Economic and Financial Analysis

Global Economics

31 August 2020

Article

Indian economy crashes 24% in April-June quarter of 2020

The last quarter was pretty much a write-off and so is much of the rest of the financial year as the Covid-19 pandemic continues to roar ahead with record daily cases. Where do we go from here?

Source: Shutterstock

Factory workers in India queue at Kapashera border after local police stopped them from crossing amid the lockdown on May 18, 2020 in Gurugram, India.

Content

23.9%

Worse than expected

India's GDP fall in April-June quarter

year-on-year

From best to worst performer

Even as the pandemic started to hit the global economy in the first quarter of 2020, the Indian economy was still doing good with at least 3.1% year-on-year growth in that quarter. Things turned upside down as India became an epicentre of Asian and, as it currently stands, the global pandemic. The just released India GDP data for the April-June quarter, which is the first quarter of the country's financial year started in April (FY2020-21), showed the economy was the worst performer in Asia and probably in the world too.

GDP crashed by a 23.9% year-on-year in the reporting quarter, sharply undershooting our -17.8% YoY forecast for the period and the consensus of -18.0%. Of course, the nation-wide lockdown to break the Covid-19 chain, which started in late March and continued for much of the quarter, deserves the blame.

> Nation-wide lockdown to break the Covid-19 chain deserves the blame

Probably, the chaotic implementation of the lockdown – it was announced just a few hours before its implementation, made the matter worse. The people weren't prepared for such an unprecedented closure of the economy, which subsequently caused panic and mass migration of workers from big cities to their native places.

Where did Covid-19 hit the economy hard?

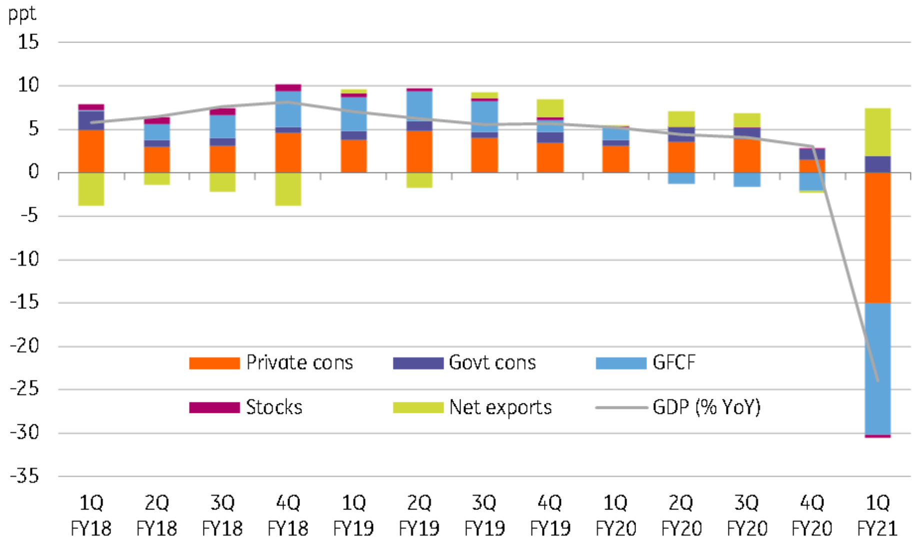
Construction and trade, hotel, transport and communication were the hardest hit sectors in the last quarter with their production halved from a year ago. Manufacturing and mining also took strong beatings with 39% YoY and 23% plunges in output, respectively. Public administration followed with -10% YoY and then utilities with -7%.

Agriculture was the lone bright spot with 3.4% YoY growth, which was despite natural disasters including typhoon Amphan in May and floods in some parts of the country.

On the demand side, investment was the hardest hit with a 47% YoY crash of gross capital formation. Consumption came next with -27% YoY and the goods and services exports with -20%. A much steeper fall in imports by 40% YoY, however, had net trade contributing positively to the headline GDP growth (see figure).

The all-touted fiscal stimulus worth 10% of GDP was also missing in action. Indeed, government consumption growth gained some traction, up to 16.4% YoY from 13.6% in the previous quarter. But its contribution to the headline GDP growth only improved marginally to 1.9 percentage point (ppt) from 1.2 ppt in the previous quarter.

Expenditure-side sources of year-on-year GDP growth (percentage points)



Source: CEIC, ING

Note: Bars may not stack up to total GDP growth due to statistical discrepancy.

Where is the macro policy headed?

Also released today, the government budget figures for July showed the cumulative fiscal deficit of INR8.21 trillion in the first four months of the fiscal year (April-July), already exceeding the INR7.96 trillion official projection for the entire fiscal year. This stems from the fiscal year-to-date revenue fall by 42% YoY and total expenditure growth of 11%.

This is unprecedented, indeed. Although the ruling government of Prime Minister Narendra Modi has been ramping up spending over the last couple of years, especially to support its re-election bid in the last year, the deficit in the same period a year ago was only 78% of the yearly target.

> Additional fiscal stimulus is next to nil

And, against such a backdrop, the chance additional stimulus from the fiscal side is just next to nil.

The Reserve Bank of India's monetary easing has also reached its limit as can be judged from the central bank's decision to leave the policy rate unchanged last policy meetings in early August on the back of accelerating inflation. The supply disruption to food prices drove inflation past the RBI's 2-6% policy target range in recent months (6.9% YoY in July). The pro-cyclical measures such as a hike in excise duty on fuel prices was another contributing factor here. That said, the RBI continues to support the economy via other channels.

Where do we go from here?

There is no light at the end of India's Covid-19 tunnel just yet. The daily rise in cases reached a new record of 79,457 over the weekend, taking the total number of infections so far to over 3.6

million.

GDP growth may have passed the bottom

And, in its bid to revive the economy the government continues to ease movement restrictions. As such, GDP growth might have passed its bottom but the thriving pandemic provides little hope of a near-term recovery.

The policy stimulus has also hit a snag given stretched public finances and rising inflation. This means pretty much nothing can save the economy from continued deep GDP declines over the rest of the year. We recently cut our full-year FY2020-21 GDP growth forecast from -5.2% to -8.6%. The below-expected 1Q FY2020-21 growth nudges it further down to -10.3%. We would imagine it being much worse than that without any more policy support.

What all this means for the markets?

Just ahead of the GDP release today, the RBI moved to inject liquidity in the banking system via special open market and term repo operations. The goal was to maintain the “orderly and congenial” market conditions as the recent inflation spike stoked government bond yields higher. The central bank also moved to boost banks’ purchases of government bonds. While we believe any easing of upward yield pressure due to the latest RBI measures to be transitory, the persistent inflation threat and the supply overhang from the wide budget gap will continue to haunt investors in the Indian government bond for some time.

The weak US dollar environment has provided some cushion for the Indian rupee, though it’s still an Asian underperformer currency so far this year with a 3% YTD depreciation against the USD. We expect it to remain so over the rest of the year. That said, we are reviewing our end-2020 USD/INR forecast of 76.50 for a downward revision in consideration of the recent rally (spot 73.6).

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