Bangalore Chamber of Industry and Commerce

BCIC RECOMMENDATIONS ON

RBI ECONOMIC POLICY IMPLEMENTATION POST PANDEMIC

Foreword

The ramifications of Covid-19 pandemic on the world have been on an unprecedented scale and the effects of the same will be felt for days at stretch. The pandemic has had an enormous negative impact on Individuals, Small Businesses and Large organisations; Private and Government alike.

The pandemic threw the livelihood of Individuals in unorganised sector in disarray and brought the functioning of business to a standstill.

Some of the major organisations could withstand the shocks, however the small business which constitutes 95% of businesses in India is the 2nd biggest employer after agriculture had to face the brunt of the pandemic.

Given the issues and its long-term impact on the economy due to the pandemic, the Government of India through its nodal agency Reserve Bank of India (RBI) brought out a slew of measures to alleviate the problems faced by small businesses. Notwithstanding the measures promulgated by RBI, the effects of such measures are still percolating and not yet made a significant impact on the ground.

The report "BCIC's recommendations on RBI economic policy implementation post pandemic" addresses the gaps in implementation of these policies and recommends key measures that can be considered by RBI for seeds sown by RBI to reach the rightful owners in the right manner.

This report is the culmination of effort of Bangalore Chamber of Industry and Commerce and report content is facilitated by group led by **Mr. P. N. Vijay** who is an investment banker along with **Mr. N Venkatakrishnan**, Mentor Banking & Corporate Affairs Committee; **Dr. K V Omprakash**, Chairman, Banking & Corporate Affairs Committee, **Mr. Joydeep Nag**, Co-Chair Banking & Corporate Affairs Committee and **Dr. Rumki Majumdar**, an Economist and Researcher at Deloitte.

This report shares "Risks that weighs on RBI's policy implementation dilemma", the Challenges that RBI has to keep an eye on, the revival of NBFCs/ HFCs/MFIs, MSME and Funds, Job creation and incentivisation and Demand creation with recommendation for each area to be considered for adoption by RBI.

We hope the insights and recommendations shared in this report to be useful.

Mr. P N Vijay
MD-Loan Saathi

Mr. P N Vijay is an Investment Banker with 48 years of experience in Investment Banking, Lending, Corporate Governance Banking and Public Affairs. During this period he has worked on countless Fund raising, M&A and Corporate Restructuring transactions both in India and Overseas. He is also been several Boards and Board Committees and with Regulators on Corporate Governance.

Mr. P N Vijay is active in Public Affairs last 30-odd years sharing my views on the Political Economy. During this period he was actively associated with the Bharatiya Janata Party as Convenor of its National Economic Cell and later as a National Spokesperson.

He is also associated with Ramana Kendra Delhi as its Secretary and as Trustee of Puthige Mutt, Udupi.

Mr. Venkatakrishnan N
Mentor, Banking, Finance and Corporate Affairs Expert Committee, BCIC
Executive Vice President and CFO, Tata Hitachi Construction Machinery Company

35 years of experience:6 years with AF Ferguson & Co, Management Consultancy Divn; 12 years with Unilever companies in India; 4 years with Dabur India Ltd; 13 years with Tata Hitachi Construction Machinery

Served on the following Committees of the Chamber: Chairman of Expert Committee on Banking, Finance & Corporate Affairs; Member of Finance Committee and Member of Expert Committee on Economic Affairs, BCIC

Dr. K V Omprakash
Co-Chairman, Banking, Finance and Corporate Affairs Expert Committee, BCIC
Advocate and Founder Director, Conscientia Consultancy Pvt Ltd

Corporate lawyer, Arbitrator and Company Secretary by profession and focuses mainly on Corporate and Business legal advisory services. He is Mentor to entrepreneurs and start-up companies and a speaker on relevant topics. He has been a great inspiration to entrepreneurs and provides practical solutions to corporate issues.

He has been in legal profession both as legal practitioner and corporate service since 1989. He is Arbitrator on the panel of BIMACC and Panel advocate for SBI. He specialises in providing Business & Corporate Legal Advisory, FDI, M&A, FEMA, IBC, legal Due diligence, corporate structuring and represent various Courts including NCLT.

Awarded "Doctor of excellence" (Honoris Causa) Ph.D. by CIAC - For outstanding achievements in Corporate law; Mentoring and Motivating entrepreneurs and Start-up/SME; Speaker and Professional training sessions SMEs, Corporate, Colleges/ Institutions, NASSCOM, ICSI and Clubs; Member in FKCCI, Member of Madras High Court Advocate Association; District Trainer, Past President, Rotary Bengaluru Basavanagudi (2017-18); RMBF Chairman 20-21

Mr. Joydeep Nag
Co-Chairman, Banking, Finance and Corporate Affairs Expert Committee, BCIC
Head and Advisor, TEC@Amrita

Senior level Multinational Executive with extensive experience in business leadership and working with Board of Directors, Bankers & Lawyers, Chartered Accountants & Consultants. Established successes in driving enterprise value, growth, globalization and controllership.

Areas of expertise include: Financial & Strategic Planning, Globalization, Business & Modality Finance, Budget Development, Business Expansion & Start ups, Talent Management

Adept in dealing with complex, conflicting and multiple organizational tasks in a highly matrixed organization. Skilled in the ability to prioritize multiple and complex tasks. Proven ability to work independently as well as perform as well as a team member. Exercise a high degree of discretion, mature judgment and tact to work on sensitive issues. Strong leadership, problem solving, planning, team building and project management skills.

Dr. Rumki Majumdar
Associate Director
Deloitte Shared Services India LLP

Background

- Dr. Rumki is a business economist and is leading the Research and Insights division under Client and Industries. She has over 12 years of experience writing thought leadership pieces on several contemporary economic and industry-specific issues related to India, with a focus on policy implications on the economy and industries. She has also written on numerous economic issues related to the United States and several emerging economies in the past.
- She has worked with eminent economists of Deloitte US, Deutsche Bank, Monetary Policy Committee, India, and the Planning Commission of India in the past and has published several white papers with them.
- She has done her PhD in economics from the Indian Institute of Science, Bengaluru, India.
- Rumki has authored over 70 publications in business and academic journals, including international journals, as well as several media articles on various contemporary issues related to the Indian economy and industry.

Selected Experience

- Her core technical skills are macroeconomic and financial analysis, econometric modeling and forecasting, and writing economic and industry white papers.
- Some of her recent publications include
  - Cyber security in the Indian banking sector (Part 1): Will 2020 redefine the cybersecurity ecosystem?; Deloitte, 2020. Link
  - Finding new frontiers: The challenges of early-stage entrepreneurs in accessing finance in an evolving startup ecosystem; Springer publication, 2020. Link
  - India: The year that was and will be, Deloitte Insights, January 2021. Link
  - Her recent publications are hosted on Deloitte Economics webpage.

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The job of a doctor is never easy. Not only does it require one to understand what ails the patient before medicine is prescribed, sometimes even a recommended medicine is not the right one because of the varying nuances of the ailments.

The predicament of Indian policymakers is no less challenging in the current times. The Indian economy had been slowing down since FY 2018-19 as the economy experienced structural reforms and changes in quick successions. The onset of the COVID-19 crisis further compounded the problem by accelerating a few of those trends. The pandemic created an unprecedented shock to both supply and demand as well as in the domestic and global markets, equally and simultaneously. With policy interventions guided by imprecise and altering information, ithas been difficult for leaders and policymakers to plan their way forward as they continue to build resilience amidst uncertainties, and then thrive.

Over the past 1.5 years, a mix of fiscal and monetary policies have been implemented to mitigate the impact of the pandemic and cushion the economy from the pandemic blow. Undoubtedly, the Reserve Bank of India (RBI) has shouldered a bigger responsibility in the fight against the pandemic. With the triple objective of mitigating the negative effects of the virus, reviving growth, and preserving financial stability, the RBI has prudently managed liquidity to keep borrowing costs for the government and private sector low.

Through continuous communications and adopting policies for a wide range of possible growth scenarios, the RBI has maintained economic confidencein its actions.

Risks that weighs on RBI's policy dilemma

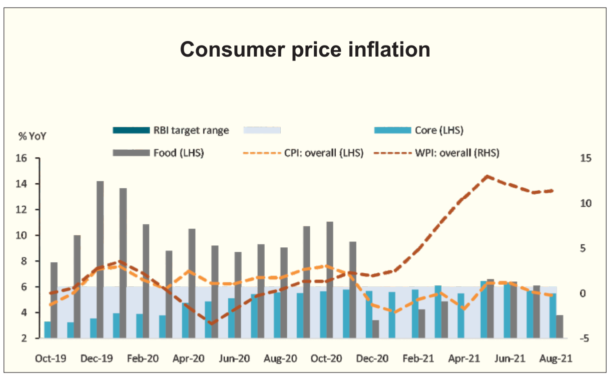
More than one-and-a-half years of living with COVID-19, yet the future of the pandemic remains uncertain. While the RBI has maintained an accommodative monetary policy to support the nascent recovery, the path forward towards an exit from monetary expansion and normalisation is likely to be perplexing for three primary reasons.

Firstly, the pandemic's impact has varied across individuals, businesses, and industries with a few bearing the brunt more than others. Consequently, the brewing inequality is gradually coming to the fore. This makes it harder for the RBI as the policies cannot be "one-size-fits-all". Besides, several of the policies announced are having less than desired effects. For instance, policy rate cuts and easing monetary policy stances were undertaken in the hope that banks will be lending and borrowers and investors will access capital at much lower costs. However, credit growth has been relatively modest. Designing and implementing risk-based policies that are commensurate with the overall financial stability could be a tight rope walking for the bank.

Secondly, inflation has remained persistently high in the upper end of the RBI's target range for over a year now. So far, supply disruptions have been the primary reason for higher inflation and in such a situation, increasing policy rates may not be able to check prices from rising. Instead, the rising cost of capital could increase borrowing costs, deter investment, increase supply-side challenges, and spur higher inflation further.

While the current dovish stance of the RBI is justified, a consistent rise in prices has its downside. It convinces businesses, workers, and consumers to anticipate persistent inflation, which could affect behaviour in ways that reinforce inflation further. Rising inflation expectations have implications on production costs and the purchasing power of consumers with the potential to dent the demand recovery. Besides, the economy is gradually emerging out of the pandemic. With oncoming festivals and rising pent-up demand post-recovery, there could be renewed pressure on supply, which has been constrained owing to disruptions, supply bottlenecks, and low investment over the past few years. Demand-pull inflation could bring expectations along for the ride. Balancing the supply-side constraints and expected pent-up demand will be tough for the RBI, and the dilemma is evident from the divergence in opinion amongst the MPC members regarding the monetary stance.

Figure 1. Inflation has remained high during the pandemic

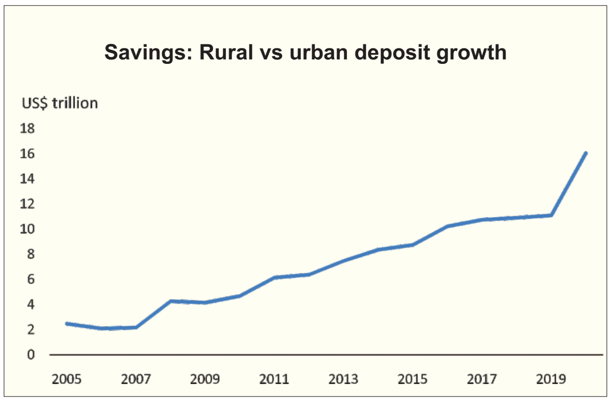


Source: Ministry of Statistics and Programme Implementation, The Reserve Bank of India

Finally, there are rising speculations about monetary policy stances in the industrial nations owing to global recovery fuelling global inflation. The central banks of these economies have been rapidly expanding their balance sheets since the 2009 global financial crisis and more so post the pandemic to inject liquidity and stimulate their economies from the pandemic-led downturn. Consequently, global liquidity is at an all-time high, and bond yields have been low compelling global investors to turn towards emerging nations with stronger economic prospects, including India.

Reversal of easy monetary policies could reverse the capital flows into emerging countries. As echoed by the Chief Economist of the IMF, a sharp increase in public and private sector debt during the pandemic createsfinancial risks and has macroprudential implications. To stem capital from outflowing and stabilising the currency, several emerging economies such as Russia, Turkey, amongst others, have increased their benchmark interest rates. This may put the RBI under the pressure to follow suit.

Figure 2. Global liquidity is at an all-time high



Source: Federal Reserve Board, European Central Bank, and Bank of Japan

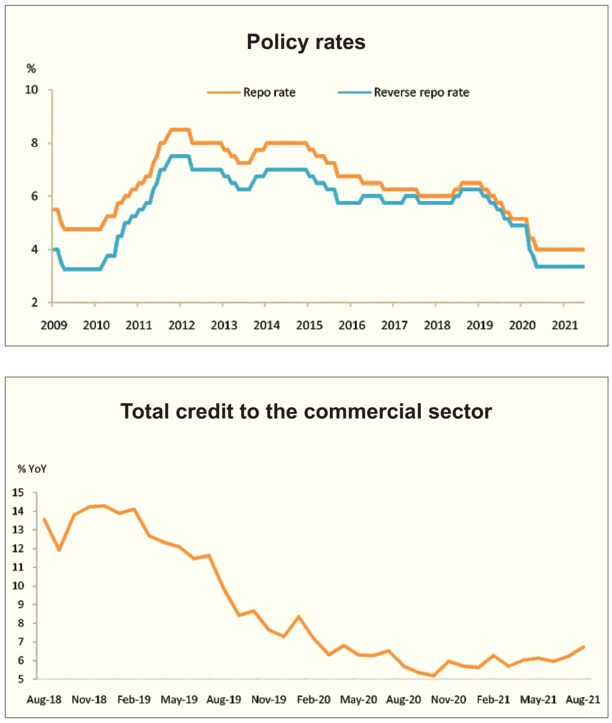
Challenges that RBI has to keep an eye on

Uncertainties are here to stay as India and the rest of the world fights the ebbs and flows of the pandemic. While the RBI paves its way to balance conflicting objectives of managing inflation and economic growth, it has to keep in mind the downside risks that could get accentuated by measures it adopts in the near-to-medium term. Our committee highlights five risks that the RBI must keep an eye on while considering its recommendations.

1. Credit flow

Credit growth is the key to a sustainable economic recovery. However, despite the sustained decline in the policy rates for over a decade, low demand and supply of credit has stunned its growth. The overall economic slowdown and the rising precautionary saving during the pandemic have led to a low appetite for credit amongst consumers and industries. At the same time, the stress in the financial sector has led to less willingness amongst banks to lend (as is reflected in the slower pace of

Figure 3. Credit growth has remained low despite low policy rates

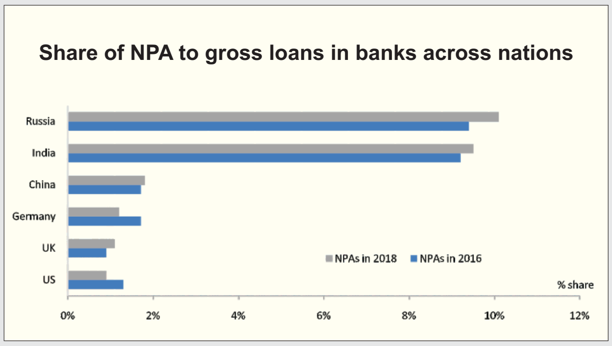


Source: The Reserve Bank of India

One of the primary reasons for banks hesitancy to lend is the falling asset quality, whichhas stressed banks' balance sheets and resulted in diverting a large proportion of banks' profits to contain losses. India has ranked poorly when it comes to the share of NPA in the banking system, which is weighing on bank lending and the overall financial system. With the pandemic, it has only worsened.

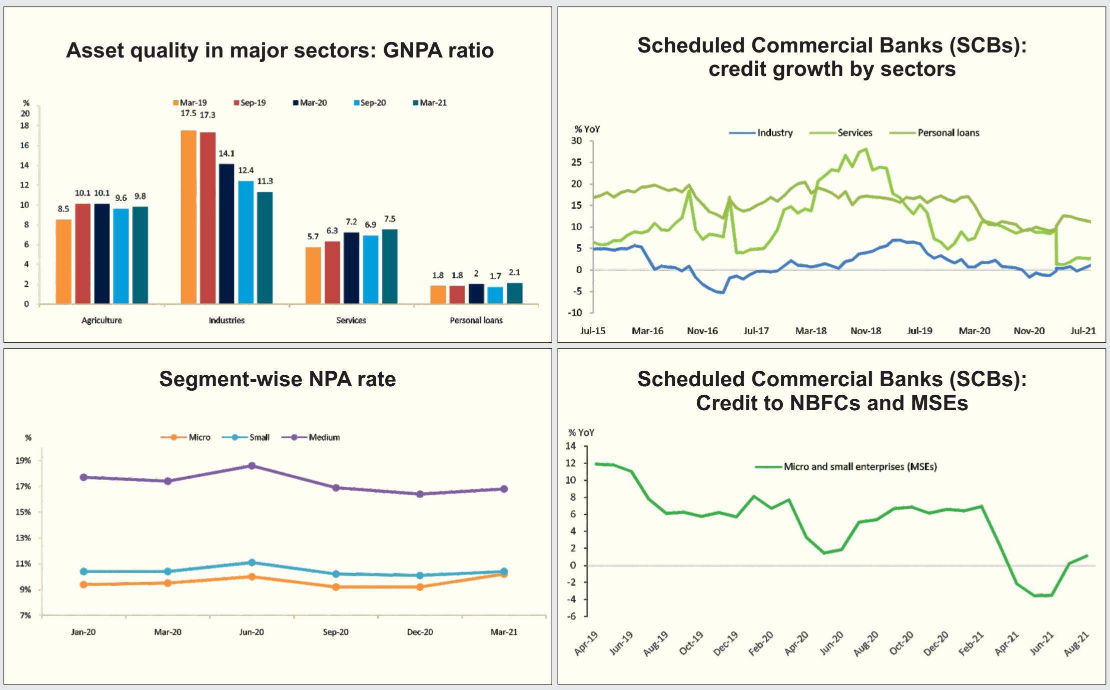
Willingness to lend to a sector is directly proportional to the asset stress in that particular sector. For instance, the GNPA ratio is the highest in the industry sector, albeit declining, and lending growth in the sector has remained muted in the past two years. On the other hand, GNPA in the household sector has remained low because of which, lending to this sector has remained steady (except during the first lockdown and the second infection wave). Similarly, the stress in the MSME sector has resulted in lower credit growth in this sector as well.

Figure 4. Share of NPA to gross loans in banks across nations



Source: World Bank, Deloitte Report

Figure 5. NPA influence the lending behaviour towards industries



Source: The Reserve Bank of India

Recommendations

Bank-led credit growth has to come back, and lending must be encouraged to ensure the availability of funds and liquidity to all sectors at affordable cost. That would require locked-in bank assets to be released so that they can be used more productively. Banks have funds to lend, what it needs is the assurance that lending will not result in further deterioration of the balance sheet. The latest measure by the government to set up bad banks to take over and resolve non-performing assets is a big step forward.

The RBI has taken prudent steps to manage liquidity and intervene as frequently as possible, it must also recognise that many of these policies have had a limited desirable impact. For instance, the steep decline in policy rates has not translated into a fall in lending rates. Working capital rates remain high due to larger defaults in repayments and the cost of collections. Consequently, a large section of the manufacturing and construction industry that are unbanked or under banked have to pay an exorbitant cost for running their operations. The RBI has to work towards ensuring lower working capital interest rates, especially for MSMEs.

The lending space has not yet been digitised (as the payment space has been) and digitisation could be a game-changer. Using the trails of transactions, lenders can analyse borrower's ability and intention to pay. Digital information is then used to enable cash-flow based lending and for credit decisions. Using digital platforms, lenders will be able to provide customised lending and a convenient and faster turnaround time to raise capital. This will motivate borrowers in the informal sector to join the formal sector, who otherwise were relying on informal credit sources at high costs.

The regulators can play an important role in setting up a basic infrastructure where different financial and non-bank entities can operate (NPCI, IDRPT, NPCIR), increasing interoperability of different digital platforms and systems, encouraging wider participation, and ensuring data storage, privacy and security. All of these will aid in last-mile inclusion and bringing more businesses into the formal sector.

The recent initiatives such as the Open Credit Enablement Network (OCEN) infrastructure connecting lenders and marketplaces has a great potential to create innovative financial credit products at scale. At the same time, the Account Aggregator framework will facilitate frictionless and secure data flow enabling customers to have better digital control over their data and enabling them quicker access to financial services at a better cost. The RBI has issued licenses to several entities to enable the Account Aggregator framework, which will revolution is ethe lending services landscape.

The regulators must develop a standardised framework between the partnership and collaboration with the fintech sector (and benchmark with international practices) that can enable banks to provide customised solutions at low costs and create new opportunities with low risks. The RBI must widen the regulatory perimeter and introduce regulation around financial technology as several non-financial firms provide credit and deposit products - a key focus of the banking regulator. This will aid in absorbing digital innovation in disruptive ways and ensure customer protection. There are no clear regulations and they are evolving along with financial services innovations. The approach by the regulator should be such that it enables digital innovation to thrive.

2. NBFCs/ HFCs/MFIs and revival:

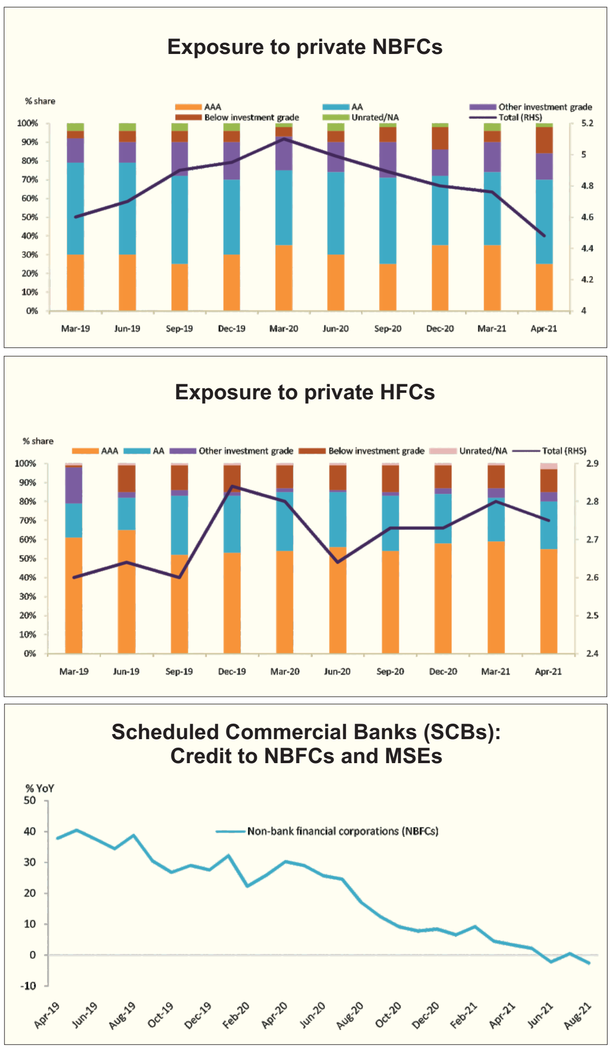
NBFCs, HFCs, and MFIs play a very crucial role in providing credit to individuals and smaller financial institutes, whose access to formal channels of borrowing is limited. They are one of the biggest lenders to small businesses that are responsible for creating investments, productive assets, employing workers, as well as funding infrastructure projects. During the pandemic, these institutions have played an important role in addressing emergent liquidity stress to important sectors.

Even before COVID-19, credit growth in these institutions was muted, partly because of modest demand for credit (due to the economic slowdown) and, to a large extent, the financial stress and regulations (because of credit events in the sector). The pandemic exacerbated these challenges manifolds. The RBI recognises the role NBFCs play in providing loans to the lenders of the last mile and therefore, has promptly taken a host of measures for a continued smooth operation of these financial intermediaries. Measures such as TLTROs, refinancing facilities, and regulatory reliefs have ensured continuous access to liquidity in the credit market and facilitated access to medium-term funds for NBFCs and other financial institutions.

These measures have had a moderate impact. Close to 88% of the funds raised by the banks under TLTROs are invested in NBFCs having a credit rating of AA and above. Even the RBI mandate that at least 50% of the funds raised by banks must be invested in small and medium NBFCs, was met with a muted response. This is because exposure of the banking sector to the private NBFC sector has been high, while private HFCs have increased over the last two quarters. The share of AAA investment grade in both NBFCs and HFCs have declined as well. Besides, NBFCs initially struggled to balance their liquidity as they had to provide moratorium to their borrowers and customers, yet had to continue repaying their banks from who they borrowed.

Consequently, large NBFCs sailed through the crisis relatively better while the small NBFCs struggled with severe asset-liability mismatches. The sector witnessed low credit growth (8.8%) andmarginally improved credit adequacy ratio and GNPAsowing to higher provisioning in the NBFC sector. Stress tests of NBFCs and HFIs suggest there exists substantial

Figure 6. High exposure of the banks to private NBFCs and HFCs are impacting decisions to credit lending



Sources: The Reserve Bank of India

Recommendations

NBFCs and HFIs are under pressure in handling the demand of moratorium and/or restructuring from their own customers while the NPA challenges are increasing. Given that these two are the largest borrowers from the financial system, there could be a significant contagion impact (solvency in banks and others) in the event of their failure.

Several of the RBI's measures to provide liquidity to the sector has had limited impact. The RBI will have to ensure adequate liquidity to these intermediary financial institutions to ensure that these NBFCs continue to lend to the unbanked and underbanked customers. A scheme similar to ECLGS could be introduced for NBFCs that may help them grappling with the challenge to repay loans to banks. This won't be a new scheme as credit guarantee schemes prevailed for small scale enterprises for a few decades since 1960s. Recalling such a scheme may be prudent. The RBI has to ensure that it does not result in loan appraisals and that there is a proper follow-up. As the regulator of the banking system, ensuring the alignment of borrowers' (these intermediaries) and lenders' (banks, MFs, insurance companies, and other institutions) interests and stability of the financial system will be critical.

The regulators can help in developing the digital infrastructure that provides structured data that can aid in real-time decision-making related to lending. Through the Account Aggregator route, these lenders will have the opportunity to move from an assessment-based to automated underwriting, which will be a huge cost saving for NBFCs. The customer acquisition costs will come down thereby leading to the inclusion of marginalised businesses. In addition, this will make sachet-sized loans economically viable.

3. MSME and funds

The pandemic has had a disproportionate impact on a few sectors, and MSMEs have been one of them. Because of their size, the scale of operations, and the amount of cash reserves, this sector has been more vulnerable (than larger firms).

The shock on both demand and supply has been unprecedented.

On the supply side, MSMEs dealt with reduced labour supply (due to health challenges), capacity utilisation (due to lack of funds and less-agile work structure), and production (due to disrupted supply chain). On the demand side, loss of demand (from consumers/ customers)and revenue (due to discontinued contracts) critically impacted their ability to continue operations and led to acute liquidity shortages. In addition, contact-intensive sectors such as tourism, restaurants and, transportation, and non-essential sectors have disproportionately felt the impact. These sectors have also had a prevalence of MSMEs.

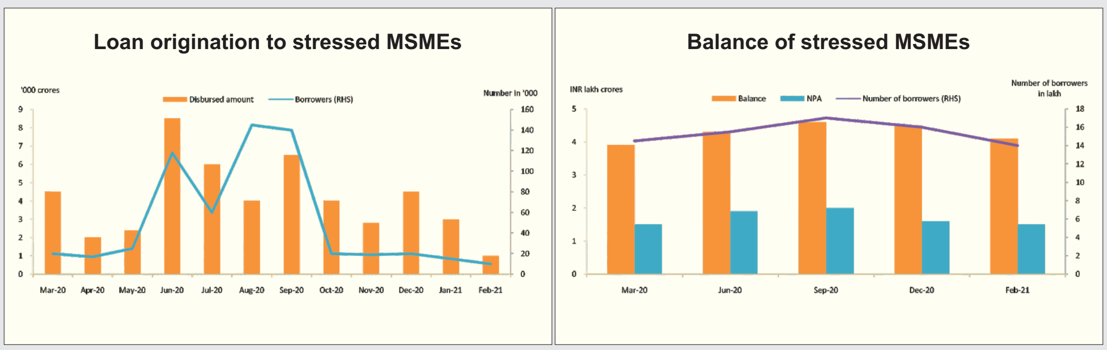
Consequently, several of these MSMEs had to suspend operations, close down, or cut costs by reducing workers. According to a survey by community platform LocalCircle, close to 59% of the startups and MSMEs are expected to close down, sell, or shut their operations this year due to the impact of the second wave of Covid-19 pandemic. In addition, risks to bankruptcies and rising debt posing challenges on solvability have also gone up. Consequently, their appetite for credit has declined and investment decisions are put on the back burner.

The situation has been no different across the world and different governments introduced several SME-specific policy measures to ensure smooth cash flows and credit growth. The most widely used instruments in response to the outbreak have been income and profit tax deferrals, loan guarantees, direct lending to SMEs, and wage subsidies. Policies in India included direct lending to SMEs, easier loan repayment terms, tax breaks, and loan restructuring, and were centred around relief to these small businesses and unorganised entities to cushion the pandemic's impact. The RBI encouraged SFBs (special long-term repo operations, loan guarantees through ECLGS scheme with extended reliefs) and banks (deduct credit disbursed to new MSME borrowers from their NDTLs for CRR calculations) to lend to MSMEs.

The impact of the policy response has been a mixed bag. Government-backed guarantees proved successful somewhat as credit growth in the MSME sectorimproved until the second infection wave hit the sector. That said, interest payment suspensions have had a very modest effect on business failures due to low uptake. A large segment of the sector (especially in the micro-segment) was outside the formal credit system and could not take benefit from the relief packages announced. Besides, relatively larger corporations cornered much of the benefits, especially of the high liquidity situation.

As a result, loan originations to the stressed segment of the MSME sector have declined considerably, despite ECLGS disbursements to eligible categories. The NPA has not changed although the number of borrowers has declined significantly, which suggests loan paying capacity continues to be under stress.Since May 2021, lending to the sector has also contracted suggesting the adverse impact of the second wave on demand for credit by the small unorganised sector as well as risk averseness amongst lenders to this sector.

Figure 7. MSMEs are stressed



Sources: The Reserve Bank of India

Recommendations

In a country where MSMEs account for a majority of jobs and income creation, it is increasingly becoming evident that high liquidity is having a limited effect on this sector. Low credit growth to this cash-strapped sector is likely to weigh onthe recovery efforts of small businesses. Despite low policy rates, interest rates on working capital remain high, especially those that are unbanked or underbanked, which raises the cost of capital for the MSMEs. Hence, the RBI will have to provide targeted interventions with more focus on different segments. Greater customisation of relief policy at the state level could also be explored. It will have to be prudent about calibrating the withdrawal of liquidity, and it has to contemplate how to communicate an exit measure without hurting the growth rebound of this sector.

The government has to continue providing financial support to eligible sectors and businesses borrowers in meeting their operational liabilities and restarting their businesses. The frequent extension of the ECLG scheme both in time and scope has been necessary till the economy revives and MSMEs see revenue growth. The government stands guarantee on the credit risk and it must honour timely disbursement of the payments to ensure that banks keep up their lending under the scheme.

There will be defaults and NPAs will rise. The RBI must prepare itself for this and prepare a taskforce that segregates non-willful defaulters from the others. An online dispute resolution and digital ombudsman scheme should be promoted to investigate complaints and resolve conflicts with the help of the chamber of commerce and industries, such as BCIC.

With a long-term vision, the RBI must enable the MSME financing ecosystem, which is rapidly evolving with a lot of fin-tech players redefining the lending landscape. One of the ways would be to expand the scope of financial services and funding channels for MSMEs. Currently, there are non-bank loan service providers (LSPs) that can leverage their connection with banks and provide customised credit to the marginalised MSME segments (who could be their vendors or are on their platform) and last-mile beneficiaries. Using the trail of transactions and access to GST records (with consent), these nimble and agile alternate lenders use information as collateral (such as cash flow and turnover as recorded in from GST statements) to advance credit to these beneficiaries. Sachetising of credit and transaction-based credit are a few of the customised purpose-based lending that will immensely benefit MSMEs that do not have access to formal channels of borrowing.

With fintech empowering financial inclusion, the government and regulators will have to nurture and fuel the evolving ecosystem that enables the credible and efficient partnerships of banks and fintech organisations. With OCEN infrastructure in place, MSMEs can access a wide variety of lenders and access credit at affordable costs. At the same time, democratising and decentralising account aggregators could help MSMEs and new-to-credit borrowers as lenders across the spectrum will be able to advance credit based on verified data such as GST invoices, bank statements, cash flow information with low risks of data tampering.

The digital credit products by LSPs must reach their customers digitally in a matter of a few minutes and meet the needs of SMEs. Besides, MSMEs have to be upskilled to use digital tools. To enable embedded finance to reach the last mile beneficiary efficiently, execution and implementation must happen seamlessly. These are areas where the government and regulators can help in a big way. Nevertheless, until legislation catches up with the rapidly changing fintech space, regulations have to adapt so that it gives time to the financial system to absorb changes

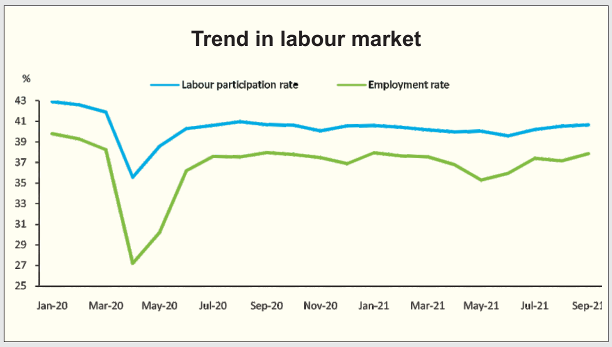
4. Job creation and incentivisation:

Job creation has been an Achilles heel for India and the situation has improved marginally over the years. According to the report by the National Sample Survey Office's Periodic Labour Force Survey (NSSO-PLFS) conducted in 2017-18, the unemployment rate touched a record 45-year high of 6.1% in 2017-18. The latest PLFS report in 2019-20shows a drop in unemployment to 4.8% but a sharp increase in employment in agriculture to 45.6% from 42.5% of the total employment in 2018-19. Knowing that agriculture yields much lower wages of the order of Rs.291 per day as compared to salaried jobs of Rs.558 per day and self-employment jobs of Rs.349 per day, this shift is unlikely to be voluntary. Besides, the share of informal employment has gone up sharply over the past three years, especially in rural areas. These probably indicate distress in the non-farm labour market forcing workers to shift to the agriculture sector.

The PLFS data also points to the fact that the share of manufacturing, construction, and transport, storage and communication in total employment declined the most. A few of these sectors such as manufacturing and construction have fairly large unorganised sectors. This could mean that job losses in the unorganised sector of these industries may have been larger. Besides, about 60% of all employed women were engaged in agriculture, which indicates limited employment opportunities available to women.

Needless to say, the labour market situation has worsened because of the pandemic. As the first lockdown of 2020 eased, the unemployment rate started to show hints of recovery; however, the labour participation rate (LPR) and employment rate (ER) continued to remain low. This is an indicator of a shrinking labour market, adding to a sense of dejection among the workers no longer pursuing employment. The second wave had a devastating impact on LPR and ER, which, despite the improvement in the unemployment rate, have been recovering gradually.

Figure 8. Pandemic's impact on the labour market is likely to last longer

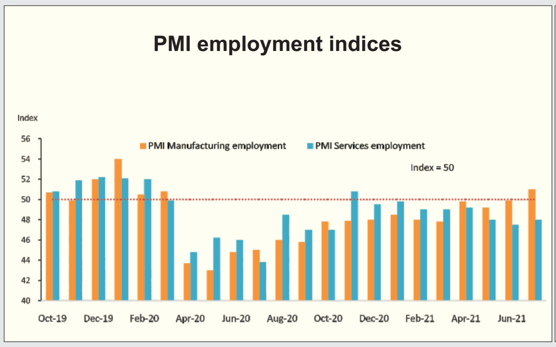


Source: Ministry of Statistics and Programme Implementation, The Reserve Bank of India

The impact on the labour market has been asymmetric across different segments of the population and industry. For instance, India lost 22.7 million jobs at the peak of the second wave (during April–May 2021), with the workers in the low- and semi-skilled, and informal sectors bearing the brunt. Close to 17.2 million daily wage earners lost jobs as against 3.2 million salaried employees. Agriculture absorbed 3.4 million of the total losses.[vii]

The impact on contact-intensive sectors has been high. The Employment Purchasing Managers' Index (EPMI) suggests that hiring has accelerated in the manufacturing sector while the services sector still shows contraction in July. While employment in agriculture grew by 11.2 million in July, employment of farm labourers, which are a part of daily wage labourers, saw the biggest increase of 9.4 million jobs. It is likely that as the kharif sowing season comes to an end, these agricultural labourers will get unemployed. The mismatch between MGNREGA work demand and person-days generated data suggests that there is stress on rural employment and a large number of casual workers are looking for jobs under the scheme. ■

Figure 9. Employment in the services sector is lagging while rural employment is stressed



Source: IHS, Markit

MGNREGA WORK DEMAND & PERSON DAYS GENERATED

HOUSEHOLDS DEMANDING WORK (IN MILLIONS)

Month	2019	2020	2021	% chg '21 vs '20	% chg '21 vs '19
April	21.00	13.40	27.30	103.73	30.00
May	24.70	37.30	27.60	-26.01	11.74
June	25.40	44.70	35.10	-21.48	38.19
July	18.35	31.98	31.90	-0.25	74.28
August*	14.49	24.31	24.36	0.21	67.77

*Figures for August 2021 are as of August 30

MGNREGA PERSON – DAYS OF WORK GENERATED(IN MILLIONS)

Month	2019	2020	2021	% chg '21 vs '20	% chg '21 vs '19
April	340.90	141.60	270.90	140.75	25.84
May	371.90	569.60	365.40	-34.71	1.78
June	452.32	640.70	319.05	-29.40	41.77
July	380.26	391.16	193.29	-2.79	96.73
August*	151.04	260.33	152.62	-41.98	-1.04

*Date as of August 30, 2021

Source: IHS, CMIE, MGNREGA website

Recommendations

According to the Nobel Laureate Paul Krugman, India needs to avoid mass unemployment by growing the manufacturing sector. This is because the sector has the potential to provide adequate alternative employment sources. This needs to be substantiated with substantially higher investments in public health services and education, all of which will need access to funding.

The government has to make concerted efforts in creating jobs, especially for the youth and the semi- and low-skilled, educating and training workers to prepare for the future workforce, and implementing reforms and schemes quickly to improve the business ecosystem and kick start private investment. The other measure could be to promote the exports sectors (through creating capacity and incentives) to take advantage of the improving global activity.

Channelising resources in MGNREGA to provide temporary jobs could help the rural economy that has been under stress because of dislocation and migration. Of the budgeted INR 73,000 crore for the scheme, around INR 55,915.31 crore (approximately 77% of the budget) has already been used within the first five months of FY22. The Centre will have to allocate more funds for the smooth running of the scheme to absorb these unemployed people and provide resources for their sustenance. Overcoming the delays in the release of wages and streamlining the payment process will be crucial.

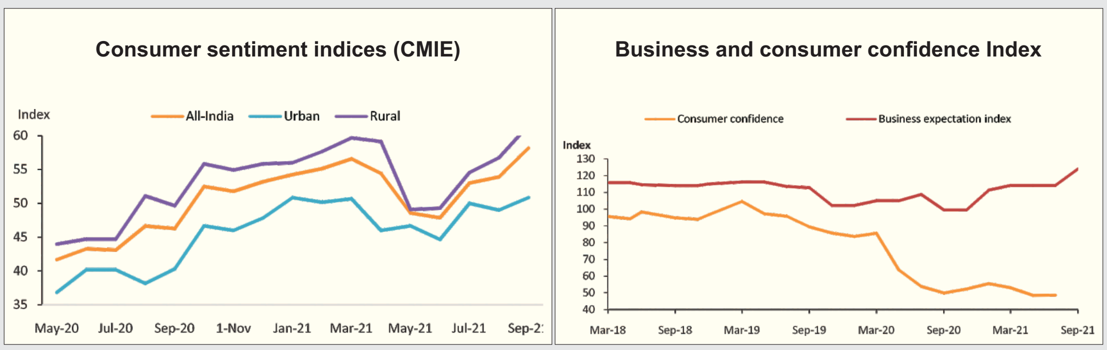
5. Demand creation

India is a consumer-driven economy with consumption spending accounting for about 60% of GDP. Therefore, the pace of demand recovery will be key for India's sustainable rebound. However, the impact on demand has lingered longer due to financial woes and restrictions on social interactions. Urban demand has remained subdued and as per Deloitte's Survey of Consumer Behaviour, the proportion of people wanting to save more has gone up steadily. With the infection being more widespread and reaching even the remotest locations during the second wave (as suggested by India's COVID-19 data) has impacted rural income and sentiments, which was largely unaffected in the first wave, has also come under pressure.

In short, consumers are anxious and are saving for rainy days.

On the other hand, with easing restrictions and reducing infections, the supply-side is currently witnessing a strong rebound. This is evident from the supply side data as manufacturing and industrial activity bounced back strongly after the first wave and is seen recovering again after the peak of the second infection wave. This has led to improved business sentiments (with a dent in the improvement during the second wave). ■

Figure 10. Consumer sentiments are poor although business confidence is improving



Source: CMIE, The Reserve Bank of India

The imbalance between the demand and supply has been accentuated after the second wave. There exist risks—all results of the ebb-and-flow nature of the pandemic— that weigh on consumer sentiment and their ability to demand credit. We list threerisks that are likely to cap the pace of demand recovery:

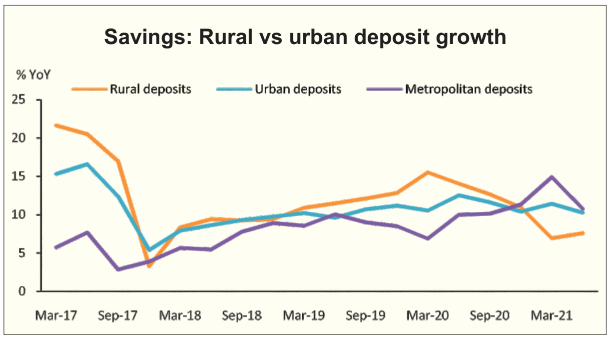
a. Inflation: From the onset of COVID-19, inflation hovered around the upper range of the Reserve Bank of India's target inflation range (2%-6%) and exceeded 6% during the second wave. It's expected to remain high with several factors contributing to price pressures, such as supply constraints(because of disruptions), and rising commodity prices of crude oil, iron, steel, etc. (due to rebound in industrial countries). High domestic oil prices(due to the government's high reliance on revenue generation) and rising pent-up demand fuelled by economic recovery are likely to increase production costs and erode the purchasing power of consumers.

a. **Weaker household balance sheets:** According to Pew Research Center, the pandemic has resulted in a sharp fall in the middle class and a rise in poverty in India. The severity of the impact on health may have compelled households to spend more on health care and treatments, while the impact on employment and income led to increased precautionary spending.

However, despite rising precautionary savings, growth in household savings has fallen sharply from 21% of GDP in Q1 FY20–21 to 8.2% in Q3 FY20–21. This suggests that overall income growth has declined. According to a report by CMIE, the proportion of urban households that claimed their incomes were higher than a year ago dropped from 4.9% in May 2021 to 4% in June, and those that said incomes worsened increased from 51.4% to 52.3% during the period. Households also borrowed heavily to meet expenses as household debts spiked to 37.3% of GDP in FY20–21, up from 32.5% last year.

The impact on rural balance sheets has been disproportionately higher. The decline in rural bank deposits in FY20–21 suggests that rural household assets are depleting probably to meet increased health expenditure and other financial requirements owing to low income.

Figure 11. Deposit growth in rural areas faster while urban deposits are reviving



Source: CMIE, The Reserve Bank of India

b. **Labour market:** The weak labour market is also weighing on demand. This challenge is detailed in the previous section.

Recommendations

Throughout the pandemic, the RBI has primarily focussed on the supply side of the economy and a majority of the policy measures have been directed towards boosting the supply side of the economy. If the recovery has to be broad-based, policymakers must recognise and address the risks (highlighted above) looming over pent-up demand and take quick actions to prevent these factors from spinning out of control.

One of the ways would be to provide targeted assistance to individuals most affected by the pandemic and their families, ensuring they have the opportunity to keep themselves safe and thriving, at work and home. One of the ways could be targeting direct relief payments to people who have been unemployed or dislocated, and boost rural demand. The RBI can play an important role in ensuring the availability of credit to those who don't have access to formal credit or have no credit history. It must enable the lending ecosystem to democratise credit and create innovative and economically viable credit products.

Infrastructure has a very strong positive economic externality on the economy. Enabling NBFCs and MFIs to fund the ambitious infrastructure projects would be another way of creating employment and income, and thereby demand. A few infrastructure projects such as roads and highways have taken off well, but many other projects are not making progress due to a lack of funds and investors. The RBI can enable the lending community to improve cash flows into these sectors. The government will also have to coordinate with RBI's measures and ensure that project plans are well implemented and contracts are efficiently managed.

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ABOUT BCIC

Bangalore Chamber of Industry and Commerce (BCIC) is the apex Chamber of Industry and Commerce representing large and medium industry in the State of Karnataka since 1976. The Chamber represents 95% of the capital investment and 90% of labour that is employed in Karnataka. The BCIC plays a critical and active role in promoting trade and investment in the State and has multi-ranging domestic and international networking and MoUs with the leading Chambers of Commerce across the globe. We have over 850+ members representing all segments of industry includes Manufacturing, IT, Bio-tech, Pharma, Engineering, Garments, Food Processing, Steel, Services among others.

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