Challenges lie ahead for Indian authorities aiming to restore stability as virus rates rise

► Analysts believe more fiscal stimulus may be needed even though the country's deficit is a cause for concern

A commuter drives on a deserted road during a state-imposed lockdown in Kolkata AFP

ECONOMY

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Authorities in India are walking a tightrope as they grapple with the economic fallout of the coronavirus pandemic alongside the need to conserve limited government finances, with Covid-19 infections continuing to surge at an alarming pace, analysts say.

India's economy has been battered by the pandemic and a strict nationwide lockdown that was enforced in March in reaction to the virus. This resulted in many businesses scaling back operations and millions were left without work during what was one of the strictest lockdowns in the world.

The latest official data revealed that this resulted in India suffering its worst quarterly contraction on record in April to June, plunging 23.9 per cent compared with the same quarter a year earlier.

Conditions prompted Moody's Investors Service in June to downgrade India to Baa3 – one notch above junk status – from Baa2 for the first time in 22 years, while keeping its outlook on the country negative.

"With uncertainty around Covid-19 and while the demand recovery and economy pickup is gradual, the government and the central bank have no option but to wait and see how the situation pans out before making any further announcements as they're left with limited resources," says Gurpreet Sidana, the chief operating officer at Religare Broking in New Delhi.

There have been calls for more measures to be taken by Prime Minister Narendra Modi's government, including further fiscal stimulus, to boost the economy. But this is not something that can be easily executed, as India exceeded its fiscal deficit target for the year in the four months to July, with a shortfall of more than $111 billion (Dh407.6bn).

"Given the restricted fiscal space with the central and state governments, it is difficult to see how it can be done without running up a higher deficit – which can pressure India's external ratings," says VP Nandakumar, the chief executive of Manappuram Finance, a non-banking financial company in Kerala. "That is a tightrope for the government to walk."

On Friday, Moody's revised India's GDP forecast for the current financial year, which runs until the end of March 2021. The agency now projects Asia's third-largest economy will shrink 11.5 per cent, compared with an earlier 4 per cent forecast.

The ratings agency said the country's "credit profile is increasingly constrained by low growth, a high debt burden, and a weak financial system" ... [and that] policymaking institutions have struggled to mitigate and contain these risks, which have been exacerbated by the coronavirus pandemic".

Several other institutions, including Fitch Ratings, slashed their GDP growth forecasts for the year, following the recent quarterly data release.

Analysts expect economic activity to improve in the coming months, compared with the huge blow suffered during the April to June quarter when lockdown restrictions were at their peak – but to remain subdued. The consensus is that growth is not expected to return until next year, however, and that would be compared with the lower base levels of this year.

"GDP should rebound strongly in [the October to December quarter] amid a reopening of the economy, but there are signs that the recovery has been sluggish and uneven," Fitch Ratings said.

The pick-up is being enabled by a reopening of the economy following the lockdown.

The government has allowed several relaxations to restrictions over the past few months, including permitting shopping malls and restaurants to reopen. Last week metro services resumed in some cities.

Relaxations are taking place despite India's health ministry on Saturday reporting a record daily rise in Covid-19 infections, up by 97,570 in a day. Sunday's level was slightly lower at 94,372 cases, taking the country's tally past 4.7 million. India is the world's second-worst hit country behind the US.

However, the government is pushing ahead with its "unlocking" of the economy, making it more difficult for states to enforce their own local lockdowns, as it tries to revive growth and restore people's livelihoods.

This approach is helping to stimulate economic activity, but the revival is still far off the levels India needs to achieve to boost employment and support its population of 1.3 billion, analysts say.

Measures taken by authorities so far include two emergency interest rate cuts made by the Reserve Bank of India earlier this year and a moratorium on loans. In May, the government introduced $266 billion in stimulus, but many said the large headline figure disguised the fact that the measures largely comprised credit schemes and other policies that were already in the works, rather than putting cash directly in the hands of people and businesses.

"Given the lower tax collections, the government has extremely limited ammunition to boost demand and revive the economy, and therefore, the majority part of the stimulus package was largely focused on making India 'self-reliant', thereby containing fiscal slippage," says Mr Sidana.

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There have, however, been some positive indicators which suggest some green shoots, experts say, with signs of improvement in consumer demand – a major driver of the economy.

On Friday, data from the Society of Indian Automobile Manufacturers revealed that passenger vehicle sales had returned to positive territory after nine months of decline. Wholesale numbers for passenger vehicles increased by 14 per cent in August compared with the same month last year, the figures revealed.

"We are also seeing growth in some part of the consumer durables segment, but is it sustainable and will it grow further during the ensuing festival season?" asks YS Chakravarti, the managing director and chief executive of Shriram City Union Finance. "It will be a wait and watch. The consumer demand as of now in my view is not consistent."

One encouraging factor is that India's agricultural sector has performed well, while this year's monsoon season has been good, which should help crop production, Mr Chakravarti says. This, in turn, is positive for rural incomes and should generate consumer demand.

"The government needs to ensure that arbitrary lockdowns do not happen any more. This would ensure seamless supply of items across the country," says Mr Chakravarti. "Opening all markets will itself alter sentiments and ensure a lower degrowth."

But there are also signs that things are not so rosy in urban areas.

A total of 21 million salaried jobs were lost in India between April and August, according to figures from the Centre for Monitoring Indian Economy think tank.

"Other types of employment have recovered most of their initial losses and some have even gained in employment," says Mahesh Vyas, the chief executive of CMIE. "But salaried employees continue to suffer increasing job losses."

All of this is eroding people's confidence, and boosting sentiment is one of the biggest challenges in the current environment. "The fear factor also plays out negatively by contributing to a mood of pessimism and uncertainty all around," says Mr Nandakumar. "Even those whose earnings are unaffected for now fear that further deterioration may be on the cards and they end up curtailing discretionary consumption, to save for a rainy day ahead. And if we don't contain this fear and pessimism, it can become a self-fulfilling prophecy."

Given the extent of the pandemic's impact, some economists say that authorities will have no option but to take further steps to boost the economy. "We expect the government to soon announce a second fiscal support measure focused on an urban employment guarantee and public investment, although it is likely to be small, as fiscal pressures remain from falling revenues," says Sonal Varma, the chief India economist for Japanese investment bank Nomura.

She says there could also be scope for further interest rate cuts by the RBI from December onwards to help stimulate the economy. For now, the central bank has limited scope to bring down interest rates because of high inflation, Ms Varma says.

Mr Sidana at Religare also believes that despite the limitations, New Delhi will have to step in to stimulate the economy. "We believe that the government would take more steps, but the quantum and allocation would depend upon several factors," he says.

"If the consumer demand recovery starts to show signs of slowing, we believe the government would focus on that by increasing spending on key sectors like infrastructure, power and agriculture. Further, to boost investment, the government needs to focus on reviving demand so that companies invest in new capacities."