

Since the Covid crisis comes on top of an ongoing downturn, the recovery might look more like the famous Nike logo, with the V tending to flatten out as the economy grows at a lower trend

The shape of economic recovery



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To economists it is amply clear, Global growth is far below potential; Some see a V-shaped recovery, some fear, That it will be more like the letter L.

Those in the Z camp are quite cock-a-hoop, The economy will accelerate; Confident growth will lost output recoup; Before falling back to original rate.

There are also those economists who, Aver that after falling off the cliff, The recovery will be like W, Rising again after a second dip.

The Indian economy you can tell, Has had the world's most devastating stall; It's growth last quarter by a quarter fell; From fastest growing went to steepest fall.

As stocks head north and labour incomes south, Analysts too alphabet shapes debate; Some a two-paced K recovery shout, To gauge the Indian economy's fate,

Then there are those economists who see, A Nike logo type recovery; For the economy had lost its way, Long before Covid-19 came its way.



A "Nike swoosh" shaped recovery ahead?

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Perhaps the most meaningful starting point for a discussion on economic recovery is the concept of the output gap. Most economists, and especially central bankers, assume that the economy has a medium to long-term growth potential. This is difficult to calculate through theoretical models but is nevertheless visible through its trend growth. This is the optimum rate of average medium-term growth consistent with macroeconomic stability, most notably with inflation within the target zone and full employment. Economic growth varies from year to year around this trendline as part of the business cycle. Countercyclical macroeconomic—fiscal and monetary—policy is designed to keep the economy ticking at this trend growth. It is stimulative when growth falls below trend, and tight when the economy overheats.

A recession is a sustained sharp fall in

economic growth, usually triggered by some traumatic event, such as a financial crisis, shocks arising from trade, the external sector, a health crisis like Covid currently, etc. This is followed by a period of recovery which may or may not recoup all the output lost or get economic growth back to the underlying trend line.

During the recession, there is a loss of potential output, as the installed capacity of the economy is not fully utilised. By way of illustration, suppose trend growth is 6%, and the economy grows at 2%, -1% and 3% during a recession before returning to 6%. The aggregate output loss then will be 12%. If the recovery to the trend line is relatively quick, the recovery is described as V-shaped. If the recession is an extended one, the recovery looks more like the letter U.

A V- or U-shaped recovery, however, implies that the output lost during the

recession is lost forever. This is what happened in the wake of the global financial crisis a decade ago. A recovery that recoups this output is, in fact, Z-shaped, as the economy grows above potential for some time during which the output lost is recouped, before falling back to the trend line.

With the recent trend of large liquidity injections by central banks asset prices, proxied by stock markets, show a trend of recovering well in advance of the real economy. This is what happened in the wake of the GFC. Asset prices have also rebounded strongly following central bank interventions during the ongoing Covid crisis, even though the recovery of the real economy is some way off. Some sectors like tourism and aviation might take much longer to recover than those like cloud and knowledge-based segments that tend to gain from the crisis. This differential recovery, sometimes

described as K shaped, is with reference to sectors and not aggregate output.

Some recessions, such as the Global Financial Crisis (GFC) of 2008, are marked by a second dip in growth after the V-shaped recovery. This is a double-dip recession. If the recovery from the second dip is also V-shaped, the recovery is described as W-shaped. The global economy grew at an average of 5.1% between 2002 and 2007. This fell sharply to 3% in 2008 and 0.1% in 2009. This was followed by a V-shaped recovery to 5.4% in 2010 before growth started faltering once again to 4.3% in 2011. It then settled into a 'secular stagnation' of around 3.5% thereafter, falling further to below 3% in 2019. What at one stage looked might be a Z-shaped recovery turned out to be a partial W-shaped one. The second V flattened into the letter L instead of returning to the original trend

line, much like the shape of the Nike logo.

The reason why several analysts expect a V-, or at worst a U-, shaped economic recovery from the Covid crisis is because unlike the GFC, demand has merely been suppressed by lockdown measures. During the GFC demand declined for an extended period because households were in debt and had to repair their balance sheets. The strong fiscal response in advanced economies has also neutralised much of the income shock caused by the lockdown for both households and businesses. Others argue that that the pandemic is likely to trigger structural changes in the economy, and a phase of bankruptcies and 'creative destruction' will drive a protracted U-shaped recovery.

Can India too expect a V- or U-shaped recovery? As elsewhere, India's growth also declined in the wake of the GFC. However, its performance by global standards was quite good. Its growth differential with China kept declining, and by 2014 had overtaken the latter. From 2017, however, it started falling behind China once again, this time rather dramatically, by 0.6% in 2018, 1.9% in 2019, and IMF projects a growth differential of 5.5% in 2020 and 2.2% in 2022. The beginning of India's growth crisis can, therefore, be dated back to 2017. Its growth spiralled downwards in each successive quarter from Q2 2018 (7.1%) to Q1 2020 (3.1%).

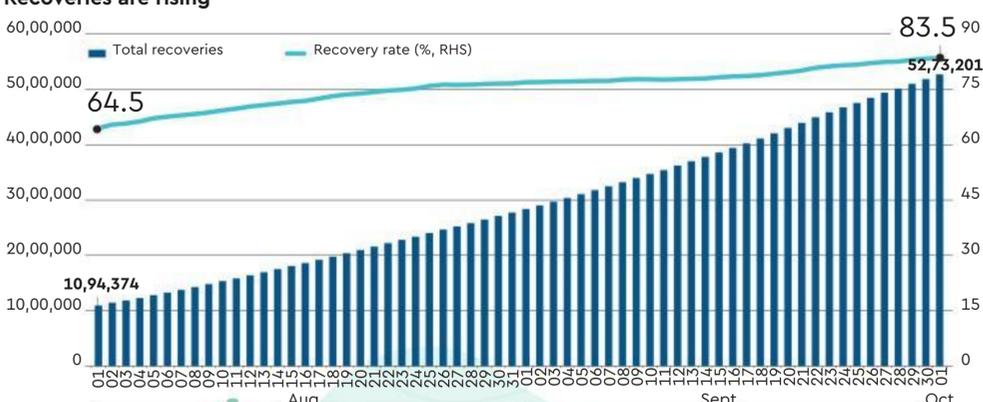
India saw the sharpest decline in economic activity amongst major economies following Covid in Q2 2020 at -23.9%. This was largely because of the severity of its early lockdown, and the lack of a commensurate fiscal stimulus to neutralise its effects. A hard fall can be followed by a robust bounce back. But while Covid aggravated India's growth crisis, it was not caused by it, as its trend growth was already declining. Its economic recovery is consequently unlikely to be V-shaped under a business as usual scenario. The Reserve Bank of India expects an extended U-shaped recovery. But since the Covid crisis comes on top of an ongoing downturn, the recovery might look more like the Nike logo with the V tending to flatten out as the economy grows at a lower trend. Good macroeconomic policy and structural reforms would be needed to get the economy back to its original trend growth.

DATA DRIVE

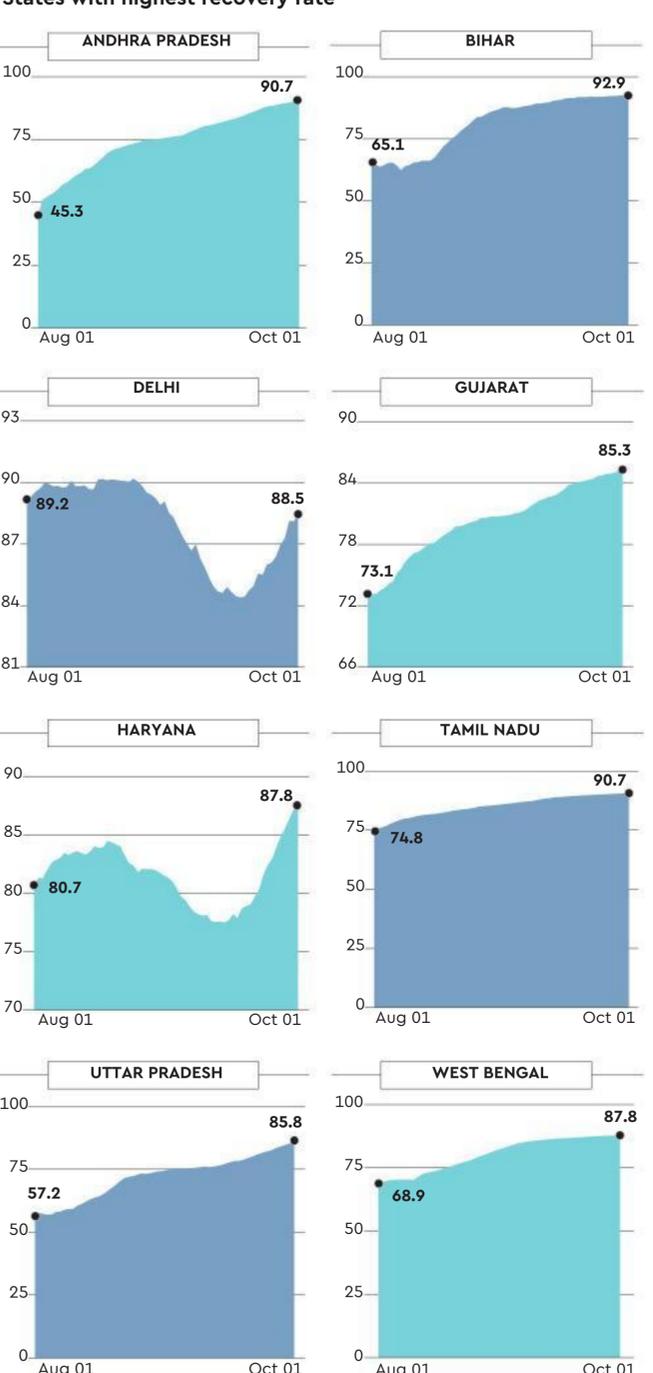
Recoveries grow faster than cases

OVER THE LAST few days, India has been recording more recoveries than cases. The country in the week till Friday recorded 5,95,914 recoveries, during the same period its new cases were a lower 5,75,498. Despite cases rising, in India, the recovery rate has inched up to 83.5%. Till now 52,72,301 people have recovered. On August 1, India had recovery rate of 64.5%, as the country recorded 10,94,374 cases. The reason for this, however, may be the faster time of recovery. As an FE analysis highlighted earlier it takes 11 days for India to recover, whereas WHO contends a recovery time of 14 days. Apparently, some of the states' recording close to 90% recovery are also the ones with the lowest recovery time. In Delhi, for instance, it takes eight days for a person to recover. West Bengal also has a recovery time of 8 days. Maharashtra, on the other hand, has the highest recovery time of 14 days. Kerala has recovery time of 13 days. Kerala has the lowest recovery time rate of 65.4%. Arunachal Pradesh has a recovery rate of 70.3%, Meghalaya has a recovery rate of 70.5%, whereas for Chhattisgarh has a rate of 71.9% and Ladakh has a rate of 73.7%.

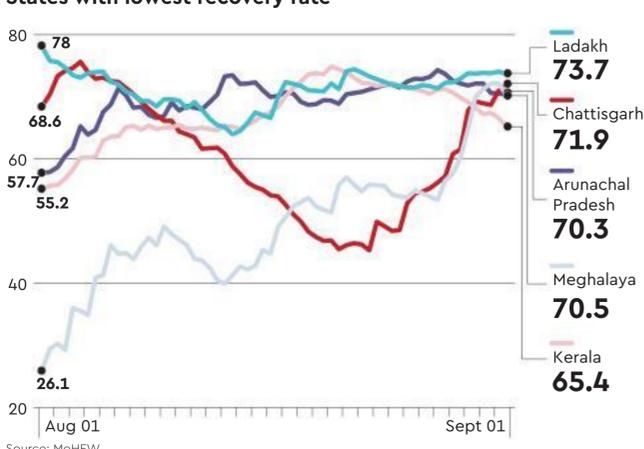
Recoveries are rising



States with highest recovery rate



States with lowest recovery rate



Recoveries have been outstripping cases

