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Economy is poised to record better growth; Sustained recovery is key

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Economic Recovery and Downside Risks

Economic recovery in India is well and truly underway. Since the middle of March 2021, the second wave of the pandemic not only has created a severe health crisis, but has also forced the imposition of lockdowns in economic activities in virtually every state, thereby arresting the recovery process, which was underway since October 2020. Thus, although GDP growth in Q1FY22 was about 20.2%, it was well below the contraction in the Q1FY21 at 24.4%. With the relaxation of restrictions, the Q2FY22 has seen a steady recovery with increasing capacity utilisation in many sectors. However, full recovery is still some distance away, and many social distancing sectors are yet to resume their activities. The RBI estimates Q2 growth at 7.9%, and considering more recent trends in leading indicators, we expect growth in the Q2 at a slightly higher rate of 8.3%. With sharp decline in the new cases and with the vaccination numbers exceeding one billion, the economy is poised to recover even faster than originally estimated, and we expect full FY22 growth to be close to 10-10.5% as against the RBI estimate of 9.5%.

Recovery is expected to be fast paced in the Q3 of FY22. The leading indicators have shown a fast turnaround, with the manufacturing PMI in October registering an eight-month high at 55.9 from 53.7 in the previous month and the services PMI at 58.4 from 55.2 in the previous month, which is the fastest growth in 10 years. The GST collection at Rs 1.3 trillion is the second highest recorded in the year after April when it was Rs 1.4 trillion. This is 24% higher than in October 2020 and 36% higher than in October 2019. With pent up demand still at work and an increase in festival demand in a more confident economy, and with a more stable technology platform in place, the November collections might come close to or even exceed the April collections. Commodity exports too have been buoyant, with the June quarter recording USD95 bn in value terms and October exports touching a record USD35 bn, recording 42% growth over the previous year. At this rate, it should not be difficult to reach the target of USD400 bn set for the year.

Interestingly, despite the clamour for increased public spending to fast pace the recovery process, the government has continued to be conservative. In the first half of the fiscal year (H1FY22), the revenue deficit was just 27.7% and the fiscal deficit, 35% of the budget estimate, which is the lowest in recent years. This was because of the almost 96% increase in revenue receipts and restraining the non-interest revenue expenditure increase at just 2.5%. The revenue collection H1FY22 was 60%. With better buoyancy expected in corporate income tax, personal income tax, excise duty on petroleum products and the GST, the tax revenue collection is likely to

exceed the budget estimate by a significant margin. The capital expenditure in the H1FY22 has shown a phenomenal 38.3% increase and constituted 41% of the budgeted. Robust revenue growth, even after the recent reduction in the excise duty on petroleum products, provides some space for fast pacing the capital expenditures even more.

While the economy will continue to recover as sectors requiring social distancing such as trade and travel become fully functional, it is important to recognise the downside risks. The tapering of liquidity by the Federal Reserve would increase the interest rates in the US and could reduce the inflow of foreign portfolio investment to India. However, the tapering is expected to be gradual, and the country is in a much better position to face the situation than in 2013, when the tapering had serious adverse consequences. As the RBI itself will be required to mop up excess liquidity in the system, the structure of interest rates will gradually start moving northwards.

More concerning are the supply-side problems creating downside risks to growth. Chip shortage is a major dampener to the production of mobile devices, automobiles, appliances, engineering goods and data centres. Rocketing raw material costs are another constraining factor in the recovery process. The elevated price of crude oil is presently at the 2014 level, and this increases not only the transportation cost, but also raw material costs. The costs of agricultural raw materials including fertilisers and pesticides, metals and mineral products such as zinc, aluminium and steel have been rising steadily since January. Ocean freight rates have increased four times since last December.

There are concerns on the price front as well. Although so far consumer prices have remained within the upper band of the inflation target, supply-side pressures could aggravate to cost push inflation. The high price of crude oil, the prices of transportation and various raw materials pointed out above in addition to edible oil can create pressures. The RBI has signalled the measures to drain liquidity. Nevertheless, the price situation needs to be watched carefully.

Thus, even as the economy is poised to recover and the growth rate is expected to accelerate in the remaining two quarters, both the government and the RBI will have to exercise vigil not only to ease supply bottlenecks, but also to undertake measures to soften the increase in prices. The recent measures to reduce the excise duties on petroleum products and import duties on edible oil are helpful, but are unlikely to have a lasting impact in controlling inflation. The emerging environment needs to be closely monitored to ensure the process of stable and sustainable recovery.

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	Oct-2021
Economy					FY21 Q2			FY21 Q3			FY21 Q4			FY22 Q1			FY22 Q2*			
GDP at 2011-12 Prices	Y-o-Y in %	6.53	4.04	-7.25	-7.44			0.46			1.64			20.16			8.35			-
GVA at 2011-12 Prices	Y-o-Y in %	5.90	4.14	-6.16	-7.31			1.04			3.72			18.77			7.35			-
Agriculture	Y-o-Y in %	2.56	4.31	3.63	3.04			4.53			3.10			4.52			5.96			-
Industry	Y-o-Y in %	5.31	-1.23	-6.96	-2.99			2.91			7.93			46.15			11.23			-
Services	Y-o-Y in %	7.20	7.19	-8.36	-11.43			-1.21			1.50			11.42			5.59			-
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	6.80
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	2.50	
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	9.90
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	56.70	55.20	58.40
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	52.30	53.70	55.90
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	-3.70	28.30	@	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	62.60	16.44	9.39	9.94	11.47	4.37	-
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	-15.05	-
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	-41.20	-
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	-16.60	-
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	-2.24	-3.59	-11.69
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	37.70	-	-
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	77.10	-	-
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	79.20	-
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	35.47
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	55.37
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	74.93
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	82.11
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	642.02
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	0.68	
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	11.57	11.39	10.66	
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	4.52	3.43	1.14	
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	11.46	11.39	11.41	
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	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	6.46
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	6.86
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	5.96
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	5.98
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	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	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.
* BWR Estimates
Source: MOSPI, RBI, PPAC, FBIL, eaindustry.nic.in, IHSMarkits.com, SBI, CMIE, FIMMDA, BWR Research

MACRO-ECONOMIC INDICATORS

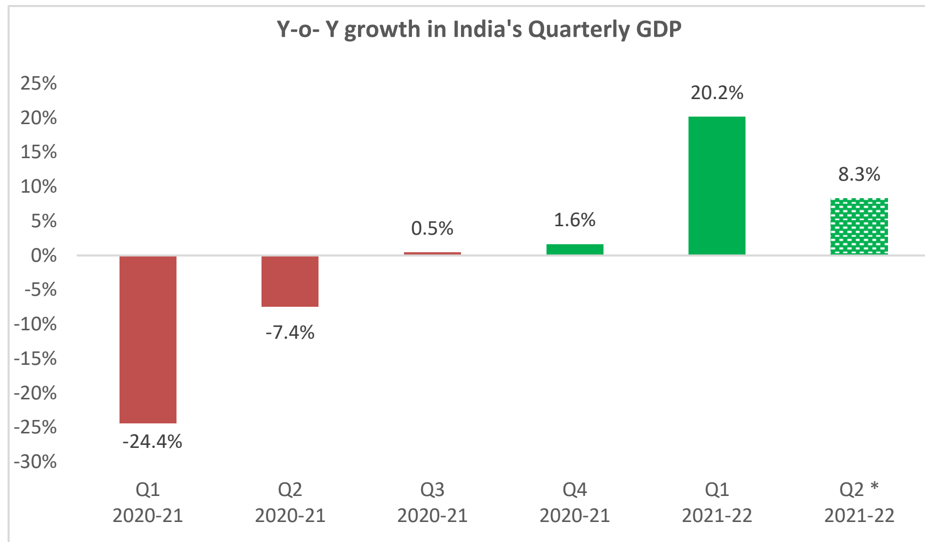
BWR Views

The economy has been recovering well from the devastation caused by the second wave, and most of the growth indicators are performing better on a year-on-year basis. We expect the economy to continue to revive at a faster pace in the coming quarters, and the downside risks of a possible third wave to growth too are limited due to the progress achieved in vaccination. 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 FY22.

We expect GDP growth for Q2FY22 at 8.3% y-o-y (year-on-year), on the back of a 7.4% contraction in Q2FY21. The subsequent quarters too will see recovery if there is no resurgence of the virus in the form of a third wave. Subsequently, we revise our GDP estimates for FY22 to 10-10.5% from 9% estimated earlier.

GDP Trends: Growth revival appears real and broad-based

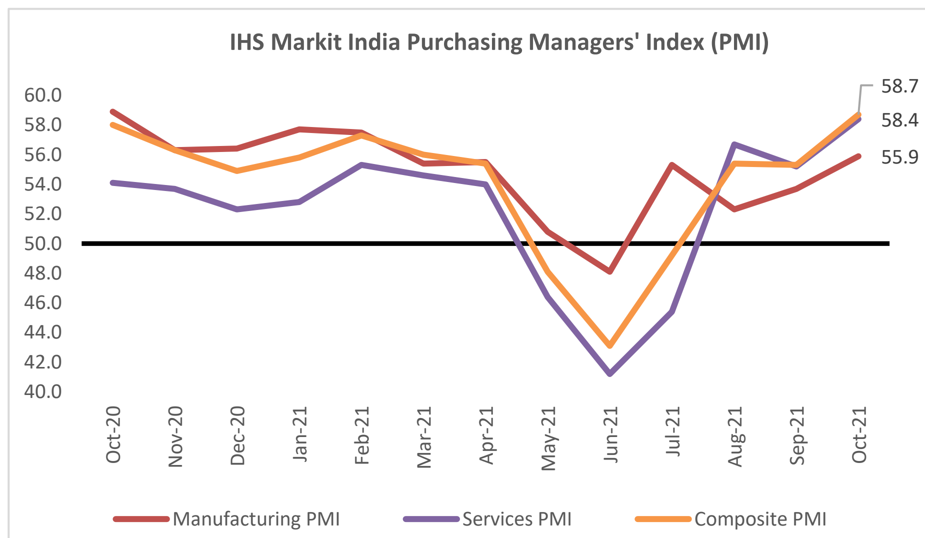
Despite the disruptions caused by the second wave, the Q1FY22 GDP grew at 20.2% largely due to base effect. However, this was well below the contraction in Q1FY21 at 24.4%. Sharp turnarounds in growth in the GVA in manufacturing at 49.6% and in construction at 68.3% show a significant revival in these sectors and their resilience in withstanding the restrictions due to the second wave of the pandemic.



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

Growing manufacturing activities strengthens recovery hopes

After having witnessed sequential decline in Q1FY22, reflecting a demand slowdown due to the second wave and lockdowns, industrial activities have shown significant growth recently. Data on the IIP in August (11.9%) and eight core industries in September (4.4%) has reported increases in production on a y-o-y basis. The manufacturing PMI improved in October to an eight-month high of 55.9, and the services PMI rose to 58.4, the strongest in ten-and-a-half years.



Source: IHS Markit, BWR Research

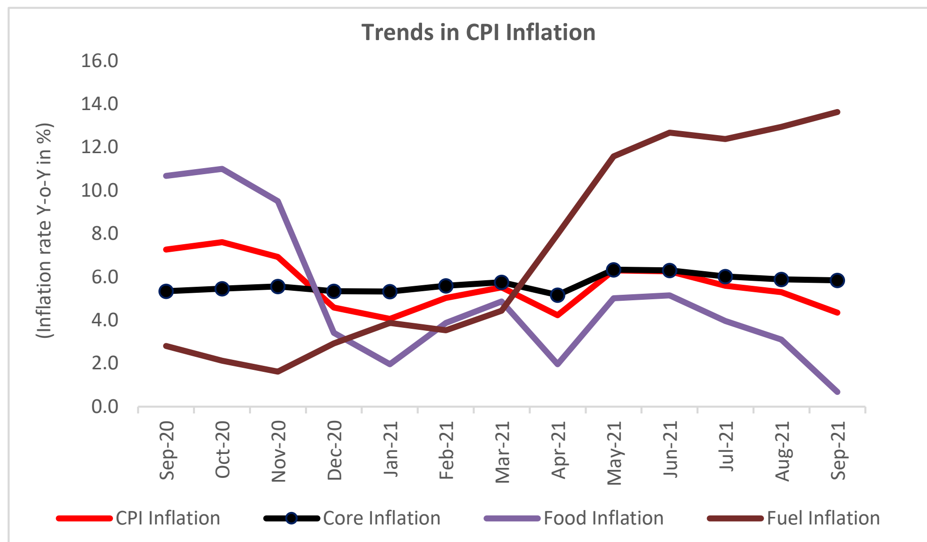
BWR Views

With good rainfall coverage, coupled with increased relaxations in restrictions to ease supply-side constraints, the inflation rate is likely to soften. However, 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. 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 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.

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

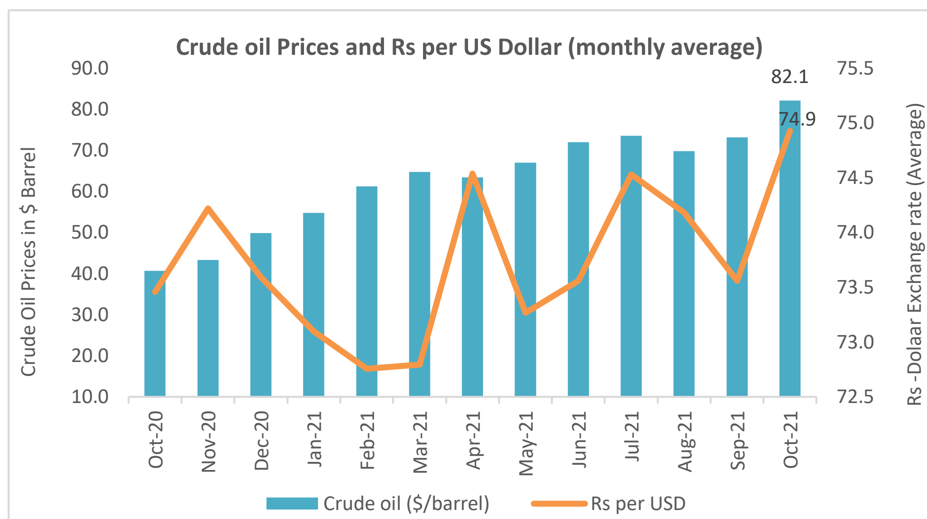
The CPI inflation eased notably in September to 4.35% as food inflation softened to 0.68%. Fuel inflation continues to remain higher due to rising international crude oil prices. The Q2FY22 average inflation rate (5.08%) is in line with the RBI's inflation rate outlook of 5.2%, which was revised from 5.9% in the October MPC. The RBI has also lowered the inflation outlook for Q3FY22 to 4.5% from 5.4% and full fiscal to 5.3% from 5.9%.



Source: MOSPI, BWR Research

Crude oil prices to increase further

Crude oil production by the Organization of the Petroleum Exporting Countries (OPEC) is an important factor that affects crude oil prices. On 4 October, OPEC+ announced that the group would keep the current production targets unchanged. With the world economy recovering faster from Covid-19, global demand for crude oil has increased sharply. In October, the average oil prices increased by USD 9/barrel from those in September. The Indian rupee too depreciated as Foreign Portfolio Investors (FPIs) withdrew USD 1.66 billion funds from Indian markets.



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

BWR Views

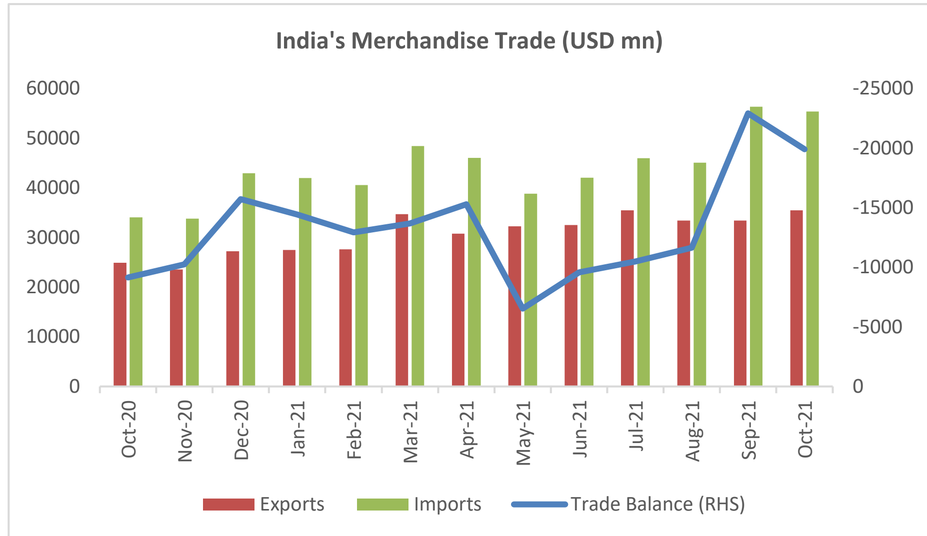
Despite growing demand, the OPEC member countries' unwillingness to increase production targets is expected to keep crude oil prices higher. Coal shortage is another concern that is expected to lead to a power shortage and may further increase demand for fuel prices. We expect Brent crude oil prices to remain at the current levels at around USD 80 to 85/ barrel in the coming days.

Merchandise Trade: Recovery in the developed world helping exports

BWR Views

With recovery in the developed world taking deeper roots, Indian exports too showed a remarkable increase during the first half of the current fiscal. Commodity exports have been buoyant, with the October exports crossing a record USD35 bn, recording 42.3% growth over the previous year. At this rate, it should not be difficult to reach the target of USD400 bn set for the year.

Merchandise exports recorded 54.5% growth during the April-October 2021 period, as against an 18.8% contraction in the corresponding period 2020. Exports are up from their 2019 levels by 25.4%. Imports too reported a 73.5% surge on a y-o-y basis during the review period of April to October 2021 over the corresponding period in the previous year; they are up by 12.8% from the corresponding period in 2019.



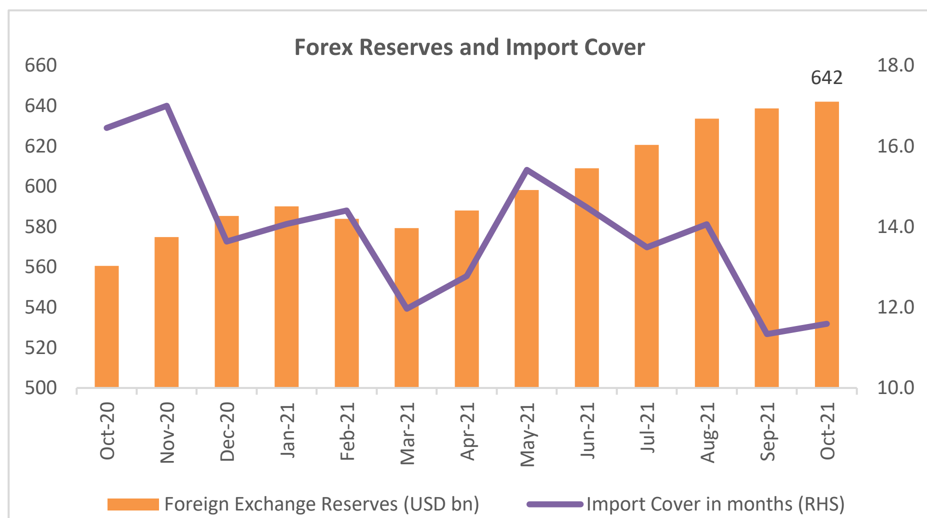
Note: Preliminary data for October 2021, data is provisional.
Source: Ministry of Commerce, BWR Research

Rising forex reserves provide cushion for external shocks

BWR Views

Intermittent fluctuations in FPI flows into domestic markets and rising crude oil prices may lead to volatility in the domestic currency. 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, offering much-needed comfort to deal with such uncertainties.

Forex Reserves rose to USD 642 billion as on 29 October 2021, up by around USD 81.5 billion compared to October 2020 levels. A healthy increase in the Foreign Currency Assets (FCR) and value of gold contributed to this rise. The FCRs increased to record levels due to sustained FDI inflows (USD 17.18 billion during Q1FY22) and FPI inflows (USD 2 billion in H1FY22). In addition, to help countries cope with the impact of the COVID-19 pandemic, the IMF has allocated 12.57 billion Special Drawing Rights (SDRs), equivalent to USD17.86 billion on 23 August 2021.



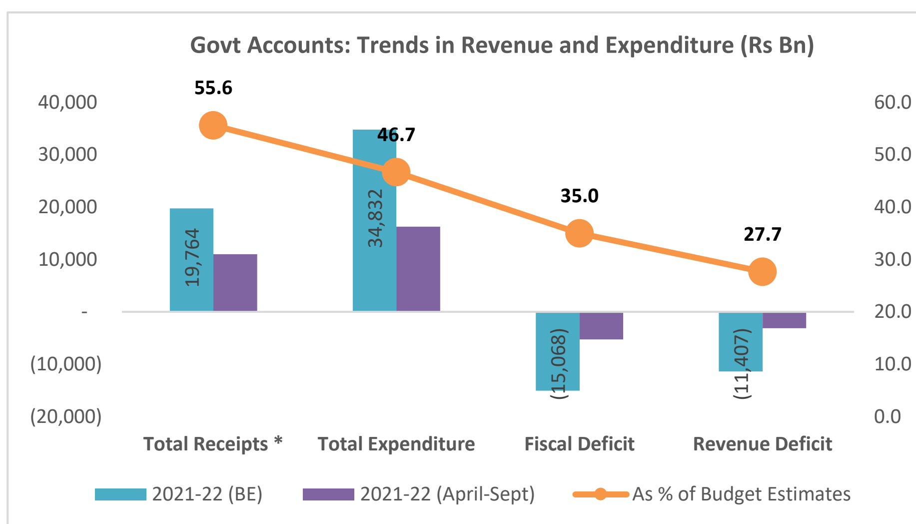
Source: Ministry of Commerce, RBI, BWR Research

Government Finances: Tax revenue collection is likely to exceed the budget estimate

BWR Views

The government's reservations (hesitancy) on increasing public spending are reflected in the H1FY22 revenue deficit and fiscal deficits, which are the lowest (than the budget targets) in recent years. The government has been far too cautious in increasing its expenditures to contain the fiscal deficit. With better buoyancy expected in corporate income tax, personal income tax, excise duty on petroleum products and the GST, tax revenue collection is likely to exceed the budget estimate by a significant margin. The government is also likely to maintain the fiscal deficit targets at budgeted levels of 6.8% of the GDP in FY22.

As per the latest data (provisional), the central government was able to collect 55.6% of the budgeted receipts during H1FY22 and spent 46.7% of the targeted budgeted expenditure, while the capital expenditure has constituted 41.4% of the budget targets. The revenue collection in H1FY22 was 60% of budget targets, and the government borrowing stood at about 35% of the budget estimates of FY22.



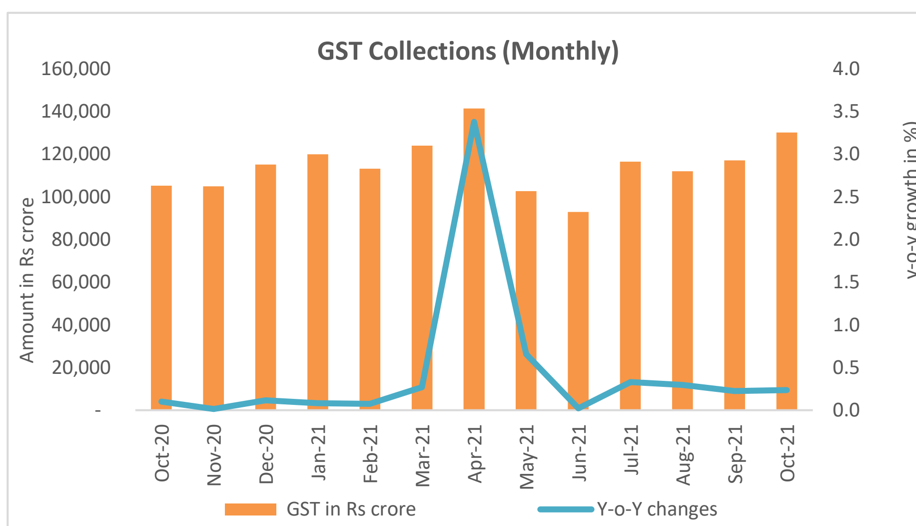
Note: Data is provisional, BE: Budget Estimates.
Source: Controller General of Accounts (CGA), BWR Research

Goods and Services Tax (GST): October collections is the second highest so far

The GST monthly collections at Rs 1.3 trillion in October are the second highest recorded so far and are 24% higher than in October 2020. The GST monthly collections continued to remain above Rs 1 lakh crore since October 2020, except for June 2021, reflecting recovery in economic activities. During April-October 2021, the GST collections increased by 45.2% over April-October 2020.

BWR Views

With the relaxation in lockdown restrictions, trade and business activity are likely to recover, and tax collections are expected to improve significantly in coming months. With pent up demand still at work and an increase in festival demand in a more confident economy, and with a more stable technology platform in place, the November collections might come close to or even exceed the April 2021 collection of Rs 1.4 trillion.



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

SECTORAL INDICATORS

Banking

Credit growth has begun to pick up as business activity resumes in full swing

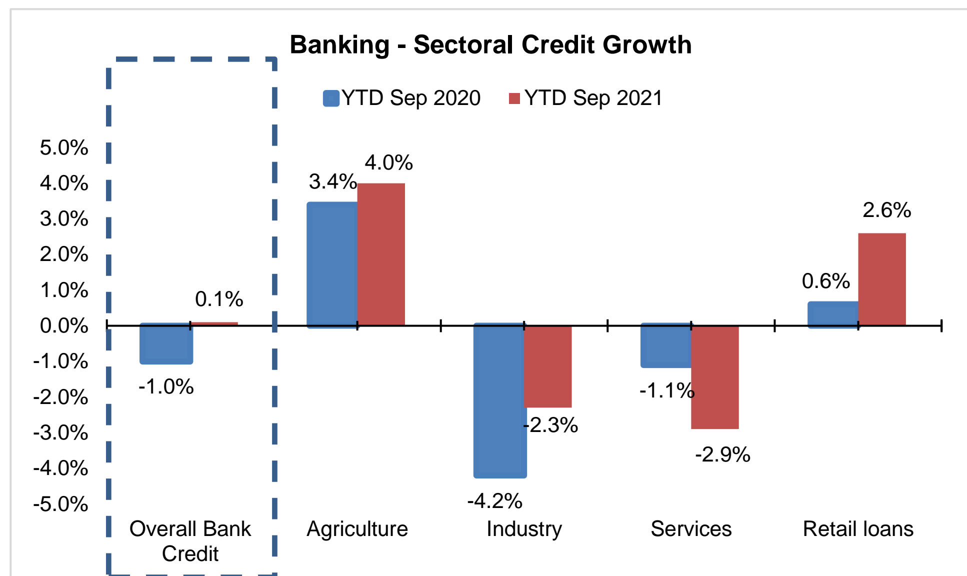
BWR Views

BWR views that the government and RBI have always been proactive in enhancing credit growth to support the business cycle across segments. Collections, which were slower during April 2021-May 2021, have since been improving. With the economy picking up, combined with rapid vaccination, further growth across industries is expected, which will ease credit flow. However, in the near to medium term, a drop in the asset quality could be expected, which can impact profitability.

Vidya Shankar
(Principal Director - Ratings)

Anuj Rastogi
(Ratings Analyst)

As of September 2021, credit to agriculture and allied activities registered higher growth. Credit growth to the services sector, however, decelerated mainly due to a contraction/deceleration in credit growth to NBFCs, trade and commercial real estate. Personal loans registered accelerated growth primarily due to faster credit growth in housing, vehicle loans and loans against gold jewellery.



Source: RBI, BWR Research

From the results for Q2/H1FY22 for the majority of the banks, the face of the banking sector has been observed to be showing an improved position, backed by persistent growth for both the quarters of the FY22 and adequate capitalisation by the government for PSBs. However, it is pertinent to note that the asset quality position for banks remains monitorable as slippages witnessed a significant increase in H1FY22.

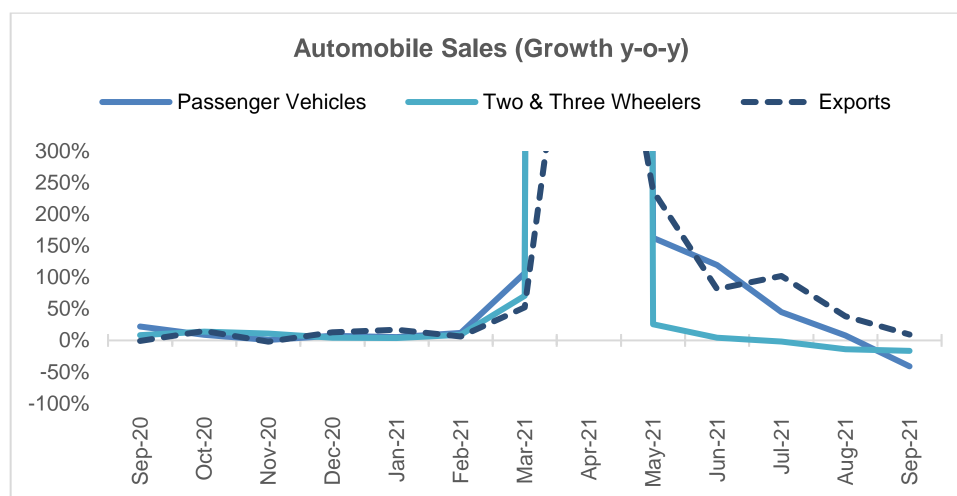
In the start of FY22, the Reserve Bank of India (RBI) had three Public Sector Banks (PSBs) under Prompt Corrective Action (PCA) restrictions, with IDBI Bank being removed in March 2021; with their financial profiles having improved, IOB and UCO Bank were removed in September 2021, and Central Bank of India is presently the sole bank under the restrictions. Moreover, the RBI has revised the PCA framework, which will be effective 1 January 2022 onwards, to enable supervisory intervention at appropriate time.

The RBI has continued to maintain liquidity in the market to help the economy revive from the effects of the pandemic. The Government of India, on the other hand, has backed PSBs through capitalisation and the formation of the National Asset Reconstruction Company Limited (NARCL) for cleaning the bank's books from a significant build-up of stressed assets. However, the ability of PSBs to raise capital from the market and instil confidence among investors will help them maintain their market presence and share.

Automobiles

Improvement in vehicle sales halted due to component shortage

Despite the festive season, automobile sales were hit in October 2021 and are substantially lower on a y-o-y basis despite a low base effect and recovery in underlying demand. The low sales volumes are primarily attributable to the much talked about lingering semiconductor chip shortage, and high fuel prices. Disrupted electric component supply chain has led to the depletion of retail inventory and also a long waiting period for vehicle purchase.



Source: CMIE, BWR Research

Passenger vehicle sales across all the categories declined in October 2021. Two-wheeler sales volumes registered significant decline of ~26% y-o-y and garnered no traction from the festive season primarily on account of high fuel prices. On the contrary, Commercial Vehicle (CV) sales volumes in October 2021 showed positive y-o-y growth due to an improvement in tractor sales on account of good monsoon 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. Exports have continued to perform well, led by a recovery in global demand and the waning effect of Covid-19.

BWR Views

Continued production loss for Original Equipment Manufacturers (OEMs) is expected as supply-side issues will take longer than expected to resolve due to multiple complexities. 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, coupled with rising commodity prices, vehicle price hikes will be inevitable and pose a challenge of high cost of ownership to buyers in the medium term. Meanwhile, the policy thrust towards Electric Vehicle (EV) penetration would necessitate investments for OEMs to remain competitive and relevant in the medium to long term.

Tanu Sharma
(Director - Ratings)

Telecom

Reforms a breather for the telecom sector

The government provided the ailing telecom sector some much needed relief by way of a robust reforms package involving a moratorium on the AGR and spectrum dues, reduction in the interest rates on the license fee and spectrum usage charges and by increasing the tenure of the spectrum payments to 30 years. While these measures have definitely increased the attractiveness of the sector from an investments point of view (which is critical for the incumbents), the overall viability of the sector will not improve unless the tariffs also undergo a change. Either the government sets-up floor tariffs for the sector or telcos willingly increase tariffs as they did in December

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
(Sr Director - Ratings)

2019. For the long-term resolution of the telecom sector's woes, the average ARPU has to increase by another 30%-40%.

Power

Power sector averts coal shortage crisis

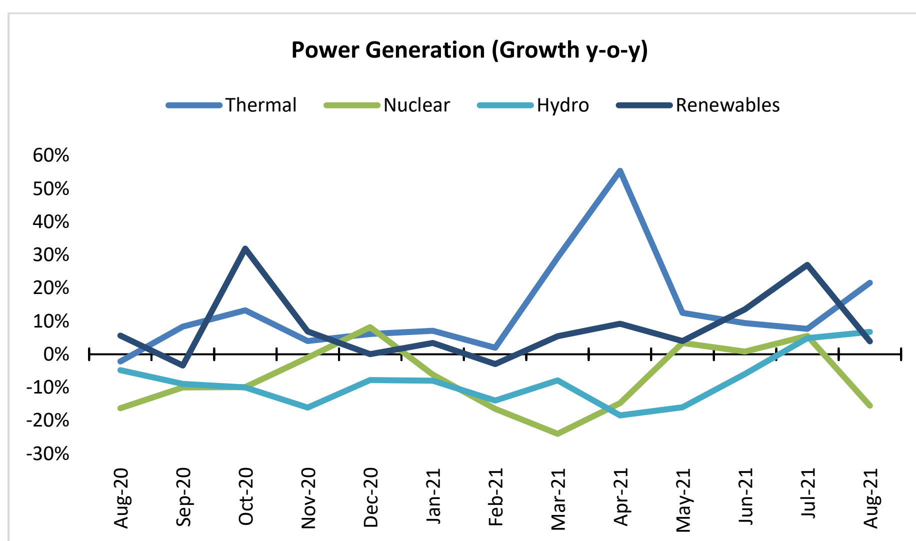
BWR Views

There is a need to replace the contribution of thermal power with renewable energy at a greater pace and adequately support it by investing in the required transmission and storage infrastructure.

Vipula Sharma
(Sr Director - Ratings)

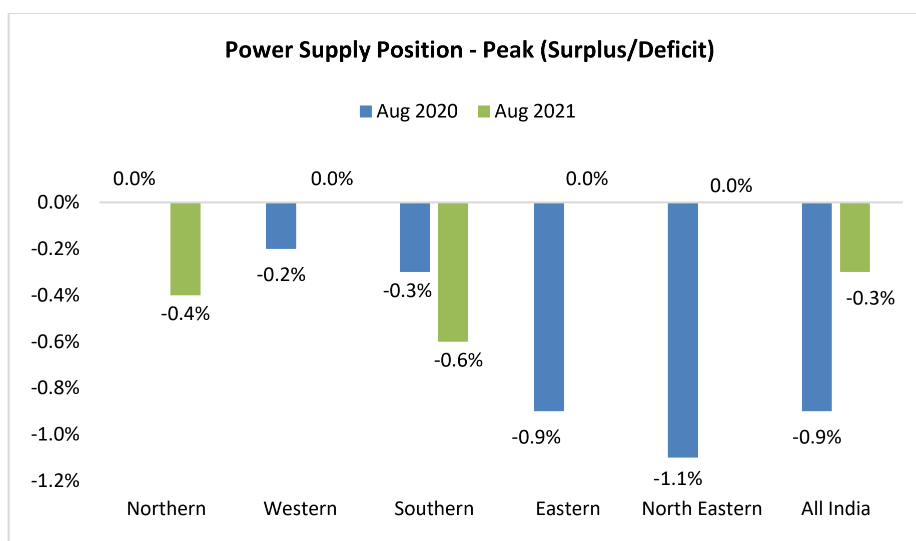
Aakriti Sharma
(Manager - Ratings)

The power demand-supply mismatch has improved significantly, according to the Power Ministry, on account of the ramping-up of coal supplied by Coal India and its subsidiaries to power generation plants. Coal supplies were impacted by the extended monsoon, which had put many states at the risk of facing power outages as adequate quantities of fuel were not available with generation companies.



Source: Central Electricity Authority, BWR Research

However, on the government's directions, Coal India curtailed supply to non-power sectors such as steel and cement and increased supply to the power sector by more than 20% during the past month, leading to an improvement in the generation capacity of thermal plants.



Source: Central Electricity Authority, BWR Research

Steel

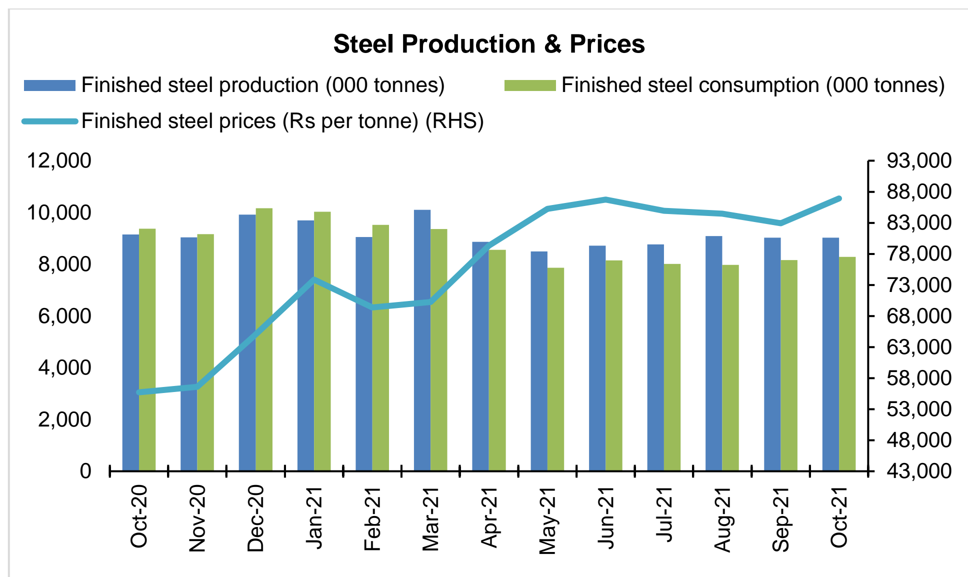
Despite iron ore prices skydiving, cost inflation may squeeze steel companies' margins.

In its earlier issue, BWR had opined that while steel demand outlook remains strong, higher input costs will cap realizations. This is happening now, as evidenced by the rise in production costs, except for iron ore. From the peak of USD 225 in January 2021, iron ore prices crashed to below USD 100 in November 2021, mainly on account of uncertainty in China's (which accounts for half of the global steel consumption) government regulations on steel mills and the ban on Chinese exports, finally resulting in a 20% cool-off in steel prices from their peak after their northward journey. Hot Rolled Coil (HRC) prices in India are hovering at around Rs 70000 per tonne, after a high of Rs 86000 per tonne in September 21.

As expected, iron ore prices, which had earlier skyrocketed, continued to tumble, and coal prices and freight costs are playing the spoilt sport. Buoyant steel demand and cost inflation in general are expected to continue to support escalated steel prices. Coking coal prices and freight costs are higher, and this, along with general inflation, is squeezing the margins of the steel industry, which has seen the highest EBIDTA margins in the January to September 2021 period.

BWR Views

In BWR's opinion, steel demand will continue to remain buoyant, and the steel prices near stable. The Indian steel outlook remains positive in the short and medium term, but cost inflation may squeeze the margins of the industry in H2 2021-22.



Source: CMIE, BWR Research

Bal Krishna Piparaiya
(Principal Director - Ratings)

Forum Parekh
(Manager – Ratings)

The domestic sponge iron sector may report negative growth, and steel prices may see sideways movements due to cost inflation. In early November, the prices of the benchmark HRC were raised by the major manufacturers in India by Rs 3,500 a tonne on the back of rising cost inflation caused by soaring coal and other fuel prices. Rising costs will lead to lower realizations to steel producers than in the past quarter, in spite of buoyant demand.

New production capacities are not expected in the near future. The Indian industry has started brown field expansions and acquiring closed steel plants, and is trying to increase the production to cash in on higher demand and prices, both in India and

abroad. Indian companies earn higher realizations in export than in the domestic market due to price differentials. However, despite higher steel prices globally, increasing costs will curb the margins of the industry. Overall, demand for steel continues to remain high; however, higher costs will lead to lower realizations for the industry.

Cement

BWR Views

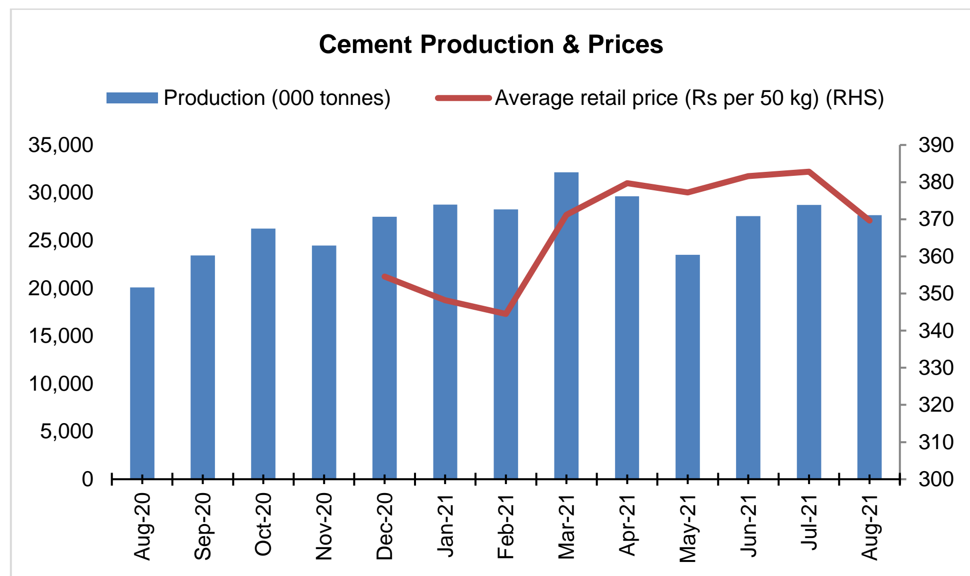
BWR expects the sector to grow at 10-12% in FY22 and keep up the momentum in FY23 as well, on the back of a faster-than-expected recovery in the housing sector and the government's thrust on infrastructure spending in the country.

Vidya Shankar
(Principal Director - Ratings)

Naveen S
(Manager – Ratings)

Strong demand recovery to be led by increased infrastructure spending

Cement manufacturers have been facing price inflation on power and fuel and freight costs, which constitute almost 55–60% of their total operating cost. On the other hand, the companies could not fully pass on the rise in input costs due to the lean period on account of the monsoon season. This resulted in theirs margin being compressed during H1FY22.



Source: CMIE, BWR Research

BWR expects cement prices to rise in H2FY22 as the manufacturers are well-positioned to pass on a good portion of the increase in the cost of cement making, on account of a robust demand scenario. Switching to renewable energy sources and revisiting efforts to reduce transportation costs is likely to improve the margins, going forward.

Sugar

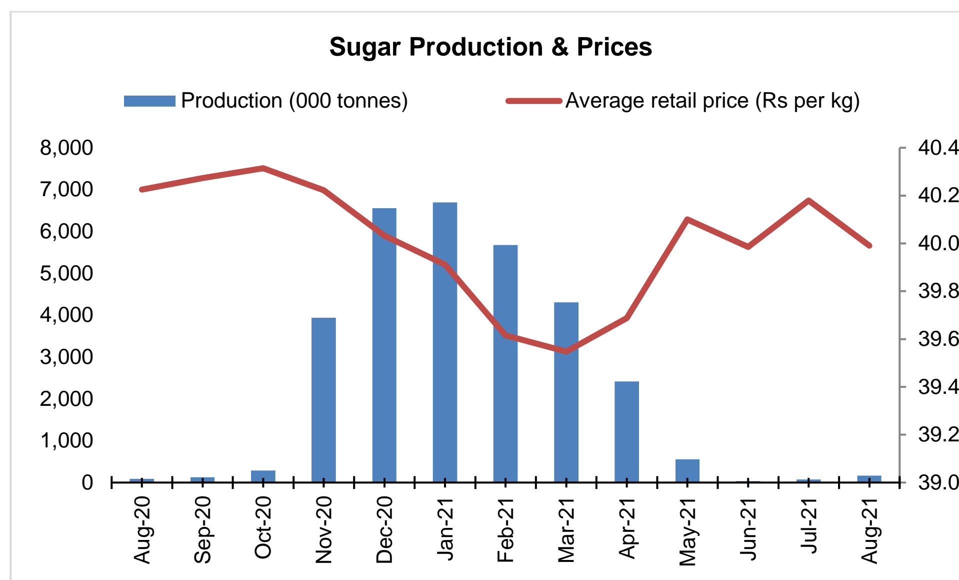
BWR Views

Sugar production is estimated to remain flat at ~30.5MT in SS 2021-22 as against the earlier estimate of ~31 MT and last year's figure of ~30.9 MT due to the diversion of sugarcane juice for ethanol manufacturing and fall in yield and sugar recovery in Uttar Pradesh. Keeping in view the

Sugar production to remain flat in SS 2021-22

India's sugar export is expected to decline to 5-6 million tonne (MT) in the 2021-22 marketing year (October - September) against an all-time high of 7.1 million tonne (MT) in the 2020-21 marketing year. The primary reasons for this expected decline are the diversion of sugarcane juice and molasses for ethanol production and higher than expected sugar export by Thailand. Higher transportation costs due to increased fuel prices are also expected to impact India's sugar export. However, amid

the reports of lower sugar production in Brazil in its current SS (April 2021 – March 2022), global sugar prices are expected to remain bullish. Brazil's next sugar season is also reported to possibly be affected due to the worst drought in Brazil in the last 90 years. Due to this, many global agencies have projected a higher sugar deficit to the tune of 4 - 5 MT in the next SS 2021-22, starting 01 October 2021.



Source: CMIE, ISMA, BWR Research

Saakshi Kanwar
(Sr Manager - Ratings)

Swarn Saurabh
(Sr Ratings Analyst)

The ethanol blending level will reach 8.5% in the 2020-21 ethanol marketing year ending November with supply of 3.25 billion litre to Oil Marketing Companies (OMCs). It is expected to reach ~10% in the 2021-22 ethanol marketing year ending November with supply of 4.25 billion litre to OMCs.

DEBT MARKET INDICATORS

Movements in Bond Yields

BWR Views

RBI Retail Direct Scheme (RRDS) in G-Sec, recently launched at the hands of Hon PM of India Shri Narendra Modi for individual buyers, will boost the hitherto large untapped potentials of Gilt investment and will provide direct, convenient, cost-free liquid and zero risk investment opportunity in Gilt to HNI and other retail investors. This is a widely much awaited positive reform and will forge a paradigm shift in the bond market, spiking up demand for government bonds and lowering the cost of the government borrowing (which has so far been higher than banks' deposit rates), going forward, in the long run. Aggressive strategic moves by the RBI to support liquidity and encourage the two-way movements of yields and assisting in the orderly evolution of the yield curve will continue. In BWR's opinion, yields are expected to maintain a hardening trend in the short and medium term, and the 10-year gilt yield is expected to remain at around 6.25% in the short run and rise to 6.5 % in the later part of H2 2022 owing to the augmented government borrowings and the inflationary tend.

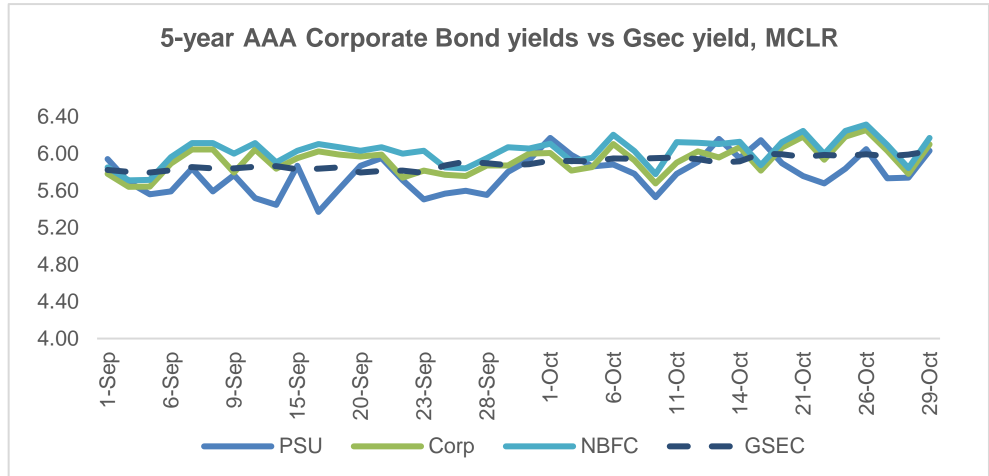
"RBI Retail Direct Scheme" for individuals for government bonds to forge a paradigm shift in the bond market

'RBI Retail Direct Scheme' (RRDS) for retailing in Government bonds (Gilt/G-Sec) launched at the hands of honourable Prime Minister Narendra on 12 November 2021 will forge a paradigm shift and has a far-reaching positive implication for bond demand. Unlike in the US, in India, investment in Gilt by individuals was minimal and hitherto limited indirectly through mutual funds and some specified banks. This direct scheme will widen the scope of investment for individual buyers, HNI, and provide them direct access to the retail market and primary auctions and will assist in managing liquidity and their investments cost-free at zero risk. The cost of borrowing by the GOI has been hitherto higher than the interest rates on bank deposits in spite of it being a sovereign investment at zero risk to the investors. Currently, the 10-year bank deposits are at 5-5.5%, while the 10-year Gilt is trading at 6.37%. One of the reasons for this is the absence of direct investment opportunities and trading by individuals in the retail segment. The launch of RRDS will therefore immensely boost demand for Gilt, reduce the cost of borrowing for the GoI and widen the bond market. This has been a much-awaited step. Kudos to the RBI and GoI.

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, whereby 10-year gilt yield is expected to move sideways around 6.25% and rise in the latter part of H2 2022, touching 6.5%, owing to augmented government borrowings. In line with BWR expectations, m-o-m, the 5- and 10-year gilt edged securities hardened by 4 bps, and 10-year closed at 6.367% YTM at the close of 11 November 2021. The upshift in the yield curve was across all the maturities up to 10 years, barring, 1, 6 and 7 years on account of lower trading in this segment. The rise was higher at the shorter end, and on the contrary, the 30-year yield softened by 17 bps due to the long-term expected higher demand on account of to-be-launched direct retailing in G-Sec by the RBI, and closed at 6.926%. The short-term yields for 3 and 6 months hardened by 15-30 bps and 3 years by 11 bp. There was a near parallel upshift in the yield curve up to 10 years, barring a few exceptions. The gilt yields were at 6.367% for 10-year, 3-month at 3.57%, 6-month at 3.84%, 1-year at 4.035%, 2-year at 5.01%, 3-year at 5.01%, 4-year at 5.72%, 5-year at 5.857% and 30-year at 6.926% as on 11 November 2021. Corporate bond yields are expected to move in tandem.

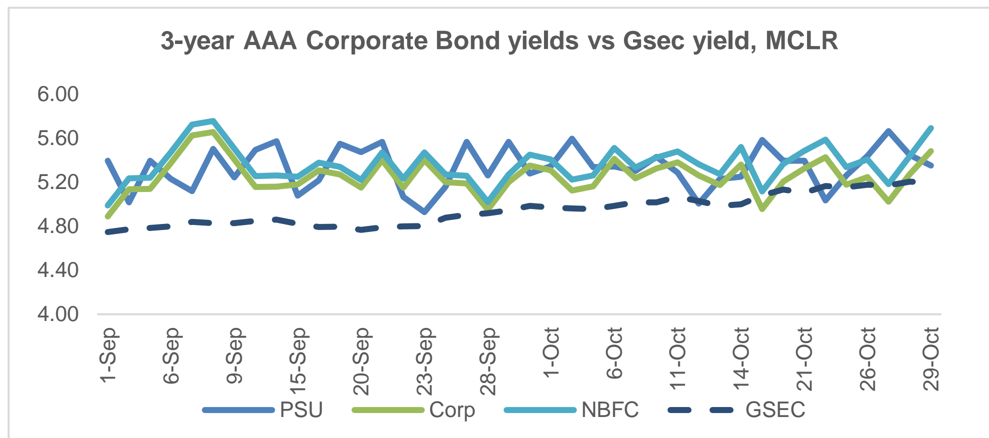
The bond yield (annualised) issued by Public Sector Units (PSUs), corporates and Non-Banking Finance Companies (NBFCs) maturing in 5-, 3- and 1-year tenures with corresponding government securities are provided below.

Bal Krishna Piparaiya
(Principal Director - Ratings)

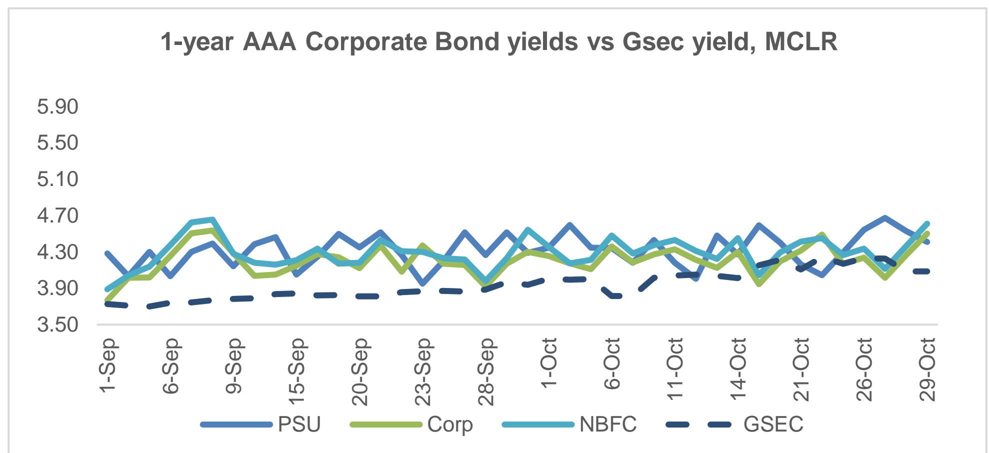


Source: FIMMDA, SBI, HDFC, BWR Research

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.



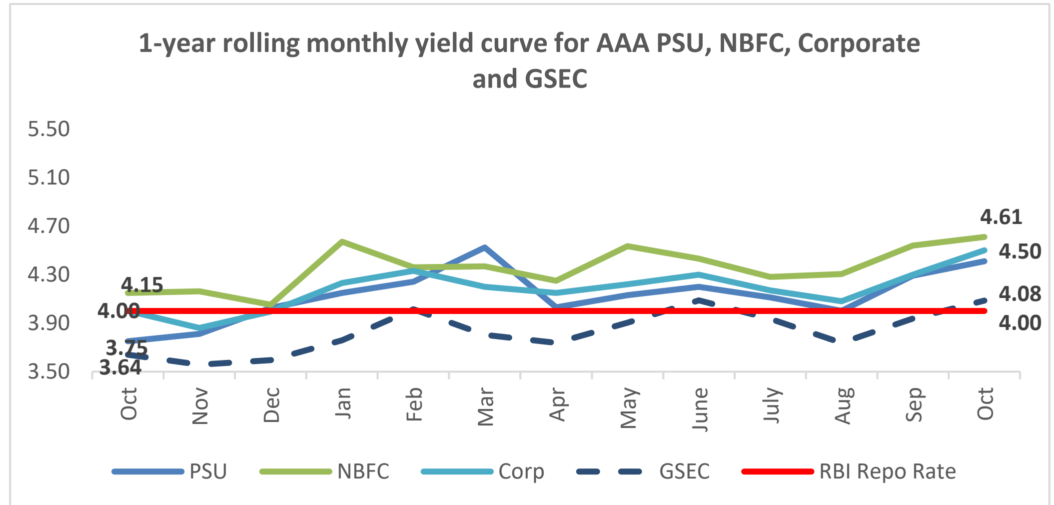
Source: FIMMDA, SBI, HDFC, BWR Research



Source: FIMMDA, SBI, HDFC, 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 hardening in the range of 46-66 bps in October, in-line with the silent G-Sec yields (45bps) against the corresponding period last year. The key policy rate (repo rate) remained muted during the same period.



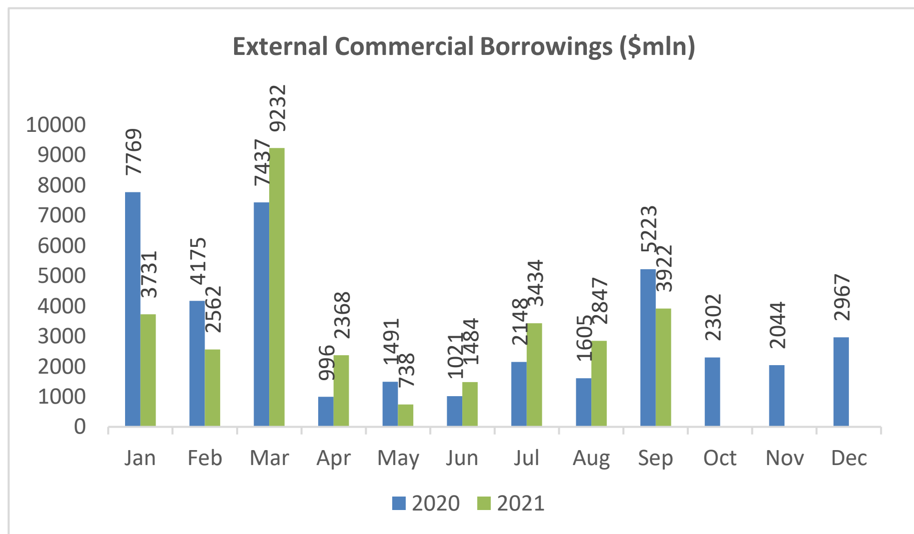
Source: FIMMDA, BWR Research

External Commercial Borrowings

According to RBI data, Indian corporates' borrowings were at USD 3.9 billion (majorly through the automatic route) from offshore markets in the form of External Commercial Borrowings (ECBs) during September 2021 compared to USD 5.2 billion during the same period last year, recording a slight dip.

BWR Views

Indian companies' ECBs, which rose by 77% in August, declined by 33% in September 2021 y-o-y on account of the expected rate hike. In BWR's opinion, demand for such borrowings, which was subdued owing to the pandemic impact on the economy, expectations of inflation and rates rising in Europe, lower lending rates in India and the transition from LIBOR-pegged rates, is expected to be moderate, going forward, in the short run.



Source: RBI, BWR Research

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