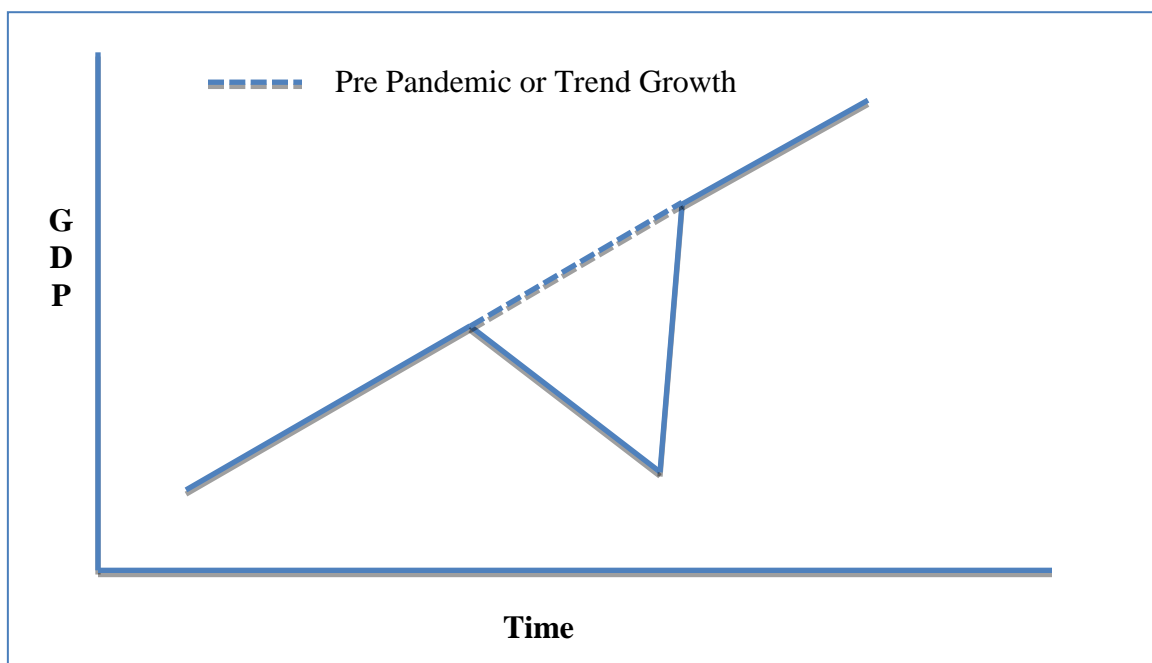


## Shapes of Economic Recovery

The most crucial question at the heart of all economic discussions after the COVID-19 crisis is what will the economic recovery look like? This question brings along a host of other questions such as whether the economic recovery will be as sharp as the decline in growth was, resulting in what is being referred to as the V-shaped recovery in India - with impressive recovery in a variety of High Frequency Indicators (HFIs) like the Index of Industrial Production (IIP), Purchasing Managers Index (PMI), and also in the Gross Domestic Product (GDP). These movements are also part of the larger economic concept of business cycles where these economic growth impulses undergo various fluctuations. The central assumption or the building block of the concept of business cycles is that there is a trend rate of growth to which the economy must gravitate over time. Coming back to the question of the trajectory of post-pandemic recovery, the response from the market as well as some economists has been to answer the question regarding the shape of recovery in terms of various alphabets. Some of the shapes being discussed are as follows:

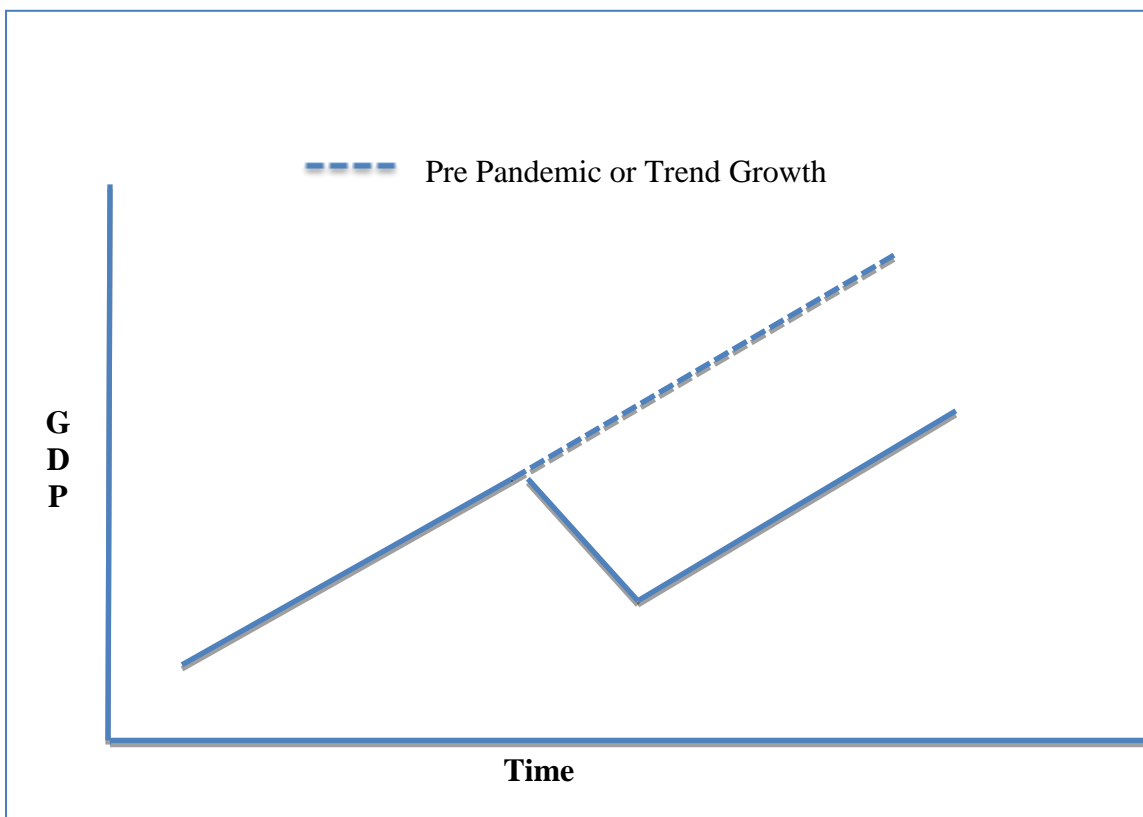
**V Shaped Recovery:** A V shaped recovery is an optimistic outcome where growth returns as sharply to the trend rate of growth as it had declined causing the path of growth to look like the alphabet V. This has been recently experienced in India post the COVID-19 pandemic when growth in the Q1FY21 declined sharply by -24% on a YoY basis and recovered to a moderate contraction of -7.3% in Q2FY21. The latest data point to a continuation of recovery with the headline growth entering a positive territory at 0.4% in Q3FY21. Although, some of the previous readings have been revised lower and partially that has been the reason for a markedly positive third quarter growth.





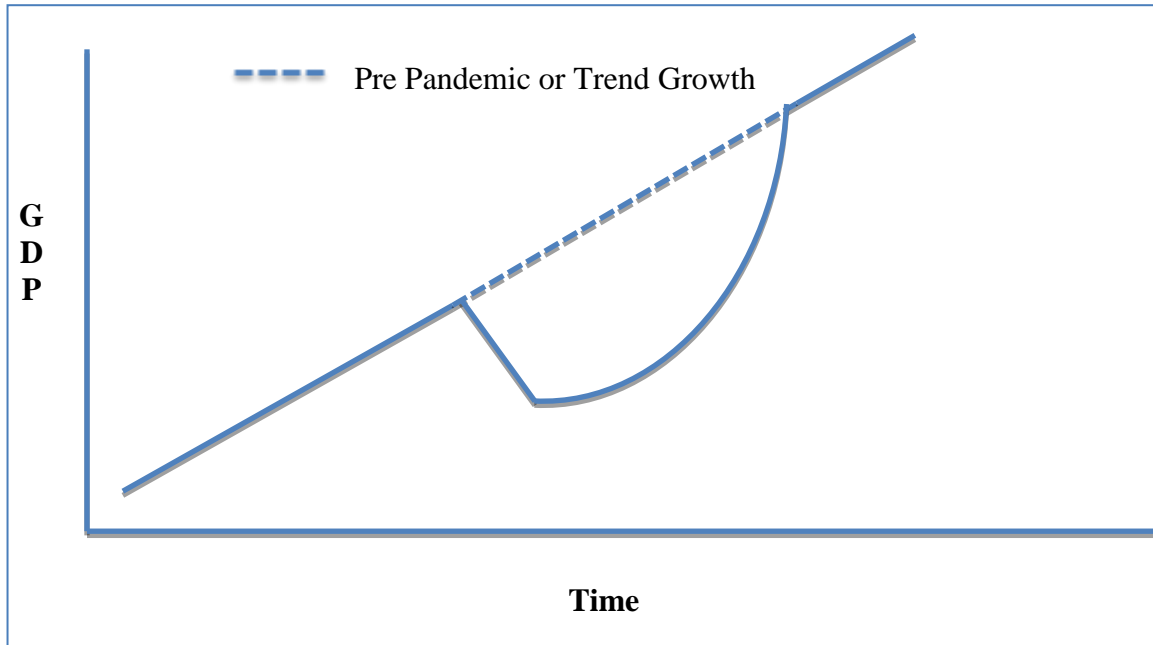
This also happens to be one of the more optimistic views on expected economic growth as it envisages an immediate return to normalcy. The other shapes that are used to depict various growth paths are as follows:

**L Shaped Recovery:** The worst case scenario is the L-shaped recovery curve where the output growth falls steeply and then remains at the lower level permanently. This is in fact not a recovery at all as the output level does not reach the trend rate (or pre-pandemic base line) of growth for a very long time. This kind of adverse scenario would be preferably avoided by policy makers.

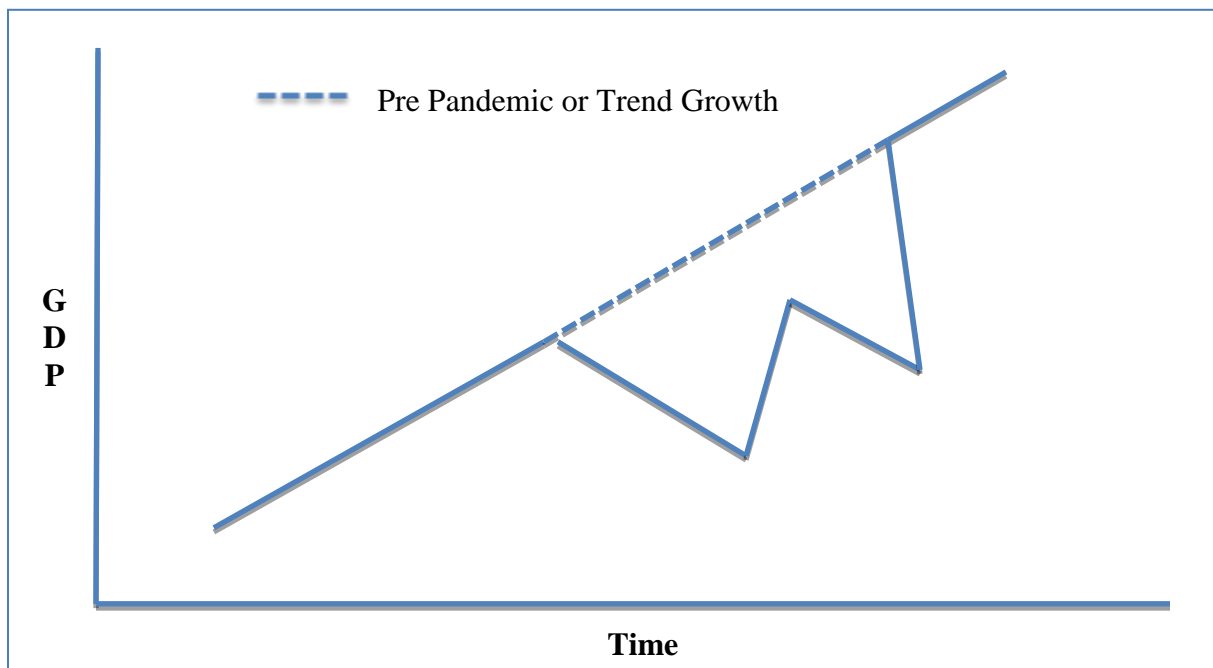




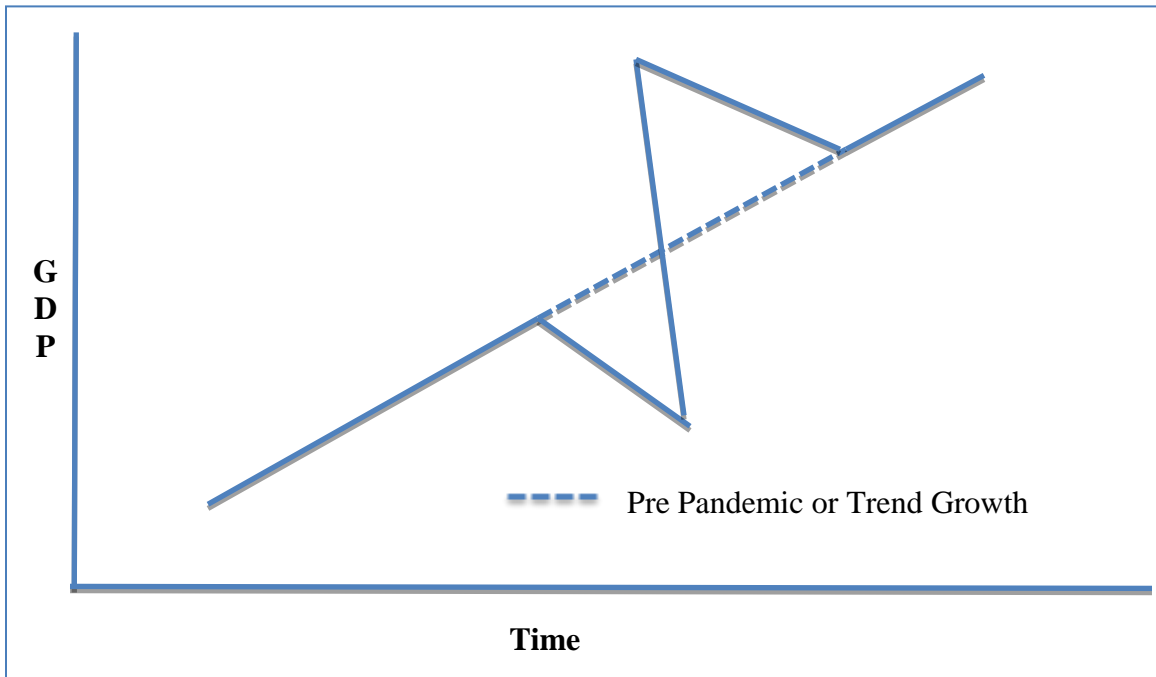
**U Shaped Recovery:** This has a similar path to a V shaped recovery though the recovery process is a more protracted one and growth takes much longer to revert to its trend rate.



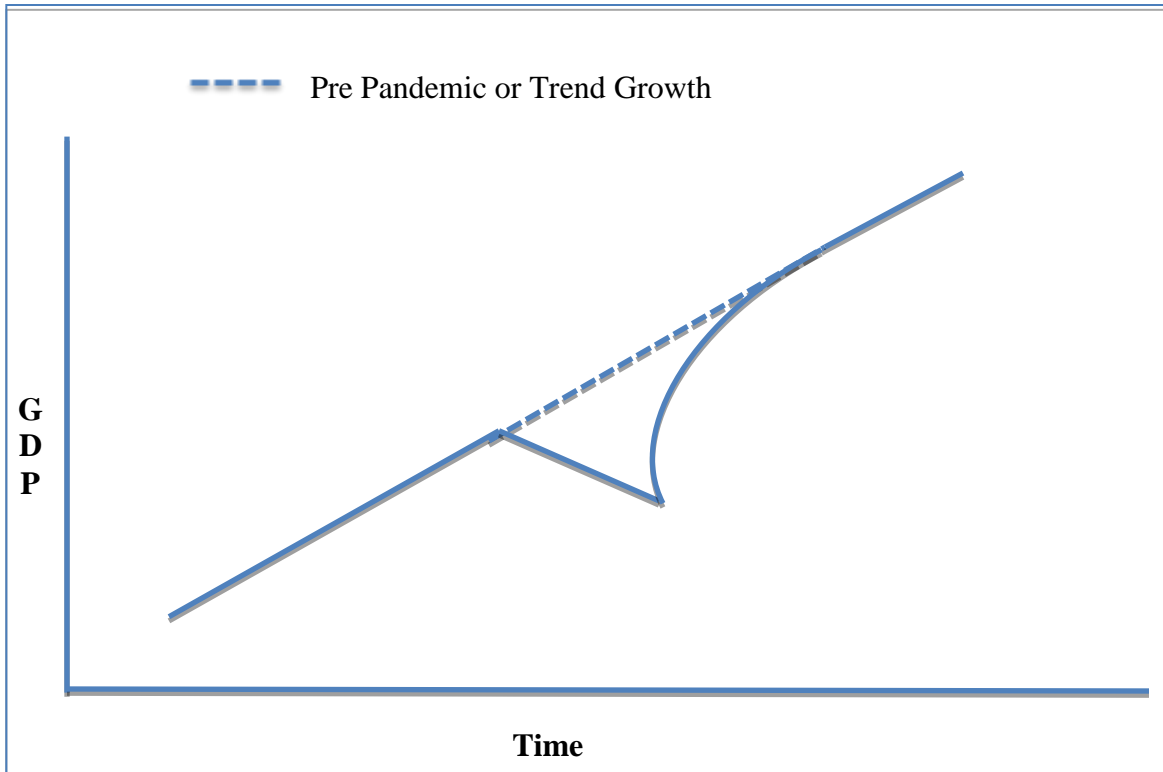
**W Shaped Recovery:** In continuation of the discussion related to a V shaped recovery, a much feared outcome is the W Shaped recovery or what is termed as a *double-dip* recovery where the growth first recovers in a V shaped recovery and then again declines immediately to lower levels before returning close to the trend rate of growth.



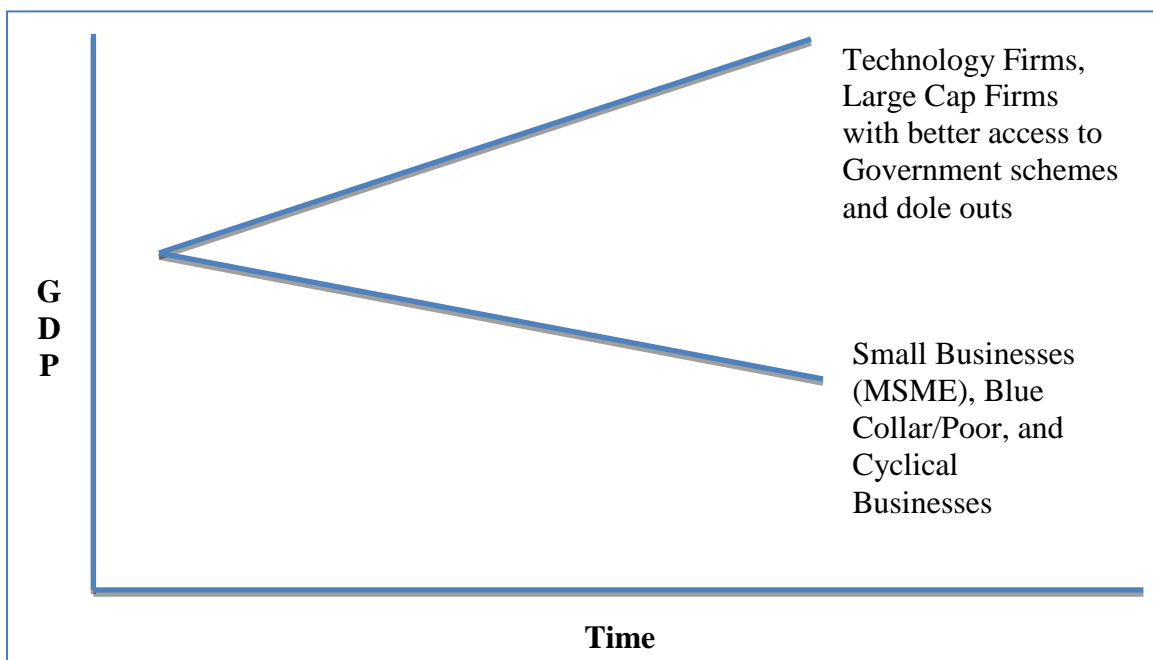
**Z Shaped Recovery:** This assumes that heavy spending by the government will have the desired multiplier effects and the economy will be pushed up to levels above the trend rate of growth albeit for a short period and then will eventually stabilise near the trend rate of growth. This is by far the most optimistic scenario in the alphabets of growth.



**Nike Swoosh Shaped recovery:** This is a slightly unusual shape of economic recovery where the trajectory of the recovery looks like the popular Nike swooshes. In this case, immediately after the decline in growth there is a sharp pick-up in economic activity (due to the lifting of economic and transport and travel restrictions), but post the initial boost of activity growth slows down as major economic stake holders are still hesitant about the near and medium term prospects, (and thus, are reluctant to spend as compared to pre-pandemic levels). Hence, it takes longer to reach the pre-pandemic levels in terms of economic activity.

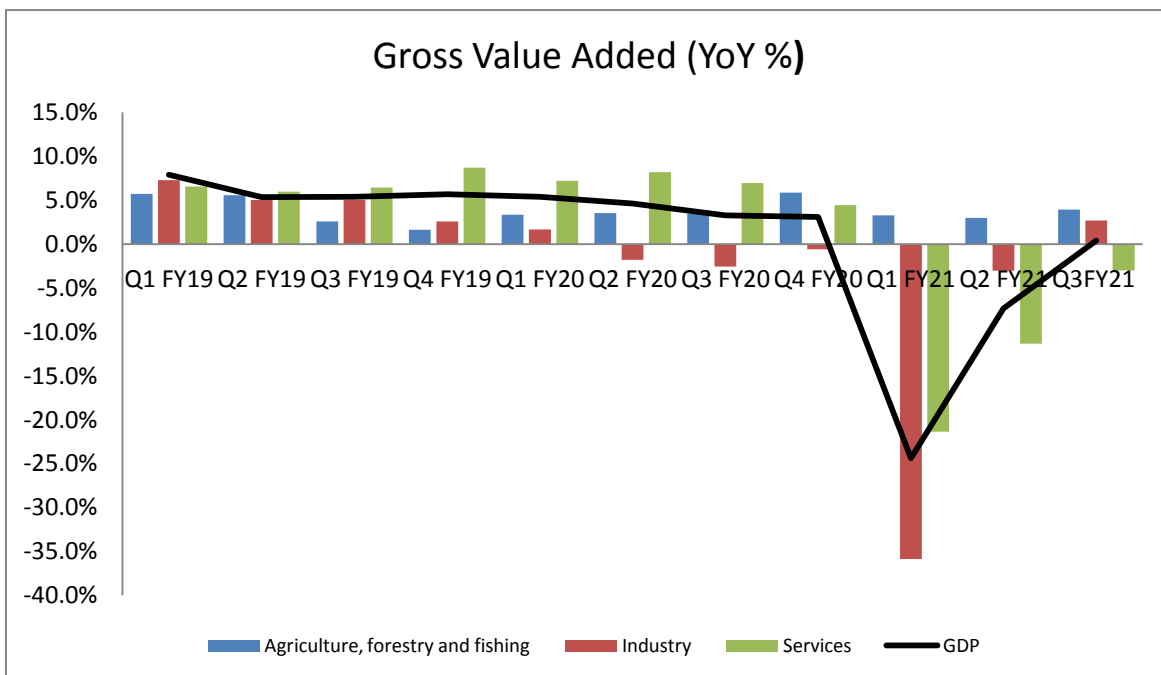


**K Shaped Recovery:** This is the worst form of economic recovery that can be encountered by the government and the economy. The recently published K shaped recovery estimate by J.P Morgan in one of its research documents envisages the observed reality that in the aftermath of a crisis and post the government stimulus, large firms which have better access to government institutions and hence the stimulus, grow exponentially while the small businesses and the poor class get left out of the stimulus. This would greatly exacerbate economic inequality already persistent in India and policy makers need to ensure that a K Shaped recovery does not materialise at all.





**The Indian Context - A V shaped recovery in sight?** The growth trends in India post the onset of the pandemic have been volatile, though the economy on the whole seems to have shown resilience in terms of the direction of growth. After a sharp decline of 24.4% in output in Q1FY21 depicted the impact of the series of stringent lockdowns announced by the Government in the wake of the pandemic, growth contracted only by 7.3% in Q2FY21, signalling that a strong recovery was underway. The Gross Domestic product (GDP) data is nonetheless a lag indicator of economic activity; although it is also the most comprehensive in terms of coverage of economic activity. The secondary and the tertiary sector were the worst affected while the primary sector remained largely impervious to the throes of the pandemic posting only a moderately lower growth of 3.0% in Q2FY21 as compared to a growth of 3.3% in the previous quarter. Q3FY21 points to a agriculture growth of 3.9% better numerically than the previous quarter, also due to a slight downward revision of the Q2FY21 estimates. The release of the 2<sup>nd</sup> Advance Estimates point to a bumper harvest in Rabi crops and also signals a positive growth trend for the Agriculture sector. The growth in the secondary segment has been very significant as the initial readings for the overall industry depicted a decline of 35.9% which narrowed significantly to a decline of 3% in Q2FY21 with a positive growth of 2.7% in the Q3FY21 in the GDP estimates.

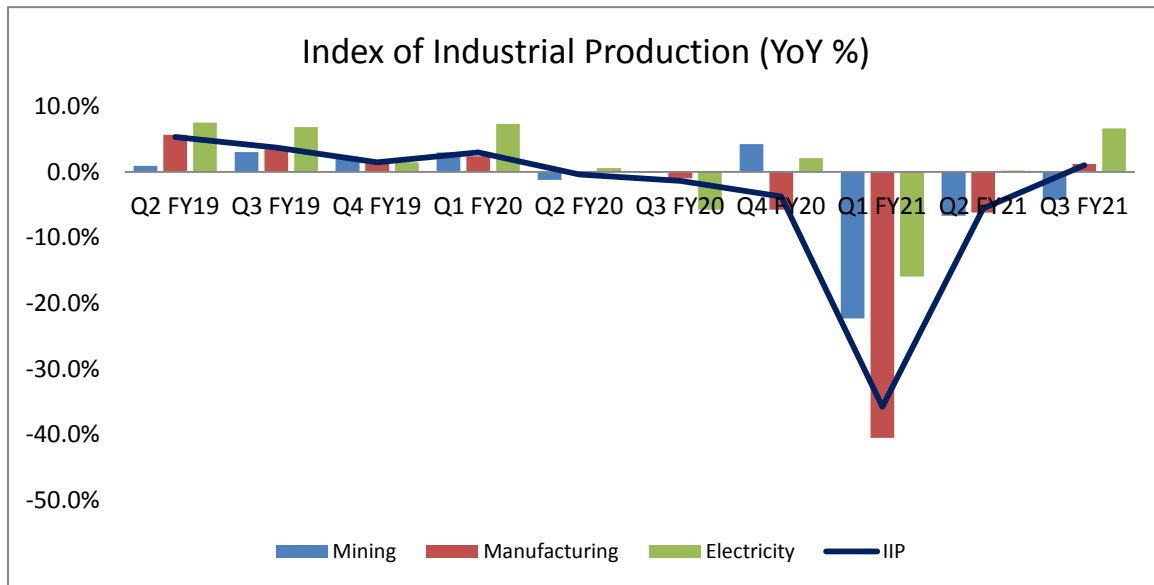


Source: MoSPI

The services sector declined by a significant 21.4% during Q1FY21, and has been slow to recover as indicated by the readings for Q2FY21 which have remained notably weak

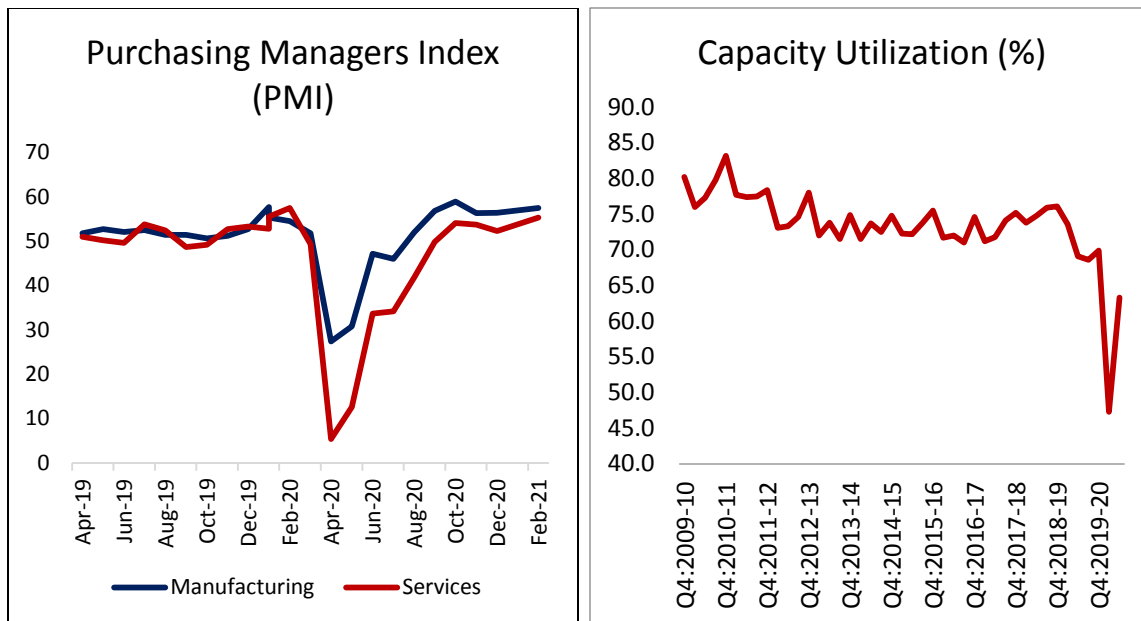


declining by 11.3%. Growth for services segment in Q3FY21 mimics the V-shaped recovery as it contracted only by 3%, suggesting a sharp pick-up in activity since Q2FY21. This was expected as part of the services which are contact intensive were slow to open up and hence are expected to see a protracted recovery process in the coming months, though the speed of recovery would depend on the success of the vaccination drives in the near term.



Source: MoSPI

The V-shape of economic recovery is also visible in other indicators of growth like the Index of Industrial Production (IIP) and the Order Book, Inventory and Capacity Utilisation survey (OBICUS) which are lag indicators of economic activity as well some of the lead indicators like the Purchasing Managers' Index (PMI) in Manufacturing as well as Services. So far the domestic economic activity indicators are pointing towards a V-shaped recovery which the policy makers would be comfortable with, although the question remains whether the growth would be sustainable in the near term. Much of the pick-up in real economic indicators like GDP and IIP have a favourable base effect at least partially which has propped up the present quarter growth and the play of the favourable base shall be even more pronounced in the quarters coming ahead as has been noted above, making the shape of the economic recovery close to a Z-Shaped one over a longer time period.



Source: Investing.com, RBI

A worse outcome would be the incidence of what is called above as a W Shaped recovery or in common parlance a double-dip recovery which would lead to growth declining once again before recovering to the pre-pandemic levels. Some segments are witnessing such a growth pattern like the automobile industry, and trends in some HFIs are pointing towards a dip in growth in the near term. Whether these trends permeate to headline growth will depend on the fiscal and monetary coordination of the government and the RBI in terms of the support that has been given during the pandemic and will be provided post the pandemic to aid the recovery process.

**Outlook:** The Indian economy has so far weathered the COVID-19 maelstrom with surprising resilience and it is expected to be amongst the fastest growing economies in the world, in the next year, assuming that the projected V shaped economic recovery has actually been realized. The shape of economic recovery is the most crucial element in the near future as, a W shaped, or worse a K shaped recovery will lead to a rise in economic inequality which will be an unfavourable outcome for the country to sustain immediately after recovering from the pandemic and will have adverse long term implications. All the economic participants and stakeholders need to sail in the same direction, as the shape of economic recovery ultimately depends on the economic performance of the households, corporates, and the government. Growth in the near term is expected to be strong and the initial quarters are expected to print growth levels in the double digits, and most of the forecasts of growth for FY22 point to a 10-11% growth, and optimistic estimates indicate real GDP growth at ~12-13% on the back of the very strong base effects and real time uptick in economic activity. The RBI is





expecting a growth of 10.5% for FY22 and the coming year shall most likely see a coincidence of low/moderate inflation and elevated growth levels.

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