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KEEP THE WHEELS OF ECONOMIC RECOVERY TURNING

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Banking, NPAs and RBI

The forthcoming Economic Survey will tell us about the state of the economy based on available empirical evidence. The first advance estimates of national income published on January 7 project a contraction of 7.7% for real GDP. The Q2 GDP estimates published by the National Statistical Office, Ministry of Statistics and Programme Implementation (MOSPI) on November 27 had suggested an economic recovery in India. An improvement in the rate of contraction from 23.9% in Q1 to 7.5% in Q2 was seen as the beginning of a sustained recovery. The Ministry of Finance, in its Monthly Economic Review highlighted it as signifying a 'V' shaped recovery and as a reflection of the resilience and robustness of the Indian economy. The Monetary Policy Statement of the Reserve Bank of India (RBI) released on December 4, 2020 also projects positive growth in the remaining quarters of the financial year. A low fatality rate and rolling out of the vaccination programme have added to the optimism.

Growth rate of the economy had collapsed from 8.2% in Q4 of 2017-18 to a mere 3.1% in Q4 of 2019-20, sliding continuously for eight quarters. The policy stance adopted by the Union government against this backdrop was premised on the hope that private corporate investment will pick up momentum sooner than later, putting the economy back in the trajectory traced in the first decade of the new millennium. The RBI did the heavy lifting through five consecutive lowering of repo rate, adding to a total of 135 basis points from February to October 2019 along with liquidity infusion programmes. However, monetary-fiscal linkages are crucial to catalyse the demand.

While being cautious of inflation, the RBI has decided to continue the accommodative stance in its latest monetary policy to support growth. It has retained status quo in the policy rate of repo at 4%. The CPI inflation after crossing 7% has cooled off to 4.6% in December. Still, the real interest rates remain very low. The RBI expects inflation to ease to the specified band. The efficacy of the new monetary framework (NMF) — the agreement between the RBI and Government of India in February 2016 to adopt inflation targeting in India — will be reviewed in March 2021, and we flag the need for revising the framework.

The RBI is continuing its liquidity infusion programmes including the on-tap Targeted Long Term Repo Operations (TLTRO). This programme announced on October 9, 2020 for five stressed sectors has been extended to 26 stressed sectors notified under the Emergency Credit Line Guarantee Scheme (ECLGS 2.0). The RBI is also continuing its 'operation twist' — the elongation of debt maturity structure through simultaneous buying of long-term bonds and selling of short-term bonds — with Open Market Operations (OMO) of 10,000 crore scheduled for December 17, 2020.

Nevertheless, the RBI Governor has rightly pointed out that the signs of recovery are far from being broad-based and are dependent on sustained policy support. He has also pointed out that it is a no-brainer that Union Budget 2021-22 will be pro-growth.

Also read | RBI to hold TLTRO of up to 1 lakh crore

The economies which rebounded fast, post the global financial crisis, were the ones which resorted to significant fiscal stimulus. We argue for fiscal stimulus not based on "business cycle" arguments to trigger animal spirits, but from the perspective of much needed targeted state interventions in public health, education, agriculture and physical infrastructure, and to redress widening inequalities in the time of the novel coronavirus pandemic. In a context where private final consumption expenditure is sluggish, contracting 26.7% and 11% in Q1 and Q2, respectively, a "fiscal dominance" is expected in India for sustained economic recovery. However, India cannot afford fiscal stimulus at the rates of advanced economies, due to a lack of fiscal space. The pandemic has hit many crucial sectors and has left millions jobless. It is in this context that the Finance Minister has promised a "never before like budget" on February 1, 2021.

The Biden Plan of $1.9 trillion will make the pandemic response of the United States a massive $5.2 trillion one. Compare this with the $800 billion worth U.S. fiscal response to the global financial crisis. According to the International Monetary Fund's Fiscal Monitor Database of Country Fiscal Measures, the fiscal stimulus for India is 1.8% of GDP. The corresponding figures are: for Brazil 8.3%, Russia 2.4%, China 4.6%, and South Africa 5.3%. The IMF, in its Fiscal Monitor, highlights the need to scale up public investment to ensure successful reopening, boost growth and prepare economies for the future. Subdued interest rates make this case even stronger.

Finance Minister Nirmala Sitharaman, in her interview on December 8, 2020 to Bloomberg TV, indicated that the "fiscal deficit fears will not derail government spending". This announcement is welcome, given the much needed fiscal package for enhancing the public health infrastructure and the COVID-19 vaccine roll out, to address the falling effective enrolment rates due to the digital divide, the employment and livelihood crises and the need for strengthening social and physical infrastructure spending.

Plummeting private corporate investment in India is a matter of concern. A co-authored paper by Hrishikesh Vinod, Honey Karun and Lekha Chakraborty in *The Handbook of Statistics* titled *Financial, macro and micro econometrics using R* using maximum entropy ensembles time series methodology showed that public infrastructure investment is the prime determinant of private corporate investment in India. The fear of financial crowding out emanating from high fiscal deficit is misplaced in the context of India.

The path of economic recovery will be determined by the degree of containment of the pandemic and the sustained macroeconomic policies. Any abrupt withdrawal of ongoing economic policy support, both by the monetary and fiscal authorities, will be detrimental to growth in times of the pandemic. The fiscal rules at the national and subnational government levels need to be made flexible to enhance the fiscal space to deal with the extraordinary situation. The public debt deficit dynamics in India, therefore, needs a careful calibration in the forthcoming Budget 2021-22.

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