

LIQUIDITY LESSONS AMIDST COVID 19 PANDEMIC

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The world is under siege. COVID 18 poses to torment the humanity. The deadly virus spreads if the people breaks the rule of Noli-me-tongere. The medical science and medicos are under trail of Corona court. The verdict to vanquish the virus is dependent on success of vaccine experiment. But this uncertainty has terrorized the humanity with daily net exponential growth of infections and death cases. The most vivacious victims are USA and European countries. India is catching hold of this feverish fearful trembling gradually but definitely. Only non-medical healing is to break the chain, the practice of Noli-me-tangere.

To keep the corona cases under control for administering healing touch, the chain is to be checked and disconnected. The ultimate weapon is lockdown, spill overing to layoffs and firm exits.

What has happened to the effect of Lockdown?

The lock down of all the activities sans essential daily needs has disrupted cashflows devastatingly; the production, distribution and consumption were stranded out of Govt's impromptu lockdown imposition to contain the spread of corona virus.

Impact of Lockdown:

The factors of production particularly were fence sited by lockdown rule. Economic activities amidst the economic agents are muted. The cash flows like rewards to the factors of production in terms of wages, rents, interests, etc trade off are choked and dried up the economic lubricants in terms of liquidity for livelihood and life-saving succors.(Annex-I).

The ceased activities out of lockdown and social distancing measures skyrocketed unemployment in a short period of around two months specifically in unorganized sector.

Unorganized sector labour force dominantly constitutes around 81% of total labour force in India. The nature of informal sector labour is that they earn daily or weekly for their livelihood. The disrupted supply chain also drastically hampered the distribution leading to temporal price rise. This also acutely affected the poor and daily wage earners.

The shuttered factories and companies are resulted into low , in some cases, no supply of products and services leading to supply shock in the economy. Side by side, the unemployment, the layoff as well as the social distancing have restricted the disposable income of the consumers leading to marginal decline in consumption demand. This deficit in demand continuity accrued to the demand shock in the economy. Resultantly, the Aggregate Demand shifts left along with decline in Aggregate Supply definitely contraction of GDP/National Income. But the price effect depends on magnitude of supply contraction in relation to demand decline. If change in AD > change in AS, then the price rise will be deflationary. If change in AD < change in AS, the price rise will be inflationary. But this dynamics is tenor

dependant. Longer the virus period, greater the uncertainty to quantify the magnitude and higher the policy gamble.

Both shocks have time lag effect. At the initial period of COVID 19 induced economic coma, though supply chains are disrupted, but regional stocks supplemented the supply position. But with complete national lockdown and curfew, the factories and shops are shuttered leading to drastic decline of supply over night. This created the supply chain havoc. But there is effective demand in the market with gradual decrease. Both declined, at the outset, with over powering of supply of all. This temporal market scenario inflated the price level. The longer the virus imbued situation persists, the consumption demand declines drastically and gradually over powers supply shock. Ultimately this leads to low employment, low National Income, & low price level dragging the economy into the recession.

Amidst this gigantic health emergency and recessionary economy what should be the policy measures fiscally as well as monetarily?

To save the life from Corona Virus, the Govt locked down all. But the threat lingers with delay in vaccine invention. Livelihood only can save the de-chained and confined lives. Livelihood depends on the disposable income of movement less people. There is no issue with haves. Have-nots are the 90 per cent informal labour force in the economy. Those poor people along with their dependant families need regular livelihood/income to feed them to save loss of lives out of hunger. To quench this need, Govt came out with initial stimulus measures of around Rs.1.70 lakh crores to provide ration and gas for daily needs. To the greater extent, the poor are benefited. This is inadequate to complement the multitudinal economic miseries of households, firms, investors exporters. The massive package with sectoral effect analysis should be effected in a continuous manner for reversing the AD with an eye on Fiscal Deficit and inflation. Since India has huge unutilized production capacity, the measured FD induced fiscal measures can generate AD which can be economically managed for higher capacity utilization and matching AS. Though it will take time, the policy makers should venture into reversal recovery strategy with a long term trajectory allowing temporal and transient policy shocks. The high level team of economists should be engaged for this gargantuan economic management.

What had happened to Liquidity Issues? And what were the measures initiated by monetary authority?

In an on-going normal economic scenario, liquidity is the life-blood of circular market economy. Further the economic prosperity depends on easy & timely to access the low cost liquidity. Since inflation costs the poor heavily the monetary authority's inflation targeting policy acts as catalysts to growth. Central Bank takes guided measures for stabilization of price to achieve the targeted growth through several liquidity windows as per Guiding Principles of Liquidity Management Framework.

Now COVID-19 dilapidated the circular flow of liquidity by forcing all economic agents to stay still and safe. Since consumption is only constant phenomena in economy, Households consumes for comfortable life, firms consume for better productive maintenance and Govt spends for growth and welfare. All are implicitly chained to consume and in effect circulate the liquidity. COVID 19 forced the dechained of all agents of the economy has blocked the flow of liquidity. People at all strata have been

suffering from higher cost consumption without getting opportunities to be employed and earned. The cost of economic life has been spiked. All economic participants need funding of adequate low cost liquidity to meet their liabilities and various payment needs for sustenance.

In pre-Covid period, Indian Economy was subdued reflecting reduced revenue collection at continuous growth imperative expenditures. Post COVID 19, Govt revenue generation took a huge hit but indispensable huge fiscal stimuli. This made Govt cash balance with a nosedive with Central Bank which also affected fractional liquidity in system. With advent of COVID 19 with uncertain vaccine discovery, economic bleak was palpable. To cut loss and to park at safe haven for future prospective investment decision, FPIs sold out the investment even at loss and capital was out flowed from equity and debt market by depleting forex balance. Consequently durable system liquidity was severely affected and RBI has intervened in forex market vide USD-INR swap operations to the extent of \$2.00 billion. With constant change of NDA, RBI modulates liquidity position to achieve the objective of monetary policy. Broadly uncertain fluctuation in system liquidity arises due to transient or frictional factors like change in Govt vash balances and due to durable factors like the change in CiC and impact of Central Bank's Forex operation.

For a well functioning and vibrant financial system liquidity plays the crucial role, especially market liquidity to support the funding liquidity. This market liquidity to a great extent connoted as System Liquidity. Specially system liquidity quantifies to the amount of net borrowing under LAF over and above the excess reserves maintained by Bank with RBI. Under Corona virus risk