June 2021

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Covid 2.0: Lingering Uncertainty over Economic Recovery

June 2021

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Faltering Growth: Need for Fiscal Activism

The provisional estimate of the GDP for 2020-21 released by the National Statistical Office (NSO) on 31 May 2021 shows a better-than-expected contraction at 7.3%. After registering negative growth of 24.4% in the first quarter and a contraction of 7.4% in the second, the economy started recovering to register positive growth rates of 0.5% and 1.6%, respectively, in the last two quarters of the year. However, this nascent recovery has come to an abrupt reversal with the raging second wave of the pandemic. The pandemic has been spreading at a faster rate than in the first phase and has been more ferocious in claiming lives. What is more saddening is that the second wave has been seen to have a much deeper penetration into rural areas as well. The sudden resurgence of the pandemic has threatened to leave a long trail of death and destruction, reverse the recovery process, sharply increase unemployment and push people deep into the poverty trap. Although there is no nation-wide lockdown, most states have declared restrictions of varying intensities and lasting different lengths of time, which has adversely impacted both the supply and demand sides of the economy.

Not surprisingly, most analysts who had estimated the economy to achieve a "V" shaped recovery to register double-digit growth before the second wave of the pandemic struck, have been busy revising growth forecasts downwards. The Monetary Policy Committee revised the growth forecast from 10.5% for 2021-22 in its April policy statement to 9.5% in the June statement, and even this seems to be optimistic. Our own estimate was revised from 11% in January 2021 to 9% in end-April after seeing that virtually every major state has been declaring lockdowns and restrictions of varying magnitudes. Although the infection rate has shown a declining trajectory, most of the producing states are still in the grip of the pandemic, and an early return to normalcy is unlikely until a significant proportion of the population is vaccinated.

Coming on the back of the unprecedented contraction of 7.3% in 2020-21, even if the economy records 9% growth, income levels in 2021-22 will still be around the same as in 2019-20. Besides, there has been a sharp increase in unemployment, and millions of middle-class persons have been pushed to the brink of poverty. According to the CMIE, in May 2021, the unemployment rate shot up to 11.9% from 8% in the previous month, and over 15 million jobs were lost in May alone. Private consumption demand in the Q4 of FY21 was 55.4% of the GDP, which itself had contracted by 7.3%. The private capital formation too has been stagnant. Credit offtake by the corporates has not picked up, and MSMEs are struggling to keep afloat, when the economic environment does not look very promising.

The Reserve Bank was proactive during the last fiscal with a slew of measures in reducing interest rates, ensuring liquidity through conventional and unconventional measures, providing a moratorium on loan repayments particularly to the MSMEs and restructuring loans in selected sectors besides advancing regulatory forbearance. In contrast, the stimulus given by the government through public spending was just about 2% of the GDP.

In its latest monetary policy, the RBI has continued the accommodating stance, has come up with some additional measures and has promised to come out with out-of-the-box measures to sustain growth. These include a special liquidity facility of Rs 50,000 crore with tenors of up to 3 years at the repo rate for ramping-up COVID-19-related healthcare infrastructure and facilities with the provision that banks can classify this as priority sector lending and a liquidity window of Rs 15,000 crore for contact-intensive sectors with tenors of up to 3 years at the repo rate until 31 March 2022. A special liquidity facility to SIDBI, of Rs 16,000 crore, in addition to Rs 15,000 crore already announced in the 7 April 2021 statement as a part of the support to All India Financial Institutions to meet the funding requirements of MSMEs and continued liquidity support through G-SAP 2 with a secondary market purchase of Rs. 1.2 lakh crore in the Q2 of FY 22 are some important measures.

While the RBI has done what it could in the prevailing circumstance, the Governor was unequivocal in stating that at this juncture, policy support from all sides is required to regain growth momentum. In particular, there is only so much that the monetary policy can do to revive the economy, and even that takes a longer time to transmit. This is the time to activate fiscal policy, particularly as both private consumption and investment have shown a declining trend. Considering the slow corporate demand for loans, increasing government consumption expenditure, transfers and capital expenditures is necessary to revive demand conditions in the economy. Counter-cyclical fiscal policy calibration requires that the government should be prepared to relax the fiscal deficit target of 6.8% budgeted for the current year. In particular, the government should front load its spending plans to achieve faster recovery. The measures taken so far are meagre, apart from the distribution of free foodgrains for 80 crore beneficiaries during May and June.

As mentioned above, the time is opportune for the Centre to announce a clear stimulus package to help the recovery process and build confidence among economic agents. Many have voiced the need to increase cash transfers to the affected and vulnerable sections, along with targeted transfers to the urban poor. The Union Finance Minister has already asked the departments and public enterprises to front load their capital expenditures, but in a situation where the virus continues to spread fast and restrictions in various states are still in place, the spending plans can be implemented only in a staggered manner. The most important measure needed now is to fast track the pace of vaccination. However, due to vaccine production capacity constraints, unfortunately, there is considerable confusion on the vaccine policy with even the Supreme Court questioning the government on differential pricing. The Indian Constitution has placed containing contagious diseases on the concurrent list, and the Centre has a predominant responsibility in this. Vaccination is a service with enormous externalities, and economic principles dictate that the Centre should bear the entire cost of universal vaccination, although it can use the services of the States and private healthcare facilities to vaccinate people.

The second wave of the Coronavirus pandemic has completely shattered confidence and has put businesses at great risk and uncertainty. Although the declining numbers of new infections provide a glimmer of hope, fast pacing the recovery process is possible only when new infections are contained and a significant proportion of the population is vaccinated. In this situation, full-fledged recovery may become feasible only by the Q3 of the current fiscal.

Annexure: Select Macro Economic and Sectoral Indicators

Indicators/ Sectors		2018-19	2019-20	2020-21	Apr-2020	May-2020	Jun-2020	Jul-2020	Aug-2020	Sep-2020	Oct-2020	Nov-2020	Dec-2020	Jan-2021	Feb-2021	Mar-2021	Apr-2021	May-2021
Economy					Q1			Q2			Q3			Q4				
GDP at 2011-12 Prices	Y-o-Y in %	6.53	4.04	-7.25	-24.43			-7.44			0.46			1.64			-	
GVA at 2011-12 Prices	Y-o-Y in %	5.90	4.14	-6.16	-22.37			-7.31			1.04			3.72			-	
Agriculture	Y-o-Y in %	2.56	4.31	3.63	3.54			3.04			4.53			3.10			-	
Industry	Y-o-Y in %	5.31	-1.23	-6.96	-35.83			-2.99			2.91			7.93			-	
Services	Y-o-Y in %	7.20	7.19	-8.36	-21.46			-11.43			-1.21			1.50			-	
Banking																		
Gross Bank Credit	Y-o-Y in %	13.29	6.80	5.00	7.40	7.00	6.90	6.90	6.00	5.80	5.50	5.96	5.88	5.77	6.56	5.00	5.70	6.00
Bank Credit to Industries	Y-o-Y in %	6.91	0.70	0.40	1.70	1.70	2.20	0.80	0.50	0.00	-1.70	-0.68	-1.22	-1.28	-0.24	0.40	0.40	-
Deposit	Y-o-Y in %	10.04	7.90	11.40	9.80	10.50	11.00	12.10	10.90	10.00	10.10	11.30	11.40	11.00	11.00	11.40	10.30	9.70
Industry																		
Services PMI	Index	52.17	51.93	41.69	5.40	12.60	33.70	34.20	41.80	49.80	54.10	53.70	52.30	52.80	55.30	54.60	54.00	46.40
Manufacturing PMI	Index	52.77	52.33	50.20	27.40	30.80	47.20	46.00	52.00	56.20	58.90	56.30	56.40	57.70	57.50	55.40	55.50	50.80
IIP	Y-o-Y in %	3.80	-0.70	-	-57.30	-33.40	-16.60	-10.50	-7.10	1.00	4.50	-1.60	2.20	-0.90	-3.40	22.40	-	-
Manufacturing in IIP	Y-o-Y in %	3.90	-1.30	-	-66.60	-37.80	-17.00	-11.40	-7.60	0.40	4.50	-1.60	2.70	-1.30	-3.70	25.80	-	-
Consumer Durables	Y-o-Y in %	5.50	-8.70	-	-95.70	-70.30	-34.80	-23.70	-10.20	5.30	18.10	-3.20	6.50	-0.20	6.60	54.90	-	-
Consumer Non-Durables	Y-o-Y in %	4.00	-0.10	-	-48.10	-9.70	6.90	1.80	-3.00	2.40	7.30	-0.70	1.90	-5.40	-4.50	27.50	-	-
Eight Core Industries	Y-o-Y in %	4.37	0.40	-7.00	-37.90	-21.42	-12.44	-7.60	-6.90	0.56	-0.52	-1.13	0.24	1.30	-3.80	11.40	56.10	-
Auto Sales	Y-o-Y in %	5.10	-17.95	-14.64	-	-85.00	-43.00	-19.10	-1.70	6.70	10.61	4.00	2.78	2.77	5.61	68.82	-	-
Passenger Vehicles	Y-o-Y in %	2.70	-17.82	-10.35	-	-86.00	-53.20	-9.00	9.80	21.80	8.80	0.40	7.30	5.20	11.90	106.70	-	-
Commercial Vehicles	Y-o-Y in %	17.60	-28.74	-21.00	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Two & three Wheelers	Y-o-Y in %	5.00	-17.47	-15.06	-	-84.10	-39.80	-17.40	0.10	8.40	14.00	10.70	4.20	3.90	8.80	70.90	-	-
Power Generation	Y-o-Y in %	3.60	-0.16	-1.17	-25.00	-18.00	-9.00	-1.00	-3.00	4.00	9.00	2.00	5.00	5.00	0.04	23.43	43.00	
Steel Consumption	Y-o-Y in %	8.80	0.72	-6.42	-85.30	-47.50	-30.70	-10.43	-8.69	1.78	5.95	15.65	14.14	13.40	21.47	34.26	516.41	52.00
Cement Consumption	Y-o-Y in %	13.80	0.00	-13.00	-87.60	-22.80	-7.40	-14.00	-15.10	-3.80	3.40	-7.30	-9.70	-8.30	-6.40	28.60	677.80	
Sugar Production	Y-o-Y in %	17.44	-19.25	15.59	3.21	71.27	204.85	-39.20	-23.08	-8.95	158.76	103.14	11.58	7.60	2.72	6.04	1.01	
Domestic Passengers carried by Airlines	Y-o-Y in %	13.70	0.71	-62.24		-98.00	-84.00	-82.00	-76.00	-66.00	-57.00	-51.00	-44.00	-39.00	-37.00	0.77	-	-
External Sector																		
Exports	USD Bn	290.35	313.36	290.18	10.17	19.24	22.03	23.77	22.85	27.59	24.93	23.57	27.14	27.45	27.67	34.00	30.21	32.21
Imports	USD Bn	393.03	474.71	388.92	17.08	22.86	21.32	29.06	31.03	30.51	33.63	33.40	42.59	41.99	40.55	48.12	45.45	38.53
Exchange Rate (Average)	INR/USD	69.48	75.39	74.20	76.24	75.66	75.72	74.99	74.67	73.47	73.46	74.22	73.59	73.10	72.76	72.79	74.54	73.27
Crude Oil (Average)	USD/barrel	69.88	60.47	44.60	19.90	30.60	40.63	43.35	44.19	41.35	40.66	43.34	49.84	54.79	61.22	64.73	63.40	66.95
Forex Reserves	USD Bn	412.87	477.81	579.29	481.08	493.56	505.70	534.63	541.43	545.64	560.72	574.82	585.32	590.19	583.87	579.29	588.00	598.17
Inflation																		
CPI	Y-o-Y in %	3.41	4.77	6.16	7.22	6.27	6.23	6.73	6.69	7.27	7.61	6.93	4.59	4.06	5.03	5.52	4.29	-
Food	Y-o-Y in %	0.14	6.71	7.70	11.73	9.21	8.72	9.27	9.05	10.68	11.00	9.50	3.41	1.89	3.87	4.87	2.00	-
Core	Y-o-Y in %	5.60	3.80	5.51	4.72	4.92	5.12	5.44	5.62	5.46	5.65	5.85	5.68	5.72	5.88	6.00	5.25	-
WPI	Y-o-Y in %	4.26	1.67	1.20	-1.57	-3.37	-1.81	-0.58	0.41	1.32	1.48	1.55	1.95	2.51	4.83	7.39	10.49	-
Food	Y-o-Y in %	0.58	6.88	3.91	4.38	2.73	3.12	4.32	4.75	6.92	5.78	4.27	1.11	-0.26	3.58	5.28	7.58	-
Interest Rates																		
Repo	Average Rate in %	6.25	4.40	4.00	4.40	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00
10-year Benchmark	Average Rate	7.47	6.80	6.40	6.80	6.00	6.00	5.90	6.10	6.11	6.04	5.90	5.98	6.00	6.30	6.40	6.37	6.31
10- year AAA Corporate Bond	Average Rate	8.55	7.60	6.90	7.90	7.30	6.90	6.60	6.90	6.88	6.61	6.69	5.98	6.70	7.20	6.90	6.85	6.83
5- year Benchmark	Average Rate	7.07	6.20	6.10	6.10	5.60	5.60	5.10	5.40	5.57	5.40	5.34	5.30	5.40	5.80	6.10	5.96	5.68
5- year AAA Corporate Bond	Average Rate	8.19	7.30	6.10	7.40	6.90	6.20	5.70	5.90	6.10	5.60	5.59	5.79	5.80	6.40	6.10	6.00	5.90
MCLR of SBI (1 year)	Average Rate	8.55	7.80	7.00	7.40	7.30	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00
Call Money	Average Rate	6.21	4.90	3.20	4.20	3.80	3.60	3.50	3.40	3.41	3.33	3.15	3.16	3.20	3.20	3.20	3.21	3.21

Notes: Data is provisional for the latest months and annual growth rates are average for the full fiscal, -: Not available, *: At the end of the period.
Source: MOSPI, RBI, eaindustry.nic.in, IHSmarkits.com, SBI, CMIE, FIMMDA, BWR Research

MACRO-ECONOMIC INDICATORS

BWR Views

The impact of the Covid-19 second wave on economic recovery is reflected in the recent plunge in leading growth indicators such as the PMI.

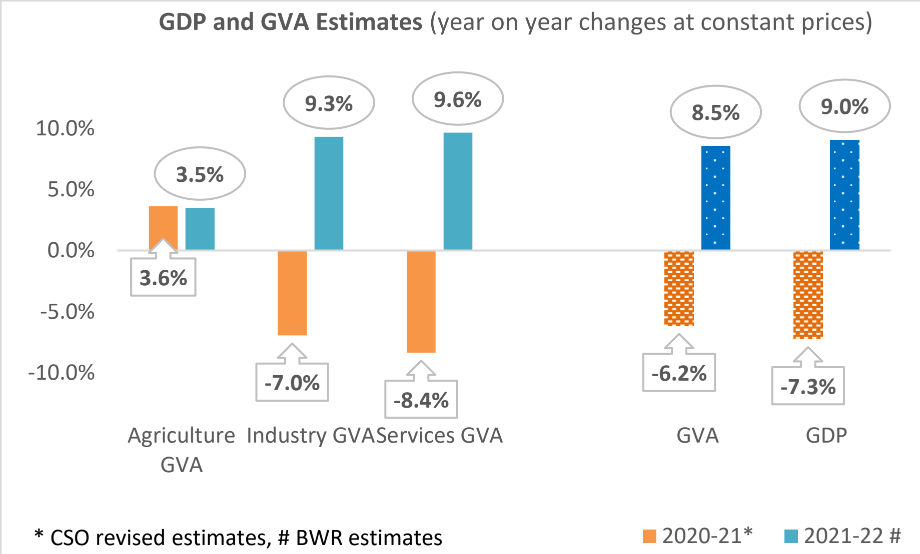
Although many states have started easing lockdown restrictions, economic activities have still not resumed completely. Until the virus spread is contained and a substantial part of the population is vaccinated, sectors that are impacted by social distancing norms and those adversely affected by supply disruptions, labour shortage and demand reduction will continue to trail and may take longer to return to a sustained growth path.

The resurgence in Covid infections and the restrictions by many states to contain the virus spread are delaying recovery progress. The economy is expected to achieve lower growth in FY22, as against the presumed double-digit growth estimated earlier, with many leading growth indicators losing growth momentum since April 2021.

We revise downwards our GDP growth projections for FY22 to **9%**, 200 bps lower than our earlier estimates.

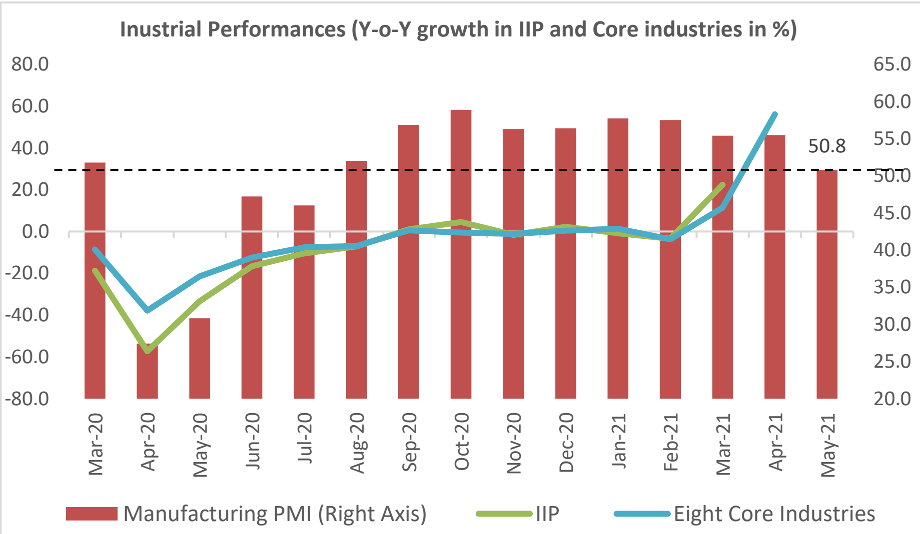
GDP Trends

The nascent economic recovery is reflected in the positive growth estimates of 0.5% and 1.6%, respectively, in the last two quarters of FY21 and the upward revision in the GDP estimates for the full fiscal to a 7.3% contraction in the GDP from the earlier estimates of an 8% contraction. However, the better-than-expected growth rebound is undermined by the enormous second wave of Covid-19.



Data is provisional, Source: MOSPI, BWR Research

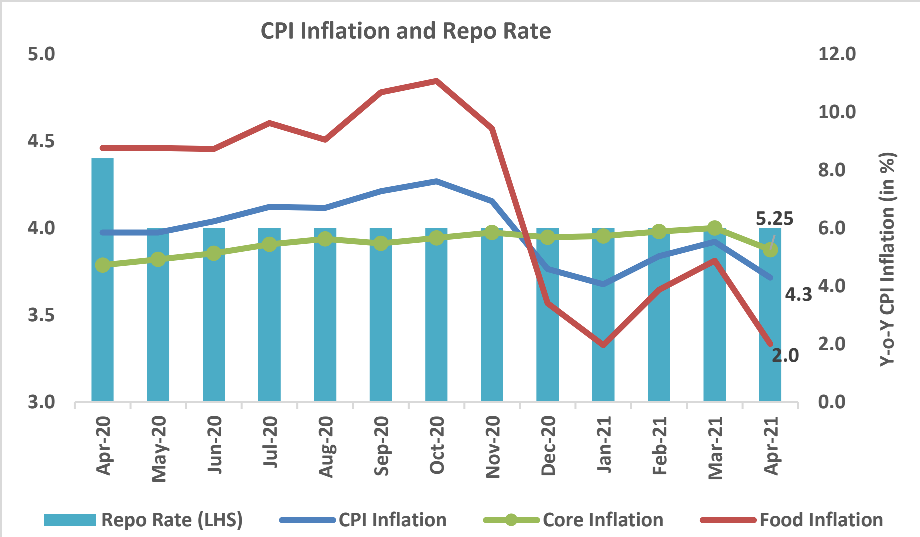
The impact of lockdowns on demand conditions is reflected in the manufacturing and services PMI, both of which plunged in May 2021, and the eight core industries reported a 15.1% contraction on a month-on-month basis in April 2021. On a year-on-year (y-o-y) basis, due to a low base, production growth in the IIP and eight core industries reported double-digit increases in March and April 2021, respectively.



Source: MOSPI, eaindustry.nic.in, IHS Markit, BWR Research

Inflation and Monetary Policy Action

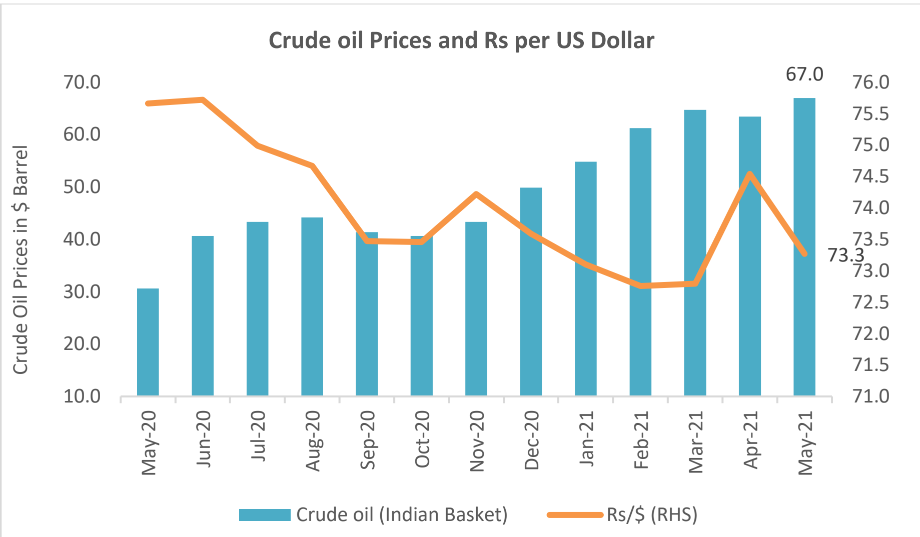
Due to a favourable base effect and demand slowdown on the back of repeated lockdowns following the second wave of Covid-19, the pressure on retail inflation eased in the recent period, and CPI inflation softened to 4.29% in April from 5.52% in March. Food inflation (2%) eased notably, and a softening trend was witnessed in the core inflation (5.3%) as well, which has otherwise remained sticky at above 5.5% for the last few months.



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

Crude Oil Prices and INR/USD Rates

Average oil prices remained firm at around USD67/barrel in May, showing a USD 3.6/barrel increase from that in April due to improved global demand. The Indian rupee appreciated by 130 paise against the USD in May over April, in spite of large global spill-overs resulting an outflow of foreign portfolio investments worth USD 626 million from Indian (equity and debt) markets in May.



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

BWR Views

Rising crude oil prices and a broad-based surge in international commodity prices amid improved global demand are likely to exert cost push pressures. This has already been reflected in the 10.47% WPI inflation in April, which is likely to be felt in CPI inflation in the next 2 to 3 months. In such a situation, the MPC's estimates of 5.1% inflation for FY22 look optimistic. Once the lockdown is lifted completely, the domestic demand conditions are expected to improve, which may lead to inflation pressure. Hence, we expect the RBI to likely maintain the repo rate at 4% and continue with the accommodative stance to support economic growth momentum.

BWR Views

State-level restrictions have dampened domestic economic activities, while a gradual improvement in the global economy, particularly from developed countries, helped renew demand. We expect a moderate increase in crude oil prices in the coming months, within a range of USD65 to 70/barrel.

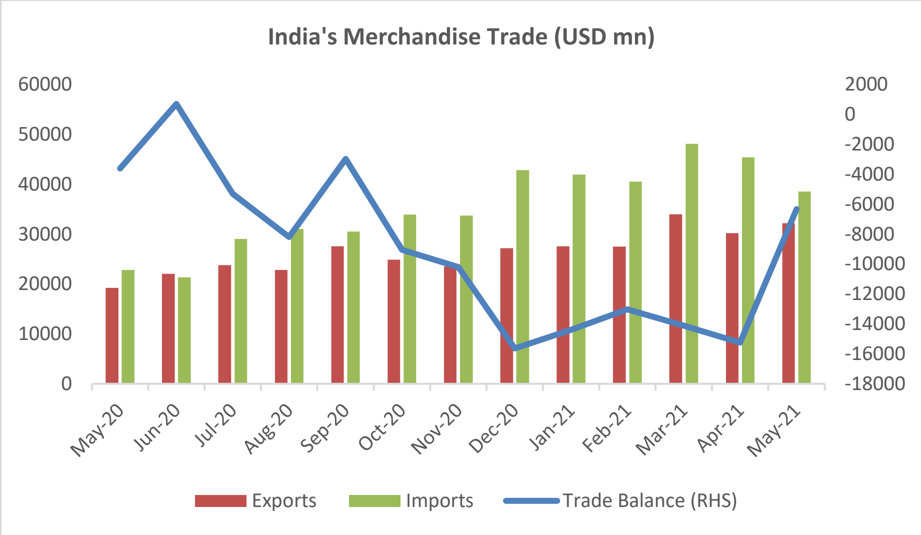
The depreciation of the rupee threatens inflationary worries, and hence we expect that the RBI would manage the rupee at current levels by actively engaging in both purchases and sales in the foreign exchange market to bring in stability and orderliness in the exchange rate.

During FY21, India's merchandise exports and imports both fell by 7.4% and 18.1% (y-o-y), respectively, due to the Covid-induced lockdowns and a slowdown in economic activities on both, the domestic and global front.

With conducive external conditions and some major economies emerging from the pandemic, global demand is reviving; hence, we expect exports to witness a sharp uptrend in coming months. Recovery in imports depends on the revival in domestic demand, which is subject to the pandemic coming under control, progress in vaccination, relaxations in lockdowns and economic recovery.

Merchandise Trade

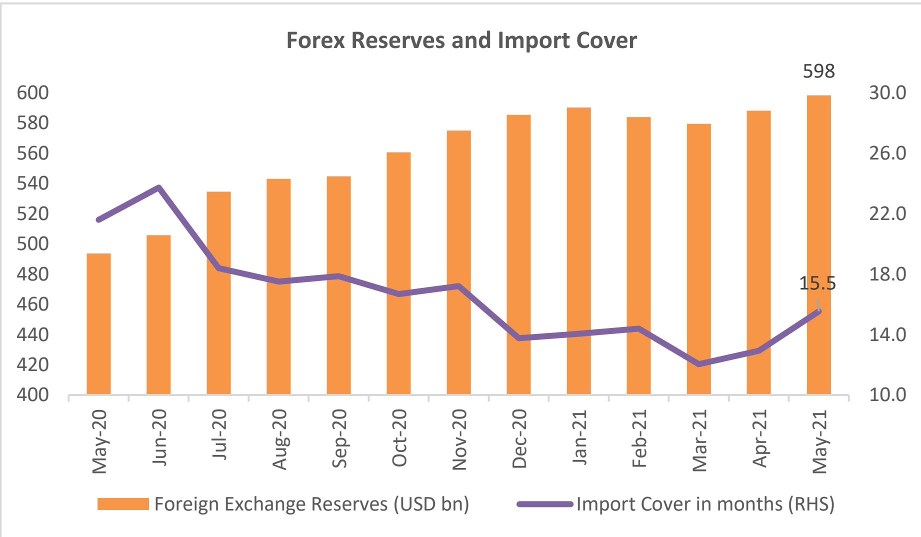
India's export performance improved notably, with provisional data for May 2021 showing significant growth of 67.39% over the May 2020 level and 6.6% over the April 2020 level. Imports also grew by 68.54% y-o-y, while reflecting muted domestic demand in the latest month, imports plunged by 15% on an m-o-m basis.



Note: Preliminary data for May 2021, data is provisional.
Source: Ministry of Commerce, BWR Research

Foreign Exchange Reserves and Import Cover

India's foreign exchange reserves rose to USD 598 billion as on 28 May 2021, rising by around USD 105 billion from a year ago period. The current level of forex reserves is sufficient to cover 15.5 months of imports, thereby providing confidence to deal with global spill-overs.



Source: Ministry of Commerce, RBI, BWR Research

BWR Views

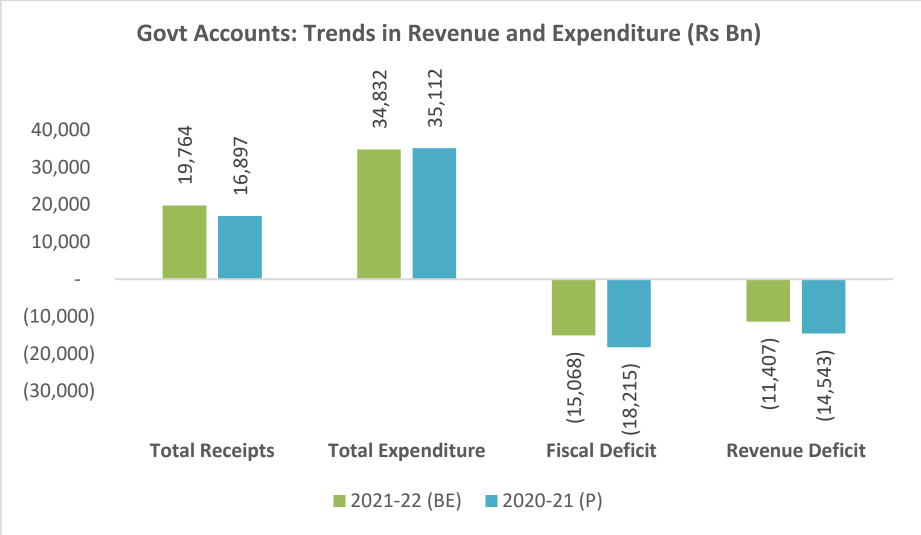
The record level of forex reserves is attributed to huge foreign portfolio investment inflows into domestic equity markets (USD 37 billion) in FY21. A risk-off by foreign investors due to the prevailing uncertainty on domestic economic recovery already led to capital outflows in April and May. The exchange rate volatility demands more forex interventions by the RBI. Hence, the accumulation of forex reserves helps the RBI to maintain the exchange rate at a comfortable level and also deal with external spill-overs.

Government Finances

As per the latest data (provisional) available, the central government was able to contain the deficit at 9.3% of the GDP during FY21 as against its revised budget target of 9.5%. Revenue collections surpassed the RBE, and effective revenue deficit stood at 6.29% of the GDP. Due to a sharp contraction in the economy, revenue receipts lowered by 29% in the RBE from the BE for FY21, while expenditure has increased by 13%.

BWR Views

For FY22, the government has budgeted a Rs 12 lakh crore market borrowing plan, with the fiscal deficit target of 6.8% of the GDP. The ongoing health crisis again brought in severe uncertainties, and given the additional burden to spend on health facilities such as to provide free vaccine to all Indian citizens above 18 years of age, the government's budget estimates are likely to undergo significant changes.



Note: Data is provisional, BE: Budget Estimates, RBE: Revised Budget Estimates.
Source: Controller General of Accounts (CGA), Union Budget, BWR Research

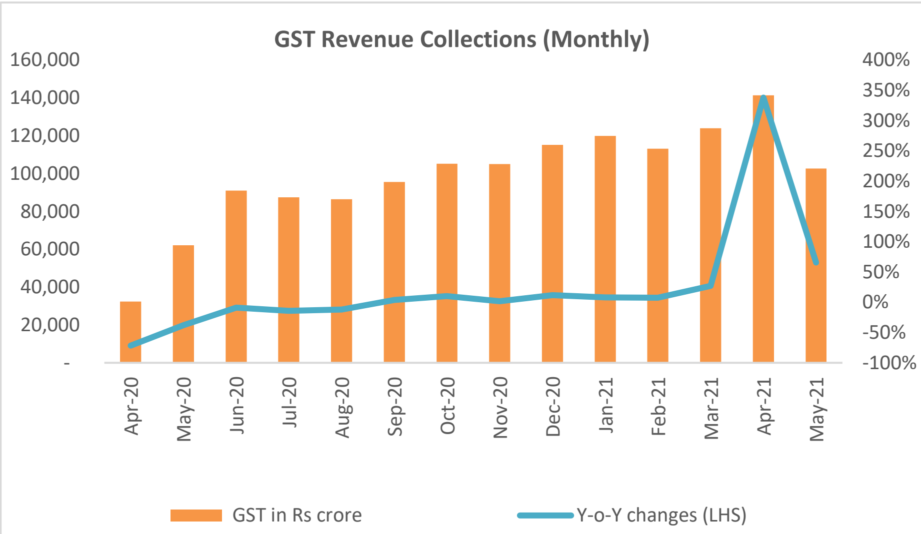
Goods and Services Tax (GST)

The GST monthly revenue collections remained consistently above Rs 1 lakh crore since October 2020, helped by the introduction of e-invoicing under the GST. In May 2021, the GST reported a 66% surge over the year in its monthly collections, despite the localised restrictions and extension provided to small taxpayers to file returns.

BWR Views

Better enforcement of the technology platform, with the introduction of e-invoicing under the GST, particularly the implementation of e-invoicing for businesses with more than a Rs 100 crore turnover, effective from 1 January 2021 onwards, helped improve collections.

Sustained economic recovery and improved business activity is key to the increase in the consumption of goods and services. With the relaxation in lockdowns, businesses will resume their activities, and tax collections may improve gradually in the coming months.

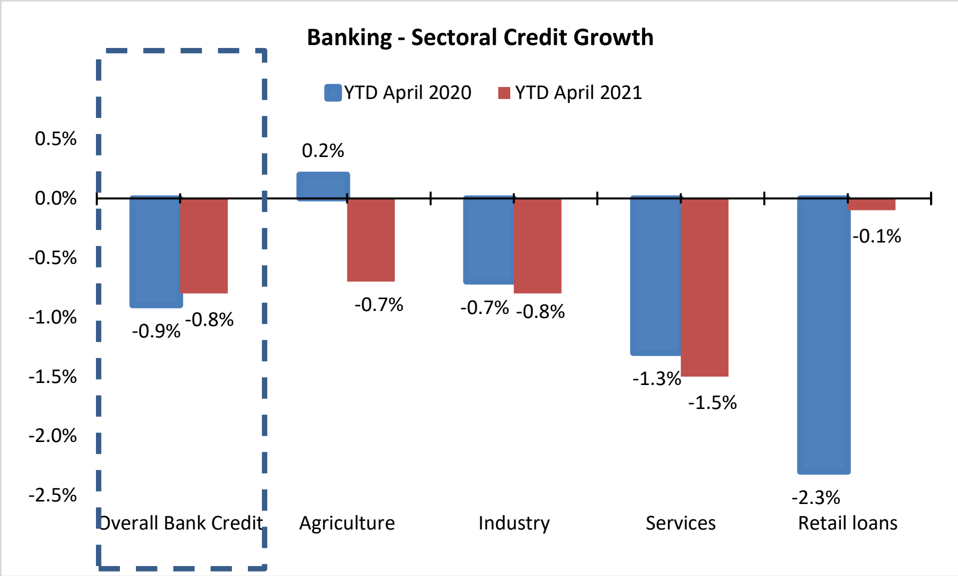


Source: Ministry of Finance, BWR Research

SECTORAL INDICATORS

Banking

The gross bank credit as of 23 April 2021 de-grew by 0.8% YTD. Credit offtake under the resurgence of the COVID-19 pandemic, the continued restrictions/relaxations during the lockdown shall be a monitorable for the current financial year.



Source: RBI, BWR Research

The Government of India (GOI) and Reserve Bank of India (RBI) continue with their series of measures to overcome the impact of the COVID-19 pandemic on the economy. The resurgence of the pandemic over the last one month and the containment measures are likely to impact the recovery process and create new uncertainties. The government shall continue with measures to contain the spread of pandemic and simultaneously ensure the functioning/operation of the economic activities of manufacturing, trading and services with restraints. The RBI announced Resolution Framework 2.0 for the resolution of Covid-19-related stress, with the objective of alleviating potential stress to individual borrowers and small businesses. The set of measures for Resolution Framework 2.0 are broadly in line with the contours of Resolution Framework 1.0, with suitable modifications. Lending institutions were permitted to offer a limited window to such borrowers while classifying them as Standard upon the implementation of the resolution plan. The limited window to such borrowers whose exposure was less than Rs. 25 crore as of 31 March 2021, is now extended to such borrowers whose exposure was less than Rs. 50 crores as of 31 March 2021 and have not availed of any resolution in terms of Resolution Framework 1.0.

Credit offtake for the March 2021- April 2021 period may be subdued, but is better than the similar period a year ago, under similar conditions. Creating opportunities to undertake business activities from the current scenario and making deliverables shall be one of the factors for the faster revival of economic activity.

BWR Views

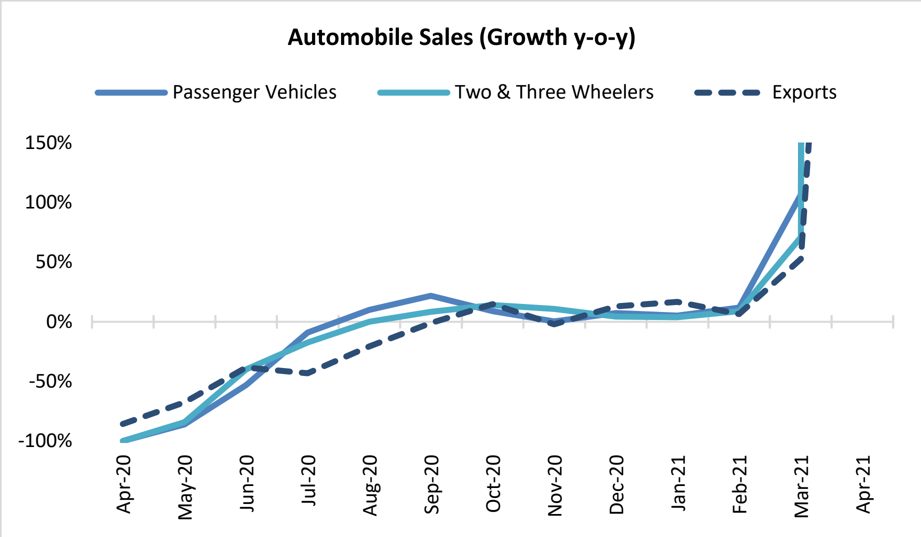
BWR expects continued support from the RBI and GOI in the interest of borrowers and lenders, along with the retention of credit quality across the banking and financial sector. The initiatives by both the GOI and RBI have been supportive in boosting economic activities and stimulating credit growth. Most sectors, including industry, witnessed credit degrowth, indicating vulnerability to credit risk among sectors. The resurgence of the COVID-19 pandemic in recent times and measures taken by the GOI and RBI to contain the pandemic and boost credit growth, respectively, are credit positives. The implementation of resolution framework 2.0 by lending institutions on borrowers shall determine the asset quality of these institutions over the medium term. BWR also views the measures adopted by the RBI to increase liquidity shall support growth in the industry and thereby, assist in a faster economic revival. BWR views these measures shall boost credit growth for a revival of the economy. Considering the existing asset quality stress and likely increase over the medium term, BWR views that maintaining healthy capitalisation levels shall assist the appetite of banks for enhancing their credit risk.

Vidya Shankar
(Principal Director - Ratings)

Hemant Sagare
(Sr Manager - Ratings)

Automobiles

Overall automobiles sales have witnessed a decline in May 2021 (on an m-o-m basis) on account of the second wave of Covid-19, temporary shutdown of many automobile dealers' showrooms, maintenance shutdowns by Original Equipment Manufacturers (OEMs) till the second week of May 2021, leading OEMs temporarily suspending operations to divert industrial oxygen for medical purposes and on account of localised lockdowns imposed by state governments.



Source: CMIE, BWR Research

Two-wheeler (2W) sales have also decreased due to the second wave of Covid-19, which has hit deeper into rural and semi-urban areas, eroding the purchasing power of many families that lost their breadwinners. Commercial vehicle (CV) sales volumes were down due to the holding back of orders by transporters over a lack of clarity on easing lockdowns. The buses segment, which depends on the reopening of schools, inter-state travel, tourism and ferrying of office staff, has been negatively affected.

Overall automobile sales are expected to decline in Q1FY22 due to Covid-19-led disruption in the supply chain and an underlying slowdown in the economy. However, demand for personal mobility remains resilient and is expected to strengthen after the second wave of the pandemic.

Telecom

The Department of Telecommunications (DoT) has recently started inviting applications for a Production-Linked Incentive (PLI) scheme for the telecom sector. Under the scheme, incentives will be given for the manufacture of network equipment, routers, broadband transmission equipment, 5G equipment, consumer premise devices and electronic items required for providing optical fibre-based connections. The total quantum of the scheme would be Rs. 12195 crore, and it is a welcome move by telecom equipment manufacturers, with many international players such as Nokia, Samsung and Foxconn already indicating their willingness to participate. This scheme will not only boost manufacturing activities in this area, but also increase employment. It will also result in reduced imports of telecom

BWR Views

Automakers expect vehicle sales in June 2021 to improve slightly on account of the easing of restrictions, decline in new Covid-19 cases in some states, normal monsoon supporting rural recovery, as well as the increasing use of digital sales initiatives by auto dealers. Continued supply chain constraints and the rising cost of vehicle ownership would lead to a subdued recovery momentum in the near future. Full-year recovery prospects are intact due to pent-up demand, but they also hinge upon the progress of the vaccination drive, and easing of input supply and prices.

Tanu Sharma
(Director - Ratings)

Shivam Bhasin
(Sr Ratings Analyst

Vipula Sharma
(Director - Ratings)

Aakriti Sharma
(Asst Manager - Ratings)

equipment, and coming at this time, it can play a significant part in the shift towards 5G.

Power

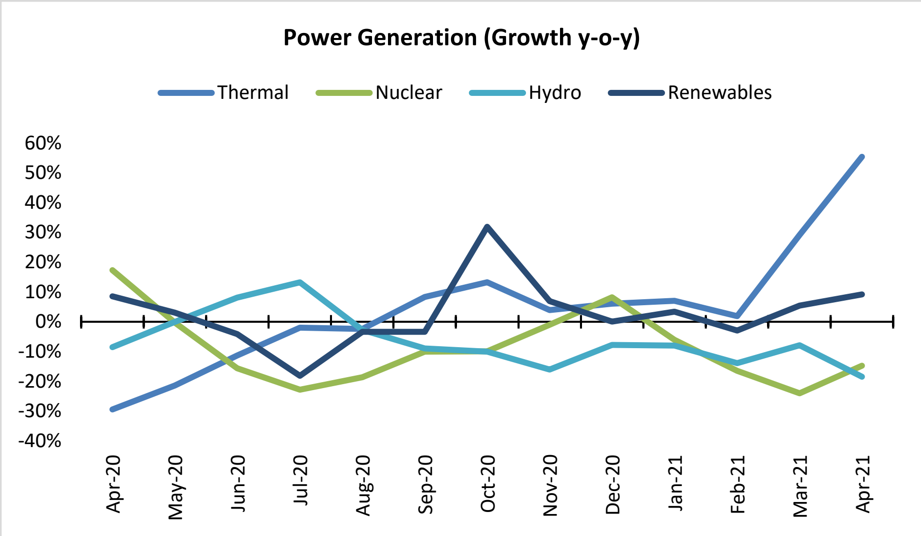
India, in 2015, had set a highly ambitious target for itself by announcing it would install 175 GW of renewable energy capacity by 2022. This included 100 GW from solar, 60 GW from wind and the balance from other sources such as biomass and small hydro. While the country has made significant progress in adding renewable energy capacities, it is far from reaching the target of 175 GW. Moreover, in a substantial portion of the projects allotted by SECI through the TBCB mode (~ 19 GW), it has still not been able to sign the final sale agreements with discoms. With the discoms being in a perennial state of dilapidation, they have been reluctant to sign any long-term power purchase agreement, and unless SECI signs these agreements with the discoms, these projects run a risk of becoming non-performing.

BWR Views

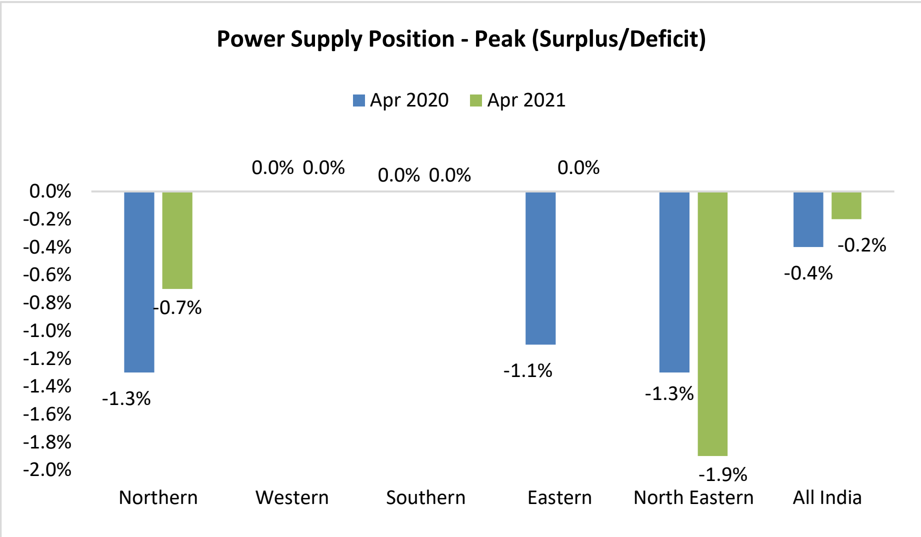
The revival of the power sector requires meaningful structural changes, targeting an improvement in the operational efficiency, a reduction in cross-subsidies and cost-reflective tariffs.

Vipula Sharma
(Director - Ratings)

Aakriti Sharma
(Asst Manager - Ratings)



Source: Central Electricity Authority, BWR Research



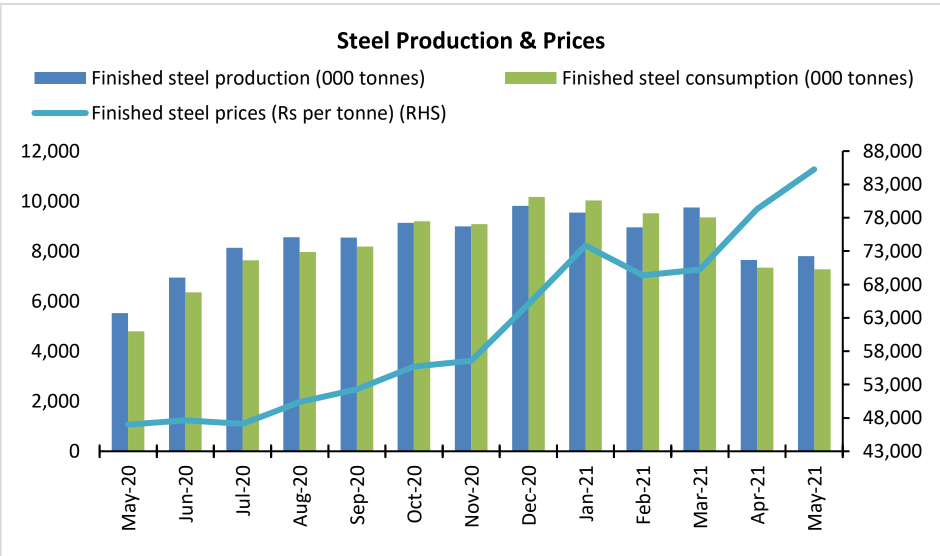
Source: Central Electricity Authority, BWR Research

Another area of concern is the non-availability of the required transmission infrastructure to support the surge in the renewable energy capacities. Due to the volatile generation patterns involved with these capacities, specialised transmission lines with a very stable grid are required to ensure smooth functioning, which has not seen much of a development in the recent years. Despite these bottlenecks, India has further set another aspirational goal of setting-up 450 GW of renewable energy capacity by 2030. While the world has hailed India's commitment to renewable energy development, unless equal measures are also taken to strengthen the distribution and transmission infrastructure, this may very well remain a distant dream.

Steel

Despite the pandemic onslaught, repeated lockdowns in India leading to lower demand, the slicing of duties by the government, criticism of the industry for hiking prices and expectations of its being temporary, steel prices never reversed their upward journey and continue their northward trend. In fact, after remaining steady in April 2021, the prices saw another uptrend recently when the Hot/Cold Rolled Coil (HRC/CRC) prices in Mumbai were revised upwards by around Rs 5000/- per tonne, thus touching a record high of around Rs 70,000 and 83,000 per tonne, respectively. The reasons are said to be the higher prices of raw material globally and lower exports from China, the largest steel producer. Domestic steel prices are still at around a 20%-25% discount to the international price and are around 15%-20% lower than the landed cost of imported steel. Domestic steel players continue to remain optimistic about the increase in steel prices in future as well.

The bull run on prices is not only leading to a hike in the cost of the infrastructure/real estate projects and consumer goods and a repeated hike in automobile prices, it is also increasing the input costs of engineering MSME exporters, which also use steel as raw material, and are seeking softer input prices to remain competitive.



Source: CMIE, BWR Research

BWR Views

With demand expected to increase globally during the remaining period of the current fiscal and supply side bottlenecks to take some time to ease out, unless international prices correct significantly or the government initiates drastic steps such as doing away fully with the current customs duty of 7.5% and restricting exports, local steel prices are expected to remain firm for some more time.

The organised sector, comprising around 70% of the production capacity, has started brownfield expansions and acquisition of closed steel plants, and is trying to increase production and is eying to push exports and take advantage of higher prices both in India and across the globe.

Bal Krishna Piparaiya
(Senior Director - Ratings)

Forum Parekh
(Asst Manager – Ratings)

The root cause for higher international steel prices is the limitation on exports by China. Most of the Chinese steel is now consumed locally, and this has resulted in short supply in global trade, resulting in a continuous upward increase in prices. The temporary curtailment in Indian production on account of the diversion of oxygen for medical use, rise in raw material prices of the iron ore by about Rs 4,000 per tonne and increased freight cost on account of higher diesel prices are some of the supplementary reasons for the unabated rise in prices locally and cannot be ignored totally.

While the ongoing second wave of the pandemic has caused the demand outlook to continue to be weak and uncertain in H1FY22, it is expected to spike in H2FY22 on account of a revival in the construction and real estate sectors, green shoots in which are already visible. Demand in the auto sector is expected to rise in the festival season in the second half wherein delivery is already waitlisted currently on account of production bottlenecks. Therefore, there appears to be no compulsion on steel prices to come down in the near future.

Cement

Indian cement companies have recently hiked prices to partly cover the increase in prices of inputs such as limestone and slag, and rise in freight costs due to surging fuel prices. The pandemic has led to a slowdown and delay in the capacity expansion projects of the cement industry. However, the industry is likely to add an ~8 MTPA capacity in cement production.

Cement production witnessed 13% degrowth in FY21 due to the Covid-19 pandemic. However, in the H2FY21, the industry showed signs of early recovery and reported strong 28.8% y-o-y growth in its sales revenues during Q4FY21.

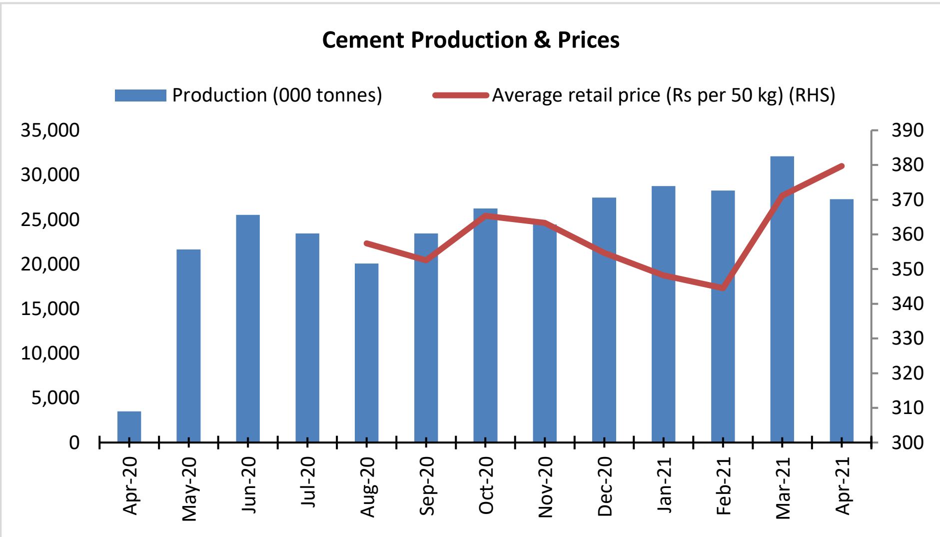
The primary growth driver for the cement industry will be the government's strong focus on infrastructure and affordable housing. The government also intends to expand the capacity of railways and the facilities for handling and storage to ease the transportation of cement and reduce transportation costs. These measures would lead to increased construction activity, thereby boosting cement demand.

BWR Views

In FY22, the consumption of cement is expected to increase by around 13%, partly due to the resumption of infrastructure and construction activities and partly on account of the low base in 2020-21. Pent-up and pre-monsoon construction requirements are expected to support demand to a large extent.

Vidya Shankar
(Principal Director - Ratings)

Naveen S
(Manager – Ratings)



Source: CMIE, BWR Research

Sugar

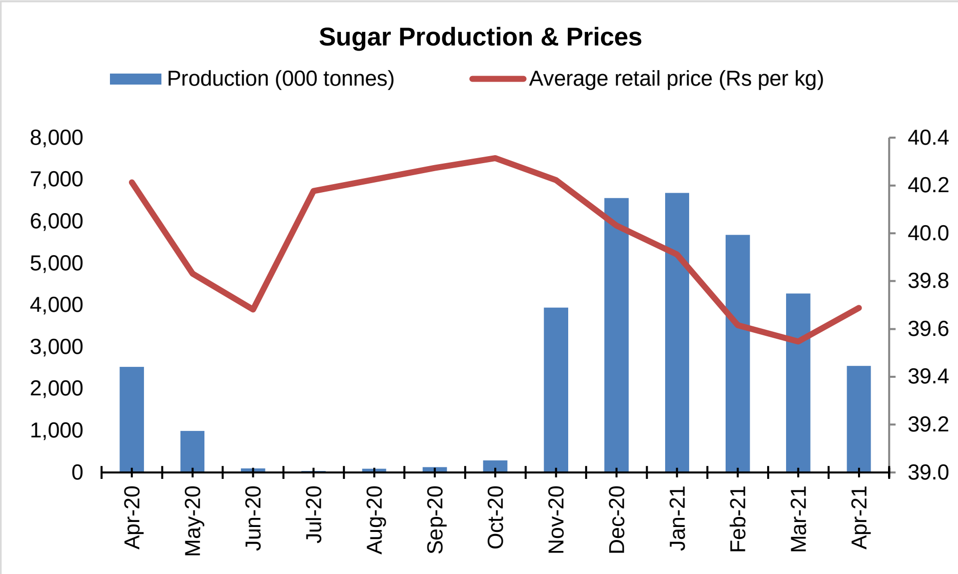
BWR Views

In SS 2021-22, sugar production is expected to increase to ~32 million tonnes due to good sugarcane harvest. The average retail price of sugar is expected to remain range-bound primarily due to the abundant carry-over stock of over 10 million tonnes and subdued domestic consumption. Export demand may increase in SS 2021-22 due to lower-than-expected sugar production in Brazil, the largest sugar exporter, along with drought conditions in Thailand which is a major exporter to Indonesia, a major importer.

Saakshi Kanwar
(Sr Manager - Ratings)

Swarn Saurabh
(Sr Ratings Analyst)

Sugar production in India increased, aided by a better harvest in Maharashtra and Karnataka. This increase was post factoring in decline in Uttar Pradesh due to red rot disease and pest infestation. Sugar production in SS 2020-21 ending September 2021 is expected to top 31.3 million tonnes, with Maharashtra and UP contributing nearly ~11 million tonnes each. The increased production (10.70 million tonnes vis-a-vis 7.8 million tonnes) in Maharashtra is attributed to better monsoons for a couple of seasons and certain grape manufacturers switching to sugarcane production owing to timely payments to farmers.



Source: CMIE, BWR Research

On the consumption front, domestic consumption is unlikely to grow enough to support strong growth. Domestic sugar consumption in SS 2019-20 was slightly lower at ~25 million tonnes compared to ~25.5 million tonnes in SS 2018-19. However, exports have seen some traction. According to official data released so far, about 2.4 million tonnes of sugar was exported during October 2020 to February 2021, about 11% higher than in the corresponding period in the previous year. The industry has already entered export contracts of 5.8 million tonnes of sugar against the Maximum Admissible Export Quota (MAEQ) of 6.00 million tonnes fixed by the central government for SS 2020-21.

DEBT MARKET INDICATORS

Movements in Bond Yields

BWR Views

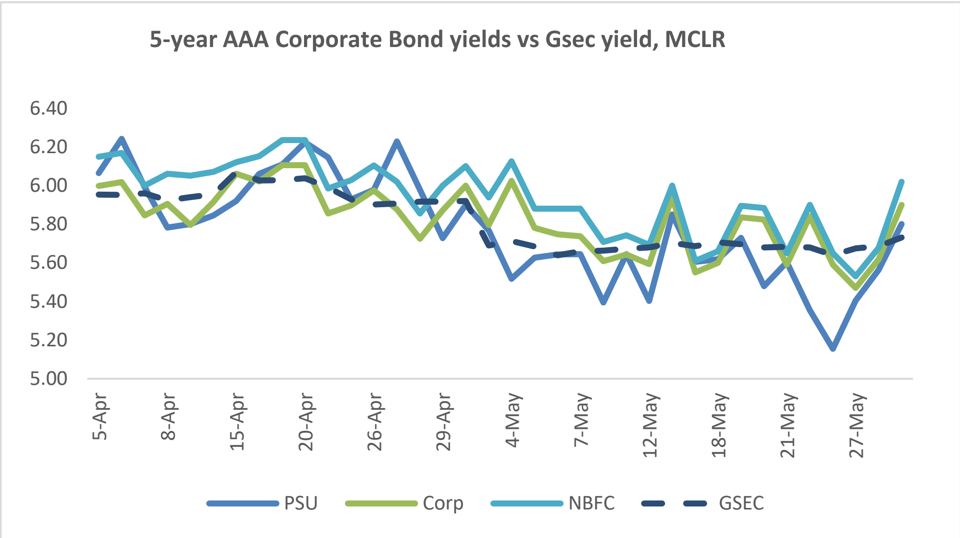
In BWR's opinion, bond yields will be contained at the current level during H1FY22 on the back of an enhanced secondary market CGS and SDL purchase mop-up programme, balancing of demand and supply through cancellations and the devolvement of G-Sec auctions and adequate liquidity support by the RBI.

Bal Krishna Piparaiya
(Senior Director - Ratings)

The 10-year gilt-edge securities yields continued to remain almost stable at around 6% even though yields for the longer tenor of 30 years rose by about 17 bps, coupled with a spike of nearly 5/10 bps in shorter and mid tenor, barring minor decline in two and three years as against a month back. This was influenced by no change in the policy repo rate from 4% and continued strategic moves by the RBI in enhancing the size of the secondary market Government Securities Acquisition Programme (G-SAP 2.0) to Rs. 1.2 trillion in Q2 from Rs 1 trillion during Q1 FY22, creating space to purchase state government securities also (SDL) in the same for effectively managing the augmented government borrowings of 12 lakh crore plus. As a result, the move is expected to contain the borrowing cost for the GOI and state governments, keep the interest rates stable and contain volatility in the gilt yields, the benchmark for interest rates. Steps taken by the RBI will also help MSME industry, including the home loan borrowers, to keep the interest rise at bay.

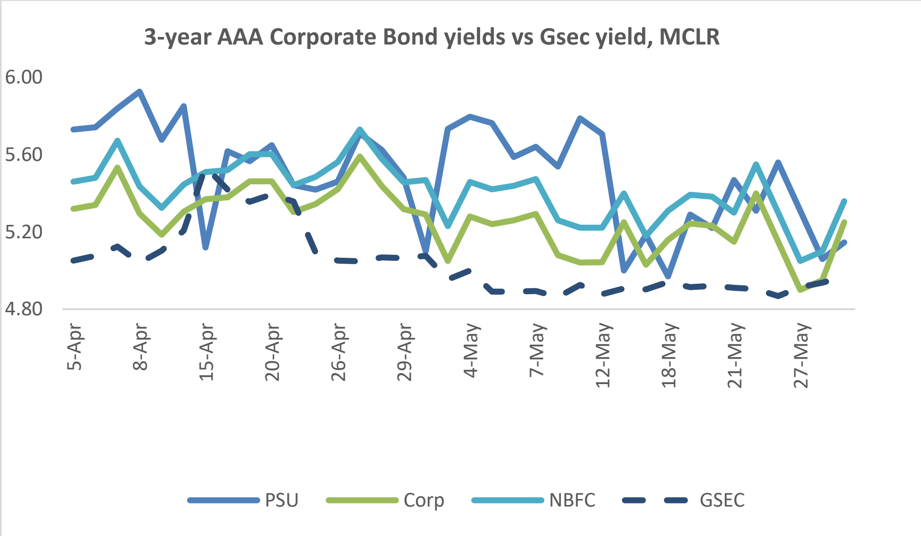
The 10-year gilt yields were at 6.022%, three months at 3.42%, six months at 3.64%, one year at 3.90%, two years at 4.30%. three years at 4.65%, four years at 5.40%, five years at 5.56% and 30 years at 6.96 % as on 7 June 2021. Corporate bond yields are expected to move in tandem.

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

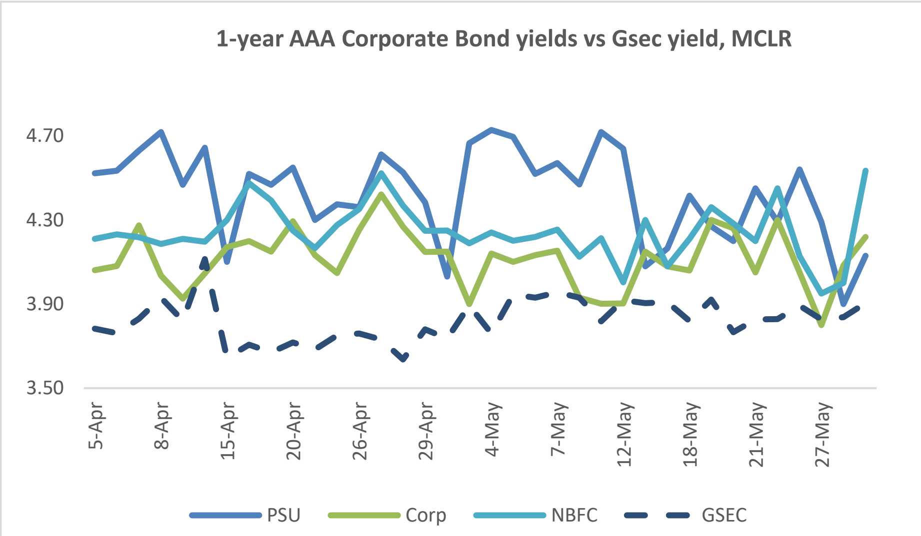


Source: FIMMDA, BWR Research

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



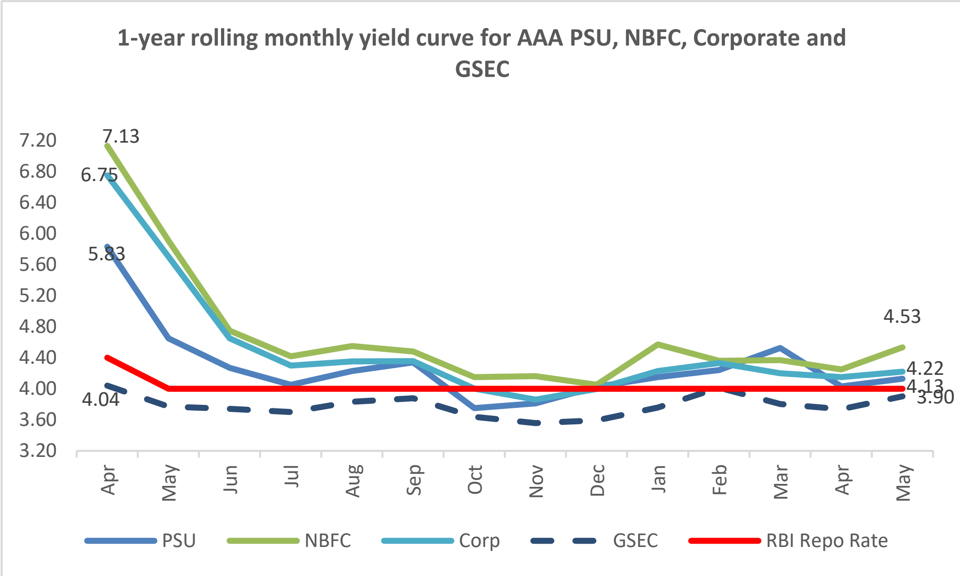
Source: FIMMDA, BWR Research



Source: FIMMDA, BWR Research

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

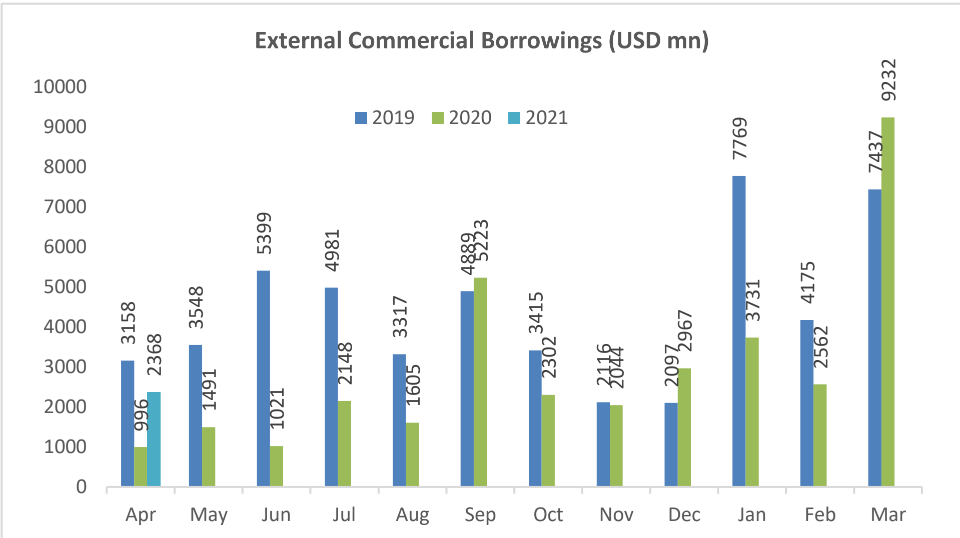
The borrowing costs for bonds maturing in one year issued by PSUs, NBFCs and corporates continued to soften in April by 52-148 bps, against the hardening of 13 bps in G-Sec yields in the corresponding period last year due to several measures taken by regulators to deepen the bond market. The key policy rate (repo rate) remained muted during the same period.



Source: FIMMDA, BWR Research

External Commercial Borrowings

According to RBI data, Indian corporates borrowed around USD 2.3 billion from offshore markets in the form of External Commercial Borrowings (ECBs) and Foreign Currency Convertible Bonds (FCCBs) during April 2020, compared to ~USD 1 billion during the same period last year.



Source: RBI, BWR Research

BWR Views

Indian companies' borrowing through ECBs, which had risen in March 2021 substantially through both automatic and approval routes on account of the increase in business activities and bulk deals by a few large corporates, was also accompanied with tightened borrowing credit standards. The RBI allowed to extend the period for parking the unutilised ECB proceeds drawn down on or before 1 March 2020 in the term deposit with Authorised Dealers with a view to provide relief to ECB borrowers impacted by Covid-19.

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