Budget sets better economic prospects; Fiscal challenges continue to weigh in
February 2020

Liquidity boosting measures to accelerate rate transmission and boost credit demand

Budget proposals and the RBI’s liquidity boosting measures, coupled with previously announced government measures, are expected to bring the domestic economy on an improved growth track in fiscal 2020. Signs of economic revival, such as improved IIP and eight core sector activities, already exist. Furthermore, the Manufacturing PMI showed substantial rebound, with the index reaching an eight-year high of 55.4% in January.

With a 3.5% fiscal deficit target for the next fiscal, the Finance Minister proposes to spend Rs 30.42 lakh crore in 2020-21, which is 12.7% higher than the revised estimate of 2019-20. On the revenue front, out of the estimated Rs 22.46 lakh crore, the government expects to collect 9% of its receipts through disinvestments (Rs 2,05,000 crore) from the sale of a large stake in LIC. For the current fiscal, the government revised the fiscal deficit target to 3.8%, breaching the target by 0.5 percentage points from its previous budget estimates.

In the recent MPC statement, the committee continued to assure a facilitating role to prop-up the economy, by maintaining rates and accommodative stance, despite the CPI inflation reaching 7.35% in December 2019. The committee’s statement that there is policy space available for future action hint at further monetary easing, if inflation falls below the 6% level. The RBI is likely to maintain a pause in its next policy actions going by the inflation projection of 6.5% for the fourth quarter (which is above the RBI’s comfort zone).

Additional measures by RBI like incentivising banks for further monetary transmission of rates, linking the pricing of loans by scheduled commercial banks for medium enterprises to an external benchmark, and providing a leeway in CRR (Cash Reserve Ratio) on incremental lending on credit disbursements to certain productive sectors such as auto, housing and MSMEs, likely to improve the credit flow to these sectors. The move also aimed at stabilising and softening yields. The transmission of past rate cuts, which otherwise remained muted thus far, is likely to materialise in the coming quarter.

The collective efforts of the RBI and government are expected to bring better growth prospects in the medium-term for the domestic economy. The nascent recovery signs witnessed in some economic indicators during the recent few months were largely attributed to festive-related demand, base effect, and earlier announced government measures influencing sentiments. If the trend continues, achieving 5% growth estimated for the current fiscal looks possible. The next release of the second advance estimates of GDP by the Central Statistics Office (CSO), expected to be released by February-end may provide further clarity on the growth projections for 2019-20, which we expect would be in line with the first advance estimates, as well as Brickwork Ratings estimates.

Economic Survey 2019-20 has estimated GDP growth of 6-6.5% for fiscal 2020-21 expects the economy to gain momentum. We also expect the economy to witness a reversal in a slowdown from the next fiscal, aided by policy initiatives taken by the government and RBI. Geopolitical risks and the expectation of a slow rebound in some key sectors that are currently under stress are major factors that may pose a downside risk to growth. The effectiveness of the measures taken to address demand is the other variable which can impact growth. Thus, our GDP growth estimates are constrained at 5.5-6% for the next fiscal.
MACRO-ECONOMIC INDICATORS

Economy Trends

GDP growth slowed to a six-year low in the first half of 2019-20 and the full-year growth estimates by the CSO at 5% is at an 11-year low. Some nascent signs of revival in economic activity were witnessed recently. After four consecutive months of contraction, IIP and eight core sectors reported positive output in November and December 2019. An improvement in demand is reflected in the sharp expansion in the Composite PMI Output Index, which reached a seven-year high of 56.3 in January 2020.

Amidst renewed optimism corroborated by positive growth in IIP and eight core sectors in addition to the sharp jump in the Composite PMI Output Index, the economy may rebound in the next fiscal. Brickwork Ratings estimates 5.5-6% GDP growth for 2020-21, as against the Economic Survey estimate of 6-6.5%.

Performance in Eight Core Industries and Index of Industrial Production (IIP)

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

The Consumer Prices Index (CPI) surged by 7.35% in December 2019, the highest in the current series (base 2011-12), mainly due to a spike in food prices. Core inflation (excluding food and fuel) and fuel inflation also inched up marginally, but only moderately. Overall inflation surpassed the MPC’s upper band target of 6% for the first time since the formation of the MPC. In the coming months, the inflation rate is expected to soften from current levels, due to low demand and easing of the food inflation, but may remain above the MPC’s upper target of 6%.

Source: MOSPI, RBI, BWR Research

Crude Oil Prices and INR/USD rates

After geopolitical developments in the Middle East, crude oil prices have been growing since November, potentially posing a risk for inflation and the exchange rate. Easing tensions helped the oil prices ease and also supported the rupee to remain stable at the previous month’s closing level. Net Investment in equities by foreign portfolio investors amounted to USD 1,718 million in January 2020, and lower crude oil prices helped the rupee strengthen slightly, despite the US dollar gaining strength abroad.

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

Latest available data pointers, such as the exchange rate, CAD and forex reserves, suggest easing external sector vulnerabilities. However, merchandise trade, both exports and imports continued negative growth in December 2019, compared with the corresponding period a year ago. Decline in imports adds to a weakening consumer spending, especially with the ongoing stress in the auto sector. Trade deficit narrowed by 22% (y-o-y), primarily because of a larger decline in imports than in exports.

![India’s Merchandise Trade Balance (USD mn)](chart)

Source: Ministry of Commerce, BWR Research

Forex Reserves and Import Cover

Foreign Exchange Reserves crossed the $458 billion mark in end-December 2019, reporting a $64 billion increase in a year. The current level of forex reserves is adequate to cover 11.8 months of imports, which is comfortable and helps absorb external shocks of oil prices and exchange rate volatility. The RBI is also seen intervening frequently, particularly by selling dollars in the forward market to manage rupee at a comfortable level.

![Forex Reserves and Import Cover](chart)

Source: Ministry of Commerce, RBI, BWR Research

BWR Views

Lower crude oil import has been keeping the import bill low, resulting in lower export growth as we re-export petroleum and crude products. The main external risks that arise in managing trade balance include volatile oil prices and currency movements. Despite geopolitical tensions, crude oil prices remained almost stable thus far, and any adverse international events that prompt an increase in crude oil prices will aggravate India’s import bill.

BWR Views

In the event of external pressures, India may continue to rely on exchange rate flexibility. With abundant forex reserves, the RBI may intervene frequently to arrest sudden or sharp falls.
Government Accounts

Fiscal deficit has crossed the Budget Estimates (BE) of Rs 7,038 billion to Rs 9,317 billion during the April to December 2019 period. Through disinvestments, the government has collected Rs 18,000 crore thus far and is expected to generate Rs 65,000 to bridge the fiscal gap. In line with our expectations, the government revised its fiscal deficit to 3.8% for the current fiscal from the earlier estimates of 3.3%.

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

The gross GST revenue collected in each of the last 3 months crossed Rs one lakh crore, showing a steady rise in collections. During April-January 2019-20, vis-à-vis 2018-19, the gross GST revenue collection grew by 5.1%, and the January 2020 GST collection is the second highest monthly collection since GST was introduced.

Source: Ministry of Finance, BWR Research
SECTORAL INDICATORS

Automobiles

Domestic automobile sales fell by 14% y-o-y in January 2020, largely driven by weak commercial vehicle and two-wheeler sales. Commercial vehicle sales were down 14%, and two- and three-wheelers sales were down by 15% y-o-y in January 2020. The weak commercial vehicle sales reflect the lower industrial activity in the country and the impact of revised axle norms and financing issues due to the NBFC crisis, while weak two-wheeler sales is an outcome of low rural demand.

![Automobile Sales (Growth y-o-y)](image)

Source: CMIE, BWR Research

Although healthy growth was witnessed in automobile sales in September and October on a sequential basis due to festive buying, this recovery was short-lived; in November, sales again slipped into the red zone. The Union Budget emphasising increasing rural consumption and renewed government focus on infrastructure spending may help boost demand for automobiles, especially two wheelers. Also, RBI’s decision to incentivise banks by providing leeway in CRR on incremental lending to auto sector will result in higher credit flow to the sector.

![Automobile Production and Sales](image)

Source: CMIE, BWR Research

BWR Views

Commercial vehicle sales will continue to remain muted, going forward. However, these sales may gain momentum in the last quarter of FY20 due to anticipated pre-buying by fleet owners before the BS-VI norm kicks in April 2020 onwards. Although sales may still be lower than that the previous year, the value is expected to improve on a month-on-month basis. A delay in the announcement of the scrappage policy will further impact sales.
Telecom

Market consolidation continues, with Jio increasing its market share and driving overall subscriber additions in the sector. The increase in subscriber base is driven by a rise in rural subscribers. The subscriber base is expected to widen further as penetration increases, especially in rural areas. Cheap data and feature phones will drive the subscriber base in rural areas.

Source: TRAI, BWR Research

The sector suffered a blow, with the Supreme Court rejecting the review petition filed by telcos in the Adjusted Gross Revenue (AGR) matter. Subsequently, the telcos filed for a modification plea with the Supreme Court, for which the hearing is expected to be happen soon. Various non-telecom PSUs, which also came under the ambit of this litigation on account of the revised AGR definition, have also filed petitions with the Supreme Court as their liabilities are expected to be 3x more than that of core telecom companies.
A pick-up in the economic activity and industrial output is critical for power demand to revive, which in turn is imperative for an improvement in the financial condition of thermal power plants.

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Power

Power generation fell by 2% y-o-y in December 2019, reflecting a slump in demand. This is evident from lower power generation from thermal sources, as thermal power units continue to struggle on account of falling demand amid a reduction in manufacturing and industry output. The power sector also faces other challenges, including the non-availability of adequate bank credit, absence of long-term Power Purchase Agreements (PPAs) and issues related to coal tie-ups.

Renewable energy has again come to the forefront, with Budget 2020-21 providing a considerable push to the sector. From developing large solar capacities alongside railway tracks on the land owned by Railways to coming up with a scheme under which farmers can set-up solar power plants on their barren lands, the government has come up with innovative ideas to increase the current installed solar capacity.

Additionally, measures such as lower corporate tax for new power companies and 100% tax exemption to Sovereign Wealth Funds on the income earned from their investments in the infrastructure sector are expected to drive investments and improve investor sentiment. Furthermore, there are expectations of reforms on the distribution side under which the PFC is expected to set-up an Alternate Investment Fund (AIF) to clear dues owed by Discoms to thermal power producers. The IREDA is likely to set-up a similar type of fund for clearing the dues to renewable energy producers. While all these measures are considered steps in the right direction, their effective implementation is imperative to bring real positive changes.

Source: Central Electricity Authority, BWR Research

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BWR Views

A pick-up in the economic activity and industrial output is critical for power demand to revive, which in turn is imperative for an improvement in the financial condition of thermal power plants.

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Steel

Steel prices started improving in December 2019, with the improvement in industrial and construction activity in the country that are evident in recently released indicators such as IIP, eight core and Manufacturing PMI. Demand has started to pick-up, and the recent announcement in the budget about a substantial push to infrastructure will further aid revival in the sector.

![Steel Production & Prices Chart](image)

Source: CMIE, BWR Research

Cement

Cement prices have started correcting from June 2019, after witnessing a sharp increase in April and May 2019, which was based on the anticipation of healthy demand, going forward. The prices have remained range-bound thereafter, reflecting a weak actual demand on account of slow construction activity in the country. However, it is expected to revive as the economy has started to show some signs of improvement.

![Cement Production & Prices Chart](image)

Source: CMIE, BWR Research
Banking

Overall, bank credit during April-December 2019 increased by only 1%, compared with 6% growth during the same period in the previous year. The lower offtake was primarily more evident in the industry and services sector, which has a high level of NPAs, and hence a cautious lending approach of banks to this sector. Credit demand has also weakened due to the very limited investments in the economy.

The industrial sector, which has relatively higher levels of non-performing assets (NPAs), has witnessed a 3% drop in credit deployment in the current fiscal thus far. Credit growth is expected to remain muted in the coming months on account of a slowdown in private investments in the economy.

Source: RBI, BWR Research
DEBT MARKET INDICATORS

Movements in Bond Yields

Bond yield (annualised) of Public Sector Units (PSUs), Corporates and Non-Banking Finance Companies (NBFCs) maturing in 5-, 3- and 1-year tenures with corresponding Government Securities and Marginal Cost of funds based Lending Rate (MCLR) of banks are provided below.

Going forward, we expect yield to ease-off as the RBI has increased the FPI limit in corporate bonds and relaxed the investment limits in Voluntary Retention Route (VRR), which may add to liquidity in the bond market.

Source: FIMMDA, SBI, HDFC, BWR Research

Source: FIMMDA, SBI, HDFC, BWR Research
Yield of AAA-rated corporate bonds maturing in 5-, 3- and 1-year tenures have changed slightly in January due to uncertainty in gauging a further course of rate action by the RBI's MPC on account of rising inflation amid concerns over economic growth.

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

The borrowing cost for corporate bonds maturing in 1-year issued by Government, Public Sector Units (PSUs), NBFCs and Corporates have dropped in January 2020 by 125-218 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. Thus, the transmission of the 135 bps rate cut has been passed on to the tune of 191 bps, 218 bps and 164 bps for PSUs, NBFCs and Corporates, respectively.

Source: FIMMDA, BWR Research

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**Diagram 1:**

1-year AAA Corporate Bond yields vs Gsec yield, MCLR

**Diagram 2:**

1-year rolling monthly yield curve for AAA PSU, NBFC, Corporate and GSEC

Source: FIMMDA, BWR Research
External Commercial Borrowings

Indian companies’ borrowing from offshore markets through External Commercial Borrowings (ECB) fell in December due to high volatility in the rupee and rising geopolitical tensions.

Companies borrowing through External Commercial Borrowing (ECB) may pace up again on the back of various measures announced by the Government of India. Going forward, the Indian companies would direct their funding from the offshore market to take advantage of the stable currency.

Source: RBI, BWR Research
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