IJCRT.ORG ISSN : 2320-2882

INTERNATIONAL JOURNAL OF CREATIVE RESEARCH THOUGHTS (IJCRT)

An International Open Access, Peer-reviewed, Refereed Journal

CURRENT CHALLENGES AND THE FUTURE THREATS FACING THE INDIAN ECONOMY AFTER POST COVID-19 PANDEMIC

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ABSTRACT

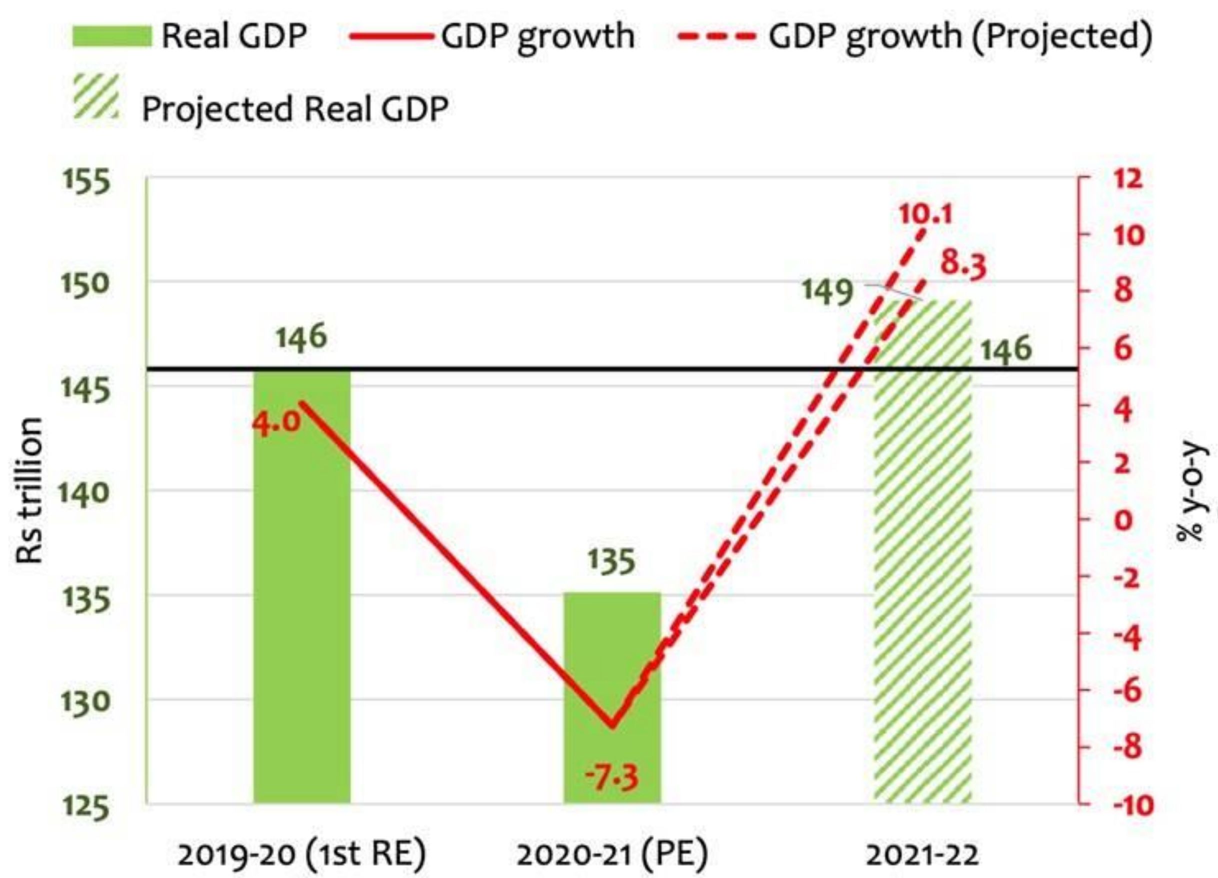
There are several ways in which India's economic recovery could become even more difficult.The end of any quarter typically throws up a lot of economic analysis. Last week, the Reserve Bank of India released its June bulletin, which provided the RBI's assessment of how the Indian economy is placed.Even though hardly any entity knows as much about the Indian economy as the RBI, the more instructive analysis was carried out by the National Council of Applied Economic Research (or NCAER) as it released its Quarterly Economic Review.The NCAER distinguished itself in finding innovative ways to map the state of the Indian economy during the pandemic. At a time when official sources of data suffered large gaps and inadequacies, researchers at NCAER found their own ways to assess the extent of economic disruption due to Covid. As early as December 2020, they had correctly forecast (to the first digit after the decimal) that the full-year GDP growth will be minus 7.3% — a number that the Ministry of Statistics and Programme Implementation (MoSPI) arrived at only by May 31 this year! As such, it makes sense to listen to NCAER's forecast in the wake of the second Covid wave

KEYWORDS: E-Economic,Q-Quarterly,I-Inadequacies,R-Researcher,I-Implementation

Let's first look at the current challenges.

1: Two years worth of GDP growth has been lost

The chart below provides an understanding of how the Indian economy has been hit. First of all, look at the green bars. They show the total amount of India's GDP as measured in trillions of rupees — the left-hand side scale.In 2019-20, India's GDP was Rs 146 trillion. In other words, India had produced goods and services worth Rs 146 trillion that year. Then, in the last financial year — that is, in 2020-21 — it fell to Rs 135 trillion. That's the fall of minus 7.3% we were talking about earlier.



Notes: RE stands for revised estimates, PE stands for Provisional Estimates.
Source: Ministry of Statistics and Programme Implementation.

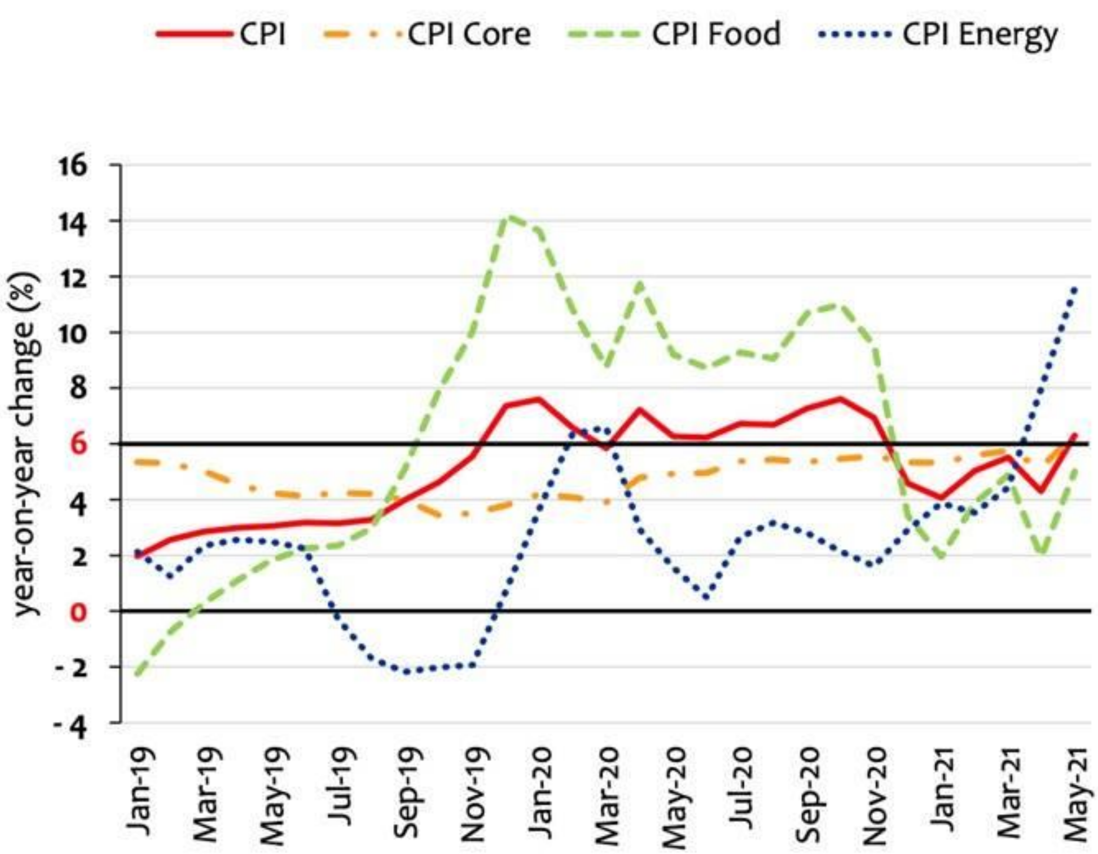
How the Indian economy has been hit

In the current financial year — that is, in 2021-22 — the GDP is expected to grow back to Rs 146 trillion after registering a growth of 8.3%. This would mean that, in terms of overall economic production, India would have lost two full years of growth. For instance, if there was no Covid disruption and India grew by even 6%

in both these years, the total GDP would have reached the level of Rs 164 trillion — that is, Rs 18 trillion more than where India is likely to end up now.There is a chance that India may grow by 10.1% this year, instead of 8.3%, and in that case, India's GDP would go up to Rs 149 trillion but even so, India would be far off from where it could have been without Covid.The red line, which maps the growth rate of GDP in percentage terms (and corresponds to the scale on the right-hand side of the Chart) gives an impression of a "V-shaped" recovery. But, in terms of actual production, the economy will only manage to recover the ground it lost last year.

2: Both retail and wholesale inflation is trending up

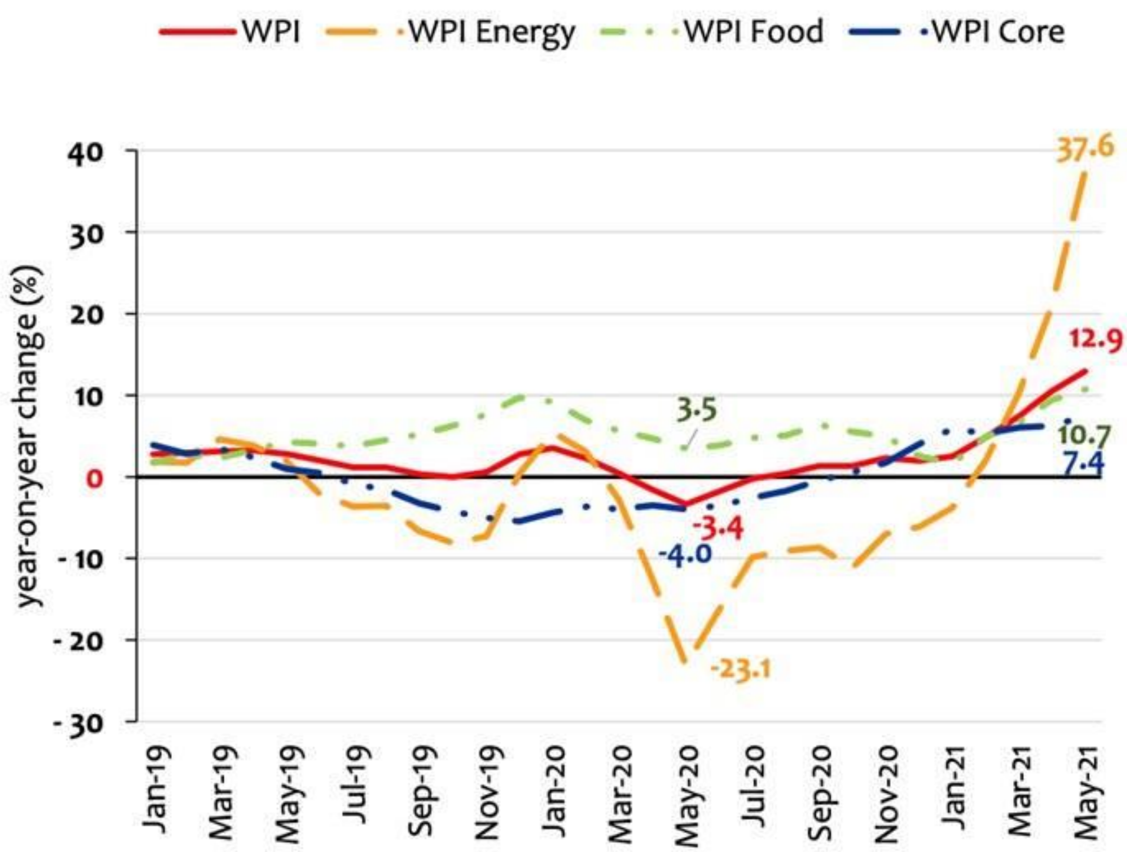
At a time when economic growth has taken a hit and recovery is muted due to the second Covid wave, India is also facing ever-increasing prices. CHARTS 2 and 3 provide a break up of how retail and wholesale inflation has behaved over the past couple of years.Headline retail inflation, the read line in CHART 2, is the rate at which prices increase for retail consumers like you. This inflation rate stayed above the RBI's comfort zone (2% to 6%) between November 2019 and November 2020. But, after a brief period of martial relief, it has again crossed the 6%-mark in May this year.



Sources: Ministry of Statistics & Programme Implementation and Office of Economic Advisor.

Rate at which prices increase for retail consumers

The other crucial line to look at is the orange dotted line. It shows the core inflation — it is calculated by taking away the price rise in fuel and food items. The fact that even this inflation rate has remained consistently close to RBI's upper limit, shows that it is not just a matter of petrol and diesel prices being very high or vegetables and fruit prices rising too fast. The common Indian is witnessing a fast rise in prices across the board.What about wholesale prices? CHART 3 provides the answer. For a long time, the wholesale prices were not increasing too fast. But starting from January onwards, that trend, too, has worsened. In May, WPI inflation was nearly 13%. In other words, wholesale prices were rising at the rate of 13%.

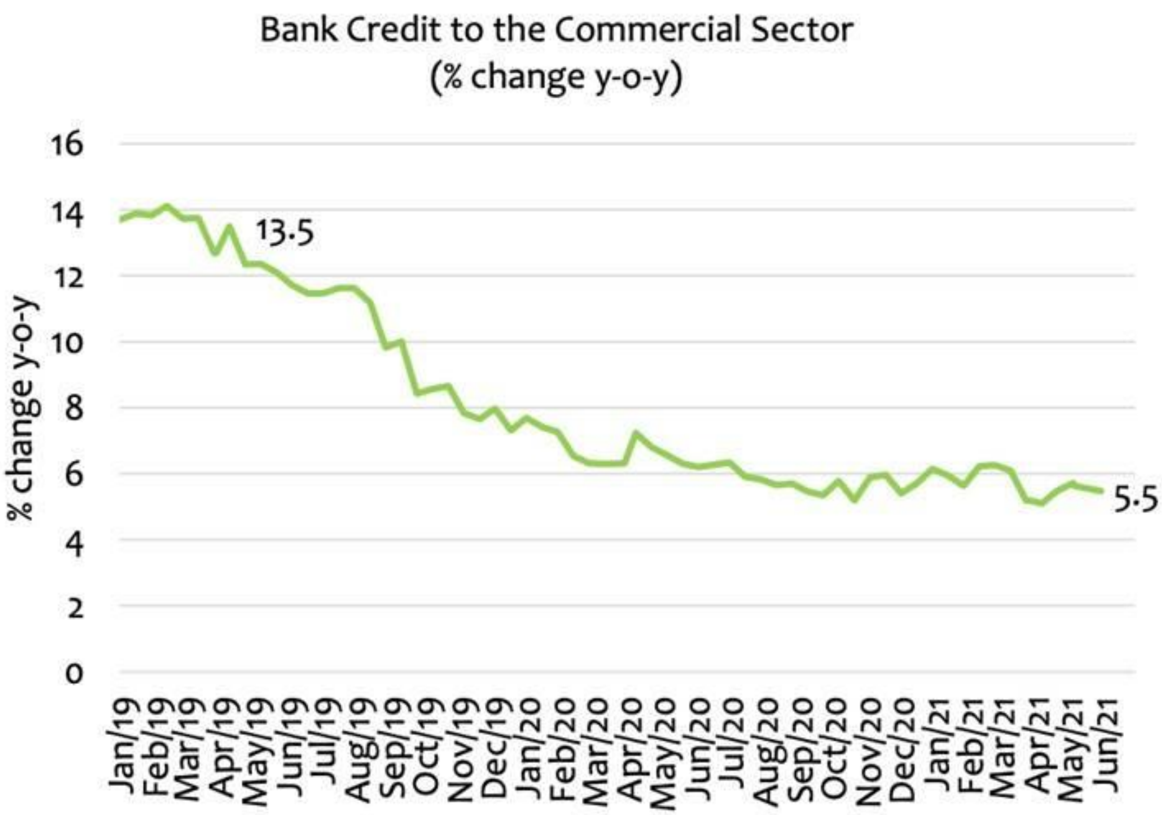


Sources: Ministry of Statistics & Programme Implementation and Office of Economic Advisor. For a long time, the wholesale prices were not increasing too fast

3: Poor credit offtake in the commercial sector

The biggest engine of GDP in the Indian economy is the expenditure that Indians undertake in their private capacity. This demand for goods and services — be it in the form of a new car or a haircut or a new laptop or a family vacation — is what accounts for more than 55% of all GDP in a year.Even before Covid, the Indian economy had reached a stage where the common man was holding back this expenditure. The first Covid wave made that trend worse with people either losing jobs or salaries being reduced. The second Covid wave has compounded the problem further because now everyone is bothered about the high health expenses.In the absence of consumer spending, the country's businessmen — both big and small — are holding back new investments and refusing to seek new loans.

CHARTS 4 shows how bank credit to the commercial sector has plummeted in just the last two years. CHART 5 shows how the percentage of sampled firms seeking loans has just collapsed.



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These essentially imply that businesses are not very hopeful of increased demand in the near term.

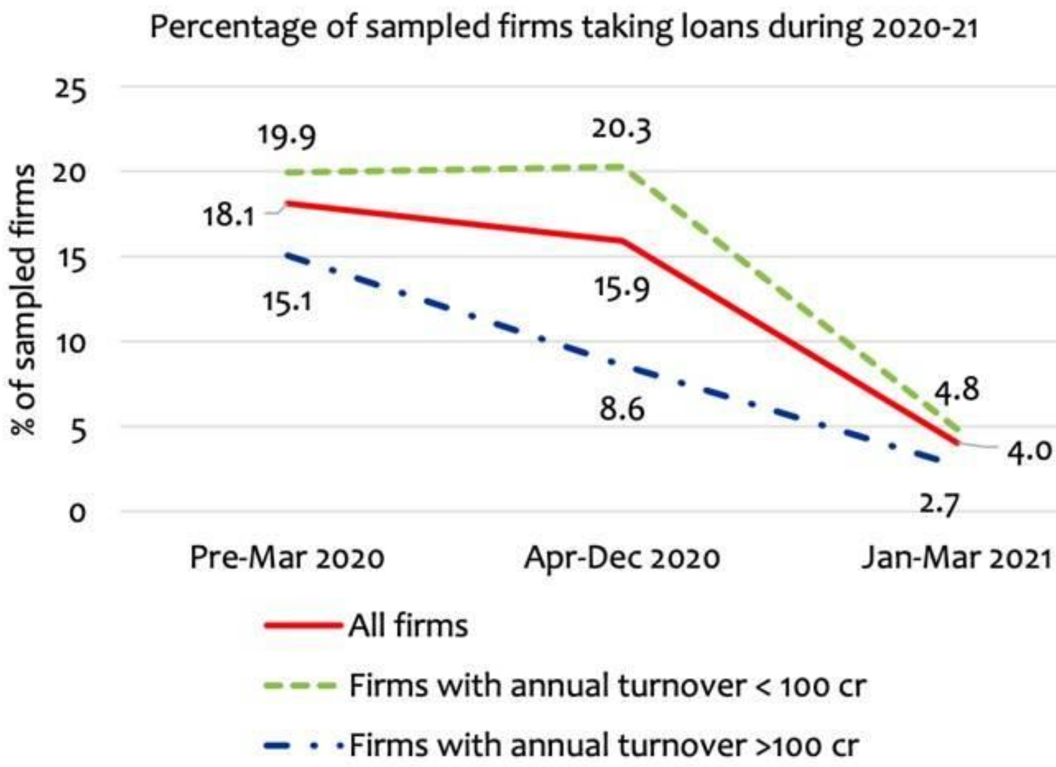
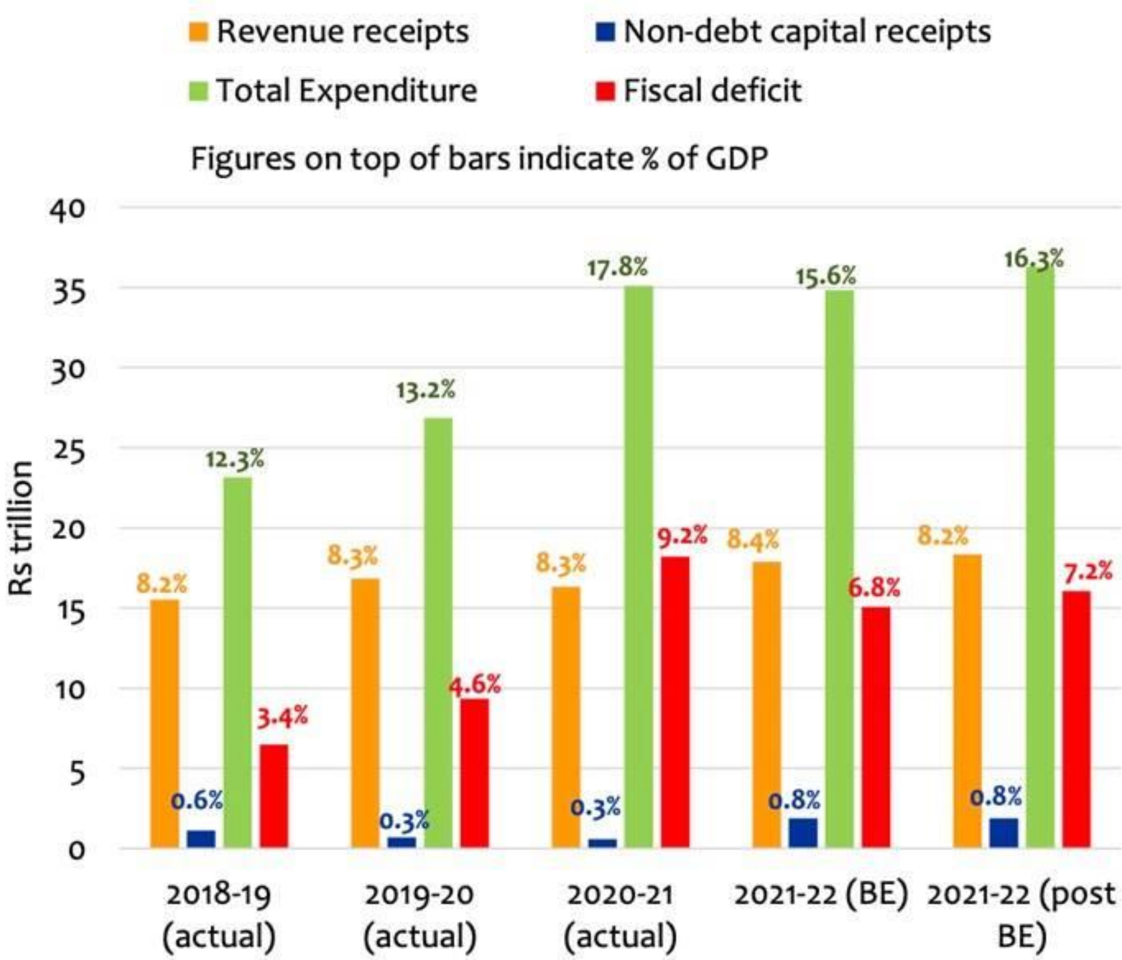


CHART 5 shows how the percentage of sampled firms seeking loans has just collapsed.

4: Inadequate spending by the government

Given that domestic consumers are holding back consumption and domestic businesses are holding back investments (the second-biggest engine of GDP growth), it was incumbent on the third-biggest engine of India's GDP growth — that is, the government — to spend more and pull the economy out of the current rut.But as the green bars in CHART 6 show, the Indian government has been stingy about spending more. The green bars show the total expenditure (in terms of a per cent of GDP). After being forced to spend more in 2020-21, the government has actually pulled back (as a proportion of GDP) in 2021-22. It is for this reason that its deficit will fall in FY22 as against FY21.



The green bars in CHART 6 show how the Indian government has been stingy about spending more

But this move is proving to be counterproductive for India's economic revival. The NCAER review makes the following remark: "Unfortunately, an inexplicably contractionary fiscal policy in 2021–22, sharply reducing the deficit, will delay recovery."

What about the future threats?

There are several ways in which India's economic recovery could become even more difficult.

1: The slow pace of vaccination and a possible third Covid wave

By now it is clear that there is no economic recovery unless India gets a significant majority of its population vaccinated. If the pace of vaccination continues to lag, there is the possibility of a third wave, which may bring with it another round of disruption.

It is also very important to understand that even the possibility of a third wave is quite dangerous for economic recovery. That's because the increased uncertainty further worsens the trends of consumers holding back consumption and businesses holding back new investments. This is more so because the people's resilience and ability to deal with the adverse effects of Covid has also been coming down.

2: Monetary policy hitting a barrier

Between fiscal policy (which has to do with government's spending) and monetary policy (the ease with which one can take a loan and the interest rate one has to pay on new loans), most of the heavy lifting towards achieving economic revival has been done by the RBI. As mentioned earlier, the government has not been expanding its fiscal policy by as much as many expected it to. Indeed, it was largely left for the RBI to pump in loads of cheap money in the form of new loans in a bid to jump-start the economy.

But there are several reasons why RBI may not be able to help out for much longer.

Coronavirus Explained

How ZyCov-D vaccine works, how it is different

How the antibody test works, and how accurate it is

Role of ventilation in preventing Covid transmission

For one, as shown earlier, inflation rates are spiking. The RBI, which is legally required to control inflation, will have to do whatever it takes to keep inflation within bounds. Typically, this would require the RBI to raise interest rates.There is another reason why RBI might have to raise the domestic interest rate. Thanks to the sharp spurt in economic growth and inflation in the US, its central bank — the Federal Reserve — could soon raise US interest rates. If India has to remain an attractive destination for global investors, RBI would have to give up on the regime of low-interest rates.

3: The long-term adverse effects of short-term shocks

Beyond the above-mentioned threats, and, in fact, regardless of them, NCAER economists such as Sudipto Mundle and Bornali Bhandari point to another key challenge: Hysteresis. In other words, the long term effects of the short term shocks.

"Starting from a 2020–21 baseline which is 7.3 per cent lower than in 2019– 20, GDP has to grow well above the recent pre-pandemic trend rate (5.8 per cent) for India to catch up with its pre-pandemic growth path. This will require deep and wide-ranging structural reforms in the financial sector, power & foreign trade. Reforms in cooperation with the states are also urgent in health, education, labour and land, which are all primarily state subjects," they wrote as early as December.While clarifying on this point during the latest quarterly review, Mundle stated: "In fact, the main burden of our song is that the impacts of this [Covid shock] are more long term than one might imagine and by then India would have gone beyond its sweet spot of so-called demographic dividend… so the long term impacts are very very

How can the Indian economy recover and stabilise from the challenges of the second wave of COVID-19?

The International Monetary Fund's growth forecast for India in 2021 is 12.5 percent compared to a negative 8.8 percent in 2020 and will settle at 6.9 percent in 2022. India's growth prospects in the midst of a Covid-19 pandemic compared to China seems better. Since there are more mutations on a daily basis now and a huge surge in the number of positive cases, we need to have a strong assessment of the trade-off between lockdown, economic activity, and livelihood. Economic activities need to be quickly adapted to the pandemic.Strong containment measures like testing, vaccination, etc, need to be fast-tracked and quicker progress in vaccination may raise the growth forecast. Vaccine production needs to be ramped up considerably to provide mass access and stop export controls.The most worrying factor at present is rising poverty globally as well as in India for the first time in the last 20 years due to disruption by the pandemic. The number of people below the poverty line (BPL) increased to 50 million in India and 95 million globally. A two-decade-long trend of poverty reduction has reversed. As per the World Bank's estimates, global poverty is expected to rise to 150 million by the end of 2021 depending on overall economic contraction. Extreme poverty, which is defined as living on less than $1.90 a day, is likely to affect between 9.1 percent and 9.4 percent of the world population.

There is an urgent need for targeted and localised lockdowns only. Revenue expenditure needs to be increased in India to target income support measures, which is extremely important now to maintain livelihood and contain poverty. Growth is expected in certain sectors whereas poverty is a reality. As per the IMF's forecast, there will be a 9 percent hit to per capita income from 2020 to 2022.

In India, a little bit of complacency due to fewer Covid positive cases during January to March and not highlighting to the public the spread of the United Kingdom, Brazil, and South Africa mutant virus variants has resulted in the present situation. There is evidence in history that a hundred years ago during the 1918 Spanish Flu pandemic a similar more dangerous second wave was witnessed due to similar complacency at that point of time. It is time to implement the learnings from history. Therefore, the needs of the hour are – all steps to be taken to control infection, strict containment in localities having a large number of positive cases, following Covid appropriate behaviors, no crowding, increasing the vaccination drive, and strengthening the hospital infrastructure such as providing more number of hospital beds and ensuring the supply of oxygen. These are the panacea needed urgently to bring the economy back on track for higher growth.

According to the second advance estimates, 2020-21 is expected to suffer a GDP contraction of 7.96 percent. The weekly moving average of daily new cases has increased 14 times since February 11, when it started rising again after declining for five months. The effects of any significant economic disruption, if it were to happen, will not be limited to the first quarter itself. It can have a cascading effect through both demand and supply channels. If supply chains get hit and inflation starts rising — it has already been on an upward trajectory —

purchasing power and therefore the demand is bound to be squeezed. Similarly, any cutback in economic activity, especially in sectors that are being forced to do so because of social distancing requirements, will adversely affect incomes and hence demand.

Many migrant workers, who returned to cities for work after months of staying home from a curfew-style lockdown, are now crowding trains and buses to return to their native towns and villages yet again. The paranoia, fear of another nation-wide lockdown being imposed, and the horrifying experiences in memory for those who suffered last summer, is making more workers anxious, uncertain about their own well-being, which may subsequently impact labour-intensive businesses and construction work (where most migrant workers tend to find employment) for months ahead.

However, there is hope for economic recovery and stabilization. Because, unlike the first wave, we have vaccines this time. It is reasonable to expect that the pace of new infections will slow down as vaccinations pick up. Whether or not India's favourable GDP revisions undergo a downgrade will depend on how fast vaccinations pick up, which will determine the time it will take to flatten the second wave. Fiscal support through an institutional mechanism – for instance through the creation of special-purpose vehicles, is required to support stages of vaccine production; its distribution through a decentralised supply-chain process for all demographic groups, and a fund to provide money to those in the private sector who can produce vaccines on a large scale.The surging debt burden is leading to increased debt servicing. In addition, there is rising inflat

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