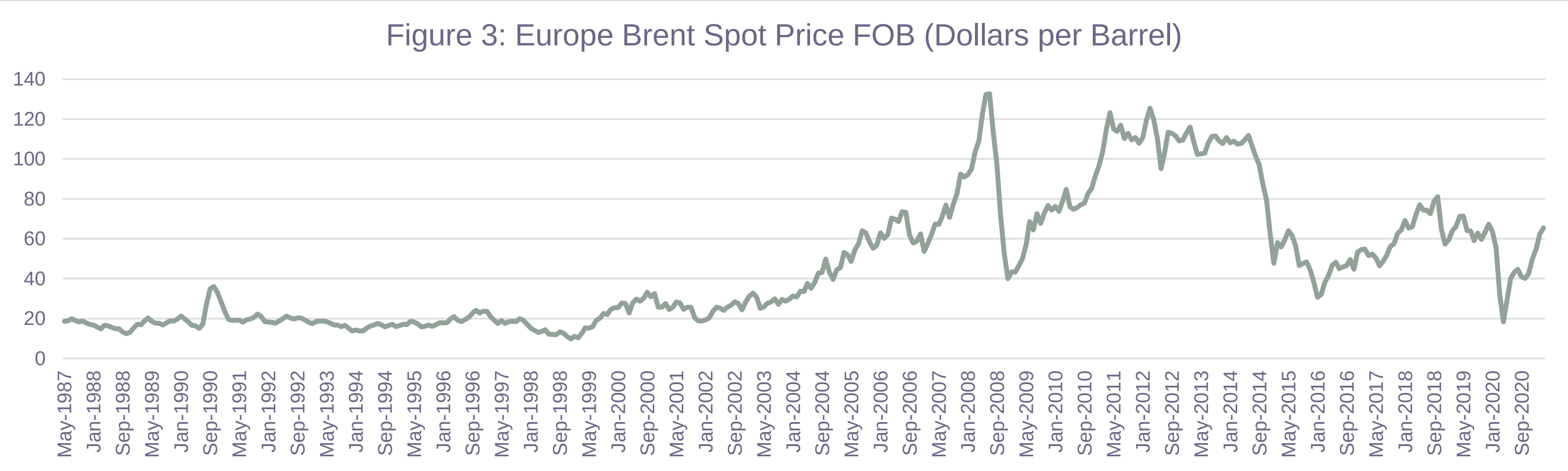
- Change in the political economy of oil pricing
  - ✓ **Green initiatives, short-term green shock**
  - ✓ **Shale oil, more elastic supply**
  - ✓ **Alternative sources of taxation; if oil in GST input tax credits**

- Agricultural productivity: China
  - ✓ **Towards surplus, exports; PMGSY interior roads; shift to horticulture; multiple shorter crop cycles**
  - ✓ **Productivity improvements; better market access, water use**
  - ✓ **MSP distortions—WTO compatibility**
  - ✓ **Pluriactivity; rural non-agriculture**
    - **IT, WFH, uniform facilities, clinics, schools—huge employment potential**
  - ✓ **Resilience to climate change**

- Finance turnaround adequate
  - ✓ **More diversity and therefore stability; deepening to continue**
  - ✓ **Neither public sector (discretion) nor market (volatility) dominance**

- Buffers against external shocks
  - ✓ **Countercyclical policy**
  - ✓ **G-20; IFS reform**

Commodity price fluctuations



Financing constraints

- Financial sector reforms essential to meet private and public financing reqts without instability
- Post GFC, credit was increasing worldwide under QE, but India had tight financial conditions
- India government more debt but overall (corporates and hhs) much less than other EMs
  - ✓ **BIS 2019 pvt: 87.2, 147.1 govt: 71.9, 43.6 (as a ratio to GDP)**
- EMs largest rise in corporate debt; AEs in govt.
- India ready to use credit-based stimulus, no high private leverage unlike most other countries
  - ✓ **But rise in public debt had to be moderate**
  - ✓ **Even so, Covid-19 year aggregate debt rise only half that of EMs**

Table 7: Core debt as a ratio to GDP

	Total credit to the private non-financial sector	Bank credit to the private non-financial sector	Total credit to household	Total credit to non-financial cooperation	Total credit to government sector at nominal value	Total credit to the non-financial sector
India						
2019	**87.2**	**53.1**	**34.5**	**52.7**	**71.9**	**159.1**
2020	**95.2**	**58**	**37.7**	**57.5**	**85.7**	**180.9**
Advanced economies						
2019	164.7	79	73.5	91.2	100.1	273.4
2020	185.3	88.6	81.1	104.2	123	321
Emerging market Economies						
2019	**147.1**	**112.8**	**45.4**	**101.7**	**53.6**	**200.9**
2020	**172.9**	**135.3**	53.9	119	**66.3**	**239.5**

Notes: 1.Core debt comprises debt securities, loans and currency and deposits in nominal values. 2. In USD at market exchange rates

Source: BIS (2021) https://stats.bis.org/statx/toc/CRE.html

Pandemic response

Indian Covid-19 stimulus

- Monetary stimulus, regulatory relief, moratoria, restructuring
  - ✓ **First stage: G spent on medical facilities, free food, unemployment insurance**
- Accused of underspending in 2020, but when the FD was revealed to be 9.5
  - ✓ **The debate swung around to worry about debt and its financing**
- Asked to clone AE protection transfers, but unaffordable for a one billion plus population
- Continued reforms, improvement in supply conditions; frontloading infrastructure spending
- I high-multiplier expenditure makes monetary accommodation more feasible
- Using the financial sector, limiting PBSR

- Covid19 facilitated a new type of crisis response for EMs
  - ✓ **Not tightening against outflows but stimulus; QE—expansion of CB BS, r cuts, ltd fisc impulse**
  - ✓ **Worked better; important to keep r<g**
  - ✓ **Correct sequencing of demand and supply measures; AEs over-emphasis on demand**
    - **Persistent supply bottlenecks**
  - ✓ **Timely reversal and reforms—to prevent risk premium rising**

Virtuous Growth Cycles

Past switches to higher growth paths

- Marginal propensity to invest rose above that to save
  - **But total savings and savings ratios also then rose with income**
  - **Pre-reform rise in public sector investment drove the process**
  - **Financial repression; 1980s unsustainable rise in public deficit, debt**

- Post reform, jump in private investment mid-90s, mid-2000s
  - **Halted by supply-side led inflation, sharp rise in interest rates, NPAs**

- Savings ratios followed the jump in investment
  - **Therefore current rates need not be a constraint**
  - **More stable and diversified financial sector can finance investment that leads savings**
  - **Changes in the composition of savings: Financial and corporate savings rise, household fall**
  - **More formalization: 2030: Financial savings share in household savings to cross 55%(41% 2020)**

- Coordinated rise in private and public investment,
  - **Together may obtain the critical mass; keep conditions conducive—PPP, gati shakti**
  - **When correctly estimated interest elasticity of demand is high**
  - **Therefore support from low interest regime**
  - **With inflation targeting and supply-side action keeping inflation low**

A better future

- Past growth volatile but constraints are easing
  - ✓ **All kinds of subsidies for a 1 billion plus population reduced sustainable inclusion through capacity building**
  - ✓ **Post GFC macro policy and regulations were too loose after 2011 too tight: Now more balance**
  - ✓ **Essential reforms adequate**

- Growth prospects
  - ✓ **Largest share of youth combined with technology/innovation, outsourcing, supply chains diversification**
  - ✓ **2030: 17% of global consumption, just behind China**
  - ✓ **13% rate of nominal growth $10 trillion in 2030; 10% $7trillion; (8-5% real growth if 5% inflation)**
  - ✓ **There is an opportunity to kick-off a virtuous growth cycle with inclusion largely from empowerment**

- Action necessary to sustain growth and employment
  - ✓ **Avoid large policy shocks; implement feasible reforms, continual supply-side improvements**
  - ✓ **M-F coordination: Conservative FA, pro-growth MA**
  - ✓ **Risks: External shocks and inappropriate policies**

Thank you