Opinion | Let politics not divert attention from a looming economic crisis

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While the government needs to focus on the economy, it is increasingly distracted by a gathering storm on the political front

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It was not so long ago that Christine Lagarde, the then head of the International Monetary Fund, had said that the Indian economy was in a sweet spot. We exulted in being the fastest-growing major economy in the world, no doubt the envy of other emerging market economies. It has not taken us long to travel from that sweet spot to the deep hole in which we find ourselves today.

Within a year-and-a-half, growth has slid from 8.1% in the fourth quarter of 2017-18 to only 4.5% in the second quarter of 2019-20. Industrial growth declined from 5.3% to 0.5% over the same period, while agricultural growth declined to 2.1%. Monthly data on the Index of Industrial Production (IIP) shows that the decline has persisted beyond the second quarter. Output is 3.8% lower in October 2019 compared to a year ago. Value added in mining and manufacturing are down by 8% and 2.1%, respectively.

The steepest decline is in electricity generation, which is down a massive 12.2%. This is particularly worrying because electricity, as the universal input for all other lines of production, is the single most important indicator of the level of economic activity. It is matched by an equally steep decline of 13.2% in imports, another leading indicator. The level of exports has also declined, but much less than the decline in imports, reflecting a much deeper demand slowdown in India compared to our trading partners. Private consumption expenditure, which had been the main prop of aggregate demand until recently, has now grown only 5.1% compared to 9.8% a year ago. Most worrying of all is the decline in growth of fixed investment to only 1% in the second quarter of 2019-20, down from 10.2% a year ago.

Unemployment continues to hover in the 5-8% range, according to data of the Centre for Monitoring Indian Economy (CMIE).

In this gloomy scenario of a steep generalized decline in economic activity, the only soothing balm was price stability. Headline Consumer Price Index inflation had remained subdued at under 3% till April-May. However, it has since crept up to 5.5% in November, which is more than double the inflation rate of 2.3% that prevailed in November 2018, and close to the 6% upper limit of the inflation band that the Reserve Bank of India (RBI) is mandated to maintain. Are we now heading for stagflation, a nightmare scenario when unemployment and inflation are both high simultaneously? After successfully maintaining stability for nearly four decades, macroeconomic policymaking in advanced countries faced a great crisis following the oil shocks of the 1970s, when both inflation and unemployment started rising simultaneously. The Phillips Curve trade-off between inflation and unemployment disappeared, and the consensus policy approach lost its way in a baffling new environment of stagflation. The question for us is whether the Indian economy today is similarly headed for stagflation, with simultaneously declining growth and rising inflation that can stump macroeconomic policymakers.

Fortunately, a close examination of price movements indicates that we are not there yet. There is no generalized trend of rising inflation. The recent increase in headline inflation is entirely because of an increase in food prices, which rose by as much as 10% year-on -year in November and 8.8% and 12.3%, respectively, in rural and urban areas. Non-food inflation in November was only 2.8%. Further, within food prices, high inflation was mainly accounted for by a massive spike of 35.6% in vegetable prices, the onion supply shock, and the rise in prices of proteins. Pulse prices rose by nearly 14%, followed by a rise of 9.4% in the price of meat and fish, and 6.2% in the price of eggs. Most other food price increases have been limited to 3-4%.

The price situation is nevertheless fragile. With the headline inflation now close to the 6% upper limit of the mandated band, the Monetary Policy Committee (MPC) was right in unanimously announcing a pause in rate reduction. If high food price inflation spills over to non-food items and further raises inflation, the MPC may even need to raise the policy rate to kill inflation. Inflation may be successfully managed through monetary policy. However, pursuing fiscal policies to revive short-term growth, pending long-term growth effects of reforms, is far more challenging. Demand stimulation requires a sharp increase in public expenditure. However, the government has shown no appetite for bold revenue measures to finance increased expenditure. It may ease the fiscal deficit target instead, but more borrowing on top of the already high public sector borrowing requirement would further crowd out private investment and may not revive growth. There is no easy way out.

The government needs to urgently focus on the economic crisis, but it is increasingly distracted by a gathering storm on the political front. Its massive political mandate this summer and a favourable Ram Mandir judgement appears to have led the Bharatiya Janata Party to swiftly pursue the Hindutva agenda of its political manifesto. The abrogation of Article 370 has been quickly followed by the Citizenship Amendment Act (CAA), and preparations seem underway for a National Register of Citizens (NRC). This appears to have frightened Muslim citizens. It has also stirred the inclusive and peace-loving Hindu soul. Across the country, students are out on the streets protesting, while opposition parties have come together to oppose the CAA-NRC project. Who knows where this new phase of confrontational politics will take us while the economy continues to flounder.

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