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Potential for the world in the post pandemic era; India's GDP surprises with a better than expected recovery

The COVID-19 pandemic has brought widespread suffering and outsized economic loss around the world in 2020, but the years ahead hold the potential for a period of prosperity yet unseen in the 21st century. If we put the current shock in the historical context of the great macroeconomic shocks of the 20th century, we could find multiple similarities between the current setting and those prevailing both a century ago at the end of the Spanish Flu and 70 plus years ago at the end of World War II, two points in history followed by rapid gains in productivity and prosperity. These three periods share (1) discretionary pro-growth economic policy; (2) pent up demand from the prolonged shutting in of economic activity; (3) immense technological progress. Based on these historical experiences, there is a possibility that expansionary economic policies, introduced in response to the COVID-19 shock, will persist for multiple years. We also see the possibility of unleashing pent-up demand spanning over the next two years as well as a faster adoption of technologies. These changes could potentially bring a period of economic growth and prosperity that will surprise many.

In the above context, It is interesting to note that India's Q2 FY2021 GDP data positively surprised as it registered a contraction of -7.5% YoY compared to our projection of -9.1% and consensus of -10.2 YoY (ET poll). This marked a sharp recovery from an unparalleled dip of 23.9% YoY in the Q1 FY2021. The surprise in Q2 was primarily on account of the manufacturing sector which turned to growth. Services followed a more modest recovery while the agriculture sector continued to lead the growth in line with its favourable outlook. In contrast to the previous quarter, private consumption and investment demand led the recovery as the economy opened up. In contrast to Q1, the government spending contracted in Q2, weighing on the economic recovery.

We expect government spending to pick up in the coming months, reflecting the impact of the recently announced stimulus packages. Moreover, high-frequency indicators in Q3 FY 2021 point towards a broader recovery. With a positive surprise in Q2 and a pick-up in economic activity in Q3, we see a strong possibility of a smaller economic contraction than -9.8%YoY that we had previously projected. Further, we also see improved prospects for economic recovery in FY2022 supported by the recent positive news regarding the outlook for vaccine development and its availability.

Christopher Wiegand
Group Head - Economics & Data
christopher.wiegand@dmifinance.in

Pramod Chowdhary
Chief Economist
pramod.chowdhary@dmifinance.in

Ashray Ohri
Economist
ashray.ohri@dmifinance.in

www.dmifinance.in

+91 11 4120 4444

DMI Finance Pvt Ltd.
Express Building, 9-10, 3rd Floor,
Bahadur Shah Zafar Marg, New Delhi,
Delhi 110002

Emerging trends and potential in the post-pandemic era

The COVID-19 pandemic has brought widespread suffering and outsized loss (economic and life) to the world in 2020, but the years ahead hold the potential for a period of prosperity yet unseen in the 21st century. As India's COVID epidemic recedes from months of exponential spread – hopefully in a manner that is not solely a respite – but having left in its wake considerable pain and suffering and locales such as North America and Europe confront second waves of the virus before winter even sets in, the case for optimism regarding the years ahead can be an extremely challenging one to envision.

Nonetheless, there are multiple similarities between the current setting and those prevailing both a century ago at the end of the Spanish Flu and 70 plus years ago at the end of World War II, two points in history followed by rapid gains in productivity and prosperity. The current setting shares with those two historical episodes a government-mandated disruption to daily life and economic activity and broad-based suffering and sacrifice. But these three periods also share (1) discretionary pro-growth economic policy; (2) pent up demand among both households and businesses from the prolonged shutting in of economic activity; (3) immense technological progress.

Pro-Growth Economic Policy

Governments around the world have been historically aggressive and proactive in both the speed and scope of their economic policy response as the virus upended economic activity. Nearly every country of note in the world has deployed both expansionary monetary and fiscal policy to some degree to try to buffer the devastating effects of the shuttering of economic activity for public health reasons. Some countries' policy responses have been singularly large – for instance the United States through outsized government spending and income transfers to individuals and businesses– while others have been more modest. But regardless of the precise details of the size and scope of policy expansion, interest rates generally have been reduced to record or near-record lows around the world and the public coffers loosened.

To be sure, expansionary government economic policy to date has been aimed at filling the economic hole created by public health measures and private sector behavioral changes owing to the virus. But the bulk of these expansionary economic policies are here to stay for multiple years. Monetary policy especially is highly likely to provide a strong tailwind to nearly every major economy around the world deep into the cyclical upturn. Low-interest rates will boost credit demand, enable the (favorable) restructuring of balance sheets, provide low-cost funds for private and public sector investment and help to keep public debt service burdens lower than otherwise thereby making it incrementally more attractive for governments to engage in additional fiscal expansionism down the road.

Making direct comparisons of monetary and fiscal policy today to periods 70 to 100 years ago is highly imperfect given the complex nature of today's economies. But directionally, the current and prospective general pro-growth policy tilt of today compares favorably to those prior periods. The 1920s were a period of 'hands-off' the private sector in the major economies of the time, while the post WWII era was a period of low taxation and government investment in myriad types of human and physical infrastructure and capital.

Pent up Demand

Government-mandated shutting in of select types of economic activity is boosting pent up demand among both households and businesses that likely will be unleashed as such restrictions are lifted over the course of 2021 and, potentially depending on the country, into early 2022.

In the early days of the pandemic, private sector demand pulled back sharply on its own prior to government-dictated restrictions on economic activity, as the virus created substantial uncertainty. In response, the private sector began to husband resources and self-limit mobility – a phenomenon that continues in part to this day and that has resulted in the unusual fact of a rise in private sector savings rates during the recession.

Early evidence of economic reopening on a cross-country basis suggests that consumers especially are eager to engage in a spurt of consumption following virus-induced limits on their economic activity. Indeed, consumer spending across countries in the quarter in which their respective economy has reopened has been notably stronger than that implied by fundamentals such as economy-wide job availability, unemployment, wage, and salary growth. This despite that in many countries, opportunities for spending on traditionally discretionary consumer outlays such as restaurant dining, travel and leisure remain severely curtailed by public health measures and/or consumer concern about potential viral exposure and infection.

History is consistent with the observation that the longer spending remains artificially curtailed – whatever the mechanism – the more pent up demand builds. And with government policy likely to continue to seek to provide support in various capacities to the private sector ahead, the fundamental supports for a spurt of very solid private sector demand on the other side of the pandemic are in place.

Immense Technological Progress

In both the 1920s and post WWII period, advanced economies experienced a sustained period of rapid technological advance that helped to transform their economic way of life. Technology borne out of and/or enhanced by production tied to WWI and WWII led to widespread advancements in production processes and access to essential building blocks of economic wellbeing.

The 1920s saw leaps forward in the distribution of electrical power across broad geographic footprints, mass production of – and in turn more affordably priced – automobiles, and civilian air travel to cite just a few transformative developments. Assembly line techniques dramatically lowered the cost of consumer goods generally, ratcheting up living standards, while advancements in transportation and power generation and distribution were key to spreading capital and resources beyond their concentration in large urban areas.

The post WWII period provided renewed impetus to these trends. Infrastructure and distribution enhancements better connected previously underserved economic areas to more vibrant economic centers and ports and innovations developed and applied for military purposes began to be repurposed by enterprising individuals and businesses for civilian life.

The current setting is unlikely to be as revolutionary as it pertains to the breadth of technological advances of those two prior periods, although no one truly knows what human ingenuity is capable of. Regardless, at a minimum, the adaptation and efficacy of existing information and communications technology have been accelerated in ways previously considered unthinkable as of early March. Consider that financial firms – be they a nascent fintech company in Asia or South America to established investment banks in New York and London – were as certain as could be that business only could be operated properly with all staff physically on site. In just weeks after the virus forced such businesses to send employees home to work, innumerable CEOs of such firms extolled the seamlessness with which their companies had used information and communications technology to function as if the virus had not upended their businesses. Similarly, relatively routine medical exams and diagnostics now are being conducted via video in many parts of the world. Such tangible evidence that tasks heretofore believed to be only possible on a job site is only in the early stages of beginning to affect how businesses think about organizing their firms and how households think about organizing their lives. The possibilities for enhanced efficiency, dispersion of human capital outside major urban/economic centers, higher quality of life are vast and never would have been considered on the timetable they now will be absent the immediate and emergency application and adaptation of information technology that COVID forced on the world.

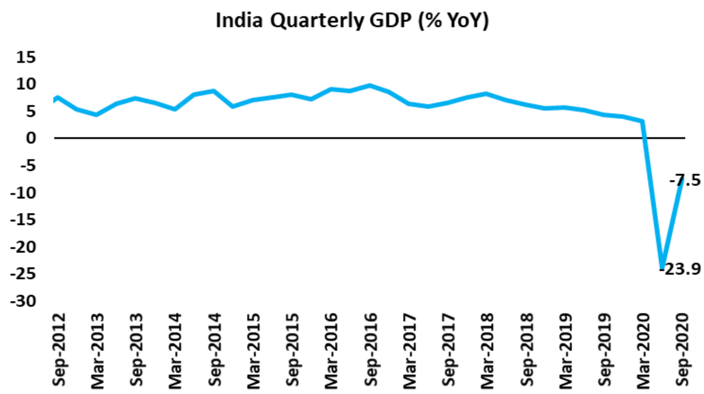
While this backdrop holds the potential for significantly (generalized) better economic times ahead, nothing is certain. Thankfully, COVID has a relatively low fatality rate, recognizing that any loss of life is a tragedy, and medical treatments – including vaccine development – are transpiring at historically unprecedented speed, suggesting that the end of the pandemic and a return to more normal life while not imminent is on the horizon.

Nonetheless, governments will need to ensure that businesses and households remain financially viable between now and the pandemic's end; governments will need to recognize and support that (large in some countries) subset of workers whose livelihood was seriously impaired or destroyed by the virus; governments will need to distribute vaccines effectively so that the combination of vaccinated populous plus naturally infected populous is sufficient to create so-called herd immunity. These are real challenges and certain countries are better equipped to deal with them than others. But assuming these challenges are met, the conditions appear to be in place for a period of economic growth and prosperity that will surprise many.

India GDP surprises to the upside in Q2 FY 2021

Given the backdrop discussed above, it is interesting to note that India's Q2-FY2020/21 GDP data has positively surprised. Real GDP posted a lower contraction of 7.5% YoY compared to our projection of -9.1% and consensus of -10.2 YoY (ET poll). The Q2 print was sharply better compared to the unprecedented slump seen in the previous quarter indicating a sharp V-shaped sequential recovery.

India GDP sees a V-shaped recovery



Source: CEIC

On the demand side, investment demand led to the recovery as it improved sharply to a contraction of 7.3% YoY versus 47.1% YoY in the previous quarter. This was broadly in line with our investment index that recovered from -52.7% YoY in Q1 FY 2021 to -6.5% YoY in Q2 FY 2021, as was visible in the improvement in demand for capital and infrastructure & construction goods. Private consumption also recovered to -11.3% YoY compared to -26.7% YoY in Q1 FY21 aided by the pent up demand and improved activity due to the easing of government restrictions across the country. Our consumption index noted a sharper recovery from -38.6% YoY in Q1 FY 21 to -3.6% YoY in Q2 FY 2021. However, government spending tapered sharply (a contraction of 22.2% YoY compared to growth of 16.4% YoY in Q1 FY21) reflecting expenditure restrain in face of a sharp deterioration in the fiscal deficit numbers. Meanwhile, the external sector continued to favour India's growth as exports contracted at a slower pace compared to imports and resulted in the second consecutive quarter of a net positive trade surplus.

Quarterly estimates for GDP at basic prices

% YoY	FY20	Q1-FY20	Q2-FY20	Q1-FY21	Q2-FY21
Private Consumption	5.3	5.5	6.4	-26.7	-11.3
Government Consumption	11.8	6.2	14.2	16.4	-22.2
Gross Fixed Capital Formation	-2.8	4.6	-3.9	-47.1	-7.3
Changes in Stocks	1.9	5.0	1.3	-20.8	6.3
Valuables	13.5	25.0	16.0	-91.0	-59.4
Exports	-3.6	3.2	-2.2	-19.8	-1.5
Less Imports	-6.8	2.1	-9.4	-40.4	-17.2
Real GDP	**4.2**	**5.2**	**4.4**	**-23.9**	**-7.5**
Real GDP excluding government	**3.3**	**5.1**	**3.1**	**-29.3**	**-5.4**

Source: MOSPI

On the supply side, the Gross Value Added contracted by 7% YoY compared to a fall of 22.8% YoY in Q1 FY 2021. A two-paced recovery was evident, with the service sector (-11.4% YoY) lagging the recovery while agriculture (3.4% YoY) and industry (-2.1% YoY) sectors noted a stronger recovery. A positive surprise was noted on the manufacturing side that posted growth (0.6% YoY versus -39.3% YoY in Q1 FY21). This came as a surprise as the IIP component for manufacturing contracted by 6.8% YoY for Q2 FY21. Even though the better than expected quarterly performance of corporates lends credence to the above, capacity utilisations have remained low during this period. As such we could see some revisions to this number later. Electricity services noted a growth, in line with the monthly data, while mining and construction also noted a strong recovery as economic activity picked up in these segments with a relatively lesser exposure of covid. On the services side, the trade, hotels, transport, communication component improved notably and was likely led by improvement in communication services and cargo transport, while other segments await a broader recovery. The finance and real estate services were likely dragged down by the laggard recovery in the real estate sector and an unfavourable base. However, the slew of government measures towards real estate is likely to aid growth in this sector in the medium term. Meanwhile, the public administration, defence, and other services reported a sharper contraction (-12.2% YoY versus -10.3% YoY in Q1 FY21) as government spending tapered.

Quarterly estimates for GVA at basic prices

% YoY	FY20	Q1-FY20	Q2-FY20	Q1-FY21	Q2-FY21
Agriculture, forestry & fishing	4.0	3.0	3.5	3.4	3.4
Industry	0.9	4.2	0.5	-38.1	-2.1
Mining & quarrying	3.1	4.7	-1.1	-23.3	-9.1
Manufacturing	0.0	3.0	-0.6	-39.3	0.6
Electricity and other utility services	4.1	8.8	3.9	-7.0	4.4
Construction	1.3	5.2	2.6	-50.3	-8.6
Services	5.5	5.5	6.5	-20.6	-11.4
Trade, hotels, transport, communication etc	3.6	3.5	4.1	-47.0	-15.6
Financial, real estate & professional services	4.6	6.0	6.0	-5.3	-8.1
Public administration, defence and other services	10.0	7.7	10.9	-10.3	-12.2
Gross Value Added (at basic price)	**3.9**	**4.8**	**4.3**	**-22.8**	**-7.0**

Source: MOSPI

Peer comparison and the near-term outlook for India

The economic recovery for India in the second quarter of the fiscal year (July-September) was in line with most other countries across the globe. However, India's real GDP contraction of 15.7% YoY in H1-FY21 remains one of the steepest among the G20 economies primarily due to the unprecedented contraction in the April-June quarter, which bore the brunt of one of the strictest phases of lockdown. The effects of this could still pervade the full-year forecast and comparison for this fiscal year.

Growth and Stringency comparison of G-20 countries

Source: CEIC; G-20 countries are included based on data release for Jul-Sep quarter. All growth numbers are on a YoY basis, except the UK - seasonally adjusted YoY basis, Mexico – annualized YoY basis.

However, as the economy reopens further and moves away from the COVID-induced restrictions, economic recovery is likely to continue. Early signs from the incoming economic data already portend towards this effect, after India's COVID-curve passed its peak in September. This was further aided by the pent-up and fresh festival demand during this period. Meanwhile, policymakers have also nudged the recovery process with additional measures by the government and the RBI.

There are near-term risks due to rising COVID-19 in some Indian states and cities as well as from the fading of festival demand effect. As such the sustainability of ongoing green shoots will have to be watched in the coming months. We presently believe that India could avoid a major sustained rise in COVID cases. This coupled with better recovery momentum seen in Q2 and Q3 of FY21, we see the possibility of a smaller economic contraction than -9.8% real GDP in FY 2021 which we had previously projected. We shall relook at the FY21 projection in the coming weeks.

Prospects of vaccine development clear the horizon ahead

The optimism around the COVID vaccine development augurs well for next year's outlook. There has been significant progress on this front, with pharmaceutical companies reporting successful interim results from trials (with the efficacy of 62% to 95%) and advancing the earlier anticipated timelines. In this context, the promising preliminary results of the Oxford-AstraZeneca vaccine trial are good news for India given it is cost-effective and logistically less challenging (can be stored at 2 to 8-degree temperature). Moreover, COVID vaccines developed by Indian companies are in the second or third phase of trials and raise the prospects of more than one vaccine available in India prior to the previously expected period. According to India's health minister, the government will start the immunization process in a phased manner. In the first phase, it is looking at vaccinating 250-300 million people by July of next year, for which it aims to procure around 500 million vaccine doses as most vaccines follow a two-dose regimen. Adhering to or advancing these timelines is likely to boost the economic recovery prospects for the next financial year. As such we see upside risks to our projection of 7.8% real GDP growth in FY22.

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