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Rising Interest Rates and Growth Challenges

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IN THIS ISSUE

Chief Economic Adviser's Views

Can NITI Aayog Foster Cooperative Federalism?

A major shortcoming in Indian fiscal federalism is the absence of a credible institution for intergovernmental coordination, bargaining and conflict resolution. The Seventh Governing Council meeting of the NITI Aayog has once again brought out its challenges in acting as an effective institution for the purpose. With significant concurrency in the assignment of functions between the Union and States, there is a need for continuous dialogue, coordination, bargaining and the resolution of differences and disputes. As this is one of the important mandates given to the NITI Aayog, the governing council meeting was expected to deliberate on the issue to do the stock taking.

The most important responsibility assigned to the NITI Aayog is to promote 'Cooperative federalism' through structured support initiatives and mechanisms with the States on a continuous basis. There is significant overlap in the functional domains assigned to the Union and States in the Seventh Schedule to the Constitution. Besides having a large list of Concurrent Subjects, there are a variety of ways in which the Union government can intervene on the State subjects, and the lack of clarity in the assignment system opens up the need for coordination and resolving conflicts. Carrying out a stable and sustainable development agenda requires fostering the spirit of cooperation and cementing the federal structure. First, there is considerable overlap in carrying out legislative and executive functions in Concurrent Subjects. Recent years have shown the need for cooperation in areas such as energy and environment, education, and poverty alleviation, where the need for coordinated action and speedy decisions is critical for pursuing the developmental agenda. Second, the Union government may have to intervene in national interest even if they are in the State List or Concurrent List. There may be some public services in the State List, which, for reasons of nationwide externalities or for redistribution, require coordinated action to ensure the minimum standards throughout the country. Examples include healthcare, urban development and poverty alleviation. In these cases, the state governments are partners in achieving a common goal. Third, in the case of Union subjects too, States may be involved in implementation as agencies due to their proximity to the people. In addition, NITI Aayog can facilitate the exchange of information and experiences, and promote healthy intergovernmental competition through monitoring and regulation. The most important issue that the NITI Aayog will have to deal with is the rationalisation of the Centrally Sponsored Schemes. In 2011, there were over 147 schemes, and these were initially consolidated into 66 umbrella schemes and later combined into 28 umbrella schemes with several sub-schemes in each of them. There are as many as 42 interventions within Sarva Shiksha Abhiyan. With the 'one size fits all' design, they do not take account of varying local conditions and institutions. The large counterpart/matching fund requirements distort the priorities of the States and conditionalities in availing the grants make them restrictive, and the final distribution of transfers is very different from the original allocation.

The governing council meeting of the NITI Aayog comes at a good time to enable the stock taking and undertake course correction. Unfortunately, the press reports on the meeting do not infuse much confidence in the ability of the NITI Aayog to steer the ground in fulfilling the mandate of promoting cooperative federalism. Indeed, the Prime Minister has emphasised that the Aayog should help in promoting collective action between the Union and States to enhance GST collection, put out a roadmap to implement the New Education Policy and help to promote trade, technology, and tourism, which are important. However, in the past seven years, the Aayog has played a very limited role in these, and it is not clear how it will be able to change now. While some moderate voices such as that of the Odisha Chief Minister are willing to give the Aayog the role of an Ombudsman, it is not clear how an agency of the Central government can act as an independent arbiter. In fact, Bihar and Telangana did not attend the meeting. Other non-BJP-ruled states took the opportunity to voice their grievances. Seeking legal guarantee for MSP, the extension of GST compensation for another five years, seeking increased tax devolution, asking for the refund of the money deposited by the States in the New Pension Scheme, refund of the money taken from the States deploying central forces to tackling the Maoist menace, demanding that the borrowing from State entities under the public accounts should not be counted for determining the overall borrowing limits and the rationalisation of centrally sponsored schemes are some of the issues raised.

The governing council meeting has clearly brought out the need for an effective institutional mechanism for intergovernmental coordination, bargaining and conflict resolution for the stability of Indian fiscal federalism. Assigning the task of promoting cooperative federalism, by itself, is not likely to empower the institution to undertake the task. Based on the recommendation of the Administrative Reforms Commission and the Sarkaria Commission on Centre-State relations, Inter-State Council was created as a Constitutional entity, but by placing it in the Union Home Ministry, the institution ceased to be effective. The creation of an independent institution rooted in the Constitution to resolve inter-State and Centre-State issues is critical now for the stability of Indian fiscal federalism.

Annexure: Select Macro Economic and Sectoral Indicators

Indicators/Sectors		FY20	FY21	FY22	Jul-2021	Aug-2021	Sep-2021	Oct-2021	Nov-2021	Dec-2021	Jan-2022	Feb-2022	Mar-2022	Apr-2022	May-2022	Jun-2022	Jul-2022
Economy					FY22 Q2			FY22 Q3			FY22 Q4						
GDP at 2011-12 Prices	Y-o-Y in %	**3.74**	**-6.60**	**8.68**	8.40			5.40			4.09			-	-	-	-
GVA at 2011-12 Prices	Y-o-Y in %	**3.81**	**-4.80**	**8.11**	8.30			4.71			3.89			-	-	-	-
Agriculture	Y-o-Y in %	**5.52**	**3.32**	**3.01**	3.16			2.54			4.13			-	-	-	-
Industry	Y-o-Y in %	**-1.37**	**-3.26**	**10.27**	6.96			0.35			1.25			-	-	-	-
Services	Y-o-Y in %	**6.34**	**-7.82**	**8.44**	10.21			8.10			5.49			-	-	-	-
Banking																	
Gross Bank Credit	Y-o-Y in %	**6.80**	**5.00**	**9.60**	6.50	6.70	6.70	6.80	7.00	9.20	8.20	7.90	9.60	11.10	12.10	13.20	14.00
Bank Credit to Industries	Y-o-Y in %	**0.70**	**0.40**	**7.10**	0.90	2.30	2.50	4.10	3.80	7.60	6.40	6.50	7.10	8.10	8.70	9.50	-
Deposit	Y-o-Y in %	**7.90**	**11.40**	**8.90**	10.70	9.50	9.30	9.90	9.80	9.60	9.30	9.10	8.90	9.80	9.30	9.30	8.40
Industry																	
Composite PMI	Index	**52.60**	**44.70**	**53.47**	49.20	55.40	55.30	58.70	59.20	56.40	53.00	53.50	54.30	57.90	58.90	59.20	56.60
Manufacturing PMI	Index	**52.33**	**50.20**	**53.97**	55.30	52.30	53.70	55.90	57.60	55.50	54.00	54.90	54.00	54.70	54.60	53.90	56.40
IIP	Y-o-Y in %	**-0.80**	**-8.40**	11.40	11.50	13.00	4.40	4.20	1.00	1.00	2.00	1.20	2.20	6.70	19.60	12.30	-
Manufacturing in IIP	Y-o-Y in %	**-1.40**	**-9.60**	11.80	10.50	11.10	4.30	3.30	0.30	0.60	1.90	0.20	1.40	5.80	20.60	12.50	-
Consumer Durables	Y-o-Y in %	**-8.70**	**-15.00**	12.50	19.40	11.10	1.60	-3.20	-5.70	-1.90	-4.40	-9.70	-2.60	7.40	58.40	23.80	-
Consumer Non-Durables	Y-o-Y in %	**-0.10**	**-2.20**	3.30	-2.30	5.90	-0.10	0.70	-0.80	0.30	3.10	-6.80	-4.60	-0.60	1.00	2.90	-
Eight Core Industries	Y-o-Y in %	**0.36**	**-6.39**	10.43	9.94	12.16	5.44	8.73	3.24	4.11	4.03	5.90	4.80	9.30	19.30	12.70	-
Auto Sales	Y-o-Y in %	**-17.95**	**-14.64**	**-10.70**	17.47	-3.58	-15.05	-20.69	-24.42	-8.04	-15.23	-17.75	-13.71	6.61	123.93	19.02	-
Passenger Vehicles	Y-o-Y in %	**-17.82**	**-10.35**	**8.00**	44.70	7.60	-41.20	-27.10	-18.60	-13.30	-8.10	-6.50	-3.90	-3.80	185.14	19..06	-
Two & three Wheelers	Y-o-Y in %	**-17.47**	**-15.06**	**-10.00**	-1.70	-13.90	-16.60	-24.40	-33.90	-10.10	-20.90	-26.80	-20.40	15.90	262.10	23.38	-
Power Generation	Y-o-Y in %	**-0.16**	**-1.17**	**7.00**	7.16	17.50	-1.65	2.90	1.61	2.59	-0.18	2.85	2.55	9.88	20.60	17.12	-
Steel Consumption	Y-o-Y in %	**0.72**	**-6.42**	**11.00**	4.80	-2.24	-3.19	-3.60	-6.73	-8.59	1.97	-4.38	4.47	6.59	21.19	6.16	14.48
Cement Consumption	Y-o-Y in %	**0.00**	**-13.00**	**22.00**	22.50	37.70	11.10	15.00	-3.30	-	14.10	11.60	15.70	-	-	-	-
Sugar Production	Y-o-Y in %	**-19.25**	**15.59**	**4.00**	98.16	77.10	25.00	61.80	-4.90	-	-2.50	5.27	26.97	19.05	57.04	-	-
Domestic Passengers carried by Airlines	Y-o-Y in %	**0.71**	**-62.24**	**59.90**	137.64	136.62	79.20	70.46	65.50	52.89	-17.15	2.16	36.74	92.14	471.21	-	-
External Sector																	
Exports	USD Bn	**313.36**	**291.18**	**417.81**	35.43	33.28	33.80	35.65	30.04	37.81	34.50	33.81	40.38	38.19	37.29	37.94	35.24
Imports	USD Bn	**474.71**	**394.44**	**610.22**	46.40	47.09	56.39	55.37	52.95	59.49	51.93	55.01	59.07	58.26	60.62	63.58	66.26
Exchange Rate (Average)	INR/USD	**75.39**	**74.20**	**74.50**	74.53	74.18	73.56	74.93	74.50	75.37	74.44	75.03	76.29	76.12	77.32	78.07	79.60
Crude Oil (Average)	USD/barrel	**60.47**	**44.60**	**78.29**	73.54	69.80	73.13	82.11	80.64	73.30	84.67	94.07	112.87	102.97	109.51	116.01	105.49
Forex Reserves (As on date)	USD Bn	**477.81**	**579.29**	**617.65**	620.06	640.70	635.36	640.39	638.00	633.61	629.76	631.53	617.65	597.73	601.36	588.31	573.88
Net FPI Flows	USD Bn	**-3.04**	**36.18**	**-19.40**	-0.99	2.23	0.39	-1.66	-0.33	-3.94	-3.82	-5.07	-6.56	-2.96	-4.73	-6.59	0.24
Inflation																	
CPI	Y-o-Y in %	**4.77**	**6.16**	**5.51**	5.59	5.30	4.35	4.48	4.91	5.66	6.01	6.07	6.95	7.79	7.04	7.01	6.71
Food	Y-o-Y in %	**6.71**	**7.70**	**3.76**	3.96	3.11	0.68	0.85	1.87	4.05	5.43	5.85	7.68	8.31	7.97	7.75	6.75
Core	Y-o-Y in %	**3.80**	**5.51**	**5.98**	5.93	5.77	5.76	6.06	6.08	6.01	5.95	5.99	6.32	7.24	6.41	6.22	6.04
WPI	Y-o-Y in %	**1.67**	**1.20**	**12.97**	11.57	11.64	11.80	13.83	14.87	14.27	13.68	13.43	14.63	15.38	15.88	15.18	13.93
Food	Y-o-Y in %	**6.88**	**3.91**	**6.73**	4.52	3.76	2.59	4.25	6.83	9.37	9.55	8.67	9.29	9.13	10.89	12.41	9.41
Manufactured Products	Y-o-Y in %	**0.34**	**2.70**	**11.06**	11.46	11.56	11.57	12.87	12.34	10.71	9.50	10.24	11.26	11.39	10.11	9.19	8.16
Interest Rates (in %)																	
Repo	Effective	**4.40**	**4.00**	**4.00**	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.40	4.40	4.90	5.40
10-year Benchmark	Average	**6.80**	**6.40**	**6.51**	6.33	6.40	6.30	6.46	6.45	6.50	6.80	6.87	7.00	7.23	7.49	7.66	7.53
10- year AAA Corporate Bond	Average	**7.60**	**6.90**	**6.90**	6.89	6.90	6.80	6.86	6.90	6.90	7.00	7.00	7.00	7.27	7.67	7.84	7.76
5- year Benchmark	Average	**6.20**	**6.10**	**5.99**	5.89	5.90	5.80	5.96	5.96	5.96	6.30	6.30	6.40	6.79	7.24	7.42	7.28
5- year AAA Corporate Bond	Average	**7.30**	**6.10**	**6.01**	5.88	5.80	5.90	5.98	6.10	6.00	6.00	6.26	6.40	6.81	7.46	7.77	7.70
MCLR of SBI (1 year)	Average	**7.80**	**7.00**	**7.00**	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.10	7.20	7.40	7.50
Call Money	Average	**4.90**	**3.20**	**3.24**	3.17	3.20	3.20	3.20	3.17	3.30	3.50	3.27	3.27	3.64	4.11	4.67	5.16

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 r
'Nil' production, affecting comparison of the indices for the months of April 2020 and April 2021. The growth rates in 2021 over corresponding period of previous year are to be inte
considering the unusual circumstances on account of COVID 19 pandemic since March 2020.

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

MACRO-ECONOMIC INDICATORS

BWR Views

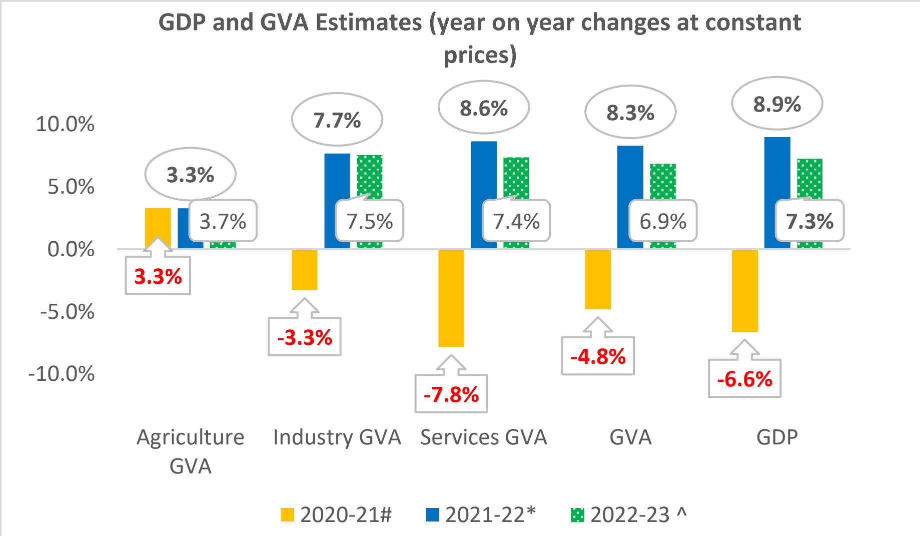
The growth dynamics for FY23 changed tremendously following Russia's war with Ukraine, and rising price pressures have added to the dilemma. The domestic growth prospects continued to impinge by adverse global developments such as the prolonged Russia-Ukraine war, tightening of financial conditions, and rising risks of a global recession. Persistent supply-side disruptions and a meteoric rise in energy-related supplies have led to a spike in inflationary challenges, while worsening external concerns, rupee depreciation and the retrenchment of capital flows have been adding to the woes. The record-level inflation has also intensified significant downside risks to the growth momentum.

Following the rising inflationary worries, the RBI has started withdrawing the accommodative stance and has already hiked the key policy repo rate by 140 bps so far since 4 May 2022.

The waning monetary policy support poses a new challenge to growth prospects, while the RBI has retained its growth projection for FY23 at 7.2%. We expect the FY23 GDP to grow by 7.3% and Q1FY23 growth at 12.5% (y-o-y).

GDP trends: Increasing interest rates and rising risks of a global recession challenging domestic growth prospects

As per provisional estimates by the MOSPI, the GDP for FY22 grew at 8.9% after contracting by 6.6% in 2020-21 due to the pandemic and lockdown restrictions. Growth in Agriculture remained firm at 3.3%, and the industry and services sectors posted 7.7% and 8.6% y-o-y growth, respectively.

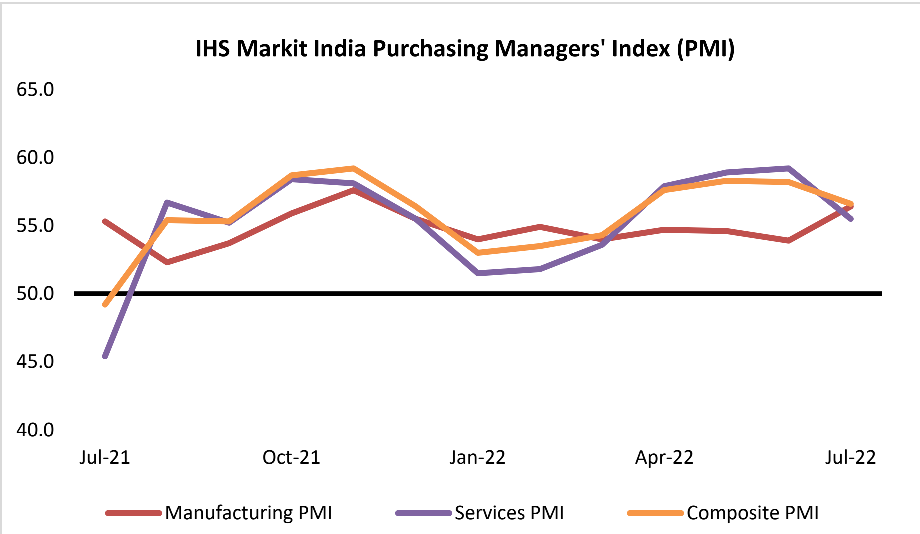


Revised Estimates * Provisional estimates

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

Mixed Signals: Manufacturing PMI grows, while Services PMI dips

The manufacturing sector sustained a strong growth momentum in July, and the manufacturing PMI reached an eight-month high at 56.4. However, the services sector PMI faltered to a four-month low due to high inflation and weaker demand, coupled with an unfavourable monsoon. IIP and eight core sectors has shown substantial improvements, but inflationary pressures may dampen the recovery.



Source: IHS Markit, BWR Research

BWR Views

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

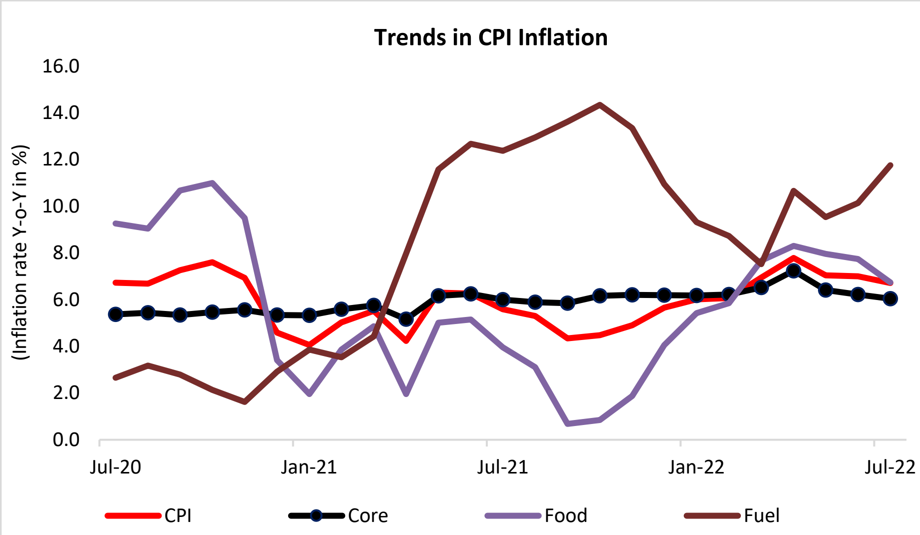
To bring down inflation, the RBI has already increased the policy repo rate by 140 bps since 4 May 2022 in addition to absorbing excess liquidity in the system. With the increase in the rate cycle, we expect CPI inflation to possibly ease below 6% during H2FY23; yet, it may remain elevated above the upper band of the target in Q2FY23. We also expect the policy tightening cycle to continue in the current fiscal until the inflation rate falls within the MPC's target band of 2% to 6%.

BWR Views

High crude oil prices have resulted in severe adverse consequences on the Indian economy as India's dependence on oil imports constitutes about 85% of its consumption. The fall in crude oil prices is likely to provide much-needed relief on the fiscal management and foreign exchange reserves, and ease some pressures on the inflation and growth fronts. After witnessing large portfolio inflows to the tune of UAD6.6 Bn in the last nine months, FPIs started investing and turned net buyers in the Indian markets in July.

Inflation: Price challenges continue

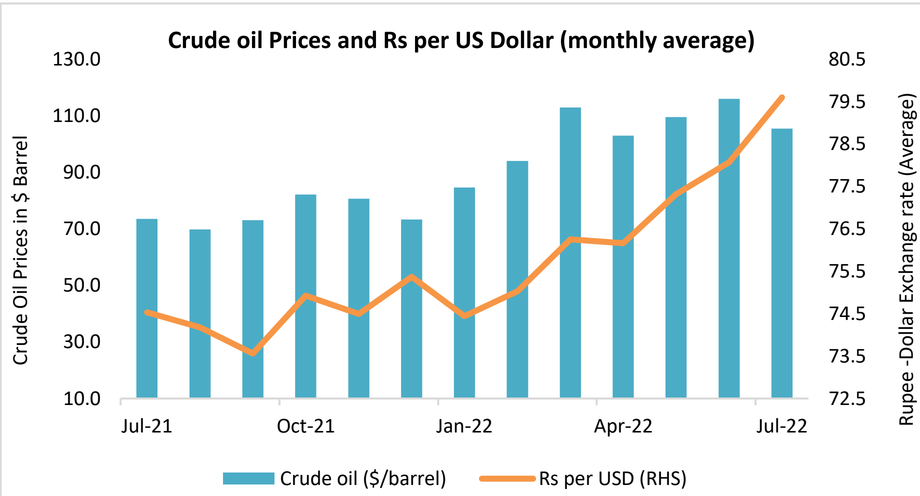
CPI inflation fell below the 7% mark in July after a gap of three months, yet inflation is still above the MPC's upper band target of 6%. Price levels remained sticky due to continued supply disruptions caused by ongoing geopolitical developments. Since March 2022, CPI headline inflation has persistently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



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

Challenging external situation

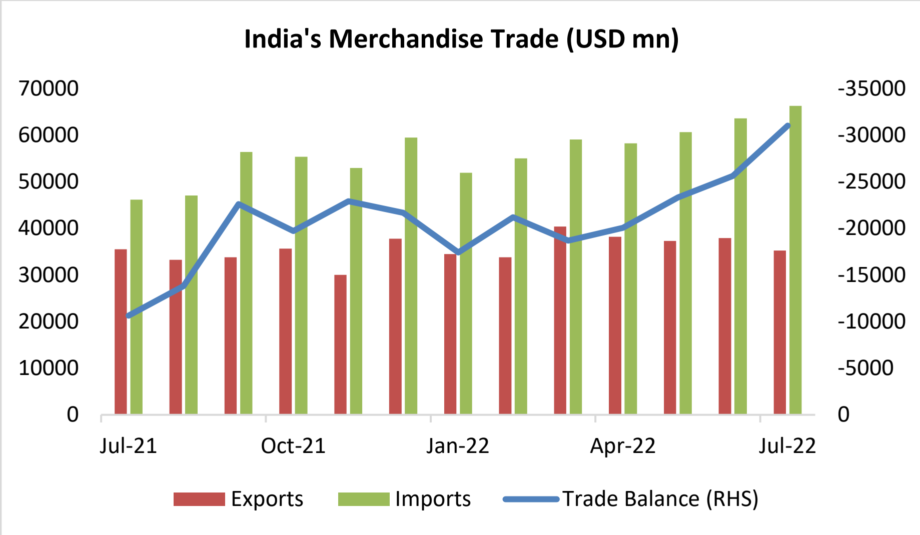
After remaining elevated since the beginning of February 2022 following the Russia-Ukraine war, crude oil prices eased marginally in July 2022. Yet, the pressure on the Indian rupee has continued, and the currency depreciated sharply to cross Rs 80/USD in July. However, RBI intervention helped the currency from further depreciation, in addition to a reversal in capital outflows. The fall in crude oil prices also brought some respite on the exchange rate front.



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

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

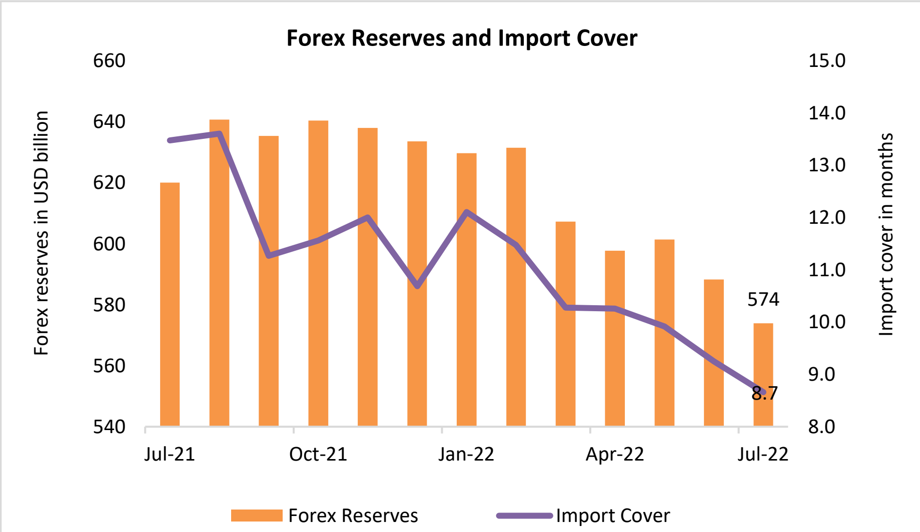
A weaker rupee, and higher crude oil and other commodity prices, have rendered imports expensive. Merchandise imports increased much more than exports in July 2022 in value terms, resulting in the widening of the trade deficit to USD31 billion from USD10.6 billion in July 2021.



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

Weak rupee continues to drain forex reserves

Forex reserves were depleted by nearly USD33 Bn since March 2022 to USD 574 billion as on 29 July 2022. Compared to June, the forex reserves are down by USD14 billion as the rupee has depreciated sharply. Along with several other measures undertaken in July, the RBI has also used its foreign exchange reserves accumulated over the years to curb volatility in the exchange rate. Despite the resultant drawdown, India's foreign exchange reserves remain the fourth largest globally.



Source: Ministry of Commerce, RBI, BWR Research

BWR Views

After showing a remarkable increase in FY22 despite weak global demand, the pace of growth in Indian merchandise exports has come down, and the recent ban on the exports of certain commodities, such as steel, to cool down inflation, may further dampen exports.

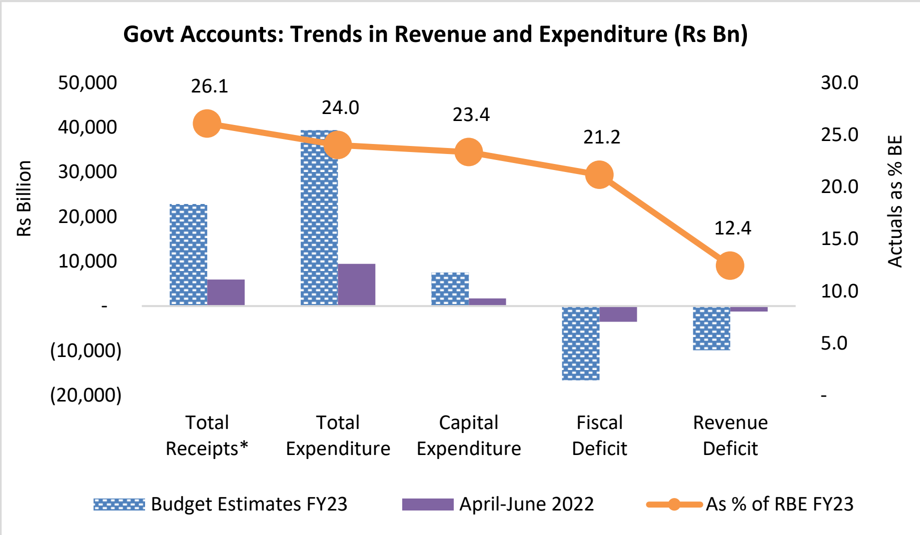
Ongoing geopolitical tensions are likely to keep the external situation under stress, while recessionary expectations in the advanced economies may lower demand for domestic exports. The recent fall in crude oil prices brings some respite on import bills, while a weaker rupee continued to be a burden on imports, but has helped exports become more competitive.

BWR Views

The outflow of funds from the Indian markets, which began since October 2021 following the withdrawal of liquidity measures by advanced economies, and the Russia-Ukraine crisis, which further increased capital outflows, have created financial uncertainty and have weakened the rupee value due to demand for the US dollar. However, timely intervention by the RBI kept the rupee from depreciating further. Due to frequent forex market interventions, forex reserves depleted sharply, and the import cover of India's foreign exchange reserves fell to 8.7 months in end-July 2022.

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

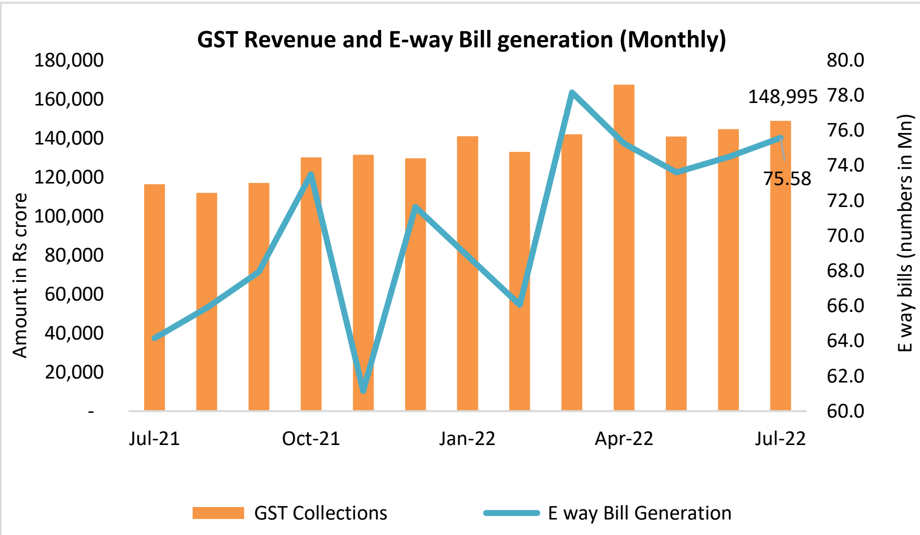
Provisional data released by the CGA for April-June 2022 shows that the central government has spent 24% of the budget expenditure for FY23 and 23.4% of the budgeted capital expenditure. The total receipts stood at 26.1% of the budget targets while the fiscal deficit continues to remain lower at 21% of the budget targets.



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

GST: Second highest ever tax collections

With the improvement in administration, particularly on the technology platform, tax compliance has improved, as reflected in the steady increase in the monthly revenue collection. The gross GST monthly collections continued to remain above the Rs 1.4 trillion mark in July 2022, showing a 28% increase y-o-y. The E-way bill generation also remained buoyant, recording an 18% increase over June 2021.



Source: PIB press releases, GSTN, BWR Research

BWR Views

In a bid to control inflation, the government announced a series of measures from tax cuts on fuel to more fertiliser and cooking gas subsidies to ease price pressures, at the risk of a stretched fiscal deficit. With a fiscal deficit target of 6.4% of the GDP for FY23, higher crude oil prices impose a huge risk on fiscal management. Easing oil prices have provided much-needed respite; otherwise, the domestic economy may face a serious dilemma if the prices remain at elevated levels.

BWR Views

The various rate rationalisation measures undertaken by the GST Council to correct the inverted duty structure have helped improve revenue. The generation of E-way bills has led to a significant improvement in compliance. Due to improved tax compliance and better tax administration by both the central and state tax authorities, coupled with a more stable technology platform in place, GST collections may continue to be higher in the coming months.

SECTORAL INDICATORS

Banking

BWR Views

The RBI, in the 5 August 2022 MPC meeting, hiked the repo rate by 50 bps to 5.40% with immediate effect. Consequently, the standing deposit facility rate has been adjusted to 5.15%, and the marginal standing facility rate and bank rate to 5.65%. The rate hike is expected to result in higher lending and deposit rates, meaning higher EMIs for housing and vehicle loans particularly. Other news that made the headlines was that banks were concerned that National Asset Reconstruction Company Ltd (NARCL) has been quoting abysmally low amounts for purchase of NPAs, in the region of 2-3% of the outstandings. This may impact the sales of the NPAs to NARCL, thereby diluting the purpose of the cleansing and strengthening of banks' balance sheets.

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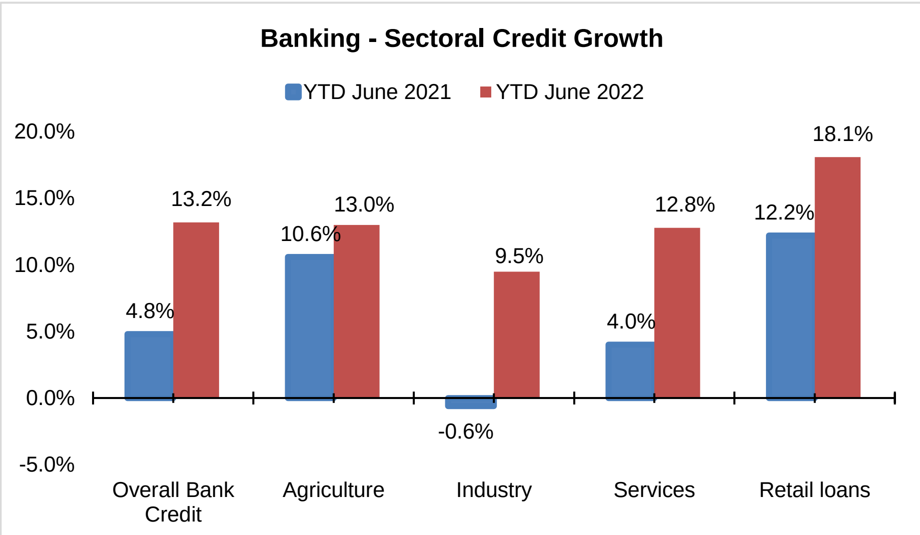
(Jr Rating Analyst)

Credit growth picking-up pace

Indian banks continued to perform well in Q1FY23, as reflected in the increased net profits, lower provision for bad assets and decreasing gross NPAs compared to Q1FY22 and FY22 year-end figures. BWR believes that banks will post robust growth in deposits and advances, while simultaneously reducing gross NPAs and provisions. The RBI has further raised the policy repo rate by 50 bps to 5.4%, and the increase in the repo rate in the last 3 months has been 140 bps. The RBI has taken this step to control inflation, which, however, still remains higher than the RBI's upper tolerance level of 6%. While raising interest rates, the RBI continues to monitor geopolitical concerns due to the ongoing Russia-Ukraine war, mounting global inflation, fear of recession, volatile crude oil prices and geopolitical tensions between the US and China due to Taiwan sovereignty. The prolonged war is impacting global food supply, especially wheat and sunflower oil, and also gas supply to Europe. Banks' net interest income will face pressure in the coming quarter of FY23, and banks with a higher CASA percentage and those that have already raised funds from the market at lower rates are likely to benefit.



Source: RBI, BWR Research

On a y-o-y basis, non-food bank credit grew by 13.7% in June 2022 as compared to 4.9% a year ago. Credit to agriculture and allied activities grew by 13.0% in June 2022 as compared to 10.6% a year ago. Credit growth to the services sector improved to 12.8% in June 2022 as compared to 4.0% a year ago.

BWR Views

Demand for PVs, tractors and certain CV segments, especially medium and heavy commercial vehicles, will remain healthy owing to robust demand in the urban sector, driven by an intermittent improvement in consumer sentiments, the continued preference for personal mobility, growth in infrastructure and an uptick in economic activities. However, waiting periods in the compact SUV segment continued to remain high. Furthermore, an increased cost of ownership, a slower revival in the purchasing power of lower-end consumers, an increase in petrol prices, global supply-chain issues and muted rural demand could limit 2W growth in the current fiscal year. Moreover, Electric Vehicle (EV) sales bounced back in June 2022 as the total registered EV volumes saw a 10% y-o-y increase.

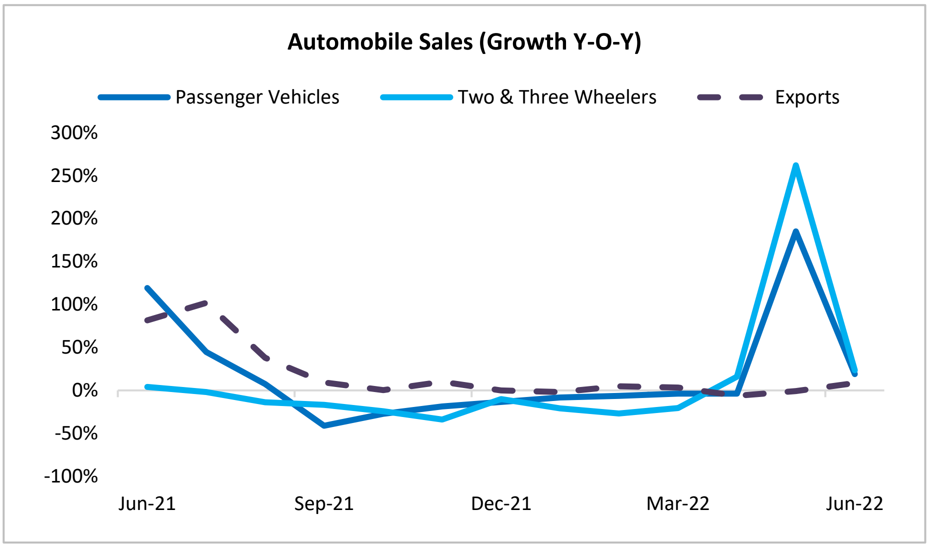
Sudeep Sanwal
(Associate Director - Ratings)

Akanksha Maindiratta
(Sr Rating Analyst)

Automobiles

Improvement in vehicle sales continue

The automobile industry has been witnessing a gradual improvement in month-on-month and year-on-year sales for most segments, buoyed by model launches, better availability of semiconductors and the softening of commodity prices. Passenger Vehicle (PV) sales continued to show positive growth compared to June 2021, improving by ~19% to 2,75,788 in June 2022.



Source- CMIE, BWR Research

Commercial Vehicle (CV) sales have outperformed other categories as demand has picked-up, in line with increased activity in road construction, mining and growth in agriculture and e-commerce. While demand in urban areas remains robust, the rural segment is slowly witnessing improvement. The Two-Wheeler (2W) segment, however, continued to remain under pressure in June 2022 owing to poor market sentiments in rural areas, high cost of ownership and inflationary pressure. The 2W and 3W segments witnessed marginal growth of 2.53% on a month-on-month basis and 23% on a year-on-year basis in June 2022. Exports of 2W and 3W? also increased by 9% on a year-on-year basis in June 2022. Going forward, recovery of rural demand and the festival season kicking in, overall sales of automobiles is expected to improve in the next quarter. However, ongoing geopolitical issues amid the Russia-Ukraine war may have a negative impact, which may lead to negative demand sentiments for consumption.

Telecom

5G auctions have largely met expected outcomes

Vipula Sharma
(Sr Director - Ratings)

Sourav Sen
(Rating Analyst)

72Ghz of the spectrum was put up for 5G auction and the government's 5G spectrum auction has garnered tremendous response from the participants. As against the Department of Telecom's (DoT) own internal estimates that the 5G auctions would generate Rs 70,000 crore to Rs 1,00,000 crore, the DoT received bids for Rs.1.5 lakh crore. Bids for the UP East circle for the 1800 MHz frequency were the most aggressive, reaching Rs.160 crores as against a reserve price of Rs.91 crores. Recent telecom reforms, along with the tariff hikes, have given a much-needed breather to service providers. The clarity in regulations, along with streamlining of the regulatory payments, has brought in renewed interest in the sector. This is visible in the large investment the companies are now willing to commit for acquiring spectrum.

The ARPUs have reached Rs.160-180 levels, with tariff hikes by service providers over the last one year. With 5G implementation and increased data usage, operators are expecting to reach ARPUs of Rs.200-300 by 2024. However, how fast the Indian tariff-conscious consumer would adopt 5G from the existing 4G for faster speeds and better experience is yet to be seen. With offices adopting hybrid work models, online learning embedding itself strongly in formal education and homes becoming digital hubs, wired broadband could also prove to be a key competitor.

Power

BWR Views

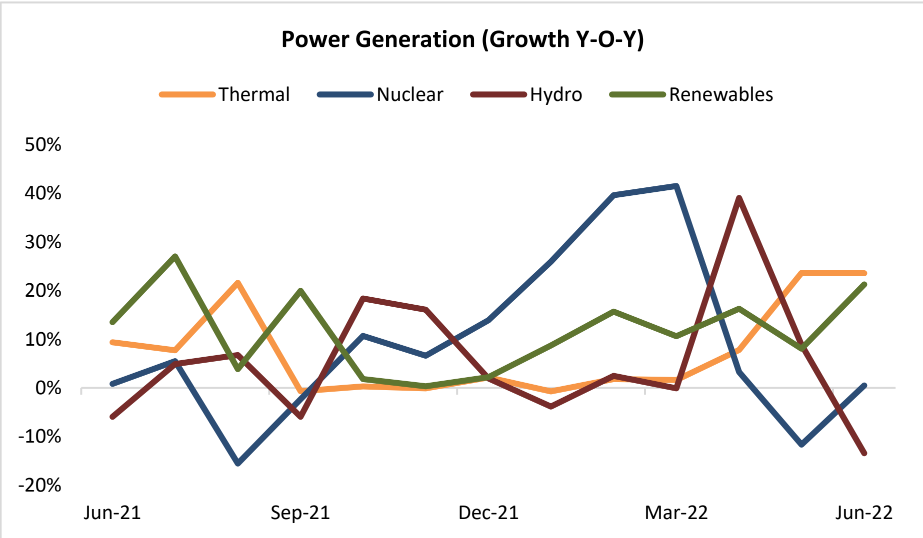
In August 2022, the Energy Conservation (Amendment) Bill, 2022, was introduced in the Parliament and it empowers the Central Government to specify non-fossil-fuel originated energy consumption thresholds for certain designated consumers such as industrial users, transportation providers and even residential buildings. There is thus, a growing thrust on renewable energy consumption at both the state procurement level, as well as a consumer level. This augurs well for renewable energy producers who can expect to see greater government-mandated adoption of renewable energy consumption in India.

Vipula Sharma
(Sr Director - Ratings)

Sourav Sen
(Rating Analyst)

Electricity Bill (Amendment), 2022, expected to nudge existing DISCOMs in the right direction; renewable power sector to benefit from greater government-mandated consumption requirements over the long term

Several amendments to the Electricity Act, 2003, was presented by the Central Government in the new Electricity Bill (Amendment), 2022 in August 2022. Some key improvements over the existing Act pertain to power distribution in the country including permitting new power distribution entrants to use the infrastructure of existing distribution companies (DISCOMs), streamlining the licencing process by regulatory commissions for new DISCOMs, authorising Load Despatch Centres to pause power supply to DISCOMs in case of inadequacies in bank guarantees in favour of power plants tied-up with as well as the setting of minimum and maximum tariff caps to inhibit predatory pricing and protect consumers. The amended Act is expected to complement the prior initiatives of the government to improve the current conditions of high leverage and unprofitability characterising DISCOMs across the country.



Source: Central Electricity Authority, BWR Research

Two recent policy developments are expected to stimulate the renewable power sector over the long term. In July 2022, the Ministry of Power issued an order wherein it specified the minimum year-wise share of energy purchase to be met from renewable energy sources (inclusive of hydroelectric power) in any distribution licensee area in the country from FY23 to FY30. The share for FY23 has been set at ~24.6% and is set to gradually increase every year till FY30, when it is needed to be around ~43.3%.

Steel

Steel prices continue to remain volatile and under pressure in the near term

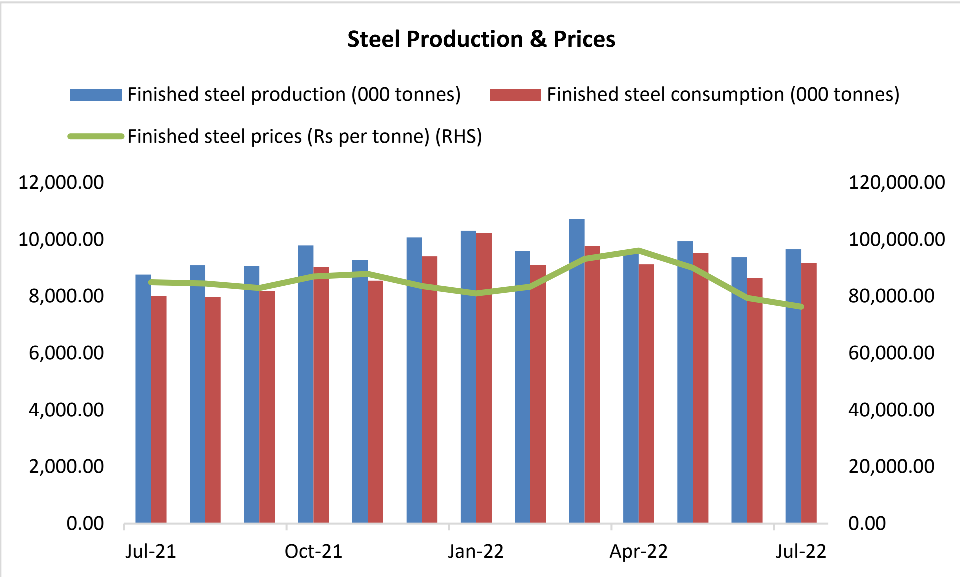
BWR Views

The fall in domestic steel prices is much higher than that in international prices. Although domestic steel prices are now back to their year-ago levels, the prices are still 10% higher than in January 2021. There will be earning downgrades for the sector as a whole. However, currently, steel companies are in a much better shape than in the past due to higher steel prices over the past couple of years. Companies have generated profits, and most companies are less leveraged compared to the past.

Bal Krishna Piparaiya
(Principal Director - Ratings)

Forum Parekh
(Manager – Ratings)

While domestic demand for steel continues to aid the volumes of the steel industry, the geopolitical events, coupled with the fight against inflation by central bankers across the world, have resulted in prices remaining under check and balanced. Steel prices have come down drastically and are down by more than 22% from their peak prices seen in early April 2022, which were around Rs 72,000 per tonne for Hot Rolled Coils (HRC) and Rs 79,000 per tonne for Cold Rolled Coils (CRC). Demand and the momentum remain steady for the sector at the national level. Domestically, demand from the infrastructure sector and consumption are driving local demand for steel. The recent fall in steel prices is aiding user industries, which should get the benefits, as demand and momentum continue to remain strong for the Indian economy.



Source: CMIE, BWR Research

Domestically, ever since the increase in the export duty for steel, export parity to the domestic market has become negative and most steel production aimed at exports has now become available for the local market. This has resulted in a much-awaited fall in steel prices. Globally also, the fear of recession and monetary tightening has led to a fall in most commodities, including steel. Currently, local steel players are exporting steel, given their commitment to the buyers, but once the contract is complete, the surplus quantum is expected to hit the local market, and prices are expected to remain under pressure. Higher production, steady demand

and the seasonal monsoon effect, all lead to a cap at the higher prices. The prices are expected to remain under pressure for some more time, as the domestic market is not ready to absorb the excess capacity created due to the imposition of export duty on steel products.

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

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

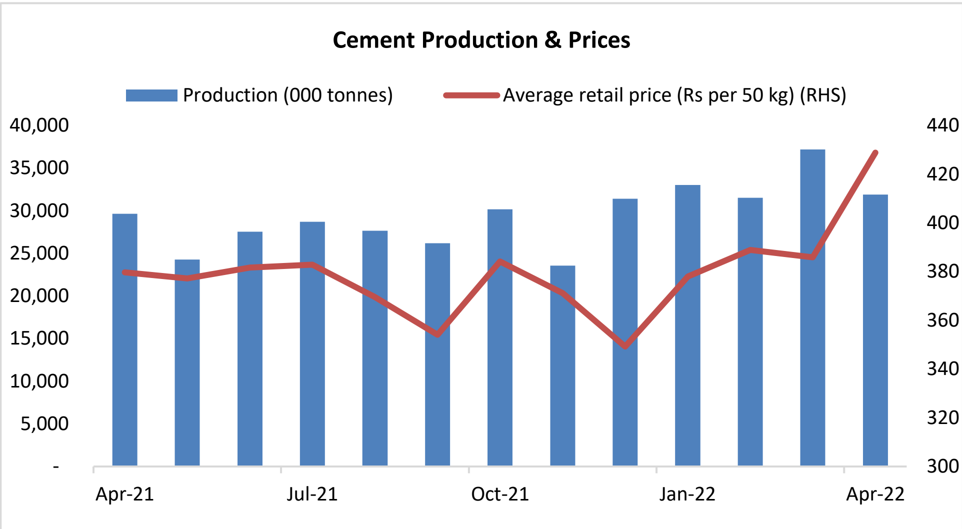
Cement

Demand expected to remain steady; pressure on margins to continue

BWR Views

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

The cement industry continued to witness growth in terms of revenue on account of demand for rural housing, aided by better crop realisation and a strong harvest season in many parts of the country. However, as expected, the operating margins remain under pressure due to the increased input costs. The margins have further been impacted due to the players' limited ability to pass on increased costs to consumers due to subdued demand during the ongoing monsoon. With the reduction in the prices of certain raw materials such as petroleum, coke and coal and improved demand, a meaningful clawback is expected from H2FY23.



Source: CMIE, BWR Research

Saakshi Kanwar
(Sr Manager - Ratings)

Vineetha Ann Varughese
(Sr Rating Analyst)

Sugar

BWR Views

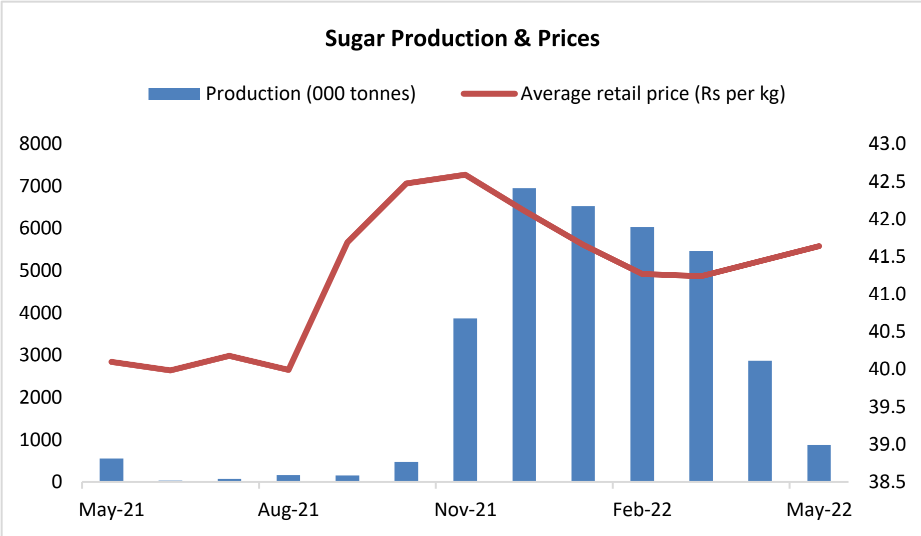
The all-India sugar production in SS 2021-22 is expected at 350 lakh tonnes after considering a diversion of 34 lakh tonnes of sugar equivalent into ethanol. The higher sugar production is due to significantly higher yields per hectare as also higher sugar recovery.

Saakshi Kanwar
(Sr Manager - Ratings)

Swarn Saurabh
(Sr Rating Analyst)

Sugar production to rise in SS 2021-22

Sugar mills produced 360 lakh tonnes of sugar during October 2021 to 15 July 2022, adjusting for the total diversion of 34.02 lakh tonnes of sugar during the period. Contributions in terms of production have remained steady from Maharashtra, UP and Karnataka at ~38%, ~28% and ~16%, respectively. Sugar export, which was 10.5 million tonnes till July 2022, is likely to cross ~11 million tonnes with the removal of the cap on exports and approval for an additional 1.2 million tonnes in Sugar Season (SS) 2021-22 ending September. Considering the diversion of ~34 lakh tonnes of sugar for ethanol blending till 10 July 2022 and the achievement of the 10% blending target (5 months in advance of the November 2022 deadline), it is likely that a 20% blending target may be achieved ahead of the deadline of 2030.



Source: CMIE, ISMA, BWR Research

Additionally, the central government increased the Fair and Remunerative Price (FRP) for sugarcane from Rs. 290 per quintal to Rs. 305 per quintal for SS 2022-23 for a basic recovery rate of 10.25%. A premium of Rs. 3.05 per quintal has been provided for each 0.1% increase in recovery over and above 10.25%, while there will be a reduction in FRP by Rs. 3.05 per quintal for every 0.1% decrease in recovery. There would be no deduction in the case of sugar mills where recovery is below 9.50%. The increase is expected to help sugarcane farmers in the ensuing season. Sugar mills that have been able to diversify their revenues through the increasing share of exports and blending are expected to have adequate liquidity, enabling them to clear farmers' dues in a timely manner.

DEBT MARKET INDICATORS

Movements in Bond Yields

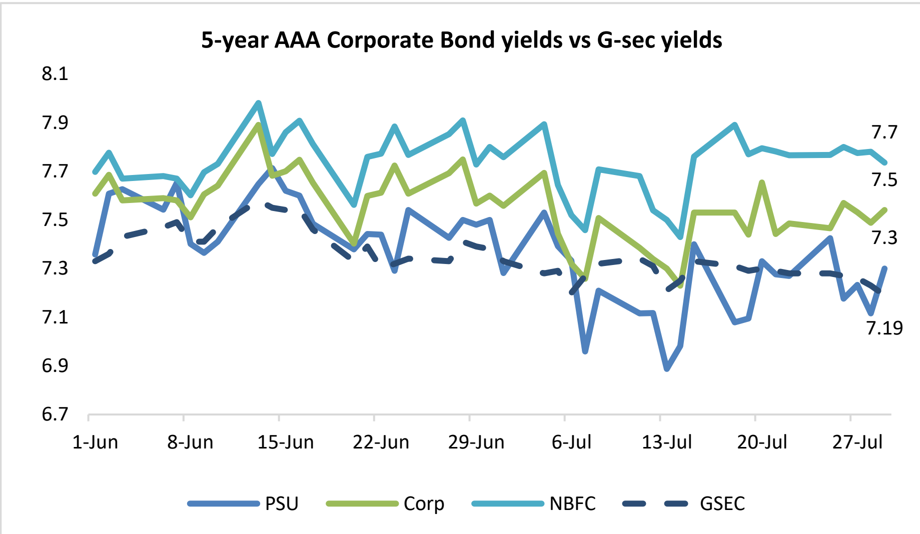
Short-term bond yields spike post repo rate rise

Following the 50 bps repo rate hike by the RBI on 5 August 2022 to 5.4% to tame inflation pressures, short-term bond yields have spiked, while the longer end moved marginally downward on account of the correction to the earlier over-reaction against the past hikes; however, the yields continue to remain elevated as forecasted by Brickwork Ratings. The hike in the policy repo rate by 140 bps in the recent past in three tranches by the RBI has not only led to a rise in bond yields, but has also put pressure on interest rates across all the debt segments and bank deposits, as expected.

Gilt yields m-o-m witnessed a marginal downtrend in mid- and long-term segments of 3 years and above in contrast to a marginal uptrend in maturities up to 2 years. The combined effect of the higher repo rate, crude oil prices, inflation, augmented governmental borrowings and depreciation in the rupee has caused a rise in the 10-year G-Sec yields by 55 bps in the last 6 months although there has been a marginal downward correction in long-term bond yields during the last one month. M-o-m, there has been a near-parallel upshift in the shorter end of the yield curve and downshift in the mid-segment and longer end.

Gilt yields were ruling at the following levels at the close of 10 August 2022 with m-o-m changes over (7 July 2022): 10-year at 7.25% (7.38%), 3-year at 6.83% (6.89%), 4-year at 6.86% (7.01%), 5-year at 6.95% (7.17%) and 30-year at 7.65% (7.65%), 3-month at 5.60% (5.14%), 6-month at 5.96 % (5.59%) and 1-year at 6.32% (6.32%). The Corporate bond yields moved in tandem.

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



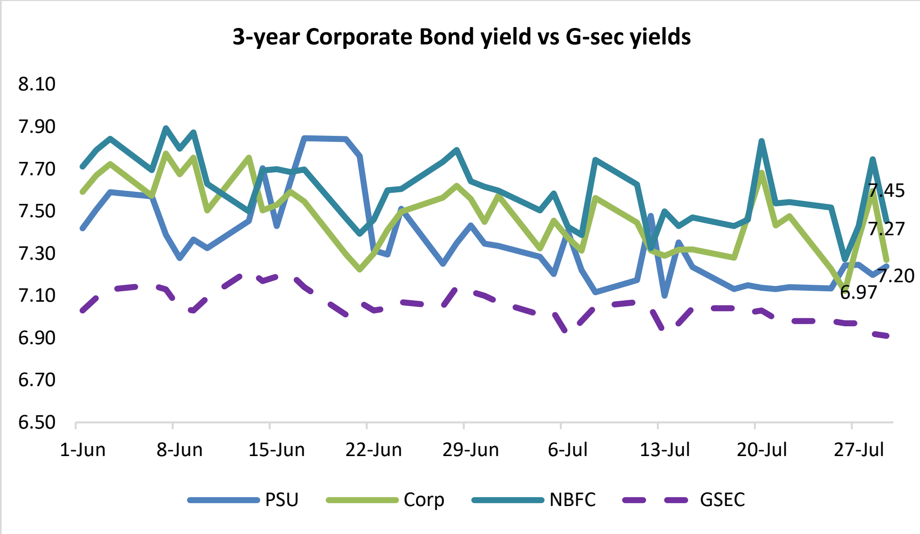
Source: FIMMDA, BWR Research

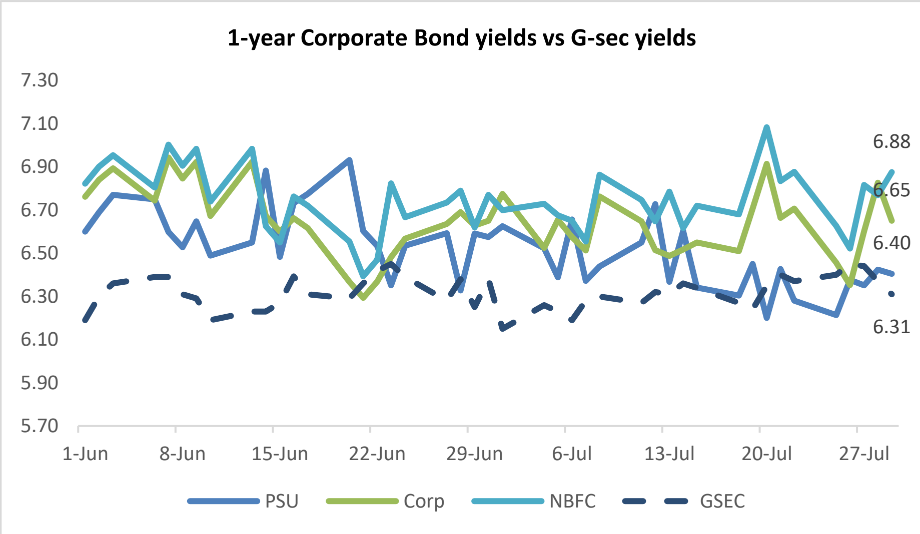
BWR Views

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

Bal Krishna Piparaiya
(Principal Director - Ratings)

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

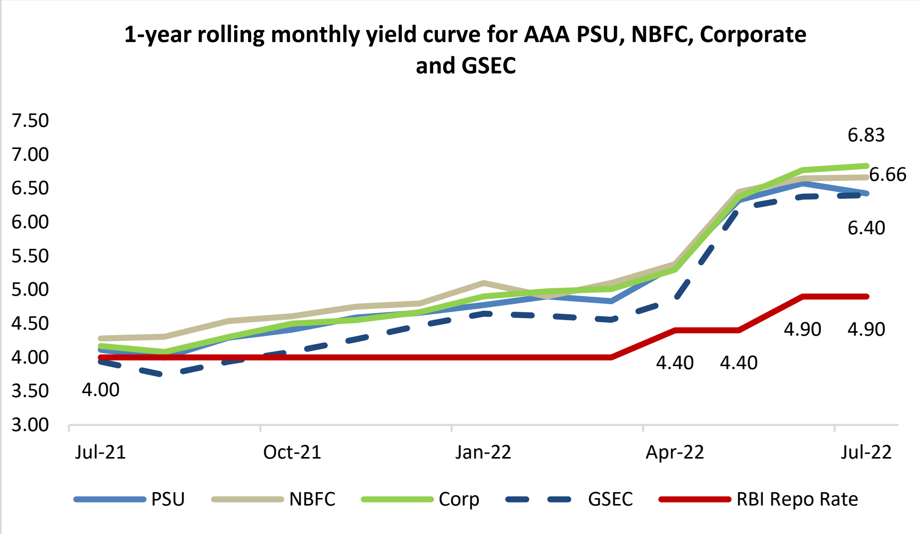




Source: FIMMDA, BWR Research

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

The borrowing costs for bonds maturing in 1 year issued by PSUs, NBFCs and corporates witnessed some escalation in the range by 231-266 bps in July, in line with the G-Sec yields (246bps) against the corresponding period last year. Similarly, the key policy rate (repo rate) had a consecutive hike in May and June 2022 by 40bps and 50bps, respectively.



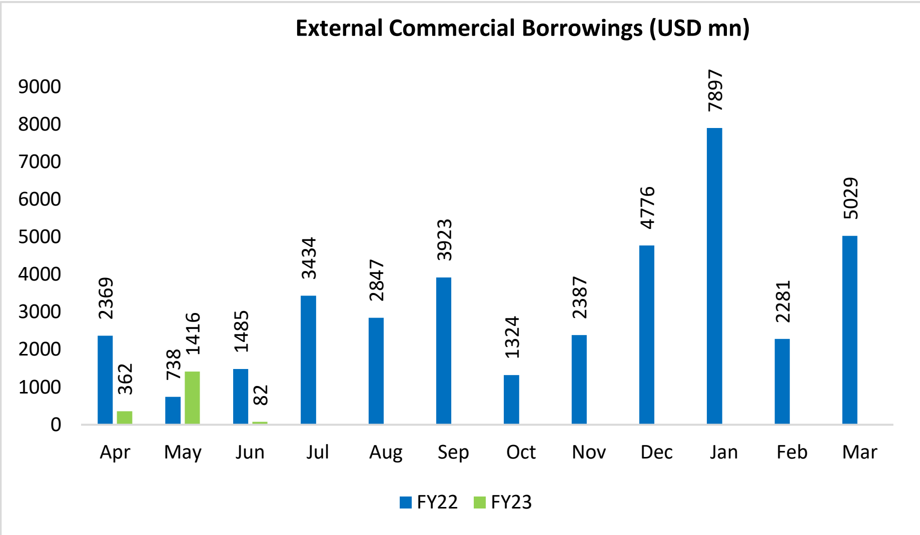
Source: FIMMDA, BWR Research

External Commercial Borrowings

BWR Views

Indian companies' ECBs, which declined to USD 362 Mn in April 2022 from USD 2.3 billion in April 2021 reversed the trend and showed a rise to 1.416 billion USD in May 2022 over 738 Mn USD in May 21. However, the borrowings in the segment were a meagre 82 Mn in June 2022 as against 1.485 billion USD in June 2021. In BWR's opinion, in spite of geopolitical disturbances, demand for ECBs is expected to rise on account of higher interest rate differentials on the back of rising interest rates in India.

According to RBI data, Indian corporates' borrowings were at USD 82 million from offshore markets in the form of External Commercial Borrowings (ECBs) during June 2022 compared to USD 1485 million during the same period last year, recording sharp fall in the trend.



Source: RBI, BWR Research

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BWR has its corporate office in Bengaluru and a country-wide presence, with offices in Ahmedabad, Chandigarh, Chennai, Hyderabad, Kolkata, Mumbai and New Delhi, along with representatives in 150+ locations. BWR has rated debt instruments/bonds/bank loans, securitised paper of over
₹ 19,02,200 Cr. Additionally, fixed deposits and commercial papers, among others, worth over ₹ 83,555 Cr have been rated.

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