Economic slowdown

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***Source**: The Hindu*

Manifest pedagogy India is facing a severe downturn with vehicle sales falling the most in 22 years. The government is trying to induce the economic system by introducing structural reforms. These reforms are important from UPSC perspective as part of broader group of second generation economic reforms.

In news: India is facing economic slowdown.

Placing it in syllabus: Indian economy and issues related to growth

Static dimensions:

- What is an economic slowdown
- Business cycle

Current dimensions:

- India growth figures
- Government measures so far
- RBI statements
- How to come out of slowdown (experts view)

Content:

Economic slowdown:

Economic slowdown can be cyclical or structural in nature.

- A **cyclical slowdown is a period of lean economic activity** that occurs at regular intervals.
- Such slowdowns last over the short-to-medium term, and are based on the changes in the business cycle.
- Generally, interim fiscal and monetary measures, temporary recapitalisation of credit markets, and need-

based regulatory changes are required to revive the economy.
- A **structural slowdown**, is a **more deep-rooted phenomenon that occurs due to a one-off shift from an existing paradigm.**
- The changes, which last over a long-term, are driven by disruptive technologies, changing demographics, and/or change in consumer behaviour.

At present, according to economic analysts, a **slowdown in consumption demand, decline in manufacturing, inability of the Insolvency and Bankruptcy Code (IBC) to resolve cases in a time-bound manner, and rising global trade tensions and its adverse impact on exports** are some of the factors affecting India's growth.

Private consumption, which contributes nearly 55-60 per cent to India's GDP has been slowing down. While the reduced income growth of households has reduced urban consumption, drought/near-drought conditions in three of the past five years coupled with the collapse of food prices has taken a heavy toll on rural consumption. Hence as per analysts, **India's economic condition is a case of structural slowdown.**

Experts have further attributed the slowdown in the consumption sector to change in the consumption pattern. Inclination towards Herbal and Ayurveda oriented personal care products, presently being made in the unorganised segments, which are not formally captured by the data, have also contributed to the slowdown.

Savings by household sector – which are used to extend loans for investment have gone down from 35 per cent (FY12) to 17.2 per cent (FY18). Gross Fixed Capital Formation (GFCF), too has declined from 34.3 per cent in 2011 to 28.8 per cent in 2018. Similarly, in the private sector, it has declined from 26.9 per cent in 2011 to 21.4 per cent in 2018. The household sector, which is the biggest contributor to the total capex in the economy has lost steam since demonetization.

The Reserve Bank of India (RBI) has highlighted a broad-based cyclical downturn in several sectors, including manufacturing, trade, hotels, transport, communication and broadcasting, construction, and agriculture, and has called for counter-cyclical actions in terms of monetary and fiscal policies, along with deep-seated reforms for the structural slowdown.

Business cycle:

A business cycle is a **cycle of fluctuations in the real Gross Domestic Product (GDP)** (which is inflation adjusted) around its long-term natural growth rate. It explains the expansion and contraction in economic activity that an economy experiences over time. A business cycle is completed when it goes through a single boom and a single contraction in sequence. A boom is characterized by a period of rapid economic growth whereas a period of relatively stagnated economic growth is a recession.

In the diagram above, the straight line in the middle is the steady growth line. The business cycle moves about the line.

–> **Expansion**

In this stage, there is an increase in positive economic indicators such as employment, income, output, wages, profits, demand, and supply of goods and services. Debtors are generally paying their debts on time, the velocity of the money supply is high, and investment is high. This process continues until economic conditions become favorable for expansion.

–> **Peak**

The economy then reaches a saturation point, or peak, which is the second stage of the business cycle. The maximum limit of growth is attained. The economic indicators do not grow further and are at their highest. Prices are at their peak. This stage marks a reversal in the trend of economic growth. Consumers tend to restructure their budget at this point.

—> **Recession**

The recession is the stage that follows the peak phase. The demand for goods and services starts declining rapidly and steadily in this phase. Producers do not notice the decrease in demand instantly and go on producing, which creates a situation of excess supply in the market. Prices tend to fall. All positive economic indicators such as income, output, wages, etc. consequently start to fall.

—> **Depression**

There is a commensurate rise in unemployment. The growth in the economy continues to decline, and as this falls below the steady growth line, the stage is called depression.

—> **Trough**

In the depression stage, the economy’s growth rate becomes negative. There is further decline until the prices of factors, as well as the demand and supply of goods and services, reach their lowest. The economy eventually reaches the trough. It is the negative saturation point for an economy. There is extensive depletion of national income and expenditure.

—> **Recovery**

In this phase, there is a turnaround from the trough and the economy starts recovering from the negative growth rate. Demand starts to pick up due to the lowest prices and consequently, supply starts reacting, too. The economy develops a positive attitude towards investment and employment and hence, production starts increasing. In this phase, depreciated capital is replaced by producers, leading to new investment in the production process.

Recovery continues until the economy returns to steady growth levels. It completes one full business cycle of boom and contraction. The extreme points are the peak and the trough.

India growth figures:

- Gross Domestic Product (GDP) grew 5% in the first quarter of FY20, data released by the government showed, marking the slowest growth since the fourth quarter of FY13. (It was 5.8% in the preceding one)
- Nominal GDP growth, a measure of GDP without adjusting for inflation, rose just 8%, the least in the current series of national accounts going back to FY12, indicating a deep slowdown.
- The slowdown in investment and consumer demand derailed manufacturing, which grew just 0.6%.
- A meagre 2% rise in farm sector added to the demand slowdown.
- Consumption, the bedrock of growth in the past few years, collapsed to an 18-quarter low of 3.1% from 10.6% in the March quarter.
- Investments grew 4%, up from 3.6% in the previous quarter.
- The two service sectors which have been significant contributors to GDP growth i.e. trade, communication etc. and finance, real estate etc. have registered a growth of 7.1% and 5.9% respectively.
- The fickle GST collections and unsteady state of the NBFC segments have to be reversed for a turnaround in these segments.

Government measures so far:

Finance Minister Nirmala Sitharaman recently made several announcements to boost Indian economy.

Investors:

* Enhanced surcharge on FPIs and surcharge on domestic investors in equity markets withdrawn.

* Aadhaar-based KYC for opening demat accounts and investment in mutual funds.

* Govt to consult with RBI to enhance Credit default swap options.

Industry:

* CSR violation would be treated as a civil offence, not a criminal offence.

* All pending GST refunds till now shall be paid in 30 days. Future GST refunds to be paid in 60 days.

* GST system to be simplified further.

Auto sector:

* BS-IV cars purchased till March 2020 to remain operational for the entire period of registration.

* Govt asks its departments to replace old vehicles.

* Higher vehicle registration fee deferred to June next year.

* Depreciation increased to 30 per cent for all vehicles purchased till March 2020.

* Scrappage policy to be announced soon.

MSMEs:

* Govt withdraws angle tax provision for startups and their investors.

* One-time settlement policy for MSME loans. Policy to be based on checkbox approach.

* Laws to be amended to ensure one MSME definition.

For NBFCs:

* NBFC can now use Aadhaar-based KYC.

* Additional liquidity to support Housing Finance Companies by National Housing Board increased to Rs 30,000 crore

* Govt to release Rs 70,000 crore upfront for PSBs recapitalisation.

Home, auto loans:

* Banks to make home, auto loans cheaper. Banks have agreed to pass on the rate cut announced by RBI to customers. Banks to launch Repo Rate linked loans.

* Online tracking system for home, auto loans.

* PSBs to return loan documents to customers within 15 days of loan closure.

Income Tax:

* From October 1, all Income Tax notices must be disposed off within 3 months.

RBI statements:

On the basis of an assessment of the current and evolving macroeconomic situation, the Monetary Policy Committee (MPC) released the Third Bi-monthly Monetary Policy Statement, 2019-20.

- On its part, the RBI has cut the repo rate by 110 basis points so far in 2019 to 5.4 percent – its lowest level since 2010.
- The central bank in its Annual Report for 2018-19, has stressed the need of addressing structural issues in land, labour, agricultural marketing.
- The reverse repo rate under the liquidity adjustment facility (LAF) stands revised to 5.15 per cent, and the marginal standing facility (MSF) rate and the Bank Rate to 5.65 per cent.
- These decisions are in consonance with the objective of achieving the medium-term target for consumer price index (CPI) inflation of 4 per cent within a band of +/- 2 per cent, while supporting growth.

The main considerations underlying the decision are:

- Global economic activity has slowed down since the meeting of the MPC in June 2019, amidst elevated trade tensions and geo-political uncertainty.
- Economic activity remained weak in major emerging market economies (EMEs), pulled down mainly by slowing external demand.
- Crude oil prices fell sharply in mid-May on excess supplies from an increase in non-OPEC production, combined with a further weakening of demand.
- Gold prices have risen sharply since the last week of May, propelled by increased demand.
- Inflation remained benign in major advanced and emerging market economies.
- On the domestic front, the south-west monsoon gained intensity and spread with the cumulative rainfall 6 per cent below the long-period average (LPA) up to August 6, 2019.
- Industrial growth, measured by the index of industrial production (IIP), moderated in May 2019, pulled down by

manufacturing and mining even as electricity generation picked up on strong demand.

- The growth in the index of eight core industries decelerated in June, dragged down by a contraction in petroleum refinery products, crude oil, natural gas and cement.
- Retail inflation, measured by y-o-y change in the Consumer Price Index (CPI), edged up to 3.2 per cent in June from 3.0 per cent in April-May, driven by food inflation.
- CPI inflation excluding food and fuel fell by 50 basis points to 4.1 per cent in May from 4.6 per cent in April, and remained unchanged in June.
- Net foreign portfolio investment (FPI) flows in the domestic capital market amounted to US$ 2.3 billion during the current financial year so far (up to August 5, 2019) as against net outflows of US$ 8.5 billion in the same period last year.
- **India's foreign exchange reserves were at US$ 429.0 billion** on August 2, 2019 – an increase of US$ 16.1 billion over end-March 2019.

How to come out of slowdown (experts view)

- Monetary Policy stimulus by the RBI and the government along with normal monsoons would provide some relief in the second half of the financial year.
- The announcement of merging of public sector banks (PSBs) and their recapitalisation would provide some relief.
- Sector-specific sops and smooth GST refunds to exporters can be worked on by the government.
- Revitalising the manufacturing sector.
- Increase in fiscal spending, deviation from fiscal deficit target, and boost in consumption sentiment are some of the suggestions by analysts to arrest the downtrend.

- Incentives to auto sector employees to upskill on electric vehicles.
- Reducing the GST slab rates
- Improving credit flow to both consumer and industry.
- Reducing real interest rates by 135 basis points as cost of capital has to come down.
- Factor market reforms, including bringing the cost of land down.