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Economy on the Move: Onwards and Upwards

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Economy on the Move: Onwards and Upwards

Steady decline in new cases and the progress achieved in vaccinating a sizeable proportion of the population have led to the relaxation of restrictions in most states. This has progressively revived both production activities and consumption demand. Pent up demand during the festival season is likely to improve demand conditions, further paving the way for improved capacity utilisation during the third quarter. The agricultural sector is also likely to post impressive growth in FY22 as the monsoon shortfall in the first three months has substantially been covered up in September and YTD in October 2021. Recovery seems to be broad-based, with the manufacturing PMI improving to 53.7 (from 52.3 in August) and services PMI at 55.2 (56.7 in August) in September. Better revenue collections have led the Union government to lift restrictions on public spending, and this is expected to increase both public consumption and investment demand in the third quarter. Aided by buoyant revenues, the government expects to contain the FY22 fiscal deficit at the budgeted level as well. With recovery in the developed world taking deeper roots, Indian exports too have shown a remarkable increase during the first five months of the current fiscal. During the April to September 2021 period, merchandise exports have registered 56.9% y-o-y growth and 23.8% as compared to FY19. The overall increase in the exports of both goods and services was 44% over FY20 and 15.8% over FY19, during the April to August period.

With improvements in both supply and demand conditions reinforced by pent up demand, the economy is likely to register impressive growth in the remaining part of the year. Not surprisingly, the Monetary Policy Committee (MPC) has maintained its earlier growth projection of 9.5% during the year, with the second, third and fourth quarters registering growth of 7.9%, 6.8% and 6.1% on the back of 20.1% growth registered in the first quarter. It has, however, reduced the inflation rate from the earlier estimate of 5.9% to 5.3%, mainly by reducing projected inflation in the second and third quarters from 5.9% and 5.3% to 5.1% and 4.5%, respectively. Of course, there are downside risks to growth from the possible third wave, but the progress in vaccination should help minimise disruptions. More important downside risks include the contagion from the financial problems in China triggered by the Evergrande crisis, global semiconductor shortage and power crisis in China triggering supply chain disruptions. Elevated commodity prices, particularly crude oil prices, pose an upside risk to inflation. With the revival of demand conditions and as capacity utilisation increases, excess liquidity in the economy too can pose dangers.

While growth revival looks real, it is still at a nascent stage, particularly in contact-intensive sectors, and needs to be nurtured. In this context, the RBI's decision to maintain the status quo in the repo and reverse repo rates, and continue with the

accommodative stance is appropriate. The MPC has also recognised the need to start mopping up liquidity as a large liquidity injection has led to short-term rates falling below the reverse repo rate. During the June-August period this year, the average daily surplus liquidity was Rs 7 lakh crore, surged to Rs 9 lakh crore during September and in the first six days of October, it increased further to Rs 9.5 lakh crore. The continuous flooding of liquidity poses inflation risk, and therefore, while continuing with the accommodative stance, the RBI has done well to signal the end to continued monetary easing by announcing the discontinuation of G-SAP operations and has also announced a proposal for fortnightly 14-day Variable Reverse Repo Rate (VRRR) auctions.

Despite the economy recording 20.1% growth in the Q1FY22, the level of GDP was 9.2% below the pre-pandemic level. More importantly, there was secular decline in the Gross Domestic Capital Formation, and GDP growth showed steady decline from 8.2% in Q4 FY19 to 3.1% in the Q4 FY20. Thus, the government's efforts are needed not merely to revive growth to pre-pandemic levels, but also to increase the medium-term growth trajectory, and this requires acceleration in the pace of reforms to remove structural rigidities and create favourable conditions for new investments and growth. In this context, the recent initiatives taken by the government are noteworthy. Initiatives to end the uncertainty on tax matters by rescinding retrospective taxation and asset monetisation are important. Similarly, reforms to address the telecom sector's grievances, including the exclusion of non-telecom revenue from the AGR, moratorium on dues and rationalisation of spectrum usage charges, will help create a healthy competitive telecom market environment. The consolidation of 29 Central labour laws into four codes will help ease rigidities in the labour market. The creation of National Asset Reconstruction Company Ltd (NARCL) and India Debt Resolution Company Limited (IDRCL) is expected to resolve the issue of the bad loans of public sector banks in a professional manner, relieving the burden on these banks.

The most important initiative is the privatisation of Air India, which has been lingering for long; this not only arrests the draining of taxpayers' money year after year, but also provides a clear signal that the government is serious about showing that its business is not only to be in business, but to provide a conducive and favourable environment for businesses to survive. Hopefully, the announcements made in the budget that two commercial banks will be privatised will be acted upon soon as also the promised disinvestments in insurance, Shipping Corporation of India, Bharat Petroleum Corporation Limited and other companies announced in the budget. These measures are necessary to reset the government's role such that its job is to govern, facilitate and regulate the market to prevent predatory competition, and not to compete with the market.

With this, hopefully, the economy will be on the move, onwards and upwards.

Annexure: Select Macro Economic and Sectoral Indicators

Indicators/ Sectors		2018-19	2019-20	2020-21	Jul-2020	Aug-2020	Sep-2020	Oct-2020	Nov-2020	Dec-2020	Jan-2021	Feb-2021	Mar-2021	Apr-2021	May-2021	Jun-2021	Jul-2021	Aug-2021	Sep-2021
Economy					FY21 Q2			FY21 Q3			FY21 Q4			FY22 Q1					
GDP at 2011-12 Prices	Y-o-Y in %	6.53	4.04	-7.25	-7.44			0.46			1.64			20.10			-	-	-
GVA at 2011-12 Prices	Y-o-Y in %	5.90	4.14	-6.16	-7.31			1.04			3.72			18.77			-	-	-
Agriculture	Y-o-Y in %	2.56	4.31	3.63	3.04			4.53			3.10			4.52			-	-	-
Industry	Y-o-Y in %	5.31	-1.23	-6.96	-2.99			2.91			7.93			46.15			-	-	-
Services	Y-o-Y in %	7.20	7.19	-8.36	-11.43			-1.21			1.50			11.42			-	-	-
Banking																			
Gross Bank Credit	Y-o-Y in %	13.29	6.80	5.00	6.90	6.00	5.80	5.50	5.96	5.88	5.77	6.56	5.00	5.70	6.00	5.80	6.50	6.70	6.70
Bank Credit to Industries	Y-o-Y in %	6.91	0.70	0.40	0.80	0.50	0.00	-1.70	-0.68	-1.22	-1.28	-0.24	0.40	0.40	0.80	-0.30	0.90	2.30	-
Deposit	Y-o-Y in %	10.04	7.90	11.40	12.10	10.90	10.00	10.10	11.30	11.40	11.00	11.00	11.40	10.30	9.70	10.30	10.70	9.50	9.30
Industry																			
Services PMI	Index	52.17	51.93	41.69	34.20	41.80	49.80	54.10	53.70	52.30	52.80	55.30	54.60	54.00	46.40	41.20	45.40	52.30	53.70
Manufacturing PMI	Index	52.77	52.33	50.20	46.00	52.00	56.20	58.90	56.30	56.40	57.70	57.50	55.40	55.50	50.80	48.10	55.30	56.70	55.20
IIP	Y-o-Y in %	3.80	-0.80	-8.40	-10.50	-7.10	1.00	4.50	-1.60	2.20	-0.60	-3.20	24.20	@	23.60	9.70	16.00	11.90	-
Manufacturing in IIP	Y-o-Y in %	3.90	-1.40	-9.60	-11.40	-7.60	0.40	4.50	-1.60	2.70	-0.90	-3.40	28.40	@	23.10	13.00	8.30	13.60	-
Consumer Durables	Y-o-Y in %	5.50	-8.70	-15.20	-23.70	-10.20	5.30	18.10	-3.20	6.50	-0.20	6.60	54.90	@	80.40	27.90	19.40	8.00	-
Consumer Non-Durables	Y-o-Y in %	4.00	-0.10	-2.00	1.80	-3.00	2.40	7.30	-0.70	1.90	-5.40	-4.50	27.50	@	0.20	-4.30	-2.10	5.20	-
Eight Core Industries	Y-o-Y in %	4.37	0.36	-6.39	-7.60	-6.90	0.56	-0.52	-1.13	0.42	1.29	-3.28	12.58	@	16.44	9.34	9.94	11.56	-
Auto Sales	Y-o-Y in %	5.10	-17.95	-14.64	-19.10	-1.70	6.70	10.61	4.00	2.78	2.77	5.61	68.82	@	97.31	26.78	17.47	-3.58	-
Passenger Vehicles	Y-o-Y in %	2.70	-17.82	-10.35	-9.00	9.80	21.80	8.80	0.40	7.30	5.20	11.90	106.70	@	162.70	119.30	44.70	7.60	-
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	-17.40	0.10	8.40	14.00	10.70	4.20	3.90	8.80	70.90	@	25.50	4.00	-1.70	-13.90	-
Power Generation	Y-o-Y in %	3.60	-0.16	-1.17	-1.00	-3.00	4.00	9.00	2.00	5.00	5.00	0.04	23.43	43.00	8.00	6.43	7.16	17.50	-
Steel Consumption	Y-o-Y in %	8.80	0.72	-6.42	-10.43	-8.69	1.78	5.95	15.65	14.14	13.40	21.47	34.26	@	69.76	28.39	4.80	-4.23	-4.67
Cement Consumption	Y-o-Y in %	13.80	0.00	-13.00	-14.00	-15.10	-3.80	3.40	-7.30	-9.70	-8.30	-6.40	28.60	@	4.80	7.80	22.50	-	-
Sugar Production	Y-o-Y in %	17.44	-19.25	15.59	-39.20	-23.08	-8.95	158.76	103.14	11.58	7.83	2.72	6.68	-4.22	-43.85	-67.99	98.16	-	-
Domestic Passengers carried by Airlines	Y-o-Y in %	13.70	0.71	-62.24	-82.00	-76.00	-66.00	-57.00	-51.00	-44.00	-39.00	-37.00	0.77	@	@	56.91	137.64	136.62	-
External Sector																			
Exports	USD Bn	290.35	313.36	290.18	23.78	22.84	27.56	24.92	23.57	27.22	27.52	27.61	34.71	30.75	32.29	32.49	35.50	33.39	33.42
Imports	USD Bn	393.03	474.71	388.92	29.06	31.03	30.52	34.07	33.81	42.94	41.95	40.54	48.41	46.03	38.82	42.06	46.00	45.05	56.34
Exchange Rate (Average)	INR/USD	69.48	75.39	74.20	74.99	74.67	73.47	73.46	74.22	73.59	73.10	72.76	72.79	74.54	73.27	73.56	74.53	74.18	73.56
Crude Oil (Average)	USD/barrel	69.88	60.47	44.60	43.35	44.19	41.35	40.66	43.34	49.84	54.79	61.22	64.73	63.40	66.95	71.98	73.54	69.80	73.13
Forex Reserves	USD Bn	412.87	477.81	579.29	534.63	541.43	545.64	560.72	574.82	585.32	590.19	583.87	579.29	588.00	598.17	609.00	620.58	633.56	638.65
Inflation																			
CPI	Y-o-Y in %	3.41	4.77	6.16	6.73	6.69	7.27	7.61	6.93	4.59	4.06	5.03	5.52	4.23	6.30	6.26	5.59	5.30	4.35
Food	Y-o-Y in %	0.14	6.71	7.70	9.27	9.05	10.68	11.00	9.50	3.41	1.96	3.87	4.87	1.96	5.01	5.59	3.96	3.11	0.70
Core	Y-o-Y in %	5.60	3.80	5.51	5.44	5.62	5.46	5.65	5.85	5.68	5.72	5.59	5.76	5.17	6.34	6.30	6.02	5.89	5.85
WPI	Y-o-Y in %	4.26	1.67	1.20	-0.58	0.41	1.32	1.48	1.55	1.95	2.51	4.83	7.89	10.74	13.11	12.07	11.16	11.39	
Food	Y-o-Y in %	0.58	6.88	3.91	4.32	4.75	6.92	5.78	4.27	1.11	-0.26	3.58	5.63	7.52	8.25	6.72	4.46	3.43	
Manufactured Products	Y-o-Y in %	3.60	0.34	2.70	0.59	1.36	1.87	2.21	3.23	4.49	5.47	6.06	7.84	9.44	11.25	10.96	11.20	11.39	
Interest Rates (in %)																			
Repo	Effective Rate	6.25	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	4.00	4.00	4.00
10-year Benchmark	Average Rate	7.47	6.80	6.40	5.90	6.10	6.11	6.04	5.90	5.98	6.00	6.30	6.40	6.37	6.31	6.37	6.33	6.40	6.30
10- year AAA Corporate Bond	Average Rate	8.55	7.60	6.90	6.60	6.90	6.88	6.61	6.69	5.98	6.70	7.20	6.90	6.85	6.83	6.83	6.89	6.90	6.80
5- year Benchmark	Average Rate	7.07	6.20	6.10	5.10	5.40	5.57	5.40	5.34	5.30	5.40	5.80	6.10	5.96	5.68	5.77	5.89	5.90	5.80
5- year AAA Corporate Bond	Average Rate	8.19	7.30	6.10	5.70	5.90	6.10	5.60	5.59	5.79	5.80	6.40	6.10	6.00	5.90	5.90	5.88	5.80	5.90
MCLR of SBI (1 year)	Average Rate	8.55	7.80	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00
Call Money	Average Rate	6.21	4.90	3.20	3.50	3.40	3.41	3.33	3.15	3.16	3.20	3.20	3.20	3.21	3.21	3.14	3.17	3.20	3.20

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.
Source: MOSPI, RBI, eaindustry.nic.in, IHSMarkits.com, SBI, CMIE, FIMMDA, BWR Research

MACRO-ECONOMIC INDICATORS

BWR Views

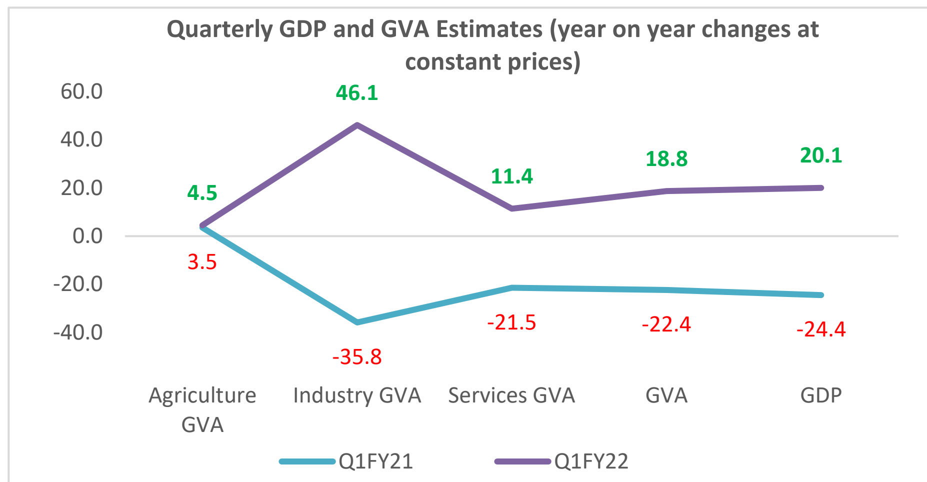
The revival of the economy will continue at a faster pace in the coming quarters, and even if there is a third wave, the disruptions are not likely to be as severe due to the progress in vaccination and the resilience the economy has gained after having experienced the first two waves of the pandemic.

With improvements in both supply and demand conditions reinforced by pent up demand, the economy is likely to register impressive growth in the remaining part of the year.

We continue to maintain our GDP projection made in July at 9% for FY22 with an upward bias.

GDP Trends: Growth revival looks real, but it is still at a nascent stage

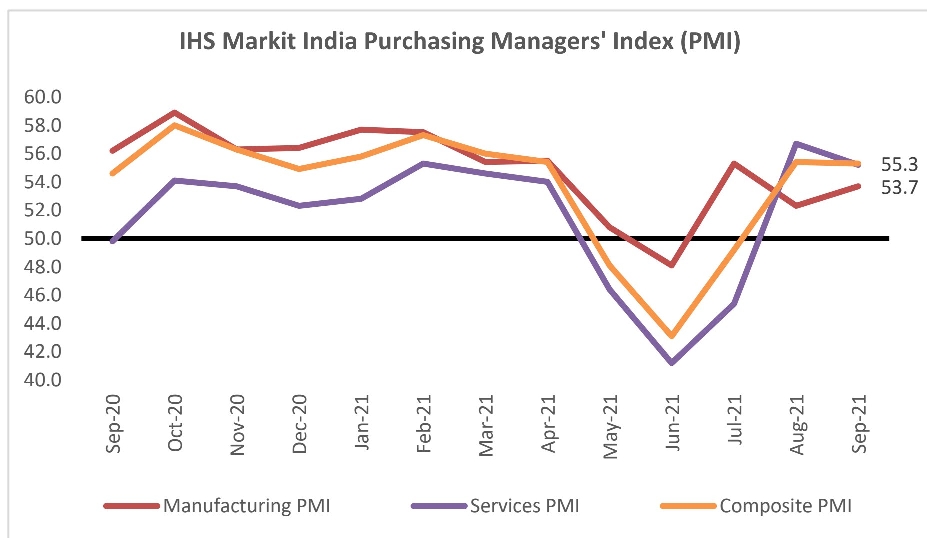
The GDP growth estimates for Q1FY22 by the Ministry of Statistics and Programme Implementation (MOSPI) at 20.1% are impressive, but this is largely based on a record 24.4% contraction in the GDP in Q1FY21. Sharp turnarounds in growth in the GVA in manufacturing at 49.6% and in construction at 68.3% show a significant revival in these sectors and their resilience in withstanding the restrictions posed by the second wave of the pandemic. The service sector still needs to pick-up significantly as it recorded only 11.4% growth in Q1FY22.



Source: MOSPI, BWR Research

Recovery seems to be broad-based, reflects in PMI indices

Strengthening demand conditions amid the easing of COVID-19 restrictions, business activity in the private sector rose further in September, as both manufacturing and services output continued to expand. The composite PMI averaged 53.3 in Q2 compared to 48.9 in Q1. The revival in economic activities also reflected in the recent data on the IIP in July (11.5%) and eight core industries in August (11.6%), both reporting increases in production on a year-on-year basis.



Source: IHS Markit, BWR Research

BWR Views

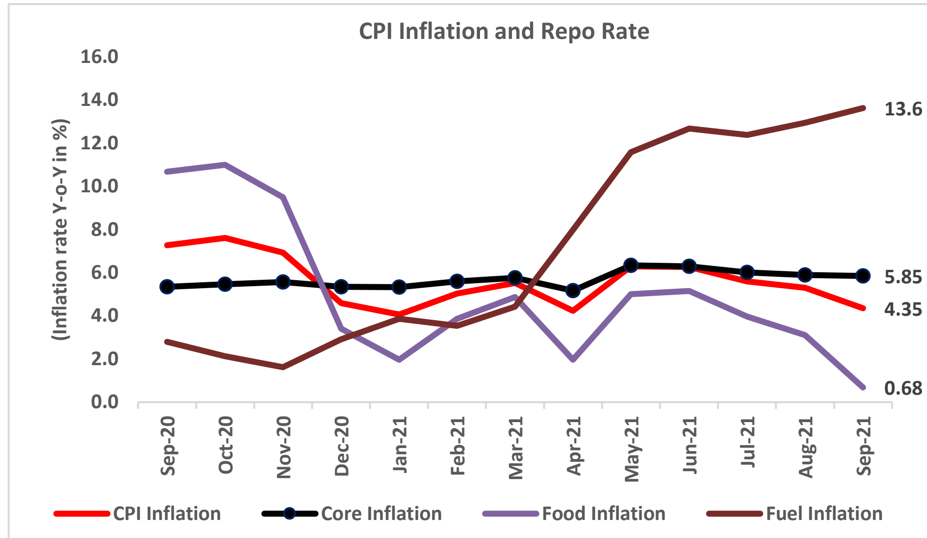
With good rainfall coverage, coupled with increased relaxations in restrictions to ease supply-side constraints, the inflation rate is likely to soften. However, edible oil prices and some important input prices, such as that of steel, will pose some risks. Elevated commodity prices, particularly crude oil prices, also pose an upside risk to inflation. With the revival of demand conditions and as capacity utilisation increases, excess liquidity in the economy too can pose dangers. Medium-term prospects depend on the behaviour of international commodity prices, although better capacity utilisation due to lower restrictions help keep the inflation rate within the target band for the whole financial year. We do not expect any possibility of an immediate policy reversal in the near future. The RBI is likely to hold the rates lower at the current levels and continue with the accommodative stance until growth recovers.

BWR Views

Oil producers' (OPEC+ grouping nations) decision to not to increase supply despite growing demand is expected to keep crude oil prices higher. Coal shortage is expected to lead to power shortage, which may further increase demand for fuel prices. We expect crude oil prices to reach USD 85/ barrel in the coming days.

Inflation: Likely to remain below 6% in the remaining fiscal

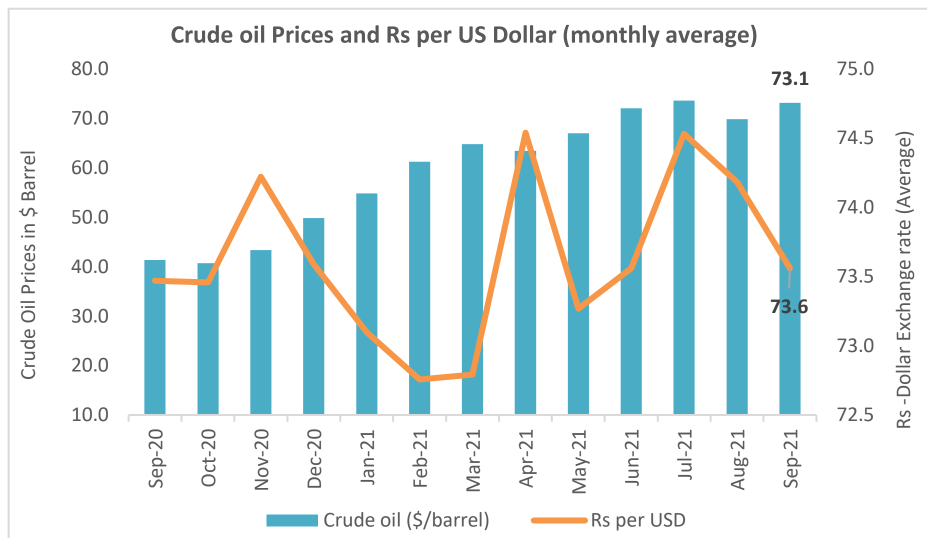
The RBI again reduced the inflation rate outlook from the earlier estimate of 5.9% to 5.3% for FY22, mainly by reducing projected inflation in the second and third quarters from 5.9% and 5.3% to 5.1% and 4.5%, respectively. The CPI inflation eased notably in September to 4.35%, as food inflation softened to 0.68%. Fuel inflation continues to remain higher due to higher international crude oil prices.



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

Crude oil prices to increase further

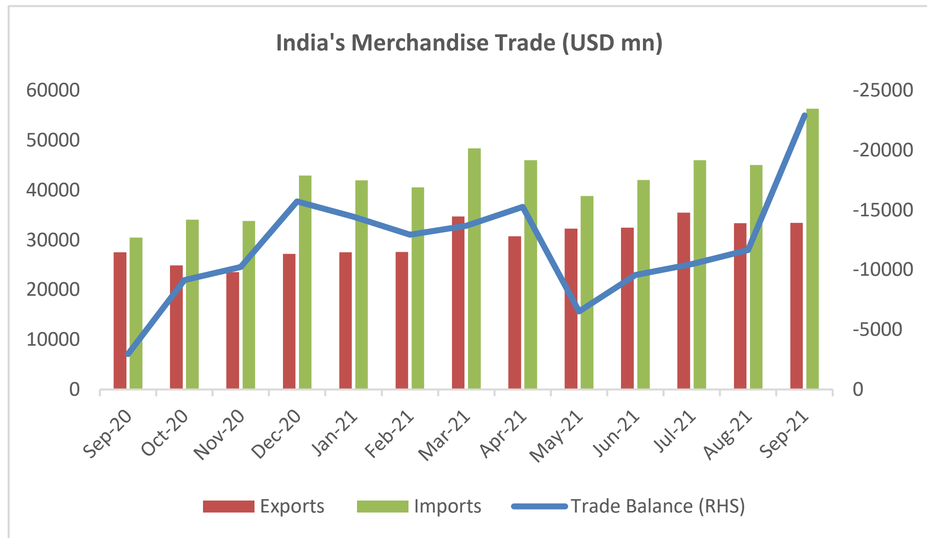
With the world economy recovering faster from Covid-19, global demand for crude oil has increased sharply, resulting in a sharp rise in prices. In September, the average oil prices increased by USD 3.3/barrel from those in August. The Indian rupee continued to appreciate despite muted Foreign Portfolio Investor (FPI) investments into the Indian markets. After investing a record USD 1,635 million in August, FPIs turned net sellers in Indian debt markets in September and sold USD 35 million, but continue to invest through debt VRR.



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

Merchandise Trade: Recovery in the developed world helping exports

Merchandise exports recorded 56.9% growth during the April-September period this year, much higher than 27% growth in the corresponding period last year. Exports during April-September 2021 are up from their 2019 levels by 23.8%. Imports too reported an 82.4% surge on a y-o-y basis during April to September 2021; however, they are up by just 11.2% from the corresponding period in 2019.



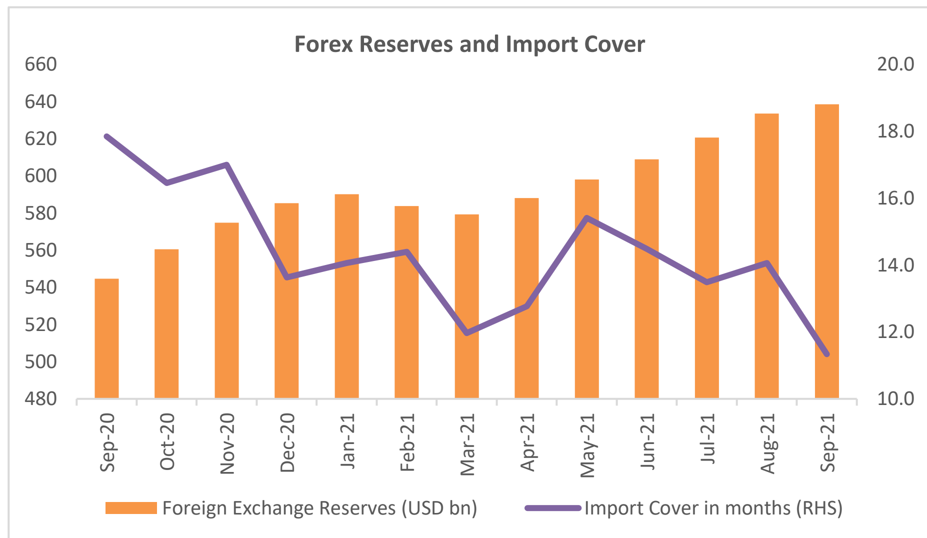
Note: Preliminary data for September 2021, data is provisional.
Source: Ministry of Commerce, BWR Research

BWR Views

With recovery in the developed world taking deeper roots, Indian exports too have shown a remarkable increase during the first five months of the current fiscal. To maintain this trend, it is necessary to ensure a realistic exchange rate and activate trade agreements with Europe and market access with the US. There is a need for a holistic review of the trade policy to drive the economy into export-led growth.

Rising forex reserves provide cushion for external shocks

The allocation of 12.57 billion Special Drawing Rights (SDRs), equivalent to USD17.86 billion, on 23 August by the IMF, reflected in India's foreign exchange reserves swelling to USD 637.48 billion as on 1 October 2021, rising by around USD 94 billion compared to September 2020 levels. The current level of forex reserves is sufficient to cover more than 11 months of imports, which provides a cushion for external shocks such as a surge in crude oil prices and reversal in FPI inflows.



Source: Ministry of Commerce, RBI, BWR Research

BWR Views

Intermittent fluctuations in FPI flows into domestic markets may lead to volatility in the domestic currency, while abundant forex reserves provide much-needed comfort to deal with such uncertainties.

With the government's decision to put an end to the retrospective tax clause by amending the Income Tax Act, 1961, the possibility of foreign investment flows to the country seems to be high in the long run.

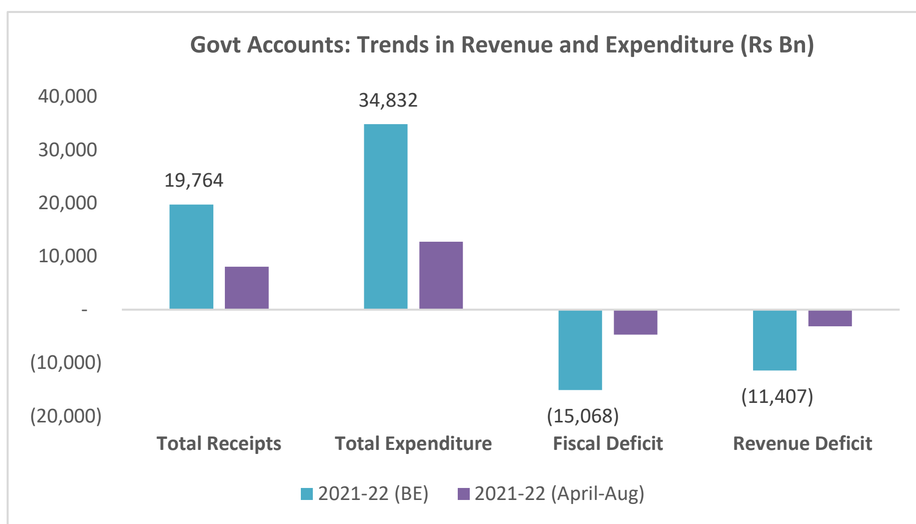
Government Finances: Better revenue collections to lift restrictions on public spending

BWR Views

GVA growth in public administration, defence and other services remained muted, at 5.8% in Q1FY22. This reflects that the government has been far too cautious in increasing its expenditures to contain the fiscal deficit.

Better revenue collections have led the union government to lift restrictions on public spending, reflected in rising government expenditure. This would increase both public consumption and investment demand in the third quarter. Aided by buoyant revenues, the government expects to contain the fiscal deficit target of 6.8% of the GDP for FY22 as well.

As per the latest data (provisional), the central government was able to collect 40.9% of the budgeted receipts during April-August 2021 and spent 36.6% of the targeted budgeted expenditure. There was a marked improvement in spending in August; government borrowing has also increased and stood at about 31% of the budget estimates of FY22.



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

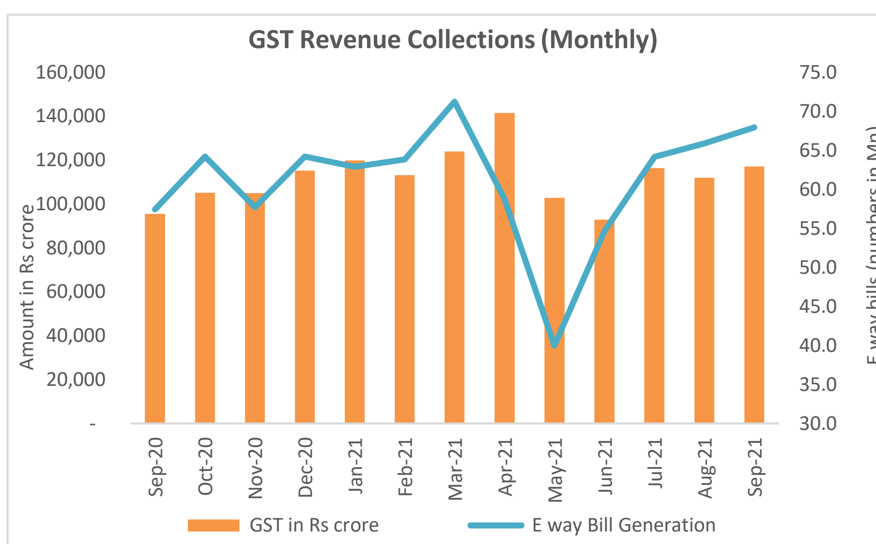
Goods and Services Tax (GST): Monthly collections depict sustained recovery in economic activities

BWR Views

With the relaxation in lockdown restrictions, trade and business activity are likely to recover, and tax collections are expected to improve gradually in the coming months.

The better enforcement of the technology platform already helped improve GST collections, and pent-up demand ahead of the festive season may lead to higher tax collections in the coming months.

The GST monthly collections continued to remain above the Rs 1 lakh crore mark in September, amounting to Rs 1.17 lakh crore. GST monthly collections in the first half of FY22 have seen a 50% increase over the corresponding period the previous year.



Note: GST collection from domestic transactions between 5 June to 5 July 2021 included in June 2021.
Source: Ministry of Finance, BWR Research

BWR Views

Resolution 2.0's support in stabilising entities impacted by the continued effects of pandemic while there is a movement in the underlying asset quality over the medium term will be a monitorable in the books of lending intermediaries. The credit flow for August 2021 was marginally slower than that of the previous month, but was better on a y-o-y basis. The Account Aggregator system will enable improving the much needed credit flow based on the borrower's past track record, especially in the SME segment, with less reliance on the collateral. While the advances to industry continue to grow slowly, the measures of vaccination and unlocking of services will surely assist in its revival with supportive measures from the regulator for this segment as well. The business community seems to have geared up, accepted the pandemic situation and resumed their business activities despite the ongoing pandemic scenario. Considering existing asset quality levels, a likely increase is expected over the medium term; however, the eligibility of overseas funds inclusion in Additional Tier 1 bonds may assist in strengthening the capital base of banks required for enhancing banks' credit growth, while monitoring the asset quality. BWR views that maintaining healthy capitalisation levels shall assist banks in enhancing their appetite for credit risk.

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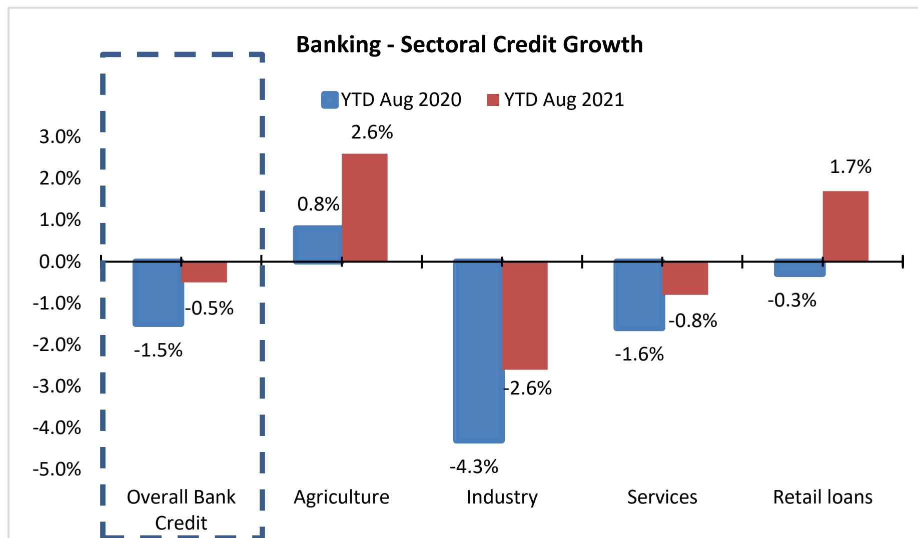
Hemant Sagare
(Associate Director - Ratings)

SECTORAL INDICATORS

Banking: *Credit growth to pick up as business activity resumes in full swing*

The personal loan segment saw a credit uptake of 12.1% in August 2021 over 8.5% a year ago, mainly from faster credit growth in housing, vehicle loans and loans against gold jewellery. The overall credit growth moderated to 3.5% in August 2021 from 10.9% in August 2020, mainly due to a contraction in credit growth in NBFCs and commercial real estate.



Source: RBI, BWR Research

The Government of India (GOI) and the Reserve Bank of India (RBI) are continuing with their series of measures to reduce the covid-19 impact on the economy, especially after the second wave of the pandemic. The RBI's Resolution Framework 2.0 for the resolution of COVID-19-related stress, with an objective to alleviate the potential stress to individual borrowers and small businesses, also helped. While the recovery process is underway, the following new risks have emerged, though at a nascent stage: international commodity prices and inflationary pressures, global spill-overs amid high uncertainty and rising incidence of data breaches and cyber-attacks. Accordingly, sustained policy support, accompanied by the further fortification of capital and liquidity buffers by financial entities remains vital. Stronger capital positions, good governance and efficiency in financial intermediation can be the touchstones of this endeavour so that the financing needs of the productive sectors of the economy are met, while the integrity and soundness of banks and financial institutions are secured on an enduring basis. On the benefit front of the pandemic, it has led to technology innovation and implementation. Fintech companies have played an important role in increasing credit penetration through the use of technology, and the increasing usage of online banking shall ensure better transparency in the country's financial system.

The regulator has provided banks with a clarification on the amount of capital funds that can be raised overseas for inclusion in raising Additional Tier I Bonds considered under perpetual debt instruments. Banks can raise up to 49% of the 1.5% of the risk weighted assets that can be issued in foreign currency and/or in rupee-denominated bonds overseas. Such issuances shall be subject to all applicable prudential norms and FEMA guidelines.

Automobiles

Improvement in vehicle sales halted due to component shortage

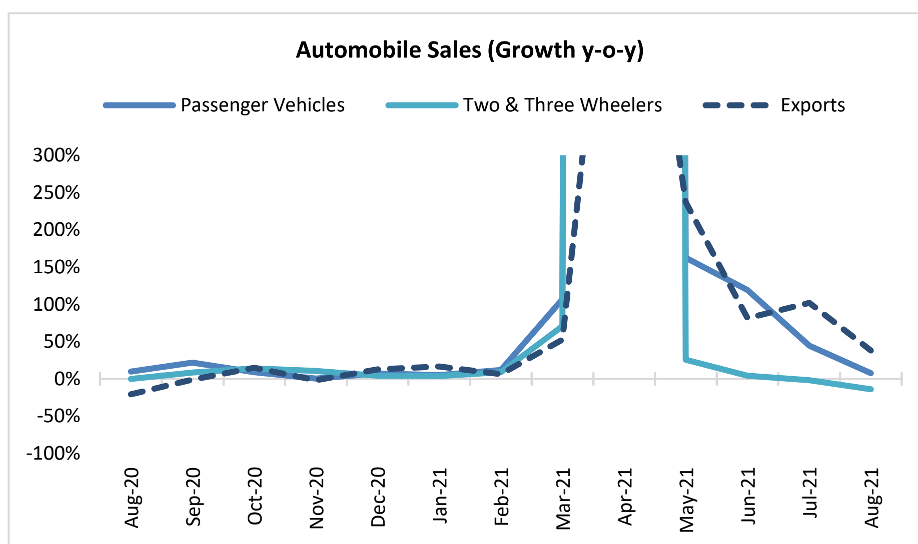
BWR Views

In line with the global trend and persisting semiconductor chip shortage, the Indian automotive industry is not likely to achieve optimum capacity utilisation in the short to medium term. While demand for new models remains strong, supply headwinds are leading to longer waiting periods for customers and impacting overall volume growth. In this backdrop, the used car market will witness a higher growth trajectory. Meanwhile, the policy thrust towards Electric Vehicle (EV) penetration would necessitate investments for OEMs in order to remain competitive and relevant in the medium to long term.

Tanu Sharma
(Director - Ratings)

Shivam Bhasin
(Sr Ratings Analyst)

Overall automobile sales have witnessed good signs of recovery, with an improvement in September 2021 (on m-o-m basis) volumes. The recovery is helped by pent up demand, a preference for personal mobility, model launches and the streamlined production schedules of Original Equipment Manufacturers (OEMs).



Source: CMIE, BWR Research

Passenger Vehicle (PV) sales volumes in September 2021 decreased m-o-m due to chip shortage, which is hampering the production schedules of OEMs, leading to a long waiting period for vehicle ownership. PV sales volumes were also lower on a y-o-y basis, reflecting supply-side headwinds despite festive demand. Two wheeler (2W) sales in September 2021 have increased m-o-m due to a surge in personal mobility, good monsoons in several parts of the country and the onset of festival spirit in the country. Commercial Vehicle (CV) sales volumes in September 2021 improved m-o-m due to an improvement in tractor sales on account of good monsoons and strong rabi sowing, as well as an improvement in the other segments of CV due to improved economic activities in various sectors such as e-commerce, construction/infrastructure and manufacturing.

Telecom

Reforms a breather for the telecom sector

BWR Views

While the reforms are definitely a step in the right direction, the woes of the sector will be resolved only if there is an increase in the tariffs as well. Unless the ARPUs move closer to Rs. 200 levels, it will be difficult for telcos to generate meaningful returns.

Vipula Sharma
(Director - Ratings)

Aakriti Sharma
(Manager - Ratings)

The telecom sector got a major boost in the form of the relief package announced by the government. The biggest relief has come in, in the form of redefining the AGR, which will now exclude all non-telecom revenue, and extending a moratorium of 4 years on the government dues. This will immediately ease the stress on telcos' cash flows to a great extent, especially for Vodafone Idea Ltd (VIL). Telcos were to pay the first instalment of AGR dues in March 2022, and spectrum payments were also supposed to start April 2022 onwards. The moratorium will help companies in conserving liquidity, which in turn can be used for debt repayments and capex

requirements. Telcos, however, will have to pay an interest of MCLR+2% during the moratorium period.

In addition, measures such as the abolishment of penalties on license fees and spectrum usage charges, annual compounding of interest rates in place of monthly compounding and rationalising the interest rates to MCLR+2% on these dues, increasing the spectrum payments tenure to 30 years (from 20 years) and the option to surrender additional spectrum after a lock-in period of 10 years will improve the viability of the sector.

Power

Power sector staring at a coal shortage crisis

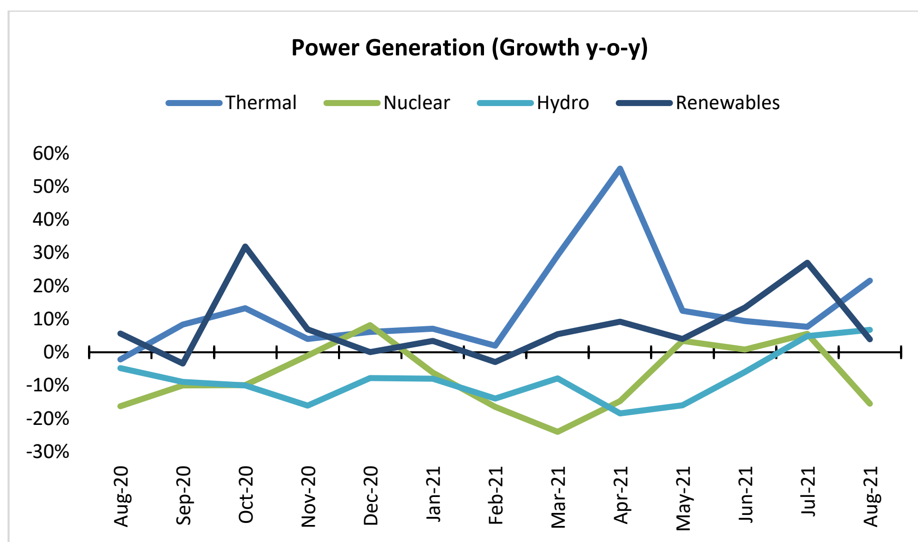
The power sector in India is facing a peculiar situation with continuously increasing power demand on the one hand and supply shortages on the other. This is in sharp contrast with the government's vision to provide 24*7 electricity access to consumers. A major share of India's power demand is still met by coal-fired power plants, and with coal supply drying up in the country, India is set to face major challenges in providing electricity to households and industrial/commercial consumers.

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.

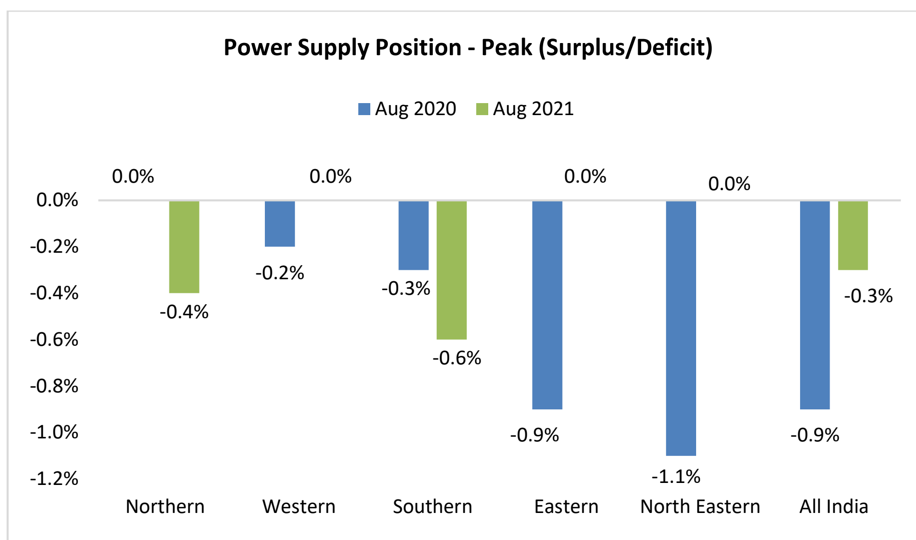
Vipula Sharma
(Director - Ratings)

Aakriti Sharma
(Manager - Ratings)



Source: Central Electricity Authority, BWR Research

At the same time, the prices of imported coal are on a rising trend that is set to make the short term cost of power even more expensive for discoms and will further add to their liquidity constraints. The revival of stranded gas-based power plants is critical to take care of such situations in future as a huge generation capacity is currently lying unused, which could have helped meet the current supply shortfall.



Source: Central Electricity Authority, BWR Research

Steel

While demand outlook remains strong, higher input costs will cap realisations

Raw material and other major costs for steel production have been seeing turbulent times. While iron ore prices, which had earlier skyrocketed, continue to tumble due to Chinese production cuts and higher supplies, of late, coal prices and freight costs are rising. While earlier, iron ore prices played the spoilt sport, now it seems that it is the turn of coal prices and freight costs to do so.

Iron ore prices have fallen from USD 130 to USD108 in the past 2 months largely due to the shutdown of many steel companies in China. Iron Ore peaked in July 2021 at USD 155 and started falling thereafter. Australian iron ore miners were hit owing to the Evergrande crisis in China; however, Australia expects iron ore prices to peak at USD 150 in 2021.

On the other hand, coking coal prices continued their northward journey. The prices hovered around US $ 235 per tonne on 1 October 2021 after reaching a peak of US $ 265 per tonne, as against US $ 100 per tonne in April 2021. Besides the prices, coal supply continues to remain a big hurdle as no new mining was done due to the pandemic. With strong demand and supply-side constraints, the prices are expected to remain high.

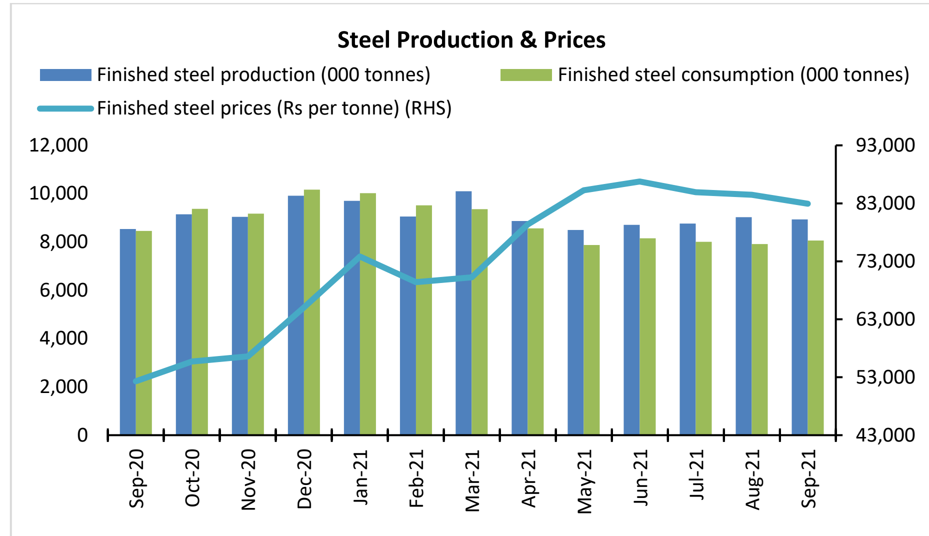
On the freight front, the Baltic dry index has crossed the 10000 mark and has risen to 2008 levels. Currently, the containers sailing between Asia and the US are down by 40% due to lower availability, rising costs and labour issues.

BWR Views

In BWR's opinion, with monsoons withdrawal, steel demand will continue to remain high, but higher costs will lead to a lower realisation for the industry. While steel prices may show a marginal declining trend, the Indian steel outlook remains positive in the short and medium terms, factoring in buoyant demand in the ensuing busy season and market forces determining prices, which are cyclical in nature.

Bal Krishna Piparaiya
(Principal Director - Ratings)

Forum Parekh
(Manager – Ratings)



Source: CMIE, BWR Research

India produced around 111 million tonnes (mt) in FY19, around 140 mt in FY20 and about 146 mt in FY21, clocking only 4% y-o-y growth. However, factoring the pandemic impact and supply-side constraints, the volume growth is impressive. Production is expected to increase to around 280 mt by FY31. The Indian industry has started brownfield expansions and the acquisition of closed steel plants, and is trying to increase production to benefit from higher demand and prices globally.

Steel prices continue to remain steady due to higher demand and tight availability. However, the rising costs are expected to lead to lower realisations to steel producers than in the past quarter. Indian companies are, therefore, preferring higher exports on account of better realisations than domestic. However, despite better global steel prices, increased export costs are squeezing margins. With no new steel capacities coming up in the medium term, the Chinese action is catalyzing to support steel prices.

Cement

BWR Views

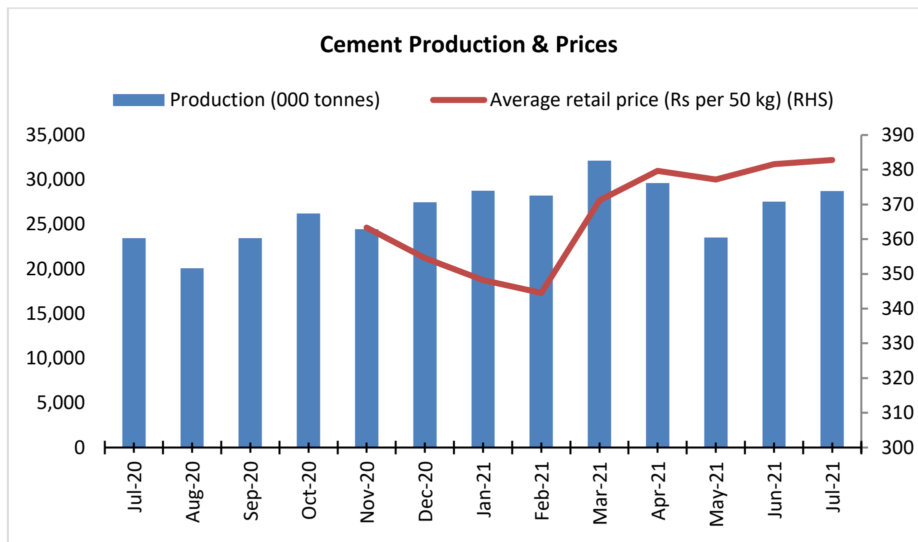
Cement demand is expected to grow steadily at over 10% y-o-y in the current fiscal, driven by a steady recovery from the pandemic impact, ramp-up in COVID-19 vaccination and the faster government spending on infrastructure and housing segments.

Vidya Shankar
(Principal Director - Ratings)

Naveen S
(Manager – Ratings)

Strong demand recovery to be led by increased infrastructure spending

Continued government focus on infrastructure and affordable housing segments has been resulting in healthy growth momentum. Additionally, the deficit rainfall in the month provided an extended window for construction activities, which aided cement demand growth.



Source: CMIE, BWR Research

The cement sector is reeling under cost pressures on account of the rising crude oil and coal prices. Despite many cement companies switching to alternative greener fuels to save costs, the majority of the sector's power and fuel costs are vulnerable to fluctuations in coal and road freight costs. Therefore, recent hikes in crude oil and coal prices resulted in margin compression during H1FY22. Cement manufacturers have been trying to raise prices to protect margins, in view of the steep cost inflation. However, recent price hikes that had to be rolled back since the recovery in terms of business volumes are not strong enough in many regions, despite pent up demand. Going forward, switching to renewable energy sources such as solar energy, wind energy and the Waste Heat Recovery System (WHRS) are likely to help operating margins to an extent. The government also intends to expand facilities for handling and storage to ease the transportation of cement and reduce transportation costs.

Sugar

Sugar production to remain flat in SS 2021-22

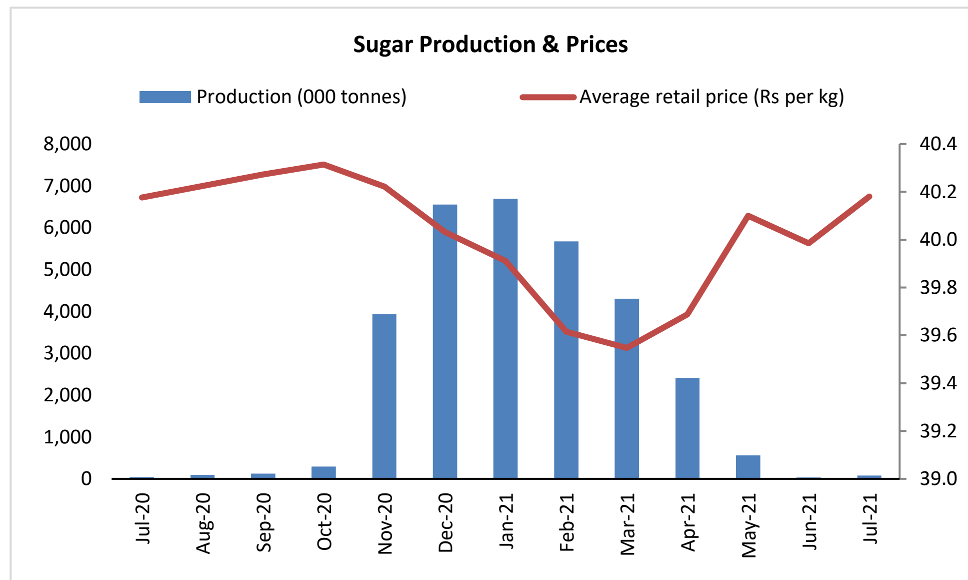
BWR Views

The total availability of sugar in SS 2021-22 is expected to be ~39.5 mt, including the opening stock of ~8.5 mt. Domestic consumption is estimated at 26.5 mt, and exports are estimated at 6 mt. The closing stock would be ~7 mt at the end of this SS. With the largest area under cultivation because of satisfactory rainfall in the past 3 years, Maharashtra is expected to replace Uttar Pradesh as the largest sugar producer in India. Sugar production in Maharashtra is estimated to be 11.2 mt, with Uttar Pradesh trailing behind at 11.1 mt.

Saakshi Kanwar
(Sr Manager - Ratings)

Swarn Saurabh
(Sr Ratings Analyst)

In Sugar Season (SS) 2021-22, 3.5 Million Tonnes (mt) of sugar is expected to be diverted for ethanol production. Around 6 mt of surplus sugar is targeted to be diverted for ethanol production by 2025 to achieve mandatory 20% blending The blending level has been expected to be at ~8.5% and ~10% in 2020-21 and 2021-22, respectively. To incentivise the diversion of excess sugarcane to ethanol, the Ministry of Consumer Affairs, Food and Public Distribution has announced that sugar mills diverting sugar towards ethanol production would be getting the entire sugar quantity sacrificed on producing ethanol in their monthly release quota.



Source: CMIE, ISMA, BWR Research

Additionally, India's sugar export rose 20% to an all-time high of 7.1 mt in SS 2020-21 on the back of better demand and financial assistance from the government. The exports were at 5.9 mt in SS 2019-20. Sugar production is estimated to remain flat at 31 mt in SS 2021-22, as the diversion of sugarcane juice and B-Heavy molasses is expected to increase.

DEBT MARKET INDICATORS

Movements in Bond Yields

BWR Views

Backed by aggressive strategic moves by the RBI to support liquidity, encourage the two-way movements of yields and assist in the orderly evolution of the yield curve, the 10-year G-Sec yield moved northward to 6.32%. In BWR's opinion, in spite of the RBI's balancing act, yields are expected to maintain a hardening trend, and the 10-year gilt yield is expected to remain at around 6.25% in the short run. The same may rise in the latter part of H2 2022, touching 6.5% owing to augmented government borrowings.

Bal Krishna Piparaiya
(Principal Director - Ratings)

Bond yields move north

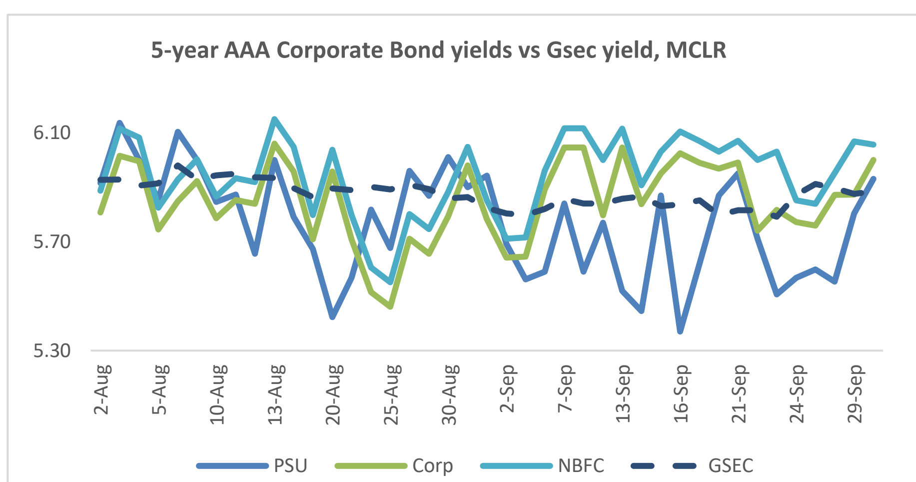
In spite of the unchanged policy rate and continuance of the accommodative stance in the RBI's monetary policy on 8 October, and the increasing liquidity surplus, bond yields spiked, and the 10-year gilt hardened by 5 bps. The announcement of halting G-Sap auctions (with the intention of conducting need-based G-Sap auctions and other strategic moves such as OMOs and operation twits) and increasing the quantum of 14 days VRRR auctions was aimed at managing surplus liquidity and short-term interest rates.

In its earlier issues, BWR had opined that the RBI's strategic moves and balancing acts will restrict the hardening of yields for some more time, wherein the 10-year gilt yield is expected to move sideways around 6.25% and is expected to rise in the latter part of H2 2022, touching 6.5%, owing to augmented government borrowings.

In line with the expectations, m-o-m, the 10-year gilt edged securities hardened by 12 bps, and traded and closed at 6.32% YTM on 8 October 202. The upshift in the yield curve was across all the maturities barring an exception in a few maturities, and the 30-year yields spiked by 8 bps and closed at 7.052%. The short-term yields for 3 and 6 months, and 1 year hardened by 15-20 bps, and 3 to 5 years by about 15-20 bps. There has been a near parallel upshift in the yield curve up to 10 years, barring a few exceptions.

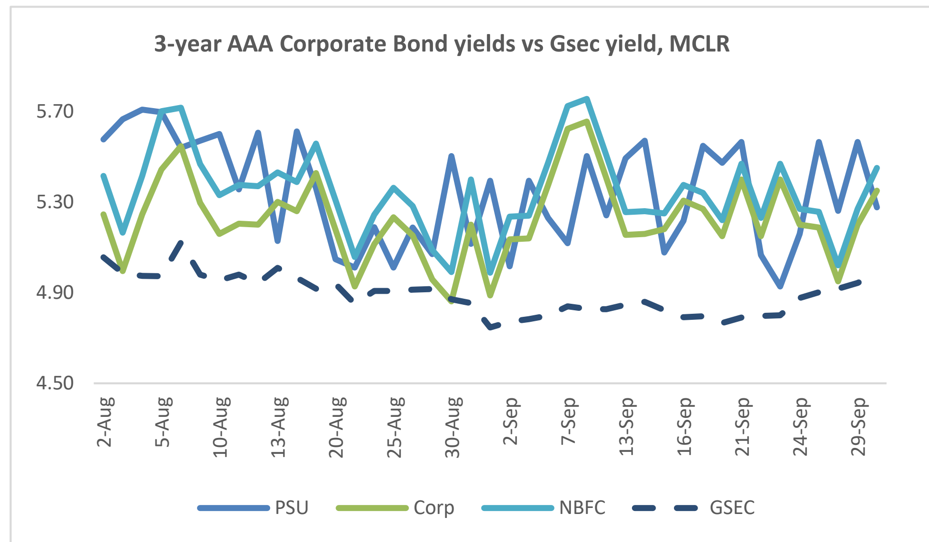
The 10-year gilt yields were at 6.32 (6.19)%, 3-month at 3.46 (3.31)%, 6-month at 3.60 (3.40)%, 1-year at 4.066 (3.90)%, 2-year at 4.71 (4.50)%, 3-year at 4.99(4.86)%, 4-year at 5.36 (5.25)%, 5-year at 5.80 (5.63)% and 30-year at 7.052 (6.98)% as of the EOD on 8 October 2021 (13 September 2021). Corporate 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 5-, 3- and 1-year tenures with corresponding government securities are provided below.

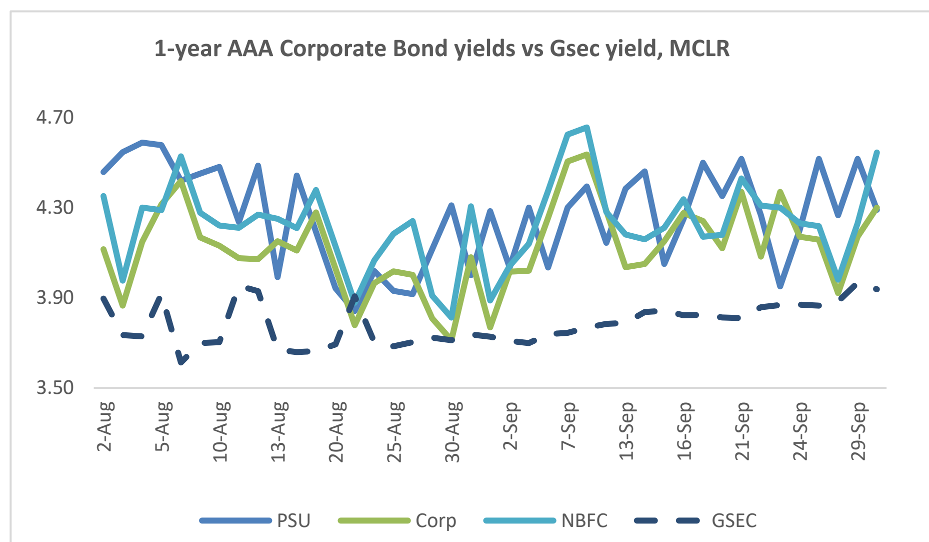


Source: FIMMDA, BWR Research

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



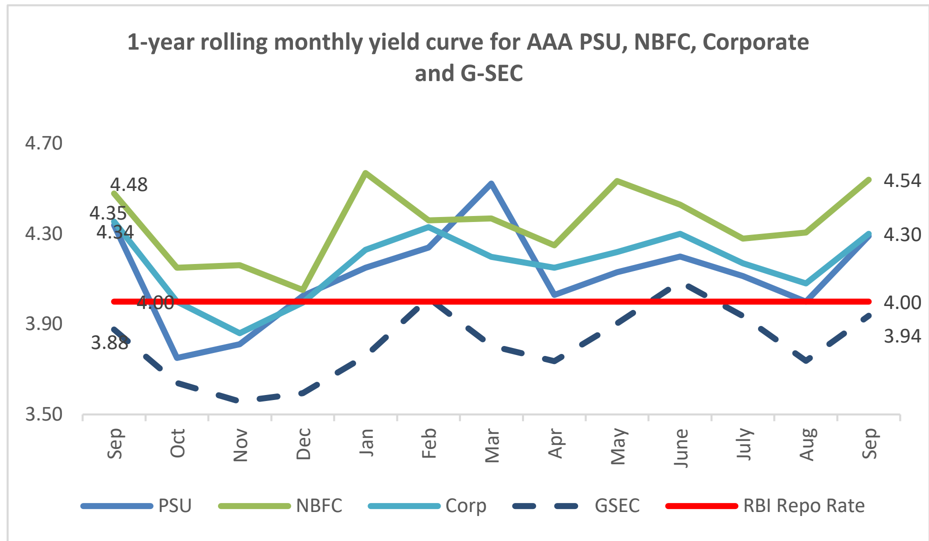
Source: FIMMDA, BWR Research



Source: FIMMDA, BWR Research

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

The borrowing costs for bonds maturing in 1 year issued by PSUs, NBFCs and corporates barely witnessed some movement in the range of 5-6 bps in September, in-line with the silent G-Sec yields (6bps) against 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.



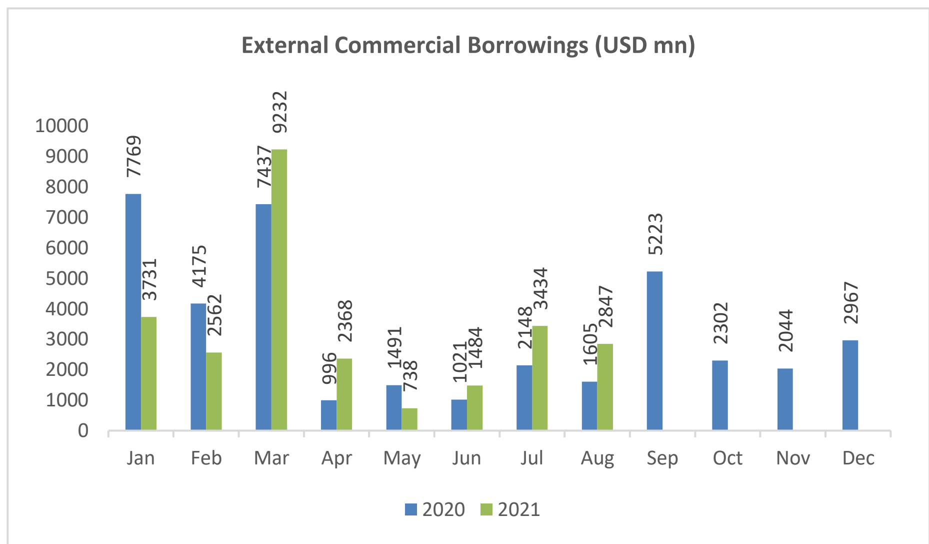
Source: FIMMDA, BWR Research

ECBs expected to improve in H2FY22

BWR Views

Indian companies' ECBs, which rose by 60% in July, rose by 77% in August 2021 y-o-y, fuelled by a buoyancy in economic growth. In BWR's opinion, demand for such borrowings, which was subdued owing to the pandemic impact on the economy, expectations of inflation rising in Europe, lower lending rates in India and the transition from LIBOR-pegged rates, is expected to improve in H2 2022.

According to RBI data, Indian corporates' borrowings were at USD 2.847 billion (majorly through the automatic route) from offshore markets in the form of External Commercial Borrowings (ECBs) during August 2021, compared to ~USD 1.605 billion during the same period last year, recording a rise of around 77% YoY and indicating improved demand post the second wave of Covid-19.



Source: RBI, BWR Research

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