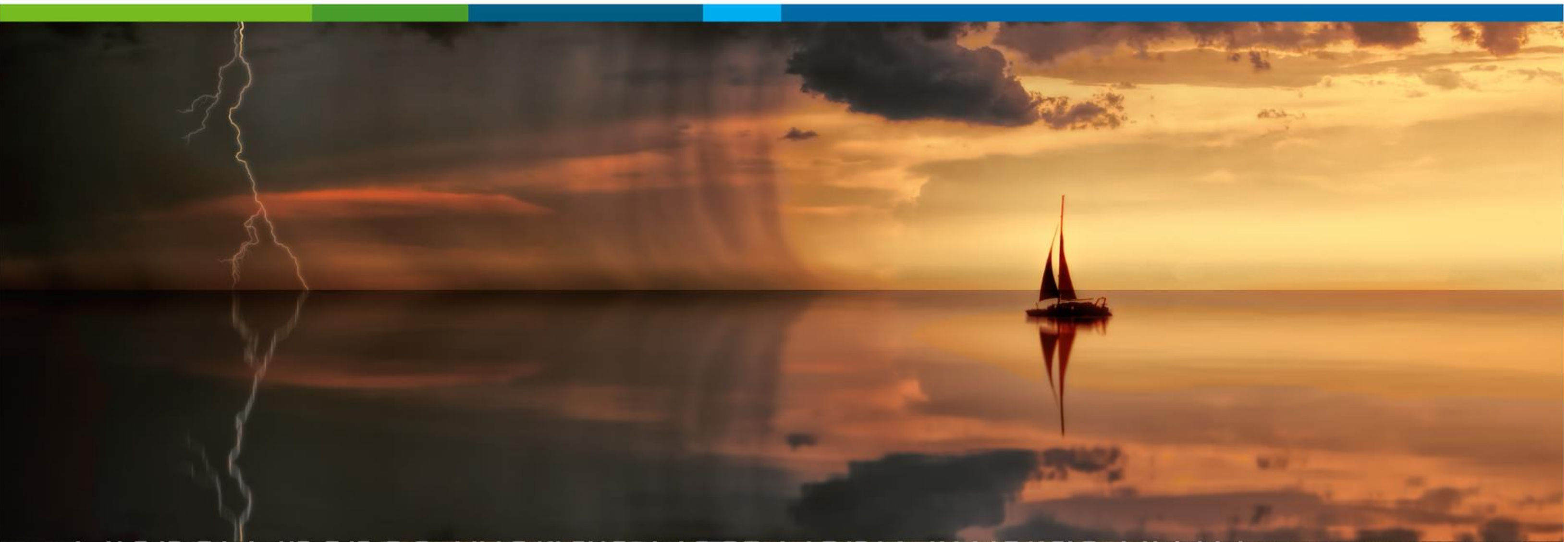

India: facing a three-decade economic low

The impact of the Coronavirus outbreak is hitting India hard. Our growth forecast for the 2020 calendar year is 0.6 per cent, significantly below 5.3 per cent in 2019.

The Reserve Bank of India (RBI) has said that it would do "whatever is necessary" to stabilise financial markets and support the economy.

We see the pandemic hitting India's economy in three ways:

1. The three-week lockdown ending 13 April will reduce GDP growth by 3.5 to 4 percentage points, with the impact split across Fiscal Year (FY) 2020 (35 per cent) and FY21 (65 per cent). A two-week extension of the lockdown could reduce FY21 GDP growth by around another 1.5 percentage points

2. We expect global growth to slow to -0.6 per cent in 2020: 16 per cent of final demand in India depends on the global economy, with the services sector most exposed

3. India's manufacturing sector is vulnerable to supply-chain disruptions led by China, along with the widening outbreak in the US and Europe

Policy response: uncertain times, unconventional measures

The Reserve Bank of India (RBI) has said that it would do “whatever is necessary” to stabilise financial markets and support the economy. In our view, India’s strong policy response will partly offset the drag on the economy and prevent an even deeper slowdown.

To pump liquidity into the economy, the RBI cut the repo rate (the rate at which it lends to commercial banks) by 75bps. The RBI also injected INR3.7 trillion (USD50 billion) of liquidity via a 100bps cash reserve ratio cut and targeted long-term repo operations for banks’ investment in corporate debt instruments.

Both the central government and the states have announced fiscal stimulus totalling at least 2 per cent of GDP to counter the adverse impact on the economy. We expect the fiscal deficit to widen sharply as revenue shortfalls due to slower growth widen both the central and state government deficits by 1 per cent of GDP. We now expect the FY21 deficit to widen to 9.8 per cent of GDP (versus 6.4 per cent previously).

We also expect the Monetary Policy Committee to reduce the repo rate by another 25bps to 4.15 per cent by June 2020, with a risk of more rate cuts if economic conditions deteriorate.

Market outlook

The Indian rupee (INR) has been impacted by fragile risk sentiment and strong foreign portfolio outflows. We have revised our mid-2020 USD-INR forecast higher to 74 (from 73.25 previously). However, given the RBI’s strong reserve position, it is likely to contain exchange rate volatility. Lower crude oil prices should also keep the current account deficit in check.