The medium-term macro-fiscal prognosis

The International Monetary Fund's (IMF's) latest fiscal monitor and world economic outlook make interesting reading. They take stock of the macro and fiscal fallout of the pandemic, and attempt an assessment of how, and to what extent, countries need to focus on reshaping macroeconomic and fiscal policies going forward, after implementing expansionary macroeconomic and fiscal policies at a scale that is unprecedented in recent times.

The headline conclusion is stark and depressing. Variation in country performance depends on local vaccination rates, the stage of the pandemic, and the ability of governments to access low-cost borrowing. On all these counts, rich countries have performed better than emerging and developing countries (EMDEs). They have been able to vaccinate their populations faster and more comprehensively and use fiscal (especially income support) policies to implement restrictive measures to flatten the curve as and when necessary. They have had greater access to low-cost borrowing than EMDEs. By 2024, advanced economies will rapidly return to pre-pandemic levels of prosperity. Most EMDEs in contrast, will not see a full recovery. Their GDP levels and revenue mobilisation will not be what they could have expected going by the trend before the pandemic hit.

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For rich economies, the pandemic is an aberration. For EMDEs, the scarring is permanent. Some countries have done better than others. China and the US have in fact emerged stronger from the pandemic. These economies will be larger than they were before the pandemic by the end of fiscal 2021. Germany did not see a large fall in GDP in 2020 and will therefore recover with modest growth over the next two years. This will not be the case with France and the UK. Most EMDEs will see increases in income inequalities compared to the pre-pandemic levels, with poorer countries, including India, also expected to see a deepening in income poverty, and unemployment.

This difference in economic performance has a knock-on impact on future fiscal scenarios. Countries that aggressively — and successfully —expanded fiscal spending have been impacted the least.

They have not suffered scarring and will be able to return to "business-as-usual" debt and deficit positions by 2024. This will enable them to deploy inflation control measures more effectively. The world will run the same fiscal deficits in 2025 (3.6 per cent) as it did in 2019. But the US, Japan and Germany will run lower, and France, the UK, Italy, and Spain higher fiscal deficits. Equally, debt to GDP ratios will stabilise faster in the first group of countries and much slower in the second group. And what of the emerging economies? Most will have less fiscal space going forward than they did in 2019. Some, like Brazil and Mexico, will be constrained to keep debt levels under control as they borrow in foreign markets. They will therefore have to practise fiscal austerity to avoid a fiscal crisis.

Only Bangladesh and Vietnam have managed to avoid a fall in total output and emerged relatively unscathed. They will also be able to maintain the investment/GDP ratios at pre-pandemic levels as the pandemic did not cause a drop in domestic savings in these countries.

What, then, of India? Much is being made of the fact that India is the fastest growing economy in 2021. But the India story was in decline before the pandemic, with GDP growing just 4 per cent in 2019 — all the other Asian EMEs were clocking much higher growth. Then, India's economy shrunk in 2020 by as much as 7.3 per cent while China, Bangladesh and Vietnam all recorded growth. In 2022, India will return to where it was in 2019 in terms of economic size, while China, Vietnam and Bangladesh will all be bigger than in 2019. Bangladesh and Vietnam will have a higher per capita income than India in 2022.

Further, unlike China, Bangladesh and Vietnam, India's savings rate is forecasted to decline reflecting the permanent scarring caused by the pandemic. The investment to GDP ratio is not forecasted to rise appreciably till 2024. India's ability to walk its big talk as an investment destination, though always fragile, has therefore taken a further credibility hit after the pandemic. Finally, India had the worst fiscal deficits before the pandemic and despite an insipid fiscal response to the pandemic, will have higher levels of debt and fiscal deficits in 2024 than it did in 2019. The silent fiscal crisis prior to the pandemic is urgently driving a programme of asset sales, but these will only plug the fiscal hole; there will not be resources left to increase the investment to GDP ratio above the IMF forecast and bring India back to its pre-2019 growth potential if we continue with business as usual. This is a grim outlook.

The IMF typically gets it wrong on India, overestimating its potential in good times and the reverse when things are difficult. But that is because India has historically shown the ability to face up to a difficult economic situation and take steps to resolve it. This time, I am worried because I see a lot of bragging and self-congratulatory messaging, from the government, but also from a swathe of the policy ecosystem. This sort of Stockholm syndrome does not bode well for India and has led to deep economic trouble in the 1960s, the late 1970s and, most recently, in 1991. Deft handling and a willingness to face facts averted crises under the Vajpayee and Manmohan Singh administrations, but the present regime and its praise singers are in grave danger of losing the plot.

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