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Economic slowdown: Cyclical or Structural?

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The article is based on “Cyclical or structural? Decoding the nature of India's economic slowdown” that was published in Business Standard on 3rd September. It talks about the nature of the current economic slowdown and the way ahead.

Context

- India is **undergoing an economic slowdown**. Its GDP grew at 5% in the first quarter of FY20, marking the slowest growth since the fourth quarter of FY13.
- In its annual report for 2018-19 released on 29th August, the Reserve Bank of India (RBI) had said that the **slowdown was cyclical, rather than structural**, which would have required deeper reforms.
- However, some experts believe that the current slowdown is more than a cyclical one and of the structural type which is evident from the fact that the successive rate cuts by the Central Bank have not yielded the desired results.

What is a Cyclical slowdown?

- A cyclical slowdown is a **period of lean economic activity that occurs at regular intervals**. Such slowdowns last over the **short-to-medium term**, and are based on the changes in the business cycle.
- **Measures to recover from cyclical slowdown:**
Generally, interim fiscal and monetary measures, temporary recapitalisation of credit markets, and need-based regulatory changes are required to revive the economy.

What is a structural slowdown?

- A structural slowdown, on the other hand, is a **more deep-rooted phenomenon** that occurs due to a one-off shift from an existing paradigm.
- The changes, which last over a long-term, are **driven by disruptive technologies**,

changing demographics, and/or **change in consumer behaviour**.

- In such a scenario, a monetary and fiscal stimulus won't be enough to revive the economy.
- Fixing such problems would require the government to undertake some structural policies. The best example in this regard would be the reforms that were carried out to address the crisis in 1991.

Major Factors Affecting India's Growth

- **Consumption:** Private consumption, which contributes nearly 55-60% to India's GDP, has been slowing down.
While the **reduced income growth of households has reduced urban consumption**, drought/near-drought conditions in three of the past five years coupled with the collapse of food prices have taken a heavy toll on rural consumption.
- **Savings:** Savings by household sector – which are used to extend loans for investment -- have gone down from 35% (FY12) to 17.2% (FY18).
Households, including MSMEs, make 23.6% of the total savings in the GDP.
- **Investment:** Gross Fixed Capital Formation (GFCF), a metric to gauge investment in the economy, too has declined from 34.3 per cent in 2011 to 28.8 per cent in 2018, government data show. Similarly, in the private sector, it has declined from 26.9% in 2011 to 21.4% in 2018.
- NBFC crisis triggered by IL&FS default led to a **liquidity crunch** in the economy.
- RBI's Annual report highlighted that there are still **structural issues in land, labour, agricultural marketing** and the like that need to be addressed.

Gross Fixed Capital Formation

- Gross fixed capital formation (GFCF) refers to the **net increase in physical assets** (investment minus disposals). It does not account for the consumption (depreciation) of fixed capital.
- It is a component of expenditure approach to calculating Gross Domestic Product (GDP).
- GFCF is not a measure of total investment, because only the value of net additions to fixed assets is measured, and all kinds of financial assets, as well as stocks of inventories and other operating costs are excluded.

Recent Steps Taken

- Subsequent **rate cuts by RBI** to lower the interest rate. The RBI has cut the repo rate by 110 basis points so far in 2019 to 5.4% – its lowest level since 2010.
- Stimulus package announced by the government along with other measures may

propel demand and thus help to recover the economy.

- Surplus transfer by the RBI to the government can help boost planned-spending of the government without compromising fiscal deficit targets. It would also help in Recapitalising Public sector Banks to tackle the NPA crisis.
- Merger of Public sector Banks would enhance the credit culture and thus spur investment in the economy.

Way Forward

- RBI, in its annual report, called for **counter-cyclical actions** in terms of monetary and fiscal policies, **along with deep-seated reforms** for the structural slowdown.
- Stimulating domestic demand and reducing supply costs to maintain the Indian industry's export competitiveness.
- Economic Survey 2018-19 asked for **taking measures to boost investment**, especially private investment, that is the 'key driver' that drives demand, creates capacity, increases labour productivity, introduces new technology, allows creative destruction, and generates jobs.
- Much needed structural reforms in land, labour and agrarian policies to tackle structural dimension of the slowdown.

Drishti Input:

“Comment whether the present economic slowdown being faced by Indian Economy is Cyclical or structural. Critically examine the measures taken by the government to recover from the slowdown.”
