Our Views

Post-Covid prescription for the economy

When a patient is wheeled into an emergency ward, a doctor's top priority is to save the life of the patient and accordingly they administer medication to assuage the immediate symptoms. Similarly, in the current economic crisis due to the unfortunate pandemic, central banks across the globe have resorted to monetary easing as an immediate pill. In the past as well, including during the Global Financial Crisis 2008 (GFC), similar tools have been used globally and by Indian policymakers to immediately put the economy back on the track. While clearly this crisis is far greater and widespread than the GFC, fortunately, like in 2009, the monetary easing measures seem to be working. There is already a feel-good factor in the economy except in some sectors and the markets are performing well.

During GFC, between October 2008 to April 2009, India had pumped in almost 10.5% of GDP as liquidity in the system. A total of ~5.61 lac crore was put into the economy by way of various method such as reduction in interest rate, reduction in CRR and SLR, open market operations (OMOs) and others. This resulted in immediate liquidity flowing into the businesses through the banking system to the tune of 3.75 lac crore – that was approximately 7% of GDP.

It's well understood that this kind of booster dose of medication is only meant to bring the patient out of the emergency. However, once the immediate situation is addressed, a well-thought through prescription to deal with the disease and the side effects of the emergency medication is advised. Similarly, in the context of the economy, it is important to evaluate the longer-term implications of this crisis to avoid a lasting damage to businesses and financial system. Going back to the experience of GFC, we witnessed fantastic growth in the period immediately following the crisis – during 2010-2012, the real GDP growth averaged around 9% and non-food credit growth was back in the 20s. The side effects of the over medication started to show only from 2013 with inflation moving to double digit, currency weakening, and banks being straddled with over 7 lac crores of non-performing assets.

In the current crisis, as a part of the overall economic package of Rs. 20 lac crore of the Government, the central bank has already pumped in ~9.57 lac crore (4.7% of GDP) in the system. Based on past learnings, it would be critical to proactively monitor the impact for the period in which monetary policy has its effects, which is approximately 18-24 months. This is important because projections do not always play out as envisaged, especially so in a period of economic recovery after a crisis like the one we are passing through. Further, this should be immediately backed by specific structural reforms focused on price stability, improved productivity and financial sector stability including avoiding piling up of non-performing assets.

The need for structural reforms has never been more important than now. There are some low hanging fruits which can be picked up immediately. Currently, availability of significant liquidity in the global and local markets and low to negative global interest rates leading to low cost of capital are a significant opportunity. Taking advantage of these, and focusing on the other structural reforms, the Government should immediately consider the following at the minimum:

1. Sale of as many PSUs as possible - This not only will reduce the burden on the government fiscal system but also improve efficiency of these organizations. Markets are flush with liquidity at these times so it will be easy to execute it.

2. Boost FDIs – It's the right time to tap into the global liquidity pool and receive long term permanent capital into India. This will also help in maintaining the currency.

3. Focus on the agriculture sector reforms as was announced as a part of the Atmanirbhar Bharat announcements. This will improve much needed efficiency in agriculture sector and improve the economy of rural India.

4. Banking sector reforms to ensure that the banks are well capitalized and to prevent banks from being saddled with large NPAs. This is extremely crucial for financial sector stability.

5. Taxation reforms - Simplify direct taxes in line with reforms already introduced for indirect taxes. This is fundamental to ease of doing business.

We need to take this global adversity as an economic opportunity to make a New and Atmanirbhar India which cannot happen without really pushing the pedal on all of the above.

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