India

Limited resources to combat the pandemic

India was not spared the coronavirus pandemic. The economic slowdown will be all the more severe with a protracted lockdown of the population. The government also lacks the fiscal capacity of the other Asian countries to bolster its economy. Already strained by the economic slowdown of the past two years, public finances are bound to deteriorate further. Public debt could reach 75% of GDP by 2022. Refinancing risks are low, but the cost of borrowing could rise for the long term if the rating agencies were to sanction its public debt and deficit overruns. India still has sufficient foreign reserves to cover its short-term liabilities.

Economic growth: a mild recovery is cut short

Until February 2020, certain economic indicators suggested a strong rebound in activity, buoyed notably by accelerating export orders. Industrial output rebounded and electrical power generation swung back into positive growth rates after five months of contraction. Exports had picked up (+2.9% y/y in February after six months of contraction). Business survey results confirmed the rebound as well as a slight upturn in corporate lending. Domestic demand, in contrast, was still disappointing: automobile sales contracted for the 16th consecutive month and household confidence indicators continued to plunge.

The slight rebound in economic activity is unlikely to withstand the COVID-19 crisis. Growth will slow sharply between March and September 2020 and is likely to take a U-shaped profile. After contracting in fiscal year 2019/20 (by about 5% according to the latest official estimates), the economy could slow again, by almost 2 percentage points (pp). Another slowdown would present a major risk for the banking sector, which is still convalescing, and could lead to the erosion of public finances. The economic slowdown will be worsened by four negative shocks: tourism, exports, capital flight and the confinement of the population, announced on 25 March. The only positive shock is the decline in oil prices.

- Tourism revenues account for only 1% of GDP. During the SARS epidemic, tourism contracted by 20%. With the current pandemic, tourism revenues could contract by as much as 50%.
- Exports account for nearly 20% of GDP. If the global economy were to slow by 2 pp, then exports would contract by 11%. Yet the decline in export volumes should be offset by the positive impact of sharply lower oil prices. The oil bill accounted for 5% of GDP in 2019. If oil prices fall by more than 38% (from USD 61.9 in 2019/20 to USD 38 in 2020/21, based on oil forward contracts), then oil imports would be reduced by at least 2 pp and probably even more if we factor in the impact of the lockdown.
- One positive point: according to the central bank, a USD 10 decline in the price of oil per barrel would have a positive impact on growth of about 0.15 pp via household purchasing power gains (or a positive impact of 0.35 pp based on our oil assumptions). The impact would be slightly smaller, however, due to the tax increase on petroleum products adopted on 14 March 2020. Moreover, the lockdown could wipe out any positive effects.

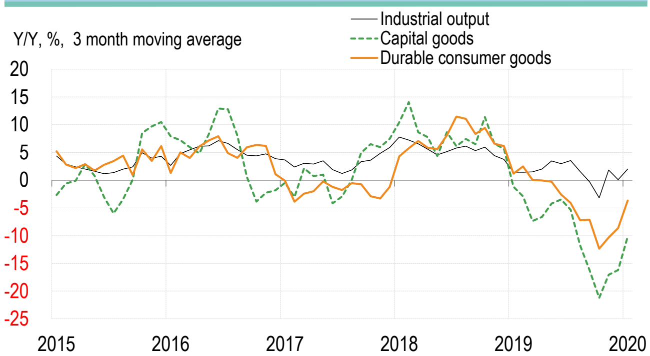
1-Forecasts

	2018	2019e	2020e	2021e
Real GDP growth(1) (%)	6.1	4.9	2.7	5.2
Inflation (1) (CPI, year average, %)	3.4	4.7	3.5	4.0
General Gov. Balance(1) / GDP (%)	-6.3	-7.3	-8.5	-7.3
Current account balance(1) / GDP (%)	-2.1	-0.8	-0.1	-1.0

(1): Fiscal year from April 1st of year n to March 31st of year n+1

e: BNP Paribas Group Economic Research estimates and forecasts

2- Industrial output



Source: CEIC

- The lockdown will trigger a decline in household consumption (59% of GDP) and delay investment projects (29% of GDP), especially since capital outflows will tighten financing conditions. Moreover, informal employment still predominates in the labour market (83% according to ILO), and undeclared workers might not benefit from any assistance during the lockdown period.

The final impact on growth will depend on the duration and severity of confinement. If the economy is partially paralysed for one quarter, then growth might slow to 2.7% in 2020/21. Yet if the entire economy is paralysed for two quarters, then GDP growth is likely to reach only 1.5% at best.

Limited support measures

Faced with intense financial market pressures and massive capital outflows, the central bank has already adopted several support measures since February to offset the rupee and dollar liquidity shortages. The central bank injected INR 1250 bn in liquidity as part of long-term repo operations (LTRO) and set up USD/INR foreign exchange swaps with a 6-month maturity for a total of USD 6.7 bn. From a fiscal perspective, the government announced an INR 1.7 trillion fiscal stimulus plan (0.8% of GDP) on 26 March. But the government has much less manoeuvring room than the other Asian countries given its high fiscal deficit and public debt, as well as the risk that rating agencies could downgrade its sovereign rating.

Without massive support not only for companies but also for households, the banking sector could be hard hit by a very sharp rise in credit risk, even though Indian companies are now in a better financial situation than in 2013-14. In Q3 2019, corporate debt amounted to 44.2% of GDP, compared to 52.9% in Q2 2013.

Low oil prices will support the rupee

Two opposing factors will have an impact on the external accounts: declining oil prices and massive capital outflows.

According to India's central bank, each USD 10 decline in the price of oil per barrel would have a positive impact on the current account balance of USD 10 bn. If oil prices averaged USD 38 a barrel in fiscal year 2020/21 (vs USD 61.9 in 2019/20), then the current account deficit, estimated at less than USD 30 bn in fiscal year 2019/20 (0.8% of GDP) could approach equilibrium during the year 2020/21.

Yet according to IFI data, capital outflows from equity and bond portfolios over the past seven weeks reached more than USD 20bn. In comparison, between May and November 2013, withdrawals from bond portfolios amounted to USD 14 bn over 28 weeks, while equity disposals were extremely limited.

At 31 March, the rupee's depreciation against the dollar was still mild at only 5.3% y/y. The monetary authorities intervened to stabilise the rupee, as illustrated by the slight decline in foreign exchange reserves (down USD 12 bn in 4 weeks). Yet given the risks to growth, we can assume that the decline will be much sharper in the weeks ahead, despite the persistently high spread between domestic and US interest rates.

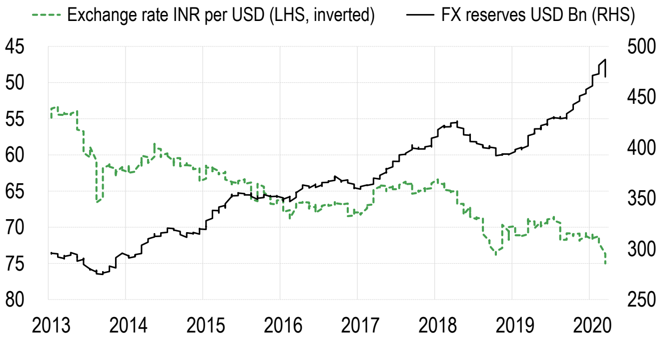
A priori, refinancing risks are small. The external debt is still moderate (20.1% of GDP). From a horizon of September 2020, debt servicing amounts to USD 239.4 bn (including USD 93 bn in non-resident deposits), while foreign reserves were reported at USD 474 bn on April, 3.

Public finances are expected to deteriorate

For the 2019/20 fiscal year ended 31 March 2020, India reported public finance overruns for the second consecutive year. The finance ministry is forecasting a 0.4 pp increase in the government deficit, to 3.8% of GDP (7.3% of GDP for all public administrations combined). Public debt probably exceeded 70% of GDP at the end of fiscal year 2019/20.

For fiscal year 2020/21, before the announcement of the stimulus plan, the government's target was to reduce the deficit by 0.3 pp to 3.5% of GDP. Under current conditions, however, this target no longer seems unrealistic. Granted, the decline in oil prices will

3- Downward pressure on the rupee and FX reserves



Source: RBI

reduce the cost of energy subsidies, but they have already fallen sharply since 2014 (to only 0.2% of GDP). The very sharp slowdown in household consumption and corporate revenues, in contrast, could trigger a decline in revenues of at least 2% of GDP. The government might also postpone the privatisation of certain state-owned companies given the collapse in the equity markets (privatisation proceeds were estimated at 0.9% of GDP in fiscal year 2020/21). At the same time, alongside the stimulus package (0.8% of GDP), government and state spending on healthcare will also increase. The central government deficit could rise to nearly 6% of GDP unless measures are taken to sharply cut back non-essential expenditures. Public debt could rise above 75% of GDP in fiscal year 2021/22. There is no immediate refinancing risk since the debt has a long maturity (10 years on average), is held by residents (more than 96%) and is denominated in rupees (97%). Yet the cost of borrowing is likely to rise if the credit agencies were to sanction these public finance overruns.

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