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ECONOMIC UNCERTAINTY RISES

Relevant for: Indian Economy | Topic: Issues relating to Planning & Economic Reforms

Stock markets globally have declined since the big drop this ‘Manic Monday’. They are reacting to the expected slowdown in the world economy due to the rapid spread of the SARS-CoV-2 virus to more than 100 countries. Crude oil prices also began dropping due to fears of global recession and drop in demand for energy. With increasing uncertainty, there is even a possibility now that the Olympics to be held in Japan this summer may be postponed. Travel and trade have been severely affected in large parts of the world, with restrictions on movement and cancellations of visa, etc.

In recent times, China, the epicentre of the outbreak and the largest supplier of many basic and intermediate goods, has come to dominate the supply chain of production of a large number of final goods. So, multiple industries have been impacted due to the spread of the virus. For instance, India has come to depend on China for supply of inputs in the areas of electronics, medicines, automobile parts and components used by small and cottage sectors. The Chinese juggernaut has been supplying even Indian cultural symbols like *pichkari*s for Holi and idols of Indian gods. China produces multiple items cheaply on a scale that other countries cannot match. Despite the low wages in India and the additional transport costs of getting these items from China, the Chinese goods have displaced a big portion of Indian manufacturing.

The current supply chain disruption requires that either Indian production is ramped up where possible, or alternative sources of supply abroad are found. But, given the fact that much of the alternative production possibilities have been disrupted in the last 20 years by cheap Chinese goods, finding producers who can quickly ramp up production is not easy. Even if alternative sources of supply are found within India, their prices will be higher, so inflation will go up. This inflationary tendency will be countered by the global decline in demand and a fall in commodity prices, similar to what is being witnessed in the case of energy.

In a recessionary scenario, there is a fall in incomes and reduction in demand in spite of a decline in inflation. Expenditures on health and disease control will rise but not enough to counter the slowdown.

The impact on the small producers is likely to be sharper due to the fact that they have small working capital. As demand declines, they are left holding inventory and also have to pay wages; this exhausts their working capital. If their units shut down for even a few months, it becomes difficult to bring them back to life. The financial sector is not very much attuned to catering to their demand and, hence, they have to depend on the more expensive source of private funds.

Also, as the economy declines, the already substantial non-performing assets (NPAs) of banks and the non-banking financial companies (NBFCs) will increase in India. The Reserve Bank of India (RBI) has already reported falling business and consumer confidence and a decline in capacity utilisation in the organised sectors of the economy. These factors are being aggravated by the virus-related impact, further denting investment.

Consumer confidence will remain low for a while even after the intensity of the spread of the virus declines with the onset of summer. But there is no certainty about this since the World Health Organization (WHO) says that not enough is known about this virus. People the world over are scared and anticipate trouble ahead, so they are unlikely to resume buying discretionary items. Car sales in China have plummeted and are unlikely to revive soon. People save more when the future is uncertain; hence, demand is not likely to increase immediately. Due to fear of lockdown and shortages, it is likely that people will hold more cash and essential items at their homes. Central banks will have to be prepared to issue more currency. They have reduced interest rates but this will have little impact since the primary reason for the global downturn and stock market volatility is decline in sentiment following the spread of the virus. It is not a cyclical downturn.

In brief, the problem is not fully understood but fears of a big impact have grown. Supply shocks emanating from China have spread and due to impact on production, incomes are declining, leading to a fall in demand and threat of global recession. The poor are likely to be impacted more in India. At present only the short run can be anticipated but since uncertainty has increased, governments will have to take fiscal steps anticipating the worst in the long run.

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