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It Takes Two to Tango: The Demand Boost versus Supply Push Conundrum

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The world economy is going through an unprecedented crisis today as the Covid19 pandemic is crippling the economic activities of all nations, both developed and emerging ones, and putting both human lives and livelihoods at a significant risk. In India, we witnessed the domestic economy suffer the dual shock of decline in demand and supply as both individuals and corporations got impacted by the stringent lockdown measures adopted by the state and central government during the past 2 months in order to control the spread of Covid19 infections.

The biggest impact of Covid19 to the domestic economy has been felt in the steep decline of private consumption which constitutes 60% of domestic demand, as consumers curtailed their discretionary expenses both as a safeguard mechanism in the prevailing economic uncertainty and associated labour market distresses as well as supply chain disruption issues owing to the lockdown measures initiated by the governments. The economic situation was further worsened by steep declines in the merchandise exports and imports by India. The steep fall in domestic demand during the recent months since the onset of Covid19 infections in India is best captured by the sharp decline in electricity and petroleum product consumptions across both urban and rural areas.

In the given scenario, there is hardly any sector which seems immune to the pain and distress that the broad economy is going through at this moment. In particular, sectors that are dependent on discretionary expenses of consumers such as hotels and restaurants, travel and tourism, real estate and constructions, consumer durables and luxury products appear to be hit particularly hard in terms of a drastic fall in their current and expected revenue and cash flow generations. Only a few sectors which cater to non-discretionary needs of consumers such as pharma and FMCG products and those which are able to provide technology enabled solutions in the prevailing lockdown situations such as internet and mobile based delivery platforms, e-commerce players and e-learning solution providers appear relatively less impacted or even marginally better off given the sudden shift in nature of demand of consumers.

Given the circumstances, the government and the policy makers are facing the dilemma of whether to focus its immediate attention on boosting consumer demand through fiscal stimulus or take urgent actions to address liquidity related supply concerns from the side of corporations and manufacturers. Proponents of direct demand stimulus measures tend to argue that the impact of Covid19 has been drastic on a huge segment of the population who have either lost their jobs and employment opportunities and facing starvation in the absence of any stable source of income and consequently are forced to migrate with family from work locations to their domicile states for food, security and shelter. Even many among those who may not have lost their jobs yet are also severely curtailing their discretionary expenses fearing an imminent job loss or a salary cut in the impending economic downturn. Hence, a direct boost to the consumer demand through direct cash transfers, subsidy schemes or income tax cuts could be the most effective way to revive the economy and kick start the financial system.

On the other hand, the proponents of supply side measures tend to argue that the financial system is facing acute liquidity distress due to lack of revenue generation opportunities while being stuck with fixed cash outflow obligations such as salary expenses, utility charges, operational obligations as well as near term interest and debt repayment obligations. In the absence of immediate attention and urgent action, the liquidity distress is likely to snowball into mass layoffs, massive defaults on financial and operational obligations and credit rating downgrades with consequent adverse impact on the banking and financial services industry. This in turn is likely to cause a negative feedback effect on the real economy eventually leading to a systemic failure of the entire financial sector.

The recent measures announced and initiated by the government on the monetary and fiscal policy fronts appear to suggest that the government has put higher weight on the liquidity distress related concerns of corporates, Micro, Small and Medium Enterprises (MSMEs) and banking and financial services firms including the Non-Banking Financial Companies (NBFCs), Housing Finance Companies (HFCs) and Micro Finance Institutions (MFIs) to avoid a larger contagion effect that may trigger a collapse of the fragile financial market. However, subsequent initiatives in the coming days are likely to bring the focus of policy measures back to direct demand stimulus actions once the supply chain disruptions are overcome as the lockdown restrictions get relaxed. After all, it takes two to tango!

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