NovaDhruva

Economic Relief Package – A necessity but a difficult balancing act

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We are in an extraordinary moment in the known history of mankind. And it is indeed both unfortunate and fortunate that we have no experience in handling a crisis of this kind – medically, socially or economically. Governments across the globe are doing their best to handle the impact of the crisis, but there is no denying that business activities all over have come to a halt.

In India, while small entrepreneurs, self-employed segment, daily wage-earners and contract workers are the worst hit, this pandemic also has severe consequences on the Government's own financial health.

According to our calculation, based on certain assumptions of activity levels and time to recovery, the government's tax revenue will be lower by approximately ₹5.5 lac crores for the current financial year. It includes gains from the lower oil prices of estimated ₹1.5 lac crore. This is computed on current budgeted tax revenue collection for FY21 of ₹24.23 lac crore. Given the market situation, some large non-tax revenue items like disinvestment and others could be lower by ₹2.5 lac crore.

In total, the revenues could be down by approximately 4% of GDP. Further, the additional expenditure being incurred to manage the pandemic and other immediate support could be ₹2 lacs crore, which is another 1% of GDP. So, unless the expenses are recalibrated, the fiscal deficit of the country could be 8-9% of GDP. And this doesn't consider the cost of any serious economic relief package, or the negative impact on state government finances and on income of state-owned undertakings. Further, lower tax revenues may continue for a couple years.

Policy-makers are challenged with no prior experience of handling a situation of this magnitude. The only experience they can draw upon is possibly from the 2008 Global Financial Crisis (GFC). Looking back, just ahead of GFC, our fiscal deficit was at 2.5% and the current account deficit was at 1.3% as oil was hovering around $80. Currency was at ₹41 to a US$. To counter the negative fallout of global slowdown on the Indian economy and reduced exports, government then chose growth over fiscal stability. Stimulus packages announced included tax relief, increased public expenditure, and monetary and liquidity measures.

The fiscal stimulus for 2008-10 at 3.5% of GDP costed ₹1.86 lac crore. Interest rates were slashed from 9.00% to 4.75% during Oct 2008-April 2009. The 10y g-sec yield dropped from 9% to 5% by end 2008. Fiscal accommodation led to a surge in fiscal deficit from 2.5% in 2007-08 to 6.5% of GDP in 2009-10. The gross tax to revenue came down from 11.9% in 2008 to 9.6% in 2010 - the effect on tax revenue lasted for quite a few years.

Unfortunately, the impact of these expansionary measures was felt for a long time. The fiscal spends and the low interest rates fueled inflation and imports. Current account deficit deteriorated by 2012 and rupee plunged from ₹44.00 in August 2011 to ₹68.80 in August 2013. India's 10y g-sec yields rose from 5% in 2008 to 9% in 2013. The mounting twin deficit coupled with NPA challenges of banks resulted in economic growth slowing down to pre-crisis level in FY12-FY14. It wouldn't be incorrect to say that the real economic crisis hit India not in 2008-2009, but in 2012-2014.

Therefore, in the current situation, to fund the fiscal deficit, apart from the conventional methods, the government could consider options such as a long-term financing support from multilateral agencies as zero-coupon rupee loan payable over 25 years. With global interest rates nearing zero, this structure should work well. The government could also ask Indian temples to monetize 10-20% of their gold reserve without paying any tax and deposit it into zero-coupon 25-year government bonds. Estimated gold reserves of Indian temples is ~$1trn which doesn't yield them anything. With current high gold prices in the international market, temples can convert their gold into liquid assets.

In the present scenario, the economic policy making has added complexities - emotions and the lives of people are inter-twined with the decisions. There is no visibility on how long the pandemic will last. While its essential to kick start the economy, should we compromise on short-term growth, and manage better our fiscal deficit, inflation and health of the banking system? We do need to be careful about the legacy that we will leave behind. This is going to be a long-drawn battle and may need multiple doses of support. It is important to be measured and targeted when providing medication to pull a patient out of emergency.

Sunil Sanghai
Founder & CEO
NovaDhruva Capital Private Ltd.

NovaDhruva

NovaDhruva Capital Private Limited

902 One Indiabulls Centre, Tower 2A
Elphinstone Road (West), Mumbai 400 013
☎: +91 22 6246 6000
www.novadhruva.com