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The State of Indian Economy: Growth-Inflation Conundrum

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Chief Economic Adviser's Views

The State of Indian Economy: Growth-Inflation Conundrum

The muted economic growth situation and rising inflation continue to be a matter of concern in India. The Q2FY23 estimate of GDP at 6.3% on year-on-year (y-o-y) basis is significantly lower than the growth in Q1FY23 (13.5%). This partly reflects the waning of the base effect and partly the stickiness in the recovery process. While the growth rate of GDP is as expected, Gross Value Added (GVA) growth is 0.7 percentage points lower at 5.6%, which shows that a considerable part of it is due to the high collection of indirect taxes minus subsidies. The high collection of Goods and Services Tax (GST) and even more important, excise duties on petroleum products and alcohol netted for subsidies account for 0.7 percentage point growth. The GVA, which is the summation of the value added from different sectors of the economy decelerated from 12.7% in Q1FY23 to 5.6% in Q2.

The sector-wise growth scenario also brings out some concerns. The agricultural sector growth at 4.6% in Q2 is a bit of a pleasant surprise as the monsoon conditions in the country were erratic. The services too performed well with a growth of 9.3% largely on the strength of contact-intensive sectors such as 'Trade, hotels, transport, storage, and communication' growing at 14.7%, representing the revival of these services as the pandemic waned. Within the services, the 'public administration' grew only at 5.6%, partly reflecting the attempt to rein in the fiscal deficit by controlling government expenditure. A more serious concern is the contractions in the mining and manufacturing sectors. The mining sector registered a negative growth of (-)2.8% as compared to the positive growth of 6.5% in Q1 and the contraction in the manufacturing sector was, even more, at (-)4.3% as compared to the positive growth of 4.8% in Q1. Although poor performance in these sectors were expected due to the recent trends in the Index of Industrial Production (IIP) and core sector growth numbers, a contraction of this magnitude has come as a surprise. While a part of this was due to base effect as these sectors in Q2FY22 showed reasonably high growth. Problems of supply disruptions partly due to external factors like the Russia-Ukraine war and continued COVID-19 restrictions in China also have contributed to the poor performance. Revival of the construction growing at 6.6% seems to have helped to improve urban employment conditions.

In terms of expenditure components, the contribution to GDP growth on y-o-y basis came mainly from private consumption expenditure (20.2%) and Gross Fixed Capital Formation (GFCF) (17.2%). In contrast, the government consumption expenditure growth was muted at 3.4% and the external sector continued to be a drag. The growth of GFCF bodes well for the economy which has been witnessing a secular decline in the investment climate. The higher non-food credit by the banking sector also shows the possibility of a reversal in the decline in investments seen in recent years.

The projections of economic growth and inflation for FY23 by the Reserve Bank of India (RBI), bring out a number of concerns. The economic growth numbers have

been downgraded from 7% to 6.8% and the inflation number is estimated at 6.7% which will continue to be higher than the upper tolerance limit of the inflation targeting framework. What is more, the muted growth numbers for the remaining two quarters at 4.4% and 4.2% do not infuse much confidence. The higher growth of 7.1% projected for the first quarter of FY24 is mainly due to the base effect as in Q2FY24 it is projected to moderate to 5.9%. As regards the inflation numbers are concerned, the Monetary Policy Committee (MPC) has clearly stated its concern about the downward inflexibility of core inflation. For the present, the focus continues to tame the inflation rate to less than 6%, which is the upper tolerance limit, and bringing it down to 4% is not yet on the radar. The relative stagnancy in the economy and high inflation will continue to be a cause for concern in the near term and the RBI will have to tread cautiously to prevent inflation from getting out of control, while supporting growth. In the prevailing situation considering the continuation of high inflation and the possibility of further rate hikes in the Fed, Bank of England, and European Central Bank, RBI is likely to continue to increase the repo rate, though at moderate hikes. The good signs, however, are the reversal in the outflow of Foreign Portfolio Investments (FPIs) and the moderation in crude oil prices. On the fiscal front, higher buoyancy in tax revenues is likely to arrest any slippage in the fiscal deficit target, despite the substantially higher food and fertilizer subsidies. Higher revenue productivity of taxes may also give the confidence to reduce the fiscal deficit by 0.5 percentage points in the next Union Budget. But the vigil on inflation and growth supporting monetary and fiscal policy will be crucial as we enter the new year.

Annexure: Select Macro Economic and Sectoral Indicators

Indicators/Sectors		FY21	FY22	Oct-21	Nov-21	Dec-21	Jan-22	Feb-22	Mar-22	Apr-22	May-22	Jun-22	Jul-22	Aug-22	Sep-22	Oct-22	Nov-22
Economy				FY22 Q3			FY22 Q4			FY23Q1			FY23Q2*				
GDP at 2011-12 Prices	Y-o-Y in %	**-6.60**	**8.68**	5.40			4.09			13.51			6.17			-	-
GVA at 2011-12 Prices	Y-o-Y in %	**-4.80**	**8.11**	4.71			3.89			12.75			5.77			-	-
Agriculture	Y-o-Y in %	**3.32**	**3.01**	2.54			4.13			4.46			2.50			-	-
Industry	Y-o-Y in %	**-3.26**	**10.27**	0.35			1.25			8.56			5.27			-	-
Services	Y-o-Y in %	**-7.82**	**8.44**	8.10			5.49			17.65			6.74			-	-
Banking																	
Gross Bank Credit	Y-o-Y in %	**5.00**	**9.60**	6.80	7.00	9.20	8.20	7.90	9.60	11.10	12.10	13.20	14.50	15.50	16.44	17.89	
Bank Credit to Industries	Y-o-Y in %	**0.40**	**7.10**	4.10	3.80	7.60	6.40	6.50	7.10	8.10	8.70	9.50	10.50	11.40	12.56	13.57	
Deposit	Y-o-Y in %	**11.40**	**8.90**	9.90	9.80	9.60	9.30	9.10	8.90	9.80	9.30	9.30	8.40	8.80	9.50	9.60	8.20
Industry																	
Composite PMI	Index	**44.70**	**53.47**	58.70	59.20	56.40	53.00	53.50	54.30	57.60	58.30	58.20	56.60	58.20	55.10	55.50	56.70
Manufacturing PMI	Index	**50.20**	**53.97**	55.90	57.60	55.50	54.00	54.90	54.00	54.70	54.60	53.90	56.40	56.20	55.10	55.30	55.70
IIP	Y-o-Y in %	**-8.40**	11.40	4.20	1.00	1.00	2.00	1.20	2.20	6.70	19.70	12.60	2.20	-0.70	3.50	-4.00	-
Manufacturing in IIP	Y-o-Y in %	**-9.60**	11.80	3.30	0.30	0.60	1.90	0.20	1.40	5.60	20.70	12.90	3.10	-0.50	2.20	-5.60	-
Consumer Durables	Y-o-Y in %	**-15.00**	12.50	-3.20	-5.70	-1.90	-4.40	-9.70	-3.10	7.20	59.10	25.20	2.30	-2.50	-3.20	-15.30	-
Consumer Non-Durables	Y-o-Y in %	**-2.20**	3.30	0.70	-0.80	0.30	3.10	-6.80	-4.40	-0.80	1.40	2.90	-2.90	-9.50	-6.30	-13.40	-
Eight Core Industries	Y-o-Y in %	**-6.39**	10.43	8.73	3.24	4.11	4.03	5.85	4.76	9.53	19.34	13.10	4.50	4.10	7.90	0.13	-
Auto Sales	Y-o-Y in %	**-14.64**	**-10.70**	-20.69	-24.42	-8.04	-15.23	-17.75	-13.71	6.61	123.93	19.02	5.86	9.86	12.33	0.30	-
Passenger Vehicles	Y-o-Y in %	**-10.35**	**8.00**	-27.10	-18.60	-13.30	-8.10	-6.50	-3.90	-3.80	185.14	19..06	11.13	21.00	92.03	28.61	-
Two & three Wheelers	Y-o-Y in %	**-15.06**	**-10.00**	-24.40	-33.90	-10.10	-20.90	-26.80	-20.40	15.90	262.10	23.38	8.95	15.62	12.36	1.87	-
Power Generation	Y-o-Y in %	**-1.17**	**7.00**	2.90	1.61	2.59	-0.18	2.85	2.55	9.88	20.60	17.12	2.95	0.67	10.87	-1.03	-
Steel Consumption	Y-o-Y in %	**-6.42**	**11.00**	-3.60	-6.73	-8.59	1.97	-4.38	4.47	6.59	21.19	6.16	14.48	17.91	14.85	11.42	-
Cement Consumption	Y-o-Y in %	**-13.00**	**22.00**	15.00	-3.30	-	14.10	11.60	15.70	-	27.32	20.29	0.48	1.79	12.38		-
Sugar Production	Y-o-Y in %	**15.59**	**4.00**	61.80	-4.90	-	-2.50	5.27	26.97	19.05	57.04	154.66	74.49	16.88	47.06		-
Domestic Passengers carried by Airlines	Y-o-Y in %	**-62.24**	**59.90**	70.46	65.50	52.89	-17.15	2.16	36.74	92.14	471.21	237.68	93.83	50.96	46.55	26.96	-
External Sector																	
Exports	USD Bn	**291.18**	**417.81**	35.65	30.04	37.81	34.50	33.81	40.38	38.19	37.29	37.94	35.24	33.00	35.45	29.78	31.99
Imports	USD Bn	**394.44**	**610.22**	55.37	52.95	59.49	51.93	55.01	59.07	58.26	60.62	63.58	66.26	61.68	61.16	56.69	55.88
Exchange Rate (Average)	INR/USD	**74.20**	**74.50**	74.93	74.50	75.37	74.44	75.03	76.29	76.12	77.32	78.07	79.60	79.56	80.23	82.34	81.80
Crude Oil (Average)	USD/barrel	**44.60**	**78.29**	82.11	80.64	73.30	84.67	94.07	112.87	102.97	109.51	116.01	105.49	97.40	90.71	91.70	87.55
Forex Reserves (As on date)	USD Bn	**579.3**	**617.7**	640.4	638.0	633.6	629.8	631.5	617.7	597.7	601.4	588.3	573.9	561.0	532.7	531.1	561.2
Net FPI Flows	USD Bn	**36.18**	**-19.40**	-1.66	-0.33	-3.94	-3.82	-5.07	-6.56	-2.96	-4.73	-6.59	0.24	7.11	-0.44	-0.38	4.14
Inflation																	
CPI	Y-o-Y in %	**6.16**	**5.51**	4.48	4.91	5.66	6.01	6.07	6.95	7.79	7.04	7.01	6.71	7.00	7.41	6.77	5.88
Food	Y-o-Y in %	**7.70**	**3.76**	0.85	1.87	4.05	5.43	5.85	7.68	8.31	7.97	7.75	6.69	7.62	8.60	7.01	4.67
Core	Y-o-Y in %	**5.51**	**5.98**	6.06	6.08	6.01	5.95	5.99	6.32	7.24	6.41	6.22	6.03	6.11	6.33	6.23	6.30
WPI	Y-o-Y in %	**1.20**	**12.97**	13.83	14.87	14.27	13.68	13.43	14.63	15.38	16.63	16.23	14.07	12.48	10.55	8.39	5.85
Food	Y-o-Y in %	**3.91**	**6.73**	4.25	6.83	9.37	9.55	8.67	9.29	9.13	10.58	11.78	9.28	10.06	8.02	6.48	2.20
Manufactured Products	Y-o-Y in %	**2.70**	**11.06**	12.87	12.34	10.71	9.50	10.24	11.26	11.39	10.27	9.35	8.24	7.51	6.12	4.42	3.59
Interest Rates (in %)																	
Repo	Effective	**4.00**	**4.00**	4.00	4.00	4.00	4.00	4.00	4.00	4.40	4.40	4.90	5.40	5.40	5.90	5.90	5.90
10-year Benchmark	Average	**6.40**	**6.51**	6.46	6.45	6.50	6.80	6.87	7.00	7.23	7.49	7.66	7.53	7.40	7.36	7.59	7.48
10- year AAA Corporate Bond	Average	**6.90**	**6.90**	6.86	6.90	6.90	7.00	7.00	7.00	7.27	7.67	7.84	7.76	7.70	7.89	8.04	7.89
5- year Benchmark	Average	**6.10**	**5.99**	5.96	5.96	5.96	6.30	6.30	6.40	6.79	7.24	7.42	7.28	7.12	7.31	7.54	7.40
5- year AAA Corporate Bond	Average	**6.10**	**6.01**	5.98	6.10	6.00	6.00	6.26	6.40	6.81	7.46	7.77	7.70	7.42	7.54	8.01	7.83
MCLR of SBI (1 year)	Average	**7.00**	**7.00**	7.00	7.00	7.00	7.00	7.00	7.00	7.10	7.20	7.40	7.50	7.70	7.95	7.95	8.05
Call Money	Average	**3.20**	**3.24**	3.20	3.17	3.30	3.50	3.27	3.27	3.64	4.11	4.67	5.16	5.13	5.12	5.99	5.91

Notes: The growth rates in 2021 and 2022 over corresponding period of previous year are to be interpreted considering the unusual circumstances on account of COVID 19 pandemic since March 2020. * BWR Estimates

Source: MOSPI, RBI, eaindustry.nic.in, IHSMarkits.com, SBI, CMIE, FIMMDA, NSDL, PPAC, PIB press releases, BWR Research

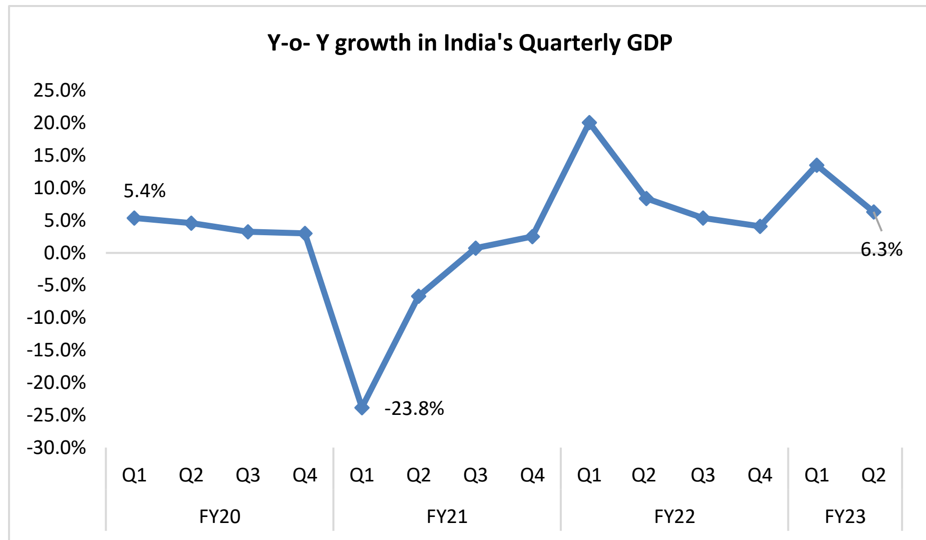
MACRO-ECONOMIC INDICATORS

BWR Views

Considering the rising risks of a global recession, coupled with the tightening of financial conditions worldwide, the GDP outlook for FY23 have been downgraded from 7% to 6.8% by RBI in its December MPC meeting. The H2FY23 growth outlook has also been revised marginally downwards, despite some high-frequency indicators showing revival in the recent months. Pick up in rural demand, improvement in private consumption, and rising demand for credit, points to an optimistic recovery, while adverse geopolitical spillovers remain a concern. The relative stagnancy in the economy and high inflation will continue to be a cause for concern in the near term. The higher growth of 7.1% projected for Q1FY24 is mainly due to the base effect, as in Q2FY24, GDP is projected to moderate to 5.9%.

GDP Trends: Muted GDP growth renews economic concerns

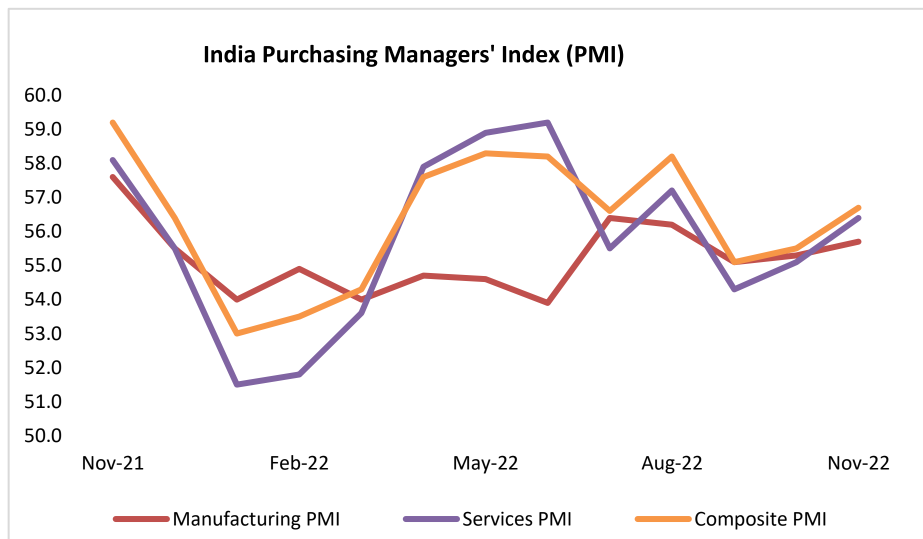
As per MOSPI's estimates, the GDP grew at 6.3% on year-on-year (y-o-y) basis in Q2FY23. This is significantly lower than the growth in Q1FY23 (13.5%) and Q2FY22 (8.4%). The agricultural sector and services performed well, yet the sector-wise growth scenario brings out some concerns, particularly the contractions in the mining and manufacturing sectors.



Source: Ministry of Statistics and Programme Implementation (MOSPI), BWR Research

Manufacturing and services PMI reflect demand buoyancy; IIP disappoints

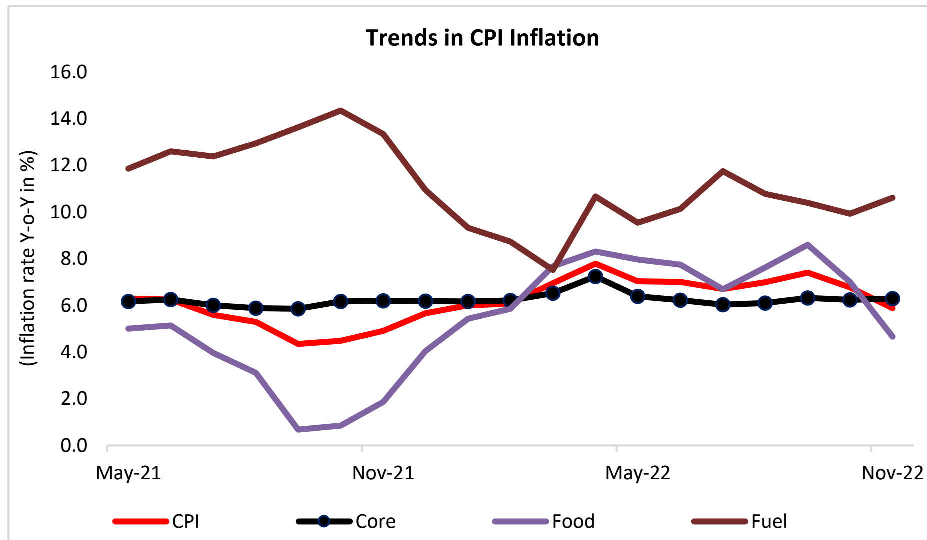
Despite inflation concerns, strong demand continues to uplift the positive sentiments, and the manufacturing and services PMI improved in November 2022 compared to October, reflecting faster increases in new business and output. However, the IIP slipped to 26-months low and contracted by 4% in October (y-o-y), due to base effect, while growth in eight core sectors remained muted at 0.1%, reflecting sluggish exports and rising production costs.



Source: www.pmi.spglobal.com, BWR Research

Inflation: CPI falls below 6% mark in November after ten months

CPI inflation fell below the MPC's upper band target of 6%, first time in eleven months and stood at 5.88% in November, due to sharp softening in food prices. The food inflation may moderate further in the rest of FY23, with a likelihood of bountiful Rabi output. However, core inflation continued to remain sticky at above 6% since October 2021, further increased to 6.3% in November 2022, which remains a major cause for concern.



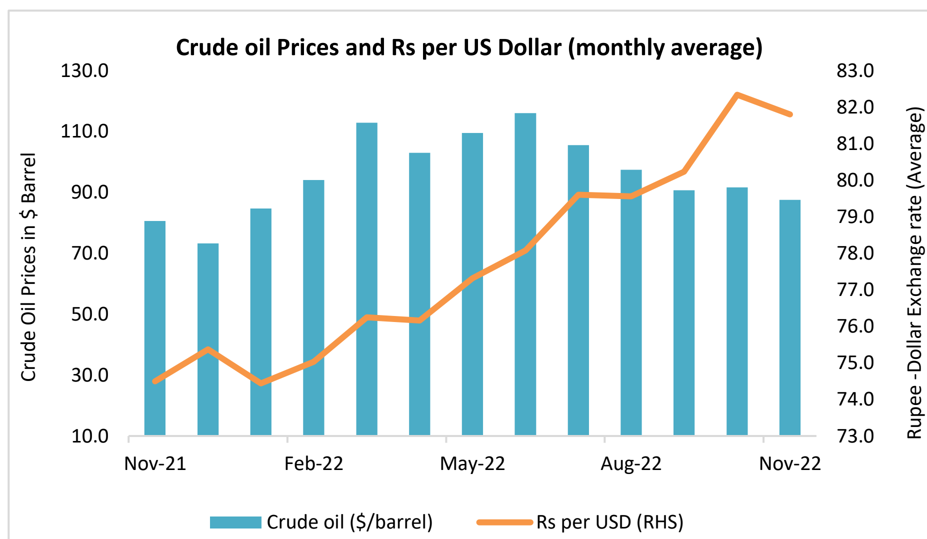
Note: Core inflation excluding food and fuel group
Source: MOSPI, BWR Research

BWR Views

With some moderation in global commodity prices, the inflation is expected to soften in the coming months. While the sticky core inflation and its downward inflexibility continued to be a major concern. Hence, the RBI has continued to maintain the inflation estimate above the upper tolerance level in Q3, and has kept the inflation outlook unchanged at 6.7% for FY23. For the next fiscal Q1 and Q2, the inflation outlook is placed at 5% and 5.4%, respectively, largely based on the assumption of a normal monsoon and average crude oil price (Indian basket) of USD 100 per barrel. Given the sharp fall in prices in November, the inflation may slip below RBI's estimate of 6.6% in Q3. If the inflation eases further and remains below the 6% levels, the RBI likely take a pause or the quantum of rate hikes will be reduced further.

Crude oil prices eased notably; rupee sees some stability

Crude oil prices eased in November and the average monthly prices fell to 10 months low due to slowing global demand amid monetary tightening and recessionary fears in the developed world. The pressure on the Indian rupee has also lessened due to cooling of the USD index and fall in crude oil prices. In addition, there has been a reversal in the outflow of Foreign Portfolio Investments (FPIs) from the domestic markets, which supported the rupee to appreciate by 0.5% against USD in November.



Source: www.ppac.gov.in, RBI, BWR Research

BWR Views

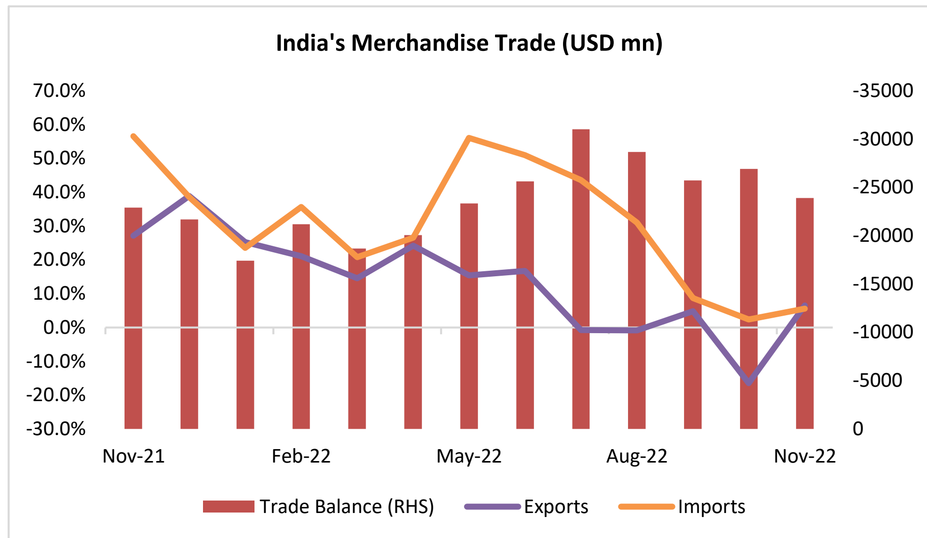
Recent sharp fall in crude oil prices provide much needed relief on the fiscal front and imported inflation. Lower crude oil prices help shrink India's import bill, narrow trade deficit and reduce demand for USDs. This in turn strengthens rupee and also eases pressure on RBI from further monetary tightening. While any additional cut in production by the OPEC+ alliance may put pressure on the prices. In October, Opec+ agreed to cut output by 2 million barrels per day, i.e., about 2% of world demand, from November until the end of 2023.

Merchandise trade: External sector concerns eased marginally

BWR Views

Geopolitical tensions continued to keep the external sector under stress, while recessionary expectations in the advanced economies continue to dampen demand for domestic exports. The recent fall in crude oil prices brings some respite on import bills. The trade deficit narrowed to USD 23.9 bn in November 2022 from USD 26.9 bn in October2022.

A weaker rupee, higher crude oil and other commodity prices have rendered imports expensive. In dollar terms, growth in merchandise imports increased by 5% in November y-o-y, while exports improved by 6.5%. During April to November FY23, exports improved by 11%, while imports risen by 29.5% over the corresponding period last year.



Note: Data is provisional.

Source: Ministry of Commerce and Industry, BWR Research

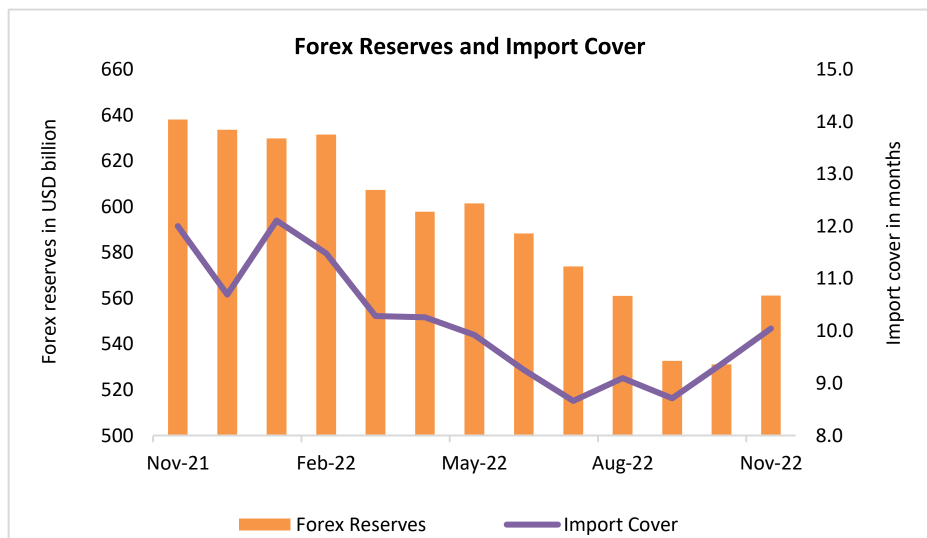
Forex reserves rose to USD 560 bn

BWR Views

With the depreciation of the rupee leading to valuation loss and frequent intervention by RBI to curb volatility in the exchange rate, India's foreign exchange reserves have depleted sharply in the first seven months of FY23, and reduced by about USD76 bn to USD 531 bn as on 27 October 2022. However, Stability in rupee-dollar exchange rate and FPIs renewed interest in Indian markets resulted the forex reserves to reach August 2022 levels.

The import cover of India's foreign exchange reserves improved to 10 months in November 2022 compared to 8.7 months in October, but still remains below last year's level of 12 months.

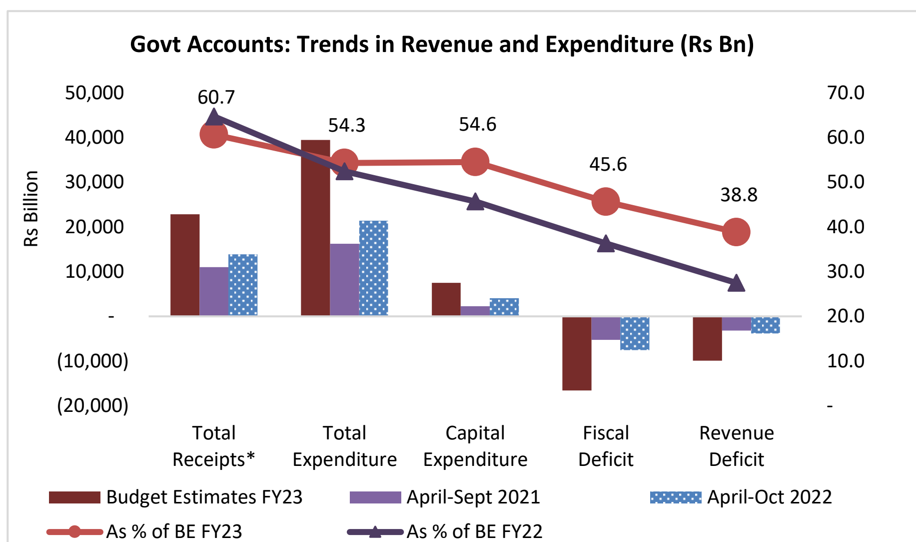
In November 2022, the forex reserves increased by USD30 bn over the previous month and rose to USD 560 bn, as the Indian rupee has moved in a narrow band and FPIs also turned net buyers in the Indian equity markets, after remaining net sellers in most part of the current fiscal so far. The revaluation of reserves held in other major global currencies due to cooling of US dollar was also a major reason for the rise in forex reserves.



Source: Ministry of Commerce, RBI, BWR Research

Government Finances: **Fiscal deficit crossed 45.6% of the budget targets**

Provisional data released by the CGA for April-October 2022 shows that the central government has spent 54.3% of the Budget Expenditure (BE) for FY23 with spending through capital expenditure reaching 54.6% of the BE, as compared to 45.7% of BE in the corresponding period last year. Similarly, fiscal deficit overshoots the level of corresponding period last year and crossed 45.6% of the budget targets so far.



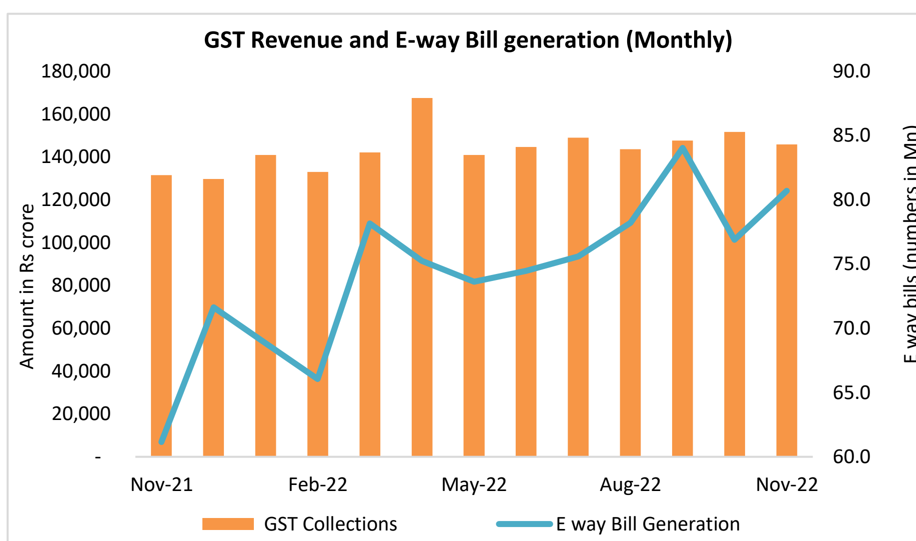
Note: Data is provisional, * Excluding government borrowing.
Source: Controller General of Accounts (CGA), BWR Research

BWR Views

The overall tax revenue collection has been healthy so far and in spite of the cuts in excise and customs duties on petroleum products and edible oil to rein in the prices, the aggregate tax revenue is expected to be higher by about Rs 2 trillion. However, the budget this year has placed heavy emphasis on capital expenditure, and it is budgeted to increase by 24.5% of the revised estimate of last year. With a fiscal deficit target of 6.4% of the GDP for FY23, higher crude oil prices impose a huge risk on fiscal management. Recent fall in crude oil prices brings some respite and it remains to be seen whether the government will be able to maintain the tempo of increasing capital expenditure in the rest of the current fiscal.

GST: Tax collections continued to remain buoyant

There has been a steady increase in the revenue collections, and the GST collections have been higher than Rs 1.4 trillion in nine months in a row since March 2022. Total GST collection in November rose by 11% over the previous year. State-wise, Maharashtra, Karnataka, Tamil Nadu and Uttar Pradesh who are the major contributors, have reported double-digit growth in GST revenue receipts, while Gujarat reported 2% contraction during the same review period.



Source: PIB press releases, GSTN, BWR Research

BWR Views

Buoyant GST collections actually indicate the stabilisation of the technology platform. Due to improved tax compliance and better tax administration by both the central and state tax authorities, coupled with a more stable technology platform in place, GST collections may continue to be higher in the coming months. The generation of E-way bills has led to a significant improvement in compliance. The pace of growth in E-way bill generation sustained, and recorded 32% increase over the corresponding month last year.

SECTORAL INDICATORS

Banking

BWR Views

The asset quality of the public sector banks had improved and BWR believes that the asset quality shall continue to improve in FY23 year-end due to level playing by the National Asset Reconstruction Company Limited for the resolution of High-value Non-Performing Assets (NPAs) in the banking industry. The Inflation concerns eased to some extent in November with CPI falling to 5.88% from 6.77% in October 2022, on account of lower food price rises. The retail inflation, though eased, still remains close to 6%, the upper limit of the RBI's tolerance band and a further rate hike cannot be ruled out in the next MPC meeting.

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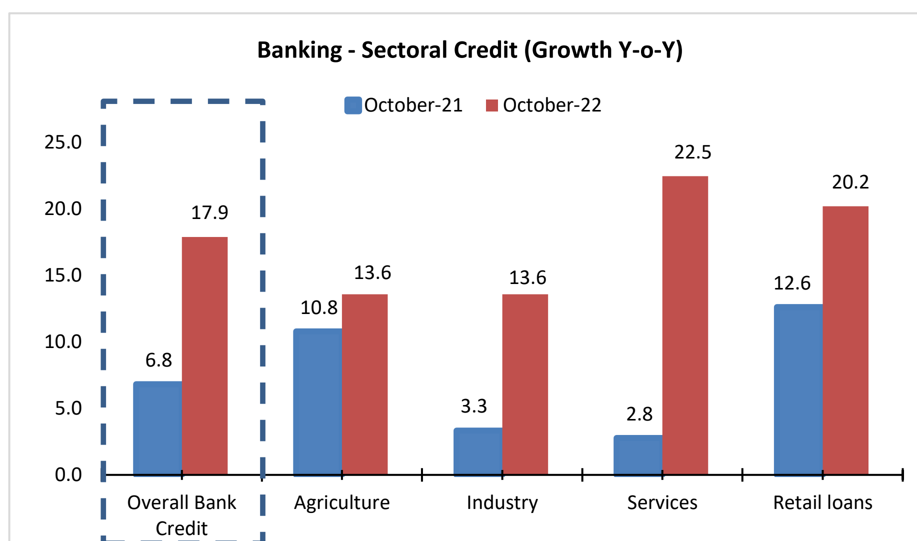
Hemant Sagare
(Director-Ratings)

Forum Rushit Parekh
(Sr Manager)

Credit growth is expected to remain strong; Asset quality shall continue to improve in FY23

The public sector banks continued to perform better as on 31 October 2022. The healthy growth in both deposits and advances continues to improve upon the earnings and better net profits supported by an increase in net interest income and other income, especially the fee based income. The improvement in Net Interest Income (NII) and Net Interest Margin (NIM) was also supported by revision in lending rates, apart from growth in overall advances. BWR had expected a further rise in the lending rates after the festive season. In the December policy, the RBI increased the repo rate by another 35 bps to 6.25%. Thus far, the RBI has increased the repo rates by a cumulative 225bps since May 2022, which resulted in an increase in cost of borrowings, benefitting the banks to increase their interest income.



Source: RBI, BWR Research

On a y-o-y basis, the non-food credit growth was at 18.3% in October 2022, compared to 6.9% a year ago. The personal loans segment grew by 20.2% (12.6% a year ago), largely driven by 'the housing' and 'vehicle loans segments, while credit to agriculture and allied activities continued to perform well, registering a growth of 13.6% (10.8%) during the same review period. Credit to industry registered an accelerated growth of 13.6% in October 2022 as compared with 3.3% in October 2021.

Since March 2022, the gross bank credit grew at 8.4% as against 0.9%, a year ago. The credit growth was led by the personal loans sector by 11.5% (against 4.4%, a year ago), followed by services sector 10.1% (against -2.3%, a year ago), industry 4.3% (against -1.3%, a year ago), and agriculture by 8.8% (against 5.3%, a year ago).

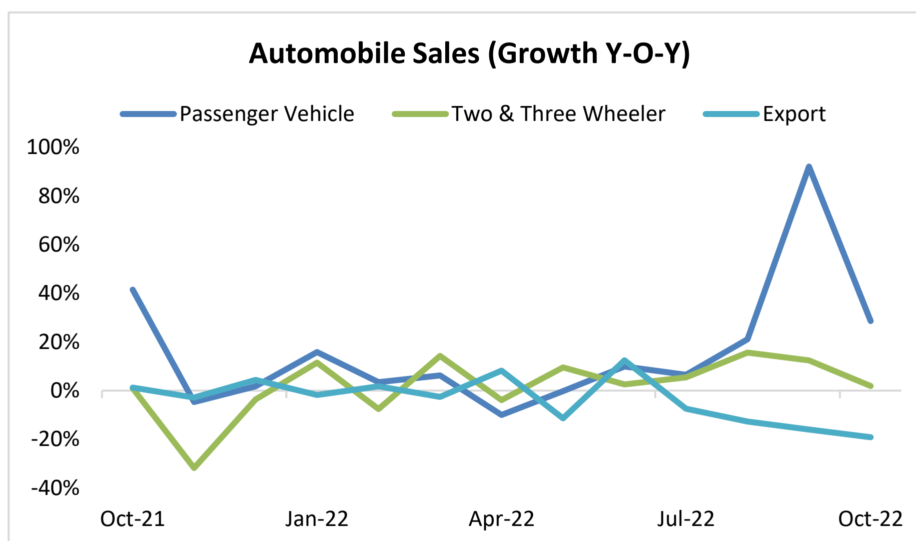
On the whole, the outlook for the banking industry appears to be brighter for FY23.

Automobiles

Cautious optimism in the domestic automobile sector

The Passenger Vehicles (PVs) segment, which has been leading the automobile growth story in India, saw 5.59% m-o-m decline in sales (2,91,113 units) in October 2022. However, the segment still reported y-o-y growth of 29% in October 2022, compared to the same period last year. PVs segment continues to see extremely high demand especially in utility vehicles segments including higher variants in most of the product categories. Apart from this, easing of semiconductor supply challenges, new launches and good customer schemes played a pivotal role in revival of demand. Furthermore, customers are getting their preferred models a lot quicker and manufacturers in turn are hoping to clear the order backlog faster too.

During October 2022, the Two and Three-Wheeler segment reported marginal y-o-y growth of 2% to 16,02,795 units and during the same period total exports declined by 19% on y-o-y basis and 2.5% on m-o-m basis to 3,69,321 units.



Source- CMIE, BWR Research

Telecom

Introduction of 5G services will provide impetus to the growth of telecom infrastructure development

Telecom companies have been aggressively expanding 5G services across the country since the launch of 5G on 1 October 2022. About 50 towns have been covered so far. The government is taking steps to scale up infrastructure deployments in the 5G network roll outs. The Department of Telecommunications (DoT) is expected to release the revised draft of the new Telecommunications Bill by the beginning of 2023 and the bill is likely to address the issues like over-the-top (OTT) apps and direct-to-home (DTH) services.

In FY23, BWR expects the Average Revenue Per User (ARPU) to increase y-o-y by 25-27% due to tariff hikes. The increase in the ARPU will help telecom companies to better manage their debt repayments and finance their 5G infrastructure.

BWR Views

BWR remains cautiously optimistic about the automobile sector's near-term growth outlook. The CVs segment is expected to see continued demand due to rising infra projects and government spending. Growth momentum in the PVs segment is likely to continue due to new launches, improvement in vehicle availability and increase in preference for premium vehicles. However, the rise in interest rates and commodity prices may increase the cost of vehicle acquisition and may play spoilsport. The overall sentiment is expected to remain positive, especially in the two wheeler and tractor segment, due to upcoming harvest season and crop realizations that would put fresh income in the hands of rural buyers. BWR expects total exports to witness a downward trend due to recessionary scenarios and high inflation in major export destinations.

Saurabh Agarwal
(Manager - Ratings)

Akanksha Maindiratta
(Sr Rating Analyst)

Chintan D Lakhani
(Director - Ratings)

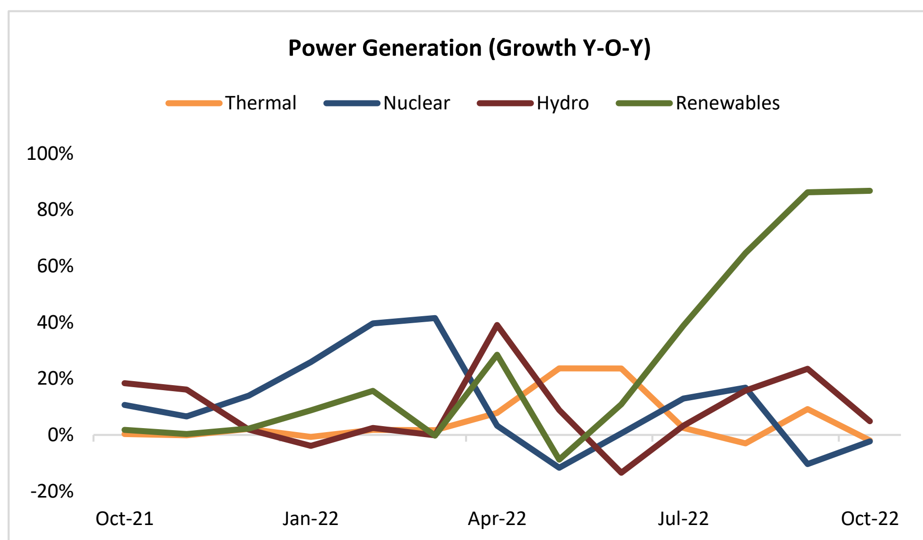
Vimal Tripathi
(Sr Research Analyst)

Power

Proposed tariff pooling for ageing coal-fired plants expected to support medium-term revenue visibility for gencos facing exits by power purchasers

In July, the Central Electricity Authority (CEA) brought out draft regulations on how thermal power plants can take on the role of steadying power sources supporting renewable power in future given inherent variations associated with renewable power generation. In a similar vein, the Ministry of Power in November released a concept note on the pooling of tariffs plus thermal and gas generating stations in India which have been in operation for over twenty-five years. According to the note, the main driver is the unwillingness of states and DISCOMs to renew their maturing Power Purchase Agreements (PPAs) with older thermal power plants given the rising cheaper renewable power supply capacity. Secondly, the purpose is to enable thermal power plants to aid in grid stability and address supply-demand imbalances given the intermittency of renewable energy (in line with the regulations by the CEA introduced in July 2022).

Basically, a generation company having stations which are more than twenty-five years old would be required to create a pool of such stations. Plants maturing beyond twenty-five years at later dates would also be allowed to be added into this pool. A power purchaser such as a state entity or a DISCOM would be required to approach such pools with the intended quantum of power requirement and the desired duration of supply. Following this, each participant DISCOM or state in a pool would be made allocations based on predetermined percentages. The incentive for power purchasers in this arrangement is that it would rationalise the charges that they would have to pay the gencos because a pool-specific payable rate is expected to be lesser than station or plant specific rates, as there would be a distribution of costs associated with a pool of stations. The notes require that the power purchasers would need to enter PPAs of a minimum term of five years.



Source- Central Electricity Authority, BWR Research

BWR Views

Tariff-pooling, if implemented, could be a win-win proposition in the medium term for both thermal power producers and power purchasers. Old coal-fired power plants with high asking power purchase rates through participation in pools of such plants, could access customers unwilling to stick with PPAs which are more expensive than the renewable power ones. For DISCOMs migrating to renewables, it also helps them to have an option of a steady, ancillary source of power supply at more rationalised rates, till the time energy storage capacity is built up in the country.

From a credit perspective, tariff pooling is expected to favour thermal-heavy generating power companies as it helps them to conserve capex by sweating their existing thermal power assets for an extended period. Secondly, it also ensures medium term revenue visibility in the form of shorter PPAs with power purchasers, who otherwise disinclined to renew their existing PPAs with these companies, given the growing availability of cheaper renewable options. Additionally, the concept note provides for such old power plants to sell unallocated power through power exchanges which can incentivize them to run at high utilisation factors.

Chintan D Lakhani
(Director - Ratings)

Sourav Sen
(Rating Analyst)

Steel

Steel industry witnesses robust demand

BWR Views

The government's decision to remove export duty on steel items will boost demand for the steel industry. The government has cut the export duty on steel products and iron ore to nil with effect from 19 November 2022, six months after the imposition of the levy on 21 May 2022, which may allow mills to raise capacity utilization, although an export resurgence and the trajectory of prices will hinge on a demand rebound.

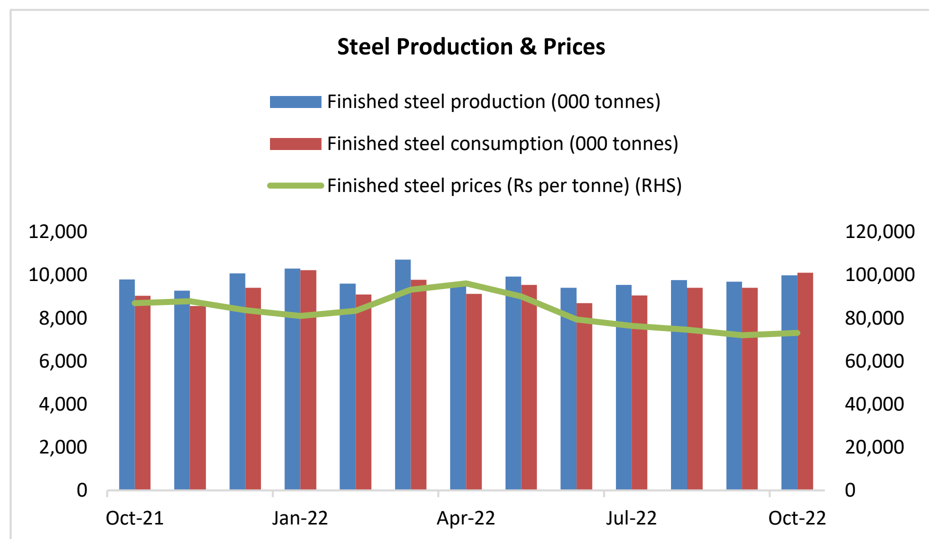
Bal Krishna Piparaiya
(Principal Director - Ratings)

Durga Lalit Purohit
(Rating Analyst)

India has emerged as the second-largest producer of crude steel by replacing Japan. The biggest steel-producing country is currently China, which accounts for 57% of world steel production.

The steel production and consumption grew by 6.4% and 11.4%, respectively, on a y-o-y basis during the first seven months of FY23 and is expected to increase by 3-5% and 9-10%, respectively, in FY23. The Government's National Steel Policy aims to increase the per capita steel consumption from 61 kgs to 160 kgs by 2030-31. By 2030–31, crude steel production is projected to reach 255 million tonnes at 85% capacity utilisation achieving 230 million tonnes of finished steel production, assuming a 10% yield loss or a 90% conversion ratio for the conversion of raw steel to finished steel. With net exports of 24 million tonnes, consumption is expected to reach 206 million tonnes by the year 2030–31. As a result, it is anticipated that per capita steel consumption will grow to 160 kg.

The government has also promoted a policy that provides a minimum value addition of 15% in notified steel products which are covered under preferential procurement. Although high inflation, monetary tightening and slowdown in China's economy contributed to a challenging 2022, we expect in FY23, steel demand will see a recovery of 1.0% to reach 1,814.7 Mt. Infrastructure demand is expected to lift 2023 steel demand slightly. The Government's thrust towards infrastructure projects, pick-up in construction and real estate activity as well as healthy demand from the automobile sector augurs well for the demand for steel products.



Source: CMIE, BWR Research

Cement

Demand is expected to continue

The cement manufacturers are expected to witness improved margins with the likelihood of increased cement prices and the moderation in input costs particularly

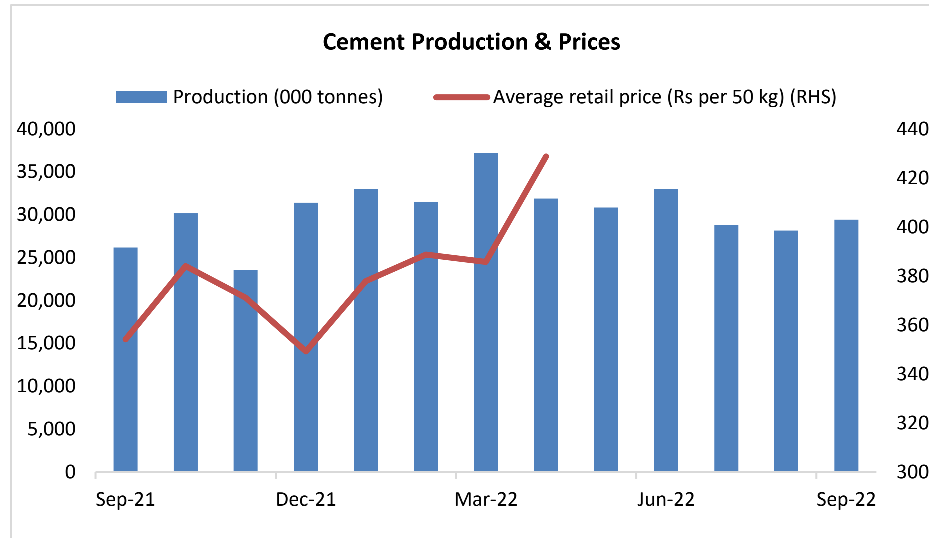
that of pet coke. Post the monsoon and festive season, the construction activity by the government as well as private players shall continue to drive the demand. With the long term growth in demand, the recent consolidation activity along with capex plans in the sector indicates it is expected to offer improved operating leverage in the subsequent years.

BWR Views

Higher government spending on infrastructure, increased focus by the government on low cost and affordable housing, and pick up in real estate demand in the backdrop of the general elections in 2024, continue to be the key drivers of demand for cement industry.

Saakshi Kanwar
(Associate Director - Ratings)

Vineetha Ann Varughese
(Sr Rating Analyst)



Source: CMIE, BWR Research

Sugar

Sugar Industry may see decline in Production

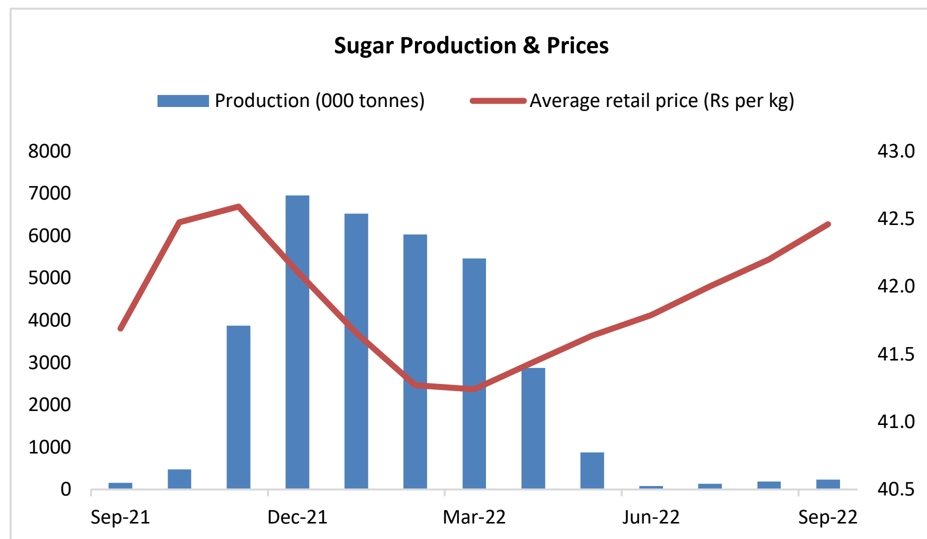
The sugar production in India till 30 November 2022 in Sugar Season (SS) 2022-23 has been ~48 lakh tonnes from 434 operating factories compared to 47.20 lakh tonnes from 416 operating factories during the corresponding period of previous SS. Maharashtra, Karnataka and Uttar Pradesh continue to contribute ~90% of the total sugar production.

BWR Views

The impact of the prolonged monsoons and erratic weather conditions on the sugarcane yield is yet to be ascertained, as the SS has just commenced. However, initial media reports suggest a drop of 7% in production. On the ethanol front, the Oil Marketing Companies (OMCs) have so far allocated ~460 crore litres of ethanol for supply in Ethanol Supply Year (ESY) 2022-23 (Dec 2022 - Nov 2023) against the requirement of 545 crore litres of ethanol to achieve the target of 12% blending. The ethanol production and recent increase in prices announced by the Government shall is expected to aid in stable margins for the integrated players.

Saakshi Kanwar
(Associate Director - Ratings)

Swarn Saurabh
(Assistant Manager- Ratings)



Source: CMIE, ISMA, BWR Research

DEBT MARKET INDICATORS

Movements in Bond Yields

Bond yields remain stable but may rise marginally by year end

BWR Views

In spite of the recent hikes in Repo rates taking it to 6.25%, the Yield curve has remained almost stable during last one month and the 10-year Gilt Yield seems to have peaked out at about 7.25%. In BWRs opinion, in the near term by end FY 2022-23, the bond yields are expected to remain at similar level, however, the 10 year benchmark Gilt yield may spike marginally up to 7.5% by this FY end owing to the impact of the recent hikes in rates by some central banks in Europe, UK and USA, high inflation therein and higher than expected Governmental borrowings in India during the fiscal year 2022-23 on account of the ensuing softer budget.

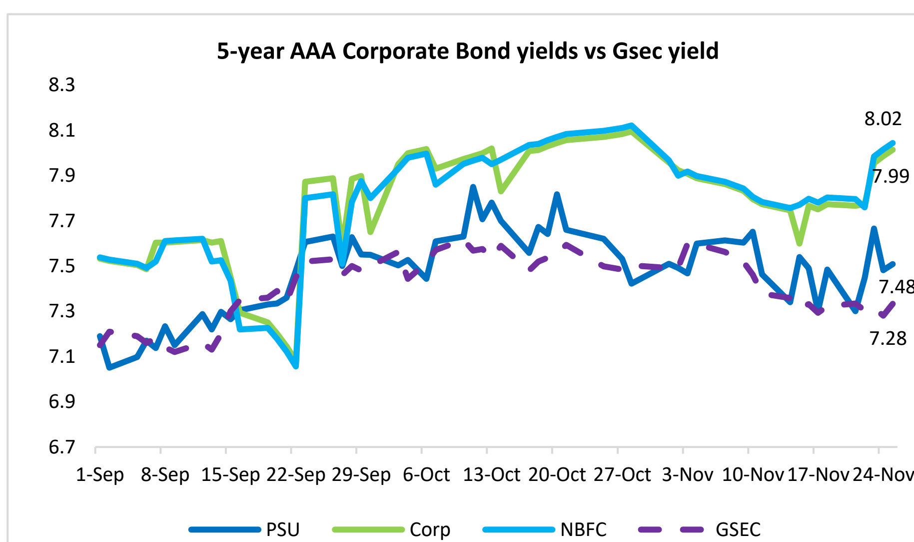
Bal Krishna Piparaiya
(Principal Director - Ratings)

In spite of the recent hike in repo rate by RBI in December 2022, the bond yields almost remained stable m-o-m. At the back of rise in repo rate by 35bps in December 2022 and the past hikes by various central Banks including RBI, the Gilt bond yields in India have maintained a steady level across most maturities and the yield curve has almost remained unchanged. Perhaps the sovereign debt yields have peaked out and the softening of inflationary trend and lower bank deposit rates have made the gilt yields at the current level attractive, thereby preventing further rise. While the gilt yields have tracked rise in repo rate, the bank deposit rates have not, and most banks are now increasing their term deposit rates.

The Gilt yields were ruling at the following levels at the close of 15 December2022- 10-year 7.28%, 3-year at 7.10 %, 5-year at 7.14 % and 30-year at 7.44 %; 3-month at 6.42%, 6-month at 6.77%, 1-year at 6.74%. The yields remained almost stable with marginal sideways movement up to 5bps m-o-m.

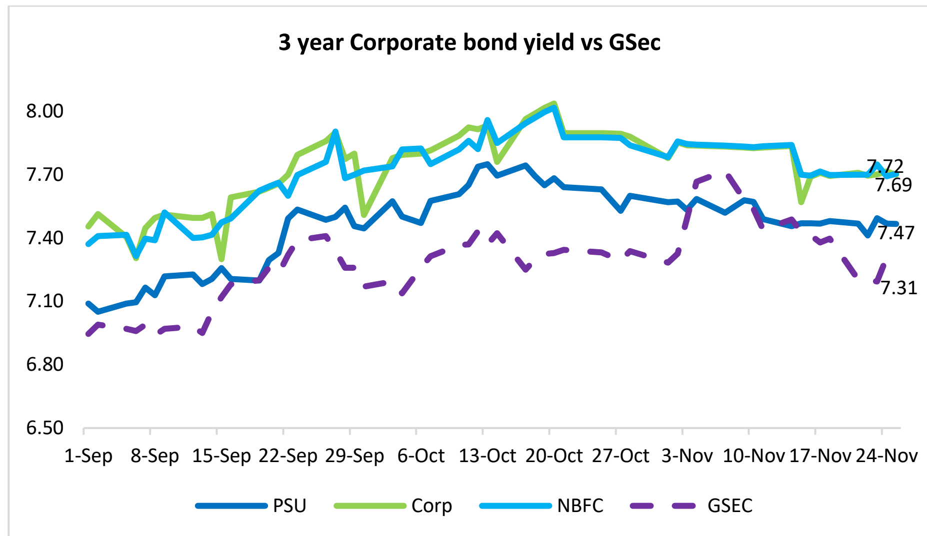
The corporate bond yields were moved in tandem.

The bond yield (annualised) issued by Public Sector Units (PSUs), corporates and Non-Banking Finance Companies (NBFCs) maturing in 5-, 3- and 1-year tenures with the corresponding government securities are provided below.

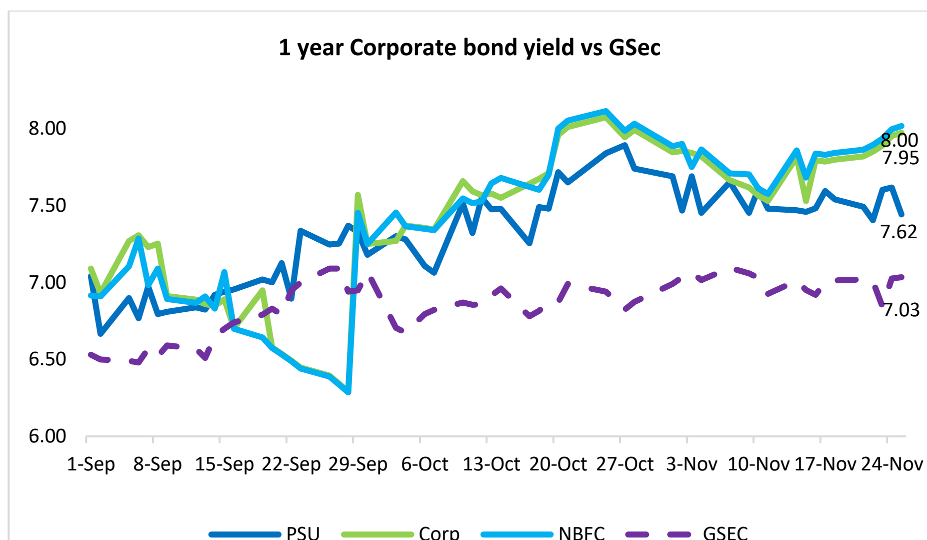


Source: FIMMDA, SBI, HDFC, BWR Research

The yield of AAA-rated corporate bonds maturing in 5-, 3- and 1-year tenures has remained stable to volatile due to timely strategic market operations and liquidity injection by the RBI.



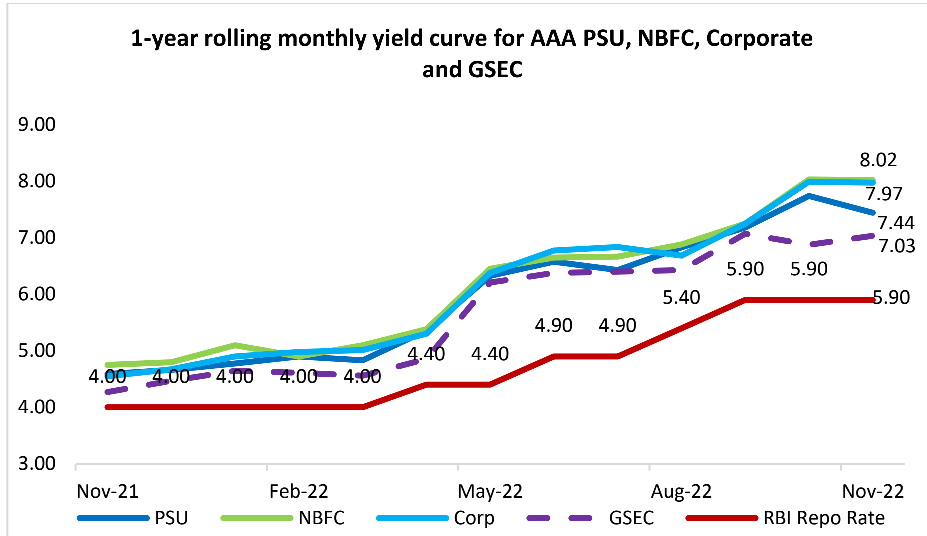
Source: FIMMDA, SBI, HDFC, BWR Research



Source: FIMMDA, SBI, HDFC, BWR Research

Yield curve of AAA PSUs, NBFCs, Corporates and G-Sec

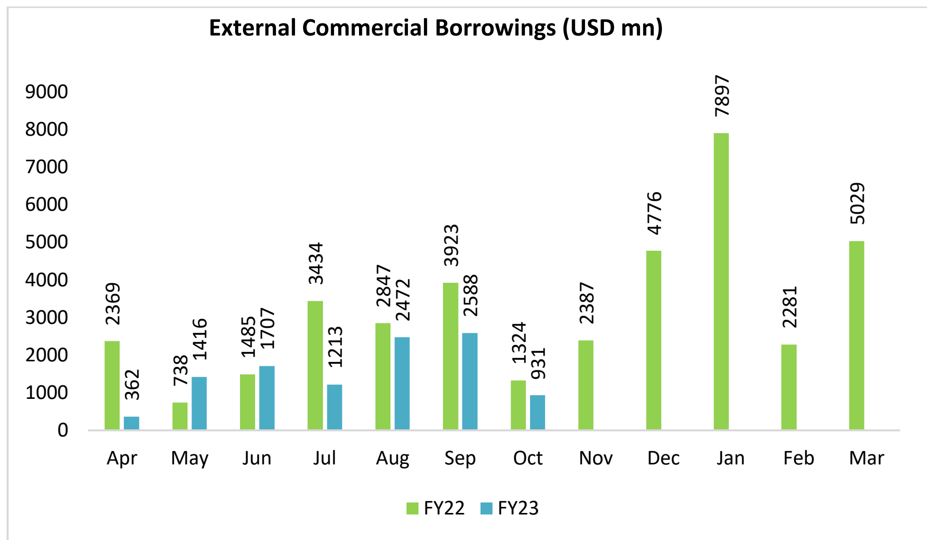
The borrowing costs for bonds maturing in 1 year issued by PSUs, NBFCs and corporates witnessed some escalation in the range by 285-349 bps in November in line with the G-Sec yields (277bps) against the corresponding period last year. The key policy rate (repo rate) had a hike in November 2022 by 190bps against the corresponding period last year.



Source: FIMMDA, BWR Research

External Commercial Borrowings

According to RBI data, Indian corporates' borrowings were at USD0.9 bn from offshore markets in the form of External Commercial Borrowings (ECBs) during October 2022 compared to USD 1.3bn during the same period last year, recording a decrease in the trend.



Source: RBI, BWR Research

BWR Views

Indian companies' ECBs borrowings showed a declining trend y-o-y in July and August 2022 on account of continuing uncertainties in the global market. The declining trend continued in September and October 2022. In BWR's opinion, the demand in ECBs is expected to remain subdued on account of uncertainties in interest rates across the globe.

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