Looming uncertainty over economic revival
November 2019

Time to address demand side issues

The deepening economic concern manifested itself with several economic indicators reporting weak or subdued performances in the recent months. In September 2019, aggregate auto production recorded a contraction for the eleventh month in a row (-18.3%), eight core sectors reported one of the worst performances ever with 5.2% fall in output and deployment of bank credit to industries in the current fiscal so far witnessed a fall of 3.8%.

Falling credit growth is attributed to weak demand and lack of effective transmission of rate cuts. RBI slash repo rate by 135 basis points cumulatively in 2019 (Feb to October) whereas PSU’s (Bank-wise) 1-year MCLR eased by 20 to 40 bps during the period between February to September 2019. For effective transmission of rate cuts, RBI directed banks to launch Repo rate /external benchmark linked loan products from October. Following this, all 18 PSBs have reviewed their lending rates and are periodically reviewing rate cuts as per the MCLR framework prescribed by RBI. Despite these efforts, credit growth remained muted, portraying stagnant demand conditions.

Further, the Index of Industrial Production (IIP) growth plunged to -0.1% in August from 4.3% in July, with manufacturing industries reporting a further worrisome picture in their output.

CPI inflation touched RBI MPC’s mid-point target level of 4% in September due to rising food price inflation. The rise in food inflation is a temporary phenomenon, but easing core inflation reflects the slump in consumption demand.

On the external front, crude oil prices have become less volatile easing inflationary worries and helped to keep the rupee-dollar exchange rate in comfortable range. With Fed cutting rates once again in September, FPIs turned net buyers in the Indian market (equity and debt) and forex reserves increased further. US-China trade settlement renewed hopes for global economic recovery, but domestic trade concerns continued with lower imports and exports growth.

As per the Ministry of Finance, among the several short and long-term measures announced in August and September to boost the economy, 15 out of 45 measures have been fulfilled and rest of the announcements are under active consideration by relevant Ministries. Amongst them, removal of Debenture Redemption Reserve (DRR), auto sector related measures, announcement to boost exports and housing and liquidity support to NBFCs coupled with upfront release of capital to PSBs are the major ones.

Government measures brought immense hope on the reforms front initially, but are expected to help revive the demand in the medium term. However, in the short-term to give impetus to boost demand, cut in personal income tax and some measures to revive the ailing real estate sector could be considered. Further, the underlying economic and financial concerns provide strong rationale for RBI MPC to continue with accommodative monetary policy stance in the current fiscal; hence, few more rate cuts are expected.
MACRO-ECONOMIC INDICATORS

Economy Trends

Weak first quarterly GDP growth at 5% created serious doubts on the possibility of the economy to achieve the growth projections made by the government earlier. Most of the economic indicators continued to hint at a gradual weakening of the economic growth prospects in India for the current fiscal. The International Monetary Fund (IMF), World Bank, RBI and others predict slowdown in India’s growth and revised the GDP estimates sharply downwards from their earlier projections for 2019-20.

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

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

CPI inflation increased to 3.99% in September compared to 3.15% in August, on the back of rising food prices particularly of vegetables. Falling fuel prices coupled with ease in core inflation continued to cushion the rise in food inflation, providing further support to an accommodative monetary policy.

Source: MOSPI, RBI, BWR Research

Crude oil Prices and INR/USD rates

Crude oil prices remained stagnant supporting rupee-dollar exchange rate.

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

Both exports and imports fell during September compared to a year ago period, while the trade deficit narrowed down sharply by 27% (y-o-y) to USD 10.9 billion. Imports fell by 13.8% (in value terms) on account of reduction in both gold (-50%) and crude oil imports (-18%). Merchandise exports also decreased by 6.6% compared to last year due to reduction in re-exports of petroleum products and non-petroleum products. India imports more than 70% of its oil needs. With global economic slowdown, crude oil prices remained almost stable and helped maintain domestic trade balance in the current fiscal so far.

Source: Ministry of Commerce, BWR Research

Forex Reserves and Import Cover

Foreign exchange reserves swelled by $28 billion to $429 billion towards the end of September 2019 compared with a year ago reserves position. The current level of forex reserves is sufficient to cover 11.6 months of imports. This reflect country’s ability to absorb external shocks.

Source: RBI, Ministry of Commerce, BWR Research
Government Accounts:

The fiscal deficit increased by 9.6% (y-o-y) to Rs 6,516 billion in H1 FY2020, while revenue deficit rose by 7.7% during the same review period. Revenue and fiscal deficits in H1 FY2020 stood at 99.9% and 92.6% of the revised Budget Estimates for FY2020. The gross GST revenue collected in the month of October 2019 is Rs 95,380 crore, showing 5.29% decline over the year. During April-October 2019 vis-à-vis 2018, the gross GST revenue collection has grown by 3.39%.

Amid gloomy economic outlook corroborated by a subdued tax revenue in the recent months in addition to announcement of the cut in corporate tax rates (expected shortfall of Rs 145,000 revenue), government may opt for cut in expenditure if it stays with the fiscal deficit target. With government’s gross tax revenues expected to fall below the Budget Estimates, despite excess transfers from the RBI, it is more likely to witness a slippage in fiscal deficit target of 3.3% of GDP in FY20.

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

Automobiles

Domestic automobile sales fell by 22% y-o-y in the month of September 2019 driven by weak sales across all the segments. High cost of ownership hampering the passenger vehicles & two-wheeler sales and financing issues due to NBFC crisis have hit the commercial vehicle sales. The overall slowdown in the economy impacted the consumer sentiments which has also resulted in muted demand for automobiles. However, on a month-on-month basis, sales increased by 10% reflecting the festive buying.

Source: CMIE, BWR Research

Automobile production and sales

Domestic automobiles production declined by 18% y-o-y in September 2019 due to production cut downs by manufacturers on account of huge inventory build-up. This has also adversely affected the ancillaries and automobile dealers.

Source: MOSPI, CMIE, BWR Research
Telecom

Consolidation of the market continues with Jio increasing its market share and driving the overall subscriber additions in the sector. The increase in subscriber base is likely driven by rise in rural subscribers. The subscriber base is expected to widen further as the 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 witnessed lot of activity during October with the Government announcing a revival plan for BSNL and MTNL involving an investment of whopping Rs. 67,000 crore followed by the ruling of the Supreme Court pertaining to the definition of Adjusted Gross Revenue (AGR). This involves a payment of Rs. 92,000 crore by the telecom players to the Government of India. While, most of these telecom operators are no longer in operation, the largest operators - Bharti Airtel and Vodafone Idea will have to shell out a significant amount of money as per the order.

Considering that both the companies are already under stress due to hyper competitive pressures in the sector, ensuring compliance with the said order is a tough task. Both the incumbents have sought relief in the matter through Cellular Operators Association of India (COAI) however, if the Government grants no relief, the incumbents may have to go for another round of fundraising, which may not attract the same kind of interest from investors as in the past.
Power

Power generation fell by 4% y-o-y in September 2019 reflecting a slump in industrial activity in the country. The decline was largely due to lower generation from thermal sources on account of lower demand and coal shortages at power plants. Coal production was down 21% y-o-y in September 2019 due to flooding in Dipka coal mine as it supplies about 5% of Coal India’s output.

While, conventional power sources declined by 4%, renewable sources witnessed a decline of 7% y-o-y in September 2019. Although, the Government has been promoting and incentivizing set up of renewable energy plants, the investor interest has been consistently declining.

Renewable energy is continuing with its weak investor sentiment with limited response to the fresh auctions in recent times. Investment in the renewable energy sector has bottomed out on the fear of uncertainty related to Power Purchase Agreements (PPAs). Bidding for new projects has reduced drastically as the international investors have turned cautious.

Source: Central Electricity Authority, BWR Research

India’s power supply position remained same in September 2019. The deficit is primarily due to DISCOMS stressed financials on account of its mounting losses and huge debt burden.

Source: Central Electricity Authority, BWR Research
Steel

Domestic steel prices are on a declining trend since October 2018 owing to subdued industrial activity visible in declining infrastructure & construction activity and lower automobile sales. Steel prices in the international market are also weak because of deceleration in global steel demand especially China. The weak demand has resulted in steel production declining by 3% y-o-y in September 2019.

![Steel Production & Prices Graph]

Source: CMIE, BWR Research

Cement

Cement prices have started correcting from June 2019, after witnessing a sharp increase in April & May 2019, which was based on anticipation of healthy demand going forward. The prices started coming down reflecting a weak actual demand.

On the other hand, softening coal and crude oil prices will result in favourable input costs for the manufacturers leading to higher production in the coming months albeit improved demand scenario.

![Cement Production & Prices Graph]

Source: CMIE, BWR Research
Banking

Overall bank credit during the period April-September 2019, declined by 0.2% as compared with a growth of 3.8% during the same period previous year. The decline was more evident in the industry and services sector. This can be attributed to cautious lending approach by banks as they have shifted focus towards lending to the retail sector, where the probability of delinquency is lower. Also, with the slowdown in the economy, the demand for credit has dried up with low or almost no private investments happening in the economy.

The industrial sector, which has relatively higher levels of non-performing assets (NPAs), witnessed 3.8% fall in credit deployment in the current fiscal so far. Credit growth is expected to remain muted in the coming months on account of slowdown in private investments in the economy.

Source: RBI, BWR Research
**DEBT MARKET INDICATORS**

**Movements in Bond Yields**

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

Yields of shorter tenor corporate bonds have eased on the back of RBI slicing key policy rate by 25 bps in October. Going forward, we expect the yields to continue to remain low on expectations of rate cut cycle to continue further.

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**BWR Views**

Source: FIMMDA, SBI, HDFC, BWR Research

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The yields of AAA rated corporate bonds maturing in 5-year, 3-year and 1-year have eased in October compared to September following repo rate cut by RBI.

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

The G-sec yield maturing in 1 year compared with Corporate bonds yields of PSUs, NBFCs and Corporates of similar maturity buckets have, shown a reviving trend due to cyclical factors and thus, resulted in lower cost of borrowing for the issuers.
External Commercial Borrowings

With the sharp increase in the cost of borrowing in the domestic market, Indian companies are witnessing a spike in overseas borrowings. The easy availability of longer tenure loans from overseas is also one of the driving factors for this rise. The registrations by companies are also witnessing a rise for raising debt via External Commercial Borrowings (ECBs).

BWR Views

Companies borrowing through External Commercial Borrowing (ECB) may continue to increase due to stable rupee amid favourable cost factors.
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