

Snowballing Uncertainty Poses New Challenges to Economy's Resurgence

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ASSESSING

Economic Outlook has become a big challenge in a highly dynamic situation. This proposition gets validated by unfolding events and a slew of reports such as Reserve Bank of India's (RBI's) 22 nd Financial Stability Report (FSR) and the World Bank's (WB's) Global Economic Prospects (GEP).

When a whole range of projections from credible entities add to the hazy outlook, the work of businesses, revenue authorities and policy planners becomes more challenging.

The eagerly-awaited Budget for 2021-22 would thus have to be judged against the ecosystem in which it is being prepared. No one can say with certainty whether economic environment would improve and how much in the coming fiscal year.

Even the well-reasoned forecast by reputed rating agencies can go haywire in uncertain times. This is best illustrated by Crisil's release dated 10th December 2020. It stated:

"The poultry industry will shake off the woes heaped by the Covid-19 pandemic and post a better performance this fiscal because of higher realisations and lower input prices, leading to a 200 basis points (bps) improvement in operating profitability, despite flattish revenues".

Within a month, this projection is becoming topsy-turvy due to Avian Influenza afflicting birds including Poultry in at least 10 States. Egg and chicken prices have fallen across the country. Some States have announced restrictions on poultry transport and shutdown of poultry markets.

Rabobank's research unit has aptly captured the highly risky job of forecasting light at the end of pandemic tunnel.

"India Economic Outlook 2021: The only certainty is uncertainty"

, says the headline of Rabobank's latest Indian report dated 12th January 2021.

It observes:

"The availability of effective vaccines has brought hope that economies can return to normality somewhere later this year, something we expect will happen in Q3. A significant risk to that scenario, however, is that COVID-19 has been mutating. Two variants of the virus have emerged in the UK (202012/01) and South Africa (501.V2). Pharmaceutical companies are confident that their vaccines only need tweaking and will be effective against these mutated versions of the virus, but new testing will have to confirm these claims".

Mutating Covid-19 virus and Bird Flu outbreak are two natural factors that should jolt those who operate in over-optimism terrain. Add to this man-made crisis whose shoots keep cropping up in democracies. Two latest pointers are 1) socio-political turmoil in the United States over outcome of Presidential elections. 2) Farmers' agitations against three central farm laws that has disrupted economic and daily life for millions. Factor in the political tension and clashes between Opposition-ruled States and BJP & BJP-led Central Government.

We wonder whether the National Statistics Office (NSO) reckoned the impact of Bird flu on poultry industry including its backward and forward chains in making the first Advance Estimates (AE) of GDP for the year 2020-21. It has projected 7.7% contraction in real GDP at 2011-12 prices in 2020-21. Contraction in GDP is likely to be higher after fresh data is captured at the completion of fiscal year. The risk of higher contraction increases prospect of loan defaults, business failures, rise in poverty and unemployment and stunting of growth prospects over the medium term. Such issues have been focused well by both WB's GEP and RBI's FSR.

While projecting 9.6% contraction in Indian GDP in 2020-21, GEP notes growth in 2021-22 is expected to recover to 5.4%, ***"as the rebound from a low base is offset by muted private investment growth given financial sector weaknesses. The pandemic will likely lower potential growth, including through eroding human capital and investment growth"***.

As for South Asia of which Indian economy is the main driver, GEP believes that "

The pandemic is expected to leave lasting scars on the region". It says: "Recent estimates suggest that potential growth will be more than 1 percentage point lower, on average, during 2020-25 compared to a no-COVID counterfactual. These losses occur through multiple channels".

The Report has also projected addition of 100 million to the category of extremely poor in South Asia. GEP adds:

"The pandemic is estimated to have erased at least 10 years of per capita income gains in more than a quarter of EMDEs (emerging market and developing economies) in 2020".

The public should ponder how Indian Revenue Department would factor in all these frightening factors to make its assumptions for 2021-22 budget and for the medium term in its fiscal policy stance.

It here pertinent to quote RBI governor Shaktikanta Das. In the foreword to FSR, Mr. Das says:

"In spite of rising public commitments for mitigating the impact of the pandemic, fiscal authorities are also witnessing revenue shortfalls. The resultant expansion in the market borrowing programme of the Government has imposed additional pressures on banks".

Implied in FSR report is risk of rise in gross non performing assets (GNPAs) and of more bank failures that have cascading impact on the economy.

FSR notes:

"Macro-stress tests for credit risk show that SCBs' GNPA ratio may increase from 7.5 per cent in September 2020 to 13.5 per cent by September 2021 under the baseline scenario. If the macroeconomic environment deteriorates, the ratio may escalate to 14.8 per cent under the severe stress scenario. These projections are indicative of the possible economic impairment latent in banks' portfolios".

It observes:

"several banks may fall below the regulatory minimum if stress aggravates to the severe scenario. The need of the hour is for banks to assess their respective stress situations and follow it up with measures to raise capital proactively".

FSR contains a contagion analysis of the banking network based on the end-September 2020 position, indicating that if the bank with the maximum capacity to cause contagion losses fails, it will cause a solvency loss of 2.5 per cent of total Tier 1 capital of Scheduled Commercial Banks (SCBs) and liquidity loss of 0.5 per cent of total High Quality Liquid Assets of the banking system.

It adds: ***"In comparing these estimates with a similar exercise undertaken six months ago when solvency and liquidity losses were estimated at 4.3 per cent and 0.3 per cent, respectively, no comfort can be drawn, given that the extent of vulnerability, as the impact of COVID-19 on banks' balance sheet is yet to be reflected in full measure"***.

This analysis would hopefully convince the Government to be more transparent in its working. It should not shy away from sharing with the public more documents and more data. It should have structured format for public consultations on reforms from which there is no escape.

We hope the Budget would ring in a wave of change in Governance.