Q2 of 2020-21 GDP Data - Historic Recession

Why in news?

India's gross domestic product (GDP) contracted by 7.5% during the July, August, and September quarter (Q2) of 2020-2021.

What does this mean?

- In Q2 of 2020-21, India produced 7.5% fewer goods and services when compared to what India produced in Q2 of 2019-20.
- Q1 saw nearly 24% contraction.
- In the process, India's economy has now formally entered into a **technical recession**.
- This is because, along with Q1 contraction, India has had two consecutive quarters when GDP growth rate has declined.

Why then is the 7.5% decline seen favourable?

- **Lower** - The 7.5% figure is decidedly lower than most other estimates.
- Moreover, this sharper-than-expected economic "recovery" has substantially changed how the Indian economy is being viewed.
- The 24% fall in GDP in Q1 was one of the worst among the major economies of the world.
- But the average decline of some 49 countries who have declared GDP data for the July-Sept quarter is 12.4%.
- So, India's 7.5% contraction is better than the global average.
- In the previous quarter (April, May, June), the average of these 49 economies was minus 5.6% while India contracted by almost 24%.
- **Broad-based recovery** - The economic recovery in India is fairly broad-based.
- The percentage change in the GVA (Gross Value Added) of each sector when compared to the same quarter in 2019-20 reveals this.
    - The GVA data provides a measure of national income by looking at the value-added by different sectors of the economy in that quarter.
- GVA data shows that as compared to just one sector adding positive value in

Q1, three sectors added positive value in Q2.
    - These were agriculture, manufacturing and utilities.
    - Moreover, in three of the remaining five sectors, the rate of decline decelerated.

What is the caution that manufacturing sector data makes?

- The most surprising aspect of Q2 data is the positive growth (albeit a meagre 0.6%) registered by India's manufacturing industry.
- Part of this can be explained by a weak base, given the minus 0.6% in Q2 of 2019-20.
    - The Q2 of 2019-20 had witnessed a contraction and the statistical effect of a low base coupled with inventory restocking likely lifted the figure.
- But, even so, it is notable that India's manufacturing firms managed to add value in such difficult times.
- Especially since other markers of such industrial activity performed rather poorly during the same period.
    - The Index of Industrial Production (IIP), for instance, is generally highly correlated with manufacturing sector's GVA.
    - But, this correlation collapsed in Q2 when IIP manufacturing declined by 6.7% (average of Jul-Sep) while manufacturing GVA grew by 0.6%.
- One possible reason for this could be favourable Corporate GVA numbers in Q2 on the back of massive cut down in costs.
- Further, small companies, with turnover of up to Rs 500 crore, are more aggressive in cutting cost, displaying reduction in employee cost by 10-12%.
- In other words, companies increased their incomes not by selling more but by ruthlessly getting rid of employees.
- This, in turn, could undermine future demand.

What is the 'demand' scenario?

- GDP data shows that all engines of growth were performing far below normal.
- The four growth engines are:
    1. Private Final Consumption Expenditure (PFCE)
    2. Government Final Consumption Expenditure (GFCE)
    3. Gross Fixed Capital Formation (GFCF)
    4. Exports and Imports
- The PFCE refers to what common people spend on consumption and this is the biggest engine of demand.
    - This spending was down 11% in this Q2 when compared to Q2 of 2019-20.
- The GFCF refers to the demand generated by investments made in the

economy by the businesses/firms - both big and small.
  - This component is the second biggest engine of growth and it was 7% less than what it was in Q2 of 2019-20.
- Both exports and imports have shrunk but imports have shrunk relatively more than exports.
  - Given this, net exports have improved marginally.
  - This provides a boost to aggregate demand in a relative sense.
  - However, such a sharp fall in import demand does not augur well for a growing economy such as India.
- The worst news, however, is that the GFCE or the spending by the government in Q2 is down by over 22% over the Q2 in 2019-20.
  - This underscores the concern that the government is not spending enough to boost economic recovery.
  - As a result, the Q2's real GDP in absolute terms is lower than what it was even 2 years ago.
  - However, the Q2 GDP data points to a trend where India will most probably witness positive growth rate in "nominal" GDP as early as the Q3 which is currently underway.
- In all, the economy needs a robust demand stimulus if a prolonged down phase is to be prevented.

Source: The Indian Express