



Covid Vaccine & Market Economy

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Context : Optimism around markets, but some factors could derail recovery.



Background : With the advent of 2021,

the Indian regulators deliberate over approving the use of Covishield, Serum Institute of India's version of the AstraZeneca-Oxford vaccine there is a sense of optimism in the public, investors and market participants.

The stupendous recovery of the stock markets after a 36% fall between February and March 23, 2020, surprised many since it coincided with the spread of the coronavirus, and recently with the emergence of a more potent mutant form of the virus just when the promise of a vaccine since November had raised hopes of a quick return to normalcy.

However, the domestic and global economic recovery, which forms the bedrock of a sustainable market growth, is still a work in progress amid concerns on various accounts. One must be conservative on expectations from 2021, keeping in mind that the rally of 2020 was driven by excess liquidity and was not based on fundamentals of the economy. If that money was to go back, it could lead to a correction. There are several factors or risks that the market is likely to grapple with this year.

Market Impact

The biggest problem area that the market may have to navigate with is a possible reversal of fund flows. As countries around the world have close to negative interest rates, leading to money flowing to emerging markets including India, there is a feeling in the market that a mere signal of a rise in interest rates can potentially derail that inflow of foreign money and reverse the trend.

One more relief package from the US will have its impact on inflation. While the immediate impact would be more inflows coming in, subsequently it will lead to a rise in inflation and that may lead to central banks increasing their interest rates.

Experts say that while no country can afford to increase interest rates significantly as that would potentially topple growth at this time, a change in this stance could result in capital outflows from emerging markets back to developed economies.

While FPIs (foreign portfolio investors) can afford to take risks, many feel they are sensitive to interest rates outside. So, whenever the US signals that it is going to shift from an accommodative to a tightening monetary policy stance, FPI money will start moving back into the US treasury bonds.

Regulators

Even the RBI Governor, in his monetary policy statement in December, said that as investors exited safe havens of US treasuries searching for higher returns, surges of capital flows have flooded into India.

Factors such as rising inflation and a shift in the interest rate stance by central banks, however, can potentially lead to reversal of the FDI flow and impact the stock markets negatively.

But, the premature withdrawal of stimulus can create a significant problem for the economic recovery across countries, and hence it will be very important to see when they start doing so. While everyone is looking at large listed entities to conclude that there is a recovery. The smaller companies in the medium and small-scale enterprises, that are major job creators, are still struggling. If that is the case then jobs will remain impacted and demand in the economy will also suffer. For us to have a sustained long-term recovery, we need revival across the entire segment of the economy and not just a few large companies.

Trial of vaccination

While the stock market rise on account of ample liquidity and fund flows was the story of 2020, it will have to be replaced with one that rides on economic recovery and growth consumer demand, private sector investment and job creation among

others. That will be essential not only for GDP and corporate earnings growth but also for long-term sustainability of equity investment, both by domestic and foreign investors.

And for that to happen, India will have to showcase the speed of its vaccination programme and the effectiveness of the vaccine as that will provide confidence to the masses, corporates and foreign investors.

The biggest risk is related to vaccine itself as there are a lot of doubts. The market is assuming that the vaccine will come and reach everyone but what if there is an issue in them reaching everyone or containing mutations. All assumptions that normal economic activity will continue are based on efficient vaccination and people resuming normal life.

Many feel the pace of vaccination will provide the confidence to people to spend and invest. That would result in demand generation and revenue growth for companies (which has been missing over the last couple of quarters), and would be a reflection of economic growth and recovery.

Any hiccup in the vaccination programme, however, would lower market confidence and the economy's ability to rebound faster.

Persistence of Virus

While a vaccine is in sight and regulators in India are deliberating on giving approval to Covishield, the emergence of a more potent virus variant from the UK has reminded the world that the threat is still very real and can potentially delay the return to normalcy. As countries went back to restricting air travel to the UK, announcing lockdowns and curfews, the markets witnessed a sharp correction and they remain under threat.

A country's ability to control the spread of the virus and keep a tab on new mutant forms will be critical for its recovery process. The country that is able to demonstrate it better will see a faster return to normalcy; however, a country that fails to do so could be in for a roller-coaster ride.

Market participants feel that if the next phase of Covid-19 spread is not severe and vaccination is efficient and effective, the economy will be back on track faster.

Connecting the Article

Question for Prelims : Consider the following statements:

1. Relief package from the US will have its impact on inflation.
2. Hiccup in the vaccination would lower the economy's ability to rebound faster.

Which of the statements given above is/are correct?

- (a) 1 only
- (b) 2 only
- (c) Both 1 and 2
- (d) Neither 1 nor 2

Question for Mains : Ability to vaccinate significant population in quick time will be the driver of economic growth. Discuss.

Covid19

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