COVID's impact on Indian growth and trade

The COVID-19 pandemic has inflicted great damage to the global economy. Pravakar Sahoo and Ashwani Bishnoi consider the developmental and policy implications for the Indian economy

Economics literature has well noted the convergence between economic growth, trade and development. With the onset of COVID-19, India's economy faces the possibility of 6.34 percent negative growth for the FY21.

The likely impact (deceleration) on exports can be 15.0 to 20.2 percent and imports from 20.8 to 26.1 percent in current fiscal year. The developmental implications of shrinking growth and trade is severe.

I. Impact assessment of COVID-19 on India's growth and trade

The corona pandemic has hit the Indian economy when it is at its lowest point of growth trajectory over last six years due to lack of aggregate demand - consumption, private investment and exports witnessing deceleration over the last few years.

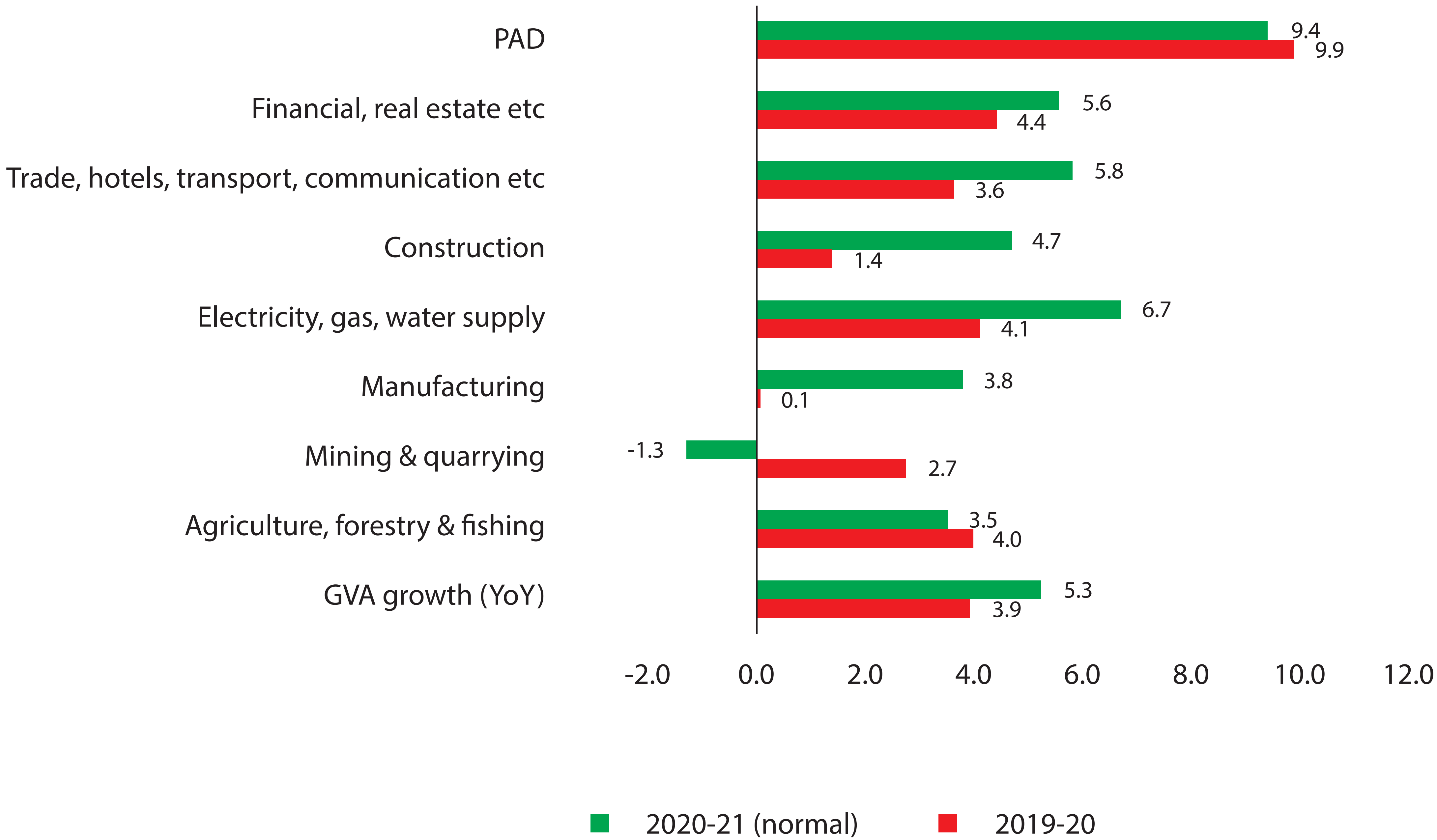
Our assessment of impact of coronavirus pandemic on India's GVA and trade in the FY21 are carried out under three scenarios- A, B and scenario C[1]. In Scenario A, we consider the complete lockdown up to 3rd May of 2020 and 50% capacity utilization of the economy till 31st May 2020.

In case of scenario B, we extend the scenario A while assuming 70% of capacity utilization in the economy by 30th of June and scenario C, more pessimistic where normalcy level is assumed in three phases- 50% by end of May, 70 % by June and 90% by September 2020[2].

II. Impact on growth:

Figure 1 reports the expected percentage increase in GVA in FY21 over FY20 across sectors in normal times ie. without COVID-19. The GVA would have increased by 5.3% in FY21 mainly led by Public Administration and Defence (PAD) services (9.4%), electricity, gas, & utilities (6.7%); trade, hotels & restaurants and financial services (around

Figure 1. GVA growth in normal conditions



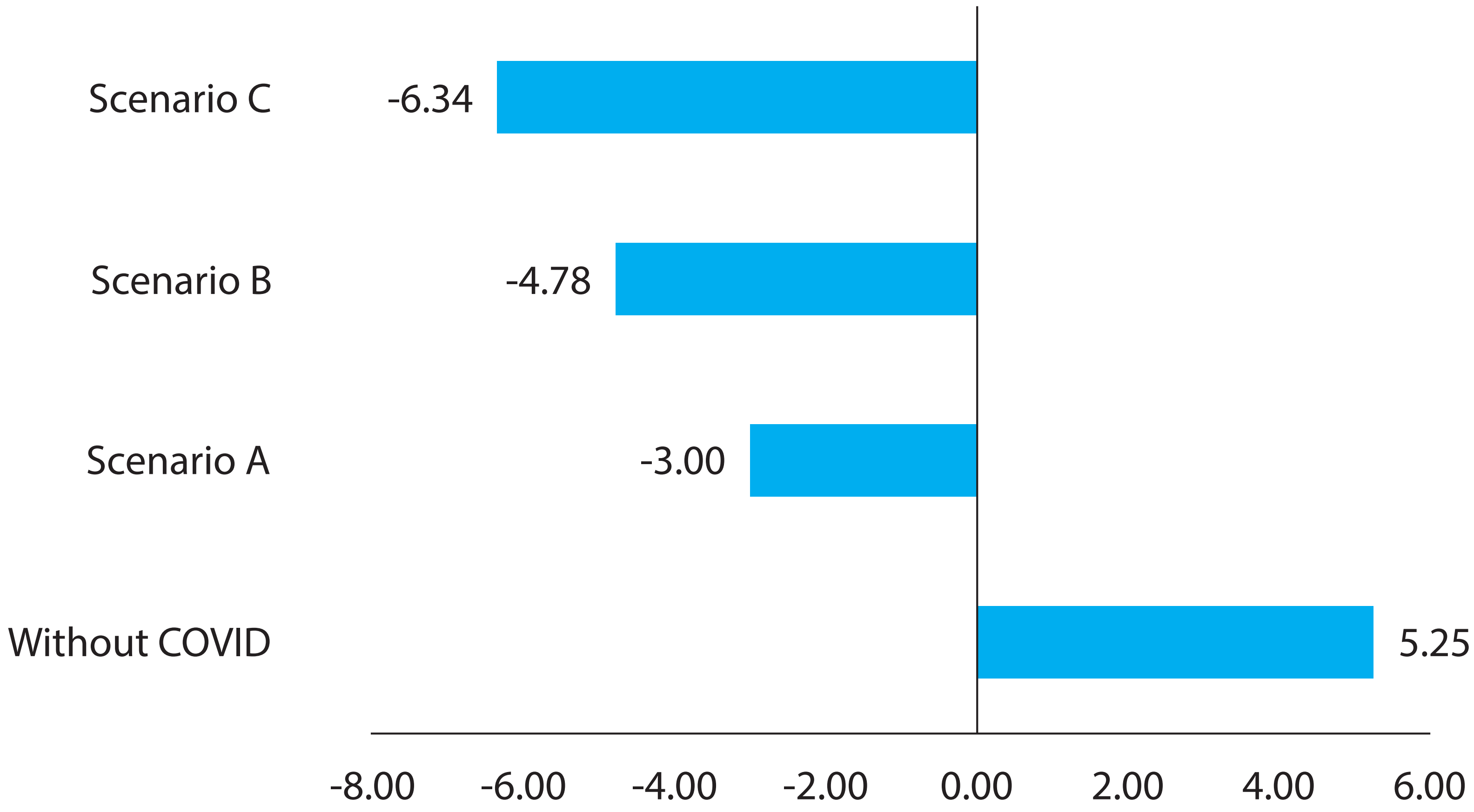
Source: Authors' computations based on NAS data

5.7%, each); construction (4.7%); manufacturing (3.8%), agriculture (3.5%) and mining and quarrying to register a fall (1.3%).

Due to lack of aggregate demand in recent quarters and onset of COVID-19 in the last quarter of FY20, Indian economy experienced 4.2 per cent in FY20 - lowest in last 11 years – compared to 6.1 per cent in FY19. The impact of COVID-19 outbreak and subsequent lockdown on real GVA (at 2011-12 base) at aggregate level for the FY 21 over FY20 is reported in Figure 2. In case of scenario A, the GVA is estimated to fall by 3%. In most likely scenario B, the deceleration can be around 4.8% in FY21 which is similar to IMF's projection of 4.5 percent for this year. However, in case of more pessimistic environment (Scenario C), the economic loss can extend to 6.3% (Figure 2)

The stimulus measures announced so far address the basic needs of the majority, and also few specific sectors, but not the drivers of the growth

Figure 2. Change (%) in GVA in FY21 over FY20



Source: Authors' computations

The estimated quarterly growth rate (Y-o-Y) of real GVA indicates that first quarter of FY21 would expect a deceleration to the tune of around 28 percentages under Scenario A and around 35% under scenario C (Figure 3). Figure 4 reports the deceleration across sectors for the current FY under scenario A.

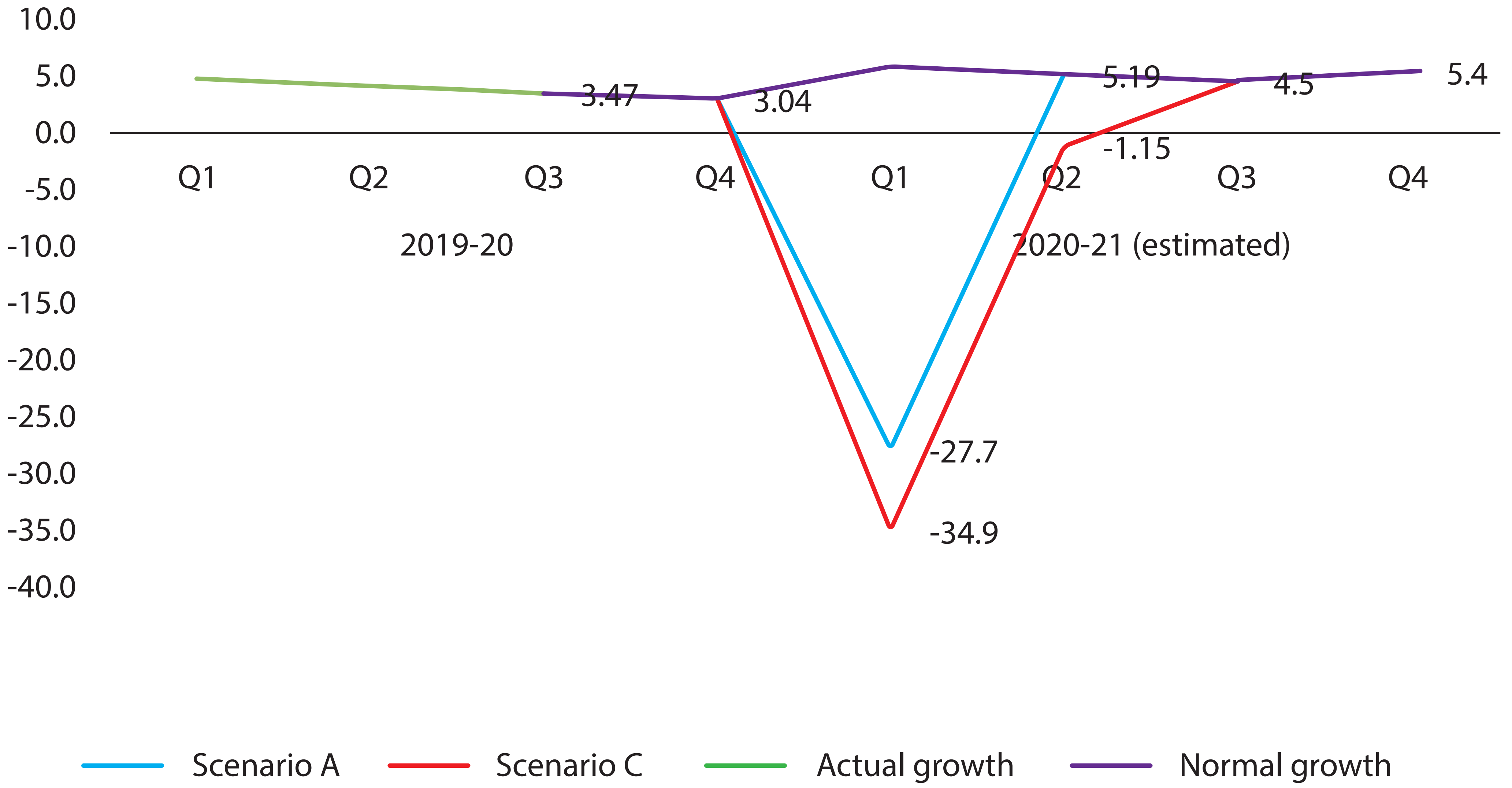
Here we assume sectors such as agriculture; electricity, gas and utility services and PAD services experience normal conditions and the corresponding growth would be 3.5%, 6.7% and 9.4% in FY21[3]. But now with the COVID-19, the growth is expected to decelerate (Scenario A) by 14.3% in mining and quarrying, 9.2% for construction sector, 9% for manufacturing, 6.3% for trade, hotels, transport and communication services, and 5% for financial & real estate services[4].

Across industries, the largest decline is expected in basic metals and electric equipment (around 21% for each), followed by textiles (18%); coke & refined petroleum products and motor vehicles (around 15%, each); rubber & plastic products and other non-metallic products (around 11% each); among others (For detail, refer Sahoo and Ashwani, 2020).

Our assessment of negative growth from 3 to 6 percent for FY 21 for Indian economy in best and worst-case scenarios is away from the IMF's projection of a negative growth of 4.5 percent with band of +/- 1.5 percent. Though the exact number would vary depending how we succeed in containing the Pandemic and unlocking the economy, the Indian economy looks certain at this point to experience a negative growth.

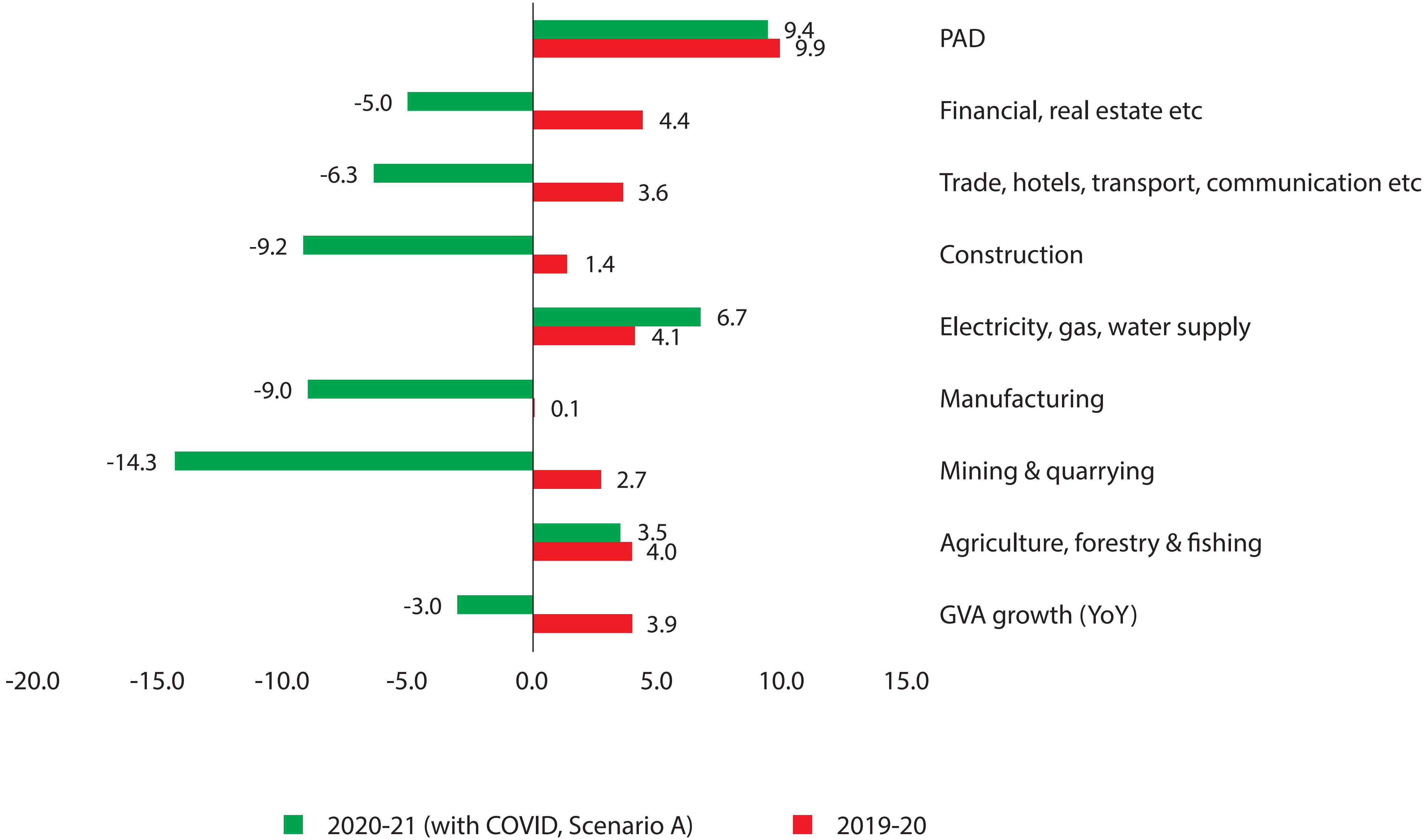
The World Bank has already projected a 3.2 per cent contraction in the Indian economy this fiscal year. Most of the rating agencies such as ICRA, CRISIL, Moody's have also projected the negative 4 to 5% growth rate for India in the FY21.

Figure 3. Quarterly growth in GVA (Scenarios A and C)



Source: Authors' computations based on NAS data

Figure 4. Sectoral deceleration (%) in GVA (Scenario A)



Source: Authors' computations based on NAS data

The pull factors for falling growth will be both from sluggish demand - both domestic as well as foreign due to falling income- and supply side disruptions due to the shutdowns, shortage of raw materials, higher inputs costs and skill shortage. Therefore, the negative growth for FY21 looks inevitable.

III. Impact on trade

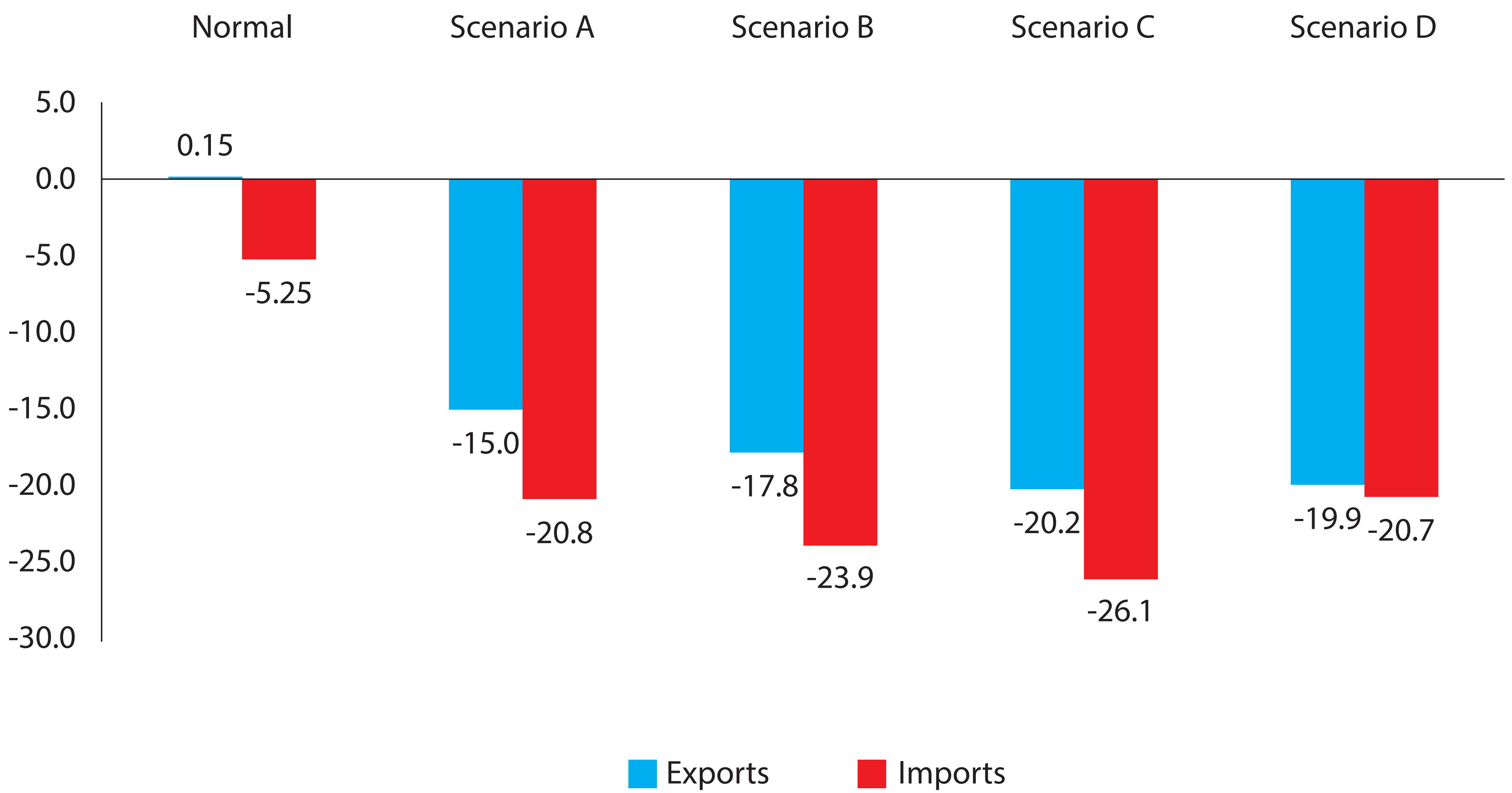
India witnessed a significant fall in India's trade in Q4 of FY20 as exports declined by 11% and imports by 9% - due to the Corona outbreak. The impact is obvious as India's trade is mainly reliant on EU, USA, China and South East Asian countries, which are worst affected by COVID-19. We estimate the potential impact on trade for different quarters of FY21.

The assessment of loss of India's exports and imports are carried out under two situations, first with normal behaviour of world trade and second with the falling world trade. For first case we carry out the impact under above mentioned hypothetical scenarios (A to C). To account for the expected fall in world trade, we take the global financial crisis as the reference point to evaluate the fall in India's trade (Scenario D).

As per our estimation[5], India's exports are going to decline by 15% to 20.2% in FY21 over FY20 under scenarios A-C. The corresponding fall in imports ranges from 20.8 % to 26.1% in FY21. In the scenario D, considering the GFC as reference point, the potential fall in exports and imports can be 19.8% and 20.7%, respectively (Figure 5).

Severe restrictions on movements of goods, services and personnel along with heightened protectionism and lower demand across the countries will not only pull-down India's trade but is likely to hamper the domestic production networks and overall competitiveness (Garg and Sahoo, 2020; Sahoo, 2020).

Figure 5. India's exports and imports in FY21



Source: Computations based on RBI data

With regard to impact on exports and imports across commodities, it is estimated that products such as petroleum products, chemical products, machinery, electronics and plastic and rubber would suffer a loss of more than the national average of 20 percentages (Sahoo and Ashwani, 2020).

Overall negative performance in manufacturing, the top value-added sectors such as base metals, electronics, machinery, coke & refined petroleum products, motor vehicles etc. have much dependence on the imports. For instance, electronics industry imports about 67% of electronic components from China. Take the example of automobile sector which is one of the success stories of Indian manufacturing in last decade.

The sector was struggling to adjust to the new regulations of BS-VI regulations, effective 1 April 2020, before COVID-19 and now facing challenges because of the dependency of the sector on China for the Original Equipment Manufacturers (OEMs). All in all, prices of the raw material as well as finished goods are expected to inflate, but with lower demand, realization of increased input cost through end prices of finished goods is difficult.

IV. Conclusion: developmental implications and policy implications

Our assessment is that Indian economy may experience negative economic growth in the range of -3% to -6.3% in FY21. The most affected sector is going to be mining sector followed by manufacturing; construction; trade, hotels and transport services, and financial services.

The likely impact (deceleration) of COVID-19 on trade in FY21 from best case scenario to worst scenario are as follows - exports from 15 to 20.2 percent and imports from 20.8% to 26.1 percent. The figures suggest that the economy is heading towards a recession and the situation demands systematic, well targeted and aggressive stimulus measures.

The developmental implications of shrinking growth and trade will be humongous. The fall out of COVID-19 has humongous developmental implications on poverty, inequality and standard of living of the masses.

It is well evidenced that the convergence towards Sustainable Development Goals (SDGs) would occur much faster with rapid, sustained and inclusive growth. Economic growth is essential to provide jobs to millions of people, empowering the state to channelize the resources for health and education and welfare schemes to reduce poverty, improving the quality of life, etc.

The study by Adams (2002) finds that a 10 per cent increase in a country's average income will reduce the poverty rate between 20 and 30 per cent in developing countries. DFID (2008) report says that 1 per cent increase in per-capita income could reduce the poverty rates by 1.7 percent.

India has seen significant fall in poverty since the 1980s mainly led by impressive growth and the reform process that was launched in the year 1991. The COVID-19 impact on the Indian economy casts a doubt on the sustainability and inclusivity of growth in India, thereby affecting its development agenda.

Economic theory underscores the role of international trade on economic development through increased per-capita income. With free proliferation of trade, the access to ideas, technology, goods, services and capital becomes easy, which in-turn leads to faster income growth.

Empirically it is estimated that rise in ratio of trade to GDP by one percentage point was found to increase income per person by 1 to 2 percent (Frankel & Romer 1999). Trade has been recognized as an engine for inclusive economic growth and poverty reduction in the 2030 Agenda for Sustainable Development.

It is the time to revive growth by stimulating demand and repairing domestic supply chains. The comprehensive stimulus measures announced so far by GoI, more through increasing liquidity in the form of providing loans and funding opportunities and less through fiscal measures, may not be sufficient. Now is the time is for sector specific fiscal stimulus to revive demand and growth.

The stimulus measures announced so far address the basic needs of the majority, and also few specific sectors, but not the drivers of the growth. For example services sector contributes 55% to GDP but there is hardly anything specific - in terms of easing the financial stress, funding opportunities and tax holidays - to sectors likes transport, travel, hotel, tourism and other services which are the worst affected and struggling to survive. ■

ABOUT THE AUTHORS

Professor Pravakar Sahoo teaches Macroeconomics and International Economics to Indian Economic Service (IES) probationers. He has 20 years of teaching and research experience. His research interests are Macroeconomics, International Trade & Investment, Development Economics, Infrastructure Development and Public Finance.

Dr Ashwani Bishnoi is with the Faculty of Economics at the National Institute of Technology Kurukshetra, an institute of national importance in India. He has work published in Scopus indexed journals in the areas of macroeconomics, financial development and international trade. He has carried out consultancy work for premier economic institutions of India, including National Council of Applied Economic Research (NCAER) and Institute of Economic Growth, Delhi. He has vast research exposure to his credit about economic policy level projects on international trade, FDI, GST, investment slowdown, etc. carried out by NCAER and Institute of Economic Growth, New Delhi.

Endnotes

1. For estimations, assumptions, scenarios etc., please see Sahoo and Ashwani, (2020)

2. Assuming that 10% of firms would remain severely affected with the epidemic and require much higher time for resuming the normalcy level.

3. See Figure 1 GVA growth in normal scenario (without COVID)

4. Assuming communication services, banking and insurance working with their normal capacity level.

5. See Sahoo and Ashwani, 2020 for estimation details.

References

Adams, R (2002), Economic Growth, Inequality and Poverty: Findings from a New Data Set, Policy Research Working Paper 2972, World Bank, February 2002

DFID (2008), Growth: Building Jobs and Prosperity in Developing Countries, Department for International Development. https://www.oecd.org/derec/unitedkingdom/40700982.pdf

Frankel, JN and Romer, D, (1999), Does trade cause growth? Am. Econ. Rev., 89 (1999), pp. 379-399

Garg, B and Sahoo, P (2020) "Corona Crash: Need Global Efforts to tackle Global Crisis", Policy Brief, No. 12, 2020, Institute of Economic Growth, Delhi.

Sahoo, P and Ashwani (June 2020), COVID-19 and Indian Economy: Impact on Growth, Manufacturing, Trade and MSME sector. Institute of Economic Growth, Working Paper No. 390.

Sahoo, P (2020) "COVID-19 crisis is a great opportunity to revive multilateral trade framework" https://ibt.tpci.in/blogs/COVID-19-crisis-is-a-great-opportunity-to-revive-multilateral-trade-framework/