

# COVID-19, Macroeconomic Policies, and Analysis of the Inflation – Unemployment Dynamics in India

JOSHY JOSEPH KARAKUNNEL\*

VIJAY VICTOR\*\*

SWETHA LOGANATHAN\*\*\*

MARIA FEKETE-FARKAS\*\*\*\*

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## Abstract

Indian economy could largely withstand the adversities of 2008 recession, the signs of a downturn were clearer by 2017 following the arrival of twin policies, Demonetization as well as the Goods and Services Tax. The COVID-19 pandemic has deepened the crisis leading to a significant reduction in production and total expenditure. Although India has resorted to a combination of conventional policies-- monetary as well as fiscal injections to face the economic crisis, it has had serious negative consequences on production and employment. We investigate the nature of relationship between inflation and unemployment during the recession and the pandemic times using the non-linear regression analysis. The results reveal that the recessionary phase has given way to a stagflationary situation owing to inflation persistence in the short run. We suggest the usefulness of a more comprehensive term structure strategy to deal with the adverse supply shocks and policy failures.

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## I. Introduction

THE INDIAN ECONOMY has been reeling under pressure since the last decade due to various factors like increasing bad loans and the after effects of the 2007 recession. In this backdrop, the government implementing the so-called "twin blows"-- Demonetization (2016) and Goods and Services Tax or GST (2017), pushed the economy to a recessionary phase by FY2016-17.

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\* Associate Professor & Head of the Department, CHRIST (Deemed-to-be-University), The Department of Economics, Bhavani Nagar, SG Palya, Bangalore, Karnataka, 560029, INDIA.

\*\* Associate Professor, Indian Institute of Technology (IIT) Roorkee, Department of Humanities and Social Science, Roorkee, Uttarakhand 247667, INDIA.

\*\*\* Doctoral (Ph.D.) Research Scholar, CHRIST (Deemed-to-be-University), , Department of Economics, Bhavani Nagar, S.G. Palya, Bangalore, 560029, INDIA.

\*\*\*\* Professor, Hungarian University of Agricultural and Life Sciences, Faculty of Economics and Social Science, Páter Károly str. 1, Gödöllo 2100, HUNGARY.

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Further, the paper sought to examine the existing policy approach to propose an alternative framework that overcomes policy paralysis. Our analysis reveals that in addition to the volume of intervention, a definite and organised agenda is critical for the long-term stability of the economy. For instance, the policy measures adopted during the 2007-08 Global Financial Crisis (the fiscal and monetary stimuli to boost the aggregate demand and economic growth) may be insufficient to overcome the current crisis with a long-term perspective. Therefore, the findings of the study highlight the significance of addressing the supply side without compromising the focus on demand side factors for building long-term growth capacity. Such a policy approach would focus on long-term growth while keeping inflationary pressure and unemployment levels within the healthy limits.

The generalisability of a short-term analysis of the inflation-unemployment dynamics in India, conducted during an unprecedented economic crisis, can be challenged. The framework for macroeconomic intervention also requires adaptation based on the specific needs of other economies. Secondly, the results present an overall picture of the pandemic and the twin economic shocks such as demonetisation and introduction of GST, without providing for disaggregation of effects. Finally, the short-term analysis does not add to the existing debate on the nature of inflation-unemployment relationship in the long-run. Future empirical research can focus on disaggregating the effects of twin policies from the effects on the pandemic. Additionally, it can also focus on empirically evaluating the effectiveness of policy alternatives proposed by this study.

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