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Economy on the path to recovery; uncertainty prevails

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GST After Five Years

On July 1 this year, we completed five years since the implementation of the reform of domestic consumption taxes to evolve the standard invoice-credit type destination-based consumption type value-added tax on goods and services. To get all the 29 states and union territories to agree to forgo their tax autonomy in favour of tax harmonisation five years ago was a phenomenal achievement. Not surprisingly, compromises had to be made, and the structure of the tax is far from ideal. With the improvement in administration, particularly the technology platform, the compliance of the tax has shown an improvement in the monthly revenue collection to record more than Rs. 1 trillion in the last ten months, and in June, the highest, at Rs. 1.45 trillion.

There have been considerable gains from the introduction of GST. First, the cascading element of the tax has been considerably reduced. The taxes subsumed in GST constitute about 60% of the domestic indirect taxes levied at the central and state levels. Second, eliminating the tax on tax, mark-up on tax, and tax on mark-ups on 60% of indirect taxes will go some distance in making the indirect tax system competitive. Third, the elimination of check-posts across the country has substantially removed impediments to the movement of goods across the country, and some estimates show a reduction in the time taken for goods movement by about 20%. Fourth, with as many as 11 indirect taxes levied by the centre and states subsumed in GST, and with uniformity in rates and administration, there have been considerable gains for administration and compliance costs. Fifth, the intent to have electronic processing to eliminate the interface between the taxpayer and collector, would lead to a reduction in the compliance cost. Finally, the creation of the GST Council to deliberate on and bargain various issues relating to the structure and operation of the tax is a unique experiment in cooperative federalism. This unique institutional arrangement can pave the way for other similar institutions to conduct intergovernmental coordination, bargaining and conflict resolution.

The journey of tax evolution too has not been smooth, and there is a considerable distance to cover before it settles into a truly good and simple tax. However, the tax is here to stay and will keep evolving. In the complex reform process involving several factors, compromises to get the reform accepted in the first place are inevitable. Thus, it is not surprising that some bad features have entered into the design of the tax, and although it is not easy, it is necessary to remove them. Some of the shortcomings of the tax are as follows: (a) the list of exemptions is large; (b) the structure suffers from a multiplicity of rates, creating avenues for misclassification and classification disputes, inverted structure and is badly in need of rationalisation; (c) As petroleum products and electricity are kept out of the GST base, considerable cascading of the tax continues; (d) More importantly, although there has been substantial progress, the technology platform is yet to be fully settled, which is critical for improving the compliance of the tax; and the rate structure needs substantial changes based on a more scientific analysis of the direct

and indirect effects of rate changes on income and employment. These need to be remedied sooner than later to make the tax system simple and rational.

In fact, the reforms are best done when the economy is on the upward phase of the cycle, and in that sense, undertaking reform now is opportune. From that perspective, the 47th meeting of the GST Council, based on the report of the Ministerial Panel headed by the Chief Minister of Karnataka, has initiated the process by removing exemptions on a number of goods and services, which is an attempt to broaden the base and is therefore, welcome. There have been changes in the rates on some goods and services to eliminate the inverted duty structure. Hopefully, the changes in the rates have been done with a view to eventually reduce the number of rates. However, much remains to be done to achieve a convergence in rates and include petroleum products and electricity into the ambit of the tax. These are difficult reforms and would require the cooperation of states.

An important matter not decided in the meeting of the Council was the issue of extending compensation to states for the loss of revenue. The states agreed to join the GST reform in 2017 on the promise of the Union government agreeing to compensate them for any loss of revenue. The compensation was to be made from the benchmarked revenue calculated by applying 14% on revenue from the subsumed taxes in 2015-16 every year. The reasoning for extending the compensation is that, of the five years covered by the compensation scheme, two years were tumultuous due to the pandemic, and with the technology platform still to fully settle down and compliance still low, the GST, far from being a 'money machine' is still to gain the desired speed in collections. However, the Union government has not been forthcoming on the issue of compensation as it entails moral hazards, particularly when the formula for giving compensation with benchmarked revenues is estimated by applying a generous 14% growth every year.

The next meeting of the GST Council is expected to discuss the issue of compensation. There are a number of reform issues that need to be addressed, and the cooperation of states in carrying these is paramount. The recent Supreme Court judgement that the GST Council is merely a recommendatory body, and the Parliament and State legislatures have the power of effecting changes in the structure and operation of the tax gets the states greater bargaining power. In this environment, to get the states to agree to undertake the desired reforms, the Centre can leverage the compensation issue by extending compensation for the next three years by revising the formula to limit growth in reference revenue at 10%. This would be realistic, as in most states, revenues are expected to increase by more than 10%, obviating the need to pay compensation. The important question is, how keen is the centre to undertake the reforms?

Annexure: Select Macro Economic and Sectoral Indicators

Indicators/Sectors		FY21	FY22	May-21	Jun-21	Jul-21	Aug-21	Sep-21	Oct-21	Nov-21	Dec-21	Jan-22	Feb-22	Mar-22	Apr-22	May-22	Jun-22
Economy							FY22 Q2			FY22 Q3			FY22 Q4				
GDP at 2011-12 Prices	Y-o-Y in %	**-6.60**	**8.68**				8.40			5.40			4.09		-	-	-
GVA at 2011-12 Prices	Y-o-Y in %	**-4.80**	**8.11**				8.30			4.71			3.89		-	-	-
Agriculture	Y-o-Y in %	**3.32**	**3.01**				3.16			2.54			4.13		-	-	-
Industry	Y-o-Y in %	**-3.26**	**10.27**				6.96			0.35			1.25		-	-	-
Services	Y-o-Y in %	**-7.82**	**8.44**				10.21			8.10			5.49		-	-	-
Banking																	
Gross Bank Credit	Y-o-Y in %	**5.00**	**9.60**	6.00	5.80	6.50	6.70	6.70	6.80	7.00	9.20	8.20	7.90	9.60	11.10	12.10	-
Bank Credit to Industries	Y-o-Y in %	**0.40**	**7.10**	0.80	-0.30	0.90	2.30	2.50	4.10	3.80	7.60	6.40	6.50	7.10	8.10	8.70	-
Deposit	Y-o-Y in %	**11.40**	**8.90**	9.70	10.30	10.70	9.50	9.30	9.90	9.80	9.60	9.30	9.10	8.90	9.80	9.30	-
Industry																	
Composite PMI	Index	**44.70**	**53.47**	48.10	43.10	49.20	55.40	55.30	58.70	59.20	56.40	53.00	53.50	54.30	57.90	58.90	59.20
Manufacturing PMI	Index	**50.20**	**53.97**	50.80	48.10	55.30	52.30	53.70	55.90	57.60	55.50	54.00	54.90	54.00	54.70	54.60	53.90
IIP	Y-o-Y in %	**-8.40**	11.40	27.60	13.80	11.50	13.00	4.40	4.20	1.00	1.00	2.00	1.20	2.20	6.70	19.60	-
Manufacturing in IIP	Y-o-Y in %	**-9.60**	11.80	32.10	13.20	10.50	11.10	4.30	3.30	0.30	0.60	1.90	0.20	1.40	5.80	20.60	-
Consumer Durables	Y-o-Y in %	**-15.00**	12.50	80.40	28.00	19.40	11.10	1.60	-3.20	-5.70	-1.90	-4.40	-9.70	-2.60	7.40	58.50	-
Consumer Non-Durables	Y-o-Y in %	**-2.20**	3.30	0.20	-3.90	-2.30	5.90	-0.10	0.70	-0.80	0.30	3.10	-6.80	-4.60	-0.60	0.90	-
Eight Core Industries	Y-o-Y in %	**-6.39**	10.43	16.44	9.39	9.94	12.16	5.44	8.73	3.24	4.11	4.03	5.90	4.89	9.30	18.10	-
Auto Sales	Y-o-Y in %	**-14.64**	**-10.70**	97.31	26.78	17.47	-3.58	-15.05	-20.69	-24.42	-8.04	-15.23	-17.75	-13.71	6.61	123.93	-
Passenger Vehicles	Y-o-Y in %	**-10.35**	**8.00**	162.70	119.30	44.70	7.60	-41.20	-27.10	-18.60	-13.30	-8.10	-6.50	-3.90	-3.80	185.14	-
Two & three Wheelers	Y-o-Y in %	**-15.06**	**-10.00**	25.50	4.00	-1.70	-13.90	-16.60	-24.40	-33.90	-10.10	-20.90	-26.80	-20.40	15.90	262.10	-
Power Generation	Y-o-Y in %	**-1.17**	**7.00**	8.00	6.43	7.16	17.50	-1.65	2.90	1.61	2.59	-0.18	2.85	2.55	9.88	20.60	-
Steel Consumption	Y-o-Y in %	**-6.42**	**11.00**	69.76	28.39	4.80	-2.24	-3.19	-3.60	-6.73	-8.59	1.97	-4.38	4.47	6.59	18.44	13.58
Cement Consumption	Y-o-Y in %	**-13.00**	**22.00**	4.80	7.80	22.50	37.70	11.10	15.00	-3.30	-	14.10	11.60	15.70	-	-	-
Sugar Production	Y-o-Y in %	**15.59**	**4.00**	-43.85	-67.99	98.16	77.10	25.00	61.80	-4.90	-	-2.50	5.27	26.97	19.05	-	-
Domestic Passengers carried by Airlines	Y-o-Y in %	**-62.24**	**59.90**	@	56.91	137.64	136.62	79.20	70.46	65.50	52.89	-17.15	2.16	36.74	92.14	471.21	-
External Sector																	
Exports	USD Bn	**291.18**	**417.81**	32.27	32.50	35.43	33.28	33.80	35.65	30.04	37.81	34.50	33.81	40.38	38.19	37.29	37.94
Imports	USD Bn	**394.44**	**610.22**	38.55	41.87	46.40	47.09	56.39	55.37	52.95	59.49	51.93	55.01	59.07	58.26	60.62	63.58
Exchange Rate (Average)	INR/USD	**74.20**	**74.50**	73.27	73.56	74.53	74.18	73.56	74.93	74.50	75.37	74.44	75.03	76.29	76.12	77.32	78.07
Crude Oil (Average)	USD/barrel	**44.60**	**78.29**	66.95	71.98	73.54	69.80	73.13	82.11	80.64	73.30	84.67	94.07	112.87	102.97	109.51	116.01
Forex Reserves (As on date)	USD Bn	**579.29**	**617.65**	598.88	611.07	620.06	640.70	635.36	640.39	638.00	633.61	629.76	631.53	617.65	597.73	601.36	588.31
Net FPI Flows	USD Bn	**36.18**	**-19.40**	-0.26	1.78	-0.99	2.23	0.39	-1.66	-0.33	-3.94	-3.82	-5.07	-6.56	-2.96	-4.73	-6.59
Inflation																	
CPI	Y-o-Y in %	**6.16**	**5.51**	6.30	6.26	5.59	5.30	4.35	4.48	4.91	5.66	6.01	6.07	6.95	7.79	7.04	7.01
Food	Y-o-Y in %	**7.70**	**3.76**	5.01	5.15	3.96	3.11	0.68	0.85	1.87	4.05	5.43	5.85	7.68	8.31	7.97	7.75
Core	Y-o-Y in %	**5.51**	**5.98**	6.40	6.11	5.93	5.77	5.76	6.06	6.08	6.01	5.95	5.99	6.32	7.24	6.41	6.22
WPI	Y-o-Y in %	**1.20**	**12.97**	13.11	12.07	11.57	11.64	11.80	13.83	14.87	14.27	13.68	13.43	14.63	15.38	15.88	15.18
Food	Y-o-Y in %	**3.91**	**6.73**	8.25	6.72	4.52	3.76	2.59	4.25	6.83	9.37	9.55	8.67	9.29	9.13	10.89	12.41
Manufactured Products	Y-o-Y in %	**2.70**	**11.06**	11.25	10.96	11.46	11.56	11.57	12.87	12.34	10.71	9.50	10.24	11.26	11.39	10.11	9.19
Interest Rates (in %)																	
Repo	Effective	**4.00**	**4.00**	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.40	4.40	4.90
10-year Benchmark	Average	**6.40**	**6.51**	6.31	6.37	6.33	6.40	6.30	6.46	6.45	6.50	6.80	6.87	7.00	7.23	7.49	7.66
10- year AAA Corporate Bond	Average	**6.90**	**6.90**	6.83	6.83	6.89	6.90	6.80	6.86	6.90	6.90	7.00	7.00	7.00	7.27	7.67	7.84
5- year Benchmark	Average	**6.10**	**5.99**	5.68	5.77	5.89	5.90	5.80	5.96	5.96	5.96	6.30	6.30	6.40	6.79	7.24	7.42
5- year AAA Corporate Bond	Average	**6.10**	**6.01**	5.90	5.90	5.88	5.80	5.90	5.98	6.10	6.00	6.00	6.26	6.40	6.81	7.46	7.77
MCLR of SBI (1 year)	Average	**7.00**	**7.00**	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.10	7.20	7.40
Call Money	Average	**3.20**	**3.24**	3.21	3.14	3.17	3.20	3.20	3.20	3.17	3.30	3.50	3.27	3.27	3.64	4.11	4.75

Notes: @ Due to the nationwide lockdown from the end of March 2020, majority of the establishments not operating in April 2020 and consequently, there were many units which reported 'Nil' production, affecting comparison of the indices for the months of April 2020 and April 2021. So the indices for month of April 2021 are not strictly comparable with April 2020.The growth rates in 2021 over corresponding period of previous year are to be interpreted considering the unusual circumstances on account of COVID 19 pandemic since March 2020.

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

MACRO-ECONOMIC INDICATORS

BWR Views

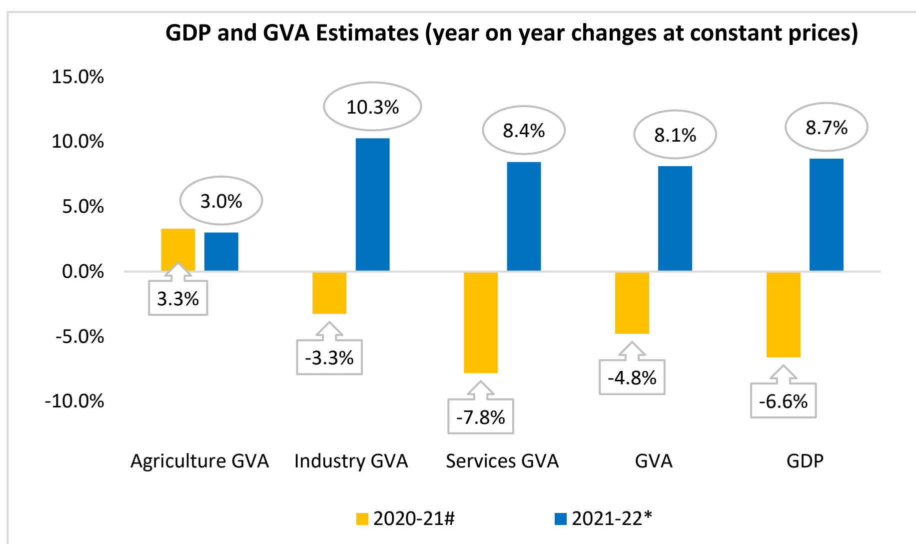
The domestic economy has been severely affected by adverse global developments despite the waning impact of the pandemic on economic activities. The Russia-Ukraine war, which began on 24 February 2022 and is still ongoing, has caused severe supply-side disruptions and a meteoric rise in energy-related supplies.

Persistent supply-side bottlenecks, along with the steady rise in international crude oil prices and commodity prices, are exerting cost-push pressures. With rising inflationary worries, the RBI has started withdrawing the accommodative stance and has already hiked the key policy repo rate by 90 bps so far since 4 May 2022. Record-level inflation has intensified significant downside risks to the growth momentum. Overall, the growth dynamics for FY23 changed tremendously following Russia's war with Ukraine. Rising price pressures have added to the dilemma, along with the waning monetary policy support by the RBI.

Growth prospects do not look very promising, while the RBI has retained its growth projection for FY23 at 7.2% made in the April MPC. We expect growth rates may be skewed more downwards than expected earlier.

GDP trends: Recovery after the big contraction

As per provisional estimates by the MOSPI, the GDP for FY22 grew at 8.7% after contracting by 6.6% in 2020-21 due to the pandemic and lockdown restrictions. Growth in Agriculture remained firm at 3%, and the industry and services sectors posted 10.3% and 8.4% y-o-y growth, respectively.

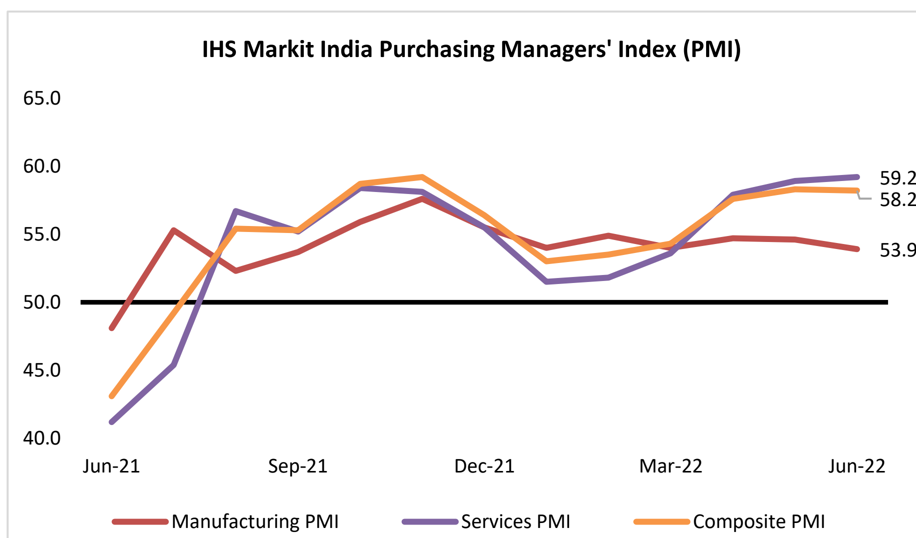


Revised Estimates * Provisional estimates

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

Services PMI grows, while Manufacturing PMI dips

The services sectors sustained a strong growth momentum in June, with the services PMI reaching its highest level since April 2011. Manufacturing sector recovery also remained firm, although the PMI slumped to a nine-month low in June as high inflation crimped demand for new orders and production. Data on the IIP and eight core sectors has shown sequential improvements, but inflationary pressures may dampen the recovery.



Source: IHS Markit, BWR Research

BWR Views

The constant increase in crude oil prices, which remained higher at above USD115/barrel on average in June, and rising manufacturing costs, evident from the record-high WPI inflation, indicates pressure on retail inflation.

The government's measures to control inflation resulted in some easing in the inflation rate in May and June compared to April; yet, the inflation level remained above the 7% mark in the last three months due to higher food and fuel inflation.

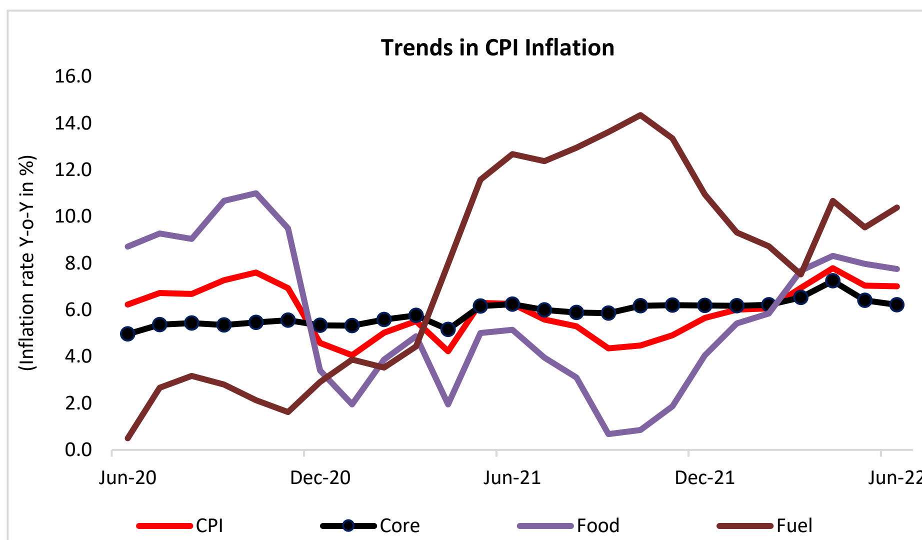
We expect the average inflation to stay above 7.0% in FY23, warranting resolute and calibrated steps by the RBI to anchor inflation expectations and contain second round effects. The RBI has already increased the policy repo rate by 90 bps since 4 May 2022. With the increase in the rate cycle, we expect a 1.5% to 2% hike in the policy rate in the current fiscal.

BWR Views

High crude oil prices result in severe adverse consequences on the Indian economy on both the growth and inflation fronts. India's dependence on oil imports constituted almost 85% of its consumption in FY22. Following the rise in crude oil prices, Rupee also depreciated by 2.4% between March and June 2022. The recent RBI decision to permit settling international trade payments in rupees is expected to ease the pressure on the exchange rate and promote growth in trade.

Inflation: Price challenges continue

CPI Inflation remained above the MPC's upper band target of 6% for the sixth straight month in June 2022. Despite the fading base effect, price levels remained sticky due to continued supply disruptions caused by ongoing geopolitical developments and the sharp increase in crude oil, edible oil and metal prices. Core inflation eased a bit, but continue to remain above 6%, while fuel inflation increased to 10.39%.

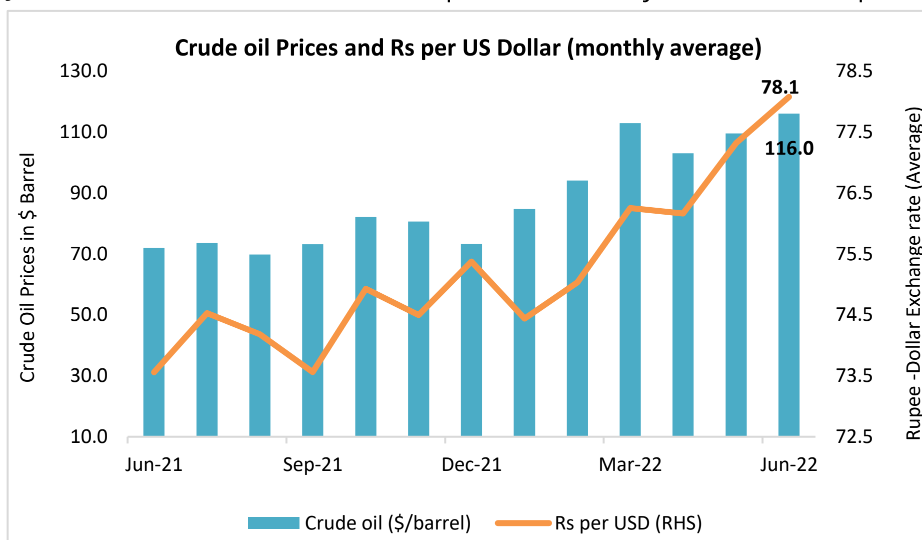


Note: Core inflation excluding food and Fuel group

Source: MOSPI, BWR Research

Challenging external situation

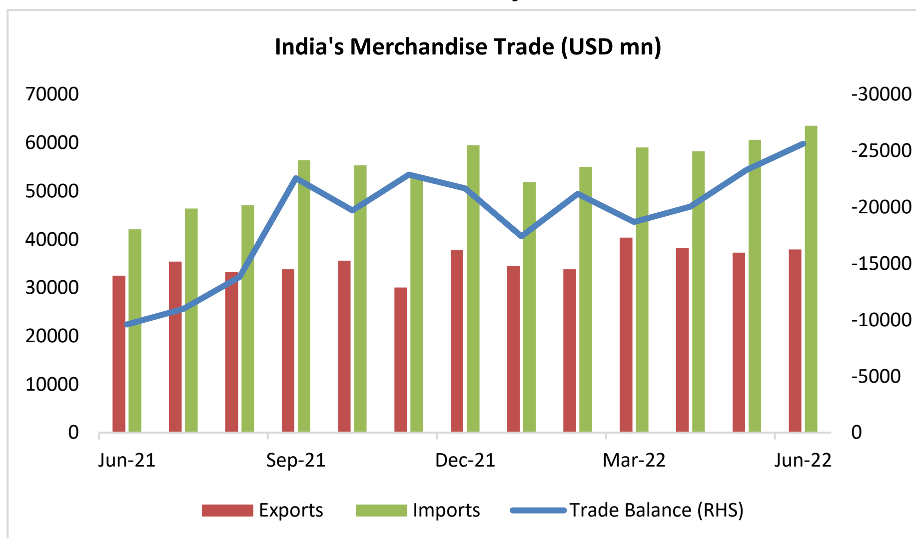
Since the beginning of February 2022, there has been a sharp rise in crude oil prices following the Russia-Ukraine war. Prices surged above USD 130/barrel in March and continued to remain at elevated levels, barring some intermittent fall. High oil prices, coupled with continued capital outflows from the Indian markets, put pressure on the Indian rupee as well, and the currency depreciated sharply to cross Rs 79/USD in June. However, RBI intervention helped the currency from further depreciation.



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

Merchandise trade: Rising import costs amid falling rupee widen deficit

After showing a remarkable increase in FY22 despite weak global demand, the pace of growth in Indian merchandise exports has come down, and the recent ban on the exports of certain commodities, such as steel, to cool down inflation may further dampen exports. A weaker rupee renders imports expensive in addition to the rising crude oil prices and other commodities. Merchandise imports increased much more than exports in June 2022 in value terms, resulting in the widening of the trade deficit to USD25.6 billion from USD9.6 billion in June 2021.



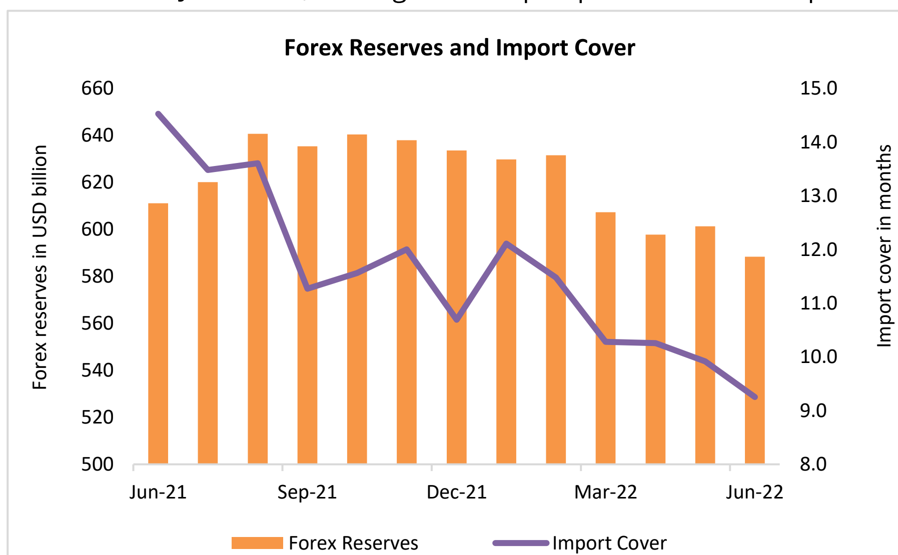
Note: Preliminary data for June 2022, data is provisional.
Source: Ministry of Commerce and Industry, BWR Research

BWR Views

Ongoing geopolitical tensions are likely to keep the external situation under stress, while recessionary expectations in the advanced economies may lower demand for domestic exports. High crude oil prices, coupled with a depreciation in the rupee, are burdening imports, and exports are not rising at the pace of imports. To promote growth in global trade with an emphasis on exports from India and to support the increasing interest of the global trading community in the rupee, the RBI made an additional arrangement for invoicing, payment and settlement of exports/imports in rupees. The mechanism is meant to facilitate trade with countries under sanction. Although the RBI's move may not have an immediate impact on external account, it would help reduce demand for dollars.

FPI outflows and weak rupee continue to drain forex reserves

Forex reserves were depleted by nearly USD 52 billion since October 2021 to USD 588 billion as on 1 July 2022 as there has been a sharp surge in capital outflows from India, in addition to the rising CAD. FPIs withdrew USD 35.7 billion funds from the Indian markets between October 2021 and June 2022. The outflows peaked to USD 6.59 billion in June 2022, leading to a sharp deprecation in the rupee.



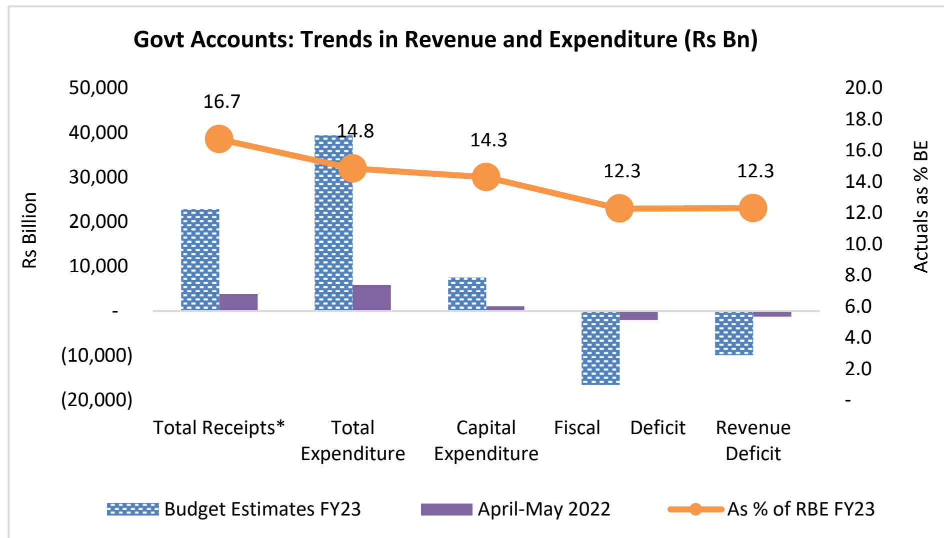
Source: Ministry of Commerce, RBI, BWR Research

BWR Views

The outflow of funds from the Indian markets, which began since October 2021 following the withdrawal of liquidity measures by advanced economies, and the Russia-Ukraine crisis, which further increased capital outflows, have created financial uncertainty and weakened the rupee value due to demand for dollars. A sharp rise in crude oil prices has increased the import burden, and the RBI has been intervening in the forex market regularly to maintain stability in the rupee to smoothen conversion rate volatility. Due to frequent forex market intervention to prevent rupee depreciation, the import cover of India's foreign exchange reserves fell to 9.3 months in end-June 2022.

Government Finances: Higher crude oil prices impose a huge risk on fiscal management

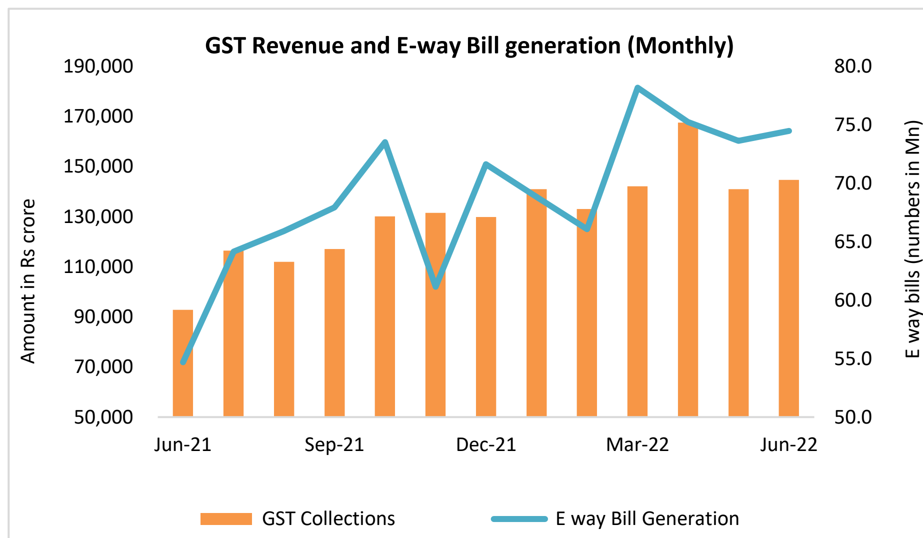
The provisional data released by the CGA for April-May 2022 shows that the central government has spent 14.8% of the budget expenditure for FY23, and 18% of the budgeted capital expenditure. The total receipts stood at 16.7% of the budget targets.



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

GST: Tax collections remained above the Rs 1.4 trillion mark

1 July 2022 marked the completion five years of GST implementation. With the improvement in administration, particularly the technology platform, the compliance of the tax has shown an improvement in the monthly revenue collection. The gross GST monthly collections continued to remain above the Rs 1.4 trillion mark and amounted to Rs 1.44 trillion in June, showing a 56% increase y-o-y. The E-way bill generation recorded a 36% increase over June 2021.



Note: GST collection from domestic transactions between 5 June and 5 July 2021 included in June 2021. Source: PIB press releases, GSTN, BWR Research

BWR Views

As per the latest budget for FY23, the government has increased the budget size by 13% over the FY22 revised budget estimates. Union Budget 2022 has laid greater emphasis on growth acceleration, rather than achieving fiscal consolidation. The budget has increased the capital expenditure to a record level of 2.9% of the GDP to nurture growth and has pegged the fiscal deficit at 6.4% of the GDP for FY23.

In a bid to control inflation, the government announced a series of measures from tax cuts on fuel to more fertiliser and cooking gas subsidies to ease price pressures, at the risk of a stretched fiscal deficit. Sharp capital outflows could weaken the domestic currency, which would increase import bills. The domestic economy may face a serious dilemma if the current situation worsens further. With a fiscal deficit target of 6.4% of the GDP for FY23, higher crude oil prices impose a huge risk on fiscal management.

BWR Views

Various rate rationalisation measures undertaken by the GST Council to correct the inverted duty structure have helped in improving revenue. The generation of E-way bills has led to a significant improvement in compliance. 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.

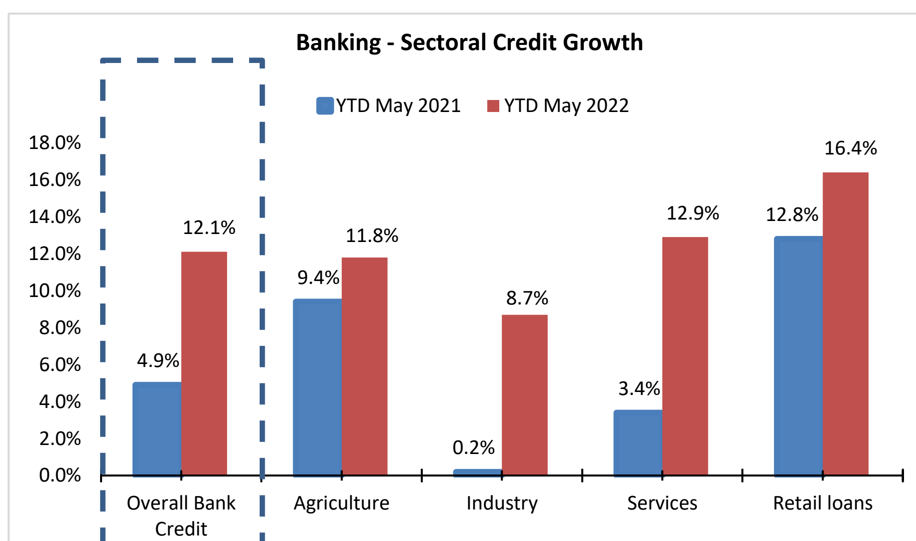
SECTORAL INDICATORS

Banking

Credit growth picking-up pace

The RBI on 8 June 2022 increased the repo rate by 50 basis points to 4.90% from 4.40%. This comes at a time when central banks around the globe are facing the task of taming high inflation without causing an economic slowdown. The RBI also continued to remain focused on the withdrawal of accommodation to ensure that inflation remains within the target, going forward, with the objective of achieving the medium-term target for CPI inflation of 2-6% while supporting growth. With the recovery in domestic economic activity, there is an improvement in credit offtake, and y-o-y growth reached double digits, to 13.2%, as on 17 June 2022.

Credit growth to industry accelerated to 8.7% in May 2022 as compared to 0.2% in May 2021. Credit in the agriculture and allied activities segment also witnessed a 11.8% growth in May 2022. Within industry, credit growth to 'all engineering', 'infrastructure', 'mining and quarrying', 'petroleum, coal products & nuclear fuels', 'rubber, plastic & their products' 'beverage & tobacco', 'chemicals & chemical products' and 'vehicles, vehicle parts & transport equipment' accelerated in May 2022.



Source: RBI, BWR Research

Banks in India showed overall healthy growth and were able to contain, and actually reduce, the NPA at the gross level. With demand for credit improving, banks are expected to maintain the tempo in the current year.

BWR Views

BWR believes the overall banking sector will overcome the emerging challenges and be supportive of the government in easing concerns over inflation. Healthy annual results, improving gross Non-Performing Assets and lower provisions declared by banks indicate an improving outlook and are likely to result in increased demand for credit. The measures taken by the RBI for improving trade capabilities are also expected to augur well for banks.

Vidya Shankar
(Principal Director - Ratings)

Hemant Sagare
(Associate Director - Ratings)

Koppula Shyam Sundar
(Jr Rating Analyst)

Automobiles

Vehicle sales again face disruption

BWR Views

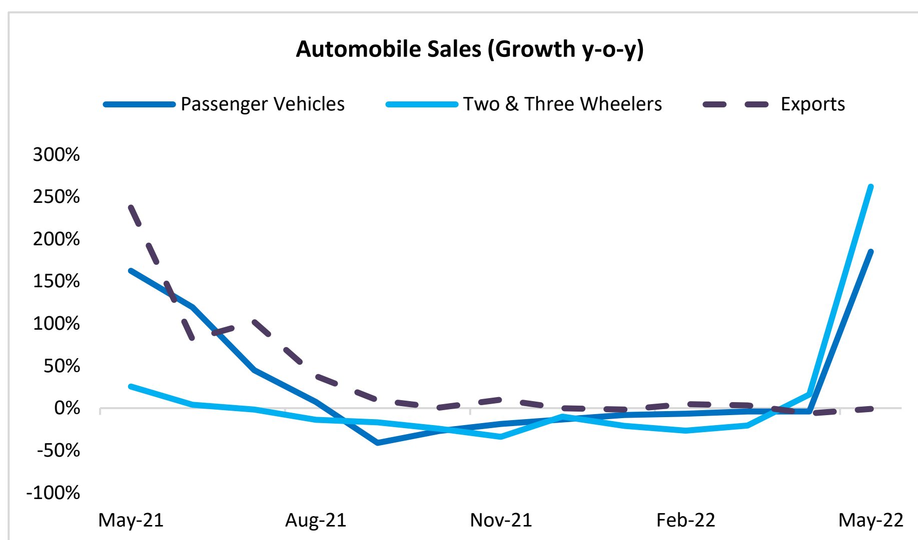
Demand for both PV and CV remains strong due to the full resumption of economic activity. However, the high levels of inflation and increased cost of ownership could keep suppressing some pockets of demand, particularly from rural areas and in the 2W segment, which are also dependent on normal monsoons.

Meanwhile, Electric Vehicle (EV) adoption is on the rise, as expected. The highest EV sales in the first half of the year (H1FY22) were recorded in March, at 77,250. In April, 72,588 EVs were sold, in May 65,879 and in June 72,463. EV sales in H1 2022 at 390,399 surpassed the sales in the entire year of 2021, i.e., 311,420.

Sudeep Sanwal
(Associate Director - Ratings)

Aditya Singh
(Rating Analyst)

Passenger Vehicle (PV) sales declined slightly in May 2022 and stood at 2,51,052 as compared to 2,51,581 April 2022 due to high oil prices, a persistent semiconductor chip shortage in the market and increased borrowing costs. The persistent chip shortage issue has rendered PV supply insufficient to meet pent-up demand, which is robust owing to new models, thereby leading to an increased waiting period. Exports also declined by 11.41% on an m-o-m basis in May 2022. However, on a y-o-y basis, PVs witnessed 185% growth in May 2022, the two-wheeler (2W) and three-wheeler (3W) vehicle segment grew by 262%. Overall, automobile sales increased by 124% on y-o-y basis in May 2022, on account of a low base effect as the Covid-19 pandemic was at its peak in India and the sector was at its all-time low in May 2021.



Source: CMIE, BWR Research

PV sales have been declining since March 2022, and on a m-o-m basis PV sale declined by 0.2% in May 2022, while the two and 3W segment grew by 9.58%. All the segments are facing supply-side challenges, and the industry is yet to see complete recovery following the disruptions it has been facing since early 2020. The increase in crude oil prices, shortage of chips, increase in metal products due to the non-availability of coal and the ongoing Russia- Ukraine- war will continue to affect the overall automotive supply chain and ownership cost in the future.

Telecom

5G operationalisation in India expected to be more cash-flow-rationalised for telecom players

Vipula Sharma
(Sr Director - Ratings)

Sourav Sen
(Rating Analyst)

The central government in June approved the auctions for the spectrum for 5G services in India. The auctions are now expected to be conducted from the last week of July 2022. The auctions would be for both low-frequency bands (ranging from 600 MHz to 2300 MHz), and the mid- (3300 MHz) and high-frequency bands (26 GHz). Securing spectra in the upcoming auctions is expected to be more cash-flow-rationalised for the winning bidders than in prior auctions on account of some key interventions such as the waiver of spectrum usage charges, option to surrender spectra after 10 years without future liabilities and ability to pay spectrum fees in equated annual instalments. These are in line with the earlier recommendations by the Telecom Regulatory Authority of India (TRAI). The allocation of spectrum for private networks has also been approved, and a Letter of Intent (LoI) has been issued to Adani Group for the Gujarat circle. Currently, the unified licence is limited to Gujarat, and Adani Group does not plan to utilise it for customer mobility service. However, if it is successful in the upcoming auction and plans to expand its operation in consumer mobility services, then competition in the telecom industry would increase.

In June 2022, the Department of Telecommunications (DOT) also extended the Production-Linked Incentive (PLI) scheme by one year to promote design-led manufacturing in the sector. The said extension can be expected to complement infrastructure build-out necessary for strengthening 5G in India, following the spectrum auctions.

Power

Generation companies are likely to bear the brunt of imported coal costs in the near term, but could reap benefits from recent power trading market developments over the long term

BWR Views

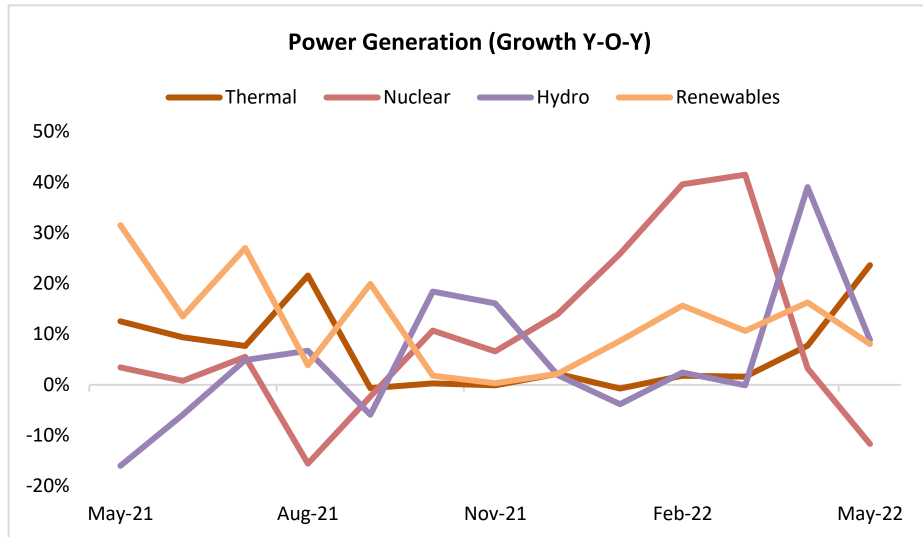
Developments such as forward contracts for power supply and a third power exchange in India could benefit both the both buy-side firms such as discoms and sell-side firms such as gencos in the long run. In addition, India needs to continue improving its renewables energy capacity to reduce the burden on the thermal power generation plants.

Vipula Sharma
(Sr Director - Ratings)

Sourav Sen
(Rating Analyst)

The country's peak power demand in June 2022 reached ~209 GW, surpassing the record of ~203 GW set in April. Given the continuing, unabated increase in demand for power in India since April, the central government has been relying on imported coal to sustain power supply over the medium term. Stakeholders at both state and firm levels, however, are opposed to coal imports for power supply, considering that on a per-tonne basis, imported coal costs nearly twice as much as coal supplied by Coal India Limited.

Back in April 2022, the Central Electricity Regulatory Commission (CERC) imposed a cap of Rs. 12 per kilowatt hour on bids by buyers at power exchanges to protect consumers at a time when buy-bids were going above Rs. 20 per kilowatt hour. The cap has recently been extended till 30 September 2022, given the prevailing high power demand levels. Generation companies are likely to see their margins contracting because they can expectably have to contend with the twin challenges of increased coal costs and the CERC-set price cap in the power exchanges.



Source: Central Electricity Authority, BWR Research

In June 2022, the CERC approved the setting-up of a third power exchange in India. Contrasted with power sales through long-term Power Purchase Agreements (PPAs) that currently cover nearly 90% of the power generated in India, power sales through exchanges account for barely 6%. A new power exchange in a national market with two players, where one has a near 95% market share, can be expected to foster deeper penetration of power trading, especially among generation companies in India. In June, the CERC also approved forward contracts for power supply of durations of up to 3 months, which earlier had been ceilinged at a maximum duration of 11 days. These developments in the wholesale power market in India can be expected to improve price discovery and benefit both buy-side firms such as discoms and sell-side firms such as gencos.

Steel

Steel prices continue to remain under pressure

Since the increase in the export duty for steel, export parity to the domestic market has become negative, and most of the steel production aimed for exports has now become available for the local market. This has resulted in a much awaited fall in steel prices. Globally also, the fear of monetary tightening and recession has led to a fall in most commodities, including steel.

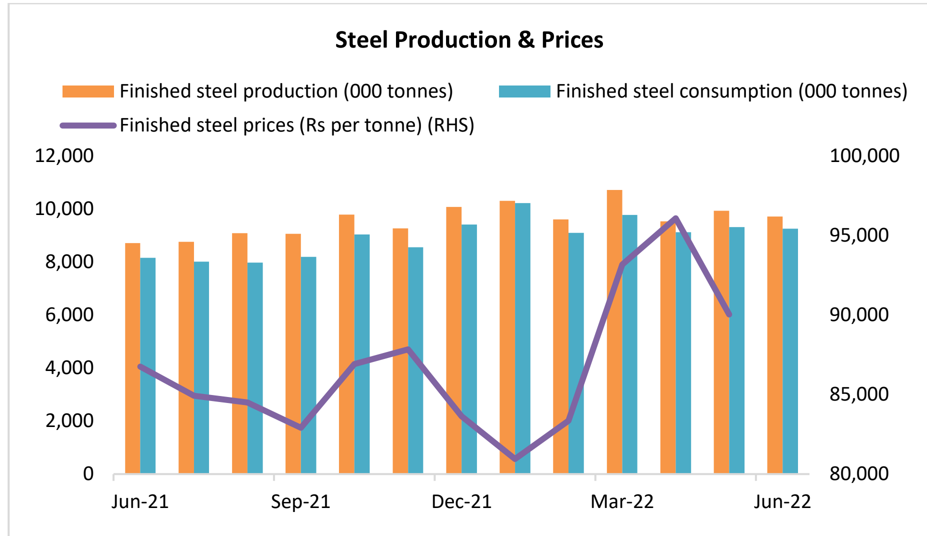
As the higher production of steel enters the domestic market, given the curb in exports, the prices continue to remain under pressure. The domestic steel prices of Hot Rolled Coil (HRC) and Cold Rolled Coil (CRC) as at end of June 2022 stood at around Rs 62500 per tonne and Rs 65000 per tonne, compared to their peak prices seen in April, which were around Rs 72000 per tonne and Rs 79000 per tonne, respectively. Higher production, steady demand and seasonal monsoon effect, have led to a cap at the higher prices. The prices are expected to remain under pressure for some more time as the domestic market is not ready to absorb the excess capacity created due to the export duty.

BWR Views

Demand and momentum remain steady for the sector at the national level. Domestically, demand from the infrastructure sector and consumption are driving local demand for steel. The recent fall in steel prices is aiding user industries which should get benefits as demand and momentum continue to remain strong for the Indian economy.

Bal Krishna Piparaiya
(Principal Director - Ratings)

Forum Parekh
(Manager – Ratings)



Source: CMIE, BWR Research

The margins for steel companies are expected to remain under pressure and the EBITDA margin per tonne of steel has come down. On the raw material side, iron ore prices continue to slide amid limited demand for steel globally. Coking coal and natural gas prices, after seeing a steep upside rally, have also been seeing downward trajectory. The actions of central bankers across the globe towards the fight against inflation have resulted in the prices of commodities falling worldwide, and central bankers are in no hurry to increase liquidity at the moment, given the inflation continues to remain high. For steel makers, the fall in steel prices will affect their realisations; however, the fall in raw material prices will somewhere protect their profits.

The fall in domestic steel prices is much higher than the reduction in international steel prices, which have also been down by around 10% during the same time. Domestic steel prices are now back to where they were a year back, although the prices are still higher by 25% compared to January 2021. Overall, the companies would see an earning downgrade in future due to decline in steel prices. However, the steel companies are in a much better shape than they were in the past due to the higher steel prices for the past couple of years. Companies have minted profits, and most companies are less leveraged compared to the past.

India exported around 13.5 Million Tonnes (MT) of steel in FY22, of which around 10 MT will be HRC, CRC and other value-added products. India's total steel capacity is around 149 MT, while its local consumption is around 110 MT. Thus, it will take some time for the local markets to absorb the surplus steel, which will result in prices to remain under pressure in the near future; and fall further.

Cement

Demand expected to remain steady; pressure on margins to continue

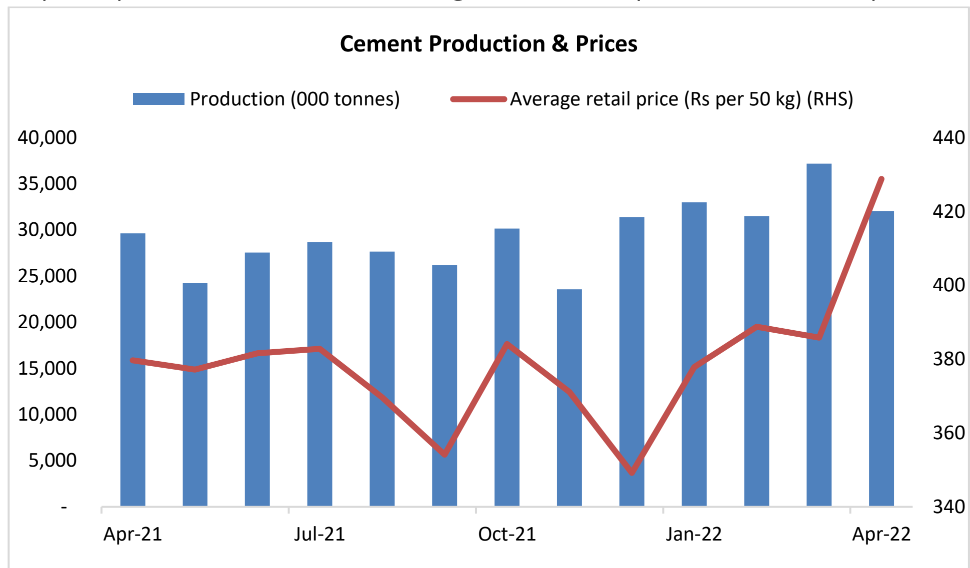
The sector continues to face elevated input costs and pricing constraints. Price hikes that were initiated in April 2022 and May 2022 were rolled back due to weak demand on account of the onset of the monsoons. The recovery of the industry during H2FY22 would be largely dependent on the fall in coal/energy prices and growth in demand post monsoons. While the larger players are expected to sustain such margin pressures on account of their scale of operations and reserves, small-sized manufacturers shall remain vulnerable. The entities may explore prioritising margins ahead of the market share in the current scenario, and cement demand is expected to pick-up with the revival of housing construction post the monsoon period.

BWR Views

In the long term, the sector is expected to grow owing to the government's push on infrastructure. Larger players are also investing to scale-up their capacity to accommodate rising demand.

Saakshi Kanwar
(Sr Manager - Ratings)

Vineetha Ann Varughese
(Sr Rating Analyst)



Source: CMIE, BWR Research

Sugar

Sugar production to rise in SS 2021-22

Sugar mills produced 352.37 lakh tonnes of sugar during the October 2021 – 06 June 2022 period compared to 307.41 lakh tonnes of sugar during the corresponding period of the previous Sugar Season (SS). Contributions have remained steady from Maharashtra, UP and Karnataka at ~39%, ~29% and ~17%, respectively. The total sugar production estimate for SS 2021-22 is 360 lakh tonnes (PY: 311.92 lakh tonnes) after considering the diversion of 34 lakh tonnes (PY: 20 lakh tonnes) of sugar equivalent into ethanol. Of the total export contracts of ~94-95 lakh tonnes entered into this SS, ~86 lakh tonnes have already been shipped by end-May 2022. The central government has capped sugar export at 100 lakh tonnes for the current SS.

BWR Views

The all-India sugar production in SS 2021-22 is expected at 350 lakh tonnes after considering a diversion of 34 lakh tonnes of sugar equivalent into ethanol. The higher sugar production is due to significantly higher yields per hectare as also higher sugar recovery.

Saakshi Kanwar
(Sr Manager - Ratings)

Swarn Saurabh
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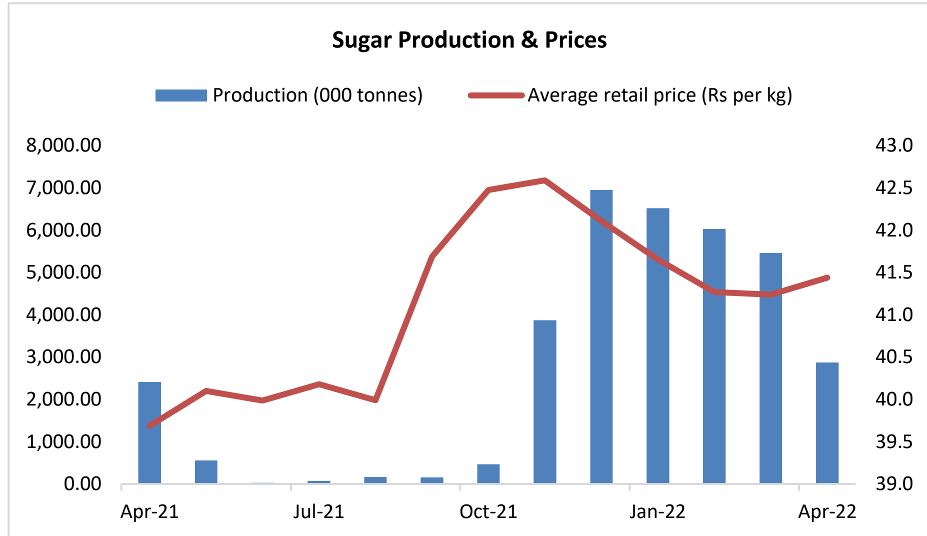


Source: CMIE, ISMA, BWR Research

In Ethanol Supply Year (ESY) 2021-22, the country has achieved the 10% blending target in June 2022, five months ahead of the November 2022 target. Considering an opening stock of about 82 lakh tonnes on 01 October 2021, domestic consumption of 275 lakh tonnes, sugar exports of 100 lakh tonnes and the estimated sugar production of 360 lakh tonnes, the closing stock at the end of September 2022 is expected to be lower at 67 lakh tonnes, which would be sufficient for 3 months of domestic consumption.

DEBT MARKET INDICATORS

Movements in Bond Yields

Bond yields remain elevated

Following the policy rate hikes from central banks globally, including the RBI, to combat inflation, the bond yields continue to remain elevated with marginal corrections. The hike in the policy repo rate by 90 bps in the recent past in two tranches by the RBI has directly led to a rise in bond yields and interest rates across all the segments as forecasted by Brickwork Ratings in its earlier bulletins.

The Gilt bond yields, which continued to rise in the recent past, witnessed a marginal downward trend in mid- and long-term segments of 3 years and above and a marginal uptrend in maturities up to 2 years. The combined effect of the higher repo rate, crude oil prices, inflation and governmental borrowings, along with the depreciation in the rupee has caused a rise in 10-year G-Sec bond yields by 85 bps in the last 6 months, although there has been a marginal downward correction in the long-term bond yield during the last one month. Consequent to the second round of hike in the policy repo rates in early June, the 10-year Gilt bond yields immediately rose by 21.4 basis points m-o-m, closing at 7.51% on 10 June 2022, and the same was ruling at 7.38% at the close of 7 July 2022, down by 12 bps m-o-m. The mid- and long-term Gilt yields of 3 years and above are corrected downward by a similar level m-o-m. However, the yield of shorter duration bonds up to 2 years have risen marginally by about 15 bps. There has been a near-parallel marginal upshift in the shorter end of yield curve and downshift in the longer end.

The Gilt yields were ruling at the following levels at the close of 7 July, with m-o-m changes over 10 June 2022 in the following maturities: 10-year at 7.38% (7.515 %), 3-year at 6.89% (7.01%), 4-year at 7.01% (7.19%), 5-year at 7.17% (7.29%) and 30-year at 7.65% (7.86%), 3-month at 5.14% (4.97 %), 6-month at 5.66% (5.59%), 1-year at 6.32% (6.16%) 2-year at 6.62% (6.51%). The corporate bond yields moved in tandem.

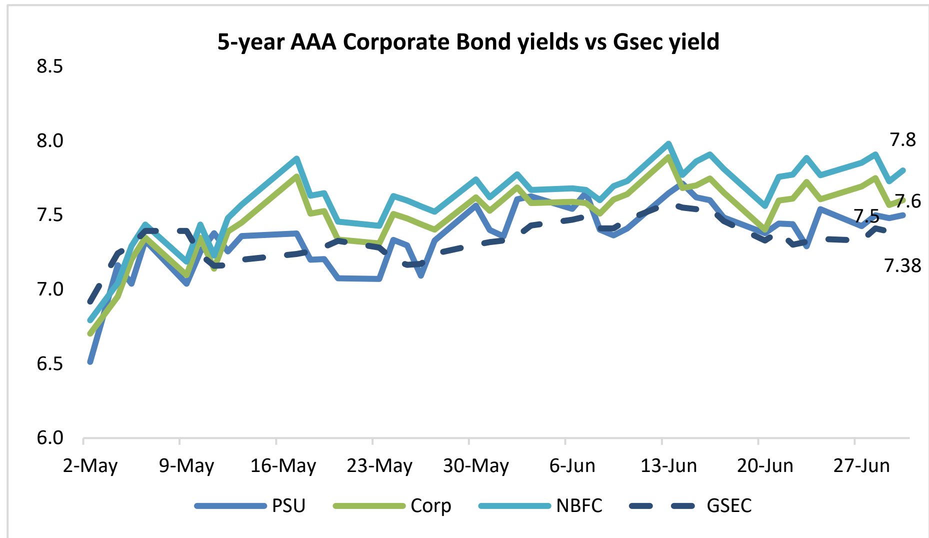
The bond yield (annualised) issued by Public Sector Units (PSUs), corporates and Non-Banking Finance Companies (NBFCs) maturing in 5-, 3- and 1-year tenures with the corresponding government securities are provided in the following page.

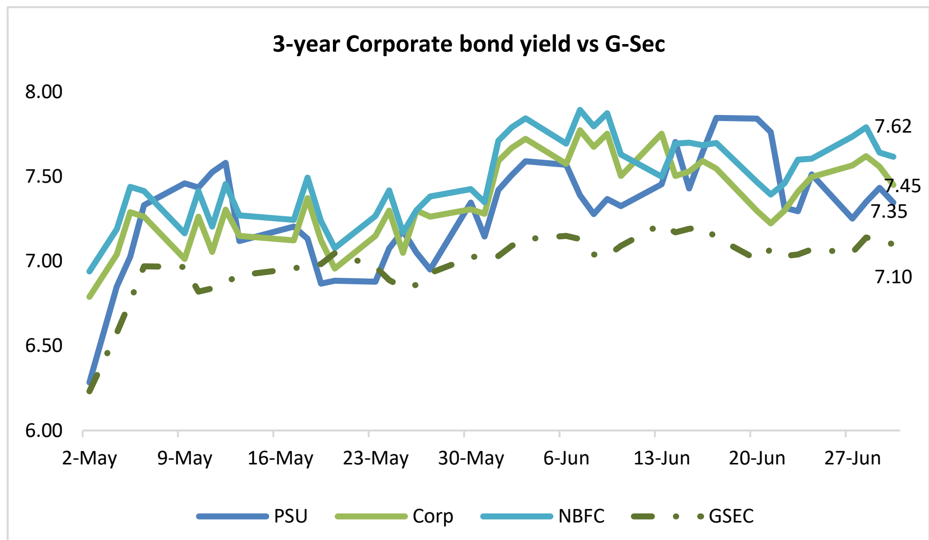
The yield of AAA-rated corporate bonds maturing in 5-, 3- and 1-year tenures has remained stable to volatile due to timely strategic market operations and liquidity injection by the RBI and regulators.

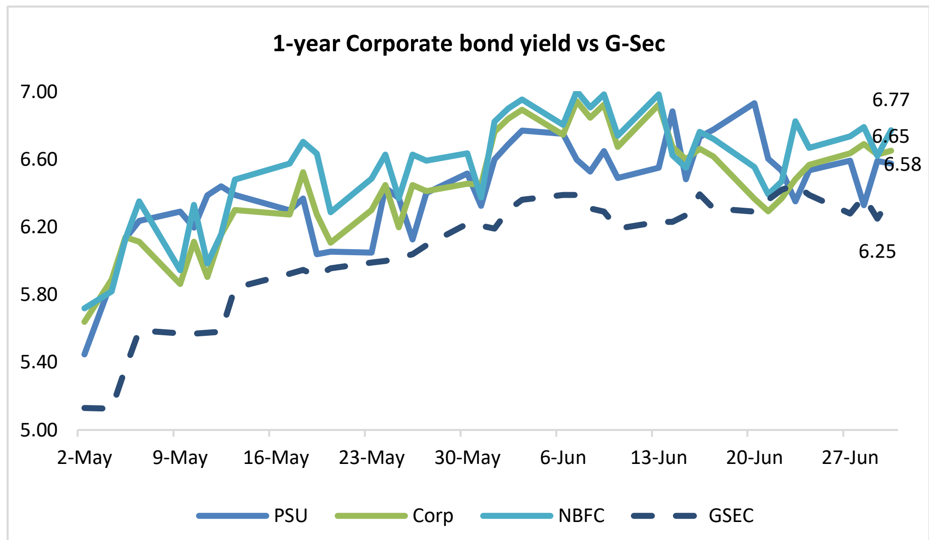
BWR Views

As forecasted by BWR, the hike in policy rates by the RBI to combat inflation has led to an elevation in bond yields and all the benchmark lending rates/Repo Linked Lending Rates (RLLR) for the retail and corporate loans of lenders; the investment portfolios of individuals in debt mutual funds and fixed income securities have depreciated, and banks' treasury profits are expected to be hit owing to m-t-m losses and lower trading income during the current rising interest rate scenario. The bond yields and interest rates are expected to remain elevated in the near term with marginal sideways movements.

Bal Krishna Piparaiya
(Principal Director - Ratings)



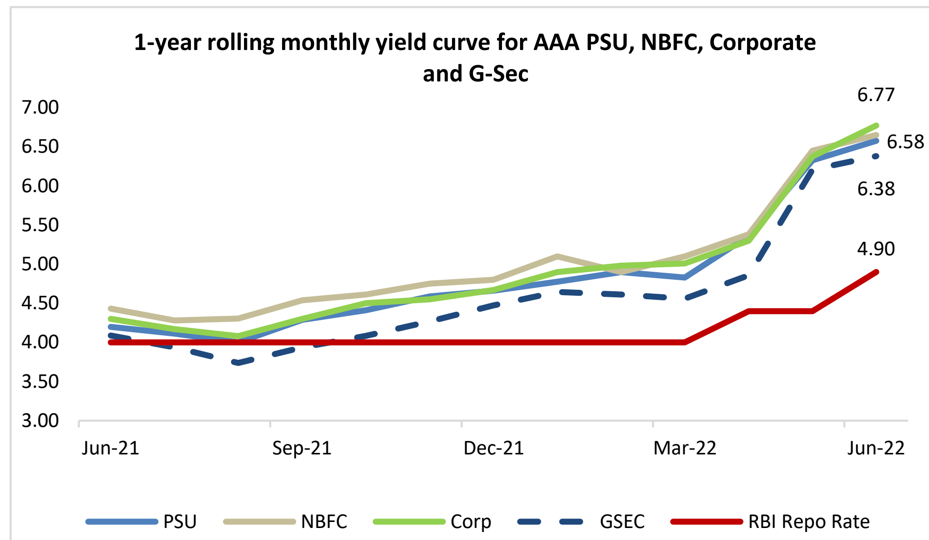




Source: FIMMDA, BWR Research

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

The key policy rate (repo rate) had a consecutive hike in May and June 2022 by 40bps and 50bps, respectively. Following this, the borrowing costs for bonds maturing in 1 year issued by PSUs, NBFCs and corporates witnessed some escalation in the range of 222-247 bps in June, in line with the G-Sec yields (229bps) against the corresponding period last year.



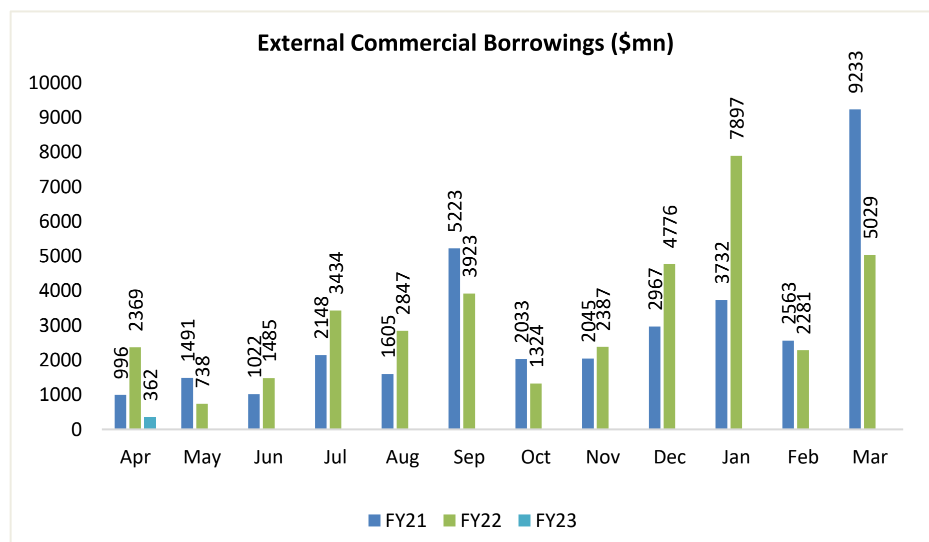
Source: FIMMDA, BWR Research

External Commercial Borrowings

According to RBI data, Indian corporates' borrowings were at USD 362 million from offshore markets in the form of External Commercial Borrowings (ECBs) during April 2022 compared to USD 2.36 billion during the same period last year, recording a drop in the trend.

BWR Views

Indian companies' ECBs, which y-o-y declined by 46% from USD 9.232 billion to USD 5.029 billion in March 2022, continued the declining trend to USD 362 million in April 2022 from USD 2.3 billion in April 2021. In BWR's opinion, on account of the uncertainties caused by geopolitical disturbances, borrowers and lenders are expected to exercise caution on rising interest rates and sanctions, and follow a wait-and-watch approach for such borrowings.



Source: RBI, BWR Research

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