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Indian Economy at Crossroads - An Analysis

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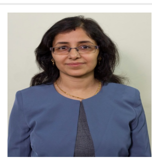

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The global financial crisis of 2008-09 and the COVID-19 pandemic have dispelled the notion that tail risks to the financial system will materialize only rarely. The outbreak of COVID-19 pandemic is the worst health and economic crisis in the last 100 years during peacetime which affects the whole world because of its high rate of spread that leads to the shutdown of the whole world in a synchronized fashion that never happened before as it is now.

The COVID-19 pandemic represents one of the biggest tests of the robustness and resilience of our economic and financial system. As we all know, India is much more integrated with the rest of the world, hence, what happens in the global economy has a significant impact on India's economy and that became a big cause of concern for India during this pandemic. Many Economists also warned that India’s GDP for the financial year 2020-21 is likely to see a sharp decline that may lead to a deep economic slowdown. Besides that, the impact of lock-down and compression in economic growth post-lock-down may result in higher non-performing assets and capital erosion of banks.

Measures Taken

To cope with the situation, the **government announced a stimulus** of Rs 20 lakh crore, including a range of liquidity measures and reforms to kick start the economy. The Reserve Bank of India has taken several important measures to protect the country’s financial system and support the real economy in the current crisis. However, the eventual success of policy responses will be visible only after some time. The certain key aspects of the measures taken for the stability of the economy are highlighted below:

Monetary policy measures

Monetary policy was already in an accommodative mode before the outbreak of COVID-19, with a cumulative repo rate cut of 135 basis points between February 2019 and the onset of the pandemic. Reversing the slowdown in growth momentum was the key thinking for this distinct shift in the stance of monetary policy and the cumulative impact of these measures was about to push a cyclical turnaround in economic activity when COVID-19 began to spread.

At current, the future looks uncertain as infection numbers are rising continuously and it is critical to anticipate the emerging economic risks and take appropriate monetary policy actions accordingly. But the fast-changing macroeconomic environment and the deteriorating outlook for growth necessitated a further cut in the policy repo rate by 115 basis points, resulting in a cumulative policy rate reduction of 250 basis points since February 2019.

Repo rate means the rate at which central bank (RBI) advance money to the commercial bank, rise in repo rate negatively impact the growth of the economy by making borrowing cost to bring down the flow of money which ultimately help in controlling inflation; on the other hand, reduction in repo rate makes borrowing cheaper which pump funds that ultimately boost the economy.

Liquidity measures

The conventional and unconventional monetary policy and liquidity measures by the RBI have been aimed at restoring market confidence, alleviating liquidity stress, easing financial conditions, unfreezing credit markets, and augmenting the flow of financial resources to those in need for productive purposes.

To improve liquidity in the market, RBI sells securities of short-term and buys longer-term government bonds. Because of surplus liquidity available in the short term, the impact of the sale of securities on price and yield is negligible. However, in longer terms, where liquidity is insufficient, the purchase of bonds pushes up the price and brings down the yield of long-term bonds. Prices and yields are inversely related. The lower yield brings down the cost of borrowing for the government and ultimately for the private sector whose borrowing rate will depend on the rate at which the government borrows.

RBI also announces a special liquidity facility for mutual funds and NBFCs to provide relief to these entities that are seeing liquidity stress.

Financial Stability and Developmental Measures

Heading into the pandemic, the financial system of the country was in a much-improved position, owing mainly to various regulatory and supervisory initiatives of the Reserve Bank. In between 2015-16 and 2019-20, the Government had infused a total of INR 3.08 lakh crores in public sector banks. As a result of the efforts by both the Reserve Bank and the Government, the overhang of stressed assets in the banking system had declined with NPAs coming down from 11.6% as of March 2018 to 8.6% as of March 2020.

Moratoriums on loans, **IBC-NCLT being put on hold**, and rating agencies being allowed to go a little slow on downgrading assets are the major steps taken by the government during the pandemic period to provide stability to the businesses.

Major Challenges

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Government needs funds to get the economy back on track, that raises the eyebrows of many economists about, with the reduction in tax receipts, how a cash-strapped government would be able to get the money to fund direct transfers and provide more capital to ailing banks and credit to businesses.

The banking sector might see a spike in stressed assets when the period of moratorium ends, and consequent to that, we may see an increase in the number of cases under IBC-NCLT.

Final Take

As Asia's third-largest economy, the Indian economy is intrinsically stronger and has started showing signs of getting back to normalcy. However, it is still uncertain how long it will take for demand conditions to normalize; and what durable effects the pandemic will leave. Possibly in the post-COVID global environment, reallocation of factors of productions within the economy and innovative ways of expanding economic activity could lead to some rebalancing and emergence of new growth drivers that provide the enabling conditions for a speedier recovery in economic activity while minimizing near-term disruptions.

A significant growth driver will be India's trade with the rest of the world, "There is an opportunity for India in sectors where China enjoys a big share in the global market". In the last few months, sensing the opportunity the government has announced production-linked incentives for the manufacturing of electronics, medical devices, and pharmaceutical products while putting restrictions on imports of Chinese products, defense products.

The big question that arises in front of all is "how to get funds? or how to infuse liquidity?" and the answer is borrowing, the same was suggested by Dr. Manmohan Singh in an interview, and he acknowledged that it would increase India's debt to GDP ratio, but if borrowing "can save lives, borders, restore livelihoods and boost economic growth, then it's worth it". He further added, "We must not be shy of borrowing but we must be prudent on how we use that borrowing".

Hope, these testing times will only strengthen the world's faith in the resilience of the Indian economy.