CARE Ratings
Professional Risk Opinion

Economic Survey 2020-21

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The economic survey has provided a comprehensive assessment of the Indian economy for 2020-21 and the outlook for the ensuing year. The survey has also examined certain pertinent aspects and ideas for the country's economic development.

The economic survey has been divided into 2 broad parts – (A) overview of the Indian Economy in FY21 and outlook for FY22, and (2)

A: Assessment of the Economy and Outlook

1. **Assessment of the Indian Economy in FY21**

Economic activity and Resilient V-shaped recovery

- In line with the advance estimates by NSO, India's GDP is estimated to grow by (-)7.7% in FY21.
- In terms of GVA, agriculture has remained a silver lining (expected to clock growth of 3.4%) while contact based services; manufacturing and construction have been the hardest hit Industry and Services to Contract by 9.6%and 8.8% respectively in FY21.
- Government consumption and net exports have cushioned the growth from falling.
- A resilient V-shaped recovery in the economy is underway and this is reflected by various high frequency indicators like power demand, e-way bills, GST collections, steel consumption.
- Factors which will continue to drive the recovery process in the economy include:
  - Mega vaccination drive
  - Hopes of a robust recovery in the services sector, consumption and investment
  - Sustained process of reforms to erase the adverse impact of the pandemic

Deviation from fiscal consolidation likely to be transient

- In the backdrop of an unprecedented crisis, the year has been challenging on the fiscal front with shortfall in revenues and additional expenditure requirements.
- Followed a calibrated approach in contrast to front-loading large economic stimulus package adopted by many countries
- The Government is expected to register a fiscal slippage during the year but the deviation from fiscal consolidation may be transient

Monetary policy – Accommodative and Liquidity support

- Monetary policy was significantly eased by 115 bps since March 2020 but elevated retail inflation has led to the MPC keeping policy rates unchanged since May 2020.
- However, the RBI has significantly enhanced the liquidity support in the forms of various unconventional liquidity measures like LTRO, TLTRO, special OMOs among others.
- Financial flows in the economy continue to remain constrained on account of subdued credit off-take by both banks and NBFCs.
- Inflation
- CPI inflation remained elevated during the pandemic with high food prices remaining a major driver of retail inflation. High inflation was chiefly on account of supply side disruptions.
- However, retail inflation softened in December and has fallen back within RBI's inflation target which reflects easing of supply side constraints.

Inflows and Surplus in the External sector

- India's current account surplus stood at 3.1% in H1-FY21 and is projected at 2% of GDP in FY21, a historic high after 17 years. This improvement has been primarily on account of strong services exports and sharp contraction in imports.
- Forex reserves have seen a notable jump in 2020 and have increased to a level of 18 months worth import cover in December 2020
- External debt increased from 20.6% in March 2020 to 21.6% in September 2020.

- FDI inflows have been robust ($27.5 bn during April to October 2020) amidst global asset shifts towards equities and prospects of quicker recovery in emerging economies
- Net FPI inflows recorded an all-time monthly high of US$ 9.8 billion in November 2020, as investors' risk appetite returned. India was the only country among emerging economies to receive equity FII inflows in 2020.

Pandemic Policy response undertaken

- India's policy responses to "once-in-a-century" crisis has been unique and mature
- India's policy response focused on minimizing losses of human lives and recognized that short term pain of an initial and stringent lockdown would lead to long term gains
- An early and intense lockdown was a win-win strategy to save lives and preserve livelihoods
- India's four pillar strategy included: Containment, Fiscal, Financial and Long-term structural reforms
- During the unlock phase, when uncertainty declined and precautionary motive to save reduced, the government increased its spending.
- A favorable monetary policy ensured abundant liquidity and immediate relief to debtors via temporary moratoria, while unclogging monetary policy transmission
- India was the only country to announce structural reforms to avoid long term damage to productive capacities.

Notable improvement in Bare Necessities

- There has been an improvement in bare-necessities : access to water, housing, sanitation, micro-environment and other facilities
- Inter-State disparities have declined across rural and urban areas; lagged states have gained relatively more between 2012 and 2018
- This improvement has led to improvement in health indicator

2. Outlook for FY22 and beyond

- The governments foresees a swift and sizeable recovery in the economic growth rates for the domestic economy in the coming financial year, aided by the low (statistical) base and the continued normalization in economic activities as the mass vaccination programme gains speed.
- The Indian economy is poised to grow (real GDP) by 11% in 2021-22. The nominal GDP growth for the year is estimated to come at 15.4%.
- Rebound expected in consumption, the services sector and investments.
- The Indian economy would take two years to attain and surpass the pre-pandemic levels.
- Focus on reforms should continue to enable realise the nation's growth potential and to overcome the impact of the pandemic. Along with this, innovations, timely regulatory support and withdrawal of forbearance is needed.

B. Ideas for the development of the Indian Economy

Fiscal Policy and Debt sustainability

The economic survey makes a case for an active counter –cyclical fiscal policy, one that provides an impetus to growth and ensures that the full benefits of reforms are reaped. It postulates that for India, high debt levels are unlikely to be problem even in the worst case scenario given its growth potential.

The survey argues that growth would lead to debt sustainability and focusing on mere debt levels would not facilitate growth. It states that Debt sustainability depends on the 'Interest Rate Growth Rate Differential' (IRGD), i.e., the difference between the interest rate and the growth rate and a negative or low IRGD is not a budget constraint for the government. In India's case, the IRGD is negative/ low as the country's economic growth rate is higher than the interest rate paid on its debt by the government. This makes its debt sustainable. As India's growth rates are expected to be higher than the interest rates for the foreseeable future a fiscal policy that stimulates growths would lead to lower debt to GDP ratio.

India's Sovereign credit rating should not be an inhibiting factor for fiscal policy

The survey argues that India's sovereign credit rating are not reflective of its fundamentals and highlights bias and subjectivity. India despite being the world's fifth largest economy has been assigned a sovereign credit ratings which is the lowest rung of investment grade (BBB-/Baa3). Other similar sized economies – which reflects ability to repay debt- have been predominantly rated AAA.

The Survey points that India's zero sovereign default history, low foreign currency denominated debt of the sovereign and comfortable size of its foreign exchange reserves are all indicative of low probability of default in honouring its debt obligation. Despite this the country continues to be inexplicable outlier, reflecting bias and subjectivity in sovereign credit ratings. The survey asserts that as India's sovereign ratings does not factor fundamentals, past episodes of sovereign credit rating changes for India have been seen to have weak correlation with financial markets and macro economic indicators. The country's fiscal policy should thus not be guided by sole concerns of adverse action to its sovereign ratings

Healthcare spending

The importance of healthcare sector was emphasized by the pandemic and its inter-linkages with other key sector of the economy. Healthcare crisis can get transformed into economic and social crisis as evidenced from the ongoing pandemic.

Healthcare is required to take centre stage. The country's healthcare infrastructure needs to be made agile, health care access needs to be provided in remote areas and the emphasis on National Health mission (NHM) needs to be continued, public healthcare spending should be increased from 1% to 2.5-3% which would help to decrease out-of pocket expenditure from 65% to 30%. Also a sector regulator to undertake regulation and supervision needs to be considered.

Review of asset quality

The forbearance which was announced by the RBI helped borrowers tide over temporary hardships. But continuance of this even after economic recovery has led to unintended consequence in the form of banks window dressing their books and misallocating credit. This in turn damages the quality of investment in the economy as borrowers who benefitted from the forbearance invested in unviable projects. The prolonged forbearance following the Global Financial Crisis engendered the recent banking crisis and therefor an important lesson for policy makers is to not extend such emergency measures after recovery. In order to get a clearer picture of the banking system asset quality, an asset quality review needs to be conducted. The legal infrastructure for the recovery of loans needs to be strengthened.

Process Reforms

There is significant over-regulation in the Indian economy which reduces discretion in policy-making. One solution to this problem is to simplify regulations and invest in greater supervision. This also needs to be balanced by transparency. This will help in cost savings for the Government and make better policy decisions.

CARE Ratings View

- The real GDP growth of 11% in FY22 would take the GDP level to just above that in FY20 and hence though impressive, needs to be interpreted with caution.
- With the nominal GDP for FY22 being pegged at 15.4%, the size of the economy would be Rs.224 lakh crores, which is 10% higher than that in FY20. The Budget would be drawn based on this number which in turn will determine the tax flows and the room left for capex after providing for various essential expenditures.
- We expect the fiscal deficit to range between 5% to 5.5% of GDP in FY22.

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