Understanding India's Economic Slowdown

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Contents

The downtrend

The Indian economy is in the grip of a deep slowdown. We faced this type of an adverse environment during the time of the global financial crisis. Now, over the last couple of years, what we are experiencing is falling economic momentum that is visible from almost all sectors of the economy.

Declining investment, falling sales, stagnation in employment, poor credit growth - all tells the different sides of the slowdown trend.

The final outcome of these downward factors is that they have brought down the GDP growth rate. GDP growth has been coming down during the last five quarters.

There is no disagreement that the economy is going through a tough period and symptoms of an uptrend seem to be far away.

In this article, we will see the nature and causes of the current economic problem that we are in.

1. What we are experiencing - slowdown or recession?

Technically, the current situation can be described as a severe *slowdown* and not a *recession*. To understand it, we have to go through the definitions of both terms.

What is recession?

A recession is a ***decline*** in real Gross Domestic Product for two or more consecutive quarters.

So, recession is declining economic activity measured by *contraction* of GDP for two or more successive quarters. It is not just declining GDP growth but declining GDP itself – that is the difference. Decline in GDP happens when the economy registers negative growth rate.

For India, the GDP is not coming down or not undergoing contraction. Rather, it is growing but the rate of growth is declining.

A well-known US research entity - the National Bureau of Economic Research (NBER)- defines recession as "a period of falling economic activity spread across the economy, lasting more than a few months."

In the past, several developed economies have registered recession. The US economy recorded recession in 2005 and 2008. At present, economists warn that the US is moving to a recession, powered by trade war.

What is a slowdown?

A slowdown is a situation of *declining growth* rate of GDP. The economy is moving forward, but its growth rate is falling. There need not be a contraction of GDP actually in the case of slow down.

For India, the GDP growth rate has been falling over the last five quarters. Hence, we can say that the economy is undergoing a slowdown and not a recession.

Table: Example for recession and slowdown

Quarter	Example for recession – GDP growth rate (quarterly)	Example for slowdown (GDP growth rate quarterly)
Q1	-1.7%	5.8%
Q2	-1.3 %	5%

What is the extent of the slowdown for Indian economy?

This question is very important while quantifying the depth of the current economic problem. *Recession is typical problem that usually happens to a developed economy.* These economies are already grown big and there are limitations for them to grow further. So, they usually face recession. It is a state of contraction of GDP or registering negative GDP growth rate.

On the other hand, for a robust and dynamic emerging market economy like India, the standard of GDP growth rate will be much higher. A developing and exuberant economy like India is supposed to achieve a growth rate of 8 per cent to 10 percent.

Recession is decline in GDP; it is contraction of GDP.

Slowdown is decline in GDP growth rate.

But now, the economy is growing at around just 5% with slowing trends in production, employment, demand etc.

Understandably, the slowdown that we are experiencing now is the equivalent of recession experiencing in an advanced economy. The seriousness of the situation is equal.

At the same time, the term slowdown is not enough to explain the grave situation that we are experiencing; it is more than that. The term slowdown is quite generic and loose and doesn’t indicate how deep the problems are. A decline in GDP growth, independent of its gravity is called as slowdown. A fall in GDP growth rate even if for two quarters or ten quarters, is described as slowdown.

Since terminologies are not available enough to explain the macroeconomic conditions of emerging market economies, just we can say that our economy is going through a *deep slowdown.*

2. Six indicators that point out a slowing economy

What are the indicators of the ongoing economic slowdown in India?

Now, our economy is not growing at a rate that is the standard for an emerging economy or that justifies its past performance. Following are six important indicators which tells us that the economy is in some sort of a trouble.

(1) Declining growth of real Gross Domestic Product,

(2) Decrease in rural income,

(3) Falling employment levels,

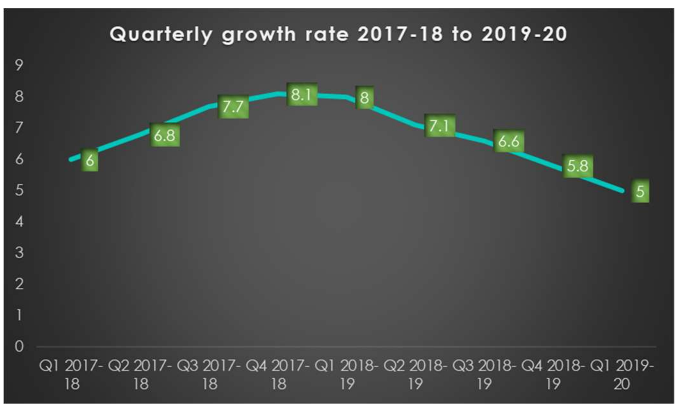
(4) Declining manufacturing activity and industrial production,

(5) Falling retail sales,

(6) Declining credit growth.

Continuing crisis in the banking and NBFC sectors adds to the negative trends. Falling credit growth is also caused by weaknesses in the banking system.

Figure: Quarterly growth rate from Q1, 2017-18 to Q1, 2019-20.



(1) Declining GDP growth statistically tells about the slowdown

The first one ie., declining GDP growth is the result of the last five factors. GDP growth has declined from 8.1 % during the fourth quarter of 2017-18 to 5% during the first quarter of 2019-20. So, the GDP growth rate has been declining over the last five quarters continuously.

Quarterly GDP growth doesn't tell anything about the reason behind the slowdown. Actually, GDP growth rate is the end product of the economic activities. It just arithmetically shows us the extent and duration of the economic fall. We have to look on the sectorwise indicators to see what is causing the slowdown that can be seen from the GDP growth rate. The other five factors tell this.

(2) Declining credit growth

Perhaps the most important indicator for a coming slowdown is slowing credit growth. Consumption, investment and the resultant spending are boosted by credit given by banks. If that credit growth is poor, it means the consumption and investment spending are coming down soon.

Whenever an economy registers a reduced credit growth, it's a warning for slowing spending and the resultant reduced growth.

(3) Decrease in rural income

Nearly 45% of the population of India lives in rural areas. Fall in rural income in recent years has led to reduced purchasing power with the rural people.

In recent years, demand for both consumer durables and non-durables have declined because of low purchasing power with the rural people.

Why Slowdown is expectation related?

Businesspeople loss confidence in getting profit and fear losses when they feel poor demand conditions. They track demand for their products and if they find that demand is going to be low in future; they reduce investment and production. So, ultimately, it is expectations and momentum that drive economic activities.

(4) Rising unemployment rate

The periodic labour force survey concluded that unemployment is rising at a higher rate. This trend is strong in both rural and urban areas. Rising unemployment deprives income of the people and this leads to reduced demand.

(5) Falling manufacturing output

In every country, recession and slowdown are highly correlated with the poor performance of the manufacturing sector. Manufacturing or the industrial sector is considered as the economic engine and it can support substantial proportion of the workers. Poor industrial growth shows the depth of the slowdown.

For India, the manufacturing growth declined to 0.6% during first quarter of 2019-20. Growth of the core industries came down sharply to 0.2% in June 2019; from 7.8 per cent in June 2018.

Table: Performance of the core industries in June 2019

Month (2019)	Growth rate of the core industries
April	6.3
May	5.1
June	0.2
July	2.1

(6) Falling sales and real estate prices

Sectors where consumer income is quickly and visibly spent – automobile and real estate sector have suffered the worst in recent quarters. Declining automobile sales and falling real estate prices shows that the slowdown is deep.

Falling sales leaves tens of thousands of employees jobless. This is the leading adverse factor that produces inability of the people to buy goods, reduction in demand, sales, production etc. Once people start to lose their jobs, slowdown spread like a wildfire.

3. What are the causes for the slowdown?

There are some visible domestic and global factors that triggered the slowdown in the Indian economy. Domestic factors can be

Six factors –

that triggered the slowdown in the economy

Demonetisation: Demonetisation was a bad vibe. It disrupted and disturbed India's production and business networks that were conducted mainly in informal ways (downplay this in exams; just mention mild shock from it).

Banking sector and the prolonged NPA problems: Banks can't lend significantly, as far as their balance sheets are weak. The prolonged NPA problem tempted them to stay back from credit expansion. The next uptrend will happen only with credit expansion.

Farmers income fall: Farmers are facing income fall due to adverse terms of trade. Agricultural prices are not increasing but the prices of other materials are increasing. Similarly, farmers living expenses to spend on industrial and service items going up.

Global factors: Trump's trade war created trust deficit in international trade. Another factor is the rising crude prices. Similarly, foreign capital is showing outflow trends.

Quick implementation of GST: GST implementation slowed down business activities as its procedural complexities discouraged big traders to procure materials from small unorganized players (downplay the point in exams).

Formalization driven away the informal sector from the value chain: Formalization of economic activities is always desirable. But its sudden implementation without preparing the small businesses slowed down economic activities.

cyclical issues and structural problems. Global factors are the deepening trade war and fall in international trade.

a. What are the structural factors?

The structural factors are always there. India's industrial sector is not progressing at the right pace. The country remains importer of major machineries and electronic goods.

Similarly, Indian manufacturing firms are not having the competitiveness to produce quality components and thus to participate in the global value chain network.

In the case of agricultural sector, the sector was not able to achieve productivity and thereby releasing the unemployed population to the industrial sector.

How structural problems can be corrected to treat the slow down?

Here, the government has to make substantial economic reform to strengthen vital sectors like manufacturing, construction etc. Technology adaptation and productivity expansion are necessary to make our industrial sector competent with the rest of the world. This will take substantial efforts, time and need good institutions.

In the medium term, revival of industrial sector investment, production, employment etc is the best way. All these are closely related or are the same.

b. What are the cyclical factors

Cyclical factors are those repetitively comes. An example is the higher volume of NPAs with the banking system. Without solving the banking sector problems, sufficient delivery of credit to the various sector becomes difficult.

How cyclical factors can be corrected?

Cyclical slowdown can be corrected by stimulating demand. Additional expenditure by the government or reduced taxes etc., can stimulate demand in the economy.

What are the global factors that contributes to slow down in India?

In the global economy, continuation of trade war between the US and China produced uncertainties. Exports are not going up; countries are adopting restrictive policies on imports. Higher crude prices adds to the external sector problems.

Similarly, global capital flows (like foreign investment inflow to India) are coming down fearing a slowdown in the developing world and recession in the advanced world.

Why automobile and real estate sectors are vital to measure the slowdown?

- these are the two sectors where mass demand lies.

India is a consumption-oriented economy where domestic consumption drives our economy. In China, slowdown can appear with reduced production in export sector as the Chinese economy's demand is driven by foreign demand.

Given the primacy of the domestic consumption in India, the two sectors where mass demand lies are the automobile and real estate. When the demand or prices of these two sectors fall, it is an indication of a coming slowdown.

4. What will be the visible trends in immediate future?

Whenever adverse economic situation like slowdown that pinches the economy and starts producing chaos, individuals restructures their activities.

Especially businesspeople and the rich goes risk averse. They will not spend or invest substantially. This of course deepens the slow down.

Following are some of the immediate effects in near future:

1. Prices of safe assets may increase eg., gold.

2. Land prices may come down because of falling business, industrial and other commercial property demands.

3. Stock price may come down with the intensity of the slowdown unless liquidity is poured into the market through policy initiatives.

4. People may spend less especially the rich. This may add to the problems.

5. What policies have to be adopted to fight the slowdown?

Slowdown is not due to absence of resources or shortage of labour; but reduced demand in the economy from low income with the people.

For the investors they track demand to make investment and production decisions. When there is general pessimism about future prospects, they hesitate to invest. So, investors are not ready to invest or produce now because of slowing demand for manufacturing items.

Here, the only and the sustainable way to retrack the economy is to improve business sentiments. Higher credit to households, along with increased government expenditure may tempt the business to raise production and investment.

No tax cuts or incentives will be successful unless businesspeople find it safe to invest. In this context, there are three necessary ways for bringing up the business momentum.

1. Rejuvenate industrial production by giving confidence to the industrial sector. Reducing taxes, providing incentives, making higher government expenditure in the market, attracting more foreign capital etc., will be helpful.

2. Add strength to new lines of production – like electronics, machineries etc. This required more commitment, effort and time. Higher the number of sectors and industries where we can competitively produce items, more will be our ability to enhance employment, income and thus our capacity to avoid future slowdown. It is the industrial sector that is the engine of the economy. Services sector is a residue of the industrial growth.

3. Government should not produce bad vibes through error policies or penny taxes that destroys business confidence. Any misstep, even if for regulation sake or for tax revenue gain, may adversely affect business sentiments.

6. Whether the government capable to bring back economic momentum or to counter the slowdown?

Given the tax resources and financial capacity of the government now, it is difficult to force back the economy through making government expenditure or tax cut alone.

But given its policy capability, the government can bring back growth momentum through sophisticated policies. Here, it is very important that every government step should nudge the investors and households to spend more.

Remember, a conducive policy may be valuable than millions of rupees worth of tax cut or expenditure commitment by the government. There are two options for the government to manoeuvre the economy in this difficult time.

First, policies like promoting credit expansion by ensuring bank's health (capitalisation) will raise credit growth. At the same time, it should not be excessively used; otherwise it will raise NPAs further in future.

Second is that the government can launch long term infrastructure investment. This will enhance the flow of money to the economy.

Similarly, it helps the business to reduce their cost of doing business and household to get better living conditions.

7. What are the measures taken by the government to counter the slow down?

Till this time (September 1, 2019), the government has launched three rounds of interventions to fight the slowdown. Following table illustrate the measures taken by the government.

Date	Steps	Possible Effects
August 23rd, 2019	Roll back of surcharge applicable on FPIs	These measures will help to inject more funds to the economy, besides encouraging more investment. Liquidity situation also will be improved with more funds with banks and NBFCs.
	Removal of angel tax for registered start-ups	
	Incentives to MSMEs	
	More NHB loans to the housing sector	
	Withdrawal of criminal treatment for CSR failures.	
	Liquidity support to NBFCs.	
August 29, 2019	Local sourcing norm for single brand retail diluted	Higher investment by single brand MNC firms may occur.
	100% FDI under automatic route for contract manufacturing.	This will help the long-term revival of the value chain network. Component making in the country will go up with the participation of more foreign investment.
	Liberalisation of digital media- investment up to 26% is allowed.	
August 30, 2019	Additional capitalisation worth of Rs 55000 cores for PSBs	Lending capacity of the PSBs will improve thereby encouraging lending.
	Merger of 10 PSBs into four banks	Efficiency in PSBs may improve.

These measures are designed to trigger an uptrend in the economy. Still, given the scale of the manufacturing slump, extraordinary interventions are needed. From the part of the government and the RBI, timely and adequate measures like expenditure enhancement and repo rate cut may be helpful to raise income, revive business confidence and thus to bring the growth momentum.

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