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Mixed growth signals; Recovery continues

September 2022

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Chief Economic Adviser's Views

Who will bear the burden of freebies

Right from the time when the Prime Minister chided the Revdi tendency of political parties, the discussion on freebies has refused to die down. Even the Supreme Court while dealing with the public interest litigation, expressed its frustration, stating that virtually all the political parties want to continue distributing freebies even as some expressed their views against them. Some are really concerned about the fact that there are no free lunches to be had, and as the opportunity cost of these freebies is high considering these are often met using borrowed funds, their burden is borne by the future generation, which had no role in the decision making. There are others who consider the distribution of the free entitlements of some essential items in a welfare state as legitimate to ensure the minimum consumption entitlements of certain essential items. Considering the fact that the resources for spending are limited, the government of the day, be it at the centre or in the states, has to make allocative decisions on short-term electoral gains and long-term growth benefits to the economy. Of course, this is a dilemma faced by all democratic governments, and the excessive short-term focus around election time is called the electoral budget cycle. Of course, the trade-off can be excessive, particularly in developing and emerging economies faced with unlimited needs and a severe resource crunch.

This is not the first time that the issue of profligacy in public spending has raised concerns, and yet, business as usual continues. In 1990, on the eve of the Eighth Five Year Plan, the Austerity Committee of the National Development Council chaired by Mr. Biju Patnaik, the then Chief Minister of Orissa, made important recommendations for making a coordinated decision to accept coordinated decisions including charging farmers for electricity. Like many others, the report simply gathered dust, and nothing came of it. The indiscriminate use of short-term palliatives to lure the voters rather than allocating resources for long-term development has been a bane practiced by both the union and state governments, and discussions on the matter remain simply platitudes for public consumption.

The rationale for government intervention is essentially market failure, and on this, there are contrasting views. Those who believe that the government is a benevolent social guardian responsible for the welfare of society would assign wide-ranging tasks to the government, even by replacing the functioning of the market. Alternatively, those who believe that government intervention is required merely in cases of market failure and their basic function is to ensure efficient functioning of the market would prefer to have a cash transfer program to address the problem of redistribution rather than directly providing public services. Of course, markets fail to redistribute incomes or alleviate poverty, and government intervention is needed. However, this has to be done through targeted cash transfers, and the distribution of freebies is not a solution to the problem. Besides the opportunity cost of freebies and severe unintended distortions, the policy perennially keeps the disadvantaged on a crutch. Surely, as mentioned above, anti-poverty intervention is a legitimate government activity because markets do not redistribute.

While there is no controversy on the need to empower the poor and disadvantaged, the question is, how should it be done? Traditional public finance experts such as Richard Musgrave have reasoned the provision of certain services, even though they are pure public goods, as 'merit goods'. These services are so meritorious that the government should ensure each individual entitlement to certain minimum standards of these services. This is also true for services having social benefits (costs) higher than the private benefits (costs), and either the government should provide minimum standards of these directly or as argued by Pigou, subsidize them to ensure their optimal provision for the society. Of course, public choice scholars would argue for cash transfers to the deserving and allowing them to exercise their choice rather than the state exercising the choice of choosing which services should be subsidized.

Irrespective of whether the state provides such services or gives them cash transfers, the empowerment of the poor for the entitlement of services such as basic education or healthcare and other anti-poverty interventions can be justified. At the same time, free provision or providing subsidies for any commodity or service creates extra costs in terms of distortions. Loan waivers violate the credit culture and create expectations of future waivers. Besides, the cost of this has to be borne by depositors or taxpayers. Providing free electricity to farmers leads to uncontrolled mining of underground water, distorted cropping patterns and declining water tables. Excessive fertilizer subsidy leads to soil salinity and water contamination. In all these, the cost of the subsidy or free provision has to be borne by other consumers (in the case of cross-subsidization), general taxpayers or the future generation.

The issue is not limited to providing services. There is a larger question of the role of the government versus the market itself. With the decision to own and control business enterprises such as hotels, telecom, airlines, drugs and chemicals, and steel, the economy incurs a huge opportunity cost besides creating distortions. Where the need for intervention is in terms of strong regulation to enable efficient competition in the market, the decision to provide private goods and services by the government has a huge opportunity cost, will lead to laxity in regulating efficient market functioning, a waste of resources and low productivity, will burden the future generation and in short, impose huge growth costs. Thus, the discussion should not be confined to the distribution of freebies alone; the time is clearly appropriate to question the role of the government versus the market itself as also the nature of the state intervention in terms of ownership and control on the one hand and effective regulation for better market functioning on the other.

Annexure: Select Macro Economic and Sectoral Indicators

Indicators/Sectors		FY20	FY21	FY22	Jul-2021	Aug-2021	Sep-2021	Oct-2021	Nov-2021	Dec-2021	Jan-2022	Feb-2022	Mar-2022	Apr-2022	May-2022	Jun-2022	Jul-2022	Aug-2022
Economy					FY22 Q2			FY22 Q3			FY22 Q4							
GDP at 2011-12 Prices	Y-o-Y in %	3.74	-6.60	8.68	8.40			5.40			4.09			13.51			-	-
GVA at 2011-12 Prices	Y-o-Y in %	3.81	-4.80	8.11	8.30			4.71			3.89			12.75			-	-
Agriculture	Y-o-Y in %	5.52	3.32	3.01	3.16			2.54			4.13			4.46			-	-
Industry	Y-o-Y in %	-1.37	-3.26	10.27	6.96			0.35			1.25			8.56			-	-
Services	Y-o-Y in %	6.34	-7.82	8.44	10.21			8.10			5.49			17.65			-	-
Banking																		
Gross Bank Credit	Y-o-Y in %	6.80	5.00	9.60	6.50	6.70	6.70	6.80	7.00	9.20	8.20	7.90	9.60	11.10	12.10	13.20	14.50	15.30
Bank Credit to Industries	Y-o-Y in %	0.70	0.40	7.10	0.90	2.30	2.50	4.10	3.80	7.60	6.40	6.50	7.10	8.10	8.70	9.50	10.50	
Deposit	Y-o-Y in %	7.90	11.40	8.90	10.70	9.50	9.30	9.90	9.80	9.60	9.30	9.10	8.90	9.80	9.30	9.30	8.40	8.80
Industry																		
Composite PMI	Index	52.60	44.70	53.47	49.20	55.40	55.30	58.70	59.20	56.40	53.00	53.50	54.30	57.90	58.90	59.20	56.60	58.20
Manufacturing PMI	Index	52.33	50.20	53.97	55.30	52.30	53.70	55.90	57.60	55.50	54.00	54.90	54.00	54.70	54.60	53.90	56.40	56.20
IIP	Y-o-Y in %	-0.80	-8.40	11.40	11.50	13.00	4.40	4.20	1.00	1.00	2.00	1.20	2.20	6.70	19.60	12.30	-	-
Manufacturing in IIP	Y-o-Y in %	-1.40	-9.60	11.80	10.50	11.10	4.30	3.30	0.30	0.60	1.90	0.20	1.40	5.80	20.60	12.50	-	-
Consumer Durables	Y-o-Y in %	-8.70	-15.00	12.50	19.40	11.10	1.60	-3.20	-5.70	-1.90	-4.40	-9.70	-2.60	7.40	58.40	23.80	-	-
Consumer Non-Durables	Y-o-Y in %	-0.10	-2.20	3.30	-2.30	5.90	-0.10	0.70	-0.80	0.30	3.10	-6.80	-4.60	-0.60	1.00	2.90	-	-
Eight Core Industries	Y-o-Y in %	0.36	-6.39	10.43	9.94	12.16	5.44	8.73	3.24	4.11	4.03	5.85	4.76	9.53	19.25	13.20	4.45	-
Auto Sales	Y-o-Y in %	-17.95	-14.64	-10.70	17.47	-3.58	-15.05	-20.69	-24.42	-8.04	-15.23	-17.75	-13.71	6.61	123.93	19.02	5.86	-
Passenger Vehicles	Y-o-Y in %	-17.82	-10.35	8.00	44.70	7.60	-41.20	-27.10	-18.60	-13.30	-8.10	-6.50	-3.90	-3.80	185.14	19..06	11.13	-
Two & three Wheelers	Y-o-Y in %	-17.47	-15.06	-10.00	-1.70	-13.90	-16.60	-24.40	-33.90	-10.10	-20.90	-26.80	-20.40	15.90	262.10	23.38	8.95	-
Power Generation	Y-o-Y in %	-0.16	-1.17	7.00	7.16	17.50	-1.65	2.90	1.61	2.59	-0.18	2.85	2.55	9.88	20.60	17.12	2.95	-
Steel Consumption	Y-o-Y in %	0.72	-6.42	11.00	4.80	-2.24	-3.19	-3.60	-6.73	-8.59	1.97	-4.38	4.47	6.59	21.19	6.16	14.48	16.74
Cement Consumption	Y-o-Y in %	0.00	-13.00	22.00	22.50	37.70	11.10	15.00	-3.30	-	14.10	11.60	15.70	-	-	-	-	-
Sugar Production	Y-o-Y in %	-19.25	15.59	4.00	98.16	77.10	25.00	61.80	-4.90	-	-2.50	5.27	26.97	19.05	57.04	154.66	-	-
Domestic Passengers carried by Airlines	Y-o-Y in %	0.71	-62.24	59.90	137.64	136.62	79.20	70.46	65.50	52.89	-17.15	2.16	36.74	92.14	471.21	237.68	93.83	-
External Sector																		
Exports	USD Bn	313.36	291.18	417.81	35.43	33.28	33.80	35.65	30.04	37.81	34.50	33.81	40.38	38.19	37.29	37.94	35.24	33.00
Imports	USD Bn	474.71	394.44	610.22	46.40	47.09	56.39	55.37	52.95	59.49	51.93	55.01	59.07	58.26	60.62	63.58	66.26	61.68
Exchange Rate (Average)	INR/USD	75.39	74.20	74.50	74.53	74.18	73.56	74.93	74.50	75.37	74.44	75.03	76.29	76.12	77.32	78.07	79.60	79.56
Crude Oil (Average)	USD/barrel	60.47	44.60	78.29	73.54	69.80	73.13	82.11	80.64	73.30	84.67	94.07	112.87	102.97	109.51	116.01	105.49	97.40
Forex Reserves (As on date)	USD Bn	477.81	579.29	617.65	620.06	640.70	635.36	640.39	638.00	633.61	629.76	631.53	617.65	597.73	601.36	588.31	573.88	561.05
Net FPI Flows	USD Bn	-3.04	36.18	-19.40	-0.99	2.23	0.39	-1.66	-0.33	-3.94	-3.82	-5.07	-6.56	-2.96	-4.73	-6.59	0.24	7.11
Inflation																		
CPI	Y-o-Y in %	4.77	6.16	5.51	5.59	5.30	4.35	4.48	4.91	5.66	6.01	6.07	6.95	7.79	7.04	7.01	6.71	-
Food	Y-o-Y in %	6.71	7.70	3.76	3.96	3.11	0.68	0.85	1.87	4.05	5.43	5.85	7.68	8.31	7.97	7.75	6.75	-
Core	Y-o-Y in %	3.80	5.51	5.98	5.93	5.77	5.76	6.06	6.08	6.01	5.95	5.99	6.32	7.24	6.41	6.22	6.04	-
WPI	Y-o-Y in %	1.67	1.20	12.97	11.57	11.64	11.80	13.83	14.87	14.27	13.68	13.43	14.63	15.38	15.88	15.18	13.93	-
Food	Y-o-Y in %	6.88	3.91	6.73	4.52	3.76	2.59	4.25	6.83	9.37	9.55	8.67	9.29	9.13	10.89	12.41	9.41	-
Manufactured Products	Y-o-Y in %	0.34	2.70	11.06	11.46	11.56	11.57	12.87	12.34	10.71	9.50	10.24	11.26	11.39	10.11	9.19	8.16	-
Interest Rates (in %)																		
Repo	Effective	4.40	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	5.40	5.40
10-year Benchmark	Average	6.80	6.40	6.51	6.33	6.40	6.30	6.46	6.45	6.50	6.80	6.87	7.00	7.23	7.49	7.66	7.53	7.40
10- year AAA Corporate Bond	Average	7.60	6.90	6.90	6.89	6.90	6.80	6.86	6.90	6.90	7.00	7.00	7.00	7.27	7.67	7.84	7.76	7.70
5- year Benchmark	Average	6.20	6.10	5.99	5.89	5.90	5.80	5.96	5.96	5.96	6.30	6.30	6.40	6.79	7.24	7.42	7.28	7.12
5- year AAA Corporate Bond	Average	7.30	6.10	6.01	5.88	5.80	5.90	5.98	6.10	6.00	6.00	6.26	6.40	6.81	7.46	7.77	7.70	7.42
MCLR of SBI (1 year)	Average	7.80	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	7.50	7.70
Call Money	Average	4.90	3.20	3.24	3.17	3.20	3.20	3.20	3.17	3.30	3.50	3.27	3.27	3.64	4.11	4.67	5.16	5.13

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. 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

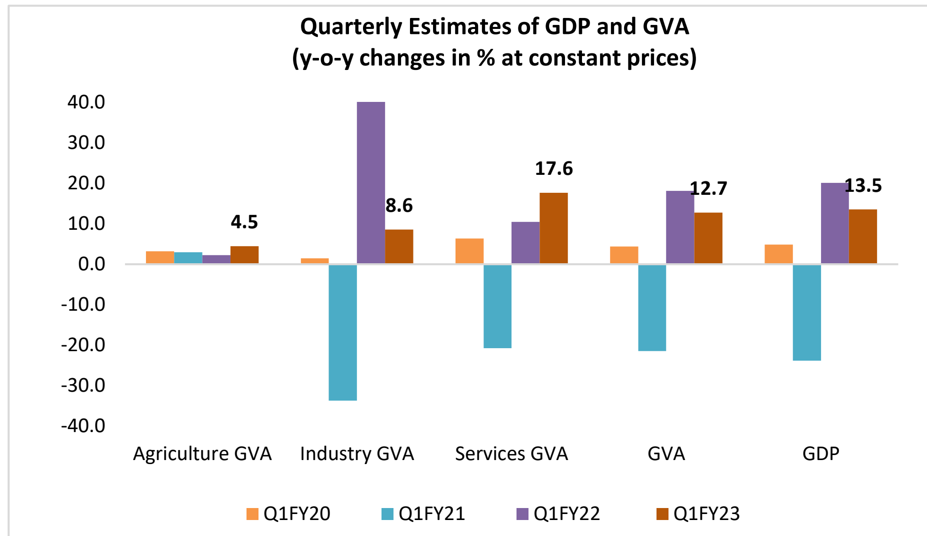
Domestic growth prospects continued to be impinged by adverse global developments such as the prolonged Russia-Ukraine war, tightening of financial conditions and rising risks of a global recession. However, there is some easing in price challenges and external concerns, such as easing crude oil prices, a reversal in capital outflows and an improvement in manufacturing activities in the recent months, bringing optimism.

The record-level inflation since intensified significant downside risks to the growth momentum. Following the rising inflationary worries, the RBI has started withdrawing the accommodative stance and has already hiked the key policy repo rate by 140 bps so far since 4 May 2022.

The waning monetary policy support poses a new challenge to growth prospects, while the RBI has retained its growth projection for FY23 at 7.2%.

GDP trends: Tightening monetary situation and continued global concerns to impinge growth recovery

As per provisional estimates by the MOSPI, the GDP grew at 13.5% (y-o-y) in Q1FY23 supported by strong base. Growth in Agriculture improved to 4.5% compared to Q1FY22, while the industry and services sectors posted lower growth during the same review period.

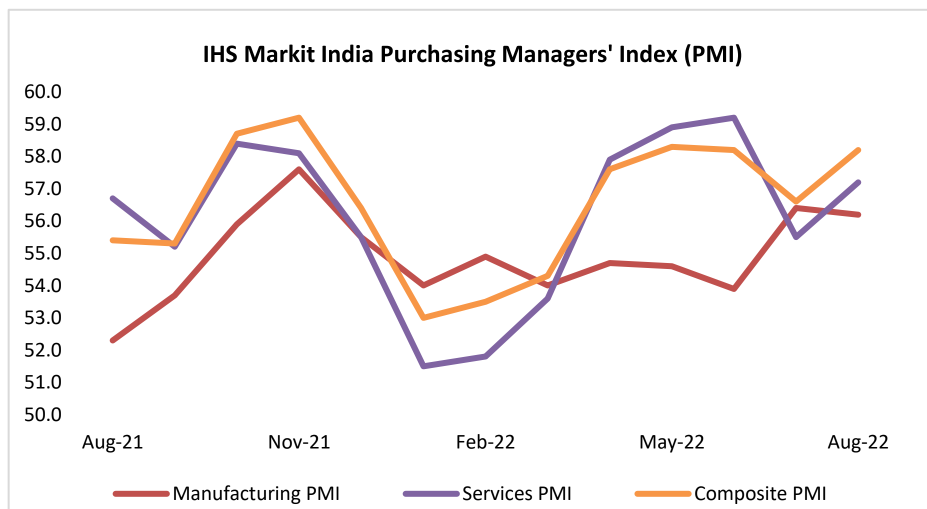


Note: Data is Provisional

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

Manufacturing and services sectors continued with strong growth momentum

Some easing in inflationary concerns and growing demand helped the manufacturing sector and services sector to sustain a strong growth momentum in August. The manufacturing PMI stood at 56.4, slightly lower than in July, while services sector PMI improved to 57.2, after having faltered to a four-month low in July. The IIP and eight core sectors also showed substantial improvements, but inflationary pressures may dampen the recovery.



Source: IHS Markit, BWR Research

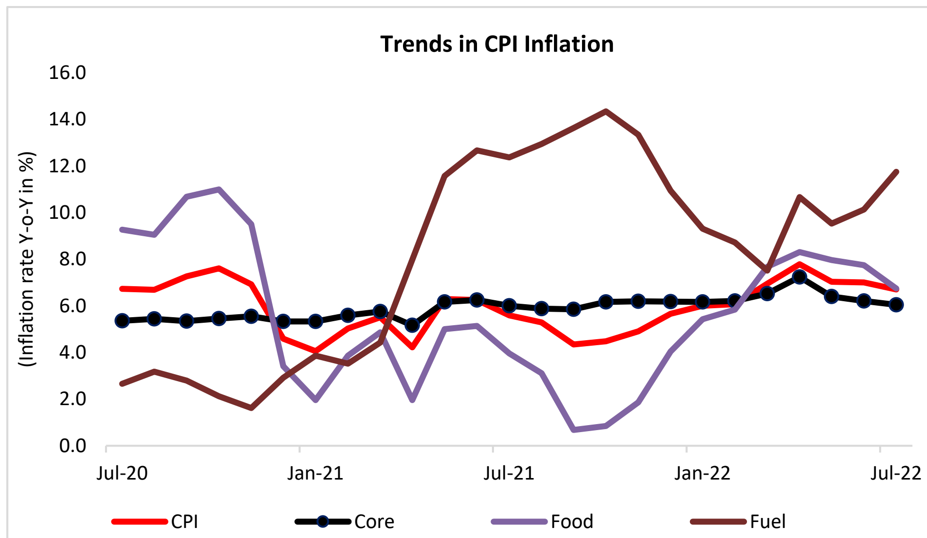
BWR Views

The government's measures to control inflation resulted in some easing in the inflation rate since May compared to April; yet, the inflation level has remained above the 7% mark in Q1FY23 due to higher food and fuel inflation. The constant increase in crude oil prices and rising manufacturing costs continued to exert pressure on inflation.

To bring down inflation, the RBI has already increased the policy repo rate by 140 bps since 4 May 2022 in addition to absorbing excess liquidity in the system. With the increase in the rate cycle, we expect CPI inflation to possibly ease below 6% during H2FY23; yet, it may remain close to 7% in Q2FY23 as food inflation is likely to increase, following excess rains or flood-like situations in many parts of the country. We also expect the policy tightening cycle to continue in the current fiscal until the inflation rate falls within the MPC's target band of 2% to 6%.

Inflation: Price challenges eases a bit

CPI inflation fell below the 7% mark in July after a gap of three months, and yet inflation is above the MPC's upper band target of 6%. Price levels remained sticky due to continued supply disruptions caused by ongoing geopolitical developments. Since March 2022, CPI headline inflation has persistently been higher than core inflation, which indicates that higher inflation in 2022 is driven by food and fuel categories. Core inflation eased slightly, but continued to remain above 6%.



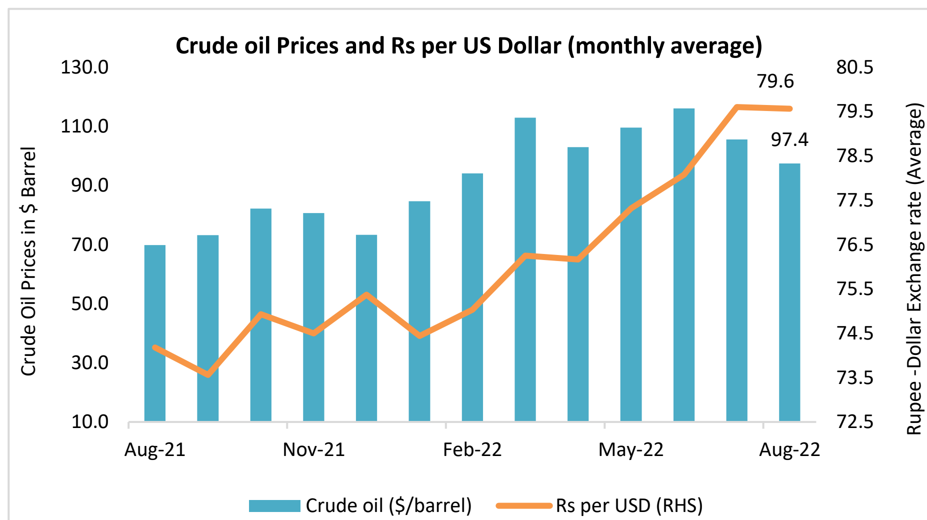
Note: Core inflation excluding food and fuel group
Source: MOSPI, BWR Research

Crude oil below USD 100 per barrel to benefit domestic economy

After remaining elevated since the beginning of February 2022 following the Russia-Ukraine war, crude oil prices eased marginally in July and remained below USD 100 per barrel in August as well. Yet, the pressure on the Indian rupee has continued, and the currency depreciated sharply to cross Rs 80.09/USD on 29 August. However, RBI intervention helped the currency from further depreciation, in addition to a reversal in capital outflows.

BWR Views

The fall in crude oil prices is likely to provide much-needed relief on fiscal management and foreign exchange reserves, and ease some pressures on the inflation and growth fronts. After witnessing large portfolio inflows to the tune of UAD6.6 bn in the last nine months, FPIs started investing and turned net buyers in the Indian markets in July and August. The fall in crude oil prices also brought some respite on the exchange rate front.



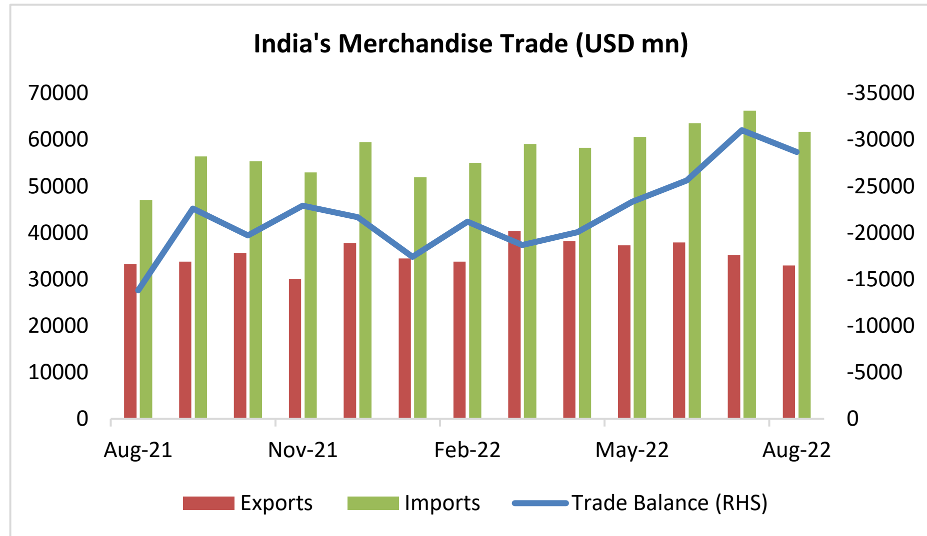
Source: www.ppac.gov.in, FBIL, BWR Research

Merchandise trade: **Rising import costs amid weak rupee scenario continue to widen trade deficit**

Merchandise imports increased much more than exports in August 2022 in value terms, resulting in the widening of the trade deficit to USD 28.68 bn from USD 11.7 bn in August 2021, as a weaker rupee, and higher crude oil and other commodity prices, have rendered imports expensive.

BWR Views

Geopolitical tensions continued to keep the external situation under stress, while recessionary expectations in the advanced economies may lower demand for domestic exports. The recent fall in crude oil prices brings some respite on import bills, with some stability in rupee.



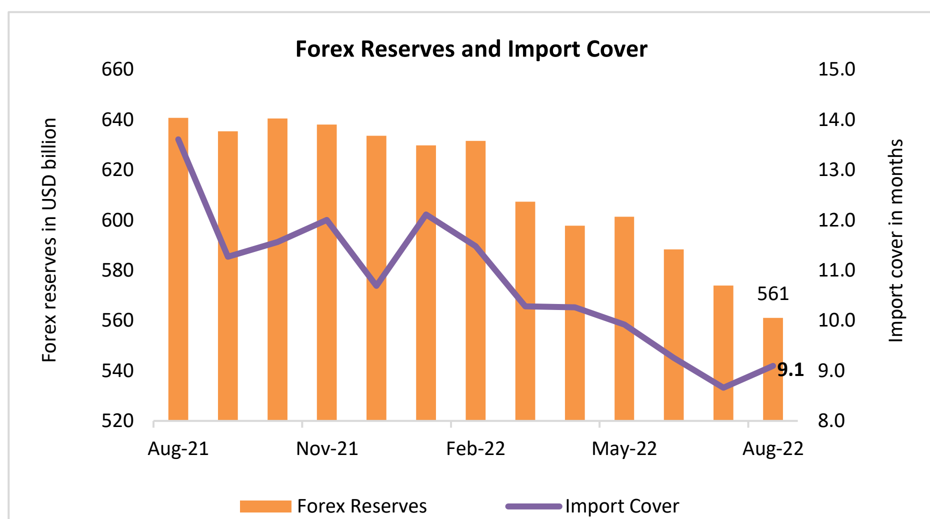
Note: Preliminary data for August 2022, data is provisional.
Source: Ministry of Commerce and Industry, BWR Research

Weak rupee continues to drain forex reserves

Forex reserves were reduced from USD 574 bn as on 29 July 2022 to nearly USD 561 bn as on 26 August 2022. Along with several other measures undertaken in July, the RBI has continued to use its foreign exchange reserves accumulated over the years to curb volatility in the exchange rate. FPIs have also started investing in Indian markets; hence, despite the resultant drawdown, India's foreign exchange reserves continue to remain the fourth largest globally.

BWR Views

Timely intervention by the RBI kept the rupee from depreciating further. Due to frequent forex market interventions, forex reserves depleted sharply, and the import cover of India's foreign exchange reserves fell to 9.1 months in End-August 2022 compared to 13.6 in the year ago period.



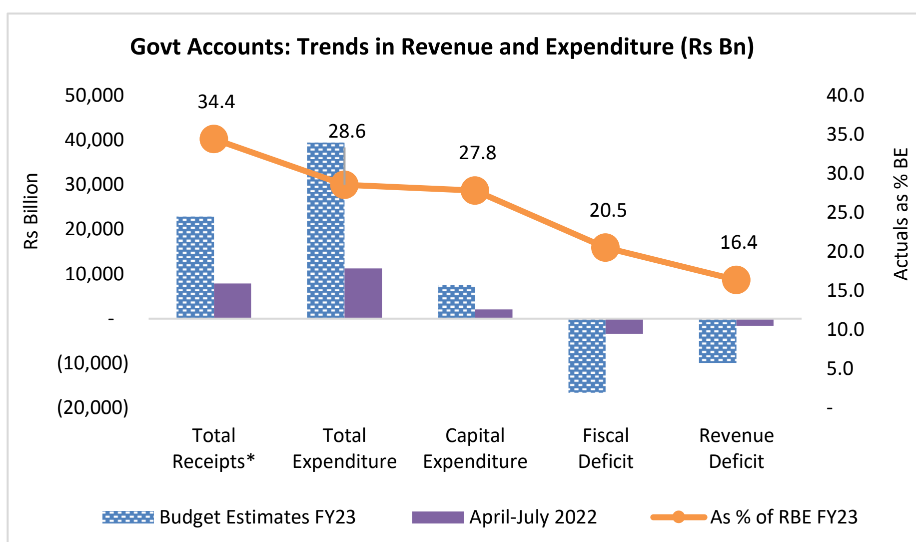
Source: Ministry of Commerce, RBI, BWR Research

BWR Views

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. With a fiscal deficit target of 6.4% of the GDP for FY23, higher crude oil prices impose a huge risk on fiscal management. The recent trend of easing in some commodity prices and crude oil prices has provided much-needed respite on the import front as India imports around 85% of its crude oil requirements.

Government Finances: Easing crude oil prices have lessened risk on fiscal management

Provisional data released by the CGA for April-July 2022 shows that the central government has spent 28.6% of the budget expenditure for FY23 and 27.8% of the budgeted capital expenditure. The total receipts stood at 34.4% of the budget targets, while the fiscal deficit continues to remain lower, at 20.5% of the budget targets.



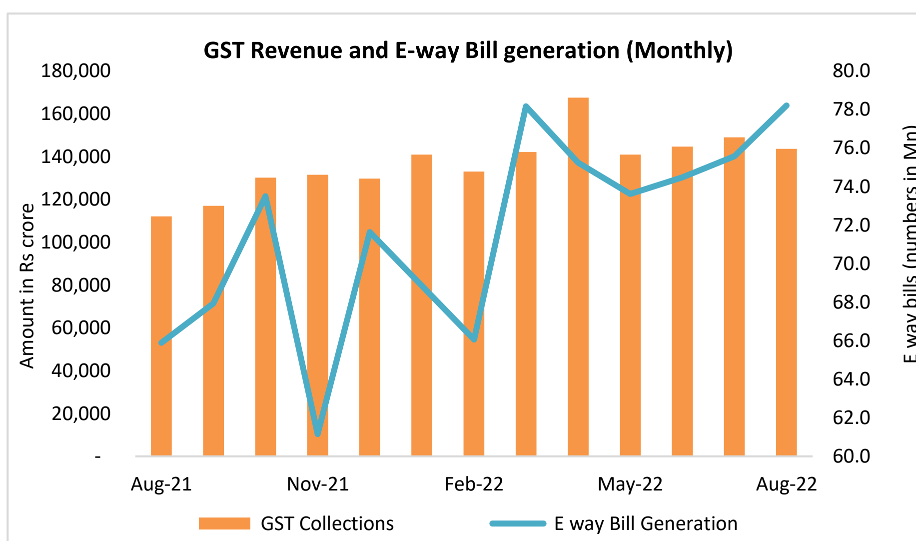
Note: Data is provisional, RBE: Revised Budget Estimates. * Excluding government borrowing.
Source: Controller General of Accounts (CGA), BWR Research

BWR Views

The various rate rationalisation measures undertaken by the GST Council to correct the inverted duty structure have helped improve 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.

GST: Tax collections remain buoyant

With the improvement in economic activities, there has been a steady increase in the revenue collections and the gross GST monthly collections continued to remain above the Rs 1.4 trillion mark since May 2022. In August 2022, tax collections have increased by 28% y-o-y. The E-way bill generation also remained buoyant in August, recording an 19% increase over August 2021.



Source: PIB press releases, GSTN, BWR Research

SECTORAL INDICATORS

Banking

BWR Views

BWR expects further hikes by the RBI in policy rates in the September monetary policy review. Banks' net interest income is expected to face pressure in Q2FY23. However, banks with a higher CASA percentage and those that have raised funds from the market at lower rates are unlikely to be affected. BWR believes that banks will continue to post robust growth in deposits and advances, resulting in reduced gross NPAs and provisions.

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Hemant Sagare
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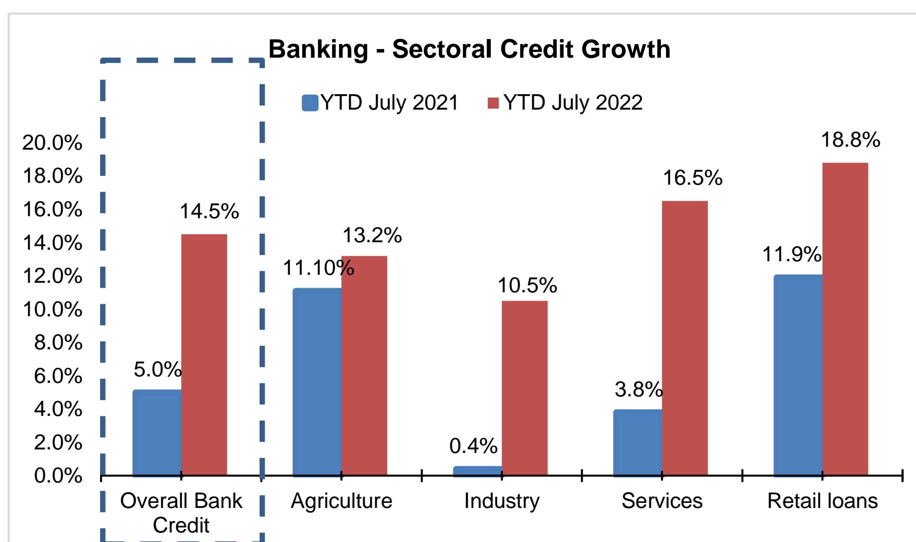
Credit growth continues to rise, but inflation remains a cause of concern

Indian banks continued to perform well in Q1FY23, as reflected in the increased net profits, lower provision for bad assets and decreasing gross NPAs compared to Q1FY22 and FY22 year-end figures.

With global economies being affected by natural and unnatural causes, stress on the Indian economy and inflation also continue to persist. The RBI has already increased the interest rates by 140 bps so far (since May 2022), and further upward movement in interest rates may deter the economic and credit revival.



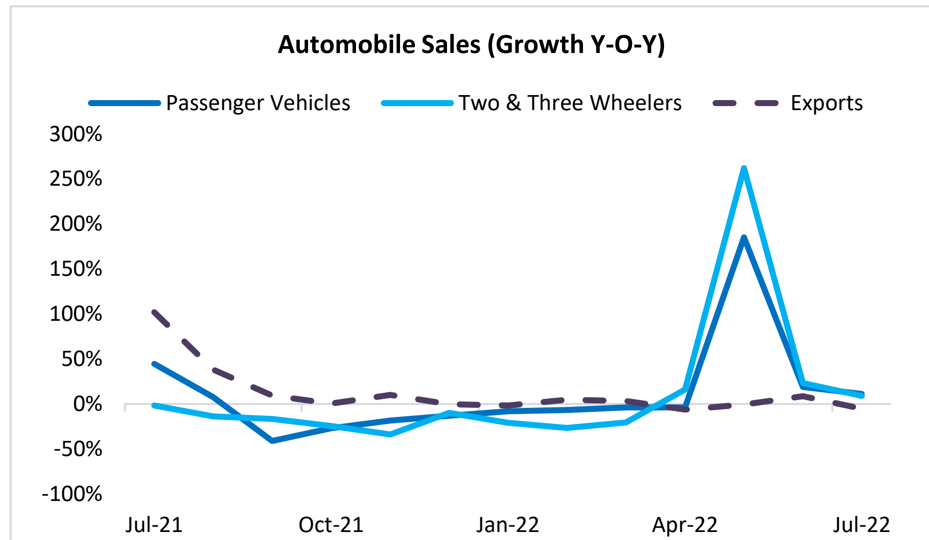
Source: RBI, BWR Research

On a y-o-y basis, non-food bank credit continued to expand, registering 15.1% y-o-y growth in July 2022 (July 2021: 5.1%). Credit growth to agriculture and allied activities improved y-o-y to 13.2% in July 2022 (July 2021: 11.1%). Services sector credit growth improved to 16.5% in July 2022 from 3.8% a year ago, mainly due to improved credit offtake to NBFCs and transport operators. Credit growth in the personal loans sector was robust at 18.8% in July 2022 vis-a-vis 11.9% in July 2021, supported by the housing and vehicle loans segments. On the other hand, deposit growth stood at 8.40% during the same period.

Automobiles

Uptick in two-wheelers and PVs assists domestic sales recovery

All the vehicle segments registered y-o-y growth of 9.32% in July FY23, with the Passenger Vehicle (PV) segment particularly deriving strength from SUVs. The sector has shown improvement largely due to the timely arrival of monsoons, improvement in the availability of semiconductors, robust demand driven by model launches and softening of commodity prices. The PV segment recorded volumes of 2,93,865 units in July 2022, registering 11% y-o-y growth and around 6.55% m-o-m growth.



Source- CMIE, BWR Research

The two and three-wheeler vehicle segments witnessed growth of 9% on a y-o-y basis in July 2022, but the overall export sales declined annually by 5% in July 2022. Demand from the international markets is facing some headwinds due to rising inflation, geopolitical tensions and adverse economic conditions in Sri Lanka and Nepal. However, in the two- and three-wheeler segments, the total sales (in units) grew by 2.56% to 21,29,088 units on an m-o-m basis in July 2022.

Affected by the chip shortage and delays in availability, the manufacturers have increased the waiting period, stretching it up to 6 months even for Compressed Natural Gas (CNG) powered models. Furthermore, the increased cost of ownership, a slower revival in the purchasing power of lower-end consumers and muted rural demand could limit the two-wheeler segment growth.

BWR Views

BWR expects the two- and three-wheeler and PV segments to drive recovery in the latter half of the year due to adequate rainfall across the country, along with the upcoming festive season, which will keep the demand sentiment positive and help keep the momentum going. Furthermore, OEMs are also increasing their production and building up inventory ahead of the festival season. However, the third hike in repo rates by the RBI to restrain high inflation will render auto loans costlier. This may restrict growth, especially in entry-level vehicle segments, which have price-sensitive customers. While demand is robust, concerns such as high fuel prices, as well as inflationary pressure, remain.

Sudeep Sanwal
(Associate Director - Ratings)

Akanksha Maindiratta
(Sr Rating Analyst)

Telecom

Tariff adequacy despite subscriber attrition risk key to sustaining 5G businesses in the medium term

The recently concluded 5G auctions fetched the government nearly Rs. 1.5 lakh crore (to be paid out by telecom bidders in equated annual receipts for 20 years). In the near term, it thus becomes imperative for the three telecom players who have obtained spectra, to be able to successfully convince their existing customer base to

Vipula Sharma
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(Rating Analyst)

transition to 5G and that too, at a rapid pace. The perception of quality of service is expected to play a key role in determining two things; one, whether a consumer feels the need to adopt 5G over the long term and two, whether a potential consumer is willing to move to higher price bands. Pricing differentiation may not be a viable strategy (as adopted by one player half a decade ago to rapidly build up its customer base) as these players have to contend with the necessary capex spends to be able to deliver 5G services, as well as the annually equated payments to the government. Tariff adequacy would be key from the telecom providers' perspective to be able to sustain their 5G models.

Power

BWR Views

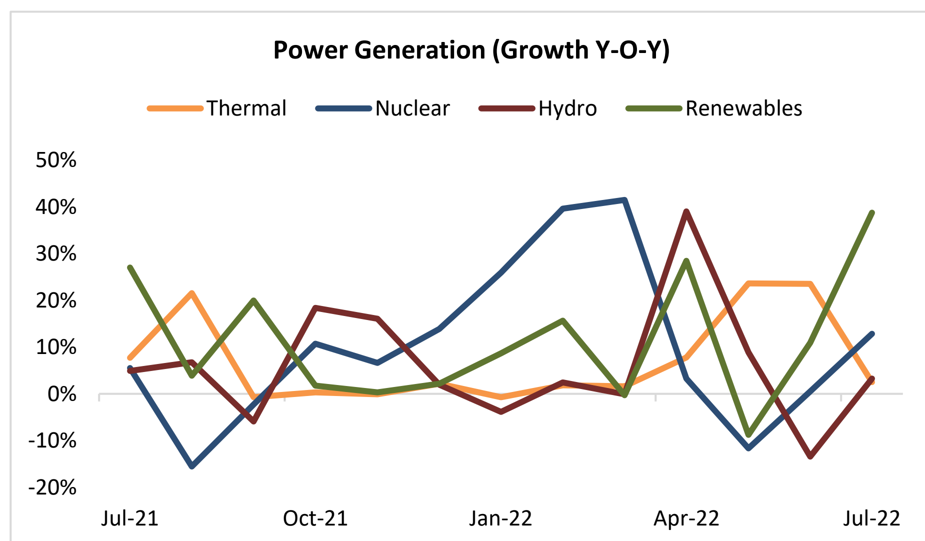
Earlier this year, the CEA introduced two sets of regulations/criteria that are expected to be conducive to the future operating environment for the power sector in the country. Given the slowly rising share of renewable power in the overall power supply mix of the country while thermal capacity stagnates, these regulations on the flexible operation of coal-fired power plants are expected to help spell out the future role these plants can play in the power sector.

Vipula Sharma
(Sr Director - Ratings)

Sourav Sen
(Rating Analyst)

Recent strategic steps by the CEA expected to support long-term growth in renewable power in the country

In June 2022, the Central Electricity Authority (CEA) brought out a draft manual on transmission planning criteria, which basically deals with the design aspects of inter-state and intra-state transmission lines in India. The introduction of these criteria assumes significance because the transmission capacity in India would need to grow in tandem with generation capacity, so that additional power can be supplied to consumers in future. The criteria are expected to help address Right-of-Way (RoW) challenges associated with building additional transmission capacity. Following this, in July 2022, the agency brought out draft regulations for the flexible operation of thermal power plants in India. The regulations basically guide how thermal power plants can take on the role of being steadying power sources supporting renewable power, given the susceptibility of renewable power generation to periodic variations.



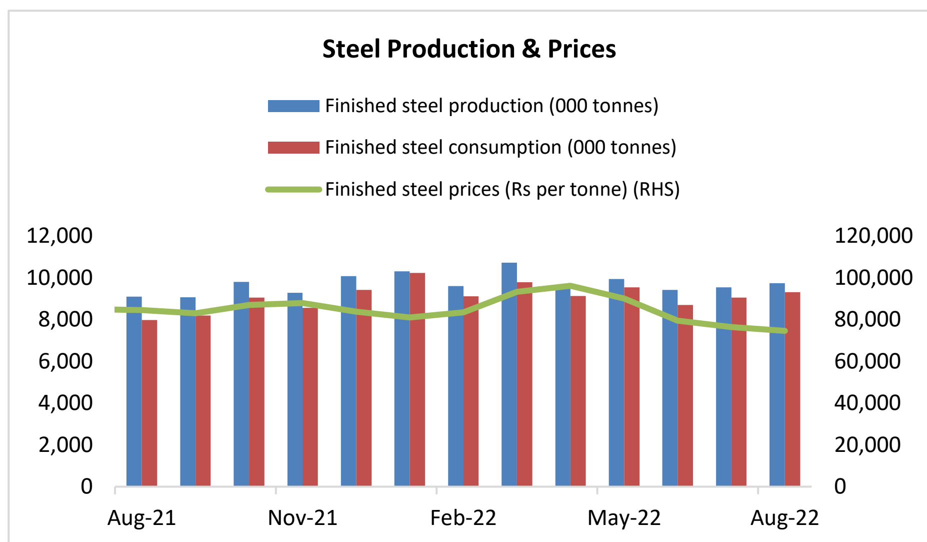
Source- Central Electricity Authority, BWR Research

Steel

Volumes remain strong despite pricing pressure in the industry

China, which accounts for more than 50% of the global steel production, is under stress due to issues such as the recent surge in Covid, resulting in extended lockdowns and thereby leading to a slower economy. Most factories in Europe are operating at the minimum levels due to higher gas prices and an overall slowdown in the economy. Lower production is expected due to uncertainty in the Eurozone and high gas prices. Lower demand from China has resulted in lower global demand. Steel consumption is expected to grow at 1% for the remaining part of FY23.

Lower exports have also resulted in capacities getting dumped in local markets. While local demand is strong and is aiding surplus capacities, exports need to improve for any further price volume benefit to the industry. In the near term, this looks difficult, given the uncertainty across the world. The continued war between Russia and Ukraine, coupled with international tensions across geographies, including China-Taiwan, is not aiding any better price outlook in the near term.



Source: CMIE, BWR Research

After a price reduction of around Rs 1,200-1,500 per tonne across all the steel products in late July 2022 in India, steel prices once again started flaring up. News from China on cutting steel production and increasing interest rates for some of the sectors to cool its economy, has resulted in a subdued steel production outlook and thus, higher prices, given the robust steel demand. Domestic steel prices still are around 12-15% lower than the landed cost of imported steel. Domestic steel players continue to remain optimistic about the increase in steel prices, going forward as well. Any further production cuts or delays in capacity addition will result in a further increase in steel prices, given the pent-up demand from almost all the sectors.

BWR Views

While Indian steel consumption is growing at around 7-8%, globally, steel demand is under pressure, which has resulted in a check on local steel pricing. The near-term outlook for the prices would continue to remain negative, while demand continues to remain healthy, helping in better volumes for the industry. Most steel companies are expanding both brownfield and greenfield, given the strong momentum in demand. The industry has started brownfield expansions, the acquisition of closed steel plants, and is trying to increase production so as to capture the advantage of higher demand and higher prices both in India and across the globe. In FY23, steel production is expected to be the highest ever, looking at a vibrant business environment for the industry

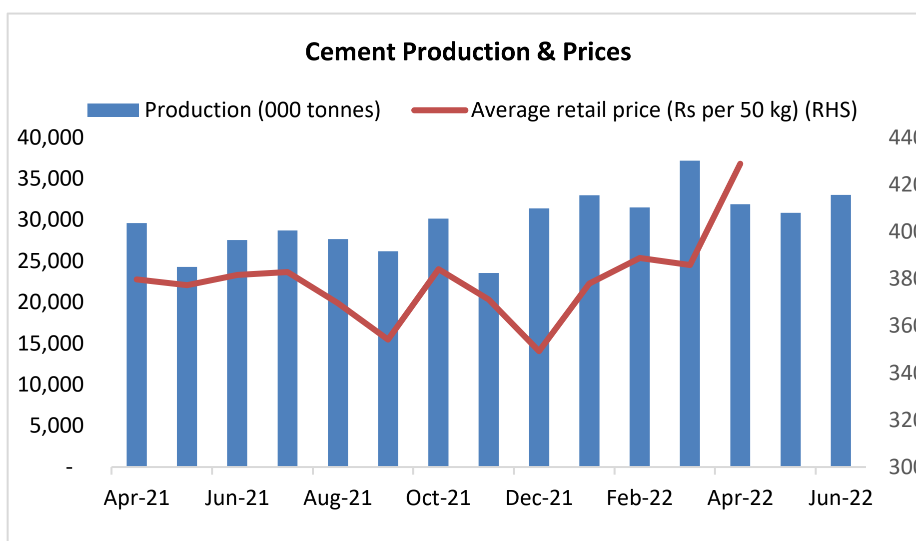
Bal Krishna Piparaiya
(Principal Director - Ratings)

Forum Parekh
(Sr Manager – Ratings)

Cement

Cement companies exploring alternative input to coal to cut down cost

Post the pandemic, cement demand has been on the rise, but at the same time, cement companies are witnessing a rise in input costs such as coal and fuel. However, as cement manufacturers are exploring alternatives to coal, demand for alternative suppliers has also increased, which has led to an increase in imports from countries which has not directly been impacted by the ongoing geo-political conflicts. Nevertheless, the quantum of such imports and its subsequent impact on the margins would be clear in the subsequent quarters.



Source: CMIE, BWR Research

BWR Views

Cement prices and demand are expected to remain subdued, factoring in the seasonality. Considering that demand is expected to remain weak during the monsoons, cement manufacturers would continue to face pressure on their operating margins with elevated costs of key inputs such as petroleum coke and coal.

Saakshi Kanwar
(Associate Director - Ratings)

Vineetha Ann Varughese
(Sr Rating Analyst)

Sugar

Increased diversion to ethanol keeping sugar production at bay

The Food and Agriculture Organization's forecast for world sugar production during October 2021-September 2022 is pegged at 174.6 million tonnes, up 5.1 million tonnes (3%) from the same period a year back.

The anticipated rebound, after three years of decline, reflects the expectations of output increase in India, Thailand and the EU and will likely offset significant decline in Brazil and China. Based on the estimated availability of sugarcane, estimated increase of acreage of 4%, installed cane crushing capacity and demand for ethanol production, the actual sugar production in SS 2022-23 is estimated to be ~355 lakh tonnes (SS 2021-22: 360 lakh tonnes), considering the diversion of ~45 lakh tonnes (SS 2021-22: 34.02 lakh tonnes) of sugarcane for ethanol production

BWR Views

The current installed capacity for ethanol production in India is ~8.25 billion liters against the target of 10.16 billion liters (20% blending target for 2025-26) of ethanol, India would need ~6 million tonnes of sugar and ~16.5 million tonnes of grains per annum. Keeping in view the government's thrust and current trends, the blending targets are expected to be surpassed.

Saakshi Kanwar
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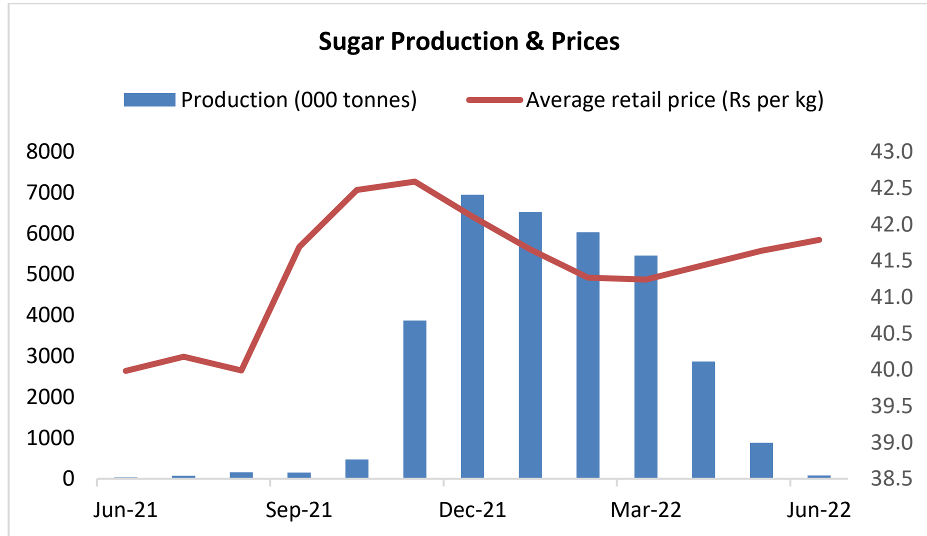
(Assistant Manager)



Source: CMIE, ISMA, BWR Research

DEBT MARKET INDICATORS

Movements in Bond Yields

Short-term bond yields continue to rise while long-term slide

On the back of substantial decline in crude oil prices during Q2, a stability in the rupee, an improvement in external inflows and a favourable economic scenario in the country, long-term Gilt yields continued to slide in spite of recent hikes in the policy rate by 140 bps in three trenches; however, short-term yields continued the rising trend, factoring in the expectation of inflationary pressure in the near run in food and essential commodities, which may deter the RBI in reversing the policy rate stance in the near future. The impact of the 75 bps rise on the European Central Bank (ECB) rate on 8 September 2022 was negligible in the Indian bond market.

Gilt yields m-o-m witnessed a downtrend in mid- and long-term segments of 3 years and above in contrast to an uptrend in short-term maturities up to 1 year. The earlier rising trend in the long-term Gilt yields owing to the combined effect of a hike in the repo rate, crude oil prices, inflation, augmented governmental borrowings and depreciation in the rupee, has seen a reversal and downward correction in the last 2 months, and the yields continued to slide, with the 10-year Gilt yield closing at 7.142% at the close of 8 September 2022 as against 7.348% a month ago. Likewise, the other longer-term G-Sec papers have shown a softening trend, and there has been an m-o-m yield downshift of 15 to 35 bps in the 5 to 30 year segments, marked by - longer the paper, higher the decline in yield. On the other hand, the short-term yields up to 1 year remained volatile, with the 3 months T-bill spiking by about 10 bps, 6 months by 30 bps and 1 year by 5 bps m-o-m as on 8 September 2022. The 10-year gilt has softened by 30 bps and 3 months to 1 year have hardened about 180 bps as against the respective yields 6 months ago.

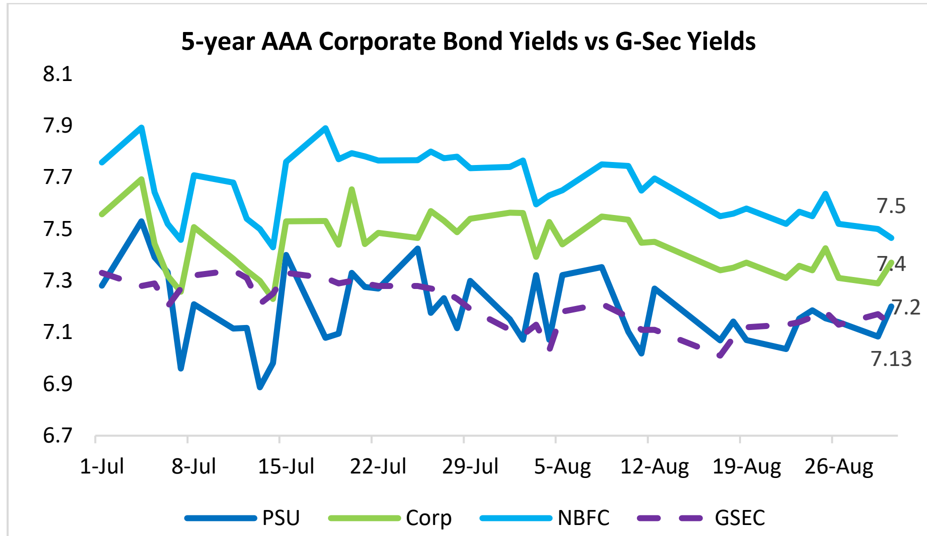
Gilt yields were ruling at the following levels at the close of 8 September 2022: 10-year at 7.142%, 3-year at 6.97%, 5-year at 6.97%, 30-year at 7.38%, 3-month at 5.66 %, 6-month at 6.11% and 1-year at 6.34%. Corporate bond yields moved in tandem.

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 below.

BWR Views

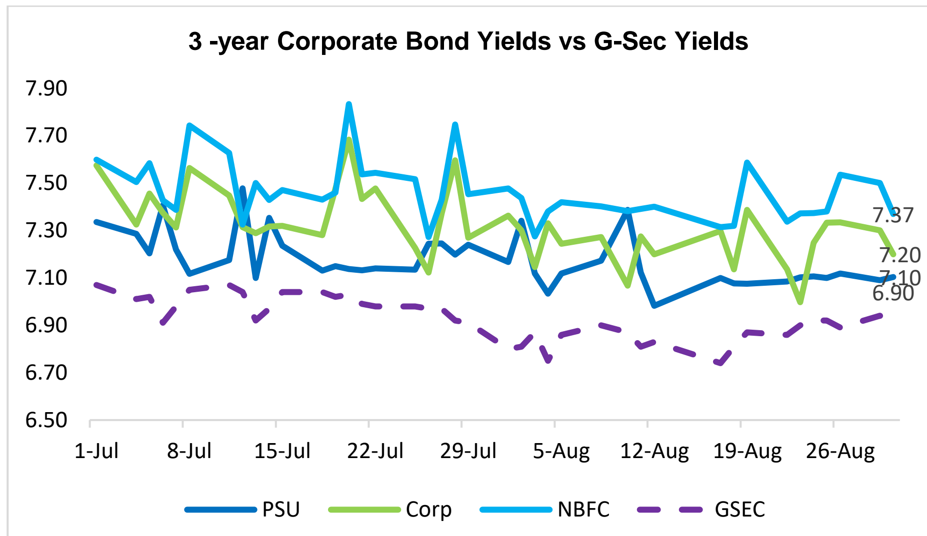
The successive hikes in the policy Repo rates by RBI have led to hikes in the benchmark lending rates/Repo Linked lending Rates (RLLR) for retail and corporate loans in BFSI segments; however, the deposit rates have not risen on the back of good growth. Fixed-income securities have depreciated, and the banks' Treasury profits in Q1 have taken a hit, as forecasted by BWR in its earlier publications. Long-term bond yields have shown a softening trend and short-term, a hardening trend. In BWR's opinion, in the near term, bond yields are expected to remain at the current level with marginal sideways movements.

Bal Krishna Piparaiya
(Principal Director - Ratings)

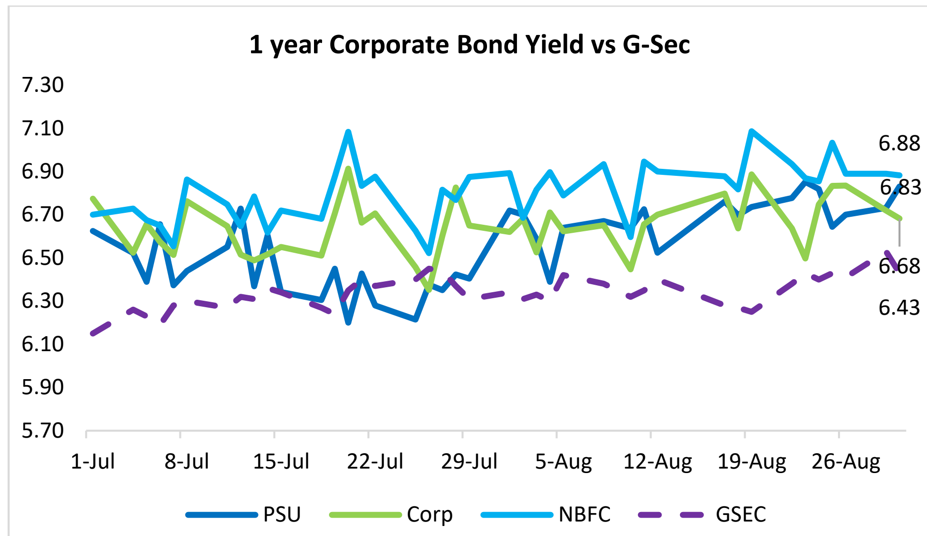


Source: FIMMDA, BWR Research

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 and regulators.



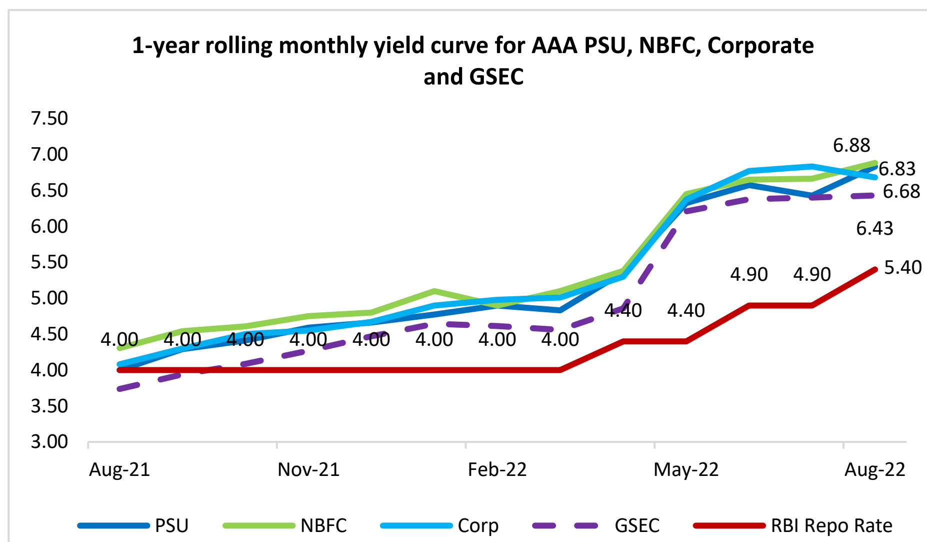
Source: FIMMDA, BWR Research



Source: FIMMDA, BWR Research

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

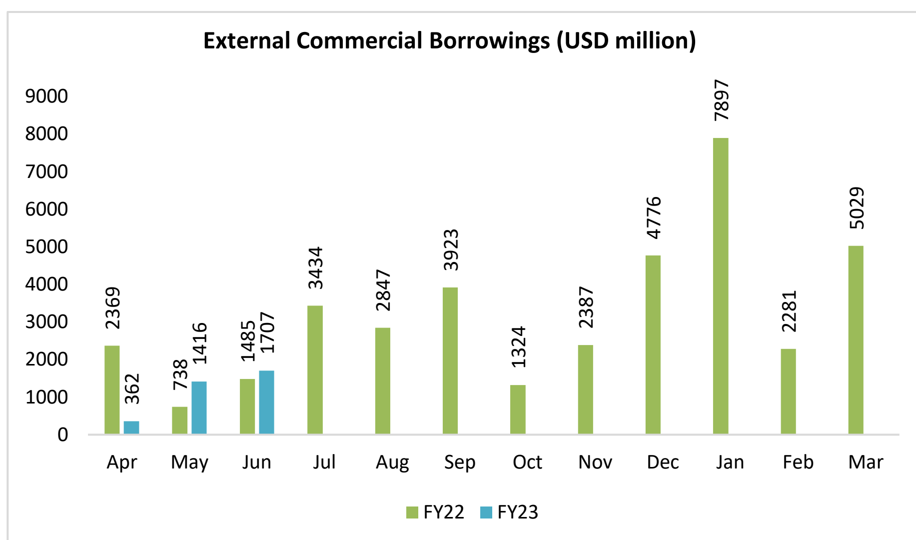
The borrowing costs for bonds maturing in 1 year issued by PSUs, NBFCs and corporates witnessed some escalation in the range by 258-283 bps in August in line with the G-Sec yields (269bps) against the corresponding period last year. Similarly, the key policy rate (repo rate) had a consecutive hike in July and August 2022 by 90bps and 140bps, respectively.



Source: FIMMDA, BWR Research

External Commercial Borrowings

According to RBI data, Indian corporates' borrowings were at USD 1.7 billion from offshore markets in the form of External Commercial Borrowings (ECBs) during June 2022 compared to USD1.5 billion during the same period last year, recording an increase in the trend.



Source: RBI, BWR Research

BWR Views

Indian companies' ECBs, which showed a reversal in trend with a rise to 1.416 bn USD in May 2022 over 738 mn USD in May 21 rose to 1.707 bn USD in June 2022 from 1.485 bn USD y-o-y. In BWR's opinion, with recent increase in the European Central Bank (ECB) rate and longer-term rates showing a declining trend in India, the ECBs growth may slow downtrend on account of declining interest rates differentials in the near term.

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