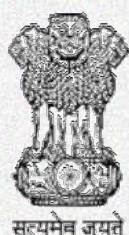


**ECONOMIC  
DIVISION**

# **Monthly Economic Review**

**August, 2020**



**आर्थिक कार्य विभाग  
DEPARTMENT OF  
ECONOMIC AFFAIRS**



## Executive Summary

*Data now available for the April-June quarter confirms a significant world-wide year-on-year contraction of output resulting from the COVID-19 pandemic. US economy has contracted by 9.1 per cent, UK, France, Spain, Italy and Germany by 21.7 per cent, 18.9 per cent, 22.1 per cent, 17.7 per cent and 11.3 per cent respectively with the overall Euro area contracting by 15.0 per cent and Japan has contracted by 9.9 percent. Relative to these advanced nations, India's GDP contraction at 23.9 per cent is slightly higher. The higher contraction has resulted from the stringent lockdown that India enforced in the April-June quarter. India enforced the most stringent lockdown as reflected in the Government Response Stringency Index developed by Oxford University. The lockdown has enabled India to restrain the pandemic induced death rate to one of the lowest in the world. India's case fatality rate was at 1.78 per cent as on 31<sup>st</sup> August as compared to 3.04 per cent in US, 12.35 per cent in UK, 10.09 per cent in France, 1.89 per cent in Japan and 13.18 per cent in Italy.*

*As countries unlocked in the quarter starting in July, recovery is underway globally. India, too, is witnessing a sharp V-shaped recovery. India's manufacturing purchasing managers' index (PMI), at 52.2, has moved into expansionary zone in August for the first time since the lockdown, presenting much required recovery prospects for the manufacturing sector. The V-shaped pattern of recovery is seen in the following high-frequency indicators: auto sales, tractor sales, fertilizer sales, railway freight traffic, steel consumption and production, cement production, power consumption, e-way bills, GST revenue collection, daily toll collections on highways, retail financial transactions, manufacturing PMI, performance of core industries, capital inflows and exports.*

*Since May, agriculture has persistently been the brightest spot in the revival of growth. Industrial production is showing definite signs of recovery with year-on-year (YoY) growth in eight core industries output showing a smaller contraction in July than in June. Consumption is picking up with passenger vehicle sales rising to their highest level at 1.83 lakh in July as compared to 1.43 lakh in March. Some revival in rural demand is also seen in growing sales of small cars, two-wheelers and sports utility vehicles and fertilizers. Increase in registrations for commercial and agricultural tractors from 52,362 in March to 66,061 in August is further indicative of strengthening rural demand.*

*Growth in activity since the April-June quarter is further evident in the railway freight traffic of 95.2 million tonnes in July, closing on to its previous year level of 99.7 million tonnes. In the first twenty-days of August, railway freight volume at 60.38 million tonnes has now crossed its previous year level of 56.60 million tonnes. Also creeping up as India unlocks are railway passenger bookings from -7.92 million in April (cancellation of bookings) to 14.62 million in July and domestic aviation passengers from 2.8 lakh in May to 21.1 lakh in July. Steel production at 74.02 lakh tonnes and cement production at 242.47 lakh tonnes in July, as compared to 86.13 lakh tonnes and 280.2 lakh tonnes respectively in the corresponding month of the previous year suggest revival of construction activity.*

Power consumption is quickly reverting to the last year's baseline, reaching 97 per cent of corresponding previous year levels and crossing pre-COVID (February) levels in August, 2020. Sustained impetus in E-way bills generated is reflected in their value at Rs. 13.8 lakh crore in August, reaching 97.2 per cent of corresponding month of the previous year. E-way bills are a strong and leading indicator of revenue collections, supply chain corrections and logistics growth, and thus their significant growth augurs well for early resumption of economic normalcy. Further, average daily electronic toll transactions and collections in 2020 have sequentially moved in tandem with value of e-way bills, reaching 80 per cent of pre-COVID (February) levels in August. Growth of electronic toll collections, broadband subscribers and retail payments transactions via NPCI platforms reflects positive externalities from the pandemic, apart from economic recovery.

Since the April-June quarter, global activity has entered the expansionary phase with global composite output index moving to a six-month high of 50.8 in July and global manufacturing index reaching a twenty one-month high of 51.8 in August. Increase in world demand continues to pull up India's economy with YoY growth in merchandize exports showing a smaller contraction in July than in June. In the domestic space, rising central government's consumption spending has been supplementing domestic demand to drive GDP growth. The growth outlook has improved with YoY contraction in GST collections declining from 38.0 per cent in May 2020 to 11.9 per cent in August 2020.

On the back of robust FDI and FPI inflows and savings from tepid imports, forex reserves, as on August 21, have risen to an all-time high of USD 537.5 billion. These are capable of financing more than 13 months of imports, should the need arise from a surge in real sector activity. The domestic space is flushed with high systemic liquidity. A system flushed with liquidity is a system ready to absorb a surge in real sector activity which is reflected in the 10-year benchmark bond yields declining from 6.55 per cent at end-April to 6.12 per cent at end-August, and narrowing of spread in yields of 3-year AAA rated corporate bonds and equivalent government securities from 246 basis points in end-April to 55 basis points in end-August. With the MPC in its August meeting further keeping the policy rates unchanged, the systemic liquidity is well entrenched to supply credit to the real sector.

The world after COVID-19 will be different with structural changes in production, consumption and work patterns. **As India emerges from this crisis, it will be critical to re-orient the country's policy matrix towards a calibrated reconstruction of the economy and building resilience for an uncertain future.** Some areas that may require specific attention include agrarian supply chains, factor markets, infrastructure, ICT, start-ups, financial inclusion, skilling and health care. Progress in these areas will sustainably boost economic growth in years to come.

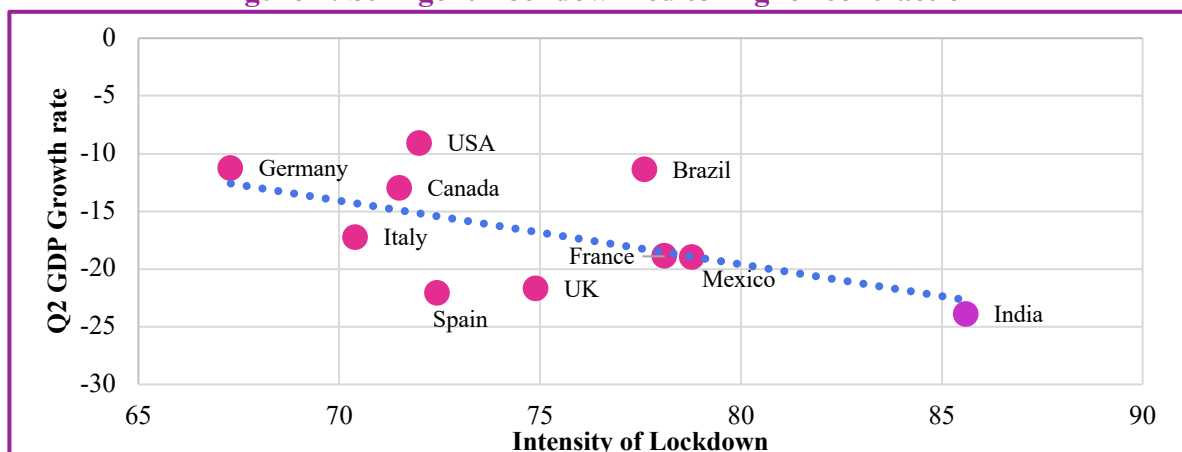
### Growth Contraction - Inevitable Impact of Lockdown

1. Data now available for the April-June quarter confirms a significant world-wide year-on-year contraction of output resulting from COVID-19 pandemic. US economy has contracted by 9.1 per cent, UK, France, Spain, Italy and Germany by 21.7 per cent, 18.9 per cent, 22.1 per cent, 17.7 per cent and 11.3 per cent respectively with the overall Euro area contracting by 15.0 per cent and Japan contracting by 9.9 percent. Relative to these advanced nations, India's GDP contraction at 23.9 per cent is slightly higher.

2. India's GDP contraction in April to June (Q1 FY21) quarter reflects the unparalleled effect of the Covid pandemic and the containment measures that have been taken to control the pandemic. The first quarter of FY 2020-21 witnessed the rapid spread of the perplexing virus, an unparalleled lockdown for two months and a sharp recovery as India unlocked in June. With the economy brought to a standstill for two complete months, the inevitable effect was a 23.9 per cent contraction in GDP as compared to previous year's quarter.

3. India enforced one of the most stringent lockdowns as reflected in the Government Response Stringency Index measured by Oxford University. Figure 1 shows the correlation between the intensity of the lockdown and the magnitude of the GDP decline among countries most affected by the virus. India's 23.9 per cent decline is consistent with this effect of the lockdown. The lockdown period gave a respite to ramp up the health and testing infrastructure in the country. Due to timely tracing, treatment and reporting, the number of people recovering from the virus is continuously rising and the active cases, as on date, are 21 per cent of the total cases in the country. This has enabled it to restrain its pandemic induced death rate to one of the lowest in the world (Table 1). India's case fatality rate was at 1.78 per cent as on 31st August as compared to 3.04 per cent in US, 12.35 per cent in UK, 10.09 per cent in France, 1.89 per cent in Japan and 13.18 per cent in Italy.

**Figure 1: Stringent Lockdown led to Higher contraction**



Source: Oxford Covid-19 government response tracker, OECD

**Table 1: Global Stringency Index, Covid -19 Fatality Rate and Growth in Q2 2020**

	GOVERNMENT RESPONSE STRINGENCY INDEX (0 TO 100. 100 IMPLIES STRICTEST)	COVID-19 FATALITY RATE (As on 31 <sup>st</sup> August)	GDP GROWTH RATE Year-on-Year in Q2 2020
<b>G-20 Advanced Economies</b>			
Canada	71.5	7.0	-13.0
France	78.1	10.1	-18.9
Germany	67.3	3.8	-11.3
Italy	70.4	13.2	-17.7
Japan	37.9	1.9	-10.0
Spain	72.5	6.3	-22.1
United Kingdom	74.9	12.4	-21.7
United States	72.0	3.0	-9.1
<b>G-20 Emerging Markets</b>			
Brazil	77.6	3.1	-11.4
China	71.8	5.3	3.2
India	85.6	1.8	-23.9
Indonesia	69.6	4.2	-5.4
Mexico	78.8	10.7	-18.7
Russia	80.1	1.7	-8.5
South Africa	83.3	2.3	
Turkey	72.0	2.4	-9.0

Source: Oxford Covid-19 government response tracker, 2019 Covid-19 Data Repository by Johns Hopkins CSSE, OECD.

Note:\* Average of April-June, 2020

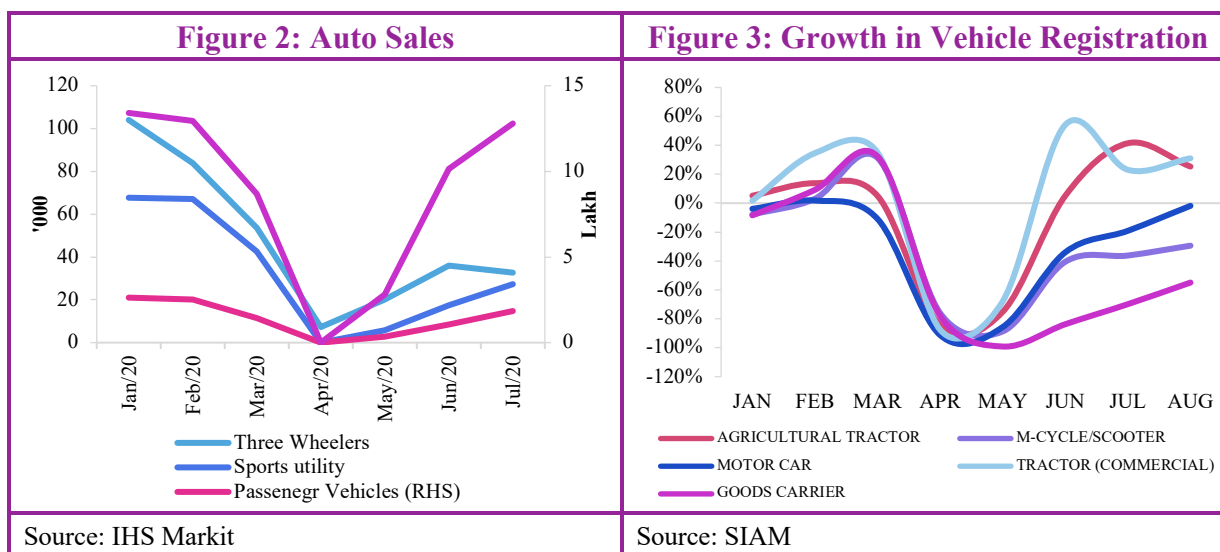
4. Estimates released by the Ministry of Statistics and Programme Implementation showed that India's Gross Domestic Product (GDP) growth rate had contracted by 23.9% for the April to June quarter in FY 2020-21. In Gross Value Added (GVA) terms, the economy had contracted by 22.8%. On the demand side, private consumption spending fell by 26.7 per cent, enduring a severe behavioral shock with demand for discretionary items reducing to negligible levels. Investment demand also declined by 47.1 owing to the ensuing pandemic-induced uncertainty. This demand contraction was moderately offset primarily by higher and counter-cyclical government spending by 16.4 per cent. On the GVA side, the decline was broad-based with deepest fall of 50.3 per cent experienced in construction followed by services like trade, hotels, transport and communication, manufacturing and mining. Agriculture emerged as the bright spot, growing at a healthy 3.4 per cent.

## Worst behind us, economy in Q2 witnessing a recovery

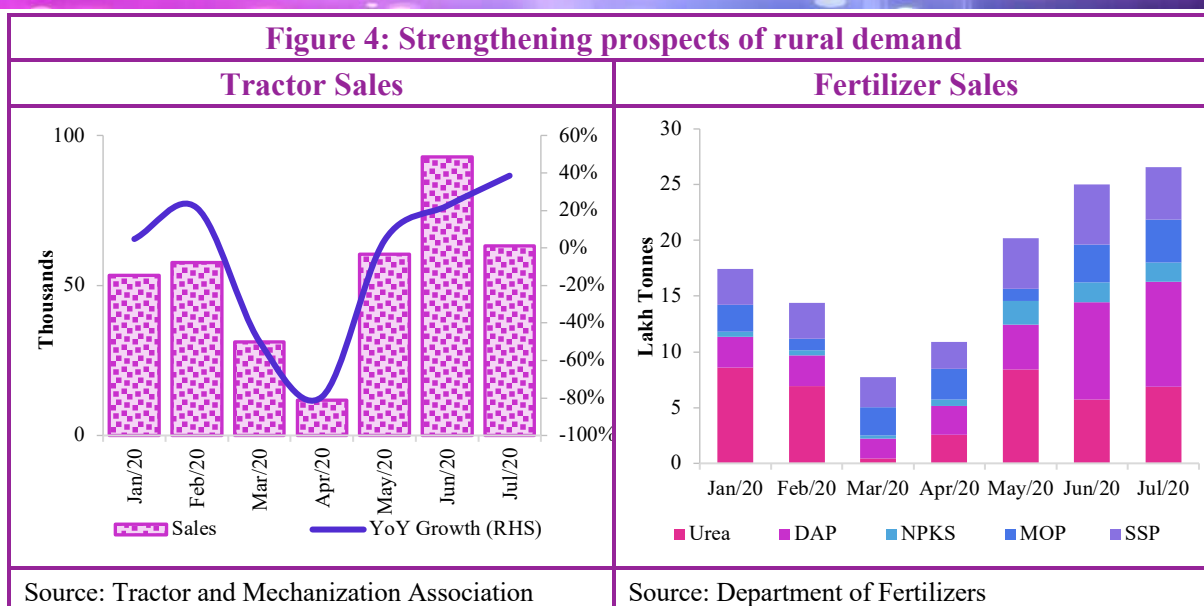
5. With India unlocking, the worst seems to be behind us as high-frequency indicators show an improvement, June onwards, from the unprecedented trough the economy had hit in the first quarter. Readings of economic data suggest growing convergence with previous year's activity levels on several indicators. Broad-based resurgent growth in several high frequency indicators such as PMI Manufacturing, eight core, E-way bills, Kharif sowing, power consumption, railway freight, cargo traffic and passenger vehicle sales augurs well for prospects of growth recovery.

## Resurgence in rural demand

6. Passenger vehicles sales grew to the highest levels in July since March, inching very close to previous year levels. Growth in sales of small cars, two-wheelers and sports utility vehicles offer early signs of revival in rural demand and tentative urban demand (Figure 2). Rising sales of fertilizers and registrations for commercial and agricultural tractors from March to August also are further indicative of strengthening rural demand (Figures 3 and 4).

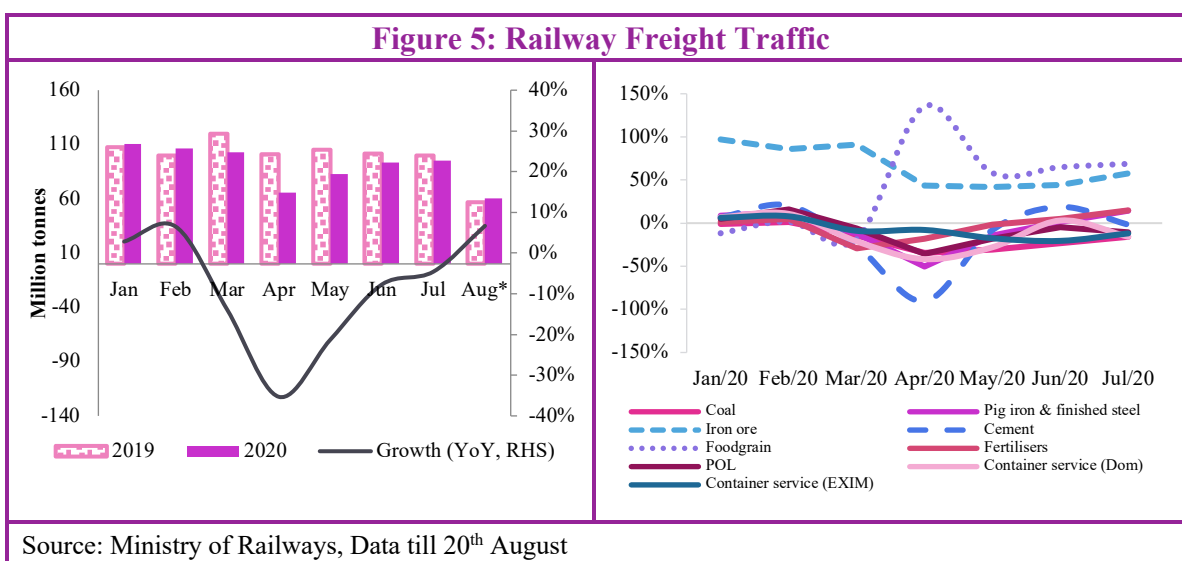






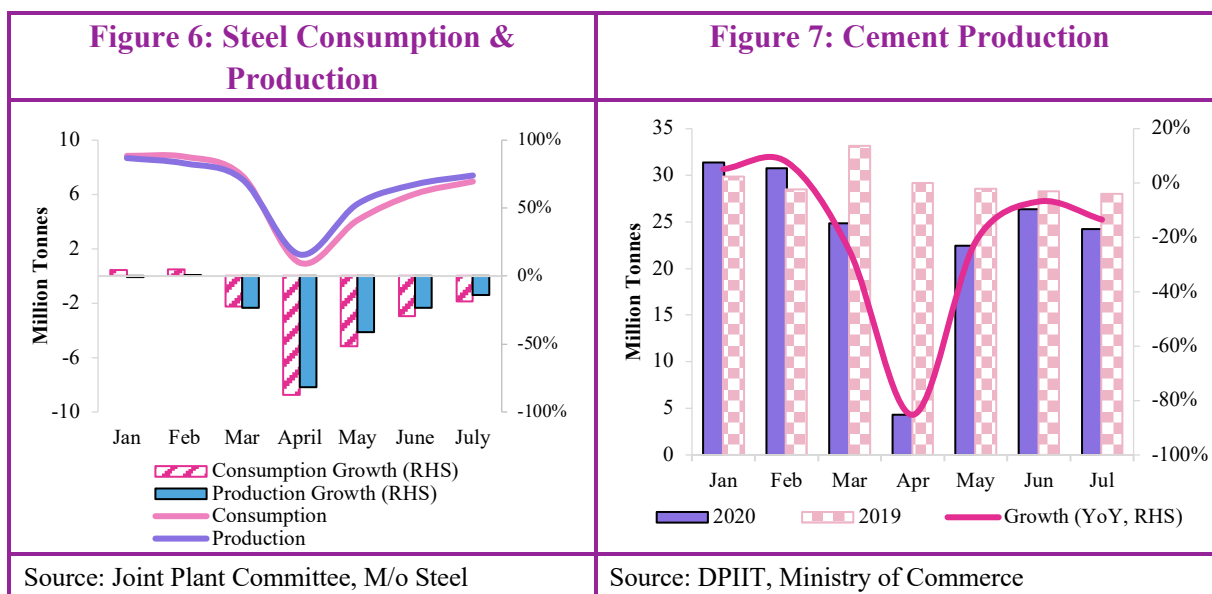
### *Rail freight on an upward trajectory*

7. Momentum in railway freight traffic continued as it inched closer to previous year levels in July (Figure 5). The recovery was driven by movement of steel, iron ore export, coal, foodgrains, fertilizers and EXIM container services. Cement, petroleum products (POL) and domestic container services, however, witnessed decline in growth in the month. August also saw a sustained growth with provisional railway freight volume crossing previous year levels in the first twenty days of the month. Railway passenger bookings picked up in July and August, particularly in the Northern zone and sub-urban regions of Central and Western zones.



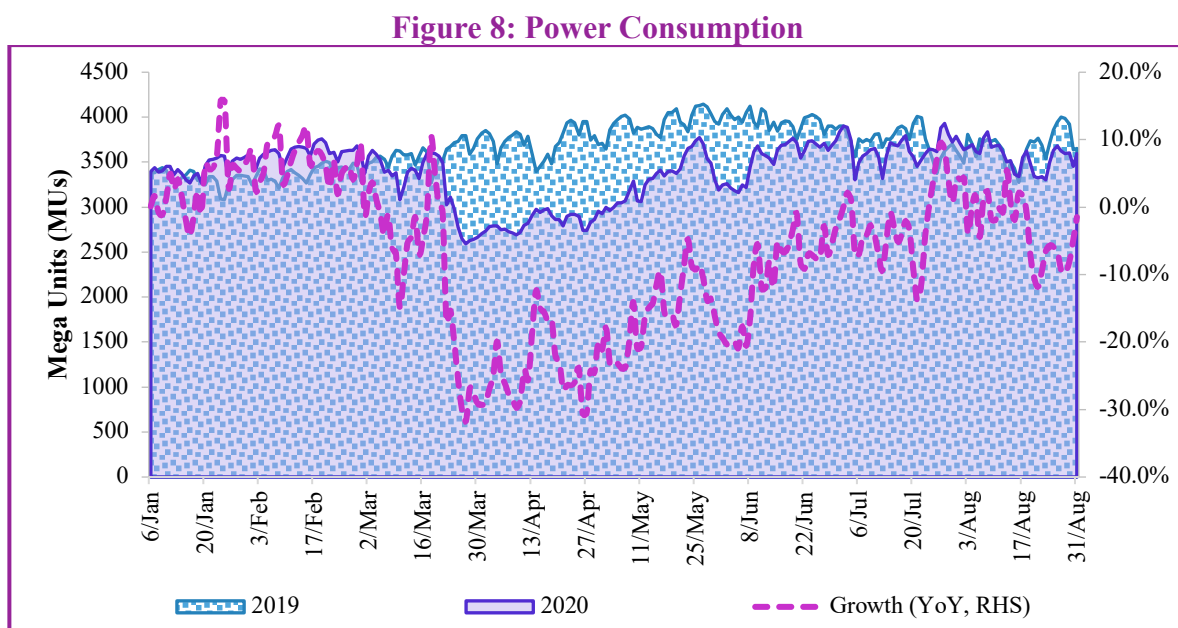
### *V-shaped recovery in steel sector, uptick in construction activity*

8. Indian steel sector demonstrated a V-shaped recovery in July from its April lows with domestic production and consumption gaining strong pace (Figure 6). Construction activity also picked up in June with cement production erasing most of the sharp contraction in April (Figure 7).



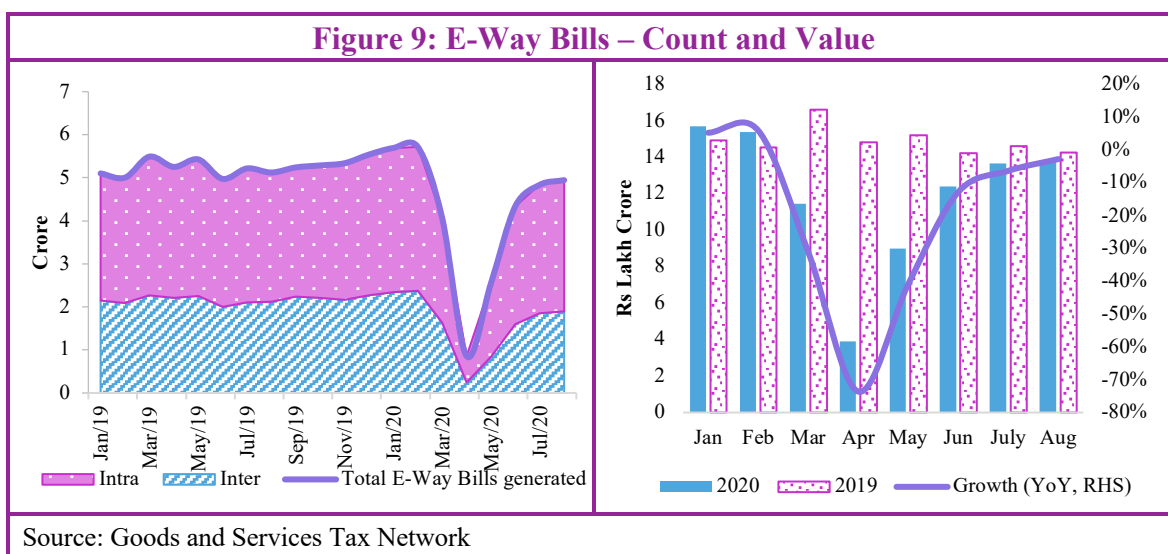
### *Power consumption, E-way bills and highway toll collections reverting to baseline*

9. Power consumption appears to be quickly reverting to the last year's baseline reaching 97 per cent of corresponding previous year levels in August 2020 (Figure 8).

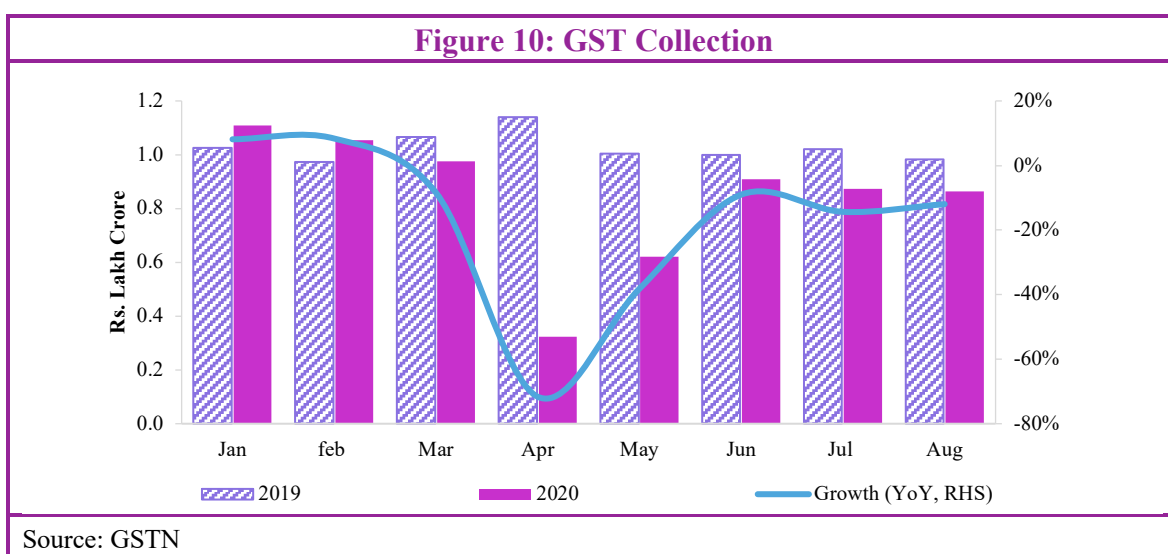




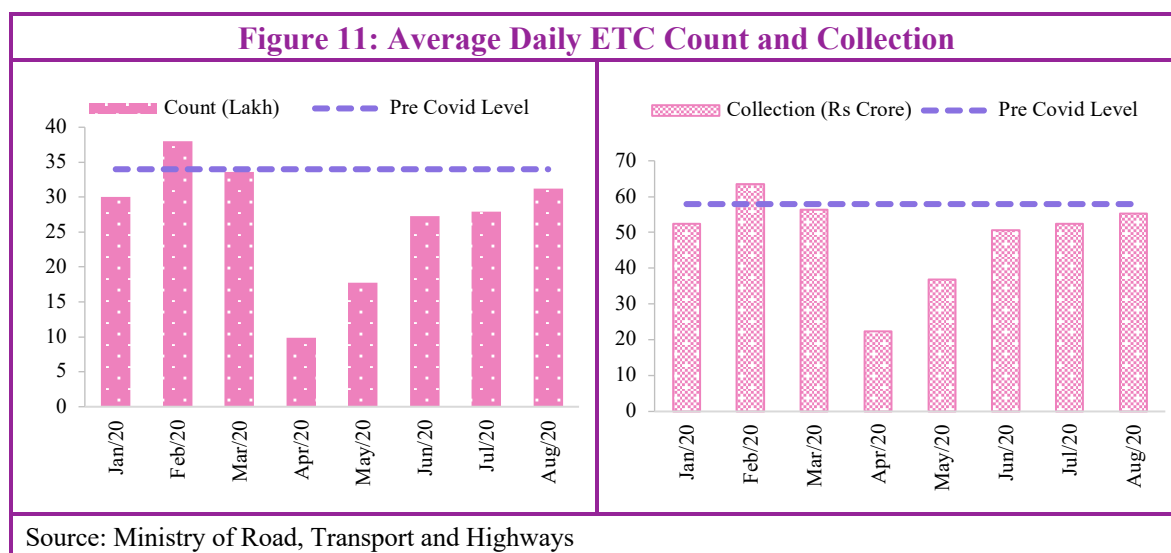
10. Sustained impetus in E-way bills generated, a strong leading indicator of revenue collections, supply chain corrections and logistics growth, augurs well for regaining economic normalcy. In terms of value, e-way bills generated reached Rs. 13.8 lakh crore in August, reaching 97.2 per cent of corresponding month of the previous year. Number of e-way bills generated also reached 96.5 per cent of previous year levels with intra-state e-way bills crossing last year's count and inter-state e-way bills at 89.5 per cent of the same (Figure 9).



11. The growth outlook has improved with YoY contraction in GST collections declining from 38.0 per cent in May 2020 to 11.9 per cent in August 2020 (Figure 10). GST collections stood at Rs 86,449 crore during August 2020, 88 per cent of the figure of the same month last year.

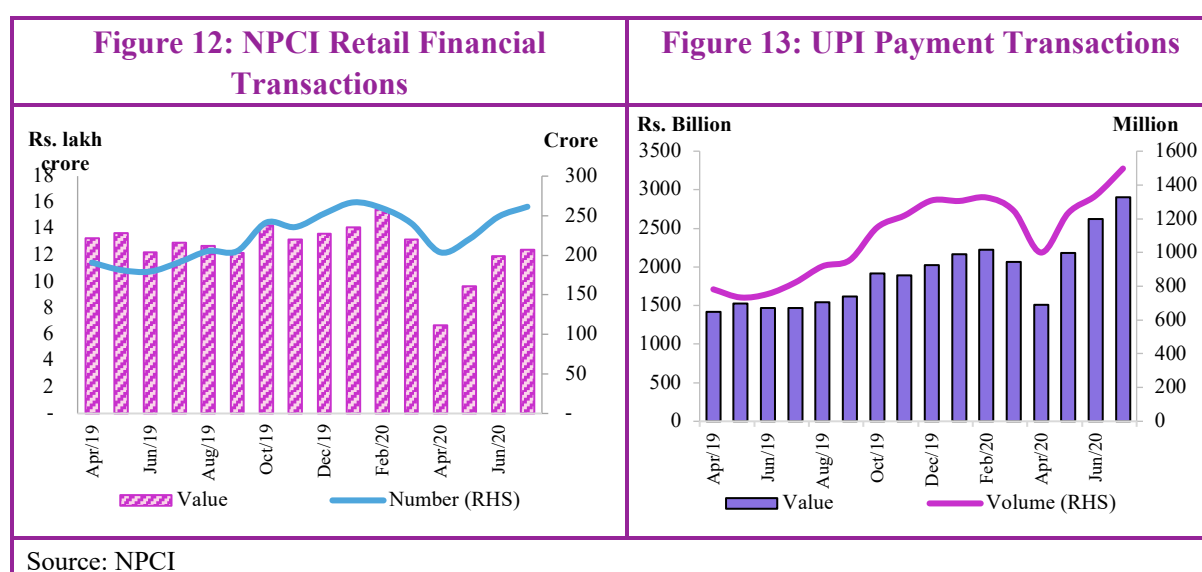


12. Toll collections on highways have also picked up significant pace in the last three months, reaching 85 per cent of pre-Covid (February) levels in August. However, the re-imposition of local lockdowns and flood situations in some states interrupted the recovery in first half of July (Figure 11).



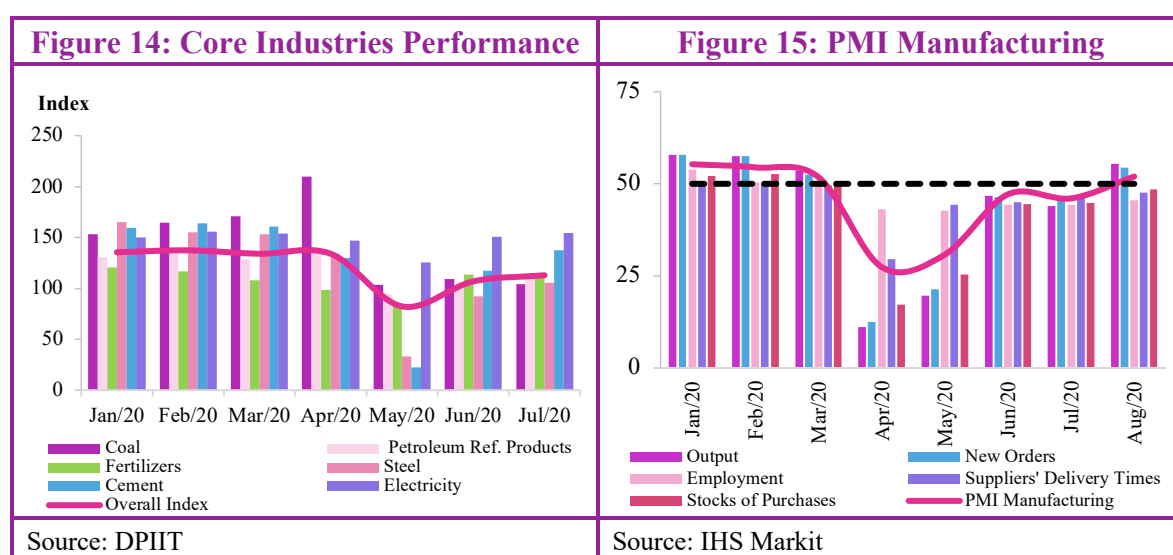
*Upbeat digital retail transactions and broadband services growth, UPI payments at new highs*

13. Retail payment transactions via NPCI platforms rebounded sharply in June and July, after the dip during the lockdown months of April and May, signalling a larger shift towards online payments amid the pandemic (Figure 12). UPI payment transactions hit an all-time high of Rs. 2.9 lakh crore in value and 149 crore in volume terms in July (Figure 13). Broadband subscriber base also grew in May after dipping in April.



### *Industrial production, the engine of growth, climbing up to recovery*

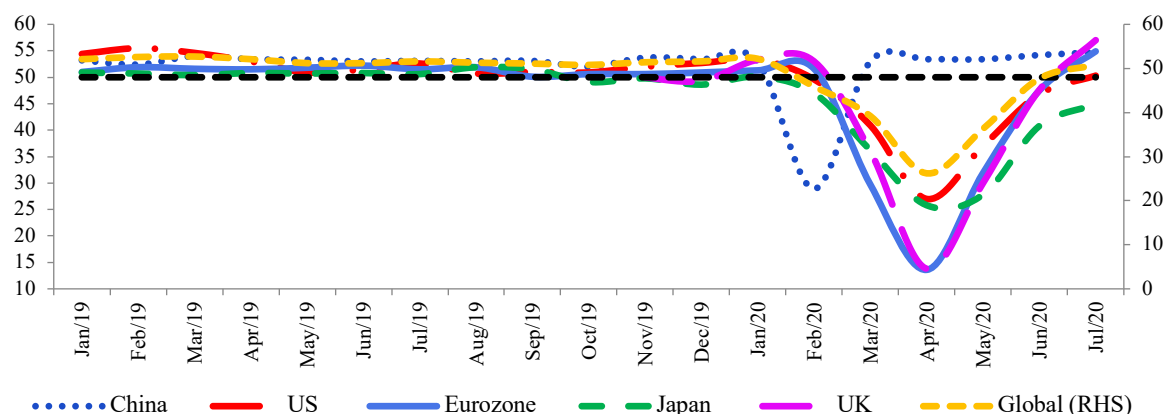
14. Industrial production saw a record decline of 38.1 per cent in Q1 2020-21 owing to the unprecedented blows of lockdown induced standstill during April and May. As India unlocked, industrial production witnessed an uptick in June, thereby softening the quarterly contraction. Consumer non-durables output sharply turned around to double digit growth likely driven by release of pent-up demand and rebuilding of inventories. Contraction in consumer durables, capital goods and infrastructure output also significantly eased. This trend got bolstered in July with contraction in core industries output easing to 9.6 percent in July relative to 12.9 per cent in June (Figure 14). Manufacturing purchasing managers' index (PMI), after marginally slipping in July, moved into expansionary zone in August for the first time since lockdown presenting optimistic recovery prospects for the manufacturing sector (Figure 15). Output and new orders expanded at the fastest pace since February.



15. This is in line with the recovery in global activity for the first time in six months (Figure 16). Global economy edged back into expansionary territory, as output and new orders both rose slightly during July. Global composite output index moved to a six-month high of 50.8 in July, up from 47.8 in June. Latest data on industrial activity complemented the recovery, as industrial production in US and China expanded further in July by 3.0 per cent (month on month basis) and 4.8 per cent (YoY basis) respectively. Additionally, business optimism recovered globally to its highest in the past 15 months during July, moving back to its pre-pandemic level. Global manufacturing index reached a twenty one-month high of 51.8 in August.



**Figure 16: Global PMI Composite Indices**

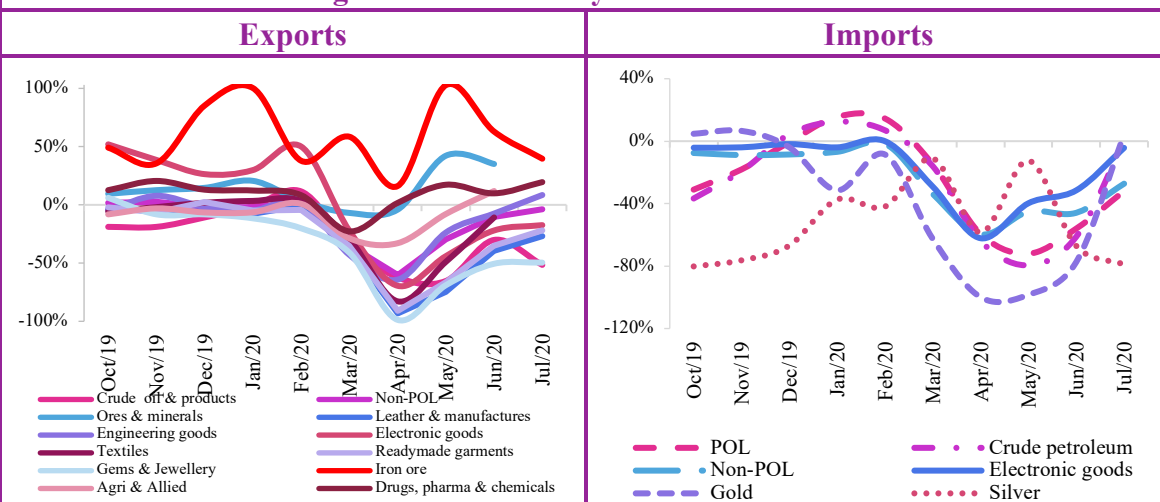


Source: IHS Markit

### *Exports recovering faster than imports*

16. India's external sector remains resilient. Merchandise exports witnessed broad-based rebound in the last three months, inching closer to pre-Covid levels in July. Exports of food items and pharmaceutical products showed healthy growth momentum in July owing to higher global demand of these essential products (Figure 17).

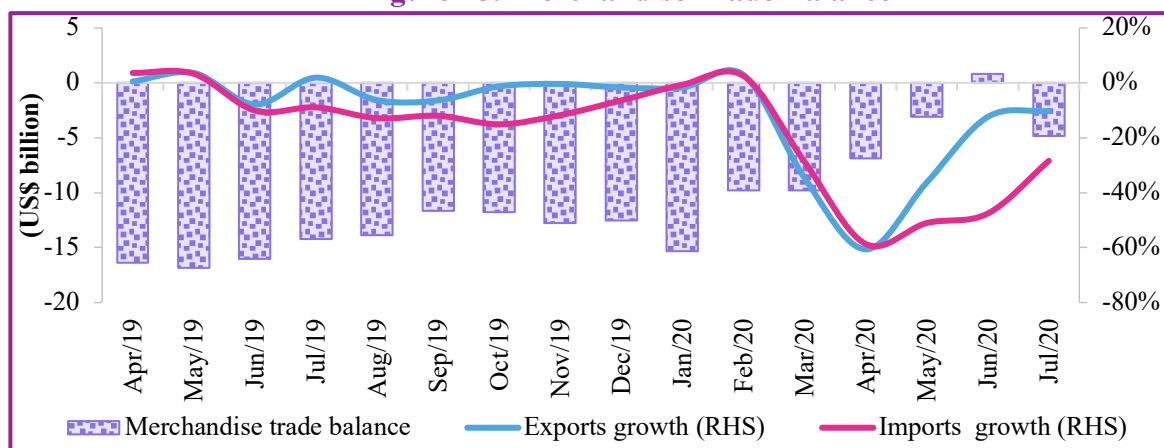
**Figure 17: Commodity Wise YoY Growth**



Source: Department of Commerce, Ministry of Commerce & Industry

17. Recovery in imports remained relatively muted and less uniform in July, suggestive of weak domestic demand for discretionary items. While crude oil and non-oil imports continued to show dispirited growth, gold imports sharply rose on rising investor demand for the safe-haven metal. As a result, India's merchandise trade balance went back into deficit in July after a surplus recorded in June (Figure 18).

**Figure 18: Merchandise Trade Balance**

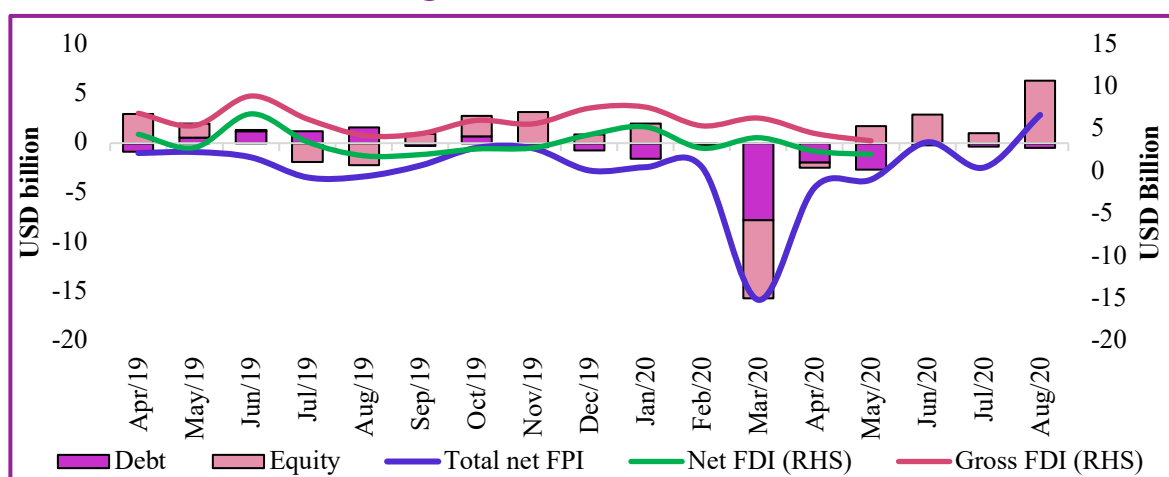


Source: Department of Commerce, Ministry of Commerce & Industry.

### *Robust FDI and FPIs at historic highs*

18. On the financing side, net foreign direct investment (FDI) moderated to US\$ 4.4 billion in April-May 2020 from US\$ 7.2 billion a year ago, though robust in a pandemic era. On the other hand, India garnered the highest foreign portfolio inflows in the first half of 2020 compared to its emerging market peers. This optimistic foreign investor sentiment continued in July and August buoyed by record capital raising by leading domestic firms and low global interest rates. In August, the selling spree in debt markets also reversed, further bolstering market confidence (Figure 19).

**Figure 19: FPI and FDI Flows**

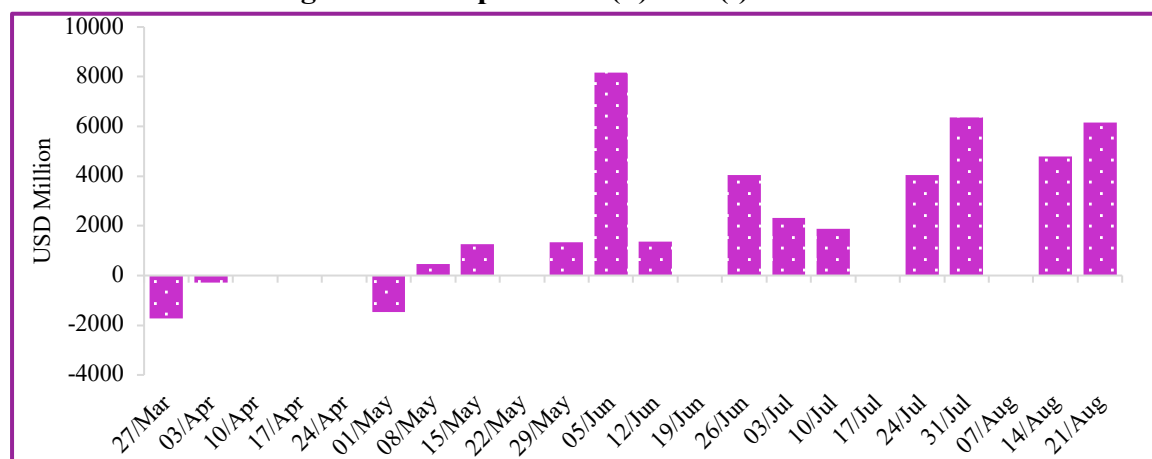


Source: CSDL & RBI

19. Owing to weakening global recovery and dollar index and rising foreign inflows, RBI actively intervened in forex market to prevent excess rupee appreciation and market volatility (Figure 20). Rupee remained range bound at the 74.5-75 INR/USD in the first

three weeks of August and appreciated in the last week to reach 73.59 INR/USD on 31<sup>st</sup> August, 2020. India's foreign exchange reserves continued to climb up to new highs on the back of purposeful dollar buying by RBI, rise in gold reserves and foreign currency assets. India's foreign exchange reserves have increased by US\$ 59 billion in 2020-21 so far (April-August) to US\$ 537.5 billion (as on August 21, 2020) – equivalent to more than 13 months of imports.

**Figure 20: Net purchase (+)/sale (-) of US dollar**



Source: RBI

20. The trend in macro-economic indicators elucidated above establishes that India is well on its path to a V-shaped recovery. Residual uncertainty persists because of the effect created by the pandemic on the precautionary motive to save which affects sharply the demand for discretionary goods and services. Unlike previous crises that originated from economic factors, the uncertainty in the current crisis stems from health factors originating from the pandemic. As a result, the uncertainty on discretionary items is likely to influence recovery. The arrival of the COVID vaccine would signal the end of this uncertainty and bring back discretionary consumption to pre-COVID levels.

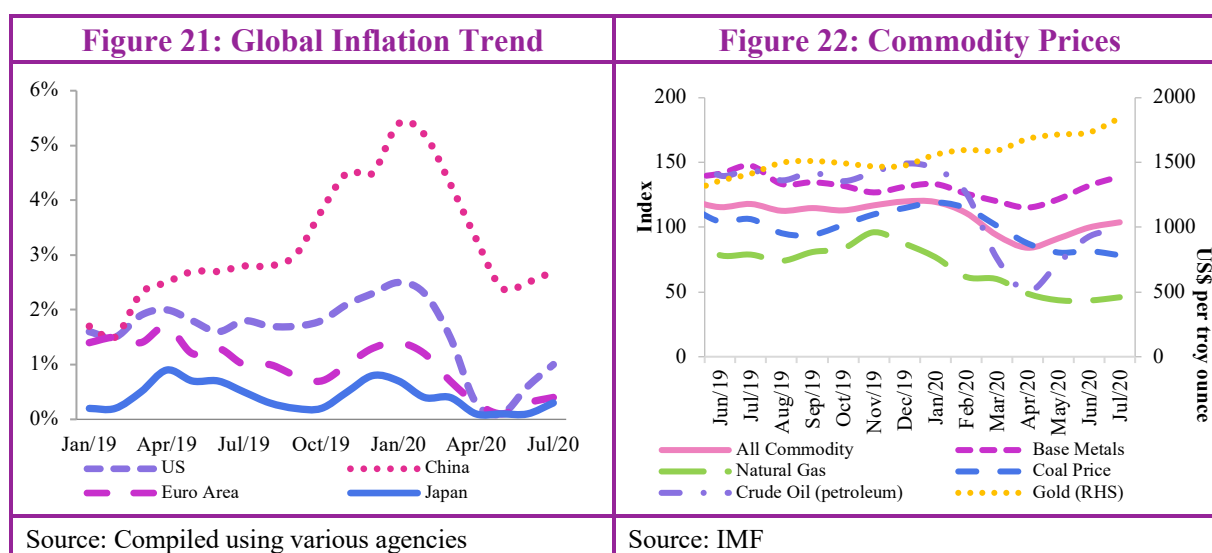
## Global Macro-economic overview

### *Inflation*

21. Consumer prices rose modestly in most part of the World since June along with core inflation, signalling petite recovery in demand conditions (Figure 21). PMI survey of July highlighted that input cost inflation accelerated to its fastest since January. Output charges rose for the first time in five months, reflecting higher selling prices at manufacturers and service providers. Prices in major economies remained elevated during July. Crude oil markets strengthened further in July compared to June with sustained demand from refiners and gradual improvement in consumption demand for oil products as more countries lifted

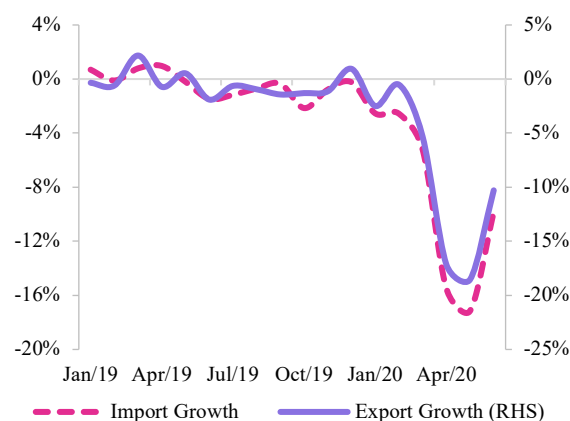


lockdown measures. Europe Brent prices increased moderately by 3.5 per cent in August to US\$ 44.7 per barrel from US\$ 43.2 per barrel in July. Australian coal prices declined by 6.1 per cent in July compared to previous month as pace of Chinese coal imports appeared to have slowed with increase in domestic coal production. The base metal price index rose by 5.3 per cent on month on month basis in July on improving prospects for global manufacturing, particularly for its largest consumer, China (Figure 22).

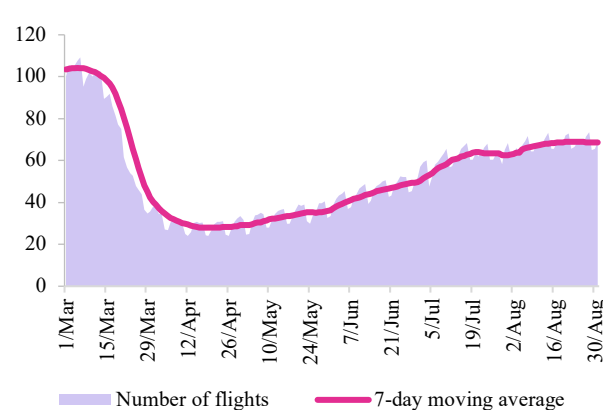


### *International trade on nascent recovery*

22. World trade in volume terms, decelerated by 14.8 per cent (YoY) during second quarter (Figure 23). Exports experienced greater decline than imports in volume terms with sharper dip in trade activity across regions of advanced economies like US, Euro area and emerging economies of Asia excluding China. International trade witnessed a nascent recovery in July as new export orders observed lowest rate of contraction since January, both in manufacturing and services sectors. Commercial flights, an indicator of trade activity, have been rebounding gradually since May and continued to improve further in August (Figure 24). The RWI/ISL container throughput index rose significantly in July, with improved handling capacity at ports especially outside China.

**Figure 23: International Trade Growth**

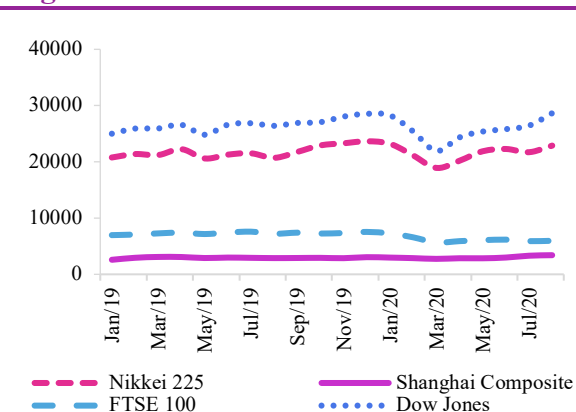
Source: CPB Bureau for Economic Policy Analysis

**Figure 24: Commercial Flight Activity**

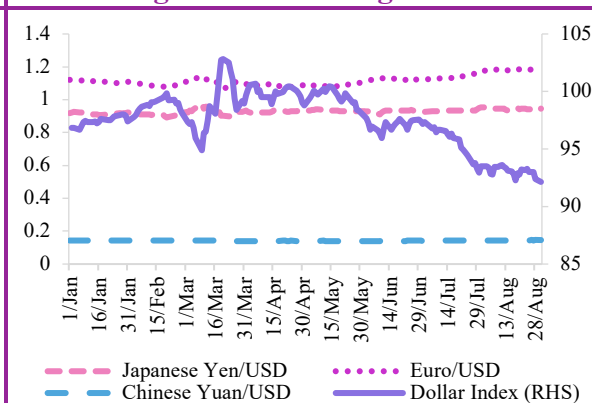
Source: Flightradar24

### *Financial markets rebounded in August after mixed results in July*

23. Global equity performance was mixed in July with a swift rebound in August as investors weighed the hopes of a vaccine and signs of sharp recovery in some regions against resurgence of the Coronavirus. US Dow Jones Index (DJI) gained by 2.4 per cent in July and further by 7.6 per cent in August supported by robust quarterly earnings from leading technology equities such as Amazon, Apple and Facebook despite unnerving economic data releases (Figure 25).

**Figure 25: Financial Market Performance**

Source: Compiled using various agencies

**Figure 26: Exchange Rates**

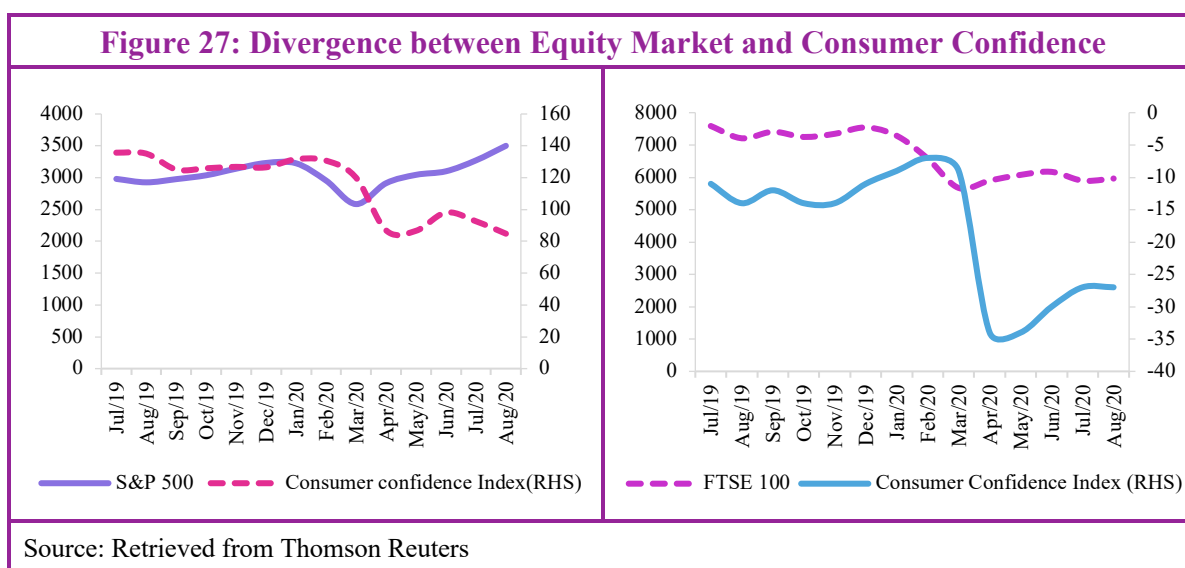
Source: Thomson Reuters

### *Exchange rates: US dollar weakens against major economies*

24. US dollar index has been weakening gradually since April. The US dollar index fell by 4.2 per cent in July, highest in a decade and depreciated further in August, albeit slowly (Figure 26). Major currencies such as the Euro, British Pound, Japanese Yen and Chinese Yuan were relatively stronger.

### *Risks to Global Economy*

25. Output recovery continues to face certain downside risks particularly, rising corporate and household debt at unsustainable levels in emerging markets. Another risk, in terms of probable asset price corrections, has emerged with a precarious divergence between market optimism and evolution of real economy (Figure 27). Equity markets have bounced back from their March troughs in the economies with systemically developed financial sectors. Market sentiment has been bolstered by the reopening of some economies and the easing of COVID-19 related lockdown measures. Fiscal and monetary policy support, in form of government credit guarantees, restructuring of loans, capital and liquidity buffers to support lending has further fuelled investor confidence. However, a rebound in global indices coexists with a decline in consumer confidence indices. This disconnect between markets and the real economy raises risks of asset price corrections should investor risk appetite fade. A number of triggers in terms of second wave of virus followed by potential containment measures or resurgence of trade tension could result in repricing of risk assets, adding to global financial stress.

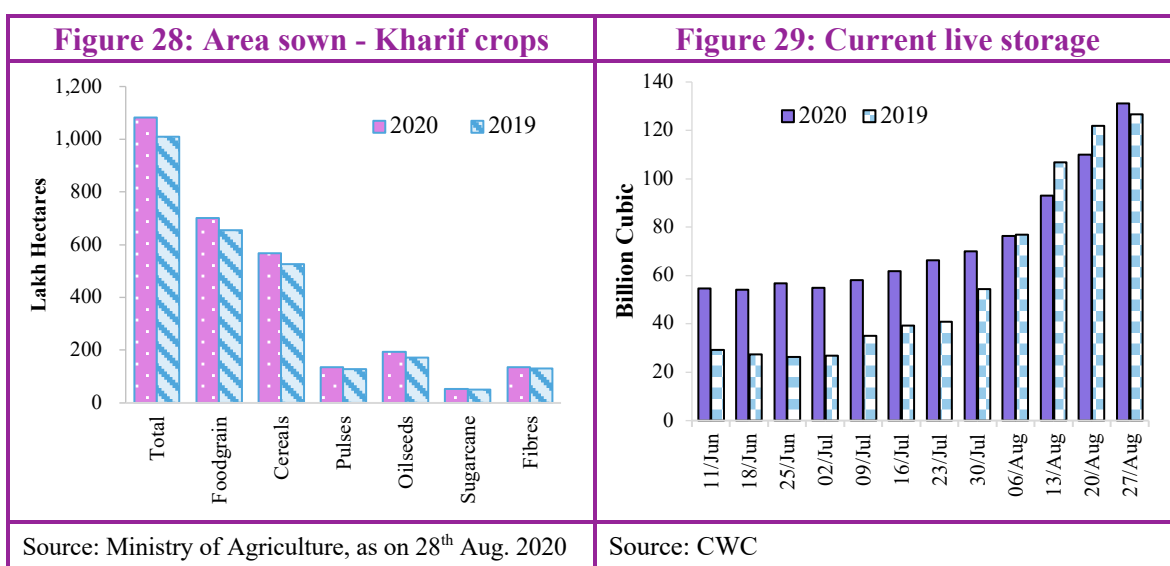


### **Domestic Macro-economic Review**

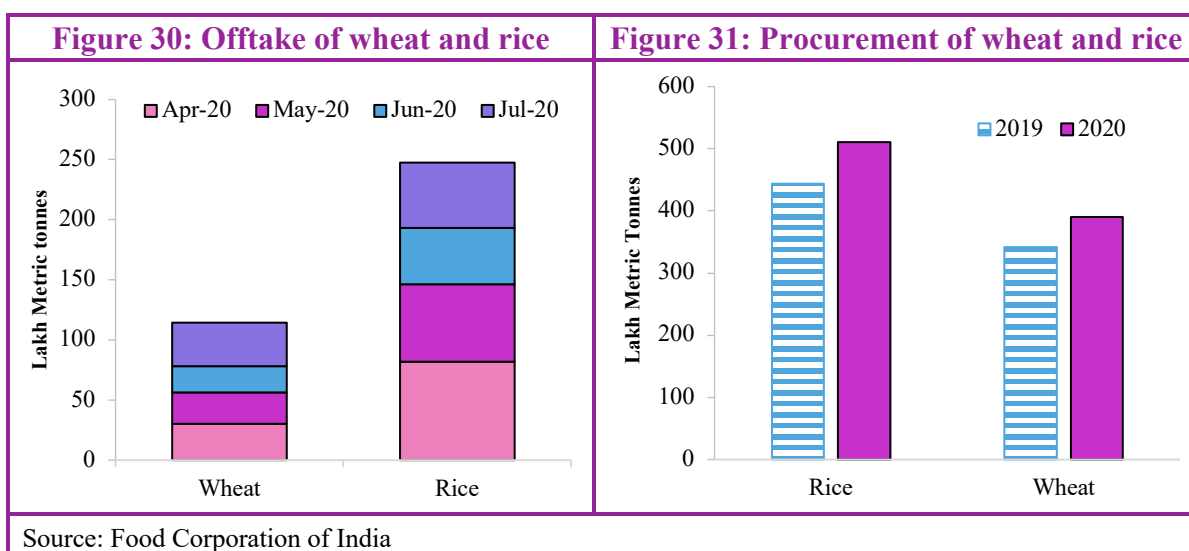
#### *Agricultural sector: the persistent bright spot*

26. The agricultural sector continues to remain a bright and resilient spot supported by a healthy south-west monsoon. The cumulative monsoon rainfall was 9.2 per cent above the long-period average (LPA) up to September 2, 2020. Record total area sown under kharif crops (Figure 28) and healthy live storage in major reservoirs bodes well for the rabi season (Figure 29). Kharif harvest in the third quarter contributes to almost one-third of the GVA in agriculture in India. A bumper kharif harvest will, therefore, provide the much needed boost to GDP in the year 2020-21.





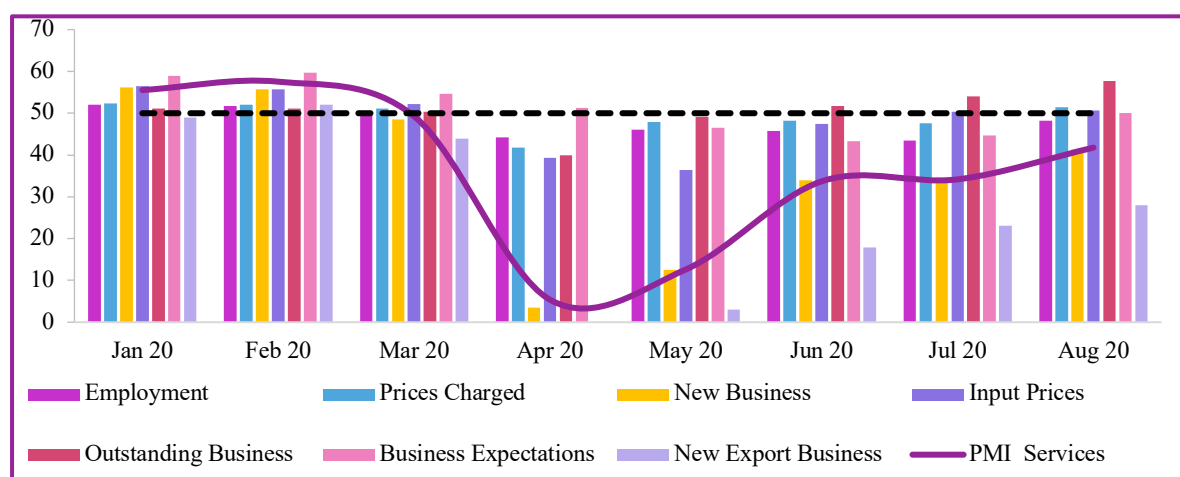
27. Amid COVID-19 induced supply chain disruptions, harvesting, procurement and off-take operations sustained their momentum in July with Food Corporation of India (FCI) and states playing an active part (Figures 30 and 31).



### *Modest resumption in services*

28. PMI services index marginally improved in August to 41.8 over 34.2 in July though still in contractionary zone (Figure 32). Movement of other high frequency indicators of services sector activity also suggest modest resumption of economic activity.

**Figure 32: PMI Services Performance**

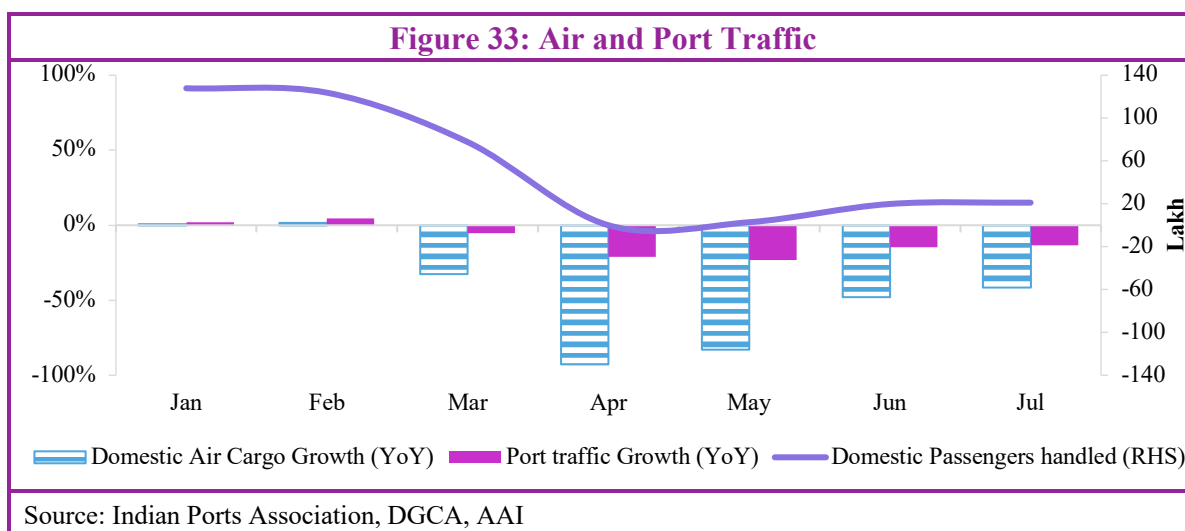


Source: IHS Markit

### *Cargo traffic on an upward trajectory, aviation activity catching up*

29. Cargo traffic volumes also rebounded appreciably in July with iron ore, fertilizers, coal (thermal and steel) and containerised cargo driving the improvement. However, POL traffic in both cargo and railway freight continued its sombre trends. Domestic civil aviation activity is also creeping up with the upcoming festive months expected to further boost growth (Figure 33).

**Figure 33: Air and Port Traffic**



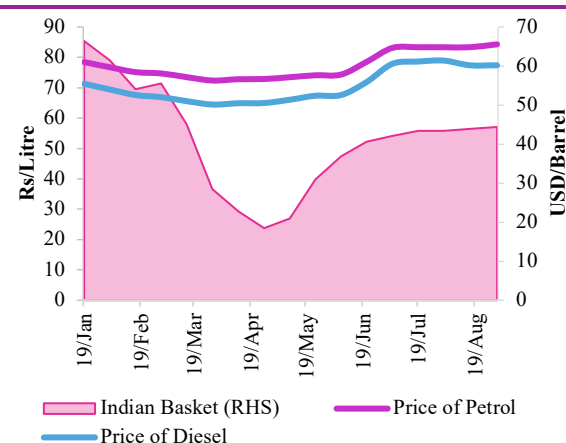
Source: Indian Ports Association, DGCA, AAI

### *Oscillating recovery in oil markets*

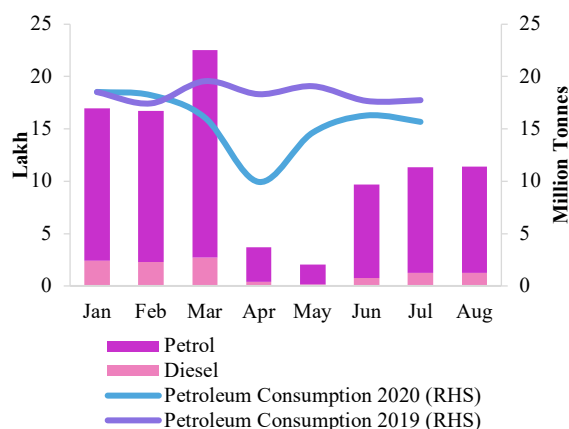
30. Global oil markets continued to remain vulnerable to risks of prolonged second wave of COVID-19 pandemic. Crude oil prices recovery remained volatile in August with easing OPEC+ supply cuts, dim demand and weather concerns in US markets. India's crude oil price rose only moderately from US\$ 42.98 per barrel as on 31 July to US\$ 44.41 per barrel as on 31 August (Figure 34). India's consumption of petroleum products dampened by 3.7

per cent in July compared to June partly due to seasonal factors such as greater reliance of agriculture on renewable sources of power during monsoon (Figure 35). Re-imposed lockdowns and floods also had a debilitating effect on diesel consumption.

**Figure 34: Crude oil & Fuel Prices in 2020**



**Figure 35: Consumption of petroleum products, diesel and petrol vehicle registrations**

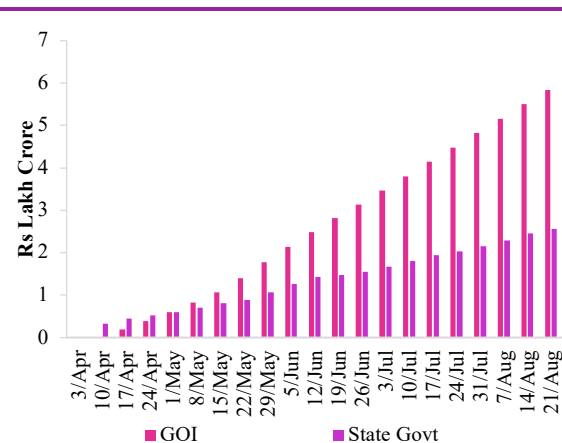


Source: PPAC, MoPNG

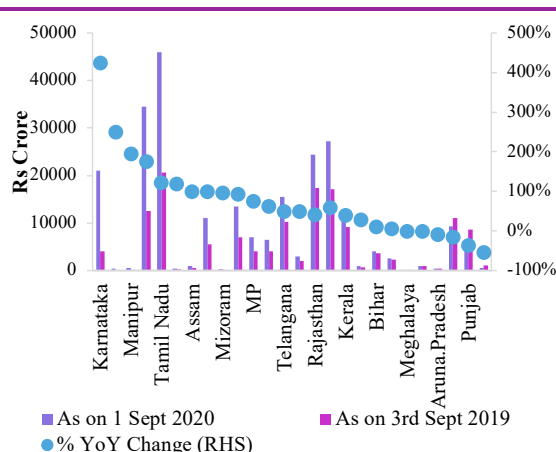
### *Government consumption demand providing necessary pandemic proofing*

31. Government consumption spending has provided a measure of relief, with central government's revenue expenditure, net of interest payments and major subsidies, having risen by 33.7 per cent in the first quarter of the year. Public finances have, however, been stretched by the imperative to mitigate the impact of COVID-19. Gross market borrowings by the Centre rose to Rs. 5.84 lakh crore upto 21 August, 2020, i.e. 1.72 times the amount raised in the last year. Gross borrowing of States has increased by 58.7 per cent year-on-year till 21 August with Karnataka, Maharashtra and Tamil Nadu among the top borrower states (Figures 36 and 37).

**Figure 36: Gross Market Borrowings- Centre & States**



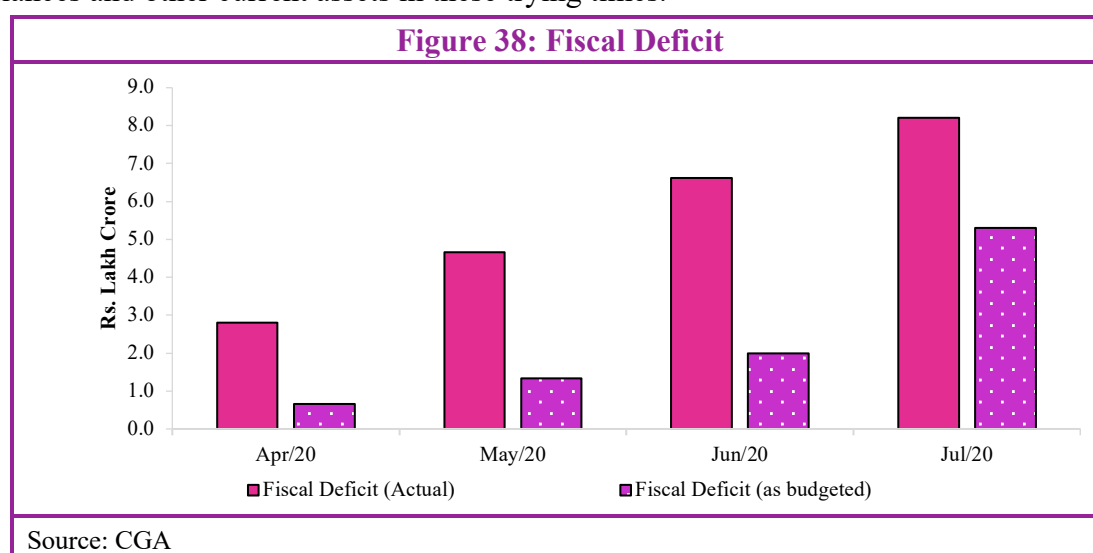
**Figure 37: State Borrowing- State wise**



Source: RBI



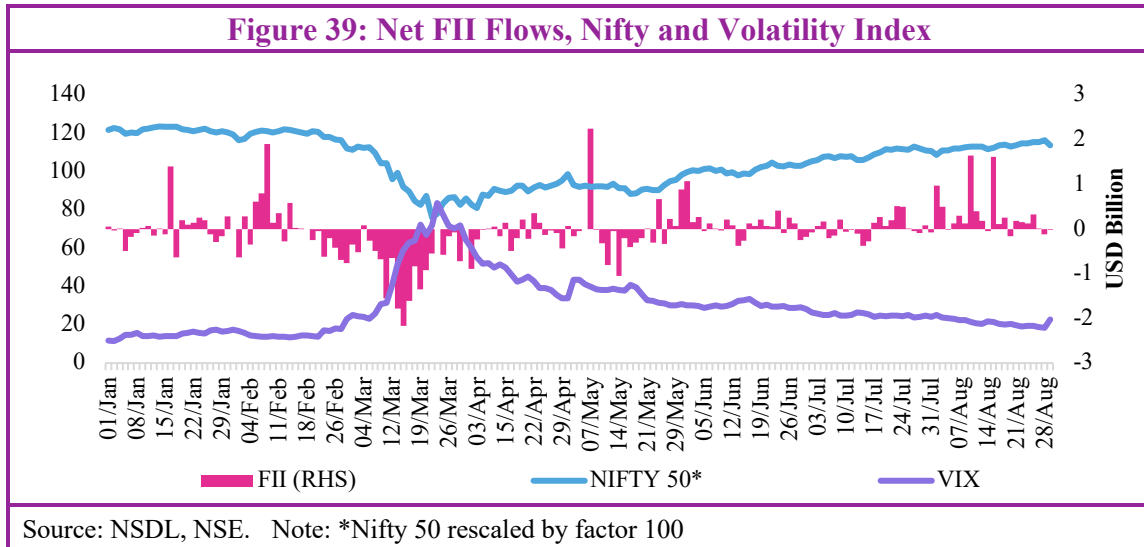
32. At the end of July 2020, fiscal deficit stood at Rs. 8.2 lakh crore which is 103.1 per cent of BE compared to 77.8 per cent during the first four months of fiscal year 2019 (Figure 38). The interruption in economic activity due to COVID-19 has led to shortfall in revenue collections. Net tax revenue collections stood at 12.4 per cent of BE compared to 20.5 per cent in the corresponding period of previous year. Personal Income Tax collections upto July end amounted to Rs. 0.91 lakh crore, compared to Rs. 1.29 lakh crore in the corresponding period of previous year. Non-debt capital receipts declined and stood at Rs. 5458 crore which is 2.4 per cent of BE compared to 14.2 per cent last year. On the expenditure side, capital expenditure stood at Rs. 1.12 lakh crore, 27.1 per cent of BE as compared to 31.8 per cent last year. Revenue expenditure was Rs. 9.42 lakh crore, 35.8 per cent of BE compared to 34.3 per cent in corresponding period of 2019-20. While the pandemic has constrained the fiscal envelope of the government, the corporate tax cut of September 2019 has provided necessary relief to businesses to service debt, build-up cash balances and other current assets in these trying times.



### *Risks of an apparent disconnect between the real and financial sector*

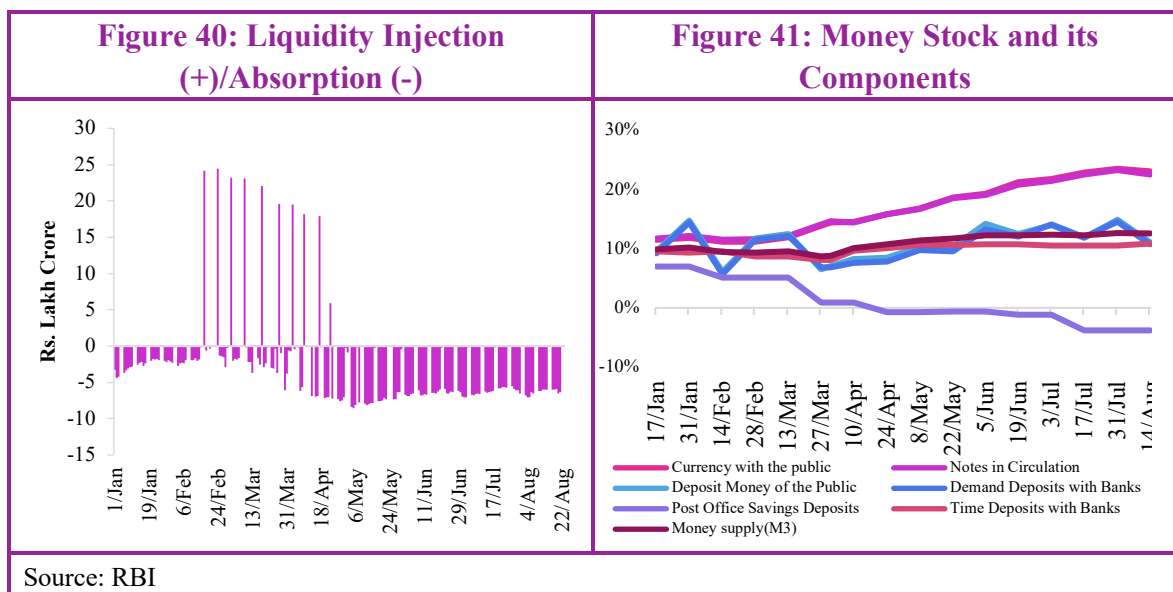
33. Risk taking sentiment has returned with global and domestic equity markets on an untamed recovery path, reaching pre-COVID highs and recouping most of their losses. The recent gush of liquidity in emerging markets is driven by low interest rates, unprecedented monetary priming by major global central banks and optimistic prospects of COVID-19 vaccine. Stock markets are deriving their inexplicable buoyancy from this global surplus liquidity. The Nifty VIX index, a leading indicator of market volatility, has also dropped sharply from the March highs signalling ebbing investor fears (Figure 39). This, however, raises concerns of an underlying disconnect between the real and financial sectors. Possible risks of disruptive market corrections may manifest in terms of capital flight, currency

volatility and ensuing worsening of balance-sheets of firms, posing negative macro-implications for global labour markets as well.



#### *Systemic liquidity continues to be in surplus*

34. With conventional and unconventional measures adopted by RBI, domestic financial conditions have eased substantially and systemic liquidity remains in large surplus (Figure 40). Cumulatively, these measures injected liquidity of the order of Rs. 9.57 lakh crore or 4.7 per cent of GDP. Reflecting these developments, reserve money increased by 14.7 per cent on a year-on-year basis (as on Aug 21, 2020), driven by a surge in currency demand (23.5 per cent). Growth in money supply (M3), however, was contained at 12.6 per cent as on August 14, 2020 (Figure 41).



*Precautionary demand for cash and time deposits continues to remain high*

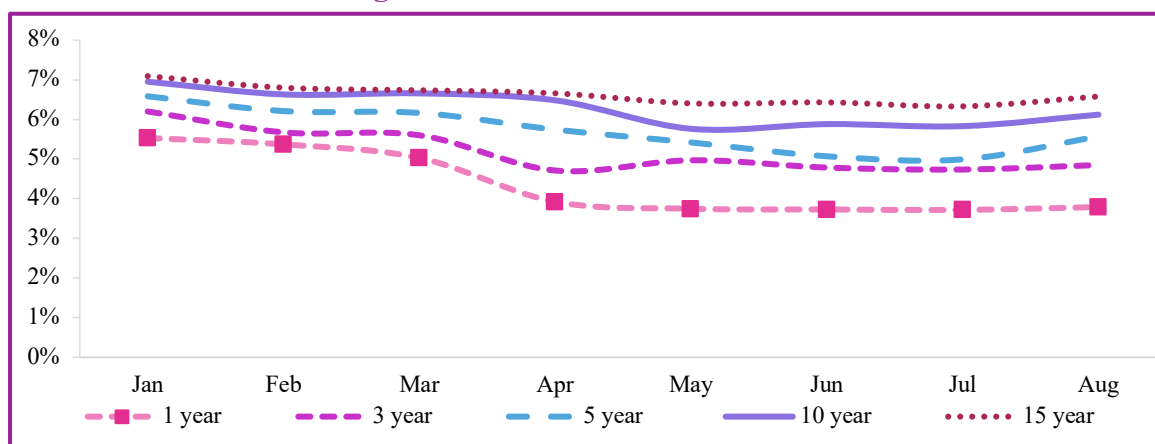
35. The resultant uncertainty from COVID-19 led to a sharp surge in precautionary demand for currency and concomitant drawdown in demand deposits in the last quarter of FY 2019-20. Moderation in deposit growth signalled impact of reduction in interest rates and subdued deposit mobilisation. Resultantly, currency-GDP ratio increased from 11.3 per cent in 2018-19 to 12 per cent in 2019-20.

36. With the pandemic effects intensifying, year-in-year growth in cash demand continued to increase in 2020 with a slight moderation to 22.7 per cent as on August 14. This rise in currency-in-circulation is a global phenomenon, witnessed not only in emerging markets but also in advanced economies such as United States, Spain, Italy, Japan and France where the use of cash is limited. Demand deposit growth has been on a rise since May reaching a high of 14.6 per cent in the fortnight ending July 31 to subsequently decline to 10.8 per cent as on August 14. Time deposits have continuously risen possibly explaining the risk aversion of investors and switch to safer avenues.

*Bond yields soften, greater easing at the lower end of the yield curve, moderate uptick in late August*

37. With COVID-19 reorienting the global economy and government finances, bond yields have been fluctuating since the outbreak of the pandemic. The Indian bond market is no exception. As the pandemic started its rapid spread in March, investors sold off equities and other risk assets and sought refuge in the bond market. This led to a bond price rally since mid-April only to stabilize in July. RBI's response to the pandemic induced financial market volatility via unprecedented policy rate cuts and massive liquidity operations also supported the bond price rally. Consequently, 10 year benchmark bond yields, which climbed to a high of 6.86 percent in mid-April fell drastically to 5.96 percent in mid-August (Figure 42). Further, RBI's liquidity infusion through LTROs and TLTROs brought down short term interest rates, which led to steepening of the yield curve. RBI's Monetary Policy Committee (MPC) in its latest bi monthly meeting kept the policy rates unchanged, citing quickening inflationary pressures. This hint of pause in rate cuts until price pressures wane inevitably stirred the bond market with 10-year benchmark bond yields rising back to more than 6 percent in late August. However, RBI's announcement of OMO of government securities worth Rs. 20,000 crore to be conducted in two tranches on August 27 and September 3 are expected to soften bond yields.

Figure 42: G-sec Yields across tenors

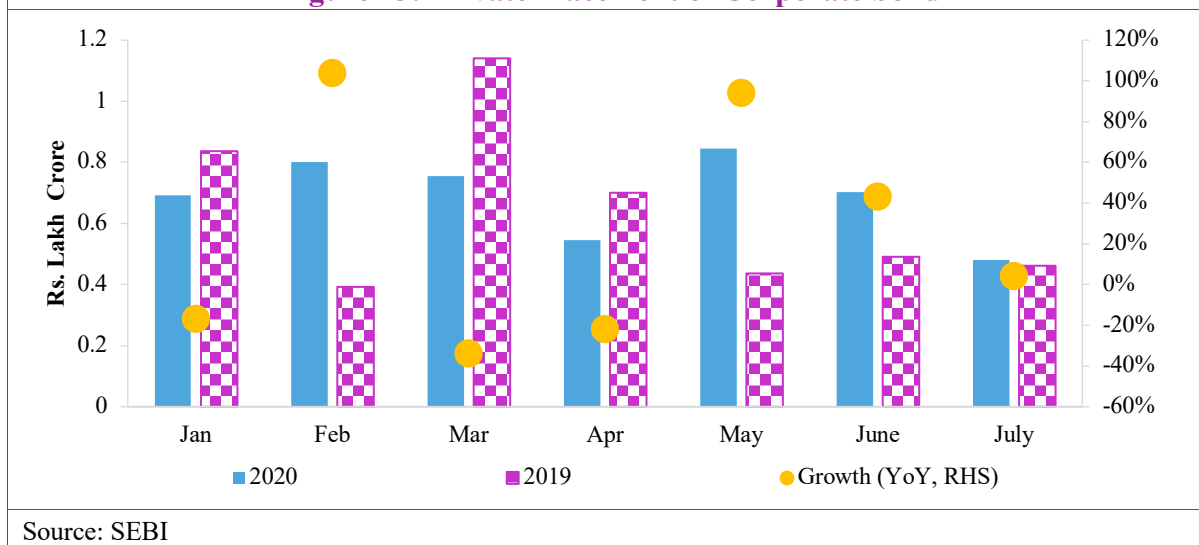


Source: FBIL & CCIL

#### Upbeat corporate bond market, credit spreads narrow down

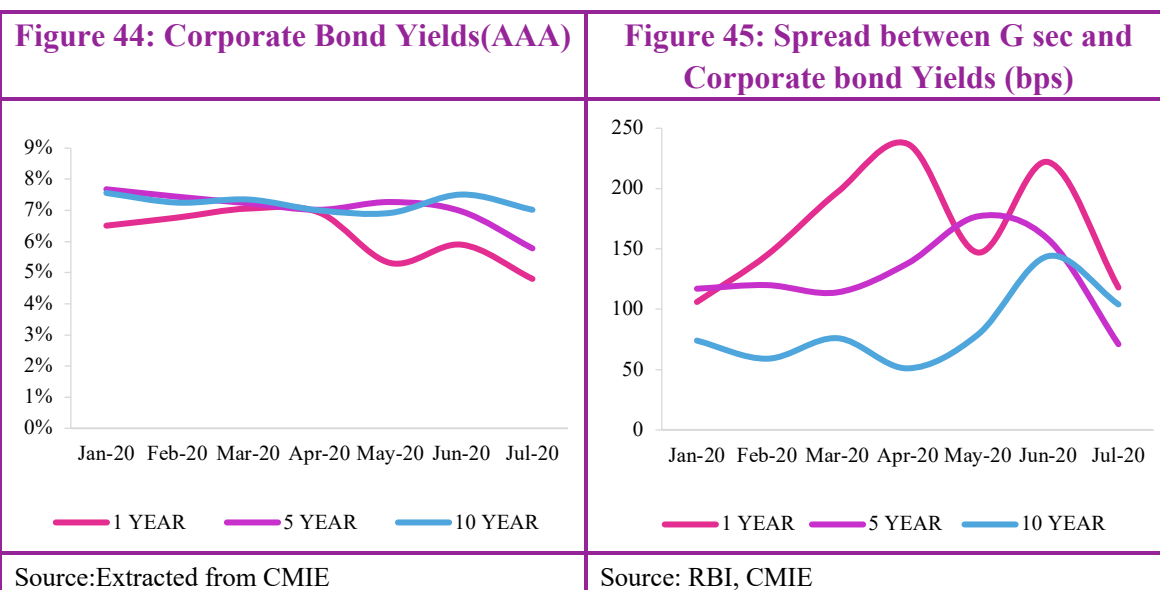
38. Borrowings costs on corporate bonds have significantly eased to fifteen year lows after record global and domestic stimulus measures to mitigate COVID-19's financial fall out. Renewed interest has emerged in this market with 91 maiden corporate bond issuers so far this year (Figure 43). These developments bode well for deepening of the corporate bond market and providing more choices for investors. At the same time, this optimism is also driven by the current liquidity flush into emerging bond markets. With illiquidity premia dissipating under the impact of Operation Twist and TLTRO 1.0, spreads of 3-year AAA-rated corporate bonds over similar tenor government securities have also declined from 246 basis points at end-April to 55 basis points in end-August (Figures 44 and 45).

Figure 43: Private Placement of Corporate bond



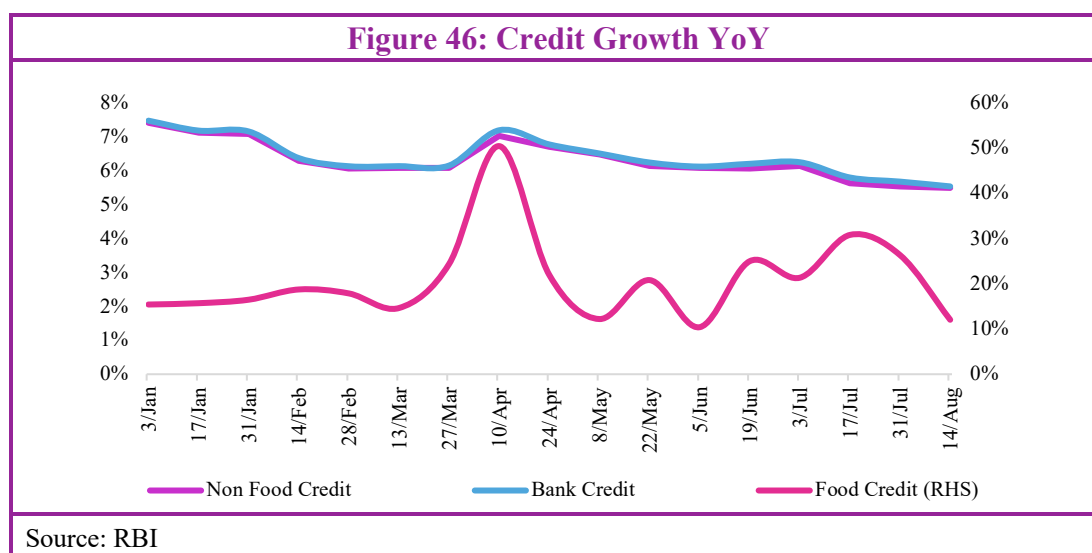
Source: SEBI





*While overall credit growth continues to remain muted, credit for agriculture, large industry and Micro & Small Enterprises (MSE) improve, services credit growth robust*

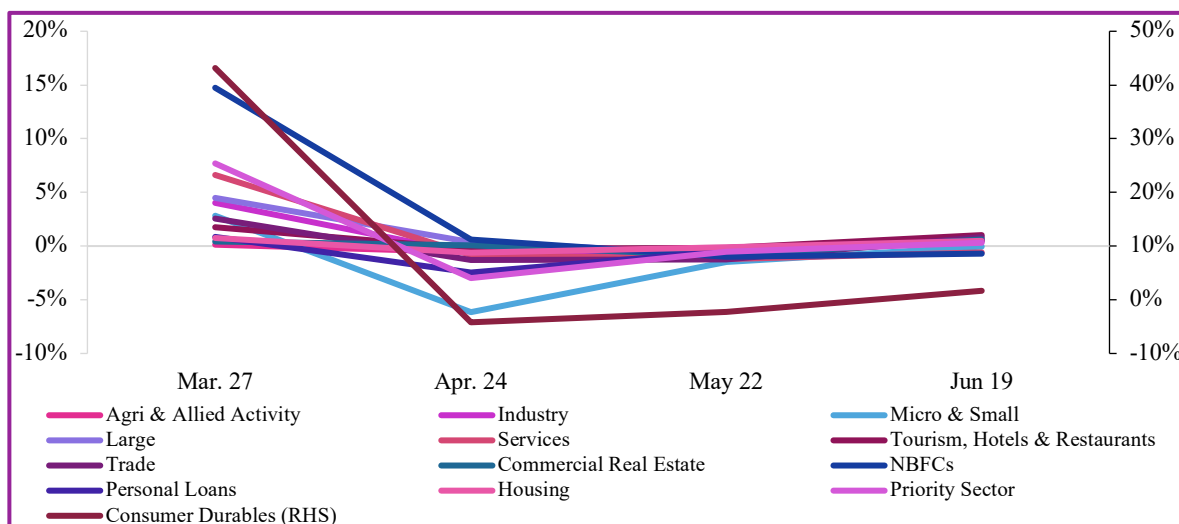
39. Credit offtake from banks was muted during FY 2019-20, growing at 6.1 per cent y-o-y in a sharp loss of pace from 13.3 per cent a year ago (Figure 46). Bank credit growth continued to moderate in the first five months of this year at 5.5 per cent as on 14th August 2020 mirroring weak credit demand and increased risk aversion in the banking system. Further, regional lockdowns and the consequent slowing of economic cycle has added to weak credit off-take.



40. However, sector-wise credit has improved month-on-month in June compared to April and May, particularly for agriculture and allied-activities, large industries and MSEs. Credit to services sector continued to grow at a robust 10.7 per cent YoY in June inching closer to

previous year levels with month-on-month recovery seen in real estate, NBFCs, trade and tourism. Personal loans and housing loans in particular, also picked up in June, auguring well for consumption sentiment (Figure 47).

**Figure 47: Sector wise Credit Growth**

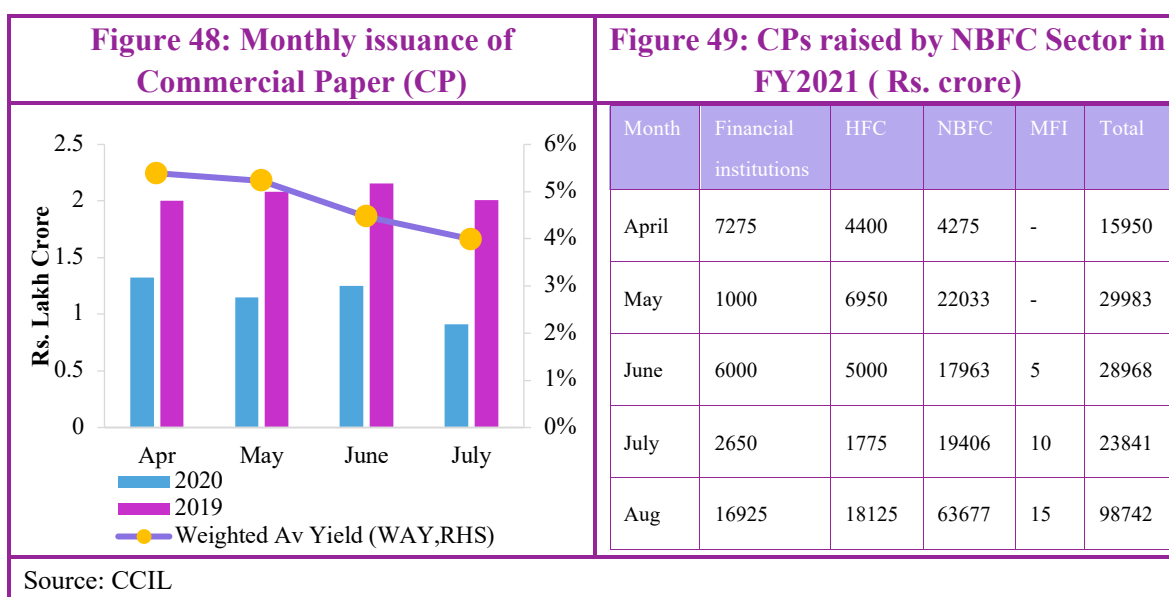


Source: RBI

41. The overall uptick in MSME credit in June may be attributed to the Emergency Credit Line Guarantee Scheme announced in May under the 20 lakh crore Atma-Nirbhar package of the Government. As on 12 August, 32.8 per cent of the committed amount under the scheme has been disbursed in 22.7 lakh MSME loan accounts. 55.4 per cent of the disbursement came from 12 public sector banks and the remaining from 24 private banks and 31 NBFCs.

#### *Improving monetary policy transmission, increasing Commercial Paper (CP) issuances for NBFCs*

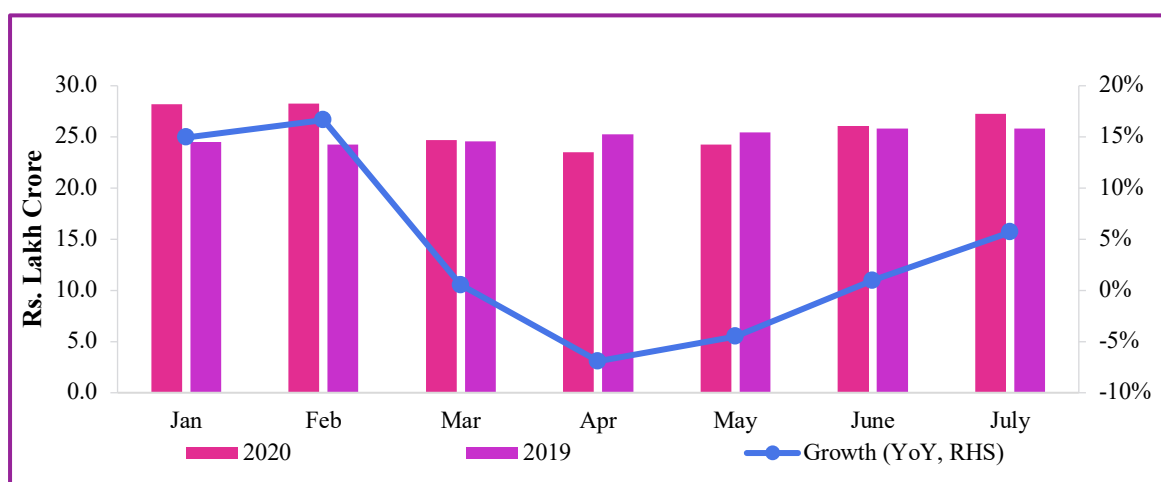
42. Strong liquidity interventions via LAF route by RBI have enabled improved monetary policy transmission. Interest rates on instruments like the 3-month Treasury bill, CP and certificates of deposit have fully priced in the reduction in the policy rate and are, in fact, trading below it in the secondary market. Commercial paper issuances in FY 2020-21 are at an all-time high (Figure 48). Effective weighted average yield of CPs has decreased from 5.39 per cent in April to 3.99 per cent in July. Oil and gas and NBFC sector dominated the CP issuance market with more than 50 per cent share. Market financing conditions for NBFCs, which had become challenging, have largely stabilised in the wake of targeted policy measures (Figure 49). CPs yield of NBFCs has softened to reach 3.80 per cent as on July 31, 2020.



### *Mutual funds recover from Franklin Templeton shock*

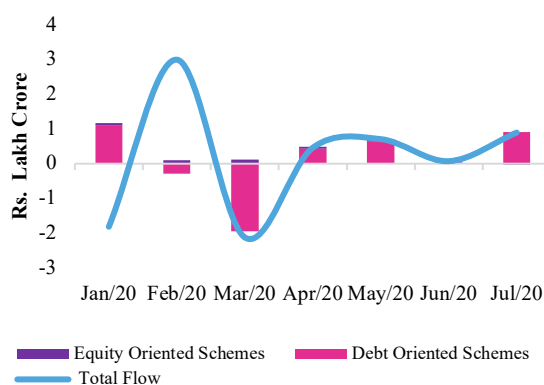
43. Abundant liquidity has supported other segments of financial markets too. In particular, mutual funds have recovered from the shocks of the Franklin Templeton episode. Assets under management of mutual funds rose by Rs. 89,812.78 crore to Rs. 27.11 lakh crore in July over June (Figure 50). Net inflows into debt mutual funds have shown a healthy uptick in liquid funds, short duration funds, corporate bond funds, and banking and PSU funds demonstrating revival of market confidence (Figure 51 and 52). Equity mutual funds, however, witnessed an outflow for the first time in four years in July, possibly exhibiting profit-booking opportunities in over-valued stocks amid surging foreign equity inflows.

**Figure 50: Assets under Management of Mutual funds**



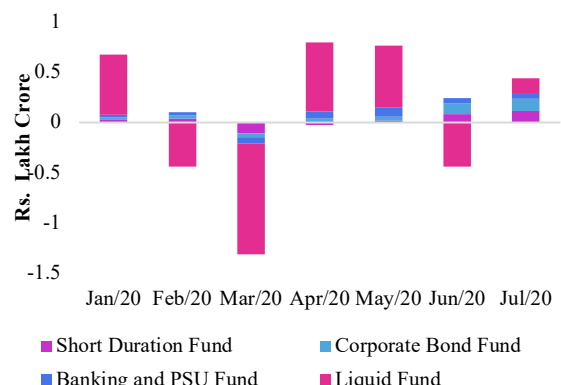
Source: SEBI

**Figure 51: Debt and Equity Mutual Funds**



Source: SEBI

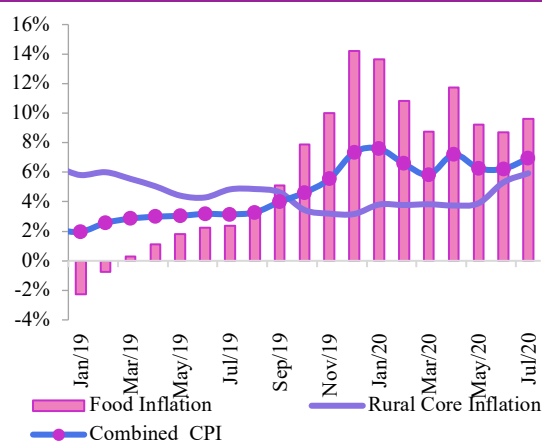
**Figure 52: Net inflows into debt mutual funds**



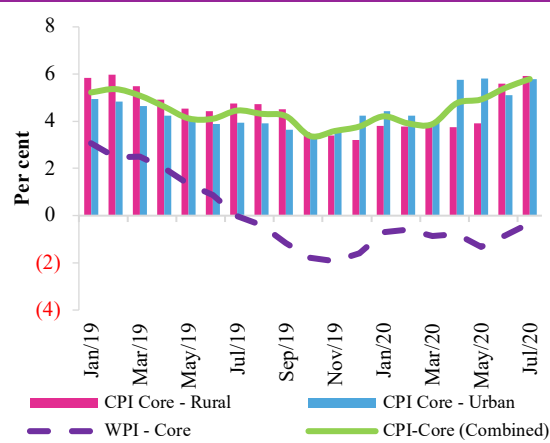
### Price pressures emerge amid monsoons and continued clogging of supply chains

44. India's retail inflation climbed up to 6.93 per cent in July against a revised 6.23 per cent in June with food prices, accounting for half of the CPI basket, dominating the rise (Figure 53). CPI core inflation also inched up to a 21 month high of about 5.79 percent, reflecting underlying price pressures. Persistent supply chain disruptions seem to have more than offset the impact of weak demand. Food cargo movement was restricted owing to re-instatement of lockdowns in many cities and heavy rains in agrarian states. While food inflation remained the dominant factor, rising transport costs due to higher domestic taxes on petroleum products also contributed to the inflationary trends. As per RBI's latest MPC statement, headline inflation is expected to remain elevated in Q2:2020-21, but likely to ease in H2:2020-21, aided by favourable base effects. A more favourable food inflation outlook may emerge in the coming months with bumper rabi harvest and improving food surplus management possibly easing prices of cereals. Price stabilisation in crude and retail fuels in August is also likely to ease incremental pressures on headline inflation.

**Figure 53: Inflation Dynamics**



Source: MoSPI

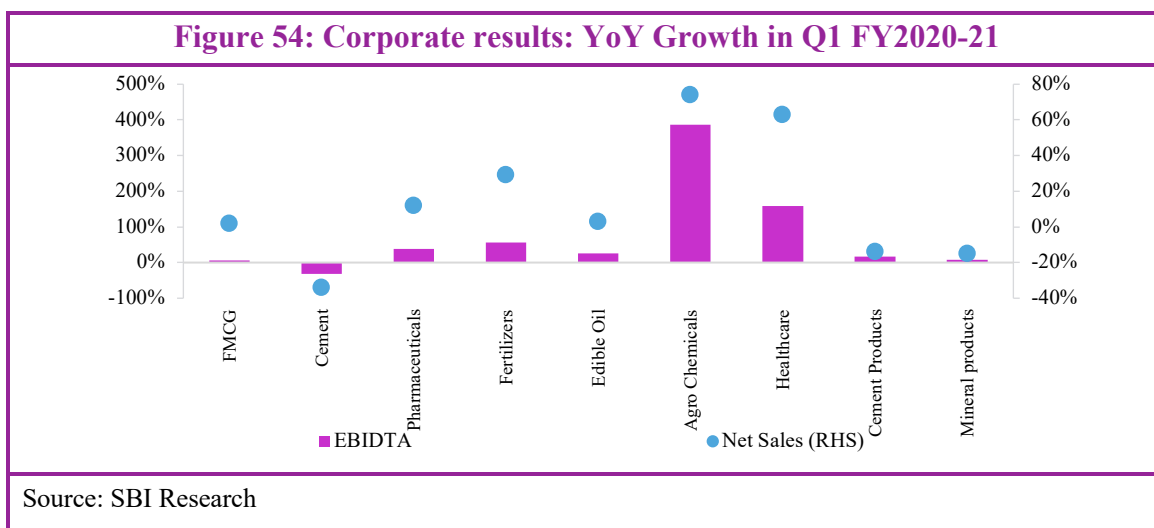


Source: MoSPI, Office of Economic Advisor

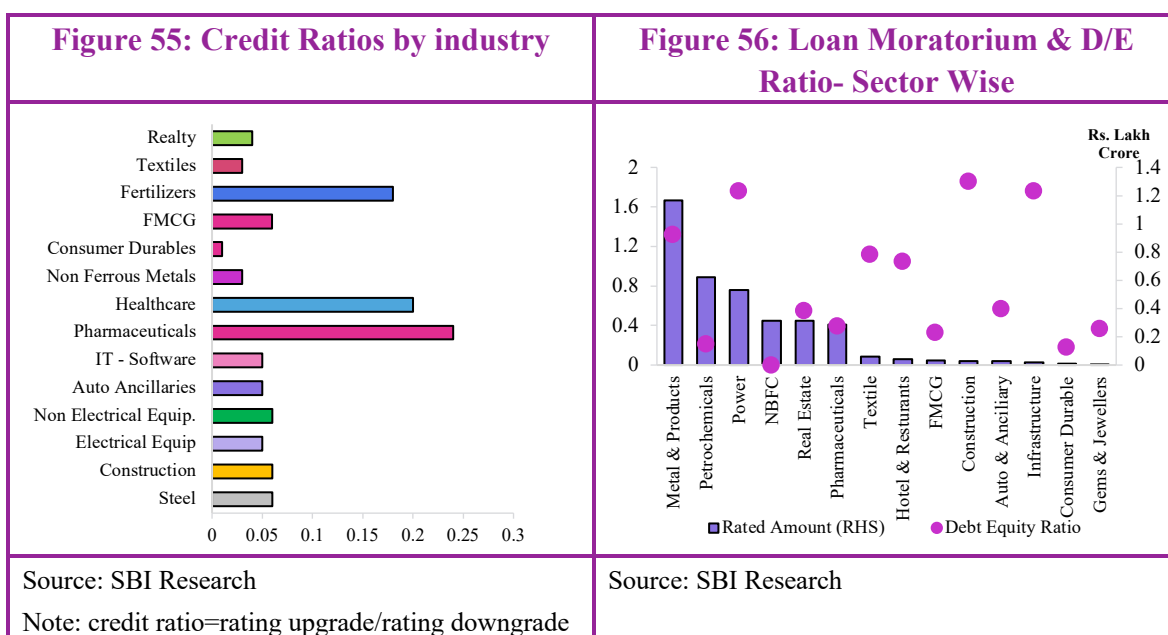


### Corporate results: Resilient and stressed sectors

45. Corporate results of Q1 2020-21 show that sectors like Pharma, FMCG and Fertilizers reported growth in revenue, operating profit and improvement in margins. Some sectors like Cement, Cement Products and Mining also reported margin improvement over Q1 2019-20, despite a decline in revenue (Figure 54).



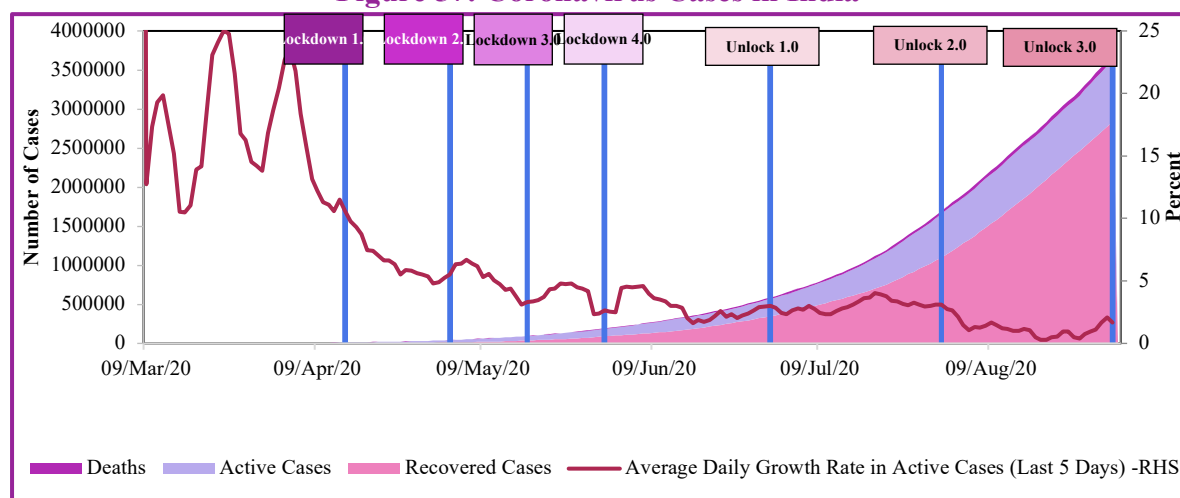
46. The ubiquitous impact of COVID-19 may be seen in the broad-based rating downgrades across sectors in Q1 2020-21. Major sectors that have opted for relief under moratorium on loan servicing include Metal, Power, Real Estate, Textile, Construction etc. However, all may not be under stress and some of the entities in the sectors such as Pharma, FMCG might have opted due to uncertainty and preference to conserve cash during these times.



## COVID-19 recoveries steadily increasing but new cases and subsequent sporadic state lockdowns pose risks to momentum of economic recovery

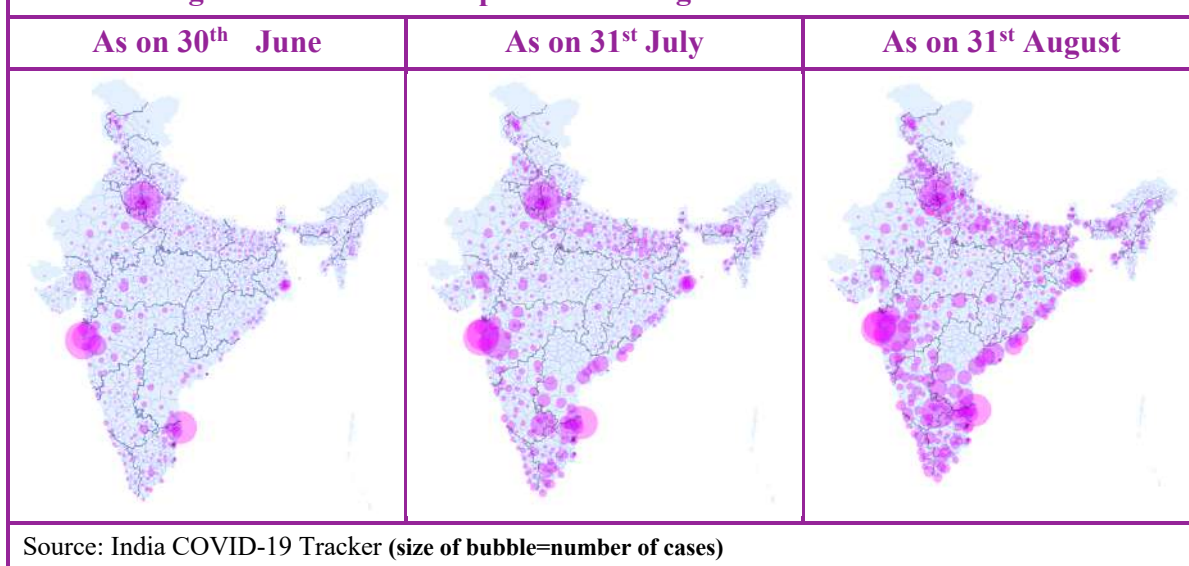
47. India reports the third highest number of active COVID cases after US and Brazil as on date. Growth in active cases fell to 1.65 per cent as on 31<sup>st</sup> August as compared to 3.12 per cent as on 31<sup>st</sup> July with the recovery rate at 77 per cent as on 2<sup>nd</sup> September (Figure 57).

**Figure 57: Coronavirus Cases in India**



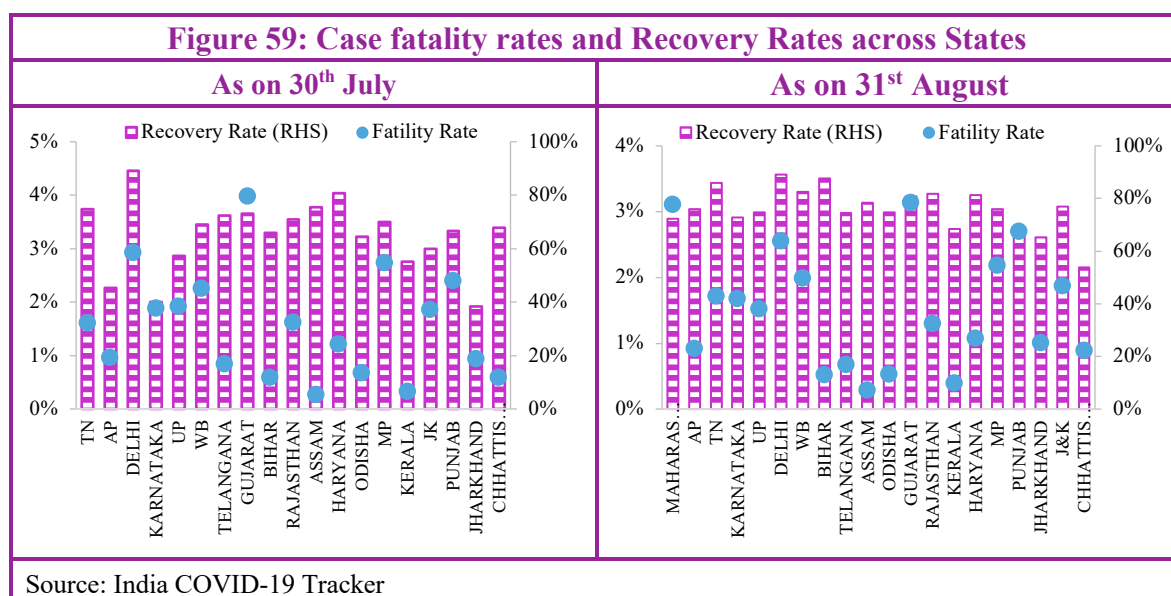
Source: India COVID-19 Tracker

**Figure 58: COVID-19 spread widening across States after unlock**



48. Recovery rates have improved across all top-20 states in terms of confirmed cases. While Delhi and Tamil Nadu reported recovery rate of more than 85 per cent, Tamil Nadu, Haryana, Gujarat, Rajasthan, Telangana, Madhya Pradesh and Uttar Pradesh reported

recovery rates greater than 75 per cent. Case fatality rate (CFR) also continued to decline with Maharashtra, Delhi, Gujarat and Punjab witnessing higher CFR than national average (Figure 59).



### Policy priorities as India unlocks

49. The world after COVID-19 will look significantly different with structural changes in production, consumption and work patterns. As India emerges from this crisis, it will be critical to re-orient the policy matrix towards a calibrated reconstruction of the economy and to build resilience in an uncertain world.

### *Enhancing resilience of India's agriculture, building efficient and sustainable agrarian supply chains*

50. Agriculture has emerged as a resilient silver lining in the current scenario. Policy priority towards building efficient and sustainable agrarian supply chains for a persistent increase in farmer incomes has got reinforced more than ever before. Such a dynamic shift towards promoting deregulation and liberalization of the agricultural sector is already underway with the Government announcing landmark reforms in this direction.

### *Deepening structural reforms in factor market and boosting infrastructure to reignite manufacturing*

51. The fundamental change in the world order also invokes realignment in the conventional perceptions on efficiency versus resilience of the manufacturing sector. Deep-seated and wide-ranging structural reforms in land, legal, labour and capital markets to reverse the slowdown in manufacturing and to boost risk appetite are pertinent in this regard. This warrants fast-tracking of the existing Government initiatives in the factor

market space. Government has also provided a necessary push to targeted mega infrastructure projects as part of the National Infrastructure Pipeline to reignite the manufacturing sector. The recent MSME related reforms to build an Atma Nirbhar Bharat hold great potential for transforming India's manufacturing trajectory.

***Leveraging ICT and startups for reconstructing a resilient and innovative services sector***

52. With COVID-19 necessitating business closures and pushing footfalls drastically below normal levels, the services sector continues to be the worst hit with demand for services plummeting across the globe. With the services sector being the biggest employer in the nation, building sufficient flexibility for service organizations for the duration of the pandemic response and beyond is paramount for India's eventual economic recovery. Leveraging India's ICT revolution and upscaling Digital India at an unrivalled pace is essential for lending much needed resilience to the service sector. Unlocking India's entrepreneurial energies as part of Capitalizing on India's 'Start-up India' efforts and holistic expansion of this ecosystem across all services sectors is key to unlocking entrepreneurial energies and quickening economic revival.

***Strengthening an AtmaNirbhar's Bharat position in global value chains***

53. To pivot and strengthen India's position in emerging global value chains amid changing trade dynamics, re-aligning policy incentives in favour of labour intensive export sectors is a pressing need. In addition, India needs to anchor its strengths in the area of generic drugs and pharmaceuticals exports and regain its market share in active pharmaceutical ingredients (APIs). Given the nature of the COVID-19 disease the world is fighting, inability of even one country to address the shortages of vaccine, will have huge negative externalities for the entire world. India can emerge as one of the forerunner in supporting easy, affordable and equitable access to the COVID-19 vaccine as and when it is available to administer.

***Harnessing digital finance to unleash the true potential of financial inclusion***

54. The digital payment infrastructure created as part of JAM trinity has enabled a timely and targeted fiscal relief response to the pandemic. Going forward, wide-spread deployment of online and offline digital payment acceptance infrastructure, particularly in remote areas, is key to unleashing the true potential of financial inclusion in an increasingly digitized post-covid world. In a world witnessing a paradigm shift in consumer behavior, expanding the digital retail space may emerge as a critical nudge to gradually regain the pre-COVID-19 consumption momentum.



### *Skilling, upskilling and re-skilling for preparedness against labour market shocks*

55. In the face of unprecedented pandemic induced job losses, the employer-employee relationship also demands structural changes. Moving away from fixed job roles, and engendering role flexibility in the workforce will enable businesses to better meet post-pandemic challenges. Skilling, upskilling and reskilling of the labour force is pre-eminent to enable it to be better-prepared and adaptive to the changing business environment.

### *Preventive health care ecosystem for resilience against tail-end events like COVID-19*

56. India's multipronged health response to the COVID-19 crisis ranging from social distancing to aggressive test-track-treat strategies has provided a necessary foundation for future disease preparedness. Relentless efforts towards building a preventive health care ecosystem will also provide the much needed stimulus to economic activity by creating more employment and mitigating labour productivity losses. This will help diminish the starkness of "lives vs livelihoods" dilemma that we face today.

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