India Economics Comment

The growth cost of intensifying lockdowns

- **As the second pandemic wave rages, local lockdowns are intensifying**
- **The reported y-o-y GDP growth in the March quarter, and the q-o-q GDP growth in the June quarter, could dip into negative**
- **The RBI's exit plans could get delayed, and fiscal finances could face a three-fold challenge**

As is well known by now, **the ongoing second wave of the pandemic is more infectious than the first wave of 2020** (see chart 1), and new cases are growing faster than testing rates (see chart 2). The wave is also spreading quickly across the states. Cases outside Maharashtra have started to grow faster than in Maharashtra, which accounts for 33% of the new cases (see chart 3). While a nationwide lockdown has been avoided, several local lockdowns have sprouted, and are intensifying.

Most recently, on 13 April, the state government of Maharashtra has announced a 15-day curfew in which only essential services will be allowed. This is an intensification of the measures the state had announced about a fortnight ago (i.e. night curfew and weekend lockdown).

How much will this 15-day curfew in Maharashtra cost? In an earlier report, we had outlined a framework to calculate the cost of such a lockdown. Scaling that by the share of Maharashtra in national GDP, and focusing on one quarter for now, implies a loss of c0.6% of the country's GVA in the quarter ending June. If the curfew is extended beyond 15-days, the cost will be higher.

This is not where it ends. Alongside several states (about 16 of them including Delhi, Gujarat, Karnataka, Bihar, UP and Punjab), have announced other local restrictions (e.g. night curfews, closure of educational institutions and malls, and limits on the number of people gathering in one place). And even though they are not as stringent as Maharashtra's curfew, they are likely to dampen activity and hurt recovery.

Already, our recovery tracker has fallen 6ppt (between February and April 2021, see chart 4), led by falling mobility and fewer e-way bills generated. Strains in the labour market cannot be ignored either. Things were weak even before the second wave struck. About 5mln fewer people were employed in the fiscal year ending March 2021, compared to the previous year. And the loss in jobs was concentrated in urban India, where salaries are 2.5 times higher than in rural India. Since the second wave, unemployment rates have begun to climb again (8.6% in mid-April versus 6.7% in mid-March, source: CMIE).

This is an abridged version of a report by the same title published on 14-Apr-21. Please contact your HSBC representative or email AskResearch@hsbc.com for more information.

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What could the growth impact of the second wave be? It is likely that reported **y-o-y GDP growth in the quarter ending March will dip into negative**. Even before the second wave struck, the Statistics Office was forecasting GDP growth at -1.1% y-o-y for the quarter (GVA growth at +2.5%y-o-y; recall GDP = GVA + indirect taxes – subsidies; this large discrepancy between GDP and GVA growth, we believe, is led by the distortions created by the repayment of past subsidy dues to the Food Corporation of India.

And now with GVA likely to be weaker (trending at +0.7% y-o-y, based on monthly data releases so far), GDP growth for the quarter ending March could come in even more negative (trending at -2.3% y-o-y currently versus +0.4% in the previous quarter).

Furthermore, the **q-o-q sequential momentum in the quarter ending June will likely come in negative**. Led by favourable base effects, the y-o-y growth number will be a large positive (over 20% y-o-y versus –24.4% in the June quarter last year).

But what matters more is the seasonally adjusted q-o-q momentum. That we think will dip into negative after consecutive positive prints over the last three quarters, led by weaker momentum in high-touch services like trade and tourism, as well as construction.

To be fair, once the second wave subsides and a larger proportion of the population are vaccinated, pent-up services demand could push GDP growth back up. But that is likely to be delayed to 2HFY22. A scenario analysis suggests that if India sticks to the run rate of 3.5mln vaccination jabs a day, it could cover over 50% of the population (2 jabs/person) by year end (see chart 5). Alongside this, sero surveys from January show that about 20% of the population may already have the antibodies.

For now, we are sticking to our FY22 GDP forecast of 11.2% y-o-y. There were upside risks to these numbers before the second wave struck, which have gone away for now. If lockdowns intensify or spill over well into May, downside risks would emerge.

India's inflation rate is likely to remain elevated. We expect CPI inflation at c5% in FY22, higher than the 4% target, but lower than the 6% upper tolerance limit. We also forecast elevated CPI core inflation, in the 5.5-6% range.

These above-target prints, are likely to be a result of three factors. One, pass-through of higher input costs from corporates to consumers (USD20/b higher oil prices could add 0.7ppt to headline inflation). Two, disruption in the informal sector led by lockdowns was the main driver of rising prices in 2020, and some of these pressures could resurface. Three, a rise in services inflation once pent-up services demand rises back up, likely in 2HFY22.

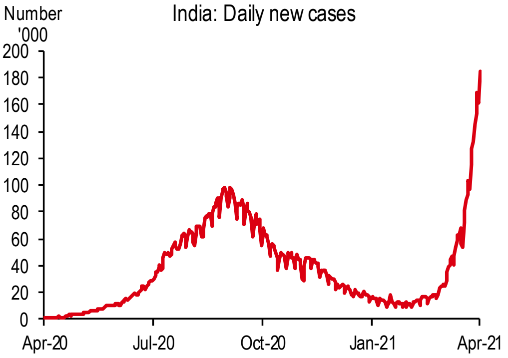
The gradual exit from loose monetary policy may now get delayed. And yet, inflation risks cannot be fully ignored. We believe the RBI will embark on a gradual exit as the current pandemic wave subsides and the vaccination drive reaches critical mass towards end-2021.

We expect it to raise the reverse repo rate (3.35% currently) and change stance from accommodative to neutral, in that order, around 4Q2021. However, we are not forecasting any hikes in the repo rate (currently at 4%) over the foreseeable future.

Fiscal finances could face a three-fold challenge. One, the demand for social welfare schemes like the rural NREGA programme could rise back up as some labour is dislocated again (though perhaps not as much as in 2020). Two, if GDP slows, so might the recent buoyancy in tax revenues. Three, if capital markets remain volatile, asset sales could get delayed. Yet, now is the time to ensure that the government meets its asset sales target (at 0.8% of GDP for FY22), as that is the only way it can meet its current spending and future debt reduction targets.

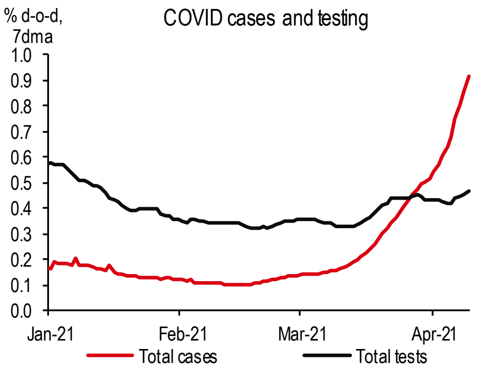
All told, gripped with a strong second wave, growth in 1HFY22 is likely to get impacted, though not as much as in 1HFY21, when lockdowns were more severe and far-reaching, and the economy had not adapted to the new normal. Fiscal finances may come under pressure again, and the RBI's gradual exit from loose monetary policy could get pushed out to 4Q2021.

Chart 1: The second pandemic wave is more infectious than the first wave



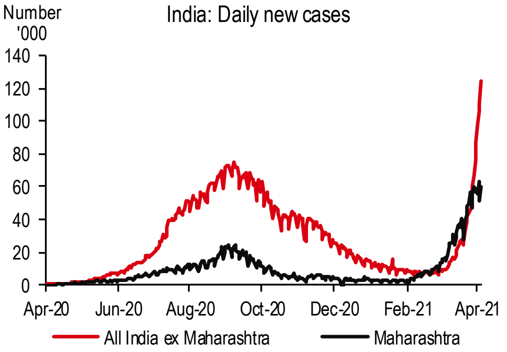
Source: CEIC, HSBC

Chart 2: New cases are growing faster than testing rates



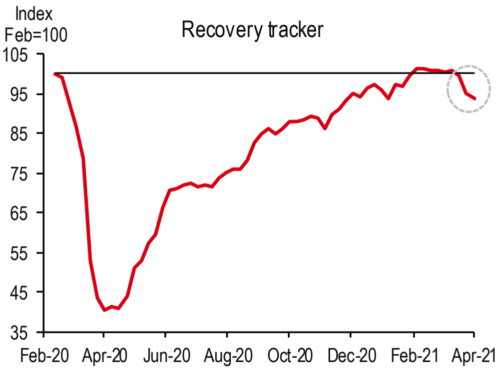
Source: Our World In Data, HSBC

Chart 3: Cases outside Maharashtra have started to grow quickly



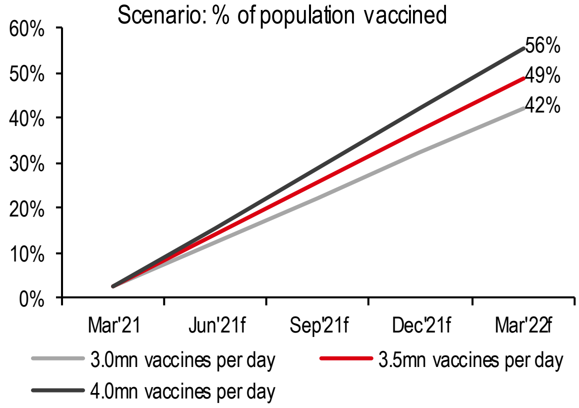
Source: CEIC, HSBC

Chart 4: The recovery tracker has fallen 6ppt (between February and April 2021)



Source: CEIC, POSOCO, GSTN, HSBC. The tracker includes six variables: Google mobility (workplace, recreation), Apple mobility (driving), labour force participation, electricity consumption and e-way bills generation

Chart 5: If India sticks to the run rate of 3.5mln jabs a day, it could cover over 50% of the population by year end



Source: HSBC estimates. Note: This is a scenario analysis assuming 2 jabs per person

Disclosure appendix

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CIN: U67120MH1994PTC081575

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