Economic recovery hits July plateau, shows data

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NEWDELHI: The rate-setting Monetary Policy Committee (MPC) of the Reserve Bank of India (RBI) will begin a two-day meeting on Tuesday amid mounting evidence that India’s nascent economic recovery is at risk of plateauing out as new coronavirus disease (Covid-19) infections pile up.

Most high-frequency indicators for July suggest that not only was economic activity in July slower than the year-ago level, but that even a sequential recovery seen in May and June may have been interrupted.

Experts believe that this may be a result of the exhaustion of pent-up demand created by lockdown restrictions in April and May. This has also raised concern that the economy could take longer than expected to come back to pre-pandemic levels. According to a Reuters poll of economists, the Indian economy may be in a contraction mode till the December quarter.

The IHS Markit India Purchasing Managers’ Index (PMI) for manufacturing went down from 47.2 in June to 46 in July. A PMI value below 50 signals a contraction in economic activity. Services PMI numbers, which had taken a bigger hit due to the lockdown, for the month of July will be released on Tuesday.

Goods and Services Tax (GST) collection in July fell to ₹87,422 cr, which was 14.3% lower than ₹102,036 cr in June. The weekly NIBRI was flat between the week ending July 26 (70.3) and Aug 2 (70.4). “Overall, the NIBRI has remained stuck at 30 percentage points below pre-pandemic levels for the month of July... it has improved by 2.7 percentage point from June” Nomura Chief India Economist Sonal Varma

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core after rising to $80,917 crore in June. On a year-on-year basis, the July collections were 14.3% lower. State-owned refiners’ diesel sales, which, according to a Reuters report, account for two-fifths of overall sales in India, fell by 13% to 4.85 million tonnes in July from the previous month, and by about 21% from a year early.

Some high-frequency indicators suggest a plateauing rather than a worsening of economic activity. The weekly Nomura India Business Resumption Index (NIBRI) was flat between the week ended July 26 (70.3) and August 2 (70.4). “Overall, the NIBRI has remained stuck at 30 percentage points below pre-pandemic levels for the month of July, although it has improved by 2.7 percentage points from June levels”, Nomura’s chief India economist Sonal Varma said in a research note.

To be sure, domestic car sales, often used as a key indicator of demand and consumer confidence, showed a spike in July. Maruti Suzuki, India’s largest carmaker, reported an 88% increase in sales over June and a 13% rise over July 2019. These numbers are of Maruti’s sales to dealers and do not reflect sales to customers. Overall, because of the decline in exports, the company’s sales declined 11.1% over last July. These numbers failed to generate enthusiasm. Maruti Suzuki’s share price fell by 1.5% on Monday. “The Street’s reaction to the auto numbers shows that investors are not quite convinced that demand will persist,” said a Mint report.

As new infections continue to surge and many states impose ad-hoc lockdowns, there is growing concern that the Indian economy may be headed for a longer period of contraction than was initially expected. “GDP growth in 2020-21 is estimated to remain in negative territory, with some pick-up in growth impulses from H1: 2020-21 (October) onwards,” RBI governor Shaktikanta Das said after the previous MPC meeting on May 22, 2020. The consensus estimates among economists is that the Indian economy will shrink by at least 5% in 2020-21.

Most economists who participated in the Reuters poll said the economy could contract by 20% in the June quarter and remain in negative territory until the December quarter. The continuing weakness in aggregate demand is likely to lead to another rate cut by 25 basis points, the poll says. One basis point is one hundredth of a percentage point. The MPC has already cut policy rates by 115 basis points since March.

Further rate cuts may not be of much help, according to some experts. “To avoid further supply disruption, viable firms may need to be kept afloat with adequate credit; but the banking system, unfortunately, is rather risk-averse, and may not fully oblige,” Pranjal Bhandardar, chief India economist at HSBC Securities and Capital Markets Private Limited wrote in a research note on July 31.

Credit disbursal data supports this view. Annual growth in non-food credit has fallen continuously for seven fortnights to 5.6%, according to the Centre for Monitoring Indian Economy’s (CMIE) database. Even agriculture, which was seen as a key factor in generating tailwinds for initial recovery, may not be able to provide the much-needed boost, according to experts.

“Green shoots of the Indian economy are unlikely to grow until they are watered with fiscal stimulus measures that create broad demand for agricultural commodities. This will require a massive increase in fiscal spending, not just to maintain agricultural incomes through increases in procurement and subsidies, but also to boost non-farm sectors that can act as strong demand generators for the agricultural sector,” Himanshu, an associate professor of economics at Jawaharlal Nehru University, wrote in his latest Mint column.

To be sure, the government has been signalling that the process of economic recovery may take longer than initially expected.

“Prime Minister Narendra Modi is getting regular feedback on the economic situation and the government is keeping all options open to facilitate a faster economic recovery... Even so, the government is cautious about overstating the green shoots of a recovery visible in the economy,” finance minister Nirmala Sitharaman told journalists on Saturday while announcing an extension of the emergency credit facility to private professionals such as doctors and chartered accountants. Last week, revenue secretary Ajay Bhushan Pandey told the parliamentary standing committee on finance that the government may not be in a position to pay compensation to states this year for a shortfall in GST collection.

The centre’s fiscal deficit in the quarter ending June has reached 83% of the full-year budget, much higher than the five-year average of 60%, according to a research note by Samiran Chakraborty, chief economist, India, at Citigroup Global Markets India Private Limited.

This happened even as spending by 13 out of top 20 ministries (by budgeted expenditure) fell in the June quarter by at least 30% on an annual basis, the note said. The 13% jump in total expenditure in the June quarter was primarily the result of a sharp jump in the ministry of Finance’s spending, which included a transfer of ₹6,400 crore of GST compensation and some Covid disaster relief to states, the note added.

With the economic situation and revenue outlook continuing to be grim, a clamour for fiscal support over and above monetary policy measures is likely to increase. In an opinion piece published in The Hindu, former Prime Minister Manmohan Singh and Congress leader Praveen Chakravarty argued that India should make “full use of loan programmes of international institutions such as the International Monetary Fund and the World Bank” and only “adopt deficit monetisation as the last resort when all other options are exhausted.”