PGDM, 2019-21
Global Business Environment
DM-302
Trimester – III, End-Term Examination: June 2020

Time allowed: 1 hrs 30 min Max Marks: 30

Covid 19 and Indian Economy – A Macroeconomic Perspective

We are witnessing world's biggest catastrophe in the form of (COVID-19/SARS-CoV-2) More than seventy six lakhs humans have already been infected by this COVID-19 and more than four lakh deaths related to coronavirus have been reported across the world till date. The current statistics of COVID-infections and accounted deaths clearly indicates the severity of situation. The world health organization (WHO) had already announced it as pandemic. Amid the coronavirus pandemic, several countries across the world resorted to lockdowns to "flatten the curve" of the infection. These lockdowns meant confining millions of citizens to their homes, shutting down businesses and ceasing almost all economic activity. According to the International Monetary Fund (IMF), the global economy is expected to shrink by over 3 per cent in 2020 – the steepest slowdown since the Great Depression of the 1930s

The Covid-19 pandemic isn't the first we've witnessed. Perhaps the best parallel to draw with today is the Spanish Flu, one of the most infamous pandemics the world, and India, saw almost exactly a century ago.The Spanish flu 1918 had hard hit the world and claimed 50 to 100 million lives globally with India suffering the highest casualty to an extent of 18 million lives. To minimize the mayhem that such a pandemic can wreak on the lives of people the Indian Government imposed a nationwide lockdown effective March 25, 2020. The downside of any Lockdown is that economic activity and businesses come to a standstill and the economy is abruptly halted in its growth track. Now the Indian government has begun the long and arduous journey to exit the lockdown .& the number of Covid 19 cases in India has reached 3.2 lakh as on June 14, 2020 .The outbreak of the Covid-19 pandemic is an unprecedented shock to the Indian economy. The economy was already in a parlous state before Covid-19 struck. With the prolonged country-wide lockdown, global economic downturn and associated disruption of demand and supply chains, the economy is likely to face a protracted period of slowdown. .It is imperative to understand the impact this pandemic has created on the Indian economy.

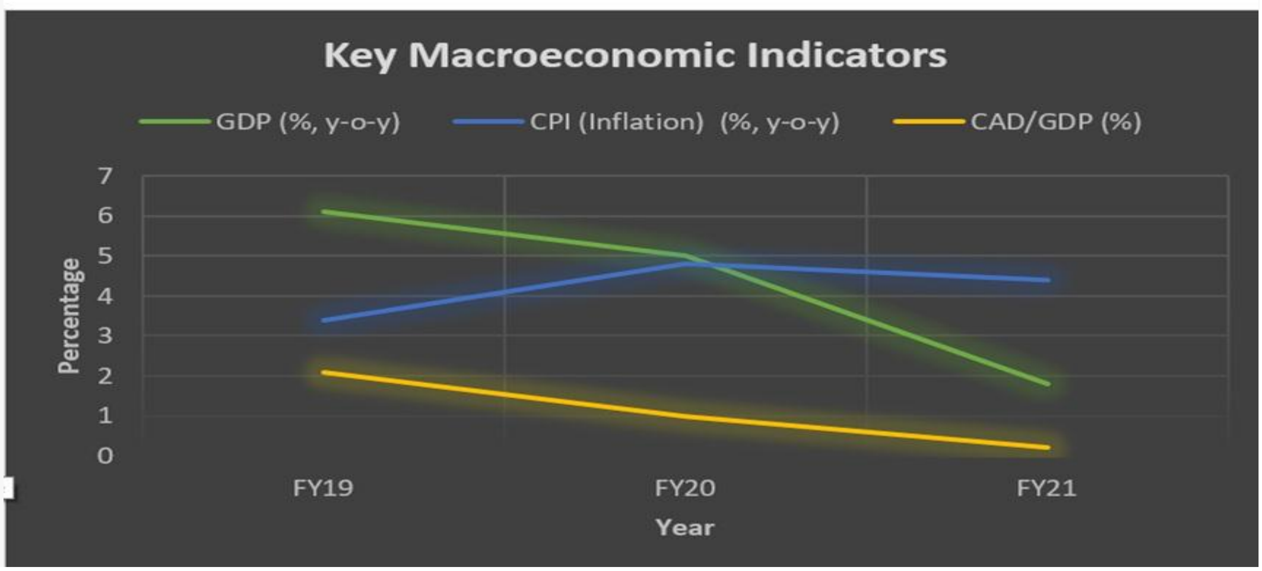
Slowdown of Economic Growth

World Bank on Monday sharply scaled down its projections for India's economy, forecasting 3.2 per cent contraction in the fiscal year 2020-21 because of the Covid-induced lockdown. It had earlier predicted 1.5-2.8 per cent growth.The country's economy grew 4.2 per cent in 2019-20, the slowest in 11 years.It, however, stressed India's economy should bounce back in 2021-22 and pegged growth at 3.1 per cent. Still, it is lower than 4-5 per cent growth projected by the bank earlier.

The International Monetary Fund (IMF) on Tuesday slashed its FY21 growth projection for India to 1.9% from 5.8% projected in January, holding that the 'Great Lockdown' to combat the covid-19 outbreak will throw the world economy into the worst recession since the Great Depression in 1930s.

Figure 1 shows the impact of Covid19 on key macroeconomic indicators ie GDP y-o-y growth, CPI inflation and CAD/GDP (CRISIL, 2020). The decline in growth numbers are reflective of the aftermath of Covid19, CPI shows a softening of inflation numbers due to increase of food grain production. The sharp plunge in oil prices is expected to have a positive impact on CPI and CAD/GDP.

Figure1



Source: National Statistical Office (NSO), Budget documents, Reserve Bank of India (RBI), CRISIL

The positive is that World Bank expects growth of Indian economy to rebound to 5% in fiscal 2022. Economists and researchers are forecasting anything from a best case scenario of 'V' shaped recovery curve to 'U' or 'L'. A 'V' or 'U' shaped curve is correlated to the timing and magnitude of government stimulus and how companies and market structures are able to cope with a low level of demand. While Q1 has been negatively impacted due to the Lockdown, Q2 and Q3 are expected to be riddled with low consumption levels, falling business investment and declining exports adversely impacting the Indian economy.

Demand and Supply Constraints

On the demand side private consumption is likely to contract due to loss of income in the face of domestic outbreak and people preferring to conserve and hold on to cash amidst increased economic uncertainty. Tourism, Hospitality and Aviation are among the worst affected sectors that are facing the maximum brunt of the present crisis. Closing of cinema theatres and declining footfall in shopping complexes has affected the retail sector by impacting consumption of both essential and discretionary items. Consumption is also getting impacted due to job losses and decline in income levels of people particularly the daily wage earners due to slowing activity in several sectors including retail, construction, entertainment, etc. With widespread fear and panic now increasing among people, overall confidence level of consumers has dropped significantly, leading to postponement of their purchasing decisions. Thus spending will only be on essentials such as food and healthcare services. On the supply side, businesses are expected to cut back on capital expenditure and conserve cash for any unforeseen emergency in the near future. Shutdown of factories and the resulting delay in supply of goods from China has affected many Indian manufacturing sectors which source their intermediate and final product requirements from China. Some sectors like automobiles, pharmaceuticals, electronics, chemical products etc. are facing an imminent raw material and component shortage. Besides having a negative impact on imports of important raw materials, the slowdown in manufacturing activity in China and other markets of Asia, Europe and the US is impacting India's exports to these countries as well

To add to its woes, the pre-Covid 19 scenario of the Indian economy of liquidity shortage and credit availability issues in the financial sector of the economy has only worsened the situation. Existing inherent weaknesses in the financial sector of the Indian economy such as hampered flow of credit due to severe liquidity constraints in the banking and non-banking financial sector and existence of large NPAs will amplify the effect of a coronavirus induced shock.,This uncertainty had adversely impacted the Sensex / Nifty as investors have resorted to relentless selling bringing down the BSE sensex from over 40,000 to hovering around sub 33,780 as on June 14though some recovery has been made.. This brings to light a paradox of FII money leaving the boundaries of the host country even though it offers a higher interest rate relative to the Fed rate.Another point of concern for emerging markets including India has been the massive sell-off in global risk assets by foreign portfolio investors due to Covid 19 pandemic thereby negatively impacting the domestic currency and making it volatile. INR has depreciated by approximately 7% since January 2020 and is around Rs. 75.96 to a dollar as on June14, 2020.

Sectoral Impact

However, the impact of the contraction will vary across sectors, states, even social groups. For example, it can be expected that at least two sectors; agriculture and government, will not see a contraction. In 2019-20, these two sectors had a share of almost 30% in total Gross Value Added (GVA). This means that the economic pain will be far more severe in the rest of the economy.

Tedious road ahead for travel & tourism and entertainment

The travel & tourism industry was one of the first sectors to be affected by the outbreak, and most likely will also be the hardest hit. The Indian Association of Tour Operators (IATO) estimates the hotel, travel and aviation sectors to incur losses of up to Rs 8,500 crores due to travel restrictions imposed on foreign tourists.Cancellation of tickets, refunds and low utilization rate of airlines have made matters worse for the already distressed aviation industry in the midst of a cash crunch.The Indian cinema industry will likely face a loss of ~INR200–250 crores over the next 2–3 months.Furthermore, unemployment and fall in income levels would aggravate the situation.

Auto industry to witness massive revenue loss due to disruption in supply chain globally

The automotive sector is feeling the pinch too. In passenger cars alone, the lockdown is estimated to have reduced production by ~240,000 units (~10% of total annual production). Each day of loss of production is causing the industry a loss of over INR2,300 crores in revenue on average. The spread of the pandemic globally had a whiplash effect across the supply chain. Automotive manufacturers in India depend highly on auto components imported from COVID-19-affected countries such as China, Germany and South Korea. This factor too will adversely impact production.

Low asset utilization rate in logistics and ports

With the movement of people/passengers restricted amid the lockdown, revenues have taken a hit in the railways, bus, airline, and cab segments of the transportation sector.Rail freight has been affected as the demand and supply of high volume bulk cargo items (such as imported coal for power plants or iron ore exported via rail to various ports in India for steel mills in China) are subdued. The impact on the sector would be long-term, reflected in the decline in revenue due to the low utilization of assets. Cash flows and working capital of firms in these businesses will also remain strained.

FMCG and retail players on a war footing; foodservice and institutional business decimated

Since the imposition of the nationwide lockdown, FMCG companies and retailers are dealing with challenges primarily around three highly interconnected issues: surge in demand & depletion of inventory, reduction in workforce, and supply chain disruption.Panic-induced stockpiling meant supermarket shelves were getting empty faster than they could be replenished. As retailers struggle to deliver orders, innovative delivery models are emerging. Some examples are Big Basket and Flipkart tying up with Uber and Swiggy for last-mile delivery of essential items, Zomato launching Zomato Market service to deliver groceries from retail stores, and ITC partnering with Domino's Pizza for zero contact delivery of Aashirvaad brand of atta and spices.The lockdown has led to the migration of workers to their homes in rural areas, causing a shortage of labourers and, thereby, disruption of supply chains. With factories being shut and migrant laborers endeavoring to return to their villages, this will result in shortage of workforce and negatively influencing manufacturing, public transport services and construction.Sectors such as automobile, electronics, chemical products, electrical machinery, leather products, mobile handsets and network equipment manufacturing etc. have been impacted big time. This could be primarily due to dependence on supply of intermediate goods from China.

Covid relief Packages

The mega Rs 20 lakh crore stimulus package announced by PM Modi includes previously announced measures to save the lockdown-battered economy, and focuses on tax breaks for small businesses as well as incentives for domestic manufacturing. The combined package works out to roughly 10 per cent of the GDP, making it among the most substantial in the world after the financial packages announced by the United States, which is 13 per cent of its GDP, and by Japan, which is over 21 per cent . The contents of the package were broad-based and announced in five tranches. However the government's Rs 20.97 lakh crore COVID-19 package lacks in addressing immediate concerns of the economy as the actual fiscal impact of the additional stimulus is only about 1 per cent of GDP as opposed to the claim of 10 per cent, Fitch Solutions said on Tuesday. Of the host of new stimulus measures, only about six -- pension fund support, temporary tax cuts, farm infrastructure upgrades (if funds are quickly disbursed and projects rapidly executed), free food provision for migrant workers, funds to safeguard rural employment and an emergency fund for post-harvest activities -- can be quantified as a fiscal stimulus with a near-term impact.Liquidity infusion and fiscal expenditures are very different things. The first impacts the availability of cash and credit in the economy. The second directly raises aggregate demand and lead to economic growth. It is widely understood that during an economic downturn, liquidity infusion does not help much because aggregate demand itself goes downhill, including the demand for credit and money. In order to come out of this liquidity trap, we require massive investments, income transfers and creation of additional purchasing power.

Coronavirus (COVID-19) and global growth

The IMF's estimate of the global economy growing at -3 per cent in 2020 is an outcome "far worse" than the 2009 global financial crises. Economies such as the US, Japan, the UK, Germany, France, Italy and Spain are expected to contract this year by 5.9, 5.2, 6.5, 7, 7.2, 9.1 and 8 per cent respectively.Advanced economies have been hit harder, and together they are expected to grow by -6 per cent in 2020. Emerging markets and developing economies are expected to contract by -1 per cent. If China is excluded from this pool of countries, the growth rate for 2020 is expected to be -2.2 per cent. China's GDP dropped by 36.6 per cent in the first quarter of 2020, while South Korea's output fell by 5.5 per cent, since the country didn't impose a lockdown but followed a strategy of aggressive testing, contact tracing and quarantining. In Europe, the GDPs of France, Spain and Italy fell by 21.3, 19.2 and 17.5 per cent respectively. World merchandise trade is set to plummet by between 13 and 32% in 2020 due to the COVID-19 pandemic.A 2021 recovery in trade is expected, but dependent on the duration of the outbreak and the effectiveness of the policy responses. Nearly all regions will suffer double-digit declines in trade volumes in 2020, with exports from North America and Asia hit hardest. Trade will likely fall steeper in sectors with complex value chains, particularly electronics and automotive products. Services trade may be most directly affected by COVID-19 through transport and travel restrictions. Merchandise trade volume already fell by 0.1% in 2019, weighed down by trade tensions and slowing economic growth.

Impact on International Trade - The pandemic has had a major impact on the supply chains as more than 60 per cent respondents indicate that their supply chains were affected. The companies also highlighted that they are closely monitoring the situation and expect the impact of the pandemic on supply chain to worsen further China has been a major market for many Indian products like sea food, petrochemicals, gems and jewellery etc. The outbreak of coronavirus has adversely impacted exports of these items to China. For instance, the fisheries sector is anticipated to incur a loss of more than Rs 1,300 crore due to fall in exports. Similarly, India exports 36% of its diamonds to China. The cancellation of four major trade events between February and April is likely to cause an estimated loss of Rs 8,000-10,000 crore in terms of business opportunity for Jaipur alone. India also exports 34% of its petrochemicals to China. Due to exports restrictions to China, petrochemical products are expected to see a price reduction.

Silver Lining on the Wall

The low demand has also not spared the demand for crude oil. Low demand coupled with the price war between the global players ie Saudi Arabia, Russia and United States of America has largely led to a fall in price of crude oil is a boon for Indian economy as 80% of our requirement is met by imports has been retained by the Government to strengthen their fiscal position.The crisis seems to have shaken up the world economic order and India’s effort should be to maximize the opportunities presented by wooing MNCs that are looking to shift manufacturing activities out of China and simultaneously wanting to take advantage of cheap labor to contain their bottomline.

Interestingly, in order to be able to seize the opportunity that the adverse situation has provided, the Indian Government is simultaneously working on changing policies to emerge as an alternative attractive manufacturing destination and has set up dedicated groups to tap firms that are wanting to diversify out of China. Additionally by rising to the grave situation existing across the world and supplying hydroxychloroquine to countries, the Indian Government has once again managed to win over both its friends and foes.

Attempt the following questions.The analysis should not be limited to the information given in the case. You are free to analyze as per your individual perception. Evaluation will be done strictly on the basis of analytical ability irrespective of your opinion.

Each question carries 10 marks

Q1 (CILO-1) Do you think COVID 19 has triggered a global recession? Should Government adopt the Keynesian theory of economic growth* or a 5 trillion economy is a distant dream now.

Q2)(CILO-2) Globalization refers to the shift towards a more integrated and interdependent world economy. Comment with reference to the impact of COVID- 19 on world economy. Is the world heading towards reverse globalization? Give arguments for & against the same

Q3)(CILO-3) In Indian Context are these measures adequate to provide the requisite boost to the economy? What according to you needs to be done by the government to revive the economy.

* **Keynes** advocated for increased government expenditures and lower taxes to stimulate demand and pull the global **economy** out of the depression