BLOG

India – At the precipice?

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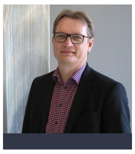

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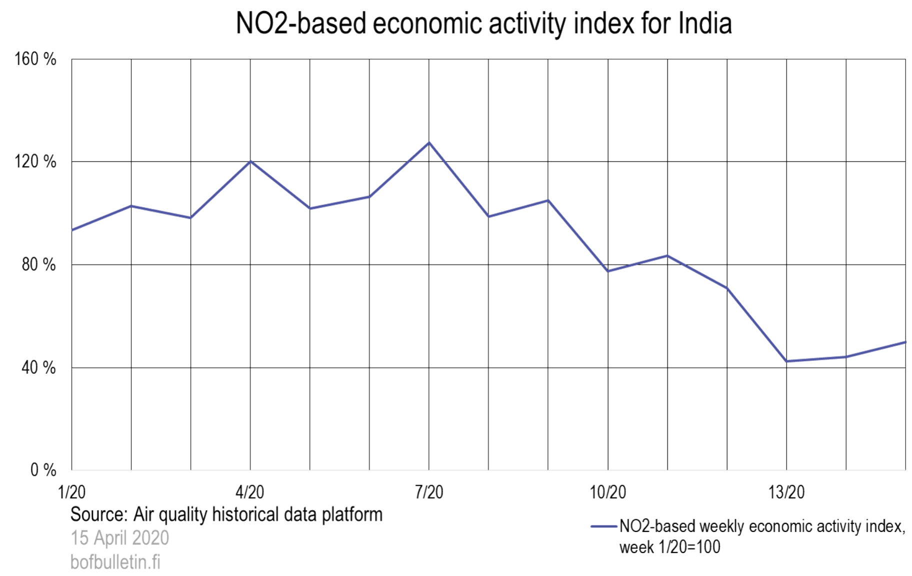
COVID-19 spreads in India. The published infection numbers for India are modest, with the number of infected still below 10,000 and deaths under 1,000. While the numbers for the world's second-most populous nation are substantially lower than in any other large economy, they mainly indicate a paucity of testing. With domestic producers now entering the market, India is making significant strides in boosting its testing capabilities, but the challenges related to effectively tracking the spread of the virus remain daunting.

Economy activity declines sharply. The March purchasing managers' index data still showed positive, albeit modest, growth in manufacturing. However, anecdotal information, as well as high frequency data such as traffic congestion levels, indicate that economic activity was feeling the impacts of the pandemic already at the end of February, partly reflecting the imposition of travel restrictions by the government. The fall in economic activity has gathered speed ever since. In early March, the government issued more restrictions to slow the spread of the virus, including the closing of schools, gyms, museums, and theaters, bans on mass gatherings, and encouraging firms to promote telecommuting. Based on survey evidence, the Reserve Bank of India (RBI) reported serious degradation of demand indicators around mid-March. In late-March, the government imposed a three-week national lockdown to contain the domestic spread of the virus.

Chart 1



Fiscal policy under considerable strain. The central government has announced various programs to help the economy, mainly targeting the healthcare sector. Some state governments have also announced programs to support the poorest households. The announced government programs are, however, relatively minor, in part reflecting the expected drastic drop in government revenue caused by the dramatic fall in economic activity. Even before the crisis, the general government was running significant deficit at around 7 percent of GDP, and its debt had reached about 70 percent of GDP, which is high by developing country standards.

Monetary policy in crisis mode. To calm the private debt markets, the Reserve Bank of India has undertaken a broad set of measures, including lowering of the policy rates and the cash reserve requirement. It has also undertaken targeted long-term repo operations with banks to shore up demand for private paper, eased repatriation requirements for foreign income, and supported state governments by easing the restrictions of overdrafts of their accounts at the central bank. Given the exceptional monetary policy environment, the RBI decided not to publish its GDP and inflation forecasts, instead opting to present scenarios with alternative outcomes. In the more optimistic scenario India's growth decelerates only 0.8 percentage points, while in the more pessimistic variant growth goes down by 1.8 percentage points.

RBI works to support the banking sector. A number of banks had already been placed under special direction, with the RBI working actively on their rehabilitation. Even before the COVID-19 epidemic, the India's banking sector was already under considerable strain, with reported non-performing loan ratios close to 10 percent. The financial sector is expected to face deteriorating conditions during the months ahead.

Tags

COVID-19, fiscal policy, India, monetary policy, COVID-19