COFACE BRIEF

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CONFIDENTIAL

India: Virus resurgence undermines the recovery

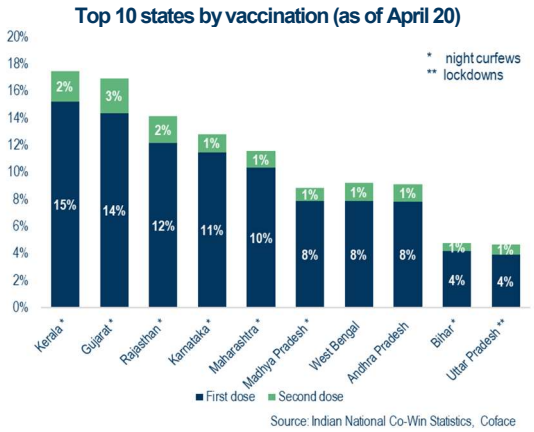
GDP forecast 2021 (FY 2021-2022): 8.0%
Coface Risk Assessment: C (high)

What

India has been facing a surge in new infections in recent weeks, with the daily tally exceeding well over 200,000 since mid-April, and significantly surpassing the previous peak reached in September 2020. The second wave was driven by a more virulent strain (B.1.617) and is expected to defer the economic recovery for at least a quarter, which will affect FY 2021-22 GDP (April 2021 to March 2022). Stricter mobility restrictions are likely to dent domestic consumption and manufacturing activity, thereby putting small businesses under further strain. Our FY 2021-22 GDP forecast for India stands at 8.0%, compared with the IMF's more optimistic 12.5%, as we have built in the assumption of fresh virus outbreaks in the first half of 2021, but this GDP projection remains highly uncertain.

Why

1. **India's vaccination campaign has accelerated but the road to herd immunity will take time.** The vaccination campaign showed, to some extent, encouraging developments. After a slow start, the government is ramping up the vaccination programme and has suspended vaccine exports until at least June in order to prioritise domestic needs. Vaccines will now be available for those aged above 18 from 1st May onwards. So far, over 120 million doses have been administered, with only a mere 1.2% of the population fully vaccinated (in contrast, the U.S. has over 25% fully vaccinated). The response to the second wave is also not homogenous. In the most affected areas, such as Maharashtra or India's capital New Delhi, less than 1% of the population have received the second dose. The current pace of vaccination indicates that India will only reach herd immunity (~70% of population) in the fourth quarter of 2022 at the earliest. This means that India should remain under mobility restrictions for the rest of 2021 and possibly into 2022. Stricter measures could also be imposed if the health situation continues to deteriorate.
2. **Measures and restrictions are therefore likely to continue or even tighten in the coming weeks**. Although the government ruled out a national lockdown due to the significant economic costs involved, the second wave of infections has nonetheless led key states to impose stricter rules (for instance, weekend lockdowns and night curfews, non-essential shops will remain closed) to contain the spread of the virus. Consequently, these movement restrictions triggered a second "Migrant exodus". Migrant workers reportedly returned to their hometowns amid talks of complete lockdown in several states such as Maharashtra. New Delhi was placed under lockdown for a week starting 19 April, as the healthcare system is overwhelmed. This massive exodus may also accelerate the spread of COVID-19 across the country.
3. **Mobility restrictions would inevitably undermine the ongoing recovery in the coming months**. While manufacturing conditions further improved in March, the manufacturing PMI slipped from 57.5 to 55.4 the same month, signalling a loss of growth momentum, with the slowdown likely to worsen in April amid the second wave of infections. Services PMI also pointed towards a softening of business activity in March. Retail sales in February showed a steady improvement, but mobility restrictions should probably hamper domestic consumption (60% of GDP) in the coming months.



Risks

1. **Credit risks are set to rise as emergency relief measures expire.** We expect higher credit risks ahead due to ongoing pandemic-related restrictions and the end of some emergency relief measures. Small businesses are particularly vulnerable, as the loan moratorium expired at the end of March 2021. Reduced relief support would in turn put pressure on banks' balance sheets, especially in state-owned banks that may not have as large a capital reserve as private banks, as businesses struggle to keep afloat. Fitch predicts that state banks' core capitalisation is close to 10% compared to 16% for private banks. The Reserve Bank of India (RBI) warned in its January 2021 Financial Stability Report that four banks would fail to meet the minimum capital level by September, and that it expects the ratio of non-performing assets to double from 7.5% to 14.8% by September 2021, if business conditions deteriorate. That said, the government could step in to consolidate public banks' balances, as it was done in 2018.
2. **Room for policy manoeuvre to support the recovery is limited this year**. On the monetary side, the RBI is constrained by rising inflation (CPI: 5.5% YoY in March) in terms of additional rate cuts, which has been paused at 4.00% since May 2020. On the fiscal front, the government seeks a balance between narrowing its fiscal shortfall and improving long-term growth prospects, with the latest budget focusing on infrastructure and health spending, which should support domestic demand. The fiscal deficit is targeted at 6.8% for FY 2021-22, down from a record 9.5% in the previous fiscal year. The recent escalation in the pandemic will exert pressure on the government's fiscal position, if the economy returns into contraction, which will lead to lower revenues.
3. **U.S. embargo on exports of vaccine raw materials could affect vaccine production in India, and impact the latter's inoculation campaign, as well as that of other countries that rely on Indian-produced vaccines.** Indian vaccine manufacturers, especially the world's largest COVID-19 vaccine producer, Serum Institute of India, could face disruptions following the United States' embargo on exports of raw materials for making vaccines. While alternatives for those inputs could be found in other countries, the U.S. remains a major supplier. Difficulty in sourcing vaccine raw materials could lead India to extend the ban on vaccine exports beyond June if the production of shots falls, amid a priority given to domestic demand. Consequently, this would slow down the inoculation campaigns in nearly 70 countries in Asia, Africa and Latin America that depend on Indian vaccine exports.