Coping with Coronavirus: The Real Battle Begins

April 2020

Time to abandon fiscal consolidation to revive crippled economy

The COVID-19 pandemic has shattered the nation’s confidence. There is no clarity on how long it will take for the nation to emerge from this crisis and how much damage it will inflict on the economy. We, in our living memory, have not seen lives and livelihoods being lost at such a large scale before, and this is shattering our confidence. The complete lockdown of economic activity at such a time when investment activity in the economy has been slowing down not only brings in considerable hardship and misery, but also makes recovery much more difficult. The lockdown created a serious sense of uncertainty, insecurity and sheer helplessness among people.

The unfolding of the COVID-19 pandemic has brought to the fore several issues of concern. It also offers a number of lessons. The most important issue of concern continues to be the poor capacity of the state to deal with an unexpected crisis like this. A pandemic like this has to be fought on multiple fronts, and both, the central and state governments should join in to combat this enemy. While the immediate lockdown was unavoidable, announcing the package up front and taking states into confidence right from the beginning would have helped manage the mass exodus better. Perhaps, it would have helped matters greatly if the central leadership had a video conference with the state leaders on 22 March, the day after the Janata Curfew was announced. Combating this pandemic is equivalent to fighting a war with an unknown enemy; it requires a war room for strategic combat to foresee the actions of the enemy and prepare for the combat, and relief and rehabilitation of the injured.

The most important fact staring us in the face is the historical neglect of the healthcare sector. The states have always underfunded the sector. The aggregate annual spending on medical and public health, including water supply and sanitation, is just around 1.3% of the GDP when the actual requirement is estimated to be 3%. In 2017-18, in per capita terms, the public expenditure on medical and public health varied from Rs. 690 in Bihar and Rs. 814 in Uttar Pradesh to Rs. 2,092 in Kerala. The time has come to shift the focus of Ayushman Bharat towards augmenting healthcare infrastructure and wellness centres instead of taking the insurance route. The acute shortage of protective gear, testing kits, ventilators and hospital beds is a major handicap, and these have to be provided to frontline soldiers in this war.

Besides lives, protecting the livelihoods of the large number of workers and small and medium enterprises that have lost their employment and incomes is important. In fact, informal sector workers have suffered the most; they have lost their sources of income, faced severe hardships and confronted enormous economic and emotional insecurity. Although business establishments have been ordered not to retrench workers and to continue paying their wages, it is virtually impossible to implement this. Moreover, many establishments are fighting to survive, with all businesses coming to a compete standstill. The government will have to handhold informal sector workers and small businesses in this time of distress.
The most important part of government intervention to revive the crippled economy is to increase public spending. The problem is formidable, and additional spending required is substantial. The speed of recovery will crucially depend on the volume of public spending. In these situations, when there is all round reluctance to lend by banks and to borrow from corporates, a reduction in interest rates may not be effective, and the fiscal policy has to take on the burden of revival. However, there is very little fiscal space available for stimulus. The shortfall in tax revenue from the revised estimates for the year and inability to realise revenue from disinvestment will result in a substantial slippage in 2019-20. The near stagnancy in economic activities and overestimation of revenues for 2020-21 will result in a substantial slippage in 2020-21 as well. Despite this, significant additional spending is necessary to revive the economy. The situation is akin to financing a war, and in this situation, the basic principle that needs to be followed is to abandon the principle! The government will have to postpone the fiscal consolidation process to increase public spending and finance deficits through monetisation. However, while loosening its purse, it is important to keep a careful watch as increases in spending financed by monetising the deficit would have a potential impact on inflation and the balance of payments. Therefore, the government will have to keep a close watch to ensure the increase in deficits does not jeopardise macroeconomic stability.

It must also be noted that being closer to the people, the burden of expenditures for saving lives, livelihoods and recovery will have to be incurred predominantly at the state level. Unfortunately, it is severely constrained by a virtual stagnancy of their own revenues and a sharp reduction in tax devolution and grants. One way to deal with the dilemma is to provide additional borrowing space to them by increasing the fiscal deficit target to 4% of the Gross State Domestic Product (GSDP). It is also important for the States to realise the importance of health and prioritise spending on healthcare services by cutting-down avoidable transfers and subsidies.
### Annexure: Select Macro Economic and Sectoral Indicators

#### Economy

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<tbody>
<tr>
<td>GDP at 2011-12 Prices</td>
<td>Y-o-Y %</td>
<td>7.0</td>
<td>6.1</td>
<td>5.8</td>
<td>-</td>
<td>5.6</td>
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<td>5.1</td>
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<td>4.7</td>
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<tr>
<td>GVA at 2011-12 Prices</td>
<td>Y-o-Y %</td>
<td>5.8</td>
<td>6.0</td>
<td>5.7</td>
<td>-</td>
<td>5.4</td>
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<td>4.4</td>
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<td>4.3</td>
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<td>-</td>
<td>-</td>
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<tr>
<td>Agriculture</td>
<td>Y-o-Y %</td>
<td>5.8</td>
<td>2.4</td>
<td>0.1</td>
<td>-</td>
<td>2.0</td>
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<td>1.1</td>
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<td>0.7</td>
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<tr>
<td>Industry</td>
<td>Y-o-Y %</td>
<td>5.6</td>
<td>4.5</td>
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<td>-</td>
<td>3.2</td>
<td>-</td>
<td>3.1</td>
<td>-</td>
<td>3.0</td>
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<tr>
<td>Services</td>
<td>Y-o-Y %</td>
<td>5.7</td>
<td>7.5</td>
<td>8.2</td>
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<td>8.7</td>
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<td>5.4</td>
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</table>

#### Banking

<table>
<thead>
<tr>
<th>Indicators</th>
<th>Y-o-Y %</th>
<th>2018-19</th>
<th>2019-20</th>
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<tbody>
<tr>
<td>Gross Bank Credit</td>
<td>6.4</td>
<td>123.5</td>
<td>147.3</td>
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<tr>
<td>Bank Credit to Industries</td>
<td>6.7</td>
<td>6.9</td>
<td>5.6</td>
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<tr>
<td>Consumer Durables</td>
<td>5.6</td>
<td>5.3</td>
<td>4.5</td>
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#### Industry

<table>
<thead>
<tr>
<th>Index</th>
<th>2018-19</th>
<th>2019-20</th>
<th>2020-21</th>
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<tbody>
<tr>
<td>Manufacturing PMI</td>
<td>51.0</td>
<td>52.6</td>
<td>54.3</td>
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<tr>
<td>MP</td>
<td>5.3</td>
<td>2.7</td>
<td>0.2</td>
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<tr>
<td>Manufacturing</td>
<td>5.7</td>
<td>3.1</td>
<td>-0.3</td>
</tr>
<tr>
<td>Consumer Durables</td>
<td>8.8</td>
<td>5.9</td>
<td>-0.9</td>
</tr>
<tr>
<td>Eight Core</td>
<td>4.3</td>
<td>4.2</td>
<td>2.2</td>
</tr>
<tr>
<td>Auto Sales</td>
<td>14.3</td>
<td>5.1</td>
<td>3.6</td>
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<tr>
<td>Passenger vehicles</td>
<td>7.9</td>
<td>2.7</td>
<td>1.1</td>
</tr>
<tr>
<td>Commercial vehicles</td>
<td>20.0</td>
<td>17.6</td>
<td>6.0</td>
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<tr>
<td>Two &amp; three wheelers</td>
<td>15.1</td>
<td>5.0</td>
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<tr>
<td>Power generation</td>
<td>5.4</td>
<td>3.6</td>
<td>-0.6</td>
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<tr>
<td>Steel consumption</td>
<td>7.9</td>
<td>8.8</td>
<td>7.2</td>
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<tr>
<td>Cement consumption</td>
<td>6.6</td>
<td>13.9</td>
<td>8.3</td>
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<tr>
<td>Domestic passenger carried by rail</td>
<td>18.0</td>
<td>13.7</td>
<td>5.6</td>
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<tr>
<td>Coal</td>
<td>2.6</td>
<td>7.4</td>
<td>7.6</td>
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<tr>
<td>Crude oil</td>
<td>4.9</td>
<td>-4.1</td>
<td>6.1</td>
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<tr>
<td>Natural gas</td>
<td>2.9</td>
<td>0.8</td>
<td>-3.8</td>
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<tr>
<td>Petroleum refinery products</td>
<td>4.6</td>
<td>3.1</td>
<td>0.0</td>
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<tr>
<td>Fertilizers</td>
<td>8.0</td>
<td>0.3</td>
<td>2.9</td>
</tr>
<tr>
<td>Steel</td>
<td>5.6</td>
<td>5.1</td>
<td>4.9</td>
</tr>
<tr>
<td>Cement</td>
<td>6.3</td>
<td>13.3</td>
<td>8.0</td>
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<tr>
<td>Electricity</td>
<td>5.3</td>
<td>5.2</td>
<td>1.2</td>
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#### External Sector

<table>
<thead>
<tr>
<th>Indicators</th>
<th>Y-o-Y %</th>
<th>2018-19</th>
<th>2019-20</th>
<th>2020-21</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exports</td>
<td>USD Bn</td>
<td>28.3</td>
<td>32.7</td>
<td>26.9</td>
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<tr>
<td>Imports</td>
<td>USD Bn</td>
<td>42.6</td>
<td>43.7</td>
<td>36.1</td>
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<tr>
<td>Exchange Rate*</td>
<td>INR per USD</td>
<td>65.0</td>
<td>69.5</td>
<td>71.2</td>
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<tr>
<td>Brent Crude Oil*</td>
<td>USD per barrel</td>
<td>69.0</td>
<td>67.6</td>
<td>66.0</td>
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<tr>
<td>Forex Reserves</td>
<td>USD Bn</td>
<td>424.6</td>
<td>411.8</td>
<td>399.2</td>
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#### Inflation

<table>
<thead>
<tr>
<th>Indicators</th>
<th>Y-o-Y %</th>
<th>2018-19</th>
<th>2019-20</th>
<th>2020-21</th>
</tr>
</thead>
<tbody>
<tr>
<td>CPI</td>
<td>4.3</td>
<td>2.9</td>
<td>2.6</td>
<td></td>
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<tr>
<td>Core</td>
<td>5.2</td>
<td>5.1</td>
<td>5.9</td>
<td></td>
</tr>
<tr>
<td>WPI</td>
<td>2.7</td>
<td>3.1</td>
<td>2.9</td>
<td></td>
</tr>
<tr>
<td>Food</td>
<td>5.0</td>
<td>3.6</td>
<td>3.3</td>
<td></td>
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</table>

#### Interest Rates

<table>
<thead>
<tr>
<th>Rate</th>
<th>2018-19</th>
<th>2019-20</th>
<th>2020-21</th>
</tr>
</thead>
<tbody>
<tr>
<td>Repo*</td>
<td>Rate</td>
<td>6.0</td>
<td>6.3</td>
</tr>
<tr>
<td>1Y Benchmark</td>
<td>Average Rate</td>
<td>7.8</td>
<td>7.6</td>
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<tr>
<td>1Y AAA Corporate Benchmark</td>
<td>Average Rate</td>
<td>8.6</td>
<td>8.6</td>
</tr>
<tr>
<td>5Y Benchmark</td>
<td>Average Rate</td>
<td>7.8</td>
<td>7.1</td>
</tr>
<tr>
<td>5Y AAA Corporate Benchmark</td>
<td>Average Rate</td>
<td>8.4</td>
<td>8.2</td>
</tr>
<tr>
<td>MCLR of SBI (1 year)</td>
<td>Average Rate</td>
<td>8.2</td>
<td>8.6</td>
</tr>
<tr>
<td>Call Money Rate</td>
<td>Average Rate</td>
<td>5.9</td>
<td>6.2</td>
</tr>
</tbody>
</table>

Notes: Data is provisional for the latest months. -: Not available, *: at the end of the period
Source: MOSPI, RBI, eaindustry.nic.in, IHSmarkit.com, SBI, CMIE, FIMMDA, BWR Research
MACRO-ECONOMIC INDICATORS

Economy Trends

Quarterly growth rates show continuous deceleration, with third quarter growth for 2019-20 being estimated at 4.7%. The contraction in the manufacturing sector (−0.2%) is likely to worsen further due to the COVID-19-related lockdown, and the services sector, which is otherwise the major GDP growth driver, is also severely impacted by the current situation. The improvement in the agriculture sector output is the only positive as it is largely unafected by the pandemic and lockdown thus far.

AE: Advance Estimates, Source: MOSPI, BWR Research

Recovery in Index of Industrial Production (IIP) and Eight Core Industries will be short-lived

Recovery signs witnessed by IIP and eight core sectors in production growth during January is unlikely to sustain in the coming months as the Composite PMI Output Index, which reflected a sharp improvement in demand since January, plunged to 51.8 in March 2020. The negative impact of the COVID-19 outbreak-led lockdown already disrupted the supply side of the manufacturing sector and is expected to curtail demand as well.

Source: MOSPI, eaindustry.nic.in, BWR Research
Inflation and Monetary Policy Action

CPI inflation eased to 5.91% in March from 6.58% in February 2020. A slight moderation in food inflation, in addition to the base effect, coupled with a marginal ease in core inflation helped the inflation to ease in March. Considering the urgency of intervention in the wake of the severe uncertainty caused by the COVID-19 outbreak, the Reserve Bank of India (RBI)-led Monetary Policy Committee (MPC) reduced the repo rate by 75 bps in March.

BWR Views

BWR expects CPI inflation to ease in April and remain below the MPC’s upper target of 6% due to muted demand led by the lockdown situation, in addition to the sharp fall in crude oil prices since March. Food inflation is also likely to subside in the coming months, but huge money supply led by the RBI’s liquidity-boosting measures may exert inflationary worries in the long run, if economic recovery takes time to pick-up.

BWR Views

Crude oil prices crashed to a historic low in March, and this is expected to provide the much needed fiscal and monetary space if it stays at current level for long. The expected contraction in oil demand due to a global economic slowdown indicates a lower oil price outlook.

Despite a fall in oil prices, the potential consequences of coronavirus epidemic on economy and FPI outflows put pressure on the rupee. Amid fiscal constraints and concerns over the global economic fallout, the rupee may continue to depreciate in the coming months. However, with the RBI’s frequent intervention in the forex market, we expect the rupee to stabilise at Rs 75-76 per USD in the coming months.

Crude Oil Prices and INR/USD Rates

On 9 March 2020, crude oil prices fell by 20% in a single day, following the breakdown of the supply coordination of the OPEC–Russia alliance. Amid the coronavirus scare and the consequent contraction of oil demand, in addition to excess supply, the fall in prices continued, and towards the end of March, Europe Brent spot price fell below USD 20 per barrel. On the contrary, the rupee continued to depreciate in March as concerns over fiscal constraints and economic fallout increased amid the COVID-19 pandemic.

Crude Oil Prices and Rs per US Dollar (Month-end)

Source: Ministry of Petroleum & Natural Gas, FBIL, BWR Research
Merchandise Trade

After reporting continued negative growth for the last many months, both merchandise exports and imports witnessed a marginal increase in February 2020. Exports improved by 2.9%, and imports increased by 2.5%, compared with the corresponding period a year ago. The trade deficit widened by 1.3% (y-o-y), as the increase in imports is comparatively lower than that in exports. On a cumulative basis, during the first 11 months of the current fiscal, exports contracted 1.5% and imports shrank 6.1% over the same period last year. The trade deficit narrowed by 17.4% during the same review period.

Source: Ministry of Commerce, BWR Research

Forex Reserves and Import Cover

Foreign exchange reserves remained at $475 billion in March-end 2020, almost the same as in the previous month. The current forex reserves level is adequate to cover 12.7 months of imports, which is comfortable and helps absorb external shocks, such as exchange rate volatility.

Source: Ministry of Commerce, RBI, BWR Research

BWR Views

The main external risks that arise in managing the trade balance include volatile oil prices and currency movements. However, the coronavirus outbreak, which already resonated across economies, began to disrupt global trade. On the domestic front also, the 21-day lockdown created production disruptions and spillovers of global economic fallout that are likely to burden both imports and exports.

The sudden and sharp fall in oil prices provides some respite on the import bill.

BWR Views

To contain exchange rate volatility, the RBI conducted forex swap auctions and sold dollars to arrest the rupee fall in March. In addition, the RBI continues to intervene in the spot and forward markets. With abundant forex reserves, the RBI is likely to intervene frequently in the foreign exchange market to manage the rupee at a comfortable level; hence, forex reserves may see some reduction in the coming months.
Government Accounts

Fiscal deficit has crossed the revised Budget Estimates (BE) of Rs 7,668 billion to Rs 10,365 billion during the April to February 2019-20 period. Amid the shortage of revenue, the government revised the fiscal deficit target for the current fiscal to 3.8% from the earlier target of 3.3%. Through disinvestments, the government has only been able to collect Rs 50,299 crore thus far, against the revised budget target of Rs 65,000 crore.

Source: Controller General of Accounts, Ministry of Finance, BWR Research

Revenue Collection through GST

The gross revenue through GST reported a steady rise in collections for four months in a row from November 2018, but fell during March due to the impact of the Covid-19-led lockdown on business continuity and consumption, resulting in an economic slowdown. During 2019-20, vis-à-vis 2018-19, the gross GST revenue collection grew by 4.1% to Rs 1,222 billion, which is marginally higher than the revised budget target of Rs 1,126 lakh crore.

Source: Ministry of Finance, BWR Research
The banking sector credit in fiscal 2020 grew just by 8% (year-on-year) and 3% (year-to-date) up to February 2020, compared with 13% and 8%, respectively, in the previous fiscal. The lower offtake was mainly due to slower growth in the industry and services sector, which has been dealing with asset quality challenges, thus resulting in a cautious approach to loan growth. Overall credit demand is weak due to a slowdown in the economy.

Source: RBI, BWR Research

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Domestic automobile sales were down by 45% y-o-y in March 2020, owing to lockdown in the second half of the month. CV sales which were already weak due to economic slowdown were down by 88% y-o-y in March 2020.

Source: CMIE, BWR Research

The pandemic crisis globally as well as in India and the resultant lockdown as a containment measures have caused huge business disruptions domestically as well as globally. This will have a significantly negative impact on the automobile industry which is already battered by low demand. Also, the auto makers plan to liquidate BS-IV inventory in March has been hampered and they will not be able to sell those post March.

Source: CMIE, BWR Research
Telecom

The telecom sector is one of the few rare sectors that are not likely to face stress because of the lockdown imposed on account of Covid-19. With the current 'work from home' scenario, demand (especially for data) is expected to surge, resulting in higher inflows because of the recently increased tariffs.

Source: TRAI, BWR Research

While telcos have provided relaxations, such as extending validities and adding talk time, to low-income subscribers, high-income subscribers are the major revenue contributors for the telcos, and with the demand from their side rising, the net impact on telcos financial performance is likely to be positive.

According to the COAI (Cellular Operators Association of India), average data consumption has increased by around 20% (after shifting video streaming to SD from HD) in the last few days. With corporates working from home, educational institutions offering online classes and increased viewing of digital entertainment content, higher data utilisation is likely to be maintained for the next one-two months.

Revenues of telcos were expected to increase by 4%-5% in Q4 FY20 with the full realisation of a tariff hike, and now with added data utilisation, it would translate into an even better growth rate. The only negative outcome of the current situation is that the setting-up of floor prices is expected to get delayed; however, with the government’s commitment to revive the sector; necessary steps from their side are expected to be taken.
Power

The negative impact of the Covid-19 pandemic has been felt across many sectors and power sector is no exception. While the various entities involved in the power value chain are operational (power being an essential service), the fall in demand from the industrial customers has impacted the cash flows of these companies. As per the data published by National Load Despatch Centre (NLDC), electricity demand, which peaked at ~164-165 GW during March 17-18 fell by nearly 30% to the range of 110-120 GW on March 25 (first day of the nationwide lockdown). In the following days, the demand has gone as low as 100 GW/day and no revival is likely to happen for the next two weeks at least. The fall in demand during the last week of FY20 is more than 30% in comparison with the last week of FY19.

Source: Central Electricity Authority, BWR Research

Therefore, the Discoms, which are already under stress, are expected to see their cash flow mismatches widen, forcing them to delay payments to the power suppliers, as well as transmission utilities. While the Ministry of Power has assured Discoms of continuous power supply despite late payments for the next three months, there is a bit of grey area there, with no clarity on whether the relaxation covers the entire power dues or only the surcharge. Many of the Discoms have also announced the curtailment of renewable power with no payments to them during the 3-month period, which may have serious implications for the overall credit profile of these companies.

Source: Central Electricity Authority, BWR Research
The Indian steel industry was already going through a difficult phase with falling operating margins, and going forward, it is expected to deteriorate further due to the current COVID-19 pandemic situation worldwide, including a 21-day nationwide lockdown in India. However, the steel ministry has reportedly released an official notification for steel units to continue production as they form a part of essential services; however, many small and medium companies have shut operations, and big players have curtailed their production due to difficulties with respect to the availability of raw materials and distribution of finished products, shortage of manpower and anticipated lower demand for upcoming months.

Steel production in China, the world’s largest producer, has not been dented by the pandemic; this is leading to steel supply in excess of demand, thereby flooding inventories and weighing heavy on prices, along with China’s recent offer regarding an export rebate, which will result in competitive pricing internationally.

Source: CMIE, BWR Research

Steel Production & Prices

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Steel

Outlook on the steel sector is negative for the coming few months, with a dip in operating margins. Government measures with respect to logistics, manpower, pricing, relief on tax and duties and relaxation on utility dues, among others, will play a key role in ensuring a minimal hit on the operating margins of the steel sector.
DEBT MARKET INDICATORS

Movements in Bond Yields

The bond yield (annualised) of Public Sector Units (PSUs), Corporates and Non-Banking Finance Companies (NBFCs) maturing in five-, three- and one-year tenures with the corresponding Government Securities and Marginal Cost of funds-based Lending Rate (MCLR) of banks is provided below.

We expect yield to continue to remain volatile, depending on the longevity and spread of Covid-19 as it is not possible to evaluate the impact of the crisis. However, opening up of select securities fully to foreign investors may help enhance liquidity in the medium term.

<table>
<thead>
<tr>
<th>Date</th>
<th>3-year AAA Corporate Bond yields vs Gsec yield, MCLR</th>
<th>5-year AAA Corporate Bond yields vs Gsec yield, MCLR</th>
</tr>
</thead>
</table>

Source: FIMMDA, SBI, HDFC, BWR Research
Yield of AAA-rated corporate bonds maturing in five-, three- and one-year tenures turned highly volatile as investor confidence is hit by the outbreak of the coronavirus pandemic. The Government of India and RBI have announced various measures, enabling adequate and cheaper working capital, supporting corporates suffering from business losses and introduced forbearance measures and additional liquidity infusing tools. The yellow dotted box (in each chart) shows the volatility on the back of the novel coronavirus impact.

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

The borrowing cost for corporate bonds maturing in one year issued by the government, PSUs, NBFCs and corporates continued to soften in February by 190-199 bps, against the corresponding period last year due to a revival in investor sentiment, coupled with several measures taken by regulators to deepen the corporate bond market.

Source: FIMMDA, SBI, HDFC, BWR Research

Source: FIMMDA, BWR Research
ABOUT BRICKWORK RATINGS

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