1. The dynamics of India's growth recession: The 2019 economic slowdown is different from 2012-13

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Date: 8 September, 2019

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- ❑ **Why should inflation matter while analysing an economic slowdown?**
- ❑ **Why is Indian economy is slowing down?**
- ❑ **What should government do to combat economic slowdown?**

GS paper 3 (Indian Economy.)

In this video, you can find detailed answers for all the above questions.

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The above article has been retrieved from:

Kaustav Das. (2019, September , 7). Should India worry as global recession fear spreads?. India Today. Retrieved from https://www.indiatoday.in/news-analysis/story/should-india-worry-as-global-recession-fear-spreads-1596088-2019-09-06

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What is the context about?

- India’s GDP growth slowed to 5% in the first quarter of the current fiscal year.

- Since June 2012, the earliest period for which we have quarterly GDP statistics for the current series, GDP growth has only been slower than 5% twice. It was 4.3% in March 2013 and 4.9% in June 2012.

- There is a crucial difference between then and now. Inflation was very high during the earlier slowdown compared to what it is now.

Why should inflation matter while analysing an economic slowdown?

Date: 8 September, 2019

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- It matters because it tells us whether the slowdown is driven by supply- or demand-side factors.

- Illustration: Let us assume that an economy has 10 workers and only one factory, which produces shirts. Five workers are employed in the shirt factory while the other five work in the tourism industry and they need new shirts every month.

- Everything else remaining the same, if the machine producing shirts were to suffer a breakdown leading to a decline in the number of shirts produced everyday, the GDP growth of the economy would go down.

Date: 8 September, 2019

However, because the other five workers are continuing to earn what they were earning from the tourism sector, this will also lead to a scarcity of shirts. This will result in a rise in shirt prices, and hence inflation as the tourism industry workers will try and outbid each other to get shirts. This is a supply-side growth shock.

- While a real economy is infinitely more complex, the thumb rule holds.
- A low-growth, low-inflation situation is more likely to reflect a demand-side problem while a low-growth, high-inflation situation is likely to be the result of a supply-side problem.

Why is Indian economy is slowing down?

Date: 8 September, 2019

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Disruptions and jolt of reforms:

- ✓ Demonetisation happened in 2016, dealing a severe blow to consumption, leading to vicious cycle of job loss and lower income , which led to further drop in demand.
- ✓ Next shock came in the form of a reform, when GST was rolled out in July 2017. This had a knock on effect on exports growth because of delay in refunds to exporters.

Tight monetary and fiscal policies: Monetary policy was focused on inflation control , which ensured interest rates remained hard.

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Global headwinds: with US CHINA trade war , global sentiments have remained poor, making the prospects of an export led growth bleak.

Financial sector still in a mess : NPA ratio is too high. No sooner did NPA ratio start improving in fiscal 2019, the NBFC stress started building up. Stress in Non banking Financial corporations (NBFCs) percolates faster than public banks, because of its greater interconnectedness.

Farmer's empty pockets: Non food inflation continued to surpass food inflation in past two years.

Date: 8 September, 2019

What should government do to combat economic slowdown?

- Many sectors have been struggling to maintain growth amid a slowdown, lakhs of employees across sectors have been laid off and foreign investors are withdrawing crores from the market every day. Like 2008, the central government should focus on implementing a combination of stimulus packages and policy boosters, to stop growth paralysis.

- As investment and consumption continue to fall in India, most economists predicted GDP growth to hit another low in the September quarter; it could further spook investors if the government is unable to come up with sector-specific boosters and tax cuts.
  - ✓ This, however, has to be backed by eased monetary policies, even though it could derail the government's fiscal targets as not addressing the slowdown could have a far worse negative long-term effect.

- Besides adding stimulus packages, the government also needs to keep monitoring the situation for the next two-three months when demand is expected to increase due to the start of the festive season.