Hiding the pain

India Inc is going through Covid-19, with the country facing strong headwinds against economic growth, which is likely to delay its recovery. The government needs to address the issues on a war-footing to reach its ambitious target of $5 trillion by 2025

In its 'State of the Economy' report, the Reserve Bank of India (RBI) has affirmed that the 'economy is holding up well', while also alerting the nation to the fact that the resurgence in Covid infections, 'if not contained in time, risks protracted restrictions and disruptions in supply chains and consequent inflationary pressures'. RBI's warning comes at a time when prospects of regional lockdowns have increased, with rising cases of corona virus infections. It is important to entrench India's inflation at 4 per cent, so that it can continue to play its stabilising role, the central bank feels.

"Strong headwinds to growth are materialising, as India is confronted with a much more intense and severe second wave of the corona virus," explains Arun Singh, Global Chief Economist, Dun & Bradstreet. "As restrictions on social distancing increases, consumer demand, especially in the urban centres, will be severely curtailed, in turn impacting the already subdued industrial activity. The loss in confidence and rising health care expenses will further dent consumption expenditure. The impact of localised lockdowns and social distancing measures on the high-contact services sectors could wipe out the gains we have achieved during the previous two quarters." Singh was commenting on the report for the month of April.

Though, according to the Dun & Bradstreet Covid-19 business disruption tracker, the number of businesses disrupted stood at only 13 per cent during the first week of April 2021, as against 31 per cent in February 2021, "this is expected to accelerate in view of the current restrictions imposed. The stricter the restrictions and the longer the period of enforcement, the larger the impact will be on the economy," adds Singh.

"The real pain in the economy is

the rather abrupt disruption to the economic recovery, which was underway in the second half of 2020-21," says Ajay Mahajan, MD & CEO, CARE Ratings Ltd. "This was due to the steep levels of infections caused by the second wave and the consequent lockdowns. This, in turn, has an impact on employment, which has still not recovered post the lockdown-I we had last year. While we expected things to turn around later this year, the progress will now be slow and limited, with the overall recovery taking one more year to come into full effect. Before the second wave, we had believed that, by 2023-24, we would be back to the path of growth of 7 per cent, which may be difficult to achieve now, given the uncertainty."

The impact of job loss

The second round of lockdown has come upon people and businesses before they had time to recover from the earlier one and settle down. "The main impact is the 'job loss' unlike in other countries, which have social security provisions so that they do not have to suffer that much," observes Sunil Pachisia, investment manager, Pratibhuti.

Besides job losses, people are also afraid of fulfilling their financial commitments, as any default therein will create problems not only to the individuals but also to those who have lent money or services. "EMIs towards various loans, taken for children's education or, more importantly, healthcare expenses, were not a drag on the income earlier," explains Pachisia. "But, now, they form a major part of monthly expenses. The government has done little for the people of such income levels and, during the current pandemic, this class is going to bleed the most."

"The second wave has severely impacted urban locations and, as health infrastructure woes got exposed, people have undergone traumatic experiences," points out Ajay Garg, MD, Equirus Capital Ltd. "But, given the people's inherent resilience, we do not expect too many scars or disruptions to surface later."

The real pain is of liquidity in the economy. "As businesses are down, receipts and payments have got stuck and that has led to delays in paying lenders as well as vendors. With the capex taking a backseat, the employment generation machine is also down", says Laxmikant Gupta, principal, associated with RiskPro India Ventures and an independent consultant.

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"Currently, the biggest risk faced by the economy is the depletion of demand in the hands of the lower middle class, which is considered to be the biggest consumer class. This may have a cascading effect on widening income inequality, thereby causing permanent destruction in select pockets of demand," observes Nirali Shah, head, equity research, Samco group.

The liquidity crisis has hit small and medium enterprises (MSMEs) the most and, though the government has come up with its Guaranteed Emergency Credit Line (GECL), this has not been found sufficient to meet the expenses involved. "The MSMEs are finding it hard to survive the liquidity problems, along with the fall in demand, labour exodus, frequent lockdowns and a bleak future. The government's recent pre-pack insolvency scheme for the MSME sector may, to some extent, help companies, but how much the banks will cut is a cause for

The pandemic has also created awareness amongst the people leading the healthcare sector to evolve from being curative to be preventive. The growing life expectancy, elderly population, sedentary lifestyle, health insurance reforms, strong economic growth in emerging markets and home care/ monitoring and preventive healthcare are some of the key drivers for growth in the sector

Mahesh Singhi, *founder & MD, Singhi & Co.*

concern," observes Lalit Dangi, CMD, Libord Financial Services.

MSMEs will have to change their approach to business and innovate to survive, revive and thrive. "They will have to focus on asset-light models, improvement in productivity, cost of funds and increasing their efficiency. Some of them will change, some of them will be acquired and some of them will close down. Only the fittest and most adaptable will survive," says Himanshu Kohli, founder, Client Associates.

Currently, the infection, mortality and spread of the pandemic are cause for regional lockdowns. There is a likelihood of a national lockdown too, which might be needed to contain the spread. "That will hurt the growth momentum generated after 20 June," says Nilesh Shah, group president & MD, Kotak Mahindra Asset Management Co.

"The one big difference is that, compared to lockdown-I, this time, there is a tangible instrument of prevention in the form of vaccines. If the constraint of supply is addressed through various measures and dispensations provided by the government, it will definitely help in controlling the transmission of the disease, once a reasonable percentage of people in the country are vaccinated," adds Mahajan.

Today, varying decisions have been taken by different states to deal with the crisis, with the models used for lockdowns also being different. States like AP, Telangana and Odisha, which are not under the pressure of assembly elections, have opted for lighter lockdowns, which has had a milder impact on business.

Some states have announced a total lockdown to curtail the worsening Covid spread. Despite selective restrictions in place, most manufacturing companies are allowed to operate with relaxed Covid protocols, with restrictions only on oxygen consumption for industrial use, as it is earmarked for medical use for needy Covid patients. "This will limit the adverse impact felt on business, unlike in the previous lockdown, when there was a complete stoppage of economic activities," argues Mahesh Singhi, founder & MD, Singhi & Co.

Balancing the situation

States which do not have high infection levels tend to have less severe lockdowns. "However, we have seen a pattern. Even in Maharashtra, the state to be infected the most, the lockdowns came in stages; it took 10 days for the state to move from night curfews to full lockdown. The same may be expected in other states too, depending on the spread. The post-election and Kumbh Mela syndromes need to be monitored," says Mahajan.

The state governments are trying to balance the situation with selective restrictions this time, taking a lesson from the previous lockdown. The idea is to minimise the impact on those who were severely impacted last year, such as daily wage workers and migrant labourers. "Also, small and medium enterprises are still vulnerable, as they are on the path to recovery after the previous dent and a complete lockdown might act as the final nail on the coffin for them. By placing selective restrictions, the governments have offered room to continue their operations, while following the guidelines to curtail the virus spread," observes Gurpreet Sidana, COO, Religare Broking.

Under the direct supervision of the prime minister; the states are doing their best while industry has come forward to contribute by diverting industry oxygen to medical oxygen, providing logistics. While the danger is looming in some rural areas, most of the rural landscape remains safe so far

Deepak Sood, *secretary general at ASSOCHAM*

"All-out war-footing efforts are underway by the government. Under the direct supervision of the prime minister; the states are doing their best while industry has come forward to contribute by diverting industry oxygen to medical oxygen, providing logistics. The global help in terms of medical infrastructure and vaccination is being graciously accepted. While the danger is looming in some rural areas, most of the rural landscape remains safe so far," explains Deepak Sood, secretary general at ASSOCHAM.

With these selective restrictions and lockdowns ordered by various state governments, mobility is experiencing yet another hiccup. Lockdowns have curbed most normal economic activities, thus posing a supply chain risk. Though, unlike in the last wave, there are not many restrictions on the transportation of goods, supply chain disruptions are bound to occur at least in the short term in a few areas. "Many listed automobile players, who maintain high levels of corporate governance, have intimated exchanges about closure of factories, which are likely to distort supply chains; a few other industries are already facing such issues," adds Shah.

No clear picture, yet

Last year, rural India was largely untouched by the virus but, this time, there appears to be a seepage to these areas, which can affect the sowing of the kharif crops, besides the harvest of the rabi crop, which is now going on. "Again, a clear picture will emerge only during the course of the year, say, by June. There is no way to pre-empt the contagion, as one is not sure where the carriers originate from," says Mahajan. "The problem however is that, as business activity slows down, there will be a tendency for unemployment to increase, and we have already seen migrants rushing back from Maharashtra and Delhi. This can lead to a shortage of staff in the transport business, just like last year. Also, with the infection spreading in places of work, logistic centres could be affected too, if the virus spreads. But, till now there does not appear to be a major challenge."

"Rural demand, the pillar of our economy, could be hit, if the virus reaches villages. The ultimate danger is the destruction of demand coming from the lower middle class of the population," observes Shah. This section being the biggest category that generates demand, the risk would spiral and broaden income inequality, which would ultimately cause permanent demand destruction. "A faster inoculation drive is the only sensible course of action left to de-risk permanent demand destruction."

This is a major issue – the virus spreading to rural areas being detrimental to the agricultural sector. There will be a pile-up of rabi crops, because of the shortage of labour for harvesting and logistics purposes, which may create economic burdens by way of inflation, loss of rural income and overall loss of rural demand. "The other side of the story is that, as of now, 81 per cent of wheat has already been harvested and, at the same time, other products like oilseeds and pulses are also under harvesting. Due to the lower density of population in rural areas, the severity of the spread may not be that high. However, the spread of the virus among the army and defence logistics network may pose danger too, from the defence perspective," observes Gupta, feeling that, if the severity of the virus spread affects the manufacturing sector, especially the production and distribution areas, then, that puts the overall output, demand and employment at risk too.

Currently, the biggest risk faced by the economy is the depletion of demand in the hands of the lower middle class, which is considered to be the biggest consumer class. This may have a cascading effect on widening income inequality, thereby causing permanent destruction in select pockets of demand

Nirali Shah, *head, equity research, Samco group*

"Supplies may get affected," warns Gupta. "Already there is a shortfall of oil demand due to the second surge of virus. Shortage of vaccines from time to time, stalls the vaccination drive and increases the risk of the virus spread. There should be a serious and permanent solution to curtail vaccine shortages."

Amidst this gloom, there are certain sectors of the economy that continue to shine. Sectors considered essential, are doing well, as demand is buoyant and will continue to be so. This includes FMCG and pharma in particular. IT, telecom and BFSI are also expected to perform well, as these businesses are not transacted in physical mode and, hence, there will be fewer points of contact here.

"IT is another area that causes less tension, as it is digital-based and thus any client interaction required can be done through the internet. So, the work from home (WFH) mode has in fact helped this sector the most, dragging down costs," says Pachisia.

"Yes, the IT and Telecom have been at the forefront of the battle along with the health infrastructure. Whether it is the dashboard of a municipality or state government or the Central Government, the IT is playing a key role in responding to the Covid challenge," says Sood.

"The Indian IT has been providing such support not only within the country but to their global clients as well. The FMCG sector too has been performing well while demand for steel, speciality chemicals including API, metals, cement has been on upswing, notwithstanding the sudden eruption of the second wave." adds Sood.

IT sector, which has a strong foundation in the country, has adapted well to the changing scenarios. "The country has capitalised on emerging technologies and its applications in various sectors of knowledge and economy. Digital space, including new services like big data, analytics and artificial intelligence, has increased opportunities. In India, the government and BFSI have continued to be the main drivers," says Gupta, who feels healthcare is definitely a winner during this situation, due to a lot of immunity-related demands, as also additional demands

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arising out of health awareness. "Other related areas with prospects of growth are diagnostic devices and other medical devices, medicines required during Covid treatment, medical oxygen, etc".

"The pandemic has also created awareness amongst the people leading the healthcare sector to evolve from being curative to be preventive. The growing life expectancy, elderly population, sedentary lifestyle, health insurance reforms, strong economic growth in emerging markets and home care/ monitoring and preventive healthcare are some of the key drivers for growth in the sector," points out Singhi.

IT in general, and pharma in particular, are considered to be defensive bets from a market perspective. "IT did well during the pandemic because of the need to improve efficiency and go digital in many aspects of our life. Be it to work from home or to improve industrial efficiency, technology is needed everywhere. This has boosted winning deals and, thereby, margins of a majority of IT players," argues Shah of Samco.

"Also, given that we are in a pandemic and pharma as a sector had relatively underperformed in the past couple of years, the last year saw a revival in cycle in healthcare with increase in drug supplies, as also heightened demand for medicines and vaccines. Further, going ahead, the government may look to boost healthcare infrastructure by allocating a larger share from its kitty. We may expect to see consolidation in the healthcare segment, along with initiation of a fresh capex cycle in building physical infrastructure, which may turn out to be a dark horse in the long run," suggests Shah.

The entire chemical sector also has witnessed robust growth and has been positively impacted due to the shift of supply chain in the post Covid world, where globally all companies are looking at alternative suppliers to China. "Chemicals and more specifically, specialty chemicals including APIs, have seen significant growth over the past year. The pandemic has also created awareness amongst the people, leading the healthcare sector to evolve from curative to preventive," says Singhi. Sectors such as building materials and packaging are the new growth drivers, adds Singhi, fuelled as they are by increased economic activities in rural India and growth in pharma & e-commerce, which has directly increased demand of primary and secondary packaging.

"Residential real estate is positively affected, since everyone needs an extra room in his/her home, as the WFH culture/ hybrid model is going to continue in the corporate world. Hence, the demand for bigger houses will go up, which will make the sector relatively attractive. Green shoots have already been visible in this space," suggests Kohli. "Digitally enabled entertainment, such as Amazon Prime, Netflix, etc, will see a higher viewership and, hence, the sector will witness growth. So will data consumption," he adds.

Sectors under stress

Among the sectors that are reeling under pressure and continue to be adversely impacted are the travel, hospitality, hotels and entertainment sectors, which will take a long time to recover. These are the sectors where restrictions were imposed first, to curtail the spread of the virus. "Hotels, restaurants, movie theatres, malls, etc, are facing huge operating losses

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Lalit Dangi, *CMD, Libord Financial Services* month on month due to high fixed overheads incurred and restrictions on business. Though domestic tourism in India had picked up somewhat in the past few months, with people wanting to explore and vacation within the country, as they had limited options to travel, the second wave has brought travelling to a halt, due to a fear amongst the people that they would contract the virus," says Singhi.

"Services feel the pressure immediately when a lockdown is imposed, as business gets closed overnight. These sectors will not only have to down their shutters, but they may also have to lay off some staff, given the uncertainties," observes Mahajan. Even when the new unlocking begins, these sectors will come last in the pecking order, as they cannot follow rules of social distancing which, hence, exacerbates the time lines.

Against this backdrop, what should the government do, in terms of sops like grants, etc? It has already taken a bold step in the budget to go for spending and use its fiscal space. And, till variables are clear on this challenge, "they should follow strategies like 'last time of preserving fiscal space' and using measures like 'interest rate cuts' and 'TDS rate cuts'," says Garg.

The government has little leverage, we feel that a focussed, upfront-funded infrastructure development is the best way to restore confidence, jobs and growth. We have a national infrastructure pipeline, which needs to be taken up on priority, even if we have to borrow more

Nilaya Varma, *CEO & co-founder, Primus Partners*

Need for stimulus

Given the impact of spending on auto and housing has on the economy, the government can look to be more explicit on new car subsidies, while also pushing the scrappage policy and enhancing the limit on interest payment deduction for house purchases. Employment subsidies in the form of tax credit for a limited time for companies engaged in travel/hospitality/leisure will assuage some of the pain.

"In the long term, the government has to really take significant measures and reforms to improve the healthcare sector, as we can't have aspiring superpower citizens needing to figure out who they can call to get medical attention or a hospital bed or treatment. This needs to be corrected – change the mindset of people first, rather than putting control on them, as we have enough talent to take care of the population. As the sector had its challenge in meeting the cost of capital criteria for debt and equity market, the management has found it harder to build good infrastructure; so, what we need is an overall reformist approach," adds Garg.

"There will be a need for stimulus," says Shah of Kotak Mahindra. "Monetary stimulus is already on. The RBI has done a fantastic job of keeping rates under check and liquidity stable. They have built strong forex reserves. What we need is fiscal stimulus in the form of higher allocation to MNREGA and, maybe, an urban version of the same. The speed with which we build PPE- and mask-making capacities should be replicated to help all aspects of the economy."

"The government has little leverage," points out Nilaya Varma, CEO & co-founder, Primus Partners. "We feel that a focussed, upfront-funded infrastructure development is the best way to restore confidence, jobs and growth. We have a national infrastructure pipeline, which needs to be taken up on priority, even if we have to borrow more."

What we need from the government is not financial grants and freebies, but clear directives to official machinery to be 'business enablers', and not 'business challengers'. "Since 50-60 per cent of the business is dependent on government spending or social expenditures (such as infra, defence, agriculture, education, healthcare, internal security, etc) in a large economy like India, it is important to take an upfront plunge to clean up past backlogs and make a fundamental change in the business generating cycle, by rewarding quality and efficiency/outcome, instead of cost alone and do away with 'lowest cost wins the business' to the 'efficient one wins the business'. The competitive bidding and awarding of business through public tenders should not be on the basis of 'L-1' as winners but on 'L-2' basis, while L-1 should be perceived as a weak player," suggests Singhi.

So, what is the expected economic growth in the near term? "We feel the growth will be 10.2 per cent due to the two months of lockdown. The fall in expected growth may be even sharper, as I believe it could take longer for the infection rates to peak. That implies that, in a somewhat pessimistic scenario, the slowdown may hit Q2 of 2021-22 as well, and then our estimate could get pushed lower to 7-8 per cent," predicts Mahajan.

"Ideally, tax cuts should have been there in the budget, but the government chose not to do so. This is what has kept consumption back. Job losses, no salary increases and absence of tax reliefs have impacted household consumption. It will take till 2023-24 before we see real growth come back. Fed measures do affect FPI flows, which affect our markets as well. But our monetary policy is based on domestic considerations and is not influenced by Fed measures. At present, any halt to the stimulus will affect the balance of payment and not growth internally, as we are still a domestic-driven economy," adds Mahajan.

Shah of Kotak Mahindra feels that India is giving far more importance to the US Fed than necessary. "It has become a convenient point to talk and shift focus from our house, when it is not in order. Our economy can grow in double digits, despite the US Fed raising rates or doing the equivalent of a taper tantrum. China has shown the path to achieve singular growth focus. If we execute projects, be they Reliance Jamnagar refinery, Delhi airport or Delhi Metro, that will enhance the possibility of strong growth."

In the event of the second wave hitting the economy but with reduced adverse impact because of expected vaccinations, "The Indian GDP is expected to grow at 4-5 per cent over the pre-Covid period (2019-20) and 10-11 per cent over the Covid year (2020-21). More than the stimulus, it's the government initiatives that should be accelerated to help corporate India invest in capital assets, similar to schemes like PLIs. Or, help corporate India in capacity building and dole out large projects towards infrastructure spending, which will make India competitive over the long term," Singhi feels. He also suggests that a selective stimulus package could increase directed spending and boost economic activities amongst micro and small business enterprises, while providing increased liquidity in this space, which is desirable.

A story of two halves

According to Dipti Deshpande, principal economist, CRISIL: "For now, we maintain our base case GDP forecast for 2021-22 at 11 per cent, though downside risks have risen and can materialise, if the surge in cases and lockdowns extend into May." She bases her analysis on two reasons: one, the restrictions so far are lower than last year's in terms of number of days and stringency, and thus less restrictive of economic activity. Also, these are concentrated in select states, with manufacturing, construction and other essential activities still allowed to function. Secondly, though high-frequency indicators, such as electricity consumption, GST e-way bill collections, mobility indicators, rail travel bookings, railway and road freight transport are showing some softening, it remains to be seen whether these trends will be sustained.

"We see 2021-22 as a story of two halves – the first half characterised by base effect but clouded by spread of the pandemic; the second half as one of broad-based growth riding on vaccination and a living-with-the-virus attitude, supporting sectors that are lagging," explains Deshpande. "Also, the second half should see stronger global growth, supporting India's exports to an extent. Of concern, however, is the growing divergence between industry and services sectors. Up till now, while industry was witnessing a recovery, the services sector – mainly, contact-based services – were lagging. With the restrictions on non-essential activities and social distancing norms expected to continue for a while, many of these services will take longer to recover, thus widening the gap. The situation remains fluid and we are monitoring the extent and stringency of restrictions to assess the downside risks to our forecast."

MSMEs will have to focus on asset-light models, improvement in productivity, cost of funds and increasing their efficiency. Some of them will change, some of them will be acquired and some of them will close down. Only the fittest and most adaptable will survive

Himanshu Kohli, *founder, Client Associates*

"India is on the growth path. Covid is a hiccup, which will definitely pass through and the Indian economy will again come on a trajectory path soon. Hopefully, 2021-22 will break all the records," says an upbeat Dangi.

Kohli expects the GDP to grow at a high single-digit to a low double-digit number in 2021-22. "We can see a 9-11 per cent growth in GDP, while corporate earnings (earnings of Nifty 500 or BSE 500) could grow by 20 per cent. "All this is due to the low base effect of 2020-21 and the continuous efforts by everyone to improve productivity."

Kohli is quite hopeful that India will become a $5 trillion economy, but expecting it to become so by 2025 is too optimistic. "If we go with what the equity markets are predicting (as they move ahead of the economy), it is the expectation of growth of our economy in 2021-22 and healthy growth for the next few years thereafter. But there are short-term and long-term risks to this growth. In the short term, extended level lockdowns or national lockdown (if the health situation is not controlled) could be speed-breakers. In the long term, possible bottlenecks could be the 3 Cs: Complex regulatory environment within India, Competitiveness of Indian industry and China's increasing diplomatic, as also industrial, dominance.

"However, if the Fed reserve stops pumping dollars, it will lead to reduction of liquidity in the emerging markets and, hence, it may also have an adverse impact on the growth of the Indian economy," adds Kohli.

However, the economy seems to be on its path to recovery for the long run, albeit with bumps on the way. "Real growth in the economy will progress as our manufacturing and infrastructure sectors continue to grow, ably aided by the government and RBI taking prompt measures to keep the economy lubricated. If so, the recovery should happen as planned," says Shah of Samco.

Nonetheless, it will be critical to monitor the rising Covid cases because that uncertainty is one thing that can puncture our running tyres. "Also, if the Fed raises the interest rates, then the immediate impact could be a turn in the capital flows towards the US, depreciating our currency. But this seems to be the plan for a future date and, for now, handling the Covid situation in India should be the priority in order to meet a 10.5 per cent GDP target for 2021-22. ◆

LANCELOT JOSEPH
lancelot.joseph@businessindiagroup.com