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COVID-19 and beyond: The IMF's take on the world economy and prospects for India

As the number of COVID-19 cases continues to rise across the globe, with some countries witnessing a second/third wave, macroeconomic implications of the outbreak and attendant containment measures are turning out to be much more adverse than envisaged earlier. While an unprecedented global contraction this year is a done deal, downside risks and uncertainties are looming large. In this context, the NSE had organised an exclusive webinar **with the International Monetary Fund (IMF) on "COVID-19 and beyond: The IMF's take on the world economy and prospects for India"** on July 29th where senior dignitaries of the Fund provided their views on global growth outlook, risks, and policy recommendations, with special focus on challenges and opportunities faced by India.

Key takeaways: a) A deeper contraction in Asia (-1.6% in 2020) is expected to be followed by a protracted recovery, resulting in a permanent output loss. b) Policy support thus far has been substantial but available ammunition for future use, particularly on the fiscal front, is limited in several emerging Asian economies including India. c) **India's growth forecasts** have been meaningfully revised downwards (-4.5% in FY21) led by an extended lockdown and rising number of cases. d) Significant below-the-line policy response in India reflects limited fiscal headroom, even as space for further monetary easing remains, supported by a benign inflation trajectory ahead. e) Renewed focus on fiscal consolidation post COVID-19 and return to medium-term growth potential are crucial to prevent a rating downgrade. f) Structural reforms announced as a part of the COVID-19 package would support **India's** recovery in the medium-term, even as further efforts are needed on land and labour fronts. g) **India's credit crunch may worsen due to COVID**-19, thereby adding to corporate sector vulnerabilities. h) Key downside risks to global growth outlook include deterioration in financial market sentiments, geopolitical tensions, social unrest and re-emergence of COVID-19. i) Policy priorities globally include effective virus containment, a collaborative and transparent fiscal and monetary policy response, debt sustainability, better safety nets with more flexible product and labour markets, and financial market reforms.

- A protracted recovery in Asia ahead: The IMF expects a deeper contraction for Asia in 2020, downgrading its growth forecasts for the region from 0% projected in April World Economic Outlook (WEO) to -1.6% in the June Update[1]. Recovery is expected to be protracted resulting in a permanent and persistent output loss of ~5.1% by 2022 as compared to the pre-COVID-19 projections, largely supported by private consumption and investment, even as risks remain skewed to the downside. This is largely on the back of stringent containment measures, weak external demand, longer-than-expected lockdowns and slower recovery after exits, rising inequality and informality and high leverage. China is the only Asian economy to have an upside potential, with the IMF's 1% growth forecast for 2020 being lower than the market expectations. Nevertheless, private consumption and investment in China remain subdued and debt levels are rising.

Asia is expected to witness a protracted recovery, thanks to stringent containment measures, weak external demand, slower recovery after exits, rising inequality and high leverage.

- Policy support substantial but limited headroom for future use: Governments and policy makers across Asian economies have provided sizeable fiscal and monetary support to alleviate the economic and social shock caused by the pandemic. Central banks have cut policy rates and taken a slew of measures, including asset purchase programs, to inject liquidity into the system, targeting vulnerable sectors of the economy. The fiscal response to COVID-19 already far exceeds than that executed during the GFC, posing further risks to an already high debt to GDP ratios. Notably, the response through below-the-line fiscal measures has been quite significant this time, especially in Japan, Korea and India, reflecting limited fiscal ammunition available for future use in case of a second wave.

Policy support has been substantial thus far but available ammunition for future use is limited, particularly in emerging Asian economies.

[1] IMF, World Economic Outlook Update, June 2020: https://www.imf.org/en/Publications/WEO/Issues/2020/06/24/WEOUpdateJune2020

- **India's growth forecasts** downgraded sharply: Growth forecasts for India have seen the sharpest downward revision among other large emerging economies, thanks to an extended and stringent lockdown and continued surge in COVID-19 cases. The IMF in its June WEO estimated the Indian economy to contract by 4.5% in FY21 and grow at 6% in FY22. Several high frequency indicators such as Google mobility, auto sales, PMI, etc. witnessed a rebound in June but have plateaued since, signalling an incommensurate impact of exit policies in reviving sentiments.

The IMF expects the Indian economy to contract by 4.5% in FY21 on the back of an extended lockdown and rising infections.

- Fiscal headroom limited in India; debt sustainability crucial: Fiscal stimulus announced in India thus far has been largely below-the-line (4.9% of GDP), reflecting strained Government's finances. Total public borrowings, Centre, States, and Central Public Sector Enterprises (CPSEs) included, rose from ~8% of GDP in FY19 to ~10% in FY20. The outstanding General Government gross public debt to GDP ratio for India is one the highest among emerging economies. The IMF expects India's government debt to GDP ratio to rise from ~70% to 80% in FY21. While muted demand by the private sector and adequate liquidity injection by the RBI have eased constraints to the Government's rising borrowing requirements, a sustained increase may result in a severe crowding out effect on the private sector when the economy recovers. Renewed focus on fiscal consolidation and debt sustainability post COVID-19 and return to medium-term growth potential are crucial to prevent a rating downgrade.

Fiscal policy response in India has been largely below-the-line, reflecting limited fiscal headroom.

Govt. debt to GDP ratio pegged to increase to 80% in FY21 as per the IMF.

- Benign inflation trajectory ahead keeps the room open for futher monetary easing: Since the adoption of Flexible Inflation Targeting Framework, headline inflation has declined significantly, remaining mostly contained within the RBI's 4% +/-2% target band, barring the food-price shock in end-2019. This has helped RBI to sharply cut policy rates this year. Besides a 115/145 bps cut in repo/reverse repo rates, the RBI have taken a slew of liquidity enhancement measures such as TLTROs (Targeted Long-term Repo Operations), easing public financing and reducing debt servicing pressures. Monetary transmission, however, has been limited, reflecting risk aversion from financial stress. Amid expectations of a benign inflation trajectory ahead, there is space available for further monetary easing.

Space for further monetary easing and liquidity measures available amid expectations of a benign inflation trajectory ahead.

- Structural reforms to support recovery in the medium-term: As part of the COVID-19 response package, the Indian Government has announced a wide range of structural reforms viz. including amendments to the Essential Commodities Act and the APMC structure, increase in FDI limit in defence manufacturing, measures to enhance ease of doing business, opening up of the notified strategic sectors to private companies and privatisation of PSEs in non-strategic sectors. These reforms, particularly in the agriculture sector, are expected to support potential growth over the medium-term. The IMF, however, highlighted the need to carry out much-needed land and labour market reforms.

- **India's credit crucial accentuated by** the COVID-19 outbreak: Stress in the non-banking financial sector and consequent tightening of financial conditions, reflected in a sharp drop in flow of funds to the commercial sector in the first half of FY20, have now got accentuated by the COVID-19 outbreak. This, in turn, has further added the corporate sector vulnerabilities. The RBI's latest Financial Stability Report projects gross NPAs of all scheduled commercial banks to increase from 8.5% in March 2020 to 12.5% by March 2021 under the baseline scenario and to 14.7% in a very severe stress scenario—the highest in nearly two decades.

- Key risks to global growth outlook: Key events/risks that impart huge uncertainty to global growth outlook at this juncture include a) deterioration in financial market sentiments: Financial market performance over the last couple of months has been in contrast to the real economy. A decline in financial market sentiments can have a substantial impact on emerging markets through foreign capital outflows. b) geopolitical tensions: Sustained tensions between the US and China, which are beyond trade now, coupled with US election results, are expected to have a bearing on global growth outlook. c) behavioural changes and social unrest: Permanent behavioural changes are expected to result in a slow and protracted recovery, thereby causing further hardships to the poor sections of the society. This may result in social unrest, thereby increasing the demand for more populist policies in an already strained fiscal environment. d) re-emergence of COVID-19: A second or third wave of COVID-19 infections, along with risks of any other virus in the offing, may further derail global economic recovery.

Key downside risks to global growth outlook include deterioration in financial market sentiments, geopolitical tensions, social unrest and re-emergence of the virus.

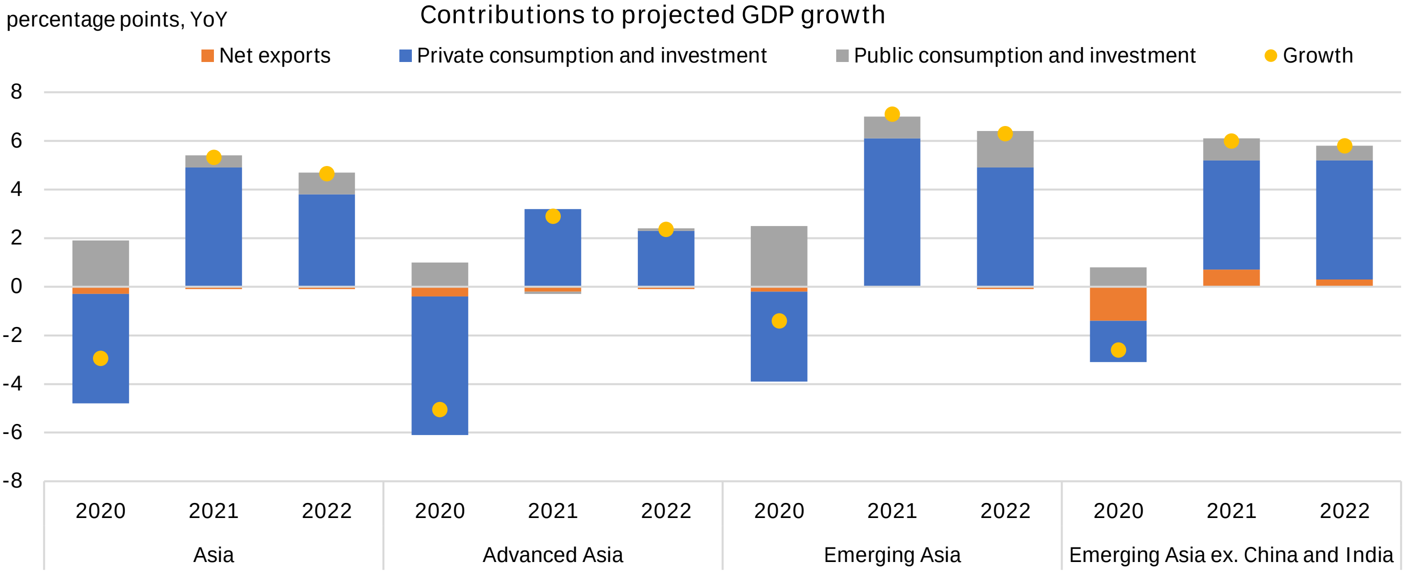
- Policy priorities: The IMF called for a better balance between stimulus and deeper reforms to deal with COVID-19 outbreak and support a sustainable recovery thereafter. Key policy recommendations included: a) effective containment of the virus and public health and micro-level measures to provide an improved new-normal environment post lockdown, b) close monetary and fiscal coordination, with central bank providing needed support to carry out fiscal policies but in a transparent manner, c) gradually unwinding targeted support as economy recovers, with credible commitment to fiscal consolidation in the medium-term, d) better social safety nets and healthcare systems with more flexible product and labour markets, and e) ensuring sound financial system to support recovery including establishment of efficient bankruptcy/insolvency regimes.

Figure 1: IMF growth projections for select Asian economies

Countries	2019	Apr-20 (% YoY)		Jun-20 (% YoY)		Change (pp)	
	(% YoY)	2020E	2021E	2021E	2021E	2020E	2021E
World	2.9	-3.0	5.8	-4.9	5.4	-1.9	-0.4
Asia	4.6	0.0	7.6	-1.6	6.6	-1.6	-1.0
China	6.1	1.2	9.2	1.0	8.2	-0.2	-1.0
Japan	0.7	-5.2	3.0	-5.8	2.4	-0.6	-0.6
India*	4.2	1.9	7.4	-4.5	6.0	-6.4	-1.4
Korea	2.0	-1.2	3.4	-2.1	3.0	-0.9	-0.4
Australia	1.8	-6.7	6.1	-4.5	4.0	2.2	-2.1
ASEAN	5.7	-0.7	7.4	-2.0	6.1	-1.3	-1.3

Source: IMF World Economic Outlook Update, June 2020. *Figures for India are on a fiscal year basis

Figure 2: Contributions to projected GDP growth for select Asian countries



Source: IMF.
Note: Asia includes Australia, China, Hong Kong SAR, India, Indonesia, Japan, Korea, Malaysia, New Zealand, Philippines, Singapore, Taiwan Province of China, Thailand, and Vietnam. Advanced Asia includes Australia, Hong Kong SAR, Japan, Korea, New Zealand, Singapore, and Taiwan Province of China, while Emerging Asia includes the rest of the economies in this group.

Figure 3: Contingency Stringency Index across countries

Economies across the world saw a significant tightening of containment measures since Mar-beginning

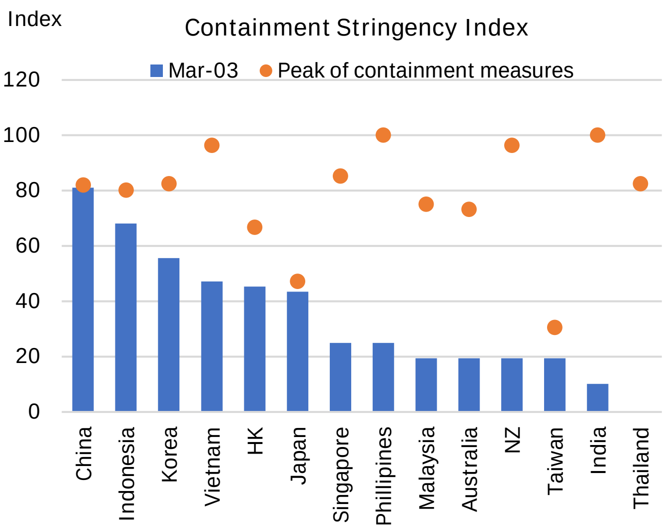
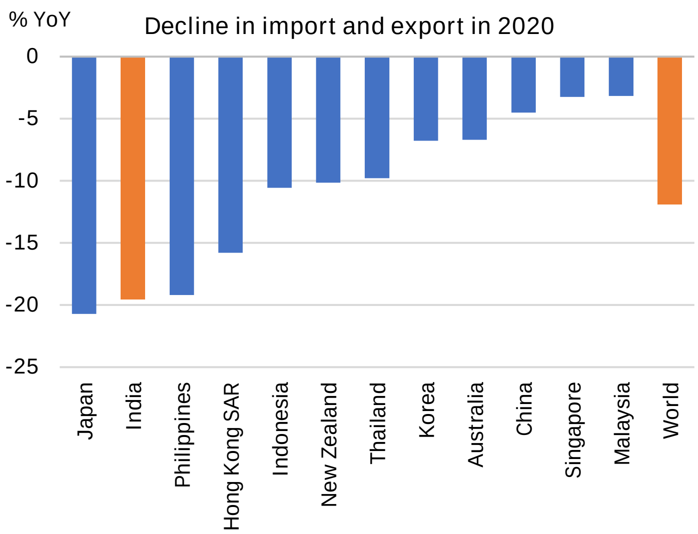


Figure 4: Anticipated decline in trade (exports and imports) across Asian economies in 2020

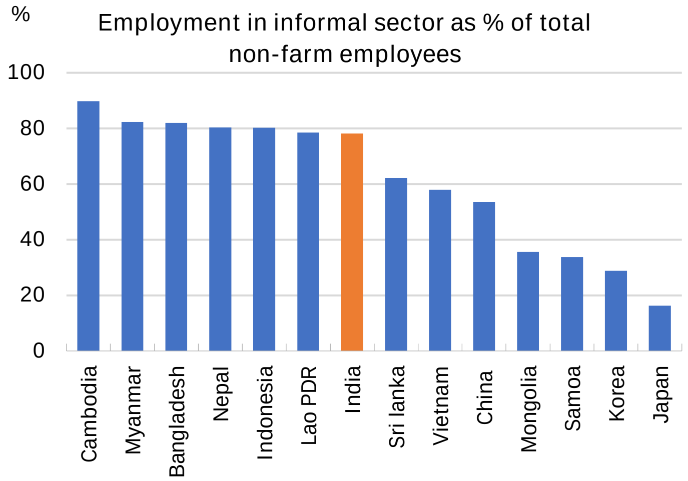
Slowdown in global growth is likely to significantly weigh on export demand from Asian economies.



Source: IMF WEO.

Figure 5: Informal employment in select Asian countries

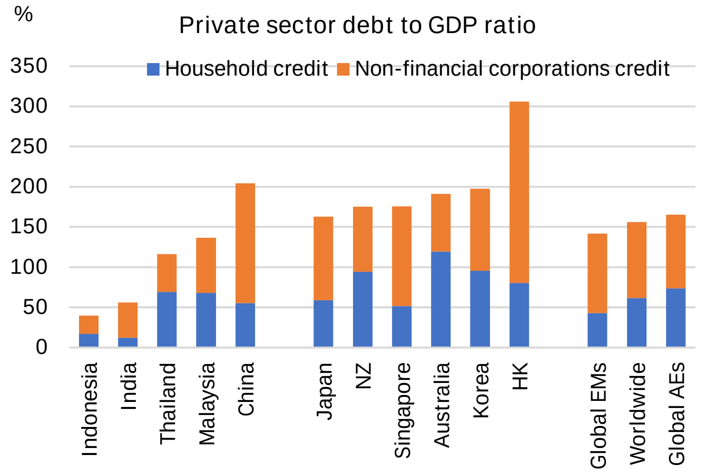
Most of the emerging Asian economies have a high share employment in the informal sectors. A protracted recovery may cause further hardships to this segment, thereby increasing inequality and leading to social unrest.



Source: Women and men in the informal economy: a statistical picture, ILO, 2018

Figure 6: Debt-to-GDP ratio for private sector (households and non-financial corporations)

Private leverage is already quite high in most Asian economies. Barring Indonesia and India, all other major Asian economies have private debt to GDP ratio exceeding 100%. This may further weigh on domestic demand.

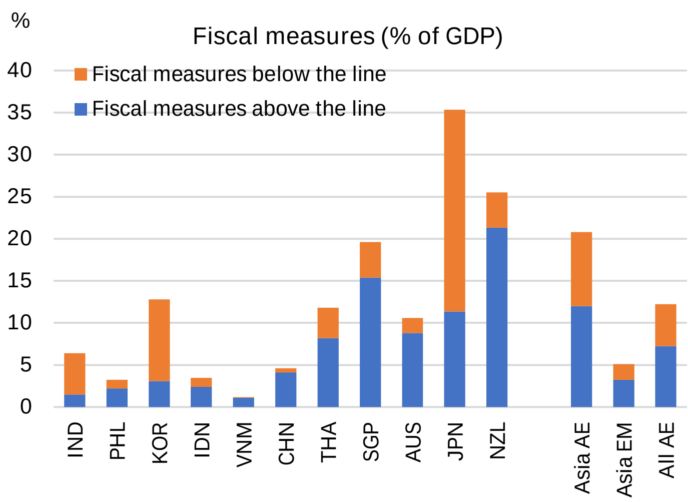


Source: BIS, IMF.

Note: Data as of 2019Q4. Total credit to the private non-financial sector is estimated based on the sum of the stock of loans from all series, domestic and foreign, to non-financial corporations, households and non-profit institutions serving households, plus the debt securities issued by non-financial corporations.

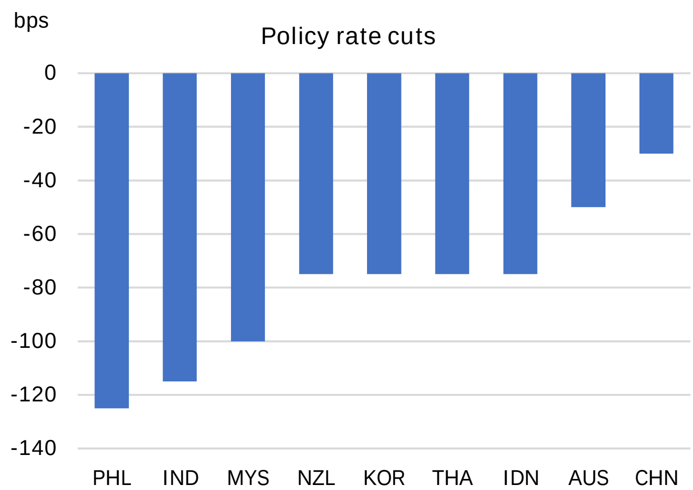
Governments and policy makers across Asian economies have provided sizeable fiscal and monetary support to alleviate the economic and social shock caused by the pandemic. Central banks have cut policy rates and taken a slew of unconventional monetary policy measures to inject liquidity into the system. The fiscal response to COVID-19 already far exceeds than that executed during the GFC, posing further risks to an already high debt to GDP ratios. Notably, the response through below-the-line fiscal measures has been quite significant this time, especially in Japan, Korea and India, reflecting limited fiscal ammunition available for future use in case of a second wave.

Figure 7: Fiscal measures (% of GDP)



Source: IMF Policy Tracker, WEO.

Figure 8: Policy rate cuts across Asian economies



Growth forecasts for India have seen the sharpest downward revision among other large emerging economies, thanks to an extended and stringent lockdown and continued surge in COVID-19 cases. The IMF in its June WEO estimated the Indian economy to contract by 4.5% in FY21 and grow at 6% in FY22.

Figure 9: COVID-19 infections in in India continues to rise...

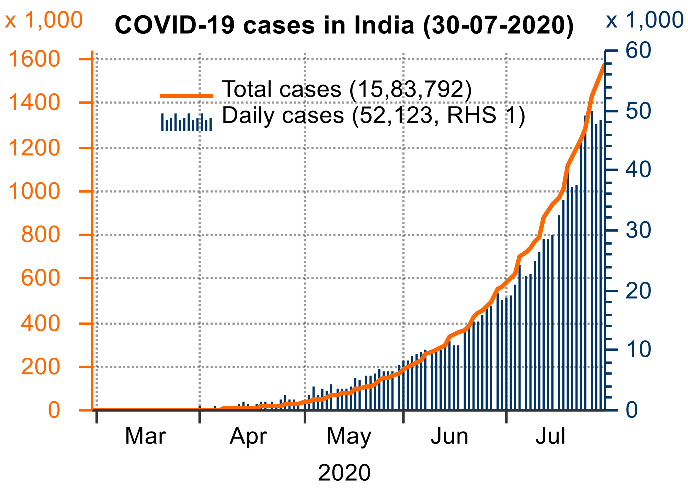
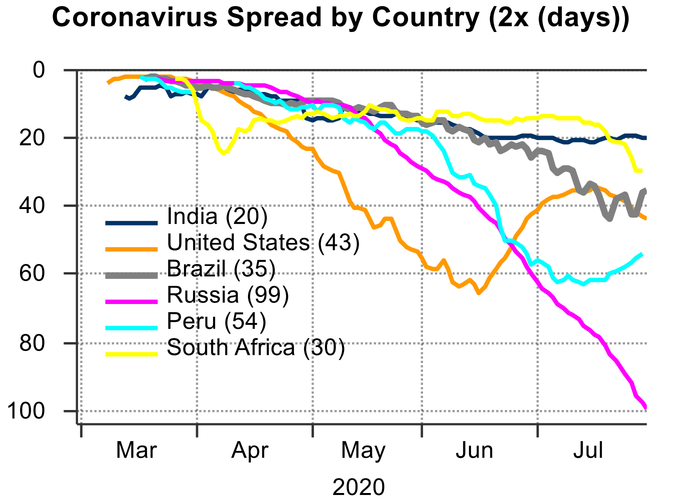
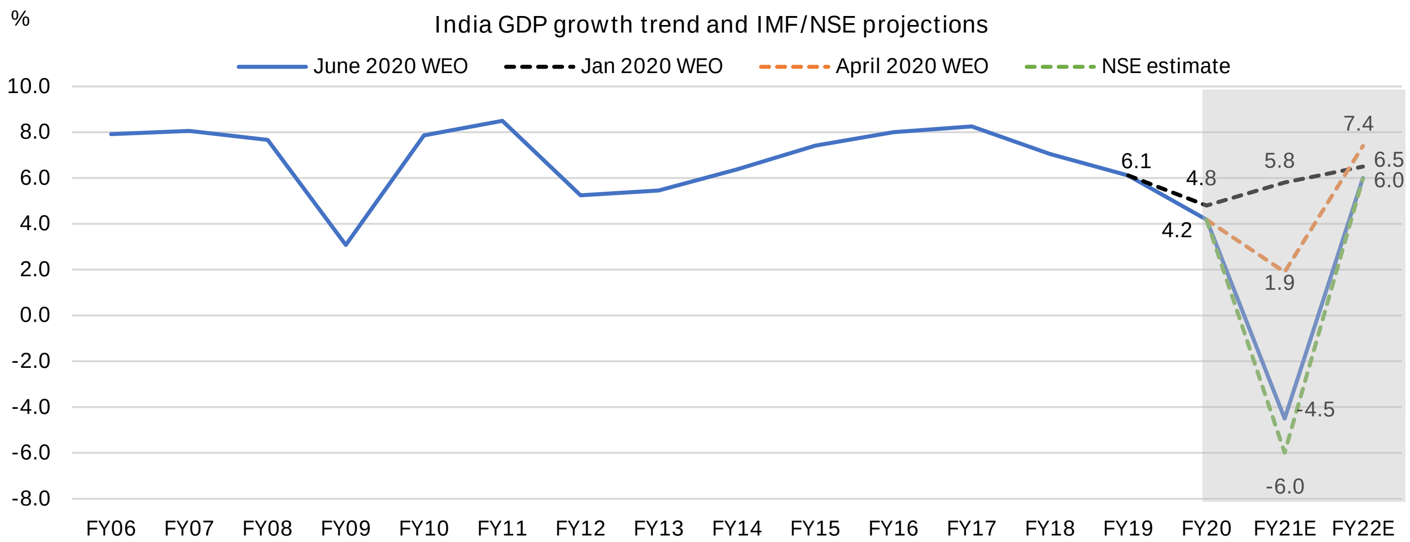


Figure 10: ...with doubling rate much lower than other top affected countries



Source: Refinitiv Datastream, NSE.

Figure 11: India real GDP growth trend and IMF/NSE projections



Source: CMIE Economic Outlook, IME World Economic Outlook, NSE.
Note: In Jan and April WEO, data for FY20 was projected but as of June WEO, data is provisional estimate

Figure 12: A declining auto sales trend in pre-COVID-19 era points to an already weak consumption demand

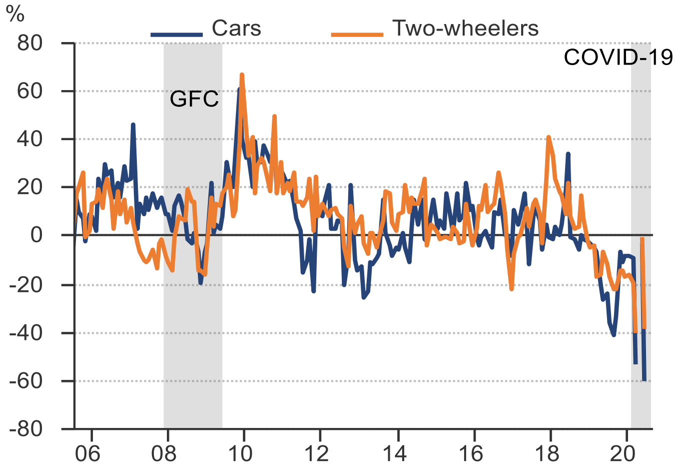
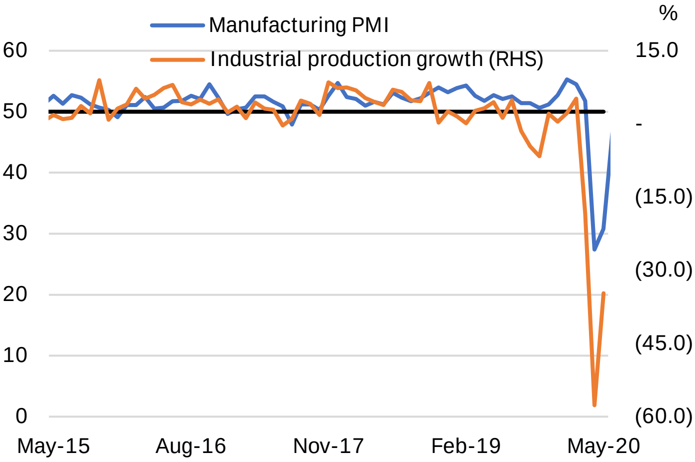


Figure 13: Weakness in industrial activity has been accentuated by the COVID-19 outbreak



Source: Refinitiv Datastream, CMIE Economic Outlook, NSE.

Figure 14: India inflation trajectory and policy rates

Since the adoption of Flexible Inflation Targeting Framework, headline inflation has declined significantly, remaining mostly contained within the RBI's 4% +/-2% target band, barring the food-price shock in end-2019. This has helped RBI to sharply cut policy rates this year. Besides a 115/145 bps cut in repo/reverse repo rates, the RBI have taken a slew of liquidity enhancement measures such as TLTROs (Targeted Long-term Repo Operations), easing public financing and reducing debt servicing pressures.

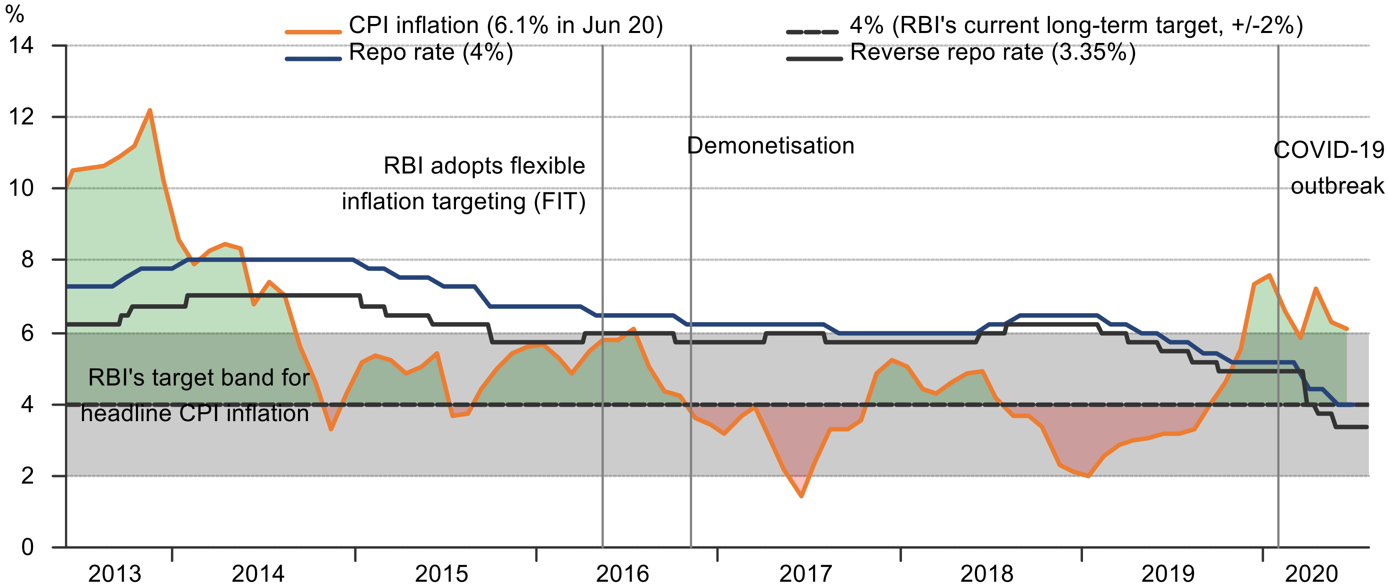


Figure 15: General government fiscal deficit as % of GDP for India

India's combined fiscal deficit has been steadily rising over the last few years and is expected at ~12% in FY21.

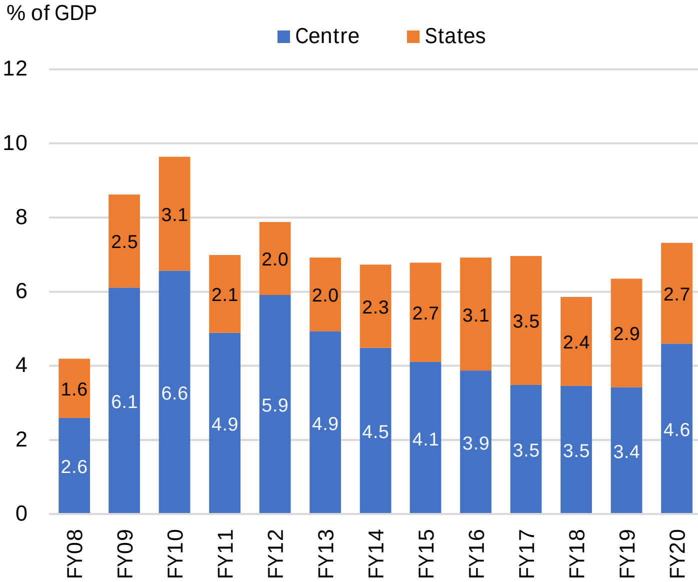
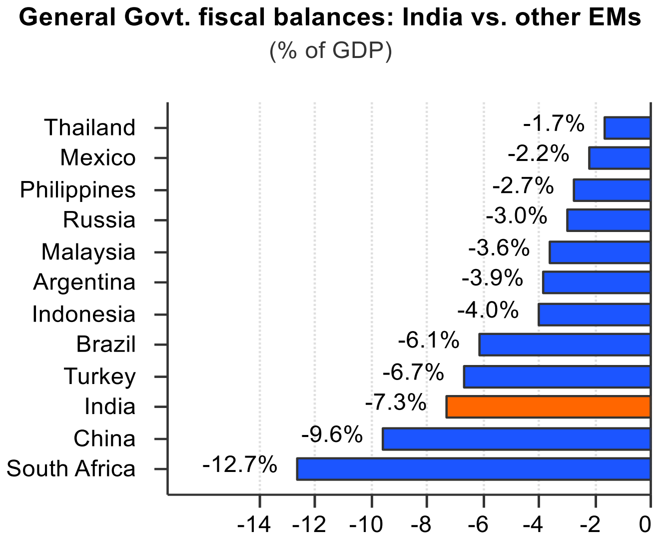


Figure 16: General government fiscal deficit as % of GDP for key emerging economies

As compared to other emerging markets, India's general government fiscal deficit stands at the higher end.



Source: Refinitiv Datastream, CMIE Economic Outlook, Budget Documents, NSE.

Note: Data for FY19 relate to Revised Estimates for states, and for FY20 relate to provisional estmates for the Centre and Budget Estimates for states.

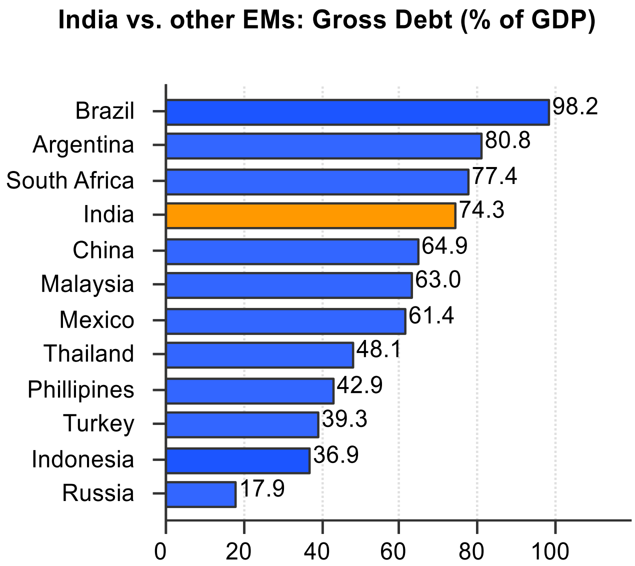
Figure 17: India's fiscal policy response to COVID-19

India's fiscal policy response to COVID-19 has been largely through below-the-line measures (credit guarantees), reflecting strained government finances

Fiscal measures	Share of GDP * (%)
Above-the-line measures	
Healthcare	0.1
Direct support and employment to vulnerable households	1.3
Extension of rural employment guarantee	0.2
Tax measures (reduction in up-front collections)	0.2
Total	1.9
Below-the-line measures	
Business and NBFC support	2.2
Credit provision for farmers/agri	1.5
Equity injection for electricity distribution companies	0.4
Other support for agri	0.7
Total	4.9

Figure 18: Sovereign debt to GDP ratio

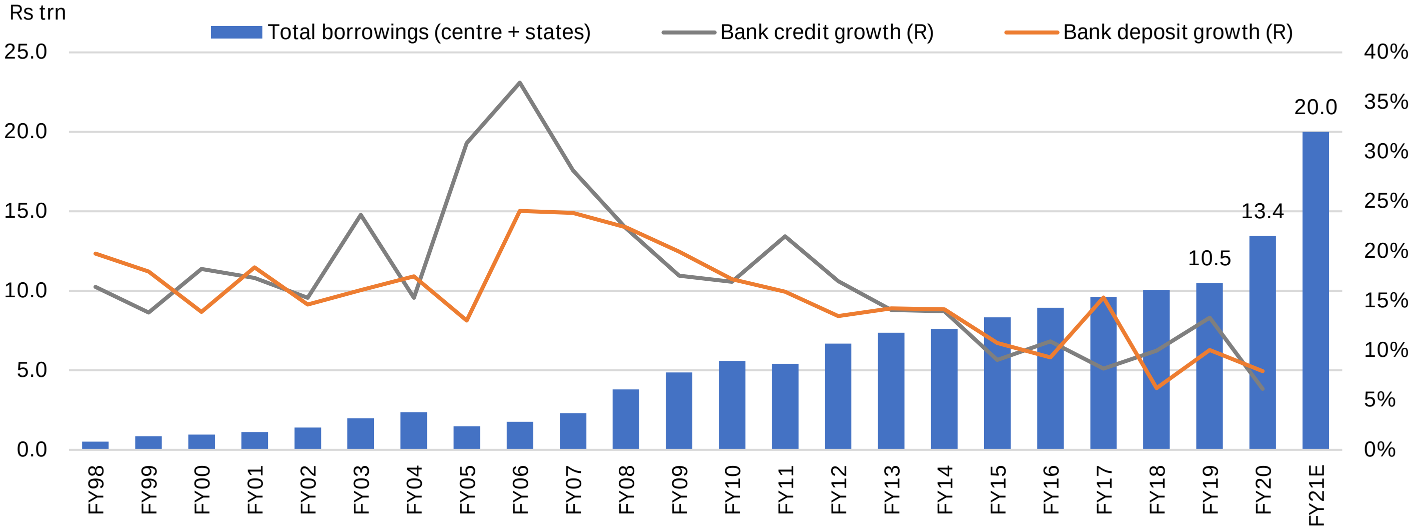
High sovereign debt has acted as a constraint to a meaningful fiscal stimulus in India. The IMF expects India's sovereign debt to GDP ratio to rise to 80% in FY21.



Source: Refinitiv Datastream, IMF, NSE. *Shares of GDP calculated using latest IMF projections

Figure 19: India's annual soveriegn borrowing trend vs. outstanding bank credit and deposit growth

While muted demand by the private sector and adequate liquidity injection by the RBI have eased constraints to the Government's (Centre as well as states) rising borrowing requirements, a sustained increase may result in a severe crowding out effect on the private sector when the economy recovers. Renewed focus on fiscal consolidation and debt sustainability post COVID-19 and return to medium-term growth potential are crucial to prevent a rating downgrade.



Source: CMIE Economic Outlook, NSE.

Stress in the non-banking financial sector and consequent tightening of financial conditions, reflected in a sharp drop in flow of funds to the commercial sector in the first half of FY20, have now got accentuated by the COVID-19 outbreak. This, in turn, has further added the corporate sector vulnerabilities. The RBI's latest Financial Stability Report projects gross NPAs of all scheduled commercial banks to increase from 8.5% in March 2020 to 12.5% by March 2021 under the baseline scenario and to 14.7% in a very severe stress scenario—the highest in nearly two decades.

Figure 20: YoY credit growth trend—distribution by bank groups

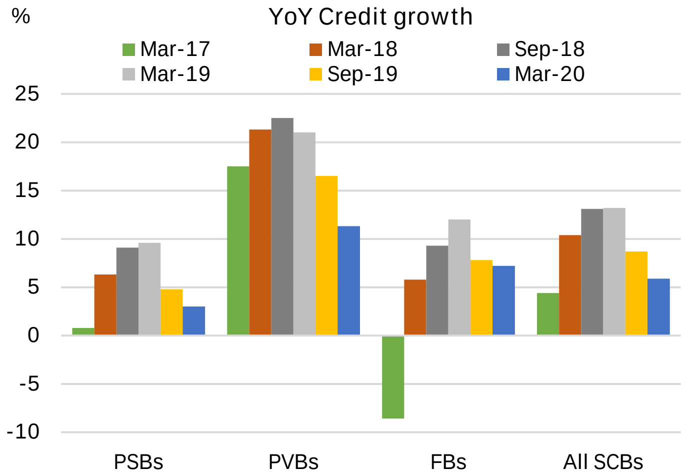
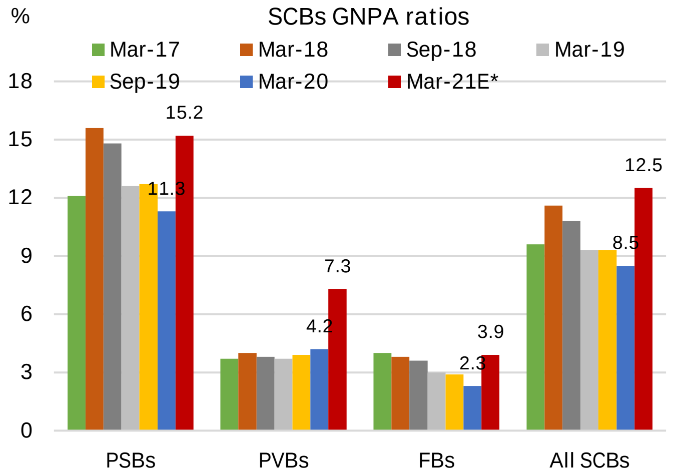


Figure 21: Asset quality of SCBs improved in H2 FY20 but expected to deteriorate in FY21



Source: RBI Financial Stability Report, NSE. PSBs = Public Sector Banks, PVBs = Private Sector Banks, FBs = Foreign Banks.
* RBI's macro stress tests predictions under the baseline scenario.

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