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HEALTHY RECOVERY: THE ECONOMY OF INDIA BETWEEN 2021 AND 2023

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Abstract

The Indian economy recovered quickly after the second wave of the Covid-19 pandemic in 2021. Later, the IMF estimated GDP growth for the year 2021 at 8.5%, while rating agency Moody's expected 7.9%. Since then, the numbers have shown a more positive trend, and Moody's changed its forecast to 9.2 percent for the 2021–2022 fiscal year, ending on 31 March 2022. While GDP growth rates are positive, India still faces the challenge of rising unemployment, as sectors with contact-intensive services are slow to recover. This briefing looks at key economic indicators for the Indian economy in 2021–2022, as well as forecasts for 2022–2023.

Keywords: India's economy, GDP growth, unemployment, Covid-19, the war in Ukraine

Growth after the global pandemic

Based on estimates for the 2021–2022 fiscal year, the Indian economy has recovered to pre-Covid levels. The pandemic hit the economy hard, similarly to other Asian countries. India responded to the spread of the virus with a strict lockdown, which severely restricted local economic activity. The recovery was helped by the loose monetary policy, as the central bank (Reserve Bank of India) kept the key interest rate at 4% during the pandemic, after cutting it twice from 5.15%). It must be added, however, that the global price increase and the associated side effects did not leave the key interest rate untouched. The Reserve Bank of India raised the policy repo rate to 4.40% on 22 May 2022, while leaving the reverse repo rate unchanged at 3.35%. GDP growth during 2021–2022 was encouraged not only through monetary policy, but also fiscal policy, with the fiscal deficit reaching 7% of GDP. Most projects financed by the public sector are related to infrastructure, especially the reconstruction of roads and railroads.

The demand for these jobs is extremely high. In January 2022, the authorities were forced to suspend the recruitment of railroad jobs in Bihar and Utter Pradesh when 10 million people applied for 36 thousand jobs, and groups protested by blocking roads and railroad lines. At the same time, the unemployment rate is falling, slowly but surely. It peaked at 11.84% last May. It then decreased to 8.10% by February 2022, further decreasing to 7.60% in March 2022.

As for future growth, earlier forecasts were lowered slightly. The main reason for the change in the assessment of potential economic growth can be attributed to geopolitical uncertainties, as well as the recent outbreak of the Covid-19 pandemic. That said, the Asian Development Bank's regional forecast emphasized that India and Pakistan are the main drivers of regional economic growth.

	2021–2022	2022–2023
IMF	8.2%	6.9%
Moody's	9.2%	9.1%
OECD	9.4%	8.1%
Asian Development Bank	8.9%	7.5%
Source: own compilation		

Table 1 GDP growth estimates for 2022–2023

Regarding the future, the IMF predicts challenges for the Indian economy in the following areas:

- implementing reforms (privatization, education, investment liberalization);
- curbing inflation while also supporting growth;
- supporting the recovery while also consolidating fiscal indicators;
- limiting bad loans, allowing for bankruptcies of non-viable firms.

Inflation and the effects of the war in Ukraine

India has taken a mostly neutral stance on the war. The country's foreign policy can be interpreted both ways; this is very deliberate and reflects the deep rooted reactions of a neutral country.

Product groups	Share of Belarus-Russia-Ukraine in India's total imports (%)
Project goods *	32.5
Edible oils	11.5
Fertilizers	11.1
Paper products	6.6
Crude oil and coal	2.8
Chemicals	2.4
Precious stones	1.6
Iron and steel	1.1
Note: * project goods means plant and machinery imports required to establish new projects for manufacturing, producing or processing a product in India.	

Table 2 Share of Belarus-Russia-Ukraine in India's total imports of certain product groups (%)

As for the economy, India's economic relationships are not deep, as Russia's share in India's trade is not significant, yet the country is also threatened by the economic sanctions imposed on Russia. This is because the economic sanctions further disrupt regional supply chains that have already been impacted by the global pandemic.

According to the Ministry of Trade and Industry, the economy's exposure to Belarus-Russia-Ukraine is low. Taken together, the 3 countries' total share in India's exports and imports is 1% and 2.1%, respectively. The share of these three countries is significant with regard to certain product groups, but India is not dependent on Russia for oil, with the Russian share in oil imports at only 1%. It must be added that spillover effects are still felt by economic players in India.

Inflationary concerns in India and twin deficits

Despite India's low level of dependence on Russian oil, world prices have skyrocketed in the last month. India is feeling the economic consequences of the war, and imports 85% of its oil. This development not only fuels inflation, but also damages India's current account balance. Last week, Morgan Stanley reported that the central bank's reserves fell to $597 billion in April 2022, the lowest level since May 2021, which also means India's current account balance could widen to a 10-year high of 3.3 percent in fiscal year 2022–2023. At present, it is not the size of the current account deficit that is of concern, as that is still relatively low, but rather the momentum with which the gap between exports and imports has widened over the past few months. In September 2021, the current account deficit stood at 1.3% of GDP, and has rapidly increased to 2.7% of GDP by the end of 2021.

Some analysts warn that India could end up like Sri-Lanka or Pakistan, which have twin deficits. According to Keynesian economists, an increase in a government's budget deficit leads to an increase in its current account deficit. The Indian government's 2022–2023 budget projects a fiscal deficit of 6.9% of GDP in 2021–2022 and 6.4% in 2022–2023, as the government plans to increase spending on transportation, infrastructure, and construction projects, while proposing to reduce the deficit to 4.5% by 2025–2026. In response to the spread of Covid-19 in India, the government's fiscal deficit in 2020–2021 was 9.4% of GDP. However, India was able to reduce the deficit after the first year of the pandemic, and was on track to restore a sound government budget when geopolitical tensions came to a head.

However, the analogy with Sri Lanka and Pakistan or the reference to the twin deficits is flawed, as the impetus did not come from a higher government deficit causing the deterioration in the current account deficit. The effect may in fact be reversed, as the trade deficit worsened to $20 billion in April 2022, an increase of over 30 percent from last year. While the total value of goods exports and imports increased year-on-year in April 2022, a month-on-month decline was recorded. Analysts believe that both the war in Ukraine and the monetary tightening policy of the FED are the reasons for the deterioration of India's trade and current account balance.

Analysts argue that a possible economic policy consequence of the twin deficits could be India accelerating privatization, receiving funds for economic policy projects, and repairing the gap in the state budget. Rajiv Biswas, APAC chief economist at S&P Global Market Intelligence, stated the following to the press at India's privatization of Life Insurance Corporation: "The Indian government has identified further government privatization of state assets as an important part of its economic policy agenda over the medium term (...) The objectives include helping to narrow the budget deficit as well as providing additional funding for government infrastructure projects." Privatization began in India in the 1990s and resumed in the early 2000s, but large parts of the economy continue to be dominated by state-owned enterprises. The reason why the privatization process has been slow and policymakers hesitant during these decades was that the process has always been hotly debated in India, and parties in power appeared to support privatization as long as they could cite the economic benefits, while the opposition concluded that privatization led to job losses and declining political popularity among voters. This time, economic considerations may prevail alongside political ones, and the privatization process may gain new momentum in India.

	2004–2013	2014	2015	2016	2017	2018	2019	2020	2021	2022 (forecast)
Inflation	8.2	5.8	4.9	4.5	3.6	3.4	4.8	6.2	5.5	6.1
Current account deficit	-	-1.3	-1.0	-0.6	-1.8	-2.1	-0.9	0.9	-1.6	-3.1

Table 3 Consumer price index and current account balance in term of GDP (%)

Summary

The most obvious sign that India has begun to contain inflation has been the increase in the policy repo rate, and the Reserve Bank of India has also increased the reserve ratio for commercial bank cash reserves. These domestic steps reinforce the effect of the FED raising key interest rates. The price of containing inflation will be a decline in growth rates everywhere, including in India, where the latest forecasts predict a decline in the GDP growth rate for fiscal year 2022–2023. (See Table 1) India will be the fastest growing major economy in 2022. (See Table 4)

The Department of Economic Affairs summarizes the challenges and trends of the Indian economy thus:

- Over a longer period of time, inflation is not seen as a major challenge, as measures taken by the government and the Reserve Bank of India mitigate the risk of persistent inflation. Lower global demand also lowers price expectations.
- Sufficient water levels in reservoirs and normal expected rainfall promise good harvests for Indian agriculture.
- The manufacturing purchasing managers' index rose to 54.7 percent in April 2022, up from 54 percent in March 2022.
- April 2022 was the 14th consecutive month of double-digit growth in goods exports, with services exports also showing high growth.

The International Monetary Fund is considerably less optimistic in its April 2022 forecast, pointing to significant downgrades for Japan and India and arguing that these downgrades "reflect in part weaker domestic demand-as higher oil prices are expected to weigh on private consumption and investment-and a drag from lower net exports."

The likely future scenario lies somewhere between the Department of Economic Affairs' optimistic forecast and the more gloomy IMF forecast. India could benefit from the changing geopolitical landscape if it continues to find a balance between competing superpowers, and does not enter into an alliance with any player under the current circumstances.

Countries, regions	2022	2023
Advanced economies		
United States	3.7	2.3
Euro zone	2.8	2.3
Germany	2.1	2.7
France	2.9	1.4
Japan	2.4	2.3
United Kingdom	3.7	1.2
Emerging and developing countries		
China	4.4	5.1
India	8.2	6.9
Russia	-8.5	-2.3
Brazil	0.2	1.4
Mexico	2.0	2.5
South Africa	1.9	1.4

Table 4 Real GDP Growth Projections (percentage)